GLOBAL MARKETS MONITOR

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Executive Summary

- **US: Fed to cut at least 50bps on Tuesday, possibly 75 bps.**
- **Europe: Higher Euro-zone Inflation May Reduce ECB's Flexibility; US Weakness Will Impact Europe More Than European Officials are Willing to Admit.**
- **UK: Will the BOE Cut Rates at next MPC Meeting on April 5th?**
- **Japan: The Cabinet Office Downgrades its Economic Assessment for the Second Consecutive Month; Japan's Emergency Economic Support Measures Disappoint; The Government Finally Acknowledged that Japan is in a State of Deflation; BOJ Governor Hayami to Consider Further Monetary Policy Actions to Ease Deflation.**
- **OPEC: Having agreed today to cut oil output by 1.0 million barrels a day, OPEC, however, has become a victim of its own success.**

Economic and Central Bank Monitor

North America

- **Fed to Cut Federal-Funds Rate at Tuesday's Meeting by at least 50bps:** The Fed is poised to cut again Tuesday, after two 50 bps cuts in January. The market has priced a 50 bps cut with 100 percent probability, while a 75 bps cut has a 75 percent probability. Nine out of 25 bond dealers who trade with the Fed expect a 75 bps cut. The Fed has a very tough decision to make especially considering the fragility of global markets: the DJIA fell almost 8 percent on the week, the Nasdaq has lost 23 percent thus far this year, and global markets followed the US as the Nikkei dropped below 12,000. Investors will be disappointed if they don't get more than 50bps, which commonly is considered to be an aggressive move for the Fed. Expectations have risen so much for 75 bps that, anything less could send stocks and bonds tumbling after the FOMC announcement. The last thing a central banker wants, however, is to be perceived as bailing out the stock market, due to moral hazard. During Chairman Greenspan's 13-year tenure, he has never cut the Fed funds rate by 75 bps in one day, a cut of that magnitude now may be interpreted as a move of desperation. Fed Vice Chairman, Roger Ferguson said, "There are clearly some signs that might suggest strengthening, and some signs that suggest the risks are still to the downside." Mixed economic data has also clouded the picture. On the positive side, consumer confidence has stopped falling, auto sales are not as weak as expected, steel production has ticked up and producer prices fell. The manufacturing sector is still struggling, however, as industrial production fell for the fifth consecutive month last month, the longest set of monthly declines since the 1990-91 recession. Factories reported that production fell 0.4 percent last month after a 0.6 percent drop in January. US companies, faced with falling demand, higher energy prices, mounting inventories and hence falling profits, have responded by cutting investment and payrolls. After Tuesday the FOMC does not have a scheduled meeting until May 15, if the economic situation in the US worsens or a systemic problem arises from the rapidly deteriorating Japanese economy, the Fed has no other alternative than an inter-meeting rate cut.

- **Almost Half of Fund Managers Worldwide Fear a US Recession:** According to a new survey by Merrill Lynch, 43 percent of fund managers globally think a US recession is looming, only 10 percent of fund managers expect a quick, "v-shaped" recession, as opposed to a more gradual, "u-shaped" one. The US managers were more pessimistic, forecasting US gross domestic product growth of just 1.9 percent, with the probability of a recession at 45 percent. Equipped with the highest level of cash since the survey began, a record number of managers reported that equities were undervalued and that they would buy "on the dip", despite a concern that stocks may not have bottomed yet. The last time this many managers saw the markets this cheap was in September 1998, just before the rally in equities following the Russian default, and the Asian financial crisis and the subsequent rapid easing of the Fed to stabilize financial markets. The survey said equities are still the favorite asset class, despite the growing popularity of cash and bonds among US managers. The fund managers' outlook was considerably brighter for Europe, as 84 percent of European managers are optimistic about their economies' ability to "decouple" from the US slowdown, but they are not as confident that earnings for European companies will manage to perform as well. Fund managers globally are concerned about corporate profits particularly managers in the US, UK and Asia.

