GLOBAL ECONOMICS WEEKLY

Things getting (even) worse

- **The increase in European yields suggests that Europe's fiscally stronger sovereigns are reaching their limits in terms of supporting their weaker counterparts, particularly as the region heads into recession.**
- **We believe Italy and Spain are likely to need an external financial 'shield' of EUR500-800bn to protect themselves from destabilizing market dynamics, probably involving the IMF, EFSF and ECB.**
- **However, this is unlikely to be the big 'bazooka' the market is hoping for. Ultimately, whether a solution is reached largely depends on developing a more coherent vision of the post-crisis landscape.**
- **We believe the Chinese soft landing is policy-induced and disagree with those who see China as an additional source of global risk.**

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With the failure of the Super Committee, risks have increased that the payroll tax cut and extended unemployment benefits will expire. We see an expiration of both short-term stimulus measures as shaving about 1pp off Q1 and about 0.5pp off Q2 growth in 2012.

Euro area: Recession likely – ECB projected to cut to 0.5% 11

We now expect a recession – negative GDP in Q4 11 and Q1 12 – with 2012 real GDP cut from +0.4% to -0.2%: we look for the ECB to lower the policy rate to 0.5%.

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While there is clear nervousness about events in the euro area, the UK economy has not yet been markedly affected, with weakness to date mostly home-grown.

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GLOBAL FORECASTS

	Real GDP % over previous period, saar					Real GDP % annual chg			Consumer prices % over a year ago				Consumer prices % annual chg		
	2Q11	3Q11	4Q11	1Q12	2Q12	2010	2011	2012	2Q11	3Q11	4Q11	1Q12	2010	2011	2012
Global	2.6	3.9	2.8	3.4	3.5	5.0	3.6	3.4	3.9	4.1	3.8	3.2	2.6	3.8	2.9
Developed	0.8	2.2	0.9	1.1	1.6	2.7	1.4	1.5 ↓	2.7	2.9	2.8	2.2	1.5	2.6	1.8
Emerging	4.9	6.0	5.2	6.2	5.8	7.9	6.3	5.8	6.5	6.7	6.1	5.6	5.3	6.4	5.3
BRIC	5.7	7.9	6.5	7.5	6.7	8.9	7.4	7.1	7.0	7.2	6.2	5.3	5.0	6.7	5.0
America	2.2	2.3	2.5	2.7	3.0	3.9	2.5	2.8	4.3	4.6	4.3	3.7	2.9	4.1	3.5
United States	1.3	2.0	2.5	2.5	2.5	3.0	1.7	2.5	3.4	3.8	3.4	2.7	1.6	3.2	2.3
Canada	-0.4	3.0	2.5	2.5	2.5	3.2	2.4	2.3	3.1	3.2	3.1	2.0 ↓	3.3 ↑	2.5 ↓	2.3
Latin America	5.0	2.8	2.6	3.4	4.4	6.2	4.5	3.8	7.9	8.4	8.4	8.0	7.5	8.3	8.2
Argentina	10.2	-1.2	1.0	4.6	4.3	9.2	8.2	3.4	23.3	22.6	22.9	24.1	21.5	23.5	26.1
Brazil	3.1	1.3	2.0	2.8	4.6	7.5	3.4	3.9	6.6	7.1	6.7	6.0	5.0	6.6	5.8
Chile	5.3	2.6	3.6	2.9	4.1	5.2	6.0	4.0	3.3	3.1	3.7	2.8	1.4	3.3	2.9
Colombia	5.5	3.2	5.5	6.1	6.0	4.3	5.7	5.5	3.0	3.4	3.6	3.5	2.3	3.3	3.9
Mexico	5.2 ↑	5.5 ↑	2.0	2.4	4.1	5.4	3.6	3.2	3.3	3.4	3.1	3.1	4.2	3.3	3.6
Peru	5.7	4.6	5.4	4.0	3.7	8.8	6.5	5.2	2.8	3.1	4.0	3.9	1.7	3.4	3.3
Venezuela	4.4	5.0	4.6	5.6	3.6	-1.4	4.3	3.5	23.1	26.0	28.0	26.8	28.2	26.3	25.9
Asia/Pacific	4.4	6.9	5.1	6.3	5.9	8.1	5.8	6.0	3.7	4.0	3.3	2.8	2.3	3.6	2.5
Japan	-1.3	6.0	1.2	0.7	2.1	4.1	-0.2	2.0	-0.2	0.2	-0.1	0.0 ↑	-1.0	-0.2	-0.2 ↑
Australia	4.8	5.1	2.4 ↓	1.6 ↓	2.4 ↓	2.7	1.7	2.7 ↓	3.6	3.5	3.5 ↓	2.5 ↓	2.8	3.5	2.4 ↓
Emerging Asia	5.8	7.2	6.2	7.9	6.9	9.4	7.5	7.1	5.8	6.1	5.2	4.4	4.1	5.6	4.1
China	7.9	8.2	8.5	8.5	8.5	10.5	9.1	8.4	5.7	6.3	5.1	4.5	3.3	5.5	4.0
Hong Kong	-2.1	2.0	2.4	12.6	1.6	7.0	5.2	4.5	5.2	7.4	5.3	4.4	2.3	5.4	4.0
India	5.5	10.5	3.6	10.7	6.0	8.9	7.5	7.6	9.6	9.6	8.8	6.7	9.6	9.4	6.5
Indonesia	7.0	5.8	7.6	3.5	7.8	6.1	6.5	6.2	5.9	4.7	4.2	3.8	5.1	5.4	4.5
South Korea	3.6	3.2	7.7	1.1	3.7	6.2	4.0	3.5	4.2	4.7	4.2	3.0	3.0	4.4	2.5
Malaysia	2.3	3.5	5.7	6.3	5.5	7.2	4.7	5.5	3.3	3.3	3.2	2.8	1.7	3.2	2.5
Philippines	-0.7	8.6	6.8	1.5	1.3	7.5	4.5	4.8	4.5	4.5	4.7	3.7	3.8	4.4	3.4
Singapore	-6.4	1.9 ↑	-2.4 ↓	7.0 ↑	-1.6 ↓	14.5	5.2	3.0 ↓	4.7	5.5	5.1	4.0	2.8	5.1	3.0
Taiwan	0.9	-1.1	4.5	5.4	5.9	10.9	4.6	4.0	1.6	1.3	1.1	1.7	1.0	1.3	2.0
Thailand	0.2 ↑	2.1 ↓	-10.0 ↑	13.5 ↓	8.0	7.8	2.3	4.5	4.2	3.8	4.2	4.1	3.3	3.8	3.4
Europe and Africa	0.9	2.0	0.3 ↓	0.5 ↓	1.1	2.6	2.2	1.0 ↓	3.6	3.6	3.6	3.0	2.6	3.5	2.7
Euro area	0.7	0.7	-1.5 ↓	-0.7 ↓	0.0 ↓	1.8	1.5	-0.2 ↓	2.8	2.7	2.9	2.3	1.6	2.7	1.9
Belgium	1.6	0.0	-1.3 ↓	-0.9 ↓	-0.1 ↓	2.3	2.0	-0.2 ↓	3.3	3.6	3.3	3.1	2.3	3.4	2.6
France	-0.2	1.6	-1.3 ↓	-0.5 ↓	0.0 ↓	1.4	1.6	-0.1 ↓	2.2	2.3	2.4	1.9	1.7	2.2	1.6
Germany	1.1	2.0	-1.3 ↓	-0.1	0.6	3.6	3.0	0.3 ↓	2.5	2.6	2.7	2.1	1.2	2.5	1.7
Greece	-2.6	-3.2	-3.2 ↓	-3.8	-3.8	-3.4	-6.0	-3.5 ↓	3.3	2.1	2.8	2.3	4.7	3.2	2.3
Ireland	6.4	-3.6 ↑	-4.8	-0.3 ↓	4.2	-0.4	1.2	0.6 ↓	1.3	1.1	1.5	1.6	-1.6	1.2	1.3
Italy	1.2	-0.8	-1.3 ↓	-0.8 ↓	-0.4 ↓	1.2	0.5	-0.5 ↓	2.9	2.7	3.6	3.0	1.6	2.9	2.3
Netherlands	0.6	-1.1	-1.6 ↓	-0.9 ↓	0.4	1.6	1.4	-0.3 ↓	2.4	2.9	2.7	2.7	0.9	2.5	2.3
Portugal	-0.3	-1.8	-6.0 ↑	-5.5	-2.2 ↑	1.4	-1.4	-3.5	3.7	3.1	4.0	3.3	1.4	3.6	2.8
Spain	0.6	0.0	-1.4 ↓	-1.4 ↓	-0.7 ↓	-0.1	0.7	-0.6 ↓	3.3	2.9	2.8	2.0	2.0	3.1	1.9
United Kingdom	0.4	2.0	0.1	1.0	1.4	1.8	0.9	1.3 ↓	4.4	4.7	4.7	3.5	3.3	4.5	3.0
Switzerland	1.4	0.8	0.0	0.4	0.4	2.7	2.0	0.5	0.4	0.3	0.1	-0.5	0.7	0.3	0.0
EM Europe & Africa	1.6	5.1	4.4	2.9	3.4	4.7	4.3	3.5	6.7	6.4	6.0	5.8	5.8	6.3	5.6
Czech Repub.	0.3	0.0	0.6	0.5	1.0	2.3	2.0	0.9	1.7	1.9	2.0	2.6	1.4	1.9	3.0
Hungary	-0.2	2.3	3.0	-0.3	-0.6	1.1	1.4	0.6	3.8	3.2	3.2	2.8	4.9	3.6	2.6
Poland	4.5	2.9 ↑	2.0	3.0	2.7	3.9	4.1	2.8	4.4	4.0	4.1	3.6 ↑	2.7	4.1	3.2 ↑
Russia	-0.4	9.0	7.5	2.9	3.1	4.0	4.1	4.4	9.6	8.3	7.0	5.9	6.9	8.6	6.1
Turkey	4.8	2.1	1.3	3.8	5.6	9.5	7.1	3.3	5.9	7.5	7.7	9.1	8.6	6.4	7.9
Israel	3.5	3.4	2.8	3.2	3.1	5.1	4.8	3.1	4.1	3.2	2.9	3.1	2.6	3.6	2.6
South Africa	1.3	1.3	2.9	3.8	4.2	2.8	3.1	3.4	4.6	5.4	6.1	6.1	4.3	5.0	6.1

Note: Arrows appear next to numbers if current forecasts differ from that of the previous week by 0.5pp or more for quarterly annualized GDP, by 0.2pp or more for annual GDP and by 0.2pp or more for Inflation. Weights used for real GDP are based on IMF PPP-based GDP (2008-2010 average). Weights used for consumer prices are based on IMF nominal GDP (2008-2010 average). Source: Barclays Capital

GLOBAL SYNTHESIS

Things getting (even) worse

Piero Ghezzi
+44 (0)20 3134 2190
piero.ghezzi@barcap.com

Belgium and France's bond markets took particularly serious hits this week

Pressure on European yields continued this week. We are not particularly concerned about the increase in German yields. We believe it was mostly attributable to technical factors even if German yields are likely to include more term premium in the future. However, the rises in yields in Belgium (up more than 200bp since the beginning of October) and France (up more then 100bp in a similar period) are driven more by fundamental factors, in our view, even if poor liquidity has exacerbated the moves. They reflect the depth of the European debt problem (as well as domestic political factors) and the risks of the piecemeal approach. It appears Europe's fiscally stronger sovereigns are reaching their limits in terms of supporting their fiscally weaker counterparts.

Unless something dramatic happens, we do not expect yields to revert to their pre-2010 average

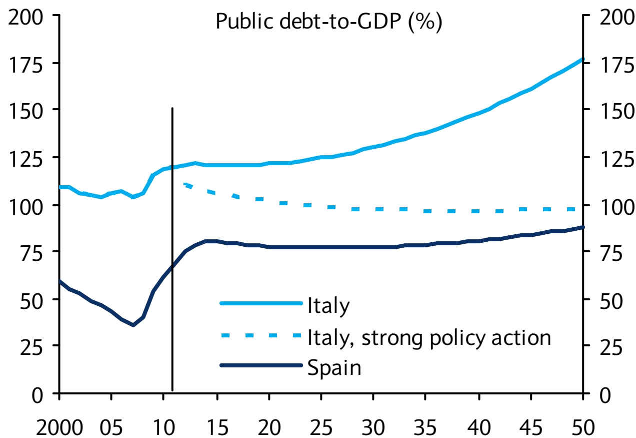
By now, most investors likely understand the root of the problem. Under the assumption that euro area government debt did not have credit risk, investors and debtor countries (not just in the periphery) allowed an extremely high accumulation of debt. High debt stocks, as well as the fact that debt is denominated in currencies that cannot be issued by the central banks of individual countries, make the latter extremely vulnerable to shocks. Euro area countries are now suffering from the same problem EM countries have previously had, but with much higher debt. Unless something dramatic happens, we do not expect yields to revert to their pre-2010 average (after all, even Italian yields of more than 7% still have relatively low implied default probabilities).

On top of policy reforms, Italy is also likely to need an external financial shield

The bellwether country seems to be Italy. We recently argued that Italian policy reforms alone, important as they would be, would not suffice to bring Italy out of the crisis (*Can Italy save itself?*, 7 November 2011). The country is also likely to need an external financial 'shield' to protect itself from destabilizing market dynamics.

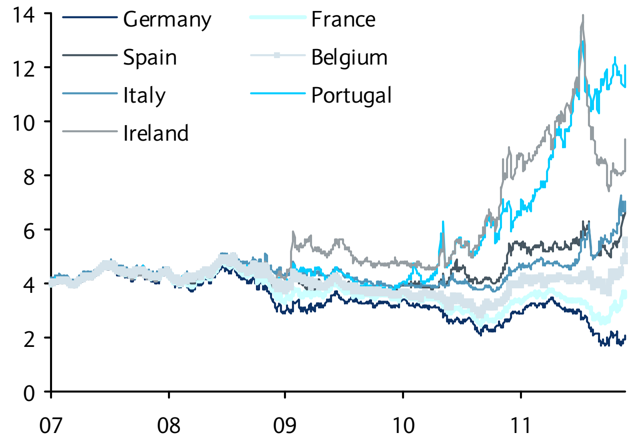
How large would this 'shield' need to be? Also, will it be possible to mobilize the required funding? While there is no scientifically precise way to estimate the contingent funding required to protect market access, we think 18-24 months of public financing requirements is a reasonable benchmark (see *What will it take to save Italy (and the euro)?*, 24 November 2011). We also believe an Italian event would be unlikely to leave the Spanish sovereign

Figure 1: Italian and Spanish debt dynamics



Source: Bloomberg, Barclays Capital

Figure 2: European yields, convergence at a higher level



Source: Datastream, Barclays Capital

A EUR500-800bn financial shield to protect market access would be necessary for Italy and Spain

unscathed, and hence we estimate the funding for both countries. This amounts to a range of EUR500-800bn for Italy and Spain combined. We would not expect Italy or Spain to be taken out of financial markets, as Ireland, Portugal and Greece were. Neither country has lost access to markets (at least not yet); financial support would likely be designed to protect market access, not compensate for its loss.

According to our calculations, the EFSF, the IMF and the ECB could jointly contribute (the latter via the SMP program), the required amount. However, the funding is not in place for now, and the situation may need to get (even) worse before such funding is catalyzed and may not be the "bazooka" some have been hoping for.

Euro area GDP likely to contract in 2012 by 0.2%; ECB expected to lower the refi rate to 0.5% by end of Q1 12

Complicating things further, the euro area is likely to have entered into a recession this quarter. We now project that euro area GDP will contract by 0.4% q/q in Q4 and by 0.2% in Q1 12. For 2012 overall, our GDP forecast has been cut from 0.4% to -0.2% (see this week's *Euro Outlook* section). Expected bank deleveraging is likely to exacerbate the negative self-reinforcing dynamics between asset prices and economic activity. The ECB will continue to lower interest rates in our view: we now look for the main policy rate to be lowered by 25bp in December (to 1.0%), and by further 25bp in January and February, taking it down to 0.5%.

Authorities do not seem to have a clear view of where the institutional endgame is

Ultimately, the likelihood of reaching (and managing) a successful solution to the euro area crisis largely depends on developing a more coherent vision of the post-crisis landscape. A few points of fiscal adjustment will not be sufficient. Any economically and politically feasible adjustment will likely leave countries with very high debt-to-GDP ratios. Both markets and policymakers need greater clarity on the institutional endgame of the European financial drama, without which markets are unlikely to settle. The announcements by politicians this week suggest that authorities do not yet have a clear view themselves. Also, a potential near-term default in Greece may add to the drama.

Disappointing news from the "super committee" in the US…

...but we still see Q4 growth at 2.5% saar

We have all been preoccupied with the eurozone developments (and for good reason), but elsewhere the situation is less dire. The news of the week in the US was obviously the failure of the "super committee" to identify the deficit reduction items. The increased risks of some fiscal tightening as a result of the expiration of unemployment benefits and (particularly) the payroll tax cut would likely shave about 1.5pp off consumption growth (1pp off headline) in Q1 and about 0.5pp in Q2 next year on a q/q (saar) basis. However, it is not our baseline scenario yet, and despite policy uncertainty, we still see Q4 growth at 2.5% on the back of strong corporate profits and inventory rebuilding (as inventory investment has subtracted 1.6pp from headline growth, versus the 1.1pp initially projected).

We believe China is in a 'soft-landing mode' and expect continued selective easing

In China, economic activity is softening (the HSBC 'Flash" PMIs this week were weaker than expected) and inflation is moderating. We believe this soft landing is the result of the tighter policy of previous months and disagree with those who see China as an additional source of global risk. Based on the downside risks associated with the deteriorating European economic outlook and the softening of the housing market, we are expecting continued selective easing (already started in October) and also see moderate downside risks to our 8.4% GDP growth forecast for 2012. However, unless there are negative growth or inflation surprises, we believe authorities will retain the neutral policy stance.

Current market conditions (and the resulting easing of CNY appreciation conditions) are presenting China with a window of opportunity. We believe a new CNY exchange rate regime, implying a two-way currency fluctuation, may be in the making (*China: A new yuan regime in the making?*, 23 November 2011). We still expect annualized CNY trade-weighted appreciation of 5-10%, consistent with the evolution of longer-term fundamentals, but global risk aversion may imply periods of depreciation in the near term.

