J.P.Morgan

Economic Research
September 5, 2014

Global Data Watch

- **ECB delivers on strong Jackson Hole rhetoric and eases further**
- **Global PMIs running well ahead of activity data, adding to conviction that acceleration in activity will continue**
- **Look for continued steady gains in China August data next week**
- **BoJ fades recent weak data while Abe responds by reshuffling cabinet**

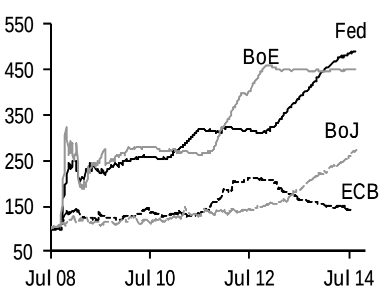
Whatever it takes, part II

Until recently, we believed ECB policymakers were failing to fully appreciate the deflationary forces facing the region. The central bank has been far too hesitant in the face of elevated unemployment and depressed levels of inflation, in our view: our estimates place the appropriate Euro area policy rate roughly 500bp below current levels. (See *Global Issues:* Pressures forcing the G4 central banks apart, July 16.)

Recent ECB news—including the June TLTRO announcement and President Draghi's second "whatever it takes" pronouncement at Jackson Hole—has prompted us to reassess our thinking as a significant shift in the central bank's reaction function appears to be taking place. At Jackson Hole, Draghi highlighted the huge costs of high unemployment in the Euro area and the importance of monetary policy in promoting demand growth—not only to reduce the cyclical component of unemployment but also to insure against the threat of hysteresis. His statement that "The risks of doing too little—i.e. that cyclical unemployment becomes structural—outweigh those of doing too much—that is, excessive upward wage and price pressure" sounds far more like a Fed than ECB official and suggested that more easing would be forthcoming.

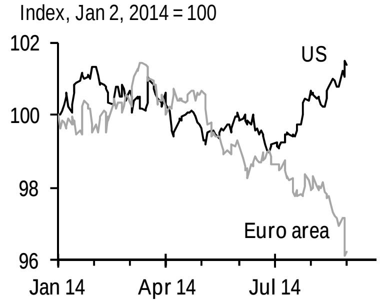
Against this backdrop, and consistent with our expectations, the ECB this week delivered a 10bp cut in the interest rate corridor and announced a private sector asset purchase program covering ABS and covered bonds, due to start next month. Whether or not the ECB moves further—and possibly implements a sovereign QE program—depends on upcoming economic news, particularly whether inflation and inflation expectations firm into year-end. Draghi stated that that he would like the central bank's balance sheet to rise to where it was in early 2012. To achieve this roughly €1 trillion move up to a €3 trillion balance sheet, action beyond the upcoming TLTROs and private sector asset purchases may be needed. Whether this would involve sovereign QE is a key open question.

Central bank balance sheet - total assets
July 1, 2008 = 100



Source: BoE, BoJ, ECB, Fed, J.P. Morgan

Effective exchange rate
Index, Jan 2, 2014 = 100



Source: J.P. Morgan

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Global manufacturing output PMI
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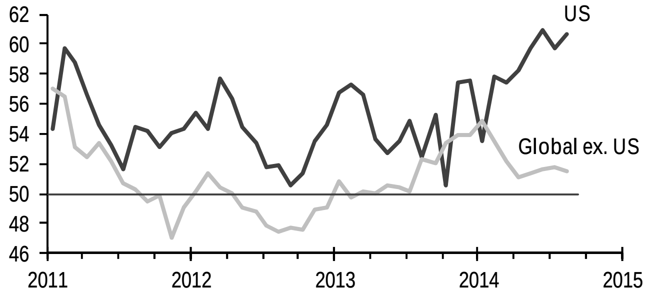


Source: J.P. Morgan, Markit

More important than the details of the program, recent ECB rhetoric and actions provide further evidence of the power of policy signals. Since the ECB policy shift was announced in June, EONIA four-year forward rates have fallen 50bp. Meanwhile, German 10-year yields are down around 40bp, peripheral spreads have tightened, and the euro-dollar exchange rate has fallen around 5%. While these market movements are encouraging, they do require the ECB to be credible and consistent. Our macroeconomic projections, which place 2H14 growth at 1.25% and inflation below 1%, show conditions improving but will continue to place pressure on the central bank to act to achieve its inflation objective.

Looking for breadth in solid growth pickup

This week's news provides generally positive signals on global growth. Our global all-industry PMI stabilized in August at a solid level consistent with above-trend global growth. It is also encouraging that both the manufacturing and services PMI remain elevated. There is some concern about the lack of regional breadth in the survey as the strength in our PMI is heavily concentrated in the US. However, these concerns are tempered as global industry shows signs of bouncing. Following a sharp decline that appeared linked to the timing of holidays, German industrial output soared in July, setting the stage for an estimated 1.1% rise in the Euro area as a whole. Brazilian industrial production strengthened after the end of the World Cup. And, while the August employment report highlights a likely slip in US activity as a one-off boost from the auto industry fades, August should be the month that Japanese output jumps following a nearly 6% fall over the preceding four months (see "Global manufacturing is bouncing back" in this *GDW*).

As weak links rise, it is also important to see signs that the US and China demand engines remain in place. From this perspective, we don't view the disappointment in August employment as a sign of sliding growth momentum. More likely, it is a signal that employment gains are set to stabilize near the roughly 200,000 average monthly pace of the past two years as productivity growth accelerates alongside the pickup in overall growth. Moreover, a surge in US August auto sales to their highest level since January 2006 suggests that consumers are growing more confident in the recovery. And with strong increases in income, huge gains in wealth over the past couple of years, and a sharp rise in the saving rate year-to-date, there is plenty of fuel for spending.

China: August data to show steady growth

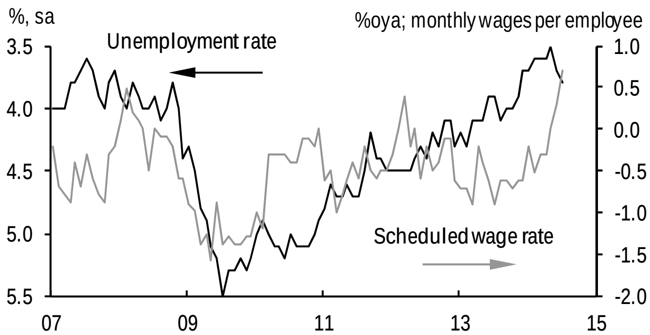
This week's August PMI reports provided more evidence that EM Asia's 3Q GDP growth is tracking at a similar pace to last quarter. In China and India, the manufacturing PMI took a breather from its July highs, while in Taiwan it reached its highest level since 2011 and in Korea it remained in expansionary territory. Next week will be a big test when Chinese August activity data are released. Export growth is likely to moderate from the jump in July, while IP and retail sales growth should remain stable. As in previous months, investment growth is likely to step back. Real-estate investment will be carefully watched. Housing has a great deal of influence on the economy and financial markets, and it represents an important source of downside risk. Housing policy recently has been eased (removal of home purchase restrictions, easing regulations on mortgage lending and on bond market funding by real-estate companies). Upcoming data will provide an early test of the efficacy of these measures.

The August update on social financing will attract the most attention. The volatility of TSF growth in recent months has created uncertainty about the macroeconomy and policy. We expect TSF growth to steady near 16%oya though year-end. Consequently, we expect monetary policy to remain on hold, with the PBOC working to improve the monetary transmission mechanism via targeted quantitative measures and tightening up on shadow banking activity.

India reforming around the edges

Market enthusiasm has persisted in India despite the gradualist approach of the Modi government, which has shied away from the big-bang reforms that investors speculated about after the election. To be sure, the government appears to have made significant progress on administrative reforms, such as faster decision-making, improving ministerial coordination, and reducing implementation bottlenecks that have constrained investment. Another positive has been the adherence to fiscal consolidation and support for the central bank's inflation targeting framework. But, more important substantive land, energy, and tax reforms still need to be enacted in order to significantly lift the potential of the economy and do justice to the recent historic election result.

Japan unemployment and scheduled wage rate



Source: Ministry of health, labor and welfare, J.P. Morgan

Kuroda optimistic despite weak spots

At this week's policy meeting, BoJ governor Kuroda reaffirmed his optimism about the outlook for the economy and inflation, signaling that he does not envision any further easing absent a major change in the forecast. Officials left unchanged their outlook for growth and inflation. Kuroda argued that the recent weakness in consumption—further highlighted by this week's report of a continued slide in auto registrations—and IP, which has persisted through the current quarter, reflects temporary factors. One piece of good news for the consumer is the recent firming in core wage growth into positive territory. Next week's update on consumer sentiment and the Economy Watchers survey bear watching.

This week, Prime Minister Abe reshuffled his cabinet. The implications for major policies should be limited because key members are mostly unchanged. Still, the appointment of Yasuhisa Shiozaki as Minister of Health, Labor, and Welfare is notable. Shiozaki played a key role in the genesis of the government's growth strategy, and his appointment might signal a new push on employment reforms.

RBA downplays weaker job market for now

The past week's news out of Australia underscored the reasons we had for removing our call for another RBA rate cut a couple of months ago. Despite a below-trend 2% real GDP gain last quarter, Governor Stevens delivered a speech declaring it would be unwise to further inflate housing markets just to speed up the recovery. Presumably the governor's overweighting of housing strength relative to labor market weakness is guided by his suspicion that recent labor market data are noisy: the unemployment rate spiked to 6.4% in July, but RBA commentary has suggested this may have been influenced by changes to survey methodology. Next week's survey for August will therefore be an important test of this view. A sticky, elevated jobless rate would signal greater downside risk to the Bank's inflation target.

Latam: evolving medium-term expectations

The cyclical disappointment suffered in Latam has the potential to reshape investor expectations regarding medium-term growth, particularly when the global landscape for commodities and rates is shifting as it is today. Central banks in Mexico and Brazil left rates on hold as expected this week. However, we look for officials in Chile to deliver a 25bp rate cut following their recent downgrade of the 2014 growth outlook. More eye-catching was the downward revision to potential growth in Chile in the latest Quarterly Inflation Report.

Political dynamics amid contentious elections are also impacting medium-term growth expectations. With unemployment low across the region, investors are scrutinizing policymakers' commitment to boost aggregate productivity and enhance the supply side of the economy in place of the traditional reliance on demand-side and exchange rate management tools. In Colombia there is a more acute sense of urgency for executing a large pipeline of infrastructure investment to deliver a new leg up in potential growth in light of the fading oil sector boom. But so far, only Mexico, where productivity has lagged the most in the region, stands out for pursuing and implementing significant reforms. The good news is that recent economic reports in Mexico suggest that a cyclical lift is taking hold, building the political capital necessary for sustaining the reform efforts.

Scottish independence polls tighten

The latest polls suggest the September 18 vote for Scottish independence is closer than expected. While our assumption is that the resolution does not pass, we believe the UK authorities would send a message of continuity for the near term even if independence is enacted and that any change in currency regime would not occur immediately. Combined with the promise of ongoing Bank of England support for all UK-based institutions until separation takes place, this would make the likely capital flows out of Scotland manageable.

There is, however, little the authorities can do to counter the broader uncertainties that a yes vote would provoke. In the event of a yes vote, we would expect a sharp (more than 4%) fall in sterling and a 10-20bp rise in 10-year bond yields. While largely guesswork, we likely would need to lower our GDP forecasts for 4Q14 and 1Q15 by 0.5%-pt, ar while pushing back our call for a BoE rate hike. Importantly, the loss of Scottish MPs in the Westminster Parliament and plausible changes in the leadership of the Conservative party would likely cause a big rightward shift in the political center of gravity of the rest of the UK. This would materially increase the likelihood of both (a) a referendum on EU membership taking place, and (b) that referendum seeing a vote to leave the EU.

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Global economic outlook summary

	Real GDP % over a year ago			Real GDP % over previous period, saar						Consumer prices % over a year ago			
	2013	2014	2015	1Q14	2Q14	3Q14	4Q14	1Q15	2Q15	4Q13	2Q14	4Q14	4Q15
United States	2.2	2.1	3.0	-2.1	4.2	3.0	3.0	3.0	3.0	1.2	2.1	2.1	1.9
Canada	2.0	2.3	2.7	0.9	3.1	2.5	2.7	2.8	2.6	0.9	2.2	2.0	2.1
Latin America	2.5	1.1	2.7	-0.1	-0.1	1.3↓	2.9↑	2.7	3.2	4.5	5.1	5.1	4.8↑
Argentina	2.9	-1.5	3.0	-3.2	-0.1	-4.6	-1.4	5.0	7.0	10.7	36.0	35.0	40.0
Brazil	2.5	0.2	1.5	-0.6	-2.3	0.1	2.6	1.1	1.4	5.8	6.4	6.3	6.3
Chile	4.1	1.9	3.1↓	2.5	0.6	0.4↓	4.5↑	2.9	3.9	2.3	5.1	4.2	3.0
Colombia	4.7	5.0	4.5	9.7	2.0	4.0	4.0	5.0	5.5	1.8	2.8	3.3↑	3.0
Ecuador	4.6	3.3	4.0	2.0	1.5	2.0	2.5	3.5	4.5	2.3	3.4	3.5	4.0
Mexico	1.1	2.7	3.8	1.8	4.2	3.9	3.7	3.6	4.0	3.7	3.6	4.1	3.1
Peru	5.8	3.3	5.5	-0.6	-1.8	6.5	9.5	5.5	5.0	3.0	3.5	3.1↑	2.8↑
Uruguay	4.7	2.7↓	3.0↓	-1.8	3.5↓	5.0↓	3.5↓	3.0	2.0 ↓	8.6	8.1	7.8	7.3
Venezuela	1.3	-2.0	2.0	-10.0	-3.0	2.0	2.0	2.0	2.5	52.9	56.2	57.0	44.9
Asia/Pacific	4.6	4.4	4.7	5.3	2.4↑	4.8	4.9↓	4.8	5.0	3.2	3.3	3.1	3.3
Japan	1.5	0.9	1.4	6.1	-6.8	2.0	2.5	2.0	2.2	1.4	3.6	3.1	2.5
Australia	2.3↓	3.1↑	3.3↑	4.3↓	2.0↑	2.3↓	2.9↓	3.0↑	3.7 ↑	2.7	3.0↑	2.1↑	2.6
New Zealand	2.8	3.2	2.8	4.0	0.8	1.9	4.7	4.8	0.5	1.6	1.8	1.6	2.0
EM Asia	6.2	6.1	6.4	5.1	6.4↓	6.3	6.2	6.2	6.5	3.9	3.3	3.3↑	3.7↓
China	7.7	7.3	7.3	6.3	7.7	7.6	7.4	7.1	7.2	2.9	2.2	2.3	3.1
India	4.7	5.3	6.5	5.4	6.8	4.0	4.7	5.9	7.5	10.4	8.1	8.2	7.0
EM Asia ex China/India	4.0	3.9	4.4	2.5	3.5↓	4.5	4.4	4.4	4.5	3.3	3.4	3.1↑	3.5↓
Hong Kong	2.9	2.0	2.1	1.2	-0.4	3.0	3.0	2.0	2.0	4.3	3.6	4.3	3.6
Indonesia	5.8	4.9	5.3	4.2	4.9	5.0	4.5	5.2	5.5	8.4	7.1	6.0↑	4.6↓
Korea	3.0	3.6↓	4.0	3.8	2.0↓	4.7	4.0	4.0	4.0	1.1	1.6	1.7↓	3.0↑
Malaysia	4.7	5.8	4.7	3.4	7.5	4.0	5.5	5.0	4.0	3.0	3.3	2.4	5.0
Philippines	7.2	6.0	6.4	5.9	7.7	5.7	5.7	6.6	6.6	3.5	4.4	3.6	3.8
Singapore	3.9	3.3	4.1	1.8	0.1	4.1	6.1	4.9	5.7	2.0	2.4	1.1	2.4
Taiwan	2.1	3.8	3.7	2.5	3.9	4.0	4.2	3.8	3.6	0.6	1.6	1.7	1.7
Thailand	2.9	1.1	4.2	-7.3	3.5	4.0	4.0	4.2	4.2	1.7	2.5	2.9	3.8
Western Europe	0.1	1.3	2.0	1.3↑	0.8↓	1.4	1.8	2.2	2.4	1.0	0.8	0.9	1.3
Euro area	-0.4	0.8	1.8	0.9↑	0.1↓	1.0	1.5	2.0	2.3	0.8	0.6	0.7	1.1
Germany	0.6	1.5	2.1	2.7	-0.6	1.5	2.0	2.5	2.5	1.3	0.9	1.0	1.7
France	0.4	0.4	1.5	0.1	-0.1	0.5	1.0	2.0	2.0	0.8	0.8	0.8	1.1
Italy	-1.8	-0.1	1.2	-0.3	-0.7	0.5	1.5	1.5	1.5	0.7	0.4	0.1	0.9
Spain	-1.2	1.2	2.1	1.5	2.3	1.5	2.0	2.0	2.5	0.2	0.2	0.0	0.0
Norway	2.0	2.5	2.4	2.0	4.9	1.9	2.1	2.3	2.5	2.3	1.8	2.2	2.4
Sweden	1.6	1.8	2.4	-0.4	1.0	2.0	2.5	2.5	2.5	0.1	0.0	0.3	1.5
United Kingdom	1.7	3.1	3.0	3.3	3.4	3.0	3.0	3.0	3.0	2.1	1.7	1.5	2.1
EMEA EM	2.0	1.7	2.3	0.5	1.1	1.3	1.8	2.1	2.5	5.1	5.8	5.5	4.7
Czech Republic	-0.9	2.8	2.8	3.3	-0.1	3.1	3.0	4.3	2.4	1.1	0.2	1.0	1.9
Hungary	1.1	3.3	2.6	4.5	3.2	2.0	2.5	3.0	2.5	0.7	-0.2	0.5	2.8
Israel	3.4	2.2	2.8	2.8	1.7	-0.4	5.3	2.0	2.6	1.9	0.8	0.3	0.9
Poland	1.6	3.0	3.2	4.5	2.4	2.0	2.8	3.5	3.5	0.7	0.3	0.1	1.9
Romania	3.5	2.2	3.5	-0.7↓	-3.8↑	4.5↑	3.0	3.6	2.4	1.8	0.9	1.8↓	2.6
Russia	1.3	0.5	1.0	-3.6	1.4	0.8	1.0	0.5	0.8	6.4	7.6	6.9	5.4
South Africa	1.9	1.4	3.0	-0.6	0.6	2.3	3.3	2.9	3.3	5.4	6.5	6.1	5.7
Turkey	4.0	3.0	4.0	7.0	0.8	1.2	0.8	4.1	6.1	7.5	9.4	9.4	6.9
Global	2.5	2.6	3.2	1.6	2.2	2.9↓	3.3	3.3	3.5	2.3	2.6	2.6	2.6
Developed markets	1.3	1.7	2.4	0.7	1.2	2.2	2.5	2.5	2.7 ↑	1.2	1.8	1.8	1.8
Emerging markets	4.6	4.1	4.8	3.1	4.0	4.2	4.7↑	4.6	5.0	4.3	4.1	4.1↑	4.1↓
Global — PPP weighted	3.0	3.0	3.7	1.8	2.9	3.3	3.6	3.7	3.9	2.8	2.9	2.9	2.9

Note: For some emerging economies seasonally adjusted GDP data are estimated by J.P. Morgan. Bold denotes changes from last edition of *Global Data Watch*, with arrows showing the direction of changes. Underline indicates beginning of J.P. Morgan forecasts. Unless noted, concurrent nominal GDP weights calculated with current FX rates are used in computing our global and regional aggregates. Regional CPI aggregates exclude Argentina, Ecuador and Venezuela.

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G-3 economic outlook detail

				2014				2015			
	2013	2014	2015	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q
United States											
Real GDP	2.2	2.1	3.0	-2.1	4.2	3.0	3.0	3.0	3.0	2.5	2.5
Private consumption	2.4	2.3	2.8	1.2	2.5	2.1	2.7	3.3	3.3	2.8	2.5
Equipment investment	4.6	6.5	6.6	-1.0	10.7	9.0	7.0	6.0	6.0	5.0	5.0
Non-residential construction	-0.5	8.2	7.3	2.9	9.5	8.0	8.0	8.0	6.0	6.0	6.0
Intellectual property products	3.4	3.6	3.4	4.7	4.5	4.0	4.0	3.0	3.0	3.0	3.0
Residential construction	11.9	3.0	13.1	-5.3	7.2	11.5	15.0	15.0	13.0	13.0	10.0
Inventory change ($ bn saar)	63.6	61.3	57.7	35.2	83.9	62.7	63.4	60.5	60.4	55.5	54.5
Government spending	-2.0	-0.7	-0.1	-0.8	1.4	-0.1	-0.3	-0.2	-0.1	0.0	0.0
Exports of goods and services	3.0	3.3	5.6	-9.2	10.1	6.5	5.5	5.0	5.0	5.0	5.0
Imports of goods and services	1.1	3.7	5.3	2.2	11.0	0.0	5.0	6.0	6.0	6.0	5.0
Domestic final sales contribution	1.9	2.2	3.0	0.7	3.2	2.6	3.0	3.3	3.2	2.9	2.6
Inventories contribution	0.0	0.0	0.0	-1.1	1.4	-0.6	0.0	-0.1	0.0	-0.1	0.0
Net trade contribution	0.3	-0.1	0.0	-1.7	-0.4	0.9	0.0	-0.2	-0.2	-0.2	-0.1
Consumer prices (%oya)	1.5	1.9	1.9	1.4	2.1	1.9	2.1	2.1	1.8	1.9	1.9
Excluding food and energy (%oya)	1.8	1.8	1.9	1.6	1.9	1.9	1.9	2.0	1.8	1.9	1.9
Federal budget balance (% of GDP, FY)	-4.1	-2.9	-2.6								
Personal saving rate (%)	4.9	5.2	5.3	4.9	5.3	5.3	5.4	5.3	5.3	5.2	5.2
Unemployment rate (%)	7.3	6.2	5.6	6.7	6.2	6.1	5.9	5.7	5.6	5.5	5.4
Industrial production, manufacturing	2.6	3.4	3.4	1.4	6.6	4.5	3.0	3.0	3.0	3.0	2.5
Euro area											
Real GDP	-0.4	0.8	1.8	0.9	0.1	1.0	1.5	2.0	2.3	2.3	2.3
Private consumption	-0.6	0.7	1.4	0.7	1.2	0.5	1.0	1.5	1.8	1.8	1.8
Capital investment	-2.8	1.2	2.7	0.9	-1.3	1.0	2.0	3.0	4.0	4.0	4.0
Government consumption	0.2	0.8	1.1	2.8	0.6	0.5	1.0	1.0	1.5	1.5	1.5
Exports of goods and services	1.5	2.6	3.6	0.3	1.8	3.0	3.0	4.0	4.0	4.0	4.0
Imports of goods and services	0.4	2.8	3.3	3.1	1.0	2.0	2.5	4.0	4.0	4.0	4.0
Domestic final sales contribution	-0.8	0.8	1.5	1.1	0.5	0.6	1.1	1.6	2.0	2.0	2.0
Inventories contribution	0.0	0.0	0.0	0.9	-0.8	-0.1	0.0	0.2	0.0	0.0	0.0
Net trade contribution	0.5	0.1	0.3	-1.1	0.4	0.6	0.4	0.2	0.2	0.2	0.2
Consumer prices (HICP, %oya)	1.3	0.6	0.9	0.6	0.6	0.4	0.7	0.7	1.0	1.0	1.1
ex unprocessed food and energy	1.3	0.9	1.0	1.0	0.9	0.9	1.0	0.9	1.0	0.9	1.0
General govt. budget balance (% of GDP, FY)	-3.0	-2.5	-2.3								
Unemployment rate (%)	11.9	11.6	11.2	11.7	11.6	11.5	11.4	11.3	11.2	11.1	11.0
Industrial production	-0.7	1.1	2.6	0.6	0.1	1.0	2.0	3.0	3.5	3.5	3.5
Japan											
Real GDP	1.5	0.9	1.4	6.1	-6.8	2.0	2.5	2.0	2.2	3.5	-3.5
Private consumption	2.0	-0.6	1.1	8.4	-18.7	3.0	4.5	2.0	3.0	6.0	-8.0
Business investment	-1.4	8.2	3.3	34.6	-9.7	3.5	4.0	4.5	4.5	5.5	2.5
Residential construction	8.8	-4.7	-4.6	8.2	-35.3	-20.0	-10.0	5.0	5.0	10.0	-5.0
Public investment	11.5	4.4	-3.7	-9.8	-2.0	10.0	5.0	-10.0	-10.0	-10.0	2.5
Government consumption	2.0	0.7	1.2	-0.4	1.5	1.0	1.0	1.5	1.0	1.0	1.0
Exports of goods and services	1.5	7.8	4.9	28.6	-1.8	5.0	5.0	5.5	5.5	5.5	5.5
Imports of goods and services	3.3	7.5	3.8	28.0	-20.5	7.0	5.5	5.5	6.5	10.0	-6.0
Domestic final sales contribution	2.0	0.9	1.1	8.7	-14.5	2.3	3.3	1.7	2.2	4.2	-4.3
Inventories contribution	-0.3	-0.1	0.1	-3.0	4.5	-0.1	-0.8	0.2	0.0	-0.2	-1.1
Net trade contribution	-0.2	0.2	0.2	0.3	3.2	-0.2	0.0	0.1	0.0	-0.6	1.9
Consumer prices (%oya)	0.4	2.9	2.0	1.5	3.6	3.4	3.1	3.0	1.3	1.2	2.5
General govt. net lending (% of GDP, CY)	-8.9	-8.1	-6.8								
Unemployment rate (%)	4.0	3.7	3.6	3.6	3.6	3.7	3.7	3.6	3.6	3.5	3.5
Industrial production	-0.6	2.5	1.8	12.5	-14.3	-4.0	5.0	4.5	4.5	5.5	-4.5
Memo: Global industrial production	1.9	2.9	2.9	2.1	2.1	3.3	4.3	4.0	4.4	4.4	3.4
%oya				3.2	2.8	2.8	2.8	3.4	4.0	4.3	4.1

Note: More forecast details for the G-3 and other countries can be found on J.P. Morgan's Morgan Markets client web site

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Global Central Bank Watch

	Official rate	Current rate (%pa)	Change since (bp) 05-07 avg	Trough[1]	Jul 11	Last change	Next mtg	Forecast next change	Forecast (%pa) Sep 14	Dec 14	Mar 15	Jun 15	Sep 15
Global		2.31	-201	52	-37				2.30	2.30	2.31	2.32	2.42
excluding US		3.08	-117	65	-40				3.05	3.05	3.06	3.08	3.08
Developed		0.26	-323	0	-58				0.27	0.28	0.29	0.32	0.49
Emerging		6.03	-98	114	-23				6.13	6.14	6.13	6.11	6.07
Latin America		7.41	-334	161	-161				7.40	7.40	7.44	7.42	7.42
EMEA EM		6.09	-15	212	176				6.58	6.52	6.42	6.32	6.09
EM Asia		5.58	-21	110	-39				5.59	5.63	5.64	5.64	5.65
The Americas		1.59	-349	50	-41				1.52	1.52	1.52	1.54	1.80
United States	Fed funds	0.125	-438	0	0	16 Dec 08 (-87.5bp)	16 Sep 14	3Q 15 (+25bp)	0.125	0.125	0.125	0.125	0.500
Canada	O/N rate	1.00	-273	75	0	8 Sep 10 (+25bp)	22 Oct 14	2Q 15 (+25bp)	1.00	1.00	1.00	1.25	1.25
Brazil	SELIC O/N	11.00	-425	375	-150	2 Apr 14 (+25bp)	29 Oct 14	On hold	11.00	11.00	11.00	11.00	11.00
Mexico	Repo rate	3.00	-487	0	-150	6 Jun 14 (-50bp)	31 Oct 14	4Q 15 (+25bp)	3.00	3.00	3.00	3.00	3.00
Chile	Disc rate	3.50	-119	300	-175	14 Aug 14 (-25bp)	11 Sep 14	11 Sep 14 (-25bp)	3.25	3.00	3.00	2.75	2.75
Colombia	Repo rate	4.50	-281	150	0	29 Aug 14 (+25bp)	26 Sep 14	4Q 14 (+25bp)	4.50	4.75	5.00	5.00	5.00
Peru	Reference	3.75	-31	250	-50	10 Jul 14 (-25bp)	11 Sep 14	1Q 15 (+25bp)	3.75	3.75	4.00	4.00	4.00
Europe/Africa		1.51	-223	18	-45				1.47	1.46	1.47	1.48	1.47
Euro area	Refi rate	0.05	-293	0	-145	4 Sep 14 (-10bp)	2 Oct 14	3Q 18 (+20bp)	0.05	0.05	0.05	0.05	0.05
United Kingdom	Bank rate	0.50	-444	0	0	5 Mar 09 (-50bp)	9 Oct 14	1Q 15 (+25bp)	0.50	0.50	0.75	1.00	1.25
Norway	Dep rate	1.50	-169	25	-75	14 Mar 12 (-25bp)	18 Sep 14	On hold	1.50	1.50	1.50	1.50	1.50
Sweden	Repo rate	0.25	-231	0	-175	3 Jul 14 (-50bp)	28 Oct 14	On hold	0.25	0.25	0.25	0.25	0.25
Czech Republic	2-wk repo	0.05	-235	0	-70	1 Nov 12 (-20bp)	25 Sep 14	On hold	0.05	0.05	0.05	0.05	0.05
Hungary	2-wk dep	2.10	-503	0	-390	22 Jul 14 (-20bp)	23 Sep 14	4Q 15 (+20bp)	2.10	2.10	2.10	2.10	2.10
Israel	Base rate	0.25	-400	0	-300	25 Aug 14 (-25bp)	22 Sep 14	2Q 15 (+25bp)	0.25	0.25	0.25	0.75	1.00
Poland	7-day interv	2.50	-202	0	-200	3 Jul 13 (-25bp)	8 Oct 14	4Q 14 (-50bp)	2.50	2.00	2.00	2.00	2.00
Romania	Base rate	3.25	-494	0	-300	4 Aug 14 (-25bp)	30 Sep 14	30 Sep 14 (-25bp)	3.00	2.75	2.75	2.75	2.75
Russia	Key pol rate	8.00	N/A	N/A	N/A	25 Jul 14 (+50bp)	12 Sep 14	1Q 15 (-25bp)	8.00	8.00	7.75	7.50	7.00
South Africa	Repo rate	5.75	-254	75	25	17 Jul 14 (+25bp)	18 Sep 14	29 Jan 14 (+25bp)	5.75	5.75	6.00	6.25	6.50
Turkey	1-wk repo	8.25	-741	324	200	17 Jul 14 (-50bp)	25 Sep 14	On hold	8.25	8.25	8.25	8.25	8.25
Asia/Pacific		3.80	13	90	-33				3.81	3.83	3.84	3.84	3.87
Australia	Cash rate	2.50	-344	0	-225	6 Aug 13 (-25bp)	7 Oct 14	3Q 15 (+25bp)	2.50	2.50	2.50	2.50	2.75
New Zealand	Cash rate	3.50	-388	100	100	24 Jul 14 (+25bp)	11 Sep 14	11 Dec 14 (+25bp)	3.50	3.75	4.00	4.25	4.25
Japan	O/N call rate[3]	0.05	-17	0	0	5 Oct 10 (-5bp)	7 Oct 14	On hold	0.05	0.05	0.05	0.05	0.05
Hong Kong	Disc. wndw	0.50	-548	0	0	17 Dec 08 (-100bp)		3Q 15 (+25bp)	0.50	0.50	0.50	0.50	0.75
China	1-yr working	6.00	-14	69	-56	7 Jul 12 (-31bp)	-	On hold	6.00	6.00	6.00	6.00	6.00
Korea	Base rate	2.25	-190	25	-100	14 Aug 14 (-25bp)	12 Sep 14	On hold	2.25	2.25	2.25	2.25	2.25
Indonesia	BI rate	7.50	-237	175	75	12 Nov 13 (+25bp)	11 Sep 14	On hold	7.50	7.50	7.50	7.50	7.50
India	Repo rate	8.00	113	325	0	28 Jan 14 (+25bp)	30 Sep 14	4Q 14 (+25bp)	8.00	8.25	8.25	8.25	8.25
Malaysia	O/N rate	3.25	1	125	25	10 Jul 14 (+25bp)	18 Sep 14	18 Sep 14 (+25bp)	3.50	3.50	3.50	3.50	3.50
Philippines	Rev repo	3.75	-331	25	-75	31 Jul 14 (+25bp)	11 Sep 14	11 Sep 14 (+25bp)	4.00	4.00	4.00	4.00	4.00
Thailand	1-day repo	2.00	-183	75	-125	12 Mar 14 (-25bp)	17 Sep 14	1Q 15 (+25bp)	2.00	2.00	2.25	2.50	2.50
Taiwan	Official disc.	1.875	-71	62.5	0	30 Jun 11 (+12.5bp)	30 Sep 14	1Q 15 (+12.5bp)	1.875	1.875	2.00	2.00	2.00

1 Refers to trough end-quarter rate from 2009-present ² Effective rate can be adjusted on daily basis 3 BoJ targets ¥60-70tn/year expansion in monetary base
Bold denotes move since last GDW and forecast changes. Underline denotes policy meeting during upcoming week. Aggregates are GDP-weighted averages.

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Nowcast global growth: 3Q14 Bottom-up and top-down realign

- The bottom-up projection for 3Q global GDP growth now stands at 2.9% annualized this week, a 0.1%-pt downward revision (though actually much smaller owing to tiny rounding only). The decline in our GDP forecast owes to modest markdowns in the Australian and Chilean outlooks.
- In contrast to the nudge lower in the bottom-up forecasts, our nowcaster for current quarter global GDP growth is bumped up to 2.9% annualized from 2.8% last week. The upward revision is driven largely by our estimate of July global IP, which now includes an estimated 1.1% increase in Euro area production. At this time, the nowcaster, which relies on our monthly global aggregate indicators, aligns perfectly with the bottom-up view provided by our country economists. This is the first time since late last year that the two views have aligned.
- This week we received the global manufacturing and services PMI for August. In all, August showed some easing in the all-industry PMI (a weighted average of the two), though the manufacturing PMI remained unchanged with services taking a hit. Much of the easing in services came from the Euro area and US indexes. By contrast, solid gains were seen the services PMIs for the UK and China.
- With the manufacturing PMI unchanged in August, we are inclined to fade the weak IP outcomes seen in May and June. This inclination is reinforced by this week's much stronger than expected German IP release and the further revision of our Euro area estimate from an assumed 0.5% monthly gain last week to a much stronger 1.1% gain this week. Despite the projected lift in global IP for July, the model still predicts a more modest 0.1% gain in August before stabilizing at an average gain of 0.3% in September. In the event, IP would post a soft 2.6% annualized gain for 3Q14. We are looking for a stronger 3.5% gain and so need to see August and September outturns that surprise the nowcaster to the upside. (See "Global Manufacturing is bouncing back" research note in this *GDW*.)
- Next week, we will have an official aggregate reading for July global IP with data releases for the Euro area, the UK, Turkey, South Africa, and India. On top of this, we expect to update our July global retail sales reading after Japan posts CAO private consumption index results. The nowcaster is currently looking for a solid 0.3% monthly gain.

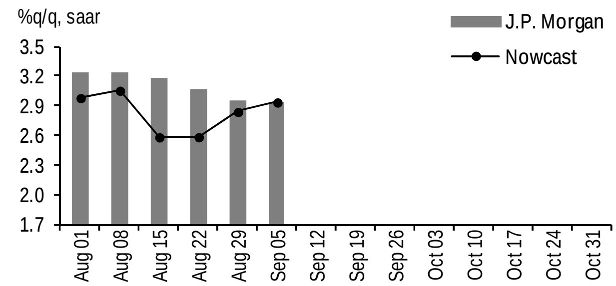
Global real GDP

%q/q, saar (Current forecast shaded)

	2Q14	3Q14		
		Current	Last week	4 weeks ago
J.P. Morgan	2.2	2.9	3.0	3.2
Global Nowcaster	3.1	2.9	2.8	3.1
Global PMI model	2.9	3.1	3.1	3.1

Source: J.P. Morgan

Nowcasting global real GDP by forecast date, 3Q14



Source:J.P.Morgan

J.P. Morgan global aggregates

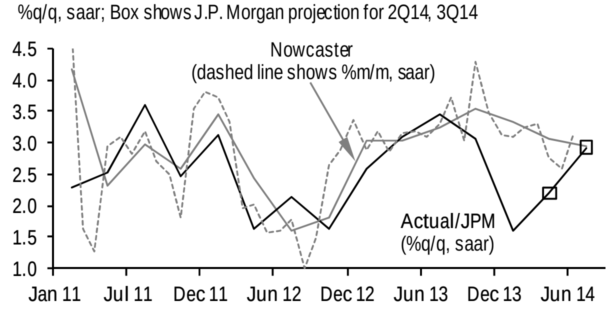
Quarters are %3m/3m,saar (PMIs avg level); Months are %m/m (PMIs level)

	2Q14	3Q14	Jun 14	Jul 14	Aug 14	Sep 14
PMI, mfg	53.5	53.8	54.0	53.8	53.8	53.7
PMI, serv	54.3	55.7	55.8	56.0	55.5	55.4
IP	1.6	2.6	-0.3	0.8	0.1	0.3
Retail sales	1.6	3.3	0.2	0.3	0.3	0.3
Auto sales	0.6	-2.3	-0.9	-0.7	0.5	0.2
Cap. orders	28.6	0.0	6.6	-2.5	1.8	-0.2
Nowcast	3.1	2.9	2.6	3.1	3.1	3.0

Note. Shaded values show forecasts computed by the Kalman filter estimates from the dynamic factor model. Underlined values are our estimates based on available data and our judgment. Source: J.P. Morgan, Markit, and national statistical agencies.

Global real GDP

%q/q, saar; Box shows J.P. Morgan projection for 2Q14, 3Q14



Source:J.P.Morgan

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1. Research notes listed have been published in *GDW; Special Reports and Global Issues* are stand-alone features, but may also have appeared in some form in *GDW*.

The J.P. Morgan View: Markets

What will happen when the Fed hikes?

- **Asset allocation —** After 7 years of easy money, Fed rates could be a shock, even if expected. We present ideas on what could happen then.
- **Economics —** Stronger US activity data, even with weaker payrolls, move Q3 growth from down- to upside risk around our 3% forecast.
- **Fixed income —** ECB cut rates and announced larger than expected purchases of private sector assets. Stay long Spain vs. Germany.
- **Equities —** Stay UW Europe vs. EM and Japan. Open longs in Euro area banks vs. Eurostoxx50 and vs. UK banks. In EM, OW Brazil and India.
- **Credit —**European HG to further = outperform HY.
- **FX —** A more aggressive ECB keeps us short EUR/USD.
- **Commodities —** We double up our long in energy.

Global equities are up again this week, while bond yields are all higher, despite ECB easing and a weaker US jobs report, as earlier data were positive for US GDP. Credit is slightly tighter. EM outperformed DM, except in currencies as the dollar is stronger again across the board.

Our economic forecasts are largely unchanged. Better US data early in the week moved our Q3 tracking from slightly below to slightly above our 3% growth forecast. The US Payroll headline number today was on the weaker side, but the rest of the report in line with forecasts. The ECB cut rates as our economists had forecast, but then did more via a new buying program for ABS and covered bonds, while still staying shy of full blown sovereign QE. The euro obliged by coming down nicely. It is this analyst's suspicion that the ECB is taking a leaf out of the BoJ book, whose effort to exit deflation had the most impact via a 25% drop in its currency vs. the dollar.

Our monthly ***GMOS*** strategy cut our long-standing equity overweight from 15% to 10%, on the maturing of the rally and the reduced impact of zero-interest rates and low vol on risk premia. We added to oil as it is near the bottom of its 3-year range and seems a good hedge against geopolitical tail risks.

Stronger US data and a new Fed staff paper that says most of the fall in labor force participation since 2007 is structural are again focusing attention on the **coming Fed rate normalization** process and how it will affect markets. The temptation is simply to take guidance from the average of past hiking cycles, but these came in different growth and inflation conditions and after much shorter periods of easy money. Just as a starting point, when the Fed started hiking over the past 10 such cycles, on average US bond yields rose, the belly underperformed, equity and credit kept rallying and the dollar fell (charts next page and N. Panigirtzoglou, *Flows & Liquidity*, June 22, 2013).

This time could be different, though, as we are starting from zero rates, after seven years of easy money and with the weakest recovery since WWII. Much will depend on why the Fed is hiking (growth/inflation) and by how much. The market currently prices in a start in Q2 next year, with the funds rate reaching 75bp by end 2015 and 1.7% end 2016. We, most economists, and the Fed, are decently higher, with our economists calling for 1% by end 2015, 2.5% by end 2016 and 3.5% by end 2017. We see the confirmation of 3%+ growth as the driver of rate normalization, rather than an inflation overshoot. Growth as the driver supports risk assets, but hiking by more than forwards is a negative. The gap is more for 2016 than next year and damage to markets should thus be a gradual phenomenon.

