

# Weekly Macroeconomic Report

27 September 2010

## Contents

<b>1. Leader</b>	<b>Page 2</b>
<b>2. US</b>	<b>Page 3</b>
<b>3. Euro Area</b>	<b>Page 6</b>
<b>4. UK</b>	<b>Page 9</b>
<b>5. Japan</b>	<b>Page 10</b>

## Summary

- US: August Leading Indicators were 0.3% higher MoM (+0.1% prior); New Home Sales were unchanged MoM at a 288K annualised rate, while Existing Home Sales rose 7.6% MoM to a 4.13M annualised rate; Durable Goods Orders fell 1.3% MoM (+0.7% prior) but were 2.0% higher ex Transportation (-2.8% prior);
- Europe: September Preliminary Euro-Zone PMI Indices were lower (Manufacturing 53.6 vs. 55.1 prior, Services 53.6 vs. 55.9); the September German IFO Index inched higher (106.8 vs. 106.7); July Euro-Zone Industrial New Orders were 2.4% lower MoM (+2.4% prior) and 11.2% higher YoY (+22.7% prior);
- Japan: the July All Industry Activity Index rose 1.0% MoM (+0.2% prior) and was 3.1% higher YoY.

## FOREX Market

The week on FX markets saw the US dollar decline as the Federal Reserve signalled its willingness to “provide additional accommodation” if necessary; versus the euro the US dollar fell from 1.305 to 1.345, versus the yen it fell from about 86 to about 84, and it was also lower against the British pound (from 1.56 to 1.58). The euro was higher versus the yen (from 112 to 113.5) and the British pound (from 0.835 to 0.85).

The Chinese yuan rose for the third consecutive week versus the US dollar, from 6.725 to 6.69 (about 0.50% higher on the week).

## 1. Leader

The NBER (the National Bureau of Economic Research) stated on 20 September that the longest and deepest US recession since the Great Depression came to an end in June 2009, after having lasted 18 months.

“The committee decided that any future downturn of the economy would be a new recession and not a continuation of the recession that began in December 2007,” the Cambridge, Massachusetts-based bureau’s business cycle dating group indicated in a statement on 20 September. “The basis for this decision was the length and strength of the recovery to date.”

The NBER committee is the accepted arbiter of when recessions start and end in the US economy; they normally issue their official statements about one year after the event (start or end of a recession) has taken place, so as to give time for a sufficient number of revisions to economic data to occur and thus “consolidate” the data.

The panel’s decision also lagged behind declarations of other economists to the same effect partly because it depends on payroll data, which were among the last economic indicators to recover ground in the present cycle.

“It’s definitely the worst apart from the Depression, which was far, far worse,” Robert Hall, a Stanford University economics professor who heads the NBER committee, stated in an interview. “It’s still too early to tote up the cost, given that we are still far from recovered from its effects”.

The committee was also concerned about the potential of a further decline going forward. The panel “has to guard against the possibility, even if very small, that what seems to be the beginning of an expansion is actually just an interruption in a longer contraction,” the group had said in April of this year.

“The recession was the worst since the 1930s,” Harvard University professor Jeffrey Frankel, another member of the committee, had stated in an interview in February of 2010. “Job loss was unusually severe relative even to output”, he added.

## 2. USA

### LEI Index

August Leading Indicators rose 0.3% MoM (+0.1% exp., +0.1% prior), as there were positive contributions from several components: there were declines in the pace of deliveries (-0.12%) and the jobless claims components (-0.19%), but they were offset by increases in the average workweek (+0.07%), building permits (+0.05%), M2 money supply (+0.11%) and in consumer expectations (+0.02%); the largest positive contribution continued to come from the interest rate spread component (+0.27%), which has continued to hover around this level for many months now.

### Durable Goods Orders

August Durable Goods Orders declined 1.3% MoM (-1.0% exp., +0.7% prior, +12.2% YoY), easing in the month as aircraft orders were again lower in the month (-40.2% MoM vs. +69.1% prior, +11.5% YoY); Capital Goods orders fell 0.8% MoM (+2.4% prior, +8.7% YoY) as did defence orders (-1.5% MoM vs. -1.7% prior, -8.8% YoY); there were, however, higher orders for electrical equipment (+0.5% MoM vs. -5.2% prior, +9.8% YoY), computer and electronics (+3.8% MoM vs. -0.5% prior, +17.6% YoY) and machinery (+3.9% MoM vs. -9.6% prior, +27.3% YoY), while those for transportation equipment fell (-10.3% MoM vs. +11.6% prior, +4.2% YoY).

