



Hadrian Brief

June 18, 2011

Growth and Inflation

The global economy has slowed from early 2011. Economic activity has been negatively impacted by the recent spike in raw material prices and macro tightening measures in the emerging world. Furthermore, the regulatory environment, worries over a sovereign credit crisis, and austerity measures in portions of the OECD have created a headwind to growth. The IMF recently cut its 2011 global GDP forecast by 0.1% to 4.3%, but left the 2012 outlook unchanged at 4.5%. The IMF trimmed its 2011 GDP forecast for the U.S. by 0.3% to 2.5%, and projected 2.7% for 2012. In contrast, the IMF lifted its 2011 EZ GDP outlook 0.4% to 2.0%. Growth in emerging Asia was forecast to decelerate slightly, but Chinese and Indian growth projections for 2011 and 2012 were kept unchanged. China was expected to expand 9.6%, while India was estimated to grow 8.2%. Lastly, growth in Latin America was revised down 0.1% for both 2011 and 2012 to 4.6% and 4.1% respectively.

Inflationary pressures have moderated with the recent decline in raw material prices. However, headline inflation readings remain elevated due to the lagged impact of the rise in commodity prices earlier this year and higher sourcing costs. The uptrend in EZ CPI paused in May, but inflation was still 2.7% y/y. The U.S. CPI continues to rise and work toward the top end of a 10 year range up 3.6% y/y, while the CPI in the U.K. is rising at 4.5% y/y rate. China's CPI is up 5.5% y/y and inching higher, while India's inflation is moderating from extremely high level. April CPI was still a lofty 9.41%. Drivers of inflation are mixed by region. Inflation in the U.S. remains limited by low wage growth and housing deflation. Likewise, the U.K. labor market is weaker and consumer demand appears to be slowing and preventing the pass through of higher prices. The EZ is seeing mixed pressures. Service sector inflation has slowed with falling prices in the periphery. Housing deflation is present in Spain. However, inflation is present in the manufacturing sector and the German labor market which is tight. In Asia, PC component

makers are reporting labor shortages in China and the PMI suggests labor tightness in India. Chinese home prices continue to rise despite measures to halt price gains. Further, Li & Fung, a large supplier of toys and other goods, saw costs up 15% this year due to higher wages in China and increased commodity costs. Over the long run, costs were forecast to rise 5% to 6% per year. Li & Fung's CEO said that higher labor costs in southern China might force manufacturing to move to western China, Vietnam, Bangladesh, and Indonesia. He noted the era of deflation had ended.

Money Markets

The 10 year treasury yield will be sensitive to the outlook for growth and resolution of the Greek debt crisis. The Philly and Empire purchasing managers surveys displayed surprisingly weak growth and make a case for a decline in the June ISM manufacturing survey and anemic private sector payroll growth. The market will be looking for confirmation of a slowdown via the flash EZ PMI and HSBC Chinese PMI due this week. A downgrade to the growth outlook coupled with fears that government officials will over capitalize banks has lifted treasury prices in recent weeks. Furthermore, weak equity markets in China and India in the face of tighter monetary policy by the PBOC and RBI suggests EM growth risks rest to the downside. A moderation in fuel prices presents the best hope for a pick up in economic activity. Slower growth has created profit taking in the corporate debt market to the benefit of treasuries. Concerns over a Greek default are also creating a safe haven bid. Sellers will be cautious until there are signs that the Greek government can implement a new round of austerity measures and the IMF/EU release aid. At last reading, the JP Morgan Client survey still displayed the trade poorly positioned for a rally. CFTC also showed a bearish bias toward the market. Large funds were short about 6,000 10 year futures and options contracts. The last two major price peaks occurred with large funds long over 80,000 futures and options contracts.

Foreign Exchange

The dollar is expected to trade reactionary. Growth prospects in the U.S. have dimmed given recent economic data points, but the Fed's balance sheet will stabilize after a period of major expansion and risk aversion is present given falling stock markets in the emerging world. Stock indices are noticeably lower on the year in Brazil, Russia, India and China. The Greek debt crisis has hurt demand for the euro and questions the outlook for an ECB rate in July, but fiscal stress continues in the U.S. at the federal level. At this juncture, there are few concrete signs that politicians can reduce the U.S. budget deficit and raise the debt ceiling. The **euro** will be sensitive to the ability of Greece to pass an austerity plan and avoid default. Furthermore, the euro has to overcome fears that credit stress in Greece will spread to Portugal, Ireland, and Spain. The **sterling** will be pressured by signs of weak economic growth. BOE King recently suggested that monetary policy needed to remain easy and projected lower inflation. Retail sales are extremely anemic and the labor market is showing signs of deterioration. Likewise, the housing market is struggling. The combination of the comments by BOE King and sluggish data should push out expectations for a BOE rate hike. A weak currency is needed to bolster growth. The **Australian dollar** faces mixed cross currents. The desire of investors to diversify from the euro and U.S. dollar along with a favorable interest differential are bullish. However, a slower global growth picture and recent sideways trend in commodity prices should cap gains. Economic numbers have displayed soft growth in Australia with PMIs below 50, May auto sales weak, and employment indicators short of expectations. Inflation is also contained and puts no pressure on the RBA to raise rates. Like the Australian dollar, the **Canadian dollar** continues to find interest as an alternative currency to the euro and the dollar. However, the softening of commodity prices and recent statements by BOC Governor Carney are negative. He recently highlighted excesses in the real estate