GLOBAL RATES AND INFLATION

Central Bank rates

Official rate		Start of cycle			Next move	Forecasts as at end of			
% per annum (unless stated)	Current	date	level	Last move	expected	4Q 11	1Q 12	2Q 12	3Q 12
Advanced									
Fed funds rate	0-0.25	Easing: 17 Sep 07	5.25	Dec 08 (-75-100)	Beyond 2012	0-0.25	0-0.25	0-0.25	0-0.25
BoJ overnight rate	0.10	Easing: 30 Oct 08	0.50	Oct 10 (0-10)	Q1 13 (+20)	0-0.10	0-0.10	0-0.10	0-0.10
ECB main refinancing rate	1.25	Easing: 9 Nov 11	1.00	Nov 11 (-25)	Dec 11 (-25)	1.00	0.50	0.50	0.50
BOE bank rate	0.50	Easing: 6 Dec 07	5.75	Mar 09 (-50)	Feb 13 (+25)	0.50	0.50	0.50	0.50
RBA cash rate	4.50	Easing: 1 Nov 11	4.75	Nov 11 (-25)	Q1 12 (-25)	4.50	4.25	4.00	4.00
Swiss National Bank	0-0.25	Easing: 8 Oct 08	2.75	Aug 11 (-25)	Q2 12 (+25)	0-0.25	0-0.25	0.25	0.25
Norges Bank	2.25	Tightening 29 Oct 09	1.25	May 11 (+25)	Q3 12 (+25)	2.25	2.25	2.25	2.50
Riksbank	2.00	Tightening: 6 July 10	0.25	Jul 11 (+25)	Q3 12 (+25)	2.00	2.00	2.00	2.25
Bank of Canada	1.00	Tightening: 1 June 10	0.25	Sep 10 (+25)	Jun 12 (+25)	1.02	1.03	1.05	1.06
Emerging									
China: Working capital rate	6.56	Tightening: 19 Oct 10	5.31	Jul 11 (+25)	Beyond 2012	6.56	6.56	6.56	6.56
Hong Kong: Base rate	0.50	Easing: 19 Sep 07	6.75	Dec 08 (-100)	Beyond 2012	0.50	0.50	0.50	0.50
India: Repo rate	8.50	Tightening: 19 Mar 10	4.75	Oct 11 (+25)	Q2 12 (-25)	8.50	8.50	8.25	8.00
Korea: Base rate	3.25	Tightening: 9 Jul 10	2.25	Jun 11(+25)	Beyond Q3 12	3.25	3.25	3.25	3.25
Poland: 2w repo rate	4.50	Tightening: 19 Jan 11	3.50	Jun 11 (+25)	May 12 (-25)	4.50	4.50	4.25	4.00
Russia: Refi rate	8.25	Tightening: 25 Feb 11	7.75	Apr 11 (+25)	Mar 12 (-25)	8.25	8.00	7.75	7.75
South Africa: Repo rate	5.50	Easing: 11 Dec 08	12.00	Nov 10 (-50)	Beyond Q3 12	5.50	5.50	5.50	5.50
Turkey: 1wk repo rate	5.75	Easing: 20 Nov 08	16.75	Aug 11 (-50)	Beyond Q3 12	5.75	5.75	5.75	5.75
Brazil: SELIC rate	11.50	Easing: 31 Aug 11	12.50	Oct 11 (-50)	Nov 11 (-50)	11.00	10.50	10.50	10.50
Chile: Monetary policy rate	5.25	Tightening: 15 June 10	0.50	Jun 11 (+25)	Q1 12 (-25)	5.25	5.00	4.25	4.25
Mexico: Overnight rate	4.50	Easing: 16 Jan 09	8.25	Jul 09 (-25)	Q1 12 (-25)	4.50	4.25	4.00	4.00

Note: Rates as of COB 24 November 2011. Source: Barclays Capital

Key CPI projections

	US		UK			Euro area			France		Sweden		Japan	
	CPI		RPI		CPI	HICPx		HICP	CPI ex tobacco		CPI		CPI ex perishables	
	nsa	y/y	nsa	y/y	y/y	nsa	y/y	y/y	nsa	y/y	nsa	y/y	nsa	y/y
Jan 11	220.2	1.6	229.0	5.1	4.0	110.11	2.19	2.3	120.32	1.69	306.15	2.5	99.4	-0.8
Feb 11	221.3	2.1	231.3	5.5	4.4	110.57	2.28	2.4	120.90	1.61	308.02	2.5	99.4	-0.8
Mar 11	223.5	2.7	232.5	5.3	4.0	112.11	2.77	2.7	121.90	1.94	310.11	2.9	99.7	-0.7
Apr 11	224.9	3.2	234.4	5.2	4.5	112.75	2.89	2.8	122.32	2.02	311.44	3.3	100.0	-0.3
May 11	226.0	3.6	235.2	5.2	4.5	112.74	2.76	2.7	122.40	1.97	312.02	3.3	100.1	-0.2
Jun 11	225.7	3.6	235.2	5.0	4.2	112.75	2.78	2.7	122.49	2.06	311.28	3.1	99.8	-0.3
Jul 11	225.9	3.6	234.7	5.0	4.4	112.03	2.49	2.5	121.94	1.89	311.13	3.3	99.8	0.1
Aug 11	226.5	3.8	236.1	5.2	4.5	112.23	2.46	2.5	122.59	2.18	311.22	3.4	99.9	0.2
Sep 11	226.9	3.9	237.9	5.6	5.2	113.08	3.02	3.0	122.49	2.18	313.41	3.2	99.9	0.2
Oct 11	226.4	3.5	238.0	5.4	5.0	113.08	2.65	3.0	122.73	2.25	313.42	2.9	99.8	-0.1
Nov 11	226.3	3.4	238.7	5.2	4.8	113.17	2.63	3.0	122.76	2.22	314.08	2.8	99.7	-0.1
Dec 11	226.0	3.1	240.0	5.1	4.3	113.62	2.42	2.8	123.23	2.17	314.87	2.3	99.6	-0.1
Jan 12	226.8	3.0	239.3	4.5	3.8	112.47	2.14	2.5	122.58	1.88	313.66	2.5	99.4	0.0
Feb 12	227.6	2.8	240.5	4.0	3.4	112.81	2.03	2.4	123.00	1.74	314.84	2.2	99.5	0.1
Mar 12	228.5	2.2	241.5	3.9	3.5	114.12	1.79	2.2	123.76	1.53	315.91	1.9	99.7	0.0
Apr 12	229.4	2.0	242.8	3.6	2.9	114.55	1.60	2.0	123.99	1.37	316.89	1.7	99.9	-0.1
May 12	229.8	1.7	244.1	3.7	3.2	114.57	1.62	2.0	124.15	1.43	317.54	1.8	99.9	-0.2
Jun 12	230.4	2.1	244.8	4.1	3.5	114.56	1.61	2.0	124.19	1.39	318.18	2.2	99.6	-0.2
Jul 12	230.7	2.1	244.3	4.1	3.1	113.72	1.51	1.9	123.54	1.31	317.86	2.2	99.5	-0.3
Aug 12	231.1	2.0	245.1	3.8	2.9	113.98	1.56	1.9	124.22	1.33	318.46	2.3	99.5	-0.4
Sep 12	231.8	2.2	246.2	3.5	2.5	114.64	1.38	1.7	124.29	1.47	320.96	2.4	99.7	-0.2
Oct 12	231.7	2.3	246.7	3.7	2.5	114.90	1.61	1.6	124.72	1.62	322.45	2.9	99.5	-0.3
Nov 12	231.9	2.5	247.2	3.5	2.4	114.87	1.50	1.5	124.66	1.55	323.02	2.8	99.5	-0.2
Dec 12	232.1	2.7	248.1	3.4	2.3	115.21	1.40	1.5	125.06	1.48	324.01	2.9	99.4	-0.2
2010		**1.6**		**4.6**	**3.3**		**1.5**	**1.6**		**1.5**		**1.2**		**-1.0**
2011		**3.2**		**5.2**	**4.5**		**2.6**	**2.7**		**2.0**		**3.0**		**-0.2**
2012		**2.3**		**3.8**	**3.0**		**1.6**	**1.9**		**1.5**		**2.3**		**-0.2**

Note: Shaded values indicate actual data. 'R' indicates revision to front-month forecast. Source: Barclays Capital

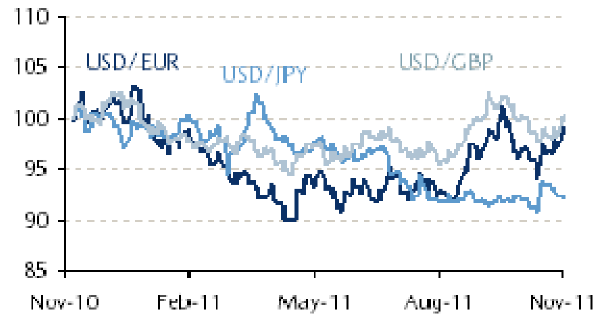
GLOBAL MARKETS WATCH

Global Equities

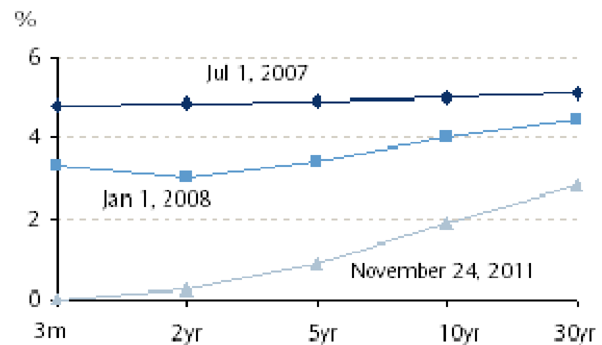
		1-week	% chng from 12/31/2010	
	Index	(% chng)	Local Curr	USD
Global	Weighted Avg.	-4.3	-15.2	-24.4
Developed	Weighted Avg.	-5.6	-20.7	-21.9
Emerging	Weighted Avg.	-3.8	-12.7	-27.2
BRIC	Weighted Avg.	-3.1	-19.7	-30.2
United States	S&P 500	-4.5	-7.6	-7.6
Euro area	FTSE Euro 100	-6.2	-19.1	-19.3
Japan	Nikkei 225	-3.7	-20.2	-15.6
UK	FTSE 100	-5.5	-13.1	-13.7
Emerging Asia	Weighted Avg.	-3.4	-16.3	-16.7
China	Shanghai Comp.	-2.7	-14.6	-11.4
India	NIFTY	-3.6	-22.5	-22.7
Korea	KOSPI	-4.3	-12.5	-14.3
EMEA	Weighted Avg.	-7.4	-20.5	-35.6
Russia	MICEX	-5.6	-17.5	-19.8
Turkey	ISE	-9.9	-24.8	-37.9
South Africa	JALSH	-3.8	-2.9	-24.0
Latin America	Weighted Avg.	-2.1	-7.4	-23.2
Brazil	Bovespa	-3.0	-20.2	-30.2
Mexico	IPC	-2.2	-8.4	-37.9

Note: Updated as of COB 24 November 2011. Weighted averages calculated using IMF share of world GDP. EM Asia includes China, India, HK, Indonesia, Korea, Malaysia, Singapore, Taiwan, Thailand and Vietnam. EMEA includes Russia, Czech Republic, Hungary, Poland, Romania, Turkey, Ukraine and South Africa. LatAm includes Brazil, Argentina, Chile, Colombia, Mexico, Peru and Venezuela. Source: Bloomberg, Barclays Capital

Key USD Exchange Rates



US Treasury Yields



Source: Bloomberg, Barclays Capital

Rates, Credit and Commodities

		1 week	3 months	12 months
	Latest	ago	ago	ago
Rates				
2 year Treasury	0.26	0.26	0.23	0.53
10 year Treasury	1.88	1.96	2.30	2.91
30 year Treasury	2.83	2.98	3.65	4.28
Overnight LIBOR	0.14	0.14	0.14	0.23
3-month LIBOR	0.51	0.48	0.31	0.29
Spread 3M LIBOR over 3M OIS	0.41	0.40	0.23	0.10
Credit				
Barclays Global Aggregate	119.0	113.4	91.3	65.1
Barclays US Aggregate	97.8	89.9	82.7	61.6
Barclays EM Aggregate	465.6	433.8	384.3	307.8
Barclays US Credit	229.0	209.9	192.7	153.8
Barclays US Corporate IG	246.4	227.3	212.5	166.8
Commodities				
CRB/Reuters Commodities Index	486.2	493.3	538.6	487.6
WTI	96.17	98.82	85.16	83.26
Gold	1694.3	1721.8	1759.3	1373.3
Barclays Metals Total Return Index	163.6	166.4	179.9	145.5
Barclays Agri. Total Return Index	148.8	154.8	186.9	161.9

Note: Updated as of COB 24 November 2011. Barclays indices expressed in option-adjusted spreads. Source: Bloomberg, Barclays Capital

Global FX

		1-week	3-month	12-month
	Spot	% Chg.	% Chg.	% Chg.
G7 Rates				
DXY Dollar Index	79.14	1.1	6.9	-0.9
EUR/USD	1.33	-0.8	-7.4	0.1
USD/JPY	77.12	0.2	0.2	-7.7
GBP/USD	1.55	-1.6	-5.4	-1.7
USD/CHF	0.92	-0.3	15.5	-7.7
USD/CAD	1.05	1.7	6.1	3.7
USD/AUD	0.92	-0.3	15.5	-7.7
USD/NZD	1.35	2.3	11.7	2.5
Selected EM Rates				
USD/KRW	1159	2.5	7.1	1.4
USD/CNY	6.37	0.2	-0.4	-4.3
USD/BRL	1.90	6.7	17.6	10.2
USD/RUB	31.48	2.1	8.7	0.7
USD/INR	52	2.3	13.2	13.9
USD/TRY	1.87	2.3	4.8	26.5
USD/MXN	14.21	3.5	13.8	14.8

Note: Updated as of COB 24 November 2011. DXY Dollar Index consists of EUR (57.6%), JPY (13.6%), GBP (11.9%), CAD (9.1%), SEK (4.2%) and CHF (3.6%). Source: Bloomberg, Barclays Capital

OUTLOOK: UNITED STATES

The December fiscal scramble

Troy Davig
+1 212 526 3714
troy.davig@barcap.com

- **With the failure of the Super Committee, risks have increased that the payroll tax cut and extended unemployment benefits will expire.**
- **We see an expiration of both short-term stimulus measures as shaving about 1pp off Q1 and about 0.5pp off Q2 growth in 2012.**
- **Despite the policy uncertainty, corporate profits continue to grow at a healthy pace, and the recent data flow is consistent with our 2.5% Q4 growth forecast.**

Our baseline assumption is that the payroll tax cut and benefits for the long-term unemployed will be extended

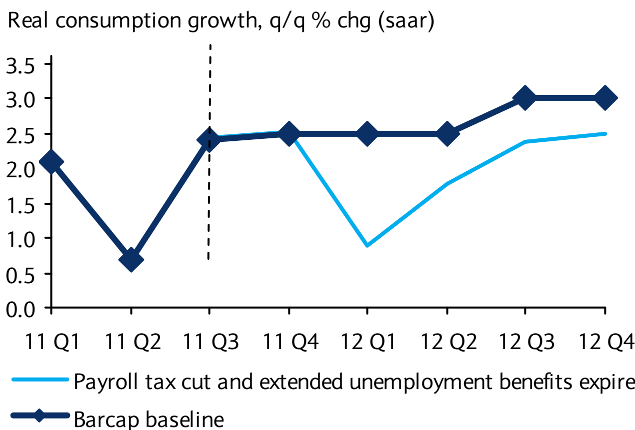
With the failure of the Joint Select Committee on Deficit Reduction, or the so-called Super Committee, a scramble is now likely in Congress to determine if it can piece together a package that will preserve some short-term fiscal stimulus. In particular, the payroll tax cut and unemployment benefits for the long-term unemployed are two important factors shaping the near-term outlook. Our baseline assumption is that both of these provisions will be extended. However, we see an elevated risk that they will expire, which would result in a drag to disposable income growth and, as Figure 1 illustrates, likely shave about 1.5pp off consumption growth (1pp off headline) in Q1 and about 0.5pp in Q2 next year on a q/q (saar) basis.

We estimate that failure to extend these provisions would shave about 1pp off headline growth in Q1 12

A major hurdle in extending the short-term stimulus measures is finding offsetting measures to pay for them

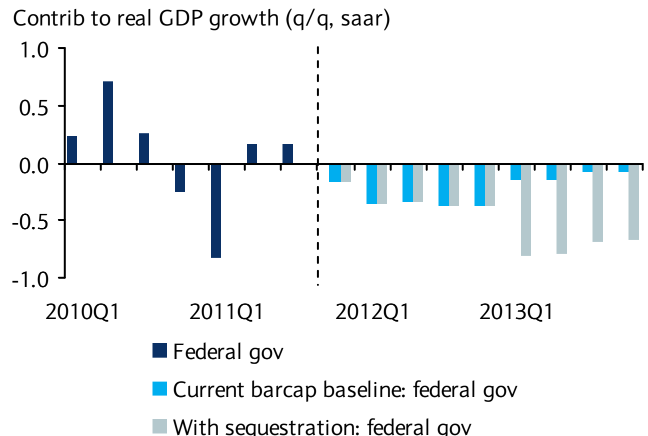
To pass the extensions, Congress will likely need to find offsetting measures to pay for these programs. Although the pay-as-you-go (PAYGO) law passed in early 2010 does not explicitly require offsetting deficit savings for the full amount of these stimulus measures, Congress would have to designate several of the provisions as "emergency requirements" to satisfy current budget rules. This was the approach used in December of last year initially to pass the payroll tax cut and some of the other measures. Given the current political climate, however, either reaching agreement in Congress that they are indeed emergency requirements or finding the deficit savings needed to extend the programs at their current levels could be a high bar. In addition, other measures, such as indexing the Alternative Minimum Tax (AMT) to inflation, the recurring "doc-fix" and extending the 100% bonus depreciation allowance are presumably on the table and could be included in legislation that extends these other stimulus measures.

Figure 1: The potential drag of expiring short-term fiscal stimulus



Source: CBOE, Haver Analytics

Figure 2: Automatic budget cuts due to the super committee failure would result in a notable drag, but not until 2013



Source: Barclays Capital

We expect some resolution to arise in mid-December, similar to last year, and before the current Continuing Resolution expires

One possible approach to resolving the array of expiring provisions is to wrap them all into a Continuing Resolution (CR). After the current fiscal year started on October 1 without a budget in place, Congress has been passing CRs to keep the federal government operating – the current one expires on December 16. Thus, a possible approach is to include the stimulus measures and "fixes" in a broader CR, which would also include funding for federal agencies through the end of the fiscal year. In terms of timing, last year's fiscal scramble showed signs of resolution on December 6, 2010, when President Obama announced the agreement of a two-year extension of the tax cuts first passed in 2001 and 2003 that were about to expire, along with the payroll tax cut and extension of unemployment benefits. The legislation was then passed by Congress on December 16, 2010. Given that the current CR expires on December 16 of this year, we expect a similar timeframe now.

Another round of the December fiscal scramble is likely to occur in 2012

Even if Congress succeeds in the extensions, as we expect, the stage is set for yet another round of policy uncertainty at the end of 2012. The tax cuts initially passed in 2001 and 2003 are set to expire, and federal agencies will be facing substantial budget cuts due to the sequestration procedures. Figure 2 show our estimates of the effect of the resulting spending cuts on headline GDP growth. Given the punitive nature of the sequestration procedure, we expect Congress to consider legislation to avoid or postpone the full amount of the cuts, but do not see this issue being seriously addressed until after the November elections.

