J.P.Morgan

Economic Research
February 19, 2010

Global Data Watch

- **Core inflation on track to make historic lows in developed world this year**
- **US economy recovering relatively well despite being at the center of global financial crisis**
- **Japan also surprising with solid growth yet remains mired in deflation**
- **South Africa budget reaffirms commitment to deficit reduction**

Fast growth, slow healing

Last quarter's national accounts are now available for most major economies, and they present a clearer picture of performance during the early stage of the recovery. The global economy took a significant step forward with GDP rising at a 3.3% pace in 2H09 and industrial activity producing its strongest two-quarter increase in more than 40 years. However, this step looks modest when viewed against the depth of the recession. Activity and employment levels remain well below their pre-recession peaks, underscoring our long-standing outlook theme regarding the tension between fast growth and slow healing.

The most striking element of recent performance is the relative standing of countries within the developed world. Sitting at the epicenter of the global financial crisis—which produced a dramatic rise in unemployment and household saving rates—there was every reason to have expected the US to be the weakest link in the global recovery. However, the US did not fall as hard as many other economies and is now expanding well above trend. As a result, it stands close to global averages that compare activity levels to previous cyclical peaks. While the better performance of EM economies is easy to understand, the relatively sluggish recoveries under way in the Western Europe and Japan are troubling. Our forecasts project US GDP to retrace the losses seen in the entire recession by the middle of this year. For the Euro area and Japan, this retracement is not expected to be realized until some time in 2012.

Two factors appear central to understanding these outcomes. First, the financial crisis was global in nature and incorporated a significant shock to global demand and the availability of trade financing. As a result, countries running external surpluses (the Euro area, Japan, and China) experienced a relatively large drag on growth from external sources. By contrast, the US recession was cushioned as it exported an important component of its domestic demand weakness to foreign suppliers. Second, policy eased everywhere but was most aggressive and timely in the US and China. Thus, China's economy was able to move forward even as its export sector plunged, and the US was able to establish a recovery even as firms continued to slash jobs and inventories.

Activity relative to recession trough
% ch from trough to most recent

	GDP	IP	Car sales	U rate[1]
Global	2.1	6.6	34.7	0.0
US	2.0	5.3	17.7	-0.4
Euro area	0.5	4.1	13.9	0.0
Japan	1.8	29.1	43.3	-0.4
UK	0.1	2.7	45.8	-0.1
China	n/a	28.5	136.4	n/a
EM excl. China	18.2	14.5	34.6	-0.3

[1]Unemployment rate, change from peak.

Activity relative to previous cyclical peak
% ch from peak to most recent

	GDP	IP	Car sales	U rate[1]
Global	-1.7	-11.1	2.3	3.2
US	-1.9	-12.5	-35.0	5.3
Euro area	-4.6	-18.8	-12.2	2.8
Japan	-7.0	-18.5	-2.9	1.0
UK	-5.9	-13.1	-9.4	2.6
China	n/a	18.4	96.9	n/a
EM excl. China	-0.6	-2.7	0.2	1.6

[1]Unemployment rate, level relative to trough.

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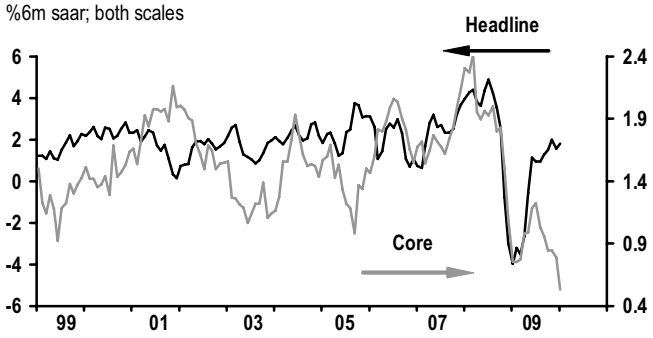
G-3 consumer price inflation



Against this backdrop, it is natural to question the sustainability of strong growth as large fiscal stimulus packages in the US, China, and elsewhere are starting to fade. We believe these fears are overblown. Global policy stances will remain highly accommodative this year, with the impact of easy monetary policy building as recoveries mature and credit conditions improve. However, the key outlook call relates, in large measure, to how large a spark last year's stimulus programs provided in shifting private sector behavior from retrenchment to expansion. This shift appears to have taken hold in Emerging Asia, and we are confident that is now being established in the US. Conditions are improving more slowly in Japan and Western Europe, but we believe this transition is on track, supported in part by the turn in performance in these countries' net trade contributions.

Core inflation slide is the main event

Easy money and strong industrial activity have provided a boost to oil and other commodity prices, which have more than doubled over the past year. This movement is lifting over-year-ago headline inflation across the globe, an effect that should peak in the next few months if commodity prices stabilize near current levels. As we have emphasized for some time, this move is masking the main inflation event of 2010—the slide in developed world core inflation. High levels of unemployment and depressed capacity utilization are exerting steady downward pressure on core price and wage inflation. Today's US CPI report was a case in point. Headline inflation climbed to 2.6%oya in January, after having fallen to a six-decade low of -2% last July. The recovery in headline inflation is juxtaposed against a retreat in core inflation. Core inflation has dropped to an 0.8% annualized pace over the past six months, in line with our forecast that core inflation will rise less than 1% this year.

With core inflation also falling in the Euro area and Japan, the rate for the entire developed-economy block has eased to near 1%. Judging by historical experience, the process of core price disinflation has further room to run. The J.P. Morgan forecast looks for core inflation to slide to near 0.5% in the DM by year-end, which would be a record low for the series. It is important to emphasize that inflation dynamics are different in the emerging economies, where utilization rates are higher and core inflation is more sensitive to movements in commodity prices. EM core inflation likely has bottomed and will be stable to slightly higher over the course of this year.

Fed policy rate hikes are still a 2011 affair

Chairman Bernanke is set to deliver his semiannual testimony to Congress next week. He will likely send the message that economic and financial conditions are improving but that it is premature to look for the start of a rate normalization process. To be sure, the Fed is unwinding measures implemented to counter the financial market crisis. The move to raise the discount rate this week should be viewed as part of this process. The next step on this path will be the completion of the agency MBS purchase plan in March. These steps taken to end unconventional easing are not intended to signal that the rate normalization process is close at hand. In contrast, Chairman Bernanke's testimony is likely to highlight the daunting medium-term macroeconomic task at hand—to achieve full employment and budget discipline and prevent further disinflation—as he reiterates the details of the Fed's exit strategy unveiled last week. As the trajectory of core inflation moves lower, we remain confident in our forecast that the first Fed policy rate hike will come in 2Q11.

Japan producing growth but not inflation

In Japan, 4Q GDP growth came in at a surprisingly strong 4.6%, meaning the economy has expanded at an average 3.3% rate since hitting bottom in 1Q09. Net exports continue to anchor the recovery, but consumer spending also has rebounded solidly despite a sharp decline in workers' compensation. It also appears that capex has turned the corner. Although this week's February Reuters Tankan encouragingly showed manufacturers' sentiment index recovered to the pre-Lehman crisis level, next week's February Shoko Chukin and PMI and January IP will be important for tracking the momentum into the new year. The forecast calls for growth to downshift to just over 1.5% in 1H10 in response to the waning of fiscal stimulus.

Although the economy has generated solid real growth in recent quarters, nominal GDP has stagnated as price deflation has become more firmly entrenched. This development has increased the political pressure on the BoJ to take more aggressive action than it has to date. The BoJ did bow to this pressure late last year, when it expanded its QE measures. Nonetheless, monetary policymakers have resisted

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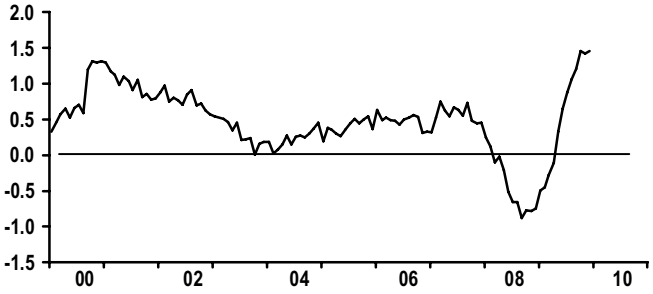
Japan real policy rate

%p.a.; o/n call rate less the year ago change in core consumer prices



taking further measures—a point that was underscored this week in Governor Shirakawa's press conference. To be sure, a sudden appreciation in the yen along with a fall in equity prices likely would trigger a response. But even here, the response would likely be limited to the BoJ's extending the maturity on its lending operations.

Looking for Greece to deliver

This week's meeting of EU finance ministers kept pressure on Greece, with an insistence that the Greek government meet the agreed-upon deficit targets. The focus on the actual deficit, rather than the cyclically adjusted position, severely limits Greece's room to maneuver if growth falls short of expectations. Additional pressure was also applied by the requirement that Greece adjust its policies in order to "remove the risk of jeopardizing the proper functioning of economic and monetary union." The next few weeks will be critical for Greece. By March 16, the Greek government needs to present a report explaining how the budgetary measures for 2010 are being implemented (see "The EU and Greece: a little bit of carrot and a lot of stick," in this *GDW*).

Not much good news for the UK

As the challenges faced by UK policymakers multiply, one has to dig deep for signs their choices will get any easier. As widely anticipated, this week saw the Governor of the BoE forced to write an open letter as headline inflation moved more than 1%-pt above target. Despite the current move up in inflation, the MPC lowered its medium-term inflation projections in its February forecasts reflecting more subdued expectations for growth. Markets appear tolerant of this view, and there are few signs of inflation expectations becoming unhinged.

Although business surveys are generally improving and the labor market is stabilizing, official output data have generally disappointed. Moreover, the combination of weather-related disruption, January's VAT increase, and the ending of tax breaks on home transactions has prompted weakness across a number of releases for the current month. With a convincing recovery yet to be established, the appropriate speed of fiscal consolidation is unclear. Unfortunately, political pressures surrounding the May 6 election will likely add more noise than signal to this debate.

Latin growth outperformance on track

Recent data releases support our forecast that Latin America will outperform the global economy in 2010. This week's January CAGED payroll report in Brazil indicated that formal net job creation is now back to historical highs, underscoring the strength of the broad economy, which is on track for 6%-plus GDP growth this year. Brazil is not the only country displaying positive growth dynamics. Two weeks ago we revised up our 2010 growth forecast for Mexico to 4.5% from 3.5% on the back of a stronger-than-expected rebound in manufacturing and an improving labor market. This week we raised projected 2010 growth in Argentina to 4.5% from 4.0% given the low inventory-to-sales ratio and the boost from exports to Brazil. We now see some upside growth risks in Peru and Colombia. Overall, we expect Latin America to grow 4.6%oya in 2010, which is more than a full point above its own potential and global growth.

Deficits to fall in South Africa and Turkey

This week's budget statement in South Africa calmed some fears that the unions and other left-leaning alliance members were starting to shape government policy. Instead, expenditure control, the existing inflation-targeting mandate for the Reserve Bank, and broad exchange rate flexibility were maintained. The consolidated budget deficit, which has widened to an estimated 7.3% of GDP this fiscal year, is projected to narrow steadily to 4.1% of GDP by FY2012/13. To achieve this, spending will lag nominal GDP growth and revenues will marginally outperform during the recovery phase for the economy. South Africa came into the crisis with more fiscal space than most other EMEA emerging markets and a resilient financial sector.

Turkey likewise is largely able to rely on the cyclical upturn to restore its desired primary surplus, along with spending discipline and the elimination of modest anti-crisis fiscal incentives. The larger Central European economies are expected to adopt additional measures to tackle their structural deficits—by way of the EU's excessive deficit procedure in Poland and the IMF/EU-supported economic program in Hungary. Hungary made progress in 2009 with a 3%-pt of GDP improvement in the structural balance. Upcoming elections in both countries are likely to limit further consolidation.

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Global economic outlook summary

	Real GDP			Real GDP							Consumer prices			
	% over a year ago			% over previous period, saar							% over a year ago			
	2009	2010	2011	3Q09	4Q09	1Q10	2Q10	3Q10	4Q10	1Q11	4Q09	2Q10	4Q10	2Q11
The Americas														
United States	-2.4	3.5	3.1	2.2	5.7	3.0	4.0	4.0	3.5	2.5	1.5	2.8	1.4	0.9
Canada	**-2.5** ↑	**2.9** ↑	3.4	0.4	**4.1** ↑	4.5	2.5	3.5	4.0	4.0	**0.8** ↓	**1.4** ↓	1.7	1.9
Latin America	-3.1	4.6	3.7	**6.4** ↑	5.6	4.6	4.5	3.6	2.8	3.4	5.3	6.7	**7.5** ↑	6.9
Argentina	-4.0	**4.5** ↑	3.0	0.2	1.0	8.0	8.0	3.0	3.0	2.0	**7.1** ↑	8.0	**10.0** ↑	10.0
Brazil	0.1	6.2	4.0	5.1	7.7	6.3	5.0	5.1	4.0	3.8	4.2	4.5	4.7	4.7
Chile	-1.7	5.0	5.0	4.6	8.0	6.0	5.0	3.0	4.0	6.0	**-3.0** ↓	**2.2** ↑	**2.9** ↑	2.9
Colombia	0.3	3.0	4.1	0.9	3.7	3.0	3.5	3.7	4.0	4.2	2.4	2.1	3.7	2.9
Ecuador	-1.0	2.0	3.0	**1.1** ↑	**-2.0** ↓	**2.0** ↓	3.5	4.0	4.5	3.0	**3.9** ↑	**4.2** ↑	**4.5** ↑	3.8
Mexico	-6.7	4.5	3.5	12.2	5.5	4.1	4.9	0.5	1.4	3.0	4.0	4.4	5.1	4.5
Peru	1.0	5.5	6.0	9.3	12.9	3.0	3.5	4.0	5.0	6.0	0.4	1.0	2.0	2.2
Venezuela	-2.9	-1.5	2.5	-7.8	-0.5	-4.0	-5.0	15.0	1.0	1.5	28.1	41.4	43.2	39.1
Asia/Pacific														
Japan	**-5.1** ↑	**2.3** ↑	1.9	**0.0** ↓	**4.6** ↑	1.8	1.5	2.0	2.2	1.8	-2.0	-1.9	-1.2	-0.1
Australia	0.9	3.0	3.5	0.8	2.5	3.3	3.8	4.2	3.9	3.1	2.2	2.6	2.6	3.0
New Zealand	-1.6	2.5	3.2	0.8	2.2	3.6	3.0	2.9	2.6	2.9	2.0	1.8	1.8	2.3
Asia ex Japan	4.4	7.7	7.2	**9.9** ↓	**6.5** ↑	7.6	7.2	7.2	6.8	6.9	2.7	4.5	3.8	3.2
China	8.6	10.0	9.4	10.3	10.0	9.8	9.4	9.5	9.0	9.1	0.7	3.2	3.1	2.4
Hong Kong	-3.3	4.5	4.1	1.6	5.0	4.2	4.0	3.8	3.5	4.2	1.4	2.4	2.3	1.9
India	6.8	7.8	8.3	11.6	1.8	10.4	8.1	7.0	8.7	7.9	12.2	11.9	6.2	5.5
Indonesia	4.5	5.5	6.6	5.8	9.6	6.0	4.0	8.5	5.0	6.0	2.6	5.3	6.3	4.9
Korea	0.2	5.3	4.1	13.6	0.7	3.6	4.2	4.2	3.5	4.0	2.4	3.1	3.6	3.4
Malaysia	-2.4	5.0	5.1	9.4	4.5	1.6	5.3	5.7	5.3	4.9	-0.5	1.7	2.4	2.4
Philippines	0.9	4.5	4.3	3.1	3.5	6.0	5.0	3.5	4.0	4.5	3.0	4.1	4.7	4.9
Singapore	**-2.0** ↑	**6.8** ↑	**4.8** ↓	**11.5** ↓	**-2.8** ↑	11.2	7.0	4.9	4.9	4.1	**-0.3** ↑	3.4	2.9	2.1
Taiwan	**-2.7** ↑	**6.8** ↑	4.8	8.3	**11.5** ↑	**4.0** ↓	**4.5** ↓	4.6	3.8	4.8	**-1.3** ↓	0.9	2.0	1.8
Thailand	-2.9	5.5	5.0	5.5	5.3	4.9	5.7	5.3	5.3	4.1	1.9	5.5	4.4	3.0
Africa/Middle East														
Israel	**0.5** ↑	3.0	4.5	**3.0** ↑	**4.4** ↑	3.0	3.5	3.5	4.0	4.0	3.6	3.2	3.0	3.1
South Africa	-1.8	3.0	3.5	0.9	3.0	4.4	4.3	4.3	4.9	3.6	6.0	4.3	5.3	5.8
Europe														
Euro area	-4.0	1.6	2.1	1.7	0.4	1.5	3.0	2.3	2.0	2.0	0.4	1.3	1.3	0.8
Germany	-4.9	1.7	2.1	2.9	0.0	1.0	3.0	2.0	2.0	2.0	0.3	0.9	1.3	1.3
France	-2.2	2.0	2.2	0.7	2.4	1.5	3.0	2.0	2.5	2.0	0.4	1.4	0.9	0.9
Italy	-4.9	1.1	1.7	2.4	-0.8	1.0	2.5	1.5	2.0	1.5	0.7	1.1	1.1	1.1
Norway	**-1.4** ↓	**2.3** ↓	2.8	**1.4** ↓	**1.3** ↓	3.0	3.0	3.0	**3.0** ↑	2.8	1.4	1.9	1.2	1.2
Sweden	-4.4	2.4	3.0	0.7	1.0	3.5	3.5	3.0	3.0	3.0	-0.4	1.1	0.9	1.8
Switzerland	-1.5	2.2	2.8	1.2	2.3	2.5	2.8	3.0	3.0	2.8	-0.1	0.9	0.7	0.8
United Kingdom	-4.8	1.4	3.1	-0.6	0.4	2.0	2.5	2.8	3.5	2.8	2.1	2.2	1.4	1.9
Emerging Europe	-5.1	**4.0** ↓	4.7	4.1	**5.1** ↓	**3.7** ↓	**3.6** ↑	**3.3** ↓	**3.9** ↓	4.4	6.2	**5.5** ↑	5.5	4.9
Bulgaria	-5.1	-1.5	4.5	…	…	…	…	…	…	…	…	…	…	…
Czech Republic	-4.3	2.0	4.0	3.3	-2.4	2.0	3.0	2.5	2.5	3.5	0.4	1.3	3.0	3.0
Hungary	-6.3	**0.5** ↓	4.0	-4.7	-1.6	**1.5** ↓	**2.5** ↓	**2.0** ↓	**2.0** ↓	4.0	5.2	**4.3** ↑	**3.0** ↑	2.8
Poland	**1.7** ↑	**3.2** ↓	4.2	2.0	**3.0** ↓	**3.0** ↓	**4.0** ↑	3.0	3.0	4.0	3.3	2.0	2.5	2.5
Romania	-7.2	1.5	4.0	…	…	…	…	…	…	…	4.6	4.5	5.3	4.5
Russia	-7.9	5.5	5.0	7.9	10.5	5.0	4.0	4.0	5.0	5.0	9.2	6.7	7.2	6.9
Turkey	-5.3	5.0	5.3	…	…	…	…	…	…	…	5.7	8.5	6.6	4.8
Global	-2.5	3.3	3.3	**2.7** ↓	**3.9** ↑	**3.1** ↓	3.7	3.6	3.4	3.0	1.3	2.2	1.8	1.6
Developed markets	-3.4	**2.6** ↑	2.6	**1.4** ↓	**3.4** ↑	2.4	3.1	3.1	2.9	2.3	0.6	1.5	1.0	0.9
Emerging markets	0.8	6.2	5.8	7.8	**5.9** ↑	**6.1** ↓	5.8	**5.5** ↓	5.3	5.5	3.9	5.1	4.9	4.3
Memo:														
Global — PPP weighted	-0.9	4.4	4.4	4.2	4.5	4.1	4.4	4.2	4.0	3.8	2.3	3.3	2.8	2.5

Note: For some emerging economies, 2009-2011 quarterly forecasts are not available and/or seasonally adjusted GDP data are estimated by J.P. Morgan.
Bold denotes changes from last edition of *Global Data Watch,* with arrows showing the direction of changes. Underline indicates beginning of J.P. Morgan forecasts.

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G-3 economic outlook detail

Percent change over previous period; seasonally adjusted annual rate unless noted

				2009		2010				2011	
	2009	2010	2011	3Q	4Q	1Q	2Q	3Q	4Q	1Q	2Q
United States											
Real GDP	-2.4	3.5	3.1	2.2	5.7	3.0	4.0	4.0	3.5	2.5	2.5
Private consumption	-0.6	2.2	2.6	2.8	2.0	2.0	2.5	3.0	3.0	2.5	2.0
Equipment investment	-16.9	8.4	8.8	1.5	13.3	10.0	10.0	9.0	9.0	9.0	8.0
Non-residential construction	-19.7	-11.1	1.5	-18.4	-15.4	-10.0	-8.0	-3.0	-3.0	0.0	7.0
Residential construction	-20.4	6.6	18.6	18.9	5.7	2.0	8.0	15.0	20.0	20.0	20.0
Inventory change ($ bn saar)	-111.7	19.1	35.4	-139.2	-33.5	-13.7	20.1	34.6	35.3	26.6	31.6
Government spending	1.9	1.6	-0.1	2.7	-0.2	1.8	1.4	1.1	1.1	-0.8	-1.0
Exports of goods and services	-9.9	13.3	9.0	17.8	18.1	14.0	13.0	12.0	10.0	8.0	8.0
Imports of goods and services	-14.2	9.1	7.6	21.3	10.5	10.0	9.0	8.0	8.0	7.0	8.0
Domestic final sales contribution	-2.8	2.2	2.9	2.4	1.8	2.1	2.7	3.2	3.4	2.7	2.5
Inventories contribution	-0.6	1.1	0.1	0.7	3.4	0.6	1.1	0.4	0.0	-0.3	0.1
Net trade contribution	1.0	0.3	0.1	-0.8	0.5	0.2	0.3	0.4	0.1	0.0	-0.1
Consumer prices (%oya)	-0.3	2.3	1.0	-1.6	1.5	2.9	2.8	2.1	1.4	0.9	0.9
Excluding food and energy (%oya)	1.7	1.0	0.6	1.5	1.7	1.5	1.1	0.8	0.5	0.4	0.4
Federal budget balance (% of GDP, FY)	-9.9	-10.1	-7.2								
Personal saving rate (%)	4.6	4.9	5.2	4.5	4.6	4.7	4.9	4.9	5.0	5.0	5.1
Unemployment rate (%)	9.3	9.5	9.1	9.6	10.0	9.8	9.4	9.5	9.4	9.3	9.1
Industrial production, manufacturing	-11.2	4.6	3.9	9.0	5.7	5.0	5.0	5.0	4.0	3.0	3.0
Euro area											
Real GDP	-4.0	1.6	2.1	1.7	0.4	1.5	3.0	2.3	2.0	2.0	2.0
Private consumption	-0.9	0.4	1.3	-0.6	0.0	0.5	1.0	1.0	1.0	1.5	1.5
Capital investment	-10.8	-0.6	3.8	-3.3	-4.0	0.0	2.0	3.0	4.0	4.0	4.0
Government consumption	2.5	1.8	1.2	2.3	2.0	1.5	1.5	1.5	1.5	1.0	1.0
Exports of goods and services	-13.6	7.0	8.1	13.1	2.0	8.0	10.0	8.0	8.0	8.0	8.0
Imports of goods and services	-11.6	5.2	7.7	12.5	0.0	7.0	7.5	6.5	7.5	8.0	8.0
Domestic final sales contribution	-2.4	0.5	1.8	-0.5	-0.4	0.6	1.3	1.5	1.7	1.9	1.9
Inventories contribution	-0.5	0.3	0.1	1.9	0.0	0.4	0.6	0.1	0.0	0.0	0.0
Net trade contribution	-1.1	0.8	0.3	0.3	0.8	0.4	1.1	0.7	0.3	0.1	0.1
Consumer prices (HICP, %oya)	0.3	1.3	0.9	-0.4	0.4	1.3	1.3	1.3	1.3	0.9	0.8
ex unprocessed food and energy	1.3	0.9	0.6	1.2	1.0	1.0	1.0	0.8	0.7	0.5	0.6
General govt. budget balance (% of GDP, FY)	-6.1	-7.4	-6.6								
Unemployment rate (%)	9.4	9.9	9.5	9.6	9.9	10.0	9.9	9.8	9.7	9.6	9.5
Industrial production	-14.9	2.5	3.2	7.7	0.7	2.0	3.5	3.5	3.5	3.0	3.0
Japan											
Real GDP	-5.1	2.3	1.9	0.0	4.6	1.8	1.5	2.0	2.2	1.8	1.5
Private consumption	-1.1	1.6	1.0	2.4	2.7	0.5	0.5	1.8	1.8	0.5	0.5
Business investment	-19.2	1.8	5.1	-9.8	4.0	5.0	6.0	6.0	6.0	4.0	5.0
Residential construction	-13.9	-6.8	4.0	-27.7	-12.8	0.0	5.0	10.0	5.0	5.0	0.0
Public investment	6.4	-7.5	-7.3	-6.2	-6.4	-10.0	-15.0	-10.0	-5.0	-5.0	-5.0
Government consumption	1.7	1.3	0.9	0.5	3.3	0.5	1.5	0.5	1.0	1.2	0.5
Exports of goods and services	-24.2	19.1	10.5	37.8	21.7	15.0	15.0	10.0	10.0	12.0	8.0
Imports of goods and services	-17.1	7.0	8.8	23.3	5.3	4.0	8.0	10.0	10.0	10.0	6.0
Domestic final sales contribution	-3.5	1.0	1.3	-1.0	2.1	0.6	0.9	1.8	2.0	1.0	0.9
Inventories contribution	0.4	-0.4	-0.1	-1.1	0.3	-0.4	-0.7	-0.2	-0.2	0.0	0.0
Net trade contribution	-2.0	1.8	0.7	2.1	2.2	1.6	1.3	0.5	0.5	0.8	0.6
Consumer prices (%oya)	-1.4	-1.6	-0.4	-2.2	-2.0	-1.4	-1.9	-1.7	-1.2	-0.9	-0.1
Central govt. balance (% of GDP, FY)	-11.3	-10.3	-10.5								
Unemployment rate (%)	5.1	4.9	4.6	5.5	5.1	5.1	5.0	4.9	4.7	4.6	4.6
Industrial production	-22.3	17.7	12.1	33.1	20.1	15.0	10.0	12.0	14.0	10.0	10.0
Memo: Global industrial production	-11.1	6.8	5.5	12.4	7.4	5.9	6.0	6.0	5.6	4.7	5.1
%oya				-10.7	-2.9	7.2	7.8	6.3	5.9	5.6	5.3

Note: More forecast details for the G-3 and other countries can be found on J.P. Morgan's Morgan Markets client web site.

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Global Central Bank Watch

	Official interest rate	Current	Change from Aug '07 (bp)	Last change	Next meeting	Forecast next change	Mar 10	Jun 10	Sep 10	Dec 10	Jun 11
Global	GDP-weighted average	1.29	-337				1.30	1.35	1.43	1.51	1.98
excluding US	GDP-weighted average	1.84	-251				1.85	1.92	2.05	2.17	2.67
Developed	GDP-weighted average	0.50	-361				0.50	0.51	0.54	0.59	1.04
Emerging	GDP-weighted average	4.45	-241				4.47	4.67	4.99	5.21	5.72
Latin America	GDP-weighted average	5.72	-321				5.91	6.41	7.10	7.36	8.32
CEEMEA	GDP-weighted average	4.42	-244				4.30	4.16	4.41	4.66	5.03
EM Asia	GDP-weighted average	4.00	-210				4.00	4.22	4.43	4.61	5.01
The Americas	GDP-weighted average	0.75	-484				0.77	0.82	0.93	0.99	1.44
United States	Federal funds rate	0.125	-512.5	16 Dec 08 (-87.5bp)	16 Mar 10	2Q 11 (+25bp)	0.125	0.125	0.125	0.125	0.50
Canada	Overnight funding rate	0.25	-400	21 Apr 09 (-25bp)	2 Mar 10	20 Jul 10 (+25bp)	0.25	0.25	0.75	1.25	1.75
Brazil	SELIC overnight rate	8.75	-325	22 Jul 09 (-50bp)	17 Mar 10	Mar 10 (+50bp)	9.25	10.25	11.25	11.75	11.75
Mexico	Repo rate	4.50	-270	17 Jul 09 (-25bp)	19 Mar 10	Jun 10 (+25bp)	4.50	4.75	5.25	5.25	6.75
Chile	Discount rate	0.50	-450	9 Jul 09 (-25bp)	31 Mar 10	3Q 10 (+25bp)	0.50	0.50	1.25	2.00	3.50
Colombia	Repo rate	3.50	-550	23 Nov 09 (-50bp)	26 Feb 10	1Q 11 (+50bp)	3.50	3.50	3.50	3.50	5.50
Peru	Reference rate	1.25	-325	6 Aug 09 (-75bp)	11 Mar 10	Jul 10 (+25bp)	1.25	1.25	2.00	2.75	4.25
Europe/Africa	GDP-weighted average	1.32	-321				1.31	1.29	1.33	1.41	2.06
Euro area	Refi rate	1.00	-300	7 May 09 (-25bp)	4 Mar 10	1Q 11 (+25bp)	1.00	1.00	1.00	1.00	1.75
United Kingdom	Repo rate	0.50	-500	5 Mar 09 (-50bp)	4 Mar 10	Nov 10 (+25bp)	0.50	0.50	0.50	0.75	1.25
Sweden	Repo rate	0.25	-325	2 Jul 09 (-25bp)	20 Apr 10	1Q 11 (+25bp)	0.25	0.25	0.25	0.25	0.75
Norway	Deposit rate	1.75	-275	16 Dec 09 (+25bp)	24 Mar 10	24 Mar 10 (+25bp)	2.00	2.25	2.50	2.50	3.25
Czech Republic	2-week repo rate	1.00	-175	16 Dec 09 (-25bp)	25 Mar 10	23 Sep 10 (+25bp)	1.00	1.00	1.25	1.75	2.75
Hungary	2-week deposit rate	6.00	-175	25 Jan 10 (-25bp)	22 Feb 10	22 Feb 10 (-25bp)	5.50	5.50	5.50	5.50	5.50
Israel	Base rate	1.25	-275	28 Dec 09 (+25bp)	22 Feb 10	**2Q 10 (+25bp)**	**1.25**	**1.75**	**2.25**	**2.75**	**3.75**
Poland	7-day intervention rate	3.50	-100	24 Jun 09 (-25bp)	24 Feb 10	3Q 10 (+25bp)	3.50	3.50	3.75	4.00	5.00
Romania	Base rate	7.00	0	3 Feb 10 (-50bp)	29 Mar 10	29 Mar 10 (-25bp)	6.75	6.25	6.00	6.00	7.00
Russia	1-week deposit rate	**3.75**	75	**19 Feb 10 (-25bp)**	Mar 10	**Mar 10 (-25bp)**	3.50	3.00	3.00	3.00	**3.00**
South Africa	Repo rate	7.00	-250	13 Aug 09 (-50bp)	25 Mar 10	4Q 10 (+50bp)	7.00	7.00	7.00	7.50	8.50
Switzerland	3-month Swiss Libor	0.25	-225	12 Mar 09 (-25bp)	Mar 10	Sep 10 (+25bp)	0.25	0.25	0.50	0.75	1.25
Turkey	Overnight borrowing rate	6.50	-1100	19 Nov 09 (-25bp)	18 Mar 10	3Q 10 (+50bp)	6.50	6.50	7.50	8.00	7.50
Asia/Pacific	GDP-weighted average	2.09	-135				2.09	2.22	2.34	2.45	2.67
Australia	Cash rate	3.75	-250	1 Dec 09 (+25bp)	2 Mar 10	6 Apr 10 (+25bp)	3.75	4.25	4.50	5.00	5.50
New Zealand	Cash rate	2.50	-550	30 Apr 09 (-50bp)	10 Mar 10	**29 Jul 10 (+50bp)**	2.50	**2.50**	3.50	4.00	4.75
Japan	Overnight call rate	0.10	-43	19 Dec 08 (-20bp)	17 Mar 10	4Q 11 (+15bp)	0.10	0.10	0.10	0.10	0.10
Hong Kong	Discount window base	0.50	-625	17 Dec 08 (-100bp)	17 Mar 10	2Q 11 (+25bp)	0.50	0.50	0.50	0.50	1.00
China	1-year working capital	5.31	-126	22 Dec 08 (-27bp)	1Q 10	2Q 10 (+27bp)	5.31	5.58	5.85	6.12	6.39
Korea	Base rate	2.00	-250	12 Feb 09 (-50bp)	11 Mar 10	3Q 10 (+25bp)	2.00	2.00	2.25	2.50	3.00
Indonesia	BI rate	6.50	-200	5 Aug 09 (-25bp)	4 Mar 10	4Q 11 (-25bp)	6.50	6.50	6.50	6.50	6.50
India	Repo rate	4.75	-300	21 Apr 09 (-25bp)	Apr 10	Apr 10 (+25bp)	4.75	5.25	5.50	5.50	6.50
Malaysia	Overnight policy rate	2.00	-150	24 Feb 09 (-50bp)	4 Mar 10	**4 Mar 10 (+25bp)**	**2.25**	**2.50**	**2.75**	**2.75**	**2.75**
Philippines	Reverse repo rate	4.00	-350	9 Jul 09 (-25bp)	11 Mar 10	2Q 10 (+25bp)	4.00	4.25	4.75	5.00	5.00
Thailand	1-day repo rate	1.25	-200	8 Apr 09 (-25bp)	10 Mar 10	2 Jun 10 (+25bp)	1.25	1.50	1.50	1.75	2.25
Taiwan	Official discount rate	1.25	-188	18 Feb 09 (-25bp)	1Q 10	4Q 10 (+12.5bp)	1.25	1.25	1.25	1.375	1.625

Bold denotes move since last GDW and forecast changes. Underline denotes policy meeting during upcoming week.

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The J.P. Morgan View: Markets

The fiscal threat is overblown

- **Asset allocation:** We add risk to the recovery trade by covering the HG underweight. The overall strategy is long equities, credit, commodities, and the dollar, and is short bonds.
- **Economics:** Downside risks from monetary and fiscal tightening are overestimated. Focus instead on whether the corporates are spending and hiring. We are bullish, but are monitoring the data closely.
- **Fixed income:** Take profit on the short position in US 2s, but add a short in 10-year UK.
- **Equities:** Current regulatory proposals would hurt bank profitability, offsetting the positive impact from reduced credit losses. UK banks will be the most impacted, followed by the Europeans and then the US banks.
- **Credit:** Close tactical short and resume overweight in US HG bonds.
- **FX:** We add USD/EUR to our basket of dollar longs.
- **Commodities:** Stay long on strong manufacturing growth.

A week of better US economic activity data despite still mixed data in Europe pushed up risky markets across the world—testimony that US numbers still matter a lot more than anybody else's. The move confirms that we should think of the sell-off in risk since mid-January as a **profit-taking correction** in a longer-lasting bull market, rather than the start of a new bear market.

Sentiment remains fragile, with market participants showing little conviction. At times, it feels like we are all afraid of our own shadows. This caution reflects the fact that the recovery is barely half a year old and there remains a lot of unresolved leverage across the world. It remains the case, though, that, with almost no return on cash, risky markets are paying risk premia that are handsome relative to the risks as we perceive them.

The worry that keeps popping up on the market's risk radar is that delevering is not over and can reemerge at any moment. Early last year, market focus was mostly on the consumer as the likely agent to be forced into a second round of delevering. Later last year, it was the corporates that everyone was afraid of. And now, the **delevering fear has shifted to governments**.

Many people ask us **whether Greece is just a dry run for a global fiscal crisis** that will drag the world economy down again. Our answer to this is, yes and no. Yes in the longer run, but no in the shorter term. Policy actions to pull the world out of recession have shifted leverage to public balance sheets. Efforts to redress fiscal imbalances are likely to require tax hikes and spending cuts that are likely to depress growth over coming years. It is our sense that this impact is fully appreciated by market participants and should thus be in the price.

But there is also a fear that market pressure on governments will induce **imminent fiscal tightening** that will in turn depress private demand. And if governments do not cut their deficits soon, they could get punished with higher bond yields, depressing private borrowing. It is our view that in the larger economies, this Catch 22 is being addressed through monetary policy and QE. The Euro area has a stronger institutional separation between fiscal and monetary policy and is thus more vulnerable to these opposing forces. Even so, market pressure for fiscal tightening is largely limited to smaller economies and thus should not make fiscal policy a major downside risk for the Euro area economy.

Of the **three potential areas of delevering risks**, one should **monitor the corporate sector most closely**. It is corporate expansion that we rely on to fuel the economic recovery, and disappointment here would be most damaging to our forecasts. Conditions are very supportive for corporate expansion—high profit margins, low borrowing costs, low inventories, and positive growth in demand. We have seen the start of corporate expansion through capex and a slowing of destocking. We now need to see a rebuilding of inventories and, most importantly, net hiring by companies. The global unemployment rate has stopped rising, but this is largely due to a fall in the labor force. Private sector employment is still falling. Watch this space.

Asian markets reacted badly over the past month to the start of Chinese **monetary policy** tightening. We accept the sensitivity of Chinese equities to a reversal in monetary policy, even when it succeeds in producing a soft landing, which is our forecast. This is why we are underweight China and tactically neutral EM versus DM equities. The developed equity markets are much less vulnerable to the start of monetary policy normalization, as was shown in this week's non-reaction to the Fed's discount rate hike.

Fixed income

Bond markets fell for the second week in a row, mirroring the rally in risky assets. The Fed's hike in the discount rate focused attention on central bank exit strategies, and pushed short rates higher. We retain a bearish medium-term view on fixed income on the basis of the eventual normalization of monetary policy and an expected fall in demand for bonds this year from QE and commercial banks. But with the Fed and ECB on hold, and inflation staying low, our forecasts are only mildly bearish. We prefer to apply a hit-and-run strategy to our bearish view. This week's backup has moved year-end forwards for the 2-year UST close to our forecast, and we thus **take profit tactically on our short duration here**. **We remain short in the Euro area short end, and add a short in 10-year gilts.**

UK inflation rose to 3.5% this week, prompting an open letter on the inflation outlook from BoE Governor King. Although the rise in inflation was expected, **UK short breakevens** rose sharply this week, partly on speculation that direct taxes will go up after the general election. We think there is some room for breakevens to rise further, and stay overweight inflation-linked bonds.

Improving economic prospects and a continuing search for higher-yielding assets should underpin demand for **local EM debt**. South Africa, where this week's budget was well received after reaffirming the country's inflation target, is a case in point. We also favor Russia and Hungary.

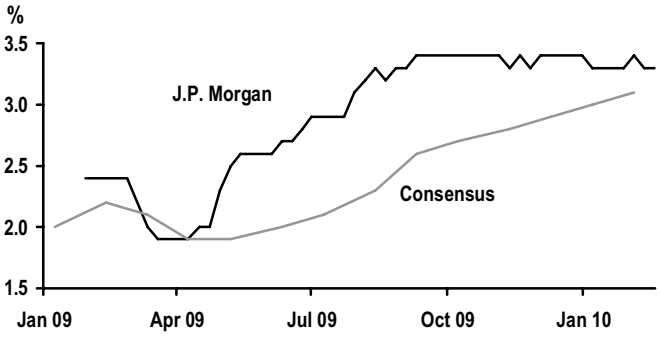
Equities

Equities are up for a second week following four straight weeks of declines. They are now halfway between their January 19 peak and their February 8 low.

Three weeks ago, we turned more cautious in equities for the near term on fears of further position squaring. We now **remove the defensive bias as investor positions appear to have been cut** to a large extent. Flows have also turned more supportive with the first weekly inflow for equity funds this week, following four straight weeks of outflows. See today's *Flows & Liquidity*.

We are encouraged by the **reduced sensitivity of the equity market to Greek debt worries**. Equities rose 3% on the week while 10-year Greece is 25bp wider versus Bunds. We believe that last week's EU statement will be very important in limiting the contagion from the Greek debt crisis, and we anticipate that the Greek debt problem increasingly will become a local problem.

2010 global GDP growth forecasts: J.P. Morgan versus consensus



Our positive stance on equities is best captured by overweighting cyclical sectors and small caps. Non-cyclical sectors such as utilities and telecoms are especially vulnerable to governments' efforts to raise tax revenues, as they cannot move operations and have stable cash flows. We are neutral on financials as the potential implementation of the regulatory proposals currently being discussed can have a significant negative impact on future bank profitability, offsetting the positive impact from reduced credit losses.

Our researchers produced a report this week (*Global Banks—Too Big to Fail*, O'Donohoe and Atunes da Silva, February 17) in which they estimate that the sum of the **current regulatory proposals would depress the RoE for global banks from 13.3% to 5.4% in 2011**. UK banks would be the most impacted followed by the Europeans and then the US banks. At these levels of return, we believe it would be difficult to attract private capital to fund growth, and so product pricing would have to increase substantially. The rising cost of doing business could have significant negative ramifications for the global economy.

Credit

We entered 2010 with a view of continuing credit spread compression. However, the conflict between heavy overweight positions and rising regulatory and fiscal risks then made us reverse course at the end of January. Spreads have widened now, positions have been trimmed, and supply has slowed. We thus advise going back to an overweight in US HG. Strengthening corporate fundamentals and US economic activity data should overcome remaining risks in the market. We reposition for US HG spreads to tighten from 164bp currently to our year-end target of 125bp.

The 4Q reporting season is showing that US corporates earnings were very strong and companies continued to delever, supporting overweights in US HG. Corporates kept accumulating cash in 4Q, although at a slower pace, while reducing leverage (debt/EBITDA) modestly.

European HG spreads widened this week despite tighter spreads in other markets, benefiting our underweight versus US HG. The **underperformance relative to US HG is likely to continue** as Euro area economies are recovering more slowly than the US, while being the most at risk of premature fiscal tightening. Stay underweight versus US HG.

In line with the downward revision of our 2010 default rate forecast for US HY bonds from 4% to 2% two weeks ago, we are lowering the 2010 default rate forecast for European HY from 6%-7% to 3%-4%, as inflows into the asset class are allowing most leveraged companies to refinance without problem.

Foreign exchange

Several major central banks have surprised with the timing and course of their exit strategies over the past six weeks. The net result has been **dollar positive**, and while it is premature to conclude that the dollar is transforming from a funding to investment currency, it can still rally further this month. Policy is still hazy, data are mixed, and positions are not overly long dollars.

We **broaden our basket of USD shorts** by selling the most vulnerable European currencies in cash (**EUR and GBP**), with GBP increasingly at risk from fiscal tensions, deteriorating economic data, and a uniquely dovish central bank. Take profits on short EUR/SEK ratio put spread on softening Swedish inflation. Continue to position for a change in commodity currency leadership. Sell NZD versus CAD and hold short AUD versus CAD. Stay short AUD and NZD versus USD. Also stay short EUR/PLN, long EUR/GBP, and short GBP/CHF.

We **retain bearish medium-term forecasts for the dollar**, however. It would be a mistake to extrapolate the past two months' moves to a view that the US will lead a global tightening cycle that will transform the dollar from a funding to an investment currency, and therefore deliver a year-long USD rally. We expect the dollar to weaken again this spring as European growth reaccelerates toward trend, Greece implements its fiscal tightening (so avoids a credit event), and fears of a Chinese slowdown fail to materialize as a risk to commodity currencies.

