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Key Macro Themes in H2

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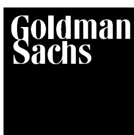
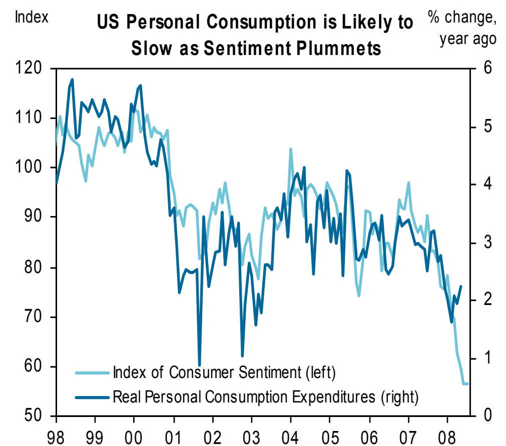


It is somewhat of an understatement to say that the first half of 2008 proved to be a volatile environment for investors. We look here at what the second half may hold. Although the picture for economic activity in the first half has not been too different from our initial forecasts, continued concerns about financial and earnings risks, global inflation that has been higher than we expected and central bank policy have all contributed to difficult trading conditions and, as a result, the uncertainty about the global macro outlook remains elevated.

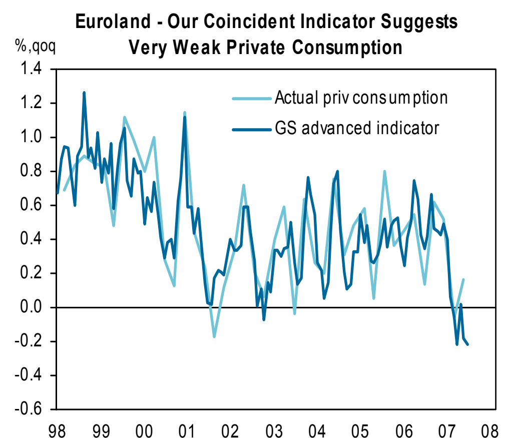
As we look into the second half, global growth is likely to slow further, although inflationary pressures may remain elevated for a while longer before trending lower. This would be consistent with the activity signals from our Global Leading Indicator (GLI) and the still high level of commodity and energy prices.

This week we highlight several key macro themes that could be critical to market performance in the next six months: renewed pressure on the US consumer; continuing cycles of losses and injections in the banking sector; clearer signs of slower growth in Europe; global inflation to be less of a concern, although commodities remain an upside risk; and softer growth and lower inflation in China—one of our biggest macro calls for H2.

While global growth is expected to slow over the forecasting horizon, inflationary pressures are likely to be slower to recede. As such, the next few months will likely remain a challenging environment for policymakers and there is a risk that some EM central banks remain behind the curve.



Source: Department of Commerce, University of Michigan



Source: Eurostat, GS Research

Important disclosures appear at the back of this document

Key Macro Themes in H2

It is somewhat of an understatement to say that the first half of 2008 proved to be a volatile environment for investors. We look here at what the second half may hold. Although the picture for economic activity in the first half has not been too different from our initial forecasts, continued concerns about financial and earnings risks, global inflation that has been higher than we expected and central bank policy have all contributed to difficult trading conditions and, as a result, the uncertainty about the global macro outlook remains elevated.

As we look into the second half, global growth is likely to slow further, although inflationary pressures might remain elevated for a little while longer before trending lower. This would be consistent with the activity signals from our Global Leading Indicator (GLI) and the still elevated level of commodity and energy prices.

Several key macro themes could be critical to market performance in the next six months:

- **Renewed pressure on the US consumer**. US growth has been stronger than expected in the first half of the year. But we expect the US economy to experience a renewed period of weakness later this year once the effects of the fiscal package have worked their way through the system. Given the ongoing deterioration in the housing and labour markets, and the elevated nature of financial and credit risks, US consumers are likely to tighten their purse strings—something that we expect will keep the Fed on hold through end-2009.

- **Continuing cycles of losses and injections in the banking sector.** With many US and European financial sector companies entering the economic downturn with highly geared balance sheets, the overriding concern of investors since last summer has been the ability of banks to recapitalise and, related to this, the ability of central banks and policymakers to provide liquidity into the system. Following the recent scare regarding the future of GSEs, these concerns are likely to be a feature of the second-half landscape.

