

Weekly Macroeconomic Report

24 August 2009



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Summary

- US: July Housing Starts (-1% to 581K ann.) and Building Permits (-1.8% to 560K) both fell in the month, while Existing Home Sales rose 7.2% MoM to a 5.24M annualised rate and sentiment indicators were all higher (August Empire Manufacturing 12.08 vs. -0.55, July Leading Indicators +0.8% MoM vs. +0.8%, August Philly Fed +4.2 vs. -7.5);
- Europe: the August German ZEW Index rose to 56.1 from 39.5, with the Euro-Zone one posting a similar rise to 54.9 from 39.5, and the Preliminary August PMIs both rising (Manufacturing to 47.9 from 46.3, Services to 49.5 from 45.7);
- Japan: 2Q Preliminary GDP rose 0.9% QoQ (-3.1% Q1) and was 6.4% lower YoY (-8.7% Q1), while the June All Industry Activity Index rose 0.1% MoM (+0.7% May).

FOREX Market

The week on Forex markets saw the US\$ relatively stable, trading between 1.41 and 1.43 against the euro, between 1.64 and 1.66 versus the pound sterling and between 93 and 95 versus the yen. It was stable at around 6.83 against the Chinese yuan. The euro traded around 132-135 versus the yen and rose from 0.86 to 0.865 versus the pound sterling.

1. Leader

The Kansas City Fed hosted its annual Symposium in Jackson Hole, Wyoming, over the weekend, devoted this year to the theme “Financial stability and macroeconomic policy”.

In the opening remarks Fed Chairman Ben Bernanke said the global economy is “beginning to emerge” from a recession after aggressive action by central banks and governments.

“After contracting sharply over the past year, economic activity appears to be levelling out, both in the United States and abroad, and the prospects for a return to growth in the near term appear good”, Bernanke said.

The policies of the world’s major central banks, led by Trichet, Federal Reserve Chairman Ben S. Bernanke and Bank of Japan Governor Masaaki Shirakawa, were scrutinized by economists at the annual symposium.

Economists including Nouriel Roubini, the New York University professor who predicted the financial crisis, have criticised the ECB for waiting too long to cut interest rates and for supplying less stimulus than the Fed. Trichet used a 20-page paper to argue that the central bank was guided by its primary aim of delivering stable prices and by a need to revive bank lending.

“Criticizing a central bank that is acting with a steady hand for being ‘behind the curve’ rather misses the point,” Trichet said. “A gradualist approach of this kind may be the most effective antidote to the threat to price stability.”

The Fed in turn was faulted for its policy of keeping interest rates close to zero for an “extended period,” which Carl Walsh, professor at the University of California at Santa Cruz, said was “potentially inconsistent” with its price-stability goal. That prompted Fed Vice Chairman Donald Kohn to respond that the policy is aimed at ensuring inflation does not get too low. “The commitment to low rates is designed to keep inflation from falling and falling persistently below what we might want it to be for a long time”, Kohn said during an audience-debate period at the symposium. “It’s not designed to raise inflation expectations. There’s no inconsistency there”.

Bernanke listened to the debate from the audience without comment.

2. USA

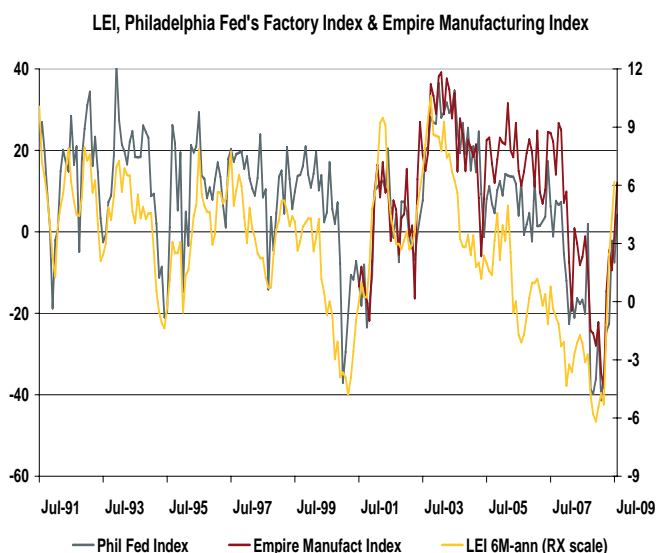
LEI, Empire Manuf. & Philadelphia FED Indexes

