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The Global Markets Weekly

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Stalling Along a Wall of Worry

The financial market response to the belated Greek bailout deal has been understandably tepid. In fact, the S&P index has stalled out, unable regain its 1400 plus high of 2008. After an impressive 20% plus run since early October, a pause in the rally (or even a correction) is understandable.

First, the Greek bailout may only buy some time and the short-term outlook in Greece is far from secure (not to mention how precarious the longer-term position is). The required austerity will be hard to swallow, particularly after the April elections in Greece may create an even less receptive environment. Participation in the voluntary private debt swap will not be known until mid-March, a number of Eurozone parliaments have to give their blessing to the deal and the level of IMF participation is still uncertain.

Second, while recent data suggest that the Eurozone recession is getting no worse, it is not clear how much the improvement in bank liquidity from the first December LTRO is alleviating the ongoing credit crunch. The credit crunch risks contributing to a deeper recession, particularly among those peripheral nations forced to adopt fiscal austerity. The private sector response to second LTRO coming this week will important in helping the ECB decide if further easing measures are needed.

Third, the upward march in oil prices recently threatens growth prospects in oil consuming nations. This adds to investors' skepticism, many of whom remain unconvinced that the US has achieved a self-reinforcing recovery, despite the big improvement in employment growth recently. Even if the closely watched PMI data in the US surprise on the upside this week, investors will still remain cautious, remembering how an even brighter outlook at this time in 2011 unraveled under the pressure of higher oil prices and other "special factors." Still, DE thinks that fundamentals remain positive and the shift in attitudes by central banks (especially the ECB) to provide liquidity and promote growth will provide a positive backdrop for the risk on trade.

- **U.S.:** Bernanke's two **Humphrey Hawkins testimonies** this week may be less important than usual (famous last words). His cautious assessment of the outlook and his implicit bias to ease has already been delivered recently in both his January press conference and February testimony to Congress. While both were given before the impressive February jobs report hit the tape, Bernanke is unlikely to upgrade his economic assessment greatly after "just one good number."
- **Eurozone:** The market reaction to this week's **second LTRO** could be key in figuring out if the ECB decides further easing measures are needed. The **money and lending** data may show if the December LTRO is softening the ongoing credit crunch.
- **UK:** The array of survey data led by the **mfg. PMI** may point to a further firming in output. While this may support the notion that the Q4 GDP weakness was exaggerated or temporary, the improvement in output seems to be based on working through order backlogs, a process which cannot last.
- **Japan:** The slew of important economic updates this week will be watched for signs of upward momentum, particularly **industrial production**, where planning forecasts are upbeat, and the job-offers-to-applicants ratio from the **labor market survey**, which has shown encouraging improvements in demand. The week also brings January **consumer price index** results (Fri), showing how far the BOJ is from its 1% goal.
- **Emerging Markets/Regions: Hungary** will leave rates unchanged. The outcome of the IMF/EU negotiations for aid remain unclear, the economy is stagnant, and inflation remains high. The central bank of **Philippines** is expected to cut rates for the second month in a row. Inflation is within target and the bank worries about external headwinds. Our view that an end to the economic slowdown in **Brazil** means the central bank will continue to cut interest rates and provide narrowly-targeted fiscal measures. In **Turkey** we argue that central bank is moving in the direction of an easier monetary policy stance.

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Decision Economics, Inc.
555 5th Avenue, 15th Floor
New York, New York 10017
Telephone: 212-884-9440
Facsimile: 212-884-9451

Decision Economics, Inc.
288 Bishopsgate, 3rd Floor
London EC2M 4QB
Telephone:011-44-20-7814-6706
Facsimile: 011-44-20-7959-3344

Decision Economics, Inc.
One Boston Place, 16th Floor
Boston, Massachusetts 02108
Telephone: 617-994-0500
Facsimile: 617-994-0501/0502

Decision Economics, Inc.
2 North La Salle, Suite 1200
Chicago, IL 60602
Telephone: 312-476-7504

Focus: US Dueling Tax Plans From Obama and Romney

Obama and Romney offer tax plans. President Obama and leading Republican presidential contender Romney offered dueling tax plans this week. Both Obama and Romney would cut the 35% corporate tax rate to 28% and 25% respectively. On the personal tax side, Romney would offer a 20% reduction in marginal tax rates, with the top rate falling to the Reagan era 28% from the current 35%. Taxes on investment income would be 15%. Obama would leave the lower income marginal rates at current policy but reinstate the 36% and 39.6% top end tax rates. Taxes on capital gains would be at 20% and dividend income would be taxed as ordinary income.

Obama offers corporate tax reform with lower rates but still some preferences. The Obama corporate tax reform proposals were introduced this week. In addition to the cut in the corporate rate to 28%, the corporate tax rate for mfg. would be capped at 25% and could be even lower in certain cases. An (unspecified) minimum tax on overseas earnings would be imposed. To be revenue neutral, the plan would broaden the corporate tax base by closing various loopholes, such as for oil and gas industries, insurance, and carried interest.

Romney wants a lower and "cleaner" corporate tax rate. The Romney corporate tax cut to 25% was introduced last September. He would transition to a territorial tax system (to help repatriate foreign profits) and also make the R&E tax credit permanent. Presumably to pay for all this he would broaden the tax base by looking at the same loophole candidates Obama has singled out. However, the Romney would not be picking winners and losers since manufacturing would not be treated preferentially as in the Obama plan.

