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Global Radar Screen

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DE Tactical and Strategic U.S. and Global Fixed Income Prospects: June 10, 2011			
Country/Region	**Tactical**	**Strategic**	**Comments**
United States			
Fed—Fed Funds	*Stable*	*Higher*	Soggy data/complicated/lengthy exit strategy push first policy hike off even further.
2-yr. Treas.	*Neutral*	*Higher*	Bernanke discounts QE3 but investors think otherwise.
10-yr. Treas.	*Neutral*	*Higher*	Hanging around 3%, which looks pretty good if the U.S. becomes Japan.
Eurozone			
ECB—Refi Rate	*Higher*	*Higher*	Save for factory sector, the real economy far from upbeat, especially around the periphery. Banking sector/debt problems remain clear. ECB hiking to be punctuated.
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 hikes unlikely in the near-term.
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—Cure for the Summertime Blues?

While US bonds continue to rally and stocks wobble around, some investors are beginning to question how bad things really are. While the sovereign debt situations in both Europe and the US, together with high oil prices, represent significant downside risks, a number of special factors have been at work. In particular the supply chain disruptions in the US from the 15% drop in Japanese IP in March followed by little change in April certainly played a role, particularly in the US auto industry which has reported widespread shortages. The 6 point rebound in Japan's PMI last month, which retraced almost all of its drop earlier in the year, implies a sizeable rebound in May IP or in subsequent months. This should help US manufacturing, which took a nosedive last month. In addition, some investors are questioning how weak the last jobs report really was. The nonfarm workweek was unchanged while the factory workweek rose a big 0.2 hours. Earnings were up 0.3%, the strongest gain in four months, well above the 2% trend. Finally, strong upward revisions to hours worked in April means that the aggregate hours worked index will rise at a 3.4% annual rate in Q2, the best gain since 2005. The pickup in average earnings on top of that implies a very good income in wage income in Q2. The unemployment rate rose (barely) to 9.1% as hiring rose 105K but less than the large labor force increase of 272K. More people looking for work is a good, not a bad sign.

- U.S.: The data flow is intense this week, with the most interest in the regional mfg surveys for June. Any rebound or even some steadying would be treated as first signs that special factors dominated the sharp drop in mfg. last month. A sharp fall in headline PPI inflation will be accompanied by a stable gain in CPI inflation. Retail sales will be hampered by the drop in vehicle sales, a victim of reduced discounting and a shortage of popular vehicles. The Fed's informal blackout period means there will be little talk this week prior to the June 21 FOMC meeting.
- Eurozone: With the ECB and Germany still at loggerheads about dealing with the Greece bailout, interest will be intense regarding the upcoming Spanish bond auction. Data flow will be of less importance. EU industrial production updates should disappoint, while the final HICP inflation figures should show a small drop in the headline rate. The ECB bulletin may provide a few clues about the latest central bank thinking.
- United Kingdom: Another busy week of key mid-month indicators. The headline CPI rate may show a slight dip, while the labor market update may be soft. A fresh drop in retail sales is likely, with updates coming on home prices from the RICS update. BoE chief King gives a keynote address as well as a speech from MPC member Beale.
- Japan: The BOJ meeting will most likely expand its program of loan support, with the Y3 trillion tranch already in use. April machinery orders will reflect the negative of seriously damaged confidence but also positive rebuilding and relocation of damaged facilities. The MOF outlook survey may be clues among the tone of the upcoming Tankan report.
- Emerging Markets/Regions: Two major central banks meet this week. In **India,** another rate increase seems likely, given the announced inflation bias by the central bank, given that inflation pressures persist and economic growth, while slowing, is still above trend. In the **Philippines**, the result is less certain. A policy hike is coming but the question is about the timing. Given that the central bank is less uncomfortable than in the recent past, the bank may refrain from action this week.