Excluding orders for volatile transportation equipment, orders were 2.0% higher MoM (+1.0% exp., -2.8% prior, +15.0% YoY), and it must be noted that the level of orders has now been higher than that of a year ago for the ninth consecutive month, a sign that growth and confidence are returning in the economy, albeit it from a low base and with still significant month-on-month volatility.

Fig. 2.1 USA LEI Index (source: US Conference Board, last update 08/2010)

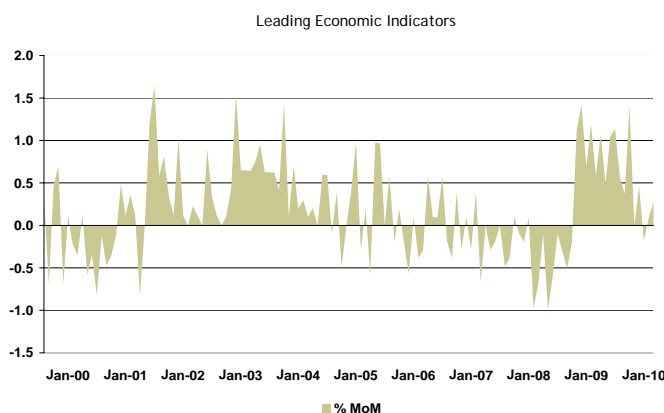
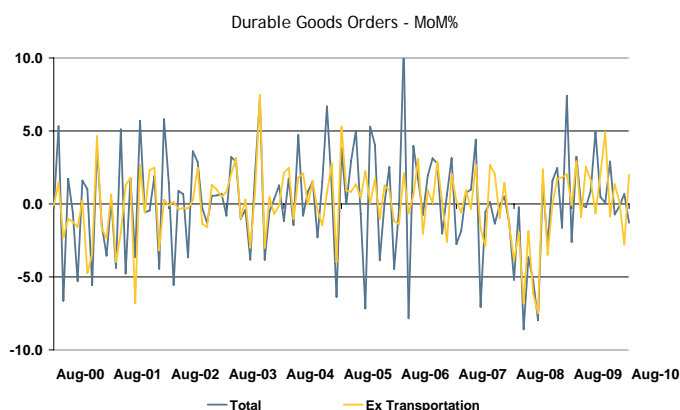


Fig. 2.2 USA Durable Goods Orders (source: US Census Bureau, last update 08/2010)



### Housing Starts & Building Permits

August Housing Starts rose 10.5% MoM to a 598K annualised rate (550K exp., 541K prior), higher for the second consecutive month after the earlier sharp falls following the expiration of tax credits; there were significantly higher starts of multifamily dwellings, such as apartments (+32.2% MoM to 160K), and a more modest increase in single-family homes (+4.3% MoM to 438K).

Building Permits rose 1.8% MoM to a 569K annualised rate (560K exp., 559K prior), led by a 9.8% increase to 168K in multifamily applications. Permits for single-family housing, the biggest part of the market, fell 1.2% to 401K, the lowest since April 2009.

The sector overall is still being hampered by the high unemployment rate and by the end of tax incentives in April; these may continue to be significant headwinds in the coming months for housing activity.

### Existing & New Home Sales

August Existing Home Sales increased 7.6% MoM (+7.1% exp., -27.0% prior) to a 4.13M annualised rate (4.1M exp., 3.86M prior), rebounding from the lowest level since records began in 1999, while the median home price fell 1.9% MoM to US\$178.6K but was 0.8% higher YoY.

Inventories of unsold homes eased 0.6% MoM to 3.98 million, equivalent to 11.6 months of sales (12.5 months prior) at the present rate. This still represents an overhang for the market as a normal housing market has a months' supply of homes for sale under six. Foreclosed properties represented 22% of sales in the month.