Why are the rate markets so sanguine versus what most economists tell them? We see three reasons, none of which give much comfort. One is risk management or the mode vs. mean issue. Consensus views on US growth have consistently been too optimistic these past few years, leading the market likely to price in a probability-weighted mean scenario for growth and the Fed that is lower than modal forecasts. A second is the carry cost of being short duration on a view on the Fed two years from now. Most investors have shorter horizons. A third is time inconsistency: the Fed has been pooh-poohing its own dots as convincing us that they are right would put them in the price and the economy today already. Each of these timing issues should pass with time and are the basis of our medium-term bearish view on US bonds.

As the first rate hike comes within sight, early 2015, the belly of the US **curve** should move up bearishly and underperform the wings and other bond markets. With neither the ECB nor BoJ in our mind tightening then, the damage to the long end should be limited, and the **dollar** should move up versus other DM FX. **EM** markets will likely be nervous and will probably weaken, as that is what most investors expect and are set to position for, but the more medium-term response of EM asset classes will depend on EM growth. We have still not seen upside on EM growth this year, and thus reserve judgment until next year. **Equities** will likely be nervous and volatile, but with strong growth should still end up higher in 2015. The **credit** outlook appears much more uncertain as this market has grown faster than others and was arguably the main beneficiary of seven years of easy money. At issue is whether outflows from retail funds would quickly find demand from yield-hungry pension funds and insurers in a world where banks can no longer use large balance sheets to absorb these flows. It is uncertainty about such tail risks that has us preferring liquid stocks over less liquid credit when the Fed starts hiking.

Fixed Income

This week, the ECB cut refi and deposit rates by 10bp to +0.05% and -0.20%, respectively. **Draghi made a surprise announcement that he would start a new covered bond purchase program in addition to ABS purchases**, and that both would commence in October (although details of both will only be made available after the next ECB meeting on Oct 2). Furthermore, Draghi hinted that the overall aim of the TLTROs and the asset purchase schemes was to increase the size of the ECB's balance sheet towards its 2012 level. **Taken at face value, this would imply a potential increase of €1tn**, or 50% of its current level. Our European colleagues estimate that the TLTROs and asset purchase programs together could add a net €450bn to the ECB's balance sheet. The bolder than expected announcement means we revise lower our expectations for the spreads of Spanish and Italian vs. German government bonds, to 95bp and 115bp, respectively, by end-2014, and **stay long carry within the Euro area via long 10Y Spain vs. Germany**.

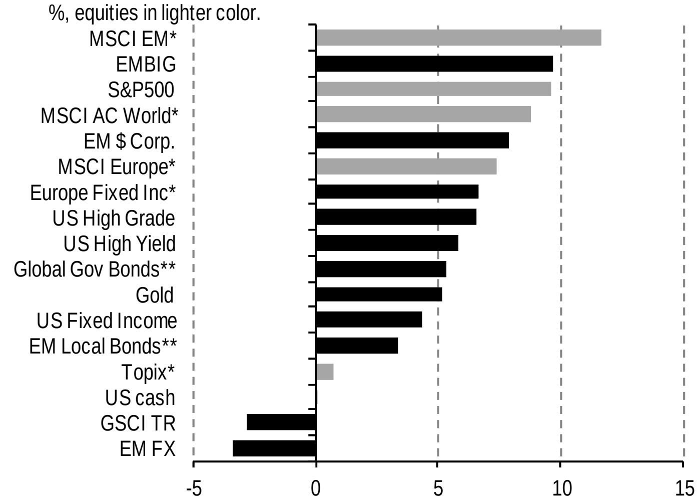
The weaker than expected US payrolls offset some of the more upbeat US data releases. Our colleagues in US rates research revise lower their yield forecasts for coming quarters on the impact of lower global policy rates and persistently short investor positioning (see *USFIMS*, Sep 5).

Equities

Equities were flat this week, with the Euro area and Japan performing best, followed by EM. European equities were buoyed by President Draghi's announcements on additional stimulus measures. **We are unwilling to chase the recent European equity rally**, given weak earnings and disappointing economic growth, expensive valuations as well as downside risks from Europe's proximity to the crisis in Russia/Ukraine. **We stay UW Europe.**

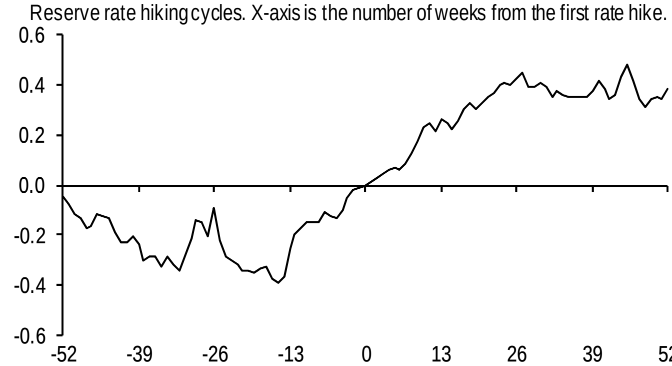
Regionally, **we continue to prefer EM and Japanese equities**. In Japan, the potential for GPIF reform, a corporate tax rate cut, a decision on the 2nd consumption tax hike and additional BoJ easing underlie our constructive view. EM equities outperformance against DM equities stalled over the past month, but has fared better this week. We hold our OW in EM for now but only vs. Europe awaiting more clarity on underlying fundamentals.

YTD returns through: 4-Sep
%, equities in lighter color.



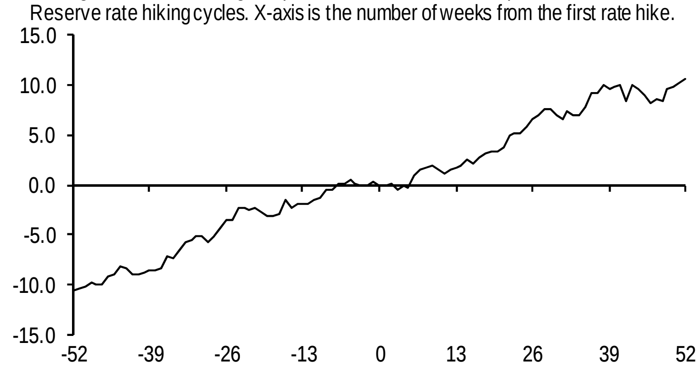
Source: J.P. Morgan, Bloomberg

US 10yr yield around Fed hiking cycles
Average cumulative change in yield around the start of the past 10 Federal Reserve rate hiking cycles. X-axis is the number of weeks from the first rate hike.



Source: J.P. Morgan

S&P500 around Fed hiking cycles
Average cumulative change in price around the start of the past 10 Federal Reserve rate hiking cycles. X-axis is the number of weeks from the first rate hike.



Source: J.P. Morgan

Within EM we close our EM Asia OW and **focus instead on Brazil and India.** Indian equities are supported by strong inflows and improving economic growth (*Indian equities*, B. Kumar, Sept 1). In Brazil, positive momentum into the elections should continue following the emergence of a new candidate, Marina Silva, who is a frontrunner in the opinion polls and is expected to implement a number of market friendly reforms.

The upcoming bank stress tests and Scottish referendum are creating a divergent outlook for Euro area and UK banks**.** The upcoming AQR is likely to provide increased clarity for the sector and is expected to show that most of the capital raising is behind us (*European Banks*, K. Abouhossein et. al, Sept 1). We expect the UK stress test to go further than the EBA tests, with the UK regulator looking to evaluate the resiliency of the UK banking system to a rise in interest rates and a UK housing downturn (*UK banks*, R. Sinha et. al, Sept 2). The rising risk of a “Yes” vote in the Scottish referendum creates further downside for UK banks vs. their Euro area counterparts. **Open a long in Euro area banks vs. Eurostoxx50 and vs. UK banks.**

Credit

We have been steadily reducing our longstanding credit OW with the aim to be flat well before the first Fed hike. However, after the sell-off late last month, we halted this steady reduction, as we considered the selloff was technical. Since then, spreads have tightened, particularly in HY. We maintain our 2% OW as we think spreads should continue to recover as fundamentals are still far from worrisome and the demand for yield remains intact, with the first Fed rate hike still almost a year away.

The ECB action is on the surface bullish for spread products, but given uncertainty about the size and implementation, we do not think it meaningfully changes credit fundamentals. Perhaps the most important impact is the weaker euro. **HG companies tend to have less domestic exposure than HY companies and so should benefit more and we think the recent outperformance of investment grade credits vs. high yield should continue** (*European Credit Weekly*, Bailey et al., Sep 5).

Foreign exchange

There was no stopping the dollar from heading higher early this week. The rally stalled only on Friday after weaker US payrolls. The broad strength pushed the trade-weighted dollar to its highest in 14 months intra-week, driven by strong US data and the ECB**. Our core strategy thus far has been to run aggregate dollar, specifically vs. several European currencies** (EUR, SEK, GBP) and JPY, which has been only partially offset by USD shorts vs. selective EM FX (CNY and KRW in particular). Looking ahead, given the weak payrolls report we see room for some downside on the dollar and recommend tactically taking profits on most USD longs. In particular, we recommend unwinding USD longs vs. SEK and JPY (the cable one-touch was triggered intra-week).

This leaves us short EUR/USD and this week’s much anticipated ECB meeting did not disappoint. The ECB delivered not only a 10bp rate cut, but also confirmed that ABS purchases will take place and added purchases of covered bonds also. While no color was provided on the size of this private QE, adding covered bonds to the program significantly increases the potential purchase amount and opens the door for a substantial increase in the ECB’s balance sheet, thus lending significant downside risk to the euro. As a result, **we keep our short in EUR/USD,** despite a tepid US payrolls report.

We have been running selective shorts in GBP to position for some loss in data momentum and the upcoming Scottish referendum. With the polls narrowing in favor of a ‘Yes’ vote this week, **we stay bearish sterling**. We have been short GBP vs. EUR and USD. The cable one-touch 1.63 put was triggered intra-week leaving us with long EUR/GBP. We also open a new short vs. AUD. Finally in EM, we stay long KRW and CNY vs. USD and add short EUR/BRL, given the supportive risk backdrop, continued downside EUR pressures and factors idiosyncratic to Brazil.

Commodities

In Wednesday’s *GMOS*, we doubled our long in energy and raised our commodity OW from 1% to 3%. Brent has been in a $100-120/bbl range for three years. This range has been remarkably stable as prices were kept above $100/bbl by OPEC, who needs prices that high to fulfill social spending commitments. Structurally higher supply from the US has kept prices from moving much above $110/bbl, except during supply shocks, like the onset of civil war in Libya in 2011. Our approach has been to short Brent whenever prices neared $120/bbl and to buy whenever they neared $100/bbl.

We see no reason to think that this has changed. OPEC still needs oil prices to average above $100/bbl and is currently producing at a higher rate than usual to offset lost Iranian (sanctions) and Libyan (civil war) supplies. This means that they can reduce production if necessary to keep prices from falling too far, without adversely affecting their spending commitments. Additionally, geo-political risk remains elevated. Our EM Europe strategists now assign a 30% probability to the flow of energy to Europe from Russia being impeded. Libya appears to be returning to fully fledged civil war and ISIS is still highly active in Iraq and Syria. As such **we still think Brent at its current $101/bbl level is a buying opportunity and we double up our position**. We trade the overall energy index rather than just Brent as the roll yield looks more attractive.

Forecasts & Strategy

Interest rates		Current	Sep-14	Dec-14	Mar-15	Jun-15
United States	Fed funds rate	0.125	0.125	0.125	0.125	0.125
	10-year yields	2.44	2.45	2.70	2.85	3.00
Euro area	Refi rate	0.15	0.10	0.10	0.10	0.10
	10-year yields	0.93	0.95	1.20	1.25	1.35
United Kingdom	Repo rate	0.50	0.50	0.50	0.75	1.00
	10-year yields	2.46	2.45	2.75	3.00	3.20
Japan	Overnight call rate	0.05	0.05	0.05	0.05	0.05
	10-year yields	0.54	0.55	0.55	0.65	0.70
Emerging markets	GBI-EM - Yield	6.50		6.77		
Credit Markets						
US high grade (bp over UST)		132		110		
Euro high grade (bp over Euro gov)		84		75		
USD high yield (bp vs. UST)		435		375		
Euro high yield (bp over Euro gov)		372		315		
EMBIG (bp vs. UST)		301		275		
EM Corporates (bp vs. UST)		316		300		
Foreign Exchange						
EUR/USD		1.29	1.30	1.30	1.28	1.26
USD/JPY		105	102	106	107	107
GBP/USD		1.63	1.67	1.67	1.65	1.64
AUD/USD		0.94	0.92	0.91	0.90	0.91
USD/BRL		2.24	2.30	2.35	2.45	2.50
USD/CNY		6.17	6.2	6.15	6.15	6.15
USD/KRW		1022	1000	1000	995	985
USD/TRY		2.16	2.20	2.20	2.15	2.15

Commodities	Current	14Q3	14Q4	15Q1	15Q2
Brent ($/bbl)	101	115	112	105	110
Gold ($/oz)	1265	1300	1300	1300	1275
Copper ($/metric ton)	6950	7100	7050	7000	6800

YTD Equity Sector Performance*	US	Europe		Japan		EM$	
Energy	9.2%	8.5%	UW	7.1%	UW	10.7%	UW
Materials	10.3%	6.1%	OW	-1.3%	UW	1.4%	UW
Industrials	4.2%	1.0%	OW	5.1%	OW	8.0%	OW
Discretionary	4.0%	1.5%	OW	-3.9%	OW	11.6%	N
Staples	6.9%	7.5%	UW	8.4%	OW	6.9%	UW
Healthcare	16.0%	15.9%	N	9.5%	UW	22.4%	N
Financials	8.1%	6.1%	OW	-13.3%	OW	14.6%	N
Information Tech.	14.2%	4.2%	OW	6.9%	UW	15.7%	OW
Telecommunications	6.8%	2.3%	UW	-2.8%	OW	14.8%	UW
Utilities	15.6%	19.6%	UW	-4.3%	UW	17.5%	N
Overall	9.8%	7.4%		0.7%		12.3%	

*Levels/returns as of Sep 4, 2014
Source: J.P. Morgan

Investment themes and impacts

It's still a weak growth world.
H2 should grow above 3%, but we still find that 2014 projections have been downgraded so far this year by 0.4% to just below trend at 2.6%, and follows steady, annual downgrades since 2010. We would need upgrades to start trading growth.

Fed hikes remain a year away, and uncertain.
In the meanwhile, we stay long risk and in yield seeking mode. In FI, OW Brazil, Spain, Australia, New Zealand, HY credit, EM external debt. In FX, be long EM selectively.

It's a much lower return world now. The 5-year rally in equities, bonds and credit has lowered IRRs and thus future long-term returns. This means we can no longer be just long risk and must become more selective and active in making choices across countries and asset types. Cut equity OW from 15% to 10%.

Macro risk remains subdued but local risks are higher, creating opportunities.
The 5-year point of the expansion, low growth and still easy money are keeping macro economic and market risks subdued. But there are much greater local economic and political risks that should drive relative performance.

Selective longs in risk and yield assets.
These themes keep us long yield and risk, but highly selectively so, based on value, ownership, cyclicality, liquidity, and local risks.
H2 should grow above 3%, but we still find that 2014 projections have been downgraded so far this year by 0.4% to just below trend at 2.6%, and follows steady, annual downgrades since 2010. We would need upgrades to start trading growth.

Source: J.P. Morgan, *GMOS*, Aug 6, 2014.

Tactical overview

	Direction	Country	Sector
Asset allocation	Bullish risk	EM	OW Equities, HY, energy
Equities	Long, but reduce	Brazil, India, Japan	Tech; J-REITs;
Bonds	Flat Duration in DM; long in EM	EU vs. US; Spain vs. GE; Long, AU, NZ, Brazil.	Higher-yielding, FX hedged
Credit	Small OW	EM, UK vs. US	HY, FINs
FX	Long EM; bullish USD vs. G10	EM Asia: THB, CNY, KRW, NGN	Short JPY, SEK, EUR, GBP
Comd's	Long		Energy; short base metals

Source: J.P. Morgan

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Economic Research Note

Global manufacturing is bouncing back

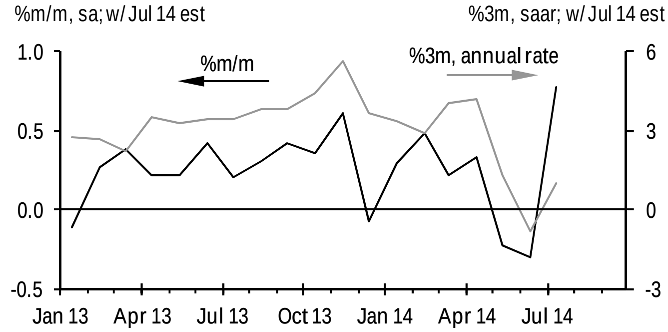
- **Temporary factors drove midyear IP slump**
- **Europe and Japan now recovering, reinforcing foundation laid in US and EM Asia**
- **Global IP likely jumped 0.8%m/m in July with global PMI pointing to further solid gains just ahead**

Manufacturing activity unexpectedly contracted into midyear, bringing to a halt an extended period of robust gains. Such declines are rare, raising the possibility that the global economy is veering off course from our forecast, which calls for a return to above-trend global economic expansion this quarter. We have argued that the midyear slump in manufacturing was caused mostly by a series of temporary factors. In general, incoming information supports this call. Although we have modestly trimmed our 3Q growth forecast, we still expect global manufacturing output growth to bounce back to a 3.5% annual rate this quarter.

Global factory output unexpectedly contracted in May and June, reducing the 3-month annualized pace to -0.8%, the first such decline since late 2012. The May/June swoon was fairly broad-based, affecting Europe and Japan and much of Latin America. However, a good portion of this appeared to reflect temporary factors. Output plunged in Japan following the VAT hike, reversing gains recorded in the first quarter. Euro area output also skidded, seemingly due to a combination of unusual weather and the holiday configuration. Perhaps related, output gains also weakened sharply in the UK and across much of central and eastern Europe. The weakness extended to parts of Latin America as well, notably Brazil, where the World Cup exacerbated the downturn in production.

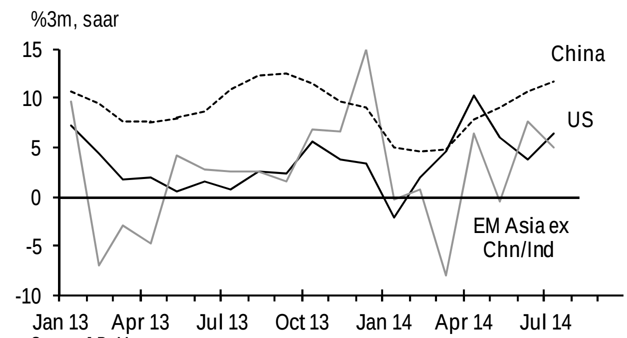
The midyear slump did not extend to the US and EM Asia. Since these two regions normally lead the global business cycle, their resilience is an encouraging sign that the weakness observed elsewhere will prove transitory. US output has accelerated smartly including a 1.0%m/m increase in July. To be sure, the July gain was flattered by a spike in auto production, which appears to have reversed in August. The underlying gains in output, ex. motor vehicles, are 0.3% to 0.4% per month. China's output advanced at a near-1% pace in recent months including July, with a 0.8%m/m increase expected in next week's August report. In the rest of EM Asia, gains topped 1%m/m on average in June and July.

Global manufacturing output



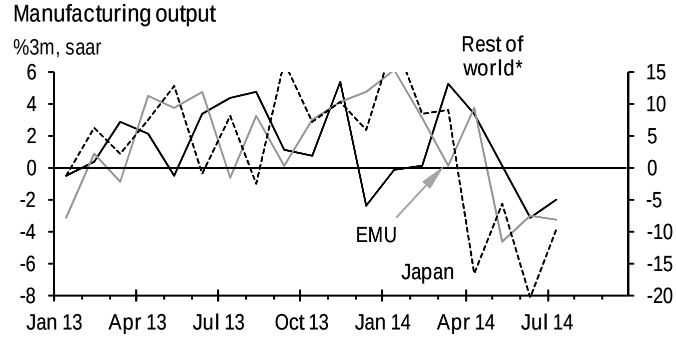
Source: J.P. Morgan

Manufacturing output



Source: J.P. Morgan

Manufacturing output



* Note: Rest of world is global ex US, EMU, Japan, EM Asia
Source: Eurostat, METI, and J.P. Morgan

Identifying leaders of global manufacturing business cycle

Global mfg output regressed on regional mfg output, %3m/3m saar (2000m1 to 2014m6)

	Coefficient	t-statistic
Constant	-1.82	-2.1
US, t-3	0.54	5.9
Euro area, t-3	-0.20	-1.8
Japan, t-3	0.02	0.4
China, t-3	0.16	2.4
EM Asia ex. India & China, t-3	0.46	3.3
EM Europe, t-3	-0.33	-2.7
Latin America, t-3	0.05	0.6
Adjusted R-square	0.56	

Source: J.P. Morgan

If we are correct that the weakness in Europe, Japan, and Latin America mostly reflected temporary factors, then IP growth should rebound quickly in these regions. The available July data offer strong support. Following a nearly 6% contraction from April through June, Japanese output returned to growth in July, although the 0.3%m/m gain fell far short of expectations. However, Japanese manufacturers reported robust production plans for August and September and though we are inclined to temper them, their contour leaves us cautiously optimistic. German output soared 2.6%m/m in July, setting the stage for an estimated 1.1%m/m bounce in the Euro area as a whole. Brazilian output jumped 0.8%m/m in July following the end of the World Cup. These gains reinforce the solid foundation already laid in the US and EM Asia.

All told, we estimate that global IP jumped 0.8%m/m in July. This is before any real recovery in Japan, which appears set to kick in beginning in August, which would offset an expected, one-off drop in the US as auto production settles down.

The continued resilience of the global manufacturing PMI through August also is encouraging. We have learned to trust that the global PMI will smooth the underlying pace of manufacturing growth, which is inherently noisy. The global PMI remained remarkably stable through the middle of the year, sending a consistent signal that underlying IP gains were tracking a pace of 4% or better. This week's August report maintained the pattern. The output PMI was unchanged last month at 53.8, a level historically associated with 4.5% IP growth on a 3m, saar basis. The orders/inventory ratio has slipped a little in the past few months, suggesting the output PMI might lose some altitude. We don't think this is cause for concern, though, since the PMI is pointing to robust IP gains well above the 3% to 3.5% pace implied by our GDP forecast.

At the regional level, regression analysis confirms that the main sources of the recent dichotomy between the global PMI and global IP growth were Japan and the Euro area. In Japan, output fell 9.7% ar in the three months through July, whereas the output PMI, which rebounded to 52.9 in August, is positioned for nearly 7% IP growth. In the Euro area, output declined an estimated 3.3%3m ar through July, which also is far off the mark. In the emerging economies, IP growth is running about 3%-pts below what is implied by the PMI. By contrast, US IP accelerated to a pace that is very close to what is implied by the US PMI.

Manufacturing output PMI and actual IP

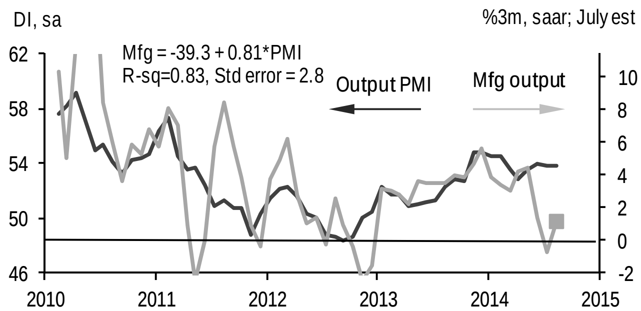
PMI is DI, sa; IP is %3m, saar

		IP growth		
	Output PMI	Implied by PMI	June	July*
Global	53.8	4.6	-0.8	1.0
DM	55.1	4.2	-2.7	0.1
US	60.7	7.5	3.7	6.5
Euro area	51.0	0.8	-3.1	-3.3
Japan	52.9	6.9	-20.5	-9.7
EM	51.6	5.8	2.9	2.5
EM ex China	51.5	2.2	0.7	0.2
China	51.8	11.3	10.7	11.6

* US, Japan, and China are actuals, all others estimates.

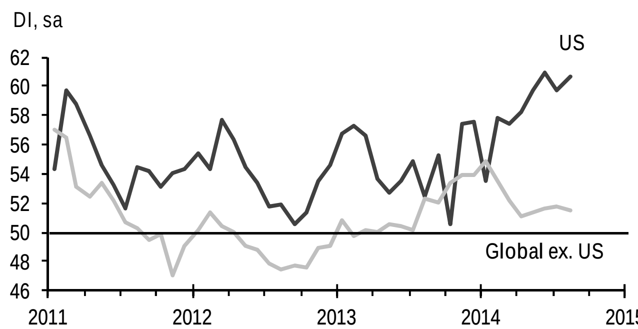
Source: Markit and J.P. Morgan

Global manufacturing output PMI and actual output



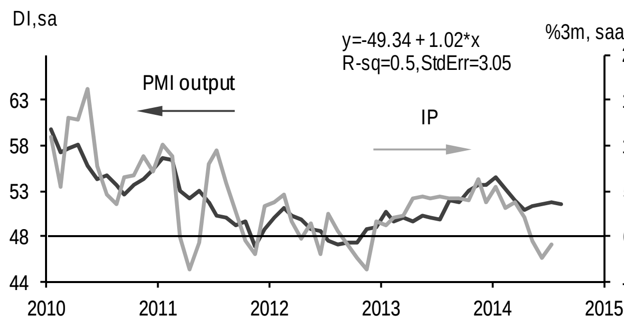
Source: J.P. Morgan, Markit

Global manufacturing output PMI



Source: J.P. Morgan, Markit

Global ex. US output PMI and IP



Source: J.P. Morgan

Economic Research Note

US: The consequences of economic calcification

- **The US economy has fewer start-ups and less labor market churn than in the past**
- **Start-ups are a known engine of productivity growth; less entrepreneurial activity should slow productivity**
- **Churning creates frictional unemployment; less churning means a lower natural rate of unemployment**
- **Less churning also means less hiring, which contributes to more labor market discouragement**

The churning that has long characterized the US economy, the frenetic creative destruction of firms rising and falling, has become less frenetic recently. New business creation has trended lower, as has the normally-massive amount of labor market reallocation. This topic has been a theme of our research (first noted here), and it was the focus of one of the key papers presented at this year's Jackson Hole conference ("Labor Market Fluidity and Economic Performance," Steven J. Davis and John Haltiwanger). This reduction in economic dynamism has taken place over the course of the last few decades, yet it has implications for economic developments at a business-cycle frequency. In particular, we identify three major ways it can affect how we think about developments over the next two to four years:

- Reduced productivity growth
- A lower natural rate of unemployment (also called NAIRU).
- A lower participation rate and employment-to-population ratio

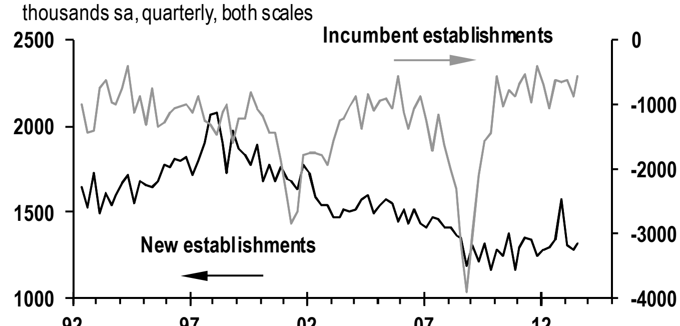
Less churning in the economy can have beneficial consequences, but the reality is that the negative effects likely outweigh the positive effects. The symptoms of reduced churn look similar to Euro-sclerosis.

Ameri-calcification

The reduced dynamism of the US economy can be seen most clearly in the quarterly Business Employment Dynamics (BED) report. There are two aspects of this survey that are relevant in this regard. First, it reports gross job flows, rather than the net increase or decrease reported in the monthly jobs report. Second, it distinguishes between job creation at newly-opening establishments vs. mature, incumbent firms.

Net job gains at opening and incumbent establishments

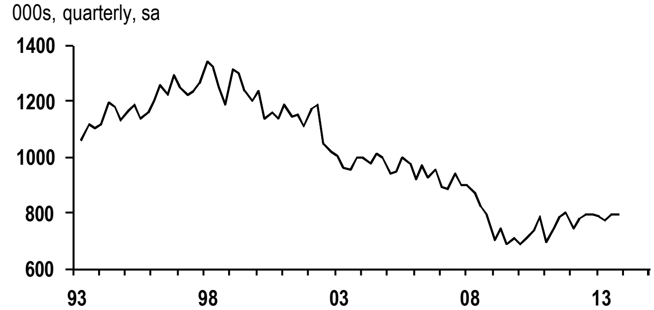
thousands sa, quarterly, both scales



Source: BLS

Private sector job gains at newly-opened firms (births)

000s, quarterly, sa



Source: BLS. Break-adjusted for 2013Q1 redefinition.

Interestingly, in almost every quarter, the net growth in jobs is driven by opening establishments; mature establishments tend to shed jobs. While that is still the case in the most recent data, the trend has clearly shifted. In 13Q4 (the most recent data point) opening establishments added 1.319 million jobs. In the last cycle this figure averaged closer to 1.5 million jobs per quarter, and in the 1990s the figure averaged 1.75 million per quarter.

Employment "births" have been even weaker (births are a subset of openings not including re-openings of seasonal businesses). Employment births in 13Q4 were 795,000; as a percent of all employment, job births held at 0.7% in 13Q4, where it has been for much of the past five years. In contrast, this figure stood between 1.1% and 1.3% during the 1990s. The good news, from the perspective of job growth, is that incumbent establishments have been doing better in this cycle than in the previous two cycles, which explains why job growth hasn't been as dismal as the employment birth numbers would suggest.

Closely related to the decline in entrepreneurship has been the reduction in job reallocation. Underlying the net change in employment growth are much larger gross job gains and losses. In the context of the BED one can sum gross job gains and losses, as a percent of employment, to appreciate the reduction in this reallocation. Throughout the 1990s, the quarterly reallocation rate averaged between 15 and 16% of employment. In recent years that has moved down to around 12%. The Job Openings and Labor Turnover Survey (JOLTS) has a shorter history, beginning only in late 2000, has a monthly instead of quarterly frequency, and uses somewhat different concepts. Yet, there too one can see less churning in the economy, as worker reallocation (the sum of the hiring and separations rate) has also trended lower.

Implications

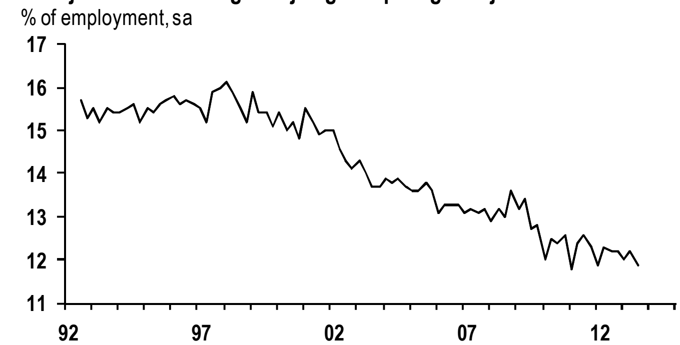
The reduction in economic and labor market dynamism has been ongoing for two decades, yet its impact could be felt at a business cycle frequency along a few dimensions:

- **Reduced productivity growth**. As we discussed in the note linked here, business churn is good for productivity growth. Aggregate productivity growth isn't simply a phenomenon of incumbent firms becoming more productive, but rather also involves leaner, more productive start-up firms gaining market share from slower, less productive incumbents. This isn't the just the usual small business rah-rah: the authors of the Jackson Hole paper cited earlier have established in a number of studies the importance of business churning for aggregate productivity growth.

- **A lower natural rate of unemployment**. In an earlier note, linked here, we discussed how reduced reallocation should mean reduced "frictional unemployment." Even when the economy is operating at its non-inflationary capacity, there will still be a positive unemployment rate. This rate, often called the natural rate of unemployment, partly arises because even in a well-performing economy some will be unemployed while they are briefly transitioning between employment spells. This frictional unemployment should be lower in an economy with less churning.

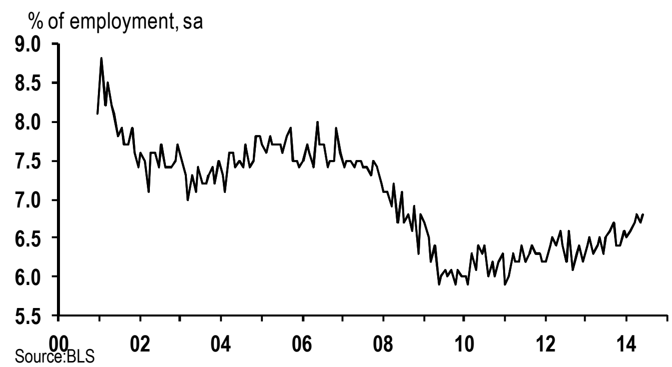
- **Lower labor force participation rates**. Reduced churn may mean less frictional unemployment, but the darker side is that it may discourage workers who are unable to quickly find employment. Labor market churning allows unemployed workers to easily become re-hired, gaining experience and confidence to remain in the workplace. As that churn has diminished, the unemployed are less likely to gain employment and more likely to see their skills atrophy and their re-employment prospects dwindle. In the Davis and Haltiwanger paper, the authors utilize state-level variations to discern an appreciable negative impact on employment-to-population ratios due to the decline in job reallocation.

BED job reallocation: gross job gains plus gross job losses



Source:BLS

JOLTS worker reallocation: hiring plus separation



Source:BLS

There are other economic implications of reduced churn. For example, it may be contributing to the "downward nominal wage rigidity" that was highlighted in Yellen's Jackson Hole address. (A fuller discussion may take this note too far afield, but a note discussing this topic can be found at this link).

What can be done?

Since declining reallocation and reduced entrepreneurship is, on net, a bad thing, it is natural to ask how policy can reverse this trend. To do so, one would first like to understand what is causing the reduction in churn and business start-ups, but it turns out the answer is not so obvious. An aging population is surely part of the reason, but statistically it seems it cannot account for the entire phenomenon. Similarly, the growth of big-box retailers may be hampering start-ups in the retail sector, but the decline in entrepreneurship is affecting most industries, not just retail. Davis and Haltiwanger speculate that the increase in occupational licensing requirements may be reducing labor market dynamism, a cause which is readily addressable by policy interventions. Similarly, growth in exceptions to the employment-at-will principle is a cause of calcification that can easily be reversed by changing policy. It is not certain that policy can reverse the decline in American economic dynamism, but given the stakes, we think it's worth trying.

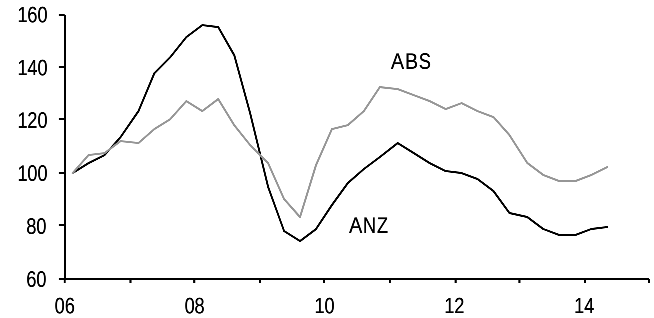
Economic Research Note

Not enough lift in Australia's leading labor indicators

- **RBA officials seem content with the outlook for employment despite the recent spike in the jobless rate,**
- **The bulk of forward indicators support the RBA view, having firmed over the past six months**
- **NAB employment index and ANZ job ads the most reliable leading indicators**
- **Meaningful declines in the unemployment rate remain some way off although indicators are firming,**

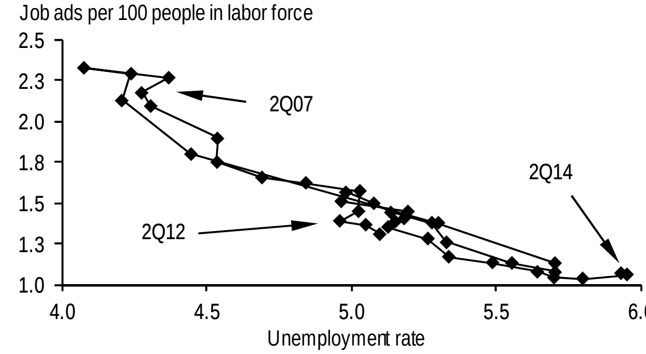
Australia's unemployment rate surprisingly increased from 6% to 6.4% in July, the highest level in 12 years. Despite this spike, the RBA has not materially altered its public assessment of the labor market. Indeed, statement accompanying this week's on-hold policy decision continued to highlight the upbeat signals from the leading indicators of the labor market and the RBA's corporate liaison program. Here, we provide an overview of these leading indicators and assess what they mean for employment growth. Simple regressions show that the ANZ job advertisement and NAB employment series are the most reliable leading indicators of employment growth in Australia.

Job vacancies
Index, 100 = 1Q06



Source: ABS, ANZ.

Beveridge curve
Job ads per 100 people in labor force



Source: ANZ, ABS, J.P. Morgan

Job vacancies looking less sick

Job vacancies provide insight into the demand for labor and the level of firms' recruitment activity. The good news is the vacancies data have started to look a little better in the past two quarters, with the number of job openings edging modestly higher following persistent declines since 2011. Australia's two best-known job vacancy releases, the ANZ job ads series (which collates the number of new postings in print and on online job boards) and the ABS vacancies series (vacancy numbers derived from business survey responses), illustrate this trend: both appear to have bottomed late last year and gradually moved higher in 2014 (first chart).

The bad news, however, is that, despite the turn in the data, both series remain consistent with a soft labor market. Indeed, the number of unfilled job openings remains unimpressive, particularly the in ANZ series, which shows vacancies tracking only marginally above 2009 lows. This is important for the unemployment rate, with the current level of vacancies unlikely to erode any of the slack that has accumulated over the past 18 months. Indeed, Australia's vacancy rate—the number of vacancies scaled by the size of the labor force—continued to drift lower in 2Q14, implying that although vacancies are climbing in an absolute sense, the run rate is still lagging growth in the labor force, which is underpinned by solid population growth. Put another way, growth in the supply of labor continues to outpace that of demand, a dynamic that will prevent any meaningful decline in the unemployment rate.

The rise in job vacancies also seems at odds with the recent rise in Australia's unemployment rate to 6.4%, the highest level since August 2002. These dynamics are often associated with a structural increase in unemployment, highlighted by an outward shift in the Beveridge curve (which maps job vacancies against the unemployment rate) as the economy becomes less efficient in matching job seekers with job opportunities. Fortunately, we are yet to see any evidence of this mismatch in the data, with recent observations appearing to move along the established Beveridge curve. This argues against assuming a change in NAIRU and pegs the high unemployment rate as mainly cyclical.

Businesses feeling better, too

NAB business confidence has firmed in recent months, also reflected in an improved outlook in the survey's employment index. This index, which measures the net balance of respondents who expect an improvement in employment conditions, has increased from a cycle low of -9 to 0 in the past few quarters. Although an encouraging development, an index level of zero remains far from robust and suggests businesses will continue to exercise caution in their hiring. The silver lining, however, is that even at the current level, the NAB survey is broadly consistent with an unemployment rate only slightly above 6%, suggesting we may be close to a peak in the jobless rate. Australia's manufacturing and services PMI employment sub-indexes have also started to edge higher in recent months, though both remain firmly entrenched in their respective longer-term ranges.

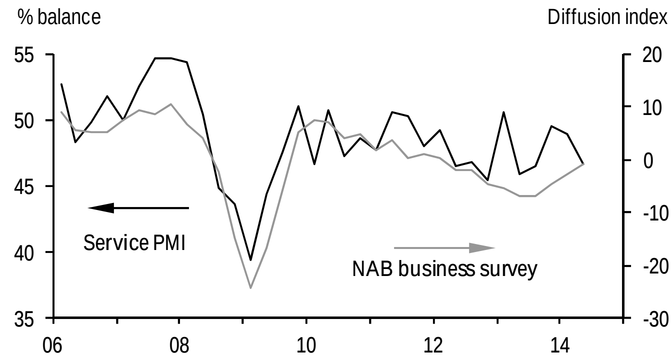
What does this mean for employment?

Our primary interest in these forward indicators is what they tell us about the state of the labor market, whether they lead employment growth, and which measures are most reliable. To address these questions, we follow a methodology previously used by the RBA, whereby lagged values of these indicators are entered into a baseline ordinary least squares (OLS) regression, in which quarterly employment growth is modeled as a function of employment growth in the preceding two quarters. This captures the extent to which changes in employment will be predicted by these indicators.

Based on our sample period from 2007-2014, we find all of the leading indicators improve the ability to forecast quarterly employment growth. With regard to the survey data, the NAB employment index improves the explanatory power of this model, lifting the model's R-squared from 0.12 in our baseline to 0.43 (table). The services PMI provides less value from a forecasting perspective, however, explaining only a quarter of the variance in employment growth in the next quarter. The business surveys are most significant in period t-1, with the impulse to employment growth fading over longer time horizons.

The job vacancies data provide mixed results, with the ANZ job advertisement series the clear standout. Indeed, including this variable in the regression significantly improves estimates relative to the baseline. In contrast, the ABS vacancies series is less useful in forecasting employment growth, only marginally lifting the model's R-squared relative to the baseline. Altering the regression to include observations from the current period (t) reveals the lead time for both job vacancies series to be shorter than that provided by the business surveys, with the coefficient largest and most significant in period t. The longer lead time for the business surveys intuitively makes sense, with sentiment likely to change before managers alter their recruitment activities. The statistical significance of all leading indicators deteriorated substantially once lagged by more than one quarter, highlighting the short-run relationship between these measures and employment growth.

