J.P.Morgan

Economic Research
May 7, 2010

Global Data Watch

- **The Euro area sovereign crisis leaves the ECB with difficult choices**
- **Although global growth is accelerating and resilient, an effective policy response is needed to limit macroeconomic damage from the crisis**
- **Global labor markets turn led by a resurgence in US private payrolls**

Frankfurt, we have a problem

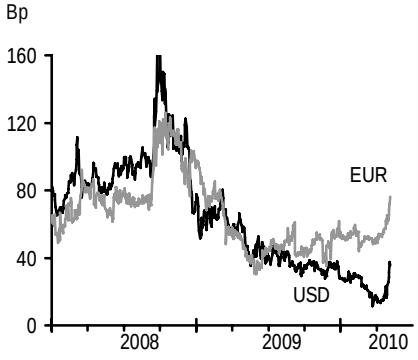
The market response to Euro area policy action this week was not exactly what authorities had hoped for. The EMU/IMF €110 billion bailout package for Greece was followed by a sharp rise in interest rates across the fiscally challenged countries on the periphery. For its part, the ECB relaxed its collateral requirements on Greek debt. But its failure to respond to building stress in bank funding markets at its policy meeting accelerated the decline in the euro and the fall in risk appetite across the globe.

At the source of the Euro area's problem is the excessive deficit and debt buildup on the periphery. The fiscal challenge for the area as a whole is not larger than the one facing the US, UK, or Japan. However, given this concentrated buildup, the Euro area system—which combines a shared currency and integrated financial markets with individual responsibility for fiscal consolidation—is poorly designed to deal with the adjustment at hand. Although this week's bailout package effectively removes Greece from funding markets for three years, it also requires Greece to shoulder an even greater fiscal burden—a more than 10% of GDP fiscal adjustment over four years. Absent a flexible currency, such an adjustment is a herculean task and leaves Euro area holders of Greek debt vulnerable.

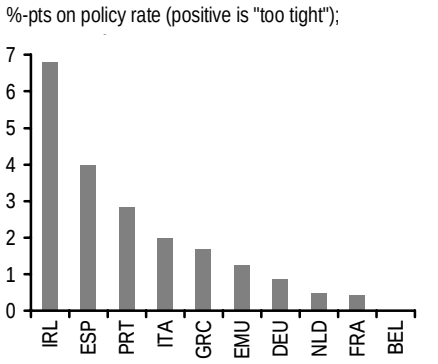
Authorities made no mention of possible funding arrangements for the other periphery nations this week. As such, their borrowing rates moved higher, and short-term funding markets across both sides of the Atlantic felt a chill. This should be no surprise given the elevated level of European bank exposure to sovereign debt and the large role European banks play in short-term dollar funding markets. Indeed, over 30% of US outstanding CP/ABCP is issued by European banks.

Action will be taken this weekend to try to reduce stress (see "Challenging times for Euro area policymakers" in this *GDW*). A reasonable first step would be to reopen the generous liquidity facilities available during the financial crisis—notably the Fed's USD FX swap lines and the ECB's longer-term repo

Swap spread: 2 year



Euro area: Taylor rule policy rate errors



Note: Assumes 1.8% target inflation rate across the area

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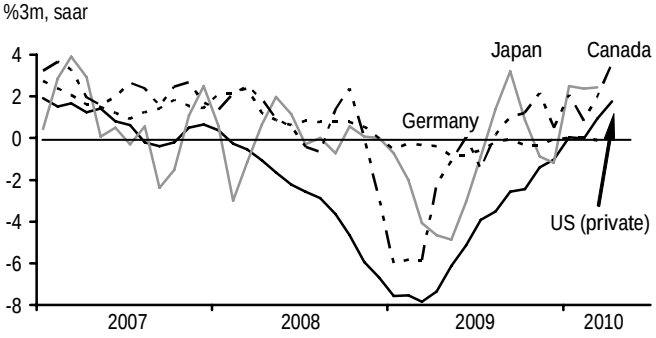
Global employment



funding. While this action looks likely, the complications regarding the Fed swap lines should be recognized. Opening swap lines requires the Fed to expand its bloated balance sheet further. And with the US Congress considering regulatory reform that limits Fed power—partly because of anger over perceptions that the Fed was too quick to support troubled banks—it is hard for the Fed to engage in something perceived to be "bailout" of foreign banks. The Fed would want to get the Treasury and some key lawmakers to sign off on this action. While the Fed led the last time in opening up swap lines, this time there would need to be a sense that the ECB is taking the lead and the Fed is playing a collegial, but supporting, role.

If concerns about fiscal positions intensify, these steps may not prove sufficient in the face of pressures on sovereign debt funding and rising fear that the quality of assets held by some European banks is impaired. As such, it may prove necessary to create a backstop facility for government debt on the periphery. It appears unlikely that the ECB will provide this backstop by direct purchases of government debt any time soon, given the resistance of central bankers to step directly into the space of funding sovereign borrowing needs. The preferred outcome would be a solution involving EU governments. However, as we have seen in the case of Greece, agreements among heads of states are difficult to forge.

Thus, the ECB may find itself in a similar position to the Fed which searched for new tools in the midst of the 2007-8 financial crisis. There is a possibility that the ECB could try to follow the Bank of England, in setting up an off-balance sheet vehicle to purchase debt (the Asset Purchase Facility), which was indemnified by the fiscal authorities. It may also follow the Fed and create a TALF-type facility in which it provides nonrecourse lending for private sector purchases of debt.

Meanwhile, global growth is accelerating

At this juncture, it is difficult to judge how much macroeconomic damage will come from this fiscal crisis. The immediate threat is focused in Europe, reflecting the extensive banking and trade relationships inside the Euro area and with the UK. However, the spillover is radiating more broadly as generalized uncertainty about sovereign risk and contagion produces a pullback from risk assets.

The economic consequences for the most fiscally challenged countries are clearly negative, in that these countries are facing some combination of higher funding costs, banking system stress, and increased fiscal tightening. However, the most affected nations—Spain, Portugal, Italy, Ireland, and Greece—account for less than 20% of Euro area output. For the healthier Euro area economies conditions are mixed. Negative spillover to the banking system are being partly offset by the shift by investors in their direction. This is evident in the differentiation in government borrowing rates, which have fallen sharply in the stronger core countries inside Europe.

It is important to recognize that the crisis is occurring against a backdrop of increasingly strong global growth. Our upbeat global forecast is premised on the formation of a positive feedback loop between financial markets, confidence, and shifts in private sector behavior that promote self-sustaining growth. The key link in this chain—a recovery in global labor markets—has now arrived. Job growth has resumed across much of the globe and today's US employment report was especially encouraging. US private payrolls have now increased in five of the past six months, with gains averaging 156,000 since February. Job gains in the household survey have been even more powerful. Combined with the recovery in other telltale indicators including the workweek, the labor force participation rate, and the ISM employment indexes, there is a convincing case that the US is in the midst of a solid labor market recovery. Notably, the booming pace of G-3 capital goods orders and shipments also indicates that an impressive recovery in business capital expenditures is in train.

This positive message about the momentum of both the economy and business spending is reinforced by the impressive round of April global business surveys. Our global all-industry PMI output index rose another point to 57.7 in April. This is the highest level since May 2006, when the economy was growing near 4% annualized. The global manufacturing PMI now rivals the series high dating back to 1998, as the global factory sector continues to boom on the back of strong final demand and a turn toward inventory restocking. Even more encouraging was the continued advance in the services index—signaling that the base of growth is broadening.

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J.P. Morgan global PMI output indexes

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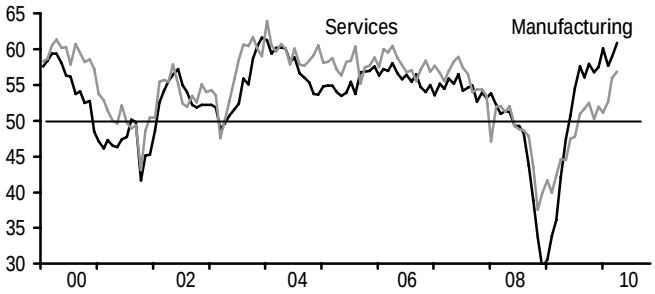

BoJ mandate change may be coming

Under pressure from the government to lift Japan out of deflation, the BoJ recently returned to unconventional easing. This resulted in last week's announcement that the central bank is preparing a new lending facility to promote growth in targeted industries including the environmental and energy industries. More radical changes may be coming. Just ahead of the summer Upper House election, the DPJ is reported to be considering new ways of achieving its inflation objective. Although the details are not yet decided, there is a possibility that the government will set a higher inflation target or even alter the Bank's mandate to include "maximizing employment" in addition to price stability, similar to the Fed.

Central Europe hit by contagion fears

The escalating fiscal crisis in peripheral Europe hit emerging markets this week, as the global flight to quality prompted risk reduction across the board. While market jitters reached the shores of Emerging Asia and Latin America, pressures were particularly acute in Central Europe given its geographical proximity, with PLN, HUF, and RON being the worst performing currencies. However, direct trade, investment, and banking sector links between Central Europe and EMU periphery countries are actually small. Exports to Greece, Spain, Portugal, and Italy together account for less than 5% of CE-4 GDP on average, with Italy accounting for about two-thirds of that. That said, second-round contagion channels can have a marked impact if stress intensifies because core Euro area countries, such as Germany and France, are the key trading partners of Central European countries. Moreover, with the exception of Romania, CE banks are predominantly owned by non-periphery Western European parents. In Romania, Greek banks hold about 18% of banking sector assets.

For now, the cyclical growth dynamic in the Euro area is expected to dominate sovereign stress. Yet, risks for slower growth or even a double-dip recession have risen. If not for these risks, we would probably be inclined to slightly upgrade some of our growth forecasts for Central Europe in light of the strong incoming high-frequency data.

The risk of contagion has a nonlinear impact on CE central bank reaction functions, in our view. A slower Euro area recovery would prompt us to push back rate hikes in the Czech Republic and Poland, and might even imply additional rate cuts. However, a double-dip recession in the Euro area, together with heightened financial market stress, might call for higher interest rates to stem the likely downward pressure on CE currencies. The sensitivity of CE central banks to FX moves differs, depending mainly on their external imbalances and the share of FX loans. Indeed, while the Romanian central bank decided to ease less than expected this week due to currency weakness, the Czech central bank cut rates unexpectedly owing to fears of a weaker recovery.

Australasia extends normalization lead

The scattered drive toward policy normalization in the Asia-Pacific region continued this week. The RBA remained at the vanguard, raising rates for a sixth time to 4.50%, by far the highest level in the developed world. The RBA appears set to take a breather in June, particularly if the stress in global financial markets continues. However, with little spare capacity and inflation already running near the top of the RBA's band, further rate hikes are likely. For its part, the RBNZ signaled this week that it may start to remove the policy stimulus "in coming months." Our call is that the first OCR hike will be in July, providing the economic data in New Zealand evolve in a positive fashion.

While financial markets are still waiting for China to begin its rate hiking cycle and to allow its currency to appreciate, the central bank turned to a different policy lever this week, raising the RRR by 50bp for the third time in 2010. In addition, the central and local governments have implemented a series of tightening measures directed at the housing sector. These moves are consistent with our forecast for moderating growth in fixed-asset investment and overall GDP growth. China will release most of its April data next week. One focus will be inflation, which is expected to move up in April, though it may not breach the 3%oya hurdle that is thought to be needed to trigger an interest rate hike. With global financial market stress building, action on rates and the currency—which we had thought would come in the April/May period— may be delayed to June. Next week's foreign trade report also bears close watching to see whether the trade balance returns to surplus after a rare fall into deficit in March, in line with our forecast.

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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	3.2	4.0	4.0	3.5	2.5	2.5	2.4	2.2	1.2	1.1
Canada	-2.6	3.5 ↑	2.9 ↓	5.0	5.8	3.3 ↑	3.2 ↓	3.5 ↓	3.0 ↓	2.0 ↓	1.6	1.3	1.8	2.1
Latin America	-2.9	4.9	3.8	7.2	4.8 ↓	4.6	3.3 ↑	4.5	4.0	4.9	5.9 ↑	6.4 ↑	7.3 ↑	7.0 ↑
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	4.9 ↑	5.3 ↑	5.8 ↑	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	3.3 ↓	3.6 ↑
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	4.0 ↓	3.2	-1.8 ↑	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	3.2	2.2	3.8	5.0	2.5	2.7	2.7	2.2	2.0	-1.2	-1.4	-0.7	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	8.6	7.2	7.6	10.4	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	5.8	4.1	0.7	7.5	4.0	4.5	3.8	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	1.4 ↓	2.1	0.2	1.0 ↓	3.0	2.3	2.0	2.0	2.0	1.1	1.5 ↑	1.5 ↑	0.9 ↑
Germany	-4.9	1.5 ↓	2.1	0.0	0.5 ↓	3.0	2.0	2.0	2.0	2.0	0.8 ↓	1.0 ↑	1.2 ↓	0.9 ↓
France	-2.2	1.9 ↓	2.2	2.4	1.2 ↓	3.0	2.0	2.5	2.0	2.0	1.5 ↑	1.8 ↑	1.3 ↑	0.6 ↓
Italy	-5.1	1.2 ↑	1.7	-1.3	2.0 ↑	2.5	1.5	2.0	1.5	1.5	1.3	1.5 ↑	1.5 ↑	1.1
Norway	-1.4	2.0 ↓	2.8	1.3	1.6 ↓	3.0	3.0	3.0	2.8	2.8	2.9 ↓	3.0 ↓	1.6 ↓	0.7
Sweden	-5.1 ↓	1.9 ↑	3.1	-1.6 ↑	3.8 ↑	4.0 ↑	3.5	3.0	3.0	3.0	1.0 ↓	1.4 ↓	1.0 ↓	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	3.5	3.3 ↓	4.0	3.7 ↓	3.9	3.6 ↑	3.5	3.1	3.1	2.2	2.2 ↑	1.9 ↑	1.7
Developed markets	-3.4	2.7	2.7	3.2	2.7 ↓	3.3	3.2	2.9	2.4	2.3	1.5	1.4	1.1 ↑	1.0
Emerging markets	1.0	6.7	5.8	6.9	7.4	5.9	5.1 ↑	5.6	5.8	6.2	4.8	5.1 ↑	5.0 ↑	4.4
Memo:														
Global — PPP weighted	-0.8 ↓	4.7 ↑	4.4 ↑	4.9 ↑	5.2 ↑	4.8 ↑	4.4 ↑	4.4 ↑	4.2 ↑	4.2 ↑	3.1 ↑	3.3 ↑	2.9 ↑	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	3.2	4.0	4.0	3.5	2.5	2.5	3.0
Private consumption	-0.6	2.7	2.6	1.6	3.6	3.3	3.0	3.0	2.5	2.0	2.5
Equipment investment	-16.6	11.0	9.5	19.0	13.4	12.0	12.0	10.0	9.0	8.0	8.0
Non-residential construction	-19.8	-12.6	1.5	-18.0	-14.0	-8.0	-3.0	-3.0	0.0	7.0	9.0
Residential construction	-20.5	1.3	15.7	3.7	-10.9	5.0	10.0	15.0	15.0	20.0	20.0
Inventory change ($ bn saar)	-108.3	46.3	49.2	-19.7	31.1	44.2	56.4	53.6	45.5	47.2	50.3
Government spending	1.8	0.4	-0.1	-1.3	-1.8	0.5	1.1	1.4	-0.8	-1.0	-1.0
Exports of goods and services	-9.6	12.2	9.8	22.8	5.8	14.0	12.0	11.0	9.0	9.0	8.0
Imports of goods and services	-13.9	9.6	7.5	15.8	8.9	8.0	8.0	8.0	7.0	8.0	7.0
Domestic final sales contribution	-2.8	2.2	2.9	1.5	2.3	3.1	3.3	3.4	2.6	2.5	2.9
Inventories contribution	-0.6	1.2	0.0	3.8	1.6	0.4	0.4	-0.1	-0.3	0.0	0.1
Net trade contribution	1.0	0.1	0.2	0.3	-0.6	0.5	0.3	0.2	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	-9.4	-7.8								
Personal saving rate (%)	4.2	3.1	3.4	3.9	3.1	3.0	3.0	3.2	3.2	3.3	3.4
Unemployment rate (%)	9.3	9.6	9.2	10.0	9.7	9.7	9.6	9.5	9.4	9.3	9.1
Industrial production, manufacturing	-11.3	5.3	4.0	5.6	6.6	7.0	5.0	4.0	3.0	3.0	4.5
Euro area											
Real GDP	-4.0	1.4	2.1	0.2	1.0	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	-1.7	3.8	-5.2	-3.0	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	7.5	8.1	7.6	6.0	10.0	8.0	8.0	8.0	8.0	8.0
Imports of goods and services	-11.4	4.6	7.7	5.1	1.0	7.5	6.5	7.5	8.0	8.0	8.0
Domestic final sales contribution	-2.5	-0.1	1.7	-1.3	-1.2	1.2	1.4	1.6	1.9	1.9	1.9
Inventories contribution	-0.8	0.3	0.1	0.4	0.1	0.7	0.1	0.1	0.0	0.0	0.0
Net trade contribution	-0.8	1.2	0.3	1.0	2.1	1.1	0.7	0.4	0.2	0.2	0.2
Consumer prices (HICP, %oya)	0.3	1.4	1.0	0.4	1.1	1.5	1.6	1.5	1.3	0.9	0.9
ex unprocessed food and energy	1.3	0.7	0.7	1.0	0.9	0.8	0.7	0.6	0.6	0.6	0.7
General govt. budget balance (% of GDP, FY)	-6.3	-6.7	-5.5								
Unemployment rate (%)	9.4	9.9	9.5	9.8	10.0	10.0	9.8	9.7	9.6	9.5	9.4
Industrial production	-14.8	3.1	3.2	8.3	2.0	4.0	3.5	3.5	3.0	3.0	3.0
Japan											
Real GDP	-5.2	3.2	2.2	3.8	5.0	2.5	2.7	2.7	2.2	2.0	1.5
Private consumption	-1.1	2.8	1.7	2.8	3.5	2.0	2.3	2.5	1.2	1.8	1.0
Business investment	-19.3	3.1	6.0	3.8	8.0	8.0	8.0	6.0	6.0	5.0	5.0
Residential construction	-13.9	0.7	9.7	-12.5	20.0	18.0	15.0	10.0	10.0	8.0	5.0
Public investment	6.6	-4.5	-11.6	-5.0	15.0	-25.0	-15.0	-10.0	-8.0	-10.0	-12.0
Government consumption	1.6	1.1	0.9	2.5	0.5	1.5	0.5	1.0	1.2	0.5	0.5
Exports of goods and services	-24.2	18.9	8.7	21.7	16.0	12.0	11.0	10.0	8.0	6.0	8.0
Imports of goods and services	-17.1	7.8	7.9	5.1	8.0	8.0	9.0	9.0	8.0	6.0	7.0
Domestic final sales contribution	-3.5	2.1	1.8	2.1	4.1	1.8	2.2	2.3	1.7	1.7	1.1
Inventories contribution	0.2	-0.5	0.0	-0.6	-0.5	-0.2	-0.2	-0.2	0.1	0.0	-0.1
Net trade contribution	-2.0	1.7	0.5	2.2	1.3	0.9	0.7	0.5	0.4	0.3	0.5
Consumer prices (%oya)	-1.4	-1.1	-0.1	-2.0	-1.2	-1.4	-1.3	-0.7	-0.5	0.1	0.2
General govt. net lending (% of GDP, CY)	-6.8	-7.5	-8.8								
Unemployment rate (%)	5.1	4.8	4.5	5.2	4.9	4.8	4.8	4.7	4.6	4.6	4.5
Industrial production	-21.8	21.6	10.0	25.9	29.4	15.0	12.0	12.0	8.0	8.0	10.0
Memo: Global industrial production	-11.1	7.8	5.3	10.3	8.2	7.5	6.1	5.4	4.5	4.8	5.6
%oya				-2.8	7.5	8.9	8.0	6.8	5.9	5.2	5.1

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	1.31	-335				1.35	1.45	1.53	1.67	1.99
excluding US	GDP-weighted average	1.87	-248				1.93	2.07	2.19	2.39	2.69
Developed	GDP-weighted average	0.52	-359				0.52	0.56	0.60	0.72	1.07
Emerging	GDP-weighted average	4.50	-237				4.67	5.00	5.22	5.44	5.67
Latin America	GDP-weighted average	5.99	-294				6.29	6.85	7.31	7.49	7.77
CEEMEA	GDP-weighted average	4.13	-273				4.16	4.40	4.48	4.67	5.11
EM Asia	GDP-weighted average	4.08	-202				4.26	4.54	4.72	4.97	5.09
The Americas	GDP-weighted average	0.78	-481				0.83	0.92	1.00	1.06	1.43
United States	Federal funds rate	0.125	-512.5	16 Dec 08 (-87.5bp)	23 Jun 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	9.50	-250	28 Apr 10 (+75bp)	9 Jun 10	**9 Jun 10 (+75bp)**	10.25	11.50	12.50	12.50	12.50
Mexico	Repo rate	4.50	-270	17 Jul 09 (-25bp)	21 May 10	Oct 10 (+25bp)	4.50	4.50	4.50	4.50	4.75
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	**3.00**	-600	**30 Apr 10 (-50bp)**	27 May 10	1Q 11 (+50bp)	**3.00**	**3.00**	**3.00**	**4.00**	**5.00**
Peru	Reference rate	**1.50**	-300	**6 May 10 (+25bp)**	10 Jun 10	**July 10 (+25bp)**	1.50	2.25	3.00	3.75	4.50
Europe/Africa	GDP-weighted average	1.28	-324				1.29	1.33	1.39	1.63	2.07
Euro area	Refi rate	1.00	-300	7 May 09 (-25bp)	10 Jun 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	**2.00**	-250	**5 May 10 (+25bp)**	23 Jun 10	**22 Sep 10 (+25bp)**	2.00	2.25	2.50	2.75	3.25
Czech Republic	2-week repo rate	**0.75**	-200	**6 May 10 (-25bp)**	23 Jun 10	**1Q 11 (+25bp)**	0.75	0.75	0.75	1.25	1.75
Hungary	2-week deposit rate	5.25	-250	26 Apr 10 (-25bp)	31 May 10	**23 Aug 10 (-25bp)**	5.25	5.00	5.00	5.00	5.00
Israel	Base rate	1.50	-250	28 Mar 10 (+25bp)	24 May 10	24 May 10 (+25bp)	2.00	2.25	2.75	3.25	3.75
Poland	7-day intervention rate	3.50	-100	24 Jun 09 (-25bp)	25 May 10	4Q 10 (+25bp)	3.50	3.50	3.75	4.00	4.50
Romania	Base rate	**6.25**	-75	**4 May 10 (-25bp)**	30 Jun 10	**30 Jun 10 (-25bp)**	6.00	5.50	5.50	6.00	6.50
Russia	1-week deposit rate	3.25	25	29 Apr 10 (-25bp)	May 10	May 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	2.17	-127				2.25	2.41	2.51	2.65	2.72
Australia	Cash rate	**4.50**	-175	**4 May 10 (+25bp)**	1 Jun 10	**Jul 10 (+25bp)**	4.50	5.00	5.25	5.50	5.75
New Zealand	Cash rate	2.50	-550	30 Apr 09 (-50bp)	10 Jun 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)	21 May 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)	24 Jun 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)	12 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)	4 Jun 10	4Q 11 (-25bp)	6.50	6.50	6.50	6.50	6.50
India	Repo rate	5.25	-250	20 Apr 10 (+25bp)	27 Jul 10	2Q 10 (+25)	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	3 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.

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The J.P. Morgan View: Markets

Everyone is cutting risk

- **Asset allocation:** The sell-off remains to us a correction in a medium-term bull market, although it is probably not over yet. We hold a reduced overweight of risky assets.
- **Economics:** Great activity data with strong US payrolls, and Global PMI back to May 2006 high. Some policy initiative is likely, but unlikely to be a fix-all.
- **Fixed income:** The Euro debt crisis is set to worsen without further official action.
- **Equities:** Keep directional risk to a minimum. Stay short Euro area equities and banks.
- **Credit:** Stay tactically short US HG and underweight European versus US corporates
- **FX:** Short sterling versus the dollar.
- **Commodities:** Be long commodities on improving fundamentals, but downside risks remain near term.

Markets went into semi-panic this week on the escalating sovereign credit crisis in Europe and the unexpected lack of action by the ECB. Hopes are high that global policymakers will take dramatic action soon, but the limited impact they have had so far is reducing their enthusiasm for new, groundbreaking initiatives. Policymakers do not appear to consider liquidity conditions and systemic risk bad enough yet to throw away the rule book. **Any policy actions next week will likely focus on bank funding, rather than the more fundamental problem of Euro government debt funding.** Markets, from their side, seem bent on making conditions bad enough to induce such needed policy action.

Given the uncertainty about policy support and the speed of the market fall, few market participants are ready to catch this falling knife. We ourselves retain a positive medium-term view on economic growth and risky markets, but recognize the negative market dynamic and the damaging impact it can have on economic fundamentals. Our monthly *Global Markets Outlook and Strategy*, released on May 5, reduced its long in risky assets to a token level, focusing risk instead on **underweighting the hot spots in the world—Europe, China, and banks**.

How bad are conditions in the Euro area? Objective conditions on the ground are not as bad as reflected in the collapse in bond and equity prices. Economic activity data for March and April are showing that the recovery is taking hold. Investment losses on higher-yielding Euro government bonds are approaching €100 billion YTD, but the gains on the lower-yielding ones remain of the same magnitude. This is not like subprime, when there was huge uncertainty about what their market value was and where losses were located, and leverage was much higher than today. Euro money markets have tightened further, but from conditions that were not great to start with, and the ECB is still the dominant money market lender. European banks, including the large Spanish banks, retain access to US CP and USD liquidity in Europe but at a significantly higher price and at shorter terms (see today's *Flows & Liquidity* for more details).

The main problems in Europe are the **"sell first and then ask questions"** attitude of market participants, **the lack of political and policy leadership, and the uncertainty of where to find a new home for the bonds of what we like to call "higher-yielding Euro sovereigns."** Sentiment will not stay in panic mode for long. But the lack of leadership in the Euro area is institutional and will remain. In addition, the long-held assumptions are that all European government bonds are safe and liquidity is damaged. This risks turning some of them into an orphan asset class, in search of a new home. If higher-yielding Euro sovereigns are not safe in govies, credit, or EM, then what are they and who will be their natural holder? In due time, this asset class, with higher risk and return than other, safer govies, will find a home, but the transition will take time, challenging the funding of a number of Euro governments.

The **correction** in global equities is so far very similar to the June and January ones (chart, next page). Both started from technically overbought levels, took three weeks, and cost 8% in price terms—similar to the last three weeks. But the current correction has not bottomed yet. The June correction ended with stronger economic data, while the January correction bottomed in early February with the EU Summit promising financial support to Greece. We are similarly getting stronger economic data today, including a great US payrolls report, and there is a decent chance of new policy measures next week. But risk cutting does not seem over, and the cavalry may not be at full strength. We are cautious.

Fixed income

The Euro area crisis widened and worsened, after last weekend's announcement of a €110 billion liquidity package for Greece failed to calm a market now squarely focused on sovereign solvency risks. The widening of Greek, Portuguese, and Irish spreads accelerated, and hitherto less-affected countries like Belgium also saw spreads widen. Bank funding conditions deteriorated further, with inter-

bank borrowing rates rising relative to expected policy rates, and the basis swap market indicating a shortage of dollars among European banks. All this, together with falling equities and credit, drove a sharp rally in core bond markets despite strong activity data. **German 10-year yields fell more than 20bp to an all-time low**, and that decline in yields was matched by Treasuries.

The debt crisis is self-reinforcing, in that higher government yields raise debt servicing costs, and thus spur concerns about solvency as well as liquidity. In addition, heightened volatility pushes conservative government bond investors to reduce their exposure to high-deficit Euro area countries. This means that significantly stronger official support will likely be needed to restore confidence in high-deficit Euro area countries, and risky assets more generally.

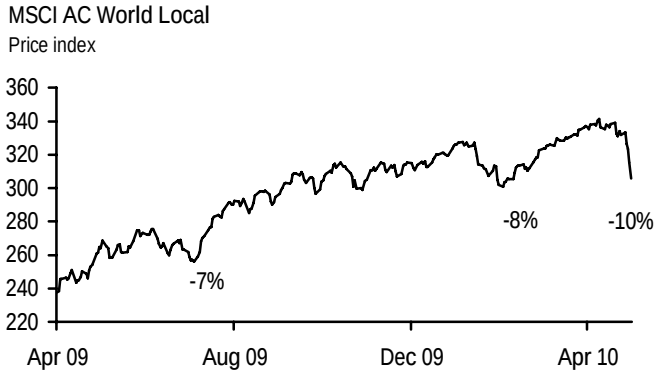
Contagion from the Euro area pushed EM bonds sharply lower this week, reversing most of this year's outperformance versus DM. Inflows to EM bond funds have remained strong so far, but are likely to be dampened by the rise in bond market volatility. We stay cautiously long in South Africa, where the central bank is on hold and government debt is relatively low, but recognize that further underperformance is possible near term.

Equities

Global equities suffered a heavy loss this week as the absence of policy support led to intensification of sovereign fears. The MSCI All Country World Index fell over 7% and now stands 3% below its level at the start of the year. **Uncertainty and volatility rose sharply** with the VIX seeing its steepest rise since Lehman, to 35%. The rise in the VSTOXX (the Euro counterpart of the VIX index) was even more pronounced to 50%.

We **advise a cautious stance near term** keeping directionality to a minimum given heightened uncertainty and contagion risks. With no signs that the debt crisis that engulfed the region is about to subside, we retain our underweight on Euro area equities, which is at the epicenter of the crisis. Similarly, we underweight banks, the sector more susceptible to sovereign stress.

Overweighting **small caps and cyclical sectors** has been at the cornerstone of our strategy this year. Both lost money this week but are well in the black year-to-date. Although we continue to like these trades medium term, we prefer to **take profits now given negative momentum**. Both trades are crowded and the potential for further risk reduction by investors represents a serious headwind. It is true that small



caps have shown resiliency to modest 5%-10% market corrections in the past, managing to outperform large caps. This is because investors tend to reduce risk by selling the more liquid large caps. History shows, though, this is less likely to happen in more pronounced corrections.

Credit

Credit markets sold off this week as the Euro area debt crisis escalated. HG bond spreads widened 15bp while HY spreads widened 61bp. CDS underperformed significantly as US CDS indices widened twice as much as cash bonds, a large 36bp and 136bp for US HG and HY, respectively.

We stay **tactically short US HG** as the risk factors that led us to underweight the market became stronger over the past week. The lack of action by the ECB suggests further deterioration in markets, while uncertainty on the US financial reform bill persists. Valuation of HG bonds in yield terms has yet to improve as the rally in US Treasuries offset the widening of HG bond spreads. Our US HG client survey is showing a **sharp deterioration in investor sentiment**. Investors are now net bearish credit spreads with a net 7% of investors expecting wider spreads over the next month versus a net 27% of investors expecting tighter spreads last month.

We stay **neutral credits that are vulnerable** due to heavy positioning and high valuations, such as EM corporates, EMBIG, and benchmark ABS. For US high yield, off-the-run/subordinated ABS and super senior CMBS, we stay overweight as positive fundamentals and strong demand outweigh near-term headwinds. The spread tightening trend will take a pause during the market correction, but given the liquidity of these instruments and our bullish medium-term view, we see sell-offs as buying opportunities.

As European sovereign risks take center stage, we favor sectors with little European exposure such as US REITS. REITS are one of the best performing sectors within US HG, with US REIT spreads at 192bp, the sector continues

to be cheap relative to HG spreads of 143bp, which historically trade at similar levels. Moreover, our strategists believe property values have bottomed and expect cash dividends to return. **Overweight US REITS** versus HG given strong momentum and good value.

Foreign exchange

The ECB's refusal this week to extend liquidity has put markets in endgame mode, where policy inertia will inspire **further deleveraging**. In currencies, this process always involves an unwind of the carry trade, so reasonable targets should be based on the assumption that investor positions in high-yield currencies would be fully liquidated. Longs in high-yield and commodity currencies were liquidated quickly during the credit crisis but did not turn meaningfully short. If we assume a repeat of this pattern, the betas between commodity currencies and IMM positions imply that AUD/USD and NZD/USD could fall to 0.84 and 0.67, respectively, and USD/CAD rise to 1.06. If yen IMM shorts were fully unwound, USD/JPY would reach 90, but given the tendency of yen positions to move from short to long during a crisis, USD/JPY could reach 87 or below.

EUR/USD's path if the crisis intensifies is much less clear, since the unwind of longs in commodity currencies and emerging markets imply euro buying as investors delever. This flow would partially offset euro selling from capital flight, but we suspect the latter would dominate, thus **pushing EUR/USD to 1.20**. Cable would fall by more since a hung parliament leaves the UK institutionally unable to tighten fiscal policy at a time when European deficits are under the microscope. GBP/USD could thus fall to 1.35.

We thus take profits on euro shorts versus Asia (IDR, INR) and commodity FX (CAD), and roll them into **short Europe versus the dollar**. Sell GBP/USD rather than EUR/USD as the sovereign funding focus shifts to the UK following confirmation of the hung parliament. As outlined last month, sterling's cheapness does not insulate it against a further decline in coming months. Whatever government emerges risks mediocre growth as fiscal policy is tightened, or a rating downgrade and funding crisis if it delays tightening. Sell GBP versus USD and add a cash short versus CHF to the existing options position. Also take losses on short USD/CAD and JPY/KRW. Stay short EUR/CHF in view of the SNB's waning tolerance for unprecedented intervention.

Commodities

Commodities are massively down this week, as markets are now more concerned about the likely spillover effects of the sovereign debt crisis. All major sectors are down with the exception of precious metals. The rally in precious metals was, however, only due to an increase in gold prices (despite USD strength), as silver, platinum, and palladium also posted losses. Energy saw double-digit percentage losses with crude oil down to below $75 at a certain point, while base metals were not too far behind.

We remain **positive on improving fundamentals, but prices are likely to remain under pressure near term**. Our modal view is that conditions for future commodity demand growth are more supportive now than a few months ago and will continue to improve. Even though our modal view is for improving fundamentals, downside risks to prices are increasing and will continue to do so if the sovereign crisis lasts a lot longer and starts hurting growth prospects. For now, we maintain our medium-term view that stronger global growth will benefit base metals and crude oil, but also keep long positions in precious metals as uncertainty should remain high.

Ten-year Government bond yields

	Current	Jun 10	Sep 10	Dec 10	Mar 11
United States	3.43	4.10	4.25	4.50	4.70
Euro area	2.80	2.80	3.00	3.35	3.75
United Kingdom	3.83	4.05	4.20	4.30	4.55
Japan	1.28	1.40	1.50	1.55	1.55
GBI-EM	7.09			7.70	

Credit markets

	Current	YTD Return
US high grade (bp over UST)	158	4.6%
Euro high grade (bp over Euro gov)	173	2.0%
USD high yield (bp vs. UST)	649	5.6%
Euro high yield (bp over Euro gov)	657	7.5%
EMBIG (bp vs. UST)	338	2.7%
EM Corporates (bp vs. UST)	339	4.3%

Foreign exchange

	Current	Jun 10	Sep 10	Dec 10	Mar 11
EUR/USD	1.27	1.30	1.35	1.35	1.30
USD/JPY	91.4	87	90	93	96
GBP/USD	1.48	1.43	1.50	1.52	1.48

Commodities - quarterly average

	Current	10Q2	10Q3	10Q4	11Q4
WTI ($/bbl)	75	86	94	93	90
Gold ($/oz)	1209	1400	1300	1200	1225
Copper($/m ton)	6912	8000	6800	6250	6500
Corn ($/Bu)	3.72	4.05	3.95	3.90	4.00

Source: J.P. Morgan, Bloomberg, Datastream

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Economic Research Note

Challenging times for Euro area policymakers

- **Significant policy measures taken this week by fiscal and monetary authorities**
- **Further support from ECB likely, reinstating previous crisis measures**
- **Debt purchases possible, but would be a last resort**

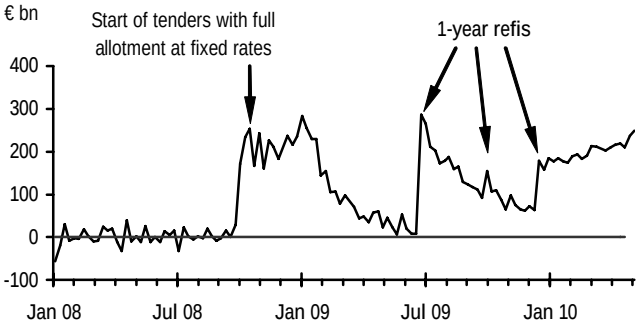
This week has seen two policy developments of huge significance. The Euro area, the IMF, and Greece agreed on a €110 billion financial support package, and the ECB announced that it was suspending the minimum rating requirement on Greek government collateral until further notice. The financial support being given to Greece is the largest package of multilateral support that any sovereign has ever received, and the ECB's collateral decision is the first time that the central bank has set its policy explicitly to support a single Euro area country. Each of these steps was taken to preserve financial stability in the region.

However, these dramatic steps have not had the effect on market sentiment that policymakers had hoped for. Asset prices have continued to fall, and bank funding pressures have continued to increase. This raises the question of what policymakers can do next to short circuit adverse market dynamics, where falling asset prices create funding problems for banks that threaten a return to a broader financial crisis. In one sense, the answer to this question is straightforward: the ECB can reinstate various policies that were put in place during 2008 as the financial crisis intensified. In another sense, the answer to this question is very hard. At its heart, this crisis is about the solvency of sovereigns. As a fiscal issue, it should be dealt with by the fiscal authorities. However, the absence of a central fiscal authority in the Euro area makes it difficult to deal with regional fiscal stresses. And, in the absence of aggressive action by the fiscal authorities, it is not clear how far the central bank should go in terms of dealing with the banking and financial market stress created by concerns about sovereign solvency.

Near-term support from the ECB

The easiest policy action to take next would be for the ECB to reestablish an FX swap line with the Fed—to deal with any dollar funding stresses—and to reinstate the longer-term refinancing operations—to deal with any euro funding stresses. It could even extend the maturity of the refinancing operations to two or three years. Each of these operations is

Excess reserves at the ECB



an appropriate way for the central bank to respond to the funding stresses that have built up in the banking system.

What the fiscal authorities could do

The next most appropriate step would be for the fiscal authorities to act. Over time, there needs to be a huge fiscal consolidation in Portugal, Spain, and Ireland. But, these sovereigns need time to achieve this in a way that minimizes the impact on the real economy. One option to create some time would be to establish financial support packages for Spain, Portugal, and Ireland similar to the one created for Greece. If each of these countries received financial support from the rest of the Euro area equivalent to 34% of their annual GDP spread over three years (the same as the €80 billion of bilateral loans for Greece) this would amount to 7.5% of annual GDP in the rest of the Euro area. This is a big number, but in our view, the rest of the region has the fiscal capacity to provide this level of support. Alternatively, the rest of the region could come up with some way of guaranteeing the debt of these sovereigns for a limited period, say three years. Guarantees are an attractive form of support because no money is needed up front, but the practicalities of such a scheme would be very challenging.

But, as we have seen with the Greek support package, in the absence of a central fiscal authority, the Euro area finds it hard to coordinate such actions quickly. To some extent, this reflects the large number of participants. But, more fundamentally, it likely reflects different views about various trade-offs that are involved, for example, between providing financial support now and encouraging moral hazard later. A key question is, what additional steps should the ECB take in the absence of more aggressive fiscal action?

Other actions by the ECB

The ECB's role is to provide liquidity to banks in order to help maintain financial stability across the region. It is clearly not appropriate for the ECB to provide monetary financing of fiscal positions, especially if there are con-

cerns about the solvency of the sovereign. But, it is not easy to separate an appropriate monetary policy response to heightened banking and financial stress from an inappropriate monetary policy response of supporting a potentially insolvent sovereign.

The next step the ECB could take, beyond the reinstatement of FX swaps and longer-term refinancing operations, would be outright purchases of sovereign debt. The ECB has not yet executed outright purchases, and it is far from clear that the central bank would be comfortable engaging in such operations in the current environment. As a generalized support mechanism for banks, the ECB would purchase a broad basket of government debt. But, in the current environment, what would be needed would be targeted purchases of sovereign debt in Spain, Portugal, and Ireland.

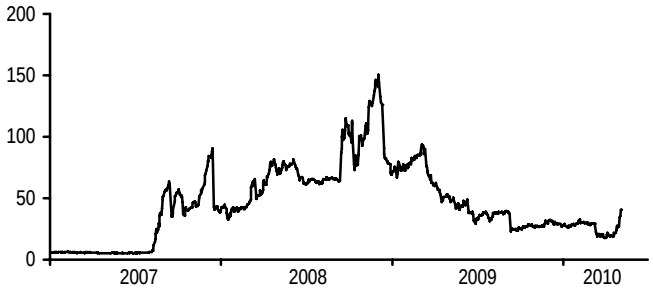
Many commentators have focused on the legality of such a move, as indicated by the Lisbon Treaty, which clearly forbids the central bank from engaging in the direct monetary financing of fiscal deficits. A lot of attention is drawn to the specific wording of the relevant article of the treaty, which rules out direct purchases of sovereign debt by the ECB or its member central banks, but leaves open the possibility of purchases in the secondary market. Rather than dwell on this distinction and the specific language in the treaty, it is more important to recognize the spirit in which the text was drafted, and how the ECB could explain its actions in that spirit.

There is little doubt that the desire to prohibit the explicit monetization of fiscal deficits guided the drafting of the various treaties governing the Euro area. It is clearly inappropriate for any central bank to provide ongoing monetary financing of a sovereign's fiscal position, which presumably only tends to happen when the solvency of the sovereign is in question. But, it is harder to know what the central bank's response should be in a monetary union like the Euro area where concern about sovereign solvency is creating banking and financial stress across the region. The appropriate response is a fiscal one, as highlighted above. But, in the absence of such a response, should the ECB step in with outright purchases to limit the ongoing pressure on banks and the broader financial system?

It is a hard question to answer, and it may be a step too far for the ECB. But, one interesting comparison is with the Bank of England (BoE). Although it might look like the BoE has financed the fiscal deficit over the past year by the creation of money, the key issue has been the motivation for the outright purchases of government debt. The BoE has argued that its actions have not comprised monetization, but rather

Money market conditions

Euribor versus EONIA spread (front contracts)



have been motivated by a desire to meet the inflation target. In a similar vein, the ECB could argue that its motivation with outright purchases would be the preservation of financial stability in the region, rather than monetary financing.

Another possible lesson from the Bank of England is how to structure outright purchases. In the UK, an off-balance-sheet vehicle was set up (the Asset Purchase Facility), which was indemnified by the fiscal authorities. Presumably in the Euro area, a vehicle could be created that had equity capital from sovereigns and that borrowed from the central bank in order to buy government debt. Given the broader circumstances, it is almost certain that the ECB would only be comfortable participating in such a facility if there was also a commitment to additional fiscal tightening in the relevant sovereigns.

