Decision Economics, Inc.
Information for Decisions™

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

Friday, September 16, 2011

DE Tactical and Strategic U.S. and Global Fixed Income Prospects: September 16, 2011			
Country/Region	**Tactical**	**Strategic**	**Comments**
United States			
Fed—Fed Funds	*Stable*	*Stable*	Chubby Checker joins the Fed this week to help twist the yield curve.
2-yr. Treas.	*Neutral*	*Higher*	Obama's $450B plan may only keep growth above 2%.
10-yr. Treas.	*Neutral*	*Higher*	And 2% GDP growth and 2% inflation still supports sub 4% 10-year yields.
Eurozone			
ECB—Refi Rate	*Stable*	*Stable/lower*	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 policy reversal possible-bond buying/liquidity injections.
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			

In an effort to respond to client requests, we are combining the best features of the *Radar Screen*, *GED*, and *U.S. Markets Weekly* into a new weekly entitled, *The Global Markets Weekly*, whose first issue will be Monday September 26.

Overview—Chubby Shows Ben How to Do the Twist This Summer...

Investors focus will shift from the ever-changing (and seemingly) never-ending debt crisis in the Eurozone to the upcoming FOMC meeting. Many investors have been front-running the expected operation twist in which the Fed will sell short-term Treasuries and buy longer-term Treasuries in an effort to keep private borrowing rates low to stimulate housing and investment. This might be less effective than purchasing mortgages and corporates directly with the proceeds of the short-term Treasury sales. But this option seems too much like "fiscal policy" to many on the FOMC, who prefer the Fed to conduct monetary policy with a "pure Treasury" portfolio. And, of course, this is an intermediate step before actually expanding the size (not just the composition) of the portfolio, the long awaited QE3. Ben ("Chubby") Bernanke risks having four dissents at the upcoming meeting, three hawks plus one dove, who might be tired of the Fed being too timid. No chairman wants to run policy for very long with 7-3 or 6-4 votes. Chubby's predecessor Greenspan only endured two votes with four dissents. Never did a three vote dissent last more than two consecutive meetings. In a highly charged election year, a continuous vote of rolling dissents could add even more ammo to the critics in Congress and on the campaign trail to kill the Fed.

- **U.S.**: In a light data week, investors may also look at Obama's deficit reduction proposals early in the week before they focus on the FOMC decision mid-week. The White House will both tell us how they plan to pay for the $450B stimulus package (mainly with taxes on the rich) as well as $1.4 trillion reductions demanded by the debt ceiling agreement.
- **Eurozone:** Markets will be digesting the news from the week-end meeting of EU finance ministers, which may shape the thinking of Greece's short-term fate. Business survey readings this week will give insight into just how much frailer the Eurozone economy has become. In this regard, perhaps the greatest heed will be paid to the flash PMI data.
- **United Kingdom:** While important figures are on tap, the focus will be on the MPC minutes, where markets will be looking to see just how much the MPC is leaning toward new asset purchases, amidst the political pressure for such action and the wariness some may be having in regard to such action given the further rise in headline inflation that is looming.
- **Japan:** The holiday-shortened week will see the all-important trade report, since significant export growth is an absolute necessity for the continuing expansion.

- **Emerging Markets/Regions:** A trio of central bank meetings in Eastern Europe this week, with **Turkey** (Tue), the **Czech Republic** (Thu), and **Hungary** (Tue) on the docket. Turkey's central bank will remain on hold after a surprise cut in August, but investors shouldn't expect the CNB or MNB to follow with easier policy measures of their own quite yet.

Specific Regional Themes

- **U.S.: How to Twist and How to Cut**

After a week of data that still seemed to support 2% GDP growth in Q3 and investors focused more on the crisis in Europe, the focus this week will be on the upcoming **FOMC meeting** with a small amount of interest regarding the **Obama budget submission**.

