J.P.Morgan

Economic Research
May 14, 2010

Global Data Watch

- **Dramatic policy actions in Europe are expected to contain sovereign crisis and limit spillover to European and global economies**
- **Revised Euro area forecast anticipates moderately slower growth and no ECB tightening through 2011**
- **Strong April activity data reaffirm China policy call for initial moves on FX and policy rates by midyear**

From liquidity crisis to existential angst

This week delivered important constructive news on the policy front across Europe as actions were taken to stem the broadening crisis surrounding sovereign debt. Most notable was the establishment of a European Stabilization Mechanism (ESM), which represents a move by EU governments toward sharing the credit risk of countries being asked to implement large fiscal consolidations. As part of this plan, tightening packages on the periphery were increased and a commitment was made to shore up the discipline of the Growth and Stability Pact. For its part, the ECB agreed to buy sovereign debt for the purpose of stabilizing markets. Across the channel, a UK coalition government was formed that proposed to deliver an emergency budget plan by the end of June.

Many details related to these initiatives are not yet available and there is implementation risk. However, we believe these risks are modest in an environment in which policymakers recognize the dire consequences of a failure to act (see "The European Stabilization Mechanism," J.P. Morgan European Rates Strategy Research, May 14, 2010). As such, there are three conclusions that should be drawn from this news regarding the path that Europe is set to follow.

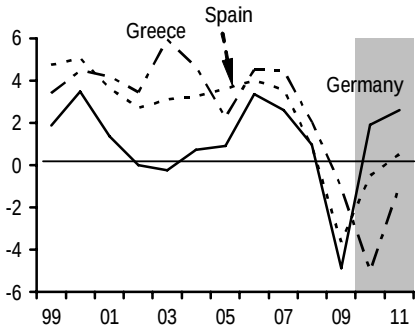
• Euro area sovereigns will have access to financing through 2012, as long as they remain on their fiscal austerity paths. Combined with the steps taken by the ECB, the building liquidity crisis facing sovereigns and the spillover to banks exposed to their debt should be successfully contained.

• Relative performance gaps will get larger. Our macroeconomic forecast already incorporates a widening gap within Europe (Germany versus the periphery) and the underperformance of Europe versus the rest of the world. Forecast revisions this week represent a widening in both of these gaps.

• Rates will remain lower for longer at the ECB and Bank of England. The combination of an even more moderate economic recovery and extremely low

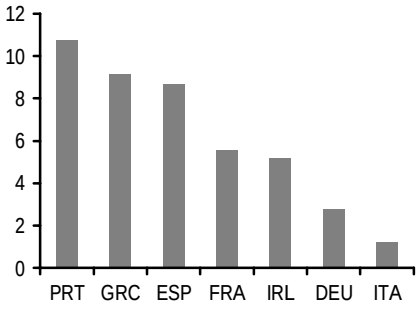
Euro area GDP

%ch from prev year



Change in primary net lending, 2009 to 2013

% of GDP; J.P. Morgan forecast



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Global financial indicators

	2Q07	4Q08	March	April	Current
TED spread (3 month, %pt)	0.6	2.4	0.1	0.2	0.3
10Y US Treasury yield (%)	4.8	3.3	3.7	3.8	3.6
Conform FRM rate (%)	6.0	5.9	5.1	5.2	5.0
US inv grade yield (%)	5.9	7.9	5.1	5.0	5.0
Euro area inv grade yield (%)	4.8	6.4	3.5	3.5	3.4
US HY yield (%)	8.0	18.4	8.9	8.5	8.8
EM corp yield (%)	6.6	12.3	6.4	6.3	6.2
Global equities (index)	128	75	96	99	95
Oil WTI ($/bbl)	65	59	81	85	74
USD broad TWI (index)	102	106	99	99	101

core inflation suggests the ECB will wait even longer to begin to normalize policy. Indeed, next week's reports are expected to show that core inflation fell to 0.8%oya in April. Against this projected economic backdrop, we now think the ECB will leave policy rates on hold through 2011. In addition, we now expect the BoE to delay the onset of its tightening cycle until early next year.

There are two questions that remain unanswered. At this stage it is hard to judge the impact of European developments on the rest of the world. Slower European growth and a falling euro will have negative direct effects on goods producers across the Americas and Asia. In addition, global equity prices have weakened, although the move has not been overly large and has been mitigated by a fall in interest rates and energy prices. It remains to be seen whether subsequent market developments, and a possible erosion in confidence, will adversely affect household and business behavior. For now, we are leaving growth forecasts unchanged outside of Europe, while recognizing that the risks no longer are skewed strongly to the upside.

Finally, it is difficult to answer at this time the question of where Europe is heading as a political unit. In recent days, regional governments moved in a decisive and comprehensive fashion under the pressure of market instability. They took an important step in the direction of regional integration with the formation of the ESM. Recognizing that Euro area financial markets are integrated and are vulnerable to a crisis in the weakest link, leaders agreed to share responsibility for sovereign credit risk. But the price they have extracted for this sharing—forcing even more pain of consolidation to be concentrated at the periphery—may not deliver a path to sustainable public finances. What is more, Germany is being asked to shoulder additional costs and is watching the ECB take steps that it did not bargain for as part of EMU.

Trimming the Euro area growth forecast

Over the past few weeks, we have struggled to calibrate the net effect of two huge forces at work in the Euro area: the powerful cyclical lift as exports, inventory, and capital spending bounce back from depressed levels versus the increasing contagion of sovereign stress that was prompting further fiscal tightening, driving down asset prices, and adding to bank funding pressures. For the most part, we had thought that the net effect of these crosscurrents would be to leave our forecast intact—an expansion that was moving forward but not at a particularly strong pace relative to the depth of the recession. Toward the end of last week, however, we became worried that the buildup of financial market and banking stress could escalate so much that the Euro area might be driven back into recession.

The dramatic policy announcements of last weekend appear sufficient to prevent a renewed financial crisis. However, the prospect of additional fiscal tightening, and at least somewhat more restrained behavior on the part of households, corporates, and banks, points to weaker growth in the southern rim of the Euro area than previously anticipated. But growth elsewhere in the region, especially in Germany, should be supported by the weaker currency. The net effect of all these developments is a modest downward revision to the entire Euro area growth trajectory, but a much bigger redistribution of growth within the region. We are now set up for a significant dispersion in growth performance, which is the opposite of what happened in the first decade of EMU's existence.

UK: new government, same problem

UK politicians have responded to the hung parliament produced in this month's election with an ambitious coalition that hopes to bridge diverging views on a number of key issues. The attempt to provide a stable government that allows accelerated deficit reduction to proceed is laudable. The hard work of identifying and implementing the spending reductions needed to bring the over 11% of GDP deficit back toward balance now begins, with an emergency budget due by midyear.

BoE Governor King argued this week that the possibility of an adverse judgment by markets on the UK's fiscal position was the key downside risk to growth. Hence a credible plan to reduce the deficit is urgently needed, and King welcomed the new government's intention to implement additional spending restraint beginning this year. Meanwhile, a sharp rise in March factory production and ongoing declines in the number receiving unemployment benefits sug-

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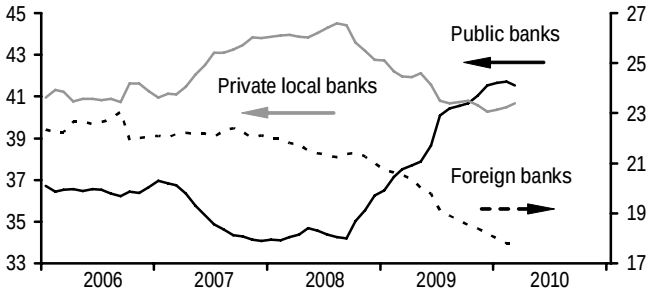
Brazil: share of banking market

% of total credit outstanding



gest a cyclical upturn is at hand. We share King's assessment that an upswing in private sector demand is likely to overwhelm the drag from fiscal policy and generate a strengthening recovery in the near term. However, the emphasis on fiscal consolidation in the UK and elsewhere will keep monetary policy makers sensitive to lingering downside risks to growth, and we have pushed the forecast for the beginning of a gradual tightening by the MPC back to early 2011.

Central Europe: longer delays joining euro

The Euro sovereign debt crisis is likely to slow the process of euro area enlargement. This week the European Commission backed Estonia's bid to join the Euro area. However, there may be further delays in the timing of Central Europe's euro adoption. Proposed changes to the interpretation of the Stability and Growth Pact, namely stricter application of the 60% of GDP public debt ceiling, would harm Hungary's euro aspirations. The country is expected to cut public debt gradually in the coming years, yet is unlikely to reach that limit until the end of the decade. Our view is that slightly higher debt levels alone would not be an obstacle to entry, but this could change.

Even more important is the declining enthusiasm for the single currency among Central Europeans. The flexibility of independent monetary policy has been beneficial to countries with a low level of FX borrowing like Poland and the Czech Republic. Surging bond yield spreads among Euro area sovereigns have undermined the belief that being in EMU would result in lower borrowing costs. Moreover, press accounts indicate that Slovakia, which joined the Euro area in 2009 well ahead of its regional peers, tends to look at its participation in the Greek rescue package as helping to subsidize a wealthier country.

Strong data reaffirm China policy call

China's April data releases were largely in line with our expectations that growth is moderating to a still-solid 9%-10% annual rate. With that said, two developments stood out. First, China's trade balance returned to surplus, consistent with our view that the March deficit was a temporary phenomenon and that the structural factors behind the trade surplus remain largely intact. Second, April CPI inflation was slightly higher than consensus expectations, but in line with our 2.8%oya forecast.

These data from China are supportive of our policy calls. In particular, our view remains that gradual CNY appreciation will resume in the coming weeks. As for an increase in China's policy rates, it is possible that inflation needs to breach the 3%oya hurdle before authorities will act. Even if this is true, there is a good chance this condition will be met with the May CPI report, which is why we believe the first rate hike will occur during the May/June period. Meanwhile, other tightening measures continue to be promulgated by central and local governments to curb credit growth, reduce liquidity, and slow the property market.

There were other central bank meetings this week that reinforced the message that EM Asia is willing to move ahead with policy normalization, albeit moderately. Malaysia hiked its policy rate again by 25bp to 2.50%. A more subtle signal was sent this week from the Bank of Korea. The MPC upgraded its assessment of the growth outlook and removed a phrase that pointed to no rate action in the foreseeable future. We maintain the view that the BoK's tightening cycle will begin as early as in July.

Baby step toward fiscal restraint in Brazil

This week's blowout March retail sales in Brazil added to signs that the economy is close to overheating. This risk is beginning to register with the government, which announced a modest R$10 billion (0.3% of GDP) cut in this year's budgeted discretionary expenditures. This measure will not prevent a significant expansion of government spending in 2010, nor was there any announcement of a plan to reverse the quasi-fiscal expansion through public banks, whose market share recently surpassed that of private banks. Nonetheless, it does constitute a first step toward a better policy mix that would ease the burden on monetary policy. Although we still think the odds of a 100bp rate hike in June are relatively high, action to rein in government spending supports our view that the central bank will move in 75bp installments in subsequent meetings.

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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	8.7 ↑	7.3 ↑	7.2 ↓	10.6 ↑	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	-2.8 ↓	7.1 ↑	4.2	10.0 ↑	10.0 ↑	4.3	4.0	3.8	4.2	4.3	1.9 ↑	2.4	2.3	1.9
India	7.2	8.3 ↑	8.5 ↑	-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	6.2 ↓	5.4 ↓	6.0	4.0	5.0	6.5	6.5	3.7 ↓	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	8.2 ↓	5.0	4.0	5.0	5.0	4.9	4.9	1.3 ↑	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	3.0 ↑	3.0 ↑	3.2 ↑
South Africa	-1.8	3.0	3.5	3.2	4.4 ↑	4.0 ↓	3.5 ↓	3.7 ↓	3.6	2.8	5.6	4.6	5.4	5.7
Europe														
Euro area	-4.0	1.3 ↓	1.9 ↓	0.2	0.8 ↓	3.0	2.0 ↓	1.8 ↓	1.8 ↓	1.8 ↓	1.1	1.5	1.5	0.9
Germany	-4.9	1.9 ↑	2.6 ↑	0.7 ↑	0.6 ↑	3.0	3.0 ↑	3.0 ↑	2.5 ↑	2.5 ↑	0.8	1.0	1.2	0.9
France	-2.5 ↓	1.7 ↓	2.1 ↓	2.2 ↓	0.5 ↓	3.0	2.0	2.0 ↓	2.0	2.0	1.5	1.8	1.3	0.6
Italy	-5.1	1.4 ↑	2.0 ↑	-0.2 ↑	2.1 ↑	2.5	1.5	2.0	2.0 ↑	2.0 ↑	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	3.0 ↓	1.8	0.8	3.0	3.0	3.5	2.5 ↓	3.0	3.3	2.9	1.9	1.5
Emerging Europe	-5.0	4.1	4.7	2.5 ↓	2.2 ↑	4.5	4.1 ↑	3.8	4.0 ↓	4.4	6.1 ↓	5.8	5.9	5.4
Bulgaria	-5.0	-1.5	4.5	…	…	…	…	…	…	…	…	…	…	…
Czech Republic	-4.2	2.0	4.0	3.0	0.7 ↓	3.0 ↑	2.5 ↑	2.0	3.0 ↓	4.0 ↓	0.7 ↑	1.3 ↑	2.8	2.8
Hungary	-6.3	0.8 ↑	4.0	0.8 ↑	3.6 ↑	2.0 ↓	2.0	1.5 ↓	3.5 ↓	4.0	6.0 ↓	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	1.0 ↓	4.0	…	…	…	…	…	…	…	4.6 ↓	4.4 ↓	4.7 ↑	4.5
Russia	-7.9	5.5	5.0	2.7 ↓	2.2 ↑	6.0	5.5	5.0	5.0	5.0	7.2 ↓	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	3.9 ↓	3.7	3.9	3.5 ↓	3.4 ↓	3.0 ↓	3.1	2.2	2.2	1.9	1.7
Developed markets	-3.4	2.6 ↓	2.6 ↓	3.2	2.7	3.3	3.1 ↓	2.9	2.3 ↓	2.3	1.5	1.4	1.1	1.0
Emerging markets	1.0	6.8 ↑	5.9 ↑	6.3 ↓	7.5 ↑	5.9	5.1	5.6	5.8	6.1 ↓	4.8	5.1	5.0	4.4
Memo:														
Global — PPP weighted	-0.8	4.7	4.4	4.6	5.2	4.8	4.4	4.4	4.1	4.1	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	1.3	1.9	0.2	0.8	3.0	2.0	1.8	1.8	1.8	1.8
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	0.2	-0.1	0.4	-0.1	0.7	-0.1	-0.1	-0.2	-0.2	-0.2
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	6.6	3.2	8.7	16.1	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	8.7	5.3	10.4	11.7	7.5	6.1	5.4	4.5	4.8	5.6
%oya				-2.8	8.3	9.8	8.9	7.6	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	1.44	1.51	1.59	1.80
excluding US	GDP-weighted average	1.88	-248				1.93	2.07	2.16	2.29	2.41
Developed	GDP-weighted average	0.52	-359				0.52	0.55	0.58	0.63	0.82
Emerging	GDP-weighted average	4.50	-236				4.67	5.00	5.22	5.46	5.69
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	4.09	-201				4.25	4.53	4.72	4.99	5.14
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	2Q 11 (+25bp)	4.50	4.50	4.50	4.50	4.75
Chile	Discount rate	0.50	-450	9 Jul 09 (-25bp)	15 Jun 10	15 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	1.32	1.34	1.42	1.53
Euro area	Refi rate	1.00	-300	7 May 09 (-25bp)	10 Jun 10	**On hold**	1.00	1.00	1.00	1.00	1.00
United Kingdom	Repo rate	0.50	-500	5 Mar 09 (-50bp)	10 Jun 10	**10 Feb 11 (+25bp)**	0.50	0.50	0.50	0.75	1.00
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)	22 Jul 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	**16 Dec 10 (+25bp)**	0.25	0.25	0.50	0.75	1.00
Turkey	Overnight borrowing rate	6.50	-1100	19 Nov 09 (-25bp)	18 May 10	17 Jun 10 (+50bp)	7.00	8.50	8.50	8.50	8.50
Asia/Pacific	GDP-weighted average	2.18	-126				2.25	2.41	2.51	2.66	2.74
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)	10 Jun 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	**1Q 11 (+25bp)**	6.50	6.50	6.50	6.75	7.00
India	Repo rate	5.25	-250	20 Apr 10 (+25bp)	27 Jul 10	2Q 10 (+25bp)	5.50	6.00	6.00	6.50	6.75
Malaysia	Overnight policy rate	2.50	-100	**13 May 10 (+25bp)**	8 Jul 10	**3Q 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	**14 July 10 (+25bp)**	1.25	1.50	1.75	2.00	2.25
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

Uncertainty still reigns

- **Asset allocation:** We are focused on a medium-term rebound in risky assets, accepting that the next month will be volatile.
- **Economics:** Consensus view on US and EM growth still rising, even as forecasts for Europe are starting to slide.
- **Fixed income:** A determined ECB backstop bid should support intra-EMU spreads.
- **Equities:** Focus on Industrials and IT across sectors. Banks remain hostage to regulatory and legal risks.
- **Credit:** Stay underweight European versus US corporates and underweight European senior bank bonds.
- **FX:** Near-term bearish EUR, even as we flatline EUR/USD forecasts at 1.25.
- **Commodities:** Stay long crude.

Last weekend's dramatic actions by European policymakers pushed risky markets up on Monday, but got little follow-through in the rest of the week, with markets lurching down again today. The new European stability plan is a daring attempt to stop the market attack on EMU in its tracks. **Markets remain unconvinced**, though, partly because many of the blanks of the plan still need to be filled in. But this is even more so because the plan may not be the real endgame and because it is changing some of the fundamental rules of the EMU game. As a result, **market uncertainty, which had been falling through the year, has risen again**. One measure of uncertainty—the dispersion of US growth forecasts—has indeed widened, though remaining well below the peaks of a year ago (first chart, next page).

One can proffer three **different paths** for risky assets over coming months. The first is down, in a repeat of the subprime/Lehman crisis of 2008. A second is volatile range trading as the bullish forces of growth and liquidity battle the bearish forces of uncertainty, back and forth to an eventual draw. The third is a clear victory of the bullish forces and a renewed rally, just as happened after the January/February correction. Our eyes are on the third—the rally—although we recognize that the rise in fundamental uncertainty that we are seeing could easily make us range trade for another one to two months in risky assets, as investors stay on the sidelines, waiting for the dust to settle. This would **delay the eventual rebound in risky assets, but we remain with our medium-term strategy of overweighting risky assets versus bonds**.

There is a solid case against the Euro sovereign crisis turning into a repeat of the subprime/Lehman debacle. Most importantly, the current crisis is not producing the massive destruction in wealth, nor the global run on the banking system that we saw in 2008. Real estate wealth has not fallen; global equities are unchanged year-to-date; and Euro government bonds are up on the year in aggregate, not down. Losses on high-yielding Euro government debt are offset by the gains in the core (second chart next page). Euro bank capital is intact. There are strains in the euro money markets, but the extra injection of ECB liquidity and continued ECB domination of this market mean that almost every bank can fund itself. Over the past month, **consensus has raised its 2010 global growth forecast, even as it fell for Europe** (second chart next page). Our own economists have trimmed their 2010 UK and Euro area forecasts this week, as the recent turmoil is bound to have a negative impact on spending.

The lack of real economic or financial contagion similar to the subprime/Lehman crisis does not mean that there are no other worrying aspects of the Euro sovereign crisis. Foremost is **political risk**. The Euro area likely cannot survive as it is: it either goes for deeper integration, with the creation of a stronger political and fiscal center, or it falls apart. Last weekend's dramatic measures show that Euro area leaders understand this and are choosing the integration path. But what if the Euro population rejects integration and replaces current leaders? A risk to be monitored closely.

What are the **long-term impacts of back-to-back crises**? Near-term uncertainty should not stop us trying to gauge the likely long-term impact of the crises that markets and economies have been going through. We mention just three here. First, risk perceptions and **risk premia** are unlikely to fall to past cycle lows. Second, confidence in the efficiency and rationality of free markets have been badly hurt: Expect a heavy-handed and multi-year move toward **increased regulation of the financial industry**, unwinding much of the deregulation of the 1980s and 1990s. This is not positive for financial equities. Third, the **erosion of the equity culture**, with many pension funds switching from equities to bonds after the two back-to-back crashes in equities in the past decade, is likely to be reconsidered, as investors rethink the safety of government debt. It could rekindle the equity culture, but is more likely to lead to a further surge into EM and real assets.

Fixed income

ECB bond buying, together with the announcement of a potential €720 billion of lending from the EU/IMF, brought

about a **dramatic rally in high-yielding Euro area government bonds** this week. The ECB likely bought around €20 billion in total, appearing to focus mainly on Greece, Ireland, and Portugal. This represents around 4% of these countries' outstanding debt, a strong signal of intent.

Private sector investors are likely to remain wary of Euro area high-yielders until deficits have been significantly reduced or the EU pledges fiscal transfers in addition to loans. Indeed, there was little sign of bond manager buying this week in the wake of the ECB's intervention, and spreads have widened somewhat today. Against this, **a determined backstop bid from the central bank can stabilize spreads**. And short-maturity bonds in particular are strongly underpinned by the sheer scale of funds available from the EU/IMF facility, which should—if approved—cover funding needs until the end of 2012 (see P. Wadhwa et al, *The European Stabilization Mechanism*). This is less true of long-dated bonds, meaning that the spread curve steepening seen this week can continue.

The ECB also signaled its determination to calm bank funding markets, reinstating term lending in unlimited quantities. This is likely to keep interbank rates relatively close to expected overnight rates, leading us to **take profit on money market spread wideners**.

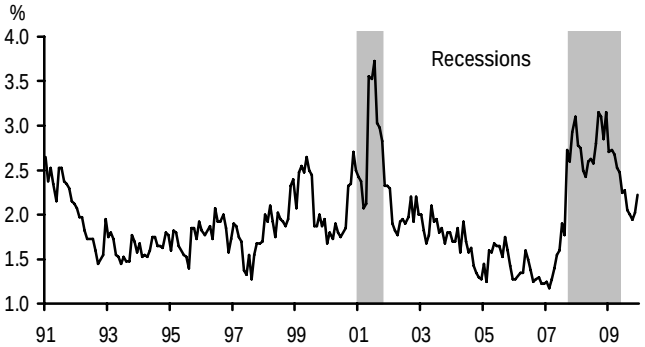
Core bond markets sold off sharply on Monday in response to the European policy actions, but have since reversed most of that move, mirroring the fall in equities. **We remain medium-term bearish**, as the strong rally over the past month has come despite solid economic data, and government supply remains heavy. This means that bond yields should move higher, as and when uncertainty about Euro area sovereigns dissipates.

Equities

Global equities rebounded sharply on Monday following the announcement of the European Stabilization Mechanism. **Half of Monday's rebound was reversed later in the week as sovereign fears resurfaced.** We had hoped that the announcement of the European Stabilization Mechanism would bolster equity investors' sentiment, but this proved short-lived. Uncertainty and volatility rose sharply with the VSTOXX (the Euro counterpart of the VIX index) rising by 1%-pt to 43% on Friday.

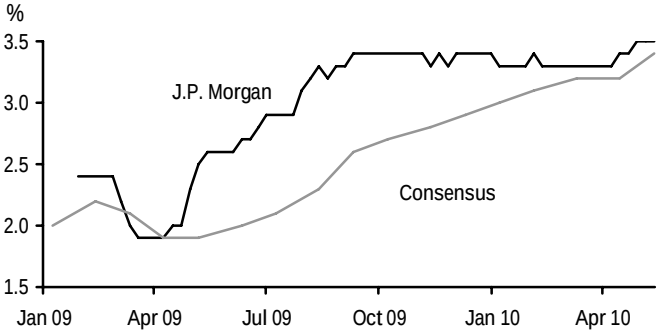
We recognize that sentiment will remain fragile and uncertainty high in the very near term, but believe that the European Stabilization Mechanism is preemptive, big, and credible enough to allow for a **gradual stabilization in equity markets and a decline in uncertainty in the medium term**. Once uncertainty starts falling again, equity investors will likely start refocusing on the very positive corporate fundamentals revealed by an impressive 1Q reporting season.

Economic uncertainty



Note: The average difference between the top and bottom 10 US growth forecasts over the next four quarters, out of just over 50 forecasts.

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



A reversal of the current equity correction in the medium term should allow Euro area equities to outperform, reasserting their higher beta. As we highlighted in our *JPMView Update* last Monday, May 10, **we reverse the MSCI EMU underweight to an overweight versus MSCI World** in our monthly *GMOS*. Positions are also favoring such a reversal as international investors have been underweighting European equities from the beginning of the year. But we retain the underweights of China, Brazil, and banks. **Banks remain hostage to regulatory and legal risks.** Across sectors, we prefer to **focus on Industrials and IT**, which continue to benefit from an impressive rebound in global manufacturing and a recovery in capex.

Credit

Credit markets rallied powerfully at the start of the week on the back of the massive rescue package in Europe. The cor-

porate bond market saw a 60% retracement of the sell-off last week, while CDS indices saw a 70% retracement.

We turned **overweight US HG** earlier in the week after the announcement of the European stabilization program. We continue to **underweight European versus US corporates** as the Euro area will remain under stress at least in the near term. With the recent rise in market volatility, there was little new issuance of European bank bonds relative to their large refinancing need. We **underweight European senior bank bonds** since they are threatened by any escalation of the sovereign debt crisis. The slow primary market is also leading to a buildup of potential supply that will hit the market when conditions stabilize, keeping pressure on European senior bank spreads.

EM assets also saw a good retracement this week, but we **stay neutral both EM external debt and EM dollar-denominated corporate bonds**. While systemic risks in Europe have been reduced, it will take time for risk appetite to recover. We continue to be medium-term bullish EM bonds given strong economic fundamentals in EM and maintain the view that EM will outperform developed markets and attract greater inflows over time.

Foreign exchange

We have revised down our forecasts for EUR/USD and flat-line the forecast at 1.25 for the next few quarters. The currency could easily trade through 1.20 if governments refuse to approve the European Stabilization Mechanism (ESM), or if the ECB appears to be extending its asset purchases beyond what seems reasonable to stabilize markets during the approval process. On a baseline assumption that the ESM will contain sovereign stress and the ECB exercise with debt monetization will prove brief, EUR/USD should stabilize around 1.25. The euro has much more downside next year since this week's events foreshadow a major policy divergence in which the Fed tightens while the ECB stays sidelined. Thus we target EUR/USD at 1.20 by end-2010 and 1.18 by spring 2011.

Commodities

Commodities finished the week lower despite the good early start. Industrial and precious metals were up 1% and 3%, respectively. All precious metals had a strong week, particularly silver and palladium. On the energy side, the main story has been the divergence between WTI and Brent as the spread continued to widen, with WTI weakening in spite of the rally in Brent crude. The spread between the two benchmarks is now above $4. WTI contango is also very steep near the front. The wild swings seen in WTI spreads yesterday are continuing today, with June/July above $4 contango this morning. Meanwhile, the Dec 10 contract is at the same level as last week.

We increased our **long position in WTI** early this week and feel comfortable holding this position longer, looking for a rapid move higher once the WTI market shows signs of rebalancing. The widening contango in Brent suggests that the rebalancing is under way, and global crude stocks are building. However, we expect higher demand and higher refinery throughput in the coming months to tighten the market rapidly.

Ten-year Government bond yields

	Current	Jun 10	Sep 10	Dec 10	Mar 11
United States	3.44	4.10	4.25	4.50	4.70
Euro area	2.86	2.85	3.05	3.15	3.25
United Kingdom	3.75	3.85	4.00	4.25	4.50
Japan	1.30	1.40	1.50	1.55	1.55
GBI-EM	6.89			7.90	

Credit markets

	Current	YTD Return
US high grade (bp over UST)	152	3.9%
Euro high grade (bp over Euro gov)	174	2.9%
USD high yield (bp vs. UST)	646	5.6%
Euro high yield (bp over Euro gov)	655	7.3%
EMBIG (bp vs. UST)	309	4.8%
EM Corporates (bp vs. UST)	312	5.0%

Foreign exchange

	Current	Jun 10	Sep 10	Dec 10	Mar 11
EUR/USD	1.24	1.25	1.25	1.20	1.18
USD/JPY	92.2	87	90	93	96
GBP/USD	1.46	1.44	1.39	1.35	1.34

Commodities - quarterly average

	Current	10Q2	10Q3	10Q4	11Q1
WTI ($/bbl)	71	86	94	93	90
Gold ($/oz)	1232	1150	1250	1200	1175
Copper($/m ton)	7127	8000	7150	6750	6500
Corn ($/Bu)	3.63	3.75	3.90	3.80	4.00

Source: J.P. Morgan, Bloomberg, Datastream

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

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Economic Research Note

US shift from pessimism gives a big lift to growth

- **First year of growth has brought an important behavioral shift away from business and household pessimism**
- **Adjustment from extremely low levels of activity has much further to run; risks of double-dip are vanishing**
- **Pattern of growth in the first year of recovery is not a useful guide to the extended expansion**

Between the end of 2007 and mid-2009 the US economy went through the steepest and longest economic downturn in more than 50 years. That downturn ended nearly a year ago, and economic output is set to pass its previous peak within the next couple of months.

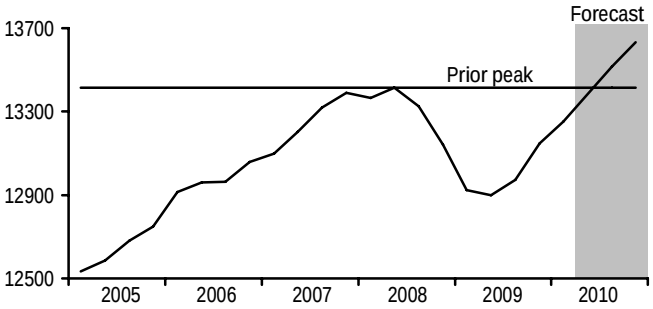
Incoming data over the past few months have gone a long way to alleviate concerns that the growth to date is merely a temporary response to fiscal stimulus and a turn in the inventory cycle. With the largest boost to the economy from inventories well behind us, the ISM manufacturing survey for April managed another increase, and to a level that approached 25-year highs. More important, the recent gains in private sector payrolls, up 174,000 in March and 231,000 in April, are providing assurance that the US has entered a more durable growth phase in which increases in spending and hiring are self-reinforcing.

These recent encouraging signs reflect a behavioral shift by business and households from a highly defensive posture through the recession toward a neutral posture now. This shift is broad and powerful, and it is more than offsetting the effects of fading support from fiscal policy. Importantly, this lift is still in its early stages as levels of most categories of cyclically sensitive spending are still at extreme lows. Despite the rapid growth in business spending on equipment and software since 4Q09, spending levels are still running below depreciation and the stock of equipment available for use is contracting. Similarly, despite increases in household purchases of cars and light trucks, unit sales are running well below the scrappage rate and the number of vehicles available for use is contracting. Household spending on nonauto durables, even scaled as a share of disposable income, is also still depressed.

The process by which business and households raise spending from extreme lows will provide substantial support for growth in the early stages of the expansion. As spending approaches more normal levels, the resulting increase in growth will depend on how powerfully the usual healing process generated by rising revenues and profits, rising employment and incomes, and improving financial markets leads to a further improvement in sentiment. Notwithstanding lingering concerns of a double-dip recession, there is no precedent for a reversal of this powerful healing process. However, history also shows that the pace of growth in the first phase of the recovery is not a good guide to the length and strength of the overall expansion.

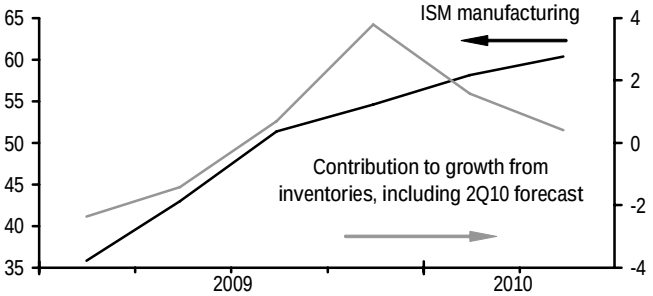
Real GDP

$2005 bn



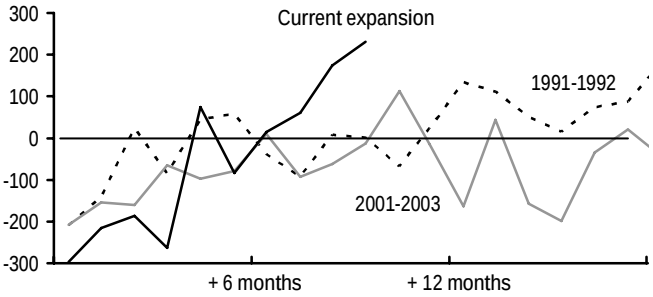
ISM manufacturing survey and inventories' contribution to growth

Sa, quarterly avg and April level %-pt contrib to annualized real GDP growth



Private payroll employment in the first 18 months of expansion

Ch '000s samr



Note: Chart assumes the current expansion began in July 2009.

From retrenchment to recovery

A year ago, the economy was still in deep recession. With

the memory of the worst of the credit crisis and associated economic downturn still fresh, business was intent on cutting spending to conserve cash. In 2Q09, the corporate sector was still liquidating inventories, cutting equipment spending, and reducing its use of labor.

Because of the enormous downside risks to financial markets and to the future revenue stream, the business response to the recession was extreme. Inventories were liquidated for seven consecutive quarters and the percentage decline in the year through 4Q09 was by far the largest in the history of quarterly accounts dating back to 1947. Spending on business equipment was cut back so steeply last year that outlays on new investment were less than depreciation. And, business also responded with deep labor cutbacks in both employment and the length of the workweek. These severe cutbacks had analogues in other parts of the economy as well, including consumer spending on durable goods.

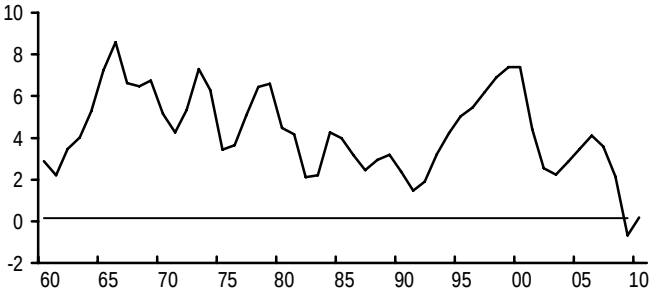
In the first stage of economic recovery, business shifts from cutbacks in spending and hiring to a neutral position, a shift that provides an early and important impetus to growth. The shift in inventories from deep inventory liquidation in 1H09 to more modest cutbacks in the second half directly added more than 2%-pts to annualized GDP growth, helping to bring an end to the recession. The benefits to growth from a move toward a more neutral position on inventories include a boost to revenues and labor income in manufacturing and a similar lift to other industries throughout the distribution channel. But with the turn to inventory growth in 1Q10, the help for the economy from inventories has largely played out. The forecast looks for the contribution to fade from an average 2%-pts over the past three quarters to an average 0.2%-pt over the rest of the year.

This does not mean that all the benefits from a shift from retrenchment are past. Deep cutbacks in spending on equipment and software led to outright declines in the real capital stock last year for the first time since the 1930s. With profit margins recovering and financing costs much lower, it seems likely that business would at least want to stabilize the size of their stocks of equipment. This by itself would ensure several more quarters of strong growth in spending on equipment and software, following the average 16.2% saar growth over the past two quarters.

Recent increases in household spending may also be viewed as simply the first step toward a neutral position rather than the beginning of genuine expansion. Auto market data for the year ended October 1 of last year show new car and light truck sales running about 5 million units below the number scrapped, and a decline in the stock of vehicles available for

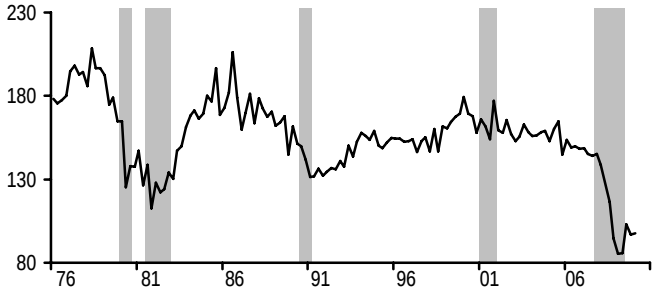
Growth rate of the real capital stock: private equipment and software

%ch, private nonresidential, with forecast for 2009 and 2010



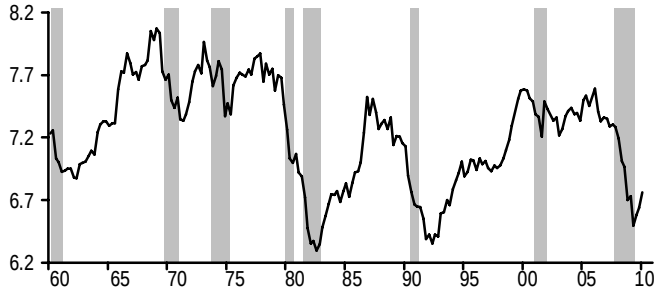
Unit sales of cars and light trucks, per thousand households

Saar



Spending on nonauto consumer durables

Percent of disposable income



use. Vehicle sales have increased from 10.3 million over that year to a pace of about 11.0 million. But sales would have to rise considerably more just to stabilize the stock of vehicles, much less return to the longer-term growth trend. Spending on other durables is also still severely depressed, even when scaled to disposable income.

Not much risk of a double-dip

Financial market jitters over the past couple of weeks, mainly reflecting shifting perceptions of contagion from Europe, have raised concerns about the durability of the expansion and the possibility of a double-dip into reces-

sion. Continued expansion is not inevitable, but it does seem very likely. For one thing, double-dips back into recession are very rare. Famously, the only expansion since 1960 that lasted less than three years was in the early 1980s, and that stumble was not the result of the internal dynamics of the economy. Then, Fed Chairman Volcker tightened monetary policy aggressively, reflecting concerns that inflation had not been wrung out of the system. The fed funds rate soared from 9.5% when the economy was emerging from recession in July 1980 to 20.0% in May 1981 just before the economy fell back into deep recession. There is no reason to think that the economy would have slipped back into recession if monetary policy had not been so restrictive.