Commodities

We stay overall **long commodities** on strong growth in both global manufacturing and EM economies. We remain bullish base metals, with most of the likely price gains in 1H due to restocking at the consumer level.**Crude oil** prices jumped US$4 to US$78 this week. We do not see much upside from current levels in coming weeks. Crude still finds resistance near US$80, and high crude inventories and still poor demand in the US should continue to limit price gains near term. Nevertheless, we expect prices to rise further until year-end. We currently forecast that WTI will average US$85 in 4Q, but risks to our forecasts are biased to the upside. In our view, prices should start moving higher more consistently in late 2Q.

But not everything is bullish in commodities. **Sugar** is down more than 10% month-to-date, and the curve has flattened considerably. We do expect a substantial supply response to the current high prices late this year, even as the physical market gets tighter in coming months. We prefer to be in flatteners now (J.P. Morgan Contag Sugar versus GSCI Sugar, vol-matched).

Ten-year Government bond yields

	Current	Mar 10	Jun 10	Sep 10	Dec 10
United States	3.80	3.90	4.10	4.25	4.50
Euro area	3.29	3.35	3.50	3.65	3.75
United Kingdom	4.17	4.40	4.45	4.50	4.60
Japan	1.33	1.30	1.40	1.50	1.55
GBI-EM	7.18				7.90

Credit markets

	Current	YTD Return
US high grade (bp over UST)	170	0.6%
Euro high grade (bp over Euro gov)	162	1.1%
USD high yield (bp vs. UST)	679	0.7%
Euro high yield (bp over Euro gov)	702	2.1%
EMBIG (bp vs. UST)	308	0.4%
EM Corporates (bp vs. UST)	356	1.1%

Foreign exchange

	Current	Mar 10	Jun 10	Sep 10	Dec 10
EUR/USD	1.36	1.45	1.48	1.45	1.40
USD/JPY	91.9	85	82	85	89
GBP/USD	1.54	1.54	1.59	1.58	1.56

Commodities - quarterly average

	Current	10Q1	10Q2	10Q3	10Q4
WTI ($/bbl)	80	72	76	80	85
Gold ($/oz)	1125	1250	1400	1300	1200
Copper($/m ton)	7238	7350	8000	6800	6250
Corn ($/Bu)	3.69	3.85	4.05	3.95	3.90

Source: J.P. Morgan, Bloomberg, Datastream

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1. Research notes listed have been published in the *GDW; Special Reports* and *Global Issues* are stand-alone features, but may also have appeared in some form in *GDW*.

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Economic Research note

Global labor markets stabilize but not yet expanding

- **Unemployment rate steadies, reflecting stable employment and unprecedented stall in the labor force**
- **Holistic shift in business behavior raises confidence that firms will soon turn expansionary**
- **Aggressive US labor market adjustment boosted productivity and profits versus Europe and Japan**

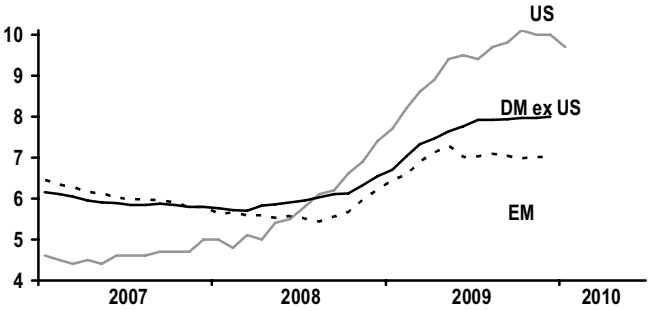
Unemployment rates appear to have peaked across much of the globe. Our global unemployment rate measure has remained within 0.1%-pt of the recession high of 8.6% for six straight months. The recent stabilization follows a period of intense job losses that produced a 3.2%-pt surge in the global unemployment rate in less than 18 months. The leveling off in unemployment rates reflects changes in both the demand for and supply of labor. The demand for labor contracted sharply during the recession when businesses slashed all spending, including employment. Now that the economy has returned to growth, employment is stabilizing in most countries.

Ordinarily, a leveling off in employment would not be enough to stabilize the rate of unemployment because of secular growth in the labor force reflecting, in part, population growth. Thus, the other change that has occurred is a decline in the supply of labor. This is easy to understand. The extreme rise in unemployment has discouraged increasing numbers of laid-off workers and potential new entrants from seeking employment. That said, outright declines in labor supply are rare. The recent, albeit small, drop in the DM labor force is the first in at least three decades. This is testimony to the severity of the recent recession. It also underscores that the economy has not yet satisfied a key condition for self-sustaining growth: a return to net hiring. That said, the recent firming in all aspects of business spending gives confidence that companies will turn expansionary soon.

Against this backdrop of broad stabilization there are important regional variations. The labor market recovery is further advanced in the emerging economies, where unemployment rates are trending down in much of Asia and Latin America, and job growth is positive. A similar pattern is seen in some developing countries, including Australia and Canada. The US is further back in line, with recent data hinting at a plateau in both unemployment and

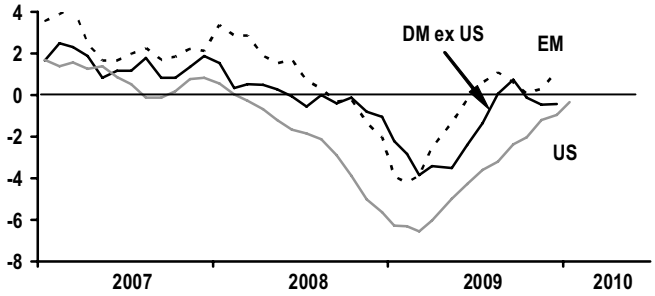
Unemployment rate

Percent, sa



Employment

%3m, saar



Employment and the labor force, developed economies

%oya; both scales

employment. Europe is the laggard, where unemployment rates are still edging up in the Euro area and also in CEEMEA countries including Poland, Hungary, and the Czech Republic.

Aggressive US cutbacks stand out

There has been wide variation in labor market adjustments across countries, both outright and—more importantly—in relation to the fall in output relative to potential GDP. This has important implications for labor productivity, labor demand, and corporate profits.

At the global level, GDP fell 4.6% from peak to trough, with the output gap declining an estimated 6.0%-pts. This

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was accompanied by a trough-to-peak rise in the unemployment rate of 3.3%-pts (beta of -0.6), and a peak-to-trough decline in employment of 3.2% (beta of 0.5). The virtually identical moves in the unemployment rate and employment reflect a highly unusual stall in labor force growth, without which the unemployment rate would have risen by more.

Looking at individual countries, the US labor market adjustment stands out as being among the most severe, with the unemployment rate rising 5.6%-pts in response to an estimated 5.3% decline in the gap between output and potential GDP (a ratio of -1.0). The US job loss was an even deeper 6.1%, implying that a modest fall in the labor force damped the rise in the unemployment rate. By contrast, unemployment rates have increased more modestly elsewhere despite relatively larger declines in the output gap. Importantly, this holds for both the Euro area and Japan, where 6.5% and 8.7% declines in the output gap were associated with unemployment increases of just 2.7%-pts and 1.7%-pts (betas of -0.4 and -0.2).

Historically, some labor markets tend to be higher beta than others, reflecting cultural and legal differences, among other factors. However, even based on these historical norms (estimated from Okun's Law relationships), the US corporate sector stands out as having retrenched very aggressively, with an increase in the unemployment rate that is 2%-pts greater than what was expected.

Notwithstanding the margins between the unemployment rate and total hours worked, these results suggest a much better outcome for labor productivity in the US compared with elsewhere. Official data for the G-3 economies show this definitively. US productivity has increased 9% since the onset of the global financial crisis in 2007, capped off by a high-powered burst in the latest three quarters. By contrast, labor productivity declined over the period in the Euro area and Japan.

This productivity performance helps explain the more impressive bounceback in US corporate profits. As our publications have highlighted, US profit margins already are expected to approach long-term highs later this year, at a relatively early stage of the expansion. In turn, this is expected to produce a more dynamic recovery in US business spending, including employment. That said, there are three possibilities for the labor market. One is that US firms continue to squeeze unusually large productivity gains out of their employees and do not raise employment. Indeed, a "jobless recovery" remains one of the biggest downside risks to the forecast. A second possibility is that the growth of labor productivity reverts toward trend. This is what is assumed in the J.P. Morgan forecast. In the context of above-trend GDP growth, this points to a return to healthy job growth. There is also an upside risk case: it is possible that the recent burst in productivity will prove transitory and that the level of productivity ultimately will return to its old trend path. This could produce an unexpected burst of hiring and a more impressive US economic recovery.

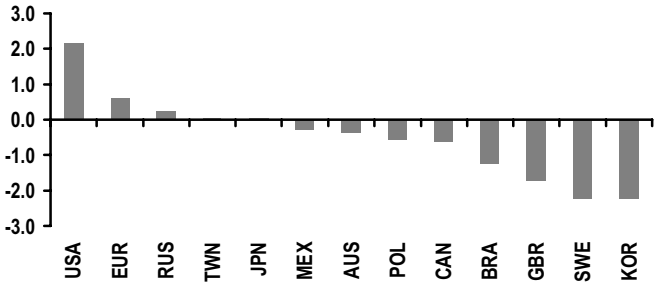
Labor market response to 2008-2009 recession

	Chg in Output gap	Trough-peak rise in u-rate	Peak-trough decline in employment	U-rate "beta"	Employment "beta"
Global	**-6.0**	**3.3**	**-3.2**	**-0.6**	**0.5**
Developed	**-5.7**	**3.4**	**-3.5**	**-0.6**	**0.6**
US	-5.3	5.6	-6.1	-1.0	1.1
Euro area	-6.5	2.7	-2.7	-0.4	0.4
Japan	-8.7	1.7	-1.9	-0.2	0.2
UK	-4.6	2.7	-2.1	-0.6	0.5
Canada	-4.0	2.6	-1.8	-0.6	0.5
Australia	-1.4	1.7	-0.3	-1.2	0.2
Emerging	**-6.9**	**1.6**	**-1.7**	**-0.2**	**0.2**
Brazil	-5.7	0.7	-0.5	-0.1	0.1
Mexico	-10.5	2.4	-4.0	-0.2	0.4
Poland	-1.2	2.4	-2.4	-1.9	2.0
Russia	-13.2	3.7	-2.9	-0.3	0.2
Korea	-5.3	1.7	-0.6	-0.3	0.1
Taiwan	-11.6	2.2	-1.6	-0.2	0.1

Note: Chg in output gap only includes quarters over which GDP declined.

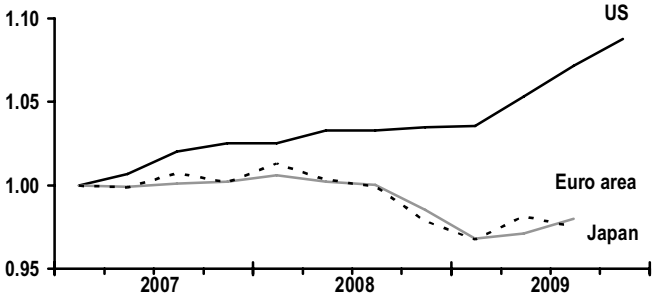
Chg in unemployment rate since 2007 relative to Okun's Law

%-pt "error" defined as actual outcome less fitted value



Labor productivity

Indexed 1Q07=1.0; output per hour



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Economic Research note

Global aggregates: market versus PPP weights

- **EM share of global GDP reached 30% in 2009, but is above 45% if PPP exchange rates are used**
- **PPP exchange rates better reflect overall well-being and are used by the IMF in creating global aggregates**
- **Market rates better reflect the thrust of global demand and are preferred for J.P. Morgan aggregates**
- **GDW will now report a PPP-based global GDP growth forecast alongside our usual aggregates**

The past decade has seen a reshuffling of the global landscape that was greatly intensified during the recent recession. Based on market exchange rates, the 26 major emerging market (EM) economies we track accounted for 30% of global GDP in 2009, a 10%-pt rise since 2000. Of this gain, half owes to China, which now accounts for over 9% of global GDP at current exchange rates. By contrast, the developed market economies lost an equal share, with the US seeing a decline of 6%-pts.

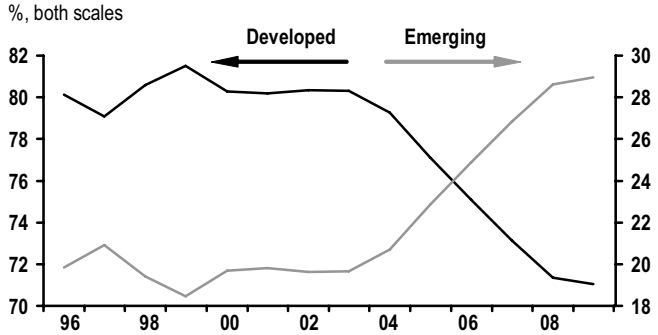
The rise in the EM share lifts the trend pace of global GDP growth, but, more importantly, it raises the region's importance as a driver of global growth. This is particularly true for China. Based on the combination of its expanded nominal share and robust gains in real output, China is projected to contribute as much to global growth in 2010 and 2011 as the US, the first such event during any expansion in history. The Euro area's contribution, by comparison, is expected to be a distant third to China and the US.

The contribution of the EM to global growth is considerably larger if nominal shares are computed using global GDP shares based on PPP exchange weights. In this case, the EM's share of global GDP jumps to 45%, with China's weight rising to 14% and its contribution to growth in 2010-11 almost doubling the US's. The result is that global GDP growth over the past decade is over 1%-pt higher using PPP exchange rates to aggregate.

PPP-based weights have attractive properties, including their relative stability and more accurate representation of overall well-being. However, one of the main advantages of PPP rates—that they reflect the value of both traded and nontraded goods and services—is also a disadvantage in that they are not relevant for tracking the global flows of goods, services, and financial assets. Global aggregates are

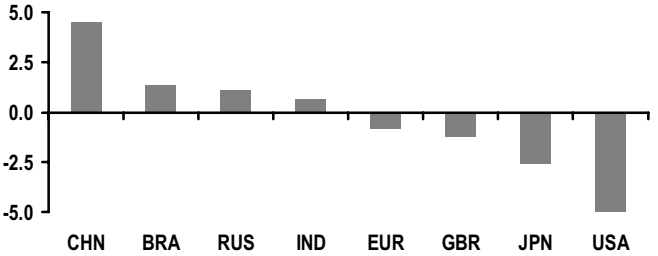
Share of global nominal GDP at current market exchange rates

%, both scales



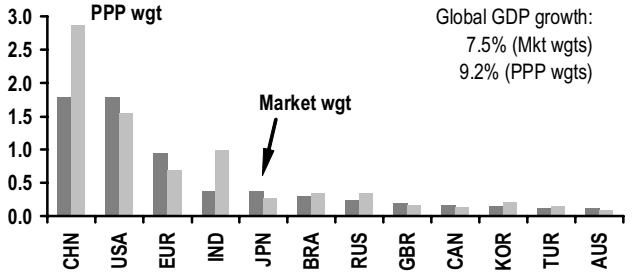
Change in global nominal GDP share, 2003 to 2009

%-point, shares based on market exchange rates



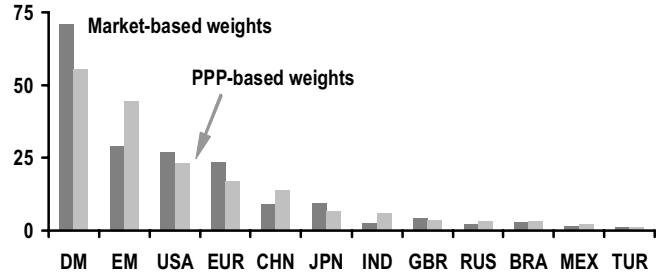
Contributions to global growth, 2010 and 2011

%-pt contribution; J.P. Morgan fcst



Global GDP share, 2009

% of global GDP



useful in that they reflect the thrust of aggregate demand emanating from, and supporting, economic activity in each country. While important for understanding well-being, the costs of nontraded goods and services have little bearing on this global thrust. Combined with the extreme difficulties

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and thus, potential errors, in measurement, we have long held that PPP exchange rates are less useful.

Beware PPP aggregate comparisons

The J.P. Morgan global GDP forecast is often compared to outside forecasts. However, in doing so, it is important to recognize that differences in aggregation methodology can lead to contrasting outcomes that are, in some cases, contrary to the underlying country growth forecasts. This is clearest in comparing the J.P. Morgan global GDP forecast to that of the IMF. Although the J.P. Morgan 2010 GDP forecast is stronger than the IMF forecast for both the developed and emerging market regions separately, the IMF's global growth forecast is stronger than J.P. Morgan's. The seeming contradiction owes to differences in weights.

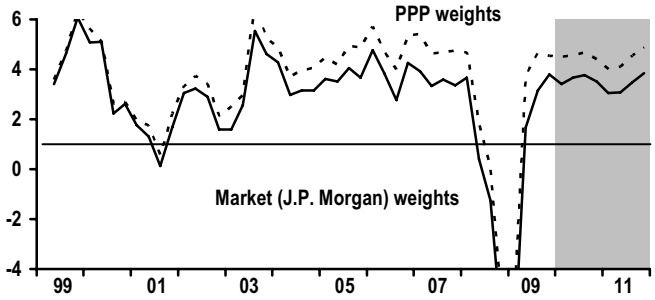
Aggregating economic concepts across countries is typically done by weighted averages where the weights reflect some type of relative importance. Most often, the weights are nominal GDP shares. For aggregate global GDP growth, summing across real growth rates for each country using nominal global shares is optimal. But even when comparing other aggregates, the nominal GDP share is a reasonably important weight, if not at times optimal.

The task is thus one of choosing the proper exchange rate to convert nominal GDP in local currencies to a common currency (usually USD). All J.P. Morgan economic aggregates are created using global GDP share weights based on market exchange rates (a five-year average, to be precise). The IMF uses PPP exchange rates. These exchange rates compare the prices of the same basket of goods and services in different currencies. The relative values then provide the appropriate exchange rate under the law of one price, i.e., all goods should cost the same.

The relative value of prices can differ considerably from market exchange rates because PPP prices cover both traded and nontraded goods and services. The wedge is largest for China and India, where nontraded products are considerably cheaper than the same products in the US (converted to renminbi at market exchange rates). To wit, the price of the same basket of US goods and services in China and India is roughly 50% to 75% more expensive when converted to local FX at market rates. It is important to note that because the relative price differences include nontraded goods, it is incorrect to interpret them as "fair-value" exchange rates. A fair-value exchange rate refers to the FX rate consistent with macroeconomic fundamentals in the market for traded goods, services, and financial assets.

Global real GDP

%q/q saar; J.P. Morgan fcst shaded



Real GDP, 2010

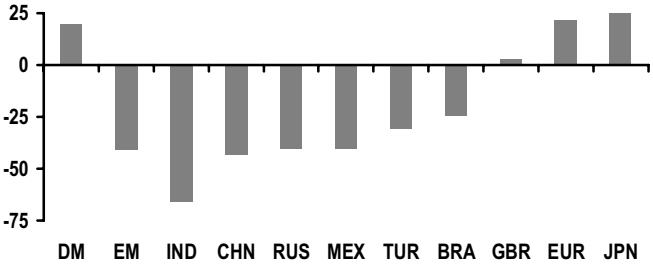
%oya; J.P. Morgan and IMF GDP forecasts

	J.P. Morgan / Market weights		PPP weights	
	JPM	IMF	JPM	IMF
Global	3.4	2.5	4.6	3.9
Developed	2.6	2.1	2.6	2.1
Emerging	6.2	5.1	7.0	6.0
EM Asia	7.9	7.8	8.3	8.4
Latin America	4.3	3.5	4.8	3.7
CEEMEA	4.3	3.0	4.3	3.0

Note. Shaded columns show values reported by respective organizations. Table shows forecasts under alternative weighting schemes. IMF projection based on January, 2010 WEO update.

Local price overvaluation relative to US prices (PPP), 2009

%, local price deviation from US prices converted to local currency



Because PPP exchange rates give a larger weight to nontraded goods and services, which are typically more labor intensive and so cheaper in the EM, it points to a stronger currency than the market exchange rate. In turn, it boosts the EM's share of global GDP from 30% to 45%. This is most pronounced in China and India, where the implied share of global GDP more roughly doubles in both cases when using PPP exchange rates.

These differences account for the seeming contradiction in the J.P. Morgan and IMF forecasts. If the IMF forecasts are aggregated using market exchange rate weights, global GDP growth in 2010 is roughly 1%-pt less than the J.P. Morgan forecast rather than 0.5%-pt stronger. For future reference, the *Global Data Watch* will report the PPP-based aggregate for global GDP growth in the "Global Economic outlook summary" on page 4.

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Economic Research note

The EU and Greece: a little bit of carrot and a lot of stick

- **EU keeps the pressure on Greece: this week brings not only more stick, but also more clarity on the stick**
- **No further details provided on the carrot**
- **March 16 key date for Greece to deliver**

Over the past week, EU leaders have made their views on the Greek situation fairly clear. On the one hand, the rest of the region requires Greece to make an appropriate fiscal adjustment, which will be measured by the achievement of a fiscal deficit of 8.7% of GDP this year and a fiscal deficit of below 3% of GDP by 2012. On the other hand, the fiscal capacity of the region as a whole will be used, if needed, to safeguard financial stability in the Euro area. EU leaders clearly feel that the monetary union is under some attack, and they will act accordingly to protect it. However, what does this expression of support mean for Greece itself? One way to think about this is to consider what the road map ahead might look like.

By March 16, Greece needs to present a report explaining how the budgetary measures for 2010 are being implemented. This report has to explain what additional measures will be taken in the event that the fiscal adjustment is not tracking the target, either due to slow implementation, weaker-than-expected growth, or higher-than-expected borrowing costs.

If Greece complies with all of the demands from the rest of the EU by implementing the fiscal measures that the rest of the region wants, and then experiences a genuine liquidity crisis in April and May, as it seeks to continue to finance its deficit and roll over the debt that is maturing, then the rest of the EU will provide financial support. The precise mechanism has not been laid out; it could be either areawide loans, credit lines, and guarantees, or bilateral loans, credit lines, and guarantees. We do not envisage any legal or logistical problems with the rest of the region providing ad hoc support.

If Greece fails to comply with all of the demands from the rest of the EU, and then experiences a genuine liquidity crisis in April and May, the most obvious next step for the region is to push Greece into the arms of the IMF. The IMF would then provide a program of financial support, with appropriate amounts of conditionality, to give Greece a couple of years to implement the appropriate fiscal adjustment. The alternative to this would be that the rest of the EU provides financial support for Greece with additional surveillance and possibly suspension of Greek voting rights in EU decision-making bodies, such as the Council of Ministers. In our view, this would be a suboptimal response—if we were to get to that point, it would suggest that pressure from the rest of the EU was insufficient to get Greece to do what was needed. The appetite in the rest of the region to provide financial help to Greece in the event that the Greeks were not behaving appropriately would be very limited. As this week's statement from the region's finance ministers made clear: Greece is threatening the stability of the monetary union.

Some relevant quotes

"Euro area Member states will take determined and coordinated action, if needed, to safeguard financial stability in the euro area as a whole."

Statement by Heads of State or Government of the European Union, February 11, 2010

"It's not money for nothing. It's money in the event Greece would have taken all the requested measures and financial markets are not reacting in the way we are expecting them to react."

Statement by Luxembourg Prime Minister Jean-Claude Juncker on the EU summit, February 11, 2010

The Council today "issued a recommendation to Greece to bring its economic policies into line with the Union's broad economic policy guidelines and remove the risk of jeopardizing the proper functioning of economic and monetary union."

Statement by ECOFIN, February 16, 2010

"A simplified treaty revision procedure would do away with the need to introduce a separate exit clause or a right of collective expulsion from the EU and, equally importantly, with the need to overcome crises similar to those triggered by the non-ratification of Treaty amendments or by the vetoing of EU accession requests."

ECB Legal Working Paper No. 10, "Withdrawal and expulsion from the EU and EMU: some reflections," December 2009

An IMF program would give the Greek government a decent window in which to make appropriate adjustments away from the pressure of financial markets. What would happen if, several years down the road, Greece is still running a huge fiscal deficit? The IMF always has the option of refusing to provide additional help, which then leaves the country to default. This provides an incentive to countries to take the appropriate measures, because default is very painful. But what is the ultimate sanction for a country within the Euro area? Euro area sovereigns are too large and interconnected to be allowed to default. At some point, the rest of the region might decide that Greece should be ejected from the Euro area. Participants in EMU have responsibilities to behave in a way that ensures the stability of the region as a whole. As this week's EU statement makes clear, Greece has passed a critical point in this respect. Presumably the forbearance of the rest of the region will not last forever. However, at the moment, there is no legal mechanism for a member state to be expelled from the EU or EMU.

In December 2009, the ECB published a legal working paper entitled "Withdrawal and expulsion from the EU and EMU: some reflections." This paper argues that the Lisbon Treaty makes provision for a voluntary secession of a member state from the EU, but it does not create a legal mechanism to expel a member state. The paper discusses the various sanctions in the treaty that are intended to encourage member states to comply with their treaty obligations. However, the ultimate question remains as to how the region would treat a member state that persistently refused to abide by the requirements of the treaty. Our view is that necessity would become the mother of invention.

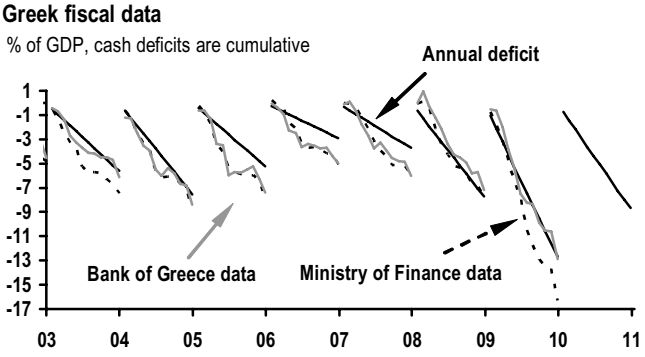
We doubt that we will ever get to such a situation, however. Policymakers are capable of taking difficult decisions if the alternative is considered worse. EU leaders are not comfortable with providing financial support to Greece, but the alternative of contagion to other sovereigns and financial institutions is considered worse. EU leaders would feel embarrassed by a full IMF program for Greece, but the alternative of an ineffective fiscal fudge could be considered worse. Similarly, EU leaders would never feel comfortable ejecting a country from EMU, but the alternative of allowing the proper functioning of EMU to be persistently jeopardized might be considered worse. What has been missing so far is a clear sense of what the alternative for Greece might be if the country persistently fails to abide by the rules governing the monetary union. Last week's statement from the EU heads of state hinted that broader IMF involvement might be acceptable as an additional sanction. This week's statement from EU finance ministers highlights that jeopardizing the proper functioning of EMU is not acceptable. The message to Greece couldn't be clearer. We believe that Greece will deliver the necessary fiscal adjustment; it will be painful, but it will not be intolerable. The alternative could ultimately be a lot worse. In the EU's approach of carrot and stick, the full nature of the stick is becoming clearer.

Tracking the Greek adjustment

One critical feature of the ECOFIN council statement this week was the requirement for the Greek government to submit a report by March 16 setting out the timetable for implementing the budget measures for 2010. The council statement goes on to say:

"To the extent that a number of risks associated with the specified deficit and debt ceilings materialise, Greece shall announce, in the report to be presented by 16 March 2010, additional measures to ensure that the 2010 budgetary target is met." (Council of the European Union press release, February 16)

This raises a critical question: how will we know whether the 2010 budget target—a deficit of 8.7% of GDP—is likely to be missed? In the coming months it will be important to assess whether the Greek public finances are tracking. We have three data sources to do this: monthly central government data on a cash basis from the Bank of Greece and the Ministry of Finance, with a reasonable history of data for both series; and a new series of monthly central government data on an accrual basis from the Ministry of Finance, but with no history. In many years, the two cash measures have a similar track record in giving an accurate impression of the annual general government data, which the government is targeting (see chart below). But, since 2003, the Bank of Greece data have done better overall. Thus far, we only have a January reading for the Ministry of Finance accrual data: this shows a surplus of €574 million in January this year, compared with a deficit of €1554 million in January 2009.



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Economic Research note

Weaker sterling and UK growth: the damp squib

- **Sterling's near 25% decline since mid-2007 has had only a small impact on trade performance to date**
- **MPC continues to expect a lagged impact on trade to emerge; we anticipate the impact will remain small**

As sterling fell sharply from mid-2007 onward, our analysis suggested the boost to UK GDP from the currency's decline would be modest and subject to long lags.[1] At first glance, the swing to a positive contribution from net trade to growth over the last couple of years challenges that view. But careful analysis of the data suggests that the swing owes more to the impact of the collapse in demand than to any impact from the exchange rate. With demand beginning to recover, the contribution to UK growth from net trade is already beginning to fade. Looking further forward, we continue to anticipate that, while demand trends will dominate swings in imports and exports, the impact of sterling weakness will be small. As the economy recovers, rebalancing toward a more manufacturing- and export-intensive economy will be a very slow process.

Although the MPC has acknowledged that the impact of sterling weakness has been limited to date, it continues to express optimism that the impact will be demonstrated over the next couple of years. Deputy Governor Bean, for example, has highlighted that it took some time after sterling's decline in 1992 to see any impact. But after looking back at other episodes of sterling weakness, the evidence of a clear and significant effect on net trade is more mixed. Moreover, there are several reasons any benefits from weaker sterling might be slow to come through in the years ahead. Though it is possible for net trade to make a longer-lasting contribution to growth, it is not safe to assume this based on sterling's decline so far.

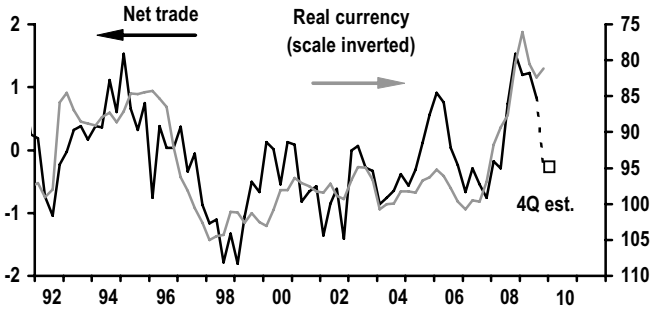
Sterling and net trade: the story so far

In the decade after sterling's sharp appreciation in 1997, net trade was a persistent drag on GDP growth. The sharp 25% drop in the currency from mid-2007 onward has held out the prospect of change, and at first glance the data have delivered: net trade contributed an average of 1.2%-pts to GDP growth in the six quarters to 2Q09. But although the currency has remained weak since, the net trade contribution appears to have turned into a drag in 3Q09. Looking at the data in more detail reveals the following:

1. See research note "UK exports and lower sterling: small lift, but right on time," *Global Data Watch*, May 29, 2009.

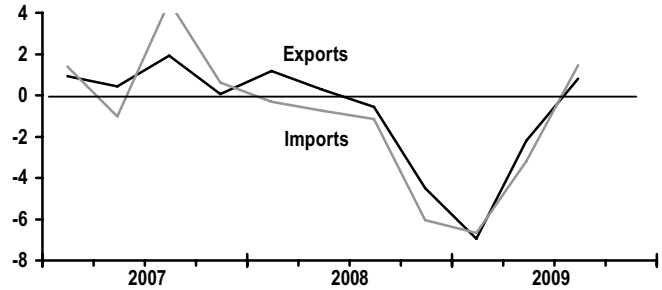
Net trade contribution to growth versus real trade weighted currency

%-pt contribution to %oya GDP — 2000=100, effective e.r.



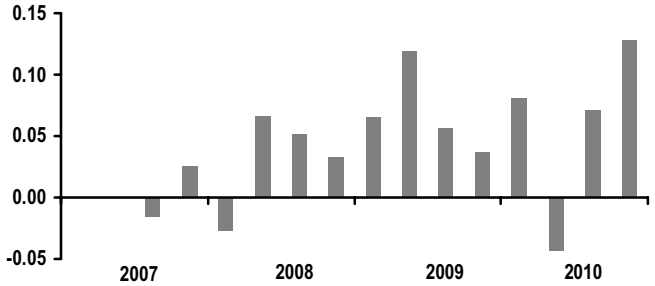
Exports and imports

%q/q, sa, actual data from national accounts, excludes MTIC fraud



Estimated impact of currency weakness on GDP

Net trade contribution to %q/q GDP, model estimate



Estimated trade elasticities

Long-run coefficients from ECMs

	1% rise in REER	1% rise in demand
Exports	-0.1 to -0.2	0.7
Imports	0.0 to 0.1	1.3

- **The effect of currency weakness so far has been modest.** After experimenting with various specifications, our models of trade volumes estimate that the long-run effects of currency swings on both exports and imports are relatively small. These effects also take a number of years to show up fully. On our estimates, the recent weakening in the currency added around 0.1%-0.3%-pt to annual GDP growth over the past two years. This is not large enough to explain the bulk of the swing in net trade over the past two years. Sterling export prices have increased rapidly since the currency weakened. This suggests firms have kept export prices stable in foreign currency terms, and have enjoyed a windfall from weaker sterling in margins.

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- **Demand swings have been the bigger driver of net trade.** A given fall in domestic demand has tended to have a larger effect on imports than a comparable move in foreign demand has on exports. This means that net trade tends to rise during downturns. If sterling had remained steady since 2007, our models suggest that net trade would still have made very significant contributions to growth during the recession. As domestic demand recovers this year, the net trade contribution is likely to fade, even assuming the currency remains weak.

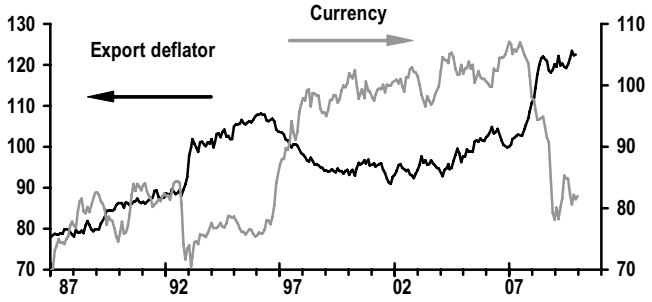
Mixed evidence of past currency effects

At the February Inflation Report, Charlie Bean noted the weaker currency was likely to generate a stronger contribution from net trade over time, even if the effects so far have been hard to identify. Bean used the early 1990s as an example, and indeed net trade did make a significant contribution to growth some years after sterling weakened back then. However, we would be more cautious about using this example to raise hopes about the future. The trade contribution to growth that began in 1993 lasted only two years, and turned flat in 1996 even with the currency still weak. Moreover, other instances of past currency weakness show more mixed evidence of a clear effect on growth. Following the early 1980s depreciation, net trade acted mostly as a drag. In the early 1970s, net trade added to growth after the currency fell. But this performance was no better than estimated by our model, which suggests the rise in net trade was mostly about demand rather than currency movements.

The Inflation Report in February also reflected Bean's argument. It noted that the higher profits UK exporters have enjoyed as a result of the weaker currency may lead to a greater net trade boost over time, as firms are encouraged to enter the market. But in reality this process may take a very long time to take effect. Certain key markets in which UK exporters currently specialize involve large amounts of technology, research, and development and as a result may have high barriers to entry. To the extent these sectors have low price elasticities, this may explain why UK exporters are able to use currency depreciations to raise profits. Moreover, it remains uncertain how long the currency will remain weak. Firms may need to see a lengthy period of weak sterling before deciding to enter new markets. In terms of imports, evidence of meaningful currency effects is even harder to find. This all suggests that stronger and persistent net trade contributions of the kind necessary to address the UK's demand imbalances cannot automatically be assumed simply because sterling has weakened. Next week's expenditure details for 4Q GDP will highlight this point; we expect a second successive quarterly drag on GDP from net trade.

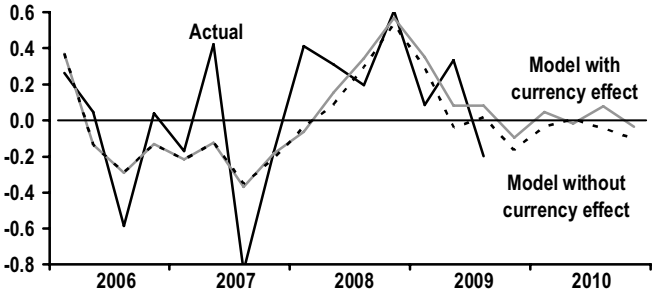
Goods export prices versus nominal effective exchange rate

2005=100, export prices in sterling terms



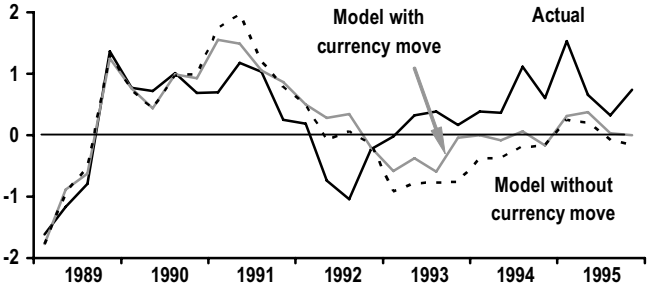
Net trade contribution to GDP

%-pts on q/q rate



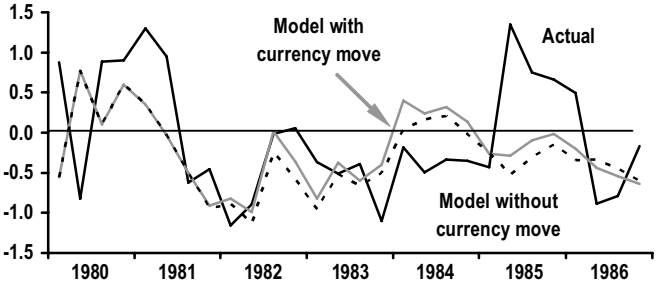
Net trade contributions to GDP

%-pts on oya, model without currency move assumes sterling stable from 1991



Net trade contributions to GDP

%-pts on oya, model without currency move assumes sterling stable from 1981



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Economic Research note

RBNZ probably will hold to hinted midyear tightening

- **RBNZ Governor Bollard wants assurance that the economy is out of most fragile recovery phase**
- **We now expect the first OCR hike in July, but anticipate a 50bp increase**
- **Prudential regulation and fiscal tightening will do some of the heavy lifting for RBNZ**

In a change of forecast, we now expect that the RBNZ will kick off the next tightening cycle in July with a 50bp hike. Previously, we had expected a 25bp move in April, arguing that the deteriorating medium-term inflation outlook would prompt the RBNZ to tighten policy before official guidance suggested. The RBNZ said in December that, providing the economy continues to recover in line with the Bank's forecasts, "conditions may support beginning to remove monetary stimulus around the middle of 2010."

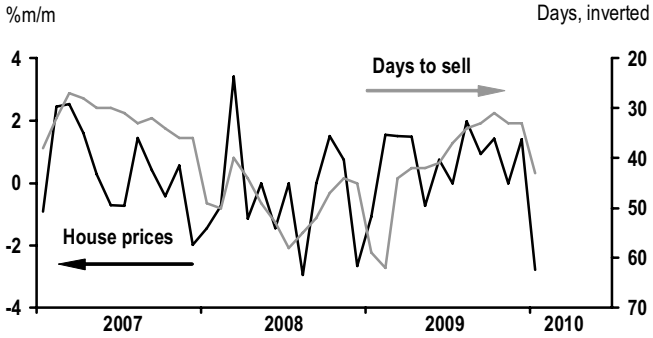
Given the persistent stream of weak data, however, and Bollard's desire for hard economy evidence that the recovery is sustainable, on top of the soon-to-be-effective bank liquidity changes and the Budget in May, the RBNZ likely will remain sidelined until July. By delaying the first rate hike, however, the RBNZ probably will have to move more aggressively; in addition to the July hike we look for another 50bp increase in September, after which the pace of tightening will slow.

Housing market losing steam

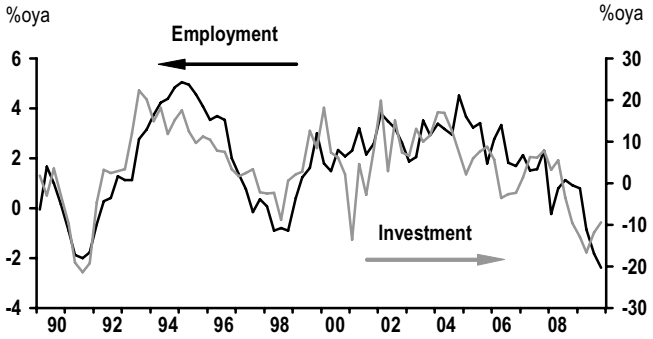
Recent data on the housing market, employment, and retail sales have painted an unexpectedly gloomy picture of the domestic economy. The moderation in housing activity, in particular, should ease the RBNZ's concerns about the potential reemergence of debt-fueled housing excesses. The pickup in house prices toward the end of 2009 was remarkably strong, but gains since have tapered off, with the REINZ reporting last week that house prices fell 3%m/m in January, while house sales slumped to an 18-year low.

With the government considering the removal of some tax breaks for property investors, uncertainty surrounding the potential changes will likely mean that near-term activity in the housing market will remain subdued. The RBNZ has been calling for the government to remove tax incentives for home ownership in order to ease the burden on monetary policy. Bollard has said that the buoyancy in the property

Housing market losing some steam



Weak business investment will weigh on employment



market is "exacerbated by a tax system which favored investment in housing." Indeed, Prime Minister John Key has acknowledged that the current tax system overly rewards those investing in residential property.

Key signaled in his opening parliamentary address last week that the government is considering changes to the way property is taxed, alongside an increase in the rate of GST from 12.5% to "no more than" 15%. He also is contemplating reductions in personal taxes and increased benefits to compensate for higher prices. The details of these changes will be revealed in the 2010 Budget on May 20.

Domestic economy losing momentum

Consumer spending has hit a wall. Retail sales values were flat in December, despite being propped up by lower market interest rates and solid net migration inflows, which recently hit a five-year high. The improvement in consumer spending we expect throughout 2010 will be modest, owing mainly to the slow recovery we forecast in the labor market. One reason for this is that lending to businesses remains soft. This weakness is, in part, due to the tendency of more firms to raise capital via means other than bank lending. That said, bank lending to businesses is still weaker than this time last year, so business investment will probably remain subdued; this will weigh on employment.

Indeed, though the jobless rate probably has peaked, the details of the latest labor market survey were exceptionally weak. The unemployment rate jumped from 6.5% to 7.3%, the highest rate in over a decade, reflecting a rise in the number of unemployed that exceeded the increase in the total labor force; this could mean that some of those entering or reentering the workforce were immediately declaring themselves unemployed. The RBNZ was looking for an unemployment rate of "just" 6.6%.

Liquidity policy to do some heavy lifting

New bank liquidity rules will do some of the heavy lifting for the RBNZ. New prudential regulations are being imposed on the large New Zealand-based Australian bank subsidiaries and on locally owned banks, which have until April 1 to meet the new requirements. The new rules will ensure that commercial banks hold sufficient retail and longer-dated wholesale funding (essentially lengthening the term of their total funding) so that, in the event of an economic downturn, lenders will have less need to access wholesale funding markets. Lenders will have to maintain a core funding ratio—the retail deposit base and longer-term wholesale funding as a percentage of assets—of 75%, up from 65% previously.

