U.S. Industrial Output, U.K. Inflation, Greek Debt

WHAT TO WATCH: Industrial production in the U.S. probably climbed 0.4 percent in April, economists said, 9:15 a.m. European finance ministers for the first time floated the idea of talks with bondholders over extending Greece’s debt-repayment schedule. U.K. inflation is likely to rise further over the next few months after accelerating to 4.5 percent in April, Bank of England Governor Mervyn King said in a letter to Chancellor of the Exchequer George Osborne.

ECONOMICS: Housing starts, 8:30 a.m., est. 3.6%. China trimmed its holdings of U.S. Treasuries for a fifth straight month in March.

COMPANIES: George Soros sold most of his physical gold holdings in the first quarter. Dell earnings, 4:01 p.m.

GOVERNMENT: Dominique Strauss-Kahn is being held without bail at New York’s Rikers Island jail complex while awaiting his next court appearance on May 20. Euro-area finance ministers endorsed Mario Draghi to take over the ECB in November and approved a 78 billion-euro aid program for Portugal.

MARKETS: The pound rose versus the euro and the dollar. Spain sold the maximum amount at a treasury bill auction and its borrowing costs declined. Oil recovered from trading at its lowest in a week. China’s one-year swap rate was near a 10-week high. The yen fell the most in six weeks against the dollar.

BIG PICTURE: COMMENTARY BY RICHARD YAMARONE, BLOOMBERG ECONOMIST

Twelve Reasons to Expect an Economic Turn for the Worse

The weak U.S. recovery that began about two years ago, according to the National Bureau of Economic Research, is showing signs of petering out. Consumer confidence measures are at recessionary levels, labor market indicators are spinning their wheels and the trade deficit continues to widen. None of this bodes well for the economy. Just yesterday, economists polled by the National Association of Business Economics shaved half a percent from their 2011 growth estimates, and are now expecting a 2.8 percent growth rate. Here are a dozen reasons why the economy may take a decisive turn for the worse before year end.

■ Real incomes and wages are trending lower. Consumers can’t spend what they don’t have.

■ Elevated prices at the pump are eating into weak incomes, and come at a time when it is not even peak season for gasoline use.

Goldman Sachs’s U.S. economics analyst Andrew Tilton on what the U.S. structural budget deficit is.
Much of the hiring taking place is coming with a lot of bargaining. Would-be employers are saying, “We can’t pay you $120k, but we’ll offer you $80k. If you don’t like it, there are dozens of others who will.”

The Bloomberg Orange Book, a compendium of economic comments from corporate earnings calls, is finding that businesses face difficult year-over-year comparisons. This portends lower earnings, hiring and capital expenditures.

More than 44 million Americans are receiving food stamps. More than 8 million are getting unemployment benefits. There are only 308 million people in the U.S.

While new order growth has been strong, much of it is “pre-order,” coming before price hikes scheduled to take place later in the year. Orders can and do get cancelled.

The index of leading economic indicators, on both a quarterly and a year-over-year basis, is pointing to a sharp reversal.

The housing depression continues. Unemployment in housing construction is more than 20 percent and home prices are still declining.

In commercial real estate, mall vacancies are at record highs and some companies are cutting store sizes, including the “big boxes.”

State and local governments still face tightening finances.

Government financial support for stimulus is waning, and severe fiscal tightening appears to be on the horizon. This may create downwards pressure on income, as the chart on the difference between real disposable personal incomes and real incomes less transfers shows.

Every time the year-over-year pace of real GDP growth has slipped below 2 percent since 1948, the U.S. economy has fallen into recession. Growth slowed to just 2.3 percent in the first quarter year over year.
**OVERNIGHT**

**Global Equity Performance**

- **EUROPE**
  - New car registrations in Europe fell 3.8 percent from a year earlier to 1.13 million vehicles, the European Automobile Manufacturers’ Association said.
  - Germany’s index of investor and analyst expectations dropped for a third month to 3.1 in May from 7.6 in April, the ZEW Center for European Economic Research said.
  - U.K. inflation quickened to 4.5 percent in April, the highest level since 2008, from 4 percent in March. Core inflation accelerated to a record 3.7 percent from 3.2 percent.
  - U.K. house prices climbed 0.9 percent in March from a year earlier after a 0.5 percent gain in February, the Department for Communities and Local Government said.
  - The average house price in Sweden was 2.035 million kronor in April, compared with 2.057 million kronor in March.

