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Action Bullets

Monday, May 10, 2010
Wells Fargo Edition
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- ***Global markets see "risk on" trades re−emerge on EUR 750 bln Europe loan package***
- ***Treasuries sharply lower, yields up, on unraveling of safe haven bid and as supply looms***
- ***U.S. calendar light today, $52bln bill auction and Fedspeak from Kocherlakota due***
- ***U.S. equities rallied hard on rescue deal, Fed swap lines, stock exchange meeting***

Action Alerts

08:57 ET U.S. equities are exploding higher following the ambitious $1 tln European rescue package, which put the markets on notice that a piecemeal break−up of the European Union would not be tolerated. This has been reportedly followed by central bank purchases of peripheral European debt. The Dow is up 380−points, S&P surged 49−points and NASDAQ is up 75−points ahead of the opening bell as investors apparently find the risk and volatility to their liking. The Fed joined in the profligacy by renewing its dollar swap lines with central banks, of low credit cost to the bank, though boosting its balance sheet again. Meanwhile, stock market authorities are in Washington to discuss fresh trading curbs to avoid the "flash crash" scenario from Thursday repeating itself. The flip side of this risk seeking action of course has been a drop in the dollar index to 83.55 compared to highs above 85.25 last Thursday, while the T−note yield gapped 15 bp higher to 3.56%, over a quarter point above Friday's lows.

08:05 ET Fedspeak is due from Kocherlakota of Minneapolis, who will be discussing "Taxing Risk" before the Economic Club of Minnesota from 13:30 ET. Non−voter Kocherlakota is moderately hawkish.

07:51 ET Treasury May refunding: The Treasury will hold its $78 bln May refunding this week, beginning with tomorrow's $38 bln 3−year sale. The back up in yield should help the auctions as they had become quite rich last week. The wi 3−year note is trading around 1.49% this morning after having closed at 1.34% on Friday, more than 40 bps rich to April's sale. The wi 10−year note is at 3.60% after finishing in the 3.40% region after having challenged 3.32% at Friday's open. Last month's award rate was 3.874%. The wi 30−year is at 4.45% after closing at 4.25% versus an intraday Friday low of 4.11%. It was reopened at 4.77% last month.

Treasury Outlook (May 10)

Treasuries are sharply lower as the markets have made huge "risk on" types of moves in response to the EUR 750 bln bailout package. European central banks are also reportedly purchasing government debt, while the Fed has re−started its currency swap lines. Treasuries and the dollar are sharply lower as safe haven demand unraveled, while stocks are sharply higher. The 2−year note yield climbed almost 15 bps to test 0.95%, with the 10−year yield having hit 3.60%, up over 18 bps, before backing off slightly. The curve steepened out over 4 bps to 265 bps, in conjunction with steepening in the German yield curve. Meanwhile, EUR−USD bounced back to challenge 1.30000, with the Dow future up over 400 points above fair value. There still considerable uncertainty, though, regarding the political will of Greece to sustain the austerity program, and for the likes of German to sustain its support −− note the German government, Chancellor Merkel's CDU party, suffered its worst defeat since WWII. Traders will be anxious to see if the gains in equities hold.

Adding to pressure on Treasuries is the upcoming $78 bln May refunding, beginning with tomorrow's $38 bln 3−year sale. The back up in yield should help the auctions as they had become quite rich last week. The wi 3−year note is trading around 1.49% this morning after having closed at 1.34% on Friday, more than 40 bps rich to April's sale. The wi 10−year note is at 3.60% after finishing in the 3.40% region after having challenged 3.32% at Friday's open. Last month's award rate was 3.874%. The wi 30−year is at 4.45% after closing at 4.25% versus an intraday Friday low of 4.11%. It was reopened at 4.77% last month. Today's calendar is virtually empty, and the week's slate is lightly populated with mostly second−string data until Friday's key reading on April retail sales. Today's line up includes only the $52 bln 3− and 6−month bill auction and comments from the Fed's Kocherlakota.