August New Home Sales were unchanged MoM (+6.9% exp., -7.7% prior, originally reported as -12.4%) to a 288K annualised rate (295K exp., 288K prior, originally reported as 276K), remaining at the second lowest rate on record in the month (tax incentives expired at the end of April), and were 28.9% lower YoY. The median home price declined 1.2% YoY to US\$204.7K, while the number of homes for sale declined 2.0% MoM to 206K, the lowest level since August 1968, and are now equal to 8.6 months of sales at the present rate (8.7 months prior); this is above the 5-6 months level normally associated with a market in equilibrium, indicating that the overhang of vacant properties is still weighing on the market at present, despite their low number in absolute terms.

Fig. 2.3 USA Housing Starts & Building Permits (source: US Department of Commerce, last update 08/2010)

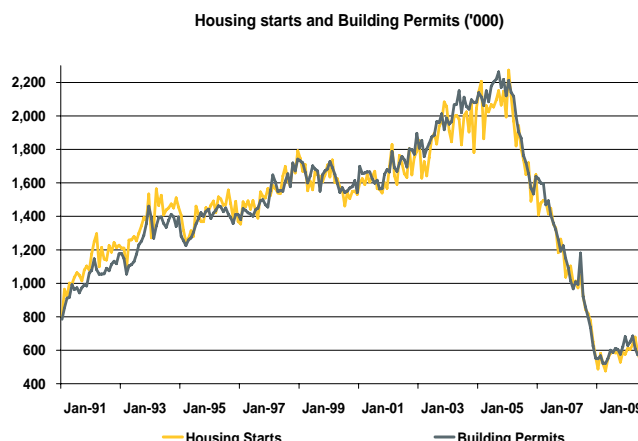
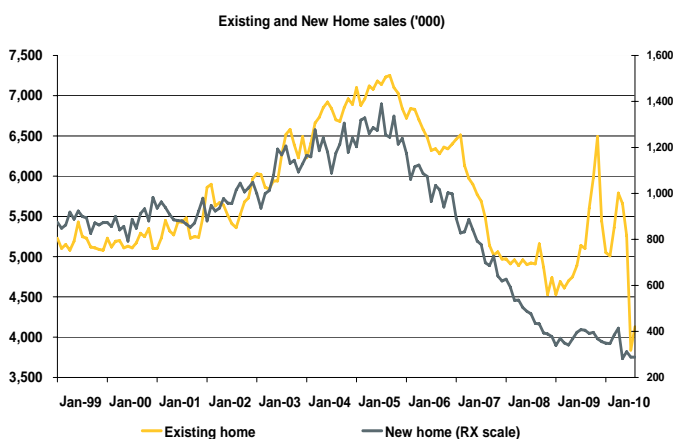


Fig. 2.4 USA Existing & New Home Sales (source: US National Assoc. of Realtors & Census Bureau, last update 06/2010)



## US – Monetary Policy

### Central Bank Monitor

The Federal Reserve (Fed) left interest rates unchanged at the existing 0% to 0.25% range on 21 September, as widely expected. However, the FOMC signalled its willingness to ease monetary policy further ("provide additional accommodation"), if needed, to help support the economic recovery and to get inflation back to its desired level. While the committee did not specify that this accommodation would come via asset purchases, this was strongly implied by the omission of a paragraph that had previously said that the committee's objective was to keep the balance sheet at its current size (US\$2.3T).

Changes to the official FED statement focused mainly on inflation. Specifically, the inflation paragraph indicated more clearly than ever before that inflation is below the range the committee judges as acceptable. The committee then reinforced this by noting that one objective of the additional easing would be to push inflation up. This is important not only because the Fed has explicitly said inflation is too low but because pushing it back up would generally require more time than to push growth up.

The outlook for growth was quite similar to the already subdued August statement. The Committee downgraded somewhat its take in business equipment spending, noting that it was less strong than earlier in the year, but it also qualified its comment on the declining trend in bank loans by noting that this trend had also abated.

### Our Outlook

United States economic growth is expected to remain moderate in the coming quarters, as the unemployment rate declines only slowly from

elevated levels, companies increase their cash stockpiles and consumers labour to reduce their debt loads.