Business survey employment index



Source: AIG, NAB

Employment growth model coefficients

	Baseline	ABS	ANZ	NAB	Services PMI	DEEWR
One-quarter lag	0.21	0.87	0.75	4.98	4.99	0.37
Two-quarter lag	0.59	0.59	-0.25	-2.30	2.04	-0.01
R-squared	0.12	0.15	0.41	0.43	0.27	0.37

1. Baseline estimates quarterly employment growth as a function of employment growth in the previous two quarters.
2. The ABS and ANZ job ads series are measured as the quarterly change in vacancies. The NAB and AiG survey data are modeled in level terms.
Source: J.P. Morgan

Sub-trend growth a high hurdle

Although Australia's leading indicators of employment portend improving employment prospects, the economy faces some stiff headwinds in coming quarters. Real GDP expanded only 0.5%q/q in 2Q, and we forecast growth to remain below potential into 2015 amid a lackluster transition away from mining-related activity. Gross national expenditure (GDP less net trade) has been even less inspiring, with annual growth tracking only marginally above recession levels, highlighting the dominance of net trade in Australia's growth mix. The underperformance is more pronounced per capita, which corroborates our sense that the leading indicators of employment growth are not improving enough, scaled for population growth.

RBA officials have declared that the level of interest rates is not the problem, suggesting firms are unlikely to get additional support in the form of a falling cash rate. Indeed, RBA officials have instead pointed toward heightened risk aversion as a major brake on employment growth. The RBA staff have therefore suggested that the unemployment rate is "not expected to decline in a sustained way until 2016." We also expect lackluster employment growth to persist, but not for quite as long, with a decline in the jobless rate likely in 2H15.

United States

- **Employment growth slowed to 142,000 in August, the slowest pace of the year**
- **The downshift in job growth contrasted with other economic data this week, which were generally solid**
- **August retail sales, the highlight of next week's calendar, expected to bounce back from July weakness**

A modest disappointment in August job growth concluded what had otherwise been a week of fairly strong economic data. The monthly pace of nonfarm employment growth slowed to 142,000 in August, down from the 236,000 average pace seen over the prior three months, and the slowest rate of job creation since last December. More favorably, the unemployment rate did reverse the July increase, easing from 6.2% to 6.1%. At this stage it's hard to tell whether the step-down in job growth is a fluke, or a more-lasting moderation in the trend from what had been a rather strong run earlier in the year. Even so, there will be little additional labor market information between now and the next Fed meeting on September 16-17. The moderating rate of job creation should remove any urgency for Fed policymakers to signal a faster path to rate hikes.

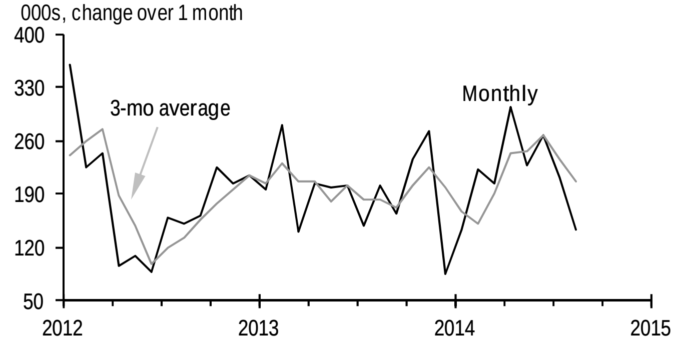
Tempering the disappointment was the message from a number of other economic releases this week, which were generally on the strong side. Unit sales of cars and light trucks soared to 17. 5 mn units saar, the first reading above 17 million in this expansion. Construction spending increased 1.8% samr in July and there were notable upward revisions to figures for prior months. The narrowing in the foreign trade balance in July, and revision to June, are modest positives for growth. And both the PMI and ISM manufacturing surveys soared to their highest readings of the year. With these reports in hand, the tracking estimate of real GDP growth in 2Q14 is up to 4.5% (from 4.3%) and risks to the 3.0% forecast for 3Q14 have shifted modestly to the high side.

The key upcoming release is Friday's retail sales report for August. Our forecast looks for a solid jump in retail sales after a relatively soft July report.

Employment

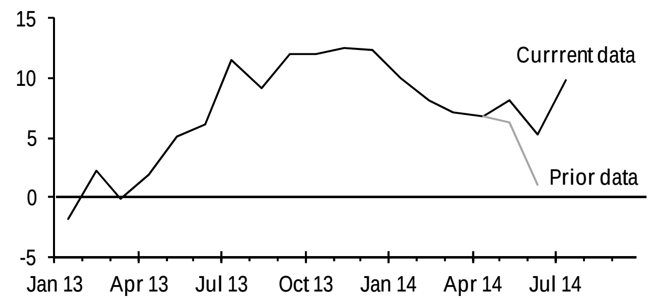
Through the first seven months of the year, job growth had averaged 226,000 per month. At some point that pace of employment expansion was bound to come back down to earth. The 142,000 figure for August may represent such a normalization, or it may simply be a statistical fluke (it is hard to over-emphasize the volatility and noisiness of first prints of employment data). At any rate, other details of the jobs report

Nonfarm employment
000s, change over 1 month



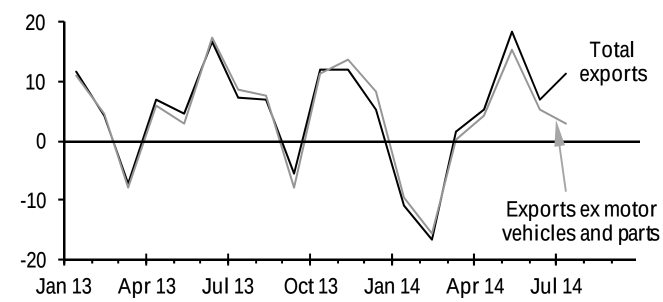
Source:BLS

Nominal construction spending
%ch saar over 6 months, ex home renovations



Source: Census

Merchandise export volumes, total and nonauto
%ch saar over 3 months



Source: Census

were consistent with recent trends. For example, average hourly earnings increased 0.2%, leaving year-ago wage growth stuck at 2.1%. The much-hoped-for acceleration in earnings has yet to manifest itself, though some hints of action brewing might be detected in the production and non-supervisory worker series. Wages in this segment of the workforce, accounting for about 83% of employees, has accelerated modestly to a 2.5%oya pace.

The recent FOMC statement highlighted "substantial underutilization" in labor markets. Indicators of such underutilization were mixed in the August report. A one-tick decline in the participation rate to 62.8%, and another increase in the number of discouraged workers, seemingly point to greater slack. At the same time, long-term unemployment declined from 2.0% to 1.9%, and there was a move down in the number of people working part-time who want full-time employment—both of which would indicate less slack. The conflicting signals will likely prevent the Fed from making major changes in how they are assessing labor market conditions.

Fade in construction has vanished

A late-August Research Note had noted that the sharp slowdown in reported construction spending through mid-year was sharply at odds with other correlates of construction activity and that the 1H14 figures on construction activity might eventually be revised up to look stronger. As it turns out, the stronger view of construction spending came much sooner than expected. Construction spending increased 1.8% samr in July and there was a net 1.4% upward revision to activity over the two prior months Whereas the prior figures had shown increases in total construction activity (ex home renovations) of only 1.0% saar in the six months through June, current data show a growth rate of 5.3% in the six months through June and growth up to 9.7% in the six months through July. Current data indicate that activity stalled through the harsh winter but has rebounded since.

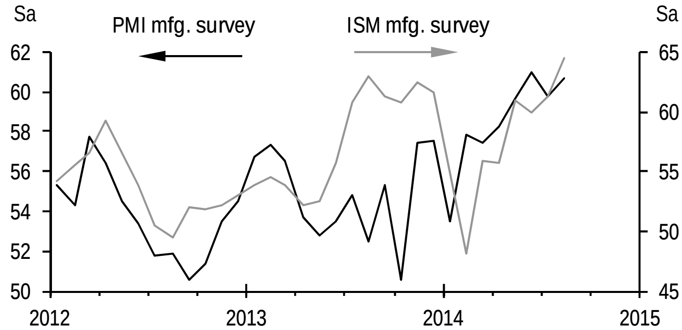
New residential construction has been sluggish lately, although the recent upturn in permits suggests growth may accelerate soon. But there have been large gains over the last three months in both private nonresidential activity (up 20.2% saar) and public construction (up 12.8%).

Auto surge masks a slowdown in exports

July trade volumes indicate that net exports are making a major contribution to growth early in the current quarter. July merchandise export volumes are running 11.3% saar above their 2Q14 average and import volumes are 4.4% below their 2Q14 average. This pattern of surging exports relative to imports looks odd against the backdrop of US demand growth outpacing that of most key trading partners.

And, it turns out, that there are a couple of one-time factors boosting net exports in July. Most important, the 1-month surge in auto output boosted export volumes for autos and parts which were 15.0% (not annualized) above their 2Q14 average, while corresponding import volumes were only 0.9% higher. Auto output is expected to reverse their July gains in August, and export volumes will likely come back down to earth as well. A similar pattern holds for trade in petroleum and products. July oil exports levels spiked relative to the 2Q14 average, (up 9.4%, not annualized) and oil imports plunged (down 4.1%).

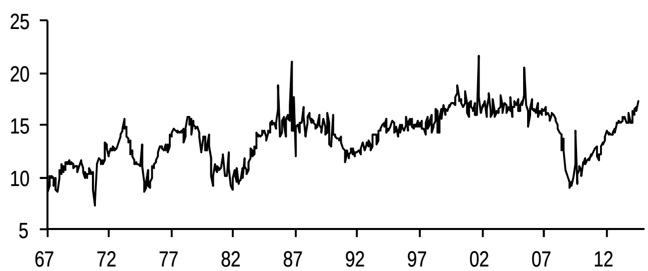
Survey measures of manufacturing output or production



Source: Markit, ISM, and J.P. Morgan

Light vehicle sales in historical perspective

Mn, saar



Source: BEA, J.P. Morgan

July export volumes for all goods except oil and autos (85% of all exports) are running a little below their 2Q14 average, as are import volumes ex oil and autos. As trade levels for autos and oil normalize over the next few months, the gap between overall export growth and import growth should narrow considerably.

Mfg. surveys stay happy in August

Manufacturing activity in August will likely be held down by a reversal of the surge in auto production in July. But both of the major national manufacturing surveys indicate that the trend in manufacturing remained very strong through mid-summer. The PMI index was the highest since April 2010 and the ISM index was the highest since February 2011. August measures of output and of new orders for both the PMI (60.7 and 60.5) and ISM (66.7 and 64.5) were above their averages for 2Q14, a quarter when manufacturing output increased 6.6% saar. These surveys have had an uneven record in tracking IP through this expansion, but the sky-high readings for both are a positive sign for manufacturing.

The August nonmanufacturing surveys were also strong, with the PMI services index (59.5) below the recent July peak but 1.5 points above the 2Q14 average. The ISM non-manufacturing survey at 59.6 was at its highest level since August 2005.

Data releases and forecasts

Tue
Sep 9
7:30am

NFIB Small-Business Optimism survey

Index, 1986=100, sa

	May	Jun	Jul	Aug
Optimism Index	96.6	95.0	95.7	
Capex plans	24.0	22.0	23.0	
Hiring plans	10.0	12.0	13.0	
Planned price increases	21.0	21.0	22.0	

The NFIB survey's headline increased 0.7pt to 95.7 in the July report, but remained below its peak for the expansion of 96.6 that was reported for May. Commentary from the NFIB regarding the August survey was mixed regarding the labor market; the NFIB reported a modest increase in the share of firms reporting job openings between July (24%) and August (26%) but a modest decline in the share of firms reporting planned hiring (from net 13% to 10%). The separate compensation subcomponents of the NFIB survey are some of the few indicators that have signaled a pickup in wage inflation pressure lately.

Thu
Sep 11
8:30am

Jobless claims

Thousands, sa

	New claims (wr.)		Continuing claims		Insured
	Wkly	4-wk avg	Wkly	4-wk avg	Jobless,%
Jun 28	316	315	2586	2572	2.0
Jul 5	305	312	2508	2559	1.9
Jul 12[1]	303	309	2508	2544	1.9
Jul 19	279	301	2542	2536	1.9
Jul 26	303	298	2519	2519	1.9
Aug 2	290	294	2549	2530	1.9
Aug 9	312	296	2502	2528	1.9
Aug 16[1]	299	301	2528	2525	1.9
Aug 23	298	300	2464	2511	1.9
Aug 30	302	303			
Sep 6	300	300			

1. Payroll survey week

We believe initial jobless claims edged down 2,000 to 300,000 during the week ending September 6. This week contained the Labor Day holiday and claims can be especially volatile in the weeks around various holidays. But claims were little changed in last week's report and we do not see a clear bias to the data regarding changes during the holiday week, so we expect claims to remain around the recent trend reported in the data.

Fri
Sep 12
8:30am

Retail sales

%m/m, sa

	May	Jun	Jul	Aug
Total	0.4	0.2	0.0	0.8
Ex autos	0.4	0.4	0.1	0.2
Ex autos and gas	0.3	0.6	0.1	0.5
Building materials	1.2	1.0	0.2	0.3
Control group[1]	0.1	0.5	0.1	0.6
Ex. autos and building mat.	0.3	0.3	0.1	0.2

1. Total ex. gasoline, automotive dealers, building materials, and food serv.

We forecast that nominal retail sales increased 0.8% in August. A decline in gasoline prices should weigh on the nominal data on retail sales at gasoline stations; we forecast that this category of sales declined 1.6% in August. But apart from this category, we expect solid details throughout the report. Unit auto sales in August were at their highest level since early 2006, and this should translate into a solid increase in retail sales at motor vehicles and parts dealers, for which we forecast an increase of 3.0%. Sales of the control group—the total excluding autos, gasoline, building materials, and food services—also look due for a strong month after the soft 0.1% gain reported for July considering how upbeat many of the related indicators have been lately; we forecast that sales of the control group increased 0.6% in August. We also look for continued increases in the series on building material sales (0.3%) and food services sales (0.4%) in August.

Fri
Sep 12
8:30am

Import prices

%m/m, nsa, unless noted

	May	Jun	Jul	Aug
Import prices	0.3	0.1	-0.2	-0.8
%oya	0.5	1.1	0.8	-0.4
Ex fuel import prices	0.0	-0.1	0.0	0.0
%oya	-0.2	0.0	0.4	0.6

We forecast that the import price index fell 0.8% in August (-0.4%oya), with falling fuel prices and unchanged nonfuel prices. We expect prices in all the major subcomponents of the fuel category fell in August, with the largest decline in imported crude prices as oil commodity prices continued to ease over the month. Coupled with falling natural gas and fuel oil prices, we believe this resulted in a 4.0% decline in overall fuel prices for the month. Excluding fuels, we expect that import prices were flat (+0.6%oya). The trade-weighted dollar rose about 1.0% between early July and early August (when most import prices are collected), which likely put some downward pressure on nonfuel import prices. Imported food prices picked up in July, and we anticipate that they continued to firm, based in part on rising coffee prices, but decelerated to a 0.4% pace in August. We also expect rising metals prices based on analysis of relevant spot prices. In other categories, we anticipate capital goods prices inched up 0.1% over the month while consumer goods prices were unchanged.

Source: ADP/Moody's Analytics, BEA, BLS, Census Bureau, Conference Board, Federal Reserve Board, ISM, J.P. Morgan forecasts, NAHB, NAR, NFIB, NY Fed, Markit, Philadelphia Fed, Standard & Poor's, University of Michigan, US Treasury

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Fri
Sep 12
9:55am

Consumer sentiment

Michigan preliminary

	Jun	Jul	Aug	Sep
Univ. of Mich. Index (nsa)	82.5	81.8	82.5	83.5
Current conditions	96.6	97.4	99.8	
Expectations	73.5	71.8	71.3	
Inflation expectations				
Short term	3.1	3.3	3.2	
Long term	2.9	2.7	2.9	
Home buying conditions	155	153	155	

We forecast that the University of Michigan consumer sentiment index increased 1.0pt to 83.5 in the preliminary September report. The latest readings from the Rasmussen Consumer Index (daily) and the Bloomberg Consumer Comfort Index (weekly) have been more upbeat than the figures reported in the prior few weeks, suggesting some recent improvement in consumer sentiment that should also be evident in the University of Michigan data.

Fri
Sep 12
10:00am

Business inventories

%m/m, sa, unless noted

	Apr	May	Jun	Jul
Inventories	0.6	0.5	0.4	0.6
Manufacturing	0.5	0.8	0.2	0.1
Wholesale	1.0	0.3	0.3	0.4
Retail inventories	0.5	0.2	0.5	1.4
Ex autos	0.1	0.0	0.3	
Autos	1.2	0.5	0.9	
Inventory/sales ratio	1.29	1.29	1.29	

We estimate that nominal business inventories increased 0.6% in July. We already have data showing that manufacturing inventories ticked up 0.1%. We believe wholesale inventories (which will be reported on September 10) increased 0.4% based on some of the related pricing data, and we also look for retail inventories to jump 1.4%. For the retail data, we think auto inventories increased 3.4% during the month in which production surged based on related industry data, and we look for a 0.3% increase in nonauto retail inventories in July to match the gain reported for June.

Source: ADP/Moody's Analytics, BEA, BLS, Census Bureau, Conference Board, Federal Reserve Board, ISM, J.P. Morgan forecasts, NAHB, NAR, NFIB, NY Fed, Markit, Philadelphia Fed, Standard & Poor's, University of Michigan, US Treasury

Review of past week's data

Markit manufacturing PMI (Sep 2)

Index, sa

	Jul	Flash Aug	Final Aug	
Composite[1]	55.8	~~58.0~~	~~58.0~~	*57.9*
New orders (30%)	59.5	~~60.8~~		*60.5*
Output (25%)	59.7	~~60.2~~		*60.7*
Employment (20%)	51.2	54.6		
Sup. del. (15%, inv.)	48.8	~~44.4~~		*45.3*
Stks of purch (10%)	51.3	54.2		
New export orders	50.3	54.4		
Backlogs of work	54.5	56.2		
Output prices	54.0	53.9		
Input prices	56.7	~~56.7~~		*56.5*
Stocks of fin. goods	50.2	~~52.3~~		*51.7*
Quantity of purchases	57.4	~~59.8~~		*59.6*
ISM-weighted comp.[2]	54.6	~~57.1~~		*57.0*

1. Weights in parentheses
2. Attributes ISM-composite weights (equal weights) to corresponding PMI series

ISM manufacturing survey (Sep 2)

Sa

	Jun	Jul	Aug	
Overall index	55.3	57.1	~~57.0~~	*59.0*
Production	60.0	61.2		*64.5*
New orders	58.9	63.4		*66.7*
Inventories	53.0	48.5		*52.0*
Employment	52.8	58.2		*58.1*
Supplier deliveries	51.9	54.1		*53.9*
Export orders	54.5	53.0		*55.0*
Imports	57.0	52.0		*56.0*
Prices	58.0	59.5		*58.0*

The two national manufacturing surveys looked pretty strong in August. The ISM manufacturing survey's headline increased from 57.1 in July to 59.0, reaching its highest level since March 2011. And the Markit PMI manufacturing survey's headline increased from 55.8 in July to 57.9 in August, reaching its highest level since April 2010 but coming in slightly below the 58.0 reading shown in the flash report for August. The fairly significant inventory build in 2Q, some expected payback after a temporary boost to July auto production, and softening in activity in a number of foreign markets all suggest that US manufacturing activity will cool off at some point, but the latest survey data paint a pretty rosy picture for the manufacturing sector in the near term.

Details of both surveys were generally very favorable in August, but there were mixed changes across the different components during the month. Perhaps the most favorable news was that the ISM survey's new orders index improved to a 10-year high of 66.7 in August. Both surveys' export orders indexes also improved despite a number of signs of weakening demand from abroad.

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Construction spending (Sep 2)

%m/m, sa

	May		Jun		Jul	
Nominal	~~0.8~~	*1.3*	~~-1.8~~	*-0.9*	~~1.0~~	*1.8*
Private	~~0.4~~	*1.1*	~~-1.0~~	*-0.6*	~~0.7~~	*1.4*
Residential	-1.1		~~0.3~~	*-0.4*	~~0.9~~	*0.7*
Nonresidential	~~2.1~~	*3.4*	~~-1.6~~	*-0.8*	~~0.4~~	*2.1*
Public	~~1.6~~	*1.9*	~~-4.0~~	*-1.8*	~~1.8~~	*3.0*

The July construction spending report was stronger than expected with nominal spending put in place increasing 1.8% in July and upward revisions to the figures reported for June (from -1.8% to -0.9%) and May (from 0.8% to 1.3%). These latest figures make the 2Q data stronger than previously reported and set up a better-than-expected trajectory for the data early on in 3Q. As a result, we are raising our tracking estimate of 2Q real GDP growth by 0.2%-pt and no longer believe there is downside risk to our 3.0% forecast for 3Q.

Most of the main component of the construction report rebounded in July after declining in June but, since the data are notoriously volatile, it is hard to know what to make of this widespread down-up swing in the data. Looking beyond the monthly changes, the trends in private nonresidential spending and public construction spending have looked favorable lately, while the trend in private residential spending has been fairly flat. Nonresidential construction spending increased 20% saar over the three months through July and started the third quarter about 17% saar above the 2Q average. Similarly, public construction spending increased 13% saar over the latest three months and the July figure was 15% saar above the 2Q average (largely due to state and local governments). Meanwhile, private residential construction spending was basically unchanged over the past three months and started 3Q about in line with the 2Q average with weakness related to single-family units offsetting strength related to multifamily units.

Factory goods report (Sep 3)

%m/m, sa, unless noted

	May	Jun		Jul	
New orders	-0.6	~~1.1~~	*1.5*	~~11.1~~	*10.5*
Shipments	-0.1	~~0.5~~	*0.8*	~~1.8~~	*1.2*
Inventories	0.8	~~0.3~~	*0.2*	~~0.4~~	*0.1*
Inventory/sales ratio	1.31	1.30		*1.29*	

New orders for factory goods jumped 10.5% in July while related shipments increased 1.2% and inventories edged up 0.1%. The strength in orders was close to expectations and reflected the surge in civilian aircraft orders that had already been evident in the advance durable goods report. The new information in the report related to nondurable goods showed that orders and shipments declined 0.9% in July while inventories slipped 0.4% and there were also small revisions reported to the data related to durable goods. There were only minor implications from the report in terms of GDP growth and we are lowering our tracking estimate of 2Q real GDP growth by 0.1%-pt and keeping our forecast for 3Q GDP growth at 3.0%. It looks like the change in inventories will be revised down modestly in 2Q, which is a small positive for 3Q GDP growth. It also looks like there will be a negligible upward revision to the equipment spending data for the second quarter, but equipment spending might be a touch softer than previously expected in 3Q because of the downward revision to core capital goods orders in July (from -0.5% to -0.7%).

Motor vehicle sales (Sep 3)

Millions, saar

	Jun	Jul	Aug	
Light trucks and autos	16.8	16.4	~~16.6~~	*17.4*
Imports	3.7	3.5		*3.6*
Domestics	13.2	12.9		*13.9*
Autos	5.8	5.7		*6.1*
Light trucks	7.4	7.3		*7.8*

International trade (Sep 4)

$ billion, samr

	May		Jun		Jul	
Balance (BOP basis)	~~-44.7~~	*-43.5*	~~-41.5~~	*-40.8*	~~-41.2~~	*-40.5*
Services	~~18.7~~	*19.6*	~~18.7~~	*19.6*	~~18.8~~	*19.6*
Merchandise	~~-63.3~~	*-63.1*	~~-60.3~~	*-60.4*	~~-60.0~~	*-60.2*
Exports (%m/m)	~~1.1~~	*1.2*	~~0.1~~	*0.0*	~~0.3~~	*0.9*
Imports (%m/m)	-0.1		~~-1.2~~	*-1.1*	~~0.1~~	*0.7*

The nominal trade balance narrowed from -$40.8 billion in June to -$40.5 billion in July and the trade deficits reported for April, May, and June were all revised narrower. These latest figures are positive for both 2Q and 3Q GDP growth; we are raising our tracking estimate of 2Q real GDP growth 4.3% to 4.5% and now believe there is some modest upside risk to our forecast for 3.0% growth in 3Q.

Within some of the details, nominal exports increased 0.9% in July while real goods exports jumped 1.3% during the month. Much of this strength was related to motor vehicles exports, which surged 12% samr (real and nominal) during a month with very strong production. Overall export volumes have now increased in five straight months following the drop-off reported late in 2013 and early in 2014. The trend in imports has been a bit choppier lately, and nominal imports increased 0.7% in July after declining 1.1% in June while real goods imports increased 0.5% after dropping 1.7%. July export volumes were about 11% (annualized) above their 2Q average while July import volumes were about 4% (annualized) below their 2Q average, setting the stage for net exports to make a decent contribution to GDP growth in 3Q.

Source: ADP/Moody's Analytics, BEA, BLS, Census Bureau, Conference Board, Federal Reserve Board, ISM, J.P. Morgan forecasts, NAHB, NAR, NFIB, NY Fed, Markit, Philadelphia Fed, Standard & Poor's, University of Michigan, US Treasury

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Productivity and costs (Sep 4)

Nonfarm business sector, %q/q, saar, unless noted

	Rev 1Q14	Prel 2Q14	Rev 2Q14	
Productivity	*-4.5*	2.5	*2.3*	
%oya	*0.7*	1.2	*1.1*	
Output	*-2.4*	5.2	*5.0*	
%oya	*2.4*	3.2	*3.2*	
Hourly compensation	*6.6*	3.1	*2.3*	
%oya	*3.2*	3.1	*2.8*	
Unit labor costs	*11.6*	0.6	~~0.0~~	-0.1
%oya	*2.5*	1.9	*1.7*	
Hours	*2.1*	2.7	~~2.7~~	2.6
%oya	*1.7*	2.0	*2.0*	

Nonfarm productivity growth in 2Q was revised down from 2.5% to 2.3% saar, while growth in unit labor costs was revised down in both the second quarter (from 0.6% to -0.1% saar) and first quarter (from 11.8% to 11.6% saar). These revisions were very close to our forecast, which was based on data that had already been released in the 2Q GDP revision from August 28. The revisions make the trends in productivity and costs look somewhat more modest than what had previously been reported, with nonfarm productivity increasing 1.1%oya in 2Q and unit labor costs increasing 1.7%oya. This soft trend in unit labor costs is consistent with core inflation below 2%.

Markit services PMI

Index, sa

	Jul	Flash Aug	Final Aug	
Business activity	60.8	~~58.5~~	~~58.5~~	*59.5*
Incoming new business	57.3	~~58.2~~		*57.9*
Employment	52.8	~~53.2~~		*52.9*
Business expectations	68.2	~~73.9~~		*70.8*
Input prices	52.7	~~56.2~~		*54.8*
Prices charged	50.2	~~53.2~~		*53.1*
Backlogs of work	49.8	~~52.0~~		*52.2*

ISM non manufacturing survey (Sep 4)

Sa

	Jun	Jul	Aug	
Nonmfg. index (NMI)	56.0	58.7	~~57.0~~	*59.6*
Business activity	57.5	62.4		*65.0*
New orders	61.2	64.9		*63.8*
Employment	54.4	56.0		*57.1*
Prices	61.2	60.9		*57.7*

The two national service sector surveys continued to look very upbeat in August. The ISM nonmanufacturing survey's headline popped up 0.9pt to 59.6 in August, reaching its highest level since August 2005. The underlying details were also pretty favorable in August with strong readings reported for business activity (65.0), new orders (63.8), and employment (57.1) as well as a decent figure reported for supplier deliveries (52.5, nsa). Also of note, the survey's inventory sentiment index continued to plunge, falling another 3.0pts to 55.0 in August. A reading above 50 for this index technically indicates that inventories are viewed as too high by firms, but this index has never crossed below the 50 threshold and this latest figure is one of the lowest readings on record, suggesting that an inventory correction is not imminent.

Separately, the Markit services PMI's business activity index was revised up from 58.5 to 59.5 between the flash and final August reports. The August figure is weaker than the readings reported for June (61.0) and July (60.8), but it is still one of the highest reported in the series, which dates back to late 2009. The other details of the survey were more mixed, but most of the survey's components improved at least to some degree between July and August.

Source: ADP/Moody's Analytics, BEA, BLS, Census Bureau, Conference Board, Federal Reserve Board, ISM, J.P. Morgan forecasts, NAHB, NAR, NFIB, NY Fed, Markit, Philadelphia Fed, Standard & Poor's, University of Michigan, US Treasury

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Labor-market report (Sep 5)
Sa

	Jun		Jul		Aug	
Payroll employment (ch, m/m, 000s)	~~298~~	*267*	~~209~~	*212*	~~225~~	*142*
Private payrolls	~~270~~	*260*	~~198~~	*213*	~~220~~	*134*
Goods-producing	~~38~~	*34*	~~58~~	*67*	~~25~~	*22*
Construction	~~10~~	*8*	~~22~~	*31*	~~15~~	*20*
Manufacturing	~~23~~	*21*	28		~~5~~	*0*
Service-providing	~~260~~	*233*	~~151~~	*145*	~~200~~	*120*
Private service-providing	~~232~~	*226*	~~140~~	*146*	~~195~~	*112*
Wholesale trade	~~14~~	*13*	~~3~~	*6*		*6*
Retail trade	~~41~~	*35*	~~27~~	*21*		*-8*
Professional services	~~73~~	*70*	~~47~~	*36*		*47*
Temporary help	~~14~~	*15*	~~9~~	*10*		*13*
Education/health	~~45~~	*48*	~~17~~	*33*		*37*
Leisure and hospitality	~~23~~	*21*	~~21~~	*12*		*15*
Government	~~28~~	*7*	~~11~~	*-1*	~~5~~	*8*
Average weekly hours	34.5		34.5		*34.5*	
Index, hrs worked	0.2		0.2		~~0.2~~	*0.1*
Hourly earnings (%m/m)	~~0.2~~	*0.3*	~~0.0~~	*0.1*	*0.2*	
(%oya)	~~1.9~~	*2.0*	~~2.0~~	*2.1*	*2.1*	
Unemployment rate (%)	6.1		6.2		*6.1*	
Participation rate (%)	62.8		62.9			*62.8*

Employment growth disappointed in August, as nonfarm jobs increased 142,000, a step-down from the 226,000 average monthly pace seen in the first seven months of the year. Beyond that headline number, most other aspects of the report were in line with expectations. The unemployment rate moved down from 6.2% to 6.1%, reversing the uptick of the prior month, though that occurred in part because the participation rate ticked down to 62.8%. The workweek held steady for the sixth consecutive month, and average hourly earnings increased 0.2%, indicating little break in the trend of subdued wage gains seen in recent years. While the headline wasn't great, we're not too bothered by the disappointment. The strong job gains seen over the past year were associated with very weak productivity growth and could have been catch-up hiring on the part of understaffed businesses. As the economy gets closer to full employment (which we still think is about a year or so away), employment growth is bound to taper down to its sustainable pace, which is in the neighborhood of 100,000 jobs per month. For the Fed, this takes their feet off the fire to make big changes to the September FOMC statement. In particular, some variant of "considerable time" is likely to remain in the Committee's description of interest rate guidance.

The 142,000 job gain was split between a disappointing 134,000 private jobs, and a trend-like 8,000 government jobs. Manufacturing employment was flat, in part due to an expected decline in motor vehicle employment. Private services added only 112,000 jobs, with a notable disappointment coming in retail, which declined by 8,000, pulled down by a 17,000 decline in food store employment. The diffusion index of job growth among 278 industries fell to 59.1, the lowest level since last December. The wage inflation Rorschach test offers a little something for everyone. Average hourly earnings of production and non-supervisory workers was up 0.3% in August, and has increased 2.5% over the past year, the highest year-ago rate since 2010. Meanwhile, the headline all-worker series has exhibited little break in trend, as average hourly earnings for that broader category have increased 2.1% over a year ago, in the middle of the range it has been stuck in the last few years.

On an unrounded basis the unemployment rate has been relatively steady the last few months: 6.09% in June, 6.20% in July, 6.15% in August. The tick down in the participation rate is mildly disappointing, but, thus far, it looks like just a reversing of the tick up in July. The employment-to-population ratio held steady for the third straight month. There was improvement in some of the broader measures of underutilization. Long-term unemployed as a share of the labor force moved down from 2.0% to 1.9% (the short-term measure was unchanged at 4.2% and has shown less improvement this year than the long-term measure). The share of the workforce employed part-time for economic reasons—which can be volatile month-to-month—moved down from 4.8% to 4.7%, a move that contributed to the decline in the broad U-6 measure of underutilization from 12.2% to 12.1%. The underutilization news wasn't uniformly good, however, as the number of discouraged workers has increased by about 100,000 over the past two months.

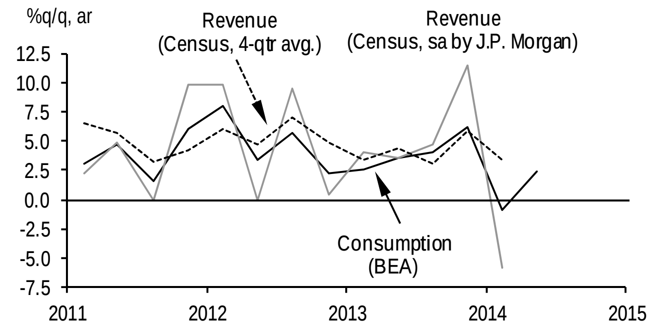
Source: ADP/Moody's Analytics, BEA, BLS, Census Bureau, Conference Board, Federal Reserve Board, ISM, J.P. Morgan forecasts, NAHB, NAR, NFIB, NY Fed, Markit, Philadelphia Fed, Standard & Poor's, University of Michigan, US Treasury

Focus: previewing the 2Q QSS

- The Census Bureau will release the Quarterly Services Survey (QSS) at 10:00am on September 11, and the BEA will incorporate the QSS data in its third estimate of 2Q GDP growth, to be released September 26. We believe that the September 26th report will show an upward revision to health care consumption in 2Q, which has favorable implications for the 3Q data as well.
- In its first two reports on GDP growth for each quarter, the BEA uses a "judgmental trend" for its estimates of health care consumption—as well as a number of other services consumption components—because reliable source data are not available in a timely manner. Once the QSS becomes available between the BEA's second and third reports on growth for each quarter, the BEA can replace its judgmental estimates with the related QSS data that better reflect activity during the quarter. This methodology typically results in little change in health care consumption growth in the first two prints of GDP for a quarter and more substantial changes in the revision between the second and third reports (second chart).
- Focusing on the recent data, the BEA's second report on GDP for the quarter (from August 28) shows real health care services consumption up only 0.4% saar in 2Q—a very soft gain for the series, which has averaged 2% growth to date in this expansion. The softness reported for 2Q is likely being affected by the weakness in the 1Q data (-1.4% saar) because the BEA's current estimate for 2Q is still based on a trend. But we think that the weakness in health care consumption in 1Q may reflect payback for the strong 4Q13 (4.3% saar) as well as a few temporary factors that will most likely be (at least partially) reversed in 2Q; specifically, the unusually harsh winter weather may have delayed or prevented some consumption of health care services, and the abnormally mild flu season may have erased some of the typical seasonal demand for health care services early on this year. Industry data related to physician office visits—which can be choppy, but have tracked the broader trend in health care consumption reasonably well in recent years—looked weak early this year but then perked up noticeably over the most recent few months through July (third chart), suggesting that health care consumption should bounce back following the decline in 1Q.
- Revisions to health care services consumption can be significant for GDP growth because the category accounts for about 11% of GDP. For example, the revision to health care consumption between the BEA's second and third reports on 1Q GDP growth took 1.2%-pts off of GDP growth during the quarter. But we expect a more modest revision in the 2Q data because the 1Q data were affected by special assumptions related to the implementation of the Affordable Care Act. The QSS data may also affect revisions to other categories of services consumption as well as investment in intellectual property products; we will have a more precise estimate of how we believe the QSS will affect 2Q GDP growth after its release.
- The 3Q health care consumption data will also be affected by the revisions to the 2Q figures because the 3Q figures are based on a trend until the incorporation of the 3Q QSS in December. As currently reported, the July pace of real health care services consumption was less than 1% saar above the 2Q average. But the 3Q data will likely look stronger once the August data and accompanying revisions are released on September 29 if the preceding trend is revised up as we expect.

Nominal health care consumption and revenue

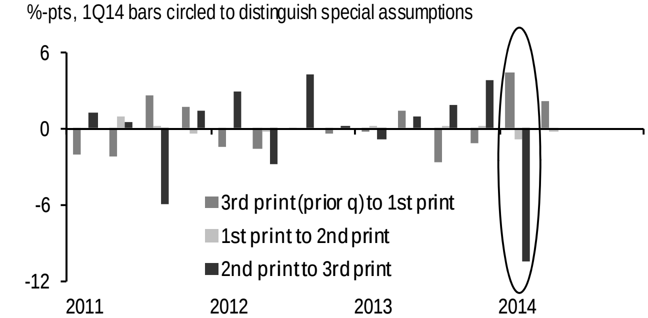
%q/q, ar



Source: BEA, Census Bureau, J.P. Morgan

Real health care consumption growth, changes between reports

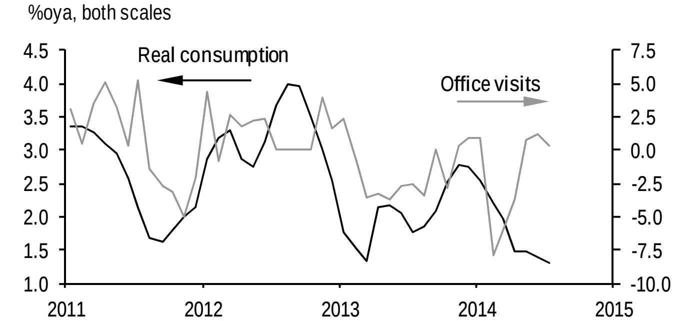
%-pts, 1Q14 bars circled to distinguish special assumptions



Source: BEA

Real health care consumption and physician office visits

%oya, both scales



Source: BEA, Thompson Reuters (Healthcare), J.P. Morgan

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Euro area

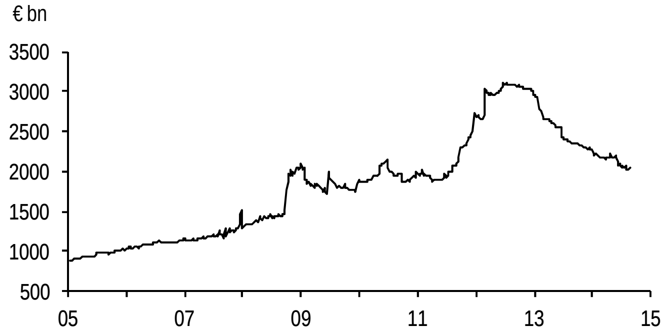
- **ECB cut its policy interest rates this week and will begin to purchase private sector assets next month**
- **Chances of sovereign QE remain high, but we think that improving macro data will ultimately prevent it**
- **Expectations of QE are having big effect on financial markets and the currency, however**
- **Official activity data rebounded in July, but final PMI report shows a worrying fall in Italy**

The ECB lowered its entire interest rate corridor by 10bp this week, moving the main refinancing rate to 0.05% and the deposit rate to -0.20%. The ECB also decided to start purchasing private sector assets in October, confirming that ABS purchases will actually take place (in June, the ECB had said only that it would "intensify" preparations for possible ABS purchases). More surprising, the ECB has also decided to launch its third purchase program for covered bank bonds. For both purchase programs (ABSPP and CBPP3), the modalities will be announced at next month's policy meeting. As a result, there is no confirmation yet of how much the ECB will actually buy or how quickly.

Overall, President Draghi delivered more than expected, especially with the decision to buy covered bank bonds, rather than just ABS. This means that purchases can reach a bigger scale. What is less clear to us is why the TLTROs were not made even more attractive by also removing the 10bp spread that will be charged over the refi rate for these funds. In our opinion, the opposition to this week's decisions by a few ECB governors and other aspects of Draghi comments in the Q&A also muddied the overall message somewhat.

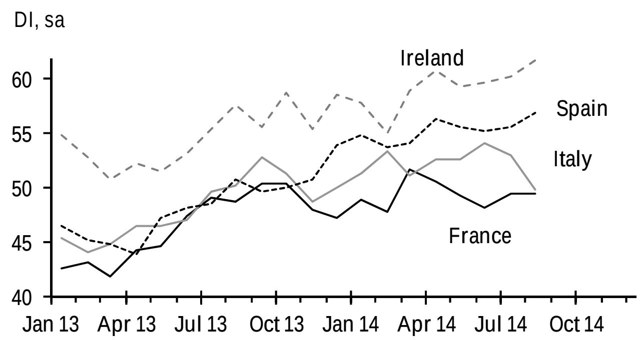
- **Is it QE or not?** Draghi referred to the ABSPP and CBPP3 as credit easing, which suggests that purchases would be targeted at specific problems but modest in size. But, he then also suggested that the aim with both purchase programs and the TLTROs is to increase the ECB's balance sheet from the current level (of €2 trillion) to the level it was at the "beginning" of 2012 (in March 2012 it was at €3 trillion). We think it is doubtful the TLTROs and the ABS purchases can achieve such an increase, so covered bond purchases may need to be large. A report by Reuters suggested that the ECB was debating purchases of up to €500 billion over the next three years. Nevertheless, we are unsure whether the ECB would be able to purchase this much and whether its commitment will hold up (especially as the macro data improve). For now, the ECB is probably satisfied as even this muddled rhetoric should keep expectations for sovereign QE alive.

