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The Global Markets Weekly

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ECB MIA?

Bond market worries resurfaced in Europe with the focus Italy and Spain, the Eurozone's third and fourth largest economies. In Spain, investors are increasingly concerned that deeper austerity measures to help meet future budget targets, after missing them this year, will only damage the economy and perhaps promote social unrest. In Italy, there are misgivings that actions undertaken by the new technocratic government are backsliding regarding long overdue labor market reforms. Would the funds provided by the ECB (which help power the market rally in Q1) be frittered away, leaving the Eurozone with the same problems in 2013 it had in 2011?

With this in mind, another LTRO offering may not help, helping to explain why one ECB member hinted at a resumption of direct bond purchases. But ECB Chairman Draghi, who has the last word on these matters, has showed no zeal to restart bond purchases, since he is probably peeved that the Eurozone finance ministers did not decide to enlarge the bailout fund and unhappy about the lack on lack of fiscal and market reforms undertaken in some of the peripheral nations.

If the ECB really does have a change of heart, will the resumption of bond purchases be a narrow response to make sure monetary policy can work properly or a much wider response indicating the ECB is drawing a line of the sand about how high interest rates can go in Spain and Italy?

- **U.S.**: A modest gain in **retail sales** report may follow a disappointing jobs report, increasing worries that 2012 may be a replay of 2011. The role of the timing of Easter and move in gasoline prices may make overstate the extent of slowdown in spending growth last month, however. **Housing sales** and **starts** should be flat-lining while various **industrial activity reports and surveys** will be mixed. After talking us to death last week, **Fed speakers** should be quiet ahead of the next week's meeting.
- **Eurozone:** A **speech by ECB President Draghi** may provide some clues on whether **the ECB is ready to buy bonds**, although it would surely be more in the interests of the central bank to keep its cards close to its chest at this juncture. And this Monday's **ECB bond buying announcement** will be too soon to record any purchases from last week. Surveys will be the key numbers this week, with a strong **IFO** reading and a more uncertain **ZEW** and **consumer confidence** updates. The final **HICP** will be soft.
- **UK:** The **minutes of the BoE meeting** will suggest that the policy backdrop remains unsettled and that any further action awaits the end of the current asset purchase program in May. The **labor markets updates** may be soft. The claimant count numbers have weakened, suggesting the signs of improvement earlier in the year may be weather related. The steady decline in the **CPI** y/y changes may be interrupted in the March update. The decline should resume, later in Q2, however.
- **Central Bank Roundup:** The **Swedish Riksbank** should maintain a stable policy, with the chance that they may hint of a policy easing before mid-2013 bank's timetable. No change is expected from the **Bank of Canada**. While inflation is above target, GDP growth has been lackluster, helping to keep their hands tied.
- **Japan:** The **BOJ** resisted intense political pressure and kept policy on hold. The upcoming outlook creation looks to some upgrading of the inflation outlook permitting a possible move towards easing at the next meeting. The data this week includes the **trade report** which should show some improvement. The **tertiary activity data** should show solid progress after seesaw results, while the **BOJ loan survey** gives another look on credit flows.
- **Emerging Markets/Regions:** The four central banks we follow meet this week. **Brazil** may ease policy further with growth still a concern. **India** should also cut rates with inflation back to target and growth a worry. Policy is on hold in **Turkey** with inflation still problematic. In the **Philippines**, rats will be unchanged but may ease later this year. We also review the slowdown in **China** and the daunting policy challenges.

Focus: Canada 2012 = US 2006?

Canada currently enjoys strong housing and banking sectors, falling unemployment rates (due in part to the stellar March jobs report), and an economy forecasted to grow 2% this year. Though upon closer inspection, economic conditions in some ways resemble those of the pre-crisis U.S. experience.

Housing market activity elevated, with little sign of moderation. Canadian home prices have increased by more than 40% since 2003, and by even more in Toronto and Vancouver markets. Housing starts have averaged around 200K since 2011—like the 215.6K print this week—or about 50% higher than pre-boom figures. Housing market observers are beginning to doubt if such gains are sustainable, some predicting a 10% to 25% price correction.

Labor market endeavors to compete internationally, yet inflation outpaces wages. As unit labor costs continue to climb, Canadian businesses are struggling to grow exports, which declined 3.9% m/m in February. Moreover since January 2011, consumer prices have increased 2.9%, wages only 2.4%.

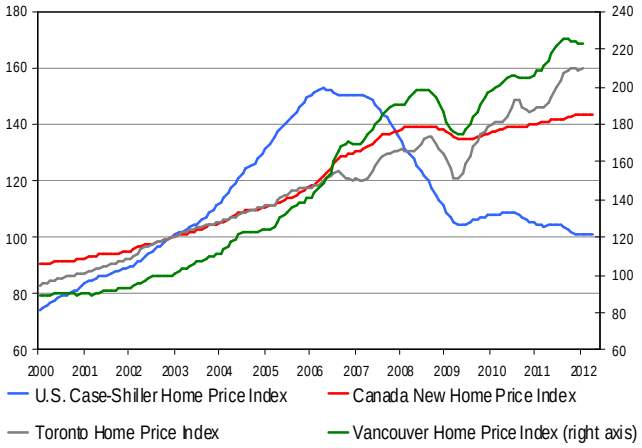
Household debt-to-income ratio rises to historic highs. Rising home prices, declining real incomes, and low interest rates have led Canadian households to dip into home equity to finance discretionary consumption. BoC Governor Mark Carney cites such household leveraging as the primary domestic risk to the economic outlook.

