



### Powerful Q2 GDP Growth... Unsustainable?

If we have one idea to leave with you in our last weekly essay before our summer break it is this: **Money and credit growth have stalled in all the G-7 economies at once. Normal economic growth cannot resume without both.** Our charts are on page ten. As regular readers know, we have written about this for a year now. It bears repeating. Traders and investors are finally, it seems, coming around to our view.

*This experience is much more akin to the Great Depression than to any business cycle we have seen in our lifetimes. It is no “double dip” of a normal economic cycle, but rather a protracted contraction of economic activity and prosperity to conform to a reduced level of money and credit. With money and credit still falling in most places, we can only expect economic activity to continue to contract.*

Traders and investors last week priced a new decline in economic activity into all financial markets. Equity prices plunged. Bond prices surged. Crude oil and industrial commodity prices dove. Even strong results for Euroland GDP could not distract investors and traders from the idea of renewed economic contraction in the G-7. *We agree. To repeat: As long as money or credit continues to contract, GDP will also decline.*

Strong second quarter economic growth was reported for Euroland last week. Traders and investors were impressed, but they also cautiously—and correctly—understood that GDP is a backward-looking indicator. *We will not know how strong the economy really was—or was not—until we see the breakdown of demand growth.* These data are due on August 24 for Germany and September 2 for the Euro Zone as a whole. *Until proven wrong, we are working on the assumption that most of Germany’s strong GDP growth was the consequence of a surge in production that was not met by an increase in demand.* An inventory run-up would be unsustainable, of course.

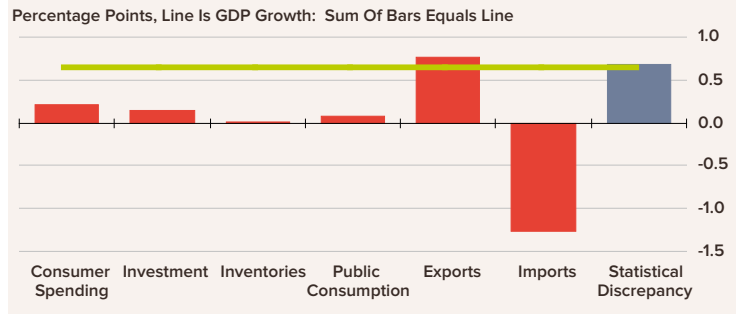
In Germany’s case, we know from monthly reports that seasonally adjusted industrial output jumped 5.4% in the second quarter from the first, a 23.4% annualized rate of growth. Retail sales volumes did not grow at all in Q2. *So where did all of that stuff go? Our fear is that it ended up in inventories. If so, running down stockpiles of unsold goods will become the economic story of the second half of this year.* Companies will cut production, fire workers and slash prices to clear out stocks. *This is how recessions begin, according to one of the oldest and best-established models we have of the business cycle. We fear a big leg down is coming for Germany’s economy, caused by a credit crunch-induced shortfall of demand.* Fiscal austerity will start to bite domestic demand, too, in the second half of this year!

We can already see potential undesired inventory-building in the data for France. INSEE published incomplete and tentative details

#### Notice To Readers

High Frequency Economics Ltd. will not publish *Notes on the Global Economy* during our annual summer break, from Monday, August 23, through Monday, September 6. All *Global Notes* readers will receive *U.S. Notes* from Monday, August 30, through Friday, September 3. HFE’s regular publication schedule will resume on Tuesday, September 7, with a 10-page edition of *Global Notes*.

#### France: Contributions To Quarterly GDP Growth 2010 Q2



of the composition of GDP in its preliminary estimate on Friday. These figures show that the demand- and output-based estimates of headline GDP diverged by as much as the output measure was reported to have grown. Of course, one reason these figures are called “advance” estimates is that the unknowns are significant. *How this divergence will be divided into inventory changes and irreconcilable statistical discrepancies remains to be seen.* Normally, much of that residual ends in inventory changes. If so, the data will show that inventories surged in Q2. *We cannot see why firms would want to hold large inventories right now, and thus we expect a liquidation of stockpiles and cuts in production this year.*

*So the reality is that strong headline GDP figures for Euroland for the second quarter may actually foreshadow a cutback in production in the second half of this year rather than a true recovery.*

**Sustained demand growth in the Euro Zone—or in any economy, for that matter—is all but impossible with money and credit contracting.** With credit to households decreasing, people are obliged to consume less. With credit to businesses declining, firms have less working capital, less inventory financing, less trade credit and less capacity to invest. They therefore have to **do** less, and they are incentivized to do less by falling demand and rising inventories. So, too, must governments cut spending when capital markets say they are unfit to borrow. **As our charts on page ten show, credit to the non-bank private sector is declining all around the G-7. So GDP must also decline in nominal terms, and that means either the volume of economic activity has to decline or prices have to fall... or both.**

When will this depression end? It will be over when households and businesses have reduced debt on their balance sheets to the point where they become comfortable again. It will end when banks have purged their books of all the risks they now believe to be excessive and have reserved adequately against properly valued risky assets that they choose to keep. With residential and commercial real estate prices depressed—and still falling in many places—the collateral base will be damaged for a long time. *True recovery of credit growth—and thus demand—remains elusive. We predict renewed economic contraction this year. Until then, bond yields will set new record lows, and deflation will be the big risk central bankers face.*

We are off on holiday for two weeks starting next Monday. *Enjoy the end of the summer!*

**Weekly Calendar of International Economic Events & Data Releases**

**High Frequency Economics®**

	United States	Canada	Japan	France	Germany	United Kingdom	Australia	Europe & Global
Monday August 16	<b>No HFE U.S. Notes</b> Empire State Survey (8) NAHB Index (8) TIC Flows (6) Weekly T-Bill Auction		<b>GDP (Q2p)</b> <b>Tertiary Index (6)</b>				Vehicle Sales (7)	<b>MUICP (7r)</b> Call For Repo Tenders
Tuesday August 17	<b>No HFE U.S. Notes</b> <b>PPI (7)</b> <b>Housing Starts (7)</b> <b>Industrial Prod'n (7)</b> Wkly Redbook Sales	<b>Survey of Mfg (6)</b> Int'l Capital Flows (6)			<b>ZEW Survey (8)</b>	<b>CPI (7)</b>	Gov Stevens Speaks RBA Minutes (8)	Current Account (6) Wkly Repos Allocated
Wednesday August 18	<b>No HFE U.S. Notes</b> Wkly MBA Mortgages	UI Claims (6)	LEI (6r)			<b>Monetary Minutes (8)</b>	<b>Wage Cost Index (Q2)</b>	Construction (6)
Thursday August 19	<b>No HFE U.S. Notes</b> <b>Philly Fed Survey (8)</b> <b>LEI (7)</b> Wkly Initial Claims	<b>LEI (7)</b> Wholesale Sales (6)	Mach Tool Orders (7r) Dept Store Sales (7)		PPI (7)	<b>CBI Industrial Svy (8)</b> <b>Retail Sales (7)</b> <b>M4 (7p)</b> PSNCR (7)	Avg Weekly Wages (Q2)	
Friday August 20	<b>No HFE U.S. Notes</b>	<b>CPI (7)</b>						
Sometime Soon	<b>September 21:</b> FOMC Meeting	<b>August 31:</b> GDP (Q2) <b>September 8:</b> BoC Rate Decision	<b>September 6 - 7:</b> BoJ Board Meeting	<b>September 8:</b> TRADE (7)	<b>August 25:</b> IFO Survey (8)	<b>September 8 - 9:</b> MPC Meeting	<b>August 21:</b> Elections <b>Sept 1:</b> GDP (Q2p) <b>September 7:</b> RBA Board Meeting	<b>September 2:</b> ECB Council Meeting <b>November 11 - 12:</b> G-20 Summit In Seoul
Key Data	Housing Still Grim LEI Steady	Mfg Sags After Gains No CPI Pressure	GDP Down In Q2! Yen To Keep Rising	Bonnes Vacances!	ZEW Down At Last?	CPI Past Its Peak, Retail Soft, M4 Down	Wages Are Flatter A\$ To Appreciate	Prices Are Cool Current Account Flat

CCI or BCI = Consumer or Business Confidence Index. p = Preliminary. f = Final data release. r = Data revision only. Figures in parentheses are dates: (1) indicates January, (2) February, etc. \*These releases will be subjects of HFE Snapshots. Italics indicate HFE estimated release date.

