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The Global Markets Weekly

March 2, 2012

More Income, Less Spending?

Both the optimists and pessimists regarding the US outlook got plenty of ammo from this week's report. For the optimists, the upward revisions to labor income and the large upward revision to the saving rate to 4.5% last quarter suggest a stronger position for consumer finances and spending going forward. For the pessimists, the same GDP data indicated that real consumer spending has not budged since October. The resulting lift-off point for January consumption (which is two-thirds of GDP) is very low relative to the Q4 average, which will constrain GDP growth even if consumer spending growth perks up in February and March. A strict interpretation of all this arithmetic suggests that Q1 GDP growth estimates could be revised down as much as 1 percentage point to 1.5% or less.

Most analysts, however, hesitate to pencil in a much lower Q1 GDP track. Monthly income and spending numbers are subject to revisions. The fragmentary evidence on last month's consumer spending is quite encouraging, with another jump in vehicle sales and pretty good chain store sales, accompanied by an improvement in consumer confidence. Wage income growth is picking up as employment growth has accelerated, with a 5.4% gain in 2011 compared to only 3.2% in 2010. Further decent income gains of 150K or higher (most forecasters have penciled in 200K or better for March) would support further income gains and eventually spending.

This leaves us with the possibility that the weakest thing about the current quarter may be GDP growth because of pause in consumer spending. We do not think this pause will continue as the economy is on the cusp of a self-reinforcing recovery. But we acknowledge that GDP growth is off to a slow start, which could give investors another reason to be skeptical and cautious (oil prices are rising and the Greek drama never ends), particularly since they saw an even more promising start to 2011 crumble by mid-year.

- **U.S.:** Our positive view about the US outlook should be supported by a strong 200K plus **employment report**, a view shared by the consensus. But job growth has been gathering steam for three consecutive months and could take a breather in February (as it did in October) which may mean very little but could cause heartburn among investors who think that recoveries improve along straight lines.
- **Eurozone:** While Greece remains in limbo, the second LTRO must be deemed a success. The **ECB meeting** this week may not suggest further LTROs but won't rule them out. The ECB may hint that Eurozone countries should be allowed to miss fiscal goals on account of weaker growth. The downside growth risks to be highlighted by the downgraded **ECB forecast** may be seen in this week's **retail sales** and **IP** reports.
- **UK:** Especially in light of the better economic data seen of late, the **BoE policy decision** this Thursday is a no brainer: policy will be on hold with the key date being the MPC meeting in May when the current asset purchase program will have been completed. Inflation data this week, including the **PPI, input/output prices** and the **BoE expectations survey**, will take on increased importance given BoE worries.
- **Central bank roundup:** The central banks in **Canada**, **Australia** and **New Zealand** will not change policy this week, thereby maintaining the current pause.
- **Japan:** A quiet week may be highlighted the possibility of an outright **current account deficit** for January, based on the very poor trade data already released. A modest upward revision to the 0.6% decline in **Q4 GDP** is expected.
- **Emerging Markets/Regions:** Asian central banks in **Korea**, **Malaysia**, and **Indonesia** will leave policy unchanged this week. Slower export growth from abroad has clipped expected growth and contributed to the downward trend in inflation, while domestic demand conditions remain promising. In **Poland**, policy will remain unchanged. While growth is strong and inflation well above target, disinflationary forces from abroad and the impacts of past monetary policy tightenings will bring inflation closer to the 2.5% target in the thinking of the central bank.

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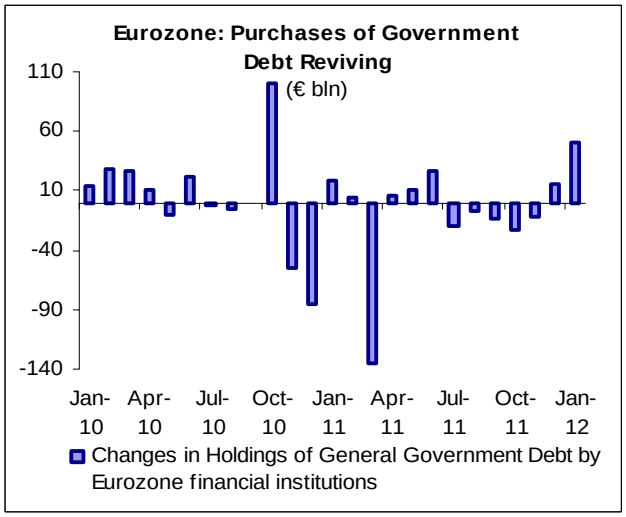
Focus: Eurozone Liquidity

There was little surprise that the ECB had to allot a somewhat higher than-expected €529.5B in is second 3-year LTRO last Wednesday. The amount was higher than the €489.2B in the previous such provision made in December with the amount of participating banks also higher (800 vs 523). Indeed, the higher overall allotment (and greater participation) was probably a result of both easier collateral rules to those applicable to the December LTRO and perhaps to a reduced stigma being attached to such funding.

Three cheers for more three year money! While the ECB will want more time to assess the impact of this latest provision of long-term liquidity, it is unlikely to change is near-term thinking in planning no further such 3-year LTROs. Even so, it will be hopping that the impact of this 3-year LTRO at least continues, if not accentuates, the impact of the December provision, which has brought money market rates down (3-month LIBOR falling below the ECB's refi rate alongside a further reduction in the Euribor-OIS spread) alongside falls in Italian and Spanish bond yields.