While some are reluctant, policymakers should act to manage home price moderation, and unwind leverage… Although lending standards have already been increased three times since 2008, tighter standards for mortgages and home equity loans are needed. Real wage growth will allow unwinding to occur without crippling domestic consumption. Therefore, the budget should include additional tax subsidies for businesses that invest in R&D. Carney has stated his willingness to use interest rates to cool housing activity if necessary, but it is not the ideal tool. Instead, a gradual tightening of monetary policy beginning in late 2012 or early 2013 along with a transparent communication strategy will be an incentive for households to unwind without shocking spending behavior.

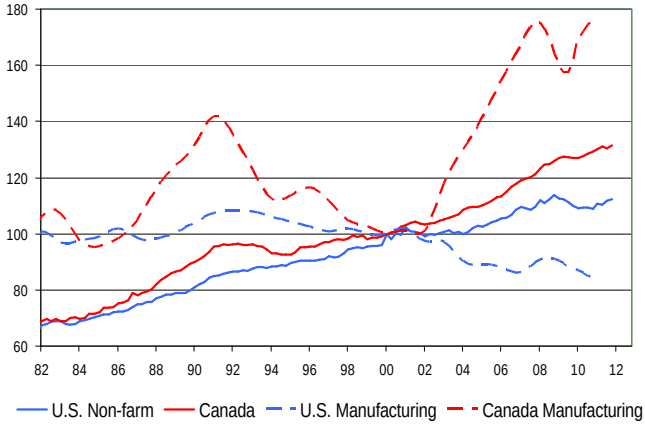
…Or 2012 GDP will be anemic. If policymakers remain on the sidelines, the housing price correction could be sharper and deeper than expected and would quite likely damage domestic consumption. Of the 2% growth forecasted for this year, the BoC attributes 1.4 percentage points to domestic consumption and housing.

Why won't it be like the U.S. in 2006? Canadian banks are healthier than U.S. banks were in terms of Tier 1 capital ratios. Moreover only 5% of mortgages in Canada qualify as sub-prime, whereas one-third of U.S. mortgages in 2006 held that distinction. Finally, the Canadian economy is one-tenth the size of the U.S. so spillover effects into the global economy would be much smaller. That is, a domestic housing market downturn would not on its own exacerbate external headwinds via banking sector and trade links, but would surely serve to weaken Canada's status as a "safer" developed market play. (Melissa Pumphrey)

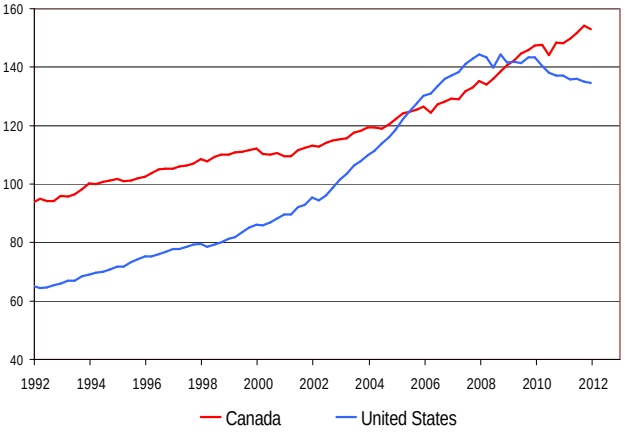
Home Prices Continue To Rise…



…as Canadian Businesses Struggle to Compete Internationally…



...and the Household Debt-to-Income Ratio is Now on Par with the U.S. in 2006.



Sources: Statistics Canada, Bureau of Economic Analysis, Bloomberg, IHS Global Insight, and Decision Economics, Inc.

United States

Squaring the Q1 Circle

Data/event recap: A smaller squeeze on Q1 earnings. Investors have been bracing for some disappointing news on Q1 earnings, since GDP growth had slowed from the 3.0% pace of 2011Q4and hiring had picked up from a 2.6% pace in Q4 to 3.7% in Q1 The latest international trade report, with its surprising drop in imports leading to a much smaller than expected $46.0B trade gap. (DE: $53.3B; consensus $52.0B). This forced analysts to pencil another 0.25 to 0.5 percentage point to their GDP forecasts. For that reason most forecasters think GDP growth might top 2.5%, much higher than the 2.0% of less figures many had worried about. This means that the so-called spending side estimate of GDP is moving close to the estimate from the labor market, which points to a 3.5% gain. The smaller gap between the two estimates implies a smaller squeeze on corporate profits.

Something for everyone in the inflation reports. The **CPI** came in close to expectation with a 0.3% gain (DE: _0.2%; consensus +0.3%), while the **PPI** was unchanged (DE: +0.1%; consensus +0.3%), thanks to an expected drop in energy prices. The CPI inflation trend has fallen from a 3.9% peak in September to 2.6% in March, about where it was one year ago. The drop inflation since September has been fairly broad based in categories outside of food energy and shelter, which is over two thirds of the index. This suggests to the doves at the Fed that inflation could decline further since they expect the recovery to only accelerated to a trend 3 1/4% paces and underlying PPI price and wage pressure appear contained. The hawks are not so sure as core inflation seems to have stabilized at a 2 /2% pace, which is higher than the 2% informal goal. A stronger growth pace, even if it is a so-so 3% would eventually be enough to push up inflation or the very least keep it uncomfortably a bit above target.