Elena Camaj, Research Analyst

Carl B. Weinberg, Chief Economist

## International Yield Curves

**Traders and investors are pricing in another downturn for the world economy.** Crude oil prices dropped 7% last week, and most commodity prices sagged along with them. *We do not expect this generally morose feeling about economic prospects to dissipate any time soon.* Indeed, we argue on page one that the global economic contraction caused by a global credit crunch is about to resume after a brief fiscal stimulus-generated pause. *Our outlook is for more declines in bond yields, even from already record and near-record lows.*

**Euroland** bond yields hit record lows in the “safe” markets last week. Yields on tens have never been lower for Germany, France or the Netherlands in the 28 years we have been writing them down every Friday night. Even though GDP figures reported for the second quarter were quite strong, most traders recognize they are backward rather than forward-looking reports. *As we note on page one, we expect GDP growth to reverse course in the second half of this year as the credit crunch resumes its bite. We think Bund and OAT yields still have room to climb in an environment where deflation is a bigger risk than inflation. This means flatter yield curves.*

Inflation expectations in **Britain**, however, are rising thanks to specific tax policies. The BoE may return to asset purchases, but the market is more focused on the inevitability of an extended period of CPI

increases over 3%. *We think gilt yields will rally with a relapse of the economy, but they will underperform safe Euroland bonds.*

**Note that we do not see the sovereign risk crisis in Euroland as over.** Even though Greece passed its first inspection by the IMF, it will be challenged to make its quantified criteria for the rest of the program. *We think a clear distinction has to be made between “safe” Euroland bonds, and their yield curves, compared to “risky” bonds.*

**Japan’s** bonds are rallying, too, on weak economic news. Investors seem to be more afraid of stocks than they are of bonds. *This may not last if the government walks away from plans to cut its fiscal deficit and tries to rekindle demand with new fiscal stimulus. Unlike Euro Zone bonds, we see substantial risks in JGBs. We cannot predict their demise, but we cannot be sure that this market will not crash.*

People in **Canada** mostly expect the BoC to hold rates steady. Marked-down growth prospects for the United States and a lousy trade report have suppressed expectations for more rate hikes. *Loonie bonds are rallying by less than Treasuries. The curve is flattening, but spreads are widening in favor of the loonie. Watch for par... soon!*

**Australia’s** tens are rallying as traders price in subpar growth and slowing prices. *We expect a steeper curve as rate hike fears vanish.*

### Yields On 90-Day Paper — August 13, 2010

Country	Yield	Spread Against:							Curve's Slope*
		U.S.	Canada	Japan	France	U.K.	Germany	Aus'	
U.S.	0.15	—	-0.52	-0.23	-0.75	-0.34	-0.75	-4.58	2.50
Canada	0.67	+0.52	—	+0.29	-0.23	+0.18	-0.23	-4.06	2.31
Japan	0.38	+0.23	-0.29	—	-0.52	-0.11	-0.52	-4.35	0.59
France	0.90	+0.75	+0.23	+0.52	—	+0.41	+0.00	-3.83	1.82
Britain	0.49	+0.34	-0.18	+0.11	-0.41	—	-0.41	-4.24	2.63
Germany	0.90	+0.75	+0.23	+0.52	+0.00	+0.41	—	-3.83	1.49
Australia	4.73	+4.58	+4.06	+4.35	+3.83	+4.24	+3.83	—	0.32

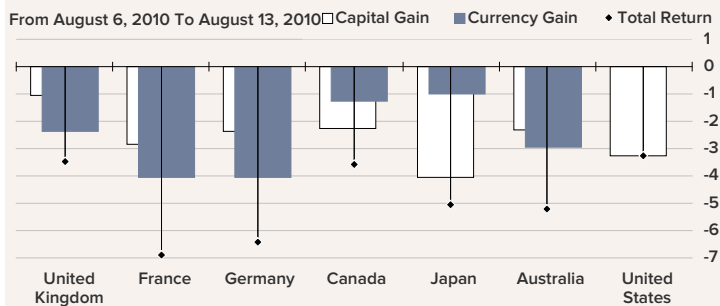
\*Calculated as 10-year yield minus 90-day yield for each currency.

### Yields On 10-Year Bonds — August 13, 2010

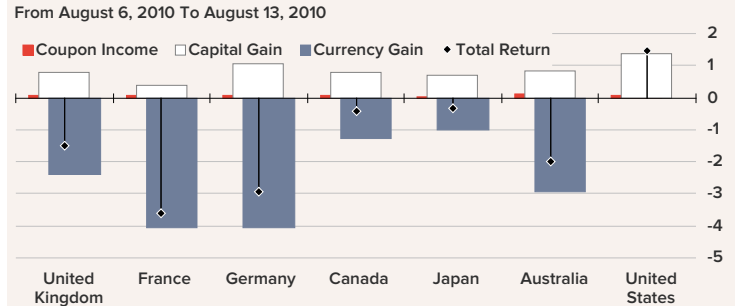
Country	Yield	Spread Against:							Curve's Slope*
		U.S.	Canada	Japan	France	U.K.	Germany	Aus'	
U.S.	2.65	—	-0.33	+1.68	-0.07	-0.47	+0.26	-2.40	
Canada	2.98	+0.33	—	+2.01	+0.26	-0.14	+0.59	-2.07	
Japan	0.97	-1.68	-2.01	—	-1.75	-2.15	-1.42	-4.08	
France	2.72	+0.07	-0.26	+1.75	—	-0.40	+0.33	-2.33	
Britain	3.12	+0.47	+0.14	+2.15	+0.40	—	+0.73	-1.93	
Germany	2.39	-0.26	-0.59	+1.42	-0.33	-0.73	—	-2.66	
Australia	5.05	+2.40	+2.07	+4.08	+2.33	+1.93	+2.66	—	

Japanese 10-year simple interest yield converted to semi-annual compound yield.

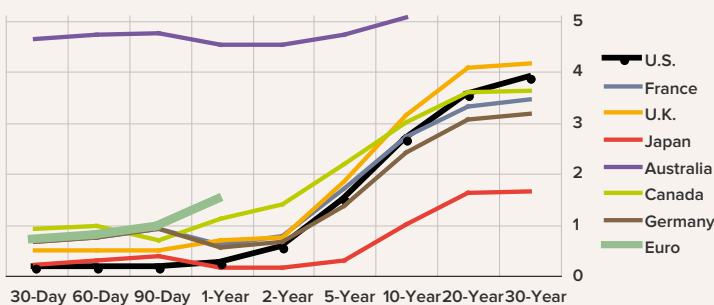
### Capital Return In U.S. Dollars, Equity Market Indexes, Percent



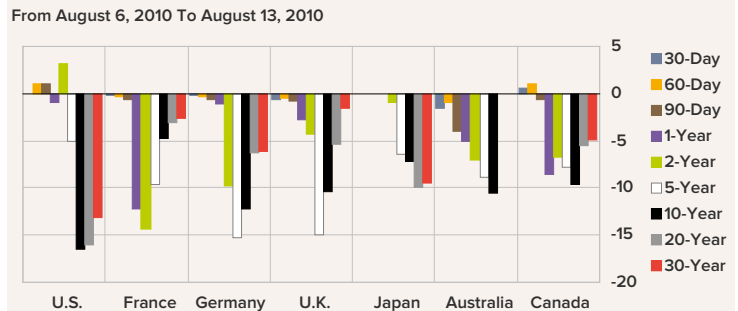
### Total Return On Ten-Year Bonds In U.S. Dollars, Percent



### Government Bond Yield Curves — August 13, 2010



### Changes In Government Bond Yield Curves, Basis Points



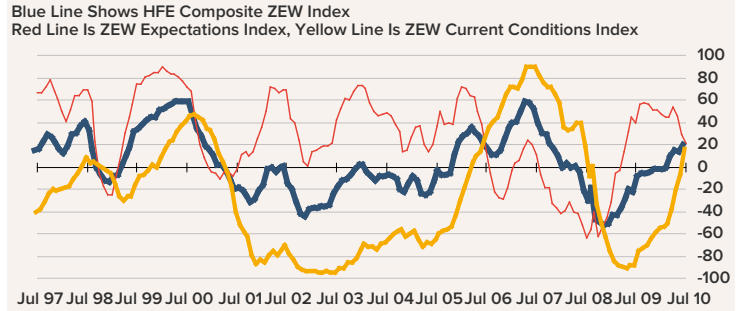
### Germany: Record Low Bund Yields!

