# Hadrian Brief

January 30, 2011

## Growth and Inflation

The global economy continues to expand. Highlighting the favorable outlook, the IMF raised its 2011 global GDP forecast 0.2% to 4.4% and projected 2012 GDP growth at 4.5%. However, the IMF indicated prediction risk was elevated. It called on Europe to contain sovereign debt stress and EM nations to avoid an asset price bubble in the face of increased inflation risk. Governmental change in Tunisia, rioting in Egypt and Yemen, and civil protest in Jordan indicate that high food costs and social discontent are new risk to the expansion.

Inflationary pressures are regional, but have risen due to higher commodity prices and sharp wage gains in India and China. The impact of higher commodity prices was clearly seen in German import price data, which rose 12% y/y in December. The gain was the fastest pace since October 1981, and occurred despite weak consumer demand. The EZ flash PMI underscored the rise input prices, but indicated that output prices were growing less quickly and austerity measures were capping inflation in the periphery. Inflation has remained stubbornly high in the U.K., and the price level has been lifted by the rise in the VAT. However, weak housing demand and austerity measures should cap gains. The BOE recent said that inflation was being lifted by commodity prices and EM price pressures, but it expected inflation to fall toward target. In the FOMC statement, the Fed indicated that measures of inflation in the U.S. continued to trend downward and inflation expectations were stable. The overhang in residential real estate, austerity measures at the state and local government level, and still high unemployment are restraining inflation. In Asia, Chinese authorities are working to cap real estate prices, slow lending, and control inflation, but news of wage hikes continue to surface. Inflation remains elevated in India. The RBI recently called on the government to reduce subsidies and take action to lower inflation. An improved transport system, for example, could bolster productivity and lower prices. Recent data shows inflation in Australia contained and Japan is still battling deflation.

## Money Markets

The 10 year treasury yield is expected to work sideways to higher. Treasury prices will be supported by the Fed's willingness to continue with its asset purchase program and a historically steep coupon curve. Moreover, the surge in deposit rates and shaky stock markets in India and China leave open the possibility of a hard landing in Asia. Safe haven flows related to civil unrest in Egypt should be limited, but could surprise. Domestically, the real estate market remains weak. Although home sales have displayed some sign of picking up, the MBA purchase index has fallen sharply in recent weeks. Homebuilder Ryland reported a 19% y/y drop in Q4 orders, while DR Horton indicated it was not purchasing more land after posting soft Q4 2010 profits. The bear case for the market rests in relatively poor valuation, rising inflation expectations, and signs of healthy economic growth. Treasuries remain poorly valued compared to corporate and even municipal paper. Although many municipalities face fiscal trouble, federal government has shaking finances, especially relative to the corporate sector. The CBO recently forecast a Federal U.S. deficit of $1.48 trln (9.8% of GDP) for FY 2011 and $1.294 trln (8.9% of GDP) for FY 2012. Real yields appear low given growth, funding needs, and the level of interest rates in Europe and Asia. For example, the EFSF recently sold an AAA 5 year 80 bps over the U.S. 5 year. Stocks are also more attractive than treasuries. Earnings yields remain high and companies are quick to return value to shareholders. Lastly, economic data has been surprising to the upside. The mixture of regional PMI numbers point to a healthy ISM and Q4 GDP data suggests inventory levels will support production, income growth and hiring.