- **Clearer signs of slower growth in Europe.** So far the rest of the world has remained relatively resilient to the US economic downturn. But we expect to see more visible signs of slowdown in some areas of the world, particularly in Euroland and other English-speaking economies.

- **Global inflation to be less of a worry, but commodities are a wild-card.** We continue to expect price pressures to recede later this year, on the back of the growth slowdown and base effects from food and energy prices. The clearest signs of deceleration could come in the EM universe, where risks of persistent inflation have been the highest. But commodities remain a wild-card to the inflation outlook, as physical shortages still suggest upside risk to prices in the near term. In that regard, it will be important to see whether the recent drop in oil prices continues.

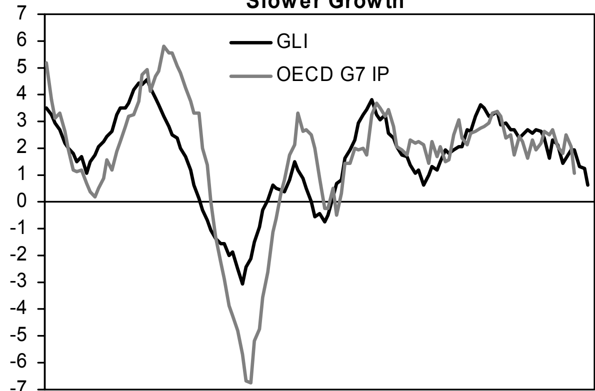
- **Softer growth and lower inflation in China.** One of our biggest macro calls for H2 is a moderate slowdown in the Chinese economy (although we expect consumption to remain robust), with CPI inflation falling somewhat from the current level of close to 8% to 5% by the end of the year.

- **Global central banks walking a tightrope.** While global growth is expected to slow over the forecasting horizon, inflationary pressures are likely to be slower to recede. As such, the next few months will likely remain a challenging environment for policymakers and there is a risk that some EM central banks remain behind the curve.

A Volatile First Half for Investors

As we entered 2008, our strongest conviction was that activity growth in the main economic areas would recouple but that the uncertainty about the overall pace of the global expansion would be the highest it has been over the past several years. Key features included below-consensus growth for the US and BRICs, stronger domestic demand in Japan and Germany, and a sharp slowdown in the UK. Within the BRICs, we expected both China and India to slow, although growth would remain robust.

Our current global GDP forecast for 2008 stands at 4%, exactly the same rate of global growth we had in our forecasts when we introduced the theme of global recoupling in November last year (and stronger than the 3.7% world GDP forecast we started this year with). As we have talked about before, global demand has remained relatively resilient mainly due to strong demand from the commodity-producing areas of the world.



Source: GS Economic Research

But while the activity picture has broadly played out in the way we had expected, concerns about the financial sector, corporate earnings, rising inflation and tighter central bank policy have contributed to a challenging time for asset markets. The breadth and depth of the housing adjustment—not only in the US but in other economies such as the UK and Spain—have also been a source of concern.

Key Macro Themes of the Outlook

Looking into the second half, some key macro themes are likely to be critical to market performance:

Renewed pressure on the US consumer. Despite strong headwinds, including plummeting consumer confidence, US consumers in the first half of the year continued to spend and overall growth has been stronger than expected. This consumer resilience is evident in the very strong retail sales report for May. As our US economists have highlighted, this most likely reflects the impact of tax rebates, which have boosted spending a bit sooner than previously expected.

But, as we have also argued for some time, the fiscal stimulus would only be a temporary boost to consumer incomes and the headwinds facing the consumer would re-impose themselves later this year. Besides higher energy prices and tightening financial conditions, US consumers are faced with the ongoing deterioration in the housing market, weaker jobs and income growth, falling equity wealth and a US banking sector that is increasingly hesitant in extending any form of lending.

Unless the recent drop in oil prices continues and/or there are additional tax cuts, we would expect the consumer spending data to slow meaningfully over the next few months. Our forecasts show US consumer spending growth falling sharply from 2% annualised in Q3 to -0.5% in Q4 and 2009Q1. Although the trade sector continues to provide a boost to the economy, this profile for consumer spending drives our view that US economy is likely to experience a double-dip, with GDP growth likely to be anaemic towards the end of this year and the first half of 2009.