market, specifically Vancouver where prices were up 26% y/y in May. The Governor also noted poor productivity and the headwind of a strong currency as factor hurting growth. However, he did warn of the eventual rise in interest rates. The **yen** remains stable lifted by lack of competition from low interest rates in the U.S. and Europe, signs of Chinese diversification flows, and fear over intervention. Recent capital flow data shows Japanese accounts reluctant to buy overseas bonds to the benefit of the yen. The economy is showing signs of recovering from the earthquake, but the bounce is not strong. The BOJ expanded lending by offering financing to institutions which failed to meet previous collateral requirements. Extra monetary ease occurred despite the BOJ upgrading the economy.

Equities

The equity market is likely to trade mixed. Profit estimates are under pressure due to the downgrade of the global growth outlook. However, 12 month forward EPS estimates have declined just marginally over the last week to \$105.12 per share, and there is a potential divergence between the trend in ISM indices and expected profits. Another round of weak ISM readings should show up in EPS estimates. Recent profit news has been mixed, but failed to provide a catalyst to prices. Valuation is attractive with the market priced just above 12.1 times forward earnings, but the market is trading the trajectory of profit growth not asset valuation. Wal-Mart just announced a \$15 bln buyback and dividend hike underscore value. Contrary indicators are in oversold territory but have yet to reach extremes and find levels which argue for a high probability rally. The market is having trouble finding leadership. Financials continue to face the hurdle of stiff regulation and the need for excess capital. Weak loan demand and a flat yield curve between overnight and 3 years are weighing on profit growth. The technology sector is suffering from an emptying of the supply channel. Memory prices have been

weak and there is concern PC and handset demand are falling short of estimate. Texas Instruments has reportedly cut fab orders. Weak profit results at Research in Motion are a sign of market share loss and cannot be applied to the entire industry, but Apple, Motorola, and Google failed to find benefit from RIMM's weakness. Retail shares have been slow to respond to easing gasoline prices, and the near term decline in unemployment claims. The retail sector remains concerned about the sustainability of job growth and higher sourcing costs. United technology affirmed its outlook for profit growth this year and next, but profit warnings from Steel Dynamics and Nucor highlight the threat of reduced economic activity.

Commodities

Commodity prices are vulnerable to long liquidation on signs of slower global growth and poor CTA returns. The deceleration in economic growth questions the vibrancy of demand, and lower raw material prices may be the only outlet for the economy to move forward. The Newedge CTA index is off 3.22% year to date lagging behind total returns indices for bonds and the S&P 500. Furthermore, passive length commodity investment continues to beat active management. Out of 17 indices displayed on Bloomberg's CRR page, 14 are higher on the year from 85 bps to 977 bps. The Jefferies Commodity Performance index has the worst return contracting 209 bps.

Crude oil is vulnerable to further losses. There are reports that Saudi Arabia will pump 10 mbd in July, and the Kingdom shows a desire to keep the market supplied now that OPEC looks fractured. The U.S. market has a comfortable supply of crude. There are 363.1 mb in storage and a 24.5 day supply compared to 24.0 a year ago. Oil stocks are falling consistent with seasonal trends. Gasoline supplies have risen sharply in recent weeks and the pace of gain has been strong compared to normal. There was a 23.3 day supply of

gasoline compared to 23.7 a year ago. Gasoline demand is up 0.5% from last year over the past four weeks. The strength of demand is surprising given relative high retail prices. In contrast, distillate supplies are failing to rise consistent with seasonal trends. As of June 10th, there was a 37.0 days supply compared to 39.7 last year. The 4-week average of distillate demand is off 3.5% y/y, but the sequential trend is flat. Oil demand is brisk in China. May implied demand was 9.27 mbd and has above 9.0 mbd the seven months. However, the year over year growth rate slowed to 8.3% which was the lowest since October 2010. Singapore Inventory data is mixed. Middle distillate stocks are at the upper end of the five year range, but light distillate supplies have been dropping. On a more bullish note, Reuters recent highlighted strategic reserve building by China, India, South Korea, and Singapore. The IEA says that 420,000 bpd will be shipped to Asia until 2016 to just fill storage. The IEA has talked about the need for OPEC to lift production to fill a short fall in output from non-OPEC countries. The expected tightness is causing the IEA to talk about stock release. CFTC data is stale given the late week sell off, but the net fund long has declined sharply over the last few months. The futures only category has declined from a net long of 275,581 contracts to a recent low of 166,371 contracts. Large funds have not carried a net short since late early 2009.