Liquidity fuelling larger bond purchases... The latter may have been at least partly a result of recent ECB data confirming clearly stepped-up government bond purchases by banks through January (of circa €50B). As the upper chart highlights, this is the largest rise in over a year and a clear contrast to the falls seen between last summer and November, in turn, suggesting that banks may have been using the cheap ECB liquidity provided to them to purchase peripheral debt. Indeed, national break-downs show that Italian and Spanish banks were responsible for most of these purchases, they presumably buying their own respective government debt.

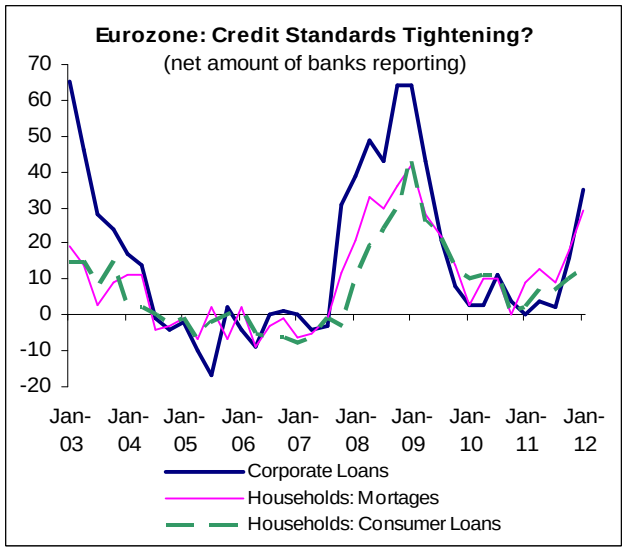


… and faster broad money growth. The December liquidity surge may also have been responsible for the improved broad money dynamics that ECB data also pointed to for January, via the rise in repo activity. Indeed, January M3 money supply growth picked up clearly, rising a full percentage point to 2.5% Y/Y, albeit only recovering from a cycle-low to a three-month high. This came on the back of a 0.7% M/M rise in adjusted M3, an increase that came after three successive drops. In addition, the narrower money supply gauge (M1) saw its Y/Y growth rate recover afresh from 1.6% to 2.0%.

Lending still soft, however. There was also a pick-up, albeit less notable, in terms of the private sector lending growth picture. Indeed, the adjusted pace of growth rose 0.3 percentage point to 1.5%, up from the 18-month low in December but still only half the cycle-high pace of 3.0% set in October. Notably, the lending breakdown showed this pick-up not to be broad-based. Indeed, underlying Y/Y corporate lending growth slowed further to a new low of 0.8%, undermined by a M/M drop. Instead, the overall pick-up came on the household loans side as the adjusted growth figure rose 0.2 percentage point to 2.1%, albeit mainly due to less weak consumer credit growth.

Overall, these figures continue to highlight the on-going problems facing the Eurozone banking system that have become only too apparent in the last few months, albeit with some less downbeat signs, possibly emanating from the boost to liquidity and confidence that recent ECB actions of late may have precipitated.

Regardless, M3 growth is still negative in real terms as is that for M1. Indeed, the relatively greater weakness in M1 growth (compared to M3) also corroborates the picture of a weak economy evident in the business and consumer surveys as it is this aggregate which seems to be better than the broader M3 numbers in tracking the economy.



More worrisome is the still weak lending backdrop, highlighting that whatever improvement in liquidity has occurred of late has yet to translate in banks being able or perhaps willing to increase their lending. This of course should be no surprise in the wake of the ECB Bank Lending Survey released at the beginning of the month which confirmed a tightening in credit standards had occurred into late-2011 with a further rise on the cards (see lower chart). With this in mind, the question is the extent to which the soft consumer and company lending backdrop may be a reflection of a building credit crunch, a development that is being accentuated by financial market turmoil but which is manifesting itself ever-more adversely on real economic activity. Crucially, the ECB, under the direction of President Draghi, does seem to be more open to admitting such credit constraints risks in some parts of the Eurozone, possibly one reason why the central bank earlier this month took the unprecedented step of allowing national member banks to use varying criteria in establishing collateral in credit operations. (Andrew Wroblewski)

United States

Will Employment Dispel Worries of Weak Q1 GDP Growth?

Data/event recap: Bernanke hints QE3 less likely. Fed chairman Bernanke implied that the Fed was no closer to QE3, even as he essentially repeated last month's cautious outlook. In particular, he did not use the recent rise in oil prices as a significant new risk to the outlook, which would have implied the Fed was more concerned about the outlook and more inclined to ease. Investors were disappointed so most asset classes went down, particularly gold. He gave a mixed message about inflation in which he emphasized the Fed's new found 2% "target" but then gave the FOMC a lot of wiggle room since the unemployment rate is still so high. Still the more the Fed emphasizes the importance of the 2% inflation target, the harder it will be to adopt QE3 if underlying inflation moves above 2%, even if the economy is weak.