Campaign pressures forced Romney to offer a 20% cut in personal tax rates. The 20% cut in personal tax rates by Romney is new, as his September plan would have maintained current marginal income tax rates. Romney felt the need to cut rates to approach those of his Republican challengers.

….**With big (unspecified) loophole closings to pay for lower rates.** Romney's plan would involve a lot of base broadening of both the personal and corporate tax bases. He has suggested "significant" limits on tax preferences of upper incomes and hinted that "middle income" Americans will continue to enjoy tax benefits that favor home ownership, charitable giving, health care and savings." Unfortunately, those four items are the largest tax breaks in the system.

....Coming mainly from the rich. Moreover, Romney's goal is to cap Federal outlays at 20% of Moreover, Romney's goal is to cap Federal outlays at 20% of GDP (from the current 24% in fiscal 2011) which would require taxes to be 20% of GDP to balance the budget. The implied tax take is much higher than the historical average of 18%. With 20% lower marginal tax rates, the implied loss of revenues approaches $300B or nearly 2% of GDP as well. As a result, the implied broadening of the tax base might approach 4% of GDP if a goal of a 20% tax share of GDP with 20% lower marginal tax rates is to be attained.

Summary

Both Obama and Romney offer significant reductions in corporate tax rates paid for with a broader tax base Romney's plan has the advantage of no longer picking winners and losers because Obama's plan would favor manufacturing and clean energy.

Obama's proposal to establish a minimum tax on foreign earnings makes sense but Romney's transition to a territorial tax system might achieve the same goal.

Finally on personal tax rates, who is not for lower tax rates in the Romney plan, with a return to the Reagan era 28% top marginal tax rate? But the lost revenue must come from somewhere, meaning that loophole closings will fall very heavily on upper incomes in the Romney plan. Just remember the top marginal tax rate fell to 28% in 1986 but didn't stay that low for long.

While Congress may debate corporate tax reform this year, expect little action until after the November election.

(M. Cary Leahey)

United States

Could Bernanke Be Less Important than the First February Data?

Data/event recap: Dueling tax packages from Obama and Romney. Both plans offer significant reductions in corporate tax rates paid for with a broader tax base Romney's plan has the advantage of no longer picking winners and losers because Obama's plan would favor manufacturing and clean energy. Romney's plan offers a 20% cut in personal tax rates compared to higher tax rates on upper income proposed by Obama. The Romney plan would return the top tax rate to the Reagan era 28%. But the lost revenue must come from somewhere, meaning that loophole closings will fall very heavily on upper incomes in the Romney plan. Just remember the top marginal tax rate fell to 28% in 1986 but didn't stay that low for long. (For more details see the focus article in this issue).

Promising indicators continue. The highlight of the week was the implied strength in **weekly claims**, which declined to 351K, the lowest pace since March 2008. The more useful 4-week moving average has fallen much faster over the February payroll snapshot week than in January, pointed to another solid (or maybe even stronger) jobs report to be reported in March. Both **existing and new home sales** in January remain at least 5% above their 12-month averages and the months supply are close to historical averages. With absolute inventories low, particularly for new homes, a pickup in sales would translate into much stronger production, depending on much the shadow inventory of current and prospective foreclosures could absorb the increased demand. Finally, **consumer sentiment** reversed its surprising decline in the preliminary February estimate to move to 75.3 in the final tally, slightly above January.

The week ahead: Could Bernanke be less important than the data? Bernanke's two Humphrey Hawkins testimonies this week may be less important than usual. His cautious assessment of the outlook and his implicit bias to ease has already been delivered recently in both his January press conference and February testimony to Congress. While both were given before the impressive February jobs report hit the tape, Bernanke is unlikely to upgrade his economic assessment greatly after "just one good number." Even if the closely watched PMI data surprise on the upside, investors (and Bernanke) will still remain skeptical, remembering how an even brighter outlook at this time in 2011 unraveled under the pressure of higher oil prices and other "special factors."

Steady mfg surveys. The **Chicago PMI** (Wed) is expected to retrace much of its January losses (DE: 62.3; consensus 61.3). The Chicago index remains extremely elevated relative to the national **ISM** (Th) of 54.1, suggesting some upside risk to the forecast of steady to slightly lower (DE: 52.9; consensus 54.5).

Aircraft orders drop cuts durable goods. Surging aircraft orders are expected to contribute to a sizeable drop in **durable goods orders** (DE: -1.5%; consensus -1.2%), after a 3.0% gain in December. Equipment spending growth held up last quarter, slowing only to a 5.2% annualized pace. The weakness in capex came from the 7.2% plunge in spending on residential structures after two quarters of massive strength.

Consumer confidence steady. The recent rise in oil prices may begin to affect consumer confidence, despite the improvement in labor market conditions (DE: 61.1; consensus 63.0). While this would still be 20 points above the recent low in October, it would trail the sentiment index by over 10 points and would be still well short of the 80 or higher readings that usually signify "good" economic conditions.

Home prices still worrisome. After showing signs of stabilizing at mid-year, **Case Shiller home prices** resumed their decline and with the pace of declines accelerating. The three-month annualized change has topped 8% compared to a y/y decline of "only" 3.7%. The forecasted decline of 3.6% y/y (DE and consensus) means that SA prices fell 0.4% in December, a bit slower pace than the previous three months. However, the **FHFA index** (a more comprehensive national index which puts lesser weight on high value properties) is upbeat, suggesting that home prices have actually risen slightly since mid-2011.