Inventory rebuilding to support Q4 growth, corporate profits forge ahead

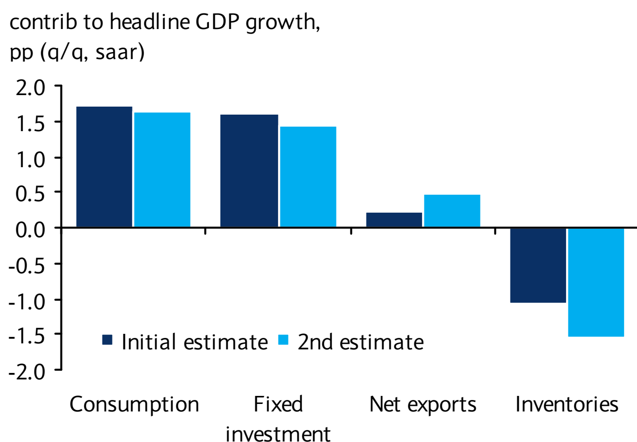
Inventory rebuilding poses some upside risk to our 2.5% q/q (saar) Q1 growth forecast

Despite the near-term policy uncertainty hanging over the economy, growth is continuing at a moderate pace. As Figure 3 shows, the second release of Q3 GDP was revised down to 2.0% q/q (saar) from 2.5%, due primarily to lower inventory investment, which is now estimated to have subtracted 1.6pp from headline growth, versus the 1.1pp initial estimate. To the extent the inventory drawdown in Q3 was unplanned, inventory stocks will likely be rebuilt in Q4. Thus, we see some upside risk to our Q4 growth forecast of 2.5%, although this week's data on consumer spending put our tracking estimate in line with this forecast.

Corporate profit growth remains healthy, yet firms are still reluctant to hire

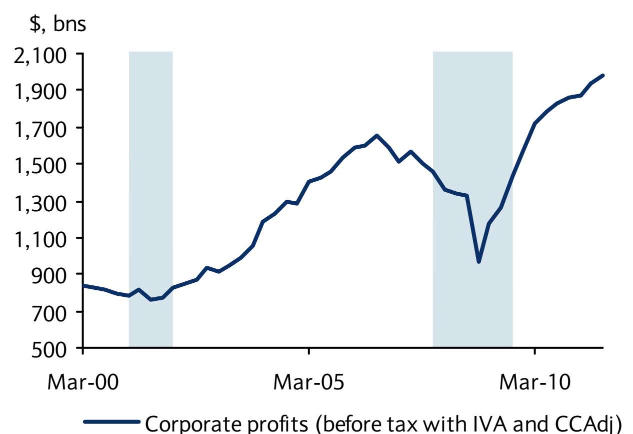
In addition, corporate profits continue to increase at a healthy pace, rising 8.5% q/q (saar) in Q3, with gains in both the financial and non-financial sectors (Figure 4). Despite the bounce following the recession, firms remain reluctant to start aggressively adding to their payrolls. We view part of this reluctance as stemming from the uncertainties hanging over the outlook, which we think are coming primarily from the crisis in Europe and the near-term path of fiscal policy in the US.

Figure 3: Inventories weighed on Q3 headline growth



Source: Bureau of Economic Analysis, NBER, Haver Analytics

Figure 4: Corporate profits continue to move higher



Source: Barclays Capital

DATA REVIEW & PREVIEW: UNITED STATES

Dean Maki, Michael Gapen, Troy Davig, Peter Newland, Cooper Howes

Review of last week's data releases

Main indicators	Period	Previous	Barclays	Actual	Comments
Existing home sales, mn saar	Oct	4.90 R	4.79	4.97	Modest gains in single-family home sales.
Real GDP, % q/q saar	Q3-s	2.5	2.3	2.0	Significant downward revision to inventory accumulation.
Real consumer spending, % q/q saar	Q3-s	2.4	2.4	2.3	Upward revision to durable goods offset by downward revisions to services and nondurable goods.
GDP price index, % q/q saar	Q3-s	2.5	2.5	2.5	In line with our expectations.
Durable goods orders, % m/m	Oct	-1.5 R	-0.6	-0.7	Core capital goods orders lower, but still up 9.5% y/y.
Personal income, % m/m	Oct	0.1	0.3	0.4	Largest gain since March.
Personal spending, % m/m	Oct	0.7 R	0.4	0.1	Below our forecast but upward revision to September.
PCE price index, % m/m (y/y)	Oct	0.2 (2.9)	0.0 (2.8)	-0.1 (2.7)	Annual increases continue to be driven by energy.
Core PCE price index, % m/m (y/y)	Oct	0.0 (1.6)	0.1 (1.7)	0.1 (1.7)	Matches highest y/y increase since March 2010.
Michigan consumer sentiment index	Nov-f	64.2	63.8	64.1	Improvement in current conditions component was offset by modest deterioration in economic outlook.

Preview of the next week

Monday 28 November		Period	Prev 2	Prev 1	Latest	Forecast	Consensus
10:00	New home sales, thous saar	Oct	297	296	313	310	310

New home sales: We look for new home sales to fall 1.0% m/m to 310,000 units in October and for months supply to remain at 6.2 months, or about two months above pre-crisis inventory levels. Our forecast would leave the 3mma of new home sales at 306k, in line with the 309k average in Q2 11 and a bit above the 299k seen in Q1 11. MBA mortgage applications for purchase did rise 2.2% in September and 0.2% in October, but they fell 9.0% in August and the series remains below its 2011 average, suggesting that lower mortgage rates have not yet translated into any significant pick-up in new housing demand. New home sales have been range bound between 275,000 and 331,000 since last May when the effects of government stimulus on housing activity began to wane; we look for new home sales to remain in this range until months supply declines further.

Tuesday 29 November		Period	Prev 2	Prev 1	Latest	Forecast	Consensus
9:00	S&P Case-Shiller composite HPI, % m/m (y/y)	Sep	-0.1 (-4.5)	-0.2 (-4.2)	-0.1 (-3.8)	0.0 (-3.0)	0.1 (-3.0)
10:00	Confidence Board consumer confidence index	Nov	45.2	46.4	39.8	42.5	43.9
10:00	FHFA house price index, % m/m (y/y)	Sep	0.7 (-4.5)	0.0 (-4.1)	-0.1 (-4.0)	-0.2 (-3.3)	-
12:30	Atlanta Fed President Lockhart (FOMC non-voter) speaks in Atlanta						
16:30	San Francisco Fed President Williams (FOMC non-voter) speaks in San Francisco						
20:00	Minneapolis Fed President Kocherlakota (FOMC voter) speaks in California						

Consumer confidence: We forecast consumer confidence to increase modestly to 42.5 in November from 39.8 in October. This is consistent with the upside surprise to the initial November value of the University of Michigan index of consumer sentiment. While uncertainty in equity markets remains elevated relative to historical norms, recent economic data have been encouraging; for example, the four week moving average of initial jobless claims is below 400k and retail sales showed solid growth in October.

Wednesday 30 November		Period	Prev 2	Prev 1	Latest	Forecast	Consensus
8:15	ADP private payrolls, thous	Nov	85	116	110	-	130
8:30	Nonfarm productivity, % q/q saar	Q3-f	-0.6	-0.1	3.1	2.5	3.0
8:30	Unit labor costs, % q/q saar	Q3-f	6.2	2.8	-2.4	-1.9	-2.3
9:45	Chicago PMI	Nov	56.5	60.4	58.4	56.0	58.4
10:00	Pending home sales, % m/m	Oct	-1.3	-1.2	-4.6	1.0	1.2
14:00	Fed releases Beige Book economic survey						

Nonfarm productivity: We expect a downward revision to productivity growth in the nonfarm business sector to 2.5% q/q (saar) in Q3, versus the initial estimate of 3.1%, due to the downward revision to nonfarm business output. The slower pace of productivity growth also implies that unit labor costs likely did not fall as far as the initial estimate suggests, so we expect them to decline 1.9%, a bit less than the initial -2.4% estimate.

Chicago PMI: The Chicago PMI has taken a significantly stronger tone than other regional indices in recent months, with a reading of 58.4 in October (suggesting strong growth), as opposed to the near-zero readings on the Empire State and the Philadelphia Fed surveys (suggesting only modest, if any, output growth). We have penciled in a modest decline in the Chicago PMI in November, to 56.0.

Pending home sales: We look for pending home sales, which track signed contracts on single-family homes, condos, and co-ops, to be up 1.0% in October following three consecutive monthly declines. MBA mortgage loan applications for purchase were up 2.2% in September and 0.2% in October, which suggests pending home sales should see less downward pressure after falling 9.0% in August. A 1.0% m/m increase would leave the pending home sale index unchanged on a y/y basis.

Thursday 1 December		Period	Prev 2	Prev 1	Latest	Forecast	Consensus
8:30	Initial jobless claims, thous (4wma)	26-Nov	393 (401)	391 (398)	393 (394)	390 (392)	-
10:00	Construction spending, % m/m	Oct	-3.3	1.6	0.2	0.3	0.3
10:00	ISM manufacturing	Nov	50.6	51.6	50.8	52.0	51.7
17:00	Vehicle sales, mn saar	Nov	12.1	13.0	13.2	13.4	13.4
9:05	St. Louis Fed President Bullard (FOMC non-voter) speaks in New York						

Construction spending: We expect construction spending to increase 0.3% m/m in October following the 0.2% increase observed in September. We look for the weakness in public construction expenditures to continue as budgetary pressures persist. However, we look for a positive contribution from both private residential spending and nonresidential spending to offset this.

ISM manufacturing: We are looking for a small increase in the manufacturing PMI in November, to 52.0 from 50.8, reversing the decline in October. Regional manufacturing surveys have been volatile in recent months but are now generally consistent with a picture of modest output growth. In addition, the new orders component of the ISM rose to a six month high in October, consistent with a slightly stronger outlook for activity.

Vehicle sales: We expect vehicle sales of 13.4m (annualized) in November, up from 13.2m in October. The rebound in sales at the main Japanese producers following supply constraints in Q2 now appears to have largely played out, although a further rise in average sales in Q4 relative to the 12.5m in Q3 is likely, providing a boost to Q4 consumer spending growth.

Friday 2 December		Period	Prev 2	Prev 1	Latest	Forecast	Consensus
8:30	Change in nonfarm payrolls, thous	Nov	104	158	80	125	112
8:30	Change in private payrolls, thous	Nov	72	191	104	150	140
8:30	Unemployment rate	Nov	9.1	9.1	9.0	8.9	9.0
8:30	Average hourly earnings, % m/m	Nov	-0.2	0.3	0.2	0.2	0.2
8:30	Average weekly hours	Nov	34.2	34.3	34.3	34.4	34.3

Employment report: We look for nonfarm payrolls to expand by 125k in the November employment report and for private payrolls to increase by 150k. This would imply a 25k decline in public payrolls. Underlying our forecast are jobless claims data, which have been pointing to gradual improvement in labor market conditions in recent weeks, the downward move in part-time employment for economic reasons, and behavior of employment diffusion indices that point toward broad-based gains in employment across multiple industries. We look for the unemployment rate to fall to 8.9%, average hourly earnings to increase 0.2%, and hours worked to rise to 34.4.

OUTLOOK: EURO AREA

Recession likely: ECB projected to cut to 0.5%

Julian Callow
+44 (0)20 7773 1369
julian.callow@barcap.com

- **We now expect a recession – negative GDP in Q4 11 and Q1 12 – with 2012 real GDP cut from +0.4% to -0.2%: we look for the ECB to lower the policy rate to 0.5%.**
- **Southern Europe is likely to be much more negatively impacted than northern Europe by the dramatic rise in financing costs.**
- **In the weeks ahead we look for a new package to support Italian debt, probably including IMF financing, as well as more aggressive non-standard ECB operations.**

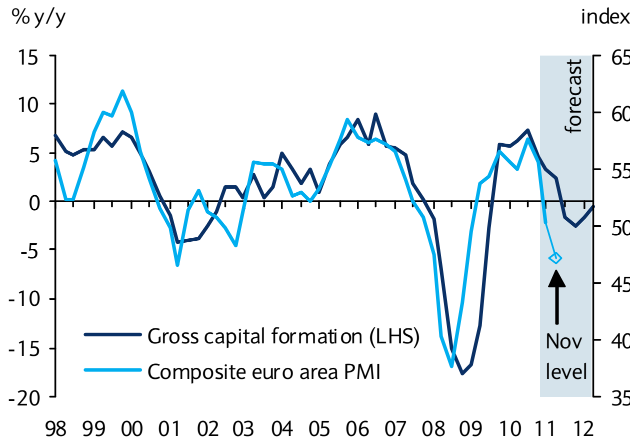
We look for the euro area to be in recession, with GDP declining 0.4% q/q in Q4 and by 0.2% in Q1 12

Recent survey data, taken in association with the sharp deterioration in overall financial conditions, imply that the euro area is likely to have entered into a recession this quarter. We now project that euro area GDP will contract by 0.4% q/q in Q4 and by 0.2% in Q1 12. In particular, we envisage a contraction in business investment and a negative contribution from the change of inventories (Figure 1). For 2012 overall, our forecast has been cut from 0.4% to -0.2%; within that our projection for investment (gross fixed capital formation) is -1.2% (vs. -0.4% previously, and compared with a projected gain of 2.2% for this year).

A rising divergence in GDP (and particularly domestic demand) is likely between northern and southern Europe on account of the shifts in financing costs

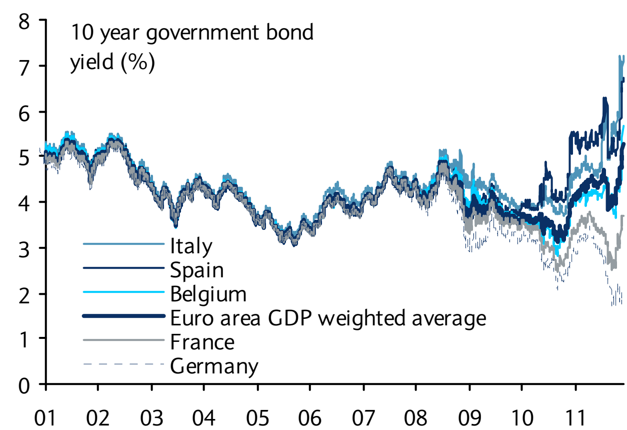
We look for a greater divergence to emerge between growth in northern and southern Europe (although the divergence in domestic demand is likely to be even wider). Whereas we project that Germany will eek out growth next year of 0.3% (revised down from 0.7%), helped by a neutral fiscal stance and record-low bond yields (which are providing a stimulus to the construction sector), financial conditions have worsened significantly across most economies, and particularly in southern Europe. This can be seen just by looking at government bond yields: the ten year GDP-weighted average euro yield is now at 5.29%, the highest since 2002 (Figure 2). The toxic correlation of sovereign and bank borrowing rates implies that the rise in government financing costs will be felt in terms of higher bank lending rates: Figure 3 shows that the rates banks charge non-financial corporations have been significantly influenced by the costs at which banks themselves can borrow (although we emphasise that Euribor rates also have an important influence on lending charges).

Figure 1: Euro area corporates set to cut investment



Source: Haver Analytics, Barclays Capital

Figure 2: Euro area GDP-weighted yield highest since 2002



Source: Datastream, Barclays Capital

There is likely to be a significant increase in the gross interest rate costs paid by non-financial firms (Figure 3), which is set to put significant strains on corporate balance sheets and lead to significant reductions in investment and inventories. We have lowered our 2012 real GDP forecast for Italy to -0.5% (from 0.2%) and Spain to -0.6% (from +0.4%).

Weaker growth implies further difficulties in meeting ambitious budget targets

The worsening economic climate makes the challenge for governments to demonstrate clear and rapid deficit closure all the tougher. For example, the French government projects that real GDP growth will be 1.0% in 2012 (whereas we project -0.1%). This comes even as France projects fiscal consolidation worth around 1.5% of GDP in 2012 (defined in terms of the change in the structural budget balance, and similar to the amount this year): if our projection is correct, it will need to raise the 2012 consolidation to around 2% of GDP.

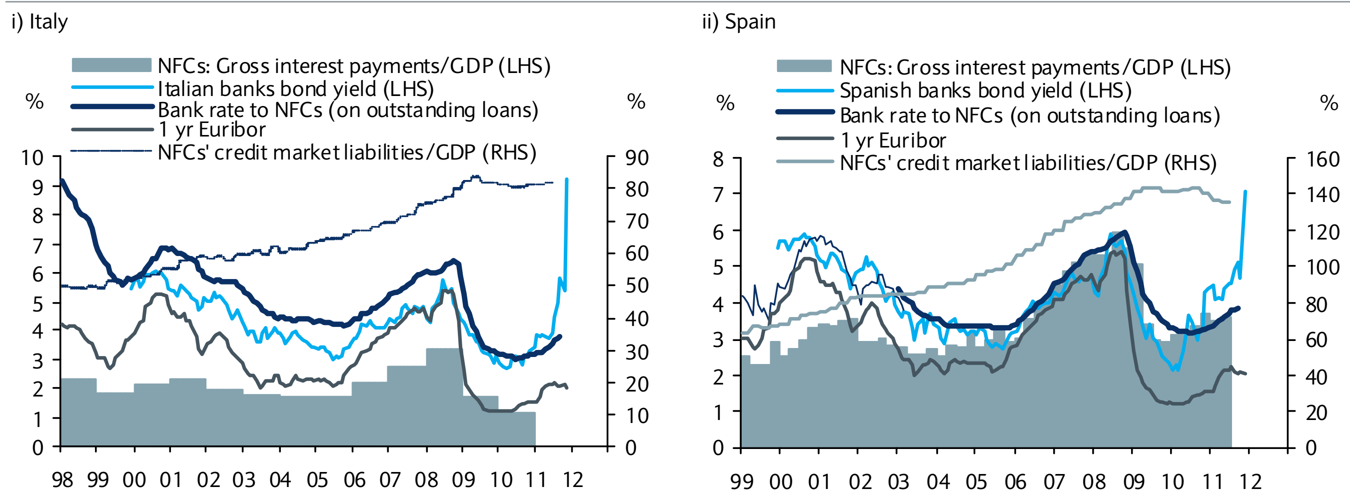
The Bundesbank is already heavily committed to the Eurosystem, with SMP holdings and 'other assets' at 21% of GDP in October

The key issue for the economy is: when will the current stressed risk premia moderate? It is hard to forecast this moment, given the complicated political framework, with northern Europe unwilling and unable (from a political perspective) to provide southern Europe with unconditional guarantees over and above existing commitments. In part, this is because Germany is already significantly committed, with Bundesbank holdings of "other assets" (dominated by claims on the rest of the Eurosystem) plus SMP holdings reaching €552bn at end-October (21% of German GDP, up from €25bn at end-2006).

