January 29, 2011

Growth and Inflation

Although the IMF cut its economic growth forecast for 2012, the global economy is attempting to firm and recent data points argue for improved growth prospects. The January flash EZ Composite PMI rose 2.1 to 50.4 working into expansion territory, while regional PMI surveys have argued for upward momentum to the U.S. economy. The picture in Asia is less vibrant, as the BOJ painted a sluggish picture of growth in Japan, and the Chinese flash manufacturing PMI could only increase 0.1 to 48.8. Putting numbers on the growth picture, the IMF cut its 2012 GDP forecast by 0.8% to 3.3%. Growth in the EZ was projected to contract 0.5% compared to a forecast for 1.1% growth in September. The U.K. economy was forecast to expand 0.6% in 2012 down from the September estimate of 1.6%. China and India were projected to grow 8.2% and 7.0% down 0.8% and 0.5% respectively from the September forecast. The outlook for global growth remains clouded by the EZ sovereign crisis and the lagged impact of macro tightening measures on the Chinese and Indian economies.

Inflationary pressures have stabilized after a period of decline. The CRB index has held the October/December lows in the 290 area, and central banks are showing a willingness to expand their balance sheets and prevent deflation until economic growth moves decisively higher. On January 25th, the BOE suggested an expansion of its asset purchase program was possible, and the Fed indicated rates would remain low through 2014. At the same time, China is selectively loosening monetary policy, and India cut its reserve ratio requirement. Brazil's central bank has also been easing monetary policy. These inflationary data points are offset by continued real estate deflation in the U.S., signs of falling home prices in China, and weak wage growth in the U.S. and Europe. Even though job creation has improved in the U.S., wages are up only 1.6% y/y and the median price of a new home contracted 12.8% y/y in December. Flash PMI data indicated service prices charged fell in the EZ and manufacturing output prices eased in China. Pricing power remains difficult given the uneasy demand backdrop.

Money Markets

The treasury market looks contained by the Fed's desire to keep rates low. Sellers are timid given the Fed's twist operation and call for low rates until 2014. Continued deflation in the housing sector, and weak wage growth have balanced an uptrend in regional PMI readings and a persistent reading of unemployment claims below 400,000. Typically, an upswing in regional PMI surveys lifts yields. The market has also ignored persistent strength in the Citi economic surprise index. The Fed's willingness to keep rates low, a struggling economy in Japan, and lack of resolution to the EZ sovereign crisis have worked to pressure treasury yields. The main negative for the treasury market is poor valuation. The 10 year TIPS break-even is around 2.10% and ratio of the TIP break-even to the 10 year yield is the highest since 1998 at about 1.09. The ratio is over 3.4 standard deviations above the mean of 0.49. Investors buying 10 year treasuries are willing to lend to a fiscally irresponsible government at an effective zero real rate. In addition to poor valuation related to inflation, the Moody's Baa corporate is yielding nearly 340 bps above the 10 year treasury yield and is in the 7.5 percentile of values since 1992. The 10 year treasury yield is also about 600 bps below the expected earnings yield on the S&P 500.

Foreign Exchange

The FX market will be focused on positioning, while watching the race to see which central bank can expand its balance sheet most dramatically. The market has been forcing a large dollar long to liquidate in the last week. The dollar continues to hold a growth advantage to the euro, but the Fed's willingness to keep rates low and seeds for QE3 have matched the expansion of the ECB's balance sheet and liquidity generated by long term repo operations. Fed policy seems aimed at containing dollar strength. These factors are overlaid by CFTC data which shows large funds a huge and little changed net short 171,347 euro currency futures contracts.

The **euro** will remain sensitive to debt restructuring talks in Greece and the possibility of a default in Portugal. At writing there was hope for an agreement between the Greek government and private bondholders, and Greece was suggesting commitment to fiscal austerity. Bond yields in Portugal are elevated and consistent with restructuring. The trade will watch to see if Portugal experiences restructuring after Greece. However, Italian and Spanish yields have been easing suggesting reduced credit stress. Growth in Germany is supporting the EZ region, but the overall growth picture is poor and a drag on the euro. A low euro would help to stimulate exports and balance weak domestic demand.