Size of ECB balance sheet



Source: ECB

Euro area composite PMI



Source: Markit, J.P. Morgan

- **Why was there opposition from some governors?** Arguably, the more hawkish ECB governors should have supported this week's decisions if they helped to prevent the ECB from having to do sovereign QE. That some opposed these measures creates uncertainty about the nature of the debate in the Governing Council, including whether Draghi would be willing to do sovereign QE without having the support of the entire Governing Council.
- **Is Draghi focused on the mandate or not?** In an interview a couple of months ago, Draghi said that the ECB must focus on its own price stability mandate, rather than worrying about what governments are doing. This was a big statement, as the ECB has often worried about the moral hazard it could create by acting aggressively. In his Jackson Hole speech, we note that Draghi had already started to backpedal, and he continued to do so this week by saying that structural reforms are needed to make demand-side stimulus effective. In our opinion, this once again muddies the debate about the possibility of sovereign QE.

In terms of our own expectations, we think the ECB will now remain preoccupied with implementing the various measures it has announced. And if the growth data begin to improve again, inflation increases from the currently very low levels, and inflation expectations remain anchored, then we think sovereign QE will not ultimately be delivered. However, expectations of QE are already having a big impact on financial conditions, which should support the economic recovery.

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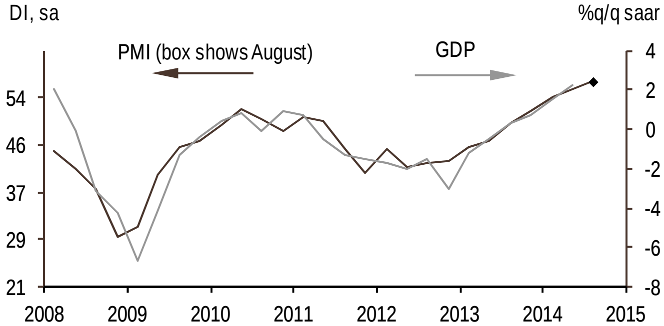
PMI reveals Italy and France weakness

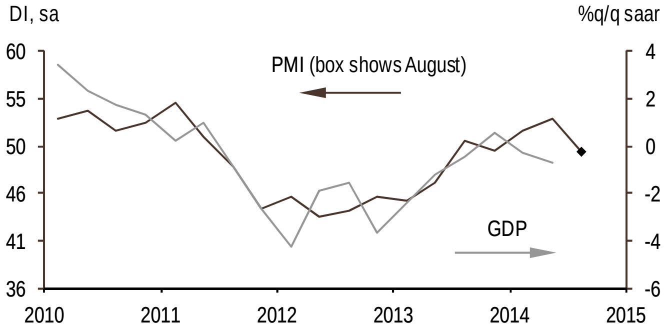
This week's final PMI report confirmed the decline in August, although the move was a bit bigger (-1.3pts to 52.5) than in the flash report. The August level still points to growth running close to our forecast but, there will need to be signs in September that the PMI can begin to move higher again in the coming months. The new country details were of greater interest. The final report no longer shows an increase in France, while Italy alone accounts for the entire decline for the periphery. For Ireland, the composite PMI is close to signaling double-digit GDP growth (in annualized terms). For Spain, the composite PMI is now signaling growth at a near-3% ar pace. But, for Italy, the sharp fall in August suggests that the economy is stagnating, at best. Similarly, for France, the composite PMI is pointing to only very modest growth. Hence, while the slowing in manufacturing is very broadly based across the region, the performance of the economies overall is much less even. It continues to look as if countries perceived as having made more progress on economic reforms are growing faster.

Spanish GDP and PMI



Source: INE, Markit, J.P. Morgan

Italian GDP and PMI



Source: ISTAT, Markit, J.P. Morgan

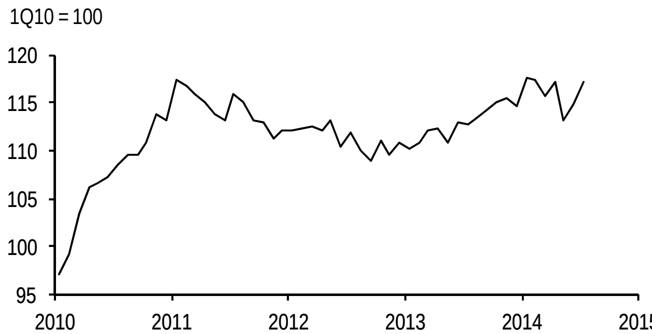
German data rebound after 2Q14 pothole

In 2Q14, the German industry data were surprisingly weak, relative to the more modest slowing signaled by the business surveys; our suspicion was that holiday distortions played a role. In this context, the July reports for both orders and IP were reassuring.

Industrial orders surged 4.6%m/m in July, with the level 8.9% ar above the 2Q14 average, led by bulk orders, which moved from being well below average in June to well above average in July. But, even if we exclude bulk orders, the July level is almost 8% ar above 2Q14. The July rebound was also broadly based across regions, with domestic orders and orders from the Euro area and from outside of the Euro area all increasing.

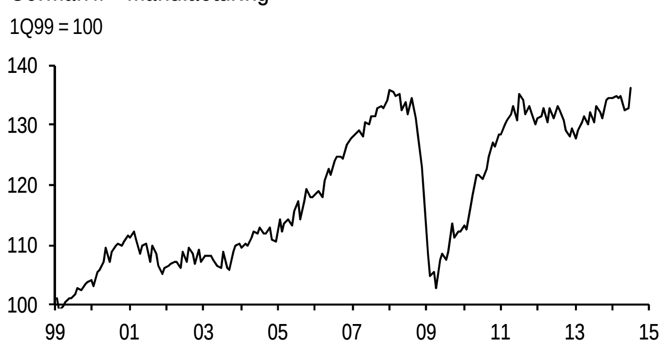
The German IP report also was very strong. IP (including construction) rose 1.9%m/m and the increase in manufacturing was even larger (2.6%m/m). This left July manufacturing output almost 9% ar above the 2Q14 average. At face value, this outcome creates some upside risk to our expectation that German GDP increases 1.5%q/q, saar in the current quarter. We are more cautious as the July rebound was affected by an outsized 11.8%m/m jump in auto production. This could relate to auto producers working through the summer holidays to meet backlogs of orders. In addition, the German data can be noisy during the summer as the shifting pattern of holidays across the German states creates problems for the seasonal adjustment of the data. Nevertheless, we think the IP report bodes well for the performance of the economy.

German manufacturing orders (excluding bulk orders)



Source: Destatis

German IP - manufacturing



Source: Bundesbank, J.P. Morgan

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Data releases and forecasts

Week of September 1 - 5

Output and surveys

Industrial production

		Apr	May	Jun	Jul
Fri	Euro area				
Sep 12	%m/m, sa	1.1	-1.1	-0.3	0.8
11:00am	%oya	1.6	0.7	0.0	
Wed	France				
Sep 10	Ind production (%m/m, sa)	0.4	-1.6	1.3	0.0
8:45am	%oya sa	-2.1	-3.4	-0.4	
	Manuf prod (%m/m, sa)	-0.1	-2.3	1.6	
	%oya sa	-0.3	-2.6	0.1	
Fri	Italy				
Sep 12	Ind prod (%m/m, sa)	0.5	-1.2	0.9	0.0
10:00am	Ind prod (%oya, sa)	1.2	-1.0	0.1	

The 0.8%m/m increase we expect for Euro area IP is largely due to the big increase already reported for Germany. As both French and Italian IP had posted decent gains already in June, we do not expect further gains in July. Nevertheless, our forecast would still leave Euro area IP in July almost 1% ar above the 2Q14 average.

Demand and labor markets

Employment

		3Q13	4Q13	1Q14	2Q14
Fri	Euro area				
Sep 12	Seasonally adjusted				
11:00am	000s, diff. q/q	5	164	112	
	%q/q	0.0	0.1	0.1	
	%oya	-0.8	-0.4	0.1	

External trade and payments

Foreign trade

		Apr	May	Jun	Jul
Mon	Germany				
Sep 8	€ bn, values, sa				
8:00am	Trade balance	17.2	18.8	16.3	
	Trade balance - year earlier	16.9	15.2	16.0	
	Exports	93.9	92.9	93.8	
	%m/m	2.6	-1.1	0.9	
	Imports	76.7	74.1	77.4	
	%m/m	0.2	-3.4	4.5	

Inflation

Consumer prices

		May	Jun	Jul	Aug
Thu	Germany (final)				
Sep 11	%m/m, nsa	-0.1	0.3	0.3	0.0
8:00am	%m/m, sa	-0.1	0.1	0.2	
	%oya, nsa	0.9	1.0	0.8	0.8
	HICP (%oya)	0.6	1.0	0.8	0.8

		May	Jun	Jul	Aug
Thu	France (final)				
Sep 11	%m/m, nsa	0.0	0.0	-0.3	0.4
8:45am	Index ex. tobacco nsa	126.27	126.22	125.81	126.46
	%oya, nsa	0.7	0.5	0.5	0.4
	HICP (%oya)	0.8	0.6	0.6	0.6

		May	Jun	Jul	Aug
Fri	Italy (final)				
Sep 12	%m/m, nsa	-0.1	0.1	-0.1	0.2
10:00am	%oya, nsa	0.5	0.3	0.1	-0.1
	HICP (%oya nsa)	0.4	0.2	0.0	-0.2

		May	Jun	Jul	Aug
Fri	Spain (final)				
Sep 12	%m/m, nsa	0.0	0.0	-0.9	0.2
9:00am	%oya, nsa	0.2	0.1	-0.3	-0.5
	HICP (%oya, nsa)	0.2	0.0	-0.4	-0.5

Euro area inflation declined another tenth in August, according to the Eurostat's flash release. We expect the HICP country details to be confirmed next week. German and French inflation should be stable in August, while Italian and Spanish inflation should decline by two tenths and one tenth, respectively.

Source: European Commission, Eurostat, ECB, FSO, Bundesbank, IFO, INSEE, ISAE, Istat, INE, CBS, BNB, Markit, and J.P. Morgan forecasts

Review of past week's data

Output and surveys

Real GDP

	4Q13		1Q14		2Q14	
Euro area (prelim)						
%q/q, sa	0.3		0.2		*0.0*	
%q/q, saar	1.2		~~0.8~~	*0.9*	~~0.2~~	*0.1*
%oya	0.5		~~0.9~~	*1.0*	*0.7*	
GDP components (%q/q, saar)						
Private consumption	0.3		~~0.6~~	*0.7*	~~1.0~~	*1.2*
Government consumption	-1.3		~~2.7~~	*2.8*	~~0.0~~	*0.6*
Fixed investment	3.8		~~0.7~~	*0.9*	~~-1.0~~	*-1.3*
Exports	~~5.5~~	*5.6*	~~0.7~~	*0.3*	~~1.0~~	*1.8*
Imports	2.6		~~3.3~~	*3.1*	~~1.5~~	*1.0*
Contribution to GDP growth (%q/q, saar)						
Domestic final sales	~~0.5~~	*0.6*	~~1.1~~	*1.2*	~~0.4~~	*0.5*
Inventories	-0.8		~~0.8~~	*0.9*	~~0.0~~	*-0.8*
Net trade	1.5		~~-1.0~~	*-1.1*	~~-0.2~~	*0.4*

Revisions to headline GDP were modest in the new estimate for 2Q14, and the new expenditure details were broadly as expected. Consumer spending increased a bit faster but capital spending declined, and only a part of this was related to weather-related payback in construction. Overall, domestic final sales growth remained close to the modest average pace of the past year. More surprisingly, inventory was cut again, leaving the level looking low relative to the business surveys. This could help the recovery in the coming quarters.

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Real GDP

	4Q13		1Q14		2Q14	
Germany						
%q/q sa	0.4		0.7		<u>-0.2</u>	
%q/q saar	1.8		2.7		<u>-0.6</u>	
%oya	1.1		2.2		<u>1.3</u>	
GDP components (%q/q, saar)						
Private consumption	~~-1.2~~	-3.1	~~2.8~~	3.1		0.4
Government consumption	~~-1.4~~	-0.4	~~1.7~~	1.6		0.5
Mach, equip, other investment	~~2.8~~	4.4	~~13.5~~	12.2		-8.8
Construction investment	~~0.8~~	2.9	~~15.4~~	17.4		-15.8
Exports	~~10.2~~	6.9	~~0.7~~	0.1		3.8
Imports	~~5.2~~	2.9	~~9.1~~	1.8		6.6
Contribution to GDP growth (%q/q, saar)						
Domestic final sales	~~-0.4~~	-0.9	~~3.9~~	4.3		-1.5
Inventories	~~-0.4~~	0.8	~~2.3~~	-0.9		1.7
Net trade	~~2.6~~	2.0	~~-3.4~~	-0.7		-0.8

German GDP was confirmed to have declined 0.6%q/q, saar in 2Q14. The new details revealed small gains in consumption spending and a big drag from capital spending. A part of the latter reflects weather-related payback in construction, but spending on machinery and equipment by the private sector was also weak in 2Q14.

Purchasing managers index final (manufacturing)

	Jun	Jul	Aug	
Euro area				
Overall region	51.8	51.8	~~50.8~~	50.7
Germany	52.0	52.4		51.4
France	48.2	47.8		46.9
Italy	52.6	51.9		49.8
Spain	54.6	53.9		52.8

Purchasing managers index final (services)

	Jun	Jul	Aug	
Euro area				
Overall region	52.8	54.2	~~53.5~~	53.1
Germany	54.6	56.7		54.9
France	48.2	50.4		50.3
Italy	53.9	52.8		49.8
Spain	54.8	56.2		58.1

Purchasing managers index final (composite)

	Jun	Jul	Aug	
Euro area				
Overall region	52.8	53.8	~~52.8~~	52.5
Germany	54.0	55.7		53.7
France	48.1	49.4		49.5
Italy	54.2	53.1		49.9
Spain	55.2	55.7		56.9

The Euro area composite PMI was revised down 0.3pt, so that the decline in August is now reported as 1.3pts to 52.5. France remained weak, while the new details for the periphery revealed that the decline occurred entirely in Italy. In contrast, both Spain and Ireland remain very strong.

Industrial production

	May		Jun		Jul	
Germany						
Prod. sector (%m/m, sa)	~~-1.7~~	-1.6	~~0.3~~	0.4	~~0.8~~	1.9
%oya sa	1.1		~~-0.4~~	-0.3		2.4
Ex. constr (%m/m, sa)	~~-1.5~~	-1.4	~~0.2~~	0.3	~~0.8~~	1.9
%oya, sa	1.4		~~-0.3~~	-0.2		2.8
Industry (%m/m, sa)	-1.6		~~0.1~~	0.3	~~0.8~~	2.6
%oya, sa	1.9		~~0.2~~	0.4		4.3

German IP rose even more strongly than we had expected, leaving the July level 6.5% ar above the 2Q14 average. A surge in auto production accounted for a large part of this, but other industry sectors also saw strong increases.

Manufacturing orders

	May		Jun		Jul	
Germany						
Volumes, sa						
Total (%m/m)	~~-1.6~~	-1.7	~~-3.2~~	-2.7	~~2.5~~	4.6
%oya	5.8		~~-2.3~~	-1.9		4.9
Domestic (%m/m)	-2.4		~~-1.9~~	-1.5		1.7
%oya	5.3		~~-0.4~~	0.0		1.6
Foreign (%m/m)	~~-1.0~~	-1.2	~~-4.1~~	-3.4		6.9
%oya	6.2		~~-3.6~~	-3.3		7.6

German orders were much stronger than expected in July, with the level up 8.9% ar on the 2Q14 average. This was partly due to bulk orders swinging from weak to strong, but orders were strong even excluding bulk orders. This is reassuring after the recent weakening in German industry data.

Demand and labor markets

Retail sales

	May		Jun		Jul	
Euro area						
Total sales, volumes						
%m/m, sa	~~0.3~~	0.2	~~0.4~~	0.3	~~-0.3~~	-0.4
%oya, working-day adj.	0.6		~~2.4~~	1.9		0.8

Euro area retail sales fell a disappointing 0.4%m/m in July, leaving the July level 0.7% ar below 2Q14. However, the decline was not too large in relation to the upward trend seen in recent months. A surprisingly weak start to the quarter in Germany is also weighing on the results. And, while consumer confidence has fallen recently, its remains at a healthy level.

Source: European Commission, Eurostat, ECB, FSO, Bundesbank, IFO, INSEE, ISAE, Istat, INE, CBS, BNB, Markit, and J.P. Morgan forecasts

Japan

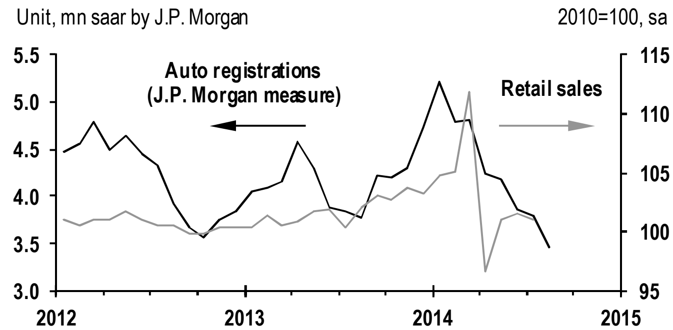
- **BoJ on hold as expected; Governor Kuroda bullish on the outlook but ready to act, if necessary**
- **August auto registrations slid further, but July wages rose 2.6%oya with a jump in summer bonuses**
- **Prime Minister Abe reshuffled the Cabinet, sending a message that he is serious on reform**

As widely expected, the BoJ stayed on hold this week. In the press conference, Governor Kuroda emphasized the positive feedback loop of household and corporate income and spending by pointing out the rise in wages, employment, and corporate profits. He named three sources of consumer spending weakness, but referred to them as temporary: (1) retrenchment after the front-loaded demand prior to the VAT hike, especially in durable consumer goods, (2) a decline in real income as a result of the tax hike, and (3) the bad weather in July and August. Kuroda addressed weak industrial production, acknowledging the unexpected weakness in exports and domestic durable consumer goods demand, but remained optimistic about the near-term outlook reflecting manufacturers' positive output projections for August and September, as well as the BoJ staff's survey of Japanese firms. There was no change to the inflation outlook; the BoJ still forecasts acceleration starting in the latter half of the current fiscal year (from October). We are comfortable with our call that the BoJ will not ease further, at least in the near future (we see only 20% chance of easing before year-end).

While these remarks may seem hawkish, the press conference included two tempering statements. First, when a reporter suggested that 2% inflation was too high for Japan and harmful to the economy, Kuroda refuted the claim, saying that a 2% target is the global standard and quite appropriate for Japan as well. This underscores our view that the BoJ will not change its 2% inflation target even if inflation does not reach 2% by next year, but will maintain its current policy until it achieves stable 2% inflation. Second, Kuroda said that it is natural to expect the yen to weaken against USD given the direction of Japanese policy and strength of the US economy. He added that he is "not thinking that further weakening of yen is unfavorable for the Japanese economy." This clear indication that Kuroda is comfortable with further yen weakness marginally raises the probability of further easing, in our view. We see a 40% chance of easing in 1H 2015.

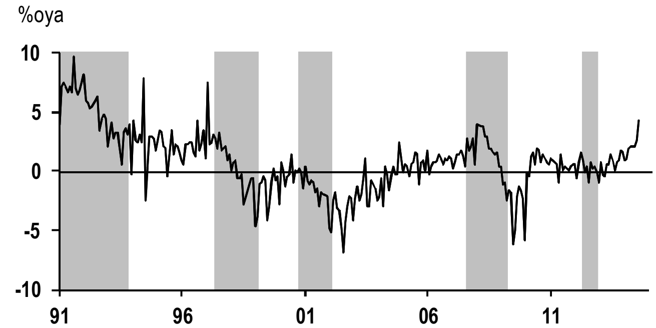
This week's data were mixed, showing that consumption has been weak this summer but revealing signs that the weakness is temporary. Indeed, auto registrations tumbled yet again in August, while the August services PMI edged down. However, the July data also marked an impressive gain in summer bonuses and a modest, but steady, rise in core wages. Since labor income has begun to rise, with gains in both wages and employment, and labor market conditions remain favorable, we think that consumption fundamentals will continue to improve. We thus expect overall consumption will pick up as the weather returns to normal in coming months. But, we acknowledge headwinds from the decline in household purchasing power due to the VAT hike and inflation. We think consumer confidence needs to improve further; next week's Economy Watchers survey and consumer sentiment for August will be key signposts to trends in consumer attitudes. July machinery orders will provide the latest momentum of business investment.

Auto registrations and retail sales



Source: JADA, METI, J.P. Morgan

Labor income (total wages times number of regular workers)



Source: MHLW, J.P. Morgan

Summer consumption likely to disappoint but wages are now rising

The J.P. Morgan adjusted measure of new auto registrations, our preferred indicator of real consumer spending on autos, fell 8.4%m/m, sa in August, the fifth consecutive monthly drop from January's post-crisis peak. Moreover, the pace of decline accelerated after slowing to 1.8% in July from 7.6% in June. The August fall was much larger than expected and there is no sign of a bottom. While auto registrations is not necessarily a good predictor of retail sales or overall consumer spending, the large mid-quarter decline raises concern that 3Q consumption (and GDP) is weaker than our forecast, which is already lower than the market consensus.

However, poor weather was, in our view, largely responsible for weak retail sales and household spending in July, and the weather in August was worse, with typhoons and heavy rains. Indeed, the rainfall in western Japan reached a record high since 1946, and hours of sunlight in the area were 48% of normal years. Thus we see consumption weakness as temporary.

Total monthly wages were strong in July, rising 2.6%oya, with a 0.7% gain in core scheduled earnings and an impressive 7.1% jump in special (bonus) payments. With a 1.6% increase in the number of regular employees, labor income rose 4.2%, the fastest increase since January 1997. However, these figures are likely to be revised down in the final report, due on September 18. In the preliminary reports, the wages of high-wage full-time workers tend to increase powerfully, while the wages of lower-paid part-timers slow from previous months. These changes typically are revised to smoother changes in the final report, resulting in smaller gains for full-time workers, bigger increases for part-timers and slower wage growth overall. Still, in our view the downward revision is unlikely to change the broad picture of wages accelerating as the labor market continues to tighten. Also, the jump in bonus payments in June and July signals upside to workers' annual incomes as total wages in these months are higher than other months except for December when firms pay winter bonuses. The ongoing slide in real wages (-1.4%oya) remains a concern, but the steady rise in employment is encouraging.

Prime Minister Abe, continued

This week, Prime Minister Abe reshuffled his cabinet and the executives of the LDP (Liberal Democratic Party of Japan). The reshuffle is the first since Abe became prime minister in December 2012—replacing the longest-serving cabinet since World War II. However, the effects on major policies should be limited, in our view, because key members, such as Minister of Finance, Foreign Minister, and Chief Cabinet Secretary, are unchanged.

Several of Abe's cabinet appointments signal that he is serious about ongoing reform, in our view. First is his appointment of Yasuhisa Shiozaki as Minister of Health, Labor, and Welfare. Shiozaki has been a strong promoter of Abe's GPIF (Government Pension Investment Fund) reforms, and as minister, he will be in charge of the public pension system, including the GPIF. Some market commentators noted that the news of his appointment buoyed equity prices and weakened the yen on the theory that he will push the fund to buy more equities and foreign assets. We think this theory is misguided as he has pushed reform of the GPIF as an institution, rather than promoting specific asset allocations. While institutional reform should enhance the governance of the large public fund (see here for more discussion on the GPIF reform), we expect the short-term impact will probably be limited.

Still, the appointment is a positive sign for reform in a more profound manner. Before his appointment as minister, Shiozaki was in charge of formulating the LDP's growth strategies, which were the basis of the government's official plans presented in June this year and last year. Given that the Ministry of Health, Labor, and Welfare, which is in charge of medical services and employment policies, is widely regarded as resistant to Abe's reforms, Abe might have put Shiozaki in this position to change the culture there. Indeed, he was Chief Cabinet Secretary when Abe was prime minister in 2006, suggesting that he is a close and trusted colleague of Abe's.

Second, Abe also appointed five female ministers (out of 18), matching the record number in Koizumi's 2001 cabinet. Abe has been actively promoting an increase in the number of women in high positions in both public and private entities as a part of the growth strategy. One criticism of the growth strategy has been that initiatives have not been implemented effectively, so Abe may have wanted to send the message that he delivers what he promises. It appears to have been effective: according to a Nikkei's poll straight after the reshuffle, the cabinet approval rate jumped to 60% from 49% with favorable comments on the appointments of women.

Third, the appointment of Sadakazu Tanigaki as Secretary General of the LDP was a bit of surprise. Tanigaki was leader of the LDP when the party was opposition and supported then-Prime Minister Noda's initiative to increase the VAT this year. He is strongly in favor of the second tax rate hike from 8% to 10%. There are many voices calling for a delay of the tax hike, given recent weak economic data. But, with the reappointment of Taro Aso as Minister of Finance and Tanigaki as LDP Secretary General, our forecast that the tax hike will be implemented in October 2015 as scheduled, is intact.

Finally, Shigeru Ishiba, former Secretary General of the LDP, was appointed minister in charge of regional economic revitalization. While this is not news, his appointment confirmed that he is unlikely to challenge Abe in the leadership election next year. It suggests that Prime Minister Abe can stay in power in the LDP until 2018 as LDP rules limit leadership to two three-year terms, and the party is widely expected to win general (lower house) and upper house elections in 2016 .

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Data releases and forecasts

Week of September 8 – 12

During the week

Cabinet Office private consumption index

%m/m, sa

	Apr	May	Jun	Jul
Overall	-8.2	1.5	0.7	-0.5

Both nominal retail sales and real household spending in the Household survey suggest that the recovery in consumer spending from the tax hike-triggered plunge paused in July, when typhoons and heavy rains hit wide areas of the country.

Mon Sep 8 8:50am

GDP—second preliminary estimates

%q/q, saar

	4Q13	1Q14	1st 2Q14	2nd 2Q14
Real GDP	-0.2	6.1	-6.8	-6.4
Private consumption	1.5	8.4	-18.7	-18.7
Residential investment	10.1	8.2	-35.3	-35.3
Bus. capital investment	5.5	34.6	-9.7	-11.5
Government consumption	0.8	-0.4	1.5	1.5
Public investment	5.8	-9.8	-2.0	-2.0
Exports	1.2	28.6	-1.8	-1.8
Imports	15.7	28.0	-20.5	-20.5
%-pt contrib. to q/q, saar GDP growth				
Net exports	-1.9	0.3	3.2	3.2
Inventories	-0.5	-3.0	4.5	5.2
GDP deflator (%oya)	-0.4	-0.1	2.1	2.1

The MoF corporate survey, key source data for the second estimate of GDP, showed that capex of nonfinancial corporate excluding software declined 7.2%q/q, saar in 2Q after an 11.8% increase in 1Q. The 2Q fall in is smaller than the fall in real GDP-based capex (-9.7%). Based on the first estimate and MoF survey-based capex, we expect the second estimate to decline 8%, which is an upward revision. However, the second estimate of 1Q GDP-based capex increased (from 34.2% to 34.6%) more than the first estimate and the MoF survey-based capex, so we expect to see the error corrected in the 2Q data, especially with the sharp slowdown in financial sector capex, which is only available nsa (+51.7%oya in 1Q to -0.0% in 2Q). We therefore expect GDP-based capex to be revised down to -11.5%. On the other hand, the change in inventories in the MoF survey is larger than that in the first estimate of the GDP report, suggesting that the contribution from inventories is larger as well.

Source: CAO, MoF, BoJ, METI, J.P. Morgan forecasts

Mon Sep 8 8:50am

Balance of payments

	Apr	May	Jun	Jul
Current account (¥ bn sa)	131	385	126	217
Trade balance	-831	-555	-796	-713
Services	-275	-213	-281	-260
Income	1418	1359	1279	1350
Current transfers	-180	-208	-76	-160
Current account (¥ bn nsa)	187	523	-399	514

We expect that a slightly smaller trade deficit will take the overall balance in July to a larger surplus than in the previous month. Already available customs trade data for the month showed solid exports and soft imports relative to recent reports, although it is unclear whether this is a change in the trend.

Mon Sep 8 8:50am

Bank lending

	May	Jun	Jul	Aug
%oya	2.4	2.5	2.3	2.3

BoJ officials noted that funding demand is no longer limited to large firms and has spread to medium-sized and small firms, and that the slowdown in oya growth in the July report reflected an unfavorable base effect and stabilizing yen FX rates, which depressed the yen value of foreign currency-denominated lending.

Mon Sep 8 2:00pm

Economy Watchers survey

DI

	May	Jun	Jul	Aug
Current conditions	45.1	47.7	51.3	51.0
Households	42.1	45.1	49.4	
Business	47.4	50.3	53.9	
Employment	59.3	57.9	57.7	

We expect the August index to show a pause in the recovery from the tax hike-related plunge in April. Both the Reuters Tankan and the Shoko Chukin surveys point to soft economic activity during the month, especially in the nonmanufacturing sector, for example retail trading.

Tue Sep 9 8:50am

Money stock

%oya

	Mar	Apr	May	Jun
M3	2.7	2.5	2.4	2.4
L	3.0	3.0	3.1	3.0

Tue Sep 9 8:50am

Index of tertiary sector activity

	Apr	May	Jun	Jul
%m/m sa	-5.7	0.9	-0.1	0.2

We expect the tertiary sector activity index to remain extremely low in July. Available data suggest that bad weather depressed consumer spending, and that the weakness in manufacturing activity likely continued to feed through to the nonmanufacturing sectors, such as transport.

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Tue
Sep 9
2:00pm

Consumer sentiment

DI, sa

	May	Jun	Jul	Aug
Consumer sentiment	39.3	41.1	41.5	42.5
Standard of living	36.8	38.4	38.5	
Income growth	37.3	37.9	39.1	
Labor market conditions	46.4	48.4	48.7	
Durable goods purchases[1]	36.6	39.6	39.6	

1. The DI asks whether a respondent thinks that now is a good time to purchase durables

In the upcoming report, consumer sentiment will probably recover further from the tax hike-induced weakness, supporting our view that consumer spending will rebound in 3Q.

Wed
Sep 10
8:50am

Machinery orders

%m/m sa

	Apr	May	Jun	Jul
Core domestic orders[1]	-9.1	-19.5	8.8	5.0
Manufacturing	-9.4	-18.6	6.7	
Core nonmanufacturing	0.9	-17.8	4.0	
Foreign	71.3	-45.9	62.8	

1. Domestic private sector, ex for ships and from utilities

We expect core machinery orders to rise further in July. Our view that business capital spending is now picking up in response to strong profits is supported by the robust rebound in capital goods shipments in the July IP report, as well as respondents' comments in the August Reuters Tankan large firm survey.

Wed
Sep 10
8:50am

Producer prices index

%m/m, nsa, 2010-based

	May	Jun	Jul	Aug
Domestic PPI [1]	0.3	0.2	0.1	-0.2
(%oya)	4.4	4.6	4.3	4.0
Export prices	-0.7	-0.1	-0.1	
Import prices	-0.7	-0.2	-0.2	

1. After removing impact from extra charges for electric utility rates in the summer months.

The oya inflation rate of the PPI will probably decline further in August, given the recent moderation in electric gas utility rates as well as in prices of petroleum products.

Review of past week's data

MoF corporate survey (Sep 1)

%q/q, saar, nonfinancial firms

	4Q13		1Q14		2Q14	
Sales	5.5	*5.2*	~~7.0~~	*5.1*		*-7.3*
Current profits	40.9	*42.4*	~~4.6~~	*1.9*		*-12.2*
Capex ex. software	4.7	*5.1*	~~12.8~~	*11.8*	~~2.5~~	*-7.2*
Capex (%oya)	4.0		7.4		~~5.0~~	*-3.0*

See text and the GDP second preliminary estimates on the previous page.

Purchasing managers survey (manufacturing)—final (Sep 1)

Diffusion index

	Jun	Jul	Aug	
Overall index	51.5	50.5	~~52.4~~	*52.2*

Auto registrations (Sep 1)

	Jun	Jul	Aug	
Total %oya	-0.7	0.6	~~-0.3~~	*-5.0*
Mn units saar	2.99	2.96	~~2.93~~	*2.79*
J.P.Morgan adjusted (incl. light vehicles)				
Mn units saar	3.86	3.79		*3.47*

See text.

Employers' survey—preliminary (Sep 2)

%oya

	May	Jun	Jul	
Total earnings per employee	0.6	1.0	~~0.8~~	*2.6*
Contract wages	0.4	0.4		*0.9*
Scheduled payments	0.0	0.2		*0.7*
Overtime payments	4.0	3.1		*3.3*
Special payments	8.0	2.0		*7.1*
Total hours worked	-0.8	0.5		*0.6*
Regular employment	1.4	1.5		*1.6*
Full-time workers	0.7	1.0		*1.6*
Part-time workers	3.1	2.8		*1.3*

See text.

Services/composite PMIs (Sep 3)

Diffusion index

	Jun	Jul	Aug
Services (business activity)	49.0	50.4	*49.9*
Composite (output)	50.0	50.2	*50.8*

The headline business activity index in the services PMI fell 0.5pt to 49.9 in August after a 1.4pt rise in July. The August level is still higher than the 2Q average, and the new business index edged down but stayed relatively high, suggesting that there has been no sudden decline in activity or demand even with the bad weather in July and August. That said, the employment index and business expectations stayed in a range, showing no clear direction.

On the other hand, the manufacturing PMI output index posted a solid gain in August, so the composite PMI output index rose for a fifth consecutive month. Note, though, actual industrial production is not as solid as the PMI suggested.

Source: BoJ, MoF, Markit, JADA, MHLW, J.P. Morgan forecasts

Canada

- **Bank of Canada remains on hold**
- **LFS employment down 11,000 in August**
- **Merchandise trade posted C$2.6 billion surplus in July**
- **Auto exports up sharply**

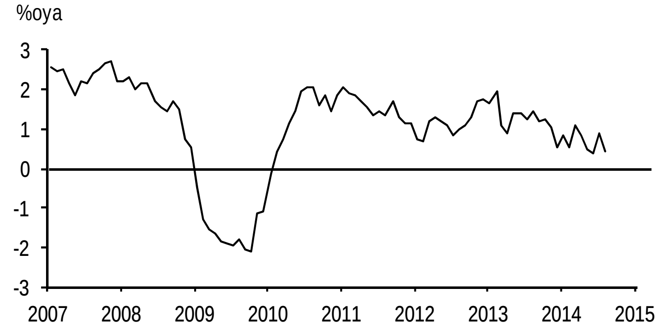
The Bank of Canada remained on hold this week as widely expected, remaining cautious in tone and neutral in policy. The Canadian economy lost 11,000 jobs in August, and the recent disappointing weakness in full-time employment continued. The Labor Force Survey has been particularly choppy in the last year, but the trend in jobs growth has clearly weakened compared with earlier in the recovery, and seems inconsistent with the renewed strength in some of the key sectors, notably manufacturing, wholesale, and retail. On the upside, a combination of weak labor demand and strong GDP growth implies a pickup in labor productivity. Indeed, labor productivity rose 1.8%q/q not annualized in 2Q and unit labor costs were up a very subdued 0.3%q/q. With labor demand weak and wage inflation tame, the Bank of Canada is unlikely to change its tone in the near term that its current expansionary monetary policy stance is appropriate.

It's early in the quarter but merchandise trade is clearly building on its solid 2Q performance, with the surplus widening from a slightly revised C$1.8 billion in June to C$2.6 billion in July. We now expect net exports to contribute a decent amount to real GDP growth in 3Q. In July real exports stood 21% ar above the 2Q average, while real imports are up 0.4%q/q, ar. Net exports have already contributed an average of 1.7%-pts to real GDP growth in 1H14. Nonetheless, the Bank of Canada remained cautious about Canadian exports in its policy announcement this week, granting that an increasing number of export sectors appear to be "turning a corner," but there is still uncertainty about whether a general pickup in exports, and a corresponding pickup in business investment and hiring, can be sustained.

Bank of Canada again finds the risks to inflation are roughly balanced

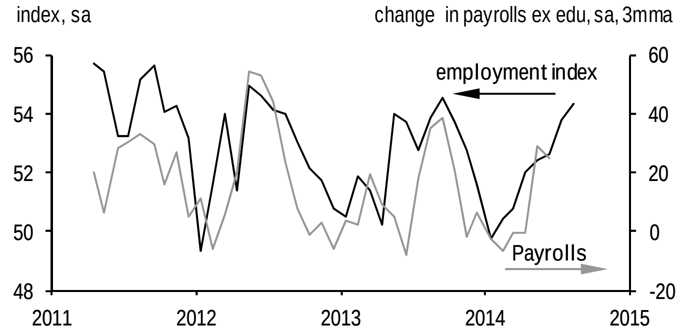
As expected, the Bank of Canada left its policy rate target at 1% this week. The policy guidance remained neutral—with the timing and direction of the next policy move dependent on new information, and no indication that any change in policy is imminent. Inflation is close to the 2% target but the Bank's outlook for inflation remains roughly balanced; it views the recent run-up as temporary and unrelated to economic fundamentals.

LFS employment



Source:Statistics Canada

PMI employment index and payrolls



Source:RBC/Markit, Statistics Canada

Having maintained for most of the recovery that a pronounced housing market correction is a key downside risk to its inflation outlook, the Bank appeared concerned about the recent strength in housing activity and the risks associated with stretched household finances; such risks have generally preceded any hawkish rhetoric. We have been forecasting a hike in the overnight rate in 2Q15, but our bias now is that any change in policy is likely to be later, based on the Bank's persistent uncertainty about the sustainability of inflation at the 2% target.

Employment down in August

Labor Force Survey employment declined 11,000 in August after a 42,000 jump in July. The unemployment rate remains at 7.0% on a slight fall-off in labor force participation. Full-time employment continued to edge lower (-2,300), and is down a combined 20,000 over the last two months. The -112,000 print in the all-private sector was the largest drop-off in the history of the series dating back to 1976.

Merchandise trade off to a good start in 3Q

The merchandise trade balance surprised on the upside in July with the surplus widening from a slightly revised C$1.8 billion in June to C$2.6 billion in July. Motor vehicles and parts led the 1.4%m/m increase in export values. In volume terms, exports rose an even stronger 1.7%m/m. Imports were down for the second month in row as lower prices overtook a small gain in volumes.

Exports of motor vehicles and parts were up 9.7%m/m in July after a 5.1%m/m decline in June. June is now the outlier as auto exports have been up in five of the last six months. Statistics Canada pointed to potentially record auto sales in both the US and Canada this year: US auto sales reached 17.5 million units in August, the best rate since January 2006, and in Canada unit auto sales reached a recovery high of 1.9 million units in May. In volume terms auto exports were up 10.7%m/m. However, exports away from autos were about flat.

Ivey PMI pulls back in August

The Ivey PMI dropped 3.2pts in August but remained north of the 50 expansion threshold at 50.9. The J.P. Morgan composite index (calculated from an average of the headline and the three underlying activity indices) also slipped to 50.7 from 51.2 in July. The Ivey prices index has been volatile, jumping to 72.2 in March when the Canadian dollar was depreciating sharply, but has now settled back to 52.2, a low for the recovery. Firms' expectations for prices play a key role in the inflation outlook and the Bank of Canada's ability to remain patient.

The Ivey employment index increased 0.4pt to 49.5 in August, but an index level below 50 is still considered weak. The RBC/Markit employment index is painting a decidedly different picture: the index has bounced from a low of 49.8 in January up to 54.4 in August and has been tracking the payroll survey (which lags the Labor Force Survey, but is much less volatile) in recent months. The trends in the payroll survey and the Labor Force Survey tend to converge over time.

