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The DE Global Markets Weekly

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Tables and Charts

Camp David + Chicago = New Eurozone Policy Mix?

European policymakers mentioned the unmentionable, beginning to speak openly about Greece leaving the Eurozone. Even though they softened that view, as even Germany indicated that it wanted Greece to remain in the euro club, the cat is now out of the bag and equity markets continue to sag and bond yields fell.

Policymakers are meeting in two sessions in the U.S. and investors can only hope that a new policy mix is forthcoming that deals with the host of problems besetting the Eurozone: blending longer-term fiscal discipline, economic reforms and stronger fiscal oversight with efforts to support near-term growth (such as a pan-European financed investment bank, stretched-out deficit targets, and stronger domestic demand growth in the richer nations like Germany), a better capitalized banking sector with a pan-European regulator, a more accommodative central bank, and an acceptance that certain countries like Germany adopt an inflation rate higher than the 2% Eurozone target.

This is a tall order in the best of times and these are not the best of times with additional worries about the U.S. expansion fading like it did in 2011, the looming U.S. fiscal drag, and China slowing "too much."

For these reasons, the investment implications are as follows:

- While DE remains strategically bullish on the U.S., DE has cut its equity exposure from 70% to 65%. DE is much more negative tactically.
- DE has adopted a greater allocation to fixed income, up from 25% to 30%.
- The DE cash strategic allocation is still 5%, with a much higher weight tactically until the dust settles.
- On alternatives, DE's view on commodities/gold is now neutral, down from positive.
- On a country basis, strategic allocations continue to move away from Europe and toward U.S., Japan, and EM, but not to Russia and India but to Brazil and China.
- **U.S.**: The moderate dataflow on **housing sales** and **durable goods** is unlikely to change the consensus view that real GDP growth will be stuck around 2 1/4% not much different from Q1 pace. Only a **few Fed speakers** opine to possibly rattle the markets.
- **Eurozone:** Investors will be following the PMI flash figures as well as the going on in the U.S. The PMI readings have pointed to softer Q1 GDP readings than actually unfolded, however. Still, the April readings pointed to further downside risks for Q2. More solid readings may come from the **Ifo** and **INSEE** updates. The **Q1 German GDP** will be scanned for the how much of the surprising strength came from exports.
- **UK:** In DE's view, the **upcoming MPC minutes** may imply that a much slower pace of growth is consistent with its inflation target, so the bar determining whether any further stimulus is needed may be higher than previously thought. While the CPI update will show a sharp drop, this may not feed into further strength in household spending, whose **retail sales** may reverse the March surge. The revised **Q1 GDP data** will confirm the economy is in recession, something the surveys do not support.
- **Japan:** The **BOJ** is expected to make no move policy moves this week, even though they are under political pressure to expand the balance sheet further. A small narrowing of the trade gap is expected for April, with both increases in exports and imports. A flat rather than rising **core CPI** result is expected for April. But will be evidence of stabilization and will not sound deflationary alarm bills yet.
- **Emerging Markets/Regions:** Few indicators of importance as the focus is on the question of whether a soft-landing is at hand in emerging markets. Data on prices in **Singapore, Hong Kong and Malaysia** should show continuation of well-behaved inflation. There are no central bank meetings of countries that we follow.

Focus: Eurozone, Sliding on Greece?

- Fresh Greece election may provide stable government willing to continue (some) austerity as voters still very much support continued membership in the Eurozone.
- But overt talk of Greek exit has created precedent that financial markets will not forget. For Greece, there are already signs that deposits are leaving Greek banks as a result of the political and economic uncertainty, with the clear risks that a run could develop. For the Eurozone, the question is whether the about-turn in which Eurozone political leaders and the ECB have now acknowledged that Greece could leave to Eurozone has opened a Pandora's box by setting a possible precedent for one country leaving the euro.

Surprising few, Greece faces a fresh, and obviously critical, general election after a week of tortured negotiations failed to provide the basis for anything like a stable government; a caretaker administration will take the reins until the fresh poll on June 17.

An Election or a Referendum? Without a stable government that would adhere to the current bail-out conditions, the EU (and notably the IMF) have made it clear that further bail-out funds will not be forthcoming, raising the stakes that Greece may be forced into a default in the next few months alongside a likely exit from the euro. Very clearly, the disparate results of the May 6 Greek election (see Table 1) were the result of voters showing their resistance to austerity measures that are part of these EU/IMF bail-out conditions. A different result is possible on June 17, however. Notably, while mustering only some 32% of the vote, the two pro-austerity parties (New Democracy and PASOK) actually came close to winning a parliamentary majority: they may very well win more seats next time around, as they are already turning the election into an effective referendum on Greece staying in the euro, aware that opinion polls suggest that the Greek electorate still very much backs continued membership in the Eurozone.