How weak Q1 GDP? For the optimists, the upward revisions to labor income in and the large upward revision to the saving rate to 4.5% last quarter suggests a stronger position for consumer finances and spending going forward. For the pessimists, the same GDP data (with an upward revsions from 2.8% to 3.0% in Q4, DE: 2.9%; consensus 2.8%) indicated that real consumer spending has not budged since October. Nominal spending rose only 0.2% in January, half what was expected (DE +0.5%; consensus: +0.4%). This means that the lift-off point for January consumption (which is two-thirds of GDP) is very low relative to the Q4 average, which will constrain GDP growth even if consumer spending growth perks up in February and March. A strict interpretation of all this arithmetic suggests that Q1 GDP growth estimates could be revised down as much as 1 percentage point to 1.5% or less.

Most analysts, however, hesitate to pencil in a much lower Q1 GDP track. Monthly income and spending numbers are subject to revisions. The fragmentary evidence on last month's consumer spending is quite encouraging, with another jump in vehicle sales and pretty good chain store sales. Wage income growth is picking up as employment growth has accelerated, with a 5.4% gain in 2011 compared to only 3.2% in 2010. Further decent income gains of 150K or higher (most forecasters have penciled in 200K or better for March) would support further income gains and eventually spending. This leaves us with the possibility that the weakest thing about the current quarter may be GDP growth because of pause in consumer spending.

Mixed signals elsewhere. Durable goods report fell a much larger than expected 4.0% drop (DE: -1.5; consensus -1.0%) in January. While disappointing, we realize that orders picked this time last year. That said, **consumer confidence** jumped nearly 10 points to 70.3, surpassing expectations (DE; 64.7; consensus 63.0). However, it is unclear how much the survey incorporated the recent rise in gasoline prices. Rising gas prices did not crimp **vehicle sales,** which were the strongest in four years at 15.1M units last month. The strength in auto sales was one the upbeat items mentioned in the **Fed's Beige Book**, which pointed to a continual gradual recovery.

How strong is manufacturing? The two key manufacturing indexes went in opposite directions. The **Chicago index** rose a more than expected 3.8 points to 64.0 (DE: 61.3; consensus 61.5). The **national ISM index** fell 1.7 points to 52.4 (DE: 54.0; consensus 54.5). The gap between the two indexes is a historically large 8 points and this wide gap has persisted since late 2010. In any event even the much lower national ISM reading is still pretty healthy.

The week ahead: Our positive view about the US outlook should be supported by a strong employment report, a view shared by the consensus based on the drop in weekly claims. But job growth has been gathering steam for three consecutive months and could take a breather in February (as it did in October) which may mean very little but could pause heartburn among investors who think that recoveries improve along straight lines.

Employment is the key report this week, even though it shares the time with the trade report (Fri). A strong report is expected (DE: +225K; consensus +210K). The **unemployment rate** should remain unchanged at 8.3% (both DE and consensus), while the **average hourly earnings** should rise 0.2% (both DE and consensus). The report will be even stronger if the workweek rise a notch to 34.6 hours (DE) rather than be unchanged (consensus). A report of 150K or greater would support our notion of a self-sustaining recovery with an eventual lift to spending from the brighter jobs performance. This would offset much of the possible drag from higher oil prices and would be more important that the knowledge that the expansion started the quarter softly, restrained by the recent pause in consumer spending.

Who will care about the trade gap? Coming at the same time as the jobs report, the **trade gap** may be ignored, particularly if it stays close to the December level of $48.8B (DE and consensus $49.0B). This implies a mild drag on Q1 GDP growth given the Q4 average trade gap of $46.2B.

Service survey maintaining strength. The **nonmanufacturing ISM** (Mon) may extend or at least hold on December 3.8 point jump to 56.8 in January (DE: 57.1; consensus 56.1).

Fedspeak: A double shot of Fisher in a light week. The always entertaining **Dallas Fed president Fisher** (voter 2014) has the sole spotlight this week (Mon), as FOMC officials adhere to the blackout rules prior ot the March 13 FOMC meeting. Fisher will most likely expound this hawkish positions, downplaying the possibility of QE3.

(M. Cary Leahey)

Canada

BoC to Remain on Hold, "Wait and See" Approach Continues.

Recap: The **current account balance** narrowed to –C$10.3B in Q4 on energy and autos. While the data undershot expectations, it is still a marked decline from –C$12.3B in Q3 and –C$ 15.6B in Q2. This trend is due to fourth quarter increases in energy (+C$4.1B) and auto sales (+C$1.9B) exports.

The **raw materials price index** rose 0.1% m/m (Consensus: 0.5% Decision Economics: 1.5%) in January, bringing the y/y change to 4.9%. The **industrial products price index** rose 0.3% (Consensus: 0.3% Decision Economics: unch.) in January, bringing the y/y change to 2.3%. Taken together, this may suggest a drop in factory margins.

Canadian **monthly GDP** matched expectations, at 0.4% M/M (Consensus: 0.3%, Decision Economics: 0.4%) for December, as rising energy prices helped oil and gas extraction contribute 0.2% to the headline. Canadian **Q4 GDP** came in at 1.8% (Consensus: 1.8%, Decision Economics: 1.7%) following Q3 which was revised upward from 3.5% to 4.2%. This deceleration was predicted, as Q3 was artificially strong due to repaired supply chains from Japan. Consumption, net exports, and private investment provided lifts to Q4 GDP, while government investment and business inventories fell.

Week Ahead: The BoC will announce their **interest rate decision** on Thursday (9:00 a.m.).

The policy rate will most likely remain at 1%, where it has been since 2010, due to offsetting factors. The CPI has been above the 2% target since 2010, and the core CPI is now also above the target. However, the unemployment rate has stagnated around 7.5% for the past year. The BoC is also worried about global headwinds impacting Canadian growth.