## Foreign Exchange

The dollar is expected to trade mixed. A still dovish Fed and large budget deficit are headwinds to dollar strength, although growth prospects appear stronger in the U.S. than Europe and Japan. Worries over civil unrest in the Middle East could provide a transitory safe haven bid for the dollar. The **euro** is being supported by stability in EZ peripheral debt markets and healthy demand for EFSF paper. Furthermore, the up tick in inflationary pressures and the desire of German unions to push for strong wage gains has the trade pulling forward ECB rate hikes even though Spanish banks need to be recapitalized and banks in the peripheral continue to utilize ECB funding. Growth remains sluggish outside of Germany and France, and consumer demand seems anemic across the EZ. The **sterling** is being supported by hawkish BOE minutes, but the contraction in Q4 GDP, sluggish housing demand, and a dip in retailer expectations in the CBI indicate downside growth risks. BOE Weale and Sentence voted for higher rates confirming the BOE saw upward risks to CPI. In contrast, BOE Posen continued to argue for an expansion in the asset purchase program. Although the **Australian** dollar is benefiting from relatively high short term rates, but a tax to pay for flooding, mixed economic growth, and risks of slower growth in India and China should cap gains. Moreover, recent inflation data was tame and will prevent the RBA from raising rates. The **yen** may catch marginal support from the BOJ's more optimistic growth outlook and still low rates in Europe and the U.S. However, S&P's recent downgrade of Japan's debt to AA- is a reminder that economic headwinds are swift and politicians are slow to ignite growth and stop the build up in government debt. The **Canadian** dollar will be supported by still high commodity prices and flooding in Australia as investors look for a strong commodity currency. The interest rate outlook is mildly supportive, but recent trends in inflation and economic growth provide limited pressure on the BOC to lift rates.

## Equities

<u>Stocks are expected to work sideways. The risks for a correction will build in February</u>. Q4 profit results have been solid. 12 month forward earnings expectations continue to rise and earnings per share for the S&P 500 are currently marching toward their pre-crisis peak. However, relative to high expectations and compared to recent quarters, the number of positive earnings surprises has been low and a drag on prices. The market has seen pockets of strength and weakness. Industrial stocks like Eaton and Caterpillar and technology shares such as Qualcomm, Apple, and IBM have displayed vibrant profit growth. In contrast, consumer and home builders have recorded disappointing results. High commodity costs hurt shares of P&G, Colgate, and Starbuck, while Amazon reported sales below lofty expectations. Likewise, Ford disappointed investors. The healthcare sector has been mixed with Baxter, Abbot, and Amgen discussing the adverse impact of recently enacted health care legislation and noting the difficult regulatory environment. Further, there appears to be a trend toward medical austerity where governments want to cheap costs and increased access. Sentiment indicators have turned less bearish, but February is typically a poor month for stock returns. Valuation remains attractive given low corporate, treasury, and cash yields and a desire of corporations to return cash to shareholders.

## Commodities

<u>Commodity prices will be sensitive to economic growth, tight balance sheets in the Ag sector and the potential for oil supply disruptions in the Middle East</u>. Investment demand remains strong. Barclays Capital recently indicated that AUM in the commodity space rose to a record $376 bln paced by institutional interest. New investment in December increased $10.9 bln and the total gain for 2010 was $62 bln. The precious metals space received about $24 bln in new money. By product type, commodity index swaps received about half the new inflow followed by ETF and medium term notes.

**Crude** oil prices will be sensitive to civil unrest in Northern Africa and the Middle East. The market has developed a risk premium related to the potential closure of the Suez cannel and the spread of rioting in Tunisia, Egypt, Yemen, and Jordan to moderate Arab oil producing states. There have been reports of increased OPEC output to meet demand, and the market seems to contain adequate supplies. The U.S. petroleum market is comfortably supplied and high prices should curtail demand. There was a 23.4 day supply of crude oil as of January 21st. Days supply has risen in recent weeks and stand 0.3 less than last year. Distillate demand looks to have slowed in recent weeks, while supplies have increased. Distillate demand in the week ending January 21st was down 0.6% y/y, which is surprising low given cold weather and signs of expansion in the manufacturing sector. The days supply of distillate rose to 45.3 and is above 42.8 last year. Distillate stocks show signs of posting a counter seasonal increase. Gasoline demand was up 1.3% y/y, but tailing off seasonally. Gasoline stocks have risen sharply in recent weeks. The gain seems more dramatic than normal. The days supply of gasoline has risen to 26.2 compared to 26.4 a year ago. In Asia, China's commercial inventories of diesel rose for a second month in December up 16% m/m. Crude inventories rose 0.5% m/m implying a reduction in shortage. In Europe, gasoline stocks have been rising rapidly, while gasoline inventories have been falling pressured by cold weather.