The **sterling** is likely to be pressured by ideas that the BOE could expand its asset purchase program. Recent BOE member statements and minutes have left to door open to additional monetary ease. On the economy, CBI data displayed a downshift in consumer spending. The bounce in December was short lived as weak wage growth and high living costs are reducing spending. Chartists are likely to judge the ability of the GBP/USD to move over the 1.5800 to 1.5900 area as an indicator of strength.

The **Swiss franc** has rallied in the face of general dollar weakness, but remains range bound against the euro. FX management by the SNB remains in place and a cap to the Swiss franc. The Financial Stability Board was critical of the SNB's cap, saying it could lead to an overheating economy, but the statements did not appear to significantly influence trade. The market is likely to be sensitive to the UBS consumption indicator, retail sales, the PMI, and trade data at the turn of the month. Weak growth expectations and the risk of deflation are the primary factors driving the SNB's FX policy.

The **Canadian dollar** is likely to be driven by the direction of commodity prices and pace of economic growth. The domestic economy is expanding and supportive to Canadian dollar strength. The December LEI argued for continued growth, and factory sales hit a three year high in November. However, retail sales growth has a softer pace. The willingness of central banks in Europe and the U.S. to enact extreme monetary ease could help support the Canadian dollar as a reserve or diversifier currency. Chart watchers will monitor the ability of the USD/CAD to fall below 0.9895 or rise above 1.0080.

The **Australian dollar** will follow commodity prices, and the outlook for a soft landing in China. Moreover, easy central bank policy in the U.S. and Europe is likely to embolden capital flow to Australia as investors search for yield. The market's upside will be tempered by expected RBA rate cuts, but the two year yield differential remains wide in favor of the Australian dollar. The Australian 2 year yield is rich at 3.25%. The recent stability in commodity prices and signs that Chinese economy may be stabilizing are also helping the Australian dollar. Movement of the CRB over 325 would likely give the AUD another boost by signaling a new uptrend in commodity prices. Chart watchers will eye the ability of the AUD/USD to work over 1.0765.

The **yen** should be pressured by signs the Japanese economy is starting to generate a trade deficit in a time of deflation. Growth is also weak. However, the USD/JPY has not moved out of its trading range. The idea of a trade deficit suggests that the yen is overvalued and inhibiting growth. This is complemented by the BOJ's assessment that economic activity is flat due to poor overseas growth and a strong yen. The high yen is also adding to deflation. The core CPI contracted 1.1% y/y in December and highlights deflationary trends. The USD/JPY will break out of its range on a move over 78.30 or under 75.35.

Equities

U.S. stocks will be driven by the outlook for profit growth, and the ability of banking and semiconductor share to advance recent gains. Q4 profit results have been lackluster. The spread between the number of positive and negative earnings surprises is low compared to both the longer term and recent averages and profit estimates for 2012 are working lower. According to S&P, the operating earnings per share estimate for the S&P 500 has fallen from $106.49 to $105.78 or $0.71 over the past two weeks. Inexpensive valuation and the hunt for relative value have helped to support the market. Alcoa, 3M, Apple, Intel, and Caterpillar did provided upbeat outlooks on the prospect for growth in 2012, helping to support the market in the face of a weak trend in earnings. Valuation is supportive as a 10 year treasury yield near 2.00% and zero interest rate on cash make stocks look cheap given an earnings yield near 8.0%. An upswing in global PMI numbers at the start of February will brighten the outlook for profit growth and could stabilize the decline in profit estimates. Technically speaking, the trade will watch to see of banks can hold their recent gains. Signs of improved housing demand, talk of a government plan to help underwater homeowners, and discount valuation may be supportive, but the BKX needs to hold the 42.25 area to suggest technical strength. Likewise, there are signs semiconductor demand is improving. Chip equipment maker KLA Tencor provided a strong sales outlook, and Intel noted it would spend $12.5 bln on equipment in 2012. If the SOX is able to move over 420, bullish psychology toward the technology sector could elevate. Lastly, the NASDAQ 100 is flirting with the 2011 highs and near breaking out of a one year trading range to the upside. Sustained gains over 2400 could drive momentum buyers into the market.