Concluding thoughts

Over the past couple of years, the monetary and fiscal authorities in the Euro area have taken some very dramatic steps to support the banking sector and to limit the adverse consequences of financial stress on the real economy. These dramatic actions have continued this week, but with a somewhat different dimension. Two years ago, the key issue was the solvency of the banks; now the key issue is the solvency of some sovereigns. The respective roles of the central bank and the fiscal authorities have been fairly clear up until now. However, there is some uncertainty about where we go next. The ECB's role is to limit financial stress by ensuring banking sector liquidity. There are clearly further steps it could take in the current environment, such as FX swaps and longer-term tenders. And, of course, there are further steps that the fiscal authorities could take. But, the biggest uncertainty is whether, in the absence of further fiscal action, the ECB would consider outright purchases in order to maintain financial stability in the region. While such purchases are possible, in our view, the ECB would not undertake them lightly or preemptively.

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Economic Research Note

Greece will need help beyond the current program

- **Financial support provided through 2012**
- **But primary budget position still in deficit in 2012**
- **Financial support likely needed in 2013 and beyond**

As stated, the objective of the Euro area/IMF support package for Greece is to give the Greek government an opportunity to move to a position of debt sustainability away from the pressure of the financial markets. Given that it is a three-year package, the implication is that Greece should return to the capital markets in 2013, at the latest.

Our analysis of the deficit and debt trajectories suggests that debt sustainability will not be achieved at the end of the current program. Given the still-wide deficit and very high level of debt outstanding likely in 2013, it remains an open question as to whether Greece will be able to return to market financing when the current program ends.

This suggests that the support program is less about Greece achieving debt sustainability over the program horizon, and more about the Greek government demonstrating that it is worthy of continued multilateral support in 2013 and beyond. This view received support from comments by EC Commissioner Rehn, who said, "Gradually Greece should be able to return to financial markets. But still beyond 2012-2013, we will partly cover the financing needs of Greece if needed." The size of the support package and these comments suggest that there is a huge reluctance in the Euro area to allow Greece to restructure its debt. Nevertheless, whether or not Greece restructures depends critically on the fiscal and structural changes that take place during the course of the current support program.

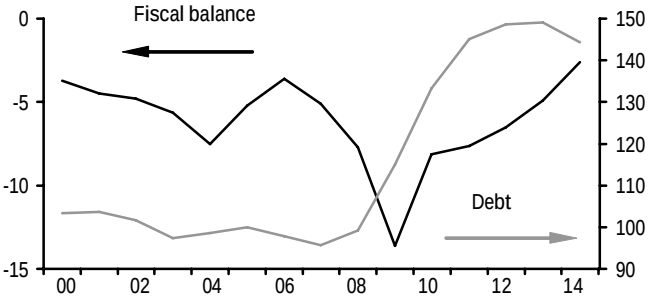
The objective of debt sustainability

In one way or another, the Greek government will achieve debt sustainability, either by generating a large primary surplus or by restructuring its debt. The three-year Euro area/IMF support package agreed this week is intended to help Greece achieve debt sustainability without restructuring. But, it is far from clear that the objective of debt sustainability will be achieved by the end of the three-year program.

The profile for deficit reduction is more modest in the new program than it was in the original Stability Program published in January, largely reflecting the upward revision to

Greek fiscal deficit and debt: government forecast

% of GDP, both scales



The outlook for Greek GDP and public finances

		2009	2010	2011	2012	2013	2014
Original SGP Jan 2010	GDP %oya	-1.2	-0.3	1.5	1.9	2.5	na
	Deficit % of GDP	-12.7	-8.7	-5.6	-2.8	-2.0	na
	Debt % of GDP	113.4	120.4	120.6	117.4	113.2	na
Revisions since January	GDP %oya	-2.0					
	Deficit % of GDP	-13.6					
	Debt % of GDP	115.1					
New program Apr 2010	GDP %oya	-2.0	-4.0	-2.6	1.1	2.1	2.1
	Deficit % of GDP	-13.6	-8.1	-7.6	-6.5	-4.9	-2.6
	Debt % of GDP	115.1	133.3	145.1	148.6	149.1	144.3

SGP refers to Stability and Growth Program. We assume that the debt projections in the new program from 2010 onwards include an upward revision of 5-7%-pts of GDP from the Eurostat Inquiry.

Changes to the deficit projections

% of GDP

	2010	2011	2012	2013
January SGP	-8.7	-5.6	-2.8	-2.0
Impact of worse 2009 outturn	-0.9	-0.9	-0.9	-0.9
Impact of growth revisions:				
2010	-1.9	-1.9	-1.9	-1.9
2011	0.0	-2.1	-2.1	-2.1
2012	0.0	0.0	-0.4	-0.4
2013	0.0	0.0	0.0	-0.2
Total impact of 2009 revisions and weaker growth	-2.8	-4.9	-5.3	-5.5
January SGP plus previous row	-11.5	-10.5	-8.1	-7.5
New program projection	-8.1	-7.6	-6.5	-4.9
Difference	3.4	2.9	1.6	2.6

European Commission new forecast on Greece

% of GDP

	2008	2009	2010	2011
Fiscal balance	-7.7	-13.6	-9.3	-9.9
Interest expenditure	4.6	5.1	5.4	5.8
Primary balance	-3.1	-8.5	-4.0	-4.1
Cyclically adjusted fiscal balance	-9.6	-14.1	-8.2	-8.2
Cyclically adjusted primary fiscal balance	-5.0	-9.0	-2.8	-2.4

Source: EC European Economic Forecast publication, Spring 2010

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the estimated deficit for last year and the downward revision to the growth projections. The effect of these developments, as well as possible higher debt servicing as the debt to GDP ratio is expected to rise to almost 150%, more than offsets the impact of additional tightening measures. In the original Stability Program, the Greek government was aiming for a fiscal deficit of 2.0% of GDP in 2013, with outstanding debt at 113.2% of GDP. In the new program, the Greek government is aiming for a deficit of 4.9% of GDP in 2013, with outstanding debt at 149.1% of GDP. The obvious question to ask is this: if financial markets are unwilling to fund the Greek government this year—when the original Stability Program was looking for a deficit of 8.7% of GDP and outstanding debt of 120.4% of GDP—will they be willing to fund the Greek government in 2013—when the new program is expecting a deficit of 4.9% of GDP and outstanding debt of 149.1% of GDP?

It is, of course, the primary budget position that is critical to debt dynamics, but unfortunately we do not yet have a new profile from the Greek government for the primary position. But, it is clear that the achievement of a primary surplus has been delayed by two years, from 2012 to 2014. In 2014, the overall deficit is projected to be 2.6% of GDP, which suggests a primary surplus of around 2.5% of GDP. This will not do much to improve the debt profile. Indeed, in its Memorandum of Economic and Financial Policies, the Greek Finance Ministry recognizes that a large primary surplus—of at least 5% of GDP—will need to be sustained after the current program ends, up to 2020. We would make three observations. First, assuming borrowing costs equal nominal GDP growth, then a 5% primary surplus sustained from 2015-2020 would take the debt-to-GDP ratio down to around 115% in 2020. Second, assuming borrowing costs are around 100bp higher than nominal growth, then a 5% primary surplus sustained from 2015-2020 would take the debt-to-GDP ratio down to around 120% in 2020. And third, the achievement of such a primary surplus implies a significant further fiscal tightening beyond the current plans.

Greece: fiscal measures included in the program
€ mn

	2010	2011	2012	2013	Cum	% of GDP
Revenue measures						
VAT rates increase by 10% (10% to 11%; 21% to 23%)	800	1000	0	0	1800	0.8
Broadening VAT base	0	1000	500	0	1500	0.7
Excise tax on fuel	200	250	0	0	450	0.2
Excise tax on cigarettes	200	300	0	0	500	0.2
Gaming royalties	0	200	400	0	600	0.3
Special levy on highly profitable firms	0	600	0	0	600	0.3
Presumptive taxation of professionals	0	400	100	0	500	0.2
Increase legal value real estate	0	400	200	100	700	0.3
Amnesty land use violations	0	500	0	0	500	0.2
Taxation of unauthorized establishments	0	800	0	0	800	0.3
Other	50	1150	525	-725	1000	0.3
Expenditure measures						
Reduce wage bill by cutting bonuses/allowances	1100	400	0	0	1500	0.7
Workforce reduction beyond 5:1 (add. 20,000)	0	0	600	500	1100	0.5
Eliminate pension bonuses (except for minimum pensions)	1500	500	0	0	2000	0.9
Cut intermediate consumption	700	300	0	0	1000	0.4
Kalikrates	0	500	500	500	1500	0.7
Cut in transfers to public enterprises	0	0	1500	0	1500	0.7
Cut domestically funded investment spending	500	500	500	0	1500	0.7
Yet to be quantified yield from structural reform initiatives	0	0	0	4200	4200	1.8
Other	750	350	750	200	2050	0.8
Total annual measures	5800	9150	5575	4775	25300	11.0
Revenue measures	1250	6600	1725	-625	8950	3.9
Expenditure measures	4550	2550	3850	5400	16350	7.1
Total measures (% of GDP)	2.5	4.1	2.4	2.0		11.0
Revenue measures	0.5	3.0	0.8	-0.3		3.9
Expenditure measures	2.0	1.1	1.7	2.3		7.1
Memorandum item:						
Nominal GDP	231	224	228	235		229

Source: Greece: Memorandum of Economic and Financial Policies, Greek Finance Ministry, May 3, 2010

More help may be needed beyond 2012

It is not clear whether the lack of market access at the moment is due to the fact that Greece has already passed the point of "debt intolerance" (which means that investors already have too much Greek debt), or to the unstable forward dynamics due to the large deficit, or to a broader-based lack of credibility. But, it is certainly possible that the Greek government will need more time to achieve debt sustainability than the current program allows. Thus, unless revenue collection gains are exceptional, spending cuts achieve more than is currently expected, growth surprises to the upside, very significant asset sales are achieved, or there is a major credibility boost, the Greek government is likely to need further financial help beyond the current program.

The likelihood of further help being necessary beyond 2012 is recognized by the Euro area authorities. This suggests that the critical role of the Greek fiscal and structural adjustment over the coming three years is not to achieve debt sustainability during that period, but rather to justify further multilateral support in 2013 and beyond.

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Economic Research Note

China: growth outlook solid despite housing policy changes

- **With policy rate moves yet to arrive, tightening measures have focused on asset inflation risks**
- **Liquidity and fundamental conditions suggest consolidation in runaway property market**
- **Overall fixed investment growth set to moderate this year; pace of gain in commodity imports likely to ease**

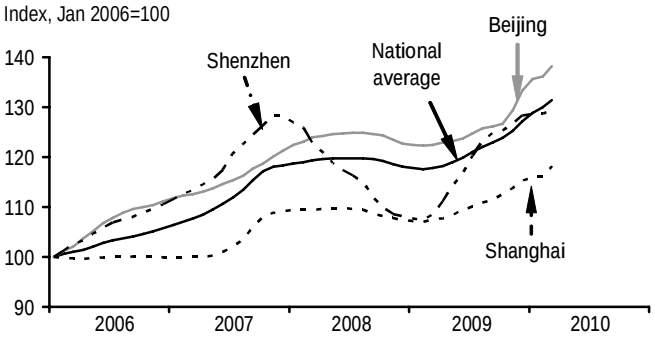
While financial markets are still waiting for China to begin its rate hiking cycle and to allow its currency to appreciate (which we expect will happen some time this quarter), in recent weeks the Chinese authorities have implemented a series of measures to address the concerns of excess liquidity and asset inflation. Over the weekend, the central bank raised the reserve requirement ratio (RRR) 50bp, the third such move this year, in order to withdraw excess liquidity from the financial system.

Perhaps more eye-catching has been the series of high-profile tightening measures directed at the housing sector by the central government since mid-April, amid growing concerns over the red-hot property market. Such measures included raising the first installment requirement of second-home purchases further to 50% and raising the mortgage interest rates applied to those home purchases. Even stricter rules apply in cities experiencing remarkable property price rises: the Beijing city government decided last week to stop banks from extending mortgage loans for third-home purchases, as well as loans to non-Beijing residents. Domestic financial markets have been increasingly concerned about the impact on the property market, the banking sector, and overall economic growth. In our view, the latest series of policy moves reinforces our call for cooling FAI growth this year, and is in line with the moderate easing in headline GDP growth (to a more sustainable 9%-9.5% sequential pace) that we have penciled in for coming quarters after the sharp rebound since 2Q09 that has averaged 12.2%. Our forecast for 10.8% 2010 GDP growth remains intact.

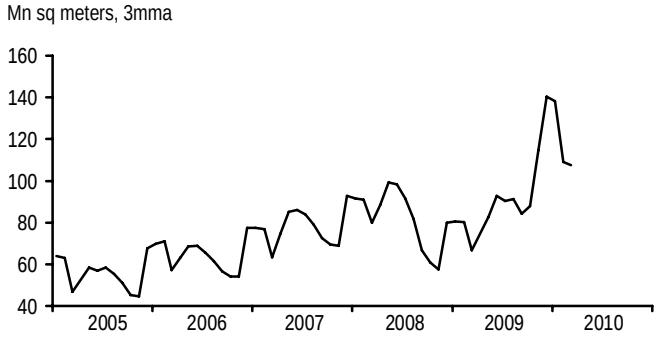
Liquidity and supply-demand adjustments

The central bank's move to remove excess liquidity from the financial system should help ease the monetary support that has been fanning the property boom since early 2009. Indeed, during the monetary normalization process gradually playing out this year, we expect the most credit-sensitive sectors to be most affected, especially domestic asset markets, such as property (see "China: monetary conditions to adjust as growth broadens," *GDW*, February 5).

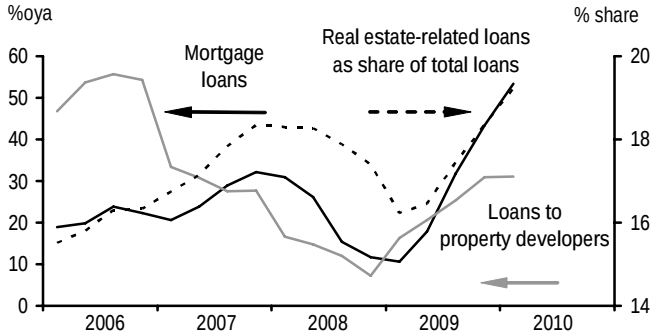
Property price indices



New building starts by floor space



Mortgage loans and loans to property developers



Meanwhile, supply and demand factors in the housing market are gradually adjusting. On the supply side, new building starts and real estate investment slowed sharply during 2H08 and early last year (second chart), on the back of earlier credit tightening in 2007 and 1H08, although they have picked up sharply since 2H09. Indeed, with rising property sales and improving credit conditions last year, new building starts for the 12 months ending March were 40% higher than the average in the previous three years; these properties should come on to the market by 2H10. On the demand side, through new, tighter mortgage rules, the authorities want to rein in speculative/investment demand for property.

Indeed, the authorities' intention to focus on mortgages is understandable, as mortgage loans leapt 53.4%oya in the 12 months through March, a much faster pace than the loan extension to property developers (third chart, previous page). Meanwhile, looking at the broader picture of the banking sector's direct exposure to the property market, total real estate-related loans rose to 19.2% of overall bank loans, the highest level seen in recent years.

Gauging the impact on overall growth

The housing sector has become an increasingly important source of economic growth in recent years. In 2009, fixed investment contributed 92.3% of the 8.7% headline real GDP growth, while housing FAI was 22.2% of total investment (first table). Looking back, during the last property tightening cycle in 2007 and 1H08, real estate investment slowed sharply, even before the global financial crisis began to impact the Chinese economy. Back then, in addition to the tightening of mortgage policy, property developers' funding for new construction projects was severely cut by banks, which, coupled with falling property transactions, forced developers to cut prices and slowed investment.

This time, most property developers entered the tightening phase in stronger financial positions, suggesting that, while they may be more cautious in investing in the face of tightening policy, the sharp slowing in real estate FAI experienced two years ago is unlikely to be repeated. Besides, as part of the plan to stabilize property prices, the authorities have emphasized speeding up the building of low-income housing. (In its April property policy statement, the State Council highlighted that no less than 70% of new land for housing development should be devoted to medium- and smaller-sized houses and economic housing.) This should promote a steady rise in total real estate investment this year. Overall, we expect that the pace of total fixed investment growth will moderate to 22.5% this year from 31% in 2009.

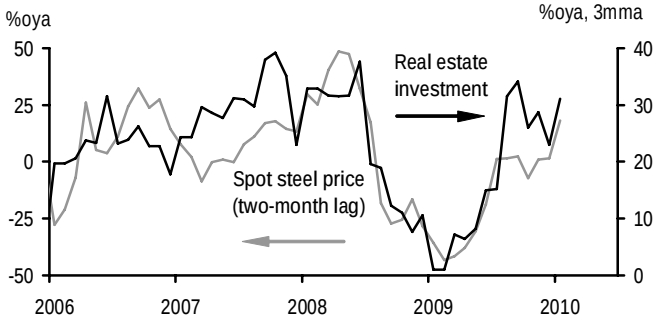
In other sectors of the economy, slowing property transaction growth may affect related consumer spending, such as expenditure on furniture and household refurbishing, which rose notably last year (second table). Alternatively, increasing confidence in the economy, improving labor markets and hence household income, and overall consumption-friendly macro policy should support solid household spending growth this year. Steady recovery in the export sector should support manufacturing employment and income growth. As China's imports of commodities and machinery are closely related to the fixed investment cycle, our outlook for moderating FAI growth suggests the pace of gain in China's imports of raw materials/commodities is likely to ease.

Nominal fixed asset investment

	2009	1H09	3Q09	4Q09	1Q10
	%share	%oya	%oya	%oya	%oya
Total	100.0	33.6	32.9	26.2	26.4
Primary industry[1]	1.7	68.9	37.4	38.4	9.7
Textile and related	2.0	11.2	15.5	28.3	21.0
Machinery and electronic equipment	7.4	34.4	29.0	35.0	27.9
Metal and commodities	11.5	27.9	17.8	17.7	39.5
Transportation equipment	2.6	36.7	37.5	18.0	17.3
Electricity, gas, and water production[1]	6.9	28.7	25.4	31.3	9.7
Housing	22.2	15.3	33.9	22.0	36.2
Transport infrastructure and construction[1]	13.0	63.4	51.2	36.3	27.0
Water conservation, environment management[1]	9.2	54.5	46.2	34.6	24.5
Healthcare, social security, education, culture[1]	4.2	55.3	55.6	28.6	26.0

1. Sectors targeted for expansion by the government.

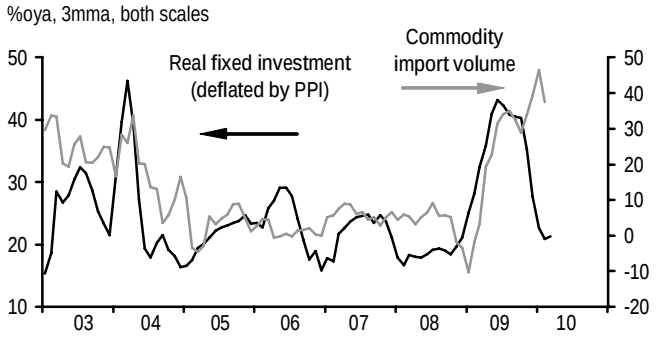
Real estate investment and domestic spot steel price



Retail sales value growth (%oya, ytd)

	Jun 09	Sep 09	Dec 09	Mar 10
Overall	15.0	15.1	15.5	17.9
Food	12.6	12.8	14.0	18.4
Consumer staple goods				
Garments/footwear	18.0	16.9	18.8	23.9
Daily-use items	14.0	14.2	15.6	22.4
Consumer durable goods				
Furniture	33.3	32.3	35.5	37.6
Construction materials	-	21.1	26.6	26.8
Automobiles	18.1	24.5	32.3	39.8
Household electronics	5.1	6.9	12.3	29.6
Luxury consumer goods				
Cosmetics	17.2	17.6	16.9	15.6
Jewelry	15.4	15.5	15.9	37.3

Fixed investment and commodity imports



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Economic Research Note

Australia's Budget to set scene for looming election battle

- **Treasurer Wayne Swan delivers Australia's annual Budget next Tuesday**
- **Looming election means the "no frills" Budget will include some sweeteners to entice voters**
- **Election could be held as early as August; Government now trailing in opinion polls**

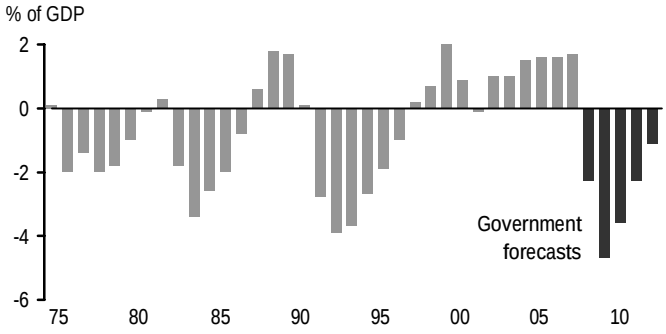
Even after recent frenetic activity, Australia's policymakers face an unusually busy period. The federal government revealed on Sunday the outcome of a "root and branch" review of the tax system, and next Tuesday night will deliver the Budget for the year ahead. Then, the government faces an election, possibly as early as August; unofficial campaigning by the major parties kicked off some time ago and no doubt will escalate in coming weeks. Meanwhile, the Reserve Bank continues to raise official interest rates; the Bank this week hiked rates for the sixth time in seven Board meetings, partly owing to the hugely stimulative effect of the booming terms of trade.

With the election looming and opinion polls tightening in favor of the opposition, the Budget will include sweeteners that government officials hope will boost their chances of re-election. There already is another round of (modest) personal income tax cuts on the way from July 1, and there will be measures such as quarantining interest earned on bank deposits from taxation. There probably will be changes to healthcare arrangements, but also broad expenditure savings across many portfolios. The imminent election means the government, though officials say the Budget will have "no frills," will steer clear of politically sensitive measures like a rise in "vice" taxes on gambling and alcohol, and higher taxes on gasoline. History shows that few treasurers are courageous enough to utter the words "tax" and "election" in the same sentence.

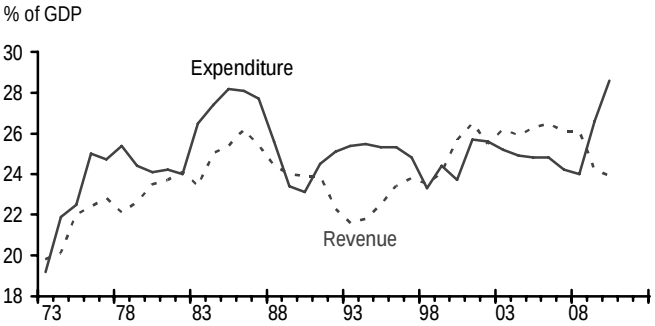
Lower headline Budget deficit and debt

The good news for the government is that the unexpectedly robust economy means the Treasurer will announce a significantly improved fiscal position, relative to the last forecasts published in November. We forecast a headline Budget deficit of A$27 billion for 2010-11, significantly below the government's previously published estimate of A$46.6 billion, which likely will remain elevated next week. The Treasurer probably will announce smaller Budget imbalances over the forecast horizon, including a small surplus in 2012-13, three years earlier than first projected. The lower peak in government debt means there will be a substantial reduction in projected CGS bond issuance. We estimate peak bonds on issue of A$215 billion in mid-2014.

Commonwealth budget balance



Commonwealth Government revenue and expenditure



The government has refused to speculate publicly about whether the Budget will be back in surplus earlier than under the existing projections. The Treasurer has indicated that accumulated corporate losses during the financial crisis, partly via asset write-downs, will be a drag on tax collection for some time. The unexpectedly rapid bounce in the economy, though, inevitably will be reflected in higher revenue. It also will have capped growth in non-discretionary spending. Predictably, however, the government's discretionary spending has ballooned as the election approaches.

Government shows mining no ReSPecT

The release last Sunday of the long-awaited Henry Tax Review (kept on ice since late 2009) revealed that the government plans to adopt a mere handful of the 138 recommendations of the review panel headed by Treasury Secretary Dr. Ken Henry. Among the more contentious measures the government adopted is a Resources Super Profits Tax (RSPT); if approved, this 40% tax will be levied from July 2012 on the "super profits" of mining companies, which stand to

make excess returns amid booming commodity prices and strong demand from China. The proceeds of the mining tax will be used to fund tax relief for small businesses, a staged decline in the company tax rate from 30% to 28% by 2014, and public spending on mining-related infrastructure. The government announced a rise in employer-funded retirement payments from 9% of income to 12% by 2020, but did not abolish a single tax, even the inefficient state levies like the payroll tax, a disincentive to job creation. Australia, therefore, will likely have more taxes in 2012 than it does now.

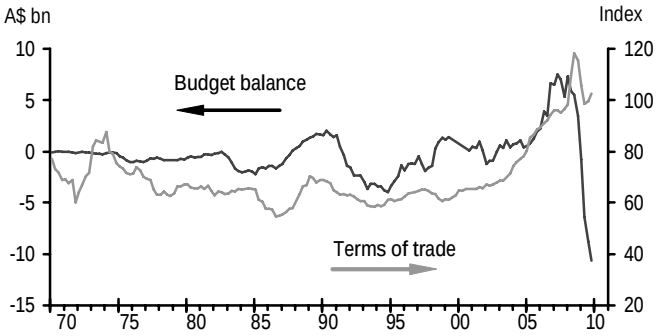
The contentious mining tax probably will face stiff opposition in parliament—the main opposition party this week committed to opposing it. The government, therefore, could delay the relevant legislation's introduction until after the next election, when government officials hope the mix of the Senate will change in their favor; Green senators, for example, seem inclined to pass the legislation. The government claims the new regime, which offsets the cost of existing royalty payments, will boost GDP growth, partly by making marginal mines more economical, thus boosting early stage investment. There is evidence, however, that investors in large projects already are having second thoughts. Global resources giant Rio Tinto has all mining investment in Australia "under review"; a number of smaller operators have put investment on hold.

Many of the reforms recommended by the Henry Review panel have significant merit on efficiency grounds, but will not be adopted in the near term. The Treasurer declined to change, for example, the tax treatment of housing, which distorts investment decision-making, or to reinstate indexation of the excise tax on gasoline; indexation was suspended by the former coalition government ahead of the 2001 election. These measures simply are too politically toxic for the government to adopt in an election year. While deferring difficult decisions is understandable in this politically charged environment, it means the Review falls short of delivering fundamental reform. We view this experience, therefore, as a golden opportunity missed.

Some sweeteners in a "beige" Budget

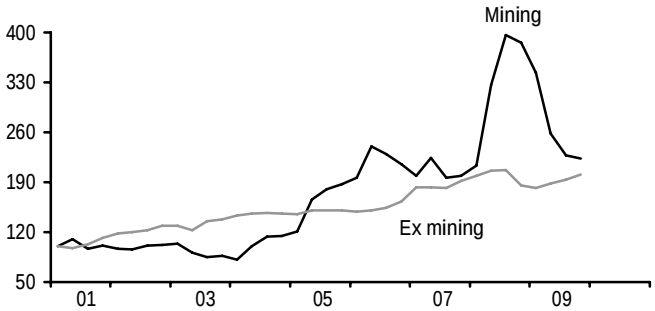
Adoption of some of the Review panel's less objectionable recommendations probably has been held over to the Budget (or even to the election campaign to follow). With many policy "cats" already out of the bag, however, this Budget could be one of the blandest for some time. The government hopes to use Tuesday's Budget to endorse its public perception as a competent manager of the economy. Opinion polling consistently indicates that respondents give the government credit for steering Australia's

Terms of trade and budget balance



Company profits

Index: 2001 = 100



economy through the global crisis with minimal damage. The government acted quickly in late 2008 via fiscal policy to stimulate growth, although evidence has emerged recently that some of the discretionary spending was misdirected into less productive parts of the economy, and even wasted. Maintaining a perception of economic competence means the government has to resist delivering a free-spending Budget, even though it precedes an election that looks increasingly like a tight contest.

Tax cuts, child care, health, and housing

However, with the election still up for grabs, and the latest published opinion polls showing the main opposition party leading the Labor government for the first time since 2006, the Budget almost certainly will include a few sweeteners for voters, including:

- Confirmation of the *personal tax breaks* announced in last year's Budget. The 38% tax rate for those earning above A$80,000 is being trimmed to 37%, and the A$35,000 threshold is being raised to A$37,000;

- The provision of *tax breaks for interest* earned on savings deposits, as recommended by the review panel. This could boost deposits with banks, lowering the banks' reliance on offshore wholesale funding;

- Addressing the *punitive tax rates* that apply to some low income earners when they move from welfare to work;
- More funding for public *child care places*. The government recently controversially shelved promised plans to build new child care facilities;
- Relief for *unincorporated small businesses*, which will not benefit from the planned cut to the corporate tax rate;
- Easing the *taxation compliance burden* on lower income earners by, for example, making personal income tax returns optional (currently, filing a return is compulsory for all taxpayers earning more than the tax-free threshold);
- A rise in funding for *health and hospitals*, in line with the recent agreement with seven of the eight state and territory governments. There may be changes to private health rebates for higher income earners;
- More public funding of *pharmaceuticals*, with relief aimed at lower income earners;
- A boost to the *old-age pension* and possibly changes to eligibility criteria for other benefits;
- Changes to the *tax treatment of superannuation*, including a possible rise in the 15% concessional tax rate for high income earners, and the contribution limits; and
- Steps to improve *housing affordability* for first-home buyers (FHBs). Possible measures include a boost to publicly funded construction to help alleviate shortages. The FHBs' grant and the existing tax break on investment in housing (negative gearing) will not be touched.

With many fiscal measures already in the public domain, the fluffiest "rabbit" the Treasurer will pull out of his hat will be the earlier return to surplus. The transition "back to black" will be helped by the first year of revenue from the new mining tax and the recent rise in the tobacco tax. The government announced the regressive rise in the tobacco tax last week, just days before releasing the tax review. Cynical commentators suggested this was to divert attention from the government's backflip on its commitment to address global warming; it shelved plans for an emissions trading scheme (ETS) until at least 2013.

Election 2010: opinion polls tightening

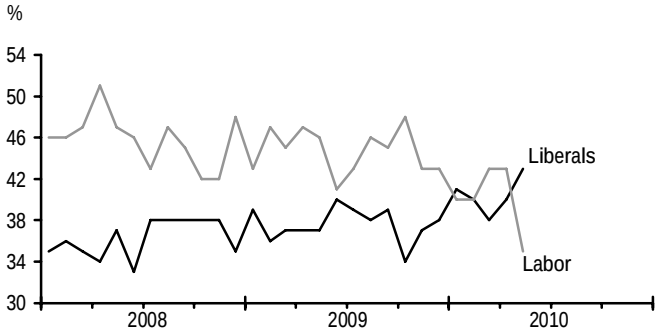
The Labor government led by Prime Minister Kevin Rudd has suffered an abrupt slide in opinion polls, following a series of policy reversals in recent weeks. In addition to the reversal on emissions trading, the government canceled the controversial roof insulation scheme, following the deaths of four installers and dozens of associated house fires; scaled back promised construction of child care centers; and announced a review of the multi-billion-dollar school construction program. Earlier, the government abandoned its programs to massage energy and grocery prices. The latest shift in polling reflects a growing concern among some voters that the government has failed to deliver on key election promises, and that ministers lack the courage to make tough political decisions. The government, for example, also recently backflipped on the established policy for asylum seekers arriving by boat from Sri Lanka and Afghanistan, to appease popular opinion.

Australia's Parliament : state of the houses
Number of seats

	Lower house	Upper house
Liberal (Coalition)	55	32
Country Liberal (Coalition)	-	1
National (Coalition)	9	4
Labor	83	32
Green	-	5
Family First	-	1
Independent	3	1
Total seats	150	76

Source: Australian Electoral Commission

Voting intentions: major parties



Source: Newspoll

That said, the government delivered on its promise to repeal the former Howard government's industrial relations laws, which proved unpopular with many voters, and gets significant credit for managing Australia's economy through the global recession—even though booming demand for bulk commodities in China and soaring commodity prices arguably played more significant roles in Australia's outperformance than the government's pump-priming. The RBA's aggressive interest rate cuts in late 2008 also were crucial in supporting domestic demand.

The government's alarming slide in the opinion polls was so sharp that the Liberals now lead the government for the first time in more than four years, even though most of the "vote" that deserted the government headed for the minor parties, not the Coalition. This implies voters are not convinced opposition leader Tony Abbott would be a better prime minister than Rudd.

Election held no earlier than August 2010

Australians generally go to the polls in federal elections every three years. Voting is compulsory. There is, however, no fixed term; prevailing governments can choose the timing of elections. There have, for example, been elections in consecutive years, like 1983-84. All 150 seats in the lower house of Parliament are up for grabs at each election, with elected members supposed to serve at least a three-year term. Only half of the 76 seats in the upper house Senate, however, are contested each time. The 12 senators from each of the six states are supposed to serve six-year terms, but the two senators each from the two territories are supposed to serve only for three years. Only under a double dissolution election, which are few and far between, are all seats in both houses of Parliament contested in the same federal election.

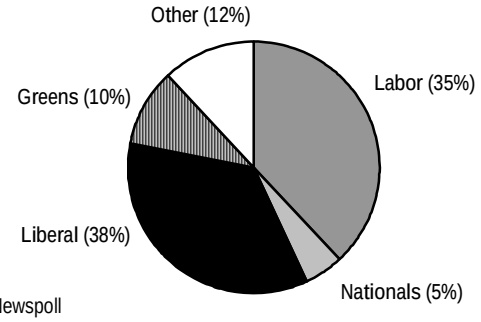
Labor topped the 2007 poll by winning 52.7% of the two-part preferred vote (after distribution of preferences of minor parties). Labor, with 83 seats, has a 16-seat majority in the lower house. The Coalition has five more seats than Labor in the Senate, but no majority; the balance of power is held by minor parties. From July 1, the outcome of the 2004 election will be reflected in a change in the composition of the Senate. Labor's poor election outcome back then will "rotate" out of the new Senate; Labor and the Greens should gain seats.

The earliest the coming election can be held is Saturday, August 7, 2010; the latest it can be held is Saturday, April 16, 2011. The most likely timing is October, after the football finals in September; politicians of all persuasions know not to distract Australians from their sport. The government can have the election earlier than in August only by calling for the dissolution of both houses of Parliament. The government already has the right to call a double dissolution election owing to key pieces of legislation twice being rejected by the Senate. The government has, however, declined to take this option, at least so far.

Election issues: health, rates, economy

The government has history on its side: only once since Federation in 1901 has a first-term government *not* been re-

Voting intentions—all parties
Percent



Source: Newspoll

elected. The government has been clearing the decks of contentious issues; its aim is to have the electorate focus on the two areas where polling indicates the government has an advantage: health and hospitals and management of the economy. The opposition, meanwhile, hopes the election will be fought over the government's recent policy reversals and rising interest rates. The latter always are politically sensitive, but particularly so ahead of an election. It can be argued that the RBA's interest rate hike two weeks ahead of the 2007 poll was the final nail in the coffin of the long-serving Howard government; Prime Minister John Howard had promised to keep interest rates low.

The 2010 election probably will be fought on the following primary issues:

- *Management of the economy*, including the impact of rising interest rates and the cost of living—the latter was a big issue in the 2007 election;
- The opposition will be pushing the idea that the government has *failed to deliver on promises;*
- *Industrial relations*—trade unions claim the Liberals would, if elected, bring back their notorious industrial laws;
- *Health and hospital reform*—the government recently announced new funding arrangements in conjunction with state and territory governments;
- *Parental leave and child care*—the government and the Coalition are competing to be more generous to families;
- The *environment*, particularly given that the government recently withdrew support for an ETS. The opposition opposes introduction of an ETS; and
- The controversial *mining tax* and other "reforms" announced following the Henry Tax Review.

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Economic Research Note

Philippines BoP surplus expected to widen

- **Structural shifts favoring remittances and services have led to current account surpluses in recent years**
- **Global cyclical upswing to provide additional boost to current account; financial account also to benefit**
- **Balance of payments (BoP) most closely follows current account; BoP surplus thus likely to widen in 2010**

After mostly running deficits between the mid-1970s and early 2000s, the Philippines' current account has shifted to surplus. This reflects structural changes that have favored service exports (mainly business processing outsourcing) and current transfers relative to goods exports.

Strong cyclical momentum should also provide support to the external accounts this year. Exports of goods and services are anticipated to rebound after contracting in 2009, while strong global growth should translate into greater remittance inflows. In addition, the financial account, which posted large deficits in 2008 and 2009, should be less of a drag in 2010 as the flight to quality by investors and repayment of external debt by Philippine banks experienced in the past two years are unlikely be repeated.

Given the cyclical and structural supports this year, we are forecasting a multi-decade-high current account surplus. Historically, the BoP has most closely followed the current account. Thus, a strong current account position combined with our expectation for a flat financial account balance should lead to a widening in the overall BoP surplus in 2010.

Important structural shifts under way

The shift in the current account to surplus in recent years reflects two notable trends. First, remittances have surged, averaging 14% growth each year since 2002. While some of the growth in remittances has been due to better tracking, much of it is a result of greater numbers of overseas foreign workers (OFWs) going abroad and their improved access to remittance facilities. Even during the height of the global crisis, remittances rose, which is an important benefit of the geographical and professional diversity of OFWs. As a result, current transfers have risen from a low of 1.7% of total current account receipts in 1998 to about 24% in 2009.

In addition to remittances, services, in particular business processing outsourcing (BPO), have become increasingly

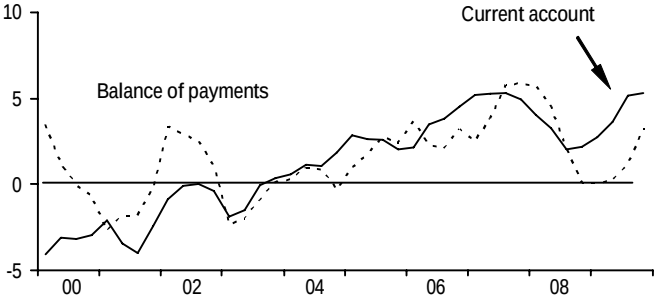
Balance of payments

% of GDP

	2004	2005	2006	2007	2008	2009	2010F
Overall balance	-0.3	2.4	3.2	5.9	0.1	3.3	5.0
Current account	1.9	2.0	4.6	4.9	2.2	5.3	5.9
Goods	-6.5	-7.9	-5.7	-5.8	-7.7	-5.5	-4.3
Other balances	8.4	9.9	10.3	10.7	9.9	10.8	10.2
Services	-2.0	-1.4	0.1	1.6	0.7	1.0	0.9
Income	-0.1	-0.3	-1.1	-0.6	0.1	0.0	-0.1
Current transfers	10.5	11.5	11.3	9.8	9.1	9.9	9.3
Financial account	-1.9	2.3	0.0	2.4	-1.1	-1.2	0.1
Direct investment	0.1	1.7	2.4	-0.4	0.8	1.0	1.2
Portfolio investment	-2.0	3.5	2.6	3.2	-2.3	0.9	0.6
Other investments	0.0	-2.9	-5.0	-0.1	0.5	-3.2	-1.7
Errors and omissions	-0.3	-1.8	-1.4	-1.4	-1.0	-0.8	-0.9

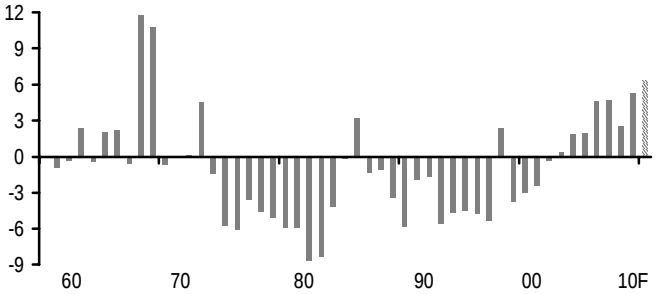
Philippines: BoP composition

% of GDP



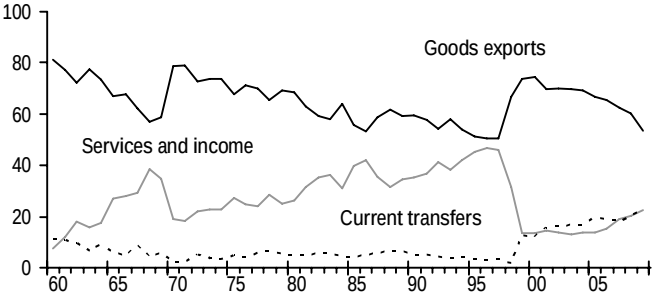
Philippines: current account

% of GDP



Philippines: current account components

Component receipts as % of current account receipts



important (BPO includes back office, call center, and other technical capacity outsourcing). Between 2005 and 2009, the share of service exports relative to total current account receipts doubled to 14%. Much of this was due to the explosion of BPO exports, which rose from 1.7% of total service exports in 2005 to an estimated 60% in 2009.

Cyclical upswing to benefit current and financial accounts in 2010

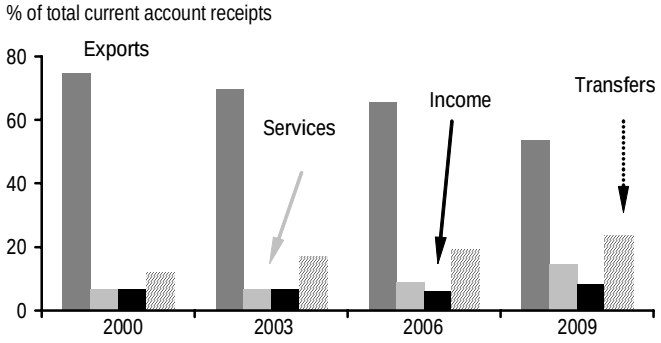
In addition to structural shifts, the current account should also benefit from the global cyclical position. Exports still account for roughly 54% of total current account receipts, and regional trade is strong. While the Philippines is less open and less reliant on the global tech cycle than many countries in EM Asia, export growth still closely parallels global GDP growth. With global GDP growth expected to continue at a firm pace, Philippine exports should grow robustly as well. We currently forecast Philippine exports to grow about 30% in 2010 following the nearly 22% contraction in 2009. Nevertheless, the trade balance will likely remain in large deficit (4.3% of GDP forecast), but that would be an improvement over the average 7.0% deficit of the past 10 years and a deficit of 5.5% in 2009.

The financial account should also improve this year. In recent years, capital outflows were unusually large due to "flight to safety" into USD assets from investors and because of local banks repaying external debt. However, by the middle of last year, "other" capital outflows eased and portfolio inflows resumed. We are not expecting massive inflows in 2010, but higher domestic interest rates, predicated on our expectation for the BSP to start hiking in June, along with a longer-term trend of modest financial account surplus, suggest that at the very least, capital flows should not be nearly as large a drag on the overall BoP position this year. Our base case scenario is for a very modest surplus, and in a more bullish scenario, the financial account could become a significant contributor to the BoP surplus.