Our forecast on US growth is consistent with further Dollar weakness (although we expect the greenback to range-trade in the near term) and a steeper yield curve. In equities, our Equity Trading Strategy (ETS) group has consistently traded this view of a US consumer under pressure, and is currently long defensive names against consumer cyclicals through the 'DEFCON' trade. Equity market consumer views appear rich to us relative to our macro benchmarks, and with the economic data set to worsen further, we think the fundamental story here still has plenty of room to play out.

Continuing cycles of losses and injections in the banking sector. The fear of a systemic collapse of the US financial sector has been at the top of the market's and policymakers' list of concerns since last summer.

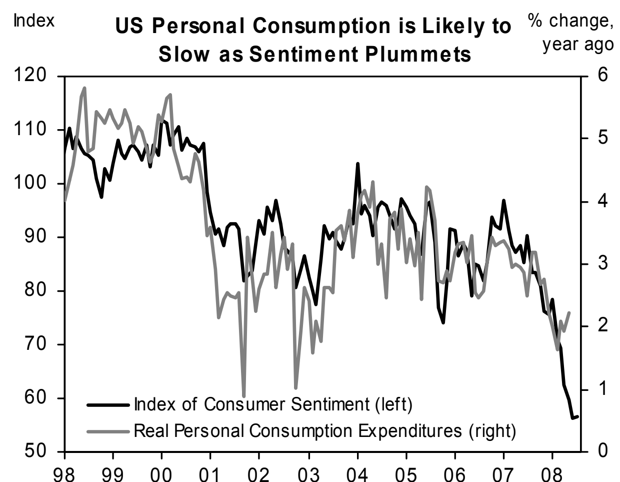
With many US and European financial sector companies entering the current housing and economic downturn with highly leveraged balance sheets, the overriding concern of investors since last summer has been the fear of further write-downs and falling earnings expectations. So far banks have been successful in raising additional capital but their ability is arguably likely to become impaired given the recent price action, which has seen financial stocks shed 14.2% over the past two weeks (and down 40.7% year to date).

Moreover, it is reasonable to expect policymakers to remain alert to the need for additional liquidity and capital injections as confidence in the financial system continues to comes under pressure.

Last week's equity meltdown of the US housing agencies Fannie Mae and Freddie Mac was reminiscent of the suddenness of the Bear Stearns demise in March, and highlighted the precarious position of those institutions that are directly exposed to the dynamics of the US housing market at the current juncture. The latest episode led to the US Treasury and Fed announcing measures to extend credit to, and buy equity in, Fannie Mae and Freddie Mac, if requested by the two GSEs, thus allowing them to remain active in the troubled mortgage market.

This cycle of losses in financial institutions, and associated swings in confidence and liquidity injections from the authorities, could remain a feature of the outlook in H2—especially if the US housing market continues to deteriorate.[1]

Clearer signs of slower growth in Europe. While we expect to see clearer signs of the US economy slowing over the next few months, growth in the BRICs and the



Source: Department of Commerce, University of Michigan

1. For more details on the US banks' outlook, see "Timing the turnaround: credit, capital, consensus, curve all moving in the wrong direction", US Banks Research, July 14, 2008.

EM universe should moderate only gradually, and their resilience should help to keep global growth reasonably strong.

But it might become clearer in the second half that growth in the advanced economies is slowing. The latest Euroland industrial production data (-1.9%mom in May) and PMI surveys suggest that growth is slowing from the very strong first quarter. Indeed, tighter financial conditions (mainly due to the stronger Euro and higher interest rates) and rising oil prices pose meaningful downside risks to Euroland growth in H2. One area that looks particularly vulnerable is the Euroland consumer. Consumer confidence has fallen to its lowest levels since 2003, and our coincident indicator (based on retail sales, car sales, consumer confidence and CPI inflation) suggests very weak private consumption. We also note that consumer-related data in France is weakening, similar to Spain, reflecting to some extent a slowing housing market.

Signs of economic weakness are also emerging in other English-speaking economies. The most striking signs of economic trouble are in the UK where falling house prices, tighter credit conditions, weaker global demand and a squeeze on household disposable incomes all suggest mounting risk of a recession. Tightening financial conditions are also slowing growth momentum in Australia, while the main driver of the New Zealand slowdown is an entrenched capitulation in the residential property market.