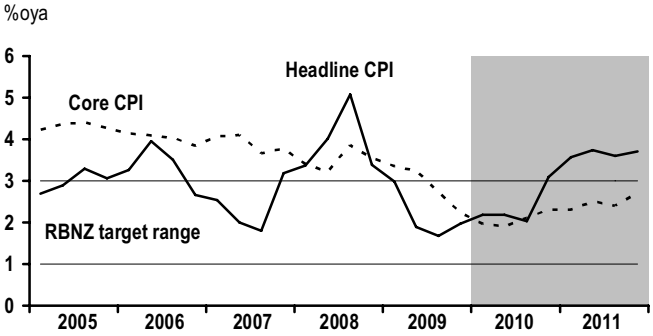
These changes should make banks more careful when lending, given that the new practices mean funding will be more expensive than when banks accessed funds in short-term wholesale markets offshore. This will limit banks' ability to fuel credit growth using cheaper short-term wholesale funding, lessening the likelihood that credit growth will return to rampant levels. Indeed, under the new policy, the RBNZ believes that, after the two year transitional period, lending rates may be "somewhat" higher (in the order of 10-20bp) if the current high premium on term rates persists. The impact on lending rates will, however, depend on how each bank sources its funding.

50bp hikes will kick off tightening cycle

The soon-to-be-revealed fiscal measures, the string of disappointing data, and the new prudential regulations should allow the RBNZ additional time to sit on the policy sidelines. Furthermore, Governor Bollard, in the face of rising global jitters, appears increasingly reluctant to threaten the economic recovery by tightening policy too soon.

When asked about GDP expectations earlier this month, the Governor said that reasonable growth should be achieved in coming quarters, and these numbers will signal whether or not the "economy is getting out of a fragile growth phase into a more assured one." We agree that the

Medium term inflation outlook a concern



RBNZ tightening cycle to kick off in July

forthcoming GDP numbers should show improvement, with our preliminary forecasts looking for growth of 0.9%q/q in 4Q09 and 0.7% in 1Q10. The first-quarter GDP print, however, is not due for release until June 26, so it looks like, on the basis of Bollard's comments, the first rate hike will be delayed until after then.

Waiting for hard evidence of sustainable growth, however, will likely be a mistake. Delaying the first rate hike probably means the RBNZ will be forced to play catchup in 2H10. Bollard himself this month indicated that the OCR didn't come down in 25bp hops, so when he is confident the recovery is sustainable, there could be some "meaty chunks" on the upside.

We maintain our forecast that the OCR will rise to 4% by year-end and increase steadily throughout 2011. The medium-term inflation outlook will become a growing concern. Domestic prices are rising, excess capacity is diminishing, and on our forecasts, headline inflation will be back at the top end of the RBNZ's target range within the foreseeable future. Furthermore, nontradable inflation, although currently within the RBNZ's comfort zone, should creep higher as the recovery gathers momentum. The RBNZ seems to be looking through this, however, waiting for more concrete signs on the real economy. Doing so, though, risks the inflation problem becoming worse.

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Economic Research note

Korea's jobless rate to drop, but labor force on decline

- **Unemployment rate spiked in January but mainly for temporary reasons**
- **Private sector employment shows signs of recovery, but labor-force participation not yet**
- **Labor-force participation rate trending down due to demographic factors**

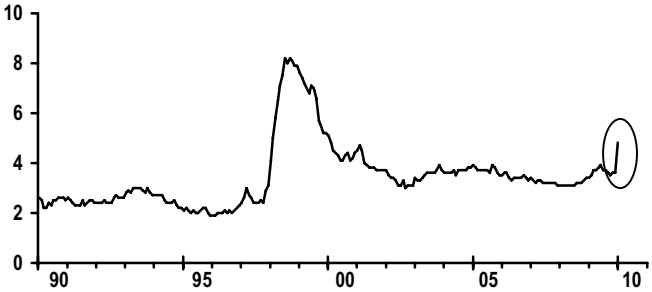
In January, Korea's jobless rate rose sharply to an almost 10-year high of 4.8%. However, the increase was mainly due to temporary factors that should fade in the next few months. Primarily, the jobless spike came more from a sudden increase in the labor force than a decline in employment, with the government hiring program having attracted a large number of applications but still not providing jobs as yet in January.

Excluding the public service sector, which was heavily affected by government hiring programs, employment has stabilized throughout 2H09 and rose recently, suggesting that private sector jobs have begun to recover.

However, after adjustment for policy-driven volatility since mid-2009, labor-force participation shows few signs of improvement and has remained in its five-year-long downward trend since 2005. Of course, some of the fall during 2008-09 was likely cyclical: those voluntarily leaving the job-seeking pool have played a key role in limiting rises in the jobless rate in economic downturns since the 1990s (second chart). Yet, the fact that labor participation was declining long before the global financial crisis hit suggests that much of the decline in labor participation is structural, and thus any meaningful rebound may be unlikely. This, in turn, could constrain the implication of a fall in the jobless rate for the domestic demand outlook.

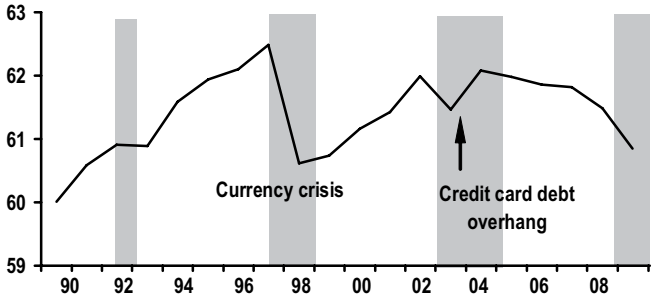
Unemployment rate

% of labor force, sa



Labor participation rate

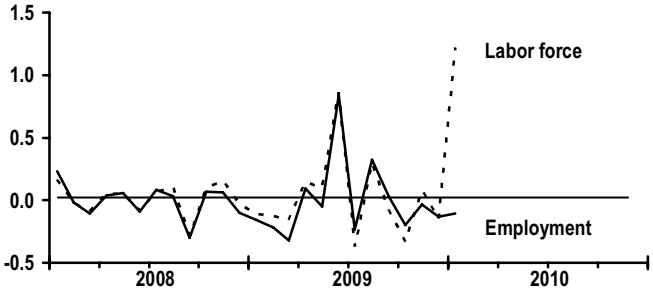
% of labor force, annual average



Shaded area denotes the period when real GDP growth is below the Bank of Korea's estimate of Korea's potential growth.

Labor force and employment

%m/m, sa



Labor market report for January distorted by temporary factors

The government had planned to launch the second round of its hiring program in March, after ending the first one in December. However, it began to receive applications for the second program as early as January; reportedly about 422,000 applications arrived by the end of the month. This affected key labor statistics in January—the National Statistical Office considered most of those submitting applications to be job seekers and, since they had not yet been employed, categorized them as unemployed and reported that the jobless rate rose sharply in January.

A similar labor force spike was seen in mid-2009 when the first round of the hiring program was implemented, but it was not accompanied by a jobless gain. At that time, the labor force and employment moved up almost simultaneously, as the program was too new to attract any meaningful interest from the general public until actual hiring started in June.

Private sector employment on the rise ...

In the past two months, the government eliminated more than 300,000 jobs when it terminated the temporary hiring

program that had been in operation since June. But when these job losses are excluded, total employment has risen for two straight months, after stabilizing in 2H09 (first chart). This is encouraging, as unfavorable weather conditions likely increased seasonal job cuts in agriculture and construction. The rise in manufacturing employment was the most notable: it has risen for six straight months, with the gain accelerating in January on a seasonally adjusted trend basis.

... while structural downturn in labor-force participation continues

However, labor participation shows few signs of recovery, after adjusting for the recent government-generated volatility. Some of this appears to be cyclical: some job seekers voluntarily leave the labor force in economic downturns. Still, we note that the labor-force participation rate was trending down even in the 2005-2007 period when the economy experienced above-potential growth (second chart, front page). Indeed, we suspect much of this downward trend since 2005 is structural, related to an aging population.

- In 2009, 10.7% of the population was above 65 years old, up from 5.1% in 1990. Importantly, the 30-49 age group's weight appears to have peaked at 43.9% in 2005, falling to 41.4% in 2009 (second chart). Since Korea's baby boom occurred in 1955-1963, the population will continue to age. This in turn will work as a drag on overall labor-force participation, as the participation rate has traditionally been the highest for the 30-49 age group.

- Partially offsetting this has been increased labor-force participation in the above-50 age group (third chart). Anecdotal evidence suggests that the group's job-seeking intentions are higher than indicated by the official data. Note that the above-50 age group comprised more than 80% of applicants for the hiring program in January, suggesting that many of them were previously discouraged workers.

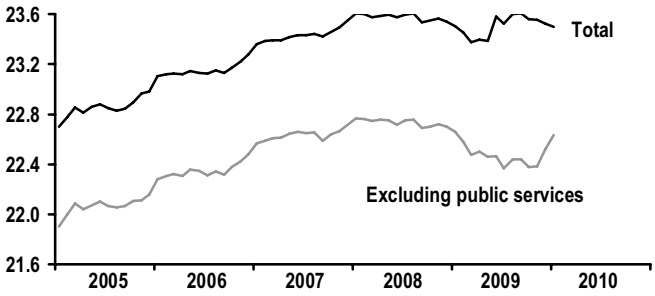
- In contrast, the labor-force participation rate has been trending down in the 20-29 age group, mostly for males. In the absence of further details, the younger age group's desire for regular jobs, amid a relatively small social safety net, is not well matched with the corporate sector's rising preference for flexible, contract-based workers.

Implications for job market outlook

We expect that the jobless rate will retreat to below 4% within two months. Yet, much of the fall should be seen in the context of labor-force adjustment. Indeed, in the very

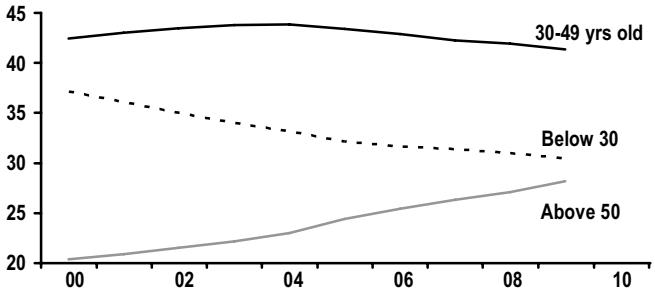
Employment

Mn sa



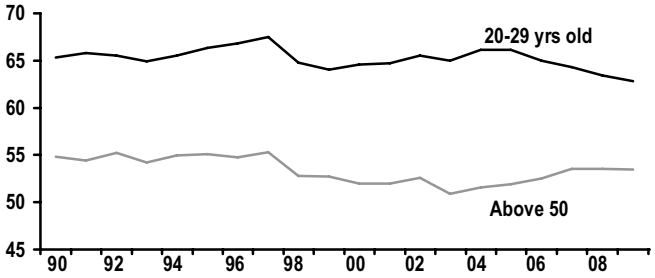
Population by age group

% of total



Labor-force participation rate

%



near term, any turn in the jobless rate will mostly come from the labor-force decline; the government plans to provide only 100,000 jobs in the second-round hiring program, potentially keeping the other applicants as jobless. In our view, however, many of them will probably become discouraged and thus leave the labor force, as they had previously. In the medium term, the structural downtrend in labor-force participation will work to cap the headline jobless rate. Of course, rising private sector employment would contribute to this as well but still be partially offset by the eventual termination of the public sector hiring program. Inasmuch as the prospective fall in the headline jobless rate would be generated in part by a decline in the labor force, this could limit its favorable impact on domestic demand

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United States

- **January core CPI down 0.1%; 6-month run rate for core inflation has dropped below 1.0%**
- **January factory output surges 1.0%; early February regional surveys point to continued solid IP growth**
- **Discount rate hike is technical; forecast still looks for first increase in the fed funds target rate in 2Q11**

The 0.1% decline in the core CPI for January provides continued support for the forecast that the core CPI will slow from 1.7% in 2009 (4Q/4Q) to substantially below 1.0% this year. The 6-month run rate on the core CPI has already dropped to 0.8% saar. And the disinflationary forces resulting from excess slack in labor markets, real estate, and industrial capacity are now being reinforced by a shift in the direction of the trade-weighted dollar from weakening during most of 2009 to appreciation since early December.

The core PCE price index is also expected to decline 0.1% in January, and this reading would take the Fed's preferred measure of inflation to 1.2%oya and 0.8% saar over the past six months. The core PCE price index had increased an average 0.2% per month in February through April of last year. So it seems very likely that the core PCE price measure of core inflation will drop below 1.0%oya by April.

This week's increase in the discount rate is one of a series of changes aimed at normalizing Fed lending facilities. As the Fed statement indicates, the changes are "not expected to lead to tighter financial conditions for households and businesses and do not signal any change in the outlook for the economy or for monetary policy." The J.P. Morgan forecast still looks for the fed funds rate target to remain at its current low level until 2Q11, given the likely backdrop of low core inflation and high unemployment.

The latest round of growth data is mixed and broadly consistent with the forecast of 3.0% real GDP growth this quarter. Manufacturing IP rose 1.0% in January and the early February regional surveys point to continued strong output growth this month. But the trend in housing starts looks no better than flat, despite the reported 2.8% monthly gain in January. And the four-week average of initial jobless claims, which had been steadily declining through early January, edged higher over the past five weeks.

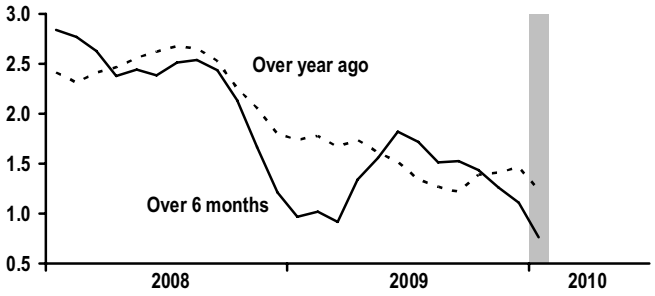
Run rate on core inflation below 1%

Higher energy prices in January lifted the CPI to a 0.2% increase. But the big news in the report is the 0.1% decline in the core CPI. The core CPI measure of inflation is running 1.6%oya but only 0.8% saar over the past six months. Details of the January CPI show continued tame pricing for owners' equivalent rent (-0.1%) and rent of tenants (0.0%) and declines in some of the more volatile components of the core CPI including lodging away from home (-2.1%), airline fares (-2.5%), and new motor vehicles (-0.5%).

Higher energy prices also boosted upstream prices, the PPI and import prices, in January. And even the core PPI (up 0.3%) and nonfuel import prices (0.4%) posted relatively large increases (with increases in nonfuel import prices concentrated in materials rather than finished goods). But commodity prices have generally leveled out since early December and the trade-weighted dollar has strengthened. If sustained, these trends should dampen upstream price pressures over the next few months.

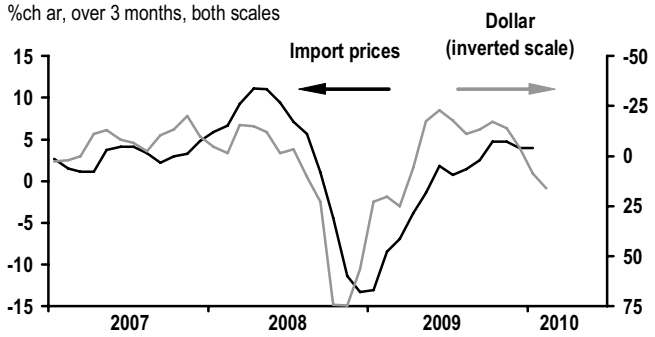
Core PCE price index, with January forecast

%ch saar



Nonfuel import prices and real trade-weighted dollar

%ch ar, over 3 months, both scales



Average of New York Fed and Philly Fed manufacturing surveys

Sa

	3Q09	4Q09	Jan	Feb
Derived composite	46.2	50.7	53.0	53.7
General conditions	4.6	18.9	15.6	21.3
New orders	5.2	13.1	11.8	15.7
Shipments	2.8	15.0	16.0	17.4

Factory IP up 1.0% in January

Results of the ISM manufacturing survey show the factory sector turning decidedly stronger in January, and this result is confirmed by the Fed's IP report. Total industrial production rose 0.9% in January, manufacturing production rose 1.0%, and nonauto output rose 0.8%. This leaves the January level of manufacturing production 7.8% at an annual rate above the 4Q09 average, well above the 5.0% growth rate that had been penciled into the forecast.

Increases in factory output are often concentrated in motor vehicles and parts and in high-tech equipment. And these industries have been growing considerably faster than most others recently. Output of motor vehicles and parts surged 4.9% in January and production of high-tech equipment rose 1.9%. But manufacturing IP outside these industries has also been strong, up 0.7% in January and 7.4% saar over the past three months. This growth is much more rapid than in the early stages of the two prior expansions.

Let it snow, let it snow, let it snow

The February manufacturing surveys provide guidance to how manufacturing is holding up this month. The two early regional surveys released this past week, from the New York Fed and the Philadelphia Fed, cover activity in parts of the Northeast that were hammered by severe snowstorms earlier this month. In past years, severe snowstorms in the Northeast had significantly depressed readings for these surveys, but this February surveys held up well, and even improved substantially in the Philadelphia Fed region, where the storms had been most disruptive.

Indeed, the derived composite from the Philly Fed survey (calculated from components using ISM survey weights) rose 2.6pts to 55.1, its highest level since March 2006. New orders rose 19.5pts to 22.7 and shipments rose 8.7pts to 19.7; both were by far the strongest readings of the expansion to date. The headline reading of the New York Fed survey (assessment of general economic conditions) also increased and, at 17.6, was actually stronger than the Philly Fed survey. But respondents in the New York region indicated that their firms' growth of both new orders (8.8) and shipments (15.6) had slowed in February. Upcoming regional manufacturing surveys from the Dallas, Richmond, and Kansas City Fed regions and the Chicago PMI will go a long way toward conditioning views on the February ISM manufacturing survey.

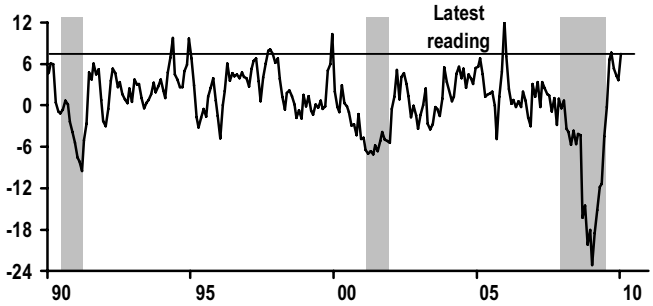
Housing flat at low levels

On the surface, January housing starts were also encouraging for growth. Total starts rose 2.8% and were 5.7% (not annualized) above the 4Q09 level. But the trend in starts would more accurately be characterized as flat at low levels. Single-family housing starts did increase 1.5% in January, but this followed a 3.0% decline the month before. Single-family starts have been fluctuating in a narrow range since last June. The recent increase in starts has been in the more volatile multifamily component, which has bounced from an extraordinarily low reading in October (which was the lowest reading for multifamily starts in the history of the series dating back to 1959). Multifamily starts are off their extreme lows, but there is little reason to think that the trend is up. Rental vacancy rates are very high, and the trend in multifamily permits, including the large decline in January, is no better than flat.

The level of single-family starts built for sale has gone from 30% below the level of sales in 1H09 to only about 5% below sales in January. This means that an upswing in starts this year is likely to require significantly stronger new home sales. The Homebuilder survey for February posted 2pt gains in both the overall index and in the component measuring current sales. But the index is still at very low levels and the latest reading is hardly a convincing sign of recovery. Upcoming reports on January new home sales (Wednesday) and existing home sales (Friday) will provide more information on housing demand.

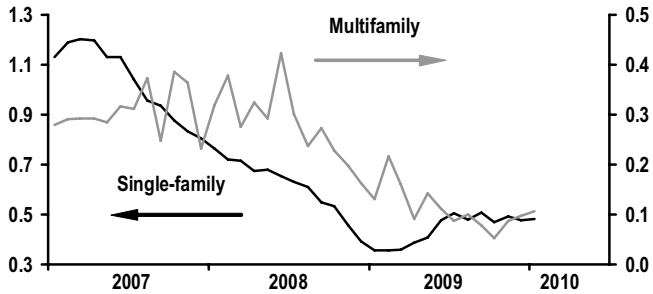
Manufacturing IP ex motor vehicles and high tech

%ch saar, over 3 months



Housing starts

Mn units, saar, both scales



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Data releases and forecasts

Week of February 22 - 26

Tue Feb 23 9:00am

S&P/Case-Shiller home price index
%oya, unless noted

	Sep	Oct	Nov	Dec
20-city composite	-9.2	-7.3	-5.3	-3.1
%m/m sa	0.1	0.3	0.2	0.3
10-city composite	-8.3	-6.4	-4.5	
	1Q09	**2Q09**	**3Q09**	**4Q09**
National composite	-19.0	-14.7	-8.9	-1.2

Thu Feb 25 10:00am

FHFA home price indexes
Purchase only

	Sep	Oct	Nov	Dec
%oya	-3.2	-2.1	0.5	0.5
%m/m sa	-0.3	0.4	0.7	0.4
	1Q09	**2Q09**	**3Q09**	**4Q09**
All transactions (%q/q)	0.7	-2.4	-2.4	0.0
%oya	-3.4	-4.0	-4.1	-4.1
Purchase only (%q/q sa)	-0.5	-0.6	0.2	0.6
%oya	-7.1	-6.0	-3.7	-0.3

Home prices as measured by the Case-Shiller and FHFA indices continued to increase in late 2009. We expect that these indices delivered further small gains in December: we forecast a 0.3%m/m increase in the Case-Shiller 20-city composite and a 0.4% gain in the FHFA purchase-only index. This would leave prices down 3.1%oya (Case-Shiller) and up 0.5%oya (FHFA).

Two other price home price measures have already been reported for December. The LoanPerformance index fell 1.0%m/m not seasonally adjusted, but we estimate that it rose 0.1%m/m on a seasonally adjusted basis. The Radar Logic 25-city price index rose 0.2%m/m not seasonally adjusted, the first increase during this period since 2004.

The Case-Shiller and FHFA reports will also include quarterly price indices for 4Q. The Case-Shiller report contains a national index, and the FHFA report contains an index based on both purchase and refi mortgages. Neither of these measures gets much attention, as they tend to be similar to the more timely monthly data.

Tue Feb 23 10:00am

Consumer confidence
Sa

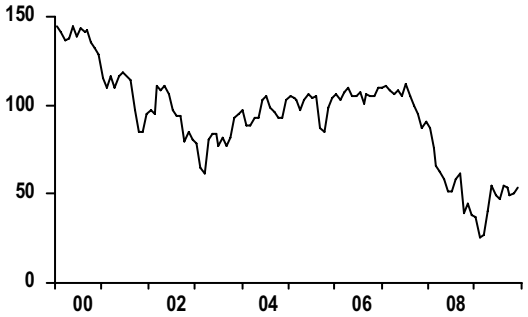
	Nov	Dec	Jan	Feb
Conference Bd index	50.6	53.6	55.9	54.5
Present situation	21.2	20.2	25.0	
Jobs plentiful	3.1	3.1	4.3	
Jobs hard to get	49.2	48.1	47.4	
Plentiful less hard to get	-46.1	-45.0	-43.1	
Expectations	70.3	75.9	76.5	

We expect that the Conference Board consumer confidence index will fall to 54.5 in February from 55.9 in January. Our forecast for a small decline in consumer confidence is related to the drop in equity prices between mid-January and early February. We have already seen the Michigan consumer sentiment index fall to 73.7 from 74.4, and the weekly ABC/WP index remains at a low level.

Probably the most important piece of information in this report will be the labor market differential, which is inversely related to the unemployment rate. The labor market differential is the share of respondents who say jobs are plentiful less the share who say jobs are hard to get. If the differential improves, as it has done in each of the last two months, then it could signal a further drop in the unemployment rate, or at least stability after a large 0.3%-pt fall in January.

Conference Board consumer confidence

Index, sa



Wed Feb 24 10:00am

New home sales

	Oct	Nov	Dec	Jan
Total (000s, saar)	408	370	342	345
%m/m	4.3	-9.3	-7.6	0.9
%oya nsa	3.1	-3.7	-11.5	4.9
Months' supply	7.1	7.6	8.1	
Median price (%oya)	0.2	-5.1	-3.6	

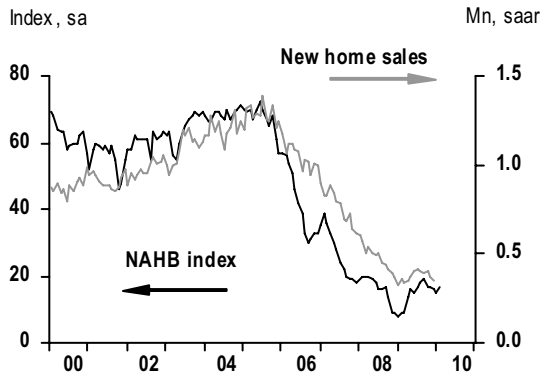
We expect that new home sales edged up to an annualized pace of 345,000 in January from 342,000 in December, an increase of 0.9%. This gain is extremely minor and does little to reverse the 16.2% fall in sales between October and December. The anticipated end of the new homebuyer tax credit probably pulled sales into earlier months and then caused a fall in sales in November and December. The tax credit has been extended and expanded, but there is no definitive evidence yet that sales are rebounding. Mortgage purchase applications rose 0.5%m/m during the month, but the homebuilders' index fell to 15 from 16 (it recovered to 17 in February, which could be a sign that sales were picking up in late January).

The recent weakness in home sales has caused the months' supply of new homes to rise to 8.1 in Decem-

ber from 7.1 in October. The actual level of inventories has continued to decline over this period. The months' supply is now back to its highest level since June, and it is well above the 5-6 level that we think indicates that inventories are reasonably well aligned with sales.

Although the months' supply of homes has risen, there is still evidence that the rate of decline in median new home sale prices is moderating. The median price fell 2.9%oya in 4Q09, the smallest drop since 2Q08.

NAHB index and new home sales



Thu
Feb 25
8:30am

Jobless claims
Thousands, sa

	New claims (wr.)		Continuing claims		Insured
	Wkly	4-wk avg	Wkly	4-wk avg	Jobless,%
Dec 12[1]	480	468	5038	5223	3.8
Dec 19	454	466	4979	5101	3.8
Dec 26	432	460	4807	5007	3.6
Jan 2	433	450	4609	4858	3.5
Jan 9	444	441	4659	4764	3.6
Jan 16[1]	479	447	4600	4669	3.5
Jan 23	472	457	4617	4621	3.5
Jan 30	483	470	4563	4610	3.5
Feb 6	442	469	4563	4586	3.5
Feb 13[1]	473	468			
Feb 20	465	466			

1. Payroll survey week.

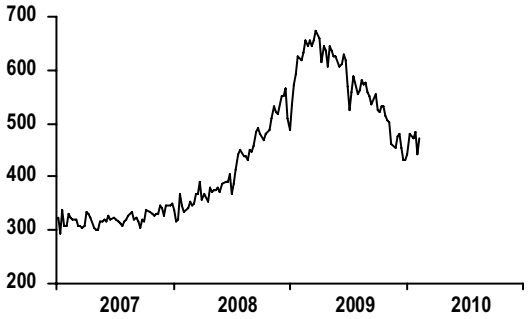
We expect that initial jobless claims pulled back to 465,000 in the week ending February 20 from 473,000 in the prior week. Claims have recently started to move sideways at a still-elevated level, a worrisome development from the standpoint of gauging labor-market conditions.

This report will include the Presidents' Day holiday, which has historically led to an increase in jobless claims. We are not predicting an increase because the rise in the prior week was large (31,000), and large swings in one direction are more often than not followed by a reversal in the next week.

Last week included major snowstorms, especially in the Northeast part of the country. Using the Northeast Snowfall Impact Scale from the NAOO, we have identified major snowstorms and found no systematic bias in claims in the week following a snowstorm.

Initial jobless claims

000s, sa



Thu
Feb 25
8:30am

Durable goods
%m/m sa

	Oct	Nov	Dec	Jan
New orders	-0.1	-0.4	1.0	-0.5
Ex transportation	-0.5	2.0	1.4	-1.8
Nondef cap. gds ex air	-1.8	3.2	2.2	-1.5
Shipments	0.2	0.8	2.8	-0.2
Nondef cap. gds ex air	0.5	1.6	2.1	-1.0
Inventories	-0.3	-0.2	-0.2	

We expect a weak durable goods report in January, with new orders falling 0.5% and shipments down 1.0%. This would contrast with other manufacturing indicators, such as manufacturing production in the IP report (1.0%) and the ISM index (58.4). The main basis for our low forecast is that the durable goods report is often weak in January, even after the data are seasonally adjusted.

The seasonal weakness in January durable goods can be seen by comparing the average percent change in January to the average of the percent changes in the two months on either side of January. From 1993 to 2009, new orders were on average 2.5% below trend, and core capital goods orders (nondefense ex aircraft) were 4.5% below trend. Shipments were 1.5% below trend and core capital goods shipments were 3.6% below trend. In next week's report this weakness should be reflected in drops in core capital goods orders and shipments after solid gains in each of the prior two months. We expect a sizable 1.8% fall in ex transportation orders, but only a 0.5% fall in total orders. Aircraft orders fell sharply in each of the last two months, but industry data suggest that aircraft orders posted a small rise in January.

The durable goods report will contain the first hard data on 1Q inventories outside of the vehicle sector, where industry data show a rise in inventories in January. Inventory changes are of interest after destocking was sharply curtailed in 4Q. The key question for the overall economy is whether inventories will flatten out or will start to rebound. For the durable goods manufactur-

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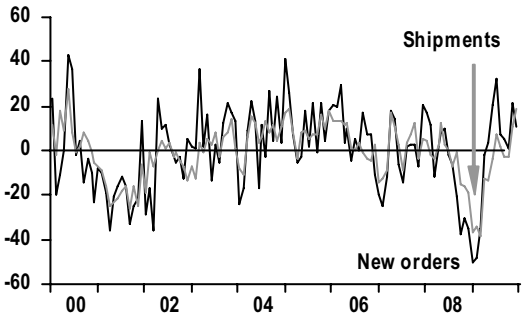
ing sector, we may continue to see inventory cuts for a while because the inventory to shipments ratio is still high in this sector.

Core capital goods orders and shipments

%ch over 3 months, saar



Fri Feb 26 8:30am

Gross domestic product
%ch q/q saar, unless noted

	2Q09	3Q09	Adv 4Q09	Second 4Q09
Real GDP	-0.7	2.2	5.7	6.0
Final sales	0.7	1.5	2.2	2.0
Domestic final sales	-0.9	2.3	1.7	1.7
Consumption	-0.9	2.8	2.0	2.1
Equip. and software	-4.9	1.5	13.3	14.0
Nonres. structures	-17.3	-18.4	-15.4	-13.5
Residential investment	-23.2	18.9	5.7	5.3
Government	6.7	2.7	-0.2	-0.2
Net exports (%-pt contr.)	1.6	-0.8	0.5	0.3
Inventories (%-pt contr.)	-1.4	0.7	3.4	4.0
Core PCE price index	2.0	1.2	1.4	
%oya	1.6	1.3	1.4	
GDP chain price index	0.0	0.4	0.6	
%oya	1.5	0.6	0.7	
Adj. corporate profits	3.7	10.8		
%oya	-12.6	-6.6		

Real GDP growth in 4Q09 was probably revised up to 6.0%q/q saar in the second report from 5.7% in the advance report. The most significant factor behind the upward revision will likely be the contribution from inventories, which we expect to be revised up from an already high 3.4%-pt to 4.0%-pt. That would imply that the annualized change in real business inventories will be revised from -US$33.5 billion to -US$15.0 billion. This is a dramatic swing from 3Q, when inventories declined at a US$139.2 billion pace.

Outside of the inventory revision we do not see any other major changes to GDP. We expect small downward revisions to net trade and residential investment, and small upward revisions to consumption and business fixed investment.

Fri Feb 26 9:55am

Consumer sentiment

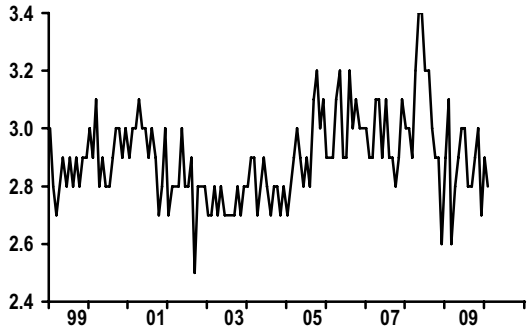
	Dec	Jan	Pre Feb	Fin Feb
Univ. of Mich. Index (nsa)	72.5	74.4	73.7	74.0
Current conditions	78.0	81.1	84.1	
Expectations	68.9	70.1	66.9	
Inflation expectations				
Short term	2.5	2.8	2.7	
Long term	2.7	2.9	2.8	
Home buying conditions	151.0	147.0	153.0	

Consumer sentiment was probably little changed between the preliminary and final February surveys. The index could increase very slightly given that equity prices have risen after falling to a three-month low in early February.

Long-term inflation expectations will be important to watch, especially after core inflation fell 0.1%m/m in January. To date, any moderation in long-term inflation expectations has been quite small: in early February and over the last 12 months, expectations were 2.8%, compared to 3.1% in the prior 12-month period and 3.0% in the year before that. If long-term inflation expectations move lower, it would reinforce the case for the maintenance of accommodative Fed policy for an extended period.

Michigan 5-10-year ahead median inflation expectations

% change at annual rate



Fri Feb 26 10:00am

Existing home sales

	Oct	Nov	Dec	Jan
Total (mn saar)	6.09	6.54	5.45	5.50
%m/m	9.9	7.4	-16.7	0.9
%oya nsa	20.6	46.3	14.7	22.5
Months' supply (nsa)	7.0	6.5	7.2	
Single-family	6.8	6.2	6.9	
Median price (%oya)	-7.6	-5.7	1.5	

Existing home sales plunged 16.7% in December, likely because the expected expiration of the new homebuyer tax credit pulled sales into earlier months. The credit has been extended and expanded, but there is not yet evidence that sales are rebounding to any significant degree. We expect that existing home sales increased to

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an annualized pace of 5.50 million in January from 5.45 million in December, a rise of 0.9%. Sales had recently risen as high as 6.54 million in November.

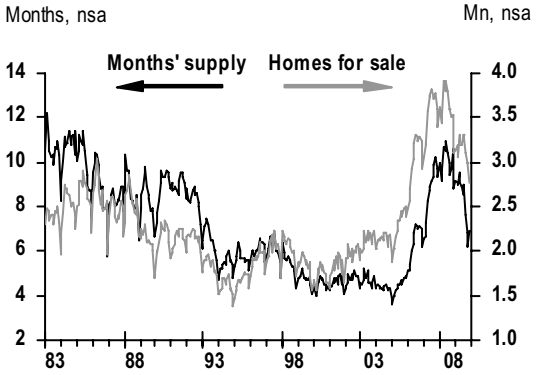
Our forecast for a small increase in January sales draws on the December pending home sales index, which rose 1.0%m/m. The pending home sales index leads existing home sales by a month or two. It's 16.4% fall in November correctly predicted the 16.7% decline in December existing home sales.

The fall in existing home sales in December caused the months' supply to break its downward trend and to rise to 7.2 from 6.5 the previous month. The rise was checked by a drop in inventories that was more than accounted for by seasonal factors; had inventories been flat the months' supply would have risen to 7.7. Months' supply will have to drop at least into the 5-6 range before supply and demand are balanced.

The median price of existing homes sold finally rose on a %oya basis in December. Prices rose 1.5%oya, the highest reading since May 2006 and the first year-over-year increase since August 2007.

Pending home sales, existing home sales

Existing single-family: months' supply, homes for sale



Review of past week's data

Homebuilders survey (Feb 16)

Sa

	Dec	Jan	Feb	
Housing market	16	15	~~15~~	*17*
Present sales	16	15		*17*

The National Association of Homebuilders (NAHB) survey rose to 17 in February from 15 in January. The increase in the NAHB index indicates that new home sales were probably beginning to rise again by early February after a 16.2% drop in the last two months of 2009. This is welcome news, although sales still look to be at very low levels. The NAHB index is only back to where it was in October and November 2009, and it is below the recent high of 19 in September. In 2009 new home sales peaked at a 419,000 annualized pace, which was 70% below the peak.

Empire State survey (Feb 16)

Diffusion indices, sa

	Dec	Jan	Feb	
General bus. conditions	4.5	15.9	~~-18.0~~	*24.9*
New orders	2.8	20.5		*8.8*
Shipments	8.4	21.1		*15.1*
Unfilled orders	-21.0	2.7		*2.8*
Prices paid	19.7	32.0		*31.9*
Prices received	-9.2	2.7		*4.2*
Composite	48.5	53.5		*52.3*

The Empire State survey pointed to continued growth in manufacturing in February, but the details were mixed, as new order and shipment growth decelerated. The headline business activity index jumped to the strong level of 24.9 in February from 15.9 in January, while the ISM-weighted composite fell to 52.3 from 53.5.

Housing starts (Feb 17)

Mn units, saar

	Nov	Dec		Jan	
Starts	0.58	~~0.56~~	*0.57*	~~0.57~~	*0.59*
Single-family starts	0.49	~~0.46~~	*0.48*	*0.48*	
Multifamily starts	0.09	0.10		~~0.09~~	*0.11*
Permits	0.59	0.65		~~0.63~~	*0.62*

The January housing starts report was constructive: the key single-family starts and permits categories both increased, starts in December were revised up, and single-family permits remained well above starts in permit-issuing areas. Both starts and permits are on track to rise this quarter, which could lead to a small increase in real residential investment spending by 2Q. Residential investment spending this quarter is likely to be about unchanged, reflecting a fall in starts last quarter.

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Import prices (Feb 17)

%m/m nsa, unless noted

	Nov		Dec		Jan	
Import prices	~~1.6~~	*1.5*	~~0.0~~	*0.2*	~~0.8~~	*1.4*
%oya	~~3.7~~	*3.4*	8.6		~~11.0~~	*11.5*
Ex fuel import prices	0.4		~~0.4~~	*0.3*	~~0.3~~	*0.4*
%oya	-1.1		~~0.4~~	*0.3*	~~1.5~~	*1.3*

Import prices were up 1.4% in January and 11.5%oya owing to the base effects of fuel. Ex fuel prices were up 0.4%. Some of the components like industrial supplies and consumer goods ex autos showed over-year-ago gains for the first time in a year.

Industrial production (Feb 17)

%m/m sa, unless noted

	Nov		Dec		Jan	
Industrial production	0.6		~~0.6~~	*0.7*	*0.9*	
Manufacturing	~~0.9~~	*1.0*	-0.1		~~0.9~~	*1.0*
Motor vehicles & parts	~~1.5~~	*2.2*	~~0.1~~	*-0.3*	~~6.8~~	*4.9*
High-tech	~~0.1~~	*0.8*	~~2.4~~	*1.2*		*1.9*
Mfg ex motor vehicles	0.9		-0.1		~~0.6~~	*0.8*
Business equipment	~~0.7~~	*-0.3*	~~0.9~~	*1.3*		*0.9*
Capacity utilization (%,sa)	~~71.5~~	*71.3*	~~72.0~~	*71.9*	~~72.7~~	*72.6*
Manufacturing	~~68.5~~	*68.4*	~~68.6~~	*68.4*	~~69.3~~	*69.2*

Industrial production posted a solid 0.9% increase in January, and manufacturing production rose 1.0%. Manufacturing has recently alternated between months of strong gains and very small declines, with the result being that manufacturing posted a 5% annualized gain in 4Q and is on track to meet or slightly exceed that rate of increase in the current quarter.

Producer price index (Feb 18)

%m/m sa, unless noted

	Nov		Dec		Jan	
Finished goods	~~1.8~~	*1.5*	~~0.2~~	*0.4*	~~0.9~~	*1.4*
%oya nsa	2.4		4.4		~~4.5~~	*4.6*
Core	0.5		0.0		~~0.2~~	*0.3*
%oya nsa	1.2		0.9		~~0.8~~	*1.0*
Energy	~~6.9~~	*5.6*	~~0.4~~	*0.7*	~~3.9~~	*5.1*
Cars	~~2.0~~	*-0.7*	~~0.3~~	*-0.2*	~~0.5~~	*-0.5*
Trucks	~~4.2~~	*3.5*	~~1.2~~	*-0.9*	~~0.5~~	*1.9*
Core intermed.	0.3		0.5		~~1.0~~	*0.5*
Core crude	~~0.8~~	*-1.0*	~~5.0~~	*4.5*		*6.6*

The headline PPI increased 1.4%m/m in January on higher energy prices and rose 4.6%oya. The core PPI increased 0.3%m/m (0.349%) and rose 1.0%oya. On a year-ago basis, core inflation remains soft, while over the last three months prices have grown at a relatively fast 3.3% annualized pace, the most since the last three months of 2008. The recent firmness in core producer price inflation should be watched closely, although there are some reasons to partially discount the jump in inflation over the last few months. First, more than half of a 0.5%m/m increase in the core PPI in November was explained by a jump in vehicle prices, a rebound after the introduction of new vehicle models had pushed prices down sharply in October. Second, there is a tendency for core inflation in January to be unusually firm. Over the last 10 years, the core PPI has risen 0.1%-pt more in January than in the average of the two months on either side of January. The upward bias increases to 0.2%-pt when the last seven years are examined, a period during which this pattern has been especially noticeable.

Philadelphia Fed survey (Feb 18)

Diffusion indices, sa

	Dec	Jan	Feb	
General bus. conditions	22.5	15.2	~~15.0~~	*17.6*
New orders	8.3	3.2		*22.7*
Shipments	14.9	11.0		*19.7*
Inventories	-5.7	-1.6		*3.2*
Prices paid	36.6	33.2		*32.4*
Prices received	1.4	2.7		*3.7*
Composite	52.6	52.5		*55.1*

The Philadelphia Fed survey shrugged off February snowstorms, showing strong improvement. The general business activity index increased to 17.6 from 15.2 and the ISM-weighted composite rose to 55.1 from 52.5. The ISM-weighted composite is at its highest level since March 2006.

