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Global

Outlook

The Global Monetary Analyst

Default or Inflate or…

How will governments and central banks respond to the sovereign debt crisis that we believe is in the making in the advanced economies? In previous issues of *The Global Monetary Analyst*, we have argued that governments may be tempted to inflate away some of the debt, and that sovereign risk therefore spells inflation risk. The markets disagree with this notion – inflation expectations are low – as do some of our colleagues! In today's lead piece, Gerard Minack, like Dick Berner in a recent note (see *We Can't Inflate Our Way Out*, February 19, or the short version on page 7), argues that bond yields and thus borrowing costs will rise in response to higher inflation and significant parts of government spending are indexed to inflation, so inflation won't do the trick. Rather than pushing inflation higher, Gerard thinks governments may try to push or keep bond yields below nominal GDP growth. One way to do this would be through regulation requiring financial institutions to hold large amounts of government bonds as a prudential measure. The debate will continue on these pages – stay tuned. p 2

Central Bank Watch

Key Central Bank Risk Events

Date	Country	Event
24 Feb	**US**	Bernanke's semi-annual monetary policy testimony
25 Feb	**Euro Area**	Jurgen Stark at workshop in Seoul, South Korea
25 Feb	**Norway**	Gov Gjedrem speech at Peterson Institute, Wash.
26 Feb	**Chile**	Monetary Policy minutes
26 Feb	**Colombia**	Rate decision: Expect on hold
02 Mar	**Canada**	Rate decision: Expect on hold
02 Mar	**Australia**	Rate decision: **Expect 25bp hike**
04 Mar	**Euro Area**	Rate decision: Expect on hold
04 Mar	**UK**	Rate decision: Expect on hold
04 Mar	**Indonesia**	Rate decision: Expect on hold
04 Mar	**Malaysia**	Rate decision: Expect on hold

What's Changed?

	Forecast Changes Since Last Week
Israel	Policy rates: 1.25% end-1Q10 (prev. 1.5%)

Where Do We Differ Most from the Market?

Fed expected to raise rates by more than markets expect (page 16)

BoJ expected to cut rates in 2Q10, markets expect no cuts (page 16)

Default or Inflate or…

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- How will governments respond to the sovereign debt crisis that looks increasingly likely in the advanced economies? Apart from open default or severe fiscal belt-tightening, covert default through inflation has historically been quite common. Our colleagues Joachim Fels and Spyros Andreopoulos have argued on these pages before that governments and central banks may choose to inflate away the debt.
- By contrast, we are not persuaded that governments and central banks would want go down the inflation route and, even if they did, that it would work. Like Dick Berner, who shares our scepticism, we think that rising bond yields in response to increasing inflation and the fact that significant parts of government expenditures are linked to inflation imply that inflation may not do the trick.
- So, rather than pushing inflation and thus nominal GDP growth higher, governments may try to push bond yields below nominal growth to reduce debt ratios. One way to do this would be through financial regulation requiring financial institutions to hold large amounts of government debt as a prudential measure.

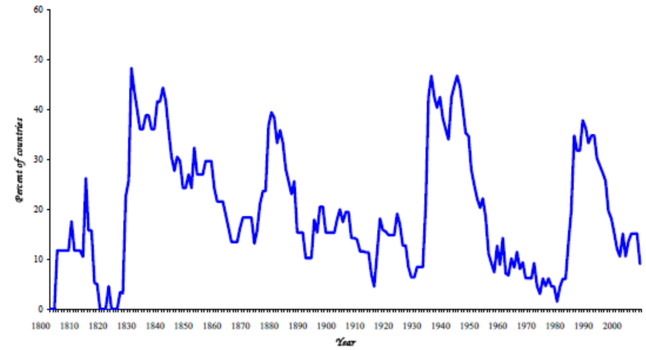
So many countries with so much debt; crisis seems very likely at some stage: As we've noted elsewhere, the options seem to be severe belt-tightening (threatening renewed developed world recession), bail-out or default, overt or covert. Last Friday we looked at what belt-tightening requires (see *Downunder Daily: What Sort of Escape?* February 19, 2010). Bail-out is possible for an individual country, but not really feasible this time, given the breadth of the problem. Who could bail out the G-20? So, here we look at the third option.

We've taken three messages from Reinhart & Rogoff's *This Time Is Different: Eight Centuries of Financial Folly*, April 16, 2008. First, debt levels now are very high by historical standards. Second, sovereign default is, on a long view, quite common. The past few years have seen a lull, but there have been lulls before (see Exhibit 1). Third, this time will probably *not* be different.

Exhibit 1

Sovereign Crises Come in Waves

Sovereign External Debt, 1800-2006
Percent of Countries in Default or Restructuring

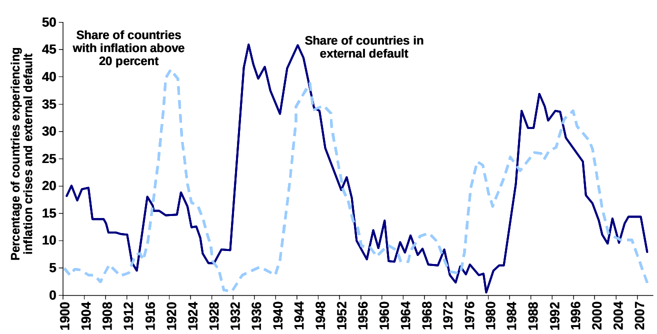


Note: Sample based on countries (out of a sample of 66) that were independent in the specified year.
Source: Carmen Reinhart & Kenneth Rogoff, This Time Is Different, Morgan Stanley Research

Sovereign borrowers can default overtly or covertly: Covert is currency debasement: literal debasement in the case of commodity-based money; by inflation with fiat money. (There used to be a third option: 'creditor reconstructions'. Absolute monarchs had a history of executing creditors, which was one reason why it was not unusual for sovereign debt to trade at an interest rate premium to private debt.) History shows that inflation tends to rise in times of sovereign stress (see Exhibit 2). This is one reason why Joachim Fels says that sovereign risk boils down to inflation risk (see "Five Themes for 2010", *The Global Monetary Analyst*, January 6, 2010; for more details see also S. Andreopoulos, "The Return of Debtflation", *The Global Monetary Analyst*, February 10, 2010).

Exhibit 2

To Default, or to Inflate?

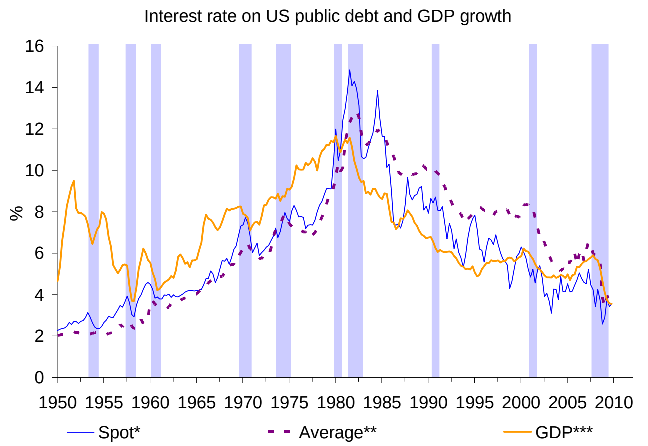


Source: Carmen Reinhart & Kenneth Rogoff, This Time Is Different, Morgan Stanley Research

As we've noted before, inflation doesn't solve a debt problem, *unanticipated* inflation does: Think of it this way: If a borrower's debt is tied to inflation (along the lines of TIPS), then it's not possible to inflate away the debt. From a macro view, a sovereign can inflate away the debt if the average interest rate on the debt falls below the growth in nominal GDP. (It doesn't matter whether it's volume growth or inflation driving GDP.) This is how the public sector deleveraging after World War II was accomplished. Exhibit 3 shows that the average interest rate on public debt in the US was below the nominal GDP growth rate.

Exhibit 3

How to De-lever: Lift Growth but Not Rates



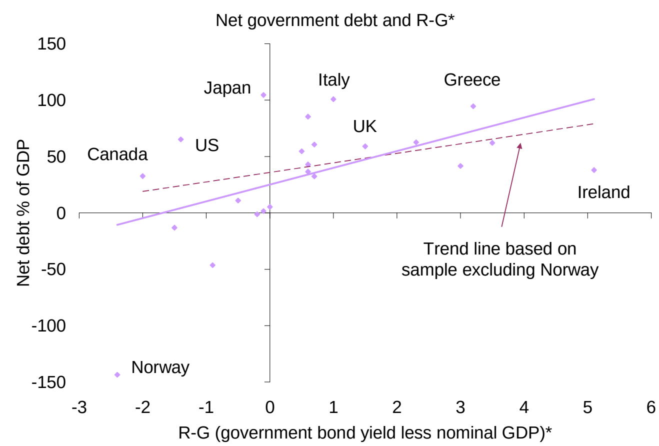
*Spot 10-year Treasury yield; **Average rate paid on stock of debt outstanding; ***5-year average nominal GDP growth
Source: Federal Reserve, Treasury, Datastream, Morgan Stanley Research

The key question now is: Can governments get the nominal growth rate above the average interest rate? We're not persuaded that targeting higher inflation will do the trick. In part that's for obvious reasons: it would require a wholesale abrogation of many of the institutional arrangements put in place over the past few decades – such as independent central banks and inflation targets – and the hard-won gains achieved through the disinflation period starting from the early 1980s.

In part we're sceptical because markets are seemingly awake to the risk. Exhibit 4 shows a scatter plot of countries' net government debt and the current gap between the bond rate and (forecast) nominal GDP growth. Most countries with high debt are already paying interest rates above expected nominal GDP growth. And markets demand a higher premium as debt increases.

