



## Economics Weekly

### Commodity prices unlikely to be affected by the credit crisis

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#### ***Commodity prices are rising, despite credit concerns***

Commodity prices seem to be holding up remarkably well to the crisis in the financial markets. Is this because it is only a matter of time before they get impacted, or because the financial problems are overstated insofar as they will affect economic growth or is it that growth in the emerging market economies is so strong that it can shrug off any slowdown in the developed economies? This may not be a question that can be answered without more time to assess the impact of the credit crisis on banks. However, the facts are that the global economy seems to be marching on and any credit market impact is being felt in the developed economies and not in the emerging markets, where the marginal rise in demand for commodities seems to be coming from. In our opinion, it is a combination of fast economic growth and a bigger share of commodity demand from the emerging economies that explains why the effect of the sub prime crisis will be small at a global level on prices. It is this fact that explains why commodity prices seem to be untroubled by the continuing turmoil in global credit markets. As a result, insofar as commodities are an asset class, there might even be a renewed flow of investment into the segment.

#### ***Uncertainty remains, but global growth is solid, led by the emerging economies...***

Oil prices are at a record high in nominal terms and approaching the all time high reached in 1979/81 in real terms as well. Gold prices are above \$720 an ounce; equity markets have shown a modest correction but no more than that, while government bond markets are seeing falling yields yet corporate spreads remain wide. What is going on? Part of the reason why oil prices are so high is that global growth remains strong, and, as chart a shows, the price of commodities and world economic growth are closely linked. But why, if growth in the developed economies is set to slow in 2008 (something, incidentally, that we do not believe is true for the US economy next year compared with 2007), is demand for commodities so strong?

The reason is strong demand growth from the emerging market economies, which is expected to persist. This fast growth has also meant a sharp fall in stock levels for a range of commodities, further fuelling price inflation. This is one reason why the rest of the world will not join the US in cutting interest rates and why long term bond yields rose in the US when short term rates were cut to 4.75% on 18th September, there is concern about future consumer price inflation from the pace of economic growth and higher commodity prices. Charts b, c and d show that economic growth is not just strong in the large economies of China, Brazil, India and Russia, but in a range of smaller emerging economies from every continent in the world and this is boosting the equity markets and exchange rates of these countries.

#### ***...and so commodities, which they are increasingly producing and using, are unaffected by the global credit squeeze***

One example of why growth in the emerging markets is more significant for the world economy than in the past is that Chinese consumption of four out of the five most basic food, energy and industrial commodities now outstrips that of the US. Our charts illustrate this point more clearly, with production and consumption being dominated by the new emerging market economies. Charts e, f, g, h, i and j show that the biggest producers and consumers of commodities from metals used in production, to energy and food are a range of emerging market economies. It is this that makes it unlikely the world will suffer anything more than the mildest of slowdowns from the credit crisis, if at all. But it also means that price inflation is more of a threat to global economic stability than at any time perhaps in the last decade. This implies higher, not lower average interest rates going forward. As a financial market strategy, it also implies further flows into commodity type investment products.

**Trevor Williams, Chief Economist**

# charts show how emerging markets growth is changing the commodities landscape

## 2007/08 calendar of central bank meetings

**European ECB (4.00%)**  
 4 Oct. (Vienna), 8 Nov,  
 6 December  
**US FOMC (4.75%) - 30/**  
 31 Oct, 11 December, 30  
 January  
**UK MPC (5.75%) -4**  
 Oct, 8 Nov, 6 December

## Rolling calendar of UK data releases and events

M4 money supply (1/10)  
 Manufacturing PMI (1/10)  
 Mortgage approvals (1/10)  
 Services PMI (3/10)  
 Producer prices (8/10)  
 Industrial prod. (8/10)  
 Trade balance (9/10)

## Rolling calendar of US data releases and events

ISM Manufacturing (1/10)  
 ISM Services (3/10)  
 Factory orders (4/10)  
 Non-farm payrolls (5/10)  
 Average earnings (5/10)  
 Consumer credit (5/10)  
 Trade balance (11/10)

Chart a: Commodity prices accelerate sharply...

