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: September 2, 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*	The weak jobs report makes an operation twist almost a lock.
10-yr. Treas.	*Neutral*	*Higher*	And the weakness in earnings growth means inflation is a long way off.
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*	More easing coming soon but only baby steps.
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—Another Baby Easing Step from the Fed?

The weak jobs report indicates that the labor market is stalled even though GDP growth might pickup to 2.5% in the current quarter. The jobs report is weak enough to persuade the Fed that another baby easing step is needed, most likely a twist of the balance sheet favoring long-term securities. As we noted before, Bernanke laid out a policy "to do" list at his July Congressional testimony. The first item on the list was to put a time stamp on the "low for long" language, which the Fed did at the August meeting. The next item would be to alter the term-structure of the balance sheet, such as selling short-term Treasuries in favor of longer-term issues. The bond market has been front-running this outcome and will get their Xmas present early at this month's FOMC meeting (Chart 1). The Fed chairman did not call for a special two-day meeting unless he is willing to roll up his sleeves and make a strong case for further action. But the report is not weak enough for the Fed to jump to the third item on the to do list—an expansion of the balance sheet or QE3. Interestingly, another baby easing step might lead to a dove dissenting this month. The August FOMC meeting minutes indicated that a "few" members wanted to do more easing. So a voting member like Evans, who argued for more easing on TV this week, might dissent, leading to four dissents on Bernanke's watch, the first time this has happened since 1992.

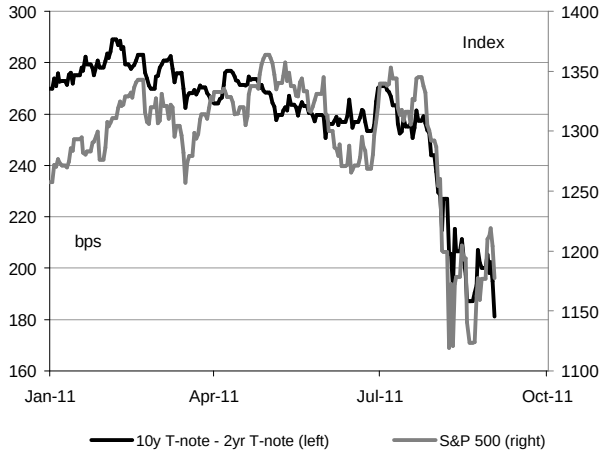
- **U.S.**: A light data calendar will put the focus squarely on speeches by Bernanke and Obama. Bernanke will be asked to speculate on what next steps the Fed might take, now that he has called for a special two-day meeting. Obama is speaking before Congress about the unemployment problem. With the Federal cupboard bare, Congress will not be receptive to his proposals to extend expiring tax cuts to offset a major swing in fiscal drag or efforts to better match available workers to available jobs. What may grab investors attention is a rumor that he will revive talk about a *forced refi proposal* for government owned mortgage, which could save homeowners as much as $50B. This would not cost the government any money immediately and might not need Congressional approval.
- **Eurozone:** While the ECB will not be changed at the upcoming meeting, a clear shift in ECB thinking is likely as the Council discusses the extent to which fresh market turmoil threatens to intensify already-growing downside risks to the economy. The Eurozone retail sales report and the details of Q2 GDP may be less important than the manufacturing updates, which may corroborate the clearly softer tone from the surveys. Most notable will be the German IP figures.
- **United Kingdom:** Nothing is expected from the BoE meeting which offers its latest verdict on Thursday. Forthcoming data could be important in regard to whether the MPC shift any more towards the consideration of fresh asset purchases. Of most interest will be the services PMI data, manufacturing IP, and the retail sales survey.
- **Japan:** This week brings the BOJ policy meeting, where they will take further easing steps, if only a lengthening of the maturity structure. Export growth critical to the outlook is increasingly threatened by a strong currency and slowing global activity. The machinery orders report may overstate business confidence as the rebound will be disaster related. Finally, revised Q2 GDP is subject to volatility from the disaster effects.
- **Emerging Markets/Regions:** One major EM central bank meets this week. **Poland's** central bank (NBP) will *keep rates on hold*, with a cautious stance toward further rate hikes at the bank's July meeting now transitioning into an extended pause.

Specific Regional Themes

- **U.S.: Obama and Bernanke Speaking**

The weak data recently is validating the bull flattener in the bond market, with a baby Fed easing step to twist the yield curve likely from the Fed this month. But the report is not weak enough to change our view that the double dip is not on our doorstep. And if a recession is not around the corner then at some time soon the equity market is a buy.