However, markets have priced in lower odds of easing, consistent with our view that the Bank would be wary of lower rates exacerbating high household debt loads, and housing market risks. The tables illustrate the probability of policy rate changes at future BoC announcement dates. Markets have moved away from pricing in easing, toward holding in March and beyond. The BoC seems to be adopting a "wait and see" approach on which of the aforementioned factors will take precedence in the next few months.

Projected Policy Rate Probabilities Implied by OIS, from 3/2/2012

	8-Mar	17-Apr	5-Jun	17-Jul
+25 bps	.004	.004	.003	.033
unch	.996	.955	.932	.904
-25 bps	0	.041	.064	.062

Projected Policy Rate Probabilities Implied by OIS, from 1/1/2012

	8-Mar	17-Apr	5-Jun	17-Jul
+25 bps	0	0	0	0
unch	.807	.768	.642	.630
-25 bps	.183	.213	.304	.311

Changes in Policy Rate Probabilities

	8-Mar	17-Apr	5-Jun	17-Jul
+25 bps	.004	.004	.003	.033
unch	.190	.187	.290	.270
-25 bps	-.183	-.171	-.240	-.249

Sources: Bloomberg and Decision Economics, Inc.

Next week is busy in terms of indicator announcements. The **Ivey PMI** survey (Tue., 10:00 a.m.) will likely reflect moderate business conditions. **Building permits** (Wed., 8:30 a.m.) likely will decelerate from December, yet still show growth due to favorable borrowing conditions and rising housing prices. Housing starts (Thurs., 8:15 a.m.) will still be elevated above long run levels, also on low interest rates and rising housing prices. Labor market conditions (Fri., 7:00 a.m.) should remain relatively unchanged, with the February **unemployment rate** forecasted to stay near January's rate of 7.6% (Consensus: 7.6%; Decision Economics: 7.5%), and **Labor Force Survey** forecasts predicting mild job growth. The **trade balance** (Fri., 8:30 a.m.) will likely remain positive, with rising energy prices providing a lift which outweighs the drag of the strong Canadian dollar. Finally, Q4 **Productivity and Cost** (Fri., 8:30 a.m.) data may help to shed light on Canada's manufacturing sector which has been weak of late.

(Melissa Pumphrey/Andrew Husby)

Eurozone

Lots of Lovely Liquidity

Data/event recap: Data/event recap: The main event of the week was surely the latest **ECB LTRO**, although perhaps the **monetary data** from the ECB was as important. Both these are discussed in the Focus page, albeit with the added liquidity boost coming to the aid of peripheral markets save for Portugal, where fresh worries necessitated the return of ECB bond buying. Otherwise, the **Heads of State Summit** saw little regarding the issue of growth, instead trumpeting the signing of the **fiscal compact,** which includes a requirement for national annual structural government deficit to not exceed 0.5% of GDP and for this rule to be incorporated into member states' national legal systems.

Fiscal Pact Pros versus cons. In some ways this fiscal pact is welcome as a necessary precursor to the Eurozone moving towards a more formal fiscal union, ie something that will have to occur if the creation of Eurobonds is ever to help resolve the sovereign debt problems of the Eurozone. However, the signing of the fiscal compact is obviously a sop to the likes of Germany, something that helps the country remain on board in regard to the unconventional policy measures that the ECB is conducting (although there are clear reservations being raised by the Bundesbank in relation to the recent decision to allow different central banks to accept different collateral).

Fiscal pact counter-productive. Regardless, apart from being somewhat vague (as the identification of a structural deficit is hard to accomplish with hindsight let alone coincidentally), it is notable that had the fiscal compact been in existence for the last decade it would not have avoided the current sovereign debt situation. In addition, it is surely pro-cyclical and may only intensify downside economic risks, the latter still emerging in terms of the ever-weaker consumer signals even from the likes of Germany. Therefore, the compact may only exacerbate the fiscal problems facing much of the Eurozone, implying the fiscal compact may do more harm than good, as not only well-known fiscally damaged countries such as **Spain** are trying to back away from the budget goals being foisted on them but also allegedly fiscal-conservative countries such as the **Netherlands** are facing added spending cuts which may be impossible politically. Finally, the fiscal compact faces potential political hurdles since it will have to be ratified by a referendum in Ireland (as early as June), something that may involve more subsidies to be thrown at the Irish in order to get a positive result.

Greece still in limbo. Otherwise the Summit still leaves **Greece** in limbo. The **Eurogroup meeting** on Thursday, while applauding recent progress made by Greece in regard to a number of areas, stopped short of releasing of the first tranche of a second bailout package. This should not increase materially the chance of Greece defaulting given the looming maturation of €14B of bonds due March 20, as long as the PSI deal is completed successfully. However, the limbo Greece is in underscores the growing mistrust that other countries have in regard to its willingness and ability to take existing let alone further austerity.

Confidence recovers further. EU Commission **business and consumer survey** figures for February provided less subdued messages for a second successive month, albeit with clear contraction still being flagged in all Eurozone countries bar Germany. In contrast to the previous months, this less downbeat ESI reading reflected improved developments in regard to industrial, retail and construction sentiment, with the services side eroding a little (despite a clear improvement on the financial side). The latest overall figure remains so clearly below the 100-mark, implying that Eurozone economic activity is very probably contracting. Even so, they echo the tone of other alternatively-sourced survey numbers such as the **PMIs,** suggesting that while recession has almost certainly returned to the Eurozone, no further major erosion has occurred of late (The ESI hit a low of less than 70 in the bottom of the 2008-09 slump).