The empirical scarcity of double-dips reflects the restorative power of economic expansion. At the bottoms of downturns, economies are very fragile. Profit margins are cyclically weak; equity prices are depressed; and household balance sheets look stressed. Unemployment rates are high, and consumer confidence is low. That is why it takes unusually low policy interest rates to lift the economy out of recession. But even the early stages of growth significantly reduce that fragility. As we have seen over the past year, the first year of recovery usually brings a substantial increase in profits, improvement in financial markets, and acceleration of final sales.

The shape of things to come

As both businesses and households turn from a contractionary stance during the recession toward a more neutral stance in the first year of growth and, presumably, a more expansionary stance soon, it is natural to attempt to anticipate the nature and extent of economic growth over the next several years. Will this expansion be unusually weak or unusually strong? Will it be short-lived or extended? And what will be its defining characteristics?

The simple answer is that it is hard to know. It is natural to want to extrapolate the experience in this first year of recovery into the indefinite future. Real GDP growth has averaged 3.7% annualized over the past three quarters. But this fact provides practically no guidance as to the strength or durability of this expansion. For example, the expansion of the 1980s started with a couple of years of explosive growth, but average growth after that was not much different from the norm, and that expansion was marked by a series of rolling recessions in agriculture, energy, and commercial real estate. The expansion of the mid- to late 1970s was unusually strong while it lasted, but did not prove very durable.

Moreover, the defining characteristics of an expansion are rarely visible in the early years. A year into the 1990s recovery, there was no basis for expecting a tech boom toward the end of the decade. A year into the 2000s recovery, banks were still tightening lending standards on home mortgage and other loans, and there were few signs that the latter stages of the expansion would be defined by an abandonment of lending standards and eventual credit crisis.

Characteristics of economic expansions
%ch saar, except as marked

Expansion	Real GDP first year	Real GDP next 2 years	Expansion length (yrs)	Ch in RU %-pt
1961-69	7.5	4.9	8 1/4	-1.7
1971-73	4.5	5.6	2 1/2	1.4
1975-79	6.2	3.7	4 1/2	0.9
1983-1990	7.7	4.9	7 1/4	-0.5
1991-2000	2.6	3.4	9 1/2	-1.3
2002-2007	1.9	3.4	5 1/2	0.5

Note: Change in unemployment rate is measured from trough in the unemployment rate in the previous expansion to the trough in the marked expansion.

Indeed, even perceptions of the current expansion have shifted significantly in just the past few months. When firms were slow to hire in the early months of the recovery, many observers became convinced that the US was set for yet another jobless recovery. But it seemed equally plausible that the severe job cuts in the recession and timid hiring early in the expansion would leave business lean, and that the combination of rising profits and tepid wage gains would leave business positioned to pursue more aggressive hiring. (See research notes “Jobless recoveries: what we know and what we don’t,” September 4, 2009, and “Essential growth says US recovery to generate jobs,” January 15, 2010.)

With the pace of private sector hiring picking up through April, and the improvement in hiring accompanied by an apparent acceleration in final sales this quarter, it is hard to see why private sector hiring shouldn’t improve from April’s 231,000 increase over the next several months. Hiring looks to be much stronger than in the jobless recoveries.

Possibly, a very durable expansion

Until recently, discussion of the economic outlook frequently tended to emphasize roadblocks to growth—tight credit standards, the likelihood of an increasing household saving rate, severe state and local government problems, and the imminent fading of fiscal stimulus. But over time, the expansion has started to look more durable. And, at least in some respects, there is reason to expect this expansion to prove unusually long-lasting.

In the latter stages of an expansion, the most common threats to continued growth no longer come from business and household caution or the economy's fragility. Instead, the risks stem from overheating and/or overconfidence on the part of lenders and borrowers.

Inflation problem: The eventual problem encountered by most extended expansions since World War II has been inflation. As the economy grows, the unemployment rate declines and utilization rates increase. A slack economy coming out of recession turns to a tight economy in the later stages, price pressures develop, and the Fed's eventual anti-inflation efforts send the economy into a downturn.

Animal spirits problem: Sometimes, as in the previous expansion, the environment of solid growth with low inflation may eventually breed extreme optimism in asset markets. This occurred in the form a high-tech dot-com bubble in the late 1990s and in the form of what is now viewed as extremely loose mortgage lending in the last decade.

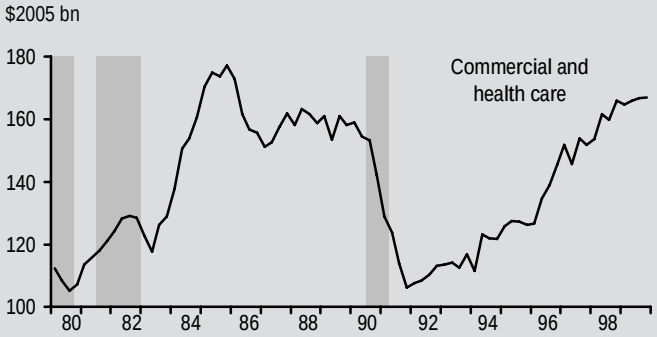
Both of these illnesses seem unlikely for at least the next several years. Inflation problems are usually associated with tight labor markets and high levels of capacity utilization. The extended and deep recession has left the US economy with a very high unemployment rate and a large pool of potential workers who have dropped out of the labor force. Absent a multi-year growth boom, unemployment rates will likely remain elevated for at least the next five years. Similarly, factory operating rates are historically low, and real estate vacancy rates are elevated. It seems unlikely that either measure of capacity will be stretched any time over the next several years. The run rate for core inflation has dropped below 1% over the past six months and, for the foreseeable future, inflation looks set to hold below the Fed's informal target.

Overexpansion of credit growth and over-easing of credit standards also seem unlikely. Economies usually learn, and sometimes overlearn, the lessons of the most recent recession (see box.). Thus, it seems very likely that both lenders and borrowers will remain relatively cautious regarding the amount of lending and credit standards during this expansion. Outstanding private sector debt continued to decline through the first two quarters of the expansion, the latest date for which official figures are available, and may still be contracting. And while the latest bank Senior Loan Officers Opinion Survey shows that banks are no longer tightening credit standards substantially, neither is there significant easing occurring.

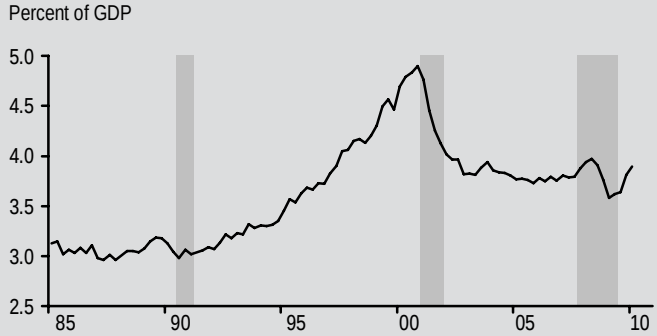
Learning the lessons of the last recession

People always seem to learn the lessons of the previous recession. Commercial real estate got overextended in the 1980s, and spending on commercial construction was unusually cautious in the following expanion. High-tech got overextended in the late 1990s, and business held back on high-tech spending in the following expansion. Following the credit boom last decade, we should expect tight lending standards, especially on mortgage loans, through this expansion.

Real business fixed investment, commercial construction, 1980-1999



Business spending on high-tech equipment and software



To be sure, different threats to the expansion could well appear over the next few years that might be associated with the exact opposite of prior threats—deflation rather than inflation or borrowing and lending that remain overly cautious rather than overly easy. But it is still far too early to tell just how things will play out.

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Economic Research Note

Central Europe: assessing the damage from EMU debt crisis

- **Central Europe to remain resilient to EMU periphery fiscal woes unless core Euro area slows significantly**
- **A weaker European recovery could delay Polish and Czech rate hikes unless their currencies fall sharply**
- **Risk of further delays to Central Europe's EMU entry timetable**

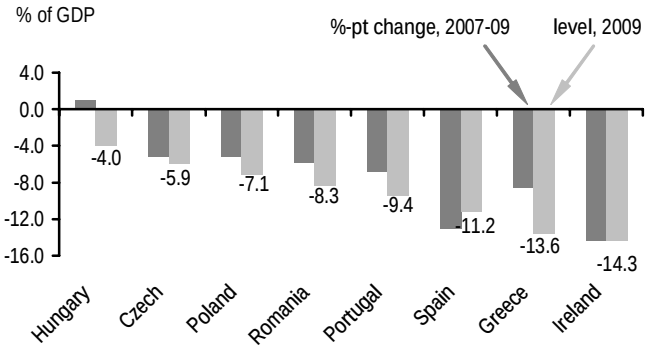
Central European (CE) countries have benefited from strong portfolio inflows this year, supported by ample liquidity and increasing optimism about a self-sustaining global recovery. Sentiment toward CE countries remained positive even as the Euro area sovereign debt crisis escalated. Only when market stresses intensified dramatically in the week prior to the May 9 announcement of large-scale policy interventions in the Euro area did contagion to CE financial markets become apparent. Nevertheless, most of the sell-off in CE assets already appears to have reversed.

We would ascribe at least part of this resilience to Central Europe's better fundamentals compared to the EMU peripherals and the fact that direct trade and banking links between the two groups are small. Yet, any setback to the cyclical recovery in core Euro area countries, due to either weaker bank lending or more widespread fiscal tightening, will weigh on CE growth. Lackluster growth could lead to further delays to the region's euro entry timetables. More broadly, a stricter interpretation of public debt criteria might make it more difficult for Hungary to adopt the euro, while the EMU periphery crisis has probably reduced incentives for Czech and Polish policymakers to enter.

Fiscal prudence helps shield CE

While Portugal, Ireland, Greece, and Spain loosened fiscal policy substantially over the past two years, stimulus has been negligible in Central Europe. Measured as the cumulative percentage-point change in cyclically adjusted primary balances, fiscal thrust in the EMU periphery amounted to an average 8% of GDP in 2008-09. By contrast, CE stimulus has averaged just 1%, albeit owing largely to Hungarian tightening. Similarly, Central Europe's average public debt-to-GDP ratio in 2009 was 30%-pts of GDP lower than that of the EMU periphery, with the difference expected to widen further in coming years. To be sure, the average masks large variation across countries: Hungary has the highest debt after Greece, but Romania's debt is less than half of Spain's.

General government deficits: CE vs. EMU periphery



Fiscal thrust and debt: CE vs. EMU periphery countries

Cumulative %-pt change in cyclically adjusted primary balance

Positive value = tightening

	Fiscal thrust		Public debt, % of GDP	
	2008-09	2010-11	2009	2011
Czech Rep.	-2.1	1.2	35.4	43.5
Hungary	4.8	-1.4	78.3	77.8
Poland	-3.8	1.7	51.0	59.3
Romania	-2.3	1.9	23.7	35.8
Portugal	-5.3	6.2	76.8	85.2
Ireland	-8.7	1.7	64.0	86.3
Greece	-6.1	11.4	115.1	147.8
Spain	-10.6	6.1	53.2	67.9

2010-11 figures are EC forecasts for Central Europe and J.P.Morgan estimates for Euro area countries. Euro area figures incorporate the fiscal tightening measures announced this week.

Direct links to EMU periphery are small

Direct trade, investment, and banking sector links between Central Europe and the EMU periphery countries are small. Exports to Greece, Spain, Portugal, and Ireland together account for less than 2% of CE-4 GDP on average. Poland and Romania would be least affected by weaker trade flows owing to their significantly lower degree of openness to trade; Poland's export-to-GDP ratio is roughly half that of Hungary or the Czech Republic. That said, second-round contagion channels can have a strong impact if they cause a slowdown in core Euro area countries, such as Germany and France, the key trading partners of Central Europe. That would choke off the ongoing recovery in the region, which thus far has been driven mostly by external demand. CE banks are owned predominantly by non-periphery Western European parents. This reduces the risk of stress to Central Europe's financial sector coming from a cut in existing credit lines or even a withdrawal of funds. Romania is the main exception, where Greek banks hold about 18% of banking sector assets.

Core Euro area growth dynamic is key

For now, the cyclical growth dynamic in the Euro area, mainly in Germany, is expected to dominate sovereign stress. Yet, risks of slower European growth have risen in

part because banks will be lending less to the private sector and because countries are likely to introduce additional fiscal austerity measures to prevent the increase of already wide budget deficits. Greece is expected to undertake double-digit fiscal tightening in coming years (table, previous page), and the latest announcements suggest that Portugal and Spain have also committed to substantial new consolidation measures. Although these will be offset by a looser fiscal stance in countries like Germany and the Netherlands this year, fiscal tightening will weigh on Euro area growth next year. If not for these risks, we would be inclined to slightly upgrade some of our growth forecasts for the region in light of strong incoming high-frequency data. Positively, after pursuing only modestly countercyclical fiscal policies during the recession, CE countries will need to tighten much less than their Euro periphery counterparts in 2010-11 (1%-pt versus 6%-pts of GDP, respectively), which should support domestic demand.

CE central banks might postpone hikes

The outlook for the Euro area has a nonlinear impact on CE-4 central bank reaction functions, in our view. A slower European 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, together with renewed financial market and banking stress, would hit investor sentiment toward CE and, in the extreme, might even call for higher interest rates to stabilize CE currencies. The sensitivity of the central banks to FX moves differs, depending mainly on the degree of foreign currency indebtedness. Indeed, while Romania's central bank eased less than expected last week due to currency weakness, the CNB unexpectedly cut rates fearing a weaker recovery.

Risk of further delays to EMU entry

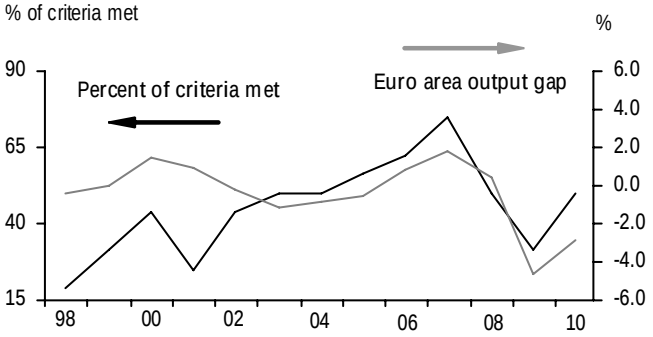
The Euro sovereign debt crisis might lead to further delays in the timing of Central Europe's euro adoption. First, Euro area governments have committed to reform of the Stability and Growth Pact. It is unlikely that the actual Maastricht criteria for euro adoption would be changed. Yet, some of the criteria, notably on debt, are open to interpretation. All else being equal, a stricter application of the 60% debt limit or new sanctions for noncompliance would be most negative for Hungary's euro aspirations; its debt-to-GDP, while expected to decline, is above the EU limit and unlikely to reach that limit until the end of the decade. Our base case remains that slightly higher debt levels alone would not be an obstacle to entry, but this could change. Second, recent comments suggest that there is waning enthusiasm for the single currency, not just from current members, but also among Central Europe's policymakers. Arguably, being outside the

Direct links with Europe: trade and banking
% of GDP

	Czech Rep.	Hungary	Poland	Romania
Goods exports to:				
Greece	0.2	0.4	0.2	0.4
Portugal	0.2	0.4	0.1	0.1
Spain	1.5	2.0	0.8	0.6
Ireland	0.2	0.5	0.1	0.1
Rest of European Union	52.4	48.0	22.0	12.3
Germany	20.7	18.5	8.1	4.0
Italy	3.2	3.8	1.9	3.8
Total exports[1]	69.5	77.8	38.9	31.2
Foreign claims of banking sector				
Greece	0.0	0.2	1.9	15.6
Portugal	0.0	0.4	3.5	0.4
Spain	0.3	1.1	1.1	0.2
Rest of Europe	85.2	84.6	45.4	44.8
Germany	7.7	19.6	10.4	8.3
Italy	5.8	23.9	13.3	2.4

1. Exports of goods and services from national accounts (2008).

Meeting EMU entry criteria easier for CE during Euro area upswing[1]



1.J.P. Morgan forecasts for 2010. Includes Slovakia. Excludes public debt criterion. Correlation rises to 94% in 2004-2010 from 38% for the entire period 1998-2010.

Euro area has been a net benefit to countries like the Czech Republic or Poland. They have reaped the benefits of EU membership via substantial structural and cohesion fund inflows, while enjoying the flexibility of an independent monetary policy. However, on balance, Hungary and Romania would probably have been better off inside the EMU.

All considered, the business cycle in Europe is still the most crucial driver of EMU entry timings (see "Window of opportunity for euro adoption in Central Europe," *GDW*, September 11, 2009). Our base case remains that the cyclical lift to CE economies will enable them to adopt the single currency around the middle of the decade, although we have pushed back our base case timings by one year to 2015-16. Yet, in a weaker growth environment, CE politicians would be reluctant to tighten fiscal policy. Finally, we note that the long-term investment thesis behind the convergence story for CE economies is primarily about catching up with Western Europe in income and price levels. Delays to euro adoption are unlikely to halt this catch-up process.

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Economic Research Note

Australia's budget back in black by 2012-13

- **Treasurer Wayne Swan this week delivered the "no frills" Budget he had promised**
- **The looming election means there were small sweeteners to entice voters, but no "spendathon"**
- **The Budget probably will be in surplus by 2012-13, three years earlier than previously forecast**

Australia's Treasurer Wayne Swan this week delivered his third budget, the last before the upcoming election. There were very few surprises relative to what government officials had hinted would be in it. In fact, most of the measures the Treasurer trumpeted already had been announced or hinted at in the Henry Tax review, released the week before last. In an otherwise "beige" Budget, the highlight was Swan's projection of a surplus by 2012-13, three years earlier than previously expected.

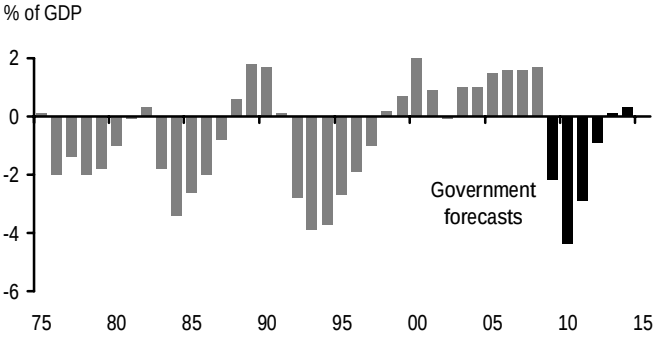
The early return to surplus reflects three main factors: first, higher taxes, via a new impost on "super profits" of mining companies and a rise in the excise tax on tobacco; second, maintenance of a 2% cap on growth in real spending until the budget returns to surplus; and third and most importantly of all, a substantially brighter outlook for the economy. Indeed, unexpected economic growth and substantially lower unemployment can do wonders to the fiscal bottom line.

No vote-buying "spendathon"... yet

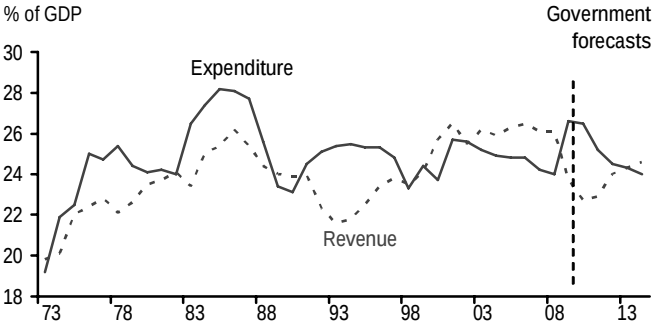
As the Treasurer had promised, the budget was indeed a "no frills" affair. It did, though, include personal tax relief (the tax cuts announced in 2007 were confirmed) and the promised benefits for small businesses and a lower company tax rate. Swan resisted the urge to launch a pre-election, vote-buying "spendathon." Instead, he reinforced the previously announced cap on spending in the near term. He did, however, promise increased spending in politically sensitive portfolios like health and hospitals, national security, and education. The imminent election means the government steered clear of politically sensitive measures like a rise in "vice" taxes on gambling and alcohol, and higher taxes on gasoline.

The Treasury forecasts a headline deficit for 2010-11that is A$5.8 billion lower than the earlier projection. The government's predicted deficits over the forecast horizon are up to A$20 billion lower than earlier Treasury estimates.

Commonwealth budget balance



Commonwealth government revenue and expenditure



The J.P. Morgan estimates look for better budget outcomes, including a deficit of "just" A$27 billion in 2010-11, nearly A$14 billion below the government's estimate. J.P. Morgan's projected budget balances in subsequent years are closer to those of the government.

The key risk from here, though, is that, with the latest opinion polls showing the government trailing the opposition party for the first time in four years, an increasingly desperate government could loosen the purse strings during the election campaign. This would undermine a thus far credible fiscal strategy. There is scope within the government's self-imposed 2% cap on real growth in spending for some pre-election largesse. For example, the budget predicts only a 0.9% rise in real spending in the next fiscal year, and a 0.6% fall in 2011-12. Boosting spending by too much, however, could make the RBA even more inclined to push the cash rate into restrictive territory.

Aside from setting the scene for the election ahead, the government's primary objective in this budget was to project an aura of fiscal responsibility; announcing an earlier return to surplus was critical here. Indeed, the government hopes that doing so will reinforce the considerable economic management credibility the government earned by appearing to steer Australia's economy through the global recession with minimal damage. The alternative, a spendthrift budget laden with pre-election goodies, would

have won stray votes, but undermined the government's perceived advantage as a better manager of the economy.

Main aggregates: lower deficit and debt

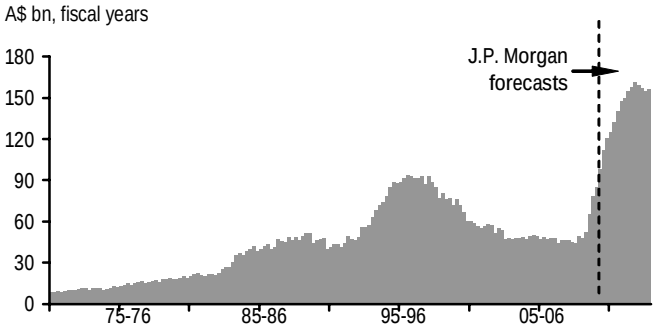
The good news for the government is that the unexpectedly robust economy means the Treasurer has been able to announce a significantly improved fiscal position relative to the forecasts published last November. Swan forecasts a headline budget deficit of A$40.8 billion (2.9% of GDP) for 2010-11, significantly below the government's previously published estimate of A$46.6 billion. He also announced substantially smaller budget imbalances over the forecast horizon, including, as we had expected, a return to a small surplus in 2012-13.

The Treasurer has indicated that accumulated tax losses during the financial crisis, partly via asset write-downs, will be a drag on revenue for some time. The unexpectedly rapid bounce in the economy, though, inevitably has been reflected in projections of higher taxation proceeds. It also will cap growth in non-discretionary spending, like transfer payments. Predictably, however, the government's discretionary spending has ballooned as the election approaches; spending was 26.5% of GDP in 2009-10, the highest ratio since 1986-87. The government has trimmed the peak net public debt forecast to A$90.5 billion in 2011-12 (6.1% of GDP). Peak bond issuance now will be A$160.9 billion in 2012-13, substantially below the earlier estimates.

The economy—what recession?

In last year's budget, a gloomy Treasurer forecast that Australia's then-fragile economy was headed for recession. This was a bold admission from the man with prime responsibility for managing the economy. We already had endured one quarter of falling GDP (4Q08), and it looked like we were headed for more. What a difference a year makes: Australia's economy has powered out of what turned out to be a very short period of contraction and now is growing at an above-trend pace. The rebound was helped

Gross Commonwealth government bond issuance



by aggressive policy support from the RBA and the government, and China's insatiable demand for commodities.

Now, Treasury's forecasts reveal a more optimistic outlook. The official forecast is for real GDP to expand 2.0% in 2009-10 and 3.5% in 2010-11. Last year, the Treasurer forecast a spike in the jobless rate to 8.5%; this year, he forecasts that unemployment has peaked below 6%. We believe these forecasts to be credible, and are broadly in line with those of the RBA. They also are similar to J.P. Morgan's prevailing forecasts. The Treasury's inflation forecasts, however, look unrealistically low; they are below the recently upgraded forecasts the RBA published last Friday. The Treasury optimistically forecasts above-trend economic growth, full employment, and booming commodity prices, yet well-behaved inflation.

Implications for monetary policy

Fiscal and monetary policy currently are working in opposite directions. The government is boosting spending in real terms, having significantly overspent during the global recession, while the RBA has hiked the cash rate six times since October. The risk to policy from here is that the government "red-lines" the fiscal boost as the election nears. This would mean that even more of the heavy lifting needed to return the overall policy stance to "normal" will have to be done by the RBA.

Commonwealth budget position and economic forecasts

	06-07	07-08	08-09	09-10(e)	10-11(f)	11-12(p)	12-13(p)	13-14(p)
Budget balance								
A$ bn	17.2	19.7	-27.1	-57.1	-40.8	-13.0	1.0	5.4
% of GDP	1.6	1.7	-2.5	-4.4	-2.9	-0.9	0.1	0.4
Bond issuance (A$ bn)								
Outstanding	46.2	49.4	78.4	78.4	120.4	147.4	160.9	156.3
GDP (%oya)								
Budget forecasts	3.7	3.8	1.3	2.0	3.3	4.0	3.00	3.00
J.P. Morgan forecasts	na	na	na	2.3	3.5	4.25	3.8	3.25

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United States

- **Latest retail sales and foreign trade reports highlight strong consumer spending and export trends**
- **Mfg IP up 1.0% in both March and April; the breadth is even more impressive than the strength**
- **May business surveys are expected to hold near April levels; still too early to see any contagion effects**

Broadly defined European sovereign risk concerns continue to rattle financial and commodity markets. It is too early to assess eventual effects of the European economic and political situation on the US economy with any great confidence. But it is still important to monitor incoming data, and these look consistent with the forecast of an acceleration to 4.0% real GDP growth this quarter.

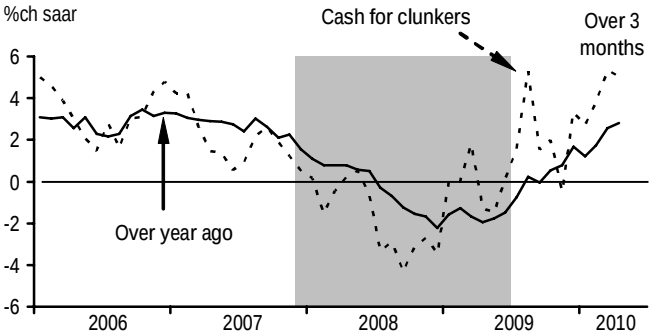
Manufacturing production increased a full percentage point in April following a like-sized gain in March. The April retail sales report points to an upward revision of 1Q09 real consumer spending to 4.0% (from 3.6%), and spending early this quarter is tracking a similar growth pace. Export and import volumes each increased about 3.5% samr in March, supporting the view that the slowdown in trade flows early this year reflected volatility in the data rather than a sustained deceleration of demand here or abroad.

Upcoming data include the first May business surveys on manufacturing and homebuilding activity. They will provide a good check on the view that it is too early to see any fallout from European problems. The key inflation data for April will also be released next week, and they are expected to show continued tame core inflation. The forecast calls for a 0.05% increase in the core CPI on the heels of three months in which core inflation has, on net, been slightly negative.

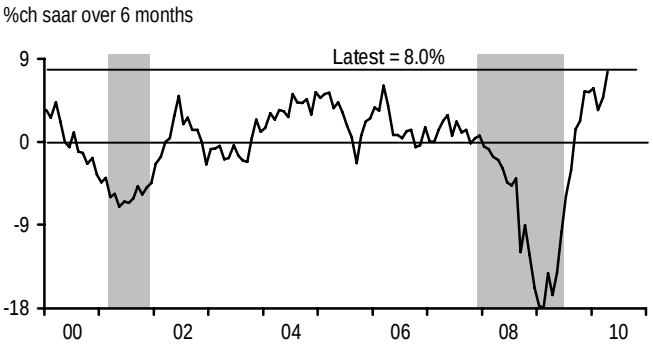
Factory output soaring into 2Q

Manufacturing output has posted huge increases the past couple of months and the three-month run rate is now up to 8.3% saar. The impressive feature of the latest report is not so much the size of the gain as the breadth. Both durables and nondurables output are up at about an 8% annual rate over the past three months. And while large gains in manufacturing are often sparked by an upturn in motor vehicle output or a surge in the high-tech industries, the latest figures come at a time when April motor vehicle output (-2.2% samr) and high-tech output (0.9%) are well below their recent trends. Factory output ex. motor vehicles and high-tech was up 1.2% in April and 0.9% in March, and the three-month run growth rate of 8.9% saar was a bit stronger than the run-rate for total manufacturing.

Real consumer spending, with April forecast



Manufacturing output ex motor vehicles and high-tech



Business equipment is part of the recent upturn in growth, increasing 1.1% in April following a 1.0% increase the month before. The decline in truck production and slowing in high-tech output in April was offset by a surge in production of industrial and other machinery, up 2.3% samr on the month. This echoes the recent message from the March factory report, showing that earlier strength in high-tech equipment is broadening to other equipment.

Shoppers seem to be maladjusted

The main message of the April retail sales report is one of continued strength in consumer spending. Total retail sales rose 0.4% in April, and including upward revisions sales have averaged gains of 1.0% per month over the past three months. Sales ex. autos and gasoline also rose 0.4% and have averaged gains of 0.9% per month over the past three months. And while core retail sales edged down 0.2% in April, core sales have averaged healthy gains of 0.6% per month over the past three months. In light of the turn to stronger gains in employment and labor income, the April dip in core retail sales should be regarded as an aberration in an inherently volatile series.

Retail sales for a large number of categories of stores were super-strong in March and then down in April, hinting that Census may have had trouble correctly seasonally adjusting the data to account for the early Easter. Sales at clothing stores were up 2.6% samr in March and down 1.0% in April; sales at furniture stores were up 2.1% in March and down 1.2% in April; sales at general merchandise stores were up 0.6% in March and down 0.4% in April.

Foreign trade flows still booming

Foreign trade flows slowed fairly sharply in the first two months of the year. The first report on 1Q10 GDP, based on two months of trade data, includes estimates showing that merchandise export volumes had decelerated from growth of nearly 20% saar through 2H09 to only 6.7% in the first quarter. The slowdown in import volumes was similar. These results are at odds with stronger demand readings in the US and in most foreign markets and stronger readings for the ISM manufacturing measure of export orders (available through April). The March trade figures confirm that the apparent slowing simply reflected the inherent volatility in the trade data. March export volumes surged 3.4% samr and import volumes were up 3.5%. While export and import volumes for 1Q10 as a whole did slow significantly, trade in industrial supplies accelerated—a symptom of stronger US and global industrial activity.

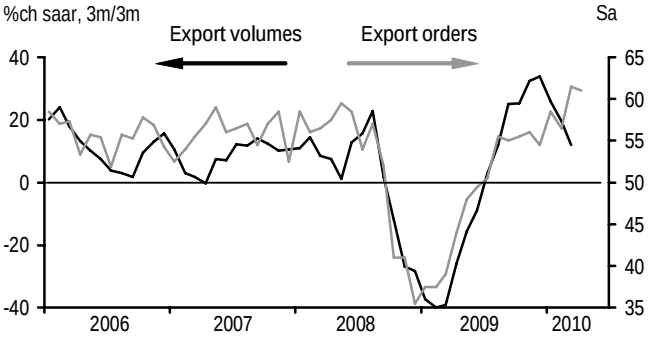
Commodities boost April import prices

April import prices continued to soar, up 0.9% and 11.1%oya. These increases mainly reflect the rapid increases in the price of oil and other material and commodities. The prices of imported finished goods remain tame. For example, the price of imported nonauto consumer goods was flat in April and up only 0.4%oya. The price of imported autos and parts is 0.6%oya, while the price of imported capital goods is -0.4%oya. The pattern of rapidly rising materials prices and tame finished goods prices is similar to what we see in the domestic PPI. Sharp increases in the price of commodities and materials have comprised just about the only inflation threat in a world of generally low and falling increases in the cost of labor, rent, and financing. In this context, the decline in the price of oil and other commodities over the past couple of weeks should reinforce the trend toward lower core inflation.

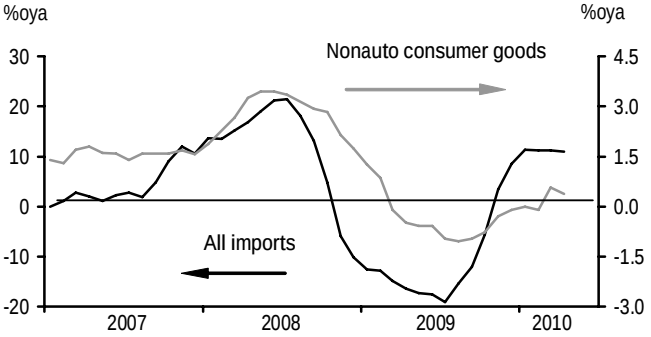
No labor market inconsistency

Initial jobless claims for the latest week edged down to 444,000 from 448,000 the prior week. But the decline was small and the trend in claims so far this year seems to be more flat than down, a break with the trend of much

Merchandise export volumes and ISM mfg export orders

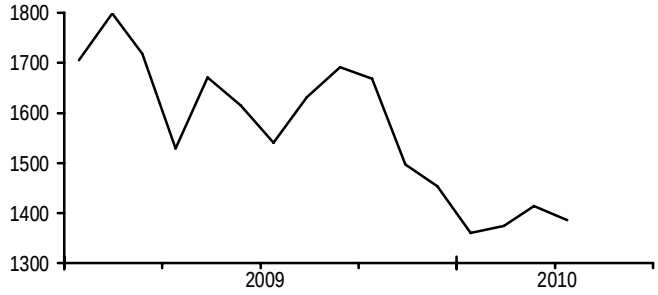


Price of all imports and of imported consumer goods



Number of workers moving from employed to unemployed

Samr, '000s; labor market flows from Household Survey



sharper declines through most of last year. The recent trend in initial claims seems at odds with the monthly payroll and household surveys that show noticeably improved job growth over the past few weeks.

But the inconsistency is more apparent than real. The job-flow detail from the household survey shows that the number of persons shifting from employed one month to unemployed the next month has stopped coming down since January and is broadly in line with the trend in initial claims. The increased net hiring so far this year has been associated with a sharp increase in hiring of those entering the labor force rather than with fewer layoffs.

Data releases and forecasts

Week of May 17 - 21

Mon May 17 8:30am

Empire State survey

Diffusion indices, sa

	Feb	Mar	Apr	May
General bus. conditions	24.9	22.9	31.9	30.0
New orders	8.8	25.4	29.5	
Shipments	15.1	25.6	32.1	
Unfilled orders	2.8	4.9	-3.8	
Prices paid	31.9	29.6	41.8	
Prices received	4.2	8.6	6.3	
Composite	52.3	57.1	59.6	

Thu May 20 10:00am

Philadelphia Fed survey

Diffusion indices, sa

	Feb	Mar	Apr	May
General bus. conditions	17.6	18.9	20.2	21.0
New orders	22.7	9.3	13.9	
Shipments	19.7	13.6	5.6	
Inventories	3.2	-11.0	2.0	
Prices paid	32.4	38.6	42.7	
Prices received	3.7	-0.4	1.0	
Composite	55.1	52.8	53.4	

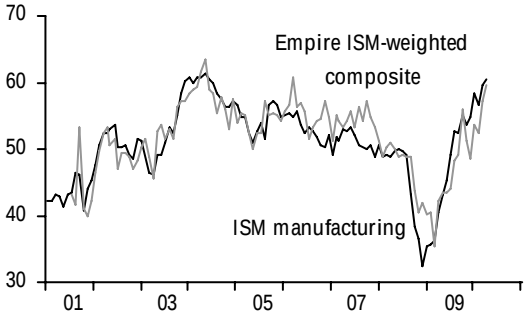
The April ISM manufacturing survey and IP report confirm that national manufacturing was booming early in the second quarter. Since new orders in the ISM survey were very high (65.7) and the assessment of customer inventories was very low (33.0), there is every reason to think that manufacturing growth continued strong into May. These manufacturing surveys will provide a first test of whether recent declines in global commodity prices and equity prices are having a discernible effect on US industrial activity yet. Based on experience, it seems too early to see any effects.

Although the headline reading for the Empire State survey was higher last October than it was in April, the derived composite reached a new high for the expansion in April. The derived composite (a measure of activity at respondent firms calculated from components using ISM weights) is considered a more reliable measure of growth than the headline number (an evaluation of general economic conditions).

The Philadelphia Fed survey's headline reading and derived composite have been running low relative to the Empire State survey and the ISM survey lately. The forecast looks for a modest increase in the Philly Fed survey in May in keeping with the levels of these other surveys.

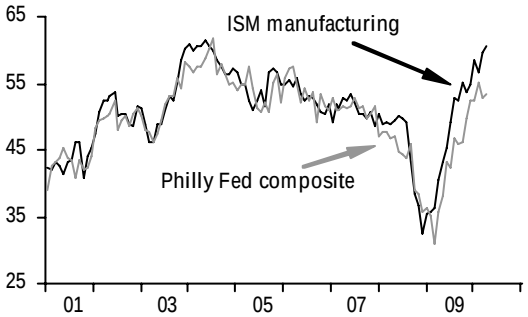
ISM mfg index and Empire State ISM-weighted composite

Index, sa



ISM mfg index and Philly Fed ISM-weighted composite

Index, sa



Mon May 17 1:00pm

Homebuilders survey

Sa

	Feb	Mar	Apr	May
Housing market	17	15	19	19
Present sales	17	15	20	
Prospective buyer traffic	12	10	14	

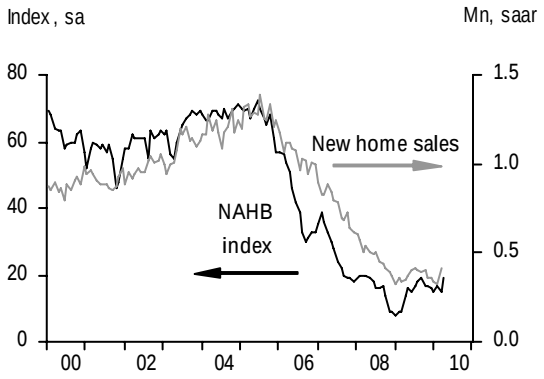
The Homebuilders survey increased 4pts to a reading of 19 in April, the high end of its range over the past two years, and the forecast looks for the survey to hold that level in May.

