

Fed data shows modest US activity. US stocks mixed & US bonds gain.

The Beige Book report on the US economy showed that economic activity improved in late 2011 with the economy increasing "at a modest to moderate pace" and holiday retail sales up "noticeably". The auto sector strengthened with suppliers reportedly nearing capacity constraints. **The US mortgage market index** rose by 4.5pct last week with the purchase index spiking 8.1pct higher.

The Germany economy grew by 3.0% in 2011 according to the Federal Statistics office after 3.7% growth in 2010, while the economy contracted by 0.25% in QIV.

French, German and Italian leaders will meet on January 20. German Chancellor Angela Merkel said the euro zone's top priority for the beginning of 2012 was to secure a second aid package for Greece, while she expressed admiration for how quickly Italy's new government has launched reforms.

European shares eased from five-month highs on Wednesday in thin and choppy trade. Weighing on sentiment were comments by ratings agency Fitch, which called for the European Central Bank to step up purchases on euro zone member country debt to support the euro. The FTSEurofirst index fell by 0.5pct with the UK FTSE down 0.5pct and German Dax eased by 0.2pct.

US sharemarkets were mixed on Wednesday as investors weighed economic news on both sides of the Atlantic. With just over an hour of trade to go, the Dow Jones was down 0.3% with the S&P 500 down just 0.1%. The Nasdaq was up 0.3%.

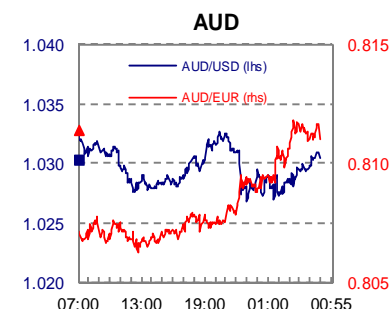
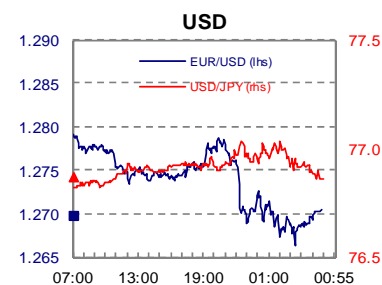
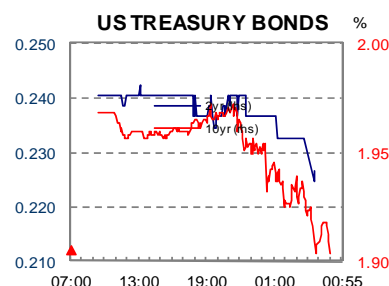
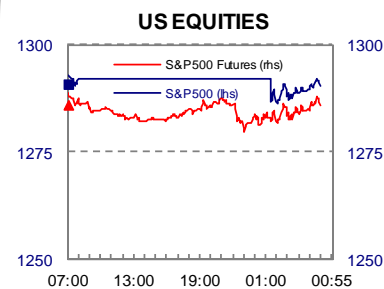
US treasuries rose on Wednesday (yields lower) as investors lightened positions in equities markets to lift holdings of US government bonds. US 2yr yields fell 2pts to 0.23pct and US 10yr yields fell by 7pts to 1.905pct.

The euro and commodity currencies fell against the USD in European trade in line with equities but clawed back losses in US trade. The Euro fell from \$1.2790 to US\$1.2665 but was near US\$1.2700 in late US trade. The **Aussie dollar** fell from US103.25c to US102.65c, and was around US103.05c in late US trade. The yen held between JPY 76.83 and JPY77.03, and was near JPY76.85 in late US trade.

World crude oil prices fell on Wednesday on data showing a sharp rise in US crude inventories. Nymex crude oil fell by US\$1.37 or 1.3pct to US\$100.87 a barrel and London Brent crude fell by US\$1.04 to US\$112.24 a barrel.

Base metals were little changed on Wednesday. Tin rose 1pct but other metals rose or fell less than 0.5pct. And the gold price rose for the second day on news that China's gold imports from Hong Kong hit record highs in November. The Comex February gold price rose by US\$8.10 or 0.5pct to US\$1,639.60 an ounce.

Ahead: In Australia, credit & debit card data and figures on overseas arrivals & departures are released. US retail sales & monthly federal budget data are released.