Is the EU Bluffing? The opposition parties will not make this straightforward. Indeed, the leading anti-bailout party, Syriza, will be all the keener to persuade the confused electorate that should Greece default, this would not lead to the country being forced out of the Eurozone for the simple reason that the undeniable damaging repercussions for Greece from such an exit would be almost as bad through the rest of the Eurozone. In other words, Syriza will continue to say that *the EU is bluffing in its threat to cut off bail-out funds*. The party may very well be right!

Watching the Polls. Regardless, the election campaign over the coming month will be crucial to financial market developments, lapping up opinion results in particular. NB: The ultimate result may actually depend upon voter turnout as the 10 percentage point rise (to 65%) in the poll this month may have favored the emergence of the fringe parties. At this juncture, and corroborated by opinion polls, *it is likely that the two pro-bailout parties may win a working parliamentary majority on June 17*, despite Syriza probably earning the most votes as the anti-austerity feeling concentrates behind the party. If so, that may only provide a brief respite for the Eurozone.

Table 1
Greece: Election Backdrop

Party	**Seats Won May 6**	**% of Total Votes (May 6)**	**Latest Opinion Poll**
New Democracy	108	18.9	19.5
Syriza	52	16.8	22.0
PASOK	41	13.2	14.0
Independent Greeks	33	10.6	7.5
Golden Dawn	21	7.0	5.5
Democratic Left	19	6.1	5.5

Firstly, even the pro-bail-out parties will demand some renegotiation of the bail-out terms, meaning that even if they win the election, acrimony between Greece and its bail-out partners may continue. Admittedly, there are hints that the EU may be more amenable to tempering the austerity measures being demanded of Greece, but the IMF may be less willing, realizing that the last few weeks of political focus on Greece have underlined that the country is insolvent.

With this in mind, the hope would be that a stable government may buy the country more time, allowing it perhaps another year in which Greece could move to a primary budget balance and then default (NB: a 1% of GDP primary deficit is expected this year), this option also providing time for the rest of the Eurozone to make greater preparations for such a move, including ensuring that the Greek banking system survives and that banks through the rest of the Eurozone are recapitalized, possibly via the use of current bail-out funds.

The Cat is Out of the Bag! However, the risk is that whatever time is bought may be minimal. For Greece, there are already signs that deposits are leaving Greek banks as a result of the political and economic uncertainty, with the clear risks that a run could develop. For the Eurozone, the question is whether the about-turn in which Eurozone political leaders and the ECB have now acknowledged that Greece could leave to Eurozone has opened a Pandora's box, accentuating the contagion risks for the rest of the Eurozone by setting a possible precedent for one country leaving the euro (NB: rising peripheral yields stand to make liquidity concerns turn into clear solvency issues for these countries). Indeed, the question is whether this is just another example of the economic mismanagement seen from Eurozone policy makers in reacting to the sovereign debt crisis. There are several opportunities in the month before the next Greek election for policy makers to make some amends, or (alternatively) make things worse – see Table 2.

Table 2:
Eurozone Key Dates Ahead

Date	**Event**
18-19 May	G8 Summit in the USA
23 May	EU (Informal) Heads of State Summit
31 May	Irish Referendum on Fiscal Compact
6 June	ECB Meeting (Updated Economic Projections Due)
10 June	French Parliamentary Elections (Round 1)
17 June	Greek General Election French Parliamentary Elections (Round 2)

United States

The Fed Rediscovers Preemptive Policy?

Fedwatch: A return to preemptive policy? When the April FOMC minutes hit the tape last week, investors noted that "several" FOMC members laid out a case for further easing, more than the "couple" at the March meeting. But investors may not have seized upon the fact that those leaning to the possibility introduced the *possibility that the economy did not have to falter to require an easing of credit.* Rather, the FOMC members had to think "the downside risks to the forecast became great enough." This is *return to preemptive monetary policy*, something prior Fed chairman Greenspan espoused in the late 1990s and Bernanke signed on to when he became a governor during the Greenspan era in 2004. This is potentially very important and may explain why bond yields may continue to rally even if the economic indicators stabilize, assuming investors think the Fed could undertake QE3 this summer if the Eurozone risks intensify or in late 2012 should the coming fiscal cliff threaten much slower growth or even a recession. Of course, it may take a while for the "several" (3 to 5 members) concerned about the downside risks too morph into "many" (6-8 members) and eventually into "most" (11 or members) needed to actually change policy.