We look for the ECB to lower the main policy rate to 0.5% (vs. 1.0% previously); additional measures to provide financing to banks likely also

We expect that at the next EU Summit in Brussels (9 December) steps will be taken to move towards treaty reform in order to pave the way for a movement in the euro area to greater central control over national budgets (as indicated at this week's Franco-Italian-German summit). As well, it seems likely that some form of EFSF and IMF assistance will emerge for Italy, which in turn could pave the way for a further increase in the pace of ECB debt purchases (see *What will it take to save Italy (and the Euro)*? 24 November). However, the scale of the problem implies that all means must be deployed, and this implies that the ECB will continue to lower interest rates, down ultimately to 0.5% in our revised view: we now look for the main policy rate to be lowered 25bp in December (to 1.0%), and by a further 50bp in Q1 (with our baseline expectation being two further 25bp cuts in January and February). We would also expect the ECB to announce steps to provide additional financing facilities, (perhaps including a two-year LTRO), and to facilitate additional scope to submit collateral.

Figure 3: Non-financial corporations (NFCs): Interest payments, bank borrowing costs, debt, vs. bank borrowing costs



Note: Credit market liabilities - Loans plus securities excluding shares

Source: Haver Analytics, Barclays Capital (including Credit Strategy)

DATA REVIEW & PREVIEW: EURO AREA

Julian Callow, Marion Laboure, Fabio Fois, Francois Cabau, Thorsten Polleit, Thomas Harjes, Marcus Widen

Review of last week's data releases

Main indicators	Period	Previous	BarCap	Actual	Comments
E17: "Flash" composite PMI, index	Nov	46.5	45.3	47.2	PMIs show first signs of stabilisation, Q4 GDP contraction unlikely to be avoided
E17: Industrial orders, sa % m/m (y/y)	Sep	1.4 (5.9) R	-4.0 (6.3)	-6.4 (1.6)	Industry sector outlook for Q4 looks weak
E17: 'Flash' consumer confidence, index	Nov	-19.9	-21.0	-20.4	Euro area consumer confidence edged down only moderately; private consumption likely to fall in Q4
Germany: IFO business climate, index	Nov	106.4	105.0	106.6	Q3 11 GDP confirmed at 0.5% q/q, while November IFO surprises on the upside

Preview of week ahead

Sunday 27 November							
-	Swi: Holds National Referendum						
Monday 28 November		**Period**	**Prev 2**	**Prev 1**	**Latest**	**Forecast**	**Consensus**
-	France: BdF Governor Noyer speaks in Tokyo						
-	E17: European Council President Rompuy and European Commission President Barroso speaks in EU-US summit						
-	Germany: Baden-Wuerttemberg CPI, % m/m (y/y)	Nov	-0.2 (2.5)	0.0 (2.5)	0.3 (2.8)	0.1 (2.6)	-
-	Germany: Bavaria CPI, % m/m (y/y)	Nov	0.0 (2.2)	0.0 (2.5)	0.3 (2.7)	0.1 (2.6)	-
-	Germany: Hesse CPI, % m/m (y/y)	Nov	-0.2 (1.9)	0.3 (2.3)	0.0 (2.4)	0.1 (2.4)	-
-	Germany: North Rhine Westphalia CPI, % m/m (y/y)	Nov	-0.2 (2.3)	0.3 (2.8)	-0.3 (2.3)	0.1 (2.3)	-
-	Germany: Brandenburg CPI, % m/m (y/y)	Nov	-0.1 (2.1)	-0.1 (2.3)	0.1 (2.4)	0.1 (2.5)	-
-	Germany: Saxony CPI, % m/m (y/y)	Nov	-0.1 (2.4)	0.3 (2.6)	0.2 (2.7)	0.1 (2.8)	-
-	Germany: Preliminary CPI, % m/m (y/y)	Nov	0.0 (2.4)	0.1 (2.6)	0.0 (2.5)	0.1 (2.5)	0.1 (2.4)
-	Germany: Preliminary HICP, % m/m (y/y)	Nov	0.0 (2.5)	0.2 (2.9)	0.1 (2.9)	0.0 (2.8)	-0.1 (2.8)
07:00	Germany: Retail sales, sa % m/m (y/y) (to 02/12)	Oct	0.3 (-1.8)	-0.7 (2.5)	0.4 (0.3)	0.2 (0.0)	0.2 (2.0)
07:00	Germany: GfK consumer confidence, index	Dec	5.2	5.2	5.3	5.2	5.2
08:30	Sweden: Retail Sales, % m/m (y/y)	Oct	-0.8 (1.1)	-0.3 (0.3)	-0.2 (-0.6)	-	0.4
09:00	E17: M3, % y/y (3mma)	Oct	2.1 (2.1)	2.7 (2.3)	3.1 (2.6)	3.4 (3.1)	3.4 (3.1)
09:00	E17: Private sector loans, % y/y	Oct	2.4	2.5	2.5	2.5	-
09:00	Italy: Business confidence, index	Nov	98.6	94.5	94.0	93.0	-
17:00	France: Jobseekers net change (sa), k	Oct	36.1	-2.0	26.0	12	-

Euro area – M3: In October, we expect annual M3 growth to rise to 3.4% y/y from 3.1% y/y in the previous month, largely driven by portfolio effects, while bank loan growth to the private sector is forecast to remain at 2.5% y/y, unchanged from September.

Germany – Retail sales: In October, we forecast German retail sales (real, excl. cars/petrol, sa) to show a 0.2% m/m gain, after a 0.4% m/m increase in the previous month, as consumer confidence is assumed to have held up.

Tuesday 29 November		Period	Prev 2	Prev 1	Latest	Forecast	Consensus
-	E17: Eurogroup meeting						
-	Spain: Budget, year-to date, € bn	Oct	-20.6	-33.7	-31.1	-	-
08:00	Spain: Preliminary HICP, % y/y	Nov	2.7	3.0	3.0	2.9	-
08:00	Spain: Adjusted retail sales, % y/y	Oct	-4.1	-4.1	-5.8	-	-
08:30	Sweden: Final GDP, % q/q (y/y)	Q3	1.2 (7.2)	0.8 (6.1)	0.9 (4.9)	0.6 (3.6)	0.4 (3.6)
10:00	E17: Final consumer confidence, index	Nov	-19.1	-19.9	-20.4 P	-20.4	-20.4
10:00	E17: Industrial confidence, index	Nov	-2.7	-5.9	-6.6	-7.0	-7.0
10:30	Belgium: CPI, % m/m (y/y)	Nov	-0.1 (3.6)	0.3 (3.6)	0.2 (3.6)	0.1 (3.5)	-

Sweden – GDP: We expect the Q3 GDP numbers to print at +0.6% q/q (3.6% y/y), after 0.9% q/q (4.9 % y/y) in Q2. Indeed, both service and industrial production numbers have show more resilience than expected compared with the rapid decline in business survey sentiment. In our view, Q3 will show above-trend growth, while weak sentiment will affect the Q4 growth numbers.

Euro area – Eurogroup/Ecofin meeting: At the Eurogroup/Ecofin meetings, discussions will likely focus on issues relating to the EFSF, Greece, and reforms to the institutional setup of EMU in preparation for the European Council meeting on 8 December.

Wednesday 30 November		Period	Prev 2	Prev 1	Latest	Forecast	Consensus
-	**E27: Ecofin Meeting**						
00:30	**E17: ECB Executive board member Stark speaks in Dallas**						
08:00	**E17: ECB President Draghi speaks in Rome**						
14:00	**Portugal: Bank of Portugal Governor Costa speaks in Madrid**						
07:45	France: Hhsld consum. goods, % m/m (y/y)	Oct	-0.3 (-1.5)	0.2 (0.1)	-0.5 (-1.3)	0.2 (-0.8)	0.1 (-0.2)
08:55	Germany: Unemployment change (000s, sa); (rate, %)	Nov	-7.0 (7.0)	-22.0 (6.9)	10.0 (7.0)	-2 (7.0)	-7.0 (7.0)
08:55	Germany: Unemployment level, mn (k nsa)	Nov	2.9 (5)	2.8 (-149)	2.7 (-58)	2.7 (12)	-
09:00	Italy: Unemployment rate, %	Oct	8.0	8.0	8.3	-	-
10:00	E17: Unemployment rate, %	Oct	10.1	10.1	10.2	10.3	10.2
10:00	E17: Flash HICP, % y/y	Nov	2.5	3.0	3.0	3.0	3.0
10:00	Italy: Preliminary HICP, % m/m (y/y)	Nov	0.4 (2.3)	2.0 (3.6)	0.9 (3.8)	-0.1 (3.7)	-
10:00	Italy: Preliminary CPI, % m/m (y/y)	Nov	0.3 (2.8)	0.0 (3.0)	0.6 (3.4)	-0.1 (3.3)	-
10:30	Swi: KoF leading indicator	Nov	1.6	1.2	0.8	0.7	0.7

France - Hhsld consum. goods: We project French household consumption of goods to have increased by 0.2% m/m (but -0.8% y/y) in October after a 0.5% m/m drop in September (-1.3% y/y).

Euro area – Unemployment: We look for the euro area unemployment rate to edge up to 10.3% in October from 10.2%, which would be the second consecutive 0.1pp increase in two months. Such an occurrence would be a confirmation that the labour market is reacting swiftly to the very rapid deterioration of overall activity, as we expect GDP to fall from +0.2% q/q in Q3 to -0.4% q/q in Q4.

Euro area – HICP: We are in line with the consensus in expecting the euro area "flash" HICP inflation rate to have remained unchanged at 3.0% y/y in November. Underpinning our forecast, we are also in line with the consensus in looking for preliminary HICP inflation in Germany to have edged down to 2.8% y/y, from 2.9% y/y previously.

Thursday 1 December		Period	Prev 2	Prev 1	Latest	Forecast	Consensus
08:00	**E17: ECB President Draghi speaking in Brussels**						
11:30	**E17: ECB Executive Board Praet speaks in Frankfurt**						
06:30	France: ILO Unemployment rate , %	Q3	9.7	9.7	9.6	9.7	9.7
06:45	Swi: GDP, % q/q	Q3	0.6	0.6	0.4	0.2	0.2
08:13	Spain: Manufacturing PMI, Index	Nov	45.3	43.7	43.9	43.0	-
08:30	Swi: Manufacturing PMI, index	Nov	51.7	48.2	46.9	45.3	46.5
08:48	France: Final manufacturing PMI, index	Nov	48.2	48.5	47.6 P	47.6	47.6
08:43	Italy: Manufacturing PMI, index	Nov	47.0	48.3	43.3	42.6	-
08:53	Germany: Final manufacturing PMI, index	Nov	50.3	49.1	47.9 P	47.9	47.9
08:58	E17: Final manufacturing PMI, index	Nov	48.5	47.1	46.4 P	46.4	46.4
17:00	Italy: New car registrations, % y/y	Nov	1.5	-5.7	-5.5	-	-
18:00	Italy: Budget, year-to date, € bn	Nov	-46.8	-58.8	-60.8	-	-

Friday 2 December		Period	Prev 2	Prev 1	Latest	Forecast	Consensus
-	**Germany: Economy Minister Roesler attends "Deutsches Wirtschaftsforum" in Germany**						
17:30	**E17: ECB Executive Board Member Stark speaks in New York**						
08:15	Swi: Retail sales, % y/y	Oct	2.9	-0.8	-0.9	0.4	-
09:00	E17: Publication of the MFI interest rate statistics	Nov	-	-	-	-	-
09:00	Norway: Unemployment rate, %	Nov	2.7	2.5	2.4	2.5	2.4
10:00	E17 : PPI, % m/m (y/y)	Oct	0.4 (6.1)	-0.2 (5.8)	0.3 (5.8)	0.2 (5.6)	0.2 (5.6)

OUTLOOK: UNITED KINGDOM

Euro area sneezes, but the UK was already sick

Chris Crowe
+44 (0)20 7773 4816
chris.crowe@barcap.com

- **While there is clear nervousness about events in the euro area, the UK economy has not yet been markedly affected, with weakness to date mostly home-grown.**
- **However, there are signs that this may be changing, and we have lowered our near-term growth forecasts as we expect weaker euro area growth to hit UK exports.**

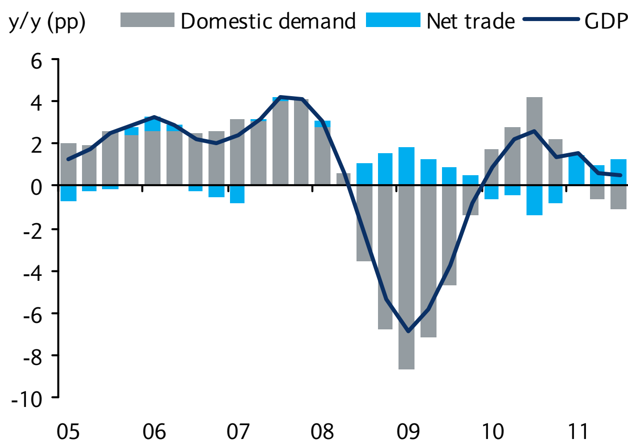
Although it is tempting to blame each negative data outturn on events in the euro area…

There is palpable nervousness about how developments in the euro area could affect the British economy, and it is tempting to blame each successive negative data outturn on events in the UK's most important trading partner. Events in the euro area clearly represent the chief source of tail risks for the UK economy. However, the UK's recent anaemic performance can be attributed mostly to domestic factors. As the minutes to the MPC's November meeting note, weak growth over the course of the previous 12 months has largely reflected "a fall in real household incomes, persistently tight credit conditions and effects of the continuing fiscal consolidation." Survey indicators in October indicated that the major factors weighing on near-term growth were also predominantly domestic in origin, although November's CBI industrial trends survey suggests this may be changing.

…the weakness seen to date is mostly home-grown

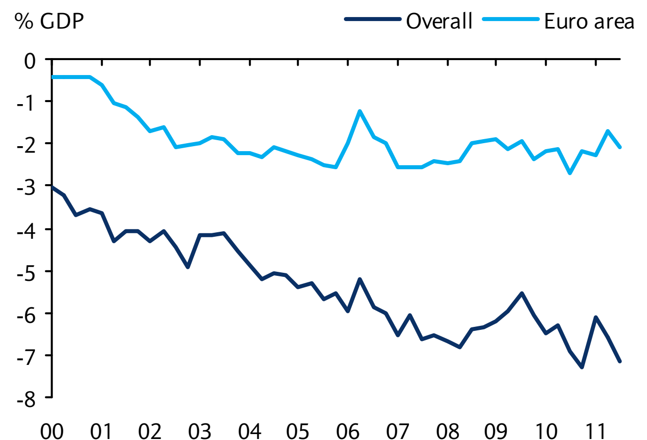
The growth slowdown seen since the end of 2010 is almost wholly attributable to domestic economic weakness (Figure 1). And far from deteriorating, the UK's visible trade balance with respect to its euro area trading partners in the four quarters to Q3 11 has trended upwards (Figure 2). Revised GDP data for Q3, released this week, suggest that this trend may have halted. Net trade subtracted 0.4pp from q/q growth, with inventory accumulation's 0.7pp contribution accounting for most of the growth in the domestic economy. However, although there are some signs of a modest reversal in the bilateral trade balance with the euro area in Q3, the deterioration is no stronger than that seen in the overall trade balance. The macroeconomic data therefore suggest that at best only the last few months' weakness could be attributed to euro area concerns, and even here it is hard to separate a euro area effect from a broader trade effect.

Figure 1: Growth weakness to date is home grown



Source: Haver Analytics, Barclays Capital

Figure 2: UK's visible trade balance



Source: Haver Analytics, Barclays Capital

Up to October high-frequency data showed little sign of contagion

As the euro crisis entered its most critical phase only around August, one would expect high-frequency and forward-looking indicators to provide stronger evidence. However, the most recent survey of business conditions carried out by the BoE's regional agents, released this week, suggested that the export outlook in the manufacturing sector was slightly better than prospects for domestic output (Figure 3). The survey cites evidence of some slowing in exports to the euro area, but also a general weakening in the pace of export growth, and notes that many suppliers with a domestic focus also reported flat or falling orders.

However, export prospects may now be slipping, and we have built this into our forecast

The manufacturing PMI and CBI industrial trends surveys for October similarly reported that exports continued to outperform domestic orders. However, the November edition of the CBI survey, released this week, showed a marked deterioration in export performance. We may therefore now be starting to see contagion via the trade channel. Our euro area economists' near-term forecast of euro area GDP growth has been revised down significantly, and as a result we expect UK exports to be weaker. The impact on GDP growth is fairly limited, in part because the high import content of UK exports limits the effect on net trade. Our q/q growth forecasts for Q4 11 – Q2 12 are now 0.1pp lower than previously, at 0.0%, 0.2% and 0.3% q/q, respectively, and we forecast GDP to grow by 1.3% in 2012.

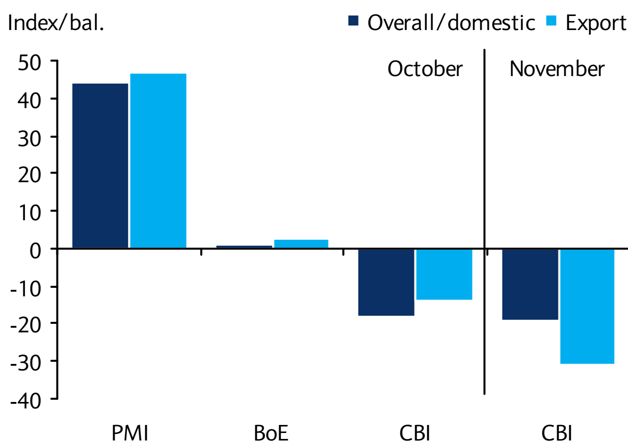
There are also signs of contagion in bank funding markets

Financial markets provide a further route for contagion. One important channel is via bank funding markets, where concern over the European banking sector has made it much harder for banks to raise term financing. Although UK banks' exposure to peripheral euro area sovereign debt is limited, UK banks have seen their funding costs rise markedly in recent months (Figure 4). So far, the increase in the rates at which banks lend to customers has largely been contained, although this is unlikely to continue if banks' funding costs increase further. The BoE agents' survey reported some evidence that smaller firms have already seen a tightening in credit conditions in recent months.

UK gilts appear to be benefiting from euro area weakness

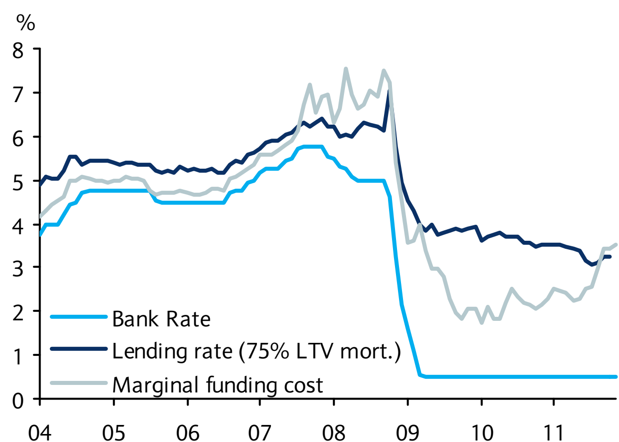
However, even in the financial arena, the effects are not unidirectional. For instance, gilt yields have fallen to around the same level as those on German bunds as UK government debt is increasingly perceived as a safe haven asset. This will lower the UK government's borrowing costs and may also support other UK asset values. Similarly, while any weakness in the value of the euro could harm UK exports to the euro area, the net effect on total exports could be positive as sterling and the euro tend to move together against the dollar.

