Bloomberg BRIEF

Economics

NEWS & COMMENTARY

10.15.10
FRIDAY

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6. China's Trade Gap With U.S. at Record
7. India's Gokarn Signals Rupee Intervention
8. China 5-Yr Plan and Domestic Demand
9. Malaysia to Boost Infrastructure Spending
10. Lomax Reluctant on More BOE Stimulus

DATA REPORTS *(NEW YORK TIME)*

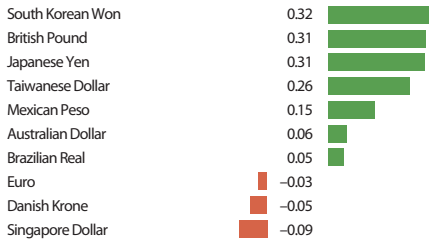
TIME	EVENT	SURVEY	PRIOR
0:30	JN Industrial Production (MoM)	–	-0.30%
5:00	EC Euro-Zone CPI (MoM)	0.20%	0.20%
TBA	CH China Property Prices	8.8	9.3
8:30	US Consumer Price Index (YoY)	1.20%	1.10%
8:30	US CPI Ex Food & Energy (YoY)	0.90%	0.90%
8:30	US Advance Retail Sales	0.40%	0.40%
8:30	US Retail Sales Less Autos	0.30%	0.60%
8:30	US Retail Sales Ex Auto & Gas	0.30%	0.50%
8:30	US Empire Manufacturing	6	4.1
9:55	US U. of Michigan Confidence	69	68.2

ECONOMIC-EVENTS CALENDAR

TIME			
10/15	2:00	JN	BOJ Gov. Shirakawa to Speak
10/15	3:00	SA	Reserve Bank Chief Economist
10/15	3:00	EC	EU's Ashton, Pakistan Aid Meeting
10/15	4:45	EC	ECB's Stark Speaks
10/15	8:10	EC	EU's Van Rompuy, Barroso
10/15	8:15	US	Bernanke Speaks
10/15	9:15	US	Fed's Lockhart Speaks
10/15	11:30	US	San Francisco Fed's Williams
10/15	TBA	US	General Electric 3rd Qtr Earnings

TOP CURRENCY PERFORMERS

One day spot return in percent



China Rebuffs Japan on Yuan; Bernanke Speech

FIRST WORD DAYBOOK:
Morwenna Coniam

■ **WHAT TO WATCH: China rebuffs Japan's** calls to make its exchange rate more flexible. **Japan's finance minister calls** on G-20 to boost cooperation on markets. **Ben Bernanke** may advocate in a speech that the Fed should adopt an inflation target to keep prices from falling. 8.15 a.m. in Boston. (See story page 8).

■ **COMPANIES: TPG Capital and KKR** in talks to acquire Seagate Technology, according to people familiar with the discussions. **BlackRock and State Street** may be forced to cut fees as they lose assets to lower-priced competitors such as Vanguard Group. **Blackstone and Bain Capital are** among buyout firms planning to bid for **Pfizer's Capsugel** business. **BMB Group offers** to pay as much as $4 billion for Kerzner International.

■ **ECONOMY: Retail sales in September probably rose** 0.4 percent, 8:30 a.m. **Consumer Price Index** Sept., 8.30 am, M/m 0.2 percent, Y/y 1.2 percent. **University of Michigan Confidence**, 9.55 a.m., 68.9. **Mexio may keep** benchmark rate at 4.5%.

■ **GOVERNMENT: Fed's Lockhart** speaks in Atlanta; 9.15 a.m. **San Francisco Fed's John Williams** at Boston Fed event; 11.30a.m. **Union-backed group** accuses U.S. Chamber of Commerce of steering foreign money into American politics.

■ **MARKETS: The dollar traded near** its weakest level in 15 years against the yen. **Copper, near a 27-month high,** headed for a fifth weekly gain. **Cotton futures jumped** to a record.

BIG PICTURE DEBORAH ALLEN HEWITT, GUEST COLUMNIST

Stronger Yuan May Not Help U.S. Economy, Workers

The U.S. is squandering precious political capital by pressuring China to strengthen the value of the yuan in order to reduce U.S. imports and help restore output and jobs to the U.S. While a weaker currency does make goods produced in China more competitive on the world market, U.S. leaders are mistaken about the effects of this on the U.S. economy and workers.

The weak yuan is stealing jobs and output from Mexico, Thailand and even Japan, not from the U.S. The top 20 products imported into the U.S. from China are in industries that account for less than 5 percent of U.S. gross domestic product. The emerging countries of the world, such as Mexico and Thailand, are China's true competitors on these largely commodity-type products. The U.S. has high wages associated with the world's highest productivity rates, and so does not have a competitive advantage in the majority of the products imported from China.

The U.S. does produce other goods — and, notably, services — that are both competitive

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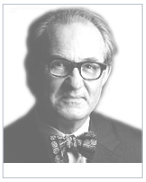

KEENE'S CORNER

Michael Aronstein of Marketfield Asset Management on how to deal with massive global liquidity.

Back Page

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BIG PICTURE DEBORAH ALLEN HEWITT
continued from page 1

and in demand in China. If the U.S. is serious about stimulating sustainable growth in U.S. production and employment, it should implement policies that encourage investment in these high-value-added products and services, rather than attempting to stimulate production of goods that represent America's past. If the U.S. wants China's assistance in reducing the trade deficit, it should pressure Chinese leaders to allow their workers to become consumers, which would lead to increased exports of these U.S.-produced goods and services.

The table lists the top 20 categories of products that the U.S. imports from China. These account for 75 percent of U.S. imports from China, but less than 5 percent of U.S. GDP. The top three Chinese import categories combined — computers and peripherals, communications devices, and apparel — constitute nearly 31 percent of total U.S. imports from China but less than 1 percent of U.S. GDP.

