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Global Radar Screen

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DE Tactical and Strategic U.S. and Global Fixed Income Prospects: April 8, 2011			
Country/Region	**Tactical**	**Strategic**	**Comments**
United States			
Fed—Fed Funds	*Stable*	*Higher*	Markets have calmed down after spate of hawkish talk.
2-yr. Treas.	*Neutral*	*Higher*	Will the policy statement really change and what will Bernanke say at press conference
10-yr. Treas.	*Neutral*	*Higher*	When will rising headline inflation from commodity prices push the core rate higher?
Eurozone			
ECB—Refi Rate	*Higher*	*Higher*	Save for factory sector, the real economy is still soft, especially around the periphery. Banking sector and continuing sovereign debt problems remain clear.
Bund (10-year)	*Neutral*	*Higher*	Despite ECB worries to the contrary, sizeable output gap, exacerbated by increasing fiscal tightening, suggest no domestic inflation risk, especially given fragile banking system and inter-related still soft monetary data.
United Kingdom			
BoE—Bank Rate	*Stable*	*Higher*	Substantial easing in place, but lending backdrop still weak. MPC splits about inflation risks are growing. Rate hike possible
Gilts (10-year)	*Neutral*	*Higher*	Economy has lost momentum as fiscal tightening starting to come through, with consumer the key downside risk.
Japan			
BOJ—Call rate	*Stable*	*Stable*	The earthquake will keep the liquidity spigot wide open.
JGB (10-yr.)	*Neutral*	*Higher*	Outlook is uncertain, but huge looming supply, exacerbated by quake rebuilding costs.
Tactical or "Short-Term"- 2 weeks to 2 months; Strategic or "Longer-Run" - 6 mos. to a year or more. Bold shading denotes change in view			

Overview—U.S. Shutdown-Lite

The US budget follies continue with the strong possibility of a government shutdown Saturday. A government shutdown is likely to be short, with limited economic effects with about 800K of the 2.2M federal civilian workforce likely to be furloughed, amounting to up to $5B per week in reduced outlays. A weekly shutdown then might cut GDP growth up to 0.2 percentage point, with some bounceback in subsequent quarters. Even if only $40B of the $61B of House planned cuts are agreed to, GDP growth could be reduced between 0.5 and 1 percentage point in Q2 and Q3, depending on how fast the cuts in budget authority translate into cuts in budget outlays, which are counted directly in GDP. If oil prices remain elevated, this could increase the chances of a mid-year economic "pothole." One can hope that these efforts will lead to a 1990 style "grand compromise," which would include tax reform (and some tax increases), entitlement reform, and reductions in nondefense discretionary spending. The House budget plan announced this week is a start in that direction. A grand compromise would of course be very supportive of financial assets. But we may only end up with a lot of pain but little gain and the possibility of a market meltdown rivaling what has unfolded in Europe.

- **U.S.**: A potentially busy week of data is headed by retail sales, consumer sentiment and inflation updates. The impact of rising energy prices is affecting all the major series. Retail sales gain will be moderate boosted by gasoline sales, while the PPI and CPI inflation indexes will jump once again. The parade of Fed talking heads continue, with perhaps Yellen's high profile speech on Monday of the most interest. We doubt she will make any noticeable shift in tone, such as the economy being on "firmer footing" or that inflation outlook has perked up.
- **Eurozone:** Markets will be digesting early next week any details of the Portuguese bailout agreed to over the weekend. The Eurozone and national IP updates will be examined for signs of weakness in the periphery. The final HICP update may show some rise in the core rate. The ECB bulletin may merit closer attention than usual given the unprecedented divides the previous bulletin pointed to between the ECB council and its staff regarding inflation risks.
- **United Kingdom**: While the first drop in CPI inflation in nine months will gather headlines, investors will be less impressed as it incorporates favorable base effects. The BRC survey will give update the shaky consumer situation, while the labor market report will show some softening in average earnings growth as bonus-related distortions unwind. The rest of the report may be mixed. Worries about housing prices may resurface in the RICS housing market survey.
- **Japan:** The upcoming BOJ Branch managers meeting will provide up to picture of the post-quake situation in Japan, with particular interest in the impacts of the supply chain and infrastructure. Other reports of interest are unfortunately pre-quake reading such as machinery orders, bank lending and money supply reports, IP, and corporate goods prices.
- **Emerging Markets/Regions**: Three notable central bank meetings take place this week. In **Mexico,** policy will be hold, as an improving growth outlook is offset by benign inflation pressures. In **Korea,** the BOK is likely leave policy on hold after the rate hike last month, in keeping the gradual rate tightening process preferred by the bank. In **Indonesia,** policy will also be left on hold. While more policy tightening is likely, the fallback in inflation recently supports no policy change this month. In **Brazil**, the central bank appears to be shifting tactics a bit. One or two more 50 bps rate hikes are There will almost certainly be one or even two more 50 basis-points rate hike, but more targeted measures will become more important to cool domestic demand while the inflation-offsetting effects of the revalued real play out.