Figure 3: Export prospects brighter in October surveys



Source: Haver Analytics, Barclays Capital

Figure 4: Bank funding costs have risen sharply[1]



Source: Haver Analytics, CML, Bloomberg, BoE, Barclays Capital

[1] Marginal funding source is long-term wholesale debt; cost is estimated as 3m Libor plus average 5y CDS premia of major UK lenders (see BoE *Quarterly Bulletin* 2010 Q3 pp172-182).

DATA REVIEW & PREVIEW: UNITED KINGDOM

Blerina Uruçi

Review of last week's data releases

Main Indicators	Period	Previous	Barclays	Actual	Comments
PSNBx, £bn	Oct	14.1	5.8	6.5	Public finances keep track with OBR forecast, despite the underperformance of the macro economy.
PSNB, £bn	Oct	11.4	3.0	3.4	
PSNCR, £bn	Oct	19.9	7.4	-0.6	
MPC minutes, Bank Rate vote	Nov	9-0	9-0	9-0	The MPC voted unanimously to keep monetary policy unchanged and ruled out any fine tuning
MPC minutes, Asset purchase vote	Nov	9-0	9-0	9-0	
BBA lending data	Oct	-	-	-	Credit conditions remain subdued
GDP 2nd release, % q/q (y/y)	Q3	0.5 (0.5) P	0.5 (0.5)	0.5 (0.5)	Unrevised growth data for Q3
UK: CBI industrial trends, total orders	Nov	-18.0	-18.0	-19.0	Manufacturing hit by weak export orders

Preview of week ahead

Monday 28 November		Period	Prev 2	Prev 1	Latest	Forecast	Consensus
11:00	CBI distributive trades, total sales	Nov	-14.0	-15.0	-11.0	-14.0	-9.0

CBI distributive trends: We expect the total sales balance to have deteriorated to -14 from -11 previously. Weak consumer confidence and negative real earnings growth are likely to weigh down on consumer spending and retailers have warned they expect very tough trading conditions this Christmas.

Tuesday 29 November		Period	Prev 2	Prev 1	Latest	Forecast	Consensus
07:00	Nationwide house price Index, % m/m (y/y)	Nov	-0.6 (-0.4)	0.1 (-0.3)	0.4 (0.8)	0.0 (1.3)	0.0 (1.3)
09:30	Consumer credit, £bn	Oct	0.3	0.5	0.6	0.5	0.5
09:30	Mortgage approvals, k	Oct	49.6	52.3	51.0	52.0	51.4
09:30	Mortgage lending, £bn	Oct	0.7	0.5	0.3	0.5	0.6
09:30	M4 money supply, % m/m	Oct	0.0	-0.4	-0.4	-	-

Nationwide house price index: We forecast the index to show house prices were flat on the month in November compared with 0.4% previously. The housing market has not registered a significant recovery over this year and the deteriorating economic outlook indicates it will likely continue to be subdued in the coming months. **BoE lending to individuals:** We expect credit creation to continue its weak trend over the near term, as sliding consumer and business confidence weakens demand and banks' elevated funding costs put pressure on supply.

Wednesday 30 November		Period	Prev 2	Prev 1	Latest	Forecast	Consensus
00:01	GfK consumer confidence, index	Nov	-31	-30	-32	-33.0	-33.0

GfK consumer confidence: We expect the GfK consumer confidence index to have fallen further to -33 in November from -32 previously. The deteriorating economic outlook and the spread of the euro area crisis are likely to weight down on consumer sentiment in the UK.

Thursday 1 December		Period	Prev 2	Prev 1	Latest	Forecast	Consensus
-	BoE interim FPC meeting	Q3	-	-	-	-	-
09:28	Manufacturing PMI, index	Nov	49.4	50.8	47.4	47.0	47.0

Manufacturing PMI: We forecast the manufacturing PMI to have fallen slightly to 47.0 in November compared with 47.4 previously. The CBI industrial trends survey for November was also consistent with a small deterioration in the sector as weak domestic demand and falling foreign orders continue to drive the downward trend in the sector.

Friday 2 December		Period	Prev 2	Prev 1	Latest	Forecast	Consensus
09:30	Construction PMI	Nov	52.6	50.1	53.9	52.0	52.0

OUTLOOK: JAPAN

Export slowdown and CPI deflation underway

Kyohei Morita
+81 3 4530 1688
kyohei.morita@barcap.com

Yuichiro Nagai
+81 3 4530 1064
yuichiro.nagai@barcap.com

James Barber, CFA
+81 3 4530 1542
james.barber@barcap.com

- **October marked a turning point for both exports and consumer prices, with the former starting to slow and the latter returning to negative territory.**
- **On a net basis, exports could subtract from GDP growth through mid-2012, with imports supported by non-nuclear energy demand and post-quake reconstruction.**
- **The core CPI could hover near zero until next March due to upward pressure on energy prices, but should resume steeper declines after that.**

This week provided the first glimpse of Q4 trade trends, and the results were broadly in line with expectations. Exports fell even more than we forecast in October, especially those bound for Europe (Figure 1). In real terms, exports dropped 4.8% m/m versus a 4.7% m/m gain for imports. Assuming flat m/m readings in November and December, net exports would subtract 0.9pp q/q from Q4 real GDP growth versus our current forecast for a positive contribution of 0.2pp.

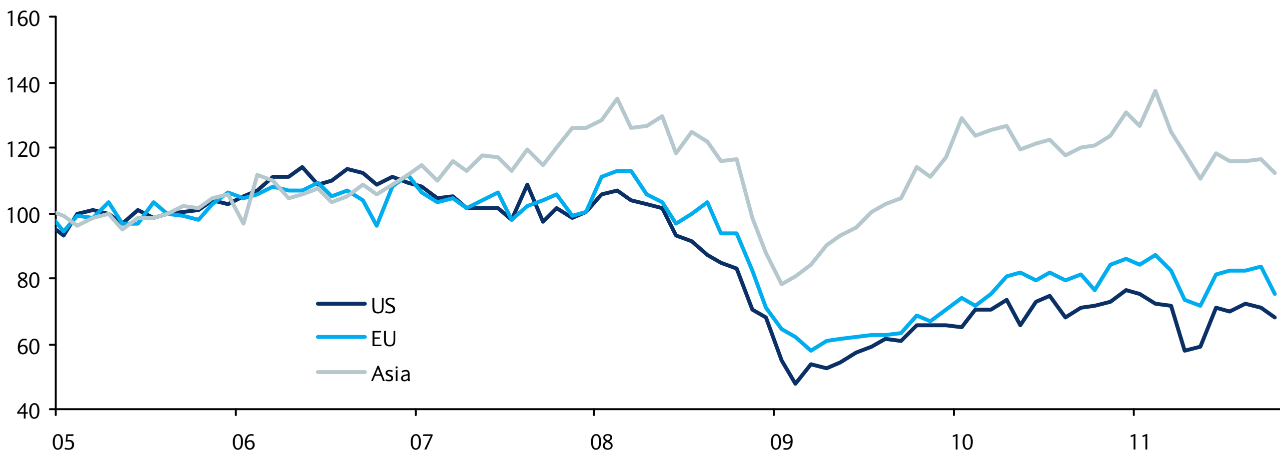
"Net" exports could weigh on growth until mid-2012

We believe net exports will continue to be a drag on economic growth until mid-2012 due not only to the effects of global economic deceleration on exports, but also due to the impact of non-nuclear energy demand and the post-earthquake reconstruction on imports. In fact, "gross" exports are slowing, not falling. On a quarterly basis, the only decrease we forecast is in Q1 12, and even then, just a marginal decline of 0.2% q/q. Instead, Japan's post-earthquake trade deficit is increasingly due to the strength of imports. Since the earthquake and related nuclear crisis, Japan has had to rely on alternative energy, and its oil and LNG imports, for example, have increased as a result. With the third supplementary budget having passed this month, imports are also likely to start drawing support from the government-led post-earthquake reconstruction.

Post-quake reconstruction, however, should boost growth overall

For the overall economy, of course, this reconstruction is not bad news. Indeed, the Cabinet Office estimates that the third supplementary budget alone will boost real GDP by about 1.7% (public works: 0.9%; private capex: 0.4%; government consumption: 0.3%; private consumption and housing investment: 0.2%). We also believe some of the funds from the

Figure 1: Export volume falls sharply, especially to EU (2005 = 100)



Note: Seasonal adjustments by Barclays Capital. Source: Barclays Capital based on MoF trade data

first supplementary budget remain in the pipeline, as discussed last week. This should set the stage for a pick-up in growth, likely from Q2 12. Around the same time, exports should also start to pick up, considering our colleagues' forecasts for other regions, adding to the GDP growth on a net basis from Q3 12.

Core CPI inflation turns down as special factors come full circle

On the price front, the nationwide CPI ex-perishables (core) fell 0.1% y/y in October, the first decline in four months, due to the same factors that led to a steeper decline in the Tokyo index for that month, ie, the end of the effects from the previous October's hikes in the cigarette tax and nonlife insurance premiums. Those subtracted 0.34pp from y/y core CPI inflation (-0.19pp and -0.15pp, respectively) – even more than they did in Tokyo, a reflection of weighting differences.

Energy prices, however, are up

Electricity and gas charges, on the other hand, continue to rise y/y, reflecting tighter supply-demand conditions accompanying the shutdown of nuclear reactors and higher prices for imported LNG, which has been used as a substitute. The per-tonne price of imported LNG, which was just JPY49,000 in January, came to JPY66,000 in October despite the JPY's appreciation over this period.

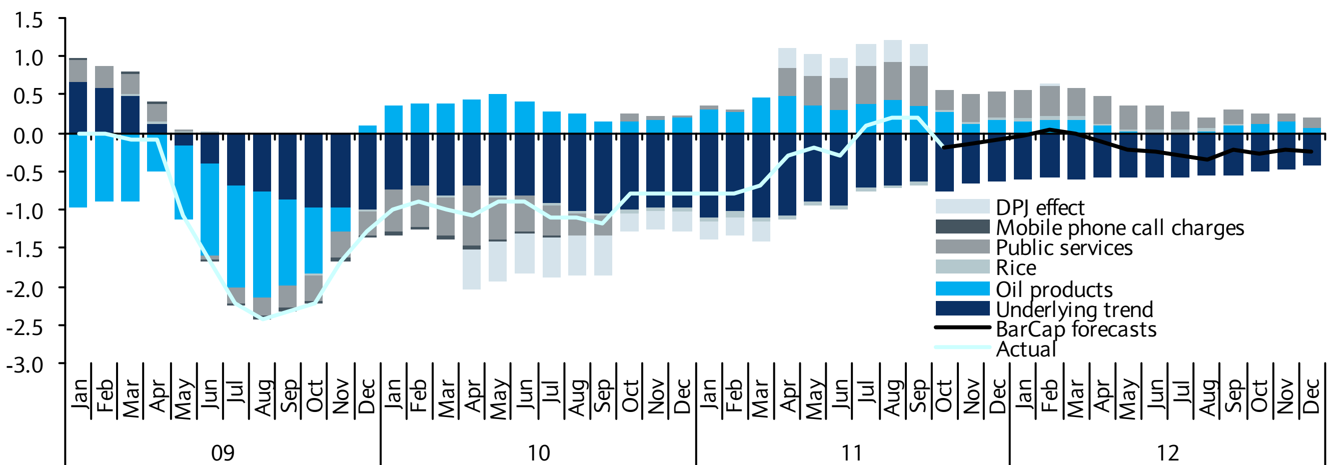
This could keep y/y core CPI around zero until next March

We have revised our forecasts for the coming months with an oil price (WTI) assumption of USD96.7/bbl versus 85.7 at the time of our previous update on 28 October (Figure 2). We expect the nationwide core CPI to fall 0.1% y/y again in November, then to hover in a narrow range around -0.1~+0.1% y/y until March 2012.

Steeper declines should resume from April, even if underlying deflation begins to ease

Unless energy prices continue to rise, however, we expect the CPI to fall more steeply from April onward. However, underlying deflation, which reflects the economic cycle (ie, output gap), is likely to ease slowly but surely.

Figure 2: CPI outlook – back into negative territory, but set to hover around zero for now (% y/y)



Note: "DPJ effect" reflects the impact of policies adopted by the current ruling parties. Our new CPI projections are based on a WTI assumption of USD96.7/bbl. Core CPI = CPI ex-perishables. "Underlying trend" = CPI components reflecting output gap. Source: MIC, Barclays Capital

DATA REVIEW & PREVIEW: JAPAN

Kyohei Morita, Yuichiro Nagai, James Barber

Review of this week's data

Main indicators	Period	Previous	BarCap	Actual	Comments
Trade balance (JPY bn)	Oct	296	-12	-274	Real exports fell 4.8% m/m in October while imports rose 4.7%. Assuming flat m/m readings in November and December, net exports would subtract 0.9pp from real GDP growth in Q4. As such, the data suggest downside risk to our forecast for net exports to add 0.2pp to growth. See Outlook.
Index of all-industry activity (% m/m)	Sep	-0.3	-1.1	-0.9	For Q3, the index rose 2.7% q/q, in line with the strong GDP growth for that period.
National CPI ex-perishables (% y/y)	Oct	0.2	-0.2	-0.1	The nationwide core CPI turned down in October as the effects from last year's hikes in the cigarette tax and nonlife insurance premiums came full circle. With energy costs up, however, the core CPI is likely to hover around 0% y/y until next March before resuming steeper declines. However, underlying deflation, which reflects the economic cycle (ie, output gap), is likely to ease slowly.
Tokyo CPI ex-perishables (% y/y)	Nov	-0.4	-0.5	-0.5	
CSPI (% y/y)	Oct	0.0	0.0	0.1	The index came out of negative y/y territory for the first time since September 2008, as global price pressures offset cost-cutting at home.

Preview of the week ahead

Tuesday 29 November		Period	Prev 2	Prev 1	Latest	Forecast	Consensus
08:30	Jobs/applicants ratio	Oct	0.64	0.66	0.67	0.68	0.68
	Unemployment rate	Oct	4.7	4.3	4.1	4.2	4.2
	Real household spending (% y/y)	Oct	-2.1	-4.1	-1.9	-1.0	-1.5

Employment data: We expect continuing modest improvements overall, but note that the recent sharp drop in the unemployment rate was due largely to an increase in discouraged workers.

Household survey: We look for a continuing decline in real household spending as the end of policy supports weighs on flat-panel TV sales, offsetting any increases in sales of passenger vehicles and apparel.

Wednesday 30 November		Period	Prev 2	Prev 1	Latest	Forecast	Consensus
08:50	Industrial production (% m/m)	Oct	0.4	0.6	-3.3	0.9	1.1
10:30	Wages per worker (% y/y)	Oct	-0.2	-0.4	-0.4	0.0	-0.1

Industrial production: We expect industrial production to turn back up in October, but we will be more focused on the METI forecast indices for November (revised) and December (new), specifically any effects from the flooding in Thailand.

Wages per worker: We estimate that wages were flat y/y in October after falling in the previous four months, but look for a continuing decline in "scheduled" pay as companies adjust to changes in demand through overtime pay and bonuses.

Friday 2 December		Period	Prev 2	Prev 1	Latest	Forecast	Consensus
08:50	Corporate survey, capex ex-software (% y/y)	Q3	4.8	3.4	-8.2	-2.6	-4.0

Corporate survey: The second preliminary GDP data for Q3 are based largely on the findings of this survey. If our forecasts for the latter are correct, GDP-based private-sector capex growth could be adjusted up to 1.5% q/q from 1.1% and private inventory investment could be largely unchanged, pushing real GDP growth to 6.3% q/q saar from 6.0% in the initial data release.

OUTLOOK: CHINA

Increasing downside risks to 2012 growth

Yiping Huang
+852 2903 3291
yiping.huang@barcap.com

Jian Chang
+852 2903 2654
jian.chang@barcap.com

Lingxiu Yang
+852 2903 2653
lingxiu.yang@barcap.com

- **We see downside risks to our 8.4% 2012 GDP growth forecast, mainly from the deterioration in the euro area growth outlook and the ongoing domestic property market correction.**
- **Property sales, which usually lead changes in prices and floor space started, point to slowing private property investment in the coming quarters.**
- **We see differentiated RRR cuts as increasingly likely in order to stabilise liquidity conditions, given capital outflows suggested by a decline in the PBoC's FX purchases.**

The latest HSBC flash PMI slipped back to below the 50 threshold again, falling to 48 in November, after rising to 51 (final print) in October from September's 49.9. While a below-50 reading does not necessarily forecast a manufacturing recession in the coming months, it does highlight the downside risks to the economy. We see downside risks to our below-consensus forecast of 8.4% GDP growth for 2012, mainly from the deterioration in the euro area growth outlook and the ongoing and widespread property market correction in China. Despite the seasonal pick-up usually recorded in November, we think the NBS PMI also likely declined in November, slipping to 50.1 from 50.4 October and 51.2 in September (Figure 1).

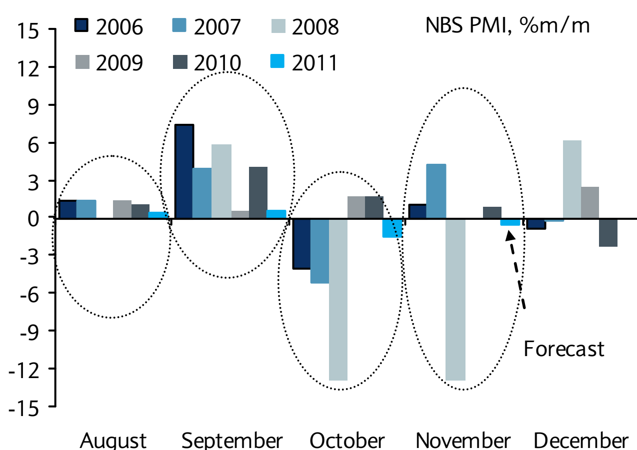
Below-50 reading highlighted the downside risks to the economy

Although the below-50 reading was a surprise, the weaker sentiment was in line with our expectations, given: 1) the slowdown in external demand, particularly an expected contraction in euro area Q4 (and likely also Q1) GDP; and 2) continued moderation in domestic activity given the significant slowdown in housing starts and construction.