The 2004 Economic Report of the President[1] made the point that rising Chinese imports were not taking markets from Mexico and other developing nations rather than U.S. producers. The reverse is equally true — foregone imports from China will be replaced by imports from Mexico, Thailand and even Japan, where they are produced more cheaply than in the U.S.

A stronger yuan will not have a meaningful effect on U.S. production because of the disparity between the products imported from China and the capacity to produce those same products in the U.S. In fact, the trade deficit might worsen if the yuan's appreciation increases the prices of these imports.

Additionally, the low level of U.S. production of these goods is not a result of the rising level of imports from China. The majority of the categories in the table have been in structural decline since before the U.S. trade deficit with China surged. The U.S. industry that has experienced the most significant reduction in size relative to the overall economy over the last decade is motor vehicles, an industry in which the Chinese do not yet compete globally.

Trade benefits all parties involved so long as trade patterns are determined by comparative advantage, meaning each country exports products in which it is competitive due to a greater availability of resources or productivity compared to cost. The U.S. has an advantage in producing capital equipment, robotics, audio and video content, sophisticated services such as insurance, banking, and real estate, and large-scale agricultural products. Accordingly, these industries command large shares of the U.S. economy, led by professional and business services at 12 percent, real estate services at 13 percent, financial and insurance services at 8 percent and health care at 7 percent. The U.S.'s $132 billion annual trade surplus on services and $121 billion surplus on income earned abroad are often overlooked in trade discussions, taking a back seat to the $500 billion deficit on goods.

Instead of pressuring China to help move the U.S. economy back to producing products for which it long ago lost its comparative advantage, the U.S. should be working to expand the buying power of Chinese workers who now save close to 40 percent of their income. This, combined with an opening of their financial and other service markets to U.S. providers, would be the best way to reduce the U.S.-China trade imbalance.

Deborah Allen Hewitt is a professor of economics at the Mason School of Business, College of William & Mary.

[1]*Council of Economic Advisors, (2004). Economic Report of the President (H. Doc. 108-145). Washington, D.C.: US GPO.*

Top 20 Categories of Imports to U.S. from China

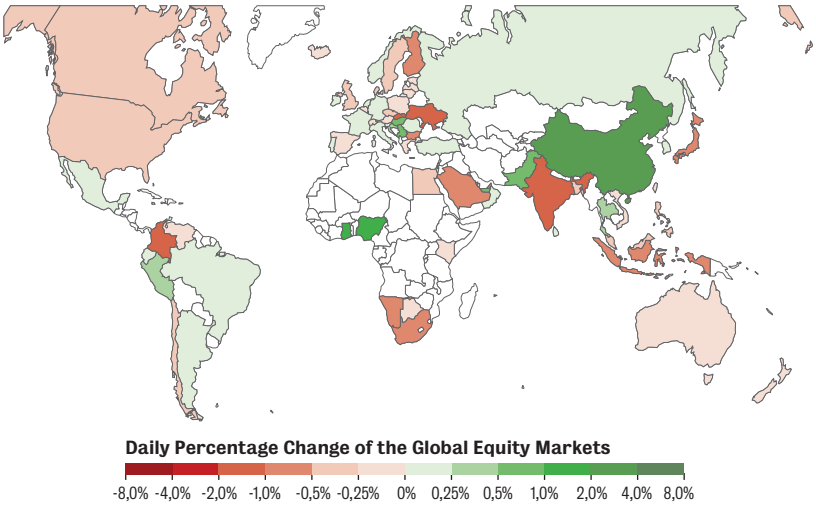
CATEGORY	FROM CHINA (2009)	U.S. PRODUCTION, % OF US GDP (2008)
Computer/Peripheral Equipment	14.5%	0.27%
Communications Equipment	8.7%	0.24%
Cut/Sew Apparel	7.6%	0.08%
Audio/Video Equipment	6.2%	0.02%
Doll, Toy, Game	6.1%	0.01%
Footwear	4.4%	0.01%
Semiconductor/Other Electronic Components	4.2%	0.40%
Household/Institutional Furniture	3.2%	0.15%
Household Appliance	2.9%	0.08%
Plastics Product	2.0%	0.63%
All Other Miscellaneous	1.8%	0.11%
Other Leather and Allied Product	1.8%	0.01%
Motor Vehicle Parts	1.5%	0.57%
Textile Furnishings Mills	1.5%	0.07%
Electric Lighting Equipment	1.4%	0.05%
Basic Chemical	1.4%	0.71%
All Other General Purpose Machinery	1.3%	0.12%
Sporting and Athletic Goods	1.2%	0.04%
Navigational, Measuring, Electromedical, Control Instruments	1.2%	0.53%
All Other Fabricated Metal Product	1.1%	0.15%
Total	**74.1%**	**4.27%**

Sources: U.S. Department of Commerce, U.S. Bureau of Economic Analysis

OVERNIGHT

BY BLOOMBERG NEWS

Global Equity Performance



ASIA

■ **The Bank of Japan** cut its economic assessment in three of the country's nine regions, its first downgrade since April 2009.

■ **Foreign direct investment in China** increased at a faster pace in September, gaining 6.1 percent from a year earlier to $8.4 billion after a 1.4 percent gain in August.

■ **India's wholesale-price index** rose an annual 8.62 percent in September from 8.5 percent in August.

■ **Singapore's retail sales** excluding motor vehicles rose 6.2 percent from a year earlier in August.

■ **New Zealand's central bank** proposed new local laws to support the development of a covered bond market.

EUROPE

■ **European exports** increased a seasonally adjusted 1 percent from July, when they slipped 0.2 percent. Inflation accelerated to 1.8 percent in September from 1.6 percent in the previous month.