The Fed reduced short-term rates in total by over 500 bps in over a year to sustain the economy and help heal financial markets after the financial crises that began in the summer of 2007, reducing rates down to the current 0% to 0.25% range in December 2008; the next scheduled meeting is on 3 November, there is no scope for further cuts, but further unconventional measures could be considered if the unemployment rate remains elevated and growth sub-par. At the August 2010 meeting the Fed decided to reinvest the proceeds of its MBS portfolio in Treasury bonds so as to keep the total size of its balance sheet unchanged, while it had previously let the portfolio slowly wind down; analysts estimate the amounts involved to be about US\$20B a month, not a huge amount in the context of the US\$13 trillion US economy, but a signal of concern and at the same time of attention to economic growth. The market currently expects US interest rates to remain around 0.25% up to August 2011; rates are then expected to gradually increase as the year progresses, reaching about 1.0% by the autumn of 2012.

Overall expectations for future rate increases have been declining in recent months as the Fed has continued to repeat at each meeting up to now that rates will remain unusually low "for an extended period" (now officially indicated to mean "at least six months"), and President Bernanke further reinforced the message in his Jackson Hole speech at the end of August.

## US – Data Due Out Next Week

September Consumer Confidence, 2Q Final GDP, September Chicago Purchasing Managers Index, August Personal Income and Personal Spending,

August PCE Deflator, September Final University of Michigan Confidence Index, September ISM Manufacturing Index.

### 3. EURO Area

#### Euro-zone PMI Indexes

The September Preliminary Euro-Zone PMI Manufacturing Index declined to 53.6 (54.5 exp., 55.1 prior), and the Preliminary Euro-Zone PMI Services Index eased to 53.6 (55.5 exp., 55.9 prior), both lower in the month as concerns regarding the strength of the economic recovery lingered. Both indices continue to remain above of the contraction territory in which they had been for over a year; this is a sign that the economy is now in the process of labouring back to a steadier plane, with the indices consistent with moderate growth in the economy.

At country level, German business confidence fell to 55.3 (58.2 prior) in the Manufacturing sector, and eased to 54.6 (57.2 prior) in the Services sector. In France the PMI Manufacturing Index rose to 55.4 (55.1 prior), whilst the PMI Services Index declined to 58.8 (60.4 prior).

#### Euro-zone Industrial New Orders

July Euro-Zone Industrial New Orders declined 2.4% MoM (-1.4% exp., +2.4% prior) and were 11.2% higher YoY (+16.2% exp., +22.7% prior), easing in the month due to lower orders for capital goods (-5.1% MoM vs. +3.8% prior, +8.3% YoY), for intermediate goods (-0.1% MoM vs. +0.1% prior, +18.2% YoY) and for durable consumer goods (-3.2% MoM vs. -1.3% prior, -1.0% YoY), while there was a slight increase in non-durable consumer goods (+0.5% MoM vs. -1.5% prior, +1.9% YoY). The improvement of industrial orders is however expected to continue going forward, albeit at a slow pace, as positive worldwide economic growth should continue to boost export orders for Euro-zone companies.

#### 2010-2Q France Final GDP Growth Rate

Q2 Final French GDP expanded 0.7% QoQ (+0.6% exp., +0.2% Q1) and was 1.7% higher YoY in adjusted terms, as expected (+1.2% Q1). Private consumption grew 0.3% QoQ (0.0% Q1), while Government consumption was 0.4% higher (0.0% Q1); a significant boost to economic expansion came from investments (+0.8% QoQ vs. -0.9% Q1), led by business investments (+1.1% QoQ vs. -1.0% Q1), while there was a negative contribution from net exports, as exports grew 2.8% QoQ (+4.5% Q1), while imports were 3.9% higher (+1.9% Q1).

Fig. 3.1 EMU PMI Indexes (source: Markit, last update 09/2010)

