Economic Research
JPMorgan Chase Bank, New York
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Global Data Watch

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Economic Research notes

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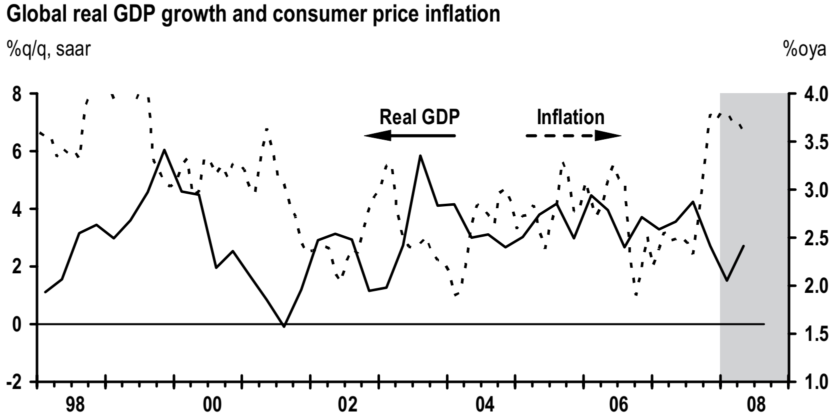
- **Japan posts surprisingly strong exports for January, but manufacturing softening is still in the offing**

There will be blood

The most immediate concern facing the global economy is the fallout from a potential US recession. The resulting sustained contraction in profits and labor income would magnify stress in credit markets that are already impaired. A US recession also would likely spill over to parts of the global financial marketplace that have, as yet, remained relatively unharmed. At present, US growth appears to be stalling, but the economy has shown little sign of a pronounced shift in business and household behavior that would mark the onset of recession. To be sure, the economy is on a razor's edge, and household purchasing power appears to be getting less relief than expected this quarter from food and energy prices. In addition, continued widening in credit spreads is thwarting the transmission of Fed easing to private sector borrowing rates.

Against this backdrop, the latest news on inflation provides a dose of irony, as it reminds us that medium-term global performance would be best served by sustained subpar US growth. Slowing trends in US productivity and labor supply growth have boosted domestic utilization rates. Combined with the US

Global real GDP growth and consumer price inflation



Bruce Kasman
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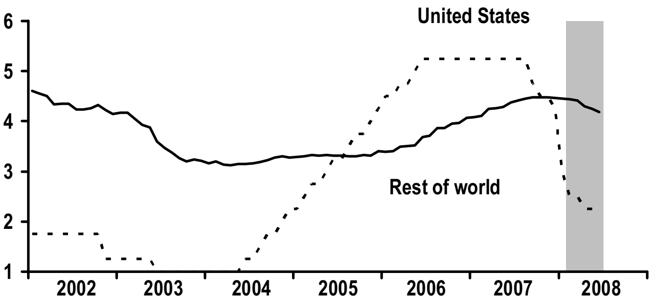
Global policy interest rates

%.p.a.



dollar's decline and an even more impressive rise in utilization rates across the globe, this backdrop continues to lift prices of global commodities and other traded goods. Estimated global headline inflation in January stood at 3.8%oya, the highest level in almost nine years. Excluding food and energy, estimated global inflation last month was 2.2%, a level not seen since 2002.

For the global economy to sustain its impressive run of strong, broad-based growth, inflation pressures need to be reduced. The most desirable path of adjustment would involve a moderation in US domestic demand. If this happens in a manner that maintains the emerging market domestic demand engines and raises US private saving, important steps will have been taken toward a sustained and balanced global expansion. The alternative path, in which global utilization rates remain high and growth is solid, would gradually intensify pressures for a broad shift in central bank policy that woould threaten the life of the global expansion.

In the US, policymakers' aggressive actions to offset recession risks make sense, given the potential for large adverse consequences of a negative feedback loop between growth and credit market stress. Chairman Bernanke is likely to emphasize this risk in next week's testimony, laying the groundwork for additional easing next month. If the US economy is sliding into recession, policy actions that will deliver a large midyear tax rebate and a zero real funds rate will provide a sizable cushion in 2H08, limiting the depth of the slowdown in the US as well as the spillover to the rest of the world.

However, if the US economy skirts recession, policy will add to growth as the drags fade from energy prices increases, declining residential construction, and inventory drawdowns. In this case, the stage will be set for US growth to move above 3% in 2H08, while keeping core inflation well above the top of the Fed's comfort zone.

The prospect of such a cyclical bounce—alongside still elevated global inflation, and an accommodative global monetary policy stance—highlights the bimodal nature of the global outlook for 2008. The challenges inherent in a scenario in which the US skirts recession are a reminder to be careful what you wish for.

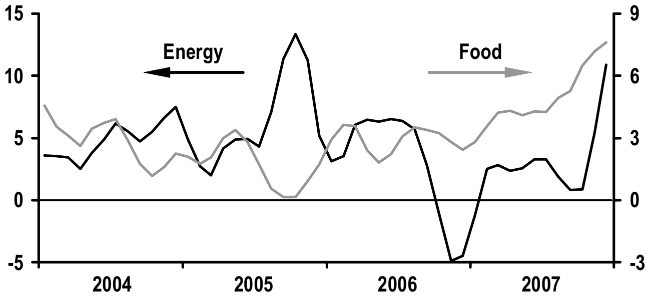
Central banks challenged by data

Although each of the G-3 economies remains at risk of recession, the indicator flow remains consistent with a global economy that is bending but not breaking. At the same time, recent reports on inflation have surprised on the upside, leading most central banks outside the United States to view risks as more evenly balanced, or even tilted toward inflation. Consequently, barring a significant deterioration in the indicator flow or in financial markets, the extent of monetary easing aside from the Fed probably will be quite limited.

- Even after the FOMC slashed the real federal funds rate target to less than 1%, this week's release of the meeting minutes underscore that growth remains the Fed's dominant concern. The minutes also indicate a growing recognition that rates may need to be kept low for an extended period of time. Notably, the Committee lowered its central-tendency projection for 2008 GDP growth 0.5% point, but raised its forecast for core inflation 0.3% point.
- In the UK, the resilience of retail sales through January, combined with a likely climb in inflation to near 3%oya by midyear, challenges our view that the MPC will ease an additional 50bp to 4.75%. Nonetheless, households face multiple headwinds from sluggish real income growth, tightening non-price terms on credit availability, and levels of interest rates above their recent norms, all against the backdrop of a sagging housing market. The most likely outcome is a marked slowing in spending growth that paves the way for additional rate cuts.
- In the Euro area, the flash PMI survey for February points to GDP growth of 1.5% annualized, alleviating concerns about a sharp slowdown. At the same time, inflation is raising concern. The January CPI release next Friday is likely to confirm headline inflation at 3.2%oya, with core at 2.3%. Also worrisome is a likely acceleration in labor

Global consumer energy and food prices

%3m/3m, saar; both scales



costs, highlighted by this week's steel workers' pay deal in Germany. With most ECB commentary aimed at discouraging market expectations for monetary easing, the risk is that the central bank will not deliver on our forecast for a rate cut in April.

- In Scandinavia, this week's GDP report out of Norway suggests that strong growth, record-high resource use rates, and increasing cost and price pressure all may lead the Norges Bank to tighten, possibly as soon as next month. Downside risks to growth appear more significant in Sweden, whose economy is more open and cannot rely on high oil prices as an extra growth engine. Although last week's rate hike made clear that the Riksbank is still focused on inflation, the minutes of the meeting (out next week) will shed more light on the MPC's thinking. We expect a split vote (possibly 4-2), with some members dissenting for a pause and the MPC showing more concern about growth than the decision alone would imply.

Little relief from the price volatiles

Down the road, the inflation consequences for a global economy that avoids a US recession are greatly amplified by the continued acceleration in energy and food prices, the run-up in the latter perhaps the more pernicious. Conventional wisdom holds that volatility means that energy and food should be discounted when gleaning the underlying thrust of price pressures. However, there is a growing recognition that persistent gains in these high-profile categories of spending have the potential to ignite wage growth or inflation expectations at a time when profit growth is already slowing.

On an over-year-ago basis, monthly energy and food prices combined outpaced core inflation less than 20% of the time during the 1990s expansion but for 80% of this decade's expansion—shades of the 1970s! If anything, price pressures were on the rise entering 2008, with energy and food prices combined rising at the fastest pace in many years.

Energy prices are increasing more moderately in the current quarter (versus 4Q), reflecting the slower ascent of oil prices. This will reduce, but not eliminate their drag on household purchasing power. However, even if oil prices level off, base effects mean that they will boost the over-year-ago inflation rate throughout this year. In contrast, consumer food prices jumped in January in most parts of the world. Further increases in food prices will likely be fueled by the ongoing surge in global food commodity prices, which statistical evidence suggests can take as long as 12 months to pass through to the consumer level. The upshot is that rising food prices are likely to remain a drag on purchasing power in the coming months, even as they boost monthly and over-year-ago rates of consumer price inflation.

Japan to join global industry slowdown

Exports out of Emerging Asia bounced in January, largely reflecting the typical front-loading of production ahead of the lunar new year in early February. As such, a corresponding dropoff in exports and IP is projected for February. Surprisingly, January exports also surged in Japan, where the holiday effect is usually more muted, suggesting that global demand for its competitively priced, high-end exports may be stronger than anticipated. This certainly is true with respect to the Middle East, where governments are engaged in massive infrastructure building.

Next week's reports will provide a closer look at the domestic side of Japan's demand equation. Indicators of consumer spending are expected to be mixed, consistent with a subdued gain in household expenditures again this quarter. The downtrend in the various business surveys also is expected to be maintained. Perhaps of most interest will be the report on January industrial production. Output is forecast to be flat, accompanied by manufacturers' forecasts for a decline in production in February-March. Having increased nearly 6%q/q, saar in 4Q07, an expected IP decline in the current quarter would set the stage for a sharp downshift in real GDP growth after the surprise 3.7% increase last quarter.

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EM central banks chart their own course,[#] *Apr 27, 2007*

1. Research notes listed have been published in the *GDW; Special Reports*[#] and *Global Issues*[##] are stand-alone features, but may also have appeared in some form in the *GDW.*

Global Economic Outlook Summary

	Real GDP			Real GDP							Consumer prices			
	% over a year ago			% over previous period, saar							% over a year ago			
	2006	**2007**	**2008**	**3Q07**	**4Q07**	**1Q08**	**2Q08**	**3Q08**	**4Q08**	**1Q09**	**4Q07**	**2Q08**	**4Q08**	**2Q09**
The Americas														
United States	2.9	2.2	1.9	4.9	0.6	0.0	2.0	3.5	2.5	3.5	4.0	**3.5** ↑	**2.7** ↑	2.3
Canada	2.8	2.5	1.3	2.9	0.8	-1.0	1.5	2.8	2.8	3.0	2.4	1.0	1.6	1.7
Latin America	5.3	**5.2** ↑	4.3	**7.0** ↑	**5.8** ↑	**3.1** ↓	3.4	**4.0** ↑	**4.5** ↓	4.5	5.6	**6.3** ↑	**6.1** ↑	5.9
Argentina	8.5	8.7	6.5	11.8	10.4	3.2	4.9	4.1	4.1	4.1	8.5	8.6	9.7	11.0
Brazil	3.8	5.4	4.9	6.9	5.3	4.9	4.3	3.7	4.2	4.1	4.2	4.2	4.2	4.3
Chile	4.0	5.2	4.0	-2.5	8.0	5.0	3.0	3.0	5.0	5.0	7.2	8.2	4.8	3.1
Colombia	6.8	6.8	5.5	6.9	5.0	5.0	5.5	6.5	6.5	4.5	5.4	**5.5** ↑	**5.0** ↑	4.0
Ecuador	3.9	2.0	2.5	4.4	5.0	2.0	1.5	1.0	1.0	2.5	2.8	4.1	3.3	3.3
Mexico	4.8	**3.3** ↑	2.7	**5.3** ↓	**3.0** ↑	1.0	2.0	4.1	4.9	4.9	3.8	4.7	4.1	3.3
Peru	7.6	**9.0** ↑	**7.5** ↑	15.9	**19.0** ↑	**2.0** ↓	**4.0** ↑	**5.0** ↑	**4.5** ↓	6.5	3.5	**3.9** ↑	**2.7** ↑	**2.5** ↑
Venezuela	10.3	**8.4** ↑	6.0	**14.2** ↑	**11.0** ↑	5.0	4.0	4.0	3.5	4.0	20.2	24.8	26.6	29.3
Asia/Pacific														
Japan	2.4	2.1	1.7	1.3	3.7	0.5	2.0	2.3	2.3	2.4	0.5	0.8	0.7	0.5
Australia	2.8	3.8	3.5	4.1	3.1	3.2	4.4	2.5	4.1	3.6	3.0	2.9	2.4	2.6
New Zealand	1.5	3.0	2.5	2.1	2.9	2.5	2.7	1.8	2.2	2.9	3.2	3.1	2.9	2.8
Asia ex. Japan	8.5	8.5	7.7	**8.1** ↓	**6.6** ↑	**7.4** ↓	7.7	**7.9** ↑	**8.1** ↓	8.0	5.3	5.1	3.8	4.1
China	11.1	11.4	10.5	8.9	9.1	10.8	11.2	10.4	10.4	10.8	6.6	5.6	3.5	4.1
Hong Kong	6.8	6.0	5.3	7.0	5.0	4.0	5.2	5.5	5.5	5.2	3.4	3.4	2.7	3.8
India	9.6	8.7	7.5	8.4	5.3	8.2	7.0	7.5	8.2	8.2	5.5	6.3	5.9	5.2
Indonesia	5.5	6.3	6.2	7.8	6.9	6.0	6.0	6.0	6.0	5.0	6.7	6.9	7.4	7.8
Korea	5.0	4.9	4.8	5.4	6.3	3.0	4.0	5.5	6.0	5.0	3.4	3.4	3.1	3.2
Malaysia	5.9	6.0	5.3	9.7	3.2	4.1	5.7	5.7	6.6	6.1	2.2	3.3	3.8	3.3
Philippines	5.4	7.1	6.1	4.0	7.4	6.0	5.0	5.5	6.0	5.8	3.3	3.2	2.4	2.4
Singapore	8.2	7.7	4.6	5.1	-4.8	6.6	4.1	8.7	9.5	5.7	4.1	5.1	2.8	2.8
Taiwan	4.9	**5.7** ↑	**4.0** ↓	**12.0** ↓	**2.6** ↑	**0.8** ↓	**2.5** ↓	**4.5** ↑	**5.0** ↓	**4.8** ↓	**4.5** ↑	4.0	1.7	2.4
Thailand	5.1	4.2	5.1	5.8	4.0	6.0	6.0	6.0	5.0	4.5	2.9	4.4	3.8	3.0
Africa														
South Africa	5.4	5.0	3.7	4.7	3.6	2.8	3.8	4.1	4.0	3.7	8.4	**8.5** ↑	**6.5** ↑	**5.3** ↑
Europe														
Euro area	2.9	2.7	1.7	3.1	1.7	1.2	1.2	2.3	2.3	2.5	2.9	2.7	2.3	2.3
Germany	3.1	2.6	1.6	2.7	1.1	1.3	1.3	2.3	2.3	2.5	3.1	2.0	1.4	1.5
France	2.2	1.9	1.8	3.2	1.4	1.5	1.3	2.3	2.3	2.3	2.5	2.4	1.8	2.0
Italy	1.9	1.7	0.7	1.7	-0.8	0.5	0.5	2.0	2.0	2.3	2.6	2.6	2.2	2.3
Norway	**4.8** ↑	**6.0** ↑	**3.9** ↑	**7.9** ↑	**3.8** ↑	3.0	2.5	3.0	3.0	3.5	1.4	5.0	3.4	2.2
Sweden	4.4	2.8	2.4	2.4	2.8	2.0	2.0	3.0	3.0	3.5	3.1	3.6	3.0	2.5
Switzerland	3.2	2.8	1.8	3.3	2.0	1.3	1.1	1.8	1.8	2.0	1.7	1.6	1.5	1.3
United Kingdom	2.9	3.1	2.0	2.7	2.4	1.2	1.6	2.0	2.3	2.5	2.1	2.4	2.7	2.1
Emerging Europe[1]	6.6	6.6	5.7	6.4	10.2	0.4	7.5	5.7	8.4	1.2	8.1	8.6	7.0	5.8
Bulgaria	6.1	6.1	5.2	…	…	…	…	…	…	…	…	…	…	…
Czech Republic	6.4	6.6	5.0	5.8	7.8	3.5	4.5	3.5	4.5	5.5	4.8	7.1	5.5	3.0
Hungary	3.9	1.3	2.0	0.8	0.4	2.8	2.8	3.0	3.0	3.0	7.1	5.9	4.3	3.7
Poland	6.2	6.5	5.5	4.9	8.2	4.5	4.8	5.3	5.5	5.8	3.5	4.1	3.8	3.3
Slovak Republic	8.5	10.3	7.0	9.2	17.9	-2.0	6.0	7.0	7.0	4.0	3.3	4.3	3.6	4.0
Romania	7.7	6.0	5.6	…	…	…	…	…	…	…	6.7	6.5	5.5	5.3
Russia	7.4	8.1	6.8	7.4	13.0	-2.5	10.5	6.5	12.0	-2.5	11.5	12.6	10.1	8.8
Turkey	6.1	5.0	5.0	…	…	…	…	…	…	…	8.2	7.4	6.2	4.1
Global	3.7	3.4	2.7	4.4	**2.8** ↑	1.5	**2.7** ↓	3.5	3.4	3.5	3.5	**3.4** ↑	**2.8** ↑	2.6
Developed markets	2.8	2.5	1.9	3.6	1.6	0.6	1.8	2.8	2.4	2.9	2.9	**2.7** ↑	**2.2** ↑	2.0
Emerging markets	7.0	7.0	6.1	7.5	**7.0** ↑	**5.0** ↓	6.5	**6.5** ↑	7.2	5.9	5.9	**6.1** ↑	5.0	4.8

Note: For some emerging economies, 2007-2009 quarterly forecasts are not available and/or seasonally adjusted GDP data are estimated by JPMorgan.
Bold denotes changes from last edition of *Global Data Watch,* with arrows showing the direction of changes.

Global Central Bank Watch

	Official interest rate	Current	Change from Jun 04 (bp)	Last change	Forecast next change	Mar 08	Jun 08	Sep 08	Dec 08	Mar 09
Global	GDP-weighted average	3.98	145			3.81	3.57	3.56	3.61	3.67
excluding US	GDP-weighted average	4.44	130			4.43	4.19	4.19	4.25	4.35
Developed	GDP-weighted average	3.21	160			3.00	2.70	2.70	2.74	2.83
Emerging	GDP-weighted average	7.11	81			7.10	7.11	7.09	7.14	7.12
The Americas	GDP-weighted average	3.72	145			3.27	3.02	3.00	2.99	3.00
United States	Federal funds rate	3.00	175	30 Jan 08 (-50bp)	18 Mar 08 (-50bp)	2.50	2.25	2.25	2.25	2.25
Canada	Overnight funding rate	4.00	200	22 Jan 08 (-25bp)	4 Mar 08 (-50bp)	3.50	2.75	2.75	2.75	3.00
Brazil	SELIC overnight rate	11.25	-475	5 Sep 07 (-25bp)	2Q 09 (-25bp)	11.25	11.25	11.25	11.25	11.25
Mexico	Repo rate	7.50	100	26 Oct 07 (+25bp)	15 Aug 08 (-25bp)	7.50	7.50	7.25	7.00	7.00
Chile	Discount rate	6.25	450	10 Jan 08 (+25bp)	10 Jul 08 (-25bp)	6.25	6.25	6.00	5.75	5.75
Colombia	Repo rate	**9.75**	300	**22 Feb 08 (+25bp)**	1Q 09 (-25bp)	**9.75**	**9.75**	**9.75**	**9.75**	**9.50**
Peru	Reference rate	5.25	275	10 Jan 08 (+25bp)	on hold	5.25	5.25	5.25	5.25	5.25
Europe/Africa	GDP-weighted average	4.53	166			4.54	4.10	4.10	4.11	4.28
Euro area	Refi rate	4.00	200	6 Jun 07 (+25bp)	10 Apr 08 (-25bp)	4.00	3.50	3.50	3.50	3.75
United Kingdom	Repo rate	5.25	75	7 Feb 08 (-25bp)	10 Apr 08 (-25bp)	5.25	4.75	4.75	4.75	4.75
Sweden	Repo rate	4.25	225	13 Feb 08 (+25bp)	17 Dec 08 (+25bp)	4.25	4.25	4.25	4.50	4.75
Norway	Deposit rate	5.25	350	12 Dec 07 (+25bp)	3Q 08 (+25bp)	5.25	5.25	5.50	5.75	5.75
Czech Republic	2-week repo rate	3.75	150	7 Feb 08 (+25bp)	26 Mar 08 (+25bp)	4.00	4.00	4.00	3.75	3.50
Hungary	2-week deposit rate	7.50	-400	24 Sep 07 (-25bp)	**25 Feb 08 (+25bp)**	**8.00**	**8.00**	**8.00**	**8.00**	**7.75**
Poland	7-day intervention rate	5.25	0	30 Jan 08 (+25bp)	**27 Feb 08 (+25bp)**	5.50	5.50	5.75	6.00	6.00
Russia	1-week deposit rate	3.50	250	4 Feb 08 (+25bp)	1Q 09 (+25bp)	3.50	3.50	3.50	3.50	3.75
Slovak Republic	2-week repo rate	4.25	-75	27 Apr 07 (-25bp)	2Q 08 (-75bp)	4.25	3.50	3.50	3.50	3.75
South Africa	Repo rate	11.00	300	6 Dec 07 (+50bp)	**Feb 09 (-50bp)**	11.00	11.00	11.00	**11.00**	**10.50**
Switzerland	3-month Swiss Libor	2.75	225	13 Sep 07 (+25bp)	Jun 08 (-25bp)	2.75	2.50	2.50	2.50	2.50
Turkey	Overnight borrowing rate	15.25	-675	14 Feb 08 (-25bp)	19 Mar 08 (-25bp)	15.00	14.00	13.50	13.50	13.00
Asia/Pacific	GDP-weighted average	3.61	114			3.61	3.66	3.68	3.85	3.86
Australia	Cash rate	7.00	175	5 Feb 08 (+25bp)	4 Mar 08 (+25bp)	7.25	7.50	7.50	7.50	7.50
New Zealand	Cash rate	8.25	250	26 July 07 (+25bp)	1Q 09 (-25bp)	8.25	8.25	8.25	8.25	8.00
Japan	Overnight call rate	0.50	50	21 Feb 07 (+25bp)	4Q 08 (+25bp)	0.50	0.50	0.50	0.75	0.75
Hong Kong	Discount window base	4.50	200	23 Jan 08 (-75bp)	19 Mar 08 (-50bp)	4.00	3.75	3.75	3.75	3.75
China	1-year working capital	7.47	216	20 Dec 07 (+18bp)	2Q 08 (+27bp)	7.47	7.74	7.92	8.19	8.19
Korea	Overnight call rate	5.00	125	9 Aug 07 (+25bp)	1Q 09 (+25bp)	5.00	5.00	5.00	5.00	5.25
Indonesia	BI rate	8.00	66	6 Dec 07 (-25bp)	3 Apr 08 (-25bp)	8.00	7.75	7.75	7.75	7.75
India	Repo rate	7.75	175	30 Mar 07 (+25bp)	Jul 08 (-25bp)	7.75	7.75	7.50	7.50	7.25
Malaysia	Overnight policy rate	3.50	80	26 Apr 06 (+25bp)	on hold	3.50	3.50	3.50	3.50	3.50
Philippines	Reverse repo rate	5.00	-175	31 Jan 08 (-25bp)	on hold	5.00	5.00	5.00	5.00	5.00
Thailand	1-day repo rate	3.25	200	18 July 07 (-25bp)	27 Feb 08 (-25bp)	3.00	2.75	2.75	2.75	2.75
Taiwan	Official discount rate	3.375	200	20 Dec 07 (+12.5bp)	1Q 09 (+12.5bp)	3.375	3.375	3.375	3.375	3.50

Bold denotes move this week and forecast changes

JPMorgan Securities Ltd., London
Jan Loeys

John Normand

The JPMorgan view: markets

Waiting for Godot

- **Markets remain convinced that a US recession is on its way**, if it has not started yet. But conclusive evidence of such a recession is lacking so far. The **US economy has stopped growing, but has not yet started to contract**, which is needed for a recession. To us, it remains a flip of a coin which way we are headed. Given this uncertainty, it is not surprising that bonds and equities have traded in a **noisy range** over the past month. In our base scenario, we will stay in a range for the next few months, until, sometime in 2Q, investors will give up "waiting for Godot," who never comes. By that time, tax rebate checks will arrive to US households, pushing up spending then.

- **Investors generally do not put on new positions** while in waiting mode, **and are more likely to lose patience with old ones**. This explains this week's dramatic curve flattening, as every bond investor has steepeners on. We consider this temporary and stay in steepeners. It also explains why credit has continued to suffer while equities are trying to break out on the upside. Equity investors are heavily long cash, and the return on this cash is slated to fall as central banks ease. Banks and hedge funds, as well as their off-balance-sheet vehicles, remain burdened by uncomfortable longs and unsold inventory, thus putting further pressure on spreads. Spread widening is not attracting sufficient buyers, though, and we thus stay bearish on credit, and underweight against equities.

- We know asset allocators are long **EM** assets, and it is good to see they are not excessively nervous, as EM equities are moving in line with developed markets while EM currencies in a range. We are medium-term bullish on EM equities, fx, and credit (but not local bonds given inflation risks there), as fundamentals are supportive and EM is far removed from the turmoil in US credit. However, the presence of the strategic EM overweight is keeping us for the moment with only small longs in EM, focused on EM equities.

Fixed income

- **Bonds declined on the week**, largely as short-maturity yields backed up, itself the result of profit-taking on steepeners. **We stay long the short end and in steepeners in Europe and the US.**

- The short end of the **US** curve prices in that fed funds will bottom at 2.25%, which matches our forecasts. But with risk still biased on the downside, and a recession likely pushing this rate to 1.5%, we see value at the short end in the US. Be long. Rising duration supply should keep upward pressure on 5s and 10s, and we thus stay in steepeners, a widely held position. We similarly hold longs and steepeners in Europe.

- Last year's run on SIVs and conduits has become this year's run on the short-dated **US municipal debt and money market**. The crisis is purely a liquidity one, so far, but is again leading to a closure of the money market, forcing issuers to switch to long-dated, fixed rate issues. Thus further supports curve steepening, but also raises the risk of banks having to acquire these instruments.

Equities

- Equities remain in a noisy range on mixed economic and earnings data, and are set to stay this way for several more months. We are long against both credit and bonds, as equity investors appear long cash while specs seem balanced. Credit, in contrast, suffers from an overhang of unwanted exposures while bond investors are long.

10-yr Government bond yields

	Current	Mar 08	Jun 08	Sep 08	Dec 08
United States	3.74	3.80	4.00	4.15	4.20
Euro area	4.01	3.85	3.70	3.70	3.60
United Kingdom	4.68	4.55	4.35	4.50	4.65
Japan	1.44	1.30	1.45	1.60	1.85

Equities

	Current	YTD Return (local currency)
S&P	1330	-8.3%
Topix	1321	-9.5%
FTSE 100	5889	-7.8%
MSCI Eurozone	212	-12.7%
MSCI Europe	1372	-10.9%

Credit markets

	Current	Jun 08	Dec 08
US high grade (bp over UST)	227	175	
US high grade (bp over swaps)	143	100	
Euro HG corp (bp over swaps)	87		65
USD high yield (bp vs. UST)	737	800	650
EMBIG (bp vs. UST)	294	250	200

Foreign exchange

	Current	Mar 08	Jun 08	Sep 08	Dec 08
EUR/USD	1.48	1.54	1.55	1.55	1.54
USD/JPY	107	98	101	101	103
GBP/USD	1.97	2.03	2.04	2.05	2.05

Commodities

		Quarterly Average			
	Current	Mar 08	Jun 08	Sep 08	Dec 08
WTI oil $/bbl	99.2	86.0	72.0	72.0	76.0
Gold ($/oz)	945	920	920	915	900
Copper($/m ton)	8487	8000	7300	6500	6000
Corn ($/Bu)	5.36	4.90	4.70	4.30	4.80

Source: JPMorgan, Bloomberg, Datastream

- **EM** equities are largely moving in line with developed markets, having outperformed them by 1% ytd. We stay long EM vs developed markets on strong commodity prices and supportive EM economic news.

- Across **sectors**, we favor **defensive plays**, underweighting consumer-exposed sectors such as consumer discretionary against defensive sectors such as healthcare. **Financials and IT are the worst performing sectors ytd.** We project these sectors to outperform into year end on value, assuming that even if a US recession takes place, it will be short-lived and contained within the US. Near term, though, these sectors face headwinds. Financials are heavily exposed to worsening credit market problems. The IT sector, especially in EM Asia, is highly levered to the weakening global growth cycle. Indeed, Asian tech exports slowed sharply in 4Q, and are set to slow further in 1Q. In addition, expectations of cuts in tech spending by banks and rising costs for materials are weighing negatively on the sector.

- Growth beat value again this week and is now outperforming ytd. Stay **long growth vs value globally.** Historical evidence shows that growth tends to outperform value into recessions. A reversal of this trend takes place in the middle of a recession or immediately after. This means that the growth vs value outperformance that started last May has at least a few more months to run, with recession risks remaining elevated.

Credit

- **Credit spreads kept widening this week,** led again by attempts at unwinding of synthetic structures. The CDS-bond basis keeps rising, reaching 9bp in US High Grade versus -40bp one month ago. Further position unwinding should continue to put more pressure on the CDS-bond basis near term, CDS curves are set to slowly steepen as 7 and 10-year structures are unwound.

- The unwinding of credit structures is driven by both mark-to-market losses and rating downgrades, but the latter is likely more important. Indeed, unwinds of transactions did not increase noticeably until a new rating methodology was proposed earlier this month. The risk of further downgrades in coming months has risen considerably and we thus see upward pressure in credit spreads near term. **Credit is extremely cheap** but in the absence of positive news and liquidity having dried up, value investors are reluctant to jump in.

- In **high yield**, the primary market remains practically closed as the unsold inventory of loans and bonds, related to previous LBO deals, deters prospective buyers. With spreads close to 700bp, high-yield loans are very cheap vs bonds. Without any demand for high yield bonds, we believe that this value discrepancy will be resolved by wider bond spreads in the next few months. Stay bearish, favoring loans vs bonds and BBs over CCCs within bonds.

Foreign exchange

- The dollar fell against all currencies except for CAD on another round of poor macro data. We had been expecting **EUR/USD** to hold a range (1.44 - 1.49) near term given the weakness of European data as well, but today's PMI reports suggest somewhat more resilience in Europe. With EUR longs negligible, EUR/USD could break to new highs this quarter absent a rebound in US data.

- **Peripheral markets** continue to demonstrate more momentum than the G-3 pairs since their rates are higher and policy stances firmer: most are tightening. Combined with supply constraints pushing commodity prices higher, this means that AUD, NZD, and NOK will likely be the strongest currencies this quarter. We are long AUD vs USD and CAD, and long NOK vs CAD.

- **Emerging market currencies** are exhibiting notable divergences, with Asia rallying while CEEMEA weakens. The moves are mostly in line with the regions' respective balance of payments positions, but the resilience of Asian currencies is still surprising in a weak equity market environment. Throughout EM we prefer cross-rate trades (long TRY/ZAR, long BRL/MXN, long SGD/KRW) to outright longs in EM.

Commodities

- **Base and precious metals** continue to soar, aided by a weak dollar, supply disruptions (precious metals) and inventory drawdowns (copper). The decoupling themes may continue to support both sectors near term but, given doubts around that view, precious metals are still the better trade for the first half of the year. **Crude** made a new all-time high this week above $100/bbl, but we see its rise as the least credible within the commodity complex. Unlike metals, which are experiencing supply disruptions or inventory draws, crude stock positions have been improving for the past several weeks. We expect lower prices this spring, but the weak dollar environment is an impediment to a quick fall.

Michael Feroli

Robert Mellman

Economic Research note

US economy faces an intensifying trio of drags

- **Three drags—weak housing, high energy prices, and tight credit—are holding growth to a standstill in 1Q**
- **The recent move up in crude oil prices suggests that overall drag will not soon abate**
- **Credit market conditions have also deteriorated, further delaying any stabilization in housing**

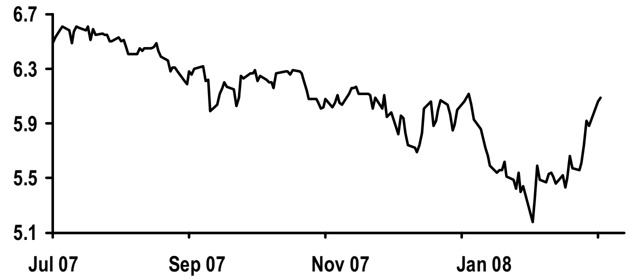
The US economy has slowed to a standstill and is teetering on the verge of recession. While the JPMorgan forecast still looks for the economy to avoid the substantial declines in payrolls and increases in unemployment associated with an economic downturn, there is little question that the economy will remain very weak through the first half of this year. The current forecast calls for real GDP growth of only 1.0% at an annual rate in 1H08, before the economy strengthens with the help of policy stimulus in 2H.

JPMorgan commentary has emphasized for some time that the shift, from better than 4% growth in the middle two quarters of last year to weakness now, is the not the result of any single influence. Instead, three separate but reinforcing drags on growth are to blame. The first influence is the continued sharp downturn in housing activity. Real residential construction declined more than 20% at an annual rate in 2H07. The second influence is the sharp increase in energy prices which has been squeezing real incomes and restraining real consumer spending since last October. Finally, the tightening of credit conditions is holding back all types of activity related to real estate or regarded as risky.

The forecast for a second-half rebound growth is largely related to the effect of policy help, both fiscal stimulus and the lagged effect of Fed easing. But it also is conditioned by expectations that the three drags on growth will ease by midyear. The downturn in housing is likely to run its course over the next several months. Slower global growth will bring some softening in the price of oil and other commodities that will help bring down headline inflation. And Fed easing and time will help to diminish the fear in the credit markets. While the 2H growth forecast still holds, these drags on growth have not eased yet. Indeed, the recent rises in long-term mortgage rates, the price of oil and other commodities, and credit spreads have prolonged the drags on growth.

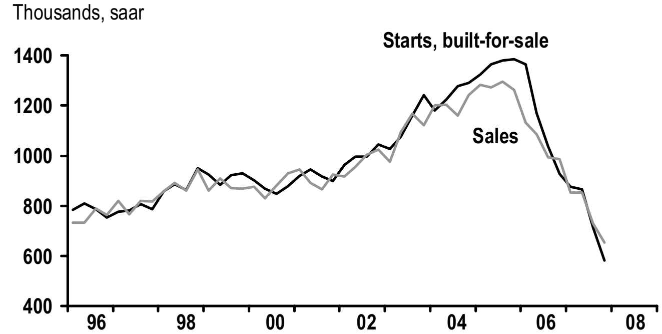
Conventional 30-year residential mortgage rate

Percent p.a.



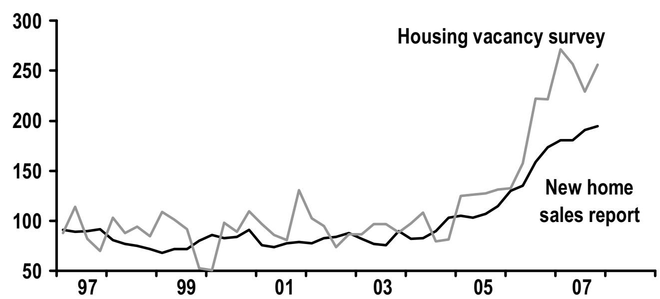
Single-family housing supply and demand

Thousands, saar



New single-family homes for sale

Thousands



Mortgage rates have backed up

The longest-lasting drag on the economy has been the sustained downturn in homebuilding activity. Real residential construction has been declining at a double-digit pace since 2Q06. The latest report shows that single-family housing starts declined 5.2%m/m in January and have plunged an average 6.0% per month since the middle of last year. Moreover, the downturn has further to run. Inventories of unsold homes are still elevated, house prices are falling, and many homebuilders have trouble financing new supply.

The big headache, of course, is that new home sales have been falling every bit as fast as housing starts through most of the past two years. Recently, however, builders have made progress in bringing starts low enough in relation to sales to work off inventories. The decline in single-family starts and in the share of starts that are built for sale has brought housing starts building for sale an estimated 11.6% below the pace of sales in December 2007. If starts were to continue to decline 6.0% per month through June, and sales were to stabilize near the December sales pace, supply and demand in the housing market would begin to come into much better balance.

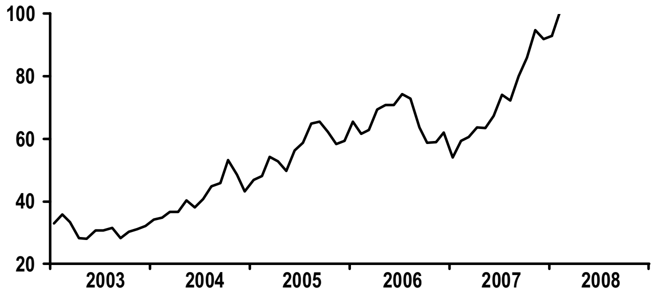
The forecast of stabilization of new home sales looked like a reasonable prospect a few months ago. Declines in mortgage rates and house prices had made housing more affordable. And numerous surveys over the past few weeks, including the national Homebuilders survey, suggested that sales were holding near their recent depressed pace.

However, it increasingly looks that the forecast for near-term stabilization of home sales will not be realized. Conventional mortgage rates are a key influence on home sales, and they have risen more than 50 basis points over the past month. Some of this increase may reflect temporary problems in the mortgage market, which should partly normalize in the next weeks. However, other problems in the mortgage market appear more lasting. And the March increase in fees announced by the housing agencies is likely to further boost mortgage rates relative to Treasuries. Mortgage applications for home purchase have not been a reliable guide to near-term home sales over the past year, but such applications over the past couple of weeks have averaged close to 10% below their December-January pace, a hint that the higher rates are biting. Significant further declines in home sales would obviously delay the forecasted stabilization of homebuilding activity.

The inability of home sales to find a bottom has prevented inventories of unsold homes from being worked down. Inventories as measured in the Census's new home sales report have only recently plateaued. The situation could be even worse than the Census data indicate: because contract cancellations are not recorded in the Census survey, inventories may be understated. Inventories as measured by an alternative source, the Housing Vacancy Survey, do not suffer from this data collection problem and show an even larger overhang of unsold homes. Absent a pickup in housing demand—which doesn't look imminent given the state of the mortgage market—this overhang will continue to weigh on home prices.

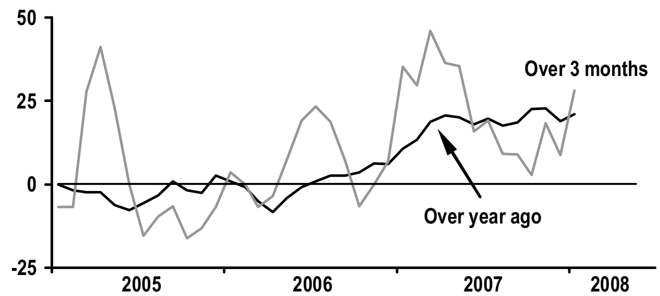
Price of crude oil.

$ per barrel, WTI, monthly average and latest



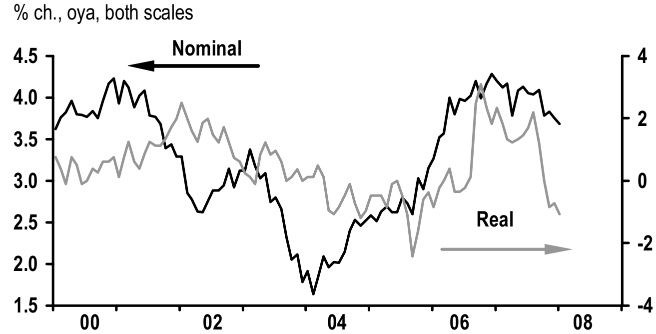
Prices received by farmers

%ch, nsa ar



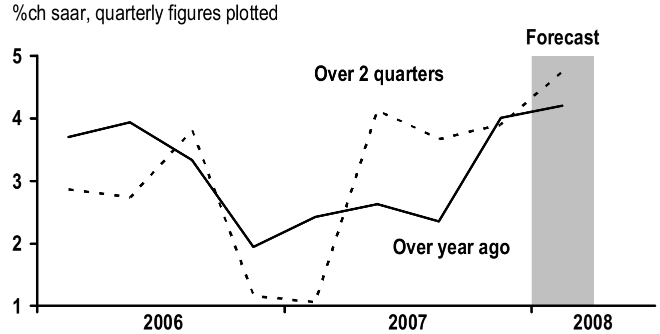
Average hourly earnings

% ch., oya, both scales



Consumer price index

%ch saar, quarterly figures plotted



Oil at $100 per barrel

Soaring headline inflation over the past few months has put a brake on real income growth and held down real consumer spending, whose growth has slowed from 2.8%q/q, saar in 3Q07 to 2.0% in 4Q07 and a forecasted 0.5% this quarter.

The headline CPI increased 0.4%m/m in the latest January reading; and it is up 4.7% at an annual rate over the past six months and 4.3%oya—well in advance of gains in hourly compensation. The resulting squeeze on real income has been mainly caused by rapid increases in the price of food (up at a 4.7% annualized pace over the past six months) and especially energy (up at a 21.4% pace).

Soaring prices for food and energy, in turn, have been fueled by soaring commodity prices, especially for oil and agricultural products. The average January price of crude oil was up more than 70%oya to $93.00 per barrel, and the price received by farmers of all products was up 20%.

The forecast has expected commodity prices to level off or even decline, bringing some near-term easing in headline inflation. Commodity prices have historically been sensitive to the pace of global growth, and North America, Europe, and Japan have all slowed substantially; growth in the Emerging Market countries is moderating as well. Still, this price forecast has not materialized as yet. The price of crude oil is up near $100 per barrel, 52% at an annual rare above its 4Q07 average. The CRB commodity price index for foodstuffs is some 90% at an annual rate above its 4Q07 average. Prices received by farmers in the latest January reading were up 21.0%oya, and up 28.1% at an annual rate over the latest three months.

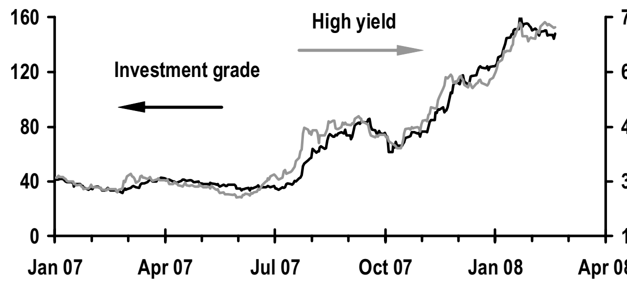
In short, there is every reason to expect that recent increases in commodity prices will continue to boost headline inflation over the next few months, further restraining growth of real income and real consumer spending. The forecast for CPI inflation in 1Q08 is now at 4.5%q/q, saar, up from a 2.8% forecast recently.