Commodities

Commodity prices will be driven by investment flows, the strength in global growth, and individual market factors. Global monetary policy is supportive to commodities given the willingness of the Fed, ECB, and BOE to provide ample liquidity at the same time central banks in India, China, and Brazil are on the path toward monetary accommodation. Barclays Capital recently projected a rebound in commodity investment in 2012 after investors bought just $15 bln worth of commodities in 2011 and withdrew $11 bln from funds in December 2011. Commodity investment under management totaled $399 bln at the end of 2011 after a peak of $418 bln in Q1 2011. Looking at individual markets:

The **oil** market has one eye on tensions in the Middle East and the other on demand. Sanctions against Iranian oil continue to cause Iran to threaten shutting the Strait of Hormuz. Geopolitics could linger as a factor well into the summer when sanctions gain greater traction. On the demand front, China's oil demand rose 0.7% y/y in December to 9.69 mbd. Platt's indicated that demand for all of 2011 increased 6.1% to an average of 9.25 mbd. The level of usage remains strong, although the IEA cut its 2012 consumption growth estimate for China by 1% to 4.3%. India's demand is running about 3.50 mbd with consumption of refined product little changed in December from November. A slower pace of economic growth seems to be dampening usage. However, the 3:2:1 crack spread in Minas has expanded in recent weeks hinting at improved demand in Asia. The spread was priced at $4.30 which is on the lower end of the $5.00 to $10.00 range seen during much of 2010 and 2011, but off its recent low near $0. In the U.S. crude oil supplies are poised to climb seasonally and stood at 334.8 mb compared to 340.6 mb a year ago. There was a 22.9 day supply of crude oil compared to 23.4 last year. U.S. domestic production remains ahead of last year at 5.786 mbd up 6.4% y/y. Imports have been near steady with a year ago in recent weeks. Product demand is weak. Warmer than normal weather is playing a roll, but high prices are restraining usage too. The demand picture is a negative for prices. U.S. gasoline demand is was down 6.4% y/y to 8.207 mbd in the last 4-weeks. Demand growth is below that seen during the 2008 recession. Gasoline stocks should build in the coming weeks and supply looks comfortable at 27.2 days verses 26.2 days a year ago. The one positive for gasoline rests in refinery shutdowns, capacity reduction, with ConocoPhillips and Sunoco closing facilities. Distillate demand is down 2.0% y/y over the past 4-weeks and has turned negative the past three weeks after showing brisk growth in October and November. Distillate supplies are in the middle of the 5-year range and ample. There was a 40.6 day supply of crude oil compared to 45.3 last year.

Natural gas prices will remain sensitive to weather and the pace that stocks are pulled from storage. The trade will also look for signs that producers are paring production. The 8 to 14 day outlook shows normal temps on the East Coast and through the South with the exception of Florida which will be below normal. The Midwest and West are expected to see above normal to much above normal temps. Weather patterns argue seasonally weak consumption. As of January 20th, there were 3,098 bln Bcf in storage. Storage was 20.7% ahead of last year and 21.4% above the 5-year average. The amount of gas drawn from storage fell more dramatically last week, but supplies are a burden to price. BENTEK reported that U.S. gas consumption was down 9.5% y/y in the period ending January 25th, while dry gas production was up 7.4% y/y. The low price is likely to ease production at the margin. Chesapeake recently announced it was cutting its dry gas drilling rig count and would reduce its gross operated gas production by as much as 1 Bcf per day. According to Baker Hughes, the gas rig count stood at 777 down 3 from the week prior and 913 at the same time last year. Bigger picture, the low price of natural gas has raised its profile as an efficient and cheap source of energy. Politicians may push more strongly for its usage.

Macro factors provide a favorable backdrop to **Gold.** Prices are being supported by easy central bank policy. The Fed, ECB, and BOE are positioned to keep their balance sheets growing and liquidity ample. The opportunity cost of holding gold is low and easy central bank policy is stoking inflation fears. Moreover, uncertainty over the Greek debt restructuring and fear Portugal may need restructuring are a benefit to gold. The main negative for gold rests in low inflation. Even though central bank policy is easy, the U.S. GDP deflator rose only 0.4% in Q4 and is historically depressed. Japan continues to show signs of deflation, and India's primary articles WPI contracted 1.1% y/y in the week ending January 14th. Furthermore, housing deflation remains strong in the U.S. and home prices are weakening in China. The inflation picture suggests that central banks may be justified in their easy policy stance. Physical demand has been robust in January. The U.S. Mint sold 106,000 ounces of gold in the first three weeks of January ahead of December's 65,500 total. There are also reports of healthy Asian demand in the Lunar New Year. CFTC data shows commodity funds a major net long. There were 173,479 futures longs and 31,256 shorts. Gold is above the 40, 50, and 200 day moving averages, which argues against fund selling near term.