Exhibit 4

Can Markets Be Fooled?



*R-G is yield on bond of average maturity less forecast nominal GDP growth for 2010-11
Source: *The Economist*, Morgan Stanley Research

Exhibit 3 also shows that in the US there is a clear link between nominal GDP growth and the bond yield (and, with a lag, the average actual rate paid on the stock of public debt). As an additional complication, Dick Berner notes that in the US nearly half of budget outlays are now effectively indexed to inflation (see *We Can't Inflate Our Way Out*, February 19, 2010, or the short version on page 7).

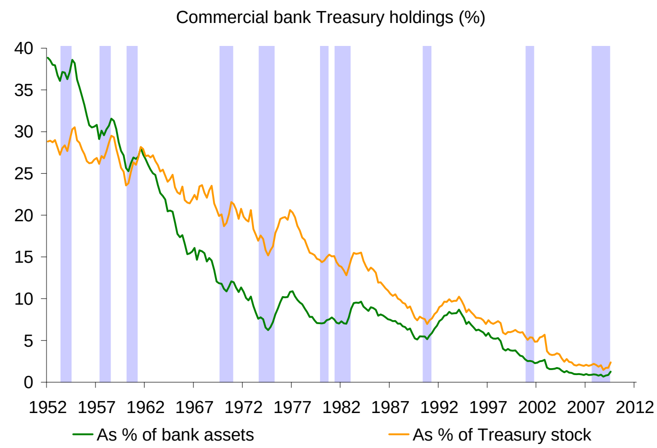
How to push interest rates below nominal growth? Interest rates were below nominal growth rates in the years after World War II, which was also when the public sector accomplished most of its deleveraging. This was largely due to financial regulation. The Federal Reserve, which was not at that stage independent, acted to cap long-end rates at 2.5%. This arrangement ended with the Treasury accord of 1951.

Regulation may be the answer: Here's our key point: If the way to covertly default is to pay an interest rate below the nominal growth rate, we think it's possible that policymakers will aim to lower the interest rate rather than lift the inflation rate. In a sense, central banks buying government debt are already a small step down that path. A medium-term approach, however, could be to compel private financial institutions to purchase government debt. Such holdings were often mandated (as prudential measures) prior to the deregulation of financial systems in the 1980s.

In the US, for example, commercial bank holdings of Treasury paper have fallen significantly, both as a percentage of bank assets and as a percentage of the stock of Treasuries on issue. Commercial banks now have a balance sheet of around US$8 trillion. Requiring them to hold 20% of their assets in Treasuries would imply demand for over US$1.5 trillion of Treasury paper. All else equal, this would obviously squeeze the provision of credit elsewhere in the system, unless regulators allowed banks to increase their leverage (which would be justified on the basis that so much of their asset base is in 'safe assets'). We are not recommending this. But it seems to us that high sovereign debt may be resolved not by a deliberate shift to higher inflation, but by re-regulation that compels buyers to accept uneconomic yields.

Exhibit 5

An Offer They Won't Be Able to Refuse?



Source: Federal Reserve, Morgan Stanley Research

Inflation Target Monitor & Next Rate Move

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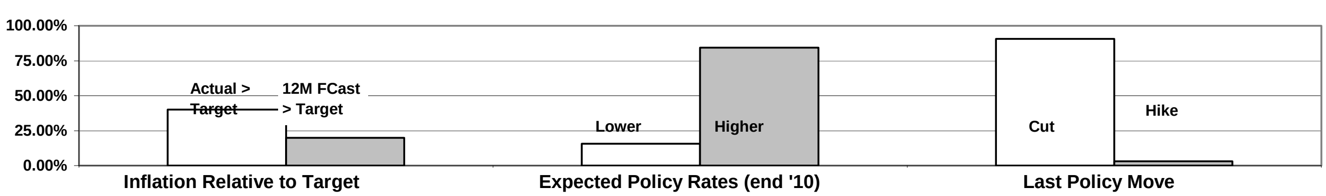
	Inflation Target	Latest Month	12M MS FCast	Next Rate Decision	Current Rate	Market Expects (bp)	MS Expects (bp)	Risks to our call
United States	1.7-2.0% PCE Price Index	1.5%	1.8%	16 Mar	**0.125**	3	0	Fed more cautious on outlook than seems appropriate to us
Euro Area	< 2% HICP (u)	1.0%	1.4%	04 Mar	**1.00**	0	0	ECB still happy with EONIA below refi rate
Japan	0-2% CPI (u)	-1.3%	-0.3%	17 Mar	**0.10**	0	0	-
United Kingdom	2% CPI	3.4%	1.3%	04 Mar	**0.50**	0	0	QE could be restarted in double-dip
Canada	1-3% on CPI	1.9%	1.7%	02 Mar	**0.25**	0	0	Downside risk from weaker-than-expected US demand
Switzerland	<2% CPI (u)	1.0%	0.4%	11 Mar	**0.25**	1	0	-
Sweden	2.0% CPI	0.6%	1.3%	20 Apr	**0.25**	7	0	Balanced
Norway	2.5% CPI	2.5%	2.5%	24 Mar	**1.75**	11	25	On hold
Australia	2-3% over the cycle	2.1%	1.9%	02 Mar	**3.75**	10	25	Rates remain unchanged
New Zealand	1-3% CPI	2.0%	1.8%	11 Mar	**2.50**	0	0	Very low risk of a hike
Russia	None	8.0%	7.5%	-	**8.50**	0	0	-
Poland	2.5% (+/- 1%) CPI	3.8%	2.4%	30 Mar	**3.50**	3	0	-
Czech Republic	3.0% (+/-1%) CPI	0.7%	2.1%	25 Mar	**1.00**	-4	0	-
Hungary	3.0% CPI	6.4%	3.0%	29 Mar	**5.75**	-21	-25	Risks of a pause have increased
Romania	3.5 (+/-1%) CPI	5.2%	3.1%	29 Mar	**7.00**	-	-50	-
Turkey	6.5% CPI end '10	8.2%	6.1%	18 Mar	**6.50**	0	0	-
Israel	1-3% CPI	3.8%	2.3%	28 Mar	**1.25**	-	0	BoI might hike
UAE	-	-	8.6%	-	**1.00**	-	-	-
South Africa	3-6% CPI	6.3%	5.7%	25 Mar	**7.00**	-11	0	D'side surprise in electricity decision; prompts further easing
China	-	1.5%	2.5%	-	**5.31**	-	0	Balanced risk
India	8.5% WPI	8.6%	5.9%	20 Apr	**3.25**	0	25	Growth weaker than expected
Hong Kong	-	1.0%	2.0%	-	**0.50**	-	0	Premature US tightening upon global inflation uptick
S. Korea	2-4% CPI	3.1%	3.3%	11 Mar	**2.00**	-	25	Political influence may delay rate hike cycle
Taiwan	-	0.3%	0.5%	25-30 Mar	**1.25**	-	25	Early rate hike possible on excessive liquidity
Singapore	1.5% (long-term CPI) (u)	0.3%	2.9%	01 Apr	**0.67**	-	NA	Changes in the FFTR and SGD appreciation pace
Indonesia	5% +/- 1.0%	3.7%	6.0%	04 Mar	**6.50**	-	0	Evenly balanced
Malaysia	-	1.1%	1.7%	04 Mar	**2.00**	-	0	Evenly balanced
Thailand	0.5-3.0% core CPI	4.1%	3.3%	10 Mar	**1.25**	-	0	Evenly balanced
Brazil	4.5% +/-2.0% IPCA	4.6%	4.9%	17 Mar	**8.75**	0	0	Start of hiking cycle is matter of time
Mexico	3% +/-1% CPI	4.5%	4.4%	19 Mar	**4.50**	0	0	Inflationary impact of tax reform in 2010
Argentina	15.5-24.2% M2 growth	8.2%	10.5%	NA	**10.75**	-	-	-
Chile	3% +/-1% CPI	-1.3%	2.8%	18 Mar	**0.50**	0	0	CB signaled first hike as early as in 2Q10
Peru	2% +/-1% CPI	0.4%	2.3%	11 Mar	**1.25**	0	0	-
Colombia	5% +/-0.5% CPI	2.1%	4.2%	26 Feb	**3.50**	0	0	Strong currency leading to more easing

(u) = unofficial
Notes: Inflation numbers in red indicate values above target; MS expectations in red (green) indicate our rate forecasts are above (below) market expectations



Source: National Central Banks, Morgan Stanley Research
Notes: (u) = unofficial target; Interest rate expectations are implied by overnight indexed swap (OIS) curves and may differ from those implied by other instruments; where adequate OIS data are not available, FRAs, foreign exchange swaps, and/or interbank cash rate futures are used; due to varying risk premia (such as liquidity, basis, credit, term, reserve management, calendar turns, etc.), these figures should be used as estimates only; where such instruments are not available, we have inserted our best guess of what markets expect based on consensus estimates.