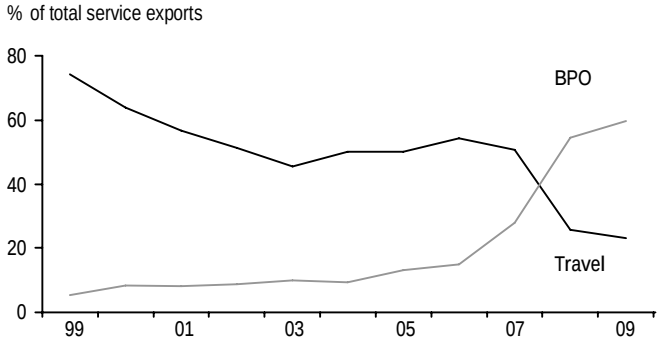
BoP surplus to be large in 2010

The close relationship between the Philippines' BoP position and the current account is important since capital flows are much more difficult to predict than the current account receipts. Thus, as long as the current account surplus evolves close to expectations, the Philippines should produce a large BoP surplus in 2010. This in turn has important implications for foreign exchange reserves, which we forecast to rise about US$8 billion in 2010 to around US$46 billion by year-end (ex. gold). The peso, which tends to move in the same direction as the BoP, should also benefit from a wider surplus.

Philippines: breakdown of current account receipts

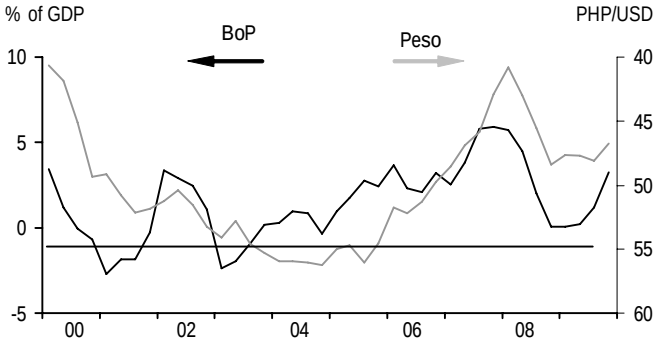


Philippines: travel and BPO service exports



Philippines: global GDP and exports

Philippines: BoP and PHP



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United States

- **Business is hiring; private sector payrolls increase 231,000 in April and the workweek expands**
- **April ISM manufacturing rises to 60.4, with both new orders and production above 65**
- **The economy is accelerating into 2Q, but financial stresses bring highly visible downside risks to growth**

This past week brought news that both business hiring and manufacturing activity are strengthening early in the current quarter. The economy is now showing unmistakable signs of self-sustaining expansion, and these latest reports tend to support the view that real GDP growth is accelerating from 3.2% in 1Q10 to 4.0% this quarter. But just when the internal dynamics of the US expansion are looking solid, financial market stresses reflecting broadly defined sovereign risk concerns in Europe have visibly increased the downside risks to the forecast.

Nonfarm payrolls increased 290,000 in April. And private sector payrolls (which leave out the temporary Census jobs) increased 231,000 with prior months' readings for private workers revised up 105,000. Current data show a trend of positive and progressively stronger job growth every month this year. The unemployment rate increased to 9.9% in April, but details of the household survey suggest that this is a temporary setback. The household survey measure of employment surged 550,000 in April (and an average 416,000 per month so far this year), but the strong job gains were offset by an even larger increase in labor force participation. Labor market evidence of a turn to stronger growth was reinforced by the further rise in the ISM manufacturing survey to 60.4 in April, with the production and new orders components both rising above 65.

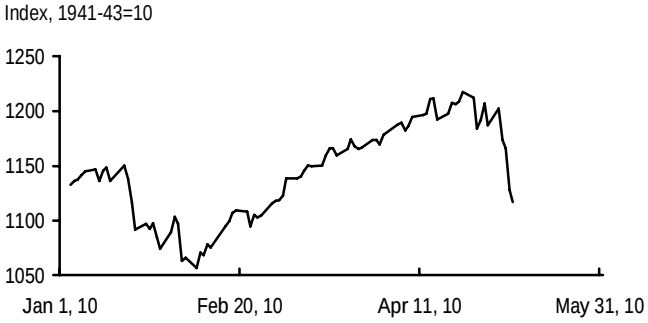
However, risks to the economy from European financial market contagion have increased substantially since April. The immediate threat is centered on concerns about falling bank asset values, associated stresses in bank funding markets, and the possible reduction in liquidity throughout the global financial system. It is still too early to gauge the size of the current problem, the effectiveness of an eventual official response, or the ultimate economic fallout. One measure of the level of concern can be seen in the 8% decline in US equity prices since their April 23 high.

Business is starting to hire in size

The key message of the April labor market report is the turn to stronger job growth.

Private sector payroll employment and hours worked

US equity market: S&P 500



Much stronger labor demand: Private sector hiring is both strengthening and broadening. Business hiring in April was greater than that in any month since March 2006, and the diffusion index of payroll growth (a measure of breadth), at 64.3 in April, was also the highest since March 2006. The increase in April payroll employment was reinforced by a second straight monthly increase in the average workweek. The identical 0.44% increases in total hours-worked in both March and April provide an important lift to labor income.

Manufacturing booming: The April labor market survey reinforces the ISM manufacturing survey in pointing to a booming factory sector. Manufacturing payrolls increased 44,000 in April, more than double the first-quarter average. And the average workweek in manufacturing increased another 0.2 hour to 40.1. With total factory hours up 0.8%, manufacturing IP should be up even more than the 0.9% increase in March.

Construction not as weak: Steep declines in construction employment have moderated noticeably. Construction jobs declined 51,000 in February, the month of the blizzards, and have retraced 40,000 of that decline since with hours worked in construction now back above the January level. The three-month decline in construction employment is the least since mid-2007.

Hourly earnings slowing: While the acceleration in hours worked is providing a boost to labor income, there is a partial offset in the form of slowing wage growth. Average hourly earnings were unchanged in April and slowed to 1.6%oya and only 0.4% saar over the past three months. The slowing has been widespread across industries, extending to both goods-producing and services-producing industries. The continued deceleration in hourly earnings is consistent with the ongoing declines in unit labor cost and slowing in core inflation.

Jobless rate is up, and so is household employment: The jobless rate rose to 9.9% in April from 9.7% in March, a reminder of the enormous pain caused by the downturn. The rise in unemployment occurred despite a surge in the household survey's measure of employment, a surge concentrated in full-time jobs, up 835,000 in April after a 416,00 increase in March. Increased unemployment reflects a 0.3%-pt increase in the labor force participation rate. The participation rate had plunged from 65.8% in May 2009 in May 2009 to 64.6% in December and, with the economy now improving, the participation rate has now increased in the last four months and is up to 65.2%.

Consumer spending continues to be strong

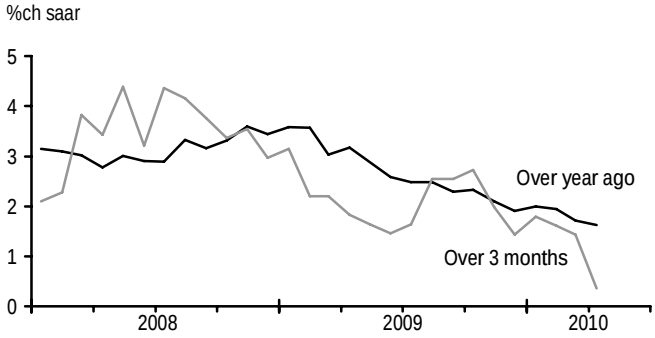
Real GDP increased 3.6% saar in the first quarter, and the monthly figures released this past week show that spending accelerated through the quarter. Real consumer spending increased 0.5% in both February and March and increased at a 4.7% annual rate in the three months through March. This was the most rapid three-month stretch, excluding the temporary boost from cash for clunkers, since late 2006. And while severe winter weather can sometimes give spending an artificial boost, spending on home heating and power declined in the three months through March.

Unit sales of new cars and light trucks did decline in April, but to a level that is still above the 1Q10 average. The more telling news on April consumer spending will come with next Friday's retail sales report. The forecast looks for a 0.3% rise in core retail sales.

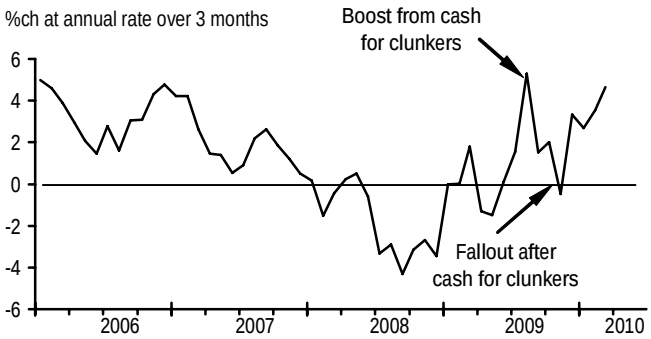
ISM mfg details point to output gains ahead

The ISM manufacturing survey advanced to a new high for the expansion in April, with substantial increases on readings for both new orders (65.7) and production (66.9). Export orders edged down 0.5pt to 61.0, holding near its recent high and providing some reassurance that the first-quarter slowing in export volume growth will prove temporary. Significantly, the measure of customers' inventories (nsa) dropped 6.0pts to a very low 33.0 reading, indicating

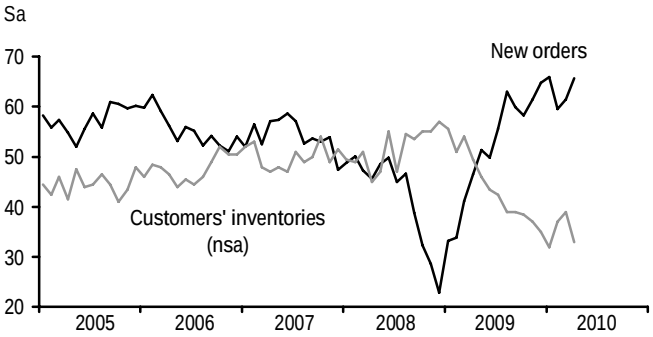
Average hourly earnings



Real consumer spending



ISM manufacturing survey: new orders and customers' inventories



that respondents view overall inventories in the economy as too lean. The combination of strong orders growth and lean customer inventories points to production increases over the next few months.

The March factory report, including upward revisions to previously released February figures, provides another upbeat message about manufacturing with special emphasis on the capital goods industries. March core capital goods orders were revised up to a gain of 4.5% (from 4.0%), and the February increase was revised up to 2.8% (from 2.1%). Core capital goods orders are extremely volatile from month to month, but orders have increased at a 15.1% annual rate over the past six months.

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Data releases and forecasts

Week of May 10 - 14

Tue May 11 7:30am

NFIB Small-Business Optimism survey

Index, 1986=100, sa

	Jan	Feb	Mar	Apr
Optimism Index	89.3	88.0	86.8	
Capex plans	20.0	20.0	19.0	
Hiring plans	-1.0	-1.0	-2.0	
Planned price increases	8.0	10.0	9.0	

Wed May 12 8:30am

International trade

$bn samr

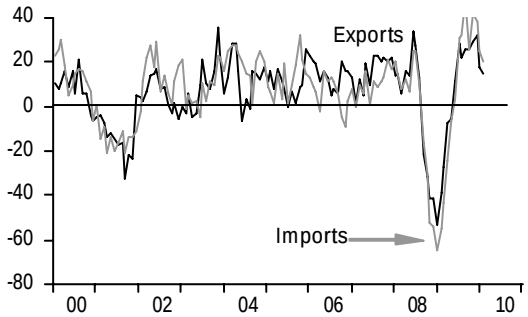
	Dec	Jan	Feb	Mar
Balance(BOP basis)	-39.9	-37.0	-39.7	-40.5
Services	12.0	12.4	11.6	11.4
Merchandise	-51.9	-49.4	-51.3	-51.9
Exports (%m/m)	3.4	-0.2	0.2	1.2
Imports (%m/m)	4.9	-1.8	1.7	1.3

After two months of anemic trade flows, imports and exports are expected to resume solid growth in March, and we anticipate that firmer imports will widen the trade deficit to $40.5 billion. The import price index for petroleum increased 4.0% in March, and we look for this to contribute to a 1.3% increase in imports. Export growth should also be solid—we look for a 1.2% increase—but not quite strong enough to prevent a deterioration in the trade balance. Two areas we expect to perform well in March are food and auto exports.

Over the last two years, net exports have contributed about 3/4%-pt, on average, to GDP growth. One risk to further contributions from trade to growth would appear to be the unfolding sovereign debt saga in Europe. Over the last year, the Euro area is the only major region of the globe where US exports haven't increased (table, upper right). As a result, exports to the Euro area have fallen to 13.6% of the total.

Nominal trade in goods and services

%ch over 3 months, saar



Wed May 12 2:00pm

Federal budget

$ bn nsa

	Jan	Feb	Mar	Apr
Unified balance	-42.6	-220.9	-65.4	-85.0
Prior year	-63.5	-193.9	-191.6	-20.9

Thu May 13 8:30am

Jobless claims

000s, sa

	New claims (wr.)		Continuing claims		Insured
	Wkly	4-wk avg	Wkly	4-wk avg	Jobless,%
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	4663	4648	3.6
Apr 17[1]	459	461	4653	4641	3.6
Apr 24	451	463	4594	4649	3.6
May 1	444	459			
May 8	440	449			

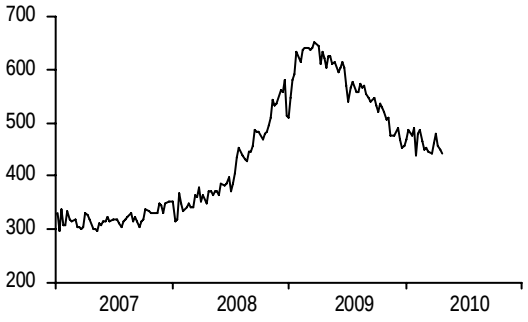
1. Payroll survey week

Initial jobless claims declined an average 22,000 per month in the second half of last year but the rate of decline has slowed to a glacial 3,000 per month through the first four months of this year. The forecast looks for a modest decline in initial claims for the week of May 8 to 440,000.

The insured unemployment rate (the unemployment rate for people receiving regular state benefits) has held at 3.6% since mid-February.

Initial jobless claims

000s, sa



Thu May 13 8:30am

Import prices

%m/m nsa, unless noted

	Jan	Feb	Mar	Apr
Import prices	1.2	-0.2	0.7	0.6
%oya	11.4	11.2	11.4	10.9
Ex-fuel import prices	0.4	0.1	0.2	0.3
%oya	1.3	1.9	2.7	2.9

We look for prices of imported petroleum products to increase by around 4% in April, nearly as much as they increased in March. Another big plunge in natural gas prices may limit how much overall fuels push up the headline import price index, though the lift will still be substantial. Outside of fuels, strong commodity price gains should also give support to pricing for a variety of products. We anticipate that imported food prices will increase 0.8%, and rising metals prices will push up prices of those imports. We expect consumer goods excluding autos will increase a trend-like 0.1% in April.

Since the beginning of the year, the trade-weighted value of the dollar against major currencies is up 1.3%. However, the broader trade-weighted dollar is almost unchanged over that period. As such, we think the strength of the dollar against the euro may overstate the influence of the currency in its potential to depress import prices in the near future.

Fri
May 14
8:30am

Retail sales

%m/m sa

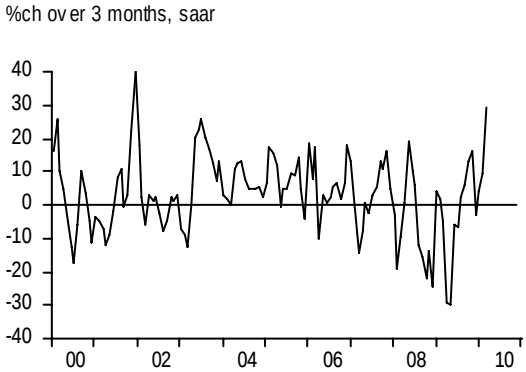
	Jan	Feb	Mar	Apr
Total	0.3	0.4	1.9	-0.1
Ex autos	0.4	1.0	0.9	0.2
Ex autos and gas	0.4	1.1	1.1	0.4
Building materials	-1.3	0.1	7.5	1.5
Control group[1]	0.6	1.1	0.4	0.1
Ex gasoline	0.6	1.2	0.5	0.3

1. Control group is total less automotive dealers and building materials.

Consumers got off to a solid start this year; in the first quarter, total retail sales rose 0.9% on average per month and core retail sales (ex. autos, building materials, and gasoline station sales) increased 0.8% per month. We expect the pace slowed considerably in April. First, already-reported unit sales of light vehicles fell 4.8%, a development we think will cause sales at vehicles dealers and auto parts stores to decline 1.8%. Second, gasoline prices increased less than the seasonal factor is expecting, which should restrain nominal sales at gasoline stations. Third, seasonally adjusted same-store chain store sales plummeted 5.7% Although this indicator has become less reliable since Wal-Mart is no longer in the sample, it is still hard to fade the magnitude of this move, which suggests a considerable cooling in core retail sales. One of the brighter spots could be sales of appliances, which should be boosted by the $176 million that states made available in the cash for appliances program. This amount should be associated with about $1.5 billion in appliance sales. Some, perhaps most, of these sales would have occurred anyway. If, however, a third of these sales is actually stimulated by the rebate, this would boost core retail sales by about 0.2%. Another area that could show some strength is sales at building material stores. The boost in home sales associated with the homebuyer tax credit may be supporting complementary purchases at building material stores, which rose 7.6% last month, an impetus that may have further to run.

Retail sales control measures

Sales at electronic and appliance stores



Fri
May 14
9:15am

Industrial production

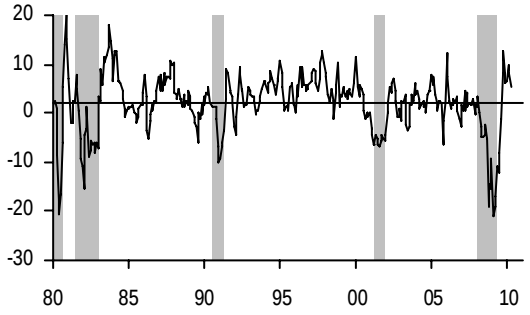
%m/m sa, unless noted

	Jan	Feb	Mar	Apr
Industrial production	1.0	0.3	0.1	1.1
Manufacturing	0.9	0.2	0.9	1.5
Motor vehicles and parts	4.8	-3.9	2.2	6.0
High-tech	2.4	3.0	1.9	
Mfg ex. motor vehicles	0.7	0.4	0.8	1.3
Business equipment	1.5	0.7	1.4	
Capacity utilization (%,sa)	72.7	73.0	73.2	73.8
Manufacturing	69.1	69.4	70.0	70.9

The strong run for industrial production is expected to continue in April. Outside of the motor vehicle sector, hours worked in manufacturing increased 0.7% last month, which points to a solid gain in factory output. Strong growth in manufacturing IP would also be consistent with the upbeat ISM survey for April. Industry data also point to increases in motor vehicle and mining output. Even after plunging in March, we expect utility output to fall further in April, as temperate weather depressed electricity production.

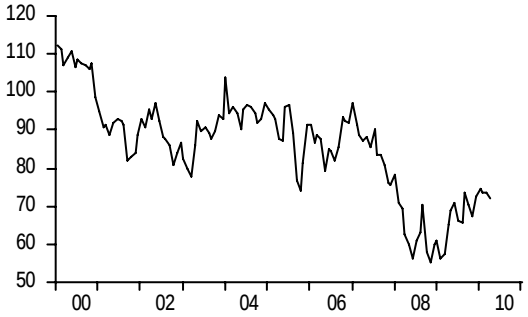
Industrial production

%ch over 3 months, saar



Michigan consumer sentiment

Index, sa



Fri
May 14
9:55am

Consumer sentiment

Michigan preliminary

	Feb	Mar	Apr	May
Univ. of Mich. Index (nsa)	73.6	73.6	72.2	73.0
Current conditions	81.8	82.4	81.0	
Expectations	68.4	67.9	66.5	
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	154.0	

The forecast looks for the University of Michigan measure of consumer confidence to register 73.0 in the preliminary May release, near the center of its very narrow range over the past year.

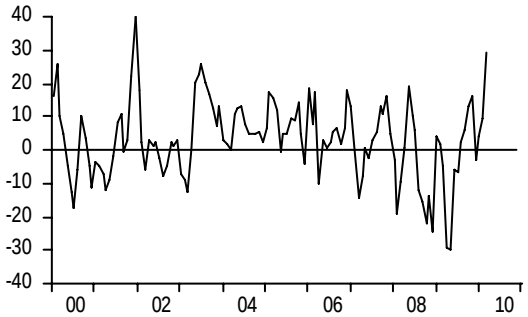
Although economic data have generally improved so far this year and the equity market has generally risen, survey respondents do not seem to regard the change in conditions as material. However, real consumer spending has accelerated, up 3.5% at an annual rate, despite low confidence readings. Note that the appraisal of current conditions has generally improved over the past year, but expectations have been broadly unchanged.

Since the time of the April survey, many survey measures indicate that the economy has continued to improve. However, the equity market has sold off recently. And the available weekly and daily confidence measures have generally not moved much relative to their April averages.

There has been a noticeable boost in attitudes toward buying autos over the past few months, and it will be interesting to see whether this trend continues into May.

Sales at electronic and appliance stores

%ch over 3 months, saar



Fri
May 14
10:00am

Business inventories

%m/m sa, unless noted

	Dec	Jan	Feb	Mar
Inventories	-0.2	0.2	0.4	0.4
Manufacturing	-0.2	0.3	0.7	0.3
Wholesale	-0.8	0.1	0.6	0.5
Retail inventories	0.2	0.1	0.2	0.3
Ex. autos	0.4	-0.2	-0.2	
Autos	-0.4	0.7	1.3	
Inventory/sales ratio	1.27	1.27	1.27	1.26

Nominal business inventories are forecast to increase 0.4% in March, the same as in February, but the forecast could be revised after Tuesday's release of the wholesale figure.

The report on factory orders for March indicates that nominal manufacturing inventories increased for the third consecutive month in March. Forecasts look for March increases in wholesale and retail auto industries as well. But the strong retail sales report for March suggests that nonauto retail inventories were about unchanged.

The first estimate of 1Q10 real GDP shows inventory growth in the first quarter, with the bulk of the build accounted for by retail auto inventories.

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Review of past week's data

Personal income (May 3)

%m/m sa, unless noted

	Jan		Feb		Mar	
Personal income	~~0.3~~	*0.4*	~~0.0~~	*0.1*	~~0.5~~	*0.3*
Wages & salaries	~~0.4~~	*0.5*	~~0.0~~	*0.1*	~~0.4~~	*0.2*
Consumption	~~0.4~~	*0.3*	~~0.3~~	*0.5*	~~0.5~~	*0.6*
Real consumption	~~0.2~~	*0.1*	~~0.3~~	*0.5*	~~0.4~~	*0.5*
PCE price index	0.2		0.0		*0.1*	
Core	~~0.01~~	*0.00*	~~0.03~~	*0.04*	*0.08*	
Mkt-Based Core	0.0		0.1			*0.1*
Core (%oya)	1.5		1.3		*1.3*	
Mkt-Based Core (%oya)	1.4		1.2			*1.1*
Saving rate	~~3.4~~	*3.5*	~~3.1~~	*3.0*	~~2.9~~	*2.7*

Real consumer spending picked up strength through the first quarter, and core consumer price inflation remained virtually nonexistent. Real consumption increased 0.5% in March. The strength in consumption late in the first quarter sets up well for second-quarter real consumption. The gain in personal income was the result of a 0.2% increase in labor compensation and a 1.1% increase in transfer payments from the government. Nominal disposable income was up 0.3%. Speculation that consumers are reforming, repenting, and rebalancing now looks either premature or overstated, as the saving rate has now fallen back to 2.7%, the lowest rate since September 2008. The core PCE deflator edged forward 0.08% and over the past three months is up at an annualized rate of just 0.5%.

ISM manufacturing survey (May 3)

Sa

	Feb	Mar	Apr	
Overall index	56.5	59.6	~~61.0~~	*60.4*
Production	58.4	61.1		*66.9*
New orders	59.5	61.5		*65.7*
Inventories	47.3	55.3		*49.4*
Employment	56.1	55.1		*58.5*
Supplier deliveries	61.1	64.9		*61.3*
Export orders	56.5	61.5		*61.0*
Imports	56.0	57.0		*58.0*
Prices	67.0	75.0		*78.0*

The manufacturing ISM report was very strong again in April, with the headline index moving up about a point to 60.4 and the details coming in even stronger than the prior month. New orders jumped up to 65.7 while the inventories index pulled back to 49.4; the relatively large gap between these two figures—16.3pts—indicates that production is barely keeping pace with demand, and the prospects for solid manufacturing growth in the coming months remain quite good. The customers' inventories index fell to 33.0, indicating that firms perceive supply chains as particularly lean. The prices index moved up to a new cycle high of 78.0, a striking contrast with the weak PCE prices number reported for March and one that highlights the gap between globally influenced commodity prices and domestically depressed service prices. The employment index rose to 58.5, the highest reading since January 2005.

Construction spending (May 3)

%m/m sa

	Jan		Feb		Mar	
Nominal	~~1.4~~	*-0.7*	~~1.3~~	*-2.1*	~~0.7~~	*0.2*
Private	~~1.7~~	*-0.1*	~~1.2~~	*-2.4*	~~0.8~~	*-0.9*
Residential	~~1.0~~	*3.8*	~~2.1~~	*-3.4*	~~0.0~~	*-1.1*
Nonresidential	~~3.8~~	*-3.3*	~~0.4~~	*-1.5*	~~1.5~~	*-0.7*
Public	~~0.8~~	*-1.9*	~~1.7~~	*-1.6*	~~1.5~~	*2.3*

A jump in state and local construction spending in March helped overall construction outlays notch their first gain in five months, a 0.2% increase. Private construction spending slipped another 0.9% in March as both residential (-1.1%) and nonresidential (-0.7%) outlays fell. The better-than-expected news on overall construction spending is tempered some by the recent tendency for this report to be revised down. The strong 2.5% increase in March state and local construction spending was led by a big jump in spending on transportation structures, particularly at airports.

Pending home sales (May 4)

sa, unless noted

	Jan	Feb		Mar	
Total (mn, ar)	90.2	~~97.6~~	*97.7*	~~100.5~~	*102.9*
%ch m/m	-7.8	~~8.2~~	*8.3*	~~3.0~~	*5.3*
%oya (nsa)	8.6	~~17.3~~	*17.4*	~~18.3~~	*23.5*

March pending home sales rose another 5.3% following an 8.3% rise in February. Pending home sales, which measure home sales at the time of contract signing and should lead existing home sales, measured at time of contract closing, increased in all regions except the Northeast. This report confirms that the second homebuyer tax credit is giving a temporary lift to home sales, and points to about a 5% or so rise in April existing home sales.

Factory goods report (May 4)

%m/m sa,unless noted

	Jan	Feb		Mar	
New orders	2.5	~~0.6~~	*1.3*	~~0.2~~	*1.3*
Shipments	0.7	~~0.1~~	*0.4*	~~1.4~~	*2.2*
Inventories	0.3	~~0.5~~	*0.7*	~~0.4~~	*0.3*
Inventory/sales ratio	1.29	1.29		~~1.28~~	*1.27*

March factory orders rose 1.3% following an upward-revised 1.3% increase in February. The better-than-expected report reflects an upward revision to durable goods orders for the past two months (now up 1.6% in February and down 0.6% in March) and a much stronger-than-expected increase in new orders and shipments of nondurables in March (2.9%) and an upward revision to February (now up 1.1%). Some of the nondurables strength is pricing. The reported rise in core capital goods orders was revised up to 4.5% (from 4.0%) in March and to 2.8% (from 2.1%) in February. Upward revisions to core capital goods shipments were much smaller. There were modest downward revisions to manufacturing inventories. Together these revisions take about 0.05%-pt out of our estimate of 1Q GDP (-0.09%-pt from inventories and +0.04%-pt from capital goods shipments). The revisions to construction spending in 1Q also shaved about 0.1%-pt off the first estimate of 1Q GDP. Combined, this leaves 1Q GDP tracking 3.0%.

ISM non manufacturing survey (May 5)

Sa

	Feb	Mar	Apr	
Nonmfg. index (NMI)	53.0	55.4	~~57.0~~	*55.4*
Business activity	54.8	60.0		*60.3*
New orders	55.0	62.3		*58.2*
Employment	48.6	49.8		*49.5*
Prices	60.4	62.9		*64.7*

The ISM survey for April was not as strong as expected, holding at the March level of 55.4 (consensus: 56.0; J.P. Morgan: 57.0). The measure of business activity edged up 0.3pt to 60.3, but new orders fell 4.1pts to 58.2 and employment edged down from 49.8 in March to 49.5 in April. Although the employment measure is lower than in March, it is still well above the 1Q10 average. Inventories rose 8.0pts to 54.5 (nsa) and inventory sentiment rose 1.0pt to 53.5 (nsa). The inventory sentiment is still extremely low for this series, indicating that many businesses consider their inventory level unusually lean.

Productivity and costs (May 6)

Nonfarm business sector, %q/q saar, unless noted

	3Q09	4Q09		Prel 1Q10	
Productivity	7.8	~~6.9~~	*6.3*	~~3.1~~	*3.6*
%oya	4.6	~~5.8~~	*5.6*	~~6.4~~	*6.3*
Output	2.2	~~7.6~~	*7.0*	*4.4*	
%oya	-3.9	~~0.2~~	*-0.3*	~~3.2~~	*3.1*
Hourly compensation	-0.4	~~0.6~~	*0.4*	~~1.8~~	*1.9*
%oya	1.8	0.8		~~2.4~~	*2.3*
Unit labor costs	-7.6	~~5.9~~	*-5.6*	~~1.4~~	*-1.6*
%oya	-2.7	~~4.7~~	*-4.6*	~~3.8~~	*-3.7*
Hours	-5.3	~~0.6~~	*0.7*	~~1.2~~	*0.8*
%oya	-8.2	~~5.7~~	*-5.6*	~~2.9~~	*-3.0*

The trend of strong productivity growth and declining unit labor cost continued in the first quarter. Labor productivity in 1Q10 was up 3.6% saar (consensus: 2.5%; J.P. Morgan: 3.1%) and 6.3%oya. Unit labor cost in 1Q10 declined 1.6% saar and -3.7%oya. The decline in unit labor cost is one important factor behind rising profits and declining inflation.

Labor market report (May 7)

Sa

	Feb		Mar		Apr	
Payroll employment (ch, m/m, 000s)	~~-14~~	*39*	~~162~~	*230*	~~145~~	*290*
Private payrolls	~~8~~	*62*	~~123~~	*174*	~~85~~	*231*
Goods-producing	~~-47~~	*-28*	~~41~~	*55*	~~0~~	*65*
Construction	~~-59~~	*-51*	~~15~~	*26*	~~-15~~	*14*
Manufacturing	~~6~~	*16*	~~17~~	*19*	~~15~~	*44*
Service-providing	~~33~~	*67*	~~121~~	*175*	~~145~~	*225*
Private service-providing	~~55~~	*90*	~~82~~	*119*	~~85~~	*166*
Wholesale trade	~~4~~	*3*	~~9~~	*10*		*4*
Retail trade	~~8~~	*7*	~~15~~	*15*		*12*
Professional services	~~40~~	*56*	~~11~~	*13*		*80*
Temporary help	~~37~~	*36*	~~40~~	*32*		*26*
Education/health	~~27~~	*30*	~~45~~	*54*		*35*
Leisure and hospitality	~~16~~	*23*	~~22~~	*41*		*45*
Government	~~-22~~	*-23*	~~39~~	*56*	~~60~~	*59*

	Feb		Mar		Apr	
Average weekly hours	33.9		34.0		*34.1*	
Index, hrs worked (%m/m)	~~-0.3~~	*-0.2*	0.4		*0.4*	
Hourly earnings (%m/m)	~~-0.2~~	*0.1*	-0.1		~~-0.1~~	*0.0*
(%oya)	2.0		~~1.8~~	*1.7*	~~1.7~~	*1.6*
Unemployment rate (%)	9.7		9.7		~~9.8~~	*9.9*

Business appears to have made a decisive shift toward hiring in the first part of this year, increasing employment by almost a half-million jobs in the first four months of 2010, with 231,000 of those new positions added in April alone. Total nonfarm employment growth was even stronger last month, up 290,000, thanks mostly to temporary government workers hired for the decennial census. The unemployment rate did increase from 9.7% to 9.9%, but the flow data indicate the increase in unemployment occurred mostly among those entering or re-entering the labor force. As such, while the elevated level of the unemployment rate may now be more indicative of the amount of slack in the labor market, last month's change in the unemployment rate partly reflects the increased confidence of jobseekers who are coming back into the labor force. The above-mentioned slack was apparent in the wage data, as average hourly earnings were flat last month and over the past three months have increased at only a 0.4% annualized rate. In terms of Fed implications, we judge this report to be about a wash: the better momentum in hiring by businesses is about offset by the intensification of the wage disinflation process. Overall, were it not for the gathering storm in Europe, the April employment data would have been greeted as a very solid indicator of the strength of the recovery.

Within the establishment survey of firms, what was most encouraging (other than the headline number) was the breadth of the business turn toward hiring. Private services added 166,000 positions, with only a relatively modest 26,000 coming from temp-help hiring. Construction added jobs for the second month in a row, and manufacturing employment increased 44,000, the biggest increase since the 1990s. In all, 64.3% of the 269 industry groups for which data are reported increased their employment in April, the highest percent since 2006. Another indicator of expansive business behavior was the 0.1-hour increase in the average workweek to 34.1 hours. The workweek has now retraced about 40% of the decline experienced over the course of the recession. Early in the second quarter, hours worked are increasing at a 4.0% annual rate, an acceleration from the 3.3% pace in the first quarter. Because of the slowdown in earnings growth, however, total labor income is increasing at a 4.2% rate, a little slower than the 4.9% rate seen in the first quarter.

Turning to the household survey, the labor force participation rate increased a very large 0.3%-pt to 65.2%. This appears to be the reason for the increase in the unemployment rate. Most of those coming back into the labor force were re-entrants, rather than new entrants. Countering the generally good tone of the report were indications of continued structural labor market dysfunction, most notably the increase in average and median duration of unemployment spells to 33.0 weeks and 21.6 weeks, respectively, each a new high.

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US focus: another big productivity quarter

- Labor productivity in the nonfarm business sector increased 3.6% saar and 6.3%oya in 1Q10. The annual increase in labor productivity was the largest since the early 1960s.

- Unit labor cost in the nonfarm business sector declined 1.6% saar and was down 3.7%oya. The annual declines in unit labor cost recently have been the steepest in the past 50 years and have been a force for lower core inflation.

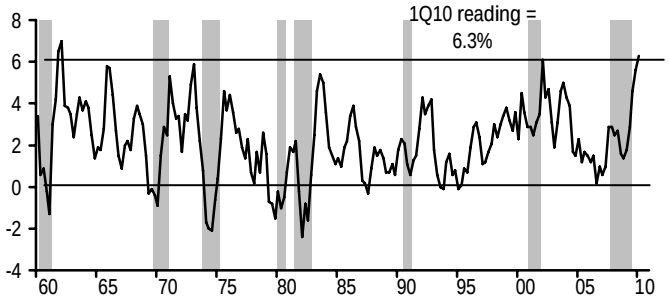
- The price deflator for output in the nonfarm business sector has barely increased over the past three quarters, but annualized growth of prices has been more than 5%-pts above that for unit labor cost. This large wedge between trends in pricing and trends in unit labor cost helps to account for the very strong rebound in corporate profits.

- The measure of labor compensation per hour has been running higher than the independent, fixed-weight employment cost index (ECI). But each measure of hourly labor cost has decelerated by an average of about 0.5%-pt per year over the past three years.

- Recent trends in productivity and unit labor cost in manufacturing have been similar to trends in the overall nonfarm business sector, only more so. Labor productivity in manufacturing increased 7.5% in the year ended 1Q10, and unit labor cost declined 6.8%oya.

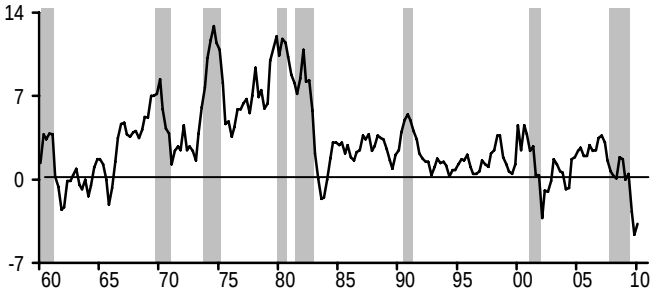
Labor productivity

%oya, nonfarm business



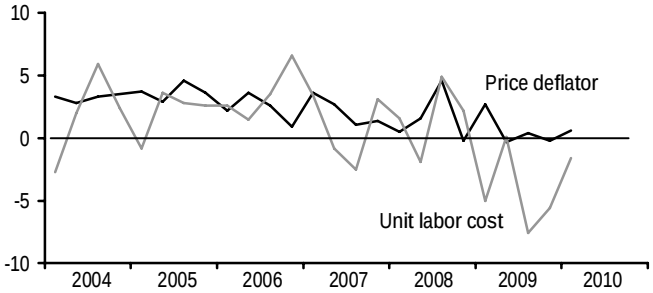
Unit labor cost

%oya, nonfarm business



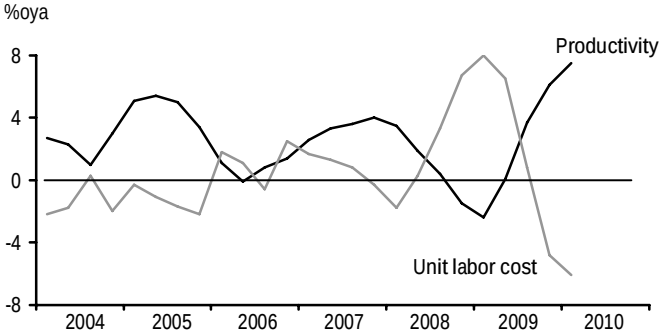
Price deflator and unit labor cost

%ch saar, q/q; nonfarm business



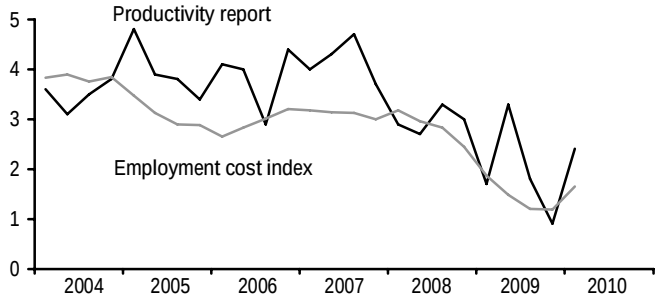
Manufacturing: labor productivity and unit labor cost

%oya



Two measures of private sector compensation per hour

%oya



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Euro area

- **Policy actions have not contained market stresses**
- **ECB did not discuss outright purchases of sovereign debt at its regular meeting**
- **German data illustrate strength of cyclical lift**

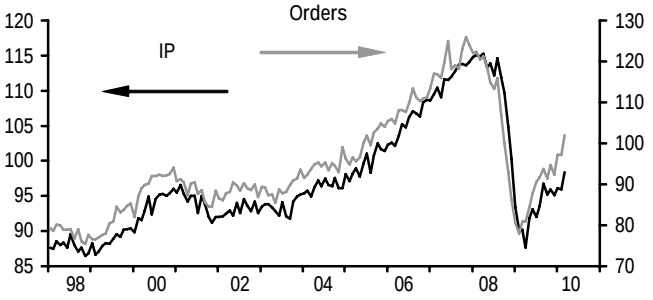
Market stresses intensified dramatically this week, even though the EU and IMF reached an agreement with the Greek government on a multi-year support package and the ECB suspended the minimum rating requirement on Greek government debt in its liquidity operations. At its regular policy meeting, the ECB could have taken further policy steps, but chose not to. Trichet said that there had been no discussion by the Governing Council of outright purchases of sovereign debt. And somewhat easier steps, such as the reinstatement of FX swaps or longer-term refinancing tenders, were also not taken. The central bank did not rule out taking such steps in the future, but at the time of the meeting the ECB did not perceive that financial stress had built to an extent that warranted a response. The situation deteriorated dramatically after the ECB meeting, making it likely that some action will be taken over the weekend.

At the policy meeting on Thursday, Trichet gave the impression of being perplexed by the ongoing stress. He emphasized that the central bank's liquidity provision remains supportive of banks, given that unlimited liquidity is effectively available at maturities up to three months. And, on the risk of contagion beyond Greece, Trichet said that "the facts and figures" make "absolutely clear" that Portugal and the other sovereigns are in a very different situation to Greece. Rather than acting itself, the ECB called on Euro area governments to step up their consolidation efforts and implement growth-supporting structural reforms as a way of strengthening confidence and reducing risk premia in financial markets. While the ECB now looks likely to take some action over the weekend, there appears to be little support for the very radical step of purchasing government debt outright. In fact, even the decision to suspend the minimum rating requirement on Greek debt in ECB liquidity operations was only taken with an "overwhelming majority," rather than unanimity.

In terms of its macroeconomic views, the ECB continues to see a moderate expansion of the economy this year, suggesting that the main policy interest rate is firmly on hold. It did acknowledge the further improvement seen in activity data in the spring, but noted that uncertainty had also increased. Meanwhile, price developments were still described as moderate over the policy-relevant horizon. But,

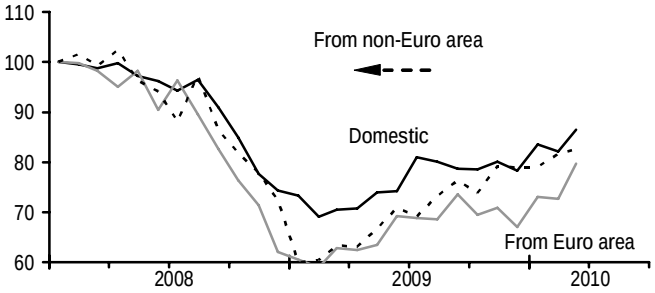
German manufacturing orders and IP ex construction

Index, sa (both scales)



German manufacturing orders

Jan 2008 = 100



equally, there was an acknowledgment of the views of Governing Council members Weber and Stark that global inflation pressures had increased and tilted the risk distribution upward, at least in the near term.

German economy powers ahead

Even as financial market stresses have continued to mount, the economic data flow has remained very positive. Business and consumer surveys in April suggest that both activity and sentiment rose impressively across the region, led by Germany. And the real activity data are now beginning to reflect the cyclical lift evident in the surveys. German industrial output and orders made huge gains in March, rising 4%m/m and 5%m/m, respectively. This left industrial orders up almost 30%q/q saar in 1Q10, while production expanded 4%q/q saar, even though this includes a huge weather-related drag from construction. And encouragingly, the breakdown of the orders data suggests that the demand is not only coming from outside of the Euro area. Domestic orders rose over 5%m/m in March and orders from the rest of the Euro area rose 10%m/m. And given that each was boosted by both capital and consumer goods orders, the data are consistent with the view that domestic demand is picking up. Clearly, the main risk now is that the intensification of the financial market and sovereign stress will significantly dampen this strong cyclical lift.