Copper prices will be driven by the outlook for economic growth. Global PMI numbers will shape the outlook for growth and copper demand. One negative for the market rests in the leading indicator of primary demand. The growth rate of the copper index is down 1.1% y/y and has been trending lower since the spring of 2011. Freeport McMoran recently stated its net cash cost of producing copper averaged $1.57/lb suggesting that prices will continue encourage production. Freeport seemed upbeat on the outlook for demand noting construction and auto output as positives. Freeport's production of copper was 823 mln pounds in Q4 2011 down from 1,007 mln pounds in Q4 2010 highlighting tightness. LME copper stocks continue to trend lower and imply tight supplies constant with Freeport's production figures. LME inventories stood at

335,435 mts and were the lowest since the fall of 2009.

South American weather and demand will drive the price of **corn** and **soybeans**. Dry conditions continue to be a risk to corn and soybean production, as Argentina and Southern Brazil have been dry. However, forecasters seemed to be expecting some rains to hit the Argentine growing areas at the turn of the month. Coverage was expected around 75% with rain totals between 0.25 and 1.25 inches. Likewise Brazilian growing areas were expected to see rains with coverage in the 40% to 50% area. However, NOAA's GFS forecast was predicting below average rain falls through much of Brazil and Argentina into the first week of February. In its weekly crop bulletin, the USDA said that conditions remained overall favorable for growing areas of central and southeastern Brazil. Highlighting the adverse impact of weather, the Buenos Aires Exchange forecast soybean production at 46.2 mmt compared to 49.2 mmts a year ago. The corn crop was forecast at 22.0 mmts verses 22.1 mmts last year. AgRural Commodities projected the Brazilian soybean crop would be 70.2 mmts down from an initial estimate of 73.1 mmts and 75.3 mmts a year ago. AgRural also reduced its corn crop forecast to 34.88 mmts down from its December projection of 36.44 mmts. Reduced production estimates for the South American corn and soybean crops are boosting the outlook for U.S. exports. However, U.S. export sales have been sluggish in recent weeks. Soybean export sales are down 23.6% y/y and corn export sales are off 2.0% y/y over the past four weeks. Soybean total commitments as a percent of total exports were 75% versus 93% a year ago and a 5-year average of 81%. Corn total commitments as a percent of total exports were 64%, which is slightly above a year ago and the 5-year average. Chartists will be watching the January 3rd high in the March soybean contract near $12.44 for signs of upside price momentum. Likewise, March corn faces significant price congestion on the daily chart between $6.50 and $6.65.

Wheat prices will be sensitive to the direction of corn and demand trends, but also eying the impact of a cold blast in Europe. In its crop bulletin, the USDA indicated that rain and snow had favored winter crops in central and Eastern Europe and Spanish wheat, while snow in the Ukraine had helped insulate winter crop from cold. However, a severe cold weather snap has traders fearful that the USDA assessment of the Ukraine is stale and production estimates could be revised down significantly. The winter wheat crop in the U.S. appears to be progressing. On the demand front, U.S. export sales have rebounded, but remain soft to a year ago. The 4-week average of export sales is off 35.6% y/y. The market saw exports of 133,200 tonnes to an unknown destination late last week, but also learned that Iraq had excluded U.S. wheat from its 50,000 tonnes tender. Chart watchers will eye the January 3rd high around $6.71 for forward momentum. Unlike soybean and corn, large funds are a net short 59,383 contracts of wheat and prices have worked above the 40 and 50 day moving averages. Prices are also flirting with the 100 day moving average in the $6.50 area**.**