Data releases and forecasts

Week of September 8 - 12

Mon
Sep 8
8:30am

Building permits
%m/m, sa, unless noted

	Apr	May	Jun	Jul
Total	2.2	15.4	13.5	4.5
%oya	-12.5	-5.1	20.1	3.3

Tue
Sep 9
8:15am

Housing starts
Saar

	May	Jun	Jul	Aug
Total (000)	195.9	198.7	200.1	199.0
(%m/m)	0.1	1.4	0.7	-0.5
(%oya)	-1.8	2.8	0.8	6.6

Thu
Sep 11
8:30am

New house prices
Nsa

	Apr	May	Jun	Jul
Total, %m/m	0.2	0.1	0.2	0.1
%oya	1.6	1.5	1.5	1.5

Review of past week's data

International trade (Sep 4)
Sa

	May		Jun		Jul	
Balance (C$ bn)	~~0.58~~	*0.45*	~~1.86~~	*1.83*	~~1.3~~	*2.58*
Exports (%m/m)	4.3		~~-1.1~~	*0.3*	~~-1.2~~	*1.4*
Imports (%m/m)	~~-1.9~~	*2.2*	~~-1.8~~	*-2.8*	~~-2.4~~	*-0.3*
Real balance	~~0.22~~	*0.20*	~~1.02~~	*1.14*		*1.62*

Labor force survey (Sep 5)
Sa

	Jun	Jul	Aug	
Employment (mn)	17.82	17.86	~~17.88~~	*17.85*
(ch, m/m, 000s)	-9.4	41.7	~~20.0~~	*-11.0*
(%m/m)	-0.1	0.2	~~0.1~~	*-0.1*
(%oya)	0.4	0.9	~~0.6~~	*0.5*
Labor force (mn)	19.19	19.21	~~19.23~~	*19.19*
(%m/m)	0.1	0.1	~~0.1~~	*-0.1*
(%oya)	0.5	0.7	~~0.5~~	*0.3*
Unemployment rate (%)	7.1	7.0	~~6.9~~	*7.0*
Avg hrly earnings (%oya)	1.9	2.1	~~1.6~~	*2.3*
Hours worked (%m/m)	-0.4	0.8	*-0.2*	

Ivey PMI (Sep 5)

	Jun	Jul	Aug	
Composite index[1] (sa)	48.7	51.2	~~51.3~~	*50.7*
Purchasing index (sa)	46.9	54.1	~~55.4~~	*50.9*
Purchasing index (nsa)	49.7	50.4	~~56.4~~	*49.1*

1. Calculated and seasonally adjusted by J.P. Morgan

Source: Statistics Canada, CMHC, Richard Ivey School of Business, and J.P. Morgan forecasts

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Mexico

- **Banxico signals no cuts or hikes for a while**
- **Business sentiment is improving across the board**
- **Next week's data to back move in sentiment**

This week Banxico left its policy rate unchanged at 3.0%, as expected. Also in line with our expectations, the central bank sounded less dovish and, in fact, the statement reads slightly hawkish given the central bank's updated balance of risks for growth and inflation. Banxico stressed that the balance of risks for growth improved following an "important recovery in activity." Furthermore, it described the recovery as being fostered not only by external factors, but also by internal demand. This is clear shift from Banxico's prior communication on growth. The statement described the balance of risks to inflation as having deteriorated in the short term due to an unexpected increase in agriculture and processed food prices that will keep inflation around 4% this year, in line with our forecast. Banxico had previously expected inflation to end 2014 below 4%.

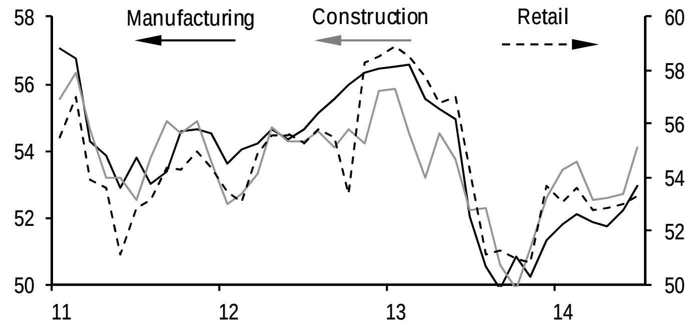
Two observations attenuate the hawkish tone. First, Banxico notes that the deterioration in inflation appears transitory, and continues to expect inflation will fall to 3% early next year driven by a host of factors (benign base effects, smaller gasoline price increases, the reversal of recent increases in agriculture and processed food prices, and prudent fiscal and monetary policies). More important, despite the uptick in activity, Banxico signaled once again that slack prevails and should keep demand side pressures at bay for some time. In a change from the previous statement, however, the board added that it expects slack to diminish over time, and, in a subtle but telling shift replaced the phrase "the output gap will likely remain negative until the end of 2015" with "demand side pressures are not expected in the next quarters."

Overall, we don't expect Banxico to cut rates, but we don't expect it to hike rates, either, for a considerable time. Banxico seems to be using the evolution of slack as a form of forward guidance for policy decisions, even as relative monetary policy also remains an important variable in its reaction function. We expect that although growth should continue to recover, slack will likely disappear only gradually, meaning that Banxico should be in no hurry to change its current policy stance.

The recovery is consolidating

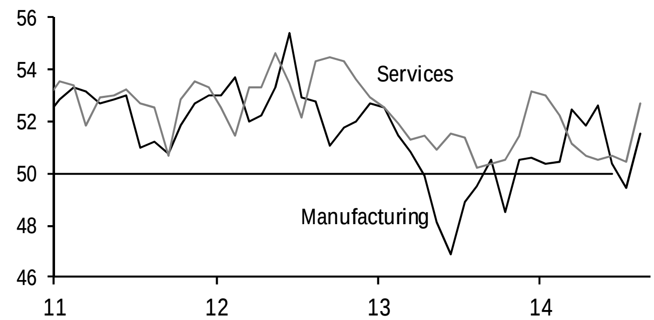
This week's business sentiment and PMI survey releases further confirmed that momentum shifted higher last quarter and firms are gaining confidence in the economy's recovery.

Business sentiment survey
DI, both scales



Source: INEGI

IMEF PMIs: Headline
Index, sa



Source: IMEF

The manufacturing and non-manufacturing PMIs both bounced back in August to levels that look consistent with our call for above-trend growth in the second half of the year. At the same time, business confidence across the retail, construction, and manufacturing sectors advanced in sync last month, reinforcing the uptrend initiated some months back. Increased business confidence was accompanied by an upward move in capex plans, most evident in manufacturing. This shift in sentiment bodes well for our call for the recent upturn in activity to broaden, with investment and consumption joining the acceleration in external demand observed in 1H14. We look for next week's data to back this view.

Firms appear to be expanding, with employment and investment rising in recent data. Next week the release of official employment data for August and gross fixed investment for June will deliver an update on these two fronts. We expect fixed investment to rise 3.3%oya, its strongest increase since April of last year. In particular we look for machinery and equipment purchases to post a robust 7.1%oya increase. Construction spending, in turn, should rise moderately in June, consistent with the strong June construction IP data.

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We expect the positive momentum in construction to be sustained. Next week's July IP report should prove a good test of this view. Available indicators suggest that both manufacturing and construction continued to expand in 3Q. Manufacturing exports and auto production firmed in July while the INEGI construction survey reported solid gains in the value of construction put in place in July/August. Thus, we would expect manufacturing and construction to post robust gains, with factory output rising 1.1%m/m and construction up 0.3%. This would leave their 3m/3m annualized rates running near 4% and 7%, respectively.

Data releases and forecasts

Week of September 8 – 12

Tue Sep 9 9:00am

Consumer prices

	Jul 1H	Jul 2H	Aug 1H	Aug 2H
%2w/2w	0.20	0.12	0.19	0.24
Core	0.14	0.05	0.15	0.05
%oya	4.00	4.14	4.07	4.25
Core	3.20	3.30	3.34	3.38

	May	Jun	Jul	Aug
All items (%m/m)	-0.32	0.17	0.28	0.37
%oya	3.51	3.75	4.07	4.16
Core (%m/m)	0.09	0.21	0.19	0.20
%oya	3.00	3.09	3.25	3.36

Tue Sep 9 10:00am

Central bank foreign reserves

US$ bn

	Aug 15	Aug 22	Aug 29	Sep 5
Gross reserves	190.5	190.3	191.5	__

Wed Sep 10 9:00am

Fixed investment

%oya

	Mar	Apr	May	Jun
Total	2.1	-3.7	0.4	3.3
M&Eq	8.2	-4.1	4.5	7.1
Construction	-1.6	-3.4	-2.2	1.1

Wed Sep 10 9:00am

Nominal wage settlements

%oya, one year ahead

	May	Jun	Jul	Aug
Nominal increase	4.4	4.3	4.1	4.6
Real terms	0.9	0.5	0.1	0.4

Thu Sep 11 9:00am

Industrial production

%oya, unless noted

	Apr	May	Jun	Jul
%oya nsa	-1.0	1.9	2.0	2.2
Manufacturing	0.0	4.0	3.4	3.8
%m/m sa	0.5	0.3	-0.2	0.5
Manufacturing	1.2	0.3	-0.6	1.1

Review of past week's data

Family remittances

	May	Jun		Jul	
Total (US$ bn)	2.1	2.0		*2.0*	
%oya	4.6	4.7		~~6.4~~	*8.4*

IMEF PMI survey

Index, sa

	Jun	Jul		Aug	
Manufacturing	50.3	~~49.1~~	*49.4*	~~50.8~~	*51.6*
Non-manufacturing	50.7	~~50.1~~	*50.4*	~~50.8~~	*52.7*

Central bank foreign reserves

US$ bn

	Aug 15	Aug 22	Aug 29	
Gross reserves	190.5	190.3	__	*191.5*

Consumer confidence, *INEGI*

Jan 2003=100

	Jun	Jul	Aug
Composite	91.0	90.5	90.9

Source: Banxico, IMEF, INEGI, and J.P. Morgan forecasts

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Brazil

- **COPOM standing still with weak activity outlook amid persistently high inflation**
- **Positive short-term surprises with higher IP and lower IPCA releases this week**
- **On the political front, President Rousseff recovers some ground in simulations**

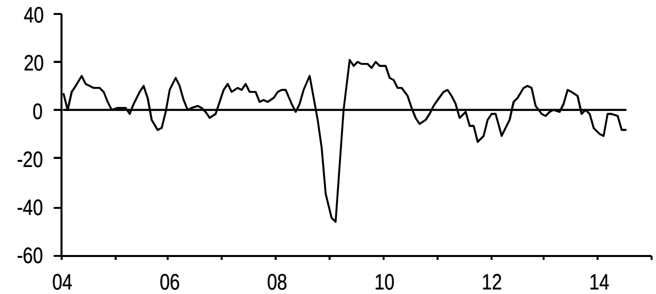
This week, data provided some relief from the downbeat economic news for this quarter, with a small positive surprise from July IP report and an August IPCA inflation print 5bp below our forecast. Even so, the inflation trend remains worrisome and the growth outlook very weak, leading us to revise our 2014 GDP forecast to a mere 0.2% and the Central Bank to leave policy rates unchanged for the third meeting in row. On the political front, new presidential polls showed President Rousseff tightening the gap with PSB candidate Marina Silva in run-off simulations, adding volatility to the markets that already seemed to be pricing in high probability of a potential shift in economic policy.

IP rises for the first time since January

Industrial production (IP) grew 0.7%m/m, sa in July, after declining every month from February to June. On an over-year-ago basis, this represents a 3.6% drop (from the recently revised -7.1% in June), a smaller decline than the -3.7% we and the market consensus of -3.7% expected. Despite this monthly recovery, the 3m/3m, saar sequential trend decline accelerated to -8.3%, from -7.7% in June, and the carry-over for 3Q now stands at -1.9%q/q, saar. The August confidence indicators pointed in opposite directions: while the manufacturing PMI recovered to 50.2 (from 49.1), FGV manufacturing confidence fell 1.2%. In our view, the PMI—which tracks the industrial production trend more closely—could be indicating further improvement ahead. However, the national auto producers association (Anfavea) released its August report, showing continued weak momentum in the auto industry. Auto and light vehicles production decreased 3%m/m (sa by J.P. Morgan) last month, after rebounding 10.2% in July, from a 15.3% plunge in June. On the investment side, truck and autobus production remained almost flat in August, after increasing 48.3%m/m, sa in July. In all, auto production remained low and is pointing to a decline in industrial production in August.

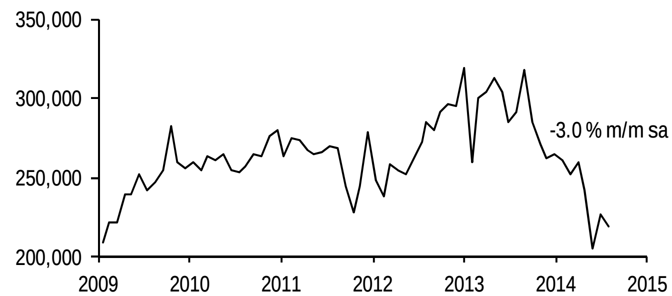
As we have noted before, the mining industry is the silver lining in IP reports this year. Mining production increased again (1.1%m/m, sa in July), the fifth consecutive monthly gain. This time, manufacturing production also increased 0.8%m/m, sa, ending a four-month straight fall. The

Brazil: industrial production
%3m/3m, saar



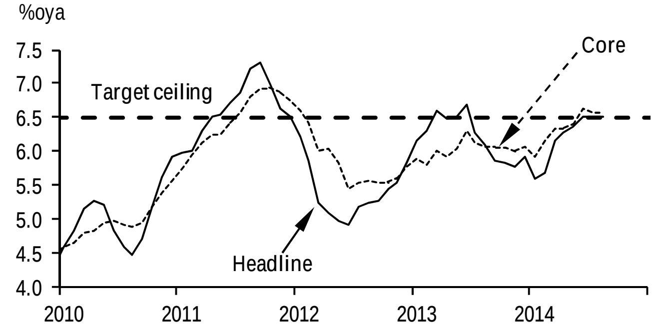
Source: IBGE

Brazil: total auto production
Total sa



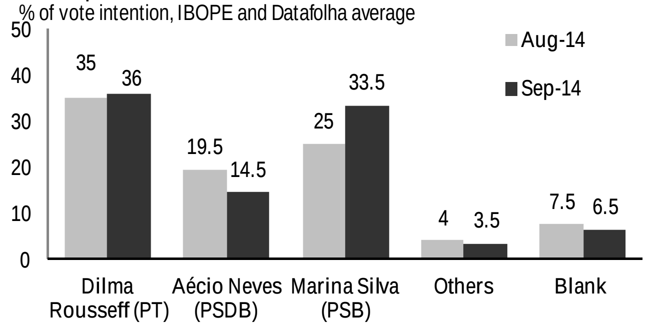
Source: Anfavea

Brazil: IPCA headline and core
%oya



Source: IBGE and J.P. Morgan forecasts

Brazil: poll for 2014 election
% of vote intention, IBOPE and Datafolha average



Source: IBOPE, Datafolha and J.P Morgan

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highlights of manufacturing performance were the rebounds in capital goods (+16.7%m/m, sa) and durable goods production (20.3%m/m, sa). However, food production plunged (-6.3%m/m, sa), despite 0.7%m/m, sa growth in the semi- and non-durable group.

COPOM doesn't rock the boat

The COPOM announced that it would maintain the Selic rate at 11.0% for the third meeting in row, as market participants broadly expected. The brief post-meeting communiqué contained only a small change from the last meeting's communiqué, excluding the expression "at this moment"—reinforcing our view that the bank is not willing to change its monetary policy stance in the short term. Despite the recent negative activity surprises, the decision and the terse statement suggest that the monetary authority remains concerned about high inflation, which is still hovering around the target ceiling. We, thus, keep our call that the Selic rate will remain on hold at 11.0% for the remainder of the year.

Downward food inflation surprise; underlying inflation remains worrisome

August IPCA came out at 0.25%m/m, matching market consensus (J.P. Morgan: 0.30%) to put the 12-month inflation rate at 6.51%, 1bp above July's print. The bulk of the difference between our forecast and the released IPCA was due to food at home deflation of 0.61% (J.P. Morgan: -0.01%). Semi-durable goods and services prices were higher than we anticipated in August, driven by lower-than-expected deflation in recreation prices (at -1.7% vs. -3% in our forecast), which had increased 5.3% in the two months before the World Cup, but decreased only 2.4% in July-August. Also, food away from home increased 0.71%m/m in August, well above our 0.29% forecast. In all, the positive surprise from lower-than-expected headline inflation was offset by higher average core inflation. Core prices increased 0.41%m/m (J.P. Morgan forecast: 0.37%) to leave the core inflation rate around the worrisome level of 6.6%oya. In addition, as we have been highlighting, the gap between market-driven and administered prices continues to narrow. For 2014 year-end IPCA, we maintain our 6.2% forecast.

President Rousseff tightens the gap with Silva in simulations

This week, two new presidential polls showed some improvement in President's Rousseff popularity and, most important, a narrower lead for Marina Silva in a run-off. The change, less than a week after previous polls, may be the result of disapproval of Silva's official government program, released last Friday amid an intense attack from opposing candidates. In the Ibope Institute poll, President Rousseff remained in first place, with 37% of voters' support, up from 34% last week, while support for Silva rose to 33% (from 29%); Aecio Neves is now at 15%, down from 19%. However, in run-off simulations, Silva beat President Rousseff by a narrower margin (46% vs. 39%, from 45% vs. 36%). A Datafolha poll released on the same day confirmed this trend, with minor differences in the levels: the incumbent had 35% of voter intention (up from 34%), while support for Silva remained at 34% and for Neves declined to 14% (vs. 15%). In the run-off simulation against Silva, Rousseff won 41% (from 40%) and Silva 48% (from 50%). When competing with Neves in the run-off, Rousseff had 49% (vs. 48%) and the PSDB candidate 38% (from 40%).

Data releases and forecasts

Week of September 8 – 12

Thu Sep 11 8:00am — Retail sales

	Apr	May	Jun	Jul
Narrow %m/m, sa	-0.3	0.3	-0.7	0.2
Narrow %oya, nsa	6.7	4.6	0.8	1.0
Broad %m/m, sa	0.1	-0.8	-3.6	1.4
Broad %oya, nsa	-0.1	0.7	-6.1	-4.0

Fri Sep 12 7:30am — Economic Activity Index: IBC-Br

	Apr	May	Jun	Jul
%m/m, sa	0.0	-0.8	-1.5	1.0
%oya, nsa	-2.3	-0.2	-2.1	-1.0

Review of past week's data

Industrial production

	May	Jun	Jul	
%m/m, sa	-0.9	-1.4	~~0.3~~	*0.7*
%oya, nsa	-3.3	-7.1	~~-3.7~~	*-3.6*

COPOM meeting

	May	Jul	Sep
Selic rate	11.0	11.0	*11.0*

Consumer prices (IPCA)

	Jun	Jul	Aug	
%m/m	0.4	0.0	~~0.30~~	*0.25*
%oya	6.5	6.5	~~6.57~~	*6.51*

Source: IBGE, BCB, FGV, and J.P. Morgan forecasts

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Argentina

- **Central Bank reduced the limit on banks' long FX position**
- **Absence of complementary FX and interest rate policy should limit its impact**
- **Managing parallel FX rate only buys time amid deteriorating terms of trade**

Argentina's inability to solve its inflation and financial problems has resulted in a reliance on the progressive tightening of capital controls to avert a balance of payments crisis. This week in its latest attempt to stem private sector capital outflows, the Central Bank announced a reduction in banks' net long FX position relative to capital.

The new regulation—which has been in the pipeline for some time—reduces the system's on-balance-sheet long FX position to 20% of capital from 30% (off-balance-sheet is unchanged at 10%). The policy move is a response to a pickup in retail USD demand that has widened the official-parallel FX rate gap and, more recently, has begun to erode reserves—though moderately, so far.

Depending on the composition of assets banks decide to sell, the measure can bolster reserves or reduce the FX gap. If, as we believe, banks prefer to sell sovereign bonds (USD-denominated local law bonds), we expect it would (temporarily) temper parallel FX rate weakness more than it would help rebuild Central Bank reserves.

This week's policy measure is much less aggressive than a similar measure taken by the Central Bank to limit peso devaluation pressures in January. We estimate that the regulatory tightening will force the sale of US$500 million; January's tightening produced an impact of about US$3 billion.

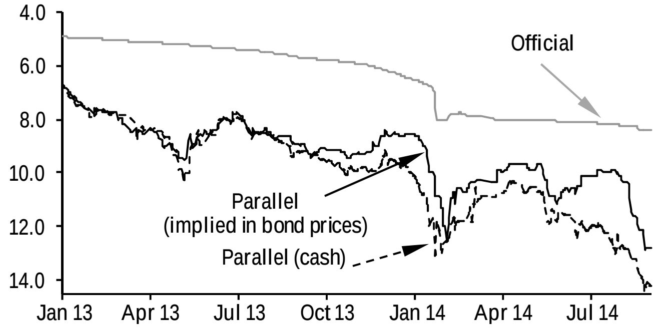
In part, the less forceful policy response reflects a less severe immediate challenge faced by the Central Bank (even following the government's debt default), as international reserves are declining at a monthly pace of US$0.4 billion vs. US$2.8 billion in January (second chart).

That said, the less aggressive policy move also reflects authorities' recognition that a belt can only be tightened so far. And after the latest step the authorities are effectively approaching the point where the spiral does not allow much more tightening as an option.

Note that in January the reduction of banks' net FX long position to 30% of capital was an important factor in the

Peso exchange rate

USD/ARS, inverse scale

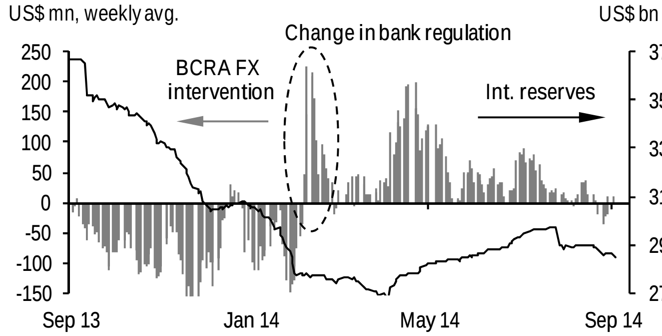


Source: J.P. Morgan

Net daily BCRA FX intervention and international reserves

US$ mn, weekly avg.

US$ bn

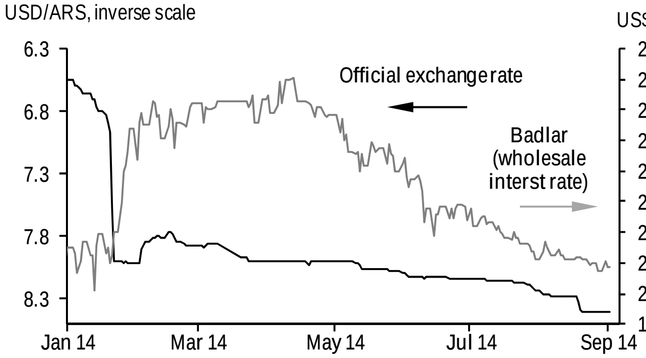


Source: BCRA

Official exchange rate and benchmark interest rate

USD/ARS, inverse scale

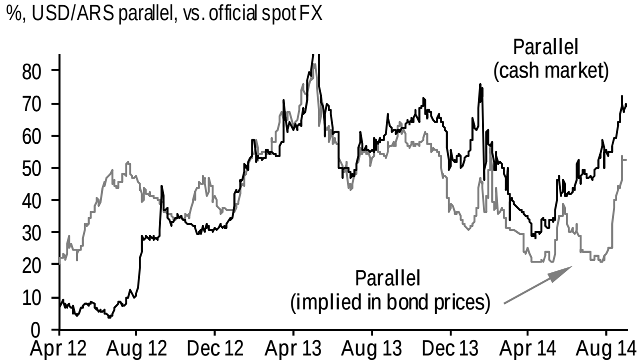
US$ bn



Source: BCRA

FX premium implied vs. the official exchange rate

%, USD/ARS parallel, vs. official spot FX



Source: J.P. Morgan

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stabilization of Central Bank reserves. The smaller scale of regulatory tightening today implies a reduced impact on the FX market relative to the January episode, especially given that it is not being complemented by other policy measures (third chart). Possible complementary policies are:

- A peso devaluation that generates profits for banks and incentivizes grain exporters to sell inventory (the official ARS exchange rate was devalued just over 2% over the past month vs. 23% in the January episode), or

- Interest rate hikes that would make peso holdings more attractive (the latest 100bp hike unwound an initial 100bp cut and has a neutral net impact today vs. a progressive 1,300bp hike around the January episode).

Additionally, in January the authorities suggested that fiscal policy would be tightened moderately. This proved to be a false signal in light of the rapid spending growth that outpaced revenues afterwards. But when the policy was announced it helped to buy enough time and patience from the market to appreciate the subsequent reserve stabilization that effectively addressed the escalation of credit risk driven by fundamental illiquidity risk. A similar policy signal is unlikely now, and fiscal policy credibility has diminished. The only aspect of the change in regulations that is more powerful now is that banks need to phase in the change over a one-month horizon instead of the three-month horizon back in January.

If banks sell local-law USD-denominated sovereign bonds to comply with regulations, that supply should help to contain the weakening of the parallel FX rate. The official-parallel FX rate gap currently lies between 52% (as implied in the peso price of USD bonds) and 69% (as quoted on the cash market). In the January episode, ANSeS (with a quasi-FX management mandate) sold domestic-law USD sovereign bonds to curb parallel FX rate weakness.

The management of the parallel exchange rate may help curb inflation expectations. More importantly, it may temporarily diffuse the expectations of near-term official peso devaluation that emerge when the gap between the official peso exchange rate and the parallel exchange rate widens (fourth chart previous page).

These devaluation expectations incentivize grain hoarding by agricultural producers and the delayed sale of FX receipts by exporters in general. But the regulatory measure should not affect devaluation expectations that are generated by the deteriorating terms of trade. Agricultural commodity prices continue to weaken, particularly for soy exports, which are key to Argentina's balance of payments. Lower prices will reduce USD export revenue s in 2015, even if falling USD commodity prices fueled the liquidation of inventories of this year's harvest, supporting USD export incomes.

Commodity price declines may not boost export earnings in the near term. But, the government is working on a reform to the law of *abastecimiento* (goods supply) that aims to give the Secretary of Commerce new confiscation powers to free up stocks of goods if producers are deemed to be unjustifiably hoarding them. While it is broadly aimed, the agricultural industry is a clear target given the contribution of its sales to exports and hence Central Bank reserves.

Data releases and forecasts

Week of September 8 – 12

Fri Sep 12	Consumer prices	May	Jun	Jul	Aug
	Private[1]				
	%oya	37.1	37.2	37.0	___
	%m/m	2.3	2.1	2.2	___
	Official				
	%oya	...	...	...	___
	%m/m	1.4	1.3	1.4	___

1. J. P. Morgan, average of private consultants.

Review of past week's data

Fiscal revenues
%oya

	Jun	Jul	Aug	
Tax revenues	35.5	33.4	___	*31.3*
External trade-related	85.7	53.1	___	*3.5*
Domestic activity-related	33.0	34.5	___	*36.8*
Labor market-related	26.3	25.3	___	*30.4*

Auto report
Official, %oya

	Jun	Jul	Aug	
Production	-19.8	-31.4	___	*-34.5*
Exports	-19.2	-38.7	___	*-18.2*
Domestic sales	-40.0	-33.5	___	*-42.5*

Source: ADEFA and Mecon, J.P. Morgan forecast

Chile

- **A dovish monetary policy report reinforces easing bias**
- **The BCCh cut 2014 growth estimates to a range of 1.75%-2.25%**
- **We expect another 25bp rate cut next week**

This week Chile's Central Bank (BCCh) published its Monetary Policy Report. The report reiterated the bank's dovish bias, emphasizing that inflation risks remain balanced, while the outlook for growth has shifted to the downside. The monetary authority cut growth projections for this year by 75bp and marginally increased its inflation forecast to 4.1%.

That said, we expect no pause in the easing cycle over the next two meetings, at which two 25bp rate cuts are widely expected. However, the central bank's current expectation of around 2.0% growth in 2014 suggests risks to this year's growth are balanced, while the risk for 2015 remains to the downside. July's higher-than-expected 0.9%oya print (J.P. Morgan: -0.2%; consensus: 0.4%) and June's upward revision to 1.1%oya (from 0.8%) should provide some peace of mind to a dovish but cautious central bank. While July's higher-than-expected growth shouldn't stop BCCh from cutting rates next week, it does suggest that, with growth bottoming in 3Q and gradually recovering in 4Q, the pace and amount of monetary easing will be modest for the rest of the year. As a result, we are pushing back the last 25bp rate cut to 1H15 for a terminal rate of 2.75% next year.

While recognizing the downturn in the economic cycle has been sharper than anticipated—which justifies further easing ahead—the central bank also acknowledged that the economy has experienced a structural shift reflecting lower expected investment rates and moderation in productivity growth. Thus, in line with our view, the central bank revised its estimate of potential GDP growth to 4.0%-4.5%, from 5.0%, acknowledging that lower structural growth has eventual implications for the central bank's reaction function (lower potential growth would implicitly narrow the economy's margin of excess capacity), as monetary policy would have limited impact on structural change. We think this can be interpreted as hawkish, as it suggests the need for less monetary easing at the margin.

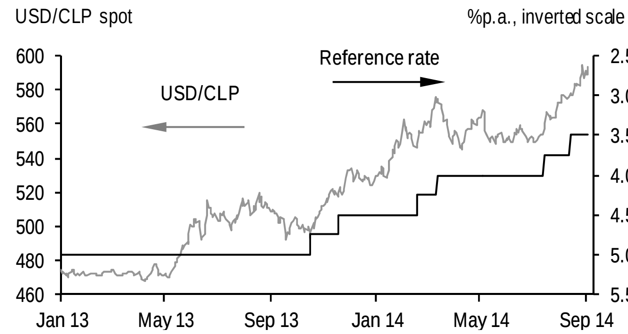
The downward revision of BCCh's 2014 growth projection hinged on a significant downgrade of investment, which the bank now expects to fall 4.1%oya (from -0.7%), while it also trimmed consumption to 2.6%, from 3.4% previously (table). The downward revision is consistent with our below-consensus 1.9% real GDP forecast (consensus: 2.5%). The central bank forecasts stronger activity for 2015 with real

Chile macroeconomic framework

	BCCh			J.P. Morgan	
	2014		2015	2014	2015
	New	Old			
GDP (%oya)	1.75-2.25	2.5-3.5	3.0-4.0	1.9	3.1
Domestic demand	0.1	1.7	3.4	-0.1	3.0
Investment	-4.1	-0.7	1.8	-4.1	1.5
Consumption	2.6	3.4	3.6	2.5	3.0
Headline inflation (%oya)	4.1	4.0	2.8	4.1	3.0
Core inflation (%oya)[1]	3.4	3.7	2.5	3.6	2.8
Current account (% of GDP)	-1.8	-2.5	-2.2	-1.6	-2.0
Copper price ($US/lb)	305	310	300	316	318

Source: BCCh and J.P. Morgan. 1. Headline ex. food and energy.

Exchange rate and monetary policy rate



Source: BCCh

GDP growth of 3.0%-4.0% (J.P. Morgan: 3.1%), underpinned by both monetary and fiscal stimulus, stronger growth in trading partners, a weaker real exchange rate, and improving private sector sentiment.

In line with the minutes, the BCCh acknowledged that FX pass-through spurred the rise in inflation this year. However, the board expects inflation to subside in 2015 as FX pass-through dissipates and is offset by the cyclical slowdown. As a result, the BCCh anticipates that inflation will remain above the upper bound of the target range for the rest of the year, ending at 4.1%oya (from 4.0% previously) but decline quickly to 2.8% in 2015. Likewise, the bank expects core inflation to hover around current levels, ending the year at 3.4% and falling to 2.5% next year.

Last, the central bank emphasized that a weaker peso is a natural consequence of monetary accommodation and lower growth expectations, and shouldn't be seen as a problem, but rather as a buffer, allowing an efficient adjustment in the economic cycle by fostering a quicker recovery in the tradable sector. Despite its undesirable short-term effects on inflation, a weaker currency appears crucial to reactivate the economy in the medium run.

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Chile

Data releases and forecasts

Week of September 8 - 12

Mon Sep 8 — CPI

	May	Jun	Jul	Aug
%m/m nsa	0.34	0.05	0.23	0.12
%oya nsa	4.74	4.31	4.50	4.34

Mon Sep 8 — Trade balance

	May	Jun	Jul	Aug
US$ bn	0.6	0.6	0.4	0.5
US$ bn, 12-m sum	5.4	5.4	6.0	6.7

Thu Aug 11 — BCCh monetary policy meeting

	Jun	Jul	Aug	Sep
Reference rate	4.00	3.75	3.50	3.25

Review of past week's data

Economic activity (IMACEC)

	May	Jun	Jul
%oya	2.3	~~0.8~~ *1.1*	~~-0.2~~ *0.9*

Source: BCCh and J.P. Morgan forecasts

Colombia

Data releases and forecasts

Week of September 8 – 12

Tue Sep 9 — Consumer confidence

	May	Jun	Jul	Aug
Index	23.2	26.6	26.7	__

Review of past week's data

CPI

	Jun	Jul	Aug
%m/m nsa	0.09	*0.2*	__
%oya nsa	2.79	*2.9*	__

Source: DANE, J.P. Morgan forecasts

Peru

Data releases and forecasts

Week of September 8 – 12

Tue Sep 9 — Trade balance

	Apr	May	Jun	Jul
US$ bn	-0.6	-0.5	-0.3	__
US$ bn, 12-m sum	-0.3	-0.6	-1.0	__

Thu Sep 11 — BCRP monetary policy meeting

	Jun	Jul	Aug	Sep
Reference rate	4.00	3.75	3.75	3.75

Review of past week's data

CPI

	Jun	Jul	Aug
%m/m, nsa	0.16	0.43	__ *-0.09*
%oya, nsa	3.45	3.33	__ *2.69*

Source: INEI and J.P. Morgan forecasts

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United Kingdom

- **Polls indicate a closer vote in the forthcoming referendum on Scottish independence**
- **We continue to expect a rejection of independence, but the odds of a "yes" vote have increased**
- **PMIs indicate growth has remained resilient into 3Q**
- **Signs of slowing confined mostly to the manufacturing sector at this stage**

An opinion poll by YouGov this week indicated an increased chance of a "yes" vote for independence in the Scottish referendum on September 18. We expect this weekend's press to reveal more polls and give a better sense of momentum. We look at the implications of a "yes" vote in this week's data watch, but we continue to expect a "no" vote against independence. Meanwhile, other data this week indicated that growth momentum was sustained into 3Q. The Markit jobs report revealed a slower pace of hiring in August, consistent with the message from the PMI surveys. But the staff availability and salary readings of the jobs report continue to point to further declines in the unemployment rate and relatively high wage growth.

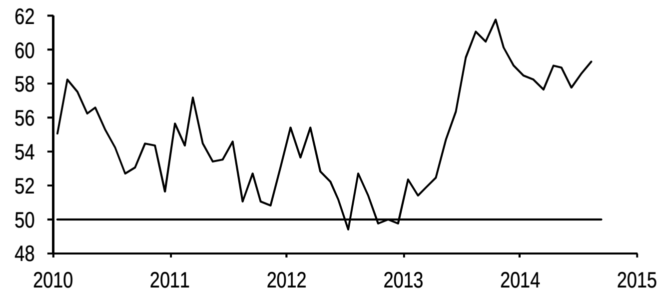
PMIs signal resilience in growth

The UK composite output PMI rose to 59.3 in August, a new high for the year, from 58.8 in July. A surprising rise in the business activity reading of the services index offset a fall in the output component of the manufacturing survey.

- The August manufacturing PMI delivered a significant downside surprise, with the overall index falling from 54.8 to 52.5. The details show a broad-based weakening, with the output reading down from 56.4 to 53.7—its fourth consecutive monthly decline from a peak of 61.1 in April. The PMI is now consistent with manufacturing growth close to 1%, saar—a sharp slowing from the near-8%3m/3m, saar pace of expansion reported in the official data back in April. This slowdown could partly reflect some payback in manufacturing after a very strong start to the year, but the size of the drop in the manufacturing PMI points to a more fundamental shift in the trend. While it may seem intuitive to attribute softer manufacturing to factors such as the currency, Euro area growth, sanctions, and other external factors, the PMI shows new orders falling more sharply than export orders in August, suggesting weaker domestic demand is a key part of the story.
- The business activity reading of the August services PMI surprised with a gain from 59.1 to 60.5, the highest level since last October and consistent with significantly above-

PMI composite output

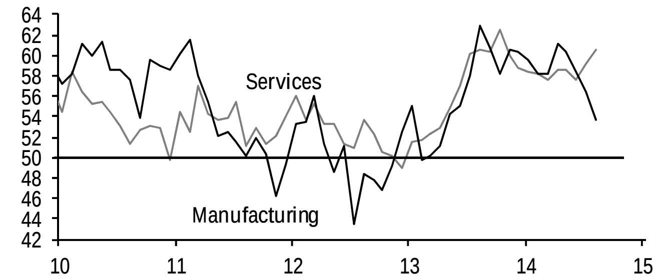
% balance, sa



Source: Markit

PMI output readings

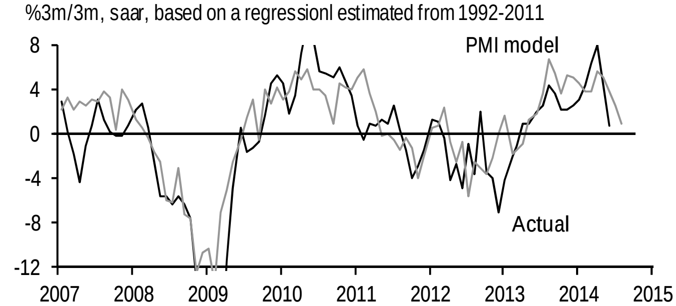
% balance, sa



Source: Markit

Manufacturing output

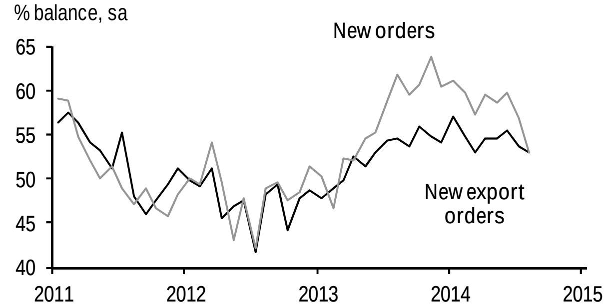
%3m/3m, saar, based on a regressionl estimated from 1992-2011



Source: Markit

Manufacturing PMI

% balance, sa



Source: Markit

trend growth. This week's dip in the manufacturing PMI, raised concerns about the sustainability of the UK recovery. But gains in both the construction and services PMIs have allayed some of those fears and suggest that overall growth momentum has held up well so far this quarter. Other data for 3Q have been more mixed, but remain strong overall. We hence remain comfortable with our near-term growth forecast; weaker momentum appears concentrated in the manufacturing sector at this stage.

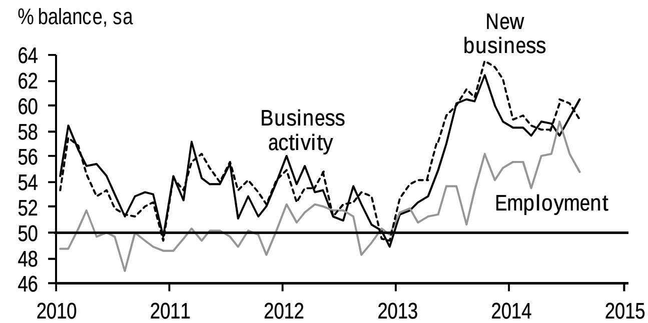
The forward-looking parts of the PMIs softened somewhat in August. For example, the new business reading of the services PMI fell to 58.8 (although clearly still a strong number overall) while business expectations dropped to 68.7, its lowest level since May 2013 and a fourth consecutive monthly decline. At least part of the recent decline in expectations likely reflects heightened geopolitical concerns, which may or may not feed through into business spending. The employment reading of the PMI also declined for a second consecutive month, to 54.7. This could reflect businesses anticipating weaker future demand, or indeed that productivity is finally accelerating. The record low in the staff availability reading of last month's Markit jobs report, however, hints at more weakness in productivity and further declines in the unemployment rate to come in 2H14.

Scottish vote looking closer

This week a poll conducted by YouGov for *The Times* showed a large drop in overall support for the unionist campaign. This is the second poll since the second live TV debate to show a slender 6pt lead for the "no" campaign. While it may be possible to downplay the first of these polls from Survation (on the grounds it had already shown a stronger bias toward the "yes" vote than other polls) the YouGov poll shows the lead for the "no" campaign more than halving. It remains to be seen whether the apparent shift in support for independence following the second TV debate will be sustained, or whether the YouGov result reflects a temporary impulse as that debate is fresh in voters' minds.

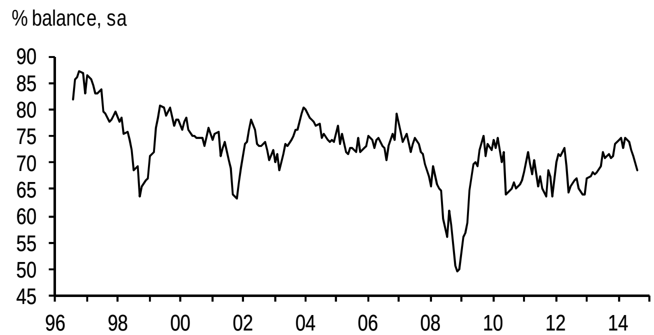
We have previously highlighted the bias toward the status quo when it comes to referenda on major constitutional reform. This bias could be more significant on September 18 than is evident in any of the polls on voting intentions we discuss. Our view is that, while the chances of a vote for independence have increased from the 20%-25% probability we expressed a few weeks ago, we do not think the probability is quite as high as some of the recent polls suggest. Polls can of course be misleading. But in the absence of other clear signs of trend, we await more survey results to get a clearer gauge of momentum in the run-up to the referendum.

