Global Data Watch

- **Global capital spending likely to rise this year at its fastest pace in a quarter century**
- **Even as the fiscal picture in Greece worsens, the Euro area is on track for a growth bounce into midyear**
- **Brazil to kick off a broadening in EM central bank tightening with a 50bp hike next week**
- **The BoJ to ease further as it shifts to a more activist anti-deflationary stance**

Contents

Economic Research note

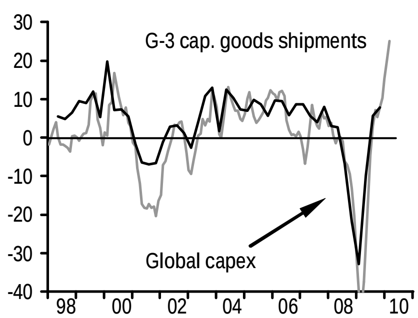
Global capital spending is starting to boom

Capital spending is generally one of the last components of demand to recover during a global economic upturn. However, a coincident turn in growth and capital spending is now under way. Global investment demand lifted in the middle of last year with business capital spending expanding at a solid 6.6% annualized pace during 2H09. High-frequency indicators from the largest capital goods producers suggest that demand for capital equipment accelerated dramatically during the first four months of this year. Shipments from the US, Germany, and Japan—which closely track global investment spending—rose at a more than 20% annualized rate last quarter. Meanwhile, the German Ifo survey points to a further sharp acceleration in demand for capital goods in April. This surge partly reflects restocking, but it now looks likely that global capital spending will rise at a double-digit pace over the course of 2010—an outcome that could prove as strong as any over the past quarter century.

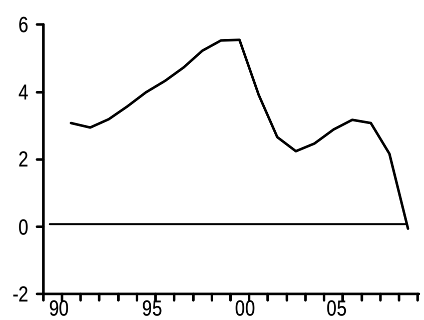
In countries that have avoided recession (China, India) or have been lifted by strong commodity prices and capital inflows (Brazil, Australia), a desire to expand plant and equipment lies behind investment spending gains. However, the global investment upturn is now largely being driven by growth in countries in which utilization rates are depressed and business attitudes remain cautious. This dynamic is in line with our views about the "paradox of lift," which allows for investment spending to pick up even at this point in the business cycle when operating rates are still low.

Having slashed capital expenditure budgets in an unprecedented manner during the financial crisis, the level of investment spending dipped below the level of depreciation in the major developed economies last year. Consequently,

Shipments and global capex
%3m/3m (shipments), %q/q (capex) saar



G-7 capital stock
% oya



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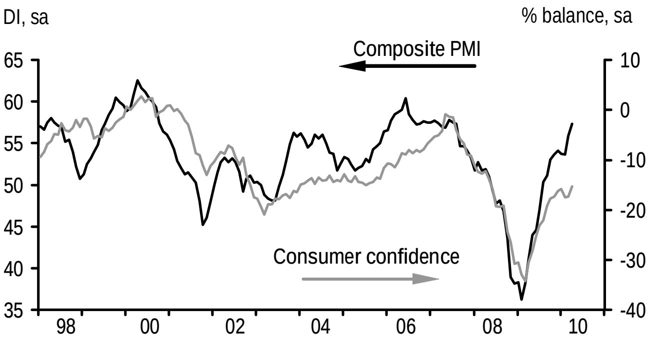
Euro area PMI and consumer confidence



2009 will likely mark the first year since World War II in which the developed world has seen an outright decline in its capital stock. From this starting point, the recovery in sentiment and earnings under way provides a powerful lever for lifting capital spending. Indeed, significant growth in business investment will be required for a number of quarters simply to return the pace of capital deepening to its lowest point over the past decade. Although it remains unclear how far forward firms will actually travel, the latest indicators provide an important reminder that the normalization of sentiment of firms and households provides a powerful engine for growth in the aftermath of deep downturns.

Widespread rate hikes just around corner

For a broad range of emerging market and commodity-producing nations, momentum is shifting decisively toward normalizing policy. Just five central banks have hiked rates since the start of the recovery (Australia, Norway, India, Malaysia, and Israel). Three months from now, we project this number to rise to 14. The breadth of action should not mask the limited size of adjustments expected. In all, we are looking for about 65bp of EM rate hikes this year—an amount representing less than one quarter of the easing delivered during the recession. Notably, after a couple of weeks of intense speculation, Chinese officials have yet to make a move on either rates or the currency (we maintain we will see a move by May).

The EM central banks at the vanguard of this policy shift are in Asia. Bank Negara Malaysia kicked off the rate hiking cycle in EM Asia early last month, followed shortly by the Reserve Bank of India. This week, the RBI added an additional 25bp to its main policy rates, and hinted that it may hike in between its quarterly policy reviews. The key factor driving the timing of such a hike, which we are now forecasting, would be WPI inflation prints in the coming months. If headline inflation surges above the 10% level—the RBI's expected peak rate—a strong policy action could follow.

Although central banks in Thailand and the Philippines stayed on hold this week, the tone of the accompanying statements turned more hawkish, signaling hikes at the next policy meeting. In the case of Thailand, the recent political uncertainty kept the BoT on hold even as the data argued for a hike. The risk is that a further deterioration in the political climate may yet keep the central bank on hold indefinitely.

Among the commodity-producing economies, the timing of rate actions has been largely dependent upon external factors. Concerns surrounding the sustainability of the US recovery have kept the Bank of Canada on hold to date. However, with the US recovery gathering momentum, the BoC rate announcement this week noted that its "extraordinary" policy measures are no longer warranted, a view underscored by the material improvements to the economic outlook in this week's Monetary Policy Report. In response, we have pulled forward our call for the first BoC rate hike to June (from July).

Next week's central bank meetings in the Americas should deliver a sharp contrast. After remaining on hold in a close split decision last month, Brazil's COPOM will begin tightening policy. We expect a 50bp hike, which should be followed by more aggressive action ahead. The FOMC should upgrade its assessment of growth in next week's statement while maintaining its "extended period" language. Although an active debate will likely take place around the timing of asset sales, no new information is likely to come from the statement.

The BoJ to ease as Japan gathers steam

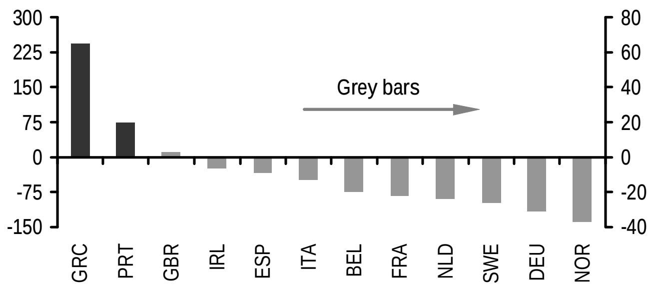
Solid growth of March export volumes confirms that Japan is continuing to enjoy the benefits of living in a rapidly growing neighborhood. With service sector activity also picking up, risks to our already upbeat GDP forecast remain skewed to the upside. Realization of forecasts for next week's key March releases will likely prompt a further upward revision to 1H10 GDP (currently 2.8% annualized).

The BoJ is also expected to upgrade its growth and inflation outlook in its April Outlook report next week. It is notable that it is likely to lift its FY2011 core CPI forecast to positive territory and follow this change with further easing—either next week or in June. We expect the BoJ to extend the maturity of the fixed-rate operation from three months to six months in June.

The specific action should be seen as less important than the signal of a new strategy emerging whereby the BoJ is more active in promoting an exit from deflation, by gearing

Change in 10-year sovereign debt yields, year-to-date

Bp, both scales



policy and rhetoric to boost sentiment and signal its comfort with a weaker yen. Part of this new strategy will entail a closer alignment of the BoJ with the government's medium-term fiscal and growth objectives to be presented in June ahead of the summer elections.

Greek pain won't keep Euro area down

Growing market concerns that the Greek fiscal crisis is quickly morphing into a solvency crisis (or was one all along) were fed this week by Eurostat's estimate that the Greek 2009 debt position could be revised up to 115% of GDP. Moreover, the agency noted that the 2009 deficit could be revised up further, by as much as 5% to 7%-pts from its already eye-popping level of 13.6%. In response to deteriorating financing conditions, on Friday Greece formally requested to activate the support mechanism. European leaders have suggested that, if necessary, funds could be made available within a couple of weeks. But the medium-term challenge of Greece achieving debt sustainability remains daunting, and this is increasingly spooking markets.

While the Greece debt saga is important on its own, the bigger concern is one of contagion to the rest of Western Europe. At present spillover is working through two offsetting channels. First, increased credit risk is acting to push up sovereign debt yields even as the macroeconomic risk from weaker growth is acting to push down borrowing rates. Not surprisingly, changing perceptions of credit risk appear largest for those economies facing the most severe fiscal challenges (Greece and Portugal), and seem to be sufficient to roughly offset the changing perceptions of macroeconomic risk where fiscal woes are still intense (the UK, Ireland, Spain, and Italy). By contrast, changes in macroeconomic risk owing to a slower recovery that keeps central banks on hold longer is dominating in the more fiscally sound parts of the region. Indeed, yields in Germany and Norway have fallen over 30bp year-to-date and are also down considerably in France and Sweden.

For the region as whole, we maintain that the powerful cyclical lifts springing from a decisive shift away from retrenchment toward expansion will dominate the structural, fiscal, and delevering drags. Based on the Euro area flash PMI reading for April, GDP growth has stepped up to a near 3%q/q saar pace, in line with our outlook. At the same time, consumer confidence also appears to have reestablished its uptrend this month, making a new high for this upswing and suggesting that an important behavioral shift is under way.

EM insulated from Greek woes

EM debt markets have displayed impressive resilience this year. In addition to the sustained growth outperformance of EM versus DM economies, EM assets are being supported by record inflows of $14 billion into EM equity retail funds and $24 billion into EM debt retail and institutional funds so far this year. Thus, as Greece faces increasing challenges to rollover debt maturities, EM sovereign and corporate issuers are enjoying easy access to international capital markets. Indeed, EM sovereigns have raised $40.2 billion in external bonds (56% of the expected issuance for the full year) and EM corporates have issued an even higher $54.8 billion (49% of this year's target).

This week's most notable visitor to the market was Russia, which issued a $5.5 billion Eurobond—the first such placement since its 1998 debt restructuring. Russia's ability to issue debt to support its recovery is an important part of the growth outlook: while growth slowed to around 1%-2% saar in 1Q10 due to cold weather, the economy should gather steam in the quarters ahead. In contrast to the rest of the CEEMEA region, which is expected to grow below potential this year, Russia and the GCC bloc will grow above potential with the help of strong oil windfalls. Indeed, if oil prices stay firmly above $80/bbl, Russian corporates will likely try to access external markets with the help of the new benchmark created by the sovereign this week. This suggests upside risks to our 5.5% growth forecast for Russia in 2010.

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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	4Q09	1Q10	2Q10	3Q10	4Q10	1Q11	2Q11	1Q10	2Q10	4Q10	2Q11
The Americas														
United States	-2.4	3.5	3.1	5.6	**3.0** ↑	4.0	4.0	3.5	2.5	2.5	2.4	2.2	1.2	1.1
Canada	-2.6	3.2	3.3	5.0	4.5	3.0	3.3	4.0	4.0	2.3	1.7	1.4	1.9	2.1
Latin America	-2.9	4.9	3.8	7.2	5.2	4.6	2.6	4.5	4.0	4.9	5.8	6.3	7.0	6.9
Argentina	-2.0	4.5	3.0	7.9	8.0	8.0	3.0	3.0	2.0	3.0	7.5	8.0	10.0	10.0
Brazil	-0.2	7.0	4.0	8.4	8.7	6.3	4.8	4.0	3.8	4.2	4.8	4.9	5.0	4.5
Chile	-1.5	5.5	5.5	5.9	-6.0	8.0	22.0	18.0	-2.0	-6.0	0.2	3.3	4.1	3.8
Colombia	0.4	3.0	4.1	4.7	2.7	2.8	2.9	3.1	4.5	4.8	2.0	2.1	3.7	2.9
Ecuador	0.4	2.0	3.0	1.3	2.0	3.5	4.0	4.5	3.0	2.5	4.1	3.9	4.7	4.4
Mexico	-6.5	4.5	3.5	8.4	5.0	3.2	-3.8	4.2	5.7	7.9	4.6	4.4	5.1	4.5
Peru	0.9	6.0	6.0	11.5	4.1	4.3	4.6	5.0	6.3	7.2	0.6	1.0	2.0	2.2
Venezuela	-3.3	-1.5	2.5	-4.6	-4.0	-2.0	12.5	1.5	1.5	1.5	27.6	31.8	33.7	39.3
Asia/Pacific														
Japan	-5.2	2.6	1.9	3.8	3.5	2.0	2.0	2.2	1.8	1.5	**-1.3** ↑	**-1.7** ↓	-0.8	**0.1** ↑
Australia	1.3	3.1	3.6	3.7	3.0	3.3	3.8	3.9	3.1	4.2	2.5	2.5	2.6	3.0
New Zealand	-1.6	2.8	2.5	3.3	3.2	3.2	3.7	2.9	1.3	2.3	2.2	2.3	2.5	2.8
Asia ex Japan	4.6	8.5	7.2	7.6	10.1	7.1	6.4	6.8	7.2	7.4	3.8	4.4	**3.8** ↑	3.2
China	8.7	10.8	9.4	10.8	13.1	9.4	9.3	9.0	9.1	9.5	2.2	3.2	3.1	2.4
Hong Kong	-2.7	5.3	4.2	9.5	4.5	4.3	4.0	3.8	4.2	4.3	1.1	2.4	2.3	1.9
India	7.2	8.0	8.3	-2.0	10.4	8.1	7.0	8.7	7.9	7.8	12.7	11.9	6.2	5.5
Indonesia	4.5	6.2	5.8	9.6	6.0	6.0	4.0	5.0	6.5	6.5	4.4	5.3	6.3	4.9
Korea	0.2	5.3	4.1	0.7	5.6	4.2	4.2	3.5	4.0	4.0	2.7	2.8	3.4	3.6
Malaysia	-1.7	7.7	4.8	15.4	5.0	4.0	5.0	5.0	4.9	4.9	0.8	1.7	2.4	2.4
Philippines	0.9	4.5	4.3	3.5	6.0	5.0	3.5	4.0	4.5	4.5	4.3	5.0	5.2	4.9
Singapore	-2.0	9.0	4.0	-2.8	32.1	5.3	-9.6	4.9	6.6	6.6	**0.9** ↑	**3.4** ↑	**4.7** ↑	**3.7** ↑
Taiwan	-1.9	8.2	4.8	18.0	5.7	3.6	3.8	4.0	5.0	5.3	-0.3	0.9	2.0	1.8
Thailand	-2.3	7.3	6.6	15.3	5.7	5.3	3.6	3.6	8.0	8.0	4.0	5.5	4.4	3.0
Africa/Middle East														
Israel	0.7	3.0	4.5	**4.8** ↓	3.5	3.5	3.0	3.0	4.0	5.0	**3.5** ↓	2.7	2.7	3.1
South Africa	-1.8	3.0	3.5	3.2	3.9	4.2	4.0	4.0	3.6	2.8	5.6	4.6	5.4	5.7
Europe														
Euro area	-4.0	1.5	2.1	0.2	1.5	3.0	2.3	2.0	2.0	2.0	1.1	1.2	1.1	0.8
Germany	-4.9	1.7	2.1	0.0	1.0	3.0	2.0	2.0	2.0	2.0	0.9	0.9	1.3	1.3
France	-2.2	2.0	2.2	2.4	1.5	3.0	2.0	2.5	2.0	2.0	1.4	1.4	0.9	0.9
Italy	-5.1	0.9	1.7	-1.3	1.0	2.5	1.5	2.0	1.5	1.5	1.3	1.1	1.1	1.1
Norway	-1.4	2.1	2.8	1.3	2.0	3.0	3.0	3.0	2.8	2.8	3.1	3.2	1.7	0.7
Sweden	-4.7	**1.3** ↓	**3.1** ↑	-2.2	**2.2** ↓	3.5	**3.5** ↑	3.0	3.0	3.0	1.2	1.6	1.2	1.9
Switzerland	-1.5	2.5	2.8	3.0	2.5	2.8	3.0	3.0	2.8	2.8	1.1	1.0	0.9	0.8
United Kingdom	-4.9	**1.4** ↓	3.2	1.8	**0.8** ↓	3.0	3.0	3.5	3.0	3.0	**3.3** ↑	**2.9** ↑	**1.9** ↑	1.5
Emerging Europe	-5.0	4.1	4.7	**5.0** ↑	1.8	4.5	3.9	3.8	4.1	4.4	**6.2** ↑	5.8	5.9	5.4
Bulgaria	-5.0	-1.5	4.5	...	...	...	...	...	...	...	...	...	...	...
Czech Republic	-4.2	2.0	4.0	3.0	2.5	2.5	2.0	2.0	3.5	4.5	0.6	1.2	2.8	2.8
Hungary	-6.3	0.5	4.0	-1.7	1.5	2.5	2.0	2.0	4.0	4.0	6.1	4.8	3.7	2.8
Poland	**1.8** ↑	3.2	4.2	**5.3** ↑	3.0	4.0	2.7	3.0	3.0	4.0	**3.0** ↑	2.0	2.6	2.8
Romania	-7.1	1.5	4.0	...	...	...	...	...	...	...	4.9	4.5	4.5	4.5
Russia	-7.9	5.5	5.0	8.1	1.0	6.0	5.5	5.0	5.0	5.0	7.3	6.5	7.2	7.0
Turkey	-4.7	5.1	5.5	...	...	...	...	...	...	...	9.3	10.3	8.5	6.6
Global	-2.5	3.4	3.3	4.0	3.5	3.8	3.4	3.4	3.1	3.1	2.2	2.1	1.8	**1.7** ↑
Developed markets	-3.4	2.6	2.6	3.2	2.5	3.3	3.1	2.9	2.3	2.3	1.5	1.3	1.0	**1.0** ↑
Emerging markets	1.0	6.7	5.8	6.9	7.3	5.9	4.9	5.6	5.8	6.2	4.8	5.0	4.9	4.4
Memo:														
Global — PPP weighted	-0.8	4.7	4.4	4.8	4.7	4.5	4.0	4.1	3.9	3.9	3.1	3.2	2.8	2.6

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	4Q	1Q	2Q	3Q	4Q	1Q	2Q	3Q
United States											
Real GDP	-2.4	3.5	3.1	5.6	3.0	4.0	4.0	3.5	2.5	2.5	3.0
Private consumption	-0.6	2.4	2.6	1.6	3.1	2.8	3.0	3.0	2.5	2.0	2.5
Equipment investment	-16.6	9.9	9.5	19.0	9.0	12.0	12.0	10.0	9.0	8.0	8.0
Non-residential construction	-19.8	-13.7	1.5	-18.0	-18.0	-8.0	-3.0	-3.0	0.0	7.0	9.0
Residential construction	-20.5	1.6	15.7	3.7	-10.0	5.0	10.0	15.0	15.0	20.0	20.0
Inventory change ($ bn saar)	-108.3	46.6	54.7	-19.7	26.2	44.7	57.0	58.2	50.4	52.5	56.0
Government spending	1.8	1.1	0.0	-1.3	0.4	1.4	1.1	1.4	-0.8	-1.0	-1.0
Exports of goods and services	-9.6	12.5	9.6	22.8	7.0	14.0	12.0	10.0	9.0	9.0	8.0
Imports of goods and services	-13.9	9.6	7.5	15.8	9.0	8.0	8.0	8.0	7.0	8.0	7.0
Domestic final sales contribution	-2.8	2.1	2.9	1.5	2.0	2.9	3.3	3.4	2.6	2.5	2.9
Inventories contribution	-0.6	1.2	0.1	3.8	1.4	0.6	0.4	0.0	-0.2	0.1	0.1
Net trade contribution	1.0	0.1	0.1	0.3	-0.4	0.5	0.3	0.1	0.1	0.0	0.0
Consumer prices (%oya)	-0.3	1.8	1.2	1.5	2.4	2.2	1.5	1.2	1.1	1.1	1.2
Excluding food and energy (%oya)	1.7	0.8	0.6	1.7	1.3	0.9	0.6	0.3	0.4	0.4	0.6
Federal budget balance (% of GDP, FY)	-9.9	-10.1	-7.8								
Personal saving rate (%)	4.2	3.1	3.4	3.9	3.0	3.1	3.1	3.2	3.2	3.3	3.4
Unemployment rate (%)	9.3	9.5	9.1	10.0	9.7	9.4	9.5	9.4	9.3	9.1	9.0
Industrial production, manufacturing	-11.3	4.9	3.9	5.6	6.6	5.0	5.0	4.0	3.0	3.0	4.5
Euro area											
Real GDP	-4.0	1.5	2.1	0.2	1.5	3.0	2.3	2.0	2.0	2.0	2.0
Private consumption	-1.0	0.0	1.3	-0.2	-1.0	1.0	1.0	1.0	1.5	1.5	1.5
Capital investment	-10.8	-1.1	3.8	-5.2	-1.0	2.0	3.0	4.0	4.0	4.0	4.0
Government consumption	2.3	0.8	1.0	-0.4	0.0	1.0	1.0	1.0	1.0	1.0	1.0
Exports of goods and services	-12.8	8.3	8.1	7.6	9.0	10.0	8.0	8.0	8.0	8.0	8.0
Imports of goods and services	-11.4	5.7	7.7	5.1	5.0	7.5	6.5	7.5	8.0	8.0	8.0
Domestic final sales contribution	-2.5	0.0	1.7	-1.3	-0.8	1.2	1.4	1.6	1.9	1.9	1.9
Inventories contribution	-0.8	0.5	0.1	0.4	0.6	0.7	0.1	0.1	0.0	0.0	0.0
Net trade contribution	-0.8	1.1	0.3	1.0	1.7	1.1	0.7	0.4	0.2	0.2	0.2
Consumer prices (HICP, %oya)	0.3	1.2	0.9	0.4	1.1	1.2	1.2	1.1	0.9	0.8	0.9
ex unprocessed food and energy	1.3	0.9	0.6	1.0	1.0	1.0	0.8	0.7	0.5	0.6	0.7
General govt. budget balance (% of GDP, FY)	-6.1	-6.7	-5.5								
Unemployment rate (%)	9.4	9.9	9.5	9.9	10.0	10.0	9.8	9.7	9.6	9.5	9.4
Industrial production	-14.7	3.1	3.2	8.2	2.0	4.0	3.5	3.5	3.0	3.0	3.0
Japan											
Real GDP	-5.2	2.6	1.9	3.8	3.5	2.0	2.0	2.2	1.8	1.5	2.0
Private consumption	-1.1	2.5	1.1	2.8	3.0	1.4	1.8	1.8	0.5	0.5	1.0
Business investment	-19.3	1.8	5.1	3.8	5.0	6.0	6.0	6.0	4.0	5.0	5.0
Residential construction	-13.9	-0.7	4.6	-12.5	20.0	15.0	10.0	5.0	5.0	0.0	0.0
Public investment	6.6	-3.9	-7.6	-5.0	8.0	-20.0	-10.0	-5.0	-5.0	-5.0	-10.0
Government consumption	1.6	1.1	0.9	2.5	0.5	1.5	0.5	1.0	1.2	0.5	1.0
Exports of goods and services	-24.2	18.5	10.4	21.7	15.0	12.0	10.0	10.0	12.0	8.0	10.0
Imports of goods and services	-17.1	9.0	8.8	5.1	12.0	8.0	10.0	10.0	10.0	6.0	8.0
Domestic final sales contribution	-3.5	1.7	1.3	2.1	3.2	1.4	1.8	2.0	1.0	0.9	1.1
Inventories contribution	0.2	-0.6	0.0	-0.6	-0.6	-0.3	-0.2	-0.2	0.1	0.0	0.2
Net trade contribution	-2.0	1.5	0.6	2.2	0.9	0.9	0.4	0.4	0.7	0.6	0.7
Consumer prices (%oya)	-1.4	-1.3	-0.1	-2.0	-1.3	-1.7	-1.4	-0.8	-0.6	0.1	0.1
General govt. net lending (% of GDP, CY)	-6.8	-7.5	-8.9								
Unemployment rate (%)	5.1	4.8	4.6	5.2	4.9	4.8	4.8	4.7	4.6	4.6	4.5
Industrial production	-22.3	18.6	12.1	19.7	19.0	10.0	12.0	14.0	10.0	10.0	15.0
Memo: Global industrial production	-11.1	7.3	5.5	9.4	6.9	6.2	6.1	5.7	4.7	5.0	6.2
%oya				-2.8	7.5	8.4	7.1	6.2	5.7	5.4	5.4

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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Central Bank Watch

	Official interest rate	Current	Change from Aug '07 (bp)	Last change	Next meeting	Forecast next change	Jun 10	Sep 10	Dec 10	Mar 11	Jun 11
Global	GDP-weighted average	1.30	-336				1.35	1.44	1.53	1.67	2.00
excluding US	GDP-weighted average	1.85	-250				1.93	2.07	2.20	2.40	2.71
Developed	GDP-weighted average	0.51	-360				0.52	0.56	0.60	0.72	1.07
Emerging	GDP-weighted average	4.44	-242				4.66	4.99	5.26	5.48	5.75
Latin America	GDP-weighted average	5.72	-321				6.22	6.78	7.47	7.65	8.15
CEEMEA	GDP-weighted average	4.25	-260				4.17	4.41	4.51	4.70	5.14
EM Asia	GDP-weighted average	4.04	-205				4.26	4.54	4.72	4.97	5.09
The Americas	GDP-weighted average	0.75	-484				0.82	0.91	1.02	1.07	1.47
United States	Federal funds rate	0.125	-512.5	16 Dec 08 (-87.5bp)	28 Apr 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 Jun 10	**2 Jun 10 (+25bp)**	0.50	1.00	1.50	2.00	2.50
Brazil	SELIC overnight rate	8.75	-325	22 Jul 09 (-50bp)	28 Apr 10	28 Apr 10 (+50bp)	10.00	11.25	12.25	12.25	12.25
Mexico	Repo rate	4.50	-270	17 Jul 09 (-25bp)	21 May 10	Oct 10 (+25bp)	4.50	4.50	5.00	5.00	5.75
Chile	Discount rate	0.50	-450	9 Jul 09 (-25bp)	13 May 10	Jun 10 (+25bp)	0.75	1.50	2.25	3.75	5.00
Colombia	Repo rate	3.50	-550	23 Nov 09 (-50bp)	30 Apr 10	1Q 11 (+50bp)	3.50	3.50	3.50	4.50	5.50
Peru	Reference rate	1.25	-325	6 Aug 09 (-75bp)	6 May 10	10 Jun 10 (+25bp)	1.50	2.25	3.00	3.75	4.50
Europe/Africa	GDP-weighted average	1.30	-323				1.29	1.33	1.39	1.63	2.08
Euro area	Refi rate	1.00	-300	7 May 09 (-25bp)	6 May 10	1Q 11 (+25bp)	1.00	1.00	1.00	1.25	1.75
United Kingdom	Repo rate	0.50	-500	5 Mar 09 (-50bp)	10 May 10	Nov 10 (+25bp)	0.50	0.50	0.75	1.00	1.25
Sweden	Repo rate	0.25	-325	2 Jul 09 (-25bp)	Jul 10	1Q 11 (+25bp)	0.25	0.25	0.25	0.50	0.75
Norway	Deposit rate	1.75	-275	16 Dec 09 (+25bp)	5 May 10	5 May 10 (+25bp)	2.00	2.25	2.50	2.75	3.25
Czech Republic	2-week repo rate	1.00	-175	16 Dec 09 (-25bp)	6 May 10	4 Nov 10 (+25bp)	1.00	1.00	1.25	1.75	2.25
Hungary	2-week deposit rate	5.50	-225	30 Mar 10 (-25bp)	26 Apr 10	26 Apr 10 (-25bp)	5.25	5.00	5.00	5.00	5.00
Israel	Base rate	1.50	-250	28 Mar (+25bp)	26 Apr 10	26 Apr 10 (+25bp)	2.00	2.25	2.75	3.25	3.75
Poland	7-day intervention rate	3.50	-100	24 Jun 09 (-25bp)	28 Apr 10	4Q 10 (+25bp)	3.50	3.50	3.75	4.00	4.50
Romania	Base rate	6.50	-50	29 Mar 10 (-50bp)	4 May 10	4 May 10 (-50bp)	5.75	5.50	5.50	6.00	6.50
Russia	1-week deposit rate	3.50	50	26 Mar 10 (-25bp)	Apr 10	Apr 10 (-25bp)	3.00	3.00	3.00	3.00	3.50
South Africa	Repo rate	6.50	-300	25 Mar 10 (-50bp)	13 May 10	1Q 11 (+50bp)	6.50	6.50	6.50	7.00	8.00
Switzerland	3-month Swiss Libor	0.25	-225	12 Mar 09 (-25bp)	Jun 10	Sep 10 (+25bp)	0.25	0.50	0.75	1.00	1.25
Turkey	Overnight borrowing rate	6.50	-1100	19 Nov 09 (-25bp)	17 Jun 10	17 Jun 10 (+50bp)	7.00	8.50	8.50	8.50	8.50
Asia/Pacific	GDP-weighted average	2.14	-130				2.25	2.41	2.51	2.65	2.72
Australia	Cash rate	4.25	-200	6 Apr 10 (+25bp)	4 May 10	4 May 10 (+25bp)	4.50	5.00	5.25	5.50	5.75
New Zealand	Cash rate	2.50	-550	30 Apr 09 (-50bp)	29 Apr 10	29 Jul 10 (+25bp)	2.50	3.00	3.50	4.00	4.25
Japan	Overnight call rate	0.10	-43	19 Dec 08 (-20bp)	30 Apr 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)	29 Apr 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)	2Q 10	2Q 10 (+27bp)	5.58	5.85	6.12	6.39	6.39
Korea	Base rate	2.00	-250	12 Feb 09 (-50bp)	11 May 10	3Q 10 (+25bp)	2.00	2.25	2.50	2.75	3.00
Indonesia	BI rate	6.50	-200	5 Aug 09 (-25bp)	5 May 10	4Q 11 (-25bp)	6.50	6.50	6.50	6.50	6.50
India	Repo rate	5.00	-275	19 Mar 10 (+25bp)	27 Jul 10	20 Apr 10 (+50bp)	5.50	6.00	6.00	6.50	6.75
Malaysia	Overnight policy rate	2.25	-125	4 Mar 10 (+25bp)	13 May 10	13 May 10 (+25bp)	2.50	3.00	3.00	3.00	3.00
Philippines	Reverse repo rate	4.00	-350	9 Jul 09 (-25bp)	3 Jun 10	Jun 10 (+25bp)	4.25	4.75	5.00	5.00	5.00
Thailand	1-day repo rate	1.25	-200	8 Apr 09 (-25bp)	2 Jun 10	2 Jun 10 (+25bp)	1.50	1.75	1.75	1.75	1.75
Taiwan	Official discount rate	1.25	-188	18 Feb 09 (-25bp)	2Q 10	3Q 10 (+25bp)	1.25	1.50	1.75	2.00	2.25

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

The J.P. Morgan View: Markets

Local brush fires in a global rally

- **Asset allocation:** Stay long risky assets, but switch further from credit (high-grade) to equities.
- **Economics:** Upside risks to growth in the US and Japan.
- **Fixed income:** Greece formally asks for EU/IMF support, but it remains too early to buy Euro high-yielders. Stay short Treasuries against Bunds. Turn neutral on Russia.
- **Equities:** Strong earnings reinforce the case for staying long equities. We see upside risks to our year-end S&P 500 target of 1,300.
- **Credit:** Tactically underweight US HG as heavy positioning and high valuations are leaving it vulnerable to the increase in global risks.
- **FX:** We lower our USD/EUR forecast to 1.30 for June.
- **Commodities:** We stay medium-term bullish crude oil.

Is it local or global? That is the question asked by investors trying to assess the impact of the rising threats to the rally in risky assets. Our view has been, and remains, that these threats—from Chinese tightening to the Greek debt crisis and the global offensive on banks—remain largely local and sectoral in impact. They are offset sufficiently by the global rebound in economic activity and company earnings, keeping intact the rally in risky assets.

This has indeed what we have seen so far this year and over the past 13 months in the global equity rally. The impact of these local fires has been largely the underperformance by the affected regions—Europe and China—without slowing the global rally in risky assets. There has as yet been no underperformance of the global banking sector, despite being targeted by regulators, legislators, and tax authorities across the world.

At some point, one such local shock will spread and become overwhelming enough to bring risky markets down. Remember that the subprime crisis started as a local shock. We surely do not want to downplay the destructive power of the risk we face, but, at the same time, in the other corner sit the **even more powerful bullish forces of the business cycle**, **company earnings**, **and the zero return on cash**. It is our judgment that while the threats of Greek contagion and regulatory/tax overkill on banks have intensified over the past month, the risk-bullish forces have gathered even more strength, keeping us overall long risky assets.

Our economists have kept their global 2010 growth forecast in a 3.3%-3.4% range since September. Over the period, the consensus has converged to our view. But the recent upside surprises on activity, and in particular in capital spending, retail demand, and industrial production, are inducing us to recognize clear upside risk, in particular in the US and Japan. Company earnings are looking even more impressive, with recent US earnings announcements already leading to a more than 10% upward revision to the 1Q consensus. The flow of our zero-return cash continues unabated, providing support to all positively yielding financial assets. We thus stay overall long equities, both outright and against bonds. In high-grade credit, we recognize that the compression in spreads to normal levels is 95% complete and go tactically underweight given heavy positions in the market.

Local shocks may not be strong enough to topple the global rally, but they do have the power to play havoc with local markets and currencies. To us, the onset of Chinese tightening remains a reason to underweight Chinese equities, and to be long EM Asian currencies. The still broadening Greek funding crisis will likely push the euro further down, and intra-EMU bond spreads wider, and has induced us to lower our USD/EUR forecast to 1.30 in June. And the gathering global assault on banks, through massive tightening of regulations and Robin Hood taxation, is a massive depressant to bank profitability and business models. At the moment, these threats are offset by high interest income from low funding, but this benefit will not last forever. We are worried about the future of bank stocks.

Fixed income

Greece today formally asked for financial support from the EU and IMF after its borrowing costs surged once again. This new turn for the worse was prompted by a Moody's downgrade, as well as upward revisions to the Greek budget deficit from Eurostat, which also expressed reservations about the quality of the Greek data. There was increased speculation that the ongoing discussions between Greece and the IMF could lead to a debt restructuring, and Greek bonds are now priced at around 84 cents on the dollar on average. The near-term prospects for Greek debt depend on what program is agreed with the EU/IMF.

A key risk for bond markets is that **Greece's problems prompt investors to reconsider the creditworthiness of government debt more broadly**. Such contagion is most evident for other high-deficit Euro area countries, whose spreads to Germany increased across the board this week, with Portuguese spreads 50bp higher. Fiscal concerns may also spread to some emerging markets, though government balance sheets are very strong on the whole in EM. Both the US and UK are also running large fiscal deficits, which are expected to persist for several years. But both are capable of sustaining higher debt-to-GDP ratios, not least because their currencies and central banks can cushion the economy from adverse developments.

Core bond markets sold off on stronger activity data. **German Bunds outperformed US Treasuries on concerns about Greece, and this move can continue; we stay short Treasuries against Bunds.** We remain modestly bearish on core markets and outright short in the UK. Bond supply still looks set to outpace demand this year, though strong retail buying and weak securitized issuance induced us to lower our estimate of excess supply by around a third to $800 billion (see last week's *Flows and Liquidity*).

Strong inflows and a search for yield keep us bullish local EM debt, but selectively so, as rising growth and inflation will prompt EM central banks to tighten before DM. Accordingly, we **turn neutral on Russia**, where rising inflation risks have prompted more hawkish central bank rhetoric recently. Stay long in South Africa and Brazil.

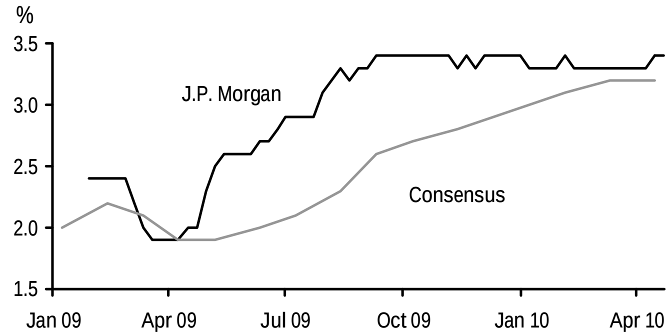
Equities

Global equities edged up on the week, driven by US stocks, on **continued positive news from the reporting season**. Of the 173 companies of the S&P 500 index that have reported so far, 80% beat expectations. The estimate for S&P 500 1Q operating EPS has risen by 11% since April 1 to $19.40, creating significant upside risks to our full-year EPS projections for both 2010 ($81) and 2011 ($90). Not only is the surprise of the 1Q reporting season the fifth in a row, but its size is exceeding that of the previous four quarters.

The strength of the reporting season reinforces the case for staying long equities. We still see the S&P 500 at 1,300 by year-end but our risk balance has now shifted firmly to the upside. **Cyclicals and small caps are our favorite sectors.** Last week's SEC fraud case, the punishing US Financial reform bill, and the IMF proposal for a double levy on banks all suggest that **the news flow is turning negative for banks**, creating downside risk to bank stocks.

China and the Euro area are the regions we would rather avoid at the moment. Chinese policymakers are stepping up their fight against rampant property prices and sky-high loan growth, raising the risk of a greater slowdown. This is likely to keep equity investors on the sidelines in China until more clarity emerges on the policy front. Similarly, we view the Greek debt crisis as a local problem, but we do recognize that the risk of contagion to other countries in the Euro area will continue to bother investors, raising the chance that European stocks, especially banks, will underperform more.

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



Credit

HG spreads widened from their cycle low last week on the back of rising European sovereign risks and rising litigation and regulatory risks on Financials. We turn **tactically short US HG** as heavy positioning and high valuations are leaving it vulnerable. US HG spreads are likely to widen near term, although we maintain the view that spreads will tighten in the medium term and keep the year-end forecast of 125bp.

As the Greek debt crisis escalates, the risk of contagion to other European countries rises. Although the initiation of the EU/IMF loan package would solve short-term funding needs, the possibility of a debt restructuring lingers. With the Euro area recovery under threat, European corporates are likely to underperform US corporates. Hence, we recommend **buying protection on European corporate credit (iTraxx Main) versus the US**.

US markets are focused on proposed taxes and regulation on banks. Rating agencies have been vocal that the Financial reform bill may result in downgrades of large banks, as the government removes the implicit support for large banks in trouble. These are countered by the strong 1Q bank earnings. We **stay neutral US bank bonds** as the strengthening credit fundamentals are offset by regulatory risks that may cause downgrades and that will reduce bank profitability.

EM corporates have rallied significantly since the start of the year. Valuations are becoming less attractive relative to EMBIG and we **turn neutral CEMBI from overweight versus EM external debt**. However, valuations of investment grade EM corporates relative to US HG continue to look attractive and we **remain overweight vs. US HG.**

Foreign Exchange

Projecting EUR/USD's path now that the EU/IMF facility has been triggered is not easy. When we last revised forecasts in March, we expected EU leaders to agree to a backstop facility quickly as they had brokered bank rescue plans in 2008, realizing the systemic consequences of a credit event within the region. We also expected Greece to follow Ireland and Latvia's lead in tightening fiscal policy with few fumbles around issuance strategy. We have been wrong on both counts and **revise forecasts lower for EUR/USD** and some crosses (EUR/GBP, EUR/NOK).

The historical precedent for currency performance during major fiscal tightening is a fall of 20% trade-weighted over a five-year period. But forecasting such a fall from current levels ignores two points: the euro has already fallen 9% trade weighed since Dec, and only a fraction of Europe (20%) would be tightening if Spain, Portugal, and Ireland followed Greece's lead. Record short positions in the euro and a now better growth also caution against much additional EUR/USD weakness. **We thus mark down the June target from 1.42 to 1.30** given pressures from spring/summer refundings, and then expect some retracement in 3Q/4Q to 1.35 on a view that balance sheets are sufficiently strong in the rest of the periphery for those countries to avoid Greece's fate.

We have been shorting the euro on the crosses rather than against the dollar to avoid the volatility inherent in a policy-driven market. Last week, we added short EUR vs. Asia (IDR) to existing shorts vs. CHF. Stay sidelined in EUR/USD to avoid its recurring short-covering bounces but add to shorts vs. Asia (INR) and commodity currencies (CAD). Also add a cash long in CAD/JPY to create a CAD basket versus the rest of the fiscally-strapped G-3 bloc. In sterling, the best pre-election trade remains a short in 6-mo GBP/USD vol versus USD/CHF vol. There is little evidence of an excessive risk premium in cash markets, but longer-dated sterling vol still looks too elevated, even for a hung parliament.

Commodities

Commodities are marginally up this week with precious metals outperforming. All precious metals were up, but palladium was the strongest, rallying almost 6%. **We remain long** the complex, favoring both palladium and platinum. Investor interest continues to support these metals, whereas the improvement in manufacturing activity is another force behind their rally. Base metals underperformed this week with aluminium weakening significantly, but we maintain our overall long position on strong manufacturing growth.

Crude prices started the week on a soft note and also declined on the US inventory number, but are now just below $85 for the WTI benchmark. We maintain our medium-term bullish view and believe that the **path to $90 remains in place**. At the same time, we continue to trade the range. On the spreads side, two weeks ago, we recommended overweighting Brent vs. WTI, and feel it is time to take profits now. Brent is now trading at a premium of more than $2 vs. a small discount two weeks ago. We believe that WTI inventories should return to a more normal balance in coming weeks, also driving a return to the previous flattening bias near the front end. Be long the front vs. the second contract in WTI.

Ten-year Government bond yields

	Current	Jun 10	Sep 10	Dec 10	Mar 11
United States	3.82	4.10	4.25	4.50	4.70
Euro area	3.06	3.30	3.45	3.60	3.90
United Kingdom	4.04	4.40	4.55	4.65	4.80
Japan	1.32	1.40	1.50	1.55	1.55
GBI-EM	6.78			7.70	

Credit markets

	Current	YTD Return
US high grade (bp over UST)	129	3.5%
Euro high grade (bp over Euro gov)	138	2.3%
USD high yield (bp vs. UST)	581	6.6%
Euro high yield (bp over Euro gov)	580	10.0%
EMBIG (bp vs. UST)	250	5.5%
EM Corporates (bp vs. UST)	288	6.2%

Foreign exchange

	Current	Jun 10	Sep 10	Dec 10	Mar 11
EUR/USD	1.34	1.30	1.35	1.35	1.30
USD/JPY	94.2	87	90	93	96
GBP/USD	1.54	1.43	1.50	1.52	1.48

Commodities - quarterly average

	Current	10Q2	10Q3	10Q4	11Q4
WTI ($/bbl)	85	82	85	90	90
Gold ($/oz)	1154	1400	1300	1200	1225
Copper($/m ton)	7655	8000	6800	6250	6500
Corn ($/Bu)	3.62	4.05	3.95	3.90	4.00

Source: J.P. Morgan, Bloomberg, Datastream

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Japan: FoF show financing fiscal deficit not imminent risk, Mar 26, 2010
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China: 2010 trade balance should still be in surplus, Apr 16, 2010
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Indonesia's trade surplus fired up by energy-related exports, Apr 16, 2010
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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*.

Economic Research Note

US: higher NAIRU won't force the Fed's hand

- **The natural rate of unemployment, or NAIRU, could now be above 6%**
- **The plausible factors pushing up NAIRU are mostly temporary and cyclical in nature**
- **By the time NAIRU matters for Fed policymakers—in a few years—it likely will have moved back down**

As economists and policymakers cope with understanding the fallout from the past recession, one of the most critical issues is what has happened with NAIRU. This measure—short for the non-accelerating inflation rate of unemployment—is the level of unemployment consistent with stable rates of wage and price inflation. It is a central variable for the monetary policy outlook: a higher NAIRU means the Fed has less time to wait before raising rates to head off inflationary pressures.

There do seem to be some important factors lifting NAIRU right now, including temporary legislative changes to employment laws, less geographical mobility due to impairment to the housing market, and perhaps greater skill mismatch. All of these factors, however, are somewhat temporary in nature, and are likely to subside in importance as the economy recovers. So we would conclude the NAIRU may be higher than previously thought, but also more cyclical than previously thought.

