



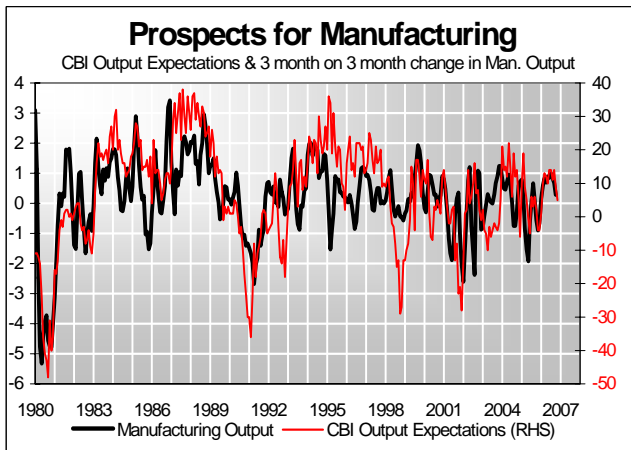
## Monday, 4<sup>th</sup> December to Wednesday, 6<sup>th</sup> December 2006

### United Kingdom

#### 6/12 Industrial Production (Oct)

| (Previous month in brackets) | mom %       | yoy%         |
|------------------------------|-------------|--------------|
| Manufacturing output         | -0.5 (0.0)  | 2.4 (2.3)    |
| Mining & quarrying           | -2.4 (2.0)  | -10.0 (-8.2) |
| Utilities                    | -3.1 (-0.3) | -4.0 (-3.6)  |
| Industrial production        | -0.8 (0.1)  | 0.6 (0.6)    |

(consensus had been for a rise of 0.1%), sufficient to drive the three-month on three-month rate of change down from +0.1% to -0.2%. What's more, even if production were now to expand by 0.2% in both November and December, activity in the fourth quarter as a whole would still be some 0.5% lower than in the third quarter. Admittedly, conditions in the larger services sector remains very much more buoyant, but the clear implication remains that overall growth in Q4 will be significantly slower than assumed with the Bank of England's revised central projection.



The industrial production report for October was hugely disappointing, casting further doubt upon the Bank of England's overall economic growth projections. Against expectations of a 0.2% rise, activity in the manufacturing sector contracted 0.5% on the month, the worst monthly performance since October 2005. This brought manufacturing output down to its lowest level since June and more importantly the three month on three month rate of change down to just 0.3%. True, October's decline could simply have been a one-off, and certainly the weakness was heavily concentrated in the volatile chemicals and machinery sectors. However, as the chart above shows, with the CBI output expectations balance dropping to a 10-month low of just +5 (below average) in November, the suggestion is that the underlying rate of growth could slow even further over the coming few months. Adding to the gloomy picture, after tentative signs of recovery in September, both the extraction and utilities industries resumed their declines, falling 2.4% and 3.1% respectively. Consequently, overall industrial production fell 0.8%

### 6/12 Pre-Budget Report

Gordon Brown's tenth (and "latest") Pre-Budget Report was a tame affair. The widely expected "green" measures were there, with Air Passenger Duty doubled to £10 and fuel duty increased in line with inflation (1.25p per litre) for the first time in three years. However, the Chancellor's revised economic and fiscal projections provided the main focus of attention, with Mr Brown taking great delight in announcing that growth this year would be slightly above his Budget forecast range of 2-2½% at 2.75% and that 2.75-3.25% was in prospect for both 2007 and 2008. Suffice it to say these are stronger than we believe is likely, whilst growth this year will only exceed his previous forecast because of some huge upward revisions to activity during this year's "Blue Book" exercise. However, on inflation, Mr Brown's forecast that the CPI annual rate will return to the 2% target by mid-2007 looks spot on. On the public finances, Mr Brown claimed that he was continuing to meet both of his fiscal rules – the Golden Rule of only borrowing to finance capital expenditure over the cycle as a whole and the Sustainable Investment Rule of keeping the debt to GDP ratio beneath 40%. However, in announcing that the current budget would swing from a deficit of £15bn this year and £8bn next year to surpluses of £4bn, £7bn, £10bn and £14bn in the final four years of the projection period, the claim of satisfying the Golden Rule owes much to recent changes made to the length of the economic cycle. Interestingly as well, these figures, which translate into overall public sector borrowing of £37bn this year and £31bn next, falling to £22bn in 2011, are actually slightly worse than the Budget projections despite the fact that growth has been stronger than expected.