Central Bank Balance Sheet Monitor

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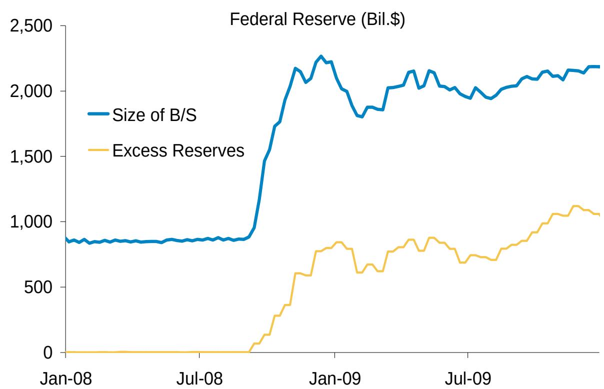
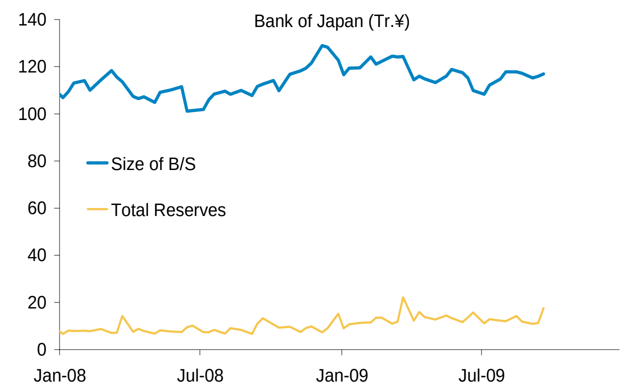
US



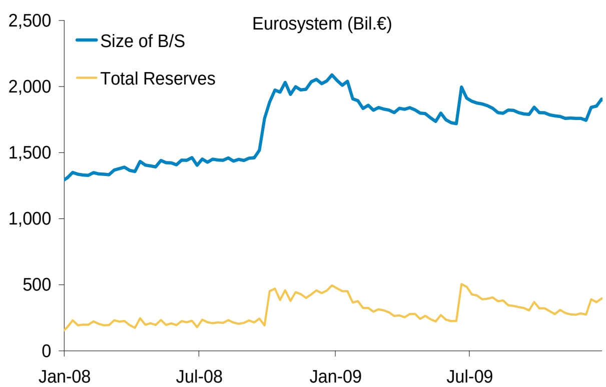
Source: Haver Analytics

Japan



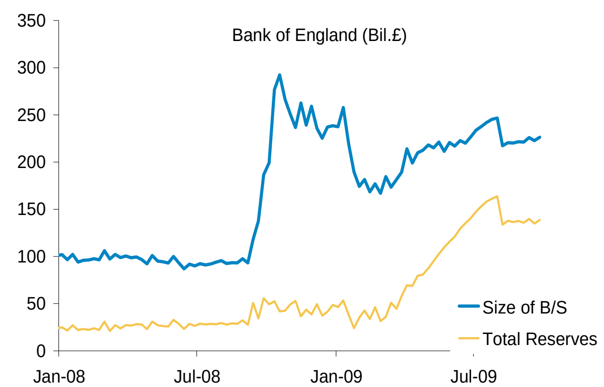
Source: Haver Analytics

Europe



Source: Haver Analytics

UK



Source: Haver Analytics

Central Bank Watch

What's New This Week?

US: We Can't Inflate Our Way Out

Richard Berner (1 212) 761 3398

Inflation is not the solution: Three hurdles preclude eroding US debt with inflation. 1) Even a stealth inflation policy would quickly push up yields. 2) Nearly half of federal outlays are linked to inflation, so inflation would boost deficits. 3) And the Fed is unlikely to acquiesce.

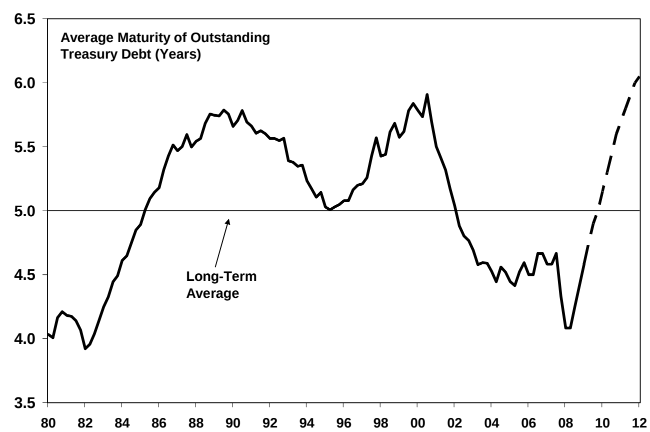
The lesson of the 1970s: The Great Inflation did erode real debt, but perhaps by less than it appears. More important, the US post-war experience was anomalous: A rapid decline in defense spending yielded a significant 'peace dividend', monetary policy was then designed to hold down interest rates, and restrictions on Treasury debt issuance also brought down debt/GDP by restraining rates and debt maturities.

Indexed budget: Inflation likely will push up US deficits: Social Security, which accounts for one-quarter of federal outlays, is officially indexed, and Medicare and Medicaid are 'unofficially' indexed. Together, these programs will account for nearly half of all federal outlays in the next decade.

Venting market pressures: Rates or currencies?
Sovereign credit risk may create inflation risk, but perhaps not for years. The more immediate pressures may instead vent in rate or currency risk. Either global investors will demand a concession to buy US debt, or they will actively diversify from it, giving 'punish the printers' a new meaning.

For details, see *US Economics: We Can't Inflate Our Way Out*, February 19, 2010.

US: Rising Interest Rates and Debt Maturities Will Boost Debt Service



Note: 2010-12 values represent Morgan Stanley Research estimates
Source: US Treasury, Morgan Stanley Research

Central Bank Watch

US: SFP Revival Begins Fed Exit Strategy

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The ramp-up in the Supplementary Financing Program (SFP) represents an unnecessary cost to US taxpayers, in our view. The US Treasury has announced that it will ramp up SFP bill issuance – and in big amounts. Thus, implementation of the Fed's exit strategy begins in earnest February 24, with the Treasury starting weekly US$25 billion SFP bill auctions. The bills will have eight-week maturities, so the total size of the program will rise to US$200 billion over the next couple of months from the current US$5 billion, draining US$195 billion from the banking system. This is a substantial portion of the current US$1.1 trillion in excess reserves in the banking system and will prevent a further increase as remaining MBS and agency purchases totaling about US$200 billion come on the Fed's balance sheet as buying is completed in March.

Admittedly, the direct impact of the SFP on US government finances is relatively neutral: The Treasury pays interest on the bills issued, but receives an implicit return on these funds because excess reserves in the banking system are reduced, lowering the amount of interest the Fed must pay on those reserves. Since the Fed remits its profits back to the Treasury, there is an implicit return to the Treasury associated with funds raised via SFP, which over time should just about match the direct cost associated with the extra issuance.

However, there is also an important indirect effect associated with the extra issuance that raises the cost of Treasury debt financing. By issuing a large volume of extra T-bills that are not needed to finance government operations, the Treasury places upward pressure on the yields of other bills, and perhaps even some short-dated coupons, via a 'crowding out' effect. While the cost might be relatively modest at the current low level of interest rates, it could grow over time. Most important, even a small cost at the margin would seem to violate the prime objective of Treasury debt management: "to achieve the lowest cost financing over time". If the Federal Reserve wants to shrink the supply of excess bank reserves, it now has the tools to do so without putting upward pressure on Treasury borrowing costs.

The SFP accomplishes the same thing as reverse repos and/or term deposits but seems to fly under the radar – and this may be why the Fed wanted to bring the SFP back. So few people appear to understand what the SFP is all about that it doesn't carry the same sort of signaling problem associated with other reserve-draining techniques. But the SFP comes at a cost to taxpayers because it results in higher Treasury yields at the margin than we would see otherwise.

Euro Area: All Eyes on the Refis

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The March meeting will likely provide ECB watchers with a long-awaited update on the ECB's outlook for the economy, inflation and monetary policy: We don't expect any major revisions to the ECB staff projections. In fact, the bearish growth forecast of just 0.8% for this year seems to be borne out by the incoming data. If anything, further down the line, the weaker euro and the stronger growth abroad could potentially boost 2011 estimates for both growth and inflation. Overall, however, we don't see a reason for the ECB to change its current assessment of the outlook for price stability.

The key debate for the upcoming ECB meeting thus will likely be the ECB's liquidity measures: In our view, the full allotment procedure will likely remain in place for the main refinancing operation, the long-term refinancing operation and the additional three-month operations. As far as the main refinancing operation is concerned, we would expect the ECB to leave full allotment in place at least until the one-year tender expires at the end of June. Under the current full allotment regime, it would only take a quick tender to allow banks to roll the collateral over into the next MRO. Another key decision the ECB is likely to announce at the press conference is whether the last six-month tender will be offered at the current refi rate or whether it will be put on a tracking rate like the December one-year tender. In our view, a tracker rate would be an indication that the ECB is not willing to commit to the current refi rate level until the end of 3Q. This would keep the door open for a September rate hike. The opposite logic applies if it goes for a fixed rate at 1%. Finally, the ECB is likely to make some announcements regarding the additional three-month tenders. There is a possibility that this will be gradually phased out, we think. In addition, the ECB Council might decide to switch these longer-dated tenders back to auction. Together with the ongoing reduction in the maturity of the ECB funding operations, this should cause money market interest rates to rise, especially for longer-dated EURIBOR contracts, which should push above the refi rate. At the same time, EONIA is still likely to be anchored closely to the deposit rate. Even though the overall amount of liquidity available to the banking system is largely determined by the banks' bidding behaviour, the markets will still perceive this as a tightening in monetary policy, which would push funding costs higher.

Central Bank Watch

Japan: Government's Serious Stance Revealed

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Not surprisingly, the policy debate was boring, however... One notable point in the January MPM minutes was in the remarks from the government representative (Mr. K.Umetani, Deputy Director-General, Economic and Fiscal Management, Cabinet Office). Indeed, the remarks show that the government has become more serious in overcoming deflation. The following is the comparison of the relevant part in the December and January MPM. Most notably, the government representative referred to the timeframe, using the term "as early as possible" in the January MPM.