July Leading Indicators rose 0.8% MoM (+0.6% exp., +0.8% prior), rising for the fourth consecutive month as higher stocks and some preliminary improvements in the jobs market were able to offset continued deterioration elsewhere in the economy. Money supply subtracted 0.11% from the index (-0.09% prior) but there were positive contributions from the interest rate spread (+0.34% vs. +0.35%), stock prices (+0.04% vs. +0.10%), pace of deliveries (+0.09% vs. +0.05%), average workweek (+0.19% vs. +0.06%) and jobless claims (+0.31% vs. +0.08%).

The August Empire Manufacturing Index rose to 12.08 from a prior -0.55 (3 exp), the first time it has been in expansion territory since April 2008. New orders rose to 13.4 (5.9 prior), positive for the second consecutive month. Shipments also rose further to 14.1 from 11.0. Inventories rose to -22.3 from a prior -36.5, bouncing from a record low. Employment also improved at -7.5 (-20.8 prior). The price components were mixed (Prices Paid rose to 13.8 vs. 10.4 prior, while Prices Received eased to -12.8 vs. -8.3 prior). Factory executives also became more optimistic about the future, as the outlook for six months rose to 48.2 from 34.

The August Philadelphia Fed Index rose to 4.2 from -7.5 (-2 exp.), boosted by the number of employees (-12.9 vs. -25.3 prior) and shipments (+0.6 vs. -9.5 prior) components. New orders improved to +4.2 (-2.2 prior), breaking into positive territory. The price components, prices paid (+10.0 vs. -3.5 prior) and prices received (-1.5 vs. -21.5 prior), registered rising energy and raw materials prices. The Philadelphia Fed's expectations index for the next six months rose to 56.8 from 51.9, approaching the five-year high set in June (56.8).

Fig: 2.1 USA LEI, Empire Manuf. & Philadelphia FED Indexes (source: US Conference Board & FED, last update 07-08/2009)



Total Net TIC Flows

June Net Long Terms Tics Flows were positive by US\$90.7B (US\$ +17.5B exp., US\$ -19.4B prior), accelerating in the month as Japan increased its portfolios of Treasuries as did many investors as stockmarkets wobbled. By contrast, China, the biggest foreign holder of US Treasuries, trimmed its holdings of Treasuries by US\$25.1 billion to US\$776.4B. In detail 100.5B of Treasuries were bought (-22.5B prior), the most since sales of 25.8B in November 2008, and there were also net purchases of agency bonds (5.1B vs. 12.8B) and corporate stocks (+19.1B vs. +16.7B prior). Total Net Tics Flows, which also include more volatile components such as T-Bills and swaps, were negative by 31.2B (+23.0B exp., -65.7B prior).

Housing Starts & Building Permits

July Housing Starts declined 1.0% MoM to a 581 annualised rate (599K exp., 587K prior), falling back after rising for two months, as works on condominiums and apartment building slowed down in the month, while single family starts improved. Building Permits declined 1.8% MoM to a 560K annualised rate (577K exp., 570K prior), also declining in the month and remaining below the level of housing starts and thus indicating continuing uncertainty in the prospects for the housing sector.

Existing Home Sales

July Existing Home Sales rose 7.2% MoM (+2.1% exp., +3.6% prior) to a 5.24M annual rate (5.0M exp., 4.89M prior) and were 5.0% higher YoY, posting the largest monthly rise since records began in 1999, rising to the highest level in two years and now well above the low set in January (4.49M), thus signalling that the housing crisis is now easing. The median price is, however, still declining MoM, to US\$178.4K from US\$182K, and is down 15.1% YoY, while the overhang of unsold homes on the market was stable at 9.4 months worth.