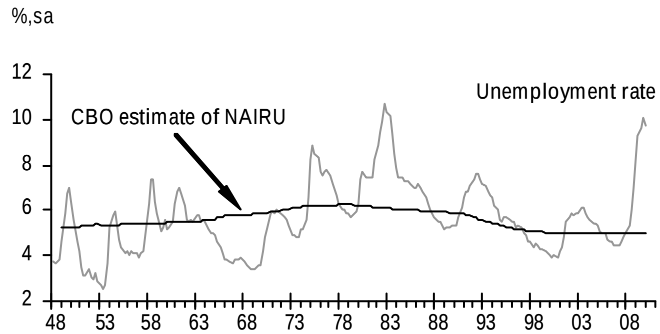
If this assessment is correct, the net impact on Fed policy from a shifting NAIRU is likely to be muted. By the time NAIRU becomes relevant for Fed policy—after the unemployment rate has moved down a couple of percentage points, which could take a few years—many of the temporary factors lifting NAIRU are likely to have passed. Moreover, Fed policymakers are well aware that one of the lessons from the European unemployment experience is that cyclical unemployment can beget structural unemployment. The policy implication of this interpretation—accommodative policy to reduce cyclical unemployment as rapidly as possible—is actually the opposite of the presumed hawkish implication of a potentially higher NAIRU.

Current NAIRU is moving higher

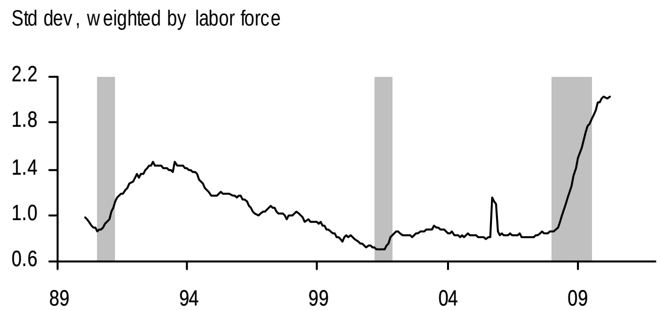
Three broad sets of explanations have been put forward as to why NAIRU could be moving higher: legislative changes, reduced geographical mobility, and skill mismatch. The legislative change most commonly pointed to as increasing structural unemployment is the extension of unemployment benefits. In every recession since 1970, Congress has enacted emergency unemployment benefits, increasing the duration and in some cases the amount of available unemployment benefits. That has been the case in the last recession as well, though the increase in availability of benefits has exceeded that of any prior recession. While the impact of this policy change is contentious—due to its obvious political overtones—most economists agree that this change has probably raised the unemployment rate some, though the estimated magnitude of this effect varies. The estimated impact on lifting the unemployment rate ranges from as low as 0.4%-pt (SF Fed) up to potentially as high as 1.8%-pt (NY Fed, SF Fed, U Mich).

A second reason offered for higher structural unemployment is decreased geographical mobility due to the housing collapse. In particular, it may be the case that homeowners with underwater mortgages lack the geographical mobility to seek jobs elsewhere in the country; the prospect of a large capital loss on selling a house may prevent job-seekers from moving. To get a sense of the magnitude of this effect, we look at the geographical mobility in a year before negative equity became a widespread phenomenon: 2006. In that year, about 8 million people moved for work-related reasons. Of those just over 2.5 million owned their

NAIRU and the unemployment rate



Standard deviation of state unemployment rates



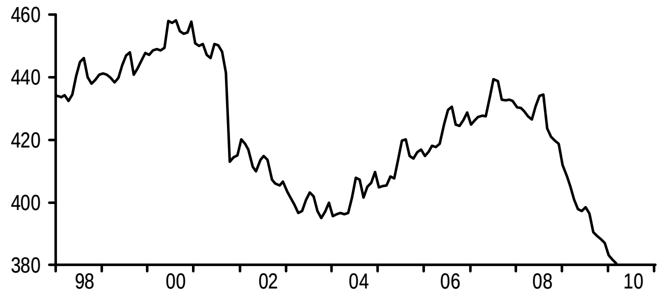
own homes. About two-thirds of homeowners have mortgages on their homes and just under 30% of those mortgages are now underwater. If those who would move for jobs resemble the average household, then this would imply about 0.5 million people may not move for job-related reasons this year who would otherwise move if they had the opportunity. Cumulatively since the recession began, this consideration could affect over 1 million people. However, this is likely overstated for a few reasons. For those with a firm job offer elsewhere, they are likely to absorb the capital loss or else hand in the keys and walk away from the mortgage. So our best guesstimate is that this may be adding only a few tenths of a percentage point to the structural unemployment rate.

The third potential factor that could be lifting structural unemployment is long-term skill mismatch. The two industries that are most commonly singled out as having experienced a onetime structural shift down in their level of activity are finance and construction. We are quite skeptical of the finance story, not because we think structuring CDOs is going to be making a big comeback, but because what is sometimes called "high finance" employs a very small share of the 6.2 million people who worked in the finance and insurance industry at its peak in 2006. Most finance jobs are actually "Main Street" occupations. The five most common occupations in this sector are, in order: bank tellers, insurance sales agents, financial services sales agents, administrative support managers, and insurance claims adjusters. This may explain why the New York City area accounts for less than 7% of total financial sector employment. Construction clearly did not have a normal recession, and is unlikely to recover soon. That said, we think its a mistake to confuse a severe cyclical shock with a structural shock. As the recovery becomes better-established, construction will return, reviving construction employment.

This latter point also applies to the two previously mentioned reasons for expecting a higher NAIRU: reduced geographical mobility and higher unemployment benefits. These factors almost certainly have important cyclical components. First, if nominal GDP continues to increase, home prices should stabilize and underwater homeowners may gradually amortize enough mortgage debt to get back into positive equity. Second, as mentioned above, Congress has always enacted emergency benefits in recessions over the past 40 years. But just as regularly, it has always let those emergency extensions lapse when the cyclical position of the economy repairs. In short, NAIRU may have moved up as actual unemployment rates have moved up. Adding up the previous influences, NAIRU could be above 6% now.

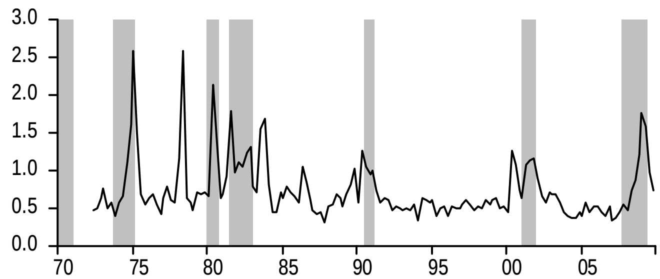
Financial sector employment—NY City area

000s nsa



Lilien measure of sectoral dispersion in job growth

Weighted standard deviation of industry employment growth



But there are reasons to believe NAIRU could move down as the economy recovers and the actual unemployment rate moves down. Because of this, the difference between the two measures—the unemployment rate gap—may not currently be as large as is often thought, but it may also persist for quite some time.

Hysteresis?

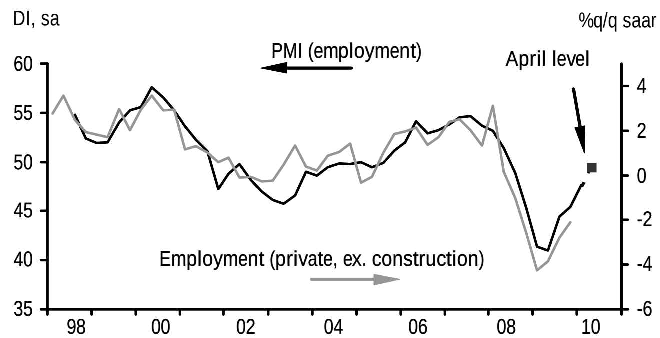
The standard view of NAIRU—originating with Milton Friedman and Ned Phelps—sees the natural rate as determined by labor market institutions and outside the central bank's control. A more recent version that has sought to explain the higher natural rate in Europe—pioneered by IMF chief economist Olivier Blanchard and White House economic adviser Larry Summers—sees the natural rate being determined in part by the cyclical experience. This view, sometimes called hysteresis, sees central banks as having some responsibility for the natural rate outcome. This would argue that the early signs of sclerosis in the labor market should be met by especially accommodative monetary policy. We wouldn't argue that this view is front and center in the Fed's thinking, but it does highlight that signs of dysfunction in the labor market can have mixed implications for monetary policy.

Economic Research Note

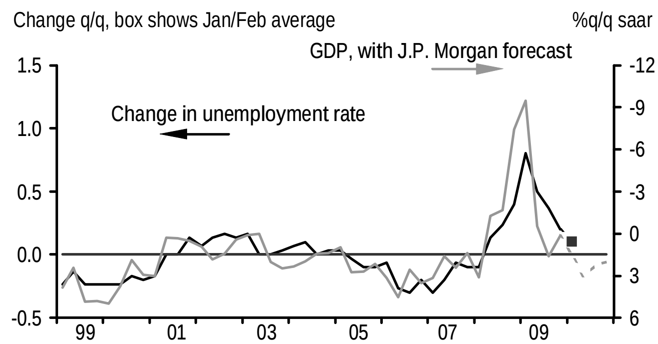
Euro area labor market edging closer to stabilization

- **Euro area labor market recovered very slowly after past recessions**
- **But, it is stabilizing much sooner this time**
- **Recovery will be partly through a longer workweek**

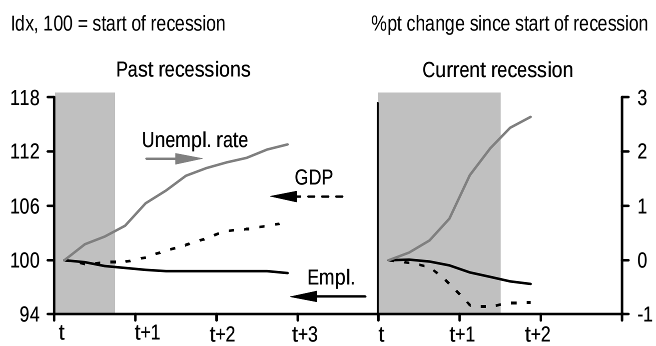
Euro area employment



Euro area unemployment rate



Euro area labor market in the current and in past recessions



Note: The horizontal axis shows the number of years from the start of recession. The first half of the chart shows average developments in GDP, employment, and the unemployment rate in the three previous Euro area recessions in the mid-1970s, early 1980s, and early 1990s. The second half of the chart shows the same variables in the current recession.

After a deep downturn in activity, expectations that labor market weakness would linger into 2011 have been widespread. The latest consensus view is that the Euro area unemployment rate will increase by another 0.5%-pt in the course of this year. However, recent data suggest that the labor market is stabilizing much earlier in the recovery of activity than has been the case after past recessions. In contrast to prior recessions, hours worked were cut sharply, especially in some countries. In addition, corporates were able to absorb the remaining increase in labor costs because easier monetary and fiscal policy reduced their interest and tax expenses and because they cut their capital spending very sharply. Overall, it is not entirely clear yet why corporates chose to hoard labor and cut back elsewhere. But, even a recovery in hours worked, in response to increases in activity, will stabilize labor markets further and generate labor income for households.

Weak labor markets in past recoveries

Past recoveries after Euro area recessions have generally been characterized by weak labor market outcomes. Employment typically trended lower even two years into the recovery, and job creation was still weak thereafter. In fact, in the average recession it has taken over five years to regain the prior cyclical peak of employment, even though GDP would already be more than 10% above the prior cyclical peak by then. As a result, the unemployment rate would also increase well into the recovery.

Given that the Euro area labor market has improved with a very long lag after prior recessions, it is not unreasonable to expect a repeat of this in the current recovery. And the expectation that the labor market adjustment has further to run is reinforced by a view, shared by the ECB, that the recovery of GDP will be subdued in the coming quarters.

Signs of stabilization in the recent data

Recent developments, however, provide considerable encouragement of an earlier stabilization. First, Euro area unemployment rose just 71,000 on average in the three months to February, compared to peak monthly increases of over 500,000 in early 2009. And the unemployment rate nudged up to 10.0% in February, but only after having held steady at 9.9% in the prior three months. While data on employment are published with a lag, the recent increases in unemployment are small enough to be consistent with broadly stable employment growth. Therefore, employment should slow further from the 1%q/q saar decline in 4Q09.

Second, business surveys provide a window on corporate hiring and support the view that the level of employment is stabilizing in key sectors. The PMI employment index has been consistent with stable private sector employment outside of construction since March, with small increases in hiring in services offsetting further small declines in manufacturing. A similar message is sent by the employment intentions index from the European Commission survey, even though it is still slightly weaker than the PMI. Therefore, while using the unemployment data to gauge developments in employment can be misleading if discouraged workers leave the work force, the business surveys add to the sense that employment is stabilizing.

Third, employment in construction and the public sector, which are less well covered by the business surveys, have been broadly offsetting each other recently. Construction jobs will fall further due to the ongoing housing market adjustments in some countries, but at a diminishing pace. And public sector job creation will gradually weaken, although fiscal consolidation measures often target public sector wages rather than the level of employment.

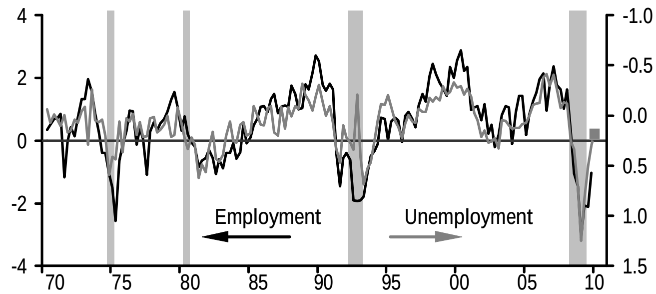
Causes, risks, and prospects

The current recession has been far deeper than any previous downturn in the region. But, unlike in prior recessions, corporates cut jobs by less than the decline in output, so that labor productivity (per worker) fell sharply this time. Therefore, outside of Spain and Ireland, where the level of employment fell very sharply, especially in construction, corporates in most other countries hoarded labor in varying degrees. Partly, this reflected government subsidies through short-time work schemes and real increases in labor market flexibility (see “Risk of large-scale German job losses is slowly fading,” *GDW*, March 19, 2010). But, it also reflected choices made by corporates in favor of retaining workers, the reasons for which are not yet entirely clear.

Looking ahead, corporates have been able to improve their financial positions in recent quarters, despite the labor hoarding, because easier monetary and fiscal policy reduced their interest and tax expenses and because they cut back sharply on capital spending. While this reduces some of the near-term pressure to cut jobs, it will still be crucial that the recovery in activity regains momentum. The large increases in the business surveys in March and April are very encouraging in this regard, suggesting that growth is stepping up in the region. And while the recovery in GDP will mostly trigger a recovery in hours worked in some countries, even this should generate increases in labor income for households.

Euro area employment and unemployment

%q/q saar — q/q mn, box shows 1Q10 tracking



Private sector employment

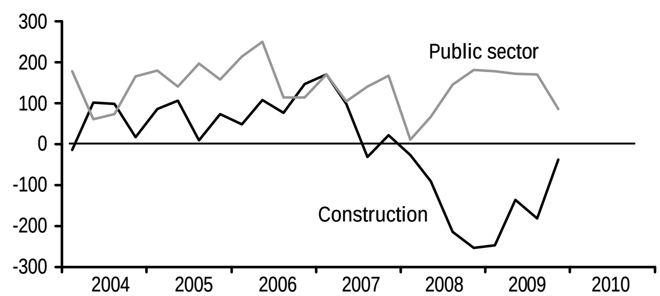
%q/q saar, total private sector (ex construction), except where stated

	Employment, actual		PMI-based predictions		
	3Q09	4Q09	1Q10	Latest	R-sq.
Euro area, of which:	-2.8	-2.2	-0.4	0.5	0.81
Private services	-1.2	-1.3	0.4	1.0	0.69
Manufacturing	-6.7	-4.4	-2.1	-0.9	0.79
Germany	-2.0	-1.2	0.3	1.3	0.59
France	-2.1	-1.1	-1.0	-0.4	0.92
Italy	-2.1	-1.1	-0.4	0.0	0.51
Spain	-6.0	-5.8	-1.4	0.1	0.76

Note: The simple tracking equations are estimated over the entire sample. Using only pre-recession data has a small (upward) effect for the tracking estimates in Euro area, Germany, or France. Generally, the correlation between the PMI and employment at the sector level is less tight in Italy and Spain.

Euro area employment

q/q, 000s, 2mma for public sector



Euro area employment and hours worked

%q/q saar

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Economic Research Note

The UK financial sector is important via credit, not output

- **Measured financial output has been surprisingly resilient in this crisis**
- **But output and employment within the industry are small, and have weak linkages with other sectors**
- **The financial sector is more important via its provision of credit—the key to a stronger growth recovery**

The financial sector was at the epicenter of the current global crisis. The significance of London as a financial hub in the world economy has raised questions about how this will affect UK growth. We look at this question from two angles: the effect on financial sector output and jobs, and changes in the industry's broader role as a provider of credit to the rest of the economy. On the first point, measured output within the financial sector has been surprisingly resilient in this downturn. One may argue that this is not sustainable in the years ahead. But financial intermediation output has a fairly small weight in GDP of 7%, and accounts for an even lower share of employment. Moreover, output and employment for the sector have weak linkages with other sectors. If financial output growth does weaken during the recovery, this would have limited implications for overall growth.

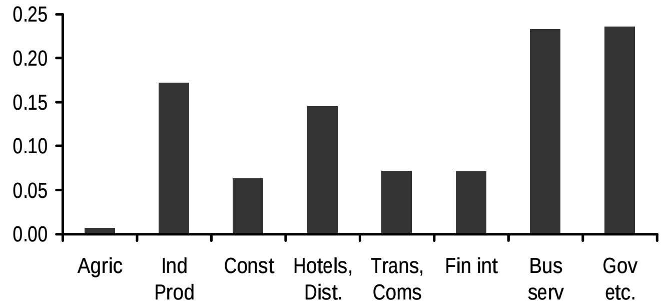
On the second, the financial sector is vital via the industry's provision of credit to households and firms—where conditions remain very tight. The rate at which the availability of credit eases will be a key factor that determines the speed of the recovery. Our forecast assumes that conditions show a gradual improvement from here, without returning to pre-crisis levels in the foreseeable future. On this basis we look for household consumption growth to strengthen to a 2%-3% pace over the course of this year, with business investment growing again from 2Q. Our analysis suggests that a failure of credit conditions to show any improvement from current levels could subtract over 0.5%-1.0%-pt from GDP growth during the recovery.

Financial sector output is outperforming

The financial intermediation sector in the UK covers a wide range of high-profile services that include banking, insurance funds, pension funds, and other specialist entities. It may come as a surprise, therefore, that this sector accounts for just 7% of GDP, and less than 4% of employee jobs. Despite its small weight, measured output in the sector (see box) has ranked fairly high in the table of contributors to GDP growth since 1997. Most remarkable of

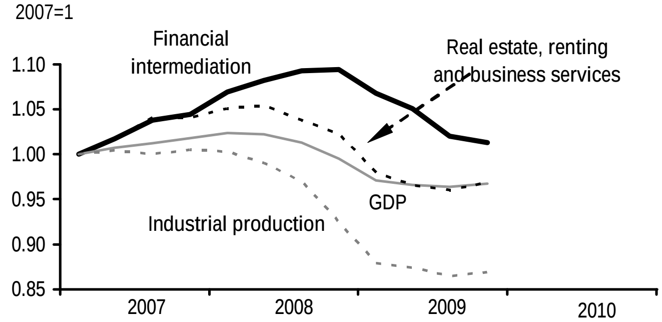
Output sector shares in GDP

Share of GDP, sums to 1, based on latest 2005 weights



Output by sector during the downturn

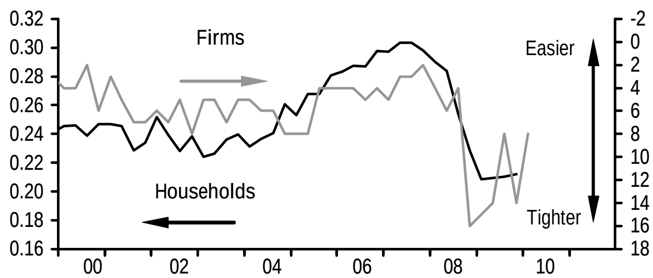
2007=1



Credit availability

Index, J.P. Morgan composite measure based on secured credit

% bal, sa, CBI manufacturing survey on factors limiting investment (scale inverted)



How is financial output measured?

One-third of financial output is directly measured, and includes fees and commission charged by institutions for providing financial services. For banking, the ONS uses the Profit and Loss Survey conducted by the BoE. Around two-thirds of financial output is indirectly measured (FISIM). As opposed to fees and commission, financial intermediaries also rely on revenue accruing from interest flows. The ONS attempts to impute direct charges for these services using data on interest rates and the volume of loans and deposits. FISIM is calculated as the difference between the effective rates of interest payable and receivable, and a reference rate of interest considered to represent the risk-free rate of lending/borrowing.

all is that the financial sector has continued this outperformance during the current crisis. Financial intermediation, as measured in the national accounts, has been the largest contributor to growth over the past three years. The employment data tell a different story. The 86,200 employee jobs shed in the sector since 2008 account for around 10% of the total drop in employment. But this means that productivity within the financial sector has surged.

This outperformance was undoubtedly made possible by significant public support during the crisis. In the years ahead, one may expect slower growth in the industry. Regulation will be tighter, and the sector will be weaned off public support. How will this affect the overall economy? If the sector's past contribution to measured output were to halve in the coming years, it would take just 0.2%-pt off GDP growth on average. This appears small, although the calculation does assume that slower financial output will not affect other sectors. So how well correlated is the financial industry with the rest of the economy? We have approached this question by first looking at the correlation of financial output and employment with other sectors. Then, we broaden the analysis to look at the effect of the financial industry via its provision of credit.

Financial output has weak sector linkages

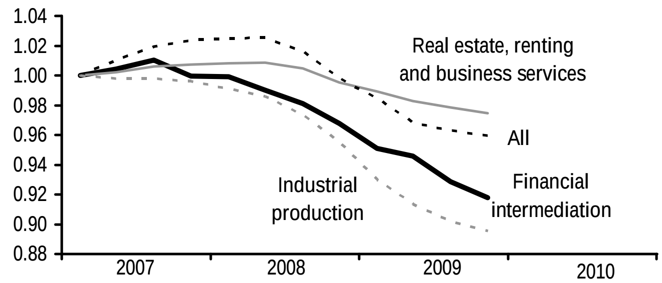
To help answer the first part of the question above, we have estimated a VAR model. The model enables us to "shock" financial intermediation output, and then estimate the corresponding changes within the other sectors of the economy over time (see box, next page). As there is some debate about whether output in the financial industry is correctly measured, we also conducted this analysis using employment instead of output. To provide an aggregate summary statistic, we have constructed weighted aggregates of the results of each sector to show the estimated effect of a financial sector shock on GDP and employment. The results of the analysis are shown in the last two charts to the right.

A one-standard-deviation increase in financial intermediation output is estimated to continue boosting output in the rest of the economy for a year. The effect of a similar shock to employment is smaller but lasts longer. The cumulative impact on both GDP and employment over time is around 0.3%. Part of this lift to GDP (and employment) reflects the contribution of the financial sector itself. But if this sector is excluded, the cumulative GDP effect is lower at just under 0.2%. This effect appears small given that a one-standard-deviation increase in output is 1.6%.

How does this compare with similar output and employment shocks from other sectors? To answer this question we applied the same methodology to the remaining sectors. The estimated cumulative response of GDP and employ-

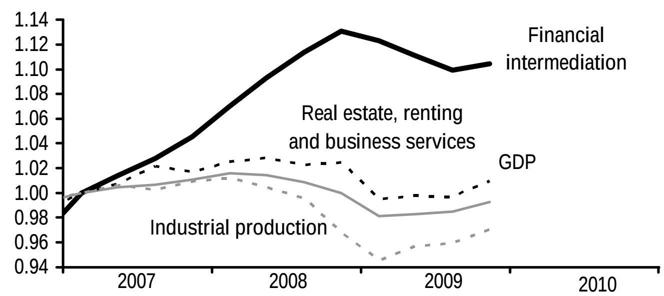
Employment during the downturn

2007 1Q=1



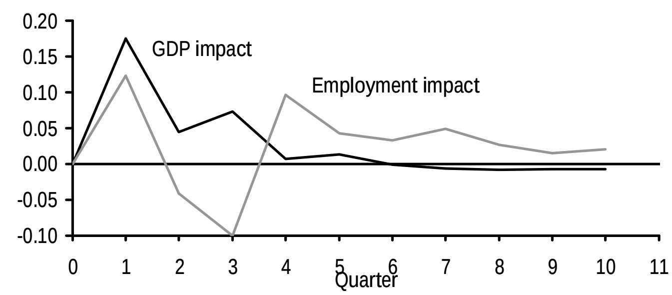
Productivity by sector during the downturn

2007=1, output divided by employee jobs by sector



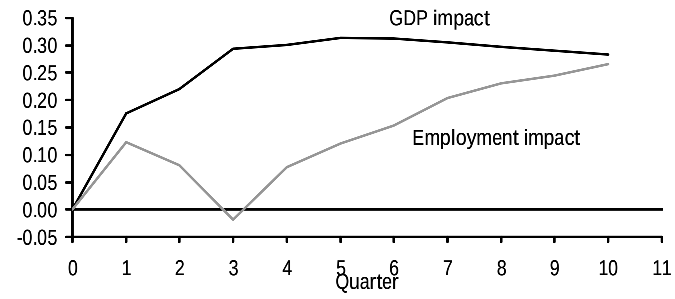
Quarterly GDP/employment impact of a financial sector shock

% chg in economy-wide GDP/employment corresponding to a 1 s.d. shock in financial sector output/employment



Cumulative GDP/employment impact of a financial sector shock

% chg in economy-wide GDP/employment corresponding to a 1 s.d. shock in financial sector output/employment



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Using a VAR model to identify linkages

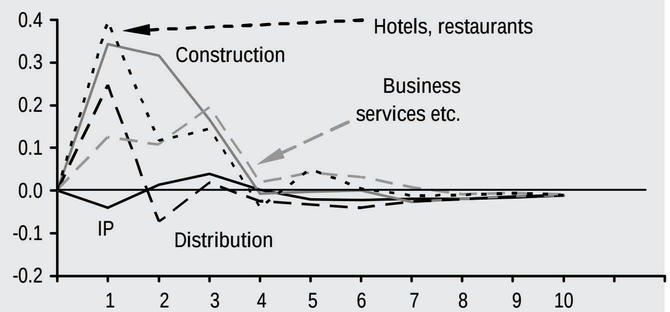
A VAR model is a purely statistical approach to explore the relationships between several variables that can influence each other. The model sets up a series of equations, one for each dependent variable—in this case the output or employment of a particular sector. In this box we use the example of output. Quarterly output growth of each sector (i) is modeled as a function of the lagged output of the remaining sectors over time (t). The estimated coefficients (β_i) of this system of equations can then be used to quantify the impact of an innovation or shock to output in any one given sector.

$$\text{Growth}(\text{Fin}_t) = \Sigma_i [\ \beta_i\ \text{Growth}(\text{Other sectors}_{it})] + \varepsilon_{FI,t}$$

We calculated the impact of a one-standard-deviation change to output in the financial intermediation (FI) sector by simulating a shock to the error term ($\varepsilon_{FI,t}$) corresponding to that sector. The results of this simulation can be seen in the charts to the right. A shock to financial intermediation output has its largest impact on the construction, hotels and restaurants, distribution, and business services sectors. This impact dissipates after around four quarters. Cumulated over time, a shock to financial output has its largest impact on construction output.

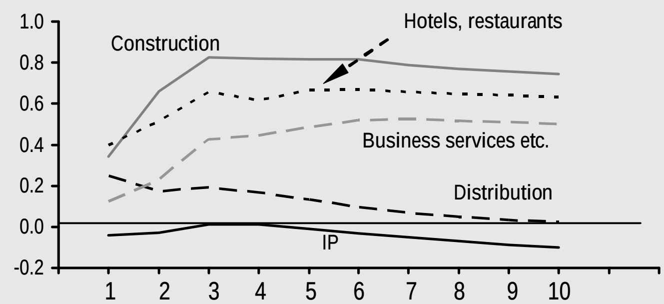
Impulse responses of various sectors to a shock in financial interm.

% change to 1 s.d. shock in financial intermediation



Impulse responses of various sectors to a shock in financial interm.

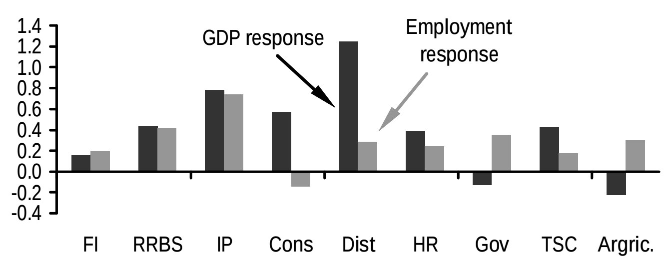
% change to 1 s.d. shock in financial intermediation



ment—this time excluding the sector where the shocks originated—is shown in the bar chart to the right. Viewed from this perspective, the GDP and employment effect of a shock from the financial sector is relatively small. The largest effects come from shocks to distribution, industrial production, and real estate, renting, and business services (RRBS). The effect of a shock to financial output still looks modest even when compared to other sectors of equally small size—e.g., construction (Cons.) and transport, storage, and communications (TSC). The results of the analysis suggest that the spillover from a shock to financial intermediation output or employment is very modest.

Estimated cumulative responses to sector-specific shocks

% chg in GDP/employment (excluding the sector where the shock was first applied) corresponding to a 1 s.d. shock to output/employment within the sector labeled

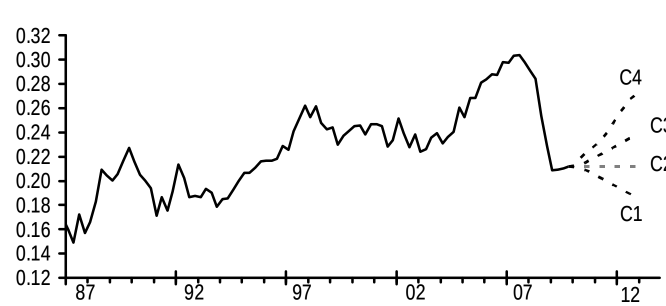


Finance is vital as a provider of credit

A key linkage between the financial industry and the rest of the economy is the sector's provision of credit. In the past, we have developed models of domestic demand that identify significant roles for the cost and availability of credit. Here we use these models to assess the marginal impact of a change in credit availability on household consumption and business investment. The former includes our own derived measure of mortgage credit availability, which is a composite of four variables: the LTV ratio, the LTI ratio, mortgage interest rate spreads over the base rate, and the composition of institutions involved in the loan market.

J.P. Morgan household credit conditions indicator

Index, higher value indicates easing in conditions



During the crisis, this credit indicator fell back to levels last seen during the mid-1990s. After showing some small improvement, the indicator is now still running very close to these levels. The model of business investment uses a credit reading from the CBI industry survey. The survey asks businesses whether the availability of credit is a factor limiting their investment decisions. The CBI credit reading spiked (deteriorated) to new highs during the crisis. Since then, it has shown a significant improvement. But it remains well above pre-crisis levels.

How sensitive is demand to credit?

We have taken these two proxies for credit conditions, and simulated four different outturns for demand in the coming three years. The scenarios range from a further gradual deterioration in credit availability (scenario C1) to a significant improvement (C4). Our baseline assumption is that credit conditions will show a modest improvement in the coming years (C3). Plugging these scenarios into our models of household and corporate spending reveals that:

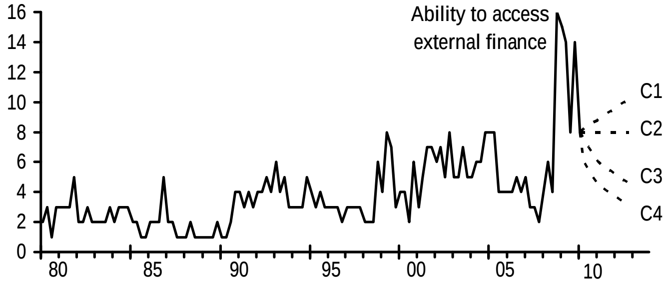
- **The failure of mortgage credit availability to improve could take 0.3%-0.4%-pt off household spending growth.** Our consumption model persistently overpredicted growth during the recent downturn. We would therefore remain cautious about the 3%-4% pace of growth the model predicts for consumption in the coming two years. However, the model helps to assess the marginal impact of a change in credit conditions. It suggests that no improvement in conditions at all would take 0.34%-pt off annual consumption growth relative to our baseline forecast. This is worth about 0.2%-0.3%-pt of GDP growth.

- **Business investment is even more sensitive to a deterioration in credit availability.** Our business investment model—with the aid of the prior quarter's CBI survey results—has done a better job of predicting capex. This model points to a stabilization in business investment from around 2Q of this year. The role for credit identified in the model suggests that the failure of credit availability to improve from current levels would have more serious consequences for businesses. Relative to our baseline case, the model suggests that a C2 scenario would result in capex being 3.1% lower than otherwise. Business investment accounts for a much smaller part of demand, but this would still be enough to take 0.2%-0.3%-pt off of average annualized GDP growth.

This analysis suggests that the total drag on growth in a scenario in which credit conditions failed to improve could subtract 0.4%-0.6%-pt from GDP growth over the next couple of years. Moreover, if the GDP contribution of output directly from the financial intermediation sector were to also fall in the coming years, the drag to growth could be even larger. There is clearly a lot of uncertainty around these estimates for a variety of reasons. But they serve to demonstrate that an improvement in credit and financial conditions is key in supporting a recovery in growth.

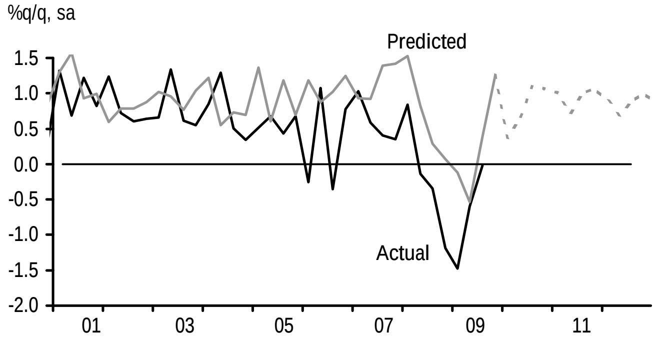
CBI industry survey: factors limiting investment

% balance, sa



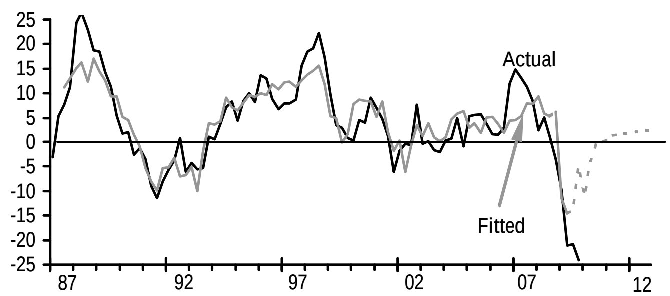
Model prediction for household consumption growth

%q/q, sa



Business gross fixed capital spending

%oya



Estimated marginal impact of credit conditions on demand

%-pt, annualized, impact based on average 2011-2012 estimates

	Credit conditions assumption	Spending impact relative to baseline: HH consumption	Capex
C1	Gradual deterioration	-0.67	-4.7
C2	No further improvement	-0.34	-3.1
C3	Baseline: Gradual improvement	-	-
C4	Significant improvement	0.43	1.9

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Economic Research Note

Aussie inflation on the back burner...for now

- **Inflation pressures appear subdued at present; core measures are falling**
- **Slack will, however, be eroded this year, with inflation pressures set to intensify in 2011**
- **Further improvement in the labor market is not necessary to generate above-trend growth**

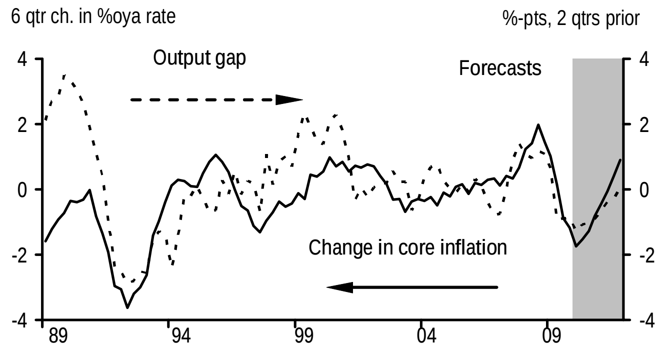
Judging by recent commentary, Australia's policymakers are confident that inflationary forces remain under control. The federal government, clearly in election campaign mode ahead of the poll in 3Q and seemingly unconcerned about inflation risks, appears highly unlikely to trim planned expenditure, particularly in the health and education sectors. This is despite cost blowouts and emphatic evidence that the gloomy expectations that, 18 months ago, appeared to justify such aggressive fiscal expansion, never eventuated. Similarly, while the RBA has raised the cash rate at five of the past six Board meetings, commentary continues to assert that inflation will remain consistent with the bank's 2%-3% target in 2010.

Such conviction seemingly grates with two broadly accepted facts regarding Australia's situation: first, the economy entered the financial crisis under boom conditions, and suffered only a minor slowdown during the global recession; second, a cascade of new mining projects is falling into place that will kick off the next investment boom, which probably will extend over the next decade or so. Given the prospect of a rapid pickup in activity, it is worth exploring where the economy currently is positioned in terms of the conventional growth/inflation framework.

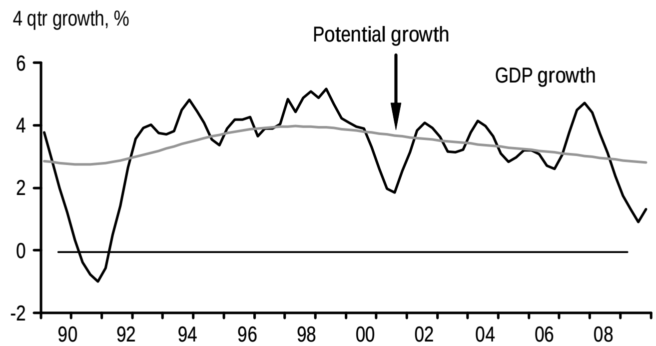
Output gap closing from 4Q09

The most common approach for describing and predicting trends in inflation revolves around the concept of slack—the amount of excess capacity in the factors of production—that is summarized by the output gap. A precise measure of the output gap is notoriously difficult to pinpoint since it attempts to quantify the difference between actual output, which is known, and potential output, which is unobserved. We construct an output gap measure by selecting

Core inflation and the output gap



Australia: actual and potential GDP growth



a smoothed GDP series, representing potential output, which econometrically explains inflation trends[1] (after controlling for currency and oil price movements), correlates well with capacity utilization measures, and generates a sufficiently stable path for potential growth. On these estimates, the output gap reached its trough for this cycle during 3Q09 at 1.3%. Our modeling suggests that, initially, the narrowing of the output gap will merely slow the decline in core inflation with trimmed mean CPI growing 2.8% in 2010 and the headline rate growing 2.9%. Core inflation then should pick up over 2011, ending the year at 3.6%oya in 4Q, as the output gap breaks into positive territory and the forces dragging down labor costs fade. The lower rate of potential growth will exacerbate the speed at which the output gap widens in 2011 and beyond.

Potential potentially disappointing

RBA communication has noted that the economy is running "at or close to trend growth" and will continue to do so over 2010. At the risk of inferring too much from various RBA publications, the growth forecasts for this year, published in the last Statement on Monetary Policy in February, are consistent with annual trend growth of "close to" 2.9%. The Federal Treasury estimates a similar figure of 3.0% for annual trend growth, as noted in November's Mid-Year Economic and Fiscal Outlook. Our analysis,

1. The data suggest that the output gap in Australia is closely connected not just with the level of inflation, but also with changes in inflation. While our formal modeling of inflation actually focuses on the former relationship, our forecasts are consistent with the latter relationship as well (first chart).

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however, suggests that potential growth has been following a steeper secular decline since the start of the past decade. A dearth of infrastructure investment and the hangover following the IT revolution of the 1990s have forced down productivity growth, such that potential GDP growth will be closer to 2.7% this year. With this in mind, our growth forecast of 3.1% for 2010, which is only moderately above the RBA's estimate, could generate a more significant narrowing of the output gap than many expect.

Labor pains and gains uncertain

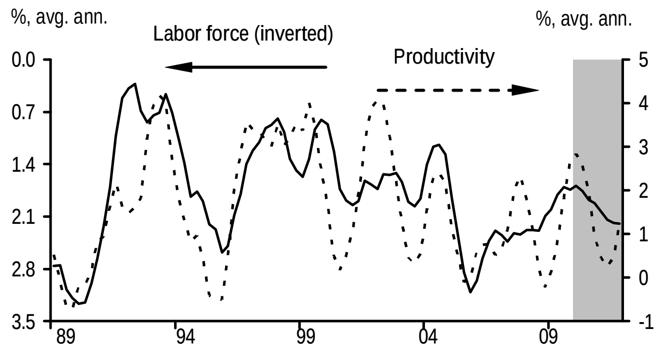
Our forecasts assume that the unemployment rate, having peaked at just 5.8%, tracks broadly sideways from its current level of 5.3% until 4Q11, owing to the anticipated reinstatement of hours worked and elevated labor force participation. While this appears pessimistic, the forecasts do incorporate reasonable employment gains. Further, our labor market view appears consistent with our forecast for GDP growth to climb *above* 3.5% by the end of 2011 since the fall from the peak in the unemployment rate thus far already appears sufficient for such a lift in the growth rate. As the Okun's Law relationship demonstrates (second chart), compared to the rapid 1.7%-pt rise in the unemployment rate from 3Q08 to 3Q09, oscillation within the 5.0%-5.5% band would represent a vastly superior outcome.

Still, the labor market remains the great unknown in the slack story. The mild increase in unemployment during the crisis was explained by a complementary decline in hours worked. In our modeling, the output gap is determined by measures of labor market capacity that incorporate both forms of adjustment. The uncertainty, therefore, lies in whether the adjustment is unwound in the same fashion as it was instated. In particular, rigidities in reinstating hours worked and employment would raise further upside risks to inflation. While difficult to quantify, there are compelling reasons to believe that such constraints—in particular, through employment in the mining sector and industrial relations reform—will hamper this transition.

Mining big on value, low on productivity

With the next leg of the mining boom set to kick off soon (see "New mining boom filling Australia's investment pipeline," *GDW*, April 2), the early effects of capital expenditure and the expansion of labor demand will push down labor productivity. While the "value-added" benefits of mining to national income become visible quickly, the associated capital investment requires several years to translate into productivity gains. Rising unit labor costs, which are an important input to our own inflation modeling, will generate greater price pressures.

Labor force and productivity growth



Okun's Law: unemployment and GDP growth

The concentration of Australia's investment projects in the mining sector also runs the risk of creating the same skilled labor shortages that characterized the last boom. While a thorough estimation of the NAIRU is beyond our treatment here, there is evidence that the economy had breached such a threshold in the lead-up to the crisis. Elevated inflation took hold over 2008, as the labor market proved incapable of achieving further falls in unemployment, despite a sustained increase in GDP growth (second chart above). Only a global recession dragged inflation back to target.

Industrial relations reforms yet to bite

In January, new IR laws came into effect that instituted minimum contractual requirements and ceded influence to the union movement. Central to this legislation are the National Employment Standards, a set of new minimum workplace entitlements, which include extended parental leave and maximum working hours protection. Companies already have expressed concern that they have not been advised sufficiently on these laws, and that the laws will constrain flexibility in the labor market. Firms and policymakers may have to learn through painful experience, as in the late 1970s to early 1980s, what these new requirements will mean for labor costs and hence, for inflation. A further risk is that employment outcomes become even more skewed in favor of mining, with other sectors less exposed to the terms of trade boom unable or unwilling to hire even more expensive labor.

Economic Research Note

Malaysia's BoP reflects private sector diversification

- **Malaysian balance of payments supported by current account**
- **Capital account has seen larger deficits, due mainly to corporate diversification**
- **Basic balance could narrow further in the absence of a rise in the domestic saving rate**

Malaysia's balance of payments dynamic has seen several evolving shifts in the post-Asian-crisis period, and this has been reflected in several ways. In the aftermath of the Asian crisis of 1998, the current account surge dominated the relative shift in the BoP, owing to the collapse in domestic investment, which fell to below 25% of GDP in 1998 from over 40% in 1997. Despite the surge in the current account, the capital account remained unaffected—with long-term private capital flows remaining broadly stable despite the exodus of short-term private capital during the crisis. However, in recent years, the capital account excluding portfolio capital has seen a shift in its composition with net direct investment turning negative and other non-portfolio flows turning increasingly negative (first chart). Despite the shift in the capital account, the overall basic balance has remained positive due to the offsetting impact of the current account (table). These capital account shifts reflect changes in corporate sector behavior, reflected in a net shift in longer-term capital flows and also an increase in outward direct investment, suggesting corporate recycling of its large external surpluses.

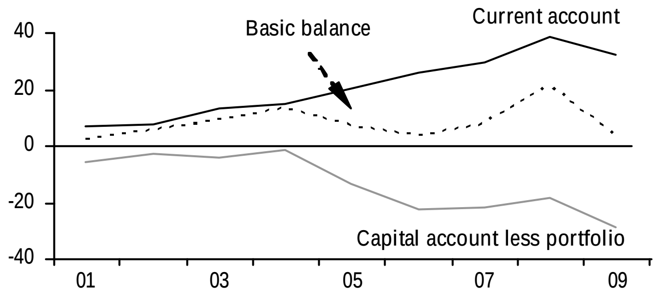
There are two implications of this shift. The first is that companies that are able to diversify successfully into the region will enjoy growth above that implied by Malaysia's own potential. Second, the surplus in the basic balance should remain, though be narrower than in previous years.