Currencies		10 Yr Bond Yields (%)		Commodities			Equities	
AUD/USD	1.0303 -0.1%	Australia	3.38 0.00	CRB Index	313.61 -0.6%	Dow	12,429 -0.3%	
NZD/USD	0.7958 0.2%	NZ	3.86 0.02	Aluminium \$/t	2135 -0.1%	S&P 500	1,291 -0.1%	
EUR/USD	1.2698 -0.6%	US	1.90 -0.06	Copper \$/t	7767 0.4%	NASDAQ	2,709 0.2%	
USD/JPY	76.87 0.0%	AU less US	1.48	Lead \$/t	1966 0.0%	FTSE	5,671 -0.5%	
GBP/USD	1.5318 -1.1%	NZ less US	1.96	Nickel \$/t	19423 -0.3%	Shanghai	2,276 -0.4%	
USD/CHF	0.9550 0.6%	AUD Swap Rates (%)		Zinc \$/t	1927 0.3%	H.Seng	19,152 0.8%	
AUD/NZD	1.2940 -0.3%	3mth	4.46 -0.01	Gold \$/o	1639.2 0.4%	Nikkei	8,448 0.3%	
AUD/JPY	79.20 -0.1%	3yr	3.92 -0.03	WTI Oil \$/b	100.93 -1.3%	ASX200	4,188 0.8%	
AUD/EUR	0.8114 0.5%	5yr	4.30 -0.03			NZSX50	3,237 0.3%	



Economics: Preview AUSTRALIA & NEW ZEALAND

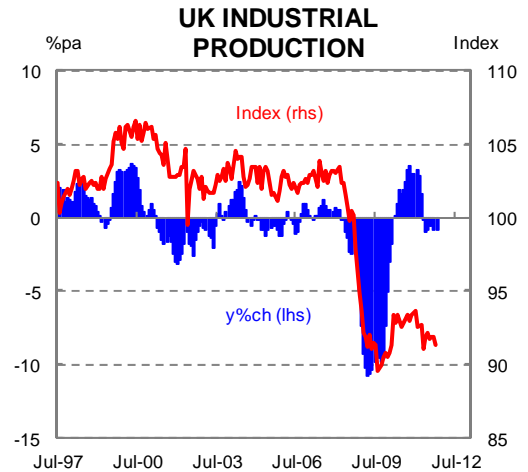
No major data to be released in Australia or New Zealand today.

Economics: Preview INTERNATIONAL

Thursday 12 January

UK Industrial Production, Nov, m/y%ch, (-0.7/-1.7 prev)

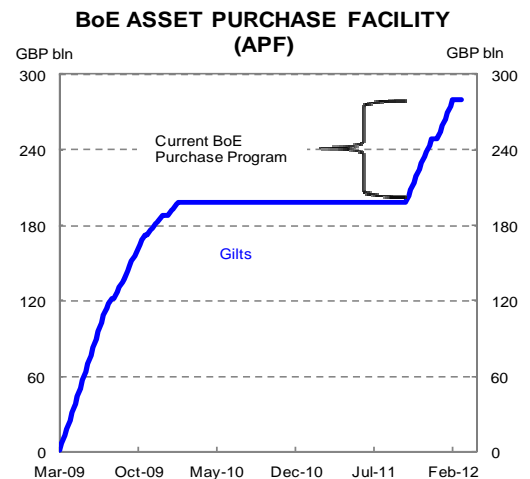
UK industrial and manufacturing production growth continues to stutter. Industrial production contracted by 1.7% (YoY) in the 12 months to October, while manufacturing production was barely positive at 0.3% (YoY). There is little reason to expect any improvement in the near term either. Manufacturing surveys such as the PMI remain soft, with sub-50 readings indicating a shallow contraction. Indeed, with the Eurozone economy likely to be in shallow recession and global growth expected to ease through H1 2012, there is a fair chance UK manufacturing production begins to contract on an annual basis in the coming months.



