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Global Radar Screen

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DE Tactical and Strategic U.S. and Global Fixed Income Prospects: August 26, 2011			
Country/Region	**Tactical**	**Strategic**	**Comments**
United States			
Fed—Fed Funds	*Stable*	*Stable*	Fed takes the no-hike pledge to mid-2013 but could break it at any time (we hope).
2-yr. Treas.	*Neutral*	*Higher*	A change in the Fed's portfolio away from Treasuries might not help.
10-yr. Treas.	*Neutral*	*Higher*	Ditto but the economy is stuck in first gear.
Eurozone			
ECB—Refi Rate	*Stable*	*Stable*	Real economy softening, especially around the periphery and in regard to the consumer. Banking sector and widening sovereign debt problems even clearer, despite latest Eurozone efforts. ECB hiking to be punctuated: policy reversal possible.
Bund (10-year)	*Neutral*	*Stable*	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*	*Stable*	Substantial easing in place, but lending backdrop still weak. MPC splits about inflation risks are clear. BoE on hold for some time.
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*	Earthquake aftermath and yen strength 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—In Ben, We Trust But When?

While sophisticated investors were not expecting much from Bernanke this time around at Jackson Hole, his speech was still disappointing. While few expected him to ease policy Friday, we had hoped that he would expand on what policy option he might choose first and what it might take to take the next step. In particular, some discussion of the merits of changing the composition (but not the size) of the Fed's balance had been expected as it was the latest fog from the rumor mill. He may have decided (or been persuaded by the hawks) to let the minutes of the August FOMC meeting available this week answer that question. Now the rumor mill will seize upon the upcoming FOMC meeting in September, which had been turned into a two-day meeting, for a fuller discussion of next steps and what it would take to take them. For the Fed to make major policy changes this elongated meeting would require some really soggy indicator flow, given the opposition of the hawks and even some moderates. This puts particular importance on the survey evidence this week in both the US and Europe as well as the always important jobs report. Consensus forecast of the ISM at 48 or job gains of 75K would not be weak enough to cause a policy change next month. The hawks at the FOMC would probably need to see a three month change in payrolls to be barely positive to consider expanding the balance sheet. But they might be willing to accept a change in the composition towards mortgages or corporates, particularly since corporate rates have widened 50 bps compared to Treasuries recently.

- **U.S.**: The indicator flow will remain weak but not weak enough we think to embolden the Fed to ease policy again at the upcoming meeting. And, depending on the severity of the east coast storm, interpreting the economic evidence for September may be difficult. This may make the Fed's decision harder or easier should the storm deal the coastal economy a dangerous body blow.
- **Eurozone:** The economic numbers will be upstaged by sovereign debt developments, most particularly the release of the size of the ECB purchases in the prior week as well as the daily bank deposit data. The EU commission updates will be of interest to see how soft they maybe while the German CPI numbers will feed into the (soft) Eurozone flash HICP figures
- **United Kingdom:** The key survey data this week include the mfg. PMI which may be soft but the next update may be better. The construction PMI may experience little change. Consumer confidence may be soft as well as the money supply/lending figures.
- **Japan:** This week brings the major round of July economic indicators, with attention focused not only on the continuing recovery from the March disasters, but also on the transition to whatever the underlying growth path of the economy now is, given the deteriorated international situation. Key numbers include the labor market survey, retail sales, and industrial production. MOF corporate financial data will give a look at the disaster's impact on sales and profits.
- **Emerging Markets/Regions:** One major EM central bank meets this week. All seems to indicate that Brazil's central bank will enter a pause in the very near-term. This may be happen at this week's meeting, but even if such expectation does not materialize, it would be highly surprising to see the bank tightening again in October. In fact, circumstances are evolving in such direction that the possibility of an interest rate reduction is now to be considered seriously, suggested even by recent official statements.

Specific Regional Themes

- **U.S.: The Storm and the Next FOMC Mtg.**

  The indicator flow will remain weak but not weak enough we think to embolden the Fed to ease policy again at the upcoming meeting. And, depending on the severity of the east coast storm, interpreting economic evidence for September may be difficult. This may make the Fed's decision harder to easier should the storm deal the coastal economy a dangerous body blow.