**Natural** gas prices will be driven by industrial demand and the level of heating needs in the closing weeks of winter. Supply is ample. As of the week ending January 21st, there was 2,542 Bcf in storage. Storage was 0.4% above last year and 1.2% ahead of the five year average. Recent numbers from BENTEK Energy Services suggest improved demand. Domestic consumption rose 3.4% w/w paced by a rise in industrial and power usage. The 8 to 14 day temperature forecast suggests below normal temps across most of the U.S. to the benefit of demand.

**Copper** prices will be sensitive to the level of global PMI numbers in early February, especially in China and India. Prices have been supported by the outlook for firm growth and still tight supplies. The bullish tone in the market is somewhat surprising as LME stocks have risen sharply in recent weeks. Freeport McMoRan's CEO recent highlighted tight supplies and the slow process of expanding production due to hard permitting and the complex resources needed to drill. Further, he noted that emerging market demand remained strong and the U.S. manufacturing sector had improved. Chile's Copper Commission recently said it did not see a global shortage, but forecast deficits of 466,000 mts in 2011 and 297,000 mts in 2012. Copper supply was expected to rise 3.3% in 2011 and 5.2% in 2012. Their price target for copper was $4.17 lb for 2011 up from a prior projection of $3.50 to $4.40 lb. **Gold** prices will be sensitive to geopolitical unrest in the Middle East and Africa, and inflation trends in India and China. Tighter monetary policy in the EM and may slow demand and cool inflation expectations. However, interest rates remain low in the OECD and need to rise more significantly to significantly reduce gold demand. The improvement in the U.S. equity market has hurt gold prices at the margin, but more gains are needed to significantly reduce investor interest precious metals. Gold ETF holdings have also dropped sharply in recent weeks suggesting that investment demand may be waning despite still strong premiums in the coin market.

**Soybean** prices will be sensitive to weather patterns in South America and the pace of demand. Rain fall has improved in South America and stress on the Argentine crop has stabilized. Further, there is talk in the trade that Brazil's crop could be 70.2 mmts against the USDA estimate of 67.5 mmts. On the demand side, there has been a slowdown in export inspections. Reduced inspections have caused some in the trade to believe the USDA's export forecast will be revised down. Total commitments as a percent of exports is 86% down 1% from last year and 10% ahead of the five year average. The bull case remains a still tight balance sheet and the need for U.S. acreage. Like soybeans, moister in South America has improved the forecast for **corn** production. At the same time, U.S. export demand is lackluster. Total commitments as a percent of exports is 57% down 1% from last year and 3% below the five year average. However, the bull case remains a very tight balance sheet and the need for acres. Monthly ethanol data has also caused some in the trade to revise up the ethanol corn grind. **Wheat** prices will be sensitive to export trends. Export sales have firmed in recent weeks, but more strength is needed to support prices. The ratio of total commitment as a percent of exports is 80% down 2% from last year and 3% below the five year average. The market has gone a long way toward discounting poor weather conditions in Australia and Russia, and China, while South American precipitation has improved. Civil unrest in Africa and the Middle East may lift demand short term as governments work to placate social unrest. Still tight corn supplies are helping to support the case for feeding wheat to livestock. The corn to wheat ratio is 0.7799 and in the 71% percentile of values, indicating wheat leans cheap to corn.