The recent increase in the survey reflects the lift to demand from the second homebuyer tax credit. The tax credit probably was responsible for the initial boost to sales seen in the March data. April new home sales surged 26.9%, albeit from severely depressed levels. To qualify for the credit, contracts must be signed by the end of April, and builders are presumably already seeing some fading in activity following the deadline. Sur-

vey results may give some idea of how much of a drop-off can be expected. Mortgage applications for home purchase had surged in the last few weeks of April but declined 9.5% in the first week of this month.

While the end of the tax credit is presumably leading to a decline in demand, the combination of improved job growth and gradually falling interest rates over the past month are likely providing a boost.

NAHB index and new home sales



Interest rate for 30-year conforming mortgage

Tue
May 18
8:30am

Producer price index
%m/m sa, unless noted

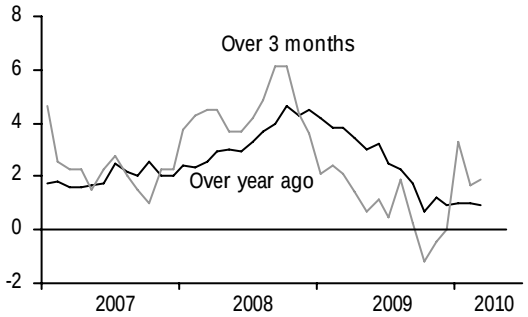
	Jan	Feb	Mar	Apr
Finished goods	1.4	-0.6	0.7	0.0
%oya (nsa)	4.6	4.4	6.0	5.5
Core	0.3	0.1	0.1	0.1
%oya (nsa)	1.0	1.0	0.9	0.9
Energy	5.1	-2.9	0.7	-0.4
Cars	-0.5	0.5	-1.1	0.3
Trucks	1.9	-0.1	-0.1	-0.1
Core intermed.	0.5	0.9	0.7	0.8
Core crude	6.6	-0.6	6.0	

The forecast looks for the headline PPI to be flat in April, as both food and energy prices appear to have settled down after gains in March. The core PPI is expected to increase 0.1%, in line with the recent trend. The core PPI has slowed substantially over the past year, despite the acceleration in both energy and food prices and in the price of other materials and parts (the core intermediate PPI).

Volatility in the PPI for cars and light trucks has had a strong influence on monthly readings for the core PPI over the past year. The forecast for April looks for vehicle prices to be tame, with the price of cars up 0.3% and the price of trucks down 0.1%.

Core producer prices have not been a helpful predictor of core consumer prices lately. Indeed, the correlation between the PPI for core consumer goods and the CPI for core goods has been negative over the past two years, both contemporaneous and with core consumer prices lagged a month.

Core PPI



Tue
May 18
8:30am

Housing starts
Mn units, saar

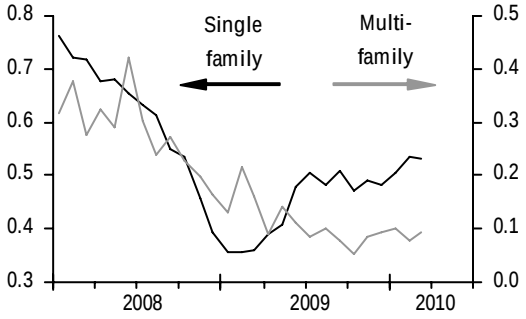
	Jan	Feb	Mar	Apr
Starts	0.61	0.62	0.63	0.65
Single-family starts	0.51	0.54	0.53	0.55
Multifamily starts	0.10	0.08	0.10	0.10
Permits	0.62	0.64	0.68	0.68

Housing starts have increased from extreme levels in each of the first three months of the year, and the forecast looks for another increase in April. The forecast is partly motivated by strong increases in both single-family and multifamily permits in February and March. At the same time, the forecast looks for housing permits to edge lower in April, reflecting builder uncertainty about the extent of decline in sales after the homebuyer tax credit expires. Note that the increase in activity so far this year has been concentrated in the single-family part of the market.

To be sure, even the expected increase in starts would leave activity at extremely low levels, some 22% below the lowest level reached in the brutal 1981-1982 recession, for example, despite substantial demographic growth since. And the boost to overall economic growth from increases in home building is relatively modest, since new housing construction now accounts for only 0.9% of GDP.

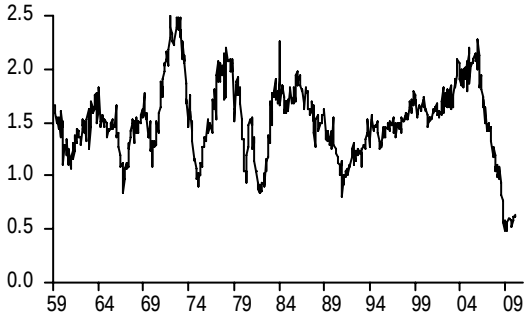
Housing starts

Mn units, saar, both scales



Housing starts

Mn, saar



Wed May 19 8:30am

CPI

%m/m sa, unless noted

	Jan	Feb	Mar	Apr
Total	0.2	0.0	0.1	0.0
%oya (nsa)	2.6	2.1	2.3	2.3
Core	-0.14	0.05	0.04	0.05
%oya (nsa)	1.6	1.3	1.1	1.0
Core services	-0.2	0.1	0.1	
Core goods	0.1	-0.1	-0.1	
Food	0.2	0.1	0.2	0.5
Energy	2.8	-0.5	0.0	-1.7
Housing	-0.3	0.0	0.0	
Owners' eq. rent	-0.08	-0.02	-0.11	-0.10
Rent	0.04	-0.03	0.06	0.05
Lodging away from home	-2.1	0.1	0.3	0.0
Apparel	-0.1	-0.7	-0.4	0.2
New vehicles	-0.5	0.1	0.1	0.1
Used vehicles	1.5	0.7	0.5	0.4
Airfares	-2.5	-0.7	0.4	
Communication	0.2	-0.1	0.0	0.0
Medical care	0.5	0.5	0.3	0.3

The CPI is expected to be unchanged in April, with a decline in energy prices more than offsetting an increase in food prices and a marginal rise in core prices.

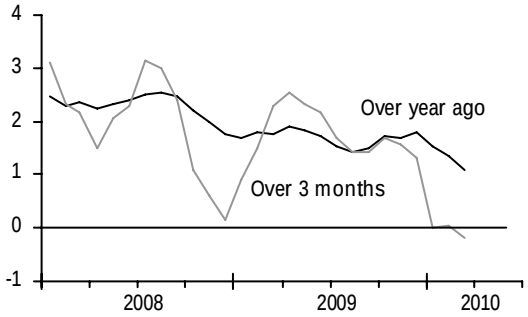
Energy prices are forecast to decline 1.7%, reflecting a 2.0% decline in seasonally adjusted gasoline prices and a slightly larger decline in the price of natural gas. Although the retail price of gasoline rose in April, it did not rise by as much as the seasonal factors expect.

The price of food is forecast to rise 0.5% in March, well above the recent trend. The PPI for food rose 2.4% in March, the largest monthly increase since 1984. And it is likely that some of this rise was passed through to consumers in April.

The core CPI has been tame lately, with the March level running only 1.1%oya, 0.6% saar over the past six months, and actually down slightly over the past three months. Core services prices have continued to slow. And last year's acceleration in core goods prices, that looked anomalous in the context of severe recession, have settled down. In the three months to March, both core goods and core services prices posted very slight declines.

Core CPI

%ch saar



Thu May 20 8:30am

Jobless claims

000s, sa

	New claims (wr.)		Continuing claims		Insured
	Wkly	4-wk avg	Wkly	4-wk avg	Jobless,%
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	4615	4654	3.6
May 1	448	460	4627	4640	3.6
May 8	444	451			
May 15[1]	440	446			

1. Payroll survey week

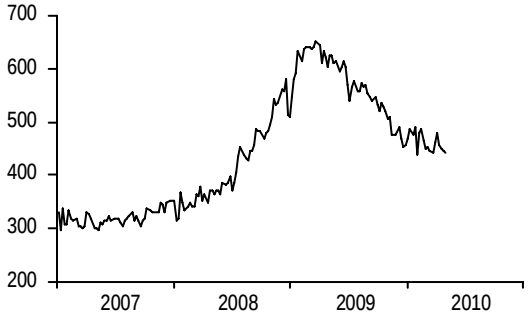
Initial jobless claims have been trending gradually lower over the past several weeks, and the forecast looks for another small decline to 440,000 in the reading for the week of May 15, the week of the May labor market survey.

Both the payroll and household surveys show greatly improving job growth so far this year, and this seems at odds with the relative stability of initial jobless claims. Some insight is provided by looking at the monthly detail on labor market flows from the household survey. These show that the number of people shifting from employed one month to unemployed the next month (a correlate of initial jobless claims) declined through January and has stabilized since. The increase in jobs the past few months has, apparently, not been associated with a further decline in layoffs.

Similarly, the rate of decline in continuing claims might seem slow relative to the improvement in employment, as measured by either the payroll or household survey. The data detail on labor flows shows that the recent increase in employment mainly reflects hiring of new entrants into the labor force rather than the formerly unemployed.

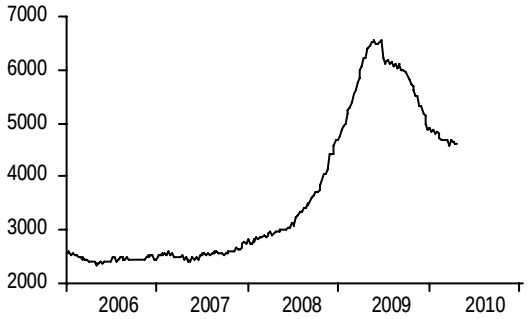
Initial jobless claims

000s, sa



Continuing jobless claims (first 26 weeks of UI)

000s, sa



Review of past week's data

International trade (May 12)

$ bn, samr

	Jan	Feb		Mar	
Balance (BOP basis)	-37.0	~~-39.7~~	*-39.4*	~~-40.5~~	*-40.4*
Services	12.4	~~11.6~~	*11.7*	~~11.4~~	*12.5*
Merchandise	-49.4	~~-51.3~~	*-51.1*	~~-51.9~~	*-52.9*
Exports (%m/m)	-0.2	~~0.2~~	*0.3*	~~1.1~~	*3.2*
Imports (%m/m)	-1.8	~~1.7~~	*1.6*	~~1.3~~	*3.1*

The US trade deficit in March was close to expectations, but both export and import growth were very strong and greater than expected. The trade balance widened from a slightly revised -$39.4 billion in February to -$40.4 billion in March. Merchandise exports rose 4.3% on the month and export volumes were up 3.4%. Merchandise imports rose 4.0% in March and import volumes were up 3.5%. Despite the slow start to trade growth in the first quarter, merchandise export volumes were up 12.1% saar in 1Q10 and import volumes were up 12.5%. There is a strong trajectory of both into the current quarter. The March trade deficit is close to what was assumed in the 1Q10 GDP estimate.

Import prices (May 13)

%m/m nsa, unless noted

	Feb		Mar		Apr	
Import prices	~~0.2~~	*-0.1*	~~0.7~~	*0.5*	~~0.6~~	*0.9*
%oya	~~11.2~~	*11.3*	~~11.4~~	*11.3*	~~10.9~~	*11.1*
Ex fuel import prices	0.1		0.2		~~0.3~~	*0.5*
%oya	1.9		2.7		~~2.9~~	*3.2*

Higher prices of oil and other commodities and raw materials lifted import prices 0.9% nsa in April and 11.1%oya. Nonfuel import prices rose 0.5% in April to stand at 3.2%oya. While the prices of imported commodities and materials continued to soar through April, the price of imported finished goods remained tame. The price of imported nonauto consumer goods was unchanged and 0.4%oya. The price of imported autos and parts was up 0.2%, but only 0.6%oya. These trends are similar to what we have seen in the domestic PPI—strong increases in core intermediate prices and slowing in core finished goods prices. With the recent weakness in commodity prices, overall import prices should settle down soon.

Retail sales (May 14)

%m/m sa

	Feb		Mar		Apr	
Total	~~0.4~~	*0.6*	~~1.9~~	*2.1*	~~0.1~~	*0.4*
Ex autos	~~1.0~~	*1.2*	~~0.9~~	*1.2*	~~0.2~~	*0.4*
Ex autos and gas	~~1.1~~	*1.3*	~~1.1~~	*1.3*	*0.4*	
Building materials	~~0.1~~	*0.7*	~~7.5~~	*7.8*	~~1.5~~	*6.9*
Control group[1]	~~1.1~~	*1.3*	~~0.4~~	*0.7*	~~0.1~~	*-0.1*
Ex gasoline	~~1.2~~	*1.4*	~~0.5~~	*0.7*	~~0.3~~	*-0.2*

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

April retail sales rose 0.4% (consensus: 0.2%; J.P. Morgan: -0.1%) and with upward revisions to each of the two prior months, retail sales are now up 0.6% February and 2.1% in March. Nonauto sales also rose 0.4% in April (consensus: 0.4%; J.P. Morgan: 0.2%) and also included upward revisions to prior months. Core retail sales declined 0.2% in April, but following upwardly revised gains of 1.4% in February and 0.7% in March. With these data in hand, it looks like real consumer spending growth in 1Q10 will be revised up to 4.0% saar and that real GDP for 1Q10 is running slightly above the 3.2% initial estimate.

Even including the decline in April, core retail sales have averaged gains of 0.6% per month this year. In the context of increasing job growth through the year, we would regard the softer core retail sales reading for April as an aberration in an inherently volatile series rather than the beginning of a slowdown. The decline reflected sales drops in categories that had shown huge gains in prior months including furniture, clothing, and general merchandise stores.

Industrial production (May 14)

%m/m sa,unless noted

	Feb		Mar		Apr	
Industrial production	~~0.3~~	*-0.1*	~~0.1~~	*0.2*	~~1.1~~	*0.8*
Manufacturing	~~0.2~~	*-0.1*	~~0.9~~	*1.0*	~~1.5~~	*1.0*
Motor vehicles & parts	~~3.9~~	*-3.0*	~~2.2~~	*1.9*	~~6.0~~	*-2.2*
High-tech	~~3.0~~	*2.5*	~~1.9~~	*2.2*		*0.9*
Mfg ex motor vehicles	~~0.4~~	*0.1*	~~0.8~~	*1.0*	~~1.3~~	*1.2*
Business equipment	~~0.7~~	*0.3*	~~1.4~~	*1.1*		*1.0*
Capacity utilization (% sa)	~~73.0~~	*72.8*	~~73.2~~	*73.1*	~~73.8~~	*73.7*
Manufacturing	~~69.4~~	*69.2*	70.0		~~70.9~~	*70.8*

US industrial production rose 0.8% in April. Mining increased 1.4% on the month and output of utilities declined 1.3% on moderate weather. But the real interest in this report is in manufacturing, which is up 1.0% in both March and April. These strong gains are consistent with the previously reported ISM survey and hours worked numbers.

Production gains were broad-based in April, with output of durable goods industries up 1.1% and nondurables up 1.0%. The April gain occurred despite a 2.2% monthly decline in output of motor vehicles and parts. Manufacturing output excluding high-tech and motor vehicles rose 1.2%, the largest increase since 2005.

Output of business equipment was up 1.1% in March and another 1.0% in April, but with rotation among components. Transit declined in April and information processing slowed to a gain of 0.5% from an average gain of 1.5% per month the prior three months. But production of industrial and other machinery soared 2.3%.

Consumer sentiment(May 14)

Michigan preliminary

	Mar	Apr	May	
Univ. of Mich. Index (nsa)	73.6	72.2	~~73.0~~	*73.3*
Current conditions	82.4	81.0		*81.1*
Expectations	67.9	66.5		*68.3*
Inflation expectations				
Short term	2.7	2.9		*3.1*
Long term	2.7	2.7		*2.9*
Home buying conditions	156.0	154.0		*150.0*

The preliminary Michigan consumer confidence survey for May edged up 1.1pts to 73.3. Confidence has remained in an extremely narrow band at low levels since last December. In May the assessment of current conditions edged up 0.1pt to 81.1 and expectations rose 1.8pts to 63.3. Note that consumer spending growth was strong in the first quarter despite relatively low confidence readings.

Both 1-year inflation expectations (3.1%) and 5-year inflation expectations (2.9%) rose to the high end of their ranges over the past year. The recent decline in the price of oil is likely to dampen inflation and inflation expectations over the next month.

Both buying conditions for cars and buying conditions for houses declined in May, although both remain near the high end of their range over the past year or so.

Business inventories (May 14)

%m/m sa, unless noted

	Jan		Feb		Mar	
Inventories	0.2		~~0.4~~	*0.6*	*0.4*	
Manufacturing	0.3		~~0.7~~	*1.0*	*0.3*	
Wholesale	0.1		0.6		*0.4*	
Retail inventories	0.1		0.2		~~0.3~~	*0.4*
Ex autos	-0.2		~~-0.2~~	*-0.1*		*0.4*
Autos	0.7		1.3			*0.3*
Inventory/sales ratio	~~1.27~~	*1.25*	~~1.27~~	*1.26*	~~1.26~~	*1.23*

Nominal business inventories increased 0.4% in March. This was the third consecutive monthly increase. The new information in the report for purposes of estimating 1Q10 GDP growth is nonauto retail inventories, up 0.4% in March. These results are very close to what the government assumed in the first estimate of 1Q10 real GDP, and we are still looking for a very modest upward revision of GDP to about 3.3% from 3.2%.

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US focus: exports and imports power ahead

- The US trade deficit on goods and services widened to $40.4 billion in March, the widest monthly deficit since December 2008. Most but not all of the recent widening is associated with higher prices for imported oil.

- Trade volumes posted very strong gains after slowing earlier in the quarter. Merchandise export volumes soared 3.4% samr and import volumes surged 3.5%. Export volumes are now only about 7% below their prior peak, and import volumes are 10% below their prior peak.

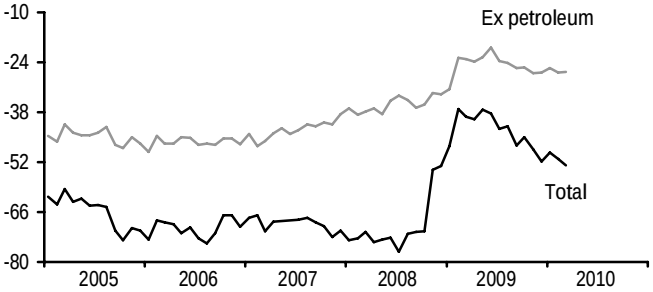
- Growth of merchandise export volumes slowed from 33.0% saar in 4Q09 to 12.1% in 1Q10. But the slowdown is probably more a wiggle in an inherently volatile series than a protracted deceleration. The ISM manufacturing survey suggests that growth of export orders is hitting a new high for the cycle this quarter.

- The nominal trade deficit with China has finally started to narrow a bit, from a gap of $263 billion in the year ended March 2009 to $228 billion in the year ended March 2010. Exports to China have grown much faster than total exports over the past year, while imports from China have grown more slowly than total imports.

- More generally, exports to Canada, Japan, and Western Europe have grown less than half as rapidly as exports to other markets over the past year. Exports to Europe have been conspicuously weak, up only 2.4%oya versus growth of 20.1% for all exports.

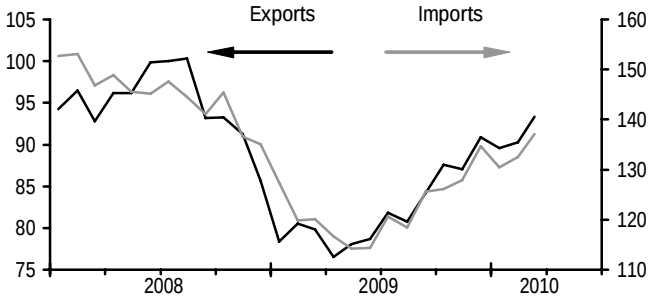
US merchandise trade balance

$ bn, samr



Merchandise export and import volumes

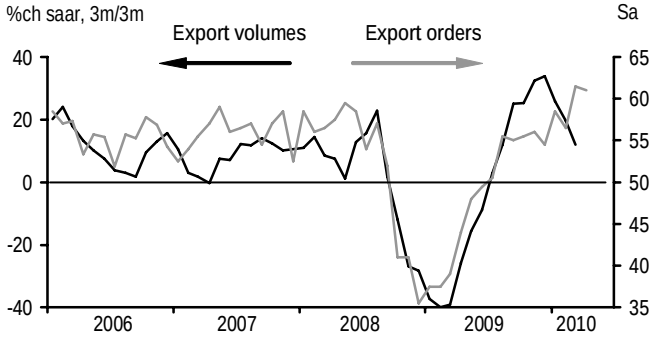
$2005 bn, samr, both scales



Merchandise export volumes and ISM mfg export orders

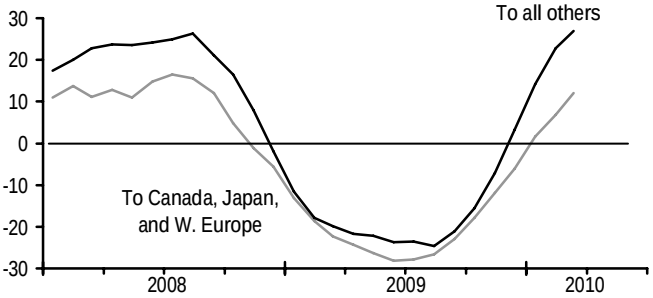
%ch saar, 3m/3m

Sa



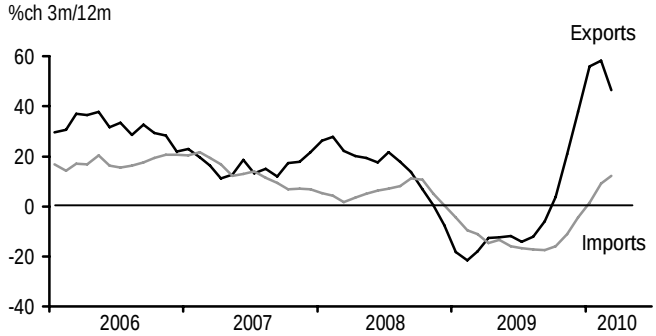
Nominal exports by market

%ch 3m/12m



Nominal trade with China

%ch 3m/12m



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Euro area

- **Dramatic policy interventions to stabilize the region**
- **Overall growth forecast revised down, but a bigger redistribution from southern periphery to Germany**
- **ECB now expected to be on hold through end-2011**

The past couple of weeks have been the most tumultuous since the EMU's inception in 1999. In the absence of the kind of dramatic policy interventions announced last weekend, the region was in danger of experiencing another major banking and financial crisis with one or more sovereigns actually defaulting. This would have been a catastrophe for the Euro area, politically, economically, and socially.

At the end of Friday, May 7, there were three huge pressure points in the region: concern about sovereign solvency; liquidity stresses in the capital markets for those sovereigns; and associated banking and financial market distress as asset prices tumbled. The dramatic policy announcements over the ensuing weekend were intended to deal with each of these issues.

In order to alleviate concerns about sovereign solvency, European leaders committed to additional fiscal consolidation and to a reform of the Stability and Growth Pact. During the course of the week, additional tightening measures were announced by Spain and Portugal. In addition, the European Commission announced some proposals to strengthen the Stability and Growth Pact. At this stage, the suggested changes are only proposals, and the final legislation could look different after a period of consultation.

In order to ensure that sovereigns in the region can continue to fund their deficits and roll over maturing debt, a European Stabilization Mechanism is being created. This will provide liquidity support to sovereigns, in the form of either a loan or a credit line. The funding for the mechanism will come from borrowing by the Commission under the auspices of the European Union (similar to the existing balance of payments facility that recently provided support to Latvia, Hungary, and Romania). Already, €60 billion is available under the current ceiling for payment appropriations in the EU budget, and €440 billion will be provided by a new special purpose vehicle (SPV). The borrowing by the SPV will be guaranteed on a pro rata basis by Euro area sovereigns, although it is possible that other members of the EU outside the Euro area will add their own creditworthiness to the guarantee.

In order to address banking and financial market dysfunction, the ECB and the Fed reopened the FX swap line, and

Fiscal thrust across the Euro area

%-pt change in cyclically adjusted primary positions
A positive is a move to tightening

	2010	2011	2012
Euro area	-0.2	1.3	1.2
Germany	-3.1	0.5	1.5
France	0.2	1.9	1.2
Italy	0.1	0.8	0.7
Spain	2.7	3.4	1.8
Netherlands	-1.5	0.8	0.3
Belgium	1.3	0.6	0.8
Austria	-1.2	0.9	0.7
Greece	9.5	1.9	1.3
Ireland	0.9	0.8	2.1
Finland	-1.4	0.6	0.1
Portugal	2.4	3.8	2.1
Slovakia	1.0	0.9	0.8
Slovenia	1.2	1.4	0.9
Luxembourg	-2.9	-1.4	0.2
Cyprus	0.0	0.0	0.0
Malta	0.0	0.0	0.0

Spanish Stability and Growth Program revised in light of the latest measures announced

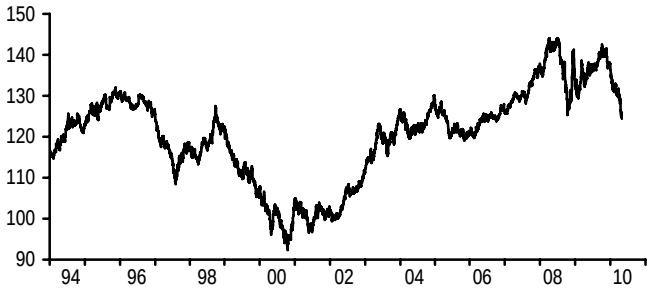
% of GDP for fiscal data, %oya for GDP, %-pts for output gap

	2009	2010	2011	2012	2013
Fiscal balance	-11.2	-9.1	-5.8	-3.6	-1.4
Interest expense	1.9	2.2	2.6	2.9	3.1
Primary balance	-9.3	-6.9	-3.2	-0.7	1.7
Cyclically adjusted fiscal balance	-9.8	-7.4	-4.4	-2.9	-1.2
Cyclically adjusted primary balance	-7.9	-5.2	-1.8	0.0	1.8
Government debt	53.2	63.2	67.5	68.2	66.4
Real GDP	-3.6	-0.3	1.8	2.9	3.1
Nominal GDP	-3.4	0.2	3.3	4.9	5.2
Output gap	-3.2	-4.1	-3.2	-1.6	-0.1

Assumptions on GDP, fiscal tightening, interest expenditures, and output gap taken from the Spanish Stability and Growth Program and the latest official announcements. Calculations by J.P. Morgan.

Euro area exchange rate

Index, 2000=100



the ECB reinstated unlimited liquidity provision at three- and six-month maturities and announced a program of outright purchases of public and private debt.

Although some have worried about the process for setting up the European Stabilization Mechanism, we are assuming that it will be established as announced; European leaders realize that they are fighting for EMU's very survival. Nevertheless, there is a legitimate debate about what borrowing cost the SPV will face. It is apparent that sovereign creditworthiness is being stretched in a number of dimensions at the moment: in terms of their own borrowing, the provision of guarantees for supranational borrowing, additional contributions to the IMF, and guarantees for bank debt issuance. With the SPV likely to be set up, and ECB intervention positioned to limit bank funding pressure and the stress on financial markets, the key execution risk remains the underlying fiscal consolidation. European leaders are still assuming that the burden of this consolidation will be borne entirely by the respective sovereigns. Many commentators are not convinced, however, and believe that there will ultimately be either fiscal transfers (in terms of forgiveness of bilateral loans) or debt restructuring. Each of these can be viewed as a mechanism for sharing the burden of achieving debt sustainability.

The outlook for Euro area growth

The Euro area recovery continued at a lackluster pace in the first quarter, with a 0.8%q/q ar gain in GDP. Since the recovery began last summer, growth has averaged 0.9% ar. This does not even match our subdued view of growth potential (1.2% ar), so none of the slack created by the recession has been reabsorbed yet.

However, business surveys point to a sharp acceleration in the spring, and we are comfortable that areawide growth will reach 3% ar in the current quarter. This reflects payback after weather-related weakness in construction early in the year as well as the arrival of cyclical lift. In the absence of the sovereign stress, the region would have been well positioned for a period of strong growth, as exports, inventories, and capital spending bounced back from depressed levels. However, the impact of the sovereign stress, via fiscal tightening, lower asset prices, and more restrained behavior on the part of households, corporates, and banks is likely to be a significant headwind. We are revising down our GDP forecast (table). Changes to the aggregate figures are modest, a couple of tenths of downward revisions to this year and next. But, the regional composition has been revised more dramatically, as Germany benefits from a weaker currency and the southern periphery suffers from additional fiscal tightening.

We had been expecting the ECB to start a rate normalization cycle in the spring of 2011. Even though we are not revising down our areawide growth numbers dramatically, we have decided to delay calling the first rate hike because the region is likely to continue to feel fragile and vulnerable for longer than previously expected. Our new forecast anticipates the ECB policy rate remaining at the current 1% level through the end of 2011 (which is as far as our official forecast extends).

Recent GDP data
%q/q, saar

	2Q09	3Q09	4Q09	1Q10
Euro area	-0.5	1.6	0.2	0.8
Germany	1.8	2.9	0.7	0.6
France	0.9	1.0	2.2	0.5
Italy	-1.1	1.5	-0.2	2.1
Spain	-3.8	-1.1	-0.6	0.4
Greece	-1.2	-1.9	-3.1	-3.1
Portugal	2.4	2.2	-0.6	4.1
Ireland	-2.9	-0.3	-8.7	na

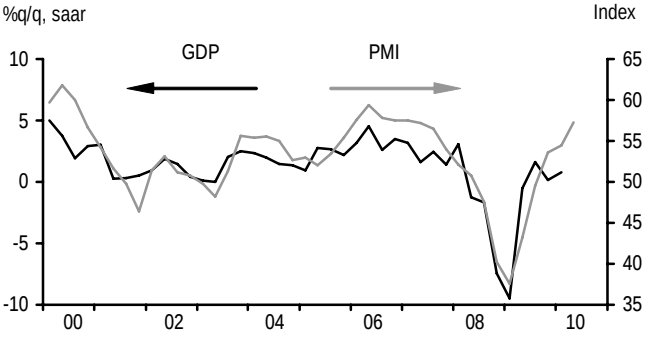
J.P. Morgan Euro area GDP forecast
%q/q, saar

	1Q10	2Q10	3Q10	4Q10
Previous	1.0	3.0	2.3	2.0
New	0.8	3.0	2.0	1.8

J.P. Morgan GDP projections
%oya

	2010	2011	2012
Euro area	1.3	1.9	1.8
Germany	1.9	2.6	2.0
France	1.7	2.1	1.8
Italy	1.4	2.0	1.7
Spain	-0.5	0.5	1.5
Greece	-5.0	-1.0	1.0
Portugal	0.3	0.6	1.0
Ireland	-0.5	0.8	2.0

Euro area GDP and composite PMI



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Data releases and forecasts

Week of May 17 - 21

Output and surveys

	Real GDP	2Q09	3Q09	4Q09	1Q10
	Euro area				
	%q/q sa	-0.1	0.4	0.0	0.2
	%q/q saar	-0.5	1.6	0.2	0.8
	%oya	-4.9	-4.1	-2.2	0.5
Fri	Germany (final)				
May 21	%q/q sa	0.4	0.7	0.2	0.2
8:00am	%q/q saar	1.8	2.9	0.7	0.6
	%oya	-5.8	-4.8	-2.2	1.5
	GDP components (%q/q saar)				
	Private consumption	3.5	-3.9	-3.7	__
	Government consumption	2.1	4.8	-2.2	__
	Mach, equip, other investment	0.7	4.5	-3.2	__
	Construction investment	5.9	3.0	-2.0	__
	Exports	-2.7	14.1	12.6	__
	Imports	-18.9	22.4	-7.1	__
	Contributions to GDP growth (%q/q saar)				
	Domestic final sales	3.1	-0.7	-3.1	__
	Inventories	-8.6	6.2	-4.7	__
	Net trade	7.8	-2.4	9.0	__
Wed	Spain (final)				
May 19	%q/q sa	-1.0	-0.3	-0.1	0.1
9:00am	%q/q saar	-3.8	-1.1	-0.6	0.4
	%oya	-4.2	-4.0	-3.1	-1.3
	GDP components (%q/q saar)				
	Private consumption	-5.1	-0.1	1.3	__
	Government consumption	1.7	5.5	-6.6	__
	Mach and equip investment	-21.7	7.2	13.0	__
	Construction investment	-10.6	-10.0	-8.5	__
	Exports	3.0	8.7	12.5	__
	Imports	-8.8	7.0	8.5	__

After the flash GDP reports this week, expenditure details for 1Q German and Spanish GDP will be released. Consumption is likely to have been soft in both economies, as is capital spending. The lift to growth that was evident in the first quarter likely came from exports. In this context, the details published this week by the French statistics office showed that exports rose rapidly in the first quarter, while household consumption was stagnant, and fixed investment declined in the quarter, albeit at a slower pace than previously.

The moderate pace of growth in the Euro area in 1Q reflects the relatively slow recovery from the recession thus far and the severe distortions related to weather conditions across the region. But things look to be changing dramatically in the current quarter. German industrial orders gained significant momentum through the first quarter of the year, and this should feed into growth in a decisive way in 2Q. And, more broadly, business surveys have improved significantly from March, reinforcing the view that a significant cyclical uplift is under way in the region. We expect GDP growth of 3.0%q/q saar in the second quarter.

Purchasing managers index flash (manufacturing)
Index, sa

		Feb	Mar	Apr	May
Fri	Euro area				
May 21	Overall region	54.2	56.6	57.6	57.7
10:00am					
9:30am	Germany	57.2	60.2	61.5	61.5
9:00am	France	54.9	56.5	56.6	56.9

Purchasing managers index flash (services)
Index, sa

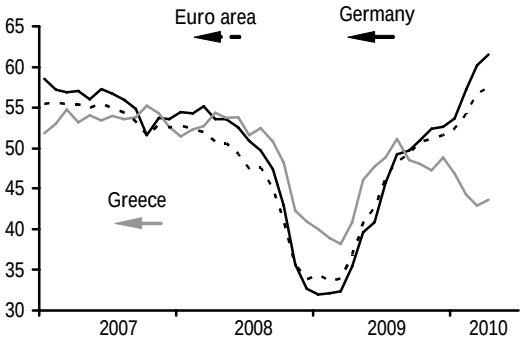
		Feb	Mar	Apr	May
Fri	Euro area				
May 21	Overall region	51.8	54.1	55.6	56.0
10:00am					
9:30am	Germany	51.9	54.9	55.2	56.0
9:00am	France	54.6	53.8	59.2	59.3

Purchasing managers index flash (composite)
Index, sa

		Feb	Mar	Apr	May
Fri	Euro area				
May 21	Overall region	53.7	55.9	57.3	57.5
10:00am					
9:30am	Germany	55.7	58.7	59.3	59.8
9:00am	France	55.6	55.8	59.2	59.4

We expect the Euro area composite PMI to have moved up a little further in May, in response to continued improvement in the service sector and broadly stable developments in the manufacturing sector. At 57.5, the composite PMI in the Euro area would signal that the region was experiencing a significant cyclical uplift through the spring, when growth looks to have moved to an above-trend pace. The details are also likely to show that the uplift is becoming more balanced sectorally (across goods and services) and geographically (with the obvious exception of Greece, which is not participating in the upswing).

PMI manufacturing - headline
Index, sa



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National business surveys

		Feb	Mar	Apr	May
Fri	Germany (IFO survey)				
May 21	2000 = 100, sa				
10:00am	Business climate	95.3	98.2	101.6	101.4
	Business expectations	100.9	102.0	104.0	103.0
	Current conditions	89.9	94.5	99.3	100.0

We expect the current conditions index of the survey to have moved up a little further in May, reflecting the improvement in sentiment connected to the release of pent-up demand following the recent deep recession. The business expectations survey, on the other hand, is likely to have fallen a little in response to adverse financial market developments. In particular, the IFO's survey period started around the middle of last week (when financial stress was very intense and equity markets performed particularly badly) and will end around the middle of next week (with the survey period including the 10 days following the announcement of the European rescue package). On balance, we would think that German corporates became a little more depressed about the outlook following recent developments.

Manufacturing orders
Index, sa

		Dec	Jan	Feb	Mar
Thu	Italy				
May 20	Values				
10:00am	New orders (%m/m sa)	4.7	-2.8	-0.4	—
	New orders (%oya sa)	5.3	4.0	5.4	—

Demand and labor markets

Consumer confidence (prelim)

		Feb	Mar	Apr	May
Thu	Euro area (European Commission survey)				
May 20	% balance of responses, sa				
11:00am	Consumer confidence	-17	-17	-15	—

External trade and payments

Foreign trade

		Dec	Jan	Feb	Mar
Tue	Euro area				
May 18	€ bn sa				
11:00am	Trade balance	3.4	1.9	3.3	—
	Trade balance—year earlier	-1.8	-3.0	-1.9	0.7
	Exports	111.9	111.7	114.7	—
	%m/m sa	2.3	-0.2	2.7	—
	Imports	108.6	109.8	111.4	—
	%m/m sa	2.6	1.1	1.5	—

Inflation

Consumer prices

		Jan	Feb	Mar	Apr
Tue	Euro area (final)				
May 18	HICP (%m/m nsa)	-0.8	0.3	0.9	0.4
11:00am	HICP (%oya nsa)	1.0	0.9	1.4	1.5
	HICP (%oya core-X)[1]	0.9	0.8	0.9	0.8
	HICP (%oya core-XX)[2]	0.9	0.8	1.0	0.8
	HICP (%m/m ex-tobacco)	-0.8	0.3	0.9	0.4

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

The Euro area inflation rate in April will reflect two offsetting forces. On one side, the volatile components of inflation, such as energy and food, are expected to rise sharply. Gasoline prices rose significantly across the region in April, and fresh food prices in particular have been increasing steadily in the past few months. On the other side, core inflation is on track for a further decline. In the month of April, inflation in sectors connected to tourism was particularly soft, and most of the downward movement in core inflation in the month can be attributed to price declines in package holidays, hotels and restaurants, and transport services. The rest of the core inflation basket is also expected to have declined, but at a lower pace.