December 18: In order to gain public acknowledgement that an economic recovery was underway, the government recognized the importance of overcoming deflation. Holding this view jointly with the Bank, the government would work together with the Bank to ensure economic recovery and overcome deflation.

January 26: Given that deflation had a considerable negative impact on the economy and eventually on people's lives, it was important that the government, with the aim of overcoming deflation, work together with the Bank to achieve a positive inflation rate as early as possible.

No policy change in February MPM, as widely anticipated: Given the recent stability in the FX and stock market, it is rather natural for no move, considering the BoJ's nature to react only when the market destabilizes or politicians put pressure on. Nonetheless, we look for more monetary accommodation in response to the government's motions. We retain our out-of-consensus call of the adoption of the inflation target (common target shared by the government and the BoJ) as early as in Apr-Jun quarter, before the Upper House elections when the government will argue for the supplementary budget and the "Mid-term Fiscal Frame". The upcoming actions include the extension of the scheme of fixed-rate facility which the Bank introduced last December, and the Rimban (outright JGB purchasing) value increases.

Australia: The Odd Expansion

Gerard Minack (61 2) 9770 1529

This year Australia faces payback for last year – the unwind of last year's policy stimulus will stunt domestic activity: Headline GDP growth will be better as exports rise. But what appears to be a statistically solid recovery may feel unexpectedly tepid for domestic consumers and business.

This year will be influenced by the events of last year: Australia avoided recession due to unprecedented policy action. Household disposable income increased by 10.1% over the year to the September quarter, while labour income – the biggest component of household income and traditionally the largest swing factor – increased by just 0.4%. The deceleration in labour income last year was not markedly different to what occurred in the early 1990s recession. Total income fell in lock-step with labour income in 1991. This time there was total disconnect.

Almost all household income growth was due to policy measures: The most important factor was falling interest payments. Net interest expenses fell by 7 percentage points of income. This was the 'benefit' of high leverage (and the preponderance of variable-rate mortgages). As an aside, none of this had anything to do with China. China did not save Australia.

The important forward-looking point is that fiscal policy is moderating and monetary policy is reversing: Monetary policy was the more important support for household income last year, so its reversal will have a big effect. While labour income is set to rise though 2010, household disposable income growth is likely to fall. I suspect that the Australian consumer faces a larger decline in income growth this year than any other consumer in the developed world.

The 'great swap': This is one specific example of what was a global phenomenon – the policy response to the 'Great Recession' was the 'great swap'. In Australia, the great swap saw a massive transfer of income from the public to the private sector. The private sector sharply increased its net lending (reduced its unprecedented borrowing), but that was cushioned by the deterioration in public sector finances.

In bigger picture terms, 2010 will start a persistent pattern likely through the coming cycle – reasonable GDP growth, but domestic demand growth that runs below that seen in the prior cycle.

Central Bank Watch

Russia: Dovish Rate Statement

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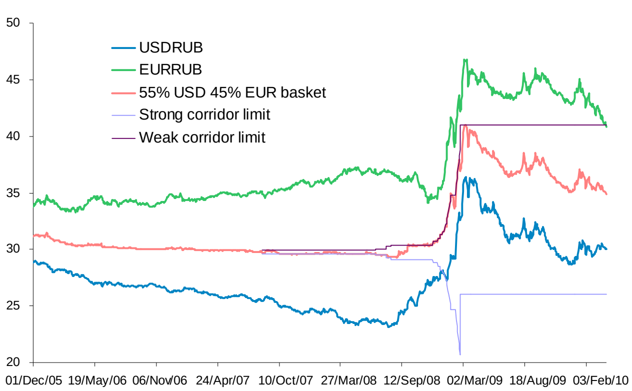
Dovish rate statement: The 25bp rate cut on February 19 was well flagged and expected, but accompanied by a statement that was to the dovish side of our expectations. In particular, the comment about an absence of significant inflation risks on the foreseeable horizon was surprisingly dovish. We remain optimistic on the near-term inflation outlook, and still expect a further 75bp of rate cuts by mid-year. We expect 0.7% CPI growth in February as a whole, and the year-on-year rate to fall to 7.0%, from 8.0%Y in January. Base effects remain favourable after last year's devaluation, unit labour costs are still falling and monetary policy has been relatively tight until recently. January's output data were somewhat distorted by extremely cold weather (7C below the average for Moscow), but retail sales and industrial production were extremely strong. We expect inflation to bottom slightly below 6.0%Y in July, but we think longer-term inflation risks are significant.

RUB still the driver: Indeed, we think pressure from capital inflows is likely to remain the main driver of near-term rate cuts, and long-term inflation risk. The CBR's options in response are limited, but we remain very positive on the near-term outlook for RUB appreciation against the basket – our year-end target remains at 33.0. The current account remains firmly in surplus at current oil prices, while we see growing prospects of a significant capital account surplus, particularly as confidence in the domestic banking system recovers. Meanwhile, the strength of the USD (and potentially the CNY) is significantly reducing the political costs of appreciation against the basket.

Russia: RUB Appreciation Accelerating



Source: Haver, Morgan Stanley Research calculations

Hungary: Narrower Room for Manoeuvre

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The National Bank of Hungary cut rates by 25bp on February 22 to 5.75%: This was in line with our and consensus expectations, though lately risks of unchanged rates had risen. The bank also released its updated GDP and CPI projections. The new forecast shows CPI inflation at 4.4% in 2010 (annual average) and 2.3% in 2011. These are up from 3.9% and 1.9%, respectively, much as expected. The GDP forecast for 2010 was nudged up slightly, from -0.6% to -0.2%. The 2011 forecast was left unchanged at 3.4%. The Council discussed both a 50bp cut and also (for the first time in a while) a motion to leave rates unchanged. In the end, the 25bp cut had a "convincing" majority. In the press conference, Governor Simor said that he did not want to predict what would happen in March, and that the April elections were not a material event for the MPC, unless they of course affect the country's risk profile. However, as the statement also mentioned explicitly, he added that the room for manoeuvre had "narrowed".

Closer to the trough: This action and tone was in line with what we expected. We will see what the MPC minutes say, but it seems likely that the MPC is close to the bottom or at the very least a pause. It has never been so clear as now that the external environment, not the GDP and CPI outlook, determines the rate profile. By Simor's own admission, the EU fiscal crisis has thus far had a limited impact on Hungary, but this can always change. Thus far, contagion from the EU periphery to Hungary has been limited, much as fundamental analysis would have suggested (see *CEEMEA: Greece and CEE Contagion*, February 11). However, if stress were to spread from the periphery back to the core (see *Greece and EMU: Between a Rock and a Hard Place*, Elga Bartsch, February 22), then it would be harder for CEE not to be affected, we think. Overall, we maintain a cautious view that rates can fall to 5.50% (just another cut). The benign combination of events that would lead the NBH to be more relaxed about the external environment, focus on domestic CPI and GDP and take rates much lower just does not seem likely to us.

Central Bank Watch

Turkey: Inflation Might Disappoint

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Headline inflation to jump: The sharp rise in inflation in January was quite anticipated and the impact was relatively muted. The high increases in taxes had been the root cause of inflation last month but food prices also contributed heavily to the headline number. In February, we expect unprocessed food prices to have a significant impact on inflation and we think the headline figure can easily reach 0.8% (data due out on March 3). Our calculations show that the recent flooding and adverse weather conditions had a dramatic impact on fruit and vegetable prices, and this alone might pose a noticeable risk to the headline print. If monthly inflation comes out at 0.8%, the 12-month trailing rate will rise to 9.4%Y – the highest reading since January 2009. According to our projections, inflation is likely to remain at or above 9% for most of the year until 4Q10.

Not much the CBT can do: The CBT had strongly stressed the fact that core inflation remained tame and was likely to stay that way. While we agree for the most part, we also believe that a rise in headline inflation might adversely impact inflation expectations and result in pricing behaviour that might cause an escalation in core inflation as well. In that sense, we will be watching the CBT's fortnightly survey of expectations, due out on February 22. Also, if headline inflation remains at around 9% or more for an extended period, the market participants' confidence in the attainment of the inflation target might be in further jeopardy. That said, we do not expect the CBT to make any move in the near term, and it is highly likely that the bank will use the communication tool to address the problem. However, we will be watching for the first signs of action on the liquidity front as the CBT might decide to raise the reserve requirement rate by 1pp and then perhaps alter the size and the duration of funding banks via repos.

We maintain our cautious view: Our year-end CPI inflation forecast still remains above that of the CBT and the consensus. Against the CBT's 6.9% and the consensus forecast of 7.5%, our forecast is 7.7%. While we maintain this position, we acknowledge the possibility that the risks might actually be on the upside, especially if monetary policy remains loose and for a more extended period than we envisage. Moreover, if food prices continue to rise (or at least not decline) and clearly depending on the currency and crude oil pair, we might need to revise our numbers.

We still expect 150bp of tightening, despite the post-MPC rhetoric of the CBT remaining dovish and the intention to hold rates steady as long as possible being conveyed. We believe that the conditions on the inflation front as well as the commencement of the monetary tightening, or normalisation, in other central banks might force the CBT to take action.

Israel: Policy Rate Unchanged

Tevfik Aksoy (44 20) 7677 6917

The BoI kept the policy rate unchanged as expected: Taking into account the tame inflation reading, the achievement of lower inflation expectations and especially given the concerns surrounding growth prospects in Europe as well as low central bank policy rates abroad, the BoI kept its policy rate unchanged this month at its February 22 meeting. This was in line with our own and the consensus forecast. In the accompanying statement, the BoI gave no indication of any future bias, which suggests that the upcoming rate decisions will be purely data-driven. While we realise that the BoI might remain cautious in the near term and refrain from hiking, our base case expectation for further tightening remains unchanged. We maintain our view that the policy rate will be hiked by 150bp until year-end.