Natural gas supplies are comfortable. As of June 10, there was 2,256 Bcf in storage. Storage was down 10.9% y/y and 3.3% under the five year average. Supplies are building consistent with normal patterns, but hot weather has led to smaller builds than last year and helped to keep supplies below the five year average. Power usage has been strong compared to last few years. Likewise, industrial use has been brisk compared to last year. In contrast, residential use has been lackluster. Worries over slower economic growth are weighing on prices at the margin. The 8 to 14 day weather forecast has normal temps

through much of the south and southeast and above normal temps in the upper great lakes through Maine. There is probably not enough hot weather to support prices at this juncture.

Copper prices will be sensitive to the direction of global growth. Signs of a slowdown in economic growth have capped prices. Likewise macro tightening measures by India and China and soft Chinese auto sales have weighed on bullish sentiment. However, Chinese cement production has remained strong and there is market chatter suggesting China will start restocking. LME stocks show signs of cresting are months of building. Shanghai copper stocks have stopped declining in recent weeks. On a side note, wires are highlighting the potential for production glitches. Worker unrest in Codelco's El Tontient mine may cause some concern over a short-term storage and remind the market of tight supplies. Freeport McMoran recently indicated it was selling copper at a \$3/pound profit and talked about boosting its capital spending in 2012 and 2013. Freeport noted copper was difficult to substitute and said supply was not meeting demand. Freeport was also positive on Chinese growth.

Gold prices are likely to remain firm. The global economic backdrop remains supportive. The market is being helped by still low interest rates in the OECD and lack of Fed tightening. Moreover, the U.S. has failed to solve its budget crisis or raise the debt ceiling, while the Greek government, which is shaky, needs to pass austerity measures to receive EU/IMF aid. Social unrest remains present not only in Greece, but parts of the Middle East (Syria, Yemen, and Libya). The biggest negative may rest in monetary tightening in India and China leading to a reduction in jewelry and investment demand. However, this is somewhat balanced by contracting EM stock markets. China Universal Asset Management recently received approval to start a fund that will invest in overseas ETFs backed by precious metals. The open end fund will be the first in China. ETF gold holdings remain below the early 2011 peak of 9.743 mln oz (current

9.294 mln oz). CFTC data also shows some mild liquidation by large funds from the peaks seen in late 2009 and 2010.

Corn prices will be sensitive to weather patterns, and ethanol policy. Seasonally, December corn can make a high for the year in June. According to the USDA, crop progress was 99% complete in the week ending June 12th. Although late, the crop has gotten into the ground. 91% of the crop has emerged compared to 97% a year ago and a five year average of 96%. 69% of the crop was in good to excellent condition compared five year average of 77%. If conditions continue to improve corn will be under pressure. Demand has been lackluster in recent weeks with corn export numbers tracking short of the USDA's projection. Moreover, ethanol production has been weak and there is talk in the market that feed and residual use will be cut by 100 mln bushels, leading to a higher ending stocks estimate in the June 30th stocks report. The Senate recently voted 73 to 27 to repeal the ethanol subsidy and import tariff, while the House blocked funding for ethanol pumps. Ethanol production is mandated, but the removal of the subsidy and tariff, if passed into law, could question demand. Ethanol is a huge portion of usage on the corn balance sheet – a great share than feed and residual.

Wheat prices have been pressured by the drop in corn prices and a slowdown in export sales. Crop conditions are mixed. Recent data shows the winter wheat harvest 22% complete. The harvest is above the five year average of 13% and last year's level of 10%. Moreover, there has been a jump in spring wheat plantings and emergence. Both measures are below the five year average and a year ago, but up sharply from the past two weeks. The market also seems more comfortable with soil moisture conditions in Europe as weather has brought rain to growing areas.

Like corn prices, **soybeans** will sensitive to the impact of weather on production, but the trade will also be examining demand. As of June 12th,

87% of the soybean crop had been planted up from 68% the week prior. 64% of the crop had emerged up 20% from the week prior. However, emergency is still low compared to the five year average of 76% and 78% a year ago. 67% of the soybean crop was in good to excellent condition compared to the five year average of 73%. On the demand front there is fear that supplies are loosening on the back of reduced export and crush activity. Soybean export sales and inspections have been tracking lower to expectations.