Cotton prices will sensitive to demand trends. The pace of retail activity in China around the Lunar New Year and export activity should help drive prices. U.S. cotton stocks remain low and supportive. As of January 26th, there were 46,867 bales of certified stocks on the ICE. Drought conditions linger in Texas and rain fall projections through February 5th were for light precipitation. However, NOAA's outlook for February and March suggests improved soil moister. Overseas, the Indian production estimate has been cut due to disease in the states of Maharashtra and Andrhra Pradesh. 34.5 mln bales were expected to be harvested compared to a November estimate of 35.6 mln bales and 35.2 mln bales in the 2010/2011 crop year. U.S. export sales of cotton have trended poorly down 76.1% y/y in the past 4-weeks. Even so, commitments for export are 101% of the USDA"s export projection compared to a 5 year average of 72%. One question surrounding the outlook for export sales is the size of China's stockpiles. China has been a large buyer recently, but AgWeb highlighted that China's cotton stocks are 14 mln bales and about 24% of global stocks. An Auburn University economist suggested that China had created an artificial shortage. Technically, the March contract failed to work over $1.00 which may have led to some liquidation. Looking at futures and options, large funds were more than three times long than short as of January 24th.

Cattle supplies remain tight, but demand is likely to be a driver of price. The semi-annual inventory survey by the USDA showed the herd down 2.1% y/y as of January 1st at 90.8 mln head. Beef Cows were off 3.1% y/y, while heifers over 500 lbs were down 1.0% y/y. Steers greater than 500 lbs were 2.0% below a year ago. Seasonally, cattle supplies should fall slowly over the next few weeks and then tighten into spring before rising into the summer. The placement of cattle on feed has been solid so far in January. Demand is a drag, as packer margins are reported negative and domestic usage has eased post the holidays. Cattle slaughter was down 3.8% w/w and 7.0% y/y at 608,000 head in the latest week. Weights were up 3 lbs from the week prior and 5 lbs to a year ago and may reflect packer reluctance to buy cattle. The cut out has dipped in early January running against the 5-year average which shows early year strength. Retail beef prices hit a new record in December at $5.02/lb. Prices are 57.8 cents/lb higher than a year ago and have displayed persistent strength over the past two years. The international market is helping to support prices. Beef export sales were up 14.5% y/y over the past 4 weeks, and hide sales rose 2.7% y/y in the same period. Large funds are almost 3 times as long as short cattle futures and options contracts.

Hog prices will be sensitive to demand. The cut out has been under pressure. U.S. retail prices are high and a headwind to consumption. Pork buying in front of the Lunar New year has faded. Domestically, the average retail price of pork was down 5 cents from November, but up 27 cents from a year ago at $3.46/lb. Pork prices have been rising on a year over year basis for nearly 2 years, but the adverse impact has been dampened by high beef prices. Hog slaughter was 2.167 mln head in the last week off 0.8% y/y. Slaughter should be tracking up about 2.0% y/y. Weakness in the cut out value could be causing packers to back off of purchases. However, Iowa Minnesota live weights are only up 1.0 lb from last year and imply hogs are not being backed up.

Coffee prices have traded heavy. The supply/demand picture is mixed with both bulls and bears finding support for their views. In terms of Brazilian production, exporter Comexim said coffee farmers in Minas Gerais could see their output cut by 20% due to drought. In contrast, Somar provided a mixed view on production noting that the crop would receive beneficial rains over the next 10 days. However, Somar provided the caveat that mild weather and lack of sun could foster disease in the south eastern portion of Brazil. In its weekly crop bulletin, the USDA noted that moisture levels were favorable for coffee growing conditions. The Mexican growers association said that coffee output would rise 8% to 4.2 mln bags, noting favorable condition. In India, the president of the Coffee Exporters Association noted that the Indian harvest would be down 6.2% due to excessive rainfall. However, he said that Indian exports could be hurt by ample harvests in Vietnam and Brazil. On the demand front, Starbucks indicated strong interest for VIA product and healthy demand for K-cups. However, Brazilian exporter Flavour said that January exports could be 2.2 mln bags down from 2.7 mln a year ago due to weak demand. The comments from Flavour run against the ICO which recently noted that global consumption was strong and 135 mln bags in 2011.