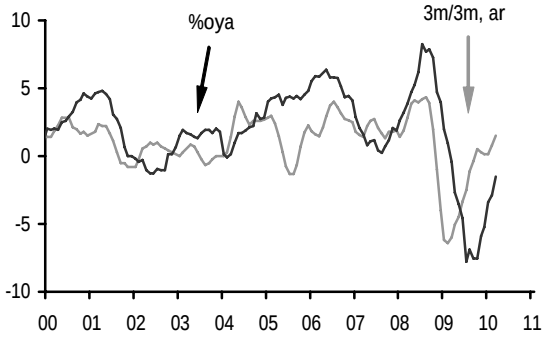
Producer prices

		Jan	Feb	Mar	Apr
Thu	Germany				
May 20	%m/m nsa	0.8	0.0	0.7	0.3
8:00am	%m/m sa	0.7	0.0	0.6	—
	%oya nsa	-3.4	-2.9	-1.5	0.1

German producer price inflation is expected to return in April. While a boost to the headline rate will arrive from the fading base effect in the energy component, after last year's sharp declines in energy prices, core inflation is also expected to move up further. In particular, we expect intermediate goods inflation to rise in April.

German PPI

%oya and %3m/3m, ar



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Review of past week's data

Output and surveys

Real GDP

	3Q09		4Q09		1Q10	
Euro area (flash estimate)						
%q/q sa	0.4		0.0		~~0.3~~	*0.2*
%q/q saar	1.6		0.2		~~1.0~~	*0.8*
%oya	-4.1		-2.2		~~0.6~~	*0.5*
Germany (flash estimate)						
%q/q sa	0.7		~~0.0~~	*0.2*	~~0.1~~	*0.2*
%q/q saar	2.9		~~0.0~~	*0.7*	~~0.5~~	*0.6*
%oya	-4.8		~~-2.4~~	*-2.2*	~~1.3~~	*1.5*
France (preliminary)						
%q/q sa	~~0.2~~	*0.3*	~~0.6~~	*0.5*	~~0.3~~	*0.1*
%q/q saar	~~0.9~~	*1.0*	~~2.4~~	*2.2*	~~1.2~~	*0.5*
%oya	~~-2.3~~	*-2.6*	~~-0.3~~	*-0.4*	~~1.4~~	*1.2*
GDP components (%q/q saar)						
Private consumption	~~0.4~~	*1.1*	3.9		__	-0.1
Government consumption	~~2.6~~	*3.1*	~~3.0~~	*2.6*	__	0.6
Fixed investment	~~-5.0~~	*-5.3*	~~-4.8~~	*-4.4*	__	-3.3
Exports	~~7.2~~	*7.0*	~~0.1~~	*1.5*	__	16.7
Imports	~~1.0~~	*0.8*	~~13.4~~	*10.6*	__	8.4
Contributions to GDP growth (%q/q saar)						
Domestic final sales	~~-0.2~~	*0.3*	2.0		__	*-0.5*
Inventories	~~-0.5~~	*-0.9*	~~4.2~~	*2.8*	__	*-0.7*
Net trade	1.6		~~-3.7~~	*-2.6*	__	*1.8*
Italy (flash estimate)						
%q/q sa	~~0.5~~	*0.4*	~~-0.3~~	*-0.1*	~~0.5~~	
%q/q saar	~~2.1~~	*1.5*	~~-1.3~~	*-0.2*	~~2.0~~	*2.1*
%oya	~~-4.8~~	*-4.7*	~~-3.0~~	*-2.8*	~~0.2~~	*0.6*
Spain (flash estimate)						
%q/q sa	-0.3		-0.1		~~0.1~~	
%q/q saar	-1.1		-0.6		~~0.5~~	*0.4*
%oya	-4.0		-3.1		~~-1.3~~	

The first-quarter GDP flash release for the Euro area showed a moderate rate of growth. No details are available from Eurostat, except for the country breakdown. France and Germany experienced similar rates of growth in 1Q, while Italian GDP rose 2.1%q/q saar in the first quarter, after an upwardly revised fourth quarter (now showing only a modest decline). Spain exited recession in the first quarter, while Greece was the only major Euro area country to record a decline in GDP in the first quarter.

The moderate rate of growth reflects the slow recovery from recession and the severe distortions related to harsh weather across the region. But conditions appear to be changing dramatically in the current quarter. Indeed, the business surveys improved significantly from March, too late to have a significant impact on growth in the first quarter, but enough to reinforce the view of a cyclical uplift under way for the region. This improvement in the data flow, and payback for weather-related weakness, is expected to push up the level of GDP growth in the second quarter to 3.0% saar.

The details published from the French national statistics office suggest that growth in the first quarter reflected a significant rise in exports but also stagnant household consumption. Fixed investment declined further in the first quarter, but the pace of decline moderated.

Industrial production

	Jan		Feb		Mar	
Euro area						
%m/m sa	~~1.7~~	*1.9*	~~0.6~~	*0.7*	~~1.7~~	*1.3*
%oya	~~1.0~~	*1.1*	~~3.8~~	*3.9*	~~6.9~~	
France						
Ind production (%m/m sa)	~~1.1~~	*1.2*	0.0		__	*1.0*
%oya sa	~~2.6~~	*2.5*	~~3.3~~	*3.1*	__	*6.2*
Manuf prod (%m/m sa)	0.6		~~0.4~~	*0.3*	__	*0.8*
%oya sa	~~3.6~~	*3.5*	~~4.6~~	*4.1*	__	*6.7*
Italy						
Ind prod (%m/m sa)	1.9		0.0		__	*-0.1*
Ind prod (%oya sa)	-0.6		2.8		__	*6.6*

The rise in Euro area industrial production ex. construction in March left output up 16.1%q/q saar in 1Q, after an 8.7%ar gain in 4Q. While the rise in the first quarter looks impressive, we have been arguing that Eurostat's IP measure for the region is not as accurate at tracking areawide GDP developments as an alternative measure we construct by aggregating individual country (seasonally adjusted) IP estimates. According to this alternative measure, IP rose a solid, though not as boomy, 7.1% ar in 1Q after growing 2.3% ar in 4Q. The rise in German orders at the start of the year and the sharp pickup in business surveys across the region suggest that IP growth should show a further acceleration in 2Q.

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External trade and payments

Foreign trade

	Jan	Feb		Mar	
Germany					
€ bn, values, sa					
Trade balance	8.8	12.1		—	*13.3*
Trade balance—year earlier	7.2	8.4		9.0	
Exports	67.8	71.3		—	*79.0*
%m/m	-6.5	5.1		~~3.0~~	*10.7*
Imports	59.0	59.2		—	*65.7*
%m/m	5.6	~~0.2~~	*0.3*	—	*11.0*

German exports reported a solid monthly gain in March, reflecting the underlying momentum in foreign demand, as also suggested by the PMI and IFO surveys. Given the above-expectations exports report, the near-record level of the export expectations index in the German IFO, and the record level of the new export orders index in the German manufacturing PMI, there will likely be a return to double-digit export growth in Germany in 2Q10.

Inflation

Consumer prices

	Feb	Mar	Apr	
Germany (final)				
%m/m nsa	0.4	0.5	*-0.1*	
%m/m sa	-0.2	0.6	*0.2*	
%oya nsa	0.6	1.1	*1.0*	
HICP (%oya)	0.5	1.2	*1.0*	
France				
%m/m nsa	0.6	0.5	*0.3*	
Index ex tobacco nsa	118.95	119.50	~~119.98~~	*119.90*
%oya nsa	1.3	1.6	~~1.8~~	*1.7*
HICP (%oya)	1.4	1.7	*1.9*	
Italy (final)				
%m/m nsa	0.1	0.3	*0.4*	
%oya nsa	1.2	1.4	*1.5*	
HICP (%oya nsa)	1.1	1.4	*1.6*	
Spain (final)				
%m/m nsa	-0.2	0.7	*1.1*	
%oya nsa	0.8	1.4	*1.5*	
HICP (%oya nsa)	0.9	1.5	*1.6*	
Netherlands				
%m/m nsa	0.7	1.2	~~0.4~~	*0.3*
%oya nsa	0.8	1.0	~~1.2~~	*1.1*
HICP (%oya)	0.3	0.7	~~0.7~~	*0.6*

The downward movement in German headline inflation was the result of a sharp decline in core inflation, not completely offset by the significant increases in food and energy inflation. The fall in core inflation was due to package holidays and hotel and restaurant inflation. The decline in the two components alone was responsible for roughly 75% of the overall fall in core inflation in April. It appears very likely that a large part of the movement is noise and will be reversed in May, but the underlying inflation trajectory for these services is downward. The rest of the core inflation basket also moved downward, although at a slower pace. Beside the intensification in the noise, it appears that German core inflation is now declining in line with expectations, after remaining practically unchanged throughout 2009.

Energy inflation rose to 5.1%oya in April from 3.9%oya in March, with a 1.3% monthly rise. Gasoline and other liquid fuel prices were up substantially, helped also by the depreciation of the euro during April. Similarly food inflation rose in April. Fresh food prices kept rising in sequential terms for the sixth month in a row. We expect to see energy and food inflation rising further in the next few months.

French inflation also followed suit with falling core inflation in April, while reporting a sharp uptick in food and energy inflation. The decline in core inflation was almost entirely caused by a fall in inflation for transport services, package holidays, and further discounts on car prices. The rise in transport services is connected with the spring school vacations and we expect a consistent part of this decline to reverse in May. More broadly, the underlying trend of a decline in core was confirmed once more.

Energy inflation was up in April, driven by increased prices for gasoline, as well as an 8.2% rise in natural gas prices. This is the first significant tariff reset since May 2008 (although some smaller increases did occur in the meantime). Food prices rose again in April, both in monthly and yearly terms. In particular, seasonal food inflation was up 7.3%oya in April, after 5.5%oya in March. We expect the upward trend to be maintained in the next few months.

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Japan

- **Real private consumption held firm in March; small business sentiment improved further in April**
- **Fiscal environment continues to deteriorate, but no political consensus on fiscal austerity**
- **Next week: 1Q GDP forecast looks for 5.0% ar growth; we anticipate no surprises from the BoJ**

Along with some stabilization in financial markets, two economic indicators released this week supported our bullish assessment of the current state of the economy. First, the Cabinet Office's composite index of real private consumption increased at a decent pace in March—although the gain was not decisively strong as suggested by retail sales and household spending data released two weeks ago. Second, the Economy Watchers survey surprised on the upside in April; the headline overall index level was very close to a neutral reading of 50, its highest rate since March 2007.

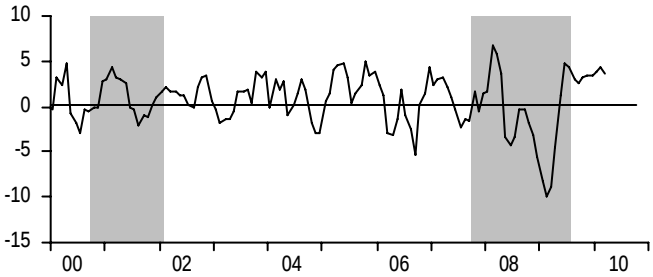
Next week's focus is the 1Q10 GDP report on Thursday and the subsequent BoJ policy meeting on Friday. While our forecast of a 5.0%q/q saar increase points to a marked acceleration when compared both to the previous quarter (4Q09: +3.8%) and to other major economies, it is reasonably close to market consensus estimates of 4.7% (according to the Economic Planning Association survey of 39 respondents). In fact, the average forecast from the top eight survey respondents was for growth of 6.3%, the highest rate since 1Q00. To be sure, Japan's GDP—especially the quarterly estimates—is prone to substantial revision, and its volatility raises doubts about its reliability. Nevertheless, the expected 1Q pickup should confirm that Japan's recovery remains solid.

Regarding monetary policy, the BoJ surprised us at its April 30 policy meeting by announcing that the Bank staff will examine "possible ways to support private financial institutions in terms of fund provisioning with a view to strengthening the foundations for economic growth." Many commentators, including us, are puzzled by this new initiative since it was far from clear how new measures can end deflation. We believe the BoJ feels the importance of conveying the message that it is taking action in the face of political pressure.

We do not expect the BoJ to disclose policy details as early as next week, but more likely at its meeting on June 15. Also, while we believe the impact of any new initiatives on the financial markets will have limited effect, either positive or negative, we do not expect them to be detrimental to the overall economy.

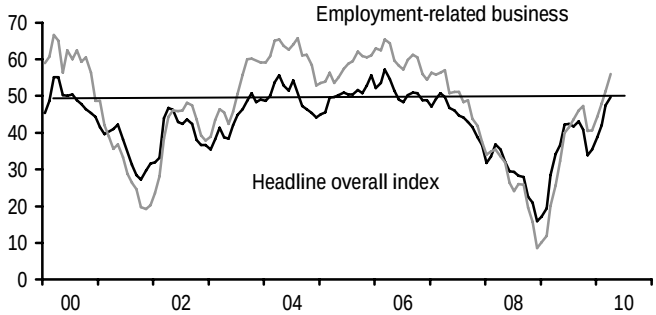
Cabinet Office composite index of real private consumption

%char 3m/3m



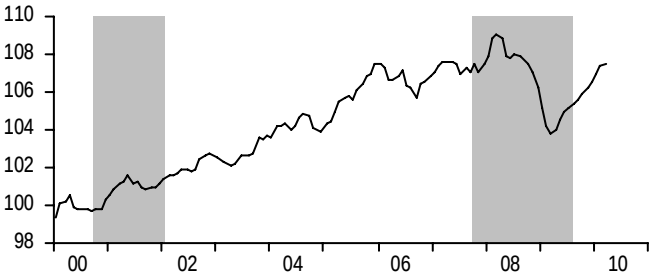
Economy Watchers survey

DI



Cabinet Office composite index of real private consumption

Index, 2000=100, sa, 3mma



Private consumption holds firm

The Cabinet Office's composite index of real private consumption edged up 0.2%m/m sa in March, after a downwardly revised 0.1% decline (from 0.0%) in February, leaving the 1Q average up 3.6% annualized from 4Q. Compared to the sharp gain in retail sales (+0.8%) and core real household spending (+5.0%) in March, the rise in this index was modest, posing some downside risk to our 1Q and 2Q forecasts of GDP-based consumption of 3.5%q/q saar and 2.0%, respectively. Nevertheless, a 2%-3% ar gain of consumption is solid, given that the average pace of gain during the last expansion period from 2002-07 was a mere 1.3%.

The consumption index is now back to its level prior to the Lehman crisis in 2008. The main driver of the recovery has

been durable goods consumption, which has been supported by government incentives. That said, recent retail sales and household spending data, as well as anecdotal information, suggest that the gain in consumption is broadening to nondurable goods and services. Next week's GDP data will indicate how much the spending component is contributing.

Looking ahead, unusually cold weather was probably a drag on consumer spending in April, but sunny weather nationwide during the Golden Week holidays in early May should have boosted consumption in services. More importantly, the expected improvement in the labor market, income, and consumer sentiment should have provided a tailwind to consumer spending. Indeed, some surveys expect an increase in employees' summer bonuses, usually paid in June and July. Moreover, payment of child care allowances—a headline DPJ policy demonstrating the new government's support for households—will start from June. While the recent plunge in equity prices may have hurt sentiment, we feel the underlying trend of consumption looks set to remain firm.

Broad-based gains in Economy Watchers survey

The Economy Watchers survey was stronger than expected, as the headline index climbed to 49.8 in April after a 5.3pt jump in March (47.4). The improvement was broad-based across sectors and regions, with the largest rises coming in employment-related businesses and manufacturers. Anecdotal evidence was generally positive; many respondents saw an increase in orders and customers, although there were some concerns about rising input prices of materials and low sales prices.

Current account surplus recovered

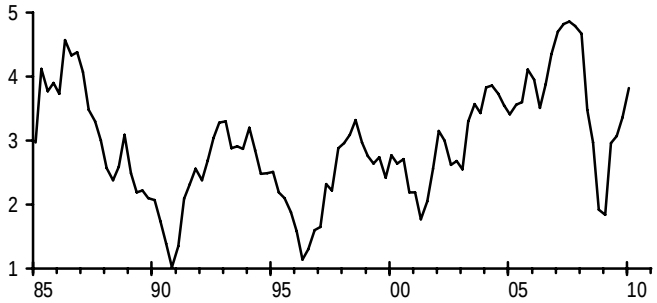
From a balance of payments perspective, Japan has returned to normal. The ratio of the current account surplus to GDP was 3.8% in 1Q, only slightly above the average during the past expansion phase from 2002-07 (3.7%). The main driver of the recovery was the trade balance, largely on the back of solid growth in external demand. The gain in the surplus means that the flow of funds in the domestic economy increased, and this should eventually filter down to finance the government deficit given that investment by firms and households (i.e., private demand of funds) remains subdued.

Europe a long way away for politicians

MoF reported the latest figures on central government debt outstanding at the end of March (end of FY2009): The debt increased ¥45 trillion (9.6% of GDP) in one year. The

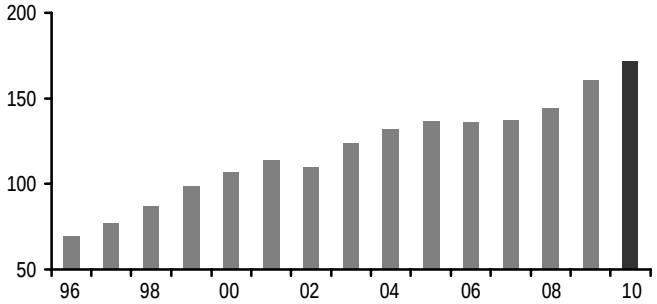
Current account surplus

% of GDP with J.P. Morgan forecast of 1Q GDP



Central government debt

% of GDP, at the end of fiscal year



Note: Fiscal Investment and Loan Program Bonds are excluded. FY2010 is calculated based on the MoF's projection of only government bonds.

MoF's projection for this fiscal year suggests that debt will increase by a further ¥42 trillion to ¥803 trillion (172%) at the end of March 2011. Including local governments' liabilities, the aggregate debt of central and local governments is expected to reach 200% of GDP.

In light of the European sovereign debt crisis, some executive members of the Cabinet mentioned the importance of fiscal discipline and indicated that new issuance of JGBs should be reduced in the next budget for FY2011. However, Prime Minister Hatoyama claimed that this was not an official statement from his Cabinet, although he emphasized the importance of financial discipline. Unlike in other major developed countries, there is no widespread belief among Japanese politicians that a period of fiscal austerity is imminent.

To be sure, it is reported that the manifesto for the July Upper House election includes a promise of raising the consumption tax rate (VAT, currently 5%) after the next Lower House election in 2013. But, with the low approval ratings of the Cabinet and the ruling party (DPJ), spending proposals have dominated recent political discussions, rather than talk of cutting expenditure and/or raising taxes. While Japan's financial situation differs from that in Greece, we view the current political climate as worrisome for Japan's long-term future.

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Data releases and forecasts

Week of May 17 - 21

Mon May 17 8:50am

Corporate goods price index

%oya

	Jan	Feb	Mar	Apr
Domestic CGPI	-2.2	-1.6	-1.3	-0.3
Export prices	2.8	1.3	-2.2	___
Import prices	10.7	8.0	4.4	___

The report is expected to show that deflationary pressure has eased somewhat at the intra-corporate level, amid a broader-based recovery in the corporate sector.

Mon May 17 8:50am

Machinery orders

%m/m sa

	Dec	Jan	Feb	Mar
Domestic private sector, ex for ships and from utilities	20.1	-3.7	--5.4	5.0
Manufacturing	17.1	3.3	-0.3	___
Core nonmanufacturing	22.9	-12.9	-4.0	___
Foreign	20.9	-8.8	8.4	___

Core machinery orders will probably continue to point to recovering business capital investment.

Mon May 17 2:00pm

Construction spending

% change

	Dec	Jan	Feb	Mar
Public	4.6	24.0	19.6	___
%m/m sa, by J.P. Morgan	0.0	18.8	-3.0	___
Private	-24.8	-9.8	-15.0	___
Residential	-20.2	-1.3	-9.5	___
Nonresidential	-29.9	-18.7	-0.6	___
Building and structures	-33.6	-21.4	-25.9	___
Civil engineering	-24.5	-14.8	-13.2	___

In the first two months of this year, oya changes in construction spending data were artificially boosted by a change in the methodology (a revision of the assumed progress pattern of construction and also of seasonal factors in the winter months). Hence, the government decided to make some adjustments as it uses the public sector component in this report as an input to public investment in the 1Q GDP report.

Tue May 18 8:30am

Reuters Tankan survey

DI, % saying "good" minus "bad"

	Feb	Mar	Apr	May
Manufacturing	-13	-8	0	___
Nonmanufacturing	-31	-22	-14	___

This monthly large-company survey will likely confirm that the economic recovery continues on a broad basis. In recent months, indicators in the nonmanufacturing sector show clear signs of picking up, while manufacturing indicators suggest that output growth is slowing, but to a still solid pace.

Tue May 18 8:50am

Index of tertiary sector activity

% change

	Dec	Jan	Feb	Mar
%m/m sa	-0.7	2.5	-0.2	-0.5
%oya	-2.7	-0.5	0.4	4.0

The tertiary sector activity report for March is expected to reinforce the message that the nonmanufacturing sector is now enjoying a solid recovery. The index showed only a marginal payback for the outsized jump in February, and the available data on activity in the commercial and financial sectors suggest that a meaningful drop is unlikely to be experienced in March.

Tue May 18 2:00pm

Consumer sentiment

Diffusion index, nsa

	Jan	Feb	Mar	Apr
Consumer sentiment	39.0	39.8	40.9	42.0
Standard of living	39.8	40.7	41.2	___
Income growth	37.9	38.8	39.5	___
Labor market conditions	33.1	34.2	35.9	___
Durable goods purchases[1]	45.3	45.4	46.8	___

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

Based on the solid recovery in sentiment among consumer-oriented businesses and employment businesses, as demonstrated by the Economy Watchers survey for the month, we expect the headline index to post a fourth consecutive monthly rise in April.

Tue May 18 2:30pm

Nationwide department store sales

%oya, unless noted

	Jan	Feb	Mar	Apr
Overall	-7.0	-7.1	-5.1	-6.0
%m/m sa, by J.P. Morgan	-1.9	0.2	-1.0	-0.8
Same store	-5.7	-5.4	-3.5	___

Major stores have been reporting that there were offsetting factors affecting their April sales: a negative impact from cold weather on sales of spring clothing and the resumption of luxury goods sales.

Wed May 19 1:30pm

Industrial production—final

%m/m sa

	Dec	Jan	Feb	Mar
Production	2.6	4.3	-0.6	0.3
Shipments	2.4	4.5	-0.2	1.6
Inventories	-0.2	1.1	1.6	-1.6
Inventory/shipments ratio	-4.8	-1.8	0.3	-5.2
Operating ratio	2.7	7.1	0.0	___
Production capacity (%oya)	-0.1	0.2	0.1	___

Thu
May 20
8:50am

GDP—first preliminary estimates
%q/q saar

	2Q09	3Q09	4Q09	1Q10
Real GDP	6.0	-0.6	3.8	5.0
Private consumption	4.6	2.4	2.8	3.5
Residential investment	-32.6	-27.7	-12.5	20.0
Business investment	-15.6	-9.8	3.8	8.0
Public consumption	1.1	0.3	2.5	0.5
Public investment	28.9	-5.8	-5.0	15.0
Exports	42.2	37.8	21.7	16.0
Imports	-14.7	23.3	5.1	8.0
%-pt contribution to q/q saar GDP growth				
Net exports	5.9	2.1	2.2	1.3
Inventories	-1.4	-0.8	-0.6	-0.5
GDP deflator (%oya)	-0.6	-0.6	-2.8	-3.1

We now expect that real GDP growth accelerated meaningfully in 1Q this year. This view is based on better-than-expected outcomes for recently released key monthly indicators, including the CAO private consumption index, core capital goods shipments, and housing starts, as well as the continued strength in net exports.

Review of past week's data

Cabinet Office private consumption index

	Jan	Feb	Mar
%m/m sa	0.3	~~0.0~~ *-0.1*	___ *0.2*

The index, our preferred measure for tracking GDP consumption, rose 3.6%q/q saar in 1Q after rising 3.5% in 4Q. This appears to pose a modest downside risk to our 1Q real GDP consumption forecast, which looks for an acceleration to +3.5%q/q saar from +2.8% ar in 4Q last year.

Indices of business conditions (May 12)

	Jan	Feb	Mar
Composite index (sa)			
Leading	~~97.3~~ *97.2*	~~98.5~~ *98.4*	~~102.9~~*102.8*
Coincident	~~100.3~~ *99.8*	~~100.5~~*100.0*	~~101.6~~*101.1*
Diffusion index			
Leading	72.7	90.9	100.0
Coincident	100.0	100.0	100.0

Money stock and bank lending (May 13)

%m/m sa, incl. agricultural worker households

	Feb	Mar	Apr
M2	2.7	~~2.6~~ *2.7*	~~2.4~~ *2.9*
L	~~1.0~~ *0.9*	~~1.0~~ *0.9*	~~1.0~~ *1.6*
Bank lending	-1.6	-2.0	~~-2.0~~ *-1.8*
Adjusted for special items	-1.3	-1.7	-1.7

The BoJ assesses that loan demand remains weak, mainly due to poor demand for investment funds from the corporate sector.

As for April's money stock report, the acceleration in demand deposits—which is included in both measures—was possibly due to a shift of demand deposit assets from the financial sector to individuals, caused mostly by the demutualization of one of the largest insurance companies. It has been reported that a large number of individual policy holders received cash instead of company equity.

Corporate liquidity continues to build from recovering profits and still-depressed investment spending. Also, valuation effects on the value of capital from the rise in equity prices during the past fiscal year (ended on March 31) probably added to the strengthening in L.

Balance of payments (May 13)

¥ bn sa, unless noted

	Jan	Feb	Mar
Current account	~~1713~~*1709*	~~1119~~*1068*	~~1364~~*1773*
Trade balance	~~994~~ *993*	~~597~~ *541*	~~769~~ 845
Services	~~-123~~ *-122*	~~-178~~ *-175*	~~-130~~ *-190*
Income	~~920~~ *918*	~~828~~ *829*	~~825~~*1171*
Current transfers	-79	-128	~~-100~~ *-54*
Current account (nsa)	900	1471	~~1890~~*2534*

In March, the trade surplus, which was the major cause of February's drop in the balance of payments, rebounded, largely due to a retreat in imports following previous rises. In addition, the income account surplus surged, led by rising net direct investment income, which had been on a declining trend. According to the BoJ, this reflected a temporary increase in dividend payments to parent companies from overseas affiliates at the fiscal year-end to compensate for soft profits. Meanwhile, the portfolio investment income component, the largest part of which reflects interest receipts on bonds, continued to show signs of stabilization after having declined during the recent recession.

Economy Watchers survey (May 13)

DI

	Feb	Mar	Apr
Current conditions	42.1	47.4	~~48.5~~ *49.8*
Households	40.6	46.5	___ *48.2*
Business	43.8	48.0	___ *51.8*
Employment	48.0	51.3	___ *56.0*

The Economy Watchers survey result reiterates the message from the Shoko Chukin small firm survey—another important indicator of smaller-firm sentiment—that the momentum in the economy has strengthened at the start of this quarter.

Looking at the components, the employment DI, which tends to capture marginal changes in economic conditions more than other components, rose markedly to a level well above 50, in line with recent developments in quantitative labor market indicators (the unemployment rate and the job offers ratio), which have been improving since 4Q last year.

The business DI has also been rising solidly, with respondents citing good demand from emerging markets (especially China), a recovery in business investment, and a pickup in construction activity/the real estate market. Despite the negative weather effect on sales of seasonal items, and the exclusion of several items from the extended "eco-point" system, the sentiment DI of consumer-oriented business extended its streak of consecutive monthly rises.

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Canada

- **Real trade deficit unexpectedly widens in March, points to neutral net exports for 1Q GDP**
- **Silver lining in surge in imports in 1Q is rebound in capex**
- **Strong rebound in terms of trade providing significant boost to national income**
- **Manufacturing shipments in March point to strong 1Q GDP**

Data released this week continue to point to an ongoing robust recovery. Housing starts rose slightly to 201,700 (annual rate) in April from 199,200 in March. For the first month of 2Q, starts were up 6% ar from the 1Q average, after quarterly increases of 49% ar in 1Q and 77% ar in last year's 4Q. So, clearly the pace of housing construction has begun to moderate. The nominal trade surplus unexpectedly narrowed in March with exports rising and imports falling. Manufacturing sales rose 1.2%m/m in March while constant dollar sales jumped 1.7%m/m, providing further support for a strong 1Q GDP reading.

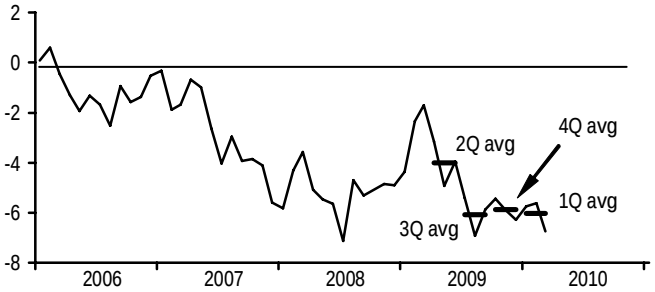
The nominal trade surplus unexpectedly narrowed to C$254 million in March from a slightly downwardly revised C$1.2 billion in February. Exports ended six consecutive months of increase, falling 1.3%m/m, but this was due solely to a 6.9% drop in the price of energy exports, which led to a 6.6%m/m drop in the exports of energy products. Excluding energy exports, overall exports were up 1.3%m/m. Real exports (chained 2002 C$) jumped 2.6%m/m. For all of 1Q, real exports rose 10.6%q/q ar, down from 16.2% in 4Q. Apart from the rebound in exports in the second half of last year, 1Q10 export growth was the most rapid since 2Q04.

Imports rose 2.0%m/m with more than two-thirds of the increase due to a record increase in imports of precious metals. Real imports were also strong, surging 5.3%m/m. Imports of industrial goods and materials rose 10.4%m/m, the largest percentage monthly increase since January 1992. The gain was due to an increase in volume as prices actually fell. Imports of precious metals jumped C$1.0 billion, a record.

With real imports outpacing real exports, the real trade deficit widened markedly in March—to C$6.7 billion from C$5.6 billion in February. For all of 1Q, the real deficit averaged C$6.0 billion per month versus a C$5.9 billion monthly average in 4Q. As a result, real net exports should be about neutral for overall GDP in 1Q. After having subtracted 5.2%-pts from

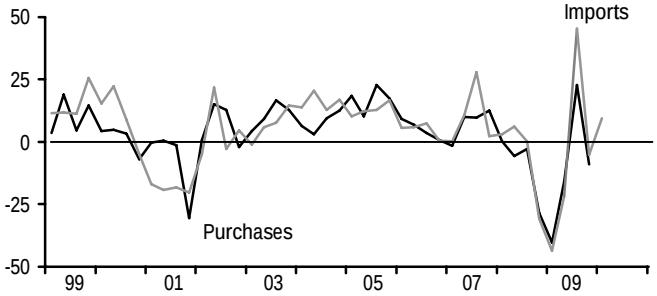
Monthly real merchandise trade balance

Chained 2002 C$ bn, monthly rate



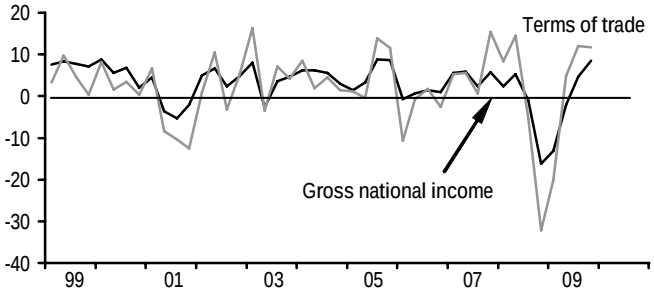
Real capital equipment: purchases and real imports

q/q %chg saar



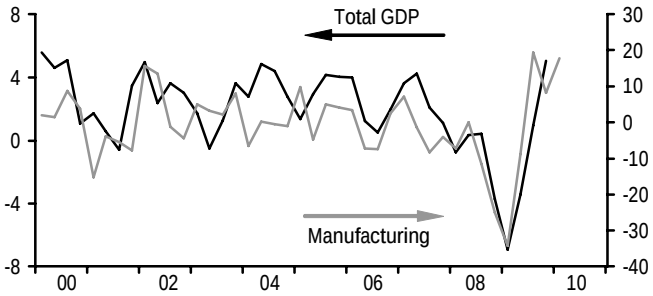
National income and terms of trade

%q/q ar



Real manufacturing shipments and total real GDP

%q/q, saar %q/q, saar



GDP in 3Q and 4.0%-pts in 2Q last year, net exports added nearly 1.5%-pts to GDP in 4Q. Before the March report, net exports were on track to make a similar contribution in 1Q as they had in 4Q.

A silver lining in the jump in real imports was the 4%m/m jump in the real imports of machinery and equipment. Canadian businesses import about 70% of their purchases of machinery and equipment. For all of 1Q, these imports were up 9.5% ar from 4Q, following a 5.2%q/q ar decline in 4Q and pointing to a rebound in business investment spending in 1Q GDP following a decline in 4Q.

Also on the trade front, the rebound in Canadian terms of trade has played a key role in the revival of the overall economy. Falling terms of trade restrained national income and thereby domestic demand during the recession. However, as commodity prices have turned around, so too have the terms of trade. While still down significantly from their peak, the terms of trade have been rebounding steadily and are boosting national income and domestic demand, a key force behind the more robust-than-expected rebound in overall activity. Real gross domestic income jumped 8.5%q/q ar in 4Q, its fastest quarterly pace of advance since 4Q05.

Manufacturing sales increased 1.2%m/m in March. Food and motor vehicle manufacturers were the largest contributors to the gains. In constant dollars, sales jumped 1.7%m/m for their seventh consecutive monthly increase. For all of 1Q, real sales were up 17.8% ar from 4Q and support our view that the pace of overall GDP growth accelerated in 1Q (1Q GDP is scheduled to be released on May 31). Inventory levels fell 1.1% in March. After falling sharply from February to September 2009, the rate of inventory decline has slowed significantly since. The inventory-to-sales ratio fell further to 1.32 in March, the lowest level since September 2008. We think the inventory correction has mostly run its course and look for inventory building in the near term.

Data releases and forecasts

Wed May 19 8:30am — **Wholesale sales**
sa

	Dec	Jan	Feb	Mar
Total, %m/m	1.3	2.4	-1.2	0.7
%oya	1.4	9.5	8.5	9.7

Thu May 20 8:30am — **Leading indicators**
%m/m

	Jan	Feb	Mar	Apr
Smoothed	0.7	0.9	1.0	
Unsmoothed	-0.2	1.5	0.5	

Fri May 21 7:00am — **Consumer price index**
%m/m nsa, unless noted

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

Fri May 21 8:30am — **Retail sales**
%m/m nsa, unless noted

	Dec	Jan	Feb	Mar
Total	0.2	0.9	0.5	0.0
%oya	6.4	6.6	6.4	6.2
Ex autos	0.4	2.0	-0.1	0.3
%oya	4.3	6.2	4.8	5.5
Ex autos & gasoline	0.2	2.0	-0.2	0.3
%oya	2.5	4.5	3.2	3.6
Real retail sales	0.5	0.2	0.6	-0.5
%oya	5.3	4.9	5.5	4.4

Review of past week's data

Housing starts (May 10)

	Feb		Mar		Apr	
Total (000)	~~204.6~~	*203.9*	~~200.9~~	*199.2*	~~205.0~~	*201.7*
%m/m	~~-8.3~~	*5.5*	~~-1.8~~	*-2.3*	~~-2.0~~	*1.3*
%oya	~~-78.0~~	*77.3*	~~-37.9~~	*36.7*	~~-83.0~~	*80.1*

International trade (May 12)
Sa

	Jan		Feb		Mar	
Balance (C$ bn)	~~0.75~~	*0.87*	~~1.39~~	*1.15*	~~1.60~~	*0.25*
Exports (%m/m)	~~-0.1~~	*0.7*	~~-2.8~~	*1.8*	~~-3.2~~	*-0.8*
Imports (%m/m)	~~-1.7~~	*-1.8*	~~-0.9~~	*1.0*	~~-2.7~~	*2.0*

Manufacturing report (May 14)
%m/m sa, unless noted

	Jan		Feb		Mar	
Sales	~~-1.8~~	*1.6*	~~-0.1~~	*0.0*	~~-2.4~~	*1.2*
New orders	~~-0.4~~	*-0.6*	~~-1.4~~	*1.3*	~~-1.6~~	*-0.7*
Unfilled orders	~~-0.3~~	*0.2*	~~-1.5~~	*1.3*	~~-0.8~~	*-0.4*
Inventories	~~-0.2~~	*0.0*	0.2		~~-0.3~~	*-1.1*
Inventory-shipments ratio	1.35		1.35		~~1.33~~	*1.32*

New motor vehicle sales (May 14)
Sa

	Jan		Feb		Mar	
Total (mn units, ar)	~~1.536~~	*1.534*	~~1.660~~	*1.664*	*1.594*	
%m/m	~~-1.0~~	*-0.9*	~~-8.1~~	*8.5*	~~-4.0~~	*-4.2*
%oya	~~-7.8~~	*7.6*	~~-22.8~~	*23.1*	~~-10.1~~	*10.2*

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Mexico

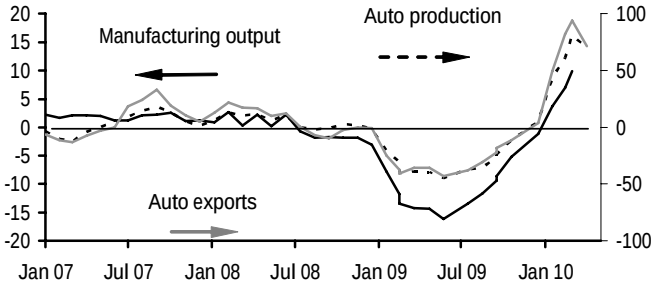
- **This week's data confirmed that economic recovery has been externally driven**
- **We anticipate GDP to have grown 4.9%oya in 1Q10**
- **Banxico is widely expected to remain on hold next week**

This week's data confirmed that Mexico's economic recovery has been driven mainly by external demand. On the supply side, industrial production surged 7.6%oya in March led by manufacturing activity that has continued on its vigorous upward trend since 2H09. It is highly likely that we will continue to observe strong IP reports as auto production jumped nearly 70%oya in April, mainly due to external demand (first chart). However, in contrast to the better-than-expected IP and auto reports, supermarket sales fell 5.1%oya in real terms in April. Even though these reflected negative base effects from last year's "panic purchases" spurred by the new strain of influenza A(H1N1), they indicate that domestic demand remains weak. Furthermore, gross fixed investment posted a monthly decline of 0.2% in February (-2.3%oya), signaling that new investment also remains subdued. Nevertheless, we believe some investment projects—particularly in the auto industry—are providing a more promising scenario for 2010. All in all, we anticipate that domestic demand will gain momentum in 2H10 as we start to observe the spillover of the industrial rebound into the services sector.