Export growth decelerated, reflecting a sharp drop in euro area demand

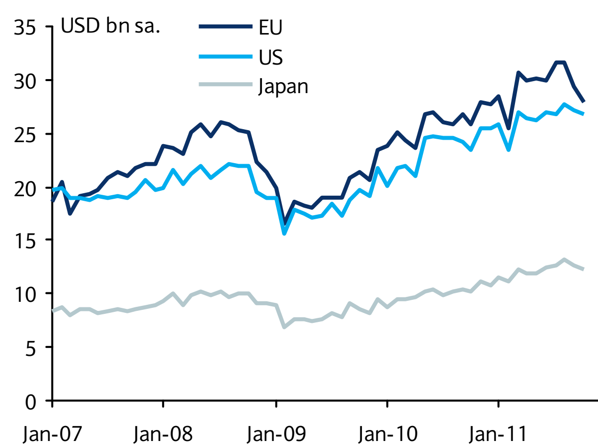
As shown in China's October trade data, export growth decelerated further to 15.9%y/y from 17.1% in September and 24.5% in August, reflecting a sharp slowdown in euro area demand (Figure 2). Shipments to the EU showed more signs of weakness (see *China: September trade evidence of weakening demand from Europe*, 13 October 2011), with growth slipping further to 7.5% y/y from 9.8% in September. In particular, exports to Italy contacted 17.6% y/y (versus -5.1% in September), while shipments to France and Germany recovered somewhat, rising 8.1% and 7.2%, respectively (versus +1% and +6.3%). While exports are likely to meet our forecast of 20% growth in 2011, we see downside risk to our forecast 12.5% growth for 2012.

Figure 1: NBS PMI likely to decline despite seasonal pick-up



Source: CEIC, Barclays Capital

Figure 2: China's exports to advanced economies



Source: Haver Analytics, Barclays Capital

Domestic activity moderated owing to the property market correction

Domestically, property sales, and floor space started and under construction all posted significant y/y slowdowns in October (Figure 3). Floor space started slowed sharply from around 25% y/y growth in Q3 to only 2.2% in October. Floor space under construction fell 2.7% in October, compared with an increase of 17.3% in Q3.

More Chinese cities saw property price declines in October

China's residential property prices have also declined m/m in an increasing number of cities. The National Bureau of Statistics' latest 70-city property price data show that existing home prices fell or were unchanged m/m in 57 cities in October, 11 more than in September. A similar trend can be seen in new home prices.

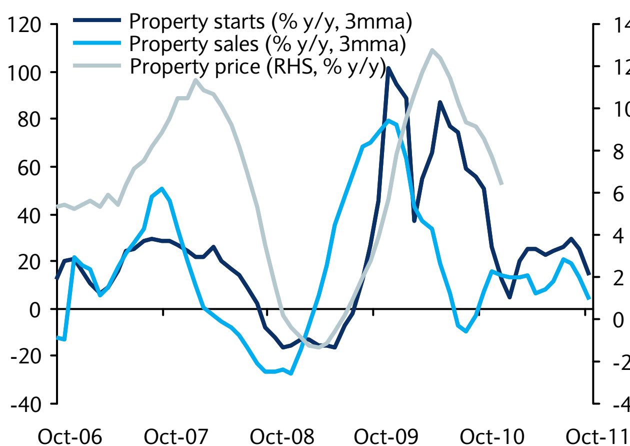
Slower property investment could cut GDP growth by 0.5-1.5pp

The ongoing property correction will directly affect fixed asset investment (FAI). Residential investment is about 25% of total FAI, while gross capital formation is about half of GDP. This implies that residential investment is about 12% of GDP. Depending on the extent of the price and sales decline, and the government's policy reactions, property investment could cut GDP growth by 0.5-1.5pp. Residential FAI is currently growing 31% y/y (23% estimated in real terms in 2011), faster than the close to 25% pace for overall FAI. Our baseline forecast looks for a 10-30% house price decline and expects real residential investment to slow to around 12% next year, half of that recorded this year. However, it is also important to remember that the property sector has become a key driver of economic growth in China. We believe the government will likely adjust policies if average house prices fall 20%, which is what we see as the government's likely tolerance level.

Differentiated RRR cuts becoming increasingly likely to stabilise liquidity conditions

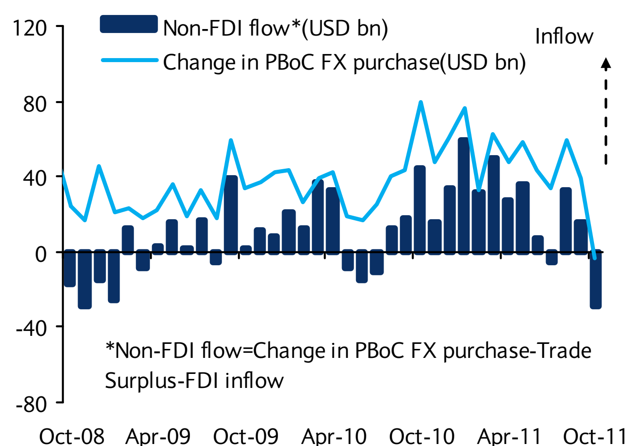
Turning to monetary policy, this week, we have seen more evidences which indicates likely differentiated RRR cuts before year-end. This would be in line with our baseline view ie, the possibility of a selective lowering of RRRs for some banks, or even a broader RRR cut before year–end, as growth in both M2 and total social financing is slowing quickly. However, even if a broader RRR cut is implemented, we would expect it to be used to stabilise liquidity conditions (rather than outright easing). Any change in the official monetary policy bias is most likely to occur during Q1 12, in our view. The latest data show that the PBoC's purchases of foreign exchange, a key indicator of cross-border capital flows, fell CNY24.9bn in October, the first decline since December 2007 (Figure 4). The decline in the PBoC's FX purchases will lead to a contraction in CNY liquidity, and if it persists, it would exacerbate the already tight year-end liquidity conditions resulting from almost zero PBoC bills and repos maturing. The PBoC also did not extend the differentiated RRR of 50bp to more than 20 rural credit cooperatives nationwide when it expired this week, and the reserve requirement for these banks is now 16% compared with 16.5%, effective from 25 November.

Figure 3: Property sales lead prices and new starts



Source: CEIC, Barclays Capital

Figure 4: Capital outflow is observed in October



Source: CEIC, Barclays Capital

IN FOCUS: CHINA

A new yuan regime in the making?

This is an edited extract of a report published on 23 November 2011.

Yiping Huang
+852 2903 3291
yiping.huang@barcap.com

Jian Chang
+852 2903 2654
jian.chang@barcap.com

Lingxiu Yang
+852 2903 2653
lingxiu.yang@barcap.com

A new CNY exchange rate regime might soon be in the making, which could pave the way for two-way fluctuations, improve the reference to a basket of currencies and slow the accumulation of foreign reserves.

Careful observers of China's exchange rate policy may have noticed a number of important changes during the past few weeks:

- the CNY spot rate has depreciated 0.34% against the USD, but it has appreciated by 0.8% against China's trading partners, on average, since November 4 (Figure 1);
- the bilateral spot rate against the USD has repeatedly hit the weaker end of the daily trading band of +/-0.5% set by the PBoC (Figure 2); and
- premier Wen Jiabao said over the weekend that "China will make the yuan more flexible in both directions".

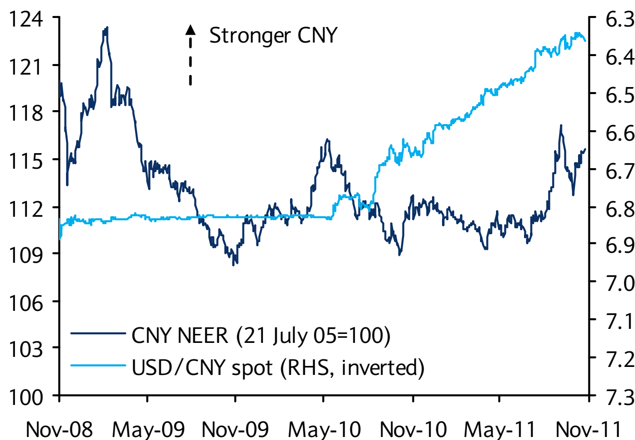
A new yuan exchange rate regime is probably in the making

However, we think the changes are more than simply policy fine tuning but herald something bigger – the making of a new CNY exchange rate regime. The timing of this reform process remains highly uncertain, depending in part on domestic economic moderation and the global economic situation. If things go smoothly, we think the new regime could take shape in a couple of months and is likely to exhibit at least the following key features:

- a wider daily trading band, possibly +/-1% for the USD/CNY spot rate;
- greater reference to a basket of currencies for exchange rate decisions; and
- the emergence of real two-way fluctuations.

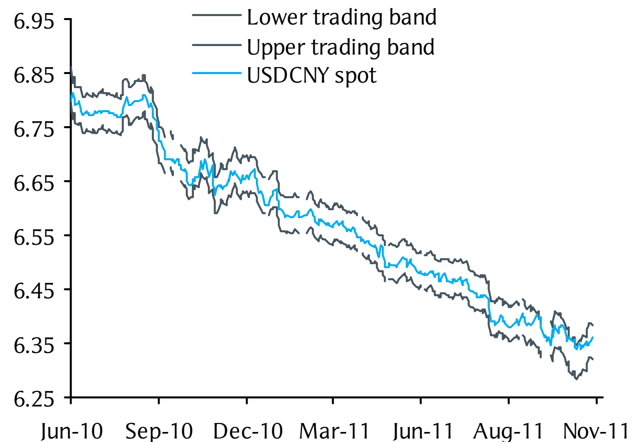
The key takeaways for investors are that exchange rate movements will probably become a lot more volatile, reflecting an end to the one-way CNY appreciation trend.

Figure 1: CNY has depreciated, while the NEER appreciated



Source: Bloomberg, Barclays Capital

Figure 2: CNY traded to the lower end of trading band



Source: Bloomberg, Barclays Capital

The three features of the new regime have been in the minds of the government

All three of the above features of the exchange rate regime were in the minds of policymakers on 21 July 2005, when, under the exchange rate policy reform, the CNY was de-pegged from the dollar and the managed float system introduced with reference to a basket of currencies. The original intention was to gradually allow market mechanisms to play a greater role in determining the exchange rate. This reform came to an abrupt halt in mid-2008 when it was replaced by a "soft peg" of the CNY to the USD, as the global financial crisis hit the Chinese economy. On 19 June 2010, the exchange rate policy reverted back to the managed float.

The daily fixing rate and trading band have limited exchange rate flexibility

So far, however, CNY exchange rate flexibility has been limited by two factors of the currency regime: 1) the daily CNY fixing rate, which is the central parity set by the central foreign exchange transaction centre after consulting market makers; and 2) the daily trading band, which sets the maximum limits for the spot rate to deviate from the central parity. In reality, however, the market rarely hit the boundaries of the trading band until very recently, implying substantial intervention in the foreign exchange market by the PBoC. The market has generally been disappointed by CNY movements, although the currency has appreciated 23% since July 2005 and 6.8% against the USD since June 2010. Lack of CNY exchange rate flexibility has also been a key focus of international criticism.

The debate on exchange rate policy is no less a domestic one than an international one

Clearly, there are always debates on exchange rate policy among Chinese policymakers. Typically, Ministry of Commerce (MOCOM) officials often argue against rapid appreciation since they are more concerned about export growth, while People's Bank of China (PBoC) officials often would support faster currency appreciation as the central bank is more worried about other macroeconomic consequences, such as increases in external imbalances, the accumulation of foreign reserves and the loss of monetary policy independence. The final decision is made by the State Council, but up to now, MOCOM had the upper hand in most of these debates. This was because the State Council was deeply concerned about implications of currency appreciation for jobs and stability.[2]

Several reasons for government to change policy track now

So why would the government change the policy track now? First, the rigid exchange rate regime has become an obstacle in the path of China's overall reform agenda. Second, the negative consequences of the inflexible exchange rate policy have become more evident. Third, while employment remains a key challenge for the Chinese government, for the past year the economy has experienced labour shortages, especially unskilled labour. As a result, wages have risen rapidly. This is likely to be a long-term trend, not a short-term cyclical event, since China is gradually running out of surplus labour in rural areas. Also, finally, market conditions have changed significantly, and are now much more favorable for two-way exchange rate fluctuations, a desired condition for widening the trading band.

A declining trade surplus reduces CNY appreciation pressure

There is a long list of evidence supporting the case that the CNY is not substantially undervalued. The most important is the declining trade surplus, which we expect to drop to about 2% of GDP this year from approximately 8% in 2007. Indeed, if the global economy remains sluggish in the coming years, we think China's trade surplus could actually disappear. In any case, such a low external surplus makes it very difficult to argue that the CNY remains significantly undervalued. The Peterson Institute of International Economics, for instance, now estimates that the CNY is currently 11% undervalued against its trading partners compared with 40% five years ago. Similarly, the PBoC's Yi suggests that the CNY exchange rate is probably not far from the equilibrium rate, pointing to China's very high prices for non-tradable goods, especially property.

[2] Wayne M. Morrison, "China and the global financial crisis: Implications for the United States", Congressional Research Service, Washington DC, June 3, 2009.

Market perceptions of one-way CNY appreciation have also changed

More importantly, market perceptions are very different today. For years, investors assumed the CNY was a one-way appreciation play. But since September, the NDF and CNH markets have started to price in CNY depreciation (Figures 3 and 4). In recent weeks, even the onshore market traded to the weaker end of the trading band. This more pessimistic market view is likely associated with a number of changes, including fears about a hard landing for the Chinese economy, concerns of a spreading financial crisis and the deteriorating capital account position. The CNH market probably taught the policymakers an important lesson: two-way exchange rate fluctuations are possible if the authorities give up their gradual appreciation policy.

One-way appreciation view has run its course, and CNY could depreciate further against USD

What does this mean for investors? In the near term, we think the one-way CNY appreciation trade will soon be over. Indeed, the CNY may be close to its equilibrium rate, given relatively high prices for non-tradable goods, more modest external surpluses and slowing potential growth. We also expect CNY appreciation on a trade-weighted basis to slow further as concerns about Chinese economic and financial risks continue to weigh on the foreign exchange market. And if the USD continues to rise, then CNY could depreciate further against the USD.

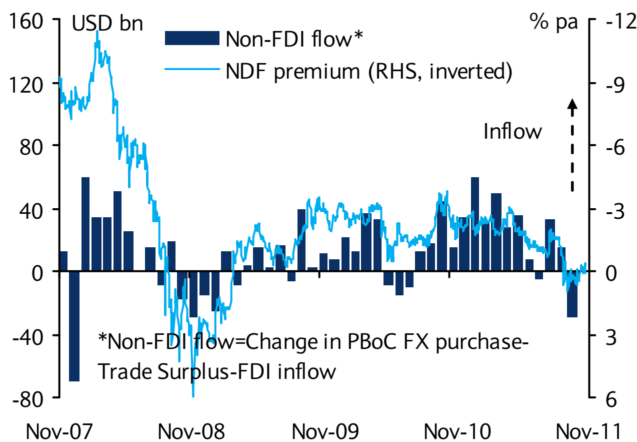
We remain optimistic about the CNY, but it could move in either direction more easily

In the medium to long run, we remain optimistic on the outlook for the CNY. The continued relatively strong growth of the Chinese economy, especially if there is a smooth transition of growth to a more consumption-based model, should make it possible for the CNY to achieve annualised 5-10% appreciation on a trade-weighted basis, in our view. But two-way fluctuations mean the currency could go in the other direction relatively easily, if growth and financial risks actually point in such a direction. For instance, concerns about rapid increases in non-performing loans could lead to capital outflows and depreciation pressures on the CNY.

Reserve accumulation to slow and liquidity pressures to ease

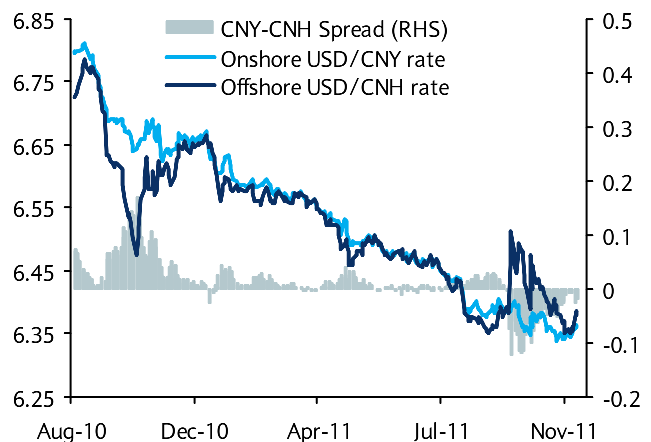
Whether or not the CNY appreciates or depreciates, the accumulation of foreign exchange reserves is likely to slow going forward, reflecting reduced intervention by the central bank in foreign exchange markets. This also implies reduced pressure on domestic liquidity conditions, which should enable the PBoC to regain its monetary policy independence. In the meantime, increases in exchange rate flexibility should create significant room for financial market development, especially the growth of hedging instruments.

Figure 3: Capital outflows amid depreciation expectations



Source: Bloomberg, Barclays Capital

Figure 4: Depreciation expectations in the offshore market



Source: Bloomberg, Barclays Capital

OUTLOOK: EMERGING ASIA

Flooding takes a toll on activity and inflation

Wai Ho Leong
+65 6308 3292
waiho.leong@barcap.com

Joey Chew
+65 6308 3211
joey.chew@barcap.com

- **Severe flood damage will cause Q4 GDP to decline sharply in Thailand. Singapore's economy is also likely to contract, but we expect Taiwan to avoid a recession.**
- **At the same time, adverse weather has pushed up food prices in the region, leading to upside inflation surprises in October in Singapore and Malaysia.**

Q4 GDP likely to contract in Thailand and Singapore…

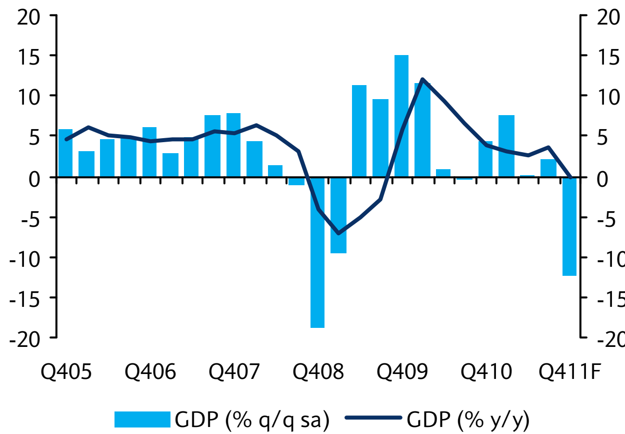
Thailand's economy will contract sharply in Q4 due to flood damage

Thailand and Singapore reported final estimates of Q3 GDP growth earlier this week. While economic activity in both countries rose on a seasonally adjusted sequential basis after contracting in Q2, the near-term outlook for both appears weak owing to country-specific factors. Thailand's 3.5% y/y (2% q/q saar) GDP growth in Q3 was driven by an improvement in net exports, as auto supply-chain disruptions dissipated. However, the expansion looks to be short-lived as we estimate economic losses from the severe flooding in Q4 have soared to 3-4% of GDP. We expect a steep 12% q/q saar contraction in Q4, which means GDP growth is likely to average only 2.4% y/y for 2011. We look for growth to improve to 4.5% in 2012 on relief and reconstruction efforts. We think the Bank of Thailand is likely to cut rates 50bp at its meeting on 30 November, but will likely characterise it as an emergency response, with the option to pull it back if inflation surprises to the upside.