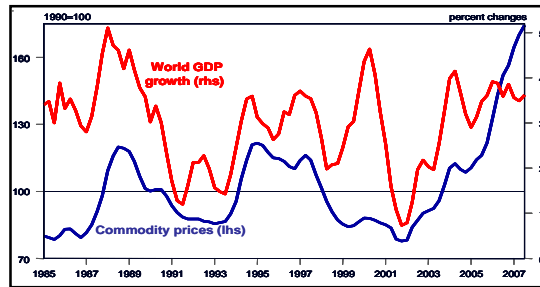


Chart b: ...driven by growth in emerging markets

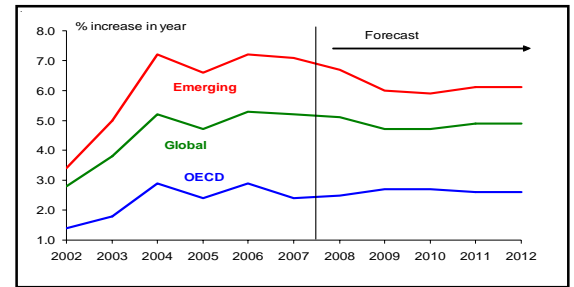


Chart c: ...from the largest economies...

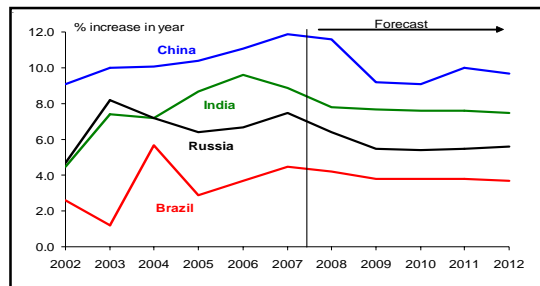


Chart d: ...to the smallest

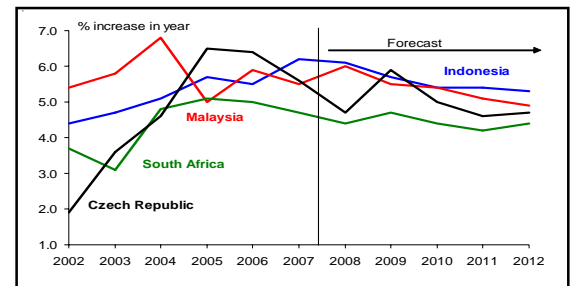


Chart e: Aluminium production (2005)

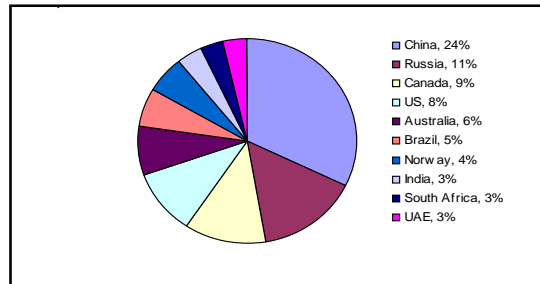


Chart f: Aluminium consumption (2005)

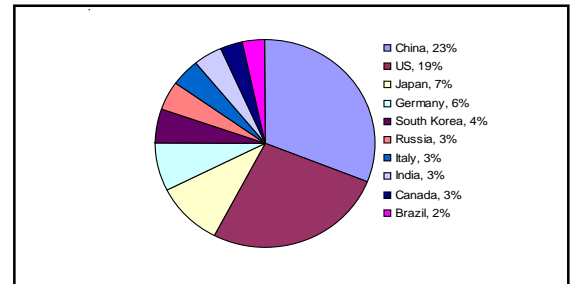


Chart g: Oil production (2005)

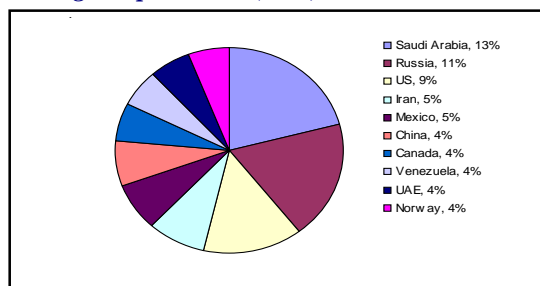


Chart h: Oil consumption (2005)