The week ahead: The moderate dataflow on **housing sales** and **durable goods** is unlikely to change the consensus view that GDP growth will be stuck around 2 1/4% not much different from Q1 pace. Only a **few Fed speakers** opine to possibly rattle the markets.

Durable goods: modest rebound (Thursday). A modest rebound is expected in **orders** (DE and consensus +0.5%) in April after the stunning 4.2% drop in March. While orders have lost momentum in Q1, **shipments** were very strong in March, virtually guaranteeing a strong pickup in equipment spending in Q2 GDP.

Existing home sales: split outlook (Tuesday). Existing home sales continue to grind higher, with 12 month trailing sale rising 3.8% in the past year. **Months supply** has fallen from 8 months in April 2011 to 5.8 months last month, although **shadow inventories** probably add another 5 months of supply, a major drag on the industry. Opinion is split about April, with DE expecting a 5.5% drop while the consensus expects a 3.1% gain.

New home sales bouncing along bottom (Wednesday). New home sales are going nowhere fast, with the 12 month trailing average having risen only 3.6% in the past year. However, **inventories** are the lowest in 40 years so that any pickup in housing will translate into strong gains in new construction. A moderate pickup is expected in April (DE: +6.7%; consensus: +2.1%).

Lower gas prices support consumer confidence. Neither DE nor the consensus sees much reason for the final May estimate for **consumer sentiment** to change from its 77.8 initial reading.

A full gamut of Fed speakers: "Median voter" **Lockhart** (voter 2012, Mon/Tu) speaks on monetary policy in Asia. Hawk **Kocherlakota** (voter 2014, Wed) speaks in Rapid City, while dove **Dudley** (always votes) gets two chances to speak in one day. Hawk **Plosser** (voter 2014, Fri) finishes the week with a talk to Bundesbankers in Germany

DE view: Will 2012 be a replay of 2011? With the benefit of 20/20 hindsight, the strength in hiring in early 2012 was due partly to very favorable weather and some payback for hiring being so weak in last 2011. Still, **hiring** in the past 12 months is 150K per month, better than the 125K pace of the 12 months prior to April 2011. In addition, a key measure of the health of the labor market the level of **weekly claims** has fallen to less than 375K compared to a recession-like 435K of April 2011. The **ISM** reading of 54.8 currently is higher than the 53.5 reading in May. (Remember the 7 point drop in the ISM in May 2011 really shocked investors). Finally **consumer sentiment** of 77.8 is higher than 74.3 reading in May 2011. So the 2012 enjoys stronger fundamentals that at this time in 2011.

DE Forecast:

- **Real GDP:** A moderate, increasingly entrenched expansion is forecasted, with real GDP growth in a range of 2 ½% to 3% in 2012 and a bit less in 2013. Ongoing debt deleveraging and increasing fiscal consolidation efforts restrain growth.
- **Inflation:** Headline CPI inflation fades from 3.1% in 2011 to 2 ½ in both 2012 and 2013. Oil prices remain high, while core inflation continues to grind higher as the expansion continues.
- **Central bank view:** While the odds of QE3 have gone up in reaction to some disappointing economic news, DE's view of a more entrenched expansion accompanied by relatively steady if not high core inflation means little chance of QE3 this year, unless the Fed thinks the downside risks have increased enough to damage the expansion. It is an open question if an intermediate policy action such as selling Treasuries to purchase mortgages is undertaken. DE expects the Fed to finally hike rates in the later half of 2013. The Fed's pledge of "low for long" (until the end of 2014) does not mean unchanged. Intermediate-term and longer-term Treasuries will front-run the eventual Fed move. But a safe-haven bid will restrain the backup in interest rates.

(M. Cary Leahey)

Canada

Price stability and financial stability: friends or foes?

The week ahead: Retail sales (Wed., 8:30 a.m.) should show some strength after a weak February. Early indicators show a 2.8% m/m gain in auto sales as well as strength in clothing and footwear sales. The forecast is for a moderate increase in both the headline (Consensus: +0.3%; Decision Economics: +0.4%) and ex-auto (Consensus: +0.5%; Decision Economics: +0.3%) indices.

Particularly strong retail sales would suggest robust household spending and hint at a better real GDP result for March compared to the disappointing -0.2% m/m in February. The Bank of Canada (BoC) is forecasting for half of real GDP growth to come from domestic consumption this year, or 1.3 of 2.4%.

Focus: Are the goals of price stability and financial stability harmonious or incompatible?