Modest GDP revisions: Both DE and the consensus expect that he initial print of 2.8% **Q4 GDP** will be unchanged in the first revision. A modestly narrower trade gap may be offset by downward revsions elsewhere. A small revision to 3.0% might lift an eyebrow as the first digit on growth would be moved up a notch.

Decline in pending home sales. **Pending home sales** remain about 8% higher than the pace of existing home sales, suggesting any downside surprises would be a return to a more "normal" relationship than a fresh source of weakness (DE: -1.5%; consensus +1.0%).

Fedspeak: Humphrey Hawkins the focus. As discussed above, **Bernanke** can be expected to repeat his cautious assessment and implicit easing bias in his two **Humphrey Hawkins** presentations Tuesday and Friday. We will also hear from a variety of other Fed speakers including four moderates unlikely to dissent: **Duke** (always votes, Mon) on housing and outlook speeches from **Pianalto** (voter 2012, Mon), **Raskin** (always votes, Th) and **Lockhart** (voter 2012, Th). The hawks can put in their oar on Tuesday with **Fisher** (voter 2014) and **Plosser** (2014). The **Beige Book** (Wed) will provide some regional and banking color and perhaps a more upbeat assessment of current conditions.

(M. Cary Leahey)

Canada

BoC's Carney Defends Flexible Inflation-Targeting, and Bernanke

Recap: BoC Governor Mark **Carney** spoke at Friday's US Monetary Policy Forum in New York, where he supported Fed Chairman Bernanke's use of unconventional tools of monetary policy, calling the Federal Reserve "appropriately and effectively radical."

The speech addressed the challenging headwinds that a non-crisis economy like Canada faces during a global recession including spillovers in both confidence and financial markets as well as weak global demand. Moreover, easy credit conditions fostered by extreme "low-for-long" periods can lead to increased risk taking and debt accumulation.

Carney went on to discuss his reasoning for BoC targeting inflation, something that the Fed stated it would also begin to do at the January FOMC meeting. While noting that alternatives to flexible inflation targeting (IT) exist, such as price-level targeting and nominal GDP targeting, Carney argued that flexible IT can handle a wide set of economic challenges.

He favors flexible IT because it is "binding," meaning the BoC is always working towards achieving 2% in the medium-run, yet "flexible," because it allows for inflation to deviate from the target in the short term in order to deal with shocks. However, communication on the projected path of inflation from the central bank to the market is crucial for flexible IT to work effectively.

While Carney notes that monetary policy can address issues like mounting Canadian household debt, he prefers first using more targeted methods like regulation of lending practices and increased capital requirements for banks (not surprising, as he chairs the Financial Stability Board, involved in Basel III formulation), and only supports using monetary policy when shocks have clear economy-wide implications. The

December **retail sales** fell by 0.2% (Consensus: -0.2%, Decision Economics: unch) to $38.8 billion, following a November figure which was revised upward from +0.3% to +0.4%, on below par holiday spending on automobiles and auto parts. Ex-auto retail sales remained unchanged, as increases in supermarket and food and beverage sales were offset by disappointing sales at department and electronics stores. This month's drop follows four months of increases; however, in volume terms retail sales were unchanged. Motor vehicles fell by 1.0% m/m to $8.69 billion, gasoline sales dropped by 1.1% m/m, and auto parts sales declined by 9.4%.

Wholesale sales increased by a more-than-anticipated 0.9% m/m (Consensus and Decision Economics: +0.6%) to $49.6 billion and brought the y/y gain to 7.4%. This marked the seventh increase in the last eight months and was largely based upon increases in the motor vehicle (+3.4% m/m) and food, beverage, and tobacco (+1.9% m/m) sectors. Inventories also increased by more than anticipated, +1.4% on increases in agricultural supplies (+9.9% m/m). Weak retail sales suggest decelerating domestic demand. With rising unemployment and historically high household debt-to-income ratio, consumer spending may be limited in its contribution to GDP growth in 2012. Wholesale sales received a boost from motor vehicles as kinks in the supply chain from Japan appear to have finally been repaired.

Week Ahead: The **current account balance** for Q4 arrives Thursday (8:30 a.m.) with the deficit likely narrowing on the C$3.3B trade surplus reported in Q4. Thursday also brings the industrial and raw materials price indices (8:30 a.m.). The expectation is for **industrial product prices** to remain unchanged, while the continuing recovery in commodities should increase the **raw material price index**. Friday brings the long-awaited arrival of December, and therefore Q4, **GDP**. After an artificially strong Q3, we are expecting GDP growth to return to a more moderate pace (DE: 1.7%).

(Melissa Pumphrey/Andrew Husby)

Eurozone

How Long Will Greek Sticking Plasters Stick

Data/event recap: Two major themes affected market thinking in the last week. The **Greek bail-out** was belatedly agreed but has done little but buy some time, while there were some signs of **clearer peripheral weakness**

It's all Greek. Most of the details of the deal are in line with what had been flagged in advance of the meeting of **Eurozone finance ministers**, the main news being the deeper haircut of circa-53.5% that private bondholders will be asked to take, this having been the issue which dragged out negotiations long into Tuesday morning. Otherwise, the bail-out comes with much tougher strings attached, including a permanent team of EU monitors in Greece and a so-called escrow account designed to ensure that Greece will prioritize debt servicing. Regardless, the time that has been bought has been crafted to be purely benefit the Eurozone, by making a Greek default in coming months (and its uncertain but potentially serious reverberations) far less likely. This may be the case, but a near-term default is still also far from impossible. Indeed, while most will argue (with some justification) that this bail-out leaves the medium to long-term position of Greece as remaining very precarious, the shorter-term outlook is far from secured. Apart from the uncertain manner in which more austerity may be digested in what is already a chaotic Greece, there are risks related to when (and if) parliaments elsewhere in the Eurozone give their blessing to the deal, the extent to which the IMF will provide funds to the bail-out, as well as to the extent to which bondholders respond to the PSI being thrust upon them: the level of voluntary participation will not be known until mid-March.