CPI (Feb 19)

%m/m sa, unless noted

	Nov		Dec		Jan	
Total	~~0.4~~	*0.2*	~~0.1~~	*0.2*	~~0.3~~	*0.2*
%oya nsa	1.8		2.7		~~2.8~~	*2.6*
Core	~~0.03~~	*0.04*	~~0.11~~	*0.10*	~~0.10~~	*-0.14*
%oya nsa	1.7		1.8		~~1.7~~	*1.6*
Core services	0.0		0.1			*-0.2*
Core goods	0.2		~~0.2~~	*0.1*		*0.1*
Food	0.1		~~0.2~~	*0.1*	~~0.3~~	*0.2*
Energy	~~4.1~~	*2.2*	~~0.2~~	*0.8*	~~2.7~~	*2.8*
Housing	0.0		0.0			*-0.3*
Owners' eq. rent	~~0.12~~	*-0.09*	~~0.02~~	*-0.01*	~~0.05~~	*-0.08*
Rent	~~0.07~~	*-0.06*	~~0.01~~	*0.00*	~~0.04~~	*0.04*
Lodging away from home	-1.5		~~0.5~~	*0.1*	~~0.5~~	*-2.1*
Apparel	-0.3		0.4		~~0.2~~	*-0.1*
New vehicles	~~0.6~~	*0.5*	~~0.3~~	*-0.2*	~~0.2~~	*-0.5*
Used vehicles	~~2.0~~	*1.9*	~~2.5~~	*2.2*	*1.5*	
Airfares	~~3.8~~	*2.7*	~~2.4~~	*2.2*	~~2.5~~	*-2.5*
Communication	-0.3		0.1		~~0.1~~	*0.2*
Medical care	0.3		0.1		~~0.2~~	*0.5*

The consumer price index (CPI) increased 0.2% last month as energy prices rose 2.8%. More surprising was the 0.14% decline in the ex food and energy core CPI. This is an extremely weak number. The year-ago rate of core CPI is now 1.5% and the six- and three-month annualized rates of change are 0.9% and 0.0%. The policy implications are clear: core inflation is moving further below the Fed's implicit inflation target and in the process, real interest rates are moving higher. This is new news—unlike the well-telegraphed discount rate hike—and reinforces the case for a Fed on hold for an extended period. Recent declarations of "mission accomplished" in the fight against deflation risks now look somewhat premature.

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US focus: inflation is falling

- The January CPI report offered fresh evidence that inflation is set to trend down this year. Of particular importance was a 0.14%m/m decline in the core CPI. This was the first one-tenth decline since 1982. In fact, when we exclude a few declines in the early 1980s that were due to technical issues, we have not seen monthly core CPI changes this low since the early 1960s.

- In the year to January, the core CPI increased 1.6%, which is hardly different than the 1.7% rise over the prior 12-month period. However, over the last six months, the core CPI has only risen at a 0.8% annualized pace, the slowest pace since 1965. The question now is whether this slower pace of inflation will be maintained. We saw a similar deceleration last year, with core inflation rising just 1.0% annualized in the six months to January 2009. A surge in core goods inflation then led to a rebound.

- The fall in the core CPI in January was concentrated in core services, which declined 0.2%m/m, the first drop since 1982. Housing away from home (-2.1%) and airfares (-2.5%) were each particularly soft, and owners' equivalent rent declined 0.1%. One interesting development was that monthly changes in rental prices firmed in each of the last three months, possibly signaling the end to a brief period of deflation in this category, although the weak housing market should keep rental inflation in check.

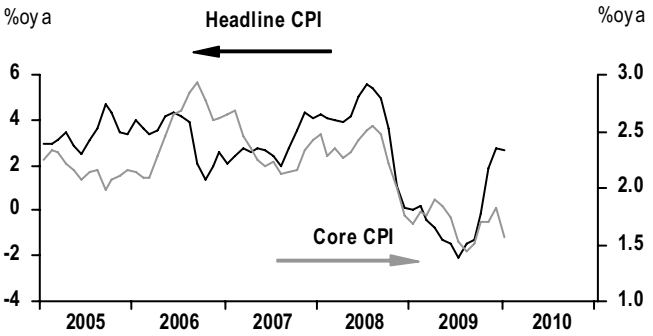
- Core goods inflation has moderated some after surging in 1H09. Core goods prices rose 1.8% annualized over the last six months, down from 4.1% in the prior six months. The fact that the core consumer goods PPI is rising more slowly than the core goods CPI could help slow core CPI inflation further. The core goods CPI rose 2.9%oya, compared to a 1.7% rise in the core consumer PPI.

Consumer prices

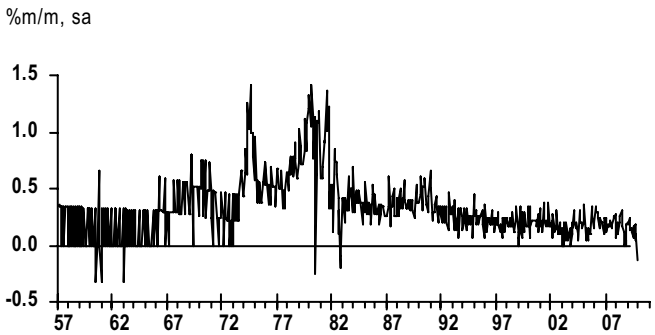
	%oya			%ch over 6m, saar		
	Jan 08	Jan 09	Jan 10	Jan 09	Jul 09	Jan 10
CPI	4.3	0.0	2.6	-6.4	2.7	2.6
Core[1]	2.5	1.7	1.6	1.0	2.1	0.8
Core ex shelter	2.0	1.6	2.8	0.7	3.4	2.3
Core goods	0.2	-0.5	2.9	-1.3	4.1	1.8
Core services	3.4	2.5	1.0	1.9	1.4	0.5
Food and beverages	4.8	5.2	-0.2	3.5	-1.4	0.9
Housing	3.0	2.2	-0.5	-0.6	-0.7	-0.5
Rent	3.9	3.4	0.5	3.4	1.2	-0.3
Owners' equivalent rent	2.8	2.2	0.4	2.2	1.2	-0.4
Apparel	-0.2	-0.9	1.7	-1.4	3.6	-0.1
Transportation	9.4	-12.6	14.3	-35.0	14.6	14.9
New and used vehicles	0.0	-3.2	5.3	-4.8	4.5	6.4
New	-0.6	-2.6	4.1	-4.7	7.4	0.9
Used	1.4	-9.0	11.5	-13.0	-2.6	27.5
Medical care	4.9	2.6	3.5	3.3	3.2	3.7
Recreation	1.0	1.6	-0.4	1.4	0.9	-1.8
Education	5.9	5.5	4.6	5.7	5.4	3.9
Communication	0.7	1.8	0.1	0.2	0.3	-0.2
Tobacco	5.4	6.1	29.5	3.6	57.8	6.4
Personal care	2.4	2.5	1.3	1.6	1.5	1.2
Core PCE deflator[2]	2.4	1.7	1.2	1.0	1.7	0.8
Cleveland Fed median CPI	3.2	2.7	1.0	2.4	1.2	0.8

1. Core is ex food and energy.
2. January 2009 value is a forecast based on January CPI.

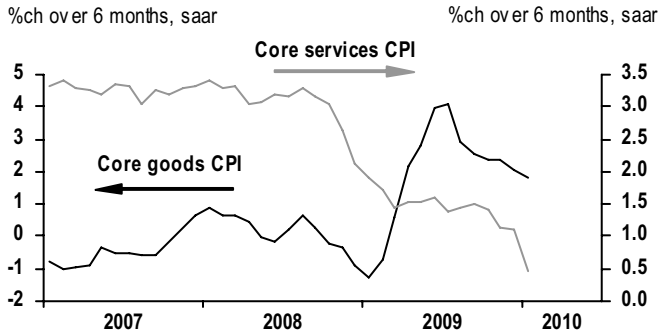
Consumer prices



Core CPI



Core goods and services inflation



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Euro Area

- **Composite PMI stagnant in February**
- **Spanish recession eases, but upswing likely to lag**

The composite PMI was stagnant in February at 53.7, a level consistent with GDP growth at around 2%ar. The manufacturing PMI continued to move up, with Germany taking over pole position from France. Meanwhile, the service PMI fell for the second consecutive month. The decline in services over the past two months has been concentrated in France, where the services PMI reached an exceptional level late last year.

We continue to expect growth to pick up to an above-potential pace, but the lack of any broadening from manufacturing to services is worrisome. The decline in services over two months is also noteworthy. Both the manufacturing and service PMIs are highly cyclical and very monotonic, so any move against a well-established trend has to be noted.

Spanish recession eases in 4Q

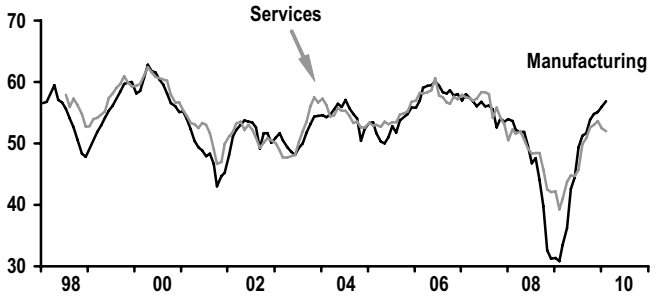
The adjustment in the Spanish private sector since early 2008 has been huge: the financial position of households has moved from -2.3% of GDP to 6.4% of GDP, and the financial position of nonfinancial corporates has moved from -11.2% of GDP to -3.6% of GDP. With this magnitude of saving adjustment in the private sector, one would have expected an extremely deep recession. But, in the event, the Spanish recession has thus far been slightly milder than in the region as a whole: a peak-to-trough fall in the level of GDP of 4.6%, compared with a decline of 5.1% in the Euro area overall.

There are two reasons for the milder recession in Spain. First, the government's saving rate has collapsed, from a surplus of 1.9% of GDP in 2007 to a deficit of 11.4% of GDP in 2009. This reflected the impact of both discretionary fiscal easing and automatic stabilizers. Second is the sharp decline in Spanish imports, which has pushed some of the domestic demand weakness onto foreign producers rather than domestic ones. Spanish imports fell 24.6% peak to trough, compared with declines of only 14.5% in Germany, 12.6% in France, and 19% in Italy.

The intensity of the Spanish recession is clearly fading, as the saving adjustment in households moderates and as corporate spending on machinery and equipment rebounds. In the fourth quarter of last year, household consumption increased by 1.4%ar, after a seven-quarter run of contraction

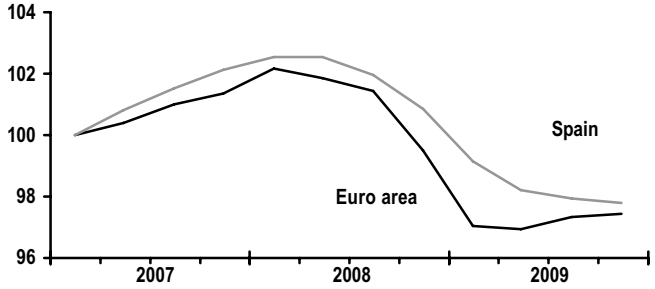
Euro area PMI output components

Index



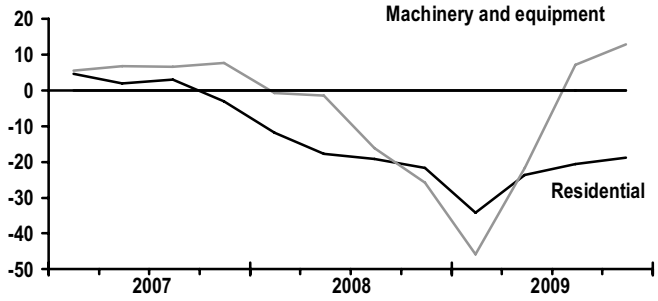
The level of GDP in the Euro area and Spain

Index, 1Q07=100



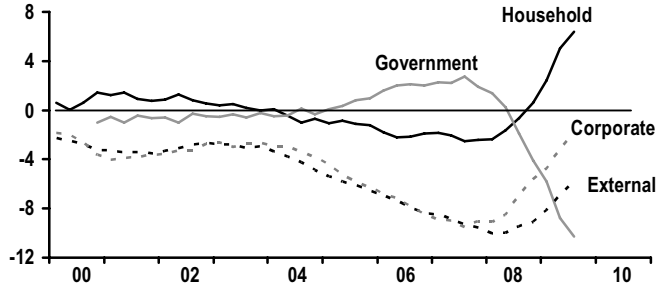
Spanish investment: machinery and equipment and residential

%q/q saar



Financial positions of Spanish sectors

% of GDP, 4-q moving sums



averaging 4%ar. Meanwhile, investment in machinery and equipment rose 13%ar in the fourth quarter, after a 7.2%ar gain in the third quarter. The intensity of the housing adjustment has barely eased at all: the contraction in residential investment was 18.8%ar in the fourth quarter, similar to the average contraction of 21.2%ar in the prior seven quarters. Residential investment was 5.3% of GDP in the fourth quarter. This was down from the peak of 9.4% of GDP seen in 2006, but still higher than the level that prevailed in the second half of the 1990s.

The Spanish economy is lagging the rather lackluster upswing in the region as a whole, and we expect this to continue. At the moment, this seems to largely reflect the ongoing adjustment in housing and a large cutback in public consumption. However, over time, we expect Spain to continue to underperform the rest of the region, reflecting the still overleveraged position of Spanish households and nonfinancial corporates, and the earlier move to fiscal tightening.

Conclusion of council of finance ministers

At their meeting this week, EU finance ministers adopted the opinion the European Commission expressed two weeks ago, essentially that Greece needs to meet the budgetary objectives in its stability program of a fiscal deficit of 8.7% of GDP this year and a fiscal deficit below 3% of GDP by 2012. Finance ministers will be focused on the targets for the overall deficit, so that in the event of any slippage in the implementation of already announced measures, or weaker-than-expected growth or higher-than-expected borrowing costs, additional fiscal tightening will be required to ensure that the budgetary targets are met. The focus on the overall deficit, rather than the cyclically adjusted budget position, is an important feature of the surveillance process being put in place for Greece: it means that the Greek government does not have any room for maneuver.

Greece is required to present a report by March 16 outlining the timetable for implementation of the budgetary measures for 2010, and another report by May 15 outlining other policy measures that will be needed to ensure that budgetary targets in future years are met and that in a broader sense Greece does not jeopardize the proper functioning of economic and monetary union. The March 16 report will need to lay out additional tightening measures to be implemented should the budget look to be overshooting this year's objective.

VAT across the region

With significant fiscal pressure in a number of Euro area countries, it seems likely that indirect taxes and user charges will go up in the coming years. This year, as part of its stability program, Spain is lifting its VAT by 2%-pts on the standard rate and by 1%-pt on the reduced rate. With a 60% passthrough, we would anticipate that this would lift the price level (and thus the year-on-year inflation rate) by 0.9%-pt, with around half showing up in July and half in August. Given the level of VAT around the region, other countries might choose this way of raising further revenue.

Euro area service PMI in upswings

	Upswing move pts	Number of reversals	Move in six months after peak
Dec 98 - Apr 00	52.7 - 62.4	2	62.4 - 57.9
Oct 01 - Apr 02	46.7 - 53.6	0	53.6 - 50.1
Apr 03 - Nov 03	47.7 - 57.5	0	57.5 - 54.5
Dec 04 - Jun 06	52.6 - 60.7	5	60.7 - 57.6

This table looks at the behavior of the PMI service output component in the four upswings seen since the survey began. The number of reversals refers to the number of months in which the PMI fell during the upswing phase.

Effect of the Spanish VAT increase on HICP inflation

Contributions are in ppt on the %oya rate

Pass-through	60.0
HICP Basket subject to the standard rate (%)	63.4
Percentage point change in the standard rate	2.0
Contribution to headline of the rise in standard rate	0.76
HICP Basket subject to the higher reduced rate	15.9
Percentage point change in the higher reduced rate	1.0
Contribution to headline of the rise in reduced rate	0.10
Total contribution on headline	**0.86**
Of which from core	0.7
Of which from energy	0.1
Contribution to core	0.9
Contribution to energy	1.2

VAT rates across Europe

% rate of imposition

	Standard rate	Reduced rate	Super-reduced rate
Spain	18	8	4
Belgium	21	6.5	
Germany	19	7	
Greece	19	9	4.5
France	19.6	5.5	2.1
Ireland	21	13.5	4.8
Italy	20	10	4
Luxembourg	15	6 and 12	3
Malta	18	5	
Netherlands	19	6	
Austria	20	10	
Portugal	20	5 and 12	
Slovenia	20	8.5	
Finland	23	8 and 17	
Cyprus	15	5 and 8	
Slovakia	19	10	

The rates for Finland and Spain reflect the changes that will take place in July 2010.

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Data releases and forecasts

Week of February 22 - 26

Output and surveys

Real GDP

		1Q09	2Q09	3Q09	4Q09
	Euro area				
	%q/q sa	-2.5	-0.1	0.4	0.1
	%q/q saar	-9.5	-0.5	1.7	0.4
	%oya	-5.0	-4.8	-4.0	-2.1
Wed	**Germany (final)**				
Feb 24	%q/q sa	-3.5	0.4	0.7	0.0
8:00am	%q/q saar	-13.3	1.8	2.9	0.0
	%oya	-6.7	-5.8	-4.8	-2.4
	GDP components (%q/q saar)				
	Private consumption	3.5	2.4	-3.5	-1.0
	Government consumption	5.1	2.3	0.5	0.0
	Mach, equip & other investment	-46.3	0.5	4.5	-8.0
	Construction investment	1.0	5.1	6.1	0.0
	Exports	-35.8	-3.2	14.2	15.0
	Imports	-20.7	-19.9	21.4	-12.0
	Contributions to GDP growth (%q/q saar)				
	Domestic final sales	-3.4	2.4	-0.9	-1.4
	Inventories	0.0	-8.2	6.0	-10.0
	Net trade	-10.2	8.1	-2.0	12.4

When publishing the flash estimate of German GDP earlier this month, the German statistics office indicated that a positive contribution from net trade was offset by weakness in all components of domestic demand. Given that the net trade contribution was likely a huge 12%-pt of GDP, the domestic drag must have been equally large. Most likely, this reflects a temporary inventory adjustment, which often occurs when net trade spikes sharply. But, interpreting this is hard as inventory changes may also reflect statistical adjustments included to ensure that GDP adds up.

Consumer spending likely fell 1%q/q saar, due to another drag from car sales, offsetting a slight increase in retail sales in 4Q09. Overall, looking through the large swings in car sales during 2009 (created by the car scrappage incentive), the trend in the consumer data has been broadly flat, continuing the theme of the past decade. More disappointingly, it looks as if capital spending declined in 4Q09, after recovering fairly solidly in mid-2009. Important to watch will also be the quarterly estimate of hours worked, given that almost the entire labor market adjustment in Germany has involved a reduced workweek, rather than job losses.

Manufacturing orders

Index, sa

		Sep	Oct	Nov	Dec
Wed	**Euro area**				
Feb 24	Values				
11:00am	New orders (%m/m sa)	1.7	-2.1	2.7	__
	New orders (%oya sa)	-16.4	-12.2	-3.1	__

European Commission survey

% balance of responses, sa

		Nov	Dec	Jan	Feb
Thu	**Euro area**				
Feb 25	Industrial confidence	-19	-16	-14	-13
11:00am	Recent production trend	-12	-7	-6	__
	Production expectations	2	3	5	__
	Export order books	-51	-49	-45	__
	Stocks of finished products	7	5	3	__
	Selling-price expectations	-9	-10	-6	__
	Construction confidence	-26	-28	-29	__
	Retail confidence	-11	-10	-5	__
	Service confidence	-4	-3	-1	__

We expect another improvement in Euro area industrial confidence, which would be consistent with the improvement already seen in the February manufacturing PMI. Important to see will be whether the broad-based improvement outside manufacturing continues in February.

National business surveys

		Nov	Dec	Jan	Feb
Tue	**Germany (IFO survey)**				
Feb 23	2000=100, sa				
10:00am	Business climate	93.8	94.6	95.8	96.2
	Business expectations	98.7	98.9	100.6	100.6
	Current conditions	89.2	90.4	91.2	92.0
Thu	**Italy (ISAE survey)**				
Feb 25	2000=100, sa				
9:30am	Producer confidence	79.3	82.4	83.2	__
Tue	**Belgium (BNB survey)**				
Feb 23	% balance of responses, sa				
3:00pm	Overall	-8.8	-7.9	7.0	__
	Manufacturing	-8.6	-9.3	-7.2	__
	Commerce	-10.0	-6.3	-9.0	__
	Construction	-10.0	-9.1	-15.7	__

We expect a small improvement in the IFO in February, driven by the current conditions index. We expect the expectations index, which has already reached an elevated level, to remain unchanged in February. Over the past three months, the improvement of the IFO has been split equally between the current conditions and expectations indices, but going forward, a progressive rotation towards gains in the current conditions index will be important. Interestingly, even though German GDP was stagnant in 4Q09, the current conditions index continued to improve.

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Demand and labor markets

Domestic consumption

		Oct	Nov	Dec	Jan
Tue	**France**				
Feb 23	Consumption of manufactured products, real terms				
8:45am	%m/m sa	0.9	0.1	2.1	__
	%oya sa	3.6	3.5	5.9	__

Unemployment

Seasonally adjusted

		Nov	Dec	Jan	Feb
Thu	**Germany**				
Feb 25	Registered (ch m/m, 000s, sa)	-1	-3	6	20
9:55am	000s, nsa	3215	3276	3617	__
	Unempl. rate (%, sa)	8.1	8.1	8.2	8.2

German unemployment in February may have been affected by the adverse weather conditions. According to the labor office, the weather already affected the January data, although the reported 6,000 increase in unemployment was modest. Nevertheless, it is possible that a lagged effect will affect the data in February. However, looking through any weather-related distortion, the German labor market data continue to look surprisingly good.

Employment

		Oct	Nov	Dec	Jan
Thu	**Germany**				
Feb 25	change m/m, 000s, sa	-6	-1	6	-10
9:55am					

The German economy unexpectedly created 6,000 jobs in December; the first monthly increase in ten months. We expect this to unwind in January, although the overall resilience in employment remains remarkable. The risk remains that the very sharp cuts in the workweek during the recession will ultimately translate into lost jobs, but there is no evidence of this occurring on a large scale at present.

Consumer confidence

		Nov	Dec	Jan	Feb
Thu	**Euro area (European Commission survey)**				
Feb 25	% balance of responses, sa				
11:00am	Consumer confidence	-17	-16	-16	-17

Consumer confidence fell in the February flash estimate by 1.6pts, the first fall in 10 months. At -17, consumer confidence would still be just 0.8 standard deviation (5.5pts) below its long-run average, after having troughed at -3.1 standard deviations below the long-run average in early 2009. But, the direction of the move will have to be monitored in the coming months.

Inflation

Consumer prices

		Oct	Nov	Dec	Jan
Fri	**Euro area (final)**				
Feb 26	HICP (%m/m nsa)	0.2	0.1	0.3	-0.7
11:00am	HICP (%oya nsa)	-0.1	0.5	0.9	1.0
	HICP (%oya core-X)[1]	1.0	1.0	1.0	0.9
	HICP (%oya core-XX)[2]	1.2	1.0	1.1	0.9
	HICP (%m/m ex tobacco)	0.2	0.1	0.3	-0.7
Tue	**France**				
Feb 23	%m/m nsa	0.1	0.1	0.3	-0.3
8:45am	%oya nsa	-0.2	0.4	0.9	1.1
	Index ex tobacco nsa	118.23	118.31	118.58	118.28
	HICP (%oya)	-0.2	0.5	1.0	1.2
Tue	**Italy (final)**				
Feb 23	%m/m nsa	0.1	0.0	0.2	0.1
10:00am	%oya nsa	0.3	0.7	1.0	1.3
	HICP (%oya nsa)	0.3	0.8	1.1	1.4

1. Excluding unprocessed food and energy.
2. Excluding food, alcohol, tobacco, and energy.

The final inflation print for the Euro area is likely to confirm the preliminary release. However, the release is particularly susceptible to revisions, because of the annual change in the weights of the HICP baskets. We expect to see a significant slowdown in core inflation, in particular in the core goods sector. Food inflation, in contrast, may have increased a bit further. The release will contain as well the updated country weights for the Euro area HICP.

French inflation in January is expected to have increased in line with the Euro area. The movement in the yearly rate of change was due to the fading base effect in the energy component, which was up also because of a significant increase in gasoline prices at the pump. We expect to see no correction in the electricity tariffs in January. Core inflation is expected to have slowed sharply, especially in the clothing sector. Service inflation as well is expected to have declined, because of a fall in transport services.

Consumer prices

		Nov	Dec	Jan	Feb
Mon	**Germany (prelim)**				
Feb 22	%m/m nsa	-0.1	0.8	-0.6	0.5
	%oya	0.4	0.9	0.8	0.7
	HICP (%oya)	0.3	0.8	0.8	0.7
	Baden Wuerttemberg (%oya)	0.4	0.7	0.8	0.7
	Bavaria (%oya)	0.4	1.0	0.6	0.5
	Brandenburg (%oya)	0.2	0.7	0.6	0.5
	Hesse (%oya)	0.3	0.8	0.8	0.4
	North-Rhine West (%oya)	0.4	0.8	0.8	0.7
	Saxony (%oya)	0.3	0.8	0.7	0.6
Fri	**Spain (flash)**				
Feb 26	HICP (%oya)	0.4	0.9	1.1	1.1
9:00am					
Thu	**Belgium CPI**				
Feb 25	%m/m nsa	0.3	0.2	0.5	0.6
11:15am	%oya nsa	-0.1	0.3	0.6	0.9

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German inflation in February is likely to have moderated a tick, due to lower energy prices. Not only did gasoline prices at the pump decline in the month, but February was also the first month since July 2009 during which the energy yearly rate of change did not move up sharply because of a base effect. Core inflation is expected to have moved down further in February. In particular, we expect a sharp decline in the inflation for household-related goods and services. However, we expect some of the sharp decline in the inflation rate for clothing that took place in January to reverse in February.

Producer prices

		Oct	Nov	Dec	Jan
Thu	**France**				
Feb 25	%m/m nsa	0.9	0.2	0.2	__
8:45am	%oya nsa	-6.6	-4.5	-2.8	__
Fri	**Italy**				
Feb 26	%m/m nsa	0.1	0.3	0.0	__
11:00am	%oya nsa	-5.2	-3.1	-1.5	__

Financial activity and public finance

Money and credit data

		Oct	Nov	Dec	Jan
Thu	**Euro area**				
Feb 25	M3 (%m/m sa)	-0.3	-0.5	0.5	-0.2
10:00am	M3 (%oya)	0.3	-0.3	-0.2	0.3
	M3 (%oya 3mma)	1.5	0.6	-0.1	-0.2
	Private loans (%oya)	-0.8	-0.7	0.0	___

We expect Euro area M3 to have fallen 0.2%m/m in January, with the annual rate of change rising to 0.3%oya. This decline would come after the upside surprise in December, which was mostly caused by a 12.4%m/m surge in repos that could partly unwind in January. Looking through this monthly volatility, M3 growth has been close to zero in recent months. This reflects not only the still subdued credit creation (note that banks create deposits when they grant new loans) but also portfolio shifts out of liquid (and low-yielding) M3 deposits.

The bank loan data will be important to watch as always. Overall, bank loan growth is still subdued, but there has been a clear increase in lending to households to almost a 4% pace recently. And while loans to nonfinancial corporates are still falling at approximately a 4% pace, this sector is accumulating bank deposits at an increasingly rapid pace (>5%). This suggests that corporate cash flows are improving and that the reliance on bank loans as a source of finance for investment spending is falling. This is what normally happens during the early phase of economic recoveries in the region: capex increases ahead of a pickup in bank lending to nonfinancial corporates due to the improved availability of corporates' internal funds at the start of the recovery.

Review of past week's data

Output and surveys

Real GDP

	2Q09		3Q09		4Q09	
Euro area						
%q/q sa	-0.1		0.4		0.1	
%q/q saar	-0.5		1.7		0.4	
%oya	-4.8		-4.0		-2.1	
Spain (final)						
%q/q sa	-1.0		-0.3		-0.1	
%q/q saar	~~-4.1~~	*-3.8*	~~-1.2~~	*-1.1*	~~-0.4~~	*-0.6*
%oya	-4.2		-4.0		~~-3.0~~	*-3.1*
GDP components (%q/q saar)						
Private consumption	~~-5.7~~	*-5.1*	~~-0.3~~	*-0.1*	__	*1.3*
Government consumption	~~-1.8~~	*1.7*	~~6.7~~	*5.5*	__	*-6.6*
Mach and equip investment	~~-23.0~~	*21.7*	~~7.9~~	*7.2*	__	*13.0*
Construction investment	~~-11.3~~	*-10.6*	~~-9.9~~	*-10.0*	__	*-8.5*
Exports	~~2.4~~	*3.0*	~~9.4~~	*8.7*	__	*-12.5*
Imports	~~-9.1~~	*-8.8*	~~8.4~~	*7.0*	__	*8.5*

For more detail on the Spanish GDP release, please see this week's Euro area essay.

Purchasing managers index flash (manufacturing)

Index, sa

	Dec	Jan	Feb	
Euro area				
Overall region	51.6	52.4	~~52.8~~	*54.1*
Germany	52.7	53.7	~~54.1~~	*57.1*
France	54.7	55.4	~~55.8~~	*54.6*

Purchasing managers index flash (services)

Index, sa

	Dec	Jan	Feb	
Euro area				
Overall region	53.6	52.5	~~52.9~~	*52.0*
Germany	52.7	52.2	~~52.8~~	*51.7*
France	58.7	56.3	~~56.5~~	*54.7*

Purchasing managers index flash (composite)

Index, sa

	Dec	Jan	Feb	
Euro area				
Overall region	54.2	53.7	~~54.1~~	*53.7*
Germany	54.3	54.6	~~55.2~~	*55.4*
France	59.2	58.0	~~58.3~~	*55.7*

The composite flash PMI was unchanged in February, after falling by 0.5pt in January. At 53.7, the pre-recession relationship with GDP would point to GDP growing slightly below 2%. The main caveat is that this is above where GDP has been running recently; clearly, there remains uncertainty about the exact mapping at present.

Another encouraging aspect of the report was that the composite PMI broadened out a bit by country, with the French PMI falling from a very high level and the rest of the region moving higher. Initially, the normalization in the French PMI was driven by services, but February also saw a very large decline in manufacturing (-3.7pts on the output index). This was not repeated elsewhere, with the German manufacturing PMI rising very strongly in the month (+3.4pts overall, +2.8pts on output, +5.3pts on employment, +2.1pts on new orders).

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By sector, the manufacturing PMI rose further in February (+1.7pts) and its output index (56.9) now stands 2.5pts above the pre-recession average. Therefore, the recovery in industry appears to be gathering pace. However, the spillover of this cyclical improvement in manufacturing is still slow to manifest itself in services. In fact, the services PMI fell 0.5pt in February after already falling by 1.1pts in January, and at 52.0 was left 3pts below the pre-recession average. As the Euro area PMI is a relatively monotonic series, such changes in direction often signal turning points. However, we are not putting much weight on this for now; rather, we are taking encouragement from the ongoing recovery in the manufacturing PMI and because February saw a convincing move up in the composite PMI employment index to 47.9. As the latter points to a much reduced pace of jobs cuts, it could prove positive for domestic demand and the services sector.

Interestingly, the employment index rose in February in both manufacturing and services, even though the activity and new business indices both fell in the services sector. And the employment index improved solidly even in France where the composite output index has been falling for three consecutive months.

Manufacturing orders

Index, sa

	Oct		Nov		Dec	
Italy						
Values						
New orders (%m/m sa)	~~0.6~~	*0.7*	~~2.6~~	2.9	__	*4.7*
New orders (%oya nsa)	-17.0		0.0		__	*10.1*

National business surveys

	Dec		Jan		Feb	
France (INSEE survey—manufacturing)						
Index						
Composite index	~~88~~	*89*	~~92~~	*91*	__	*91*
Index of past production	-2		~~5~~	*2*	__	*3*
Expected output—personal	-8		~~-9~~	*-5*	__	*-6*
Expected output—general	-11		~~-4~~	*-5*	__	*-5*

French business confidence was unchanged in February. Indicators of output were also mostly stable, which left them looking low relative to the much more upbeat message of the French manufacturing PMI (even after taking into account the latter's large decline in February, see commentary above).

External trade and payments

Foreign trade

	Oct		Nov		Dec	
Euro area						
€ bn sa						
Trade balance	~~4.7~~	*6.3*	~~3.9~~	*5.3*	__	*7.0*
Trade balance—year earlier	~~-2.6~~	*-2.4*	~~-4.9~~	*-4.1*	__	*0.6*
Exports	~~108.5~~	*110.9*	~~108.0~~	*110.9*	__	*114.4*
%m/m sa	~~-0.1~~	*2.7*	~~-0.4~~	*0.0*	__	*3.1*
Imports	~~103.8~~	*104.7*	~~104.1~~	*105.6*	__	*107.3*
%m/m sa	~~-1.0~~	*-0.8*	~~0.3~~	*0.9*	__	*1.7*

Euro area exports rose strongly in December to be up 23%q/q saar in 4Q09. As a result, the level of exports has now recovered a third of the peak-to-trough decline during the recession. This is certainly encouraging. And as imports increased by less, the net trade contribution to 4Q09 GDP was likely large at almost 4%-pt q/q saar. Of course, GDP itself rose just 0.4%q/q saar in 4Q09, according to the flash estimate, so that the large net trade contribution was offset by weakness elsewhere. Most likely is a larger inventory drag, which may partly reflect a statistical alignment adjustment to ensure that the GDP components add up.

Inflation

Producer prices

	Nov	Dec	Jan	
Germany				
%m/m nsa	0.1	-0.1	~~0.2~~	*0.8*
%m/m sa	0.6	0.0	__	*0.7*
%oya nsa	-5.9	-5.2	~~-4.0~~	*-3.4*

The sharp upward movement in the German PPI inflation was caused by the fading base effect in the energy component and a significant 2.2% rise in monthly terms. Core PPI deflation moderated in January. The details show that most of the upward pressure on prices came from intermediate goods deflation, which was up to -2.3%oya in January after -3.6%oya in February , due to a 0.3%m/m rise in the month. Deflation in consumer non-durable products (mainly food) also moderated in January.

The January figure represents only a very small uptick in price levels from the trough reached in September 2009. We expect the yearly rate of change for PPI to move further up in the next few months, because the very sharp declines in oil prices and core PPI prices that took place last year are not likely to be repeated. However, we expect the sequential increases to remain very modest.

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Japan

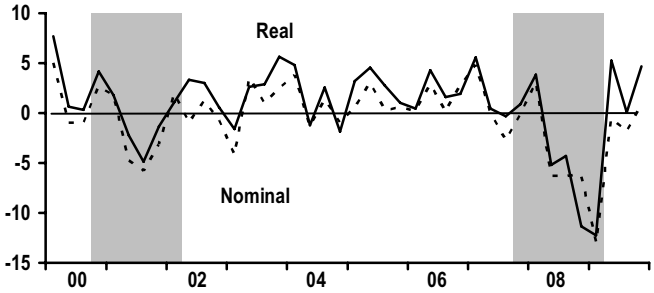
- **Fourth-quarter GDP grew 4.6%q/q saar after a flat 3Q, easing concerns of a double-dip recession**
- **But, details were mixed, and a slowdown in 1H10 looks likely as fiscal stimulus effects fade**
- **Next week's IP report and the Shoko Chukin sentiment survey will gauge the direction of momentum**

Fourth-quarter real GDP was unexpectedly strong, jumping 4.6%q/q saar (J.P. Morgan: 3.0%; consensus: 3.5%). It was encouraging that the contribution to growth was evenly distributed between external and domestic demand, particularly with the pickup in capex. However, compared to our forecast, the details were not so positive. Indeed, the contribution to growth from net trade was larger than expected, but it was due to weaker-than-projected imports. Despite the elevated level of the inventory to final sales ratio, inventories continued to increase through last year. A large gain in public consumption was a surprise, but it had little meaning for the economic cycle.

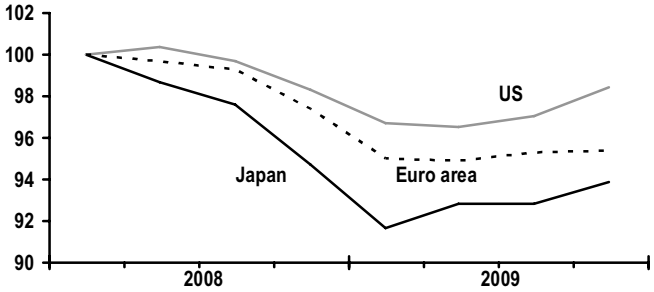
More fundamentally, the volatility in the quarterly growth rate, -12.3% in 1Q09, 5.2% in 2Q, 0.0% in 3Q, 4.6% in 4Q, makes it difficult to gauge the underlying pace of recovery. The average of the last three quarters (3.3%), which seems to be a reasonable measure, is decisively higher than the 0.5% potential growth rate, but still weak after the record downturn in 4Q08 and 1Q09. Indeed, the 4Q level of real GDP was still far below the 1Q08 peak—even lower than in the Euro area (second chart)—and 4Q nominal growth was a mere 0.9%q/q saar, underscoring stubborn deflation.

To be sure, the strong growth in 4Q GDP supported our relatively bullish view that Japan's export-driven recovery continues even as the domestic economy remains tepid. Indeed, with the improvement in sentiment surveys—including this week's Reuters Tankan—and other major monthly indicators, the strong 4Q growth rate was widely perceived as a sign that Japan will avoid a double-dip recession. Nevertheless, it appears too optimistic to expect growth to maintain its solid 3%-4% growth this year, for at least two reasons. First, the positive effects from fiscal stimulus are likely to wane, particularly those on public investment. Second, the increase in exports and IP likely will slow from an unsustainable 30%-40%ar pace to a more moderate but still solid 10%-15%. While the downside risk to our forecast appears to have diminished, we maintain our 1H10 forecast, which looks for a slowdown to an average of 1.7%ar growth from the 3.3% average in the last three quarters of 2009.

GDP
%q/q saar



Real GDP
1Q08=100



Next week's IP report for January—which includes manufacturers' projections through March—and the February Shoko Chukin small firm survey bear close watching to gauge the direction of the economy's momentum. Also, the data calendar includes the manufacturing PMI, January custom trade, retail sales, and CPI.

The BoJ's policy meeting this week delivered no surprises, although it was the shortest ordinary meeting since 2006. The statement was effectively a copy of January's, and Governor Shirakawa's press conference offered no new insight to the Bank's thinking. We are comfortable with our view that the BoJ will stay on hold, while leaning toward further easing if financial markets tumble again like they did last November.

Firm private consumption with strong increase in durable goods sales

One recent surprise in Japan's economic data was the firmness of private consumption toward the end of last year. Indeed, despite a 4.9%q/q saar fall in real labor income, private consumption rose 2.7% even after a firm 2.4% gain in 3Q and a 4.6% jump in 2Q. While the firmness can be partly explained by the fall of prices as nominal consumption continued to fall in 4Q (-0.2%) and 3Q (-0.9%) after a

2.7% rise in 2Q, the solid increase in volume was impressive. Note, however, that this is not the first time consumption has been strong relative to labor income. During the early part of the previous recovery period (from 2002 to 2004), labor income fell in year-over-year terms for two years, but real consumption generally rose (first chart). Assuming the data are reliable, this suggests that Japan's consumption—at least in the short term—is affected more by factors other than labor income, such as weather, sentiment, and government supports (see below).

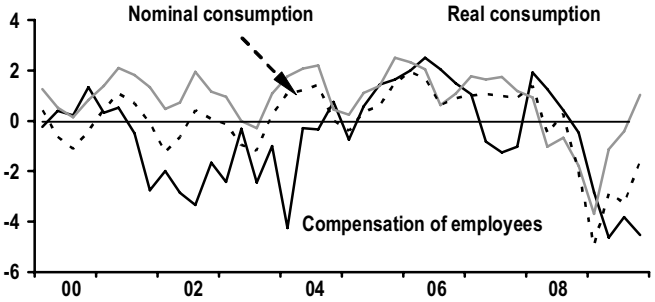
A more important observation in terms of the outlook is that the firmness of overall consumption was due solely to strong durable goods consumption. Indeed, nondurable goods and service consumption has been sluggish, showing essentially no gain even after the economy started to recover in 2Q last year (second chart). The sales of durable goods have been supported by government incentives for the purchase of environmentally friendly goods—specifically autos, TVs, refrigerators, and air conditioners. The incentives started in April last year, and the expiration dates were extended from the end of March to September (for autos) and to December (for others). Durable goods accounted for only 14% (in 2009) of total household consumption in GDP. According to the Survey of Household Economy—the key source of durable goods consumption from the demand side—the weight of the items subject to the incentives was 65% of durable goods consumption (2009). This implies that overall consumption was lifted by a mere 9% of items. Given that the ratio of durable goods consumption to labor income has risen markedly (third chart), a further surge of sales in durable consumer goods seems unlikely, although we do not expect an outright decline.

Operating rate and capex

One notable positive aspect of the GDP report was the pickup of capex, which had been in decline since 2Q08. While the modest 4.0%q/q saar gain may be revised down in the second estimate of GDP due on March 11, which will incorporate the MoF corporate survey due on March 4, monthly indicators such as capital goods shipments and machinery orders suggest that capex has in fact bottomed. This week's operating rate for manufacturing, contained in the final IP report, was also encouraging, rising 1.4% in December. Indeed, the correlation between the year-over-year change in capex and the operating rate has been high (fourth chart), especially the operating rate advanced one quarter. As long as IP continues to increase along with a solid gain in external demand, the capex recovery is unlikely to falter.

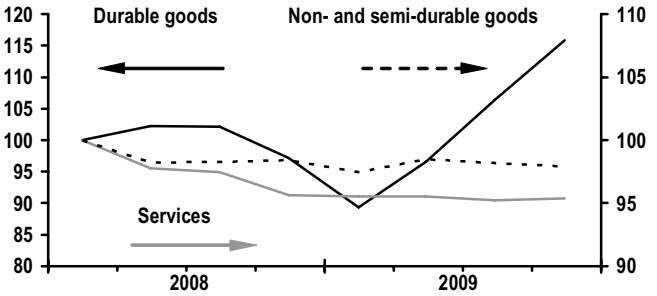
Compensation of employees and private consumption

%oya



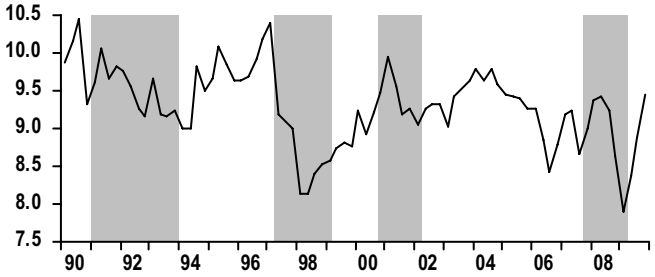
Real consumption

1Q08=100



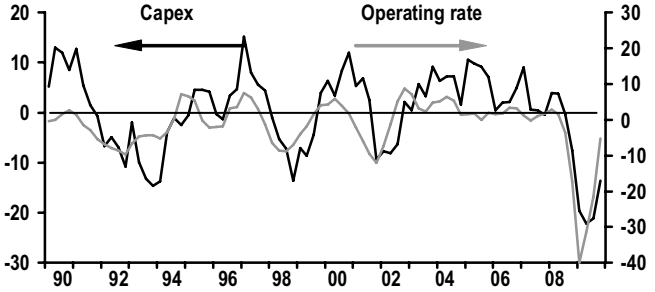
Durable goods consumption

% of compensation of employees



Real capex and manufacturing operating rate

%oya for both scales



Data releases and forecasts

Week of February 22 - 26

Wed Feb 24 8:50am

Customs-cleared trade

¥ bn sa, unless noted

	Oct	Nov	Dec	Jan
Balance	487	517	524	372
Exports (%m/m)	4.3	4.7	2.5	1.7
Imports (%m/m)	1.0	4.6	2.6	5.2
Balance (nsa)	804	371	545	-238
BoJ real export index (%m/m)	3.3	0.6	2.8	___
BoJ real import index (%m/m)	-6.5	4.9	0.0	___

The data in hand (foreign machinery orders through December, manufacturers' output projections for January, and January trade reports from other Asian countries) uniformly suggest that Japan's exports remained on an uptrend in January. Meanwhile, nominal imports were also strong during the first 20 days of the month, led by petroleum imports.