- **AFRICA**
  - South Africa’s inflation accelerated to 4.2 percent in April from 4.1 percent in March.

- **ASIA**
  - The Reserve Bank of Australia said a rising currency is helping contain inflation pressures that may need to be slowed “at some point” by higher interest rates, minutes of its May 3 meeting showed.
  - Tourist spending in New Zealand dropped 6.1 percent in the year ended March 31 from a year earlier to NZ$5.6 billion.
  - Foreign direct investment in China climbed 15 percent in April from a year earlier to $8.5 billion. For the first four months, the total was $38.8 billion, a gain of 26 percent.
  - The State Bank of Vietnam raised the repurchase rate to 15 percent effective today.

**POLITICAL WATCH**

**Money Fund Risks**

Mutual fund executives said U.S. taxpayers may be exposed to more risk if regulators push investors out of money-market funds and into bank deposits. “Is the Federal Deposit Insurance Corp. prepared to add $2.7 trillion in deposits under its umbrella?” Vanguard Group CEO F. William McNabb said. “Are taxpayers willing to foot the bill if these banks, now with larger FDIC-insured deposits, go bust?” Asset managers say the proposals will kill a product vital to the short-term funding of U.S. corporations, states and municipalities.

**California Crisis Looms**

California Governor Jerry Brown’s revised budget with $6.6 billion more revenue may not avert a cash crisis looming in July that may force the state to pay bills with IOUs for the first time since 2009. Brown proposed asking lawmakers to keep $9.1 billion of taxes and fees from expiring, then having a referendum to validate the extension in November or later, when a ballot can be arranged. The state won’t be able to borrow cash in July or August with that vote pending unless Brown and lawmakers agree on spending cuts, Treasurer Bill Lockyer said.

**Berlusconi Vote Setback**

Italy’s Silvio Berlusconi suffered a setback in local elections with Milan’s city hall poised to swing to the opposition as a weak economy and corruption charges sapped support for the prime minister and his allies. Milan Mayor Letizia Moratti trailed her rival Giuliano Pisapia 41.6 percent to 48 percent in the race to control the government in Berlusconi’s hometown, preliminary results showed. Piero Fassino, of the opposition Democratic Party, was poised to win the mayoral seat in the manufacturing center of Turin, results showed.
Mohamed El-Erian, chief executive officer of Pacific Investment Management Co., said “deteriorating debt dynamics” will stoke faster inflation and financial repression in the U.S. as well as at least one sovereign-debt restructuring in Europe. In a report, El-Erian raised the prospect of U.S. policy makers trying to force savers to accept returns below the rate of inflation.

Teppei Ino, an analyst at Bank of Tokyo-Mitsubishi UFJ, said the euro may fall to a two-month low against the dollar after dropping below support levels on two different Fibonacci charts. The euro “easily broke below” $1.4217, a 23.6 percent Fibonacci retracement of its rally from a May low to a May high, as well as $1.4148, a 38.2 percent Fibonacci retracement of its June 2010 low to a May high, ino said.

Paul Rawkins, senior director at Fitch Ratings, said Iceland may keep its junk credit rating for as long as two years or until it can completely lift capital controls that the government has warned could stay in place until 2015. Fitch yesterday raised the outlook on Iceland’s BB+ rating to stable from negative.

Adrian Mowat, chief Asia and emerging-markets strategist at JPMorgan Chase, said Chinese economic data suggests that the risk of a “hard landing” is rising. Residential inventories in China will climb and home prices will fall. “These are still very low levels,” said PNC’s chief economist, the top forecaster of housing starts according to Bloomberg Rankings.