**Cattle** prices will be supported by tight supplies, but high prices are a negative and leave the market focused on export demand. Cattle inventories and the beef cow herd fell 1.4% y/y and 1.6% y/y respectively on January 1st. Inventories are the lowest since the early 1950's and high feed costs argue against expansion. Cattle supplies should be flat to lower in April. Packer margins are about average, but the cut out value is at historically high levels, especially for January. Typically, the cut out value peaks in April. **Hog** prices are being supported by strong foreign demand. Foot and mouth dieses in Korea is expected to cause the culling of 2.9 mln hogs and Korea has lifted its import tariff on frozen pork to at least June. Demand also looks present from China which is trying to cool food inflation. On the supply side, production has been running ahead of a year ago since the fall. Hog weights are heavy and suggest that a decline in demand will quickly lead to lower prices. Futures are trading at a large premium to the spot market - $8 for February and $14 for April. The premium leaves the market vulnerable to a sell off.

**Coffee** prices are being supported by vibrant demand and lingering worries over supply. Demand is strong. A Brazilian industry group projected Brazilian coffee demand to rise 5% in 2011 to 20.3 mln bags. Starbucks is talking up its expansion into Asia, and reported strong Q4 sales. However, high prices were eating into margins and profit estimates were lowered for Q1 2011. ICE inventories continue to track lower highlighting tight supplies. Too much rain continues to plague Columbia where production is likely to fall below last year, and Brazil is in the short crop year leading to a slow build in supply. The **Sugar** market remains tight. The USDA cut its forecast for the Russian crop to 2.6 mmts from 3.31 mmts. At the same time, Russia is looking to reduce its import tax and the EU is examining an increase its sugar import quota. Indian refiner, Shree Renuka recently stated that adverse weather in Brazil, India, and Australia would keep prices between 30 and 35 cents. It also suggested that India's output might be 25.0 to 25.5 mmts below a prior forecast of 26 mmts. Weather has also impaired Chinese sugar production. **Cocoa** prices will be sensitive to political developments in the Ivory Coast. The African Union is offering to mediate the election conflict which could reduce fears of a civil war. High prices and talk that companies are still obtaining supply from farmers have slowed the recent rally. On January 27th, it was reported that December cocoa bean exports from the Ivory Coast fell 17% y/y justifying the recent rally.

**North America**

*The **U.S**. economy is expanding led by the business sector as regional purchasing managers data points to healthy economic activity and Q4 GDP data argues for sustained growth. However, consumer spending appeared to slow in January with some retailer analysts cutting chain store sales forecasts. Housing appears to have a better tone looking at pending home sales, but existing inventory remains bloated and a drag on construction activity. State and local governments continue to retrench. Inflationary pressures have risen, but have yet to show up in CPI or PCE data. The Fed will keep policy unchanged with a rate hike most likely late 2011. The **Canadian** economy is expanding and remains buoyed by high commodity prices. Retail sales data displayed continued growth, but the pace of economic activity seems to have a softer tone given recent housing and manufacturing data. Inflation is tame. The BOC will remain biased toward tightening, but will move very slowly. Key economic indicators:*

**U.S.:**
- Q4 GDP rose 3.2% [3.5% expected]. The price index rose 0.3% [1.6% forecast]. Inventories rose $7.2 bln and the trade deficit narrowed $113 bln. Final Sales to domestic purchasers rose 3.4% and has been firm in recent quarters. Government spending fell 0.6% and 0.9% at the state level.
- January NAHB survey was flat at 16 [17 expected]. The index has been unchanged for 3 months and the 6 six month average is 15.0. Present and future sales were steady at 16 and 25 respectively. Traffic was up 1 to 12.
- December Pending home sales rose 2.0% [1.0% expected]. Sales have firmed in recent months, but may have been aided by the expiration of a tax credit in California.
- December Existing Home Sales rose 12.3% to 5.28 mln [4.87 mln expected]. The median price fell 1.0% y/y, and the number of homes for sale declined to a still high to 3.56 mln.
- December Housing Starts fell 4.3% to 529,000 units [550,000 expected]. Single family starts declined, but multi-family rose 17.9%. Permits jumped 16.7% to 635,000 [554,000 forecast]. Multi-family permits surged 53.5%, while single-family permits rose 5.5%.
- December Durable Good Orders fell 1.3% [1.5% forecast]. Details were more economy friendly with non-defense capital good orders excluding air up 1.4%