1Q GDP to rise 4.9%oya

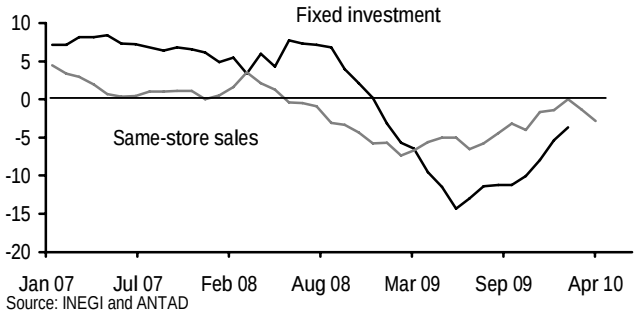
Next week INEGI will release the supply-side GDP figure for the first quarter of the year. We expect the Mexican economy to have grown 4.5%oya during this period, rebounding from -2.3%oya in the fourth quarter of 2009. Taking a look at the breakdown, we already know that industrial activity—which accounts for 32% of GDP—increased 5.4%oya (7.9% q/q saar). However, we are still missing the agriculture and services data for March. So far, agricultural production surged by 1.1%oya during the first two months of the year, while the services sector increased 2.3%oya in the same period. In this context, we anticipate these components to have posted year-over-year growth rates during 1Q10 of -1.3% and 2.7%, respectively. These figures should indicate that the Mexican economy has continued to recover, mainly because of the rebound in externally driven manufacturing activity. However, in our view, they should also signal that the services sector—which is highly correlated with domestic demand—has stabilized. All in all, we forecast Mexico's GDP to grow 4.5% in 2010

Manufacturing output, auto production, and exports
%oya, 3mma



Source: INEGI and AMIA

Fixed investment and ANTAD's same-store sales
%oya, 3mma, real terms



Source: INEGI and ANTAD

GDP

%oya	1Q09	2Q09	3Q09	4Q09	2009	1Q10F
GDP	-7.9	-10.0	-6.1	-2.3	-6.5	4.9
Agriculture	0.1	3.4	1.3	2.1	1.8	-1.3
Industrial	-9.6	-11.1	-6.3	-1.9	-7.3	5.4
Manufacturing	-13.5	-16.1	-9.4	-1.4	-10.2	9.9
Nonmanufacturing	-4.3	-4.2	-2.1	-2.7	-3.3	-0.1
Services	-7.3	-10.2	-6.2	-2.9	-6.6	2.7

Source: INEGI and J.P. Morgan

(consensus: 4.1%), as we expect domestic demand to gain momentum in 2H10 when we look for the better labor market conditions we have begun to observe to translate into increased consumption.

Banxico to keep rates unchanged and confirm a dovish stance

Next Friday (May 21), Banco de México will hold its monthly monetary policy meeting. It is widely expected that the board will leave the reference rate unchanged at 4.5%, where it has been since July 2009. We believe that in its post-meeting communiqué the monetary authority will emphasize that: (1) Global growth has continued to expand, but the Euro area sovereign crisis has posed some risks to the pace of economic recovery going forward;

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(2) Mexico's economic recovery has been driven mainly by external demand, while domestic demand remains weak. As a result, the output gap remains wide and will probably close sometime next year; (3) Even though consumer prices surged dramatically during 1Q10, inflationary pressures from the higher taxes and administered price hikes implemented at the beginning of the year have eased, and these have not led to second-round effects; and (4) Medium- and long-term inflation expectations remain well anchored. Even though Banxico's statement might advise that the members of the board will continue to pay close attention to wage settlements and inflation expectations, we believe that the overall tone of the written communication will be on the dovish side. In this context, and pretty much for the same reasons mentioned above, about two weeks ago we changed our monetary policy call to a low-for-long view, instead of predicting hikes in the fourth quarter of this year, as the market consensus continues to expect.

Data releases and forecasts

Week of May 17 - 21

Mon May 17 — **Consar report**
Mex$ bn

	Jan	Feb	Mar	Apr
Assets under management	1,160	1,196	1,223	___
Government securities	772	796	791	___
Equity investment	147	156	172	___

Tue May 18 9:00am — **Central bank foreign reserves**
US$ bn

	Apr 23	Apr 30	May 7	May 14
Gross international reserves	97.3	97.4	98.1	___

Thu May 20 9:00am — **Real GDP**
%oya, unless noted

	2Q09	3Q09	4Q09	1Q10
Total	-10.1	-6.1	-2.3	4.9
%q/q saar	1.1	10.4	8.4	0.0
Agriculture	3.4	1.3	2.1	-1.3
Industry	-11.1	-6.3	-1.9	5.4
Services	-10.2	-6.2	-2.9	2.7

Thu May 20 9:00am — **Indicator of overall economic activity (IGAE)**

	Dec	Jan	Feb	Mar
%oya	0.5	2.4	3.4	4.5
%m/m sa	0.0	-1.0	0.5	0.6

Fri May 21 9:00am — **Retail sales**

	Dec	Jan	Feb	Mar
Retail sales				
%oya	1.6	-1.8	2.3	1.8
%m/m sa	0.3	-0.6	1.4	1.2

Review of past week's data

Central bank foreign reserves (May 11)
US$ bn

	Apr 23	Apr 30	May 7	
Gross international reserves	97.3	97.4	___	*98.1*

Automobile production and sales (May 11)
%oya

	Feb	Mar	Apr	
Production	55.6	85.1	___	*69.6*
For export	59.6	82.9	___	*79.2*
Domestic sales	-3.3	1.8	___	*17.6*

Nominal wage settlements (May 11)
% per annum, one year ahead

	Feb	Mar	Apr	
Nominal increase	4.5	4.6	~~4.9~~	*4.8*
Real terms[1]	-0.3	-0.3	___	*0.5*

1. Using 12-month average CPI inflation.

Fixed investment (May 12)
%oya nsa

	Dec	Jan	Feb	
Total	-4.1	-4.8	~~-3.0~~	*-2.3*
Machinery and equipment	-8.6	-9.4	~~-2.7~~	*-3.7*
Construction	-0.4	-1.9	~~-0.4~~	*-1.5*

Industrial production (May 12)

	Jan		Feb		Mar	
%oya nsa	~~3.5~~	*3.6*	~~4.4~~	*5.0*	~~5.9~~	*7.6*
Manufacturing	~~8.0~~	*7.7*	~~8.8~~	*8.9*	~~12.5~~	*13.1*
%m/m sa	-0.1		~~0.6~~	*0.9*	~~0.3~~	*0.9*
Manufacturing	-1.4		~~0.2~~	*0.8*	~~1.3~~	*1.5*

ANTAD same-store sales (May 12)
%oya, real terms

	Feb	Mar	Apr	
Total	-1.7	-1.7	~~-5.5~~	*-5.1*

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Brazil

- **Consensus for 2010 inflation and GDP growth is drifting higher; we believe it has further to go**
- **March retail sales surprised on the upside and grew more than 20%q/q ar in 1Q10 from 12% in 4Q09**
- **Government announced it may curb expenditure growth to ease burden on monetary policy**

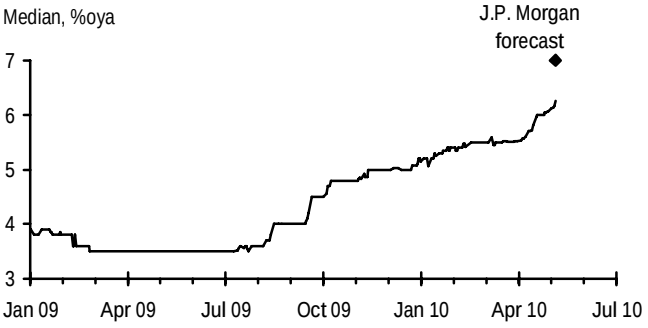
The recent string of strong activity and high inflation releases continues to push up market expectations. In this week's BCB survey, the 2010 IPCA market consensus increased to 5.50%, with most of the rise from last week's 5.42% (8bp) being explained by the April release, which was 7bp higher than expected (0.57% versus 0.50%). The 12-month-ahead IPCA also increased to 4.83% (from 4.72%), and is now above the 2011 IPCA projection, which was flat at 4.80%. Last week, we also changed our 2010 IPCA projection to 5.90%, on the back of increases in 2Q10 monthly projections. Our 2011 IPCA forecast was maintained at 5.10%. For GDP, market expectations for this year's growth increased to 6.26% (from 6.06% a week ago), on the back of the strong recent activity data flow. We still believe the market consensus will converge to our 7.0% forecast (first chart), and this week's March retail sales should help to consolidate this trend.

Hefty retail sales acceleration in 1Q10

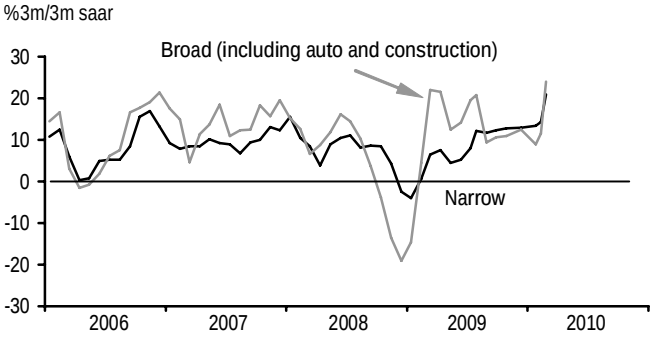
The narrow retail sales index (which excludes vehicles and building materials) accelerated significantly in 1Q10, from the double-digit pace registered in 2H09. March retail sales surprised the consensus (calling for 1.0%m/m sa) on the upside, expanding 1.6%m/m sa (15.7%oya) by the narrow measure. The February increase was also revised up to 1.8% (from 1.6% previously) following a 3.0%m/m sa surge in January. The double-digit expansion pace of narrow retail sales registered since 2H09 actually accelerated in 1Q10, with 3m/3m saar growth reaching 20.9% in 1Q10, from 13% in 4Q10 (second chart).

Sales by the broad measure (which includes vehicles and building materials) rose 5.0%m/m sa in March, from 2.2% in February, pointing to significant reacceleration in the broad component following the slowdown registered late last year. In fact, the broad retail sales index grew 24%q/q saar in 1Q10 (from 12.4% in 4Q09). Also for the oya calculation, the low comparison base last year resulted in an unprecedented expansion of 22% in March. The upsurge in auto sales in March (10.3%m/m sa) accounted for much of the increase in the broad concept. Car dealers' reports for

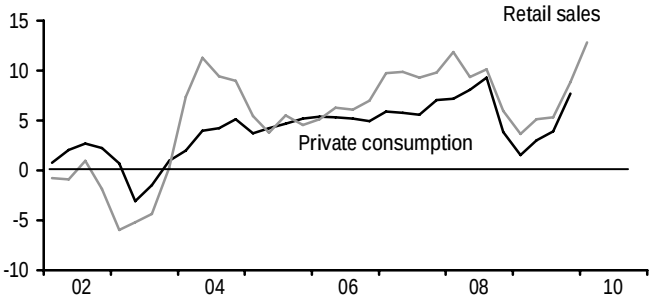
BCB survey of 2010 real GDP growth and J.P. Morgan forecast



Sharp acceleration of retail sales in 1Q10

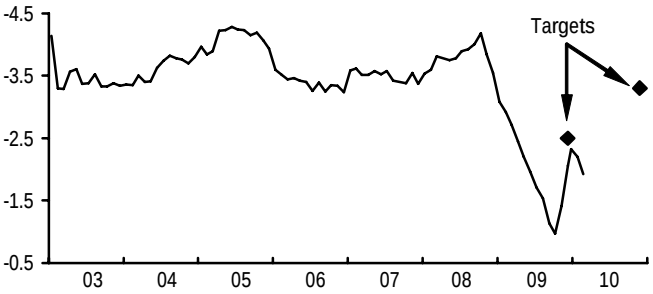


Surging retail sales should be reflected in 1Q consumption



Public sector primary balance (ex. interest)

12-month trailing as % of GDP, inverted scale (- denotes surplus)



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April showed that there was a retreat in car sales following the exceptional performance in March.

The retail sales results added support to the view that private consumption boomed in 1Q10 due to robust labor and credit market conditions, fiscal expansion, and very high consumer confidence. In fact, considering the close relationship between narrow retail sales and private consumption in the GDP accounts (third chart previous page), we expect total private consumption to rise about 9%oya in 1Q10. We've already highlighted that fixed capital formation likely grew more than 20%oya. These two components underpinned GDP growth in 1Q10.

Partial data point to some payback in April, but this will not prevent solid 2Q10 retail sales expansion. We've already noted that auto sales gave back part of the March gains, and this is also true for supermarket sales. However, the carryover effect left by the 1Q10 expansion is huge (7% for the narrow index and 17% for the broad component). Moreover, labor income gains should continue, and we see no signs of slower credit expansion in the short term. Therefore, even recognizing that the pace of expansion in 2Q10 will likely slow from the record high pace in 1Q10, high-frequency indicators are still consistent with quite solid gains during this quarter.

First signal of a better policy mix ahead

Minister of Finance Guido Mantega and Minister of Planning Paulo Bernardo announced this week that the government intends to cut BRL10 billion from the expansion of the central government's primary expenditures planned for 2010. The ministers highlighted that these measures should be considered "countercyclical" and help monetary policy to rein in the ongoing economic expansion. Minister Mantega also mentioned that the government has instruments to prevent excessive growth, and that GDP growth should not surpass 7%. Our assessment is that this measure will not prevent significant expansion of real expenditures in 2010, but it suggests that the government is taking stock of inflationary risks. Indeed, even allowing for the implementation of the BRL10 billion cut, the public sector primary surplus would still be around 2.6% of GDP, which is not much higher than last year's reading and is well below the 3.6% average that prevailed during 2003-2007. While the outright fiscal stance will not be tight, it is certainly encouraging to see the response of the government in favor of a more balanced policy mix. However, considering fiscal rigidities, the reduction in quasi-fiscal expansion would be the best way to help the monetary policy, but nothing has been announced on this front.

Data releases and forecasts

Week of May 17 -21

Thu May 20 7:00am — Consumer prices (IPCA-15)
%m/m nsa, % weights in parentheses

	Feb	Mar	Apr	May
Total (100)	0.9	0.6	0.5	0.59
%oya	4.6	5.0	5.2	5.2
%ytd	1.5	2.0	2.5	3.12
Ex volatile	0.8	0.4	0.4	0.5
Trimmed mean	0.4	0.4	0.5	0.5
By major component				
Food (20.5)	1.0	1.2	1.7	0.9
Transport (20.7)	1.3	0.4	-0.7	0.4
Housing (13.6)	0.4	0.3	0.1	0.4

Formal job creation (CAGED)
May 17 - 21

	Jan	Feb	Mar	Apr
Monthly creation (000)	181.4	209.4	266.4	na
12-month sum	1278.3	1478.5	1710.1	na

Review of past week's data

Retail sales

	Jan	Feb	Mar
%m/m sa	*3.1*	*1.8*	*1.6*
%oya nsa	*10.4*	*12.3*	*15.7*

General prices (IGP-10)
%m/m nsa

	Mar	Apr	May	
Overall	1.1	0.6	~~0.8~~	*1.1*
%oya	1.3	2.7	~~3.3~~	*3.6*
Wholesale prices	1.3	0.5	~~0.9~~	*1.3*
Consumer prices	0.8	0.8	*0.6*	
Construction costs	0.3	1.0	~~0.9~~	*0.8*

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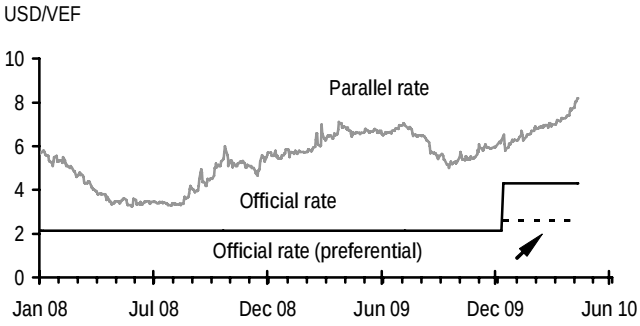
Andeans: Colombia, Ecuador, Peru, Venezuela

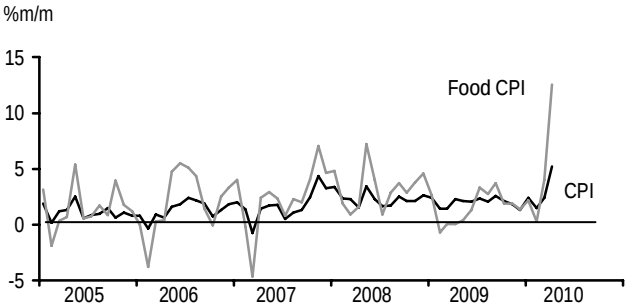
- **Venezuela is seeking to ban—or at least strictly regulate—a skyrocketing parallel FX rate**
- **Barring an increase in USD supply, these actions would only foster a less transparent "black" market**
- **The measures will exacerbate inflation pressure**

Venezuela's National Assembly this week approved a revision to the Law Against Illicit Foreign Exchange Transactions that could drastically change the nature of Venezuela's existing parallel FX market—essentially by driving out or at least strictly regulating local brokers that up to now have been the market's main participants. Recall that Venezuela currently has two official exchange rates, set at USD/VEF 2.6 and 4.3 as of January 2010, that operate in the context of Venezuela's seven-year-old capital controls. Meanwhile, as a result of reduced USD flows through the official rate(s), a well-established parallel FX rate has increased in relevance, but depreciated by more than 20% to over USD/VEF 8 just in this year.

Venezuela: official FX rate(s) and parallel rate



Venezuela: CPI inflation and food prices



Even when the FX law was tightened in 2008, a key loophole was deliberately left open. Namely, the law explicitly excluded FX-denominated securities from the definition of an FX transaction. Under Venezuela's capital controls, all FX transactions *in cash* require approval from FX controls agency CADIVI and are conducted through the Central Bank (BCV) at the official FX rate. However, the legal loophole allowed operations in *FX-denominated securities* to flourish in an unregulated parallel FX market. Mechanically, brokers would carry out swaps (or "permutas") of onshore VEF-denominated securities for offshore USD-denominated securities. For example, a local corporate long VEF would go to a broker and purchase a VEF-denominated local government bond, which in turn would be swapped to a counterparty in exchange for a USD-denominated bond (often a US Treasury or a Venezuela or PDVSA global) in an offshore account. The pricing of the VEF security and the USD security in the deal produced an implied FX rate—the so-called "permuta" rate. While legally this rate cannot be published, the transaction itself was perfectly legal. The bill introduced in the legislature this week would broaden the law's definition of FX transactions to include transactions in FX-denominated securities. It would also give the BCV the sole authority to carry out any FX transactions (including via securities).

Volumes in the parallel market in the past few years have averaged close to US$100 million per day. This compares to the CADIVI official rate flows currently in the range of US$115-120 million per day. We doubt whether the BCV (or any authorized agents acting in a future regulated market) can fully replace the volume of FX transactions that had been flowing through brokers in the parallel market. Thus, the BCV may effectively end up overseeing yet another quasi-official rate, while driving the "market" rate further underground.

The government's own focus on this issue appears to have intensified following the eye-popping 5.2%m/m inflation print for April—the highest monthly reading in more than seven years—that pushed oya inflation back above 30% (31.9% to be precise) for the first time in 15 months. While the main driver of the CPI spike was a 12.5%m/m increase in food prices caused by the relaxation of some price controls, the surge in the parallel FX rate certainly did not help.

Regulating the parallel rate will not solve the inflation problem. The government is attempting to reverse a deep recession by stimulating demand: public spending is up, interest rates are already negative in real terms, and credit conditions have been eased further. But the economy's supply side continues to be constrained by the inability to import key inputs and reluctance to invest given pervasive nationalization threats. In this environment, increased local liquidity will likely continue to seek safety in foreign currency—and inflation pressures will persist.

Argentina:

Data releases and forecasts

Week of May 17 - 21

Mon	Consumer confidence				
May 17		Feb	Mar	Apr	May
	Index	43.54	41.38	43.48	___
Fri	Trade balance				
May 21		Jan	Feb	Mar	Apr
	US$ bn	43.54	41.38	43.48	___
Fri	Industrial production				
May 21		Jan	Feb	Mar	Apr
	%oya nsa	5.2	11.0	10.6	___
Fri	Economic activity				
May 21		Jan	Feb	Mar	Apr
	%oya nsa	4.8	4.9	6.0	___

Review of past week's data

Consumer prices

	Feb	Mar	Apr	
Consumer prices (%m/m)	1.2	1.1	___	*0.8*
%oya	9.1	9.7	___	*10.2*
Wholesale prices (%m/m)	1.3	1.3	___	*1.0*
%oya	13.2	13.6	___	*14.5*

Chile:

Data releases and forecasts

Week of May 17 - 21

Tue	Real GDP				
May 18		2Q09	3Q09	4Q09	1Q10
	%q/q saar	-0.5	6.6	5.9	-6.0
Tue	Current account balance				
May 18		2Q09	3Q09	4Q09	1Q10
	US$ bn	-0.5	6.6	5.9	___

Review of past week's data

BCCh meeting

	Mar	Apr	May
Nominal O/N rate target (%)	0.50	0.50	0.5

Colombia:

Data releases and forecasts

Week of May 17 - 21

Thu	Industrial production				
May 19		Dec	Jan	Feb	Mar
	%oya nsa	1.78	1.47	2.99	8.0
Thu	Retail sales				
May 19		Dec	Jan	Feb	Mar
	%oya nsa	2.86	8.70	3.90	8.20

Review of past week's data

No data released.

Ecuador:

Data releases and forecasts

Week of May 17 - 21

No data releases expected.

Review of past week's data

No data released.

Peru:

Data releases and forecasts

Week of May 17 - 21

Mon	Real GDP				
May 17		Dec	Jan	Feb	Mar
	%oya nsa	4.88	3.60	5.90	7.90

Review of past week's data

No data released.

Venezuela:

Data releases and forecasts

Week of May 17 - 21

No data releases expected

Review of past week's data

Consumer prices

	Feb	Mar	Apr	
Consumer prices (%m/m)	1.5	2.4	___	*5.2*
%oya	27.0	28.2	___	*31.9*

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United Kingdom

- **Cameron and Clegg opt for more ambitious coalition than expected**
- **BoE Governor King emphasizes need for fiscal consolidation; forecast for first hike pushed back to 1Q11**
- **Industrial production surges despite poor trade performance**

For several weeks, some form of Conservative-Liberal Democrat coalition has appeared the most likely outturn of the May election. As the new government has been formed this week, the surprise is the ambitious nature of that coalition. The Liberal Democrats could have stayed out of the government but offered support in Parliament to the Conservatives on an issue-by-issue basis. Instead, the two parties have agreed on a seven-page document outlining a common policy program, with Nick Clegg becoming Deputy Prime Minister and other Liberal Democrats taking ministerial positions. A number of observations on the agreement are worth making:

- **It attempts to provide political stability.** The parties have agreed to establish five-year, fixed-term parliaments, and will bring forward legislation in which a dissolution of Parliament (leading to the elections) would require 55% of votes in the House of Commons. Assuming this is passed, it will mean that the incumbent Prime Minister no longer has the option of calling an election when he sees an advantage in doing so. It would also mean the Liberal Democrats could not force an election simply by voting with the opposition.

- **It will accelerate deficit reduction.** There will be a "significantly accelerated reduction in the structural deficit over the course of Parliament," with spending cuts the main form of adjustment. New forecasts for GDP growth and borrowing will be made by an independent "Office for Budget Responsibility" ahead of an emergency budget by the end of June. The £6 billion (0.4% of GDP) reduction in non-front-line spending proposed by the Conservatives for this year will go ahead.

- **It recognizes policy differences.** While the agreement reports compromises that have been reached across a number of policy fields, it provides scope for the parties within government to differ without threatening the administration as a whole. There will be a referendum on electoral reform, but the parties are free to take differing positions on how to encourage the public to vote. The Liberal Democrats will continue to argue against nuclear power generation even as Conservative plans for new nuclear power stations move ahead, but the Liberal Democrats will abstain from voting on the issue.

The UK's new cabinet

Liberal Democrat members italicized	
Prime Minister	David Cameron
Deputy PM	*Nick Clegg*
Chancellor	George Osborne
Foreign office	William Hague
Justice	Ken Clarke
Home office	Therese May
Defence	Liam Fox
Business and skills	*Vince Cable*
Work and pensions	Ian Duncan Smith
Energy and climate change	*Chris Huhne*
Education	Michael Gove
Health	Andrew Lansley
Communities and Local Government	Eric Pickles
Transport	Philip Hammond
Environment, food and rural affairs	Caroline Spelman
International Development	Andrew Mitchell
Chief Secretary to the Treasury	*David Laws*
Culture, Olympics and Sport	Jeremy Hunt
Northern Ireland	Owen Paterson
Scotland	*Danny Alexander*
Wales	Cheryl Gillan

It is reasonable to raise questions about the longevity of an arrangement that attempts to bridge political parties with divergent views on a number of issues. But in the absence of a majority in Parliament for any individual party, this agreement strikes us as a more stable basis upon which to begin to tackle the deficit than the alternatives.

King emphasizes fiscal urgency

This week's Inflation Report saw only minor changes in the MPC's forecasts for growth and inflation. The central forecast for a recovery in growth that gathers strength is largely unchanged, but near-term downside risks are assessed to have risen given the sovereign debt crisis. The near-term inflation projection has been raised because of recent outturns and higher oil prices, but the central forecast for inflation two years hence remains well below the 2% target, with upside risks around that central view.

BoE Governor King has kept his own counsel during the election campaign, but his views on the advisability of near-term spending reduction have been sought by the new government. With his concerns heightened by the recent market turmoil, King used the Inflation Report press conference to emphasize the urgent need for a credible plan of fiscal consolidation, and that credibility requires some action to be taken this year. King described himself as encouraged by what he has been hearing as the new government is formed. He also stated that, while

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fiscal change was necessary and would have some negative impact on growth, its impact may be overwhelmed by changes in domestic demand taking place for other reasons. King's remarks and the Inflation Report document keep the possibility of further QE open, although we doubt that is being actively contemplated at this stage.

Our forecast has anticipated that the election would likely be followed by measures that add to the planned fiscal tightening for next year. But the debt crisis in the Euro area has led us to reduce our forecast there, and to push our call for ECB tightening back. The direct impact of those changes on UK growth is relatively small given that our trade is skewed toward Northern Europe, but we have reduced the GDP forecast for 2011 from 3.2% to 3%. And the likelihood that European fiscal concerns will linger has caused us to push our call for the first MPC tightening back by three months to February 2011.

IP rises despite trade disappointment

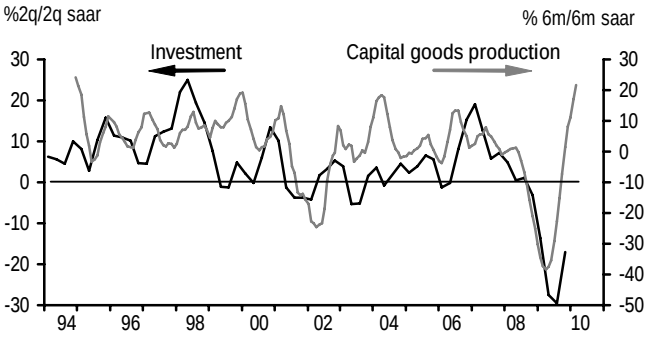
The March data report a 2.3%m/m sa surge in manufacturing output. Some have argued that the lower level of sterling is beginning to boost export performance. The trade data, however, continue to argue against the idea that sterling weakness is playing any particular role. The trend in both export and import volumes is showing decent gains as demand recovers in the wake of the recession. But the gains in imports are outpacing those in exports; indeed, core export volumes fell in 1Q compared to the prior quarter thanks to the weather-induced weakness in January. The bounce in manufacturing output appears to reflect recovering final demand in the UK and abroad, and slowing inventory drawdown, rather than any specific impact from the weaker currency.

One portion of demand that may be lifting manufacturing output is business investment. After a shocking decline through this recession, the 4Q data showed investment continuing to register heavy declines. But the manufacturing production data have now been reporting solid growth in capital goods output for a while, and imports of capital goods have also been rising since the middle of last year. The preliminary estimate for 1Q business investment spending is due next week.

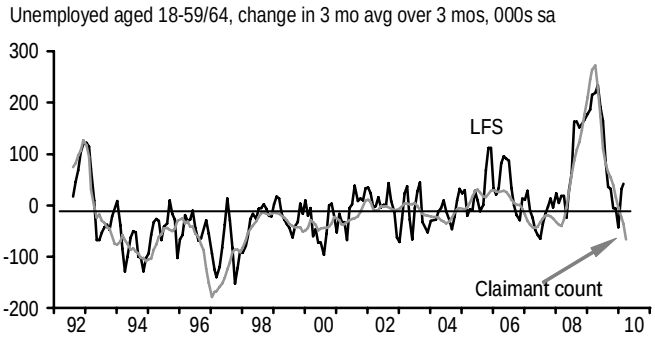
Conflicting labor market data remain

The latest labor market report remains marked by a key divide. The number of recipients of the jobseekers allowance fell by 27,100 in April, maintaining the recent rapid downward trend in this measure. But the measure of unemployment based on a survey of households continues to report

Business investment versus production of capital goods



Two measures of unemployment



rising unemployment, with a 53,000 gain in the three months to March compared to 4Q. Moreover, the composition of the household survey data looks even worse, with employment falling 76,000 (-1% 3m/3m saar), offset by a 23,000 drop in the labor force.

How can this difference be explained? There have been no changes in eligibility criteria that would account for the drop in the claimant count. And on the UK's current arrangements recipients of the jobseekers allowance are not automatically refused benefits after a set period of time (provided they are willing to work). Deviations between the picture on unemployment emerging from these two data sets are not uncommon, and given the volatility in the LFS data, our bias is to place more weight on the claimant count measure of unemployment as a timely guide. Similar messages of labor market improvement are also being sent by a range of survey data. If these signals are accurate, we would expect to see the LFS survey move toward showing declines in unemployment soon. However, the LFS data are reported as a three-month average, with some limited detail available for developments in each individual month. That data set suggests the unemployment rate made a new high in monthly terms in March. As a result, the divergence between these two data sets looks likely to get wider before it begins to narrow.

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Data releases and forecasts

Week of May 17 - 21

Mon May 17 12:01am

Rightmove house price index

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

Mon May 17 11:00am

CBI industrial trends

% balance

	Feb	Mar	Apr	May
Total order book	-36	-37	-36	-35
Output expectations	7	5	14	16
Output prices	8	17	16	__

The CBI has been slow to improve compared to the PMI. But in the April release, the CBI showed significant improvement, consistent with manufacturing growth of around 2% ar or so. We look for some further improvement in the output expectations reading in May. However, this still leaves the CBI looking relatively soft, compared to both the PMI and the recent performance in the official data. The ONS figures report a 5% ar gain in manufacturing in 1Q, with current quarter growth likely to look even better.

Tue May 18 9:30am

Retail prices

%oya

	Jan	Feb	Mar	Apr
CPI	3.5	3.0	3.4	3.5
Core CPI[1]	3.1	2.9	3.0	2.8
RPI (1987=100)	217.9	219.2	220.7	221.7
RPI	3.7	3.7	4.4	4.8
RPIX	4.6	4.2	4.8	4.8

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

Food prices have been showing strong gains lately, and despite cuts in utility bills in April, rising petrol prices are likely to mean energy price inflation accelerates as well. We expect core inflation will slow by two-tenths to 2.8%. But the behavior of food and energy prices is likely to push the wedge between headline and core inflation significantly wider in April. There we look for a rise in the headline CPI to 3.5%, which would match the peak recorded at the start of the year—and trigger another open letter of explanation from Mervyn King to the new Chancellor.

Our view that inflation will fall back to 2% by the end of the year requires a broad stabilization in energy prices, while space capacity pulls down further on core inflation. A key unknown is the behavior of core goods pricing. We have assumed these prices stop rising, owing to the stabilization in the currency. News on whether this has been happening has been mixed in recent releases, with price gains at the start of the year coming in softer than expected, but the April release then delivering an upside surprise reminiscent of last year. In this sense, the April inflation report provides a test to our view. If core goods (and services) deliver another notable upside surprise, this would start to challenge the view about whether inflation will fall as quickly as we expect.

Wed May 19 9:30am

BoE's minutes of May MPC meeting

A 9-0 vote for unchanged policy is expected. The meeting took place as the sovereign debt crisis reached its height, so the minutes will likely echo the concerned tone shown by King in the Inflation Report press conference. We doubt any of the MPC members saw an extension of QE as the appropriate response at this stage, however.

Thu May 20 9:30am

Retail sales

Volumes, seasonally adjusted

	Jan	Feb	Mar	Apr
Including auto fuel (%m/m)	-3.3	2.6	0.4	-0.2
Ex auto fuel (%m/m)	-2.4	2.0	0.2	-0.5
Ex auto fuel (%oya)	0.9	5.1	4.0	2.6
Ex auto fuel (% 3m/3m saar)	1.3	-0.2	-2.4	1.9

The BRC survey was very weak in April, and, taken literally, appears to point toward a drop in retail spending volumes of around 1%m/m. The picture is somewhat blurred by the fact the CBI survey was steady in the month. Our forecast for a 0.5%m/m decline (ex auto fuel) is intended as a compromise between the two surveys. This would still leave the level of spending higher than the 1Q average, pointing to an acceleration in growth in the current quarter. But this assumes that any decline we see in April is more due to noise, rather than a significant weakening in the underlying trend.

Fri May 21 9:30pm

Business investment prelim

2000=100, sa

	2Q09	3Q09	4Q09	1Q10
%q/q	-11.5	-0.8	-4.3	0.0
%oya	-22.5	-21.4	-23.5	-16.7

The level of business investment is already down 27% from the peak in early 2008, and we had assumed a further decline in 1Q. However, the IP data continue to show that capital goods production is surging. Though the linkage with investment is not strong, the IP suggest that some stabilization in business spending may have occurred in 1Q. We look for capex to begin growing again from 2Q.

Fri May 21 9:30am

Provisional estimates of M4 money and credit

Seasonally adjusted

	Jan	Feb	Mar	Apr
M4 (%m/m)	0.3	0.2	0.2	__
M4 (%oya)	5.0	3.9	3.6	__
M4 lending (%m/m)[1]	0.5	-0.1	0.5	__
M4 lending (%oya)[1]	5.0	3.7	3.3	__

1. Excludes the effect of securitization.

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Fri
May 21
9:30am

Public sector finances

£ bn, nsa

	Jan	Feb	Mar	Apr
PSNCR	-12.1	8.0	25.8	__
PSNB	0.3	9.7	23.5	11.5
Balance on current budget	5.0	-4.0	-14.8	-10.5
Net debt to GDP (%)	60.1	60.5	62.0	__

Borrowing for the 2009/10 fiscal year turned out to be slightly less severe than initially thought, coming in at £163 billion (excluding financial sector interventions). We expect a further improvement in borrowing this fiscal year, aided in part by faster tightening from the new government. April is the first month of the current fiscal year, making it difficult to use the data to say much about how full-year borrowing will turn out. But we have assumed a deficit of £11.8 billion for April, and for total borrowing to drop to £154 billion for 2010/11.

Review of past week's data

Bank of England interest rate announcement and asset purchase target

No change in policy. See main text.

RICS housing market survey

%bal sa

	Feb	Mar	Apr
Prices in last 3 months	17.6	~~8.9~~ *9.2*	~~3.0~~ *17.2*
Stocks of homes on books	~~63.2~~ *62.9*	~~67.0~~ *67.3*	~~65.0~~ *61.3*
Sales in last 3 months	17.6	17.1	~~16.8~~ *17.4*
Sales to stocks ratio (%)	~~27.8~~ *27.9*	25.5	~~25.8~~ *28.4*
New buyer enquiries	~~7.2~~ *7.0*	~~-0.4~~ *0.6*	~~2.0~~ *8.3*

After three consecutive declines, reported average sales in RICS housing survey picked up slightly in April, while the balance on sales expectations rose to its highest since last September. New buyer enquiries also picked up to show the highest reading this year. Sales are still weak, but the downward trend has been arrested. The stamp duty changes for first-time buyers may partly explain this change. A drop in the average number of unsold properties indicated that there had been a slowing in the flow of property coming onto the market for sale, pushing back the sales to stock ratio from 25.5 to 28.4, after four straight declines. On our estimates this is consistent with a flattening in real house prices.