Fresh price data for March released Friday showed CPI at the 2% annual target, while core CPI was at 2.1%. Canada has had a single monetary policy mandate of price stability since 1991, accomplished through flexible inflation targeting (FIT). Price stability goals have been criticized as too narrow—ignoring other economic or financial developments for the sake of inflation targets. The BoC is a strong proponent of FIT, and a May 17 research paper outlines strengths while debunking myths about its incompatibility with financial and output stability.

Table 3: Selected Monetary Policy Frameworks

Country	Date Adopted	Current Inflation Target	Policy Horizon	Target Set By
Canada	February 1991	2% midpoint in 1% to 3% range	6 to 8 quarters	Government and Central Bank
U.K.	October 1992	2% plus/minus 1%	Medium term	Government
Eurozone	January 1999	Below, but close to 2%	Medium term	Central Bank
U.S.	January 2012	2%	Medium term	Central Bank
Japan	February 2012	1%	Medium to long term	Central Bank

Source: The Bank of Canada

Canada has been relatively successful at anchoring inflation expectations and credits FIT with its ability to conduct successful unconventional monetary policy in these “zero lower bound” times. In the wake of the financial crisis in 2009-10, the BoC gave significant forward guidance on the path of interest rates, committing to hold them low conditional on the inflation outlook. In the two years following the crisis, IT countries had better growth performance than the non-IT counterparts. Recently, both the U.S. and Japan adopted an inflation target.

But price stability does not mean financial stability. The BoC believes that stable growth but unregulated banks make a risky combination: if perceived risks decline and the capacity to leverage increases, then financial imbalances can build. Therefore the BoC concluded that “if financial imbalances pose an economy-wide threat or are being encouraged by a low-interest rate environment,” then monetary policy may be appropriate to support financial stability. Rising household debt levels have the potential to damage the economy particularly in the event of a housing market correction; however the BoC continues to view this as a secondary concern relative to global headwinds.

DE Forecast & Investment Themes:

- **Real GDP:** The BoC is forecasting 2.4% growth for the year, the DE forecast is for an inline 2% to 2.5% gain. Risks tilt towards the downside on tensions in Europe. The U.S. recovery seems to be on softer footing of late.
- **Inflation:** Prices are likely to remain close to the +2% y/y target for the year.
- **Central Bank:** Policy rate on hold at least until late 2012—even with the recent improvements in the labor market. The BoC likely will not tighten before the Eurozone stabilizes and U.S. economic data shows more consistent firmness. (Melissa Pumphrey)

Eurozone

Speaking the Unspeakable

The week ahead: With the naming of the fresh election day of June 17 for Greece, markets have an obvious target date after which a clearer picture regarding the country's potential future in the euro will emerge (see Focus). However, the question may very well be whether the rest of the Eurozone will hold together in the interim given the contagion dangers that are clearly intensifying. These contagion risks seemingly have resulted from Eurozone *politicians and central bankers breaking the clear taboo by suggesting that Greece could exit the euro,* thereby highlighting that the Eurozone is not the irreversible currency zone it has hitherto been advertised as being.

DE view: All of which makes the various **meetings of Eurozone politicians** in coming days even more important. Of course, the genie of a country exiting the euro cannot be put back into the bottle but the hope is surely that more solidarity is shown to the vulnerable members of the Eurozone.

Certainly, there has been an important change in Eurozone political rhetoric of late, with the election of President Hollande in France helping promote the more pro-growth agenda that not only Greece is demanding, but is even the priority of the German SPD opposition party (who Chancellor Merkel may have to work with more closely in coming months). This does not mean that fiscal discipline can be readily jettisoned. Instead, *politicians have to come up with a more appropriate policy mix of growth-promotion and deficit-control* than they have hitherto.

Possibly, and still very much sympathetic with the so-called Fiscal Compact that Chancellor Merkel favors, would be a shift away from an emphasis on headline budget deficit targets to structural deficits, the latter much more consistent with the present needs of a Eurozone, much of which is in recession and with growing downside risks to activity ahead. Of course, other matters need to be addressed, ranging from the size and use of bailout funds and greater fiscal union – NB it is notable that German Finance Minister this week urged the creation of a political union in Europe. A more active role for the ECB may also be discussed, something that Germany may be less resistant to given the recent and seemingly very important acknowledgment by the Bundesbank that it may have to tolerate a higher German inflation rate than the Eurozone average. In this regard, it will be interesting to see of any change in tone emerges in a **speech by ECB President Draghi** (Thu).