In the latter, the White House will spell out how they will pay for the $450B stimulus program and how they would meet the $1.4 trillion long-term deficit reduction mandated by the **2011 Budget Control Act** (Mon). The deficit reduction super-committee will review the president's proposals before coming up their own proposals to Congress by November 23, House speaker Boehner would also like the super-committee to consider tax reform with lower marginal tax rates paid for by base broadening along the lines of the Reagan reform of 1986. This is giving the super-committee three Herculean tasks-finding $1.4 trillion in long-term savings, paying for the $450B stimulus package, and reforming the tax system-all in less than 10 weeks. Good luck!

That said, the main event is the **FOMC decision** (Wed). The market is leaning to operation twist-Fed style as another intermediate step on the possible road to QE3. As we discussed on the front page, there could be four dissents at the meeting-the three hawks who already dissented in August and a dove who would like to do more than just change the composition of the portfolio.

Thankfully, the calendar is light lead by two housing market indicators. **Housing starts** (Tu) should be steady in August (DE: 585K; consensus 590K). **Existing home sales** (Th) may edge higher (DE: 4.74M; consensus 4.75M).

Only a few Fed speakers are on tap again. Doves NY Fed czar **Dudley** (always votes) and SF president **Williams** speak on Friday. In addition the powers that be convene for the IMF-World Bank meetings in DC, **Trichet** will also be speaking that day, as well as the man of the hour at the ECB, outgoing member **Stark**, who may tell us why he did it (Sat). (M. Cary Leahey)

- **Eurozone: Key Surveys Awaited**

Markets will be digesting the news from the week-end meeting of EU finance ministers, which may shape the thinking of Greece's short-term fate. Business survey readings this week will give insight into just how frailer the Eurozone economy has become.

In this regard, perhaps the greatest heed will be paid to the **flash PMI** data (Thu). The **manufacturing** survey eroded clearly for a fourth successive month last time around, with any fresh slippage (Consensus: 48.5; DE: 49.0) possibly being viewed as evidence of even weaker global momentum, given the clear and on-going reliance on exports behind Eurozone growth. NB: **German ZEW numbers** (Tue) and the **French INSEE survey** (Fri) will give alternatively-sourced survey insights, albeit with a very much German (and therefore potentially relatively more upbeat) perspective.

Meanwhile, the **services PMI** also slipped last time around, albeit slightly but still revealing continued signs of geographical disparities: more such evidence may be forthcoming (Consensus & DE: 51.0).

Perhaps as much interest should be in the flash **Eurozone consumer confidence** reading (Thu), to see if the financial market turmoil is having any major spill-over effect.

- **United Kingdom: BoE Insight**

There are important numbers in the coming week, not least **public borrowing** figures (Wed) which should show that the budget deficit is narrowing in the current FY, but only modestly (Consensus: £ 13.0 bln; DE: £ 13.5 bln).

There is also the **CBI industry survey** (Thu), giving insights into the manufacturing sector, numbers that have not been as downbeat of late as other factory sector gauges such as the PMI figures.

However, the focus will be on Wednesday with the **minutes to this month's MPC meetin**g, where markets will be looking to see just how much the committee may be leaning toward fresh asset purchases, amidst the political pressure for such action and the wariness some members may be having in regard to such action given the further rise in headline inflation that is looming.

- **Other Europe: Central Bank Focus**

In **Sweden,** domestically, there may be some focus in the **Riksbank Board minutes** from the meeting earlier this month (Tue). That meeting saw policy unchanged, but the accompanying statement still implied a desire by the Riksbank to hike further, partly due to updated forecasts that point to a continued if not very resilient and upbeat economy. The minutes may reveal where the Riksbank sees risks playing out.

Central bank policy will also be the focus in **Norway**, with the **Norges Bank** due to give its next **interest rate verdict** (Wed). The European backdrop clearly will make the Norges bank pause further, the question being whether the central bank admits defeat more clearly in its desire to hike afresh by paring back its projections for tighter policy in the accompanying Monetary Policy Statement.

Switzerland sees little of note, save for **money supply** numbers, the question being the extent to which they show the initial impact of the series of SNB liquidity measures seen though August.