U.S. Comprehensive Calendar

DATE	ET	LOCALE	INDICATOR − EVENT	FOR	FORECAST	MEDIAN	LAST
08 May	09:30	South Carolina	Fed Chairman Bernanke gives commencement at University of South Carolina				
10 May	07:00	United Kingdom	BoE rate announcement (defered from May 6 due to election)				
10 May	13:30	Minneapolis	Fed's Kocherlakota speaks on "Taxing Risk" at Economic Club of Minn				
11 May	07:45	United States	ICSC−Goldman Sachs 05/08				−0.4%
11 May	08:30	North Carolina	Fed's Lacker speaks				
11 May	08:55	United States	Redbook 05/08				−2.2%
11 May	10:00	United States	Wholesale Inventories	MAR	0.1%		0.6%
11 May	10:00	United States	Wholesale Sales	MAR	1.3%	1.0%	0.8%
11 May	13:00	United States	Treasury Auctions 3−Year Notes				
11 May	13:15	Atlanta	Fed's Lockhart speaks at Atlanta Fed's Financial Markets Conference				
11 May	13:30	Atlanta	Fed's Plosser speaks at Atlanta Fed's Financial Markets Conference				
11 May	17:00	United States	ABC Consumer Comfort Index 05/09				−47
12 May	07:00	United States	MBA Mortgage Applications 05/07				4.0%
12 May	08:30	United States	Trade: Goods & Services	MAR	−$41.0B	−$40.0B	−$39.7B
12 May	08:30	United States	Goods & Services Exports (BOP)	MAR	$144.7B	$144.0B	$143.2B
12 May	08:30	United States	Goods & Services Imports (BOP)	MAR	$185.7B	$184.8B	$182.9B
12 May	10:15	Atlanta	Fed's Rosengren moderates panel at Atlanta Fed's Financial Markets Conference				
12 May	10:30	United States	EIA Crude Oil Stocks 05/07				2.8M
12 May	10:30	United States	EIA Gasoline Stocks 05/07				1.2M
12 May	10:30	United States	EIA Distillate Stocks 05/07				0.6M
12 May	12:30	Atlanta	Fed's Lockhart speaks at Atlanta Fed's Financial Markets Conference				
12 May	13:00	United States	Treasury Auctions 10−Year Notes				
12 May	13:15	Nashville	Fed's Bullard speaks on the economy				
12 May	14:00	United States	Treasury Budget	APR	−$60.0B	−$20.0B	−$65.4B
13 May	08:30	United States	Export Price Index	APR	0.2%	0.4%	0.7%
13 May	08:30	United States	Import Price Index	APR	1.0%	0.8%	0.7%
13 May	08:30	United States	Import Price Index ex−Petro	APR	0.1%		−0.2%
13 May	08:30	United States	Initial Claims 05/08		440K	440K	444K
13 May	08:30	United States	State Benefits 05/01		4,600K		4594K
13 May	09:00	Ottawa	Fed's Kohn speaks on monetary policy				
13 May	10:30	United States	EIA Natural Gas Stocks 05/07				
13 May	12:30	Philadelphia	Fed Chairman Bernanke in Q&A on reinventing older communities				
13 May	13:00	United States	Treasury Auctions 30−Year Bonds				
13 May	13:15	Texas	Fed's Fisher speaks on the Fed's functions and the economy				
13 May	13:30	Wisconsin	Fed's Kocherlakota speaks				
13 May	16:30	United States	M2 − Week Ended 05/03				
14 May	08:30	United States	Retail Sales	APR	0.5%	0.2%	1.9% R
14 May	08:30	United States	Retail Sales ex−Auto	APR	0.8%	0.5%	0.9% R
14 May	09:15	United States	Industrial Production	APR	0.7%	0.6%	0.1%
14 May	09:15	United States	Capacity Utilization	APR	73.8%	73.8%	73.2%
14 May	09:55	United States	Michigan Sentiment Prelim	MAY	73.5	73.5	72.2
14 May	10:00	United States	Business Inventories	MAR	0.4%	0.4%	0.5%
14 May	13:40	Illinois	Fed's Evans gives keynote address at Wesleyan University Associates Lunch				
17 May	08:30	United States	Empire State Index	MAY	30.0	29.5	31.9
17 May	09:00	United States	Net Long−Term Security Purchases	MAR	$50.0B		$47.1B
17 May	09:00	United States	Total Net TIC Flows	MAR	$50.0B		$9.0B
17 May	13:00	United States	NAHB Housing Mkt Index	MAY	18		19
18 May	07:45	United States	ICSC−Goldman Sachs 05/15				
18 May	08:30	United States	PPI	APR	0.2%	0.3%	0.7%
18 May	08:30	United States	PPI Y/Y	APR	5.6%		6.0%
18 May	08:30	United States	PPI ex−Food & Energy	APR	UNCH	0.1%	0.1%
18 May	08:30	United States	PPI ex−Food & Energy Y/Y	APR	0.8%		0.9%