Current account pre- and post Asian crisis

The saving-investment gap provides a useful framework in assessing Malaysia's current account position. In the pre-crisis years, the current account printed deficits of 5%-10% of GDP, but then experienced a persistent surplus above 10% of GDP in the post-crisis years (second chart). The shift reflects the decline in investment outlays, which fell to 21% in 2009 from 40% of GDP before the crisis (third chart). The recent decline in the saving rate owes to the expansion of the public sector deficit in the past two years

Balance of payments

US$ bn



Balance of payments

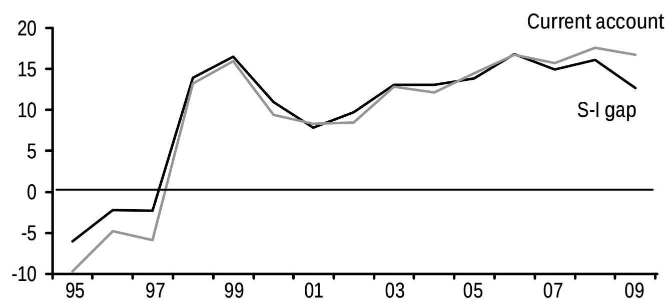
US$ bn

	2001	2002	2003	2004	2005	2006	2007	2008	2009
1. Current acct.	7.3	8.0	13.3	15.1	20.7	26.2	29.2	38.9	32.0
Goods	18.4	19.0	25.7	27.6	34.0	37.4	37.2	51.3	40.2
Services	-2.2	-1.6	-4.0	-2.2	-2.5	-2.0	0.7	0.1	0.9
Income	-6.7	-6.6	-5.9	-6.4	-6.3	-4.7	-4.1	-7.1	-3.6
Transfers	-2.2	-2.8	-2.4	-3.9	-4.5	-4.6	-4.6	-5.3	-5.5
2. Capital acct.	-3.9	-3.1	-3.2	5.1	-9.8	-11.8	-11.0	-34.0	-23.4
FDI	0.3	1.3	1.1	2.6	1.0	0.1	-2.7	-7.8	-7.2
Portfolio	-0.6	-1.7	1.1	8.7	-3.7	3.5	5.3	-24.6	0.4
Others	-3.5	-2.7	-5.4	-6.2	-7.0	-15.3	-13.7	-1.5	-16.7
E&O	-2.2	-1.0	0.3	1.9	-7.3	-7.5	-5.1	-8.6	-4.6
3. Overall	1.2	3.8	10.5	22.0	3.5	6.9	13.1	-3.5	3.9
FX reserves[1]	1.9	3.8	10.3	21.8	3.8	12.0	18.9	-10.0	5.3
Basic balance[2]	1.8	5.6	9.4	13.4	7.3	3.5	7.8	21.0	3.5

1. Cumulative increase. 2. Overall less portfolio.

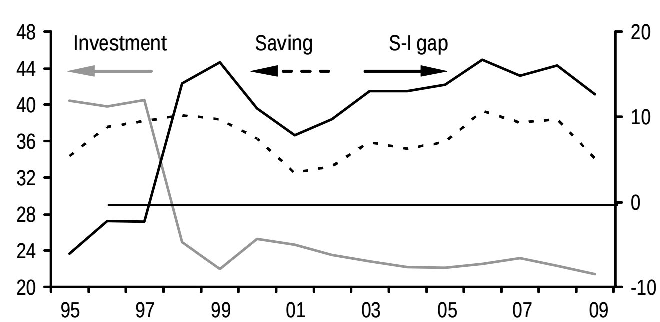
Current acccount and S-I gap

% of GDP



National saving and investment

% of GDP, both scales



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and should reverse in 2010 (first chart). This, in turn, should provide added support to the current account.

Capital account reflects corporate flows

By the same token, the weakness in investment was not reflected in the overall balance of payments until recently. Indeed, net foreign direct investment flows remained positive between 2003 and 2006 and only turned negative after 2006, reflecting increasingly larger outward investment by Malaysia's corporate sector with outward direct investment printing US$15 billion in 2008, while FDI was US$7.2 billion. These outflows should be seen as a logical complement to the slowing in domestic investment and a response to the draw of stronger growth prospects elsewhere. This dynamic is not unique to Malaysia and has also been observed in other countries in the region.

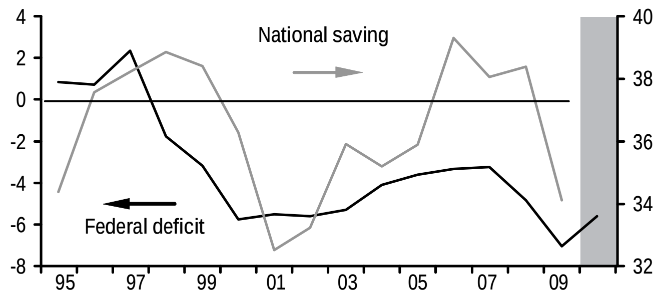
Another corollary of the increase in outward direct investment flows is that there should be an accompanying increase in funding operations for these overseas assets. These flows should also be reflected in the capital account, under the subheading of "others," which is a catch-all term including loans, letters of credit, and deposits. This seems to have occurred since 2003, with both outward investment and other flows marking similar trends (second chart). The anomaly appears to be in 2008, when other outflows slowed even as outward direct investment remained strong. To some extent, the slowdown in other outflows likely reflects the impact of risk aversion following the onset of the recent crisis, manifested in the pulling back of credit lines. However, over the course of 2009, these flows normalized and now have resumed their historical trends.

Of note, the authorities publish timely data on investment flows, which, unlike the BoP data, also capture flows to the Labuan International Offshore Financial Center (LIOFC), and these have continued to show significant outflows (third chart). This discrepancy owes to methodological issues, with the investment flow data reflecting short-term loans extended to treasury operations based in the LIOFC, but not including their repayment.

More importantly, this discrepancy does not reflect capital flight. Indeed, Malaysia's overall deposit base has been remarkably stable—with switching between FX and local currency deposits occurring within the banking system and not through outflows of private retail capital (fourth chart). That said, the large negative contribution from Errors and Omissions since 2005 is somewhat unusual relative to its recent history, but this has begun to slow in 2009. At this juncture, we believe it is not yet a major source of concern unless it widens further and is reflected in a concomitant decline in domestic deposits.

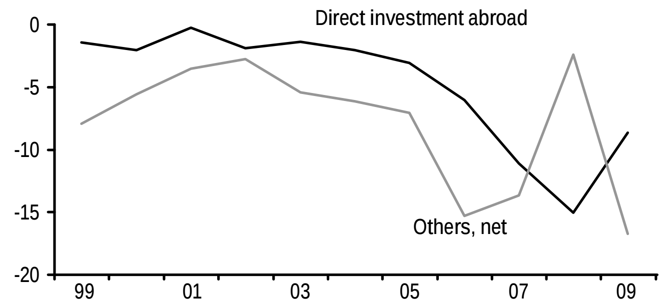
Fiscal deficit and gross national saving

% of GDP, both scales



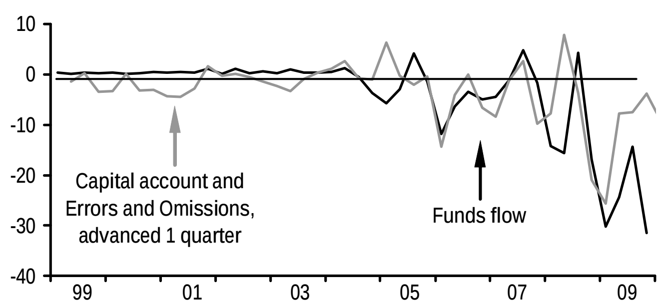
Direct outward investment and others

US$ bn, BoP terms



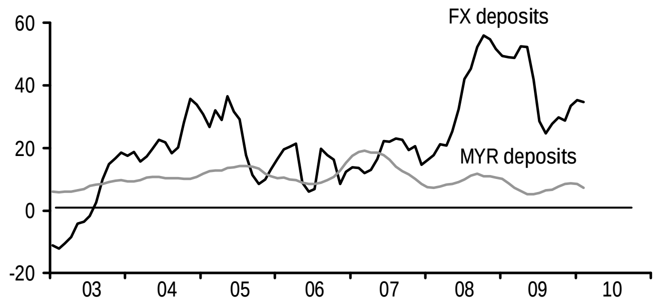
Capital account and investment flows

US$ bn



Banking system deposits

%oya, local currency terms



United States

- **Durables and home sales reports continue the string of strong March data**
- **Core PPI slips to 0.9%oya despite large increases in materials prices**
- **Reports on 1Q10 expected to show 3.0% real GDP growth, ECI increases of only 0.4%q/q and 1.6%oya**

Incoming data for March continue to show an acceleration in activity late in the first quarter. The March durables report includes a large monthly decline in incoming orders for civilian aircraft, among the most volatile components of the survey. But the rest of the report is unusually strong with new orders ex. transportation up 2.8% samr in March and core capital goods orders up 4.0%. Similarly, March new and existing home sales were up much more than expected even accounting for the effects of the homebuyer tax credit: New home sales surged 26.9% in March and existing home sales were up 7.8%.

The only noteworthy challenge to the view of accelerating growth had come from the rise in initial jobless claims around the time of the Good Friday holiday week. But initial claims fell 24,000 in the latest week. And Labor Department officials confirmed that prior increases were related to specific difficulties in adjusting for the timing of school vacations (and associated temporary layoffs) in New York and for the Chavez holiday and certain quarter-end technical issues in California.

The FOMC has a two-day meeting next week. The Committee is likely to reaffirm its commitment to exceptionally low rates for an extended period and note that the policy guidance is conditional on economic conditions including subdued inflation trends. The statement is likely to upgrade the characterization of growth while continuing to assert that “inflation is likely to be subdued for some time.” No decision is expected on the issue of asset sales.

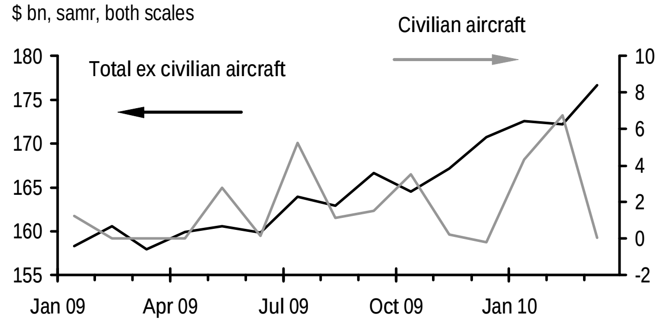
The key upcoming releases are Friday’s reports on real GDP and the Employment Cost Index for 1Q10. Real GDP growth is expected to come in at 3.0% with an acceleration of domestic final sales to 2.0% growth and the first build in real inventories since 1Q08. The forecast for current quarter real GDP growth remains 4.0%. The ECI is expected to show tame labor costs, up only 0.4% saqr and 1.6%oya.

Another strong signal on capex

The March durable goods report reinforces prior upbeat

New orders for durable goods

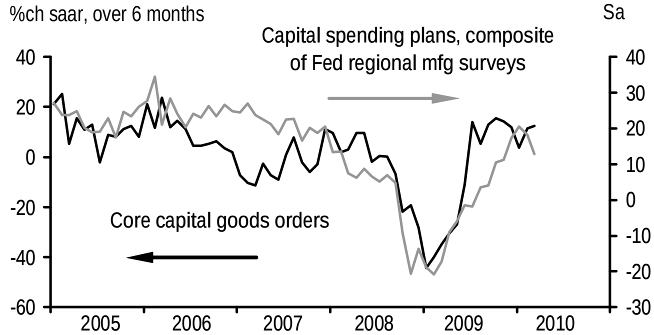
$ bn, samr, both scales



Core capital goods orders, Fed survey of capital spending plans

%ch saar, over 6 months

Sa



messages on industrial activity from the March ISM manufacturing survey and March IP release. Total new orders declined 1.3%, but only because of the plunge in new orders for civilian aircraft, a plunge that followed huge increases in prior months. Total new orders ex. civilian aircraft rose 2.6% and sustained a fairly stable trend of roughly 15% annualized growth since mid-2009.

The news from the capital goods industries is especially strong. Core capital goods orders rose 4.0% in March following a 2.1% increase the month before. And core capital goods shipments rose 2.2% in March following an upwardly revised 1.5% increase in February. The March upturn in capital goods orders is very broad-based. New orders for machinery surged 8.6%, orders for computers and electronic products rose 12.9%, and incoming orders for electronic equipment, appliances, and components rose 4.9%.

Core capital goods shipments slowed modestly from growth of 8.7% saar in 4Q09 to 7.4% last quarter. But the strong gains in both orders and shipments in March provide a strong trajectory into the current quarter (although the monthly data are volatile enough that we are not yet raising the capital spending forecast for the current quarter). The March level of core capital goods orders is 3.3% (not annu-

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alized) above the 1Q10 average; the March level of core capital goods shipments is 1.9% above the 1Q10 average.

Note that the recent acceleration in core capital goods orders and shipments is broadly consistent with results of the regional Fed manufacturing surveys that also show increased capital spending plans. And the March rise in core capital goods orders is also consistent with the results of the March IP report. Production of business equipment surged 1.4% in March following a healthy 0.7% increase in February. And the March IP gains were also broad-based across categories—transit (2.2%), information processing (1.9%), and industrial and other (0.8%).

To be sure, it is not clear how much of the recent strength in the capital goods industries reflects domestic demand and how much is export. But recent gains most likely reflect some of each.

Homebuyer tax credit brings in buyers

The current homebuyer tax credit is limited to home purchases for which the contract is signed by the end of April and the closing occurs by the end of June. And it appears that these incentives are once again front-loading home sales in the months leading up to the deadlines.

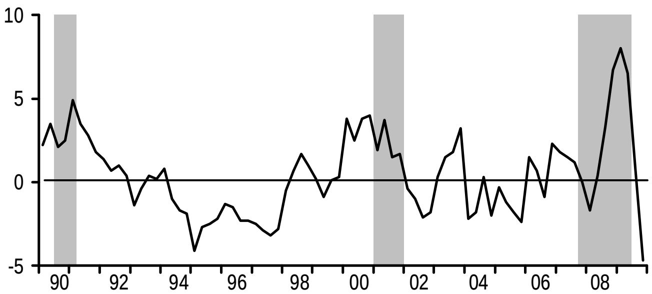
March new home sales surged 26.9% samr from a record February low to reach 411,000 saar, a level that is still nearly 65% below the 2002-2006 average. Sales increased across all four regions, but the gain was especially large in the South, where sales increased 43.5% in March. Existing home sales for March count closings in March and reflect contracts signed in earlier months. But sales were already starting to ramp up in these earlier months. Existing home sales rebounded 7.8% saar from a depressed February level to a pace of 5.35 million units.

Some of the recent house-price measures indicate that house prices have stabilized, and even increased over the past several month. The Case-Shiller 20-city house price index for February, out next Tuesday, is forecast to rise 0.2% samr. This would be the ninth consecutive monthly increase and lift prices above year-ago levels. But the large number of existing homes on the markets is still a source of potential downward pressure on prices. The inventory of unsold houses has come down from its peak, both in levels and as measured in months' supply. But the 8.5 months' supply on the market in March (sa) was still very much on the high side of prior norms. And most market analysts look for a sharp increase in foreclosures and other forced sales over the next few quarters.

Core PPI and other PPI measures
sa

	Mar	Sept 2009	Mar 2010
	%ch samr	%ch saar, over 6 months	
Core PPI	0.1	0.7	0.9
Finished food	2.4	0.4	13.5
Finished energy	0.7	22.4	24.1
Core intermediate PPI	0.7	1.7	6.3
Core crude PPI	6.0	48.1	41.1

Unit labor cost in manufacturing
%oya



PPI: Strong upstream prices, slowing core

The J.P. Morgan inflation forecast has expected a cyclical lift in commodity and materials prices as the global economy recovers alongside a slowing in core finished goods prices that reflects the offset of weak unit labor cost. The PPI report for March provides strong evidence that this view is playing out.

The core PPI rose only 0.06% in March and is now running 0.9%oya. At the same time, the PPI shows very rapid increases in March and over the past six months in the price of finished food and energy, in core intermediate prices (parts and materials ex food and energy), and in core crude prices (commodity prices ex. food and energy)—see table.

All things equal, rising downstream input prices would be pushing up the prices of finished goods. But manufacturers are getting an offset to the higher costs from falling unit labor costs. Data available through 4Q09 show that unit labor cost in manufacturing had declined 4.7%oya, the largest decline in the history of this series going back to 1950. And unit labor cost declined a huge 10.1% saar in the second half of last year, almost double the largest prior decline over a two-quarter period. Recent declines in unit labor cost reflect slower labor costs and, more important, a procyclical surge in productivity growth.

Data releases and forecasts

Week of April 26 - 30

Tue
Apr 27
9:00am

S&P/Case-Shiller home price index

%oya, unless noted

	Nov	Dec	Jan	Feb
20-city composite	-5.4	-3.1	-0.7	1.2
%m/m sa	0.2	0.3	0.3	0.2
10-city composite	-4.5	-2.4	0.0	

The FHFA home price index for February declined 0.2%, which is an improvement from the 0.6% and 1.9% declines registered over the prior two months. That said, the FHFA has been the odd indicator out among house price indexes. We are anticipating a 0.2% increase in the 20-city composite seasonally adjusted Case-Shiller index.

Tue
Apr 27
10:00am

Consumer confidence

Sa

	Jan	Feb	Mar	Apr
Conference Bd index	56.5	46.4	52.5	53.0
Present situation	25.2	21.7	26.0	
Jobs plentiful	4.4	4.0	4.4	
Jobs hard to get	46.5	47.3	45.8	
Plentiful less hard to get	-42.1	-43.3	-41.4	
Expectations	77.3	62.9	70.2	

After taking a drubbing in February, consumer confidence recouped only part of that loss in March. We expect the April number will remain below the January level as well. The news on consumer attitudes has been quite poor: the Michigan survey slumped in the preliminary April reading, and the ABC Survey has tumbled in the last two weeks.

Thu
Apr 29
8:30am

Jobless claims

000s, sa

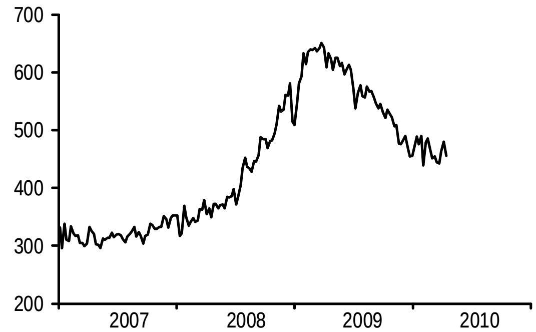
	New claims (wr.)		Continuing claims		Insured
	Wkly	4-wk avg	Wkly	4-wk avg	Jobless, %
Feb 13[1]	479	471	4794	4826	3.7
Feb 20	486	474	4712	4787	3.6
Feb 27	466	468	4694	4762	3.6
Mar 6	451	471	4694	4724	3.6
Mar 13[1]	454	464	4668	4692	3.6
Mar 20	445	454	4681	4684	3.6
Mar 27	442	448	4562	4651	3.5
Apr 3	463	451	4686	4649	3.7
Apr 10	480	458	4646	4644	3.6
Apr 17[1]	456	460			
Apr 24	445	461			

1. Payroll survey week

The most recent claims report wasn't good, but it did reduce the odds that something much more worrisome was brewing in the data. After spiking up over the prior two weeks, claims moved down to 450,000 in the latest print, which covers the payroll survey week. With more data available, it appears that the backlog that was reported in the prior week's data was due to California—the second time this year that the Golden State has distorted the national data due to an inability to process claims in a timely manner. While the improvement in initial claims has been halting, the improvement in the continuing claims data has been even more hesitant.

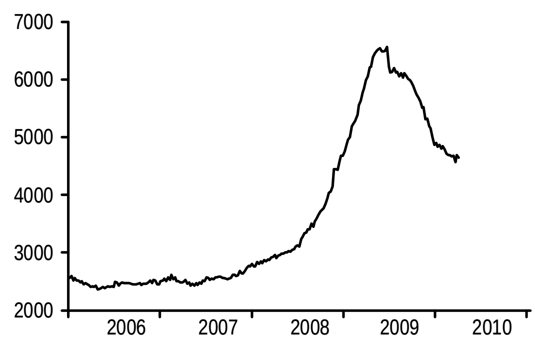
Initial jobless claims

000s, sa



Continuing jobless claims (first 26 weeks of UI)

000s, sa



Fri
Apr 30
8:30am

Gross domestic product

%ch q/q saar, unless noted

	2Q09	3Q09	4Q09	Adv 1Q10
Real GDP	-0.7	2.2	5.6	3.0
Final sales	0.7	1.5	1.7	1.6
Domestic final sales	-0.9	2.3	1.4	2.0
Consumption	-0.9	2.8	1.6	3.1
Equip. and software	-4.9	1.5	19.0	9.0
Nonres. structures	-17.3	-18.4	-18.0	-18.0
Residential investment	-23.2	18.9	3.7	-10.0
Government	6.7	2.7	-1.3	0.4
Net exports (%-pt contr.)	1.6	-0.8	0.3	-0.4
Inventories (%-pt contr.)	-1.4	0.7	3.8	1.4
Core PCE price index	2.0	1.2	1.8	0.6
%oya	1.6	1.3	1.5	1.4
GDP chain price index	0.0	0.4	0.5	0.5
%oya	1.5	0.6	0.7	0.3

Real GDP is expected to have grown at a 3.0% annual rate in the first quarter. That would be a step down from the inventory-fueled 5.6% rate seen in the prior quarter, though domestic final sales growth should accelerate modestly to 2.0%.

We look for consumption to expand at a 3.1% rate. Retail sales boomed in the first quarter, and auto sales also contributed to the expected pickup in consumer spending. One of the few areas of weakness was caused by the good March weather, which severely depressed consumption of household utilities in that month.

Equipment and software spending should have expanded close to 9.0% last quarter. Nominal core capital goods shipments increased at a 7.4% rate last quarter. Software investment probably also increased last quarter, though not as briskly as the 22% rate of increase seen in the fourth quarter. In contrast, investment in structures—both residential and nonresidential—should continue to contract.

We expect real nonfarm inventories to increase at a $26 billion rate, which would add about 1.4%-pts to GDP growth. Most of the inventory building is expected to occur in the auto sector.

Based on our expectation of a 0.1% increase in core PCE prices in March, we estimate that the core PCE deflator increased at a 0.6% annual rate in 1Q.

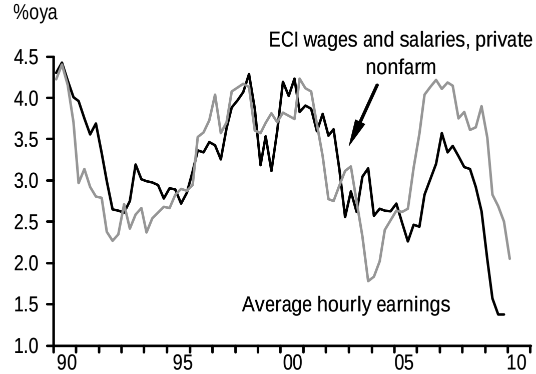
Fri
Apr 30
8:30am

Employment cost index

	2Q09	3Q09	4Q09	1Q10
Total (%q/q sa)	0.4	0.4	0.5	0.4
Wages and salaries	0.4	0.4	0.5	0.5
Benefits	0.3	0.4	0.5	0.3
Total (%oya nsa)	1.8	1.5	1.5	1.6
Wages and salaries	1.8	1.5	1.5	1.7
Benefits	1.8	1.6	1.5	1.4

Like all compensation data, the ECI has been very soft lately. Average hourly earnings for all workers increased a tepid 0.4%q/q in 1Q, suggesting that wage and salary growth in the ECI will be weak yet again. Unlike average hourly earnings, the ECI includes bonuses (though it excludes bonuses that require the valuation of equity—either stock grants or stock options). The ECI is seasonally adjusted so it is hard to find a regular pattern of ECI outperformance relative to average hourly earnings due to bonus payments. Benefits growth firmed last quarter, though we are expecting those to ease back in 1Q.

ECI wages and salaries, average hourly earnings



Employment cost index components

Fri
Apr 30
9:55am

Consumer sentiment

	Feb	Mar	Pre Apr	Fin Apr
Univ. of Mich. Index (nsa)	73.6	73.6	69.5	71.0
Current conditions	81.8	82.4	80.7	
Expectations	68.4	67.9	62.3	
Inflation expectations				
Short term	2.7	2.7	2.9	
Long term	2.7	2.7	2.7	
Home buying conditions	151.0	156.0	151.0	

The Michigan consumer sentiment number unexpectedly sank in the preliminary April reading. Since then, the incoming information relating to consumer sentiment has been mixed. Stock prices have moved sideways and jobless claims increased. There has been a tendency recently for the sentiment report to strengthen from the preliminary to the final reading, though the weekly ABC survey—which has dropped recently—suggests any bounce back in the final reading will likely be muted.

Review of past week's data

Producer price index (Apr 22)

%m/m sa, unless noted

	Jan	Feb	Mar	
Finished goods	1.4	-0.6	~~0.6~~	*0.7*
%oya nsa	4.6	4.4	~~6.1~~	*6.0*
Core	0.3	0.1	*0.1*	
%oya nsa	1.0	1.0	*0.9*	
Energy	5.1	-2.9	~~2.3~~	*0.7*
Cars	-0.5	0.5	~~0.3~~	*-1.1*
Trucks	1.9	-0.1	~~0.5~~	*-0.1*
Core intermed.	0.5	0.9	*0.7*	
Core crude	6.6	-0.6		*6.0*

The March Producer Price Index was up 0.7% on the back of rising food and energy prices. Excluding these two categories, the core PPI was up a modest 0.1% for the second straight month and is only up 0.8% over the past year, the second lowest print in the last six years. Almost all of the increase in core was due to a 5.9% increase in jewelry prices, a 27-year record; outside of this category, core prices were flat last month. The continued strength in commodity prices is showing through to the intermediate and crude PPIs, which were up 0.6% and 3.2%, respectively. One might suspect that this would show through to factory prices later on in the supply chain. Yet the intermediate and crude PPIs have been running hot for a year now, and still the finished goods PPI has continued to print very soft, suggesting higher input prices are being more than offset by declining unit labor costs.

Existing home sales (Apr 22)

	Jan	Feb		Mar	
Total (mn, saar)	5.05	~~5.02~~	*5.01*	~~5.20~~	*5.35*
%m/m	-7.2	~~0.6~~	*-0.8*	~~3.6~~	*6.8*
%oya nsa	7.0	~~7.9~~	*7.1*	~~12.8~~	*19.6*
Months' supply (nsa)	7.8	~~8.6~~	*8.5*		*8.0*
Single-family	7.6	8.2			*7.7*
Median price (%oya)	0.1	~~1.8~~	*-2.1*		*0.4*

Existing home sales jumped 6.8% in March to an annual sales rate of 5.35 million units. Apparently, the expiration of the homebuyer tax credit at the end of this month is pulling forward sales into March, and presumably April as well. There is no clear way to assess how much of last month's gain was due to the tax credit versus other factors, though the anecdotes suggest the preponderance of the gain owes to buyers seeking to take advantage of the tax credit. (Unlike the last time around, the tax credit is now available to existing homeowners who are buying to move, and so the first-time homebuyer share won't be as informative regarding the impact of the credit.) The sales gain was about evenly shared across regions, which makes sense given the national nature of the tax credit. Unsold inventories increased a little, but the months' supply pulled back to 8.5 from 8.0. Both the median and mean price were up modestly relative to a year ago. The sugar rush to existing home sales from the tax credit may not wear off as abruptly as last time; the current credit allows buyers until the end of June to close—which is when existing home sales are recorded—even though they need to have a firm contract by the end of April.

Durable goods (Apr 23)

%m/m sa

	Jan	Feb		Mar	
New orders	3.8	~~0.9~~	*1.1*	~~1.3~~	*-1.3*
Ex transportation	-0.8	~~1.4~~	*1.7*	~~2.3~~	*2.8*
Nondef cap. gds ex air	-4.4	~~2.0~~	*2.1*	~~2.7~~	*4.0*
Shipments	-0.1	~~0.6~~	*-0.5*	~~2.2~~	*1.2*
Nondef cap. gds ex air	-1.9	~~0.6~~	*1.5*	~~2.0~~	*2.2*
Inventories	0.1	~~0.4~~	*0.5*		*0.2*

The March durable goods report confirmed that the rebound in capital equipment spending is marching on with pretty solid momentum. Although the headline orders number disappointed by falling 1.3%, that decline was attributable to the extremely volatile aircraft category where orders sank 42%; the details beyond the headline were quite strong. Ex transportation orders rose 2.8% and the core (nondefense, ex aircraft) capital goods category saw orders rise 4.0%. More encouraging were the better shipments numbers—core capital goods shipments were up 2.2% and February was revised from up 0.6% to up 1.5%. This report leaves core capital goods shipments increasing at a 7.4% annual rate in 1Q after rising at a 8.7% rate in 4Q. Inventories at manufacturers of durable goods increased $0.5 billion last month, the third consecutive monthly increase. While we don't put a lot of stock in the forward-looking properties of the orders data, at the margin the March report suggests that respectable growth in capital equipment spending will continue into the second quarter.

New home sales (Apr 23)

	Jan		Feb		Mar	
Total (000s,saar)	~~315~~	*338*	~~308~~	*324*	~~325~~	*411*
%m/m	~~8.7~~	*-4.2*	~~2.2~~	*-4.1*	~~5.5~~	*26.9*
%oya nsa	~~8.3~~	*-4.2*	~~17.2~~	*-13.8*	~~2.1~~	*22.6*
Months' supply	~~8.9~~	*8.2*	~~9.2~~	*8.6*		*6.7*
Median price (%oya)	~~0.3~~	*3.5*	~~5.2~~	*5.7*		*4.3*

New home sales ripped higher last month, presumably stimulated by buyers rushing to get in ahead of the expiration of the homebuyer tax credit at the end of April. The 87,000 increase in the rate of new home sales to 411,000 is not the largest change in new home sales, but coming off a base that was the lowest new home sales on record, the 26.9% increase was the second biggest percentage increase in the series' history. New home sales, which are recorded at the time of contract signing, could see further support in April, as first-time homebuyers seek to take advantage of the $8,000 credit and long-time homeowners take advantage of the $6,500 credit. Sales jumped the most in the South, where the median house price is only $184,500 and the tax credit can potentially take a big bite out of the cost of buying a home.

US focus: hiring trends across regions

- Charts on this page compare regional job growth with national job growth as measured by the sum-of-states total. (Note that the sum-of-states measure of payroll growth in 1Q10 averaged about 50,000 per month more than the more reliable national payroll estimate.)

- The major shift from deep job cuts in early 2009 to stabilization or even modest hiring by 1Q10 has occurred in all regions. Economic improvement has been national, and similarities in performance across regions are more striking than the differences.

- Nonetheless, there are noticeable differences in the recent pace of hiring across regions. The strongest job growth over the past three months has been in the Northeast. Nonfarm payrolls in the New England states rose 1.6% saar in the first three months of the year versus 1.0% for the sum-of-states. Employment in the Mid-Atlantic states was up 1.7% saar, with New York State up 2.1% saar. Payrolls in the northern part of the South Atlantic states (from Delaware to Virginia) also grew a relatively rapid 2.1% saar.

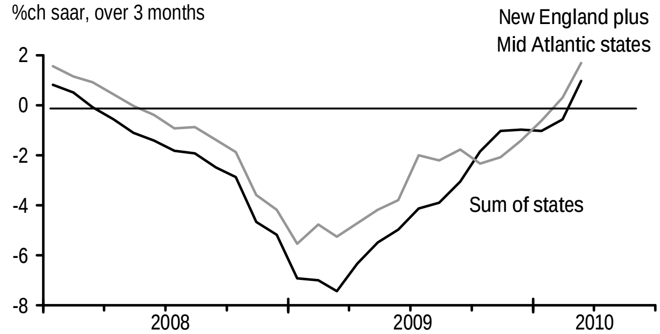
- The weakest region for hiring in the first quarter was the Mountain states, where payrolls edged lower. Employment in this region continued to be held down by Nevada (-2.8% saar) and Arizona (up only 0.1% saar).

- Despite the marked improvement in manufacturing over the past few quarters, hiring in several of the industrial states was still running well below the national average in 1Q10. Conspicuously, payroll employment in Michigan declined 1.9% saar in the first three months of the year.

Note: Regions are defined in the BLS report on state and regional employment at: http://www.bls.gov/news.release/laus.t01.htm

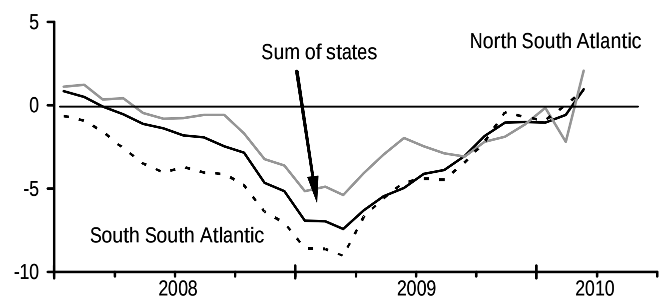
Nonfarm payrolls by region, Northeast

%ch saar, over 3 months



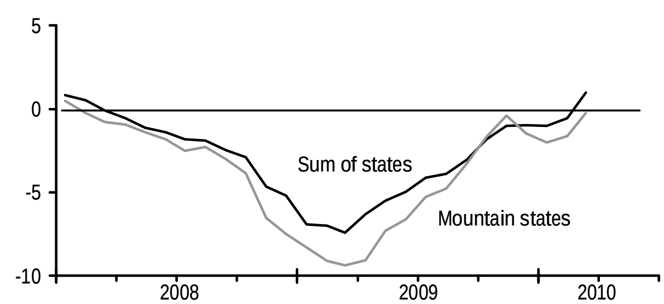
Nonfarm payrolls by region, South Atlantic states

%ch saar, over 3 months



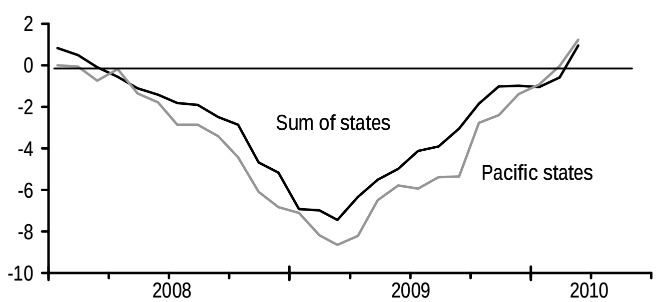
Nonfarm payrolls by region, Mountain states

%ch saar, over 3 months



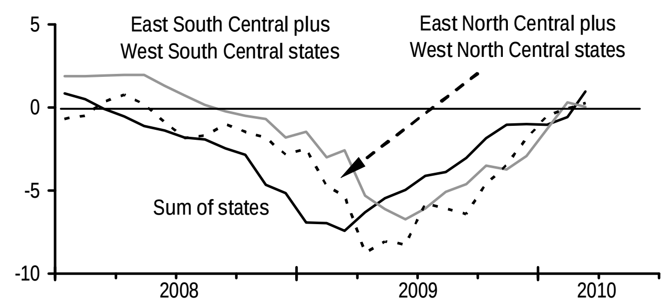
Nonfarm payrolls by region, Pacific states

%ch saar, over 3 months



Nonfarm payrolls by region, Central states

%ch saar, over 3 months



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Euro Area

- **April business surveys strengthen even further**
- **Revised data show even larger 2009 fiscal deficits in Greece and Ireland**
- **Greece activates EU/IMF support mechanism**

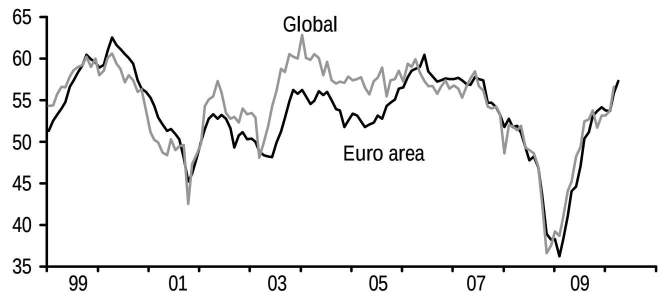
Even as concerns over Greece intensified this week and the risk of contagion to other countries increased, the April business surveys suggested that the cyclical rebound in Euro area growth is gathering further pace. The composite PMI output index increased by another 0.9pt in April to 57.5, a level that is normally consistent with a 3% annualized pace of GDP growth. And the German IFO now suggests that German GDP growth may be stepping up to a 4% annualized pace. Of course, the 1Q10 GDP reports, due to be published next month, will still be affected by weather-related hits to construction and exports (especially in Germany). But, if the strength of the surveys is reflected in the real activity data, it will create a large upside surprise for the consensus view. In contrast to the 2003 to 2005 period, when the Euro area experienced a lackluster recovery, this time it is participating in the global upswing.

The details of the business surveys reinforced the sense that the strong recovery in industry and trade is spilling over into the broader economy. The service PMI increased by 1.4pts to a level that is now above the pre-recession average. And there were strong gains in retail, wholesale, and services sentiment in the German IFO. In addition, the surveys suggest that the level of employment in the region is stabilizing much earlier than widely expected (see the research note “Euro area labor market edging closer to stabilization” in this *GDW*). This improvement in the labor market may have contributed to the increase in Euro area consumer confidence in April (offsetting concerns over the public finances).

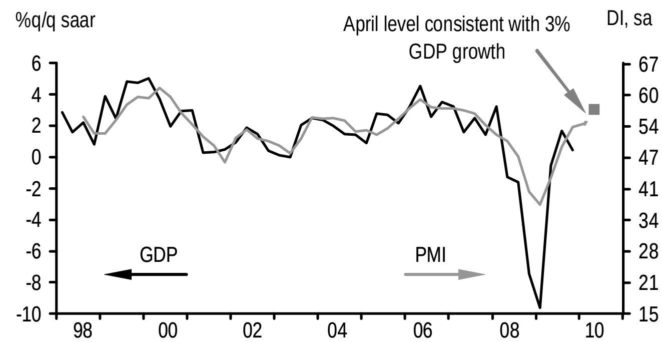
Two points should be noted on the German surveys. First, after 2001, there were two occasions when the IFO expectations index got ahead of itself; current conditions did not follow, expectations moderated again, and GDP growth failed to take off. This time, current conditions have almost closed the gap, pointing to self-sustaining growth. Second, comments in the IFO press release suggest that capacity utilization in manufacturing has risen markedly since the beginning of the year and that it is now only “a bit” below its long-run average. This matters because low capacity utilization is often cited as a reason for expecting weak capital spending. In our view, capital spending will in fact pick up this year.

Global and Euro area composite PMI—output index

DI, sa

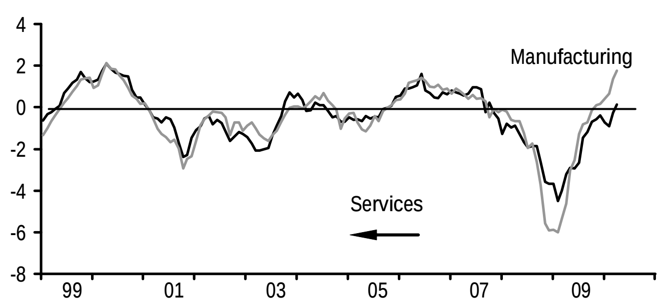


Euro area GDP and the composite PMI output



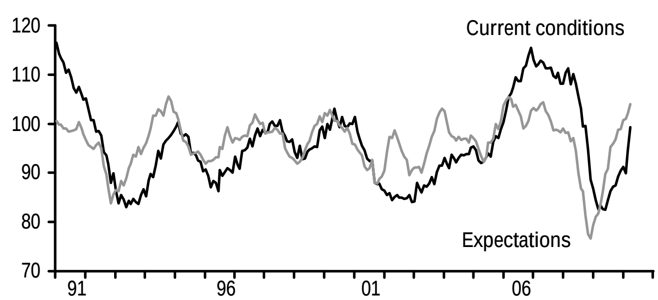
Euro area PMI—output and activity indices

Standard deviations from pre-recession average



IFO current conditions and business expectations

Index, sa



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Greece requests the EU/IMF aid

The Greek Prime Minister formally asked on Friday for the activation of the aid package that has been discussed jointly with the European Commission and the IMF. The request does not come as a surprise. However, the speed of the announcement reflects the reaction of the Greek government to this week's sequence of events. In particular, Eurostat reported further risks of upward revisions to Greek's debt (worth between 5% and 7% of GDP), spreads in the government bond market for Greece widened sharply, and Moody's cut the Greek credit rating to A3. Although the exact details of the plan are not available yet, the aid package does not include any form of debt restucturing at the moment.

Monthly data track fiscal consolidation

Meanwhile, the flow of monthly fiscal data from Portugal, Ireland, and Spain opens the ground for some modest optimism: Data up to March suggest that public finances are roughly in line with the fiscal consolidation objectives drawn up by the governments in their respective Stability and Growth programs. The main caveat to this conclusion is that the monthly data cannot be directly compared to the annual budget objective.

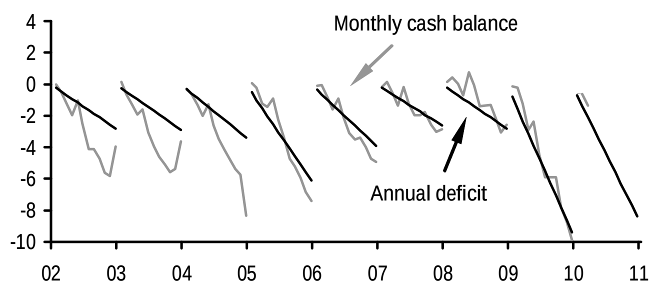
To track the fiscal situation, it is necessary to fix a benchmark and assess where the cumulative monthly movement stands in regard to the benchmark. Our benchmark is the cumulative general government budget series, which shows what monthly movement in the public finances is compatible with a given objective for the year as a whole.

- Data for Portugal are recorded on a cash basis and include the central government and social security. So far, the monthly data appear to track the government objective of a fiscal deficit of 8.3% of GDP in 2010, after a 9.3% of GDP deficit in 2009.
- The Irish data are recorded on a cash basis and cover the central government. The March cumulative position is several points above the benchmark. Although a part of this improvement may be seasonal and is therefore likely to reverse in April, overall the data look encouraging.
- The Spanish data for central government balance are calculated on an accrual basis. The data, available until February, appear a couple of percentage points of GDP above their target, but it is too early to draw conclusions. The data appear to have a marked seasonality, and the improvement may partially reverse a bit in the coming months.

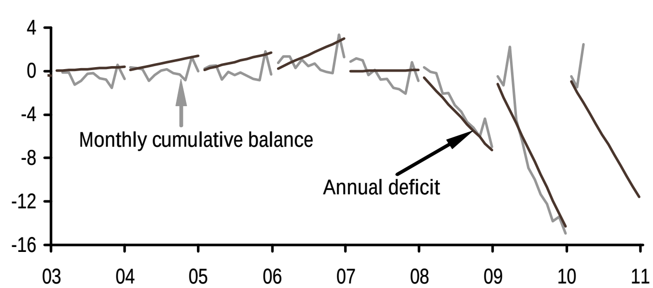
Euro area countries general government budget and debt for 2009
% of GDP

	Stability and Growth Program deficit	Deficit (Eurostat)	Primary deficit	Gross debt
Euro area		-6.3	-3.5	78.7
Germany	-3.2	-3.3	-0.7	73.2
France	-7.9	-7.5	-5.2	77.6
Italy	-5.3	-5.3	-0.6	115.8
Spain	-11.4	-11.2	-9.4	53.2
Netherlands	-4.9	-5.3	-3	60.9
Belgium	-5.9	-6	-2.3	96.7
Austria	-3.5	-3.4	-0.7	66.5
Greece	-12.7	-13.6	-8.5	115.1
Ireland	-11.7	-14.3	-12.2	64.0
Finland	-2.2	-2.2	-1	44
Portugal	-9.3	-9.4	-6.6	76.8
Slovakia	-6.3	-6.8	-5.3	35.7
Slovenia	-5.7	-5.5	-4.1	35.9
Luxembourg	-1.1	-0.7	-0.2	14.5
Cyprus	-0.9	-6.1	-3.6	56.2
Malta	-6.6	-3.8	-0.6	69.1

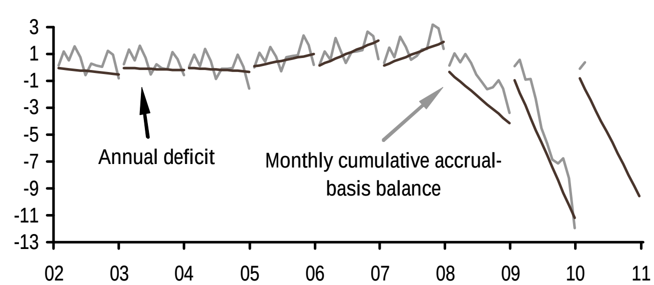
Portugal government cash deficit and net lending
% of GDP, cumulative



Ireland monthly Exchequer balance and annual net
% of GDP, cumulative



Spain government monthly and annual net borrowing
% of GDP, cumulative



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Data releases and forecasts

Week of April 26 - 30

Output and surveys

European Commission survey
% balance of responses, sa

		3Q09	4Q09	1Q10	2Q10
Thu	Euro area				
Apr 29	Level of capacity utilization	69.6	71.0	72.0	74.0
11:00am					

		Jan	Feb	Mar	Apr
Thu	Euro area				
Apr 29	Industrial confidence	-14	-13	-10	-8
11:00am	Recent production trend	-7	-5	0	__
	Production expectations	5	7	9	__
	Export order books	-45	-42	-37	__
	Stocks of finished products	3	4	0	__
	Selling-price expectations	-6	-4	-1	__
	Construction confidence	-29	-29	-25	__
	Retail confidence	-5	-9	-6	__
	Service confidence	-1	1	1	__

National Euro area business surveys (IFO, INSEE, BNB) have increased solidly in April across the region, showing no adverse impact of the fiscal stresses. As a result, we expect a solid increase in the EC survey in April. In addition, there should also be a relatively broad-based improvement in the other sectors, pointing to an increase in overall sentiment in the region and a sustained recovery.