Specific Regional Themes

- **U.S. Busy Week for Data Flow**

  The data flow is intense this week, with the most interest in the **regional mfg surveys** (Wed, Th) for June. Any rebound or even signs of stability would be treated as first signs that special factors dominated the sharp drop in mfg. last month. The strength in the mfg workweek, despite all the other poor news from the mfg. surveys last month, means that **IP** (Wed) will rise a modest 0.3% according to the consensus, although DE worries about the potential for a small drop. **Business inventories** will rise a trend-like 0.8% (DE) to 1.0% (consensus) in March (Tu).

  A sharp fall in headline **PPI** inflation (Tu) to 0.1% (DE and consensus) is likely. The core rate will be steady at 0.2%. The **CPI** will rise modestly (DE: +0.3%, consensus +0.2%), while the core rate remains stuck at 0.2% (Wed).

  Retail sales (Tu) will be hampered by the drop in vehicle sales, a victim of reduced discounting and a shortage of popular vehicles. The headline will fall moderately (DE: -0.5%, consensus -0.3%), while excluding autos a small gain is likely (DE: +0.1%; consensus +0.3%). **Consumer sentiment** is liable to fall a few points (DE: 71.5; consensus steady at 74.5) as job growth slowed.

  Housing starts should be little changed according to the consensus at 550K in May, although DE holds out for a modest gain to 575K (Th).

  The Fed's informal blackout period means there will be little talk this week prior to the June 21 FOMC meeting. Only Richmond Fed president **Lacker** (voter 2012, Mon) is scheduled to speak. He should continue the parade of (hawkish) Fed talking heads discounting the recent slowdown and should be ready to tighten credit later this year.

- **Eurozone: Peripheral Worries Remain the Focus**

  With the ECB and Germany split in regard to what extent the private sector should (or can) partake in any fresh Greek bail-out, comments from either party will be digested rapidly for any sign of a compromise. Germany wants an enforced roll-over of Greek debt, something the ECB understandably worries would represent a default and 'credit event', that would, in turn, prevent the ECB from continuing to support the already fragile Greek banking system. It looks unlikely that either party will back down, at least until backs are against the wall once the apparent deadline for a decision over Greece approaches by month-end.

  In the interim, the **Spanish bond auction** (Thu) should help to accentuate interest in such matters. But there is plenty of data to digest as well, albeit with few likely to be market-moving events. **Eurozone industrial production** on Wednesday could disappoint (Consensus: 0.1% M/M; DE: -0.1%): a clearer picture will emerge once **Italian output** numbers appear on Monday.

  Price updates are also due, culminating with **final Eurozone HICP** data (Thu). A small fall in the headline rate should be confirmed, with a bigger drop possibly coming in the core figure.

  Otherwise, an insight into the consumer comes with **car registrations** figures on Friday while some update on **ECB** thinking will come via the **Monthly Bulletin** (Thu).

- **United Kingdom: Key Data Due**

  The usual mid-month array of important data arrives in coming days. First up is the **CPI** update (Tue), where the possibility of a dip back in the headline rate could surprise markets (Consensus: 4.5% Y/Y; DE: 4.3%). The same day sees a further insight into house prices from the **RICS housing market survey**. Wednesday brings the **labor market report** where hints a fresh softening seen in some parts of recent data such as the **claimant count** could become more manifest (Consensus: 7 000; DE: 2 500). Further subdued **average earnings** numbers should also be seen (Consensus: 2.1% Y/Y; DE: 2.0%). Lastly, on Thursday, **retail sales** figures may show some fresh drop (Consensus: 0.1% M/M; DE: 0.3%), albeit from a clearly distorted April outcome. here are also BoE comments scheduled, both from **MPC member Weale** (Mon) and then a **keynote address from Governor King** (Wed).

- **Other Europe: SNB Quarterly Assessment Due**

  In **Sweden**, **CPI** data (Tue) may show little change, thereby also keeping inflation within the projections of the Riksbank. **House price** data (Thu) are unlikely to cause much excitement either.