EU Summit. It will be interesting to see if any of these issues emerge from the **G8 Summit** this week-end, a meeting in which leaders will be able to familiarize themselves with President Hollande as well as getting a clear reminder from the U.S. of how critical things have become. Otherwise, the focus will shift to the (informal) **meeting of EU Heads of State** on Wednesday. Already, the agenda for this meeting is set to discuss an increase in infrastructure spending, including giving the European Investment Bank greater scope to support unstable economies.

Key survey numbers. Of course, markets will have their eyes peeled on the economic data due this week, especially the always closely-watched **PMI flash figures** on Thursday. Perhaps the surprise resilience shown in various Q1 Eurozone GDP readings should be seen as a clear indication of the shortcomings of such survey data, the latter having pointed to a much worse backdrop than explicit in those GDP updates. This is a reminder that these surveys are far from accurate in calibrating the pick-ups and softening in cycles, instead being more designed in establishing turning points.

The question being the extent to which the much clearer weakness in business surveys seen in April are evidence of a further turning point to the downside. No further erosion is seen in either the **manufacturing** (Consensus: 46.5; DE: 46.0) or **services PMI** (Consensus: 47.5; DE: 47.0) this time around, with relatively more solidity still likely to be portrayed in the **Ifo** (Consensus: 109.5; DE: 109.4) and **INSEE** survey updates also due on Thursday.

There are also **consumer confidence** updates, most notably the Eurozone flash number on Tuesday. More than passing notice will be paid to the details of the **Q1 German GDP** numbers due on Thursday, in particular the extent of pick-up in exports that caused the surprise strength in the overall number.

DE Forecast & Investment Themes:

- **Real GDP:** Recession continues, with the uncertainty being both the geographical breadth and length of the contraction. DE sees GDP falling on average by a below-consensus 0.5% in 2012, with clearly less chance of activity stabilizing in the second half of the year and with only an anemic sub-1% rise seen in 2013. Downside risks very much building, obviously if Greece defaults in a disorderly manner.
- **Inflation:** Headline HICP inflation has been above the 2% target since the end of 2010, largely due to food and particularly energy prices. DE sees the rate falling from 2.5% this year to 1.8% in 2013.
- **Central bank view:** Main ECB rate likely to be cut by a further 50 bps in coming months, with more unconventional central bank measure also in the offing, including resurrection of bond purchases. German resistance to current policy measures diminishing.

(Andrew Wroblewski)

United Kingdom

BoE Splits Clarified

The week ahead: Large drop in inflation beckons, but sales to fall sharply. One did not have to read much between the lines of the BoE Inflation Report to see that the MPC is more uncertain about the inflation outlook, now envisaging inflation staying higher than previously thought, at least over the next year or so. All of which makes the **CPI** numbers this Tuesday all the more interesting. Notably these April numbers may show a sizeable drop in the Y/Y rate, actually to an 18-month low (Consensus and DE: 3.1% Y/Y).

However, a weaker prices backdrop is not going to feed into any further strength in household spending. Instead, the very opposite is on the cards, with the April **retail sales** numbers (Wed) likely to show a clear reversal of the surge seen in March, partly a result of very unfriendly weather conditions during the month (Consensus: -0.2% Q/Q; DE: -0.4%). Even so, such data would only serve to highlight that the better labor market numbers seen of late are not resulting in a better spending trend, partly because of damaged confidence but as much due to the fact that the rise in jobs is not bringing about any growth in incomes.

The week also has **public borrowing** numbers (Tue) likely to be consistent with on-going budget deficit reduction, albeit with a large surplus emerging from the transfer of Royal Mail pension assets to the state sector.

GDP still contracting. Revised **Q1 GDP** data (Thu) is very likely to confirm that the economy has been in recession, with the risk from the way that monthly data has moved of late being that the 0.2% Q/Q drop is actually made slightly more sizeable (Consensus and DE: -0.2% Q/Q). Regardless, the data will still be at odds with findings of various business surveys and labor market data which instead point to an economy probably growing slowly, but not being recession-bound. An update for one such survey arrives next Thursday in the form of the **CBI manufacturing survey** numbers on Wednesday.

MPC insights on offer. A preference to believe survey data rather than GDP numbers is likely to be reiterated in the **MPC minutes** (Wed) and series of **BoE speeches** which will also put more gloss on thinking implicit and explicit in the Inflation Report. That Report provided some rationale for the MPC decision this month not to extend its asset purchases. Admittedly, the Report seemingly leaves open scope for a further increase in asset purchases at some juncture, especially as the projections cannot fully incorporate the risks stemming from what could be disorderly developments in the Eurozone, at least over and beyond those already evident in funding costs and confidence.