PNC Financial Services Group’s Stuart Hoffman expects a slight gain in March housing starts and he said building permits for home construction likely will have declined in March. “These are still very low levels,” said PNC’s chief economist, the top forecaster of housing starts according to Bloomberg Rankings.

STUART HOFFMAN, PNC FINANCIAL SERVICES GROUP’S CHIEF ECONOMIST

RUSSELL PRICE, AMERIPRISE FINANCIAL’S CHIEF ECONOMIST

TOP FORECASTERS OF HOUSING STARTS FOR MARCH 2011

Hoffman said builders remain wary of undertaking new projects because of the large inventories of unsold new and existing homes, as well as uncertainty about home prices. “Can you get the funding? Can you put together a project that makes economic sense?” Hoffman said.

On Monday, industry group National Association of Home Builders said its monthly survey of home builders found that expectations about sales over the next six months fell from the previous month. Hoffman said he expects the Northeast to have seen more housing starts than the South and the West.

— Aleksandra Rozens

Top Forecasters of Housing Starts for March 2011

<table>
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<tr>
<th>FORECASTER</th>
<th>FIRM</th>
<th>AVERAGE ERROR</th>
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<td>1 Stuart Hoffman*</td>
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<tr>
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* Came closest to March 2011 actual

Source: Bloomberg Rankings

METHODOLOGY
To identify the top forecasters for this index, we compiled estimates submitted to Bloomberg News over a two-year period. We calculated the error for each forecast by subtracting it from the actual figure. Then we totaled up the errors and divided it by the number of forecasts to derive each forecaster’s average error. To qualify for the ranking, forecasters must have made at least 15 of the 24 forecasts. More than 60 forecasters were ranked. Economists not presently associated with a firm, those who had not submitted forecasts for more than two months, and those who had not made at least two consecutive estimates within the last 6 months were excluded from final ranking.

Please note italicized names indicate the forecast was submitted unattributed. The individual identified is the chief economist for the firm.
Empire Manufacturing Indicates Slower Growth, Rising Inflation

The Empire Manufacturing Survey report, the first look at May industrial production data, indicates that survey participants expect continued, if slower, growth on the one hand, and higher inflation and thinning profit margins on the other. This corroborates data in the recent Institute for Supply Management Manufacturing survey that suggested industrial production likely hit its cyclical peak earlier this year.

On the plus side, firms still expect to increase spending on capital expenditures and technology six months from now, and the 52.69 in general business conditions expected six months out is the best reading since January 2011. The average work week increased to 12.90 in May from 6.41 in April, supporting more hiring by manufacturing firms.

On the minus side, the general business index unexpectedly slowed to 11.9 from 21.70, suggesting some risk of a sharper deceleration in new orders over the next several months. Firms may be worried that continued consumer deleveraging in the U.S. and central bank rate increases globally to address rising prices will cool global economic activity this year.

The report also suggests inflation is now embedded in firms’ expectations of future economic conditions. Prices firms paid for inputs soared to 69.89 in May, the second highest level on record after a reading of 77.89 in July 2008, from 57.69 in April. Prices received increased to 27.69 from 26.92 in April. Survey participants expect prices paid to be 68.82 six months from now, and prices received to be 35.48. An increase in expectations of prices paid by firms is one more sign of inflation hitting industrial firms, while a declining outlook for prices received indicates firms will have to continue to absorb much of the hit themselves in the form of thinner profit margins.

China Trims U.S. Bond Holdings as Democrats, Republicans Argue

China, the biggest foreign owner of U.S. Treasuries, trimmed its holdings for a fifth straight month in March as American lawmakers grappled with government debt. The Asian nation owns $1.145 trillion of the debt, down $9 billion, or less than 1 percent, from the previous month, according to U.S. government data. The holdings reached a record $1.175 trillion in October last year.

Former Chinese central bank adviser Yu Yongding said last month that China should stop buying Treasuries because of the risk that the U.S. may eventually default. China may “gradually cut its U.S. Treasuries as it seeks to diversify its foreign-exchange holdings,” said Yao Wei, an economist with Societe Generale SA. She said, “China is probably routing trades through other places such as London,” meaning U.S. data may not give a full picture.