Wed Feb 24 8:50am

Corporate service prices

%oya

	Oct	Nov	Dec	Jan
Overall	-2.3	-2.2	-1.5	-1.4
Ex international transport	-1.4	-1.6	-1.4	___

On an underlying trend basis, the CSPI likely continued to decline quite steadily amid ongoing weakness in wages and domestic demand.

Wed Feb 24 2:00pm

Shoko Chukin small firm survey

Diffusion index

	Nov	Dec	Jan	Feb
Sentiment index	43.0	40.4	41.3	42.2
Manufacturers	45.0	41.3	41.3	___
Nonmanufacturers	41.3	39.6	41.3	___
Sales (%oya)	-13.0	-9.0	-4.1	___
Profit margins	-13.1	-14.1	-14.7	___
Financing conditions	-8.2	-7.7	-6.8	___
Inventory	-15.8	-16.5	-14.9	___
Capacity	-24.8	-24.0	-23.6	___
Employment	-12.6	-12.3	-14.2	___
Input prices	-0.6	-2.8	-2.7	___
Output prices	-12.1	-14.5	-14.3	___

The headline index should rise further, validating our view that IP grew 15.0%q/q saar and real GDP growth was 1.8%ar this quarter.

Fri Feb 26 8:15am

Purchasing Managers Survey (manufacturing)

DI

	Nov	Dec	Jan	Feb
Overall index	52.3	53.8	52.5	52.5

The overall index is expected to stay firm in February, when manufacturers are expecting a continuation of the consecutive output rises since March last year.

Fri Feb 26 8:50am

Consumer prices

%oya

	Nov	Dec	Jan	Feb
Tokyo				
Overall	-2.2	-2.2	-2.1	-2.1
Core (ex fresh food)	-1.9	-1.9	-2.0	-2.0
Ex food and energy	-1.3	-1.5	-1.4	-1.5
Nationwide				
Overall	-1.9	-1.7	-1.4	
Core (ex fresh food)	-1.7	-1.3	-1.2	
Ex food and energy	-1.0	-1.2	-1.2	

Given the remaining output gap, which has been a drag on the core core CPI, core CPI deflation will probably linger for a while.

Fri Feb 26 8:50am

Commercial sales

%oya, unless noted

	Oct	Nov	Dec	Jan
Commercial sales	-19.2	-14.6	-10.9	___
Wholesale sales	-24.2	-18.7	-14.6	___
Total retail sales	-1.0	-1.1	-0.2	-0.3
%m/m sa	-0.9	0.0	-1.1	0.0

We think consumer spending will lose some of its momentum this quarter, as the effects from the government measures to promote purchases of environmentally friendly cars and energy-efficient household appliances are fading. Note that this series, which does not accurately reflect the diversified pattern of consumption and is not used to construct GDP, already weakened in 4Q.

Fri Feb 26 8:50am

Industrial production—preliminary

%m/m sa

	Oct	Nov	Dec	Jan
Production	0.5	2.2	1.9	1.0
Shipments	1.3	0.9	1.0	___
Inventories	-1.5	0.4	-0.1	___
Inventory/shipment ratio	0.3	-3.4	-4.8	___

Based on manufacturers' optimism included in the December report, as well as the solid manufacturing PMI output index for the month, we expect January IP to continue rising at a decent pace.

Fri Feb 26 2:00pm

Housing starts

%oya, unless noted

	Oct	Nov	Dec	Jan
Housing units %oya	-27.1	-19.1	-15.7	-10.0
%m/m sa	7.3	3.8	3.3	3.3
Mn units saar	0.76	0.79	0.82	0.85

The December report made it clear that housing construction started to recover from a very low level.

Fri Feb 26 2:00pm

Construction orders

%oya, unless noted

	Oct	Nov	Dec	Jan
Total	-40.1	-11.6	0.6	___
Domestic, private sector	-32.7	-25.5	-9.3	___
Domestic, public sector	-39.4	27.9	-24.7	___

Review of past week's data

GDP—First preliminary estimates (Feb 15)

%q/q saar

	2Q09		3Q09		4Q09	
Real GDP	~~2.7~~	*5.2*	~~1.3~~	*0.0*	~~3.0~~	*4.6*
Private consumption	~~4.8~~	*4.6*	~~3.8~~	*2.4*	~~3.0~~	*2.7*
Residential investment	~~-32.8~~	*-32.7*	~~-28.1~~	*-27.7*	~~-5.0~~	*-12.8*
Business investment	~~-17.0~~	*-15.6*	~~-10.6~~	*-9.8*	~~3.0~~	*4.0*
Public consumption	1.1		~~-0.5~~	*0.5*	~~0.5~~	*3.3*
Public investment	~~27.5~~	*28.4*	~~-6.3~~	*-6.2*	~~-5.0~~	*-6.4*
Exports	~~28.8~~	*42.2*	~~28.6~~	*37.8*	~~20.0~~	*21.7*
Imports	~~-13.0~~	*-14.7*	~~13.9~~	*23.3*	~~5.0~~	*5.3*
%-pt contribution to q/q saar GDP growth						
Net exports	~~4.5~~	*5.9*	~~2.0~~	*2.1*	~~2.0~~	*2.2*
Inventories	~~-2.6~~	*-2.0*	~~0.3~~	*-0.2*	~~-0.5~~	*0.2*
GDP deflator (%oya)	~~-0.5~~	*-0.7*	~~-0.6~~	*-0.7*	~~-2.7~~	*-3.0*

See main essay.

Industrial production—final (Feb 15)

%m/m sa

	Oct	Nov	Dec	
Production	0.5	2.2	~~2.2~~	*1.9*
Shipments	1.3	0.9	~~1.1~~	*1.0*
Inventories	-1.5	0.4	~~0.0~~	*-0.1*
Inventory/shipments ratio	0.3	-3.4	~~-4.7~~	*-4.8*
Operating ratio	0.2	3.2	___	*1.4*
Production capacity (%oya)	-0.2	-0.1	___	*0.0*

See main essay for comments on the operating rate.

Reuters Tankan survey (Feb 17)

DI, % saying "good" minus "bad"

	Dec	Jan	Feb	
Manufacturing	-27	-19	___	*-13*
Nonmanufacturing	-39	-34	___	*-31*

The large manufacturers sentiment DI continued to rise solidly in February, with eight of the nine sectors showing m/m rises. Moreover, their outlook DI, which reflects prospects for business conditions three months ahead, looks for a further solid improvement to -5, consistent with respondents' comments that the recovery is gathering momentum as the new year progresses. Note, though, that the improvement has reportedly been mostly due to robust external demand (mainly from Asian countries), and concern about the severe profit squeeze from ongoing deflation continues to be cited.

Meanwhile, the large nonmanufacturers sentiment DI posted its second consecutive rise, and their outlook DI also rose to -20. Still, the nonmanufacturing recovery has been weaker than that in the manufacturing sector, with both the pace of rise and the current level of the DI being well below those of manufacturers.

Index of tertiary sector activity (Feb 17)

% change

	Oct	Nov	Dec
%m/m sa	0.4	~~-0.2~~ *-0.1*	~~-0.2~~ *-0.9*
%oya	-4.7	~~-3.2~~ *-3.1*	~~-2.2~~ *-2.8*

In December, the weakness of wholesale trade and civil engineering/architectural services intensified. On the brighter side, the activity index of information and communication extended its rise. Personal service providers, overall, rose modestly m/m, but fell in 4Q, consistent with weak service consumption in this week's 4Q GDP report.

Construction spending (Feb 17)

% change

	Oct	Nov	Dec	
Public	4.5	5.7	___	*4.6*
%m/m sa, by J.P. Morgan	-1.1	0.1	___	*-0.1*
Private	-26.2	-24.6	___	*-24.8*
Residential	-25.5	-22.2	___	*-20.2*
Nonresidential	-27.1	-27.2	___	*-29.9*
Civil engineering	-19.3	-19.2	___	*-24.5*

The public sector component was broadly consistent with the first estimate of 4Q GDP public investment, which, in real terms, continued to fall at 6.4%q/q saar after -6.2%ar in 3Q. The ESRI uses this indicator to estimate public investment in GDP; the actual reading for the last month of each quarter is included in the second estimate.

The decline in public sector construction spending is expected to accelerate, reflecting the government's intention to cut spending on public works.

Nationwide department store sales (Feb 18)

%oya, unless noted

	Nov	Dec	Jan	
Overall	-13.2	-6.6	-7.0	
%m/m sa, by J.P. Morgan	-0.2	4.1	-1.9	
Same-store	-11.8	-5.8	___	*-5.7*

January sales fell but only partial reversed the previous month's strong rise, which included a boost from front-loaded clearance sales, as well as sales of Christmas cakes and New Year delicacies. The amount of sales in January was 0.7% above the 4Q average.

With customer traffic improving, the Japan Department Store Association now thinks that consumer sentiment has picked up, as the government measures appear to have eased uncertainty about the economy.

That said, this indicator does not capture the overall picture of consumption well. The retail component in the commercial sales report (due on February 26), the household survey (due on March 2), and the most reliable, the CAO private consumption index (due around March 8), will provide a more accurate look at overall consumption at the start of this year.

Index of all-sector activity (Feb 19)

%m/m sa

	Oct		Nov		Dec	
All sector	~~1.1~~	*1.2*	~~0.1~~	*0.2*	~~0.2~~	*-0.3*
Tertiary sector	0.4		~~-0.2~~	*-0.1*	~~-0.2~~	*-0.9*
Industrial production	0.5		2.2		~~2.2~~	*1.9*
Construction	-0.6		1.8		___	*-0.1*
Public sector	~~-0.4~~	*-0.3*	~~0.1~~	*0.6*	___	*-0.4*

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Canada

- **Key December indicators point to a 0.4%m/m increase in GDP**
- **A swing in net exports probably pushed 4Q GDP up 4%q/q ar**
- **Ministry of Finance announced regulatory changes for mortgages**

This was a particularly busy week for data releases with all of the key data (manufacturing, wholesale, and retail sales) behind December GDP released. They all posted solid gains but were generally a little weaker than market expectations. Nonetheless, taken together, they point to a solid 0.4%m/m increase in GDP, which in turn implies a 4.1%q/q ar increase for all of 4Q (above our initial 3.0% expectation and the 3.3% increase envisaged by the Bank of Canada). Leading indicators recorded another marked increase and continue to point to a sharp acceleration in GDP growth. CPI inflation surprised on the upside, though both total and core remain well contained and at the Bank's 2% target. The Ministry of Finance announced three changes to the standards governing government-backed mortgages, apparently reflecting some concern over the robust rise in house sales and prices.

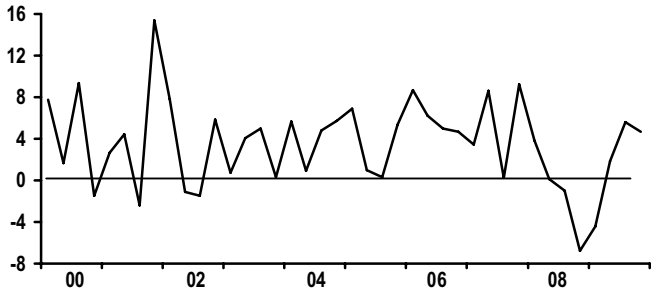
Manufacturing sales rose 1.6%m/m in December. The gains were mostly concentrated in the transportation equipment industry. Gains in the aerospace product and parts, motor vehicle, and petroleum and coal product industries were largely responsible for December's increase. Real manufacturing sales increased 2.1% in December.

Wholesale sales increased by 0.7%m/m in December, the sixth increase in seven months. Real wholesale sales grew by 1.5%. The machinery and electronic equipment sector contributed the most to the December increase. Retail sales rose 0.4%m/m in December, mostly offsetting the decline in November. Real retail sales increased 0.6% in December. The largest contributor to the overall increase in nominal sales was a 3.3% rise in sales at general merchandisers, which include department stores. November's unseasonably warm weather caused some consumers to postpone purchases of clothing and footwear until December.

Combining these key inputs yields a 0.4%m/m increase in GDP for December (released March 1), the same rise as in November. For the fourth quarter as a whole, we now look for a 4.1%q/q saar increase, up sharply from a 0.4%q/q ar increase in 3Q. Though our expectation is generated largely from the monthly output data, we think of GDP more from

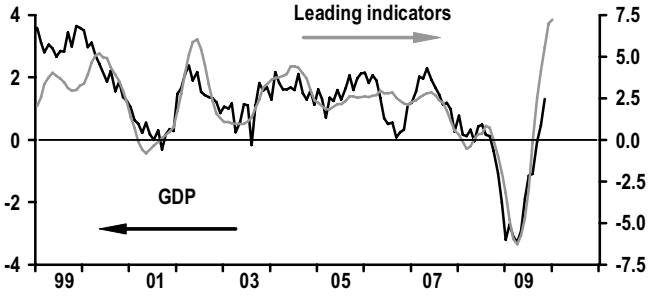
Real retail sales

q/q %ch saar



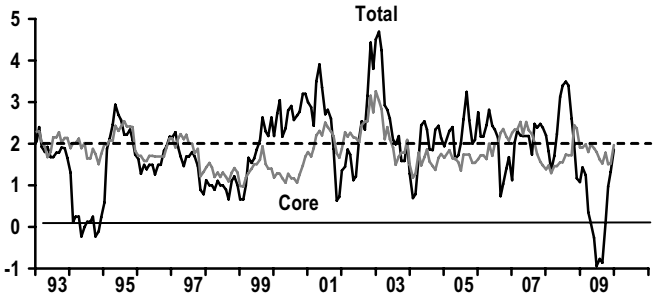
Monthly GDP and leading indicators

6-mo % ch, both scales



Consumer prices

%oya



the expenditure side. Unfortunately, there is less high-frequency data than on the output side. Nonetheless, we can construct a general picture of the likely expenditure composition of 4Q GDP from the available data.

The key factor in the likely acceleration of GDP in 4Q is trade. Real net exports subtracted 5.3%-pts from overall GDP growth in 3Q. In 4Q, we estimate that net exports added about 0.5%-pt, reflecting a continued rebound in exports and a sharp slowing in imports. The sharp slowdown in imports will likely be reflected in weaker business capital spending. The 4Q import slowdown was due mostly to a 6%q/q decline in imports of machinery and equipment (after a 46%q/q surge in 3Q). Canadian businesses import more than 70% of their spending on equipment and ma-

chinery. So, the decline in these imports points to a weak quarter for overall business investment spending. Real retail sales were up nearly 5%q/q ar, only slightly slower than in 3Q, and thereby pointing to another strong contribution from household consumption in 4Q. Similarly, housing starts posted another strong quarter, up nearly 16%q/q following a 22%q/q jump in 3Q and indicating another solid contribution from residential investment.

The Ministry of Finance announced three regulatory changes in the mortgages that it will insure and guarantee. Although these changes are technically only for government-insured mortgages, the new regulations will likely be applied to all mortgage lending. The Finance Ministry announced that beginning April 19, the five-year mortgage interest rate would be used to determine income qualification for a mortgage (rather than the three-year rate currently being used); mortgage refinancing would be restricted to 90% of the value of the home (down from 95% currently); and buyers of non-owner-occupied dwellings would have to provide a 20% down payment.

Even though these regulatory changes should take a little of the steam out of an otherwise extremely robust housing market (and thereby do some of the heavy monetary lifting for the BoC), they have not changed our view that the Bank will begin to move policy away from the current emergency setting in July. The economy is clearly no longer in need of emergency policy support as witnessed by the strong rebound in 4Q GDP, the record-high levels of financial market conditions, and the surge in leading indicators.

Data releases and forecasts

Week of February 22 - 26

Fri
Feb 26
8:30am

Current account
C$ bn saqr

	1Q09	2Q09	3Q09	4Q09
Current account	-7.8	-11.9	-13.1	-8.2
% of GDP	-2.0	-3.2	-3.4	-2.2
Merchandise	1.0	-1.6	-4.0	0.1
Nonmerchandise	-8.8	-10.3	-9.1	-8.3

The current account deficit looks to have shrunk from 3.4% of GDP in 3Q to 2.2% in 4Q, mainly as a result of the disappearance of the merchandise trade deficit.

Review of past week's data

Manufacturing report (Feb 16)
%m/m sa, unless noted

	Oct		Nov		Dec	
Sales	~~-2.1~~	*1.5*	0.1		~~-2.5~~	*1.6*
New orders	~~-2.2~~	*-0.9*	~~-3.2~~	*0.8*	~~-2.0~~	*7.4*
Unfilled orders	~~-3.6~~	*-2.8*	~~-1.4~~	*-2.3*	~~-1.8~~	*2.3*
Inventories	~~-0.2~~	*0.1*	~~-0.3~~	*-0.2*	~~-0.2~~	*-1.0*
Inventory-shipments ratio	1.41		~~1.40~~	*1.4*	~~1.36~~	*1.37*

Wholesale sales (Feb 17)
sa

	Oct		Nov		Dec	
Total,%m/m	~~-0.5~~	*0.6*	~~-2.5~~	*2.7*	~~-0.5~~	*0.7*
%oya	~~-8.1~~	*-7.9*	~~-4.4~~	*-4.0*	~~-0.4~~	*-0.2*

Consumer price index (Feb 18)
%m/m nsa, unless noted

	Nov		Dec		Jan	
Total CPI	0.5		-0.3		*0.3*	
%oya	1.0		1.3		*1.9*	
CPI Core	0.4		-0.3		~~-0.0~~	*0.1*
%oya	1.5		1.5		~~-1.9~~	*2.0*
Ex food & energy	0.2		-0.4		~~-0.0~~	*-0.1*
%oya	0.8		0.6		~~-1.3~~	*1.2*
Ex food, energy, taxes (%oya)	0.8		0.6			

Retail sales (Feb 19)
%m/m sa, unless noted

	Oct		Nov		Dec	
Total	1.0		~~-0.3~~	*-0.5*	~~-0.3~~	*0.4*
%oya	-1.2		~~-1.2~~	*1.0*	~~-6.9~~	*6.7*
Ex autos	0.3		~~-0.0~~	*-0.2*	~~-0.0~~	*0.4*
%oya	~~-1.4~~	*-1.5*	~~-1.1~~	*0.8*	~~-4.4~~	*4.5*
Ex autos & gas	-0.2		~~-0.3~~	*-0.7*	~~-0.0~~	*0.1*
%oya	~~-1.1~~	*1.0*	~~-0.6~~	*0.1*	~~-2.8~~	*2.4*
Real retail sales	0.8		~~-1.0~~	*-1.3*	~~-0.7~~	*0.6*
%oya	~~-0.2~~	*0.3*	~~-0.7~~	*0.4*	~~-5.2~~	*4.9*

Leading indicators (Feb 19)
%m/m

	Nov	Dec	Jan
Smoothed	1.3	1.5	*0.9*
Unsmoothed	3.1	1.1	*0.1*

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Mexico

- **Banco de México left rates unchanged, as widely expected**
- **We examine the pension fund regulator's modifications to the investment regime**
- **Banxico might soon announce a foreign reserve accumulation program**

Banco de México's left the overnight rate unchanged at 4.5%, where it has been since July 2009. In its post-meeting communiqué, Banxico's board was more positive on growth, along the same lines as the recently-published Quarterly Inflation Report. On the other hand, they also acknowledged that inflationary pressures from higher taxes and energy price hikes have started to materialize. We highlight that at first sight, the statement looked slightly more dovish than January's communiqué, particularly as the board explicitly mentioned that it seems there are no second-round inflationary effects derived from the higher taxes and administered price hikes so far, while they emphasized the effects of the administered price hikes and higher prices of fruits and vegetables—affected by unusual weather conditions—on non-core inflation.

Nevertheless, on the hawkish side, the communiqué stated that the prices of several items with a high weight in the CPI have increased more than could be justified by the recently implemented fiscal measures, while negotiated prices, particularly transport tariffs, have risen more than expected. In our view, the apparently hawkish comments were dampened by dovish pronouncements. In sum, we believe that the bias was slightly dovish, particularly as the board decided to remove the following sentence from the statement "…second round effects could put the Central Bank's price stability objective at risk." However and more importantly in our view, we think that the prominence of the discussion of inflationary pressures accompanied by predominantly dovish comments, points to a debate among board members about what signal to send to market participants.

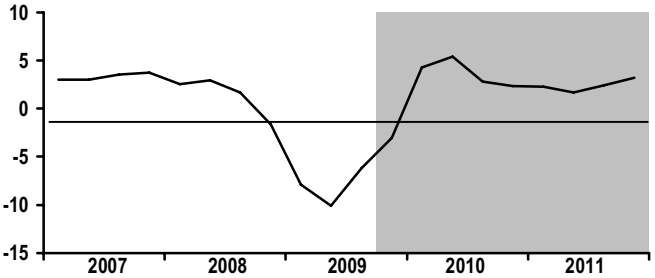
All in all, we believe that the clearer message coming out of the statement was that Banxico will not act soon, but that it is closely monitoring when and how one-off prices increases could spread more widely to other prices. As a result, going forward, we continue to forecast that Banco de México will hike interest rates by 25 bps in June (consensus: July) as the better macroeconomic outlook should enhance workers' bargaining power, probably translating into higher wages and inflation expectations and thereby triggering an interest rate hike by the end of the first half of the year.

Snapshot of Mexico's economic activity
%oya

	1Q09	2Q09	3Q09	4Q09	2009
GDP	**-7.9**	**-10.1**	**-6.2**	**-2.7**	**-6.7**
Agriculture	0.9	2.7	-1.1	0.0	0.7
Industry	-9.8	-11.5	-6.6	-2.4	-7.6
Services	-7.4	-10.2	-6.5	-3.3	-6.9
Nominal GDP	-3.1	-7.1	-3.3	2.3	-2.8

Source: INEGI and J.P. Morgan

Real GDP and forecast
%ch over 4 quarters



Source: INEGI

Pension fund regulator now allows portfolio managers to pick equities

The pension funds' regulator, *CONSAR*, published new investment guidelines for the *AFORES* during the week. *CONSAR*'s modifications focused on two issues: a more flexible Value-at-Risk (VaR), particularly during times of financial stress, and stock picking. In our view, the more flexible VaR will allow pension fund managers to adapt better to adverse financial market conditions, while the more open equity investment framework will provide more leeway for pension fund managers to improve their portfolios' risk-return profiles. In our view, the mechanism to make the VaR a more flexible metric does not represent a meaningful change in risk management regulations. As a result, we do not foresee sizable repositioning of pension funds' short-term portfolios, particularly in fixed income securities. On the equity front, however, we believe that these modifications will be a positive development for the Mexican equity market as a whole. The guarantee that their portfolio will not exceed the VaR limits in times of financial turmoil will likely provide a higher degree of confidence among portfolio managers to invest in the equity market.

We expect Banxico to announce a foreign reserve accumulation program very soon

In our view, the government has been concerned that the competitiveness gained from the depreciation of the peso in 2009 could be lost by speculative inflows in 2010. As a result, the Minister of Finance and the Banxico Governor

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have made comments about the possibility of implementing a foreign reserve accumulation program. It should be noted that the Foreign Exchange Committee—formed by members of the MoF and Banxico—sold nearly US$17 billion to market participants during 2009. In this context, we believe that the central bank will probably "revive" its USD put options mechanism in which it sells these options to commercial banks and they exercise the options, selling US dollars to Banxico whenever there is an apparent excess supply (i.e., when the strike price of the option is at or below the 20-day average USD/MXN spot rate). We believe that Banxico's board does not have an explicit targeted amount of reserve accumulation in mind. However, we expect that the central bank would be able to accumulate around US$10 billion from its "traditional sources" (e.g., Pemex and the government's bond issuance and loans), and would like to obtain at least US$2-3 billion from the option mechanism this year. We think the announcement will take place before the expiration of the IMF's Flexible Credit Line (April 1, 2010). However, it could be as early as next week.

Data releases and forecasts

Week of February 22 - 26

Mon Feb 22 9:00am — **Real GDP**
%oya, unless noted

	1Q09	2Q09	3Q09	4Q09
Total	-7.9	-10.1	-6.2	-2.7
%q/q saar	-23.4	-1.1	12.2	5.5
Agriculture	0.9	2.7	-1.1	0.0
Industry	-9.8	-11.5	-6.6	-2.4
Services	-7.4	-10.2	-6.5	-3.3

Mon Feb 22 9:00am — **Indicator of overall economic activity (IGAE)**

	Sep	Oct	Nov	Dec
%oya	-5.4	-5.2	-1.5	0.8
%m/m sa	0.8	0.3	1.5	0.9

Mon Feb 22 2:30pm — **Banamex CPI inflation expectations survey**
%oya, except policy rate: %p.a., median value

	Dec 21	Jan 12	Feb 4	Feb 22
End-2010	4.98	5.10	5.14	___
Core	4.47	4.69	4.62	___
End-2011	3.86	3.84	3.89	___
One year forward	4.98	4.65	4.54	___
Banxico policy rate (YE10)	5.50	5.50	5.25	___

Tue Feb 23 9:00am — **Retail sales**

	Sep	Oct	Nov	Dec
Retail sales				
%oya	--4.6	-4.6	-1.5	-1.2
%m/m sa	-0.1	-0.3	1.7	-0.7

Tue Feb 23 9:00am — **Trade balance**

	Oct	Nov	Dec	Jan
Balance (US$ mn)	-93	-195	-246	-225
ytd (US$ bn)	-4.2	-4.4	-4.7	-0.2
Exports (US$ bn)	22.0	22.3	22.9	21.9
%oya	-10.0	10.1	22.8	43.6
%m/m sa	7.4	5.5	0.5	14.3
Imports (US$ bn)	21.9	22.5	23.2	22.1
%oya	-21.1	-3.2	11.7	31.6
%m/m sa	2.0	7.7	-0.6	14.3

Tue Feb 23 9:00am — **Central bank foreign reserves**
US$ bn

	Jan 29	Feb 5	Feb 12	Feb 19
Gross international reserves	92.6	93.5	93.4	___
Change over week	1.4	0.9	-0.1	___

Wed Feb 24 9:00am — **Consumer prices**

	Dec 2H	Jan 1H	Jan 2H	Feb 1H
%2w/2w	0.22	0.75	0.45	0.32
Core	0.19	0.42	0.29	0.29
%oya	3.55	4.17	4.74	4.90
Core	4.46	4.64	4.76	4.76

Wed Feb 24 — **Nominal GDP**

	1Q09	2Q09	3Q09	4Q09
%oya	-3.1	-7.1	-3.3	-2.2
Deflator	5.2	3.3	3.1	0.8

Thu Feb 25 9:00am — **Balance of payments**
US$ bn

	1Q09	2Q09	3Q09	4Q09
Current account balance	-3.5	0.9	-1.9	0.4
Transfers	5.6	5.7	5.5	4.7
CA as % of GDP	-1.8	0.4	-0.8	0.2
Capital account balance	-1.2	-2.8	3.6	11.0
FDI	5.6	4.8	-0.6	2.0
Equity flows	1.3	0.1	2.1	0.6
Local bond market flows	-0.5	-0.1	2.2	1.8
Reserves, change	-6.6	-4.7	1.9	14.6

Thu Feb 25 9:00am — **Labor market report**
% of labor force

	Oct	Nov	Dec	Jan
Open unemployment rate	5.9	5.3	4.8	5.3

Review of past week's data

Consar report (Feb 16)
Mex$ bn

	Nov	Dec	Jan	
Assets under management	1124	1151	___	*1160*
Government securities	755	764	___	*772*
Equity investment	140	150	___	*147*

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Brazil

- **Hawkish data flow returns, with higher inflation expectations and strong labor market**
- **January pace of formal job creation was back to historically high levels, after a disappointing December**
- **Electoral race tightening as government candidate becomes better known**

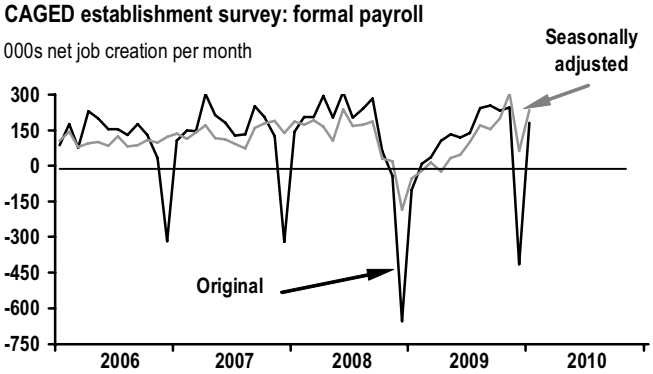
The more hawkish economic data flow was back in the headlines as the market reopened this week after the long Carnival weekend. The weekly BCB survey of market expectations showed another increase in this year's median IPCA projection to 4.80%, from 4.78%, while the median 2011 IPCA forecast remained flat at the targeted level of 4.50%. As in recent weeks, while the median for next year remains flat, the average of the survey continued to rise and is above the target at 4.64%. Also, the previews of February inflation from IPC-S and IPC-Fipe confirmed the expectations of deceleration to 1.04% and 1.09% from 1.33% and 1.29%, respectively, in the previous week. The reduction in the seasonal effect from the January increase in education fees, lower pressure from fresh food prices, and the absence of bus fare readjustments explained the bulk of this deceleration, but core inflation remains relatively high. In addition, despite the slowdown in the IPC-S and IPC-Fipe, methodological differences will likely keep the targeted IPCA on the rise in February. We expect the February IPCA-15 (released next week) to be 0.83% , up from 0.52% in January. Finally, the CAGED payroll report marked a new record for formal job creation in the month of January, reinforcing the view that final demand will remain well supported by real labor income, on top of credit expansion and high consumer and business confidence.

Formal net job creation back to historical highs

The January CAGED payroll report showed 181,419 new formal jobs, a record for the month of January. On a seasonally adjusted basis, we estimate a very strong January performance of 235,500, up from a disappointing 61,800 in December, to bring the pace of net job creation back up to its historical highs (first chart). Last month, gross job creation improved (+1.2%m/m sa) while the pace of gross job cuts decreased (-8.6%m/m sa), reinforcing the trend seen since the beginning of last year of a stabilization in monthly job cuts and a steady increase in gross job creation (second chart). Against this backdrop, even taking into account some acceleration in labor force growth (people looking for jobs), unemployment should continue to test

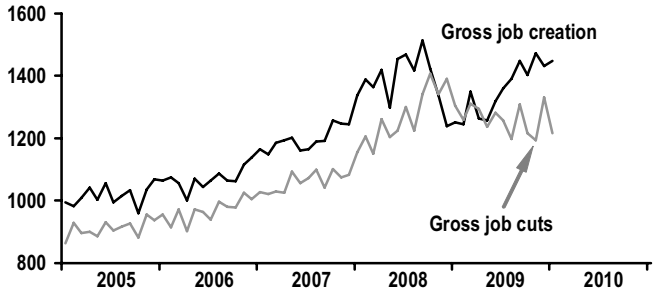
CAGED establishment survey: formal payroll

000s net job creation per month



CAGED establishment survey: job creation and cuts

000s, sa

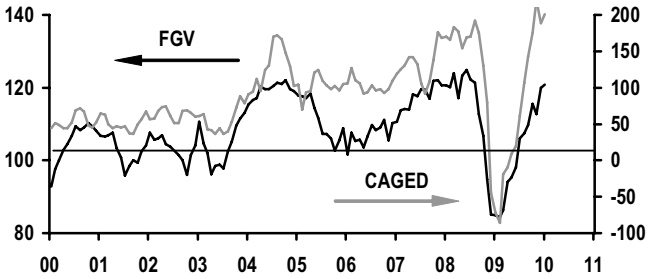


CAGED survey: net job creation

000s	Jan 10	Dec 09	Jan 09	Last 12 months avg.
Total	181.4	-415.2	-101.7	106.5
Manufacturing industry	68.9	-166.0	-55.1	11.2
Construction	54.3	-51.0	11.3	18.3
Commerce	-6.8	10.6	-50.8	28.4
Services	57.9	-68.1	2.5	46.3
Agriculture	4.1	-117.2	-12.1	0.1
Others	2.9	-23.5	2.5	2.1

CAGED and FGV manufacturing surveys of employment

Diffusion index — 000s of net job creation, 3-mma sa



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new lows this year. The formal employment expansion in January was broad-based across sectors, but manufacturing, civil construction, and services represented the bulk of the improvement from last year's report (table).

Serra's lead declining as Dilma's popularity rises

A new Ibope presidential election poll was released that confirmed that the candidate supported by the current administration is gaining momentum, taking advantage of the strong economic backdrop. In the survey, conducted in the beginning of this month, the percentage of respondents preferring the opposition candidate, Jose Serra, declined to 36% (from 38% in December), while the popularity of the government candidate, Dilma Roussef, increased to 25% (from 17%). The two other candidates registered 11% (Ciro Gomes), and 8% (Marina Silva). When Ciro Gomes is excluded from the poll, Serra's lead increases to 41% against 28% for Dilma and 10% for Marina. Although the presidential election will not take place until October, the policy debate beyond 2010 is starting to be monitored by market participants, and the release of official economic platforms from both opposition and government candidates will be the next event to be followed in the coming months.

Data releases and forecasts

Week of February 22 - 26

Tue Feb 23 6:00am — **Retail sales**

	Sep	Oct	Nov	Dec
%m/m sa	0.6	1.5	0.9	0.1
%oya nsa	5.1	8.6	8.7	10.7

Wed Feb 23 6:00am — **Consumer prices (IPCA-15)**
%m/m nsa, % weights in parentheses

	Nov	Dec	Jan	Feb
Total (100)	0.4	0.4	0.5	0.9
%oya	4.1	4.2	4.3	4.6
%ytd	3.8	4.2	0.5	1.4
Ex. volatile	0.3	0.5	0.5	0.8
Trimmed mean	0.4	0.4	0.5	0.5
By major component				
Food (20.5)	0.4	0.2	0.8	1.2
Transport (20.7)	1.0	0.8	0.6	1.3
Housing (13.6)	0.2	0.3	0.2	0.3

Wed Feb 23 7:30am — **Current account balance**
$ bn, net inflows

	Oct	Nov	Dec	Jan
Current account (CA)	-2.9	-3.3	-5.9	-5.3
Trade balance	1.3	0.6	2.1	-1.4
Services	-4.5	-4.1	-8.4	-4.2
Net transfers	0.2	0.2	0.3	0.3
CA, 12-month sum	-18.9	-21.2	24.3	27.1
CA, 12-month sum, %GDP	-1.3	-1.4	-1.6	-1.7
Foreign direct investment	1.6	1.6	5.1	4.0

Thu Feb 25 5:00am — **General prices (IGP-M)**
%m/m nsa

	Nov	Dec	Jan	Feb
Overall	0.1	-0.3	0.6	1.0
%oya	-1.6	-1.7	-0.7	0.0
Wholesale prices	0.1	-0.5	0.5	1.1
Consumer prices	0.1	0.2	1.0	0.9
Construction prices	0.2	0.2	0.5	0.5

Thu Feb 25 6:00am — **National unemployment**
% of labor force, new methodology

	Nov	Dec	Jan
Open rate, nsa (30 days)	7.4	7.0	7.7

Thu Feb 25 7:30am — **Public Sector Borrowing Requirement**
Minus denotes surplus

	Oct	Nov	Dec	Jan
R$ bn				
Primary	13.8	12.7	0.3	13.9
Primary, ytd	51.5	64.2	64.5	13.9
12-month sum, as % of GDP				
Primary	-1.0	-1.4	2.1	2.2
Interest payments	-5.5	-5.6	-5.4	-5.3
Nominal	4.2	4.2	3.3	3.1
Net debt, % of GDP	43.6	43.1	43.0	40.8

Review of past week's data

Formal Job Creation (CAGED)

	Nov	Dec	Jan
Monthly creation (1000)	246.7	-415.2	*181.4*
ytd, nsa	1410.3	*995.1*	*181.4*

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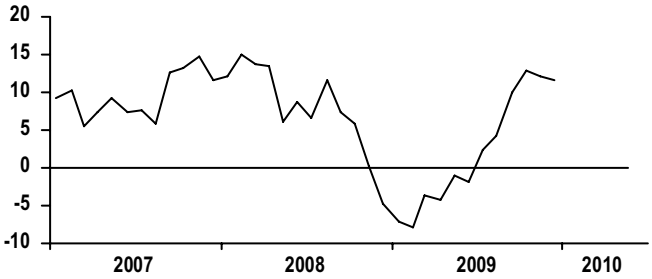
Andeans: Colombia, Ecuador, Peru, Venezuela

- **Peruvian GDP grew only 1.1% in 2009, but accelerated in the second half—to 11.5%q/q saar in 4Q09**
- **The central bank of Peru hinted at the end of the "low for long" strategy in the February meeting**
- **1Q10 Inflation Report in Colombia revealed concerns over short-term CPI but a still benign overall outlook**

Peru: GDP grew 1.1% in 2009 but showed sharp acceleration in 2H

% 3m/3m saar



December GDP was strong, confirming that economic activity rebounded sharply in 4Q09 on the back of a pickup in the manufacturing sector. On an over-year-ago basis, the December expansion stood at 6.4%, resulting in full-year GDP growth of 1.1% in 2009. Note that while 2009 growth was quite modest compared to 9.8% in 2008, this result was still relatively strong compared to the rest of Latin America. Furthermore, the end of last year saw a significant acceleration in GDP growth. Indeed, the seasonally adjusted data posted 1.2%m/m growth in December and 11.5%q/q annualized growth in 4Q09. The rebound in the manufacturing sector has underpinned the strong GDP performance lately; the manufacturing sector expanded 4.2%m/m sa in December and 18.9%q/q saar in 4Q09. Certainly the inventory cycle has been an important factor behind the pickup in manufacturing growth, and therefore the pace of growth will likely slow in the coming quarters. Nonetheless, we already see clear upside risks to our 5.5% GDP growth forecast for 2010, since: business confidence is still on the rise; banking credit is reaccelerating; fiscal stimulus should not end any time soon; and the carryover effect is close to 4.0%-pts, meaning that even in the absence of sequential growth in 2010, full-year growth should be relatively high.

BCRP hints at end of "low for long"

Peru's central bank left the policy rate unchanged at 1.25% in the February meeting, in line with expectations; however, the statement signaled a shift to a slightly more hawkish bias. On the one hand, the central bank is clear that it sees the recent uptick in inflation as a result of supply-side impulses and not yet indicative of demand pressure. Moreover, the central bank repeated the language from January's statement that the clear signs of economic recovery are not yet causing short-term inflationary pressures. Nonetheless, the central bank removed the now-familiar line that "absent important changes in the outlook for inflation and its determinants, no new adjustments to the reference rate are foreseen." This was replaced with a statement that the Board is "attentive" to the inflation outlook, and "if necessary will adopt preventive measures" to keep inflation within the target range. While the low core CPI inflation in January has allowed the BCRP to stay in its comfort zone for now, the authorities have recognized that the policy rate is clearly at a simulative level. The February BCRP statement reinforces our view that the odds of some monetary tightening by 2Q10, particularly through an increase in reserve requirements, is quite high. Our current forecast sees the policy rate being raised by midyear once inflation rebounds toward the BCRP's target (2.0% +/- 1.0%), with 150bp of hikes likely by year-end. However, we will look at upcoming inflation and activity figures with a bias to revising upward the 2010 GDP growth forecast and bringing forward the tightening call.

BanRep concerned with inflation in 1H10

The Colombian central bank (BanRep) released the 1Q10 Inflation Report unveiling new concerns over short-term inflation but reaffirming its benign medium-term forecasts. The report highlighted that recent figures suggest the El Niño phenomenon may indeed generate some upward pressure on food prices, particularly in 1H10. Additionally, recent increases in the value-added tax (particularly on beverages and cigarettes) along with higher fuel prices will boost upcoming inflation figures, and this may have a more lingering impact on inflation dynamics, depending on the response of inflation expectations (that indeed stopped falling in the February survey). At the same time, BanRep reaffirmed the view that the drag caused by falling exports to Venezuela and only a gradual recovery in domestic demand will preserve a relatively large output gap, and this should prevent a rekindling of now relatively tame underlying inflation.

Argentina:

Data releases and forecasts

Week of February 22 - 26

Fri Feb 19	**Industrial production**				
		Oct	**Nov**	**Dec**	**Jan**
	%oya	1.5	4.0	10.4	___
Fri Feb 19	**Economic activity**				
		Sep	**Oct**	**Nov**	**Dec**
	%oya	0.4	0.6	2.2	___
Mon Feb 22	**Unemployment rate**				
		1Q09	**2Q09**	**3Q09**	**4Q09**
	% of labor force	8.4	8.8	9.1	___
Tue Feb 23	**Trade balance**				
		Oct	**Nov**	**Dec**	**Jan**
	US$ bn	1.18	1.29	1.25	___
Fri Feb 26	**Construction activity**				
		Oct	**Nov**	**Dec**	**Jan**
	%oya	0.3	0.4	4.2	___
Week of Feb 22 - 26	**Budget balance**				
		Oct	**Nov**	**Dec**	**Jan**
	ARS bn	0.70	2.80	5.08	___

Review of past week's data

Consumer prices

	Nov	**Dec**	**Jan**
Consumer prices (%m/m)	0.8	0.9	___ *1.0*
%oya	7.1	7.7	___ *8.2*
Wholesale prices (%m/m)	0.9	1.0	___ *1.0*
%oya	8.5	10.0	___ *11.5*

Consumer confidence

	Dec	**Jan**	**Feb**
Consumer prices (%m/m)	40.22	45.56	___ *43.54*

Chile:

Data releases and forecasts

Week of February 22 - 26

Fri Feb 26	**Industrial production**				
		Oct	**Nov**	**Dec**	**Jan**
	%oya	-6.6	1.0	-0.3	___
Fri Feb 26	**Unemployment rate**				
		Oct	**Nov**	**Dec**	**Jan**
	% of labor force	9.7	9.1	8.6	___

Review of past week's data

No data released.

Colombia:

Data releases and forecasts

Week of February 22 - 26

Thu Feb 25	**Industrial production**				
	%oya				
		Sept	**Oct**	**Nov**	**Dec**
	Total	-3.59	-2.72	2.02	___
Thu Feb 25	**Real retail sales**				
		Sep	**Oct**	**Nov**	**Dec**
	%oya	-7.28	0.82	2.00	___
Fri Feb 26	**BanRep monetary policy meeting**				
	%p.a.				
		Nov	**Dec**	**Jan**	**Feb**
	Repo rate	3.5	3.5	3.5	3.5
Fri Feb 26	**Unemployment rate**				
		Oct	**Nov**	**Dec**	**Jan**
	% of labor force	12.4	12.1	12.3	___

Review of past week's data

Trade balance

	Oct	**Nov**	**Dec**
US$ bn	0.13	0.18	___ *0.29*

Peru:

Data releases and forecasts

Week of February 22 - 26

Fri Feb 26	**Real GDP**				
		1Q09	**2Q09**	**3Q09**	**4Q09**
	%oya nsa	2.0	-1.1	-0.4	3.40
	%q/q saar	-5.3	-2.0	9.3	12.9

Review of past week's data

Real GDP

	Oct	**Nov**	**Dec**
%oya nsa	0.83	4.20	~~4.0~~ *6.4*

Venezuela:

Data releases and forecasts

Week of February 22 - 26

Tue Feb 23	**Real GDP**				
		1Q09	**2Q09**	**3Q09**	**4Q09**
	%oya nsa	0.50	-2.40	-4.50	-4.80

Review of past week's data

No data releasesd.