The **cotton** balance sheet is expected to loosen, but risks to the U.S. crop linger. The USDA raised its ending stocks of the global cotton crop to 48.25 mln bushels up from 47.93 mln bushels in May. Reduced usage in China and higher ending stocks in India were present. U.S. production was cut 1 mln bushels to 17.0 mln bushels, but ending stocks were raised 0.5 mln bushels and exports were reduced by 0.5 mln bushels. There is market chatter that the Indian crop is larger than reported with planted area up 15% to 20% compared to expectations of 11%. Crop progress looks normal with 95% of the crop in the ground consistent with a year ago and the five year average. However only 28% of the crop had emerged compared to a five year average of 62%. Export sales continue to be weak compared to Q1 2011 and highlight overseas production prospects have improved and high prices have rationed demand.

Front month **cattle** prices are receiving support from lower corn prices, and leave the trade sensitive to grain prices in the short term. On the supply, numbers should be flat to higher through early September and be a negative. As of June 1st, cattle on feed were up 4.1% y/y. However, placements were down 10.8% y/y and marketings were up 7.3%. The quick pace of marketing and drop in placements will be a psychological bullish factor for the market implying robust demand and tightening supply. Looking at demand, packer margins have been high and product bookings for July 4th buoyant. The surge in demand has helped to lift prices,

but demand is likely to fade by month end as July 4th needs are booked.

Hog supplies are tightening seasonally and will support the market, but demand is questionable and is a major downside price risk to the market. In the last week, hog slaughter was down 1.5% y/y at 1.973 mln head. More importantly, hog weights have fallen sharply and suggest producers are current. The Iowa-Minnesota live weight was off 2.0 lbs from the week prior and 2.4 lbs from last year. The drop in corn prices will also benefit near by prices by taking some pressure off of producers to move hogs. On demand, Smithfield's CEO suggested that Chinese demand was present and could help prices. He called the export market booming. Cut out values, near record levels, look high relative to the price of hogs, suggesting that packers will bid cautiously for hogs.

Sugar prices are being supported by near term supply tightness. Datagro projected sugar cane production in the Center South of Brazil down 4% y/y on low yields, while expecting the line up of ships at Brazilian ports to last another 20 to 30 days. At the same time, India has ruled out additional sugar exports before the next harvest. Officials are going to assess the crop. The move by India has stoked ideas of shortage. However, the Indian Sugar Mill Association is disputing the need for the government to curb exports. The Association is looking for 2011/2012 output to rise 9.5% to 26.5 mmts and believes stocks could rise to 6.5 mmts. The OECD/UN is also looking for a looser market. The agencies recently projected 2011/2012 supply at 173.6 mmts and demand at 168.6 mmts. The surplus should help cap prices bigger picture. The OECD/UN did indicate that Chinese sugar demand would rise 3% a year over the next ten years. Funds have been strong buyers recently.

The **coffee** market seems tight, but general macro weakness and a progressing harvest in Brazil are providing pressure. Vocafo said that producers have already picked 19% of the crop

and projected output at 43.5 mln bags. Harvest conditions are reportedly good for output. On a more bullish front, Licht recently indicated that coffee stocks in Vietnam were about 24% below last year and noted cash trade was occurring at a \$20 to \$20 premium over London. U.S. Green Coffee inventories fell 3.1% y/y in May. The pace of decline is slowing, and the market may be focused more

on the sequential gain which has been higher. Inventories are still historically low but off the bottom established in late 2010. There were 4.426 mln bags in storage up from a low of 3.866 mln bags in November 2010. European coffee stocks were up in April rising 3.5% to 11.46 mln bags. The ICO is projecting coffee production at 130 mln bags in 2011/2012. This level of output should keep the market tight.

North America

*The **U.S.** economy has slowed. The June Empire and Philly surveys point to a contraction in manufacturing activity, while housing demand remains lackluster. Consumer spending is in no man's land in front of back to school and the vacation season, and government austerity measures remain a headwind to growth at the state and local government level. The regulatory environment is hurting activity and highlighted by talk of further layoffs in the financial sector, and the National Labor Relation Board's decision to take sides with unions and fight Boeing's desire to transfer jobs to South Carolina from Washington. Inflationary pressures are falling with fuel prices, but the CPI remains elevated. Fed policy will remain expansion until the end of QE2 in late June, and turn steady into year end. The **Canadian** economy is expanding paced by the trade and manufacturing sectors. The BOC is looking for the export and business sectors to replace the consumer and government sectors as drivers of growth. Monetary policy will be biased toward tightening but a strong Canadian dollar and lack of confidence in the growth outlook will lead to a slow increase. Inflation is contained. Key economic indicators:*