Weaker consumer. As for the consumer, it is notable that the willingness to make major purchases eroded afresh, while inflation expectations slipped back, something corroborated in the latest official spending numbers. More adverse consumer signs were evident, however**. French household spending** on goods in January fell 0.4% in M/M terms, adding to the 0.2% drop seen in the previous month (revised from -0.7%). **German** data were even worse, where **real retail sales** dropped 1.6% in M/M terms in January, a much softer-than-expected outcome.

The week ahead: Little from the ECB? The **ECB** may be hoping to take something of a breather the **Council meeting** this Thursday, very clearly not pointing to any further 3-year LTROs, albeit not denying their possibility. It may have to give an opinion on the extent to which certain Eurozone countries should be allowed to miss fiscal goals on account of ever weaker economies. In this regard, the ECB will also unveil surely downgraded **GDP projections**, possibly incorporating a much softer tone to consumer spending, something that may be evident in the details to the **Q4 national accounts** (Tue). However, the ECB will also be raising its inflation forecasts, largely on the back of higher oil prices. Probably, this rise in oil prices will be seen as an (added) downside growth risk, but it may also be causing inflation concerns within parts of the Council possibly accentuating already clear divisions regarding unconventional policy measures.

As for the downside growth risks, Eurozone **retail sales** numbers (Mon) may highlight that they are still materializing. A less downbeat picture may come from the key **industrial production** updates due at the end of the week. **German** (Consensus: 0.9% M/M; DE: 1.0%) and **French** (Consensus: 0.5% M/M; DE: 0.3%) output data may show some perkiness, while **Italian** numbers may be far gloomier (Consensus: -1.4% M/M; DE: unch). (Andrew Wroblewski)

United Kingdom

Better Data?

Data/event recap: Better monetary messages. BoE numbers on underlying **monetary dynamics** showed more reassuring messages in January data. These aggregates, which exclude intermediate other financial companies, are the ones that the BoE has been using to help assess the health of bank lending and monetary conditions generally. They showed a marked M/M rebound of 1.9%, more than repairing the record fall of 0.7% in underlying broad money supply seen in December, the result of which pulled the three-month annualized rate (possibly more closely watched by the BoE given the volatility in the numbers) back to a three-month high of 4.28%.

Mortgage approvals rise yet again. According to BoE-computed data, the number of **mortgage approvals** rose even further in January, with the 58 728 reading not only above the recent average, but also the highest in 25 months. Moreover, the value of overall approvals also rose, recovering to £13.2B and with actual net mortgage lending rising to a 13-month high of £0.4B.

Consumer confidence still shaky. The GfK **consumer confidence** gauge in February remained at -29, thereby still up from a 35-month low in December. The breakdown showed no major swing across components save for a clear fall back in the willingness to spend.

Construction sector improves. Coming in higher than most expectations, the **construction PMI** recovered 2.9 points in February to 54,3 swinging from a four-month low to an 11-month high. The improvement reflected a sharp rise in new work, with all three broad construction categories – housing, commercial and civil engineering growing.

Manufacturing still growing. The headline **manufacturing PMI** for February still remained in clear expansion territory despite the headline index losing 0.8 point (to 51.2). The survey noted that inflows of total new work and export orders were both broadly unchanged following mild gains in January, while input cost inflationary pressures rose sharply, actually showing almost a record M/M rise.

BoE worries on inflation returning? The drop in the February manufacturing PMI needs to be put in perspective given the damage that poor weather during parts of the month may have had. In addition, it must be stressed that the weaker February reading came after the 4.3 point cumulative recovery seen in December and January. In addition, other factory sector surveys such as that from the CBI also seem to be pointing to an on-going, if not strengthening, recovery.

As a result, the survey data adds to the better signs seen in UK economic numbers of late, a trend that helps explain the hints from the MPC that another tranche of asset purchases is far from automatic once the current program is completed in May. Indeed in testimony to a parliamentary committee with other MPC members, Governor King even chose to highlight that he saw no hard and fast market expectations for much further BoE asset purchases

In addition, signs of higher inflationary pressures (that were echoed in the PMI numbers) are clearly starting to affect MPC thinking, albeit with the more vocal concerns coming (understandably) from the more well-known hawks on the committee, with comments from Martin Weale on Wednesday very explicit in this regard.

The week ahead: BoE on hold. Especially in light of the better economic data seen of late, the **BoE policy decision** this Thursday is a no brainer: policy will be on hold with the key date being the MPC meeting in May as it is only then that the current asset purchase program will have been completed. Even so, given signs of fresh divides about the inflation outlook, the meeting may be far from straight-forward, although the extent of any fresh divides may only come to light with the release of the minutes later this month.