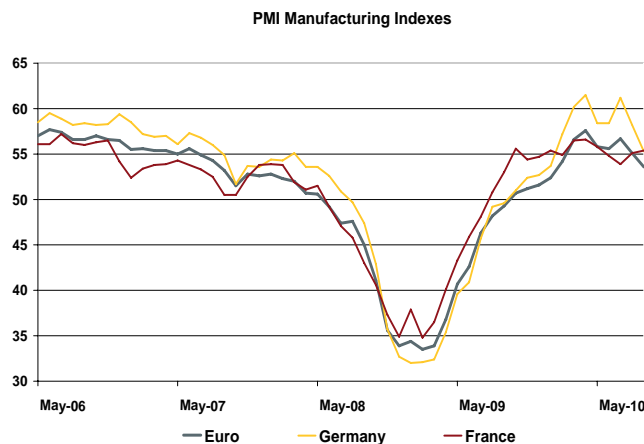
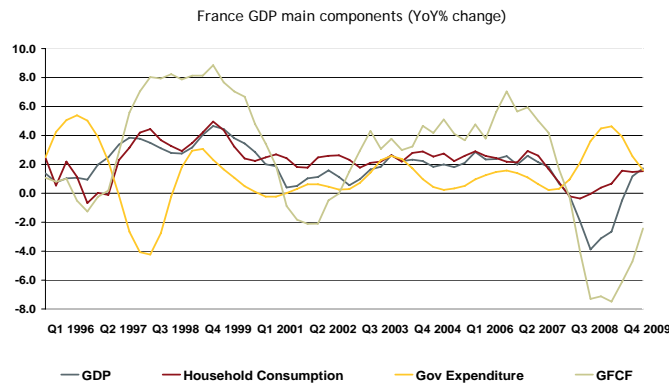


Fig. 3.2 EMU Ind. New Orders (source: Eurostat, last update 07/2010)



Fig. 3.3 FRA GDP Growth Rate (source: INSEE, last update 06/2010)



### Germany IFO Index

The September German IFO Business Climate Index climbed to 106.8 from 106.7 (106.4 exp.), the highest level since June 2007, as the Current Assessment component rose to 109.7 from 108.2, while the Expectations component eased slightly to 103.9 from 105.2, indicating that the strong Q2 growth (+2.2% QoQ) is likely to slow somewhat going forward; the further unexpected increase in the headline index was due to falling unemployment, which leads to an increase in private consumption, and companies, which remain confident about the outlook for profits.

The index overall still seems to be in an uptrend that has been evident for over a year now. It is progressively moving up from the lowest level in five years (82.2 in March 2009) but is still somewhat below the 109.1 December 2006 high.

### Italy Retail Sales

July Italian Retail Sales were unchanged MoM (-0.2% exp., +0.5% prior) and 1.7% higher YoY (0.0% exp., +0.7% prior); in the month there were higher food sales (+0.4% MoM vs. +0.3% prior, +2.4% YoY) but this was offset by a decline in non-food products (-0.2% MoM vs. +0.6% prior, +1.3% YoY) as stagnant unemployment prospects and continuing uncertainty about the economic outlook combined to limit consumers' propensity to spend on non-essential items.

Fig: 3.4 GER IFO Indexes (source: IFO, last update 09/2010)

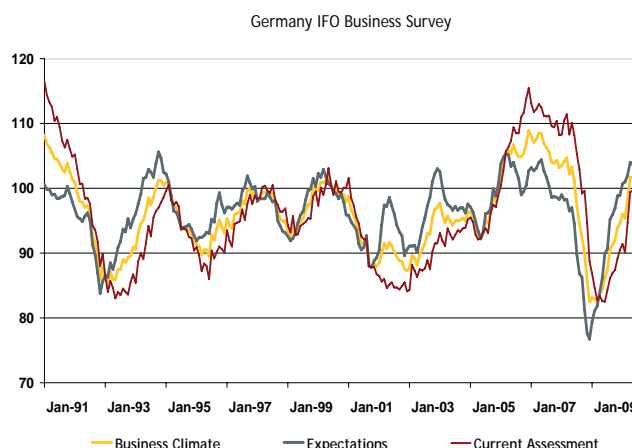
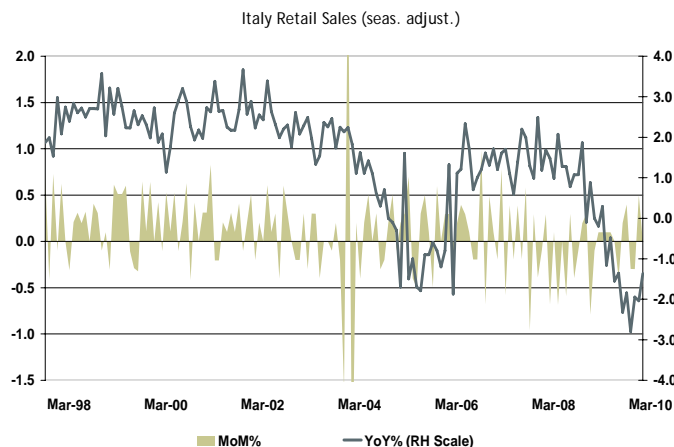


Fig: 3.5 ITA Retail Sales (source: ISTAT, last update 07/2010)



## EUR – Monetary Policy

### Central Bank Monitor

European Central Bank (ECB) President Jean-Claude Trichet said Europe is making progress on financial supervision as the EU Parliament approved the new European supervisory agencies.