Europe

- **Higher Euro-zone Inflation Reduces ECB's Flexibility:** Consumer prices were up 2.6 percent February from a year earlier, compared with a rise of only 2.4 per cent in January. This rise, combined with OPEC's decision to cut oil output and Europe's agricultural crises, will cause inflation to remain above the ECB's target ceiling of 2 percent, reducing the ECB's maneuverability to cut interest rates to mitigate the impact of the sharp US slowdown. The euro fell to a three-month low against the dollar on Friday, as traders were disappointed with the inflation news as well as ECB's decision on Thursday to leave interest rates unchanged. The euro's weakness in foreign exchange markets raises the possibility of renewed inflationary pressures from higher import costs. The ECB's reluctance to cut interest rates is depreciating the euro by raising doubts about the euro-zone's economic growth prospects. Some analysts regarded the ECB's decision as too hawkish, given the risks to European growth from both the US slowdown and Japanese economic crisis. In fact, the ECB is the only G10 monetary authority that has not lowered interest rates in the current global economic slowdown.
- **US Weakness Will Impact Europe More Than Officials are Willing to Admit:** With trade accounting for 28 percent of UK GDP, it is more dependent than most industrial nations on global growth. Although Euroland's trade dependency is lower, at 20 percent of GDP, it is still vulnerable to the problems in the US despite whatever Wim Duisenburg states to the contrary. The trade mechanism was one of the major contributors to the contagion, which infected other economies during the Asian crisis. The US inventory adjustment, not yet complete, has already damaged economic activity in Asia. Its next victim will be Europe.
- **Will the BOE Cut Rates at next MPC Meeting on April 5th?** Robust UK retail sales, positive housing market data, and strong mortgage lending and consumer borrowing, offset by a declining UK manufacturing sector, continued weak US economy, and a global sell-off in equities, present the BOE with a dilemma at its next MPC meeting on April 5th. With tame UK inflation (for the moment) and slower pay growth, the BOE should take the opportunity to cut rates and add much needed global liquidity. The OPEC output cut and agricultural crisis will put the BOE in bind, in the months to come, and hinder its monetary flexibility. Most economists, at the moment however, do not anticipate a rate cut. The BOE has only cut interest rates by 25 bps to 5.75 percent, since the US downturn started. The MPC is likely to be split 4 to 5 over whether to give more weight to the weak global economy or to the strength at home which will be further fueled by the previous cut and this month's fiscal stimulus package. Ian Plenderleith, a BOE MPC member, said that the BOE was prepared to cut rates again if the US slowdown turned out worse than expected. "That would, of course be grounds for us to contemplate further easing of our monetary stance." The risks to the BOE's projections of economic activity lay " predominately on the downside," he added, and "the US slowdown could have a material dampening effect on UK activity."

