

July 30, 2011

Growth and Inflation

The global economy is growing slowly and showing signs of deceleration. Growth is being restrained by the headwind of fiscal consolidation in Europe and the U.S., a high regulatory burden, and macro tightening measures in the emerging world. High food and energy costs also linger as a drag on consumer spending. The flattening yield curves in India and to a lesser degree China are forecasting weaker growth in the developing world. Caterpillar recently projected 2011 global GDP at 3.5% down from 3.9% in 2010.

Inflationary pressures have eased given the moderation in global growth, but headline inflation remains elevated in the emerging world and price pressures linger. In the U.S. fuel prices have eased from their peak, but remain high. Likewise, food inflation is stubborn and slow to fall. Restaurant operator Pender Bread recently projected a 4% to 5% rise in food costs. However, a high unemployment rate and on going price pressures in the housing market are checking the ability of inflation to advance. Consumer Confidence data showed 1-year inflation expectations at a still high 5.7%, but down from a peak of 6.5% in May. In Europe, the UK's CBI Industrial survey showed easing price pressures, and pricing power is also limited at the retail level. In the EZ, government austerity measures and soft labor market conditions are capping prices in the peripheral. In contrast, inflation in Germany is firm, and the labor market appears tight. Inflation remains elevated in China and India. Still strong wage growth and high food and energy prices are lifting price indices. Macro policies aimed at taming inflation provide hope for a reduction into year end. The RBI is aggressive with tightening policy in order to check inflation. Recent reports indicate cement prices have fallen over the last month in China, hinting at a reduction in inflationary pressures.

Money Markets

The 10 year treasury yield is expected to trade mixed. The market has weathered to debt ceiling storm with little fall out. Poor positioning for a decline in yields, signs of slower growth, and lack of alternative have helped to support treasury prices despite poor valuation. The JP Morgan Client survey continues to show investors sidelined to bearish, expecting yields to rise. The lack of exposure has limited selling. At the same time, Fitch published a report suggesting that the U.S. treasury market would maintain its global benchmark status despite a downgrade from AAA. Liquidity and depth were favorable factors. Furthermore, yields are extremely low in Japan despite an AA- rating. Continued credit stress in the peripheral of Europe has helped to keep money in the treasury market due to lack of competition. The economic trend has supported prices. Chain store sales have been strong and initial unemployment claims have cracked below 400,000, but weak growth is highlighted by the 1.3% rise in Q2 GDP and slide in flash Chinese and EZ PMIs. Extremely weak distillate demand and a sharp slowdown in rail car data have also caught the market's attention. Weakness in the Chinese container market also questions the vibrancy of the Asian expansion.

Foreign Exchange

Currency markets will trade choppy, driven by politics, and the differential in interest rates and growth. The **dollar** continues to face the headwind of poor political leadership. Anti-growth related fiscal and regulatory policy coupled with out of control entitlement spending creates a negative backdrop. Without meaningful reductions in entitlement spending, investors are likely to lose their desire for dollar assets. Interest rate and growth disadvantage are also dollar negative. The **euro** will watch the ability of the EFSF and politicians to stabilize the crisis in peripheral debt. Germany does not want to give a black check to Greece or any struggling EZ state. European banks look under capitalized and vulnerable to sovereign stress. The ECB's recent lending survey displayed weak loan