BRC retail sales monitor

	Feb	Mar	Apr
Like for like sales (%oya)	2.2	4.4	~~1.0~~ *-2.3*
Total (%oya)	4.5	6.6	~~3.2~~ *-0.2*

The BRC retail survey turned weaker in April. We had been looking for some weakening in the BRC, as April this year included only part of the Easter period that boosts sales. With Easter last year falling entirely in April, this would have pushed down the BRC to some extent. But even so, the reported outturn is notably weaker than we expected, and is difficult to attribute to the timing of Easter alone. The BRC report suggests that pre-election uncertainty may have been a factor. We look for the BRC to bounce back in May, close to its prior 2% average.

Industrial production

	Jan	Feb	Mar
IP (%m/m sa)	~~-0.4~~ *-0.6*	~~1.0~~ *0.9*	~~0.1~~ *2.0*
%oya sa	~~-1.6~~ *-1.7*	~~-0.1~~ *-0.3*	~~0.2~~ *2.0*
Manufacturing (%m/m sa)	~~-1.0~~ *2.3*	~~1.3~~ *1.4*	~~0.3~~ *2.3*
%oya sa	~~0.1~~ *-0.1*	~~1.4~~ *1.3*	~~1.4~~ *3.3*

See main text.

Labor market statistics

Seasonally adjusted

	Feb	Mar	Apr
Claimant count (000s ch m/m)	-40.1	~~-32.9~~ *-32.7*	~~-25.0~~ *-27.1*
Claimant count rate (%)	4.9	4.8	4.7

	Jan	Feb	Mar
Average weekly earnings (3mma % oya)			
Headline	~~0.8~~ *0.9*	~~2.3~~ *2.5*	~~1.9~~ *4.0*
ex bonuses	1.5	1.7	~~2.0~~ *1.9*
Private sector ex bonuses	0.5	~~0.9~~ *0.8*	~~1.0~~ *1.2*

Three months to:	Sep	Dec	Mar
Labor force survey (all % rates)			
Activity rate	63.4	63.2	63.0
Employment rate	58.4	58.3	58.0
Unemployment rate	7.8	7.8	8.0

See main text.

BoE Inflation Report

See main text.

Nationwide consumer confidence index

	Feb	Mar	Apr
Index sa	~~81~~ *82*	~~72~~ *73*	~~72~~ *74*

Trade balance

£ bn, seasonally adjusted

	Jan	Feb	Mar
Trade balance (goods)	~~-8.1~~ *-8.0*	~~-6.2~~ *-6.3*	__ *-7.5*
Trade balance (services)	4.2	4.1	__ *3.8*
Total trade balance	~~-3.9~~ *-3.8*	~~-2.1~~ *-2.2*	__ *-3.7*

The trade deficit widened in March, reflecting a strong gain in import volumes and a drop in exports. The monthly trade data are exceptionally volatile, thus call for caution. Core trade volumes are still up significantly relative to a year ago. That said, the more recent trend shows that there has been some slowing in export growth, while imports have continued to rise quickly. Moreover, net trade looks likely to be another drag on growth in 1Q. This comes as a disappointment given the weakness in the currency.

DCLG monthly house price data

	Jan	Feb	Mar
All dwellings (%oya nsa)	6.2	7.3	__ *9.7*

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Russia

- **Recovery gaining breadth and momentum in April**
- **But imports are also recovering**
- **Consumer price inflation continues to decelerate**

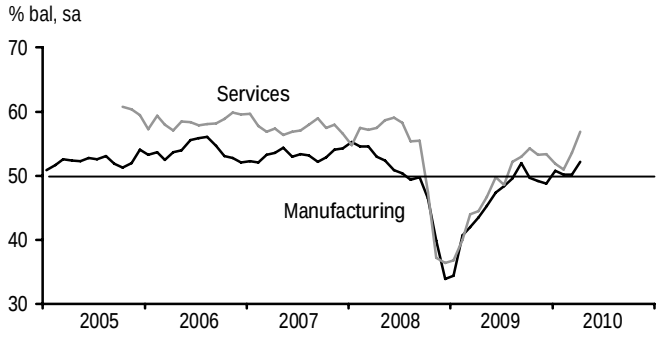
After the winter sleep, when activity was hit by cold weather, the economy has been gaining momentum. Over the past two weeks, the package of strong data releases has included PMIs, capacity utilization, car sales, and railway transportation. That said, the pickup in growth momentum itself, in our view, is overshadowed by the evidence that the recovery is becoming more broad-based.

The manufacturing PMI jumped to 52.1 in April from 50.2, with increases across all subindices. New orders jumped to 52.6 from 49.5, as new export orders jumped to 53.0 from 45.9. The forward-looking orders to inventory ratio has again approached its long-term average, increasing from 1.05 to 1.11. The rise in the services PMI was even more impressive, with the headline index moving up to 56.9 in April from an already solid 53.6. More importantly, the employment subindex in both the manufacturing and the services surveys moved to above the 50 threshold for the first time since 2008, which indicates that businesses have finally begun to expand. This should add further to consumer confidence and put the consumption recovery on an even firmer footing in the coming months.

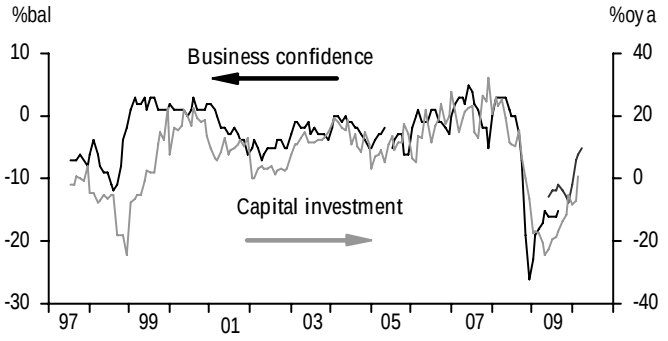
A pickup in economic activity in April was also flagged by railway shipments, which rose 1.2%m/m sa in April, after rising 2.1%m/m sa in March. Furthermore, the Rosstat survey shows that capacity utilization in industry advanced to 57% in April from 55%, while business confidence edged up to -5 from -6. Improving business confidence, if history is a guide (second chart), should soon lead to increased business activity, not only on the employment and inventory fronts, but also in capital investment.

Particularly encouraging was the jump in capacity utilization in vehicle and transport equipment manufacturing (to 52% in April from 48%), the sector that had been one of the main laggards in this recovery. The improvement came on the back of a solid rise in new car sales in April; sales surged 29%m/m to bring the over-year-ago growth rate from -7% to 20% (versus 7% expected). Car sales were helped primarily by the “cash-for-clunkers” program launched in March. The program favors locally produced cars; further production increases in the sector, which normally has high growth multiplier effects, can be expected in the coming months.

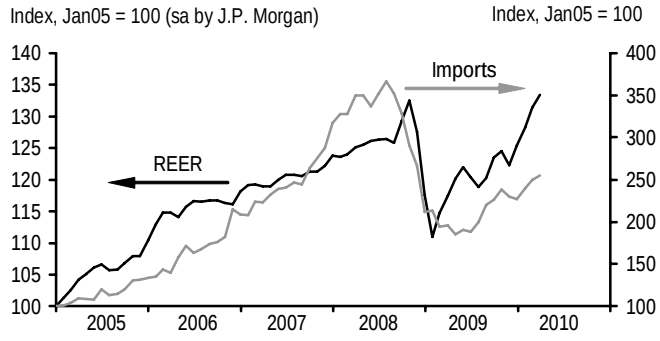
Headline PMI: manufacturing versus services



Business confidence (Rosstat survey) vs. capital investment



Imports from non-CIS countries vs. REER



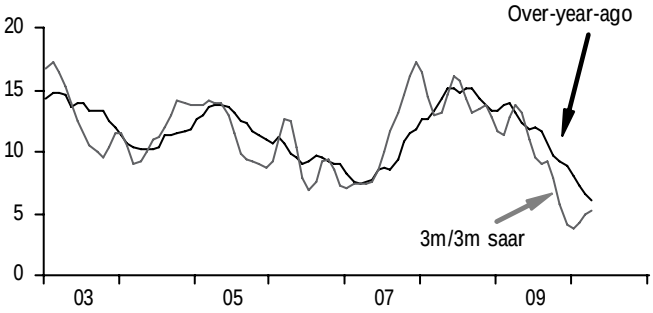
In a sign of the continued rise in domestic demand, but also a reflection of the stronger ruble, imports have continued to grow rapidly. Imports from non-CIS countries rose 2%m/m sa by our estimates in April, on top of a 4.2%m/m rise in March. Still, the recovery in imports lags far behind the real effective exchange rate appreciation. The REER has already fully recovered its crisis losses, while imports have recovered less than a half of the peak-to-trough decline, as the level (not growth rate) of domestic demand remains depressed.

The next Russia data watch will be published on May 28.

Depressed domestic demand, being reflected in a still large negative output gap, remains a key factor behind the continued slide in consumer price inflation, even though commodity prices and the PPI are climbing. The CPI surprised on the downside in April for the second month in a row, rising just 0.3%m/m versus 0.4% expected by both J.P. Morgan and consensus. Over-year-ago inflation thus fell from 6.5% to 6.0% (consensus, J.P. Morgan: 6.2%oya). The downward slide in inflation was broad-based, with services, food, and nonfood goods inflation all printing lower than expected. CPI ex. food, energy, and regulated tariffs (our measure of core inflation) fell from 6.2%oya to 5.2%oya on our estimates. However, sequential trend inflation was even lower, with the 3m/3m sa annualized rate of CPI inflation at 5.3% (up marginally from 5%) and core inflation at 3.7%.

Headline CPI

%oya and %3m/3m saar (J.P. Morgan estimate)



Data releases and forecasts

Weeks of May 17 - May 28

Industrial production

	Jan	Feb	Mar	Apr
%oya	7.8	1.9	5.7	5.5
Mining	6.9	6.6	6.6	___
Manufacturing	7.6	0.8	5.1	___
Electricity, gas, water	8.4	7.2	5.1	___

Industrial producer prices

	Jan	Feb	Mar	Apr
%m/m nsa	-1.0	2.3	1.8	1.5
%oya	33.1	22.9	19.2	18.1

Real economy indicators

Real terms, %oya

	Jan	Feb	Mar	Apr
Construction	-10.7	-9.8	-5.1	-7.0
Fixed investment	-8.7	-7.4	0.7	1.5
Transportation	12.2	9.8	12.4	14.4
Retail sales	0.0	0.9	2.9	4.0
Unemployment	9.2	8.6	8.6	8.1
Average monthly wage due	1.2	2.5	3.4	4.0

Broad money supply

RUB bn

	Jan	Feb	Mar	Apr
Broad money, M2	15331	15566	15997	16255
%m/m nsa	-2.3	1.5	2.8	1.6
%oya	27.9	29.5	32.1	31.7

Review of past two weeks' data

Consumer prices

	Feb	Mar	Apr	
%m/m nsa	0.9	0.6	~~0.4~~	*0.3*
%oya	7.2	6.5	~~6.2~~	*6.0*
Food				
%m/m nsa	0.6	1.0	___	*0.3*
%oya	6.1	4.8	___	*4.4*
Food (ex fresh fruit)				
%m/m nsa	0.8	0.7	___	*0.2*
%oya	5.8	5.1	___	*4.4*
Nonfood goods				
%m/m nsa	0.3	0.4	___	*0.3*
%oya	7.7	6.6	___	*5.9*
Services				
%m/m nsa	1.0	0.4	___	*0.2*
%oya	8.7	8.4	___	*8.4*

Federal budget

RUB bn, cash flows

	Feb	Mar	Apr	
Balance	-257	-138	~~-140~~	-200
% of GDP	-7.9	-3.9	~~-3.8~~	-5.7
Revenue	571	645	~~660~~	663
Tax revenue	537	626	~~630~~	640
Expenditure	827	783	~~800~~	863
Noninterest	809	748	~~770~~	857
% of GDP	24.8	21.3	~~21.0~~	24.6

International reserves

US$ bn, eop

	Mar	Apr	May 7	
Gross international reserves	447.0	460.7	___	*456.7*
Gold	23.7	25.2	___	

Market indicators, eop

	Mar	Apr	May 13
USD/RUB (official CBR)	29.50	29.15	29.86
RTS index (USD terms)	1430	1573	1476

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Turkey

- **The fiscal rule could become the next policy anchor**
- **Targeting a medium-term government deficit of 1% of GDP appears sensible**
- **As always, implementation will be key**

Turkey's structural transformation and the improvement in economic fundamentals experienced over the past 10 years are largely attributable to the strong policy anchors provided by IMF programs and the EU convergence process. Each of these anchors has now lost its relevance as the government decided to go ahead without an IMF program and as the EU negotiations lost momentum. In this environment, the government is hoping that the fiscal rule to be implemented from 2011 onwards will be the next powerful policy anchor. The fiscal rule as presented by Deputy Prime Minister Babacan is based on realistic assumptions and, if implemented rigorously, could prove to be a strong and credible foundation for policy, in our view.

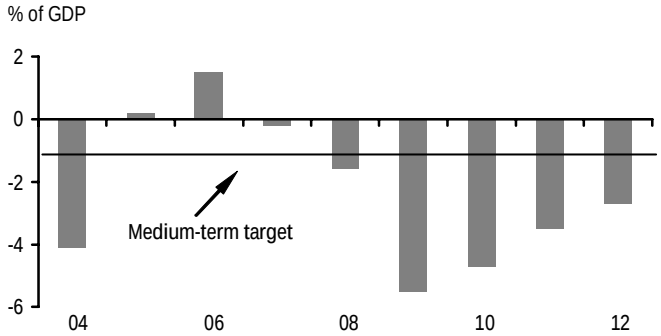
The fiscal rule is based on a simple formula that calculates the pace of fiscal adjustment in case the general government balance deviates from the medium-term target of 1% of GDP. Measuring the deficit figures as a percent of GDP, the adjustment formula is:

Change in general government balance = -0.33 * (last year's government balance - medium-term fiscal target) - 0.33 * (GDP growth - medium-term GDP growth target)

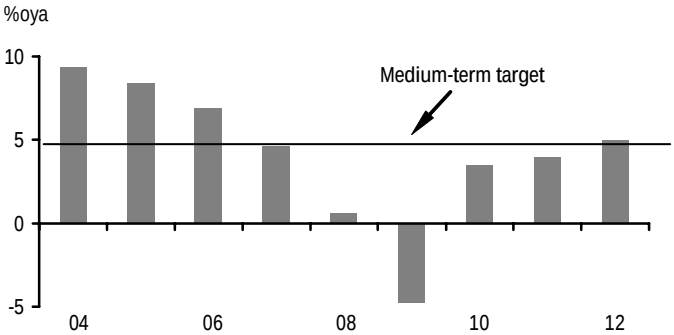
The first term on the right-hand side of the equation is the fiscal adjustment factor and the second is the cyclical factor. The formula is a straightforward one; the critical factors are the coefficients and the medium-term targets. We think that a coefficient of 0.33 means that the government is targeting a relatively rapid convergence to the medium-term targets. The medium-term targets for the fiscal deficit and for GDP growth are set at 1% and 5%, respectively. We believe the targets are reasonable but call for continuous fiscal discipline. Turkey's total government deficit was around 5.5% of GDP in 2009 and, according to the medium-term fiscal plan, the government plans to lower the deficit gradually to 2.7% in 2012. Remembering that the government balance was in surplus in 2005 and 2006, we think these targets appear reasonable. Similarly, looking at Turkey's performance over the past decade, assuming real GDP growth of 5.0% seems appropriate.

Also encouraging is that the rule applies not only to the central government balance, but also to the sum of the central government, social security system, local administration, and unemployment fund. Following the tradition in Europe, state economic enterprises are not included, but even there Deputy Prime Minister Babacan vowed that transparency will be improved. In particular, the fiscal performance of these enterprises will be made public by the Treasury each quarter. In a further effort to improve fiscal transparency, yearly reports on the long-term actuarial balance of the social security system will be made public each year.

General government balance



Real GDP



On the whole, we are encouraged by the government's commitment to fiscal discipline and transparency. As always, implementation will be key (note that the rule will become applicable in 2011). If the rule is implemented rigorously, it could serve as a powerful policy anchor, improve the government's credibility, facilitate an upgrade of Turkey's debt to investment grade, and enhance the attractiveness of Turkish financial assets. There could be two criticisms, however. First, there is no independent auditor. The Court of Accounts will audit the fiscal rule, but we do not expect this to hurt the credibility as long as the quarterly reports on fiscal performance remain objective and believable. Second, in contrast to some countries, the fiscal rule will not be written into the Turkish Constitution. This could be seen as a weakness at first glance, but given the difficulties in changing the Constitution (e.g., the political noise of the past few weeks), it is more practical to legislate the rule.

The next Turkey data watch will be published on May 28.

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Data releases and forecasts

Weeks of May 17 - 28

Mon
May 17
10:00am

Labor market data

	Nov	Dec	Jan	Feb
Unemployment (%)	13.1	13.5	14.5	14.9
Nonfarm payrolls (%oya)	2.0	2.2	3.8	4.3
Labor participation (%)	48.1	47.6	47.5	47.2

As expected, the improvement in labor market conditions is lagging the recovery in economic activity. Although this partly reflects a very weak base, oya growth in nonfarm payrolls has resumed and implies that labor market conditions are finally bottoming. Low labor participation shows substantial slack in the labor market.

Mon
May 17
10:00am

Consumer confidence

Index

	Jan	Feb	Mar	Apr
Consumer confidence	79.2	81.8	84.7	85.5
Purchasing power—current	71.9	73.8	76.1	77.5
Purchasing power—future	78.7	80.8	82.7	73.3
Economic setting	74.2	78.3	82.3	74.0
Employment	74.9	77.1	79.0	79.5

The improvement in global risk appetite, some pickup in external demand, and the resilience of Turkish financial assets (especially of the lira) are the main factors behind the continued strengthening in consumer confidence. Euro area-related risks look to be the main factor that could restrain further improvement in sentiment in the coming months.

Tue
May 18
7:00pm

CBRT rate decision

	Feb	Mar	Apr	May
CBRT ON borrowing rate (%)	6.50	6.50	6.50	6.50

Despite the sharp rise in headline inflation, the CBRT is expected to remain on hold mainly as a result of Euro area-related risks. It might, however, adopt more cautious rhetoric.

Mon
May 24
10:00am

Capacity utilization

%

	Feb	Mar	Apr	May
Total manufacturing	67.8	67.9	72.2	72.7
Durables	65.5	64.1	67.5	68.0
Nondurables	69.6	69.9	72.1	72.5

Manufacturing capacity usage likely increased gradually in May mainly due to seasonal factors. Despite the rise in recent months, headline capacity usage remains around the 70% mark, pointing to a still large output gap. Survey results are likely to indicate that inflationary pressures remain relatively muted.

Review of past two weeks' data

Inflation

%

	Feb	Mar	Apr
Consumer prices			
%oya	10.1	9.6	~~10.3~~ *10.2*
%m/m	1.5	0.6	~~0.7~~ *0.6*
Producer prices			
%oya	6.8	8.6	~~9.3~~ *10.4*
%m/m	1.7	1.9	~~1.3~~ *2.4*
Core CPI			
%oya	4.1	5.4	~~6.0~~ *5.7*
%m/m	-0.5	0.6	~~1.5~~ *1.1*

Due to a weak base, yearly inflation climbed above the 10% mark once again in April, but because the price data were more benign than expected, the negative repercussions on inflation expectations should be minimal, thus providing some breathing room for the CBRT.

Balance of payments

US$ bn

	Jan	Feb	Mar
Current account	-2.9	-2.7	~~-4.1~~ *-4.3*
Trade balance	-2.6	-2.3	~~-3.8~~ *-3.6*
Exports, fob	8.4	9.0	~~10.6~~ *10.7*
Imports, fob	11.0	11.2	~~14.4~~ *14.3*
Net invisibles and transfers	-0.3	-0.4	~~-0.3~~ *-0.7*
Capital account	1.8	0.6	~~2.5~~ *6.3*
Overall balance	0.7	-1.7	~~0.5~~ *1.9*

Turkey's current account deficit continued to widen in March, mainly on the back of higher energy prices and the recovery in domestic demand.

Industrial production

%oya

	Jan	Feb	Mar
Total	12.3	18.0	~~16.1~~ 21.1
Manufacturing	14.5	20.4	~~18.0~~ 23.9
Mining	0.5	12.2	~~9.4~~ 9.1
Utilities	3.2	5.0	5.5 6.7

Although the recovery in domestic and external demand also helped, an extremely weak base was the main factor behind the elevated oya IP growth rates.

Central government budget

TRY bn, current prices

	Feb	Mar	Apr
Expenditures	22.3	23.4	~~25.3~~ *25.2*
Interest	4.6	4.3	6.8 7.1
Non-interest	17.7	19.1	~~18.5~~ *18.1*
Revenues	20.0	17.5	~~20.0~~ *20.7*
Taxes	16.1	14.5	~~16.0~~ *15.3*
Primary balance	2.3	-1.6	~~1.5~~ *2.6*
Budget balance	-2.3	-5.9	~~-4.3~~ *-4.4*

The improvement in fiscal performance continued on the back of a cyclical rise in tax collection and some spending discipline in April.

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Australia and New Zealand

- **Australia added another 33,700 jobs in April, bringing the total to 110,000 so far this year**
- **Wage growth, however, remains subdued… for now**
- **NZ budget will likely consider changes to property tax**

Economic indicators headed in different directions in Australia this week, with the number of new home loans plunging, but employment booming (again). Earlier, Treasurer Wayne Swan had delivered a "no frills" annual budget offering few surprises. In fact, most of the measures the Treasurer trumpeted already had been announced. New Zealand's budget next Thursday probably will include measures to prevent property investors from offsetting their losses against income and other taxes. This should have the effect of further dampening housing market activity.

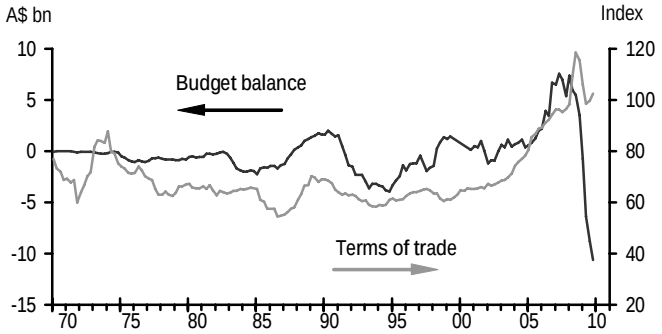
RBA meeting preceded events in Europe

The RBA raised the cash rate two weeks ago; the minutes from the Board meeting will be released on Tuesday. They should reveal more detail on one of the main reasons the RBA is returning the policy rate to normal: the soaring terms of trade. They also will likely betray official anxiety about booming house prices. It will be interesting to see whether the minutes refer to market interest rates being back to "normal." If they do, it will endorse our view that the pace of tightening will slow. We anticipate a policy pause in early June, but a resumption of tightening in July.

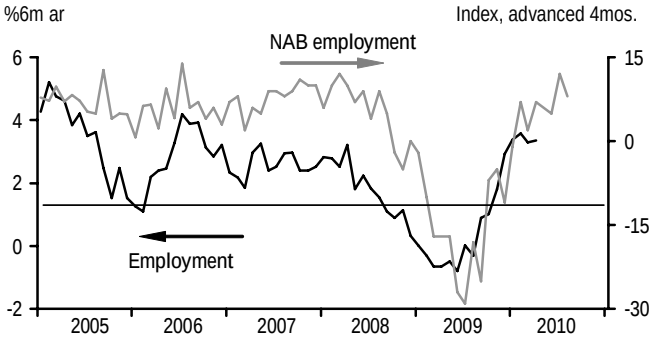
A lot has happened, however, since the last RBA Board meeting, so the upbeat tone of the minutes should be interpreted in that context. In particular, the RBA's statement announcing the sixth hike since October may not have been as hawkish had officials known what was transpiring in Europe. Similarly, the RBA upgraded its inflation forecasts immediately following a night of financial market turmoil, owing mainly to the adverse sovereign debt developments in Europe. We believe it might not have done so had it known the extent of the contagion through global markets.

Phil Lowe, the RBA's Assistant Governor (Economic), this week made upbeat comments about the economic outlook, while adding cautious sentiment about the risks offshore. With more complete information than Board members had at the time of the last policy meeting, it seems the RBA still is optimistic that the economy remains well-placed to grow above trend in the period ahead. Reference to the importance of keeping inflation expectations well anchored was prominent in Lowe's speech.

Terms of trade and budget balance



Australia: NAB survey and employment growth



Australia headed for full employment

The Australian economy added a further 33,700 jobs last month (J.P. Morgan estimate: 7,500; consensus: 22,500), taking total employment gains to date in 2010 to a whopping 110,000; the economy has added 28,000 jobs on average each month this year. The recent shift from part- to full-time work continued. Full-time employment surged 37,500, marking the eighth straight monthly gain, while part-time work fell by 3,900, marking the third straight monthly decline. However, workers' hours were, surprisingly, lower, falling 0.5%m/m in April; this may to some extent be payback for the 2.3% spike recorded in February.

The unemployment rate remained at 5.4%, and although it increased in most states—New South Wales, Queensland, and South Australia—it fell in Victoria and Western Australia (WA). In fact, at 4.7%, the unemployment rate in WA is at its lowest in 12 months. It is important to note that total employment in WA actually fell in April, though the impact was deflated by a 0.7%-pt drop in the participation rate. With the resource-dependent states set to benefit the most from firms' solid investment plans, employment growth should pick up significantly in coming months.

With leading indicators of employment recently creeping higher, it appears that solid employment gains are set to

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continue. The NAB employment measure is now at its highest level since November 2007, suggesting even stronger employment numbers going forward. We do, though, expect that the unemployment rate will maintain a 5% handle this year. This owes to an elevated level of labor force participation, which held at 65.2% in April. The participation rate will likely meander higher owing to a number of factors, including the fact that older workers are staying in the workforce for longer and some members of those households that are struggling in the face of rising interest rates are re-entering the workforce.

The tightening of the labor market will be a growing concern for the RBA, particularly after the government announced this week that it expects the economy to approach full employment by mid-2012. Indeed, this highlights the risk of a wages breakout. In this week's budget (see the research note "Australia's budget back in black by 2012-13," in this *GDW*), the government forecast wage inflation of 3.75% in the year to June 2011, although the risks are skewed to an even higher rate given that the economy already is growing around trend and doing so with little spare capacity.

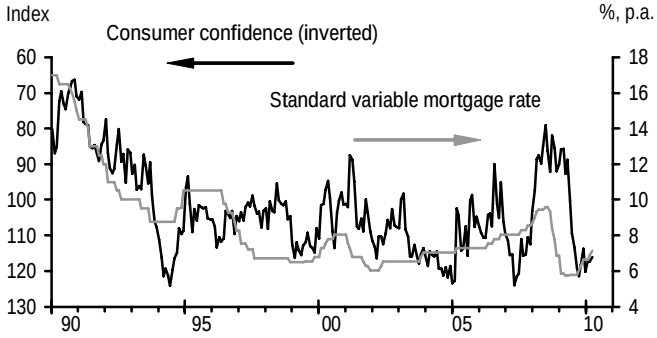
The government has pledged to inject A$660 million into skills and job creation over the next four years, including 39,000 new training places for industries suffering skill shortages. But, with existing shortages already a problem, upward pressures on wages will likely build in the near term. These pressures are expected to rear their heads as soon as next week. Wednesday's labor cost index should print at 0.8%q/q in 1Q, up from 0.6% in previous months. This result will take annual growth to 2.9%, the same rate as in 4Q, and probably the low point in the current cycle.

Confidence set to be stung by rate hikes

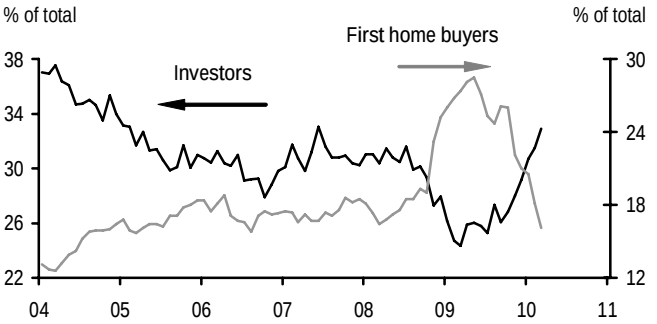
We expect consumer confidence in Australia, as measured by the Westpac-Melbourne Institute (WMI), to have fallen in May. Not only did the RBA deliver another rate hike, but the government delivered a "no frills" budget that did little to woo voters in this election year. We forecast that the WMI will fall 3%m/m, although at a level of 113, this suggests that optimists continue to outnumber pessimists.

It appears that the RBA's assertive policy tightening has started to bite, with confidence having fallen in four of the six months since October when the RBA kicked off the current tightening cycle. The RBA has delivered a 25bp hike to the official cash rate at six of the past seven meetings. As a result, confidence toward family finances in next week's survey will likely show a considerable decline. The WMI reported in April that confidence among those that

Australia: Westpac-MI consumer confidence and mortgage rates



Australia: housing finance



own their houses fell just 1% in April, but among those that have a mortgage, confidence actually rose 0.2%. This may owe to the fact that the majority of mortgage holders maintained their monthly repayments over the course of the RBA's easing cycle. Now, though, mortgage rates are at a point where rate hikes have a major impact on confidence.

First-home buyer exodus continues

This week's Australian housing finance numbers indicated that the hangover from last year's stimulus-induced first-home buyers' (FHBs') mortgage buy-in continues to linger. New loan commitments slid a further 3.4%m/m in March (J.P. Morgan: -3.5%; consensus: -3.0%), and have now been falling in trend terms since July 2009. Since the expanded FHBs' grant was originally expected to expire in June 2009 (it was extended to the end of 2009), it is perhaps not surprising that the majority of buyers had already taken the plunge in 1H09. However, the protracted nature of the payback is something of a concern, especially given that there are still at least two more interest rate hikes yet to flow through to the data, those delivered in April and May this year. In coming months, rising interest rates will start to bite, even if the stimulus hangover starts to fade, with the RBA having hiked the cash rate at six of the past seven meetings, and with mortgage rates now near long-term average levels.

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The average loan size rose 2.4%m/m in March, while loan sizes for FHBs were up 0.6%. Over the March quarter, average loans for FHBs essentially were flat relative to 4Q09, and are still near the peaks from March last year. The fact that average loan sizes are holding up supports the assertion that the weakness in housing finance reflects a demand substitution over time, rather than a fundamental deterioration in underlying demand. Indeed, the proportion of commitments lodged by FHBs continued to fall in March, sliding to 16.1% from 18.1% in the previous month. This proportion is now below the long-run average of 20% for the period preceding the expanded grant, after reaching an all-time high of 28.5% in May last year.

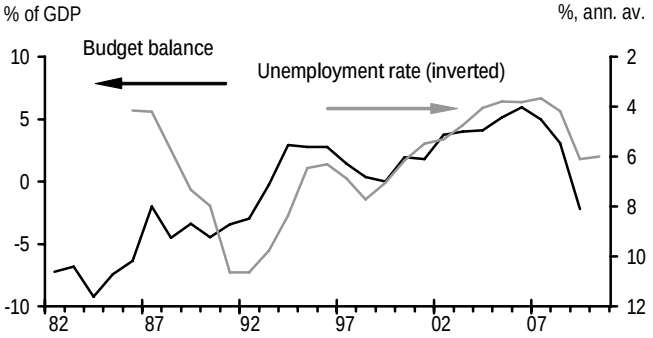
The value of home loans issued declined 3.4%m/m, though with average loan sizes fairly resilient; this was largely due to a volume effect. Loans for investment purposes, on the other hand, rose an impressive 3%m/m in value terms. The diminishing role of FHBs has transferred greater weight to property investors, which now represent 32.9% of loans by value. The increasing representation of investors in the housing finance statistics, which last reached such levels around the middle of the previous decade, does lend an air of speculative activity to the market outlook. Ultimately, though, fears of a "bubble" appear overblown, given that such conditions usually would involve investors and FHBs competing for housing, rather than one group replacing the other, as appears to be the case here.

After the dramatic withdrawal of FHBs in recent months, the precipitous fall in home loan commitments should slow. We do expect sluggish demand for home loans over the remainder of 2010, but with prices well supported by a healthy labor market and a chronic undersupply of housing stock. The downside risks to the outlook lie in the fact that policy continues to reinforce, rather than counterbalance, financing conditions in the housing market—the stimulus hangover has arrived just as accumulated interest rate hikes are starting to bite.

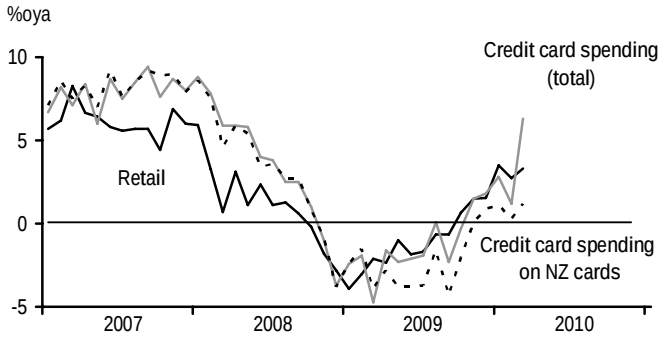
NZ 2010 budget will target growth

The New Zealand government next week will release Budget 2010. Finance Minister Bill English already has flagged that the budget will set out important policies to lift economic growth and give New Zealanders "incentives to get ahead." Indeed, the Treasury will likely forecast a stronger recovery in the next couple of years than forecast in the Budget Policy Statement (BPS), its half-yearly budget update released in December. The Treasury forecast in the BPS that the economy would start to expand in 2011 after contracting 0.4% in the 12 months to March 2010. In the

New Zealand: government fiscal balance and unemployment



New Zealand: retail sales and credit card billing



2011 March year, the government forecast that the economy would expand 2.4%; we expect this figure to be revised higher to somewhere around the 2.8% mark.

The government already has flagged that its focus now is on two key objectives: lifting the long-term performance of the New Zealand economy, and maintaining firm control of the government's finances. The latter will mean bringing the budget back into surplus over the next few years. Indeed, the improved growth outlook will mean that operating balance before gains and losses (OBEGAL) in 2010-11 will be less than the -NZ$6.7 billion forecast in December. We suspect that the government will rein in its OBEGAL forecast to around -NZ$6 billion, although J.P. Morgan estimates an OBEGAL of -NZ$5.5 billion is achievable in the 2010-11 year. New operating expenditure allowances will remain limited to NZ$1.1 billion a year, increasing at 2% annually from 2011-12.

Of particular interest will be what the Treasury takes on from the recommendations of the Tax Working Group. The budget is expected to include measures to prevent property investors from offsetting their losses against income and other taxes. Housing market activity has indeed cooled in recent months amid uncertainty surrounding potential changes to the way property is taxed.

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Kiwi consumers finding their feet, slowly

Retail sales in New Zealand bounced back in March, rising 0.5%m/m (J.P. Morgan: 0.9%; consensus: 1.1%), after a disappointing drop of 0.6%m/m in the previous month. Two-thirds of retail industries recorded an improvement in sales over the month. The rebound, though, was less than we (and the market) had expected. Core sales more than recovered the ground lost last month, bouncing 1.1%m/m after slumping 0.9% in February. While the turnaround in core sales is welcome, the complexion of the quarterly print shows that consumers remain hesitant. Core sales contracted 0.5%q/q in 1Q—only a surge in motor vehicle retailing (up 4.2% on the quarter) pushed total retail volumes into the black, up to 0.2%q/q. This week showed a very substantial fall in credit card spending for April (-1.7%m/m), which also suggests we will see a further deterioration in retail sales near term.

Australia:

Data releases and forecasts

Week of May 17 - 21

Wed May 19 10:30am — **WMI consumer confidence survey**
100=neutral, seasonally adjusted

	Feb	Mar	Apr	May
%m/m	-2.6	0.3	-1.0	-3.0

Review of past week's data

ANZ job advertisements

	Feb	Mar	Apr	
%m/m sa	19.1	1.8	__	*-1.2*

NAB monthly business survey
% balance, seasonally adjusted

	Feb	Mar	Apr
Business confidence	19	16	13

Housing finance approvals: owner occupiers
Number of loans, seasonally adjusted

	Jan		Feb		Mar	
%m/m	~~-7.3~~	*-7.4*	~~-1.8~~	*-2.0*	~~-3.5~~	*-3.4*
%oya	~~-11.6~~	*-11.9*	~~-16.1~~	*-16.4*	~~-23.2~~	*-23.3*

Labor force

	Feb		Mar		Apr	
Unemployment rate (% sa)	5.3		~~5.3~~	*5.4*	5.4	
Employed (000 m/m sa)	~~-4.7~~	*-11*	~~19.6~~	*28*	~~7.5~~	*34*
Participation rate (% sa)	~~65.2~~	*65.1*	~~65.1~~	*65.2*	~~65.1~~	*65.2*

New Zealand:

Data releases and forecasts

Week of May 17 - 21

Tue May 18 8:45am — **Producer price index**
nsa

	2Q09	3Q09	4Q09	1Q10
Inputs (%q/q)	0.0	-1.1	0.3	0.8
Outputs (%q/q)	-0.7	-1.4	-0.4	0.0

Producer output prices should be flat in 1Q, having fallen for four straight quarters previously. Input prices should be up 0.8%q/q, rising for the second straight quarter, thanks mainly to higher gasoline prices.