The recent release of the headline CPI inflation at -0.7%M was a surprise. The reading turned out to be much better than the consensus estimate of -0.3%M and even our more optimistic -0.5%M. As a result of the low monthly print, the 12-month trailing inflation rate eased 3.8%. In fact, the January reading was a second surprise in a row, which must have helped the BoI's decision quite noticeably. Essentially, inflation eased on the back of a 0.6%M drop in housing and the lowering of VAT. If housing prices continue to ease, or at least remain rather tame, then a disinflation process could materialise even faster than expected. While the January annual inflation figure was clearly higher than the 1-3% target range, the base effects played a significant role. In fact, we expect the base effects to remain dominant until May 2010, after which we should start experiencing a more notable decline in inflation. The BoI acknowledged this as part of the short summary published following the rate-setting meeting. As the BoI indicated, the surprisingly low reading in inflation data helped to improve inflation expectations almost immediately as the 12-month forward-looking inflation expectations declined from 2.7%Y to 2.2%Y.

Central Bank Watch

South Africa: V-Shaped Recovery

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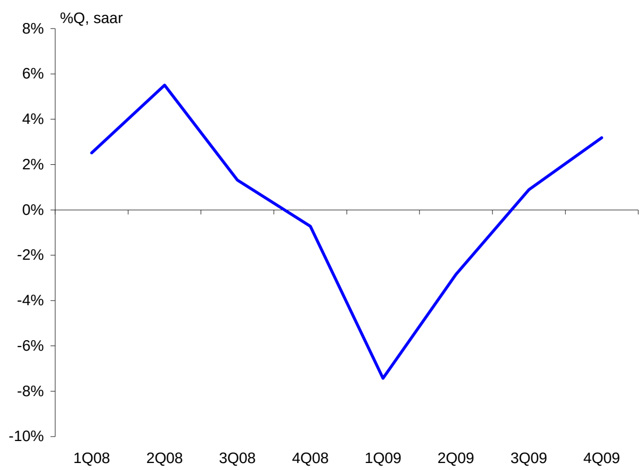
Brisk growth in 4Q: South African GDP growth registered a brisk 3.2%Q (seasonally adjusted and annualised) in 4Q09 – enough to limit the annual rate of contraction to 1.8%. Consensus estimates were revised upwards to 2.6%Q just last week, compared to our more aggressive 2.9%Q forecast.

The 4Q09 print should be well received by investors concerned about the durability of the domestic recovery: Trends in PMI indicators suggest that restocking activity by industrialists is underway, and for as long as global (particularly Asian) demand continues to improve, we expect such trends to metamorphose into sustainable inventory build at some point.

No rate cut likely in March: We believe that the February 23 GDP print shows, in no uncertain terms, that further monetary policy easing is unnecessary. From a market pricing perspective, 1x4 forward rate agreements rose after the reading, decisively pricing out any chance of a rate cut at next month's MPC meeting on March 25. On our estimates, the next move in policy rates will be a 50bp hike in 1Q11 (as part of 100bp of hiking in that quarter).

South Africa: GDP Rebound a Classic V-Shaped Recovery



Source: Statistics South Africa, Morgan Stanley Research

China: Rebounding CPI in February

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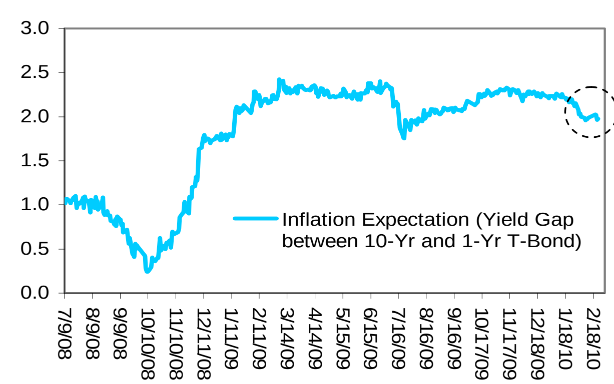
Rebounding CPI in February: We forecast that the February CPI will rebound to +1.9%Y after the lower-than-expected reading of +1.5%Y in January. The regained strength of CPI is attributable to Chinese New Year seasonality as well as last year's low base (-1.6%Y). We expect PPI to intensify to +4.8%Y after the strong reading of +4.3%Y in January, which will be transmitted into CPI via non-food inflation. According to our estimates, the carryover effects of CPI and PPI inflation will be -0.8% and -4.1% for February, respectively, which means that 0.8pp of CPI and 4.1pp of PPI will be explained by carryover effect rather than new price increases in February.

Higher week-on-week producer product prices: After softening for four consecutive weeks, the producer product index rebounded +0.6%W during February 15-21. In terms of sub-categories, except for a mild correction of energy products and flattish ferrous metals, all other products saw positive week-on-week growth rates. Mineral products and non-ferrous metals rose strongly, after dipping during February 1-7.

Inflation outlook: The PBoC has raised the RRR twice in the first two months of 2010, which has helped to manage inflation expectations effectively. With the gradual kick-in of the low base effect (or carryover effects) in coming months, we expect headline inflation to trend up, peaking in June. Any surprise on the upside, which derails the inflation rate from the forecast trajectory, could bring about an earlier hike of benchmark interest rate by the PBoC, in our view.

China: Well-Contained Inflation Expectations



Source: CEIC, Morgan Stanley Research

Central Bank Watch

Hong Kong: January Inflation Biased Downwards by New Year

Denise Yam, CFA (852) 2848 5301

January headline CPI +1%Y, in line with forecast: After surprising on the upside in December (+1.3%Y), headline CPI inflation eased somewhat to 1%Y in January, in line with our and market expectations. The ease, nevertheless, was primarily due to the Lunar New Year-related high base for comparison in the year-ago period. Meanwhile, as the headline figure remains biased upwards by the cancellation of fiscal concessions (electricity bill subsidy and reduced concession on property rates), we continue to follow the trends in underlying deflation (netting out the distortion from fiscal concessions), which came to 0% in January, down from 0.3% in December.

Downward bias due to Lunar New Year (LNY) effect: Prices for a few categories in the CPI basket were elevated in January 2009 amid the LNY, which fell instead in February this year. As a result, food (ex-eating out) prices fell in January 2010, with the most noticeable drop in poultry. Also because of the different timing of the holiday, package tours cost less in January versus a year ago. Likewise, February CPI data, to be released on March 22, will likely be biased upwards, in our view.

LNY effect aside, inflation continues to head up with economic recovery: The deflation episode that Hong Kong underwent last year turned out to be much shallower than expected, primarily due to the prompt bounce-back in the property market. Meanwhile, the consumer demand recovery has been allowing better pricing in discretionary items such as clothing and footwear, entertainment/holiday expenses and travel/sports goods.

Upside risk in inflation forecast in 2010; we will revisit after announcement of F2010/11 Budget: The earlier-than-expected return to positive underlying inflation amid a robust consumer demand recovery and buoyant asset markets poses significant upside risk to our current 2% inflation forecast for 2010. Nevertheless, we shall await the F2010/11 Budget, to be unveiled on February 24, to factor in any extension in (or introduction of new) fiscal concessions that lowers the cost of living in the coming months, before we pin down our new forecasts.

Singapore: 4Q09 GDP and Likely Policy Reaction Function

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What's new? Singapore's 4Q09 GDP estimate was released on February 19, coming in at 4.0%Y (versus 0.6%Y in 3Q09). This compares to the 3.5%Y GDP advance estimate released earlier in January and is a touch higher than the 3.8%Y and 3.9%Y expected by us and consensus. On a seasonally adjusted sequential basis, the economy declined 2.8%Q annualised, but this is largely due to a pharmaceutical correction. We doubt that this is a precursor to a double-dip recession. Full-year 2009 GDP now stands at -2.0%Y, an outcome significantly better than we were expecting earlier on. With the 4Q09 numbers, the economy stands at 4.1% below the pre-crisis peak levels of 1Q08. Separately, the government has already revised upward its 2010 GDP forecast from a range of 3-5% to 4.5-6.5%, bringing it more in line with consensus. The inflation forecast is also revised upward to a range of 2.5-3.5% from 2-3% for 2010.

Impact on our 2010 views: The GDP data are more or less in line with the trajectory we had penciled into our model heading into 2010. Our GDP forecast for 2010 remains unchanged at 5%, somewhat below consensus expectations of 5.9%Y. If the 5% annual growth rate is achieved for 2010, it would be roughly in line with the average recovery momentum seen post a contraction year if one were to compare the four down cycles (1964, 1985, 1998 and 2001) since 1960s.

On policy response: The next monetary policy review is due in April, alongside the 1Q10 GDP advance estimate. We are expecting the MAS to maintain its zero appreciation stance. Looking at the MAS' modus operandi since 2001 (when it officially released policy review statements), it typically shifts to or maintains a gradual appreciation stance only when growth conditions have been higher for longer (~8% over six months). Inflation may be a stronger argument. However, we see the inflation acceleration as primarily policy-driven (due to the re-assessment of the annual values in HDB which is used as a proxy for owner-occupied accommodation) and the MAS would probably be more focused on its definition of 'core inflation' (excludes private transport and accommodation) where demand-pull pressures are still scant. Moreover, it seems like inflationary pressures are occurring in pockets such as residential real estate where the exchange rate policy would be a blunt tool.