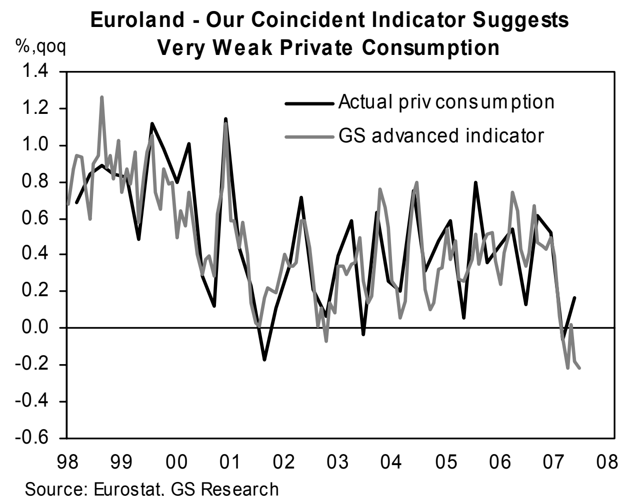
In bonds, one way to play a slower Eurozone economy and the associated view that inflation is more likely to ease over the next few months is through our recent recommendation to short 5-year EUR inflation swaps. In equity markets, our ETS group has noted that UK consumer views have already moved significantly, but Euro-area consumer views have only just started to move. Our Euro-area DEFCON basket (GSSTEUDC) is up about +8% since the start of June compared with +24% for our UK DEFCON basket (GSSTUKDC). And as we pass through what is likely to be a weak patch of Euro-area economic data (partly a reversion of Q1 strength), Euro-area consumer views could witness similar pressure.

Global inflation to be less of a worry, but commodities are a wild-card. Global inflation could still rise further, but for some time our central view has been that global inflation will begin to fall later this year as growth slows and base effects from food and energy prices start to kick in (assuming that the prices of food and energy stabilise). The recent drop in oil prices will be important to monitor in this regard.

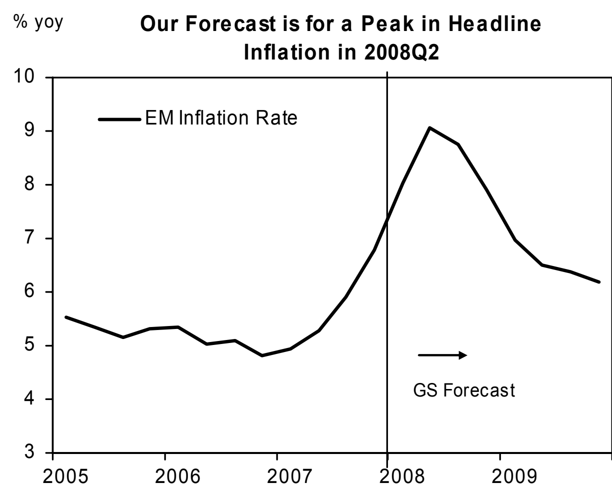
As we have noted before, the rise in inflation has been more evident in the EM space relative to the developed world (where rising inflation expectations are perhaps more concerning). EM inflation has risen from a low of 4.8% in late 2006 to current levels of 9.1%. As we have shown in previous research, we believe that EM inflation may have peaked in 2008Q2 and expect the downward trend to continue until end-2009. The main driver of this forecast is our view that commodity price inflation (both food and energy) is likely to slow from current levels, leading to favourable base effects.

The main risk to this view is if commodity and energy prices continue to accelerate, and this in turn keeps upward pressure on headline inflation intact in various countries. According to our Commodity Research team, physical shortages for many commodities, together with strong emerging market demand, suggests the risk still lies to further upside price risk in the near term.[2] In addition, the risk of second-round effects materialising also rises significantly if near-term headline inflation continues to rise.

China: Softer growth, lower inflation. One of our biggest global macro calls for the second half of the year is that China will experience a moderate slowing in



2. See "Commodity risk still skewed to the upside as fundamentals tighten", *Commodity Watch*, July 11, 2008.



growth (but with consumption remaining strong) and a marked fall in inflation.

We expect the Chinese authorities to be successful in slowing money and credit growth, leading to a significant moderation of Chinese inflation from slightly under 8% currently to about 5% by the end of the year. In its pursuit of lower inflation, we continue to believe that currency adjustment will take on a larger role in tightening monetary conditions this year, and one of our Top Ten trades is to be long CNY vs. a basket of USD and Euro.

The expected fall in Chinese inflation would obviously relieve current global and EM inflation fears, and likely be a boon to investor sentiment and Asian equity markets in particular. Tomorrow's Chinese CPI release will be key to watch; we expect headline inflation in China to come in at 7.1%yoy in June (thus pulling the sequential momentum down to 4.5% annualised) compared with 7.7% in May and the recent peak of 8.7%yoy in February.