demand and a pull back of credit extension. The ECB would like to continue the process of normalizing interest rates, but soft growth and a fragile banking system should slow or even prevent more than a one more 25 bp rate hike. The **sterling** is being pressured by sluggish economic growth, but may be receiving some diversification flow at the expense of the U.S. dollar. Austerity measures are in place, and the BOE is unlikely to raise rates in spite of high inflation. CBI retail sales data suggests anemic demand, while housing activity remains stagnate. The **Australian** dollar is supported by attractive interest rate differential and diversification flows. Commodity exposure has also generated buying. A higher than expected Q2 CPI has lifted rate hike expectations, although the RBA is unlikely to tighten monetary policy in the near term. The domestic economy is growing at a moderate pace, and the RBA does not see a significant tightening of labor market conditions. Additionally, loan growth is weak. Any serious slowdown in Asian growth risks pressuring investment flows. The **Canadian dollar** will be pressured by the drop in CPI which takes pressure off the BOC to tighten. BOC is also predicting moderate growth into year end, and has noted the strong Canadian dollar as a headwind to growth. However, the need for U.S. dollar alternatives and relatively healthy fiscal policy will support the Canadian dollar. The **yen** is being supported by lack of capital outflow and risk aversion. The Eurozone and U.S. debt struggles have caused Japanese foreign bond buying to remain depressed, and contract slightly in recent weeks. The Japanese economy has also shown signs of improvement given the pace of June retail sales, a rebound in small business confidence, and increase in the manufacturing PMI. The threat of central bank intervention is slowing the yen's gain.

Equities

Stocks are likely to trade mixed. The inability of politicians in Europe and the U.S. to enact pro-growth policies and effectively manage fiscal crisis has hurt investor confidence. More

importantly, Q2 profit results in the technology and industrial sector have cooled the outlook for second half growth. Juniper network indicated that telecom carriers were spending less than expected, Corning highlighted weak LCD glass demand, and Linear Technologies suggested inventory burn and a push out of customer orders. Additionally, Taiwan Semiconductor cut its foundry industry growth forecast from 15% to 7%. Texas Instruments called consumer computing demand weak, while the market remains skeptical of Intel's strong Q3 revenue outlook due to growing tablet and smart phone demand. Strong unit growth at Apple remains the most bullish dynamic for the technology sector. In the industrial space, Ingersoll Rand, Caterpillar, UPS, ITW, Emerson Electric, and Bemis are a few companies which disappointed the market with profit results or guidance. On a more bullish front, valuation is appealing. The S&P 500 is priced at 11.7 times expected forward 12 month earnings and 13.0 times forecast 2011 earnings. Based on a 14.5 trailing PE ratio, which is low for the past 20 years, the market's year end price target is 1140 off projected 2011 EPS of \$99.50. Cheap valuation is also underscored by the fact that a number of financials are priced near or below tangible book value.

Commodities

Signs of slowing economic growth have acted to cap commodity prices, but investor interest remains strong given fiscal uncertainty in the U.S. and Europe. Gold has been a major beneficiary of fiscal unease. Individual market fundamentals paint a mixed picture, and don't support a major leg higher in major commodity indices.

Although supplies are expected to tighten in the coming months, weak demand is checking the advance of **oil prices**. U.S. crude oil stocks bounced in the week ending July 22nd, but the overall season downtrend remains in place. There were 354.0 mln barrels in storage, and the level of storage is comfortable for this time

of year. The days supply of is trending lower with oil supplies and stood at 23.0 days compared to 23.4 last year. U.S. supply outlook is improving, as the EIA recently highlighted the 40% y/y rise in oil production in North Dakota. Production hit 360,000 b/d in February. On the product side, distillate stocks have risen sharply in recent weeks at a pace slightly quicker than normal. The days supply of distillate has jumped from 39.6 at the end of June to 43.6 as of July 22nd. A year ago, the days supply was 46.4. Like distillate, gasoline supplies have firmed in recent weeks and the increase is running a bit counter seasonal. The days supply has risen slightly from late June increasing to 23.5 on July 22nd from 23.0 on June 24th. A year ago, the days supply was 23.6. Of interest, the average U.S. retail gasoline price was \$2.75 a gallon a year ago compared to the current price of \$3.70. Product demand is weak and should weigh on prices. Gasoline and distillate demand are off 3.5% y/y and 3.3% y/y over the past 4-weeks. Internationally, Oil Movements said that OPEC's Middle Eastern members would boost supply by 1.9% to 17.78 mbd in the four weeks to August 6th. The increase in output is seen as meeting Asian refinery demand. There is a spat between Iran and India over payment. Iran has said it will cut shipments to India, but Indian buyers are said to be seeking replacement from Saudi Arabia. Saudi shipments to India are expected to be 3 mln barrels above normal in August to meet supply.