U.S.:

- May ISM Manufacturing Index fell 6.9 to 53.5 [57.1 forecast] showing surprise weakness. 1) New orders fell 10.7 to 51.0. 2) Production declined 9.8 to 54.0. 3) Employment dropped 4.5 to 58.2. Of the 18 industries report, 14 grew and 3 contracted.
- May ISM Non-manufacturing rose to 54.6 [54.0 expected]. Employment jumped 2.1 to 54.0, new orders increased 4.1 to 56.8, and prices paid fell 0.1 to 53.6.
- May Payrolls rose 54,000 [165,000 expected]. The net March and April revision was -39,000. The birth/death model added 206,000 compared to 192,000 last year, providing support. Manufacturing, government, temporary, and construction jobs fell. Retail and finance post small gains.
- The May Unemployment Rate rose 0.1% to 9.1% [8.9% expected] and remains elevated. The U6 Rate fell 0.1% to a still high 15.8%. Household employment rose 105,000 and unemployment jumped 167,000.
- June NAHB Survey fell 3 to 13 and points to a depressed housing market.
- May Housing Starts rose 3.5% to 560,000 [545,000 expected]. April was revised up to 541,000 from 523,000. May Permits were up 8.7% to 612,000 [557,000 forecast].
- May Retail Sales fell 0.2% [-0.5% expected]. April sales revised to 0.3% from 0.5%. Ex-auto sales rose 0.3% [0.2% forecast]. April sales ex-auto were revised up 0.1% to 0.3%. Motor vehicle, furniture, general merchandise, sporting goods, and electronic sales fell. Clothing, building materials, and eating and drinking sales rose providing support.
- May CPI rose 0.2% m/m [0.1% forecast] and Core CPI rose 0.3% m/m [0.2% expected]. The year over year rates were 3.6% and 1.5% respectively and both were above estimate. 1) Food and beverage rose 0.4% -- food & beverage inflation has been brisk this year. 2) Housing rose 0.2% with lodging away from home up 2.9%. Owners' equivalent rent and rent of primary

residence each rose 0.1%. 3) Apparel and upkeep surged 1.2% showing signs of higher sourcing and commodity costs. 4) New and used vehicles leapt 1.0% 5) Other goods and services contracted 0.2% paced by a 1.2% drop in personal care items and 0.2% fall in tobacco.

Canada:

- May Ivey rose 11.4 to 69.1 [60.0 forecast]. Manufacturing activity is elevated and vibrant. Employment rose 2.7 to 56, but delivery times fell 9.1 to a low 38.9.
- May Housing Starts rose 2.7 m/m to 183,600 [182,000 expected]. Starts have been flat to lower over the past year.
- May Employment rose 22,300 [20,000 forecast]. Service jobs paced the gain rising 37,200. Job growth was concentrated in the trade sector. Labor conditions appear healthy.
- May Unemployment Rate fell 0.2% to 7.4% [7.6% expected] and continues to trend lower. The rate was below 6.0% prior to the 2008 crisis and a dip in the participation rate may have pressured growth.
- April Exports fell 1.9% m/m, but 10.8% y/y. Imports contracted 0.6% m/m and rose 12.9% y/y. Trade activity is supportive to growth.

Europe

*The **EZ** economy continues to show divergent trends with activity in Germany and France stronger than the peripheral. The trade and business sectors continue to support growth. Domestic demand is sluggish. The sovereign debt crisis in Greece, Ireland, and Portugal remains a downside risk to growth. Inflation shows signs of a pause, but the ECB raised its 2011 inflation forecast to 2.5% - 2.7% from 2.0% - 2.6%. The Greek crisis has generated a question over the ECB's ability to raise rates July 7th. The trade is leaning toward a 25 bps rate hike given comments from President Trichet at the June press conference. The **U.K.** economy has decelerated and appears to be growing at an anemic rate. Retail sales are weak, the housing market is stalled, and the labor market shows deterioration. Government austerity measures have weighed on growth. Inflation remains above target, but is likely to moderate into year end. Underlying demand does not look quick enough to support the current inflation rate which is being lifted by the VAT increase. The BOE will keep monetary policy steady and rate hike expectations are being pushed out. Key economic indicators:*

Eurozone:

- May Manufacturing PMI was 54.6 [54.8 expected]. 1) Production and new orders eased to 7 and 8 month lows. 2) Backlog posted its smallest rise in 8 months. 3) Employment expanded, but growth was the weakest since January. 4) Input prices eased, but selling prices rose. Sales prices gained at the slowest rate since January. Prices did fall in Greece.
- May EZ Service PMI rose 0.6 to 56.0 [55.4 forecast]. 1) France and Germany are leading the recovery. Growth in Spain, Italy, and Ireland was called limited. 2) The labor market is firm with job creation seen in each of the large service economies. 3) New business moderated to a five month low, but was still above the long-term average. 4) Optimism is at a 1.5 year low – November 2009. 5) Prices charged increased but the rate of inflation was a function of higher costs and divergent by nation. Italy, Spain, and Ireland saw prices fall, while France and Germany saw higher prices.
- May EZ Retail PMI fell to 48.8 from 52.2 in April, posting its lowest figure since October 2010. Bullets include: 1) Sales were only marginally higher than a year ago. 2) Retailers cut staffing levels and purchases 3) France and Germany posted slower growth, but conditions weakened in Italy. 4) Retailers saw gross margin erosion.

- April German Retail Sales rose 0.6% m/m [1.8% forecast]. The index of activity has been flat to lower in real terms since September 2010.
- April French Consumer Spending fell 1.6% m/m [-0.3% forecast]. Spending has been relatively flat since the fall 2010 and suggests weak consumer demand.
- May German Unemployment fell 8,000 [-30,000 expected], while the May Unemployment Rate fell 0.1% to 7.0% [7.0% forecast]. The unemployment rate continues to drift lower and suggest tightening labor market conditions. The decline in unemployment is the lowest since December's 2,000 contraction. Vacancies were 461,000 up 2,000 and have been trending higher in recent months. The labor market is still healthy.
- May EU 25 car registrations rose 7.1% y/y. The series is showing strength off a low base.
- May EZ Core CPI rose 1.5% [1.6% forecast]. Inflation has taken a pause, but the number is still on the lower end of the 10 year range.
- May Spanish Consumer Confidence rose 1.1 to 74.3. Confidence has bounced the past few months, leaving the overall trend sideways.
- May Irish Live Register rose 2,600. The labor market shows some signs of weakening. May Irish Unemployment Rate rose 0.2% to 14.8%. The unemployment rate remains extremely elevated and shows little signs of decline.

U.K.:

- May Manufacturing PMI fell 3.5 to 52.1 [54.1 forecast]. 1) There is a significant drop off in the growth rate of activity. Production and new orders fell slightly for the first time since 2009. 2) Consumer goods and small manufactures were hardest hit by weakness. 3) There was a modest reduction in new orders. 4) Staffing levels rose. 5) The rate of increase in input and output charges moderated in May.
- May Service PMI fell 0.5 to 53.8 [54.2 forecast]. 1) Employment and backlog were reported unchanged. 2) Input prices remain elevated and selling prices were raised at a solid pace. 3) Confidence improved to its highest level since February. 4) New business growth continued but the index dipped slightly.
- May Construction PMI rose 0.7 to 54.0 [53.5 forecast]. Commercial construction and homebuilding expanded, while civil engineering declined. Government spending cuts could be weighing on civil engineering. Inflationary pressures remain high and historically elevated. Employment expanded for the first time since June 2010.
- May Retail Sales fell 1.4% m/m [-0.6% expected]. Sales volume was weak in apparel, household goods, food, and non-specialized stores. Non-store retailing and auto fuel posted gains. The level of activity has been slightly lower since February and is barely above last year.
- May Jobless Claims rose 19,600 [6,500 expected]. The count change has been climbing higher in recent months.
- April ILO Unemployment Rate was flat at 7.7% [in line], and remains elevated.
- Average weekly earnings rose 1.8% y/y [2.1% forecast]. Wage growth is anemic.
- Q3 Manpower rose 1% to 3%. It was 1% a year ago. The survey suggests firmer conditions than official government data.
- May RICS fell 7% to 28% [-20% forecast]. Stocks on books rose 5 to 71 and points to inventory build. Number of homes sold fell to 14.7 from 15.2. Lending restrictions and lack of confidence-hurt sales. New buyers fell 2 to -2.
- May CPI rose 0.2% m/m and 4.5% y/y [both in line]. Clothing prices moderated, but still rose 0.4%. Health and transport contracted 0.2% and 0.8% respectively. Inflation remains elevated.