Has consumer confidence plateaued? The stability of consumer confidence in the last several months, after the jump in the latter half of 2011, is adding to investors disquiet. Consumer sentiment dipped to 75.7 in early March (DE: 76.0; consensus: 76.5). This remains well short of the 80 plus that characterized an "ok" expansion, meaning that household attitudes are vulnerable to downside shocks.

The week ahead: Disappointing jobs = disappointing retail sales? After a disappointing jobs report, investors will be on edge to see if it is followed by a disappointing retail sales report. At first blush the **retail sales** report (Tu) will be disappointing with a small gain in the headline (DE: +0.1%; consensus: +0.4%) after a barn-burning 1.1% gain in February. But the underlying trend is much stronger for two reasons. First, given the drop in vehicle sales to a still healthy 14.3M units last month, ex auto retail sales will be higher (DE: +0.3%; consensus: +0.5%). Second, gasoline prices dropped eased in March so that retail sales ex autos and gas may very well rise 0.5% in March, not much slower than February 0.65 pace. So the degree of the slowdown in March consumption will be difficult to interpret and less than the headline figures suggest.

Soft tone to manufacturing? The mixed message from the jobs report, with mfg. hiring gains but a fall in the workweek means a modest gain in **IP** (Tu, DE: +0.2%; consensus +0.3%). There is a mixed view on the timelier but less comprehensive regional surveys. Relative to the 20.2 level of the **empire state index** (Mon) in March, DE anticipated a small increase to 22.7 in April while consensus anticipates a small drop to 18. The consensus looks for the **Philly Fed** (Th) to be stable at 12.5 in April, while DE looks for strong gain to 18.

Sideways housing. Little change in expected in the housing indicators this week. **Housing starts** (Tu) will be steady (DE: 705K; consensus 700K). **Existing home sales** (Th) are expected to edge up less than 1% (DE: 4.60M; consensus 4.62M). Extensive shadow inventory is restraining the favorable impacts of the continuing recovery in the labor market and low financing costs.

Moderate inventory accumulation. Inventory accumulation jumped to Q4 to $54.3B from -$2.0B in Q3, adding nearly 2 percentage point ot GDP growth. Inventory investment appears to have moderated in Q1 to less than a $40B pace, in which inventories will drag down Q1 GDP growth by 0.5 percentage point. However, we are basing those estimates using just one months of actual data and the expectation that **business inventories** (Tu) will rise a moderate 0.5% in February (DE and consensus) after a 0.7% gain in January.

Fed speak slows to a trickle prior to April 24/25 FOMC meeting. The week-long backup period prior to the April 24-25 FOMC meeting that the Fed speak will be spare and early. The only scheduled speakers are **Pianalto** (voter 2012) and **Bullard** (voter (2013), both Monday. Both will probably support what the ton of Fed speakers said last week-that their overall view has not swayed by just one disappointing jobs report last March. Hawks continue to suggest that a rate hike could unfold in 2013 while the doves cautioned that the "low for longer" guidance could stretch past 2014. In fact, the doves still advocated further action should the unemployment rate not continue to fall.

M. Cary Leahey

Canada

BoC: "Wait and See" Approach on Interest Rates to Continue

Recap: Business expectations more upbeat. The BoC quarterly **Business Outlook Survey** showed rosier expectations on future sales activity. The survey also showed firms, on average, are planning on increasing investment spending—particularly on productivity enhancements—and increasing employment. Ninety-one percent of firms expect the inflation rate to stay within the 1% to 3% target band over the next two years, while 5% believe inflation will be higher.

Business credit easier to find. The BoC quarterly **Senior Loan Officer Survey** reported easier lending conditions for Canadian non-financial firms. Firms believed these easier conditions were a result of competition between lenders. In general, the findings suggest that the demand for business credit was largely unchanged in 2012 Q1.

Housing won't cool down. Canadian **housing starts** outpaced forecasts, growing 5.0% m/m to 215.6K (Consensus: 200K; Decision Economics: 195K) for March, building upon a February print that was revised upward by 4.2K to 205.3K. Activity increased on multi-unit urban starts (+8.3% m/m) and rural starts (+11.9% m/m) while single-unit urban starts declined by 2.4% m/m. Multi-unit starts increased by 50% m/m in Ontario, while urban starts declined 28% m/m in British Columbia.

This is the fastest pace for housing starts since 2008—about 50% above the average pace of starts from 1994-2001. It provides additional evidence that the housing market will not cool itself down voluntarily.

The trade balance narrowed to +C$0.3B (Consensus: +C$2.1B; DE: +C$0.4B) for February as exports declined and imports were flat. Exports eased 3.9% m/m to C$39.6 billion, on lower energy and automotive exports. Imports were nearly flat for the month, increasing 0.2% to C$39.3B. Increases in energy imports were offset by reductions in automobile imports. In volume terms, exports declined 3.5% m/m and imports fell 0.9% m/m.

Week Ahead: The BoC will announce their **interest rate decision** on Tuesday (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, and Q1 GDP figures have been lackluster. While the labor market has looked stronger of late—adding 82,000 jobs last month—the BoC is still worried about headwinds from Europe, decelerating growth in China, and slow expansion in the U.S. Meanwhile, Canadian policy makers now consider the housing market and rising consumer debt levels as the primary risks to the domestic outlook (See this week's focus on Canada).