The **sugar** balance sheet continues to show signs of loosening, but there are significant risks to the outlook. Two signs of loser supply rest in Robobank's forecast for a 6 mmts surplus this year and India setting up to announce the export an additional 1 mmts of sugar February 7th. India's Sugar Mills Association indicated that production was 10.5 mmts between October 1st and January 15th up 19% from a year ago. Russia is reporting that its sugar beet crop doubled last year to 46.3 mmts in 2011, and imports are forecast to be on the lower end of the historical range. However, the market remains concerned about the potential for weak production in Brazil and the ability of the country to meet ethanol demand. Likewise, China's sugar consumption could be strong. China's Guangzi province is stockpiling 900,000 mts this year. China imported nearly 500,000 in December compared to 421,400 tons in November. Imports were the strongest since September 1988. Usually China is in the early stages of crushing its domestic crop in November and thus big imports imply an imbalance between supply and demand. The bar chart on March NY sugar shows signs of support and price congestion between 22.50 and 23.50. CFTC data shows large funds a heavy long. Through the period ending January 24, large funds added 35,742 futures and options contracts to their long position. There were 142,887 contracts longs and 38,442 contracts short.

North America

*Regional PMI numbers suggest the U.S. economy is expanding and finding upward momentum. Labor market conditions are improved and homebuilders are more optimistic. However, consumer spending appears be in a post-holiday lull and Q4 GDP displayed weak underlying demand. Inflation looks tame given low wage gains and deflation in the housing sector. The Fed is using verbal intervention to keep rates low and suggesting no rate hike until 2014. Further, the Fed is leaving the door to additional QE open, but will continue to execute the twist near term. The **Canadian** economy is expanding given the recent trend in manufacturing orders, LEI, and retail sales; however, the pace of retail activity has softened. Inflation is contained and the BOC will keep rates steady near term. Key economic indicators:*

U.S.:

- Q4 GDP rose 2.8% [3.0% forecast]. The deflator was 0.4% [1.9% expected]. Real final sales were 0.8%, and final sales to domestic purchasers were 0.9% showing soft underlying growth.
- January NAHB Survey rose 4 to 25 [22 forecast]. The survey points to green shoots in the housing sector.
- December Housing Starts were 657,000 [680,000 expected]. Multi-family starts fell 20.4% to 187,000 and the payback hurt the headline. Single family starts rose 4.4% to 470,000 and point to improvement.
- December New Home Sales fell 2.2% m/m to 307,000 units [321,000 forecast]. Prices plunged 12.8% y/y and inventories remain historically lean.
- December Existing Home Sales rose 5.0% m/m to 4.61 mlu [4.65 mlu forecast]. The median price fell 2.5% y/y and there was a 6.2 month supply of inventory. Inventories are being burned off.
- December Pending Home Sales fell 3.5% m/m [-1.0% forecast]. The decline was a payback from November.
- December Durable Good Orders rose 3.0% m/m [2.0% forecast]. Nondefense capital good orders ex-air rose 2.9% m/m [1.0% forecast]. Aircraft orders were strong up 18.9%. Machinery and primary metals were firm. The inventory to shipment ratio fell to 1.79 from 1.82. It is high to a year ago (1.71) but shows some mild clean up.
- December CPI was flat [+0.1% expected]. Core rose 0.1% [in line]. The headline rate fell to 3.0% y/y from 3.4%, while core rate was unchanged at 2.2%. Vehicle and apparel prices helped to cap inflation, while rent costs show signs of firming.

Canada:

- November Retail Sales rose 0.3% m/m [0.2% forecast]. Sales are up 3.1% y/y and shows signs of decelerating.
- December LIE rose 0.8% m/m [0.6% forecast], pointing to continued economic expansion.
- November Home Prices rose 7.3% y/y [7.1% forecast] and show signs of accelerating.
- Canada's CPI contracted 0.6% m/m [-0.2% forecast]. Inflation eased to 2.3% y/y down from 2.9%. Core inflation tumbled 0.5% m/m and rose 1.9% y/y off from 2.1% in November. Clothing, recreation, and transportation was weak.

Europe

*The **EZ** economy shows signs of stability given the flash PMI numbers and the German IFO survey. However, growth looks greatest in Germany and the rest of the EZ is still struggling. Consumer and government spending are restrained and the slowdown in global growth has dampened export activity. Inflation shows signs of cresting. The ECB is likely to cut rates another 25 bps by March. An expansion of liquidity provisions is possible, but not likely unless credit stress flares. So far, the ECB's 3 year LTRO has been successful in pressuring yields in Italy and Spain. The **U.K**. economy is growing slowly. After a bounce in December it looks like retail sales eased in January. Manufacturing activity has a firmer tone, but remains weak overall. Housing demand is inching higher slowly. Inflation should decline in the coming months, but remains high. The BOE is open to more policy accommodation, but inflation needs to fall and growth must continue weak in order to support an expansion in the asset purchase program. Key economic indicators:*