Global central banks walking a tightrope—the risk is that some are behind the curve. Global central banks will have to tread carefully over the next few months in their attempt to keep inflation (and inflation expectations) under control. Applying too much pressure on the brakes would risk growth prospects. But not doing enough would fuel inflation concerns.

The ECB did not seem to be overly concerned about braking too hard when it raised rates 25bp this month. But, judging by the accompanying statement following this hike, ECB will likely remain on hold during H2. In the absence of inflation expectations becoming unanchored, the Fed is also unlikely to raise rates either. The market has certainly moved in this direction, with just a 13.5bp hike now priced in by the end of the year compared with nearly 72bp in mid-June. We closed our long position in Dec-08 Fed fund futures late last week, locking in a gain of 37.5bp. Given our view that a US consumer downturn will keep overall growth sub-par for several quarters, our Fed call is for unchanged rates until end-2009, and it seems yesterday's rather dovish Humphrey Hawkins testimony from Fed chairman Bernanke, in which he emphasised downside risks to growth, supports this view. That said, the higher than expected +1.1% and +0.3% rise in June headline and core CPI respectively is a timely reminder of the inflation risks.

Given the macro headwinds the UK economy is currently facing, we are also more dovish on UK rates than the market, which is pricing in a 40% chance of a rate hike by year-end (our view is that the BoE will cut rates by 50bp in 2009H1). We are also more dovish on rate prospects in Australia and New Zealand, where we expect 75bp and 225bp of easing, respectively, by end-2009 (the market is still pricing in a 20% chance of a 25bp hike by the RBA by year-end). To reflect the deteriorating economic picture in New Zealand, short NZD/BRL is one of our Top Ten trades.

Turning to the emerging markets, while we expect EM inflation to have peaked in Q2, for some time we have been highlighting rising inflation (and the policy response to it) as a criterion for selecting investment opportunities. Some EM central banks have been more proactive in counteracting rising inflation expectations than others.

Among the major EMs, Brazil and Mexico have generally taken a fairly aggressive stance and even in those countries, where the central banks initially appeared to be behind the curve, interest rates are now being lifted. For instance, last week, the Russian central bank raised rates by 25bp and also allowed the currency to appreciate. Moreover, the Reserve Bank of India has responded to soaring WPI inflation by recently raising rates and the cash reserve ratio.

In contrast, in other EMs, such as the Philippines, Taiwan, Hong Kong and some Middle-Eastern economies, inflation appears to be turning into a broad-based problem and central banks are still behind the curve. Of course, in NJA, countries with large BBoP surpluses and undervalued currencies (such as the MYR, CNY, TWD or SGD) are still able to use their exchange rate in order to fight inflation. Accordingly, we recommend long positions in SGD, TWD, MYR and CNY through our Top Ten trades. We are also long MYR short PHP in our tactical trades as a means to express the theme of this differential impact of inflation on different currencies in the region.

From an equity standpoint, countries with positive exposure to the near-term upside risk to commodity prices (such as Brazil and Mexico) will remain at a relative advantage compared with markets such as India and Turkey, which have negative exposure to commodities and are also experiencing macro headwinds generated by policy tightening.

Binit Patel and Salman Ahmed

Main Economic Forecasts

	2006	2007	2008	2009
Real GDP, % chg, yoy				
USA	2.9	2.2	**1.5**	**1.1**
Japan	2.4	2.1	**1.5**	**1.4**
Euroland	2.9	2.6	**1.7**	**1.6**
Germany	3.1	2.6	**1.9**	**1.4**
France	2.4	2.1	**1.8**	**1.5**
Italy	1.9	1.4	**0.5**	**1.0**
Netherlands	3.0	3.5	**2.5**	**1.6**
Spain	3.9	3.8	**1.8**	**1.8**
Sweden	4.5	2.9	**2.5**	**2.2**
Switzerland	3.2	3.1	**2.2**	**1.5**
UK	2.9	3.1	**1.4**	**0.9**
EU27	3.2	3.0	**2.0**	**1.8**
Canada	3.1	2.7	**1.1**	**2.3**
Australia	2.7	4.3	**2.5**	**2.7**
G7	2.7	2.2	**1.5**	**1.2**
Advanced Economies	3.1	2.8	**1.9**	**1.8**
Asia	7.6	7.8	**6.8**	**6.9**
Central and Eastern Europe	6.2	6.1	**4.9**	**5.0**
Latin America	5.5	5.8	**4.6**	**3.7**
Emerging Markets	8.3	8.5	**7.3**	**7.1**
World	5.0	4.9	**4.0**	**3.9**