Substantially awful industrial production figures for June, published two weeks ago, set off a round of adverse speculation about Germany's economy. It has yet to end. Last week, pessimism was cultivated by signs that other major economies, including and especially that of the United States, are faltering. This has reinforced downward pressure on both stock prices and bond yields.

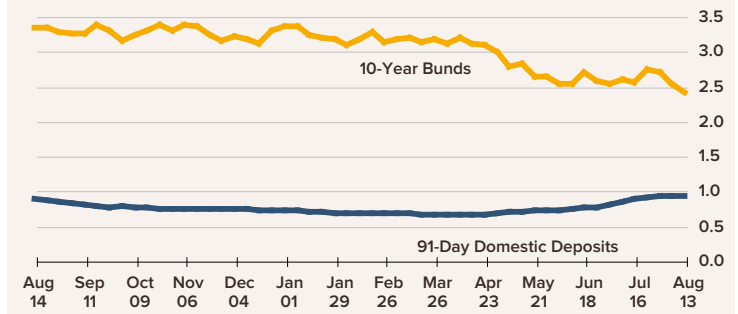
*We expect more of the same this week, even though the economic calendar is all but empty. There is a chance that the ZEW index will reflect new pessimism by producers in the wake of a marked down outlook for the world economy. We think that pessimism is merited. Our theory has been that industrial production soared in the spring, driven by unrealistic optimism among companies, where managers have been looking for sustained economic recovery. That is not happening. Excess production was absorbed in inventories, an unsustainable trend. We think ZEW's expectations index will turn down in this report as elevated inventories compel firms to cut production. This is the beginning of a normal economic downturn, except that the cyclical downturn is coming on top of a credit-induced downturn in the economy. Companies and consumers cannot get credit from banks. Therefore, they cannot produce, invest or consume. Uh, oh!*

The next thing to go wrong is that the euro's recovery from June lows will start to bite into exports, scaling back another source of demand growth. *In this setting, falling demand and rising inventories may very well lead to falling prices. Watch for deflation fears to propel Bund yields to new record lows... still!*

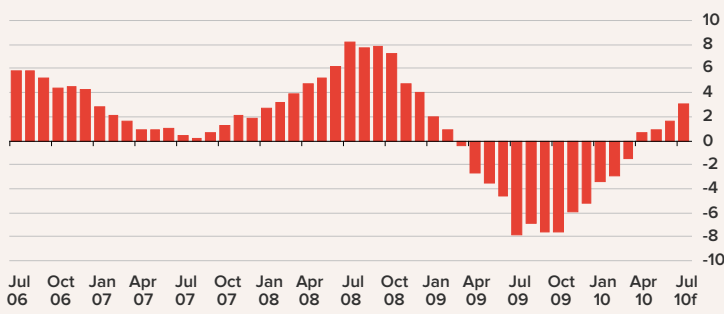
### Germany: ZEW Index And Its Components



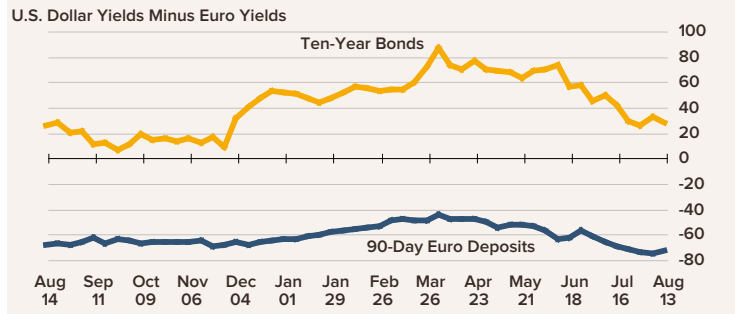
### Germany: Yields, Percent



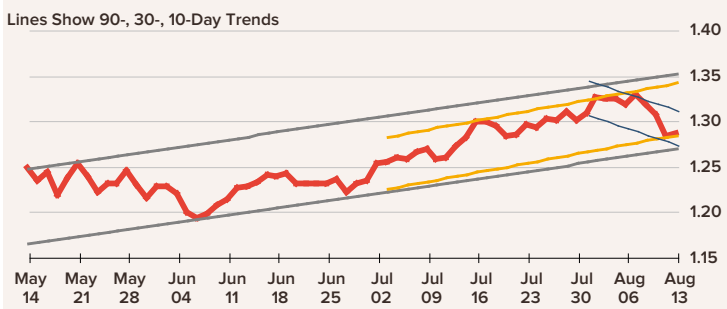
### Germany: Producer Price Index, Percent Change Year Ago



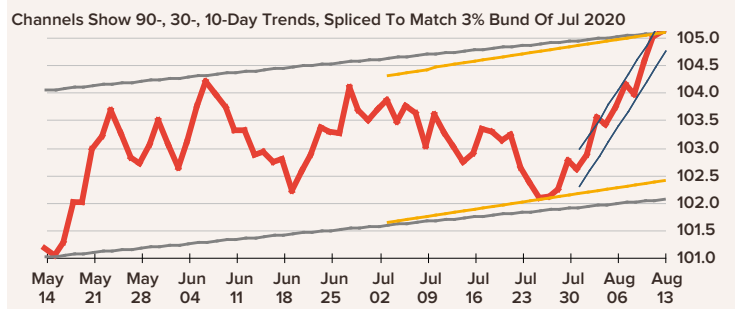
### Euro Vs U.S. Dollar Yield Spreads, Basis Points



### The Euro In U.S. Dollars, Daily Exchange Rate & Trends



### Germany: Daily Price Of 10-Year Bund



Monday 16	Tuesday 17	Wednesday 18	Thursday 19	Friday 20																																				
	<table border="1"> <thead> <tr> <th>ZEW</th> <th>Expectations</th> <th>Current</th> <th>HFE Composite</th> </tr> </thead> <tbody> <tr> <td>Aug 09</td> <td>56.1</td> <td>-77.2</td> <td>-10.6</td> </tr> <tr> <td>May 10</td> <td>45.8</td> <td>-21.6</td> <td>12.1</td> </tr> <tr> <td>Jun 10</td> <td>28.7</td> <td>-7.9</td> <td>10.4</td> </tr> <tr> <td>Jul 10</td> <td>21.2</td> <td>14.6</td> <td>17.9</td> </tr> <tr> <td>Aug 10f</td> <td>?</td> <td>?</td> <td>?</td> </tr> </tbody> </table>	ZEW	Expectations	Current	HFE Composite	Aug 09	56.1	-77.2	-10.6	May 10	45.8	-21.6	12.1	Jun 10	28.7	-7.9	10.4	Jul 10	21.2	14.6	17.9	Aug 10f	?	?	?		<table border="1"> <thead> <tr> <th>PPI</th> <th>%chya</th> </tr> </thead> <tbody> <tr> <td>Jul 09</td> <td>-7.8</td> </tr> <tr> <td>Apr 10</td> <td>0.6</td> </tr> <tr> <td>May 10</td> <td>0.9</td> </tr> <tr> <td>Jun 10</td> <td>1.7</td> </tr> <tr> <td>Jul 10f</td> <td>3.0</td> </tr> </tbody> </table>	PPI	%chya	Jul 09	-7.8	Apr 10	0.6	May 10	0.9	Jun 10	1.7	Jul 10f	3.0	
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## Japan: Politics And Economics Are Troubling

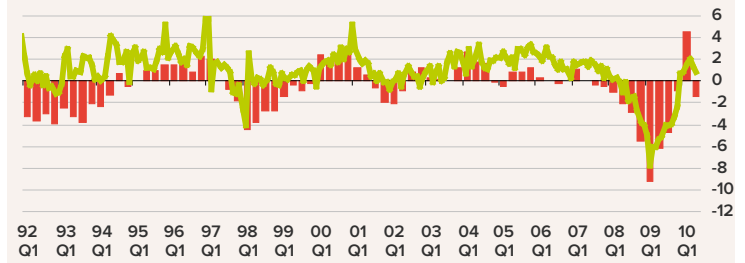
By the time you read this, you will know whether Japan's national accounts statisticians have pulled another rabbit out of their collective hat or if GDP actually contracted in the second quarter... as we suspect it must have. Output rose in Q2, but demand did not. Bank lending contracted in Q2 as well. *So we suspect inventories rose, and that promises a run-down of stockpiles of unsold goods in the second half of this year: Pencil in expectations of falling prices, too.*