DE view: However, while the Report still sees a continued undershoot of the 2% target, and at least as sizeable as that seen in the February Report, it is notable that the BoE still considers that the risks to the inflation projections at the forecast horizon to be balanced rather than skewed to the downside as was the case through 2011.

The latter is the case despite a weaker growth outlook, albeit with the BoE more open that this partly stems from what it describes as an unusually slow rise in the supply side of the economy, and with the balance of risks suggesting a return to trend growth by the end of the forecast horizon. As for risks, the Report is again quite candid that the greatest of these continue to come from the Eurozone. However, and very notably, the MPC still sees no meaningful way to quantify all such risks and therefore many are excluded from its updated fan charts, as was the case in the last three Reports. In other words, *the downside risks may be greater than embodied in the fan chart projections*.

Regardless, the clear worries and uncertainty regarding the supply side of the economy implies that some MPC members may not yet be convinced enough of the disinflationary pressures implicit in this outlook. Indeed, there may have been clear divisions in the vote this month not to extend asset purchases, with minutes on Wednesday, possibly revealing whether some members are wary that asset purchases may actually have become counter-productive. Nevertheless, while BoE worries about the supply side still pale into insignificance compared to the (impossible to calculate) risks it perceives still emanate from the Eurozone, they have important policy implications. Basically, *the BoE may be thinking that a much lower pace of growth is consistent with its inflation target, implying that the bar determining whether any further stimulus is agreed may be higher than previously thought*.

DE Forecast & Investment Themes:

- **Real GDP:** Official data suggest UK back in recession, but data has been hit by an array of distortions. Even so, underlying GDP growth is close to flat, with zero outcomes likely for 2012. Hope is for something a little above 1% in 2013.
- **Inflation:** Headline CPI proving stubborn, partly a result of energy prices, but should still fall from around 2½% this year to under the BoE target of 2% in 2013.
- **Central bank view:** Bank Rate on hold until 2014. As for unconventional policy, further enlargement of asset purchases possible later in the year, the latter helping to cap gilt yields.

(Andrew Wroblewski)

Other Europe

Sweden: Riksbank Powerless?

The week ahead: Labor market update. A key indicator on the health of the domestic economy arrives this Wednesday via the April **labor market report** (Wed). Notably, the last set of data saw the (unadjusted) unemployment rate fall further in March relative to its year-before counterpart. Moreover, at 7.7%, it was 0.4 percentage point below that of the same month in 2011, reversing the trend towards less clear-cut Y/Y drops seen in previous readings. In addition, seasonally adjusted numbers suggested that that underlying joblessness may be falling afresh (down 0.2 percentage point to 7.3%) and therefore pointing to a better labor market backdrop than that assumed by the Riksbank in updated forecasts released only last month. More improvement may be on the cards. However, for Swedish markets such data is becoming a side issue compared to data and developments in the Eurozone. This has been acknowledged by the Riksbank which noted that what happens abroad is the decisive factor in its current discussions. A further such acknowledgement may come in a **speech from Riksbank Governor Ingves** (Tue).

DE Forecast & Investment Themes:

- **Real GDP:** Economy recovering, but with feeble GDP growth of 0.5% likely on average this year, giving way to nearer 2% in 2013.
- **Inflation:** Headline and underlying CPI rate likely to remain below 2% target until late 2013.
- **Central bank view:** Riksbank likely to be on hold until mid-2013, especially if Krona rallies afresh.

Norway: Economic Resilience Continues

The week ahead: Q1 GDP continues solidly? The Norwegian economy has very clearly avoided any move into recession. Admittedly, GDP growth did slow for the mainland economy in Q4 last year, but at 0.6% Q/Q, it was a far from weak reading. If anything, the array of monthly data seen in the last few months suggest that a fresh pick-up may be in store in the **Q1 GDP numbers** due this Tuesday, possibly to a greater extent than implicit in Norges bank projections made in March. Production data have been mixed to better, but consumer spending figures during Q1 have been far stronger, echoing credit and employment developments. The **Norges Bank** is clearly relieved that Norwegian economic resilience is not enough to make its currency a safe haven, with the krona having continued to soften of late even against the beleaguered euro. The krona issue may be something touched by **Governor Olsen** in an address on Friday.

DE Forecast & Investment Themes:

- **Real GDP:** Mainland GDP growth of just under 2% seen both this year and next.
- **Inflation:** Headline and underlying CPI rate likely to approach 2% target by late 2013.
- **Central bank view:** Norges Bank on hold until at least next year.