	2006	2007	2008	2009
Consumer Prices, % chg, yoy				
USA	3.2	2.9	**4.3**	**3.2**
Japan	0.2	0.1	**1.6**	**1.5**
Euroland	2.2	2.1	**3.5**	**2.4**
Germany	1.8	2.3	**2.9**	**2.5**
France	1.9	1.6	**3.2**	**2.0**
Italy	2.2	2.0	**3.3**	**2.1**
Netherlands	1.7	1.6	**2.6**	**2.8**
Spain	3.6	2.8	**4.6**	**3.0**
Sweden	1.4	2.2	**3.6**	**2.7**
Switzerland	1.1	0.7	**2.2**	**1.6**
UK	2.3	2.4	**3.6**	**2.0**
EU27	2.2	2.3	**3.7**	**2.6**
Canada	2.0	2.1	**1.3**	**1.7**
Australia	3.5	2.3	**4.2**	**3.4**
G7	2.3	2.2	**3.4**	**2.6**
Advanced Economies	2.3	2.2	**3.7**	**2.8**
Asia	2.8	3.6	**5.7**	**3.5**
Central and Eastern Europe	2.5	3.7	**5.6**	**4.5**
Latin America	5.5	5.8	**7.5**	**6.2**
Emerging Markets	5.3	6.0	**8.7**	**6.3**
World	3.4	3.6	**5.6**	**4.2**

	2006	2007	2008	2009
Real GDP, % chg, yoy				
China	11.6	11.9	**10.5**	**10.0**
India	9.6	9.0	**7.8**	**8.2**
Hong Kong	7.0	6.4	**5.2**	**5.8**
Indonesia	5.5	6.3	**5.5**	**5.8**
Malaysia	5.8	6.3	**5.0**	**5.3**
Philippines	5.4	7.2	**5.5**	**5.7**
Singapore	8.2	7.7	**5.5**	**6.1**
South Korea	5.1	5.0	**4.8**	**5.3**
Taiwan	4.9	5.7	**4.5**	**4.8**
Thailand	5.1	4.8	**4.0**	**4.5**
Brazil	3.8	5.4	**5.2**	**3.2**
Argentina	8.5	8.7	**6.2**	**4.0**
Mexico	4.8	3.3	**2.4**	**3.4**
Venezuela	10.3	8.4	**5.1**	**3.7**
Russia	7.4	8.1	**7.5**	**7.0**
Turkey	6.9	4.5	**3.0**	**4.0**
South Africa	5.4	5.1	**3.0**	**3.5**
Central and Eastern Europe	6.2	6.1	**4.9**	**5.0**
Asia ex Japan	9.2	9.4	**8.2**	**8.2**
Latin America	5.5	5.8	**4.6**	**3.7**
BRICs	9.4	9.8	**8.7**	**8.3**
Emerging Markets	8.3	8.5	**7.3**	**7.1**

	2006	2007	2008	2009
Consumer Prices, % chg, yoy				
China	1.5	4.8	**6.8**	**3.0**
India	5.5	4.5	**10.0**	**4.7**
Hong Kong	2.0	2.0	**8.0**	**7.2**
Indonesia	13.1	6.4	**10.5**	**8.2**
Malaysia	3.6	2.0	**6.0**	**4.1**
Philippines	6.3	2.8	**7.0**	**5.1**
Singapore	1.0	2.1	**6.0**	**3.3**
South Korea	2.2	2.6	**4.4**	**3.8**
Taiwan	0.6	1.8	**4.3**	**3.2**
Thailand	4.6	2.2	**5.5**	**3.7**
Brazil	4.2	3.6	**6.0**	**6.2**
Argentina	10.9	8.8	**9.0**	**8.5**
Mexico	3.6	4.0	**4.7**	**4.4**
Venezuela	16.1	20.2	**28.3**	**20.1**
Russia	9.7	9.0	**14.0**	**14.2**
Turkey	9.6	8.8	**11.5**	**8.2**
South Africa	4.6	6.5	**11.3**	**10.5**
Central and Eastern Europe	2.5	3.7	**5.6**	**4.5**
Asia ex Japan	3.5	4.6	**6.8**	**3.9**
Latin America	5.5	5.8	**7.5**	**6.2**
BRICs	4.2	5.6	**7.9**	**5.5**
Emerging Markets	5.3	6.0	**8.7**	**6.3**

For India we use WPI not CPI. Asia consists of China, Hong Kong, India, Indonesia, Japan, Malaysia, Philippines, Singapore, South Korea, Taiwan, Thailand.