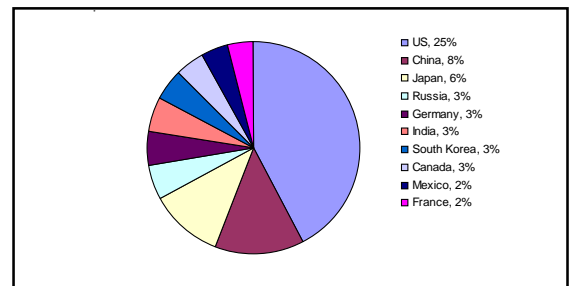


Chart i: Wheat production (2005)

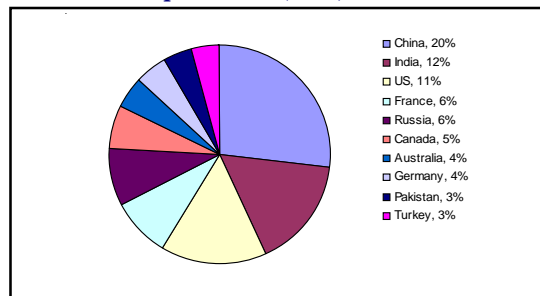
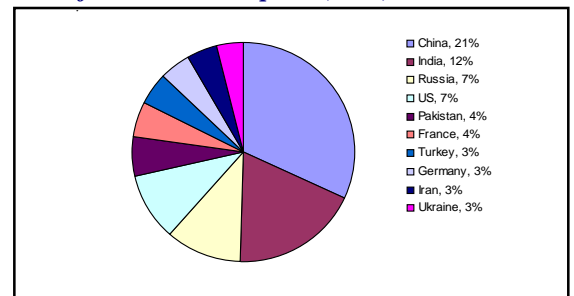


Chart j: Wheat consumption (2005)



\* All charts are sourced to *Lloyds TSB Corporate Markets Economic Research and Datastream*

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# Weekly economic data preview

W/c 24 September 2007  
www.lloydstsb.com/corporatemarkets

## Focus on UK consumer confidence, US data and Fed speakers

*The ongoing fallout from the credit crisis and the broad based decline in the dollar will still cast a shadow over the economic calendar this week as market participants consider the implications of a weaker dollar and worry about the downturn in US housing for the global economy. Attention in the UK will centre around the latest surveys on house prices and consumer confidence, and what the instability in financial markets means for UK base rates. The next MPC meeting is still two weeks away but the fact that market participants have started to debate the possibility of an earlier rate cut than 2008 merits some attention. The minutes of the September BoE MPC meeting revealed that members on the committee now believe that inflation risks have receded. If the Bank similarly concludes that risks of a slowdown in economic growth have intensified, then a rate cut could indeed be brought forward. We stick to our original view, for now, that an immediate cut in base rates cannot be justified by economic data and will not occur until 2008, possibly May. However, we will be on alert to a turn in incoming data and conditions in money markets which could warrant an earlier move.*

