DECISION ECONOMICS, INC.
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New York: 212 884 9440
London: 011 44 20 7814 6706
Boston: 617 994 0500
Chicago: 312 476 7504
Email: decisioneconomics@pdeeco.com

Allen Sinai, Chief Global Economist

Global Radar Screen

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DE Tactical and Strategic U.S. and Global Fixed Income Prospects: April 15, 2011			
Country/Region	**Tactical**	**Strategic**	**Comments**
United States			
Fed—Fed Funds	*Stable*	*Higher*	What hawk will dare dissent and spoil Bernanke's first press conference?
2-yr. Treas.	*Neutral*	*Higher*	Pothole in Q1 to 2% GDP growth could spillover to Q2
10-yr. Treas.	*Neutral*	*Higher*	Core CPI inflation looking better and inflation expectations have retreated
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—US Growth Slipping Off Its "Firmer Footing?"

The hawkish turn in Fed rhetoric in the past month was predicated in part on the notion that the US recovery was on the "firmer footing" mentioned in the mid-March policy statement. This may prove to be "famous last words" as private forecasters began revising down their Q1 GDP growth estimates right after FOMC meeting concluded. Q1 forecasts which had been in the "healthy" range of 3% and higher are now in the uncomfortably soft range of 1.5% to 2.5%, with a large number below 2%. This undercuts the case for the Fed tightening sooner rather than later, as it depends not only on further increases in core (and headline) inflation, but a continuation of reasonably solid GDP growth. Unfortunately, we are not ready to pencil in a strong rebound in Q2, given continuing headline of higher oil prices. (Fortunately, the potential headwind of sharp budget cuts from the recent budget compromise appears much less likely now). The Fed staff forecast presented at the April FOMC meeting will surely be marked down, as they are looking at the same data with the same tools as we are. This makes major changes at the meeting less likely, with a full continuation of Q2 to its termination in June. However, some jiggering of the "low for long" policy language could happen, particularly if it serves to prevent disgruntled hawks from dissenting just before Bernanke has his very first "meet the press" moment with the world. Just one dissent might spoil his whole day.

- **U.S.**: The data flow and parade of Fed speakers slows as we approach the FOMC meeting on April 26. Some improvement is expected in both housing starts and sales but the March forecast will not be much different from 12 month averages. Only a few Fed speakers hit the tape and Congress enjoys a two-week recess. But a lot of newspaper ink may be shed this week regarding the relative merits of the dueling deficit reduction plans from both the White House and the House Republicans.
- **Eurozone**: Survey evidence takes pride of place, with especial emphasis on business surveys. Further softness in the mfg. readings would be signs of a weaker global momentum given the clear reliance on exports behind Eurozone growth. The German IFO will be relatively more upbeat, however. The services PMI may be more upbeat as well but clearly signal regional disparities between the strong core and weak periphery.
- **United Kingdom**: The BoE minutes will be checked for (unlikely) signs of further division within the MPC as well as reactions to the surprise drop in the latest CPI. Further potential increases in the public borrowing figures would be further evidence of economic weakness, an update which will come from the retail sales figures.
- **Japan:** The first significant March reading comes with merchandise trade, which should point to a severe deterioration in both imports and exports after the quake. The BOJ loan officers survey will give more ground-level perspective of the immediate post-crisis period and some discussion of the emergency action that have been undertaken.
- **Emerging Markets/Regions**: Four notable central bank meetings take place this week. In **Brazil,** look for another 25 bps rate hike as inflation and output growth continue to surprise on the upside. In **Turkey,** rates should remain on hold, as the central bank's assesses the impact of higher reserve requirements on consumer lending. In **Hungary,** policy will keep rates on hold with a bias to a policy easing if growth slows. Another 25 bps rate hike by the **Bank of Thailand** is likely given the rise in inflation. In **China**, the strong Q1 growth performance should not be a surprise and suggests that policy steps expected before the Q1 release should remain in place: one or two more interest rate increases in the next few months, with perhaps a pause at some point in Q3, plus the continuation of administrative efforts to keep loan growth within target, and other measures designed to reduce price pressures in targeted segments of the economy, such as housing.