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An update on income, saving, and leverage

The 4Q09 flow of funds showed the following:

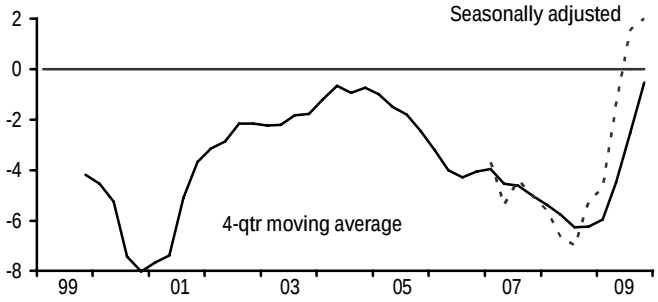
- **Nonfinancial corporates have moved into surplus.** At the peak of the last cycle, Euro area corporates were running a financial deficit equivalent to over 3% of GDP, or 6% of their revenues. This implied a large reliance on external finance in order to sustain their level of spending. Since then, they have made a huge adjustment and generated a surplus of €100 billion in 2H09—equivalent to around 1% of GDP on a seasonally adjusted basis. This huge shift reflects a number of developments. First, profits have already recovered half of the peak-to-trough decline seen during the recession, as revenues have risen faster than labor costs. Second, corporates are still benefiting from significant policy support, which is keeping their interest and tax expenses low. Third, corporate spending on capex and inventory was cut very sharply during the recession and has been slow to recover through 4Q09. Overall, corporates have moved to the best financial position since 1999, even though they have had to absorb the cost of the hoarded labor and even though they have incurred more debt.

- **Cross-currents on household income.** Real household disposable income fell at the end of last year, although the impact on actual spending was reduced slightly because the saving rate retreated from its peak. In the detail, employment and self-employment income continued to expand modestly; fiscal support provided another significant boost worth almost 2%-pt annualized. Only property income (net interest and dividend receipts) was a drag again. Looking ahead, the sources of income should continue to rotate toward employment and property income, with the automatic fiscal stabilizers gradually weakening. Clearly, this rotation and the recovery of income itself will be stronger if economic activity and labor markets evolve as we currently expect.

- **No active deleveraging.** Even though both households and nonfinancial corporates are spending less on consumption and capex than their incomes, neither sector decided to use this surplus to reduce debt. Instead, both sectors chose to accumulate financial assets and have even had to take on further liabilities to finance these acquisitions. In the case of nonfinancial corporates, the much reported decline in lending by Euro area banks has been offset by greater market-based financing and intercompany lending and trade credits. It remains likely that this substitution is not the result of severe bank credit constraints. And, on the asset side of their balance sheets, nonfinancial corporates have continued to build their cash buffer, which can be used to finance capex.

Nonfinancial corporate position

% of corporate output



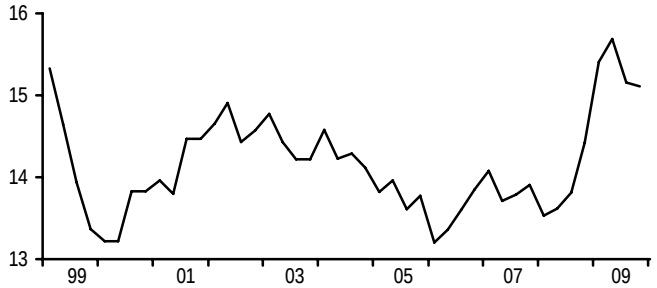
Euro area household disposable income

%q/q saar; data shown can differ slightly from national accounts equivalents

		Weight	4Q08	1Q09	2Q09	3Q09	4Q09
+	Self-employment income	25	-4.3	-9.2	0.8	2.3	1.6
+	Employment income	73	-0.3	-5.7	1.5	1.3	0.8
+	Net interest/dividend inc.	16	-20.4	11.3	-12.6	-10.0	-7.1
-	Net taxes, contributions	14	-7.3	-23.1	-31.1	0.2	-12.8
=	Disposable income	100	-3.7	-1.7	3.7	-0.1	1.4
-	Inflation		-1.6	-2.8	0.5	1.2	2.1
=	Real income		-2.1	1.2	3.2	-1.3	-0.6
	Real spending		-4.9	-3.4	1.9	1.3	-0.4
	Saving rate		14.4	15.4	15.7	15.2	15.1

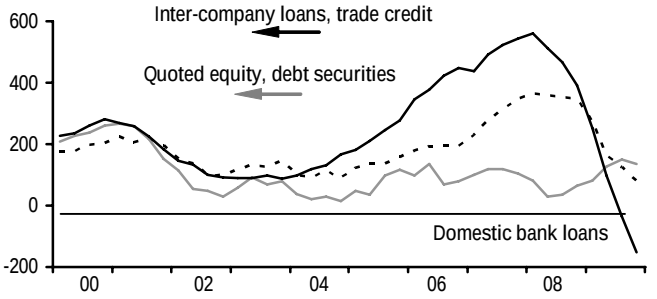
Euro area household gross saving rate

% of gross disposable income, sa



Sources of financing for Euro area nonfinancial corporates

€ bn, 4-quarter moving sums



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Data releases and forecasts

Week of May 10 - 14

Output and surveys

Real GDP

		2Q09	3Q09	4Q09	1Q10
Wed	Euro area (flash estimate)				
May 12	%q/q sa	-0.1	0.4	0.0	0.3
11:00am	%q/q saar	-0.5	1.6	0.2	1.0
	%oya	-4.9	-4.1	-2.2	0.6
Wed	Germany (flash estimate)				
May 12	%q/q sa	0.4	0.7	0.0	0.1
8:00am	%q/q saar	1.8	2.9	0.0	0.5
	%oya	-5.8	-4.8	-2.4	1.3
Wed	France (preliminary)				
May 12	%q/q sa	0.3	0.2	0.6	0.3
8:45am	%q/q saar	1.1	0.9	2.4	1.2
	%oya	-2.8	-2.3	-0.3	1.4
	GDP components (%q/q saar)				
	Private consumption	1.2	0.4	3.9	__
	Government consumption	2.5	2.6	3.0	__
	Fixed investment	-3.9	-5.0	-4.8	__
	Exports	1.8	7.2	0.1	__
	Imports	-9.6	1.0	13.4	__
	Contributions to GDP growth (%q/q saar)				
	Domestic final sales	0.5	-0.2	2.0	__
	Inventories	-2.9	-0.5	4.2	__
	Net trade	3.6	1.6	-3.7	__
Wed	Italy (flash estimate)				
May 12	%q/q sa	-0.5	0.5	-0.3	0.5
10:00am	%q/q saar	-1.9	2.1	-1.3	2.0
	%oya	-6.1	-4.8	-3.0	0.2
Wed	Spain (flash estimate)				
May 12	%q/q sa	-1.0	-0.3	-0.1	0.1
9:00am	%q/q saar	-3.8	-1.1	-0.6	0.5
	%oya	-4.2	-4.0	-3.1	-1.3

There are two important considerations regarding the 1Q10 GDP reports. First, they will be affected by the severe winter, especially in Germany. Second, the significant pickup in growth momentum that is evident in the business surveys and also in some of the hard data (German IP, orders) occurred too late in the quarter to have much impact. Both considerations, however, point to a significant step up in 2Q10. In this sense, the 1Q10 data will perhaps be more backward-looking than usual.

No details will be published about the expenditure or production-side breakdowns in the flash report. On the production side, an increase in manufacturing has likely outweighed the decline in construction, leaving this part of the economy up almost 2%q/q saar. In services, the PMI points to some growth, but did so in 4Q09 already when services output stagnated. Our forecast assumes that services output moved more in line with the PMI in 1Q10.

The expenditure side breakdown points to some downside risk to our 1Q10 GDP forecast. While retail spending has been flat in 1Q10, the fall in car registrations implies lower consumer spending (perhaps -1%q/q saar). Government consumption is likely to be soft also, while capital spending will likely be adversely affected by the weakness in construction spending. On the positive side, the monthly trade data through to February point to a solid net trade contribution to GDP (up to 2.5%-pts annualized). While large net trade contributions to GDP are often partly offset by inventory drags, our forecast assumes that inventory cuts actually slowed a bit. This would be consistent with what the business surveys are signaling.

By country, the weather-related distortions appear to have been concentrated in Germany. Outside of Germany, there has been some payback from the car scrappage incentives and weaker underlying growth momentum, according to the business surveys. Nevertheless, the IP, exports, and retail sales data show solid gains in France, Italy, and Spain in 1Q10.

Industrial production

		Dec	Jan	Feb	Mar
Wed	Euro area				
May 12	%m/m sa	0.8	1.7	0.6	1.7
11:00am	%oya	-3.9	1.0	3.8	6.9
Mon	France				
May 10	Ind production (%m/m sa)	-0.3	1.1	0.0	__
8:45am	%oya sa	-2.0	2.6	3.3	__
	Manuf prod (%m/m sa)	-1.0	0.6	0.4	__
	%oya sa	-1.7	3.6	4.6	__
Mon	Italy				
May 10	Ind prod (%m/m sa)	-1.1	1.9	0.0	__
10:00am	Ind prod (%oya sa)	-5.5	-0.6	2.8	__

We expect Eurostat's measure of Euro area industrial production excluding construction to have increased 1.7%m/m in March. National releases for Germany and Spain showed that IP ex construction rose 2.6%m/m and 1.9%m/m, respectively, in the two countries. We also expect some increase in Italian and French IP, each released next week. If our forecast is realized, Euro area IP will have increased a huge 16% ar or so in 1Q according to the Eurostat measure. But we have been arguing that this measure is less relevant for tracking GDP than an alternative measure we construct by aggregating individual seasonally adjusted country estimates for IP. The 1Q increase according to this other measure will be a slower but still solid 5%-6%ar.

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External trade and payments

Foreign trade

		Dec	Jan	Feb	Mar
Mon	Germany				
May 10	€ bn, values, sa				
8:00am	Trade balance	16.6	8.8	12.1	—
	Trade balance—year earlier	11.0	7.2	8.4	9.0
	Exports	72.5	67.8	71.3	—
	%m/m	3.3	-6.5	5.1	3.0
	Imports	55.9	59.0	59.2	—
	%m/m	5.0	5.6	0.2	—

We expect German exports to show a solid monthly gain in March. This would reflect not only the underlying momentum in foreign demand, as suggested by the PMI and IFO surveys, but also that the 5.1%m/m increase in February did not entirely reverse the weather-related decline in January. Even if exports do show the 3.0%m/m increase that we expect for March, exports will have barely increased in 1Q10 overall. This would, however, mostly reflect the low level of exports in January, rather than the trend. The near-record level of the export expectations index in the German IFO and the record level of the new export orders index of the German manufacturing PMI both point to a return to double-digit export growth in Germany in 2Q10.

Inflation

Consumer prices

		Jan	Feb	Mar	Apr
Tue	Germany (final)				
May 11	%m/m nsa	-0.6	0.4	0.5	-0.1
8:00am	%m/m sa	0.0	-0.2	0.6	0.2
	%oya nsa	0.8	0.6	1.1	1.0
	HICP (%oya)	0.8	0.5	1.2	1.0
Wed	France				
May 12	%m/m nsa	-0.2	0.6	0.5	0.3
8:45am	Index ex tobacco nsa	118.32	118.95	119.50	119.98
	%oya nsa	1.1	1.3	1.6	1.8
	HICP (%oya)	1.2	1.4	1.7	1.9
Fri	Italy (final)				
May 14	%m/m nsa	0.1	0.1	0.3	0.4
10:00am	%oya nsa	1.3	1.2	1.4	1.5
	HICP (%oya nsa)	1.3	1.1	1.4	1.6
Fri	Spain (final)				
May 14	%m/m nsa	-1.0	-0.2	0.7	1.1
9:00am	%oya nsa	1.0	0.8	1.4	1.5
	HICP (%oya nsa)	1.1	0.9	1.5	1.6
Tue	Netherlands				
May 11	%m/m nsa	0.0	0.7	1.2	0.4
9:30am	%oya nsa	0.8	0.8	1.0	1.2
	HICP (%oya)	0.4	0.3	0.7	0.7

German CPI is expected to confirm the low preliminary print for April. According to the preliminary results, the inflation rate was pulled down by inflation in services connected with tourism, and pushed up by food and energy inflation.

Core inflation in April appears to have declined significantly: leisure inflation and inflation for hotels and restaurants were each down very sharply in April. The rest of the core inflation basket appears to have declined as well, but only by a little.

French inflation is expected to have risen further in April, thanks to energy and food inflation. Energy inflation is expected to have risen sharply, driven by a 9.5%m/m rise in natural gas prices and further increases in gasoline prices at the pump. Food inflation also is expected to have increased in April, pushed up by fresh food price increases. Core inflation, on the other side, is expected to have declined in April, with service inflation declining further to 1.5%oya, after 1.7%oya in March.

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Review of past week's data

Output and surveys

Purchasing managers index final (manufacturing)

Index, sa

	Feb	Mar	Apr	
Euro area				
Overall region	54.2	56.6	~~57.5~~	*57.6*
Germany	57.2	60.2	~~61.3~~	*61.5*
France	54.9	56.5	~~56.7~~	*56.6*
Italy	51.6	53.7	~~54.5~~	*54.3*
Spain	49.1	51.8	~~52.5~~	*53.3*

Purchasing managers index final (services)

Index, sa

	Feb	Mar	Apr	
Euro area				
Overall region	51.8	54.1	~~55.5~~	*55.6*
Germany	51.9	54.9	~~55.0~~	*55.2*
France	54.6	53.8	~~57.8~~	*59.2*
Italy	50.8	55.3	~~55.5~~	*54.5*
Spain	47.1	51.3	~~52.5~~	*50.9*

Purchasing managers index final (composite)

Index, sa

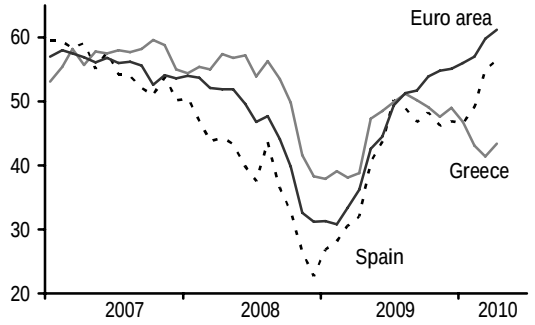
	Feb	Mar	Apr	
Euro area				
Overall region	53.7	55.9	*57.3*	
Germany	55.7	58.7	~~59.1~~	*59.3*
France	55.6	55.8	~~58.4~~	*59.2*
Italy	51.9	55.6	~~56.0~~	*55.1*
Spain	47.7	52.3	~~53.5~~	*52.3*

The final release confirmed the message of the flash report. The composite PMI is pointing to GDP growing at a 3% pace; its employment index is pointing to stable employment overall; and the significant increase of the services PMI is suggesting that the strong recovery in industry is increasingly creating positive spillover effects for the broader economy.

By country, the improvements are being led by Germany. But, an upward revision to the French PMI (from the flash report) now suggests similar strength in France. In contrast, the rest of the region consolidated the large improvement seen in March. The Greek manufacturing PMI remained very depressed despite rising by 2pts to 43.4.

PMI manufacturing—output index

DI, sa



Industrial production

	Jan		Feb		Mar	
Germany						
Production sector (%m/m sa)	0.1		~~0.0~~	*-0.2*	~~2.0~~	*4.0*
%oya sa	2.1		~~5.4~~	*5.2*	~~6.8~~	*8.6*
Prod sec ex constr (%m/m sa)	1.1		~~-0.1~~	*-0.2*	~~1.2~~	*2.6*
%oya sa	2.9		~~6.5~~	*6.4*	~~7.7~~	*9.1*
Industry (%m/m sa)	0.6		~~0.1~~	*0.0*	__	*3.4*
%oya sa	2.7		~~6.4~~	*6.3*	__	*9.3*

IP rose 4%m/m in March. The huge gain was driven by a robust rise in output ex. construction (2.6%m/m) and a massive bounce back in construction output (26.7%m/m), which had fallen sharply at the start of the year due to bad weather. The rise in ex. construction output was driven by widespread increases across product categories, with investment goods production rising particularly strongly (4.4%m/m). Energy output, on the other hand, declined following strong weather-related gains earlier in the year.

In 1Q as a whole, German IP rose 3.7%ar thanks to a 6% ar rise in ex. construction output, which more than offset a fall in construction activity of 27.3% ar. This outcome to some extent challenges the general expectation that German GDP would at best be flat in the quarter given weak construction activity. More importantly, the recent IP trajectory suggests that 2Q could be a blockbuster quarter for German growth. Even if IP were to remain stable at the March level through 2Q (which we view as a pessimistic assumption), it would grow almost 11% ar in the quarter, an outcome that historically has been consistent with GDP growth of 4%-5%ar.

Manufacturing orders

Index, sa

	Jan		Feb		Mar	
Germany						
Volumes, sa						
Total (%m/m)	~~5.1~~	*5.2*	0.0		~~2.5~~	*5.0*
%oya	~~20.5~~	*20.6*	~~24.5~~	*24.6*	~~22.7~~	*26.0*
Domestic (%m/m)	6.7		~~-1.9~~	*-1.7*	__	*5.4*
%oya	14.0		~~18.7~~	*18.9*	__	*22.8*
Foreign (%m/m)	~~3.7~~	*3.8*	~~1.8~~	*1.7*	__	*4.7*
%oya	~~27.0~~	*26.9*	30.1		__	*29.0*

German orders surged in March, owing to strong gains in both foreign (4.7%) and domestic (5.4%) orders, with strength across product categories. After rising at an average pace of 33% ar in 2Q and 3Q last year, orders growth slowed to 3.5% ar in 4Q. In 1Q this year, orders growth reaccelerated to a pace of 28.5% ar.

The rise in orders in recent months is consistent with the message from business surveys, and provides support for our view that the German economy is in the midst of a significant cyclical uplift. German growth in 1Q is still likely to have been subdued, partly due to the sharp weather-related fall in construction output at the start of the year. The marked reacceleration in manufacturing orders in recent months, coupled with the likely rebound in construction output in the spring, however, set 2Q up for a strong growth performance.

In the details, the rise in orders in March was driven by a 3.6%m/m rise in intermediate goods orders, a 6% gain in capital goods orders, and a 6.2% rise in consumer goods orders. The strong gains in the different product categories were driven by increases in both foreign and domestic orders.

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Encouragingly, domestic capital goods orders reaccelerated significantly, rising 36.4% ar in 1Q after a 20.7% ar drop in 4Q. As for foreign demand, foreign orders from the rest of the Euro area rose very strongly in 1Q (39.6% ar) thanks to a particularly strong performance in capital goods orders (62.7% ar).

Demand and labor markets

Retail sales

Total sales, volumes

	Jan		Feb		Mar	
Euro area						
%m/m sa	~~-0.2~~	*-0.3*	~~-0.6~~	*-0.2*	~~0.5~~	*0.0*
%oya, working-day adj.	-0.6		~~-1.1~~	*-0.2*	__	*-0.1*
Germany						
Sales ex autos and petroleum, volumes						
%m/m sa	-1.3		1.1		~~0.2~~	*-2.4*
%oya sa	-1.6		-0.3		__	*-2.6*

Euro area retail sales remained unchanged in March despite the large decline reported in Germany. This reflected increases in most other countries. The report leaves Euro area retail sales in 1Q10 broadly unchanged from the 4Q09 level. However, car registrations were lower again in 1Q10, and as a result, consumer spending is likely to have declined overall.

Retail spending in the region is not yet growing, but after large declines in 2008, it has been broadly stable for the past year. Looking ahead, we would expect some gradual improvement if the cyclical upswing in the region remains on track. By country, retail spending is growing steadily in France and Austria, and there has also been some improvement recently in Spain. In most other countries, the trend remains closer to flat. Greek retail spending data are not yet available for March but were still holding up through February.

The fall in German retail sales in March left the 1Q10 average 3.5%q/q saar below the 4Q09 level. With car registrations in 1Q10 also well below the 4Q09 average, overall consumer spending in Germany is set to show a large decline last quarter.

However, we are cautious about overinterpreting the weakness in the German retail sales data since they are very noisy and prone to revision.The large decline for March seemed weak relative to other developments: large increases in consumer confidence in March and April, large declines in German unemployment, and improving retail confidence in the IFO survey. Finally, the published details seemed firmer than the headline number and are not sending a clear message of weakness; there were increases in clothing sales and furniture sales in March and a second monthly increase in car sales.

Nevertheless, the report suggested that the huge improvement in German growth momentum reported in key business surveys in the spring likely reflects increases in corporate activity and exports, rather than consumer spending at present.

Inflation

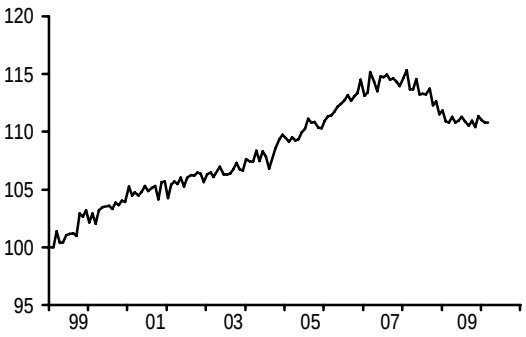
Producer prices

	Jan		Feb		Mar	
Euro area						
%m/m nsa	0.7		0.1		0.6	
%oya nsa	~~-1.1~~	*-1.0*	~~-0.5~~	*-0.4*	~~0.8~~	*0.9*

Producer prices moved from deflation to inflation in March. Beside the boost from energy producer price inflation, the largest sequential increase was registered in intermediate goods prices, which rose 0.6%m/m and 2.8%oya in March, after -0.8%oya in February.

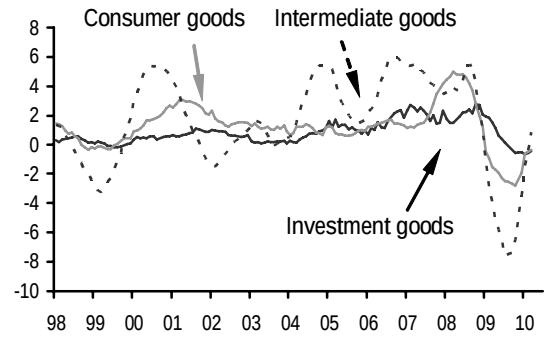
Euro area retail sales volumes

Jan99 = 100



Euro area PPI

%oya



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Japan

- **April PMI services activity index moved above 50; auto sales increased to above 1Q average**
- **Direct impact from the European crisis looks limited, but fear of contagion dominated financial markets**

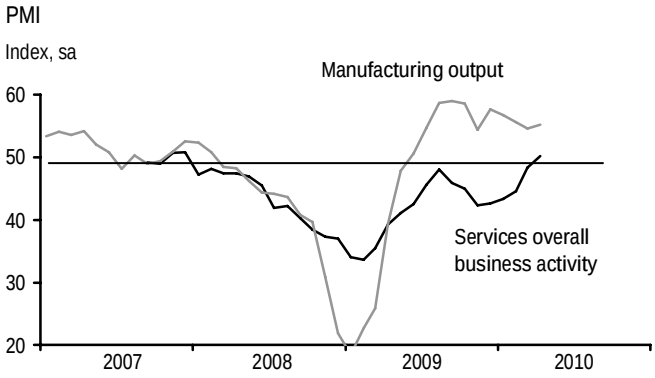
With the Golden Week holiday and hence only two business days this week, data releases were limited to PMI services and auto registrations for April. Each indicator was encouraging: the former confirmed that the recovery is broadening from the manufacturing sector to the service sector, while the latter showed that auto sales picked up after a decline in 1Q. Next week's Cabinet Office composite index of private consumption in March (likely released on Monday) and April's Economy Watchers survey (Thursday) are anticipated to support further the view that the consumption and sentiment of small firms, which are particularly sensitive to the economic cycle, improved during the spring season.

Despite the improvement in the domestic economy, Japan's financial markets took a severe hit this week largely due to fears about the Euro sovereign debt crisis: the headline Nikkei fell 6.3% from the end of last week, and the yen appreciated around 7% against the euro. The direct spillover from the European crisis to Japan's economy through real macroeconomic channels is probably not as significant. The percentage of euro-denominated transactions for Japanese exporters was only 6.7% in 2H09 (USD made up 49.8%). The share of exports to the EU was 12.5% in 2009, far less than the 54.2% to Asia, while March's over-year-ago increase in exports to Asia (+52.8%) was nearly double that to the EU (+26.7%). For Japanese exporters as a whole, the US is a more important destination of exports (representing 16.1%), and the recent acceleration of the US recovery is encouraging.

However, the concern among market participants is understandable given that the impact on Japan's real economy and financial markets from the global financial crisis just 18 months ago was far more significant than on the countries that were responsible for the crisis. We believe that the economic environment now is far stronger than before the crisis, mostly as inventories, productive capital, and labor are currently considered to be less excessive than at the beginning of the earlier crisis. Still, the threat of contagion from financial markets to the real economy, both globally and domestically, requires close attention.

PMI confirms broadening of recovery

The business activity index within the services PMI report rose further in April, even after March's 3.7pt jump. The index now stands at 50.2, its highest level since December 2007. This result reinforces the view from other nonmanufacturing DIs—including the Reuters Tankan large nonmanufacturing DI and the Shoko Chukin small nonmanufacturing DI—as well as the tertiary sector activity index that the large-manufacturing-led recovery is now spreading across the nonmanufacturing sector. The services PMI report also contained encouraging feedback from new businesses and firms when they were asked about prospects for their own business activity 12 months ahead. Expectations rose to above-neutral levels, and the employment index continued to recover declines sustained during the first two months of this year, despite remaining below 50.



Trade in goods by region (nominal value)

	Exports		Imports	
	%oya[1]	Share[2]	%oya[1]	Share[2]
Total	43.5	100.0	20.6	100.0
Asia	52.8	54.2	16.5	44.6
US	29.5	16.1	2.6	12.4
EU	26.7	12.5	13.4	10.7
Latin America	33.5	5.7	36.1	3.6
Middle East	53.4	3.7	55.7	16.8
Other	39.5	7.8	15.4	11.8

1. Data for March 2010
2. Data for CY2009

Auto sales picked up in April

After three consecutive months of decline, auto registrations rose in April, moving 9.1% ar above the 1Q average. The increase mainly reflected cuts in the auto weight tax—paid at registration or compulsory inspection—that took effect on April 1, and an additional measure to promote sales of environmentally friendly cars. The incentive (a maximum of ¥250,000) toward purchasing replacement vehicles will continue until the end of September (other tax cuts are scheduled to expire in 2012), so we expect auto sales to remain firm in the coming months.

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Data releases and forecasts

Week of May 10 - 14

During the week

Cabinet Office private consumption index

	Dec	Jan	Feb	Mar
%m/m sa	0.9	0.3	0.0	___

The CAO's private consumption index, which combines demand- and supply-side statistics, is expected to continue tracking solid growth in 1Q, consistent with likely gradual improvement in aggregate labor income and a recovery in consumer sentiment. Indeed, the strong rise in March "core" real household spending in the household survey somewhat reduced the significant gap between the performance of the two major monthly consumption indicators (that measure and nominal retail sales in the commercial sales report) that had emerged in the first two months of 1Q.

Wed May 12 2:00pm

Indices of business conditions

	Dec	Jan	Feb	Mar
Composite index (sa)				
Leading	94.4	97.3	98.5	102.9
Coincident	97.2	100.3	100.5	101.6
Diffusion index				
Leading	83.3	72.7	90.9	100.0
Coincident	95.5	100.0	100.0	100.0

Thu May 13 8:50am

Money stock and bank lending

%m/m sa, incl. agricultural worker households

	Jan	Feb	Mar	Apr
M2	3.0	2.7	2.6	2.4
L	1.1	1.0	1.0	1.0
Bank lending	-1.7	-1.6	-2.0	-2.0
Adjusted for special items	-1.4	-1.3	-1.7	-1.7

Bank lending is expected to have remained very weak in April. As a reason for the ongoing weakness, the BoJ has been pointing to weak corporate demand for both operating and investment funds, and the 1Q loan officers survey supports this view. The weak loan demand appears to be related to abundant liquidity in the corporate sector, which reflects the combination of improving profits and a still-cautious investment stance.

Thu May 13 8:50am

Balance of payments

¥ bn sa, unless noted

	Dec	Jan	Feb	Mar
Current account	1302	1713	1119	1364
Trade balance	661	994	597	769
Services	-102	-123	-178	-130
Income	839	920	828	825
Current transfers	-96	-79	-128	-100
Current account (nsa)	901	900	1471	1890

Thu May 13 2:00pm

Economy Watchers survey

DI

	Jan	Feb	Mar	Apr
Current conditions	38.8	42.1	47.4	48.5
Households	37.4	40.6	46.5	___
Business	40.4	43.8	48.0	___
Employment	44.3	48.0	51.3	___

We expect that the headline index will show the fifth consecutive rise in April. The April Shoko Chukin survey, another important small firm survey, suggests that the momentum in the economy has strengthened at the start of this quarter.

Review of past week's data

Services/composite PMIs (May 6)

DI

	Feb	Mar	Apr
Services (business activity)	44.6	48.3	___ *50.2*
Composite (output)	47.4	50.3	___ *51.8*

The services PMI business activity index rose further in April, even after March's 3.7pt jump. The current level is the highest since December 2007. The result reinforces the message sent by the other nonmanufacturing DIs (the Reuters Tankan large nonmanufacturing DI and the Shoko Chukin small nonmanufacturing DI) and the tertiary sector activity index that the large-manufacturing-led recovery is now spreading to the nonmanufacturing sector.

The details of the report were encouraging as well. While forward-looking new business and business expectations (the latter of which asks about prospects for firms' own business activity 12 months ahead) each rose to an above-neutral level, the employment index continued to recover the declines in the first two months of this year.

Auto registrations (May 6)

%oya, unless noted

	Feb	Mar	Apr
Total	35.1	37.2	~~35.0~~ *33.5*
mn units saar	3.30	3.21	~~3.46~~ *3.43*
J.P. Morgan-adjusted (incl. light vehicles)			
mn units saar	4.08	3.95	___ *4.16*

New auto registrations recovered part of the loss in the previous four months in April. The April level of the J.P. Morgan adjusted measure, our preferred measure of real consumer auto spending, was 4.16 million units (at an annual rate), which was higher than the 3.95 million 1Q average, though lower than the level in any month from October 2009 through January 2010.

It appears that the weakness in the previous few months included consumers' waiting for cuts in the auto weight tax (paid at registration or compulsory inspections), which took effect on April 1. Still, it is likely that momentum in auto consumption, triggered by government measures to promote sales of environmentally friendly cars, moderated somewhat around the turn of the year.

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Canada

- **Employment jumped 108,700 in April; also big jump in hours worked**
- **Improving job prospects attracting job seekers back to the labor market**
- **Solidifies view that BoC will begin to normalize monetary policy in June**

The April labor market report was the highlight of this week. Employment rose 108,700 in April with the unemployment rate edging down to 8.1%. In other releases, building permits halted a four-month decline with a 12.2%m/m jump in March. And the headline Ivey PMI unexpectedly rose in April—to 58.7, pointing to a pickup in the pace of the overall recovery. This was only the second monthly increase in April in the index's relatively short 12-year history.

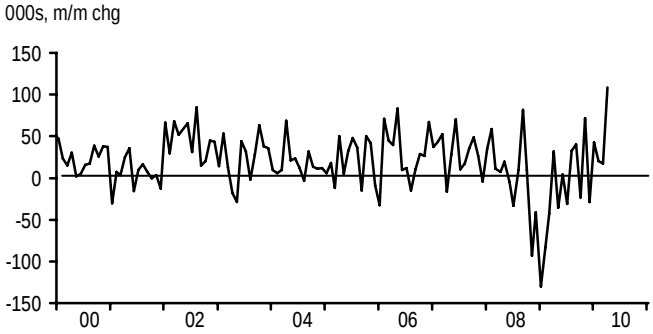
Canadian employment jumped 108,700 (consensus: +25,000) in April following a 17,900 rise in March. This was the fourth consecutive monthly increase and the largest monthly increase in employment since January 1976. The labor force also experienced an outsize, though slightly smaller, increase. As a result, the unemployment rate edged down to 8.1%, 0.6%-pt below what now appears to be the 8.7% peak reached last August. Labor market conditions are clearly improving. Since its trough in July 2009, employment has increased 285,100, recovering 68% of the jobs lost in the 2008-09 recession.

In April, two-thirds of the employment growth was among men aged 25 and over (+71,800), the strongest monthly increase for this group since comparable data became available in 1976. Employment growth in April was in both part-time (+64,800) and full-time (+43,800) work. All of April's increase was among employees in the private sector and was heavily concentrated in the service-producing sectors, which added 106,600 jobs. Employment in the goods-producing sector edged up 2,100. Construction jobs rose a strong 24,400 (mild weather aided) but this was nearly offset by a 20,600 decline in manufacturing jobs.

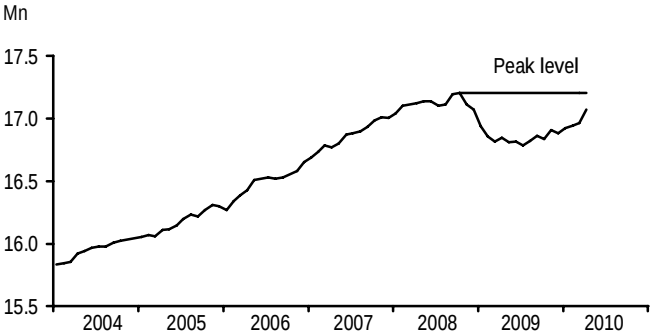
The improvement in job prospects is attracting job seekers into the labor market. The labor force jumped 92,000 in April, its largest monthly increase since August 2008. Consequently, the unemployment rate only edged down 0.1%-pt to 8.1%, the lowest since April 2009.

Hours worked jumped 1.1%m/m in April after a 0.4% decline in March and were up a strong 2.5% from a year ear-

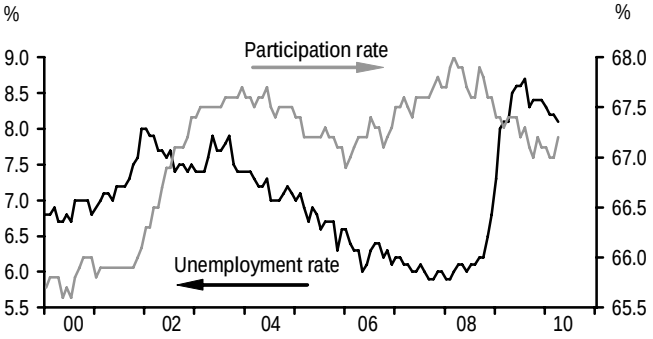
Monthly employment



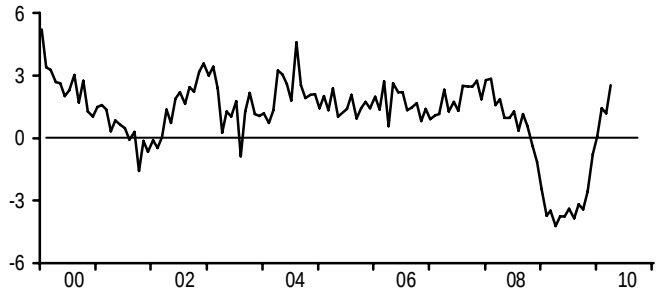
Household employment



Unemployment and labor force participation



Hours worked



lier. This represents a strong start to 2Q. Compared with the 1Q average, hours worked in April are up 3.4% ar, pointing to another solid gain in GDP. The economic recovery in Canada continues to gather pace, reinforcing that the Bank of Canada will likely begin to normalize monetary policy with a 25bp increase in the overnight rate on June 1.

The sharp jump in building permits in March put them up 39% from a year ago in the depths of the recession. The March rise came mostly from multi-family and industrial permits. The value of single-family permits was unchanged but was up 97% from a year earlier, while multi-family permits soared 53.6%m/m. In nonresidential, industrial permits exploded 56.9%m/m, their third consecutive monthly increase. The gains were mostly associated with transportation.

Historically, the headline Ivey PMI, which is not seasonally adjusted, had fallen in April, declining in 10 of the 11 Aprils for which it had been calculated. So, the increase this April was unexpected and underscored the head of steam the economy is building. Also note that the headline index reflects only purchases made by purchasing managers and is just one of four activity indexes contained in the report. J.P. Morgan constructs a seasonally adjusted composite index (an average of the four activity indexes in the report, constructed along the lines of the US ISM index). This composite rose to 55.2 from 53.7 in March. The April reading on the composite index was the highest since August 2008. Three of the four activity components in the J.P. Morgan composite pointed to stronger activity in April (note the supplier delivery index is a counter indicator, meaning that decreases point to slower deliveries, which are an indicator of stronger activity).

Data releases and forecasts

Mon May 10 8:15am — **Housing starts**
Sa

	Jan	Feb	Mar	Apr
Total (000)	189.0	204.6	200.9	205.0
%m/m	7.6	8.3	-1.8	2.0
%oya	39.5	78.0	37.9	83.0

Housing starts are expected to rebound in April. The large increase in construction jobs in April colors our expectation.

Wed May 12 8:30am — **International trade**
Sa

	Dec	Jan	Feb	Mar
Balance (C$ bn)	0.23	0.75	1.39	1.60
Exports (%m/m)	4.0	-0.1	2.8	3.2
Imports (%m/m)	3.4	-1.7	0.9	2.7

Wed May 12 8:30am — **New house prices**
Nsa

	Dec	Jan	Feb	Mar
Total,%m/m	0.4	0.4	0.1	0.3
%oya	-0.9	0.1	0.9	1.6

Fri May 14 8:30am — **New motor vehicle sales**
Sa

	Dec	Jan	Feb	Mar
Total (mn units, ar)	1.551	1.536	1.660	1.594
%m/m	3.7	-1.0	8.1	-4.0
%oya	15.6	7.8	22.8	10.1

Preliminary estimates of March new vehicle sales show a decline of 4%m/m according to Statistics Canada. Even with a decline in March, 1Q average sales would be up 3% from the average pace in 4Q09. Monthly levels have been trending up since year-end 2008.

Fri May 14 8:30am — **Manufacturing report**
%m/m sa, unless noted

	Dec	Jan	Feb	Mar
Sales	1.5	1.8	0.1	2.4
New orders	6.7	-0.4	1.4	1.6
Unfilled orders	2.2	0.3	1.5	0.8
Inventories	-0.8	0.2	0.2	0.3
Inventory-shipments ratio	1.37	1.35	1.35	1.33

Review of past week's data

Building permits (May 6)
Sa

	Jan	Feb		Mar	
Total,%m/m	-4.7	~~-0.5~~	*-0.7*	~~-1.9~~	*12.2*
%oya	32.9	~~56.7~~	*56.4*	~~26.4~~	*38.9*

Ivey PMI (May 6)

	Feb	Mar	Apr	
Sentiment index[1] (sa)	49.2	53.7	~~53.6~~	*55.2*
Purchasing index (nsa)	51.9	57.8	~~52.8~~	*58.7*
Prices index (nsa)	55.9	61.5		*59.2*

1. Calculated and seasonally adjusted by J.P. Morgan

Labor force survey (May 7)
Sa

	Feb	Mar	Apr	
Employment (mn)	16.95	16.96	~~16.98~~	*17.07*
ch, m/m, 000s	20.9	17.9	~~-20.0~~	*108.7*
%m/m	0.1	0.1	~~-0.1~~	*0.6*
%oya	0.5	0.9	~~-0.8~~	*1.3*
Labor force (mn)	18.46	18.48	~~18.50~~	*18.57*
%m/m	0.0	0.1	~~-0.1~~	*0.5*
%oya	0.8	0.9	~~-0.8~~	*1.2*
Unemployment rate (%)	8.2	8.2	*8.1*	
Avg hrly earnings (%oya)	2.5	2.5	*2.3*	
Hours worked (%m/m)	0.2	-0.4	~~-0.2~~	*1.1*

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Mexico

- **We have changed our monetary policy call to a low-for-long view**
- **Consumer confidence still signals skepticism about the economic recovery**
- **However, rising employment and the upcoming fall in inflation could improve consumer sentiment**

We now expect Banco de México to remain on hold for the remainder of 2010 and the first half of 2011, instead of our previous call for hikes in October and November 2010. We changed our call to a low-for-long view mainly because: (1) medium- and long-term inflation expectations have remained well anchored and wage increases have moderated significantly, while inflation will probably drop in 2011, particularly in the first quarter, mainly due to base effects reflecting large price increases in early 2010; (2) the output gap remains quite wide, and it is not likely that domestic demand could overheat in the short term; and (3) the Euro area sovereign crisis will probably cause central banks, with certain exceptions, to keep rates unchanged for a longer period of time. In our view, Banxico will wait for monetary authorities in developed economies to start hiking rates and then take the appropriate actions to maintain long-term relative neutrality (for further details, please see our *Mexico Economic Comment*, "Banxico—on hold indefinitely," May 5, 2010).

Skepticism among consumers about economic recovery

Consumer confidence, released during the week by INEGI, rose 1.1%m/m sa to 81.8 in April, from 80.9 in March. In our view, the better growth scenario and the strong manufacturing rebound continue to permeate consumer sentiment. In fact, looking at the breakdown (table), each component posted a monthly increase. However, it seems that consumers still have doubts about the sustainability of the economic recovery.

Indeed, the "current conditions" subcomponents at the household and national levels posted larger month-over-month growth rates than the "expectations" components. On the other hand, even though purchasing power printed a monthly increase of 1.3% sa, in over-year-ago terms it is still down 12.1%, reflecting, in our view, the higher inflationary pressures the country has experienced since the beginning of the year. However, while employment conditions have continued to improve, the upcoming CPI figures will probably continue to print lower monthly figures compared to 1Q10.

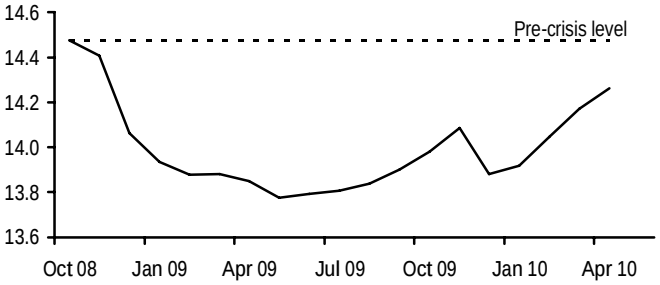
Consumer confidence[1]

	Apr 10	Mar 10	%m/m	%oya nsa
National	81.8	80.9	1.1	0.5
Current conditions	80.5	79.2	1.6	7.5
Expectations	90.6	90.6	0.1	2.0
Households				
Current conditions	88.0	86.5	1.8	1.3
Expectations	95.1	93.7	1.5	1.3
Purchasing power	56.2	55.4	1.3	-12.1

Source: J.P. Morgan with data from INEGI

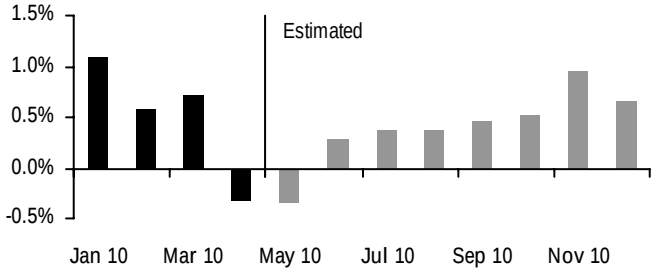
1. All data are seasonally adjusted unless otherwise stated.