The United Kingdom increased its holdings by $29.7 billion to $325.2 billion in March.

— Bloomberg News
ECB Refrains From Buying Peripheral Bonds Again

The economic woes of Europe’s peripheral nations continue as the European Central Bank fails to buy their bonds. Since March the ECB hasn’t bought any of the weaker European economies’ debt even as it begins raising interest rates, removing an important crutch supporting the peripheries. This is exerting more pressure on euro-zone officials to come up with a definitive plan to stabilize the region as the cost of borrowing continues trending upward.

Without more of a proactive response from euro-zone officials’ peripheral yields may re-test their high of 9.3 percent set on April 27, based on the average 10-year yield of Greece, Ireland, Italy, Portugal, and Spain.

This yield has a history of re-testing previous highs as new crises surface in the EU, as when a bailout proved necessary for Portugal, or as previous measures prove inadequate, as the bailout of Greece now appears to be.

Top-Line Inflation Isn’t the Only Price Measure on the Rise in EU

Europe’s headline inflation rose at an annual rate of 2.8 percent in April, its fastest pace in two years. Core inflation, which has been relatively tame, is playing catch-up. In April, core inflation rose to 1.6 percent on an annual basis, above analysts’ expectations of 1.5 percent and up from just 1 percent in February.

Combined with higher headline inflation, this is likely to add pressure on the ECB to raise interest rates, hurting the peripheral countries seeking cheaper funding options. Headline inflation has been above the central bank’s target of 2 percent since December.

According to Bloomberg, analysts forecast the ECB will raise its main refinancing rate to 1.75 percent by the end of the year, 50 basis points higher than was expected at the beginning of March. While the ECB did not indicate a rate increase was likely in June during its May meeting, more data like yesterday’s CPI increase the chances of a 25 basis point increase on July 7.

Greek, Portuguese, Irish Spreads Continue to Widen After Bailout Announcements

European bailouts have yet to narrow the spread between the 10-year bonds of countries that receive them against the European benchmark equivalent German bonds.

The chart rebases the spread for Greece, Ireland, and Portugal to the day each country announced it would seek a bailout, with the X axis representing the first 126 trading days after each announcement.

Spreads in all three countries have widened despite the bailout. Greek spreads widened the most during the period shown, by nearly 430 basis points, followed by Irish spreads, which widened nearly 200 basis points during the 126 trading days following its announced bailout. Portuguese spreads have widened approximately 75 basis points since it sought a bailout. Rising spreads highlight mounting risk in the region despite the EU and IMF-sponsored backstop.
Euro Watch

Euro Set for Further Declines Versus Dollar as Growth Slows

The euro appears poised to continue its decline versus the U.S. dollar as global economic growth slows from its recent peak.

The outlook for EUR/USD over the short to medium term will probably be heavily influenced by the performance of equity and commodity markets. The daily correlation between the percentage change of the exchange rate and that of oil over the last month stands at 0.76. The correlation with the S&P 500 is 0.7.

The influence of interest rate differentials has declined. The daily correlation between the percentage change of EUR/USD and the absolute change of the spread between the two-year swap rates in the euro area and the U.S. is now at 0.51. (For details, see: STNI FXCHART-BOOK <GO>.)

Those markets appear to be reversing as signs emerge that the global economic expansion is losing momentum. The JP Morgan Global Manufacturing PMI Survey, most recently published on May 3, fell to 55 in April from 55.8 in March and 57.4 in February. Crude oil peaked on May 2 and has since declined by about 14 percent. The S&P 500 hit its highest level on the same day and has fallen by about 2 percent during the same period.

That is creating a safe-haven bid for the U.S. dollar and Treasury securities. Speculators purchased 26,326 contracts on the U.S. dollar in the week ended May 10, according to Bloomberg Brief calculations based on data from the Commodity Futures Trading Commission. They also hold large long positions on short-dated Treasuries. The net long position on two-year notes stands at 231,464 contracts, which is three standard deviations above its one-year average. The holdings of five-year notes total 267,324 contracts, which is 2.4 standard deviations above the one-year average.