Central Bank Watch

Indonesia: Starting a New Credit Cycle

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New credit cycle is underway: The macro recovery and rising inflation pressures herald a credit uptick. The credit cycle tends to lag the real macro cycle. With 4Q09 GDP showing a strong acceleration of 5.4%Y (versus 4.2%Y in 3Q09 and 4.1%Y in 2Q09), we think that the new credit cycle in Indonesia is currently underway. The bank loan survey for new loan demand, which typically leads by around two quarters, has already picked up significantly. Liquidity conditions, as seen in the FX accretion and stock of OMO instruments, are likely to remain supportive in the near term. Moreover, with the risk that Bank Indonesia would hike rates later rather than sooner, there would be some time before lending rates start rising. Given the historical credit multiplier, we forecast credit growth of 16-26% for 2010.

Inflationary risks point to need for working capital loans: While working capital loans in the most recent credit downcycle have suffered given disinflation, higher inflation in the pipeline now likely points to greater demand for working capital loans. We highlighted previously (see *ASEAN MacroScope: Inflation Risk or Scare?* January 20, 2010) that among the ASEAN economies, Indonesia is most susceptible to upside inflation risks, given the commodity exposure in the CPI basket and the demand-pull inflationary pressures conferred by the positive terms of trade. Moreover, the existence of infrastructure bottlenecks also tends to accentuate such demand-pull pressures when they happen.

Supportive near-term lending rates as rate hikes may start later rather than sooner: Bank Indonesia still seems sanguine about inflationary risks at this stage. The risk is that rate hikes may start later rather than sooner relative to our base case of a first rate hike in 2Q10. In this regard, lending rates may start to rise slightly later than we are currently expecting. In the last easing cycle between Apr-06 and Dec-07 when the policy rate was reduced from 12.75% to 8.0%, the average working capital lending rate declined from a peak of 16.4% to 12.9%, implying a response elasticity of 73%. In this easing cycle, when the policy rate was reduced from 9.5% in Nov-08 to 6.5% currently, lending rates have only fallen from a peak of 15.2% in Jan-09 to 13.7% in Dec-09, implying an elasticity of 51%. We suspect that this may be because we came from a previous position of relatively tight liquidity conditions as the average loan-to-deposit ratio stood at a peak of 81.3 in Aug-08.

Brazil: Inflation Pressures?

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Inflation has moved up: The national consumer price IPCA inflation increased to 4.6%Y in January, after a trough of 4.2%Y last October. The official inflation target for the full calendar year is 4.5%. At its latest quarterly inflation report, as of December, the central bank estimated that monthly IPCA inflation would cumulate 1.5% during the first three months of 2010, but it now looks like monthly inflation during 1Q could easily cumulate a figure close to the 2.0% mark. While seasonal and one-off factors may exaggerate headline readings, underlying trends have started to move higher too.

Commodity prices a risk: The January Copom minutes underscored that the main external risk to the domestic inflation outlook derives from a potential increase in commodity prices. Note that it is the interplay of international commodity prices and the currency rate that determines the path of commodity prices in local currency terms. While the local impact of rising international commodity prices can be partially offset by a strengthening currency, this is not the case when commodity prices increase without corresponding currency appreciation.

Inflation expectations are worsening, as rising actual inflation has started to contaminate market forecasts too. In turn, inflation expectations seem crucial for monetary policy decisions, judging by previous cycles. Typically, it is only after market consensus inflation expectations are already rising for some time that the central bank embarks on a rate-hiking cycle. The market consensus forecast for 2010 IPCA inflation is increasing, from a low of 4.3% late last year to above the official 4.5% target, and now quickly moving closer to the 5.0% mark. We suspect that risks are getting biased to the upside – odds of inflation moving above 5% look higher than odds of inflation falling below 4%.

Rate hikes are on the way: We reaffirm our view that monetary tightening is coming. The Copom is already paving the way for upcoming rate hikes through its policy statements. While it does not seem to be in a rush to hike, and would likely prefer to wait until April 28 rather than March 17 if it can, policy decisions will remain data-dependent – the risk is that evolving conditions could force the hand of the central bank to hike in March.

Central Bank Watch

Mexico: We Expect Moderation of CPI

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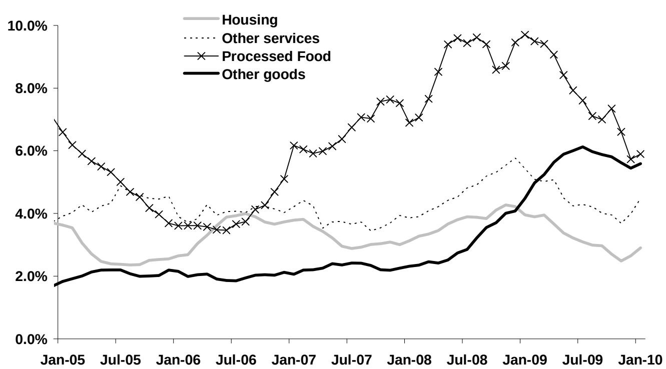
We expect moderation of CPI: Following a surprisingly high January inflation reading – boosted by volatile produce prices as well as pressures from higher taxes and administered prices – the pace of price increases likely moderated during February. The February 1H CPI data is due out later today.

No hike likely anytime soon: Even as annual inflation readings are set to continue moving higher in coming months, Banxico is unlikely to hike rates anytime soon: in its February 19 policy statement, the central bank highlighted that medium and long-term expectations remained "anchored" and that, despite the pressure from taxes and administered prices, it had found no evidence that broader inflationary pressures were materializing.

Mexico: Goods and Services Core Inflation (%Y)



Source: Banxico

Colombia: No Rate Change Likely

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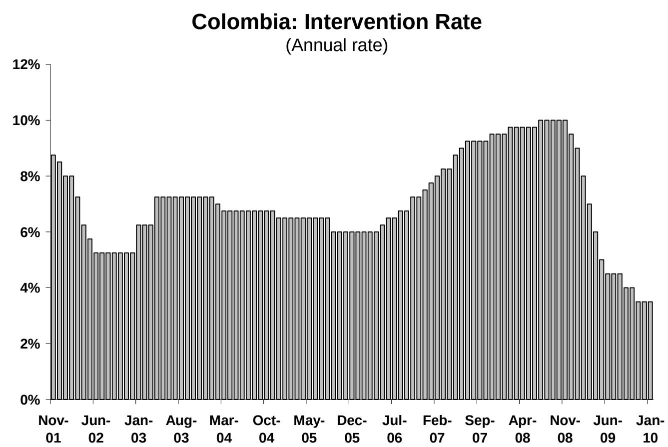
Inflation pressures remain muted for now – the uptick last month was largely a weather-related supply shock. As such, we suspect that the central bank remains comfortable with its current policy stance and will make no change on February 26.

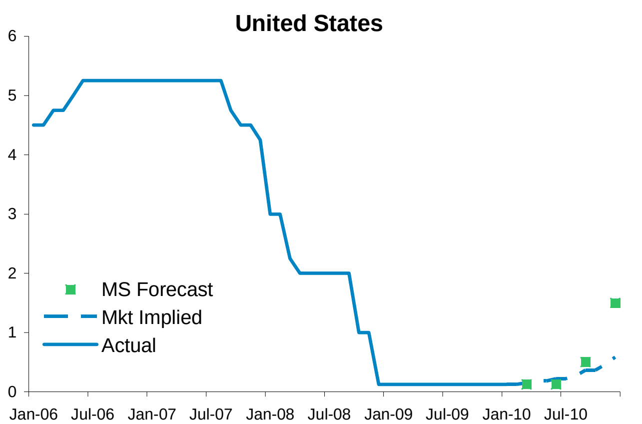
We still expect more aggressive tightening in 2H10: Looking ahead, the evolution of economic recovery will likely hold the key to future policy action – we expect a stronger rebound this year (4.1% GDP growth versus 2.9% consensus) and thus expect more aggressive tightening in 2H10 (200bp versus consensus of 50bp).

Colombia: Intervention Rate

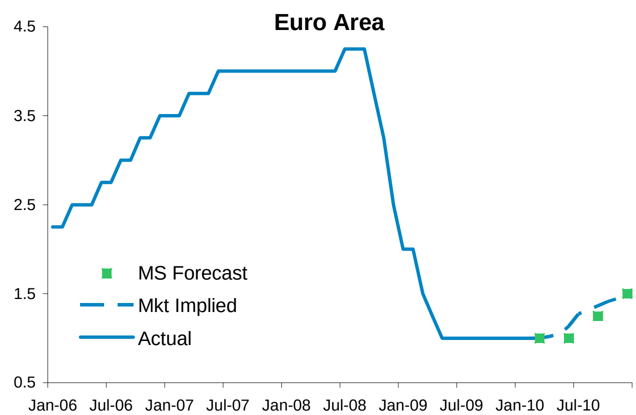


Source: BanRep

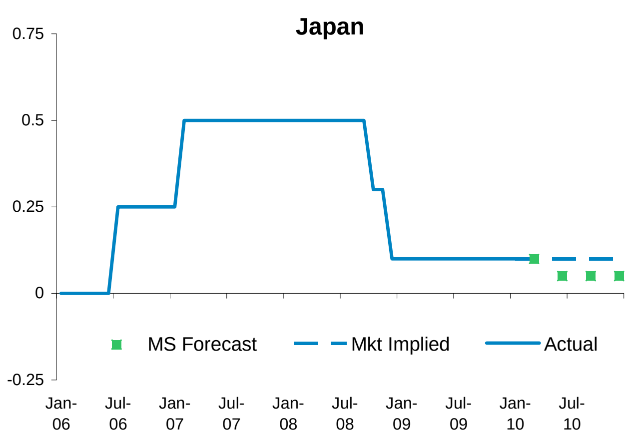
Monetary Policy Outlook – Morgan Stanley versus Markets



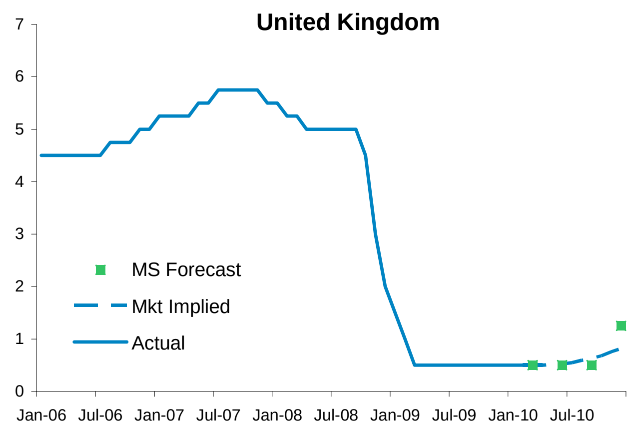
- We expect reverse repos and term deposits to start in size in the summer; reserve draining through SFP bills may start soon.
- Rate hikes should begin soon after reverse repos, and we expect a much more aggressive start to tightening than markets are pricing in.