Credit conditions are tighter

The third change in the environment that is weighing on growth prospects is a further tightening of credit conditions. Investors continue to shun structured products—with the turmoil recently spreading to the auction-rate notes in the municipal market—and are favoring liquid and safe homes for their assets. The result is much tougher financing conditions for riskier borrowers and tougher financing con-

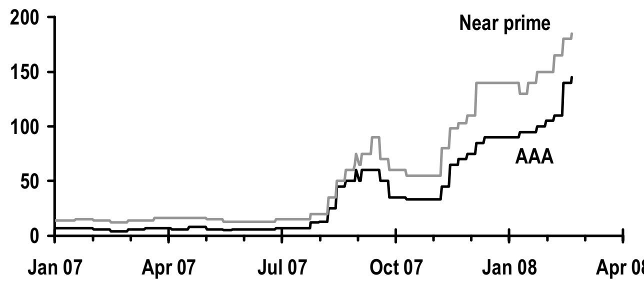
Corporate bond spreads

Basis points over Treasuries, both scales



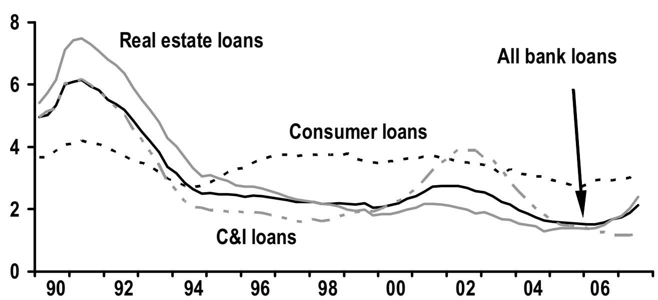
ABS 3-year auto loans, spread to swaps

Basis points



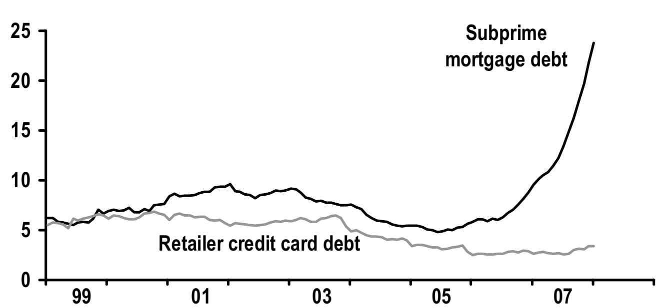
Delinquency rates on bank loans

Percent, Fed series through 4Q07, more than 30 days past due



Delinquency rates on securitized loans

Percent 60 days or more past due



ditions even for investment-grade firms and many credit-worthy households.

It is not easy to quantify the extent of credit market tightening. But the latest Fed survey of bank senior loan officers shows a fairly abrupt and general turn to tighter credit conditions, most dramatically for lending for commercial real estate. Credit spreads have also continued to trend much wider for high-grade and high-yield corporate bonds as well as for a wide variety of consumer loans.

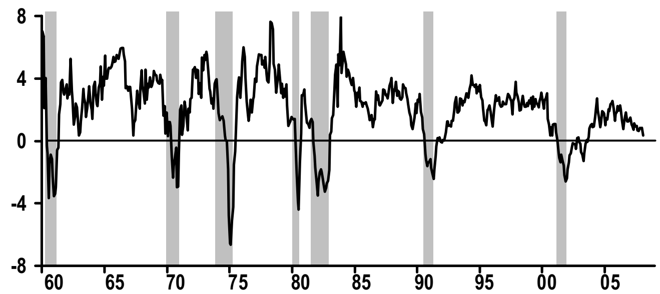
The tightening of credit conditions has occurred against the backdrop of low unemployment rates and relatively low delinquency rates in most categories of loans so far. This week's release of Fed data on bank problem loans for 4Q07 showed an overall delinquency rate of 2.49%—up from 1.68% a year earlier but still relatively low, and well within the norms of the past decade. Credit tightening partly reflects justifiable concerns that the current period of slow growth will only bring further increases in problem loans.

What obviously account for the severity of trouble in the credit markets broadly are the enormous problems in the market for subprime mortgages and other risky housing loans. The delinquency rate on securitized subprime mortgages (60 days or more past due) reached 23.8% in early January, up from 5.8% two years earlier and an earlier peak of 9.1% following the 2001 recession. Enormous losses on these loans, and distrust of the bond ratings that supported their purchase in the first place, has shifted the credit markets from extremely easy financing through 2006 to the extremely tight conditions now.

Recent surveys indicate that credit tightening is a relatively minor problem for small business and for most households.

Nonfarm payrolls

%ch saar, over 3 months



However, credit market tightening and concerns about financing are doubtless a source of considerable anxiety and uncertainty for many larger corporations. They will make these firms more cautious in their hiring and spending decisions.

The key issue for the economic forecast is whether the intensified drags from higher mortgage rates, higher headline inflation, and deteriorating credit market conditions will affect the labor markets. Substantial declines in payrolls are probably the most important defining characteristic of recessions. Even in the relatively mild recession of 2001, nonfarm payrolls averaged declines of 200,000 per month (and 150,000 per month in the months before the September 11 attacks.) So far, at least, the combination of rising mortgage rates, higher headline inflation, and tighter credit conditions has not prompted such pronounced job cutbacks, judging by either payroll reports through January or the weekly readings on initial jobless claims through the middle of February. But these intensified drags are, at a minimum, a source of downside risks to the 2.0%q/q, saar GDP forecast for next quarter.

Economic Research note

EMU expansion to put upward pressure on Euro area inflation

- **The Euro area is set to expand rapidly into Central and Eastern Europe over the next two decades**
- **Joining countries will not have completed their price level and income convergence processes before entry**
- **This will put significant upward pressure on Euro area inflation; possibly up to 0.3%pt**

The prospect of EMU expansion into Central and Eastern Europe has important implications for inflation dynamics in the enlarged Euro area. Normally, it is reasonable to assume that long-term inflation trends will be broadly in line with the central bank's target, once short-term fluctuations have played out. However, this assumption is an oversimplification in a rapidly expanding Euro area. New joiners that have not completed the process of income and price level catchup will put upward pressure on Euro area HICP inflation during the convergence process. As these processes are typically slow, they will affect Euro area inflation dynamics for an extended period of time. This is true even if these countries have met the inflation convergence criterion before entering EMU.

Causes of higher Euro area inflation

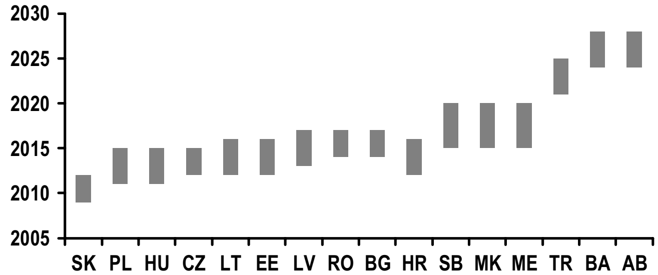
EMU is likely to expand rapidly over the next 20 years.[1] But, none of the candidate countries is likely to have completed the process of income and price level convergence before entry. The resulting dynamics will generate a number of upward pressures on Euro area inflation:

- **Price level convergence.** A single currency improves price transparency and hence the convergence of traded goods prices via increased arbitrage. During this process, inflation rates will tend to be higher in countries with low initial price levels.
- **Price liberalization.** Tight controls on administered prices are widespread in candidate countries, especially in some parts of the service sector. Thus, large price rises will result from privatization and price liberalization.
- **Real convergence.** Low-income countries tend to experience structurally high inflation rates during convergence, reflecting the Balassa-Samuelson effect. This theory asserts that catchup is mainly driven by fast productivity growth in the traded goods sectors. This pulls up the wage rate for all workers in the economy. However, the nontraded sectors, which tend to have more sluggish productivity growth, can only pay these wages if they increase prices, leading to higher inflation. The strength of this effect depends on the size of the productivity growth gap between the traded and nontraded sectors.

1. Predicting EMU entry dates for candidate countries is difficult, as the ultimate decisions will be political, rather than purely economic. Our baseline assumptions suggest two large waves of entrants: the first wave of countries will join between 2009 and 2015 and a second wave, led by Turkey, will join around 2025. Ukraine, Moldova, and Belarus are not considered, owing to their low entry probabilities over the next three to four decades.

Timing of EMU entry - baseline assumptions

Bars show most likely joining corridors



Note: The country identifiers are Slovak Republic (SK), Poland (PL), Hungary (HU), Czech Republic (CZ), Lithuania (LT), Estonia (EE), Latvia (LV), Romania (RO), Bulgaria (BG), Croatia (HR), Serbia (SB), FYR Macedonia (MK), Montenegro (ME), Turkey (TR), Bosnia Hercegovina (BA), Albania (AB).

Summary indicators for EMU candidate countries

	Price level Euro area=100	GDP/capita Euro area=100	GDP growth %oya 99-06	Population million
Poland	61	48	3.8	38.1
Czech Republic	60	72	3.8	10.3
Slovak Republic	57	58	4.3	5.4
Hungary	59	59	4.4	10.1
Latvia	59	49	8.6	2.3
Lithuania	55	51	6.2	3.4
Estonia	65	62	8.0	1.3
Romania	56	35	6.0	21.5
Bulgaria	44	33	5.2	7.9
Croatia	68	47	3.8	4.4
Turkey	67	29	4.0	74.3
Bosnia-Hercegovina	na	na	5.1	3.8
Serbia	na	na	5.5	7.5
Montenegro	na	na	2.9	0.7
FYR Macedonia	na	na	2.2	2.0
memo item:				
Euro area	100	100	2.1	319.6

Source: Eurostat and EBRD. GDP price levels and GDP per capita are for 2006 at purchasing power parities (rescaled to Euro area = 100). Average real GDP %oya growth data available only from 2000 for Balkan countries and Latvia and since 2001 for Romania.

As a result of these factors, EMU joiners will have higher inflation than existing EMU members. Before EMU entry, this inflationary pressure can show up via higher domestic inflation or an appreciating nominal exchange rate (which makes domestic prices more expensive in euro terms). The experience of candidate countries illustrates this well:

countries that already fix their exchange rate to the Euro (e.g., the Baltic states and Bulgaria) have high inflation, while inflation-targeting countries (e.g., Poland and the Czech Republic) have appreciating nominal exchange rates. To get a sense of the total size of the inflationary pressure in each candidate country, it is important to look at the real exchange rate against the euro, as it combines the observed inflation and exchange rate movements.[2] Of course, once inside EMU, these appreciations will show up entirely as above-average inflation.

Convergence is rapid but far from over

The data confirm that real effective exchange rates (REERs) in candidate countries have appreciated around 3-6% annually against the Euro area. This is distinctly faster than in the former catchup economies already in EMU (Spain, Portugal, Greece, Slovenia, and Ireland), where real appreciations have been closer to 1% annually. One driver is the Balassa-Samuelson effect, which is very difficult to quantify, but recent academic research suggests that it is at most 2% p.a., less than half of the observed nominal price convergence. One possible reason for the relatively small Balassa-Samuelson effect is that in some catchup economies nontraded sectors also have rapid productivity growth, keeping the sectoral productivity growth gap down.

The other two factors are also at work. Owing to arbitrage, the price level of goods (a good proxy for traded products) is significantly closer to the EU-15 level (around 70% in 2006) than the price level of services (a good proxy for nontraded goods), which are still mostly below 50% of the EU-15 level. In addition, prices in highly traded categories such as clothing and footwear have rapidly moved to the EU-15 level since 1999. Finally, categories with a high proportion of government intervention and administered prices have low price levels: around 40% of the EU-15 level for health and housing, just 28% for education. In total, the share of administered prices in CPI is between 15% and 25% in most countries; notable exceptions are Poland and Croatia, where it is virtually zero. While EMU candidate countries are converging faster than former catchup economies already in EMU, the process is far from over.

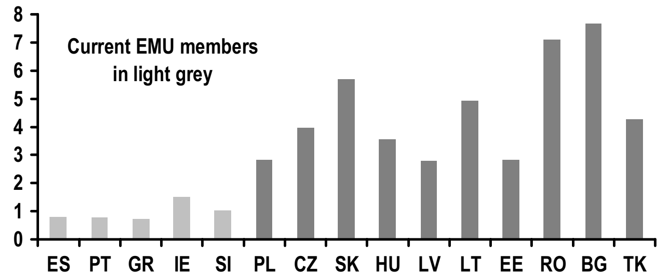
Lessons from former catchup economies

At the start of EMU in 1999, Spain, Portugal, and Greece

2. Real effective exchange rates (REERs) against the Euro area are driven by the inflation differential between two countries, adjusted for nominal exchange rate changes. Therefore, to measure the size of the inflationary pressures caused by catchup, it is important to look at REER trends over longer time periods, as in the shorter term, nominal exchange rate and inflation shocks can affect the trend. Current account imbalances can also lead to REER movements, although research suggests that the trends in candidate countries have been driven almost entirely by the convergence forces outlined above rather than by trade imbalances.

Real appreciations versus the Euro area

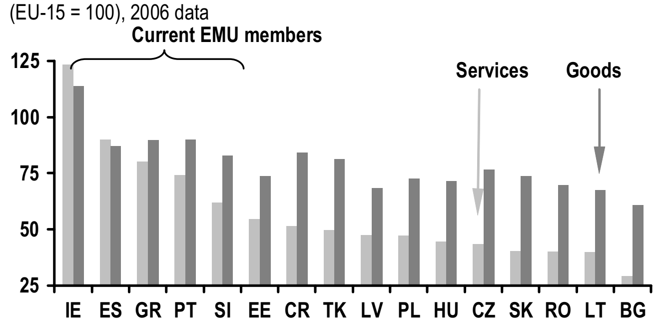
Real effective exchange rate, 1996-2006 % p.a.



Note: REERs are deflated by the HICP. In addition, all REERs are relative to the Euro area and thereby provide a more accurate measure of catchup versus the Euro area, rather than against a broader set of countries. The size of appreciation depends to some extent on the sample period chosen, owing to the occurrence of large shorter-term shocks. However, the general conclusion holds that candidate countries have seen faster real appreciation.

Price level of consumer goods and services

(EU-15 = 100), 2006 data



Note: Comparative price levels (CPLs) are not directly comparable to HICP data. CPLs compare the cost of the same consumption basket across countries, while HICP measures the price change of a representative basket. Inflation trends recorded by HICP capture not just price convergence of similar goods and services, but can also be affected by the changing composition of the representative basket. However, there is a close relationship between changes in price levels and relative HICP inflation rates across Euro area countries.

Price levels in former catchup countries and future joiners

Catchup countries:	Former		Future	
	1999	2006	1999	2006
Food	87	87	55	67
Alcohol and tobacco	69	75	48	60
Clothing and footwear	97	96	63	89
Housing	72	79	27	38
Household equipment	85	93	59	67
Health	73	79	26	41
Transport	84	86	56	71
Communications	78	105	81	91
Recreation and culture	88	89	45	57
Education	71	76	18	28
Hotels and restaurants	89	84	50	58
Miscellaneous goods and services	77	80	37	49
Total	81	85	45	58

Source: Eurostat. "Former" includes Spain, Portugal, and Greece. Ireland is left out due to its very high price level. "Future" joiners include PL, CZ, SK, HU, LV, LT, EE, RO, BG, HR, and TK. For both categories, simple averages of country price levels are shown.

had price levels of around 80% of the Euro area average and GDP per capita levels ranging from 68% to 84%. Slovenia was at a similar stage of convergence when it joined EMU in 2007. A number of lessons emerge from the experiences of these countries:

- **The pace of price level convergence slows over time.** Over the past decade, countries with lower starting price levels subsequently saw larger REER appreciations and price level increases. This holds on average, although individual countries can behave differently owing to special factors. When a country's price level reaches around 80% of the Euro area average, further convergence becomes significantly slower.
- **EMU has little impact on the pace of convergence.** There is little conclusive evidence to suggest that joining EMU significantly accelerates the convergence process. Perhaps this is not surprising as EMU membership is preceded by membership of the EU's internal market, which removes many trade barriers. In addition, some countries have already fixed their exchange rate to the euro, removing exchange rate risk from trade.
- **Catchup countries experience higher inflation**. Even for traded goods, convergence leads to higher inflation in catchup countries, rather than lower inflation in high-income countries.
- **Cyclical divergences are important.** Above-trend economic growth in an EMU country likely pushes up its inflation rate, leading to a gradual loss of price competitiveness, which eventually pulls growth and inflation back down to trend. However, this equilibrating mechanism appears weak in the Euro area as both Ireland and Spain have enjoyed decade-long booms. Therefore, cyclical factors have a large impact on observed inflation.

Overall, the impact of Spain, Ireland, Greece, and Portugal has been to raise Euro area HICP inflation by around 0.18%pt p.a. This gap has been relative steady since 1999.

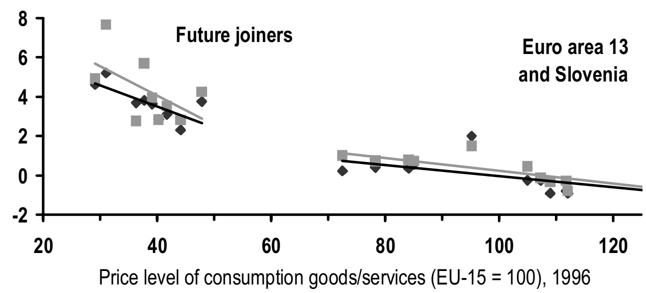
Quantifying the impact of EMU expansion

The impact of EMU expansion on Euro area HICP inflation will depend on a number of parameters. First, a country's price and income level at the time it enters EMU; second, the speed of convergence and hence its inflation rate after it has joined EMU; and third, the evolution of the country's weight in the expanding Euro area.

It would be nice to build a forecast based on the separate price pressures: Balassa-Samuelson effects pushing up prices of nontraded goods, European integration leading to

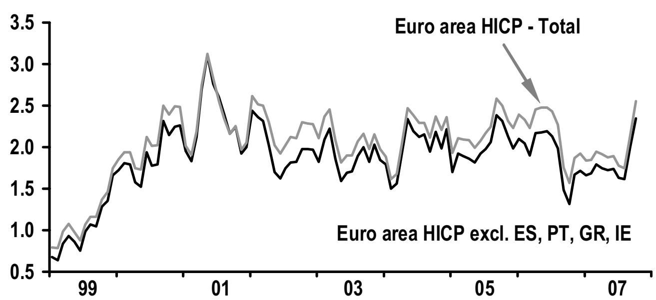
Starting price levels and subsequent changes in price levels and REER

% p.a. avg since 1996, price level (black) and REER (grey)



Impact of Spain, Portugal, Greece and Ireland on Euro area HICP

%oya



greater convergence of traded goods prices, liberalization of administered prices and cyclical factors. However, this bottom-up analysis is difficult. The direction, size, and timing of cyclical swings are difficult to predict, and because of data constraints, academic research has been unable to produce reliable estimates of the Balassa-Samuelson effect in EMU candidate countries.

The alternative approach used here and in some academic work is to take as the starting point the observed appreciation of each candidate country's REER over the past decade. This gives an estimate of its recent convergence speed, which is then cross-checked with the observed pace at which its price level has risen toward the Euro area average. Over time, the speed of convergence and hence the REER appreciation, price level increase, and HICP inflation gap will gradually moderate. We model this as linearly declining catchup rates, so that the inflation gap in each candidate country declines the same amount each year and becomes zero when its price level reaches the average of the current Euro area. For example, a country with a starting price level of 50% of the Euro area average and a convergence speed of 5% will take 28 years to converge. After 14 years, its catchup speed will have halved to 2.5%.

HICP country weights depend on each country's share of the Euro area's nominal household spending on goods and services covered by the HICP. This is well proxied by nominal GDP, which in turn is projected forward in two parts. The nominal convergence implied by the REER appreciation provides an estimate of the price deflator in each country. Real GDP is projected forward separately using a similar methodology: each candidate country's real GDP catchup rate declines linearly but is assumed to lie above the Euro area average until the GDP per capita level (at PPP) has reached the average in current Euro area countries. Based on the evolution of nominal GDP in each candidate country, the HICP country weights of the current EMU countries will gradually fall to under 70% of the expanded Euro area. Given that candidate countries have 37% of the population of the expanded Euro area, this is of the right order of magnitude.

Based on these assumptions, the simulations imply that Euro area inflation faces upward pressures of around 0.3%pt p.a. from 2015, lasting for around 10 years and diminishing thereafter. The magnitude is uncertain but not unreasonable, given that the impact of Spain, Portugal, Greece, and Ireland has been to raise Euro area inflation 0.18%pt annually since 1999. EMU expansion into Eastern and Central Europe will be on a larger scale.

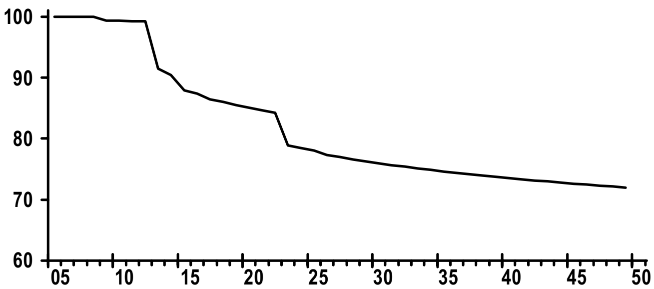
The results are sensitive to entry dates: the later a country joins EMU, the more convergence it will achieve before entry and the lower the eventual impact on Euro area inflation. There is also a question about whether predictable convergence ends before countries reach 100% of the current Euro area's price and income level, and whether recently observed convergence speeds can be sustained. A lower price level target reduces and shortens the impact on HICP, while slower convergence speeds prolong the catchup process and reduce the magnitude of the HICP impact only in the shorter term.

Many risks along the way

Convergence involves significant institutional, social, and economic change; it is unlikely to be a smooth process. The contrast of Portugal and Ireland illustrates clearly the risk of long cyclical divergences of EMU countries in both directions. While this can affect national inflation dynamics, in aggregate the impact on Euro area HICP is likely to average out to some extent. More significant is the possibility of inflation surges in the period just after EMU entry, especially if inflationary pressures were deliberately suppressed shortly before entry in order to meet the entry criteria, or if the exchange rate is fixed at an accommodative level.

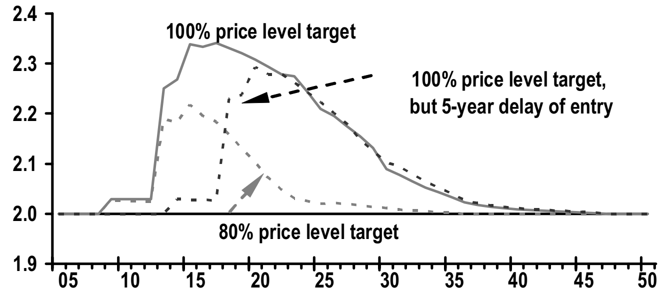
Impact of EMU expansion on HICP weight of current EMU countries

%, assuming 100% price level target and convergence speeds



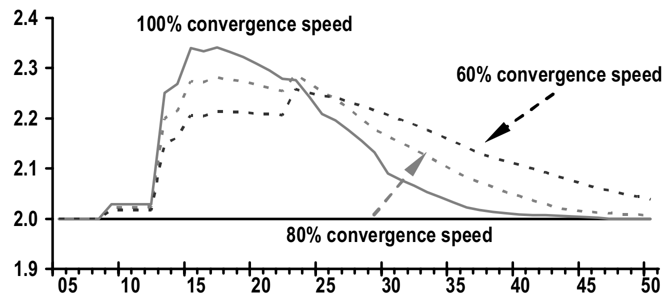
Impact of EMU expansion on Euro area inflation

%oya HICP inflation; sensitivities to price level targets and entry dates



Impact of EMU expansion on Euro area inflation

%oya HICP inflation; sensitivities to how high inital convergence speeds are



Two further points are worth mentioning. First, even if the ECB targets an inflation rate of just below 2% p.a. in the enlarged Euro area, it would have to weigh down on the inflation rates of mature economies by around 0.3%pt p.a.. Second, the model and much academic research illustrate that countries are unlikely to meet the inflation convergence criterion if they fix their exchange rate. The easier strategy is to target a low inflation rate and let the nominal exchange rate float instead. The model suggests that the resulting nominal exchange rate appreciation would be too small in all candidate countries to breach the ±15% band of the Exchange Rate Mechanism over the required two years. This strategy allows both the inflation and exchange rate criteria to be met.

Economic Research note

UK house prices begin to fall, forecast anticipates more

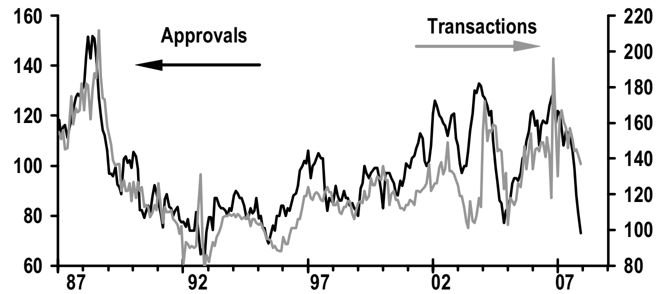
- **Recent data show plunge in demand, surge in supply, and falls in actual prices**
- **Forecast marked down to show house prices down 6%oya in 4Q08, rather than flat**

In November 2007, we published a *Special Report* that described the outlook for house prices and how they might affect consumer spending.[1] We argued that, while assessments of the level of house prices based on econometric models and other metrics suggested that residential property was significantly overvalued, nominal house prices were likely to stabilize rather than decline. We identified two markers of a transition to falling house prices in the monthly data: mortgage approvals for new home purchase falling below 85,000 a month, and the sales to stocks ratio in the RICS survey falling below 25%. How do the data look three months later?

The short answer is that the data look pretty bleak. We anticipated that mortgage approvals would breach 85,000 a month, but they have done so abruptly. The sales to stocks ratio is not yet below 25%, but it is falling toward that level quickly, driven by a marked acceleration in the flow of property on to the market as owners attempt to sell. The data on house prices themselves have slowed more rapidly than is usual given the approvals and RICS data, with the data from both Halifax and Nationwide showing declines in 3m/3m terms. While indicators of mortgage credit availability have tightened, the Bank of England's survey warns of a potentially destabilizing interaction between lending standards and expectations of falling home prices. Consequently, we are revising our forecasts to show house prices falling over the course of 2008, with the average oya rate of change across the lender's data expected near -6% in 4Q08. With policy rates falling, the forecast anticipates a smaller decline over 2009 (with the oya rate running near -3% in 4Q09). Recent data in more detail show the following:

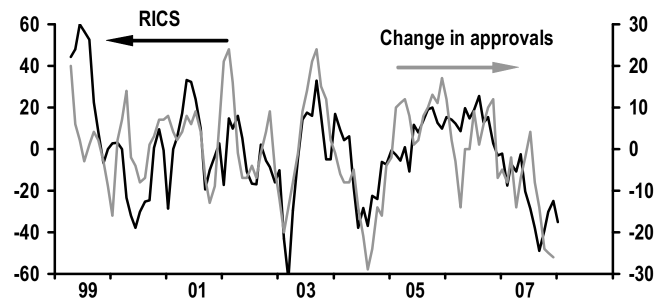
Mortgage approvals for new home purchase and property transactions

000s sa, BOE data — 000s sa, Land Registry data



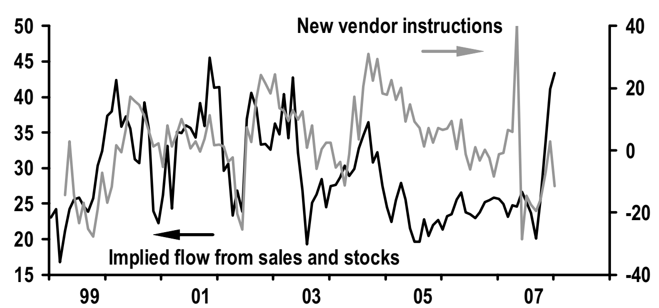
RICS new buyer enquiries versus change in mortgage approvals

% balance, sa — 000s sa, change over 3 months



RICS measures of property coming on to the market to sell

Average units per surveyor over 3 months — % balance, sa



- **A sharp fall in mortgage approvals for new home purchase, and few signs of near-term stabilization.** The more than 26% fall in approvals between December and September was the sharpest 3-month decline in data extending back to 1987. At 73,000 per month, approvals in December were the weakest since 1995. The weakest outcome in the downturn of the early 1990s was 63,000 in September 1992. The new buyer enquiries reading in the RICS survey has recovered a little over the last handful of readings, suggesting that the pace of decline in approvals may slow, but that approvals are likely to fall further in early 2008.

- **RICS data suggest a rush to sell property**. As house purchase activity has slowed abruptly over the last few months, the RICS data suggest that the flow of property coming on to the market has accelerated sharply. The new vendor instructions balance in the RICS data does

1. See "UK house prices and consumption: a guide to the coming slowdown," *Special Report*, Nov 2, 2007.
2. We derive our measure of the flow of property to the market from the only two numbers in the RICS survey that are not diffusion indices: the average number of sales per surveyor over the last three months, and the average number of properties available for sale. The implied flow is calculated as flow of property over last three months = sales over last three months plus change in stocks over last three months.

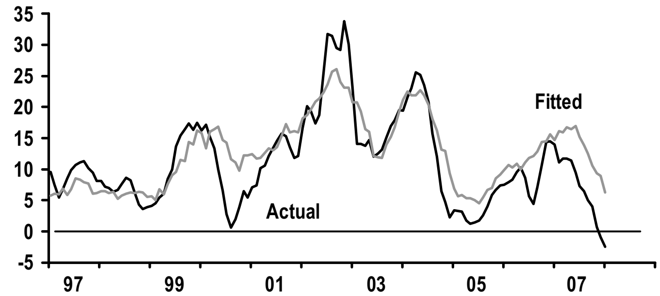
not send the same message (chart, previous page). But the weakening in the ratio of sales to stocks—a widely watched measure of market tightness—has come from rising stocks, rather than falling sales. The sales to stocks ratio has fallen 10% points over the last four readings, to 28.6% in January. With mortgage approvals suggesting weak sales, and the flow of property for sale running high, a breach of the 25% level we identified as consistent with falling house prices appears inevitable in the coming months.

- **House price data show a swift move into declines**. The 3m/3m rates of change of both the Halifax and Nationwide indices have moved below zero. Averaging across the two indices, the speed of the slowing has been more rapid than the usual relationship with indicators of demand and tightness would suggest. The rapid slowing in prices, the stepup in new supply, and the marked drop in household expectations for house prices (chart), suggest that the credit crisis has encouraged existing home owners who were considering a sale to move quickly, and accept a lower asking price, to realize existing capital gains before they eroded.

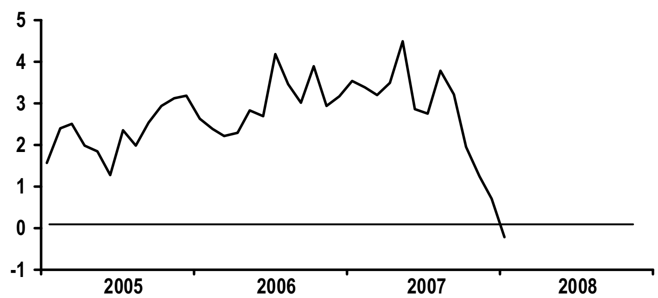
- **Warning signals of negative interaction between expected prices and lending standards**. Both the Bank of England's credit conditions survey, and the stickiness of quoted mortgage rates as market rates have fallen provide evidence of tightening credit availability in the wake of the credit crisis. The Bank's survey suggests that while deteriorating funding conditions were the motivation for tighter lending standards in late 2008, this is shifting toward concern that house prices may begin to fall. After close to a year of price declines, the commercial property sector already appears to be demonstrating this destabilizing dynamic: in 4Q the Bank of England reported the largest expected tightening in credit availability for this sector.

While the set of housing-related data warns of weakness in prices in the short run, putting a magnitude on potential declines is tough. One gauge provided by the model of house prices we presented back in November has not tracked price movements well over the last year or so, but it does suggest that a large overvaluation in the level of prices pressed down on the forecast. Plugging in our forecasts for the driving variables, the model projects a near 4% decline in nominal house prices over the course of 2008, with prices broadly stable in 2009. The forecast for the oya rate of decline across the lenders' data to reach 6% in late 2008 is hence a little more aggressive than the model alone would suggest.

House prices versus fitted value from RICS and approvals model
%3m/3m saar

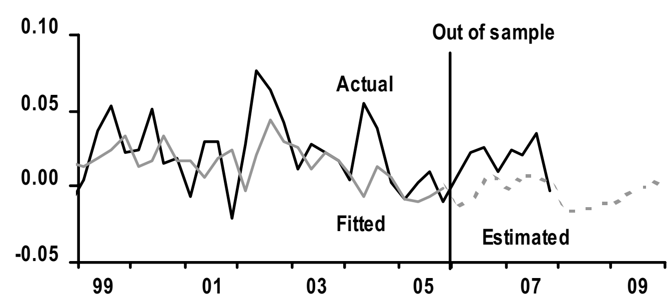


Nationwide consumer survey: expected house prices
% change expected over next 6 months



Quoted 2 year fixed mortgage rates versus 2 year swap rates
% per annum, quoted rate on 75% loan to value mortgage

Model of the change in real house prices
Quarterly difference in the long of real DCLG house prices, sa



Economic Research note

Australian fiscal policy targets lower inflation

- **Fiscal policy to play key role in macroeconomic management, particularly inflation targeting**
- **Significant government spending cuts expected in federal budget in May**
- **A terms-of-trade correction, although unlikely, could result in a budget deficit, and increased bond issuance**

In response to building inflation pressures, Australia's newly elected Labor government last month announced a five-point plan to fight inflation. Core inflation is hovering well above the RBA's 2-3%oya target range; the RBA expects inflation to remain uncomfortably high for at least the next two years. Spending cuts and additional savings of more than A$10 billion identified during last November's election campaign are key to the government's plan to curb inflation, which it believes will be its primary challenge in its three-year term of government.

Budget restraint key to fighting inflation

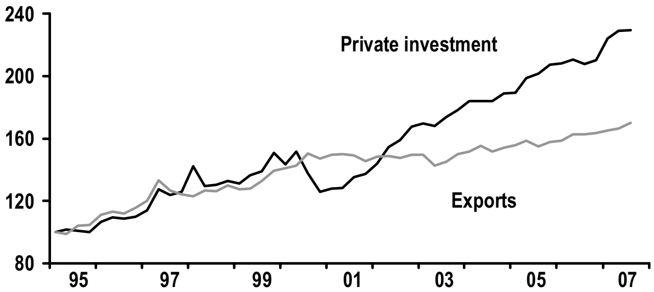
Key to Labor's inflation fighting plan is cutting government spending. A budget surplus of 1.5% of GDP has been targeted in 2008-09, up from the 1.0% targeted by the previous Coalition government. The government already has announced A$643 million of spending cuts, focused mainly on reversing promises made by the former administration.

The other four parts of Labor's inflation fighting plan are:

- **incentives to encourage private saving**, for example, via first home saver accounts. Households have saved, on average, none of their disposable income since 2000;
- **tackling the chronic skill shortage**. Another 20,000 training places have been made available under the government's "Skilling Australia for the Future" plan;
- **alleviating infrastructure bottlenecks.** A statutory body called Infrastructure Australia will address chronic underspending on roads, ports, and railways; and,
- **boosting work force participation** by helping people reenter the work force, via practical measures such as boosting affordable child care and removing other disincentives to returning to work.

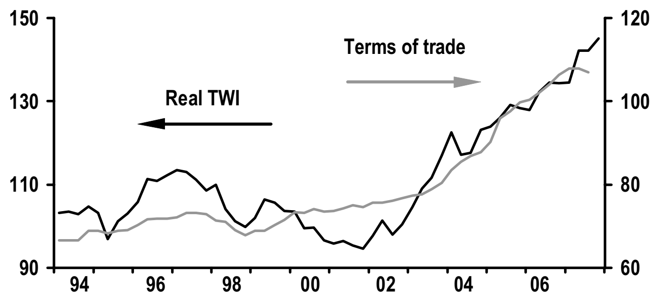
Business investment to increase capacity

Constant prices, 1995=100



Real effective exchange rate and terms of trade

1989-90=100, ABS estimates, both scales



The measures will not immediately counter building inflation pressures. The fiscal tightening will have to come largely from even deeper spending cuts, as Labor has pledged to deliver the generous income tax cuts promised in the election campaign. Not doing so during the government's first term would be committing political suicide.

Tax cuts to add further fiscal stimulus

Labor has pledged to deliver A$31 billion in tax cuts over the next three years, in the face of a deteriorating inflation outlook that suggests that this would be economically irresponsible. When discussing the inflation outlook in its quarterly *Statement on Monetary Policy*, the RBA attributed solid household income growth to strong employment gains, rising real wages, and income tax relief. Although the statement did not refer directly to the government's planned tax cuts, five straight years of income tax cuts have undoubtedly stimulated private demand to a greater extent than rising interest rates have tempered it, fanning inflation.

Indeed, the anticipated fiscal stimulus comes at a time when the economy is calling out for restraint. The RBA recently lifted its inflation forecasts to above the 2-3% target range out to 2010. Labor, not surprisingly, has come under significant pressure to defer the tax cuts, or direct at least some of them into pension accounts to curb inflation pressures. The government argues, though, that the planned tax cuts will not be inflationary, and will improve work force participation by providing incentives for people to return to work and encouraging skilled immigration. In 2007, Treasury Secretary Ken Henry estimated that the tax cuts could lift worker effort about 0.1 hour a week. Increased labor supply and higher participation would help limit wage growth, easing upward pressure on inflation.

Terms of trade to fuel even bigger surplus

Expansionary fiscal policy during the long resource boom has made inflation harder to curb. The terms of trade has surged 40% over the last four years. This helps to explain why real domestic income and nominal GDP have risen steeply, and company profits have skyrocketed, fueling faster import growth and higher production. The widening gap between real domestic income and production fueled inflation, which strong AUD could only partially offset.

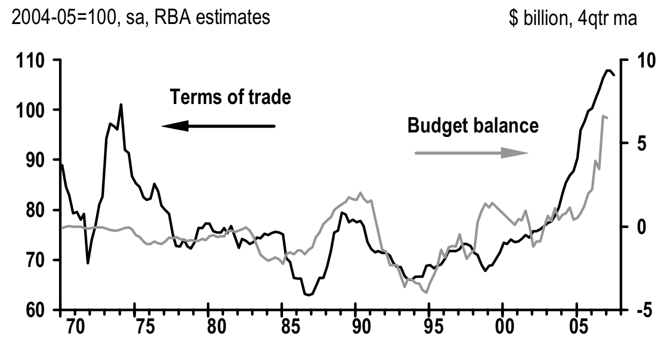
The rise in company profits led resource companies to invest in new projects and expand production. Solid business investment—which, as a proportion of GDP, is at a record high—and capital deepening should lift productivity growth, which has been in structural decline since the 1990s. Investment has now reached a mature phase; the increase in capacity and productivity growth anticipated therefrom should help dampen inflation.

But, the terms of trade is on track to hit new record highs in 2008, making even more economic stimulus likely. JPMorgan's forecasts iron ore contract prices to rise 65%, owing to continued robust demand from China, where steel production is growing rapidly and iron ore production is slowing. Coal contract prices are expected to roughly double and, on our forecasts, thermal coal and coking coal contract prices will jump over 60% and 40%, respectively. This is greater than the 40-50% rise in contract prices for major commodities that the RBA forecasts, so the 5% boost to the terms of trade the central bank expects will be surpassed. A further rise in the terms of trade would enable the government to target an even larger budget surplus.

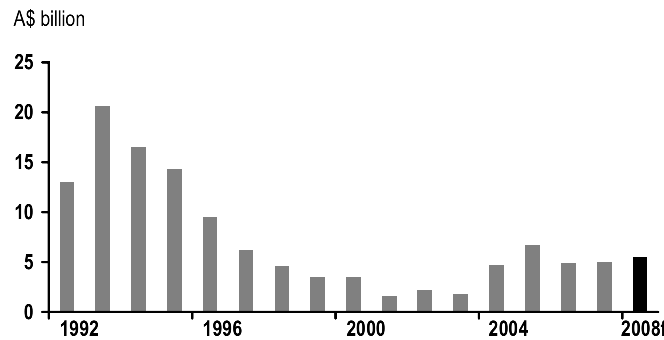
Higher bond issuance if targets not met

That said, a terms-of-trade correction is a growing risk beyond 2008. The terms of trade is strongly correlated with global GDP growth, the outlook for which has rapidly deteriorated in recent months.

Terms of trade bolster Commonwealth budget surplus



Gross new issuance of Australian government bonds



A sustained correction in the terms of trade even could lead to budget deficits, the threat of which would encourage the government to make even deeper spending cuts, as it probably would not have the luxury of being able to rely on positive shocks like the resource boom to generate revenue. A deficit probably would result in greater government bond issuance. In 1993, for example, the fiscal deficit of 6% of GDP was met with government bond issuance of more than A$20 billion. A small portion of this sum, though, was issued solely to maintain market liquidity. Despite having run surpluses since 1997 (except for a small deficit in 2001), the government has issued around A$5 billion in bonds each year to maintain market liquidity. Issuance became a function of managing liquidity rather than budget funding, especially following the elimination of net debt in 2006.

Low bond issuance can make it harder for the RBA to carry out normal market operations. When demand for money outweighs supply, the RBA supplies funds to the banking system to ease upward pressure on the cash rate. To do this, it buys government bonds from private holders, but low bond issuance can make it harder to find counterparts with enough securities to offer. Greater bond issuance, therefore, could grease the wheels for the RBA.

Economic Research note

Thailand: inflation expected to cool in 2H08 on energy prices

- **Thai CPI reflects supply forces; increases driven by global energy prices and domestic vegetable prices**
- **Aside from food and fuel, other prices remain broadly stable with limited evidence of spillover**
- **2008 CPI trajectory thus hinges crucially on global oil price movements**

As in most ASEAN countries, recent inflation in Thailand has been dominated by supply-side influences, not domestic demand pressures. This was true even during the periods of above-trend domestic growth between 2002 and 2004. This also is no surprise, given the openness of the economy and its relatively flexible labor market. Food and fuel prices have accounted for the bulk of inflation in Thailand, and are a consistent theme over the past few years. Aside from these two components, inflation has shown little uptrend, as is reflected in the relatively stable cost of services, even as prices of tradable items have risen.

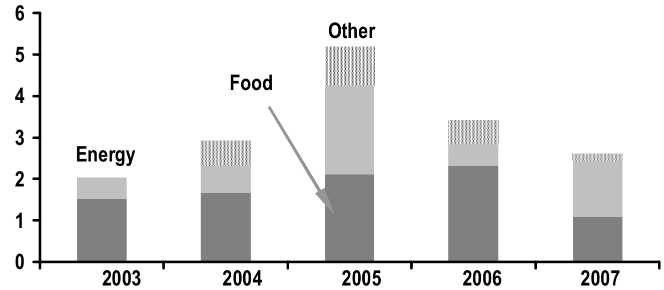
With the contours of inflation largely defined by two components—food and oil prices—the inflation forecast for Thailand mainly requires predicting the future development of these two variables. For the food component, Thai prices tend to reflect local idiosyncracies—especially important for fresh fruits and vegetables—more than global food prices. For oil, the JPMorgan forecast of global crude prices sees the WTI price declining 20% or so from the current level to US$76 per barrel by 4Q08. If this forecast materializes—and there is much risk to the forecast—local CPI inflation on a 12-month basis should decline in 2H08, after a period of elevation in 1Q08 because of base effects from lower energy prices in 1Q07.

Benign inflation outside of CPI's oil and food components

Inflation in consumer prices other than energy and food has been modest, despite the increases in those two categories. The modest response of other prices reflects in part the impact of price controls imposed by the Ministry of Commerce. But the controls have not created local shortages, suggesting that their impact in distorting pricing and producers' margins remains manageable. A very simple two variable regression of Thai inflation suggests that farm prices and domestic diesel prices together account for over

Contributors to consumer price inflation

% pt. contribution to oya inflation



A simple model of Thai inflation

This model identifies two variables as influencing CPI inflation: diesel prices and farm prices (table). The regression shows the model to have had quite high explanatory power over the course of the last seven years and affirms the view that supply pressures rather than demand pressures have shaped the recent contours of Thai inflation.

Regression model of Thai CPI inflation[1]

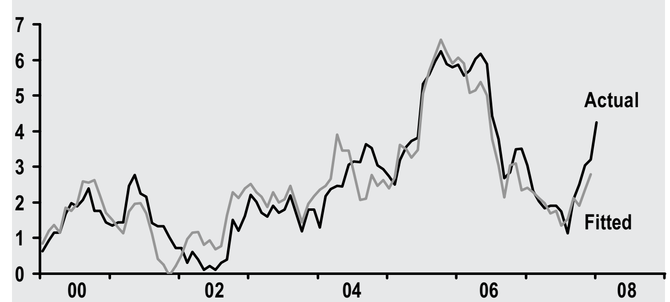
%oya, sample data: 2000-07, monthly

Independent variable	Lag	Coefficient	T-statistic
Constant		0.56	5.65
Domestic diesel prices	none	0.14	18.31
Farm output prices	none	0.04	14.39
R-squared	0.87		
Adjusted R-squared	0.86		
Durbin-Watson statistic	0.43		

1. Dependent variable: headline CPI inflation, %oya terms, monthly data.

Headline CPI

%oya



JPMorgan forecast assumptions for 2008

	1Q08	2Q08	3Q08	4Q08
WTI crude price (US$/bbl) - JPMorgar	86.0	72.0	72.0	76.0
Futures	100.2	99.4	97.8	97.4
Trend	100.2	120.0	140.0	160.0
Farm prices (%oya)	9.5	9.5	9.5	9.5

80% of Thai CPI inflation (text box). This is generally consistent with patterns seen in the rest of the Asian region.