The current positioning on EUR/USD of speculators may provide fuel for further depreciation, even though that position was reduced by 32,952 contracts to 63,267 contracts during the latest reporting period. The present level is still the largest net long position versus the U.S. dollar among the G-10 currencies, even surpassing that on the Australian dollar of 60,844 contracts.

The deteriorating sentiment of market participants toward EUR/USD may contribute to the currency pair’s decline. The one-month 25-delta risk reversal skew declined to minus 1.8 from minus 1.7 over the last week, a 0.2 standard deviation move. That follows a 1.1-standard-deviation shift during the previous seven-day period. The risk reversal is now 0.7 standard deviations below its one-year average.

From a technical point of view, EUR/USD appears likely to decline to at least 1.3770, the 38.2 percent retracement line of the rally from the June 2010 low to the May 2011 high, after breaking below support at 1.4217 created by the 23.6 percent retracement line of that same rally. A decline below support, currently at 1.3442, formed by the lower leg of the channel formation that started on July 6, 2010, is required to signal that the currency pair’s rally has come to an end. That is looking increasingly likely.
**Strauss-Kahn’s Downfall Is Chance for IMF Renewal**

It couldn’t have come at a worse moment. A bailout of Portugal was being completed. Greece was tottering on the edge of default. And where was the managing director of the International Monetary Fund, the man meant to be guiding the world economy through this chaos? 

Dominique Strauss-Kahn was in a cell in New York’s Rikers Island jail, awaiting his next court hearing on charges of sexually assaulting and attempting to rape a hotel housekeeper. The trial of Strauss-Kahn will finish his career and transform the race for the French presidency, for which he was the leading candidate. It may well determine the fate of Europe’s single currency. There is no guarantee that the next head of the IMF will support the euro with the same determination that Strauss-Kahn did.

Yet the most significant consequence of the scandal will be the effect it has on the IMF itself. It has become painfully obvious that giving the top job to a French, German or even British politician who happens to have some spare time on his hands is no longer good enough. The IMF plays the most important role in the world economy right now. In the next decade, we will see multiple sovereign-debt crises stemming from the extravagance of the last decade. We may also witness the emergence of a new currency system. The IMF is the only body that can provide leadership on both fronts and that will require someone with different qualifications and ambitions. For this reason, it should select internal candidates and groom a new generation of leaders from within its own ranks.

Strauss-Kahn does remain innocent until proven otherwise. He denies all charges and his lawyer says Strauss-Kahn will plead not guilty. He is entitled to a fair trial, and may yet emerge from this scandal as a free man. Still, it seems unlikely he will remain in office after the case is over. The IMF will need a new managing director. John Lipsky, who is filling in for Strauss-Kahn, is due to leave his post as deputy at the end of August.

Tradition states that a European gets the job. More often than not, it goes to someone French. Normally, they are former bankers, finance ministers or policy makers. There won’t be any shortage of candidates in that mold. Christine Lagarde, the French finance minister, has already been linked to the job. So has former Bundesbank chief Axel Weber. Former U.K. Prime Minister Gordon Brown would love to run the IMF.

The IMF already has a talented pool of insiders. Whether the managing director comes from Europe or is a consolation prize for someone who missed out on running the European Central Bank.

There will never be a more important time to overhaul the IMF’s leadership culture. The sovereign-debt crisis is just starting. Greece, Ireland and Portugal are only the tip of a very large iceberg. Far bigger countries face huge fiscal challenges in the next 10 years. The IMF will have to anticipate and prevent defaults from turning into a more general financial crisis.

At the same time, the dollar’s role as a reserve currency is in long-term decline. With the rise of emerging economies, the U.S. can no longer maintain its position at the center of the financial system. At some point, a new reserve currency will be needed. It might be based on a basket of currencies or on gold. Perhaps it will be based on something no one has even thought of yet. Whatever it is, the IMF will be pivotal to bringing it into being and stabilizing the global economy in the dangerous transition from one system to another.