Fig: 2.2 USA Net Long-term TIC Flows (source: US Treasury, last update 06/2009)

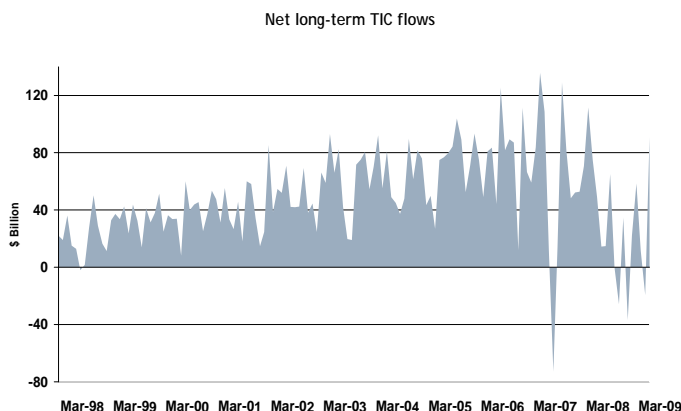


Fig: 2.3 USA Housing Starts & Building Permits (source: US Department of Commerce, last update 07/2009)

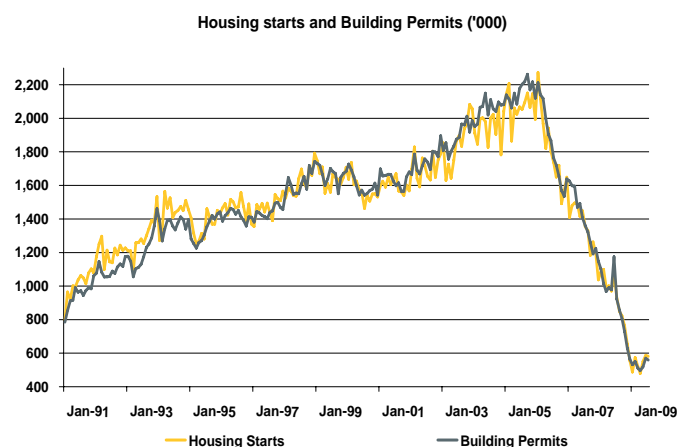
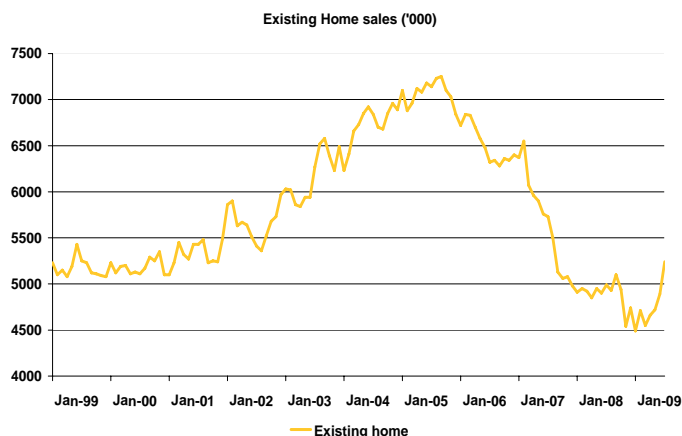


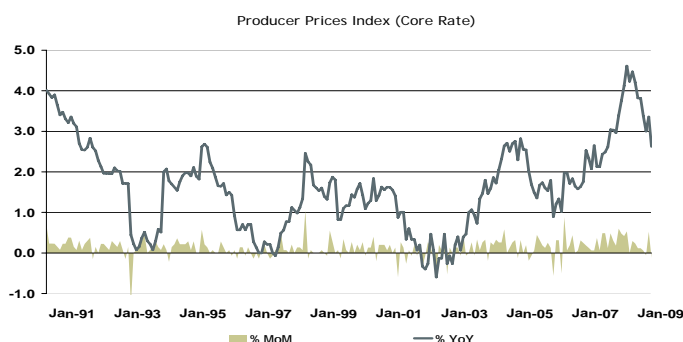
Fig: 2.4 USA Existing & New Home Sales (source: US National Assoc. of Realtors & Census Bureau, last update 07/2009)



PPI Indexes

The July PPI Index fell 0.9% MoM (-0.3% exp., +1.8% prior) and was 6.8% lower YoY (-5.9% exp. - 4.6% prior), pulled down by lower food (-1.5% MoM and -4.2% YoY) and energy prices in the month (-2.4% MoM and -29.7% YoY), while the Core rate fell 0.1% MoM (+0.1% exp., -0.5% prior) and rose 2.6% YoY (+2.8% exp., +3.3% prior), on the back of lower prices for passenger cars (-1.7% MoM vs. +2.0% prior, +1.0% YoY) and computers (-1.5% MoM and -19.6% YoY).