Also, despite the sharp increase in global commodity prices, service inflation rates have remained stable, or even moderated, in Thailand over the past couple of years. While some of it may reflect weak domestic demand since 2H06, this observation of modest nontradables inflation despite high price increases for tradable goods appears to be a common theme around the region, suggesting that broader forces are still suppressing overall inflation (see "ASEAN: tracking inflation and fine-tuning the policy rate view," *GDW*, Aug 4, 2006). External cost pressures have not filtered through into broader prices, a pattern that offers some relief to policymakers concerned about second-order inflation effects from energy and food prices (first chart).

Food and oil reflect different dynamics

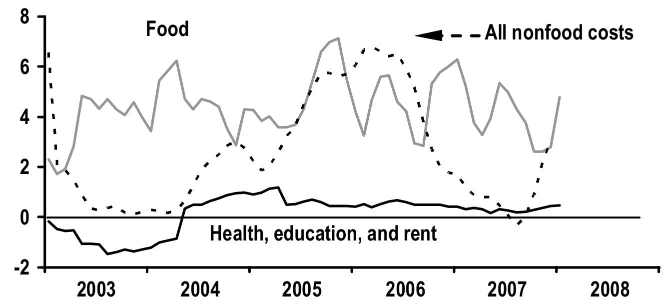
Another observation in Thailand is that short-term changes in food and nonfood inflation are not closely correlated (first chart). This comes as a slight surprise given that transport prices—a direct reflection of fuel oil prices—are thought to make up a fairly large proportion of such costs.

Instead, the key driver of food prices appears to be fresh fruit and vegetable prices. Overall food inflation has mirrored movements in the prices of fresh produce over the past four years (second chart). Thailand is self-sufficient in agricultural products and a net regional exporter of key staples—including rice, fruits, and vegetables. So, while domestic agricultural output likely determines the domestic price of food in the short term, the longer-term risk is that rising food prices in the rest of the region may exert some demand pull on Thailand's domestic prices. Although this is not likely to be a significant factor in 2008, medium-developments are worth watching.

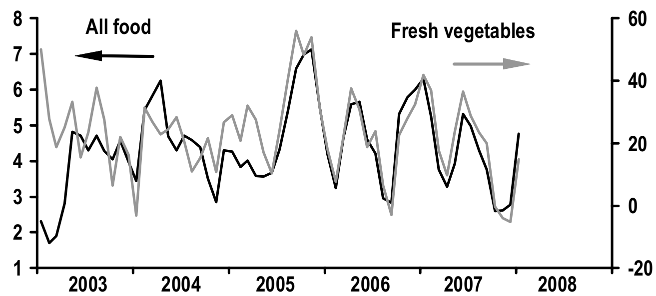
Oil prices key to Thai inflation outlook

The other key driver of inflation in Thailand is energy prices, especially for diesel fuel. If JPMorgan's forecast is realized that crude oil prices will moderate to US$72/bbl in 2Q08, compared to US$100/bbl currently, inflation in Thailand will likely be significantly mitigated (third chart and table, previous page). Indeed, even if food price inflation hovers around the recent average—that is, if food prices rise another 9.5%oya in 2008—the projected decline in energy prices should by itself slow headline inflation over the course of the year. Base effects from higher energy prices in 2H07 will add to this effect, but again the range of outcomes is potentially wide depending on the evolution of energy prices in 2008 (fourth chart).

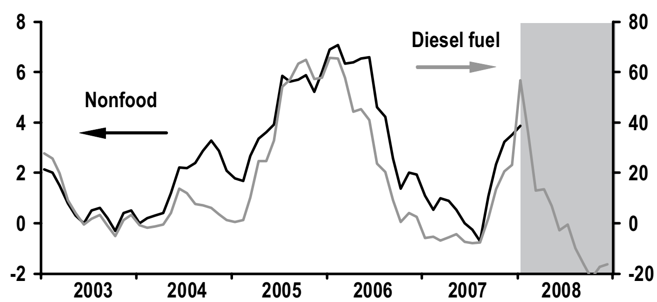
Food, nonfood, and selected service prices
%oya



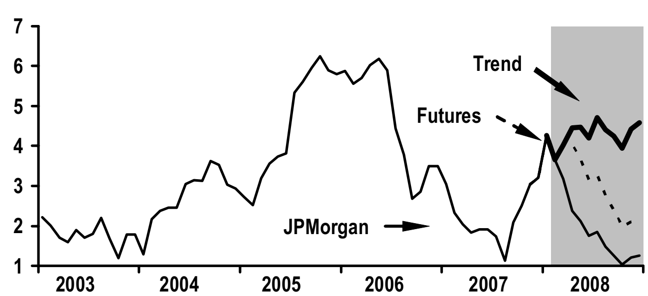
Food and fresh vegetable prices
%oya, both scales



Nonfood CPI and retail diesel fuel prices
%oya, both scales, THB terms



Overall CPI inflation
%oya



United States

- **Incoming data send mixed signals about the severity of economic weakness**
- **Inflation remains high in 1Q, squeezing real income**
- **Bernanke testimony is scheduled for Wednesday**

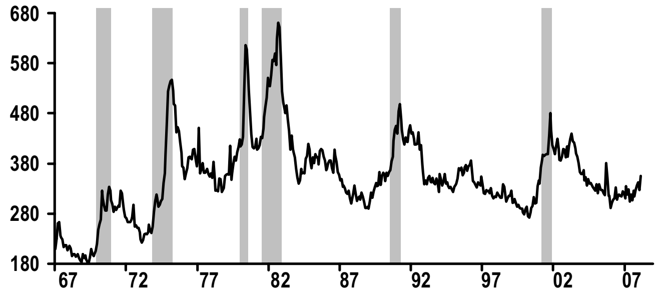
The relatively light calendar this week sent mixed signals as to the severity of economic weakness. Initial jobless claims, one of the better indicators of cyclical momentum over the years, have edged lower the past two weeks. And the average 355,000 per week reading for the first three reports for February is more consistent with slow growth than with recession.

But the plunge to -24.0 in the February Philadelphia Fed survey raised concerns that the economy might be turning down, especially in the context of the sharp downside breaks in other recent business surveys (including the latest ISM nonmanufacturng survey, Empire State manufacturing survey, and Michigan consumer confidence survey). Note that the headline reading of the Philadelphia Fed survey (reflecting perceptions of overall economic performance) is weaker than the derived composite (reflecting conditions at respondent firms.). The derived composite of 45.9, while weak, is not as low as readings during the 1995 mid-cycle slowdown.

Next week's economic releases, including January new and existing home sales and durable goods orders and shipments, will help shape perceptions of economic performance; the February labor market report and ISM surveys out the following week will be even more important. Fed Chairman Bernanke will deliver the semiannual congressional testimony this Wednesday and Thursday.

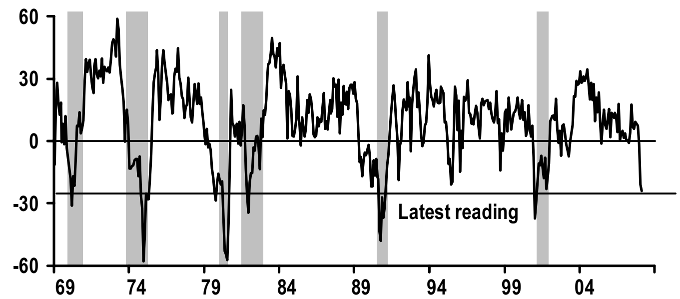
Initial jobless claims

Thousands, sawr, monthly average and Feb 08 to date



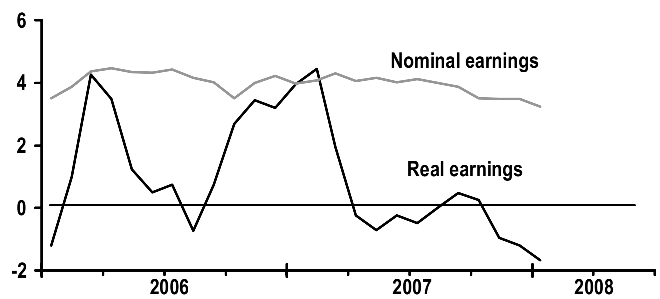
Philadelphia Fed regional manufacturing survey

Sa



Average hourly earnings

%ch saar, over 6 months



Inflation remains high in 1Q

Recent measures of underlying labor cost pressures in the domestic economy have eased significantly. Unit labor cost growth receded from 4.1%oya in 4Q06 to 1.0% in 4Q07. Average hourly earnings growth slowed from 4.2%oya in January 2007 to 3.7% last month.

However, actual inflation readings have accelerated, presumably because of pressures other than labor costs. The January CPI increased 0.4%m/m, reflecting continued outsized gains in the prices of energy and food. Headline inflation has accelerated sharply since last fall and looks set to average 4.75%q/q, saar over 4Q07-1Q08. The increase in headline inflation has squeezed real average hourly earnings, which have declined 1.7% at an annual rate over the past six months. The squeeze on real income is in large part responsible for the recent slump in real consumer spending.

The core CPI increased 0.3%m/m in January; the core has accelerated to 2.5%oya and is up 3.1% at an annual rate over the past three months. The high-side surprise in the core CPI for January was not the result of a huge gain in one quirky component. Instead, there were unusually large gains in a large number of items. The price of apparel rose 0.4%m/m, medical care 0.5%, air fares 0.8%, lodging away from home 1.1%, and tobacco products 1.1%. Even the declining trend in the price of computers and peripherals was interrupted by a 1.0%m/m price increase in January.

Although prices for both core goods and core services have accelerated since the middle of last year, the acceleration has been much more pronounced for core goods. With labor costs moderating, the recent increase in core inflation probably reflects the passthrough of higher import prices and higher energy prices. Over the last three months, the price of imported (nonauto) consumer goods has increased at an unusually rapid 2.4% annual rate, the price of all nonfuel imports at a 5.2% pace, and the CPI for energy at a 43.6% annual rate. The commentary accompanying the abrupt decline in the January nonmanufacturing ISM survey highlights the cost squeeze on firms. Some of these costs are now being passed through into higher final prices to consumers.

Housing starts continue to plunge

Single-family housing starts declined another 5.2%m/m in January and are down an average 6.0% per month since the middle of last year. Continued sharp declines are negative for near-term GDP growth, and suggest that real residential construction will contract roughly 25%q/q, saar this quarter as in the forecast. The glass-half-full aspect of the decline is that builders are finally bringing new supply to levels that are low relative to sales, paving the way for a reduction in inventories and an eventual easing of downward pressure on new home prices.

January single-family housing starts were down to an annualized pace of 743,000, some 58% below their average quarterly peak in 1Q06. The latest available (fourth-quarter 2007) figures indicate that 68% of single-family starts are for homes built for sale; so roughly 506,000 single-family starts in January (saar) were to build for sale. The latest December report on new single-family home sales showed a decline to a pace of 604,000 (saar) and the forecast for January sales is 590,000. Thus, a substantial gap between starts and sales has started to open up. The forecast looks for starts to drop relative to sales through the middle of the year. Further sharp declines in starts seem extremely likely, against the backdrop of elevated inventories of unsold homes, falling home prices, and financial problems facing many builders.

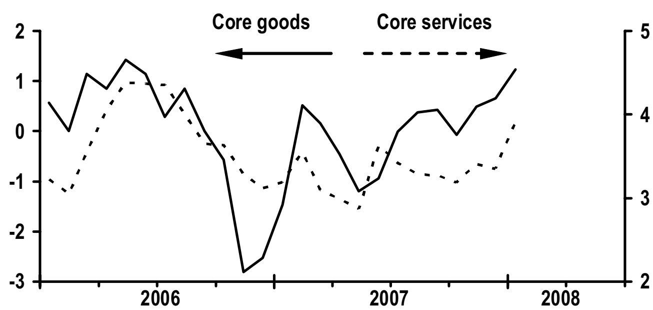
The key issue is whether sales start to stabilize, or at least fall appreciably less than housing starts. Once they do, the gap between new supply and sales would widen, and the decline in inventories of unsold new homes this year could be substantial. The Michigan consumer sentiment survey indicates that homebuying attitudes have improved enormously of late, partly reflecting the lure of lower prices. Although the monthly Homebuilders survey remains depressed, it also indicates marginal improvement in demand conditions over the past couple of months. The index has edged slightly higher in the past two months, as have the measures of current sales and prospective buyer traffic.

Core CPI

%ch saar

CPI for core goods and services

%ch saar, over 3 months, both scales



This puts the focus on the upcoming reports on existing home sales (Monday) and new home sales (Wednesday). New home sales are considered a more important influence on new construction. But because of well-know statistical problems with the new home sales series related to the treatment of sales that have been cancelled, existing home sales may give a better read as to the tone of the market.

Upcoming data

Reports this coming week on the housing market include January existing home sales (Monday), new home sales (Wednesday), and house price reports from S&P/Case-Shiller and OFHEO (both Tuesday). The January durables report (Wednesday) and five February regional manufacturing releases will help gauge activity in the industrial sector. Results of the January PPI (Tuesday) will be used to refine the forecast of the core PCE price index. The calendar also includes the January report on income and consumer spending (Friday) and the monthly consumer confidence surveys.

United States:

Data releases and forecasts

Week of February 25 - 29

Mon
Feb 25
10:00am

Existing home sales

	Oct	Nov	Dec	Jan
Total (mn, saar)	4.98	5.00	4.89	4.77
%m/m	-1.0	0.4	-2.2	-2.5
%oya, nsa	-18.7	-17.8	-23.2	-25.9
Months' supply (nsa)	10.7	10.1	9.6	
Single-family	10.4	9.8	9.2	
Median price (%oya)	-5.5	-4.0	-6.0	

The pending home sales index, which leads existing home sales by one to two months, fell 4.4% from October to December. New home sales, which fell 16.7% over the same period, have also signaled the potential for further weakness in existing home sales. New home sales measure contract signings and thus lead existing home sales, which measure contract closings.

Inventories of existing homes probably rose in January, regardless of what happened to sales. This is because the inventory series, which is not seasonally adjusted, typically falls sharply in December and rebounds in January. This pattern appears to be repeating itself again this year: inventories declined 7.5%m/m in December and the months' supply fell to 9.6 from 10.1 even though sales declined 2.2%.

While housing market conditions remain tough, the rate of decline in existing home sales has moderated significantly in recent months. The three-month annualized rate of change rose from a trough of -44% in October to -11% in December. However, condo and co-op sales, which make up 12% of existing home sales, have improved much less. Sales fell 40% annualized in the three months through December, up from a trough of -56% in October.

Tue
Feb 26
7:45am

ICSC-UBS chain store sales
Same-store sales

	%oya	% wkly change
Jan 26	1.3	-1.2
Feb 2	1.6	1.7
Feb 9	1.8	-0.7
Feb 16	1.9	0.0
Feb 23		

Tue
Feb 26
8:40am

Redbook retail average
Same-store sales

	%oya	%m/m, sa
Jan 26	0.4	-0.3
Feb 2	0.2	-0.4
Feb 09	0.6	-1.2
Feb 16	0.8	-1.1
Feb 23		

Tue
Feb 26
8:30am

Producer price index
%m/m, sa, unless as noted

	Oct	Nov	Dec	Jan
Finished goods	0.5	2.6	-0.3	0.5
%oya (nsa)	6.1	7.2	6.3	7.2
Core	0.1	0.3	0.2	0.3
%oya (nsa)	2.5	2.0	2.0	2.2
Energy	1.4	11.4	-3.0	0.6
Autos	0.1	0.6	-0.5	0.5
Trucks	-2.3	2.3	-0.6	0.5
Core intermediate	0.1	1.0	0.0	0.5
Core crude	2.0	0.2	0.2	0.0

Energy prices should have provided a small boost to headline inflation as both gasoline and natural gas prices rose. Food inflation is also expected to have been quite firm again given a rise in prices received by domestic farmers and a surge in import prices.

As always, volatile light vehicle prices are an important swing factor in the core PPI. Both car and light truck prices declined 0.6%m/m in December. Outside of light vehicles the core PPI has firmed in recent months. It rose 1.9%q/q, saar in 3Q followed by 2.7% in 4Q, and the year-over-year rate has steadily risen from a trough of 1.9% in March to 2.6% in December.

The ISM prices paid index continued to rise through January. This suggests that the core intermediate goods PPI increased again after having been flat m/m in December.

Tue
Feb 26
9:00am

S&P/Case-Shiller home price indices
%oya

	Sep	Oct	Nov	Dec
20-city composite	-4.9	-6.1	-7.7	
10-city composite	-5.5	-6.7	-8.4	
	1Q07	**2Q07**	**3Q07**	**4Q07**
National composite	-1.7	-3.3	-4.5	

The S&P/Case-Shiller home price indices are one of the best measures of single-family existing home prices currently available. These indices, which control for changes in the mix of homes sold, are most comparable to the OFHEO purchase-only index, although there are a number of source data and methodological differences between the two indices. Unlike the OFHEO indices, the Case-Shiller indices include transactions financed with nonconforming mortgages, and they have more comprehensive coverage of subprime transactions. However, the Case-Shiller indices have less comprehensive geographic coverage. For a more detailed discussion of the differences between these two indices, see *Revisiting the Differences between the OFHEO and S&P/Case-Shiller House Price Indexes*, Andrew Leventis, OFHEO, Jan 2008.

The Case-Shiller indices showed single-family existing home prices declining at an intensifying rate through last November. The monthly 20-city composite declined 7.7%oya and 8.6% peak-to-trough while the 10-city composite declined 8.4%oya and 9.4% peak-to-trough. The 10-city composite, which has history since 1987, is declining faster than at any time on record. The 20-city composite is also declining at a record pace, although it only has history since 2000.

The December report will include both the latest monthly city composites and the quarterly national index. The national index fell 4.5%oya in 3Q and was down 5.0% from its 2Q06 peak. By comparison, nominal prices fell 3.9% peak-to-trough during the 1990-91 housing downturn.

Tue
Feb 26
10:00am

Consumer confidence

Sa

	Nov	Dec	Jan	Feb
Conference Board index	87.8	90.6	87.9	83.0
Present situation	115.7	112.9	115.3	
Jobs plentiful	23.3	23.6	23.9	
Jobs hard to get	21.4	22.7	20.1	
Plentiful less hard-to-get	1.9	0.9	3.8	
Expectations	69.1	75.8	69.6	

The Conference Board consumer confidence index is expected to decline to 83.0 in February from 87.9 in January. If our forecast is realized, confidence would be at its lowest level since the fall of 2003.

Other consumer confidence indicators have collapsed in February. The Michigan consumer sentiment index fell to an 18-year low of 69.6 in the preliminary February survey from 78.4 in January. Meanwhile the weekly ABC/Washington Post consumer comfort index dropped from -27 in the week ending January 26 to -37 in the week ended February 9; it then held constant in the week ended February 16.

The consumer confidence index should decline in line with these other surveys. One important component to watch will be the labor market differential, the share of respondents saying jobs are plentiful less the share saying jobs are hard-to-get. While not a great predictor of monthly moves in the unemployment rate, the labor market differential does mirror the general trend in joblessness. The differential rose to 3.8% in January from 0.9% in December and a 4Q average of 1.3%.

Tue
Feb 26
10:00am

OFHEO house prices

%q/q, saar, unless noted

	1Q07	2Q07	3Q07	4Q07
House price index	0.6	0.1	-0.4	-1.3
%oya	4.5	3.3	1.8	-1.0
Purchase-only	0.9	0.5	-0.3	-0.8
%oya	3.5	2.8	1.8	0.3

The OFHEO home price indices, unlike many other home price measures, continued to show year-over-year price increases through 3Q. Since then, the continued deterioration of other price measures, most notably the Case-Shiller indices, suggest that the headline OFHEO index will finally have begun to fall on a year-over-year basis in 4Q. The OFHEO purchase-only index, which does not update home prices when a mortgage is refinanced, is expected still to have risen a very small amount year-over-year. That will have been due to an easier year-over-year comparison.

This release will also introduce a new set of monthly purchase-only indices. Indices will be available for the nation and the Census regions. Unlike the Case-Shiller monthly indices, the OFHEO indices will not use a rolling average of monthly transactions, but instead just transactions from the relevant month. Finally, 18 months of history will likely be available at first, although OFHEO has not yet finalized this.

While both the national headline and purchase-only index rose 1.8%oya in 3Q, some states already showed large price declines. The states with the largest declines included the once-hot housing markets of California, Nevada, Florida, and Arizona, states in the upper Midwest (Michigan, Minnesota, and Ohio), and states in New England (Rhode Island, Massachusetts, and New Hampshire). Meanwhile, the states with the largest rise in home prices were located in the Northwest.

Wed
Feb 27
8:30am

Durable goods

%m/m,sa,unless noted

	Oct	Nov	Dec	Jan
New orders	-0.5	0.5	5.0	-6.5
Ex transportation	-1.0	-0.5	2.3	-2.5
Nondef capital gds ex-air	-3.0	-0.1	4.5	-3.0
Shipments	0.5	-0.4	-0.2	0.0
Nondef capital gds ex-air	-1.2	0.1	1.9	-2.2
Inventories	0.4	0.7	1.0	

New orders for durable goods should post a sizable decline, led by a large pullback in aircraft bookings. Data from Boeing suggest seasonally adjusted aircraft orders tumbled in January following two unsustainably strong months. Defense aircraft orders also look to have reverse December's large increase. Motor vehicle assemblies were down over 3%m/m in January, which should also hold down the transportation segment of the report.

Non-transportation orders should also be weak. Several factors point to weakness in January. First, the normal first month of the quarter seasonal issue will form a challenging base for both orders and shipments. Second, industry data on physical product shipments were fairly soft last month. Third, while the ISM survey held up well in January, other regional surveys, as well as the capital expenditure components of those surveys, have deteriorated notably, imparting further downside risk.

Wed
Feb 27
10:00am

New home sales

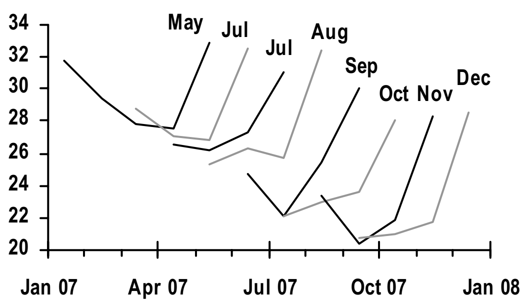
	Oct	Nov	Dec	Jan
Total (000s,saar)	725	634	604	590
%m/m	4.6	-12.6	-4.7	-2.3
%oya,nsa	-23.0	-35.2	-40.8	-33.7
Months' supply	8.4	9.4	9.6	
Median price (%oya)	-8.3	2.4	-10.4	

New home sales are expected to have declined to 590,000 units in January. New home sales in December were down 41% from their year-earlier level. Reports from homebuilders point to further weakness in sales in January. To be sure, some indicators were positive for housing demand during the month: conventional conforming mortgage rates sank and mortgage purchase applications rose. Surveys of home-buying conditions—for both consumers and homebuilders—were about unchanged from December.

While the complex of indicators would point to either a flat or small increase in new home sales from December's 604,000 pace, we expect that the December level of new home sales will be revised down again. The level of new home sales has been revised down in each of the last 20 months. The assumption for homes sold but for which construction hasn't begun (a category that is entirely imputed) has consistently been too optimistic. That appears to be the case again with the December sales number.

"Not started" home sales as % of total sales - first prints

%



Thu
Feb 28
8:30am

Jobless claims

Thousands, sa

	New claims (wr.) Wkly	New claims (wr.) 4-wk avg	Continuing claims Wkly	Continuing claims 4-wk avg	Insured jobless,%
Dec 15[1]	348	344	2713	2645	2.0
Dec 22	357	345	2754	2685	2.1
Dec 29	334	343	2688	2698	2.0
Jan 5	322	340	2747	2726	2.1
Jan 12[1]	300	328	2669	2715	2.0
Jan 19	306	316	2710	2704	2.0
Jan 26	378	327	2780	2727	2.1
Feb 2	357	335	2736	2724	2.1
Feb 9	358	350	2784	2753	2.1
Feb 16[1]	349	361			
Feb 23	360	356			

1. Payroll survey week

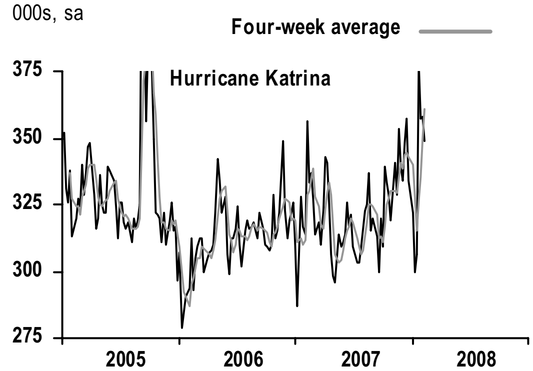
The four-week average of initial jobless claims has drifted up in recent weeks and is now at its highest level in four years. However, while claims are pointing to a weak labor market, they do not currently signal any sudden collapse.

This initial claims report will be for the week containing the Presidents Day holiday. Historically, this holiday week usually brings a rise in claims.

This report will contain the continuing claims reading for the February payroll survey week. Continuing jobless claims have been increasing since the January payroll survey week, and with the exception of the Hurricane Katrina period the four-week average is now at its highest level since November 2004.

Initial jobless claims

000s, sa



Thu
Feb 28
8:30am

Gross domestic product

%ch, q/q, saar, unless noted

	2Q07	3Q07	Adv 4Q07	Pre 4Q07
Real GDP	3.8	4.9	0.6	0.7
Final sales	3.6	4.0	1.9	2.0
Domestic final sales	2.1	2.5	1.4	1.3
Consumption	1.4	2.8	2.0	1.8
Equipment and software	4.7	6.2	3.7	3.3
Nonresidential structures	26.2	16.4	15.8	14.6
Residential investment	-11.8	-20.5	-23.9	-24.0
Government	4.1	3.8	2.6	3.0
Net exports (%-pt.contr.)	1.3	1.4	0.4	0.7
Inventories (%-pt.contr.)	0.2	0.9	-1.2	-1.3
Core PCE price index	1.4	2.0	2.7	

Real GPD growth in 4Q07 is expected to be revised up to 0.7%q/q, saar from 0.6%. Revisions have been fairly minor across categories, with the most significant revision being due to the better than expected December trade report. Elsewhere, we expect real consumption growth to be revised down to 1.8%q/q, saar from 2.0%, slighter weaker construction spending and equipment investment, and slightly stronger inventory building.

Fri
Feb 29
8:30am

Personal income
%m/m, sa, unless noted

	Oct	Nov	Dec	Jan
Personal income	0.2	0.4	0.5	0.1
Wages and salaries	0.0	0.6	0.4	-0.1
Consumption	0.3	1.0	0.2	0.4
Real consumption	-0.1	0.4	0.0	0.0
PCE price index	0.3	0.6	0.2	0.4
Core	0.22	0.22	0.23	0.31
Market-based core	0.2	0.2	0.2	
Core (%oya)	2.0	2.2	2.2	2.2
Market-based core (%oya)	1.7	1.9	2.0	
Saving rate	0.5	0.0	0.2	-0.2
(%oya)	2.0	1.9	2.1	
GDP chain price index	2.6	1.0	2.6	
(%oya)	2.7	2.4	2.6	
Adj. corporate profits	6.1	-1.2		
(%oya)	4.2	1.8		

Personal income: The product of nonfarm business aggregate hours worked and hourly earning from the employment report fell 0.1%m/m in January. Aggregate hours worked were particularly weak, declining 0.3%m/m, the lowest reading since April.

Real consumption: Real consumption is expected to have been unchanged in January. Control retail sales—nominal retail sales ex auto dealers and building material stores—advanced 0.4%m/m, while unit light vehicle sales declined 6.4%. Real control retail sales was likely little changed because of inflation.

Services consumption should have received a moderate boost from two volatile categories. First, the IP report showed utility output rising 2.2%m/m, which suggests a rise in utility consumption. Second, stock trading volumes on major exchanges surged. Part of the rise was seasonal, but even after seasonal adjustment the increase was of a decent magnitude. Stock trading volumes are used in the initial estimate of spending on brokerage commissions.

Inflation: We estimate that the headline PCE deflator rose 0.4%m/m (3.6%oya). We also estimate that the core PCE deflator rose 0.31%m/m, which would take the year-over-year rate down to 2.20% from 2.24%. Both of these forecasts are preliminary, and will be updated after the release of the PPI report next Tuesday. The PPI report contains important inputs to the medical care services deflator, which makes up more than a fifth of the core PCE deflator.

Inflation has steadily firmed in recent months. The three-month annualized core CPI rate was 3.1% in January, the highest since July 2006 and up from 2.3% just three months earlier. The year-over-year rate also increased to 2.5% from 2.4%. The year-over-year rate on both the January core CPI and the December core PCE deflator are the highest figures since March.

Fri
Feb 29
9:45am

Chicago PMI
Sa

	Nov	Dec	Jan	Feb
Composite index	53.6	56.4	51.5	47.0
Production	60.4	62.0	51.3	
New orders	49.4	56.7	44.7	
Employment	52.6	49.3	47.0	
Supplier deliveries	46.7	48.7	61.7	
Order backlogs	45.2	60.7	48.0	
Prices paid index	74.1	67.4	81.7	

Two regional manufacturing surveys have already been released this month, and both were terrible. The Empire State survey's general activity index fell to -11.7 from 9.0 and its ISM-weighted composite declined to 48.1 from 50.9, while the Philadelphia Fed survey's general business activity index fell to -24.0 from -20.9 and the ISM-weighted composite declined to 45.9 from 46.6. Expectations were also low, and capital expenditure plans declined. These two surveys and the soft tone of other data suggest that the remaining February regional surveys will be on the weak side.

Fri
Feb 29
10:00am

Consumer sentiment

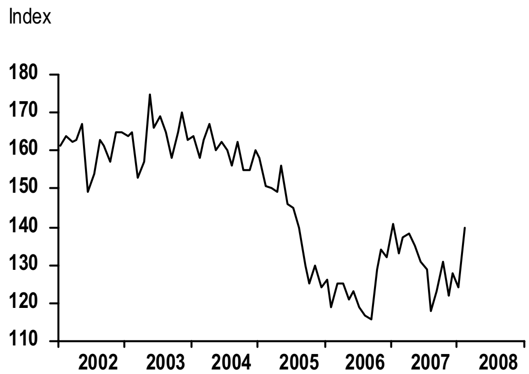
	Dec	Jan	Pre Feb	Fin Feb
Univ. of Mich. Index (nsa)	75.5	78.4	69.6	69.0
Current conditions	91.0	94.4	85.4	
Expectations	65.6	68.1	59.4	
Inflation expectations				
Short-term	3.4	3.4	3.7	
Long term	3.1	3.0	3.0	
Home buying conditions	128.0	124.0	140.0	

Consumer sentiment plunged to a 16-year low in early February in the biggest one-month decline since Hurricane Katrina. Declines were broad-based across people in different income, age, and geographic groups. Employment expectations, which are not an input to the headline sentiment index, also continued a steady decline, and are at their lowest level since November 2001.

Short-term (12-month ahead) inflation expectations drifted up in early February, to 3.7% from 3.4% in January. However, long-term inflation expectations held at 3.0% p.a., the same as the average for the prior two years.

One piece of positive news in the preliminary February survey was a rise in the home-buying conditions index to 140 from 124. That was the largest increase in almost five years. Especially notable was the rise in the number of people saying now is a good time to buy because of low interest rates. Prior to this, the steady decline in prime conforming mortgage rates that had continued until recently had caused no improvement in the home-buying conditions index.

Michigan home-buying conditions



Review of past week's data

Homebuilders survey (Feb 19)
Sa

	Dec	Jan	Feb	
Housing market	18	19	~~17~~	*20*
Present sales	19	19		*20*

The NAHB housing market index edged up in February, primarily because of a sizable improvement in prospective buyer traffic. However, the index for current sales rose only a point, while the expectations index slipped a point. With the headline index only two points above its all-time low, homebuilders clearly continue to have a dim view of the housing market. Increased affordability is probably getting individuals to at least look at homes, but this apparently hasn't translated into much of a boost to sales activity.

CPI (Feb 20)
%m/m, sa, unless noted

	Nov		Dec		Jan	
Total	~~0.8~~	*0.9*	~~0.3~~	*0.4*	~~0.2~~	*0.4*
%oya (nsa)	4.3		4.1		~~4.2~~	*4.3*
Core	~~0.27~~	*0.24*	~~0.24~~	*0.22*	~~0.21~~	*0.31*
%oya (nsa)	2.3		2.4		~~2.4~~	*2.5*
Core services	0.3		0.3		~~0.3~~	*0.4*
Core goods	~~0.2~~	*0.1*	0.0		~~0.0~~	*0.2*
Food	~~0.3~~	*0.4*	0.1		~~0.3~~	*0.7*
Energy	~~5.7~~	*6.9*	~~0.9~~	*1.7*	~~0.5~~	*0.7*
Housing	0.4		0.3			*0.2*
Owners' equivalent rent	~~0.34~~	*0.30*	~~0.28~~	*0.26*	~~0.31~~	*0.25*
Rent	~~0.40~~	*0.39*	~~0.36~~	*0.37*	~~0.33~~	*0.34*
Lodging away from home	-0.2		~~0.2~~	*0.3*	~~0.3~~	*1.1*
Apparel	~~0.8~~	*0.6*	~~0.2~~	*0.1*	~~0.1~~	*0.4*
New vehicles	~~0.1~~	*0.0*	~~0.0~~	*-0.1*	~~0.1~~	*-0.3*
Used vehicles	-0.2		0.2		~~0.2~~	*0.2*
Airfares	~~2.6~~	*1.9*	~~1.6~~	*1.2*	~~0.5~~	*0.8*
Communication	-0.5		0.0		~~0.3~~	*0.1*
Medical care	0.4		0.3		~~0.3~~	*0.5*

Consumer inflation excluding food and energy jumped up at a stronger-than-expected pace in January. Over-year-ago core inflation is now running at 2.5% and over the last three months the core CPI has increased at a 3.1% annual rate, the fastest pace since July, 2006. The increase in core CPI inflation was fairly broad-based across categories and thus harder to dismiss as driven by a few flukey increases. The recent acceleration in core inflation complicates the Fed's job. While slowing growth should create a disinflationary impetus, the trend inflation rate from which that disinflation might begin is now looking higher than it did just a few months ago. The real worry is that the higher trend inflation rate may be seeping into inflation expectations.

Housing starts (Feb 20)
Million units, saar

	Nov		Dec		Jan	
Starts	~~1.17~~	*1.18*	~~1.01~~	*1.00*	~~1.00~~	*1.01*
Single-family starts	0.82		~~0.79~~	*0.78*	*0.74*	
Multi-family starts	0.36		~~0.21~~	*0.22*	~~0.26~~	*0.27*
Permits	1.16		1.08		~~1.03~~	*1.05*

Housing starts edged up 0.8%m/m in January, but the details were on the weak side. The rise in total starts was entirely due to a 22%m/m increase in the volatile multifamily category, which rebounded after a large drop in December. Single-family starts fell 5.2%m/m and single-family permits declined 4.1%. Both single-family starts and permits are sliding at a rapid pace that has shown no significant sign of moderating. The January report is also consistent with our 1Q GDP forecast, in which we anticipate that real residential investment will drop 24% annualized, the same as in 4Q.

Philadelphia Fed survey (Feb 21)
Diffusion indices, sa

	Dec	Jan	Feb	
General business conditions	-1.6	-20.9	~~-10.0~~	*-24.0*
New orders	12.0	-15.2		*-10.9*
Shipments	15.0	-2.3		*-12.2*
Inventories	-6.5	-11.7		*-13.0*
Prices paid	36.5	49.8		*46.6*
Prices received	15.2	32.0		*24.3*
Composite	52.2	46.6		*45.9*

Following a huge decline in January, the Philadelphia Fed manufacturing survey weakened even further in February. The general business activity index is now at a level that has historically occurred only around a recession. Expectations for activity six months ahead also collapsed. This survey and the Empire State survey, which plunged from 9.0 to -11.7, strongly suggest the ISM will drop below 50 in February.

US focus: consumer prices

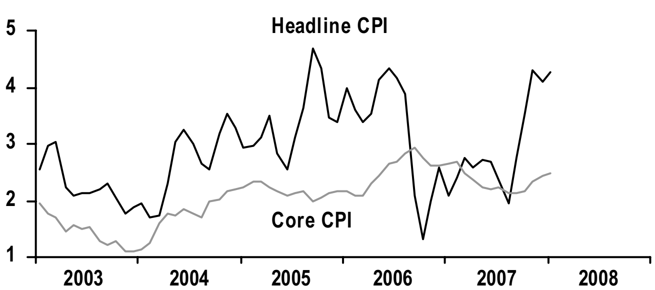
- Both headline and core inflation continued to firm in January, and headline inflation remained well above core inflation. The %oya rate on the headline CPI had been fairly similar to the rate on the core CPI over the first three quarters of 2007, but in January 2008 it rose to 4.3%, compared to 2.5% for the core CPI.
- The three-month annualized change in the core CPI was 3.1% in January, up from 2.3% in October. The year-over-year rate on the core CPI has risen from a recent trough of 2.1% in August.
- The firming in core inflation over the last few months has been broad-based, though two major categories stand out: shelter and apparel. Accelerating shelter costs reflect both the cost of lodging away from home and owners' equivalent rent. Firmer apparel prices come after earlier declines and are likely boosted by rising import prices.
- The rise in the CPI's year-over-year rate over the last couple of quarters has also been broad-based, though the shelter component has restrained the overall increase. The two biggest contributors to the rise in the year-over-year rate have been new and used vehicles, and airline fares. Airfares have risen along with jet fuel prices.

Contributions to core CPI from major categories

	%oya		%ch over 3m, saar	
	Jul 07	Jan 08	Oct 07	Jan 08
Core CPI	2.2	2.5	2.3	3.1
%-pt. contribution to change				
Core goods	-0.2	0.0	0.0	0.3
Core services	2.4	2.4	2.3	2.8
Shelter	1.5	1.3	1.1	1.5
Rent	0.3	0.3	0.3	0.3
Lodging away from home	0.2	0.2	0.0	0.2
OER	0.9	0.8	0.9	1.0
Household furnishings and operation	0.0	0.0	-0.1	0.0
Apparel	0.0	0.0	0.0	0.2
New and used vehicles	-0.2	0.0	0.0	0.0
Vehicle repair	0.0	0.1	0.0	0.1
Vehicle insurance	0.0	0.0	0.0	0.1
Public transportation	0.0	0.1	0.1	0.1
Medical care	0.3	0.4	0.5	0.4
Recreation	0.0	0.1	0.1	0.1
Education	0.2	0.2	0.2	0.3
Communication	0.0	0.0	0.0	0.0
Tobacco	0.1	0.0	0.0	0.1
Personal care	0.1	0.1	0.1	0.1

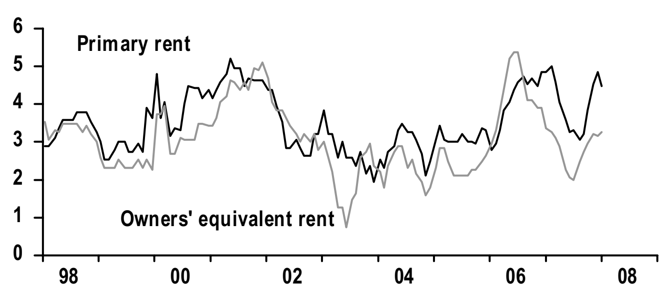
Headline and core CPI

%oya



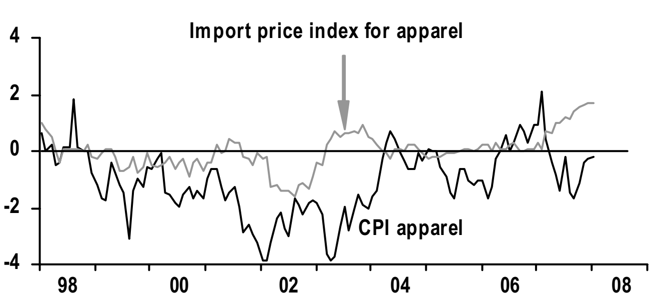
CPI for primary rent, owners' equivalent rent

%ch over 3 months, saar



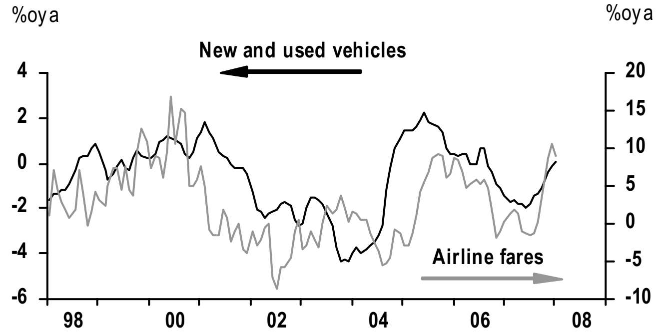
CPI apparel and import price index of apparel

%oya



CPI for new and used vehicles, airline fares

%oya %oya



Euro area

- **ECB easing may be delayed to the latter part of 2Q**
- **Growth slowdown still gradual, uneven**
- **Pipeline cost pressures still increasing; German wage growth picking up**

Just two weeks ago, it looked as if the ECB might start easing monetary policy early in the second quarter. Since then, the situation has evolved to suggest an increased likelihood of a later start.

First, incoming information continues to point to a gradual slowdown, relieving some of the immediate worries that growth may slip below 1% sooner than expected. Downside risks have crystallized rather than increased. Second, the inflation backdrop has deteriorated more than expected: strong international energy and food price pressures are increasingly visible in measures of producer and wholesale prices, risks of stronger wage growth were highlighted with this week's German steel workers 5.2% deal, and the January HICP release looks likely to confirm headline inflation at 3.2%, with core inflation little changed at 2.3%oya, next week. Third, the bulk of the most recent ECB commentary has aimed at discouraging market expectations that rate cuts might be around the corner.

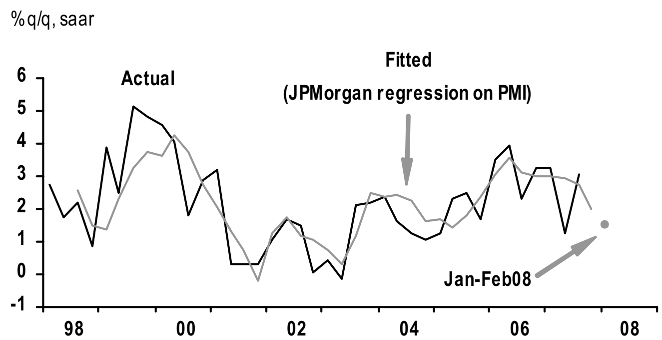
That said, the overall situation remains uncertain and fluid, both domestically and internationally. Things could change quickly, inducing a faster reaction than the central bank would otherwise have envisaged. As a result, we have decided to hold onto our April rate cut forecast, although we recognize that the likelihood of a delay has increased considerably. One complication resides with the ECB's preference for giving markets notice of forthcoming rate changes. The March press conference is due in less than two weeks, and no major data release is scheduled between now and then. While a downward revision to the staff growth forecasts looks likely, it looks now less clear that the ECB will be ready to signal a rate cut for the following month. A quicker adaptation to fast changing conditions would be possible were the ECB to adopt a more flexible mode of communication.