“I’d say we are making a very important step forward,” Trichet stated in an interview with German broadcaster ZDF on 22 September. “The European Systemic Risk Board will have the particular responsibility to concentrate on the systemic risks,” which are cross-border in nature and are not dealt with by supervisors.

He also declared that the decision by European Union lawmakers to create EU-wide financial supervisors is “a great step forward”.

ECB Governing Council member Nout Wellink said the bank will make sure that its exit from unconventional measures will not hurt growth.

“The moment we start our unwinding process, we will take all relevant elements into account,” Market News International quoted him as saying on 21 September. “So if, at that very moment, we would be afraid of a negative impact on the economy, we would most certainly reconsider our plans.”

### EUR – Data Due Out Next Week

August Euro-Zone M3, September Preliminary German and Italian EU-Harmonized CPI, September German Unemployment Rate, August Euro-Zone Unemployment Rate, September Euro-

### Our Outlook

The messages being sent to financial markets from ECB sources are fully consistent with a neutral bias, given that the ECB is not worried about the risks of inflation in the coming months, has recognised the moderate level of economic activity and is expecting a positive, but moderate pace of recovery in the coming quarters; overall, it has reduced official interest rates by 3.25% since October 2008, to the current 1.0% level, which was reached after the last 25 bps rate reduction that the ECB enacted at its meeting in early May 2009.

**A variation of interest rates is not likely at the next meeting on 7 October**, and most economists continue to expect very low interest rates going forward, as economic growth is forecast to improve only gradually in the coming quarters, and the low level of economic activity limits the potential for price increases at present.

*The early May decision to purchase euro-area government bonds and to once again supply unlimited funds to financial institutions in the three-month and six-month tenders also indicate that monetary policy is unlikely to be tightened anytime soon in the euro area.*

Zone CPI Estimate, September Final Euro-Zone PMI Manufacturing and Services Indexes.

## 4. UK

No fundamental data were released past week.

### UK – Monetary Policy

#### Central Bank Monitor

The minutes of the 9 September Bank of England (BOE) meeting were released on 22 September; they indicated that officials voted 8 to 1 in favour of maintaining interest rates unchanged at 0.50% and the total size of the bond purchase programme at £200B. Andrew Sentance was the dissenter, for the fourth consecutive meeting, calling for a 25 bps rate increase and indicating that interest rate should be raised “gradually” going forward.

“Most members thought that the current level of bank rate and stock of asset purchases financed by the issuance of central bank reserves remained appropriate compared to balance the risks,” the minutes indicated. “For some of those members, the probability that further action would become necessary to stimulate the economy and keep inflation on track to hit the target in the medium term had increased.”

“We have to distinguish between unevenness of the rate of growth which we often get at this stage of the economic cycle and a genuine double-dip recession,” Sentance said to support his position. “Certainly in the case of the UK, I see that not as the main scenario, or globally as the main scenario.”

In the minutes, policy makers indicated that the risks to the inflation outlook were “substantial” in both directions. “Members stood ready to respond in

either direction as the balance of risks evolved,” the minutes stated.

“Most indicators of inflation expectations were broadly unchanged,” officials pointed out. “Overall, the committee judged that the upside risks to inflation expectations, and so the inflation outlook, remained but had not changed materially over the month.”

Data in the past month still signalled a “reduction in growth prospects” for the second half of the year, the minutes also underlined.

#### Our Outlook

Since March 2009 the BOE has kept its official interest rate at a record low 0.50% level to fight the economic and financial crisis. Even though the economic data of the latest months has suggested that the UK economy has begun to grow again, it is likely that the central bank will not change its policy in the foreseeable future as it has warned several times that, according to its forecasts, the recovery would be “slow and protracted”.