Natural gas prices will be driven by cooling needs and the strength in economic activity. Supplies are adequate. As of the week ending July 22nd, there was 2,714 bcf in storage. Storage levels were 6.9% below a year ago and 2.3% under the 5-year average. Storage builds have been light to normal over the last few weeks. Weather has been hotter than normal and helped to dampen the pace of build. Heat will continue, but at a lesser rate. Temperatures will be closer to normal in the upper Midwest and Northeast over the next 8 to 14 days. Temps will remain hot in the South. Unusually hot weather has played a key

roll is supporting the market. Data through July 21st indicated that cooling degree days were 50 days above normal for the central U.S. The pace of economic growth does not look vibrant enough to generate significant demand to materially raise prices.

Copper prices will focus on strike activity and the strength of global growth. The global economy looks to have a softer tone, and China appears more price sensitive in its purchases. In its earnings conference call, Freeport McMoran highlighted slowing economic data, but noted tremendous amounts of infrastructure spending and home building in China. Copper inventories in Shanghai and on the LME look adequate. However, Strike activity is weighing on production. On July 30th, workers at the Collahuasi copper mine in Chile went on strike due to a dispute on production bonuses. The strike at Escondida was on going with workers rejecting a bonus offer. The Collahuasi and Escondida mines produce about 10% of global output. Beyond the strikes, Newmont said its copper production was 44 mln pounds in Q2 down 45% y/y hurt by lower grade. The low grade issue continues to be a big picture positive. Freeport reported copper costs were \$.93/lb leaving current production extremely profitable. Its copper production has been little changed in recent quarters.

Gold prices will remain supported by low interest rates and chaotic fiscal policy. The sovereign credit crisis in Greece and wrangling in the U.S. over deficit reduction have generated safe haven interest in gold. Further, investors are nervous over the health of Chinese banks and the ability of the government to achieve a soft landing. Enthusiasm for gold is highlighted by the bullish statement by gold producers. Goldcorp recently projected \$1700 oz by year end due to fiscal turmoil and vibrant Chinese and Indian demand. Goldcorp is looking for Chinese demand to outstrip Indian demand. Goldcorp is looking to ramp up production and sees 60% production growth in the next five years, but

cut its 2011 forecast to 2.5 to 2.55 mln oz from 2.65 to 2.75 mln oz. Production was little changed from last year in Q2. Newmont Mining projected gold at \$1750/oz by year end in its press release. Newmont indicated that costs were \$583 Oz and noted its production was off 5% y/y in Q2.

The **corn** market will remain focused on weather with one eye on demand. Unusually hot conditions across production areas have stressed the crop, and put yield projections at risk of downward revision, **but** the 8 to 14 day outlook is forecasting above normal rain fall through much of the Midwest. As of July 22nd, 62% of the corn crop was in good to excellent condition. Conditions had deteriorated over the past two weeks, and the crop rating is 10% below a year ago. Corn silking is also slow. 65% of corn was silking compared to 82% a year ago and a 5-year average of 69%. The outlook for warm and wet weather should stabilize crop conditions and may allow for improvement. On the demand front, export sales have been weak and the current trend is putting pressure on analysts and the USDA to cut their 2010/2011 export projections. The ethanol crush is also appears to be working under the USDA's estimate.

Like corn, **soybeans** will focus on weather. Weather conditions in mid to late July put some stress on the crop, but precipitation is expected to pick up in the coming week and should help improve crop conditions. As of last report, the rating of good to excellent soybeans had declined 4% over the prior two weeks to 62%. The rating is 5% below a year ago. Crop development is slow relative to history. 60% of soybeans were blooming compared to 73% last year and a 5-year average of 68%. Similarly, 16% of soybeans were setting pods compared to 32% last year and a 5-year average of 27%. Demand has been soft. Export sales are down 60.2% y/y over the past 4-weeks.