Projected Policy Rate Probabilities

Implied by OIS, from 4/12/2012

	17-Apr	5-Jun	17-Jul	4-Dec
+25 bps	0.021	0.023	0.034	0.158
unch	**0.979**	0.977	0.965	0.835
-25 bps	0	0	0	0.002

Projected Policy Rate Probabilities

Implied by OIS, from 3/9/2012

	17-Apr	5-Jun	17-Jul	4-Dec
+25 bps	0	0	0.081	0.305
unch	0.977	0.938	0.863	0.601
-25 bps	0.023	0.061	0.056	0.038

Changes in Policy Rate Probabilities, in Basis Points

	17-Apr	5-Jun	17-Jul	4-Dec
more than +25 bps	0	0	0	-4
+25 bps	2	2	-5	-15
unch	0	4	10	23
-25 bps	-2	-6	-6	-4

Sources: Bloomberg and Decision Economics, Inc.

The BoC has its hands tied: lowering rates will encourage inflation, housing activity, and household leverage, while raising rates may crimp growth. The tables illustrate the probability of policy rate changes at future BoC announcement dates. Markets have moved away from pricing in easing or tightening, toward holding through the end of the year. 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.

The **Survey of Manufacturing** (Tues., 8:30 a.m.) measures the pickup, if any, in manufacturing activity. The BoC **Monetary Policy Report** (Wed., 10:30 a.m.) will provide insight into the BoC mindset. **Consumer prices** (Fri., 7:00 a.m.) will likely decelerate as negative base effects outweigh the upward pressure from commodity prices.

(Melissa Pumphrey)

Eurozone

The Pain in Spain Lies…

Data/event recap: ECB to the rescue? Peripheral bond market worries intensified clearly in the last week, albeit with the focus at this juncture more on Italy and Spain, the third and fourth-largest Eurozone economies, with the latter more in the firing line as Spanish benchmark 10-year government yields hit 6% at one stage, the highest since last November. To some extent markets were reacting further to the admission in March that Spain would not respect budget targets for this year. Investors also worried that any deeper austerity, such as that announced over the Easter weekend by the Spanish government, will both damage the already-ailing economy and possibly even lead to social unrest.

Liquidity not the answer? The rally in Spanish and Italian bonds in the first quarter was powered by the provisions of central bank liquidity, but with markets now of the view that these actions merely papered over the cracks rather than having brought any resolution to the fiscal problems of Spain and Italy. Indeed, these liquidity provisions have merely underlined how intertwined is the long-standing relationship between banks and their respective governments. Against this background, even if the ECB were to offer a further long-term LTRO, the market response is unclear.

Bond purchases to resume? Perhaps as a result, the ECB tried to calm markets (with some degree of success) by hinting at a resumption of bond purchases instead. Board member Coeure used a keynote speech on Wednesday to acknowledge that the new government in Spain has taken very strong deficit measures and has shown an enormous political will which suggests to him that market conditions are not justified.

The question is if this is a sign of the ECB being willing to re-start its bond purchase program, which has lain dormant for many weeks, why the change of heart? Indeed, the question is all the more valid as just last week, ECB President Draghi seemingly showed no zeal to restart bond purchases, implying that the fresh peripheral bond market weakness seen of late was merely markets reacting to a lack of reforms and fiscal consolidation from governments, this being clearly a dig at the likes of Spain, but also perhaps the Eurozone as whole where the ECB is clearly dissatisfied with the recent decision by finance ministers not to enlarge bail-out funds to beyond the € 500 bln intrinsic in the upcoming ESM. Maybe the ECB is now somewhat more confident in the fiscal plans being pursued by Spain, especially the renewed emphasis in the country aimed towards reforms designed to help control of regional budgets.

Perhaps a more likely rationale for the ECB 'change of heart' is a clear and growing realization that rising market interest rates will not only undermine the debt servicing ability of the Spanish government, but also the solvency of its banking system, the latter especially so in light of the huge government bond purchases made by Spanish banks in the wake of the long-term liquidity injections provided by the ECB in the last few months.

Will bond purchases mean that the ECB has drawn a line in the sand? Indeed, the latest available data show that Spanish banks bought close to € 70B of (presumably) Spanish government bonds between December and February with probably a good deal more via the proceeds of the last LTRO. The clear fall in bond prices over the last month implies hard-to-digest balance sheet damage to banks, regardless of the clear income flow emanating from the carry-trade. In this regard, if the ECB does indeed start purchasing Spanish bonds afresh, it would be responding within its remit by ensuring that the transmission mechanism of monetary policy continues to work, the question being whether it is effectively 'drawing a line in the sand' regarding Spanish yield levels?

Output surprisingly rises, albeit boosted by energy. Coming in a higher than expected, Eurozone industrial production rose afresh in February, climbing 0.5% M/M, albeit the upside surprise tempered by downward revisions to past data. More notably, the rise in February was hardly broad-based, instead coming from a surge in energy output that very likely reflected the impact of cold weather through the month. Admittedly, that same poor weather may have been responsible for much of the continued weakness in much of the rest of the data, albeit making the modest M/M recovery in capital goods production all the more creditable.

The week ahead: ECB remains the focus? Exactly if and when the ECB may start to buy bonds afresh is unclear. Perhaps a clearer impression will come from a **speech by ECB President Draghi** on Tuesday, although it would surely be more in the interests of the central bank to keep its cards close to its chest at this juncture. Certainly it is unlikely that the Monday announcement of ECB bond buying will be illuminating as any bond purchases that the ECB may have made will not have cleared in time to be recorded this early.