18 May	08:30	United States	Housing Starts	APR	0.640M	0.645M	0.626M
18 May	08:30	United States	Building Permits	APR	0.680M		0.685M
18 May	08:30	United States	Housing Completions	APR	0.655M		0.656M
18 May	08:55	United States	Redbook 05/15				

Action Report

Week Ahead: Containing Contagion
By Michael Wallace
On May 10, 2010

Volatility remains the name of the game as the markets pushed back on officials Friday to come up with a comprehensive approach to the burgeoning European sovereign credit crisis. Legacy activity from the broken equity trades on Thursday bubbled up early and sent stocks sharply lower, but another savage down−move was arrested by rumors that a substantial emergency liquidity package for the eurozone could be put in place this weekend. EU officials on Friday in fact agreed in principle to set up an "emergency fund" to help protect the euro and sovereign debt in the region after pressure from a nervous G7, which would come on top of the $140 bln already promised to Greece.

In Asia, China's monthly data package and GDP readings across the region should highlight that economic engine is still humming. A spate of GDP releases are due from Europe as well, while civil unrest against new austerity measures in Greece threatens to derail carefully constructed fiscal measures. Focus in the UK will be on the formation of a new coalition government and the BoE is expected to keep policy on hold in the meantime. The U.S. meanwhile is still examining the root causes of the near $1 tln plunge in equity value last week, as the SEC mulls pan−exchange circuit breakers to avoid a catastrophic repeat of that event after automated systems simultaneously and convulsively obeyed the "sell in May and go away" mantra compounded by a reputed mistaken trade entry.

NORTH AMERICA

After the month got off to a splendid start with the better than anticipated payrolls report last Friday, it was a cruel fact that all the volatility spreading from the eurozone like a volcanic cloud completely obscured that good news on the economic front. Just as Europe appears increasingly subject to the forces of new normalcy, it seems ironic that the U.S. is beginning to turn more positive. Complacency is the true enemy, however, as Wall Street last week fell prey to its own algorithms and program trading caused a near−10% seizure on the Dow. If nothing else, this argues against premature unwinding of policy accommodation and in favor of speeding enlightened financial reform. The SEC is already considering unified trading curbs across exchanges aimed at slowing trade during times of cascading price declines, such as the mysterious "flash crash" on Thursday that is still being investigated.

The ***U.S.*** economic calendar is lightly populated with mostly second−string data until Friday's key reading on April retail sales. First up on Tuesday is the wholesale trade report, where sales are seen rising 1.3% (median 1.0%) and inventories up 0.1%. Wednesday will revisit the MBA mortgage market survey after the headlong rush to lock in mortgages in time to qualify for the home buyer tax credit. This is the first week without the tax safety net and in theory we should see a large drop in mortgage purchase demand, though refinancing activity could spike higher with the 40 basis point plunge in yields. The trade deficit is expected to widen slightly to −$41 bln in Mar (median −$40 bln) vs −$39.7 bln, EIA energy inventory data is due and the budget deficit may narrow to −$60 bln in Apr (median −$20 bln) vs −$65.4 bln.