Economic risks are looming large, and from every direction. We have already seen warning signals of an extension of Japan's 21-year depression in the report of a decline of industrial production in June. Export sales are also likely to drop hard as the yen appreciates on all cross rates. Everyone in Japan wants the government to cool the yen's appreciation... not that it has any options to do so. Intervention does not work. *The yen is rising as funds liquidate foreign assets to raise cash for pension pay-outs. We do not expect these capital flows to reverse anytime soon. Exporters will not like that.*

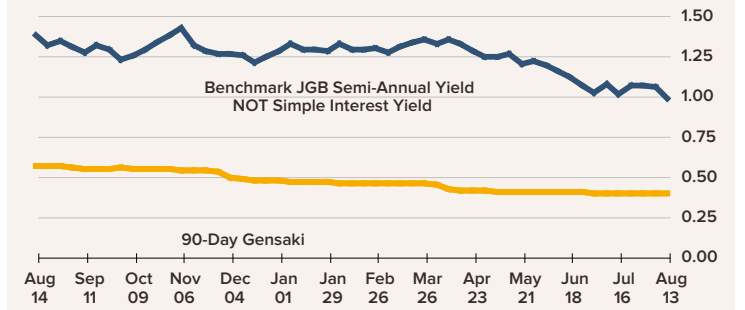
The biggest risks, though, are from the political side. Prime Minister Kan will face a test of his leadership of the DPJ in September. His proposal to boost the sales tax rate to 10% over time would help close the fiscal deficit—now more than double GDP—and stabilize the debt ratio. However, he is under pressure to delay those plans and to stimulate the economy instead. *If the government shelves plans for fiscal austerity, JGBs will look a lot scarier than stocks! Watch for traders to sell JGBs if Kan-san reverses course on tax hikes and fiscal austerity. If Kan-san balks, the yield curve will steepen.*

### Japan: GDP Cycle Vs Tertiary Index, Year-Over-Year

Bars Show GDP Minus Trend, Line Shows Tertiary Sector Index, %chya  
GDP Through 2010 Q2f, Tertiary Index Through Jun 10f

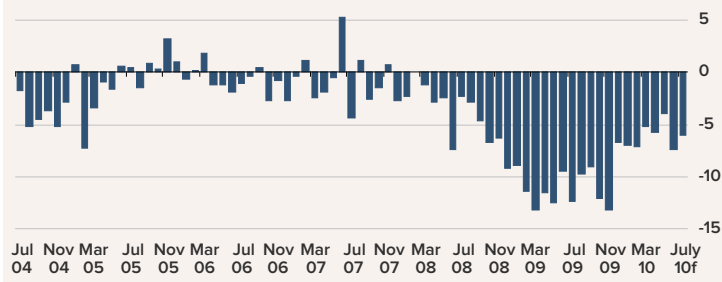


### Japan: Yields, Percent



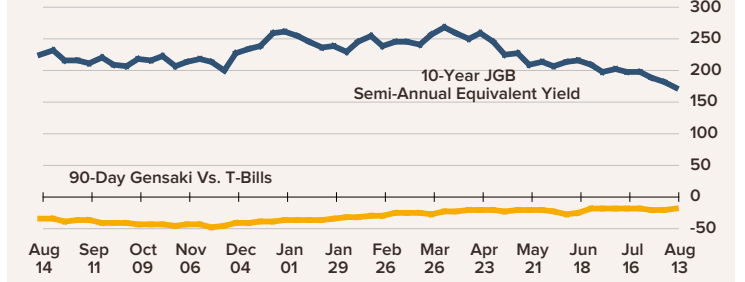
### Japan: Department Store Sales, Percent Change Year Ago

Japan Department Stores Association



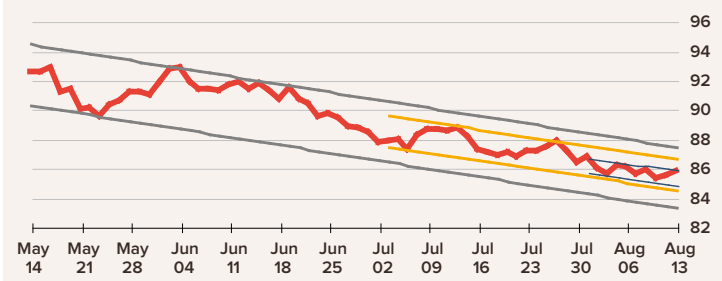
### Yen Vs U.S. Dollar Yield Spreads, Basis Points

U.S. Dollar Yields Minus Yen Yields



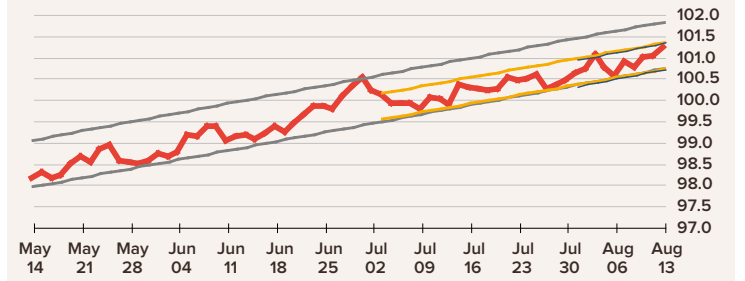
### Yen Per U.S. Dollar, Daily Exchange Rate & Trends

Lines Show 90-, 30-, 10-Day Trends



### Japan: Daily Price Of 10-Year Benchmark JGB

Channels Show 90-, 30-, 10-Day Trends, Spliced To Match JGB No. 305, 1.1% Due Jun 2020



Monday 16

Monday 16

Wednesday 18

Thursday 19

Thursday 19

GDP			Tertiary Index			Leading Coinc't Composite			Machine Tool Orders			Department Store Sales		
	%SAAR	%chya		%chya	%chSP	Index	Index	Composite	%chya	%chSP		%chya		
09 Q2	6.9	-6.0	Jun 09	-5.6	-6.6	Jun 09	66.7	81.8	80.7	Jun 09	-72.8	-75.3	Jul 09	-12.4
09 Q3	0.4	-4.9	Mar 10	1.4	-7.2	Mar 09	83.3	90.9	101.9	Mar 10	262.2	-46.5	Apr 10	-5.8
09 Q4	4.6	-1.4	Apr 10	1.8	-4.9	Apr 10	90.9	95	101.7	Apr 10	220.9	-43.0	May 10	-3.9
10 Q1	5.0	4.2	May 10	1.0	-5.8	May 10	54.5	90	98.6	May 10	192.5	-43.2	Jun 10	-7.4
10 Q2f	-4.3	1.4	Jun 10f	0.5	-6.1	Jun 10p	30	44.4	98.9	Jun 10p	139.5	-41.0	July 10f	-6.1

### France & Euroland: Summer Doldrums

During the summer doldrums, the few people who are left on the trading desks have enormous latitude to make big things out of little things. Fear of slowing global economic growth soured financial markets last week despite strong economic news.

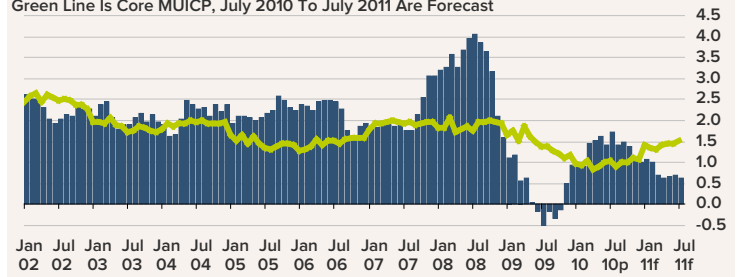
Euroland's GDP estimate was stronger than expected. Until we see the details, though, no one can know whether that growth is sustainable. Our view, based on the chart below, is that more goods—and services, too—were produced than consumers bought. If we are right, this inventory run-up will be the prompt for price and output cuts to liquidate stockpiles. Production already declined in June data.

Traders seem to share our concerns. Bonds rallied last week on soft economic expectations and did not retrace their gains much on Friday's strong GDP reports. Bond yields ended last week at historic lows. Kudos to traders for looking forward rather than backward.