To do that, the IMF needs to be allowed to develop its own leadership from within. Central banks aren’t run by former politicians or finance ministers parachuted into the role. Neither are big companies. They are led by men, and occasionally women, who have made their careers within those institutions. By the time they get the top job, they know the issues, and they know how they want to tackle them.

The IMF already has a talented pool of insiders. Whether the managing director comes from Europe doesn’t matter. What counts is whether he or she has the knowledge, expertise and vision to do the job. Strauss-Kahn may well leave his post in disgrace. Yet if his downfall can establish the point that the IMF needs a different kind of leader, he will have done his colleagues in Washington an unexpected service.

(Matthew Lynn is a Bloomberg News columnist and the author of “Bust,” a book on the Greek debt crisis.)
EU Sees Possible Greek Debt ‘Reprofiling’ in Follow-Up Aid

European finance ministers for the first time floated the idea of talks with bondholders over extending Greece’s debt-repayment schedule, saying last year’s 110 billion-euro ($156 billion) rescue has failed to restore the country to financial health.

European would consider “reprofiling” Greek bond maturities as part of a package including stepped-up sales of state assets and deeper spending cuts, Luxembourg Prime Minister Jean-Claude Juncker said.

“If all these conditions are fulfilled, we can discuss the question of reprofiling,” Juncker said after a meeting of euro-area finance chiefs “It’s not reprofiling or nothing.”

Introducing that prospect marks a break in Europe’s strategy, with governments potentially shifting some costs to bondholders instead of relying on taxpayer-funded bailouts to end the debt crisis.

Previously, governments ruled out write-downs on privately held bonds before a permanent rescue fund is set up in mid-2013, and then only as a last-ditch option for countries deemed insolvent. A “large restructuring” remains taboo, Juncker said.

To be sure, striking an agreement with banks to reschedule Greece’s bond redemptions wasn’t discussed in the meeting, and finance ministers including Christine Lagarde of France and Didier Reynders of Belgium voiced opposition.

“Restructuring, reprofiling — off the table,” Lagarde said. “We don’t want to do that,” Reynders said.

— James G. Neuger and Stephanie Bodoni

Banks Forgo $20.5 Billion

Small banks organized as corporations applied for less than a third of $30 billion available from a U.S. program intended to increase small-business lending, according to the Treasury Department.

A total of 676 banks organized as so-called C corporations had applied for $9.5 billion of capital under the small business lending Fund, a spokeswoman said. Other types of banks organized like partnerships called S corporations, where profit and losses are passed to shareholders, have until June 6 to apply.

The Treasury program provides the capital at subsidized rates as low as 1 percent if the banks expand lending to small companies. The capital, available only to lenders with less than $10 billion in assets, may generate as much as $300 billion in new loans, the department has said.

— James Sterngold

China Foreign Investment Climbs

Foreign direct investment in China climbed 15 percent to $8.5 billion in April as companies including Starbucks and Walt Disney expand to tap rising incomes. For the first four months, the total was $38.8 billion, a gain of 26 percent.

Foreigners are targeting Chinese consumers as earnings rise and families move to cities. Inflows add to the nation’s record $3 trillion foreign-exchange reserves, complicating efforts to limit gains in the currency and curb inflation. China aims to increase per capita net income by more than 7 percent a year in real terms over the next five years.

— Bloomberg News

Around the Web

Nancy Folbre, an economics professor at the University of Massachusetts Amherst, explores how wealthy individuals and groups are influencing universities to spread their point of view. “In the marketplace of ideas, people with a lot of money can buy whatever they want, and that’s fine,” she writes at the New York Times Economix blog. “Unfortunately, they also have the power to influence other people’s ideas in ways that violate principles of justice, undermine democracy and distort the truth.”

http://economix.blogs.nytimes.com/2011/05/16/economics-for-sale/

Household income uncertainty is rising, particularly among single-earner households and households in the top income quartile, a Federal Reserve Board discussion paper finds.