As for data, the key updates will surely be the survey numbers. The German Ifo figure (Fri) is likely to show continued strength (Consensus: 109.5; DE: 109.8), both absolutely and relative to other alternative-sourced survey numbers, including the likes of the **ZEW numbers**, which are due for an update on Tuesday. Apart from such business survey insights, perhaps as important will be the **consumer confidence** updates,, most notable being the flash figures from the Eurozone due on Thursday. Some further insight into consumer will come from **car registration figures** (Tue). Otherwise, **final HICP** data are due on Tuesday. These should confirm the small drop in the headline rate as well as a soft, if not softer, **core reading** (Consensus and DE: 2.6% Y/Y), the later being something that the ECB can use as evidence against there being any 'second-round effects'.

(Andrew Wroblewski)

United Kingdom

Inflation Drop to Stop?

Data/event recap: (More) mixed data. The last week has brought no more decisive image of the UK economic backdrop. The latest Royal Institute of Chartered Surveyors **house price survey** highlighted a moderately less negative price picture at the national level, although significant divergences at the regional level were still evident. The better tone to the activity data remains more or less intact, although anecdotal evidence from surveyors suggests this has been partly driven by temporary factors, ie the expiration of the first-time buyer stamp duty exemption in March, albeit with some firmer underlying tone evident. Regardless, the survey once again showed more surveyors (realtors) reporting falling rather than rising prices, but with the headline price net balance actually at a 20-month high (of -10). In addition, on a less downbeat note, new buyer enquiries moved further into positive territory.

There were **better consumer signals**, albeit not unambiguously so. According to the British Retail Consortium (BRC), like-for-like **nominal store sales growth** rose afresh rise in March, albeit with the growth rate swinging from -0.3% Y/Y to 1.3%, a three-month high. As the BRC itself stresses, a three-month average better reflects underlying trends given the gamut of distortions that have dogged recent data, these now including the likely boost to sales last month from the unusually warm weather as well as favorable base effects. These continue show that sales have been largely flat of late. It is also worth noting that as the BRC sales data are in nominal terms, they imply that real sales have continued to fall clearly.

Mixed labor market signals? The March REC **labor-market survey** continued to suggest an on-going improvement in the jobs market. Admittedly, the survey showed the permanent placements index slipping back slightly, albeit with the decrease of 0.8 points (to 52.4) being the first in four months and only from a February reading which was the highest since last May.

Exports correct back clearly. Showing a clearly larger shortfall than expected, the total **visible trade** gap widened from an upwardly-revised deficit of £7.88B in January to a deficit of £8.77B in February. The main factor was **a fall back in exports**. The data clearly point to a weaker net trade impact in the last quarter, possibly even a fresh negative contribution, although the February numbers may be anomalous given the impact of poor weather during the month.

Price pressures resurfacing. Coming in above expectations, March **producer output prices** rose by 0.6% in M/M terms, adding to a same-sized increase in the previous month. This further gain was fairly broad based, with another clear push from higher fuel and alcohol & tobacco costs.

The week ahead: Labor market insight. Recent official numbers have also brought mixed messages regarding the labor market. Admittedly, the media may have focused clearly on more subdued rise in the **ILO jobless total**. However, the more up-to-date **claimant count numbers** which (notably) show a fresh pick-up do urge caution in assessing the labor market backdrop, their fresh rise being an indication that perhaps the more lagging ILO data improvement is a result of mild weather seen in late 2011 and January this year rather than any underlying turn for the better. Indeed, a further rise is expected in the update on Wednesday (Consensus: +5 900; DE: +5 000). Regardless, what work is being garnered is still being remunerated softly and still clearly below what is now falling consumer or retail price inflation rates. Indeed, the weaker **average earnings** data seen of late and which may soften further in this update (Consensus: 1.3% Y/Y; DE: 1.2% Y/Y), in tandem with increased signs that what work there is far from full-time (self-employment remains near an all-time high), actually implies even more erosion may be occurring in regard to household spending power.

BoE splits still evident? The **minutes to this month's BoE meeting** (Wed) are likely to show the committee still split over the asset purchase program, with MPC members Miles and Posen still arguing for more. , not too much should be read into this split. More notable, will be the extent to which there was any clearer discussion about upside risks to inflation, with it clear that last time around, there were worries about supply disruptions pushing up oil prices, with the committee noting that if oil prices were to rise to a level significantly higher than currently assumed, then that would tend to slow the recovery, reduce supply growth, and put upward pressure on domestic costs and prices. Even so, this does not mean that there is not a contingent within the MPC more worried about domestic inflation risks than the majority. Regardless, what is likely to be implicit in these minutes is that the majority of the MPC were probably content not to have to make any further policy decision this month, instead deferring any more active consideration about both inflation risk and recovery prospects until the current asset purchase program is completed in May. However, the likely still-confused policy backdrop that is likely to be evident at that juncture implies that if any further stimulus is agreed it will not arrive as soon as May.

Inflation resilience to return? February **consumer price inflation** fell to the lowest since November 2010, dropping another 0.2 percentage point to 3.4% Y/Y, this actually being the fifth consecutive fall. Notably, the core rate (which excludes energy, food, alcohol and tobacco) fell to 2.4% Y/Y, a fresh cycle-low. However, March CPI data (Tue) may interrupt this downward trend, reflecting fresh food and energy price gains (Consensus and DE: 3.4% Y/Y). As a result, it is unlikely that inflation in Q1 will fall to the 3.35% rate forecast by the BoE in its February inflation report. Regardless, fresh falls should resume later this quarter. . (Andrew Wroblewski)

Other Europe

Sweden: All Eyes on the Riksbank

Data/event recap: Disappointing output numbers! Surprising very much to the downside this time around, **industrial production** slumped by 5.2% M/M in February, more than unwinding the unexpectedly large 3.3% bounce seen in the previous month. Moreover, the Y/Y rate of growth moved back into negative territory and clearly so at-7.1%. Moreover, orders also fell appreciably, dropping 5.5% M/M, albeit this and the January drop not fully eroding the 9.5% surge seen in December. To what extent poor weather through the month hit activity is unclear, albeit with official statisticians suggesting that decline is due to a reduction in production that appears to be temporary. Indeed, industrial survey data remains rerlatively more upbeat.