- ECB might still be too gloomy on growth and too complacent on inflation.
- Watch out for announcements on the 3M tenders going back to variable rate.



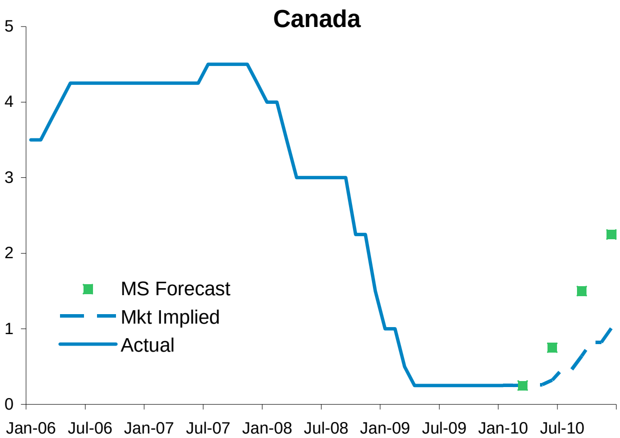
- The government has made beating deflation its priority, and we believe tightening is unlikely to be a discussion item this year.
- We pushed back the expected timing of exit by six months from Jul-Sep 2011 to Jan-Mar 2012.



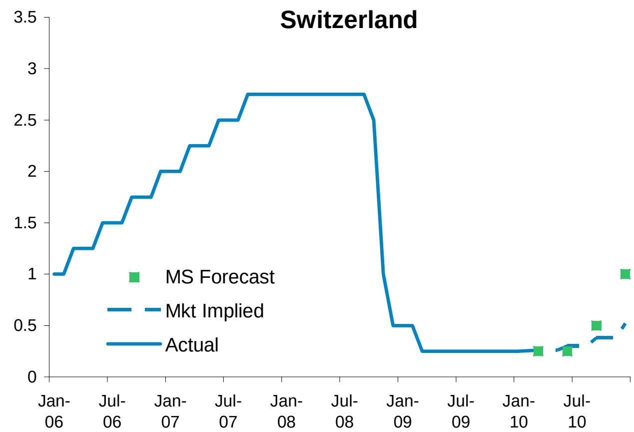
- We think the MPC will start raising rates in late 2010. Markets seem to be pricing in slightly earlier hikes.
- Fiscal policy decisions and the election will complicate decisions on timing/pace.

Source: National Central Banks, Morgan Stanley Research
Notes: (u) = unofficial target; Interest rate expectations are implied by overnight indexed swap (OIS) curves and may differ from those implied by other instruments; where adequate OIS data are not available, FRAs, foreign exchange swaps, and/or interbank cash rate futures are used; due to varying risk premia (such as liquidity, basis, credit, term, reserve management, calendar turns, etc.), these figures should be used as estimates only; where such instruments are not available, we have inserted our best guess of what markets expect based on consensus estimates.

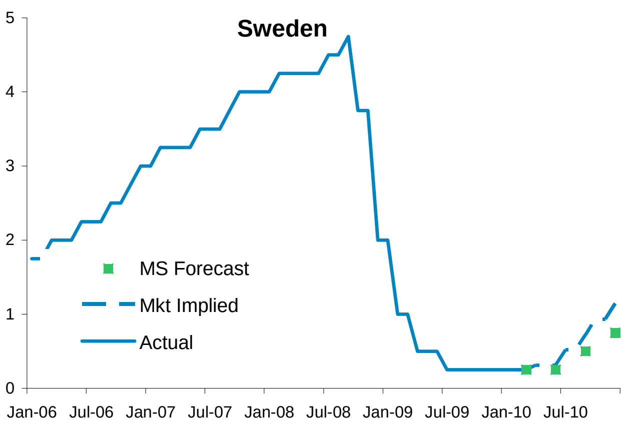
Monetary Policy Outlook – Morgan Stanley versus Markets



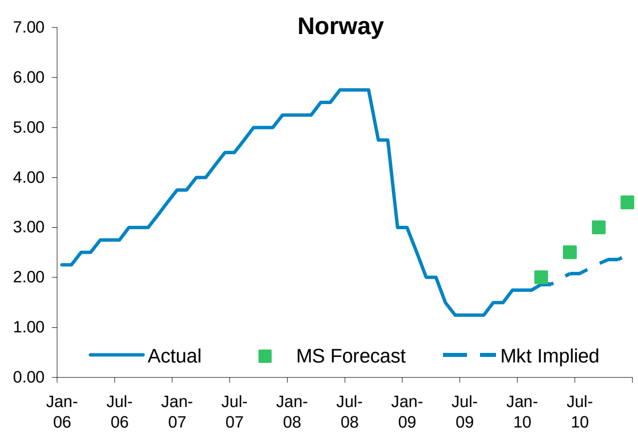
- The risks to both growth and inflation lie north of the Bank of Canada's forecasts.
- We believe the BoC will need to begin removing accommodative policy sooner rather than later. We forecast a rate hike in April 2010.



- SNB starting to prepare stimulus withdrawal – we expect a first rate hike in 3Q10.
- SNB likely to stay committed to preventing excessive Swiss franc appreciation versus the euro through intervention, if needed.



- Riksbank's rate cycle has most likely reached its trough; on hold for an extended period now.
- Watching the dissenting votes on the Executive Board closely for indications of a shift in consensus.



- We expect the policy rate at 3.50% by the end of the year.
- Norges Bank concerns about excessive currency appreciation and signs of renewed global economic weakness point to downside risks.

Source: National Central Banks, Morgan Stanley Research
Notes: (u) = unofficial target; Interest rate expectations are implied by overnight indexed swap (OIS) curves and may differ from those implied by other instruments; where adequate OIS data are not available, FRAs, foreign exchange swaps, and/or interbank cash rate futures are used; due to varying risk premia (such as liquidity, basis, credit, term, reserve management, calendar turns, etc.), these figures should be used as estimates only; where such instruments are not available, we have inserted our best guess of what markets expect based on consensus estimates.

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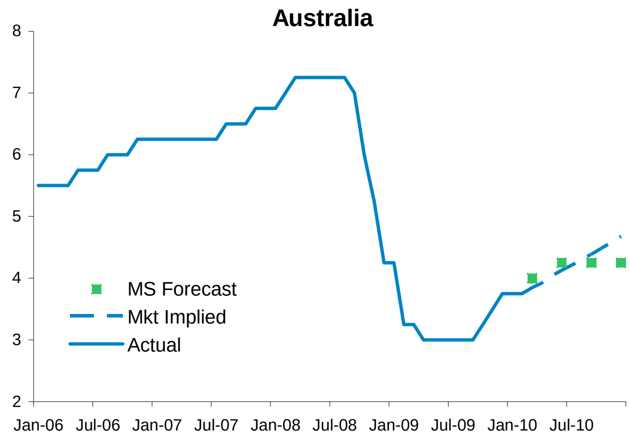
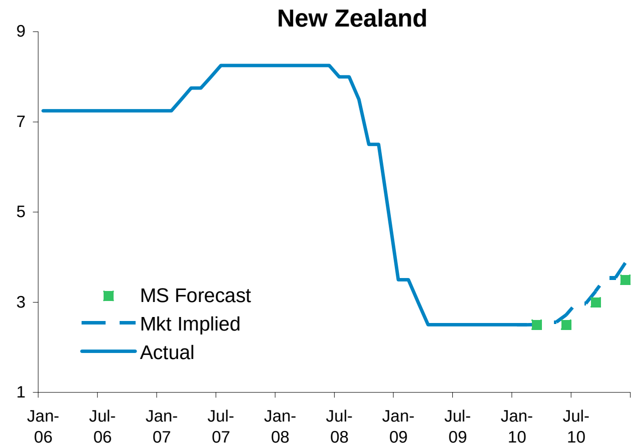


- Against expectations, RBA didn't tighten in February, but flagged a pause, not an end, to hikes.
- We expect another 1-2 25bp increases in 1H, but see the RBA on hold through most of 2H.



- We continue to expect a first rate hike in July, though there is a small risk of a hike in June.
- RBNZ guidance has policy rates at or below 2.5% through the latter half of 2010, but this is conditional on inflation.

Source: National Central Banks, Morgan Stanley Research
Notes: (u) = unofficial target; Interest rate expectations are implied by overnight indexed swap (OIS) curves and may differ from those implied by other instruments; where adequate OIS data are not available, FRAs, foreign exchange swaps, and/or interbank cash rate futures are used; due to varying risk premia (such as liquidity, basis, credit, term, reserve management, calendar turns, etc.), these figures should be used as estimates only; where such instruments are not available, we have inserted our best guess of what markets expect based on consensus estimates..