Peripheral weakness clearer? The **February flash PMIs** suggest that Eurozone economic activity is at best stabilizing into the current quarter but may have contracted afresh. Indeed, the aggregate PMI reading softened for the first time in four months, to levels marginally consistent with contracting activity for the whole Eurozone and to a more clear-cut fall outside of France and Germany. Even so, the survey carried mixed messages as the manufacturing PMI rose for the third month in succession, while the services PMI only slid from a five-month high.

These PMI flashes may disappoint, but perhaps not too much should be read into them, especially given fleeting signs of a recovery in **consumer sentiment**. For a start, the mixed messages in the data are too imprecise to suggest anything at this juncture but that the activity in the Eurozone overall has largely stabilized, particularly given the cold weather in much of the region. In addition, the fall back in the German readings came in contrast to even more upbeat signals for the economy from the alternatively sourced **Ifo survey**. As a result, it is still more likely than not that the Eurozone may be able to avoid any deeper contraction in the current quarter than the 0.3% Q/Q drop posted in Q4. Therefore, these survey data continue to suggest that while downside economic risks are still very much evident they are yet to materialize any further. Regardless, these and other survey data continue to suggest that the rest of the Eurozone is still contracting clearly, making these countries all the more vulnerable to the **on-going rally in oil prices.**

The week ahead: ECB liquidity injection the focus. Surely the focus this week is set to be the **second 3-year LTRO** (Wed). The first one in December saw over 500 banks borrow €489B, tempering the ongoing credit crunch and shoring up market sentiment via its ability to help banks refinance debt. Initial expectations of doubling of size in February have diminished toward December's size in reaction to reassuring signs that banks have been able to issue their own debt. The added liquidity has allowed banks not only to play a carry trade in buying high-yield sovereign debt but also purchase paper from fellow banks. The market reaction may be key in determining when or if the ECB decides further measures may be needed to support the Eurozone, including fresh conventional rate cuts. A relatively quick update may be forthcoming in this regard with **bond auctions** in France on Thursday helping to assess the digestion.

EU Summit to revisit Greece. The **EU Summit** on Thursday and the **meeting of Eurozone leaders** (Fri) are supposed to tackle the issue of the Eurozone firewall, but German resistance is unlikely to mean that any more resources are produced to the likes of the ESM at this juncture. Instead, the Summit may revisit the Greek situation, assessing the extent to which the country has started to address the array of demands made of it, all of which could highlight on-going skepticism from some of the EU regarding the chances of the Greek bail-out actually working.

Monetary update important. Perhaps the most important will be the ECB monetary update (Mon), especially given the clear weakness seen of late in regard to both **broad money growth and private sector lending**, the latter reflecting the on-going problems facing the Eurozone banking system.. The increasingly soft private sector lending data provide corroboration of the weaker consumer spending signals increasingly seen across the Eurozone. The question is the degree the softer lending backdrop points to a spreading credit crunch and the extent these January numbers show any initial benefit from the ECB liquidity actions seen of late including the December **3-year LTRO.** Regardless, another weak **M3 figure** is expected (Consensus: 1.8% Y/Y; DE: 1.4%). The week sees further key **business and consumer survey** updates, the most wide-ranging being the **EU Commission numbers** (Tu), alongside actual consumer updates from **German retail sales** (Fri, consensus: 0.5% M/M; DE: 0.8%) and **French household consumption** (Wed, consensus: 0.3% M/M; DE: 0.6%), they having been weak of late possibly at least partly on account of still high **CPI inflation** Thursday). The inflation update (Th, consensus: 2.6% Y/Y; DE: 2.7%) should show no further decline given the fresh rise in oil prices. (Andrew Wroblewski)

United Kingdom

BoE Splits Evident

Data/event recap: Surprising most, the **minutes from the 8-9 February BoE MPC meeting** showed the committee split over the decision to enlarge the asset purchase program a further £ 50 bln. However, rather than dissenting against any enlargement as some had suggested, the two votes against the decision (from MPC members Miles and Posen) were actually in favor of a larger increase (ie of £ 75 bln).

However, not too much should be read into this split. Indeed, comments from Posen in the last few days underscore that his thinking is largely consistent with the BoE outlook as evident in the Inflation Report this month. Admittedly, there was some discussion suggesting more of a split in the committee than the vote would suggest, with some members envisaging somewhat larger upside risks to inflation than in the Inflation Report, something that provided a case for no additional stimulus being provided at all. Most likely, these members may have been concerned about productivity and profit margins, issues that have clearly bothered the MPC for some time. In addition, the slightly better economic signs may have had some impact on overall thinking.

More likely than not therefore the decision to enlarge the asset purchase program by a further £ 50 bln was something of a compromise, with an added rationale being that any larger increase may have surprised markets to a degree that may have led to the impression that the MPC was more concerned about the economy than it actually was.

With this in mind, these minutes offer nothing of major note to the policy outlook, certainly not providing any suggestion of a greater predilection to further stimulus than the even-handed outlook offered by the Inflation Report. Instead, the MPC reaction function remains very much data-driven. Against this backdrop, further stimulus may be on the cards but it may not arrive as soon as the current asset purchase program is completed in May.