Still soft inflation. Largely in line with expectations, March headline **CPI inflation** fell 0.4 percentage point to 1.5% Y/Y now the lowest in 17 months. Prices rose by 0.3% in M/M terms last month. Notably, the long-standing core measure (CPIX, which excludes mortgage costs and taxes) remained at 1.2% Y/Y, while the underlying measure (CPIF, which the Riksbank puts more emphasis on and which holds mortgage interest expenditure constant) stayed at 1.1%. The various rates are largely in line with projections made by the Riksbank back in February and will have negligible input into monetary policy thinking.

The week ahead: At least domestically, the focus this week surely is the **Riksbank Board meeting** which delivers its verdict on Wednesday. Rates were cut after each of the last two Board meetings (in December and February), the Riksbank justifying the moves as reactions to the weaker global backdrop and its potential impact on a slowing Swedish economy. Clearly, the Swedish economy has softened, but better signs are evident, admittedly most clearly in business survey readings, something acknowledged by recent central bank comment. As a result, it seems likely that the **stable policy** course signaled after the February meeting **will be adhered to at this meeting**, the question being whether the Riksbank start to echo market thinking by suggesting a possible rise in rates may come sooner than the mid-2013 timetable highlighted in its last Monetary Policy Report.

Norway: Soft Data

Data/event recap: Headline inflation rises further. Largely in line with expectations again, March **CPI inflation** fell clearly, easing 0.4 percentage point to 0.8% Y/Y, back towards a December reading that at 0.2% was the lowest since late-2007. On a M/M basis, prices fell 0.1%, largely reflecting a drop in electricity costs. Notably, however, the core rate, CPI-ATE (excluding taxes and electricity) rose 0.2 percentage point to 1.5% Y/Y. The new data still leaves inflation largely in line with Norges Bank projections, at least those provided in new forecasts presented last month.

Meanwhile, **manufacturing production** saw a 0.7% M/M fall in February, unwinding some of the unrevised 1.1% bounce seen in the preceding month. While the numbers still seem consistent with a volatile pattern, a better underlying tone may be emerging, albeit something not so much evident in the slightly softer Y/Y rate of 0.8%.

Regardless, these official production numbers do not echo fully the recent pick-up in manufacturing survey data, with it likely that (as with Sweden) poor weather may have been behind the February output drop. If so, better weather surely points to clear and fresh pick-up in official data in the next batch of official numbers.

The week ahead: There is no data of note in the coming week, but markets may be taking increasing note of the **behavior of the Krone** after central bank remarks in the last week. While clearly the krone was one, if not the main reason, behind the recent Norges Bank easing, the fact that Governor Olsen was only willing to suggest that there is no 'specific' exchange rate target rather than none at all, merely underlines how important the currency has become in shaping policy actions.

Switzerland: Focus on the Franc Continues

Data/event recap: The last week saw no data of great importance. What there was provided no surprise. Indeed, largely as expected, the seasonally adjusted **jobless rate** remained at 3.1% in March, consolidating the rise seen at the end of last year, the first in over two years.

However, there was a clear reminder from the **SNB** of its on-going determination to protect the SFr 1.20 limit against the euro, after briefly breaching seen in the previous week. Admittedly, SNB interim President Jordan said that any doubts about the SNB resolve were misplaced, and repeated that the bank was prepared to buy foreign currency in unlimited quantities. He did admit though that such breaches could happen again.

The week ahead: There is no data of note in the coming week. However, speculation will surely continue that the SNB may adjust its currency ceiling to an even more demanding level.

(Andrew Wroblewski)

Oceania

Australia: RBA Minutes Awaited

Data/event recap: Mixed messages in surveys. The past week saw the arrival of a range of survey updates, including the **Performance of Construction Index** and **NAB business confidence** numbers, which both showed slight improvements, albeit with the former still implying contraction in the sector for a twenty-second-straight month, while the latter rose to the joint second-highest in the cycle. **Westpac consumer confidence** figures, in contrast, fell for a second straight month in April, now a fresh cycle-low.

Labor market conditions stabilizing? Most of the focus in the past week, however, was on the March **labor force survey**, which came in above nearly all expectations and showed a clear increase in employment last month. The survey also revealed that hiring in Q1 this year was the highest since 2010, but the unemployment rate was stable from the previous month as the participation rate picked up. In terms of policy implications, the latest numbers will have relatively little if any as the labor market remains soft despite the upside surprise and with CPI data due to be release later this month like to be the focus for the RBA.

Elsewhere, **home loan approvals** data showed the largest fall in total home loans since March 2011.

The week ahead: RBA the focus. The coming week kicks off with the main event of the week, namely the **minutes** to the **RBA policy meeting** on 3 April (Tue) which, despite the attention it usually garners, will likely provide few new insights into RBA thinking beyond the information in the statement by Governor Stevens following the meeting. The remainder of the week sees survey updates in the form of the February **Westpac Leading Index** and **NAB business confidence** numbers for Q1 arriving on Wednesday and Thursday respectively, before **import prices** data for the first quarter wraps up the week (Fri).