Chart 1: Front-Running the Fed



The indicator calendar is light as it usually is in the week after the jobs report, with only two reports of note. On Tuesday the nonmanufacturing ISM is expecting to fall nearly 2 points to around 51 in August. Aided by export growth, the **trade gap** (Th) is expected to reverse much of June's widening in July (DE: 51.8B; consensus $51.1B).

Only a few Fed speakers are on tap again. Fed chairman **Bernanke** puts in an appearance Thursday and is sure to be asked the importance of the "special" two day meeting. Minn. president **Kocherlakota** (voter and dissenter 2011) on Tuesday, followed by dovish Chicago president **Evans** (voter 2011) on Wednesday. A super-dove SF president **Williams** (voter 2012) will speak Wednesday and Friday. The **Beige Book** (Wed) will tell us the same old, same old-sluggish economy with a weakening mfg. sector.

President Obama give a "major" speech on fixing the unemployment problem before Congress on Thursday. *What may grab investors attention is a rumor that he will revive talk about a forced refi proposal for government owned mortgage, which could save homeowners as much as $50B.* This would not cost the government any money immediately and might not need Congressional approval. He will probably also discuss *extending existing tax cuts*, such as the *employee payroll tax cut*, which are scheduled to expire at year-end, as a way to prevent fiscal policy from turning "too" contractionary in 2012. He will also talk about other options that have bandied about before—an *employer jobs tax credit*, *aid for "green" jobs*, and *energy conservation tax cuts*. What is really needed is a way to reduce the mismatch between workers and jobs (ie how to help laid-off construction workers more easily become software engineers). However, this is really expensive and would take 6-12 months to set up and 18-24 months to see some results. (M. Cary Leahey)

- **Eurozone: A Key Week Ahead**

The **ECB Council** has its next regular **meeting** next Thursday, with much to discuss (and decide) in the wake of month that has brought fresh market turmoil alongside more weak economic data. As far as formal policy is concerned, no changes are envisaged. However, a clear shift in ECB thinking is likely as the Council discusses the extent to which fresh market turmoil threatens to intensify already-growing downside risks to the economy. In this regard, President Trichet used a high-profile testimony earlier this week to signal that the ECB will use the update of its economic forecasts next week to reassess the inflation outlook, albeit very clearly hinting that the Council may no longer point to upside risks to inflation. Such a reassessment will very much validate the removal of further ECB rate hikes from market expectations seen in the last month, the question being the extent to which the budding pricing-in of rate cuts is accentuated or not.

Otherwise, the ECB is likely to highlight its frustration over the Greek bail-out backdrop, while there may be explicit criticism of the lack of credible deficit cutting action by Italy. This frustration may be even more paramount in regard to the EFSF, the alleged enhancement of which on July 21 was probably instrumental in persuading the ECB to resume bond purchases. As a result, the ECB is likely to feel that government inaction has pushed it into a position where it cannot extricate itself from either government bond purchases or bank liquidity provisions, ie measures which it regards are extraordinary and therefore temporary, with the German contingent on the Council very opposed to buying Government debt. As a result, the ECB may be in no mood to offer any further sop to governments by hinting at rate cuts.

Even so, the ECB is likely to be on the defensive. Indeed, President Trichet will probably have to address criticisms made of late from the IMF, in regard to the speed of budget consolidation being foisted on certain countries as well as the extent to which Eurozone bank balance sheet problems may be understated. All of which makes the Council meeting next Thursday all the more interesting, with the hope (at least from the ECB) that neither the raft of key data due in the interim, nor further market turmoil, make it more attention-grabbing.

As for data there is plenty in store, with a weak **Eurozone retail sales** report in the offing on Monday (Consensus: unch M/M; DE: -0.3%). Tuesday brings the details to the **Q2 GDP** report, ie providing more

of the reasons behind the sharp growth slow-down. However, perhaps the most important data will be the **manufacturing** updates, the question being how much they corroborate the clearly softer tone in recent surveys which have at least partly reflected a slowing global economy. Most notable will be **German industrial production** figures on Wednesday (Consensus: 0.5% M/M; DE: unch), but **French** and Spanish updates will also garner attention.