Fig: 2.5 USA PPI (source: Bureau of Labor Statistics, last update 07/2009)



US – Monetary Policy

Central Bank Monitor

The Kansas City Fed hosted its annual symposium in Jackson Hole, Wyoming at the end of the week; for a detailed analysis of events please see the Leader on page 2.

Our Outlook

United States economic growth is expected to remain moderate at best in the coming quarters as the housing market remains weak, domestic auto makers struggle, and financial markets, despite the improvements since the March lows, overall continue to remain hesitant. A significant slowing of the economy is currently unfolding as

investments and international demand remain modest, despite the continuing barrage of fiscal and financial measures, which are however expected to progressively help to stabilise the economy in the coming quarters. The Fed has noted the troubles on financial markets and reduced short-term rates by over 500bps in total, down to the current 0% to 0.25% range in December 2008, as equity markets stuttered and credit markets remained impaired. **The next scheduled Fed meeting is on 23 September;** there is no scope for further cuts but more unconventional measures may be announced. The market now expects US interest rates to remain around 0.25% up to October 2009, followed by a modest increase to about 0.35% by December 2009; rates are then expected to reach 1.0% by June 2010.

US – Data Due Out Next Week

August Consumer Confidence, July Durable Goods Orders, July New Home Sales, 2Q Preliminary GDP, July Personal Income and Personal Spending, July PCE Deflator, August Final University of Michigan Confidence.

3. EURO Area

Euro-zone & Germany ZEW Surveys

The August German ZEW Economic Sentiment Index rose sharply to 56.1 from 39.5 (45.0 exp.), resuming the rebound from the October 2007 lows (63.0) after a one month pause, and is now at the highest level since 2006. The survey, which aims to predict economic developments six months ahead, was positively impacted by the government stimulus efforts and by an improvement in exports as global destocking fades.

The Current Situation component also improved, rising to -77.2 from a prior -89.3.

The August Euro-Zone ZEW Economic Sentiment Index also jumped to 54.9 from 39.5. The indicator for the current economic situation also rose, to -82.1 from -90.7 points prior.

Euro-zone PMI Indexes

The August Preliminary Euro-Zone PMI Manufacturing Index posted a further increase to 47.9 (46.3 prior), and the Preliminary Euro-Zone PMI Services Index also rose to 49.5 (45.7 prior), but both remained in contraction territory as they have been for over a year as the global recession curbed demand for exports and investments, and depressed consumer spending, which are now in the process of labouring back to a steadier plane.

Euro-zone Trade Balance

The June Euro-Zone Balance was in surplus by €4.6B in non seasonally adjusted terms (€+2.1B prior) and by €1.0B in seasonally adjusted terms (€1.3B exp., €1.1B prior), posting a positive figure for a third straight month as Exports held up while the slump in the European economy kept demand limited for imported consumer products. Exports fell in the month to €101.5B from €101.6B in seasonally adjusted terms (-0.1% MoM), while imports were stable at €100.5B.