Wheat prices will be sensitive to demand trends and global production levels. Unlike corn

and soybeans, the spring wheat crop saw improved quality at last measure, but remains at risk of poor yield. 74% of the crop was in good to excellent condition from mid July. However, the rating was still below last year when 83% of the crop was in good to excellent condition. Spring wheat headed was 83% verses 92% a year ago and a 5-year average of 95%. The market may be hurt by high relative prices to other growing areas. Egypt recently bought 240,000 mts from Russia. In the last reporting period, wheat export sales were down 14.3% y/y over the past 4-weeks. It looks like global supplies are adequate and muting concerns over weather related production glitches (drought in the southwest). Improved rains in the EU are lifting global production estimates. A Bloomberg survey indicated EU production would be 135.7 mmmts compared to a USDA estimate of 132.2 mmmts and an EU Commission forecast of 133.5 mmmts

Cotton prices will be sensitive to Chinese demand, and weather in Texas. Export sales are lackluster with weekly sales numbers showing cancellation. Weaker global growth and high prices are weighing on the demand outlook. However, U.S. crop conditions remain poor and weather is not set for material improvement. The 8 to 14 day has above normal temps and below normal rains through growing areas of the U.S. south. The crop is already under heavy stress. Only 29% of the crop is in good to excellent condition well below last year's reading of 68%. Moreover, cotton squaring and set bolls are both tracking below a year ago and the 5-year average. Warehouse stocks are tight. As July 28th, there were only 13,566 bales certified on ICE down from 142,000 bales in early May. Overseas, the Indian Monsoon has been a bit below normal which is leading to some slight downward revision in the India crop. There have also been some indications of dryness developing in Chinese growth areas.

Cattle prices will be sensitive to demand. Supplies will remain abundant into mid August and then start to decline into fall. The latest

weekly slaughter numbers showed kills up 1.7% y/y and the average steer dressed weight 14 lbs ahead of last year. Placement numbers have been tracking strong relative to last year due to dry pasture conditions in Kansas, Oklahoma, and Texas. Cattle are being pushed on to feed and may pressure December 2011 and February 2012 futures. Bigger picture, the herd is shrinking. The July cattle inventory report indicated that cattle supplies were down 1.1% y/y. The calf crop was expected at 35.5 mln head, which down 0.5% y/y and the smallest since 1950. On the demand front, domestic demand is being restrained by summer heat, high beef prices, high fuel costs, and still high unemployment. The USDA indicated that beef prices were up 8% y/y in June with steak up 4% y/y and ground beef up 11%. Pork prices are providing limited competition up 8.5% y/y, while poultry prices are up 3% y/y and will generate substitution. News of foot and mouth disease in Guizhou China will keep pork prices high, and beef exports continue to be strong and lend support to cattle prices. A reduction in overseas demand would be catalyst needed to take prices materially lower.

Hog prices are being supported by ideas of Chinese imports and hot weather, which has slowed weight gain. Stories of foot and mouth disease in Guizhou China have lifted expectations for Chinese imports. Pork prices are a key driver of Chinese inflation, and the disease risks shrinking already tight supplies. U.S. hog slaughter was up 2.2% y/y in the latest week at 1.992 mln head, but Iowa Minnesota live weights were 263.7 lbs down 4.7 lbs from last year. The light weighs are pressuring production. The Agricultural and Applied Economics Association's Extension Section survey indicates that pork production is expected to be up 0.8% y/y in H2 2011 and 0.5% y/y in 2012. Production levels are price supportive. The survey projected average hog prices (live weight) of \$69.30/cwt in Q3 and \$62.98/cwt in Q4. Into Q1 2012, the average prices was forecast at 64.64/cwt. For all of 2012, prices were projected \$1/cwt above

2011. The large discount in October and December 2011 futures, \$8 and \$14 respectively, is price supportive.

Sugar supplies look to be loosening. In a recent report Rabobank predicated a 2011/2012 global surplus of 9.8 mmts up from 3.7 mmts in 2010/2011. India was expected to be in surplus and a large exporter. A Bloomberg survey indicated that Indian exports could be 4 mmts verses 2.1 mmts this year. Indian farmers reported boosted sugar plantings to 5.18 mln hectares compared to 4.9 hectares mln last year. One risk to the outlook for strong Indian production rests in signs the Indian monsoon is falling short of normal. On a more bullish note, the market remains jittery about the outlook for production in Brazil. Brazil is also talking about cutting the ethanol tax in order to bolster ethanol production and reduce sugar production. Unica said that production in the Center South was about 90% completed and the cane harvest is off 15% from last year. However, the backlog of ships at Brazilian ports continues to ease. There were 50 ships waiting for loading on July 28th down 8 from the week prior. The backward structure of the board reflects current production troubles in Brazil and the outlook for improved supplies in 2012 and 2013.