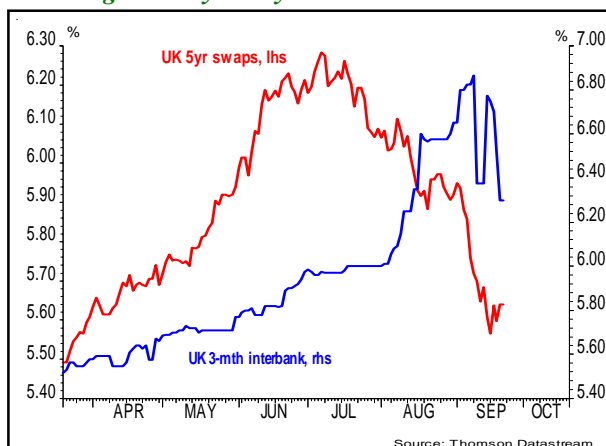
- House prices and consumer confidence are two of the indicators that will attract attention in the UK this week. Demand for UK housing has been reported by the RICS to be tapering off in August with the balance of buyers vs sellers falling in negative territory for the first time since 2005. A month of falling house prices this summer has already been reported by the Rightmove property website, so it should be no surprise to see a weaker set of numbers from the Nationwide on Thursday. Retail sales data for August surprised to the upside last week and suggest that consumer confidence is holding up, even if sales were supported by heavy discounting. The CBI distributive trades survey for September is due on Thursday and may offer a glimpse of retail turnover this month and expectations for the final quarter of 2007. To what extent the drama for customers of Northern Rock has affected the mood among the broader public may be captured in the Gfk consumer confidence survey on Friday. An update on the state of public finances for August is due on Monday. The final estimate of Q2 gdp will be released on Wednesday.

- US data and Fed speakers are likely to make the biggest impact on financial markets for a second consecutive week. The Fed cut interest rates by 0.50% to 4.75% last week and explained that this was effectively an insurance against a possible further deterioration in the housing market which could impact the wider economy. With this in mind, markets will focus on consumer confidence on Tuesday and durable goods orders on Wednesday. Existing home sales will be published on Tuesday and new home sales will be released on Thursday. A further decline in sales is likely, but this is something the Fed already pre-empted last week with its surprise 0.50% move in fed funds. Market participants will also concentrate on the latest figures for the PCE index or the Fed's preferred measure of core inflation. Concerns that last week's rate cut could stoke inflation sparked a rise in long term bond yields and lifted the gold price to a 28-year high. Personal spending and construction data are due on Friday. Fed speakers will attract at least as much attention as the data for clues about the direction of US interest rates.

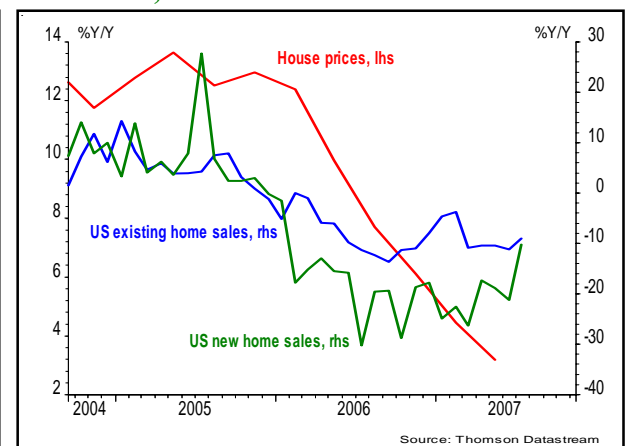
- Tentative signs that the euro zone economy may be starting to feel some pressure from the credit crunch or from earlier ECB rate increases emerged on Friday when the flash PMI indicators of manufacturing and services activity fell to a two year low in September. This will reinforce the view that growth has already peaked. With €/£ strengthening above 1.41 last Friday, a negative surprise from the German IFO on Tuesday could make it harder for the ECB to justify its hawkish stance and would undermine the prospect of another rise in euro zone interest rates this year. Preliminary euro zone CPI inflation for September is due on Friday and may show a rebound from 1.7% in August close to 2.0% due to statistical base effects and record oil prices. Euro zone M3 money supply data for August is due on Thursday and may show some distortion from higher than usual demand for short term instruments following the flight-to-quality from risky assets last month.