■ **Overnight deposits** with the European Central Bank dropped to the lowest in almost a year yesterday. Banks lodged 27.97 billion euros ($39.5 billion) in the ECB's overnight deposit facility at 0.25 percent, compared with 28.52 billion euros the previous day.

■ **Czech industrial producer prices** rose an annual 2.4 percent in September, the most in almost two years, from 1.8 percent in August. Producer prices rose 0.3 percent on the month.

■ **Swedish house prices** increased an annual 6 percent in the three months through September, the same as in the August quarter.

■ **Slovenian real gross wages** grew 2.7 percent in August after a 1.9 percent increase in July.

■ **Croatia's inflation rate** rose to 1.4 percent in September from 0.9 percent in August. On the month, consumer prices increased 0.3 percent.

■ **Iceland's pension funds,** which hold the bonds behind most of the country's mortgage debt, will try to block proposals to forgive $2 billion in bad loans.

POLITICAL WATCH

BY BLOOMBERG NEWS

Bank Bonuses Still Risky

Banks are failing to implement bonus practices that rein in risks blamed for contributing to the financial crisis, global banking regulators said. The principle of matching pay to risk "has proven to be challenging," the Basel Committee on Banking Supervision said yesterday. "Effective implementation" of such bonus practices "has not been achieved," said the committee, which last month proposed tougher capital rules for banks worldwide. Regulators are still grappling with "the best feasible way" to control guaranteed bonuses for new employees, the committee said.

No Big Mortgage Fix

Washington policy makers, who moved swiftly to calm markets during the subprime mortgage crisis in 2008, have resisted calls for similarly broad steps in response to concern that banks may have acted illegally to seize homes. **Barack Obama** and the agencies that share responsibility for housing finance are opposing calls for a nationwide foreclosure freeze. Even as bank stocks tumbled yesterday on concern the mishandled loans will increase costs for lenders, Obama and federal regulators avoided any grand gestures designed to reassure investors.

Bank of Japan Changes

A group of ruling Democratic Party of Japan legislators called for revising the law that governs the Bank of Japan to allow for more political input in efforts to end more than a decade of deflation. The 150-member group agreed today to push the DPJ to propose a law requiring the central bank to adopt an inflation target and make increasing employment a policy goal.The legislators also called for reviewing the selection process for BOJ governor, vice governor and board members. "We'll definitely work on this," said **Jin Matsubara**, the head of the group.

NEWSMAKERS

BY BLOOMBERG NEWS

Rachel Lomax, former Bank of England Deputy Governor, said the prospect of more asset purchases by central banks makes her "queasy" because such measures don't have clear economic benefits and may fuel asset bubbles.

Carmen Reinhart, a professor of economics at the University of Maryland in College Park who co-wrote a book on crises with Harvard professor Kenneth Rogoff, has been named Dennis Weatherstone Senior Fellow at the Peterson Institute for International Economics. Morris Goldstein, who had held the chair, is retiring.

Japanese Finance Minister **Yoshihiko Noda** said the strong yen is having a serious effect on the economy and the government is ready to take bold action as necessary in markets.

FACE OFF

Rich DeKaser of **Woodley Park Research** forecasts a 0.8 percent rise in advance retail sales for September.

Uwe Duerkop of **Landesbank Berlin** expects a 0.1 percent decline. The median estimate is for a 0.4 percent increase, according to a Bloomberg survey.

Makoto Utsumi, 76, who led Japan's currency policy from 1989 to 1991 as vice finance minister for international affairs, said the yen's gains against the dollar may be "coming to an end."

Steve Major, HSBC Holdings Inc. global head of fixed-income research, said Greek, Irish and Portuguese bond yields will remain at "wide" premiums to German debt.

European Central Bank Chief Economist **Juergen Stark** said the bank will keep buying government bonds "as long as it's necessary," Handelsblatt newspaper reported.

Christian Kielland, a managing director at brokerage BTIG Hong Kong Ltd., said emerging-market stocks, including those in South Korea, may decline in the short term.

Richard Woolnough, M&G Investments money manager, said currency traders may supplant so-called bond vigilantes credited with enforcing government fiscal discipline in past decades as more nations ease monetary policies through asset purchases.

Top Forecasters of Consumer Price Index as of September 30

Patrick Franke of **Helaba** is the only one of the top forecasters of the consumer price index, as compiled by Bloomberg Rankings, to predict a number other than the median forecast for a 0.2 percent increase month over month. Franke expects a 0.1 percent increase in the index.

Excluding food and energy, the median prediction is for an increase of 0.1 percent.

The team at **Barclays Capital**, led by **Dean Maki**, tops the ranking. They wrote in a report yesterday that they believe a flat August performance for core CPI resulted from declines in lodging and apparel prices and is unlikely to be repeated in September. Their view is "that core CPI inflation is close to a trough," they wrote.

— Jennifer Rossa

	FORECASTER	FIRM	AVERAGE ERROR	FORECAST FOR OCT. 15
1	Dean Maki*	Barclays Capital	0.0625	0.2%
2	*Louis Crandall**	Wrightson ICAP	0.0792	0.2%
2	David Resler*	Nomura Securities Intl.	0.0792	0.2%
2	Michael Feroli*	JPMorgan Chase	0.0792	0.2%
5	Patrick Franke	Helaba	0.0818	0.1%
6	Peter D'Antonio*	Citi	0.0857	0.2%
7	Nariman Behravesh*	IHS Global Insight	0.0870	0.2%
7	William Jordan	Ried Thunberg	0.0870	–
7	Gabriele Widmann/Rudolf Besch*	DekaBank	0.0870	0.2%
10	Joshua Shapiro*	MFR	0.0909	0.2%
10	Bernd Weidensteiner*	Commerzbank AG	0.0909	0.2%
Median (All 78 Economists)				0.2%

** Perfect forecast for September 2010*

Source: Bloomberg Rankings

Please note italicized names indicate the forecast was submitted unattributed. The individual identified is the chief economist for the firm.