Fig: 3.1 EMU & GER ZEW Surveys (source: ZEW, last update 08/2009)

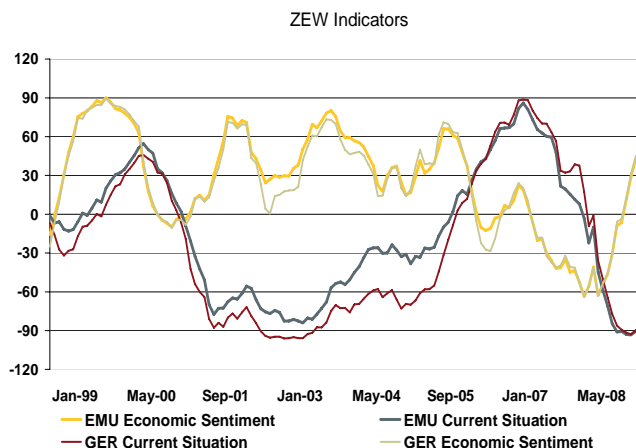


Fig: 3.2 EMU PMI Indexes (source: Markit, last update 08/2009)

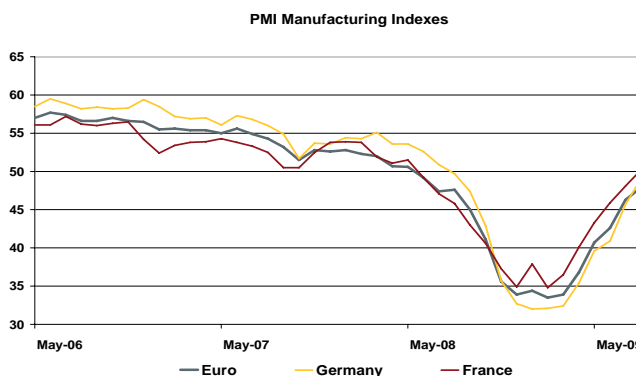
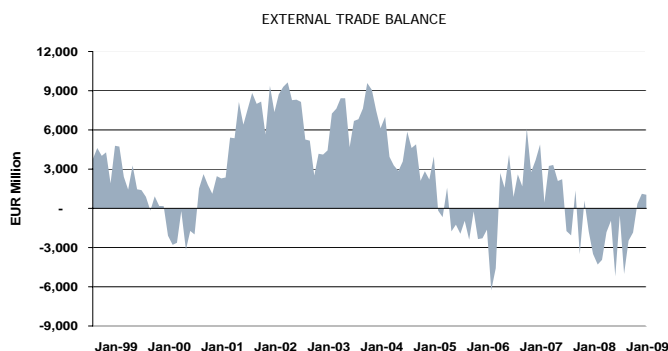


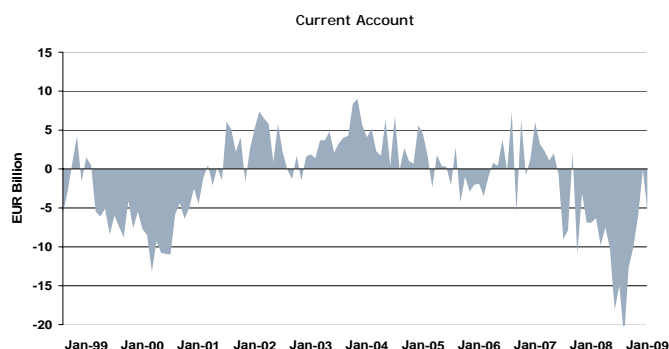
Fig: 3.3 EMU Trade Balance (source: Eurostat, last update 06/2009)



Euro-zone Current Account

The June Euro-Zone Current Account Balance was in deficit by €5.3B (-0.1B prior) in seasonally adjusted terms, as the goods balance posted a modest surplus (€+2.2B vs. €+2.9B prior), the services surplus declined (€0.5B vs. €2.9B prior), the income balance posted a deficit (€-2.8B vs. €+2.0B prior) and there was the usual significant deficit in transfers (€-5.2B vs. €-7.9B prior); **in unadjusted terms there was a deficit of €0.3B (€-11.9B prior).**

Fig: 3.4 EMU Current Account (source: ECB, last update 06/2009)



EUR – Monetary Policy

Central Bank Monitor

ECB Governing Council member Axel Weber indicated during the week that the bank will start withdrawing stimulus measures once the economy recovers and financial markets stabilise, *Die Zeit* reported, citing an interview.

The ECB will exit the measures “once the economic recovery becomes sustainable and the situation on financial markets gets sufficiently stable”, he was quoted as saying. “With this assessment we mustn’t only focus on strong banks, we also have to keep an eye on situation of the weaker ones”, Weber said, according to the report.