Formal employment
Mn workers



Source: IMSS (Mexican Social Security Institute)

Headline CPI
%m/m



Source: Banco de México

Employment continues to recover

According to the Ministry of Labor, slightly more than 92,000 new formal jobs were created in April (both permanent and temporary urban workers). This is the tenth time in the past 11 months that the number of workers registered at the IMSS (Mexican Social Security Institute) has risen. Even though the total number is still below the pre-crisis level by 180,000 jobs, there is no doubt that employment conditions have been continuously improving (second chart).

Low upcoming monthly inflation figures

Electricity discounts as well as lower agricultural prices will keep monthly inflation readings subdued. The headline CPI in April—released during the week—fell 0.20%, push-

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ing 12-month inflation down by 60bp to 4.4%, from 5% in March. Even though this was mainly driven by seasonal effects (i.e., electricity tariff discounts as well as agricultural and tourism-related price declines), the large output gap the economy continues to experience and the electricity tariff cuts that will be in place until October will probably guarantee lower monthly inflation numbers than the ones we observed at the beginning of the year (third chart, previous page).

All in all, we continue to expect better employment conditions to help keep domestic demand on its gradual upward trend. The possibility that credit conditions could improve in the second half of the year should also help to dissipate consumers' skepticism.

Data releases and forecasts

Week of May 10 - 14

Tue May 11 9:00am — **Central bank foreign reserves**
US$ bn

	Apr 16	Apr 23	Apr 30	May 7
Gross international reserves	97.4	97.3	97.4	___

Tue May 11 12:00am — **Automobile production and sales**
%oya

	Jan	Feb	Mar	Apr
Production	102.4	55.6	85.1	___
For export	130.7	59.6	82.9	___
Domestic sales	-8.0	-3.3	1.8	___

Tue May 11 — **Nominal wage settlements**
% per annum, one year ahead

	Jan	Feb	Mar	Apr
Nominal increase	4.4	4.5	4.6	4.9
Real terms[1]	0.0	-0.3	-0.3	___

1. Using 12-month average CPI inflation.

Wed May 12 9:00am — **Fixed investment**
%oya nsa

	Nov	Dec	Jan	Feb
Total	-7.3	-4.1	-4.8	-3.0
Machinery and equipment	-16.0	-8.6	-9.4	-2.7
Construction	-0.8	-0.4	-1.9	-0.4

Wed May 12 9:00am — **Industrial production**

	Dec	Jan	Feb	Mar
%oya nsa	1.6	3.5	4.4	5.9
Manufacturing	4.3	8.0	8.8	12.5
%m/m sa	1.0	-0.1	0.6	0.3
Manufacturing	2.7	-1.4	0.2	1.3

Wed May 12 — **ANTAD same-store sales**
%oya, real terms

	Jan	Feb	Mar	Apr
Total	-0.6	-1.7	-1.7	-5.5

Review of past week's data

Banxico expectations survey (May 3)
%oya, average value

	Feb	Mar	Apr	
Inflation				
End-2010	5.21	5.28	___	*5.19*
Four years forward	3.69	3.69	___	*3.73*
Real GDP				
2010	3.9	4.1	___	*4.2*
2011	3.7	3.6	___	*3.6*
USD/MXN				
2010	13.04	12.70	___	*12.45*
2011	13.24	12.93	___	*12.72*

IMEF PMI survey[1] (May 3)
Index

	Feb	Mar		Apr	
Manufacturing	52.2	~~55.2~~	*53.7*	~~54.5~~	*54.6*
Nonmanufacturing	53.7	55.1		~~55.0~~	*54.1*

1. Using the same methodology as the US ISM survey.

Central bank foreign reserves (May 4)
US$ bn

	Apr 16	Apr 23	Apr 30	
Gross international reserves	97.4	97.3	___	*97.4*

Banamex CPI inflation expectations survey (May 5)
%oya, except policy rate: %p.a., median value

	Apr 7	Apr 19	May 5	
End-2010	5.25	5.22	___	*5.10*
Core	4.60	4.50	___	*4.36*
End-2011	3.81	3.83	___	*3.87*
One year forward	3.89	3.86	___	*4.01*
Banxico policy rate (YE10)	5.00	5.00	___	*4.75*

Employment IMSS (May 5)
Chg m/m, 000s

	Feb	Mar	Apr	
Total	128.4	136.4	___	*67.9*
Permanent	85.4	79.4	___	*59.0*
Temporary	43.0	57.0	___	*8.9*

Consumer prices (May 7)

	Mar 2H	Apr 1H	Apr 2H	
%2w/2w	0.16	-0.31	~~0.05~~	*-0.18*
Core	0.19	-0.03	~~0.15~~	*0.09*
%oya	4.88	4.41	~~4.27~~	*4.13*
Core	4.35	4.13	~~4.16~~	*4.10*

	Feb	Mar	Apr	
All items (%m/m nsa)	0.58	0.71	~~-0.20~~	*-0.32*
%oya	4.83	4.97	~~4.39~~	*4.27*
Core (%m/m nsa)	0.40	0.36	~~0.14~~	*0.11*
%oya	4.60	4.40	~~4.15~~	*4.11*

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Brazil

- **COPOM minutes justify the 75bp hike, but avoid sending a clear signal about the bank's next steps**
- **IP boomed in 1Q10, raising upside risks to our GDP growth forecast**
- **April IPCA confirmed the inflation acceleration; we now foresee the 2010 IPCA increasing 5.9%Dec/Dec**

The minutes of the last COPOM meeting, which inaugurated the hiking cycle with a 75bp increase in the Selic rate to 9.50%, avoided sending a clear signal about the bank's future actions, but the tone is in line with a pace of 75bp increases. Inflation risks have deteriorated since the March meeting, and this deterioration triggered what the COPOM described as an "incisive" action, aiming to avoid the propagation of short-term price pressures to longer-term inflation. Although this could be interpreted as an indication that the 75bp pace is in line with the less favorable balance of risks, the committee maintained the paragraph that the pace of adjustment should adapt to the inflation outlook, leaving the door open for different paces at future meetings.

Despite the hawkish description of the inflation scenario (deterioration in core and inflation expectations, labor scarcity, increasing costs of production, and higher COPOM inflation forecasts), the introduction of Europe's fiscal crisis as a new risk factor affecting future policy actions could be read as slightly dovish. The committee noted that the fiscal problems in Europe are moderating the demand for risky assets, but on the FX side, they have mainly resulted in EUR weakening. Note that COPOM's remarks were based on last week's price action, therefore did not reflect this week's sell-off.

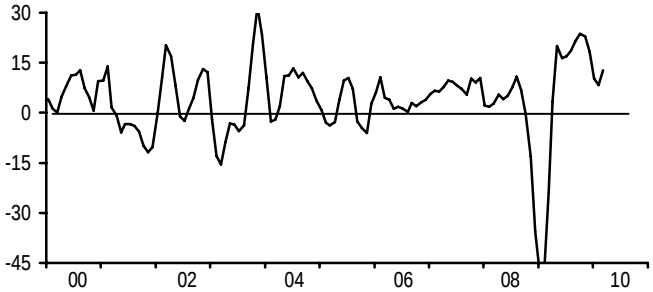
Against this backdrop, we keep our forecasts of two more hikes of 75bp at the June and July meetings, and three more hikes of 50bp at the September, October, and December meetings, lifting the Selic rate to 12.50% by year-end. Given the macroeconomic outlook of strong high-frequency activity indicators, and further fiscal stimulus, our forecast of a total adjustment of 375bp in the Selic rate is biased toward more hikes, but this week's COPOM minutes were more in line with a prolonged cycle than a faster pace of adjustment.

IP is back to the pre-crisis peak

March industrial production (IP) posted a 2.8%m/m sa increase, well above the 1.9%m/m sa consensus and a little higher than the J.P. Morgan forecast (2.6%). Including the March reading, IP expanded 13%q/q saar (first chart) in

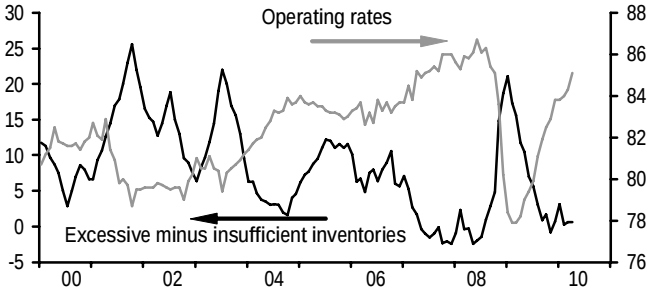
IP surprised up in March, growing 13% q/q saar in 1Q10

%3m/3m, saar



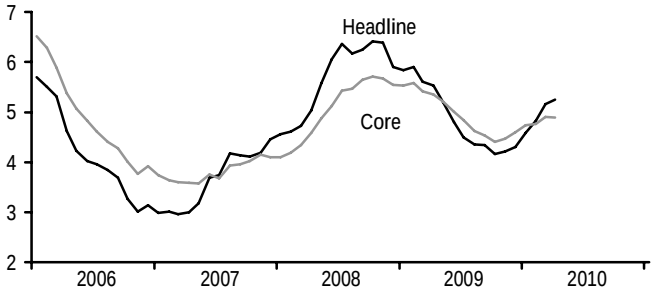
Inventories at low levels; operating rates on the rise

Excessive minus insufficient inventories (% of firms), sa — Operating rates, sa



IPCA headline and core inflation above the 4.5% target

%oya, nsa



1Q10, slower than the 18% pace registered in 4Q10, but a figure that points to continued strong growth momentum. In fact, the production level has fully recovered from the 2008 slump, and recent increases have left a huge carryover effect for 2Q10 (that would reach 9% even without any sequential growth between April and June). While softer car production will be a headwind in 2Q, relatively low inventories, surging investment, and high confidence still point to firm growth ahead. We have been highlighting that some specific factors (like the upsurge in car sales and production) contributed to the strong performance of late, and some payback will take place in April and May. However, we stick with the view that temporary factors aside, fundamentals remain quite supportive. Despite the continued IP pickup, there are no signs of significant inventory

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accumulation, and this along with very high business confidence and firm domestic demand expansion (for example, above-trend growth of retail sales) should underpin the momentum of IP growth—although it is a foregone conclusion that IP will grow more slowly than the pace registered in 2H09. In terms of sectors, capital goods production led the expansion of IP in March, and taking into account the major lift in capital goods net imports, total capital goods absorption increased more than 5%m/m sa. Production of building materials is also increasing steadily (4%m/m sa in March) and the outlook for the sector (boosted by official incentives and investment) remains quite supportive. We estimate that total fixed capital formation grew 20%q/q saar in 1Q10, and even allowing for moderation in 2H10, it should easily hit our 19.3% growth forecast for full-year 2010. With several activity indicators (IP, employment, and capex) tracking slightly above our expectations for 1Q10, we already see upside risks to our 8.7%q/q saar GDP growth forecast.

2010 IPCA forecast revised up to 5.9%

The April IPCA increased 0.57%m/m nsa, slightly above consensus (0.55%) and slightly below our forecast (0.60%), but an acceleration from the 0.52%m/m increase in March. Most of the acceleration was due to a seasonal increase in apparel prices, the end of fuel price declines, and price readjustments for medicine. Setting aside these specific factors, underlying inflation remains under upward pressure, with the average of core measures increasing 0.45%m/m, up from 0.42% in March. On a 12-month cumulative basis, the IPCA is running at 5.26% (from 5.17% in March), and core inflation is hovering around the uncomfortable level of 4.9%, clearly above the midpoint of the central bank's target range (4.5% +/-2.0%).

Recent inflation figures along with expected increases in wholesale inflation (linked to strong domestic activity) should continue to add pressure to inflation expectations. Note, for example, that in last week's central bank survey, the consensus for April CPI stood at 0.50%m/m, meaning that the actual release will add 7bp to 2010 expectations. Moreover, the consensus for May IPCA was 0.38%m/m last week, and we think that this month's inflation should be closer to 0.50%m/m, suggesting there is room for about a 20bp lift in the consensus forecast for 2010 IPCA (which was 5.42% last week). Taking into account the short-term pressures and the strong pace of domestic demand expansion, we are lifting our 2010 IPCA forecast to 5.9% (from 5.4%). At this point, we are keeping our 5.1% forecast for 2011 inflation, but we still expect the current consensus for next year's inflation (4.8%) to also move up in the future.

Data releases and forecasts

Week of May 10 - 14

Wed May 12 7:00am — Retail sales

	Dec	Jan	Feb	Mar
%m/m sa	-0.6	3.1	1.8	1.6
%oya nsa	9.2	10.4	12.3	15.7

Review of past week's data

Merchandise trade balance
US$ bn

	Feb	Mar	Apr	
Trade balance	0.4	0.7	~~1.2~~	*1.3*
Year to date	0.2	0.9	~~2.0~~	*2.2*
Past 12 months	24.3	23.3	~~20.7~~	*20.9*
Exports	12.2	15.7	~~14.8~~	*15.1*
%oya	27.2	33.2	~~19.7~~	*23.0*
Imports	11.8	15.0	~~13.6~~	*13.9*
%oya	50.8	50.0	~~57.6~~	*61.1*

Industrial production

	Jan	Feb	Mar	
%m/m sa	1.3	~~1.6~~ *1.5*	~~2.6~~ *2.8*	
%oya nsa	16.0	18.4	19.7	

Vehicles production (Anfavea)

	Feb	Mar	Apr
Output (000 units)	249.8	339.6	289.9
%oya nsa	22.2	23.4	14.2

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

	Feb	Mar	Apr	
Overall	1.1	0.6	*0.7*	
%oya	0.8	2.3	*3.0*	
Wholesale prices	1.4	0.5	*0.7*	
Consumer prices	0.7	0.9	~~0.7~~	*0.8*
Construction costs	0.4	0.8	~~1.0~~	*0.8*

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

	Feb	Mar	Apr	
Total (100)	0.8	0.5	*0.6*	
%oya	4.8	5.2	*5.3*	
%ytd	1.5	2.0	*2.7*	
Ex fuel and most volatile food	0.7	0.4	~~0.4~~	*0.5*
Trimmed mean	0.4	0.5	*0.5*	

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Andeans: Colombia, Ecuador, Peru, Venezuela

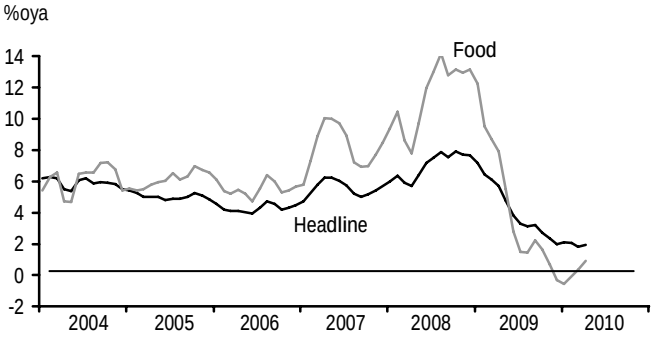
- **Colombian central bank unexpectedly cut rates last week, suggesting that inflation will remain subdued**
- **Banrep recognized that growth is surprising on the upside; we think 2010 expansion could surpass 3.0%**
- **But odds of a rate hike in 4Q10 increased appreciably**

After leaving the policy rate at 3.5% since November 2009, Banrep unexpectedly cut its policy rate another 50bp at last week's meeting. According to the post-meeting communiqué, the reduction in inflation (headline and core) and inflation expectations (including official forecasts) along with remaining slack in the economy justified the additional monetary stimulus. The Board highlighted that the impact of El Niño on inflation was lower than expected—reducing inflation expectations—at the same time that Banrep's staff is quite confident that inflation will remain in the target range (3.0% +/-1.0%) in both 2010 and 2011.

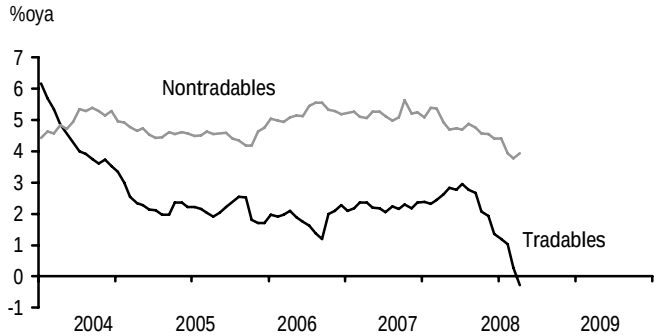
The communiqué also mentioned that more recently, economic growth has been surprising on the upside, boosted by the global rebound and higher confidence of economic agents. But Banrep's Board suggested that the remaining slack in the economy along with anchored inflation expectations will ensure that the additional monetary stimulus does not add inflation pressures or any kind of macroeconomic instability. The Board also announced that it will not sell local bonds (TES) to sterilize the ongoing FX intervention program anymore. In fact, the Bank has been selling TES bonds from its portfolio to sterilize USD purchased in the spot market (US$20 million per day); however, this has been adding pressure to the local curve since it lifts the supply of bonds when the market is already concerned with the possibility of less-than-expected privatization revenues and more issuance by the National Treasury.

A key takeaway from last week's decision is that Banrep is willing to endure more risk in order to boost economic growth (note that Colombia is clearly lagging behind in the Latin American recovery). Tame short-term inflation opens the door for more aggressive action, since the inflationary impact of weaker COP and more liquidity will be quite limited in the near future. Note also that lingering problems on the fiscal front restrict the capability of a fiscal response, meaning that monetary policy is the only alternative to provide economic stimulus at this point. We do not expect an additional rate cut in May, and last week's decision sowed the seeds for tightening in 4Q10. Note that economic recovery is already under way, while last week's surprising action should prevent an additional fall in inflation expectations. Moreover, continued global recovery and loose monetary conditions will further boost economic growth in 2H10, and it is quite possible that 2010 GDP growth will surpass our above-consensus 3.0% forecast. Also, a low base effect will prompt higher over-year-ago inflation in 2H10. While we have been expecting Banrep to remain on hold for all of 2010, this decision substantially increases the odds of a 4Q10 rate hike, in our view.

Colombia: headline and food inflation at low levels



Colombia CPI: tradable and nontradable components



April CPI printed above consensus

Colombian CPI surprised on the upside in April, printing up 0.46%m/m nsa—above the 0.36% consensus and our 0.30% forecast. Including the April reading, oya inflation increased to 1.96% from 1.83% in March (first chart). The driver of higher headline inflation in April was an acceleration of food inflation to 1.1%m/m from 0.52% in March—that was at odds with the slowdown in food inflation in the wholesale market reported by the Ministry of Agriculture. Despite the elevated headline, the breakdown was relatively benign with significant deflation (0.17%m/m) in tradable goods and tame inflation (0.20%m/m) in nontradable items. The consensus for the April CPI in the Banrep survey was 0.36%, and therefore, theses releases will not lower expected inflation for 2010, which was 3.3% in the April survey and should remain roughly stable.

Argentina:

Data releases and forecasts

Week of May 10 - 14

Wed May 12	Consumer prices	Jan	Feb	Mar	Apr
	Consumer prices (%m/m)	1.0	1.2	1.1	___
	%oya	8.2	9.1	9.7	___
	Wholesale prices (%m/m)	1.0	1.3	1.3	___
	%oya	11.5	13.2	13.6	___

Review of past week's data

Construction activity

	Jan	Feb	Mar
%oya	2.2	5.2	___ *18.1*

Government tax revenue

	Feb	Mar	Apr
ARS bn	27.40	28.51	___ *30.1*

Chile:

Data releases and forecasts

Week of May 10 - 14

Thu May 13	BCCH meeting	Feb	Mar	Apr	May
	Nominal O/N rate target (%)	0.50	0.50	0.50	0.50

Review of past week's data

Unemployment rate

	Jan	Feb	Mar
% of labor force	8.7	8.5	___ *9.0*

Economic activity

	Jan	Feb	Mar
%oya	4.22	2.67	___ *-2.8*

Inflation

	Feb	Mar	Apr
Consumer prices (%m/m)	0.30	0.10	___ *0.5*
%oya	0.30	0.30	___ *0.9*

Trade balance

	Feb	Mar	Apr
US$ bn	1.33	1.36	___ *1.36*

Colombia:

Data releases and forecasts

Week of May 10 - 14

No data releases expected.

Review of past week's data

Consumer prices

	Feb	Mar	Apr
Consumer prices (%m/m)	0.83	0.25	~~0.30~~ *0.46*
%oya	2.09	1.84	___ *1.98*
Wholesale prices (%m/m)	0.86	0.58	___ *0.47*
%oya	-0.44	-0.17	___ *0.28*

Ecuador:

Data releases and forecasts

Week of May 10 - 14

No data releases expected.

Review of past week's data

Inflation

	Feb	Mar	Apr
Consumer prices (%m/m)	0.34	0.16	___ *0.52*
%oya	4.31	3.35	___ *3.21*

Peru:

Data releases and forecasts

Week of May 10 - 14

No data releases expected.

Review of past week's data

Inflation

	Feb	Mar	Apr
Consumer prices (%m/m)	0.32	0.28	~~0.11~~ *0.03*
%oya	0.84	0.76	~~0.85~~ *0.77*
Wholesale prices (%m/m)	0.07	0.26	___ *0.24*
%oya	-1.22	-0.47	___ *0.48*

BCRP monetary policy meeting

	Mar	Apr	May
Reference rate %p.a.	1.25	1.25	~~1.25~~ *1.50*

Venezuela:

Data releases and forecasts

Week of May 10 - 14

Tue May 11	Consumer prices	Jan	Feb	Mar	Apr
	Consumer prices (%m/m)	2.4	1.5	2.4	___
	%oya	26.9	27.0	28.2	___

Review of past week's data

No data released.

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United Kingdom

- **Conservatives and Liberal Democrats begin negotiations with the intention of forming a new government**
- **Growth still looks solid into 2Q**
- **An update on mortgage credit conditions**

The General Election delivered a hung parliament as anticipated. The Conservative party has the largest number of seats, but falls short of an absolute majority. At least 320 seats would be needed for a majority, and at the time of this writing the Conservatives have 305. Labour has 258 seats, with the Liberal Democrats (LD) at 57. Nick Clegg, the leader of the LD party, stated that he would first give the Conservative party the opportunity to negotiate with his party—with the aim of combining the parties' seats in some way to form a government. In a speech, Labour party leader Gordon Brown publicly offered the LD party a much-sought-after referendum on electoral reform. But discussions appear to have first opened up between the Conservative party and the LDs. In a speech, Conservative leader David Cameron said he would be willing to form a minority Conservative government with LD support. Cameron outlined some issues that were not negotiable—such as immigration policy, further EU integration, a faster deficit reduction plan, and defense spending. But he then noted that the two parties did share enough common ground on other policies to come to an agreement, and offered an inquiry into electoral reform.

While these discussions go on this evening and over the course of the weekend, the incumbent Labour government remains in power, and so Gordon Brown remains Prime Minister. The situation is still very uncertain. And if negotiations between the Conservatives and the LDs break down, then the LDs will likely start talking to Labour. But our sense is that the LDs will be satisfied with what the Conservatives have proposed as an initial basis for discussion. More statements are likely to come out over the coming days. We expect an agreement will be made and announced by the middle of next week at the latest. If this happens, Gordon Brown will likely resign as Prime Minister, paving the way for the Queen to invite the two parties to form a government on May 25, in the Queen's speech. Our sense is that this would be the better outcome from the point of view of financial markets given the current climate. Both the Conservatives and LDs agree that more action needs to be taken on the fiscal deficit.

Growth momentum still looks solid

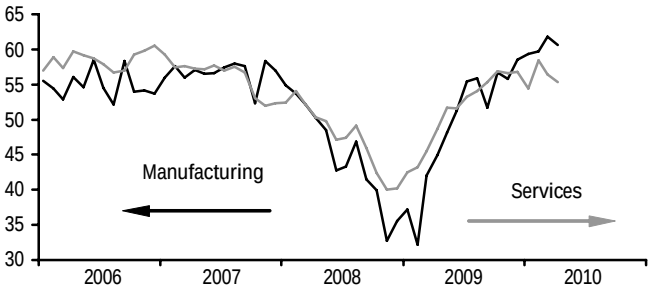
The PMI surveys brought mixed news in April. The output readings of both the manufacturing and services surveys showed declines. This by itself is not a concern; the elevated levels of these readings mean that, even following these declines, the PMIs are consistent with our forecasts for both manufacturing and private services growth for 2Q. The more substantial issue is whether these declines are the beginning of a softer trend, which would be more damaging with regard to our forecast for 3% GDP growth from this quarter and beyond. At this stage, we are inclined to downplay the drops in these surveys. Markit claims the services PMI was significantly affected by the volcanic ash cloud that suspended air travel for several days at the end of April. And the other details of both PMIs offer some encouragement. Export orders in the manufacturing survey leapt to a new record high. And the employment readings from each survey made significant gains, consistent with an expansion in jobs. It seems unlikely that this would be the case if firms believed that the growth upswing was transitory.

Preview of next week's inflation report

At Monday's policy meeting, the MPC will almost certainly leave the policy rate and its target for reserve funded asset purchases unchanged. The May Inflation Report (IR) will then follow on Wednesday. In the current environment of sovereign and financial market stress, the IR is very unlikely to contain any meaningful change in tone. Some indicators point to a firming in growth and improvement in confidence. But the IR will likely continue to emphasize that the recovery remains fragile and downside risks to growth remain. The MPC may make some slight upward revisions to its central projection for inflation at the two-year horizon relative to the February forecast. But we would expect inflation to still be shown undershooting the 2% target on unchanged rates. After the last inflation report, King and Dale explicitly noted that the BoE's communication policy with regard to how it presents its forecasts at the IR was under review. This seems to imply changes will be made at some point. It is possible this happens in next week's report, although we have no specific reason for thinking this will be the case.

PMI output readings

% balance, sa



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The Markit report on jobs—a survey of recruitment consultants—moderated in April but also remains strong and consistent with accelerating job growth. These survey indicators offer some clarification about labor market developments, after a very confusing official report last month: in the February/March release, the ILO measure of unemployment was shown rising, while the claimant count recorded a large decline. Our bias at the time was to put more weight on the smoother claimant count measure. The survey data on employment so far appear to be supporting this view. In next week's official labor market report for March/April, we look for another sizable drop in claimant count unemployment, with the ILO rate stabilizing.

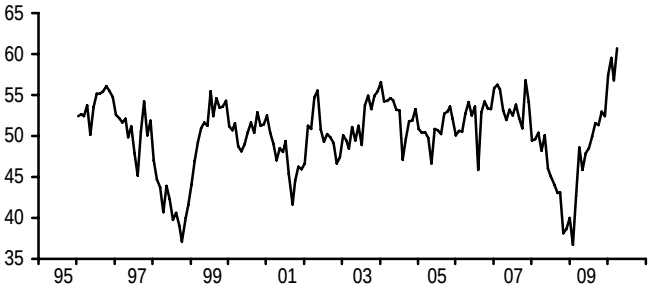
An update on mortgage credit conditions

The Bank of England's monetary and financial statistics release for March continued to report strengthening money growth for households and private nonfinancial firms, but weak flows of bank credit to each sector. Though credit availability is still very tight, demand conditions are likely playing a significant role in this weakness. As the demand for credit picks up, these lending flows may show some cyclical improvement this year. But for lending to show more persistent and stronger gains, an easing in credit conditions appears necessary. A while back, we developed a composite measure of mortgage credit availability, derived from four key indicators. Unlike survey responses from lenders or borrowers regarding access to credit, our composite measure looks directly at various lending criteria, and how they have evolved. The four indicators used in our indicator show the following:

- **After stabilizing late in 2009, the loan to value ratio dropped in 1Q.** The median LTV ratio—as reported by the Council of Mortgage Lenders—fell sharply following the Lehman crisis, and continued to trickle lower throughout most of 2009. After rising slightly at the end of last year, the CML reports that the median LTV ratio dropped significantly in January, and recovered only part of that decline in February, to reach 70.5.
- **The loan to income ratio is up from its crisis low.** The median LTI ratio also dropped sharply in late 2008, and then began rising last year. However, like the LTV ratio, the LTI also disappointed in the first quarter of this year. The LTO ratio is down from the 2.97 reported in 4Q, and stands at 2.93 as of February.
- **Mortgage spreads over the policy rate remain wide, but have started to narrow.** As the BoE slashed its policy rate in late 2008, the effective interest rate on new mortgages was slow to drop, resulting in a sharp widen-

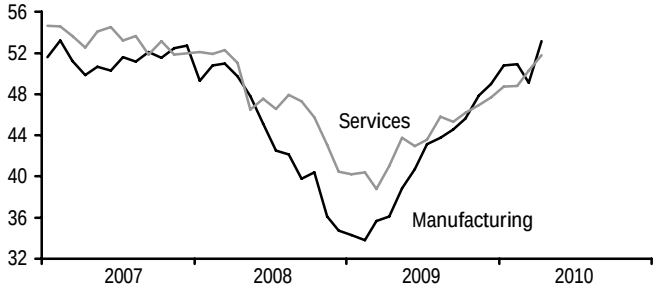
Manufacturing PMI: new export orders

% balance, sa



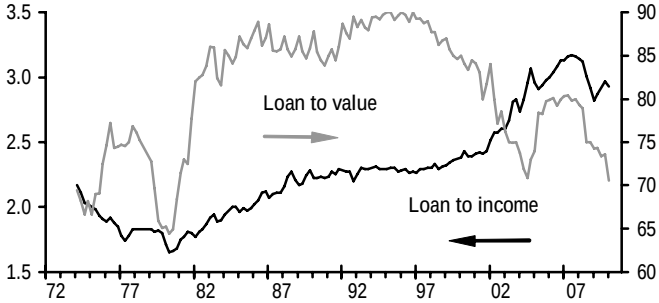
Employment readings from the PMIs

% balance, sa



Loan to income and loan to value ratio

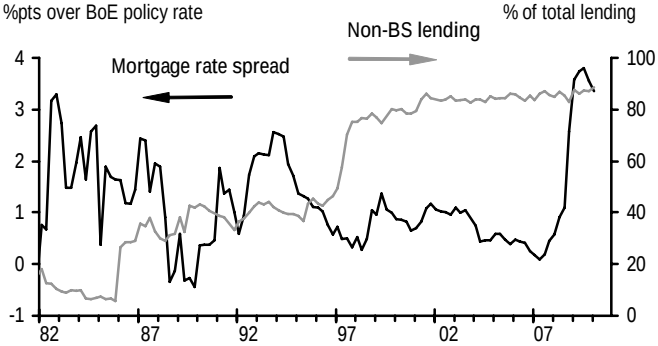
Loan advanced as % of household income/house price, for the median borrower



Mortgage spread versus non-building society mortgage lending

%pts over BoE policy rate

% of total lending



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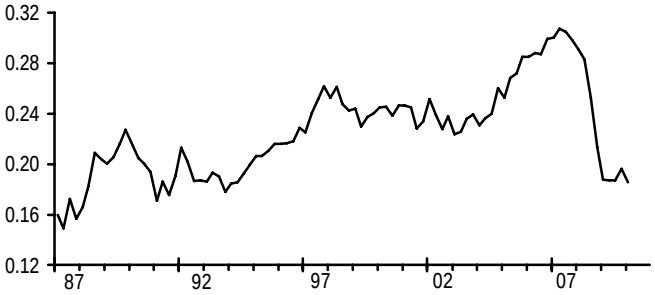
ing in spreads. After continuing to widen during most of 2009, spreads narrowed in 4Q09. In the first quarter of this year, the spread continued to fall to 3.36%.

- **The number of non-building society mortgage lenders has remained stable.** We used this as a proxy for the large-scale deregulation of the mortgage market that occurred during the early 1980s. The share of non-building society lenders has remained broadly stable during the crisis.

Putting these together into our composite suggests that mortgage credit availability has broadly stabilized, but has yet to show any meaningful improvement. In a research note we published two weeks ago, we noted that the failure of credit conditions to show an improvement could restrain growth by 0.5%-1.0%. Our view therefore requires signs of an improvement in credit conditions to develop more clearly over the course of this year.

J.P.Morgan credit conditions indicator

Index, higher value indicates easing in conditions



Data releases and forecasts

Week of May 10 - 15

Mon May 10 12:00pm — **Bank of England interest rate announcement and asset purchase target**

No change in rates expected. See main text.

Tue May 11 12:01am — **RICS housing market survey**

%bal sa

	Jan	Feb	Mar	Apr
Prices in last 3 months	30.1	17.6	8.9	3.0
Stocks of homes on books	65.0	63.2	67.0	65.0
Sales in last 3 months	18.3	17.6	17.1	16.8
Sales to stocks ratio (%)	28.1	27.8	25.5	25.8
New buyer enquiries	-20.2	7.2	-0.4	2.0

The survey has been pointing to a steady slowing in the average number of home sales. We look for this slowing to continue in April. But we would note that the sales reading is already back to 3Q09 levels, and we would expect to see a stabilization soon. Assuming some payback in stocks of unsold properties after the large gain in March, the sale to stocks ratio should broadly stabilize. This ratio is already pointing to higher-frequency measures of nominal house price inflation running at close to 2% ar. This compares to a run rate of the average of the Halifax/Nationwide, which is more than double this pace.

Tue May 11 12:01am — **BRC retail sales monitor**

	Jan	Feb	Mar	Apr
Like for like sales (%oya)	-0.7	2.2	4.4	1.0
Total (%oya)	1.2	4.5	6.6	3.2

Last month, the BRC stated that the tail end of the sample period used to compute its March estimate was affected by the earlier timing of Easter. Although Easter this year fell in the first few days of April, it also impacted the final calendar week of March. This implies that some of the typical Easter-related boost to spending happened in the March figures this year. Given that the BRC reports yearly changes in sales, this implies that the April reading will be weaker than usual. We therefore look for the BRC survey in April to drop below its February levels, and then return back close to these levels in May.

Tue May 11 9:30am — **Industrial production**

Seasonally adjusted

	Dec	Jan	Feb	Mar
IP (%m/m)	0.5	-0.4	1.0	0.1
%oya	-3.7	-1.6	-0.1	0.2
Manufacturing (%m/m)	0.9	-1.0	1.3	0.3
%oya	-1.9	0.1	1.4	1.4

Our forecasts for March were derived from the preliminary release of 1Q GDP—for which the ONS had to make an assumption about the final month of the quarter, with little hard data at hand. When faced with similar situations during the past six months, the ONS has tended to err on the side of caution when making these assumptions. Therefore, the risks around our forecast for March IP appear to the upside.

Barring any large surprises, our forecast would leave IP running three-tenths above the 1Q average, which would set up 2Q for another solid quarter of IP growth in the region of 2%-3% annualized.

Wed May 12 9:30am — **Labor market statistics**

Seasonally adjusted

	Jan	Feb	Mar	Apr
Claimant count (000s ch m/m)	16.2	-40.1	-32.9	-25.0
Claimant count rate (%)	5.0	4.9	4.8	4.7

	Dec	Jan	Feb	Mar
Average weekly earnings (3mma % oya)				
Headline	0.6	0.8	2.3	1.9
ex bonuses	1.2	1.5	1.7	2.0
Private sector ex bonuses	0.2	0.5	0.9	1.0

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Three months to:	Aug	Nov	Feb	Mar
Labor force survey (all % rates)				
Activity rate	63.4	63.3	63.1	63.0
Employment rate	58.5	58.3	58.0	58.0
Unemployment rate	7.9	7.8	8.0	8.0

Last month's report sent conflicting signals about hiring trends. Claimant count unemployment fell significantly, while the ILO rate measure rose to 8%. Our bias is to place more weight on the more timely and less volatile claimant count measure. Though the declines in this measure may be being driven in part by a declining labor force, it still appears consistent with accelerating employment growth.

If this view is correct, the LFS should eventually start sending the same signal as the claimant count. It is not clear whether this will happen in this release. We have assumed the ILO unemployment rate at least stabilizes in March. Wage inflation has been subdued for over a year. However, the average weekly earnings data appear to have troughed late in 2009, and we look for another modest acceleration in the smoothed measure of whole economy (ex. bonus) pay growth from 1.7% to 2.0% in March.

Wed May 12 10:30am

BoE Inflation Report

See main text.

Thu May 13 12:01am

Nationwide consumer confidence index

Sa

	Jan	Feb	Mar	Apr
Index	76	81	72	72

Though its broad trend has been stable, the Gfk consumer confidence survey surprised with another decline in April. We would have assumed the same in the Nationwide, but March showed a particularly large decline—and so we look for this reading to stabilize in April.

Thu May 13 9:30am

Trade balance

£ bn, seasonally adjusted

	Dec	Jan	Feb	Mar
Trade balance (goods)	-7.0	-8.1	-6.2	__
Trade balance (services)	4.3	4.2	4.1	__
Total trade balance	-2.8	-3.9	-2.1	__

Thu May 13 9:30am

DCLG monthly house price data

	Dec	Jan	Feb	Mar
All dwellings (%oya nsa)	2.9	6.2	7.3	__

Review of past week's data

PMI survey, manufacturing

% balance, sa

	Feb		Mar		Apr	
Overall index	~~56.5~~	*56.7*	~~57.2~~	*57.3*	~~57.7~~	*58.0*

Money supply [1]

Seasonally adjusted

	Jan		Feb		Mar	
M4 ex IOFCs (%m/m)	~~-0.1~~	*0.0*	~~0.3~~	*0.4*	__	*1.1*
M4 ex IOFCs (%3m/3m ar)	~~0.6~~	*0.4*	~~-1.0~~	*-0.9*	__	*5.9*
M4 (%m/m)	0.3		0.2		~~0.1~~	*0.2*
M4 (%oya)	5.0		3.9		~~3.5~~	*3.6*
M4 lending (%m/m)[2]	~~0.6~~	*0.5*	-0.1		~~0.4~~	*0.5*
M4 lending (%oya)[2]	~~5.1~~	*5.0*	~~3.8~~	*3.7*	~~3.3~~	

1. Forecast taken from provisional release.
2. Excludes the effect of securitization.

Net lending to individuals (BoE release)

£ bn, average

	Jan		Feb		Mar	
Consumer credit (ch, m/m)	~~0.5~~	*0.4*	~~0.5~~	*0.6*	~~0.5~~	*0.3*
Secured lending (ch, m/m)	1.5		~~1.6~~	*1.8*	~~1.5~~	*0.3*
Mortgage approvals (000s sa)	~~56.8~~	*47.9*	~~47.1~~	*46.9*	~~48.5~~	*48.9*

PMI survey, construction

% balance, sa

	Feb	Mar	Apr	
Overall index	48.5	53.1	__	*58.2*

Markit report on jobs

% balance, sa

	Feb	Mar	Apr	
Permanent placements	63.2	65.2	__	*63.2*
Permanent salaries	54.1	53.6	__	*55.2*
Availability of permanent staff	52.6	53.1	__	*52.1*

PMI survey, services

% balance, sa

	Feb	Mar	Apr	
Overall business activity	58.4	56.5	~~57.5~~	*55.3*

Halifax house price index

	Feb	Mar		Apr	
%m/m sa	-1.6	~~1.1~~	*1.0*	~~0.5~~	*-0.1*
%oya sa	4.1	6.9		~~9.6~~	*8.7*
%3m/3m saar	7.2	~~2.5~~	*2.4*	~~-0.9~~	*-1.9*

New car registrations

%3m/12m nsa

	Feb	Mar	Apr	
Total	32.7	27.3	__	*22.5*
Private (ex business and fleet)	72.8	37.8	__	*35.6*

Producer prices

	Feb		Mar		Apr	
Input prices (%m/m nsa)	~~0.6~~	*0.7*	~~3.6~~	*3.8*	~~1.0~~	*0.6*
%oya nsa	~~7.5~~	*7.6*	~~10.1~~	*10.3*	~~13.2~~	*13.1*
Output prices (%m/m nsa)	0.3		0.9		~~0.3~~	*1.4*
%oya nsa	4.2		5.0		~~4.6~~	*5.7*
Core output prices[1](%m/m nsa)	0.4		~~0.7~~	*0.8*	~~0.3~~	*1.1*
%oya nsa	3.0		~~3.6~~	*3.7*	~~3.5~~	*4.4*

1. PPI output ex food, beverages, tobacco, and petroleum products.

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Sweden and Norway

- **Norges Bank hikes, but shows concern over Europe**
- **Swedish IP finally bounces, confirming cyclical uplift**
- **Riksbank shows bias toward early rate hike, but April minutes already look outdated to some extent**

The Norges Bank this week raised the policy rate 25bp to 2%. We expected the hike, but thought that it was a close call, a view that the Norges Bank shared: "the Executive Board considered the alternative of leaving the key policy rate unchanged." The Bank assessed that Norwegian growth and inflation have been broadly in line with its forecast, and reasserted that rising household credit and house prices warrant a gradual normalization of the policy rate. More broadly, the Bank felt encouraged by the ongoing rebound in global growth, but showed clear concern over fiscal stress and financial developments in Europe, mentioning "the risk of a renewed downturn" in the region.

The Bank did not publish new projections this week, and the statement accompanying the rate decision did not depart significantly from the monetary strategy announced in March (which entailed a hike in September and a 50% chance of another hike in December, with the policy rate reaching 2.25%-2.50% by year-end). This is broadly consistent with our view, which sees the policy rate reaching 2.50% by year-end. A deterioration of the European financial and economic landscape would undermine this view, but it is hard to know how things will play out right now.

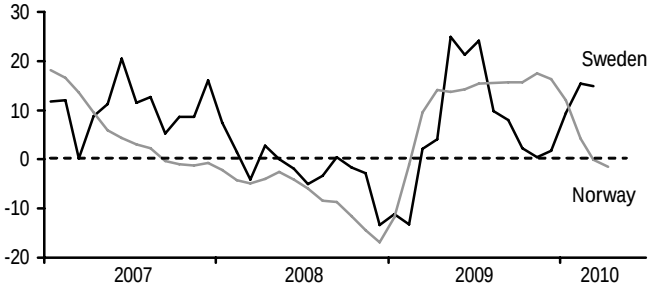
Swedish cyclical uplift finally materializing

After months of disappointments, Swedish IP finally bounced in March, by 4%m/m. The bounce came alongside upward revisions to prior months, which lifted the February level of IP by 1.5% relative to earlier estimates. In 1Q as a whole, IP rose around 6.6% ar excluding energy products, and 8.4% ar including energy. The sharp rise in output in March came alongside good news from orders, which rose 4.2%m/m and were up 18.9% ar in 1Q. The rise in orders, coupled with strong business survey readings at the start of 2Q—the manufacturing PMI output reading was at 66.3 in April—sets IP up for a strong performance in the spring.

We recently revised down our 1Q GDP forecast to reflect downside surprises in production and various demand indicators through the quarter. As the March data have come in, however, the situation has changed. Exports, retail sales, and car sales bounced, and IP was a lot stronger than envisaged. We are therefore revising our 1Q GDP growth forecast back up from 2.2% ar to 3.8% ar, an outcome largely in line with the Riksbank's latest projection. Given the high level of IP in March, we are also raising our 2Q GDP growth forecast from 3.5%ar to 4%ar.