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.

ORANGE BOOK Economy Sputters Along

RICHARD YAMARONE
Bloomberg Economist

The earnings season is a slow train coming — only four contributions to the Bloomberg Orange Book this week. The contents of these conference calls suggest the economic recovery is holding up, if with a note of caution. As the excerpts below show, Intel noted stronger global demand, although at a slower pace than in the first half of the year. J.P. Morgan highlighted increased M&A activity. At the same time, it said concerns about the economy and the political picture may discourage consumers and businesses from spending and investing. One hotel group found meetings are rising even as most consumers were hesitant about food and beverage purchases. And CSX reported strong volumes and increased carloads, while mentioning issues regarding possible government regulations.

Intel [INTC] Earnings Call 10/12/10: "Consumers will have a limited amount of discretionary income, and some will choose to purchase a tablet instead of upgrading an existing PC or purchasing a netbook in any given period."

"Despite softness in the consumer market segments of Europe and North America, demand strengthened in the emerging markets. And our robust enterprise market segment led to record microprocessor units."

"The worldwide economy is growing but more slowly than anticipated heading into the second half of the year. We are taking advantage of the slower growth to more quickly upgrade older generation factories to support the very strong customer demand that we see for our new Sandy Bridge products."

"I think the other dynamics in low-end desktop and netbooks and so forth are not going to really change. It's still tough out there. And we're not projecting or we're not assuming inside of Intel that we have a very, very robust worldwide GDP scenario. We're, I think like most people, assuming modest growth, and not a double dip."

J.P. Morgan [JPM] Earnings Call 10/13/10: "Since January 2009, we've prevented 429,000 foreclosures through either modifications, short sales, or other loss mitigation actions. And just to remind everyone, this is a very lengthy process. And so from the initial default to the actual foreclosure sale for our serviced mortgages, that's on average 14 months in the process or 448 days. Mortgages in the state of Florida for us, that process is 678 days. In New York, it is 792 days, more than two years."

"Balance sheets continue to be very, very healthy. You're starting to see a pickup in the appetite for M&A, and I think part of that is a function of people getting their balance sheets prepared and ready to go and looking for growth. There continues to be a little more uncertainty out there about both the economy and what the political landscape entails. And so we haven't seen a rush towards activity, but you would expect as you get clarity there to get some real momentum behind it."

Host Hotels & Resorts [HST] Earnings Call 10/13/10: "Consistent with a pattern we have been experiencing this year, our booking cycle continues to be very short-term. Bookings for the quarter exceeded last year's strong pace, and were well above levels we experienced in 2007."

"I think what you're just seeing is, it's good news as the customers are meeting again, groups are coming back to properties and the events are happening. What we found over the course of the summer and as we looked out into the fourth quarter, is that they were probably being a bit more cautious about what they spent on food and beverage."

"The short answer on that is that we've continued to see very good demand. September, based on preliminary results, was up 9.5 percent."

> "We're not projecting inside of Intel that we have a very, very robust worldwide GDP scenario."

CSX Corp. [CSX] Earnings Call 10/13/10: "In the third quarter of 2010, an improving economy helped almost all of the markets that we serve recover from the lows experienced during 2009."

"Total volume of 1.6 million units was up 10 percent versus the same period last year. As you will recall, the U.S. economy began growing again in the third quarter of 2009, and despite the tougher year-over-year comparison, overall volume growth in third quarter remained strong. You can also see on the chart that total carloads also grew sequentially versus the second quarter despite what is normally a lower-volume quarter due to seasonality."

"Consistent with our market-by-market outlook, U.S. industrial production is expected to grow 4.9% for the fourth quarter of 2010."

"On the broader aspect around potential regulation, we really do believe that policy makers are going to understand the importance of the railroads to this economy, because if we are in effect hindered in our ability to invest, we're going to stop building; it'll stop job creation."

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DATA WATCH

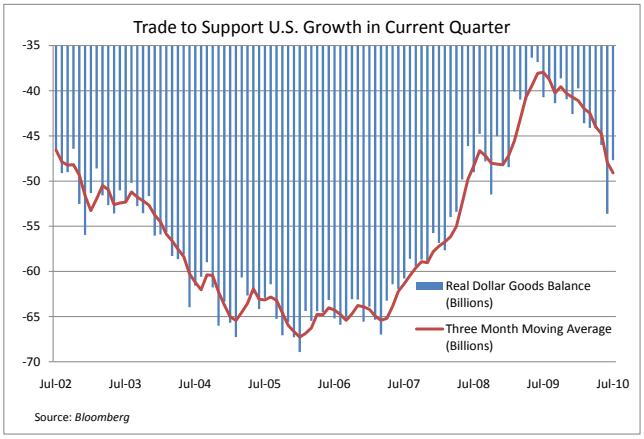
JOSEPH BRUSUELAS, BLOOMBERG ECONOMIST

Trade and GDP

The widening of the U.S. trade deficit in August to $46.2 billion, or $51.2 billion adjusted for inflation, implies that the initial estimate of third quarter gross domestic product is likely to be revised down. Net exports subtracted 3.5 percent from overall growth, according to the Commerce Department's initial estimate of GDP.

Still, this shouldn't extend into the coming quarter, when net exports are likely to receive a boost from trade. Rising demand for capital equipment by manufacturers to meet foreign deman is the primary reason the deficit widened. Also, on a trade-weighted basis, the dollar has depreciated nearly 10 percent since June 2. Given the Federal Reserve's likely resumption of large-scale asset purchases, this decline may well continue for several months.