Global Monetary Policy Rate Forecasts

Global Economics Team

	Current	1Q10	2Q10	3Q10	4Q10	1Q11	2Q11	3Q11	4Q11	Last change (bp)	Since peak/ trough (bp)	Since Dec 06 (bp)
United States	0.125	0.125	0.125	0.50	1.50	2.00	2.00	2.00	2.00	-87.5 (16/12/08)	-512.5	-512.5
Euro Area	1.00	1.00	1.00	1.25	1.50	1.75	2.00	2.25	2.50	-25 (07/05/09)	-325	-200
Japan	0.10	0.10	0.05	0.05	0.05	0.05	0.05	0.05	0.05	-20 (19/12/08)	-40	-40
United Kingdom	0.50	0.50	0.50	0.50	1.25	1.50	1.75	2.00	2.25	-50 (05/03/09)	-525	-450
Canada	0.25	0.25	0.75	1.50	2.25	2.50	2.75	3.00	3.25	-25 (21/04/09)	-425	-400
Switzerland	0.25	0.25	0.25	0.50	1.00	1.25	1.50	1.75	2.00	-50 (11/12/08)	-250	-175
Sweden	0.25	0.25	0.25	0.50	0.75	1.25	1.75	2.25	2.75	-25 (01/07/09)	-450	-275
Norway	1.75	2.00	2.50	3.00	3.50	4.00	4.50	5.00	5.25	+25 (16/12/09)	+50	-100
Australia	3.75	4.00	4.25	4.25	4.25	4.50	4.50	4.75	5.25	+25 (01/12/09)	+75	-250
New Zealand	2.50	2.50	2.50	3.00	3.50	3.75	4.00	4.00	4.00	-50 (29/04/09)	-575	-475
Russia	8.50	8.50	7.75	7.75	7.75	8.00	8.00	8.50	9.00	-25 (19/02/10)	-425	-225
Poland	3.50	3.50	3.50	3.75	4.00	4.25	4.50	4.50	4.50	-25 (24/06/09)	-250	-50
Czech Republic	1.00	1.00	1.25	1.50	2.00	2.50	2.75	3.00	3.25	-25 (06/08/09)	-275	-150
Hungary	5.75	5.50	5.50	5.50	5.50	5.50	5.75	6.00	6.00	-25 (22/02/10)	-575	-225
Romania	7.00	6.50	6.50	6.25	6.25	6.25	6.25	6.25	6.25	-50 (03/02/10)	-325	-150
Turkey	6.50	6.50	6.50	7.25	8.00	9.25	9.75	9.75	9.75	-25 (19/11/09)	-1100	-1100
Israel	1.25	1.25	2.00	2.75	2.75	3.25	3.50	3.75	4.00	+25 (26/11/09)	+50	-350
UAE	1.00	1.00	1.00	1.50	2.50	3.00	3.50	4.00	4.25	-50 (28/01/09)	-425	-425
South Africa	7.00	7.00	7.00	7.00	7.00	8.00	8.00	8.00	8.00	-50 (13/08/09)	-500	-200
China	5.31	5.31	5.58	5.85	6.12	6.12	6.12	6.12	6.12	-27 (23/12/08)	-216	-81
India	3.25	3.50	4.00	4.50	5.00	5.25	5.50	5.75	6.00	-25 (21/04/09)	-275	-275
Hong Kong	0.50	0.50	0.50	1.00	2.00	2.50	2.75	3.00	3.25	-100 (17/12/08)	-625	-625
S. Korea	2.00	2.25	2.50	3.00	3.25	3.50	3.75	4.00	4.25	-50 (12/02/09)	-325	-250
Taiwan	1.25	1.50	1.75	2.00	2.25	2.50	2.75	3.00	3.00	-25 (18/02/09)	-238	-150
Singapore	0.67	0.70	0.80	1.00	1.30	1.55	1.80	2.05	2.30	-	-	-
Indonesia	6.50	6.50	7.25	8.00	8.50	8.50	8.50	8.50	8.50	-25 (03/08/09)	-300	-325
Malaysia	2.00	2.00	2.25	2.75	3.00	3.00	3.00	3.00	3.00	-50 (24/02/09)	-150	-150
Thailand	1.25	1.25	1.75	2.25	2.75	3.25	3.75	3.75	3.75	-25 (08/04/09)	-250	-375
Brazil	8.75	8.75	9.25	10.00	11.00	12.00	12.00	12.00	12.00	-50 (22/07/09)	-500bp	-500bp
Mexico	4.50	4.50	4.50	4.50	4.50	5.25	6.00	6.00	6.00	-25 (17/07/09)	-375	-250
Chile	0.50	0.50	0.50	1.00	2.00	3.25	4.50	4.50	4.50	-25 (09/07/09)	-775	-475
Peru	1.25	1.25	1.25	3.25	4.75	5.00	5.00	5.00	5.00	-75 (06/08/09)	-525	-525
Colombia	3.50	3.50	3.50	4.75	5.50	5.50	5.50	5.50	5.50	-50 (23/11/09)	-650	-550
Global Policy Rate	2.0	2.0	2.1	2.4	2.9	3.2	3.3	3.4	3.5			
std. deviation	2.9	2.6	2.6	2.6	2.6	2.7	2.7	2.6	2.6			
# countries above	14	14	16	18	17	19	20	20	20			
# countries below	18	18	16	14	15	13	12	12	12			
G10 Policy Rate	0.5	0.5	0.6	0.8	1.4	1.7	1.9	2.0	2.1			
std. deviation	1.2	1.3	1.4	1.4	1.3	1.4	1.4	1.5	1.6			
# countries above	3	3	4	4	5	5	5	7	6			
# countries below	6	6	5	5	4	4	4	2	3			

Source: National Central Banks, Morgan Stanley Research
Note: Global policy rates are GDP weighted averages of national policy rates

Global GDP and Inflation Forecasts

	GDP			CPI		
	2009E	2010E	2011E	2009E	2010E	2011E
GLOBAL	**-1.1**	**4.4**	**4.0**	**2.0**	**3.1**	**3.3**
G10	**-3.3**	**2.3**	**2.1**	**0.0**	**1.7**	**1.8**
United States	-2.4	3.3	2.8	-0.3	2.6	2.5
Euro Area	-4.0	1.2	1.1	0.4	1.3	1.5
Germany	-4.9	1.9	1.2	0.3	0.9	1.4
France	-2.3	1.8	1.4	0.1	0.8	1.6
Italy	-4.8	1.2	1.2	0.8	1.2	1.4
Spain	-3.6	-0.7	0.8	-0.3	1.1	1.4
Japan	-5.0	1.8	1.6	-1.3	-0.9	-0.2
United Kingdom	-4.8	0.9	1.4	2.2	2.4	1.6
Canada	-2.5	3.0	3.3	0.2	1.7	1.9
Sweden	-4.5	2.4	2.2	-0.3	1.2	1.9
Australia	0.7	2.1	4.6	1.7	1.6	2.4
Emerging Markets	**1.7**	**6.9**	**6.0**	**4.4**	**4.8**	**5.0**
CEEMEA	**-5.5**	**3.9**	**3.0**	**8.1**	**5.8**	**6.4**
Russia	-7.9	5.3	2.8	11.7	6.2	8.7
Poland	1.7	3.3	2.7	3.5	2.2	2.6
Czech Republic	-3.8	2.1	2.8	1.0	1.9	1.9
Hungary	-6.8	-0.9	1.7	4.2	3.8	3.1
Romania	-6.8	1.1	2.8	5.6	3.2	3.6
Ukraine	-15.0	4.5	2.5	16.0	13.0	15.0
Turkey	-5.0	4.0	4.2	6.3	8.9	5.6
Israel	0.7	3.7	3.2	3.3	2.8	2.4
UAE	-4.8	1.0	2.6	1.7	0.4	1.5
South Africa	-1.7	3.0	3.6	7.2	5.6	5.4
Asia ex Japan	**5.7**	**8.8**	**7.8**	**2.4**	**4.1**	**4.1**
China	8.7	11.0	9.0	-0.7	3.2	3.5
India	6.4	8.5	8.4	10.8	7.4	6.5
Hong Kong	-3.1	3.8	3.5	0.5	2.0	2.5
Korea	0.2	5.0	4.3	2.8	3.3	3.0
Taiwan	-3.5	4.5	3.6	-0.9	0.5	2.0
Singapore	-2.0	5.0	5.0	0.4	2.9	1.3
Indonesia	4.6	5.5	6.3	4.8	6.0	6.5
Malaysia	-2.1	4.8	4.8	0.6	1.7	1.9
Thailand	-2.7	4.6	4.8	-0.8	3.3	3.0
Latin America	**-2.6**	**4.1**	**3.7**	**6.3**	**6.0**	**6.5**
Brazil	0.0	4.8	4.0	4.9	4.0	5.2
Mexico	-7.0	3.8	3.0	5.3	4.6	3.7
Chile	-1.4	5.0	4.4	1.5	1.5	2.8
Peru	0.9	4.9	5.5	2.9	0.9	2.5
Colombia	0.5	4.1	3.8	4.3	3.4	3.4
Argentina	-4.4	3.3	4.2	5.2	5.2	5.2
Venezuela	-1.9	1.3	1.8	27.3	34.3	38.5

Source: National Statistics Offices, IMF, Morgan Stanley Research estimates
Note: Figures in parenthesis indicate the country's or region's weight (in %) in global GDP, using PPPs.

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