Asia

*Asian growth has a softer tone. Macro tightening measures are dampening growth in **China**, but the rate of activity remains high. Weak May auto sales and a downshift in PMI numbers highlight slower activity. Inflation remains elevated and has yet to peak. The PBOC will be biased toward more tightening measures, but the surge in the 7 day bank rate suggests that policy is working. The **India** economy remains strong. PMI data is elevated and the RBI appears confident in growth despite signs of tighter liquidity. Inflation remains too high and the RBI has signaled a desire for further rate hikes. The **Korean** economy is expanding and BOK statements point to confidence in future growth. Inflation is elevated, and the BOK will be biased toward more rate hikes. The window for another rate hike will open late summer. The **Australian** economy has a softer tone given PMI numbers and employment growth. High commodity demand and trade with Asia remain supportive. Inflation is contained. The RBA is biased toward raising rates, but will act slowly. No near term policy change is likely. The **Japanese** economy is slowly recovering from the earthquake/tsunami, but activity is still depressed. The BOJ has raised its outlook for growth. The economy has not clearly kicked deflation, and the BOJ will continue with accommodative monetary policy.*

Australia:

- May Manufacturing PMI fell 0.7 to 47.7. Growth appears sluggish. The index was 56.3 a year ago and has been below 50 every month but one since October. Production declined 6.4 to 46.9, new orders lifted 2.2 to 48.6, employment rose 1.4 to 46.4, average wages fell 0.8 to 59.3, and selling prices jumped 2.3 to 48.3.
- May AIG Service PMI fell 1.6 to 49.9. The index has been below 50 six of the past seven months. 1) New orders fell 0.5 to 49.4. 2) Employment declined 9.4 to 48.4. 3) Sales rose 4.0 to 53.2 and displayed a bright spot. 4) Input prices rose 3.1 to 69.0, while selling prices fell 3.2 to 51.9.
- May New Auto sales fell 7.6% m/m, Sales have declined sharply the past two months and the sequential trend is weak consistent with very poor demand.
- June Consumer Inflation Expectations were flat at 3.3%. Inflation expectations are contained.
- April Retail Sales rose 1.1% m/m [0.4% expected]. Sales growth is grinding higher. Department store sales (3.6%), other retailing (2.0%), and apparel (1.2%) paced the gain. Cafes fell 0.3% and accounted for much of the weakness.
- April Exports and Imports rose 0.5% m/m and 1.0% m/m respectively. Exports are up marginal over the past 6 months and suggest slow growth. Imports are rising at a steady pace.
- April Building Approvals fell 1.3% m/m [-1.8% forecast]. Approvals have been down three of the past four months. The level number is flat to slower since Q4 2010.
- Q3 Manpower fell 6% to 17%. It was 21% a year ago. There was a softer tone in manufacturing, service, and wholesale/retail trade.
- May Employment rose 7,800 [25,000 forecast]. Full time employment fell 22,000, while part time employment rose 29,800. Employment growth has had a slower tone in recent months.
- Unemployment Rate was flat at 4.9% [in line]. The rate is tracking flat to lower.

China:

- May NBS Manufacturing PMI fell 0.9 to 52.0 [51.6 forecast]. Output eased 0.4 to 54.9, new orders fell 1.7 to 52.1, and employment declined 0.9 to 50.9. Growth has eased over the past 6 months.
- May HSBC Manufacturing PMI declined 0.2 to 51.6. 1) Sluggish new business growth was noted. 2) Job creation was called modest. 3) The rate of input cost inflation eased to a 9 month low.
- May HSBC Service PMI rose 2.7 to 54.3. 1) There was a sharp rise in new orders. 2) Backlog fell slightly. 3) Input costs quickened with the pace of gain at a 6 month high. 4) Output inflation moderated to an 8 month low. 5) Confidence was positive lifted by optimism over further growth

and new product development. 6) Strong competition was noted in the hotel and restaurant space. On a side note, the May Non-Manufacturing PMI (NBS) fell 0.6 to 61.9

- May Retail Sales rose 16.9% y/y [17.0% expected]. There was clear deceleration in electronics and sports & recreation items, but generally spending is firm.
- May Industrial Production rose 13.3% y/y [13.1% expected]. Cement output rose sharply on a sequential basis, while steel and electricity output remained solid. Vehicle production dipped and provided the biggest drag on output.
- May Exports rose 19.4% y/y [20.4% forecast], while Imports gained 28.4% y/y [22.0% forecast]. The trade sector is supportive to growth, but commodity demand was unexciting.
- Q3 Manpower survey fell 10% to 29%. It was 27% a year ago. Manufacturing, service and wholesale/retail trade displayed clear sequential weakness and fell relative to a year ago.
- May New Yuan loans rose CNY 551.6 bln [650 bln forecast]. By comparison, May 2010 and 2009 saw lending at CNY 603 bln and CNY 664 bln respectively.
- May CPI rose 5.5% y/y [in line] and 0.1% m/m. The sequential pace of gain has slowed in recent months. Food inflation remains high up 11.7% y/y. Household items rose 2.5% y/y and are rising. Clothing shows a similar uptrend trend, but was up at a slower rate of 1.8% y/y
- May New Home Prices rose in 67 to 70 cities. The largest gain was in Dandong, which saw prices up 9.7% y/y. New home prices in Beijing and Shanghai rose 2.1% y/y and 1.4% y/y respectively