Key activity updates due. Regardless, the coming week has more important data that will be part of the data backdrop at that May MPC meeting. First up, and possible most important, will be the **services PMI** figures on Monday (Consensus: 55.0; DE: 54.5). In January, and providing a third successive and marked upside surprise, the headline rose further. Specifically, it increased by 2.0 points to 56.0, ie the largest of what is now a run of three successive rises, resulting in the highest reading since last March. The latest gain incorporated an accelerated increase in new business to the highest since last July. More notably, business expectations jumped by a record amount, albeit from a cycle-low recorded in December. Some correction may be on the cards, especially given possible weather distortions. Other survey data are due, in the form covering **retail sales from the BRC** (Tue) and the **labor market** (Wed). Corroboration of the better factory sector backdrop may arrive with the official **manufacturing output** data on Friday (Consensus: 0.3% M/M; DE: 0.2%). After the surge seen in December data, there may be a more muted outcome this time around.

Price signals now more important. Given the greater inflation worry that seems to be evident with at least parts of the MPC, numbers such as the **PPI figure** may take on increasing importance. This may be especially so given the clear rise in **input costs** that may be signaled (Consensus: 1.0% M/M; DE: 0.8%), the question being the extent to which these have (or not) spilled over into **output prices** (Consensus: 0.3% M/M; DE: 0.4%). Perhaps as important for the BoE will be the results from its latest survey of **household inflation expectations**, with the MPC possibly keen to see if the lower prevailing CPI figure has led to any fall back in expectations.

(Andrew Wroblewski)

Other Europe

Sweden: Economy Contracting

Data/event recap: Preliminary national accounts data for Q4 came in below already-muted expectations, including those of the Riksbank. Indeed, Q4 GDP fell 1.1% Q/Q, a contrast to the downwardly-revised 0.9% Q3 outcome, also ending a run of eight successive gains in quarterly activity. The fresh drop was far from broad-based, however, showing weakness very much on the external side, a contrast to the Q3 numbers. The weakness in exports in late-2011 echoes the thinking outlined as the **minutes to last Riksbank Board** meeting underscored.

However, **data so far this year have perked up**, not only in terms of continued signs of firmness in domestic demand but also on the business side. Indeed, seasonally adjusted **retail sales** in January rose by 0.1% M/M, adding to same-sized December rise and extending the run of positive outcomes to four months. The Y/Y rate of growth was little changed at 1.5%. Meanwhile, the February **manufacturing PMI** lost 1.1 points to 50.3, albeit unwinding some of the strong gain seen in January. Even so, the softer export backdrop in the GDP numbers will reinforce the caution that lay behind the last rate cut announced on February 16. However, despite the weak Q4 GDP numbers, the balance of data surely corroborates the stable policy outlook that the Riksbank signaled when it made that cut.

The week ahead: Will orders rise further? The key data this week is the **industrial production and orders** data, where it will be interesting to see if output starts to pick-up after the lackluster pattern of late and if orders show any further rebound. Indeed, industrial orders leapt at the end of last year due to a surge on the export side, with that better external signal echoed in the latest set of visible trade data where export growth returned to the positive (and clearly so).

Norway: Credit growth Rises Further

Data/event recap: Private sector credit growth in January was 6.9% Y/Y, up 0.2 percentage point from December. **Household credit** was down a notch at 7.2% Y/Y, while non-financial company credit growth increased 0.4 percentage point to 5.8%. On a very more upbeat note, a consumer recovery was evident in the broadly based index of **household consumption** (which includes vehicle and energy purchases and is also in inflation-adjusted terms). This jumped 2.2% M/M, ending a run of clear weakness (three drops in four months). These numbers may not attract much market attention, but will be of some worry to the likes of Norges Bank, where the fresh pick-up of late clearly argues against further monetary stimulus. Meanwhile, mfg. sentiment from the **PMI**, improved clearly once again last month.

The week ahead: Manufacturing production is due for an update this Wednesday. Recent numbers still seem consistent with a flat trend in the level of output. Indeed, the still soft but flat tone to the numbers was also seen in the weak Y/Y rate, albeit with this relative weakness a contrast to the recent pick-up in manufacturing survey data. **CPI numbers** arrive on Friday. In January, CPI inflation increased for the first time since last September, increasing 0.3 percentage point to 0.5% Y/Y, up from a December reading that was the lowest since late-2007.

Switzerland: Economy Still Growing

Data/event recap: GDP rose 0.1% Q/Q in Q4, avoiding the widely-expected decline but still slowing from the upwardly revised gain of 0.3% seen in the previous quarter, actually showing the softest outcome in almost three years. Notably, there were some upward revisions to previous data worth 0.1 percentage point, something that did not prevent the Y/Y rate of growth slowing clearly from 1.6% to 1.3%, a two-year low. The expenditure breakdown was quite revealing. Most notable was the Q/Q recovery in exports of 1.2%, one based around a rebound in sales of price-sensitive goods, something that would seemingly temper arguments that the still strong Swiss franc is inhibiting activity (the SNB has characterized the currency as still being massively overvalued). Moreover, the bounce in exports was accompanied by a fall in imports, also something that runs contrast to the expected impact of the strong franc, although this fall was probably more related to the marked and negative swing in inventory building that knocked half a percentage point from the overall Q4 GDP result. Indeed, final domestic demand showed solid growth, boosted by a pick-up in consumer spending and a recovery in capex.

Overall, the GDP numbers showed that growth in 2011 came in at the top end of the SNB GDP projection of 1.5%-2% made at the end of last year. However, with downside risks being flagged by still soft (albeit less negative) survey data such as the latest **PMI and KoF readings** seen in the last week, the SNB is likely to emphasize the deflationary risk that the strong currency may still be bringing in its wake, ignoring the fact that the Swiss monetary backdrop is not showing any signs consistent with this. Regardless, the latest batch of data will not fan speculation that the SNB may raise its Swiss franc target at the next quarterly assessment on March 15.