Thursday features trade prices, with export prices seen rising 0.2% in Apr (median 0.4%) vs 0.7%, while import prices may rise 1.0%. Initial jobless claims are forecast to drop 4k to 440k for the week ended May−8. Friday wraps up with a flurry of releases, starting with the Apr retail sales report, expected to rise 0.5% (median 0.2%) vs 1.9%, while ex−auto sales are set to rise 0.8%. There is expected to be a little give−back from Mar gains due to autos and the pull−ahead of Easter same−store sales. Apr industrial production is set to gain 0.7% (median 0.6%), while capacity use rises to 73.8% from 73.2%. Preliminary May Michigan sentiment may also rise to 73.5 vs 72.2 and business inventories climb 0.4% in Mar vs 0.5%.

Fedspeak: Fed Chairman Bernanke will speak on Thursday on "Community Development" at a Philly Fed conference on "Reinventing Older Communities" from 12:30 ET, taking part in a panel discussion. Several other speakers will be appearing over the week, including Minneapolis Fed's Kocherlakota on Monday, Richmond Fed's Lacker, Atlanta's Lockhart and Philly's Plosser on Tuesday, St. Louis Fed's Bullard, Boston's Rosengren and Lockhart again Wednesday, the trio of VC Kohn, Dallas' Fisher, and Kocherlakota on Thursday, wrapping up with Chicago Fed's Evans on Friday. *Note, it is also possible that, if requested by the ECB, the Fed could reopen its dollar swap lines with little credit risk to support the effort to stabilize the markets, though this will temporarily boost its balance sheet again, seemingly at odds with its current modus operandi.*

Treasury May Refunding: Treasury will sell $78 bln in coupons this week and the auctions have a lot of going for them. Obviously the huge flight to quality trade is first and foremost, and it's not likely the fear trade will dry up over the next few days. There's still a ton of uncertainty over Greece and the periphery, not to mention the U.K., along with a sharp increase in counterparrty risk, making Treasuries very attractive. Additionally, the size of the refunding was cut $3 bln, with the likelihood of more reductions in short and intermediate coupons going forward. The one major negative, though, is that issues have become very rich. The wi 3−year note closed at 1.34% on Friday, more than 40 bps rich to April's sale. The wi 10−year finished in the 3.40% region after having challenged 3.32% at Friday's open. Last month's award rate was 3.874%. The wi 30−year closed at 4.25% versus an intraday Friday low of 4.11%. It was reopened at 4.77% last month.

In ***Canada,*** the huge April jobs gain has maintained pressure on the BoC to tighten in June, although competing with deepening risk of credit contagion. Moreover, domestic indicators are expected to remain firm throughout the week, featuring housing, trade and manufacturing data.

Housing starts (Mon) are expected to rebound 3.9% to a 205k unit pace in April following the 1.5% drop in March. Ongoing strength in housing permits supports our expectation for further improvement in housing starts during March and in the first half of 2010. The trade surplus (Wed) is projected to widen slightly to C$1.6 bln surplus in March from C$1.4 bln in February. Export values are expected to rise 1.5% in March following the robust 2.8% bounce in February. And a 1.0% rise in import values is anticipated following the 1.9% gain in February. And manufacturing shipments are expected to rise 0.5% in March, accelerating from +0.1% in February.

Supply features the C$3 bln GoC 3−year auction (Wed), launching a new issue maturing September 2013. The BoC minimum purchase is C$150 mln. In addition, C$12 bln will be offered at the regular T−bill auction (Tues), split between 98−day, 181−day and 364−day bills. And the BoC will conduct a C$1 bln cash management repurchase operation (Tues).

And BoC Deputy Governors Duguay and Murray will participate in discussions at Carleton University in Ottawa on Thursday and Friday respectively.