Typically it takes four to six months before shifts in the terms of trade due to changes in the exchange rates translate into gains in net exports. It is likely that trade will remain a source of growth for the economy well into 2011.

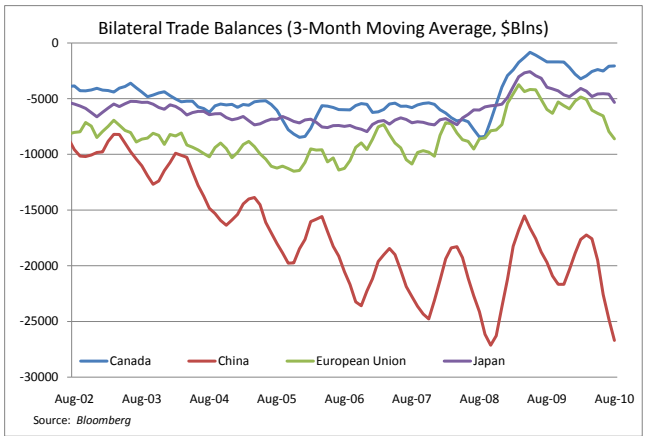


Trade Tensions

The U.S. runs bilateral trade deficits with a number of countries. This trend intensified in August, adding fuel to the political fire over currency imbalances. U.S. demand for industrial supplies sent the bilateral deficit with China soaring to $28 billion and with Japan to $5.8 billion.

Less than three weeks from the U.S. Congressional election and three days after the announcement that China's foreign exchange reserves grew to $2.6 trillion, expect a collective howl from the political class between now and election day over currency manipulation by Beijing and a recent series of currency interventions by Japan and other Pacific Rim countries.

After the mid-term elections, a lame duck session of Congress could well consider legislation targeting currency manipulators. What might stop this is interim moves by other central banks to permit some appreciation of their currencies or to adopt more accommodative monetary policies. Either would increase demand for U.S. goods and services.

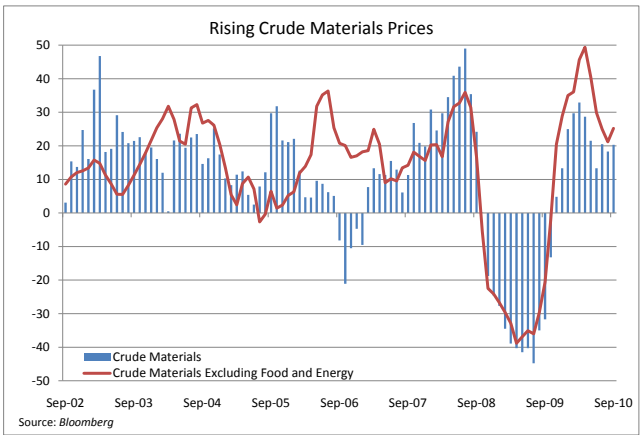


Profit Margins at Risk

Producer prices increased a greater-than-expected 0.4 percent in September, largely due to a 1.2 percent increase in the cost of food and 0.5 percent rise in the price of energy. The core PPI figure rose 0.1 percent month over month and 1.6 percent year over year. Together, volatile food and energy prices comprise nearly 40 percent of the overall index. Food costs rose 5.1 percent on an annual basis for producers, while energy costs rose 10.5 percent.

There are signs of higher prices elsewhere in the supply chain. The price of raw materials has increased 20.3 percent over the past 12 months and core crude goods prices have climbed 25.2 percent.

Firms have chosen to accept thinner profit margins rather than pass along rising costs to weak consumers, as they try to retain market share and competitiveness. This is likely to continue. Given the recent increase in commodity prices in response to the Federal Reserve's likely resumption of large-scale asset purchases, firms are likely to take a hit on profit margins in the fourth quarter of 2010.



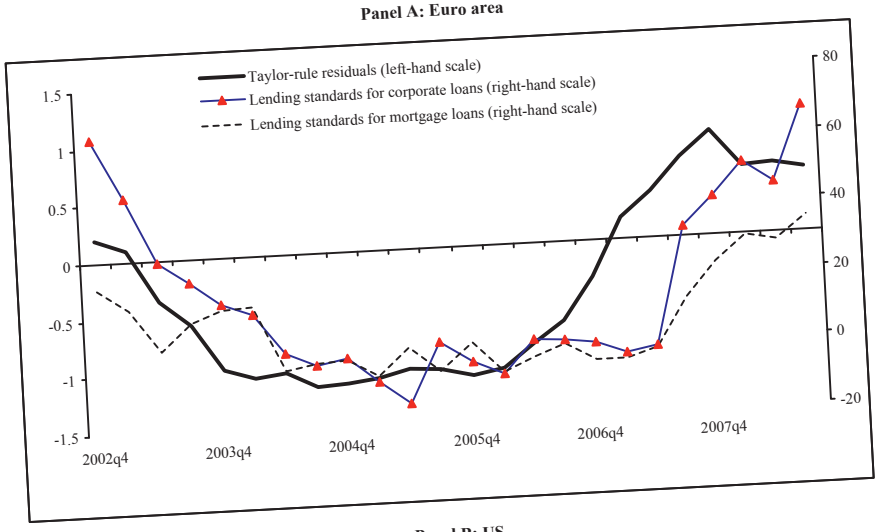
DOCUMENTED

Central Banks and Loose Lending Standards

People haven't been shy in suggesting that low interest rates set by central banks contributed to the financial crisis by encouraging lenders to loosen their standards. In a new paper, Angela Maddaloni and Jose-Luis Peydro of the European Central Bank present research of lending standards in the U.S. and euro area that suggests low short-term rates — i.e., monetary policy rates — soften lending standards. "We provide suggestive evidence that too low for too long monetary policy rates, by inducing a softening of lending standards and a consequent buildup of risk on banks' assets, were a key factor leading to the financial crisis and possibly triggering, through the subsequent bank credit reduction, a real and fiscal crisis," they write.