Asia/Pacific

- **The Japanese Cabinet Office Downgrades its Economic Assessment for the Second Consecutive Month:** The Japanese government downgraded its outlook for the second consecutive month, emphasizing the rapid deterioration in domestic conditions as weak stock markets and slowing global growth batter Japan's economy. The major contributing factor behind the government's decision to downgrade its economic assessment was the sharp drop in industrial production during January. Output plummeted 4.2 percent from the month earlier, as shipments of automobiles and high tech goods suffered from continued weak demand in the U.S. Exports have fallen as the U.S. economy has slowed causing Japanese manufacturers to slash production. Most disconcerting are the signs of a slowdown in domestic business, practically the only area of private sector growth in Japan. "While we expect capital investment to remain firm, there are indications it will begin to slow," the monthly report said. Government hopes for an economic recovery is dependent upon continued strength in the business sector. But a drop-off in machinery orders in January indicated that corporate investment may begin to weaken later this year. The report also took a more pessimistic view of the domestic labor market, reflecting a fall in job offers in January. Deterioration in the job market will further weaken consumer spending, which continues to weaken as stagnating incomes and job insecurity weigh heavily on the minds of consumers.
- **Japan's Emergency Economic Support Measures Disappoint:** Japan's latest emergency support package, which includes measures to assist the ailing financial system and tax cuts, has fallen short of expectations. Over the past decade, Japan has spent Y128,000 billion ($1,075 billion) trying to boost the failing Japanese economy. One proposal this time around, which disappointed investors, was to loosen governmental inspection guidelines for small financial institutions. Another new measure calls for Japanese banks to transfer shares they hold in other companies, which currently are worth Y32 trillion ($267.7 billion), to a privately funded purchasing organization. The purpose of the transfer of volatile stocks is to improve bank's balance sheets without further depressing an already weak stock market (the Nikkei is down 12 percent thus far this year after dropping below 12,000 March 13th and 14th). This transfer of equity assets would alleviate the bank's financial soundness from being tied to the stock market. This is especially important since starting April 1, banks will need to mark to market their books and any losses due to plummeting stock prices would have to be written off of their capital bases. The LDP gave no indication as to how much the organization would purchase or who would finally buy the shares of these less than stellar companies. Other proposals in the package included measures to dispose of bad loans more quickly and extend legislation to allow the Resolution and Collection Corp., Japan's national debt-collection agency, to buy non-performing loans from healthy banks. In addition, one measure proposes to change legislation to make it easier for companies to issue cheaper priced shares and lower commissions on mutual fund sales. The government also proposed to cut the following taxes in half to boost the attractiveness of equities: taxes on dividends to individuals, inheritance tax on stocks held for more than one year, and capital gains tax on long-held stocks. The elimination of double taxation on capital gains for corporations was also proposed.
- **The Government Finally Acknowledged that Japan is in a State of Deflation:** Tokyo finally admits Japan suffers from deflation, defined by officials as "continued price declines." After a bout of deflation in 1995-96, Tokyo and Japan as a whole has been suffering from deflation for the last two years. While most of the world's central banks worry about higher prices, the BOJ worries about falling prices. In a deflationary economy, normal operating procedures of central banks are reversed. In a typical economy, borrowers' real interest rates, adjusted for inflation, are lower than nominal interest rates. For example, a real interest rate of 6 percent, less the inflation rate of 3.5, yields a real borrowing burden of 2.5 percent. But if nominal borrowing rates were low at 2 percent and prices were falling at 2 percent then the burden to borrowers actually would be greater at 4 percent. Another reason why falling prices are not healthy for sustained periods is because consumers postpone purchases and wait for even lower prices. This starts a vicious circle, falling prices weaken demand, and weaker demand puts downward pressure on prices, which then translates into further weaker demand. Now that the word "deflation" is part of Tokyo's arsenal of criticism, the government is sure to step up attacks on the BOJ in an effort to convince the central bank to take more aggressive measures to stop widespread deflation. The BOJ's MPC meets Monday and is widely expected to cut its overnight call rate target to zero – reinstating the zero interest rate policy the central bank abandoned last August when it hiked interest rates for the first time in a decade.

- **BOJ Governor Hayami to Consider Further Monetary Policy Actions to Ease Deflation:** Hayami was responding to questions from senior Liberal Democratic Party members on how the BOJ planned to address the fact that Japan is in a state of deflation. Hayami said that both supply- and demand-side factors were pushing down consumer prices in Japan, but that prolonged price declines would have negative effects on corporate profits. While Hayami emphasized that he didn't think prices would fall indefinitely, "the BOJ will carefully consider whether more (monetary policy) steps are needed." Although Hayami did not give specific examples, he told government officials that the central bank will carefully consider what further monetary policy steps can be taken to help ease deflation. At its meeting on Monday, the BOJ Policy Board may approve quantitative easing of its monetary policy in addition to reinstating its zero-interest-rate policy. Quantitative easing aims to solve the vicious circle of falling prices and weak demand caused by deflation. The mechanism of quantitative easing is to inject more cash into the economy, which puts more money into the hands of businesses and consumers, creating more money to chase fewer goods and hence causing inflation. The BOJ is deciding whether or not to conduct quantitative easing steps by increasing the value of long-term Japanese government bonds (JGB's) it will purchase and set targets for financial institutions' reserve deposit levels in their current accounts at the BOJ. If the policy board decides to use current-account balances as measurement of its credit policy, that would allow the BOJ to inject massive sums of cash into financial institutions that may face credit crunches in times of financial crisis. On March 1, the BOJ cut the official discount rate to 0.25% and lowered the target rate for the overnight call money rate to 0.15 percent. The board will also discuss a suggestion to cut the official discount rate again.