Services PMI



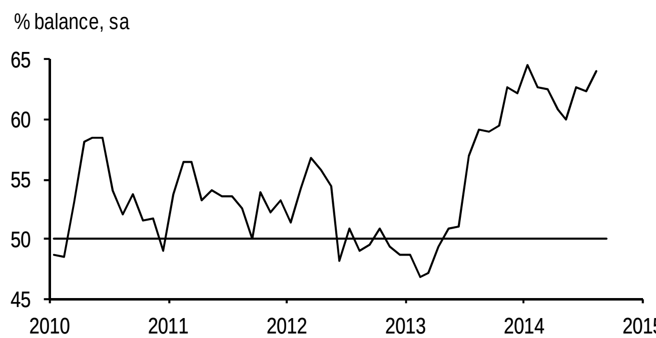
Source: Markit

Services PMI: business expectations



Source: Markit

PMI Construction total activity



Source: Markit

Immediate consequences of a "yes"

With opinion polls highlighting an increased risk of a vote for Scottish independence in the referendum in two weeks' time, we think it is worth sketching out some of the key issues that will arise in the immediate aftermath of a potential "yes" vote. To be clear, we continue to expect a "no" vote against independence, but the tightening in the polls reported last weekend has certainly shifted the odds on this call. Further polls likely will be published over the coming weekend, and it will be important to see whether the apparent shift in voting intentions is confirmed.

Reassurances and deposit flight

On the day after a "yes" vote we would expect immediate recognition of the result by the UK government in the form of a commitment to begin negotiations on the exact terms of the separation. We would expect two things to be made clear very quickly:

- An assurance that the basic functioning of UK government departments—together with taxation and spending budgets—would remain as they are at least until Parliament votes on specific proposals that suggest otherwise. This likely means a vote on the full package of measures that would implement independence. Crucially, we expect the BoE would issue prompt assurance that it would continue to provide lender of last resort facilities to all UK banks for as long as the United Kingdom exists in its current form, unless instructed otherwise by politicians.
- A statement that the process of negotiation of the terms of potential separation will take time. Holyrood has suggested independence could come into effect after 18 months. But we expect the rest of the UK authorities will not choose to prioritize meeting any specific deadline over completing the detailed and complex negotiations in a satisfactory way, while recognizing that uncertainty needs to be resolved as quickly as possible. Indeed it is possible that the rest of the UK side of the negotiations state that the terms of separation will need to be voted on not just in parliament, but in a referendum.

These assurances will help contain deposit flight and capital flows out of Scotland, given the unresolved issue of which currency Scotland would use—which would be a key source of uncertainty. In effect, the message would be that nothing is going to change precipitously. Over time, we believe it is likely that some Scottish-based financial institutions would choose to shift their headquarters south of the border to guard against the potential threat that redenomination might pose to their clients. It is plausible that such announcements could be brought forward if the magnitude of the shift in deposits/investors was large. As the negotiations on the terms of separation begin, we expect the rest of the UK to restate its position that Scotland should ultimately introduce its own currency as part of independence. But we would expect that position to be softened by recognizing that there may need to be a lengthy transition period before that occurs.

Economic effects and the BoE

Our strategists expect a significant (at least 4%) initial weakening in the pound, together with an initial increase (10-15bp) in 10-year bond yields as the immediate impact of a "yes" vote. And we anticipate at least modest outflows of liquid claims against Scottish-based financial institutions. A currency move following a "yes" vote would need to be large to have a material impact on inflation. As a very rough guide, a sustained 4% drop in the currency, for example, might raise year-ahead inflation by 0.2%.

The immediate impact on growth following a rise in Scotland-related uncertainty is hard to quantify. Although the possibility of a "yes" vote on Scottish independence has been known by firms and investors for some time, we doubt that many have planned for such an outcome as their modal view. And given the uncertainty about what the regime change would ultimately mean, the value of deferring capital spending and home purchases (which are hard to reverse) should rise. Given that impact, our bias would be to revise down our GDP forecasts for 4Q14 and 1Q15 by 0.5%-pt, ar (from 3% to 2.5%q/q, saar) in the immediate aftermath of a "yes" vote, while leaving the remainder of the forecast unchanged. Remember that our base view is also that the weaknesses in sentiment variables in the Euro area will become more contained as time passes.

Where would a weaker currency, higher uncertainty on the outlook, and a weaker near-term growth path leave the MPC? Our bias is to think these developments would push the start of BoE policy tightening back by a quarter, to 2Q15. Although the May 2015 inflation report meeting sees a decision announced on the Monday after the scheduled May 7 election, we do not see this as a big hindrance to a rate hike being announced at that point provided the likelihood of such action has been flagged in advance.

Fiscal policy

We would expect the government to broadly stick to the existing fiscal path in the Autumn Statement (December 3) and in the spring budget that follows next year. Under a Scottish "yes" vote, the rest of the UK's debt to GDP ratio would be set (although not initially) to rise by just under 10%. Even if Scotland agreed to take on part of this burden, this would likely take the form of a series of payment flows rather that carving up UK debt, which the UK government has already stated it intends to honor in full under any scenario. This would constrain the willingness of the government to offer material fiscal giveaways in the run-up to the next election, as it will have one eye on the larger debt ratio it will inherit following independence. Instead, a larger part of the battleground in the run-up to the next election is likely to be dominated by party views on how the negotiations with Scotland should be handled in the year that follows.

Future political landscape

A "yes" vote would also create at least two additional layers of political uncertainty. First, after next May's general election it is highly likely that a new election in the rest of the UK would need to be held after the eventual date of the

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Scottish independence. So the term of the post-May government might prove to be unusually short. Second, with the loss of Scottish MPs in the Westminster Parliament, and amid plausible changes in the leadership of the Conservative party, there would likely be a rightward shift in the political center of gravity of the rest of the UK. As we have written previously, we believe a Scottish "yes" vote would materially increase the likelihood of both (a) a referendum on EU membership, and (b) that referendum seeing a vote to leave the EU.

Data releases and forecasts

Week of September 1 - 5

Tue Sep 9 12:01am — BRC retail sales monitor

%oya

	May	Jun	Jul	Aug
Like-for-like sales	0.5	-0.8	-0.3	
Total	2.0	0.6	1.3	

Tue Sep 9 9:30am — Industrial production

Sa

	Apr	May	Jun	Jul
IP (%m/m)	0.3	-0.7	0.3	0.0
%oya	2.9	2.2	1.2	
Manufacturing (%m/m)	0.3	-1.4	0.4	0.3
%oya	4.3	3.7	1.9	

Tue Sep 9 9:30am — Trade balance

£ bn, seasonally adjusted

	Apr	May	Jun	Jul
Total balance (goods)	-8.8	-9.2	-9.4	
Trade balance (services)	6.8	6.8	7.0	
Total trade balance	-2.1	-2.4	-2.5	

Thu Sep 11 12:01am — RICS housing market survey

%bal, sa

	May	Jun	Jul	Aug
Prices in last 3 months	56.2	52.3	49.1	
Stocks of homes on books	59.0	61.2	60.0	
Sales in last 3 months	23.4	24.5	24.6	
Sales to stocks ratio (%)	39.6	40.1	41.0	
New buyer inquiries	10.9	6.9	-2.3	

Fri Sep 12 9:30am — Construction output

Sa, constant prices

	Apr	May	Jun	Jul
% m/m	1.7	-1.2	1.2	0.3

During the week — Halifax house price index

Sa

	May	Jun	Jul	Aug
%m/m	4.0	-0.4	1.4	
%oya	10.7	9.6	10.2	
%3m/3m saar	8.2	9.3	15.0	

Review of past week's data

Money supply

Sa

	May		Jun		Jul	
M4 ex. IOFCs (%m/m)	0.2		0.5			*0.2*
M4 ex. IOFCs (%3m/3m, ar)	~~2.7~~	*2.6*	~~4.6~~	*4.5*		*3.8*
M4 (%m/m)	-0.1		0.1			*0.3*
M4 (%oya)	~~-0.8~~	*-0.9*	~~-0.6~~	*-0.7*		*-1.0*
M4 lending (%m/m)[1]	0.3		0.0			*0.3*
M4 lending (%oya)[1]	-4.1		-3.8	*-3.7*		*-3.4*

1. Excludes the effect of securitization.

Net lending to individuals (BoE release)

£ bn, average

	May		Jun		Jul	
Consumer credit (ch, m/m)	~~0.7~~	*0.9*	~~0.4~~	*0.7*		*1.1*
Secured lending (ch, m/m)	2.3		~~2.1~~	*2.2*		*2.3*
Mortgage approvals (000s sa)	~~62.0~~	*61.9*	~~67.2~~	*67.1*	~~66.8~~	*66.6*

PMI survey, manufacturing

% balance, sa

	Jun		Jul		Aug	
Overall index	~~57.2~~	*56.7*	~~55.4~~	*54.8*	~~55.0~~	*52.5*

PMI survey, construction

% balance, sa

	Jun		Jul		Aug	
Overall index	62.6		62.4			*64.0*

PMI survey, services

% balance, sa

	Jun		Jul		Aug	
Overall index	57.7		59.1		~~58.5~~	*60.5*

New car registrations

%3m/12m nsa

	Jun		Jul		Aug	
Total	7.3		6.8			*6.8*
Private (ex bus&fleet)	5.1		6.5			*6.6*

MPC rate announcement and asset purchase target

No change in policy.

Markit report on jobs

% balance, sa

	Jun		Jul		Aug	
Perm. placements	61.3		64.9			*62.4*
Perm. salaries	66.2		66.0			*65.7*
Avail. of perm. staff	28.9		28.5			*29.5*

BoE/NOP Inflation attitudes survey

%oya, median expectations

	1Q14		2Q14		3Q14	
Inflation next 12 months	2.8		2.6			*2.8*

Source: Rightmove, CBI, BBA, BCC, GFK, BRC Markit, SMMT, RICS, ONS, BoE, and J.P. Morgan forecasts

Turkey

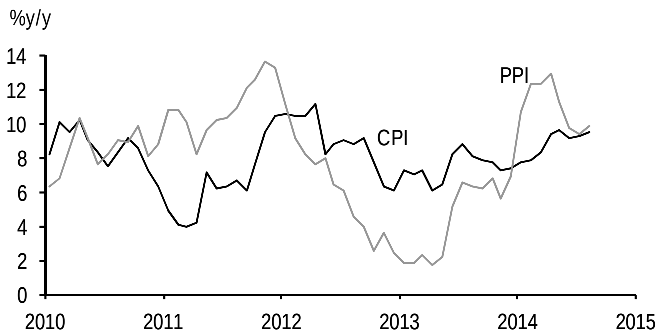
- **Yearly inflation comes closer to the 10% mark mainly on the back of higher unprocessed food prices**
- **Core inflation measures imply the impact of the FX pass-through is waning**
- **The CBRT sounds more worried by stubbornly high inflation and should remain on hold**

The August CPI data underscored once again that Turkey's agricultural supply problems, and the resulting food price inflation, pose a constant threat to the disinflation process. The headline CPI rose 0.09%m/m, nsa (J.P. Morgan: +0.04%; consensus: -0.10%) in August, largely on the back of higher unprocessed food prices. The annual inflation rate rose to 9.5% from 9.3% in July, reflecting unfavorable base effects. Although the inflation print was marginally higher than expected, it came as a relief in markets, because the unofficial ICC (Istanbul Chamber of Commerce) data released on Monday signaled the risk of a much higher figure.

A 0.9%m/m increase in food prices constituted the main factor behind the high CPI inflation print in August. In fact, annual food price inflation climbed to a four-year high of 14.4%oya. Especially worth noting is the continued increase in unprocessed food prices, including a 21%m/m increase in cucumber prices and an 18% jump in tomato prices, which together, pushed up headline inflation by 0.3%-pt. Supply constraints resulting from the severe drought and expectations of increased food exports to Russia drove the pickup in food price inflation, and we expect these factors to continue exerting upside pressure on headline CPI. In contrast to the broad-based inflationary pressures evident in the July data, the August data revealed some moderation in inflation in nonfood sectors. A 4.9% seasonal drop in clothing prices led the move, but price increases in other product categories were either equal to or below our forecast. Importantly, core inflation measures confirm that the passthrough from lira depreciation, which boosted inflation readings earlier this year, has started to wane. Although the annual core inflation rate (index I) at 9.7% remains close to its 9.77% May peak, we expect a steady decline in coming months, provided that the currency remains stable. However, headline inflation remains dangerously high, confirming the risk of further increases in inflation expectations, leaving the CBRT no room for complacency.

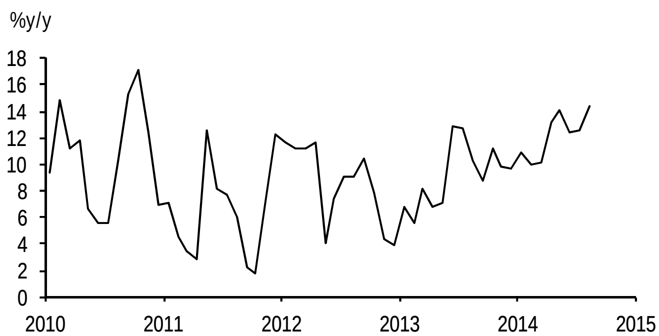
The Bank has sounded increasingly worried about food prices and, more importantly, about the risk of a general increase in prices. We think this was the main reason why the MPC kept the policy rate unchanged and adopted more cautious rhetoric at the August meeting. And the latest CPI data confirmed again that these concerns are real. Yearly inflation is likely to remain dangerously close to the 10% mark in the coming months. We expect yearly inflation to be stable in the 9.4%-9.6% range in the next three months and to decline thereafter to reach 9.0% in December. Hence, we expect the CBRT to keep up its relatively hawkish rhetoric and hold the policy rate unchanged. Just as the MPC did at the August meeting, the Bank could narrow its policy rate corridor by cutting the upper band (the ON lending rate) further, especially if Turkey attracts portfolio inflows. The Bank appears to believe that lower tail risks in the global economy warrant a more normalized policy framework and hence a more symmetric interest rate corridor.

Consumer and producer prices



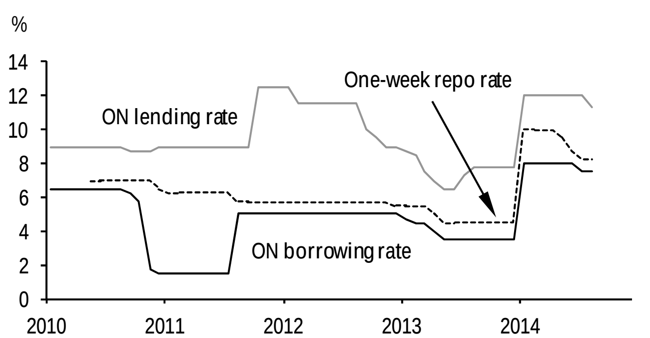
Source: Turkstat

Food prices



Source: Turkstat

CBRT rates



Source: CBRT

The Turkey data watch is published biweekly, next on September 19.

Data releases and forecasts

Weeks of September 8 – 19

Mon
Sep 8
10:00am

Industrial production

%oya

	Apr	May	Jun	Jul
Total	4.5	1.5	1.9	1.0
Manufacturing	4.0	0.8	1.5	1.2
Mining	9.6	8.7	-2.3	-2.3
Energy and utilities	5.8	5.4	2.6	0.3

The fall in IP growth mainly reflects fewer business days arising from the religious holidays in July. The resilience in exports likely prevented a lower growth figure.

Wed
Sep 10
10:00am

Gross domestic product

%oya, real terms

	3Q13	4Q13	1Q14	2Q14
GDP	4.3	4.4	4.3	2.5
Agriculture	2.8	0.9	3.9	2.0
Manufacturing	4.9	4.9	4.9	1.8
Construction	8.6	6.2	5.2	4.7
Commerce	5.4	6.2	3.0	0.0
Transportation comms.	3.3	4.4	2.9	1.1
Financial services	11.0	12.7	13.9	7.5

Geopolitical problems (especially in Iraq) and the general weakness in global demand have dragged on export momentum. In contrast, domestic demand is recovering on the drop in bank lending rates. Hence, the risks are balanced on our 2014 GDP growth forecast of 3.0%.

Thu
Sep 11
10:00am

Balance of payments

US$ bn

	Apr	May	Jun	Jul
Current account	-4.9	-3.5	-4.1	-2.4
Trade balance	-5.6	-5.5	-6.2	-4.9
Exports	14.4	14.8	13.9	14.2
Imports	20.0	20.3	20.1	19.1
Net invisibles/transfers	0.7	2.0	2.1	2.5
Capital account	8.7	4.7	6.9	2.5
Overall balance	2.7	1.9	1.5	0.7

Exports remain strong as Turkish exporters switch their focus from the Middle East to Europe. The seasonal increase in tourism revenues likely led the expected decline in the CAD in July. Capital inflows likely covered the external financing needs comfortably.

Mon
Sep 15
10:00am

Labor market data

	Mar	Apr	May	Jun
Unemployment (%)	9.7	9.0	8.8	8.7
Nonfarm payrolls (%oya)	4.6	3.0	2.2	2.4
Labor participation (%)	49.9	50.7	51.2	51.5

In seasonally adjusted terms, the unemployment rate has stabilized around 9.5%. Low labor participation reflects the slack in the labor market.

Review of past two weeks' data

Capacity utilization

%

	Jun	Jul	Aug	
Total manufacturing	75.3	74.9	~~75.0~~	*74.7*
Durables	76.1	72.9	~~73.5~~	*72.4*
Nondurables	73.5	73.9	~~73.2~~	*72.6*

Low capacity usage rates support our view that growth remains below potential. This also shows that the supply constraints have a limited role in inflation.

CBRT rate decision

%

	Jun	Jul	Aug	
CBRT 1-week repo rate	8.75	8.25	8.25	
CBRT ON borrowing rate	8.00	7.50	7.50	
CBRT ON lending rate	12.00	12.00	~~12.00~~	*11.25*

See main text.

Consumer confidence

Index

	Jun	Jul	Aug	
Consumer confidence	73.7	73.9	~~73.5~~	*73.2*
Financial situation - current	86.1	86.6	~~86.0~~	*86.4*
Financial situation - future	90.9	91.1	~~90.5~~	*91.7*
Economic setting	95.1	96.5	~~95.5~~	*99.4*
Employment	81.2	81.1	~~81.0~~	*77.7*

Worries over global growth prospects along with the uncertainty regarding the presidential elections at home should be the main reasons for the weakening in confidence.

Foreign trade

US$ bn, except as noted

	May	Jun	Jul	
Trade balance	-7.2	-7.9	~~-7.6~~	*-6.5*
Exports	13.7	12.9	~~12.6~~	*13.4*
%oya	3.3	4.1	~~-3.6~~	*2.6*
Imports	20.9	20.8	~~20.2~~	*19.9*
%oya	-10.2	-1.1	~~-12.0~~	*-13.5*

The foreign trade deficit was significantly lower than expected as strength in exports to the EU in July compensated for the sharp drop in exports to Iraq.

Inflation

% change

	Jun	Jul	Aug	
Consumer prices				
%oya	9.2	9.3	~~9.4~~	*9.5*
%m/m	0.3	0.5	~~0.0~~	*0.1*
Producer prices				
%oya	9.8	9.5	~~9.8~~	*9.9*
%m/m	0.1	0.7	0.4	
Core CPI (I)				
%oya	9.7	9.8	~~9.5~~	*9.7*
%m/m	0.3	0.3	~~-0.2~~	*-0.1*

See main text.

Source: Turkstat, CBRT, Ministry of Finance, J.P. Morgan forecasts

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Australia and New Zealand

- **Australian economy grew below potential in 2Q; minimal signs of interest rate transmission**
- **While Governor Stevens indicates monetary policy is constrained from providing more support**
- **August labor force report important in re-setting benchmarks**
- **New Zealand 2Q terms of trade not yet showing dairy pain, but the RBNZ's forecasts will**

Australia's 2Q national accounts data were not as soft as feared, with inventories saving the day. The economy expanded 0.5%q/q, with net exports retreating after a boomy 1Q. Still, the parts of the economy that should be benefiting most from low interest rates generally underperformed. Moving to more contemporary data, retail sales rose moderately in July, and are climbing gradually out of the Federal Budget-induced sentiment hole, while exports firmed, but with the trade balance still deep in deficit following a nose-dive in commodity prices.

The RBA left the cash rate steady on Tuesday, extending the period of policy stasis to over a year. Later in the week, Governor Stevens indicated that he sees housing market strength as constraining the RBA from providing more support for demand and employment. On this front, RBA officials have been skeptical that the recently recorded 6.4% unemployment rate is a true reflection of labor market conditions. As a result, this week's update will be important in re-calibrating views on slack in the economy. Were the 6.4% level to stick, the housing impediment would appear less of an issue.

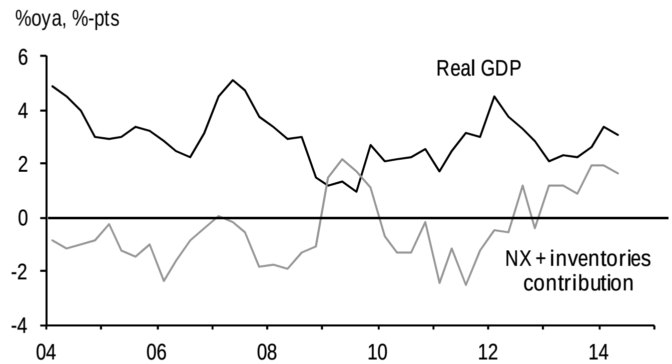
In New Zealand, the 2Q terms of trade did not reflect the weakness in spot prices for dairy products, the nation's number one export, evident since February. However, another steep decline in dairy auction prices during the week reminds us that this is likely just a matter of time. With dairy volumes growing strongly, any stress in the farm sector is most likely to show up in consumption, rather than real exports. This week's retail card spending numbers for August will be important to watch here. In next week's RBNZ Monetary Policy Statement (MPS), we expect the first rate pause in four decisions, while the Bank's bill rate projections are likely to be pulled lower.

Another lackluster GDP report

The anticipated retrenchment after the robust growth in Australia's economy in the first quarter was realized in the June-quarter National Accounts release. The economy grew only 0.5%q/q last quarter, less than half the rate of expansion in 1Q, and the weakest quarterly gain in over a year. Moreover, most of the growth in 2Q came from a buildup of inventories in mining, a handy lift for growth last quarter, but a drag on future output. The rotation away from mining investment to other sources of growth remains a work in progress, with consumer spending and ex-housing private investment subdued.

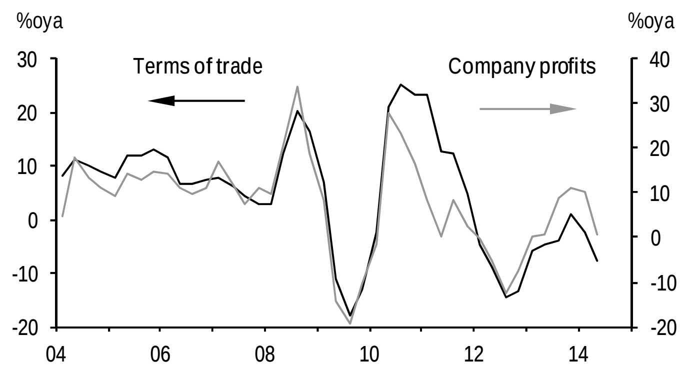
Moreover, the income side of the economy remains very weak, owing mainly to the falling terms of trade. In fact, nominal gross national income was flat in 2Q, albeit after a solid 1Q. The weakness in the income measure of GDP has been a recurring theme of recent reports—the nominal side of the economy soared with the high and rising terms of trade, during the commodities boom, but now is being compressed as commodity prices fall. At present, the terms of trade drag is being absorbed mostly by company profits (second chart), though spillovers to labor income will continue over time, as weak profitability depresses hiring.

Australia: real GDP and NX+inventories contribution to growth



Source: ABS

Australia: company profits and the terms of trade



Source: ABS

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Governor Stevens faces trade-offs

By comparison to the Governor's speech delivered later in the week, the September rate decision was a non-event. The RBA left the cash rate steady at 2.5%, where it has stood since August 2013. There was some rearrangement of language in the post-meeting statement, but the tone was essentially unchanged from recent meetings, save for some beefing up of the currency language: AUD was described as "overvalued," a somewhat bolder term than the previous "high by historical standards."

Later in the week, Governor Glenn Stevens delivered a more revealing speech, asserting that monetary policy had done enough, and asking local firms to take more risk, again calling for the return of "animal spirits." After tolerating house price inflation as a mechanism to boost housing construction, the RBA now sees rising house prices as a constraint on further easing, with Stevens stating that "Inflating an already elevated level of house prices seems an unwise route" to achieve a faster fall in the unemployment rate. We think house price inflation is likely to moderate (first chart), but until this is clear in the data, the hurdle for rate cuts will be high.

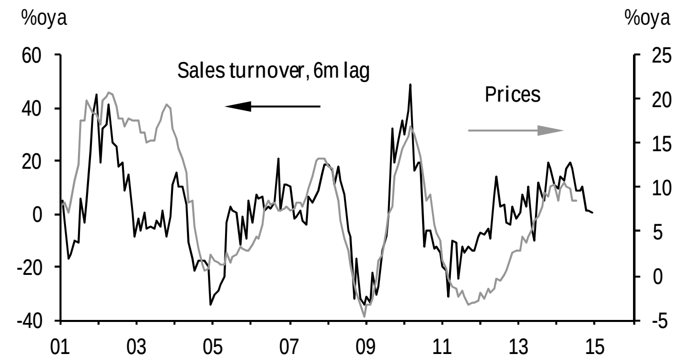
Labor survey: will we get mean reversion?

Presumably, part of the Governor's reluctance to respond to the rise in the unemployment rate is his suspicion that the data are noisy. In the July Labor Force Survey, the participation rate jumped while the employment to population ratio fell; the jobless rate spiked three-tenths to a 12-year high of 6.4%. There were two statistical factors that led the RBA to downplay the July report, acknowledging this week only that the "recorded" unemployment rate has risen (the actual unemployment rate being uncertain by implication).

The first distortion was a change to the survey methodology regarding the classification of job-seeking behavior. These definition changes cut both ways for measured participation, and shouldn't in principle have had an influence—the ABS actually stated there was "no evidence" of "a significant impact on the estimates." But we think the new definitions might have interacted with recently announced changes in government policy. In particular, tougher eligibility criteria for unemployment benefits might have induced a rush to register job-seeking activity, which would have boosted the measured unemployment and participation rates.

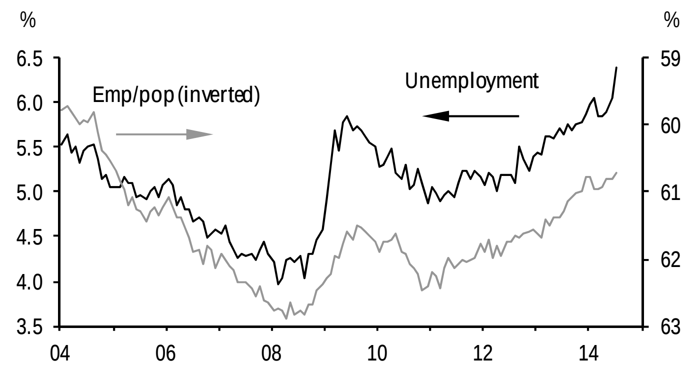
The second statistical effect was a garden-variety sample rotation effect, where the ABS noted the difference in sample characteristics of the newly survey group accounted for around one-third of the rise in the unemployment rate. To the extent that either of the above effects was influential, they look like "level" shifts to us. The survey methodology is staying, and the new survey participants will be with us for months. We don't believe much has changed fundamentally in the labor market: GDP growth is still below trend and vacancies are not rising fast enough to absorb labor force growth. But we nevertheless assume a slight pullback in participation from last month's spike, to allow for some unwind of prior noise. With jobs growth of 10,000 positions, this would pull the unemployment rate down to a still-elevated 6.3%.

Australia: dwelling sales turnover and house prices



Source: RP Data

Australia: employment to population ratio and unemployment rate



Source: ABS

Current account slides back to normal

After the 1Q balance of payments report saw Australia's CAD/GDP ratio narrow sharply to a 34-year low, the June-quarter report realigned it with the levels we expect to prevail over the next few years. The current account deficit expanded from a (revised) A$7.8 billion to A$13.7 billion, and from 1.9% of GDP to 3.4% on a four quarter basis.

Both falling export prices and weak volumes hit export revenues. The terms of trade decline is structural, in our view, but the negative net trade contribution to GDP (-0.9%-pt against our expectation of -0.7%-pt) cuts against the trend—we expect net trade to be the largest contributor to growth over the next few years. The turnaround in the real net trade contribution in 2Q was payback for a 1Q exports surge, when an unusually benign cyclone season boosted gas exports in seasonally adjusted terms.

More low-yielding foreign liabilities

The income balance continued to narrow in 2Q14, from a deficit of 2.6% of GDP in 1Q to 2.2%q/q. Falling primary income debits fell A$1.1 billion (5%) in 2Q due to lower income payments on FDI equity liabilities, likely a result of the reduced income accruing to the majority foreign-owned mining sector—mirroring the terms of trade-induced decline in the trade balance and profits. On the financial/capital account side, portfolio investment was the biggest mover in 2Q, recording a net inflow of A$10.0 billion, an increase of A$6.1 billion on the 1Q net inflow. Most of the inflow landed in debt securities (A$18.9 billion), up A$11.3 billion on the March quarter.

NZ terms of trade stable

New Zealand's terms of trade were surprisingly stable in the June quarter. A 2%q/q decline in export prices was more than offset by a 2.3%q/q fall in import prices, leaving the terms of trade index up 0.3%q/q. The surprise was that implied export prices in USD terms were flat, given the decline in prices for key agricultural exports, in particular, dairy products. Dairy price weakness was only partially reflected, with this group down 4.3%q/q in the June quarter, while spot prices for dairy are down over 40%. As we wrote in a research note last week, unit prices in NZD terms are already down 19%-26% as recorded in Stats NZ's own monthly trade data. So the relative stability in the terms of trade in 2Q appears very much a timing issue.

RBNZ to deliver a partial re-think

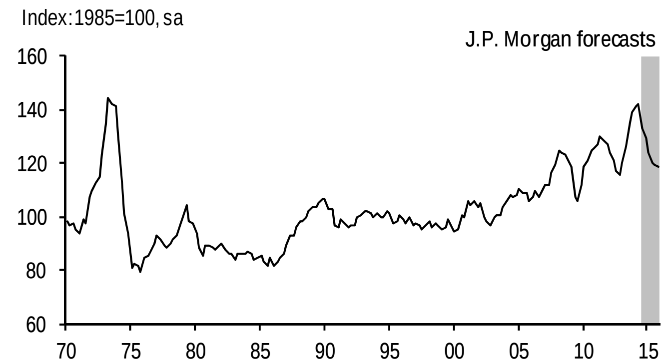
In the RBNZ's July decision, Governor Wheeler flagged the likelihood of a rate pause, to allow "a period of assessment." We therefore expect no change to the OCR at next week's decision, for the first time in four meetings. The pause is well-telegraphed, so the focus will be on the RBNZ's projections, with the broad weakness in nominal indicators (terms of trade, inflation, inflation expectations) testing the view embedded in the staff's June forecasts. The bill rate path is the one most in need of a refresh, in our view. Migration strength is not generating the inflation impulse the staff expected, housing market activity is moderating under LVR restrictions, and dairy prices are dragging on nominal GDP, all arguing for fewer rate hikes.

In June the projections showed the 90-day bill rate peaking at 5.3%. This terminal rate forecast looks rich relative to market expectations; the forwards imply less than half of the projected tightening. But we suspect the RBNZ will be reluctant to fully "meet the market," given its desire to keep intermediate swap rates elevated, and to prop up fixed mortgage rates. Even if officials suspect they will under-deliver on the rate track, the forecasts should only slowly evolve to that view, so we expect at most 50bp to be pulled out of the rate projections. To the extent that this looks like less of a capitulation than the market expects, unwarranted currency appreciation can be averted by the Bank's continued use of aggressive FX intervention grammar in the statement, and weaker TWI projections.

The growth and inflation forecasts present a bit of a conundrum. As a tracking exercise, real GDP growth looks rock solid. And the growth supports from reconstruction and real exports remain in place. Any downgrades would then have to be predicated on spillovers from lower terms of trade. For inflation, the TWI projections should fall, which is supportive. At the same time, we believe the staff will be reluctant to jettison their 4.5% estimate for the post-crisis neutral rate. This means that a lower bill track, if delivered, mostly represents an easing of conditions, also supporting the inflation forecasts.

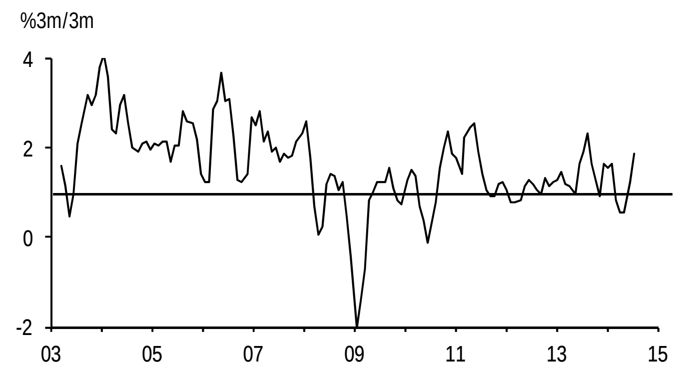
Perhaps the easiest thing for the RBNZ to do is to leave growth and inflation alone, but pull the rates and TWI paths lower. This would be consistent with the fact that the Bank's main surprise has been on the inter-temporal effects of migration.

New Zealand: terms of trade



Source: NZ Stats, J.P. Morgan

New Zealand: retail card transactions



Source: NZ Stats

The Bank previously viewed migration as adding to inflation before it added to potential growth, but if the potential growth impulse is front-loaded, both rates and the currency can be lower today for the same growth and inflation outlook.

NZ card spending restrained by hikes

Retail card spending in New Zealand has been flat over the last two months. In the July report, core spending was admittedly stronger than that, with fuel a major drag. Still, on our modeling the 100bp of rate hikes delivered by the RBNZ between March and July roughly offset impact of accelerating immigration, which argues for only a slight increase in card spending of 0.3%m/m in August.

In terms of risks, the decline in dairy prices is shaping up as an important, if hard-to-calibrate sentiment drag. On the plus side, though, consumers have shown restraint this year relative to strong house price and headline income growth, meaning there could be some pent-up demand to be unleashed. That is particularly so given the RBNZ's stated intention to leave policy on hold for a while—we expect until December, which would be close to six months in between tightenings in an environment of above-trend growth.

Australia

Data releases and forecasts

Week of September 8 – 12

Tue Sep 9 11:30am — Housing finance

	Apr	May	Jun	Jul
%m/m	0.0	-0.1	0.2	0.0

Tue Sep 9 11:30am — NAB business confidence

	May	Jun	Jul	Aug
Index	7.0	8.0	11.0	11.0

Wed Sep 10 10:30am — Westpac-MI consumer confidence

	Jun	Jul	Aug	Sep
%m/m	0.2	1.9	3.8	1.0

Thu Sep 11 11:30am — Labor force survey

	May	Jun	Jul	Aug
Unemployment rate (%)	5.9	6.1	6.4	6.3
Employment (ch. 000s)	-5.0	15.0	0.3	10.0
Participation rate (%)	64.6	64.7	64.8	64.7

Review of prior week's data

Inventories

	4Q13	1Q14		2Q14	
%q/q	-0.6	-1.7		~~0.0~~	*0.8*

Company profits

	4Q13	1Q14		2Q14	
%q/q	2.5	~~3.0~~	*-2.0*	~~-3.0~~	*-6.9*

Net exports of GDP

	4Q13	1Q14		2Q14	
%-pts	0.4	1.4		~~-0.7~~	*-0.9*

Building approvals

	May	Jun		Jul
%m/m	10.3	~~-5.0~~	*-3.8*	2.5

RBA official cash rate announcement

	Jul	Aug	Sep
%	2.5	2.5	2.5

Real GDP

	4Q13	1Q14	2Q14	
%m/m	0.8	1.1	~~0.3~~	*0.5*

Retail sales

	May	Jun	Jul	
%m/m	-0.3	0.6	~~0.6~~	*0.4*

New Zealand

Data releases and forecasts

Week of September 8 – 12

Tue Sep 9 8:45am — Retail card sales

	May	Jun	Jul	Aug
%m/m	1.5	0.0	0.0	0.3

Thu Sep 12 2:30pm — RBNZ cash rate announcement

	Apr	Jun	Jul	Sep
%	3.0	3.25	3.5	3.5

Review of prior week's data

Terms of trade

	4Q13	1Q14	2Q14	
%q/q	2.5	1.8	~~-6.3~~	*0.3*

Source: ABS, NAB, RBA, Westpac, RBNZ, Stats NZ, J.P. Morgan forecasts

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Greater China

- **China: August NBS manufacturing PMI eased to 51.1**
- **Taiwan: August manufacturing PMI rose again to 56.1, the highest level since early 2011**
- **Taiwan's August CPI up 2.07%oya on food- and housing-related components; input costs eased**

Looking through the monthly volatility, the Chinese economy appears to be sustaining stable growth momentum through 3Q (first chart). Although China's August manufacturing PMI, compiled by the NBS and the China Federation of Logistics and Purchasing, eased to 51.1 from to 51.7 in July, the decline followed five consecutive monthly rises and the August reading remains the second highest this year (second chart). Meanwhile, the final reading for the August Markit manufacturing PMI was 50.2, compared to 51.7 in July.

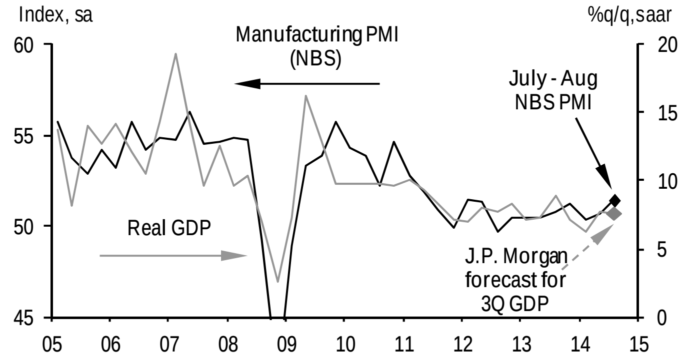
Economic and policy outlook

The easing in both the NBS and Markit manufacturing PMIs for August followed July's notably weak credit data and weaker-than-expected domestic fixed investment growth. The NBS report ascribed the easing in the PMI to weaker demand and business operations, which was reinforced by the decline in the orders to inventory ratio (third chart). By sector, PMI readings for higher-end manufacturing industries, including universal equipment manufacturing, special purpose equipment, and communication, computer, and other electronic equipment have generally outperformed overall PMI readings this year. On the other hand, PMI readings for those sectors suffering overcapacity problems have underperformed consistently. For instance, the steel industry PMI has remained below the 50-threshold most of the year, falling 0.2pt to 48.4 in August.

Overall, the sharp swings in manufacturing PMIs in recent months appear to reflect volatility in economic and credit data, as well as shifts in market expectations about further policy easing. Smoothing out the monthly volatility, the NBS PMI in July-August averaged 51.4, compared to the average monthly level of 50.7 in 2Q; similarly, the Markit PMI in July-August averaged 51.0, compared to the 49.4 monthly average level in 2Q. Thus, it appears that China's remains on a stable growth path through 3Q and we keep our 3Q GDP forecast at 7.6%q/q, saar, vs. 7.7% in 2Q. Our full-year 2014 GDP growth forecast stands at 7.3%oya, slightly below the government's full-year target of 7.5%.

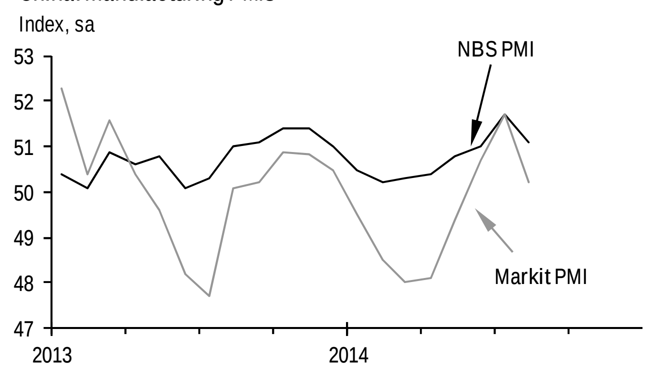
We expect the export sector, which would benefit from the anticipated acceleration in advanced economies and the lagged impact of CNY depreciation, to lead 2H14 growth.

China: GDP growth vs. NBS PMI



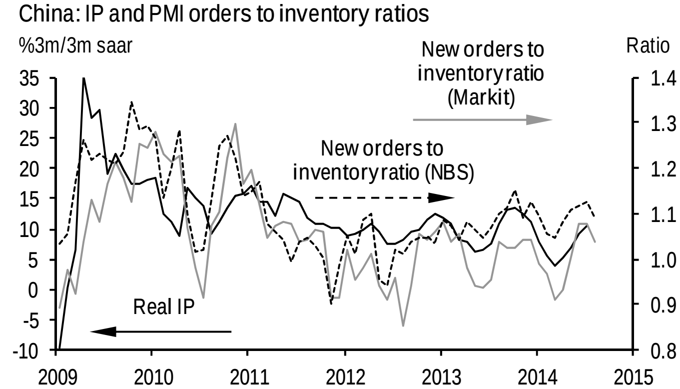
Source: NBS, Markit

China: manufacturing PMIs



Source: NBS, J.P. Morgan forecast

China: IP and PMI orders to inventory ratios



Source: NBS, J.P. Morgan

Targeted support in certain domestic sectors, including, infrastructure and affordable housing, will continue. Investment spending in manufacturing and real estate remain the major drag on growth. But, the recent easing in home purchase restrictions at the local level and declining mortgage rates first-home buyers, reflecting moral suasion by the PBoC should help to slow the downtrend in the housing market. Meanwhile, if the gradual improvement in industrial sales and profit since 2Q is sustained in 2H, along with the recovery of industrial sector, this well help stabilize manufacturing FAI growth, which had fallen off sharply since 3Q13.