Figure 1: Taylor-rule residuals and lending standards

Panel A: Euro area



Panel B: US

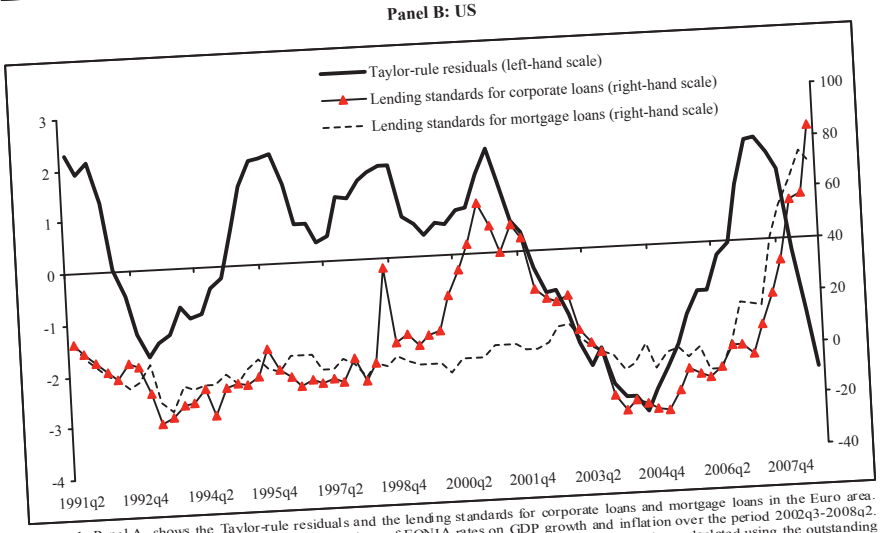


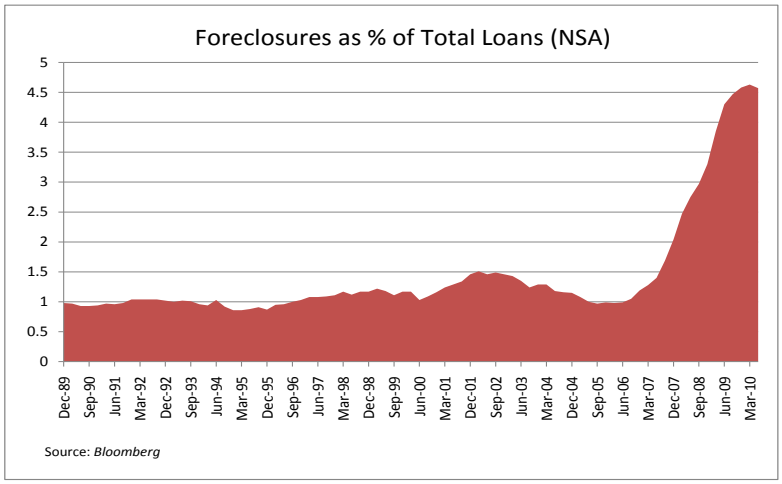
Figure 1, Panel A, shows the Taylor-rule residuals and the lending standards for corporate loans and mortgage loans in the Euro area. Taylor-rule residuals are the residuals of the regressions of EONIA rates on GDP growth and inflation over the period 2002q3-2008q2. The residuals are estimated separately for each country in the Euro area and a weighted average is then calculated using the outstanding amount of loans in each country. Data for 12 Euro area countries are included (Austria, Belgium, France, Finland, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal and Spain). Lending standards for corporate and mortgage loans are the net percentages of banks reporting a tightening of credit standards for loans to enterprises and households in the Bank Lending Survey (BLS). The Euro area figure is calculated using the same weights as for the Taylor-rule residuals over the period 2002q4-2008q3. Panel B shows Taylor-rule residuals and lending standards for corporate and mortgage loans for the US. Taylor-rule residuals are the residuals of the regressions of fed funds rates on GDP growth and inflation over the period 1991q1-2008q2. The lending standards are the net percentages of banks reporting a tightening of credit standards for corporate and mortgage loans in the Senior Loan Officer Survey (SLO) from 1991q2 to 2008q3. See Section II, Appendix A and B for a detailed description of the variables and the data sources.

DATA WATCH

U.S. Home Seizures Reach Record as Lenders Review Foreclosures

More than 100,000 U.S. homes were seized by lenders in September, a record number that probably will decline in coming months as major banks halt repossessions and review their foreclosure practices.

Lenders took over 102,134 properties last month, RealtyTrac Inc. said in a report yesterday. That was the highest monthly tally since the company began tracking the data in 2005, surpassing the August record of 95,364. Foreclosure filings, including default and auction notices, rose 3 percent from the prior month to 347,420. One out of every 371 households received a notice.



Sales of properties in the foreclosure process accounted for almost a third of all U.S. transactions in the month, a sign that a prolonged delay in repossessions may hurt the housing market, RealtyTrac said. Bank of America Corp., the largest U.S. lender, said Oct. 8 it would curtail foreclosures across the country, while JPMorgan Chase & Co. and Ally Financial Inc. stopped seizures in 23 states where court approval is required.

"We're talking about loans that are almost certain to be foreclosed on," Rick Sharga, senior vice president of Irvine, California-based RealtyTrac, said in an interview. "The delays are only providing a stay of execution."

Attorneys general in all 50 states began a coordinated investigation yesterday into whether lenders used false documents and signatures to justify foreclosures. Banks and mortgage companies would be "well served" to cooperate with the probe and should consider negotiating settlements with borrowers in cases of potential fraud, Ohio Attorney General Richard Cordray told Bloomberg Television.