India:

- May PMI fell 0.5 to 57.5. Bullets: 1) New orders increased substantially due to conditions at home and abroad. 2) Output eased, but remained strong. 3) Employment declined, but a shortage of workers played a roll. There was also a high level of voluntary leavers. 4) A shortage of certain raw materials was noted. 5) Input prices rose substantially in May, but the rate of cost inflation slowed for the second month. 6) Manufactures continued to pass on higher costs.
- May Service PMI fell 4.2 to 55.0 displaying a notable slow down in activity. The recent peak was 60.2 in February. 1) New business eased. 2) Backlog fell showing slower growth. 3) Employment growth rose solidly. 4) There was a slight rise in input costs and a marginally slower pace of output inflation. 5) There was optimism over rising activity in the next 12 months, but the level of positive sentiment fell to a 10 month low.
- April Exports rose 34.4%, while Imports rose 14.1%. Export and import growth are showing deceleration. Export and import levels displayed sequential weakness, but it is too early to call the trend weaker.
- Q1 GDP rose 7.8% [8.1% forecast]. Private consumption slowed, investment spending decelerated sharply, and the trade sector was positive.

Japan:

- May Markit/JMMA Manufacturing PMI rose 5.6 to 51.3. Bullet points include: 1) New business decreased marginally. 2) Firms reduced staff numbers for a second month. 3) Output prices rose for the first time since November 2008 due to higher input costs. Input cost inflation did ease, however. 4) Supply chain pressure eased allowing for increased output.
- May Service PMI rose 8.8 to 43.8. 1) There was a slower contraction in new orders and outstanding business. 2) Output prices were lowered despite rising input costs. 3) Firms were optimistic one year ahead. 4) Employment numbers were reduced.
- May Small Business Confidence rose 1.7 to 37.8. June was forecast to rise to 40.4. Manufacturing rose 0.9 to 36.9 (June forecast of 41.30), while non-manufacturing rose 2.3 to 38.5 (39.6 forecast).
- April IP rose 1.0% [2.0% forecast] rebounding from a 15.5% decline in March. The recovery in output is sluggish post quake.
- May Nationwide Department Store Sales fell 2.4% y/y. Activity is depressed.

- April Household Spending fell 3.0% y/y [-2.7% forecast]. Sequentially, real spending rose 0.2% up from a -2.3% contraction in March.
- April Unemployment Rate rose 0.1% to 4.7% [4.7% forecast]. The rate shows some sign of bottoming. Employed persons fell 140,000 after declining sharply in March due to the quake. Unemployment rose 20,000 after contracting the past four months.
- Q3 Manpower fell 2% to 8%. It was 6% a year ago providing a mixed view on labor demand.
- May Vehicle Sales fell 37.8% y/y. Sales growth remains extremely depressed, but is running off a high base.

South Korea:

- June BOK Sentiment: Manufacturing fell 2 to 93 and has been choppy in recent months. Rising from the fall to winter and then falling into June. Non-Manufacturing Sentiment was flat at 83 and has trended sideways to lower.
- June Business Survey (Federation of Korean Industry) rose 1.4 to 98.7. The downtrend has stabilized. Employment shows signs of deterioration.
- May HSBC PMI fell 0.5 to 51.0. 1) There was a modest rise in new business. 2) Output growth slowed for a third month sequentially. 3) There was a rise in backlogs, as production did not rise enough to meet demand. 4) Employment rose driven by new orders and output. 5) Input costs rose markedly. 5) Output prices increased only slightly and at the weakest pace in 7 month. Competition for new business prevented a sharp price hike.
- May CPI was flat m/m [+0.2% expected] and up 4.1% y/y [4.2% expected]. Core CPI rose 3.5% y/y. Clothing and footwear, alcohol/tobacco, housing, and furnishings displayed strength. The core rate is accelerating higher.
- May Exports rose 23.5% y/y [27.7% forecast]. Export growth is elevated and robust. May Imports rose 29.9% y/y [29.0% forecast]. Like export growth, import growth is elevated and consistent with healthy growth.
- April Industrial Production contracted 1.5 m/m [+0.5% forecast]. Production has taken on a softer tone since February.
- May Bank lending to households rose KRW3.28 trln, while loans to companies jumped KRW 4.35 trln. Lending to households was strong and companies solid.

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