The week ahead: Real retail sales are due on Monday. They rose by 0.6% Y/Y in December, softer than the unrevised November rise of 1.8%. Otherwise the week sees the monthly **CPI update** on Thursday. In January, consumer price inflation dropped 0.1 percentage point to -0.8% Y/Y, a fourth straight negative reading but still the lowest in just over two-years. Even so, core inflation (excluding food, energy and fuel) actually rose, rising 0.1 percentage point to -1.0% Y/Y, while the core inflation measure excluding administered price products increased twice as much to -1.4% Y/Y. The impact of the strong franc is clear: domestic good inflation was little changed at 0.1% Y/Y, while that for imported goods fell 3.2%. (Andrew Wroblewski)

Oceania

Australia: GDP Data and RBA Decision Awaited

Data/event recap: The past week began with a number of relatively downbeat housing market updates in the form of Q4 **construction work done**, January **building approvals** and **HIA home sales** data. The former surprised clearly to the downside, showing the first fall since Q3 2010 while the latter two both saw moderate falls. Elsewhere, **capex** data for Q4 revealed a moderate correction following a surge in the previous quarter, dragged down by a clear deterioration in the private sector. **Private sector credit** figures, meanwhile, brought further downbeat messages, showing a slight moderation in credit growth in January. **Retail sales**, however, provided some upbeat messages, ending a run of two successive falls with a gain in January while the **Performance of Manufacturing Index** still implied a moderate expansion in the sector despite a slight fall last month.

The week ahead: The coming week sees the arrival of a number of key economic events/data, kicking off with survey updates in the form of the **Performance of Services** (Mon) and **Construction** (Wed) **Indexes**. Q4 data for **company profits** and **inventories** are also due on Monday, which is then followed by **current account** data on Tuesday, where a clear widening of the deficit is envisaged by markets. All of this precedes the key data release of the week, with **GDP** figures for Q4 arriving on Wednesday, and where markets are generally expecting to see a slight moderation in growth from the previous quarter. The remainder of the attention next week, meanwhile, will likely be on the **policy decision** by the **Reserve Bank of Australia** (Tue), where expectations are that the Bank will hold rates for a second-straight month following two successive rate cuts at the end of 2011 despite the recent increases in lending rates by a number of the nation's banks. The February **labor force survey** (Thu) and **trade balance** (Fri) data then complete the week.

New Zealand: RBNZ the Focus

Data/event recap: The past week started with **visible trade** data for January, which showed the trade balance swinging into a deficit from the same month of 2011 on the back of a rebound in imports. The only other release of note were **private sector credit** figures which showed a jump in credit growth to a new cycle-high, albeit with M3 money supply growth falling to a four-month low.

The week ahead: The spotlight in the coming week will be on the **policy decision** by the **Reserve Bank of New Zealand** (Wed), where expectations are for the recent policy pause to continue. The only other data release of note next week is **manufacturing activity** data (also Wed) for the fourth quarter, which wraps up the week.

(Chang Liu)

Japan

Current Account Deficit Is Coming!

Data/event recap: Mixed employment report. Economic data of the week were mixed, but with positive indications vastly predominating—and of greater significance for the outlook. The key negative report was the January **labor force survey**, which showed the seasonally adjusted unemployment rate rising 0.1 point from December, to 4.6%, on the combination of a dramatic 350,000 drop in employment and a 270,000 shrinkage in the labor force. Meanwhile, however, the job openings to applicants ratio moved up two more ticks, to 0.73—suggesting that basic demand for labor continues to grow.

More upbeat IP, retail sales, capex, and housing starts. Key among the strong-side indicators of the week was January **industrial production**, which rose 2.0% and brought with it output-plan projections of a further 1.7% gain (revised up from +1.2%) in February, and 1.7% in March. Complete realization of those plans would finally restore production to the pre-tsunami level. There was also a very favorable reading for January **retail sales**, showing them to have been up 2 percentage points more year-to-year than expected (+1.9%, versus -0.1%). In another strong demand-side indication, MOF corporate financial data showed **capital spending** to have jumped 11.9% seasonally adjusted in the fourth quarter from the third—the first such rise in five quarters. And January **housing starts** were strong too, with the seasonally adjusted total up 5.0% from December.

Slower deflation in the CPI. Those strong domestic-demand indicators gave some reassurance that economic growth remains reasonably supported, even as export demand continues shaky. January **CPI** data, meanwhile, were mildly encouraging, with the ex-fresh-food measure down 0.1% year on year in January, just as it had been in December, but the decline in the ex-food-and-energy measure slowing to -0.9% year-on-year, from -1.1% year on year.

BOJ focuses on downside risks. Despite the strong numbers, however, outgoing Bank of Japan Policy Board member **Kamezaki** used a speech to business executives, and a press conference, to highlight downside risks to the outlook—notably the European situation routinely cited as a concern by BOJ policymakers, and also the rise in energy prices, which would be amplified in its domestic effects by the decline in the yen. Deputy Governor **Yamaguchi**, meanwhile, gave a press interview where he emphasized the Bank's willingness to "come up with more ingenuities" in the efforts to acquire assets under its recently expanded lending program.