Growth slowdown still gradual, uneven

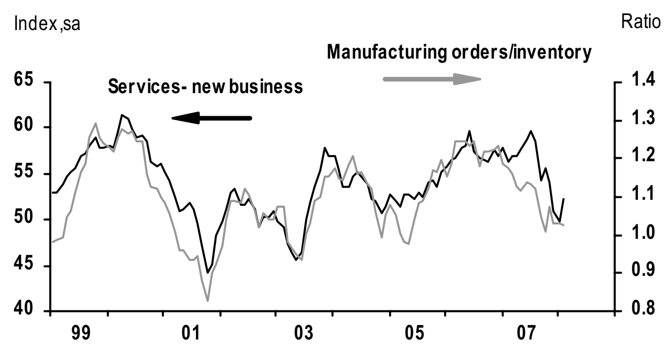
The slowdown in overall Euro area economic growth momentum continues, but remains remarkably gradual. This is the message from the most recent survey indicators of both output and business confidence. The composite PMI, in particular, regained in February half of the ground lost last month, relieving fears that the sharp deterioration in the service sector in January heralded a broader break in growth momentum. At 52.2 on average in January and February this year, it remains consistent with output growth close to 1.5%q/q, saar. With the downtrend still in place and significant headwinds hitting the economy, we expect the PMI to resume falling next month, to align more closely with our 1.2%q/q saar growth forecast for the first half of this year.

We highlighted last week that a sharp slowdown in household demand had yet to materially affect the spending atti-

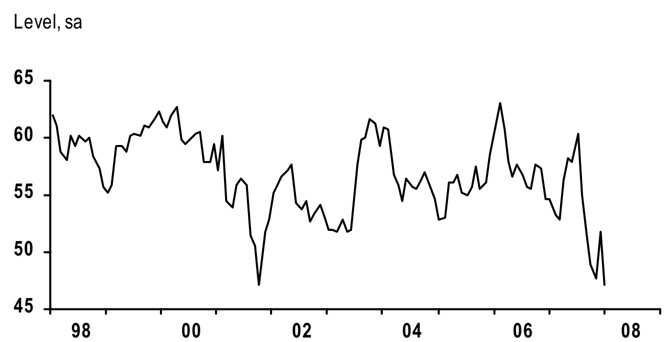
Euro area GDP and composite PMI



Forward looking details of Euro area PMI



EU PMI all financials



tude of nonfinancial corporations. The incoming information reinforces the dichotomy between household and corporate activity. The PMI sector details now available for the EU up to January (charts) revealed that the weakening in the household spending was more broad-based than previously known, spanning services as well as goods. Along with finance and real estate, the consumer-related industries are the hardest hit so far, while other areas of manufacturing have been holding up fairly well. Also, the BNB survey for February showed a marked divergence between robust developments in manufacturing and weak retail confidence. French consumption of manufactured products was reported to have been soft in January. The longer and deeper the shortfall in consumer demand (exacerbated by decelerating exports), the more likely it becomes that corporations may react with cutbacks in their spending and production plans.

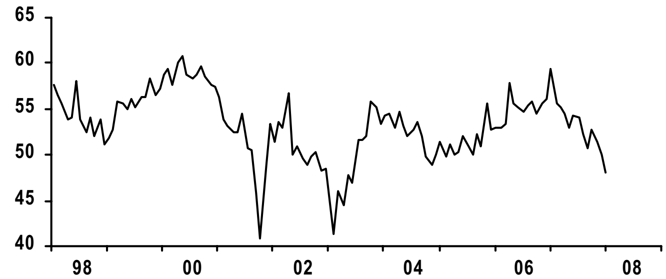
German wage growth picking up

The 5.2% wage deal obtained this week by German steel workers received considerable attention. By itself, the steel workers' deal is not particularly significant, since it covers only 85,000 workers in a sector with strong productivity growth. Negotiations for public sector employees are under way, while negotiations in the chemical sector will start next week. The main IGMetall contract (covering about 3 million workers) expires in October this year, so negotiations in that key area are not due for a while.

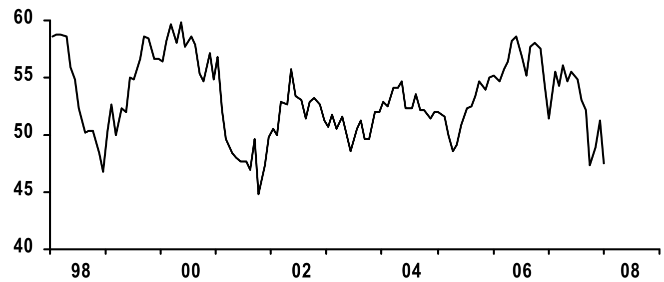
German negotiated wage growth has accelerated in recent months, with the hourly measure moving towards 2.5-3.0% from close to 1% in 2005-06. Importantly, German wage growth appears to be normalizing after a period of weakness that led to a decline in the labor share of national income. The move up in contractual wage growth will likely affect overall compensation growth (as reported in the national accounts) more clearly this year, as the downward impact of last year's one-off cut in labor contribution fades.

Germany was the key reason for subdued wage and unit labor cost growth in the Euro area as a whole over the last few years. Thus, a move of German wage inflation closer to the trend in the rest of the Euro area requires the other countries in the region to make additional efforts to moderate wages if a generalized pickup in wage inflation is to be avoided in the Euro area. Also, it removes an offset to the surge in other input costs (energy, metals).

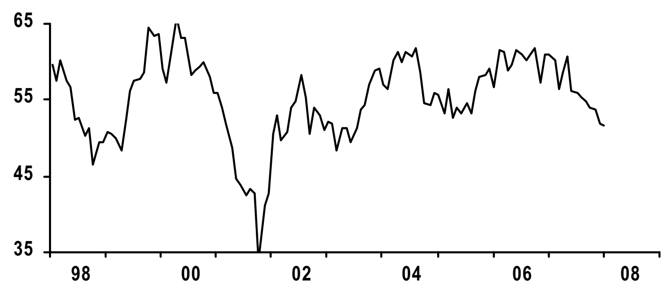
EU PMI consumer services
Level, sa



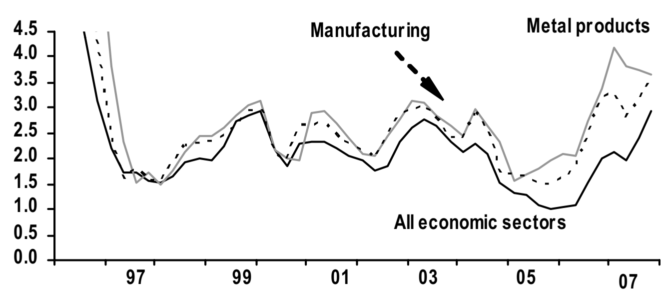
EU PMI personal and household goods
Level, sa



EU PMI - electronic and electrical equipemtn
Level, sa



Contractual wages in Germany
Blue-collar workers, hourly, % change oya, 2qma



Data releases and forecasts

Week of February 18 - 22

Output and surveys

Real GDP

		1Q07	2Q07	3Q07	4Q07
	Euro area				
	(%q/q, sa)	0.8	0.3	0.8	0.4
	(%q/q, saar)	3.3	1.2	3.1	1.6
	(%oya)	3.2	2.5	2.7	2.3
Tue	**Germany (final)**				
Feb 26	(%q/q, sa)	0.7	0.2	0.7	0.3
08:00am	(%q/q, saar)	2.6	0.7	2.7	1.1
	(%oya)	3.7	2.6	2.5	1.8
	GDP components (%q/q, saar)				
	Private consumption	-7.6	3.2	2.2	-2.0
	Government consumption	7.3	-0.2	-0.2	0.5
	Mach and equip investment	11.8	3.7	2.8	13.0
	Construction investment	5.8	-13.3	2.2	4.0
	Exports	-1.2	3.2	12.8	3.0
	Imports	9.6	-6.9	16.7	-3.0
	Contributions to GDP growth (%q/q, saar)				
	Domestic final sales	-1.8	0.7	1.7	0.6
	Inventories	8.9	-4.6	1.6	-2.4
	Net trade	-4.5	4.7	-0.6	2.9
Fri	**Italy (final)**				
Feb 29	(%q/q, sa)	0.3	0.1	0.4	-0.2
12:00pm	(%q/q, saar)	1.3	0.2	1.7	-0.8
	(%oya)	2.3	1.8	1.9	0.6
	GDP components (%q/q, saar)				
	Private consumption	3.0	2.0	0.9	0.5
	Government consumption	0.1	-0.2	0.8	0.8
	Fixed investment	2.0	1.3	5.9	1.0
	Exports	1.0	-5.4	3.8	1.0
	Imports	-4.7	-0.7	9.8	-2.0
	Contributions to GDP growth (%q/q, saar)				
	Domestic final sales	2.1	1.4	1.9	0.6
	Inventories	-2.4	0.1	1.3	-2.2
	Net trade	1.6	-1.3	-1.5	0.8

The details of German GDP growth in the final quarter of last year are expected to confirm a noticeable deceleration in overall activity. Based on the high-frequency data and comments from the Federal statistics office with the flash estimate release, private consumption was a negative contributor to growth while investment was a strong support. Net exports likely contributed significantly to growth, because of a drop in imports. If correct, this would be consistent with a sharp correction in inventories.

Italian GDP probably contracted in the final three months of last year, following a moderate rebound during the summer months. Our forecast would confirm that Italy has been among the most sluggish in the Euro area for a while. Looking at the composition of growth in 4Q, the available monthly indicators point to broad weakness across the board.

Purchasing managers index (retail)

Index, sa

		Nov	Dec	Jan	Feb
Thu	**Euro area**	45.9	46.0	48.1	48.0
Feb 28	**Germany**	43.6	44.0	44.2	44.5
10:00am	**France**	48.8	49.1	56.2	55.0
	Italy	45.3	44.7	43.0	43.5

Most likely, the Euro area retail PMI was little changed in February, after a modest rise last month. Our forecast would leave the headline index still well below the 50 no-change level, signaling a decline in retail sales for the fourth consecutive month. Only France likely continued to print an expansion.

European Commission survey

Percent balance of responses, sa

		Nov	Dec	Jan	Feb
Fri	**Euro area**				
Feb 29	Industrial confidence	3	2	1	1
11:00am	Recent production trend	7	4	3	
	Production expectations	12	11	12	
	Export order books	1	1	-2	
	Stocks of finished products	6	7	7	
	Selling-price expectations	12	13	14	
	Construction confidence	-4	-5	-6	-5
	Retail confidence	2	1	-3	-6
	Service confidence	13	14	12	12

Based on first mixed results from the national business readings, Euro area industrial sentiment, as measured by the EC survey, is expected to have moved sideways in February. If this is correct, Euro area business confidence will remain at a healthy level, suggesting some resilience in the corporate sector.

National business surveys

		Nov	Dec	Jan	Feb
Tue	**Germany (IFO survey)**				
Feb 26	2000=100, sa				
10:00am	Business climate	104.2	103.0	103.4	102.2
	Business expectations	98.3	98.2	99.0	98.0
	Current conditions	110.3	108.1	107.9	106.5
Tue	**Italy (ISAE survey)**				
Feb 26	1980=100, sa				
9:30am	Producer confidence	92.1	91.7	91.6	91.5
Tue	**Netherlands (CBS survey)**				
Feb 26	Percent balance of responses, sa				
9:30am	Producer confidence	8.7	8.0	9.5	8.5

The German IFO survey likely resumed its downward trend this month, following a surprising uptick in January. Our assessment is that the IFO survey needs to be in the 100-103 range to be broadly consistent with our growth forecast of 1.2%q/q saar.

Italian business confidence is likely moving sideways in February, which would leave the headline index at its lowest level in two years. It seems that the current headwinds are affecting industrial sentiment in Italy more significantly than elsewhere in the region.

Demand and labor markets

Retail sales

Total sales, volumes

		Oct	Nov	Dec	Jan
Fri	**Germany**				
Feb 29	Total sales, volumes				
08:00am	(%m/m, sa)	-1.1	-1.8	0.4	0.5
	(%oya, sa)	-3.1	-5.5	-9.1	2.8
	Sales excl. autos and petroleum, volumes				
	(%m/m, sa)	-1.6	-1.6	-1.0	1.0
	(%oya, sa)	-2.2	-3.6	-7.0	-1.8

German retail sales likely bounced back in January after a weak performance in the final three months of last year. The gain should be more visible in spending excluding autos as car sales fell in January. If correct, the forecast rise would leave overall retail sales starting the first quarter on a soft note, up 0.5%ar relative the 4Q average.

Unemployment

Seasonally adjusted

		Oct	Nov	Dec	Jan
Fri	**Euro area**				
Feb 29	Harmonized measure (Eurostat)				
11:00am	Unemployment rate (%)	7.2	7.2	7.2	7.1
		Nov	**Dec**	**Jan**	**Feb**
Thu	**Germany**				
Feb 28	Registered (ch m/m, 000s, sa)	-57	-80	-89	-50
09:55am	(thousands, nsa)	3378	3406	3659	3645
	Unempl. rate (%, sa)	8.5	8.3	8.1	8.0

The downtrend in Euro area unemployment likely continued at the start of the year. Another decline in the number of unemployed, driven by good results in Germany, may have been enough to push the jobless rate to a new record low in January.

In Germany, the unemployment rate may have gone down once more. Although economic activity may have slowed a bit from 4Q, we expect to see more resiliency in the German labor market in the next few months.

Employment

		Oct	Nov	Dec	Jan
Thu	**Germany**				
Feb 28	(change m/m, 000s, sa)	33	37	30	34
09:55am					

Employment is expected to have increased again in January, contributing to the sharp reduction in the number of unemployed reported for that month.

Consumer confidence

		Nov	Dec	Jan	Feb
Fri	**Euro area (European Commission survey)**				
Feb 29	Percent balance of responses, sa				
11:00am	Consumer confidence	-8	-9	-12	-12
Thu	**France (INSEE survey)**				
Feb 28	Percent balance of responses, sa				
08:45am	Consumer confidence	-29	-30	-34	-34
Tue	**Netherlands (CBS survey)**				
Feb 26	Percent balance of responses, sa				
09:30am	Consumer confidence	-2	-2	-4	-2
		Dec	**Jan**	**Feb**	**Mar**
Wed	**Germany (GFK survey)**				
Feb 27	Index, sa	4.4	4.5	4.5	4.5
08:10am					

Euro area consumer confidence has likely stabilized in February after falling noticeably last month. Given the current downshift of the domestic economy and the ongoing high level of inflation, there is no reason to expect a rebound in household sentiment this month across the region.

Inflation

Consumer prices

		Oct	Nov	Dec	Jan
Fri	**Euro area (final)**				
Feb 29	HICP (%m/m, nsa)	0.5	0.5	0.4	-0.4
11:00am	HICP (%oya, nsa)	2.6	3.1	3.1	3.2
	HICP (%oya, core)[1]	2.1	2.3	2.3	2.3
	HICP (%m/m, ex-tobacco)	0.5	0.5	0.4	-0.4
Fri	**Germany (final)**				
Feb 29	(%m/m, nsa)	0.2	0.5	0.5	-0.4
08:00am	(%m/m, sa)	0.3	0.6	-0.3	0.4
	(%oya)	2.4	3.1	2.8	2.6
	HICP (%oya)	2.7	3.3	3.1	2.9
		Nov	**Dec**	**Jan**	**Feb**
From	**Germany (prelim)**				
Tue	(%m/m, nsa)	0.5	0.5	-0.4	0.4
Feb 26	(%m/m, sa)	0.6	-0.3	0.4	-0.1
	(%oya)	3.1	2.8	2.5	2.5
	HICP (%oya)	2.7	3.3	2.9	2.9
	Baden Wuerttemberg (%oya)	2.4	3.0	2.5	2.4
	Bavaria (%oya)	2.4	3.1	2.7	2.7
	Brandenburg (%oya)	2.4	3.1	2.6	2.5
	Hesse (%oya)	2.3	2.9	2.3	2.3
	North-Rhine West (%oya)	2.6	3.2	2.7	2.7
	Saxony (%oya)	2.7	3.4	2.5	2.5
Fri	**Italy (prelim)**				
Feb 29	(%m/m, nsa)	0.4	0.3	0.4	0.3
11:00am	(%oya, nsa)	2.4	2.6	2.9	2.9
	HICP (%oya, nsa)	2.6	2.8	3.1	3.1
Fri	**Spain (flash)**				
Feb 29	HICP (%oya, nsa)	4.1	4.3	4.4	4.4
09:00am					
Thu	**Belgium CPI**				
Feb 28	(%m/m, nsa)	0.9	0.3	0.4	0.6
11:30am	(%oya, nsa)	2.9	3.1	3.5	3.5
	HICP (%oya, nsa)	2.9	3.1	3.6	3.5

1. Excluding unprocessed food and energy.

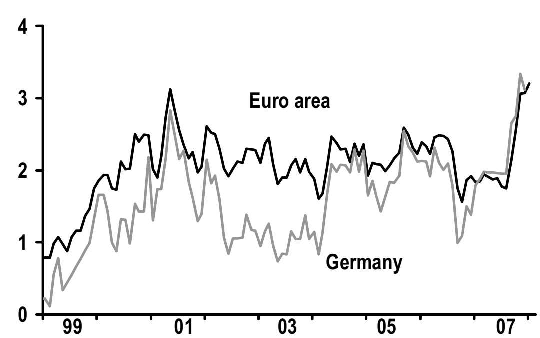
Euro area final inflation for January is expected to confirm the preliminary result. In fact, despite the expected revision of German inflation, the strong results that were recorded in other countries such as France, the Netherlands, Finland, and Ireland would leave the headline rate unchanged from the flash release.

The driver for this month's inflation is definitely food and in particular dairy prices, as well as cereal prices, which likely pushed processed food inflation to 6.2%oya from 5.7%. Higher processed food prices are as responsible for keeping core inflation at 2.3%oya, unchanged from December. Core goods inflation likely declined two tenths to 0.8%oya, because of the offsetting effect of increased medical product prices in France, as well as the fading base effect from the VAT hike in Germany. Clothing prices likely helped in January to pull core goods prices down. Service inflation, though, is expected to show less of the fading base effect due to the German VAT hike, because everywhere else in the Euro area service prices were strong on the month. The overall effect is a one-tenth decline to 2.3%oya for January.

German final inflation for January may turn out to be lower than stated in the January press release, because of the revision in the weights and in the CPI basket composition that takes place every five years. We expect the revision to reduce January CPI and HICP inflation by one or two tenths. In addition to this, the January number is likely to show a decline in certain components owing to the fading VAT base effect. In particular we expect clothing and furniture to show a sharp decline in oya terms, together with communication prices. But the volatile components may have offset the fading of the VAT base effect in January. Food prices may have moved up further on the month, maybe slightly more than we initially thought, because of more increases in dairy prices, as well as cereal prices. Energy prices may have risen to 10.3%oya after 8.6%oya in December.

Euro area and German inflation

%ch. oya



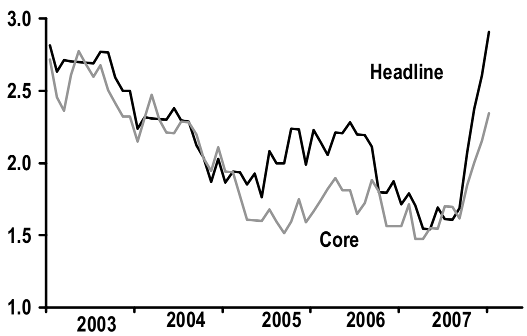
Preliminary February inflation for Germany is subject to a great deal of uncertainty, because no details are yet available for January. But, on the basis of our expectations for January, February inflation is expected to move sideways, as strength in processed food prices is offset by a sharp downward correction in unprocessed food prices.

Energy prices are expected to have kept increasing in February, this time because of higher gasoline prices, rather than higher utility bills. Core inflation, though, may have benefited in February from the fading base effect of last year's VAT increase.

Italian preliminary inflation is expected to move sideways in February. We expect to see a decline in unprocessed food prices, after a surge in January. Energy prices may decline 0.3%m/m, but still accelerate in yearly terms to 8.7%oya, after 8.3% in December. Core components are expected to come off a bit, with service price growth likely to decline to 2.5%oya, after a January peak at 2.6%. Processed food price increases are still expected to rise to 4.7%oya, after 4.4%.

Italian inflation

%ch. oya



Producer prices

		Oct	Nov	Dec	Jan
Thu	**France**				
Feb 28	(%m/m, nsa)	0.7	0.8	0.2	0.4
08:50am	(%oya, nsa)	3.3	4.2	4.5	4.8

Higher oil prices in January, along with ongoing upward pressure from the food component, will have pushed French producer prices up on the month. A sharp increase has already been reported in Germany this week.

Import prices

		Oct	Nov	Dec	Jan
Wed	**Germany**				
Feb 27	(%m/m, nsa)	0.7	0.7	-0.1	0.3
08:00am	(%oya, nsa)	2.3	3.5	3.7	4.7

German import price inflation is expected to have risen sharply in January, mainly because of the food components, as well as a base effect overall.

Financial activity and public finance

Money and credit data

		Oct	Nov	Dec	Jan
Wed	**Euro area**				
Feb 27	M3 (%m/m, sa)	1.6	1.1	0.3	__
10:00am	M3 (%oya)	12.3	12.3	11.5	11.4
	M3 (%oya, 3mma)	11.7	12.0	12.1	11.7
	Private loans (%oya)	11.3	11.1	11.1	__

After decelerating a bit from its high level in December, Euro area M3 money supply growth likely moved sideways at the start of the year. The data will continue to be distorted by ongoing financial market turmoil.

Euro area loans to private sector

%ch. oya

Review of past week's data

Output and surveys

Real GDP

	2Q07	3Q07	4Q07
Euro area (flash estimate)			
(%q/q, sa)	0.3	0.8	0.4
(%q/q, saar)	1.2	3.1	1.5
(%oya)	2.5	2.7	2.3
Spain (final)			
(%q/q, sa)	0.9	0.7	*0.8*
(%q/q, saar)	3.8	2.9	*3.2*
(%oya)	4.0	3.8	*3.5*

The slight rise in Spanish GDP in 4Q last year was confirmed in the final report. Not surprisingly, the details showed that household consumption slowed further towards year end, moving from 2.0%q/q, saar in 3Q to 1.2% in the final quarter. Consumer spending was probably affected by the increase in unemployment, tightening credit conditions, and the correction in the housing market. Meanwhile, overall investment increased at a solid pace of 3.6%q/q saar in 4Q, reaccelerating from the 2.4% registered in 3Q and in spite of a clear deceleration of construction investment (moving from 1.6%q/q saar in 3Q to 0.8% in 4Q). Exports and imports slowed down in a similar way at the end of last year, leaving the net trade contribution broadly neutral.

Purchasing managers index flash (manufacturing)

Index, sa

	Dec	Jan	Feb	
Euro area	52.6	52.8	~~51.8~~	*52.3*
Output	53.5	54.0	__	*53.4*
New Orders	51.7	51.7	__	*51.0*
Employment	52.3	52.2	__	*52.2*
Delivery times	44.3	44.3	__	*45.4*
Stock of purchases	48.5	49.5	__	*49.5*
Input Prices	61.5	64.8	__	*65.9*

The Euro area manufacturing PMI resumed its gradual downtrend this month, after the January pause. The decline in the headline indicator along with a further easing in the order/inventory ratio continue to point to softer output growth ahead.

Purchasing managers index flash (services)

Index, sa

	Dec	Jan	Feb	
Euro area	53.1	50.6	~~50.0~~	*52.3*
Business outstanding	50.5	49.3	__	*50.0*
New business	51.0	49.8	__	*52.3*
Employment	54.1	54.1	__	*54.4*
Input prices	63.0	61.8	__	*60.6*
Prices charged	53.7	53.6	__	*52.0*

Following the sharp fall reported in the January final release, the Euro area service PMI bounced back this month, indicating that last month's decline was exacerbated by temporary factors. But the February reading remains below December's level, leaving the downtrend of recent months in place.

Purchasing managers index flash (composite)

Index, sa

	Dec	Jan	Feb	
Euro area	53.3	51.8	~~51.0~~	*52.7*
New business	51.3	50.5	__	*51.9*
Employment	53.4	53.4	__	*53.6*
Input costs	62.4	62.9	__	*62.5*

As a result of a rebound in the service PMI, the composite index edged up in February. But the report continues to point to an ongoing gradual deceleration in Euro area activity, as the composite PMI averaged 52.2 in the quarter to date, down from 54.0 in the fourth quarter and 57.8 in July last year. At 52.2, the index is consistent with GDP growth running close to 1.5%q/q saar. The overall PMI survey is set to resume falling next month, aligning more closely with our 1.2%q/q saar GDP growth forecast for the first half of 2008.

Manufacturing orders

Index, sa

	Oct		Nov		Dec	
Euro area						
Values						
New orders (%m/m, sa)	~~2.5~~	*2.7*	~~2.7~~	*2.0*	~~-1.5~~	*-3.6*
New orders (%oya, sa)	~~8.3~~	*10.8*	~~11.7~~	*11.4*	__	*2.1*
Italy						
values						
New orders (%m/m, sa)	~~-0.5~~	*-1.1*	~~3.6~~	*2.9*	~~-1.5~~	*-5.4*
New orders (%oya, nsa)	8.4		13.0		__	*0.5*

As expected, Euro area manufacturing new orders corrected at the end of last year, in line with developments in the major Euro area countries.

National business surveys

	Dec	Jan		Feb	
France (INSEE survey - manufacturing)					
Index					
Composite index	109	~~109~~	*108*	~~108~~	*107*
Index of past production	23	~~18~~	*17*	~~13~~	*15*
Expected output - personal	12	~~19~~	*17*	~~18~~	*13*
Expected output - general	4	~~-4~~	*-5*	~~-8~~	*-14*
Belgium (BNB survey)					
Percent balance of responses, sa					
Overall	-1.9	-0.8		~~-4.0~~	*0.2*
Manufacturing	-1.8	-0.8		~~-4.0~~	*0.5*
Commerce	-3.3	-2.7		~~-5.0~~	*-8.0*
Construction	-0.7	1.4		~~-2.5~~	*7.0*

As expected, French business confidence eased further in February, confirming its recent gradual downtrend. At a level of 107, the composite index remains well above its long-term average of 100, but the details of the report confirm slower activity, with both current output conditions and business expectations worsening on the month.

In contrast, the Belgian BNB survey continued to surprise on the upside in February after demonstrating unexpected improvement last month. The gain was driven by another pickup in the dominant manufacturing sector and a surge in construction. This confirms the view of a gradual deterioration in the Euro area industrial activity.

Demand and labor markets

Domestic consumption

	Nov	Dec		Jan	
France					
Consumption of manufactured products, real terms					
(%m/m, sa)	0.1	~~2.0~~	2.1	~~0.1~~	-1.2
(%oya, sa)	2.6	4.0		~~3.6~~	2.2

French consumer spending turned out much weaker than expected in the first month of the year. The decline was entirely driven by a sharp correction in car sales, down 8.7% on the month after gaining 6.7%m/m in December. The introduction of a green tax on cars, applied as of January 1, boosted car sales in December and then depressed them in January. Nonauto spending was flat on the month in January, reflecting solid gains in both household equipment and apparel sales offset by a fall in other manufactured goods (roughly 45% of total spending). Through the up and down related to the auto sector, French consumption appears to have decelerated quite significantly over the past few months, dampened by numerous negative factors, in particular high inflation.

Consumer confidence

	Dec	Jan	Feb	
Italy (ISAE survey)				
1980=100, sa	106.9	102.2	~~102.2~~	103.0

Despite the increase, the headline index remains very weak, well below its long-term average of 112.1. Household sentiment in Italy slightly recovered this month as consumers' concerns over the overall economic situation eased. However, the small increase does not change the overall trend of declining consumer confidence. This reflects the current weakness in the domestic economic situation, including a high probability that growth was negative in 4Q last year.

External trade and payments

Balance of payments

€ billion, nsa, net flows

	Oct	Nov		Dec	
Euro area					
Current account	3.9	~~1.0~~	2.7	__	1.9
Goods	8.7	~~5.1~~	6.3	__	-1.5
Services	3.1	~~2.0~~	2.3	__	2.2
Capital account	1.2	1.1		__	3.6
Financial account	-80.6	~~-11.7~~	-13.1	__	-23.6
Direct investment	21.3	~~11.0~~	10.6	__	-21.0
Portfolio investment	-56.1	~~10.2~~	8.7	__	1.5

Foreign trade

	Oct		Nov		Dec	
Italy						
€ billion, sa						
Trade balance	~~-0.9~~	-1.0	~~-0.3~~	-0.7	__	-1.3
Trade balance-year earlier	-2.1		-0.9		-0.5	
Exports, fob	~~30.6~~	30.3	~~30.7~~	30.3	__	29.0
(%m/m, sa)	~~0.5~~	-0.1	~~0.4~~	0.0	__	-4.5
Imports, cif	~~31.0~~	31.3	~~31.0~~	31.0	__	30.3
(%m/m, sa)	~~1.6~~	1.4	~~-1.4~~	-0.7	__	-2.4

Inflation

Consumer prices

	Nov	Dec	Jan	
Euro area				
HICP (%m/m, nsa)	0.5	0.4	-0.4	
HICP (%oya, nsa)	3.1	3.1	3.2	
France				
(%m/m, nsa)	0.5	0.4	~~-0.2~~	-0.1
(ex. tobacco %m/m, nsa)	0.6	0.4	~~-0.3~~	-0.1
(%oya, nsa)	2.4	2.6	~~2.7~~	2.8
HICP (%oya)	2.6	2.8	~~3.1~~	3.2
Italy (final)				
(%m/m, nsa)	0.4	0.3	0.4	
(%oya, nsa)	2.4	2.6	2.9	
HICP (%oya, nsa)	2.6	2.8	3.1	

The upside surprise in French CPI inflation essentially came from food prices, which increased 4.2%oya, up from 3.1% in December. In particular, dairy prices rose significantly again in January: 8.7%oya following 5.1% in December. Energy prices were also up 12.3%oya, after 10.6% in December. As expected, gas prices gained 4.0%m/m, bringing the annual change to 4.6%oya in January, up from 0.7% in December. Gasoline prices rose 0.6% on the month, bringing the year on year change up to 16.6% from 15.4%. Developments in the core components were broadly in line with our expectations, with core goods and services inflation moving slightly down from 0.4%oya and 2.4%oya to 0.3% and 2.3%, respectively. In January, the harmonized measure's divergence from the national CPI was exacerbated by the introduction of fees on certain health products and services.

Italian inflation was confirmed to have moved up quite substantially at the start of the year. As expected, the volatile food and energy components were behind the pickup in inflation. In particular, processed, following 4.1% in December. Energy inflation also rose in January, to 8.3%oya from 6.5%, because of increases in gas and electricity tariffs, which were revised 3.9%m/m and 3.4%, respectively. Core inflation edged up one tenth to 2.3%oya in January.

Producer prices

	Nov	Dec	Jan	
Germany				
(%m/m, nsa)	0.8	-0.1	~~0.1~~	0.8
(%m/m, sa)	0.9	0.0	~~-0.1~~	0.7
(%oya, nsa)	2.5	2.5	~~2.6~~	3.3

German producer prices rose much more than expected in January. The upward surprise came from both the energy and nonenergy components. Energy prices were up 2.1% on the month and 5.9%oya in January, following a rise of 3.3%oya in December. Excluding energy, producer prices also rose 0.4% on the month to be up 2.4%oya in January, compared to 2.2%oya in December.

Japan

- **Real exports were stronger than expected in January**
- **But large manufacturers' confidence is deteriorating**
- **Construction activity still low, but is recovering**
- **Busy week ahead with monthly data fest**

Adding to the encouraging news on business capital spending in the 4Q07 GDP report last week, this week's trade data for January showed relatively solid growth in exports. This single month of strength, particularly since front-loading was anticipated ahead of the lunar new year holidays in Asian neighbors, has not altered our view that export growth is moderating this quarter. Still, the solid start to the year tempered worries that Japan's economy might have slipped into a recession at the beginning of 2008.

Nonetheless, even large manufacturers' confidence—which is still better than that of small firms—deteriorated noticeably in February, raising concern that the economy might stall in the near future. The next clue to whether growth will continue should come from next week's January IP report, which includes producers' projections for February and March. While output is likely to contract this quarter, the March projection bears close watching for what it says about momentum going into the new fiscal year that starts in April. Also, the CPI reports and consumer-related indicators will be important for gauging the extent of weakness in real private consumption this quarter.

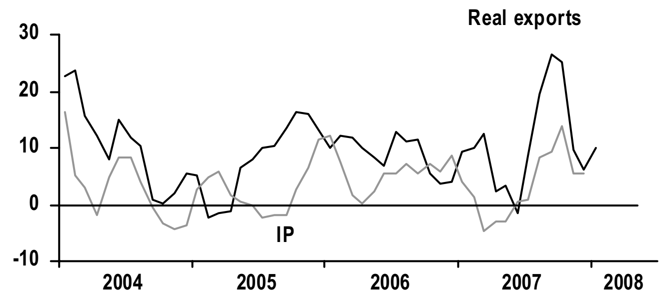
Exports held up well in January . . .

Real exports of goods accelerated unexpectedly last month, growing 4.6%m/m, sa in January after a flat December. And real imports gained 0.6%m/m, sa after a 0.1% dip in the previous month. In three-month sequential growth terms, real exports improved after moderating in 4Q07 (first chart)—a quarter when GDP-based real exports of goods and services actually grew a rapid 12.1%q/q, saar.

The unexpected strength of trade flows probably reflected frontloading in Asian neighbors, a function of the early timing of this year's lunar new year holidays. The nominal data in the customs trade statistics show that over-year-ago growth of exports to most destinations (excluding the US, but including the EU) remained relatively high. But growth of total exports unexpectedly slowed in January—to 7.7%oya from 10% in 2H07—mainly because of slower exports to China (table). To be sure, growth rates in the month-on-month, seasonally adjusted, series and the oya series sometimes paint inconsistent pictures. But we can at least say that Japan's overall exports held up well in January, although there is a risk that the strength will be reversed in coming months.

Real exports and IP

%char, 3m/3m



Nominal exports by destination

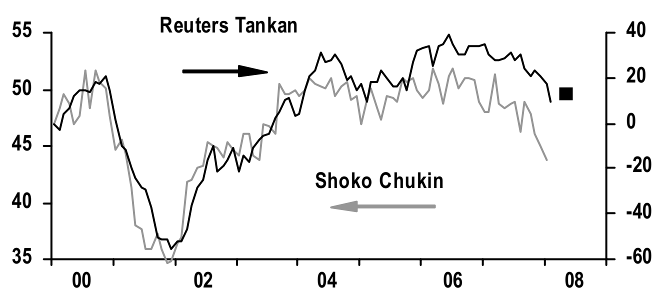
%pt contribution to the total year-over -year growth rate

	2004	2005	2006	1H07	3Q07	4Q07	Jan 08
Total	12.1	7.3	14.6	12.8	10.7	10.0	7.7
US	0.6	1.8	3.2	0.6	-0.3	-0.9	-0.7
EU	2.0	0.3	1.9	2.2	2.0	1.6	1.6
China	2.5	1.4	3.0	3.0	2.9	2.0	0.7
NIES[1]	4.2	1.4	2.3	2.1	1.5	1.4	1.4
Asean[2]	1.5	0.7	0.8	1.8	1.8	1.8	1.7
Middle East	0.1	0.4	0.6	1.1	0.9	1.4	0.7
Russia	0.2	0.3	0.5	0.6	0.6	0.5	0.5
Latin America	0.8	0.7	1.2	1.0	0.4	0.6	0.5
Africa	0.3	0.1	0.3	0.3	0.4	0.4	0.1

1. Korea, Taiwan, Hong Kong, Singapore.
2. Vietnam, Thailand, Singapore, Malaysia, Brunei, Philippines, Indonesia, Cambodia, Laos, Myanmar.

Confidence of manufacturers

Diffusion index, both scales, black box shows the survey's projection



. . . but large manufacturers have become less confident

Nonetheless, large manufacturers in February started to display the decline in confidence that has already been observed among smaller firms. The Reuters Tankan survey's manufacturing index declined to 9, the lowest level of the past three years (second chart). The speed of deterioration is certainly less severe than among small firms and consumers, and the level is still comparable with that during the growth pause of 2005. Also, it should be noted that the survey's projection for three months out (i.e., May), was for a partial recovery to 13, suggesting that large manufacturers are not despairing, just becoming more cautious.

Still, anecdotal information in the survey points to a worsening environment for firms because of higher input prices (chart), soft domestic demand, and the credit-related problems in the US. While we still believe that Japan's economy can avoid outright recession, our level of conviction has been reduced by the cumulating signs of heightened stress in international credit markets, and the resurgence of oil and other commodity prices.

Construction industry still suffering, but starting to add to growth

December construction spending data show that residential investment is continuing to recover from the plunge last summer (second chart). The level of starts and of construction put in place (a proxy of investment) is still low, suggesting that the industry is still suffering from the turmoil caused by the government authorities' rule changes last June. Indeed, the plunge is activity is being called the *kansei fukyo,* meaning "official-driven recession." Still, no matter how aberrant the reasons behind it, the drop in activity matters for overall growth rates, and the panic will subside eventually. The improvement in train validates our forecast that residential investment will turn into a positive contributor to real GDP growth starting this quarter.

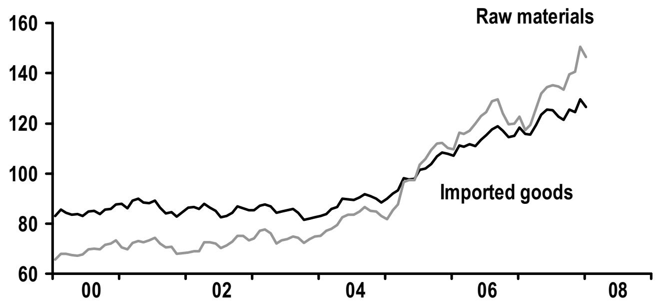
However, no recovery is yet visible in nonresidential construction put in place (third chart). Since nonresidential starts have already returned to their level before the plunge, actual investment is likely to bounce back starting this quarter. In fact, the 4Q07 fall in nonresidential construction put in place looks at odds with the strong gain in GDP-based capex. But, if the strength in other components of capex—including corporate spending on autos and software—more than compensated for the plunge in construction last quarter, that implies that the rebound in construction will lift capex early this year, even if other components slow somewhat. This supports our view that capex will continue to grow, even if at a reduced pace.

Busy week ahead

Next week's calendar includes many major monthly data for January and February. The main ones will be the IP report for Jan (Thu), as indicated above. The January nationwide and February Tokyo CPIs (Fri) will be important for gauging real consumption, along with private consumption-related indicators such as the January household survey (Fri), labor force survey (Fri), and commercial sales reports (Thu). On business sentiment, the Shoko Chukin's release of its small business survey for February (Tue), and the February PMI for manufacturing (Fri) will draw scrutiny. Also, January housing starts and construction orders (Fri) need to be checked carefully to forecast the strength of the rebound in housing investment in 1H08. In addition, the report on January corporate service prices is due next week (Tue). Regarding monetary policy, BoJ Board Member Mizuno will speak at a meeting with business leaders in Oita Prefecture (Thu).

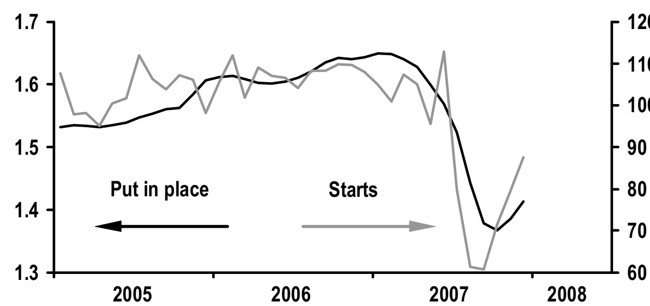
Import and raw material prices

2005=100



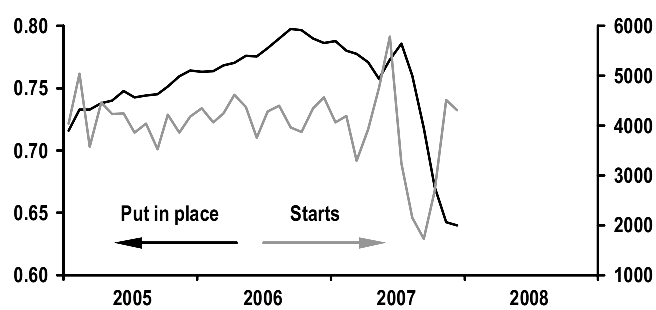
Residential construction

Trillion yen, sa by JPMorgan   Thousand units, sa



Nonresidential construction

Trillion yen, sa by JPMorgan   Floor space, thousand square meters, sa



Data releases and forecasts

Week of February 25 - 29

Tue
Feb 26
8:50am

Corporate service prices

	Oct	Nov	Dec	Jan
%oya	1.4	1.4	1.4	1.3

The transportation component, which has been explaining most of the rise, is expected to have moderated due to the yen's strength, slightly decreasing the rate of CSPI inflation in January.

Tue
Feb 26
2:00pm

Shoko Chukin small firm survey

Diffusion index

	Nov	Dec	Jan	Feb
Sentiment index	46.9	44.5	43.5	43.5
Manufacturers	46.1	45.0	43.2	___
Nonmanufacturers	47.5	44.1	43.7	___
Sales (%oya)	4.1	3.4	3.9	___
Profit margins	-10.2	-12.2	-12.3	___
Financing conditions	-4.0	-4.3	-4.5	___
Inventory	-8.5	-9.5	-8.9	___
Capacity	-2.0	-0.4	-3.2	___
Employment	8.9	8.2	7.6	___
Input prices	27.8	27.4	25.9	___
Output prices	2.2	2.1	0.1	___

In the January report, respondents predicted a meaningful recovery in business conditions for February, probably reflecting confidence that they can pass higher input costs on to their sales prices. However, the latest Economy watchers survey indicated that the pass-through has caused a large decline in sales volume.

Thu
Feb 28
8:50am

Industrial production - preliminary

%m/m, sa

	Oct	Nov	Dec	Jan
Production	1.7	-1.6	1.4	0.0
Shipments	2.4	-1.7	1.6	___
Inventories	0.6	1.7	-0.5	___
Inventory/shipment ratio	-5.4	2.7	1.3	___

While producers' predictions in the December report looked for a m/m decline of 0.4%, the strength in real exports indicates that those predictions were too conservative.

Thu
Feb 28
8:50am

Commercial sales

%oya, unless noted

	Oct	Nov	Dec	Jan
Commercial sales	4.4	4.1	2.2	___
Wholesale sales	5.4	4.8	2.8	___
Total retail sales	0.8	1.6	0.2	-1.0
%m/m, sa	0.3	0.4	-0.8	1.2

Although department store sales suggest that January retail sales will repeat the tendency of the past few years (sales were relatively strong in January, even after seasonal adjustment), the underlying message will be weak consumption against the background of food price hikes, elevated energy prices, and the uncertain global economy.

Fri
Feb 29
8:15am

Purchasing Managers Survey

Index, sa

	Nov	Dec	Jan	Feb
Overall index (manufacturing)	50.8	52.3	52.3	52.0
Output	51.0	52.5	52.3	___
New orders	50.6	52.9	53.5	___
New export orders	52.6	52.1	52.1	___
Inventories	49.1	49.7	49.4	___
Employment	50.8	52.5	50.9	___
New orders/ inventory	1.03	1.06	1.08	___

We expect the headline sentiment index to stay close to the previous two months' level. While manufacturers' output plans in the December IP report were quite pessimistic, this week's trade reports showed unexpectedly strong readings for January exports.

Fri
Feb 29
8:30am

Consumer prices

%oya, nsa

	Nov	Dec	Jan	Feb
Tokyo				
Overall	0.3	0.4	0.2	0.5
Core (excl. fresh food)	0.1	0.3	0.4	0.4
ex. food and energy	-0.1	-0.1	0.0	0.0
Nationwide				
Overall	0.6	0.7	0.6	
Core (excl. fresh food)	0.4	0.8	0.8	
ex. food and energy	-0.1	-0.1	-0.1	
CAO's core core	-0.03	0.18	___	

On our estimate, the contribution from energy, which has been the key to movements in CPI inflation, will have declined modestly to +0.63% point in January, after having increased to +0.67%pt in December from November's +0.44%pt. This will be an offset to acceleration in the nonperishable food component, already revealed by the Tokyo preliminary report.

Fri
Feb 29
8:30am

Household survey of expenditures

%m/m, sa, incl. agricultural worker households

	Oct	Nov	Dec	Jan
All households				
Real spending	0.1	-1.0	2.3	-0.8
%oya	0.6	-0.6	2.2	0.0
Core	-0.4	1.4	-0.7	0.0
%oya	0.1	1.0	1.6	0.5
Worker households				
Real disposable income	0.2	-1.4	2.6	___
Propensity to spend ratio (%)	74.7	73.7	73.8	___

The underlying trend in consumption should be soft, since consumer sentiment has been worsening amid the ongoing headwinds. In addition, the composition of spending increases in the previous month was unusual: a strong rise in spending on culture and recreation was accompanied by a material slowdown in spending on basic consumption items such as food, rent, utilities, and medical care services.