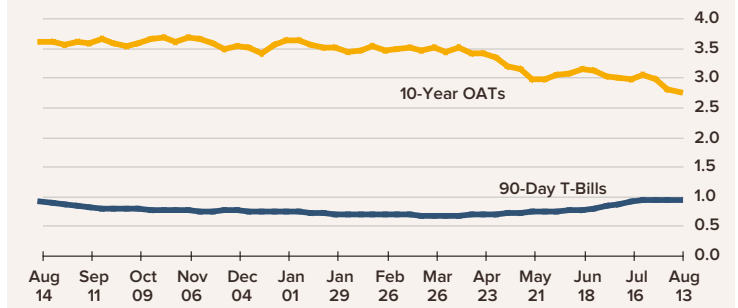
For those people who have to trade this week, little news will be coming from the economic fundamentals to reverse the momentum of the markets. "Inflation" will be reported below its 2% target, but no one will be surprised by that. Technically, the euro has just completed a picture-perfect consolidation of its January to June slump and ought to resume its decline. *In summer doldrums, techies often rule, and that would imply more euro depreciation.* When the market is re-populated at summer's end, traders should be looking at expectations for easier monetary conditions in the United States relative to Euroland. That, in time, will define the bottom of this technical dip of the euro. Until then, we expect more euro downside than upside.

### Euro Zone: MUICP, Percent Change Year Ago

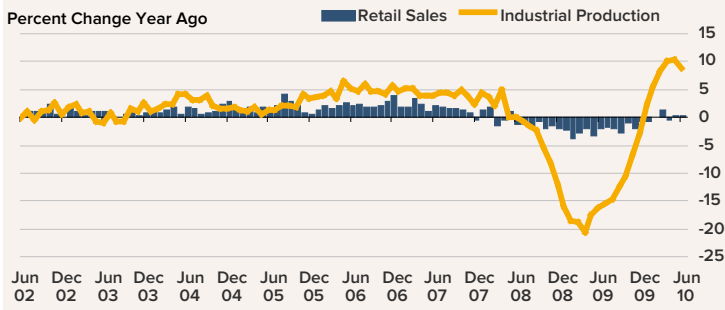
MUICP Through July 10p (Blue), July 2010 To July 2011 Are Forecast  
Green Line Is Core MUICP, July 2010 To July 2011 Are Forecast



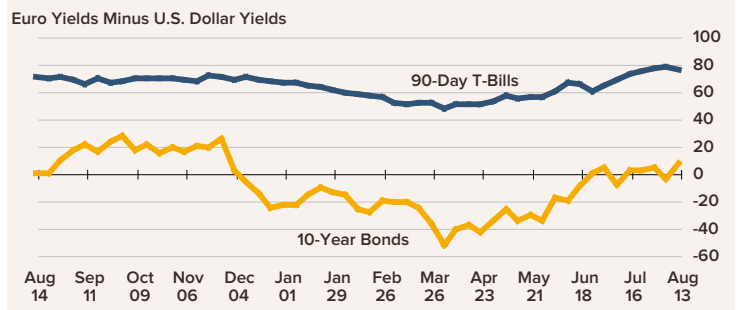
### France: Yields, Percent



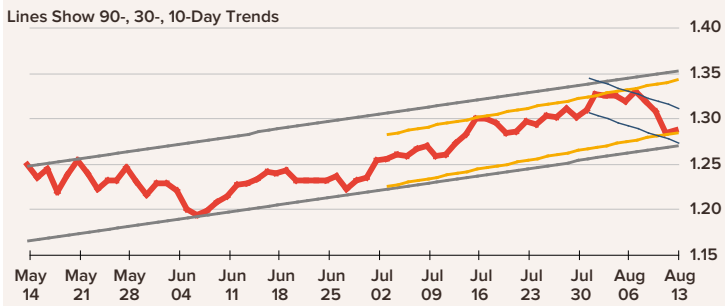
### Euro Zone: Retail Sales And Industrial Production



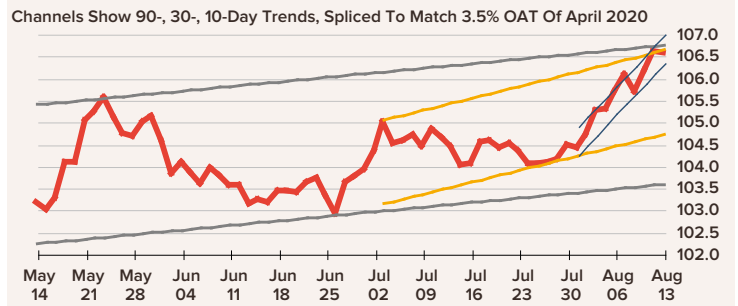
### Euro Vs U.S. Dollar Yield Spreads, Basis Points



### The Euro In U.S. Dollars, Daily Exchange Rate & Trends



### France: Daily Price Of 10-Year OAT



#### Monday 16

EZ MUICP	Core		
	%ch	%chya	%chya
Jul 09	-0.7	-0.6	1.3
Apr 10	0.5	1.5	0.8
May 10	0.1	1.6	0.9
Jun 10	0.0	1.4	0.9
Jul 10p	-0.4	1.7	1.0

#### Tuesday 17

EZ Current Account	
	€bns
Jun 09	1.5
Mar 10	-2.2
Apr 10	-7.5
May 10	-16.7
Jun 10f	1.7

#### Wednesday 18

Construction (6)

#### Thursday 19

#### Friday 20

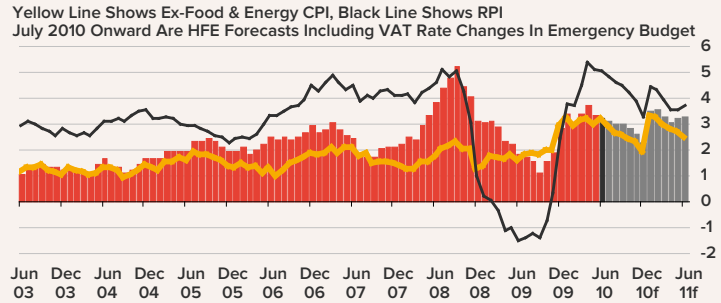
## United Kingdom: Inflation Risks Stymie BoE

While the ECB and the Fed can expect stable prices for the foreseeable future, the BoE faces the certainty that VAT rate hikes will keep its inflation metric above its 2% target at least through the end of next year. At least one MPC member is arguing that expectations of year-over-year CPI increases between 3% and 3.5%—of which 1-1/2 percentage points are from the VAT hikes and 1-1/2 to-2 points are from core price gains—mandate a response from the BoE. Inaction could allow inflation expectations to rise and become self-fulfilling. *The MPC has resisted this argument so far. Today's CPI report will give the Committee little comfort that soft demand is restraining prices.*

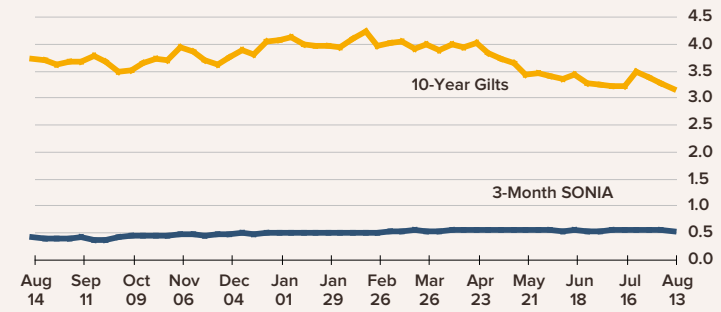
Prices are also rising faster than average wages, we learned last week. This will be reflected in the retail sales report due this week, which we think will show a year-over-decline. Households are not only looking at falling real pay packets, they are also seeing banks cutting back credit lines. Money and credit figures this week will confirm that. Also, house prices have lost their upward momentum. This caps wealth and therefore diminishes consumer spending. *People are still set back on their lifetime savings plans from house price declines earlier in this depression. Things are getting worse for them.*

Decaying demand should be the main driver for markets now: Fiscal austerity, falling real wages, a credit crunch and declining house prices are each reasons enough on their own to depress demand. *Look for stocks to stay depressed and gilt yields to fall again. The yield curve may flatten a bit. Gilts cannot keep up with Euroland bonds because of inflation expectations, but the yield curve can still flatten.*

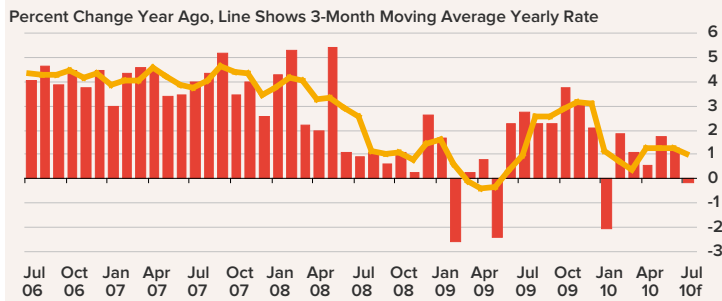
## United Kingdom: CPI, Percent Change Year Ago