Coffee prices have eased despite signs of still strong demand. Starbucks reported vibrant demand in its quarterly report. Fiscal 2012 comparable store sales were projected to rise at a mid-single digit pace. Comparable store sales were up in the mid 30% range in China and Via sales were "impressive". Further, Starbucks will add 200 stores in the U.S. and said it can have at least 1,000 stores in Brazil. High input costs were eroding profits. Like Starbucks, Green Mountain reported vibrant sales and Dunkin Brand is talking about doubling its U.S. store count. On the supply front, weather is projected to be favorable for Brazil's crop. Somar Meteorologia predicted conditions which will be supportive of a record crop. Some of the weakness in prices may be related to satisfied roaster needs. Volcafe said

that Vietnamese farmers had sold 90% of their crop compared to 75% last year. Volcafe also indicated that growing conditions were favorable. More of the price weakness may be linked to fund activity. Futures and options positions of large funds have shown a trend

toward increasing shorts and decreasing longs in recent weeks. The non-commercial reportable category has not seen this level of net short since early 2009.

North America

*The **U.S.** economy is growing slowly. Still high fuel prices and a restrictive regulatory environment are weighing on growth. Furthermore, state and local governments continue to restructure and budget politics in Washington has shaken consumer and business confidence. Housing demand is lackluster and job growth is limited. Regional purchasing managers' data has been mixed in July. Inflationary pressures have eased, but the core inflation rate is likely to creep higher, while the headline rate moderates. Fed policy is on hold. The **Canadian** economy shows signs of slow growth. The BOC projected 1.5% growth in Q2 and indicated the Japanese earthquake, high food and energy inflation, and lower government spending weighed on growth. Output was expected to improve in the second half and rise 2.8%, but the BOC highlighted headwinds, lowering its outlook from 2.9%. Key economic indicators:*

U.S.:

- June Housing Starts increased 14.6% m/m to 629,000 [575,000 expected]. Single-family starts rose 9.4% and multi-family starts jumped 30.4%. Single family starts are a shade above last year's level, but multi-family starts are strong -- some strength may be linked to the need for rental property.
- July NAHB survey rose 2 to 15 [14 expected]. The index remains depressed. Traffic was flat at 12, but present sales rose 2 to 15. Future sales rose 7 to 22. Numbers are close to the 6-month average.
- June New Home Sales fell 1.0% m/m to 312,000 [320,000 expected]. The median price rose 7.2% y/y, showing some strength. However, actual prices are flat to lower this year.
- June Architecture Billing index fell 0.9 to 46.3. It has been below 50 three straight months and suggest lackluster growth.
- June Durable Good Orders fell 2.1% m/m [0.3% expected]. Orders excluding defense and air declined 0.4% [+1.0% forecast]. 1) Primary metals rose 1.0% and have been firm in recent months. 2) Fabricated metals rose 2.1% and have rebounded from March/April weakness. 3) Machinery fell 2.3% - soft. 4) Computer and electronics rose 0.2% and has shown anemic growth the past 2 months. 5) Transport orders fell 8.5% with motor vehicles off 1.4%. Auto has been a drag the past few months. Aircraft order plunged 28.9%.
- Q2 GDP rose 1.3% [1.8% expected]. The price index jumped 2.3% [2.0% expected]. 1) PCE gained just 0.1% paced by a 4.4% drop in durables. 2) Fixed Investment jumped 5.9% with equipment and software up 5.7% and residential structures up 3.8%. 3) Exports rose 6.0% and imports increased 1.3%. 4) Government spending fell 1.1% with federal up 2.2% (defense). State and local down 3.4% -- state and local spending has contracted four straight quarters. 5) Inventories rose \$49.6 bln.