- **United Kingdom: BoE on Hold**

  Nothing is expected from the **BoE meeting** which offers its latest verdict on Thursday. Forthcoming data could be important in regard to whether the MPC shift any more towards the consideration of fresh asset purchases. In this regard the **services PMI** data on Monday (Consensus: 54.3; DE: 53.0) and the **manufacturing production** update on Wednesday (Consensus & DE: unch M/M) will be important, especially of added softness is hinted at. **Retail sales survey** data from the BRC (Tue) will get more than passing interest as will producer price figures, which may highlight a fall back in input price costs (Consensus: -1.5% M/M; DE: -2.5%).

- **Other Europe: Riksbank Policy Pause**

  In **Sweden,** until very recently, markets were bracing themselves for another hike from the **Riksbank** after the **Board meeting** (decision Wednesday). However, markets conditions and comments from the Riksbank itself have made a rate pause all but certain, the question being how long a pause is envisaged by the accompanying Monetary Policy Update. Otherwise, **industrial production** data may get a more than fleeting attention.

  Norway too has an **industrial production** update on offer (Wed), albeit with markets more braced for further softness given the volatile nature of the series lately. **CPI** numbers (Fri) should show largely stable inflation. Instead a series of speeches through the week by **Norges Bank Governor Olsen** may attract more attention. **Switzerland** also has **CPI** data (Tue) and **jobless** figures, but with markets more interested in whatever action the SNB may be contemplating to temper the soaring franc: noting may be forthcoming with the SNB waiting until its looming quarterly assessment due on September 15.

- **Oceania: Aussie Policy Pause Extended**

  In **Australia**, the week begins with the **Performance of Services Index**, **company profits** and **inventories** data for Q2 on Monday. **Current account** figures for the second quarter then follows on Tuesday, but all of the attention will likely be turned to the **policy decision** from the **Reserve Bank of Australia** (also Tue), where the Bank is generally expected to extend its recent policy pause. Wednesday sees the arrival of the **Performance of Construction Index** but, again, the spotlight will be on Q2 **GDP** numbers (Wed), where modest growth is generally expected. The **labor force survey** then wraps up the week on Friday, where conditions are generally expected to be stable. In contrast, **New Zealand** sees another quiet week, with Q2 **manufacturing activity** (Thu) numbers the only data of interest. (Andrew Wroblewski)

- **Japan: BOJ Policy Meeting: Baby Easing Steps**

  The major event this week should be the monthly **Bank of Japan monetary policy meeting** (Tue, Wed), where there is a fair chance that policymakers will take new easing steps, if only a lengthening of their portfolio duration, as the export growth critical to the economy is increasingly threatened by a strong currency and slowing global activity. Beyond the BOJ decision will come the July **machinery orders** report (Thu), which gives a snapshot reading on business confidence—though any underlying message may this month be confused by strength in spending tied to earthquake and tsunami reconstruction—and **revised second-quarter GDP** numbers (Fri), where the potential for significant changes is probably heightened by the great volatility in activity through the quarter. (Pierre Ellis)

- **Emerging Markets: Central Bank Watch: Poland**

  This week brings meetings of only one central banks that we cover. **Poland'**s central bank (NBP) will *keep rates on hold*, with a cautious stance toward further rate hikes at the bank's July meeting now transitioning into an extended pause. Some market participants are speculating about a potential cut in months ahead. Support for that view will likely not be found this week.

  Instead, the Council will likely acknowledge the clear signs of a slowdown in the U.S. and Euro areas, and heightened risk aversion, but stay guarded about the inflation outlook. That outlook is improving, with the headline measure more likely to return to the 2.5% target in 2012, but it's currently-elevated level (still running above 4.0%), and heightened-but-easing inflation expectations, will make the Council reluctant to add credibility to near-term easing chatter. The bank will also want to wait and see what measures the Fed ends up pulling out of its hat later this month. If "printing money" appears to be in the pipeline, the NBP could again become concerned about a replay of late-2010/early-2011, when it perceived that hot money flowed into commodities, pushing up domestic inflation. That interpretation would pressure the more-benign inflation scenario that has evolved of late, keeping the argument for cuts off the table for now.

  However, looking ahead, it is not hard to gin up a scenario where the global slowdown transitions into something more ominous. That, combined with a "fool me once, shame on you/fool me twice, shame on me" response of investors to policy stimulus measures in the major advanced economies, would indeed begin to raise the spectre of easing in Poland, just not quite yet. (Andrew Husby)