Commodity Markets

- **OPEC Agreed Friday To Cut Oil Output by 1.0 million barrels a day**, effective April 1, lowering OPEC's production target (excluding Iraq) to 24.2 million b/d, in an effort to support crude prices to its target price level of at least $25/bbl. Due to a drop in crude oil demand caused by a slowdown in economic activity in the U.S., Latin America and Japan, OPEC cut production, according to the official communiqué, "to stabilize the oil market." The decision to cut was complicated by fragile global stock markets, fears of a possible global recession and just how much could they cut supply without higher energy prices putting additional pressure on consuming economies and pushing the world closer to a global recession. Rodriguez, President of OPEC, said the cut was "greatly influenced by the U.S. economic slowdown and Japan crisis."
- **OPEC, however, has become a victim of its own success:** Until recently, production cuts have supported prices. But, OPEC ministers are now worried about OPEC's compliance with production reductions as members exceeded their output ceiling in February by 600,000 barrels a day. The problem with cheating is that it promotes more cheating, as no one wants to play the fool to another members' greed. In addition, compliance has also cost the cartel market share. And, as the cartel loses market share they must lower prices to defend its share and it fails as a cartel. Higher prices have not only encouraged cheating, but have drawn new investment into the industry and new production on line. As prices have risen since the beginning of 1999, investment in new production and exploration has followed. Capital expenditures are expected to rise 14% industry wide this year from last year. To the extent that OPEC can support high prices or limit production, this encourages new production outside the cartel as well as cheating from within. In other words, OPEC is likely to fail as it tries to ignore the laws of supply and demand. OPEC President Chakib Khelil warned that without cooperation among all participants in the oil market, producers and consumers alike, there could be a price crash such as the one seen in 1998, which sent prices to about $10 a barrel

G-7+ Central Bank Monitor

Country	Official Interest Rate	Current (%)	Change from prev. bias	Last Change	Next MPC Mtg.
The Americas					
United States	Federal funds rate	5.50	19 Dec 00 (-100 bps)	31 Jan 01 (-50 bps)	20 Mar 2001
Canada	Overnight rate	5.00	23 Jan 01 (-75 bps)	6 Mar 01 (-50 bps)	17 Apr 2001
Europe					
ECB	ECB rate	4.75	4 Nov 99 (+225 bps)	5 Oct 00 (+25 bps)	15 Mar 2001
U.K.	Base rate	5.75	11 Jan 01 (-25 bps)	8 Feb 01 (-25 bps)	4 - 5 Apr 2001
Asia/Pacific					
Australia	RBA Cash rate	5.50	6 Feb 01 (-75 bps)	7 Mar 01 (-25 bps)	3 Apr 2001
New Zealand	Cash rate	6.50	16 Nov 99 (+200 bps)	17 May 00 (+50 bps)	14 Mar 2001
Japan	Overnight call rate	0.15	28 Feb 01 (-10 bps)	28 Feb 01 (-10 bps)	19 Mar 2001

Economic Calendar – March 19 to March 23 2001					**(all times are CST)**
Country	**Mon. March 19**	**Tues. March 20**	**Wed. March 21**	**Thurs. March 22**	**Fri. March 23**
The Americas					
U.S.		Redbook Trade Balance (Jan) Federal Budget (Feb) FOMC Meeting (Announcement Expected at 1:15pm CST)	Mortgage Applications (Mar 16) CPI (Feb) Real Earnings (Feb)	Jobless Claims (Mar 17) Leading Indicators (Feb) FOMC Policy Action Record	
Canada		Wholesale Sales (Jan) Trade Balance (Jan) Merchandise Exports and Imports (Jan)	CPI (Feb) Retail Sales (Jan)	Composite Index (Feb) Employment Insurance (Jan) Int'l Securities Transactions (Jan)	Manufacturing Shipments and Orders (Jan) Inventory-to-Shipment Ratio (Jan)
Europe					
ECB		**Euroland:** IP (Jan) **France:** Industrial Production (Jan) Manufacturing Production **Italy:** GDP (Q4) CPI (Mar-P)	**Germany:** IFO Business Survey (Feb) CPI (Mar-P)	**Germany:** PPI (Feb) Import Prices (Feb) **France:** Household Consumption (Feb) **Italy:** ISAE Consumer Confidence (Mar)	**France:** CPI (Feb-F) Special EU Summit in Stockholm
U.K.		Money Supply (Feb) Retail Prices (Feb) RPIX (Feb) RPIY (Feb) Trade Balance (Jan/Feb) Public Finances (Feb) PSNB (Feb) PSNCR (Feb)	Minutes of MPC Meeting (Mar 7-8)	CBI Monthly Trends Enquiry (Mar)	
Asia-Pacific					
Japan	BOJ Meeting	Merchnds Trade Balance Total (Feb) Crude Steel Production (Feb)	Tertiary Industry Activity Index (Jan)	Corp Service Price Index (Feb) BOJ Board Minutes (Feb 9)	
Australia					
NZ					Balance of Payments (Q4)
Singapore	Trade Balance (Feb)				