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United Kingdom

- **Headline inflation hits 3.5% but tide of upside surprises is about to turn**
- **Snow impacting activity data; February CBI industry survey improves; 4Q GDP data next week**
- **MPC communication policy under fire**

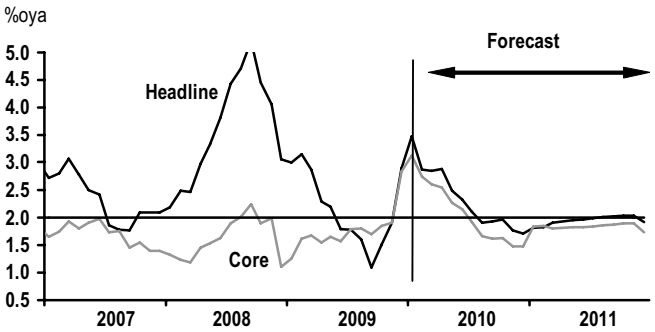
Since the middle of last year, we have been warning that the early 2010 hike in VAT would likely prompt an overshoot of 3% in CPI inflation. While the data delivered, with a move up to 3.5%oya in January, the last handful of releases has brought some better news in the breakdown. Through 2009, our key concern was that the long-lasting period of deflation in core goods prices had given way to a period of rising prices. That partially reflects passthrough of sterling's decline over 2007 to early 2009. But calibrating where core goods prices would settle as the exchange rate impact faded is tough.

Our working assumption has been that, aside from the impact of changes in indirect taxes, the price increases of 2009 would fade as we moved into 2010, and core goods prices would stabilize. Releases since October have shown a step down in the sequence of monthly observations for price gains in this sector once we allow for seasonality and the VAT hike. Assessing the impact of the latter is tricky, and there are some reports that retailers may have postponed VAT hikes until February rather than implementing them as the tax increased in January. Even so, we take the composition of January's release as supportive of the view that price gains in this sector are beginning to fade. Substantial uncertainties about the behavior of food and energy prices and the timing of future VAT moves remain (our forecast pencils in a hike in VAT to 20% in January 2011, but we acknowledge it could come sooner after the election). But the forecast shows inflation falling back substantially in the next release, and our best guess is that a second open letter from the Governor of the BoE will be avoided as inflation prints below 3.1% in the data for April. Though we doubt inflation will fall as low as the 1.5%-1.7% that the MPC forecasts for 4Q of this year, the next few months appear likely to see the tide of persistent upside inflation surprises reverse.

Activity uptrend buffeted by weather

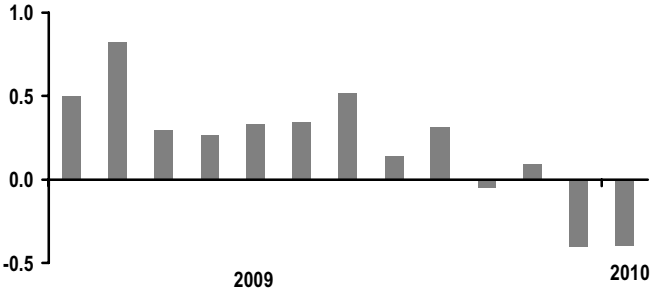
Activity-related releases continue to suggest a recovery is developing but are being buffeted by January's snowstorms. Claimant count unemployment recorded a surprise gain in January after two monthly declines, but with both inflows and outflows from the count falling in the month, weather disruption appears to have been the culprit. The trailing data based on a survey of households through to December

CPI inflation



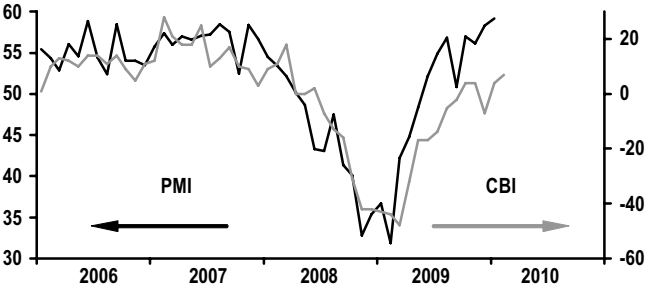
Monthly changes in core goods prices excluding est. VAT impact

% m/m sa by J.P. Morgan



Manufacturing: PMI versus CBI

% balance, sa, CBI is output expectations



show the unemployment rate stabilizing, but continued weakness in hours worked and virtually no growth in nominal pay. The CBI's survey of industry for February saw the main activity-related balances mark new highs for this upturn, although the levels remain below average and do not show the strength present in the PMI. Data from the bank of England show a marked drop in mortgage approvals in January, reflecting both the weather and the end of the holiday on stamp duty for lower-valued properties. Retail sales (excluding auto fuels) dropped 1.2%m/m in January. The ONS noted that retailers had cited weather conditions as a key source of this weakness. Virtually every direct measure of consumer spending has now fallen sharply in January. We expect sales to rebound in February—and the first indication of this will come from next week's CBI retail survey.

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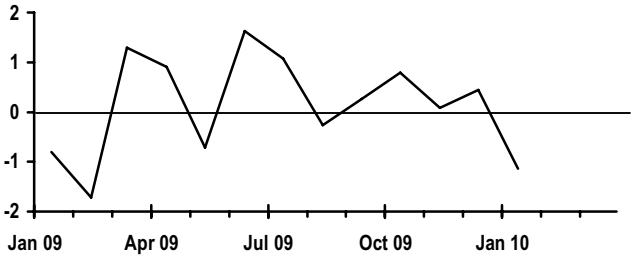
In light of this volatility, the challenge at the moment is to identify the underlying trend in spending. Our inclination is that this trend is showing modest improvement. Our tracker of household spending—which fuses together a range of monthly spending indicators—points to a firming in growth late last year, before the worst of the weather effects took place. Next week's 4Q GDP release will reveal last quarter's expenditure details. We look for a modest acceleration in consumption from 0.1%q/q to 0.3%q/q, and for business investment to have stabilized. Evidence that households are lifting spending and firms are no longer retrenching will be needed to validate our forecast that growth will accelerate at a 2%q/q saar pace in 1Q. We also look for 4Q GDP to be revised higher, showing a stronger trajectory for output. The December IP report, togther with the likelihood of an upward revision to services output, suggests GDP growth in 4Q could be revised from the initially reported 0.1%q/q to 0.3%q/q.

Retail sales

%m/m, sa, excludes auto fuel sales



Comparing two MPC inflation forecasts

	November	February
Mode	2.35	1.76
Mean	2.35	2.16
Probabilities		
At or above target	59	51
Above 2.5%	46	39
Below 1.5%	28	35

Forecast for CPI inflation two years hence assuming Bank rate at 0.5% and £200bn of asset

MPC communication: a critical view

Last week's Inflation Report press conference has generated some criticism of the MPC's communication policy. We regard much of that criticism as justified. Moreover, we would suggest that the quality of the MPC's communication with markets has been deteriorating for some time. Commentary from the MPC has become steadily less quantitative, while the explanation of both the channels of influence of QE and its magnitude has been a mess. At a time when fiscal policy is clearly leaning on credibility accumulated over time, and inflation is running well above the target, it may prove dangerous for the MPC to exploit its past credibility. The judgement of markets on UK policy has been benign to date, and it is important to keep it that way. Even accepting that the economic outlook is unusually uncertain, the MPC can do a better job of explaining itself.

Last week's Inflation Report press conference created a degree of confusion. The MPC lowered its central forecasts for both GDP growth and inflation but moderated the degree of downside risk associated with the growth forecast, while pushing inflation risks from balanced to the upside. Asked about the resulting distribution of the growth and inflation forecasts, Deputy Governor Charlie Bean suggested these were "about the same" as in November: "the big message that you should take away from this forecast is that our view of the average outlook going forward is pretty much where we were in November."

This week saw the MPC publish the detail of its forecasts. The distributions shown in February are not "about the same" as November. The differences are at least as large, and in some aspects larger, than we normally see comparing one Inflation Report with the next. To be more specific (here we focus on the inflation forecast assuming constant policy, as it is the comparison with fewest moving parts):

- The mean two-year-ahead forecast for inflation in November assuming unchanged policy was 2.35%. In February it is 2.16%. It is fair to point out that the shifting of risks mitigates the much larger fall in the modal projection for inflation (from 2.35% to 1.75%). But the 0.19%-pt reduction in the average inflation forecast is a meaningful downgrade. The median change in this forecast between Inflation Reports since 1997 is actually slightly smaller, at 0.155%-pt. It is also significant because the 2.35% mean forecast in November was actually the highest forecast relative to target the MPC has made since 2002 (while the modal forecast at 2.35% was the highest relative to target since independence). So looking at the average, the downgrade in February was of some size, and moved substantively away from the latent hawkishness of the November forecast.

- In November, the probability of inflation running above the target two years hence was put at 59%, with a 41% probability below. February saw that shift to an almost balanced 51%-49%. The 8%-pt swing in those probabilities is again a little above the median change seen in those probabilities between Inflation Reports. Meanwhile, the probability of inflation running above 2.5% was reduced by 7%-pts compared to November, while the probability of inflation running below 1.5% was raised by the same amount.

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The bottom line is that the February report did see a meaningful change compared to November, and it would have been clearer if the press conference had not tried to downplay that change. We would put the issues created by last week's Inflation Report alongside some more general problems of MPC commentary of late. Since the shift to the "new" Bank model over 2004-5, we would argue that commentary from the MPC, the Inflation Report, and other documents such as working papers have furnished markets and MPC watchers with less understanding of the quantitative elements of the forecast than previously. The Inflation Report document itself increasingly reads like the main chapters are dissociated from the forecast: At no stage does the document seek to show in a quantitative sense the interaction between the observations made in chapters 2-4 versus the forecasts for growth and inflation themselves.

This lack of quantitative clarity has been conspicuous as the MPC has attempted to "explain" asset purchases. The MPC has produced reams of material that describes the process linguistically. Unfortunately, the qualitative account differs as one moves from one MPC member to another. And anyone searching for an explanation why the scale of the program is £200 billion rather than £20 billion, £500 billion, or £1 trillion will find very little to work with.

If growth fails to accelerate, an extension of QE by the MPC is the first line of defense. How much confidence markets would have in that response in unclear, given that £200 billion has been spent already and the MPC has not offered a coherent account why that amount was chosen. It would be reasonable for markets to worry that the uncertainty created by continued extension of QE was a meaningful offset to its potential positive impact on activity. Given the risks on the fiscal side, it is important for the MPC to continue to act as a stabilizing force. Its lack of attention to providing careful quantitative detail about how its forecast and policy are evolving risks undermining that.

Data releases and forecasts

Week of February 22 - 26

During the week 8:00am

Nationwide house price index
Sa

	Nov	Dec	Jan	Feb
%m/m	0.6	0.5	1.2	0.5
%oya	2.7	5.9	8.6	11.2
%3m/3m saar	12.5	9.4	8.5	8.7

Look for a softer gain in house prices in February after last month's upside surprise. This would be consistent with the softer housing activity data.

Tue Feb 23 9:30am

BBA lending

	Oct	Nov	Dec	Jan
Secured lending (ch £ bn, sa)	3.2	3.4	3.5	3.6
Loan approvals (000s sa)[1]	42.5	44.9	45.9	40.0

1. For house purchase.

The trends in lending document published by the BoE showed a sharp decline in mortgage approvals from 60,000 to 49,000 in January. This is most likely weather related. We look for BBA to show the same.

Thu Feb 25 9:30pm

Business investment prelim
2000=100, sa

	1Q09	2Q09	3Q09	4Q09
%q/q	-8.8	-10.3	-0.6	0.2
%oya	-9.6	-21.3	-19.9	-18.4

The investment reading within the BCC survey picked up in 4Q but remained very weak. We look for business capex to have stabilized last quarter. This assumes that the sharp pace of contraction still going on in investment by the manufacturing sector eased substantially in 4Q, with the nonmanufacturing sector showing very modest growth.

Thu Feb 25 11:00am

CBI survey of distributive trades
% balance

	Nov	Dec	Jan	Feb
Volume of retailer sales	13	13	-8	8

The January survey showed clear evidence of a drag from the VAT hike and poor weather at the start of the year. Retailers expected an improvement in sales in February, but not by much. We assume sales will bounce back more significantly in February.

Fri Feb 26 12:01am

Gfk consumer confidence
Sa

	Nov	Dec	Jan	Feb
% balance	-17	-19	-17	-16

Consumer confidence strengthened in January despite most other consumer surveys weakening in the month. This has encouraged us to believe that consumer attitudes toward spending held up at the start of the year, despite the weather keeping people away from the shops.

Fri Feb 26 9:30am

Real GDP (2nd estimate)
Sa

	2Q09	3Q09	4Q09[1]	4Q09
Total GDP (%q/q)	-0.7	-0.2	0.1	0.3
%oya	-5.8	-5.1	-3.2	-3.3
%q/q ar	-2.7	-0.6	0.4	1.1

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Breakdown (%q/q sa)				
Private consumption	-0.7	0.1	__	0.3
Public consumption	0.7	0.3	__	0.4
Fixed investment	-5.9	2.2	__	0.5
Exports	-2.2	0.8	__	3.2
Imports	-3.2	1.5	__	4.9

1. Preliminary outcome.

The stronger gain reported in December IP points to an upward revision to GDP to 0.2%q/q in 4Q. The downward trajectory of services output during the quarter—which looks odd—suggests GDP could be revised even higher. We have assumed that will happen in this release, taking GDP growth up to 0.3%—and leaving a better growth trajectory in place for the current quarter.

This release of GDP will contain the expenditure details. The monthly data suggest net trade was a significant drag on growth in the quarter. We expect final demand was a significant offset to this drag, with consumption growing 0.3% and a rise in total investment. This would increase our confidence that a recovery can be sustained in the current quarter. The risk is that consumption was weaker than we have assumed, with inventories providing a greater lift to growth.

Fri Feb 26 9:30am

Index of services
Sa

	Sep	Oct	Nov	Dec
%m/m	0.5	0.0	0.1	0.2
%oya	-3.8	-3.8	-2.2	-1.8
%3m/3m saar	-0.9	-0.9	0.4	1.0

Review of past week's data

Rightmove house price index

	Dec	Jan	Feb	
%m/m nsa	-2.2	0.4	__	*3.2*

Retail prices

%oya

	Nov	Dec	Jan	
CPI	1.9	2.9	~~3.4~~	*3.5*
Core CPI[1]	1.9	2.8	~~3.3~~	*3.1*
RPI (1987=100)	216.6	218.0	*217.9*	
RPI	0.3	2.4	*3.7*	
RPIX	2.7	3.8	*4.6*	

1. CPI ex food, energy, alcohol, and tobacco.

See main text.

DCLG monthly house price data

	Oct		Nov		Dec	
All dwellings (%oya, nsa)	~~-2.2~~	*-2.3*	~~0.6~~	*0.5*	__	*2.9*

BoE's minutes of Feb MPC meeting

The minutes of the February MPC meeting report a unanimous vote to pause QE even as the majority recognized that case for an extension of QE could be made on the basis of the February Inflation Report projections. See main text.

Labor market statistics

Seasonally adjusted

	Nov		Dec		Jan	
Claimant count (000s ch m/m)	-10.8		~~-15.2~~	*-9.6*	~~-12.0~~	*23.5*
Claimant count rate (%)	5.0		5.0		*5.0*	
	Oct		**Nov**		**Dec**	
Average weekly earnings (3mma %oya)						
Headline	0.6		~~0.7~~	*0.8*	~~0.9~~	*0.8*
ex bonuses	1.2		~~1.1~~	*1.2*	*1.2*	
Private sector ex bonuses	0.3		0.2		~~0.1~~	*0.2*
Three months to:	**Jun**		**Sep**		**Dec**	
Labor force survey (all % rates)						
Activity rate	63.5		63.4		~~63.3~~	*63.2*
Employment rate	58.5		58.4		~~58.4~~	*58.3*
Unemployment rate	7.8		7.8		~~7.7~~	*7.8*

See main text.

Provisional estimates of M4 money and credit

Seasonally adjusted

	Nov		Dec		Jan	
M4 (%m/m)	~~0.1~~	*0.0*	~~-1.1~~	*-0.9*	__	*0.6*
M4 (%oya)	9.2		~~6.4~~	*6.6*	__	*5.1*
M4 lending (%m/m)[1]	-0.2		~~-0.1~~	*0.0*	__	*0.0*
M4 lending (%oya)[1]	~~6.3~~	*6.2*	4.7		__	*4.3*

1. Excludes the effect of securitization.

The holdings of nonbank financial corporations—especially those that intermediate between banks—have been a particular source of volatility in M4, and were likely responsible for the gain in M4 in January.

Public sector finances

£ bn nsa

	Nov		Dec		Jan	
PSNCR	~~14.6~~	*14.7*	23.6		__	*-11.8*
PSNB	~~18.7~~	*17.9*	~~15.7~~	*14.0*	~~-0.4~~	*4.3*
Balance on current budget	~~-15.2~~	*-14.4*	~~-11.5~~	*-10.3*	~~6.3~~	*1.2*
Net debt to GDP (%)	60.1		~~61.7~~	*61.4*	__	*59.9*

The January public finances showed the first deficit since records began in 1993. Nevertheless, the public finances are actually looking in better shape than the Chancellor thought in the PBR. Borrowing for the fiscal year through to December was revised down in January by nearly £2 billion. And with only two months of the current fiscal year to go, it looks like the PSNB will come in at just under £160 billion for the FY2009/10 reporting period, or 11.4% of GDP (HMT 12.6%).

CBI industrial trends

% balance

	Dec	Jan	Feb	
Total order book	-42	-39	*-36*	
Output expectations	-7	4	*7*	
Output prices	-6	8	__	*8*

See main text.

Retail sales

Volumes, seasonally adjusted, excluding auto fuels

	Nov		Dec		Jan	
%m/m	~~-0.3~~	*0.1*	0.4		~~-1.0~~	*-1.2*
%oya	~~2.7~~	*4.1*	~~2.1~~	*2.9*	~~0.6~~	*2.6*
% 3m/3m saar	~~2.8~~	*4.1*	~~2.9~~	*4.4*	~~0.4~~	*2.5*

See main text.

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Russia

- **Mixed economic activity data for January**
- **Consumer inflation remains muted; CBR cuts**
- **The ruble has started to appreciate again**

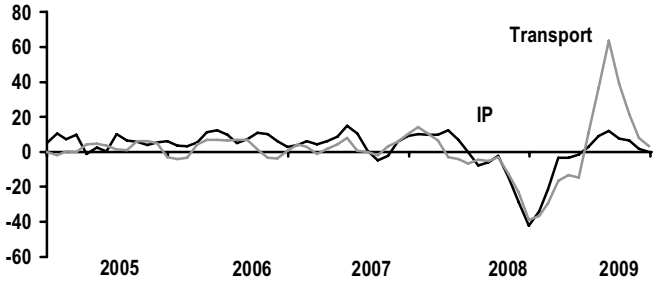
The past week brought some mixed signals about economic activity in Russia, which were additionally complicated by weather effects and a change in methodology in estimating industrial production. The latter was the change of the base year from 2002 to 2008 (the structure of industrial production changed significantly during this period). The problem was not this change itself, but rather the resulting absence of any historical series based on the new base-year weights. It was thus particularly hard to extract the correct signal from the January IP reading, which printed above expectations in over-year-ago terms (7.8% versus an expected 5%), while the month-on-month nsa decline was unusually deep (due, we think, to an increased share of volatile manufacturing in the structure of the index; we were unable to perform seasonal smoothing without a historical series). Our rough estimates suggest that there likely was a small sequential increase in IP in January, but we are unlikely to get more clarity until midyear, when the Rosstat is scheduled to publish the newest historical IP series.

At the same time, cold weather seems to have substantially affected several other activity indicators. Construction, which is particularly sensitive to weather conditions in winter, plunged around 2%m/m sa (seasonally adjusted by J.P. Morgan). Accordingly, investment was down 1.4%m/m sa, and transport turnover fell 1.3%. Adverse weather effects likely also contributed to the steep rise in unemployment from 8.2% to 9.2% nsa in January (+0.4%-pt in seasonally adjusted terms). On the positive side, private consumption indicators have continued to rise. Food retail sales increased 1.6%m/m sa, likely driven primarily by increased demand from pensioners, who received a 45% increase in their (state) pensions starting in early 2010. Non-food sales have also continued to gain momentum, rising 1.2%m/m sa, while consumption of services edged up by 0.2%.

Consumer price inflation pressures have remained muted. Over the first two weeks of February, prices rose only 0.4%, driven mainly by seasonal inflation in a few food product groups. For the full month of February, consumer inflation seems to be on track to print at around 0.7%-1.0%m/m, which would reduce over-year-ago inflation from 8% to 7%-7.3% this month.

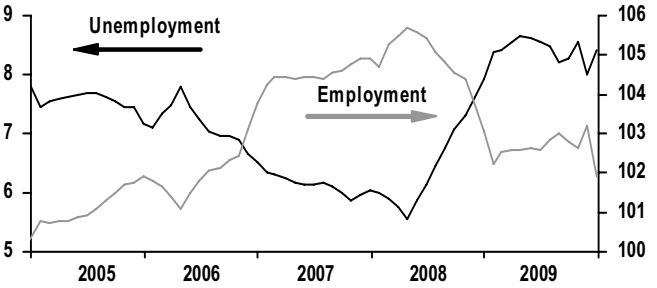
Industrial production vs. cargo transport turnover growth

%3m/3m sa



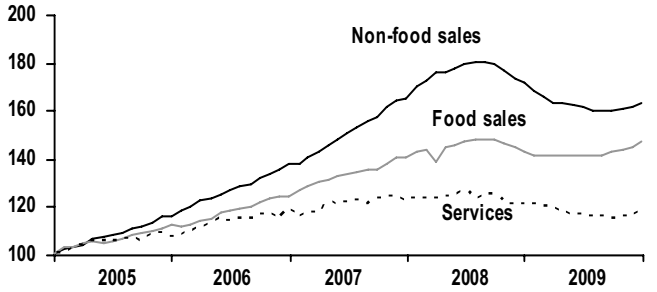
Unemployment vs. employment

%, sa by J.P. Morgan Dec.04 = 100, sa by J.P. Morgan



Real retail sales and consumption of services

Index, Dec.04 = 100, sa by J.P. Morgan



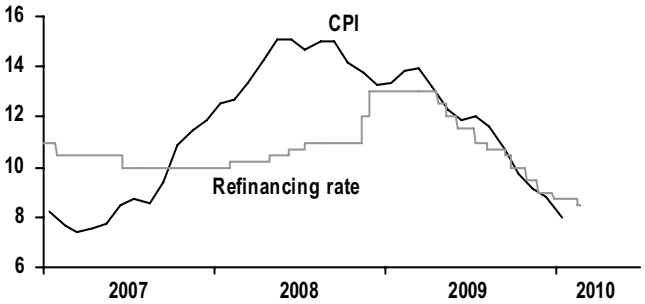
Steady deceleration of inflation, uneven signals from the real economy, and still stagnant credit activity pushed the CBR to another 25bp rate cut on February 19. The step came as no surprise as the potential cut had been vaguely signaled by CBR Deputy Chairman Ulyukaev last week. With real rates elevated, inflation muted, the CBR lagging other EM central banks in its easing cycle, and the output gap still large, we expect that the CBR will cut another 75bp in 1H10, with 25bp to be delivered in March.

The next Russia data watch will be published on March 5.

Renewed ruble appreciation will be an additional factor encouraging a rate cut, we believe. After a weak January, February apparently brought another wave of capital inflows in Russia, which pushed the ruble toward the lower bound of the dual-currency basket last week. In line with its previous statements that the boundaries of the floating ruble corridor would move by 5 kopecks per every US$700 million of FX intervention, the CBR has moved the corridor from 35-38 to 34.8-37.8. The gradual economic recovery, strong current account and modest fiscal deficit, combined with the fact that the ruble has lagged the appreciation of other commodity currencies, are likely to keep the ruble under appreciation pressures in coming quarters, we believe.

Refinancing rate vs. CPI

%oya, %pa



Data releases and forecasts

Weeks of February 22 - March 5

Consumer prices

	Nov	Dec	Jan	Feb
%m/m, nsa	0.3	0.4	1.6	0.9
%oya	9.1	8.8	8.0	7.2

Merchandise trade

$ mn nsa

	Oct	Nov	Dec	Jan
Broad money, M2	13875	14224	15698	14827
%m/m, nsa	1.6	2.5	10.4	-5.5
%oya	2.6	7.5	16.3	23.7
Cash in circulation	3567	3600	4038	3888
%m/m, nsa	2.3	0.9	12.2	-3.7
%oya	-10.0	-5.1	6.4	17.4
Bank deposits	10308	10624	11660	10939
%m/m, nsa	1.4	3.1	9.7	-6.2
%oya	7.9	12.6	20.2	26.1

Review of past two weeks' data

Industrial production

	Nov	Dec	Jan	
%oya	1.5	2.7	~~-5.0~~	7.8
Mining	4.9	4.9	___	6.9
Manufacturing	-0.8	0.7	___	7.6
Electricity, gas, water	1.4	4.5	___	8.4

Industrial producer prices

	Nov	Dec	Jan	
%m/m, nsa	-0.5	0.5	~~0.5~~	*-1.0*
%oya	6.5	13.9	~~17.8~~	*33.1*

Real economy indicators

Real terms, %oya

	Nov	Dec	Jan	
Construction	-13.2	-6.2	___	*-10.6*
Agriculture	5.6	6.9	___	*3.2*
Transportation	5.1	6.4	___	*11.3*
Retail sales	-6.4	-3.6	~~-3.5~~	*0.3*
Fixed investment	-14.8	-8.9	~~1.0~~	*-8.7*
Income per capita	3.5	7.6	~~7.0~~	*7.1*
Average monthly wage due	-0.5	0.6	~~0.7~~	*2.6*

Federal budget

RUB bn, cash flows

	Nov	Dec	Jan	
Balance	-252	-593	~~350~~	66
% of GDP	-7.2	-16.0	~~14.8~~	2.4
Revenue	658	890	~~850~~	738
Tax revenue	625	763	~~800~~	576
Expenditure	910	1483	~~500~~	671
Noninterest	900	1466	~~480~~	654
% of GDP	25.6	39.5	~~20.3~~	23.3

International reserves

$ bn, eop

	Dec	Jan	Feb 12	
Gross international reserves	439.0	435.8	___	*431.5*
Gold	22.4	22.3	___	

Market indicators

End of period

	Dec	Jan	Feb 18
USD/RUB (official CBR)	30.19	30.43	30.11
RTS index ($ terms)	1445	1474	1411

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Turkey

- **Fiscal performance continues to improve**
- **This should reduce the domestic borrowing needs of the Treasury**
- **Pre-election spending is the main risk**

Some tax hikes along with a cyclical improvement in tax collection and some spending discipline led to a significant improvement in fiscal performance in January. Although it remains to be seen whether the spending discipline is maintained, the fiscal performance in the last three months has made us more confident that this year's fiscal targets will be overachieved comfortably. The improvement in fiscal performance suggests that the domestic debt rollover ratio could fall from around 100% to around 90% in the coming months. There are two risks to this benign scenario: economic activity loses momentum, resulting in a weakening in tax collection, or the government increases spending as we approach next year's general election. We think that the second risk is higher but, even in this case, spending discipline should be eased only toward the end of the year.

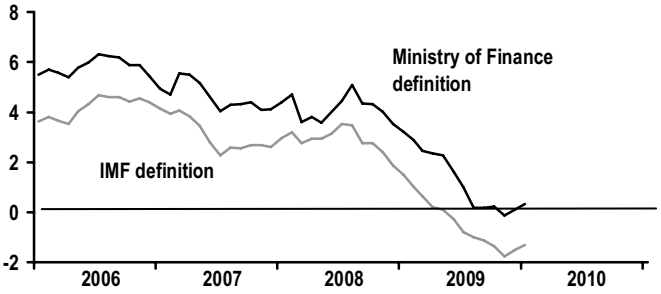
The central government secured a primary surplus of TRY3.0 billion in January. This compared very favorably with the January 2009 surplus of just TRY0.8 billion. Looking at the IMF-defined primary surplus (which among other things excludes privatization and interest revenues), we see a similar improvement from TRY0.7 billion in January 2009 to TRY2.9 billion this year. As a result, the 12-month trailing primary surplus rose from 0.1% of GDP in December to 0.3% in January. We forecast a primary surplus of 0.7% of GDP, which would translate into a cash budget deficit this year of 3.7% of GDP (the official target is 4.7%). The performance in recent months suggests that even our forecast could prove to be too pessimistic.

Looking at the details of the January budget data, we see that the strongest revenue performance comes from indirect tax collection. This reflects the recovery in domestic demand and more importantly the tax hikes on petroleum, tobacco, and alcoholic beverages. The impact of tax hikes can be vividly seen in the 37%m/m rise in special tax collection on tobacco. Another factor behind the high oya growth rates is the weak base. Looking at monthly data, sequential growth is slower. Accounting for the impact of the tax hikes, the growth in tax revenues points to a gradual recovery in domestic demand. Encouragingly, the rise in non-interest expenditures is much slower than that in tax revenues, suggesting early signs of some spending discipline. The rise in personnel expenditures was mainly due to the introduction of a general health insurance system, which led to an increase in premium payments recorded under personnel expenditures and a corresponding decline in other current transfers. Also improving fiscal performance are the measures implemented in healthcare. In order to slow the rapid expansion in healthcare expenditures, the government raised patients' copayments sixfold and introduced a global budgeting system. The results of these measures will be closely watched.

All in all, the improvement in fiscal performance implies that the fiscal targets for 2010 and 2011 in the medium-term fiscal program can be achieved more easily. It will also lead to a decline in the Treasury's borrowing requirements. However, domestic borrowing requirements should remain high and fiscal discipline will remain key to promote demand for auctions in the coming months.

Primary balance of central government

% of GDP



Central government balance: January

TRY bn

	2009	2010	% change[1]
Revenues	15.8	19.5	14.0
Tax revenues	13.8	17.3	15.7
Income tax	4.1	3.9	-12.9
Corporate tax	0.1	0.1	-18.6
SCT	3.2	4.1	18.9
Domestic VAT	1.9	2.9	38.4
Import VAT	1.7	2.9	63.3
Other tax	2.8	3.4	11.9
Non-tax	2.0	2.2	2.4
Expenditures	18.8	22.6	11.4
Non-interest	15.0	16.6	1.9
Personnel	6.3	7.4	7.3
Other current	1.1	0.7	-38.0
Investment	0.0	0.0	271.5
Social security	4.3	4.8	3.8
Other	3.3	3.7	1.7
Interest	3.8	6.1	48.8
Primary balance	0.8	3.0	236.1
Budget Balance	**-3.0**	**-3.1**	**-2.8**

[1] CPI-adjusted.

The next Turkey data watch will be published on March 5.

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Data releases and forecasts

Weeks of February 22 - March 5

Mon Feb 22 10:00am

Capacity utilization

%

	Nov	Dec	Jan	Feb
Total manufacturing	69.2	67.6	67.8	67.5
Durables	66.9	64.3	63.9	64.0
Nondurables	71.5	69.8	69.9	70.5

Manufacturing capacity usage likely remained stable in February. Seasonal factors are expected to be offset by the bottoming out of domestic and external demand.

Fri Feb 26 10:00am

Foreign trade

US$ bn, except as noted

	Oct	Nov	Dec	Jan
Trade balance	-2.6	-3.7	-4.9	-2.2
Exports (FOB)	10.1	8.9	10.1	8.3
%oya	3.9	-5.2	30.3	5.3
Imports (CIF)	12.7	12.6	15.0	10.5
%oya	-14.8	4.5	31.4	13.1

The fall in foreign trade volume is mainly due to seasonal factors. Otherwise, the recovery in global demand supported exports, while the recovery in domestic demand likely resulted in an increase in imports, especially of consumer goods.

Wed Mar 3 10:00am

Inflation

%

	Nov	Dec	Jan	Feb
Consumer prices				
%oya	5.5	6.5	8.2	9.3
%m/m	1.3	0.5	1.9	0.7
Producer prices				
%oya	1.5	5.9	6.3	6.3
%m/m	1.3	0.7	0.6	1.2
Core CPI (I)				
%oya	4.1	3.8	3.8	4.2
%m/m	2.3	-0.4	-0.5	-0.3

A weak base and increases in unprocessed food prices likely led to a jump in headline inflation in February. Core inflation should have remained benign.

Review of past two weeks' data

Balance of payments

US$ bn

	Oct	Nov	Dec	
Current account	0.3	-1.8	~~-3.4~~	*-3.2*
Trade balance	-1.3	-2.6	~~-3.6~~	*-3.4*
Exports, fob	10.8	9.5	~~10.6~~	*10.7*
Imports, fob	12.1	12.1	14.2	
Net invisibles and transfers	1.6	0.8	0.2	
Capital account	-0.2	0.4	~~1.0~~	*2.3*
Overall balance	0.0	-0.5	~~0.7~~	*1.3*

The current account deficit started widening again, mainly on the back of higher energy prices and the recovery in domestic demand. However, this widening will likely be gradual as the recovery both in economic activity and in global energy prices should also be gradual. Interestingly, as economic activity started to recover, private sector external borrowing started to rise. Given the improvement in external financing conditions, the fall in external financing needs of the private sector, and the recovery in portfolio inflows, the deficit should be financed very comfortably.

Consumer confidence

Index

	Oct	Nov	Dec	
Consumer confidence	80.5	78.4	~~79.0~~	*78.8*
Purchasing power—current	74.0	72.6	~~73.3~~	*72.5*
Purchasing power—future	77.7	76.3	~~76.5~~	*77.6*
Economic setting	76.2	73.5	~~74.3~~	*73.0*
Employment	72.6	72.3	~~72.0~~	*72.2*

The recovery in sentiment mainly follows the improvement in global demand. Respondents note no major improvement in current purchasing power and are hopeful about an improvement in the coming months.

Labor data

%

	Sep	Oct	Nov	
Unemployment	13.4	13.0	~~13.3~~	*13.1*
Nonfarm payrolls (%y/y)	-0.5	0.9	~~3.0~~	*2.0*
Labor participation rate	49.0	48.8	~~48.6~~	*48.1*

Although unemployment remains high and labor participation is low, it was encouraging to see an improvement in nonfarm payrolls. We expect this improvement to continue gradually over the coming months.

CBRT rate decision

%

	Dec	Jan	Feb
CBRT ON borrowing rate	6.50	6.50	6.50

As universally expected, CBRT left its key ON borrowing rate unchanged at 6.5%. The statement clearly shows that the Bank will try to keep rates unchanged for a long period of time. The CBRT will be comfortable with the current policy unless core inflation rises above 6.5% or the credibility of the Bank and the inflation-targeting regime is jeopardized.

Central government budget

TRY bn, current prices

	Nov	Dec	Jan	
Expenditures	20.9	27.7	~~23.1~~	*22.6*
Interest	1.9	1.0	6.1	
Non-interest	19.0	26.7	~~17.0~~	*16.6*
Revenues	17.8	21.9	~~19.2~~	*19.5*
Taxes	15.1	18.2	~~17.0~~	*17.3*
Primary balance	-1.2	-4.8	~~2.2~~	*3.0*
Budget balance	-3.1	-5.9	~~-3.9~~	*-3.1*

See main text.

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Australia and New Zealand

- **RBA commentary hints Board members will stay on sidelines in March**
- **Aussie credit growth probably eased in January**
- **Business confidence likely dropped in New Zealand**

A flurry of RBA commentary kept market pundits alert this week. Tuesday's minutes seemed more dovish in tone than the statement two weeks earlier announcing the Board's shock decision to leave the cash rate unchanged. Assistant Governor (Economic) Philip Lowe's speech Thursday, though, was more upbeat, although it highlighted again the official anxiety about the strength of the household sector. This was a key theme in RBA Governor Glenn Stevens' Parliamentary testimony on Friday, too, which went even further in highlighting heightened uncertainty.

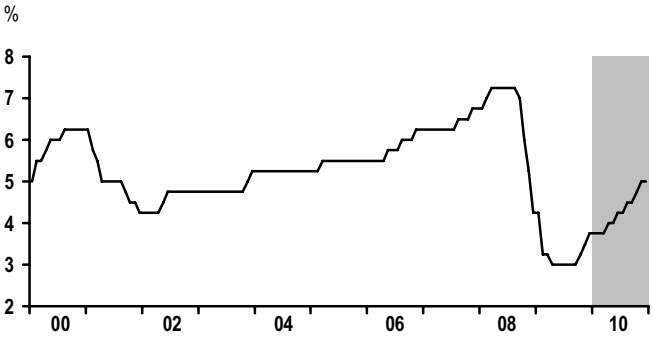
In New Zealand, there was little to chew on this week, aside from the fourth-quarter PPI numbers. The PPI print has few direct implications for the RBNZ but, along with a persistent stream of soft data, reaffirms our view that the RBNZ will sit on the sidelines in coming months. In a change of forecast, as discussed in detail in this week's research note "RBNZ probably will hold to hinted midyear tightening," we now expect Governor Bollard will kick off the tightening cycle in July with a 50bp hike. Previously, we had forecast a 25bp move in April.

RBA minutes more dovish

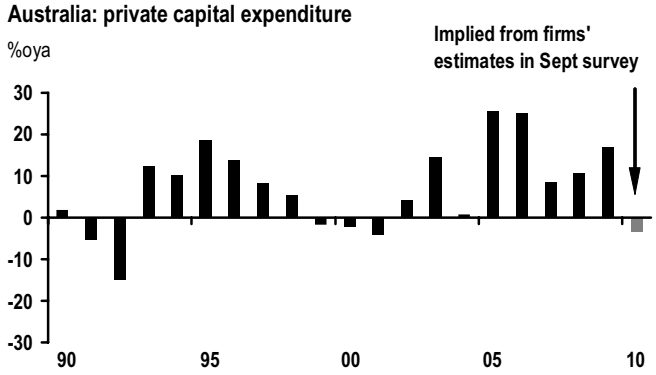
The RBA this week released the minutes of the February Board meeting at which members left the cash rate steady at 3.75%. That decision two weeks ago, which the minutes described as "finely balanced" (as was the case in December, when the RBA did hike) came as a shock to us and other market economists; we had expected another 25bp rate hike. The main message from the minutes is that the RBA is in no rush to hike again. Further hikes are coming, that remains clear, but the risk now is that the pause the RBA has embarked on could last longer than we currently expect. We are sticking with our call for the next hike to come in April but, on this week's evidence, the next hike even could come as late as midyear.

The tone of the commentary announcing the "on hold" decision on February 2 was unexpectedly upbeat—it would have sat comfortably with an announcement of another hike. This week's "commentary" is noticeably more balanced. As expected, the minutes reveal that officials left the cash rate unchanged two weeks ago because evidence on

Australia: RBA cash target rate



Australia: private capital expenditure



how the economy (and, in particular, households) was handling the earlier rate hikes was "mixed." Officials wanted more time to assess how, and at what speed, the earlier rates hikes were feeding through to the domestic economy. The level of uncertainty is unusually high because the Aussie banks have out-hiked the RBA.

Indeed, in testimony to parliament Friday, RBA Governor Stevens said the February pause was made partly on the basis that the Aussie banks had out-hiked the RBA. This meant that the burden on households, and the uncertainty about how they would react, was larger than would otherwise be the case. It seems, though, that the sovereign events in Europe and the likely impact of policy tightening in China also were prominent in the RBA's thinking. The sovereign debt issues in Europe, however, were important only at the margin.

On the domestic economy, the Governor on Friday reiterated the point that Australia seems to have emerged from the global downturn in better shape than most. The country now is in a good position to benefit from rapid growth in its major export markets in Asia. The challenge now, according to Stevens, is to manage the next period of expansion, not limit damage in a downturn. Issues like capacity, productivity, and flexibility, therefore, once again will take

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center stage. Recent changes to labor laws add another level of complexity: according to Stevens, the flexibility available to Australian employers played a big role in limiting the rise in the jobless rate.

The Governor indicated two key challenges for conditions offshore. The first is that there seem to be two speeds of global recovery. In many of the smaller emerging economies, the recovery is V-shaped. In the larger developed economies, though, conditions remain mixed, with accommodative policy settings still playing an important role in supporting activity. The second challenge is the increasing focus on sovereign creditworthiness. Dealing with the substantial increase in the size of government balance sheets will require a "delicate balancing act."

What's next for RBA?

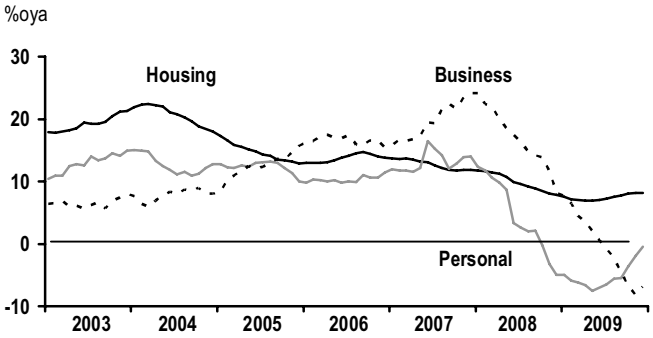
With the cash rate still very accommodative, the Bank's seemingly rosy outlook for Australia—officials expect GDP growth to be above trend—indicates that there are further rate hikes ahead. The RBA has paused on the way to a significantly higher cash rate; it has not stopped the tightening cycle. Indeed, we still expect the cash rate to be 5% at the end of 2010, but with slightly more of the tightening now likely to come in 2H10. Previously, we had expected a more even spread of rates hikes.

In our view, the cash rate will rise a further 125bp over the remainder of 2010, but, given heightened uncertainty on how local consumers are dealing with the rate hikes already delivered, the next rise will not come until April. Indeed, by the time of the next Board meeting in early March, we suspect Board members still will be uncertain about how the local punters are dealing with the earlier rate hikes. Next week's speech by the RBA Deputy Governor is the only RBA event scheduled ahead of the March decision.

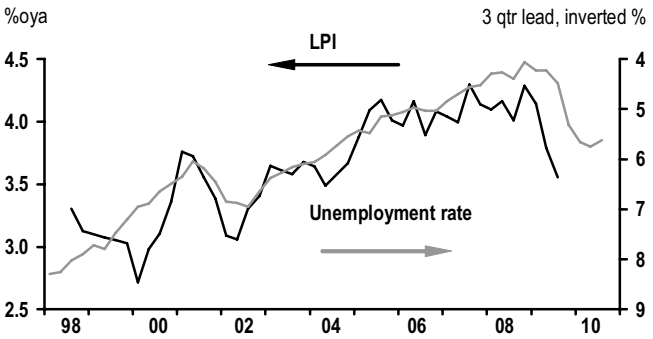
Mining firms to upgrade capex plans

Next week sees the release of the December quarter private investment survey. This is one of the few important data releases scheduled before the March 2 RBA decision. The survey will include the first glimpse of firms' spending plans for the year ended June 2011 and provide an update on plans for the current fiscal year. One reason the RBA was the first central bank in the G-20 to raise the cash rate was because the economy rebounded unexpectedly quickly, partly owing to a rapid swelling of the investment pipeline that capped the rise in unemployment. The capex survey will provide important color on whether the pipeline continues to expand.