For our latest Bond, Currency and GSDEER forecasts, please refer to the Goldman Sachs institutional portal (https://360.gs.com/gs/portal/research/econ/econmarkets/).

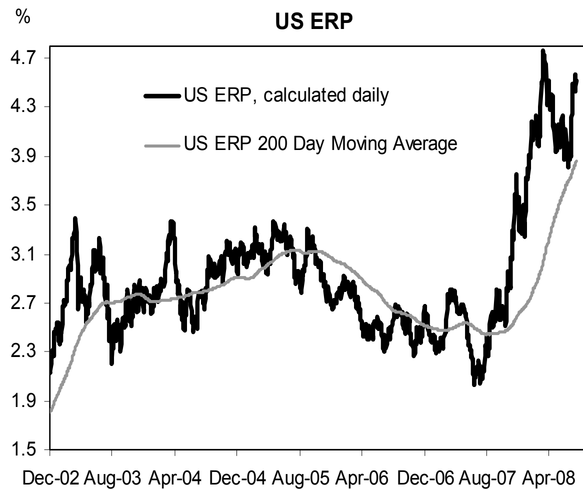
Equity Risk and Credit Premiums

Updated Estimates for the Equity Risk Premium*

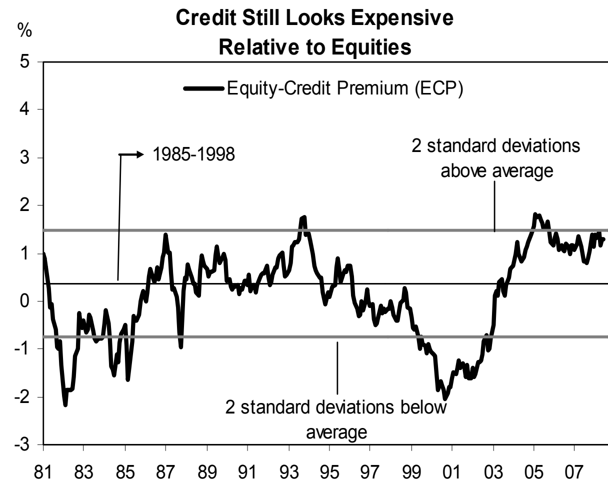
	Real GDP Growth	Real Earnings Growth +	Dividend Yield =	Expected Real Return	- Real Bond Yield =	Implied ERP	Expected Inflation	Expected Nominal Return
US	3.0	3.0	2.3	5.3	0.8	4.5	2.0	7.3
Japan	1.5	1.5	1.9	3.4	1.1	2.3	0.5	3.9
UK	2.8	2.8	4.5	7.3	1.8	5.5	2.0	9.3
Europe ex UK	2.3	2.3	3.7	6.0	1.8	4.1	2.0	8.0
World	2.5	2.5	2.9	5.4	1.3	4.2	1.8	7.2

*Calculated as of 15 July 2008.
Source: Datastream; real GDP grow th and expected inflation are GS Economics Research forecasts.

The US ERP continues to rise and has reached the high levels seen in mid-March of this year.



Our ECP remained unchanged at 1.3% in May, and is 50bp above the most recent trough reached in August 2007.