**Canada:**
- November Retail sales rose 1.3% m/m [0.5% forecast]. Motor vehicle sales, building material sales, and food sales were strong. Furniture, electronics, and miscellaneous sales were weak. The data is consistent with strength.
- December CPI was flat m/m [0.1% forecast]. The Core rate contracted 0.3% m/m [-0.1% forecast]. On a year over year basis, the core CPI is a contained 1.5%.
- November Home Prices fell 0.2% m/m and rose 4.9% y/y. Price appreciation is slowing.

## *Europe*

*Growth in the **Eurozone** remains paced by Germany and France. Flash PMI data argues for a health expansion, but also displayed still difficult conditions in the peripheral. Numbers on consumer spending remain weak. Inflationary pressures have risen in Germany given import prices and wage demand by unions, but austerity measures in the peripheral will cap inflation. Furthermore, lending data is anemic and January CPI dipped in German. ECB rhetoric will have a hawkish bias, but no change in rates is likely until late year. The **U.K**. economy is in flux. The manufacturing sector is expanding, but consumer spending has downshifted and housing is weak. The economy must over come government budget cuts and higher taxes. The drop in Q4 GDP has raised fears of a double dip recession. Inflation remains above the BOE's target, but is expected* *to moderate. The BOE will keep rates unchanged monitoring the impact of the government's austerity measures on output and inflation. Key economic indicators:*

**Eurozone:**

- January Composite PMI rose 0.8 to 56.3 [55.6 forecast]. The Manufacturing PMI fell 0.2 to 56.9 [57.0 forecast], while the Services PMI rose 1.0 to 55.2 [54.3 forecast]. Manufacturing firms saw the largest rise in output in six months. Growth was led by Germany and France and output was stagnating in other areas. Employment rose for a ninth month in a row, but the rate of increase eased. Input prices rose at their highest rate since August 2008, while output price rose at a reduced pace. Prices charged fell in the periphery.
- January German IFO Business Climate rose 0.3 to 110.3 [109.9 expected]. Current Assessment fell 0.1 to 112.8 [113.2 expected], while expectations rose 0.9 to 107.8 [106.5 expected]. The index is at a record high and suggests vibrant activity.
- January French Business Confidence rose 5 to 108 and is working toward the pre-crisis high in a strong uptrend. In the breakdown, retail confidence was flat at 108, construction confidence fell 1 to 98, and service confidence rose 1 to 103.
- December Dutch Unemployment Rate fell 0.1% to 5.1% [5.2% forecast] and is inching lower.
- December Irish New Vehicle sales were 1,008 down from 2,888 in November. A year ago, sales were 871 compared to 1,518 in December 2008. Consumption remains sluggish.
- December Irish Retail Sales fell 1.1% m/m. The index has been trending lower since May. Demand is weak.
- December Spanish Retail Sales fell 4.4% y/y and show sluggish consumer demand.
- January French Consumer Confidence fell 1 to 85. It has eased from a recent peak of 89 in November. Unemployment rose 2 to 46, but is still trending lower.
- January Portugal Consumer Confidence fell 0.4 to -50.6. The index is very depressed and flirting with levels seen during the late 2008/early 2009 period.
- January German Flash CPI fell 0.5% m/m [-0.3% forecast] and rose 2.0% y/y [2.2% expected] easing inflation fears. The breakdown in Baden showed a sharp drop in leisure and entertainment (-4.4%) and clothing (-3.5%). Services fell 1.1% with flat rents. Food rose 0.7% and household energy surged 3.4%.