**Kenneth Broux, Economist**

*UK money markets show signs that conditions are stabilising and may slowly return to normal*



*Will data this week for US home sales show that demand has stabilised, or could the decline resume?*



Date	United Kingdom	United States	EU 13
Mon 24	<b>Public finances - PSNCR</b> Jul -£13.2bn Cumulative -£13.2bn Aug (act) +£5.0bn Cumulative -£13.2bn Median +£3.4bn Range +£2.0bn:+£4.6bn <b>Public finances - PSNB</b> Jul -£6.3bn Cumulative +£10.1bn Aug (act) +£9.1bn Cumulative +£19.2bn Median +£6.5bn Range +£5.4bn:+£8.0bn		<b>EU-13 industrial orders (10:00)</b> Jun +4.5% Y-O-Y +14.0% Jul (act) -4.0% Y-O-Y +10.9% Median -3.0% Range -5.0%:+1.0%
Tue 25		<b>House price index (S&amp;P/CaseShiller) (Jul)</b> Jun Y-O-Y -3.5% Median -4.0% Range -4.1%:-3.8% <b>Consumer confidence (15:00)</b> Aug 105.0 Sep (f'cast) 107.0 Median 104.5 Range 100.0:107.0 <b>Existing home sales (15:00)</b> Jul 5.75mn Aug (f'cast) 5.60mn Median 5.49mn Range 5.15mn:5.75mn	<b>German CPI (prel) (07:00) (25-27)</b> Aug -0.1% Y-O-Y +2.0% Sep (f'cast) +0.1% Y-O-Y +2.6% Median zero Range -0.3%:+0.3% <b>German import prices (07:00)</b> Aug +0.3% Y-O-Y +0.4% Sep (f'cast) +0.2% Y-O-Y +2.4% Median zero Range -0.8%:+0.3% <b>French consumer spending (07:45)</b> Jun +1.6% Y-O-Y +4.4% Jul (f'cast) -0.5% Y-O-Y N/A Aug (f'cast) +0.3% Y-O-Y N/A Median +0.3% Range -0.4%:+0.8% <b>German IFO business survey (09:00)</b> Aug 105.8 Sep (f'cast) 105.2 Median 105.0 Range 103.0:105.8
Wed 26	<b>GDP (final)</b> Q2 (prel) +0.8% Y-O-Y +3.0% Q2 (f'cast) +0.8% Y-O-Y +3.0% Median +0.8% Range +0.7%:+0.9% <b>Current account</b> Q1 -£12.2bn Q2 (f'cast) -£10.4bn Median -£11.3bn Range -£13.8bn:-£10.0bn	<b>Durable goods orders (13:30)</b> Jul +5.9% Aug (f'cast) -2.0% Median -3.0% Range -7.9%:+6.0%	<b>German GfK consumer confidence (07:10)</b> Sep 7.6 Oct (f'cast) 7.2 Median 7.0 Range 6.5:8.2
Thu 27	<b>Nationwide house prices (07:00)</b> Aug +0.6% Y-O-Y +9.6% Sep (f'cast) +0.2% Y-O-Y +8.5% Median +0.4% Range -0.5%:+0.8% <b>CBI distributive trades survey (11:00)</b> Aug +15 Sep (f'cast) +11 Median +12 Range +5:+22	<b>Initial claims (w/e 22/9) (13:30)</b> Previous 319K Forecast 312K Median 318K Range 310K:330K <b>GDP (sa, annualised) (final) (13:30)</b> Q2 (prel) +4.0% Q2 (f'cast) +4.0% Median +3.9% Range +3.6%:+4.0% <b>GDP deflator (sa, annual) (final) (13:30)</b> Q2 (prel) +2.7% Q2 (f'cast) +2.7% Median +2.7% Range +2.7%:+2.7% <b>Core PCE deflator (13:30)</b> Q2 (prel) Y-O-Y +1.3% Q2 (f'cast) Y-O-Y +1.3% Median +1.3% Range +1.3%:+1.3% <b>New home sales (15:00)</b> Jul 0.87mn Aug (f'cast) 0.85mn Median 0.83mn Range 0.73mn:0.87mn	<b>German unemployment (sa, rate) (08:55)</b> Aug -15K Rate 9.0% Sep (f'cast) -10K Rate 9.0% Median -20K Rate -40K:-4K <b>EU-13 money supply, M3 (sa) (09:00)</b> Jul Y-O-Y +11.7% Aug (f'cast) Y-O-Y +11.7% Median +11.6% Range +10.5%:+11.7% <b>French unemployment (sa, rate) (18:00)</b> Jul 8.0% Aug (f'cast) 8.0% Median 8.0% Range 7.9%:8.1%
Fri 28	<b>Consumer confidence (GfK) (10:30)</b> Aug -4 Sep (f'cast) -4 Median -6 Range -8:-3	<b>Personal income (13:30)</b> Jul +0.5% Aug (f'cast) +0.4% Median +0.4% Range +0.2%:+0.5% <b>Personal spending (13:30)</b> Jul +0.4% Aug (f'cast) +0.4% Median +0.4% Range +0.2%:+0.6% <b>PCE deflator (13:30) (Aug)</b> Jul Y-O-Y +2.1% <b>Core PCE deflator (13:30)</b> Jul +0.1% Y-O-Y +1.9% Aug (f'cast) +0.2% Y-O-Y +1.8% Median +0.2% Range +0.1%:+0.2% <b>Chicago PMI (14:45)</b> Aug 53.8 Sep (f'cast) 54.2 Median 53.7 Range 50.0:56.0 <b>Uni. of Michigan confidence (final) (15:00)</b> Sep (prel) 83.8 Sep (f'cast) 84.5 Median 84.0 Range 82.0:88.0 <b>Construction spending (sa) (15:00)</b> Jul -0.4% Aug (f'cast) zero Median -0.2% Range -0.6%:+0.5%	<b>French consumer confidence (07:40)</b> Aug -15 Sep (f'cast) -16 Median -16 Range -21:-13 <b>French GDP (07:45) (final)</b> Q2 (prel) +0.3% Y-O-Y +1.3% Q2 (f'cast) +0.3% Y-O-Y +1.3% Median +0.3% Range +0.2%:+0.4% <b>French producer prices (07:50)</b> Jun +0.2% Y-O-Y +% Jul (f'cast) +0.1% Y-O-Y N/A Aug (f'cast) +0.1% Y-O-Y N/A Median zero Range zero:+0.4% <b>EU-13 consumer confidence (10:00)</b> Aug -3 Sep (f'cast) -4 Median -4 Range -5:-3 <b>EU-13 industrial confidence (10:00)</b> Aug +5 Sep (f'cast) +4 Median +4 Range +3:+5 <b>EU-13 CPI (prel) (10:00)</b> Aug Y-O-Y +1.7% Sep (f'cast) Y-O-Y +1.9% Median +2.1% Range +1.7%:+2.2%
Mon 1 Oct	<b>Money supply, M4 (final, sa) (Aug)</b> Jul +1.2% Y-O-Y +13.5% <b>Consumer credit (Aug)</b> Jul +£1.1bn <b>Net mortgage lending (sa) (Aug)</b> Jul +£9.2bn <b>Mortgage approvals (Aug)</b> Jul 115K <b>Manufacturing PMI (Sep)</b> Aug 56.3	<b>ISM Manufacturing index (15:00) (Sep)</b> Aug 52.9	<b>French Manufacturing PMI (08:50) (Sep)</b> Aug 52.5 <b>German Manufacturing PMI (08:55) (Sep)</b> Aug 56.0 <b>EU-13 Manufacturing PMI (09:00) (Sep, final)</b> Sep (prel) 53.2