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The World in a Nutshell

THE GLOBAL ECONOMY

	OUTLOOK	KEY ISSUES
UNITED STATES	The US economy is still in the midst of its stimulus-induced rebound. As a result, real GDP growth is tracking modestly in positive territory for Q2, possibly borrowing from the 2% growth rate we expect for Q3. We expect the economy to slow to a standstill in the first quarter of 2009, then gradually move back towards trend growth over the remainder of the year. We expect no change in the 2% federal funds rate target for the foreseeable future.	It's clear that the fundamentals of the economy are still weakening. Housing prices continue to decline rapidly, the credit crunch is becoming increasingly evident in lending data, oil is marking new highs, the factory sector is poised for a downturn, and the labour market is unravelling. Without major additional policy support, or a sharp drop in energy prices, consumer spending is very likely to slow this autumn, taking the economy's overall growth with it.
JAPAN	The pace of price increases is accelerating. Core CPI inflation is on track to reach +2%yoy mid-year for the first time since 1992. Core-core CPI inflation, which has been declining steadily for some time, is also beginning to rise. The current price rises are concentrated in items that consumers purchase frequently, such as food. We forecast core CPI inflation of +1.6% and +1.5% in 2008-2009, and expect average core CPI inflation to trend at just over +1% over the next ten years.	Despite the accelerating inflationary pressure, the BoJ sees downside risk to the economy from the decline in household real purchasing power resulting from price increases. The real policy interest rate has already fallen into negative territory, but a policy stance of lagging behind the yield curve is likely to cause little harm to the economy compared with its potential impact on other major economies, where the trade-off between growth and inflation has deteriorated rapidly.
EUROPE	Our forecast for Q2 GDP is +0.1%, reflecting in part a correction of Q1 strength. Private consumption has been weak and preliminary data suggest little recovery into Q2. Firm industrial production in April was followed by a sharp contraction in May, which broadly supports our growth expectation for Q2. We expect growth of about 0.3%qoq in 2008H2. We see CPI inflation averaging 3.5% in 2008 and 2.4% in 2009.	As expected, the ECB hiked rates by 25bp to 4.25% in July. The statement was more dovish than expected, and Trichet said that the ECB's stance had no bias. We expect the ECB to keep rates unchanged at 4.25% for the foreseeable future. Although the ECB acknowledged that the economy had weakened in Q2, with the Council intent on taming inflation expectations, the risks to our call are to the upside.
NON-JAPAN ASIA	With overall headline inflationary pressures running well above the comfort level for policymakers and the market, we continue to look for monetary policy tightening in many countries in the region. We continue to see upside risks to our 2009 inflation forecast and downside risks to our 2009 growth forecast. This could create headwinds for regional equity markets.	In China, the growth impact from high oil prices is better cushioned and easier for policymakers to manage, because the GDP share of net energy imports is relatively small and China relies on domestic sources for most of its energy consumption. In addition, the government has a robust fiscal position and can undertake fiscal stimulus if needed.
LATIN AMERICA	Expansionary demand management policies have led to excess demand. Despite the aggregate supply response from higher investments, the boom in demand outstrips the supply response. The excess demand for tradable goods is reducing the trade surplus and leading to wider current account deficits.	For Brazil, we now forecast that COPOM will raise the pace of tightening to 75bp per meeting on July 23. This should be followed by two more hikes of 75bp each, and two hikes of 50bp. As a result, we expect COPOM to raise SELIC to 15.50% by January 2009.
CENTRAL & EASTERN EUROPE, MIDDLE EAST AND AFRICA	We expect the impact on inflation of higher oil prices to show up mainly in 2009. Our largest forecast change is in Russia, where we expect inflation to return to over 14% after a dip towards end-2008. The impact of such large oil price increases on the current account surpluses of oil-producing countries is substantial, exacerbating the dilemma they face in managing inflation and restraining currency appreciation.	The CBR's recently announced changes to its FX intervention regime have not amounted to much yet, but the CBR may finally be taking tentative steps towards loosening its grip on the RUB and moving towards inflation targeting. In the short run, we see the new policy as confirming our expectation of gradual RUB appreciation against the basket, although higher volatility may reduce the attractiveness of the trade.

CENTRAL BANK POLICIES

	CURRENT SITUATION	NEXT MEETINGS	EXPECTATION
UNITED STATES: FOMC	Fed funds rate cut by 25bp to 2.00% on April 30, 2008.	August 5 September 13	We expect no change in the Fed Funds Rate for the foreseeable future.
JAPAN: BoJ Monetary Policy Board	The BoJ raised the overnight call rate by 25bp to 0.5% on February 21, 2007.	August 18/19 September 161/17	We expect the BoJ to keep rates on hold through to the end of FY2008.
EUROLAND: ECB Governing Council	The ECB raised rates by 25bp to 4.25% on July 3, 2008.	August 7 September 4	We expect the ECB to hold rates at 4.25% for the foreseeable future.
UK: BoE Monetary Policy Committee	The BoE cut rates by 25bp to 5.0% on April 10, 2008.	August 6/7 September 3/4	We expect the MPC to cut rates to 4.5% by the middle of 2009.