Australia: private sector credit aggregates



Australia: labor price index and unemployment



For 2009/10, the spending estimate probably will print at A$110 billion, which will imply a broadly flat outcome from the previous year. Given the collapse in investment spending outside Australia and the depths of the recession in some of Australia's key export markets, this will be a remarkably good outcome. For 2010/11, the survey should show that firms plan to spend just over A$100 billion. While this implies a fall from 2009/10, firms always underestimate spending in the early investment surveys. Using the long-term estimation error as a guide, this outcome will imply something like a 20% rise from the previous year. The majority of upgrades will be in the mining industry.

Credit growth to ease on housing finance

The RBA's January credit aggregates should show a fall in credit growth to 0.2%m/m, from 0.3%. This will push growth over the year down to just 1.1%oya. Credit to housing probably eased a notch to 0.6%m/m in January, owing to the end of the expanded first home buyers' (FHBs') grant on December 31, the introduction of caps on the original FHBs' grant from January 1, and, of course, rising market interest rates. Personal credit growth will have slowed to 0.5%m/m in the wake of the RBA tightening.

Credit to businesses probably contracted for the twelfth straight month in January, falling 0.4%m/m. Total business

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credit growth will likely remain contained this year given that larger companies are relying on capital markets for the majority of their funding. That said, local banks will likely make more credit available to smaller businesses, given the more attractive returns available from higher-risk lending.

Fading slack will force uptick in LPI

Australia's labor price index probably rose 0.8%q/q in 4Q, slightly higher than the 0.7% recorded in the previous quarter, which had marked a five-year low. This result would translate to over-year-ago growth of 3.1%, the slowest rate since June 2002. Wage growth near term probably will remain subdued but, given that the unemployment rate already has peaked, should accelerate in the second half of the year, especially given that skill shortages and capacity constraints will again rear their heads. Highly skilled jobs are critical to the economy given that another resource boom is getting under way due to China's insatiable demand for the nation's key commodity exports, iron ore and coal.

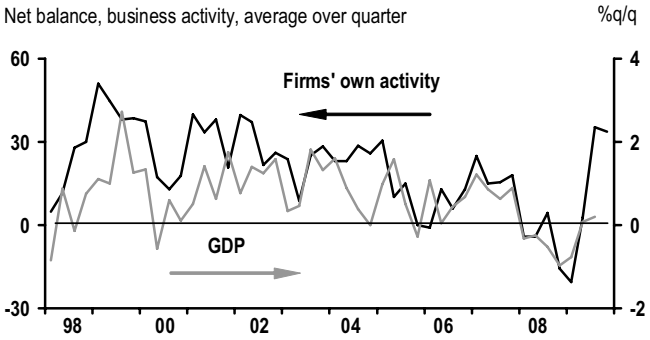
On this note, RBA Assistant Governor (Economic) Philip Lowe, in a speech Thursday, downplayed concerns that China's steps to rein in lending would lead to a significant slowdown in the Chinese economy. Lowe highlighted that "the recent tightening in credit conditions is a favorable development in that it increases the likelihood that the Chinese economy is on a sustainable path." This, of course, has positive implications for the Aussie outlook given China's position as Australia's largest trading partner. Lowe also singled out the Aussie labor market as a "star performer," saying that the unemployment rate peaked at a much lower level owing to the flexibility in the local labor market—a large number of employers cut workers' hours, rather than shed jobs, during the downturn.

Kiwi firms' confidence probably fell again

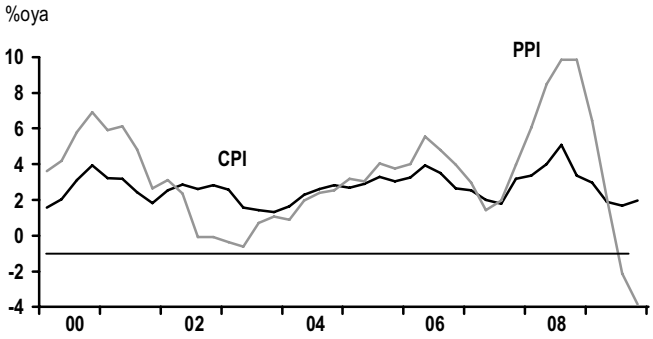
The NBNZ business confidence survey next week probably will show that sentiment fell for the fourth straight month in January, with the headline reading falling from 38.5 in December to 37.0. This will suggest that a net 37% of those surveyed expect that business conditions will improve over the next 12 months.

We expect that business confidence deteriorated last month as the economic recovery under way in New Zealand lost some momentum. News from offshore also was mixed. The all important firms' own activity outlook probably continued to improve, however, rising to 38.5 from 36.9, supporting our view that the Kiwi economy will continue to expand in coming quarters.

New Zealand: NBNZ business outlook survey and GDP growth



New Zealand: CPI and PPI



In the last survey in December, 69% of firms expected that the RBNZ would hike the cash rate in the next year, compared to 73% in November. We suspect that in January fewer firms surveyed will have expected a rate hike to be delivered in the year ahead. As discussed in detail in this week's *GDW* in "RBNZ probably will hold to hinted mid-year tightening," we now expect that RBNZ Governor Bollard will kick off the next tightening cycle in July with a 50bp hike. Previously, we had expected a 25bp move in April. A string of weaker-than-expected data and hints from Bollard that he wants assurance that the economy is out of the most fragile growth phase are the main reasons we pushed out the forecast tightening.

NZ PPI adds to run of soft data

The 4Q PPI numbers released in New Zealand this week provided yet another piece of weak economic data. The PPI print alone will have few implications for the RBNZ, but reaffirms the view that the RBNZ will sit on the policy sidelines in coming months. Producer output prices fell for the fourth straight quarter, slipping 0.4%q/q (J.P. Morgan: -0.5%; consensus: 0.4%). The biggest drag on output prices was the fall in the meat and meat products manufacturing index (-8.5%), which was the largest on record. Input prices were up 0.3%q/q (J.P. Morgan: -1.0%; consensus: 0.5%), marking the first rise since 3Q08. The dairy product

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manufacturing index (+15.2%) made the most significant upward contribution to input prices due to higher whole milk prices at the farm-gate.

Australia:

Data releases and forecasts

Week of February 22 - 26

Mon Feb 22 11:30am — **Sales of new motor vehicles**
Units, sa

	Oct	Nov	Dec	Jan
%m/m	4.5	5.9	3.3	__
%oya	3.6	16.1	17.2	__

Wed Feb 24 11:30am — **Labor price index**
sa

	1Q09	2Q09	3Q09	4Q09
%q/q	0.8	0.8	0.7	0.8
%oya	4.1	3.8	3.6	3.1

Thu Feb 25 11:30am — **Construction work done**
sa

	1Q09	2Q09	3Q09	4Q09
%q/q	-3.6	4.5	2.2	3.5
%oya	5.7	10.7	6.9	6.5

Thu Feb 25 11:30am — **Private new capital expenditure**
sa

	1Q09	2Q09	3Q09	4Q09
%q/q	-5.1	2.1	-3.9	4.5
%oya	11.7	8.0	-1.3	-2.6

Fri Feb 26 11:30am — **Private sector credit**
sa

	Oct	Nov	Dec	Jan
%m/m	-0.1	0.1	0.3	0.2
%oya	1.2	0.9	1.5	1.0

Review of past week's data

NAB monthly business survey
% balance, sa

	Nov	Dec	Jan	
Business confidence	19	8	~~12~~	*15*

WMI leading index

	Oct		Nov	Dec	
%m/m sa	~~0.4~~	*0.5*	1.0	__	*0.5*

NAB business confidence

	2Q09	3Q09	4Q09
% balance, sa	-4	16	15

New Zealand:

Data releases and forecasts

Week of February 22 - 26

Thu Feb 25 3:00pm — **NBNZ business confidence**

	Nov	Dec	Jan	Feb
% balance of respondents	48.2	43.4	38.5	35

Fri Feb 26 10:45am — **Building consents**
sa

	Oct	Nov	Dec	Jan
%m/m	13.2	0.1	-2.4	__
%oya	27.7	20.3	23.6	__

Fri Feb 26 10:45am — **Trade balance**
nsa

	Oct	Nov	Dec	Jan
Trade balance (NZ$ mn)	-502	-276	2	-100

The trade balance probably fell back into deficit in January after surprisingly posting a surplus in the previous month, albeit only just. In January, exports are likely to have fallen by more than imports, owing mainly to elevated NZD, leading to a deficit of NZ$100 million.

Review of past week's data

Producer price index

	2Q09	3Q09	4Q09	
Inputs (%q/q nsa)	0.0	-1.1	~~-1.0~~	*0.3*
Outputs (%q/q nsa)	-0.7	-1.4	~~-0.5~~	*-0.4*

Credit card spending
% change

	Nov	Dec	Jan	
%oya	1.5	1.8	__	*2.6*

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Greater China

- **China: pace of increase in US Treasury security holdings slowed in 2009 amid FX reserve diversification**
- **2009 fiscal deficit lower than budgeted at Y740 billion; rising concerns on local government borrowing**
- **Hong Kong: November-January unemployment rate remained at 4.9%**

The latest data from the US Treasury International Capital (TIC) reports show that China's holdings of US Treasury securities fell modestly during the last two months of 2009, registering US$755.4 billion in December. This compares with US$727.4 billion at the end of 2008. (Meanwhile, Japan increased its holdings of US Treasuries notably last year, to US$768.8 billion in December 2009, overtaking China as the largest holder of USTs.)

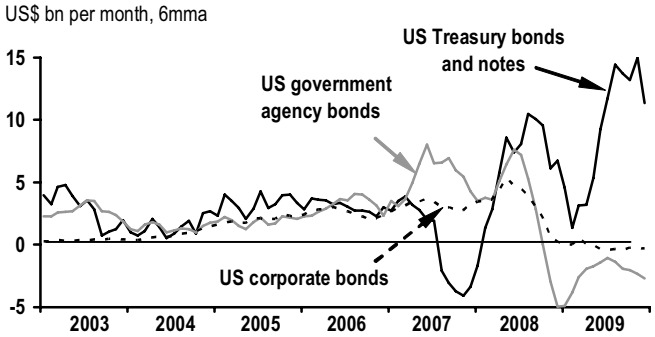
The monthly TIC data show that China's net purchases of longer-term US Treasuries, including bonds and notes, recorded a solid gain last year, rising US$123.5 billion for the full year. Meanwhile, the much slower increase in China's total holdings of USTs indicates maturing or selling of its holdings of short-term US government bills (second chart). In addition, China's total holdings of US agency securities fell US$24.7 billion in 2009, likely indicating lingering concerns over difficulties in these US institutions.

In our view, China is actively diversifying away from USD assets, and we continue to think China's purchases of USD assets will decrease as a result. Indeed, China has been shifting its FX reserves toward other high-yield currencies and alternative investments. Overseas strategic investments in crucial sectors of national interest, including energy and resources, have been a key focus of China's FX reserve diversification in recent years. Overall, China will continue to allocate more FX reserves for such "alternative investment" and encourage the private sector to pursue global mergers and acquisitions.

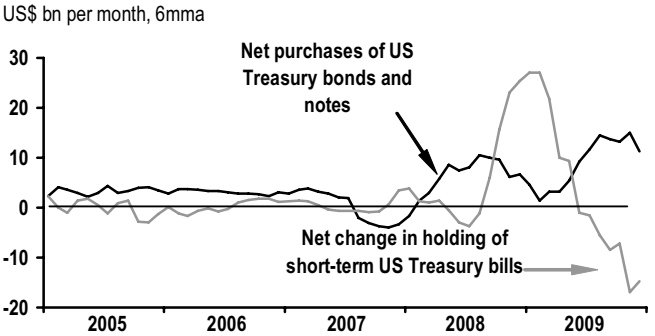
2009 fiscal condition better than budgeted

China's fiscal condition softened in late 2008 and early 2009 due to a significant increase in government spending and weaker revenue collection. But, fiscal revenue growth has rebounded notably since the middle of last year, along with the solid recovery in overall economic activity and the boom in equity and property markets. Beginning last year with a 17.1%oya decline in January, fiscal revenue growth accelerated to 55.9%oya in December and averaged

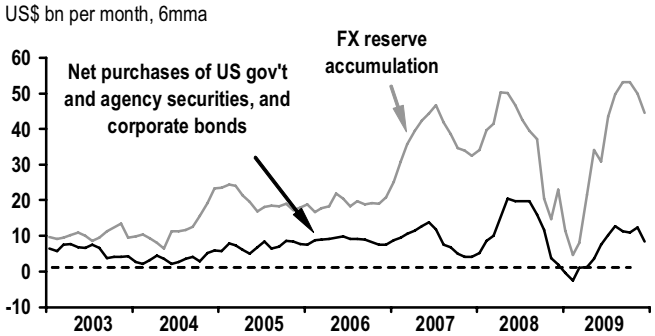
China: net purchases of UST, US agency, and corporate bonds



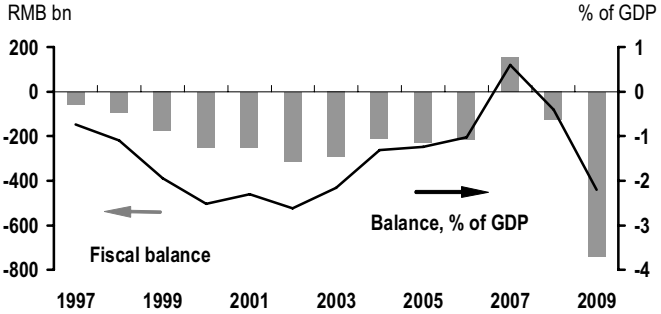
China: net purchases of US Treasury securities of various durations



China's FX reserves and net purchases of UST, agencies, corporates



China: fiscal position



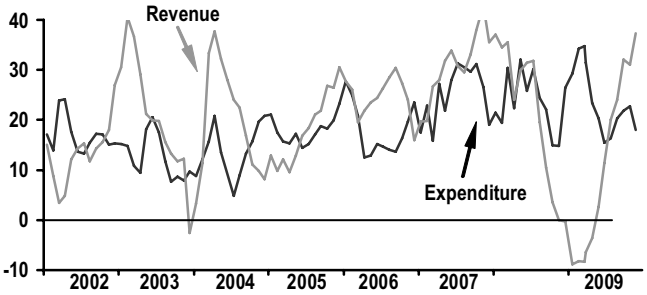
11.7%oya in 2009. Excluding the RMB50.5 billion drawn from the budget stabilization fund, fiscal revenue increased 10.8%oya last year, the slowest growth since 1992 but still modestly higher than the Ministry of Finance's target of 8% for 2009. Fiscal spending surged in early 2009, but the growth pace subsequently eased markedly to average 21.2%oya for the whole year. Indeed, given concerns about overcapacity and inefficient spending, the government has turned more cautious with regard to approval of new projects and is focused on completing ongoing investment projects. The fiscal deficit for 2009 came in at 740 billion yuan (2.2% of GDP) in 2009, which is modestly lower than the 950 billion yuan budgeted earlier this year.

The upcoming National People's Congress in early March is expected to emphasize continued stimulative fiscal policy, with the focus on building social infrastructure and encouraging private consumption. We expect the central government to maintain a sizable deficit this year, despite solid growth in revenue. This reflects continued fiscal spending to complete ongoing projects, as well as a higher share of funding from the central government in the stimulus package, on concern over local governments' fiscal conditions given cooling property and land markets as well as the quality of their borrowing from banks.

- For projects in the stimulus package, the common practice is that central government, local government, and commercial banks will each provide one-third of the funding. As such, out of the Y4 trillion fiscal package, the central government is budgeted to spend Y1.18 trillion from 4Q08 to end-2010, with Y588.5 billion reserved for 2010. However, local government funding has been lagging last year's schedule. China's tax system channels a large portion of revenue to the central government, while local governments are responsible for most of the spending. In 2009, 53% of government revenue went to the central government, but 80% of the spending was conducted by local governments. Although the central government will return part of the revenue to local governments, most local governments rely on ex. budget revenue, such as land sales, to fund spending. However, the downturn in the property market in 2008 has weakened local governments' fiscal conditions notably, and many found the burden to fund the massive stimulus program too heavy.

- China's municipal bond market is still immature. So, local governments have been borrowing from commercial banks heavily through companies they own, since the law prohibits local governments from borrowing directly from banks. For those loans, either the future revenue

China: government revenue and expenditure
%oya 3mma



China's tax-revenue-sharing system

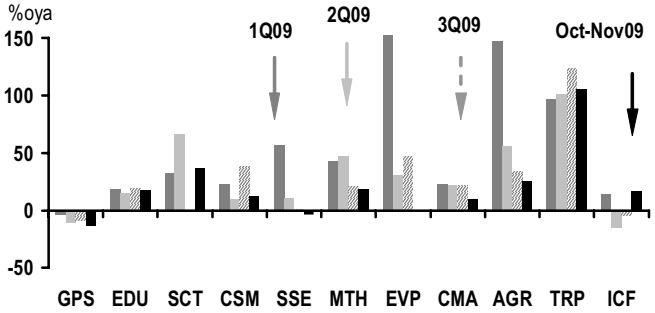
Central tax revenue: consumption tax; customs duties; VAT, and consumption tax collected by the customs on behalf of the central government.

Local tax revenue: stamp tax; city and township land use tax; farmland occupation tax; fixed asset investment orientation regulation tax; land appreciation tax; house property tax; urban real estate tax; vehicle and vessel usage tax; vehicle and vessel usage license plate tax; deed tax; slaughter tax; banquet tax; agriculture tax and animal husbandry tax, and their local surtaxes. Revenue from selling land is considered ex. budget revenue for local governments.

Revenue shared: Resource tax (tax paid by offshore oil enterprises to the central government and by others to local governments); value-added tax (75% goes to central government and 25% to local governments); business tax (the part paid together by the railway department and the headquarters of various banks and insurance companies goes to the central government; the rest is assigned to local governments); enterprise income tax (income tax paid by central enterprises, local banks and nonbank financial institutions, and together by the railway department and the headquarters of various banks and insurance companies to the central government; of the rest, 40% is paid to local governments and 60% to the central government); individual income tax (tax on deposit interest income to the central government; for the rest, 60% to the central government and 40% to local); income tax on enterprises with foreign investment and foreign enterprises (the income tax paid by foreign-funded banks to the central government, and by others to local governments); stamp duty tax on stock trading (98% to central government); city maintenance and construction tax (the part paid together by the railway department and the headquarters of various banks and insurance companies to the central government; the rest to the local governments).

from those projects or land will be used as collateral, and local governments provide implicit guarantees for the repayment of these loans. It is estimated that total outstanding loans to local government-owned companies could have reached Y6 trillion, which is nearly 18% of GDP. There have been rising concerns about the quality and efficiency of the local-government-funded projects. Meanwhile, there is little fiscal transparency at the local government level. Although the rebound in the property and land market last year has temporarily eased concerns about local governments' fiscal conditions (land sales revenue jumped 63.4% to Y1.6 trillion in 2009), uncertainty remains over their debt-paying ability in the long run, once there is less land available for sale. The central government will likely increase its share of funding for the stimulus package this year to lower the funding burden for local governments.

China: government expenditure



GPS: general public service; EDU: education; SCT: science and technology; CSM: cultural, sports and media; SSE: social security and employment; MTH: medical treatment and health; EVP: environment protection; CMA: community affairs; AGR: agriculture affairs; TRP: transportation; ICF: industry, commerce, and finance.

Hong Kong: unemployment rate unchanged

Hong Kong's seasonally adjusted unemployment rate for the November-January period was unchanged at 4.9% (J.P. Morgan and consensus: 4.8%). Seasonally adjusted, the number of unemployed fell by an average of 3,700 persons per month in that period. Meanwhile, seasonally adjusted total employment posted a monthly average gain of 6,300 for the three months ending January, after the decline of 8,600 persons during the October-December period. Monthly volatility aside, the underlying trend in total employment has finally turned positive, rising 2.2%3m/3m saar through January. The total labor force registered a modest decline of 900 for the three months ending January. The unemployment rate fell for the information and communications, accommodation services, and professional and business services sectors.

Hong Kong: labor force survey

Looking ahead, we expect the Hong Kong economy to show a solid, steady recovery this year. On the external side, the constructive outlook on the global manufacturing sector would boost regional trade, benefiting Hong Kong's trade sector. On the domestic side, as business sentiment turns decidedly more positive and financial market activities continue to gather momentum, and with respectable growth in the tourism sector, these major sectors of the Hong Kong economy should come together to support further recovery in domestic demand. The benign outlook for these crucial sectors of the economy should help the labor market to improve steadily, with a gradual upturn in total employment and household incomes, hence boosting private consumption expenditure.

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China:

Data releases and forecasts

Week of February 22 - 26

Foreign direct investment
US$ bn

	Nov	Dec	Jan
Utilized FDI	7.0	12.1	__
%oya	32.0	103.1	__
%oya ytd	-9.9	-2.6	__

Review of past week's data

No data released.

Hong Kong:

Data releases and forecasts

Week of February 22 - 26

Tue Feb 23 4:15pm **Consumer prices**
% change

	Oct	Nov	Dec	Jan
%oya	2.2	0.5	1.3	1.3
%m/m sa	1.0	0.0	0.4	0.4

Wed Feb 24 4:15pm **Real GDP**
% change

	1Q09	2Q09	3Q09	4Q09
%oya	-7.8	-3.6	-2.4	0.6
%q/q saar	-16.1	14.8	1.6	5.0

Hong Kong's economy likely rose solidly in 4Q09, on the back of a steady upturn in consumption, fixed investment, and external trade.

Thu Feb 25 4:30pm **Merchandise trade**
HK$ bn

	Oct	Nov	Dec	Jan
Balance	-19.2	-20.7	-33.4	__
Exports	240.8	234.1	224.8	__
%oya	-13.1	1.3	9.2	__
Imports	259.9	254.8	258.3	__
%oya	-10.7	6.5	18.7	__

Review of past week's data

Labor market survey (Feb 18)
sa 3mma

	Nov	Dec	Jan	
Unemployment rate (% avg)	5.1	4.9	~~4.8~~	*4.9*
Employed (ch, m/m, 000 persons)	5.4	-8.6	__	6.3

Taiwan:

Data releases and forecasts

Week of February 22 - 26

Mon Feb 22 **Real GDP**
% change

	1Q09	2Q09	3Q09	4Q09
% oya	-9.1	-6.9	-1.3	6.2
%q/q saar	-11.3	18.8	8.3	11.5

Taiwan's economy continued its solid expansion through 4Q09, with strong momentum in IP and impressive expansion in the export sector. On the domestic front, manufacturing capex picked up notably, with improving domestic retail sales as well as a marked pickup in service sector employment.

Mon Feb 22 4:00pm **Labor market survey**
%

	Oct	Nov	Dec	Jan
Unemployment rate, sa	6.0	6.0	5.8	5.7
Unemployment rate, nsa	6.0	5.9	5.7	5.6

The labor market likely improved further in January, with the passthrough from solid export growth and the notable pickup in domestic service sector employment.

Fri Feb 26 4:00pm **Export orders**
% change

	Oct	Nov	Dec	Jan
Oya	4.4	37.1	52.6	78.3
M/m sa	1.9	4.4	3.5	3.8

Export orders likely registered a solid gain in January, with broad-based growth in demand across the major markets.

Fri Feb 26 4:00pm **Industrial production**
% change

	Oct	Nov	Dec	Jan
Oya	7.1	31.4	47.3	77.2
M/m sa	1.2	4.7	2.9	3.0

IP likely showed further strong expansion in January, as suggested by the merchandise trade report released earlier in the month, with the Lunar New Year holidays in mid-February causing some front-loading of production and shipments in January.

Fri Feb 26 4:00pm **Composite leading indicator**
% change

	Oct	Nov	Dec	Jan
M/m sa	0.5	0.9	0.9	__

Review of past week's data

No data released.

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Korea

- **Lunar holiday, weather, and other temporary factors will make interpreting upcoming data difficult**
- **Next week: January BoP and surveys**

In the absence of important data reports this week, we maintain the view that real GDP growth will reaccelerate modestly in the current quarter. To be sure, hard activity data released over the past three weeks have been disappointing. Following the weaker-than-expected 4Q09 GDP, customs exports fell sharply and the headline unemployment rate spiked in January. However, much of the 4Q GDP weakness was concentrated in the earlier part of the quarter, while exports and the labor market report for January were affected by temporary factors, suggesting that manufacturing activity in January was firmer than indicated by those two reports.

- The customs trade balance slipped into deficit in January, with exports down significantly. Yet, much of the trade loss was a seasonal phenomenon, with the seasonally adjusted trade balance remaining in surplus. Exports fell 5.3%m/m sa in January, but did not completely reverse the impressive 9.8% gain in December. If we are correct in judging that export flows were depressed by heavy snowfall earlier in the month, industrial activity in January should have performed better than exports. Note also that imports were relatively solid, even considering the fact that unusually harsh winter weather should have boosted imports for crude oil and energy products. Given that more than half of Korea's imports are used for export purpose, exports are likely to rebound in the following months. The trade balance should return to surplus in February although the lunar holiday effect could delay the full comeback until March.

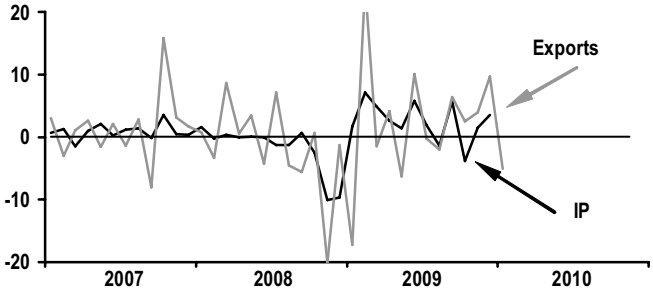
- The jobless rate surged sharply in January, but mainly due to the time lag between the announcement and implementation of the government hiring program. Excluding the public sector, employment moved up in January, notably led by manufacturing (see "Korea's jobless rate to drop, but labor force on decline," in this *GDW*).

Next week's focus

The Bank of Korea will release a clutch of data reports next week. The current account balance should have posted a deficit in January, with the merchandise trade surplus down sharply, while the deficit in the service account likely widened due to increased seasonal outbound travel. Meanwhile, both business and consumer sentiment likely softened, not because of domestic factors but more due to financial market adjustment to the renewed risk aversion globally over the past several weeks. The Federation of Korean Industries (FKI) will also report its monthly business survey. Although the headline outlook index is likely to decline on a seasonally adjusted trend basis from elevated levels, the employment, exports, and profitability outlooks will likely confirm our view that recent weakness in trade and labor market reports was temporary. Finally, the BoK will release a quarterly report of household credit, which will probably show that Korea's household sector continued to increase debt in 4Q09 but also to move modestly away from mortgage loans due to the regulatory changes.

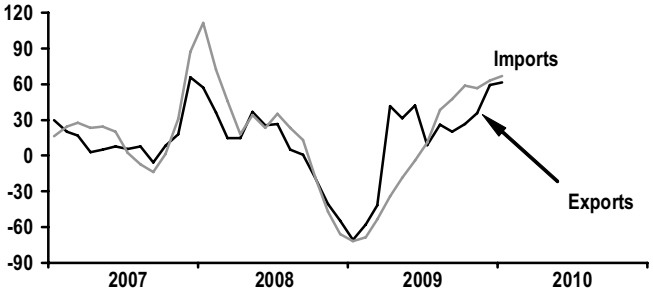
Industrial production and customs exports

%m/m sa



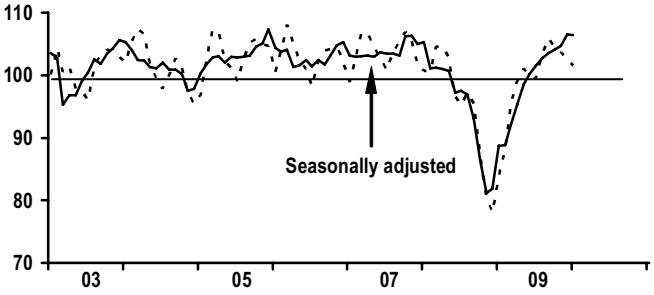
Customs exports and imports

%3m/3m saar



BSI: simple average of all component indices

100=neutral reading



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Data releases and forecasts

Week of February 22 - 26

Week of Feb 22

FKI business survey
100=neutral reading, nsa

	Nov	Dec	Jan	Feb
One-month-ahead outlook	105.9	103.1	102.3	109.0
Current conditions	103.8	104.8	99.2	100.0

The BSI likely rose for seasonal reasons. Seasonally adjusted, both outlook and current condition indices likely moved down but should stay at elevated levels. Also see main story.

Sun Feb 21 12:00pm

Bankruptcy filings

	Oct	Nov	Dec	Jan
Bankruptcy filings	124	135	152	145
Dishonored bill ratio	0.02	0.04	0.03	0.03

Wed Feb 24 6:00am

Consumer survey
100=neutral reading, nsa

	Nov	Dec	Jan	Feb
Index	113	113	113	112

Thu Feb 25 8:00am

Current account
$ bn nsa

	Oct	Nov	Dec	Jan
Balance	4.8	4.3	1.5	-0.3

See main story.

Review of past week's data

Export and import prices (Feb 15)
%oya, in local currency terms

	Nov	Dec	Jan	
Export prices	-13.4	-8.6	~~-8.4~~	*-6.9*
Import prices	-7.5	-1.4	~~-1.9~~	*-0.9*

Stage of processing price index (Feb 15)
%oya

	Nov	Dec	Jan	
Index	-3.0	0.8	~~1.6~~	*1.8*

Housing prices (Feb 19)
% change from previous week, apartment prices only

Week of Feb 1	Feb 8	Feb 15	
0.1	0.1	—	*0.0*

BoK Watch

- **Korea introduces a new benchmark rate for floating-rate mortgages**

On February 16, the Korea Federation of Banks (KFB) introduced the Cost of Funds Index (COFIX), which will selectively be used as a new benchmark rate for floating-rate mortgages. The lenders' federation expects the new index to better reflect the real funding costs of banks and also to reduce the reliance on a simple spread to the 3-month CD fixing. COFIX will be calculated based on funding cost data provided by nine domestic banks and will be posted on the KFB website every month. The new index will have two components: the Outstanding Balance COFIX will measure the weighted average funding cost of month-end outstanding balances, and the Monthly Acquired New Funds COFIX will be calculated from the average monthly interest rate of newly acquired funds. Borrowers will be able to select either one of the new indices, while loans linked to the current 3-month CD fixing will also be available. Current outstanding loans linked to the 3-month CD fixing can also be converted to COFIX-linked products without any charge, in order to promote the utilization of the new index. It appears that the COFIX-linked floating loans will typically have a longer period between revaluations compared to loans linked to the 3-month CD rate in an attempt to provide more stabilization to both lenders and borrowers.

Interest rates
% p.a.

	Jan 28	Feb 4	Feb 11	Feb 18
Overnight call	2.00	2.00	2.02	2.01
3-month CD fixing	2.88	2.88	2.88	2.88
1-year MSB	3.32	3.24	3.18	3.10
3-year treasury bond	4.31	4.26	4.18	4.10
3-year corporate bond	5.43	5.39	5.31	5.24

Deposit changes at deposit money banks
KRW tn

	Nov	Dec	Jan	Feb 1-16
Total deposits	5.2	6.2	22.1	9.5
Demand	2.1	2.8	0.7	0.3
Time and savings	3.1	3.5	21.5	9.2

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ASEAN: Indonesia, Malaysia, Philippines, Singapore, Thailand, Vietnam

- **Headline over-year-ago inflation to be distorted by base effects**
- **Underlying inflationary pressures remain modest; some administrative price liberalization expected**
- **Fuel and food prices remain key drivers of inflation**

Headline inflation data from the ASEAN region will in the coming months be exaggerated by base effects from the dramatic drop in commodity prices in 2009. Over-year-ago inflation, the preferred inflation measure around the region, will be distorted by these base effects, biasing the over-year-ago prints higher. In the Philippines, these base effects will add around 3%-pts to overall over-year-ago headline inflation in 2010, while in Singapore, the impact is expected to be smaller at 0.8%-pt (first table). In the face of these statistical factors, sequential trend inflation readings should be a better measure to assess underlying inflationary pressures.

Inflation around the region tends to be dominated by commodity prices, reflecting the relatively large weights of both the food and energy components in the CPI index. Nonetheless, the underlying outlook for inflation remains relatively benign, underpinned by the expectation of stable commodity prices. This remains the key risk factor for inflation within the region.

Base effects to distort headline CPI

Following the collapse in energy and food prices in 1Q09, over-year-ago inflation readings in 2010 will be increasingly distorted by base effects, with the largest distortions expected in Thailand and the Philippines (first table). In terms of the CPI contours, 2Q10 should see the highest contribution from base effects but should normalize relatively quickly by 2H10 (first chart). Nonetheless, with central banks in Indonesia, the Philippines, and Thailand targeting over-year-ago inflation in their monetary policy frameworks, these base effects could bring inflation readings to the higher side of the target range, especially in 1Q10 (second table).

When adjusted for these base effects, over-year-ago inflation readings are expected to track a modest uptrend in most of these inflation-targeting countries but remain well within the bounds of the inflation targets. Nonetheless, most regional central banks are expected to normalize policy rates in a modest and gradual manner over the course of 2010. This normalization process reflects not so much concern over demand-side inflationary pressures but more the risk that an excessively accommodative stance could lead to asset bubbles, especially if real rates were to be persistently negative.

ASEAN: inflation base effects

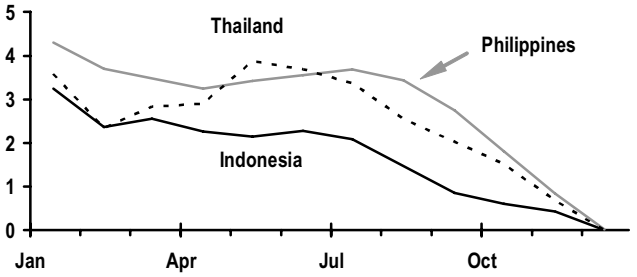
%oya, period average[1]

	1Q10	2Q10	3Q10	4Q10	Average
Philippines	3.8	3.4	3.3	0.7	2.8
Thailand	2.9	3.5	2.6	0.7	2.4
Indonesia	2.7	2.2	1.5	0.6	1.8
Malaysia	0.9	1.4	1.8	0.7	1.2
Singapore	0.4	1.6	0.6	0.7	0.8

1. Holding CPI index constant at December 2009 levels.

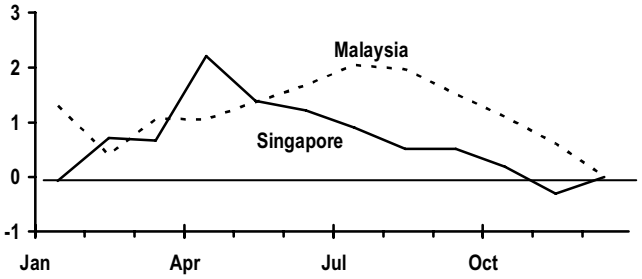
CPI inflation in 2010: base effects

%oya, holding CPI index constant at December 2009 level



CPI inflation in 2010: base effects

%oya, holding CPI index constant at December 2009 level



ASEAN-3: inflation targets and CPI base effects

%oya

	1Q10	2Q10	3Q10	4Q10
Indonesia		Headline—4%-6%		
1. Base effect	2.7	2.2	1.5	0.6
2. Forecast	3.6	4.3	4.8	4.8
3. Adjusted (2-1)	0.8	2.1	3.3	4.2
Philippines		Headline—3.5%-5.5%		
1. Base effect	3.8	3.4	3.3	0.7
2. Forecast	4.2	5.1	6.2	5.0
3. Adjusted (2-1)	0.4	1.7	2.9	4.2
Thailand		Core—0.5%-3.0%oya		
1. Base effect	0.1	0.2	0.3	0.1
2. Forecast	0.5	1.2	1.6	1.4
3. Adjusted (2-1)	0.4	1.0	1.3	1.4

Food and fuel continue to dominate CPI

Within the region, inflation in the past few months has been broadly driven by supply-side cost factors. This is reflected in the relatively large contributions from food and energy prices to headline price increases (first chart and table). Part of this dominance of commodity prices reflects the large weight of food and fuel components in the CPI baskets, ranging from 30% in Singapore to almost 60% in the case of the Philippines.

Various country-specific factors have contributed to the non-food and fuel price increases. In the case of Indonesia, higher clothing and education costs have pushed up the CPI, adding a combined 0.5%-pt to prices. In Singapore, recreation costs, particularly for travel, contributed 0.4%-pt to the overall increase. In the case of Malaysia, rising jewelry and entertainment costs have lifted overall prices outside of food and fuel.

Moreover, the relative lack of any energy-related inflation in Indonesia and Malaysia reflects the impact of subsidies that remain in place. In Indonesia, the authorities have committed to maintaining the subsidies through the course of 2010 while in Malaysia, some modification of the subsidy scheme is expected in May.

Watching administered prices in Malaysia and Thailand

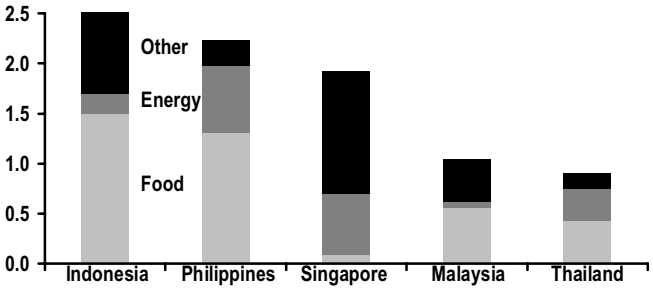
In Malaysia, energy prices are expected to be increased in May, gradually and less drastically than hikes seen in the last few years. Even so, the impact of this on headline inflation, outside of energy, has been relatively muted (second chart).

In terms of the potential increase, the current pump price for 95 Octane gasoline hovers around MYR1.8/liter against a market price of MYR1.82/liter. Operating and supplier margins add another MYR0.27/liter to the price, bringing the all-in pump price before taxes to MYR2.1/liter, implying a subsidy of around MYR0.3/liter, which is at the top end of the subsidy range the authorities have indicated they will support. An increase of 15% to pump prices would eliminate the subsidy at current prices. The expectation is that the subsidy scheme will be tweaked in May to reduce the subsidy cost and redistribute the beneficiaries of the subsidy.

In the case of Thailand, the existing subsidies that affect lower-income groups are expected to remain in place through 3Q10. Lifting those subsidies could ostensibly add around 0.5%-1.0%-pt to the headline index at current commodity prices.

ASEAN: sources of CPI inflation

%-pt contribution to cumulative inflation, 2H09



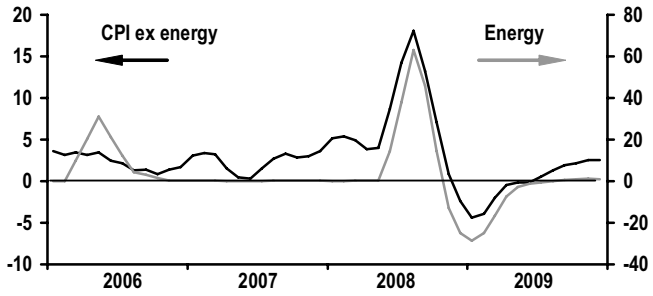
ASEAN sources of inflation

%-pt contribution to cumulative inflation

		Total	Food	Energy	Other	F&E
Indonesia	Weights	100.0	36.1	18.2	45.7	54.3
	2008	11.0	5.3	3.0	2.8	8.2
	2009	2.8	2.1	-0.7	1.4	1.4
	2H09	2.5	1.5	0.2	0.8	1.7
Malaysia	Weights	100.0	33.3	9.2	57.5	42.5
	2008	4.4	3.4	0.0	1.0	3.4
	2009	1.1	0.4	-0.1	0.8	0.3
	2H09	1.0	0.6	0.1	0.4	0.6
Philippines	Weights	100.0	50.0	9.9	40.1	59.9
	2008	8.4	6.4	-0.1	2.1	6.3
	2009	4.3	2.6	0.8	0.9	3.4
	2H09	2.2	1.3	0.7	0.3	2.0
Singapore	Weights	100.0	23.4	7.1	69.5	30.5
	2008	4.4	1.5	0.5	2.3	2.1
	2009	0.3	0.1	-0.5	0.7	-0.4
	2H09	1.9	0.1	0.6	1.2	0.7
Thailand	Weights	100.0	33.0	11.1	55.9	44.1
	2008	0.5	4.6	-3.8	-0.2	0.8
	2009	4.6	0.7	4.2	-0.2	4.9
	2H09	0.9	0.4	0.3	0.2	0.7

Malaysia: energy and non-energy consumer prices

%3m/3m saar, both scales



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Indonesia:

Data releases and forecasts

Week of February 22 - 26

No data releases.

Review of past week's data

No data released.

Malaysia:

Data releases and forecasts

Week of February 22 - 26

Wed Feb 24 5:00pm **Consumer prices**
% change

	Oct	Nov	Dec	Jan
Oya	-1.5	-0.1	1.1	1.6
M/m sa	0.4	0.5	0.6	0.3

Headline inflation is expected to rise in over-year-ago terms on account of base effects and also some increases in pump prices.

Wed Feb 24 6:00pm **Real GDP**
%

	1Q09	2Q09	3Q09	4Q09
Oya	-6.2	-3.9	-1.2	1.7
Q/q saar	-14.8	10.1	9.4	4.5

The recent moderation in production should be reflected in a moderation of the underlying growth pace in 4Q09.

Review of past week's data

No data released.

Philippines:

Data releases and forecasts

Week of February 22 - 26

Thu Feb 25 9:00am **Merchandise trade**
US$ bn nsa

	Sep	Oct	Nov	Dec
Imports	3.7	3.8	3.6	3.4
%oya	-25.0	-16.8	4.2	2.2

Review of past week's data

OFW worker remittances (Feb 15)

% change

	Oct	Nov	Dec
Oya	6.7	11.3	~~13.4~~ *11.4*
M/m sa	~~0.0~~ *-0.2*	~~0.4~~ *0.5*	~~0.5~~ *-0.5*

Government budget (Feb 18)

PHP bn

	Oct	Nov	Dec
Balance	-28.5	-6.4	~~-28.6~~ *-26.0*
Revenue	85.6	96.3	~~111.4~~ *101.5*
Expenditure	114.1	102.7	~~139.9~~ *127.6*

The December headline fiscal deficit printed at PHP26 billion, which brings the full-year deficit to PHP299 billion (around 3.9% of GDP)—at the top side of the government's forecast (originally PHP290.2 billion). Despite the wider-than-expected deficit, the forecast for the 2010 deficit remains at PHP293.2 billion—though the risk is that tax relief could reduce revenues by around PHP41 billion, down slightly from the PHP49 billion in 2009. Thus, the overall focus will continue to be on the revenue side of the ledger, especially with growth prospects turning up although the 2010 elections could limit the impact of these gains on the overall deficit.

Singapore:

Data releases and forecast

Week of February 22 - 26

Tue Feb 23 1:00pm **Consumer prices**
% change

	Oct	Nov	Dec	Jan
Oya	-0.8	-0.2	0.0	0.9
M/m sa	0.3	0.5	-0.3	1.0

January inflation likely rose on account of increases in energy prices.