Switzerland: Perkier Consumer

The week ahead: Some relevant data due. After the dearth of the last week, several important economic updates fall due in coming days, albeit all falling well short of the focus on the Franc that is obviously dominating SNB thinking. Even so, **consumer confidence** data (Mon) is likely to show the benefit of the still very low jobless rate. Meanwhile, **money growth** numbers (also Mon) should provide a further reminder of one reason why Switzerland has avoided the recession seen in other parts of Europe, namely a still well-functioning banking sector.

DE Forecast & Investment Themes:

- **Real GDP:** Recession, or even contraction, so far avoided, but with GDP growth still likely to undershoot 1% this year. Pick-up to 1.5% seen in 2013.
- **Inflation:** CPI inflation to remain negative into early 2013, still averaging little more than 1% next year.
- **Central bank view:** Rates on hold for at least another year: threat of fresh intervention to hold down Swiss Franc still being made by SNB.

(Andrew Wroblewski)

Oceania

Australia: Surveys the Focus

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New Zealand: Trade Data Expected

The week ahead: Little of note. After a week of key but mixed data, the coming week is again quiet in terms of economic updates. In fact, the only notable releases in the next week are the **RBNZ Quarterly Survey of Inflation Expectations** for Q2, where inflation expectations are generally expected to remain well contained, and April **visible trade** data which, after a clear narrowing in the trade surplus in March, is projected to widen afresh.

DE Forecast & Investment Themes:

- **Real GDP:** A moderate expansion is expected in 2012 following a disappointing result in Q4, with GDP growth of 1.5% to 2% envisaged, and with growth seen picking up in the latter part of this year as the recovery in the earthquake-hit areas gains momentum.
- **Inflation:** Headline CPI is expected to ease further from the 1.6% seen in Q1 through the early part of the year, before picking up towards the end of 2012 as the recovery speeds up, albeit remaining below 2% for most of 2012 and 2013.
- **Central bank view:** The RBNZ will likely be on hold (at 2.50%) until at least 2013 as the New Zealand dollar remains elevated and after Q4 GDP came in below the Bank’s forecasts.

(Chang Liu)

Japan

Will BOJ Stand Firm?

The week ahead: Will the Bank of Japan hold steady? First-quarter GDP growth exceeded strong expectations, but gave no concrete indication of momentum—leaving very open the critical issue of whether the upswing in activity will stick, and be extended at a more sustainable pace. The Bank of Japan Monetary Policy Board this week will contemplate the unbalanced composition of the GDP increase—strong consumer and government spending, but weak private investment, both residential and nonresidential, and exports growing just enough to offset the rise in imports—and decide whether the picture presented, and the evolution likely in coming quarters, hangs closely enough with the baseline policy forecast to argue against immediate further policy action.

DE view: Solid first-quarter GDP growth was heavily driven by unsustainable strength in consumer spending, but broader-based earthquake/tsunami reconstruction activity will help sustain the overall economic expansion in a more subdued—but still above-trend—range, probably through year end. A firming global economic picture will gradually kick in to support longer-term growth in the 1% to 1.5% annual zone over coming years.

Bank of Japan makes no new move (Wed). The Monetary Policy Board, though under continuing political pressure to expand its balance sheet yet further, will make no change at this meeting. Concerns about yen strength, and about potential worse-than-expected weakness in China and other Asian trading partners, are serious, but not weighing heavily enough to outweigh resistance to the appearance of direct manipulation by politicians. Meanwhile, market conditions are forcing scheduled JGB purchases beyond the under-two-year maturity sector, into the two-to-three year zone which the Board opened up to operations at the last meeting—an effective easing in itself. The potential for foreign-exchange market intervention is strongly hinted at by the government, and the BOJ would certainly accommodate such action—but argue for opportunistic tactics, in the face of current strong safe-haven inflows.

Trade Deficit shrinks year-on-year (Wed). April merchandise trade data will feature large year-on-year increases in both imports and exports, as comparisons are made to very depressed 2011 levels—likely producing a slight narrowing in the deficit from the total back then.

CPI disinflates (Fri). April consumer price index results will show a slowdown from March in the year-on-year increases for both the overall figure (+0.2% versus +0.5%) and the ex-fresh-foods core (unchanged versus +0.2%). Alarms will not sound immediately on the appearance of a flat, rather than rising, core result, but evidence of stabilization in coming months will be imperative to sustain the plausibility of the BOJ's forecast of gradually firming inflation.

DE Forecasts:

Real GDP: Near-term growth is boosted by the long-delayed arrival of earthquake recovery and rebuilding funds, pushing the economy modestly above trend growth for a period—beyond which an improving global market will lift exports and sustain overall growth at trend of about 1.3%.

Inflation: Inflation-targeting will force the BOJ, under its current management, or under newly installed management next year, to take steps to prevent any extended deviation from a path towards 1% core inflation over the next three years.