Comments from the IFO suggested that capacity utilization in German manufacturing has increased markedly since the start of the year, and that it has risen to much nearer its long-run average. Partly consistent with this, Belgian capacity utilization increased by 3pts and has already recovered half of the peak-to-trough decline. Taken at face value and considering that the level of activity is still well below pre-recession peak, it would suggest that corporates have managed down their capacity and that pricing pressures could be normalized more quickly than previously thought.

National business surveys

		Jan	Feb	Mar	Apr
Wed	Italy (ISAE survey)				
Apr 28	2000=100, sa				
9:30am	Producer confidence	83.2	84.0	84.1	__

Demand and labor markets

Unemployment
sa

		Dec	Jan	Feb	Mar
Fri	Euro area				
Apr 30	Harmonized measure (Eurostat)				
11:00am	Unemployment rate (%)	9.9	9.9	10.0	10.0
		Dec	Jan	Feb	Mar
Thu	Germany				
Apr 29	Registered (ch m/m, 000s sa)	-1	-1	-31	-10
9:55am	(000s nsa)	3617	3643	3568	__
	Unempl. rate (% sa)	8.1	8.1	8.0	8.0

The Euro area unemployment rate edged up to 10.0% in February, but only after having held steady at 9.9% in the prior three months. The monthly increases in unemployment have also eased to well below 100,000 (after peak increases of over 500,000 in early 2009). These monthly changes give a more timely indication of the trend than the unemployment rate and will therefore be important to watch.

In Germany, we also expect the unemployment rate to remain unchanged, although here the pressure is already downward. See further details below in the discussion of our German employment forecast.

Employment

		Dec	Jan	Feb	Mar
Thu	Germany				
Apr 29	(change m/m, 000s sa)	6	4	7	5
9:55am					

German employment has increased for three consecutive months and so have vacancies. This has come even though the take-up of the government's short-time work subsidy scheme has been falling. While there remains some pressure in manufacturing to cut jobs, a shift toward part-time work and increased hiring in the public and service sectors is continuing to provide relief. We expect these trends to continue and employment to increase again in March. The stability of the German labor market in the coming months will be reinforced by additional government support measures targeted both at protecting existing jobs and at creating incentives for new job creation.

Consumer confidence

		Jan	Feb	Mar	Apr
Thu	Euro area (European Commission survey)				
Apr 29	% balance of responses, sa				
11:00am	Consumer confidence (final)	-16	-17	-17	-15

The flash release already showed consumer confidence rising to -15 in April. While this still left confidence close to the range it has been in since October last year, the direction of the move in April is interesting in light of the fiscal stresses in the region. The final release will give a full component and country breakdown. Recent months have seen consumer confidence stagnate in most countries and fall sharply in Greece. In addition, consumer expectations about unemployment have remained stubbornly high despite signs that the labor market is stabilizing. And the sub-index on major purchase intentions, which correlates most closely with actual spending, has nudged lower over the past two to three months. It will therefore be important to see which of these trends is reversing.

Inflation

Consumer prices

		Jan	Feb	Mar	Apr
Fri					
Apr 30	Euro area (flash)				
11:00am	HICP (%oya nsa)	1.0	0.9	1.4	1.6
Wed	Germany (prelim)				
Apr 28	%m/m nsa	-0.6	0.4	0.5	0.2
8:00am	%oya	0.8	0.6	1.1	1.3
	HICP (%oya)	0.8	0.5	1.2	1.4
	Baden Wuerttemberg (%oya)	0.8	0.3	1.3	1.5
	Bavaria (%oya)	0.6	0.4	1.1	1.2
	Brandenburg (%oya)	0.6	0.3	0.8	1.0
	Hesse (%oya)	0.5	0.3	0.8	1.0
	North-Rhine West (%oya)	0.8	0.6	1.2	1.3
	Saxony (%oya)	0.7	0.5	1.3	1.4
Fri	Italy (prelim)				
Apr 30	%m/m nsa	0.1	0.1	0.3	0.2
11:00am	%oya nsa	1.3	1.2	1.4	1.4
	HICP (%oya nsa)	1.3	1.1	1.4	1.5
Thu	Spain (flash)				
Apr 29	HICP (%oya nsa)	1.1	0.9	1.5	1.6
9:00am					
Thu	Belgium CPI				
Apr 29	%m/m nsa	0.5	0.4	0.4	0.4
11:15am	%oya nsa	0.6	0.7	1.7	1.8

Euro area inflation will likely increase a bit more in April, due to further increases in energy prices. We expect the flash release to reflect also the ongoing strength seen in food inflation and a general but small moderation in core inflation across all inflation components. One exception may be hotel and restaurant inflation: it appears that the volcanic ash cloud that forced the cancellation of many flights across the region have produced a rise in demand in hotel accommodation, as an undesired consequence, possibly affecting prices. However, it is very difficult to quantify the effect accurately.

German inflation may have increased slightly more than the Euro area aggregate, because of the sharp rises in gasoline prices seen in the month of April. Also, food prices likely rose significantly more than last April, pushing the yearly rate up from 0.1%oya in March to 0.7%oya in April. Core inflation likely moved down very slightly in April, with the possible exception of hotels and restaurants.

Producer prices

		Dec	Jan	Feb	Mar
Fri	France				
Apr 30	%m/m nsa	0.1	0.6	0.2	__
8:45am	%oya nsa	-2.9	0.3	1.0	__
Fri	Italy				
Apr 30	%m/m nsa	0.0	0.6	0.2	__
10:00am	%oya nsa	-1.5	-0.3	0.4	__

Import prices

		Dec	Jan	Feb	Mar
Tue	Germany				
Apr 27	%m/m nsa	0.5	1.7	1.0	0.8
8:00am	%oya nsa	-1.0	1.4	2.6	4.0

German import inflation in March is expected to have increased further, likely driven by energy and food prices. The currency depreciation that took place in the past months may have also marginally impacted the overall result.

Financial activity and public finance

Money and credit data

		Dec	Jan	Feb	Mar
Thu	Euro area				
Apr 29	M3 (%m/m sa)	0.3	-0.2	0.0	0.0
10:00am	M3 (%oya)	-0.3	0.1	-0.4	-0.2
	M3 (%oya 3mma)	-0.1	-0.2	-0.2	-0.2
	Private loans (%oya)	-0.1	-0.6	-0.4	__

We expect Euro area M3 to have remained unchanged in March (with the annual comparison rising to -0.2%oya). With credit creation, which is the main driver of bank deposit growth, close to stagnant, there is no reason to expect any increase in M3 for now. However, key details of recent reports have been much more positive than the headline number. First, in aggregate, the shedding of assets by the banking sector has come to a halt. Second, within the details of the loan data, household loans continue to grow at a solid 3% annualized pace and loans to nonfinancial corporates also increased in February. Third, nonfinancial corporates are continuing to build their cash reserves; their holdings of deposits have increased 5%oya, after having fallen outright in early 2009 due to severe cost and revenue pressures. It will be important to see whether these trends continue. Overall, they have been pointing to some healing and to the absence of severe credit constraints in the Euro area.

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Review of past week's data

Output and surveys

Purchasing managers index flash (manufacturing)
Index, sa

	Feb	Mar	Apr	
Euro area				
Overall region	54.2	56.6	~~57.0~~	*57.5*
Germany	57.2	60.2	~~60.2~~	*61.3*
France	54.9	56.5	~~56.8~~	*56.7*

Purchasing managers index flash (services)
Index, sa

	Feb	Mar	Apr	
Euro area				
Overall region	51.8	54.1	~~54.5~~	*55.5*
Germany	51.9	54.9	~~55.1~~	*55.0*
France	54.6	53.8	~~54.5~~	*57.8*

Purchasing managers index flash (composite)
Index, sa

	Feb	Mar	Apr	
Euro area				
Overall region	53.7	55.9	~~56.2~~	*57.3*
Germany	55.7	58.7	~~58.9~~	*59.1*
France	55.6	55.8	~~56.3~~	*58.4*

After the very strong gains in March, the Euro area flash PMI stepped up even further in April. This level is normally consistent with around a 3% annualized pace of GDP growth. The details were strong and continued the positive themes of the March release. In particular, the service PMI increased further and has now surpassed the pre-recession average, adding to the sense that the strong recovery in industry is spilling over into the broader economy. Second, the employment index increased again, and its level is consistent with stable employment in aggregate. This is an earlier stabilization than widely expected and should further support domestic demand and households. Finally, the increases were again broad-based across countries, with Germany still leading the way.

In the country detail, the composite output index rose by 2.7pts in France and by 0.4pt in Germany (from a very high March level). Therefore, the rest of the region must have increased by around 0.7pt on average, after a very large 4pt gain in March. In the component detail, the Euro area PMI employment index rose in both manufacturing and services. The composite employment index, at 49.6 in April, is consistent with stable employment (modest cuts in manufacturing are being offset by small gains in services). At the same time, composite new orders increased by 0.4pt, driven entirely by services; in contrast, new orders in industry held their very high March level (59.7). And the new orders to inventory ratio in manufacturing remained high, suggesting that the output index will be able to at least hold on to its very high level of 61.3 in the near term. In manufacturing, Germany is clearly leading the way; its output index hit a new record high of 66.8, even though the new orders index moved lower.

Manufacturing orders
Index, sa

	Dec		Jan		Feb	
Euro area						
Values						
New orders (%m/m sa)	~~0.8~~	*0.6*	~~-2.0~~	*-1.6*	__	*1.5*
New orders (%oya sa)	~~9.5~~	*9.7*	~~9.9~~	*10.4*	__	*12.2*
Italy						
Values						
New orders (%m/m sa)	4.7		-2.8		__	*-0.4*
New orders (%oya sa)	5.3		4.0		__	*5.4*

National business surveys

	Feb		Mar		Apr	
Germany (IFO survey)						
2000 = 100, sa						
Business climate	~~95.2~~	*95.3*	~~98.1~~	*98.2*	~~98.8~~	*101.6*
Business expectations	100.9		~~101.9~~	*102.0*	~~102.0~~	*104.0*
Current conditions	~~89.8~~	*89.9*	~~94.4~~	*94.5*	~~95.5~~	*99.3*
France (INSEE survey—manufacturing)						
Index						
Composite index	~~91~~	*90*	~~94~~	*93*	__	*97*
Index of past production	~~3~~	*1*	~~4~~	*5*	__	*22*
Expected output—personal	~~-4~~	*-1*	~~3~~	*5*	__	*4*
Expected output—general	~~-5~~	*1*	~~-5~~	*-3*	__	*8*
Belgium (BNB survey)						
Percent balance of responses, sa						
Overall	-7.0		-3.6		__	*-2.4*
Manufacturing	-8.6		-6.5		__	*-4.5*
Commerce	-4.9		-1.2		__	*1.5*
Construction	-14.3		-9.3		__	*-7.0*

The German IFO index rose very strongly in April and is pointing to a sharp acceleration in German growth, driven not only by manufacturing, but increasingly also by the broader economy. Similarly, the increase in the Euro area PMI suggests that area-wide conditions are weathering the fiscal pressures very well so far.

In the detail, there were large increases in retail, wholesale, and services, in addition to a further improvement in manufacturing. Overall, the 10pt cumulative increase in current conditions over the past two months is particularly encouraging. On two occasions after 2001, the expectations index got ahead of itself, current conditions did not follow, and expectations moderated again (and the recovery remained lackluster). This time, current conditions have almost closed the gap to the very elevated expectations, suggesting that the recovery will be self-sustaining. Comments in the IFO press release suggested that employment intentions and capacity utilization each improved in manufacturing, as did export orders. All three developments are positive.

Other national surveys were also positive. Strong increases in the French INSEE survey bought some of the output-related sub-indices much more closely in line with the more upbeat French PMI.

Demand and labor markets

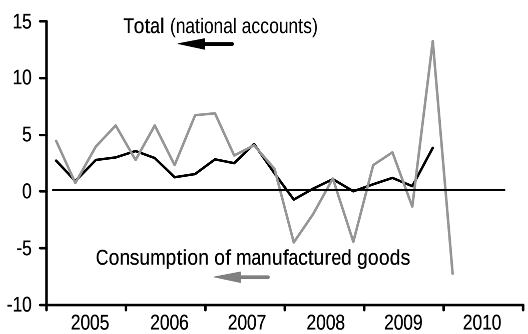
Domestic consumption

	Jan	Feb		Mar	
France					
Consumption of manufactured products, real terms					
%m/m sa	-2.5	~~-1.2~~	*-1.4*	~~0.8~~	*1.2*
%oya sa	1.5	~~1.6~~	*1.3*	~~2.1~~	*2.5*

French consumption of manufactured goods increased 1.2%m/m in March, driven by a rebound in spending on textiles and household durables. Car sales also increased, in line with more stable car registrations (after the huge 17%m/m decline in January). Overall, French consumption will likely decline in 1Q10 due to payback from the car scrappage incentives. But, the recent trends in the data do not currently point to ongoing weakness.

French consumer spending

%q/q saar



Consumer confidence (prelim)

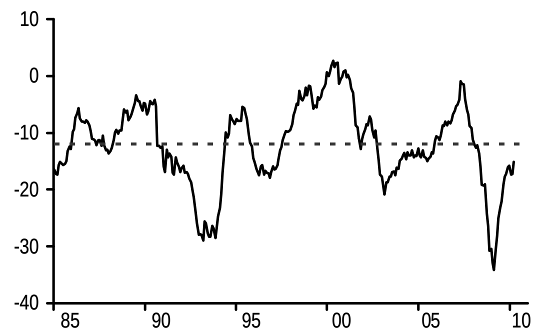
	Feb	Mar	Apr	
Euro area (European Commission survey)				
%bal of responses, sa				
Consumer confidence	-17	-17	~~-17~~	*-15*

Euro area consumer confidence increased by a solid 2pts in April, marking a new high in this recovery. While this increase still left confidence close to the range it has been in since October last year, the direction of the move is interesting in light of the fiscal stresses in the region.

No country or component details are published with the flash report. But, the recovery in confidence had stalled in most countries in recent months, while in Greece, confidence has been falling sharply. Therefore, a renewed shift to rising confidence in the coming months would certainly be a positive.

Euro area consumer confidence

% balance, sa, dotted line shows long-run average



Inflation

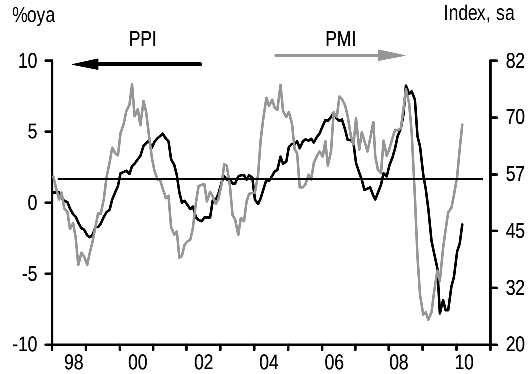
Producer prices

	Jan	Feb	Mar	
Germany				
%m/m nsa	0.8	0.0	~~0.3~~	*0.7*
%m/m sa	0.7	0.0		*0.6*
%oya nsa	-3.4	-2.9	~~-1.8~~	*-1.5*

Producer prices inflation in Germany rose sharply in March, pushed up by a surge in intermediate goods price inflation, as well as a rise in durable consumer goods inflation. The weakening of the exchange rate is likely to have contributed to the rise.

Germany PPI and PMI input prices

%oya | Index, sa



Japan

- **Real exports remained solid, while imports unexpectedly fell in March**
- **Both consumer and business sentiment improved in March**
- **Busy week ahead with nearly all major monthly data and the BoJ semiannual outlook report released**

While the quarterly pace of increase is slowing gradually, real exports rose at a decent pace in March, underscoring that external demand remained solid at the end of 1Q. On the other hand, real imports were somewhat weaker than we had anticipated. Accordingly, the contribution of net trade to 1Q real GDP growth is likely to be higher than our expectation, posing some upside risk to our forecast for 3.5% annualized growth. We will review the forecast after seeing the slew of monthly indicators next week.

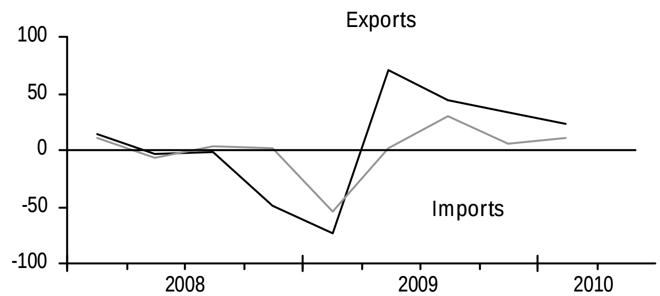
Next week, especially Friday, is extremely busy for data releases and central bank watchers. Almost all major monthly indicators and the BoJ's outlook report will be released next Friday. The key focus will continue to be the IP report (Friday), which includes manufacturers' projections for April and May. Combined with the April Shoko Chukin small business sentiment (Tuesday), this projection provides a good look at the strength of both manufacturing and the overall economy in this quarter. March consumption-related data—retail sales (Wednesday) and the household survey (Friday)—as well as labor market and wage data (Friday) are also important to substantiate the recent firming of consumption. The March CPI, which includes the April preliminary number for the Tokyo district, will be released on Friday as well.

The outlook report is the most important communication tool for the BoJ to express its view on the economy and inflation over the next two years. We believe that it will upgrade its forecast of the economy in both this and the next fiscal year, and predict the end of deflation in the next fiscal year. The CPI forecast for FY2010 is expected to be revised down from January due to the reduction in high school tuition, which was decided in March and took effect this month, but the Bank likely will emphasize that, excluding this temporary effect, the underlying trend of prices has improved.

If the tone of the report is in line with our expectation, the market will likely view this as a signal that the Bank will shift its policy stance from a further easing bias to remaining on hold. However, as described in last week's essay, the reaction function of the BoJ appears to have changed from March, implying that further easing cannot be ruled

Real exports and imports of goods

%q/q saar



BoJ's latest real GDP and core CPI forecasts

%y/y

	FY2009	FY2010	FY2011
Real GDP			
Median	-2.4	2.0	2.2
Previous (Jan)	-2.5	1.3	2.1
J.P. Morgan	-2.4	2.4	2.0
Core CPI			
Median	-1.5	-0.8	0.1
Previous (Jan)	-1.5	-0.5	-0.2
J.P. Morgan	-1.6	-1.1	0.0

Note: the CPI forecast for FY2010 includes a -0.5%-pt impact from free high school tuition.

out even if the outlook for the economy and inflation has improved. Indeed, Deputy Governor Kiyohiko Nishimura said in a speech this week that "the Bank's decision on further easing at a time when the economy has been improving somewhat more than projected was considered by some as unexpected. However, since it continues to be the case that some time is needed for Japan's economy to return to a sustainable growth path with price stability, we judged it necessary to ensure the improvements in economic activity and prices through an additional easing."

J.P. Morgan does not expect additional easing at next week's policy meeting, but believes that the expected relatively bullish report and tone of the Bank's communication—including Governor Shirakawa's press conference—does not guarantee that the BoJ will stay on hold from here. We expect that the Bank will ease further in June.

March exports were solid, while imports fell unexpectedly in March

Real exports rose 2.8%m/m sa in March after 1.1% and 0.3% gains in the previous two months. While the quarter-over-quarter growth slowed to 22.5% from 28.4% in 4Q09 and 31.3% in 3Q, the pace remains solid. The level of real exports in March is still 15.3% below the peak in March 2008, but has recovered 47.4% from the bottom in February last year. Demand from emerging Asia is the key driver of the export recovery.

On the other hand, real imports were weak, falling 3.8% after rising in each of the past two months. However, they rose 10.6%q/q saar in 1Q as a whole, up from 7.9% in 4Q09. Also, a decline in imports is positive in terms of the contribution to GDP from net trade. While the softness in imports may suggest that domestic demand is not strengthening as we had expected, positive payback is likely in April and the following months.

Consumers also feel better now

The ESRI's consumer sentiment index for March posted 40.9, which was higher than the recent peak of 40.5 marked in September and October last year. With a similar improvement in the household DIs in the Economy Watchers survey, this suggests that consumer confidence is recovering along with that of business.

Looking at the details, the recent improvement was broad-based in terms of both questions—standard of living, income growth, labor market conditions, timing to buy durable goods—and regions. Also, the special quarterly questionnaire revealed that cuts in consumer spending on services have moderated further.

Consistent with this improvement, the March nationwide department store sales report showed that sales have been holding up, after having strengthened around the turn of year. To be sure, some of the improvement came from increased purchases by Asian tourists who visited Japan during the Lunar New Year holiday season in February. But according to the Japan Department Store Association, sales of luxury goods have picked up through March, probably suggesting that wealthy Japanese consumers' demand is reviving.

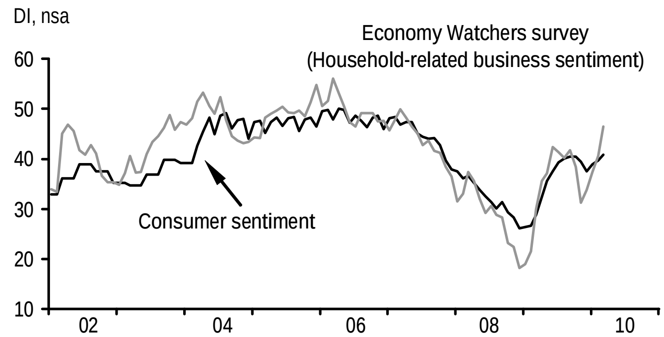
Some improvement in bank loan demand

The BoJ bank loan officers survey for 1Q indicated that corporate loan demand continued to decline, although at a more moderate pace, while demand from households, mainly for mortgages, recovered. The pickup of demand for mortgages is consistent with the recovery of housing starts and anecdotes suggesting a rise in home sales. Looking ahead, though, while the fall in corporate loan demand likely will stabilize and the increase in mortgages is expected, we feel that a further substantial rise of bank loans as a whole is unlikely given the ample corporate cash flows.

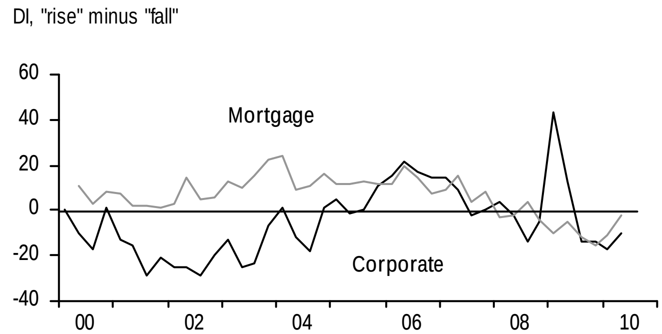
Political turmoil means more noise

While economic indicators are now encouraging, political developments have been discouraging. Indeed, the Cabinet's approval rating is nose-diving as public disappointment is mounting in the DPJ-led government, which has failed to settle controversial issues, including the transfer of the US military base in Okinawa. Meanwhile, several central figures of the LDP (the former ruling party and the largest opposition) have left the party to establish new, smaller parties, aiming to lead a political realignment after the Upper House election in July. While the final outcome of these political developments is unclear, uncertainty for financial markets will likely increase in the near future as many politicians rush to propose economic policies—including those that impact the BoJ—to give the appearance that they are playing an important policy role.

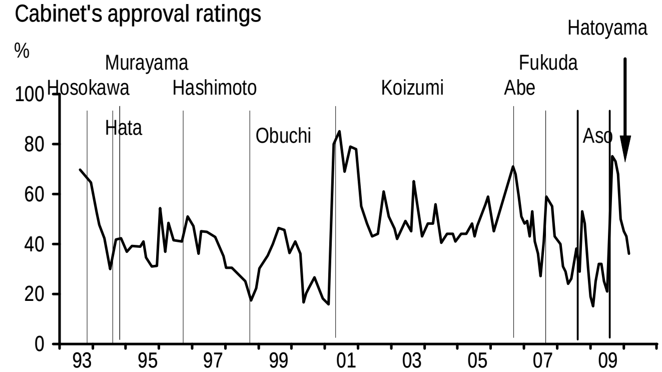
Consumer and small business sentiment



Senior loan officer survey: loan demand



Cabinet's approval ratings



Data releases and forecasts

Week of April 26 - 30

Mon
Apr 26
8:50am

Corporate service prices

%oya

	Dec	Jan	Feb	Mar
Overall	-1.6	-1.2	-1.3	-1.5
Ex international transport	-1.5	-1.7	-1.7	___

The CSPI should continue falling at a consistent pace amid still-weak wages and domestic demand.

Tue
Apr 27
2:00pm

Shoko Chukin small firm survey

Diffusion index

	Jan	Feb	Mar	Apr
Sentiment index	41.3	42.3	45.8	44.0
Manufacturers	41.3	44.2	47.9	___
Nonmanufacturers	41.3	40.7	44.1	___
Sales (%oya)	-3.5	1.4	0.3	___
Profit margins	-14.7	-16.3	-10.3	___
Financing conditions	-6.8	-8.5	-5.1	___
Inventory	-14.9	-15.7	-13.2	___
Capacity	-23.6	-24.0	-20.8	___
Employment	-14.2	-13.2	-10.5	___
Input prices	-2.7	1.9	3.5	___
Output prices	-14.3	-11.4	-9.8	___

In the March report, small manufacturers predicted a meaningful decline in their sentiment index in April, with the weakest sector being transportation machinery—mostly auto producers, where production is anticipated to have been weak in April in an effort to reduce inventory abroad. Meanwhile, small nonmanufacturers were less pessimistic about their business conditions at the start of the current quarter, while nonmanufacturing DIs in survey reports have uniformly begun to rise.

Consequently, we expect the headline index, the nonmanufacturing component of which is used as an input in our real GDP growth model along with actual industrial production, to fall but only to a level that is still consistent with our view that the recovery is spreading to SMEs from the large manufacturing sector, which is benefiting from the solid rebound in exports.

Wed
Apr 28
8:50am

Commercial sales

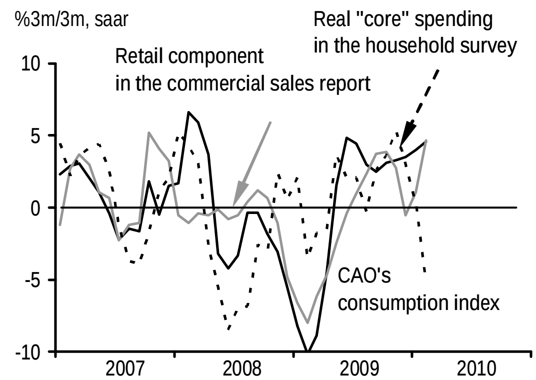
%oya, unless noted

	Dec	Jan	Feb	Mar
Commercial sales	-10.9	-3.8	-0.9	___
Wholesale sales	-14.6	-6.1	-2.7	___
Total retail sales	-0.2	2.3	4.2	3.2
%m/m sa	-0.3	2.0	0.9	-1.0

There has been a significant gap between the performance of the major two monthly consumption indicators (nominal retail sales in this report and "core" real household spending in the household survey, which excludes several volatile components and is the measure the government uses as an input to GDP consumption) in the first two months of 1Q.

The CAO's private consumption index, which combines demand- and supply-side statistics, has been tracking solid growth in 1Q, consistent with likely gradual improvement in aggregate labor income, as well as a recovery in consumer sentiment. We place more confidence in this measure.

Monthly consumption indicators



Fri
Apr 30
8:15am

Purchasing Managers Survey (manufacturing)

DI

	Jan	Feb	Mar	Apr
Overall index	52.5	52.5	52.4	52.5

The manufacturing PMI for March is expected to remain well above the neutral 50 level, indicating that manufacturing output continues to increase at a solid pace.

Fri
Apr 30
8:50am

Industrial production—preliminary

%m/m sa

	Dec	Jan	Feb	Mar
Production	2.6	4.3	-0.6	1.0
Shipments	2.4	4.5	-0.2	___
Inventories	-0.2	1.1	1.6	___
Inventory/shipment ratio	-4.8	-1.8	0.3	___

Manufacturers' output predictions for March, which were included in the February report, look for a solid recovery, and indeed, this week's March trade data revealed that real exports continued to rise firmly during the month. Thus, we expect that March production rebounded, more than offsetting the February drop.

Fri
Apr 30
8:30am

Consumer prices

%oya

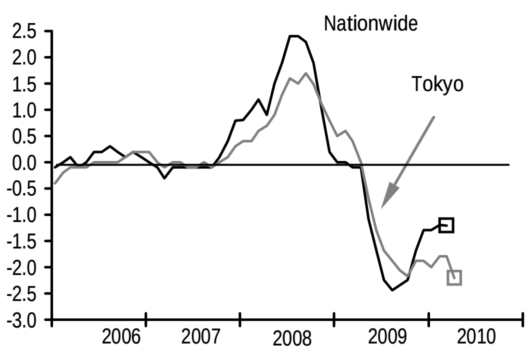
	Jan	Feb	Mar	Apr
Tokyo				
Overall	-2.1	-1.8	-1.8	-2.1
Core (ex fresh food)	-2.0	-1.8	-1.8	-2.2
Ex food and energy	-1.4	-1.3	-1.2	-1.1
Nationwide				
Overall	-1.3	-1.1	-1.2	
Core (ex fresh food)	-1.3	-1.2	-1.2	
Ex food and energy	-1.2	-1.1	-1.0	

As we think the output gap, which we estimate peaked in 1Q09, affects the core core CPI with a three- to four-quarter lag, movement of the core core measure is now increasingly important to gauge pricing conditions. In this regard, the February nationwide/March Tokyo preliminary reports provided early evidence that the underlying trend in CPI is already near the bottom.

That said, the elimination/reduction of high school tuition, which started this month, will have a measurable impact on overall consumer prices. On our estimate, it will subtract 0.5%-pt from the oya change in the nationwide core CPI and 0.4%-pt from that in the Tokyo measure (this release will provide information on the impact in Tokyo).

Core CPI

%oya, 2005-based, boxes denote J.P. Morgan forecasts



Fri
Apr 30
8:30am

Labor force survey

	Dec	Jan	Feb	Mar
Unemployment rate (% sa)	5.2	4.9	4.9	4.9
Labor force (%m/m sa)	0.0	0.7	-0.4	___
Total employment (%m/m sa)	0.1	0.9	-0.4	___
Unemployed (%m/m sa)	-1.4	-4.7	-2.1	___
Job offers ratio (sa)	0.43	0.46	0.47	0.48

The report will likely continue to show a gradual recovery in the labor market, which has also been reflected in survey indicators.

Fri
Apr 30
8:30am

Household survey of expenditures

%m/m sa, incl. agricultural worker households

	Dec	Jan	Feb	Mar
All households				
Real spending	0.2	-1.3	-1.6	2.0
%oya	2.1	1.7	-0.5	1.4
Core	-0.2	-1.9	-0.7	___
%oya	1.7	0.4	0.1	___
Worker households				
Real disposable income	-2.1	3.4	-0.1	___
Propensity to spend ratio (%)	75.6	73.5	72.2	___

See comment on the commercial sales report.

Fri
Apr 30

Employers' survey

%oya

	Dec	Jan	Feb	Mar
Total earnings per employee	-5.9	-0.2	-0.7	___
Contracted wages	-1.1	-0.5	-0.4	-0.2
Scheduled payments	-1.2	-0.8	-1.0	___
Overtime payments	-0.2	2.4	8.1	___
Special payments	-9.9	8.4	-26.1	___
Total hours worked/employee	-0.9	0.4	0.6	___
Regular employment	-0.2	-0.2	0.2	___
Full-time workers	-1.1	-0.8	-0.9	___
Part-time workers	2.3	1.4	3.0	___

Wages are expected to remain depressed for a while, amid still-soft labor-market conditions. Note, though, that the pace of decline in contracted wages has been slowing gradually since the start of this year, in line with gradual recovery in employment, and thus labor income (the product of average wages and the number employed) is likely improving.

Fri
Apr 30
2:00pm

Housing starts

%oya, unless noted

	Dec	Jan	Feb	Mar
Housing units %oya	-15.7	-8.1	-9.3	-5.0
%m/m sa	3.3	5.4	-7.9	4.8
Mn units saar	0.82	0.86	0.79	0.83

Despite concern over the sustainability of the recovery raised by the February decline, we expect housing construction to continue growing at a modest pace in 2Q, against the backdrop of improving household sentiment. There has also been news of progress in reducing inventories and a rise in the contract ratio in the metropolitan area condo market.

Fri
Apr 30
2:00pm

Construction orders

%oya

	Dec	Jan	Feb	Mar
Total	0.6	15.7	-20.3	___
Domestic, private sector	-4.8	9.5	-20.2	___
Domestic, public sector	-24.7	13.7	-12.8	___

Review of past week's data

Consumer sentiment (Apr 19)

Diffusion index, nsa

	Jan	Feb	Mar
Consumer sentiment	39.0	39.8	~~40.5~~ *40.9*
Standard of living	39.8	40.7	___ *41.2*
Income growth	37.9	38.8	___ *39.5*
Labor market conditions	33.1	34.2	___ *35.9*
Durable goods purchases[1]	45.3	45.4	___ *46.8*

1. The DI asks whether a respondent thinks that now is a good time to purchase durable goods.

The headline index for March rose to a level above the recent peak of 40.5 marked in September and October last year. The result, together with the similar improvement in the Household and the employment DIs in the Economy Watchers survey, suggests that consumers' confidence is recovering despite fading government support.

Looking at the details, the recent improvement was broad-based in terms of either questions (standard of living, income growth, labor market conditions, timing to buy durable goods) or surveyed regions, with all four component DIs extending their consecutive increases on a national basis, and all seven of the regional DIs rising m/m. Also, the special quarterly questionnaire revealed that cuts in consumer spending on services have moderated further.

Nationwide department store sales (Apr 19)

%oya, unless noted

	Jan	Feb	Mar
Overall	-7.0	-7.1	~~-5.0~~ *-5.1*
%m/m sa, by J.P. Morgan	-1.9	0.2	~~-0.9~~ *-1.0*
Same-store	-5.7	-5.4	___ *-3.5*

Department store sales held until March, after having strengthened at year-end 2009 and early 2010. The strength in the previous three months was partly because of a temporary boost from seasonal sales and robust demand of tourists from Asian countries during the Lunar New Year holidays. By our seasonal adjustment, the measure rose 1.8%q/q saar in 1Q, after eight consecutive quarterly declines through 4Q. According to the Japan Department Store Association, sales of luxury goods have picked up amid recovering corporate profits and stock prices, though consumers' shift to lower-priced goods appears to be continuing.

Note, however, that sales at department stores do not completely capture the overall picture of consumption. The incoming data (the retail component in the commercial sales report and the household survey, each of which will be up next week, and the CAO's private consumption index, due around May 10) will provide additional information on consumption at the end of last quarter.

Index of tertiary sector activity (Apr 20)

% change

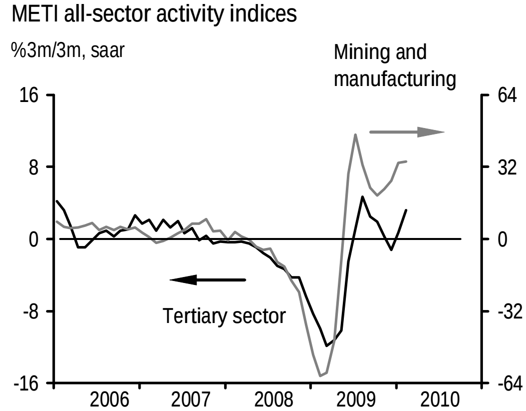
	Dec	Jan	Feb
%m/m sa	~~-0.9~~ *-0.7*	~~2.9~~ *2.5*	~~-1.2~~ *-0.2*
%oya	-2.7	~~-0.8~~ *-0.5*	~~0.6~~ *0.4*

The tertiary sector activity index for February showed only a marginal payback for the outsize jump in January. Its 1Q trajectory so far is +9.1%q/q saar, compared to -1.2% in 4Q and +2.5% in 3Q. Together with the recent upward momentum in nonmanufacturing DIs in survey reports, this confirms that the large-manufacturing-led recovery is now spreading to the nonmanufacturing sector.

In February, the activity indices for several sectors, such as wholesale trade, securities businesses, information services, and automobile maintenance services, gave back some of their previous gains, but the declines were relatively small. Meanwhile, the activity index for retail trade continued to rise, tracing the movement of the retail component in the commercial sales report. Transport and utilities also extended their rises, amid the continued recovery in the manufacturing activity.

In addition to the improving trend in retail trade, personal services on our measure (aggregate of restaurants and hotels, medical and healthcare, tutorial schools for students and instruction services for enjoyment or self-advancement, and personal and amusement services) have been holding up well (falling only 0.1%m/m sa after +0.3% in January and +0.4% in December, pushing the %3m/3m sequential rate back to positive territory at +0.8%). It appears that consumers have become more willing to spend, beyond household durables (indeed, the ESRI's consumer sentiment index returned to an increase despite fading government support).

METI all-sector activity indices



BoJ bank loan officer survey (Apr 21)

DI, % balance

	3Q09	4Q09	1Q10
Demand for loans			
Corporate loans	-14	-17	___ *-10*
Large firms	-10	-13	___ *-15*
Small firms	-10	-12	___ *-5*
Household loans	-15	-11	___ *0*
Mortgages	-15	-11	___ *-2*
Consumer loans	-9	-8	___ *-2*
Banks' lending attitude			
To large firms	6	5	___ *5*
To small firms	20	21	___ *21*
To households	10	11	___ *18*

The loan demand DIs indicate that corporate loan demand continued to decline, although at a more moderate pace, while demand from households remained stable at a low level during last quarter. Meanwhile, banks' lending attitude DIs were stable for the corporate sector, both large and small firms, and but were more aggressive for households.

Actual bank lending fell 1.8%oya in 1Q, compared to +0.1% in 4Q and +1.9% in 3Q. Given that lending attitudes toward businesses were unchanged in 1Q, it would appear that the decline in bank loans reflects lower demand. Indeed, the BoJ has been pointing to weak corporate demand for both operating and investment funds, even as liquidity in the corporate sector has been building, reflecting the combination of improving profits and a still-cautious investment stance.

The report includes additional information that sustained weakness in demand prevented banks from being aggressive on loan margins, particularly to low-rated companies.

Customs-cleared international trade (Apr 22)

¥ bn sa, unless noted

	Jan	Feb	Mar
Balance	~~651~~ *601*	~~470~~ *472*	~~610~~ *666*
Exports (%m/m)	~~9.1~~ *8.6*	~~-1.7~~ *-1.8*	~~-1.6~~ *0.0*
Imports (%m/m)	~~7.8~~ *9.4*	~~1.6~~ *0.5*	~~-4.5~~ *-3.7*
Balance (nsa)	61	650	~~558~~ *949*
BoJ real export index (%m/m)	0.3	1.1	___ *2.8*
BoJ real import index (%m/m)	~~1.6~~ *1.5*	~~1.7~~ *1.8*	___ *-3.8*

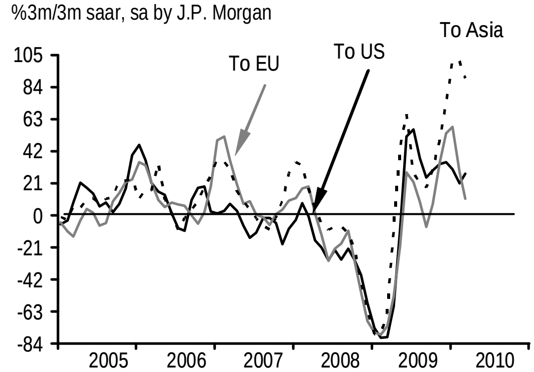
The BoJ real export index, our preferred measure for tracking real exports in GDP, extended its string of consecutive rises since last April. That said, its %3m/3m sequential trend rise slowed for the third straight month.

Looking at the details in the customs trade data, which are in nominal terms, the 3m/3m sequential trend in shipments to Asian countries has decelerated from an extremely rapid pace and that for exports to EU softened further. Meanwhile, nominal exports to the US have been rising at a steady pace. By goods, shipments of autos, where the negative impact from Toyota recalls has been evident, maintained solid growth, even to the US, though the trend in nominal exports of industrial machinery has been recently moderated.

The yen value of exports remained essentially unchanged between February and March after February saw the first drop since February 2009. Nominal imports fell m/m, after four consecutive rises through February. The seasonally adjusted surplus rose to the largest level since January 2008.

Value of exports by destination

%3m/3m saar, sa by J.P. Morgan



Index of all-sector activity (Apr 23)

%m/m sa

	Dec	Jan	Feb
All sector	~~-0.2~~ *-0.3*	~~3.8~~ *3.4*	~~-1.5~~ *-2.3*
Tertiary sector	-0.7	2.5	-0.2
Industrial production	2.6	4.3	-0.6
Construction	~~0.1~~ *-0.4*	~~17.3~~ *0.7*	___ *4.5*
Public sector	~~0.4~~ *0.2*	~~0.2~~ *0.1*	___ *-1.2*

After annual revisions, which pulled the January rise in the construction sector activity index down to a much more reasonable rate, the pace of rise in the all-sector activity index was still the largest in its history since 2003. In February, while industrial output fell for the first time since February 2009, the tertiary sector activity index showed only a marginal payback for the strength in January, and the construction activity rose at a faster pace (though the latter may be distorted by a change in the methodology in the construction spending report, which supplies source data for the index). The all-sector activity index was tracking a solid growth path in last quarter.

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Canada

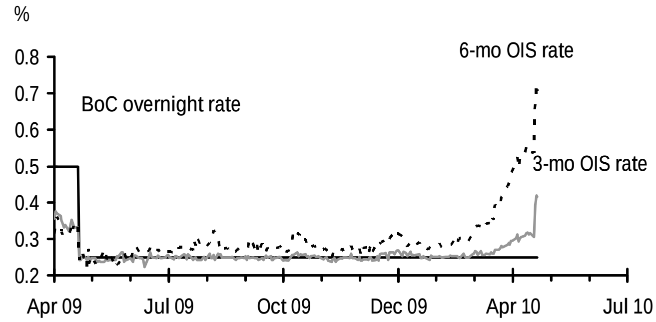
- **BoC drops rate commitment; we now look for first rate hike in June**
- **BoC sees faster return to full capacity with inflation around target**
- **Data point to a slightly softer pace of activity in February; March core CPI back below target**

As was almost universally expected, the Bank of Canada left its key overnight interest rate unchanged at 0.25% at this week's rate announcement. However, the Bank took the market by surprise by omitting its conditional commitment entirely. (There were widespread expectations that it would alter the wording of the commitment in preparation for its expiration at the end of June.) Instead, the Bank commented that the rate commitment had served its purpose successfully and noted that "with recent improvements in the economic outlook, the need for such extraordinary policy is now passing, and it is appropriate to begin to lessen the degree of monetary stimulus." This clearly raised the odds of a rate hike as early as the next announcement on June 1. Indeed, we have pulled forward our expectation from July and now look for a 25bp increase at the next announcement (June 1) followed by 25bp increases at the remaining four announcements this year. And the OIS market has fully priced in a 25bp increase in June. The Bank did give itself a little wiggle room concerning a rate hike in June by professing it to be data dependent. It qualified its statement about the propriety of removing monetary accommodation, noting that "the extent and timing [of a policy action] will depend on the outlook for economic activity and inflation, and will be consistent with achieving the 2 percent inflation target."