Better fiscal messages continue. Public sector finance data, excluding financial interventions, for last month (the tenth month of the FY) saw the budget backdrop improve somewhat further, still a reflection of control on spending and relatively strong receipt growth. **Public Sector Net Borrowing** showed a surplus of £ 7.75 bln in January, up from the surplus of £ 5.20 bln in the same month of 2011. The latest result was better than expectations, especially as borrowing in previous months revised lower so that current cumulative FY borrowing was lower than anticipated at £ 93.5 bln, some £ 15.7 bln below that of the previous year. The data offer more mixed messages. The good news is that, despite the under-performance of the real economy this year, borrowing is actually falling and on track to meet if not undershoot targets. Alongside the impact of spending cuts, this is seemingly a result of the strength in the nominal economy as opposed to the flatness in real activity, the former helping bolster revenues.

Modest drop in GDP. Matching the initial estimate, real **GDP** decreased by 0.2% in Q/Q terms in Q4 2011, it also being a contrast to the (downwardly revised) 0.5% rise seen in the previous quarter. Even so, the Y/Y rate picked up 0.3 percentage point to a downwardly revised 0.7%, albeit still up from the seven-quarter low seen in Q3.

The main news in this report is the first break-down to the expenditure side of the economy where the most high-profile development will be seen as the 0.5% Q/Q rise in **consumer spending**, the first such rise in six quarters, albeit one partly flagged by the better tone to retail sales during Q4. Perhaps more notable was the bounce in exports, this mainly accounting for the clear boost to the economy from net trade during the quarter.

As for the Q4 weakness this came from some slide in **business investment** but mainly from a large fall in inventories. While the latter may have helped temper imports during the quarter, the inventory unwind more than accounted for the overall GDP decline. This, together with the better tone in some updates for the current quarter as well as the upbeat manner in which the economy ended Q4, will only encourage the likes of the BoE to believe that the Q4 GDP weakness was either exaggerated and/or temporary with some bounce-back on the cards for this quarter, thereby avoiding formal recession, ie as the latest BoE Inflation Report implicitly suggests.

The week ahead: More surveys awaited. There is an array of consumer and business surveys due in the coming week, including a **retail trade report from the CBI** (Tue) and **household confidence** figures from GfK. Most market sensitive, however, will be the **manufacturing PMI** (Thu), especially after the clear rise seen in the January when the headline index moved back into clear expansion territory for the first time since the middle of last year. CBI data in the last week actually suggest that a further rise may be on the cards (Consensus: 51.8; DE: 52.3). However, caution is still warranted as the improvement in output still seems to be based on working through backlogs, a process which cannot last.

Otherwise **consumer lending and money supply** data from the BoE (Wed) could be interesting. Last time around (in December), the number of **mortgage approvals** rose further; another rise is expected. Meanwhile, numbers on underlying monetary dynamics showed mixed messages in December 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 record M/M drop in underlying **broad money supply**, while the underlying lending numbers picked up afresh, actually showing a second positive reading in three months. (Andrew Wroblewski)

Other Europe

Sweden: GDP Data Awaited

Data/event recap: Unemployment no longer falling? Coming in slightly above expectations once again, the (unadjusted) unemployment rate still fell further in January relative to its year-before counterpart. At 8.0%, it was 0.2 percentage point below that of the same month in 2011, a less clear-cut Y/Y drop to that evident in previous readings. However, seasonally adjusted numbers confirm that underlying joblessness is no longer falling (now at a rate of 7.6%). In addition, employment growth has also come to a standstill.

Confidence improves. Data from the National Institute for February showed the **economic tendency indicator** increased for the first time in nine months. Indeed, it rose 1.4 points, exactly unwinding the January drop which took the headline figure to a cycle-low of 91.6. The headline figure is still clearly below its long-term average, and with its fall of late clearly pointing to an economy growing weaker than normal, albeit not significantly so as had been the case hitherto.Among the business sectors, there was a small rise for manufacturing and services, both offsetting a fresh fall back in construction. In contrast, the consumer confidence indicator corrected back, losing 1.9 points to -2.3, albeit eroding less than half of the marked recovery seen in January.

The week ahead: The coming week sees the arrival of several pieces of key economic data. **Household lending** (Mon) and **retail sales** (Tue) data kick off the week, with the former having slowed in December while the latter rose by 0.1% M/M, adding to the bounces seen in the months before. Most of the attention, however, will be on **GDP** numbers for Q4 arriving on Wednesday, which came in well ahead of expectations last time around, showing a marked pick-up from the gains in the first half of last year. Q3 GDP growth came in at 1.6% Q/Q, up on the 1.0% Q2 outcome, also being the eighth successive gain in quarterly activity. However, a clear fall back is expected for Q4, the question being the extent to which it looks to be a reflection of an inventory unwind that overwhelms a recovery on the consumer side. In addition, the data may look somewhat historical given the better signs that have emerged so far this year. In this regard, the **manufacturing PMI** for February on Thursday may be even more important. The index increased 2.5 points to 51.4 in January, the first above-50 reading since mid-2011, this jump then having been echoed by more upbeat **National Institute** figures (see above). Otherwise the week has the **minutes to the Riksbank meeting** which cut rates further earlier this month. Little new may be forthcoming.

Norway: Labor Market Conditions Improve

Data/event recap: Better jobs data. The seasonally adjusted unemployment dropped a notch to 3.3% in the three months to January, suggesting an end to the slight uptrend in previous months. Regardless, there were more encouraging signs of an increase in employment as the data did show a continued rise of 0.4% in the last three months, helping to push up the Y/Y change in employment growth to 2.1%.