Central Bank: BOJ policy rates will not be noticeably increased before 2014, if by then. Longer-term rates will likely remain in the current range for 6-9 months, beyond which a fading in global safe haven demand, and increasing market conviction that the BOJ is serious about pushing up inflation, will lift the ten-year JGP rate slowly towards 2.0%, and ultimately beyond.

(Pierre Ellis)

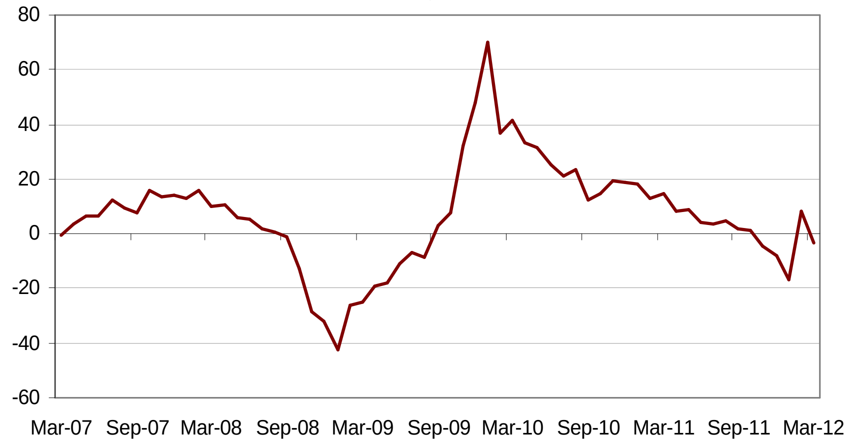
Emerging Markets

Well Behaved Inflation Updates

Week ahead: Few indicators of importance as the focus is on the question of whether a soft-landing is at hand in emerging markets. Data on prices in **Singapore, Hong Kong and Malaysia** should show continuation of well-behaved inflation.

The only potentially important growth information is the industrial production release in **Taiwan** (Singapore's series, also on the schedule for this week, is too volatile and too narrowly driven). The country's export-dependent economy is already flirting with recession; its exports have fallen during the past few months, and consumer spending has decelerated to low-single-digits rates. Industrial production declined 4.7% year-on-year during the first quarter, partly, to be sure, on account of a very strong comparison base.

Chart 1: **Taiwan: Industrial Production**
Percent Change: Year over Year



As that statistical effect wanes, current weakness notwithstanding there is likely to have been some marginal improvement in April (+0.3% year-on-year); a stronger result could be symptomatic of an upturn in China, a deeper negative a worrisome sign.

Central Bank Watch

No scheduled policy meetings this week.

DE Forecast & Investment Themes:

Soft landing materializing. A soft-landing scenario is gradually—but not yet fully—materializing across emerging markets. Economic activity has cooled, particularly on the manufacturing side, but conditions cannot be called recessionary even stretching the meaning of the term.

Stronger consumer, easier credit and prices… With few exceptions, consumer and investment spending remains well-supported, unemployment rates low; borrowing costs have diminished modestly as a disinflationary trend has taken hold.

…with possible inflation pickup on commodities. Central Banks remain watchful of a potential commodity-price induced re-acceleration of inflation, but for now caution leads them into either gradual easing or prolonged pauses following significant rate reductions. Across EM, rate increases appear likely to occur only as a result of exceptional domestic circumstances in the months to come.

Exports vulnerable to Eurozone crisis. EM Exports remain exposed, and are already growing slowly; there is some financial risk arising out of the lingering European debt crisis, making markets sensitive to euro-zone development s the foreseeable future.

Growth likely to accelerate if Eurozone avoids "Lehman moment." From current perspective, it is reasonable to expect that if a full-fledged financial crisis is avoided in Europe, EM would likely experience a moderate rebound later this year and into 2013, on the basis if easier money, stronger US demand, plus a bottoming and modest re-acceleration of growth in China.

As China goes, other EMs follow. Emerging markets will probably replicate, more or less closely depending of size, economic structure and location, China's near-term growth pattern: further deceleration through the middle months of 2012, followed, later in the year and into next, by a moderate up-turn. Should the Asian giant slip into recession (or a recession-like stage, say 5%-to-6% growth), the pace of economic activity would be hurt significantly not just in manufacturing-oriented Asia but in commodity driven EMS there and elsewhere, as commodity markets would be heavily impacted. There is a reasonable expectation that such Chinese-recession scenario will be avoided, but Chinese policymakers' failure to shift towards easing creates some concern. (Francisco Larios)

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