Specific Regional Themes

- **U.S.: Mid-Month Dataflow If No Shutdown**

  The looming federal government shutdown may be averted after we go to press. Nonetheless, most investors expect a "shutdown-lite," lasting about a week. A week-long furlough of 800K employees (of a total 2.2M civilian federal workers) might trim Q2 GDP growth by as much as 0.2 percentage point. And if there is a shutdown, virtually all major indicators save IP, the empire state survey, and consumer sentiment would not be released.

  A potentially busy week of data is headed by retail sales, consumer sentiment and inflation updates. The impact of rising energy prices is affecting all the major series. **Retail sales** (DE: +0.6%; consensus +0.7%, Wed) will be boosted by gasoline sales, making it hard to figure out the underlying trend of consumer spending. Retailers have reported better than expected sales in March, however. The **PPI** will jump (DE: +0.7%; consensus +1.0%, Wed), while the core will be more subdued at 0.2%. The **CPI** will make a similar move (DE and consensus +0.5%, Th) with the core rising perhaps +0.2%. **Consumer sentiment** (Fri) has already fallen 10 points in March, retracing six months of gains. Both DE and the consensus look for a stable reading (DE: 68.0; consensus 69.0).

  Other indicators of note include a modest improvement in the trade gap (DE: $44.5B, consensus $44.3B, Tu) after the large widening in January. Another sizeable gain in **business inventories** (DE: +1.2%; consensus +0.8%, Wed) and a modest increase in **IP** (DE: +0.4%, consensus +0.6%, Fri). A steady reading of the **empire state regional index** (at a high level, DE: 18; consensus 17) finishes the data flow (Fri).

  The parade of Fed talking heads continue, with perhaps **Yellen'**s high profile speech on Monday of the most interest. We doubt she will make any noticeable shift in tone, such as the economy being on "firmer footing" or that inflation outlook has perked up. Another dove **Dudley** (always votes) swings through Asia with speeches Monday and Tuesday). Centrist **Tarullo** (always votes) gives a rare macro speech (Th), while dovish **Evans** (voter 2011) hits the tape (Fri). The hawks can respond with **Fisher** (Tu) **Kocherlakota** (voter 2011), **Plosser** (voter 2011), **Lacker** (voter 2012, all three Th), and arch-hawk **Hoenig** (Tu and Fri). The **Beige Book** (Wed) will probably support the Fed's notion of a "firmer footing" to underlying growth and pooh-pooh the signs of spillover from commodity prices to core inflation.

- **Eurozone: Production and CPI details.**

  There are no major economic events in the coming week, with markets (in any case) possibly starting the week by digesting any details of the Portuguese bail-out that finance ministers may have agreed over the week-end.

  However, **Eurozone industrial production** data (Wed) will be watched closely for any signs of a fresh pick-up (Consensus: 0.7% M/M; DE: 1.0%), with some further insight on offer from the **French** (Consensus: 0.4% M/M; DE: 0.1%) and **Italian production** (Consensus: 1.7% M/M; DE: 1.0%) updates due on Monday. More notably, the Eurozone numbers will be examined for any signs of peripheral-country weakness, albeit with more recent signs suggesting that their manufacturing sectors are seeing resilience, underpinned by global demand.

  The other major figure will be the **final Eurozone HICP** data for March on Friday. **Spanish** and **French CPI** numbers will provide some details ahead of the data, but with it likely that some rise in the core rate will be seen (largely a result of an unwinding of an aberration regarding swings in Italian clothing costs. The week also has the **ECB Bulletin** (Thu), something that may merit closer attention than usual given the unprecedented divides the last issue pointed to between the central bank Council and its staff in regard to inflation risks emanating from monetary conditions.

- **United Kingdom: Lower Inflation**

  If **CPI** data (Tue) provides a somewhat unexpected first drop in the headline rate in nine months (Consensus: 4.4% Y/Y; DE: 4.2%), it may warrant much media attention. Markets may be less impressed, however, aware of the favorable base effects at work, also with the focus on other, possibly more important, data. Indeed, with worries about house prices resurfacing the **RICS housing market survey** (Tue) will get more than a cursory glimpse.

  However, more attention may be given to the **BRC retail survey** (Tue), especially in lieu of the largely more negative signs regarding the UK consumer seen of late. Otherwise the week sees the always-important labor market report (Wed). These figures should show some softening back in **average earnings** growth (Consensus: 2.6% Y/Y; DE: 2.1%), as bonus-related distortions unwind.

  The rest of the data may show further mixed signals, albeit with it far from clear whether the (February) drop in **claimant count unemployment** will be repeated in the next set of numbers (Consensus-3 000; DE: unch).

- **Other Europe: Inflation Updates**

  In **Sweden**, **CPI** data will be the sole economic event of the week (Tue). The last set of numbers saw CPIF reading coming in well below that envisaged the, albeit with the headline figure a touch above. It is unlikely that the inflation backdrop by itself will alter the Riksbank hiking mindset.