The week ahead: Data releases in the coming week start on Wednesday with **credit growth** figures for January, which saw recovery in December from the month before. This is then followed by the **manufacturing PMI** number (Thu) for February, which improved clearly last month, actually rising for the month in six. Elsewhere, the week also sees **labor market** data (also Thu) for February, having just released data January in the previous week (see above). The week is then completed by real **retail sales** numbers (Fri), which fell by 0.3% M/M in December, a downside surprise and with consumer weakness evident in the more broadly based index of household consumption (which includes vehicle and energy purchases and is also in inflation-adjusted terms).

Switzerland: GDP Data (not the Franc) the Focus: Mild Contraction in Store

Data/event recap: There was little of note in the last week in terms of economic events/data.

The week ahead: GDP data (Thu) for Q4 will be the clear focus in the coming week, after having risen 0.2% Q/Q in Q3, a largely as-expected gain that was nevertheless the softest in over two years. The expenditure breakdown revealed that the Q/Q fall was not only a result of a further drop in services exports (allegedly less price-sensitive), but instead, the clearly more price-sensitive goods exports also fell. Consensus expectations this month point to a mild contraction in Q4, following fairly broad based deterioration in growth across the continent in the last quarter, but some resilience may nevertheless be still evident. Elsewhere, the week also sees **CPI** figures for January on Wednesday, which are expected to see a steeper decline in inflation compare to December. Otherwise, the **manufacturing PMI** and **KOF leading indicators** arrive on Thursday and Wednesday respectively, with both surprising to the downside last time around, the former showing deeper contraction in the sector and the latter a ninth consecutive decline.

(Andrew Wroblewski)

Oceania

Australia: Little New from RBA Minutes

Data/event recap: The past week began with the **Reserve Bank of Australia minutes** to its 7 February policy meeting which, as expected, provided little additional insight beyond the information already released in the statement by Governor Stevens following the meeting and the subsequent Statement on Monetary Policy. However, it was notable that Governor Stevens commented in speeches over the past week that the recent increases in lending rates by the nation's banks (independently of the cash rate) had been expected by the RBA and further stated that these new rates are roughly what the bank assesses to be appropriate. Meanwhile, **Leading Indexes** compiled by the **Conference Board** and **Westpac** respectively provided broadly upbeat messages, both bouncing back after slight falls in December. The remainder of the week centered mostly around labor market updates, which revealed mixed messages, with the **Wage Cost Index** for Q4 showing a pick up in wage growth while **average weekly wages** data revealed a slowing in wage growth.

The week ahead: Most of the data in the coming week arrives on Wednesday, which sees housing market updates in the form of **construction work done** for the fourth quarter and **HIA new home sales**. **Company profits** and **capex** data for Q4 also arrive that day, alongside **retail sales** and **private sector credit** figures. The remainder of the week only sees the **Performance of Manufacturing Index**, which wraps up the week on Thursday.

New Zealand: Moderation in Inflation Expectations

Data/event recap: The past week started with a recovery in the January **Performance of Services Index**, which implied a faster pace of expansion in the sector but was unable to fully unwind the large drop in the month before. The week was then completed by the **Quarterly Survey of Business' Inflation Expectations** conducted on behalf of the Reserve Bank of New Zealand for the current quarter, which saw firms' expectations of inflation for both one and two years ahead fall to fresh cycle-lows.

The week ahead: The coming week kicks off on Monday with **visible trade** data for January. The remainder of the data next week is then concentrated on Wednesday, which sees the arrival of **private sector credit** data, **building permit** numbers as well as **NBNZ business confidence** figures.

(Chang Liu)

Japan

Major January Releases: Signs of Upward Momentum?

Data/event recap: Data were very limited over the week, though releases included the critical **merchandise trade** report—which showed yet another deterioration, with the January balance in deficit by ¥1475.0 billion, versus a ¥479.4 billion deficit in the same month of 2011. January is a seasonally weak month for trade, and that factor may have even more intense than usual because of the early Chinese New Year timing this year. In any case, exports dropped 9.3% year-on-year, while imports rose 9.8%. But, those movements were not grossly out of line with fourth-quarter trends—seasonally adjusted numbers showed exports down a relatively mild 0.4% from December and imports up by exactly the same amount, and the monthly deficit growing far less from the fourth-quarter average than that average grew from the third quarter. The other interesting release of the week was the December **all industry activity** report, which showed a 1.3% rise from November, as stronger gains in the industrial production (+3.8%) and tertiary industry (+1.4%) components were offset by weakness in construction activity (-1.9%) and government services (-0.4%). The December overall level was 0.5% above the fourth-quarter average, giving a leg up to the first-quarter trend.

There was also little news on the **Bank of Japan** front. Governor Shirakawa used testimony to the lower house budget committee to emphasize that there is no daylight between the BOJ and the government in terms of economic outlooks, and to reiterate earlier comments pointing out the Bank's policy framework is now very similar to that recently adopted by the U.S. Fed. Whether either strictly represents "inflation targeting" remains open to debate, bur Shirakawa noted that "What is clear is our policy stance—we are pushing ahead with our powerful monetary easing until we see clear prospects for 1% for now." In a separate session of testimony, he said that the BOJ would not react "mechanically" to a temporary rise in oil prices, "That's why we avoid using the term 'targeting,' which often evokes an automatic response. We make our judgment by watching the trend in prices."