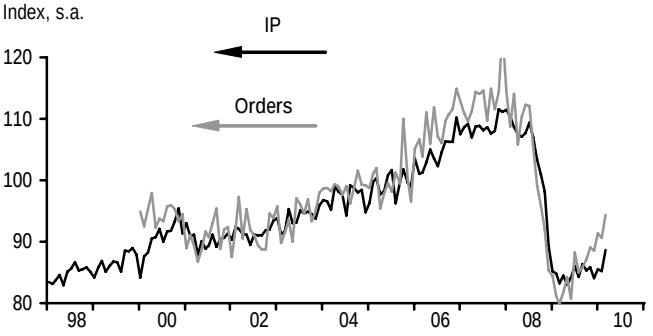
House prices

%3m/3m, s.a. by J.P. Morgan



Swedish industrial production and orders excluding energy products

Index, s.a.



Riksbank's minutes show early hike bias

The Riksbank's Board was unanimous in deciding to keep the policy rate unchanged at 0.25% in April, while five out of six members supported the Bank's policy rate projections (which assign an equal probability to the first rate hike being delivered in July or in September this year). The minutes of the meeting, however, showed that there was more dissent on the Board than it appeared at first glance. In particular, three Board members—Governor Ingves (who expressed his opinion in a separate speech as he could not be present at the meeting), Nyberg, and Wickman-Parak—expressed a bias toward starting the rate normalization in July rather than September. Meanwhile, Board member Ekholm expressed a slight preference for September and Svensson (the only member to enter a formal reservation against the published rate path) thought that the policy rate should not move until December. The only member who was fully neutral with respect to both the rate decision and the rate path was Oberg.

With at least three out of six members preferring a rate hike in July rather than in September, and with one of them being

The next Sweden and Norway data watch will be published on May 21,2010.

the Governor (who holds the swing vote in the case of a 3-3 split), it is reasonable to conclude that the Board as a whole was biased toward a July hike at the time of the April meeting.

Given the Riksbank's rhetoric, and signs that growth is turning, our view that the Swedish policy rate will not start rising until early next year looks under pressure. This view has been grounded in the idea that core inflation would fall more rapidly than the Bank envisioned, but the Bank's concern over rising asset prices and household leverage may supercede worries about a rapid slide in core inflation in the near term. That said, mounting sovereign stress and deteriorating financial conditions in Europe may be providing support to our monetary policy view, which we maintain for now. In this context, the Riksbank's expression of a bias toward an early hike at the time of the April meeting looks already outdated to some extent.

Sweden:

Data releases and forecasts

Weeks of May 10 - 21

		Jan	Feb	Mar	Apr
Tue May 11 9:30am	Consumer prices				
	CPI (%oya)	0.6	1.2	1.2	1.2
	CPIF (%oya)	2.6	2.7	2.5	2.4
Tue May 11 10:00am	Unemployment: monthly labor market board	Jan	Feb	Mar	Apr
	% of labor force, nsa	5.7	5.6	5.2	__

Review of past two weeks' data

Trade balance

Skr bn, nsa

	Jan	Feb	Mar
Exports	~~79.0~~ *79.1*	~~81.8~~ *82.6*	__ *99.4*
Imports	~~70.7~~ *70.9*	~~81.2~~ *80.6*	__ *92.2*
Trade balance	~~8.3~~ *8.2*	~~0.6~~ *2.0*	__ *7.2*

Unemployment: Labor Force Survey (Statistics Sweden)

	Jan	Feb	Mar
% of labor force, nsa	9.4	9.3	__ *9.1*

NIER business and consumer surveys

	Feb	Mar	Apr
Mfg tendency index, sa	3	~~3~~ *2*	__ *-4*
Consumer index, nsa	13.0	15.5	__ *19.5*

Retail sales

Volumes

	Jan	Feb	Mar
%m/m sa	~~0.7~~ *0.4*	~~-1.0~~ *-1.1*	__ *0.7*
%oya wda	3.3	~~2.3~~ *2.0*	__ *4.1*

Purchasing managers survey, manufacturing

% balance, sa

	Feb	Mar	Apr
Overall index	61.5	61.1	__ *64.0*

Industrial production

	Jan	Feb	Mar
Production (%m/m sa)	~~1.2~~ *1.7*	~~-0.8~~ *-0.4*	__ *4.0*
Production (%oya nsa)	~~-0.6~~ *0.1*	~~-1.5~~ *0.2*	__ *6.7*

Norway:

Data releases and forecasts

Weeks of May 10 - 21

		Jan	Feb	Mar	Apr
Mon May 10 10:00am	Consumer prices				
	CPI (%oya)	2.5	3.0	3.4	3.3
	CPI-ATE (%oya)	2.3	1.9	1.7	1.7
Thu May 20 10:00am	Real GDP Non-oil	2Q09	3Q09	4Q09	1Q10
	Mainland GDP (%q/q sa)	0.1	0.3	0.3	0.4
	Mainland GDP (%q/q saar)	0.5	1.4	1.3	1.6

Review of past two weeks' data

Quarterly business tendency survey

	3Q09	4Q09	1Q10
Actual production (index, sa)	~~45.4~~ *45.1*	~~47.5~~ *48.2*	__ *49.2*
Expected production (index, sa)	~~48.1~~ *48.4*	~~50.7~~ *51.9*	__ *53.6*
Capacity utilization (%,sa)	76.4	~~76.8~~ *76.9*	__ *77.0*

Retail sales

Volumes

	Jan	Feb	Mar
%m/m sa	-0.4	0.3	__ *-0.1*
%oya sa	2.5	3.3	__ *3.2*

Labor Directorate

	Feb	Mar	Apr
Unemployment rate (%, nsa)	3.2	3.1	__ *3.0*

Purchasing managers survey, manufacturing

% balance, sa

	Feb	Mar	Apr
Overall index	49.3	~~49.6~~ *49.7*	__ *51.9*

NEF/EEF house prices

All dwellings, NOK

	Feb	Mar	Apr
%m/m	~~0.0~~ *0.2*	~~1.2~~ *1.0*	__ *1.3*
%oya	~~10.0~~ *10.2*	~~10.9~~ *10.7*	__ *9.8*

Industrial production

Manufacturing

	Jan	Feb	Mar
%m/m sa	-0.4	~~0.8~~ *0.9*	__ *0.4*
%oya wda	~~-2.0~~ *-1.9*	0.2	__ *1.6*

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Switzerland

- **Swiss growth is being buoyed by the global upswing**
- **But fiscal stress may indirectly affect Switzerland**
- **SNB is leaning toward a more cautious approach**

A key theme that has emerged from Western Europe in recent weeks is the juxtaposition of a strengthening in growth and increasing concerns about a spillover from the Greek sovereign crisis. Though Switzerland has no fiscal problems of its own, each of these developments is affecting the outlook for the Swiss economy and the SNB in a material way.

Growth buoyed by the global upswing

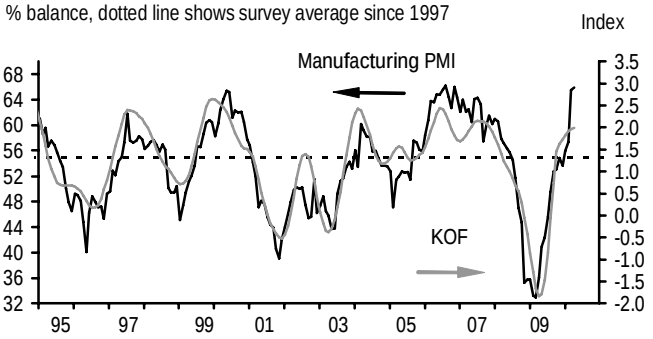
The business surveys continue to point to a strong acceleration in the pace of GDP growth this quarter. The manufacturing PMI is only a shade away from the record highs of the 2006 upswing. And the KOF measure of whole economy activity is still advancing—although it is not quite as elevated. Estimates of GDP based upon these surveys, though subject to a wide margin of error, point to growth of around 2.5%-3% ar in the first half of the year. The PMI—which has done a better job of tracking overall GDP of late—suggests upside risks to this estimate. As we have argued in the past, part of the strength being reported likely reflects the influence of the fast-growing emerging market economies. But with the Euro area being Switzerland's largest trading partner, the better news on growth around the region recently will further underpin the Swiss recovery.

Fiscal stress may indirectly affect growth

Working in the other direction, the sovereign stresses developing around Europe pose a real risk to the recovery. These issues are unlikely to have any direct effect on Switzerland, as public debt and the fiscal deficit are relatively low. However, there are a number of indirect channels by which the economy could be affected. Some pose direct concerns to the Swiss banking sector—via credit risk, falling asset prices, and a weakening in bank capital positions. However, Swiss banks do not look to be particularly exposed to the Southern European countries (and Ireland) that fiscal stress is affecting most. These countries account for a tiny fraction of the assets and liabilities of the largest 88 banks in Switzerland (table). One possible implication of a renewed banking crisis outside of Switzerland is reduction in interbank lending and widening in spreads—which could affect all banks. However, as the SNB sets a target for 3-month Libor, this should help to prevent short-term bank lending rates from moving too far away from the central bank's target. However, this would require the SNB to enlarge its balance sheet and increase its offerings of liquidity to keep bank lending rates in check.

Business surveys of activity

% balance, dotted line shows survey average since 1997



Swiss banking sector balance sheet as of 2008

CHF bn or % of total, based on 88 banks

	Assets		Liabilities	
	CHF bn	% total	CHF bn	% total
Total	1,851	100.0	1,740	100.0
UK	528	28.6	456	26.2
US	490	26.5	355	20.4
Germany	80	4.3	80	4.6
Greece	3	0.2	2	0.1
Portugal	2	0.1	2	0.1
Spain	9	0.5	8	0.4
Ireland	18	1.0	10	0.6
Other	720	38.9	828	47.6

Other channels of contagion are more indirect, but potentially pose a greater risk of contagion for Switzerland. A drop in confidence could affect the behavior of households and firms. And to the extent this impacts the growth upswing around Europe—in addition to the drag in the fiscally stressed countries—this could affect Switzerland via trade, on which it is highly dependent.

SNB is taking the cautious approach

In its commentary since the turn of the year, the SNB has expressed two concerns. On the one hand, it is concerned that an accommodative policy setting is already fueling a rapid increase in mortgage lending, and if left unchanged for longer than necessary, could stoke future price imbalances. On the other hand, the SNB remains concerned about downside growth risks. Up until recently, the latter concern had been fading fast. But since the Greek fiscal crisis has begun to affect other economies around Europe, the former concern is looking increasingly pressing.

The Switzerland data watch is published monthly, next on June 11, 2010.

For example, in its recent commentary, SNB members have chosen to emphasize the point that "price stability can be assured over the course of the next two years" (Danthine, April 24). However, the SNB's projections show a sharp rise in inflation next year, which shoots through the 2% ceiling of the bank's target from 2Q12 (assuming unchanged rates). Around the same time, SNB President Hildebrand stated that he remains "moderately optimistic" about Swiss growth. But Jordan noted that current interest rates in Switzerland were "correct." The SNB is not sending a signal that a rate hike is in the cards in the near term. This creates significant risks that the SNB will not tighten in 3Q—as our forecast currently assumes. It is too early to tell how the European sovereign crisis will pan out, and so we are inclined to stick with our forecast for now. But unless signs of stronger growth again begin to dominate any lingering fiscal concerns, a later policy tightening by the SNB would appear more likely.

Data releases and forecasts

Week of May 10 - 14

Tue May 11 7:45am — **SECO consumer confidence**

	2Q09	3Q09	4Q09	1Q10
Headline index (%bal)	-38	-42	-30	__

Wed May 12 9:15am — **Producer and import prices**
nsa

	Jan	Feb	Mar	Apr
Producer prices (%oya)	-1.5	-1.0	-0.3	__
Import prices (%oya)	-1.1	-0.9	0.6	__
Prod and imp prices (%m/m)	0.3	-0.3	0.5	__
Prod and imp prices (%oya)	-1.3	-1.0	0.0	__

Week of May 17 - 21

Fri May 21 9:00am — **SNB Monthly Statistical Bulletin (core inflation)**

	Jan	Feb	Mar	Apr
SNB trimmed mean (%oya)	0.9	0.7	0.7	__

Week of May 24 - 28

Thu May 27 9:15am — **Employment**
Sa

	2Q09	3Q09	4Q09	1Q10
Actively occupied	0.4	0.7	0.6	__
Persons employed	-0.4	0.2	-0.1	__

Fri May 28 8:15am — **Merchandise trade**
Sf bn, nominal nsa ex gems

	Jan	Feb	Mar	Apr
Trade balance	2.4	1.3	2.0	__
Exports	14.5	15.0	17.8	__
Imports	12.1	13.7	15.8	__

Fri May 28 11:30am — **KOF leading indicator**
Sa

	Feb	Mar	Apr	May
Index	1.91	1.96	1.99	2.05

Week of May 31 - June 4

Tue Jun 1 7:45am — **Real gross domestic product**
Sa

	2Q09	3Q09	4Q09	1Q10
%q/q	-0.1	0.5	0.7	0.6
%q/q ar	-0.6	2.0	3.0	2.4
%oya	-2.4	-1.4	0.0	1.7

Tue Jun 1 9:30am — **Purchasing managers index—manufacturing**
Sa

	Feb	Mar	Apr	May
Headline (% bal)	57.4	65.5	65.9	65.5
Output (% bal)	61.5	70.2	69.3	69.0
Purchase prices (% bal)	62.4	62.8	70.3	__

Review of past five weeks' data

SNB Monthly Statistical Bulletin (core inflation)

	Jan	Feb	Mar	
SNB trimmed mean (%oya)	0.9	0.7	__	*0.7*

KOF leading indicator

	Feb	Mar	Apr
Index, sa	~~1.90~~ *1.91*	~~1.93~~ *1.96*	*1.99*

Purchasing managers index—manufacturing

	Feb	Mar	Apr	
Headline (% bal, sa)	57.4	65.5	__	*65.9*
Output (% bal, sa)	61.5	70.2	__	*69.3*
Purchase prices (% bal, sa)	62.4	62.8	__	*70.3*

Consumer prices

	Feb	Mar	Apr	
Headline (%m/m nsa)	0.1	0.1	__	*0.9*
Headline (%oya nsa)	0.9	1.4	__	*1.4*
SFSO[1] core (%oya nsa)	0.5	0.5	__	*0.3*

1. Excludes food, drink, tobacco, seasonal goods, energy, and fuel.

Unemployment

	Feb	Mar	Apr	
Unemployment rate (%, sa)	4.1	4.1	__	*4.0*
Change (000s, sa)	~~-2.1~~ *-0.1*	~~0.6~~ *-2.1*	__	*-2.8*

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Central Europe: Czech Republic, Hungary, Poland, Romania

- **Czech: CNB cuts to 0.75% as dovish MPC members seem to expect a sizable slowdown in Czech recovery**
- **Romania and Hungary to renegotiate conditions of IMF program; Romania's next tranche faces delays**

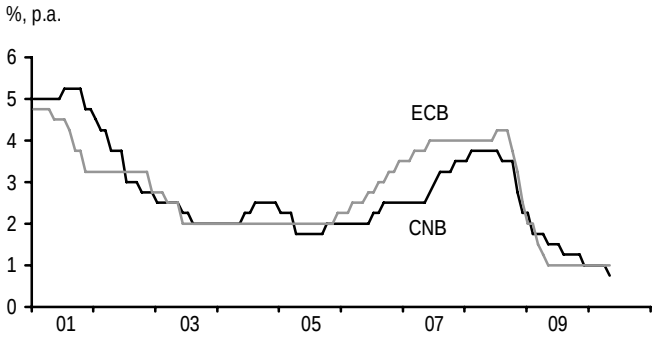
Czech: CNB eased again

The Czech National Bank (CNB) cut its base rate to an all-time low of 0.75%. Even more surprisingly, there were negligible changes to the CNB's forecasts for a gradually reviving economy and inflation. The only visible change was the drop in the expected 3-month Euribor next year to 1.6% from 2.3% taken from the Consensus Forecast. While we perceived the probability of a rate cut to be as high as 40% on the back of recent dovish comments from CNB officials, the cut surprised us. We think that cutting the base rate from the very low level of 1% to 0.75% adds little value in an economy already returning to growth and CPI inflation having bottomed in October and now gradually rising.

The rate outlook is complicated, with strong arguments in both directions. In our view, a rate cut now would make sense if one expected the recovery to come to a halt or reverse into recession. This is not in the CNB forecast, but it is probably the view of dovish MPC members. Further escalation of fiscal problems in peripheral Europe and a consequent slowdown in the Euro area recovery would validate the views of dovish MPC members and justify their recent policy action. In that case, another rate reduction would be in the pipeline. Yet, we do not think the CNB will cut rates further in the current cycle. First, a halt in the Euro area recovery is not our base case. Second, and more important, further rate cuts would be justified in a scenario of weaker Euro area growth, but not a double-dip recession. If the ongoing fiscal crisis sparks recession in Europe and further stress in the financial markets, it would have negative implications for the koruna due to a drop in exports, a deteriorating fiscal position, banking sector stress, and negative investor sentiment toward the region as in early 2009. Recent days have shown that CE currencies can weaken quickly. If they do, policymakers' perception that the koruna is too strong could change very rapidly to the perception that the koruna is too weak, calling for higher interest rates to stabilize currencies. This is simply a negative risk scenario for now. Given our Euro area base case scenario for growth, the most likely outcome is that the CNB will remain on hold for the rest of the year.

The Central Europe data watch is published biweekly, next on May 21.

Czech: CNB and ECB base rates



Romania and Hungary to renegotiate IMF programs

The ongoing review of the IMF loan program to **Romania** is becoming more complicated as Romanians are trying to renegotiate the budget deficit target for this year from the previously agreed 5.9% of GDP. On Thursday, President Basescu announced that next tranche of the IMF loan, in the amount of €0.85 billion, will be delayed from mid-June to July. Moreover, he announced large-scale cuts in pensions (15%) and public wage costs (25%) to cut the budget deficit to be in line with IMF demands without the need to hike the VAT and flat income tax as proposed by the IMF mission, which is currently in Bucharest. We doubt that announced cost cuts are fully doable and expect further negotiations resulting most likely in smaller spending cuts, a small rise in taxes, and a budget target of 6.5%-7% of GDP. The conflict with the IMF has been negative for Romanian assets.

In **Hungary**, the current IMF program runs until October 6, 2010, but it is likely that the incoming Fidesz government will extend the program by at least one year. The main question is to what extent Fidesz will try to renegotiate the terms and conditions of the program. Fidesz officials have indicated that the 2010 fiscal deficit will overshoot the current target of 3.8% of GDP even though year-to-date fiscal performance has been better than planned. We believe the IMF would be willing to agree to a higher 2010 deficit, of around 5% of GDP, in exchange for commitment to structural reforms and a lower deficit from 2011 onward. However, European officials are likely to be less amenable to allowing Hungary to loosen fiscal policy. Hungary has not drawn on IMF/EU funds that have been available since September 2009 given the gradual improvement in economic and financial conditions. Yet, we believe that extension of the program would help to lend credibility to the government's economic policies. Total disbursements to Hungary amount to €5.5 billion from the European Union and €8.7 billion from the IMF, or nearly two-thirds of the total loan commitment agreed in late 2008.

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Czech Republic:

Data releases and forecasts

Weeks of May 10 - 21

Mon May 10 9:00am

Consumer prices

%oya

	Jan	Feb	Mar	Apr
%oya	0.7	0.6	0.7	1.1
%m/m nsa	1.1	0.0	0.3	0.3
Food	-3.2	-2.5	-1.5	-0.5
Housing	0.9	1.1	1.0	1.4
Transport	6.7	4.1	4.3	4.0

While demand-side inflationary pressures are generally nonexistent, the price level is slowly creeping higher after bottoming in October 2009. With the absence of a positive base effect, headline CPI is expected to fluctuate around 1%oya in the coming months and to rise up to 3%oya by the end of the year.

Wed May 12 9:00am

Real GDP, preliminary

%oya, unless otherwise stated

	2Q09	3Q09	4Q09	1Q10
GDP growth	-5.2	-5.0	-2.8	1.7
%q/q saar	-1.1	2.3	3.0	2.5

First-quarter GDP should confirm that the economic recovery is continuing, driven by foreign demand, and GDP should post its first annual growth since 4Q08. We expect the open and small Czech economy to follow the recovery in core EMU countries closely, especially the recovery in Germany. Unless the current fiscal crisis in peripheral EMU countries causes a sizable slowdown in Germany, the Czech economy is expected to grow 2%-2.5% this year. The main driver of growth should change from almost completely foreign demand to at least partially domestic demand.

Mon May 17 10:00am

Balance of payments

CZK bn

	Dec	Jan	Feb	Mar
Current account	-16.8	15.6	10.3	-1.0
Ytd	-37.0	15.6	25.9	24.9
Ytd a year ago	-22.9	1.0	21.4	25.0
Trade balance	5.2	15.6	17.8	17.0
Services	0.0	1.0	1.2	1.0
Income	-20.4	-6.9	-6.1	-18.0
Current transfers	-1.7	5.9	-2.6	-1.0
Financial account	19.9	-0.9	2.1	__
FDI	18.2	7.4	8.2	__
Portfolio investment	-14.2	3.3	2.2	__
Other investments	25.8	-7.1	-13.8	__

We expect the narrowing of the current account gap to fade over the coming months on the back of less favorable terms of trade and reaccelerating dividend outflows. We expect the C/A to reach 1.7% of GDP this year.

Review of past two weeks' data

Monetary policy announcement

See main essay.

External trade

CZK bn

	Jan		Feb		Mar	
Trade balance	~~14.4~~	*14.6*	~~15.3~~	*14.4*	~~15.0~~	*18.3*
Ytd	~~14.4~~	*14.6*	~~29.7~~	*29.0*	~~44.7~~	*47.3*
Ytd a year ago	3.9		13.3		34.3	
Exports, %oya	~~9.0~~	*8.7*	~~11.0~~	*10.3*	~~5.2~~	*12.7*
Imports, %oya	~~2.6~~	*2.1*	~~7.9~~	*7.6*	~~9.3~~	*15.8*

The acceleration in trade dynamics is encouraging. We the expect nominal trade surplus to narrow over the coming months as depressed imports catch up with the surge in exports.

Industrial output

%oya

	Jan	Feb	Mar
Production	4.9	7.0	~~3.0~~ *10.2*

Industry continues to ride the German recovery nicely.

Hungary:

Data releases and forecasts

Weeks of May 10 - 21

Mon May 10 9:00am

External trade

EUR mn

	Dec	Jan	Feb	Mar
Trade balance	375	290	373	500
Ytd	3979	290	664	1364
Ytd a year ago	-319	-200	96	582
Exports, %oya	8.8	14.6	18.0	__
Imports, %oya	-1.3	2.7	17.4	__

Tue May 11 9:00am

Consumer prices

%oya

	Jan	Feb	Mar	Apr
All items (KSH)	6.4	5.7	5.9	5.7
%m/m nsa	1.4	0.2	0.6	0.6
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	__

Inflation likely slowed in April as forint strength contributed to easing price growth in consumer durables and sluggish consumer demand pulled service price inflation lower. Food prices probably continued to put upward pressure on the CPI.

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Wed May 12 9:00am

Real GDP, preliminary

%oya, unless otherwise stated

	2Q09	3Q09	4Q09	1Q10
Real GDP	-7.5	-7.1	-4.0	-1.2
%q/q saar	-5.6	-4.7	-1.7	1.0

The pace of GDP contraction looks to have eased to around -1%oya, while the economy likely returned to growth on a sequential basis. Risks to our GDP forecasts, particularly for 2H10 and 2011, are skewed to the downside as the intensification of Euro area sovereign credit concerns could dampen the cyclical upswing.

Tue May 18 9:00am

Average gross wages

%oya

	Dec	Jan	Feb	Mar
Gross wages, nominal	0.0	6.5	0.9	1.5
Private sector	1.2	5.2	4.0	—
Public sector	-2.4	8.9	-6.2	—

Review of past two weeks' data

Monetary policy announcement

The NBH trimmed rates another 25bp, in line with expectations, taking the base rate to a new low of 5.25%. The accompanying statement suggests that interest rates could be reduced further if "changes in perceptions about the risks associated with the economy allow it." A 50bp rate cut was also discussed, but 25bp was supported by a clear majority of members. We believe the next few months could bring a mixture of good and bad news from the new Fidesz government. Measures to cut public administration spending would be welcomed by the market, but there is lingering uncertainty with regard to the renegotiation of the IMF program and the magnitude of upward revisions to fiscal deficit targets. A potential increase in tensions between the government and the central bank could also weigh on investor sentiment. Our base case is for just one more 25bp rate cut, in part because we are not as optimistic as the NBH that inflation will significantly undershoot the target next year.

Producer prices

%oya

	Jan	Feb	Mar	
Producer prices	-0.6	-2.8	~~-4.0~~	*-3.5*
Domestic	1.6	0.0	~~1.0~~	*1.2*
Export	-2.7	-5.4	-7.9	

Industrial output

%oya

	Jan		Feb		Mar	
Production, wda	~~5.7~~	5.1	~~8.4~~	*8.1*	~~4.7~~	*2.8*
Production, nsa	~~3.4~~	*2.8*	~~8.4~~	*8.1*	~~4.7~~	*2.8*
%m/m swda	~~8.9~~	*8.3*	~~-1.7~~	*-1.5*	~~1.3~~	*-0.4*

The over-year-ago expansion slowed to 2.8%, largely owing to a high base as output posted its largest monthly increase last year of 4.5%m/m in March. The statistics office noted that exports remained the main driver of output growth, especially vehicle manufacturing, electrical equipment, and consumer electronics. Domestic industrial sales and new orders remained depressed through February as consumption is still sluggish. Despite the downside surprise in March, the trend is still clearly an expansionary one. Thanks to the huge gain in January, sequential growth picked up to 12.5%q/q annualized in 1Q10 from 5% in 4Q09.

Poland:

Data releases and forecasts

Weeks of May 10 - 21

Fri May 14 2:00pm

Consumer prices

%oya

	Jan	Feb	Mar	Apr
All items				
%oya	3.5	2.9	2.6	2.3
%m/m	0.6	0.2	0.3	0.4
Food, %oya	3.0	2.8	1.4	—
Fuel, %oya	22.3	14.5	15.6	—

CPI inflation likely continued to drift lower in April on the back of a high base in food prices (twice the typical seasonal increase last April) and easing core CPI.

Mon May 17 2:00pm

Balance of payments

EUR mn

	Dec	Jan	Feb	Mar
Current account balance	-959	-754	106	-885
Ytd (bn)	-5.1	-0.8	-0.6	-1.5
Ytd a year ago (bn)	-18.3	-0.8	0.0	-0.1
Trade balance	-645	-205	-248	—
Exports, %oya	12.4	11.9	20.1	—
Imports, %oya	-3.3	7.6	22.3	—
Service balance	379	259	109	—
Income balance	-868	-841	-923	—
Current transfers	175	33	1168	—
Fin. + cap. account balance	306	7000	1847	—
FDI, net	219	1153	814	—

The current account likely widened on the back of rising investment income outflows and a gradually deteriorating trade balance from a drop in EU funds transfers. The forecast would put the 12-month trailing C/A gap at 2% of GDP, up from 1.8% in the previous month.

Wed May 19 2:00pm

Gross wages and employment

%oya

	Jan	Feb	Mar	Apr
Gross wages, nominal	0.5	2.9	4.8	5.0
Real (CPI-adj.)	-3.0	0.0	2.2	2.7
Employment, ths, nsa	5301	5293	5294	5300
Employment, %oya	-1.4	-1.1	-0.6	-0.2

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Thu May 20 2:00pm

Producer prices
%oya

	Jan	Feb	Mar	Apr
Producer prices	0.2	-2.4	-2.4	-1.0
%m/m nsa	0.4	-0.1	0.0	—

Thu May 20 2:00pm

Industrial output
%oya

	Jan	Feb	Mar	Apr
Industry	8.5	9.2	12.3	9.0
%oya swda by GUS	11.3	10.1	9.6	11.5
%m/m swda by GUS	2.8	1.5	2.3	0.6
Manufacturing	10.1	10.7	13.6	—
Construction	-15.3	-24.7	-10.8	—

Headline IP growth will have been dampened by a negative working day effect but the underlying trend should remain expansionary. Our forecast would put the 3m/3m annualized IP rate at 14.5%.

Thu May 20 2:00pm

Core inflation
%oya

	Jan	Feb	Mar	Apr
CPI—ex food and energy	2.4	2.2	2.0	1.7
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	—

Fri May 21 10:00am

Retail sales
%oya, unless otherwise stated

	Jan	Feb	Mar	Apr
Retail sales (nominal)	2.5	0.1	8.7	4.5
Real, CPI-adjusted	-1.0	-2.7	6.0	2.2
%m/m sa	-0.8	0.0	4.9	-4.0

Review of past two weeks' data

Monetary policy announcement

The NBP left interest rates unchanged as widely expected and maintained a neutral policy stance—inflation pressures are still seen as balanced. The statement noted the strong rise in industrial activity in 1Q10, accompanied by a gradual improvement in the labor market and signs of increased lending to households. The NBP highlighted the zloty's appreciation trend as a reflection of Poland's strong fundamentals, and that the NBP would use all instruments at its disposal to ensure zloty stability. Our view remains that the next move in Polish rates is likely to be up, most likely in the fourth quarter when inflation starts to reaccelerate and the drivers of growth rotate toward domestic demand. Near term, inflation is set to fall below 2%oya by July, but a move back above the 2.5% midpoint of the NBP's target range is likely by year-end. This, coupled with a narrowing of the output gap, could prompt the NBP to initiate a gradual hiking cycle in 4Q10.

Romania:

Data releases and forecasts

Weeks of May 10 - 21

Tue May 11 9:00am

Consumer prices
%oya

	Jan	Feb	Mar	Apr
%oya	5.2	4.4	4.2	4.1
%m/m nsa	1.7	0.2	0.2	0.2

We expect a slight decline in headline CPI to 4.1%oya in April but we think that the current disinflation is close to the bottom. We expect CPI to remain in the range of 4%-5%oya in the rest of the year with the harvest and resulting impact on food prices as the key risk.

Wed May 12 9:00am

Real GDP, preliminary
%oya

	2Q09	3Q09	4Q09	1Q10
%oya	-8.8	-7.1	-6.6	-1.5
%q/q saar	-5.8	0.2	-6.0	0.0

While foreign demand continues to support the industrial sector, domestic demand remains depressed. Therefore, the Romanian economy is lagging the recovery seen in Western European and Central European peers. We continue to expect the recovery to come this year and forecast GDP up 1.5%.

Mon May 17 9:00am

Current account balance
EUR bn

	Dec	Jan	Feb	Mar
Current account	-0.4	-0.1	-0.6	-0.4
Ytd	-5.1	-0.1	-0.8	-1.0
Ytd a year ago	-16.9	-0.5	-0.4	-0.7

Review of past two weeks' data

Monetary policy announcement

The NBR reduced its base rate to an all-time low of 6.25% from 6.5%. The easing cycle is approaching its end, in our view, but it is not likely there yet. The Romanian economy has yet to confirm that the recession is over; as domestic demand remains depressed and private credit has not yet recovered. Headline CPI inflation of 4%-5%oya remains high relative to the weakness in household spending, and there is the risk of reacceleration driven by food prices. Yet, demand-side inflationary pressures are still absent and likely to recover only gradually later this year and in 2011. We continue to expect the Romanian central bank to finish the easing cycle at 5.5% in the third quarter. The key risk to our NBR call and the generally positive view on the Romanian economy and assets is an adverse development abroad. Given the recent events in peripheral EMU countries and negative impact on CEE currencies, the risk around our rate call has recently shifted from downward to upward.

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South Africa

- **Recent data paint a mixed picture of the consumer recovery as unemployment rises unexpectedly**
- **Inflation continues to trend lower and may further surprise on the downside**
- **We expect the SARB to keep rates on hold at 6.50% after a surprise cut at the last meeting**

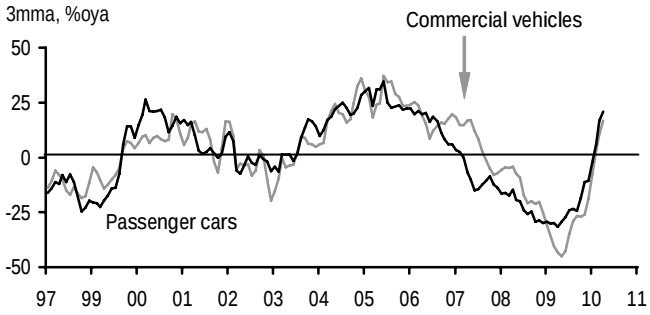
We believe monthly activity reports to date point to a first-quarter economic expansion of 3.9%q/q (1.2%oya) saar; upcoming data releases in manufacturing, wholesale, and retail will help to flesh out the forecast. Indicators of consumer spending in 1Q10 were overall fairly strong. Despite the negative surprise versus consensus in February, retail sales are up sharply on a sequential basis and are on track for a 13.8%q/q saar expansion in the first quarter. We believe that the upcoming retail sales number for March will push over-year-ago growth up to 1.1% from a 1.5%oya contraction in February. Data this week also showed that growth in vehicle sales accelerated further to 28%oya in April with sales up 14.5% in 1Q10, though this is from a low base and passenger car sales in the past three months remain 33% below their previous cyclical high. We expect the trade sector to contribute 1.8%-pt to quarter-over-quarter annualized GDP growth in the first quarter, while manufacturing is likely to contribute a modest 0.4%-pt. Data for the first two months of the quarter tracked a lackluster 2.6%q/q saar recovery in manufacturing, but, in our view, manufacturing data for March could surprise consensus on the upside. We expect next week's manufacturing number to post a recovery in growth to 3.9%oya from 2.7% in February.

This week's weak unemployment report places some downside risk to the consumer recovery after the soccer World Cup in the second half of the year. The unemployment rate unexpectedly rose to 25.2% in 1Q10 from 24.3% previously with 171,000 jobs eliminated. Job cuts affected most sectors, but were particularly concentrated in finance, construction, manufacturing, and trade. The weak labor market report reduces most of the upside risk to our 3%y/y growth forecast for 2010.

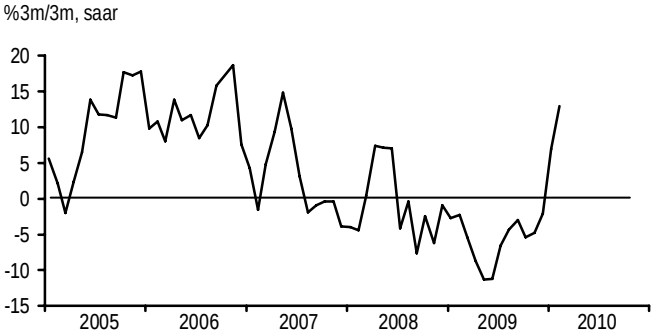
MPC expected to keep policy on hold

Despite the mixed picture on the consumer recovery and declining inflation, we believe that the SARB will keep its policy rate unchanged at next week's meeting. We expect the SARB to revise down its inflation forecast, but leave its GDP growth outlook broadly unchanged. CPI inflation fell to 5.1%oya in March on the back of subdued food inflation and passthrough from a stronger currency in 1Q10. We believe that inflation pressures will ease further with CPI inflation dropping to the midpoint of the target band in May with risks tilted to the downside as food inflation continues to ease. Inflation is likely to tick up again toward year-end. The medium-term outlook continues to be dominated by significant increases in administered prices and a potential recovery in food prices with inflation expected to hover between 5.5% and 6.0% throughout most of 2011.

New vehicle sales



Retail sales: recovery gaining momentum



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

The South Africa data watch will be published next on May 21.

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Data releases and forecasts

Weeks of May 10 - 21

Wed May 12 1:00pm — **Manufacturing production**

Volume output

	Dec	Jan	Feb	Mar
Manufacturing (%oya)	3.2	3.5	2.7	3.9
%m/m sa	2.9	-0.6	-1.5	__

Thu May 13 3:00pm — **MPC decision**

We expect the policy rate to be left on hold at 6.50%.

Wed May 19 11:30am — **Retail sales**

%oya

	Dec	Jan	Feb	Mar
Real	-3.8	-1.5	-1.5	1.1
Nominal	3.2	4.8	4.0	__

Review of past two weeks' data

Consumer prices

%oya, except as noted

	Jan	Feb	Mar
CPI	6.2	5.7	~~5.2~~ *5.1*
%m/m nsa	0.3	0.6	~~0.9~~ *0.8*
Core	5.7	5.3	~~4.9~~ *5.0*

See essay.

Producer prices

	Jan	Feb	Mar
Total (%oya)	2.7	3.5	~~3.9~~ *3.7*
%m/m nsa	1.3	0.4	__ *0.3*

Monetary and credit aggregates

	Jan	Feb	Mar
M3 (%oya)	0.6	0.1	__ *1.5*
M0 (%oya)	6.3	4.8	__ *12.4*
Private sector credit (%oya)	-0.7	-0.6	~~-0.9~~ *-0.7*
%m/m nsa	0.0	0.6	__ *0.2*
Credit to households (%oya)	2.9	3.5	~~4.2~~ *3.6*
Total domestic credit (%oya)	0.9	-0.3	__ *-0.1*

Trade balance

R bn, except as noted

	Jan	Feb	Mar
Trade balance	-3.4	~~-5.7~~ *-5.5*	__ *0.5*
Exports	36.6	~~40.3~~ *40.4*	__ *51.5*
%m/m	-19.4	~~10.1~~ *10.5*	__ *27.5*
Imports	40.0	45.9	__ *51.1*
%m/m	-4.1	15.0	__ *11.2*

Kagiso BER PMI

	Feb	Mar	Apr
PMI (% weights)	60.4	55.6	~~60.9~~ *55.2*
Business activity (25)	65.2	59.9	__ *54.3*
New sales orders (30)	68.6	54.8	__ *56.2*
Suppliers' performance (15)	48.1	52.4	__ *55.9*
Inventories (10)	58.7	56.8	__ *50.6*
Employment (20)	52.1	53.2	__ *56.3*
Memo: prices paid	61.9	61.6	__ *63.8*
Business expectations	74.0	73.2	__ 65.7
PMI nsa	55.5	53.4	__ *50.6*

New vehicle sales

%oya, except as noted

	Feb	Mar	Apr
Passenger car sales	21.2	~~13.7~~ *13.6*	__ *28.0*
%m/m nsa	-7.4	9.9	__ *-20.1*
Light commercial vehicles	13.0	~~15.1~~ *14.8*	__ *28.1*
Heavy/medium comm. veh.	-14.1	44.0	__ *1.73*
Total vehicle sales	16.2	~~15.0~~ *14.8*	__ *26.6*
%m/m nsa	0.5	~~11.7~~ *11.4*	__ *-20.2*

See essay.

SARB official reserves

	Feb	Mar	Apr
Gross reserves (R bn)	303.9	307.8	~~316.9~~ *310.4*
Gross reserves (US$ bn)	39.4	42.0	~~42.8~~ *42.3*
International liquidity (US$ bn)	38.3	38.3	~~39.1~~ *38.5*

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Australia and New Zealand

- **First phase of RBA's tightening cycle now complete**
- **Aussie consumers restraining spending**
- **NZ employment grows for first time in five quarters**

The RBA completed phase one of its tightening cycle this week, returning market rates to "normal" levels. The RBNZ, though, reiterated that it would commence the tightening cycle "in coming months." Fresh comments from RBNZ Governor Bollard and an unexpectedly upbeat jobs report increased the risk of an OCR hike in June, a month earlier than in the J.P. Morgan forecast.

We expect the RBA to sit on the policy sidelines next month as officials assess the impact of the 150bp of tightening delivered since October. The RBA this week upgraded its inflation forecasts, reinforcing the decision to hike. The week ahead in Australia sees the release of the Budget, an important policy event ahead of the upcoming federal election (see the research note, "Australia's Budget to set the scene for looming election battle," in this *GDW*).

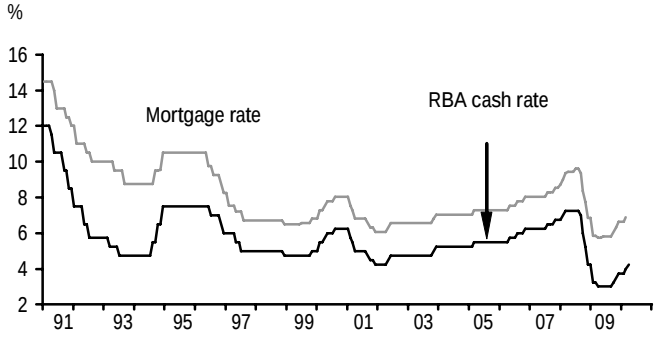
Hawkish RBA lifted cash rate again

The RBA Board this week lifted the cash rate another 25bp to 4.5%, as we and consensus had expected. The surprise was that the RBA delivered unexpectedly hawkish commentary. Indeed, the statement made important adjustments in three key areas. First, global growth now may be "a little above trend," rather than just "at trend." Second, the RBA now expects the rise in the terms of trade to be larger than previously expected. Third, the official assessment now is that inflation will be higher than previously expected: in the upper half of the RBA's 2%-3% target range over the coming year.

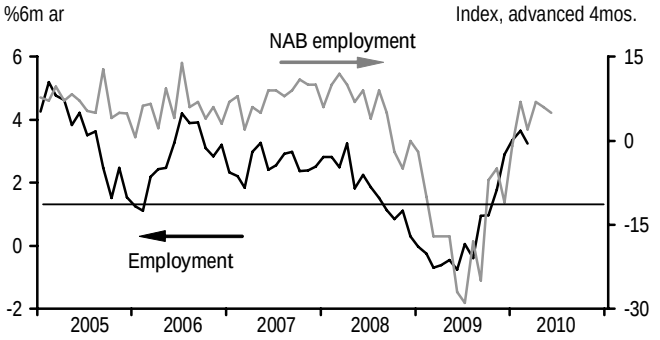
The flipside of this, though, is that the statement also indicated that market interest rates now are back to "average" levels. The reference to "average," a key phrase mentioned by RBA officials in speeches in recent weeks, means the RBA probably has scope to pause next month. That said, if key domestic data print on the firm side of expectations, a fourth straight hike in June is possible. With the policy stance now closer to a normal setting, though, we lean toward the RBA delaying the next hike until July.

The main arguments for this week's hike are the same as those used to explain the hike in early April: the booming terms of trade, which are about to trigger a huge wave of national income, and soaring house prices. Interestingly, the RBA's reference to the terms of trade again led the discussion on Australia's economy; there is a clear message in that. It seems the recent bounce in bulk commodity prices has fed through to the official commentary. On inflation, the statement now indicates that inflation will be in the upper half of the target range in the year ahead. Before, the commentary said inflation will be "consistent with target."