Specific Regional Themes

- **U.S.: Stabilizing at 2% not 3% GDP Growth?**

  The enthusiasm among investors regarding the 2011 outlook has all but disappeared as Q1 growth estimates have been pared back from the 3% plus range to something around 2% or less (DE is at 2% to 2.5%). The Q1 outlook has been pared back for three reasons: a reversal of the Q4 improvement in the trade gap, paring back of the already modest expected growth in consumer spending after the Q4 boom, and a slower pace of capex growth.

  After a busy week, the calendar settles with two housing reports and the Philly Fed the main events. **Housing starts** (Tu) are expected to retrace some of their 22.5% February plunge (DE: +7.5%; consensus +9.6%). This March estimate would still be below 12 month averages. **Existing home sales** (Wed) should finally move above its 12 month average of 4.93M (DE: 5.10M; consensus: 5.00M). The **Philly Fed** survey (Th) should give back some of its March gains (DE: 42.0; consensus 36.0) but would still point to a strong national ISM reading.

  Ready for your closeup, Mr. Bernanke? The Easter holiday gives investors tired of the gaggle of Fed talking heads some respite before the FOMC meeting in late April. (Congress in on recess as well). Only three Fed speakers should hit the tape, all on Monday. **Fisher** (voter 2011) and **Lockhart** (voter 2012) discuss globalization, while **Bullard** (voter 2011) discusses banking. We finish the day with a double shot of **Fisher** with an outlook talk. Once again, we think that the chances of Fed dissent is fairly low at this month's FOMC meeting. The Fed chairman does not want to appear on his first press conference in the history of the Fed with his first dissent of the year just crossing the tape. This means, however, that Bernanke may have to compromise on the wording in the statement, perhaps even modifying the "low for long" language, which would be the first baby step in exiting.

- **Eurozone: Surveys Due.**
  In terms of economic data, surveys will be the clear focus for markets in the coming week. **Consumer surveys**, including the **flash estimate** for the Eurozone (Mon) will be looked at for any additional sign that households are feeling the pinch from rising prices. However, it will be the business surveys that will grab most attention. Most closely watched will be the flash **PMI** data (Tue). The **manufacturing** survey dipped clearly last time around, any further slippage (Consensus: 57.0; DE: 56.7) may be seen as evidence of weaker global momentum given the clear and on-going reliance on exports behind Eurozone growth. NB: **German Ifo** data on Thursday will give an alternatively-sourced survey insight, albeit with a very much German (and therefore relatively more upbeat) perspective (Consensus: 110.5; DE: 110.3). Meanwhile, the **services PMI** was more upbeat in March, but still revealed signs of wider geographical disparities, with clear weakness around the peripheral economies: more such evidence may be forthcoming (Consensus: 56.9: DE: 56.5).

- **United Kingdom: Sales and BoE updates. .**
  The holiday-shortened week still has plenty to interest markets, especially in view of the reverberations that recent data may have caused. Indeed, the BoE **minutes to this month's MPC meeting** (Wed) will be examined not only for any further (but unlikely) divides within the committee but also for the central bank's reaction to the surprise drop in CPI inflation (the MPC will have been furnished with a draft of the price data ahead of its formal release last Tuesday). Wednesday also sees an update in regard to **public borrowing**, numbers that have become more important of late given the recent trend of a fresh deterioration in government finances (Consensus: £ 20.1 bln; DE: £ 20.1 bln). Any further sign of deterioration may be attributed to the emerging signs of economic weakness, an update on which will come from the **retail sales** data (Thu). Indeed, these numbers may verify signs of clear and unfolding softening in consumer spending (Consensus: -0.5% M/M; DE: -1.0% M/M)

- **Other Europe: More Riksbank Rate Hikes?**
  In **Sweden**, the **Riksbank Board** meets again this week with their verdict arriving on Wednesday. Another 25 bps hike is almost certain, the question being whether any faster degree of hiking is signaled in updated central bank projections: most likely not.

  There is nothing of note in **Norway**, while **Switzerland** only has **money supply** data (Thu) to provide interest datawise.

- **Oceania: Aussie RBA Policy Minutes**
  In **Australia**, the week starts with the **Reserve Bank of Australia minutes** of its 5 April policy meeting due Tuesday, unlikely to provide any additional insights beyond the information already released in the monetary policy statement. The **Westpac leading index** and **import prices** follow on Wednesday and with **producer prices** (Thu) wrapping up the week.