ASIA

Asian markets are hardly immune to the global panic surrounding the Greek crisis, with the MSCI Asia Pacific index plunging 5.9% last week, in its biggest drop since Feb−09, with the Nikkei−225 down 6.3%. At the same time, the flight to safety saw many regional currencies slip to multi−month lows versus USD, interrupting recent gains that had taken many to their strongest since the Lehman failure. As always, the exception was the JPY, one of the few currencies anywhere to gain versus USD amid reduced in investor risk appetite. Like everywhere, eyes will remain focused on the European handling of their fiscal problems, amid fears that this could spiral into another financial crisis, potentially derailing the global economic recovery.

It comes even as this week's data package from China, along with Q1 GDP reports from Indonesia, Malaysia and Hong Kong, and even Japanese leading indicators, will highlight the continued strong economic rebound across the region. This has seen their central banks leading the world toward normalization of interest rates from recent accommodative levels, and Bank Negara Malaysia had been been expected to tighten by another 25 bps at its meeting this week, though the latest global market turmoil might give them reason to pause, just as the RBA is seen pausing in June after last week hiking for a sixth time in seven meetings.

A light ***Japanese*** calendar this week will include March prelim leading index (Wednesday), projected rising 2.5 m/m, a 13th straight increase following the sharp drop in 9 of the 10 previous months. Along with the coincident index rising 1.0 m/m, a 12th straight increase after 10 straight declines, these reflect continued economic recovery. March current account surplus (Thursday) is projected widening to 2100 bln JPY NSA from 1471 bln JPY in February, up sharply y/y. It reflects the strong rebound in exports, expected to continue at +49% y/y in the April 20−day trade data (Thursday). April money & credit (Thursday) expected to show M2 narrowing to +2.4% y/y from +2.6% y/y, and bank loans slipping to −2.0% y/y from −1.8% y/y in March, after December showed the first y/y decline in 5 years.

In ***Australia,*** as elsewhere***,*** domestic data will compete with ongoing uncertainties over the situation in the eurozone periphery, with the latter furthering the already strong argument for a pause from the RBA in June and heightening speculation of no change in August. However, an expected 25.0k rise in April employment (Thursday) will highlight the ongoing recovery in the domestic economy, backing additional rate hikes in the second half of this year. Housing finance for March (Wednesday) and ANZ job ads (Monday) round out the data calendar. RBA Assistant Governor Lowe speaks in Sydney (Thursday). Additionally, the government releases the 2010−11 budget (Wednesday). ***New Zealand***'s sparse calendar features retail sales (Friday), expected to bounce 0.3% in March following an 0.6% drop in February.

The monthly data package from ***China*** begins with April trade report (Monday), which we project swinging back to a $4.0 bln surplus from −$7.2 bln in March, the first monthly deficit in six years. Though partly due to seasonal factors, the market will be watching for clarification of a new trajectory, which we forecast showing exports rising to +37.5% y/y from +24.3% y/y the month before, and imports to +55.5% y/y after +66% y/y. Together April retail sales (Tuesday) projected rising to +19.5% y/y from +18% y/y in March, and April industrial production to +19% y/y from +18.1% y/y, they will reflect continued solid growth. The April CPI is forecast picking up to +3.0% y/y from +2.4% y/y, and the April PPI to +6.0% y/y from +5.9% y/y, both their fastest y/y growth in 18 months. Concerns over inflation have prompted the PBoC to raise reserve requirements three times this year, along with administrative guidance to restrain credit growth, which should be reflected in data projected showing April cumulative fixed investment narrowing to +26.2% y/y from 26.4% y/y through March, and yuan−denominated loans narrowing to +21% y/y from +21.8%, with yuan loans seen at 425 mln CNY, all still strong by any standards, but further narrowing from last year's robust pace. April M2 growth is projected at +21.5% y/y after +22.5% y/y.