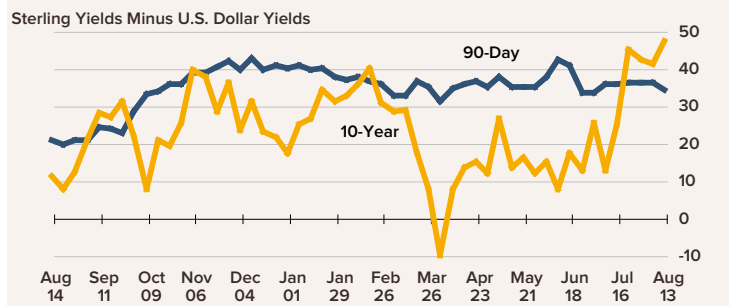
## United Kingdom: Yields, Percent



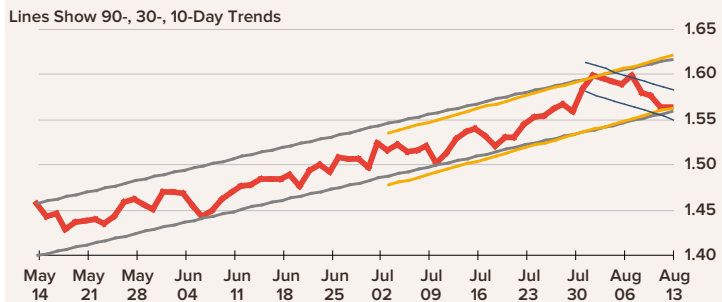
## United Kingdom: Retail Sales Volume



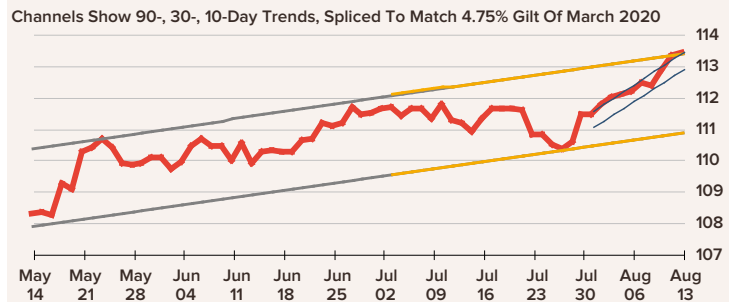
## Sterling Vs U.S. Dollar Yield Spreads, Basis Points



## Sterling In U.S. Dollars, Daily Exchange Rate & Trends



## United Kingdom: Daily Price Of 10-Year Gilt



Tuesday 17

Wednesday 18

Thursday 19

Thursday 19

Thursday 19

Thursday 19

CPI	Ex-Energy		
	%ch	%chya	%chya
Jul 09	-0.1	1.7	1.7
Apr 10	0.6	3.7	3.1
May 10	0.2	3.3	2.9
Jun 10	0.2	3.2	3.1
Jul 10f	-0.2	3.1	2.8

Monetary Minutes (8)

CBI Industrial Survey

	Index
Aug 09	-54
May 10	-18
Jun 10	-23
Jul 10	-16
Aug 10f	-25

Retail Sales

	%chya
Jul 09	2.7
Apr 10	0.5
May 10	1.7
Jun 10	1.3
Jul 10f	-0.2

£M4

	%chya	Ex-APF %chya
Jul 09	14.2	7.2
Apr 10	3.2	-6.8
May 10	2.7	-7.3
Jun 10	3.0	-7.0
Jul 10p	1.8	-8.0

PSNCR

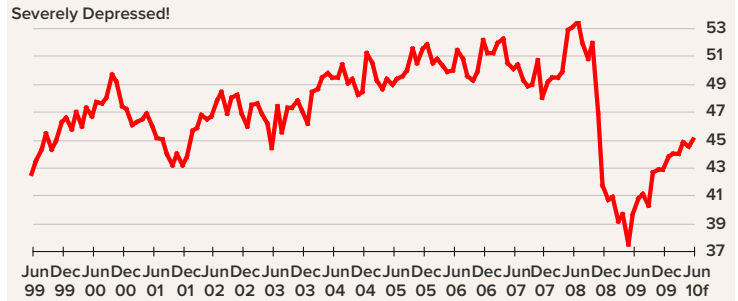
	£ bns	FYTD
Jul 09	0.94	45.19
Apr 10	6.48	6.48
May 10	14.06	20.54
Jun 10	20.91	41.45
Jul 10f	0.42	41.87

### Canada: BoC On Hold... It's About Time

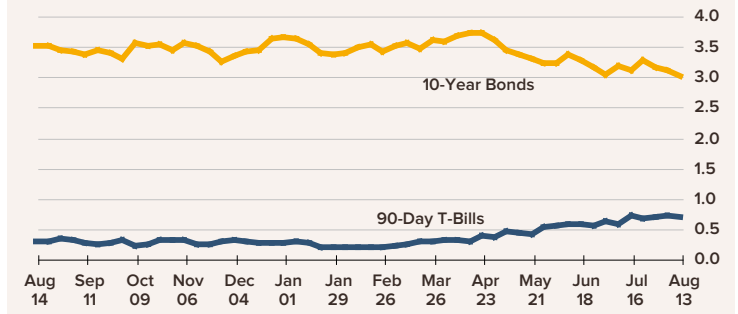
Everyone seems to be in agreement with the idea that the BoC is not going to hike interest rates again for a while. That notion has helped the loonie stabilize against the U.S. dollar, to the relief of manufacturers Up North. Take a look at the chart to the right showing our estimate of manufacturing production—derived from survey of manufacturing data—to see that this sector has not come back from the big post-Lehman bump to world trade. Exports show an identical pattern, which is the link: Canada manufactures stuff largely for export to the United States. The rise of the loonie, the slump in the U.S. economy and the restructuring of the North American auto industry are all painful hits to Canada's economy. Raising interest rates cannot help industry heal—it only boosts the loonie, which is a burden to manufacturing and to the economy.

Last week's retracement does not reverse the loonie's steady upward trend against the greenback. Why should it continue to appreciate? While the BoC may refrain from hiking interest rates again, the U.S. Fed announced last week that it would reinvest maturing debt in Treasuries to keep monetary conditions easy. Canada's yield curve has declined by less than the U.S. yield curve since then, and spreads continue to move in favor of the loonie. *We think that once the uproar over growth expectations settles down, traders will judge that U.S. interest rates have more downside potential than already elevated BoC rates. We still see a clear path toward par with the U.S. dollar, and we expect C\$ bonds to rally as the loonie rises. Capital flows support the C\$ now.*

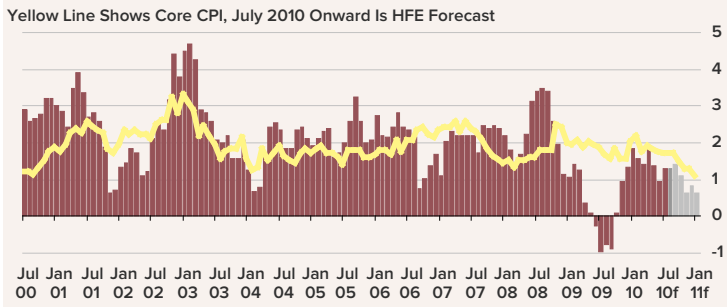
### Canada: Manufacturing Output, C\$ Billions



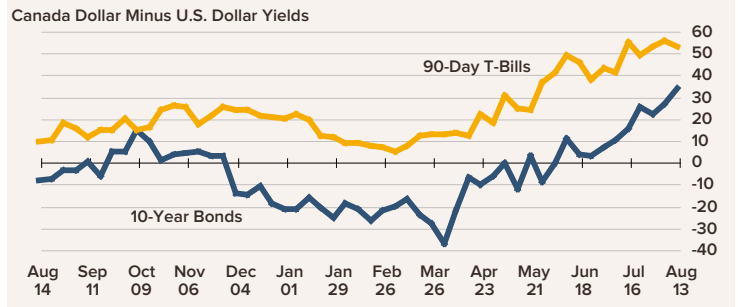
### Canada: Yields, Percent



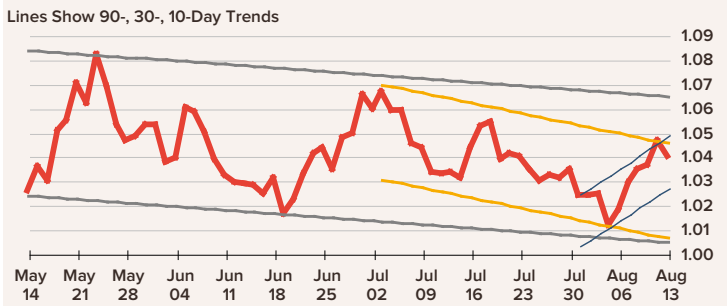
### Canada: CPI, Percent Change Year Ago