Based on the above, we expect a m/m decline in overall spending for January. "Core" spending will show a different movement, because that measure excludes volatile subcategories such as housing and autos.

Fri
Feb 29
8:30am

Labor force survey

	Oct	Nov	Dec	Jan
Unemployment rate (%, sa)	4.0	3.8	3.8	3.9
Labor force (%m/m, sa)	0.2	0.6	0.0	___
Total employment (%m/m, sa)	0.3	0.8	-0.1	___
Unemployed (%m/m, sa)	-2.2	-4.2	0.8	___
Job offers ratio (sa)	1.02	0.99	0.98	0.98

We expect the unemployment rate to have risen a bit after having returned to the level prevailing in the first half of 2007. The large declines in the employment indices of both the consumer sentiment report and the Economy watchers survey may have been indicating the end of an improving trend for females, whose working intentions and job choices tend to be much more flexible than those of males.

Fri
Feb 29
2:00pm

Housing starts

%oya, unless noted

	Oct	Nov	Dec	Jan
Housing units %oya	-35.0	-27.0	-19.2	-9.4
%m/m, sa	17.5	11.6	9.9	8.5
mil units, saar	0.86	0.96	1.05	1.14

Housing starts will likely show further improvement from the extreme weakness that followed the change in the building standards law (implemented June 20).

Fri
Feb 29
2:00pm

Construction orders

%oya

	Oct	Nov	Dec	Jan
Total	-22.7	-3.8	4.7	___
Domestic, private sector	-22.7	0.3	-3.6	___
Domestic, public sector	-38.6	-15.1	27.5	___

Review of past week's data

Index of tertiary sector activity (Feb 18)

% change

	Oct	Nov	Dec
%m/m, sa	1.2	~~0.1~~ 0.0	~~0.0~~ -0.6
%oya	1.2	~~1.7~~ 1.6	~~0.7~~ 0.0

The December decline was led by the securities industry and consumer-oriented businesses, whose activity receded against the background of a dull stock market and weak consumer sentiment.

Construction spending (Feb 18)

%oya, unless noted

	Oct	Nov	Dec
Public	-3.6	-2.2	___ -3.6
%m/m, sa by JPMorgan	~~0.5~~ 1.0	~~2.6~~ 1.8	___ 0.0
Private	-11.6	-11.4	___ -11.2
Residential	-16.9	-15.4	___ -13.9
Nonresidential	-4.9	-6.3	___ -7.9
Buildings and structures	-15.8	-18.7	___ -18.6
Civil engineering	12.4	12.5	___ 7.1

The 4Q result for the public component was broadly consistent with the first estimates of GDP public investment.

Nationwide department store sales (Feb 19)

%oya, unless noted

	Nov	Dec	Jan
Overall	0.7	-2.6	~~-2.0~~ -2.2
%m/m, sa by JPMorgan	~~4.6~~ 3.6	~~-5.3~~ -4.5	~~5.1~~ 2.3
Same-store	0.9	-2.3	___ -2.1

The solid m/m rise in seasonally adjusted sales probably reflected an inadequate adjustment. (January sales tend to be relatively strong, but this tendency emerged only in the past few years.) Indeed, sales continued to decline quite rapidly in oya terms, and the tone of comments by the Japan Department Store Association became more cautious than in the previous month.

Customs-cleared trade (Feb 21)

¥ billion, sa, unless noted

	Nov	Dec	Jan
Balance	827	642	687
Exports (%m/m)	0.6	0.9	-1.3
Imports (%m/m)	3.2	3.9	-2.1
Balance (nsa)	788	875	-421

See main essay.

Index of all-sector activity (Feb 21)

%m/m, sa

	Oct	Nov	Dec
All sector	1.2	-0.5	~~0.5~~ -0.2
Tertiary sector	1.2	~~0.1~~ 0.0	~~0.0~~ -0.6
Industrial production	1.7	-1.6	1.4
Construction	-1.4	1.4	___ -0.1
Public sector	-0.1	~~0.5~~ 0.4	___ 0.1

The all-sector activity index, which is compiled using supply-side data, finished 4Q on a softer note (+0.2%q/q, saar after 3Q's -0.1%ar) than indicated by the first estimate of GDP (+3.7%q/q, saar after +1.3%ar).

Key dates for Bank of Japan monetary policy

Feb 23	Governor Fukui's speech at Nikkei Islamic Finance Symposium (1:05pm)
Feb 28	Board Member Mizuno's speech at a meeting with business leaders in Oita Prefecture (11:10am)
Mar 6-7	Monetary Policy Meeting (Statement likely by 3:00pm on the 7th)
Mar 7	Monthly Economic Report (3:00pm)
Mar 7	Governor Fukui's Monthly Press Conference (3:30pm)

Canada

- **Core inflation tame for now on strong CAD**
- **CAD's depressing effect on core goods prices likely to prove temporary**
- **Core service inflation likely to fall as economy slows**

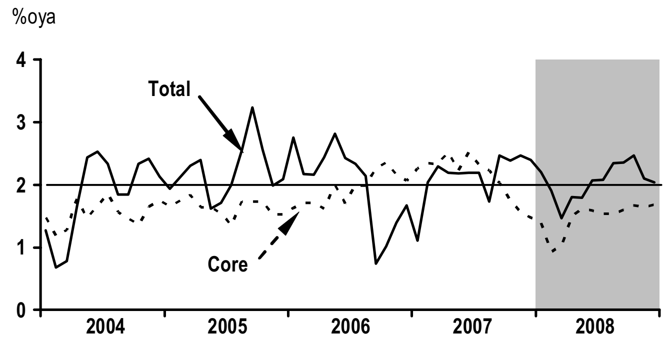
Since last October, core CPI inflation has fallen faster and further than either the Bank of Canada or most private sector economists had anticipated. In January, core inflation fell to 1.4%oya, the lowest since July 2005 and well below the 2% inflation target. Total inflation remained above the 2% target, at 2.2%oya in January, despite a 1% point reduction in the Goods and Services Tax (GST), which trimmed 0.6% pt from total inflation. Energy prices were up 11.0%oya, led by a 20.9% increase in gasoline prices.

The BoC's new Governor, Mark Carney, noted in his inaugural speech in Vancouver on Monday that globalization has contributed to strong gains in prices of commodities, especially energy, which are excluded from the BoC's measure of core inflation. Carney said that recent BoC research indicates that, despite such persistent relative price shifts, core CPI inflation remains a better predictor of future changes in the total CPI than is the total CPI itself.

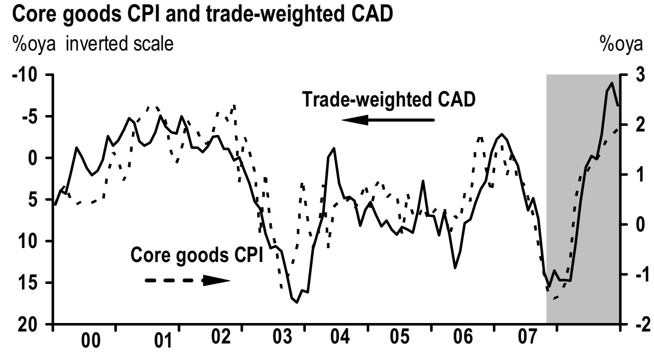
The JPMorgan forecast of core inflation is based on expectations for three major components of the core CPI, each of which has its own principal driver. The main driver of the core goods CPI (45% of core CPI) is the trade-weighted CAD. The surge of CAD above parity with USD in 2H07 translated into a decline in core goods CPI inflation to an estimated -1.1%oya in January. Given the JPMorgan forecast that CAD will weaken as 2008 unfolds, the depressing effect of the exchange rate on core inflation is likely to prove temporary. Indeed, if USD/CAD matches the JPMorgan forecast of 1.06 by the end of 2008 (i.e., CAD falls to US$0.94), then core goods CPI inflation will likely move back up to the +1.0-2.0% range.

Core service inflation is likely to weaken significantly in 2008, however. Core shelter CPI inflation (22% of core) is likely to fall to 1.5%oya or less by 4Q08 from 2.9% in January as new house price gains decelerate. Core nonshelter service inflation (33% of core) is likely to fall to 2%oya or lower from 3.4% in January as labor market slack increases and unit labor cost growth slows. This mix is likely to cause core inflation to bottom in 1Q08 before climbing back toward 2%oya in 2H08. The current core inflation outlook provides the BoC with substantial flexibility to address stalling economic growth and increases the likelihood of a 50bp rate cut on March 4.

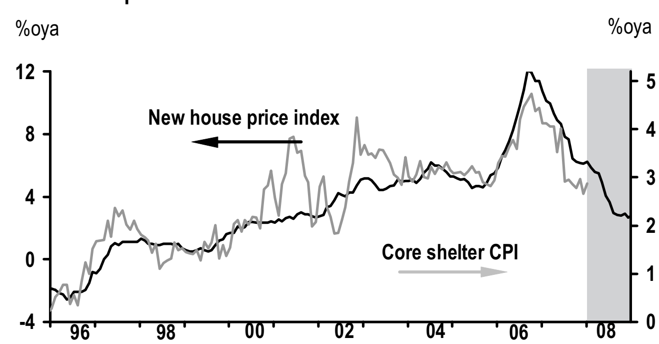
Total and core CPI



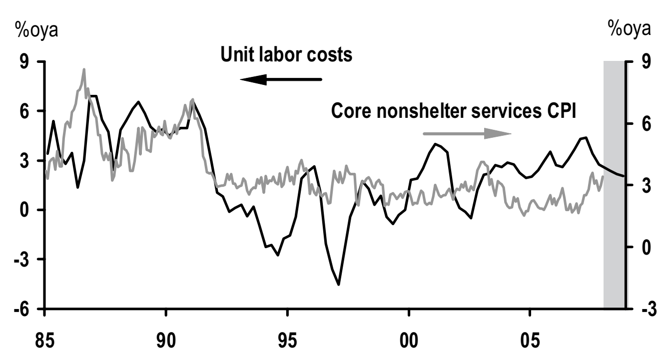
Core goods CPI and trade-weighted CAD



New house prices and core shelter CPI



Unit labor costs and core nonshelter services CPI



Data releases and forecasts

Week of February 25 - 29

Tue Feb 26 8:30am — Employment, earnings, and hours

	Sep	Oct	Nov	Dec
Payrolls (%m/m, sa)	0.2	0.4	-0.1	-0.1
(%oya)	2.0	2.3	1.6	1.3
Avg weekly wages (%oya)	3.2	3.2	4.0	3.4
Avg hourly wages (%oya)	3.2	3.0	5.0	4.2
Fixed-wt hrly wages (%m/m)	0.6	0.4	0.6	0.5
(%oya)	3.7	3.6	4.1	3.0
Avg workweek (hours, sa)	31.0	31.1	31.0	30.9

Tue Feb 26 8:30am — Employment insurance claims

	Sep	Oct	Nov	Dec
New claims (000, sa)	214.4	209.9	207.4	209.0
(%m/m)	2.4	-2.1	-1.2	0.8
(%oya)	-6.3	-6.0	-7.4	0.3

Fri Feb 29 8:30am — Current account balance

	1Q07	2Q07	3Q07	4Q07
Merchandise (C$ bn, saqr)	14.6	16.3	11.1	9.2
Nonmerchandise	-8.2	-10.0	-10.0	-9.7
Current account	6.4	6.4	1.0	-0.5
(% of GDP)	1.7	1.7	0.3	-0.1

A sharp decline in the merchandise trade surplus in December likely pulled the current account into deficit for the first time since 2Q99.

Fri Feb 29 8:30am — Industrial product price index

	Oct	Nov	Dec	Jan
Total (%m/m, nsa)	-1.2	0.6	1.1	1.3
(%oya)	-1.1	-0.6	-0.9	0.2
Ex energy (%m/m, nsa)	-1.2	-0.3	0.9	1.3
(%oya)	-2.8	-3.3	-3.4	-2.8

Wholesale gasoline prices rose about 2%m/m, nonenergy raw material prices rose 3.3%, and CAD depreciated 0.8%m/m against USD, which likely resulted in a strong rise in industrial product prices.

Week of March 3 - 7

Mon Mar 3 8:30am — Monthly GDP

	Sep	Oct	Nov	Dec
Total (%m/m, sa)	0.1	0.2	0.1	-0.5
(%oya)	2.9	2.8	2.7	1.8

Mon Mar 3 8:30am — Quarterly GDP

	1Q07	2Q07	3Q07	4Q07
Real GDP (%q/q, saar)	3.5	3.8	2.9	0.8
(%oya)	1.9	2.5	2.9	2.7

Tue Mar 4 9:00am — Bank of Canada interest rate announcement

The BoC is expected to lower the policy rate 50bp to 3.5%, and indicate that further easing may be required.

Thu Mar 6 8:30am — Building permits

	Oct	Nov	Dec	Jan
Total (%m/m, sa)	7.3	-9.9	0.4	-4.3
(%oya)	6.3	-3.3	6.8	-7.5

Thu Mar 6 10:00am — Ivey purchasing managers index

	Nov	Dec	Jan	Feb
Sentiment index[1] (sa)	58.9	52.6	56.5	52.9
Purchasing index (nsa)	58.7	45.9	56.2	56.0
Prices index (nsa)	52.1	60.1	67.1	68.5

1. Calculated and seasonally adjusted by JPMorgan.

Fri Mar 7 7:00am — Labor force survey

	Nov	Dec	Jan	Feb
Employment (mn, sa)	17.02	17.01	17.06	17.06
(ch, m/m 000s)	22.9	-2.9	46.4	0.0
(%m/m, sa)	0.1	0.0	0.3	0.0
(%oya)	2.6	2.2	2.0	1.9
Labor force (mn, sa)	18.09	18.09	18.11	18.13
(%m/m)	0.3	0.0	0.1	0.1
(%oya)	2.3	2.0	1.6	1.7
Unemployment rate (%, sa)	5.9	6.0	5.8	5.9
Avg hrly earnings (%oya)	4.1	4.9	4.9	4.8
Hours worked (%m/m, sa)	0.2	-0.5	0.8	0.0

Review of past week's data

Consumer price index (Feb 19)

	Nov		Dec		Jan	
Total CPI (%m/m, nsa)	0.3		0.1		*-0.2*	
(%oya)	2.5		2.4		*2.2*	
CPI Core (%m/m, nsa)	0.0		-0.3		*0.1*	
(%oya)	1.6		1.5		*1.4*	
Ex food and energy (%m/m, nsa)	0.0		-0.2		*-0.4*	
(%oya)	1.8		1.7		~~1.4~~	*1.3*
Ex food, energy, taxes (%oya)	1.8		1.7		~~1.8~~	*1.9*

Wholesale sales (Feb 19)

	Oct		Nov		Dec	
Total (%m/m, sa)	0.4		0.3		~~-2.5~~	*-2.9*
(%oya)	6.3		5.5		~~-0.3~~	*-0.6*

Leading indicators (Feb 20)

	Nov		Dec		Jan	
Smoothed (%m/m)	~~0.0~~	*-0.1*	~~-0.1~~	*0.0*	~~0.1~~	*0.2*
Unsmoothed (%m/m)	~~-0.1~~	*-0.6*	~~-0.2~~	*0.0*	~~0.4~~	*0.8*

Retail sales (Feb 22)

	Oct		Nov		Dec	
Total (%m/m, sa)	~~0.3~~	*0.2*	~~0.7~~	*0.9*	~~0.3~~	*0.6*
(%oya)	~~5.9~~	*6.0*	~~6.2~~	*6.5*	~~4.5~~	*5.2*
Ex autos (%m/m, sa)	~~0.2~~	*0.1*	~~1.7~~	*2.0*	~~-0.2~~	*-0.4*
(%oya)	~~6.8~~	*6.7*	~~8.3~~	*8.5*	6.4	
Ex autos and gas (%m/m, sa)	-0.3		~~0.7~~	*0.9*	~~-0.1~~	*-0.7*
(%oya)	4.7		~~6.1~~	*6.3*	~~4.6~~	*4.1*
Real retail sales (%m/m, sa)	~~0.4~~	*0.8*	~~0.2~~	*0.3*	~~0.5~~	*0.6*
(%oya)	~~4.8~~	*5.3*	~~5.2~~	*5.8*	~~4.2~~	*4.9*

Mexico

- **Real GDP data confirm moderate economic deceleration in the final quarter of last year**
- **Manufacturing outperformance and strong domestic demand explained the moderate degree of slowdown**
- **Next week's focus: capital inflows in 4Q07**

Market focus this week was on economic activity, with the release of the 4Q07 real GDP and December retail and wholesale sales reports. The 3%q/q, saar (or 3.8%oya) real GDP advance in the fourth quarter topped the 0.6%q/q, saar advance reported in the US and beat market expectations. Although the real GDP gain was barely half the 5.9%q/q, saar posted in the previous quarter, the slowdown was much less severe than in previous US downturn episodes.

The main messages from the GDP data are:

- **Manufacturing resilient this time to US downturn**. Mexican output in manufacturing managed a 1.46%q/q, saar advance last quarter while the US manufacturing sector contracted 1.9%. Indeed, the Mexican slowdown in the sector was mild relative to the 2.1%q/q, saar output gain in 3Q07, but quite steep relative to the 6.55% gain in 2Q07. Even compared with six months earlier, however, the slowdown was not as dramatic as that suffered by the US manufacturing sector, even though crossborder links in the sector are very close. Two factors may explain Mexico's manufacturing resilience. First, MXN has depreciated against the currencies of most of the Asian and European countries that are Mexico's competitors in the US market. Second, Mexico has gained competitiveness relative to its main trading partners as indicated by unit labor cost and productivity trends. These factors have helped Mexico gain market share in the US market and also penetrate Asian and European markets, to which manufactures exports have boomed;.
- **Domestic demand remained strong**. This is indicated by the 4.3%q/q, saar advance in service output in 4Q07. True, this was lower than the 6.1%q/q, saar gain in the previous quarter, but this deceleration was relatively mild. Most of it traced to the commerce, hotel, and restaurant subsector where output slowed to 2.1%q/q, saar in 4Q07 from 3.7% in 3Q07. Moreover, retail sales hung in fairly well for most of 4Q until dropping 0.9%m/m, sa in December, indicating that most of the deceleration occurred at the end of the quarter. And some sectors flourished: telecommunications output advanced 10.8%q/q, saar (albeit less than 3Q's 14.5% gain) and financial services output grew 5.2%q/q, saar (from 5.3%). This indicates that sectors oriented to the domestic market have largely retained their dynamism, thus offsetting the drag from the external sector;
- **Counter-cyclical fiscal policy is in place**. Although it will be a few weeks more before the 4Q07 GDP demand components will be released, the public sector finance data are informative. Total primary expenditure accelerated to be up 13.9%oya in 4Q07, vs an 11.6% gain in the previous quarter; and fixed public sector investment leapt 46.3%oya, up from an 18.3% advance. The spending surge resulted mostly from allocation of oil windfall gains to states and municipal infrastructure investment funds. This acceleration in public sector spending, especially investment, should remain a source of dynamism for the economy and add to overall real GDP growth.

Although the 4Q07 report adds upside risk to our 2.7%y/y real GDP growth forecast for full-year 2008, demand drag from the US will continue and may well intensify during the year. Moreover, the statistical institute (*INEGI*) has announced revisions to its National Accounts and, in particular, will change its base year to 2003. This should result in an upward revision to pre-2008 GDP estimates but may well dampen estimates for this year a little. Given this prospect, and before analyzing *INEGI*'s new methodology, it would be premature to change our GDP forecast.

Next week's economic calendar will be busy. However, most of the reports due will be backward-looking, adding little to the fairly current information already offered by the 4Q07 GDP data. Important, though, will be the 4Q07 BoP and January public finance reports. The BoP data should confirm that capital flows have remained plentiful; and the public finance figures should confirm that public expenditure remained strong at the start of 2008.

Data releases and forecasts

Week of February 25 - 29

Mon
Feb 25

Balance of payments
$ billion

	1Q07	2Q07	3Q07	4Q07
Current account balance	-2.5	-1.4	-1.3	-2.7
Transfers	5.6	6.5	6.5	5.8
C.A. as % of GDP	-1.2	-0.8	-0.7	-1.2
Capital account balance	4.2	3.2	4.2	7.5
FDI	7.7	6.0	4.7	4.6
Equity flows	-2.7	0.0	1.0	-1.0
Reserves, change	1.5	0.7	3.3	4.8

Mon Feb 25 — **Employment *IMSS***

Ch, 000s mr

	Oct	Nov	Dec	Jan
Total	138	98	-199	___
(%oya, nsa)	6.0	5.9	5.6	___
Total, sa	65	53	41	___
Permanent	25	28	23	___
Temporary	30	27	23	___

Tue Feb 26 9:30am — **Central bank reserves**

$ billion

	Jan 25	Feb 1	Feb 8	Feb 15
Gross int. reserves	79.9	80.1	80.0	___
Ch. over 1 month	2.0	1.8	1.1	___

Tue Feb 26 — **Nominal GDP**

	1Q07	2Q07	3Q07	4Q07
%oya	6.9	1.7	7.0	6.9
deflator	4.2	-1.1	3.1	3.1

Wed Feb 27 2:30pm — **Manufacturing indicators**

%m/m, sa

	Sep	Oct	Nov	Dec
Employment	-1.0	0.1	-0.2	___
Hours worked	0.1	-0.5	-0.4	___
Real earnings per worker	-0.7	0.1	0.2	___

Thu Feb 28 2:30pm — **Indicator of overall economic activity**

	Sep	Oct	Nov	Dec
%oya	2.7	4.8	3.8	3.9
%m/m, sa	0.2	0.2	0.0	0.5
%3m/3m, saar	6.0	5.0	3.3	2.4

Fri Feb 29 — **Public-sector indicators**

Mex$ billion

	Oct	Nov	Dec	Jan
Overall balance	50.3	3.6	-191.1	___
(ytd)	188.5	192.1	1.0	___
Primary balance	58.6	15.5	-149.9	___

Thu Jan 31 2:30pm — **Construction indicators**

%oya, nsa, real terms

	Sep	Oct	Nov	Dec
Output	0.9	1.7	2.1	___
Employment	2.4	2.3	2.4	___
workers (ch, 000s mr)	-1.8	3.6	-13.5	___
Earnings	3.2	3.4	2.3	___

Thu Jan 31 — **Monetary aggregates**

%oya, real terms

	Oct	Nov	Dec	Jan
Credit to private sector	28.6	27.5	24.6	___
Consumption	23.7	21.8	21.1	___
Housing	20.5	22.9	19.9	___
Corporate	36.8	36.3	30.2	___

Review of past week's data

Real GDP (Feb 19)

%q/q, saar, unless noted

	2Q07		3Q07		4Q07	
Total	~~5.7~~	*5.4*	~~5.9~~	*5.3*	~~1.0~~	*3.0*
Services	~~5.5~~	*5.6*	~~6.5~~	*6.1*	~~4.1~~	*4.3*
IP	~~5.0~~	*4.9*	~~4.5~~	*2.7*	~~-0.4~~	*1.4*
Agriculture	~~14.4~~	*6.3*	~~0.1~~	*4.5*	___	*-2.6*
Manufacturing	~~7.0~~	*6.6*	~~4.2~~	*2.1*	~~-0.4~~	*1.5*
%oya, nsa	~~2.8~~		~~3.7~~		~~3.4~~	*3.8*

Central bank reserves (Feb 19)

$ billion

	Feb 1	Feb 8	Feb 15	
Gross int. reserves	80.1	80.0	___	*80.5*
Ch. over 1 month	1.8	1.1	___	*0.8*

Labor market report (Feb 20)

% of labor force

	Nov	Dec	Jan	
Open unemployment rate	3.5	3.4	___	*4.1*
Sa	3.7	3.8	___	*3.8*
Underemployment rate	7.6	6.4	___	*6.7*

Wholesale and retail sales (Feb 21)

	Oct	Nov	Dec	
Retail sales				
%oya	4.1	3.4	~~3.6~~	*1.1*
%m/m, sa	-0.3	0.0	~~0.3~~	*-0.9*
%3m/3m, saar	4.3	1.2	~~-0.2~~	*-2.8*
Wholesale sales				
%oya	7.6	3.5	~~4.4~~	*5.3*
%m/m, sa	1.7	-0.5	~~0.0~~	*0.8*
%3m/3m, saar	5.2	5.7	~~6.3~~	*7.0*

Tertiary sector indicators (Feb 21)

%oya, nsa

	Oct	Nov	Dec	
Aggregate income index	8.0	7.1	___	*6.6*

Trade balance - provisional (Feb 22)

	Nov		Dec		Jan	
Balance ($ million)	-760		-1103	*-1107*	___	*-2157*
ytd ($ billion)	-10.1		-11.2		___	*-2.2*
Exports ($ billion)	24.4		23.4		___	*22.3*
%oya	17.1		16.3		___	*17.2*
%m/m, sa	~~3.4~~	*3.8*	~~-0.3~~	*-0.1*	___	*1.5*
Imports ($ billion)	25.2		24.5		___	*24.4*
%oya	~~12.0~~	*12.1*	~~15.1~~	*15.2*	___	*18.0*
%m/m, sa	~~-2.5~~	*-3.0*	~~4.1~~	*4.8*	___	~~4.5~~

Consumer prices (Feb 22)

	Jan 1H	Jan 2H	Feb 1H	
(%2w/2w)	0.27	0.05	~~0.20~~	*0.13*
Core	0.25	0.19	*0.24*	
(%oya)	3.78	3.63	~~3.69~~	*3.61*
Core	4.08	4.04	*4.06*	

Brazil

- **December retail sales were flat m/m, but 4Q07 printed a strong 9.8%q/q, saar advance**
- **Auto sales declined in December, although surveys point to a rebound last month**
- **Higher food prices are eroding real disposable income**

In line with other economic activity indicators (IP, the labor report, and others), retail sales posted some moderation in December, after surprising on the upside at the beginning of last quarter. This could be a signal that some growth normalization is under way, but, at this moment, we attribute greater importance to the atypically low number of working days this past December than in previous years, which will have created seasonal adjustment difficulties. Indeed, our short-term model based on coincident indicators points to a very substantial IP expansion in January, and car sales also suggest that final sales rebounded last month. We don't expect further signals of growth moderation to come through until 2Q08, when the effects of the monetary easing cycle fade (the last Selic rate cut was in September 2007) and the recent increase in reserve requirements on some bank deposits pinches credit growth. In the meantime, the COPOM will stick with its cautious tone, stressing the risky background of an economy growing at an above-trend pace, while being hit by a number of food price shocks.

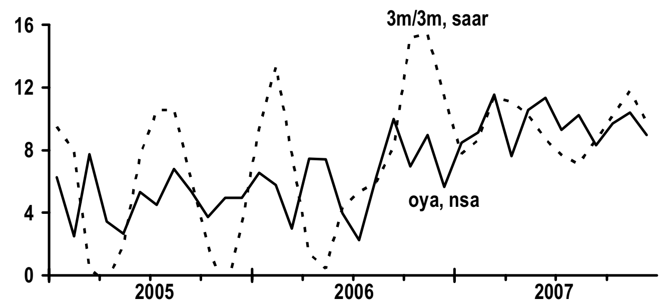
Retail sales were flat in December, but delivered a strong 4Q07

The narrow retail sales volume index (ex autos and building materials) remained flat m/m last December (JPMorgan, -0.1% ; consensus 0.4%). But this followed a 1.7%m/m, sa November surge, and put sales growth for all of 4Q07 at 9.8%q/q, saar, up from 8.6% in 3Q07 (first chart). This week's readings on retail sales performance reinforce our call that private sector consumption on a national accounts basis continued to grow close to 6%q/q, saar in 4Q07 (second chart), as should be revealed by the 4Q07 GDP figures due on March 12.

To be sure, broad retail sales exhibited some growth moderation in 4Q07 (third chart), particularly due to a slowdown in sales of motor vehicles and parts: growth of the latter cooled to 8%q/q, saar in 4Q07 from 22% in 3Q07. But this slowing should not be perceived as starting a new trend, since preliminary indicators (such as the Fenabrave survey) point to a strong auto sales rebound in January (fourth chart), and credit conditions remain supportive for acquisition of durable goods. We do expect, however, that

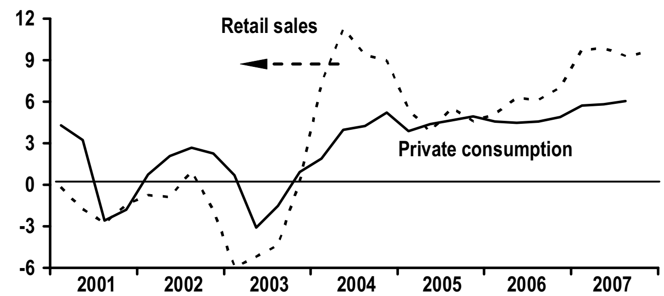
Despite flat Dec outcome, retail sales grew 9.8%q/q, saar in 4Q07

% change



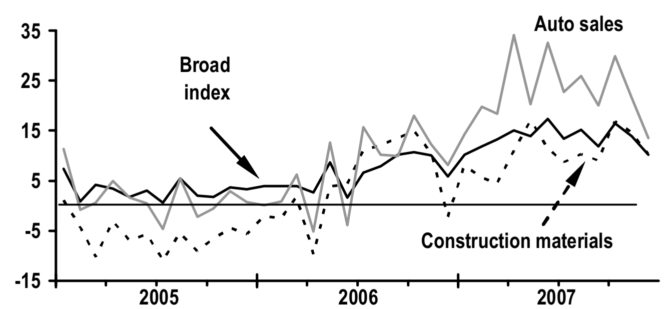
Retail sales suggest large private consumption gain in 4Q07

%oya



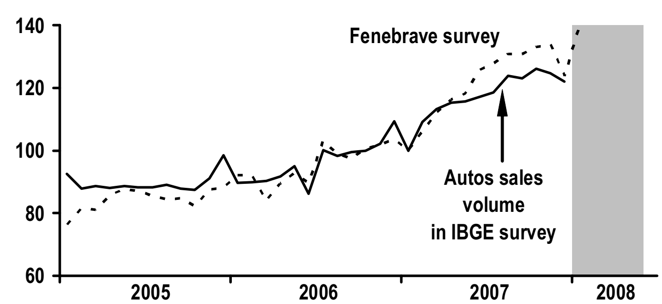
Broad retail sales growth slowed in 4Q, on the back of softer auto sales

%oya



Auto sales likely rebounded in January, following 4Q07 slowdown

Jan 2007=100



JPMorgan Chase Bank, Sao Paulo
Fabio Akira Hashizume

Julio Callegari

the recent acceleration in food prices will take a toll on supermarket sales by reducing real disposable income, and in turn curtail growth in the narrow retail sales index in the early months of this year. Even so, and despite the volatility in the monthly indices, we expect private consumption growth to remain firm, exhibiting merely gradual moderation in the coming quarters.

Data releases and forecasts

Week of February 25 - 29

Mon
Feb 25
08:30am

Current account balance
$ billion, net inflows

	Oct	Nov	Dec	Jan
Current account (CA)	0.0	-1.3	-0.7	-2.5
Trade balance	3.5	2.0	3.6	0.9
Services	-3.8	-3.7	-4.7	-3.8
Net transfers	0.3	0.3	0.5	0.4
CA, 12-month sum	7.4	4.7	3.6	0.7
CA, 12-mo. sum, %GDP	0.6	0.4	0.3	0.0
Foreign direct investment	3.2	2.5	0.9	4.5

Tue
Feb 26
03:00am

Consumer prices (FIPE)
%m/m, nsa (% weights in parentheses)

	Jan W4	Feb W1	Feb W2	Feb W3
Total (100)	0.5	0.3	0.2	0.2
Housing (32.8)	0.0	0.1	0.1	0.1
Food (22.7)	1.0	0.3	0.1	-0.1
Transport (16.0)	0.3	0.2	0.3	0.3

Thu
Feb 26
8:00am

Consumer prices (IPCA-15)
%m/m, nsa, % weights in parentheses

	Nov	Dec	Jan	Feb
Total (100)	0.2	0.7	0.7	0.62
(%oya)	4.0	4.4	4.6	4.71
(%ytd)	3.6	4.4	0.7	1.32
Ex food and energy prices	0.3	0.7	0.5	0.78
Trimmed mean	0.3	0.4	0.4	0.51
By major component				
Food (20.5)	0.3	1.7	2.0	0.87
Transport (20.7)	0.1	0.8	0.6	0.28
Housing (13.6)	0.2	0.2	0.2	0.24

Wed
Feb 27
08:30am

Public Sector Borrowing Requirement
Minus denotes surplus

	Oct	Nov	Dec	Jan
R$ billion				
Primary	-15.4	-6;8	11.7	-13.0
Primary, ytd	-100.6	-113.4	-101.6	-13.0
12-month sum, as % of GDP				
Primary	-4.2	-4.2	-4.0	-3.9
Interest payments	6.4	6.3	6.3	6.2
Nominal	2.2	2.1	2.3	2.3
Net debt, % of GDP	43.2	42.5	42.8	42.6

Thu
Feb 28
06:00am

General prices (IGP-M)
%m/m, nsa

	Oct	Nov	Dec	Jan
Overall	1.1	0.7	1.8	0.6
(%oya)	6.3	6.2	7.8	8.8
Wholesale prices	1.4	1.0	1.2	0.8
Consumer prices	0.3	0.0	1.0	0.3
Construction prices	0.5	0.5	0.4	0.4

Thu
Feb 28
08:30am

National unemployment
% of labor force, new methodology

	Oct	Nov	Dec	Jan
Open rate, nsa (30 days)	8.7	8.2	7.4	8.1

Review of past week's data

Retail sales

	Oct	Nov	Dec
%m/m, sa	-0.1	1.6	~~-0.1~~ 0.0
%oya, nsa	9.7	9.9	~~8.6~~ 9.0

Argentina

- **Export tax revenues boost fiscal performance**
- **Spending and revenue are converging near 40%oya**
- **Pension hike will curb potential surplus overshoot**

Early signs of this year's forecasted fiscal adjustment surfaced as early as January. The (adjusted) primary surplus rose to APs3.39 billion last month, implying a visible improvement to 2.4% of GDP (on a 12-month basis) from 2.2% last year. January's upbeat tax revenue performance had anticipated the good fiscal result for that month. But the additional news from this week's report was that the pace of primary spending continued to moderate as well.

The JPMorgan forecast pencils in a fiscal adjustment of 1.3% of GDP in 2008 that would take the primary surplus back to 3.5% of GDP—with almost 1% point explained by increased taxes on commodity exports. An overshoot of fiscal results vs the forecast remains possible. Whether the primary surplus ends up being closer to 3.8-4.0% of GDP will depend largely on the evolution of primary spending, given that the short-term outlook for commodity prices already secures robust revenue performance.

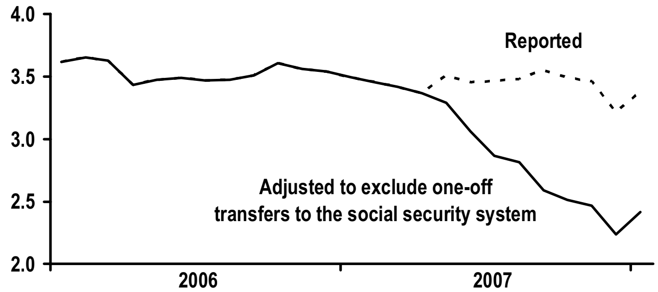
Primary spending and revenue growth are converging from both sides. Primary spending advanced 36%oya in January, down from an average 45% increase in 4Q07. Therefore, spending growth has continued to moderate steadily from its lofty 3Q07 peak even as revenue growth has just begun to pick up in 1Q08 (second chart).

Strong economic performance and accelerating inflation have underpinned tax revenues. But the more recent revenue acceleration also traces back to increases in global commodity prices and the upward adjustment of tax rates on commodity exports. Prices for commodities relevant to Argentina's exports were up almost 50%oya in January. Unsurprisingly, export tax revenues have accelerated dramatically, gaining 157%oya in January vs a 17% advance in 3Q07 (third chart). Other revenues—excluding those related to export taxes—have kept up a fairly steady growth pace: 39%oya in January vs 38% in 3Q07.

While primary spending growth was reported to have slowed down in January, the government announced last week a 15% hike in pensions to be granted in two equal steps of 7.5% in March and July. The budget did not contemplate pension hikes in 2008, thus the growth rate of pensions in the budget reflected only the adjustments granted in 2007. The new pension hikes will have an estimated fiscal cost of APs6.2 billion or 0.6% of GDP and will lift the pace of administrative (or rigid) spending once. Assuming no further hikes in pensions, social security spending will rise 30.6% this year above 2007 levels. This gain exceeds both the 16.6% increase reflected in this year's budget law, and JPMorgan's 25% forecast.

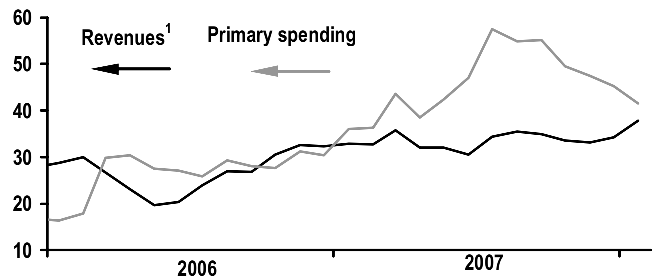
Primary fiscal surplus

12-month sum, % of GDP



Public sector revenues and spending

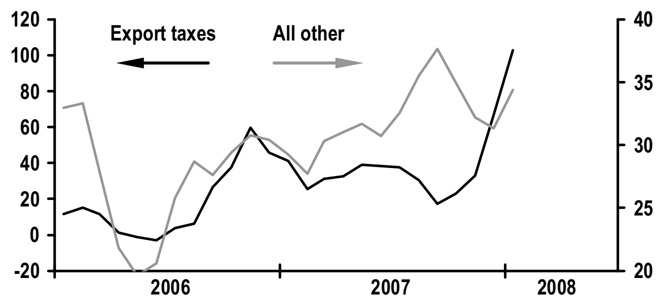
%oya, 3-month moving average



1. Revenues adjusted to exclude one-off transfers to the social security system.

Tax revenues

%oya, 3mma, both scales



Data releases and forecasts

Week of February 25 - 29

Mon Feb 25

Merchandise trade

$ billion

	Oct	Nov	Dec	Jan
Balance	1.14	1.04	1.79	1.15
12-month sum	10.65	10.83	11.15	11.87
year to date	8.33	9.37	11.15	1.15
Exports	5.54	5.42	5.67	5.64
%oya	31.8	32.3	34.3	66.7
Imports	4.40	4.38	3.88	4.49
%oya	35.2	35.4	40.8	52.3

President Kirchner has preannounced that the merchandise trade surplus stood near $1.2 billion in January, or $0.7 billion above the year-earlier result. Last month's surplus benefited from record-high commodity prices, which more than offset an acceleration in imports. Following January's improvement, the trade surplus has now fully reversed last year's deterioration.

Thu Feb 28

Construction activity

	Oct	Nov	Dec	Jan
%oya	12.7	8.8	10.4	11.5
%m/m, sa	2.8	2.3	-0.3	___

Thu Feb 28

Industrial production (INDEC - final)

Industrial production (INDEC - preliminary)[2]

	Oct	Nov	Dec	Jan
%oya	9.6	9.9	9.9	13.6
%m/m, sa	1.2	1.2	0.5	___

Household survey (labor market report)[2]

National aggregate

	1Q07	2Q07	3Q07	4Q07
Unemployment rate (%)[1]	9.8	8.5	8.1	6.9
incl. people in social plans	11.1	9.5	8.8	7.4
Employment (000)[2]	-63	56	186	103

1. % of labor force. 2. Change since last survey.

2. Reports not available at publication time.

Review of past week's data

Consumer confidence (UTDT)

Buenos Aires City

	Dec	Jan	Feb	
Index level	50.4	53.9	___	*47.8*
Current conditions	47.7	50.0	___	*47.2*
Expectations	53.1	57.8	___	*48.5*

Economic activity indicator

	Oct		Nov		Dec	
%oya	~~9.4~~	*9.2*	~~9.6~~	*9.2*	~~9.8~~	*9.7*
%m/m, sa	~~0.3~~	*0.2*	~~1.1~~	*0.9*	___	*0.6*

Public-sector balance

APs billion except where noted, federal government and agencies

	Nov	Dec	Jan	
Primary balance (ex interest)	1.90	-1.20	~~3.33~~	*3.39*
12-month trailing	27.15	25.67	~~27.37~~	*27.43*
% of GDP	3.4	3.2	3.4	
Headline balance	1.52	-5.24	~~2.39~~	*2.42*
12-month trailing	12.12	9.25	~~10.87~~	*10.90*
% of GDP	1.5	1.2	1.3	

Industrial production (FIEL - final)

	Nov		Dec		Jan	
%oya	~~8.3~~	*8.8*	___	*9.3*	___	*12.9*
%m/m, sa	~~1.7~~	*2.5*	___	*1.8*	___	*-1.1*

Managers survey (FIEL)

Level, min=0, max=100

	Nov	Dec		Jan	
JPMorgan synthesis	50.8	___	*n.a.*	___	*51.5*
General conditions	53	___	*n.a.*	___	*53*
Demand trend	50	___	*n.a.*	___	*51*
Outlook	50	___	*n.a.*	___	*47*
Inventories	51	___	*n.a.*	___	*54*
Capacity utilization, %	74.0	___	*73.5*	___	*68.6*

BCRA Watch

Central bank balance sheet

$ billion, eop, except where noted

	Nov	Dec	Jan	Feb 8
International reserves	44.9	46.2	47.7	48.1
Domestic financial liabilities[1]	46.9	48.8	50.7	50.7
Monetary liabilities	28.5	31.4	29.9	30.1
S-T liquidity paper (LEBAC)	18.3	17.3	20.7	20.6
Reserve backing of fin. liabilities (%)	96	95	94	95
Memo:				
Monetary liabilities, pesos billion	89.8	99.0	94.5	94.7
Pesos held by the public	60.0	67.3	64.4	66.5
Banks' peso reserves	29.8	31.6	30.1	28.3

Bank deposits

APs billion, weekly average, nsa

	Nov 8	Dec 8	Jan 8	Feb 8
Total reported deposits	194.8	198.2	203.6	210.8

Peso interest rates and spot fx rate

	Feb 1	Feb 8	Feb 15	Feb 22
Overnight pesos (% p.a.)	7.6	6.9	7.6	7.8
Peso/$ exchange rate	3.16	3.17	3.15	3.15

1. Peso liabilities valued at last fx rate

Andeans: Colombia, Ecuador, Peru, Venezuela

- **Peru's GDP growth again surprises on the upside**
- **Stellar GDP growth in 2007, modest deceleration expected in 2008**
- **BCRP continues to intervene heavily in the currency market to curb PEN appreciation**

Peru remains one of the fastest growing economies in Latin America,: it expanded an unexpectedly high 9.9%oya in December, bringing full-year 2007 growth to 9.0%y/y (JPMorgan 8.4%). This made last year's economic expansion the fastest since 1994. While Peru's growth cycle has benefited from the boom in commodity prices, growth is now driven primarily by domestic demand. In fact, over the past two years, consumption and investment have, on average, contributed around 5% points each to annual real GDP growth. The demand-side breakdown (and final 4Q07 aggregates) should be released next week, but December's numbers allow us to estimate that total domestic demand increased about 11.3%y/y in 2007 (after 10% in 2006), while net exports remain a drag as import expansion (close to 20%) is more than triple the pace of export growth.

Despite softer global growth, the vigor of the country's economic activity in 2007, and the upside risk provided by a combination of fiscal stimulus with still robust private sector investment and consumption trends, have prompted us to raise our 2008 GDP growth forecast to 7.5%y/y (from the previous estimate of 7.0%)—even allowing for a considerable deceleration due to the worsening global environment. Indeed, confirmation of the economy's strong start in 2008 comes from the Finance Ministry's monthly index of leading indicators, which predict output gains of 8.6% in January and 8.3% in February. There is no sign that labor and credit market conditions are deteriorating appreciably, and this year's steady PEN appreciation (3.2% to date) suggests that contagion from external turmoil is not a major concern so far.