— Dan Levy

NEWS OF NOTE

Bernanke Ponders 'Crapshoot' as Fed Seeks to Support Prices

Federal Reserve Chairman **Ben S. Bernanke** once advocated setting an inflation target to keep prices from rising too fast. Now he may get the Fed to adopt a target to keep the inflation rate from falling.

Bernanke gives a speech on monetary-policy tools today, three days after minutes of the Fed's Sept. 21 meeting showed policy makers discussed "providing more detailed information about the rates of inflation" that officials consider consistent with stable prices and maximum employment. The objective would be to boost inflation expectations and stimulate the economy.

Announcing an inflation goal as a way to accelerate rather than slow price increases has a scant track record outside of Japan's efforts to beat deflation over the past decade. Fed officials are considering the move alongside a resumption of large-scale asset purchases intended to spur growth and lower unemployment stuck near a 26-year high.

"It's pretty much a crapshoot," former Fed Governor **Lyle Gramley**, now senior economic adviser at Potomac Research group in Washington, said of using an inflation target to support prices. "We don't really have any background of history to know how it's going to work." Still, "it's worth trying."

Bernanke, 56, is scheduled to speak at 8:15 a.m. at the Boston Fed's annual economic conference. The Fed's Open Market Committee next meets in Washington Nov. 2-3.

The minutes of last month's meeting signaled concern among officials about too-low inflation, saying businesses had "little pricing power" to pass on costs of some commodities and imported goods. Also, declining short-term inflation expectations would increase short-term real interest rates, after taking inflation into account, the minutes said.

Bond traders' inflation expectations for the next five years, measured by the breakeven rate between nominal and inflation-indexed bonds, rose to 1.68 percent yesterday, the highest level since June, from 1.47 percent on Oct. 12, when the minutes were released.

— Scott Lanman

TRENDS

DAVID POWELL, BLOOMBERG ECONOMIST

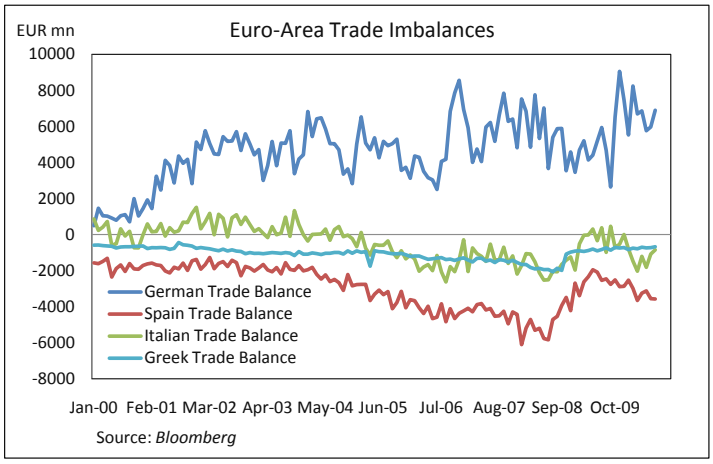
European Trade Imbalances Grow

Trade imbalances in the euro area are growing again. The year-to-date trade surplus of Germany increased in July to 87.7 billion euros from 72.4 billion euros in July 2009. The deficits of Italy and Spain widened to 12.5 billion euros from 1.3 billion euros and to 30.2 billion euros from 26.9 billion euros, respectively. Portugal's widened to 11.4 billion euros from 10.5 billion euros in the previous year.

Greece is adjusting. The trade deficit narrowed to 14.4 billion euros from 17.3 billion euros in the year to July 2009. The improvement was largely due to a 10 percent decline in imports, while exports were up 2 percent.

Greece would be better off if the reduction came from export growth instead of an import decline. That isn't likely as the country becomes less competitive. With inflation increasing in Greece faster than in other euro-area nations, the country's real effective exchange rate – the inflation-adjusted value of its currency – continues to rise, decreasing the attractiveness of Greek exports.

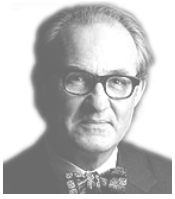
Eurostat reported today that the Greek consumer price index rose 5.7 percent year over year in September versus 5.6 percent in August. That compares to 2.1 percent in Spain and 2.0 percent in Portugal. The euro-area average was 1.8 percent. Prices rose 1.3 percent in Germany, suggesting that the largest economy in Europe will continue to outperform its neighbors.



MARKET INDICATORS

BOND MARKET	10-YEAR YIELD	1-DAY CHANGE IN BP	YTD CHANGE IN BP
U.S.	2.49%	–1.8	–134.7
Euro-Area	2.33%	3.9	–105.3
Germany	2.33%	3.9	–105.3
France	2.73%	3.1	–86.2
U.K.	2.91%	3.2	–110.3
Switzerland	1.45%	1.8	–44.7
Norway	3.20%	0.0	–94.1
Sweden	2.60%	4.5	–69.2
Turkey	8.19%	0.0	–264.0
S. Africa	7.86%	–1.7	–130.5
Canada	2.76%	2.6	–85.6
Brazil			
Mexico	6.02%	0.5	–198.5
Australia	5.08%	5.3	–56.5
New Zealand	5.05%	2.3	–76.0
Japan	0.89%	0.0	–41.0
Hong Kong	2.08%	4.7	–50.4
Singapore	1.96%	3.0	–70.0
CURRENCY MARKET	**LAST VS. USD**	**1-DAY% CHANGE**	**YTD% CHANGE**
Euro	1.4080	–0.03%	–1.68%
Japanese Yen	81.2300	–0.31%	–12.67%
British Pound	1.6061	0.31%	–0.67%
Swiss Franc	0.9539	0.09%	–7.85%
Canadian Dollar	1.0061	0.20%	–4.47%
Australian Dollar	0.9947	0.05%	10.81%
New Zealand Dollar	0.7579	–0.17%	4.86%
Danish Krone	5.2959	0.04%	1.90%
Norwegian Krone	5.7481	0.29%	–0.78%