Fri May 21 10:45am — **Visitor arrivals**
nsa

	Jan	Feb	Mar	Apr
Total (%m/m)	-2.4	-1.9	1.1	__

We expect this volatile series to post a fall in April. Although healthy numbers of tourists are expected to have continued from Australia, owing to joint-venture campaigns, arrivals from New Zealand's second- and third-largest markets—the UK and US—probably remained sluggish owing to economic factors and the volcanic ash disruptions.

Fri May 21 10:45am — **Net permanent immigration**
Not seasonally adjusted

	Jan	Feb	Mar	Apr
Monthly (000s)	2.5	2.6	-0.3	__
12-month sum (000s)	22.6	21.6	21.0	__

Fri May 21 3:00pm — **Credit card spending**
% change

	Jan	Feb	Mar	Apr
%oya	2.8	1.2	6.3	1.5

After bouncing 6.3%oya in March, some payback in credit card spending is likely in April. We forecast a rise of 1.5%oya, which suggests slower growth in retail sales during the month.

Review of past week's data

QVNZ house prices
%, medians

	Feb		Mar		Apr	
%oya	5.5		6.1		__	*6.1*

Business PMI

	Feb		Mar		Apr	
Index, sa	~~53.6~~	*53.7*	~~56.3~~	*56.7*	__	*58.9*
%oya sa	35.3		~~34.4~~	*34.2*	__	*34.2*

Retail trade

	Jan		Feb		Mar	
%m/m sa	~~0.7~~	*0.6*	-0.6		~~0.9~~	*0.5*
%oya sa	3.6		2.3		~~3.7~~	*3.2*

Retail trade ex. inflation

	3Q09		4Q09		1Q10
%q/q	~~0.1~~	*0.3*	~~1.0~~	*0.9*	0.2

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Greater China

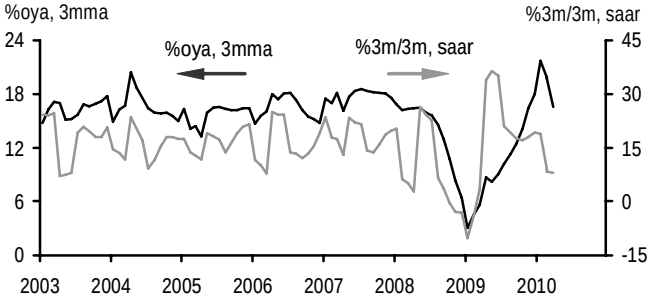
- **China: April macro indicators suggest steady economic expansion; CPI inflation ticked up to 2.8%**
- **Expect first rate hike and beginning of gradual CNY appreciation during May/June period**
- **April trade balance returned to surplus; exports gained steadily, imports fell**
- **Hong Kong: 1Q GDP expanded at 10.0%q/q saar; broad gains across external and domestic sectors**

China's economy continued its steady pace of expansion in April, as suggested by the major macro indicators. While the authorities' various measures to curb excessive credit expansion have begun to take effect, momentum in private sector demand, both domestic and external, remained solid in April. For overall industrial activity, IP rose 17.8%oya in April, translating to a steady 1.0%m/m sa, with the underlying sequential trend moderating to 8.0%3m/3m saar through April.

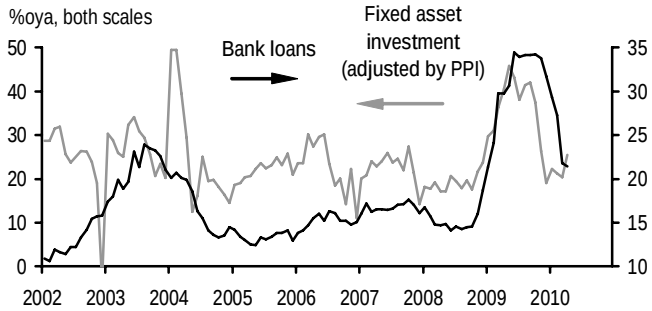
On the demand side, exports showed steady expansion in April, rising 30.5%oya, with the trade balance returning to a surplus. Fixed investment rose 26.1%oya ytd, which, by our calculations, suggests 25.6%oya growth for April alone. The pace of growth in infrastructure investment has peaked in recent months, while real estate investment growth has picked up, which likely reflects the impact of the authorities' recent policy to reduce land hoarding by property developers. Retail sales rose, too, at a stronger-than-expected 18.5%oya in April (up 1.9%m/m sa). April CPI inflation has been the focus recently for financial markets, and was in line with our forecasts at 2.8%oya (up 0.3%m/m sa). On the monetary front, M2 increased 21.5%oya in April, while new loan creation turned up to 774 billion yuan.

Looking ahead, we expect the sources of growth in the economy to continue to broaden steadily in the coming quarters, with a further upturn in the export sector and expansion in private consumption and investment. On the domestic front, this year should feature improving labor markets and hence household income, and solid expansion in overall private investment. Meanwhile, public investment programs should remain largely in place in 2010, but with the pace of growth leveling off. Overall, we believe the authorities' various measures to curb excessive credit expansion and reduce excess liquidity, as well as the central and local governments' series of high-profile tightening measures directed at the housing sector in recent weeks, reinforce our call for moderating FAI growth this year, and are

China: real industrial production



China: real fixed asset investment and bank loan growth



in line with the moderate easing in the headline GDP sequential growth rate that we have penciled in for coming quarters. Our forecasts for 10.8% GDP growth in 2010 with 3.2% CPI inflation remain intact.

Expect rate hike, CNY move in May/June

While the April CPI inflation rate came in a touch higher than consensus forecasts, the general sense is that CPI inflation breaching the 3%oya hurdle (which in our forecast could happen as soon as this month) is a necessary condition for the authorities to initiate the rate-hiking cycle. Indeed, we believe that there is still no consensus among policymakers regarding near-term rate hikes, and the government is still concerned about the growth outlook, given the potential impact of the EU sovereign debt crisis on global financial markets and the world economy. Overall, we continue to expect China to begin its rate hike cycle and allow CNY to begin a gradual appreciation phase during the May/June period.

In particular, while the sovereign debt crisis in Europe may cause Chinese policymakers to wait and watch for clearer signs of the impact on the global economy, the general consensus of currency policy has been built around the need to introduce more maneuverability in the conduct of monetary policy. We believe the window of opportunity for the change in CNY policy is still open in the near term. In this

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regard, the April trade report, showing that the trade balance returned to a surplus, confirmed that the structural factors behind China's trade surplus remain intact, supporting the call for resumption of gradual CNY appreciation.

Further details of April indicators

On the domestic front, within fixed investment, real estate investment growth picked up, rising 36.2%oya ytd through April, likely reflecting the impact of recent policy changes to reduce land hoarding by property developers. Furthermore, the pace of growth in infrastructure investment, which jumped sharply last year on the back of the government's aggressive fiscal stimulus, seems to be peaking. In particular, the pace of railway investment growth had moderated in recent months, up 17.5%oya between January and April compared to 67.5% oya in full-year 2009. Nominal retail sales also increased, rising 18.5%oya in April (up 1.9%m/m sa). Urban area retail sales increased 18.9%oya in April, while rural area retail sales rose 16.0%oya.

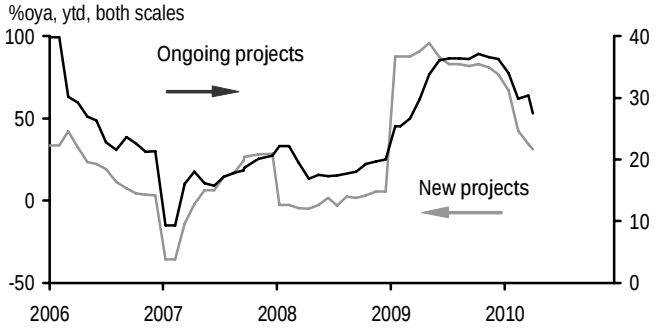
CPI and PPI pick up

April CPI inflation picked up, rising 2.8%oya compared to 2.4%oya in March. Seasonally adjusted, the headline CPI rose 0.3%m/m in April, after a 0.5%m/m decline in March, with the sequential trend rising 3.2%3m/3m saar. The April rise in the headline CPI again reflects moderate rises in food prices, at 5.9%oya (up 0.8%m/m sa). Excluding the food component, the nonfood CPI edged ahead 1.3%oya in April, compared to a gain of 1.0%oya in March. Seasonally adjusted, the nonfood CPI rose 0.2%m/m sa in April, with the sequential trend rising 0.9%3m/3m saar.

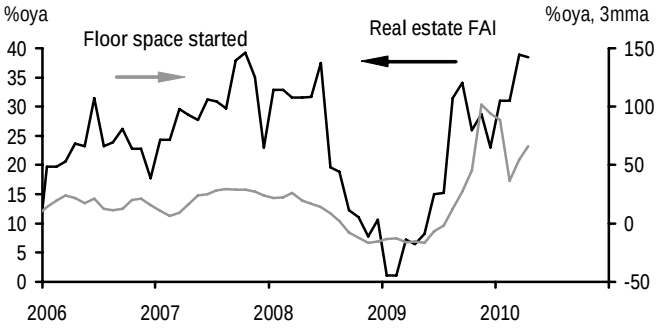
The PPI increased 6.8%oya in April, compared to 5.9%oya in March. Seasonally adjusted, the PPI inched up 0.5%m/m sa in April, with the sequential trend gaining at 9.3%3m/3m saar. Among the major categories, the PPI for mining jumped 30.9%oya in April, and the PPI for industrial raw materials rose 13.6%oya. The PPI for consumer goods rose moderately, up 1.4%oya in April.

The M2 money supply rose 21.5%oya in April. Seasonally adjusted, the pace of monthly gain in M2 remained steady, at 1.2%m/m in April, with the sequential trend rising at 22.2%3m/3m saar. New loan creation picked up in April. New household loans registered 325.5 billion yuan in April (compared to 270.6 billion yuan in March). New medium- to long-term corporate loans were 325.9 billion yuan in April (easing from 519.1 billion yuan in March). New short-term corporate loans came in at 46.7 billion yuan in April. Meanwhile, bill discounting reversed its previous

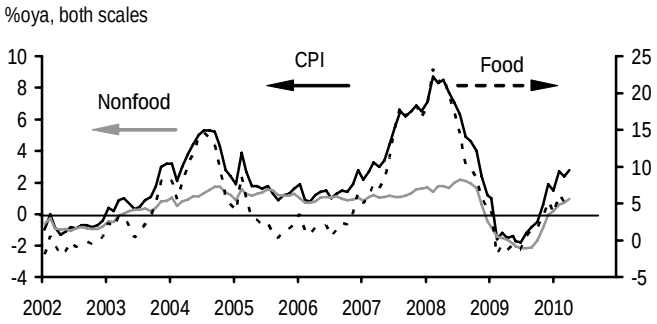
China: ongoing and new fixed investment projects



China: real estate investment growth and floor space started



China: headline, food, and nonfood CPI



declining trend, with new total bill discounting coming in at 47 billion yuan in April.

April trade balance returns to surplus

China's exports rose 30.5%oya in April, translating into a 3.4%m/m sa gain, following the 6.3% fall in March. Monthly volatility aside, growth momentum in exports has cooled in recent months, rising at 19.2%3m/3m saar through April from the rampant 82.9% pace early this year. Meanwhile, imports rose 49.7%oya in April, translating into a 3.6%m/m sa drop, with the sequential trend similarly moderating to 44.3%3m/3m saar. The trade balance returned to surplus in April at US$1.68 billion. While the

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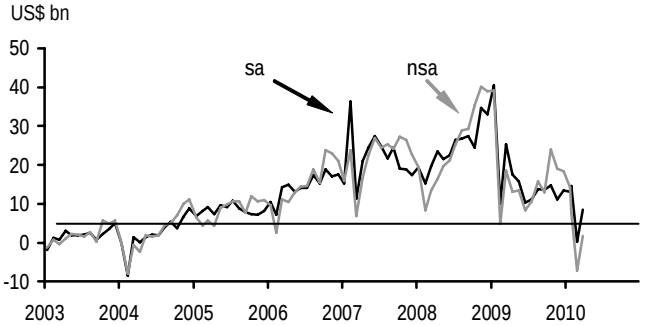
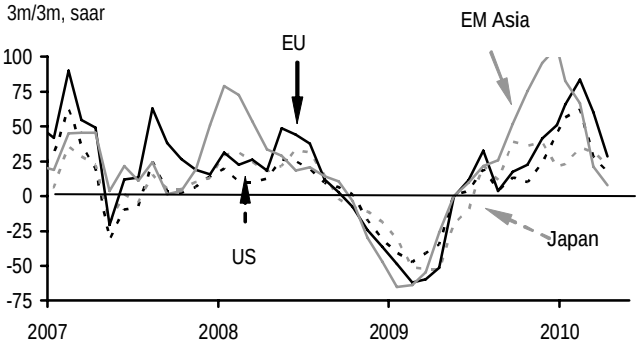
surplus on processed trade (imported raw materials, parts, or components for processing and assembly of export-oriented products) has remained generally steady, the deficit on ordinary trade (the major broad trade category besides processing trade) narrowed somewhat to US$12.2 billion in April, compared to $20.3 billion in March. For the first four months of this year, the trade surplus was US$16.2 billion versus US$75.7 billion in the first four months of last year.

On the back of the marked post-crisis recovery in China's export sector since late last year, it is not surprising that the sequential growth momentum has moderated in recent months. Nonetheless, the growth pace remains solid and the latest developments on both the external and global fronts are consistent with our view that the steady recovery trend in China's export activity should continue. The global labor market is recovering and the booming pace of G-3 capital goods orders and shipments also indicates that a sharp recovery in business capital expenditures is in train. Meanwhile, China's direct economic exposure through exports to Greece, Portugal, Spain, Ireland, and Italy is small. This, together with the expected gradual moderation in FAI growth this year, reinforces our view that March's deficit was an outlier. Overall, we expect China's 2010 trade account to remain in surplus of about US$100 billion.

China: merchandise trade balance



China: exports by region



Hong Kong: strong 1Q GDP report

Hong Kong's 1Q GDP came in stronger than expected, expanding a solid 10.0%q/q saar, the same increase as in 4Q09. This leaves the rate of over-year-ago real GDP growth at 8.2%. In seasonally adjusted terms, export/import sectors expanded significantly in 1Q, driven by strong trade with other Asian countries, as well as a moderate recovery in the US market. Private consumption eased sequentially in 1Q, which was likely a payback from the strong growth in 4Q09, while the %oya growth rate remained strong at 6.5%.

Looking ahead, given our constructive outlook for the global economy, particularly in Asia, as well as solid economic momentum in the US, we expect Hong Kong's economy to maintain a solid pace of growth in the coming quarters. On the external side, the swift turnaround in the mainland and regional economies should continue to boost Hong Kong's trade sector. We have noted that the March trade figures have already returned to their pre-2008 level. Domestically, improving conditions in the labor market and in business sentiment and the rebound in tourism should all come together to support further domestic recovery. We have revised our full-year 2010 real GDP growth forecast to 7.1%oya (previously: 5.3%).

- Total exports of goods increased 38.1%q/q saar in 1Q, backed by strong growth of intra-Asia trade flows. Exports of services also expanded strongly, rising 29.1%q/q saar in 1Q. The export of financial and business services grew vibrantly along with the surge in financial markets and commercial activity.

- On the domestic front, local consumer sentiment recovered further in 1Q10 on the back of the improving economic outlook and a stabilizing labor market (the unemployment rate fell to 4.4% in 1Q10). Nonetheless, overall private consumption expenditure nearly stalled in 1Q, in seasonally adjusted terms, which we feel was a payback for the strong gain in 4Q09. Government consumption expanded notably, by 5.3%q/q saar in 1Q10.

- In addition, overall investment spending remained firm, increasing 10.5%oya in 1Q, after rebounding strongly in the previous quarter (14.7% in 4Q09). By sectors, machinery and equipment acquisitions surged 12.1%oya in 1Q, with a larger contribution from the private sector component. Expenditure on buildings and construction declined modestly, sliding 2.1%oya in 1Q10. Public sector works continued to grow while private sector construction activity remained sluggish.

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China:

Data releases and forecasts

Week of May 17 - 21

No data releases.

Review of past week's data

Merchandise trade (May 10)
US$ bn

	Feb	Mar	Apr	
Balance	7.6	-7.2	~~0.3~~	*1.7*
Exports	94.5	112.1	~~125.0~~	*119.9*
%oya	45.6	24.2	~~35.9~~	*30.5*
Imports	86.9	119.3	~~124.7~~	*118.2*
%oya	44.7	66.0	~~58.2~~	*49.7*

Consumer prices (May 11)
% change

	Feb	Mar	Apr	
%oya	2.7	2.4	2.8	
%m/m sa	1.0	-0.6	~~0.4~~	*0.3*

Producer prices (May 11)
%oya

	Feb	Mar	Apr	
Producer (NBS)	5.4	5.9	~~6.7~~	*6.8*
Producer (PBoC)	5.7	5.6	—	

Fixed investment (May 11)
% change

	Feb	Mar	Apr	
Fixed investment				
%oya	26.6	26.2	~~25.8~~	*25.6*
%oya ytd	26.6	26.4	~~26.2~~	*26.1*
Real estate				
%oya ytd	31.1	35.1	—	*36.2*
Manufacturing				
%oya ytd	23.6	25.8	—	*25.8*

Retail sales (May 11)
% change

	Feb	Mar	Apr	
%oya	22.1	18.0	~~18.0~~	*18.5*
%m/m sa	1.0	1.4	~~1.7~~	*1.9*

Industrial production (May 11)
% change

	Feb	Mar	Apr	
%oya	12.8	18.1	~~18.5~~	*17.8*
%m/m sa	-4.0	7.0	~~1.6~~	*1.0*

Monetary aggregates (May 11)
%oya

	Feb	Mar	Apr	
M2	25.5	22.5	~~21.6~~	*21.5*
Bank lending	27.2	21.8	—	*22.0*

Foreign direct investment (May 14)
US$ bn

	Feb	Mar	Apr	
Utilized FDI	5.9	9.4	—	7.3
%oya	1.1	12.1	—	*24.7*
%oya ytd	7.8	7.7	—	*11.3*

Hong Kong:

Data releases and forecasts

Week of May 17 - 21

Tue May 18 4:30pm — Labor market survey
sa, 3mma

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

Thu May 20 4:15pm — Consumer prices
%change

	Jan	Feb	Mar	Apr
%oya	1.0	2.8	2.0	2.1
%m/m sa	0.2	2.3	-1.6	0.2

Review of past week's data

Real GDP (May 14)
% change

	3Q09		4Q09		1Q10	
%oya	~~-2.2~~	*-2.4*	~~2.6~~	*2.5*	~~7.0~~	*8.2*
%q/q saar	~~1.6~~	*1.2*	~~9.5~~	*10.0*	~~4.5~~	*10.0*

Taiwan:

Data releases and forecasts

Week of May 17 - 21

Thu May 20 4:00pm — Export orders
% change

	Jan	Feb	Mar	Apr
%oya	71.8	36.3	43.7	39.6
%m/m sa	2.4	5.5	-1.1	0.5

Thu May 20 — Real GDP
% change

	2Q09	3Q09	4Q09	1Q10
% oya	-6.9	-1.0	9.2	12.9
%q/q saar	18.1	10.2	18.0	5.7

Taiwan's economy continued its solid expansion through 1Q10, with strong momentum in IP and exports. Domestic manufacturing capex also rose notably.

Review of past week's data

No data released.

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Korea

- **Bank of Korea keeps base rate on hold, but comments are turning increasingly hawkish**
- **Jobless rate falls further in April**

As widely expected, the Bank of Korea (BoK) left the base rate on hold at 2% this week. However, both the Monetary Policy Committee (MPC) statement and the Governor's comments appear to have turned modestly hawkish, signaling that BoK tightening is not far off. Of particular note was the BoK's change in rhetoric concerning the direction of future monetary policy, in an effort to increase its flexibility in deciding the timing of the actual rate hike. While less evident in the official English translation, local language versions of the MPC statement clearly removed the wording that had been long considered a hint of no rate action in the foreseeable future. The BoK retreated from its previous emphasis on the phrase "the Committee will maintain the accommodative policy stance for the time being," instead placing more weight on the comment that "it will take into overall consideration financial and economic conditions" (implying that the BoK has finally opened the door for an actual rate hike). In the press conference following the MPC meeting, the Governor confirmed that the change reflects the BoK's perception that private sector fundamentals have steadily improved—one of the key preconditions for a rate hike.

We also note that the BoK amended the wording of its GDP growth outlook, pointing to the improvement in labor market conditions, notably in the private sector. The Governor also commented that Korea's output gap would soon close, thereby increasing demand-side inflation pressures.

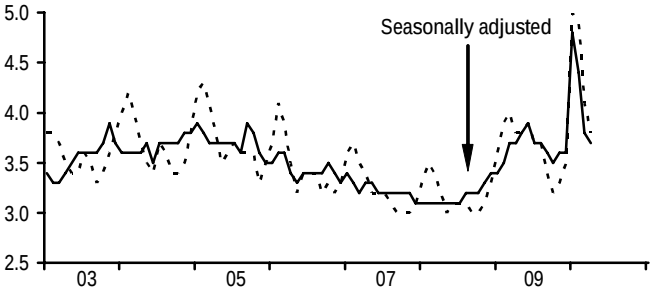
That said, the BoK is still wary of potential risks given the sovereign debt problems in Europe. To be sure, Korea's direct exposure to peripheral Europe (Greece, Iceland, Italy, Portugal, and Spain) is limited, with those countries accounting for less than 2% of Korea's exports, while local Korean financial institutions' direct exposure is estimated to be just US$640 million. However, the second-order impact via demand from the overall Euro area and the health of the financial sector could adversely impact Korea's economy. Domestically, Korea's house prices continue to be closely watched, as concerns are rising that micro-level regulation of housing loans and taxation may be too strict, possibly depressing housing demand sufficiently to accelerate price declines in the market.

Against this backdrop, we maintain the view that the BoK will begin to raise its policy interest rate in 3Q10, possibly as early as July if peripheral Europe's debt concerns stabilize and the fall in house prices turns out to be both modest and regional.

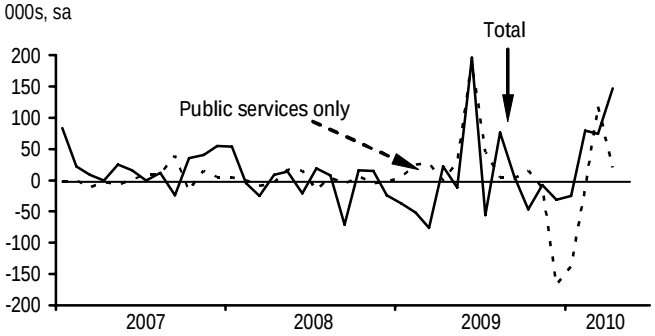
Korea exports to peripheral Europe
% of total exports

	2008	2009	Jan-Mar 2010
Peripheral Europe	2.2	2.4	1.7
Greece	0.3	0.9	0.2
Iceland	0.2	0.1	0.2
Italy	0.8	0.8	0.6
Portugal	0.1	0.1	0.1
Spain	0.8	0.5	0.4
EU	13.8	12.8	11.4

Unemployment rate
% of total labor force



Changes in employment
000s, sa



April employment gain led by private sector

The seasonally adjusted jobless rate registered a third consecutive monthly decline, falling to 3.7% in April after having peaked at 4.8% in December. Details were also encouraging. Employment rose for the third straight month, with a larger monthly increase than in the two previous months. Also, while the employment gain in the previous two months owed much to temporary factors, such as the

Lunar Holiday effect and hiring programs in the public sector, the April gain was driven more by the private sector. The labor force also rebounded in April to a slightly higher level than in January, when job applications for the public sector's hiring program boosted job-seeking statistics. Average weekly working hours moved up, too.

Going forward, the jobless rate is expected to come down further to reflect improvements in the labor market. However, we expect employment gains are unlikely to be as impressive in the second half, with the public sector's temporary hiring programs ending, partially offsetting job gains in the private sector.

Data releases and forecasts

Week of May 17 - 21

Wed May 19 12:00pm **Bankruptcy filings**

	Jan	Feb	Mar	Apr
Bankruptcy filings	141	111	144	130
Dishonored bill ratio	0.03	0.03	0.02	0.02

The dishonored bill ratio likely stayed flat, but the number of bankrupt companies looks to have fallen. While real estate weakness raised the number of bankrupt companies in the construction sector, other sectors seem to have provided some offset, reflecting continued recovery.

Review of past week's data

Producer prices (May 10)
% change

	Feb	Mar	Apr	
%oya	2.4	2.6	~~3.5~~	*3.2*

Producer prices rose markedly in April, led by a seasonal gain in industrial goods prices and higher agricultural prices on colder-than-usual spring weather. However, after J.P. Morgan's seasonal adjustment, pipeline inflation pressure remained rather modest, with the headline index up 0.1%m/m sa in April, after a 0.2% gain in March. Nevertheless, the inflation environment is likely to turn less favorable in 2H10, with supply-side cost pressure eventually building on forecast hikes in global commodity prices and public utility charges.

Monetary aggregates (May 11)
%oya, monthly average

	Jan	Feb	Mar	
M2	9.3	9.4	~~9.0~~	*9.3*
Lf	8.1	8.6	~~8.8~~	*8.9*

M2 growth moderated back to 0.5%m/m sa in March, after the holiday-driven acceleration to 0.8% in February, while Lf rose 0.9% (1.0% rise in February).

Unemployment rate (May 12)
% of labor force

	Feb	Mar	Apr	
Seasonally adjusted	4.4	3.8	~~3.8~~	*3.7*
Not adjusted	5.0	4.9	~~4.5~~	*4.1*

See main story.

Export and import prices (May 14)
%oya, in local currency terms

	Feb	Mar	Apr	
Export prices	-10.2	-12.2	~~-8.4~~	*-6.7*
Import prices	-4.1	-4.3	~~1.7~~	*5.1*

Import prices increased 1.0%m/m sa in April, mainly driven by the surge in crude oil prices. The impact of energy price hikes was notable because crude oil prices are represented by Dubai crude, which rose sharply by 8.2% in USD terms compared to a 4.0% rise in WTI crude.

Stage of processing price index (May 14)
%oya

	Feb	Mar	Apr	
Index	0.4	0.5	~~4.3~~	*4.2*

Housing prices (May 14)
% change from previous week, apartment prices only

Week of Apr 26	May 3	May 10	
0.0	0.0	__	*0.0*

BoK Watch

- **Local bond market sold off on MPC comments**

As a result of the rather hawkish BoK MPC meeting this Wednesday, the Korea local bond market sold off and the curve flattened, with market expectations for the BoK's first rate hike now lying mostly in 3Q10. Indeed, the benchmark three-year KTB yield jumped 13bp on the day of the MPC meeting, while the 10-year KTB yield moved only 7bp higher. Also depressing market sentiment was this week's release of the minutes for the March 22 MPC meeting (no rate decision), which indicated that the MPC had discussed further unwinding its unconventional stimulus measures that were put in place during the crisis, such as liquidity support for the bank's recapitalization fund and the reduction of loan ceilings to small- and medium-sized enterprises (see "Bank of Korea: tracking policy aims of the new MPC," *GDW*, March 19).

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

- **Philippines' balance of payments to widen as current and financial account outlooks expected to improve**
- **BSP expected to hike rates next month despite greater European sovereign stress**
- **Successful elections have provided "Noynoy" Aquino with a strong mandate to pursue reforms**

After mostly running deficits between the mid-1970s and early 2000s, the Philippines' current account has shifted to surplus due to structural changes that have favored service exports and current transfers. These shifts combined with strong cyclical momentum should lead to a widening in the surplus. In addition, we expect the financial account, which posted large deficits in 2008 and 2009, to be less of a drag. Given these supports, we expect the overall BoP surplus to widen in 2010.

Inflation has begun to rise and we expect it to accelerate further. Though the BSP's 3.5% to 5.5% target for average inflation in 2010 appears attainable, we anticipate that inflation will likely breach the upper band before rolling over. As a result, we expect the BSP to begin hiking its policy rate in June with a 25bp move.

As expected, President-apparent "Noynoy" Aquino won the Philippines' first-ever automated election by a wide margin. The quick, clean, and relatively peaceful election provides Aquino with a strong mandate to pursue reforms and address the country's economic and social challenges. Key events to watch include Aquino's taking of office on July 1, his selection of cabinet members, and his announcement of priorities for economic policy.

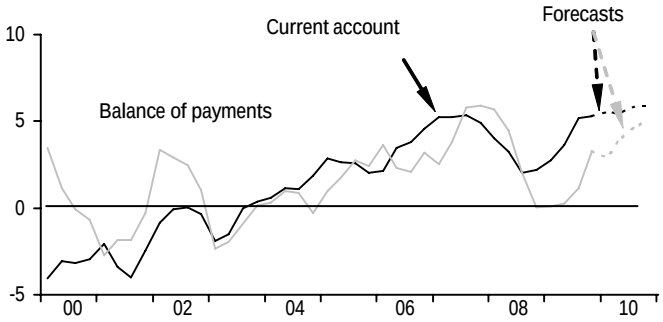
Cyclical and structural shifts to boost current account in 2010

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 the result of greater numbers of overseas foreign workers (OFWs) and their improved access to remittance facilities. Second, services, in particular business processing outsourcing (BPO), have become increasingly 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 re-

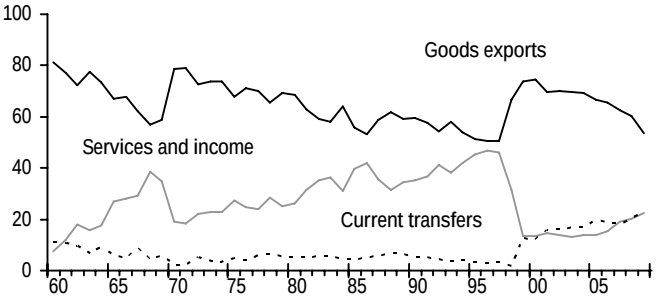
Balance of payments
% of GDP

	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

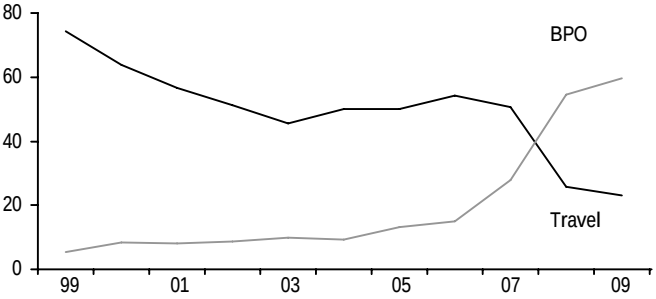
Philippines: BoP composition
% of GDP



Philippines: current account components
Component receipts as % of current account receipts



Philippines: travel and BPO service exports
% of total service exports



ceipts 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. In addition, the current account should also benefit from the global cyclical recovery. Exports still account for roughly 54% of total current account receipts, and regional trade is strong. With global GDP growth expected to continue growing at a firm pace, Philippine exports should grow robustly as well.

The financial account should also improve this year. In recent years, capital outflows were unusually large due to "flight to safety" into USD assets by 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, along with a longer-term trend of modest financial account surplus, suggest that at the very least, capital flows should not be as large a drag on the overall BoP position this year.

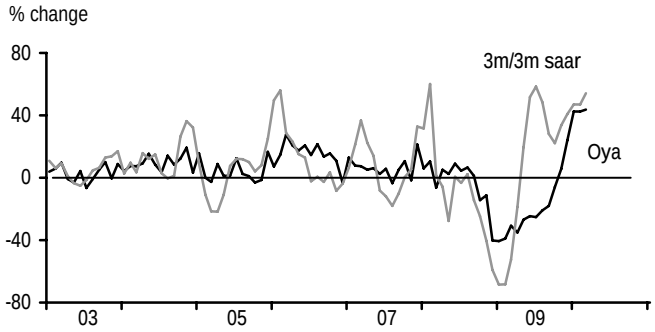
Looking for BSP to tighten in June

Inflation was 4.4%oya in April and we expect it to rise further in coming months. Though the BSP's 3.5% to 5.5% target for average inflation in 2010 appears attainable, inflation will likely breach the upper band before rolling over. Concern about the impact of sovereign stress in Europe on financial markets globally will likely make the central bank think twice about hiking. However, the successful completion of elections and a positive economic outlook along with rising inflation should provoke the BSP to tighten 25bp. We expect another 50bp of tightening in 2H10 as the BSP normalizes policy further.

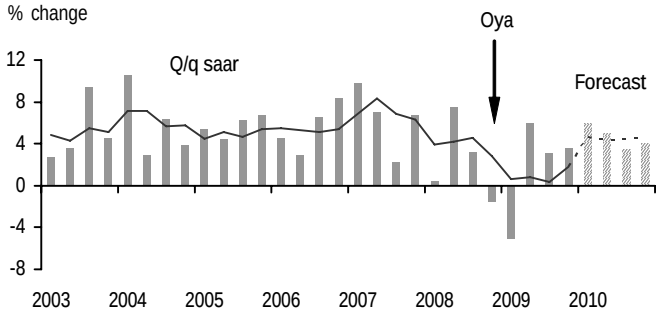
With elections complete, focus shifts to Aquino's policy plans

Despite his strong mandate, there are some concerns about Aquino's ability to really pursue economic reform. Aquino ran on a platform to reduce corruption, poverty, and tax evasion. Other presidential contenders have made similar claims in the past before failing to make much progress once in power. However, Aquino is expected to appoint competent cabinet members and advisors, and to surround himself with well-respected reformers. It is too early to know whom exactly, but names circulating of people Aquino may appoint include many of those who quit Arroyo's government in 2005, known as the "Hyatt 10," amid the election fraud scandal. These include former Finance Secretary Cesar Purisima and former BIR chief Guillermo Parayno, who have a track record for spearheading reform.

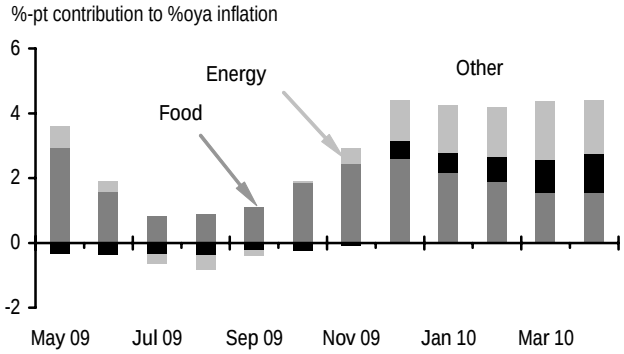
Philippines: exports



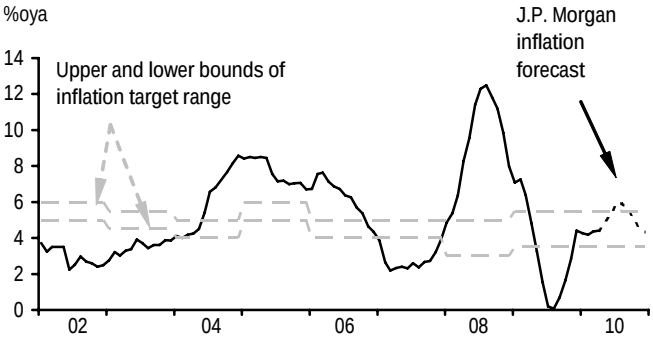
Philippines: real GDP



Philippines: inflation contributions



Philippines: CPI inflation



Indonesia:

Data releases and forecasts

Week of May 17 - 21

No data releases.

Review of past week's data

Real GDP (May 10)

% change

	3Q09		4Q09		1Q10	
Oya	4.2		5.4		~~6.2~~	*5.7*
Q/q saar	5.8	6.3	~~9.6~~	*6.2*	~~5.5~~	*5.4*

Indonesian 1Q10 real GDP grew a solid 5.4%q/q saar despite a sharp decline in government consumption offset by the strength in private final demand. After surging in 4Q09, government spending fell by a massive 52.5%q/q saar, but private consumption and fixed investment each increased, by 7.0% and 8.6%, respectively. As a result, total consumption fell only 3.8% on the quarter. Exports, meanwhile, gained a modest 5.3% after three quarters of double-digit growth, while imports also cooled, following a similar trajectory to exports over the past four quarters. In terms of overall contributions to the 5.7%oya growth print, domestic demand drove growth (4.7%-pts) as private consumption (2.3%-pts), fixed investment (1.8%-pts), and inventories (1.1%-pts) all contributed. External demand added 1%-pt to growth. The 1Q10 GDP print suggests that private final demand started the year on a strong note. Nonetheless, annualized GDP numbers can be choppy, and private consumption is up only 3.9%oya. With the government trying to boost fixed investment, private consumption running at a solid, but not particularly fast pace (the five-year average is about 4.4%oya), and core inflation still moderate, we do not expect Bank Indonesia to hike its policy rate in the near future.

Malaysia:

Data releases and forecasts

Week of May 17 - 21

Wed May 19 5:00pm — Consumer prices

% change

	Jan	Feb	Mar	Apr
Oya	1.3	1.2	1.3	1.9
M/m sa	0.2	0.7	-0.3	0.2

Inflation likely rose at a modest pace in April reflecting a small increase in food prices.

Review of past week's data

Industrial production (May 11)

%oya

	Jan		Feb		Mar	
Total	13.8		~~5.0~~	*4.9*	~~7.5~~	*14.2*
%m/m sa	~~2.9~~	*4.0*	~~-2.2~~	*-1.8*	~~0.2~~	*4.2*

March IP rose a larger-than-expected 4.2%m/m sa, leaving the headline growth rate higher than expected at 14.2%oya (consensus: 13.4%). Details of the report were uniformly strong with most categories, except electricity, recovering from the dip in February. In particular, the strong March print in manufacturing production now puts sequential growth at a very solid 26.3%3m/3m saar, and suggests a re-acceleration in 1Q10 following a stabilization—albeit at high growth rates—in 4Q09.

With production as strong as it has been, there is likely to be some payback in 2Q10 although the underlying leading indicators, including the PMI and regional electronics shipments/inventory ratios, remain strong as well. The strength in leading indicators suggests that production growth should hold at relatively strong levels, even into early 2Q10. In all, we believe the strength of the data, notwithstanding risks in the EU area, should keep the central bank normalizing rates steadily through 3Q10.