**U.K.:**

- December Retail Sales fell 0.8% [-0.2% expected]. Textile & clothing dropped 2.0%, household goods declined 0.9%, and auto fuel fell 5.9%. Weather played a roll in depressing sales, but sales have been down 2 of the past 4 months and the index level was unchanged from last year.
- January CBI Volume of Sales index fell 19 to 37 [38 forecast]. Expected sales fell 10 to 25 and are easing lower from the Q4. The CBI said: "The lure of seasonal sales and price discounting may have helped mitigate some of the impact of the VAT increase on volumes". Consumer demand is expected to be weak in the coming months, as the spending power of households is hit by a combination of sharply rising prices and weak wage growth". On autos, the volume of sales balance was -59 the weakest since July 2009. Sales were expected to fall in February.
- January CBI Business Optimism rose 5 to 7 [3 forecast], but total orders sank 13 to -16 [-1 expected]. Average selling price surged to 31 from 16 and is trending higher, but lifted by the VAT increase. Volume of output was up 4 to an elevated 17. Little change was expected in headcount, but there as a bias toward adding staff.
- December RICS rose 5% to -39% [-44% forecast]. The number of homes sold was flat at 15 and stocks of home rose 2 to 71. Housing demand is weak.
- December Claimant Count fell 4,100 [flat expected]. The change in the count is consistent with the pre-crisis period.

- November ILO Unemployment Rate was flat at 7.9% [in line]. However, unemployment among 16 to 24 year olds rose to 951,000, which is the highest since records began in 1992.
- November Average Weekly Earnings rose 2.1% [2.2% forecast]. Wage growth is well below the levels seen during the early to mid 2000's.
- Q4 GDP contracted 0.5% q/q [+0.5% forecast]. Weather was blamed for part of the weakness. The National Stats Office said that growth would have been flat without weather. There was across the board weakness with construction off 3.3%, transport & communication down 0.8%, and government and other services off 0.2%. Manufacturing did rise 1.4%.
- December CPI rose 1.0% m/m [0.7% forecast]. Food and energy paced the gain rising 0.9% and 3.4% respectively. Housing was firm up 1.0%, but medical products fell 0.4%. Core CPI rose 2.9% y/y [2.7% expected]. Core CPI is below the recent high, but elevated compared to the past 10 years.

## Asia

***Asia*** continues to expand, but inflation in India and China remains a risk to growth. Consumer spending and industrial output are growing at a brisk pace in **China**, but show signs of moderation. Construction activity appears to have slowed, and price gains are easing as the government works to prevent a real estate bubble. Despite measures by the government to cap inflation, the CPI remains elevated and the PBOC will continue to tighten monetary policy. There is market chatter suggesting the next rate hike will occur over the Lunar New Year. **India's** economy is growing, but the RBI is looking for moderation in the new fiscal year. Higher credit costs and normalized agricultural output will slow the pace of growth. Inflation remains troublesome and the RBI will continue to tighten monetary policy. ***South Korea's*** *economy is expanding and the BOK is looking for 2011 GDP growth to exceed trend. Q4 GDP showed year over year growth consistent with pre-crisis levels. Inflation is contained, but the BOK will remain biased toward lifting rates due to an upward creep in inflation expectations. Growth in* ***Australia*** *has been hurt by flooding. Measures to slow growth in India and China should also dampen output in Australia. A tax to pay for flooding will also weigh on output. A strong labor market is supportive to growth. Inflation is contained. Recent inflation data give the RBA plenty of time to monitor economic developments and keep rates steady. The* ***Japanese*** *economy appears to be improving. The BOJ raised its growth forecast 1.2% to 3.3% and saw a path leading to the end of deflation. Despite a strong yen, trade data showed healthy export growth. However, consumer spending was poor in December. Deflation remains, although the pace is easing. The BOJ will keep policy easy. Key economic indicators:*

**Australia:**
- January Westpac Consumer Confidence fell 5.7% to 104.6 – flooding hurt confidence.
- January DEWR Skilled Vacancies fell 4.6% m/m and has declined sharply over the past 5 months.
- Q4 CPI rose 0.4% q/q [0.7% forecast]. CPI is up 2.7% y/y and contained

**China:**
- Q4 GDP rose 9.8% y/y [9.4% forecast]. The deceleration in growth has moderated in recent quarters, but is firm relative to the 2002 to 2007 period.
- December CPI rose 4.6% y/y [in line]. Sequentially, prices rose 0.5% and the pace of gain has been brisk over the past 4 months. Food and housing inflation are strongest up 9.6% y/y and 6.0% y/y respectively. The other 6 major categories show little inflation with maybe the exception of medical, which rose 4.0% y/y.
- December PPI rose 5.9% y/y [5.7% forecast]. PPI is elevated to the 10 year trend, but has moved sideways in recent months.