CURRENCY MARKET	LAST VS. USD	1-DAY% CHANGE	YTD% CHANGE
Swedish Krona	6.5600	0.16%	–8.39%
Czech Koruna	17.4137	0.21%	–5.69%
Hungarian Forint	195.2700	0.31%	3.32%
Polish Zloty	2.7788	0.25%	–2.94%
Russia Ruble	30.2020	0.46%	0.56%
S. Africa Rand	6.8287	0.72%	–7.70%
Turkish Lira (000)	1407750.0000	0.05%	–6.23%
Brazil Real	1.6602	0.44%	–4.83%
Mexican Peso	12.3948	–0.14%	–5.32%
Chinese Renminbi	6.6411	–0.15%	–2.72%
Hong Kong Dollar	7.7585	0.01%	0.05%
Indian Rupee	44.1363	0.03%	–5.13%
Indonesian Rupiah	8919.0000	0.01%	–5.16%
Singapore Dollar	1.2965	0.12%	–7.72%
S. Korea Won	1111.5000	0.04%	–4.51%
Taiwan Dollar	17.4300	0.81%	21.89%
COMMODITY MARKET	**LAST VALUE**	**1-DAY CHANGE**	**1-DAY% CHANGE**
Crude Oil (Brent)	84.07	–0.13	–0.15%
Gasoline (NYM)	213.65	–2.96	–1.37%
Natural Gas (NYM)	3.66	–0.04	–1.06%
Gold (CMX)	1376.70	7.20	0.53%
Silver (CMX)	24.44	0.50	2.10%
Copper (LME)	8381.25	–18.75	–0.22%
Aluminum (LME)	2404.50	–8.50	–0.35%
UBS-Bloomberg Cmdty	1242.16	0.34	0.03%
Goldman Sachs Cmdty	570.47	0.25	0.04%
CRB Index	299.93	0.19	0.06%
Baltic Dry Index	2769.00	21.00	0.76%



KEENE'S CORNER

Tom Keene and Ken Prewitt talk with **Michael Aronstein,** president of **Marketfield Asset Management**, about green swans and global liquidity.

Q: Many of us knew you years ago at Merrill Lynch. Is it harder to do strategy now or easier with all the communication abilities and research advantages?

A: The hard part really is filtering out the noise to try to extract a signal. We've gone through a big period of data inflation and opinion inflation where every 10 seconds you can get an opinion from around the world, and it moves markets. And it's very, very difficult to have the discipline to take enough distance so you formulate your own perspective.

Q: You have a phrase - I love this - it explains the wall of worry. You call it "The green swan." Explain the green swan.

A: Well, it's an actually rare thing, as opposed to a black swan, which people believed to be rare but was much more common. And we've talked since August really about the possibility that the capital markets could just take off given the fact that our central bank seems to have panicked again in the midst of what is, I think, a reasonably good economic environment, and certainly with some tinges of inflation beginning. But they seem to be fixated on the unemployment rate at this point, which I doubt monetary policy is going to influence.

Q: But one of the great rules here is capital markets finance investment can really be removed from the labor economy in any given nation.

A: That's exactly right. The fundamentals of the capital markets, if you look at liquidity and the posture of the participants, are much, much better now than people are judging if they come at it from one of the fundamentals of the economy and how will that affect the capital markets.

Q: What's the most important fundamental you see?

A: Global liquidity.

Q: There's just so much cash around.

A: Yes. I just got back from Switzerland last week, and their private banks have between 25 and 35 percent of their customers' assets sitting in cash, which over there yields one basis point per annum. You have to really be wealthy to live on that.

Q: And yet, some banks are going beyond the latest capital standards and raising fresh capital so they can have even more cash sitting there doing basically nothing.

A. There's almost a panic into safe assets here across the board. And, you know, I think in a world that is this liquid, that's sort of the residue of central bank activity over the past 40 years. You know, banks come and go, funds come and go, but global savings are preserved by the intervention of central banks. So global - what we used to call "L," liquid assets, just keeps going up and up and up and up. And now its size is such that it's overwhelming the real economy.

Q: We've been having this conversation with equity guys for a couple of years now. Along the lines of, when are people going to get tired of getting no return, and when is safety going to be less important than some kind of income?

A: I think the investment community, and particularly their retail portion, is suffering from a form of Post-Traumatic Stress Disorder. I mean, '08 and '09 were so devastating to people, both actually and emotionally, that they just can't even think about undergoing the same experiences. I've spoken to lots of people who said, you know, "I really don't care what the stock market does. I just can't stand it." If stocks were not quoted, they would be much, much more popular at this point. And that's why you have all this money flowing into alternatives — office buildings and farmland and all kinds of esoterica, because they aren't quoted. You don't walk past the TV screen and see them fluctuate all day, which has become intolerable to people.

Q: Doesn't that get solved by, say, three years of good performance?

A: If you've been in the right sectors for the last dozen years or so, the whole notion of a lost decade is wrong. I mean, you had to make the transition away from the S&P 500, which was everybody's preferred investment in '99, 2000, index funds. You had record flows into S&P 500 index funds. If you just shifted to sort of global growth in some emerging market, some commodity related, if you did it on the day that Merrill Lynch closed its commodity department, which was somewhere, I think within two weeks of the low, you know, you had a very, very good decade.

Today's guests:
Jonathan Tisch of Loews Corp.; Brad Hunter of Metrostudy; Charlotte St. Martin of the Broadway League; Bloomberg's Al Hunt; NBC's David Gregory; James Wolfensohn, former president of the World Bank; ABC's Christiane Amanpour; Dana Telsey of Telsey

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