  There is nothing of note in **Norway** in the coming week.

  However, it is a key week in **Switzerland** given the **SNB quarterly assessment** on Thursday, all the more so as there have been (increasing) calls that the SNB should start raising rates, with even the IMF making such a call in a report late last month. Apart from the real economy strength, such a call is perhaps all the more valid given what are still very solid monetary dynamics in Switzerland as signaled by broad money continuing to expand strongly (7.5% Y/Y), ie implying nothing like the banking sector frailties that are still besetting the likes of the UK and the Eurozone.

  Regardless, while the SNB may talk tougher and even hint (via its updated inflation projections) that rates hikes may be in the offing, it is unlikely to bite the bullet in the near-term, with Board member Blattner having used a recent newspaper interview to underscore the obstacle he believes is still being posed by the strong franc.

- **Oceania: Busy Aussie Survey Week**

  In **Australia**, the week sees a number of survey updates, including the **NAB business confidence** numbers and the **Westpac consumer survey**. The

remainder of data next week will be concentrated on Thursday, when the **Westpac leading index**, **consumer inflation expectations** and **dwelling starts** figures all due.

The week is relatively quiet in **New Zealand** in terms of economic data; all of the focus will be on the **retail sales** update on Wednesday, with real sales expected to see some recovery after the slump in the previous quarter caused by the earthquake. The only other data of note next week is the **Performance of Manufacturing Index** out Thursday. (Andrew Wroblewski/Samuel Sidenbladh)

- **Japan: BOJ Meeting**

The big news of the coming week arrives early, in the form of April **machinery orders**, on Monday, and the monthly **Bank of Japan Monetary Policy Meeting** on Tuesday. The March "core" machinery orders figure hinted at remarkable resilience of demand, showing a 2.9% rise despite the devastating human and business-activity costs of the earthquake/tsunami. April results could tell a truer story, reflecting the negative of seriously damaged confidence, but also the positive of direct rebuilding—and relocation—of damaged production facilities.

The BOJ is very likely at this meeting to expand its program of support to loans for innovative technology investments—with the original Y3 trillion tranche now fully in use.

The week will also bring the second-quarter **Ministry of Finance Business Outlook Survey** (Tue), giving clues as to the tone of the more-substantial Tankan, due in a few weeks. (Pierre Ellis)

- **Emerging Markets: Central Bank Watch**

Two major central banks meet this week In **Asia**, the **Reserve Bank of India** is meeting on Thursday; with *another rate hike once more looking likely*. Admittedly, Q1 GDP data showed some further moderation. However, GDP growth is still slightly above the long-term trend, with nothing suggesting any serious deterioration in domestic demand. More importantly for the central bank, price pressures are still elevated and, at its last meeting, the RBI acknowledged both that there was an upward bias to its inflation forecast and that inflation so far this year had been stronger than expected. The price backdrop is also the main concern of the Government, which is further adding to the pressures on the central bank to act once more.

The **Philippines' central bank** (BSP) is meeting on the same day but with the outcome less certain. The economy saw some further moderation in growth in Q1, but with it notable that the weaker reading was mainly due to government spending and net trade providing drags on growth, with private consumption expenditure still very healthy. Moreover, although slowing, GDP growth remains above trend, a development the central bank has suggested will continue. Meanwhile, consumer price inflation has picked up afresh. Hence, *further policy tightening by the BSP is bound to be necessary, with the only question being the timing.* In this regard it is noteworthy that the language in the last (May) statement seemed to have been stepped down from that seen in March, with the BSP no longer referring to itself as vigilant against emerging inflation risks, but merely stating that it remained prepared to take appropriate actions necessary to ensure the achievement of price stability. This suggests that although further rate hikes are clearly in the offing, the BSP *may leave rates on hold at this meet*ing. (Samuel Sidenbladh)