This week, the central bank (BCRP) continued to intervene in the fx market. Its purchases of around $600 million brought the year-to-date total to around $4.2 billion. Despite the BCRP's desire to check PEN strength, the large surplus in the external accounts, the de-dollarization of domestic portfolios, and the market's expectation of a further widening of the interest rate differential vis-à-vis the US should support further sol appreciation. JPMorgan expects the external accounts to remain well supported this year—although less so than in 2007. In 2008, both the current and capital accounts should remain in surplus, by the equivalent of 0.2% of GDP (down from 1.5% in 2007) and 5.7% of GDP (8.6% in 2007), respectively. The capital and financial account is underpinned by growing capital flows into the private sector, especially FDI in the mining and hydrocarbons sector. In contrast, the current account surplus will be eroded by higher imports due to strong domestic demand and by lower prices for export commodities. Despite BCRP's persistent fx intervention, the currency should continue to strengthen through the year and move from the current USD/PEN 2.90 to 2.85 by end-2008—or even much sooner.

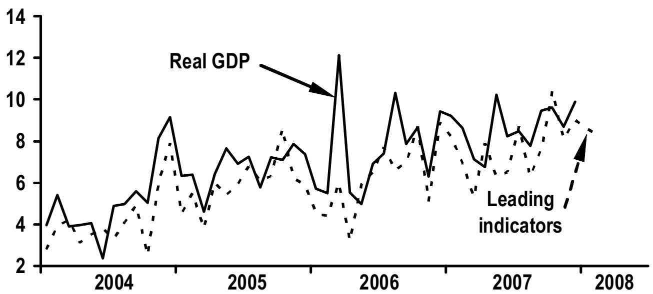
Peru: real GDP growth by sector

%oya, nsa

	2007 Dec	2007 Jan-Dec
Real GDP	**9.9**	**9.0**
Agriculture	7.4	3.2
Fishing	-0.8	6.9
Mining and hydrocarbons	12.4	2.1
Manufacturing	6.5	10.6
Electricity and water	7.6	8.4
Construction	24.5	16.5
Retail and commerce	8.6	10.5
Other services	11.0	9.3

Peru: real GDP and leading economic indicators

%oya, sa



Peru: balance of payments

% of GDP

	2006	2007	2008	2009
Current account	**2.8**	**1.5**	**0.2**	**0.7**
Trade balance	**9.6**	**7.7**	**4.2**	**3.3**
Merchandise exports	25.5	25.7	22.4	23.4
Merchandise imports	16.0	18.0	18.2	20.1
Services (net)	-1.0	-1.0	-1.0	-1.0
Income (net)	-8.1	-7.4	-4.9	-3.8
Current transfers	2.3	2.3	2.0	2.2
Capital & financial account	**0.3**	**8.6**	**5.7**	**3.5**
Private sector	1.6	10.8	0.0	0.0
Public sector	-1.3	-2.2	0.0	0.0
Exceptional financing	0.0	0.0	0.0	0.0
Errors and omissions	**-0.6**	**0.0**	**0.0**	**0.0**
Change in reserves[1]	**-2.4**	**-10.1**	**-5.9**	**-4.1**

1. "-" sign denotes increase in reserves.

Andres Ortiz

Florencia Vazquez

Chile:

Data releases and forecasts

Week of February 25 - 29

Mon Feb 25 **International reserves**
$ billion

	Dec 31	Jan 15	Jan 31	Feb 15
Gross reserves	16.9	16.9	16.9	___

Thu Feb 28 **Industrial production and sales (ex copper)**
%oya

	Oct	Nov	Dec	Jan
Output	5.0	4.2	3.4	___
Sales	4.9	2.7	4.6	___

Thu Feb 28 **Unemployment rate**

	Oct	Nov	Dec	Jan
% of labor force, nsa	7.7	7.3	7.2	7.3
% of labor force, sa	7.4	7.4	7.9	7.9
Change oya, % pt	0.3	0.7	1.2	1.2

Review of past week's data

No data released.

Colombia:

Week of February 25 - 29

Industrial production
%oya

	Sep	Oct	Nov	Dec
Total	5.9	8.2	7.3	__

Real retail sales
%oya

	Sep	Oct	Nov	Dec
Total	9.4	3.4	8.2	___

Review of past week's data

BanRep monetary policy meeting
% p.a.

	Dec	Jan	Feb	
Repo rate	9.50	9.50	~~9.50~~	*9.75*

Ecuador:

Week of February 25 - 29

No data releases expected.

Review of past week's data

No data released.

Peru:

Week of February 25 - 29

Real GDP

	1Q07	2Q07	3Q07	4Q07
%oya, nsa	8.1	8.0	8.4	10.7

Review of past week's data

No data released.

Venezuela:

Week of February 18 - 22

Real retail sales
%oya

	Jul	Aug	Sep	Oct
Total	43.83	47.12	54.10	__

Unemployment rate
% of labor force

	Oct	Nov	Dec	Jan
Unemployment	7.2	6.3	6.2	___

Review of past week's data

Industrial production

	Aug	Sep	Oct	
%oya	9.33	2.72	___	*7.1*

Real GDP

	2Q07	3Q07	4Q07	
%oya	8.5	7.9	~~7.5~~	8.5

United Kingdom

- **Retail sales recorded large gain in January**
- **MPC commentary turns more dovish**

This week's commentary from the MPC turned a little more dovish, while activity data outside of the housing and financial service sectors suggested that the slowing so far has been contained:

- **February MPC minutes show 8-1 vote for lower rates; MPC speeches sounded more dovish.** Blanchflower dissented with a vote for a 50bp cut, but his views have generally been distinct from the rest of the MPC in the past. The text left the door open to further policy easing. However, unlike in last week's inflation report, comments about the magnitude and speed of future easing were notably absent from the text. This more dovish slant to the central bank's commentary also came across in speeches by individual members this week. Besley published an academic paper highlighting the adverse effects on consumption of a rise in borrowing rates for riskier lenders. Barker noted that, on balance, she was more concerned by downside risks to growth than inflationary pressures. Sentance discussed the current economic environment in the context of past recessions.

- **Retail sales much stronger than expected in January.** Sales rose 0.8%m/m, sa and there was an upward revision to December. Given the increased uncertainty about a shift in seasonal trends, we always treat the monthly spending data around the turn of the year with extra caution. But the December-January average growth in sales stands at 0.3%m/m, and gives little sense that spending has stopped slowing. Indeed, the sharp declines in house purchase activity in 2H07 suggest that significant slowing in spending is still likely in early 2008 (chart). But January's retail sales release—while not indicative of the underlying trend in the data—suggests a more gradual slowdown. We have penciled in two 0.3%m/m declines in February and March, which would leave 1Q spending up 2%q/q, saar.

- **CBI industry survey firm in February.** Readings on orders and output expectations stabilized this month. The level of orders remains elevated, while output expectations are slightly above average. Recent drops in the manufacturing PMI, including a new orders reading currently below 50, suggest that further weakness will come in the manufacturing sector. We tend to put more weight on the PMI, but the CBI suggests that the slowing so far has been contained. The price balance of the CBI rose from +21 to +22, the highest since May 2007 and well above average.

Our view is that clearer signs of broad-based weakness in the UK data will prompt the MPC to lower rates twice more in 1H08. This week's activity data—in particular the January retail sales release—challenge this view, but we are not inclined to revise the policy call at this stage. We acknowledge that other indicators, and the retail sales data themselves for February, now have to show more weakness if the MPC is to ease in April as we had forecast.

Recent commentary from the MPC

Minutes of February MPC meeting:

Interest rates were probably still bearing down on demand, partly because higher market spreads meant that the level of Bank Rate consistent with any given monetary stance was lower than it had been before spreads had widened.

Tim Besley speech:

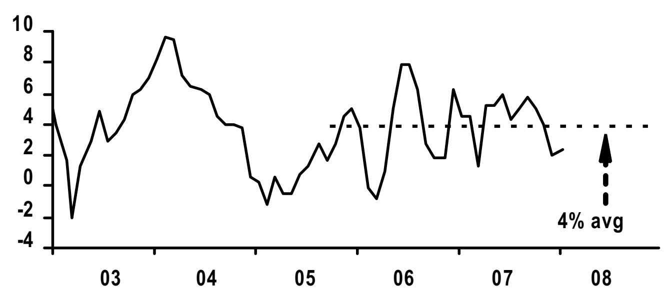
My time on the MPC, before and after the events of last summer, has reinforced my view that considerable weight should be placed on conditions in financial markets in understanding the transmission of monetary policy to the real economy.

Kate Barker speech:

My chief concern is the significant possibility of a large downside risk to growth, and therefore to inflation, as the impact of the credit tightening works through the economy. I rate this a little higher than a large upside risk to inflation over the medium-term from dislodging inflation expectations on the upside. And the change in credit conditions themselves means that any given level of Bank Rate is somewhat more restrictive.

Retail sales

Volumes, % 3m/3m saar



Data releases and forecasts

Week of February 25 - 29

During the week

Nationwide house price index

Sa

	Nov	Dec	Jan	Feb
%m/m	-0.9	-0.4	-0.1	-0.1
%oya	6.9	4.8	4.2	3.5
%3m/3m, saar	5.7	3.8	-1.2	-3.1

Mon
Feb 25
09:30am

BBA lending

	Oct	Nov	Dec	Jan
Secured lending (ch £bn, sa)	4.0	4.6	4.7	4.7
Loan approvals (000s, sa)[1]	44.2	43.9	42.1	41.0

1. For house purchase.

Tue
Feb 26
11:00am

CBI survey of distributive trades

% balance

	Nov	Dec	Jan	Feb
Volume of retailer sales	13	8	4	1

Tue
Feb 26
09:30pm

Business investment prelim

2000=100, sa

	1Q07	2Q07	3Q07	4Q07
%q/q	-0.5	0.5	2.0	1.5
%oya	10.2	7.8	6.6	3.6

Wed
Feb 27
09:30am

Real GDP (2nd estimate)

Sa

	2Q07	3Q07	4Q07[1]	4Q07
Total GDP (%q/q)	0.8	0.7	0.6	0.6
%oya	3.2	3.3	2.9	2.9
%q/q ar	3.4	2.7	2.4	2.4
Breakdown (%q/q sa)				
Private consumption	0.8	1.0	__	0.5
Public consumption	0.3	0.3	__	0.3
Fixed investment	-0.9	1.6	__	1.0
Exports	0.2	2.7	__	-0.1
Imports	-0.4	3.9	__	-0.2

1. Preliminary outcome.

A soft IP report for December alone is not enough to prompt downward revision of the forecast at this stage, but risks are slanted in that direction.

Wed
Feb 27
09:30am

Index of services

Sa

	Sep	Oct	Nov	Dec
%m/m	-0.1	0.3	0.3	0.2
%oya	3.5	3.6	3.5	3.1
% 3m/3m saar	3.3	2.5	2.2	2.8

Fri
Feb 29
09:30am

Money supply

Seasonally adjusted

	Oct	Nov	Dec	Jan
M4 (%m/m)	0.2	0.4	1.5	__
M4 (%oya)	11.8	11.6	12.3	__
M4 Lending (%m/m)	0.9	0.8	0.8	__
M4 Lending (%oya)	13.5	12.7	13.0	__

Fri
Feb 29
09:30am

Net lending to individuals (BoE release)

£ billion, average

	Oct	Nov	Dec	Jan
Consumer credit (ch, m/m)	1.6	1.2	0.6	0.8
Secured lending (ch, m/m)	7.9	8.0	8.6	8.5
Mortgage approvals (000s sa)	88	81	73	71

Fri
Feb 29
10:30am

Gfk consumer confidence

Sa

	Nov	Dec	Jan	Feb
% balance	-10	-14	-13	__

Review of past week's data

Rightmove house price index

	Dec	Jan	Feb
%m/m (nsa)	-3.2	-0.8	__ *3.2*

Public-sector finances

£ bn, nsa

	Nov	Dec	Jan
PSNCR	9.0	~~17.0~~ *16.0*	~~-16.7~~ *-22.1*
PSNB	~~11.4~~ *10.5*	~~7.8~~ *6.9*	~~-10.1~~ *-14.1*
Balance on current budget	~~-8.8~~ *-8.4*	~~-5.1~~ *-4.5*	~~13.0~~ *17.0*

January is always a revenue-intensive month, and has the potential to surprise. The finances for Jan did just that with a £14.1bn surplus on PSNB. It now looks likely that borrowing will come within measurement error of the forecasts given in the PBR. We expect the PSNB for FY07/08 to come in at £34bn (as forecast), and current borrowing of £10bn (a modest £2bn overshoot of the Treasury's £8bn forecast). Northern Rock did not show up in the net debt figures in January—the ONS stated that this will happen in due course, although not in time for the 2008 Budget. The adjustment still looks likely to lift the net debt to GDP ratio far above 40%. However, this is very unlikely to prompt a change to tax or spending plans in the upcoming 2008 Budget.

Provisional estimates of M4 money and credit

Seasonally adjusted

	Nov	Dec	Jan
M4 (%m/m)	0.4	~~1.5~~ *1.6*	__ *1.3*
M4 (%oya)	~~11.6~~ *11.7*	~~12.3~~ *12.4*	__ *12.9*
M4 Lending (%m/m	0.8	~~0.8~~ *0.9*	__ *1.0*
M4 Lending (%oya)	12.7	13.0	__ *12.4*

BoE's minutes of MPC meeting

The MPC voted 8-1 for the Feb rate cut. See main text.

CBI industrial trends

% balance

	Dec	Jan	Feb
Total order book	2	2	~~-3~~ *3*
Output expectations	3	9	~~4~~ *11*
Output prices	15	21	__ *22*

Retail sales

Volumes, seasonally adjusted

	Nov	Dec	Jan
%m/m	0.4	~~-0.4~~ *-0.2*	~~0.1~~ *0.8*
%oya	4.2	~~2.7~~ *2.8*	~~4.6~~ *5.6*
% 3m/3m saar	4.0	~~1.9~~ *2.1*	~~0.9~~ *2.3*

Turkey

- **Cypriot election outcome increases the chances for progress on Turkey's relations with the EU**
- **Current account deficit failed to narrow in 2007**
- **Lira not under pressure, due to strong capital inflows**

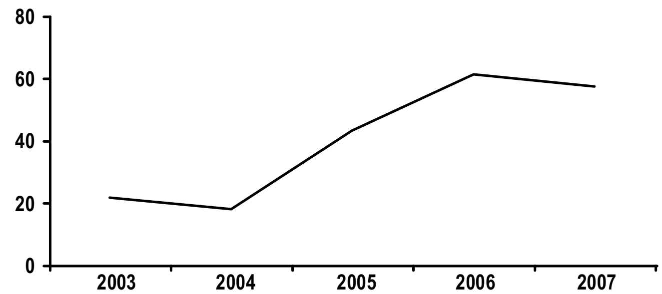
The first leg of the presidential election in Cyprus produced a rather surprising result, one that may be positive for Turkey's EU aspirations in the medium term. Incumbent Cypriot president Tassos Papadopoulos, who was very instrumental in the rejection of the UN-backed reunification plan in 2004, failed to make it to the second round of the election, which instead will decide between center-right DISI party leader Yannakis Kasoulidis and communist AKEL leader Dimitris Christofias. Both of the latter are known to support further efforts toward reunification. The Cyprus problem is a source of constant noise in Turkey-EU relations. For example, in reaction to Turkey's reluctance to open its ports and seaports to Greek Cypriot vessels, the European Council decided in December 2006 to suspend negotiations on eight of the total 35 chapters of the *acquis communautaire.* And none of the other chapters can be closed until the ports problem is resolved. So any progress on Cyprus would be positive for Turkey's EU aspirations. Although it is still very early to be optimistic here, we think that the chances have now risen for some positive developments concerning the island.

On the macroeconomic front, the most important data released in the past two week were the December BoP figures. An unexpected increase in interest payments (likely a one-off event) and some weakness in "luggage" trade (presumably due to the religious holiday in Turkey) raised the December current account deficit (CAD) to US$5.2 billion, much higher than the JPMorgan forecast of US$4.3 billion and the market consensus of US$3.8 billion. As a result, the deficit reached US$38.0 billion (7.7% of GDP) for all of 2007, up from US$32.3 billion (8.1% of GDP) in 2006. This means that, despite the moderation in domestic demand and the continued strength of exports, the improvement in Turkey's external balances has been marginal.

There are three factors behind this: 1) high energy and other commodity prices (evident in the rapid rise of agricultural, metal, and oil imports); 2) the high import dependence of Turkish exports, which implies that export strength is accompanied by higher imports (intermediate goods imports rose 24%oya in 2007, topping the 16% growth in consumption goods imports); and 3) structural problems and intense competition in the tourism industry,

Current account deficit (CAD)
% of GDP

FDI inflows
% of CAD



which meant that total tourism revenues climbed only 10% in 2007 even though the number of tourist arrivals jumped 18%. None of these problems can be solved overnight, so a meaningful decline in Turkey's current account deficit in the coming years is likely only if energy prices fall. And even if oil prices do come down, the CAD is expected to remain above 5% of GDP.

Turkey has been having no difficulty in financing its CAD, thanks to large capital inflows. The total BoP financing need (CAD plus net errors and omissions) was US$38.4 billion in 2007. Also, US$4.0bn was repaid to the IMF. Yet, the official reserves still rose US$8.0bn last year. As important as the size of capital inflows has been their improved quality, most of all the growth of FDI. Net FDI inflows covered only 18% of the CAD in 2004, but 62% in 2006, and 58% in 2007. Given potential M&A activities and the heavy privatization agenda, we expect this high FDI coverage to continue. Still, with global credit conditions worsening, we expect FDI inflows to fall from US$21.9bn in 2007 to US$18bn in 2008. However, the US$1.9bn inflow associated with the sale of the retailer Migros and the foreign participation in the privatization of the Tekel cigarette factories show that the $18bn projection could prove conservative. In short, although we expect no major improvement in the CAD, Turkey is unlikely to have much trouble financing its external deficit in coming years.

The Turkey data watch is published biweekly, next on Mar 7.

Data releases and forecasts

Weeks of February 25 - March 7

Fri
Feb 29
5:00pm

Foreign trade
$ billion, except as noted

	Oct	Nov	Dec	Jan
Trade balance	-5.7	-5.3	-6.4	-6.3
Exports (FOB)	9.9	11.3	9.7	9.7
%oya	43.5	30.4	12.5	47.7
Imports (CIF)	15.6	16.6	16.1	16.0
%oya	39.3	28.8	23.0	51.0

Both exports and imports likely scored sharp oya increases, thanks mainly to the weak base that resulted from a religious holiday in January 2007. Strong export performance manifests continued competitive power. Despite the moderation in domestic demand, imports remain strong owing to higher energy prices and the high dependence of Turkish exports on imported raw materials.

Mon
Mar 3
5:00pm

Inflation
Percent

	Nov	Dec	Jan	Feb
Consumer prices				
%oya	8.4	8.4	8.2	8.2
%m/m	2.0	0.2	0.8	0.5
Producer prices				
%oya	5.7	5.9	6.4	6.3
%m/m	0.9	0.2	0.4	0.8
Manufacturing prices				
%oya	4.3	4.3	4.9	4.9
%m/m	1.1	0.1	0.0	0.7

We expect the secondary effects of the administrative price hikes to be limited given the moderation in domestic demand. Higher commodity prices, especially for gold and oil, were probably the major factors pushing up the headline inflation rate in February.

Review of past two weeks' data

Labor data
% of work force

	Sep	Oct	Nov
Unemployment	9.3	9.8	~~9.9~~ *10.1*
Underemployment	2.9	2.8	2.8
Total	12.2	12.6	~~12.7~~ *12.9*

The rise in the unemployment rate in November was mostly seasonal. Labor force participation is still below 50%, showing that much slack remains in the labor market. That slack, though, helps the disinflation process.

Consumer confidence
Index

	Nov	Dec	Jan
Consumer confidence	92.5	93.9	~~91.5~~ *92.1*
Purchasing power - current	82.1	82.7	~~82.0~~ 80.8
Purchasing power - future	86.7	88.1	~~86.0~~ *86.7*
Economic setting	87.4	90.1	~~98.0~~ *87.4*
Employment	89.4	89.7	~~89.3~~ *87.3*

Consumer confidence fell further, mainly due to worries about the global financial markets and their possible impact on the Turkish economy and financial markets.

Central government budget
TRY billion, current prices

	Nov	Dec	Jan
Expenditures	16.2	19.1	~~17.9~~ 16.3
Interest	2.3	1.8	4.4 4.3
Noninterest	13.9	17.3	~~13.5~~ *12.0*
Revenues	18.8	14.9	~~15.3~~ *15.8*
Taxes	16.8	12.2	~~13.0~~ *14.2*
Primary balance	4.8	-2.4	~~1.5~~ *3.8*
Budget balance	2.6	-4.2	~~-2.9~~ *-0.5*

Strong tax collection (especially of indirect taxes) along with spending discipline resulted in a positive surprise in January's fiscal outcome.

Capacity utilization
Percent

	Nov	Dec	Jan
Total manufacturing	82.6	81.2	~~80.3~~ *80.5*
State-owned	90.8	90.6	~~88.0~~ *88.7*
Private	81.3	79.7	~~79.0~~ *79.3*

Aside from seasonal factors, worsening global economic conditions and moderating domestic demand were the main factors trimming capacity usage in manufacturing. The survey showed some rise in inflationary expectations, mainly on the back of the administrative price hikes.

Central government debt
$ billion

	Nov	Dec	Jan
Domestic debt stock	216.9	219.2	220.5
Market	158.4	161.8	~~163.3~~163.0
Public sector	58.5	57.4	~~57.2~~ *57.5*
External debt stock	66.8	67.0	~~67.1~~ *66.6*
Loans	28.0	28.3	~~28.1~~ *28.4*
Bonds	38.8	38.7	~~39.0~~ *38.2*
Total debt stock	283.7	286.2	~~287.6~~*287.1*

The rise in central government debt in dollar terms was solely due to dollar weakness. As a percentage of GDP, total debt continued easing in January.

Balance of payments
$ billion

	Oct	Nov	Dec
Current account	-3.3	-3.3	~~-4.3~~ -5.2
Trade balance	-4.3	-3.8	~~-4.7~~ *-4.9*
Exports, fob	10.4	11.9	~~10.2~~
Imports, fob	14.7	15.7	~~14.9~~ *15.1*
Net invisibles and transfers	1.0	0.5	~~0.4~~ *0.3*
Capital account	4.7	1.1	~~2.5~~ *6.8*
Overall balance	0.1	-0.7	~~1.5~~ *1.4*

See main text.

South Africa

- **Budget maintains fiscal discipline despite slowing global and domestic economy**
- **4Q GDP growth likely moderated to 3.9%q/q, saar**
- **CPIX inflation expected to have increased to 8.4%oya and PPI inflation to 10.4% in January**

Finance Minister Trevor Manual surprised the market this week by delivering a conservative budget that maintains strict fiscal discipline despite an expected economic slowdown, both domestic and global. The central government now expects to run fiscal surpluses averaging 0.5% of GDP over the next three years. The budget emphasizes the government's aims to reduce poverty and inequality, increase exports, and invest more in productive capacity. The macroeconomic estimates of the National Treasury see the current account deficit widening to 8% of GDP by 2010. Even so, the buildup of reserves and stable macroeconomic policy should help cushion external shocks to the economy.

The estimated budget surplus for FY07/08 (year ending March 31) is revised to R15.8bn or 0.8% of GDP from the estimates given in the Medium Term Budget Policy Statement (MTBPS) of R10.7bn or 0.6% of GDP, thanks to higher than expected tax receipts. Tax revenue in FY07/08 is expected to exceed the FY06/07 budget target by R14.5bn. The fiscal surplus is then expected to narrow to 0.6% of GDP in FY2008/09 and 0.5% of GDP for both FY2009/10 and FY2010/11. Estimates of expenditure growth have been revised up (to an average of 11.2% p.a. over the next three years) reflecting increased social grants and accelerating infrastructure investment. Revenue is to rise 10.8% p.a. over the medium term, benefiting from high commodity prices. The primary surplus is seen at 2.9% of GDP in the upcoming FY2008/09 fiscal year, before gradually declining to 2.4% of GDP in FY2010/11. The budget proposes R10.5bn in tax cuts this next fiscal year (of which R7.7bn is for personal tax relief), down from R12.4bn relief in the current year's budget. In order to boost economic growth and business confidence, company tax is to be reduced to 28%, from 29% until now.

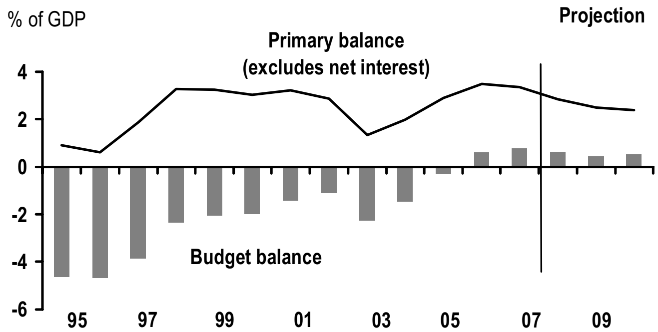
The budget also announced that capital controls on institutional investors will be removed. They will be replaced by a prudential guideline system for the domestic savings industry, obviating any further need for SARB approvals. The ceiling on offshore investment is raised to 20% of assets from 15% for pension funds and life assurers, and to 30% from 25% for unit trusts. Pension funds currently have 14.5% of their assets offshore. This announcement on exchange controls is seen as rand negative, however, particularly in an environment where consumer and business confidence is declining. Our fx strategist believes that the announcement will increase risk to the rand should domestic investors look to diversify in light of concerns about domestic economic prospects.

National Treasury: macroeconomic projections

%oya unless otherwise indicated

Calendar year:	2006	2007e	2008f	2009f	2010f
Final household consumption	8.2	7.0	3.7	3.8	4.2
Final government consumption	5.2	5.2	4.6	4.5	4.5
Gross fixed capital formation	13.8	15.3	9.6	9.7	9.9
Gross domestic expenditure	9.2	6.4	5.0	4.6	4.8
Exports	5.6	7.1	3.8	6.0	6.4
Imports	18.8	11.0	7.0	6.9	6.3
Real GDP	**5.4**	**5.0**	**4.0**	**4.2**	**4.6**
Nominal GDP (R billion)	**1741.1**	**1986.1**	**2229.8**	**2449.1**	**2691.2**
CPIX	4.6	6.5	7.1	4.9	4.7
Current account balance (% of GDP)	-6.5	-7.2	-7.3	-7.8	-8.0

Main budget balances



Budgetary spending initiatives reflect the government's desire to provide a meaningful social safety net for marginalized groups in society, while also encouraging employment and investment growth in crucial economic infrastructure. Mostly as an inflation adjustment, social grant spending rises to R70bn in FY2008/09 (versus R67bn previously expected). And from January 2009, the child support grant will be extended to children up to the age of 15 years (up from 14 years). In addition, the qualifying age for pension grants to men will be cut to 63 years (from 65 years previously).

The central government is allocating R60bn over the next five years to electricity producer Eskom, to help finance its expansion. Over the next three years, though, the transfer to Eskom will total only R20bn, drawn from the contingency reserve. The balance of R40bn is to be provided in years four and five. Near term, this decision is more negative for Eskom debt than for national government debt in relative value terms, in that government debt issuance will not be needed to meet the first three years' payments.

The South Africa data watch will be published next on February 29.

Data releases and forecasts

Week of February 25 - 29

Tue
Feb 26
11:30am

Real GDP by output sector
%q/q, saar, except as noted

	1Q07	2Q07	3Q07	4Q07
GDP (market price)	5.0	4.4	4.7	3.9
GDP (market price, %oya)	5.7	5.0	5.1	4.5
Primary sector	-5.9	-1.1	3.0	__
Agriculture	2.0	4.4	0.5	__
Mining	-8.8	-3.1	4.0	__
Secondary sector	7.8	2.0	0.6	__
Manufacturing	4.5	-0.1	-2.5	__
Tertiary sector	5.6	5.9	6.7	__
GDP excluding agriculture	5.1	4.4	5.1	__

Real GDP growth probably fell in the fourth quarter, bringing full-year growth down to 5%y/y in 2007, from 5.4% in 2006. The slowdown will largely have reflected moderation in consumer demand and weak mining production. The retail trade sector probably slowed markedly, but other sectors such as construction and communication should have performed well. The supply-side outlook for the economy remains dim, given the electricity supply crisis and softer global demand. However, the tertiary sector should remain robust, supported by the finance sector.

Wed
Feb 27
11:30am

Consumer prices

	Oct	Nov	Dec	Jan
Total metro (%oya)	7.9	8.4	9.0	9.1
(%m/m, nsa)	0.9	0.4	0.9	0.9
Core metro (%oya)	6.4	6.9	7.8	7.5
(%m/m, nsa)	0.5	0.3	0.7	0.6
CPIX metro/urban (%oya)	7.3	7.9	8.6	8.4
(%m/m, nsa)	0.7	0.5	0.7	0.8

CPIX inflation probably rose in January, mainly driven by high food prices and by medical care and health prices, each component likely having contributed 0.4% pt to the monthly rise in the CPIX. Risks to inflation are to the upside, particularly since January is a high-survey month for the CPI, with medical and health care services, water and electricity, property insurance, and communication tariffs also surveyed. Hikes in electricity tariffs, the fuel levy, and excise duties announced in the budget will put upward pressure on inflation.

Thur
Feb 28
11:30am

Producer prices

	Oct	Nov	Dec	Jan
Total (%oya)	9.3	9.1	10.3	10.4
(%m/m, nsa)	1.1	0.3	0.5	0.5
Domestic (%oya)	10.2	9.7	10.0	__
(%m/m, nsa)	1.1	0.1	0.2	__
Imported (%oya)	7.5	7.3	11.3	__
(%m/m, nsa)	1.0	0.7	1.3	__

The January PPI release, will include a set of new weights to be consistent with international practice, but this is not expected to change the inflation numbers as the new index will continue to be published using the 2000=100 base. Both the PPI and CPI will be rebased early in 2009. The main change will be a weighting of the main PPI groupings by their value-added as measured in the national accounts (used to calculate GDP). Previously, the groupings were weighted by relative importance of sales. Moreover, gold will now be included in the PPI. Mining and quarrying will receive a higher weight of 19.4%, up from 8.9%, while the weight of agriculture will be reduced to 9.95% from 11.1%. The weight of manufacturing in the PPI will fall to 62.3% from 75.3% and that of electricity will rise to 8.3% from 4.7%.

Fri
Feb 29
08:00am

M3, private-sector credit growth

	Oct	Nov	Dec	Jan
M3 (%oya)	23.4	23.2	23.7	24.2
(%m/m, nsa)	0.8	2.2	1.0	0.4
M0 (%oya)	14.1	12.7	14.9	__
Private-sector credit (%oya)	22.3	22.6	21.5	21.4
(%m/m, nsa)	1.7	2.2	0.5	0.7
Underlying credit ext. (%oya)	24.5	23.1	22.2	21.3
(%m/m, nsa)	1.5	1.3	1.2	1.3

Fri
Feb 29
2:00pm

Customs trade
Rand billion, except as noted

	Oct	Nov	Dec	Jan
Balance	-14.9	-0.7	-1.2	-5.5
Exports	41.4	48.2	42.6	__
(%m/m)	4.0	16.6	-11.6	__
Imports	56.3	49.0	43.8	__
(%m/m)	27.4	-12.9	-10.5	__

Review of past two weeks' data

Mining production

	Oct	Nov	Dec
Mining, %oya	~~-3.2~~ *-3.1*	~~-6.4~~ *-5.8*	~~-0.1~~ *-1.4*
%m/m, sa	~~-3.0~~ *-2.6*	~~0.8~~ *1.0*	~~1.3~~ *0.3*
Non-gold mining, %oya	~~-2.7~~ *-2.6*	~~-5.4~~ *-4.8*	__ *-1.1*
%m/m, sa	~~-3.2~~ *-2.9*	~~2.2~~ *2.5*	__ *-0.4*

Total mining output fell 1.4%oya in December on a 4.1% drop in gold production. Mining production eased 0.2%y/y in 2007 as a whole, after falling 1.5% in 2006.

Manufacturing production

	Oct	Nov	Dec
Manufacturing, %oya	~~5.6~~ *5.7*	~~4.4~~ *4.1*	~~4.0~~ *0.3*
%m/m, sa	~~7.7~~ *7.1*	~~-0.6~~ *-0.7*	~~1.5~~ *-2.5*

Manufacturing production fell 2.5%m/m in December, but was still up 0.3%oya vs a revised gain of 4.1% in November. For 2007 as a whole, production grew 4.2%y/y, down from a 4.8% gain in 2006, due to slower growth in output of motor vehicles and parts, and electrical machinery.

Retail trade sales

%oya, nsa

	Oct	Nov	Dec
Real (2000=100, %oya)	2.0	-0.2	__ *-0.5*
Nominal	~~10.1~~ *10.2*	~~9.1~~ *8.7*	__ *9.4*

Australia and New Zealand

- **February minutes show RBA considered 50bp hike**
- **Private sector credit growth to slow in January**
- **NZ housing confidence wobbles as house prices fall**

Minutes from the RBA's monetary policy meeting released Tuesday showed that Board members considered hiking interest rates 50bp at their February meeting. The RBA decided to hike the cash rate 25bp on February 5, but debated the need for a larger move. The labor price index midweek showed that wage growth picked up in 4Q. Next week's capital expenditures survey will likely show that business investment rebounded in 4Q, while the RBA's private sector credit aggregates will probably show that credit growth eased in January amid rising interest rates.

In a relatively quiet week for economic data in New Zealand, the ASB housing confidence survey showed that optimism that house prices will rise continued to weaken. The sharp downturn in New Zealand's housing market, coupled with the recent drought, are likely to influence the RBNZ's rhetoric, coloring the next monetary policy statement on March 6. In other data, electronic card spending showed a substantial 0.6%m/m drop in spending on core retail goods (excluding vehicle-related industries). Higher gasoline prices and rising interest rates are taking their toll.

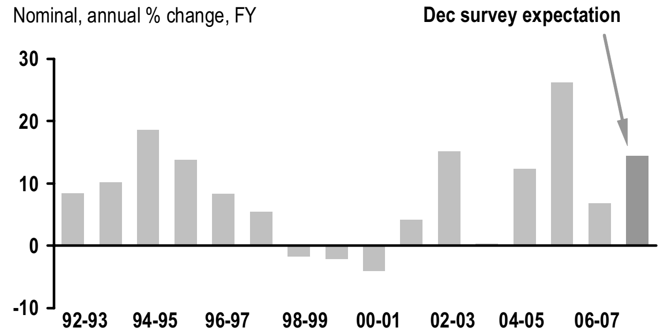
Capex rebound in the fourth quarter

The 4Q business survey is expected to show that capital spending rebounded 6.0%q/q, after falling 6.5% in the previous quarter. Investment unexpectedly fell in 3Q across each of the main industry groups—mining (-3.0%), other selected industries (-9.3%), and manufacturing (-2.1%)—as some firms struggled to acquire the required labor and equipment to undertake planned investment projects. More importantly, the forward-looking component of the 3Q survey showed that firms downgraded expectations for spending growth in the year ending June 2008 to a still-healthy 14%oya, from 17% previously. The downgrade probably reflected growing uncertainty over the global growth outlook, tightening credit conditions, and rising domestic interest rates.

Solid business investment should help boost productive capacity and alleviate pressure on stretched resources which, in the long term, should assist in curbing inflation. That said, while business investment is presently growing at a healthy double-digit pace, the current investment cycle is at a very mature phase; spending will probably start to moderate in coming quarters.

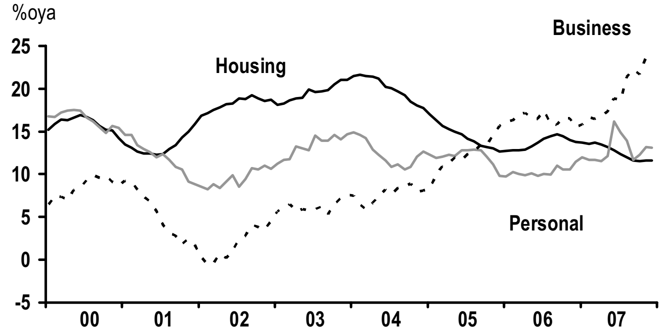
Australia: business investment

Nominal, annual % change, FY



Australia: private sector credit aggregates

%oya



Credit growth to hold steady in January

Private sector credit likely grew 1.0%m/m in January, slowing from 1.1% in December. The 12-month growth rate likely fell to 16.3% from 16.5%, which was the highest since 1989. This moderation will be welcomed by the RBA given that credit growth has recently accelerated in annual terms even though the central bank lifted interest rates in August and November.

In January, business lending will again have underpinned total credit growth. Presumably, lending to businesses is being used to fund investment in additional capacity and help alleviate infrastructure bottlenecks. Personal and housing credit growth, in comparison, will appear soft, and probably has slowed under the weight of the RBA's November rate hike and the rise in banks' standard variable mortgage rates—outside of an RBA rate hike—in early January. While lending to corporates is preferable to excessive credit inflated by household borrowing, the RBA will remain anxious that credit continues to expand so rapidly.

RBA considered 50bp move in February

Minutes from the RBA's February monetary policy meeting released Tuesday show, among other things, that RBA officials considered hiking interest rates 50bp at their

Stephen Walters
Jarrod Kerr
Helen Kevans

last meeting. The RBA decided on February 5, however, to hike the cash rate 25bp to a 12-year high of 7%.

RBA officials debated whether to raise the cash rate 25bp or 50bp in early February. The argument in favor of a 50bp move stemmed from the deteriorating inflation outlook. The Board acknowledged also that the cash rate in real terms was relatively low given current domestic economic fundamentals. A 25bp hike was judged “more persuasive,” however, given that several domestic banks had lifted their borrowing rates in recent months in the absence of a rise in the official cash rate. Furthermore, the RBA decided that further tightening could be implemented in March, or thereafter, if policy is judged not restrictive enough. JPMorgan forecasts that the RBA will hike interest rates 25bp in both March and May, taking the key rate to 7.5%.

The Board also discussed the weakness in the US economy, particularly in the housing sector, noting that this weakness could spread to other sectors as growth in income and spending falls. Other developed economies, such as Japan, had softened, but developing countries, like China, were performing well. On financial markets, the RBA noted ongoing turbulence in currency and equity markets, further writedowns by financial institutions, and rising pessimism about the global growth outlook. The RBA discussed the policy responses of other central banks to recent global developments, noting policy easing in some developed countries and tightening in some emerging markets.

On the domestic economy, the Board discussed recent data on businesses, households, the housing market, credit growth, trade, and the labor market. The RBA forecast that GDP growth will slow to 3.25%oya by the end of 2008. On inflation, RBA officials noted that price rises in the past two years have been broad-based, with prices of both non-tradable and tradable items rising. It forecast, though, that underlying inflation would rise to 3.75%oya in early 2008 and decline gradually to 3% by mid-2010—holding at the very top end of the Bank’s 2-3% target range.

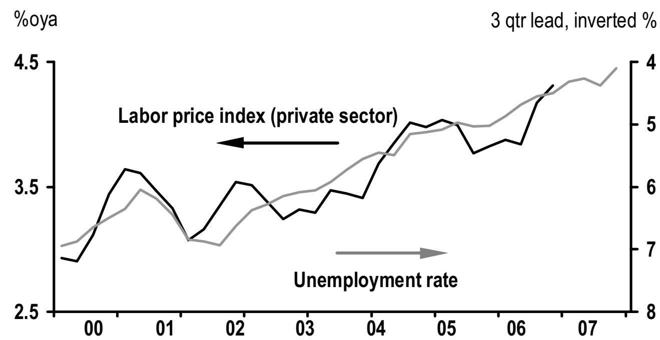
RBA output and inflation forecasts

%oya

	Real GDP	Consumer price index	Underlying inflation
Sep 07	4.30	1.90	3.00
Dec 07	3.50	3.00	3.60
Jun 08	3.25	3.50	3.75
Dec 08	3.25	3.50	3.50
Jun 09	3.00	3.25	3.25
Dec 09	3.00	3.25	3.25
Jun 10	3.00	3.00	3.00

Source: RBA, ABS.

Australia: labor price index and unemployment



RBA’s Edey maintains hawkish bias

RBA assistant governor Malcolm Edey, in a speech to the Committee for Economic Development of Australia on Tuesday, reiterated comments made in the Bank’s quarterly Statement on Monetary Policy last week, which reaffirmed widespread expectations that interest rates will rise further.

Edey acknowledged that the housing-driven slowdown in the US economy was feeding back into employment and incomes, but noted several positive forces likely to support US economic growth—the weak US dollar favoring exports, the significant fiscal stimulus in the pipeline, and falling interest rates. He suggested also that the current weakness in major industrial economies would have a dampening effect on the Asian region, and forecast that growth in Australia’s trading partners will slow to a below-trend 4%y/y in 2008 and 2009, down from 5% last year, mainly owing to weak growth in G-7 economies. He restated, though, that the weakness in developing countries, such as China, was less pronounced, and noted firm conditions in other Asian economies.

Edey said that economic growth in Australia remains robust and will likely be sustained. In particular, the terms of trade will remain a significant stimulus to the domestic economy, with the RBA forecasting that the terms of trade will rise another 5% this year. Strong demand and tight capacity, rising commodity prices, and faster wage growth will continue to fan inflation, however. The RBA believes that the underlying trend in inflation is now around 3.5%oya, and remains concerned that rising inflation might feed back into domestic wage and price expectations.

Wage growth accelerated in 4Q

Wage growth picked up in 4Q, with the labor price index rising 1.1%q/q (JPMorgan 1.2%, consensus 1.1%) up from 1.0% in 3Q. Annual wage growth held steady at 4.2%oya for the second straight quarter, as private sector wage growth picked up (+4.3%) and public sector wage growth eased (+4.1%).

Persistently tight labor market conditions, widespread skill shortages, and anecdotal evidence suggesting that labor costs are rising mean that wage growth will likely accelerate in coming quarters. The threat of additional wage cost pressures clearly worries the RBA. The February monetary policy minutes highlighted the tight labor market, but noted that wage growth to date had surprisingly remained contained. The RBA pointed out, though, that average earnings from the national accounts show a significant pickup in wage growth, which we expect will be illustrated by a gradual increase in the labor price index in coming quarters.

RBNZ inflation expectations on the rise

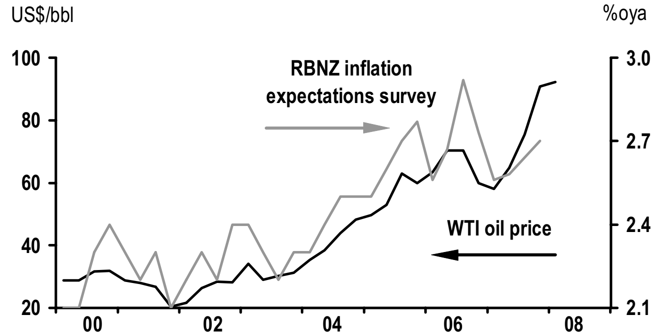
The RBNZ inflation expectations survey, out Tuesday, should garner interest in the market. Inflation expectations are a major input to the RBNZ's inflation model, and expectations are likely to have risen in 1Q. Inflation expectations tend to track oil and food prices, both of which have increased substantially in recent months. Rising inflation expectations will worsen the inflation outlook, and keep the possibility of an interest rate cut off the table (chart).

That said, while the inflation trajectory will keep RBNZ officials on guard, the chances of another rate rise in this cycle are diminishing by the day. The housing market has turned south harder and faster than RBNZ forecasts, and an unfortunate drought in New Zealand's major dairy producing regions is taking a slice out of growth in export volumes. We expect the RBNZ to lower its housing market forecasts in the March quarter monetary policy statement to show a slight decline in house prices—on the order of 5% in 2008—and a minor cut in export volume growth.