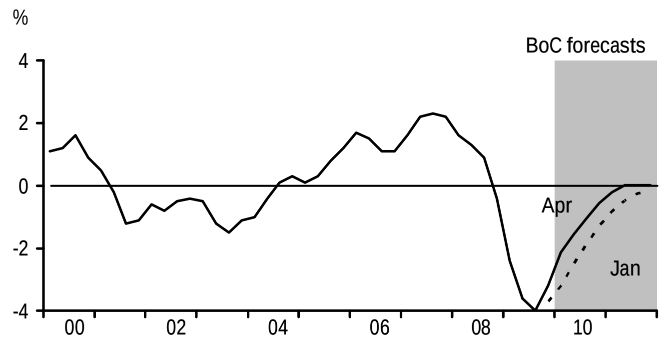
In the rate announcement (and in more detail in its quarterly Monetary Policy Report, issued two days after the announcement), the Bank raised both its GDP and inflation trajectories for the near term, reflecting in part the stronger-than-expected performance of the economy in 4Q09 and into 2010. It increased its outlook for GDP growth in 2010 to 3.7% from 2.9% in January. However, it lowered its outlook for 2011 to 3.1% from 3.5% in January, and offered its first look at 2012, when it expects GDP to rise only 1.9%—its estimate of potential GDP growth. The Bank now expects the economy to return to full capacity in 2Q11, one quarter sooner than it had expected in January.

The Bank's expected trajectory for total CPI experienced marginal changes with total CPI inflation now expected to spend a short time period this year above the 2% target before moving down to target in 2Q11. The expected trajectory for core CPI inflation was altered more significantly. In the near term, core inflation is expected to recede a bit as the temporary factors behind its recent acceleration fade. It then is expected to return to the target by late 2011.

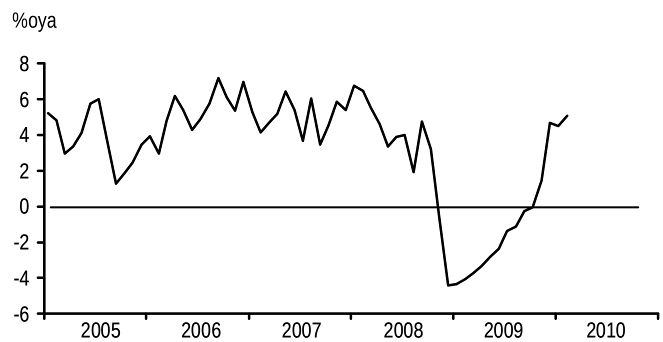
BoC overnight rate and OIS rates



Output gap



Real retail sales



While the MPR offered little news after the sea-change in views expressed in Tuesday's rate announcement, it may have offered the first hints of how the normalization of monetary policy may progress after the emergency setting has been removed. While the pace and extent of rate hikes will depend on the incoming data and the currency response, that the Bank now expects the economy to return to full capacity by mid-2011 may indicate that it would like to return its overnight rate by then to a level that is near neutral. This would imply an increase in the overnight rate to at least 3% by mid-2011. Though this is not our current

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forecast (we look for 2.50% by mid-2011), the risk would now appear to be to the upside.

Data released this week pointed to solid, but slightly slower growth in February. Wholesale and retail sales, when combined with last week's manufacturing shipments report, point to a 0.2%m/m increase in February GDP (to be released on April 30) versus a 0.6%m/m jump in January and 0.5% monthly increases in both November and December. Still, our expected February rise puts GDP on course for a quarterly increase of around 5% ar in 1Q. (Our current 1Q forecast is 4.5%. We will reassess our 1Q forecast after the release of February GDP.) Wholesale sales defied market expectations with a sharp 1.2%m/m drop in February, but this followed three consecutive outsize monthly increases. In volume terms, sales were down 1.8% but again after large increases in the preceding three months. A drop in sales of motor vehicles and parts was the major factor behind the decline. Compared with a year ago, sales were still up 8.5%. Retail sales in February rose 0.5%, but this was a smaller rise than consensus had been expecting. Still, the general rebound in retail activity remains intact. Real retail sales are up more than 5%oya and have now more than recouped their losses from the recession.

The Canadian total CPI was unchanged not seasonally adjusted in March and edged down 0.1%m/m when seasonally adjusted. The over-year-ago inflation rate slipped to 1.4% from 1.6%oya in February. The core index fell 0.2%m/m not seasonally adjusted and declined 0.3%m/m when seasonally adjusted. The over-year-ago core rate slipped to 1.7% (back below target) from 2.1% in February. A reversal of the Olympics-related jump in accommodation prices accounted for most of the decline in both CPIs in March.

The inflation report clearly defuses the concern generated by the surge of the core rate above target in February. But we doubt that it will have much impact on the Bank of Canada's near-term course for policy. The Bank is preparing to normalize policy not because it feels it needs to rein in inflation, but rather because the recovery is firmly in place and hence the economy no longer needs policy at an emergency setting. So, we stand by our recently updated view that the Bank will initiate its normalization process with a 25bp rate hike on June 1.

Data releases and forecasts

Fri
Apr 30
8:30am

Monthly GDP
sa

	Nov	Dec	Jan	Feb
Total,%m/m	0.5	0.5	0.6	0.2
%oya	-1.5	0.0	1.3	1.7

Monthly output-based GDP is expected to increase 0.2%m/m in February. GDP was held down by weak manufacturing sales (0.3%) and a decline in wholesale sales (-1.8%). Real retail sales were up 0.6%.

Fri
Apr 30
8:30am

Industrial PPI
%m/m nsa, unless noted

	Dec	Jan	Feb	Mar
Total	0.1	0.4	0.0	-0.5
%oya	-0.6	-0.2	-0.6	-1.4
Ex energy	0.4	-0.1	0.2	-0.7
%oya	-2.7	-2.7	-2.9	-3.9

Review of past week's data

Wholesale sales (Apr 21)
sa

	Dec		Jan		Feb	
Total,%m/m	~~0.9~~	*1.3*	~~3.0~~	*2.4*	~~0.5~~	*-1.2*
%oya	~~0.3~~	*1.4*	~~7.9~~	*9.5*	~~10.4~~	*8.5*

Leading indicators (Apr 22)
%m/m

	Jan		Feb		Mar	
Smoothed	0.7		~~0.8~~	*0.9*		*1.0*
Unsmoothed	~~0.0~~	*-0.2*	~~1.2~~	*1.5*		*0.5*

Consumer price index (Apr 23)
%m/m nsa, unless noted

	Jan	Feb	Mar	
Total CPI	0.3	0.4	~~0.3~~	*0.0*
%oya	1.9	1.6	~~1.7~~	*1.4*
CPI core	0.1	0.7	~~0.0~~	*-0.2*
%oya	2.0	2.1	~~1.9~~	*1.7*
Ex food & energy	-0.1	0.7	~~0.3~~	*-0.3*
%oya	1.2	1.4	~~1.5~~	*0.9*
Ex food, energy, tax (%oya)	1.3	1.4		*0.9*

Retail sales (Apr 23)
%m/m sa, unless noted

	Dec		Jan		Feb	
Total	~~0.5~~	*0.2*	~~0.7~~	*0.9*	~~0.6~~	*0.5*
%oya	~~7.0~~	*6.4*	~~6.0~~	*6.6*	~~6.3~~	*6.4*
Ex autos	~~0.7~~	*0.4*	~~1.8~~	*2.0*	~~0.1~~	*-0.1*
%oya	~~5.1~~	*4.3*	~~5.5~~	*6.2*	~~5.0~~	*4.8*
Ex autos & gas	~~0.4~~	*0.2*	~~1.8~~	*2.0*	~~0.4~~	*-0.2*
%oya	~~3.0~~	*2.5*	~~3.5~~	*4.5*	~~3.6~~	*3.2*
Real retail sales	~~0.8~~	*0.5*	~~0.1~~	*0.2*	~~0.5~~	*0.6*
%oya	~~5.2~~	*5.3*	~~3.4~~	*4.9*	~~4.3~~	*5.5*

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Mexico

- **Early April inflation much lower than expected**
- **Focus this week will be on the Central Bank's Quarterly Inflation Report . . .**
- **. . . and the Foreign Exchange Committee's monthly auction of USD put options**

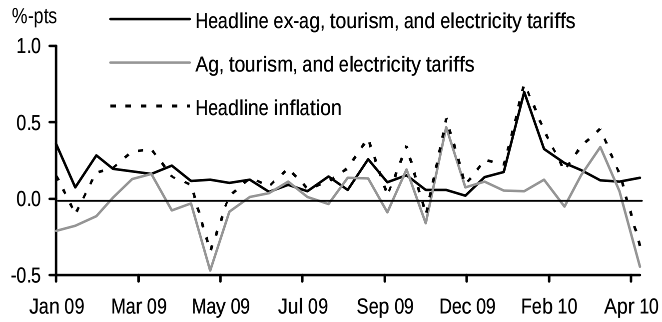
Consumer prices fell 0.31% during the first half of April, from the last two weeks of March. Core inflation also printed a biweekly decline of 0.03%. In this context, 12-month headline and core inflation came in at 4.41% and 4.13%, respectively, during the first half of April, down from 4.97% and 4.40% in March. As we had anticipated, this low biweekly headline inflation reading was mainly explained by the implementation in April of the summer electricity tariff reduction, which accounted for -27bp. However, we underestimated the additional -18bp that agricultural prices and tourism services and airfares subtracted. Prices of fresh fruits and vegetables have fallen from the highs observed during 1Q10 due to the unusually cold weather in Florida and the earthquake in Chile, and tourism-related prices fell from the elevated levels charged during the Easter holiday vacation period. In fact, stripping the early April figure of the effects of these seasonal factors, biweekly inflation should have been around 0.14%2w/2w (first chart).

On the other hand, we overestimated the rise in the prices of the other core components such as processed foods and overall services, mainly reflecting, in our view, the absence of second-round effects, despite the continuously rising inflation figures during the first quarter of the year. However, we still expect 12-month inflation to start rising again in 4Q10 as electricity tariff discounts fade and domestic demand picks up, gradually reducing the output gap (J.P. Morgan's headline inflation forecast for year-end 2010 is 5.4%). In this context, we continue to expect Banco de México to hike interest rates by 25bp in October; the consensus among analysts also forecasts the first hike to take place in October (the interest-rate swap market expects the first hike in September).

Quarterly Inflation Report

When the Quarterly Inflation Report is released next Wednesday (April 28), we believe the markets will focus on: (1) the central bank's assessment of inflation and its inflation projections; (2) whether there is any mention of possible benefits of the current peso strength for inflation; (3) the possibility of an upward revision to Banxico's growth forecast; and (4) the potential announcement of the

Biweekly inflation



Banxico's current inflation projection intervals[1]

%oya	
1Q10	4.25 - 4.75
2Q10	4.50 - 5.00
3Q10	4.75 - 5.25
4Q10	4.75 - 5.25
1Q11	4.50 - 5.00
2Q11	3.50 - 4.00
3Q11	3.25 - 3.75
4Q11	2.75 - 3.25

Source: Banco de México

1. 12-month inflation quarterly average.

upcoming publication of meeting minutes. We think the board will leave Banxico's projected inflation ranges unchanged (table) for the time being, especially taking into account the very low inflation figure posted for the first half of April. However we still believe it is highly likely that inflation will break above the upper end of the range in 4Q10—mainly due to the strong base effects posted by the large decline in CPI observed in 4Q09. The central bank's board will probably revise its GDP forecast for 2010 from 3.2%-4.2% to 4.0%-5.0%. In terms of the impact of the exchange rate on inflation, we believe that historically, the effect has not been symmetrical. In other words, whenever we have observed an abrupt depreciation of the peso vis-à-vis the US dollar, we have observed a significant positive impact on inflation, while the restraint of a stronger peso on consumer prices has been rather mild. However, we do believe that the board might emphasize that a stronger peso will be one of the factors that, in addition to the large output gap, will keep inflation within the monetary authority's projection range. Last but not least, according to several remarks by Governor Carstens, we could see some modifications to the communication structure regarding the publication of minutes. We think Banxico may lean toward either Banco Central de Chile's style of a detailed statement followed by the publication of minutes, or the Bank of England's modest statement but complete set of minutes.

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High likelihood of increasing the amount of the USD put/MXN call monthly auction

Next Friday (April 30), Banco de México will hold its third monthly auction of USD put/MXN call options to domestic financial institutions. The owners of the options will have the right to sell US dollars to the central bank (in exchange for pesos) at the previous day's "fixing" rate (i.e., strike price), whenever the fixing rate is at or below the 20-day moving average. As a result, option owners will only sell US dollars to the central bank whenever there is an apparent "excess supply" of dollars. In the last two auctions, the FEC has sold US$600 million worth of options. Nevertheless, we believe that this time the FEC will either increase the amount to a range between US$1 and 1.3 billion or announce an additional US$600 million intra-month auction if 80% or more of the amount auctioned is exercised before the middle of the month. This could come as a result of an adjustment in the FEC's balance of payments projections. The new estimates might take into account the large amounts of portfolio capital that have flowed into Mexico's financial markets in the past few weeks, as well as the ones we could see if Mexico's local bonds are included in Citigroup's World Government Bond Index (WGBI), as Citi has already announced.

Data releases and forecasts

Week of April 26 - 30

Tue Apr 27 9:00am

Central bank foreign reserves
US$ bn

	Mar 31	Apr 9	Apr 16	Apr 23
Gross international reserves	95.7	96.2	97.4	___

Tue Apr 27 9:00am

Indicator of overall economic activity (IGAE)

	Nov	Dec	Jan	Feb
%oya	-1.7	0.5	2.4	3.9
%m/m sa	1.6	0.1	-0.8	0.8

Wed Apr 28 9:00am

Family remittances

	Dec	Jan	Feb	Mar
Total (US$ bn)	1.6	1.3	1.6	1.7
%oya	-12.1	-15.8	-14.1	-19.2

Fri Apr 30 3:30pm

Public sector indicators
Mex$ bn

	Dec	Jan	Feb	Mar
Overall balance	-56.4	6.4	16.5	___
Ytd	-274.5	6.4	22.9	___
Primary balance	17.0	25.4	24.2	___

Fri Apr 30 9:00am

Commercial bank credit supply
%oya, real terms

	Dec	Jan	Feb	Mar
Credit to private sector	-3.4	-6.0	-6.3	___
Consumption	-19.9	-20.3	-18.5	___
Housing	11.8	10.7	10.3	___
Corporate	0.7	-4.2	-5.7	___

Review of past week's data

Banamex CPI inflation expectations survey (Apr 19)
%oya, except policy rate: %p.a., median value

	Mar 22	Apr 6	Apr 20	
End-2010	5.22	5.25	___	*5.22*
Core	4.62	4.60	___	*4.50*
End-2011	3.84	3.81	___	*3.83*
One year forward	3.98	3.89	___	*3.86*
Banxico policy rate (YE10)	5.00	5.00	___	*5.00*

Central bank foreign reserves (Apr 20)
US$ bn

	Mar 31	Apr 9	Apr 16	
Gross international reserves	95.7	96.2	___	*97.4*

Retail sales (Apr 22)

	Dec	Jan	Feb	
Retail sales				
%oya	1.6	-1.8	~~-0.3~~	*2.3*
%m/m sa	0.3	-0.7	~~0.0~~	*1.4*

Consumer prices (Apr 22)

	Mar 1H	Mar 2H	Apr 1H	
%2w/2w	0.46	0.16	~~0.00~~	*-0.31*
Core	0.18	0.19	~~0.27~~	*-0.03*
%oya	5.06	4.88	~~4.73~~	*4.40*
Core	4.45	4.35	~~4.44~~	*4.13*

Trade balance (Apr 23)

	Jan	Feb	Mar	
Balance (US$ mn)	-333	244	~~700~~	*237*
Exports (US$ bn)	19.3	21.1	~~23.4~~	*25.9*
%oya	26.7	31.2	~~25.5~~	*39.0*
%m/m sa	1.4	2.5	~~-3.8~~	*3.3*
Imports (US$ bn)	19.6	20.9	~~22.7~~	*25.7*
%oya	16.9	25.7	~~22.5~~	*38.6*
%m/m sa	2.8	2.2	~~-3.5~~	*5.5*

Labor market report (Apr 23)
% of labor force

	Jan	Feb	Mar	
Open unemployment rate	5.9	5.4	~~4.9~~	4.8
Sa	5.5	5.2	__	4.8

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Brazil

- **COPOM ready to inaugurate a tightening cycle**
- **Underlying inflation running above target**
- **Current account deficit widening**

After last month's decision to remain on hold, with three members voting for a 50bp hike, the COPOM is widely expected to inaugurate a rate-tightening cycle next week. As we have been arguing, the economic fundamentals of high inflation and very little (if any) economic slack would suggest a firm policy action to tame inflation expectations, and the local yield curve is indeed pricing in higher odds of a 75bp increase than the 50bp initially signaled by the COPOM as its preferred pace. Although we recognize that it is a close call between 50bp and 75bp, we are keeping our call that the COPOM will start with a more moderate 50bp Selic rate increase, stepping up the pace to 75bp at the subsequent meeting in June. Besides an apparent preference for smoothing tightening cycles (present in the past two cycles), the recent communication from the monetary authority also suggests a less aggressive strategy. In fact, this week BCB Chairman Henrique Meirelles stated that the latest activity and inflation releases are not surprising to the BCB, suggesting the bank will maintain its original plan for tightening monetary policy.

Core goods and services simultaneously on the rise

The April IPCA-15 (a preview for the targeted IPCA) printed at 0.48%m/m, in line with market consensus of 0.47%, slightly below our 0.50%m/m forecast, and down from the 0.55% March reading. The moderation in monthly inflation was caused mainly by the end of the seasonal impact of school tuition costs and a decline in fuel prices. Despite the monthly deceleration, the over-year-ago measure accelerated to 5.2% from 5.1% in March, and the average of core measures monitored by the BCB remained above target at 4.9%oya. This week's April preview, along with the recent signals from other price surveys, points to an end-April IPCA likely accelerating from the 0.52% registered in March.

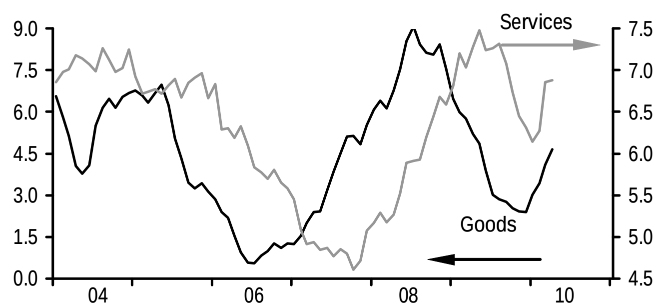
Almost all IPCA-15 groups accelerated in over-year-ago terms in April. In core goods (4.7%oya from 4.1%), nondurable goods (basically food prices) accelerated to 6.1%oya from 5.3%, while semidurables, composed mainly of apparel prices, were more stable at 5.3% versus 5.2%. In turn, durable goods, after experiencing deflation for more than a year, accelerated to 0.6%oya, although increasing less than

IPCA-15: headline and core inflation above the 4.5% target

%oya

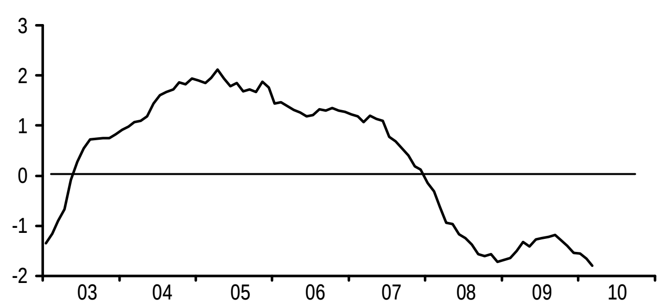
IPCA-15: both goods and services inflation on the rise

%oya, both scales



Current account deficit moving towards 3% of GDP

12-months trailing, % of GDP



Latest electoral polls released between March and April 2010

Candidate (party)	Sensus	Vox Populi	Ibope	Datafolha
José Serra (PSDB)	33	34	36	38
Dilma Rousseff (PT)	32	31	29	28
Ciro Gomes (PSB)	10	10	8	9
Marina Silva (PV)	8	5	8	10
Serra's lead over Dilma	0	3	7	10

suggested by the end of tax incentives for vehicles in March. On the services inflation side, the group remained flat at 6.9%, tamed by inertial services inflation (such as condominium and education costs), which slipped to 6.3% from 6.6%. However, the more cyclical part of services

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surpassed 7% in April, after bottoming at 6.3%oya last year. The combination of very tight labor markets (the unemployment rate is at a historical low) and a generous increase in the minimum wage in January (+9.7%) is fueling services inflation, especially through increases in personal services.

Current account deficit already at 1.8%

The March BoP report revealed a significant deterioration in the current account balance, printing a deficit of US$5.1 billion, which was below market consensus of -US$4.0 billion and February's -US$3.3 billion result. On a 12-month cumulative basis, the current account reached a deficit of US$31.6 billion (1.8% of GDP) in March, from -US$24.3 billion in 2009 (1.5% of GDP). The current account deteriorated US$7.2 billion in the first quarter (to -US$12.1 billion in 1Q10 from -US$4.9 billion in 1Q09), with the deficit in the services account responsible for 70% of this deterioration, and the reduction in the trade surplus explaining the remaining 30%. Even factoring in the recent boost in the terms of trade from rising iron ore prices, we still see the current account deficit deteriorating toward 3% of GDP this year, in response to booming domestic demand growth and a relatively strong currency.

Despite the deterioration in the current account, capital inflows remained supportive of BRL in 1Q10, with FDI and corporate debt rollover rates remaining strong, and portfolio and short-term capital inflows booming compared to the same period last year. In March, specifically, the net capital inflow printed at +US$8.5 billion, with the BCB continuing to mop up the resulting surplus in external accounts. In April, however, the bank continued to purchase USD in the spot market (US$2.3 billion), despite the net outflow of US$1.0 billion registered until April 22. The net outflows and the BCB purchases led to a shift in the banking system USD position to net-short US$2.9 billion by April 22 from net-long US$0.5 billion in March.

Dispersion in presidential election polls

The various popular polls on this year's presidential elections are showing a wide dispersion regarding the opposition candidate Jose Serra's lead over the government-supported candidate Dilma Roussef. Besides methodological differences, it seems that the reduced conviction of the electorate six months ahead of the election explains this dispersion across polls, clouding the electoral outcome at this point. Indeed, Serra's 10%-pt lead over Dilma in the Datafolha poll contrasts with 7%-pts in Ibope, 3%-pts in Vox Populi, and 0.3%-pt in the Sensus poll.

Data releases and forecasts

Week of April 26 - 30

Thu
Apr 29
6:00am

General prices (IGP-M)
%m/m nsa

	Jan	Feb	Mar	Apr
Overall	0.6	1.2	0.9	0.7
%oya	-0.7	0.2	1.9	2.8
Wholesale prices	0.5	1.4	1.0	0.5
Consumer prices	1.0	0.9	0.8	0.8
Construction prices	0.5	0.4	0.5	1.0

Thu
Apr 29
7:00am

National unemployment
% of labor force, new methodology

	Jan	Feb	Mar
Open rate, nsa (30 days)	7.2	7.4	7.6

Fri
Apr 30
8:30am

Public sector borrowing requirement
Minus denotes surplus

	Dec	Jan	Feb	Mar
R$ bn				
Primary	0.3	16.1	0.9	2.7
Primary, ytd	64.5	16.1	17.0	19.8
12-month sum, as % of GDP				
Primary	-2.0	-2.3	-2.2	-2.0
Interest payments	5.4	5.3	5.4	5.3
Nominal	3.3	3.0	3.2	3.3
Net debt, % of GDP	42.9	41.7	42.1	42.6

Review of past week's data

Consumer prices (IPCA-15)
%m/m nsa, % weights in parentheses

	Feb	Mar	Apr
Total	0.9	0.6	*0.5*
Ex volatile	0.8	0.4	*0.4*
Trimmed mean	0.4	0.4	*0.5*

Current account balance
US$ bn, net inflows

	Jan	Feb	Mar
Current account (CA)	-3.8	-3.2	~~-3.8~~ *-5.0*
Trade balance	-0.2	0.4	~~1.6~~ *0.7*
CA, 12-mo. sum, %GDP	-1.6	-1.7	~~-1.8~~ *-1.9*
Foreign direct investment	0.7	2.9	~~1.5~~ *2.0*

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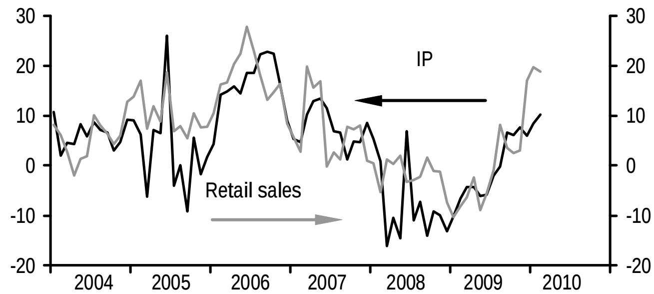
Andeans: Colombia, Ecuador, Peru, Venezuela

- **Colombian activity data for February were mixed, but still consistent with a gradual economic recovery**
- **Retail and industrial employment trends have bottomed and will soon show positive oya readings**
- **Venezuelan FX reserves have dipped on Fonden transfers but oil should support 2H recovery**

Colombia: IP and retail sales recovered in February

%3m/3m saar, both scales



Colombian industrial production and retail sales for February (released Monday evening) sent mixed signals, but in general the data are consistent with the economic recovery we have been expecting. IP rose 3.0%oya, above the 2.0% expected by the consensus, and up from 1.5%oya in January. On a seasonally adjusted basis (by J.P. Morgan), IP remained roughly flat in February following the strong January reading (1.6%m/m sa), and therefore the 3m/3m saar accelerated to 10.1% from 8.4% in January. Retail sales rose 3.9%oya, down from a strong 8.8% in January, and well below market consensus (6.9%). However, the lower-than-expected over-year-ago figure still represented a 0.5%m/m sequential expansion, lifting the 3m/3m saar growth rate to 18.9%3m/3m saar.

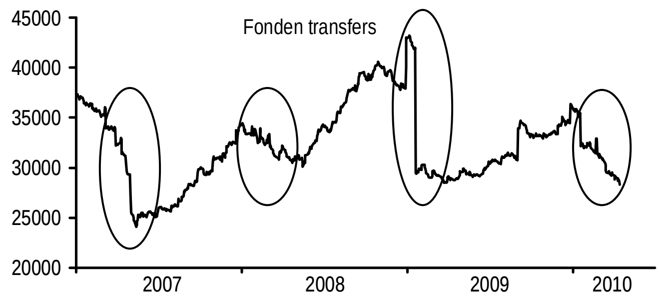
It should be noted that not only production and sales are recovering; total employment in these sectors is already bottoming and should show positive over-year-ago readings in coming months. In fact, employment in the retail sector decreased only 0.9%oya, from -1.7%oya in January, and the March number should disclose the first growth since November 2008 (first chart). In the industrial sector, total employment contracted 3.2%oya in February, a less pronounced retreat than the -4.8%oya registered in January, and we expect oya increases to appear in 2Q10. Considering that real wages have been relatively flat, the increase in employment will also represent an expansion of labor income in these sectors, and this, along with rising consumer confidence, should underpin the recovery in private consumption in 2H10. Therefore, despite the mixed February data (vis-à-vis expectations), the economic recovery remained on track in 1Q10, and is consistent with our above-consensus 3.0% forecast for full 2010 GDP.

Venezuela FX reserves fall on transfers

In Venezuela, central bank international reserves now stand at US$28.3 billion (including the government's US$0.8 billion FEM fund). Reserves have dropped from US$35 billion at end-2009 to the lows of the past year—driven mostly by US$5 billion of transfers to the Fonden development fund. Based on the BCV's end-2009 adequate reserves projection (US$28 billion), another US$2 billion may still be transferred to the Fonden in the coming months.

Venezuela: Central Bank FX reserves

US$ mn



The Fonden transfers and the drop in reserves match the typical seasonal pattern; reserves tend to trend up in the last three quarters of the year. Indeed, with oil prices well above $80/bbl, we expect reserves to recover. However, this assumption is made tenuously, since aside from higher prices, it is extremely difficult to ascertain important variables—namely the current state of Venezuela's stagnating oil production, and the degree to which the electricity crisis is competing for Venezuela's petrodollars (for example, to finance the importation of thermal generation units). Amid these uncertainties, pressure on the parallel FX rate is likely to continue—especially as September legislative elections are likely to be preceded by an increase in both monetary liquidity (due to fiscal spending) and political noise/social tension. Against this backdrop, demand for USD seems quite likely to remain strong.

Argentina:

Data releases and forecasts

Week of April 26 - 30

Fri Apr 23 — Trade balance

	Dec	Jan	Feb	Mar
US$ bn	1.25	1.22	0.60	___

Fri Apr 23 — Industrial production

	Dec	Jan	Feb	Mar
%oya nsa	10.4	5.2	11.0	___

Fri Apr 30 — Construction activity

	Dec	Jan	Feb	Mar
%oya	2.6	2.2	5.2	___

Review of past week's data

Economic activity

	Dec	Jan	Feb
%oya nsa	4.8	4.9	___ *6.0*

Consumer confidence

	Feb	Mar	Apr
Index	43.54	41.38	___ *43.48*

Chile:

Data releases and forecasts

Week of April 26 - 30

Wed Apr 28 — Industrial production

	Dec	Jan	Feb	Mar
%oya nsa	-0.30	-1.10	0.50	___

Fri Apr 30 — Unemployment rate

	Dec	Jan	Feb	Mar
% of labor force	8.6	8.7	8.5	___

Review of past week's data

No data released.

Colombia:

Data releases and forecasts

Week of April 26 - 30

Fri Apr 30 — BanRep monetary policy meeting
%p.a.

	Jan	Feb	Mar	Apr
Repo rate	3.5	3.5	3.5	3.5

Review of past week's data

Industrial production

	Dec	Jan	Feb
%oya	1.78	1.47	~~5.30~~ *2.99*

Real retail sales

	Dec	Jan	Feb
%oya	2.86	8.70	~~7.5~~ *3.9*

Ecuador:

Data releases and forecasts

Week of April 26 - 30

No data releases expected.

Review of past week's data

No data released.

Peru:

Data releases and forecasts

Week of April 26 - 30

Sat May 1 — Inflation

	Jan	Feb	Mar	Apr
Consumer prices (%m/m)	0.30	0.32	0.28	0.11
%oya	0.44	0.84	0.76	0.85
Wholesale prices (%m/m)	0.82	0.07	0.26	___
%oya	-2.81	-1.22	-0.47	___

Review of past week's data

No data released.

Venezuela:

Data releases and forecasts

Week of April 26 - 30

No data releases expected.

Review of past week's data

No data released.

United Kingdom

- **GDP in 1Q was disappointing but not destructive to our view; signs about 2Q GDP still look good**
- **Inflation surprised to the upside in March, but meaningful disinflation still to come this year**

The first estimate of 1Q GDP this week undershot expectations by showing only modest growth of 0.2%q/q. We would characterize the release as disappointing, but not destructive to our view that growth will accelerate to around 0.7%q/q in 2Q. The downside surprise in the report came from sectors that are plausibly volatile, or weather affected. For example, distribution, hotel, and restaurant output fell sharply in January. Despite a rebound in February, this left output within these sectors looking soft for the quarter as a whole. The implied level of March output in these industries is also running significantly above the 1Q average. This points to a healthy return to growth for these sectors in the current quarter. Meanwhile, the key components of private sector output are starting to accelerate more powerfully. Business services and finance rose 0.6%q/q, with an implied level of March output that already appears to be 0.2% above the quarterly average.

As best as we can tell, the MPC's February forecast had implied an 0.4%q/q underlying pace of growth in 1Q. But the committee had already acknowledged that there appeared to be a weather impact in the data at the start of the quarter. The implied monthly profile of the official data vindicate this assertion. Moreover, the business surveys into 2Q are looking more encouraging. The April CBI manufacturing survey this week showed marked improvement. Its output expectations reading points to a strengthening in manufacturing activity. We therefore doubt the MPC will characterize the 1Q GDP report as a significant surprise. If growth were to fail to step up this quarter, this would be very damaging to our own medium-term view. But we feel reasonably confident that underlying growth momentum is improving. The level of the PMI in March was consistent with 2Q growth in line with our current 0.7%q/q forecast. Though the volatility in 1Q meant the official data undershot the PMI survey, this relationship looks to reassert itself this quarter.

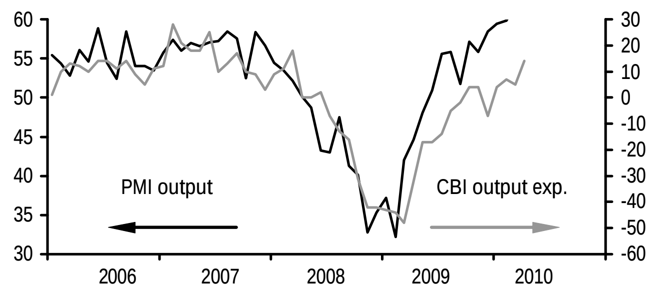
Mixed signals about job growth

Though the February/March labor market report looks puzzling at first glance, our take is that it is hinting at stronger job growth to come. On the one hand, the LFS household survey reported a 43,000 rise in unemployment in the three months to February. And on the other, the number of people claiming jobseekers' unemployment benefits, over exactly the same period, *fell* by 43,000. How can these two unemployment measures be consistent? There have been no meaningful changes in eligibility criteria. One may argue there is a lag between these two measures of unemployment, as it takes time to register for benefits after a job loss. But the claimant count measure of unemployment fell by another 33,000 in March alone. Another argument is that benefits have been withdrawn for some people claiming allowance who have not managed to find a job. However, unlike in some other countries, there is no time limit to such benefits in the UK—provided workers show they are still willing and looking for work.

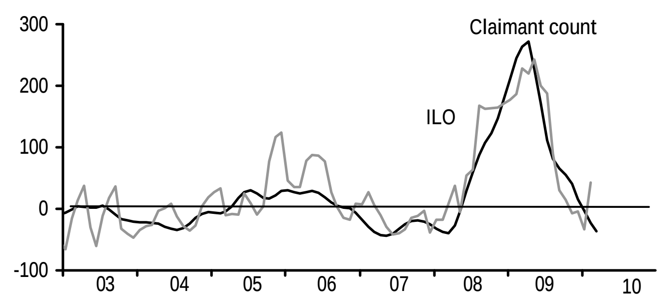
GDP output side breakdown
%q/q, sa

	Weight	Avg	09Q2	09Q3	09Q4	10Q1
GDP	100	0.6	-0.7	-0.3	0.4	0.2
Agriculture	0.7	0.0	-1.8	-1.7	-1.4	-1.1
Industrial production	17.2	0.1	-0.6	-1.0	0.5	0.7
Manufacturing	13.3	0.2	-0.1	-0.3	0.7	0.8
Utilities	1.5	0.8	-2.9	0.3	-2.7	2.6
Mining (incl. oil and gas)	2.5	-0.3	-1.1	-6.0	0.3	-0.7
Construction	6.3	0.4	0.0	1.9	-1.0	-0.7
Services	75.9	0.1	-0.6	-1.0	0.5	0.7
Distribution, hotels, restaurants	14.6	0.6	-0.3	1.1	1.9	-0.7
Transport, comms., storage	7.2	1.1	-1.8	0.8	0.6	0.7
Business services, finance	30.4	0.9	-1.0	-1.2	0.4	0.6
Government and other	23.6	0.4	0.0	-0.1	-0.1	0.0

Manufacturing: PMI versus CBI
% balance, sa, both scales



Change in unemployment
000s, change over three months in three month moving average



The answer may be a lot simpler. These two measures of unemployment are from different samples, and there is no reason why they must add up. In fact, divergences of the sort described above are not uncommon. It is also true that gaps between the two have not tended to grow much larger. This implies that one will soon converge toward the other. With the LFS measure by far the noisier of the two, our money is on the claimant count being the more reliable signal. In other words, we think that employment is starting to grow at a healthy pace. Our models suggest that the current pace of decline in the claimant count would usually be associated with 2%-3% annualized job growth. But this assumes no unusual moves in activity. As the LFS reports a significant decline in labor force participation, the kind of drops currently being reported in the claimant count are likely consistent with a smaller pace of job growth than our model suggests.

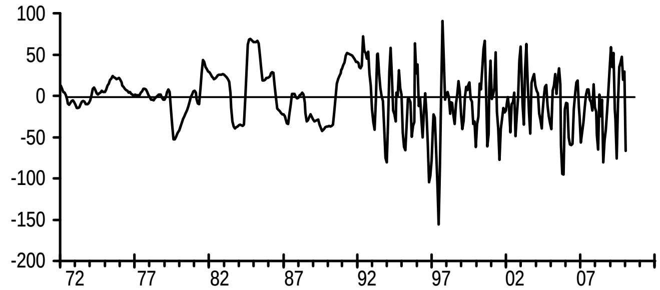
Inflation refuses to go down without a fight

During most of last year, a recurring theme was slower disinflation due to persistent upside surprises in core goods prices. Since then, the currency has stabilized, and gains in core goods prices had appeared to be running out of steam. This week brought a broad-based upside surprise in March inflation, and in particular, a significant sequential gain in core goods prices. We continue to look for a significant slowing in both headline and core inflation this year—as our analysis on both service and goods prices suggests. But the March surprise is a reminder that the speed and magnitude of disinflation ahead remains a key uncertainty. We would not want to place too much weight on this release alone, given that core inflation had started to turn softer in recent months. But another genuine upside surprise in April would start to challenge the forecast. Our forecast currently shows the CPI hitting a trough of 1.5% in 2Q11, even assuming another VAT hike in early 2011.

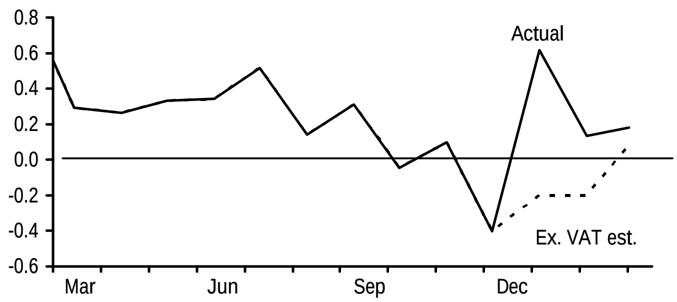
Thoughts on the MPC's inflation headache

This upside surprise in inflation will raise some uncomfortable questions for the MPC. We are not subscribers to the view that the MPC has become less committed to meeting its inflation target—reflecting political pressures or otherwise. But it is difficult to deny the charge that, as upside inflation surprises have continued, the MPC appears to have become less sensitive to them. As inflation surged back in mid-2008, the MPC flirted with following the ECB's rate hike—at a time when GDP is now shown to have been falling. Now wind forward the clock to this February's inflation report. The MPC maintained a view that inflation was not just set to fall from 3%, but was set to move significantly

Difference between claimant count and ILO unemployment changes
000s, average of past three months minus prior non-overlapping three months



Core goods CPI
%m/m, sa



below target in 2011. As inflation has risen this time around, Mervyn King has stated that inflation will fall back to target as it has done in the past. We agree, but that overlooks the fact that through these "shocks," inflation has now averaged more than 0.6%-pt above the target since 2006.

Through these swings in the MPC's rhetoric, its view on the path of inflation is increasingly colored by the MPC's perception of risks to activity, rather than current inflation outturns. Given the dramatic decline in output seen during the recession, that is understandable to some degree. But the MPC's assessment of the inflation outlook has tended to focus too narrowly on only two variables: inflation expectations and slack. If the former are stable, the latter sets the inflation trend. That may be a reasonable as a medium-term view. But in the short term there are many other forces that are hard to predict and may prove persistent even if measures of inflation expectations are stable now.

Last summer we thought the MPC would be pushed into hiking this year, as inflation accelerated and growth recovered. Even though our inflation view was correct, our MPC view was proved wrong. The MPC has been more tolerant of the inflation surprise than we had thought likely, and

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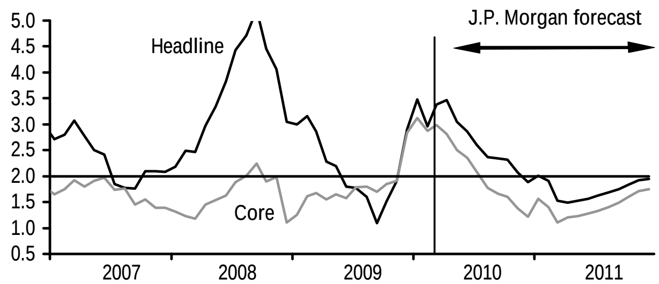
there has been little pressure from markets to respond. We retain the view that the MPC will begin tightening policy later this year. Its rhetoric on inflation could shift quickly if its perception of risks to growth were to change. On several previous occasions, Mervyn King has appeared to chastise fiscal policymakers for failing to detail the fiscal path ahead. In the fiscal policy space, the UK is leaning heavily on the credibility established by a history of its ability to make significant adjustments. But following the last Inflation Report, it became clear that the MPC is doing just the same. We would expect the May inflation report to be rather more vocal than February's in making that promise of lower inflation explicit.

CPI inflation

%oya



Data releases and forecasts

Week of April 26 - 30

Tue
Apr 27
9:30am

BBA lending

	Dec	Jan	Feb	Mar
Secured lending (ch £bn, sa)	3.2	2.6	2.8	2.6
Loan approvals (000s sa)1	45.7	35.2	35.3	38.0

1. For house purchase.

The BoE's survey of the major lenders pointed to a 4,000 pickup in mortgage approvals in March. We have assumed a slightly smaller gain of 3,000 in the BBA, taking approvals to 38,000. This would leave approvals still running low, and below the 4Q average.

Tue
Apr 27
11:00am

CBI survey of distributive trades
% balance

	Jan	Feb	Mar	Apr
Volume of retailer sales	-8	23	13	14

In last month's survey, respondents indicated that they expected slightly firmer growth in sales in April. We therefore look for a small improvement in the balance on sales volumes from 13 to 14. This would be consistent with a stable underlying trend in sales.

However, there does appear to be some risk of a decline in the April CBI survey, for slightly technical reasons. Although all of Easter was in April this year—the same as last year—half of the holiday actually occurred in the last week of March. This may mean that some of the sales retailers report for the first week of April will be lower than last year, which may bias down the survey.

Thu
Apr 29
8:00am

Nationwide house price index
Sa

	Jan	Feb	Mar	Apr
%m/m	1.4	-0.8	0.7	0.4
%oya	8.7	9.3	9.1	9.6
%3m/3m saar	8.6	7.2	6.7	4.0

The house price data have been more volatile of late. We would focus attention on the 3m/3m saar reading. Another sequential gain in the Nationwide in April of 0.4% would take the 3m/3m saar down from 6.8% to 4.0% and indicate that the underlying trend is toward softer price gains.

Fri
Apr 30
12:01am

Gfk consumer confidence
Sa

	Jan	Feb	Mar	Apr
% balance	-17	-14	-15	-14

Consumer confidence has been broadly stable in recent months. We look for a small nudge up in April, after last month's decline.

Review of past week's data

Rightmove house price index

	Feb	Mar	Apr
%m/m nsa	3.2	0.1	__ 2.6

Retail prices
%oya

	Jan	Feb	Mar
CPI	3.5	3.0	~~3.1~~ 3.4
Core CPI1	3.1	2.9	~~2.7~~ 3.0
RPI (1987=100)	217.9	219.2	~~220.2~~ 220.7
RPI	3.7	3.7	~~4.2~~ 4.4
RPIX	4.6	4.2	~~4.5~~ 4.8

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

The upside surprise in CPI in March was broad-based. The details showed that a large part of the rise in service inflation came from a sharp acceleration in airfares. But even excluding this, the other parts of services showed a larger gain than expected. With regard to core inflation, the oya dropped less than expected. This equated to a seasonally adjusted sequential monthly gain of 0.2%, after a run of softer prints in recent months. There was also a small upside surprise on food prices. The magnitude of the surprise in RPI and RPIX mostly reflected the same factors that drove the upside surprise in the CPI.

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BoE's minutes of Apr MPC meeting

The MPC's April minutes demonstrate that while they continue the wait-and-see mode—with a unanimous vote for unchanged policy and QE—differences between members are widening.

Labor market statistics

	Jan	Feb	Mar
Claimant count (000s ch m/m sa)	~~5.3~~ *16.2*	~~-32.3~~ *-40.1*	~~-15.0~~ *-32.9*
Claimant count rate (% sa)	~~5.0~~ *5.1*	~~4.9~~ *5.1*	~~4.9~~ *5.0*
	Dec	**Jan**	**Feb**
Average weekly earnings (3mma % oya sa)			
Headline	~~0.7~~ *0.6*	~~0.9~~ *0.8*	~~2.4~~ *2.3*
ex bonuses	1.2	~~1.4~~ *1.5*	~~1.6~~ *1.7*
Private sector ex bonuses	0.2	0.5	~~0.6~~ *0.9*
Three months to:	**Aug**	**Nov**	**Feb**
Labor force survey (all % rates)			
Activity rate	63.4	63.3	~~63.2~~ *63.1*
Employment rate	58.5	58.3	~~58.2~~ *58.0*
Unemployment rate	7.9	7.8	~~7.8~~ *8.0*

See main text.