Our Outlook

The messages being sent to the market from ECB sources are fully consistent with a neutral bias,

given that the ECB is no longer worried about the risks of inflation in the coming months and has recognised the significant slowdown in economic activity, but at the same time has indicated that further rate cuts, though in theory possible, are unlikely; overall, it has reduced official interest rates by 3.25% since October 2008, to the current 1.0% level.

Another interest rate cut is not likely at the next meeting on September 3rd, but most economists continue to expect very low interest rates going forward, as economic growth is forecast to remain sluggish in the coming quarters, financial markets remain highly volatile, and low levels of energy prices and economic activity are leading to a modest decline of the headline inflation readings for now.

EUR – Data Due Out Next Week

August Advance Euro-Zone PMI Indexes, June Euro-Zone Industrial New Orders, 2Q Final German GDP, August German IFO Index, August

Preliminary German CPI, July Euro-Zone M3 Growth Rate, August German Retail Sales.

4. UK

Retail Sales

July Retail Sales rose 0.4% MoM (+0.4% exp., +1.3% prior) and were 3.3% higher YoY (+2.7% exp., +3.1% prior), rising again in the month thanks to higher purchases of furniture and electrical goods. Food sales declined 1.0% MoM (+0.9% prior, +2.0% YoY), while sales at non food stores increased by 1.1% MoM (+1.7% prior, +3.4% YoY) due to stronger sales at household goods stores (+4.5% MoM vs. -1.0% prior, -1.3% YoY), and overall a surge in purchases by tourists attracted by the cheap pound, which benefited mainly apparel stores, was also supportive (-0.4% MoM vs. +5.0% prior, +10.3% YoY).

CPI Indexes

July CPI was flat MoM (-0.3% exp., +0.3% prior) and was 1.8% higher YoY (+1.5% exp., +1.8% prior), the lowest level since September 2007, with the monthly data showing lower food (-0.4% MoM vs. -0.2% prior, +4.0% YoY), household goods (-3.0% MoM vs. +1.4% prior, 3.6% YoY) and clothing & footwear (-2.7% MoM vs. -1.4% prior, -4.8% YoY) costs. Core CPI was slightly higher, at 1.8% YoY (+1.6% prior).

RPI was flat MoM (-0.2% exp., +0.3% prior) and was 1.4% lower YoY (-1.7% exp., -1.6% prior) with the YoY decline dominated by lower energy related costs (-17.2% YoY).

Fig. 4.1 UK Retail Sales (source: O.N.S., last update 07/2009)

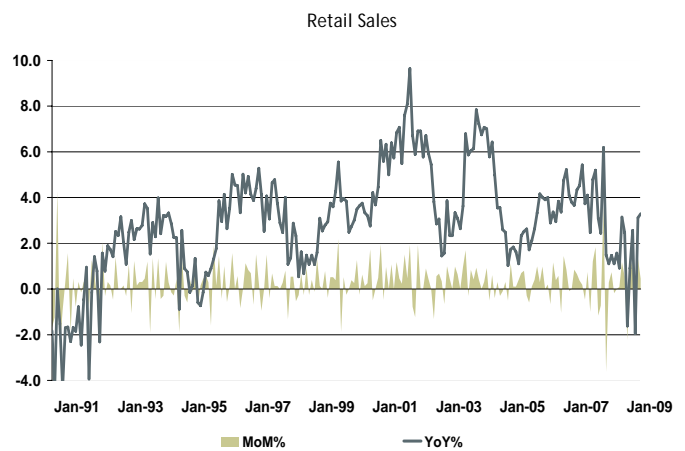
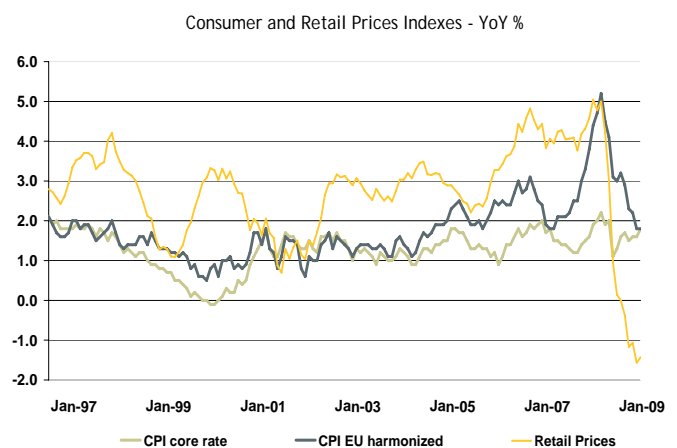