Economists’ favorite pre-20th Century economist is Adam Smith, according to an article in Econ Journal Watch. Their favorite deceased 20th Century economist is J.M. Keynes. And their favorite living economists are Gary Becker and Paul Krugman, according to the article, accessible via Greg Mankiw’s blog. It also ranks favorite economics journals and favorite economics blogs.

http://gregmanwix.blogspot.com/2011/05/poll-of-economists.html

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— James Sterngold
### 10Y Government Bond Yields

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<tr>
<th>Ticker</th>
<th>Country</th>
<th>Last Price</th>
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### Market Indicators

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<td>7.7%</td>
<td>5.7%</td>
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### Currency Rates

<table>
<thead>
<tr>
<th>Ticker</th>
<th>Country</th>
<th>Last Price</th>
<th>Change</th>
<th>1Y %</th>
<th>3Y %</th>
<th>5Y %</th>
<th>10Y %</th>
</tr>
</thead>
<tbody>
<tr>
<td>CNDX Index</td>
<td>Canada</td>
<td>1.02%</td>
<td>0.2%</td>
<td>11.2%</td>
<td>5.7%</td>
<td>2.5%</td>
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<tr>
<td>USD Index</td>
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<td>1.15%</td>
<td>-0.2%</td>
<td>0.7%</td>
<td>0.6%</td>
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<td>0.5%</td>
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### Other Indicators

<table>
<thead>
<tr>
<th>Ticker</th>
<th>Country</th>
<th>Last Price</th>
<th>Change</th>
<th>YTD %</th>
<th>1Y %</th>
<th>3Y %</th>
<th>5Y %</th>
<th>10Y %</th>
</tr>
</thead>
<tbody>
<tr>
<td>CSWGC2010 Yuan</td>
<td>China</td>
<td>7.2</td>
<td>-0.3%</td>
<td>1.3%</td>
<td>0.3%</td>
<td>0.1%</td>
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<td>0.1%</td>
</tr>
<tr>
<td>CSWGC2010 Yuan</td>
<td>China</td>
<td>19.3</td>
<td>0.1%</td>
<td>0.3%</td>
<td>0.2%</td>
<td>0.1%</td>
<td>0.1%</td>
<td>0.1%</td>
</tr>
<tr>
<td>USDCNY Index</td>
<td>China</td>
<td>7.15%</td>
<td>0.0%</td>
<td>0.0%</td>
<td>0.0%</td>
<td>0.0%</td>
<td>0.0%</td>
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</table>

### Commodities

<table>
<thead>
<tr>
<th>Ticker</th>
<th>Country</th>
<th>Last Price</th>
<th>Change</th>
<th>1Y %</th>
<th>3Y %</th>
<th>5Y %</th>
<th>10Y %</th>
</tr>
</thead>
<tbody>
<tr>
<td>GSCL2010 Corn</td>
<td>U.S.</td>
<td>7.2</td>
<td>-0.3%</td>
<td>1.3%</td>
<td>0.3%</td>
<td>0.1%</td>
<td>0.1%</td>
</tr>
<tr>
<td>GSCL2010 Corn</td>
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<td>0.1%</td>
<td>0.3%</td>
<td>0.2%</td>
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### Other Currencies

<table>
<thead>
<tr>
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<th>Change</th>
<th>1Y %</th>
<th>3Y %</th>
<th>5Y %</th>
<th>10Y %</th>
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</thead>
<tbody>
<tr>
<td>EUR/USD</td>
<td>Euro</td>
<td>1.42%</td>
<td>0.1%</td>
<td>1.6%</td>
<td>0.8%</td>
<td>0.4%</td>
<td>0.1%</td>
</tr>
<tr>
<td>JPY/USD</td>
<td>Japanese Yen</td>
<td>106.11</td>
<td>-0.6%</td>
<td>0.5%</td>
<td>0.3%</td>
<td>0.2%</td>
<td>0.2%</td>
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### Equities

<table>
<thead>
<tr>
<th>Ticker</th>
<th>Country</th>
<th>Last Price</th>
<th>Change</th>
<th>1Y %</th>
<th>3Y %</th>
<th>5Y %</th>
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<td>0.1%</td>
<td>0.3%</td>
<td>0.2%</td>
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### Indexes

<table>
<thead>
<tr>
<th>Ticker</th>
<th>Country</th>
<th>Last Price</th>
<th>Change</th>
<th>1Y %</th>
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</tr>
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<td>0.1%</td>
<td>0.3%</td>
<td>0.2%</td>
<td>0.1%</td>
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</table>
Andrew Tilton, U.S. economics analyst at Goldman Sachs, speaks with Tom Keene and Ken Prewitt about what the U.S. structural budget deficit is.