Fri Feb 26 1:00pm **Industrial production**
% change

	Oct	Nov	Dec	Jan
Oya	2.8	-9.5	14.4	15.7
M/m sa	-7.4	-4.6	18.1	0.6

Review of past week's data

Merchandise trade (Feb 17)

US$ bn nsa

	Nov	Dec	Jan
Trade balance	3.1	2.3	~~2.9~~ *2.3*
Exports	25.6	26.5	~~26.5~~ *25.9*
Non-oil domestic (NODX)	9.4	9.5	~~9.7~~ *8.7*
%m/m sa, US$ terms	~~11.3~~ *11.8*	~~2.7~~ *2.0*	~~0.4~~ *-2.2*
%oya, US$ terms	~~17.2~~ *18.0*	33.4	~~43.5~~ *29.0*

Despite the modest monthly decline in January, the sequential trend rate was up 57.1%3m/3m saar due to previous strong growth. Moreover, although electronics were soft in January, the big decline came from pharmaceuticals. Outside of the volatile pharma sector, exports expanded at robust rates.

Real GDP (Feb 19)

	2Q09	3Q09	4Q09
%oya	-3.3	0.6	~~3.7~~ *4.0*
%q/q saar	21.7	14.2	~~-6.2~~ *-2.8*

The quarterly decline was due to contraction in the manufacturing sector, which fell 21.1%q/q saar, after a stunning average sequential growth of over 26.6% in the two preceding quarters. While the 4Q09 print came in pretty much as expected and sets a positive tone for 1Q10, the outlook remains somewhat mixed and is reflected in messages from the MTI. Although the MTI has revised up 2010 growth to 4.5%-6.5%oya (previously 3%-5%), it cautioned that the outlook is unclear, with the expectation that 1H10 will be positive and that the bulk of uncertainty will be focused on 2H10, especially with global fiscal stimulus expected to end and with most of the inventory restocking process to have run its course in 1H10. With the outlook still unclear, J.P. Morgan maintains the view that the MAS will keep its NEER stance unchanged at the upcoming April monetary policy meeting.

Thailand:

Data releases and forecasts

Week of February 22 - 26

Mon Feb 22 9:30am — **Real GDP**
% change

	1Q09	2Q09	3Q09	4Q09
%oya	-7.1	-4.9	-2.8	3.3
%q/q saar	-6.0	9.0	5.5	5.3

The strong data prints in 4Q09 suggest that GDP growth likely ended the year on a firm note.

Fri Feb 26 2:30pm — **Merchandise trade**
US$ bn nsa

	Oct	Nov	Dec	Jan
Trade balance	1.7	1.1	-0.1	-0.3
Exports, %oya	-2.6	17.3	26.2	29.3
Imports, %oya	-19.0	-0.3	33.0	58.0

Fri Feb 26 2:30pm — **Manufacturing production**
% change

	Oct	Nov	Dec	Jan
Oya	0.5	9.2	35.7	37.2
M/m sa	0.9	-0.3	10.4	0.7

Production in 1Q10 is expected to have slowed from the solid pace in 4Q09, but the trajectory should remain solidly positive.

Fri Feb 26 2:30pm — **Private consumption index**
% change

	Oct	Nov	Dec	Jan
Oya	-0.9	4.0	3.9	6.5
M/m sa	-1.2	1.3	1.0	0.5

Strong gains in farm incomes from rising agricultural prices should help boost consumption into 1Q10.

Fri Feb 26 2:30pm — **Private investment index**
% change

	Oct	Nov	Dec	Jan
Oya	-10.1	-6.5	-2.3	4.5
M/m sa	1.4	2.2	1.4	0.5

Review of past week's data

No data released.

Vietnam:

Data releases and forecasts

Week of February 22 - 26

During the week — **Consumer prices**
%oya

	Nov	Dec	Jan	Feb
All items	4.4	6.5	7.6	9.0
%m/m sa	1.4	1.5	1.1	1.1

During the week — **Merchandise trade**
US$ bn nsa

	Nov	Dec	Jan	Feb
Trade balance	-2.0	-1.9	-1.3	-2.0
Exports, %oya	11.1	7.1	28.1	-20.7
Imports, %oya	45.5	33.0	86.6	43.1

Review of past week's data

No data released.

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Asia focus: diverging direct investment trends

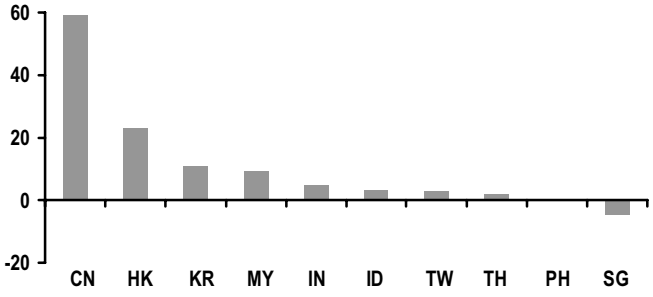
One striking trend in Asia has been the growing size of direct investment flows: in 2008 outward and inward investment together totaled US$786 billion, doubling 2005's US$350 billion. While historically the focus has been on inward investment, a fairly recent phenomenon is the rapid increase in outward flows of direct investment, which have risen in almost all countries across the region (first chart below). By contrast, inward investment flows have remained flat in most countries (second chart below).

- In **China**, net direct investment in 2008 slowed to US$135 billion from US$172 billion in 2007, reflecting rising outward direct investment and slowing inward investment. Outward investment surged to US$87 billion in 2008, well above the US$24 billion in 2007. In **Malaysia**, outward investment rose to US$15 billion in 2008, an unusually large increase relative to the size of its economy (table). Similarly, **Korean** outward direct investment flows have risen briskly to reach US$19 billion in 2008 from US$8 billion in 2006.

- In **India**, direct investment inflows have kept a solid pace even into 2009, with FDI likely to near its 2007 high.

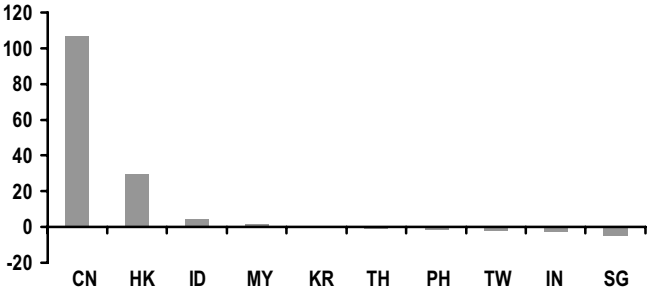
Emerging Asia: outward direct investment

US$ bn, change, 2008 less 2005



Emerging Asia: inward direct investment

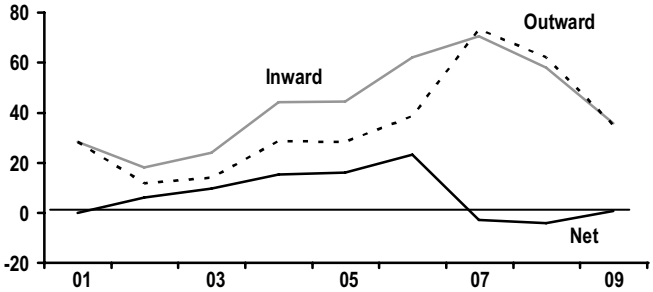
US$ bn, change, 2008 less 2005



In Emerging Asia ex. China and India, net FDI flows turned negative in 2007, reflecting slowing inward direct investment and an increase in outward investment (first chart). While some of this likely owes to cyclical effects, it may also signal a broader shift in regional outward direct investment flows.

Emerging Asia ex. China and India

US$ bn, BoP basis



Asia: net direct investment

US$ bn, BoP terms

	2001	2002	2003	2004	2005	2006	2007	2008	2009e[1]
Japan	-32	-23	-23	-23	-42	-57	-51	-106	-64
Inward	6	9	6	8	3	-7	22	25	15
Outward	38	32	29	31	45	50	73	131	79
China	54	70	74	84	90	88	172	135	16
Inward	57	72	75	86	105	115	197	222	29
Outward	3	3	1	3	15	28	24	87	13
Hong Kong	-10	-10	-8	-11	-16	-16	-20	-10	-7
Inward	22	23	25	30	35	45	63	74	72
Outward	31	33	33	40	51	61	83	84	79
India	7	5	11	13	17	16	41	8	43
Inward	8	7	13	15	20	29	58	26	59
Outward	1	2	2	2	3	14	17	18	16
Korea	1	0	0	4	2	-5	-14	-16	-6
Inward	4	2	4	9	6	4	2	3	0
Outward	2	3	3	5	4	8	16	19	6
Taiwan	-1	-3	-5	-5	-4	0	-3	-5	-3
Inward	4	1	0	2	2	7	8	5	2
Outward	5	5	6	7	6	7	11	10	5
Indonesia	-	-	-	-2	5	2	2	3	1
Inward	-	-	-	2	8	5	7	9	5
Outward	-	-	-	3	3	3	5	6	4
Malaysia	0	1	1	3	1	0	-3	-8	-6
Inward	1	3	2	5	4	6	8	7	3
Outward	0	2	1	2	3	6	11	15	8
Philippines	0	1	0	0	2	3	-1	1	1
Inward	0	2	0	1	2	3	3	1	2
Outward	0	0	0	1	0	0	4	0	0
Singapore	-5	4	9	9	3	14	7	14	10
Inward	15	6	12	20	14	28	31	23	18
Outward	20	2	3	11	11	13	24	9	8
Thailand	5	3	5	6	8	8	8	6	2
Inward	5	3	5	6	8	9	11	9	5
Outward	0	0	1	0	1	1	3	3	3

1. Estimated using 1Q-3Q data, except China 1H and Japan, Korea, full year.

US economic calendar

Monday	Tuesday	Wednesday	Thursday	Friday
22 Feb **Dallas Fed survey** (10:30am) Feb San Francisco Fed President Yellen speaks on economy (11:00am) Auction 30-year TIPS $8 bn	**23 Feb** **S&P/Case-Shiller HPI** (9:00am) Dec, 4Q 0.3% (-3.1%oya) **Consumer confidence** (10:00am) Feb 54.5 **Richmond Fed survey** (10:00am) Feb St Louis Fed President Bullard speaks on regulation (5:05pm) Auction 2-year note $44 bn	**24 Feb** **New home sales** (10:00am) Jan 345,000 Fed Chairman Bernanke delivers semiannual monetary policy testimony before the House (10:00am) Auction 5-year note $42 bn	**25 Feb** **Initial claims** (8:30am) w/e prior Sat 465,000 **Durable goods** (8:30am) Jan -0.5% Ex transportation -1.8% **FHFA HPI** (10:00am) Dec, 4Q 0.4% (0.5%oya) **KC Fed survey** (11:00am) Feb Cleveland Fed President Pianalto speaks (8:35am) Fed Chairman Bernanke delivers semiannual monetary policy testimony before the Senate (9:00am) St Louis Fed President Bullard speaks on the economy (1:15pm) Auction 7-year note $32 bn	**26 Feb** **Real GDP** (8:30am) 4Q second 6.0% **Chicago PMI** (9:45am) Feb **Consumer sentiment** (9:55am) Feb final 74.0 **Existing home sales** (10:00am) Jan 5.50 mn US Monetary Policy Forum event with comments by Fed officials Dudley and Kocherlakota (10:45am) and Tarullo and Evans (1:30pm)
1 Mar **Personal income** (8:30am) Jan **ISM manufacturing** (10:00am) Feb **Construction spending** (10:00am) Jan Richmond Fed President Lacker speaks (9:45am)	**2 Mar** **Light vehicle sales** Feb Minneapolis Fed President Kocherlakota speaks (1:00pm)	**3 Mar** **ADP employment** (8:15am) Feb **ISM nonmanufacturing** (10:00am) Feb **Beige book** (2:00pm) Boston Fed President Rosengren speaks (9:00am) Atlanta Fed President Lockhart speaks (12:00pm)	**4 Mar** **Initial claims** (8:30am) w/e prior Sat **Productivity and costs** (8:30am) 4Q revised **Pending home sales** (10:00am) Jan **Factory orders** (10:00am) Jan **Chain store sales** Feb Announce 3-year note $40 bn Announce 10-year note (r) $21 bn Announce 30-year bond (r) $13 bn	**5 Mar** **Employment** (8:30am) Feb **Consumer credit** (3:00pm) Jan
8 Mar	**9 Mar** **NFIB survey** (7:30am) Feb **JOLTS** (10:00am) Jan Chicago Fed President Evans speaks (9:30am) Auction 3-year note $40 bn	**10 Mar** **Wholesale trade** (10:00am) Jan **Federal budget** (2:00pm) Feb Auction 10-year note (r) $21 bn	**11 Mar** **Initial claims** (8:30am) w/e prior Sat **International trade** (8:30am) Jan NY Fed President Dudley speaks (2:00pm) Auction 30-year bond (r) $13 bn	**12 Mar** **Retail sales** (8:30am) Feb **Consumer sentiment** (9:55am) Mar preliminary **Business inventories** (10:00am) Jan
15 Mar **Empire State survey** (8:30am) Mar **TIC data** (9:00am) Jan **Industrial production** (9:15am) Feb **NAHB survey** (1:00pm) Mar	**16 Mar** **Housing starts** (8:30am) Feb **Import prices** (8:30am) Feb **FOMC meeting**	**17 Mar** **PPI** (8:30am) Feb	**18 Mar** **Initial claims** (8:30am) w/e prior Sat **CPI** (8:30am) Feb **Current account** (8:30am) 4Q **Philly Fed survey** (10:00am) Mar **Leading indicators** (10:00am) Feb Announce 2-year note $44 bn Announce 5-year note $42 bn Announce 7-year bond $32 bn	**19 Mar**

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Euro area economic calendar

Monday	Tuesday	Wednesday	Thursday	Friday
22 Feb **Germany:** CPI 6 states and prelim (8:00am) Feb 0.7%oya **Netherlands:** CBS cons. conf. (9:30am) Feb	**23 Feb** **Germany:** IFO business survey (10:00am) Feb 96.2 Index, sa **France:** Cons. of mfg goods (8:45am) Jan CPI (8:45am) Jan 1.1 %oya, nsa **Italy:** ISAE cons. conf. (9:30am) Feb CPI final (10:00am) Jan 1.3%oya, nsa **Belgium:** BNB bus. conf. (3:00pm) Feb **Netherlands:** CBS bus. conf. (9:30am) Feb	**24 Feb** **Euro area:** Industrial new orders (11:00am) Dec **Germany:** GDP final (8:00am) 4Q 0.0 %q/q, saar GfK cons. conf. (8:00am) Mar ECB member Lorenzo Bini Smaghi speaks in Pavia, Italy (11:00am) & Milan, Italy (8:00pm)	**25 Feb** **Euro area:** M3 (10:00am) Jan 0.3 %oya EC bus. conf. (11:00am) Feb -13%bal, sa EC cons. conf. (11:00am) Feb -17 %bal, sa **Germany:** Employment (9:55am) Jan -10 ch m/m, 000s, sa Unemployment (9:55am) Feb 20 ch m/m, 000s, sa **France:** INSEE cons. conf (8:45am) Feb PPI (8:45am) Jan **Italy:** ISAE bus. conf. (9:30am) Feb **Belgium:** CPI (11:15 am) Feb 0.9%oya, nsa ECB member Jürgen Stark speaks in Seoul, S. Korea (2:45am CET)	**26 Feb** **Euro area:** HICP final (11:00am) Jan 1.0 %oya, nsa **Italy:** PPI (11:00am) Jan **Spain:** HICP flash (9:00am) Feb 1.1%oya, nsa
1 Mar **Euro area:** PMI Mfg final (10:00am) Feb Unemployment (11:00am) Jan **Germany:** Import prices (8:00am) Jan PMI Mfg final (9:55am) Feb **France:** PMI Mfg final (9:50am) Feb **Italy:** Annual GDP report (11:00am) PMI Mfg (9:45am) Feb **Spain:** PMI Mfg (9:15am) Feb	**2 Mar** **Euro area:** HICP flash (11:00am) Feb PPI (11:00am) Jan **Italy:** CPI prelim (11:00am) Feb	**3 Mar** **Euro area:** PMI services & composite final (10:00am) Feb Retail sales (11:00 am) Jan **Germany:** PMI services & composite final (9:55am) Feb **France:** PMI services & composite final (9:50am) Feb **Italy:** PMI services & composite (9:45am) Feb **Spain:** PMI services & composite (9:15am) Feb	**4 Mar** **Euro area:** GDP prelim (11:00am) 4Q ECB rate announcement (1:45pm) ECB press conf. (2:30pm) **France:** ILO unemployment (8:45am) 3Q **Netherlands:** CPI (9:30am) Feb	**5 Mar** **Germany:** Mfg orders (12:00am) Jan
8 Mar **Germany:** Retail sales (8:00am) Jan Industrial production (12:00pm) Jan	**9 Mar** **France:** Foreign trade (8:45am) Jan	**10 Mar** **Germany:** Foreign trade (8:00am) Jan CPI final (8:00am) Feb **France:** Industrial production (8:45am) Jan **Italy:** Industrial production (10:00am) Jan GDP final (11:00am) 4Q **Belgium:** GDP final (3:00pm)	**11 Mar** **Euro area:** ECB monthly bulletin (10:00am) Mar BoP prelim (10:00am) 4Q **France:** Employment final (8:45am) 4Q Monthly budget situation (8:45am) Jan	**12 Mar** **Euro area:** Industrial production (11:00am) Jan **Italy:** Labor costs (9:00am) 4Q **Spain:** CPI final (9:00am) Feb **Netherlands:** Industrial production (9:30am) Jan
15 Mar **Euro area:** Employment (11:00am) 4Q	**16 Mar** **Euro area:** HICP final (11:00am) Feb **Germany:** ZEW bus. survey (11:00am) Mar **France:** CPI (8:45am) Feb **Italy:** CPI final (10:00am) Feb	**17 Mar** **Euro area:** Labor costs (11:00am) 4Q	**18 Mar** **Euro area:** BoP (10:00am) Jan Foreign trade (11:00am) Jan **Italy:** Foreign trade (10:00am) Jan **Netherlands:** CBS cons. conf. (9:30am) Mar	**19 Mar** **Germany:** PPI (8:00am) Feb **Italy:** Industrial new orders (10:00am) Jan

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Japan economic calendar

Monday	Tuesday	Wednesday	Thursday	Friday
22 Feb	**23 Feb** Minutes of Jan 25-26 BoJ MPM s (8:50 am) Auction 20-year bond	**24 Feb** **Trade balance** (8:50 am) Jan -238 billion yen, nsa **Corporate service prices** (8:50 am) Jan -1.4%oya **Shoko Chukin small business sentiment** (2:00 pm) Feb 42.2, DI BoJ deputy governor Yamaguchi's address in Kagoshima (11:20 am) Auction 3-month bill	**25 Feb** Auction 2-year note	**26 Feb** **PMI manufacturing** (8:15 am) Feb 52.5, DI **Nationwide core CPI** (8:30 am) Jan -1.2%oya **Total retail sales** (8:50 am) Jan 0.0%m/m, sa **IP preliminary** (8:50 am) Jan 1.0%m/m, sa **Housing starts** (2:00 pm) Jan -10.0%oya **Construction orders** (2:00 pm) Jan
1 Mar **Auto registrations** (2:00 pm) Feb	**2 Mar** **Unemployment rate** (8:30 am) Jan **Job offers to applicants ratio** (8:30 am) Jan **All household spending** (8:30 am) Jan **Monetary base** (8:50 am) Feb Auction 10-year bond	**3 Mar** **PMI services/ composite** (8:15 am) Feb **Nominal wages** (10:30 am) Jan Auction 3-month bill	**4 Mar** **MoF corporate survey** (8:50 am) 4Q BoJ board member Noda's address in Shiga (11:10 am)	**5 Mar** Auction 6-month bill
8 Mar **M2** (8:50 am) Feb **Current account** (8:50 a m) Jan **Economy watcher survey** (2:00 pm) Feb	**9 Mar** **Coincident CI** (2:00 pm) Jan Auction 30-year bond	**10 Mar** **Private machinery orders** (8:50 am) Jan **Corporate goods prices** (8:50 am) Feb Auction 3-month bill	**11 Mar** **GDP 2nd est.** (08:50am) 4Q Auction 5-year note	**12 Mar** **IP final** (1:30 pm) Jan
During the week: Cabinet Office private consumption index Jan				
15 Mar **Consumer sentiment** (2:00 pm) Feb Auction 1-year note	**16 Mar** BoJ Monetary Policy Meeting Auction 3-month bill Auction 20-year bond	**17 Mar** **Tertiary sector activity index** (8:50 am) Jan **Construction spending** (2:00 pm) Jan BoJ Monetary Policy Meeting and statement BoJ governor Shirakawa's press conference (3:30 pm)	**18 Mar** **Reuters Tankan** (8:30 am) Mar **MoF business outlook survey** (8:50 am) 1Q BoJ monthly economic report (2:00 pm)	**19 Mar** **All sector activity index** (1:30 pm) Jan Auction 2-month bill
During the week: Nationwide department store sales Feb				

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Canada economic calendar

Monday	Tuesday	Wednesday	Thursday	Friday
22 Feb BoC Deputy Governor Jenkins participates in a panel discussion (2:30pm)	**23 Feb**	**24 Feb**	**25 Feb** **Payroll employment** (8:30am) Dec	**26 Feb** **Current account** (8:30am) 4Q -$8.2 bn
1 Mar **Quarterly GDP** (8:30am) 4Q **Monthly GDP** (8:30am) Dec **IPPI** (8:30am) Jan	**2 Mar** **BoC rate announcement** (9:00am)	**3 Mar**	**4 Mar** **Building permits** (8:30am) Jan **Ivey PMI** (10:00am) Feb	**5 Mar**
8 Mar **Housing starts** (8:15am) Feb	**9 Mar**	**10 Mar**	**11 Mar** **International trade** (8:30am) Jan **New house price index** (8:30am) Jan **Capacity utilization** (8:30am) 4Q	**12 Mar** **Employment** (7:00am) Feb
15 Mar **New vehicle sales** (8:30am) Jan	**16 Mar** **Manufacturing sales** (8:30am) Jan **Productivity and costs** (8:30am) 4Q	**17 Mar** **Wholesale trade** (8:30am) Jan	**18 Mar**	**19 Mar** **CPI** (7:00am) Feb **Retail trade** (8:30am) Jan

Latin America economic calendar

Monday	Tuesday	Wednesday	Thursday	Friday
22 Feb **Argentina:** Unemployment rate 4Q **Mexico:** IGAE Dec Real GDP 4Q	**23 Feb** **Argentina:** Trade balance Jan **Brazil:** Retail sales Dec 10.7%,nsa IPCA-15 Feb 0.94% m/m,nsa Current account Jan -US$5.3bn,nsa FDI Jan US$ 4bn, nsa FGV CPI IPC-S Feb 22 0.84%m/m, nsa **Mexico:** Central bank reserves Trade balance Jan Retail sales Dec **Venezuela:** GDP 4Q	**24 Feb** **Brazil:** Fipe CPI Feb 21 0.85%m/m,nsa Consumer confidence Feb Central govt budget Jan **Mexico:** CPI Feb 1H Nominal GDP 4Q	**25 Feb** **Brazil:** IGP-M Feb 0.97%m/m, nsa Unemployment rate Jan 7.7%,nsa Primary budget balance Jan R$13.9bn Net Debt % GDP Jan 40.8%,nsa **Colombia:** IP Dec Retail sales Dec **Mexico:** BoP 4Q Unemployment rate Jan	**26 Feb** **Argentina:** Construction activity Jan **Chile:** BCCh minutes IP Jan Unemployment Jan **Colombia:** BanRep meeting Feb no change Unemployment rate Jan **Peru:** GDP 4Q 12.9%q/q, saar
During the week: **Argentina:** Budget balance Jan **Venezuela:** Unemployment rate Jan				
1 Mar **Brazil:** FGV CPI IPC-S Feb 28 PMI manufacturing Feb Trade balance Feb **Peru:** CPI Feb WPI Feb	**2 Mar** **Brazil:** Fipe CPI Feb 28 **Mexico:** Banxico expectations survey Feb Public sector balance Jan	**3 Mar** **Mexico:** Central bank reserves IMEF PMI survey Feb	**4 Mar** **Brazil:** IP Jan Auto report (Anfavea) Feb **Ecuador:** CPI Feb **Mexico:** Consumer confidence Feb	**5 Mar** **Brazil:** IPCA Feb **Chile:** Economic activity Jan
During the week: **Argentina:** Government tax revenues Feb Auto sales Feb **Brazil**: Capacity utilization Jan **Colombia:** CPI Feb PPI Feb				
8 Mar **Brazil:** FGV CPI GP-DI Feb FGV CPI IPC-S Mar 7 **Chile:** CPI Feb Trade balance Feb	**9 Mar** **Brazil:** FIPE CPI Mar 7 **Mexico:** Central bank reserves CPI Feb Core Feb	**10 Mar** **Brazil:** FGV IGP-M 1st rel Mar **Mexico:** Wage settlements Feb **Peru:** Trade balance Jan	**11 Mar** **Brazil:** Retail sales an GDP 4Q **Colombia:** BanRep minutes **Mexico:** Auto report Feb Gross fixed investment Dec **Peru:** BCRP meeting Mar	**12 Mar** **Argentina:** CPI Feb WPI Feb **Mexico:** IP Jan
During the week: **Colombia:** Trade balance Jan Auto sales Jan **Venezuela:** CPI Feb				
15 Mar **Argentina:** Consumer confidence Mar **Peru:** GDP Jan Unemployment Feb *Holiday: Mexico*	**16 Mar** **Brazil:** FGV CPI IPC-S Mar 15	**17 Mar** **Brazil:** FIPE CPI Mar 15 COPOM meeting Mar	**18 Mar** **Brazil:** FGV IGP-10 Mar **Chile:** GDP 4Q Current account balance 4Q BCCh meeting Mar	**19 Mar** **Argentina:** GDP 4Q Current account balance 4Q IP Feb *Holiday: Venezuela*
During the week:				

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UK/Scandinavia/Switzerland economic calendar

Monday	Tuesday	Wednesday	Thursday	Friday
22 Feb **Switzerland:** Monthly statistical bulletin (09:00am) Jan	**23 Feb** **United Kingdom:** Treasury Committee Hearing - February 2010 Inflation Report: Governor, Charles Bean, Spencer Dale, David Miles & Kate Barker (09:15am) BBA mortgage lending (09:30am) Jan 3.6 ch £bn, sa (secured) Loan approvals 40.0 K, sa BoE's Deputy Governor Paul Tucker speaks (12:10pm) **Sweden:** PPI (09:30am) Dec **Switzerland:** UBS consumption indicator (08:00am) Jan	**24 Feb** **United Kingdom:** BoE's Adam Posen speaks (09:25am) **Sweden:** Riksbank's minutes of monetary policy meeting on 11 February (09:30am) Riksbank's Deputy Governor Lars E O Svensson speaks (02:00pm) **Norway:** AKU unemployment (10:00am) Dec	**25 Feb** **United Kingdom:** Business investment prelim (09:30am) 4Q 0.2 %q/q, sa CBI distributive trades (11:00am) Feb 8%bal, sa BoE's Governor King speaks at the Banking Commission Hearing (09:30am) BoE's David Miles speaks(6:00pm) **Sweden:** Business tendency (09:15am) Feb Consumer conf. (09:15am) Feb PPI (09:30am) Jan **Norway:** Labor directorate unemployment (10:00am) Feb Norges bank's Governor Svein Gjedrem speaks (07:00pm) **Switzerland:** Employment (09:15am) 4Q	**26 Feb** **United Kingdom:** GfK cons. conf. (12:01am) Jan -16 %bal, sa GDP advance (09:30am) 4Q 0.3 %q/q, sa Index of services (9:30) Dec 0.2%m/m, sa **Sweden:** Retail sales (09:30am) Jan Trade balance (09:30am) Jan **Norway:** Mfg wage index (10:00am) 4Q **Switzerland:** KOF leading indicator (11:30am) Feb 1.82 Index, sa
During the week : **United Kingdom:** Nationwide HPI (08:00am) Feb 0.5 %m/m, sa				
1 Mar **United Kingdom:** Net lending to indiv. (09:30am) Jan M4 & lending final (09:30am) Jan PMI mfg (09:30am) Feb **Sweden:** PMI (08:30am) Feb GDP (09:30am) 4Q Wage stats (09:30am) Dec **Norway:** PMI mfg (09:00am) Feb Credit indicator (10:00am) Jan Retail sales (10:00am) Jan NEF house prices (11:00am) Feb **Switzerland:** PMI (09:30am) Feb 57.2%bal,sa	**2 Mar** **United Kingdom:** PMI construction (09:30am) Feb **Switzerland:** GDP (07:45am) 4Q 2.5%q/q, saar	**3 Mar** **United Kingdom:** Markit jobs report (12:01am) Feb Nationwide cons. conf. (12:01am) Feb PMI services (09:30am) Feb **Norway:** BoP (10:00am) 4Q	**4 Mar** **United Kingdom:** New car regs (09:00am) Feb MPC rate announcement & Asset purchase target (12:00pm) Mar No change expected	**5 Mar** **United Kingdom:** PPI (09:30am) Feb **Norway:** IP mfg (10:00am) Jan Government Pension Fund Global. Annual Report 2009 (10:00am)
During the week : **United Kingdom:** Halifax HPI (08:00am) Feb				
8 Mar **Switzerland:** SECO unemployment (07:45am) Feb	**9 Mar** **United Kingdom:** BRC retail sales (12:01am) Feb RICS HPI (12:01am) Feb Trade balance (09:30am) Jan Quoted mortgage interest rates (09:30am) Feb **Norway:** Gallup cons. cons. (07:00am) 1Q **Switzerland:** CPI (09:15am) Feb	**10 Mar** **United Kingdom:** Industrial production (09:30am) Jan **Sweden:** TNS Prospera Inflation expectations survey (08:00am) 1Q Activity index (09:30am) Jan Industrial production (09:30am) Jan Industrial orders (09:30am) Jan AMV unemployment (10:00am)Feb **Norway:** CPI (10:00am) Feb PPI (10:00am) Feb	**11 Mar** **United Kingdom:** BoE/ NOP Inflation attitudes survey (10:30am) **Sweden:** CPI (09:30am) Feb **Norway:** Regional network (10:00am) 1Q **Switzerland:** SNB rate announcement (02:00pm)	**12 Mar**
15 Mar **United Kingdom:** Rightmove HPI (12:01am) Mon BoE bulletin (09:30am) 1Q **Norway:** Trade balance (10:00am) Feb **Switzerland:** Producer and import prices (09:15am) Feb	**16 Mar** **United Kingdom:** DCLG HPI (09:30am) Jan	**17 Mar** **United Kingdom:** MPC minutes (09:30am) Labor mkt report (09:30am) Feb	**18 Mar** **United Kingdom:** Public sector fin. (09:30am) Feb M4 and lending prelim(9:30am)Feb CBI industrial trends (11:00am)Mar **Sweden:** Labor force survey (09:30am) Feb **Switzerland:** Trade balance (08:15am) Feb Industrial production (09:15am) 4Q SNB' Jean-Pierre Danthine speaks (06:00pm)	**19 Mar**

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Emerging Europe/Middle East/Africa economic calendar

Monday	Tuesday	Wednesday	Thursday	Friday
22 Feb **Hungary:** Monetary policy announcement -25bp **Israel:** Monetary policy announcement no change	**23 Feb** **Poland:** Retail sales (10:00am) Feb 6.0%oya **South Africa:** GDP (11:30am) 4Q09 3.0%q/q, saar	**24 Feb** **Hungary:** Retail trade (9:00am) Dec -7.4%oya NBH Inflation Report (10:00am) **Poland:** Monetary policy announcement No change **South Africa:** CPI (11:30am) Jan 6.4%oya	**25 Feb** **South Africa:** PPI (11:30am) Jan	**26 Feb** **Czech Republic:** Industry output Jan (9.00am) 10%oya **South Africa:** M3 (8:00am) Jan Private sector credit extension (8:00am) Jan 0.0%oya Trade balance (2:00pm) Jan R-6.8bn **Turkey:** Trade balance (10:00am) Jan –US$2.2bn
During the week:				
1 Mar **Hungary:** PPI (9:00am) Jan PMI (9:00am) Feb **Poland:** PMI (9:00am) Feb **South Africa:** Kagiso PMI (11:00am) Feb	**2 Mar** **Poland:** GDP (10:00am) 4Q 3.0%oya **South Africa:** Vehicle sales (11:00am) Feb	**3 Mar** **Romania:** Final GDP (9:00am) 4Q **Turkey:** CPI (10:00am) Feb 0.7%mom PPI (10:00am) Feb 1.2%mom	**4 Mar**	**5 Mar**
During the week:				
8 Mar **Czech Rep:** Trade balance (9:00am) Jan **Israel:** Current account 4Q **Turkey:** Industrial production (10:00am) Jan	**9 Mar** **Czech Rep:** CPI (9:00am) Feb Average real wage (9:00am) 4Q **Hungary:** Industrial output (9:00am) Jan	**10 Mar** **Czech Rep:** Current account (10:00am) 4Q **Hungary:** Final GDP (9:00am) 4Q **Romania:** CPI (9:00am) Feb	**11 Mar** **Czech Rep:** Final GDP (9:00am) 4Q **Hungary:** CPI (9:00am) Feb Trade balance (9:00am) Feb **Turkey:** Balance of payments (10:00am) Jan	**12 Mar** **Czech Rep:** Current account (10:00am) Jan **Poland:** Current account (2:00pm) Jan **Romania:** Current account ytd Jan **Turkey:** Capacity utilization (10:00am) Feb 67.5%
During the week:				
15 Mar **Israel:** CPI (6:00pm) Feb **Poland:** CPI (2:00pm) Feb	**16 Mar** **Czech Rep:** Retails sales (9:00am) Jan **Poland:** Average gross wages and employment (2:00pm) Feb	**17 Mar** **Hungary:** Central bank minutes **Poland:** PPI (2:00pm) Feb	**18 Mar** **Turkey:** MPC decision (10:00am) no change	**19 Mar** **Hungary:** Average gross wages (9:00am) Jan
During the week:				

Non-Japan Asia economic calendar

Monday	Tuesday	Wednesday	Thursday	Friday
22 Feb **Australia:** New motor vehicle sales (10: 30 am) Jan **Taiwan:** GDP (1:30 pm) 4Q 6.2 %oya Unemployment rate (4:00 pm) Jan 5.2 %, sa **Thailand:** GDP (9: 30 am) 4Q 3.3%oya	**23 Feb** **Hong Kong:** CPI (4:30 pm) Jan 1.3 %oya **Singapore:** CPI (1:00 pm) Jan 0.9%oya	**24 Feb** **Australia:** Labor price index (10:30 am) 4Q 0.8 %q/q,sa **Hong Kong:** GDP (11:00 pm) 4Q 0.6 %oya **Korea:** Consumer survey Feb 112 Index, nsa **Malaysia:** CPI (5:00 pm) Jan 1.6 %oya GDP (6:00 pm) 4Q 1.7 %oya	**25 Feb** **Australia:** Pvt. capital exp. (10:30 am) 4Q 4.5 %q/q,sa Construction work done (10:30 am) 4Q 3.5%q/q, sa **Hong Kong:** Trade balance (4:30 pm) Jan **Korea:** Current account (8:00 am) Jan -0.3 US$ bn **New Zealand:** NBNZ business confidence (2: 00 pm) Feb 35 %bal **Philippines:** Trade balance (9.00 am) Dec 3.4 US$bn Imports (9.00 am) Dec	**26 Feb** **Australia:** Pvt. Sector credit (11:30 am) Jan 0.2 %m/m,sa **India:** GDP 4Q Union Budget FY 11 **New Zealand:** Building permits (10:45 am) Jan Trade balance (10:45 am) Jan -100 NZ$ mn,nsa **Singapore:** IP (1:00 pm) Jan 15.7 %oya **Taiwan:** Export Orders (4:00 pm) Jan 78.3 %oya IP (4:00 pm) Jan 77.2%oya Leading index (4:00 pm) Jan **Thailand:** Trade balance (2:30 pm) Jan -0.3 US$ bn IP Jan 37.2 %oya PCI Jan 6.5 %oya PII Jan 4.5 %oya *Holiday Indonesia, Malaysia*
During the week: **China:** FDI Jan **Korea:** FKI Business survey Feb 109.0 Index, nsa Bankruptcy fillings Jan 145 Number **Vietnam:** CPI Feb 9.0%oya Trade balance Feb -2.0US$ bn				
1 Mar **Australia:** Company operating profits (11:30 am) 4Q Current account (11:30 am) 4Q Inventories (11:30 am) 4Q **China:** PMI manufacturing (9:00 am) Feb **Indonesia:** CPI (2:00 pm) Feb Trade balance (2:00 pm) Jan **New Zealand:** Visitor arrivals (10:45 am) Jan ANZ commodity price (2:00 pm) Feb **Thailand:** CPI (2:00 pm) Feb *Holiday India, Korea, Thailand*	**2 Mar** **Australia:** Building approvals (11:30 am) Jan Retail sales (11:30am) Jan RBA cash target (2:30 pm) Mar **India:** Trade balance Jan **Korea:** CPI (1:30 pm) Feb Trade balance (10:00 am) Feb **Singapore:** PMI (9:30 pm) Feb	**3 Mar** **Australia:** GDP (12:30 am) 4Q **Korea:** IP (1:30 pm) Jan Leading index (1:30 pm) Jan Service sector activity (1:30 pm) Jan	**4 Mar** **Australia:** Trade balance (12:30 am) Jan **Hong Kong:** Retail sales (4:30 pm) Jan **Indonesia :** BI rate announcement (1:00 pm) Mar **Malaysia:** BNM monetary policy meeting (6:00 pm) Mar	**5 Mar** **Malaysia:** Trade balance (6:00 pm) Jan **Philippines:** CPI (9:00 am) Feb **Taiwan:** CPI (4: 00 pm) Feb
During the week: **New Zealand:** QV house prices Feb				
8 Mar **Taiwan:** Trade balance (4:00 pm) Feb **New Zealand:** Manufacturing activity (10:45 am) 4Q	**9 Mar** **Australia:** NAB bus. Confidence (11: 30 am) Feb ANZ job ads Feb **Korea:** PPI (12:00pm) Feb	**10 Mar** **Australia:** Westpac consumer confidence (10: 30 am) Mar Housing finance approvals Jan **China:** Trade balance (10:00 am) Feb **Korea:** Money supply Jan **New Zealand:** Terms of trade index (10:45 am) 4Q **Philippines :** Exports Jan **Thailand:** BoT monetary policy meeting (2:30 pm) Mar	**11 Mar** **Australia:** Unemployment rate (11:00 am) Feb **China:** CPI, PPI, (10:00 am) Feb FAI (10:00am) Feb Retail sales, IP (10:00 am) Feb **Korea:** Bank of Korea monetary policy meeting (10:00 am) Mar **Malaysia:** IP (12:00 pm) Jan **New Zealand:** Business NZ PMI (10:30 pm) Feb RBNZ official cash rate Mar **Philippines :** BSP Monetary policy meeting (5:00 pm) Mar	**12 Mar** **India:** IP Jan **New Zealand:** Retail sales (10:45 am) Jan **Singapore:** Retail sales (1:00 pm) Jan
During the week: **China:** Money supply Feb **Korea:** Export price index Feb Import price index Feb SPPI Jan				
15 Mar **Philippines:** OFW remittances (10:45 am) Jan	**16 Mar** *Holiday Indonesia*	**17 Mar** **Australia:** Dwelling starts 4Q Westpac leading index Jan **Korea:** Unemployment rate Feb **Malaysia:** CPI (5:00 pm) Feb **Philippines:** BOP (2:00 pm) Feb **Singapore:** NODX (1:00 pm) Feb	**18 Mar** **Hong Kong:** Unemployment rate (4:30 pm) Feb	**19 Mar** **New Zealand:** Visitor arrivals (10:45 am) Feb Credit card spending (2:00 pm) Feb **Taiwan:** Export Orders (4:00 pm) Feb
During the week: **China:** FDI Feb				

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Global Data Diary

Week / Weekend	Monday	Tuesday	Wednesday	Thursday	Friday
22 - 26 February	**22 February**	**23 February**	**24 February**	**25 February**	**26 February**
	Germany • CPI prelim (Feb) **Hungary** • NBH mtg: -25bp **Israel** • BoI mtg: No Chg **Mexico** • Real GDP (4Q) **Taiwan** • GDP (4Q)	**Brazil** • Retail sales (Dec) **France** • Cons of mfg goods (Jan) • CPI (Jan) **Germany** • IFO bus surv (Feb) **Japan** • BoJ minutes: Jan 25-26 **South Africa** • GDP (4Q) **United States** • Richmond Fed surv (Feb) • S&P/C-S HPI (Dec, 4Q)	**Euro area** • Industrial orders (Dec) **Germany** • GDP final (4Q) **Japan** • Shoko Chukin (Feb) • Trade balance (Jan) **Poland** • NBP mtg: No Chg **United States** • New home sales (Jan) • Bernanke delivers semiannual House testimony	**Euro area** • EC bus survey (Feb) • M3 (Jan) **Germany** • Labor mkt report (Feb) **Italy** • ISAE bus surv (Feb) **United Kingdom** • Bus invest prelim (4Q) **United States** • Durable goods (Jan) • FHFA HPI (Dec, 4Q) • Bernanke delivers semiannual Senate testimony	**Colombia** • BanRep mtg: No Chg **Euro area:** HICP final (Jan) **India:** GDP (4Q) **Japan** • CPI, IP prelim, Retail sales (Jan) • PMI mfg (Feb) **Taiwan** • Export orders, IP (Jan) **UK:** GDP (4Q) **United States** • Chicago PMI (Feb) • Consumer sent (Feb) • Existing homes (Jan) • GDP 2nd est (4Q)
1 - 5 March	**1 March**	**2 March**	**3 March**	**4 March**	**5 March**
	Canada: GDP (4Q) **China:** PMI mfg (Feb) **Euro area** • PMI mfg final (Feb) • Unemployment (Jan) **Japan:** Auto regs (Feb) **Sweden:** GDP (4Q) **UK:** PMI mfg (Feb) **United States** • Construct spending (Jan) • ISM mfg (Feb) • Personal income (Jan)	**Australia** • Retail sales (Jan) • RBA mtg: No Chg **Canada** • BoC mtg: No Chg **Euro area:** HICP flash (Feb) **Japan** • Hhold spending (Jan) • Unemployment (Jan) **Korea** • CPI, Trade balance (Feb) **Poland:** GDP (4Q) **United States:** LV sales (Feb)	**Australia:** GDP (4Q) **Euro area** • PMI services final (Feb) • Retail sales (Jan) **Japan:** PMI services (Feb) **Korea:** IP (Jan) **Turkey:** CPI (Feb) **United Kingdom** • PMI services (Feb) **United States** • ADP employment (Feb) • Beige book • ISM nonmfg (Feb)	**Brazil** • Auto report (Feb) • IP (Jan) **Euro area** • GDP prelim (4Q) • ECB mtg: No Chg **Indonesia:** BI mtg: No Chg **Japan:** MoF corp survey (4Q) **Malaysia:** BNM mtg: +25bp **United Kingdom** • New car regs (Feb) • BoE mtg: No Chg **United States** • Factory orders (Jan) • Pending homes (Jan) • Productity and costs (4Q)	**Brazil** • IPCA (Feb) **Germany** • Mfg orders (Jan) **United States** • Consumer credit (Jan) • Employment (Feb)