Canada:

- June CPI fell 0.7% m/m [-0.2% expected] and 3.1% y/y [3.6% forecast]. Core CPI contracted 0.6% m/m [flat expected] and rose 1.3% y/y [1.9% forecast]. Tame numbers.
- May Retail Sales rose 0.1% m/m [-0.3% expected]. Sales were up a healthy 4.0% y/y. Vehicle and furniture sales contracted, but electronic and building material sales were strong.

- May GDP contracted 0.3% [+0.1% forecast]. GDP has been soft in recent months. Wildfires in Alberta and oil field maintenance hurt output. There was also a set back in mining.

Europe

*The **EZ** economy is growing slowly paced by strength in Germany and to a lesser degree France. Growth in the South remains weak. Business confidence shows less strength and consumer spending is sluggish. Inflation has stabilized after a run up. The ECB is leaning toward more rate hikes, but downside risks to growth and the need for banks to raise capital will slow the process. Sovereign debt markets also remain unsettled. At this juncture, it looks like one more 25 bp rate hike is possible this year. The **U.K.** economy is sluggish. Government spending cuts and tax hikes are weighing on consumer spending. The labor and housing markets continue to be soft and limit growth. The brisk pace of manufacturing has moderated. Inflation remains above target, but the BOE is looking for a decline on the back of weaker aggregate demand. A rate hike looks unlikely in the medium term. Economic indicators:*

Eurozone:

- July Flash EZ PMI Composite fell 2.5 to 50.8. The Manufacturing PMI declined 1.5 to 50.4 [51.5 forecast], while the Service PMI dropped 2.3 to 51.4 [53.2 expected]. Details: 1) Manufacturing saw the orders to inventory ratio fall to the lowest level since April 2009. 2) Staff rose, but growth was present only in Germany and France. Other areas saw weakness. Manufacturing was stronger than services in hiring. 3) Backlog fell more in manufacturing than services. 4) Prices charged rose at the fastest rate in six months, but input prices dropped in both sectors to a 12 month low.
- July German IFO Business Climate fell 1.6 to 112.9 [113.7 forecast]. Current assessment eased 1.9 to 121.4 [122.3 forecast], while expectations declined 1.3 to 105.0 [105.0 forecast]. Details: 1) Service Business Climate fell 1.1 to 25.3. 2) Manufacturing fell 2.9 to 18.1 and is softening. 3) Construction rose 1.3 to -0.7 and is firming. 4) Retail dipped 0.7 to 10.7 and is choppy to lower.
- July French Business Confidence fell 4 to 105 [107 forecast]. The index made a recent high of 110 in March and June. Details: 1) Service Confidence fell 4 to 103 and shows softening. Expected demand fell 5 to 2 and is weak to trend. 2) Retail Confidence fell 3 to 102. 3) Expected demand fell 3 to -14 and has deteriorated sharply in recent months. 4) Construction Confidence was flat at 103 and firm to trend. Order and expected activity were strong to trend.
- July Finish Business Confidence fell 6 to 0 and is rolling over.
- July Italian Business Confidence fell 2.0 to 98.5 [99.7 expected] and is showing peaking activity. Domestic and foreign orders are weakening. The employment outlook is steady.
- July Retail PMI fell 0.6 to 48.2, hitting a 9 month low. Sales growth rose in Germany, but fell in Italy and France. The drop in French sales was marginal, but Italy saw a steep decline. Details: 1) Sales missed plan by the greatest amount in 9 months. 2) Prices paid rose to the highest level since July 2008. 3) Gross margins declined by the fastest pace since May 2010. 4) There was a rise in retail employment, but it was called lackluster and firms were unlikely to hire.
- June German Retail Sales rose 6.3% m/m. [1.7% expected]. Sales are working higher and suggest moderate consumer demand.
- June French Consumer spending rose 1.2% m/m bouncing after 3 months of decline. Spending levels are flat since January. The index level ex-cars has jumped sharply in recent months and points to firm activity.
- August German Gfk fell 0.3 to 5.4 [5.6 forecast]. Confidence is easing lower from the March peak of about 6.0, and remains depressed compared to the peaks in 2006 and 2007.