We expect Q4 GDP to contract in Singapore, as net exports will likely remain a drag

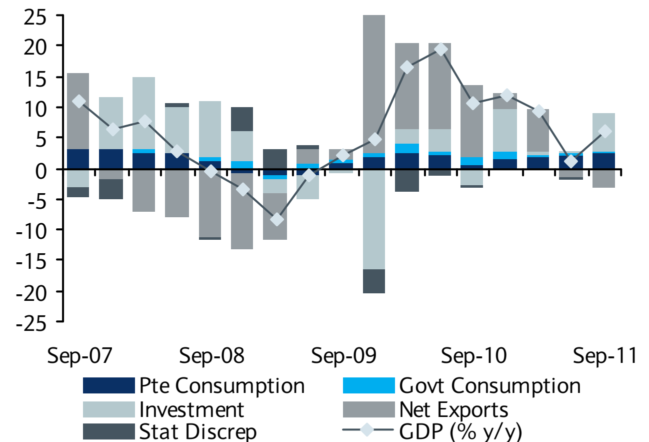
For Singapore, strong inventories and resilient private consumption offset a 3pp drag from net exports, allowing GDP to expand 6.1% y/y in Q3. From an industry perspective, the Singapore economy was lifted 1.9% q/q saar in Q3 almost solely owing to a surge in biomedical production, which is not expected to be sustained in Q4. As such, the Ministry of Trade and Industry (MTI) forecasts full-year GDP growth will average around 5%, implying it expects a 4% q/q saar contraction in Q4. For 2012, MTI now estimates GDP growth at 1-3%, with downside risks from further deterioration in external economic conditions. We maintain our 2011 GDP forecast of 5.2%, but lower our expectations for growth in 2012 to 3% from 4%.

Figure 1: Q4 GDP likely to decline sharply in Thailand



Source: Haver Analytics, Barclays Capital

Figure 2: Net exports continued to contract in Singapore



Source: Haver Analytics, Barclays Capital

… but Taiwan should avoid a recession

Taiwan will avoid a recession in Q4, as soft momentum in industrial production appears to be bottoming out

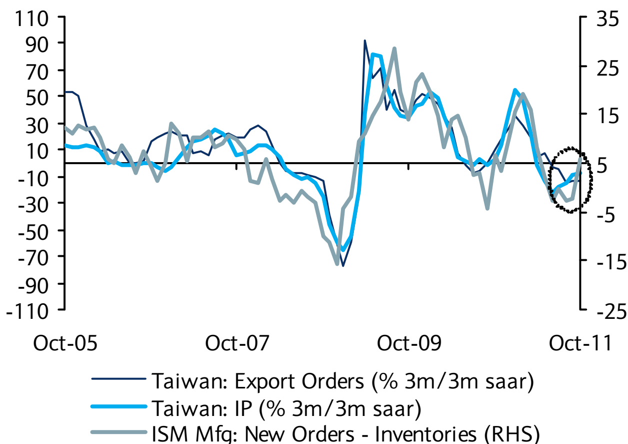
Compared with Singapore and Thailand, Taiwan reported some encouraging developments this week. Due to unfavourable base effects, the weak headline growth in industrial production (1.4% y/y) masked a seasonally adjusted 2.5% m/m gain in October, following two straight months of declines that averaged 2%. This mirrors the improvement in October exports (+5% m/m sa) and export orders (+1.7%). We think these recent positive developments could be attributed to: 1) festive season demand, which may be weaker than in previous years but has not disappeared; and 2) orders diverted from Thailand owing to the flooding there. Global indicators have also turned around, with the US ISM new orders index rising to 52.4, after three months of below-50 prints, while inventories declined. We think the underlying soft momentum in IP could be bottoming out. This supports our expectations for a small rebound in economic activity in Q4, after a contraction of 1.1% q/q saar in Q3 due to a plunge in investments in the IT sector. We expect GDP growth to average 4.5% in 2011 and dip to 4% in 2012.

Weather disruptions drive upside surprises in inflation

Even as growth slows, inflation continues to surprise on the upside, as imported food prices accelerate on weather disruptions and pass-through of weaker exchange rates

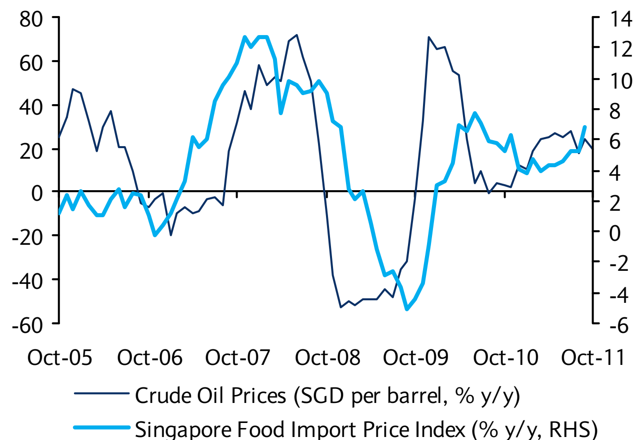
Even as downside risks to growth increase with the further deterioration in the European sovereign debt situation, we still find inflation remaining fairly sticky in the region. Inflation continued to exceed market expectations in October for Singapore and Malaysia, at 5.4% and 3.4% respectively, as food price inflation accelerated. Higher imported food prices for both countries reflected weather-induced supply-side disruptions to regional crops and the pass-through from weaker currencies (against the USD) since August. Prices for Thai fragrant rice, for instance, have soared to USD1,000 per tonne, as flooding damage takes a toll. We expect Singapore's inflation to remain above 5% for the rest of the year, but to moderate to an average of 3% next year when more favourable base effects kick in. However, core inflation will be fairly slow to recede as the step-up in cost levels in the economy, which is in part structural and not only cyclical, will feed through slowly. Similarly, for Malaysia, inflation is forecast to moderate slowly, easing from an average of 3.2% in 2011 to 2.5% in 2012. Given our outlook on inflation, we think the current monetary stance in both countries remains appropriate, for now. The Monetary Authority of Singapore shifted to a slower appreciation pace for the SGD NEER since October, and Bank Negara Malaysia is likely to hold rates at 3% until at least the first half of next year.

Figure 3: Soft momentum in Taiwan IP bottoming out



Source: Haver Analytics, Barclays Capital

Figure 4: Imported commodity price inflation accelerated



Source: CEIC, Bloomberg, Barclays Capital

DATA REVIEW & PREVIEW: ASIA

Rahul Bajoria, Jian Chang, Joey Chew, Waiho Leong, Prakriti Sofat, Siddhartha Sanyal, Gavin Stacey, Joaquin Vespignani

Review of last week's data releases

Main indicators	Period	Previous	BarCap	Actual	Comments
Australia: Construction (% q/q)	Q3	0.7	2.0	12.5	Largest increase on record, reflecting very strong mining capex.
Singapore: GDP (% y/y)	Q3	1.0	5.9	6.1	Biomed outperformance not likely to be sustained in Q4.
Thailand: GDP (% y/y)	Q3	2.7	4.1	3.5	Sharp sequential decline likely in Q4 owing to flood damage.
Taiwan: Industrial production (% y/y)	Oct	1.8	1.4	1.4	High base masked 2.5% m/m sa improvement.
China: Markit "flash" PMI	Nov	51	–	48	Below-50 print highlights downside risks to growth in 2012.
Singapore: CPI (% y/y)	Oct	5.5	5.2	5.4	Rise in imported food prices and housing rents surprised us.

Preview of week ahead

Monday 28 November		Period	Prev 2	Prev 1	Latest	Forecast	Consensus
10:00	Philippines: GDP (% y/y)	Q3	6.1	4.6	3.4	3.3	4.1

Philippines: Growth to remain weak given poor export performance and underspending by the government.

Tuesday 29 November		Period	Prev 2	Prev 1	Latest	Forecast	Consensus
07:00	Korea: Current account balance (USD bn)	Oct	3.8	0.3	3.1	3.4	–

Korea: Trade surplus likely widened on a drop in imports, while exports held relatively steady.

Wednesday 30 November		Period	Prev 2	Prev 1	Latest	Forecast	Consensus
07:00	Korea: IP (% y/y)	Oct	4.0	4.7	6.8	8.0	5.0
08:30	Australia: Private capital expenditure (% q/q)	Q3	1.5	7.7	4.9	8.0	–
13:30	India: GDP (% y/y)	Q3	8.3	7.8	7.7	7.2	6.8
15:30	Thailand: Benchmark interest rate (%)	Nov	3.25	3.50	3.50	3.00	3.13

Korea: We expect continued outperformance from autos, and modest improvement in electronics in Q4.

Australia: Strong capex on the back of some very large infrastructure projects undertaken by the mining industry.

India: Manufacturing remains under pressure, but services and agriculture continue to be steady performers.

Thailand: In view of the recent flooding, we believe the Bank of Thailand is likely to cut rates 50bp.

Thursday 1 December		Period	Prev 2	Prev 1	Latest	Forecast	Consensus
07:00	Korea: CPI (% y/y)	Nov	5.3	4.3	3.9	4.2	4.4
09:00	Korea: Exports (% y/y)	Nov	25.5	18.1	8.0 R	16	10
09:00	China: NBS PMI manufacturing	Nov	50.9	51.2	50.4	50.1	49.8
12:00	Thailand: CPI (% y/y)	Nov	4.3	4.0	4.2	4.4	4.5
12:00	Indonesia: CPI (% y/y)	Nov	4.8	4.6	4.4	4.2	–
12:00	Indonesia: Exports (% y/y)	Oct	39.5	35.9	46.3	30	–
16:00	Philippines: Overnight borrowing rate (%)	Dec	4.5	4.5	4.5	4.5	–

Korea: A low base and imported cost pressures would have raised inflation to 4.5% y/y, but rebasing will lower it 0.2-0.3pp. Export growth is likely to jump from a low base and likely will reflect a small turnaround in seasonally adjusted shipment levels.

China: PMI to decline on slowdown in external demand and a moderation in domestic activity.

Thailand: Food prices likely to push up headline inflation, but a weak growth outlook could bias core prices lower.

Indonesia: A high base should see inflation ease further, despite a pick-up in food prices during the Muslim holiday in early November. We expect exports to weaken given the ban on tin export by key producers and strike-related output disruptions.

Philippines: Rates to remain unchanged, given manageable inflation and rising external headwinds. We think the central bank's bias is shifting towards supporting growth from being balanced between managing growth and inflation.

OUTLOOK: EUROPE, MIDDLE EAST AND AFRICA

Focus on rate decisions

Daniel Hewitt
+44 (0)20 3134 3522
daniel.hewitt@barcap.com

- **Hungary likely to stay on hold next week, with rating agency downgrades and the government's request for financial assistance from the IMF and EU in the background.**
- **Israel's rate decision is a close call, we lean towards no change. Egypt increased its policy rate 100bp amid political uncertainty and currency weakness.**
- **GDP for Q3 in South Africa and Poland is expected to have slowed gradually.**

We expect the Nation Bank of Hungary (NBH) to keep its 6.0% policy rate on hold next week. The real rate remains quite high, even though inflation has accelerated to 3.9% y/y. Growth is likely to be held back by euro area weakness. Currency weakness remains a concern.

The Hungarian government is initiating programme talks with the IMF/EU

Meanwhile Hungary's sovereign rating has come under pressure because of European financial weaknesses. Moody's downgraded its sovereign rating of Hungary to Ba1 and retains its negative outlook. S&P has a negative watch on its BBB-, to be resolved by February. The Hungarian government has requested precautionary programme support from the IMF and EU. There is some uncertainty about what IMF facility Hungary might qualify for. The government expressed interest in a low conditionality precautionary credit line (probably the new Precautionary and Liquidity Line, PLL). However, it is not clear that Hungary will qualify, given strained relations with the IMF-EU following the election of the Fidesz government last year. The IMF/EU may require a more articulated programme that would carry full conditionality, such as a Stand-By Arrangement (SBA, which can also be precautionary). The IMF mission that had been in Budapest for the Article IV review has returned to Washington for consultations. Meanwhile, the EU is asking the government to respond by January to its concerns regarding the FX mortgages conversions scheme. Given these issues, it remains to be seen how fully the Hungarian government will develop relations with the IMF/EU.

Egypt demonstrations lead to the resignation of the Government of PM Sharaf

In Egypt, the political and security situation deteriorated rapidly one week ahead of the parliamentary elections. Clashes erupted between security forces and protesters across the country, leaving more than 30 dead and several hundred injured. Demonstrators called for a more rapid transfer of power to a civilian government, and to curb the power of the Supreme Council for the Armed Forces. The latter has accepted the resignation of PM Sharaf's government, confirmed that parliamentary elections are due to take place as scheduled (starting next Monday), and committed to undertaking presidential elections by end-June 2012. This seems unlikely to calm the protesters, given their demands for assurances of an immediate transfer of power to a representative government. The ongoing clashes and political deadlock will likely leave a heavy toll on an already-weak economy and add to pressure on the currency. The central bank increased the policy rate 100bp amid currency pressures. S&P downgraded Egypt's sovereign rating to B+ from BB- following a downgrade last month.

Israel MPC is expected to hold policy rate unchanged, with further cuts to come later

Israel's rate decision next week is a close call. Previously when the Governor decided rates on his own, monetary policy was very flexible, and subject to rapid directional changes. With the MPC meeting only for the second time, we think directional change will be more gradual. Last month the MPC voted 6-0 to keep rates unchanged following the 25bp cut the previous month, and the minutes imply a neutral bias. We think the MPC will keep the rate on hold in November as well, but with some votes in favour of a rate cut, signalling future cuts. Inflation moderated to 2.7% in October (well inside the 1-3% target), but the decline is primarily from falling fruit and vegetable prices (Figure 1). Housing inflation has accelerated

even though housing market conditions appear to be easing; Governor Fischer warned that rapid increases in construction could cause a too-quick drop in housing prices. Inflation forecasts increased slightly. Growth in Q3 was higher than expected, although forward indicators imply moderation, the leading "S" indicator fell to 0.1% in October from 0.3%.

Turkey keeps policy rate on hold, Fitch outlook lowered to stable

Turkey decided to keep its policy rate on hold at 5.75%, as expected. Fitch revised the outlook on its BB+ of Turkey to stable from positive, citing near-term risks to Turkey's macroeconomic stability. Russia kept its policy rate unchanged, as expected.

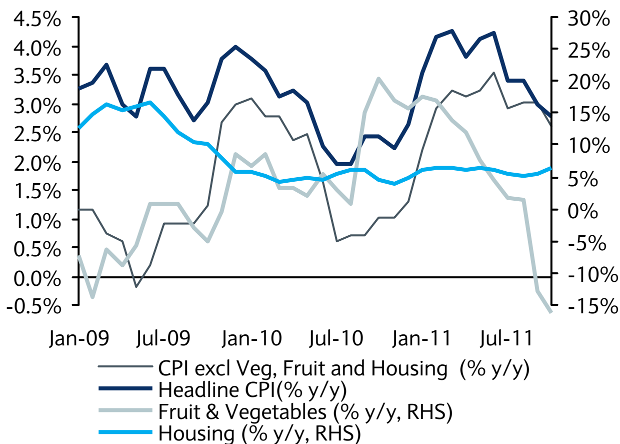
New Polish government's programme designed to improve fiscal performance has been very well received

Poland Q3 GDP will be released next week and we expect modest signs of easing growth. Several factors signal growth deceleration, including declines in trade volumes and slightly slower activity indicators. Accordingly, we forecast that growth moderated to 0.7% q/q from 1.1% q/q in H1 11 (seasonally adjusted). Meanwhile the PO-PSL government announced that it is prioritizing fiscal adjustment to bring the budget below 3% of GDP next year and into balance by 2015, which is designed to bring government debt-to-GDP lower. In addition, the government is emphasizing structural reforms, particularly unification of the different pension schemes and raising retirement age. This week some of the tax increases were already passed. The plans have been well received; rating agencies have indicated that successful implementation could bring upgrades and NBP Governor Belka indicated that the improved 2012 budget prospects increase the likelihood of rate cuts.

South Africa inflation rising, but GDP likely to slow

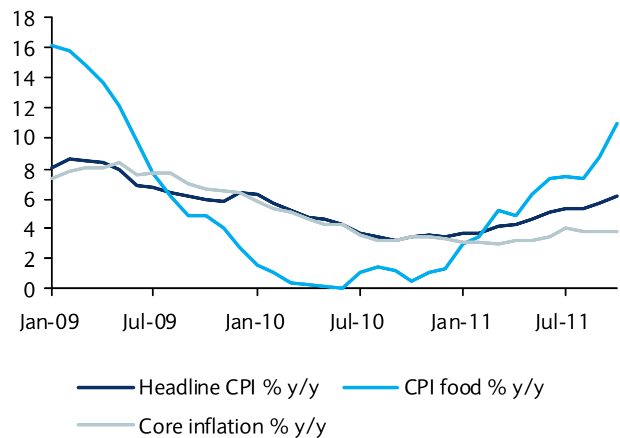
Monetary policy in South Africa faces a tricky trade-off between rising inflation risk and downside GDP growth risks. Inflation accelerated to 6.0% y/y in October from 5.7% y/y in September, predominantly driven by food and transport (Figure 2). Core inflation (excluding food and energy) at 3.8% y/y was flat for a third consecutive month. Q3 GDP will be released next week, and we forecast growth to moderate to 2.5% y/y from 3.0% in Q2 (quarterly growth is expected to remain flat at 1.3% q/q). For 2012 we estimate CPI to remain above the 6% target ceiling until Q4 12. Against this, our baseline forecast is for growth acceleration to 3.4% in 2012, but admittedly, this forecast is at risk if Europe falls into a deeper recession than we are currently pricing in. We continue to expect monetary policy decisions to be dictated by Europe but for as long as economic growth projections continue to muddle around the 3% mark, rising inflation will likely keep the SARB from reducing rates further. Our baseline remains rates on hold at 5.5% for most of 2012.