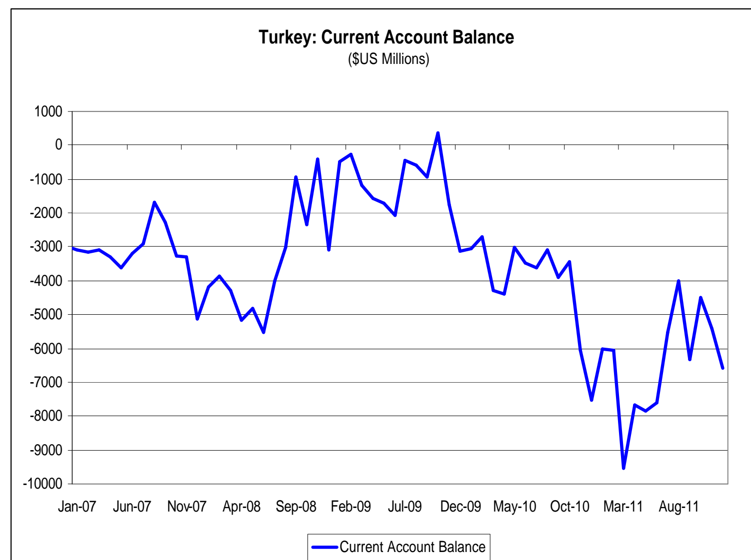
The week ahead: This week brings the major group of January data releases, giving the first indications as to whether the strong production-side close to the fourth quarter was the start of a transition back to relatively normal growth. Data flow starts Tuesday, with the **retail sales** report, which will combine with February **vehicles sales** results (Thu) and the January **Family Income and Expenditure Survey** (Fri) to give a sense of whether consumers are seeing income and confidence gains adequate to promote new growth in spending. January production-side data start arriving Wednesday, with the **industrial production** and **housing starts** reports, and continue with the **labor-market survey** data on Friday. All of the numbers will be watched for signs of upward momentum, particularly industrial production, where planning forecasts are upbeat, and the job-offers-to-applicants ratio, which has shown encouraging improvements in demand. The week also brings January **consumer price index** results (Fri), showing how far the Bank of Japan is from its 1% "goal," or "guidance," depending on the translation.

(Pierre Ellis)

Emerging Markets

A Look at Turkey and Brazil. Plus the Central Bank Watch

Turkey: Monetary Policy Easing? Turkey's central bank policymakers seem to be moving in the direction of an easier-money stance. The TCB has just reduced the upper ceiling of its overnight-interest rate corridor from 12% to 11%, leaving, however, the lower boundary of the corridor unchanged at 5% and the one-week repo rate also unchanged at 5.75%.

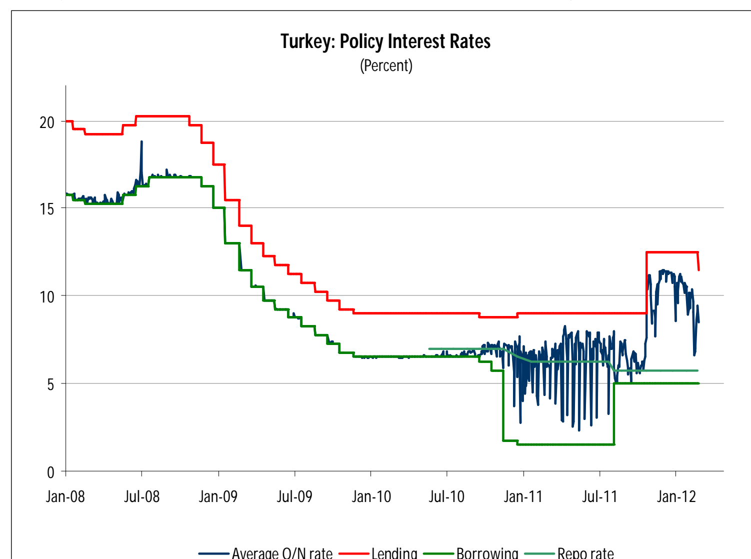


From a practical standpoint, the move does not affect the current cost of borrowing for Turkey's banks, which has recently hovered around 8%.

But as a signal, it clearly indicates that policymakers foresee a less acute risk of inflation ahead, and also a more favorable trend regarding the current account deficit.

The latter exploded in 2010-11 and prompted an intense policy debate followed by the adoption of a heterodox strategy in which interest rates were cut/kept low to weaken the lira and thus stem the widening of the external shortfall. This policy course seemed exhausted in the third quarter of 2011, as the current account deficit proved resilient and consumer price inflation—which had been low—jumped again into double-digit territory.

Now conditions seem to be somewhat, but not drastically, different: the current account deficit has begun to shrink, and inflation has stabilized in early 2012--although it remains in double digits. The government has seized on these seemingly emerging trends to justify their earlier pressures on the central bank and against what Prime Minister Erdogan had called "the interest rate lobby". Policymakers get the room to make a low-cost concession that puts them on the good side of the political leadership.



The outcome, a gradual shift to a less hawkish stance, might prove to be reasonably adequate to manage a soft-landing of the economy—given the apparent cooling underway and the lingering risks from the euro-zone—provided that the stabilization trend of the current account and of consumer price inflation continues.

But there is still a significant risk that inflation will not descend back into single-digits, possibly even accelerating on the back of oil prices.