**The next Monetary Policy Meeting is scheduled on 7 October, and with interest rates already at a record low 0.50%, a further cut seems unlikely.** The BOE now seems to prefer to continue to adopt a ‘wait-and-see’ attitude on the economy, inflation and interest rates, and its now completed £200B bond purchase programme may be restarted if deemed appropriate and necessary.

### UK – Data Due Out Next Week

2Q Final GDP, August Net Consumer Credit, September PMI Manufacturing Index.

## 5. JAPAN

### All Industry Activity Index

The July All Industry Activity Index rose by 1.0% MoM (+1.0% exp., +0.2% prior) and was 3.1% higher YoY (+3.0% prior); in the month there was, however, stagnation in the construction sector (0.0% MoM vs. -2.7% prior, -6.0% YoY), and weakness in manufacturing (-0.2% MoM vs. -1.1% prior, +14.2% YoY) and in government (-0.2% MoM vs. 0.0% prior, -1.1% YoY), but this was offset by higher activity in the tertiary industry (+1.6% MoM vs. +0.2% prior, +1.7% YoY).

The index has risen for the second consecutive month, but overall seems to indicate a modest rate of economic growth for the Japanese economy in the coming months.

## JAPAN – Monetary Policy

### Central Bank Monitor

Two senior Bank of Japan (BOJ) officials spoke during the last week, signalling rising risks to Japanese economic growth from the strengthening of the yen on FX markets.

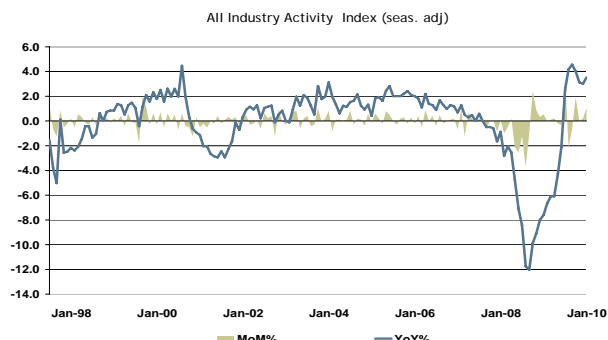
“We’re entering a situation where we need to pay more attention to downside risks,” BOJ board member Ryuzo Miyao said in a speech in Tokushima, western Japan, on 22 September. On the same day, Governor Masaaki Shirakawa indicated that the central bank needs to monitor risks to Japan’s economy, exports and corporate profitability, according to an interview with the Yomiuri newspaper; he described the previous week’s currency intervention as appropriate and indicated that the central bank must monitor “more carefully than before” the risk that the yen’s gain would hurt exports and corporate profits, he was also quoted as saying.

“There is a growing risk that the US economy may fall into a period of low growth that could be a bit protracted,” Miyao also indicated. “From a longer perspective, for instance, one or two or three years, there’s a risk that the level of growth could be lower than expected,” he added at a subsequent news conference.

## JAPAN – Data Due Out Next Week

Merchandise Trade Balance, 3Q Tankan Index, August Retail Trade and Household Spending, August Preliminary Industrial Production, August

**Fig: 5.1 JAP All Industry Activity Index (source: METI, last update 07/010)**



Miyao concluded by saying that the central bank will not rule out any policy options, including increasing its bond purchases.

### Our Outlook

The BOJ unexpectedly reduced rates to 0.10% (from 0.30%) in December 2008 in a bid to help sustain economic growth, responding to negative inflation and to the weakness of the global economy, and has since left interest rates unchanged. However, it has recently taken steps to supply more funds to the financial system, as it strives to combat the bout of mild deflation that has once again manifested itself in the Japanese economy. The BOJ has indicated that it is aware of the risk of keeping interest rates too low for too long, but is unlikely to be in a position to increase interest rates until the economy overcomes the current difficult phase and CPI returns to a positive rate of growth (National CPI has now been negative YoY since February 2009, and is unlikely to return to positive territory soon). It is currently increasing liquidity provision to financial markets and to selected areas of the real economy through loans.

**The policy board’s next interest rate setting meeting is on 5 October and no action on interest rates is expected.**

Jobless Rate, August National CPI and August National CPI.

## Important Information

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Date of First Use: 27 September 2010.