The week ahead: A current account deficit? The week ahead is relatively quiet, but does feature revised fourth-quarter **GDP** results on Thursday—with the strong MOF corporate investment reading virtually certain to produce an upward revision of several tenths to the original -0.6% quarter-on-quarter result. Thursday will also bring the January balance of payments data, where the very poor merchandise trade results for the month are likely to combine with a seasonally low investment income surplus to produce an outright **current-account deficit**—probably a transitory development in the immediate context, but an ominous indication on the longer-term trend

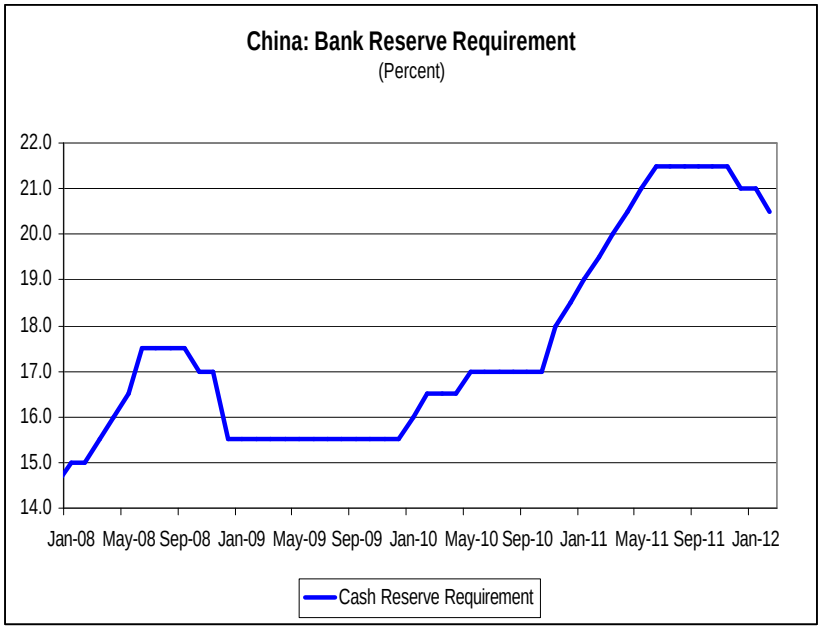
(Pierre Ellis)

Emerging Markets

A Look at China. Plus the Central Bank Watch and Key EM Data

China: Unsurprising PBOC Move.
China's central bank cut commercial banks' reserve requirements by an additional 50 basis points last month. The move is entirely unsurprising and quite uninformative in a period (January-to-February) when data is particularly difficult to interpret, delayed and distorted by the lunar year calendar.

In that context, the bank's decision looks rather inertial, just one more step in the direction of a looser monetary policy—policymakers' response to a clear shift of risks away from inflation and in the direction of slower growth.



The pace of monetary easing will obviously vary depending on the emerging data. One might be (reasonably) tempted to say that thus far it appears slow, on the basis of a relatively small reduction of cash-reserve-requirements.

The cash reserve requirement (CRR) for large banks, which was as low as 15.5% in early 2010, was raised to 21% by June of last year; it was kept on hold at that level until December, then cut by a cumulative 100 basis points to date.

However, the key ingredient of monetary policy, credit growth, actually jumped in December, suggesting a more decisive reversal of the tight-money approach in place for the past two years.

Unfortunately, it will be necessary to wait until March, when all monetary statistics for January and February are available, to assess whether credit's fast growth continued in the early part of 2012.

(Francisco Larios)

Central Bank Watch: In Asia, the central banks of the **Republic of Korea, Malaysia, and Indonesia** will announce rates and are all expected to leave rates untouched. The falling global demand resulting from the EU debt crisis has negatively impacted the export markets for this region and as a result forced a slight downgrade in expected 2012 growth. However, all the countries show promising signals of sustained high levels of domestic demand which allow for positive growth estimates in the current year. Inflation has recently been on a slight downward trend in Asia, all three countries saw a decline in January's CPI figure and the central banks see continued deflationary pressures in the economy as the slowed global demand will ease commodity price pressures.

The **National Bank of Poland** is expected to make no changes to its rates this week as forecasts remained unchanged from last meeting. Poland experienced high growth this past year, largely export driven, and industrial output and sales currently remain high. They expect some decline in growth in 2012 but still see positive growth. Inflation remains a large concern for the central bank as the depreciation of the zloty and increased commodity prices, in particular crude oil, has led to very high inflation of 4.8%, almost double the Central Bank's target. However, no further action under the current condition will be taken as the central banks see upcoming deflationary factors on the horizon. The bank sees continued downward pressure on prices from tightened monetary policy and decreased government spending, along side of falling global demand and expects inflation to fall close to the 2.5% target towards the end of 2012.

Week Ahead: In addition to the four central bank meetings, there are three 2011:Q4 GDP releases. **Brazil** will announce on Tuesday and is expected to have a slight decline from quarter three's 2.1% (Consensus: 1.5% and DE: 1.7%). This release will help guide estimates on when Brazil will hit its cyclical growth-floor. **Czech Republic** will announce Q4 GDP results on Friday and will give more insight to the depth of the European debt crisis's impact on the economy, which largely relies on its export market. Czech is expected to have a decline from last quarter's 1.2% (DE: 0.9%). Also announcing on Friday, **Argentina** is forecasted to have a large decline from the previous quarter's 9.3% (DE: 7.7%)

(Anne Hooper)