Australia: RBA cash rate and standard variable mortgage rate



Australia: NAB survey and employment growth



There may, therefore, be further upgrades in the pipeline. Indeed, it now is crystal clear that the economy has entered a new, more rapid pace of expansion, with very little spare capacity. Rates of capacity utilization are rising and the jobless rate has been falling. Inflation pressures, therefore, are building. Already, there is evidence of substantial wage gains in the hot mining regions. The riches on offer in mining towns to the west and north have triggered skill shortages even in non-mining sectors of the economy, as the mining industry drains the pool of workers elsewhere.

Aussie job gains should slow in April

Australia likely added 7,500 jobs in April after adding 75,000 jobs in the first three months of the year. We suspect that the gain in employment, albeit more modest than that recorded in previous months, will owe mainly to an increase in full-time employment. The recent shift from part- to full-time work will continue as workers' hours, which were cut significantly in 2009, are reinstated. Work-

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ers' hours should, therefore, have risen again in April, after rising 1.9%oya in February and 1.5% in March.

The jobless rate probably edged up to 5.4%; the rate will creep higher in the near term, owing to a rise in workforce participation. The anticipated rise in the unemployment rate will occur even though solid gains in employment are likely in 2H, owing to the swelling investment pipeline, which has positive implications for the labor market.

Housing finance likely to fall modestly

We expect a further decline in housing finance in Australia in March, with commitments likely to fall 1%m/m. The impact of rising interest rates is beginning to bite, and the stimulus tailwinds that pushed the surge in demand over the life of the subsidy now are buffeting loan volumes from the opposite direction. On the supply side, lenders are keen to rebalance their loan books after the mortgage binge under the expanded grant, which will lead to increasingly tighter mortgage lending conditions this year.

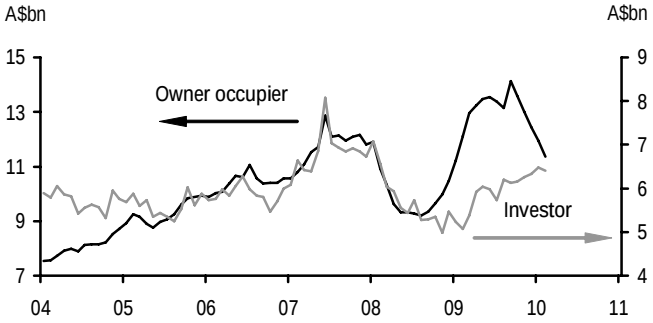
The RBA's sanguine observation in this week's statement that "new loan approvals have moderated" underplays the persistent decline in home loan demand observed in recent months. Monthly home loan demand is currently 20% below the levels of June 2009, which marked the planned expiry of the expanded First Home Buyers' (FHBs') grant.

Aussie consumers still cautious

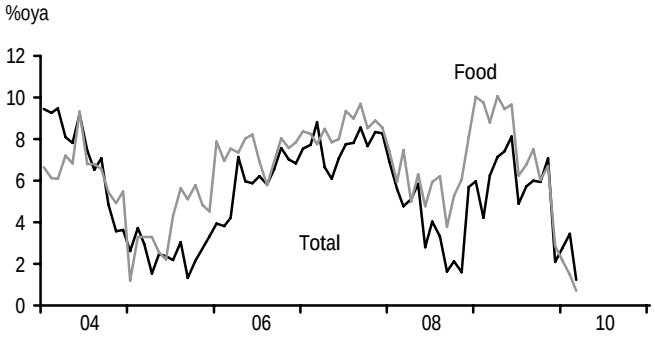
Consumer spending remained sluggish in Australia in March, which was not entirely surprising given the RBA's recent policy tightening and expectations of further hikes to come. Retail sales values grew just 0.3%m/m (J.P. Morgan: 0.2%; consensus: 0.7%), in line with anecdotes from retailers suggesting that sales were soft during the month. The result was, though, a marked improvement on the revised 1.2%m/m slump recorded in February.

Anecdotal evidence suggests consumers are taking a conservative approach to spending even though consumer confidence remains elevated. Such restraint by households, as evidenced by the retail sales data, combined with continued discounting of goods among the nation's retailers, has weighed down retail sales values. Several major retailers have highlighted that the absence of the government's A$900 fiscal stimulus payments, which were delivered in late 2008 and early last year, are making comparative growth this year harder to achieve. Indeed, with no added fiscal handouts likely to be delivered, interest rates rising, and growing uncertainty about global financial markets, further spending restraint is likely.

Australia: housing finance



Australia: retail sales



House prices kept climbing into 2010

Australian house prices increased 4.8%q/q in 1Q (J.P. Morgan: 3.5%; consensus: 3.0%), decelerating only very modestly from the 5.1% gain in 4Q. The gain took over-year-ago growth in house prices to a breakneck 20%.

With the expanded FHBs' grant being phased down over 4Q09, then eliminated at year-end, we had been expecting a more marked moderation in price growth in 1Q. It is important to note that the ABS house price index, which reflects sales for detached houses in capital cities only, probably overstates true economywide dwelling prices. Also, the housing market indicators of late have painted a more mixed picture than is implied by this week's report, with prices and general market sentiment buoyant, but loan demand sagging. Nonetheless, this week's result will surely unnerve RBA officials and, if nothing else, add to the media fervor suggesting that a bubble is building in the housing market.

We still expect house price growth to ease over 2010 as the significant policy tailwinds pushing the sector fade away. The FHBs' grant is now back to its original level and price caps were introduced on the grant as of January 1. The risk, though, is that the supply constraints that have lingered, unresolved for so long, combined with the momentum garnered in the last year, cause the market to overheat.

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RBNZ Governor talks up the recovery

RBNZ Governor Bollard this week spoke on the outlook for the New Zealand economy. The speech appeared to be an expansion on the bank's statement on April 29, when the RBNZ left the OCR at a record-low 2.5% and signaled that the policy stimulus may be removed "in coming months," rather than "around the middle of 2010." We interpreted the new guidance as hinting at a June or July move, or possibly even later. The new language can be rolled over from month to month should economic conditions deteriorate. As such, Governor Bollard this week maintained the flexibility acquired in last week's statement, which will allow the policy stimulus to be removed when economic conditions are appropriate.

Key to the Governor's speech this week, however, was his "truck driver" analogy: "Using a truck driver analogy, our foot is strongly on the accelerator. Over coming months we expect to reduce the pressure on this pedal, but in effect to keep some throttle going. Truck drivers know they must reduce acceleration long before the corner."

Indeed, this implies that the RBNZ is readying to begin to remove the policy stimulus, but exactly when the truck driver will decide to "reduce acceleration" will depend on how the economic data evolve. If the data continue to evolve in the remarkably positive fashion of this week's employment numbers (see below), we expect a June rate hike to be delivered. Governor Bollard this week reiterated, however, that conditions on the domestic front remain fragile.

We still think that a July move is more likely. By then, the RBNZ should have another healthy GDP print in hand (we are forecasting 1Q GDP growth of 0.8%q/q), and the case for keeping the cash rate at historic lows should have weakened substantially.

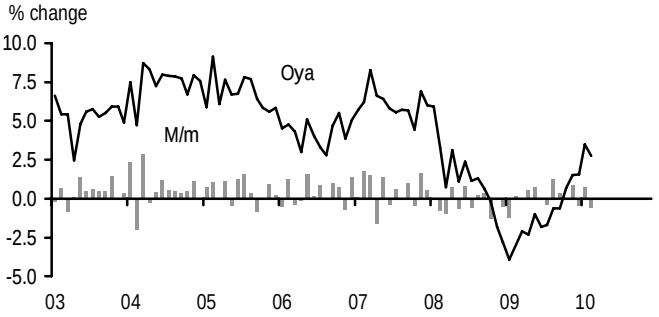
Kiwi unemployment dropped sharply

New Zealand's unemployment rate posted a remarkable fall in 1Q. The key rate dropped from a revised 7.1% in 4Q to just 6.0%, marking the largest drop since 1986 and the first fall in more than two years. J.P. Morgan and the market consensus expected the unemployment rate would have remained unchanged at a decade-high 7.3%.

The tumble in the jobless rate can be largely explained by the 1.0%q/q increase in employment, which marks the first rise in five quarters, as the participation rate held steady at 68.1%. There were significant seasonal factors at play, however, that were described by Statistics New Zealand as "atypical." We believe that the unemployment rate is unlikely to head below 6.0% in the near term, however. The NZIER quarterly surveys have showed that hiring intentions have turned marginally positive, but actual hiring is still below long-run averages. With corporate profitability having fallen in 1Q, any significant pickup in new hiring will be delayed.

New Zealand: employment

New Zealand: retail trade



NZ retail due for a jump higher

After two months of decline, retail sales in New Zealand should have spiked 0.9%m/m in March, or 3.7%oya. Credit card data showed that total billings on New Zealand credit cards surged 1.2%m/m in March, suggesting strong growth in retail sales during that month. Core sales probably rose only modestly, however, increasing 0.4%m/m. Part of this will be linked to the small rise in food prices in March (+0.2%m/m), given around 45% of the value of core retail sales comes from the five food-related industries.

Despite the anticipated rebound in retail sales, any recovery in consumer spending this year, in our view, will be only modest. With gasoline prices having risen considerably since the start of the year, housing market activity having moderated owing to uncertainty surrounding prospective changes to the taxation of property, and wage growth still subdued, households will remain cautious.

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Australia:

Data releases and forecasts

Week of May 10 - 14

Mon May 10 11:30am — **ANZ job advertisements**
Seasonally adjusted

	Jan	Feb	Mar	Apr
%m/m	-8.1	19.1	1.8	__

Tue May 11 11:30am — **NAB monthly business survey**
% balance, seasonally adjusted

	Jan	Feb	Mar	Apr
Business confidence	15	19	16	13

The fall in business confidence will owe to a further hike to the cash rate and a drop in sentiment among currency-sensitive firms.

Wed May 12 11:30am — **Housing finance approvals: owner occupiers**
Number of loans, seasonally adjusted

	Dec	Jan	Feb	Mar
%m/m	-5.2	-7.3	-1.8	__
%oya	-0.1	-11.6	-16.1	__

Thu May 13 11:30am — **Labor force**
Seasonally adjusted

	Jan	Feb	Mar	Apr
Unemployment rate (%)	5.2	5.3	5.3	__
Employed (000 m/m)	59.4	-4.7	19.6	__
Participation rate (%)	65.3	65.2	65.1	__

Review of past week's data

House price index: eight capital cities
Weighted average

	3Q09	4Q09		1Q10	
%q/q	4.4	~~5.2~~	*5.1*	~~3.5~~	*4.8*
%oya	6.6	~~13.6~~	*13.5*	~~18.5~~	*20.0*

RBA cash rate announcement

25bp hike delivered. See main text.

Building approvals

	Jan		Feb		Mar	
%m/m sa	~~-5.5~~	*-5.0*	~~-3.3~~	*-2.7*	~~-1.0~~	*15.3*
%oya sa	~~52.7~~	*53.5*	~~34.2~~	*36.3*	~~23.1~~	*51.6*

The spike in approvals owed to a huge 60% jump in approvals for higher-density dwellings. Private sector building approvals for houses rose just 0.5%.

Retail trade

	Jan	Feb	Mar
%m/m	1.1	-1.4	0.2
%oya	3.0	3.4	1.1

Retail trade ex inflation

	3Q09	4Q09	1Q10
%q/q sa	-0.7	1.1	0.1
%oya sa	3.2	3.4	2.2

Trade balance

	Jan	Feb	Mar
Trade balance (A$ mn, sa)	-1120	-1924	-1500

Both sides of the trade ledger pushed higher over the month, though export growth was much softer than forecast, pushing the deficit wider. It seems some of the improvement in the deficit we had penciled in for March already was incorporated in revisions to the February data, though the weakness in non-rural commodity exports remains a disappointment.

New Zealand:

Data releases and forecasts

Week of May 10 - 14

Mon May 10 — **QVNZ house prices**
%, median

	Jan	Feb	Mar	Apr
%oya	4.4	5.5	6.1	__

Thu May 13 10:30am — **Business PMI**
Seasonally adjusted

	Jan	Feb	Mar	Apr
Index	52.2	53.6	56.3	__
%oya	23.0	35.3	34.4	__

Fri May 14 10:45am — **Retail trade**
Seasonally adjusted

	Dec	Jan	Feb	Mar
%m/m	-0.5	0.7	-0.6	xx
%oya	1.8	3.6	2.3	xx

Review of past week's data

ANZ commodity price series
Not seasonally adjusted

	Feb	Mar	Apr	
Index—world prices (%m/m)	3.8	1.8	__	*4.9*
Index—NZD (%m/m)	7.9	0.4	__	*3.8*

Labor cost index and average hourly earnings
Private sector, ordinary time, sa

	3Q09	4Q09	1Q10
%q/q	0.4	0.3	*0.3*

Labor force survey

	3Q09	4Q09	1Q10
Unemployment rate (% sa)	6.5	7.3	7.3
Employment (000, q/q sa)	-17	-2	4.9
Participation rate (% sa)	68.0	68.1	68.1

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Greater China

- **China: PBoC hikes RRR 50bp for third time this year in order to withdraw further excess liquidity**
- **April manufacturing PMIs suggest solid expansion in industrial activity; upward pressure on input costs**
- **Taiwan: April CPI inflation edged up modestly; growing focus on next move in monetary policy**
- **Steady gain in April exports; sequential momentum moderating from elevated post-crisis pace**

The People's Bank of China (PBoC) announced over last weekend that the reserve requirement ratio (RRR) for most financial institutions' yuan deposits would be raised 50bp, effective May 10. This is the third hike in the RRR this year, and the move should sterilize about 300 billion yuan in the banking system. The RRR for small and medium-sized banks now stands at 15% and 17% for large banks, compared to the historical high of 17.5% in mid-2008.

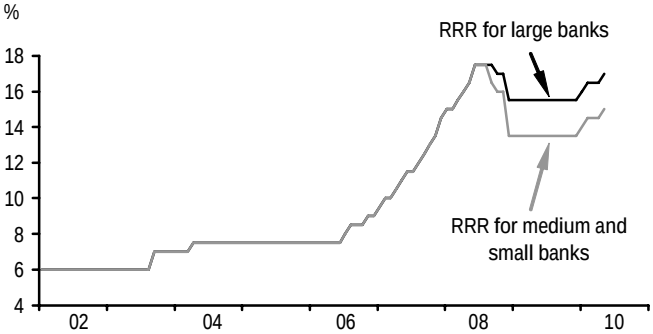
The latest RRR hike is in line with our expectations as the central bank continues to focus on withdrawing excess liquidity—lifting the RRR remains a cheaper and more high-profile move than open market operations (the PBoC drained net liquidity of 437 billion yuan from the economy in April), with one-year PBoC bills now yielding 1.9264% versus 1.62% interest on required reserves. Our rates strategy team calculates that the excess reserve ratio was around 2% by end-March.

In terms of timing, the latest RRR hike comes on the back of a strong NBS PMI reading, released on Saturday, which climbed to 55.7 in April, with higher levels of output, new orders, and input prices (see below). Indeed, the April PMI report suggests that growth momentum accelerated somewhat after the strong gain in 1Q10. The local press also reported that bank lending seems to have rebounded last month after steadily moderating in February and March.

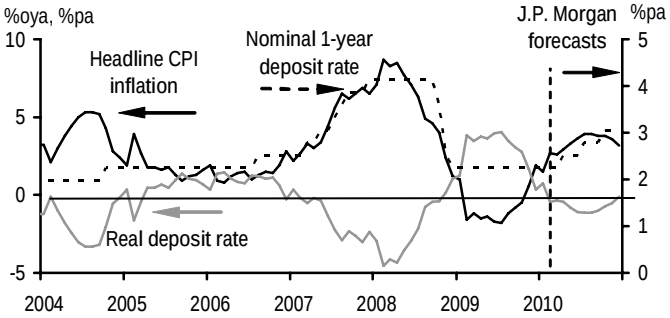
- Overall, we expect the PBoC to continue to focus on withdrawing liquidity through open market operations (OMO) and RRR hikes, as well as strengthening credit control. We expect two more RRR hikes over the rest of the year to alleviate excess liquidity (with the seven-day repo rate at around 1.6%), while RRR increases represent a cheaper policy alternative to OMO. Banks that extend too much credit could face further RRR hikes as punishment.

- However, we believe that there is still no consensus among policymakers regarding near-term rate hikes, which are perceived to have a broader impact on the economy.

China: reserve requirement ratios for financial institutions



China: CPI and one-year real deposit rate, with 2010 forecasts



- Indeed, there are still some concerns over the growth outlook, given the potential impact of the EU sovereign debt crisis on global financial markets and the world economy. As a result, we believe policymakers may want to keep their powder dry in an effort to gauge the impact of the latest tightening measures in the real estate sector on domestic demand.

- In directing policy, CPI readings in coming months are likely to be particularly important. We continue to expect the first interest rate hike to be in the current quarter as headline CPI rises above 3%oya.

March manufacturing PMIs still solid

China's two manufacturing PMIs moved in opposite directions in April. The official NBS manufacturing PMI series rose to 55.7 in April from 55.1 in March. Meanwhile, the Markit PMI was 55.4 in April, down from the elevated 57.0 in March, but still a solid figure compared to recent trends. The overall tone of the latest data is that industrial activity is enjoying further solid growth. We expect this pattern to continue in the coming months, though the momentum may moderate as policymakers extend monetary normalization, particularly via sector-specific measures targeting the property market.

- The NBS PMI output component increased to 59.1 in April from 58.4 in March. Among the forward-looking

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indicators, new orders continued to rise, ticking up to 59.3 in April from 58.1 in March, while consumer spending continued to expand with auto sales still booming. In contrast, we believe the strong public spending continued to ease and the authorities turned more cautious in approving and extending credit to new projects. Still, export orders in the NBS series remained solid at 54.5 in April, the same level as in March.

- The inventory component in the NBS manufacturing PMI series cooled to 46.2 in April from 48.3 in March, still below the 50 expansion threshold. Together with the gain in orders, the orders to inventory ratio rose to 1.28 in April (from 1.20 in March) suggesting that, with further recovery in final demand conditions, steady sequential trend growth in the manufacturing sector should continue.

- Meanwhile, NBS PMI input prices rose significantly to 72.6 in April, compared to 65.1 in March, reflecting the latest trend in global commodity prices and import price inflation, fueling growing cost concerns in recent months. Indeed, metal products and nonferrous metals smelting; petroleum, coking, and nuclear fuel processing; electric machinery and equipment; and textiles each recorded input price components above 80.

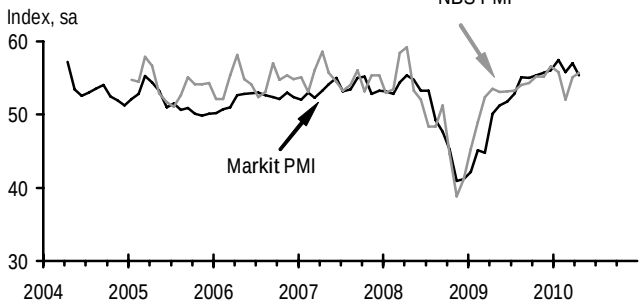
Taiwan: April CPI edged up modestly

Taiwan's headline CPI rose 1.34%oya in April, compared to 1.26%oya in March. Our seasonal adjustment calculation shows that the headline CPI rose 0.16% m/m sa in April, after falling 0.87% m/m in March. Meanwhile, core CPI (overall CPI excluding fruit, vegetables, fish, and energy) edged up 0.24%oya in April, after rising just 0.1%oya in March, and remained unchanged on a seasonally adjusted basis. In terms of input cost pressures, the wholesale price index added 9.09%oya in April (up 0.6%m/m sa), while the import price index, in local currency terms, rose 12.67%oya (up 0.6%m/m sa). Sequentially, the rate of increase in the seasonally adjusted trends in both the WPI (up 8.1%3m/3m saar by April) and import price index (up 9.6%3m/3m saar) gradually stabilized in recent months, reflecting the recent stabilization in global commodity prices.

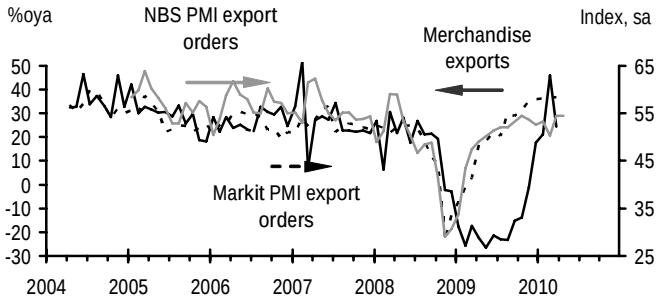
Focus on next monetary policy move

We expect the Taiwan economy to show a broad-based recovery in the coming quarters, with real GDP rising 8.2%oya for full-year 2010 and with the average CPI inflation forecast at 1.8%oya. Attention is also focusing on the central bank's next monetary policy move. In the near term, the Bank has continued to focus on managing overall liquidity conditions, especially through CD issuance. However, as CPI inflation (in %oya terms) rises steadily (though still at a moderate pace), and as real interest rates gradually fall into negative territory, central bank policymakers are likely to be increasingly concerned about the impact of their stance on asset markets and overall financial stability.

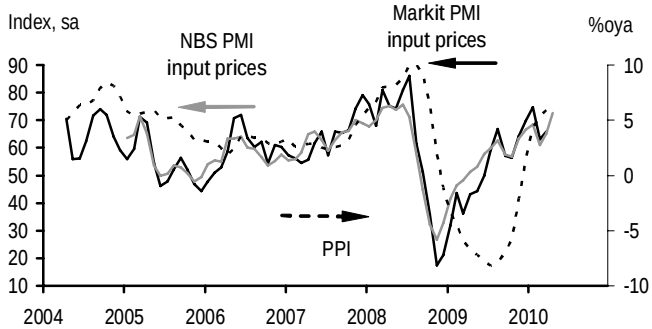
China: manufacturing PMIs



China: PMI export orders and merchandise exports



China: PPI and PMI input prices



An important factor for the Taiwan central bank policy decision, as stated in its March policy statement, will be labor market conditions. The pace of recovery in Taiwan's labor market has been moderate in this cycle, with the unemployment rate still 1.7%-pt above the pre-crisis level. Going forward, as the broadening of the global expansion and the double-digit global capex expansion further support the Taiwanese economy, the labor market should experience a decent recovery. The other major factor for Taiwan's policy rate decision is the potential move by other major

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central banks, not only the Fed, but also People's Bank of China and other regional central banks. Taking all factors together, our current forecast has the Taiwan central bank beginning to raise policy rates moderately, by 25bp, at its 3Q monetary policy meeting in September. However, the probability of an earlier, modest rate move, possibly of 12.5bp, in the June policy meeting cannot be ruled out.

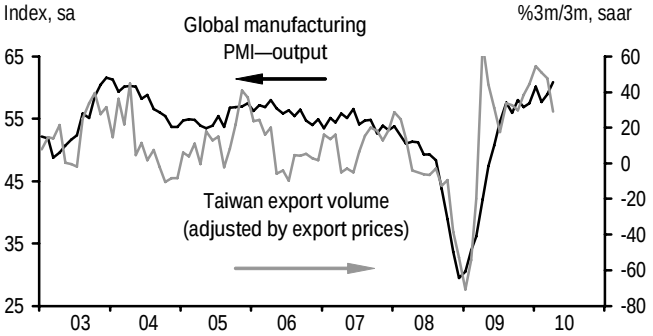
Moderating momentum in exports

Taiwan's April exports rose at slower-than-expected 47.8%oya, compared to the 50.1%oya gain in March. Seasonally adjusted, April exports rose 3.1%m/m, while the sequential trend began to ease from the elevated pace in the previous three quarters, rising 37.4%3m/3m saar. Adjusting for price effects, exports rose at a modest 0.8%m/m sa in April, with the sequential trend growth moderating to 28.9%3m/3m saar. Meanwhile, imports also rose more slowly than expected at 52.6%oya in April, bringing the trade surplus to US$2.55 billion.

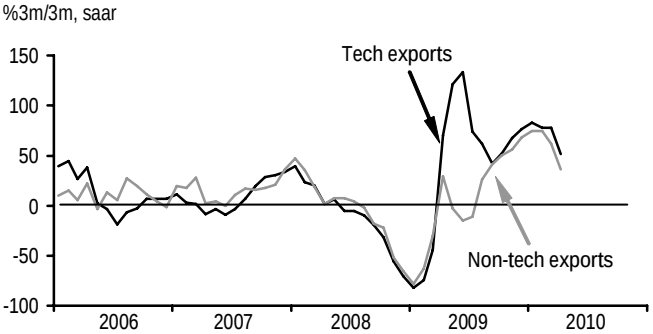
The April trade report showed that Taiwan's export sector, while still growing at a steady pace, began to moderate compared to the elevated post-crisis recovery pace over the previous 12 months. Overall, Taiwan's latest export figures are consistent with the global theme of broadening demand recovery. Shipments to China (up 29.2%3m/3m saar) and other Asian markets continued to expand, though at a slightly slower pace. Meanwhile, shipments to the US (up 50.5%3m/3m saar by April), as well as to Japan (up 33.9%) and Europe (up 29.3%), remained strong.

Looking ahead, our global team expects global capital spending to rise at a double-digit pace over 2010. Consumer spending should also sustain solid gains. And the global manufacturing PMI index moved to a new cycle high in April. Meanwhile, it is worth noting that emerging market PMIs underperformed developed market PMIs for the second month in April, and the pace of growth in Taiwan's imports of raw materials and intermediate goods has begun, suggesting that the expansion in exports may ease somewhat going forward. Putting all this together, Taiwan's export sector and industrial activity would likely show steady growth in the coming quarters, though the pace of sequential gain may continue to ease from the sharp post-crisis rebound seen in the past 12 months. Our forecast for Taiwan's 2010 real GDP growth remains at 8.2%.

Global manufacturing PMI and Taiwan real export growth



Taiwan: export growth breakdown



China:

Data releases and forecasts

Week of May 10 - 14

Mon May 10 10:00am — **Merchandise trade**
US$ bn

	Jan	Feb	Mar	Apr
Balance	14.2	7.6	-7.2	0.3
Exports	109.5	94.5	112.1	125.0
%oya	21.0	45.6	24.2	35.9
Imports	95.3	86.9	119.3	124.7
%oya	85.5	44.7	66.0	58.2

April merchandise exports likely rebounded from the notable decline (in m/m sa terms) in March, on the back of solid external demand growth. The merchandise trade balance likely returned to a modest surplus in April.

Tue May 11 10:00am — **Consumer prices**
% change

	Jan	Feb	Mar	Apr
%oya	1.5	2.7	2.4	2.8
%m/m sa	-0.2	1.0	-0.6	0.4

Weekly data from the Ministry of Agriculture suggest that food prices eased moderately in April. Meanwhile, the hike in oil prices likely boosted nonfood CPI. Overall, we expect headline CPI to have picked up in April, rising 2.8%oya.

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Tue May 11 10:00am

Producer prices
%oya

	Jan	Feb	Mar	Apr
Producer (NBS)	4.3	5.4	5.9	6.7
Producer (PBoC)	4.5	5.7	5.6	__

The PPI likely continued to tick up further in %oya terms in April, though the pace of sequential m/m gain has eased somewhat in recent months.

Tue May 11 10:00am

Fixed investment
% change

	Jan	Feb	Mar	Apr
Fixed investment				
%oya	26.6	26.6	26.2	25.8
%oya, ytd	26.6	26.6	26.4	26.2
Real estate				
%oya, ytd	31.1	31.1	35.1	__
Manufacturing				
%oya, ytd	23.6	23.6	25.8	__

Fixed investment likely rose at a steady pace in April. We expect strong public investment growth last year to moderate, as authorities turn more cautious in approving and extending credit to new projects.

Tue May 11 10:00am

Retail sales
% change

	Jan	Feb	Mar	Apr
%oya	14.1	22.1	18.0	18.0
%m/m sa	0.3	1.0	1.4	1.7

Retail sales are anticipated to have continued to rise at a solid pace in April. Increasing confidence in the economy, improving labor markets and hence household income, and overall consumption-friendly macro policy should support solid household spending growth.

Tue May 11 10:00am

Industrial production
% change

	Jan	Feb	Mar	Apr
%oya	29.5	12.8	18.1	18.5
%m/m sa	1.2	-4.0	7.0	1.6

Industrial production likely showed steady expansion in April. While the authorities' various measures to curb excessive credit expansion have begun to show some impact, momentum in private sector demand, both domestic and external, remained solid.

During the week

Monetary aggregates
%oya

	Jan	Feb	Mar	Apr
M2	26.0	25.5	22.5	21.6
Bank lending	29.3	27.2	21.8	__

The M2 money supply should have increased at a solid month-on-month pace in April, as liquidity in the banking sector remained ample.

During the week

Foreign direct investment
US$ bn

	Jan	Feb	Mar	Apr
Utilized FDI	8.1	5.9	9.4	__
%oya	7.8	1.1	12.1	__
%oya ytd	7.8	4.9	7.7	__

Review of past week's data

Manufacturing PMI (May 3)
Index, sa

	Feb	Mar	Apr
Overall (Markit)	55.8	57.0	~~57.5~~ *55.4*
Output	57.8	58.1	__ *57.1*
Overall (NBS)	52.0	55.1	~~55.5~~ *55.7*
Output	54.3	58.4	__ *59.1*

Hong Kong:

Data releases and forecasts

Week of May 10 - 14

Fri May 14 4:15pm

Real GDP
% change

	2Q09	3Q09	4Q09	1Q10
%oya	-3.7	-2.2	2.6	7.0
%q/q saar	12.1	1.6	9.5	4.5

Expect strong 1Q GDP growth, driven by stronger domestic demand and improvements in the export sector.

Review of past week's data

Retail sales volume (May 3)
% change

	Jan		Feb		Mar	
Oya	3.2		31.5		~~29.9~~	*17.2*
M/m sa	~~0.0~~	*-0.2*	~~9.8~~	9.9	~~0.4~~	*-8.1*

Taiwan:

Data releases and forecasts

Week of May 10 - 14

No data releases.

Review of past week's data

Consumer prices (May 5)
% change

	Feb	Mar	Apr	
Oya	2.4	1.3	~~1.5~~	*1.3*
M/m sa	1.2	-0.9	0.2	

External trade (May 7)
US$ bn

	Feb	Mar	Apr	
Balance	0.9	1.5	~~1.2~~	*2.6*
Exports	16.7	23.4	~~22.4~~	*21.9*
%oya	32.6	50.1	~~50.7~~	*47.8*
Imports	15.8	21.9	~~21.1~~	*19.4*
%oya	45.8	80.3	~~66.2~~	*52.6*

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Korea

- **No rate action expected at next week's MPC meeting**
- **Exports solid, but imports softened in April**
- **Unfavorable weather lifted agriculture prices**

The upcoming MPC meeting is unlikely to generate much surprise, although we expect the GDP growth outlook to be updated slightly further. The 1Q GDP outcome was better than the Bank of Korea's latest forecast, upgraded only three weeks ago, while April's export data remained solid. However, we do not expect the BoK to turn hawkish and hint at any near-term rate hike action given growing concern that the Greece debt problem could spread to other European countries. On the domestic front, concerns over asset price bubbles have been subsiding, as house prices have begun a modest decline. Overall housing demand has been restrained by microlevel regulations, and the government's plan to increase public housing is helping to cap housing prices.

Trade surplus expands further in April

The customs trade surplus widened significantly last month, helped in part by seasonal strength in exports. In our estimates, the seasonally adjusted trade surplus increased to US$3.0 billion in April from US$2.3 billion in March. Exports moved up a solid 2.4%m/m sa in April after slipping slightly in March. The gain was broadly based across key export products but most notable in semiconductors and vehicles. Vessel and oil products also saw solid rates of growth, but the former was only from usual monthly volatility and the latter was mainly on the back of global price gains. By region, exports to the US and Euro area increased, although shipments to China played a smaller role than in the preceding three months.

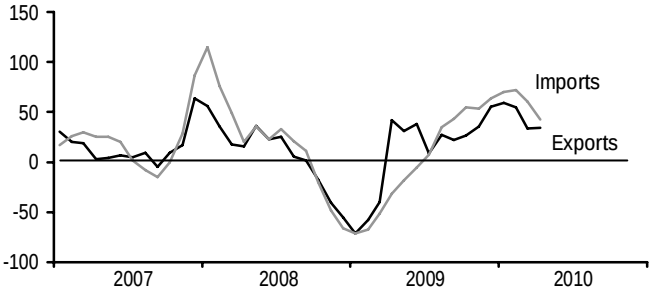
More noteworthy was that some of the widening of the trade surplus was due to softer imports. Seasonally adjusted imports rose only 0.5%m/m sa in April, their smallest increase since May 2009. Crude oil imports were reported to rise, implying that non-oil imports headed down after rising strongly for about three quarters. It remains uncertain if this is a shift in trend or a temporary pause. Of note, about 60% of imports is used for domestic purposes, with business equipment investment in particular relying on imported goods.

Headline inflation up; core prices stable

Consumer prices rose 0.5%m/m nsa in April with the over-year-ago rate accelerating to 2.6% from 2.3%oya in March.

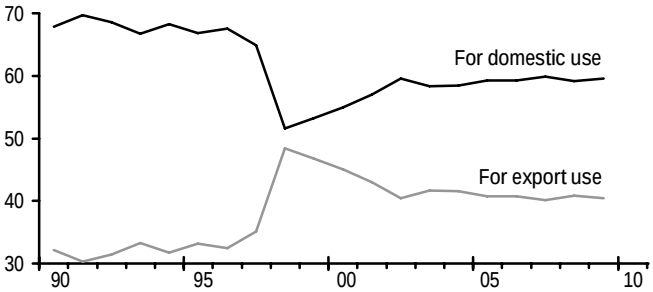
Customs trade

%3m/3m saar



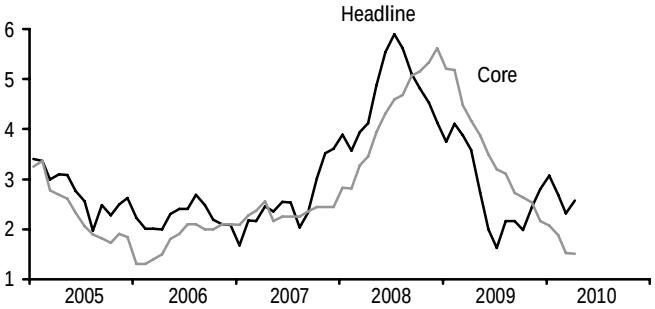
Customs imports by purpose

% of total



Consumer price inflation

%oya



The weather-driven surge in agricultural prices and a seasonal rise in energy prices were the main drivers, while core prices remained stable. By our seasonal adjustment, the headline CPI is estimated to have risen 0.3%m/m sa, after edging down in March. Core prices rose 0.2% in April, but did not fully reverse the 0.3% fall in March when regulatory moves constrained mobile phone rates and there was a seasonal hike in key education service prices. However, we expect price pressures to build during 2H10, with some increases in public charges in the pipelines after June's regional elections. Commodity prices are also expected to trend higher if we are correct in our forecast that the global economy remains on the road to recovery.

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Data releases and forecasts

Week of May 10 - 14

Mon May 10 12:00pm — **Producer prices**
% change

	Jan	Feb	Mar	Apr
%oya	2.8	2.4	2.6	3.5

Tue May 11 12:00pm — **Monetary aggregates**
%oya, monthly average

	Dec	Jan	Feb	Mar
M2	9.3	9.3	9.4	9.0
Lf	8.1	8.1	8.6	8.8

Wed May 12 8:00am — **Unemployment rate**
% of total labor force

	Jan	Feb	Mar	Apr
Seasonally adjusted	4.8	4.4	3.8	3.8
Not adjusted	5.0	4.9	4.1	3.9

Jobless rate likely declined further in April, but mainly for seasonal reasons.

Fri May 14 12:00pm — **Import and export prices**
%oya

	Jan	Feb	Mar	Apr
Export prices	-6.9	-10.2	-12.2	-8.4
Import prices	-0.9	-4.1	-4.3	1.7

April trade prices likely contracted on a seasonally adjusted month-on-month basis, with trade-weighted KRW appreciating 4.0% in April.

Fri May 14 12:00pm — **Stage of processing price index**
% change

	Jan	Feb	Mar	Apr
%oya	1.8	0.4	0.5	4.3

Review of past week's data

Customs trade (May 1)
US$ bn nsa

	Feb	Mar	Apr	
Trade balance	2.1	1.8	~~2.4~~	*4.4*
Exports	33.1	37.4	*39.9*	
Imports	31.0	35.6	~~37.5~~	*35.5*

Customs exports and imports surged 31.5%oya and 42.6%, respectively. Using J.P. Morgan's seasonal adjustment, exports rose 2.4%m/m sa in April, while imports moved up only 0.5%. Also see main story.

Consumer prices (May 3)
% change

	Feb		Mar		Apr	
%oya	2.7		2.3		~~2.5~~	*2.6*
%m/m sa	~~0.3~~	*0.2*	~~0.0~~	*-0.1*	*0.3*	

See main story.

Foreign exchange reserves (May 4)
US$ bn nsa

	Feb	Mar	Apr	
Total	270.7	272.3	__	*278.9*

Housing prices (May 7)
% change from previous week, apartment prices only

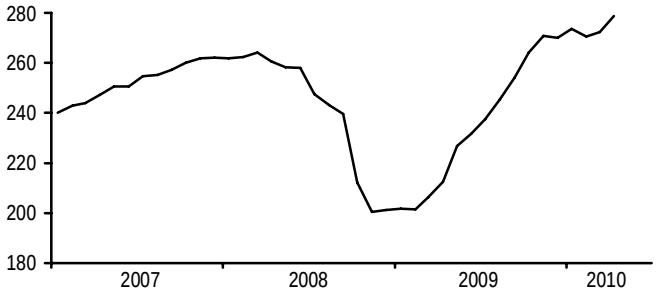
Week of Apr 19	Apr 26	May 3	
0.0	0.0	__	*0.0*

BoK Watch

- **FX reserves rose at an accelerated pace in April**

Korea's foreign exchange reserves increased US$6.5 billion in April to US$278.9 billion, the second consecutive monthly rise and at a faster pace than in March. The central bank's official release stated that this was mainly attributable to operating profits, despite EUR and JPY depreciation that led to a decrease in the USD value of reserves. According to the Bank of Korea's annual report, USD-denominated assets accounted for 63.1% of total reserves at end-2009.

Korea's foreign exchange reserves
US$ bn



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

- **Indonesian April inflation lifted by food even as core inflation moderates**
- **Narrowing in trade balance bears watching; domestic demand firming rapidly**
- **Inflows remain strong; banking sector liquidity rising quickly**

The recent data flow from Indonesia is still positive with domestic demand recovering strongly and inflation still muted. However, the strength in domestic demand is to an extent reflected in the narrowing of the trade surplus. That said, the commodity surplus continues to provide a cushion for the overall balance and the moderation is expected to be relatively muted, especially with commodity prices and volumes expected to turn up over the course of 2010. Despite the strength in domestic demand, inflation remains modest, and, even though food prices were up slightly in April, this likely reflects one-off increases. Indeed, the prices of staple foods, which in Indonesia include soy, rice, and cooking oil, have remained tame.

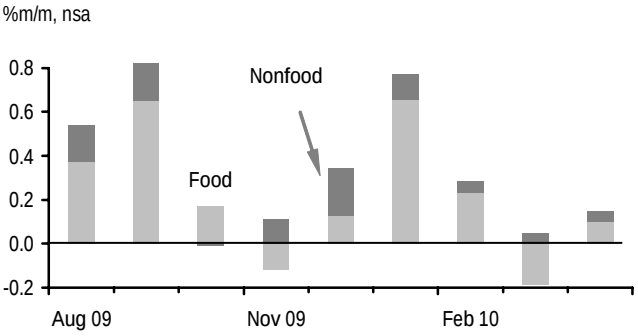
The impact of a still supportive trade account and continued capital inflows to Indonesia has led to an increase in domestic liquidity. Furthermore, with bank credit growing less rapidly than deposits, banking system liquidity continues to move up, while interbank rates continue to soften relative to policy rates.

CPI up on food even as core moderates

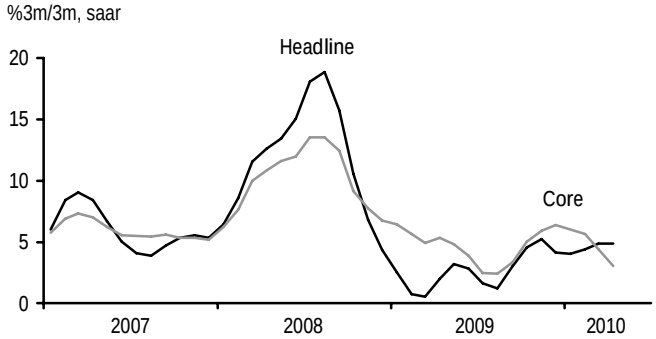
The April inflation print came in higher than expected—up 3.9%oya (consensus: 3.7%) and up a larger-than-expected 0.7%m/m sa. In terms of the overall contribution to the 0.15%m/m nsa increase in headline inflation, food accounted for 0.1%-pt of the rise, while nonfood prices added a modest 0.05%-pt to the overall index change (first chart).

In sequential trend terms, inflation rose 4.9%3m/3m saar while core inflation was up 3.1%3m/3m saar (second chart). Of note, the increase in food prices was focused in certain items—herbs/spices—rather than reflecting a broad-based increase in food items. By contrast, nonfood prices have remained very modest; this is reflected in the very muted increases in nonfood prices over the past several months. The relative stability in nonfood prices amid volatility in certain food prices has led to the different sequential trend trajectories in core and overall inflation—with core inflation now below overall inflation. However, food prices

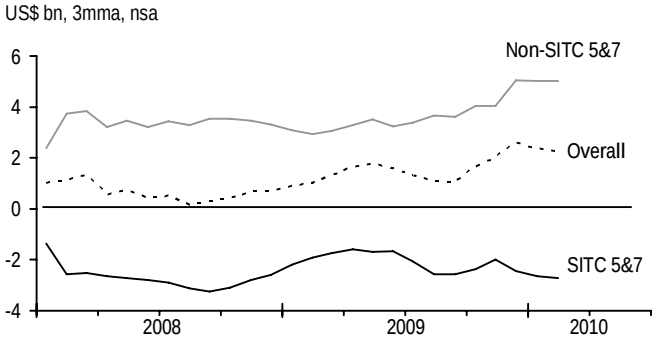
Indonesia: sources of inflation



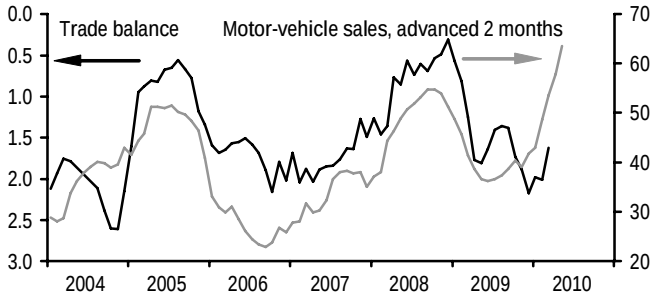
Indonesia: core and headline inflation



Indonesia: trade balance



Indonesia: trade balance and vehicle sales



have tended to be volatile in the past few months—that they did not soften in April is certainly a concern, and sug-

gests that supply issues may have played a role in the recent increase. Nonetheless, the behavior of core inflation should keep the central bank sending the message that the inflation outlook will remain muted through 1H10.