Bank Negara Policy Statement (May 13)

	Mar	Apr	May
% p.a.	2.25	2.25	*2.50*

Malaysia hiked its overnight policy rate 25bp to 2.50%; the hike was fully expected by the markets. This hike moves BNM one step further along the normalization path, which we expect will be complete when the OPR rate moves to 3% in 3Q10, although this does assume consistent 25bp hikes at each of the next two policy meetings. Moreover, the BNM has effectively normalized its FX rate over the past couple of months—the second part of the broader policy normalization process. While the accompanying BNM statement is, on balance, more positive on growth and somewhat balanced on risks, the comments from the authorities following the hike were clear—the normalization will go on. These comments thus suggest that a 25bp hike at the July 8 meeting is highly likely.

Real GDP (May 14)

% change

	3Q09	4Q09	1Q10
Oya	-1.2	4.5	~~10.4~~ *10.1*
Q/q saar	10.4	15.4	*5.0*

Malaysian 1Q10 real GDP rose 10.1%oya (J.P. Morgan: 10.4%; consensus: 9.8%oya) and was up a solid 5%q/q saar. While headline sequential growth was firm, though slower than the frenetic pace seen in 2H09, the demand-side details were somewhat weaker than expected. In particular, private consumption rose a modest 1.5%q/q saar—more slowly than in 2H09—while private investment actually contracted in sequential terms by 7.2%q/q saar. Although some of the contraction in fixed capital formation is a payback for the strength in 4Q09, an outright contraction was unexpected given that the underlying demand cycle was firm during the quarter, which should have fueled a modest expansion in capacity. While private domestic demand was relatively lackluster in 1Q10, the external sector registered a stellar performance, with exports growing a robust 46.2%q/q saar. Looking ahead, the strength in external demand is expected to broaden further into domestic demand. Looking ahead,

J.P. Morgan maintains its 2010 growth forecast of 7.7%oya, which assumes that the strength in external demand will remain for a good part of the year, albeit with some moderation in 2H10, and also that domestic demand will remain supportive despite the somewhat disappointing outcome in 1Q10.

Philippines:

Data releases and forecasts

Week of May 17 - 21

During the week — Government budget
Bn pesos

	Jan	Feb	Mar	Apr
Balance	-37.1	-33.2	-63.9	__
Revenue	92.3	76.5	96.9	__
Expenditure	129.4	109.9	160.7	__

The government deficit was wider than expected in 1Q, but, due to election-related restrictions on spending, 2Q spending is expected to decline. The government's deficit target of 3.5% of GDP this year, compared to 3.9% last year, looks achievable, in our view.

Mon May 17 10:45am — OFW worker remittances
% change

	Dec	Jan	Feb	Mar
Oya	11.4	8.5	7.1	9.0
M/m sa	-2.9	-0.3	1.8	0.5

OFW remittances tend to be choppy, but given strong momentum in global growth and improvement in the labor market data globally, we expect them to register a modestly positive print for a second straight month.

Review of past week's data

Merchandise trade (May 12)
US$ bn nsa

	Jan	Feb	Mar
Exports	3.6	3.6	~~4.3~~ *4.2*
%oya	42.5	~~42.3~~ *42.5*	~~46.8~~ *44.6*

Philippines' exports continued to grow robustly as the country benefits from the pickup in global trade. Interestingly, nonelectronics exports posted the largest gain in March while electronics exports were up only marginally. This likely reflected price effects for food and commodities as well as strength in previous months as nonelectronics have lagged electronics. We continue to expect a trade deficit this year, as is usually the case for the Philippines.

Singapore:

Data releases and forecast

Week of May 17 - 21

Mon May 17 1:00pm — Merchandise trade
US$ bn nsa

	Jan	Feb	Mar	Apr
Trade balance	2.3	1.5	3.5	2.9
Exports	25.7	23.4	29.3	29.0
Non-oil domestic (NODX)	8.6	8.5	10.7	10.0
%m/m sa, USD terms	-4.4	6.2	4.5	-0.4
%oya, USD terms	27.7	33.3	37.9	33.4

Exports likely took a bit of a breather in April due to payback from very strong electronics growth in March. Despite the April setback, we would expect the general trend for export growth to remain strong in coming months.

Thu May 20 8:00am — Real GDP

	2Q09	3Q09	4Q09	1Q10
%oya	-3.1	0.6	4.0	13.9
%q/q saar	16.2	11.5	-2.8	33.5

Strong March data suggest that 1Q GDP rose at a slightly faster 33.5% annualized pace than the 32% reported in the advance print.

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Review of past week's data

Retail sales (May 14)
% change

	Jan	Feb	Mar
Oya	2.6	4.7	~~2.3~~ *-3.6*
M/m sa	5.3	-5.5	~~2.5~~ *-2.4*

Retail sales fell for a second straight month as motor vehicle sales plunged. This likely reflected the recent surge in the prices of COE (the certificate that must be purchased along with the car as legal documentation of ownership). Ex automobiles, however, retail sales rose a modest 0.1%m/m sa and 5.4%oya.

Thailand:

Data releases and forecasts

Week of May 17 - 21

No data releases.

Review of past week's data

No data released.

Vietnam:

Data releases and forecasts

Week of May 17 - 21

No data releases.

Review of past week's data

No data released.

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India

- **April headline inflation moderates, but core inflation rises**
- **IP and export momentum ease after two months of rapid growth**
- **Intermeeting rate hike on the cards**

Driven by lower sugar prices, food inflation eased modestly in April, while core inflation picked up on higher steel and cement prices. Separately, both IP and export growth momentum moderated, although still printed high over-year-ago growth due to last year's low base. The economic recovery is becoming more broad-based. With the investment revival expected in 2H10, we have revised our FY2011 GDP forecast to 8.3% from 8.0%. As we had long suspected, industrial capacity is being strained, and this is pushing up core inflation. The RBI could raise rates before the July policy review, although it is unlikely to hike the cash reserve requirement (CRR) as liquidity could tighten on advanced tax and 3G license payments scheduled by June.

Headline inflation slows, but rising non-food inflation may induce rate hike

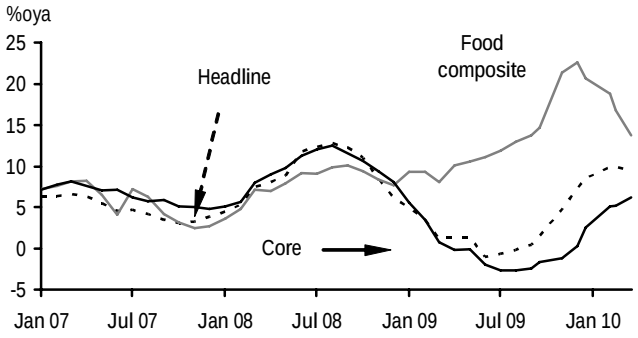
April WPI headline inflation declined to 9.6%oya from 9.9% in March, but core inflation (ex. food and energy) rose markedly to 6.2% from 5.2%. The decline was largely driven by sugar (-5.7%oya) and edible oils (-2%oya). Prices of primary food articles, which the government had hoped would decline sharply as the winter harvest made its way to the market, instead rose to 16.9%oya from 16.7% in the previous month on higher sugar cane prices. Rising steel and cement prices, which climbed 11.4% and 5%, respectively, drove up core inflation. More ominously, core inflation also accelerated to 0.8%m/m sa from -0.2% in March.

Looking through the headline print, the RBI will likely be concerned by the pace of core inflation, which could trigger a rate hike before the July policy review. But the RBI is unlikely to raise the CRR because liquidity could be squeezed in the coming months as advance tax and 3G license payments (around Rs550 billion or US$13 billion) are due by June.

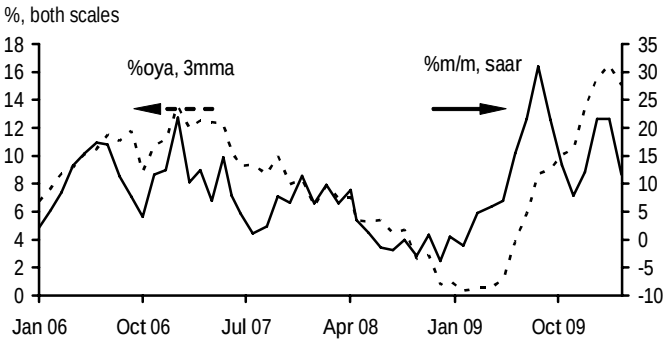
What could delay an early RBI action is the rise in global uncertainty brought on by the European debt crisis. If in the coming weeks, financial markets settle down and the scope of the impact on global growth appears limited, the RBI is likely to act, but in a small dose of 25bp in rate hikes.

The India data watch is published biweekly, next on May 28.

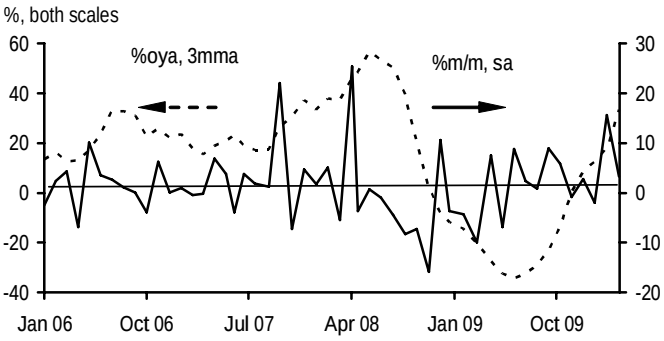
India: Headline inflation moderates, but core picks up



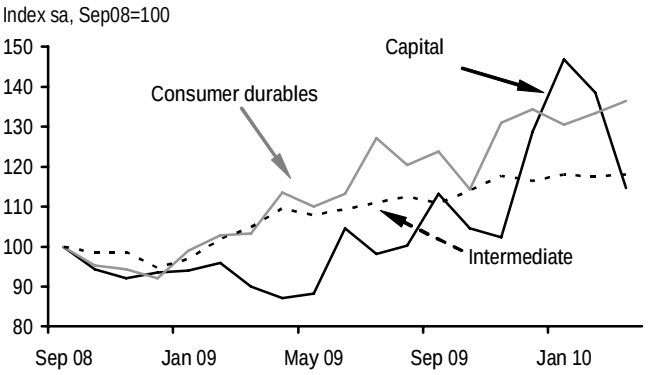
India: IP growth slows



India: export momentum moderates



India: volatile capital goods production slows sharply



IP growth slows from capital goods

March IP declined 1.5%m/m sa, resulting in lower-than-expected 13.5%oya growth. This is the second straight month of sequential decline, and as in February, it was led by falling capital goods production (18.1%m/m sa). Overall manufacturing fell (2.2%m/m sa), while mining declined 0.7%. Electricity continued to surge at 4.8%m/m sa. With this, overall IP grew 10.4% in FY2010 versus 2.7% in FY2009.

We expect capital goods production to pick up in the coming months, as corporates begin expanding capacity, which is getting increasingly stretched, and public spending on infrastructure increases. Also, in the summer months demand for products like air conditioners and refrigerators rises materially, raising consumer durables production.

Export momentum moderates

The March trade deficit fell to US$7.8 billion from US$8.9 billion in February. The pace of expansion in exports moderated to 3.3%m/m sa after a 15.6% rise in February. Last year's low base pushed over-year-ago growth to 54.1%. Import growth also slowed to 0.3%m/m sa from 13.5% in February, on lower oil. The FY2010 trade deficit stood at US$104 billion against US$118 billion in FY2009.

Despite recent moderation, FY2011 GDP growth expected to be higher at 8.3%

Despite the moderation in IP and export momentum, activity is becoming more broad-based. And with the expected revival in investment, India's main growth driver over 2003-08, we now expect FY GDP growth to come in around 8.3%, higher than our previous projection of 8.0%. This will place additional strain on capacity, but with a normal monsoon and timely monetary tightening, FY2011 inflation could be contained within 9.5%-10%.

Data releases and forecasts

Week of May 17 - 28

During the week — **Core infrastructure index**
% oya nsa

	Dec	Jan	Feb	Mar
Overall	6.4	9.4	4.5	__
%m/m sa	0.5	3.8	-3.8	__
Electricity	6.7	6.7	7.3	__
Coal	2.5	5.9	6.8	__
Finished steel	9.6	15.3	0.9	__
Crude petroleum	1.1	9.7	4.0	__
Petroleum refining	0.8	3.8	0.8	__
Cement	11.0	12.4	5.8	__

During the week — **Federal government fiscal balance**
Rs. bn

	Dec	Jan	Feb	Mar
Total receipts	821.1	368.9	429.5	__
Revenue	821.5	357.5	337.1	__
Tax (net)	747.2	257.5	253.1	__
Nontax	74.3	100.1	84.1	__
Total expenditure	858.7	764.5	743.1	__
Plan	364.8	168.2	301.3	__
Nonplan	493.9	596.4	441.8	__
Interest payments	105.0	272.6	199.9	__
Fiscal deficit	37.6	395.6	313.6	__
Revenue deficit	-66.5	330.4	315.8	__
Primary deficit	-67.4	123.0	113.7	__

Fri Apr 30 — **Foreign exchange reserves**
US$ bn

	Jan	Feb	Mar	Apr
Total foreign reserves	281.0	278.4	277.0	__
FX reserves ex gold	256.4	254.0	252.8	__

Mon May 3 — **Manufacturing PMI survey**

	Jan	Feb	Mar	Apr
Index	57.6	58.5	57.8	__
%m/m sa	3.7	1.4	-1.2	__

Mon May 3 — **Merchandise trade**
US$ bn, nsa

	Dec	Jan	Feb	Mar
Trade balance	-10.1	-10.4	-9.0	__
Exports	14.6	14.3	16.1	__
%oya	9.3	11.5	34.8	__
Imports	24.7	24.7	25.0	__
%oya	27.2	35.5	66.4	__

Review of past two week's data

Industrial production
%oya nsa

	Dec	Jan	Feb
Overall	17.6	16.7	__ *15.1*
%m/m sa	3.1	~~1.2~~ *0.3*	__ *-0.4*
Mining	10.7	~~14.6~~ *15.3*	__ *12.2*
Manufacturing	19.3	17.9	__ *16.0*
Electricity	5.4	5.6	__ *6.7*

Wholesale prices
%oya

	Jan	Feb	Mar
Overall	8.5	9.9	__
Primary	14.5	15.5	__
Energy group	6.9	10.2	__
Manufactured products	6.6	7.4	__

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Asia focus: trade balances with China

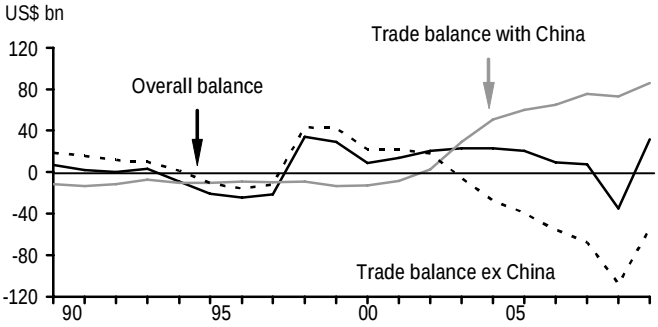
One of the defining aspects of the Asia region in the past decade was China's accession to the WTO in 2001. This effectively opened up an investment hinterland for the region, which led to a surge in foreign direct investment into China, dominated in the region by the North Asian countries of Japan, Korea, and Taiwan.

These foreign direct investment inflows have effectively led to a shift in trade flows within the region, with a particularly striking increase in Asia's merchandise surplus with China (chart opposite and table). This surplus in effect captures the triangular trade dynamic—with the North Asian manufacturers benefiting from the relative cost differentials with China. Of late, however, this may also reflect final demand from China rather than intermediate demand from the G-7 nations. In total, the trade surplus with China was US$80 billion in 2009, up from a deficit of US$21 billion in 2002. By contrast, excluding China, Asia's trade balances would have printed a deficit of US$19 billion.

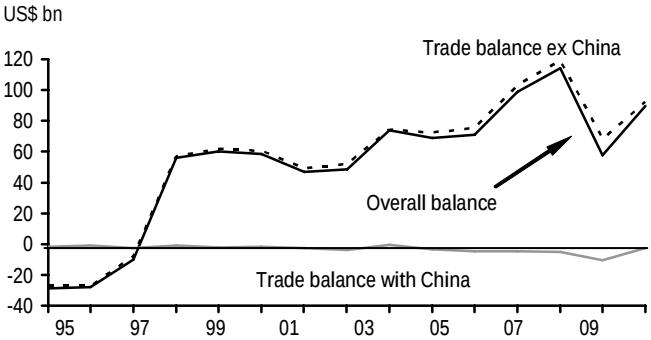
Within the region, the most striking developments have been in North Asia: Korea, Hong Kong, and Taiwan (chart below). In these three countries, the trade surplus surged to US$86 billion in 2009 from US$3 billion in 2002. Moreover, the 2009 financial crisis did not affect the trend even though the non-China deficit widened as exports collapsed. That China provided a consistent pull helped offset the impact of the deficits on the overall balance.

Within the ASEAN region, China's impact has been less dominant, with the trade balances showing no material shift in their bilateral balance with China. This suggests that local manufacturing companies have not benefited as much from the triangular trade dynamic with China.

North Asia ex. Japan: trade balance

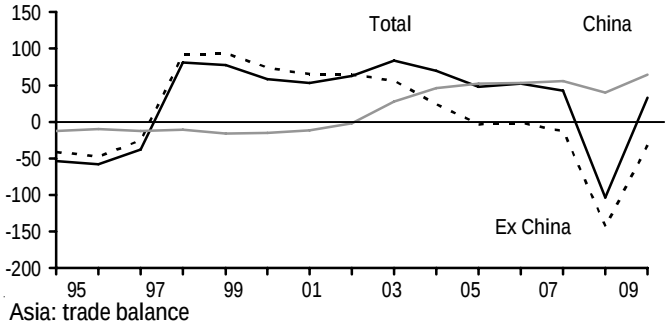


ASEAN: trade balance



Emerging Asia: trade balance

US$ bn, customs basis



Asia: trade balance

US$ bn

		2000	2002	2004	2006	2007	2008	2009	Change[1]
Asia	Total	158	142	180	120	134	-83	61	-59
	With CN	-38	-21	31	43	61	55	80	37
Em. Asia	Total	59	63	69	52	43	-103	33	-19
	With CN	-15	-2	46	53	55	40	65	11
N. Asia ex. JP	Total	9	21	23	10	8	-35	32	22
	With CN	-13	3	51	65	76	73	86	21
ASEAN	Total	59	48	69	99	114	58	90	-9
	With CN	-2	-4	-3	-5	-5	-10	-3	2
Japan	Total	99	79	111	68	92	20	29	-39
	With CN	-25	-22	-20	-26	-19	-18	-13	13
Korea	Total	12	10	29	16	15	-13	40	24
	With CN	6	6	20	21	19	14	32	12
Taiwan	Total	8	18	6	12	17	4	20	9
	With CN	4	10	35	49	60	64	52	2
Hong Kong	Total	-11	-8	-12	-18	-23	-26	-29	-11
	With CN	-22	-13	-4	-5	-3	-5	2	7
India	Total	-9	-6	-23	-57	-79	-126	-89	-33
	With CN	-1	-0.8	-2	-8	-15	-22	-19	-11
Indonesia	Total	29	26	25	40	40	8	20	-20
	With CN	1	0	1	2	1	-4	-3	-4
Malaysia	Total	16	14	21	30	30	43	34	3
	With CN	0	-1	-2	-5	-3	-1	2	6
Philippines	Total	4	-4	-4	-4	-5	-8	-5	0
	With CN	0	0	0	1	2	1	-1	-2
Singapore	Total	3	9	25	33	36	18	24	-9
	With CN	-2	-2	-1	-1	-3	-3	0	1
Thailand	Total	7	3	2	0	13	-3	17	17
	With CN	-1	-1	-1	-2	-2	-4	-1	1

1. 2009 less 2006.

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US economic calendar

Monday	Tuesday	Wednesday	Thursday	Friday
17 May Empire State survey (8:30am) May 30 TIC data (9:00am) Mar NAHB survey (1:00pm) May 19	18 May PPI (8:30am) Apr 0.0% Core 0.1% Housing starts (8:30am) Apr 650,000 Permits 675,000 Cleveland Fed President Pianalto speaks in Pittsburgh (2:40pm)	19 May CPI (8:30am) Apr 0.0% Core 0.05% FOMC minutes Meeting of April 27-28, 2010 (economic projections)	20 May Initial claims (8:30am) w/e prior Sat 440,000 Philly Fed survey (10:00am) May 21 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 Boston Fed President Rosengren speaks in Springfield, Mass (12:15pm)	4 Jun Employment (8:30am) May
7 Jun Consumer credit (3:00pm) Apr San Francisco Fed President Yellen speaks (5:00pm)	8 Jun NFIB survey (7:30am) May JOLTS (10:00am) Apr Auction 3-year note $36 bn Fed Governor Duke speaks (8:00am) Kansas City Fed President Hoenig speaks (7:00pm)	9 Jun Wholesale trade (10:00am) Apr Beige book (2:00pm) Auction 10-year note (r) $20 bn	10 Jun Initial claims (8:30am) w/e prior Sat International trade (8:30am) Apr Flow of funds (12:00pm) 1Q Federal budget (2:00pm) May Auction 30-year bond (r) $13 bn	11 Jun Retail sales (8:30am) May Consumer sentiment (9:55am) Jun preliminary Business inventories (10:00am) Apr Philadelphia Fed President Plosser speaks (8:20am)

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Euro area economic calendar

Monday	Tuesday	Wednesday	Thursday	Friday
17 May Netherlands: Foreign trade (9:30am) Mar	18 May Euro area: HICP final (11:00am) Apr 1.5%oya, nsa 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 0.4%q/q, saar ECB President Jean-Claude Trichet speaks in Frankfurt, Germany (5:00pm)	20 May Euro area: EC cons. Conf. Prelim (4:00pm) May Germany: PPI (8:00am) Apr 0.1%oya, nsa Italy: Industrial orders (10:00am) Mar Belgium: BNB cons. Conf. (3:00pm) May Colloquium in honour of ECB member Lucas Papademos (20 May 3:30pm & 21 May , 12:45pm) in Frankfurt, Germany	21 May Euro area: BoP (10:00am) Mar PMI flash (10:00am) May Manufacturing 57.7 Index, sa Services 56.0 Index, sa Composite 57.5 Index, sa Germany: GDP final (8:00am) 1Q PMI flash (9:30am) May Manufacturing 61.5 Index, sa Services 56.0 Index, sa Composite 59.8 Index, sa IFO bus. survey (10:00am) May 101.4 Index, sa France: PMI flash(9:00am) May Manufacturing 56.9 Index, sa Services 59.3 Index, sa Composite 59.4 Index, sa 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
7 Jun Germany: Mfg orders (12:00am) Apr	8 Jun Germany: Foreign trade (8:00am) Apr Industrial production (12:00am) Apr France: Foreign trade (8:45am) Apr Monthly budget situation (8:45am) Apr Netherlands: Industrial production (9:30am) Mar	9 Jun Belgium: GDP final (3:00am) 1Q	10 Jun Euro area: ECB rate announcement (1:45pm) No change expected ECB press conf. (2:30pm) Germany: CPI final (8:00am) May France: Industrial production (8:45am) Apr Italy: Industrial production (10:00am) Apr GDP final (11:00am) 1Q	11 Jun France: CPI (8:45am) May Spain: CPI final (9:00am) May

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Japan economic calendar

Monday	Tuesday	Wednesday	Thursday	Friday
17 May Corporate goods prices (8:50 am) Apr -0.3%oya Private machinery orders (8:50 am) Mar 5.0%m/m, sa 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 -0.5%m/m, sa Consumer sentiment (2:00 pm) Apr 42.0, DI Nationwide department store sales (2:30 pm) Apr -6.0%oya Auction 5-year note	19 May IP final (1:30 pm) Mar Auction 3-month bill	20 May GDP 1st est. (08:50am) 1Q 5.0%q/q, saar 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)
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 at 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 BoJ governor Shirakawa's speech at the Japan National Press club (1:30pm)	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 BoJ board member Suda's address in Wakayama prefecture (11:00am)	4 Jun Auction 6-month bill
7 Jun	8 Jun M2 (8:50 am) May Current account (8:50 a m) Apr Economy watcher survey (2:00 pm) May Coincident CI (2:00 pm) Apr Auction 30-year bond	9 Jun Private machinery orders (8:50 am) Apr Auction 3-month bill	10 Jun GDP 2nd est. (08:50am) 1Q Corporate goods prices (8:50 am) May Consumer sentiment (2:00 pm) May Auction 5-year note	11 Jun
During the week: Cabinet Office private consumption index Apr				

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Canada economic calendar

Monday	Tuesday	Wednesday	Thursday	Friday
17 May Existing home sales Apr	18 May	19 May Wholesale sales (8:30am) Mar 0.7%	20 May Leading indicators (8:30am) Apr	21 May CPI (7:00am) Apr 0.1% (1.6%oya) Core 0.1% (1.7%oya) Retail sales (8:30am) Mar 0.0% Ex auto 0.3%
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
7 Jun	8 Jun Housing starts (8:15am) May	9 Jun	10 Jun International trade (8:30am) Apr New house price index (8:30am) Apr	11 Jun Capacity utilization (8:30am) 1Q

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Latin America economic calendar

Monday	Tuesday	Wednesday	Thursday	Friday
17 May Argentina: Consumer confidence May Brazil: FGV CPI IPC-S May16 0.63% m/m, nsa Peru: GDP Mar 7.9%oya, nsa Unemployment Apr Mexico: Pension funds report Apr *Holiday: Venezuela*	18 May Brazil: Fipe CPI May15 0.51% m/m, nsa Chile: GDP 1Q -6.0%q/q, saar Current account 1Q Mexico: Central bank reserves	19 May Brazil: IGP-M 2nd rel May Colombia: IP Mar 8.0%oya, nsa Retail sales Mar 8.2%oya, nsa	20 May Brazil: IPCA 15 May 0.59% m/m, nsa Mexico: IGAE Mar Real GDP 1Q	21 May Argentina: Trade balance Apr IP Apr Economic activity Mar Mexico: Retail sales Mar Banxico meeting May no change *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 1H May Core 1H May 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
During the week: Argentina: Government tax revenue May Colombia: CPI May				
7 Jun Brazil: Auto Report (Anfavea) May Chile: Economic activity Apr Trade balance May	8 Jun Brazil: GDP 1Q Chile: CPI May Mexico: Central bank reserves	9 Jun Brazil: COPOM meeting Jun IPCA May Mexico: CPI May Core May	10 Jun Brazil: Fipe CPI Jun 7 Peru: BCRP meeting Jun Trade balance Apr Mexico: Auto report May Wage negotiations May	11 Jun Argentina: CPI May WPI May Colombia: BanRep minutes Mexico: IP Apr Fixed investment Mar
During the week: Venezuela: CPI May				

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UK/Scandinavia/Switzerland economic calendar

Monday	Tuesday	Wednesday	Thursday	Friday
17 May United Kingdom: Rightmove HPI (12:01am) May CBI industrial trends (11:00am) May -35 %bal, sa Sweden: Riksbank's Governor Stefan Ingves speaks (3:00pm) Switzerland: SNB's Philipp Hildebrand speaks (6:00pm)	18 May United Kingdom: CPI (9:30am) Apr 3.5 %oya Sweden: House prices (9:30am) Apr Norway: Trade balance (10:00am) Apr Norges bank's Svein Gjedrem's Hearing before the Standing Committee on Fin. and Eco Affairs of the Storting (11:00am & 3:00pm)	19 May United Kingdom: MPC minutes (9:30am) May A 9-0 vote expected Sweden: Riksbank's Deputy Governor Lars Nyberg speaks (3:00pm)	20 May United Kingdom: Retail sales (9:30am) Apr -0.5%m/m, sa Norway: GDP (10:00am) 1Q 1.6%q/q, saar (Mainland) Switzerland: SNB's Thomas Jordon speaks (4:00pm)	21 May United Kingdom: Business investment prelim (9:30am) 1Q 0.0%q/q, sa Public sector finance (9:30am) Apr PSNB £11.5 bn, nsa Provisonal estimates of M4 & M4 lending (9:30am) Apr Switzerland: Monthly statistical bulletin (9:00am)
24 May	25 May United Kingdom: GDP Prelim (2nd release) (9:30am) 1Q Index of services (9:30am) Mar BBA lending (9:30am) Apr Sweden: Labor force survey (9:30am) Apr Norway: Sector accounts (10:00am) 1Q Switzerland: UBS cons. Indicator (8:00am) Apr	26 May Sweden: Trade balance (9:30am) Apr	27 May United Kingdom: CBI distributive trades (11:00am) May Sweden: PPI (9:30am) Apr Switzerland: Employment (9:15am) 1Q	28 May United Kingdom: Gfk cons. Conf. (12:01am) May Sweden: GDP (9:30am) 1Q Retail sales (9:30am) Apr Norway: Labor directorate unemployment (9:00am) May 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 (9:15am) May Consumer conf. (9:15am) May Wage stats (9:30am) Mar Norway: Retail sales (10:00am) Apr Credit indicator (10:00am) Apr	1 Jun United Kingdom: PMI mfg (9:30am) May Sweden: PMI (8:30am) May Financial Stability Report 2010:1 (9:30am) Norway: PMI (9:00am) May NEF HPI (11:00am) May Switzerland: GDP (7:45am) 1Q 2.4%q/q, saar PMI (9:30am) May 65.5 %bal, sa	2 Jun United Kingdom: Net lending to individuals (9:30am) Apr M4 & M4 lending final (9:30am) Apr PMI construction (9:30am) May	3 Jun United Kingdom: PMI services (9:30am) May	4 Jun United Kingdom: New car regs. (9:00am) May Switzerland: SNB's Philipp Hildebrand speaks (9:40am)
During the week : United Kingdom: Halifax HPI May				
7 Jun Norway: IP Mfg (10:00am) Apr	8 Jun United Kingdom: BRC retail sales (12:01am) May RICS HPI (12:01am) May Norway: Gallup cons. Conf. (7:00am) 2Q Norges Bank'sGovernor Svein Gjedrem speaks Switzerland: Unemployment (7:45am) May CPI (9:15am) May	9 Jun United Kingdom: Nationwide cons. Conf. (12:01am) May Markit jobs report (12:01am) May Trade balance (9:30am) Apr Quoted mortgage int. rates (9:30am) May Sweden: TNS prospers inflation expectation survey 2Q Industrial production and orders (9:30am) Apr Norway: Regional network 2/10	10 Jun United Kingdom: MPC rate announcement and Asset purchase target (12:00pm) No change expected Sweden: CPI (9:30am) May AMV unemployment (10:00am) May Norway: CPI (10:00am) May PPI (10:00am) May	11 Jun United Kingdom: Industrial production (9:30am) Apr PPI (9:30am) Apr

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Emerging Europe/Middle East/Africa economic calendar

Monday	Tuesday	Wednesday	Thursday	Friday
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 14.9% Consumer confidence (10:00am) Apr 85.5	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: MPC minutes (2:00pm) Poland: Average gross wages 5.0%oya & employment -0.2%oya (2:00pm) Apr South Africa: Retail sales (11:30am) Mar 1.1%oya *Holiday Turkey*	20 May Poland: PPI (2:00pm) Apr -1.0%oya Industrial output (2:00pm) Apr 11.2%oya Core inflation (2:00pm) Apr 1.9%oya MPC minutes (2:00pm) Apr	21 May
During the week: Sunday (May 16) Israel: GDP 1Q10 3.3%oya, 3.5%q/q saar				
24 May Israel: Monetary policy announcement +25bp Turkey: Capacity utilization (10:00am) May 72.7% Russia: Retail sales Apr 4.0% Unemployment Apr 8.1% Capital investment Apr 1.5%	25 May Hungary: Retail sales (9:00am) Mar Poland: Monetary policy announcement No change South Africa: GDP (11:30am) 1Q	26 May Poland: Retail sales (10:00am) Mar 4.5%oya South Africa: CPI (11:30am) Apr	27 May South Africa: PPI (11:30am) Apr	28 May Czech Rep: General elections on 28-29 May
During the week:				
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 Hungary: Industrial output (9:00am) Apr
During the week:				
7 June Czech Rep: Trade balance (9:00am) Apr Industrial output (9:00am) Apr Retail sales (9:00am) Apr South Africa: Gross reserves (8:00am) May	8 June Czech Rep: Current account (10:00am) 1Q Hungary: Trade balance (9:00am) Apr Romania: Industrial output (10:00am) Apr Turkey: Industrial production (10:00am) Apr	9 June Czech Rep: CPI (9:00am) May GDP final (9:00am) 1Q Hungary: Central bank minutes GDP final (9:00am) 1Q Romania: Trade balance (10:00am) Apr	10 June Romania: CPI (10:00am) May	11 June Hungary: CPI (9:00am) Apr Turkey: Current account (10:00am) Apr
During the week:				

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Non-Japan Asia economic calendar

Monday	Tuesday	Wednesday	Thursday	Friday
17 May Philippines: OFW remittances (10:45 am) Mar 9.0%oya Singapore: NODX (1:00 pm) Apr 10.0 US$ bn	18 May Hong Kong: Unemployment rate (4:30 pm) Apr 4.5% New Zealand: PPI (8:45 am) 1Q 0.8%q/q Philippines: BOP Apr	19 May Australia: Westpac consumer confidence (10: 30 am) May -3.0%m/m, sa Korea: Bankruptcy fillings (12:00pm) Apr 130 Number Malaysia: CPI (5:00 pm) Apr 1.9%oya	20 May Hong Kong: CPI (4:30 pm) Apr 2.1%oya Singapore: GDP (8:00 am) 1Q 13.9%oya Taiwan: Export Orders (4:00 pm) Apr 39.6%oya GDP 1Q 12.9%oya	21 May New Zealand: Visitor arrivals (10:45 am) Apr Net permanent immigration (10:45am) Apr Credit card spending (3:00 pm) Apr 1.5%oya *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 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	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 Taiwan: Leading index (4:00 pm) Apr *Holiday India*	28 May New Zealand: Building permits (10:45 am) Apr *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, 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 China: PMI manufacturing May Hong Kong: Retail sales (4:30 pm) Apr India: PMI Apr Trade balance 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 *Holiday Korea*	3 Jun Australia: Trade balance (11:30 am) Apr Philippines: CPI (9:00 am) May BSP Monetary policy meeting (5:00 pm) Jun	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
7 Jun Australia: ANZ job ads (11:30 am) May New Zealand: QVNZ house prices May Taiwan: CPI (4: 00 pm) May Trade balance (4:00 pm) Apr *Holiday New Zealand*	8 Jun Korea: PPI (10:00 am) May New Zealand: Manufacturing activity (10: 30 am) 1Q	9 Jun Australia: Westpac consumer confidence (10: 30 am) Jun NAB bus. Confidence (11: 30 am) May Housing finance approvals (11:30 am) Apr Korea: Unemployment rate (9:00am) May Money supply (10:00 am) May	10 Jun Australia: Unemploy rate (11: 30 am) May New Zealand: RBNZ official cash rate (9:00 am) Jun Business NZ PMI (10:30 pm) May Terms of trade (10:45 am) 1Q China: Trade balance (12:00 pm) May Korea: BoK monetary policy meeting (10:00 am) Jun Malaysia: IP (12:00 pm) Apr Philippines: Exports (9:00 am) Apr	11 Jun China: CPI 10:00 am) May PPI(10:00 am) May FAI (10:00am) May Retail sales (10:00 am) May IP (10:00 am) May India: IP Apr
During the week: China: Money supply May				

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
17 - 21 May	17 May	18 May	19 May	20 May	21 May
Venezuela • GDP (1Q)	Japan • Private mach orders (Mar) United States • Empire State survey (May) • NAHB survey (May)	Chile • GDP (1Q) Euro area • HICP final (Apr) • Foreign trade (Mar) Germany • ZEW bus survey (May) Japan • Reuters Tankan (May) • Consumer sentiment (Apr) Turkey • CBRT mtg: No chg United Kingdom • CPI (Apr) United States • Housing starts (Apr) • PPI (Apr)	Euro area • Trichet speech Spain • GDP final (1Q) United Kingdom • BoE MPC minutes (May) United States • CPI (Apr) • FOMC minutes (Apr)	Japan • GDP 1st est (1Q) Mexico • Real GDP (1Q) Norway • GDP (1Q) Poland • IP (Apr) United Kingdom • Retail sales (Apr) United States • Philly Fed survey (May) • Leading indicators (Apr)	Canada • CPI (Apr) Euro area • PMI flash (May) Germany • GDP final (1Q) • IFO bus surv (May) Japan • BoJ MPM mtg: No chg • Shirakawa press conf Mexico • Banxico mtg: No chg
24 - 28 May	24 May	25 May	26 May	27 May	28 May
	Israel • BoI mtg: +25bp Japan • All sector act index (Mar) Russia • Retail sales (Apr) Thailand • GDP (1Q) United States • Existing home sales (Apr)	Euro area • Ind new orders (Mar) Italy • ISAE cons confl (May) Poland • NBP mtg: No chg South Africa • GDP (1Q) United Kingdom • GDP, 2nd rel (1Q) United States • Case-Shiller HPI (Mar) • Cons conf (May) • FHFA HPI (Mar) • Richmond Fed surv (May) • Bernanke speech	France • INSEE bus conf (May) Japan • Shoko Chukin (May) • BoJ MPM minutes (Apr) • Shirakawa speech United States • Durable goods (Apr) • New home sales (Apr)	Colombia • BanRep mtg: No chg France • INSEE cons conf (May) Italy • ISAE bus confl (May) Japan • Trade balance (Apr) Philippines • GDP (1Q) United States • Real GDP, 2nd rel (1Q) • KC Fed surv (May)	Japan • Core CPI (Apr) • Household spending (Apr) • Unemployment (Apr) Sweden • GDP (1Q) United States • Chicago PMI (May) • Personal income (Apr)