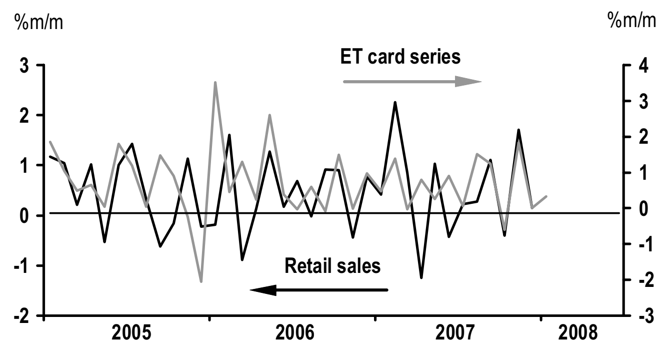
Housing confidence not so confident

Optimism on the direction of house prices weakened further in the January ASB housing confidence survey. A very slight net margin of just 1% of respondents expect house prices to rise over the next year, compared to 12% previously. The survey is a good indicator of activity over the next two to three months, and this finding suggests that activity will be very subdued indeed.

New Zealand: WTI oil price and inflation expectations



New Zealand: electronic card transactions and retail trade



The ASB survey follows last week's REINZ and QVNZ housing market data, which show that New Zealand's housing market is crumbling under the weight of higher interest rates and reduced net-permanent migration. The pendulum has swung from a seller's market to a buyer's market, and all the street signs are reading "buyer beware."

Electronic card spending weak in January

The relatively new electronic card transaction series, compiled by Statistics NZ, shows a 0.6%m/m decline in core retail sales purchased via electronic card transactions in January. The headline retail spending series shows a small gain of just 0.3%m/m. Although the series is still in its infancy, the correlation with monthly movements in the retail trade survey is strong, and is pointing to very weak spending in January (chart).

Higher interest rates, coupled with rising gasoline prices, have hit the consumer purse. The shock of paying more in interest, rent, and gasoline is now being compounded by the widespread view that New Zealand's housing market has turned and will, at best, track sideways for the next few years. We believe that house prices will contract in 2008.

Australia:
Data releases and forecasts

Week of February 25 - 29

Wed
Feb 27
11:30am

Construction work done
Seasonally adjusted

	1Q07	2Q07	3Q07	4Q07
(%q/q)	3.6	-2.1	2.8	__
(%oya)	10.2	3.0	8.9	__

Thu
Feb 28
11:30am

Private new capital expenditure
Seasonally adjusted

	1Q07	2Q07	3Q07	4Q07
(%q/q)	9.4	7.1	-6.5	6.0
(%oya)	4.5	11.8	9.0	16.1

Fri
Feb 29
11:30am

Private-sector credit
Seasonally adjusted

	Oct	Nov	Dec	Jan
(%m/m)	1.0	1.7	1.1	1.0
(%oya)	15.4	16.2	16.5	16.3

Review of past week's data

WMI leading index
Seasonally adjusted

	Oct	Nov	Dec
(%m/m)	0.5	~~1.0~~ *0.9*	__ *-0.2*

Labor price index
Seasonally adjusted

	2Q07	3Q07	4Q07
(%q/q)	1.1	1.0	~~1.2~~ *1.1*
(%oya)	4.0	4.2	~~4.3~~ *4.2*

Sales of new motor vehicles
Units, seasonally adjusted

	Nov	Dec	Jan
(%m/m)	1.5	~~1.1~~ *1.6*	__ *0.6*
(%oya)	10.6	~~11.6~~ *11.7*	__ *7.2*

New Zealand:
Data releases and forecasts

Week of February 25 - 29

Tue
Feb 26
3:00pm

RBNZ inflation expectation
Not seasonally adjusted

	2Q07	3Q07	4Q07	1Q08
(%q/q)	2.6	2.6	2.7	2.8

Wed
Feb 27
10:45am

Building consents
Not seasonally adjusted

	Oct	Nov	Dec	Jan
(%m/m)	4.9	5.0	-20.6	8.0
(%oya)	-12.3	-1.9	-7.7	-0.2

Wed
Feb 27
3:00pm

NBNZ business confidence

	Nov	Dec	Jan	Feb
% balance of respondents	-19.6	-24.9	n/a	-25

Thu
Feb 28
10:45am

Visitor arrivals
Not seasonally adjusted

	Oct	Nov	Dec	Jan
Total (%m/m)	-2.5	2.8	-1.2	__

Net permanent immigration

	Oct	Nov	Dec	Jan
Monthly (000s)	1.6	1.8	-0.1	__
12 month sum (000s)	7.5	6.6	5.5	__

Fri
Feb 29
10:45am

Trade balance
Not seasonally adjusted

	Oct	Nov	Dec	Jan
Exports ($NZ mn)	3369	3373	3677	3700
Imports ($NZ mn)	4142	4001	3644	3800
Trade balance ($NZ mn)	-773	-628	33	-100

Review of past week's data

Credit card spending
Seasonally adjusted

	Nov	Dec	Jan
(%oya)	9.5	7.6	__ *8.6*

Greater China

- **China: January CPI bounced on seasonal factors; PPI inflation ticked up, reflecting input cost pressure**
- **Policymakers are likely to accelerate currency appreciation to curb supply-side inflation pressure**
- **Taiwan: unexpectedly strong 4Q GDP reflects rising net exports; domestic demand lost some momentum**
- **Current account surplus rose solidly in 4Q; net capital outflow still large, but has started to moderate**

China's headline CPI inflation bounced back in January to a new eleven-year high of 7.1%oya, after having eased modestly to 6.5% in December. After seasonal adjustment, prices leapt 0.6%m/m, sa in January, reflecting the dual impact of the approaching holidays and recent snowstorms. Smoothing out the monthly volatility, the underlying sequential trend has moderated somewhat in recent months: the CPI rose only 6.3%3m/3m, saar through January. Seasonal factors are likely to keep headline inflation readings elevated in the near term. However, toward the middle of 2008 these factors will fade; supply conditions for grain and meat are also set to improve, and base effects will kick in to lower food price growth and headline CPI inflation.

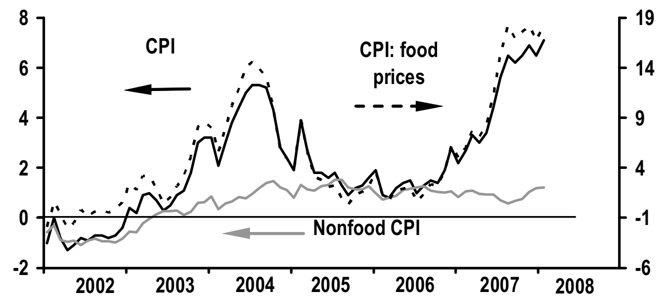
Food prices remain the most important swing factor in headline CPI inflation this year, contributing 6.0 points of the 7.1%oya rise in the overall CPI for January. Food price inflation increased to 18.2%oya last month from December's 16.7%. The details show that, while grain and egg price increases have slowed, meat prices further accelerated to be up 41.2%oya in January and the volatile fresh vegetable component rebounded to be up 13.7%.

But the nonfood CPI, after a modest uptick in November due to the hike in oil product prices, remained largely stable in January, rising 1.5%oya according to NBS's calculation. This compares to a 1.4%oya rise in November and 1.0% average increases in Jan-Oct last year. But the 12-month increase in fuel prices, utility prices, and transportation charges remained high even after oil product prices were raised. In contrast, the decline in prices of manufactured goods, including clothing, telecom products, and transportation facilities picked up speed, on the back of improving productivity and technological innovation. In addition, residential rents rose 4.7%oya in January, close to the pace of previous months.

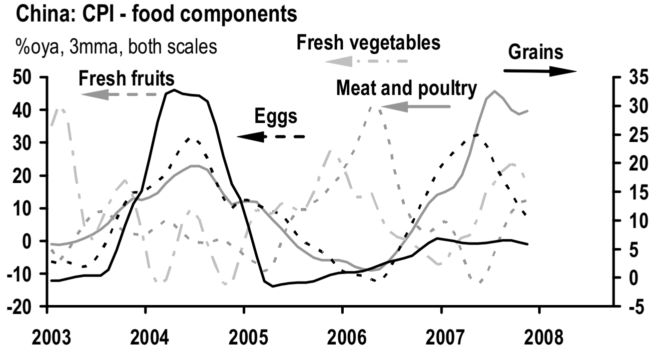
Rising pipeline inflation pressure in China

Producer goods prices accelerated further in January, rising

China: headline CPI, food prices, and nonfood CPI inflation
%oya, both scales



China: CPI - food components
%oya, 3mma, both scales



6.1%oya in the highest 12-month reading since December 2004. In seasonally adjusted sequential terms, the PPI posted another 1.0%m/m, sa leap, adding to the 1.2% and 1.1% gains in the previous two months. The sequential trend thus rose a remarkable 14.4%3m/3m, saar through January. The further acceleration of intermediate goods prices in the PPI reflects a broad-based uptick in a range of commodity and raw material costs, highlighting the intensifying pipeline pressure on inflation in China.

Last month's PPI for downstream consumer goods was up 4.6%oya, compared to 3.7% in December; and the acceleration reflected food prices. Price increases for producer goods were broadly based, as seen in rising costs for the major categories of mining, raw materials, and manufactures. Further breakdown shows that the PPI for crude oil soared 29.9%oya in January, while gasoline, diesel, and fuel oil prices continued to post high 12-month increases following the November price hike in domestic oil product prices. The coal component of PPI inflation, having trended upward through last year, rose sharply to 14.3%oya in January. This is not surprising considering the severe shortages of domestic coal that developed recently after transportation was disrupted by the snowstorms at a time of record low inventory. Within the commodity category, the PPI for ferrous metals also picked up further in January, rising 17.3%oya. By contrast, PPI inflation for nonferrous metals eased to 4.7%, from double digits last year.

Policymakers to accelerate RMB appreciation and strengthen liquidity management

On the policy front, the central bank is not expected to respond to the spurt in monthly inflation rates with rate hikes, recognizing that the acceleration is temporary. More relevant steps for curbing the current bout of supply-side inflation pressure will be allowing faster CNY appreciation, and increased imports of essential commodities, including agricultural products. The rebound in January money supply and loan growth (see last week's *GDW),* on the back of still elevated trade surpluses and a surprising jump in FDI inflows (up 109.8%oya in January), also means that the central bank will likely move to strengthen its liquidity management, with further RRR hikes and sterilization.

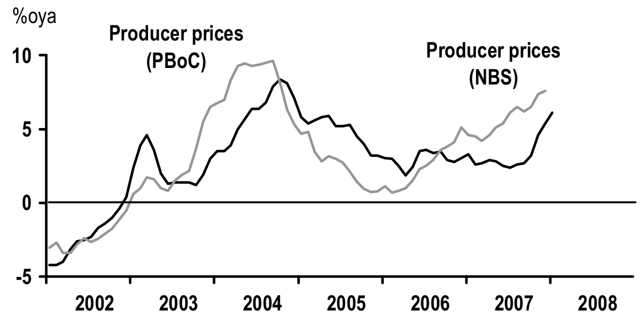
Taiwan: solid 4Q GDP growth fueled by rising net exports

GDP in Taiwan last quarter grew an unexpectedly strong 6.4%oya (JPMorgan 6.1%, consensus 5.6%), after 6.9% growth in 3Q. Sequential growth was a moderate 2.6%q/q, saar in 4Q, but after remarkable gains of 12.0% and 9.2% in 3Q and 2Q. The economy's further expansion in 4Q largely came from net exports, as exports managed to rise modestly—helped by demand from neighboring Asian economies—despite the downshift in global manufacturing, while imports slowed after two quarters of strong growth. Domestically, fixed investment and private consumption slowed in 4Q , reversing the acceleration earlier in the year.

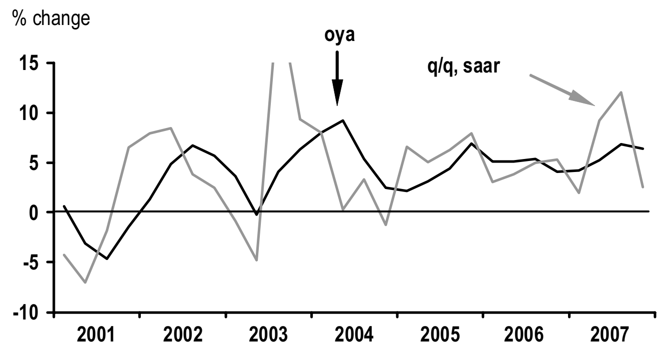
With the global industrial slowdown expected to continue in coming months, as demand growth slows further in the major advanced economies, Taiwan's exports and manufacturing activity will likely continue to soften. Slower domestic manufacturing activity may therefore be a drag on near-term employment and household income growth. But, domestic sentiment is likely to improve after the March presidential election, especially since optimism is growing about an improvement in cross-strait economic links, as well as other growth-friendly policy initiatives (including tax reforms) that have been suggested by both parties. We have fine-tuned the forecast of Taiwan's 2008 real GDP growth to 4.0%y/y (previous forecast: 4.2%).

- Total exports of goods and services rose 3.5%q/q, saar in 4Q, despite the downshift in the global manufacturing sector; exports were helped by demand from neighboring Asian economies and were especially strong in nontech.
- Domestic gross fixed investment, which had expanded at a remarkable pace in earlier quarters, fell 23.4%q/q, saar, in 4Q. This suggests that the significant facility expan-

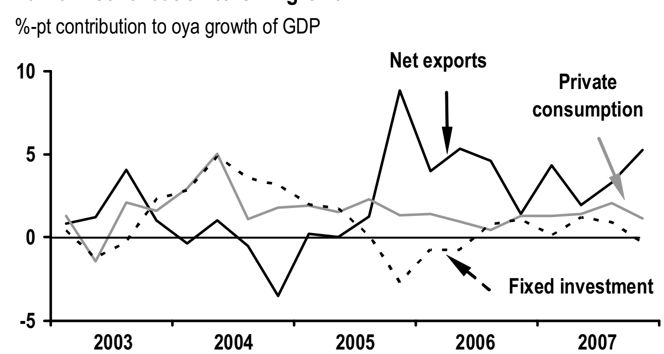
China: producer prices



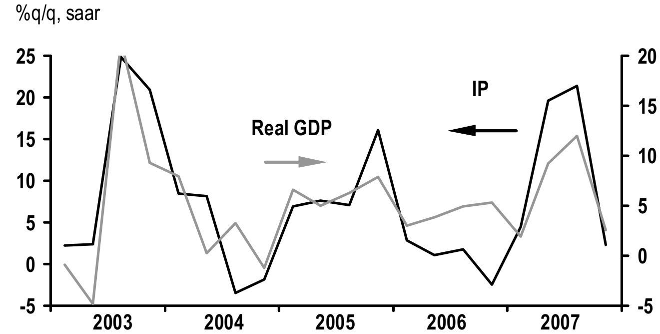
Taiwan: real GDP growth



Taiwan: contribution to GDP growth



Taiwan: real GDP and IP



sion undertaken by the tech industry earlier in the year has started to subside.

- The statistics department also indicated that general construction activity may have slowed after rising input costs.
- Private consumption demand, too, reversed the earlier trend toward solid strengthening, reflecting slower employment growth as well as the erosion of real purchasing power by rising consumer prices.

Taiwan current account surplus up in 4Q, net capital outflows started to moderate

The current account surplus increased 37.1%oya last quarter, to a record US$11.6 billion. The full-year 2007 current account surplus rose again, to US$ 31.7 billion, equal to an impressive 8.3% of GDP.

- While Taiwan's export sector was affected by the global slowdown in 4Q, the underlying export uptrend still managed to produce a modest quarterly expansion. Even though rising global commodity prices pushed up the overall import bill, the merchandise trade surplus thus rose further in 4Q.
- In addition, the deficit on the service account narrowed in 4Q, helped by trade-related service income. The net income surplus remained solid at US$3.3 billion in 4Q, supported by steady earnings from foreign assets.

Net capital outflow, which had accelerated notably in previous quarters, seemingly started to moderate in 4Q.

- Taiwan had reported significant net capital outflows in recent quarters, and total outflow in the balance of payments financial account amounted to US$38.9 billion for 2007, more than offsetting the current account surplus.
- The acceleration in capital outflows for most of last year largely took the form of higher net outflows for portfolio investment. This reflected Taiwan individuals' and insurance companies' growing inclination to invest in overseas assets, especially given the wide differential between low domestic interest rates and higher USD rates.
- the drop in USD interest rates during 4Q helped to narrow TWD-USD rate differentials, and this helped to moderate the net capital outflow for portfolio investment.
- With the TWD-USD interest rate gap likely to narrow further, and with investor sentiment toward Taiwan assets improving based on hopes for improved cross-strait economic links after the March presidential election, net capital outflows may ease further in the coming months.

Taiwan: private consumption and employment growth

%oya, both scales

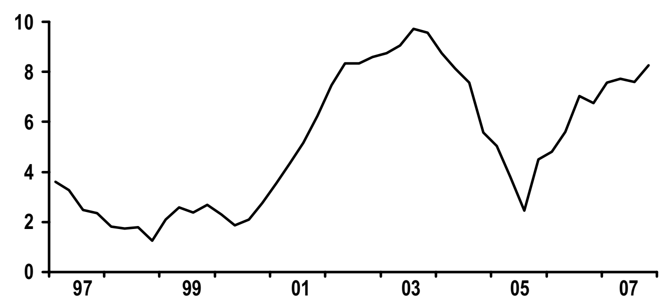
Taiwan: balance of payments

USD bn, nsa

	2006	2007	1Q07	2Q07	3Q07	4Q07
Overall Balance	6.1	-4.0	0.4	-1.9	-7.7	5.2
Current Account	24.7	31.7	8.7	5.3	6.2	11.6
Goods	23.4	29.4	6.9	4.9	7.7	10.0
Services	-4.4	-5.4	-1.4	-1.5	-1.8	-0.7
Income	9.6	11.5	4.0	2.9	1.3	3.3
Current Transfers	-3.9	-3.8	-0.9	-1.0	-1.0	-1.0
Financial Account	-19.6	-38.9	-10.3	-7.6	-13.9	-7.1
Direct Investment	0.0	-3.8	0.0	-0.3	-1.5	-2.0
Portfolio Investments	-18.9	-39.9	-11.7	-7.0	-14.1	-7.2
Other Investments	-0.7	4.8	1.4	-0.3	1.7	2.0
Errors and Omissions	1.1	3.3	2.1	0.5	0.0	0.8

Taiwan: current account balance

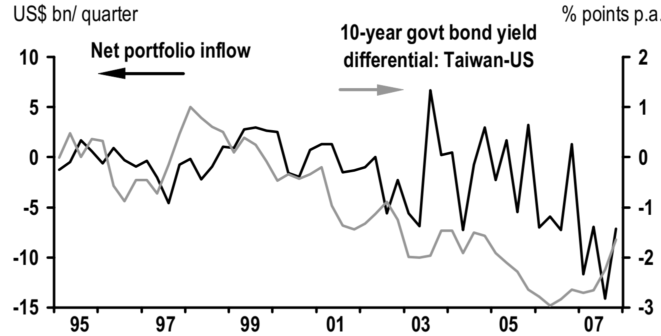
% of GDP, 4qma



Taiwan: BoP portfolio investment flows and yield differential

US$ bn/ quarter

% points p.a.



China:
Data releases and forecasts

Week of February 25 - 29

No data releases expected.

Review of past week's data

Producer prices (Feb 18)
%oya

	Nov	Dec	Jan
Producer (NBS)	4.6	5.4	~~5.6~~ *6.1*
Producer (PBoC)	7.4	7.6	—

See main text.

Consumer prices (Feb 19)
Percent change

	Nov	Dec	Jan
%oya	6.9	6.6	~~7.0~~ *7.1*
%m/m, sa	0.7	0.4	~~0.5~~ *0.6*

See main text.

Foreign direct investment (Feb 18)

Hong Kong:
Data releases and forecasts

Week of February 25 - 29

Wed
Feb 27
04:15pm

Real GDP
Percent change

	1Q07	2Q07	3Q07	4Q07
%oya	5.6	6.6	6.2	5.7
%q/q, saar	3.6	7.8	7.0	5.0

GDP likely continued to expand solidly in 4Q07, with a strong upturn in domestic demand and continued expansion in external trade.

Thu
Feb 28
4:15pm

Merchandise trade
HK$ bn

	Oct	Nov	Dec	Jan
Balance	-8.7	-16.0	-27.4	-6.7
Exports	253.0	244.0	232.3	229.0
%oya	9.8	6.6	8.2	10.4
Imports	261.7	260.0	259.7	235.7
%oya	12.1	9.3	10.3	11.3

Trade flows likely accelerated in January ahead of the lunar new year holidays, echoing the results for mainland China, Taiwan, and Korea.

Review of past week's data

Labor market survey (Feb 19)
4:15pm

	Nov	Dec	Jan
Unemployment rate (%, 3mma, sa)	3.6	3.4	~~3.5~~ *3.4*
Employed (000 persons, 3mma, sa)	3508	3533	*3539*

Consumer prices (Fri 22)
Percent change

	Nov	Dec	Jan
%oya	3.4	3.8	~~4.4~~ *3.2*
%m/m, sa	0.5	0.6	~~0.5~~ *-0.2*

A waiver of property tax for Jan and Mar 2008 reduced the CPI. Netting out this factor, the government noted that inflation hit another nine-year high of 4.3%oya, after 3.8% in Dec. This translates 0.5%m/m, sa, mostly due to higher food and energy prices. Solid domestic demand, rising rents and wages, and the weakening of HKD on a trade-weighted basis will continue to exert upward pressure on overall prices.

Taiwan:
Data releases and forecasts

Week of February 25 - 29

Tue
Feb 26
04:00pm

Labor market survey

	Oct	Nov	Dec	Jan
Unemployment rate, sa	3.9	3.9	4.0	4.0
Unemployment rate, nsa	3.9	3.9	3.8	3.9

Tue
Feb 26
4:00pm

Industrial production
%oya

	Oct	Nov	Dec	Jan
Total	15.9	11.9	10.7	10.5
%m/m, sa	1.9	-0.7	-1.7	1.5

Frontloading of production ahead of the lunar new year holidays likely added to January output.

Tue
Feb 26
4:00pm

Export orders
%oya

	Oct	Nov	Dec	Jan
Total	18.0	17.2	17.6	14.6
%m/m, sa	-0.9	1.2	1.0	3.2

Wed
Feb 27
4:00pm

Composite leading indicator

	Oct	Nov	Dec	Jan
Total	148.2	148.6	148.8	148.6

Review of past week's data

Real GDP (Feb 21)
Percent change

	2Q07	3Q07	4Q07
% oya	5.2	6.9	~~6.1~~ *6.4*
%q/q, saar	9.2	12.0	~~0.5~~ *2.6*

Korea

- **Pipeline inflation pressure still runs high**
- **Seasonally adjusted jobless rate falls further**

This week's data reports countered rising expectations that the Bank of Korea would soon cut its policy rate. Both the trade price report and the stage of processing price index (SPPI) for January showed that inflation risks remain high, giving no support for the BoK's forecast that consumer price inflation will come down and settle within the Bank's target band in the second half of this year. The jobless rate also declined further on a seasonally adjusted trend basis, although the details were less positive. In our view, the BoK's thinking has been moving in favor of a rate cut, but any action will require further evidence of deterioration in growth conditions and greater confidence about medium-term inflation (see "Bank of Korea comes close to expressing an easing bias," *GDW,* Feb 1).

Import prices still rising

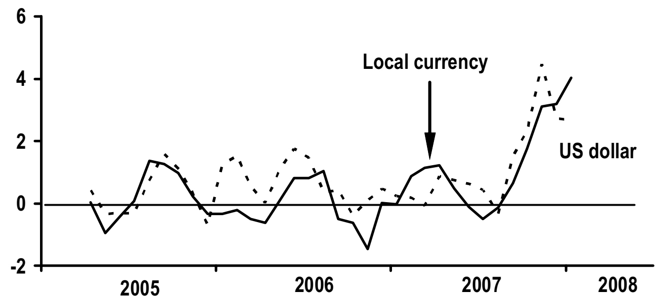
Prices of imported goods in local currency terms rose 3.0%m/m, nsa, in January, following gains of 4.1% in November and 1.7% in December. Using JPMorgan's seasonal adjustment, imported goods prices surged 4.7%m/m, sa in January. The price gains were still mainly driven by raw materials, but appear to have become more broadly based: prices of capital and consumption goods moved up last month as well. Some of the increase in recent months stemmed from KRW weakness, as seen in the smaller increase of imported goods prices in US dollar terms: 3.0%m/m, sa in January, following 0.4% in December.

The stage of processing price index (SPPI) rose 1.5%m/m, nsa in January, following 1.1% in December. On JPMorgan's calculation, the SPPI moved up 1.8%m/m, sa, about the same as in the previous month. Price gains were mostly for imported raw materials and intermediate goods, whose domestic passthrough was lessened by the government's action to cut taxes on several energy products.

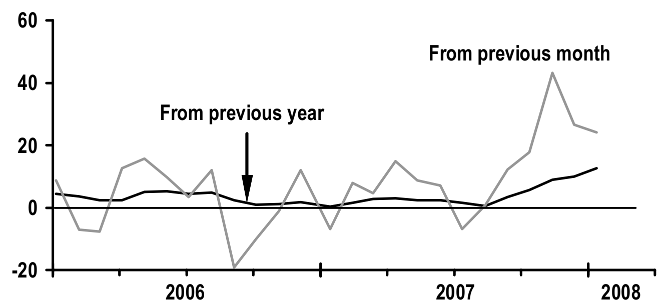
Employment rose in January, but outlook less upbeat

The jobless rate rose to 3.3% in January, but only because of seasonal slack in the agricultural and construction sectors. Seasonally adjusted, the unemployment rate fell for a second straight month, to 3.0%, the lowest level since September 2002. Both the labor force and employment moved up in January on a seasonally adjusted trend basis.

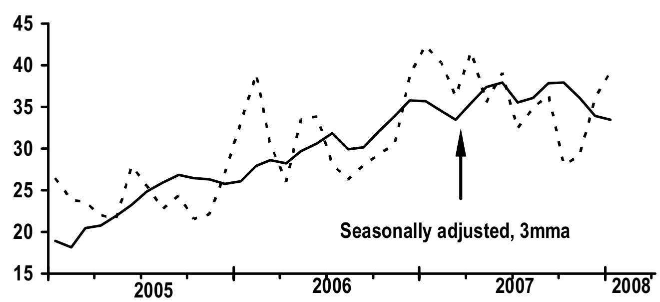
Import prices in local currency and in US dollars
%m/m, sa, 3mma



Stage of processing price index
Percent change, annualized



Ratio of new company registrations to bankruptcy filings
Ratio



However, the details of the report caution against any complacency about the employment outlook. First, job gains were led by those in construction and public services, while key private sector industries such as manufacturing and retail trade actually reduced employment. Second, according to recent business surveys, companies have turned relatively cautious about new hiring. Third, the rise in newly registered companies has been outpaced by bankruptcy filings in recent months, on a seasonally adjusted trend basis. Given the historically close relationship with job growth, this suggests that new hires are set to slow, at least for now.

Data releases and forecasts

Thu Feb 28 8:00am — Current account
US$ billion, nsa

	Oct	Nov	Dec	Jan
	2.5	1.5	-0.8	-3.0

Current account deficit likely widened, mainly due to larger deficit in merchandise trade balance.

Thu Feb 28 — FKI business survey
100=neutral reading, nsa

	Nov	Dec	Jan	Feb
1-month ahead outlook	103.4	103.0	94.8	102.0
Current condition	106.0	98.9	95.2	95.0

The outlook index likely rebounded, but mainly for seasonal reasons. Seasonally adjusted, business sentiment more likely weakened slightly.

Review of past week's data

Unemployment rate (Feb 18)
Percent of total labor force

	Nov	Dec	Jan	
Seasonally adjusted	3.2	3.1	~~3.1~~	*3.0*
Not adjusted	3.0	3.1	~~3.4~~	*3.3*

On a seasonally adjusted basis, total employment went up 0.2%m/m, sa in January, following a 0.1% gain in the previous month, while the labor force edged up after staying flat in December.

Import and export prices (Feb 19)
%oya

	Nov	Dec	Jan	
Import prices	13.7	15.6	~~17.0~~	*21.2*
Export prices	1.8	3.4	~~3.7~~	*5.8*

See main story.

Bankruptcy filings (Feb 19)

	Nov	Dec	Jan	
Bankruptcy fillings	210	178	~~195~~	*193*
Dishonored bill ratio	0.04	0.03	0.03	

Bankruptcy filings increased, partly due to payback for a seasonal decline in the previous month. Using JPMorgan's seasonal adjustment method, bankruptcy filings rose to 204 in January, marking a third consecutive monthly rise. The dishonored bill ratio also increased to 0.04%, after falling to 0.03% in December. Meanwhile, the number of newly registered companies increased more than bankruptcy filings, but mostly for seasonal reasons. Seasonally adjusted, the ratio of new company registrations to bankruptcy filings fell further.

Stage of processing price index (Feb 21)
%oya

	Nov	Dec	Jan	
	8.9	10.1	~~12.4~~	*12.6*

See main story.

BoK Watch

- **Bank of Korea's policy choice becomes more difficult**

According to the Bank of Korea's MPC minutes for January, the Bank's decision not to change the policy interest rate was unanimous. Most members sounded neutral, worrying about growth as well as inflation risks. Still, one member put more weight on inflation concerns, emphasizing that the BoK's objective is to maintain price stability.

The BoK's perception of future risks has moved toward more emphasis on growth concerns since that January meeting, judging by the February MPC statement issued last week. The governor also highlighted rising downside risks to growth, and he discounted inflation concerns slightly by forecasting that consumer price increases would moderate in 2H. Unfortunately, this week's price reports for January were not particularly supportive of the BoK's expectation of a benign medium-term inflation path.

Korea's President-elect Lee Myung-bak will officially start his five-year term on February 25. He has already appointed 15 ministers to the new government, including Kang Man-soo, a former vice finance minister in 1997, as minister of finance and the economy (MoFE). Reportedly, Kang is a proponent of Lee's pro-growth policy, and this has raised expectations that he will pressure the BoK to ease monetary policy. Such a possibility cannot be ruled out in the medium term, but we note that the new government has so far emphasized the need to stabilize housing prices as well as to support growth. Accordingly, in the very near term, any crusade by the government to boost the economy via monetary policy will proceed only to the extent that it is deemed unlikely to stimulate real estate prices in a serious way.

Interest rates
% p.a.

	Feb 1	Feb 5	Feb 14	Feb 21
Overnight call				
Overall	4.91	4.93	5.00	5.02
interbank	4.91	4.94	5.00	5.02
1-yr MSB	5.07	5.09	4.99	4.99
3-yr treasury bond	5.05	5.14	5.01	5.12
3-yr corporate bond	6.29	6.38	6.24	6.32

Deposit changes at deposit money banks
Won trillion

	Nov	Dec	Jan	Feb 1-18
Total deposits	8.6	3.2	4.7	7.4
Demand	2.1	3.1	-6.8	4.1
Time and savings	6.4	0.2	11.5	3.3

ASEAN: Indonesia, Malaysia, Philippines, Singapore, Thailand

- **Singapore's economy contracted more sharply in 4Q than previously thought, mainly owing to biomedicals**
- **2008 forecasts revised up for inflation, down for growth; MAS to maintain current stance in April**
- **Fiscal policy in 2008 to balance inflation and growth concerns; budget handouts target low-income earners**

Singapore's 4Q GDP report last week shows that the economy ended 2007 on a sour note. The government also revised down its 2008 growth forecast to reflect deteriorating global demand. There was a silver lining in the GDP report: the data show that the slump was limited to the volatile biomedical sector, and it exaggerates weakness in the economy as a whole. We expect growth to moderate in 2008, but the economy still should expand 4.6%y/y.

In addition to lowering the growth projection for 2008, the authorities have raised their inflation forecast for this year. Slowing growth and rising inflation leave policymakers in a difficult position, as was clear in the 2008 budget unveiled last week. The government announced measures that it hopes will support growth and help low-income earners without exacerbating inflation. The MAS is also balancing growth and inflation concerns; it is expected to leave exchange-rate policy unchanged at the meeting in April.

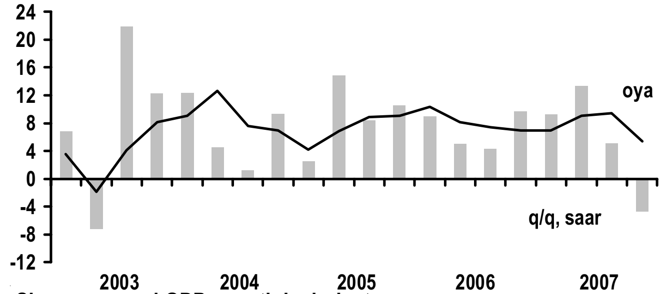
Details less dismal than headline GDP

The Singaporean economy contracted 4.8%q/q, saar in the final quarter of last year, marking the first quarter of negative growth since 2Q03 (first chart). Over the last four years, Singapore has enjoyed a lengthy economic expansion characterized by low volatility and high growth relative to prior experience. However, the 4Q outcome is a reminder that Singapore remains extremely open to trade and is vulnerable to shifts in global conditions. With worsening external economic conditions adding downside risks to growth, the government has revised down its 2008 GDP forecast range to 4-6%y/y, from 4.5-6.5% previously.

The past quarter's dire GDP figure, however, exaggerates the severity of economic weakness. The contraction was concentrated in biomedical output, which is notoriously volatile because of industry-specific requirements that lead factories to shut down periodically for cleaning, often for several days, before shifting production to new drugs (table). Output in other manufacturing industries generally held up in 4Q while service and construction activity expanded strongly. Services contributed the most to quarterly GDP growth, while total manufacturing slumped (second chart). On the expenditure side, domestic demand drove growth and net exports were a drag (third chart).

Singapore: real GDP growth

% change



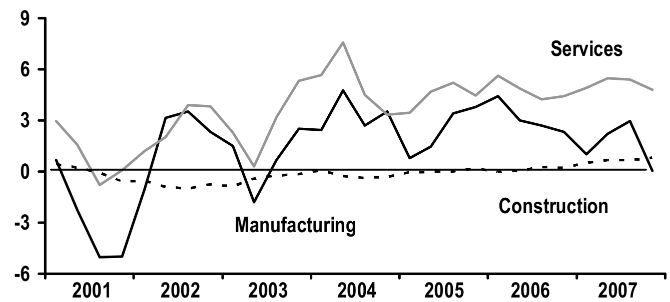
Singapore: real GDP growth by industry

%oya

	1Q07	2Q07	3Q07	4Q07	2007
Manufacturing	3.9	8.6	11.0	0.2	5.8
Electronics	0.8	2.5	5.8	6.4	4.0
Chemicals	2.5	3.0	2.6	5.0	3.3
Biomedical	-5.4	10.6	29.0	-28.0	-0.6
Pharmaceuticals	-7.3	8.5	28.3	-30.5	-2.5
Medical technology	11.3	26.3	35.0	-5.3	15.6
Transport engineering	23.6	13.4	18.1	22.0	23.5
Construction	14.4	22.4	20.1	24.3	20.3
Services	7.7	8.6	8.5	7.7	8.1

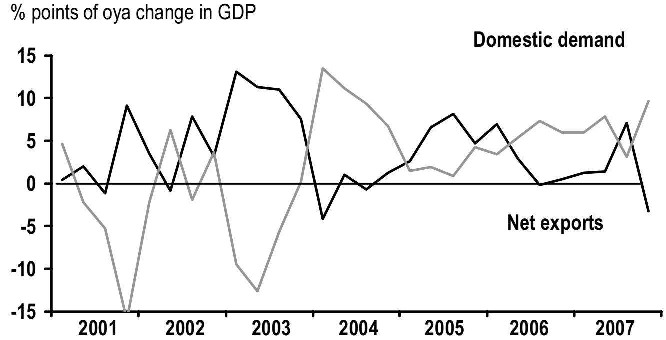
Singapore: contributions to GDP growth

% points of oya change in GDP



Singapore: contributions to GDP growth

% points of oya change in GDP



Singapore inflation revised higher but MAS policy restrained by growth concerns

While the government revised down its GDP forecast for 2008 last week, the MAS revised its inflation forecast higher. The MAS now expects consumer prices to rise 4.5-5.5%y/y, up from 3.5-4.5% previously (and 2.0-3.0% as of November). Such high inflation is a concern, but so too is growth. Moreover, the average figure for 2008 masks the changing contours of the inflation trajectory: inflation has risen rapidly since midyear 2007 owing to a combination of supply-side impetus from high food, oil, and housing costs, demand-pull pressures, and a 2%-point GST rate hike. However, inflation is expected to slow in 2H08 (first chart), reflecting more moderate GDP growth (second chart), base effects from the GST hike last July, and less rapid commodity price inflation compared to last year.

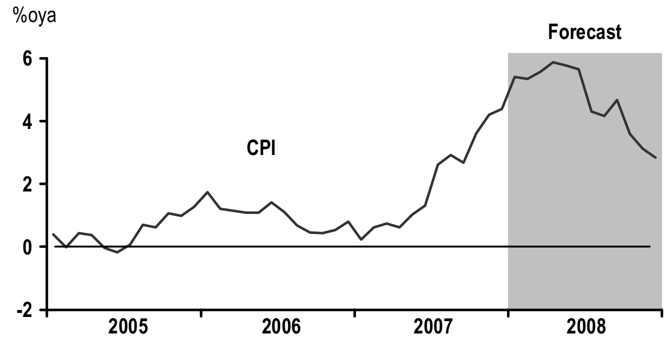
Since the MAS is a forward-looking institution, we expect it to be looking toward the inflation-growth trade-off at year end 2008 and in 2009 when it meets in April. The tone of the April policy statement will thus likely be more dovish than the last one, as global economic conditions have deteriorated significantly. We expect policy to remain unchanged in April as the MAS tries to balance high inflation with growing risks to the growth outlook.

2008 budget walks a fine line

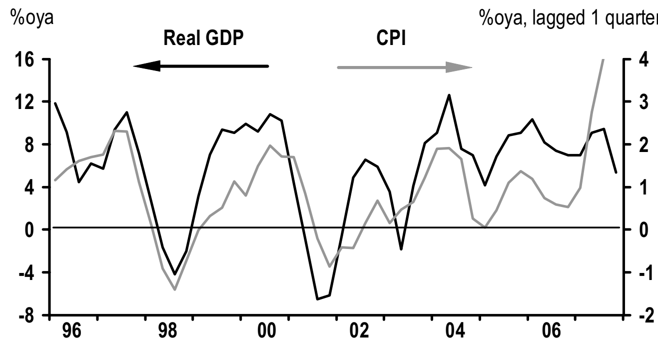
The Singapore government's budget for FY08, which starts April 1, was released last week, forecasting a slight deficit (table). This follows a record estimated surplus in FY07 owing to unexpectedly high tax revenues. The expected deterioration stems from a large increase in special transfers, and softer revenue growth due to slower economic growth. However, government estimates tend to be cautious, so the FY08 budget period may still finish in surplus.

Budget handouts for FY08 were much as expected, but the unprecedented size of largesse suggests that fiscal policy is meant to stimulate growth. Total government distributions in FY08 should total a record SG$5.4 bn, or roughly 2% of GDP. However, the government is attempting a fine balance between supporting growth and restraining inflation. Thus, special transfers will be targeted at specific segments of the population, such as the poor and elderly, who have been hit hardest by rising living costs. On the structural side, the government announced initiatives to promote industries such as finance, specifically wealth management and insurance. It aims also to increase the number of high-tech start-ups and the amount of research and development done in Singapore, to enhance the country's long-term competitiveness in high value-added sectors.

Singapore: CPI inflation - actual and forecast



Singapore: real GDP and CPI inflation



Singapore: FY2007 and FY2008 budgets
S$ billion, fiscal years beginning April 1

	Revised FY2007	Estimated FY2008	Change
Operating revenues	39.7	39.8	0.5
Tax revenues	35.0	34.7	-0.8
Fee revenues	4.7	5.1	10.1
Total expenditure	33.3	37.5	12.5
Operating expenditure	26.2	29.0	10.6
Development expenditure	7.1	8.5	19.2
Primary balance	6.4	2.4	-62.4
Special transfers:	2.2	5.4	145.5
Growth dividends	0.0	0.9	
GST credits	0.5	0.5	
Senior citizens' bonus	0.1	0.1	
Top-up post-secondary education	0.2	0.5	
SME assistance	0.0	0.1	
LIFE bonus	0.0	0.3	
National research fund	0.5	0.8	
Workfare income supplement	0.3	0.0	
Other top-up funds	0.3	1.6	
Other transfers	0.2	0.8	
Net investment income	2.3	2.2	
Overall budget balance	6.5	-0.8	

Indonesia:

Data releases and forecasts

Week of February 25 - 29

No data releases expected.

Review of past week's data

No data released.

Malaysia:

Data releases and forecasts

Week of February 25 - 29

Mon Feb 25 6:00pm

Bank Negara Policy Statement

	Nov	Dec	Jan	Feb
% p.a.	3.50	3.50	3.50	3.5

Balanced concerns about inflation and growth should keep BNM on hold again at this next policy meeting.

Wed Feb 27

Real GDP
Percent change

	1Q07	2Q07	3Q07	4Q07
oya	5.5	5.8	6.7	6.3
q/q, saar	7.1	5.0	9.7	3.6

The economy likely expanded at a more moderate pace than in previous quarters, reflecting a less supportive external environment and less robust domestic demand.

Review of past week's data

Consumer prices (Feb 20)
%oya

	Nov	Dec	Jan
All items	2.3	2.4	2.3
(%m/m, sa)	0.5	0.3	0.3

Inflation came in basically as expected (consensus 2.4%oya). Food and oil prices led the overall price rise. Through the monthly volatility, CPI inflation rose to 4.1%3m/3m, saar, from 2.8% in November. Core prices (excluding food and transportation) rose 0.2%m/m, sa, and accelerated to 1.9%3m/3m, saar, from 1.4% in December. The upward movement in inflation on both measures suggests that pressures are picking up beyond just food and oil prices.

On a year-over-year ago basis, food and beverage prices, and the alcoholic beverages and tobacco component, contributed 1.4% points to the 2.3% measure of headline inflation, while housing, water, electricity, gas, and other fuels contributed another 0.3% point. The rest of the index contributed 0.6% point.

Philippines:

Data releases and forecasts

Week of February 25 - 29

During the week

Government budget
Bn pesos

	Oct	Nov	Dec	Jan
Balance	-1.5	54.1	-22.0	__
Revenue	83.7	148.3	90.3	__
Expenditure	85.2	94.2	112.4	__

The fiscal position is expected to show that recurring revenues remain soft even as overall revenues were lifted by privatizations.

Tue Feb 26 9:00am

Merchandise trade
US$ billion, nsa

	Sep	Oct	Nov	Dec
Imports	4.7	5.2	5.1	4.7
%oya	8.9	9.9	12.8	12.5

Review of past week's data

No data released.

Singapore:

Data releases and forecasts

Week of February 25 - 29

Mon Feb 25 1:30pm

Consumer prices
%oya

	Oct	Nov	Dec	Jan
All items	3.6	4.2	4.4	5.8
(%m/m, sa)	1.3	0.6	0.5	0.6

Inflation likely rose in January, reflecting continued increase in supply-side pressures, and higher property valuations from which imputed rents are calculated. This will create a sharp rise in the over-year-ago figure.

Tue Feb 26 1:00pm

Industrial production
Percent change

	Oct	Nov	Dec	Jan
%oya	2.8	-0.5	-1.7	18.6
%m/m, sa	-1.5	6.4	-4.7	12.6

Biomedical production fell considerably during the last two months of 2007. We expect a big rebound in January. Along with frontloading of shipments ahead of the Chinese new year, this should have provided a large boost to monthly IP.

Review of past week's data

Merchandise trade (Feb 18)

US$ billion, nsa

	Nov	Dec	Jan	
Trade balance	1.9	2.0	~~2.0~~	*2.8*
Exports	26.7	26.0	~~25.9~~	*29.7*
Non-oil domestic (NODX)	10.1	9.1	~~9.7~~	*10.8*
(%m/m, sa, US$ terms)	-0.1	-5.0	~~1.6~~	*13.6*
(%oya, US$ terms)	3.9	1.5	~~-0.9~~	*10.5*

NODX exceeded expectations last month (consensus 1.3%oya). Exports outside of biomedical products were surprisingly strong, no doubt affected by frontloading of shipments prior to the Chinese new year holidays in early February. Through the monthly volatility, NODX growth remained sluggish at 4.1%3m/3m, saar. We expect to see negative payback in the current month for the Chinese new year timing effect, and NODX growth should be soft in the months ahead because of weaker global growth.