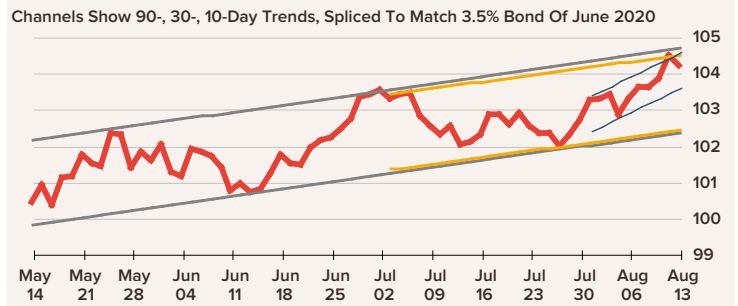
### Canada Vs United States Yield Spreads, Basis Points



### Canadian Dollar Per US\$, Daily Exchange Rate & Trends



### Canada: Daily Price Of 10-Year Bond



Tuesday 17

Tuesday 17

Wednesday 18

Thursday 19

Thursday 19

Friday 20

#### Survey of Industry

%chya	Jun 10f	May 10	Apr 10
New Orders	10.4	33.8	22.3
Shipments	13.7	16.5	10.8
Backlogs	-10.7	-9.0	-16.5
Inventories	-7.0	-6.8	-7.8
Prod'n	13.4	18.9	13.1

#### Int'l Capital Flows

	C\$ Billions
Jun 09	9.3
Mar 10	-6.9
Apr 09	12.2
May 10	26.1
Jun 10f	10.3

#### UI Claims (6)

#### Leading Indicator

	Index	%chya
Jul 09	215.5	-6.1
Apr 10	237.6	11.1
May 10	240.1	12.3
Jun 10	242.5	13.3
Jul 10f	245.1	13.7

#### Wholesale Sales (6)

#### CPI

	%ch	%chya	Ex-Energy %chya	X8 %chya
Jul 09	-0.3	-0.9	1.1	1.8
Apr 10	0.3	1.8	1.2	1.9
May 10	0.3	1.4	1.1	1.8
Jun 10	-0.1	1.0	1.0	1.7
Jul 10f	0.0	1.3	1.0	1.7

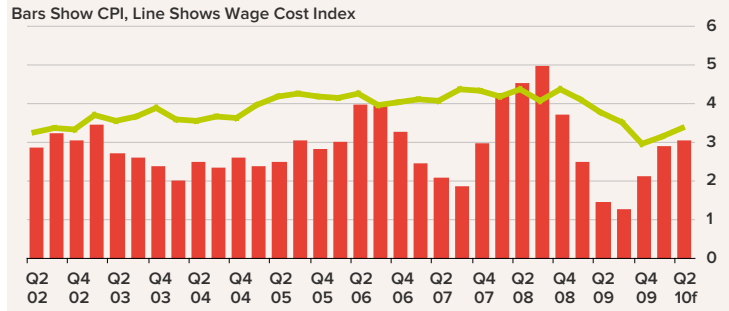
### Australia: Hiccup!

The labor market burped last month. ABS reported a rise in the unemployment rate and a loss of full time jobs. This news supported expectations that the economy is faltering and that more rate hikes will not be coming for a while. We did not have to wait for this jobs report to conclude that the local economy is slowing. Retail sales growth in the second quarter slowed to a mere 1.6% year-over-year pace, the smallest yearly rise since 1983. Vehicle sales, charted below, are still way below pre-downturn levels and faltering... probably because of the RBA's 150 basis points of rate hikes. Mortgage approvals are down, another victim of higher interest rates. That can only mean that the housing sector is going to fade sometime soon.

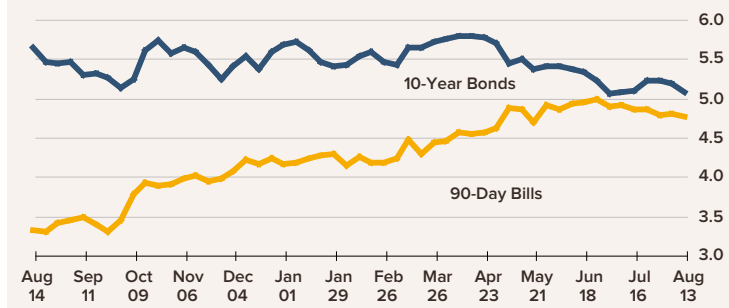
Of course, we also know that the RBA's preferred "inflation" metrics are within their target range and slowing. *That should be the biggest clue that the RBA need not continue hiking interest rates.*

So you would think that people had already digested the notion that outside of the commodity extraction sector—which is prospering on sales to Asia's booming economies in general, and to China in particular—things are mezzo-mezzo at best in the domestic economy. With expectations for steady rates, one would think that the Ozzie dollar would stabilize. However, spreads between A\$ and U.S. dollar markets—indeed, between the A\$ and any other major currency—are so totally wide that the Ozzie dollar is still prone to appreciation. *So do look for the yield curve to steepen as locals price out rate hike expectations, but expect the Ozzie dollar to continue to rise on all the major cross rates.*

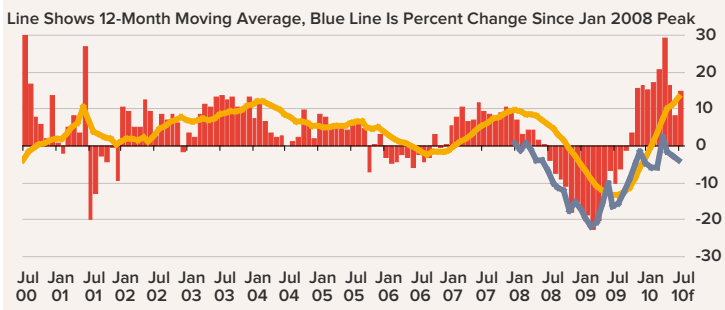
### Australia: Consumer Price Index Vs Wage Costs



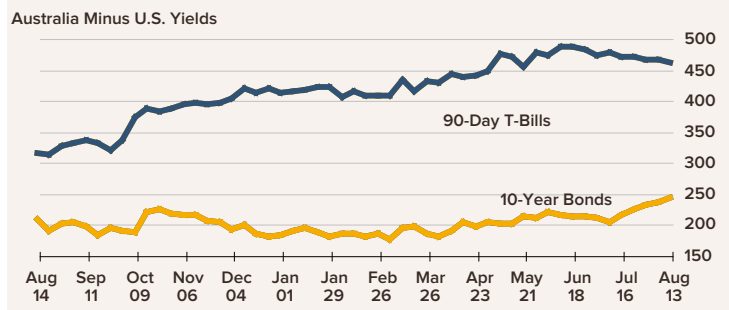
### Australia: Yields, Percent



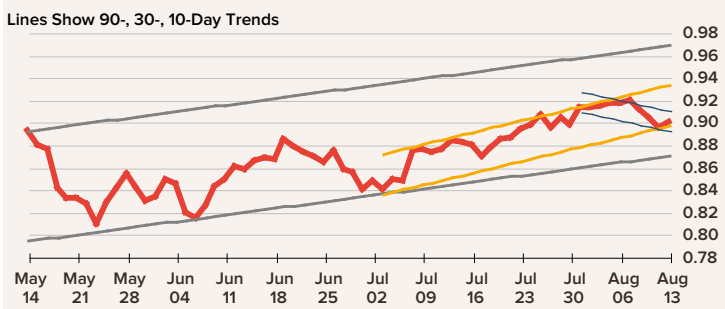
### Australia: New Vehicle Sales, Percent Change Year Ago