Eurozone:

- January Flash Composite PMI rose 2.1 to 50.4 [48.5 forecast]. Manufacturing rose 1.8 to 48.7, while Services rose 1.7 to 50.5. Strength in Germany is supporting EZ activity and it appears ECB actions are bolstering confidence.
- January French Business Confidence fell 3 to 91.0 [95 expected] and is trending lower. Order book fell 6 to -32 and the production outlook dropped 1 to -37. Both are showing weakening. Detail: 1) Retail Confidence fell 4 to 89 and shows a steady downtrend. Hiring and expected demand fell. 2) Service Confidence rose 1 to 92 and has been flat over the past few months. Expected demand and hiring declined. 3) Construction Confidence rose 1 to 100 and has been steady the past three months. Expected activity and order book level were about flat
- The January German IFO Business Climate rose 1.1 to 108.3 [107.6 forecast]. Current assessment fell 0.4 to 116.3 [116.8 forecast], while expectations rose 2.5 to 100.9 [99.0 forecast]. The climate index is showing signs of a small bottom and stability. Details: 1) Manufacturing jumped 4.5 to 13.4. 2) Construction rose 2.6 to -3.7. 3) Retail fell 6.1 to -0.5. The drop in retail seems noteworthy.
- January Italian Business Confidence was flat at 91.6 [92.0 forecast], but is at historic lows.
- February German GfK Consumer Confidence rose 0.3 to 5.9 [5.6 expected] and is gliding higher.
- January French Consumer Confidence rose 1 to 81 [80 forecast], but is depressed just above the 2008 low.
- January Finish Consumer Confidence rose 3.0 to 3.4 [1.7 forecast], and shows signs of carving out a bottom. None-the-less, it is still historically depressed.
- December Spanish Retail Sales fell 5.4% y/y [-5.9% expected]. Consumer demand remains extremely depressed.
- December Irish Retail Sales rose 3.0% y/y, and show some signs of turning higher. However, sales growth remains depressed to the 2006 to 2007 period.
- December M3 growth rose 2.1% y/y [2.3% forecast]. Growth shows signs of stalling.
- Final December EZ CPI rose 0.3% m/m [0.4% expected] and rose 2.7% y/y [2.8% expected]. Inflation is moderating.

U.K.:

- December BBA loans for home purchase were 36,171 [35,000 expected]. The trend is drifting higher at a slow rate.
- Q4 GDP contracted 0.2% [-0.1% forecast]. There was across the board weakness.
- January CBI Industrial Orders increased 7 to -16 [-23 forecast]. Selling prices rose 6 to 13 [3 forecast] and volume of output rose 23 to 15 – notable pick up.
- December Retail Sales rose 0.6% m/m [in line]. Sales are up 2.6% y/y. Activity seemed firm and rebounded from a soft November.
- January CBI Reported Sales plunged -31 to -22 [-6 expected]. The December rebound faded. Volume of sales fell 4 to -11, while sales for time of year decreased 4 to -20. The CBI notes that wages are under pressure and inflation is high. Both are limiting purchasing power.
- December Claimant Count rose 1,200 [+7,000 expected]. The pace of job loss is slowing, but conditions appear weak.
- November ILO Unemployment Rate rose 0.1% to 8.4% [8.3% forecast] and continues higher.
- November Average Hourly Earnings rose 1.9% y/y -- wage growth remains anemic.
- December CPI rose 0.4% m/m and 4.2% y/y [in line]. Core CPI rose 3.0% y/y [as expected]. Core inflation shows signs of cresting.