Thursday 12 January

UK BoE Policy Meeting, Jan, %/£bn, (f) 0.5/275 (0.5/275 prev)

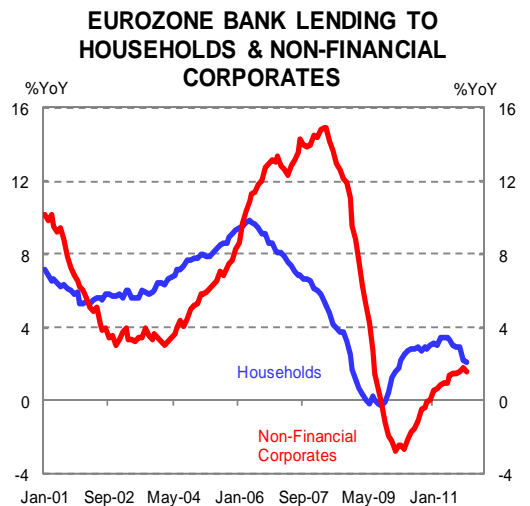
The first Bank of England meeting of 2012 is eagerly anticipated for any indication that the Monetary Policy Committee (MPC) intends to expand the current asset purchase program. The current expansion of the program up to £275bn is set to end in February. Given the softening in the UK economy in late 2011, we expect the MPC to increase the QE program up to the £350-400bn range. The main question is rather over the timing of any such an extension. We see little reason for the MPC to pause after the £275bn level has been reached in February and therefore expect an announcement of more QE to come either at the January or February MPC meetings.



Thursday 12 January

EZ ECB Meetings, Jan, %, (f) 1.0 (1.0 prev)

The first ECB meeting of 2012 begins with little in terms of the European debt crisis being resolved and the economy likely to be in recession. The ECB finished last year off with two successive 25bpt rate cuts, which took the refi rate back down to 1.0%. Given the current recessionary environment, ongoing uncertainty and strains in the financial markets, we expect further easing to come in coming months. That being said, there is a question mark over the pace of further rate cuts. ECB President Draghi confirmed that the decision to cut the refi rate by 25bpts in December had not been unanimous, albeit with the disagreement being over timing not direction. Given the huge take-up at the ECB's three-year LTRO, the ECB may choose to pause and see if there is any impact on lending to the wider real economy. However there is a high risk that the ECB acts in an effort to promote growth and cuts rate further in January.

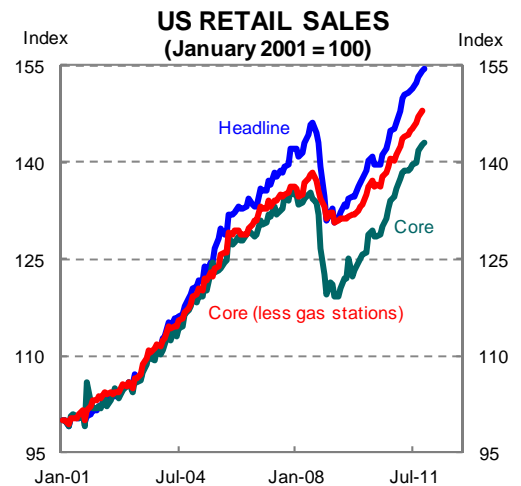




Thursday 12 January

US Retail Sales, Dec, m%ch, (0.2 prev)

Retail sales in the US have grown consistently over the past six months, averaging monthly growth of 0.5%. Significantly core retail sales have also increased on a consistent basis. Anecdotal evidence suggests that the holiday shopping period in the US was relatively robust. But growth in December is unlikely to be the catalyst for a sustained acceleration in retail sales growth. The savings ratio in the US continues to ease. Consumption fuelled by a drawing down of savings has its limits. And despite showing signs of improvement significant levels of slack remain in the US labour market.



Overnight in the US.

- **The US mortgage market index** rose by 4.5pct last week with the purchase index spiking 8.1pct higher.
- **The Beige Book report on the US economy** showed that economic activity improved in late 2011 with the economy increasing "at a modest to moderate pace" and holiday retail sales up "noticeably". The auto sector strengthened with suppliers reportedly nearing capacity constraints.

US Markets

US sharemarkets were mixed on Wednesday as investors weighed economic news on both sides of the Atlantic. With just over an hour of trade to go, the Dow Jones was down by 33 points or 0.3pct with the S&P 500 down just 0.1pct while the Nasdaq was up 7pts or 0.3pct. **US treasuries rose** on Wednesday (yields lower) as investors lightened positions in equities markets to lift holdings of US government bonds. US 2yr yields fell 2pts to 0.23pct and US 10yr yields fell by 7pts to 1.905pct. **The Euro and commodity currencies fell against the greenback in European trade in line with equities but clawed back losses in the US session.** The Euro fell from near \$1.2790 to US\$1.2665 and was near US\$1.2700 in late US trade.