- July French Consumer Confidence rose 3 to 86 [82 expected]. Confidence is low, but has been stable in recent months. Details included: 1) Jobless concerns rose 10 to 43. 2) Inflation fears fell 4 to -18
- July Dutch Consumer Confidence fell 4.2 to -2.2 [+1.4 forecast]. Confidence is rolling over and suggests the economy has hit a near term peak.
- July Italian Consumer Confidence eased 1.9 to 103.7 [104.5 expected]. Confidence is trending flat to lower since early 2010.
- Q2 Spanish Home Price Index fell 1.4% q/q and 5.1% y/y. Deflation in housing remains strong.
- June French Jobseekers rose 33,600 or 1.3% from May. The labor market has a softer tone.
- July German Unemployment fell 11,000 [-15,000 forecast]. Unemployment has fallen at a slower rate over the past 3 months. Vacancies rose 3,000 to 464,000, suggesting the labor market is healthy. The July German Unemployment Rate was flat at 7.0% -- the rate is still in a downtrend.
- June EZ M3 rose 2.1% y/y [2.3% forecast]. Money supply growth is slow.
- July German flash CPI was +0.4% m/m [+0.3% expected]. Prices were up 2.4% y/y [2.3% expected]. The year over year gain continues to trend higher, but the rate of gain has slowed in recent months. State data showed sequential strength in leisure costs, hotels, restaurants, transport, and services ex-rents. Clothing fell sharply.

U.K.:

- July CBI Reported Sales fell 3 to -5 [2 expected]. The index is at its lowest level since June 2010. The report said "Rising prices, especially for fuel, continue to impact consumer confidence and make life tough on high street". Details: 1) demand at grocery stores fell to the lowest level since December 2008. 2) Sales at clothing stores were called modest. 3) Demand for household durables fell. 4) Sales were well below average for time of the year and below expectations. The measure of sales for time of year declined to -33 from -19.
- June Retail Sales rose 0.7% m/m [0.6% forecast]. Food was soft down 0.2%, while non-food rose 1.1%. There was a firm tone reversing weakness in May. The level of activity is grinding slowly higher in non-food, but has weakened in food.
- July CBI total Orders fell 11 to -10 [-3 forecast] Selling prices declined 23 to 4 [27 forecast]. Export orders weakened, and volume of output slowed fell 6 from 13 – the lowest since the 4 in November 2010. July CBI Business Optimism declined 25 to -16 [+10 forecast].
- June BBA Loans for Home Purchase were 31,747 [31,000 expected]. Loan numbers are flat to showing some light firming in recent months. The overall level of activity is extremely depressed compared to the last 10 years.
- Q2 GDP rose 0.2% q/q [in line] and 0.7% y/y. GDP growth has decelerated in recent quarters and growth is sluggish compared to the 2002 to 2007 period.

Asia

*Asia is growing at a slower rate. Weaker demand in Europe and the U.S. coupled with macro tightening measures in the Asian region present a downside risk to the growth picture. **China's** growth may be pressured by recent rail accident which has caused a rethinking of the infrastructure build out and pace of urban sprawl. Flash PMI data showed a weaker tone, but the pace of industrial profits through July was healthy. Inflation remains elevated, but is expected to peak in the coming months despite signs of healthy wage gains. The PBOC will look to raise rates cautiously given growing unease over the global growth picture. **India's** economy is likely to slow, but the RBI seems confident in growth and is focused on reducing inflation. In the wake of a surprise 50 bps rate hike, the RBI stated that level of WPI was a concern and inflationary pressures were strong. The RBI saw no broad based slowdown in economic activity. The RBI may look to raise rates in September/October. The **Korean** economy shows signs of slowing given business*