New Zealand: CPI Data the Focus

Data/event recap: Continued expansion in manufacturing. The only economic data release of any note in the past week was the **Performance of Manufacturing Index** for March. The latest results revealed a drop in the headline index, but unable to unwind fully the jump seen in the previous month and still implying solid expansion in the sector.

The week ahead: Consumer price data awaited. The coming week is again relatively quiet in terms of economic data, but with the spotlight likely to be on **CPI** data for the first quarter arriving on Thursday, where markets are generally expecting to see a further moderation in price pressures in Y/Y terms. Elsewhere, the only other notable release of the week is the **Performance of Services Index** for March (Mon).

(Chang Liu)

Japan

BOJ Contemplates Ultra Senstive Outlook Formulation

Data/event recap: Good Orders, BOJ Holds its Ground, for Now. There was relatively little important data in the week, but it all tended modestly to the firm side. Most notable was a 4.8% month-to-month jump in **core machinery orders**, as against expectations of a 1% decline. That result came on the heels of a 3.4% March increase—*putting the level up near the top of the post-crash range, and confirming that business confidence so far remains steady in a very difficult period.* There were also relatively firm results for March **bank lending** (+0.8% year-on-year)) and **money supply** (+3.0% year-on-year), *confirming that the recent mild loosening in bank credit flow continues*.

BOJ holds its ground. The **Bank of Japan,** meanwhile, resisted heavy political pressure and left its policy settings—the target interest rate and the asset-purchase and lending programs—unaltered at the monthly Monetary Policy Board meeting. The immediate economic assessment was modestly firmed up, with new mentions of a rise in housing investment and of "some signs of picking up" in production—and Governor Shirakawa, in his post-meeting press conference, opined that "Our recovery scenario seems to be becoming more realistic, thanks to diminishing tail risks in Europe." Reports from the quarterly branch managers meeting were also modestly more upbeat than in the previous round.

Meanwhile pressure on the BOJ stepped up a notch, with PM **Noda** announcing, in the midst of the Monetary Policy Board sessions, the institution of regular ministerial meetings, with Governor Shirakawa as an observer, on efforts to "escape deflation and improve the economy." After the rate decision, ruling DPJ-Party officials requested a meeting with four rank-and-file members of the MPB, broadening direct political confrontation beyond the often-testifying Governor and his Deputies.

The developments increased the focus on the **BOJ's regular late-April meeting**, at which the semiannual Outlook for Economic Activity and Prices will be released—an occasion opening *some potential for the inflation outlook to be downgraded, and policy to be eased further.*

The week ahead: **Helping Shape BOJ *Outlook?*** The week ahead brings several potentially important inputs to the Bank of Japan's deliberations on the baseline policy forecast it will unveil in the *Outlook* document. There will be no data directly impacting the inflation outlook, but meaningful new information will come on the immediate behavior of the real economy. Foremost among the reports will be the March **merchandise trade** release (Thu), giving a fresh reading on export demand (Decision Economics: -7.0% year-on-year—worsening from -2.7% in February, but improved from -9.2% in January) that will influence thinking about immediate global-economy risks. A partial updating on the state of the first-quarter production-side economy will come in February **tertiary-industry activity** results, due Friday (Decision Economics: +0.4%)—which would be most encouraging if they show some solid progress in the wake of the whipsaw December (+1.8%) and January (-1.7%) results that have started the quarter off on a weak footing. Lastly, a cross check on the health of financing flows will come in the quarterly **BOJ Senior Loan Officer Opinion Survey** (Fri), where evidence on borrowing uptake will give some indication on business-activity growth.

(Pierre Ellis)

Emerging Markets

Update on China; Central Bank Watch – Brazil, Turkey, Philippines, and India

China: Soft Landing or Recession-bound? China's GDP grew 8.1% year-on-year during the first quarter. The number was unsurprising (Consensus: 8.4%; Decision Economics: 8.0%), and it was consistent with the picture of soft-landing depicted by the series throughout the past year: GDP inching ever closer to the government's target (7.5%), slowing in a very gradual and non-menacing way without any apparent sharp downward movement in the rate of growth that could signal a recession (or recession dynamics) ahead.

Fixed capital formation numbers fit within the same description. It is hard to call a 20% pace of annual expansion recessionary, or even weak. Yet it must be noted that the pace documented for March (20.1% year-on-year) is marginally lower than the pace registered at the end of last year, and clearly weaker than has been the norm in the past 10 years, when investment expanded at rates in the 25%-to-30% range.

Still, the negatives in the most recent Chinese data cannot escape notice. Real GDP has clearly slowed, to a large extent because the export sector reflects less buoyant global conditions, particularly in Europe. But unlike previous episodes of external hardship, domestic demand is not offsetting the slowing-exports drag on GDP.