  There is a major indicator every day, with the key ones at the end of the week. The **jobs** report on Friday should be soft (DE: +77K; consensus: +80K), with an unchanged unemployment rate (DE and consensus: 9.1%). The **ISM** report (Th) should fall below the pivotal 50 reading suggesting the first contraction in the mfg. sector since mid-2009 (DE and consensus: 48.0).

  Other reports of note include the **Chicago PMI** (Th) should remain above 50 (DE: 51.0; consensus 53.5). The **consumer confidence** figure (Tu) which should show a smaller drop than the Michigan counterpart (DE: 55.1; consensus 52.0). The **Case-Shiller home price index** (Tu) should fall modestly in June to produce a modest rise in the year-ago change from -4.5% to 4.6%. On Monday a modest rise in both **income** and **spending** is expected in July.

  Only a few Fed speakers appear after their Jackson Hole labors. Minn president **Kocherlakota** (voter and dissenter 2011) on Tuesday, supplemented by dovish Chicago president **Evans** (voter 2011), and middle of the roader Atlanta president **Lockhart** Wednesday. Governor **Duke** speaks to a housing conference Thursday. Of more interest will be the **August FOMC minutes** which may explain how much the Fed considered other policy options such as changing the size or composition of the balance sheet (Tu). (M. Cary Leahey)

- **Eurozone: Data a Side-Show?**

  There is a range of economic updates due in the coming week, but all may be upstaged by markets worries about the sovereign debt crisis, specifically whether the fresh Greek bail-out may be unraveling.

  As for the other fiscally troubled countries, perhaps the main piece of data will be Monday's update from the **ECB** identifying the size of its **government bond purchases** in the last week. Other ECB updates will also be watched closely, not least the daily figures on the amount deposited at the central bank as well as the mount of money it has lent, both sets of data helping to calibrate the extent of banking sector stress that may be intensifying.

  However, the economic data will be far from ignored, especially if the business and consumer survey data – eg **EU Commission numbers** on Tuesday – echo the softness in alternatively sourced survey numbers released in the last week.

  However, there are also inflation updates due, starting with **German CPI** numbers on Monday (Consensus: 2.3% Y/Y; DE: 2.4%), this feeding into **Eurozone flash HICP** data (Wed), all of which may continue the softer price signals now emerging (Consensus: 2.5% Y/Y; DE: 2.4%). The question is whether such a softer price backdrop turns the head of the inflation-sensitive ECB.

- **United Kingdom: Key Surveys Awaited**

  The early month array of survey data arrive in the coming week, with the focus on the **manufacturing PMI** (Thu), especially given the fresh contraction in the sector the numbers pointed to last time around (Consensus: 48.8; DE: 51.2). However, some recovery may be in store in the next update, while the **construction PMI** (Fri) may be little changed.

  Consumer confidence numbers (Wed) may be another matter, however, where more weakness may be signaled, something other surveys have already hinted at.

  There is also the **money supply and lending** update from the BoE (Tue), data that will underscore the still fragile monetary backdrop. These arrive alongside **consumer lending figures** from the central bank, the likelihood being that some less downbeat signs may appear at least in regard to the likes of mortgage approvals (Consensus: £ 0.6 bln; DE: £ 0.7 bln).

- **Other Europe: Some More Softness in Sweden?**

  In **Sweden,** the **PMI** data (Thu) are perhaps the main focus, the question being whether they echo the added weakness in other recently-released factory sector survey data. There are also **retail sales** numbers, data that have been subject to great volatility of late, and a speech by **Riksbank Governor Ingves** on Wednesday.

  A similar data slate awaits in **Norway**, albeit with a somewhat weaker profile evident of late in regard to **retail sales** (Wed), while the **PMI** numbers have remained upbeat).