  In **New Zealand**, the only data of note are the **Performance of Services Index** and **consumer prices** (both Mon), with the latter being the more closely watched and likely see a in inflation rise further above the RNBZ's target-band (Andrew Wroblewski/Samuel Sidenbladh)

- **Japan: How Bad Was Post Quake Trade**
  The week ahead is relatively quiet, but does bring the first significant March reading on real-economy activity, in the **merchandise trade** report (Wed). Pre-disaster results in the first ten days of the month looked quite solid, but the middle ten days brought severe deterioration in both imports and exports, and conditions in the final third of the month can hardly have been better. In coming months, these data will surely be watched as a sensitive reading on domestic and global supply-chain adjustments to the catastrophic quake/tsunami disruption, and also on

Japan's consumer-sector response. Thursday, meanwhile, brings the quarterly **Bank of Japan Senior Loan Officer Opinion Survey**, which will give some ground-level perspectives on credit demand and supply conditions after the immediate crisis period—and perhaps hint at the alacrity with which corporate recovery actions are being initiated. The only other major indicator scheduled for the week is the quite ancient-history report on February **tertiary industry activity**.

- **Emerging Markets: Central Bank Watch**

Four central banks meet this week. In **Brazil**, we look for *another hike of 50 bps* as inflation and output readings continued to surprise to the upside in the intermeeting period. High interest rates are attracting significant capital flows, heightening concerns that the economy has insufficient capacity to absorb them without creating asset bubbles, but given that inflation will not be approaching the target in 2011 (4.5% y/y, +/- 2%; currently running at 6.3%), further monetary tightening appears necessary to curb price pressures. The scope for further Selic rate hikes is limited, implying that authorities will need to focus on tightening macroprudential in the quarters ahead. It does appear that the tightening cycle is in its later stages, but for now, another 50 bps hike is all but assured this week, and incoming data will be watched closely for hints of further moves heading into mid-year.

In **Turkey**, *rates should remain on hold* as the central bank waits for signs that its progressively higher reserve requirements are having an impact on consumer lending. On that front, there appears to be little progress in the recent data, but further increases in reserve ratios may not come this week given the magnitude of last month's increase. On the inflation front, year-on-year price growth continued to plumb fresh lows, but it should head markedly higher heading into 2011 as food and energy prices rise, and favorable base effects fall away. This suggests that the central bank will be abandoning its strategy of rate cuts (to curb capital inflows), in favor of steady rates for now, and a possible hike late this year.

Finally in **Hungary**, the Monetary Council aims to *keep rates on hold* at 6% for an "extended period," but is leaving open the possibility of a cut if domestic demand slows, or an increase if cost-push shocks appear to be flowing through to price and wage-setting decisions. The scope for an increase is quite limited given elevated headline inflation and solid wage gains, but the bar will likely be set quite high for a hike in the near term. Taken together, it's steady-as-she-goes for the Hungary rate outlook as the growth outlook only-gradually begins to brighten. (Andrew Husby)

In **Asia**, the **Bank of Thailand** is offering a policy update on Wednesday. The economy has been recovering clearly from the downturn seen in 2009, with little to suggest any serious weakening in domestic demand going forward. Meanwhile, consumer price inflation rose further in March, albeit driven mainly by food costs, although core rates have begun climbing as well. Moreover, the BoT is expecting headline consumer price inflation to increase even further over the coming months, especially as the government cannot keep the current food and fuel subsidies going forever. In light of these developments, *another 25 bps hike* by the BoT is likely at this meeting as well. (Samuel Sidenbladh)

China: Will Strong Q1 GDP Growth Change Policy? Real GDP grew 9.7% year-on-year last quarter. The result was above consensus expectations and virtually unchanged from the last three months of 2010. Certainly this is not a shocking result; not descriptive of a qualitatively different reality than analysts and the markets perceived based on earlier high-frequency and anecdotal information. The same can be said about inflation at the consumer level, which rose to 5.4% year-on-year, marginally above expectations (5.2% year-on-year). Nonetheless, the data marginally re-shapes the picture of current conditions and risks in the direction of a strong-economy, in which inflation would be slightly more distinctly the key driver for near-term macroeconomic policy. The *policy steps that had been expected prior to this release remain the most likely outcome*: there should be one or two more interest rate increases in the next few months, with perhaps a pause at some point in the third quarter, plus the continuation of administrative efforts to keep loan growth within target, and other measures (fiscal and monetary, nationwide and local) designed to reduce price pressures in targeted segments of the economy, such as housing. (Francisco Larios)