Provisional estimates of M4 money and credit

Seasonally adjusted

	Jan	Feb	Mar
M4 (%m/m)	~~0.2~~ *0.3*	0.2	__ *0.1*
M4 (%oya)	5.0	3.9	__ *3.5*
M4 lending (%m/m)[1]	~~0.0~~ *0.6*	~~-0.2~~ *-0.1*	__ *0.4*
M4 lending (%oya)[1]	~~4.3~~ *5.1*	~~2.9~~ *3.8*	__ *3.3*

1. Excludes the effect of securitization.

Public sector finances

£ bn nsa

	Jan	Feb	Mar
PSNCR	~~-12.8~~ *-12.1*	~~7.7~~ *8.0*	__ *25.8*
PSNB	~~0.0~~ *0.3*	~~12.4~~ *9.7*	~~22.0~~ *23.5*
Balance on current budget	~~5.2~~ *5.0*	~~-6.0~~ *-4.0*	~~-13.0~~ *-14.8*
Net debt to GDP (%)	~~59.9~~ *60.1*	~~60.3~~ *60.5*	__ *62.0*

As March is the last month of the fiscal year, this leaves FY09/10 borrowing at £152.8 billion. This number is not directly comparable with the Treasury's projections, which remove the effect of financial sector interventions. If this adjustment is made, then the ONS reports that PSNB (ex fin. interventions) is £163.4 billion. This is £3 billion lower than the Treasury's most recent £166.5 billion forecast, made at the 2010 Budget. It is quite a lot lower than the £178 billion projection made in last year's PBR. The Chancellor's most recent projections anticipate slightly smaller borrowing for the current fiscal year of £163 billion (11% of GDP). But if the recent improving trend in the public finances is anything to go by, the deficit for FY10/11 could well show a larger improvement than currently projected—without assuming any additional discretionary fiscal tightening.

Retail sales

Volumes, sa

	Jan	Feb	Mar
Including auto fuel (%m/m)	~~-3.0~~ *-3.3*	~~2.1~~ *2.6*	~~0.5~~ *0.4*
Ex auto fuel (%m/m)	~~-2.1~~ *-2.4*	~~1.6~~ *2.0*	~~0.5~~ *0.2*
Ex auto fuel (%oya)	~~1.3~~ *0.9*	~~5.4~~ *5.1*	~~4.2~~ *4.0*
Ex auto fuel (% 3m/3m saar)	~~1.9~~ *1.3*	~~0.4~~ *-0.2*	~~-1.7~~ *-2.4*

After the sharp swings seen earlier in the quarter, retail sales for the quarter as a whole show an annualized decline of 2.4%. But this drop owes to the weakness in January, which looks increasingly (predominantly) like a weather-related blip. The level of retail sales is still lower than in December, suggesting some impact from the VAT hike. But momentum going into 2Q looks strong. The level of retail sales in March is now 0.8% higher than 1Q, which sets up 2Q for a gain in the ballpark of 4% ar or so. This is consistent with the idea that, despite higher VAT and weak labor income, the underlying trend in spending growth is holding up reasonably well.

CBI industrial trends

% balance

	Feb	Mar	Apr
Total order book	-36	-37	~~-34~~ *-36*
Output expectations	7	5	~~9~~ *14*
Output prices	8	17	__ *16*

The output expectations reading of the survey—which tracks the official data on manufacturing output more closely than orders—rose significantly in April from +5 to +14. The improvement in the CBI to date has been slower than the PMI. But the move in the CBI takes this part of the survey well above its +3 average of the past decade. It suggests the message of strengthening manufacturing output growth is broadening in the data. The orders readings of the CBI showed a much smaller improvement than the output reading, rising from -37 to just -36 in April. But this divergence can be explained by the fact that this reading asks where orders are relative to normal. In contrast, the orders readings in the quarterly part of the survey measure growth in orders. And these readings showed a significant gain in 1Q. Business optimism also rose, as did expectations of output and orders. The survey also reports that the upswing in activity so far has prompted a significant drop in the number of firms running below capacity (from 66% to 62%). This is consistent with weak potential growth during the initial phase of the recovery. On a somewhat more disappointing note, the employment and investment readings of the quarterly CBI survey showed virtually no improvement.

Real GDP (preliminary estimate)

	3Q09	4Q09	1Q10
Total GDP (%q/q sa)	-0.3	0.4	~~0.4~~ *0.2*
%oya	-5.3	-3.1	~~-0.1~~ *-0.3*
%q/q ar	-1.1	1.8	~~1.5~~ *0.8*
Breakdown (%q/q sa):			
Industrial production	-1.0	0.4	*0.7*
Services	-0.2	0.5	~~0.4~~ *0.2*
Construction	1.8	-0.9	~~0.0~~ *-0.7*

See main text.

Index of services

	Dec	Jan	Feb
%m/m sa	0.6	~~-0.7~~ *-0.8*	~~0.7~~ *0.6*
%oya sa	-1.1	~~-1.1~~ *-1.2*	~~0.3~~ *0.1*
%3m/3m saar	1.9	~~2.4~~ *2.3*	~~2.2~~ *1.8*

Sweden and Norway

- **The Riksbank sticks to its guns**
- **For now, we stick to ours**

The Riksbank this week left the policy rate at 0.25% and its policy rate projections unchanged. The outcome was a little more hawkish than we anticipated—we expected the Bank to lower its rate projections marginally—but not massively so.

Despite the significant downside GDP surprise at the end of last year, the Riksbank remained sanguine about the growth outlook, taking a lot of reassurance from the fact that employment has started to rise. To some extent, the Riksbank played down recent data on activity and put more emphasis on labor market developments and strong business surveys.

The Bank's views on resource use were mixed. On the one hand, the weaker GDP figures suggest that the output gap is larger than previously estimated, while labor market surveys point in the other direction. On inflation, the Bank lowered its headline CPI forecast considerably, but this was due mostly to lower estimates for expenditures related to interest rates. The CPIF forecast (which excludes the effect of interest rate changes and is operationally more relevant for the Bank) was raised slightly in the near term (due to the recent energy price spike), but lowered marginally a year from now. More broadly on inflationary pressures, the Bank mentioned that the currency has been stronger than expected, and that recent wage deals have been historically low (though not very different from its expectations). The Bank, however, highlighted that these developments were offset in part by lower-than-expected productivity growth.

On policy, the Bank mentioned that the situation is complicated by a divided economy, in which exports are still weak, while consumer spending, household indebtedness, and house prices are rising relatively quickly. On balance, the Bank judged that it will soon be time to move from a "crisis interest rate" to "monetary policy in a recession," and maintained the view that the policy rate will start rising in the "summer or early autumn" (the policy rate path still assigned a 50% probability to the first hike being delivered in July or September). Most on the Board were united in this assessment, with the exception of Lars Svensson, who did not vote for a rate cut this time, but believed that the policy rate should remain unchanged until next year.

We agree with the Riksbank that prospects for the Swedish economy are good, and that growth will move to an above-trend pace this year. That said, we find the Bank's near-term GDP forecast optimistic. In particular, the Bank's upward revision of its 1Q GDP projection to 3.6%ar from 2.6%ar is surprising to us, coming at a time in which hard data have clearly disappointed. Given the weak retail sales, trade, and IP releases for February, we are lowering our 1Q growth projection to 2.2%ar from 3.5%ar. Also, importantly, we believe that the large output gap, falling cost pressures, and the recent currency appreciation will lead to a quicker slide in core inflation than the Bank forecasts, especially from midyear. Our inflation view, coupled with the fact that growth will likely surprise to the downside in the near term, leads us to stick to our belief that the policy rate will not start rising until early next year. The Riksbank's reiteration of its intention to hike soon after midyear, however, provides a challenge for this view, and we will need to continue tracking upcoming data closely.

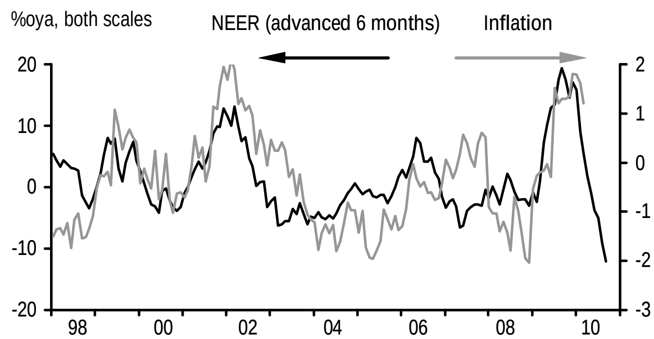
Riksbank's projections

Old (Feb 11) and new (Apr 20)

	Policy rate (%)		GDP (%q/q saar)		CPIF (%oya)	
	Old	New	Old	New	Old	New
4Q09	0.25	0.25	1.8	-2.2	2.3	2.3
1Q10	0.25	0.25	2.6	3.6	2.5	2.6
2Q10	0.25	0.25	2.9	3.8	2.0	2.1
3Q10	0.37	0.37	3.0	3.8	1.6	1.7
4Q10	0.70	0.70	3.5	3.7	1.5	1.7
1Q11	1.12	1.12	3.5	3.7	1.3	1.3
2Q11	1.56	1.56	3.6	3.6	1.4	1.3
3Q11	2.00	2.00	3.7	3.6	1.4	1.3
4Q11	2.40	2.40	3.6	3.6	1.5	1.4
1Q12	2.81	2.81	3.5	3.5	1.6	1.5
2Q12	3.15	3.15	3.5	3.4	1.7	1.7
3Q12	3.49	3.49	3.4	3.3	1.9	1.9
4Q12	3.75	3.75	3.4	3.2	2.0	2.0
1Q13	3.95	3.95	3.3	3.2	2.1	2.1

The CPIF index excludes the effect of interest rate changes from the headline CPI, but includes food and energy prices.

Sweden: currency (NEER) and core goods inflation



The next Sweden and Norway data watch will be published on May 7.

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Sweden:

Data releases and forecasts

Weeks of April 26 - May 7

Mon
Apr 26
9:30am

Trade balance

Skr bn, nsa

	Dec	Jan	Feb	Mar
Exports	84.0	79.0	81.8	__
Imports	79.1	70.7	81.2	__
Trade balance	4.9	8.3	0.6	__

Tue
Apr 27
9:30am

Producer prices

%oya

	Dec	Jan	Feb	Mar
PPI	-0.8	0.3	0.8	__
For domestic supply	0.6	2.1	2.3	__

Wed
Apr 28
9:30am

Unemployment: Labor Force Survey (Statistics Sweden)

	Dec	Jan	Feb	Mar
% of labor force, nsa	8.6	9.4	9.3	__

Thu
Apr 29
9:15am

NIER business and consumer surveys

	Jan	Feb	Mar	Apr
Mfg tendency index, sa	-4	3	3	__
Consumer index, nsa	8.5	13.0	15.5	__

Thu
Apr 29
9:30am

Retail sales

Volumes

	Dec	Jan	Feb	Mar
%m/m (sa)	0.4	0.7	-1.0	__
%oya (wda)	3.3	3.3	2.3	__

Mon
May 3
8:30am

Purchasing managers survey, manufacturing

% balance, sa

	Jan	Feb	Mar	Apr
Overall index	61.7	61.5	61.1	__

Fri
May 7
9:30am

Industrial production

	Dec	Jan	Feb	Mar
Production (%m/m sa)	-2.0	1.2	-0.8	__
Production (%oya nsa)	-6.3	-0.6	-1.5	__

Review of past two weeks' data

Consumer prices

	Jan	Feb	Mar
CPI (%oya)	0.6	1.2	~~1.4~~ *1.2*
CPIF (%oya)	2.6	2.7	~~2.7~~ *2.5*

Unemployment: monthly labor market board

	Jan	Feb	Mar
% of labor force, nsa	5.7	5.6	__ *5.2*

Norway:

Data releases and forecasts

Weeks of April 26 - May 7

Wed
Apr 28
10:00am

Quarterly business tendency survey

Sa

	2Q09	3Q09	4Q09	1Q10
Actual production (index)	41.0	45.4	47.5	__
Expected production(index)	44.2	48.1	50.7	__
Capacity utilization (%)	76.2	76.4	76.8	__

Thu
Apr 29
10:00am

Retail sales

Volumes

	Dec	Jan	Feb	Mar
%m/m sa	0.8	-0.4	0.3	__
%oya sa	4.2	2.5	3.5	__

Fri
Apr 30
10:00am

Labor Directorate

Nsa

	Jan	Feb	Mar	Apr
Unemployment rate (%)	3.3	3.2	3.1	__

Mon
May 3
9:00am

Purchasing managers survey, manufacturing

% balance, sa

	Jan	Feb	Mar	Apr
Overall index	50.1	49.3	49.6	__

Mon
May 3
11:00am

NEF/EEF house prices

All dwellings, NOK

	Jan	Feb	Mar	Apr
%m/m	3.7	0.0	1.2	__
%oya	13.0	10.0	10.9	__

Wed
May 5
10:00am

Industrial production

Manufacturing

	Dec	Jan	Feb	Mar
%m/m sa	-0.5	-0.4	0.8	__
%oya wda	-2.5	-2.0	0.2	__

Wed
May 5
10:00am

Labor Force Survey

3mma sa

	Nov	Dec	Jan	Feb
Unemployment rate (%)	3.3	3.3	3.3	__

Review of past two weeks' data

Trade balance

Nkr bn, excluding erratics, nsa

	Jan	Feb	Mar
Exports	~~63.5~~ *63.4*	64.2	__ *70.5*
Imports	29.2	~~31.7~~ *31.8*	__ *41.5*
Trade balance	~~34.3~~ *34.2*	32.4	__ *29.0*
Balance ex oil and gas	~~-2.8~~ *-2.9*	~~-6.2~~ *-6.3*	__ *-11.1*

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Central Europe: Czech Republic, Hungary, Poland, Romania

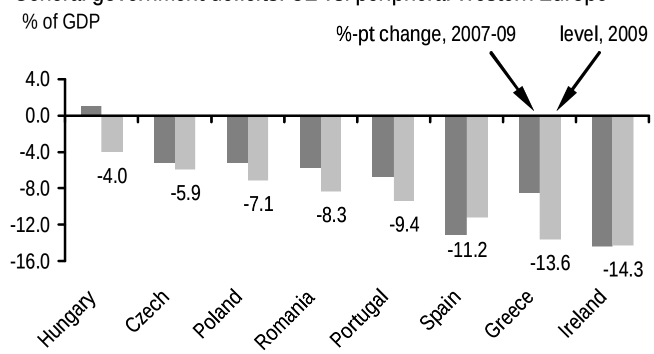
- **Poland: NBP to remain on hold and keep neutral stance**
- **Hungary likely to ease another 25bp, and Romania 50bp**
- **Czech: CNB likely to hold key rate unchanged in a close call; CNB Governor Tuma to resign at end- June**

Confirmation that a self-sustaining global recovery is in place has helped drive the global outlook for risk markets. The combination of ample liquidity and CEE fundamentals that are outstripping those of Western Europe has encouraged portfolio inflows to the region, helping to drive currency appreciation. As a result, a number of CEE central banks are now actively leaning against what they perceive as excessive currency gains.

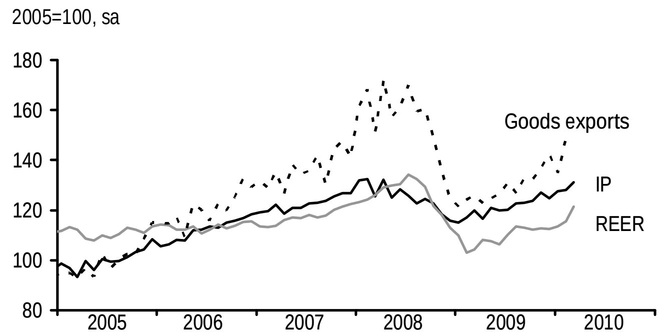
We expect the National Bank of **Poland** to remain on hold at next week's meeting and maintain its neutral policy stance. While inflation is set to fall to below 2%oya in coming months, economic activity continues to recover, and the improvement in the labor market is gathering pace. The NBP caught the market by surprise earlier this month when it intervened in the FX market for the first time in 10 years to slow the pace of zloty appreciation. Further, the tone of the minutes from the March MPC meeting was dovish and suggested that a rate cut had been discussed to curb excessive zloty gains. However, the view that temporary rate cuts now would necessitate steeper rate hikes later on seems to have prevailed. In line with our view, some MPC members argued that current zloty levels do not appear to be hurting competitiveness and appreciation has been consistent with the recovery in IP and exports. We maintain our call that the next move in Polish policy rates is likely to be a hike, most likely in 4Q10 when inflation starts to re-accelerate.

In **Hungary**, we look for the NBH to cut rates another 25bp on the back of forint strength and healthy investor appetite for Hungarian government bonds. Although we do not share the NBH's view that inflation will significantly undershoot its target next year, the absence of inflationary pressures coupled with benign market conditions should allow the policy rate to be cut to 5.00% in the next three months. Investor appetite for Hungarian assets could receive an additional boost if center-right opposition party Fidesz gains a two-thirds majority in the second round of parliamentary elections this Sunday, as this would enable the parliament to make far-reaching changes to the constitution, including streamlining local governments. An extension of the forint's

General government deficits: CE vs. peripheral Western Europe



Poland: IP, exports, and the real exchange rate



appreciation trend could provide scope for rates to be lowered to below 5% without damaging the NBH's inflation fighting credibility, but this is not our base case.

We expect the National Bank of **Romania** (NBR) to cut its base rate by another 50bp to an all-time low of 6% in early May on the back of a still weak economy, stagnating private credit, low inflation, and an appreciating FX trend. That said, we think the end of the easing cycle is near. We expect the economy to recover this year and CPI inflation to bottom in the coming months, and we do not expect the NBR to want the real base rate significantly below 2%. Currently, we expect the base rate to bottom at 5.5% with a currency rally as a key risk that could push the central bank to move the rate even lower.

Czech: looking for a new CNB governor

An interest rate cut will be seriously discussed at the upcoming meeting of the **Czech** National Bank (CNB) as well. The strong koruna recently tested a psychological level of 25 against the euro, CPI inflation is below 1%oya, and consumer demand is still weak—all strong arguments for doves in the MPC. Recent commentary suggests that the two MPC members who voted for a cut at the previous meeting, Vice-Governor Singer and Tomsik, will vote for a

The Central Europe data watch is published biweekly, next on May 7.

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cut again. While we perceive the probability of a rate reduction to be as high as 40%, we think the current level of 1% will remain the bottom of this easing cycle. We think that ongoing global recovery will boost not only the Czech export-oriented sectors but also consumer demand. In such an environment, the CNB will have to consider raising, not lowering, the base rate (most likely starting in late 4Q).

CNB Governor Zdenek Tuma announced that he would resign at the end of June. His second six-year term in the CNB was scheduled to end in mid-February 2011 along with the first term of three other MPC members. According to Tuma, the decision should reduce the uncertainty surrounding who will be the new Governor. Vice-Governors Singer and Hampl are the main favorites, and their mounting rivalry has been visible even outside the central bank. Besides them, Jiri Weigl, Chancellor of the President's Office and an economist by training, is cited as a dark-horse by local sources. Given the possible replacements, we do not see strong enough reasons to expect significant changes in interest rate or FX policies. However, it is unlikely that any new Governor appointed by President Klaus would support early euro adoption.

Czech Republic:

Data releases and forecasts

Weeks of April 26 - May 7

Thu
May 6

Monetary policy announcement

We expect the CNB to leave its key rate unchanged at 1%. See main essay.

Fri
May 7
9:00am

External trade

CZK bn

	Dec	Jan	Feb	Mar
Trade balance	2.4	14.4	15.3	15.0
Ytd	151.5	14.4	29.7	44.7
Ytd a year ago	67.2	3.9	13.3	34.3
Exports, %oya	4.8	9.0	11.0	5.2
Imports, %oya	-2.3	2.6	7.9	9.3

Foreign trade is likely to continue to post a solid surplus as the recovery in domestic demand is still lagging the ongoing bounce in export demand. Note that March data will be influenced by a large base effect. We look for a gradual reversal of a rising trade surplus in the coming months on stronger domestic demand.

Fri
May 7
9:00am

Industrial output

%oya

	Dec	Jan	Feb	Mar
Production	1.8	4.9	7.0	3.0

The industrial sector continues to recover on the back of recovering foreign demand. The PMI increased to 56.8 in March, to levels last seen in early 2008, and recent data in from Germany, the country's main trading partner, are encouraging as well. The March annual figure will slip a bit due to base effects but the outlook for further improvement seems to be unshaken. We expect that the ongoing recovery in industrial output will revive capex spending and also consumer demand.

Review of past two weeks' data

Balance of payments

CZK bn

	Dec	Jan	Feb
Current account	-16.8	15.6	~~8.5~~ *10.3*
Ytd	-37.0	15.6	~~24.1~~ *25.9*
Ytd a year ago	-22.9	1.0	21.3
Trade balance	5.2	15.6	~~15.5~~ *17.8*
Services	0.0	1.0	~~1.0~~ *1.2*
Income	-20.4	-6.9	~~-8.0~~ *-6.2*
Current transfers	-1.7	5.9	~~0.0~~ *-2.6*
Financial account	29.8	3.6	*-3.4*
FDI	18.2	7.4	*8.2*
Portfolio investment	-14.2	3.3	*2.2*
Other investments	25.8	-7.1	*-13.8*

The current account (C/A) continues to post only a small deficit (close to 1% of GDP) on a 12-month cumulative basis and a small surplus when adjusted for reinvested earnings. We expect a minor C/A gap widening this year on the back of renewed growth in dividend outflows and reviving domestic demand and the pace of improvement in imports exceeding that of exports.

Hungary:

Data releases and forecasts

Weeks of April 26 - May 7

Mon
Apr 26

Monetary policy announcement

We look for the NBH to cut policy rates another 25bp to 5.25%. See main essay.

Fri
Apr 30
9:00am

Producer prices

%oya

	Dec	Jan	Feb	Mar
Producer prices	1.3	-0.6	-2.8	-4.0
Domestic	0.7	1.6	0.0	1.0
Export	1.6	-1.4	-5.4	-7.9

Thu
May 6
9:00am

Industrial output

%oya

	Dec	Jan	Feb	Mar
Production, wda	-1.0	5.7	8.4	4.7
Production, nsa	1.0	3.4	8.4	4.7
%m/m swda	-5.9	8.9	-1.7	1.3

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A 1.4%m/m sa rise in output would imply a slowdown in the oya rate due to a high base, but a significant pickup in sequential growth to 14.5% annualized from -4.4% in the previous month. The output component of the March manufacturing PMI fell 2.6pts from the previous month, but, at 60.4, remained well in expansion territory.

Review of past two weeks' data

Consumer prices

%oya

	Jan	Feb	Mar
All items (KSH)	6.4	5.7	~~5.8~~ *5.9*
%m/m nsa	1.4	0.3	~~0.6~~ *0.7*
Food	2.9	2.1	*2.3*
Consumer durables	3.9	3.4	*3.7*
Gasoline	31.7	22.3	*25.5*
Services	5.6	6.0	*5.9*
Core inflation	5.1	5.1	*4.7*
%m/m sa	0.4	-0.1	*0.2*
Regulated g&s (NBH)	6.3	6.5	*6.7*
Market g&s (NBH)	3.9	3.6	*3.6*

March CPI inflation accelerated to 5.9%oya. As expected, higher fuel prices were the main driver of the pickup in the oya rate. The upside surprise compared to our forecast came from food prices, which increased much more strongly than the typical seasonal rise. The 3m/3m annualized core CPI rate remained below the central bank's 3% target. We expect disinflation to resume in April, helped by base effects, but a significant drop is unlikely until July.

Average gross wages

%oya

	Dec	Jan	Feb
Gross wages, nominal	0.0	6.5	~~2.5~~ *0.9*
Private sector	1.2	5.2	~~3.2~~ *4.0*
Public sector	-2.4	8.9	~~0.9~~ *-6.2*

February wage growth was weaker than forecast, but only because of irregular public sector bonus payments. Private sector wage gains actually exceeded the forecast; excluding bonuses, they picked up to 5.2%oya from 4.7% previously.

Retail trade

%oya, unless otherwise stated

	Dec	Jan	Feb
%oya wda	-7.4	-5.6	~~-5.2~~ *-4.3*
%m/m swda	-0.6	0.6	~~0.3~~ *0.0*

Poland:

Data releases and forecasts

Weeks of April 26 - May 7

Tue Apr 27 — **Monetary policy announcement**

The NBP will likely leave rates on hold. Watch for any comments on the zloty to gauge the MPC's comfort with the current exchange rate level. See main essay.

Review of past two weeks' data

Balance of payments

EUR mn

	Dec	Jan	Feb
Current account balance	~~-1034~~ *-959*	~~-710~~ *-754*	~~500~~ *106*
Ytd (bn)	~~-5.0~~ *-5.1*	~~-0.7~~ *-0.8*	~~-0.2~~ *-0.6*
Ytd a year ago (bn)	~~-18.2~~ *-18.3*	~~-1.2~~ *-0.8*	0.0
Trade balance	~~-711~~ *-645*	~~-171~~ *-205*	*-248*
Exports, %oya	~~12.3~~ *12.4*	~~12.3~~ *11.9*	*20.1*
Imports, %oya	~~-2.6~~ *-3.3*	7.6	*22.3*
Service balance	379	~~273~~ *259*	*109*
Income balance	~~-900~~ *-868*	~~-855~~ *-841*	*-923*
Current transfers	~~198~~ *175*	~~43~~ *33*	*1168*
Fin. + cap. account balance	~~-132~~ *-359*	~~6900~~ *5746*	*867*
FDI, net	~~192~~ *219*	~~1162~~ 1153	*814*

The February current account surplus was down sharply from €0.8 billion a year earlier. Deterioration in the trade deficit, as imports picked up sharply, and widening of the income deficit, as investment income outflows picked up, were to blame. The €1 billion+ inflow of current transfers, largely due to EU fund transfers, kept the overall current account in surplus in February. The 12-month trailing current account deficit inched up to 1.8% of GDP. Positively, improving growth prospects are also boosting FDI inflows, which covered 120% of the C/A gap in the 12 months to February.

Consumer prices

%oya

	Jan	Feb	Mar
All items			
%oya	3.5	2.9	2.6
%m/m	0.6	0.2	~~0.4~~ *0.3*
Food, %oya	3.0	2.8	*1.4*
Fuel, %oya	22.3	14.5	*15.6*

The March CPI was very close to our forecast in terms of both the headline number and its breakdown. Food prices alone subtracted three-tenths from the headline CPI rate owing to a high base from last year. Core inflation was broadly steady.

Gross wages and employment

%oya

	Jan	Feb	Mar
Gross wages, nominal	0.5	2.9	~~3.0~~ *4.8*
Real (CPI-adj.)	-3.0	0.0	~~0.4~~ *2.2*
Employment, mn, nsa	5301	5293	~~5290~~ *5293*
Employment, %oya	-1.4	-1.1	~~-0.7~~ *-0.6*

March wage growth picked up more than forecast. Although some special effects may have been responsible for part of the surprise (e.g., bonus payments, one additional working day), it is difficult to dispute the improving uptrend in recent months. The latest reading on employment figures lends further support to the view that improvement in the labor market is gathering pace. March only saw 3,000 job losses compared to 27,000 a year earlier and 8,000 in February. Over-year-ago changes in employment should turn positive by midyear.

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Producer prices
%oya

	Jan	Feb	Mar
Producer prices	0.2	-2.4	~~-2.5~~ *-2.4*
%m/m nsa	0.4	-0.1	*0.0*

Industrial output
%oya

	Jan	Feb	Mar
Industry	8.5	9.2	~~9.5~~ *12.3*
%oya swda by GUS	11.3	9.5	~~7.2~~ *9.6*
%m/m swda by GUS	2.8	0.9	~~0.6~~ *2.3*
Manufacturing	10.1	10.7	*13.6*
Construction	-15.3	-24.7	*-10.8*

The 2.3%m/m sa increase in output in March implies a 14% annualized gain in the first quarter, up from 10.4% in 4Q09. The recovery in IP was broad-based, albeit largely driven by export-oriented sectors. News from the construction sector was also encouraging. After contracting a cumulative 16% in January-February, construction production rose 3.6%m/m sa in March. Overall, the figures do not lend support to the view that zloty appreciation has been excessive. IP and exports have now risen back to their end-2007 levels, and zloty appreciation to date appears consistent with that rise. The NBP's latest business tendency survey showed that while the share of firms citing the exchange rate as barrier to growth increased from 13% to 13.3% in the previous quarter, current levels of EUR/PLN and USD/PLN are still well above the threshold guaranteeing that exporters break even (on EUR/PLN this level is around 3.65). Policymakers will likely become tolerant of PLN gains as the recovery gathers steam.

Core inflation
%oya

	Jan	Feb	Mar
CPI—ex food and energy	2.4	2.2	2.0
CPI—ex administered prices	3.2	2.7	*2.3*
CPI—15% trimmed mean	3.1	2.8	*2.6*
Avg. of four NBP measures	3.0	2.7	*2.4*

Retail sales
%oya, unless otherwise stated

	Jan	Feb	Mar
Retail sales (nominal)	2.5	0.1	~~6.0~~ *8.7*
Real, CPI-adjusted	-1.0	-2.7	3.4
%m/m sa	0.8	-1.8	0.5

Retail sales rose much more strongly than expected in March, jumping 8.7%oya in value terms. Real retail sales (CPI-adjusted) picked up to 5.4%oya from -2.7% in February and -1% in January. Improving weather conditions and one extra working day are likely to have contributed to the upswing. While real retail sales in 1Q10 on average were down from in 4Q09, the upside surprise in March suggests that 1Q GDP growth likely exceeded 3%oya. The ongoing improvement on the labor market should bring stronger consumer demand in coming quarters. We are likely to see some pullback in headline retail sales in April due to national mourning, as trading hours were shortened following the Smolensk tragedy, but the uptrend should remain intact.

Romania:

Data releases and forecasts

Weeks of April 26 - May 7

Tue May 4 — Monetary policy announcement

We expect the NBR to cut its base rate to 6%. See main essay.

Review of past two weeks' data

Consumer prices
%oya

	Jan	Feb	Mar
%oya	5.2	4.5	~~4.1~~ *4.2*
%m/m nsa	1.7	0.2	~~0.1~~ *0.2*

Headline inflation slowed to its lowest rate since the summer of 2007. We expect CPI inflation to drop to 4%oya or slightly lower in the coming few months. That should be a bottom in CPI slowdown as depressed consumer demand is about to recover. Commodity prices are also rather inflationary, raising the risk of a stronger rebound in food prices, and the positive base effect is about to fade.

Current account balance
EUR bn

	Dec	Jan	Feb
Current account	-0.3	-0.1	~~-0.5~~ *-0.6*
Ytd	-5.1	-0.1	~~-0.6~~ *-0.8*
Ytd a year ago	-16.9	-0.5	-0.5

The current account (C/A) data continue to show a significantly smaller deficit than before the recession but the narrowing has essentially ended. We expect a gradual rewidening of the C/A gap from 4.8% of GDP last year to 5.5% of GDP this year.

South Africa

- **High-frequency data track a 3.9%q/q saar expansion in 1Q10 GDP with upside risks to our 3%y/y forecast**
- **Activity reports point to a strong rebound in tertiary sector activity, led by the trade sector**
- **CPI likely eased further to 5.2%oya in March, heading toward the midpoint of the band by midyear**

We believe recent monthly activity reports point to a first-quarter economic expansion of 3.9%q/q (1.2%oya) saar with moderate risks to the upside. Based on our estimates, the main underpinning to growth shifted from manufacturing and government services to wholesale and retail trade in 1Q10, while we had anticipated that such a shift would take place only in the subsequent quarter. The pickup in growth momentum and broadening of the underlying recovery suggest that rates will be kept on hold for the remainder of 2010 and add upside risks to our 3%y/y forecasts for this year.

The primary sector is likely to have remained weak in 1Q10. While mining production should have expanded 11%q/q saar in 1Q10, food production probably contracted further, subtracting 0.2%-pt from growth. Meanwhile, support from the secondary sector waned quickly at the beginning of the year. Data for the first two months of the quarter tracked a lackluster 2.6%q/q saar recovery in manufacturing, adding a mere 0.4%-pt to growth after a solid 1.5%-pt contribution in 4Q09. In our view, however, manufacturing data for March could surprise on the upside. The main underpinning appears to have shifted back to the tertiary sector in 1Q10: the recovery in the trade sector is gaining momentum at a surprisingly quick pace. Retail sales grew 12.9%3m/3m in February and are on track for a 13.8%q/q saar expansion in the first quarter. At the same time, the recovery in the finance, real estate, and business sector—representing 21.4% of GDP—is expected to have registered further gains. Positive surprises in either manufacturing or finance and real estate could lift growth to 4.4%q/q saar in the first quarter, presenting the main risks to our forecasts.

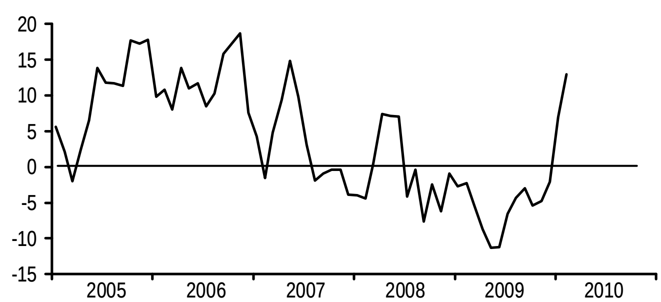
Inflationary pressures subside further

Next week's inflation reports should confirm that CPI inflation is on track to return to the midpoint of the band by midyear. CPI inflation in March probably fell to 5.2%oya from 5.7% in February, with prices rising 0.9%m/m in a high survey month. The main contribution comes from increases in the excise duty on beverages and tobacco, which likely added 0.3%-pt to inflation. The quarterly surveys of education and rents are also due in March, contributing a further 0.2%-pt each. These two components present the main uncertainty around the inflation report and could surprise on the downside. The remainder of the CPI increase comes from the miscellaneous category (in particular, car insurance), domestic workers' wages, and a small increase in gasoline prices. We see CPI inflation easing to 4.6%oya in May before picking up again to end the year at 5.9%oya.

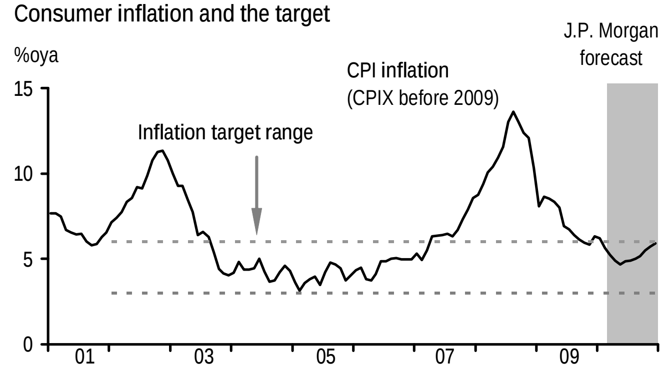
Gross Domestic Product by activity
Contributions (%-pt q/q saar)

	2008		2009				2010
	3Q	4Q	1Q	2Q	3Q	4Q	1Qe
Agriculture and forestry	0.4	0.1	-0.1	-0.3	-0.2	-0.2	-0.2
Mining and quarrying	-0.5	0.0	-1.7	0.8	-0.3	0.2	0.5
Primary sector	-0.2	0.1	-1.8	0.5	-0.6	0.0	0.3
Manufacturing	-0.9	-2.9	-4.4	-1.6	1.1	1.5	0.4
Electricity, gas, and water	0.1	0.0	-0.2	0.0	0.1	0.0	0.0
Construction	0.2	0.2	0.3	0.3	0.2	0.1	0.1
Secondary sector	-0.6	-2.8	-4.3	-1.4	1.4	1.6	0.5
Wholesale and retail trade	-0.7	0.0	-0.3	-0.7	-0.1	-0.1	1.8
Transport, communication	0.3	0.1	-0.2	-0.1	0.1	0.2	0.2
Finance, real estate, bus.	1.7	1.6	-0.5	-0.8	-0.3	0.2	0.4
General government services	0.8	0.8	0.3	0.4	0.7	1.0	0.3
Personal services	0.2	0.1	0.2	0.2	0.2	0.2	0.2
Tertiary sector	2.3	2.4	-0.6	-1.2	0.5	1.5	2.8
Taxes and subsidies	-0.2	-0.4	-0.7	-0.7	-0.4	0.1	0.3
GDP at market prices	1.3	-0.7	-7.4	-2.8	0.9	3.2	3.9

Retail sales: recovery gaining momentum



Consumer inflation and the target



The South Africa data watch will be published next on May 7.

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Data releases and forecasts

Weeks of Apr 26 - May 7

Wed
Apr 28
11:30am

Consumer prices

%oya, except as noted

	Dec	Jan	Feb	Mar
CPI	6.3	6.2	5.7	5.2
%m/m nsa	0.3	0.3	0.6	0.9
Core	6.3	5.7	5.3	4.9

See text.

Thu
Apr 29
11:30am

Producer prices

	Dec	Jan	Feb	Mar
Total (%oya)	0.7	2.7	3.5	3.9
%m/m nsa	0.7	1.3	0.4	__

Fri
Apr 30
8:00am

Monetary and credit aggregates

	Dec	Jan	Feb	Mar
M3 (%oya)	1.8	0.6	0.1	__
M0 (%oya)	5.3	6.3	4.8	__
Private sector credit (%oya)	-0.1	-0.7	-0.6	-0.9
%m/m nsa	0.0	0.0	0.6	__
Credit to households (%oya)	2.9	2.9	3.5	4.2
Total domestic credit (%oya)	1.8	0.9	-0.3	__

Credit extension to households likely picked up further to 4.2%oya in March, driven by a stronger-than-expected recovery in house prices.

Fri
Apr 30
2:00pm

Trade balance

R bn, except as noted

	Dec	Jan	Feb	Mar
Trade balance	3.7	-3.4	-5.7	__
Exports	45.4	36.6	40.3	__
%m/m	-1.1	-19.4	10.1	__
Imports	41.7	40.0	45.9	__
%m/m	-13.7	-4.1	15.0	__

Mon
May 3
11:00am

Kagiso BER PMI

	Jan	Feb	Mar	Apr
PMI (% weights)	53.6	60.4	55.6	60.9
Business activity (25)	56.2	65.2	59.9	__
New sales orders (30)	55.4	68.6	54.8	__
Suppliers' performance (15)	49.2	48.1	52.4	__
Inventories (10)	51.8	58.7	56.8	__
Employment (20)	51.9	52.1	53.2	__
Memo: prices paid	52.8	61.9	61.6	__
Business expectations	73.3	74.0	73.2	__
PMI nsa	46.2	55.5	53.4	__

Wed
May 5
11:00am

New vehicle sales

%oya, except as noted

	Jan	Feb	Mar	Apr
Passenger car sales	15.3	21.2	13.7	__
%m/m nsa	47.8	-7.4	9.9	__
Light commercial vehicles	9.2	13.0	15.1	__
Heavy/medium comm. veh.	-17.6	-14.1	31.3	__
Total vehicle sales	12.0	16.2	15.0	__
%m/m nsa	26.6	0.5	11.7	__

Fri
May 7
8:00am

SARB official reserves

	Jan	Feb	Mar	Apr
Gross reserves (R bn)	298.0	303.9	307.8	316.9
Gross reserves (US$ bn)	39.5	39.4	42.0	42.8
International liquidity (US$ bn)	38.6	38.3	38.3	39.1

We expected the SARB to have continued building up reserves in April on the back of the rand strengthening.

Review of past two weeks' data

Retail sales

%oya nsa

	Dec	Jan	Feb
Real	-3.8	~~-1.7~~ *-1.5*	~~-1.3~~ *-1.5*
Nominal	~~3.3~~ *3.2*	~~4.7~~ *4.8*	__ *4.0*

Retail sales volumes declined 1.5%m/m sa, leaving the over-year-ago figure at -1.5%oya, disappointing consensus and markets and attracting particular attention ahead of next month's MPC meeting. Despite the negative surprise versus consensus in February, retail sales are up sharply on a sequential basis. Retail sales volumes rose 12.9%3m/3m saar from 7% in January and -2.1% in December, and are on track for a 13.8%q/q saar expansion in 1Q10. This contradicts widespread impressions that the consumer recovery is not yet in full swing in South Africa.

After strong monthly gains of a seasonally adjusted 1.8%m/m in December and 3.1% in January, we believed that a small pullback was inevitable, which substantiated our forecast. As seasonally adjusted data were not released in prior months, we believe analysts may have misjudged the seasonality factor. Looking through the monthly noise, the latest reading is encouraging and suggests that the consumer recovery has picked up momentum. In addition, the recovery in sales volumes has now become more broad-based. Volume sales in pharmaceutical goods are now up 7.2%oya with sales in textiles and household furniture and appliances increasing 5% and 5.1%, respectively. Retailers in hardware and paint continue to register a contraction in sales volumes of 15.5%oya.

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Australia and New Zealand

- **RBA says rise in terms of trade significantly stronger**
- **Aussie 1Q CPI key ahead of RBA's May meeting**
- **RBNZ on hold in April, but will tweak language**

Following the RBA Board minutes this week, a speech by Governor Stevens, and data showing a sharp rise in the terms of trade in 1Q, we stick by our call for a further hike to the official cash rate in May. Next week's CPI data are key ahead of the May rate decision, which again we expect to be a close call. We expect that headline and core inflation remained stuck at the top end of the RBA's target range in 1Q, a concern for RBA officials given that the economy already is growing at trend and with very limited spare capacity.

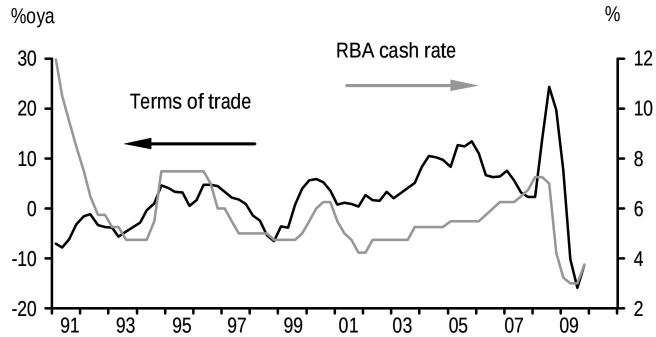
Across the Tasman, the RBNZ, in contrast, will likely sit on the policy sidelines in the coming months. We expect that Governor Bollard will leave the official cash rate (OCR) steady next week, but we look for a change in the official policy guidance, which currently suggests that the policy stimulus in place may be removed around the middle of the year. Given the slew of weaker-than-expected data, combined with a softer-than-expected CPI print this week, there appears little urgency to tighten policy in the near term. We maintain that the first move will be a 25bp hike in July.

RBA raises the stakes on terms of trade

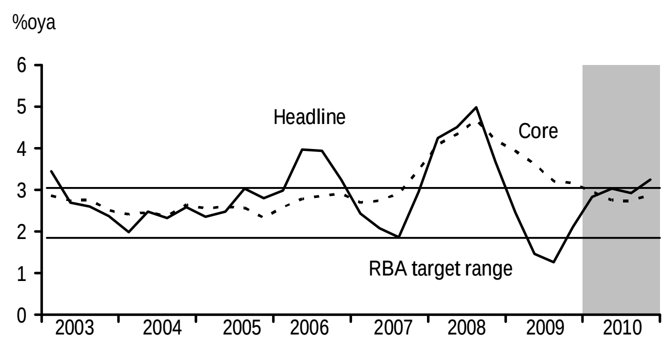
The Reserve Bank this week released minutes of the early April Board meeting, during which Board members elected to deliver a second straight monthly rate hike. The minutes were upbeat, similar to the tone of the statement accompanying the Board's decision two weeks ago, but the word "gradual," which has featured prominently in recent RBA commentary, made no appearance. Indeed, it is becoming increasingly difficult to describe the pace of tightening as gradual, with the RBA now having increased the cash rate five times since October.

The Board minutes indicated that, two weeks ago, RBA officials thought it "might be prudent" not to delay an adjustment to the cash rate; this owed mainly to the fact that the rise in the terms of trade was likely to be significantly stronger than expected. Data on Friday showed that the terms of trade rose 3.5%q/q in the opening three months of the year; this, though, is only a precursor to the huge gains we expect over the next two years. Board members, therefore, believed in early April that it was appropriate to take a further step to return interest rates toward more "normal" levels. Given that lending rates are still below their long-

Australia: terms of trade and RBA cash target rate



Australia: CPI



run average, however, the RBA signaled that they will "probably need to rise further in the period ahead." One may interpret the "period ahead" as one, two, three months or possibly more, but we believe the next rate hike will be delivered as soon as May, as the case for returning policy to neutral remains strong.

We acknowledge that the precise timing of rate moves remains highly dependent on the ebb and flow of domestic data as well as events offshore. The March quarter CPI print will be the key domestic data point ahead of the next RBA Board meeting. Though there has been little new information on inflation over the past month, the RBA minutes highlighted that various measures of inflation expectations had been "around or a little above their average levels." The RBA continues to forecast inflation consistent with the medium-term target, but we believe that with the economy having moved back onto a trend-like growth path, and with very limited spare capacity, inflation pressures are likely to continue to build.