Asia

Asian economic growth appears to be stabilizing after a slowdown. ***China's*** *GDP, retail sales, and industrial production recently exceeded expectations, and government officials are selectively loosening policy to stimulate growth. Housing remains the biggest downside risk to growth with prices falling and demand weakening. Inflation should continue its moderation, but a decline in the inflation rate will occur slowly. The PBOC will be loosening monetary policy over the medium term.* ***India's*** *economy is experiencing weak growth to trend, and inflation has moderated. The lagged impact of monetary tightening, the EZ crisis, and general slower tone of global growth has hurt output. The RBI will be loosening monetary policy and a discount rate cut is possible in the coming weeks. Loose fiscal policy and deficit spending seems to be the biggest hurdle to a near term rate cut.* ***South Korea's*** *growth is mixed. The BOK's survey of growth showed steady manufacturing activity but a downshift in the service sector. Weak overseas growth is hurting activity. Inflation remains above the BOK's target. Monetary policy will be unchanged as the BOK works to balance above target inflation and a slower pace of growth. Signs of economic stability in China and firmer commodity prices argue for improved growth in* ***Australia.*** *However, recent data points on the economy were sluggish given auto sales, consumer confidence, and the LEI. Inflation looks a bit sticky, but should moderate. The RBA will cut rates 25 bps on February 7th. The* ***Japanese*** *economy is growing at an anemic rate. A strong yen, weak export markets, and slow earthquake reconstruction are limiting activity. Deflation is present given a contracting core CPI growth rate. The BOJ is already enacting super easy monetary policy, but will remain biased toward additional monetary ease until the yen weakens and the economy shows clear signs of growth. Key economic indicators:*

Australia:

- December Vehicle Sales contracted 2.9% m/m and 3.0% y/y. Sales have declined 3 of the past 4 months.
- January Westpac Consumer Confidence rose 2.4% to 97.1. The index is still at depressed levels and argues for sluggish growth. The recent cycle peak was close to 120.
- November Westpac LEI fell 0.2% m/m. The index has been working lower since August.
- Q4 CPI was flat [+0.2% forecast]. Inflation is up 3.1% y/y and shows signs of rolling over.

China:

- January HSBC Flash PMI rose 0.1 to 48.8. The details showed new orders and employment contracting at a slower rate. In contrast, output contracted at a faster pace. Input and output prices declined at slower rates.
- Q4 GDP rose 8.9% y/y [8.7% expected]. Growth has slowed, but less that feared.
- December Retail Sales rose 18.1% y/y [17.2% forecast]. Consumer spending appears vibrant.
- December Industrial Production rose 12.8% y/y [12.3% forecast]. The growth rate rebounded from November, but is on the lower end of the one year range. Electricity output rebounded to 403.8 bln kwh and rose 9.7% y/y. Motor vehicle production rebounded to 1.820 mlu sequentially, but fell 6.5% y/y.
- The National Bureau of Statistics (NBS) said 2011 housing transactions rose 10%, but growth hit a 3 year low.
- December Home Prices fell in 52 cities and rose in 2 of the cities tracked. Prices have fallen three straight months in Shanghai, Beijing, Xhenzen, and Guangzhou. The spread in price increases to decreases was -50 down from +25 in July.

India:

- Primary Articles WPI fell 1.03% y/y in the period ending January 14th showing deflation.

Japan:

- December Exports fell 8.0% y/y [-7.4% expected], while Imports rose 8.1% y/y [in line]. On a volume basis, exports were down 6.6% y/y, but the index rebounded from weakness in November and October. Import volume declined 0.7% y/y, and has been sequentially weak since August.
- December Consumer Confidence rose 0.8 to 38.9 [38.5 forecast]. Confidence is creeping higher. Employment rose 1.8 to 36.1 and is inching higher.
- January CPI fell 0.2% y/y [in line] and the core rate contracted 1.1% y/y [in line]. Deflation continues.
- December Retail trade rose 2.5% y/y [2.1% forecast]. Growth looks in line with the long term trend and supportive to growth.

South Korea:

- December Department Store Sales rose 11% y/y, while Discount Store Sales rose 3.7% y/y. Department store sales displayed a rebound in activity. Clothing picked up. Discount sales are choppy.
- Q4 GDP rose 0.4% q/q [0.5% forecast]. Growth expanded 3.4% y/y and has been flat to lower in recent quarters. Details displayed poor activity with private consumption falling 0.4% and government consumption off 1.7%. Export and import growth shrank. Capital formation rose marginally.
- February BOK Business Sentiment in Manufacturing rose 2 to 87. The index is in the middle of the nine month range. Non-manufacturing fell 1 to 81 and continues to slide lower. The service sector is arguing for a material slowdown in growth.
- January Consumer Confidence declined 1 to 98 and is grinding lower. Employment up ticked 1 to 83 but is low compared to trend.

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