Figure 1: Israel - fruits and vegetables bring inflation lower



Source: Central Bureau of Statistics, Haver Analytics

Figure 2: South Africa - inflation rising, rates likely on hold



Source: Statistics South Africa

DATA REVIEW & PREVIEW: EMERGING EUROPE, MIDDLE EAST & AFRICA

Eldar Vakhitov, Daniel Hewitt, Christian Keller, Vladimir Pantyushin, Jeffrey Schultz, Alia Moubayed

Review of last week's data releases

Main indicators	Period	Previous	Barclays	Actual	Comments
Hungary: Average gross wages (% y/y)	Sep	6.5	-	5.2	Wage data is of limited importance at this point, in our view
Poland: Average gross wages (% y/y)	Oct	5.2	-	5.1	Wages have held up very well
Russia: Disposable income (% y/y)	Oct	2.9	-	0.4	Growth remains positive, but somewhat unstable
Russia: Real wages (% y/y)	Oct	5.3	7.0	5.0	Consumer sector continues to post solid figures, also helped by pre-election spending
Russia: Retail sales real (% y/y)	Oct	9.2	7.2	8.8	
Russia: Unemployment rate (%)	Oct	6.0	6.0	6.4	Unexpected spike
Russia: Investment in productive capacity (% y/y)	Oct	8.5	7.0	8.6	Investment continues to recover
Poland: Sold Industrial output (% y/y)	Oct	7.7	-	6.5	IP holding steady, notwithstanding lower exports
Poland: Core inflation (% y/y)	Oct	2.6	2.8	2.8	Implies underlying inflation rising, probably from PLN dep
South Africa: CPI (% y/y)	Oct	5.7	5.9	6.0	Larger than expected jump in food prices saw CPI hit the 6% target ceiling; core CPI remains well contained
South Africa: Business confidence (index)	4Q	39	-	38	Modest fall in confidence again led largely by supply-side sectors in manufacturing and construction
Turkey: Benchmark repo rate (%)	Nov	5.75	5.75	5.75	On hold, as expected
Egypt: Deposit rate (%)	Nov	8.25	8.25	9.25	An unexpected 100bp hike, likely aimed at containing the exchange rate pressures in a volatile political situation
Hungary: Retail trade IA (% y/y)	Sep	0.4	-	0.3	Bleak outlook for domestic demand, given developments in the banking system
South Africa: PPI (% y/y)	Oct	10.5	10.9	10.6	Downside surprise; still expected to rise in medium term
Turkey: Capacity utilization (%)	Nov	77.0	-	76.9	Continues to increase on sa basis
Turkey: Industrial confidence, index	Nov	101.9	-	102.3	Relatively volatile on sa basis in recent months
Poland: Retail sales (% y/y)	Oct	11.4	-	11.2	Domestic demand remains elevated
Poland: Unemployment rate (%)	Oct	11.8	-	11.8	Stable over the past months
Croatia: Real GDP (% y/y)	Q3 P	0.8	0.2	0.6	Higher than expected, but still quite weak; driven by tourism, partly offset by declines in IP and exports
Russia: Overnight deposit rate (%)	Nov	3.75	3.75	3.75	As expected, due to improving growth and slowing inflation
Russia: Refinancing rate (%)	Nov	8.25	8.25	8.25	

Preview of week ahead

Monday 28 November		Period	Prev 2	Prev 1	Latest	Forecast	Consensus
08:00	Hungary: Unemployment rate (%)	Oct	10.8	10.8	10.7	-	10.7
15:30	Israel: Base rate announcement (%)	Nov	3.25	3.00	3.00	3.00	2.75

Israel: This is a close call, but we think the BoI will decide to remain on hold partly because of inertia from the 6-0 vote last month.

Tuesday 29 November		Period	Prev 2	Prev 1	Latest	Forecast	Consensus
06:00	South Africa: Private sector credit (% y/y)	Oct	5.7	6.1	5.5	5.8	5.6
09:30	South Africa: Real GDP (% q/q saar)	Q3	4.5	4.5	1.3	1.3	1.8
10:00	Croatia: Industrial output (% y/y)	Oct	0.9	-4.4	-2.3	-	-
13:00	Hungary: Base rate announcement (%)	Nov	6.00	6.00	6.00	6.00	6.00

South Africa: Supply-side sectors in mining and manufacturing are likely to have remained the largest drag on GDP growth, while demand-led sectors are likely to have remained the backbone of growth. As for private sector credit growth, we look for a modest uptick in October but believe the detail is likely to continue to show relatively subdued momentum in bigger ticket household credit items (mortgage advances etc), given a still somewhat uncertain economic climate.

Croatia: Similar to two previous months, we expect the shutdown of a main oil refinery to have weighed on October IP growth.

Hungary: We expect the NBH to remain on hold for the time being as the government considers its new initiative to begin programme negotiations with the IMF/EU.

Wednesday 30 November		Period	Prev 2	Prev 1	Latest	Forecast	Consensus
08:00	Turkey: Trade balance (USD bn)	Oct	-9.0	-8.2	-10.4	-	-
09:00	Poland: Real GDP (% y/y)	Q3	4.4	4.4	4.3	3.9	4.1
12:00	South Africa: Trade balance (Rand bn)	Oct	-3.9	-3.7	2.5	-	-2.0
	Israel: Unemployment rate (%)	Q3	6.5	6.0	5.5	-	-
	Serbia: Industrial output (% y/y)	Oct	-3.3	-0.3	-1.8	-	-
	Serbia: Retail trade (% y/y)	Oct	-19.5	-18.3	-18.3	-	-

Turkey: The trade balance was significantly worse than expected last month due to a surge in mining (mainly oil) import growth; we do not expect a much better result in October, given that there was also some TRY appreciation in the month.

Poland: We expect GDP to have moderated in Q3, having risen at 0.7% SA q/q compared with levels of 1.1% SA q/q in both Q1 and Q2. External demand appears to have weakened in Q3, while domestic demand has held steady.

Israel: Unemployment has remained very low as the domestic economy is still holding up very well.

Serbia: We expect IP growth to remain weak as export growth continues to underperform due to lower demand from the EU.

Thursday 1 December		Period	Prev 2	Prev 1	Latest	Forecast	Consensus
05:00	Russia: Manufacturing PMI	Nov	49.9	50.0	50.4	-	-
08:00	Poland: Manufacturing PMI	Nov	51.8	50.2	51.7	-	-
08:00	Turkey: Manufacturing PMI	Nov	48.8	51.6	53.3	-	-
08:30	Czech Republic: Manufacturing PMI	Nov	53.4	52.4	51.7	-	-
09:00	South Africa: Kagiso PMI	Nov	48.2	50.2	50.5	-	49.2
	Czech Republic: Budget balance (CZK bn)	Nov	-87.3	-105.1	-91.5	-	-
	Hungary: Manufacturing PMI	Nov	49.9	50.7	48.2	-	-
	Kazakhstan: CPI (% y/y)	Nov	9.0	8.7	8.0	7.6	-

Russia: Gradual IP slowing will likely continue to keep PMI readings around the 50.0 level.

Poland: Economic growth has resisted downward pressures so far and thus, PMI should remain above 50.

Turkey: We expect PMI to have remained solidly in expansionary territory, in line with other relatively robust growth indicators.

Czech Republic: Further signs of a slowing economy could be reflected in more declines in PMI.

South Africa: Slightly more positive growth momentum in manufacturing production suggests the PMI should remain above its neutral level of 50 in November, though a concerning global backdrop could place some pressure on sentiment.

Hungary: Economic growth appears to be under pressure from decelerating euro area demand.

Kazakhstan: Easing pressure from food prices should help bring consumer inflation further down.

Friday 2 December		Period	Prev 2	Prev 1	Latest	Forecast	Consensus
09:00	South Africa: Naamsa Vehicle Sales (% y/y)	Nov	11.1	30.0	18.9	-	-
10:00	Croatia: Real retail trade (% y/y)	Oct P	0.9	2.0	1.0	-	-
	Romania: International Reserves (USD bn)	Nov	36.8	37.6	36.3	-	-

South Africa: We continue to look for relatively resilient y/y growth rates in new vehicle sales, once again driven through passenger sales given a still supportive consumption backdrop (low interest rates, nominal incomes etc.).

Romania: Further declines in FX reserves are likely due to NBR intervention to keep the exchange rate stable.

OUTLOOK: LATIN AMERICA

Trade, more than sentiment, is hurting growth

Alejandro Arreaza
+1 212 412 3021
Alejandro.Arreaza@barcap.com

Marcelo Salomon
+1 212 412 5717
marcelo.salomon@barcap.com

- **Although the more open economies, including Chile, are already feeling the effects of softer global growth, depressed financial sentiment has yet to dent LatAm activity.**
- **Mexico 3Q GDP surprised on the upside, while economic activity moderated in Peru and Colombia in September after two months of exceeding expectations.**
- **With few signs of an imminent and long-lasting solution for the European crisis, the balance of risks remains tilted to less growth in the region.**

The week was market by good activity releases in Latam. Positive surprises came from Mexico and Venezuela, while signs of further moderation came from Peru, Chile, Colombia and Argentina. With the exception of Brazil, which slowed by more than expected in Q3, we continue to see signs of growth moderation, at best in most of the region. And although the financial shock in Europe has not spilled over decisively into Latam, we are still cautious and believe that the balance of risks for growth remains skewed to the downside.

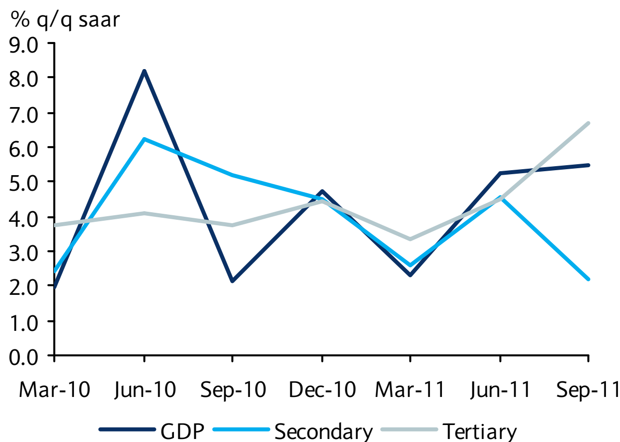
A strong Q3 for Mexico

Strong Q3 11in Mexico, with services moving up while industry lost impetus

Mexico Q3 GDP surprised on the upside, rising by a stronger-than-expected 4.5% y/y growth rate from 3.3% in Q2 (BarCap 4.2% and consensus 3.9%). At the margin, real GDP expanded by a robust 5.5% q/q saar. But the big news was the revision in the series, which strongly boosted Q2 11 growth and raised the balance of risks to our 3.6% forecast in 2011.

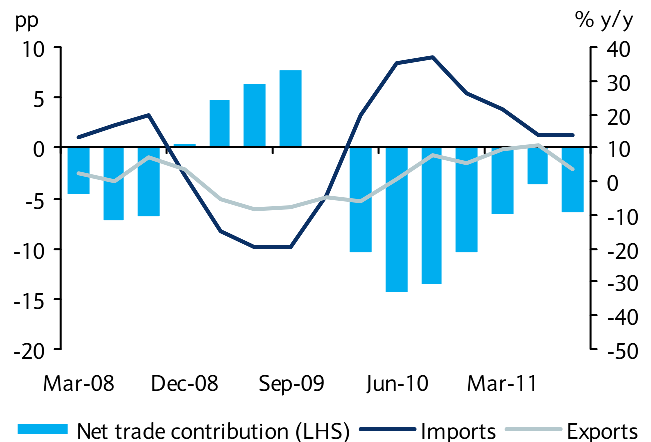
Considering the supply breakdown, primary activities growth surged to 56% q/q saar from 1.9%, driven by a surge in agricultural products. This component is very volatile (Figure 1) and we do not rule out a swift contraction in the coming quarters. Secondary activities slowed to 2.2% q/q saar from 4.6%, in line with the softening of IP during the period (which was at 0.5% 3m/3m saar in September, versus 2.8% in June), but also reflecting softer mining activities. Finally, tertiary activities accelerated to 6.7% from 4.5%, underlying a strong retail activity. This squares with the September retail sales release, which surprised at the margin printing a strong 4.7%y/y result and keeping retail sales growth trend close to 3.5%.

Figure 1: Mexico - tertiary activities up, secondary down



Source: INEGI, Barclays Capital

Figure 2: Chile - weaker net exports exert big drag on growth



Source: BCCh, Barclays Capital

The demand breakdown should be out on 21 December; however, the fixed investment monthly index suggests that investments will be the highlight of the release, as it increased by an impressive 12.2% 3m/3m saar in August.

Chile starts to feels the effects of slower global growth

The drag from net exports in Chile is offsetting the strong pull from domestic demand

Chilean Q3 GDP increased 4.8% y/y, in line with our and the consensus forecast (both at 4.8%). At the margin, growth slowed to 0.6% q/q sa from 1.3% in Q2. Even though the headline release was not much of a surprise, the growth breakdown shows that although domestic demand remains strong, net exports are taking a larger toll on growth. We are revising down our 2011 year-end real GDP forecast to 6.0% from 6.4%.

Private consumption increased 7.5% y/y. But it was the surge in investment that caught the eye, accelerating by 21.5% y/y from 10.7% in the previous quarter. This was led mainly by machinery investments, which increased 31.5% from 13.8%. This is a strong signal that the financial shock has not yet reached business sentiment in Chile. Meanwhile, government consumption decelerated further, to 1.2% y/y from 3.3% and 7.1% in the previous two quarters, probably reflecting the fiscal adjustment announced earlier this year. Taking all these into account, domestic demand accelerated to 9.4% y/y from 8.6%, contributing 11.3pp to headline growth.

But it has been via a slowdown in external demand that the global crisis has been moving into Chile. Net trade reversed course, wiping 6.5pp off growth in Q3, reflecting weaker European growth. Exports slowed sharply, to 3.9% y/y from 10.8%, while imports remained sturdy, rising by 13.8% y/y from 13.9%. If sentiment has not yet been dented, the combination of less growth in the developed world with worsening financial market sentiment should keep the balance of risks skewed to the downside in Chile.

Colombia and Peru lower-than,-expected growth but still strong

Weakening domestic and external demand drove growth moderation in Peru

After two months of higher-than-expected growth, economic activity moderated in September in Peru and Colombia, with GDP expanding 5.8% y/y in the former and IP growing 5.2% in the latter. In the case of Peru, the deceleration was driven by slower growth in domestic and external demand. On the domestic side, public and private consumption experienced some moderation but still registered high growth, with an increase in household retail sales of 8.3% and government consumption of 7.3%. Meanwhile, investment that had recovered in the previous month seems to have experienced a renewed deceleration, given modest growth of the construction sector of just 1.6%. Additionally, on the external side, exports basically failed to register any growth, mainly because of a contraction of traditional exports (particularly minerals) of 9.7%, which could partly reflect some impact from the global deceleration.

Even as growth in Colombia remains strong, softer retail sales suggest some moderation of consumption growth

In Colombia, despite the deceleration of IP, the economy continued to show strong dynamism, suggesting further GDP acceleration in Q3 (we believe growth could be around 6% y/y). However, slower-than-expected growth in retail sales for the third consecutive month (8.1% in September), could suggest the possibility of slower-than-expected consumption growth in Q3. This moderation could be explained by the fall in consumer confidence that has been reported in recent months.

DATA REVIEW & PREVIEW: LATIN AMERICA

Alejandro Arreaza, Alejandro Grisanti, Guilherme Loureiro, Marcelo Salomon, Sebastian Vargas

Review of the week's data releases

Main indicators	Period	Previous	BarCap	Actual	Comments
Brazil: Current account, USD bn	Oct	-2200	-3000	-3109	FDI summed up USD5.5bn, more than financing the gap
Mexico: GDP, % y/y	Q3 11	3.3	4.2	4.5	Consistent with a robust 5.5% q/q saar growth at the margin
Mexico: Econo. activity index, % y/y	Sep	4.4	4.4	4.5	Primary and tertiary are the more dynamics sectors
Argentina: Trade balance, USD mn	Oct	1064	800	1222	Higher than expected on strong exports, import restrictions
Brazil: IPCA-15 inflation, % m/m	Nov	0.42	0.48	0.46	Upside highlights are food and personal expenses groups
Brazil: Total outstanding loans, BRL bn	Oct	1929	-	1946	Grantings at the margin increased impressive 3.5% m/m sa
Mexico: Retail sales, % y/y	Sep	2.7	4.0	4.7	Strong 0.9% m/m sa gain, supported by increasing wages

Preview of the week ahead

Monday 28 November		Period	Prev 2	Prev 1	Latest	Forecast	Consensus
-	Peru: GDP, % y/y	Q3 11	9.2	8.7	6.6	6.6	-

Tuesday 29 November		Period	Prev 2	Prev 1	Latest	Forecast	Consensus
05:00	Brazil: IGP-M inflation, % m/m	Nov	0.44	0.65	0.53	0.40	0.43
07:00	Chile: Industrial production, % y/y	Oct	0.7	1.7	5.2	1.2	4.2
07:00	Chile: Retail sales, % y/y	Oct	9.6	9.1	9.6	8.5	9.5

Chile industrial production: IP is hurt by a calendar effect on a y/y basis, with one less working day this year. Even though we expect industrial activity to slow down to -0.1% m/m sa (from 0.3% m/m in September), overall activity seems to be moving sideways rather than contracting strongly, which should keep BCCh pat at least until Q1 12.

Wednesday 30 November		Period	Prev 2	Prev 1	Latest	Forecast	Consensus
-	Brazil: Selic overnight rate, %	Nov	12.00	12.00	11.50	11.00	11.00
07:00	Chile: Unemployment rate, %	Oct	7.5	7.4	7.4	7.3	7.5
11:00	Colombia: Unemployment rate, %	Oct	11.3	10.4	10.2	10.0	9.8
15:30	Mexico: Budget balance, MXN bn	Oct YTD	-164.3	-172.5	-179.0	-	-

Brazil Selic overnight rate: Weaker-than-expected August and September activity releases made us adjust our Q3 real GDP growth to 0.3% q/q sa and reconsider our expectations of the easing cycle. We continue to expect a 50bp cut in this meeting but are penciling in another 50bp cut in the January meeting, with the Selic rate forecast at 10.5% throughout 2012.

Thursday 1 December		Period	Prev 2	Prev 1	Latest	Forecast	Consensus
-	Peru: CPI inflation, % m/m	Nov	0.27	0.33	0.31	0.22	-
-	Peru: WPI inflation, % m/m	Nov	0.44	0.67	0.21	-	-
08:00	Brazil: Trade balance, USD mn	Nov	3873	3074	2355	1400	-
10:00	Mexico: Remittances, USD mn	Oct	1897.6	2134.7	2084.7	-	-

Friday 2 December		Period	Prev 2	Prev 1	Latest	Forecast	Consensus
-	Panama: GDP, % y/y	Q3 11	7.9	9.3	11.4	10.9	-
06:00	Brazil: Industrial production, % y/y	Oct	-0.5	2.0	-1.6	-0.6	-0.8
10:00	Mexico: Overnight rate, %	Dec	4.50	4.50	4.50	4.50	4.50
12:00	Uruguay: CPI inflation, % m/m	Nov	0.56	0.51	0.71	0.25	-
16:00	Colombia: PPI inflation, % m/m	Noc	-0.08	0.77	0.88	-	-

Brazil industrial production: Our forecast is consistent with a 0.2% contraction at the margin, following a 2.0% drop in the previous month. Auto and steel production are leading the way down.

Mexico overnight rate: Banxico failed to deliver a sense of urgency about starting an easing cycle. We expect the board to start cutting rates in Q1 12 but we would not completely rule out a rate cut by this meeting, given the deterioration of the global outlook.

Week 28 November - 02 December		Period	Prev 2	Prev 1	Latest	Forecast	Consensus
-	Argentina: Govern. tax revenue, ARS bn	Nov	46.8	47.7	47.6	-	-
-	Venezuela: CPI inflation, % m/m	Nov	2.20	1.60	1.80	2.1	-