**ODL Securities Limited**  
**UK**  
The Northern & Shell Building  
10 Lower Thames Street  
London EC3R 6AD

**ODL Securities Inc.**  
**USA**  
125 South Wacker Drive Suite 300  
Chicago  
IL 60606 USA

**ODL Securities Limited**  
**Japan**  
Akasaka Shinko Bldg 5F  
4-7-14 Akasaka, Minato-ku  
Tokyo 107 0052



ODL Securities

# Economic data roundup

**Thursday, 7<sup>th</sup> December to Friday, 8<sup>th</sup> December 2006**

## **United Kingdom**

### **7/12 MPC interest rate decision**

There was very real surprise in financial markets when the minutes of the November meeting revealed that Rachel Lomax – none other than the Bank's Deputy Governor with responsibility for monetary policy – had joined David Blanchflower in voting against an immediate interest rate hike. However, they did so for different reasons. Whilst Blanchflower's rationale remains the belief that there is more supply capacity in the economy than assumed in the central projection (as exemplified by rising unemployment), Lomax was more concerned about the downside risks to demand (recent retail sales data indicated a weakening in consumer demand) and the fact that the effects of the August rate hike had yet to be felt. In addition, the minutes record that Blanchflower believed that as "the current spike in inflation was mainly related to large gas and electricity prices, which were still more than offsetting the recent fall back in petrol prices", "once their immediate impact had dissipated, CPI inflation was likely to fall back sharply next year". We concur entirely. Although financial markets currently think differently, the split vote combined with the reduced forecast inflation profile in the Bank of England's central projection mean that it is less likely that the MPC will raise interest rates again in February. Financial markets expect rates to be held in December.

## **United States**

### **8/12 Employment Situation Report (Nov)**

Non-farm payrolls again disappointed consensus expectations in October, rising by just 92,000. However, once again there were big upward revisions to the previous two months' data, with the level of employment in September now standing some 139,000 higher than the initial estimate. This in turn drove the three-month on three-month growth rate up to 0.36% from 0.29% just two months ago. We have written many times about the shortcomings of the establishment-based payroll figures, with the reliability of the data further undermined by the announcement last month from the Bureau of Labor Statistics that it intends to revise up payrolls in the 12-months to March 2006 by a massive 810,000. Because of these problems, we have long since advocated looking at what is happening to the data from the Household Survey. In October, employment on this basis surged a massive 437,000, meaning that the US economy has created almost one million new jobs in the last three months. Moreover, the more detailed breakdown reveals that the vast majority of these were in the private sector. Although only a comparatively modest 98,000 were full time jobs, this follows increases of 426,000 in September and

423,000 in August. These gains in employment pushed the unemployment total down by 238,000 (third successive fall) and the unemployment rate to just 4.4%, the lowest since May 2001. That conditions in the labour market should be tightening against a backdrop of slowing economic growth does, however, have a negative side, especially with average hourly earnings rising 0.4% on the month and 3.9% on the year (total increase in employment incomes of 5.7% year-on-year). Barring a sudden reacceleration in growth – which is unlikely – the implication has to be that productivity growth will slow further and may even turn negative, putting further upward pressure on unit labour costs and undermining profitability. In November, the consensus is looking for payrolls to rise 115,000.

## **Eurozone**

### **7/12 ECB Interest Rate Decision**

As expected, the ECB kept official interest rates unchanged at 3.25%, but by using in the post-decision press conference the usual code-words that the central bank would continue to exercise "strong vigilance" in the fight against inflation, ECB President Jean-Claude Trichet put the seal on a further quarter-point increase in December. Indeed, as if to leave no room for doubt, he went on to state that he would do nothing to alter current market expectations, which incorporate another hike this year. As was also the case in October, Trichet was at pains not to comment on market expectations for next year, suggesting perhaps that the Committee is divided over the need for "further removal of the policy accommodation" in 2007. However, the very fact that the ECB still believes that policy remains accommodative surely does suggest that we will see at least one more rate hike early on in the New Year.

**John Clarke**  
Economic Adviser

**ODL Securities Limited**  
**UK**

The Northern & Shell Building  
10 Lower Thames Street  
London EC3R 6AD

**ODL Securities Inc.**  
**USA**

125 South Wacker Drive Suite 300  
Chicago  
IL 60606 USA

**ODL Securities Limited**  
**Japan**

Akasaka Shinko Bldg 5F  
4-7-14 Akasaka, Minato-ku  
Tokyo 107 0052