Electronics exports surged 12.9%m/m, sa last month. Prior to the January bounce, electronics exports had performed poorly since midyear 2007. Given the deterioration that has occurred in global demand conditions and the extreme strength in the January figure, the recent surge in electronics exports was most likely due to frontloading of shipments prior to the Chinese new year, not the sign of a new trend. Electronics exports will likely be soft until 2H08, when global demand is expected to pick up, and when new production facilities are expected to come on line in Singapore.

Thailand:

Data releases and forecasts

Week of February 25 - 29

Mon
Feb 25
9:30am

Real GDP

Percent change

	1Q07	2Q07	3Q07	4Q07
%oya	4.2	4.3	4.9	5.5
%q/q, saar	5.5	4.6	5.8	6.0

Growth in 4Q07 likely recovered modestly following the pickup in private domestic demand. This was likely complemented by an increase in net exports thanks to stronger exports.

Wed
Feb 27
02:30pm

BoT monetary policy meeting

% p.a.

	Nov	Dec	Jan	Feb
1-day repo rate	3.25	3.25	3.25	3.00

The BoT is expected to lower its policy rate 25bp in the expectation of lower inflation rates in 2H08.

Fri
Feb 29
2:30pm

Merchandise trade

US$ billion, nsa

	Oct	Nov	Dec	Jan
Trade balance	1.4	2.0	1.1	1.3
Exports, %oya	27.3	24.5	19.5	28.0
Imports, %oya	22.4	17.1	10.6	32.7

Seasonal effects likely reduced imports in January, raising the overall trade surplus.

Fri
Feb 29
2:30pm

Manufacturing production

%oya

	Oct	Nov	Dec	Jan
All items	12.6	12.1	11.7	12.4
%m/m, sa	0.3	1.4	0.9	0.5

Fri
Feb 29
2:30pm

Money supply

Bt billion

	Oct	Nov	Dec	Jan
M2	8454	8439	8317	__
%oya	3.3	1.7	1.2	__

Fri
Feb 29
2:30pm

Private investment index

	Oct	Nov	Dec	Jan
%oya	2.0	3.4	3.6	2.7
%m/m, sa	1.5	-0.6	1.5	0.3

Private investment likely continued to expand in January, with investors anticipating that the election outcome would lead to a semblance of political calm.

Fri
Feb 29
2:30pm

Private consumption index

	Oct	Nov	Dec	Jan
%oya	5.3	3.7	0.9	5.9
%m/m, sa	2.5	0.1	-1.3	0.3

Private domestic demand likely continued the expansion of 2H07.

Review of past week's data

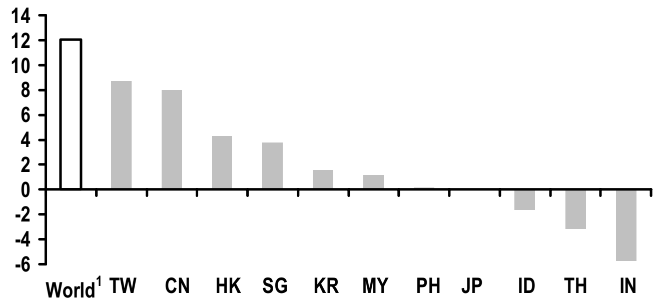
No data released.

Asia focus: tracking food prices

Food price inflation varied across the region in 2007. The largest increases relative to 2006 occurred in Greater China (China, Taiwan, and Hong Kong) and the smallest in India, Indonesia, and Japan (first chart at right). In **China** and **Hong Kong**, the rise reflected dearer meat prices, whereas in **Taiwan** it was a weather-related increase in vegetable prices (lower charts at right). However, there are some common threads across the region. One is that edible oil prices surged in 2H07, probably reflecting the rise in soy, corn, and crude palm oil prices—all common sources of cooking oil. The related impact of higher grain prices likely lifted animal feed prices as well, and thus helped to raise meat prices around the region. Despite the sharp increase in other grain prices, the price of rice—an important staple in Asia—has risen only modestly. Also notable is that cooked food prices have risen noticeably in Malaysia, Taiwan, and Singapore, probably reflecting some passthrough from basic foodstuffs which bears watching (first chart at left).

Food inflation

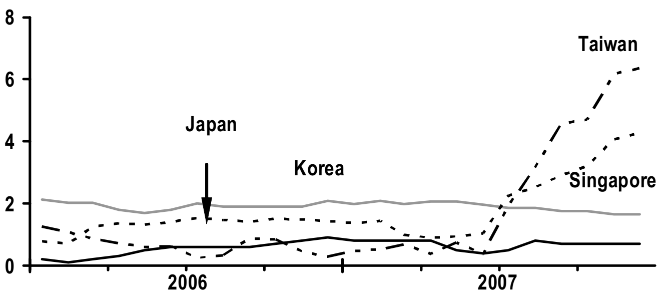
%-pt. change in over-year-ago growth rates, 2007 less 2006



1. IMF index.

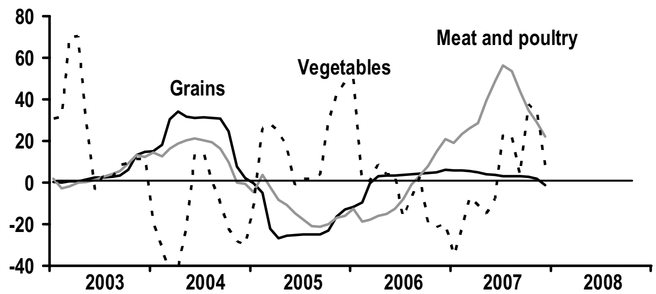
Emerging Asia: food away from home

%oya



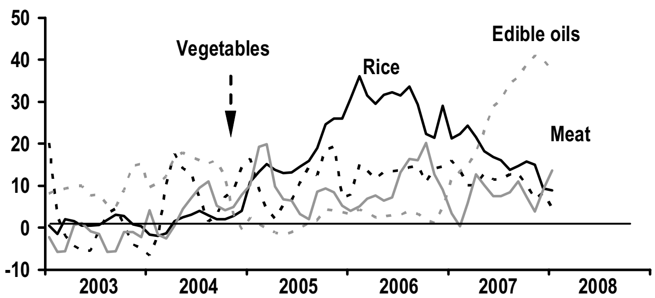
China: food inflation

%oya



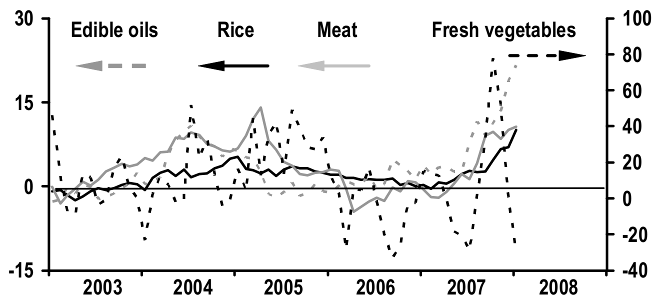
Indonesia: food inflation

%oya



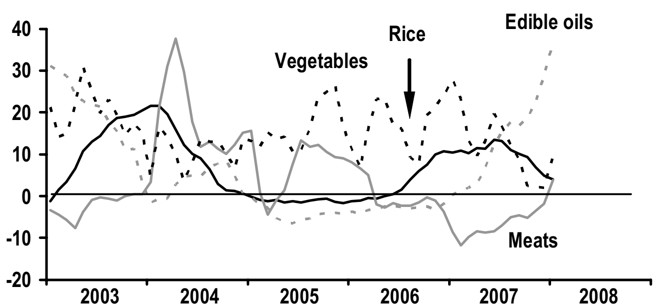
Taiwan: food inflation

%oya



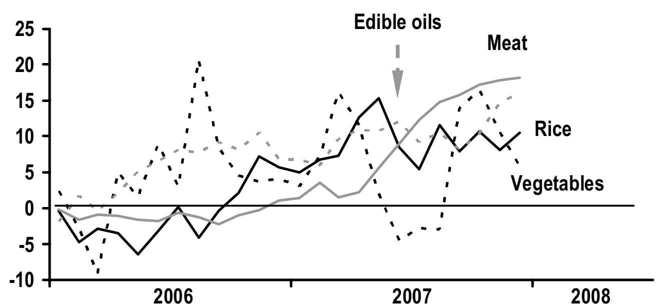
Thailand: food inflation

%oya



Hong Kong: food inflation

%oya



US economic calendar

Monday	Tuesday	Wednesday	Thursday	Friday
25 Feb **Existing home sales** (10:00am) Jan 4.77 mn **Dallas Fed survey** (10:30am) Feb Fed Governor Kroszner speaks on risk management (9:50am) Fed Governor Mishkin speaks on inflation (3:30pm) Announcement 2-year note $24bn Announcement 5-year note $14bn	**26 Feb** **PPI** (8:30am) Jan 0.5% (7.2%oya) Core 0.3% (2.2%oya) **S&P/Case-Shiller HPI** (9:30am) Dec, 4Q **Consumer confidence** (10:00am) Feb 83 **Richmond Fed survey** (10:00am) Feb **OFHEO HPI** (10:00am) 4Q -1.3%q/q (-1.0%oya) Fed Vice-Chairman Kohn speaks on the economy (12:15pm)	**27 Feb** **Durable goods** (8:30am) Jan -6.5% Ex transportation -2.5% Core cap. goods orders -3.0% Core cap. goods shipments -2.2% **New home sales** (10:00am) Jan 590k Fed Chairman Bernanke delivers semiannual monetary policy report to the Congress (10:00am) Fed Chairman Mishkin speaks on financial literacy (10:00am) Auction 2-year note $24bn	**28 Feb** **Initial claims** (8:30am) w/e prior Sat 360k **Real GDP** (8:30am) 4Q preliminary 0.7% **KC Fed survey** (11:00am) Feb Fed Chairman Bernanke delivers semiannual monetary policy report to the Congress (10:00am) Auction 5-year note $12bn	**29 Feb** **Personal income** (8:30am) Jan 0.1% Real consumption 0.0% Core PCE deflator 0.3% (2.2%oya) **Chicago PMI** (9:45am) Feb 47 **Consumer sentiment** (10:00am) Feb final 69 **Agriculture prices** (3:00pm) Feb Fed policymakers speak at monetary policy forum: - Mishkin, Rosengren (10:15am) - Poole, Evans (1:30pm) Atlanta Fed President Rosengren speaks on subprime mortgages (12:15pm)
3 Mar **ISM manufacturing** (10:00am) Feb **Construction spending** (10:00am) Jan **Light vehicle sales** Feb Philadelphia Fed President Plosser speaks on monetary policy (8:00am) Fed Governor Kroszner speaks on the economy (2:00pm)	**4 Mar** Fed Chairman Bernnake speaks at community bankers' conference (9:00am) Fed Governor Mishkin speaks to economists (12:15pm)	**5 Mar** **ADP employment** (8:15am) Feb **Productivity and costs** (8:30am) 4Q revised **ISM nonmanufacturing** (10:00am) Feb **Factory orders** (10:00am) Jan **Beige book** (2:00pm) Cleveland Fed President Pianalto speaks to money managers in New York (7:30pm)	**6 Mar** **Initial claims** (8:30am) w/e prior Sat **Pending home sales** (10:00am) Jan **Flow of funds** (12:00pm) 4Q St Louis Fed President Poole speaks in Illinois (8:00pm)	**7 Mar** **Employment report** (8:30am) Feb **Consumer credit** (3:00pm) Jan Kansas City Fed President Hoenig speaks at finance conference (TBA) Fed Governor Mishkin speaks about central banking (8:30am)
10 Mar **Wholesale trade** (10:00am) Jan Announcement 10-year note (r) $9bn	**11 Mar** **Wholesale trade** (12:01am) 2Q **NFIB survey** (7:30am) Feb **International trade** (8:30am) Jan	**12 Mar** **JOLTS** (10:00am) Jan **Federal budget** (2:00pm) Feb	**13 Mar** **Initial claims** (8:30am) w/e prior Sat **Retail sales** (8:30am) Feb **Import prices** (8:30am) Feb **Business inventories** (10:00am) Jan Auction 10-year note (r) $9bn	**14 Mar** **CPI** (8:30am) Feb **Consumer sentiment** (10:00am) Mar prelim
17 Mar **Current account** (8:30am) 4Q **Empire State survey** (8:30am) Mar **TIC data** (9:00am) Jan **Industrial production** (9:15am) Feb **NAHB survey** (1:00pm) Mar	**18 Mar** **PPI** (8:30am) Feb **Housing starts** (8:30am) Feb **FOMC meeting**	**19 Mar**	**20 Mar** **Initial claims** (8:30am) w/e prior Sat **Philadelphia Fed survey** (10:00am) Mar **Leading indicators** (10:00am) Feb	**21 Mar** **Good Friday** **Markets closed**

JPMorgan Chase Bank, New York
Silvia Pepino
Maryse Pogodzinski
Marta Bastoni

Euro area economic calendar

Monday	Tuesday	Wednesday	Thursday	Friday
25 Feb ECB president Jean-Claude Trichet speaks in Frankfurt, Germany	**26 Feb** **Germany:** GDP final (08:00am) 4Q07 1.1%q/q ,saar IFO bus.survey (10:00am) Feb 102.2 Index, sa **France:** Housing starts (08:45am) Jan **Italy:** ISAE bus. conf. (09:30am) Feb 91.5 Index, sa **Netherlands:** CBS cons. conf. (09:30am) Feb -2%bal, sa CBS bus. conf. (09:30am) Feb 8.5%bal, sa	**27 Feb** **Euro area:** M3 (10:00am) Jan 11.4%oya **Germany:** Import prices (08:00am) Jan 4.7%oya , nsa GfK cons. conf. (08:10am) Mar 4.5 Index, sa **Belgium:** GDP prelim (03:00pm) 4Q07 ECB's Lorenzo Bini Smaghi speaks in Firenze , Italy (12:45pm)	**28 Feb** **Euro area:** Retail PMI (10:00am) Feb 48.0 Index, sa **Germany:** CPI 6 states & prelim Feb 2.5%oya Employment (09:55am) Jan 34 ch. m/m, 000s, sa Unemployment (09:55am) Feb -50 ch. m/m, 000s, sa **France:** PPI (08:50am) Jan 4.8%oya, nsa INSEE cons. conf (08:45am) Feb -34 Index, sa **Belgium:** CPI final(11:30am) Feb 3.5%oya, nsa ECB president Jean-Claude Trichet speaks in Amsterdam , Netherlands (03:15pm)	**29 Feb** **Euro area:** HICP final (11:00am) Jan 3.2%oya, nsa Unemployment (11:00am) Jan 7.1% EC bus. conf. (11:00am) Feb 1%bal, sa EC cons. conf. (11:00am) Feb -12%bal, sa **Germany:** Retail sales (08:00am) Jan 0.5%m/m, sa CPI final (08:00am) Jan 2.6%oya **Italy:** CPI prelim (11:00am) Feb 2.9%oya, nsa GDP final (12:00pm) 4Q07 -0.8%q/q ,saar **Spain:** HICP flash (09:00am) Feb 4.4%oya, nsa
3 Mar **Euro area:** PMI mfg final (10:00am) Feb HICP flash (11:00am) Feb **Germany:** PMI mfg (09:45am) Feb **France:** PMI mfg (09:50am) Feb **Italy:** PMI mfg (09:45am) Feb PPI (10:00am) Jan	**4 Mar** **Euro area:** PPI (11:00am) Jan GDP prelim (11:00am) 4Q	**5 Mar** **Euro area:** PMI services final (10:00am) Feb PMI composite final (10:00am) Feb Retail sales (10:00am) Jan **Germany:** PMI services (09:55am) Feb **France:** PMI services (09:50am) Feb **Italy:** PMI services (09:45am) Feb	**6 Mar** **Euro area:** ECB rate announcement (01:45pm) ECB press conference (02:30pm) **Germany:** Manufacturing orders (11:00am) Jan **France:** Monthly budget situation (08:45am) Jan **Netherlands:** CPI (09:30am) Feb	**7 Mar** **Germany:** Industrial production (12:00pm) Jan
10 Mar **Germany:** Foreign trade (08:00am) Jan **France:** Industrial production (08:45am) Jan Foreign trade (08:45am) Jan **Italy:** Industrial production (10:00am) Jan	**11 Mar** **Germany:** ZEW survey (11:00pm) Mar	**12 Mar** **Euro area:** Industrial production (11:00pm) Jan **France:** CPI (08:45am) Feb	**13 Mar** **Euro area:** ECB monthly bulletin (10:00pm) Mar **France:** Employment final (08:45am) 4Q **Italy:** CPI final (10:00am) Feb **Netherlands:** Industrial production (09:30am) Jan **Spain:** CPI final (09:00am) Feb	**14 Mar** **Euro area:** Labor costs (11:00pm) 4Q CPI (11:00pm) Feb **Germany:** CPI final (08:00am) Feb
17 Mar	**18 Mar** **Italy:** Foreign trade (10:00am) Jan	**19 Mar** **Euro area:** Foreign trade (11:00pm) Jan **Germany:** Import prices (08:00am) Feb **Italy:** Industrial new orders (10:00am) Jan **Belgium:** BNB cons. conf. (03:00pm) Mar	**20 Mar** **Euro area:** PMI flash (10:00am) Feb Mfg, Services, Composite **Germany:** PPI (08:00am) Feb **Italy:** Labor force survey (10:00am) 4Q	**21 Mar** **France:** Cons. of mfg. goods (08:45am) Feb **Italy:** ISAE cons. conf. (10:00am) Mar

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Japan economic calendar

Monday	Tuesday	Wednesday	Thursday	Friday
25 Feb	**26 Feb** **Corporate service prices** (08:50am) Jan 1.3%oya **Shoko Chukin small business sentiment** (02:00pm) Feb 43.5, DI	**27 Feb**	**28 Feb** **IP preliminary** (08:50am) Jan 0.0%m/m, sa **Total retail sales** (08:50am) Jan -1.0%oya BoJ Board Member Mizuno's speech at a meeting with business leaders in Oita Prefecture (11:10am)	**29 Feb** **PMI manufacturing** (08:15am) Feb 52.0, DI, sa **Nationwide core CPI** (08:30am) Jan 0.8%oya **All household spending** (08:30am) Jan -0.8%m/m, sa **Unemployment rate** (08:30am) Jan 3.9%, sa **Job offers to applicants ratio** (08:30am) Jan 0.98, sa **Housing starts** (02:00pm) Jan -9.4%oya **Construction orders** (02:00pm) Jan
3 Mar **Nominal wagers** (10:30am) Jan **Auto registrations** (02:00pm) Feb	**4 Mar** **Monetary base** (08:50am) Feb	**5 Mar** **MoF corporate survey** (08:50am) 4Q	**6 Mar** **Leading business index** (02:00pm) Jan BoJ Monetary Policy Meeting	**7 Mar** BoJ Monetary Policy Meeting and statement BoJ monthly economic report (03:00pm) BoJ Governor Fukui's press conference (03:30pm)
During the week: **Cabinet Office private consumption index** Jan				
10 Mar **Private machinery orders** (08:50am) Jan **M2+CDs** (08:50am) Feb **Economy watcher survey** (02:00pm) Feb	**11 Mar**	**12 Mar** **GDP 2nd est.** (08:50am) 4Q **Corporate goods prices** (08:50am) Feb **Current account** (08:50am) Jan **Consumer sentiment** (02:00pm) Feb Minutes of Feb 14-15 BoJ MPM (08:50am) BoJ Board Member Noda's speech at a meeting with business leaders in Gunma Prefecture (11:10am)	**13 Mar** **IP final** (01:30pm) Jan	**14 Mar**
17 Mar **Tertiary sector activity index** (08:50am) Jan **Construction spending** (02:00pm) Jan	**18 Mar**	**19 Mar** **All sector activity index** (08:50am) Jan	**20 Mar** ***Holiday***	**21 Mar** **Flow of funds** (08:50am) 4Q
During the week: **Nationwide department store sales** (02:30pm) Feb				

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Canada economic calendar

Monday	Tuesday	Wednesday	Thursday	Friday
25 Feb	**26 Feb** **Employment payrolls** (08:30am) Dec -0.1%m/m **Average weekly earnings** (08:30am) Dec 3.4%oya **Employment insurance claims** (08:30am) Dec 0.8%m/m Federal Budget 2008 (4:00pm) *Bank of Canada Senior Deputy Governor Paul Jenkins and Deputy Governor John Murray appear before the Standing Committee on Industry, Science and Technology and speak on "The Impact of the Appreciating Value of the Canadian Dollar on the Canadian Economy", House of Commons, Ottawa, ON (11:00am)* Details in a media advisory.	**27 Feb** 30-year real return bond auction (12:00pm) C$500mn	**28 Feb** Details of 5-year switch repurchase bond auction on Mar 5	**29 Feb** **Industrial PPI** (08:30am) Jan 1.3%m/m **Current account** (08:30am) 4Q C$-0.5bn, sa
3 Mar **Monthly GDP** (08:30am) Dec -0.5%m/m **Real GDP** (08:30am) 4Q 0.8%q/q ar	**4 Mar** Bank of Canada interest rate announcement (09:00am) Mar -50bp to 3.5%	**5 Mar** 5-year switch repurchase bond auction	**6 Mar** **Building permits** (08:30am) Jan -4.3%m/m **Ivey purchasing managers index** (10:00am) Feb 56.0 **Ivey Sentiment index, sa** (10:00am) Feb 52.9	**7 Mar** **Employment** (07:00am) Feb 0.0Km/m **Unemployment rate** (07:00am) Feb 5.9%
10 Mar **Housing starts** (8:15am) Feb 205,000	**11 Mar** **New house prices** (08:30am) Jan 6.0%oya **Trade balance** (08:30am) Jan C$2.79bn, sa	**12 Mar**	**13 Mar** **Industrial capacity utilization rate** (08:30am) 4Q 81.8% Details of 10-year switch repurchase bond auction on Mar 19	**14 Mar** **Labor productivity** (08:30am) 4Q -0.2%q/q, saqr **Unit labor cost** (08:30am) 4Q 1.1%q/q, saqr **Wage settlements** (10:00am) Jan 3.9%
17 Mar **New motor vehicle sales** (08:30am) Feb 7.0%m/m **Manufacturing sales** (09:30am) Jan ___ **Manufacturing new orders** (09:30am) Jan ___ **Existing home sales** (09:30am) Feb ___	**18 Mar** **CPI** (08:00am) Feb ___ **CPI Core** (08:00am) Feb ___	**19 Mar** **Wholesale sales** (10:30am) Jan ___ 10-year switch repurchase bond auction	**20 Mar** **Leading indicators smoothed** (09:30am) Feb ___	**21 Mar** Holiday: Good Friday

Note: Times are Eastern Daylight Saving Time (EDST).

JPMorgan Chase Bank, New York
Tejal Ray
Florencia Vazquez
Andres Ortiz
Fabio Akira

Latin America economic calendar

Monday	Tuesday	Wednesday	Thursday	Friday
25 Feb **Argentina:** Merchandise trade Jan US$1.15bn **Brazil:** FGV CPI IPC-S Feb 25 0.25%m/m FDI Jan US$4.5bn Current account Jan -US$2.5bn **Chile:** Monetary aggregates Feb 15 International reserves Feb 15 **Mexico:** BoP 4Q	**26 Feb** **Brazil:** Fipe CPI weekly Feb 21 0.15%/m/m IPCA-15 Feb 0.62%m/m	**27 Feb** **Brazil:** Net Debt as % GDP Jan 42.6% Primary budget balance Jan -BRL12.9bn **Mexico:** Manufacturing indicator Dec	**28 Feb** **Argentina:** Construction activity Jan 11.5%oya IP (INDEC) final Jan **Brazil:** IGP-M final rel Feb 0.63%m/m Unemployment rate Jan 8.1% **Chile:** Unemployment rate Jan 7.3%oya Industrial sales Jan IP Jan **Mexico:** Indicator of overall econ activity Dec	**29 Feb** **Colombia:** Unemployment Jan **Mexico:** Monetary aggregates Jan Public sector Indicator Jan Construction indicator Dec
3 Mar **Argentina:** Tax revenues Feb Help-wanted index Feb **Brazil:** FGV CPI IPC-S Feb 29 Trade balance Feb **Mexico:** Worker remittances Feb IMEF survey Feb Banxico expectations survey Feb Manufacturing PMI Feb	**4 Mar** **Mexico:** Central bank reserves	**5 Mar** **Brazil:** Fipe CPI monthly Feb IP Jan COPOM meeting Mar **Chile:** CPI Feb WPI Feb Nominal wages Jan Real wages Jan Econ activity (IMACEC) Jan **Mexico:** Consumer confidence Feb	**6 Mar** **Argentina:** CPI Feb WPI Feb	**7 Mar** **Chile:** International reserves Feb 29 Monetary aggregates Feb 29 Merchandise trade Feb **Mexico:** CPI Feb Core CPI Feb
During the week: **Argentina:** Auto production Feb Cement sales Feb				
10 Mar **Brazil:** FGV CPI IPC-S Mar 7 IGP-DI Feb **Mexico:** Wage settlements Feb Auto sector Feb Trade balance (revised) Jan	**11 Mar** **Brazil:** IPCA Feb **Mexico:** Central bank reserves Fixed investment Dec	**12 Mar** **Brazil:** Fipe CPI weekly Mar 7 IGP-M 1st rel Mar GDP 4Q	**13 Mar** **Argentina:** GDP 4Q **Chile:** BCCh meeting Mar	**14 Mar** **Brazil:** Retail sales Jan **Mexico:** Banxico meeting
During the week: **Chile:** Consumer confidence Feb				
17 Mar **Argentina:** Consumer confidence (UTDT) Mar	**18 Mar**	**19 Mar** **Argentina:** Current account 4Q Indicator of overall activity Jan *Holiday: Venezuela*	**20 Mar** *Holiday: Argentina, Mexico, Venezuela*	**21 Mar** *Holiday: Argentina, Brazil, Chile, Mexico, Venezuela*

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JPMorgan Chase Bank
Malcolm Barr
Allan Monks
Nicola Mai

JPMorgan

UK/Scandinavia/Switzerland economic calendar

Monday	Tuesday	Wednesday	Thursday	Friday
25 Feb **United Kingdom:** BBA mortgage lending (09:30am) Jan 4.7 ch £bn, sa **Sweden:** Trade balance (09:30am) Jan Riksbank's monetary policy meeting minutes (09:30am) **Switzerland:** SNB's Jean-Pierre Roth speaks in Vienna	**26 Feb** **United Kingdom:** CBI distributive trades (12:00pm) Feb 1%bal Business investment Prelim (01:15pm) 4Q 1.5%q/q,sa Speech by BoE Deputy Governor Rachel Lomax at the Institute of Economic Affairs Annual Conference **Sweden:** Riksbank Governor Ingves reports on the monetary policy (10:00am) **Switzerland:** UBS consumption indicator (10:00am) Jan	**27 Feb** **United Kingdom:** GDP prelim (09:30am) 4Q 2.4 q/q ,saar Index of services (09:30am) Dec 0.2m/m ,sa Speech by Sir John Gieve at the Euro money Bond Investors Congress **Sweden:** Business tendency (09:15am) Feb Consumer confidence (09:15am) Feb **Norway:** AKU unemployment (10:00am) Dec	**28 Feb** **Sweden:** PPI (09:30am) Jan Retail sales (09:30am) Jan **Norway:** Labor directorate (10:00am) Feb **Switzerland:** Employment (09:15am) 4Q	**29 Feb** **United Kingdom:** Nationwide HPI (07:00am) Feb -0.1%m/m ,sa M4 money supply & lending final (09:30am) Jan Net secured lending to individuals (09:30am) Jan 8.5, ch,m/m Mortgage approvals 71K,sa GFK cons. conf. (10:30am) Feb **Sweden:** GDP (09:30am) 4Q 0.7%q/q, sa **Norway:** Retail sales (10:00am) Jan Credit indicator (10:00am) Jan Quarterly wage index (10:00am) 4Q **Switzerland:** KOF leading indicator (11:30am) Feb 1.45 Index , sa
3 Mar **United Kingdom:** PMI mfg (09:30) Feb **Sweden:** PMI mfg (09:30am)Feb **Switzerland:** PMI mfg (09:30) Feb 59.0%bal, sa	**4 Mar** **United Kingdom:** PMI construction (09:30) Feb **Norway:** PMI mfg (09:00am) Feb **Switzerland:** GDP 4Q 2.0%q/q, saar CPI (07:45am) Feb 2.2%oya ,nsa	**5 Mar** **United Kingdom:** Nationwide cons. conf. (12:01am) Feb PMI services (09:30am) Feb NTC job report (12:01am) Feb	**6 Mar** **United Kingdom:** MPC rate announcement (12:00pm) New car regs (11:30) Feb **Switzerland:** SECO unemployment (07:45am) Feb 2.6%,sa	**7 Mar** **Norway:** Industrial production (10:00am) Jan Jarle Bergo Colloquium; conference at Norges Bank (09:00am)
During the week:	**United Kingdom:** Halifax HPI Feb			
10 Mar **United Kingdom:** PPI (09:30) Feb Industrial production (09:30) Feb **Sweden:** Industrial production (09:30am) Feb Industrial orders (10:00am) Feb **Norway:** PPI (10:00am) Feb CPI (10:00) Feb	**11 Mar** **United Kingdom:** BRC retail sales monitor (12:01am) Feb DLCG HPI (09:30) Jan **Sweden:** CPI (10:30am) Feb Activity index (10:30am) Feb	**12 Mar** **United Kingdom:** Trade Balance (09:30am) Jan UK Annual Budget (01:30am) **Sweden:** AMS unemployment (11:00am) Feb	**13 Mar** **United Kingdom:** BoE/Gfk Inflation Attitudes Survey Feb **Sweden:** Labor force survey (10:30am) Feb **Norway:** Norges bank rate announcement and Monetary Policy Report (02:00pm) No change expected **Switzerland:** SNB policy rate decision (10:30am) No change expected	**14 Mar** **Norway:** Trade balance (11:00am) Feb **Switzerland:** Monthly bulletin of banking stats (09:00am) Mar
During the week:	**United Kingdom:** RICS house price survey Feb			
17 Mar **United Kingdom:** BoE Quarterly Bulletin 2008 Q1	**18 Mar** **United Kingdom:** CPI (09:30am) Feb	**19 Mar** **United Kingdom:** MPC minutes (09:30am) Labor mkt. report (09:30am) Feb **Switzerland:** Monthly statistical bulletin (09:00am) Mar	**20 Mar** **United Kingdom:** Retail sales (09:30am) Feb Public sector finances (09:30am) Feb Provisional estimates of M4 & lending (09:30am) Feb **Switzerland:** Merchandise Trade (08:15am) Feb	**21 Mar**
During the week:	**Switzerland:** Industrial production 4Q , Producer & Import prices Feb			

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JPMorgan Chase Bank
Neena Sapra
Nora Szentivanyi

Emerging Europe/South Africa/Israel economic calendar

Monday	Tuesday	Wednesday	Thursday	Friday
25 Feb **Hungary:** Monetary policy announcement (2.00pm) +25bp **Israel:** Monetary policy announcement no change **Poland:** Retail sales (10.00am) Jan 18.0%oya Unemployment (10.00am) Jan	**26 Feb** **Slovakia:** Monetary policy announcement no change **South Africa:** GDP (11.00am) 3Q 4.5%oya	**27 Feb** **Poland:** Monetary policy announcement +25bp **South Africa:** CPIX (11.30am) Jan 8.4%oya	**28 Feb** **Slovakia:** PPI (9.00am) Dec **Hungary:** Unemployment (9.00am) Jan **Russia:** International reserves w/e prior Fri (10.00am) **South Africa:** PPI (11.30am) Jan 10.4%oya	**29 Feb** **Russia:** Monetary base 25 Feb **Poland:** GDP (10.00am) Q4 6.1%oya **Hungary:** Producer prices (9.00am) Jan 2.0%oya **South Africa:** PSCE (8.00am) Jan 21.4%oya M3 (8.00am) Jan 24.2%oya Customs trade (2.00pm) –R5.5bn **Turkey:** Foreign trade (5.00pm) Jan -$6.3bn
During the week:				
3 March **Poland**: GDP (10.00am) 4Q **Turkey**: CPI (5.00pm) Feb 8.2%oya PPI (5.00pm) Feb 6.3%oya **Russia**: PMI (10.00am) Feb Reserve fund, National well-being fund (10.00am) Feb	**4 March**	**5 March** **Hungary**: Industrial output (9.00am) Jan Trade balance (9.00am) Jan **Russia**: CPI (10.00am) Feb	**6 March** **Czech**: Trade balance (9.00am) Jan Average real wage (9.00am) 4Q Current account (9.00am) 4Q **Russia:** International reserves w/e prior Fri (10.00am)	**7 March** **Russia:** Monetary base 3 March **Hungary:** Industrial output (9.00am) Jan Trade balance (9.00am) Jan
During the week:				
10 March **Czech**: CPI (9.00am) Feb Unemployment (9.00am) Feb **Hungary:** Budget balance (5.00pm) Feb **Turkey**: Industrial production (10.00am) Jan	**11 March** **Hungary**: CPI (9.00am) Feb	**12 March** **Czech**: Industrial output (9.00am) Feb	**13 March** **Czech**: Current account (9.00am) Jan **Poland**: Current account (2.00pm) Jan **Russia:** International reserves w/e prior Fri (10.00am)	**14 March** **Czech**: PPI (9.00am) Feb **Poland**: CPI (2.00pm) Feb **Russia:** Monetary base 10 March
During the week:				
17 March	**18 March** **Czech**: Retail sales (9.00am) Jan **Poland**: PPI (2.00pm) Feb Industrial output (2.00pm) Feb	**19 March** **Hungary**: Average gross wages (9.00am) Jan	**20 March** **Russia:** International reserves w/e prior Fri (10.00am)	**21 March** **Hungary**: Retail trade (9.00am) Jan **Russia:** Monetary base 17 March **Poland**: Net core inflation (2.00pm) Jan, Feb
During the week:				

JPMorgan Chase Bank, Hong Kong
Peng Chen
Youna Kim
Sneha Sanwlani

Non-Japan Asia economic calendar

Monday	Tuesday	Wednesday	Thursday	Friday
25 Feb **Malaysia:** Overnight rate (06:00pm) Feb No change expected **Singapore:** CPI (01:00pm) Jan 5.8 %oya **Taiwan:** Money supply (04:20pm) Jan **Thailand:** GDP (09:30am) 4Q 5.5 %oya *Holiday Philippines*	**26 Feb** **Philippines:** Imports (09:00am) Dec 12.5 %oya **Singapore:** Industrial production (01:00pm) Jan 18.6 %oya **New Zealand:** RBNZ inflation expectation (03:00pm) 1Q 2.8 %q/q **Taiwan:** Industrial production (04:00pm) Jan 10.5 %oya Export orders (04:00pm) Jan 14.6 %oya Unemployment rate (04:00pm) Jan 4.0 %, sa	**27 Feb** **Australia:** Construction work done (11:30am) 4Q **Hong Kong:** GDP (04:15pm) 4Q 5.7 %oya **Malaysia:** GDP 4Q 6.3 %oya Money supply (06:00pm) Jan **New Zealand:** Building permits (10:45am) Jan 8.0 %m/m, nsa NBNZ business conf. (03:00pm) Feb -25 %bal **Taiwan:** Leading index (04:00pm) Jan 148.6 Index **Thailand:** Benchmark interest rate (02:30pm) Feb -25 bps change expected	**28 Feb** **Australia:** Private capital expenditure (11:30am) 4Q 16.1 %oya **Hong Kong:** Trade balance (04:15pm) Jan -6.7 HK$ bn **Korea:** Current account (08:00am) Jan -3.0 USD bn FKI bus. survey Feb 102.0 Index, nsa **New Zealand:** Visitor arrivals (10:45am) Jan Money supply (03:00pm) Jan *Holiday Taiwan*	**29 Feb** **Australia:** Private sector credit (11:30am) Jan 1.0 %m/m, sa **India:** GDP 4Q 8.6 %oya Budget 2008 **New Zealand:** Trade balance (10:45am) Jan -100 NZ$ mn **Singapore:** Money supply (10:00am) Jan **Thailand:** Trade balance (02:30pm) Jan US$1.3 bn Mfg. prod. (02:30pm) Jan 12.4 %oya PCI (02:30pm) Jan 5.9 %oya PII (02:30pm) Jan 2.7 %oya
During the week: **Philippines:** Budget deficit/surplus Jan				
3 Mar **Australia:** Inventories (11:30am) 4Q Company profits (11:30am) 4Q RBA comm. index (04:30pm) Feb **China:** PMI Mfg Feb **Hong Kong:** Retail sales (04:15pm) Jan PMI Feb **Indonesia:** Trade balance (03:00pm) Feb CPI (03:00pm) Feb **India:** Trade balance Jan **Korea:** Trade balance (10:00am) Feb CPI (01:30pm) Feb **Thailand:** CPI (02:30pm) Feb	**4 Mar** **Australia:** Current account (11:30am) 4Q Retail sales (11:30am) Jan RBA cash target (02:30pm) Mar **Korea:** Service sector activity (01:30pm) Jan IP (01:30pm) Jan Leading index (01:30pm) Jan **New Zealand:** ANZ commodity price (03:00pm) Feb **Singapore:** PMI (09:30pm) Feb	**5 Mar** **Australia:** GDP (11:30am) 4Q **Korea:** Money supply (12:00pm) Jan **Taiwan:** CPI (04:00pm) Feb Foreign reserves (04:20pm) Feb	**6 Mar** **Australia:** Trade balance (11:30am) Jan Building approvals (11:30am) Jan **Indonesia:** Indonesia reference rate Mar **Korea:** Cons. conf. (01:30pm) Feb **Malaysia:** Trade balance (12:01pm) Jan **New Zealand:** RBNZ official cash rate (09:00am) Feb **Philippines:** CPI (09:00am) Feb *Holiday India*	**7 Mar** **Australia:** Foreign reserves (04:30pm) Feb **Malaysia:** IP (12:01pm) Jan Foreign reserves (05:00pm) Feb **Philippines:** Money supply Jan Foreign reserves Feb **Taiwan:** Trade balance (04:00pm) Feb **Thailand:** Foreign reserves (02:30pm) Feb *Holiday Indonesia*
During the week: **Indonesia:** Consumer confidence Feb Foreign reserves Feb **Korea:** PPI Feb Foreign reserves Feb				
10 Mar **Australia:** ANZ job advertisements (11:30am) Feb New homes sales Jan **China:** PPI (11:00am) Feb **New Zealand:** QV house prices Feb	**11 Mar** **Australia:** Housing finance (11:30am) Jan **China:** CPI (10:00am) Feb **Hong Kong:** Manpower survey (12:01pm) 2Q **Philippines:** Exports (09:00am) Jan **Taiwan:** Manpower survey (12:01am) 2Q	**12 Mar** **Australia:** Westpac consumer confidence (10:30am) Mar **China:** Retail sales (10:00am) Feb **India:** IP (12:30pm) Jan **Korea:** Unemployment rate (01:30pm) Feb	**13 Mar** **Australia:** Unemployment rate (11:30am) Feb **China:** IP (10:00am) Feb **Korea:** Overnight rate (05:00pm) Mar **New Zealand:** Retail sales (10:45am) Jan PMI (12:00pm) Feb **Philippines:** Overnight rate Mar	**14 Mar** **China:** Fixed asset investment (10:00am) Feb **Hong Kong:** IP (04:15pm) 4Q PPI (04:15pm) 4Q **New Zealand:** Mfg. activity (10:45am) 4Q **Singapore:** Retail sales (01:00pm) Jan **Thailand:** Foreign reserves (02:30pm) Mar
During the week: **China:** Money supply Feb Trade balance Feb **Korea:** Nationwide dep't store sales Feb Import /Export price index Feb **Philippines:** Budget deficit/surplus Feb				
17 Mar **Philippines:** Balance of payments Feb **Singapore:** NODX (01:00pm) Feb	**18 Mar** **Hong Kong:** Unemployment rate (04:15pm) Feb **Philippines:** Unemployment rate (09:00am) Jan	**19 Mar** **Australia:** BoP imports prelim. (11:30am) Feb WMI leading index (11:30am) Jan **Malaysia:** CPI (05:00pm) Feb **New Zealand:** Credit card spending (03:00pm) Feb	**20 Mar** **Australia:** Motor vehicles sales (11:30am)Feb **Hong Kong:** CPI (04:15pm) Feb **New Zealand:** Visitor arrivals (10:45am) Feb *Holiday Indonesia, Malaysia, Philippines*	**21 Mar** **Thailand:** Foreign reserves (02:30pm) Mar **Taiwan:** Unemployment rate (04:00pm) Feb *Holiday Australia, Hong Kong, India, Indonesia, New Zealand, Philippines, Singapore*
During the week: **Korea:** GDP final 4Q **Taiwan:** Benchmark interest rate Mar				

Highlighted data are scheduled for release on or after the date shown. Times shown are local.

Global Data Diary

Week / Weekend	Monday	Tuesday	Wednesday	Thursday	Friday
25 - 29 Feb	**25 Feb**	**26 Feb**	**27 Feb**	**28 Feb**	**29 Feb**
	Euro area • Trichet speech **Hungary** • NBH meeting **Malaysia** • BNM meeting **United States** • Existing home sales (Jan)	**Canada:** Payrolls (Dec) **Germany** • GDP final (4Q) • IFO bus survey (Feb) **Italy:** ISAE bus survey (Feb) **Japan** • Shoko Chukin small bus survey (Feb) **Slovak Republic** • NBS meeting **Taiwan** • Export orders, IP (Jan) **United States** • OFHEO HPI (4Q) • PPI (Jan) • S&P/C-S HPI (Dec, 4Q)	**Euro area** • M3 (Jan) **Poland** • NBP meeting **Thailand** • BoT meeting **United Kingdom** • GDP prelim (4Q) **United States** • Durable goods (Jan) • New home sales (Jan) • Bernanke delivers semiannual monetary policy report to Congress	**Euro area** • Trichet speech **Germany** • CPI 6 states and prelim (Feb) • Employment (Jan) • Unemployment (Feb) **Japan** • IP prelim (Jan) • Retail sales (Jan) **United States** • GDP prelim (4Q) • Bernanke delivers semiannual monetary policy report to Congress	**Euro area** • EC bus survey (Feb) • HICP final (Jan) • Unemployment (Jan) **Germany** • CPI final (Jan) • Retail sales (Jan) **Japan** • Core CPI (Jan) • Household spending (Jan) • Housing starts (Jan) • PMI mfg (Feb) • Unemployment rate (Jan) **Sweden:** GDP (4Q) **United Kingdom** • Nationwide HPI (Feb) **United States** • Chicago bus survey (Feb) • Consumer sent final (Feb) • Personal income (Jan)
3 - 7 Mar	**3 Mar**	**4 Mar**	**5 Mar**	**6 Mar**	**7 Mar**
Japan • Cabinet Office private consumption index (Jan) **United Kingdom** • Halifax HPI (Feb)	**Canada** • Real GDP (4Q) **China** • PMI mfg (Feb) **Euro area** • HICP flash (Feb) • PMI mfg final (Feb) **Korea** • CPI (Feb) • Trade balance (Feb) **United Kingdom** • PMI mfg (Feb) **United States** • Construction spend (Jan) • ISM mfg (Feb) • Light vehicle sales (Feb)	**Australia** • RBA meeting **Canada** • BoC meeting **Euro area** • GDP prelim (4Q) **Korea** • IP (Jan) **Singapore** • PMI mfg (Feb) **United States** • Bernanke speech	**Australia:** GDP (4Q) **Brazil** • IP (Jan) • COPOM meeting **Euro area** • PMI services final (Feb) • Retail sales (Jan) **Japan:** MoF corp surv (4Q) **Taiwan:** CPI (Feb) **UK:** PMI services (Feb) **United States** • ADP employment (Feb) • Beige book • Factory orders (Jan) • ISM nonmfg (Feb) • Prod and costs (4Q)	**Germany** • Mfg orders (Jan) **Canada** • Ivey PMI (Feb) **United States** • Pending home sales (Jan) **Central bank meetings** • Euro area • Indonesia • New Zealand • United Kingdom	**Germany** • IP (Jan) **Japan** • BoJ meeting **Taiwan** • Trade balance (Feb) **United States** • Consumer credit (Jan) • Employment report (Feb)