- December Property Prices rose 6.4% y/y [7.0% expected]. The sequential gain was 0.3% which is in line with the recent trend.
- December Property Climate Index fell 1.41 and has declined 4 of the past 5 months. Real estate is slowing.
- December IP rose 13.5% y/y [13.4% forecast]. Output is firm, but sequentially the data is less strong. Motor vehicle output was 1.954 mlu and high compared to the past 5 months. Electricity output was 367.8 bln khw, which is up from the past 3 months, but below late summer levels. Cement output was 170.0 mmts, and has been flat to lower over the past 4 months. Rolled and crude steel outputs are little changed from the summer.
- December Retail Sales rose 19.1% y/y [18.7% expected]. Sales growth has flattened. The level of sales in rural areas has not changed since September. Urban sales continue to work higher, but at a slower pace. Food, sports/recreation, electronics, communication appliances, autos, and petroleum showed strength.

**India:**

- January 15 Primary Article's WPI rose 17.26% y/y and remains elevated. The strength is coming against a high base underscoring high inflation.

**Japan:**

- December Unemployment fell 0.2% to 4.9% [5.1% forecast]. The trend is sideways to lower. The participation rate fell 0.3% to 59.1% and has been trending down. Employment did rise 190,000 breaking two months of contraction, while unemployment declined 130,000.
- December Jobs to Applications Ratio was flat at 0.57 [0.58 forecast]. The ratio continues to work higher, but slowly. Job offers rose 0.4% m/m and have been up nicely in recent months. The December gain was soft to trend. New applications contracted 6.0% m/m and have been weak in recent months.
- December Household Spending fell 3.3% y/y [-0.6% forecast], posting a sharp drop off in growth. Sequentially, spending also declined 3.3%. Spending has been down three of the past four months. Demand looks to be falling.
- December retail Sales fell 4.1% m/m [-1.4% forecast]. The seasonally adjusted index level shows retail sales flat to lower in recent months. Sluggish demand.
- December Exports rose 13.0% y/y [9.3% expected] and Imports gained 10.6% y/y [12.0% forecast]. Export volumes surged sequentially and point to vibrant growth. The index was 110.6 compared to 98.6 in November and 94.8 in May. Import volume eased sequential but is tracking higher. The index was 106.9 compared to 109.9 in November and 94.1 in May. Imports from the U.S. have been tracking poorly in recent months.
- December CPI was flat y/y [-0.1% expected]. The core rate declined 0.7% y/y [-0.8% expected]. Core inflation is rising in part due to easy base effects. Core inflation ranged between -0.5% and +0.5% between mid 2005 and late 2008. Sequentially core inflation rose 0.2% and has risen the past three months suggesting a pick up in inflationary pressures.

**South Korea:**

- January Consumer Confidence fell 1 to 108. The trend has been flat to lower since the summer. Employment has been stabile. The expected inflation rate was projected to rise 3.7% from 3.3%.
- Q4 GDP rose 0.5% [0.4% forecast]. Exports and private consumption paced the gain. Capital spending and government expenditures contracted. Sequentially, the trend is growth appears slower, but the year over year pace is stable and in line with pre-crisis levels.

HADRIAN PARTNERS, LTD

- December Department Store Sales rose 11.6% y/y, while Discount Store Sales rose 2.9% y/y. Luxury goods and household goods paced the gain in department store sales. Spending looks solid.