  Switzerland has a key week data-wise, with all the important numbers arriving on Thursday. Most prominent is the Q2 **GDP** figure, numbers that should still highlight an economy growing clearly and may be up from the modest growth of the previous quarter. Such figures will highlight the extent to which the strong franc has actually undermined exports, with the possibility that upbeat data could add to the currency's luster. Alongside come **PMI** numbers, data that have seen a clear softening in the last few months.

- **Oceania: Aussie Housing/Mfg. Updates**

  In **Australia**, the week begins with a number of housing markets updates, including **HIA new home sales** (Mon) and **building approvals** (Tue). **Private sector credit** data then follows on Wednesday, before the **Performance of Manufacturing Index** and **retail sales** numbers (both Thu) wrap up the week**.**

In **New Zealand**, the week is relatively quiet, starting with **Building permits** data on Tuesday. The arrival of **NBNZ business confidence** and **M3 money supply** figures (both Wednesday) then completes the week. (Andrew Wroblewski)

- **Japan: First July Readings.**
  This week brings the major round of July economic indicators, with attention focused not only on the continuing recovery from the March disasters, but also on the transition to whatever the underlying growth path of the economy now is, given the deteriorated international situation.

  Key numbers start Tuesday, with the **labor-market survey** providing the first production-side reading on the month. There will be particular interest in the **effective-job-offers-to-applicants ratio**, and what it suggests about labor demand. Also arriving Tuesday will be **retail sales** results, an important indication on the stability of consumer spending, and on the potential for domestic demand to pull the economy forward.

  Wednesday brings some key direct readings on economic output, in the **industrial production** report, including the production-plan survey, and in **housing starts** data. Production has yet to re-attain its pre-earthquake level, and the plan forecasts will give a sense of whether it is likely that level will be reached soon. Housing results will be watched for early signs of rebuilding activity.

  Friday will close the week with the release of second-quarter **Ministry of Finance corporate financial data**, giving a detailed, industry-by-industry picture of initial catastrophe damage to sales and profits. (Pierre Ellis)

- **Emerging Markets: Central Bank Watch:**
  This week brings meetings of three central banks that we cover. All seems to indicate that **Brazil**'s central bank will enter a pause in the very near-term. This may be, quite possibly, the result of next week's meeting, but even if such expectation does not materialize, it would be highly surprising to see the bank tightening again in October. In fact, circumstances are evolving in such direction that the possibility of an interest rate reduction is now to be considered seriously, suggested even by recent official statements. Justification for a pause is increasingly clear, despite the fact that annual inflation is still—and may remain during the next couple of months-- above the 6.5% central bank ceiling (latest figure: 6.9% year-on-year in July). It should be noted, however, that the monthly pace of inflation points to a decline of the annual rate as early as October towards the 6.5% mark, descending into the target range.

  Importantly, this is the view of inflation on which the central bank has publicly based the current policy discourse, as well as the general market expectation. There is clearly some chance that such optimistic assessments might not be vindicated, but for now the stabilization of commodity prices and the strength of the real actually provide additional encouragement. Thus the focus of policymaking is rapidly shifting from containment of inflation to ensuring the continuation of the expansion, subject to numerous external risks. To be sure, the economy's vital signs are quite healthy, with unemployment at very low levels, export revenues growing strongly, the current account deficit at a very manageable (indeed falling) level, retail sales expanding at a seemingly stable but relatively strong pace, and domestic investment still quite vigorous.

  Nonetheless, economic activity has decelerated sharply from last year's extraordinary rates, and some sectors, such as industry, are expanding only at a modest pace. In part this results from a comparison with a very strong base. The data as a whole actually point to GDP growth close to 4% during the second quarter. This is quite respectable given the central bank's efforts to slow the economy. But there are a few pieces of recent statistical evidence that suggests that further tightening might take domestic demand growth from moderate to anemic, exposing GDP to a potential recessionary turn, especially in view of mounting external risks. It will not escape policymakers' attention, for example, that the central bank's own index of economic activity dropped 0.26% during June, the first negative figure on the series since the brutal drops caused by the recession at the end of 2008. Lending growth has also—finally--stabilized, after its sharp acceleration of 2010, as borrowing costs escalate for both individuals and corporations. (Francisco Larios)