Q: Give us an update on your GDP view here. You have been cautious.
A: We are still looking at around 3.5 percent GDP growth in the second quarter, maybe a touch slower in the second half of the year. Overall, first quarter was certainly a disappointment to us and a lot of people. But a number of other non-GDP indicators like the business survey, like industrial production, like the employment numbers, suggested that we're seeing a decent pace of overall growth and activity in the first quarter. So we think the second quarter numbers will look fairly good.

Q: Is the slowdown of stimulus going to drag the economy to a lower GDP over the next 24 months?
A: There are three basic conclusions. Number one is we do need a very large fiscal adjustment. There is some dispute among different commentators about exactly how big that is. We think at least six percent of the budget deficit, at least six percent of GDP is what is known as structural. You need deliberate fiscal tightening to close that much of the budget gap. That is really the low end of the reasonable range of estimates as to the structural budget deficit. So point number one is that there is a very big gap that needs to be closed and it won't be closed just through growth. Point number two is that the research in this area has generally shown that what are known as spending-based adjustments are on average more successful. That means that fiscal adjustments that rely more on spending cuts and structural adjustment tend to result in a better economic outcome or more often tend to result in a bigger closure of the budget deficit than adjustments which predominantly focus on taxes. That doesn't mean there can't or won't be a mix of both, but it is simply a matter of how the adjustment is skewed. The third conclusion is simply that a big budget adjustment does slow growth. This has been somewhat disputed as well. Some people are arguing that if you cut government dramatically, the private sector will boom. While, over the long term, there may be some offsets of that sort, there is no doubt that in the first few years you will see a growth hit from a big budget adjustment. That is one element of our forecast for the next couple of years. We are assuming that the fiscal adjustment takes about a point off GDP growth.

Q: The National Association for Business Economics trimmed its forecast from 3.3 percent growth to 2.8 percent. They say they are going to do that is commodities prices. Are you expecting commodities prices to stop rising?
A: We don't think they are going to rise a lot more in the near term. We certainly would agree that they will have an impact on the economy. We actually had a slightly more optimistic forecast coming into the year for a number of different reasons, including the fact that financial conditions were easy. We thought the private sector had mostly finished its adjustment of savings. We saw at the end of last year more fiscal and monetary stimulus. We thought the labor market was improving. All of those reasons for being more optimistic about growth are actually still true, but what has changed more than anything else in 2011 is the move up in commodity prices. We did take down our numbers a bit a couple of weeks ago primarily for that reason. The rise in oil prices so far this year is probably worth something like half a point on real GDP growth, maybe a touch more. Our commodity strategists thought some of the increase was due to aggressive market positioning, and I think they have been shown right, that there has been a little bit of relief recently. But oil prices and gas prices are a lot higher than we thought they would be going into the year.

Q: One of the hallmarks of your research was mortgage equity withdrawal. There are a lot of houses priced at less value than the mortgage right now. Give us the dynamic.
A: Going into the crisis and the years of the boom, there was a huge amount of mortgage equity withdrawal. People were using their houses as ATMs. That has clearly ended. Now, in part because of the drop in home prices, in part because of the substantial tightening in credit availability, you actually have a paying down of mortgage debt on the margin. So the mortgage equity withdrawal is negative or zero to negative for all practical purposes. And so that particular source of fuel for consumer spending during the boom days is gone. Going forward, the fuel for consumer spending growth is going to have to come from the labor market.

(This interview was condensed and edited.)

Today’s guests:
David Ader of CRT Capital Group; Anne Mathias of MF Global; Paul Sheard of Nomura; Robert Wettenhall of RBC Capital Markets; Edward Lazear of Stanford Business School