Overnight in Europe.

Euro-zone

- **German GDP expanded by 3.0%** in full year 2011 in line with expectations, while the economy may have contracted by 0.25% in Q4 according to the official statisticians. This suggests that Germany will experience a technical recession over the Q4/Q1 period.
- **The full year fiscal deficit in Germany in 2011 was 1% of GDP.**
- **The fiscal deficit in Italy in the first three quarters of 2011 was 4.3% of GDP.**

UK

- **The UK trade deficit widened out to GBP 2.566b.** in November, with the goods trade deficit widening to GBP 8.644b

European Markets

European equity indices gave back ground, EUR/USD pushed back down under 1.27 on a relatively quiet day in Europe ahead of the ECB meeting and eagerly anticipated Spanish and Italian bond auctions to close the week. Comments from Fitch's Head of Sovereign Ratings that the ECB should ramp up bond purchases to support Italy and prevent a "cataclysmic" collapse of the euro grabbed a fair amount of attention. That being said, European bond markets generally rallied, Italy and Spain outperforming strongly. AUD/USD ended the day relatively flat around 1.03. Investors are waiting for



direction from the ECB and sovereign auctions over the next couple of days.

In Asia

China

- Estimates suggest that **institutional investors increased their respective holdings in listed Chinese firms by a total of CNY 800bn or 750mn shares in the first two weeks of 2012**. The brisk pace of share repurchases was catalysed by a change to the regulation regarding merger and acquisition at the end of last year. More specifically, the new regulation no longer requires some administrative approvals from majority shareholders in share repurchase transactions. On the other hand, the poor state of corporate governance, particularly inadequate protection of minority investors, has been a key impediment to the longer term development of the Chinese capital markets. Therefore, while the share repurchases, as well as similar measures by the authorities to inject more funds, might put a floor to the equity markets in the short-term, the medium term outlook remains clouded, in our view. The two domestic stock markets, having rallied strongly in the last two sessions, took a breather on Wednesday. Shanghai composite index fell by 0.42% on the day.
- **The People's Bank of China (PBoC)** set the USD/CNY midpoint at 6.3155 or 16 points lower. The lower fixing was roughly consistent with a higher EUR/USD close overnight, but below market expectation of more significant downward adjustments during the US Treasury Secretary Geithner's visit to Beijing at present. The cross closed at 6.319.
- This week, maturing central bank bills and repos amounted to CNY 73bn. With the PBoC pledging to keep liquidity flush, money market rate were largely unchanged. 7-day CHIBOR rose by 9bpt to 4.19%. For the remainder of the month, the PBoC is likely to inject liquidity with reserves repos as maturing bills and repos dwindle.

Rest of Asia

- No important data releases from the rest of Asia.

Thursday 12 Jan

JP Current account, Nov, ¥bn, (518.6)
 JP Trade balance, Nov, ¥bn, (-206.1)
 UK Industrial production, Nov, y%ch, (-1.7)
 UK BoE rates decision, %, (0.5)
 GE CPI-EU harmonised, Dec, y%ch, (2.4)
 EC Eurozone industrial output, Nov, y%ch, (1.3)
 EC Eurozone ECB rate decision %, (1.0)
 US Advance retail sales, Dec, m%ch, (0.2)
 US Business inventories, Nov, m%ch, (0.8)

Friday 13 Jan

AU Ai-Group PCI, Dec, Index, (39.6)
 EU Retail sales, Nov, m/y%ch, (0.4/-0.4)
 GE Factory orders, Nov, m/y%ch, (5.2/5.4)
 US Non-farm payrolls, Dec, '000, (120)
 US Unemployment rate, Dec, %, (8.6)
 US Avg hrly earnings, Dec, m/y%ch, (-0.1/1.8)
 CA Net change in employment, Dec, '000, (-18.6)
 CA Unemployment rate, Dec, %, (7.4)

Monday 16 Jan

AU-Housing finance, Nov, m%ch
Vol. of own-occupiers, %, 3.0, (0.7)
Vol. of all loans, %, 2.0, (-1.2)
AU ANZ Job ads, Dec, m%ch, (0.0)
AU TD Inflation gauge, Dec, y%ch, (2.1)
 NZ Food prices, Dec, m%ch, (0.2)
 JP Machine orders, Nov, m/y%ch, (-6.9/1.5)
 JP Consumer confidence, Dec, Index, (38.1)



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