survey results and the trajectory of Q2 GDP growth. Like the RBI, the BOK seems more concerned about checking inflation than lifting growth. BOK Deputy Governor Kim Jae Chun recently said economic growth would pick up in H2 helped by pretty strong exports and noted a slowdown was not on the list of policy concerns. The BOK will look to raise rates very late summer, but will be mindful of credit stress in the U.S. and Europe. **Australia's** economy remains led by the raw materials sector. Domestic activity is lackluster, and the index of leading indicators has been flat since January. RBA Governor Stevens indicated that consumption would not grow as quickly as the 1995 to 2009 period. A strong Australian dollar is helping to check inflation, but a higher than expected Q2 CPI may tilt the outlook for monetary policy toward tightening. The RBA is likely to keep rates on hold given the loss of momentum in global growth and contained domestic demand. The **Japanese** economy shows signs of recovering from the earthquake, but the growth picture is slow. Production has increased and consumer spending has a stronger tone. Inflation is extremely low, and the BOJ will keep policy steady for the foreseeable future. A strong yen is checking growth and capping inflation. Key economic indicators:

Australia:

- May LEI (Conference Board) fell 0.1% m/m. The trend has been flat to lower since January and suggests limited growth prospects.
- June Private Sector Credit Growth declined 0.1% m/m [0.4% expected]. Growth rose 2.7% y/y and has decelerated.
- Q2 CPI rose 0.9% q/q [0.7% forecast]. Prices were up 3.6% y/y [3.4% forecast]. Inflation is creeping higher and moving toward the top of the 10-year range. The sequential change was firm in clothing, food, health, and household furnishings. Recreation and education were tame.

China:

- July HSBC Flash Manufacturing PMI fell 1.2 to 48.9 and hit a 28-month low.
- June New Home prices rose in 67 cities. Prices in Beijing and Shanghai both gained 2.2% y/y. Home prices in Beijing were unchanged sequentially. Existing home prices in Beijing fell 0.1% m/m and rose 1.4% y/y, while existing home prices in Shanghai rose 0.2% m/m and 2.4% y/y.

India:

- Primary Articles WPI rose 10.49% y/y in the week ending July 16th. Inflation continues to inch lower, but remains elevated.

Japan:

- July Manufacturing PMI rose 1.4 to 52.1. Details include: 1) New orders rose and supply pressures have abated to support output. 2) Employment rose but at a marginal rate. 3) Input inflation hit a 6 month low. 4) Output inflation was modest due to competitive pressures.
- June Jobs to Application Ratio rose 0.2 to 0.63 [0.61 forecast], grinding higher slowly.
- June Unemployment Rate rose 0.1% to 4.6% [in line]. The rate has stopped its decline.
- June Household Spending fell 4.2% y/y [-2.3% forecast], but spending rose 0.8% m/m. Spending appears to be on a recovery path post quake.
- June Retail Trade rose 2.9% m/m [1.5% forecast]. The index level has rebounded above February (102.3 v. 101.0) and shows recovery from the quake.
- June IP rose 3.0% m/m [4.5% expected]. Production is rebounding from quake weakness. However, the index level of 92.7 is still below the February level of 97.9.
- June Exports fell 1.6% y/y [-4.1% forecast], while Imports rose 9.8% y/y [11.0% projected]. The index shows export volume at 102.7, which is mixed to trend. The import index was 101.9, which is on the softer side of the eight-month range.

- July Small Business Confidence rose 4.0 to 47.1. Confidence is rebounding from the quake and showing recovery.
- June CPI rose 0.2% y/y [in line]. Core CPI rose 0.1% y/y [in line]. CPI has been moving higher, but the increase has stalled in recent months. Sequentially, CPI fell 0.2% and has been flat to lower since March. Food prices rose, but other major categories contracted.

South Korea:

- Q2 GDP rose 0.8% q/q [in line]. Finance and real estate contracted. Manufacturing and business activities were firm. The year over year rate rose 3.4%, decelerating. Growth is on the lower end of the 10 year range ex-the 2008/2009 crisis.
- August BOK Manufacturing Sentiment rose 3 to 90, but the trend is lower.
- August BOK Non-manufacturing Sentiment fell 1 to 84. The trend remains downbeat.

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