Fig. 4.2 UK CPI Indexes (source: O.N.S., last update 07/2009)



UK – Monetary Policy

Central Bank Monitor

The minutes of the August BOE meeting indicated that the nine-member Monetary Policy Committee kept the benchmark interest rate at 0.5% and voted 6-3 to raise the total they will spend by 50 billion pounds.

Governor Mervyn King, Timothy Besley and David Miles dissented in favour of a 75 billion-pound expansion.

“All members agreed that substantial further asset purchases were needed over the next three months,” the minutes said. *“The projections indicated that an increase in asset purchases of 50 billion pounds would probably need to be combined with a lower path of bank rate than implied by market yields to balance the risk of inflation around the 2% target in the medium term”.*

King, who has now been defeated three times as governor, said last week it's “likely” that inflation will slow below 1% this year and won't return to the goal until at least the end of 2012. Investors scaled back expectations for interest-rate increases next year after the comments.

An argument for a larger expansion of the bond purchases was that “insufficient stimulatory monetary policy” would harm confidence in the recovery. The risks of “another large stimulus might be less than the possible costs of acting too cautiously”, and the policy could be reversed if found to be “overly expansive”, the minutes said.

The argument for a smaller extension included that “the most immediate downside risks to the economy seemed to have receded”. The effects of the purchases were “uncertain”, risked “unwarranted increases in some asset prices”, and an early unwinding of the programme might “prompt a sharp rise in market interest rates that was unwarranted by the economic outlook”, the minutes said.

Our Outlook

With the UK economy in a difficult phase, the BOE has vowed to do what it takes to sustain economic growth and further interest rate reductions could be enacted going forward as the Bank moves to contrast weakness in the economy and financial market turbulence; inflationary concerns are now very limited as food and energy prices decline, YoY comparisons become more favourable and the economic environment remains weak.

The next Monetary Policy Meeting is scheduled on Thursday, 10 September and another rate cut cannot be ruled out entirely, even though, with interest rates already at a record low 0.50%, the BOE now seems to prefer to continue with its recently increased (to £175B from £125B) programme to purchase financial assets directly and generally adopts a wait and see attitude.

UK – Data Due Out Next Week

August Nationwide House Prices, 2Q Preliminary GDP.

5. JAPAN

2009-2Q GDP Growth Rate

2Q Preliminary GDP rose 0.9% QoQ (+1.0% exp., -3.1% Q1, originally reported as -3.8%), equivalent to a 3.7% annualised increase (+3.9% exp., -11.7% Q1) but was still 6.4% lower YoY (-8.7% Q1). The rebound in the quarter ended the deepest post-war recession, as exports and consumer spending rebounded, the second was helped by the government stimulus package, which is unlikely to provide as large a support in coming quarters. The GDP deflator rose 0.5% YoY (+1.8% exp., +0.9% prior), indicating that inflation is nearly non-existent at the moment.

All Industry Activity Index

The June All Industry Activity Index rose 0.1% MoM (+0.3% exp., +0.7% prior) but was still 8.2% lower YoY (-10.2% prior), as increases in tertiary industry (+0.1% MoM vs. -0.3% prior, -5.3% YoY) and manufacturing (+2.3% MoM vs. +5.7% prior, -23.5% YoY) were mostly offset by declines in government (-0.2% MoM vs. +1.1% prior, -0.8% YoY) and construction (-2.6% MoM vs. -1.5% prior, -1.1% YoY).