- **Oceania: RBA Minutes**
  In **Australia**, the week begins with the **Reserve Bank of Australia minutes** of its 6 September policy meeting (Tue), which are unlikely to provide any additional insights beyond the information already released in the statement by Governor Stevens following the meeting. The rest of the week sees the arrival of the **Westpac** (Wed) and **Conference Board Leading Indexes** (Fri).

  In **New Zealand**, the week begins with the **Performance of Services Index** on Monday. **Current account** numbers for Q2 then follow on Wednesday, and are generally expected to show a slightly wider deficit. Most of the attention, however, will be focused on Q2 **GDP** numbers (Thu), where the moderate pace of growth seen in the previous quarter is expected to continue. (Andrew Wroblewski)

- **Japan: Trade Update**
  Next week is shortened by a holiday at each end, and the important economic indicators—the August merchandise trade balance, and July all-industry activity—both appear on Wednesday. The **merchandise trade report** is, by far, the more important, since significant export growth is an absolute necessity for continuing expansion in Japan's economy—and even the recovery from the tsunami-related export crash gives signs of faltering. **All-industry activity** figures will complete the production-side portrayal of the July economy, but the bulk of the news is already out, in the form of the earlier industrial production and tertiary-industry activity reports. There too, recovery from the March disasters is incomplete, and disturbingly uneven—raising concerns about the underlying trend to which the economy was returning, even before the recent Western-economy deterioration. (Pierre Ellis)

- **Emerging Markets: Central Bank Watch:**
  A trio of central bank meetings in Eastern Europe this week, with **Turkey** (Tue), the **Czech Republic** (Thu), and Hungary (Tue) on the docket. Turkey's central bank will remain on hold after a surprise cut in August, but investors shouldn't expect the CNB or MNB to follow with easier policy measures of their own quite yet, if at all.

  Turkey's central bank surprised markets in August, cutting rates in the face of heightened downside risks to the global economy. In the interim, reserve requirements were also lowered slightly. Part of the justification for the recent rate cut was external – slower growth in its major European trading partners Italy and Spain – but the bank also expects a slowdown in domestic activity. Risks have indeed increased, and it remains an open question just how much the recent surge in credit growth turns sour in the quarters and years ahead. The bank attempted to lean against surging credit growth in late 2010/early 2011 with higher reserve requirements, and a slowdown finally seems to be occurring. That may help to ease (along with a weaker lira) steep imbalances in the country's current account.

  This week, risks to growth will remain the focus, the TCB likely to discount still-elevated inflation measures, expecting weaker growth to bring inflation down in the period ahead. The bank will also likely reiterate it may ease further if conditions warrant, but its scope to act will be limited by a steeper decline in the lira than the bank probably intended. In short, rates on hold this week at 5.75%, with eyes on the data flow in coming months.

  In the **Czech Republic**, rates should remain on hold at 0.75%, but attention will be on language surrounding the balance of risks, and the expected rate path. Officials have noted in recent weeks that policy could be eased if downside risks materialize. But, tentative signs that global policymakers will continue to step in to keep the banking system afloat amid sovereign debt troubles, will ease near-term need for the CNB to take action. In any event, the Board will likely note increased downside risks, and either push back its expectation of rate hikes (currently late-2011, early 2012) deeper into 2012 or simply refer to higher rates near the end of its forecast horizon, which would be sometime in 2013. The latter would be consistent with the bank's behavior around the time the Fed started QE2, while the former (that of referring to a date in 2012) would allow more room to maneuver if the global recovery does show signs of reacceleration later this year.

  For **Hungary**, risks to growth will continue to be dominated by the need to support the forint, which has continued to fall versus the dollar and euro, but saw a welcome rebound versus the franc on the SNB action. High levels of foreign currency debt imply a greater drag on household balance sheets and consumption, which combined with a clearly more subdued external picture, heightens risks to growth. There has been much talk about plans to allow holders of foreign currency mortgages to pay back loans at more-favorable exchange rates, but the details, and their impact on the banking system, are causing plenty of debate, adding to perceptions of risk toward the Hungarian economy. As much as the central bank might prefer to ease, that will not come quite yet. But, if inflation pressures do show easing ahead amid softer but stable global growth, a cut in 2012 is possible. (Andrew Husby)