Importantly, the Board minutes this week provided more color on two areas that appeared to be of growing concern for RBA officials when they decided to lift the cash rate a further 25bp to 4.25% two weeks ago: the rising terms of trade and conditions in the established housing market. On the terms of trade, the RBA noted that spot prices for

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Australia's key commodity exports—iron ore and coal—had continued to rise. It attributed this to large increases in steel production over the past decade, rises that owe mainly to strong growth in China. As a result, the terms of trade were likely to be significantly higher than forecast in the last Statement of Monetary Policy in February. The resulting boost to nominal incomes and inflation in the years to come will likely pose "challenges" for the Board.

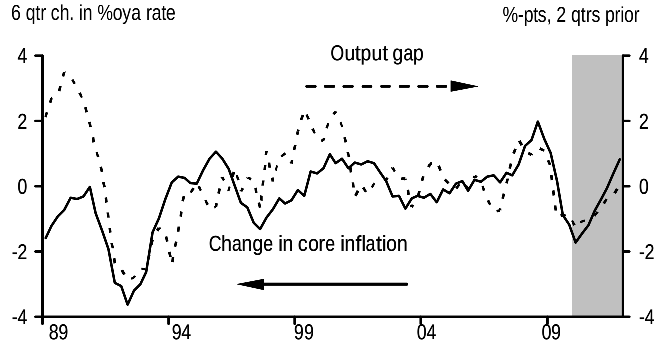
The RBA again described the housing market as "buoyant," with price growth continuing and auction clearance rates remaining high, due to the ongoing supply-demand imbalance. On the one hand, underlying demand continued to rise owing to strong population growth, the healthy outlook for household incomes, and below-average mortgage rates. On the other hand, new housing supply remained constrained, owing to ongoing financing issues faced by developers and government red tape.

RBA Governor reiterates growth challenge

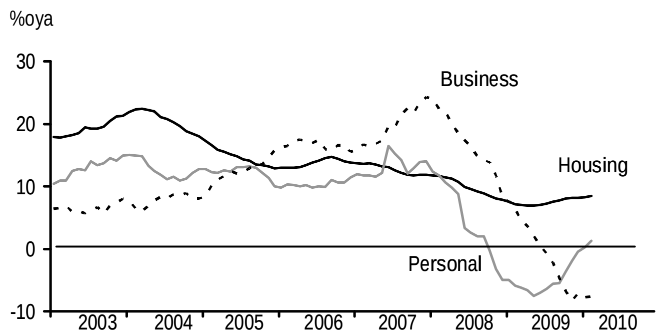
The other key policy event this week was a speech delivered by Reserve Bank Governor Glenn Stevens on "Economic Conditions." It was interesting that the Governor opened the speech by highlighting the importance of next week's CPI numbers, saying that "we [the RBA], and everyone else, will have an opportunity to update our thinking on the current and likely future course of inflation." This statement makes the remainder of the commentary somewhat conditional, and indicates that the RBA's thinking on the future path of inflation remains, at the least, somewhat more fluid than is usual.

Indeed, the precise timing of rate moves remains highly data dependent, with the 1Q CPI numbers key ahead of the next Board meeting. The Governor noted that the RBA has moved early to raise the cash rate, leaving interest rates for borrowers and depositors now close to average. What happens from here, though, remains an "open" question. The Governor spent considerable time in the speech discussing the challenging task of managing the upturn. In our view, RBA officials want to keep moving interest rates toward "normal" levels, and, as flagged in this week's minutes, the risks to delaying such moves are significant, due to the coming terms of trade boom. The economy will enter this expansion, on Governor Stevens' guidance, with growth already at trend, the unemployment rate having peaked at a much lower rate than expected, and skills shortages already emerging. The case for further tightening of policy is therefore compelling, in our view.

Australia: core inflation and the output gap



Australia: private sector credit aggregates



Inflation rising to top of RBA's range

The 1Q CPI numbers next week are, of course, in the spotlight ahead of the RBA's May Board meeting. We forecast headline inflation to print at 0.8%q/q, or 2.8%oya, at the very top end of the RBA's 2%-3% target range. More importantly, the core inflation measure should print at 0.7%q/q, up from 0.6% in the previous quarter, or 3.0%oya. These results, combined with the deteriorating medium-term inflation outlook, will reaffirm our view that another rate hike from the RBA is imminent.

The main drivers of inflation in 1Q will likely be higher prices for food and fuel. Hospital and medical services costs also should be up, as will insurance services owing to rising motor insurance costs. Offsetting these, due to the elevated AUD, will be price declines in clothing, travel and accommodation, and motor vehicles. The financial services component should also be lower, owing mainly to the fact that consumers enjoyed a large rise in deposit rates, relative to lending rates, in the opening three months of the year.

The inflation outlook is deteriorating. As already highlighted, the economy is expanding with what appears to be limited spare capacity, and there already is evidence that some sectors, like mining, are bumping up against the same

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constraints faced during the previous period of expansion. In particular, skill shortages mean that wage pressures are building, and there is a risk that outsized pay increases being claimed in sectors like mining will spill over into broader sectors of the economy, particularly with the unemployment rate seemingly having peaked at just 5.8%. This outlook supports our view that the official cash rate will likely be in restrictive territory in 2011.

Credit growth continuing to improve

The RBA's credit aggregates should show a 0.5%m/m increase in March, up from 0.4% in February. The increase in the pool of outstanding credit will owe to a rise in business lending. After contracting for 13 straight months, we expect that business credit increased 0.3%m/m in March. The process of deleveraging for businesses appears to be ending, and with domestic banks now making more credit available to small and medium-sized businesses, we believe this series will continue to meander higher in coming months.

Housing credit should have moderated last month, however. This will owe to a combination of higher market interest rates, the end of the government's expanded first home owners' grant on December 31, and the introduction of caps on the original grant of A$7,000 on January 1 this year. Housing credit growth should have eased to 0.6%m/m, after holding steady at 0.7% for the four months prior. Personal credit growth should have accelerated, albeit mildly, to 0.5%m/m from 0.4%m/m previously.

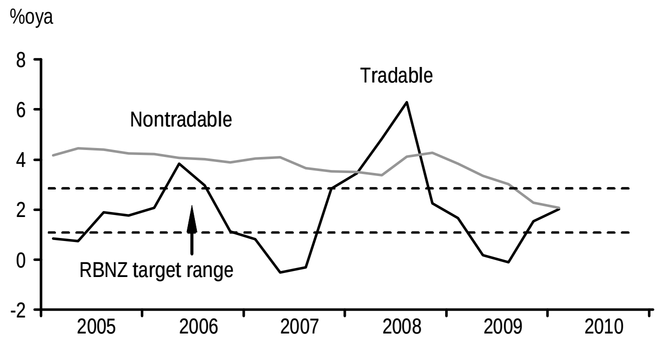
RBNZ on hold, but will adjust guidance

We expect the RBNZ to leave the OCR steady at a record low 2.5% on Thursday, but the commentary accompanying the decision will offer more for market pundits to chew on. As flagged in *GDW* recently ("RBNZ to tweak rhetoric in April policy statement," April 16), we suspect that Governor Bollard will step away from the current policy guidance, which suggests that the policy stimulus in place may be removed "around the middle of 2010."

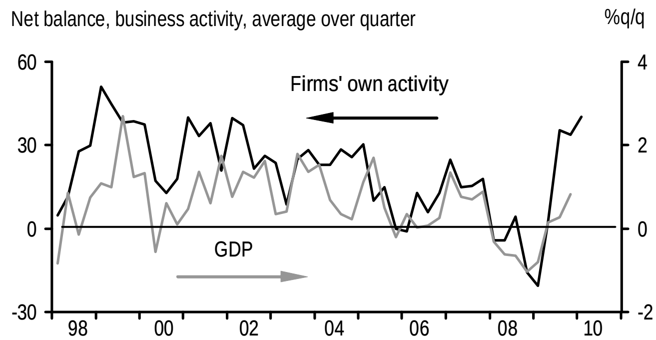
In the wake of the disappointing economic data, the RBNZ will likely be concerned that economic conditions will not support a rate hike around midyear, so we expect it to drop an explicit reference to the likely timing of the first hike. By laying the foundation for a later-than-June move next week, Governor Bollard will allow himself greater flexibility when making future policy decisions.

We maintain that the first 25bp rate hike will be delivered in July. Governor Bollard wants hard evidence that the recovery is sustainable, so, in our view, will remain on the

New Zealand: nontradable and tradable inflation



New Zealand: NBNZ business outlook survey and GDP



policy sidelines until after the late-June release of the 1Q GDP report. The RBNZ will be reluctant to leave the cash rate too low for too long, however, given the deteriorating inflation outlook. Our forecast is for headline inflation to print consistently above the RBNZ's 1%-3% target range in 2011, but the risks are skewed to the upside if inflation expectations begin to rise. This is possible given the upcoming introduction of the amended Emissions Trading Scheme (July 1) and the likely GST hike (October 1).

NZ CPI spiked up in 1Q on food and fuel

Inflation in New Zealand spiked up in 1Q, owing to higher food costs and a rise in gasoline prices. Consumer prices rose 0.4%q/q (J.P. Morgan and consensus: 0.6%), after falling 0.2% in the previous three months. This left annual inflation at 2.0%, remaining at the midpoint of the RBNZ's target range for the second straight quarter.

The details showed that food prices were up 1.0%q/q in 1Q, after slumping 2.4% in 4Q. This owed mainly to higher grocery prices, with prices for milk, cheese, and butter rising significantly over the quarter. Large price rises also were recorded in fruit and vegetables. Thanks to higher gasoline prices, prices in the transport group were up 1.1%. Gasoline prices surged 6.9% over the quarter to an 18-month high. Had gasoline prices remained steady in 1Q, the CPI would have recorded no change. Prices in the re-

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ception and culture group, and in the education group, posted the largest falls, both declining 1.4%q/q.

Kiwi firms soothed by global calm

The NBNZ's measure of business confidence will likely have risen in April, owing mainly to the fact that global financial jitters have eased. The NBNZ business confidence index should rise to an elevated net balance of 44.0 from 42.5 in March. This result would indicate that the percentage of respondents surveyed this month who expected economic conditions to improve over the next year exceeded the percentage expecting a decline by 44%.

Signs that the recovery under way in New Zealand shed some momentum early this year will have weighed, however, on the all-important reading of firms' own activity, which came in at 38.6 in March. Nevertheless, this reading continues to track our solid GDP growth forecasts. In the opening two quarters of this year, we forecast GDP growth of 0.8%q/q, followed by growth of 0.9% in 3Q and 0.7% in 4Q.

Australia:

Data releases and forecasts

Week of April 26 - 30

From Apr 23 11:30am

NAB business confidence

sa

	2Q09	3Q09	4Q09	1Q10
% balance	-4	16	18	—

Tue Apr 27 11:30am

Producer price index

% change

	2Q09	3Q09	4Q09	1Q10
%oya	2.1	0.2	-1.5	-0.6
%q/q	-0.8	0.1	-0.4	0.6

The rise in producer prices in 1Q will owe to higher gasoline prices. The PPI numbers do not feed directly into our CPI model.

Wed Apr 28 11:30am

Consumer price index

% change

	2Q09	3Q09	4Q09	1Q10
Headline				
%oya	1.5	1.3	2.1	2.8
%q/q	0.5	1.0	0.5	0.8
Core (trimmed mean)				
%oya	3.6	3.2	3.2	3.0
%q/q	0.9	0.8	0.6	0.7

Fri Apr 30 11:30am

Private sector credit

sa

	Dec	Jan	Feb	Mar
%m/m	0.3	0.4	0.4	0.5
%oya	1.5	1.3	1.6	1.9

Review of past week's data

WMI leading index

	Dec		Jan		Feb	
%m/m sa	~~0.6~~	*0.7*	~~0.2~~	*0.4*	—	*0.5*

Sales of new motor vehicles

Units, sa

	Jan		Feb		Mar	
%m/m	~~-3.5~~	*-3.2*	-1.9		—	*-2.7*
%oya	15.5		~~17.1~~	*17.3*	—	*19.2*

Export price index

	3Q09	4Q09	1Q10	
Index, nsa	150.5	148.0	~~154.8~~	*153.6*
%q/q nsa	-9.6	-1.7	~~4.6~~	*3.8*
%oya nsa	-20.7	-32.7	~~-26.2~~	*-26.8*

Import price index

	3Q09	4Q09	1Q10	
Index, nsa	120.9	115.7	~~114.4~~	*116.0*
%q/q nsa	-3.0	-4.3	~~-1.2~~	*0.3*
%oya nsa	-2.3	-15.5	~~-14.2~~	*-12.9*

New Zealand:

Data releases and forecasts

Week of April 26 - 30

Wed Apr 28 3:00pm

NBNZ business confidence

	Dec	Feb	Mar	Apr
% balance of respondents	38.5	50.1	42.5	44.0

Thu Apr 29 9:00am

RBNZ cash rate announcement

No change expected.

Thu Apr 29 10:45am

Trade balance

nsa

	Dec	Jan	Feb	Mar
Trade balance (NZ$ mn)	-28	263	321	400

Review of past week's data

Consumer price index

	3Q09	4Q09	1Q10	
Headline (%oya nsa)	1.7	2.0	~~2.2~~	*2.0*
Headline (%q/q nsa)	1.3	-0.2	~~0.6~~	*0.4*

Net permanent immigration

	Jan	Feb	Mar	
Monthly (000s, nsa)	2.5	2.6	—	*-0.3*
12-month sum (000s, nsa)	22.6	21.6	—	*21.0*

Credit card spending

	Jan		Feb		Mar	
%oya	~~2.6~~	*2.8*	~~1.1~~	*1.2*	~~1.0~~	*6.3*

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Greater China

- **China: sustained twin surpluses in 2009 balance of payments report; steady adjustment in CAB**
- **Hong Kong: CPI inflation eased in March; unemployment rate fell further in January-March**
- **Taiwan: some easing in March export orders and IP, but trend solid; unemployment edged down**

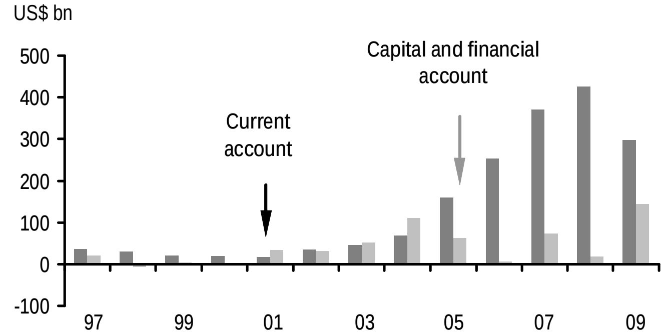
China's State Administration of Foreign Exchange (SAFE) this week released the 2009 balance of payments figures. As largely expected, the twin surpluses in the current account adn in the capital and financial accounts continued for the eleventh consecutive year. In particular, the current account surplus retreated to US$297.1 billion in 2009, a decline of 30.3% compared to the surplus of US$426.1 billion in 2008. As China's exports fell notably from the global recession, imports held up better, leading to the 30.8% annual decline in the merchandise trade surplus last year. The deficit on the services account widened significantly in 2009, to US$29.4 billion, while the surplus on the income account increased further, to $43.3 billion, supported by steady returns on China's growing external assets. Looking ahead, while China's current account will remain in surplus (the structural factors behind China's trade surplus remain largely intact), the gradual downward adjustment in the absolute level of the surplus is likely to continue. Indeed, we expect the country's trade surplus to narrow further this year (see "China: 2010 trade balance should still be in surplus," *GDW*, April 16).

Hong Kong: CPI inflation eased in March

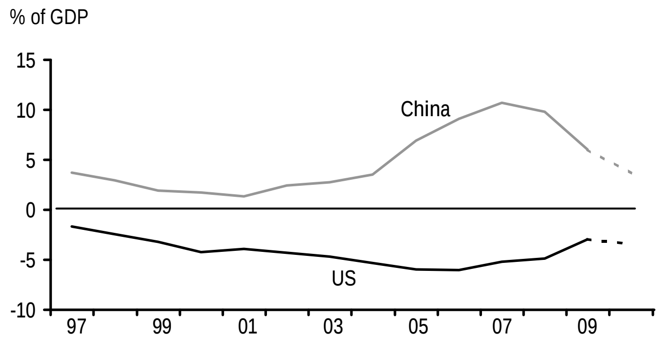
Hong Kong's March headline CPI rose 2.0%oya, slowing from February's increase of 2.8%oya. Netting out the effects of all government fiscal relief measures, the underlying inflation rate edged up to 0.8%oya in March, compared to a 1.6%oya rise in February, translating into a decline of 1.0%m/m sa. (The headline inflation rate with the relief measures has been higher than the underlying rate since late 2009 as the fiscal relief measures are being withdrawn.) Food prices increased only 1.3%oya in March, compared to a 2.5%oya rise in February, driven mainly by lower prices of meals away from home. Housing prices increased 0.1%oya in March, compared to an increase of 0.2%oya in February. Meanwhile, the consumer durable goods and clothing sectors posted declines of 1.7%oya and 1.1%oya, respectively.

As the impact of various government relief measures gradually fades, and the economic recovery gains momen-

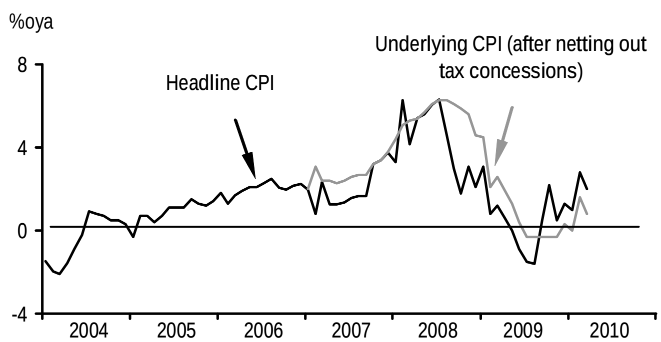
China: balance of payments



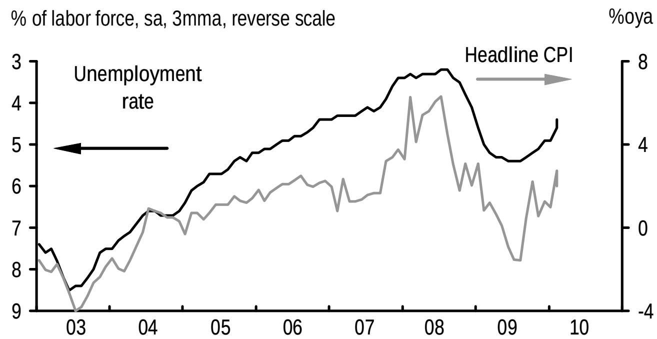
China and US current account balances



Hong Kong: headline CPI and underlying CPI



Hong Kong: unemployment and CPI inflation



tum, Hong Kong's underlying CPI inflation is likely to continue a gradual uptrend in 2010; however, we do not expect to see the rate increase substantially in the near future. The latest unemployment data and payroll statistics suggest a continued, yet modest, recovery in the labor market. Therefore, there is unlikely to be a sharp rise in inflation stemming from domestic cost pressures. Nevertheless, volatility in the price of imported goods, such as fuel, could generate certain risks to the import-price inflation outlook.

Unemployment rate fell further

Hong Kong's unemployment rate for the January-March period fell slightly, to average 4.4% sa compared to 4.6% for the three months ending February. The number unemployed fell by an average of 8,700 people sa in January-March. Meanwhile, total employment posted a decline of 43,600 sa in the three months ending March, after a sizable gain of 55,600 people during the December-February period. Monthly volatility aside, the underlying trend in total employment has expanded further at 3.1%3m/3m saar through March. The total labor force fell 54,000 in the three months ending March. The data show that the unemployment rate fell in the insurance, arts, entertainment and recreation, and information and communication sectors.

Looking ahead, we expect Hong Kong's solid economic recovery to continue this year. On the external side, the recovery of the global economy should boost regional demand, and with it Hong Kong's trade sector. On the domestic front, this year should see improving business sentiment and steady growth in tourism and financial activity. The optimistic outlook in various crucial sectors is likely to further strengthen the labor market, thereby boosting household income and consumption.

Taiwan: modest easing in March export orders and IP

Taiwan's March export orders expanded 43.7%oya, compared to 36.3%oya growth in February. Seasonally adjusted, export orders fell 1.1%m/m sa in March, on the back of the 5.6%m/m gain in February, with the sequential trend expanding at a solid pace of 47.1%3m/3m saar. March IP rose at 39.2%oya, compared to 35.2%oya growth in February. Seasonally adjusted, IP fell modestly, by 0.6% m/m in March, on the back of the 2.6% m/m gain in February, with the sequential trend up 31.7% 3m/3m saar.

The solid growth momentum in Taiwan's industrial activity in the past 12 months has been consistent with the recovery of global manufacturing cycle, especially for the tech sec-

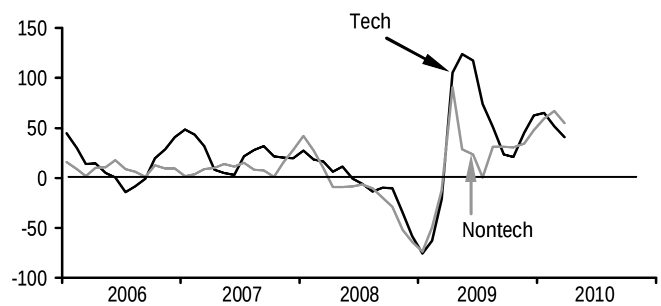
Hong Kong: labor force survey

% of labor force, sa, 3mma

000 persons, sa, 3mma

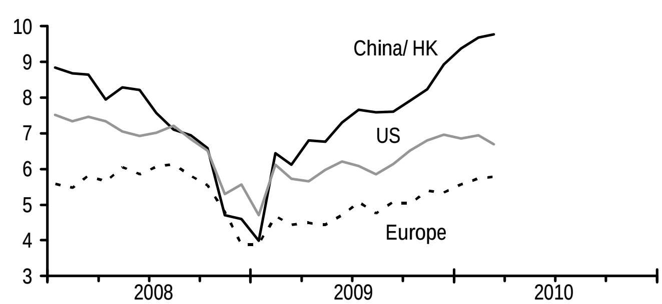
Taiwan: export orders

%3m/3m, saar



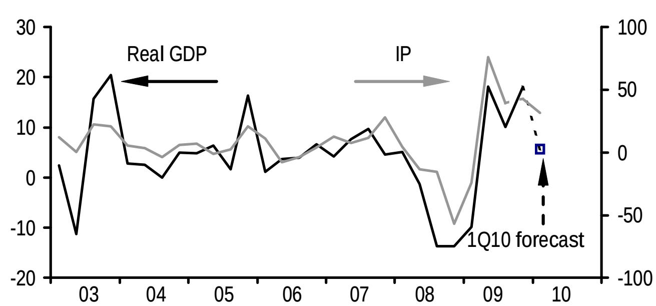
Taiwan: export orders by region

US$ bn, sa



Taiwan: real GDP and IP

%q/q, saar, both scales



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tor. Looking ahead, our global team is looking for the manufacturing sector to continue with solid expansion in the coming months, considering the broadening of the global recovery, the constructive outlook on the global capex cycle and consumer demand, the bottoming and turnaround in the inventory cycle, and the promising outlook on the tech sector. These factors should all support solid growth in Taiwan's export sector, and hence of IP, in the coming months, though the pace of sequential growth may begin to ease somewhat from the sharp rebound seen in the past 12 months. Our forecast for Taiwan's 2010 real GDP growth stands at 8.2%.

- Tech orders fell 1.2%m/m sa in March, on the back of the 2.4%m/m gain in February, with the sequential trend rising 40.7%3m/3m saar. Orders for telecom and information products, including notebook computers, fell a notable 5.4%m/m sa in March, while orders for precision products jumped 6.3%m/m sa. Orders for electronics products, including consumer electronics and semiconductors, edged up 0.1%m/m sa in March. Nontech orders gained modestly by 0.5%m/m sa in March (up 54.9%3m/3m saar).

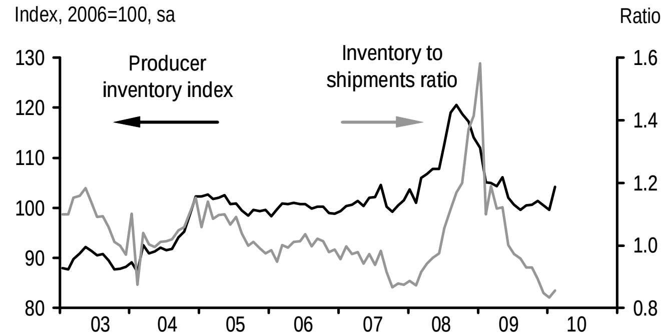
- Sources of demand details show a notable correction in orders from the US, down 3.6%m/m sa in March, bringing the sequential trend down to a mere 4.3%3m/3m saar through March. Orders from Japan were largely flat while orders from China/Hong Kong (up 0.8%m/m sa in March) and Europe (up 0.7%m/m sa) gained further last month.

- The latest data show that the Taiwanese manufacturing sector's total inventory jumped 4.5% m/m sa in February (up 2.4% 3m/3m saar). Meanwhile, shipments continued to rise at a solid pace, up 1.6% m/m sa, with the sequential trend rising at an elevated 41.6% 3m/3m saar. The overall inventory to shipments ratio thus held around the its historical low (first chart). This suggests that as final global demand continues to improve, the inventory cycle should be a positive factor for headline GDP growth.

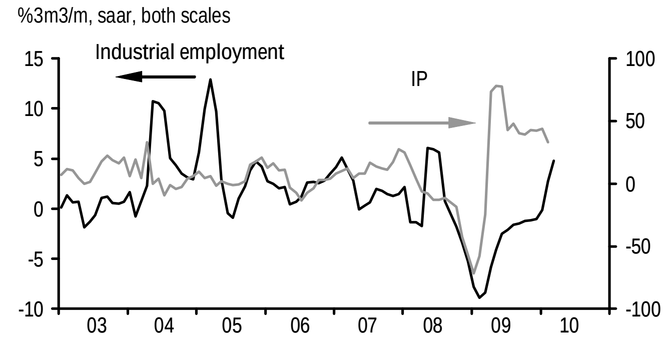
Steady improvement in labor market

Taiwan's unemployment rate edged down fractionally to 5.64% sa in March, compared to 5.65% in February. Smoothing out Lunar New Year volatility, the underlying trend in total employment rose 3.8%3m/3m saar in March. Meanwhile, total unemployment fell 14.3%3m/3m saar in March. The steady, solid expansion in total employment since 3Q09 has been largely in line with the broad-based recovery in the overall economy.

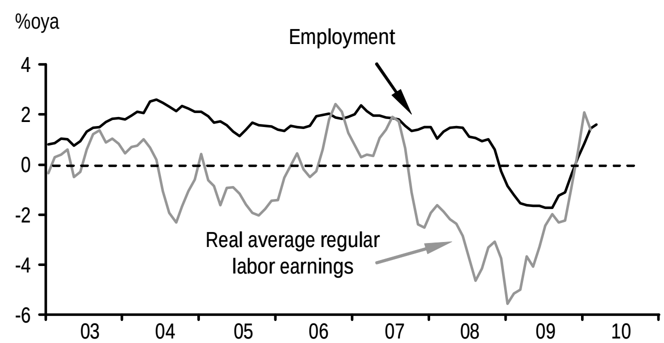
Taiwan: producer inventory and shipments



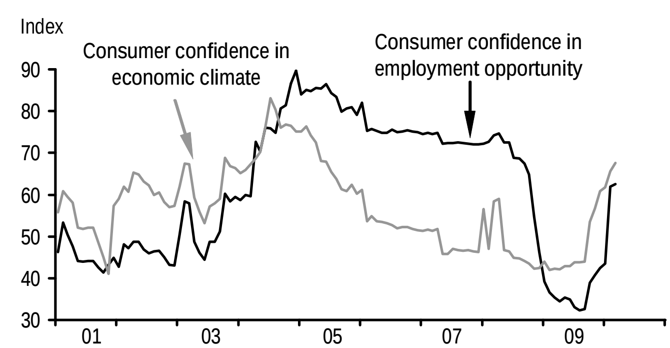
Taiwan: IP and industrial employment



Taiwan: employment and real labor earnings



Taiwan: consumer confidence index – six-month outlook



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Looking ahead, Taiwan manufacturers, especially tech producers, should continue to boost their capex plans and increase hiring through this year, on the back of improving conditions for external demand, especially given the constructive outlook for the global capex cycle (for instance, equipment investment in the US is expected to expand at a solid 10%-12% annualized pace in the coming quarters). On the domestic front, general confidence in the overall economic outlook has increased notably, with steady improvement in the services sectors. As such, we believe the labor market will continue to improve steadily this year, supporting private consumption demand in the coming quarters.

- Industrial employment growth picked up significantly in the past four months, rising 4.8%3m/3m saar in March, helped by the upturn in the export sector. Furthermore, employment in the service sectors began to improve earlier in this recovery, registering solid monthly gains since May 2009, though the pace of expansion has moderated of late, up 1.9%3m/3m saar in March.

- Average monthly regular labor earnings, which had fallen steadily since 3Q08, began to stabilize in recent months, with real average employment income registering positive growth at 1.4%oya in February.

- Perhaps unsurprisingly, the most recent surveys suggest that household confidence in employment opportunities and the general economic climate six months ahead jumped markedly through March.

China:

Data releases and forecasts

Week of April 26 - 30

Review of past week's data

No data released.

Hong Kong:

Data releases and forecasts

Week of April 26 - 30

Tue Apr 27 4:30pm — Merchandise trade
HK$ bn

	Dec	Jan	Feb	Mar
Balance	-33.4	-29.5	-19.7	-37.1
Exports	224.8	222.3	182.5	226.0
%oya	9.2	18.4	28.5	28.8
Imports	258.3	251.8	202.1	263.1
%oya	18.7	39.5	22.4	35.9

Review of past week's data

Labor market survey (April 20)
sa, 3mma

	Jan	Feb	Mar
Unemployment rate % avg	4.9	4.6	~~4.5~~ *4.4*
Employed ch, m/m, 000 persons	7.6	56.5	~~5.3~~ *43.6*

Consumer prices (April 22)
%change

	Jan	Feb	Mar
%oya	1.0	2.8	~~1.9~~ *2.0*
%m/m sa	0.2	2.3	~~-1.3~~ *-1.6*

Taiwan:

Data releases and forecasts

Week of April 26 - 30

Tue Apr 27 4:00pm — Composite leading indicator
% change

	Dec	Jan	Feb	Mar
M/m sa	1.5	1.9	0.6	__

Review of past week's data

Export orders (Apr 20)
% change

	Jan	Feb	Mar
Oya	71.8	36.3	~~42.9~~ *43.7*
M/m sa	2.4	5.5	~~-0.8~~ *-1.1*

Labor market survey (Apr 22)
%

	Jan	Feb	Mar
Unemployment rate, sa	5.7	5.7	5.6
Unemployment rate, nsa	5.7	5.8	~~5.6~~ *5.7*

Industrial production (Apr 23)
% change

	Jan	Feb	Mar
Oya	70.1	35.2	~~40.9~~ *39.2*
M/m sa	1.8	2.6	~~1.0~~ *-0.6*

Korea

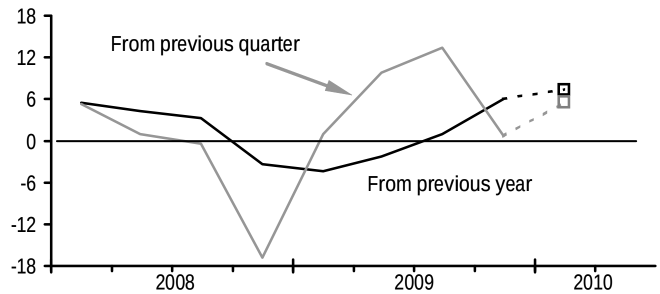
- **Growth optimism continues**
- **Next week: 1Q GDP, March IP, and composite leading index**

The data calendar remained light this week, but initial estimates for the first 20 days of customs trade suggest that Korea's exports stayed relatively firm. This was despite the temporary disruption to semiconductor exports; semiconductor shipments are mostly made by air and were therefore hit by the recent disruption to air traffic in Europe. The final month's outcome is likely to be better than the first 20 days' estimate given that exports are more concentrated in the last week of the month and that European airspace appears to have returned to more normal service.

Meanwhile, next week will bring a clutch of data to round out 1Q activity figures. Overall, most reports should show that growth momentum firmed through March, with key, forward-looking surveys remaining at elevated levels.

Real GDP

%change, annualized, boxes show J.P. Morgan forecast for 1Q10



NSO composite leading indicators

%m/m sa, box shows J.P. Morgan forecast for March

1Q10 real GDP

Real GDP should have increased strongly in 1Q, accelerating to 5.6%q/q saar from 0.7% in 4Q09, with manufacturing activity advancing the most, but service activity staying firm as well. However, the construction sector should have softened, notably residential, with regulatory moves restricting housing demand and slowing transactions, while small-sized construction firms have experienced a deterioration in cash flow. We also expect that agricultural output fell in 1Q, as weather conditions remained unfavorable. The wild card is public sector construction activity. Based on monthly data reports of construction orders and completions, public construction looks to have softened in 1Q, but this week's release of 1Q fiscal progress poses some upside risks to our forecast. On the expenditure side, the main contribution to 1Q GDP should have come from net exports.

March IP and producers' inventories

Industrial production likely stayed almost flat in March, after rising strongly in February. High-tech sectors probably paused after having been boosted by inventory accumulation in February, offsetting continued gains in the auto sector. Producers' shipments should have moved higher, also due to some inventory correction.

Balance of payment position

The current account surplus is estimated to have widened in March, with the merchandise trade surplus increasing significantly. The service balance, too, likely improved, with seasonal outbound travel fading. A partial offset would be the income accounts, which likely dipped into deficit during the month as dividend pay to overseas investors is usually concentrated in the March-April period. Meanwhile, the capital account position is expected to have improved in March as rising global risk appetite boosted foreign investment in local bonds and equities.

Composite leading index and surveys

The National Statistics Office will release composite leading indicator data, which are forecast to edge higher in March, recovering some of February's decline. Sentiment indices may have fallen slightly further, but should be more than offset by other components such as conditions in the job market, capital goods imports, and financial indicators. Meanwhile, the Bank of Korea's two key survey reports will show both consumer and business sentiment at levels consistent with continued economic expansion. However, consumer sentiment could still be dampened by the crash of a naval ship in late March, which gripped public interest due to the high number of deaths, an extensive investigation into the cause, and the possibility of North Korean involvement.

Data releases and forecasts

Week of April 26 - 30

Week of Apr 26

FKI business survey

100=neutral reading, nsa

	Jan	Feb	Mar	Apr
One-month-ahead outlook	102.3	116.2	111.2	120.0
Current conditions	99.2	98.7	113.1	112.0

On a seasonally adjusted basis, business sentiment is likely to stabilize at well above neutral levels in April, with the recovery ongoing both at home and abroad.

Tue Apr 27 6:00am

Consumer survey

100=neutral reading, nsa

	Jan	Feb	Mar	Apr
Index	113	111	110	108

Consumer sentiment likely pulled back in April, with the news on a sunken naval warship weighing on consumers. Still, the index remains at a fairly high level.

Tue Apr 27 8:00am

Real GDP first estimate

% change

	2Q09	3Q09	4Q09	1st 1Q10
%oya	-2.2	1.0	6.0	7.4
%q/q saar	9.8	13.4	0.7	5.6

See main story.

Wed Apr 28 8:00am

Current account

US$ bn nsa

	Dec	Jan	Feb	Mar
Balance	1.5	-0.4	0.2	1.2

Fri Apr 30 8:00am

Industrial production

% change

	Dec	Jan	Feb	Mar
%oya	34.2	36.9	19.1	21.0
%m/m sa	2.4	0.0	3.6	0.1

Fri Apr 30 8:00am

Producer shipments and inventories

%oya

	Dec	Jan	Feb	Mar
Shipments	26.2	32.0	14.3	16.5
Inventories	-8.0	-3.8	4.7	4.0

Producers' inventories likely edged lower after rising significantly in February. See also main story.

Fri Apr 30 8:00am

Consumption goods sales

% change

	Dec	Jan	Feb	Mar
%oya	12.7	6.8	12.9	9.0

Consumption goods sales are anticipated to have declined in March, partially reversing February's gains resulting from the lunar holiday.

Fri Apr 30 8:00am

Composite leading indicator

2005=100, sa

	Dec	Jan	Feb	Mar
Index	127.0	127.4	127.1	127.3

Fri Apr 30 8:00am

Service activity

%change

	Dec	Jan	Feb	Mar
%oya	7.2	4.3	7.1	7.3

Review of past week's data

Bankruptcy filings (Apr 19)

	Jan	Feb	Mar
Bankruptcy filings	141	111	~~125~~ *144*
Dishonored bill ratio	0.03	0.03	~~0.03~~ *0.02*

Housing prices (Apr 23)

% change from previous week, apartment prices only

Week of Apr 5	Apr 12	Apr 19
0.0	0.0	__ *0.0*

BoK Watch

- **Governor offers no hint of near-term action**

The Bank of Korea's new governor, Kim, in a meeting with private sector research institutions, stated that the economy is expected to remain in recovery, but risks persist both at home and abroad. He also raised some concern over the elevated level of unsold home units, a shift from the Bank's traditional concern over housing inflation, and just as we had anticipated (see "Bank of Korea: tracking policy aims of the new MPC," *GDW*, March 19).

Interest rates

% p.a.

	Apr 1	Apr 8	Apr 15	Apr 22
Overnight call	1.99	2.00	2.00	2.00
3-month CD fixing	2.78	2.53	2.45	2.45
1-year MSB	2.67	2.68	2.73	2.72
3-year treasury bond	3.84	3.74	3.85	3.77
3-year corporate bond	4.84	4.74	4.79	4.62

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

- **Malaysia stages solid recovery into 1Q10**
- **Bank Negara has begun to normalize policy—revising up our policy rate outlook**
- **Watching inflows and BNM's balance sheet**

High-frequency data from Malaysia remain strong. The recent production and export prints continue to convey the theme that external demand has firmed into 1Q10, and the forward-looking indicators, as conveyed by the global PMI data, remain positive. Moreover, domestic demand indicators since 2Q09 have been on a solid upward trajectory and, together with strong credit growth data, suggest that the underlying momentum remains firm.

The strength of the data, together with the very accommodative monetary policy settings, prompted Bank Negara Malaysia (BNM) to begin to normalize monetary policy settings in March. We expect that the policy normalization process will be front-loaded, with policy rates expected to reach 3% by 3Q10, and pencil in a 25bp hike at each of the next three policy meetings. This forecast has been revised up from an expectation of policy rates reaching 2.75% by the end of 2010. Aside from policy rates, the central bank has already normalized the exchange rate, which, in nominal effective terms, is back to pre-crisis levels. Moreover, with Malaysia expected to be a proxy for regional appreciation, inflows are likely to remain strong over the course of 2010. BNM, learning lessons from the 2006-07 episode when inflows were particularly strong, appears ready to deal with inflows through a combination of active sterilization and recycling local currency back into foreign currency.

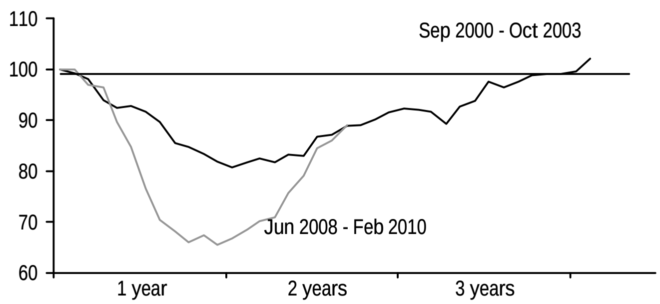
Demand firing on all cylinders

Recent high-frequency data remain upbeat—exports are now returning to pre-crisis levels after a strong recovery since 2Q09, which has been led by electronics. The recent recovery has traced a trajectory that is even stronger than the recovery seen in the previous recession (first chart). In addition to external demand, domestic demand has also recovered smartly. Indeed, the downturn in domestic demand was, on balance, more modest than the downturn experienced in the external sector, but the pace of recovery appears to be just as rapid as that seen in the external sector (second chart).

Moreover, domestic credit data continue to be strong, with credit expansion in February up 10%oya, driven in particular by nonconsumer credit, which is a catch-all for corporate-related borrowing (third chart).

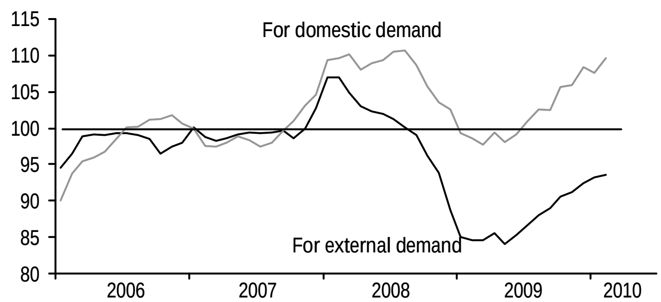
Malaysia: exports around recessions

Month of export peak =100, 3mma, sa, US$ terms



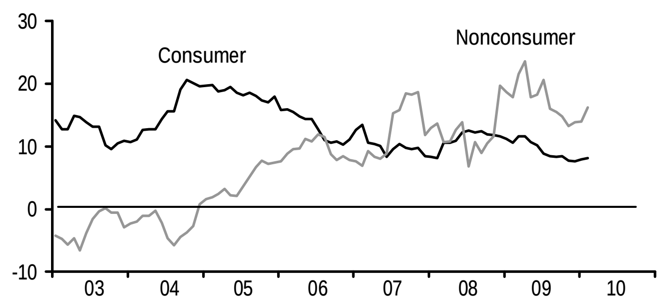
Malaysia: industrial production

2007=100, 3mma, sa



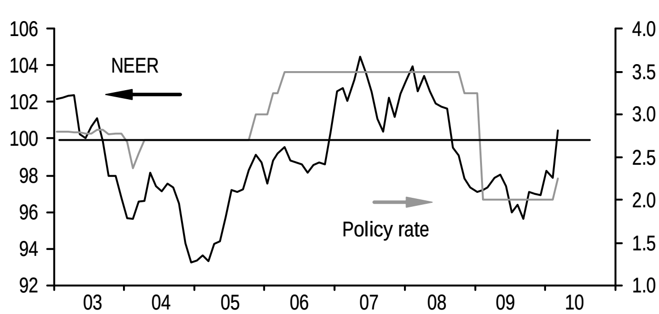
Malaysia: term loans

%oya, local currency terms



Malaysia: nominal effective exchange rate and policy rate

Index, 2000=100 % p.a.



BNM begins journey to normalcy

With the recent data flow as strong as it has been, the need for the monetary authorities to keep policy settings accommodative becomes less necessary. So, on March 4, BNM began normalizing policy rates while simultaneously permitting the currency to appreciate in nominal effective terms, returning it to pre-crisis levels (fourth chart previous page). With FX normalization near completion, policy rates still have room to rise. As the trajectory for economic activity is likely to remain firm, the normalization in policy rates should be front-loaded to restrict financial excesses. Policy rates were perceived as accommodative even at 3.5% in 2008, and this suggests that neutral rates should hover between 3% and 4%. If this is correct, policy rates may rise further, and the forecast now assumes the OPR (overnight policy rate) will reach 3% by 3Q09, implying a 25bp hike at each of BNM's next three policy meetings.

BNM's sterilization has been eclectic

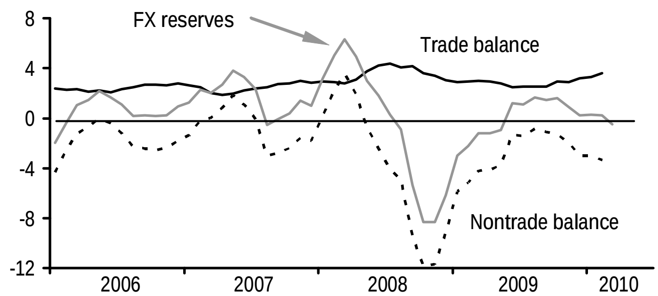
This normalization in rates, together with the expected appreciation of MYR in line with the likely revaluation of regional currencies, should lead to strong inflows to Malaysia. However, FX reserves through March have effectively remained flat even when adjusted for valuation effects. This suggests that nontrade-related outflows have stayed high into 1Q10 (first chart). Nonetheless, the potential strength of inflows and the persistence of the current account surplus should see FX reserves rise into 2Q10.

Bank Negara is familiar with dealing with these inflows. The strength of inflows between 2003 and 2008 was fully sterilized, reflected in the modest increase in high-powered money even when foreign assets were climbing sharply (second chart). This gain in net foreign assets was almost fully offset by a contraction in net domestic assets. What is perhaps more interesting is the nature of BNM's sterilization operations. Between 2004 and 2006, BNM relied on three main tools; issuing its own debt, BNMN (Bank Negara Monetary Notes); FX forwards; and taking deposits from the banking system (third chart).