Fig: 5.1 JAP GDP Growth Rate (source: E.S.R.I., last update 06/2009)

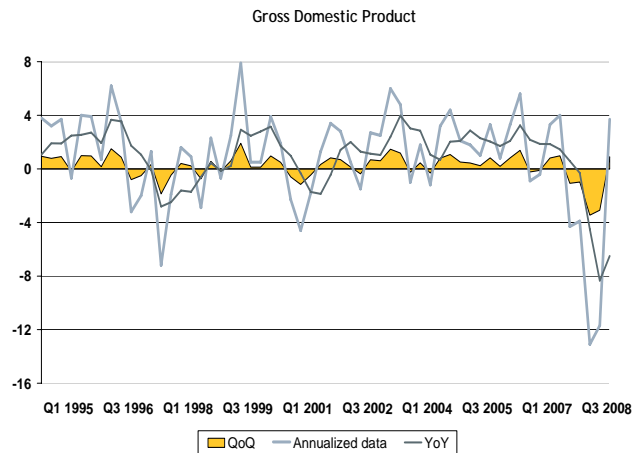
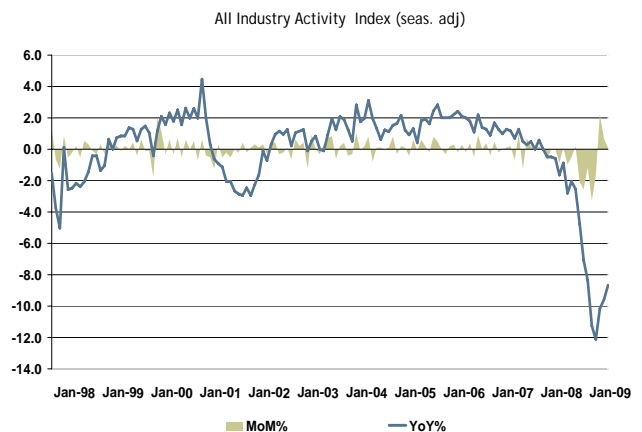


Fig: 5.2 JAP All Industry Activity Index (source: METI, last update 06/2009)



JAPAN – Monetary Policy

Central Bank Monitor

BOJ board member Atsushi Mizuno said the central bank may set preconditions for ending its policy of keeping interest rates near zero should the economy deteriorate and deflation take hold. “It is an option to show our commitment to keep interest rates at extremely low levels should we judge that the economy and prices will get worse,” Mizuno said during the week in a speech in Okayama, western Japan. **A sustainable recovery is “highly uncertain,” he said.**

Japan’s economy emerged from its deepest post-war recession last quarter, growing for the first time in more than a year as stimulus efforts at home and abroad bolstered exports and consumer spending. *Economists say attaching prerequisites for raising the key rate from 0.1% would help to assure investors that the central bank isn’t in a hurry.* Speaking as Governor Masaaki Shirakawa travels to the Federal Reserve’s annual conference in Jackson Hole, Wyoming, Mizuno said the global recovery is “fragile” and can’t go on without help from governments and central banks. **It will take “considerable time” for a worldwide expansion to be sustained and major central banks will have to keep rates “extremely low” for a long time, he said.**

Mizuno said central banks should indicate their plans for unwinding their “extraordinary” steps “without delay” and emphasize the difference between ending those actions and raising rates to avoid misleading investors.

“It’s necessary to send signals by differentiating an exit from untraditional and temporary measures and an exit from very low interest rates”, he said.

Our Outlook

The BOJ unexpectedly reduced rates to 0.10% (from 0.30%) in December 2008 in a bid to help faltering economic growth, responding to declining inflationary pressures and the weakness of the global 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 financial turmoil subsides, the economy overcomes the current difficult phase and CPI returns to a positive rate of growth.

The policy board’s next interest rate setting meeting is on 17 September and no further action on rates is expected, and the likelihood of new quantitative easing measures being announced has also declined after recent comments by officials.

JAPAN – Data Due Out Next Week

July Merchandise Trade Balance, July Jobless Rate, July Household Spending, July National CPI and August Tokyo CPI.

Important Information

Unless otherwise stated all information and all views contained in this document are from Pioneer Investments and are as at 24 August 2009.

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