Elsewhere in the region, the calendar features ***Indonesia*** Q1 GDP (Monday) projected rising to +6.0% y/y from +5.4% y/y in Q4, along with ***Malaysia*** Q1 GDP (Friday) soaring to +10.5% y/y from +4.5% y/y and ***Hong Kong*** Q1 GDP (Friday) to +7.8% y/y from +2.6% y/y, highlighting the strong economic rebound across the region from the softness a year earlier. This will also be reflected in ***Malaysia*** March production (Tuesday) projected +16% y/y after narrowing to +4.9% y/y in February, on holiday calendar, and ***Philippine*** March exports (Wednesday) forecast +45% y/y after +42.3% y/y, and ***Singapore*** March retail sales (Friday) expected showing solid +13% y/y rebound ex−vehicles, but slowing to +0.5% y/y overall, held down by softness in vehicle sales.

Against this backdrop, regional central banks have begun to normalize monetary policy from generally accommodative rates implemented during the downturn. ***Bank Negara Malaysia*** is expected to hike rates by another 25 bps to 2.50% at its policy meeting (Thursday) on top of the 25 bps hike at the previous meeting, though they might be inclined to pause this month in the face of the global uncertainties surrounding the Greek crisis. ***Bank of Korea*** was already expected to hold steady at 2.00% at its meeting (Wednesday), remaining patient under recently−installed Governor Kim. April PPI (Monday) is forecast picking up to +3.0% y/y from +2.6% y/y, but still tolerable, while the April unemployment rate (Wednesday) is expected to edge down only gradually to 3.7% SA from 3.8%, still not fully retracing the uptick from 3.5% to 4.8% in December.

EUROPE

Eurozone: The widening debt crisis is overshadowing economic data at the moment, but data releases this week include first quarter GDP numbers from Germany, Italy, France, Spain and the eurozone. We see German Q1 GDP down 0.1% q/q (median same), French growth up 0.2% q/q (median 0.3%) and

Italian GDP unchanged over the quarter (median 0.3%), which should leave eurozone GDP up 0.1% q/q. The cold winter weather, the phasing out of incentives for the car industry and still high unemployment are all weighing on Q1 GDP developments, but confidence has picked up considerably, which confirms that the recovery remains on track.

At the same time inflation is picking up. Final German April CPI as well as HICP inflation are expected to be confirmed at −0.1% m/m and 1.0% y/y (medians same). Italian HICP is expected to be confirmed at 1.5% y/y, Spanish HICP at 1.6% y/y and French HICP is expected to remain steady at 1.7% y/y. There is also eurozone production data for March Markets will also keep a very close eye on the Portuguese 10−year auction on May 12, when Germany is selling a 2−year Schatz. Italy is selling bonds on May 13.

UK: The main U.K. event of the week will be the possible forming of a new government. After Thursday's election results ended with a hung Parliament −− with the Conservatives as the largest party, though without an outright majority −− Conservative party leader Cameron reached out to the Liberal Democrats for co−operation. Gilt futures fell Friday, as market players are worried that the weak leadership associated with a minority government or a coalition, will make it hard for necessary budget cuts to be pushed through Parliament.

We expect the BoE to leave the repo rate and its asset purchase target stable at its Monday meeting, at 0.50% and GBP200 bln respectively. The BoE is likely to hold rates at record lows for an extended period, and given recent events in Europe, it might now hold rates steady for even longer, if the eurozone recovery appears to be threatened. We still look for a first rate hike in Q4 of 2010 and a year−end repo rate of 1.00%, but acknowledge the possibility of a first hike being pushed into early 2011.

On the data side, March manufacturing production is expected to show further improvement, while labor market data are forecast to show another monthly decline to claimants. The ILO unemployment rate is expected to have remained at 8.0% in the three months to March, however. There is also April RICS house price data, BRC retail sales and March trade data. The DMO will auction GBP2.25 bln in 4.25% 2027 Gilts and GBP1.1 bln in 1.875% 2022 index−linker, after a week of no supply.

Scandinavia: April inflation data will be out both in Sweden and Norway and inflation pressure is likely to remain subdued. We forecast Swedish CPI to have picked−up slightly, estimating a 1.3% y/y rate (median 1.2%), versus 1.2% in March. Meanwhile, we look for Norwegian core CPI to have slipped to 1.5% y/y (median 1.6%) from 1.7%, which would support the Norges Bank's decision to go easy on the monetary tightening this year.