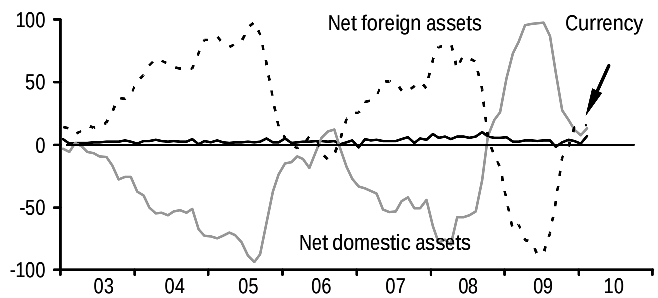
BNM recycling liquidity

This last tool is of particular interest. Starting in 2006, BNM effectively recycled MYR liquidity from its sterilization operations into foreign currency, placing these with other banks (fourth chart). This recycling helped to mitigate pressure on the FX rate and also provided a useful conduit to ease the pressure from its sterilization operations. This FX recycling should help ease the pressures on BNM in the coming months from the expected rise in inflows to the region.

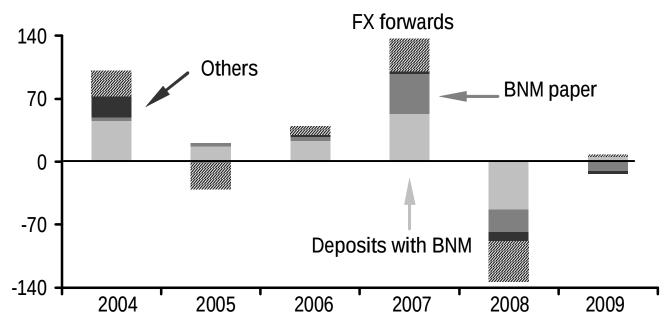
Malaysia: balance of payments
US$ bn, 3mma, nsa



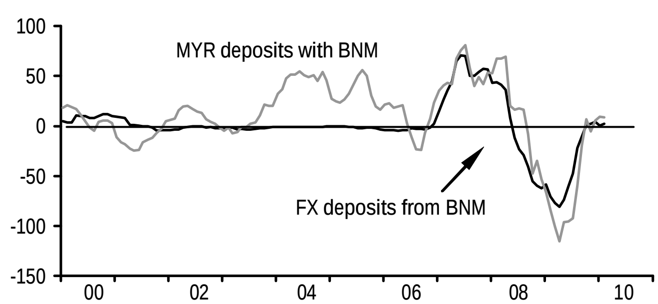
Malaysia: sources of high-powered money
MYR bn, oya changes



Malaysia: Bank Negara sterilization
MYR bn



Malaysia: Bank Negara deposits
MYR bn, oya changes



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Indonesia:

Data releases and forecasts

Week of April 26 - 30

No data releases.

Review of past week's data

No data released.

Malaysia:

Data releases and forecasts

Week of April 26 - 30

No data releases.

Review of past week's data

Consumer prices (Apr 21)
% change

	Jan	Feb	Mar
Oya	1.3	1.2	~~1.4~~ *1.3*
M/m sa	0.3	0.0	~~0.2~~ *-0.3*

March inflation in Malaysia eased, with headline inflation up a lower-than-expected 1.3%oya (consensus 1.5%oya) and down 0.3%m/m sa on the month. Core inflation, excluding food and transport costs, rose 1.3%oya and was down 0.7%m/m sa. The decline in inflation owed to a decline in energy, clothing, and food prices. In sequential trend terms, headline inflation moderated to 4.6%3m/3m saar from 5.8% in February while core inflation moderated to 1.9%3m/3m saar from 2.8% in February.

In the coming months, base effects from the fall in prices in 2009 will begin to be reflected in the over-year-ago data and could distort the underlying inflation trend. These base effects are expected to add 1.4%-pts to the over-year-ago print in 2Q10. Thus, the main focus in underlying inflationary trends should be on the sequential data rather than the over-year-ago numbers. See main story.

Philippines:

Data releases and forecasts

Week of April 26 - 30

Tue
Apr 27
9:00am

Merchandise trade
US$ bn nsa

	Nov	Dec	Jan	Feb
Imports	3.6	3.9	3.8	3.8
%oya	4.1	17.9	30.3	23.0

Imports likely remained steady in February, which would still leave growth strong.

Review of past week's data

BSP monetary policy meeting (Apr 22)
% p.a.

	Feb	Mar	Apr
Reverse repo rate	4.00	4.00	*4.00*

The BSP kept the policy rate unchanged, but its more hawkish tone and decision to reduce the budget of the rediscount facility to PHP20 billion from PHP40 billion suggest that a rate hike is coming soon. We continue to expect a 25bp rate hike in June, followed by another 75bp of tightening in 2H10.

The BSP's decision to reduce the rediscount facility's budget was expected, and it has gradually lowered the budget from a record high of PHP60 billion over the last several months. The budget now stands at PHP20 billion, which is where it was prior to the expansion in late 2008 and early 2009. The rediscount facility is a rarely used standing facility to extend loans and advances to banks; the BSP's actions so far to "drain liquidity" have been mostly symbolic.

Singapore:

Data releases and forecast

Week of April 26 - 30

Mon
Apr 26
1:00pm

Industrial production
% change

	Dec	Jan	Feb	Mar
Oya	15.4	39.2	19.1	38.9
M/m sa	14.0	11.0	5.9	-4.0

IP likely took a breather after three months of strong gains but we do not see this as a concerning trend.

Fri
Apr 30
10:00am

Unemployment
%

	2Q09	3Q09	4Q09	1Q10
Unemployment rate, sa	3.3	3.4	2.1	2.3

The unemployment rate declined by an unusually large amount in 4Q09. In past recoveries, the unemployment rate has declined in a choppy manner. So there should also be some choppiness along the way down this time as stronger hiring conditions attract more workers into the labor force.

Review of past week's data

Consumer prices (Apr 23)
% change

	Jan	Feb	Mar
Oya	0.2	1.0	~~1.4~~ *1.6*
M/m sa	0.4	0.6	~~0.3~~ *0.5*

The CPI rose 0.5%m/m sa in March, leaving the over-year-ago figure up less than expected at 1.6% (consensus 1.8%). The sequential trend rate rose for the third straight month to 5.8%3m/3m saar. The over-year-ago rate now stands at its

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highest point since early 2009 and is likely to rise over most of the year. The rise in inflation in recent months has mostly reflected higher transport, food, and housing costs while other components have generally remained subdued.

Thailand:

Data releases and forecasts

Week of April 26 - 30

Fri
Apr 30
2:30pm

Merchandise trade

US$ bn nsa

	Dec	Jan	Feb	Mar
Trade balance	-0.1	0.6	0.5	1.4
Exports, %oya	26.2	31.3	23.1	40.9
Imports, %oya	33.0	50.0	80.8	58.5

External demand likely remained strong in March though there is some likelihood that the recent protests may have slowed domestic demand, which could result in a larger trade surplus by restraining imports. If so, net exports may help offset some of the weakness in domestic demand.

Fri
Apr 30
2:30pm

Manufacturing production

% change

	Dec	Jan	Feb	Mar
Oya	36.1	29.0	30.3	27.7
M/m sa	10.8	-5.2	3.3	0.7

Production likely expanded on continued strength in external demand which has helped to mask some softness in production for domestic demand.

Fri
Apr 30
2:30pm

Private consumption index

% change

	Dec	Jan	Feb	Mar
Oya	4.0	4.8	9.7	6.9
M/m sa	0.7	-0.5	0.3	0.0

Private consumption likely slowed in March owing to the impact of the protests on discretionary spending.

Fri
Apr 30
2:30pm

Private investment index

% change

	Dec	Jan	Feb	Mar
Oya	-1.7	5.9	11.4	14.6
M/m sa	2.4	2.3	1.6	0.5

Private investment was buffered from the impact of the protests by the strength in external demand, which should continue to bolster demand from the externally oriented industries.

Review of past week's data

BoT monetary policy meeting (Apr 21)

% p.a.

	Feb	Mar	Apr
One-day repo rate	1.25	1.25	*1.25*

The Bank of Thailand (BoT) held its policy rate at 1.25% as widely expected. In its statement, the BoT was clear that the political situation is the reason for remaining on hold as it is the "key factor clouding the economic outlook." Otherwise, the BoT noted that macroeconomic stability continues, the economy shows signs of robust growth, and core inflation is projected to rise.

Bloomberg reported that the central bank stated that "rate normalization will be the next step." Core inflation rose 0.4%oya in March, below the BoT's 0.5% to 3.5% target range, but we expect it to rise toward 2% by 3Q. CPI inflation is already at 3.4%oya and this will likely breach 5% by midyear. Assuming that the protests do not last for the next six weeks, we expect the BoT to begin the normalization process at its next meeting. Thus, we retain our forecast for a 25bp rate hike on June 2.

Vietnam:

Data releases and forecasts

Week of April 26 - 30

During
the week

Merchandise trade

US$ bn nsa

	Jan	Feb	Mar	Apr
Trade balance	-0.9	-1.3	-1.4	-1.6
Exports, %oya	31.1	-25.6	-3.0	26.3
Imports, %oya	79.3	21.1	28.9	28.7

Exports should bounce nicely in April, but imports will also likely remain strong. The rise in imports will likely be larger than the improvement in exports and thus the trade balance will likely deteriorate modestly.

Review of past week's data

Consumer prices

%oya

	Feb	Mar	Apr
All items	7.6	9.5	~~10.4~~ *9.2*
%m/m sa	1.5	1.1	~~0.9~~ *0.1*

The CPI rose 0.1%m/m sa in April, the most modest gain since June 2009 when the global economy was just starting to stabilize. This left inflation up 9.2%oya and 10.4%3m/3m saar.

We had expected inflation to rise to above 10%oya this month. The soft inflation print was a surprise and was completely due to a decline in food prices. Food prices fell 0.9%m/m sa after rising an average 1.3%m/m sa in the previous eight months. In terms of contributions to %oya inflation, the food and foodstuffs component fell 0.5%-pt compared to a 0.3%-pt decline in the headline rate. In other words, components outside of food continued to push inflation higher. This is consistent with the J.P. Morgan measures of core (ex food and energy) and nonfood inflation, which show price pressures outside of food still rising.

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Asia focus: inflation not likely to peak for several months

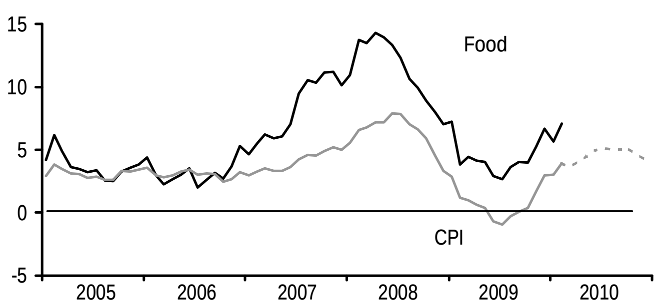
After bottoming at -0.9%oya in July last year, deflation eased in August and inflation returned to the region in September. And since printing 0.1%oya last September, inflation has risen consistently.

Inflation rose to 3.9%oya in February and is expected to continue to rise into 3Q. Currently, J.P. Morgan forecasts show inflation in EM Asia peaking at 5.1%oya in July before slowing gradually into year-end. The contours of this trajectory are consistent across the region, with inflation in EM Asia ex China and India also likely to peak in July before moderating into year-end, though it is expected to do so at a more modest 3.5%.

The extent to which our current forecasts will prove to be accurate depends partly on the strength of future growth and wage pressures emanating from tighter labor markets. However, it also will depend in large part on food and commodity prices given these components' large weightings in regional CPI baskets and volatile movements in recent years.

EM Asia: CPI and food prices

%oya



EM Asia: headline and food CPI inflation

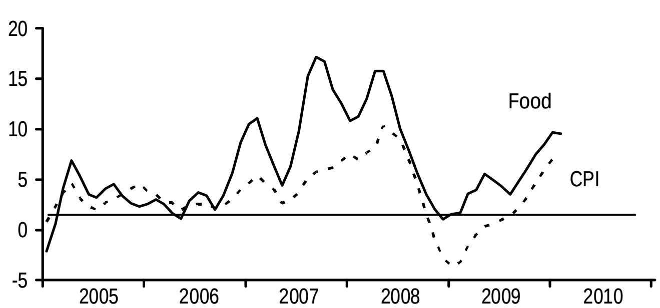
%oya except where noted; parathenses are food weights in CPI basket

	2007	2008	2009	Jan10	Feb	Mar
EM Asia CPI inflation	4.1	6.4	0.8	3.0	3.9	na
Food	8.2	11.4	4.4	5.7	7.1	na
Food contribution[1]	2.4	3.3	0.8	1.2	1.7	na
China CPI inflation	4.8	5.9	-0.7	1.5	2.7	2.4
Food (33.2)	12.4	14.6	0.8	3.7	6.2	5.2
Food contribution[1]	4.1	4.8	0.3	1.2	2.1	1.7
Hong Kong CPI inflation	2.0	4.3	0.5	1.0	2.7	2.0
Food (26.9)	4.3	10.1	1.3	-0.5	2.5	1.3
Food contribution[1]	1.2	2.7	0.4	-0.1	0.7	0.3
India WPI inflation	4.8	9.1	2.2	8.5	9.9	na
Food (15.4)	5.7	7.8	12.9	19.4	18.9	na
Food contribution[1]	0.9	1.2	2.0	3.0	2.9	na
Indonesia CPI inflation	6.0	9.7	4.9	3.7	3.8	3.4
Food (19.6)	11.4	16.9	7.2	4.9	4.8	4.1
Food contribution[1]	2.2	3.3	1.4	1.0	0.9	0.8
Korea CPI inflation	2.5	4.7	2.8	3.1	2.7	2.3
Food (14.0)	2.4	4.7	7.5	2.0	3.0	2.7
Food contribution[1]	0.3	0.7	1.1	0.3	0.4	0.4
Malaysia CPI inflation	2.0	5.4	0.6	1.3	1.2	1.3
Food (31.4)	3.0	8.8	4.3	1.2	1.3	1.7
Food contribution[1]	1.0	2.8	1.3	0.4	0.4	0.5
Philippines CPI inflation	2.8	9.3	3.3	4.3	4.2	4.4
Food (50.0)	3.3	12.9	6.0	4.3	3.8	3.1
Food contribution[1]	1.6	6.5	3.0	2.1	1.9	1.5
Singapore CPI inflation	2.1	6.6	0.6	0.2	1.0	1.6
Food (23.4)	2.9	7.7	2.3	0.1	1.2	0.9
Food contribution[1]	0.7	1.8	0.5	0.0	0.3	0.2
Taiwan CPI inflation	1.8	3.5	-0.9	0.3	2.4	1.3
Food (25.1)	2.9	8.6	-0.3	-0.2	1.6	0.9
Food contribution[1]	0.7	2.2	-0.1	0.0	0.4	0.2
Thailand CPI inflation	2.2	5.5	-0.8	4.1	3.7	3.4
Food (38.5)	4.1	11.5	4.6	3.2	5.1	4.4
Food contribution[1]	1.6	4.4	1.8	1.2	1.9	1.7
Vietnam CPI inflation	8.2	23.0	7.0	7.6	8.4	9.5
Food (40.0)	11.3	36.8	9.0	7.6	9.1	10.7
Food contribution[1]	4.5	14.7	3.6	3.0	3.6	4.3

1. %-pt contribution to oya headline inflation.

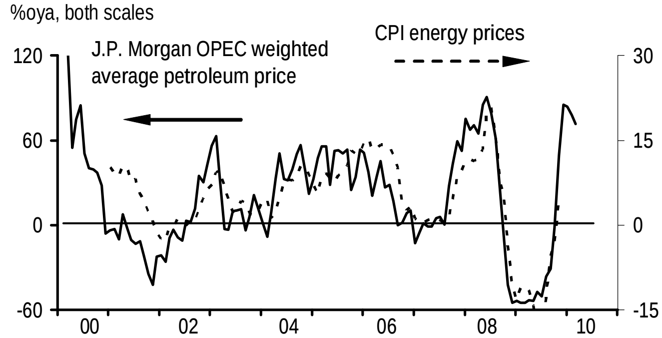
EM Asia: CPI and food prices

%3m/3m saar



EM Asia ex China/India: CPI energy prices and oil

%oya, both scales



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US economic calendar

Monday	Tuesday	Wednesday	Thursday	Friday
26 Apr Housing vacancies (10:00am) 1Q Dallas Fed survey (10:30am) Apr Auction 5-year TIPS $11 bn	27 Apr S&P/Case-Shiller HPI (9:00am) Feb 1.2% Consumer confidence (10:00am) Apr 53.0 Richmond Fed survey (10:00am) Apr Auction 2-year note $44 bn Fed Chairman Bernanke speaks in Omaha (10:00am) FOMC meeting	28 Apr Auction 5-year note $42 bn FOMC meeting	29 Apr Initial claims (8:30am) w/e prior Sat 445,000 KC Fed survey (10:00am) Apr Auction 7-year note $32 bn	30 Apr Real GDP (8:30am) 1Q advance 3.0% Employment cost index (8:30am) 1Q 0.4% (1.6%oya) Chicago PMI (9:45am) Apr Consumer sentiment (9:55am) Apr final 71.0
3 May Personal income (8:30am) Mar ISM manufacturing (10:00am) Apr Construction spending (10:00am) Mar Light vehicle sales Apr	4 May Pending home sales (10:00am) Mar Factory orders (10:00am) Mar	5 May ADP employment (8:15am) Apr ISM nonmanufacturing (10:00am) Apr Announce 3-year note $38 bn Announce 10-year note $25 bn Announce 30-year bond $16 bn Boston Fed President Rosengren speaks in Boston (8:30am) and New York (7:00pm)	6 May Initial claims (8:30am) w/e prior Sat Productivity and costs (8:30am) 1Q preliminary Chain store sales Apr Fed Chairman Bernanke speaks to Chicago Conference (9:30am) Chicago Fed President Evan speaks at Banking conference (9:20am)	7 May Employment (8:30am) Apr Consumer credit (3:00pm) Mar Philadelphia Fed President Plosser speaks in Delaware (12:30pm)
10 May Minneapolis Fed President Kocherlakota speaks (1:00pm).	11 May NFIB survey (7:30am) Apr Wholesale trade (10:00am) Mar JOLTS (10:00am) Mar Auction 3-year note $38 bn Atlanta Financial Markets Conference with comments by Atlanta Fed President Lockhart (1:15pm) and Philadelphia Fed President Plosser (1:30pm)	12 May International trade (8:30am) Mar Federal budget (2:00pm) Apr Auction 10-year note $25 bn Atlanta Financial Markets Conference with comments by Boston Fed President Rosengren(10:15am) and Atlanta Fed President Lockhart (12:30pm)	13 May Initial claims (8:30am) w/e prior Sat Import prices (8:30am) Apr Auction 30-year bond $16 bn Fed Vice-Chairman Kohn speaks in Ottawa (9:00am).	14 May Retail sales (8:30am) Apr Industrial production (9:15am) Apr Consumer sentiment (9:55am) May preliminary Business inventories (10:00am) Mar
17 May Empire State survey (8:30am) May TIC data (9:00am) Mar NAHB survey (1:00pm) May	18 May PPI (8:30am) Apr Housing starts (8:30am) Apr	19 May CPI (8:30am) Apr FOMC minutes (economic projections)	20 May Initial claims (8:30am) w/e prior Sat Philly Fed survey (10:00am) May Leading indicators (10:00am) Apr Announce 2-year note $42 bn Announce 5-year note $40 bn Announce 7-year note $31 bn	21 May

Euro area economic calendar

Monday	Tuesday	Wednesday	Thursday	Friday
26 Apr ECB President Jean-Claude Trichet speaks in NY, USA (6:30pm CET)	27 Apr Germany: Import prices (8:00am) Mar 4.0%oya, nsa Gfk cons. conf. (8:00am) May France: INSEE cons. conf. (8:45am) Apr Italy: ISAE cons. conf. (9:30am) Apr ECB member Lucas Papademos speaks in Brussels, Belgium (9:00am) ECB member Gertrude Tumpel-Gugerell speaks in Paris , France (4:15pm) ECB President Jean-Claude Trichet speaks in IL, USA (4:15pm CET)	28 Apr Euro area: ECB Bank lending survey (10:00am) Germany: CPI 6 states and prelim (8:00am) Apr 1.3%oya Italy: ISAE bus. conf. (9:30am) Apr Belgium: GDP advance (3:00am) 1Q ECB President Jean-Claude Trichet speaks in IL, USA (12:15am CET) ECB member Jürgen Stark speaks in Berlin, Germany (9:20am) ECB member Gertrude Tumpel-Gugerell speaks in Madrid, Spain (10:00am)	29 Apr Euro area: M3 (10:00am) Mar -0.2 %oya EC bus. conf. (11:00am) Apr -8 %bal, sa EC cons. conf. final (11:00am) Apr -15 %bal, sa Capacity utilization (11:00am) 2Q 74 %bal, sa Germany: Employment (9:55am) Mar -10 ch m/m, 000s, sa Unemployment (9:55am) Apr 5 ch m/m, 000s, sa Italy: Contractual wages (10:00am)Mar Spain: HICP flash (9:00am) Apr 1.6%oya, nsa Belgium: CPI (11:15am) Apr 1.8%oya, nsa ECB President Jean-Claude Trichet speaks in Munich, Germany (1:30pm)	30 Apr Euro area: Sectoral accounts (10:00am) Q2 Unemployment rate(11:00am) Mar 10.0 %, sa HICP flash (11:00am) Apr 1.6%oya, nsa France: PPI (8:45am) Mar Employment prelim (8:45am) 1Q Italy: PPI (10:00am) Mar CPI prelim (11:00am) Apr 1.4%oya, nsa
3 May Euro area: PMI Mfg final (10:00am) Apr Germany: Retail sales (8:00am) Mar PMI Mfg final (9:55am) Apr France: PMI Mfg final (9:50am) Apr Italy: PMI Mfg (9:45am) Apr Spain: PMI Mfg (9:15am) Apr	4 May Euro area: PPI (11:00am) Mar	5 May Euro area: PMI services & composite final (10:00am) Apr Retail sales (11:00am) Mar Germany: PMI services & composite final (9:55am) Apr France: PMI services & composite final (9:50am) Apr Italy: PMI services & composite (9:45am) Apr Spain: PMI services & composite (9:15am) Apr	6 May Euro area: ECB rate announcement (1:45pm) No change ECB press conf. (2:30pm) Germany: Mfg orders (12:00am) Mar	7 May Germany: Industrial production (12:00pm) Mar France: Foreign trade (8:45am) Mar Monthly budget situation (8:45am) Mar
10 May Germany: Foreign trade (8:00am) Mar France: Industrial production (8:45am) Mar Italy: Industrial production (10:00am) Mar	11 May Germany: CPI final (8:00am) Apr Netherlands: CPI (9:30am) Apr	12 May Euro area: GDP flash (11:00am) 1Q Industrial production (11:00am) Mar Germany: GDP flash (8:00am) 1Q France: GDP prelim (8:45am) 1Q CPI (8:45am) Apr Italy: GDP flash (10:00am) 1Q Spain: GDP flash (9:00am) 1Q Netherlands: GDP prelim (9:30am) 1Q	13 May Euro area: ECB monthly bulletin (10:00am) May	14 May Italy: CPI final (10:00am) Apr Spain: CPI final (9:00am) Apr
17 May Netherlands: Industrial production (9:30am) Mar	18 May Euro area: HICP final (11:00am) Apr Foreign trade (11:00am) Mar Germany: ZEW bus. Survey (11:00am) May Italy: Foreign trade (10:00am) Mar	19 May Spain: GDP final (9:00am) 1Q	20 May Euro area: EC cons. Conf. Prelim (4:00pm) May Germany: PPI (8:00am) Apr Italy: Industrial orders (10:00am) Mar Belgium: BNB cons. Conf. (3:00pm) May	21 May Euro area: BoP (10:00am) Mar Germany: GDP final (8:00am) 1Q IFO bus. Survey (10:00am) Mar Netherlands: CBS cons. Conf. (9:30am) May

Highlighted data are scheduled for release on or after the date shown. Times shown are local.

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Japan economic calendar

Monday	Tuesday	Wednesday	Thursday	Friday
26 Apr Corporate service prices (8:50 am) Mar -1.5%oya	27 Apr Shoko Chukin small business sentiment (2:00 pm) Apr 44.0, DI Auction 2-year note	28 Apr Total retail sales (8:50 am) Mar 3.2%oya	29 Apr *Holiday:Japan*	30 Apr PMI manufacturing (8:15 am) Apr 52.5, DI Nationwide core CPI (8:30 am) Mar -1.2%oya All household spending (8:30 am) Mar 2.0%m/m, sa Unemployment rate (8:30 am) Mar 4.9%, sa Job offers to applicants ratio (8:30 am) Mar 0.48, sa IP preliminary (8:50 am) Mar 1.0%m/m, sa Nominal wages (10:30 am) Mar -0.2%oya, contracted wages Housing starts (2:00 pm) Mar -5.0%oya Construction orders (2:00 pm) Mar BoJ MPM and statement BoJ outlook report (3:00pm) BoJ governor Shirakawa's press conference (3:30 pm)
3 May *Holiday:Japan*	4 May *Holiday:Japan*	5 May *Holiday:Japan*	6 May PMI services/ composite (8:15 am) Apr Auto registrations (2:00 pm) Apr	7 May Monetary base (8:50 am) Apr Auction 3-month bill
10 May Minutes of Apr 6-7 BoJ MPM (8:50 am)	11 May Auction 6-month bill Auction 10-year bond	12 May Coincident CI (2:00 pm) Mar Auction 3-month bill	13 May M2 (8:50 am) Apr Current account (8:50 a m) Mar Economy watcher survey (2:00 pm) Apr Auction 40-year bond	14 May
During the week: Cabinet Office private consumption index Mar				
17 May Corporate goods prices (8:50 am) Apr Private machinery orders (8:50 am) Mar Construction spending (2:00 pm) Mar Auction 1-year bill	18 May Reuters Tankan (8:30 am) May Tertiary sector activity index (8:50 am) Mar Consumer sentiment (2:00 pm) Apr Auction 5-year note	19 May IP final (1:30 pm) Mar Auction 3-month bill	20 May GDP 1st est. (08:50am) 1Q BoJ MPM Auction 2-month bill Auction 20-year bond	21 May BoJ MPM and statement BoJ governor Shirakawa's press conference (3:30 pm)
During the week: Cabinet Office private consumption index Apr				

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Canada economic calendar

Monday	Tuesday	Wednesday	Thursday	Friday
26 Apr	27 Apr BoC Governor Carney appears before the Standing Committee on Finance, House of Commons (3:30pm)	28 Apr	29 Apr Payroll employment (8:30am) Feb BoC Governor Carney appears before the Standing Senate Committee on Banking, Trade and Commerce (10:30am)	30 Apr Monthly GDP (8:30am) Feb 0.2% IPPI (8:30am) Mar -0.5% Ex energy -0.7%
3 May	4 May	5 May Building permits (8:30am) Mar Ivey PMI (10:00am) Apr	6 May BoC deputy Governor Murray speaks in Edmonton (8:05pm)	7 May Employment (7:00am) Apr
10 May Housing starts (8:15am) Apr	11 May	12 May International trade (8:30am) Mar New house price index (8:30am) Mar	13 May	14 May Manufacturing sales (8:30am) Mar New vehicle sales (8:30am) Mar Existing home sales Apr
17 May	18 May	19 May Wholesale sales (8:30am) Mar	20 May Leading indicators (8:30am) Apr	21 May CPI (7:00am) Apr Retail sales (8:30am) Mar

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Latin America economic calendar

Monday	Tuesday	Wednesday	Thursday	Friday
26 Apr Brazil: Fipe CPI Apr 22 0.30% m/m, nsa	27 Apr Brazil: Consumer Confidence Apr Mexico: Central bank reserves IGAE Feb 3.9%oya	28 Apr Brazil: COPOM meeting Apr 9.25% Chile: IP Mar Mexico: Banxico inflation report 1Q10 Family remittances Mar -19.2%oya	29 Apr Brazil: FGV IGP-M Apr 0.65% m/m, nsa Unemployment rate Mar 7.6% m/m, nsa Primary budget balance Mar -R$2.7 bn Net Debt % GDP Mar 42.6%, nsa	30 Apr Argentina: Construction activity Mar Chile: Unemployment rate Mar Colombia: BanRep meeting Apr no change Unemployment rate Mar Mexico: Public sector balance Mar
During the week: Peru (May 1): CPI Apr 0.11%m/m, nsa WPI Apr				
3 May Brazil: PMI manufacturing Apr Trade balance Apr Mexico: IMEF survey Apr Banxico survey Apr	4 May Brazil Fipe CPI Apr 30 IP Mar Colombia: PPI Apr Mexico: Central bank reserves Consumer confidence Apr	5 May Brazil: Capacity utilization Mar Chile: Economic activity Mar Colombia: CPI Apr	6 May Brazil: COPOM minutes Auto report (Anfavea) Apr Ecuador: CPI Apr Peru: BCRP meeting	7 May Brazil: IPCA Apr Chile: CPI Apr Trade balance Apr Mexico: CPI Apr Core CPI Apr
During the week: Argentina: Government tax revenue Apr Auto sales Apr				
10 May Brazil: IGP-M 1st rel May Mexico: Formal employment report Mar Peru: Trade balance Mar	11 May Brazil: Fipe CPI May 07 Mexico: Central bank reserves Auto report Apr	12 May Argentina: CPI Apr WPI Apr Brazil: Retail sales Mar Mexico: Wage negotiations Apr Fixed investment Feb IP Mar	13 May Chile: BCCh meeting Colombia: Trade balance Mar	14 May Colombia: BanRep minutes
During the week: Venezuela: CPI Apr				
17 May Argentina: Consumer confidence May Brazil: FGV CPI IPC-S May16 Peru: GDP Mar Unemployment Apr	18 May Brazil: Fipe CPI May15 Chile: GDP 1Q Current account 1Q	19 May Brazil: IGP-M 2nd rel May Colombia: IP Mar Retail sales Mar	20 May Brazil: IPCA 15 May Mexico: IGAE Mar Real GDP 1Q10	21 May Argentina: Trade balance Apr IP Apr Economic activity Apr Mexico: Retail sales Mar Banxico meeting
During the week: Venezuela: GDP 1Q Brazil: CAGED Formal Job Creation Apr				

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UK/Scandinavia/Switzerland economic calendar

Monday	Tuesday	Wednesday	Thursday	Friday
26 Apr Sweden: Trade balance (09:30am) Mar Riksbank's First Deputy Svante Öberg speaks at SACO (10:00am)	27 Apr United Kingdom: BBA mortgage lending (09:30am) Mar 2.6 ch £bn, sa (secured) Loan approvals 38.0 K, sa CBI distributive trades (11:00am) Apr 14 %bal, sa Sweden: PPI (09:30am) Mar Switzerland: UBS consumption indicator (08:00am) Mar	28 Apr Sweden: Labor force survey (09:30am) Mar Norway: Business tendency survey (10:00am) 1Q	29 Apr Sweden: Riksbank's Deputy Governor Barbro Wickman-Parak speaks at SEB bank (07:45am) Business tendency (09:15am) Apr Consumer conf. (09:15am) Apr Retail sales (09:30am) Mar Wage stats (09:30am) Jan & Feb Norway: Retail sales (10:00am) Mar Regional network - phone survey Apr (10:00am)	30 Apr United Kingdom: GfK cons. conf (12:01am) Apr -14 %bal, sa Norway: Labor directorate (09:00am) Apr Credit indicator (10:00am) Mar Switzerland: KOF leading indicator (11:30am) Apr 1.99 Index, sa Speeches: Hansueli Raggenbass, Philipp Hildebrand, SNB's Genereal Meeting of Shareholders, Berne (10:00am)
During the week : United Kingdom: Nationwide HPI (08:00am) Apr 0.4%m/m, sa				
3 May Sweden: PMI (08:30am) Apr Minutes of Riksbank's April monetary policy meeting (09:30am) Norway: PMI Mfg (09:00am) Apr NEF HPI (11:00am) Apr Switzerland: PMI (09:30am) Apr	4 May United Kingdom: PMI mfg (09:30am) Apr Net lending to individuals (09:30am) Mar M4 & M4 lending final (09:30am) Mar	5 May United Kingdom: N'wide cons. Conf. (12:01am) Apr PMI construction (09:30am) Apr Norway: IP Mfg (10:00am) Mar AKU unemployment (10:00am) Feb Norges bank rate announcement (02:00pm) 25bp hike expected	6 May United Kingdom: Markit jobs report (12:01am) Apr PMI services (09:30am) Apr General Elections 2010 Switzerland: CPI 09:15am) Apr	7 May United Kingdom: New cars regs. (09:00am) Apr PPI (09:30am) Apr Sweden: Industrial production and orders (09:30am) Mar Norway: Government Pension Fund Global Quarterly Report (10:00am) Q1 Switzerland: Unemployment (07:45am) Apr
During the week : United Kingdom: Halifax HPI (08:00am) Apr				
10 May United Kingdom: MPC rate announcement and Asset purchase target (12:00pm) No change expected Norway: CPI (10:00am) Apr PPI (09:30am) Apr	11 May United Kingdom: BRC retail sales (12:01am) Apr RICS HPI (12:01am) Apr Industrial production (09:30am)Mar Sweden: CPI (09:30am) Apr Capacity utilization (09:30am) 1Q AMV unemployment (10:00am) Apr Norway: Financial Stability 2010:01 (02:00pm) Switzerland: Consumer climate (07:45am) 1Q	12 May United Kingdom: Labor mkt report (09:30am) Mar Quoted mortgage int. rates (09:30am) Apr BoE quarterly inflation report (10:30am) Switzerland: Producer & import prices (09:15am) Apr	13 May United Kingdom: Trade balance (09:30am) Mar DCLG HPI (090:30am) Mar	14 May
17 May Switzerland: SNB's Philipp Hildebrand speaks (06:00pm)	18 May United Kingdom: CPI (09:30am) Apr Norway: Trade balance (10:00am) Apr	19 May United Kingdom: MPC minutes (09:30am) May	20 May United Kingdom: Retail sales (09:30am) Apr	21 May United Kingdom: Business investment prelim (09:30am) 1Q Public sector finance (09:30am) Apr Provisonal estimates of M4 & M4 lending (09:30am) Apr Switzerland: Monthly statistical bulletin (09:00am)

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Emerging Europe/Middle East/Africa economic calendar

Monday	Tuesday	Wednesday	Thursday	Friday
26 Apr Hungary: Monetary policy announcement -25bp Israel: Monetary policy announcement +25bp Turkey: Capacity utilization (10:00am) Apr 68.3%	27 Apr *Holiday South Africa*	28 Apr Poland: Monetary policy announcement No change South Africa: CPI (11:30am) Mar 5.2%oya Financial Stability Review (SARB)	29 Apr South Africa: PPI (11:30am) Mar 3.9%oya Turkey: Inflation Report Q2	30 Apr Turkey: Foreign trade (10:00am) Mar -$2.3bn Hungary: PPI (9:00am) Mar -4.0%oya South Africa: Credit & money supply data (8:00am) Mar -0.9oya Trade balance (2:00pm) Mar
During the week: Russia's CBR decision on rates				
3 May Czech Rep: PMI (9:30am) Apr Hungary: PMI (9:00am) Apr Turkey: CPI (10:00am) Apr PPI (10:00am) Apr PMI (10:00am) Apr South Africa: Kagiso PMI (11:00am) Apr 60.9	4 May Poland: PMI (9:00am) Apr Russia: Manufacturing PMI Apr Romania: Monetary policy announcement -50bp	5 May Romania: Retail sales (10:00am) Mar South Africa: Vehicle sales (11:00am) Apr Russia: CPI Apr 0.5%m/m	6 May Czech Rep Monetary policy announcement no change Hungary: Industrial output (9:00am) Mar	7 May Czech Rep: Trade balance (9:00am) Mar CZK 15bn Industrial output (9:00am) Mar 3%oya Retail sales (9:00am) Mar Romania: Industrial output (10:00am) Mar South Africa: Gross reserves (8:00am) Apr US$42.8bn
During the week:				
10 May Czech Rep: CPI (9:00am) Apr Turkey: Industrial production (10:00am) Mar	11 May Turkey: Current account (10:00am) Mar Hungary: CPI (9:00am) Apr Romania: CPI (9:00am) Apr	12 May Czech Rep: GDP (9:00am) 1Q Hungary: GDP (9:00am) 1Q Romania: GDP (9:00am) 1Q South Africa: Manufacturing output (1:00pm) Mar	13 May South Africa: MPC decision (2:00pm) No change	14 May Hungary: Industrial output (9:00am) Mar Poland: CPI (2:00pm) Apr Israel: CPI (6:00pm) Apr
During the week:				
17 May Czech Rep: PPI (9:00am) Apr Current account (10:00am) Mar Poland: Current account (2:00pm) Mar Romania: Current account Mar Turkey: Unemployment (10:00am) Feb Consumer confidence (10:00am) Apr	18 May Hungary: Average gross wages (9:00am) Mar Turkey: Monetary policy announcement	19 May Hungary: Central bank minutes Poland: Average gross wages & employment (2:00pm) Apr South Africa: Retail sales (11:30am) Mar	20 May Poland: PPI (2:00pm) Apr Industrial output (2:00pm) Apr Core inflation (2:00pm) Apr	21 May Poland: Retail sales (10:00am) Mar
During the week:				

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Non-Japan Asia economic calendar

Monday	Tuesday	Wednesday	Thursday	Friday
26 Apr Singapore: IP (1:00 pm) Mar 38.9 %oya *Holiday Australia*	27 Apr Australia: PPI (11:30 am) 1Q -0.6 %oya NAB bus. Confidence (11: 30 am) 1Q Hong Kong: Trade balance (4:30 pm) Mar -37.1HK$ bn Korea: Consumer survey (6:00 am) Apr 108 Index, nsa GDP (8:00 am) 1Q P 7.4 %oya Philippines: Imports (9.00 am) Feb 23.0 %oya Budget balance Mar Taiwan: Leading index (4:00 pm) Mar	28 Apr Australia: CPI (11:30 am) 1Q 2.8%oya Korea: Current account (8:00 am) Mar 1.2 US$ bn New Zealand: NBNZ business confidence (2: 00 pm) Apr 44.0 %bal	29 Apr New Zealand: RBNZ official cash rate (9:00 am) Apr no change expected Trade balance (10:45 am) Mar 400 NZ$ mn	30 Apr Australia: Pvt. Sector credit (11:30 am) Mar 0.5 %m/m, sa Korea: IP (1:30 pm) Mar 21.0 %oya Leading index (1:30 pm) Mar 127.3 Index, sa Service sector activity (1:30 pm) Mar 7.3 %oya New Zealand: Building permits (10:45 am)Mar Singapore: Unemployment rate 1Q 2.3 % rate Thailand: Trade balance (2:30 pm) Mar 1.4 US$ bn IP (2:30 pm) Mar 27.7 %oya PCI (2:30 pm) Mar 6.9 %oya PII (2:30 pm) Mar 14.6 %oya *Holiday Vietnam*
During the week: Korea: FKI business survey Apr 120.0 Index, nsa Vietnam: Trade balance Apr				
3 May Australia: RBA cash target (3:30 pm) May HPI (11:30 am) 1Q China: PMI manufacturing Apr Hong Kong: Retail sales (4:30 pm) Mar India: Trade balance Mar India PMI manufacturing Apr Indonesia: CPI (2:00 pm) Apr Trade balance (2:00 pm)Mar Korea: CPI (1:30 pm) Apr Trade balance (10:00 am) Apr New Zealand: ANZ commodity price (2:00 pm) Apr Thailand: CPI (2:00 pm) Apr *Holiday China, Thailand, Vietnam*	4 May Australia: RBA cash target (3:30 pm) May Malaysia: Trade balance (6:00 pm) Mar New Zealand: Labor cost index 1Q Singapore: PMI (9:30 pm) Apr	5 May Australia: Building approvals (11:30 am) Mar Indonesia: BI rate announcement (1:00 pm) May Philippines: CPI (9:00 am) Apr Taiwan: CPI (4: 00 pm) Apr *Holiday Korea, Thailand*	6 May Australia: Retail sales (11:30am) Mar Trade balance (11:30am) Mar New Zealand: Unemployment rate (10:45 am) 1Q	7 May Australia: Quarterly monetary policy meet Taiwan: Trade balance (4:00 pm) Mar
10 May Australia: ANZ job ads (11:30 am) Apr China: Trade balance (12:00 pm) Apr New Zealand: QVNZ house prices Apr *Holiday Philippines*	11 May Australia: NAB bus. Confidence (11: 30 am) Apr China: CPI 10:00 am) Apr PPI(10:00 am) Apr FAI (10:00am) Apr Retail sales (10:00 am) Apr IP (10:00 am) Apr Korea: Money supply (9:00 am)Apr Malaysia: IP (12:00 pm) Mar	12 May Australia: Housing finance approvals (11:30 am) Mar India: IP Mar Korea: BoK monetary policy meeting (10:00 am) May Unemployment rate (9:00am) Apr Philippines: Exports (9:00 am) Mar	13 May Australia: Unemployment rate (11: 30 am) Apr Malaysia: BNM monetary policy meeting (6:00 pm) Apr New Zealand: Business NZ PMI (10:30 pm) Apr *Holiday Indonesia*	14 May Hong Kong: GDP (4:30 pm) 1Q India: WPI Apr Korea: Export price index (10:00 am) Apr Import price index (10:00 am) Apr SPPI Mar New Zealand: Retail sales (10:45 am) Mar Singapore: Retail sales (1:00 pm) Mar
During the week: China: Money supply Apr FDI Apr				
17 May Philippines: OFW remittances (10:45 am) Mar Singapore: NODX (1:00 pm)Apr	18 May Hong Kong: Unemployment rate (4:30 pm) Apr New Zealand: PPI (10:45 am) 1Q Philippines: BOP Apr	19 May Australia: Westpac consumer confidence (10: 30 am) May Malaysia: CPI (5:00 pm) Apr	20 May Hong Kong: CPI (4:30 pm) Apr Taiwan: Export Orders (4:00 pm) Apr	21 May New Zealand: Visitor arrivals (10:45 am) Apr Credit card spending (2:00 pm Apr *Holiday Hong Kong, Korea*
During the week: Indonesia: GDP 1Q Malaysia: GDP 1Q Philippines: Budget balance Apr				

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Global Data Diary

Week / Weekend	Monday	Tuesday	Wednesday	Thursday	Friday
26 - 30 April	**26 April**	**27 April**	**28 April**	**29 April**	**30 April**
Russia • CBR mtg: -25bp	France • INSEE cons conf (Apr) Hungary • HNB mtg: -25bp Israel • BOI mtg: +25bp Italy • ISAE cons conf (Apr) Singapore • IP (Mar)	Japan • Shoko Chukin sm bus sent (Apr) Korea • GDP (1Q) United States • Case-Shiller HPI (Feb) • Consumer confidence (Apr) • Richmond Fed surv (Apr) • FOMC mtg	Australia • CPI (1Q) Belgium • GDP adv (1Q) Brazil • COPOM mtg: +50bp Chile: IP (Mar) Germany • CPI (Apr) Italy • ISAE bus conf (Apr) Japan • Retail sales (Mar) Poland • NBP mtg: No chg United States • FOMC mtg: No chg	Euro area • M3 (Mar) • EC bus conf (Apr) Germany • Labor mkt report (Mar) New Zealand • RBNZ mtg: No chg Sweden • Retail sales (Mar) Turkey • Inflation report (2Q)	Canada • GDP (Feb) Colombia • BanRep mtg: No chg Euro area • Unemp rate (Mar) • HICP flash (Apr) Japan • PMI mfg (Apr) • Core CPI, Hhold spdng, Unemployment, IP prelim (Mar) • MPM: No chg Korea • IP (Mar) United States • Real GDP (1Q) • Chicago PMI, Consumer sent final (Apr)
3 - 7 May	**3 May**	**4 May**	**5 May**	**6 May**	**7 May**
	Germany • Retail sales (Mar) United States • ISM mfg (Apr) • Light vhcl sales (Apr) PMI: • Czech Republic, Hungary, South Africa, Sweden, Turkey (Apr) PMI mfg: • Brazil, China, Euro area, France, Italy, India, Spain (Apr)	Australia • RBA mtg: +25bp Brazil: IP (Mar) Euro area: PPI (Mar) Poland: PMI (Apr) Romania • BNR mtg: -50bp Russia: PMI mfg (Apr) Singapore: PMI (Apr) UK: PMI mfg (Apr) United States • Pending home sales, Factory orders (Mar)	Euro area • PMI srv/comp (Apr) • Retail sales (Mar) Indonesia: BI mtg: No chg Norway • IP mfg (Mar) • Norges bnk mtg: +25bp UK: PMI cons (Apr) United States • ADP employment, ISM nonmfg (Apr) PMI srv/comp: • France, Germany, Italy, Spain (Apr)	Czech Republic • CNB mtg: No chg Euro area • ECB mtg: No chg Germany • Mfg orders (Mar) Hungary: IO (Mar) Japan • PMI srv/comp (Apr) Peru: BCRP mtg: No chg United Kingdom • General elections 2010 United States • Bernanke speech	Germany • IP (Mar) Japan • Monetary base (Apr) Sweden • IP (Mar) United Kingdom • New car regs (Apr) United States • Employment (Apr) • Consumer credit (Mar)