Overall, our forecast for 2H14 has been relatively cautious compared to the consensus view. One key factor is that we expect no further policy easing. On the fiscal policy side, recent front-loading of fiscal spending implies tighter fiscal policy in the future: fiscal spending rose 15.0%oya in the first seven months of the year, much more than the 9.5% growth budgeted for the full year. As a result, the accumulated fiscal surplus stood at 788.9 billion yuan at end of July, lower than 1137 billion yuan at the same time last year (first chart). Tighter restrictions on local government debt limit local governments' ability to raise funds from banks and non-bank sources, while land sale revenues tend to fall amid housing market corrections, constraining their ability to support economic activity.

The central bank reiterated its neutral monetary policy stance, and we expected policy rates will stay unchanged and credit growth will remain stable in 2H14. Monetary policy is aimed at improving monetary transmission via two channels. One is to ensure that credit directly supports economic activity, by tightening rules on shadow banking activity to reduce regulatory arbitrage between banks and non-banks and with targeted quantitative measures including pledged supplementary lending (PSL), re-lending, and targeted RRR cuts. The other is to lower funding costs for business borrowers, by removing hidden charges in bank lending, shortening the credit chain, and developing alternative financing channels, including, among other measures, direct financing and more diversified financial institutions.

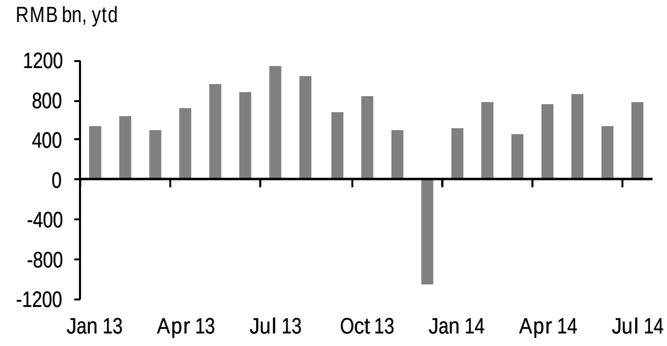
Taiwan: manufacturing PMI rose further

Taiwan's headline manufacturing PMI rose to 56.1 in August from a 55.8 reading in July 55.8 (second chart), the fourth consecutive monthly increase to the highest level since April 2011. The continued rise in the PMI suggests that businesses remain constructive on the near-term aggregate demand outlook, which is consistent with the J.P. Morgan outlook for sustained above-trend growth in the global economy.

The output component fell a modest 1.2pts to 57.7—still the second highest level since January this year. The forward-looking demand indicators including new orders and new export orders both remained high, comparable to early 2011 levels. Meanwhile, the stock of finished goods component fell 2.1pts to 50.6. With the rise in new orders and decline in inventory, the new orders to inventory ratio, a leading indicator of production, rose to 1.17 in August, compared to 1.11 in July (third chart).

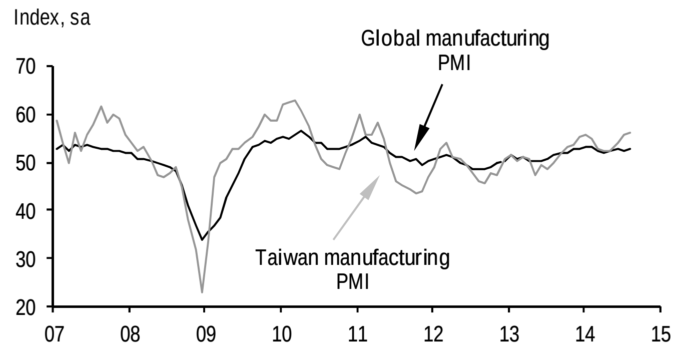
J.P. Morgan forecasts a solid pickup in global GDP growth to an above-trend 3%-plus pace beginning this quarter, led by DM economies, and expects EM growth to pick up in 2H, led by China policy support and spillovers from stronger DM growth. We thus look for solid growth in Taiwan's exports and industrial activity in 2H14. The strength in Taiwan's latest PMI readings, with the headline figures and the key demand indicators returning to the highest levels since early 2011, is consistent with our constructive outlook for Taiwan's manufacturing sector. However, our outlook is vulnerable to external uncertainty. Indeed, our global team now believes the risk bias to the 2H14 global growth forecast has shifted to the downside, particular in the Euro area where our European team recently trimmed their 2H14 growth forecast by 0.5% to 1.25%.

China: fiscal surplus



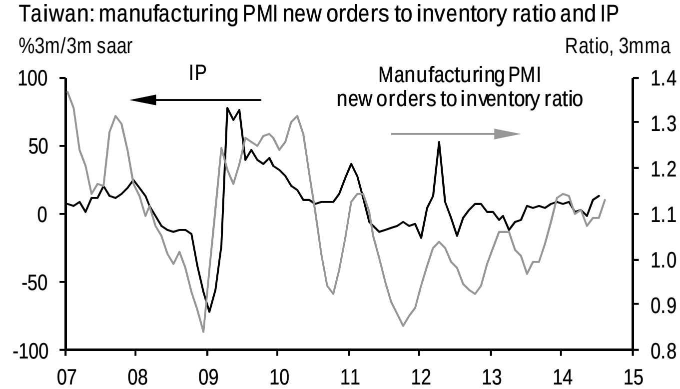
Source: MOF, CEIC

Global and Taiwan manufacturing PMI



Source: Markit, J.P. Morgan

Taiwan: manufacturing PMI new orders to inventory ratio and IP



Source: Markit, MOEA, J.P. Morgan

In all, we expect the Taiwan economy to register solid growth in 2H14, with sequential growth averaging 4.1%q/q, saar. Our forecast for Taiwan's full-year 2014 GDP growth remains at 3.8%oya.

August CPI higher than expected

Taiwan's August headline CPI rose more than expected at 2.07%oya, or 0.3%m/m in seasonally adjusted terms (first chart), led by price increases for food as well as housing (particularly its subcomponent of water, electricity and gas), which together contributed 1.87%-pts to year-over-year headline inflation (vs. +1.45%-pts in July). Poor weather and festival-related demand increases may have boosted food prices. Meanwhile, core CPI (overall CPI excluding fruits, vegetables, fish and energy) rose 1.67%oya (and 0.16%m/m, sa) in August. Service prices rose 1.53%oya in the month (0.14%m/m, sa).

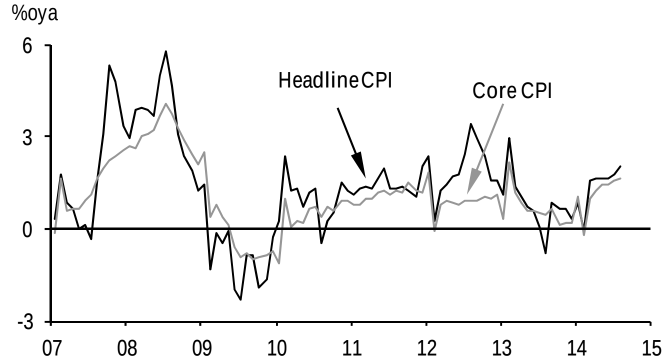
Regarding input cost pressures, in sequential terms, WPI declined in %m/m sa terms for the first time since April. Import prices in local currency terms dropped 2.0%m/m, sa in August, after staying unchanged in July. The August WPI and import prices paint a mixed picture of easing prices of oil and natural gas, chemical products, and electronic components, while the prices of agricultural products rose during the month. In addition, TWD depreciated modestly in August (down 0.08%m/m against USD), after four straight months of appreciation that may have helped to ease imported price pressures.

Given the higher-than-expected August inflation reading, we fine-tuned our forecast for Taiwan's 2014 inflation rate to average a moderate 1.5%oya (vs. our previous 1.4%oya projection), compared to 0.8%oya in 2013, echoing the modest increase in world inflation we expect as global growth picks up.

During their latest quarterly monetary policy meeting in July, the Taiwan central bank Board members raised their concerns about near-term food prices, as well as the recent geopolitical-related rise in oil prices.

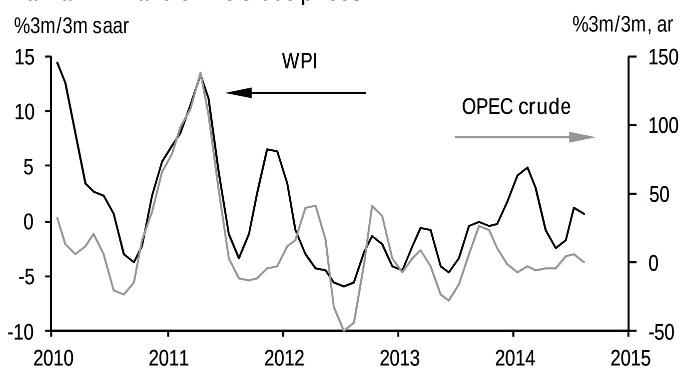
Our baseline scenario looks for the Bank to begin raising major policy rates modestly by 12.5bp in March 2015. However, considering the solid improvement in recent macro data and the constructive 2H14 growth picture, we do not rule out the possibility of an earlier move, say by December this year; and the inflation figures in coming months will be a key determining factor.

Taiwan: headline and core CPI



Source: DGBAS

Taiwan: WPI and OPEC crude prices



China:
Data releases and forecasts

Week of September 8 – 12

		May	Jun	Jul	Aug
Mon Sep 8	**Merchandise trade** US$ bn				
	Balance	35.9	31.6	47.3	47.6
	Exports	195.5	186.8	212.9	214.6
	%oya	7.0	7.2	14.5	12.7
	Imports	159.6	155.2	165.6	167.1
	%oya	-1.6	5.6	-1.5	2.9
Sep 10–15	**Monetary aggregates** %oya, bn yuan	May	Jun	Jul	Aug
	M2	13.4	14.7	13.5	13.3
	New loan creation	870.8	1080.0	385.2	635.5
Thu Sep 11 9:30am	**Consumer prices** % change	May	Jun	Jul	Aug
	%oya	2.5	2.3	2.3	2.3
	%m/m, sa	0.7	0.2	0.2	0.2

Source: Taiwan Ministry of Economic Affairs, DGBAS, J.P. Morgan forecasts

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Thu
Sep 11
9:30am

Producer prices
% oya

	May	Jun	Jul	Aug
Producer (NBS)	-1.4	-1.1	-0.9	-1.1
Producer (PBoC)	0.2	0.2	0.2	-0.1

Sat
Sep 13
1:30pm

Fixed investment
% change

	May	Jun	Jul	Aug
%oya	17.0	17.6	15.7	15.9
%oya, ytd	17.2	17.3	17.0	16.8

Sat
Sep 13
1:30pm

Industrial production
%

	May	Jun	Jul	Aug
%oya	8.8	9.2	9.0	8.7
%m/m, sa	0.9	1.0	0.9	0.8

Sat
Sep 13
1:30pm

Retail sales
% change

	May	Jun	Jul	Aug
%oya	12.5	12.4	12.2	12.4
%m/m, sa	1.6	1.3	1.1	1.2

Review of past week's data

Purchasing managers index (Sep 1)
Index

	Jun	Jul	Aug	
Overall (Markit)	50.7	51.7	~~50.3~~	*50.2*
Output	51.8	52.8	—	*51.8*
Overall (NBS)	51.0	51.7	~~51.2~~	*51.1*
Output	53.0	54.2	—	*53.2*

Source: NBS, Markit, J.P. Morgan forecasts

Hong Kong:
Data releases and forecasts

Week of September 8 - 12

No data releases.

Review of past week's data

No data released.

Source: Hong Kong Census and Statistics Department, J.P. Morgan forecasts

Taiwan:
Data releases and forecasts

Week of September 8 - 12

Tue
Sep 9
4:00pm

Merchandise trade
US$ bn

	May	Jun	Jul	Aug
Balance	5.3	1.9	2.6	3.8
Exports	26.7	26.8	26.8	26.8
%oya	1.4	1.2	5.8	4.5
Imports	21.4	24.9	24.2	23.0
%oya	-2.3	7.5	9.5	9.4

Review of past week's data

Markit manufacturing PMI (Sep 1)
Index, sa

	Jun	Jul	Aug	
Overall	54.0	55.8	~~54.3~~	*56.1*
Output	56.0	58.9	—	*57.7*

Consumer prices (Sep 5)
% change

	Jun	Jul	Aug	
%oya	1.6	1.8	~~1.8~~	*2.1*
%m/m, sa	0.1	0.1	~~0.1~~	*0.3*

Source: Taiwan Ministry of Economic Affairs, DGBAS, J.P. Morgan forecasts

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South Korea

- **Customs exports up in August, accompanied by relatively upbeat message from manufacturing PMI**
- **Cost-push price pressures ease**
- **BoK to stay pat next week, likely to maintain easing bias**

Both customs exports and manufacturing PMI moved up in August, supporting our forecast that real GDP growth would recover in 3Q. Meanwhile, consumer inflation only edged up in the month, with cost-push factors easing amid few signs of demand-pull pressures. The Bank of Korea is scheduled to hold an MPC meeting on September 12; we expect it to stay on hold, while keeping an easing bias.

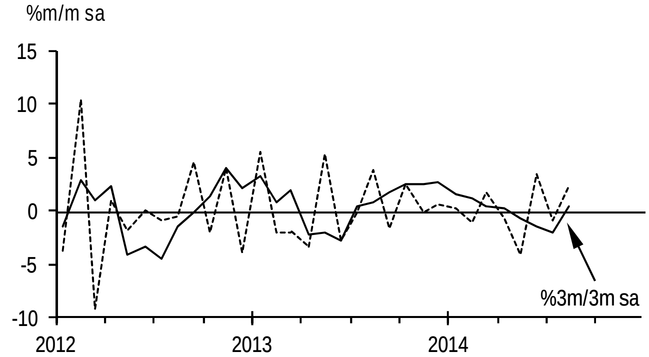
Customs exports rebounded in August

Customs exports edged down 0.1%oya in August, after surging 5.4% in July. The over-year-ago growth comparison is heavily distorted by calendar and base effects; J.P. Morgan's seasonally adjusted data shows that customs exports bounced 2.3%m/m, sa in August, after falling 0.9% in July. But, it remains difficult to gauge underlying exports strength due to several erratic factors. First, the August exports gain was helped by vessels, which tend to have a volatile monthly delivery schedule. Excluding vessels, exports grew a modest 0.8%m/m, sa in August, following a 0.6% rise in July. Second, August exports likely were inflated by a pre-lunar holiday effect, with exporters front-loading shipments ahead of the earlier-than-usual Full Moon Festival (September 7-10). In contrast, an unfavorable August production schedule and labor strikes likely curbed exports of automobiles and components. The strikes should be followed by positive payback in either September or October. Against this backdrop, it is encouraging that the sequential exports gain, excluding vessels and vehicles, rebounded 2.2%3m/3m, saar in August, after having fallen at an accelerating pace for three straight months.

Manufacturing PMI moved up

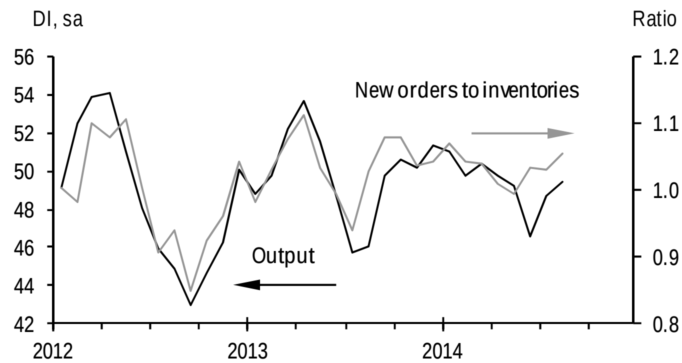
The Markit manufacturing PMI rose for the second straight month in August, reaching 50.3 for its first move into expansionary territory in four months. The details have also been more upbeat than local business surveys. The forward-looking new orders rose firmly by 2.4pts to 51.6, likely led more by domestic orders than exports. Finished goods inventories rose as well, but less than the orders gain, and thus the ratio of new orders to inventories rose to the highest level in four months, signaling further gains in the output index in the months ahead. The output index also moved up for the second month although it remained below the expansion threshold level.

Customs exports



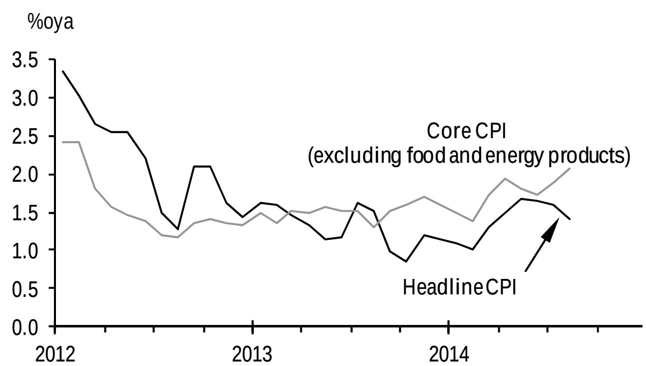
Source: MoTIE, KITA, and J.P. Morgan

Manufacturing PMI



Source: Markit and J.P. Morgan

Consumer prices



Source: NSO

Consumer prices only edged up in August

Consumer price inflation eased to 1.4%oya in August from 1.6% in July. In J.P. Morgan's seasonally adjusted data, consumer prices rose only 0.1%m/m, sa in August, the same pace as the previous three months. Agricultural product prices fell 0.1% in the month, with price hikes for the lunar holiday-limited to a few product categories. Oil and energy product prices declined for the second month running. Partially offsetting the decline, industrial goods prices rose 0.3% in August, likely due to the lagged impact of global oil price increases and temporarily renewed KRW weakness. We do not expect pipeline price pressures to rise anytime soon, with cost-push factors, such as the trade-weighted KRW, global energy prices, and food prices, having eased somewhat, amid few signs of demand-pull pressures. As a result, we revised down our forecast for full-year 2014 consumer price inflation from 1.7%y/y to 1.5% (consensus: 1.8%; BoK: 1.9%).

Data releases and forecasts

Week of September 8-12

Thu
Sep 11
12:00pm

Monetary aggregates
%oya, monthly average

	Apr	May	Jun	Jul
M2	5.5	6.0	6.1	6.2
Lf	6.2	6.6	6.7	6.8

Fri
Sep 12
8:00am

Unemployment rate
% of labor force

	May	Jun	Jul	Aug
Seasonally adjusted	3.7	3.6	3.4	3.3
Not seasonally adjusted	3.6	3.5	3.4	3.2

The jobless rate likely dropped in August with both the labor force and employment up modestly.

Review of past week's data

Customs trade (Sep 1)
US$ bn nsa

	Jun	Jul	Aug	
Trade balance	5.5	2.4	~~2.1~~	*3.4*
Exports	47.9	48.3	~~45.8~~	*46.3*
Imports	42.4	45.9	~~43.7~~	*42.8*

Seasonally adjusted, the customs trade surplus rose to US$3.0 billion in August from US$2.0 billion in July. Exports rebounded 2.3%m/m, sa, while imports rose a mild 0.4%, but marking the third monthly rise in a row. The over-year-ago comparison was heavily influenced by base and calendar effects, with exports edging down 0.1%oya, while imports rose 3.1%. Also see main story.

Purchasing Managers Index (Sep 1)
Index, sa

	Jun	Jul	Aug	
PMI - Manufacturing	48.4	49.3	~~49.3~~	*50.3*

See main story.

Consumer prices (Sep 2)
% change

	Jun	Jul	Aug	
%oya	1.7	1.6	~~1.7~~	*1.4*
%m/m, sa	0.1	0.1	~~0.3~~	*0.1*

Consumer prices rose 0.2%m/m, nsa in August, following a 0.1% rise in July. In J.P. Morgan's seasonal adjustment, consumer prices edged up 0.1%m/m, sa in August. Also see main story.

Real GDP 2nd estimate (Sep 4)
% change

	1Q14	1st2Q	2nd2Q	
%q/q, saar	3.8	2.4	~~2.4~~	*2.0*
%oya	3.9	3.6	~~3.6~~	*3.5*

Most final demand components were trimmed, while inventories declined less than in the first report. By industry, manufacturing, services, and construction activity was downgraded, while agricultural output was revised up. The slower pace of inventory reduction has negative implications for 3Q GDP, but we are inclined to maintain our forecast that real GDP growth will accelerate to 4.7%q/q, saar in 3Q, with July IP and August exports up smartly. Yet, the downward revision of 2Q GDP ahs still pulled down our full-year 2014 GDP forecast from 3.7% to 3.6%.

BoK watch

According to the August MPC minutes, Moon Woo-sik delivered the lone dissent in the August rate cut decision; Moon has been considered the representative hawk since registering a minority vote against the 25bp easing last May. Governor Lee did not vote, with the opinion already in favor of a 25bp move. Out of five members who voted for a 25bp cut, one preferred a 20bp move, mainly to leave room for further rate action (as the nominal policy rate approaches the historical low of 2.0%). Based on the debates detailed in the MPC minutes, four out of seven members appear open to further easing, with three indicating future action would be data-dependent. Two members, including Governor Lee, delivered no meaningful hints of their preference for future rate action.

Interest rates
% p.a.

	Aug 14	Aug 22	Aug 29	Sept 4
Overnight call	2.24	2.23	2.24	2.25
3-month CD fixing	2.46	2.41	2.40	2.35
1-year MSB	2.376	2.384	2.354	2.365
3-year Treasury bond	2.538	2.584	2.511	2.540
3-year corporate bond AA-	2.929	2.956	2.884	2.905

Deposit changes at deposit money banks
KRW tn

	May	June	July	Aug
Total deposits	15.8	11.9	-6.5	7.4
Demand	4.0	7.7	-7.9	4.8
Time and savings	11.8	4.2	1.4	2.6

Source: BoK, KITA, Markit, MoTIE, NSO, and J.P. Morgan forecasts.

ASEAN

- **Indonesian data reflect seasonal noise, capex cycle could slow further on soft commodity prices**
- **Capital inflows remain strong—Bank Indonesia expected to lean against the wind**
- **Hike in subsidized energy prices looming with IDR1,500/liter hike expected this quarter**

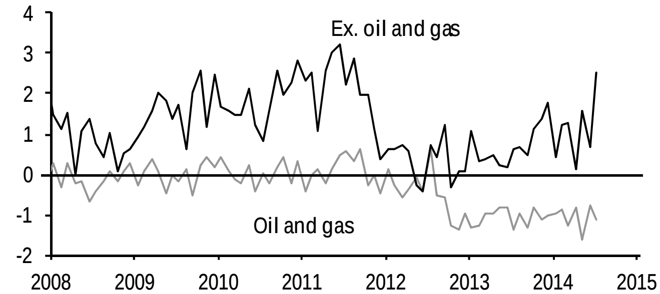
Despite seasonal noise in the July/August data, Indonesia's broader macro narrative appears little changed. Import compression continues, reflecting soft domestic fixed investment, which could continue to ease given the recent downdraft in prices of key commodities, including coal and crude palm oil. The risk is that exports may tread water, thus leaving the heavy lifting of adjustment to import compression (see "Indonesia's external balance: running to just stand still," *GDW*, August 9). This implies that policy likely will continue to facilitate external adjustment via a weaker currency, with J.P. Morgan expecting the USD/IDR FX rate to reach 11,900 by year-end, and via measures to curtail external borrowing.

Clouding the inflation outlook, the incoming administration plans to hike subsidized energy prices IDR1,500/liter a year to create fiscal space for infrastructure spending; J.P. Morgan expects the hike to come at the end of October or in early November. Positively, it appears that the 2014 budget has set aside around IDR5 trillion for the direct cash assistance program (BLT; *Bantuan Langsung Tunai*) in the event of a fuel price hike. This scheme has in the past helped offset the impact of price hikes on lower-income households and could reduce the concomitant social costs.

July trade surplus: Import compression likely continued

Indonesia's seasonally adjusted July trade balance was US$1.4 billion, with the non-oil and gas (NOG) balance reaching a surplus of US$2.5 billion, while the oil and gas deficit reached US$1.1 billion (first chart). The surge in the NOG balance was led by a fall in imports (second chart), likely due in part to seasonal factors and also possibly to election-related uncertainty. With Ramadan occurring unusually early this year (July), there is likely to have been some frontloading of goods imports ahead of the fasting month, and the data will likely be quite choppy in August, as well, given that the post-Eid festivities likely carried through to early August. The presidential elections, which may have led to some postponement of imports, could exacerbate this choppiness this year. There is thus an off-chance that imports may have risen firmly in August.

Indonesia: trade balance
US$ bn, sa, FOB-CIF terms

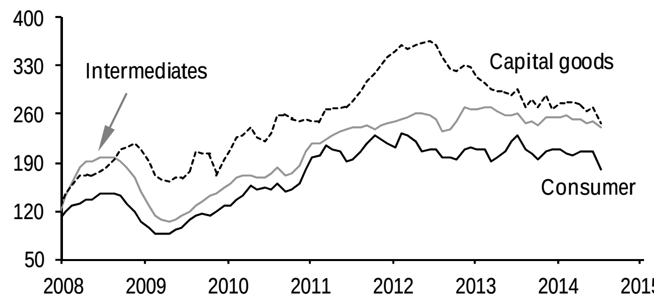


Source: BPS

Indonesia: non-oil and gas trade
US$bn, sa, FOB-CIF terms

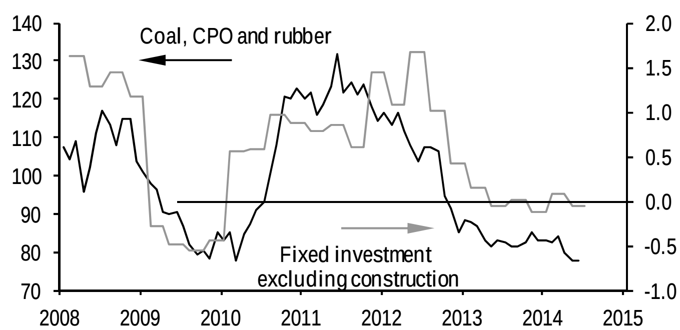
Source: BPS

Indonesia: import composition
Index 2007=100, 2mma, sa, US$ terms



Source: BPS

Indonesia: commodity prices and non-construction fixed investment
Index, 2010=100, 3mma, nsa
%pt. contribution to oya GDP growth



Source: BPS and Bloomberg

The less affected post-Lebaran data will likely be available only in September. More broadly, capital and consumer goods imports have remained soft, and we expect the softness in capital goods demand to continue (third chart previous page). Moreover, with the recent decline in coal and crude palm oil (CPO) prices, which reached around US$650/MT (down 29% from the 2014 high), the commodity-related capex cycle could turn down even further (fourth chart previous page).

Capital flows firm, policy bias remains

Despite the ostensible slowing in growth, inflows into local fixed income have surged, rising to a cumulative IDR110 trillion in August, well above previous years' run rates, and have also lifted net FX reserves to US$87.9 billion in July from US$74 billion at the end of last year, despite the current account deficit (first chart). Given the dependence on portfolio inflows, policy remains focused on steering the current account deficit toward a more sustainable level. In this context, the policy stance likely will seek to limit currency strength, recognizing that changes in IDR are a key driver of investment decisions. Thus, J.P. Morgan expects the currency to weaken further to facilitate further real adjustment via relative import/export prices (second chart).

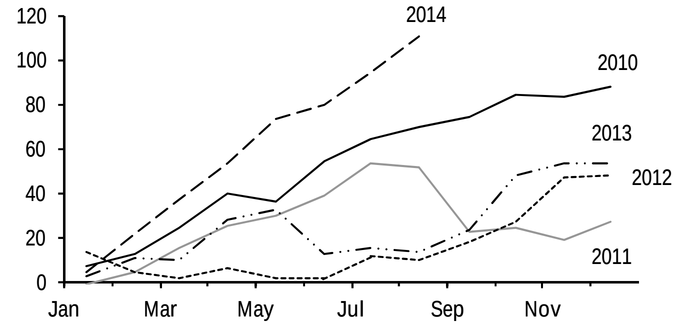
Inflation benign—watching for subsidized price hike during 4Q14

Indonesia's August CPI rose 0.1%m/m, sa, leaving it up 4.0%oya. Leading the CPI gain were increases in education costs (contributing 0.12%-pt to the overall rise) due to the August start of the school year, and utility costs (0.18%-pt), due to the hike in utility tariffs; together they added 0.3%-pt to the overall 0.47%m/m, nsa rise. Notably, the government tightened restrictions on the use of subsidized fuels, especially diesel, in early August, subsequently easing them late in the month; its current run rate suggests that the 46mn kl quota for subsidized fuels will be reached in late November.

At this juncture, an IDR3,000 liter hike would be needed to close the gap with global prices (third chart). J.P. Morgan is penciling in an IDR1,500/liter (23% rise) hike in subsidized automotive diesel and RON88 motor gasoline prices in late October/early November, which could lift headline inflation by 1.3-1.5%-pts when implemented and lift inflation to 5.8-6.3%oya by 4Q14 (fourth chart). Despite the anticipated hike, we do not expect the central bank to raise rates and add insult to injury, given the contractionary impact of the price hike on domestic demand. It is also not clear whether the hike in subsidized energy prices will narrow the oil and gas deficit materially, especially after the recent drop in real exports of oil and gas (see "Indonesia: figuring the macro signals from trade flows," *GDW*, June 7, 2013).

Indonesia: foreign inflows into local bonds

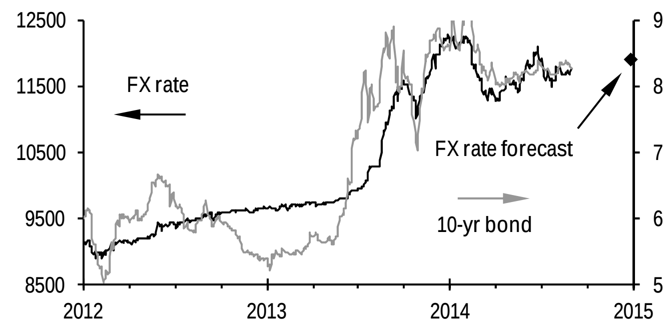
IDR tn, cumulative



Source: BI

Indonesia: FX rate and 10-yr bond yield

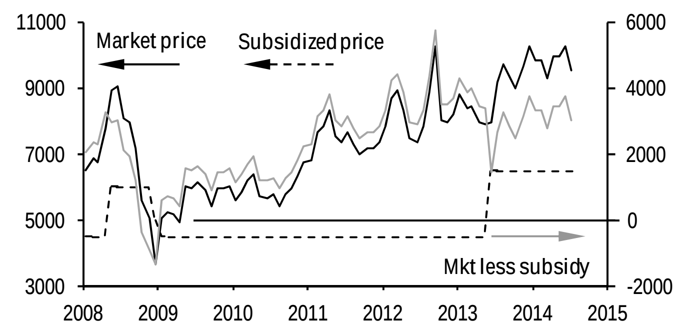
IDR/US$ %p.a.



Source: Bloomberg and J.P. Morgan

Indonesia: subsidized motor gasoline prices

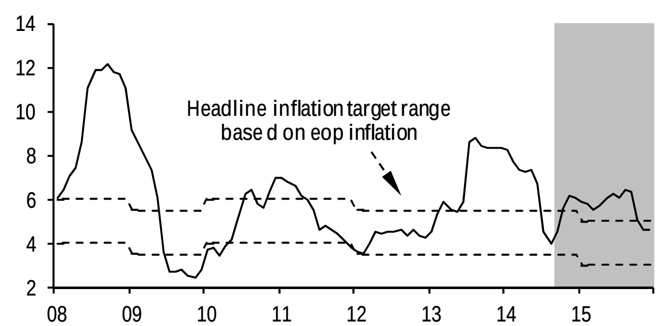
IDR/liter, both scales



Source: BPS and EIA

Indonesia: headline inflation

%oya



Source: BPS, BI and J.P. Morgan

ASEAN

Indonesia:

Data releases and forecasts

Week of September 8 - 12

Thu
Sep 11

BI monetary policy meeting
% pa

	Jun	Jul	Aug	Sep
BI rate	7.50	7.50	7.50	7.50

Review of past week's data

Consumer prices (Sep 1)
% change

	Jun	Jul	Aug	
All items, %oya	6.7	4.5	~~3.7~~	*4.0*
%m/m, sa	0.1	0.5	~~-0.1~~	*0.1*
Food, %oya	6.9	3.2	___	*-0.3*
Nonfood, %oya	6.6	5.0	___	*4.7*

See main story.

Merchandise trade (Sep 1)
US$ bn, nsa

	May	Jun	Jul	
Trade balance	0.1	-0.3	~~0.0~~	*0.1*
Exports, %oya	-8.1	4.5	~~-10.5~~	*-6.0*
Imports, %oya	-11.4	0.5	~~-22.2~~	*-19.3*

See main story.

Malaysia:

Data releases and forecasts

Week of September 8 - 12

Thu
Sep 11
12:00pm

Industrial production
% change

	Apr	May	Jun	Jul
Total, %oya	4.7	5.9	6.9	5.2
%m/m, sa	2.8	1.0	1.2	0.2

Review of past week's data

Merchandise trade (Sep 5)
US$ bn, nsa

	May	Jun	Jul	
Trade balance	1.7	1.2	~~0.7~~	*1.1*
Exports, %oya	8.3	5.4	~~3.8~~	*0.9*
Imports, %oya	4.5	6.8	~~5.2~~	*-0.4*

The export data were mixed in July. Overall, exports rose 0.1%m/m, sa, led by electronics, while non-electronics exports fell 0.2%m/m, sa. Despite the sequential rise, tech exports were down 7.6%3m/3m, saar. Nonetheless, idiosyncratic factors could have affected the Malaysian electronics sector amid what appears to be a broadening of the global lift to EM from DM, especially with the firmer July trade data from the region and July/August global manufacturing PMIs. This lift should percolate to Malaysia over the course of this quarter.

Capital goods imports in July dropped 13.6%m/m, sa, though this could reflect some seasonal noise around Hari Raya Aidul Fitri, rather than a shift in trend. We expect investment outlays to rise in 2H14, significantly increasing demand for imported goods. This is a key factor behind our forecast for a continued narrowing in the trade surplus (see "ASEAN," *GDW*, August 22).

Philippines:

Data releases and forecasts

Week of September 8 - 12

Wed
Sep 10
9:00am

Merchandise trade
US$ bn, nsa

	Apr	May	Jun	Jul
Exports	4.6	5.5	5.4	5.9
%oya	1.3	6.9	21.3	21.8

Thu
Sep 11

BSP monetary policy meeting
% pa

	Jun	Jul	Aug	Sep
Reverse repo rate	3.50	3.75	3.75	4.0

With domestic demand growth likely to recover in 2H14 and beyond and food inflation likely to remain elevated, the risk is that the central bank could hike its O/N RRP rate by another 25bp, to 4.00%.We expect that inflation expectations are more likely conditioned by food prices, which are observed daily by the average Filipino consumer, than other prices. Indeed, if food prices rise further, which is the extant risk given supply issues, then this could affect inflation-setting behavior more broadly, and the BSP would likely be keen to anchor these expectations.

Review of past week's data

Consumer prices (Sep 5)
% change

	Jun	Jul	Aug	
All items, %oya	4.4	4.9	~~5.0~~	*4.9*
%m/m, sa	0.3	0.6	~~0.3~~	*0.3*

Food prices stood out, rising 0.5%m/m, sa while alcoholic beverage prices were up 1.0%. Otherwise, price increases were pretty tame, ranging between -0.1% and +0.4%.

Within food, rice continues to be the main driver. Food contributed 3.2%-pts to the 4.9%oya CPI rate (utilities added another 0.6%-pt), with rice alone contributing 1.2%-pts. Also notable of late has been the recent rise in meat prices, which may reflect supply bottlenecks at the ports. Thus, it appears that local dynamics in the Philippines, given lower regional rice prices, have driven prices up, and the hope is that rice imports, which are expected in September, could put downward pressure on rice prices soon.

Source: Central Bureau of Statistics, Indonesia; Department of Statistics, Malaysia; National Statistical Coordination Board and National Statistics Office, Philippines; J.P. Morgan forecasts

Singapore:
Data releases and forecasts

Week of September 8 - 12

No data releases.

Review of past week's data

Purchasing managers index (Sep 2)
Index

	Jun	Jul	Aug	
PMI	50.5	51.5	~~52.0~~	*49.7*
PMI—electronics	50.7	52.4	~~51.0~~	*50.2*

While the weakness was fairly broad-based, the overall inventory-to-new orders ratio improved in August, showing signs that the inventory buildup in previous months is being digested. The August PMI reading for Singapore more or less reflects the mixed PMI readings in the region in August, after strong survey numbers in July. Looking through the monthly volatility, in the coming months, we expect the pickup in the tech cycle to benefit Singapore's manufacturing sector and look to external demand to provide a lift in the remainder of the year.

Thailand:
Data releases and forecasts

Week of September 8 - 12

No data releases.

Review of past week's data

Consumer prices (Sep 1)
% change

	Jun	Jul	Aug	
All items, %oya	2.4	2.2	~~2.3~~	*2.1*
%m/m, sa	0.0	0.1	~~0.1~~	*0.0*

Thai consumer prices remained flat in August for the third consecutive month, leaving headline inflation softer than expected, at 2.1%oya. While we expect inflation to pick up modestly in the second half of the year as domestic demand continues to recover, the August inflation print reinforces our view that inflation will be contained comfortably in BoT's target range of 0.5-3.0%. We do not expect inflationary pressures in 2H14 to trigger a monetary policy response from the BoT, as price controls on energy and key consumer goods should keep inflation benign for the remainder of the year. We are forecasting BoT's first 25bp rate hike in 1Q15.

Vietnam:
Data releases and forecasts

Week of September 8 - 12

No data releases.

Review of past week's data

No data released.

Source: Singapore Department of Statistics; Office for Industrial Economics, Thailand; Bank of Thailand; General Statistics Office of Vietnam; J.P. Morgan forecasts

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India

- **CAD mean reverted to 1.7% of GDP on both cyclical and seasonal factors, as expected**
- **Non-oil, non-gold imports rose sequentially, consistent with firming growth in 2Q**
- **Despite widening CAD, BoP registers a robust surplus on strong capital inflows**
- **August manufacturing PMI activity and price indicators pause for breath**

CAD widens on seasonal and cyclical factors

As expected, India's current account deficit (CAD) widened to 1.7% of GDP in 2Q14 from 0.3% in 1Q, on a combination of seasonal and cyclical factors. Exports declined in 2Q, contributing to the widening, but the drop was largely seasonal. On a seasonally adjusted basis, exports rose 3.7%q/q, sa in 2Q, after a 3.8% drop in 1Q14. However, non-oil, non-gold imports, spurred by firming growth, was the main driver of the widening in the current account deficit, rising a strong 5.6%q/q, sa in 2Q after slipping 2.2% in 1Q. Gold imports also rose to US$7 billion from US$5.3 billion; the relaxation in May of the definition of entities eligible to import gold contributed marginally to the widening.

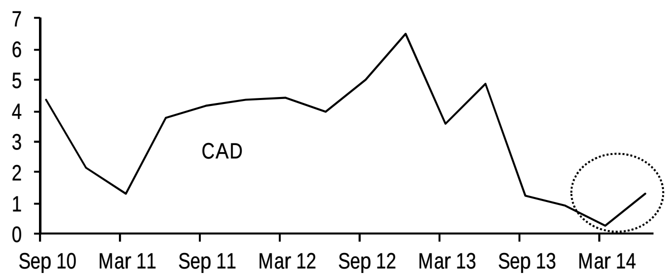
The only negative in the CAD data was services exports, which fell 4.8%q/q, sa in 2Q compared to 4.4% growth in 1Q. On the whole, the 2Q CAD, despite widening to 1.7% of GDP, is not a cause of concern, in our view, as the increase was largely due to seasonality and the cyclical upturn in the economy. Moreover, the deficit remains far below historical norms (first chart). We expect the widening trend to continue, leading to a 2.3% of GDP print in FY15 as the recovery gains momentum, but we see the risks to this forecast to the downside, reflecting falling oil and commodity prices.