  Norway also has **CPI** numbers to digest (Mon). The question is whether the Norges Bank starts to think that core inflation, likely to remain very much short of its predictions, is another reason, alongside the strong exchange rate and mixed real economy news, to defer

the rate hike that it is clearly considering putting in place by mid-year.

There is nothing of note due in **Switzerland** in the coming week.

- **Oceania: Aussie Survey Data**
  What little data that is due in **Australia** is survey-related, with the spotlight falling on the **NAB business survey** (Tue). Both the business confidence and activity index saw some recovery in the last survey (covering February), albeit the former more clearly so. The question is to what extent the March numbers will continue to accentuate that development, or if confidence will have been dented by events in Japan. Also due is the **Westpac consumer confidence** survey (Wed).

  In **New Zealand**, the only data of note are the nominal **retail sales** and the **Performance of Manufacturing Index**, both due Wednesday. (Andrew Wroblewski/Samuel Sidenbladh)

- **Japan: BOJ Take of the Post Quake Environment**
  This week starts with what is probably the most interesting item on the schedule: the regular quarterly **BOJ Branch Managers Meeting** (Mon). The Bank's regional heads will bring local-level information and insights on the effects of the earthquake and tsunami—giving a far more up-to-date picture than the national economic indicators can at this point. Impacts from supply-chain problems and electricity shortages will surely be the main focus, but there will also be great interest in any positive effects felt in regions where companies are shifting operations, and potential investments, away from the stricken zones. At least some of the findings will be summarized in the **BOJ Regional Report**.

  Also arriving Monday will be the February **machinery orders** report, giving a pre-disaster reading on the state of business willingness-to-invest. Of course, data in coming months will be of far greater interest, as expenditures related to production shifting and plant rebuilding become visible—providing key input to forecasts for general-economy revival. Tuesday will bring the March **bank-lending** and **money supply** reports, probably showing some ripples from the catastrophe—but with unclear significance at this early stage. The remaining reports of the week, covering March **corporate goods prices** (Wed) and revised February **industrial production** (Fri), are likely to be even less topical.

- **Emerging Markets: Central Bank Watch**
  Three central banks meet this week. In **Mexico**, the overnight *rate will remain on hold* at 4.5% as an improving growth outlook is offset by benign inflation pressures, bucking the tightening cycles on which other Latin American central banks, most notably Brazil, have already embarked. Peso strength and slack in the labor market are keeping a lid on core price pressures, which continue to soften, most recently slowing to 3.2% y/y in March (the central bank maintains a 3% +/- 1% target range for inflation). In addition, policymakers expect both measures to remain within the target range through 2012, albeit with the headline measure testing the upper end of that range. Upside risks to that view from commodity prices or a more-rapid recovery in domestic demand and investment are increasing, but the central bank is still very likely to keep rates on hold through the end of 2011. (Andrew Husby)

  In **Asia**, the **Bank of Korea** is meeting on Tuesday. The BoK hiked rates at its previous (March) meeting and with the statement accompanying that decision having a seemingly more hawkish bent, probably a reflection of the 'war on inflation' declared by the Government. Since then, consumer price inflation has risen further, but not as acutely as had been expected by markets. Nevertheless, the BoK is still likely to leave policy on hold at this meeting, since it still seems to favor a gradual tightening of monetary policy, something evident form the timing of the rate-hikes seen so far.

  Bank Indonesia is meeting on the same day and the same policy outcome (unchanged) can be expected. Back in February, the central bank surprised a slim majority of forecasters by beginning to tighten policy. However Bank Indonesia then left it on hold in March and with inflation having fallen back in that month there is also space of the central bank to leave policy on hold once more this month, even though further tightening will be necessary going forward. (Samuel Sidenbladh)

  Brazil: Is the Central Bank Done Tightening? The central bank hiked its benchmark Selic-overnight rate to 11.25%. High interest rates are contributing to the enormous inflows of money that are entering Brazil, complicating central bank policy and lifting the exchange rate to below 1.6/US$. Policymakers continue to resist these pressures, most recently there has even been an implicit acknowledgement that the currency could get to 1.5/US$ despite all efforts. Meanwhile, there are signs that the economy may be finding a path in the 4.5%-5% growth range, following a period of deceleration. Industrial production, in particular, seems to have bottomed (on a 3-month average basis), as of February, and is now growing at an annual rate of close to 4%. And with unemployment at historically low levels and fixed capital investment advancing at a healthy pace, the expansion seems broad based and sustainable even with significantly higher borrowing costs. Against this background, the central bank appears to be shifting tactics a bit. There will almost certainly be one more 50 basis-points rate hike, with a second still possible, but more targeted measures will become more important (such as this week's increase of the tax on domestic financing) to cool domestic demand while the inflation-offsetting effects of the revalued real play out. . (Francisco Larios)