Domestic demand recovering smartly—watching trade balance

Indonesia's March trade data suggest that domestic demand is ramping up quickly, with imports rising a very strong 71.3%3m/3m saar even as exports slowed to 28.8%3m/3m saar. The trade surplus narrowed to US$1.37 billion sa from an average run rate of US$2.2 billion in 4Q09, reflecting the rising deficit in the machinery and chemicals categories as defined by SITC (third chart, previous page). This narrowing in the trade surplus reflects to a large extent the strength in domestic demand, proxied by the striking increase in motor vehicle sales, now reaching all-time highs (fourth chart, previous page).

Our forecast for 2010 had assumed strong tailwinds from the current account, which should have provided policy flexibility for the central bank to allow FX appreciation, rather than higher rates, to temper imported inflation (see "Indonesia's trade surplus fired up by energy-related exports," *GDW*, April 16). The recent narrowing in the trade surplus could ostensibly reduce some of the tailwind behind the BoP, and this is a dynamic that needs to be watched in the coming months. If the trade surplus continues to narrow to a run rate of around US$1 billion/month from US$1.58 billion currently, this could place the current no-hike view for 2010 at risk—and possibly bring rate hikes forward to 4Q10. The real test of this hypothesis will be when domestic demand is firing on all cylinders, which we expect to occur in 2Q10 when the investment cycle picks up more steam.

Inflows remain strong

While nontrade flows could provide some buffer, they tend to be more volatile (first chart). That said, inflows to the bond market have continued to surge, with US$4.2 billion flowing into the bond market and an estimated US$1 billion into the SBI market (second chart). Moreover, the bond inflows tend to be targeted toward longer-dated paper, which has led to a flattening of Indonesia's term structure (third chart).

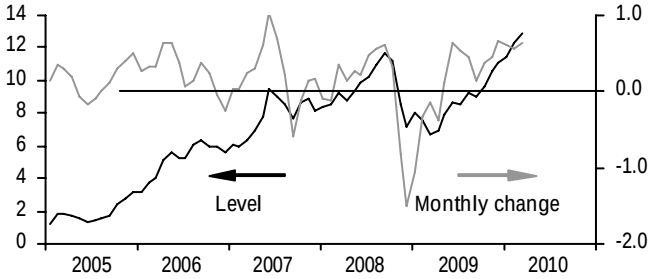
The combination of these inflows and incomplete sterilization has led to a rise in deposits and, twinned with still-soft credit expansion, has led to a rise in liquidity. This has been reflected in a recent decline in interbank rates, which also emphasizes the impact of the phasing out of one-month SBI paper (fourth chart).

Indonesia: balance of payments

US$ bn, nsa

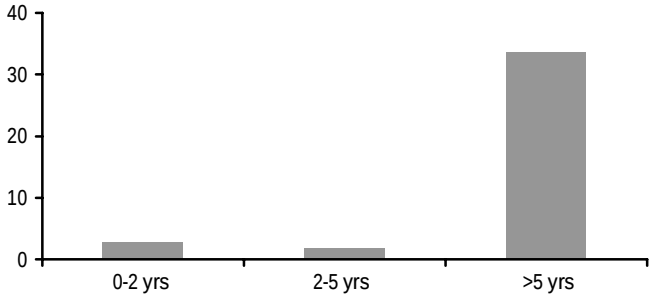
Indonesia: foreign ownership in bonds

US$ bn, nsa | US$ bn, 3mma



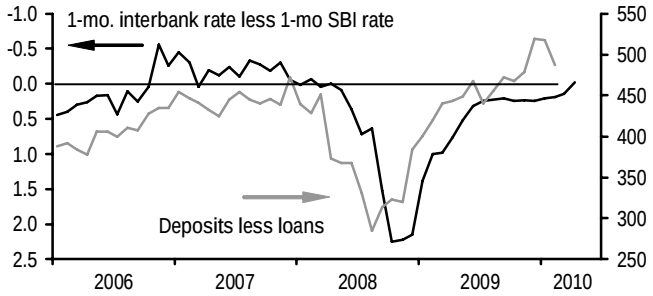
Indonesia: foreign ownership of Indonesian bonds by tenor

IDR tn, year to April 26



Indonesia: banking sector liquidity and interbank rates

%p.a., eop | IDR tn



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Indonesia:

Data releases and forecasts

Week of May 10 - 14

Mon May 10 12:00pm — Real GDP, % change

	2Q09	3Q09	4Q09	1Q10
Oya	4.1	4.2	5.4	6.2
Q/q saar	4.1	5.8	9.6	5.5

Review of past week's data

Merchandise trade (May 3)
US$ bn nsa

	Jan	Feb	Mar	
Trade balance	2.1	1.7	~~2.4~~	*1.6*
Exports (%oya)	59.3	~~57.1~~ *56.5*	~~52.8~~	*46.6*
Imports (%oya)	43.8	59.9	~~64.0~~	*68.6*

See main story.

Consumer prices (May 3)
% change

	Feb	Mar		Apr	
Oya	3.8	3.4		~~3.5~~	*3.9*
M/m sa	0.4	~~0.2~~	*0.3*	~~0.2~~	*0.7*
Food	4.8	4.1		—	*5.9*
Nonfood	3.5	3.2		—	*3.4*

See main story.

BI monetary policy meeting (May 5)
% p.a.

	Mar	Apr	May
BI rate	6.50	6.50	*6.50*

As expected, Bank Indonesia kept its policy rate on hold at 6.5%. The tone of the accompanying policy statement repeated the message from previous meetings, which is that growth remains positive and recent data have come in stronger than expected. What was somewhat different about this RDG report compared to those in previous months was the short discussion on inflation and its outlook in 2H10. In the previous RDG releases, the statements suggested that the outlook for inflation in 1H10 would continue to be modest and that inflation for 2010 remained comfortably in the range of 4%-6%%oya. However, this most recent release has a relatively short section on April inflation, commenting that core inflation has been modest, with hardly any discussion on the outlook for the rest of 2010. This is unusual, and it is not clear at this point whether or not the omission reflects a deliberate change in tone.

Malaysia:

Data releases and forecasts

Week of May 10 - 14

Tue May 11 12:00pm — Industrial production, %oya

	Dec	Jan	Feb	Mar
Total	7.5	13.8	5.0	7.5
%m/m sa	1.3	2.9	-2.2	0.2

Production likely recovered in March following weakness in February.

Thu May 13 6:00pm — Bank Negara Policy Statement

	Feb	Mar	Apr	May
% p.a.	2.00	2.25	2.25	2.50

While the macro data argue for the BNM to continue its normalization approach, the recent weakness in market sentiment may provide for a pause before resuming. As a result, this has become a close call.

Fri May 14 6:00pm — Real GDP, %

	2Q09	3Q09	4Q09	1Q10
Oya	-3.9	-1.2	4.5	10.4
Q/q saar	11.1	10.4	15.4	5.0

There is likely to be upside risk to the GDP report given the strength of the recent data.

Review of past week's data

Merchandise trade (May 4)
US$ bn nsa

	Jan	Feb	Mar	
Trade balance	3.8	3.4	~~3.9~~	*4.9*
Exports	15.5	13.7	~~17.0~~	*17.9*
%oya	44.8	26.1	~~43.2~~	*50.9*
Imports	11.7	10.3	~~13.0~~	*13.6*
%oya	38.5	36.2	~~54.5~~	*60.7*

March exports surged, rising 6.3%m/m sa in USD terms, leaving export growth up 50.9%oya (J.P. Morgan: 43.2%; consensus: 35.4%). Sequential trend growth maintained its recent pace, up 54.8%3m/3m saar from 70.4% in February. Export growth started off the year on a strong note and maintained its strength at the end of 1Q10. In terms of export details, electronics were up 38.7%3m/3m saar, moderating from the 49% sequential trend pace in February, while nonelectronics exports maintained their momentum, rising 67.1%3m/3m saar from 88% in February. Imports rose 5.3%m/m sa in USD terms, leaving import growth about as expected at 60.7%oya (J.P. Morgan: 54.5%; consensus: 45.9%). Imports rose to 31.8%3m/3m saar from 47% in February. In terms of the details, capital and intermediate goods slowed in trend sequential terms while consumer goods maintained their recent strength. The trade balance came in at a large US$4.87 billion, and is now close to its 2008 peak.

Philippines:

Data releases and forecasts

Week of May 10 - 14

Wed May 12 9:00am	Merchandise trade US$ bn nsa	Dec	Jan	Feb	Mar
	Exports	3.3	3.6	3.6	4.3
	%oya	24.2	42.5	42.3	46.8

Review of past week's data

Consumer prices (May 5)
%oya

	Feb	Mar	Apr	
All items	4.2	4.4	~~4.6~~	*4.4*
%m/m sa	0.9	0.3	~~0.4~~	*0.2*

Philippine CPI inflation was marginally lower than expected (consensus: 4.5%oya). The moderate inflation reading was due primarily to food prices, which actually fell on the month again. However, core inflation (ex. food and energy), rose 0.3%m/m sa, and was up 3.9%oya from 3.8% in March. While %oya inflation was essentially stable in April, sequential trend inflation diverged. CPI inflation continued to moderate to 5.2%3m/3m saar from 5.6% in March and a peak of 9.4% in December, but core inflation firmed to 5.5% from 5.0% in March. This suggests that outside of the easing in food prices in recent months, other cost pressures are holding steady or even firming modestly. The 5.5% sequential trend core inflation rate is the highest since the end of 2008. BSP Governor Tetangco stated that today's inflation report bodes well for the BSP's full-year target (which is 3.5% to 5.5%) and that policy is still appropriate. The next MPC meeting is June 3, just one day before the May CPI release, which we expect to rise to almost 5%. The Governor did temper his more dovish statements about policy appropriateness by also noting that the BSP will be watchful to ensure that CPI remains within the target path. We note that April's subdued inflation print does increase the risk that the BSP will hold firm in June, but with the trajectory clearly heading higher on a %oya basis and pressures outside of food and energy rising this month, we maintain our call for the BSP to hike its policy rate 25bp at the next meeting.

Singapore:

Data releases and forecast

Week of May 10 - 14

Fri May 14 1:00pm	Retail sales % change	Dec	Jan	Feb	Mar
	Oya	-5.0	2.6	4.7	2.3
	M/m sa	-0.7	5.3	-5.5	2.5

Review of past week's data

Purchasing managers index (May 4)
Level

	Feb	Mar	Apr	
PMI	51.9	51.1	~~52.0~~	*51.9*
PMI—electronics	53.0	53.4	~~53.5~~	*51.8*

The PMI rose 0.8pt in April to 51.9, essentially reversing an equal-sized fall in the previous month. The electronics index, however, fell notably to 51.8 in April from 53.4 in March. Despite the mixed headline numbers, the details for each index were more positive. New orders, new export orders, and employment rose while inventories, production, and imports were the main reasons for the softer headline numbers. New orders and new export orders rose in each index to robust levels. In the overall PMI, new orders now stand at 53.7, and new export orders stand at 54.8. In the electronics index, they stand even higher at 55.2 and 56.7, respectively. Employment also continued to rise, and this component is now in expansionary territory in each index for the first time this year. On a less positive note, production was mixed, but this may reflect a drawdown in inventories. Leaner inventories can be positive for future production, but use of inventories to meet orders currently (perhaps because they rose too high in previous months) is a drag on production. Singapore is one of the places in EM Asia (perhaps the only) where inventories appear high relative to orders.

Thailand:

Data releases and forecasts

Week of May 10 - 14

No data releases.

Review of past week's data

Consumer prices (May 3)
% change

	Feb		Mar		Apr	
Oya	3.7		3.4		~~3.8~~	*2.9*
M/m sa	~~0.7~~	*0.8*	~~-0.6~~	*-0.9*	~~0.2~~	*-0.3*

The CPI fell 0.3%m/m sa and was up 2.9%oya (consensus: 3.2%oya). In sequential trend terms, inflation was 2.7%3m/3m saar down from 6.1% in March. The core CPI rose 0.1%m/m sa and was up 1.3%3m/3m saar. In the details, the moderation in headline inflation owed to the declines in food and energy prices, which fell 0.5%m/m sa and 2.2%m/m sa, respectively. Moreover, rice prices have continued to decline, with end-April prices for Thai white rice declining to US$481/metric tonne from over US$600/MT around the turn of the year. Thus, food price inflation should likewise remain muted, especially if transport costs continue to hold steady. Aside from inflation, which has been relatively well behaved, the continuing political crisis is expected to take its toll on domestic demand and likely will be a drag on growth. However, recent events suggest that the crisis may soon be resolved, and this raises the probability that the central bank could start its rate hike cycle on June 2.

Vietnam:

Data releases and forecasts

Week of May 10 - 14

No data releases.

Review of past week's data

No data released.

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Asia focus: FX reserves hitting new highs

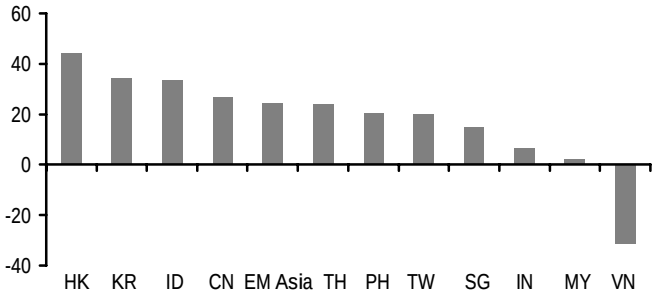
After falling modestly at the height of the global recession, FX reserve levels have rebounded strongly. Indeed, since bottoming at US$3.3 trillion in February 2009, FX reserves in EM Asia have grown roughly 25% to US$4.2 trillion (chart and table below). If Japan is included, regional reserves now stand at US$5.2 billion.

While central bank reserve accumulation has been impressive over the past year, it has slowed in recent months (first chart on right). Since December, the average monthly rise in EM Asia reserves has been about US$18 billion compared to US$86 billion in the previous nine months. The slowdown likely reflects several factors, including greater currency flexibility, moderation in inflows to the region following the run-up last year, and currency revaluation effects.

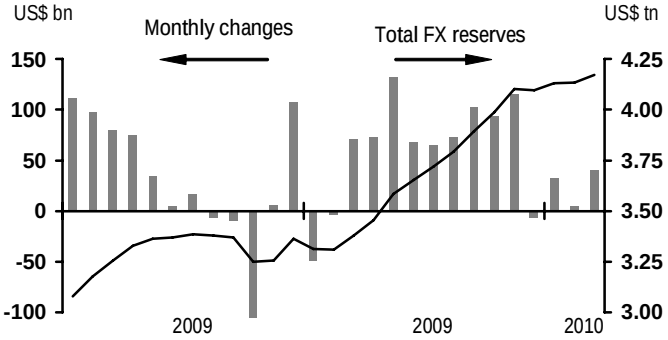
The slowdown in reserve accumulation is not a concern, in our view. EM Asian FX reserves now account for roughly 47% of global FX reserves, and if Japan is included, the regional total rises to about 60% (second chart below). Indeed, even though sovereign debt concerns are a major issue right now, particularly in Europe, FX reserves relative to external government debt in EM Asia continue to rise. FX reserves are now more than five times sovereign external debt in EM Asia, which is much higher than in other EM regions (table below). Even countries that have not experienced a rapid rise in reserves over the past year—mainly Malaysia and Vietnam—still have high FX reserve levels relative to external government debt.

EM Asia: FX reserve accumulation

% change between February 2009 and February 2010

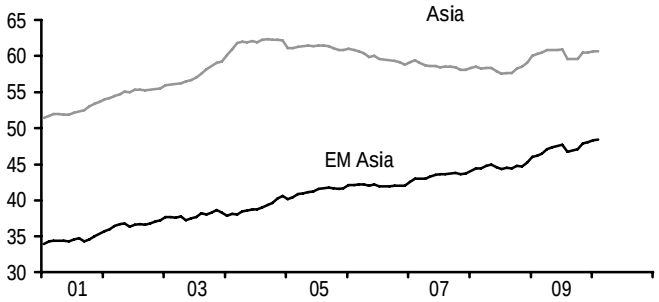


EM Asia: FX reserves



Emerging Asia: FX currency reserves

% of global FX currency reserves



Asia: official foreign exchange reserves

US$ bn, eop

	Nov 08	Dec 08	Jan 09	Feb 09	Mar 09	Apr 09
Asia	5177	5146	5166	5168	5200	na
Japan	1074	1049	1053	1051	1043	na
Emerging Asia	4103	4097	4113	4117	4157	na
China	2389	2399	2415	2425	2447	na
Hong Kong	256	245	247	248	251	na
India	288	283	281	278	278	na
Indonesia	66	66	70	70	72	na
Korea	271	270	274	271	272	279
Malaysia	97	98	98	98	95	na
Philippines	44	44	46	46	46	na
Singapore	189	188	190	188	196	na
Taiwan	347	348	351	353	355	na
Thailand	140	138	142	142	144	na
Vietnam	17	17	na	na	na	na

EM Asia: ratio of FX reserves to sovereign external debt

%	2004	2005	2006	2007	2008	2009E
Latin America	44	63	84	117	129	113
EM Europe	79	119	172	229	223	221
Emerging Asia	482	571	697	877	942	1038
China	1816	2481	3104	4381	5846	6510
Hong Kong	7660	7768	7749	8483	10541	17409
India	251	265	325	442	403	363
Indonesia	49	47	56	71	58	66
Korea	1916	2485	2325	826	952	971
Malaysia	242	291	381	531	342	357
Philippines	46	56	68	97	102	114
Taiwan	4835	1816	2509	7810	19344	23090
Thailand	322	358	458	699	827	874
Vietnam	57	73	98	143	128	80

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US economic calendar

Monday	Tuesday	Wednesday	Thursday	Friday
10 May Minneapolis Fed President Kocherlakota speaks in Minneapolis (1:00pm).	11 May NFIB survey (7:30am) Apr Wholesale trade (10:00am) Mar JOLTS (10:00am) Mar Auction 3-year note $38 bn Richmond Fed President Lacker speaks in Greensboro, NC (8:30am) 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 -$40.5 bn Federal budget (2:00pm) Apr -$85 bn 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) St Louis Fed President Bullard speaks in Nashville (1:15pm)	13 May Initial claims (8:30am) w/e prior Sat 440,000 Import prices (8:30am) Apr 0.6% Auction 30-year bond $16 bn Fed Vice-Chairman Kohn speaks in Ottawa (9:00am) Fed Chairman Bernanke speaks in Philadelphia (12:30pm) Minn Fed President Kocherlakota speaks in Wisconsin (1:00pm) & Dallas Fed President Fisher speaks in Odessa, TX (1:15pm)	14 May Retail sales (8:30am) Apr -0.1% Ex auto 0.2% Industrial production (9:15am) Apr 1.1% Manufacturing 1.5% Capacity utilization 73.8% Consumer sentiment (9:55am) May preliminary 73.0 Business inventories (10:00am) Mar 0.4% Chicago Fed President Evans speaks in Bloomington, IL (1:40pm)
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 Meeting of April 27-28, 2010 (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
24 May Existing home sales (10:00am) Apr	25 May S&P/Case-Shiller HPI (9:00am) Mar, 1Q Consumer confidence (10:00am) May FHFA HPI (10:00am) Mar, 1Q Richmond Fed survey (10:00am) May Auction 2-year note $42 bn St Louis Fed President Bullard speaks in London (11:15am) Fed Chairman Bernanke (8:30pm) and Philadelphia Fed President Plosser (10:00pm) speak at Bank of Japan Conference	26 May Durable goods (8:30am) Apr New home sales (10:00am) Apr Auction 5-year note $40 bn Chicago Fed President Evans speaks at Bank of Japan Conference (8:00pm)	27 May Initial claims (8:30am) w/e prior Sat Real GDP (8:30am) 1Q second KC Fed survey (10:00am) May Auction 7-year note $31 bn St Louis Fed President Bullard speaks in Stockholm (2:40pm)	28 May Personal income (8:30am) Apr Chicago PMI (9:45am) May Consumer sentiment (9:55am) May final
31 May Memorial Day Markets closed	1 Jun ISM manufacturing (10:00am) May Construction spending (10:00am) Apr Dallas Fed survey (10:30am) May	2 Jun ADP employment (8:15am) May Pending home sales (10:00am) Apr Light vehicle sales May	3 Jun Initial claims (8:30am) w/e prior Sat Productivity and costs (8:30am) 1Q revision ISM nonmanufacturing (10:00am) May Factory orders (10:00am) Apr Chain store sales May Announce 3-year note $36 bn Announce 10-year note (r) $20 bn Announce 30-year bond (r) $13 bn	4 Jun Employment (8:30am) May

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Euro area economic calendar

Monday	Tuesday	Wednesday	Thursday	Friday
10 May Germany: Foreign trade (8:00am) Mar 3.0%m/m, sa – Exports France: Industrial production (8:45am) Mar Italy: Industrial production (10:00am) Mar	11 May Germany: CPI final (8:00am) Apr 1.0%oya Netherlands: CPI (9:30am) Apr 1.2%oya	12 May Euro area: GDP flash (11:00am) 1Q 1.0%q/q,saar Industrial production (11:00am) Mar 1.7%m/m, sa ECB Convergence Report 2010 Germany: GDP flash (8:00am) 1Q 0.5%q/q,saar France: GDP prelim (8:45am) 1Q 1.2%q/q,saar CPI (8:45am) Apr 1.8%oya, nsa Italy: GDP flash (10:00am) 1Q 2.0%q/q,saar Spain: GDP flash (9:00am) 1Q 0.5%q/q,saar Netherlands: GDP prelim (9:30am) 1Q Industrial production (9:30am) Mar	13 May Euro area: ECB monthly bulletin (10:00am) May ECB member José Manuel González-Páramo speaks in Valencia , Spain (1:15pm)	14 May Italy: CPI final (10:00am) Apr 1.5%oya, nsa Spain: CPI final (9:00am) Apr 1.5%oya, nsa
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 France: Employment prelim (8:45am) 1Q 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 PMI flash (10:00am) May Mfg, services, composite Germany: GDP final (8:00am) 1Q PMI flash (9:30am) May Mfg, services, composite IFO bus. survey (10:00am) Mar France: PMI flash(9:00am) Apr Mfg, services, composite Netherlands: CBS cons. conf. (9:30am) May
24 May Germany: Import prices (8:00am) Apr	25 May Euro area: Industrial new orders (11:00am) Mar Italy: ISAE cons. conf. (9:30am) May Netherlands: CBS bus. conf. (9:30am) May	26 May Germany: GfK cons. conf. (8:00am) Jun France: INSEE bus. conf. (8:45am) May Consumption of mfg goods (8:45am) Apr Belgium: BNB bus. conf. (3:00pm) May	27 May Germany: CPI 6 states and prelim (8:00am) May France: INSEE cons. conf. (8:45am) May Italy: ISAE bus. conf. (9:30am) May Contractual wages (10:00am)Apr	28 May Spain: HICP flash (9:00am) May Belgium: CPI (11:15am) May
31 May Euro area: M3 (10:00am) Apr EC business conf. (11:00am) May EC cons. conf. final (11:00am) May HICP flash (11:00am) May Germany: Retail sales (8:00am) Apr Italy: PPI (10:00am) Apr CPI prelim (11:00am) May	1 Jun Euro area: PMI Mfg final (10:00am) May Unemployment rate(11:00am) Apr Germany: PMI Mfg final (9:55am) May Employment (9:55am) Apr Unemployment (9:55am) May France: PPI (8:45am) Apr Employment final (8:45am) 1Q PMI Mfg final (9:50am) May Italy: PMI Mfg (9:45am) May Spain: PMI Mfg (9:15am) May	2 Jun Euro area: PPI (11:00am) Apr	3 Jun Euro area: PMI services & composite final (10:00am) May Retail sales (11:00am) Apr Germany: PMI services & composite final (9:55am) May France: ILO unemployment (8:45am) 1Q PMI services & composite final (9:50am) May Italy: PMI services & composite (9:45am) May Spain: PMI services & composite (9:15am) May Netherlands: CPI (9:30am) May	4 Jun Euro area: GDP prelim (11:00am) 1Q

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

Japan economic calendar

Monday	Tuesday	Wednesday	Thursday	Friday
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 101.6, sa Auction 3-month bill	13 May M2 (8:50 am) Apr 2.4%oya Current account (8:50 a m) Mar 1890billion yen, nsa Economy watcher survey (2:00 pm) Apr 48.5, DI 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 Monetary Policy Meeting Auction 2-month bill Auction 20-year bond	21 May BoJ Monetary Policy Meeting and statement BoJ governor Shirakawa's press conference (3:30 pm)
During the week: Nationwide department store sales Apr				
24 May All sector activity index (1:30 pm) Mar BoJ monthly economic report (2:00 pm)	25 May	26 May Corporate service prices (8:50 am) Apr Shoko Chukin small business sentiment (2:00 pm) May Minutes of Apr 30 BoJ MPM (8:50 am) BoJ governor Shirakawa's opening address at the 2010 international conference held by BoJ Institute for Monetary and Economic Studies of BoJ (9:30am) Auction 3-month bill	27 May Trade balance (8:50 am) Apr Auction 2-year note	28 May Nationwide core CPI (8:30 am) Apr All household spending (8:30 am) Apr Unemployment rate (8:30 am) Apr Job offers to applicants ratio (8:30 am) Apr Total retail sales (8:50 am) Apr
31 May PMI manufacturing (8:15 am) May IP preliminary (8:50 am) Apr Nominal wages (10:30 am) Apr Housing starts (2:00 pm) Apr Construction orders (2:00 pm) Apr	1 Jun Auto registrations (2:00 pm) May Auction 10-year bond	2 Jun Monetary base (8:50 am) May Auction 3-month bill	3 Jun PMI services/ composite (8:15 am) May MoF corporate survey (8:50 am) 1Q	4 Jun Auction 6-month bill

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Canada economic calendar

Monday	Tuesday	Wednesday	Thursday	Friday
10 May Housing starts (8:15am) Apr 205,000 (2.0%)	11 May	12 May International trade (8:30am) Mar $1.6 bn New house price index (8:30am) Mar 0.3% (1.6%oya)	13 May BoC Deputy Governor Duguay speaks in Ottawa (2:00pm)	14 May Manufacturing sales (8:30am) Mar 2.4% New vehicle sales (8:30am) Mar -4.0% Existing home sales Apr BoC Deputy Governor Murray speaks in Ottawa (11:00am)
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
24 May Victoria Day Markets closed	25 May	26 May Payroll employment (8:30am) Mar	27 May	28 May Current account (8:30am) 1Q
31 May Quarterly GDP (8:30am) 1Q Monthly GDP (8:30am) Mar IPPI (8:30am) Apr	1 Jun BoC rate announcement (9:00am)	2 Jun	3 Jun	4 Jun Employment (7:00am) May Building permits (8:30am) Apr Ivey PMI (10:00am) May

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

Latin America economic calendar

Monday	Tuesday	Wednesday	Thursday	Friday
10 May Brazil: IGP-M 1st rel May FGV CPI IPC-S May 9 0.70%m/m, nsa Peru: Trade balance Mar	11 May Brazil: Fipe CPI May 7 0.42%m/m, nsa Mexico: Central bank reserves Auto report Apr Wage negotiations Apr 4.9%oya	12 May Argentina: CPI Apr WPI Apr Brazil: Retail sales Mar 1.6%m/m, sa Mexico: Fixed investment Feb -3.0%oya IP Mar 5.9%oya *ANTAD* same-store-sales Apr -1.3%oya	13 May Chile: BCCh meeting May no change Colombia: Trade balance Mar US$108mn	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 *Holiday: Venezuela*	18 May Brazil: Fipe CPI May15 Chile: GDP 1Q Current account 1Q Mexico: Central bank reserves	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 1Q	21 May Argentina: Trade balance Apr IP Apr Economic activity Mar Mexico: Retail sales Mar Banxico meeting *Holiday: Chile*
During the week: Argentina: Budget balance Apr Brazil: CAGED Formal Job Creation Apr Venezuela: GDP 1Q				
24 May Brazil: FGV CPI IPC-S May 23 Mexico: CPI May 1H Core May 1H Trade balance Apr *Holiday: Argentina, Ecuador*	25 May Brazil: Fipe CPI May 23 Current account Apr FDI Apr Mexico: Central bank reserves Current account balance 1Q10 Unemployment rate Apr Nominal GDP 1Q10 *Holiday: Argentina*	26 May	27 May Brazil: Unemployment rate Apr Primary budget balance Apr Net Debt % GDP Apr Colombia: BanRep meeting May	28 May Brazil: IGP-M May Chile: IP Apr Peru: GDP 1Q Mexico: Public sector balance Apr
31 May Chile: BCCh minutes Unemployment rate Apr Colombia: Unemployment rate Apr	1 Jun Brazil: IP Apr Trade balance May Mexico: Central bank reserves Banxico survey May Family remittances Apr Peru: CPI May WPI May	2 Jun Brazil: Fipe CPI May 30 Capacity utilization Apr	3 Jun Mexico: Consumer confidence May IMEF survey May Manufacturing Nonmanufacturing *Holiday: Brazil*	4 Jun Colombia: PPI May Ecuador: CPI May

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UK/Scandinavia/Switzerland economic calendar

Monday	Tuesday	Wednesday	Thursday	Friday
10 May United Kingdom: MPC rate announcement and Asset purchase target (12:00pm) No change expected Norway: CPI (10:00am) Apr 3.3%oya PPI (09:30am) Apr Switzerland: SNB's President Philipp Hildebrand & IMF's Strauss-Kahn speak in Zurich	11 May United Kingdom: BRC retail sales (12:01am) Apr 3.2 %oya (Total) RICS HPI (12:01am) Apr 3.0%bal, sa (Prices) IP (09:30am) Mar 0.1 %m/m,s a Sweden: CPI (09:30am) Apr 1.2%oya Capacity utilization (09:30am) 1Q AMV unemployment (10:00am) Apr Riksbank's Deputy Governor Karolina Ekholm speaks (03:00pm) Norway: Financial Stability Report 2010:1 (02:00pm) Switzerland: Consumer climate (07:45am) 1Q	12 May United Kingdom: Labor mkt report (09:30am) Mar Claimant count -25.0 k,ch,m/m,sa Average Earnings Mar 1.9%oya, 3mma, sa ILO Unemployment Rate Mar 8.0% sa Quoted mortgage int. rates (09:30am) Apr BoE quarterly inflation report (10:30am) Switzerland: Producer & import prices (09:15am) Apr	13 May United Kingdom: Nationwide cons. conf. (12:01am) Apr 72 Index, sa Trade balance (09:30am) Mar DCLG HPI (090:30am) Mar	14 May
17 May United Kingdom: Rightmove HPI (12:01am) May Switzerland: SNB's Philipp Hildebrand speaks (06:00pm)	18 May United Kingdom: CPI (09:30am) Apr CBI industrial trends (11:00am)May Norway: Trade balance (10:00am) Apr Norges bank's Svein Gjedrem's Hearing before the Standing Committee on Fin. and Ec. Affairs of the Storting (11:00am & 3:00pm) Sweden: House prices (09:30am) Apr	19 May United Kingdom: MPC minutes (09:30am) May	20 May United Kingdom: Retail sales (09:30am) Apr Norway: GDP (10:00am) 1Q 1.6%q/q, saar (Mainland) Switzerland: SNB's Thomas Jordon speaks (04:00pm)	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)
24 May	25 May United Kingdom: GDP Prelim (2nd release) (09:30am) 1Q Index of services (09:30am) Mar BBA lending (09:30am) Apr Sweden: Labor force survey (09:30am) Apr Norway: Sector accounts (10:00am) 1Q Switzerland: UBS cons. Indicator (08:00am) Apr	26 May Sweden: Trade balance (09:30am) Apr	27 May United Kingdom: CBI distributive trades (11:00am) May Sweden: PPI (09:30am) Apr Norway: Labor directorate unemployment (09:00am) May Switzerland: Employment (09:15am) 1Q	28 May United Kingdom: Gfk cons. Conf. (12:01am) May Sweden: GDP (09:30am) 1Q Retail sales (09:30am) Apr Norway: Mfg wage index (10:00am) 1Q AKU unemployment (10:00am) Mar Switzerland: Trade balance (8:15am) Apr KOF leading indicator (11:30am) May 2.05 Index, sa
During the week : United Kingdom: Nationwide HPI (08:00am) May				
31 May Sweden: Business tendency (09:15am) May Consumer conf. (09:15am) May Wage stats (09:30am) Mar Norway: Retail sales (10:00am) Apr Credit indicator (10:00am) Apr	1 Jun United Kingdom: PMI mfg (09:30am) May Sweden: PMI (08:30am) May Financial Stability Report 2010:1 (09:30am) Norway: PMI (09:00am) May NEF HPI (11:00am) May Switzerland: GDP (07:45am) 1Q 2.4%q/q, saar PMI (09:30am) May 65.5 %bal, sa	2 Jun United Kingdom: Net lending to individuals (09:30am) Apr M4 & M4 lending final (09:30am) Apr PMI construction (09:30am) May	3 Jun United Kingdom: PMI services (09:30am) May	4 Jun United Kingdom: New car regs. (09:00am) May
During the week : United Kingdom: Halifax HPI May				

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Emerging Europe/Middle East/Africa economic calendar

Monday	Tuesday	Wednesday	Thursday	Friday
10 May Czech Rep: CPI (9:00am) Apr 1.1%oya Hungary: Trade balance (9:00am) Mar €500mn Israel: Central bank minutes Turkey: Industrial production (10:00am) Mar 16.1%oya *Holiday Russia*	11 May Turkey: Current account (10:00am) Mar -US$4.1bn Hungary: CPI (9:00am) Apr 5.7%oya Romania: CPI (9:00am) Apr 4.1%oya	12 May Czech Rep: GDP (9:00am) 1Q 1.7%oya Hungary: GDP (9:00am) 1Q -1.2%oya Romania: GDP (9:00am) 1Q -1.5%oya South Africa: Manufacturing output (1:00pm) Mar 3.9%oya	13 May South Africa: MPC decision (3:00pm) No change	14 May Czech Rep: Central bank Minutes Israel: CPI (6:00pm) Apr 2.5%oya Poland: CPI (2:00pm) Apr 2.3%oya
During the week: Russia: GDP 1Q 6.3%oya				
17 May Czech Rep: PPI (9:00am) Apr Current account (10:00am) Mar CZK -1bn Poland: Current account (2:00pm) Mar -€885mn Romania: Current account Mar -€0.4bn Turkey: Unemployment (10:00am) Feb Consumer confidence (10:00am) Apr	18 May Hungary: Average gross wages (9:00am) Mar 1.5%oya Turkey: Monetary policy announcement no change Russia: PPI April 1.5%m/m IP April 5.5%oya	19 May Hungary: Central bank minutes Poland: Average gross wages 5.0%oya & employment -0.2%oya (2:00pm) Apr South Africa: Retail sales (11:30am) Mar 1.1%oya	20 May Poland: PPI (2:00pm) Apr -1.0%oya Industrial output (2:00pm) Apr 9.0%oya Core inflation (2:00pm) Apr 1.7%oya	21 May Poland: Retail sales (10:00am) Mar 4.5%oya
During the week:				
24 May Israel: Monetary policy announcement +25bp Turkey: Capacity utilization (10:00am) May	25 May Hungary: Retail sales (10:00am) Mar Poland: Monetary policy announcement No change South Africa: GDP (11:30am) 1Q	26 May South Africa: CPI (11:30am) Apr	27 May South Africa: PPI (11:30am) Apr	28 May
During the week: Czech Rep: General elections on 28-29 May				
31 May Hungary: PPI (9:00am) Apr Monetary policy announcement No change Poland: GDP (10:00am) 1Q Turkey: Foreign trade (10:00am) Apr South Africa: Credit & money (8:00am) Apr Trade balance (2:00pm) Apr	1 June Czech Rep: PMI (9:30am) Apr Hungary: PMI (9:00am) Apr Poland: PMI (9:00am) Apr Turkey: PMI (10:00am) Apr Russia: Manufacturing PMI Apr South Africa: Kagiso PMI (11:00am) Apr	2 June South Africa: Vehicle sales (11:00am) Apr	3 June Romania: Retail sales (10:00am) Apr Turkey: CPI (10:00am) Apr PPI (10:00am) Apr	4 June
During the week:				

Non-Japan Asia economic calendar

Monday	Tuesday	Wednesday	Thursday	Friday
10 May Australia: ANZ job ads (11:30 am) Apr China: Trade balance (12:00 pm) Apr 0.3 US$ bn Indonesia: GDP (12:00 pm) 1Q 6.2 %oya Korea: PPI (12:00 pm) Apr 3.5 %oya New Zealand: QVNZ house prices Apr *Holiday Philippines*	11 May Australia: NAB bus. Confidence (11: 30 am) Apr 13 % bal, sa China: CPI 10:00 am) Apr 2.8 %oya PPI(10:00 am) Apr 6.7 %oya FAI (10:00am) Apr 25.8 %oya Retail sales (10:00 am) Apr 18.0 %oya IP (10:00 am) Apr 18.5 %oya Korea: Money supply (9:00 am) Mar 9.0 %oya Malaysia: IP (12:00 pm) Mar 7.5 %oya	12 May Australia: Housing finance approvals (11:30 am) Mar India: IP Mar Korea: BoK monetary policy meeting (10:00 am) May no change Unemployment rate (9:00am) Apr 3.8 %, sa Philippines: Exports (9:00 am) Mar 4.3 US$ bn	13 May Australia: Unemployment rate (11: 30 am) Apr Malaysia: BNM monetary policy meeting (6:00 pm) May 25 bp hike New Zealand: Business NZ PMI (10:30 pm) Apr *Holiday Indonesia*	14 May Hong Kong: GDP (4:30 pm) 1Q 7.0 %oya India: WPI Apr Korea: Export price index (10:00 am) Apr -8.4 %oya Import price index (10:00 am) Apr 1.7 %oya SPPI Apr 4.3 %oya Malaysia: GDP (6:00 pm) 1Q 10.4 %oya New Zealand: Retail sales (10:45 am) Mar Singapore: Retail sales (1:00 pm) Mar 2.3 %oya
During the week: China: Money supply Apr 21.6 %oya 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: Philippines: Budget balance Apr				
24 May Australia: New motor vehicle sales (10: 30 am) Apr Singapore: CPI (1:00 pm) Apr Taiwan: Unemployment rate (4:00 pm) Apr Taiwan: IP (4:00 pm) Apr Thailand: GDP (9:30 am) 1Q	25 May	26 May Australia: Westpac leading index (10: 30 am) Mar Construction work done (10:30 am) 1Q Philippines: Imports (9.00 am) Mar Singapore: IP (1:00 pm) Apr Taiwan: Leading index (4:00 pm) Apr	27 May Australia: Private capital expenditure (10:30 am) 1Q Hong Kong: Trade balance (4:30 pm) Apr Korea: Current account (8:00 am) Apr Philippines: GDP (10:00am) 1Q New Zealand: Trade balance (10:45 am) Apr *Holiday India*	28 May New Zealand: Building permits (10:45 am) Apr Taiwan: GDP (5:00 pm)1Q *Holiday Indonesia, Malaysia, Singapore, Thailand*
During the week: Vietnam: CPI May Trade balance May				
31 May Australia: Pvt. Sector credit (11:30 am) Apr Current account balance (11:30 am) 1Q Company operating profits 1Q India: GDP 1Q Korea: IP (1:30 pm) Apr Leading index (1:30 pm) Apr Service sector activity (1:30 pm) Apr Thailand: Trade balance (2:30 pm) Apr IP (2:30 pm) Apr PCI (2:30 pm) Apr PII (2:30 pm) Apr	1 Jun Australia: Building approvals (11:30 am) Apr Retail sales (11:30am) Apr RBA cash target (3:30 pm) Jun Hong Kong: Retail sales (4:30 pm) Apr India: PMI Apr Korea: CPI (1:30 pm) May Trade balance (10:00 am) May Indonesia: CPI (2:00 pm) May Trade balance (2:00 pm) Apr Thailand: CPI (2:00 pm) May	2 Jun Australia: GDP (11:30 am) 1Q New Zealand: ANZ commodity price (2:00 pm) May Singapore: PMI (9:30 pm) May Thailand: BoT monetary policy meeting (2:30 pm) Jun	3 Jun Australia: Trade balance (11:30 am) Apr Philippines: CPI (9:00 am) May BSP Monetary policy meeting (5:00 pm) Jun *Holiday Korea*	4 Jun Indonesia: BI rate announcement (1:00 pm) Jun Korea: GDP (9:00 am) 1Q F Malaysia: Trade balance (6:00 pm) Apr Philippines: CPI (9:00 am) May
During the week:				

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

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Global Data Diary

Week / Weekend	Monday	Tuesday	Wednesday	Thursday	Friday
10 - 14 May	**10 May**	**11 May**	**12 May**	**13 May**	**14 May**
China • Money supply (Apr) Japan • Cabinet Office private consumption index (Mar) Russia • GDP (1Q)	France • IP (Mar) Germany • Foreign trade (Mar) Indonesia • GDP (1Q) Italy • IP (Mar) Japan • BoJ MPM minutes (Apr) Turkey • IP (Mar) United Kingdom • MPC mtg: No chg	China • CPI, FAI, retail sales, IP (Apr) Germany • CPI final (Apr) United Kingdom • Retail sales (Apr) • IP (Mar) United States • JOLTS (Mar)	Brazil: Retail sales (Mar) Euro area • IP (Mar)) India: IP (Mar) Korea: BoK mtg: No Chg Mexico: IP (Mar) United Kingdom • Labor mkt rpt (Mar) • BoE qtrly inflation rpt United States • International trade (Mar) • Federal budget (Apr) GDP: • Euro area, France, Germany, Italy, Spain (1Q)	Chile • BCCh mtg: No chg Japan • Econ Watcher surv (Apr) Malaysia • BNM mtg: +25bp South Africa • MPC mtg: No chg United Kingdom • Trade balance (Mar) United States • Bernanke speech	Hong Kong • GDP (1Q) United States • Retail sales (Apr) • IP (Apr) • Consumer sent (May) • Bus inventories (Mar)
17 - 21 May	**17 May**	**18 May**	**19 May**	**20 May**	**21 May**
Venezuela • GDP (1Q)	United States • Empire State surv (May) • NAHB surv (May)	Euro area • HICP final (Apr) • Foreign trade (Mar) Germany • ZEW bus surv (May) Japan • Reuters Tankan (May) Turkey • CBRT mtg: No chg United Kindgom • CPI (Apr) United States • Housing starts (Apr)	Spain • GDP final (1Q) United States • CPI (Apr)	Japan • GDP 1st est (1Q) • BoJ MPM mtg Mexico • Real GDP (1Q) Norway • GDP (1Q) Poland • IP (Apr) United Kingdom • Retail sales (Apr) United States • Philly Fed surv (May)	Argentina: IP (Apr) Canada • Retail sales (Mar) Euro area • PMI flash (May) Germany • GDP final (1Q) • PMI flash (May) • IFO bus surv (Mar) Japan • BoJ MPM mtg: No chg • Shirakawa prss conf Mexico • Banxico mtg: No chg