Reversal of worrying capital account trend

Despite the widening current account, the balance of payments (BoP) registered a robust surplus on back of the strong capital inflows. Capital inflows rose to US$19.8 billion (4.2% of GDP), which resulted in a US$11.2 billion accretion in reserves. The strong flows resulted from hope kindled by the May elections. Of particular interest were net FDI flows, which rose to US$8.2 billion as outbound FDI declined sharply. As economic reforms progress in India, we would like to see FDI inflows increase and outbound FDI wane, especially in light of the FDI reforms carried out by the new government. More generally the non-portfolio component of capital flows registered inflows after registering outflows in

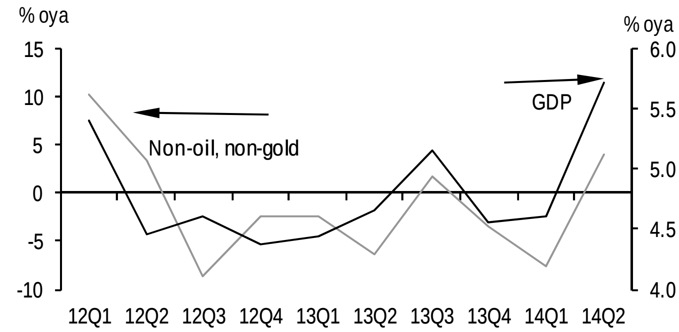
India: current account deficit

As % of GDP



Source: RBI

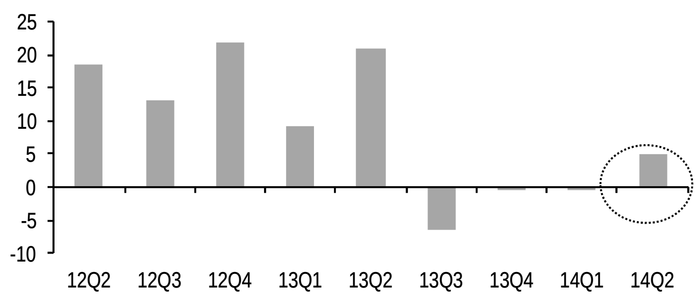
India: GDP and non-oil, non-gold imports



Source: RBI, MOSPI

India: capital flows ex. portfolio flows ex. FCNR scheme

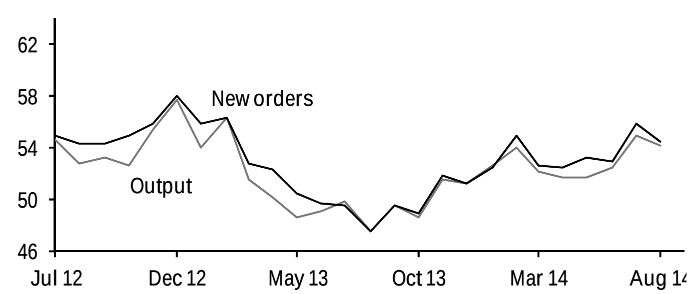
US$ bn



Source: RBI

India: manufacturing new exports and output

Index



Source: Markit

the last three quarters. Specifically, short-term trade credit turned positive in 2Q after outflows in previous three quarters.

PMI manufacturing output and prices take a breather

After surging to a 17-month high in July, the manufacturing PMI took a breather in August. The output index had jumped 2.5pts to 54.9 in July, and reversed some of the gain in August, retreating to 54.1. Despite this disappointment, the average manufacturing output index in July and August, at 54.5, is meaningfully higher than the 51.9 average in 2Q, which bodes well for manufacturing production in the 3Q GDP print. This outcome should come as a relief because, despite all the excitement about 2Q GDP accelerating to 5.7% oya and manufacturing growth rising to 3.5% oya, the sequential momentum in manufacturing output actually softened to 0.9%q/q, saar in 2Q from 3.6% in 1Q. This slowdown mirrors the manufacturing output index declining to 51.9 in 2Q from 52.9. The fact that it has bounced back in 3Q bolsters our view that a modest, cyclical recovery is underway.

Similarly, the new orders index—which had jumped almost 3pts to 55.9 in July—retreated to 54.5 in August. At the same time, stocks of finished goods rose to 51 from 50.5. Consequently, the orders-to-inventory ratio fell sharply compared to July, but remains higher than the average of the first six months in 2014. But there was also some good news on both the orders and price fronts. First, new export orders, after retreating in July, inched up to 54.5 from 54.3. Export orders have now advanced in six of the last eight months, suggesting that the export-induced IP acceleration witnessed in recent months should continue. Input prices had surged almost 4pts to 59.6 in July. However, the price index retreated 1.8pts in August, likely reflecting the softening of oil and global commodities prices last month, though it is still elevated at 57.9. Output prices edged down further in August (to 50.4 from 50.7) for the second successive month, which bodes well for core manufacturing prices in the August inflation report.

Data releases and forecasts

Sep 8-12

Merchandise trade
US$ bn, nsa

	May	June	July	Aug
Trade balance	-11.2	-11.7	-12.2	-10.7
Exports	28.0	26.5	27.7	-
%oya	12.4	10.2	7.3	-
Imports	39.2	38.2	40.0	-
%oya	-11.4	8.3	4.3	-
Oil	14.5	13.3	14.3	-
Gold	2.6	3.3	1.9	
Non-oil	20.9	22.5	23.4	-

Fri
Sep 12
5:30pm

Industrial production
% oya

	Apr	May	June	July
Overall	3.4	5.0	3.4	2.3
%m/m, sa	1.7	0.4	-1.3	-
Manufacturing	1.1	0.7	-2.3	-
Mining	-0.2	-0.7	1.5	-
Electricity	6.7	-1.3	3.8	-

Fri
Sep 12
5:30pm

Consumer prices
% oya

	May	June	July	A
Overall	8.3	7.5	8.0	8.0
Core	7.9	7.5	7.4	___

Review of past week's data

BoP—current account balance (Sep 1)
US$ bn

	3Q13	4Q13	1Q13	2Q14
Current account balance	-5.2	-4.1	-1.3	-7.9

Manufacturing PMI Survey (Sep 1)
Index, sa

	May	June	July	Aug
Index	51.4	51.5	53.0	52.4

Service PMI Survey (Sep 3)
Index, sa

	May	June	July	Aug
Index	50.2	54.4	52.2	50.6

Source: Central Statistical Organization and Ministry of Commerce, Government of India; Markit; Reserve Bank of India, and J.P. Morgan forecast

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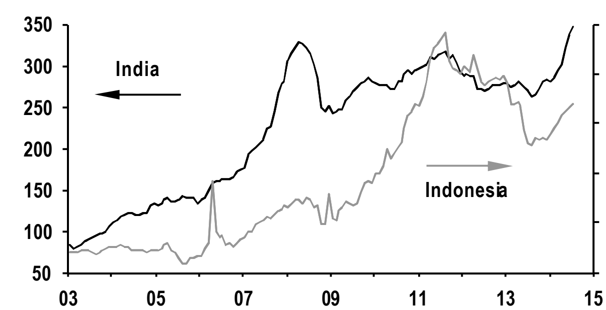
Asia focus: A mixed picture of FX reserves accumulation

Trends in FX reserves accumulation in Asia this year have been mixed, with strong increases in India, Korea, and Indonesia (chart at right and table), and decreases on balance in the ASEAN region and Japan. In **India**, the correction in the current account balance into a smaller deficit, twinned with capital inflows, has strengthened the overall balance of payments. In **Indonesia**, although we do not expect the current account to narrow significantly from 2013, portfolio inflows have been unusually strong this year. Both countries' central banks have been intervening to prevent currency appreciation. In **Korea**, the current account surplus continues to dominate the balance of payments and is unlikely to shrink anytime soon we believe. In the rest of ASEAN, despite current account surpluses, FX reserves have been stable to lower (second chart below), likely due to the impact of capital account flows, which in the past year have been more volatile and larger than the current account surpluses. Separately, it is not clear to what extent low domestic interest rates have led to deposit disintermediation, reflected in capital outflows (see "Asia focus, trends in interest bearing and demand deposits," *GDW*, August 15).

India and Indonesia: net FX reserves

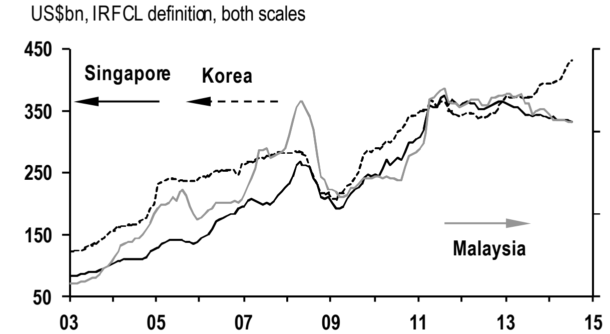
US$bn, IRFCL definition, both scales



Source: BI and RBI

Korea, Malaysia and Singapore: net FX reserves

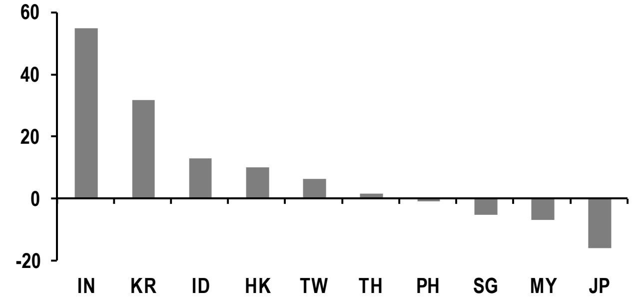
US$bn, IRFCL definition, both scales



Source: BOK, BNM and MAS

Asia: net FX reserves

US$bn , change from 4Q13 to latest;TW gross FX reserves



Source: Central Banks except Japan, MOF.

Asia: international reserves and FX liquidity position

US$ bn, eop

	4Q13	Jan	Feb	Mar	Apr	May	Jun	Jul
China: gross	3821	3867	3914	3948	3979	3984	3993	n/a
Taiwan: gross	417	417	418	419	421	422	423	424
Japan	1324	1328	1313	1295	1303	1296	1308	1312
1. Gross	1267	1277	1288	1279	1283	1284	1284	1276
2. Net FX flows	0	0	0	0	0	0	0	0
3. Net FX FWDs	33	31	29	30	30	30	30	30
Korea	394	395	396	397	402	414	425	430
1. Gross	346	348	352	354	356	361	367	368
2. Net FX flows	-3	-3	-3	-3	-1	-1	-1	-1
3. Net FX FWDs	50	49	47	46	47	55	60	64
India	283	281	285	295	301	323	338	347
1. Gross	294	291	294	304	311	312	316	320
2. Net FX flows	-4	-4	-4	-4	-4	-4	-4	-4
3. Net FX FWDs	-7	-6	-5	-5	-6	15	26	31
Singapore	341	338	340	334	336	334	336	331
1. Gross	273	272	274	273	275	276	278	274
2. Net FX flows	0	0	0	0	0	0	0	0
3. Net FX FWDs	68	66	66	61	60	58	58	58
Hong Kong	310	311	315	316	316	319	320	n/a
1. Gross	311	312	316	317	318	320	321	n/a
2. Net FX flows	-1	-1	-1	-1	-1	-1	-1	n/a
3. Net FX FWDs	0	0	0	0	0	0	0	n/a
Thailand	190	189	192	191	192	191	192	n/a
1. Gross	167	167	168	167	169	168	168	n/a
2. Net FX flows	0	0	0	0	0	0	0	n/a
3. Net FX FWDs	23	22	24	24	24	24	24	n/a
Malaysia	138	135	132	131	131	132	131	131
1. Gross	135	133	131	130	131	131	132	132
2. Net FX flows	0	0	0	0	0	0	-2	-2
3. Net FX FWDs	3	2	2	2	0	1	0	0
Indonesia	73	76	78	81	83	85	86	88
1. Gross	99	101	103	103	106	107	108	111
2. Net FX flows	-16	-16	-16	-14	-14	-14	-13	-13
3. Net FX FWDs	-10	-9	-8	-8	-9	-8	-8	-10
Philippines	79	77	77	76	76	77	78	78
1. Gross	83	79	81	80	80	80	81	81
2. Net FX flows	-5	-3	-4	-4	-4	-4	-4	-5
3. Net FX FWDs	0	1	0	0	1	1	1	2

Shaded area is sum of gross reserves, pre-determined net FX flows and FWDs

Source: Respective central banks, except Japan; MoF

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US economic calendar

Monday	Tuesday	Wednesday	Thursday	Friday
8 Sep **Consumer credit** (3:00pm) Jul	9 Sep **NFIB survey** (7:30am) Aug **JOLTS** (10:00am) Jul Auction 3-year note $27bn Fed Governor Tarullo testifies to Senate (10:00am)	10 Sep **Wholesale trade** (10:00am) Jul Auction 10-year note (r) $21bn	11 Sep **Initial claims** (8:30am) w/e Sep 6 300,000 **QSS** (10:00am) 2Q **Federal budget** (2:00pm) Aug Auction 30-year bond (r) $13bn Announce 10-year TIPS (r) $13bn	12 Sep **Retail sales** (8:30am) Aug 0.8% Ex. auto 0.2% **Import prices** (8:30am) Aug -0.8% **Consumer sentiment** (9:55am) Sep preliminary 83.5 **Business inventories** (10:00am) Jul 0.6%
15 Sep **Empire State survey** (8:30am) Sep **Industrial production** (9:15am) Aug	16 Sep **PPI** (8:30am) Aug **TIC data** (4:00pm) Jul **FOMC meeting**	17 Sep **CPI** (8:30am) Aug **Current account** (8:30am) 2Q **NAHB survey** (10:00am) Sep **FOMC statement and projections** (2:00pm) **and press conference** (2:30pm)	18 Sep **Initial claims** (8:30am) w/e Sep 13 **Housing starts** (8:30am) Aug **Philadelphia Fed survey** (10:00am) Sep Auction 10-year TIPS (r) $13bn Announce 2-year note $29bn Announce 2-year FRN (r) $13bn Announce 5-year note $35bn Announce 7-year note $29bn	19 Sep **Leading indicators** (10:00am) Aug
22 Sep **Existing home sales** (10:00am) Aug New York Fed President Dudley speaks in New York (10:05am)	23 Sep **FHFA HPI** (9:00am) Jul **Manufacturing PMI** (9:45am) Sep flash **Richmond Fed survey** (10:00am) Sep Auction 2-year note $29bn St. Louis Fed President Bullard and Kansas City Fed President George speak at conference in St. Louis (9:00am and 9:30am) Kansas City Fed President George speaks on economy in Wyoming (9:15pm)	24 Sep **New home sales** (10:00am) Aug Auction 2-year FRN (r) $13bn Auction 5-year note $35bn Cleveland Fed President Mester speaks on monetary policy in Cleveland (12:05pm) Chicago Fed President Evans speaks in Washington, DC (1:00pm)	25 Sep **Initial claims** (8:30am) w/e Sep 20 **Durable goods** (8:30am) Aug **Services PMI** (9:45am) Sep flash **KC Fed survey** (11:00am) Sep Auction 7-year note $29bn Atlanta Fed President Lockhart speaks in Mississippi (1:20pm)	26 Sep **Real GDP** (8:30am) 2Q final **Consumer sentiment** (9:55am) Sep final
29 Sep **Personal income** (8:30am) Aug **Pending home sales** (10:00am) Aug **Dallas Fed survey** (10:30am) Sep Chicago Fed President Evans speaks in Chicago (9:00am)	30 Sep **S&P/Case-Shiller HPI** (9:00am) Jul **Chicago PMI** (9:45am) Sep **Consumer confidence** (10:00am) Sep	1 Oct **ADP employment** (8:15am) Sep **Manufacturing PMI** (9:45am) Sep final **ISM manufacturing** (10:00am) Sep **Construction spending** (10:00am) Aug **Light vehicle sales** Sep	2 Oct **Initial claims** (8:30am) w/e Sep 27 **Factory orders** (10:00am) Aug Announce 3-year note $27bn Announce 10-year note (r) $21bn Announce 30-year bond (r) $13bn	3 Oct **Employment** (8:30am) Sep **International trade** (8:30am) Aug **Services PMI** (9:45am) Sep final **ISM nonmanufacturing** (10:00am) Sep

Euro area economic calendar

Monday	Tuesday	Wednesday	Thursday	Friday
8 Sep Germany: Foreign trade (8:00am) Jul ECB's Lautenschläger speaks in Hamburg (12:15pm)	9 Sep France: Foreign trade (8:45am) Jul Monthly budget situation (8:45am) Jul	10 Sep France: Industrial production (8:45am) Jul 0.0%m/m, sa ECB's Mersch speaks in Frankfurt (5:00pm)	11 Sep Euro area: ECB monthly bulletin (10:00am) Germany: CPI final (8:00am) Aug 0.8%oya France: CPI final (8:45am) Aug 0.4%oya ECB's Draghi speaks in Milan (9:00pm)	12 Sep Euro area: Employment (11:00am) 2Q Industrial production (11:00am) Jul 0.8%m/m, sa Italy: CPI final (10:00am) Aug -0.1%oya Industrial production (10:00am) Jul 0.0%m/m, sa Spain: CPI final (9:00am) Aug -0.5%oya
15 Sep Euro area: Foreign trade (11:00am) Jul	16 Sep Euro area: Labor costs (11:00am) 2Q Germany: ZEW bus. survey (11:00am) Sep	17 Sep Euro area: New car regs (7:00am) Jul/Aug HICP final (11:00am) Aug Italy: Foreign trade (10:00am) Jul	18 Sep Netherlands: CBS cons. conf. (9:30am) Sep	19 Sep Euro area: Balance of payments (10:00am) Jul Germany: PPI (8:00am) Aug Belgium: BNB cons. conf. (3:00pm) Sep
22 Sep Euro area: EC cons. conf. (4:00pm) Sep	23 Sep Euro area: PMI mfg prelim (10:00am) Sep PMI serv. & comp prelim (10:00am) Sep Germany: PMI mfg prelim (9:30am) Sep PMI serv. & comp prelim (9:30am) Sep France: GDP final (8:45am) 2Q INSEE bus. conf. (8:45am) Sep PMI mfg prelim (9:00am) Sep PMI serv. & comp prelim (9:00am) Sep	24 Sep Germany: IFO bus. survey (10:00am) Sep Import prices (8:00am) Aug Italy: ISAE cons. conf. (10:00am) Sep Belgium: BNB bus. conf. (3:00pm) Sep Netherlands: CBS bus. conf. (9:30am) Sep	25 Sep Euro area: M3 (10:00am) Aug	26 Sep Germany: GfK cons. conf. (8:00am) Oct Retail sales (8:00am) Aug France: INSEE cons. conf. (8:45am) Sep Italy: ISAE bus. conf. (10:00am) Sep
29 Sep Euro area: EC cons. Conf. (11:00am) Sep EC econ. sent. (11:00am) Sep Germany: CPI 6 states and prelim (8:00am) Sep Spain: CPI prelim (9:00am) Sep Belgium: CPI (8:00am) Sep	30 Sep Euro area: HICP flash (11:00am) Sep Unemployment rate (11:00am) Aug Germany: Employment (9:55am) Sep Unemployment (9:55am) Sep France: Cons. of mfg goods (8:45am) Aug PPI (8:45am) Aug Italy: CPI prelim (11:00am) PPI (12:00pm) Aug	1 Oct Euro area: PMI mfg final (10:00am) Sep MFI interest rates (10:00am) Aug Germany: PMI mfg final (9:55am) Sep France: PMI mfg final (9:50am) Sep Italy: PMI mfg final (9:45am) Sep Spain: PMI mfg final (9:15am) Sep	2 Oct Euro area: PPI (11:00am) Aug ECB rate announcement (1:45pm) No change expected	3 Oct Euro area: PMI serv. & comp final (10:00am) Sep Retail sales (11:00am) Aug Germany: PMI serv. & comp final (9:55am) Sep France: PMI serv. & comp final (9:50am) Sep Italy: PMI serv. & comp final (9:45am) Sep Spain: PMI serv. & comp final (9:15am) Sep

Highlighted data are scheduled for release on or after the date shown. Times shown are local.

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Japan economic calendar

Monday	Tuesday	Wednesday	Thursday	Friday
8 Sep GDP 2nd est. (8:50 am) 2Q -6.4%q/q, saar Current account (8:50 am) Jul 514 billion yen, nsa Bank lending (8:50 am) Aug 2.3%oya Economy Watchers survey (2:00 pm) Aug 51.0, DI Auction 6-month bill	9 Sep M3 (8:50 am) Aug 2.4%oya Tertiary sector activity index (8:50 am) Jul 0.2%m/m, sa Consumer sentiment (2:00 pm) Aug 42.5, DI Minutes of Aug 7- 8 BoJ Monetary Policy Meeting (8:50 am) Auction 30-year bond	10 Sep Producer prices (8:50 am) Aug 4.0%oya Private machinery orders (8:50 am) Jul 5.0%m/m, sa BoJ deputy governor Iwata's address in Ishikawa (10:30 am)	11 Sep Auction 3-month bill Auction 5-year note	12 Sep IP final (1:30pm) Jul BoJ governor Kuroda's speech at National Graduate Institute for Policy Studies (3:05 pm)
During the week: CAO private consumption index Jul -0.5%m/m, sa				
15 Sep *Holiday*	16 Sep BoJ governor Kuroda's address in Osaka (2:35 pm)	17 Sep Construction spending (2:00 pm) Jul Auction 1-year note Auction 20-year bond	18 Sep Reuters Tankan (8:30 am) Sep Trade balance (8:50 am) Aug Flow of funds (8:50 am) 2Q Employers survey final (10:30 am) Jul BoJ governor Kuroda's address at a meeting of securities firms (3:35 pm) Auction 3-month bill	19 Sep
During the week: Department store sales Aug, PMI Manufacturing preliminary Sep				
22 Sep	23 Sep *Holiday*	24 Sep	25 Sep Services producer prices (8:50 am) Aug Auction 3-month bill	26 Sep Nationwide core CPI (8:30 am) Aug
29 Sep	30 Sep All household spending (8:30 am) Aug Unemployment rate (8:30 am) Aug Job offers to applicants ratio (8:30 am) Aug IP preliminary (8:50 am) Aug Total retail sales (8:50 am) Aug Employers survey preliminary (10:30 am) Aug Housing starts (2:00 pm) Aug Auction 2-year note	1 Oct BoJ Tankan (8:50 am) 3Q Auto registrations (2:00 pm) Sep	2 Oct Auction 3-month bill Auction 10-year bond	3 Oct
During the week: Shoko Chukin small firm survey Sep				

Highlighted data are scheduled for release on or after the date shown. Times shown are local.

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Canada economic calendar

Monday	Tuesday	Wednesday	Thursday	Friday
8 Sep Building permits (8:30am) Jul 4.5%	9 Sep Housing starts (8:15am) Aug 199,000(-0.5%)	10 Sep Capacity utilization (8:30am) 2Q	11 Sep New housing price index (8:30am) Jul 0.1%	12 Sep National Balance Sheet (8:30am) 2Q Teranet/National Bank HP Index (9:00am) Aug
15 Sep New vehicle sales (8:30am) Jul Existing home sales (9:00am) Aug	16 Sep Manufacturing sales (8:30am) Jul BoC Governor Stephen S. Poloz speaks at the Drummondville Economic Development Society, Drummondville, Quebec (Press Conference to follow) (12:30pm)	17 Sep	18 Sep	19 Sep CPI (8:30am) Aug Wholesale sales (8:30am) Jul
22 Sep BoC Senior Deputy Governor Carolyn Wilkins speaks at CFA Society of Toronto in Toronto (12:40pm)	23 Sep Retail sales (8:30am) Jul	24 Sep	25 Sep CFIB Business Barometer Index (6:00am) Sep Payroll employment (8:30am) Jul	26 Sep
29 Sep	30 Sep Monthly GDP (8:30am) Jul IPPI (8:30am) Aug	1 Oct RBC manufacturing PMI (9:30am) Sep	2 Oct	3 Oct International trade (8:30am) Aug

All existing home sales are tentative. Times shown are local.

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Latin America economic calendar

Monday	Tuesday	Wednesday	Thursday	Friday
8 Sep Chile: CPI Aug: 0.12%m/m CPI Aug: 4.34%oya Trade balance Aug: US$530mn Colombia: Core CPI Aug	9 Sep Brazil: IGP-M 1st release Sep Mexico: CPI Aug: Headline: 0.37%m/m Headline: 4.16%oya Core: 0.20%m/m Core: 3.36%oya Central bank reserves (prior week) Peru: Trade balance Jul	10 Sep Mexico: GFI Jun: 3.3%oya Nominal wages Aug: 4.6%oya	11 Sep Brazil: COPOM minutes Retail sales Jul 1.0% oya 0.2%m/m sa Chile: BCCh meeting: 3.25% Mexico: Industrial production Jul: 2.2%oya Peru: BCRP meeting Uruguay: Industrial production Jul	12 Sep Argentina: CPI Aug Brazil: Economic activity Jul -1.0%oya 1.0% m/m sa Colombia: BanRep minutes
During the week: Brazil: Auto report Aug Colombia: Consumer confidence Aug Mexico: Formal employment Aug Auto report Aug				
15 Sep Colombia: Retail sales Jul Industrial production Jul Peru: Economic activity Jul Unemployment rate Aug Uruguay: GDP 2Q	16 Sep	17 Sep Brazil: IGP-10 Sep Mexico: Central bank reserves (prior week)	18 Sep Colombia: GDP 2Q	19 Sep Brazil: IGP-M 2nd release Sep IPCA-15 Sep Colombia: Trade balance Jul Mexico: Aggregate supply and demand 2Q Banxico minutes
During the week: Brazil: Tax collection Aug Formal job creation Aug Colombia: Outstanding loans Jul				
22 Sep Mexico: Unemployment rate Aug Banamex economic survey	23 Sep Argentina: Consumer confidence Sep Mexico: Retail sales Jul Central bank reserves (prior week)	24 Sep Argentina: GDP 2Q Brazil: Consumer confidence Sep Current account balance Aug FDI Aug Mexico: Economic activity index Jul CPI Sep 1H	25 Sep Brazil: Unemployment rate Aug	26 Sep Argentina: Current account 2Q Economic activity Jul Brazil: PPI manufacturing Aug BCB credit report Aug Colombia: BanRep meeting Mexico: Trade balance Aug
During the week: Colombia: Industrial confidence Aug Retail confidence Aug Vehicle sales Aug				
29 Sep Brazil: IGP-M Sep Central government budget balance Aug	30 Sep Argentina: Industrial production Aug Construction activity Aug Brazil: Net debt % GDP Aug Nominal budget balance Aug Primary budget balance Aug Chile: Manufacturing index Aug Unemployment rate Aug Retail sales Aug BCCh minutes Colombia: Unemployment rate Aug Mexico: Central bank reserves (prior week) Bank credit Aug PS budget balance Aug Uruguay: Current account 2Q	1 Oct Brazil: PMI manufacturing Sep Trade balance Sep Mexico: Remittances Aug HSBC manufacturing PMI Sep IMEF manufacturing PMI Sep IMEF non-manufacturing PMI Sep Peru: CPI Sep WPI Sep Uruguay: Trade balance Sep	2 Oct Brazil: FIPE CPI Sep Industrial production Aug	3 Oct Argentina: Auto report Sep Colombia: PPI Sep Mexico: Consumer confidence Sep Banxico economic survey Sep Uruguay: Unemployment rate Aug CPI Sep
During the week: Argentina: Tax collection Sep Colombia: Current account balance 2Q				

UK and Scandinavia economic calendar

Monday	Tuesday	Wednesday	Thursday	Friday
8 Sep	9 Sep United Kingdom: BRC retail sales monitor (12:01am) Aug Industrial production (9:30am) Jul 0.0%m/m, sa Trade balance (9:30am) Jul BoE's Carney speaks in Liverpool (11:45)	10 Sep United Kingdom: Treasury Select Committee hearing on the August BoE Inflation report (2:45pm) Appearances by Carney, Shafiq, Miles, and Weale Norway: PPI (10:00am) Aug BoE's Kohn speaks London	11 Sep United Kingdom: RICS HPI (12:01am) Aug Sweden: PES unemployment (8:00am) Aug CPI (9:30am) Aug House price data (9:30am) Aug Labor force survey (9:30am) Aug	12 Sep United Kingdom: Construction output (9:30am) Jul 0.3%m/m, sa
During the week: United Kingdom: Halifax HPI Aug (6-8 Sep) Norway: CPI Aug (10-15 Sep)				
15 Sep United Kingdom: Rightmove HPI (12:01am) Sep Norway: Trade balance (10:00am) Aug	16 Sep United Kingdom: CPI (9:30am) Aug ONS HPI (9:30am) Jul PPI (9:30am) Aug BoE quarterly bulletin (00:00am) 3Q	17 Sep United Kingdom: Labor market report (9:30am) Aug MPC minutes (9:30am)	18 Sep United Kingdom: Retail sales (9:30am) Aug CBI industrial trends (11:00am) Sep Sweden: GDP final (9:30am) 2Q Norway: Norges Bank rate announcement (10:00am) Sep No change expected	19 Sep
Enter weekly event here.				
22 Sep	23 Sep United Kingdom: BBA mortgage lending (9:30am) Aug Public sector finances (9:30am) Aug	24 Sep Sweden: Consumer confidence (9:00am) Sep Economic Tendency survey (9:00am) Sep Norway: AKU unemployment (10:00am) Jul	25 Sep United Kingdom: CBI distributive trades (11:00am) Sep Sweden: Household lending (9:30am) Aug PPI (9:30am) Aug	26 Sep Sweden: Trade balance (9:30am) Aug
During the week: United Kingdom: Nationwide HPI Sep (25-30 Sep)				
29 Sep United Kingdom: M4 & M4 lending final (9:30am) Aug Net lending to individuals (9:30am) Aug Sweden: Retail sales (9:30am) Aug	30 Sep United Kingdom: Gfk cons. conf. (12:05am) Sep BoP (9:30am) 2Q Business investment final (9:30am) 2Q Index of services (9:30am) Jul Real GDP final (9:30am) 2Q Sweden: Wage stats (9:30am) Jul Norway: Retail sales (10:00am) Aug	1 Oct United Kingdom: PMI Mfg (9:30am) Sep Sweden: PMI Mfg (8:30am) Sep Norway: PMI Mfg (9:00am) Sep	2 Oct United Kingdom: PMI Construction (9:30am) Sep	3 Oct United Kingdom: PMI Services (9:30am) Sep Sweden: PMI Services (8:30am) Sep Services production (9:30am) Aug Norway: Labor directorate unemployment (10:00am) Sep
During the week: Norway: Credit indicator growth Aug (30-10 Oct) Budget balance Sep (1-10 Oct)				

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Emerging Europe/Middle East/Africa economic calendar

Monday	Tuesday	Wednesday	Thursday	Friday
8 Sep Czech Republic: Industrial output (9:00am) Jul 0.9%m/m sa; 3.7%oya Trade balance (9:00am) Jul CZK30.3bn Hungary: Trade balance (9:00am) Jul EUR450m Turkey: Industrial output (10:00am) Jul	9 Sep Czech Republic: CPI (9:00am) Aug 0.5%oya Current account (10:00am) 2Q Romania: Trade balance (10:00am) Jul South Africa: Current account and Quarterly Bulletin (10:00am) 2Q 6.1%of GDP BER business confidence (12:00pm) 2Q	10 Sep Hungary: NBH minutes (2:00pm) Romania: CPI (10:00am) Aug 1.1%oya Turkey: GDP (10:00am) 2Q 2.5%y/y nsa	11 Sep Hungary: CPI (9:00am) Aug 0.1%oya Romania: Industrial output (10:00am) Jul 1.6%m/m, sa; 6%oya Russia: Foreign trade Jul Turkey: Current account (10:00am) Jul –US$2.4 billion South Africa: Manufacturing output (1:00pm) Jul	12 Sep Russia: CBR rate decision No change
During the week: Russia: GDP prelim 2Q (8-9 Sep) Israel: Current account 2Q (14 Sep)				
15 Sep Czech Republic: Current account (10:00am) Jul Poland: CPI (2:00pm) Aug Current account (2:00pm) Jul Budget balance (3:00pm) Aug Romania: Current account Jul Turkey: Unemployment (10:00am) Jun Israel: CPI (6:30pm) Aug	16 Sep Czech Republic: PPI (9:00am) Aug Poland: Average gross wages and Employment (2:00pm) Aug Core inflation (2:00pm) Aug Israel: GDP prelim (1:00pm) 2Q	17 Sep Poland: Industrial output (2:00pm) Aug PPI (2:00pm) Aug Russia: Retail sales, Unemployment & Investment (4:00pm) Aug South Africa: CPI (10:00am) Aug Retail sales (1:00pm) Jul	18 Sep South Africa: SARB rate decision	19 Sep
During the week: Russia: Industrial output Aug (17-18 Sep), PPI Aug (17-19 Sep)				
22 Sep Israel: BoI rate decision (4:00pm)	23 Sep Hungary: Current account (8:30am) 2Q NBH rate decision (2:00pm) South Africa: Quarterly employment statistics (11:30am) 2Q	24 Sep Turkey: Capacity utilization (2:30pm) Sep *Holiday: South Africa*	25 Sep Czech Republic: CNB rate decision (1:00pm) Turkey: CBRT rate decision (2:00pm) *Holiday: Israel*	26 Sep Hungary: Unemployment (9:00am) Jul *Holiday: Israel*
During the week: Poland: Retail sales Aug (22-23 Sep), Unemployment Aug (22-23 Sep)				
29 Sep	30 Sep Czech Republic: GDP final (9:00am) 2Q Hungary: PPI (9:00am) Jul Poland: Current account (2:00pm) 2Q NBP inflation expectations (2:00pm) Sep Romania: NBR rate decision Russia: Current account final 2Q Turkey: Foreign trade (10:00am) Aug South Africa: Private sector credit (8:00am) Aug Budget (2:00pm) Aug Trade balance (2:00pm) Aug	1 Oct Czech Republic: PMI (9:30am) Sep Hungary: PMI (9:00am) Sep Poland: PMI (9:00am) Sep Romania: GDP final (10:00am) 3Q Russia: Manufacturing PMI (11:00am) Sep Turkey: PMI (10:00am) Sep South Africa: Vehicle sales Sep Kagiso PMI (11:00am) Sep	2 Oct Romania: Retail sales (10:00am) Aug South Africa: BER consumer confidence (12:00pm) 3Q	3 Oct Hungary: Retail sales (9:00am) Aug Turkey: CPI (10:00am) Sep *Holiday: Israel*
During the week: Russia: GDP 3Q (1-2 Oct), Current account 3Q (2-3 Oct), CPI Sep (4-9 Oct)				

Times shown are local.

Non-Japan Asia economic calendar

Monday	Tuesday	Wednesday	Thursday	Friday
8 Sep Australia: ANZ job advertisements (11:30am) Aug New Zealand: Manufacturing output (10:45am) 2Q China: Trade balance Aug US$47.6bn *Holiday: China, Korea, Taiwan*	9 Sep Australia: Housing finance (11:30am) Jul 0.0%m/m NAB business confidence (11:30am) Aug 11, index Taiwan: Trade balance (4:00pm) Aug US$3.8bn *Holiday: Hong Kong, Korea*	10 Sep Philippines: Exports (9:00am) Jul 21.8%oya *Holiday: Korea*	11 Sep Australia: Unemployment rate (11:30am) Aug 6.3% New Zealand: RBNZ official rate announcement (9:00am) no change China: CPI (9:30am) Aug 2.3%oya PPI (9:30am) Aug -1.1%oya Indonesia: BI monetary policy meeting no change Korea: Unemployment rate (8:00am) Aug 3.3%, sa Money supply (12:00pm) Jul 6.2%oya Malaysia: IP (12:00pm) Jul 5.2%oya Philippines: BSP monetary policy meeting (4:00pm) +25bp rate hike	12 Sep New Zealand: Business NZ PMI (10:30am) Aug India: CPI (5:30pm) Aug IP (5:30pm) Jul Korea: BoK monetary policy meeting (10:00am) no change
During the week: China: Money supply Aug (10-15 Sep) 13.3%oya , Retail sales Aug 12.4%oya; FAI Aug 15.9%oya; IP Aug 8.7%oya India: Trade balance Jul (10-15 Sep)				
15 Sep India: WPI (12:00pm) Aug Korea: Export price index (6:00am) Aug Import price index (6:00am) Aug Philippines: OFW remittances Jul Singapore: Retail sales (1:00pm) Jul	16 Sep *Holiday: Malaysia*	17 Sep New Zealand: Current account balance (10:45am) 2Q Malaysia: CPI (5:00pm) Aug Singapore: NODX (8:30am) Aug Thailand: BoT monetary policy meeting	18 Sep New Zealand: GDP (10:45am) 2Q Hong Kong: Unemployment rate (4:30pm) Aug Malaysia: BNM monetary policy meeting (6:00pm)	19 Sep Korea: PPI (6:00am) Aug
22 Sep Hong Kong: CPI (4:30pm) Aug Taiwan: Unemployment rate (8:30am) Aug Export orders (4:00pm) Aug	23 Sep China: PMI Mfg. (9:45am) Sep Singapore: CPI (1:00pm) Aug Taiwan: IP (4:00pm) Aug	24 Sep New Zealand: Trade balance (10:45am) Aug Vietnam: CPI Sep	25 Sep Hong Kong: Trade balance (4:30pm) Aug Philippines: Imports (9:00am) Jul Taiwan: CBC monetary policy meeting	26 Sep Korea: Consumer survey (6:00am) Sep Singapore: IP (1:00pm) Aug Taiwan: Leading index (4:00pm) Aug
During the week: Philippines: Budget balance Aug (22-26 Sep) Vietnam: GDP 3Q (25-30 Sep) Vietnam: Trade balance Sep (25-30 Sep)				
29 Sep Hong Kong: Retail sales (4:30pm) Jul Korea: Current account balance (8:00am) Aug Thailand: Mfg. Production Aug	30 Sep Australia: Pvt. sector credit (11:30am) Aug New Zealand: Building permits (10:45am) Aug NBNZ business confidence (1:00pm) Sep China: PMI Mfg. (9:45am) Sep India: RBI monetary policy meeting (11:00am) Sep Korea: IP (8:00am) Aug Thailand: PCI (2:30pm) PII (2:30pm) Trade balance (2:30pm) Aug	1 Oct China: PMI mfg. (NBS) (9:00am) Sep India: PMI mfg. (10:30am) Oct Indonesia: Trade balance Aug CPI (11:00am) Sep Korea: CPI (8:00am) Sep PMI mfg. (9:00am) Sep Trade balance (9:00am) Sep Singapore: PMI (9:30pm) Sep Taiwan: PMI mfg. (10:00am) Sep Thailand: CPI Sep	2 Oct Australia: Building approvals (11:30am) Aug Trade balance (11:30am) Aug New Zealand: ANZ commodity price (2:00pm) Sep	3 Oct

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Global Data Diary

Week / Weekend	Monday	Tuesday	Wednesday	Thursday	Friday
6 - 12 September	**8 September**	**9 September**	**10 September**	**11 September**	**12 September**
Brazil • Auto sales (Aug) **China** • Retail sales (Aug) • IP (Aug) • Social financing (Aug) • FAI (Aug) **India** • Trade balance (Jul) **Japan** • CAO prvt cons indx (Jul) **Mexico** • Auto sales • Labor mrkt report (Aug) **Russia** • GDP (2Q, prlm)	**China** • Trade balance (Aug) **Germany** • Trade balance (Jul) **Japan** • Econ watchers srvy (Aug) • GDP (2Q, 2nd est) **Turkey** • IP (Jul)	**Japan** • Consumer sntiment (Aug) **Taiwan** • Trade balance (Aug) **Mexico** • CPI (Aug) **United Kingdom** • IP (Jul) **United States** • NFIB survey (Aug) • JOLTS (Jul)	**France** • IP (Jul) **Japan** • Producer prices (Aug) • Prvt machnry ordrs (Jul) **Turkey** • GDP (2Q) **United States** • Wholesale trade (Jul)	**Brazil:** COPOM minutes • Retail sales (Jul) **Chile:** BCCh mtg: -25bp **China:** CPI (Aug) **Indonesia:** BI mtg: no chg **Mexico** • IP (Jul) **New Zealand** • RBNZ mtg: no chg **Peru** • BCRP mtg: no chg **Philippines:** • BSP mtg: +25bp **Russia:** Trade balance (Jul) **South Africa:** IP (Jul) **Turkey:** Trade balance (Jul) **United Kingdom** • RICS HPI (Aug)	**Brazil** • GDP proxy (Jul) **Euro area** • Labor mrkt report (2Q) • IP (Jul) **India** • CPI (Aug) • IP (Jul) **Korea** • BoK mtg: no chg **Russia** • CBR mtg: no chg **United States** • Retail sales (Aug) • CB cons sent (Sep, prlm) • Bus inventories (Jul)
13 - 19 September	**15 September**	**16 September**	**17 September**	**18 September**	**19 September**
Russia • IP (Aug)	**Euro area** • Trade balance (Jul) **India** • WPI (Aug) **Poland** • CPI (Aug) **United States** • Empire state survey (Sep) • IP (Aug)	**Israel** • GDP (2Q, prlm) **United Kingdom** • CPI (Aug) **United States** • PPI (Aug)	**Euro area** • New car regs (Jul/Aug) • HICP (Aug, fnl) **Poland:** IP (Aug) **Russia:** Retail sales (Aug) • Labor mrkt report (Aug) **Singapore** • NODX (Aug) **South Africa:** CPI (Aug) **Thailand** • BoT mtg: no chg **United Kingdom** • Labor mrkt report (Aug) • MPC minutes **United States:** CPI (Aug) • NAHB survey (Sep) • FOMC mtg: 10bn taper and projections	**Colombia:** GDP (2Q) **Japan** • Reuters Tankan (Sep) • Trade balance (Aug) **New Zealand** • GDP (2Q) **Malaysia** • BNM mtg: +25bp **Norway** • Norges mtg: no chg **South Africa** • SARB mtg: no chg **United Kingdom** • Retail sales (Aug) **United States** • Housing starts (Aug) • Philly Fed survey (Sep)	**Mexico** • Banxico minutes