For the time being, the central bank seems firmly in the inflation-optimist camp, which suggests that borrowing costs may follow a downward short-term trajectory unless new data force a policy reversal. The official rationale is provided in the February 22nd TCB policy statement:

…"the rebalancing between the domestic and external demand is ongoing as envisaged. Final domestic demand is decelerating while the contribution of net external demand to growth is increasing. Accordingly, the rebalancing process and the improvement in the current account deficit will continue in the forthcoming period. Starting from February, core inflation indicators are expected to follow a downward path due to favorable cost factors."

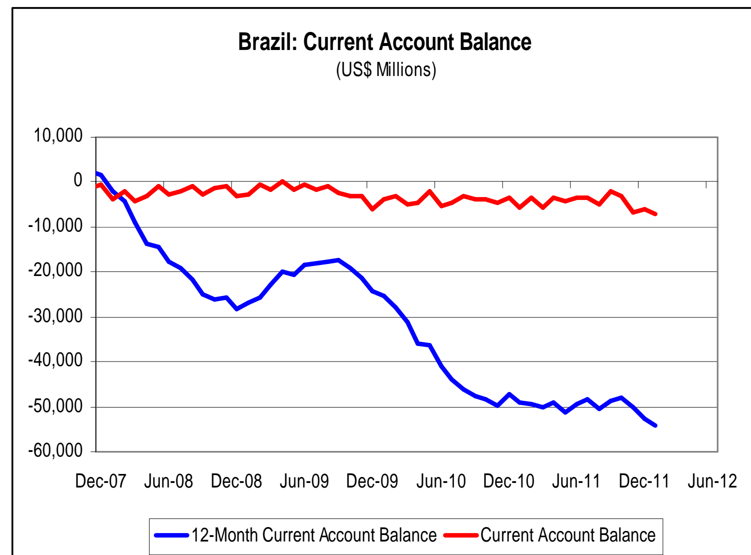
Brazil: Recession? (II) Recent data suggest that the Brazilian economy, which has been slowing in recent quarters, could be approaching a cyclical growth-floor, with real GDP still in positive territory and driven fundamentally by domestic demand. The indications come from the retail sector, trade statistics, industrial data, and data on the labor market.

Retail sales: up 6.7% year-on-year in December and 5.9% year-on-year in the fourth quarter, nearly unchanged from the previous three months (6.2% year-on-year).

Merchandise trade: import growth (17.7% year-on-year in January) outpacing exports (6.1% year-on-year during the same month).

Industrial production: recovered for two months in a row in seasonally adjusted terms (+0.9% month-on-month in December, +0.2% in November), following three months of decline that lowered its level by a cumulative 2.4%.

Labor market: formal employment growth has slowed as the market moves to unprecedentedly low rates of unemployment. Nonetheless, gains are still substantial. According to the Ministry of Labor and Development, January of 2012 was in fact one of the best in the admittedly short (2003) history of the time series, with a net addition of 119 thousand jobs. It is worth highlighting that while developed economies' labor markets suffered the effect of the global crisis in the 2009-to-2011 period, the Brazilian economy added 4.7 million officially registered jobs.



The details of the most recent labor market data provide further reasons for optimism regarding the likely resilience of domestic demand in the face of the current external-sector headwinds. The service sector, for example, added 61 thousand jobs last month—the second highest on record for the month of January. Construction posted a similarly solid performance, adding 42 thousand net jobs. And the manufacturing sector, which struggled for much of 2011 under the burden of slowing exports and high interest rates, added roughly 37 thousand net jobs. The only negatives during January were the retail sales sector (for seasonal reasons) and a tiny diminution of government employment.

Despite the signs that the end of the down-phase of the cycle is near, it is reasonable to expect only a modest pace of economic expansion in the early part of 2012, as part of what increasingly looks like a soft-landing, threatened by external risks but unlikely to mutate into a recession unless the global scenario deteriorates dramatically.

To help matters, the central bank will continue to cut interest rates, and the government will add to the monetary stimulus by introducing some still unspecified narrowly-targeted fiscal measures. Perhaps more importantly, there is likely to be a policy push to prevent further real appreciation from current levels, and some pressures to drive the currency back perhaps to the 1.80 neighborhood.

The reason: the expensive real induces substitution away from domestically produced goods and local manufacturers. This obviously tends to widen the current account gap, which could trigger a market correction of the real's exchange rate if the external shortfall became large enough relative to the available sources of finance. That, however, is not happening. The current account deficit has more than doubled since the 2009-10 global recession, but it remains quite manageable as a share of GDP (around 2.2%). Moreover, in absolute terms it has actually been rather stable since the end of 2010, although the latest (January 2012) figure represents (at least) a temporary widening. (Francisco Larios)

Central Bank Watch: **Hungary** will leave rates unchanged at Tuesday's central bank meeting, on hold as the outcome of ongoing IMF/EU negotiations remains unclear. The central bank currently is forecasting a stagnant economy for 2012 and as tightened credit markets and soft export markets as well as decreased domestic demand take effect on the economy. Inflation is also expected to be high and hit well above inflation target in 2012 as indirect tax increases and the depreciating forint increases prices. Inflation should wane as decreasing demand and some stabilization in the currency ease price pressures, but there is will be little scope for easing. The leading issue in Hungary remains the unresolved deal with the IMF and EU for help. The government still has not made all the necessary changes to ease IMF and EU's concerns over the independence of the central bank.

The Central Bank of the **Philippines** is expected to cut rates for the second month in a row. In the last release, the central bank saw inflation within target with no immediate concerns on the horizon. The central bank is easing monetary policy to aid growth, as it sees strong headwinds from Europe's debt crisis and remains uncertain about the US economic recovery. (Anne Hooper)