NB: UK data released at 9.30 a.m., unless otherwise stated. Market medians are as of preceding Friday. Release times of US data are stated in brackets after the description of the indicator. Events are listed in the events column on the next page.

Date	Japan	Other Countries	Main events
Mon 24			<ul style="list-style-type: none"> <li>• US Fed member Fisher speaks in Dallas (14:00)</li> <li>• US Fed Governors holds a public meeting on "Banking Regulations" in Washington (14:30)</li> <li>• US Fed member Evans gives introductory remarks at a conference in Chicago (17:30)</li> <li>• US Fed Chairman Bernanke speaks (18:00)</li> </ul>
Tue 25			<ul style="list-style-type: none"> <li>• ECB member Liebscher speaks in Vienna (15:30)</li> <li>• Bank of Canada's Governor Dodge speaks in Vancouver (21:10)</li> <li>• US Fed member Plosser speaks in New Jersey (22:30)</li> </ul>
Wed 26	<b>Trade balance (BoP) (00:50)</b> Jul <span style="float: right;">+Y671.2bn</span> Aug (f'cast) <span style="float: right;">+Y280.5bn</span> Median <span style="float: right;">+Y221.5bn</span> Range <span style="float: right;">+Y85bn:+Y650bn</span>		<ul style="list-style-type: none"> <li>• Germany to auction €2bn of 5yr bonds due 2012 (10:30)</li> <li>• UK DMO to auction £900m of 1.125% gilts due 2037 (10:30)</li> <li>• Norges Bank Monetary Policy meeting, interest rates expected to stay at 4.75% (13:00)</li> <li>• US Fed member Poole speaks in St. Louis (13:30)</li> <li>• US Treasury to auction 2yr notes (18:00)</li> <li>• ECB President Trichet speaks in Maastricht (16:10)</li> </ul>
Thu 27			<ul style="list-style-type: none"> <li>• BoJ board member Suda speaks at a conference in Tsu (03:30), followed by a press conference (05:30)</li> <li>• Swiss National Bank publishes Monetary Policy report (10:00)</li> <li>• US Fed member Rosengren speaks in Boston (13:30)</li> <li>• US Fed member Evans speaks at a "Globalisation and Systemic Risk" conference in Chicago (15:40)</li> <li>• US Treasury to auction 5yr notes (18:00)</li> <li>• US Fed Chairman Bernanke gives welcoming remarks at a Fed conference in Washington (18:00) followed by fellow Fed member Mishkin (22:30)</li> </ul>
Fri 28	<b>Job-applications ratio (00:30)</b> Jul 1.07% Aug (f'cast) 1.07% Median 1.07%    Range 1.06%:1.08% <b>Unemployment rate (00:30)</b> Jul 3.6% Aug (f'cast) 3.6% Median 3.6%    Range 3.6%:3.7% <b>Workers' spending (00:30)</b> Jul Y-O-Y -0.1% Aug (f'cast) Y-O-Y +1.0% Median +1.2%    Range +0.2%:+2.2% <b>Tokyo core consumer prices (00:30)</b> Aug Y-O-Y zero Sep (f'cast) Y-O-Y -0.1% Median zero    Range -0.1%:zero <b>National core consumer prices (00:30)</b> Jul Y-O-Y -0.1% Aug (f'cast) Y-O-Y -0.2% Median -0.1%    Range -0.2%:+0.1% <b>Industrial output (00:50) (prel)</b> Jul Y-O-Y +3.2% Aug (f'cast) Y-O-Y +3.6% Median +4.0%    Range +2.1%:+5.8% <b>Retail sales (prel) (00:50)</b> Jul Y-O-Y -2.2% Aug (f'cast) Y-O-Y +0.2% Median -0.4%    Range -2.0%:+1.5%	<b>Canada GDP, monthly (13:30)</b> Jun +0.2% Jul (f'cast) +0.3% Median +%    Range -%:+% <b>Canada IPPI (13:30)</b> Jul -0.7% Aug (f'cast) -0.5% Median -%    Range -%:+% <b>Canada RMPI (13:30)</b> Jul +3.9% Aug (f'cast) -1.0% Median +%    Range -%:+%	<ul style="list-style-type: none"> <li>• ECB member Bini Smaghi speaks in Venice</li> <li>• US Fed member Lockhart speaks on the US economic outlook in Tennessee (15:00)</li> <li>• US Fed member Yellen speaks in Boston (15:15)</li> <li>• US Fed member Poole speaks on "Central Banking" in New York (18:00)</li> <li>• US Fed member Mishkin speaks in Chicago (18:15)</li> <li>• ECB President Trichet and EU's Almunia speak in Malta (30/9)</li> </ul>
Mon 1 Oct	<b>Tankan manufacturing index (00:50) (Q3)</b> Q2 23 <b>Tankan services index (00:50) (Q3)</b> Q2 22		<ul style="list-style-type: none"> <li>• ECB members Liebscher (08:00) and Noyer (09:30) speak in Salzburg</li> </ul>