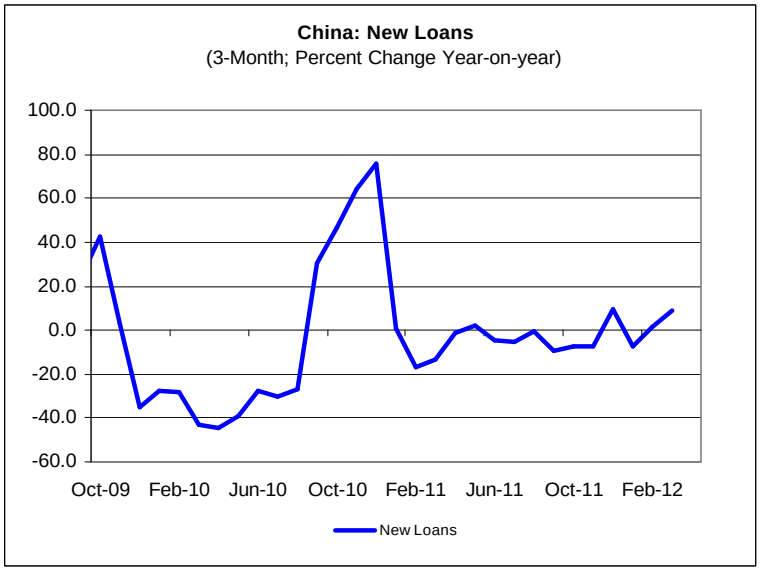
Policymakers have made it clear that they do not want a repeat of 2009-10, when massive credit easing facilitated a public sector investment push to lift the economy. Instead, they have insisted that the focus now is on re-balancing the economy towards consumption.

In other words, expect a more gradual and less pronounced recovery as consumption picks up a larger share of GDP, while investment advances without extraordinary policy incentives and exports follow the global cycle, wherever that takes them.

But in the context of a weakening economy, with the large investment component moving more slowly and exports not only slowing but uncertain, is it reasonable to expect that consumption will accelerate and lift the economy?

As of the first quarter of this year, the data on retail sales, for example, suggest that household consumption is resilient, but not vigorous, certainly not to a degree sufficient to induce an acceleration of growth from present rates and possibly vulnerable to continuing softness in the export sector and in investment spending.

Thus, some modification of the policy stance seems to be needed to both support the soft-landing that the real GDP series depicts and to actually advance the re-balancing of demand. The policy change would have to include a measure of easing on the monetary side, which recent data suggest has just begun to occur, but only at a very modest pace.



To be sure, China's new loans (a key policy indicator, since the system is overwhelmingly in the hands of the state) jumped 48.7% year-on-year in March. But the figure is not evidence of a strong rebound in credit, i.e., a sharp move to ease policy. First quarter monthly numbers tend to be very volatile on account of the lunar year calendar. A more informative approach is to look at the total amount of new lending over the past three months. On that basis, there was an increase of new loans, but far more modest: 8.9% year-on-year, slightly less than the pace of the preceding quarter (9.6% year-on-year). More generally, the minimal speed of growth of monetary aggregates--M1, for example expanded only 4.4% year-on-year during the same period-- is noteworthy and worrisome, as it provides evidence of how tight the current policy stance is and/or how much the economy has cooled, perhaps to a degree not fully or accurately reflected in the latest GDP statistics.

The bottom line is that the combination of moderately growing exports and still-strong (although slowing) investment spending, plus the effects of the moderate monetary easing underway, remain likely to prevent a sharp reduction of real GDP growth from current pace: the 7.5% rate that policymakers have presented as their target for this year seems to reflect quite well the probable conditions that are foreseeable, on average, during the next few quarters. Such scenario can be reasonably called a "soft-landing" in the context of Chinese growth. There are, however, some lingering concerns. One is whether--and if so, to what extent--the published pace of real GDP growth might be an overstatement of the strength of the economy. Another is the question of a transition to a consumption-driven model. That transition will of necessity occur, but it is unclear at what cost to real GDP growth, as it is a possibility that in the absence of

booming exports and of a public-sector-investment policy push, there could be further and significant slowing of domestic investment that could introduce adverse dynamics into the Chinese economy. (Francisco Larios)

Central Bank Watch: Brazil's central bank will ease policy further, likely cutting the Selic rate by 50 bps this week. Inflation has remained on a downward trend and dropped to 5.2% y/y in March, a 60 bps decline from February's release. Economic growth still remains a large concern as fourth quarter GDP slumped to 1.4% y/y. The bank hopes continued easing of monetary policy will boost growth. Brazil has continuously dropped rates sharply since September 2011, totaling 275 basis points. Brazil is nearing the end of the easing cycle as inflation adjusted interest rates approach historic lows.

Turkey's central bank will keep benchmark rates on hold this week. Turkey's last headline rate move was in August 2011 when it eased rates 50 bps, while the bank's multi-tool approach saw a 100 bps drop in the ceiling rate last month. Inflation while still very high at 10.4% in both February's and March's release, has finally steadied and the bank sees while food and other prices are holding steady, high oil prices remain a large concern for inflation. Turkey's current account deficit also has begun to narrow, but slightly, while loan growth, another concern, remains robust.

The **Philippines** is currently experiencing very low inflation as the CPI dropped 140 basis points from January to February and came in at 2.4% y/y in March. Growth remained fairly steady in 2011 and came in at 3.7% in Q4 compared to 4.1% at the start of 2011. The central bank is expected **to leave rates unchanged this month**. The last rate move was in January when the bank eased by 25 bps. In coming months, the bank may continue to ease rates if inflation remains at the current low levels, especially if the softer global demand becomes too large a drag on economic growth.

India's inflation remains on a downward trend and has dropped 300 bps since reaching 10% y/y in September. However, growth remains a concern for the central bank as GDP growth dropped to 6.1% in the fourth quarter and historically incredibly low for India. As inflation now has dropped back down, the central bank, which has not moved rates since tightening policy in September, can ease policy and help boost growth. The bank will most likely **cut rates 25 bps this meeting and may need further easing** as softer global growth takes more of an effect on the economy.

(Francisco Larios/Anne Hooper/Andrew Husby)