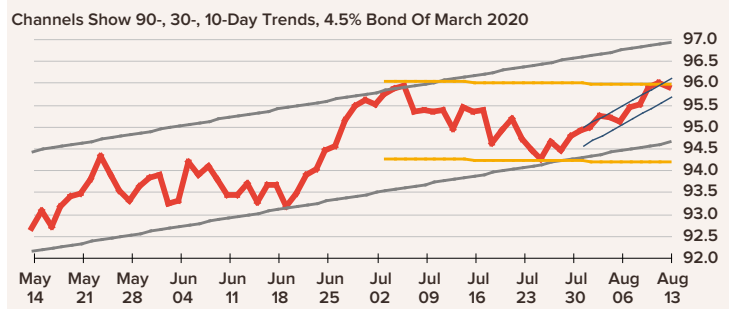
### Australia Dollar Vs U.S. Dollar Yield Spreads, Basis Points



### U.S. Dollars Per Australian Dollar, Daily Exchange Rate & Trends



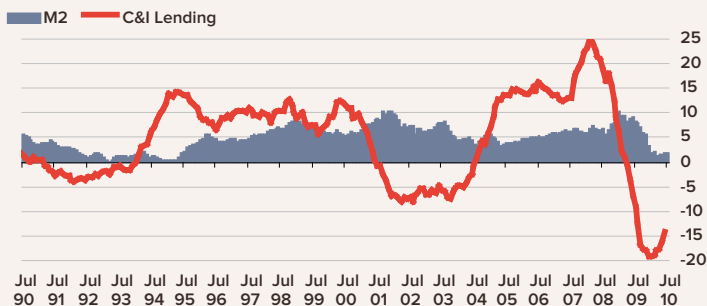
### Australia: Daily Price Of 10-Year Bond



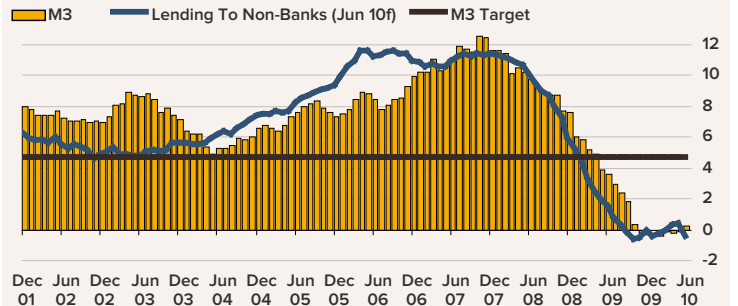
Monday 16	Tuesday 17	Wednesday 18	Thursday 19	Friday 20	Saturday 21
<b>Vehicle Sales</b> %ch %chya %chSP Jul 09 -6.8 -10.3 -17.0 Apr 10 8.6 29.2 1.5 May 10 -3.9 16.5 -2.4 Jun 10 -1.2 8.2 -3.6 Jul 10f -1.0 14.9 -4.6	RBA Governor Stevens Speaks RBA Minutes (8)	<b>Wage Costs Index</b> %ch %chya Q2 09 0.6 3.7 Q3 09 0.9 3.4 Q4 09 0.7 2.9 Q1 10 0.9 3.1 Q2 10f 0.8 3.3	Average Weekly Wages (Q2)		National Elections

### Money And Credit Growth At A Glance

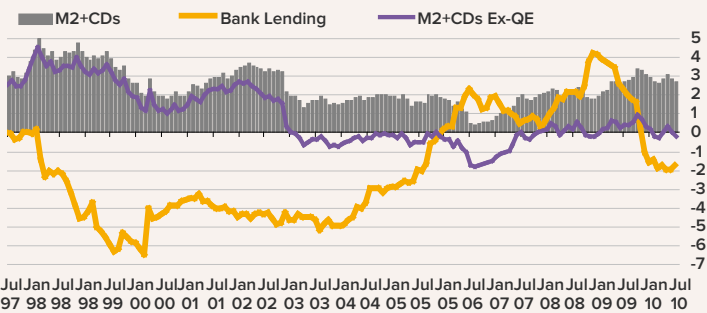
United States: Money & Credit, Percent Change Year Ago



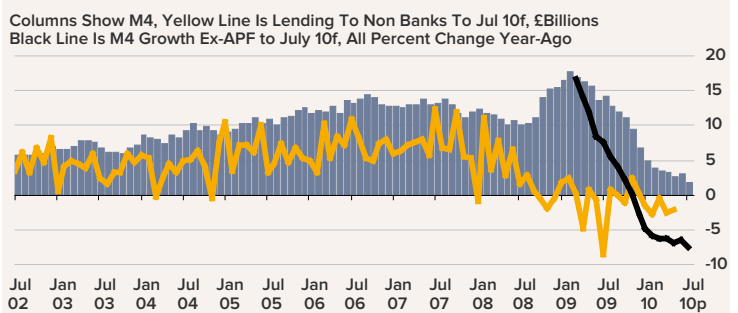
Euro Zone: M3 And Credit Growth, Percent Change Year Ago



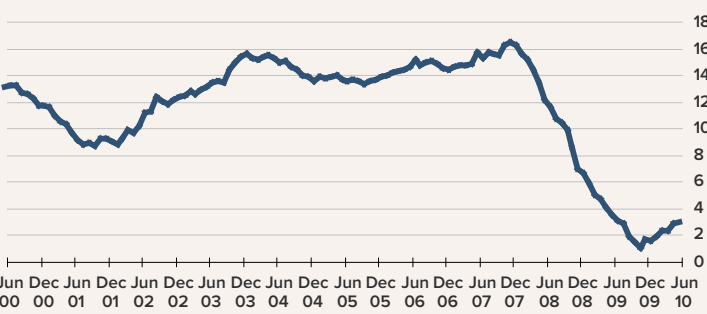
Japan: Money And Credit, Percent Change Year Ago



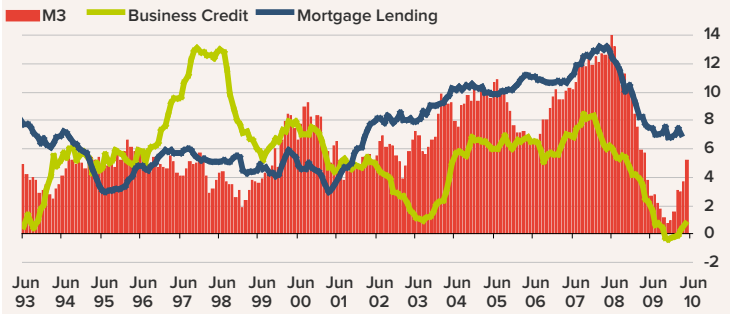
United Kingdom: Growth Of Broad Money & Credit



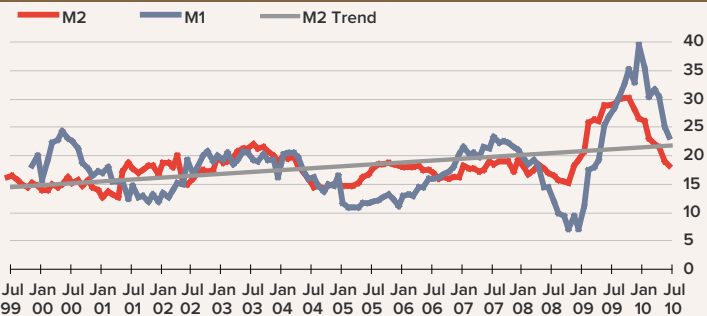
Australia: Domestic Credit, Percent Change Year Ago



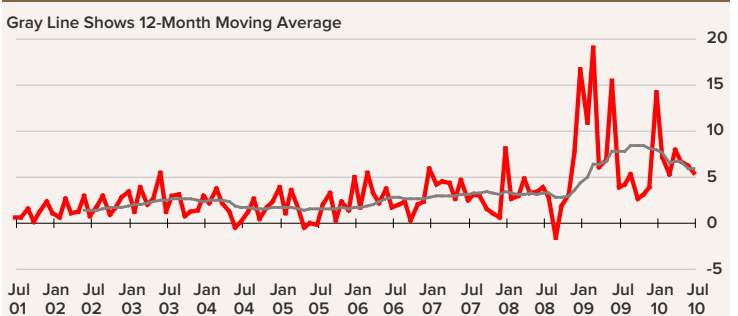
Canada: M3 And Credit, Percent Change Year Ago



China: Money Supply, Percent Change Year Ago



China: Bank Lending, RMB Billions



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Carl B. Weinberg, Chief Economist