

## DAILY GLOBAL COMMENTARY

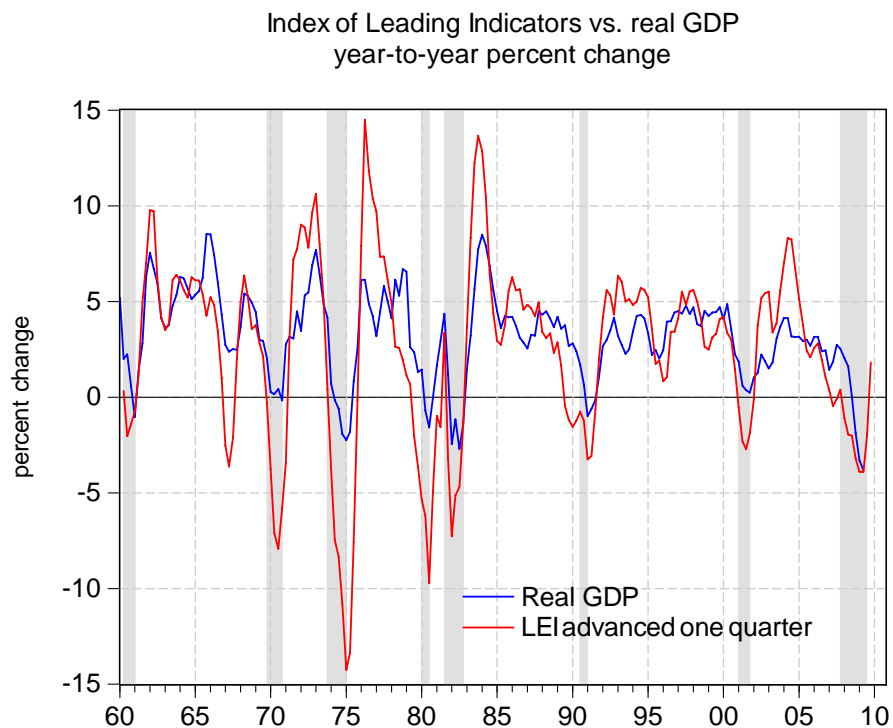
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### Index of Leading Indicators Confirms Forecast of Economic Recovery October 22, 2009

The Index of Leading Indicators increased 1.0% in September, marking the sixth consecutive monthly increase. This string of gains is convincing indication that an economic recovery is underway. On a quarterly basis, the index has moved 1.8% from a year ago, the first increase since the fourth quarter of 2006. Once again, the index has provided valuable guidance about the course of the economy. In September, with exception of the average workweek and building permits, all the other components of the leading index made positive contributions.

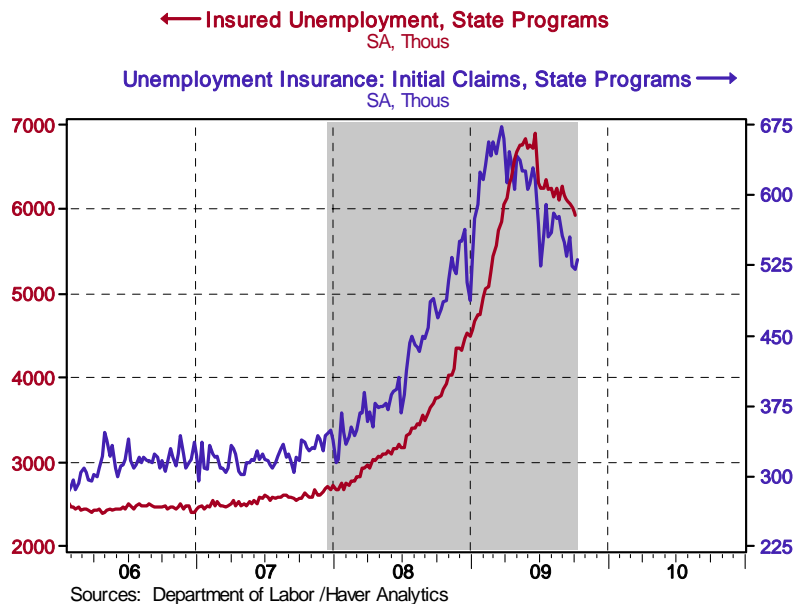
Chart 1



### Continuing Claims Inclusive of Special Programs have Stopped Advancing Rapidly

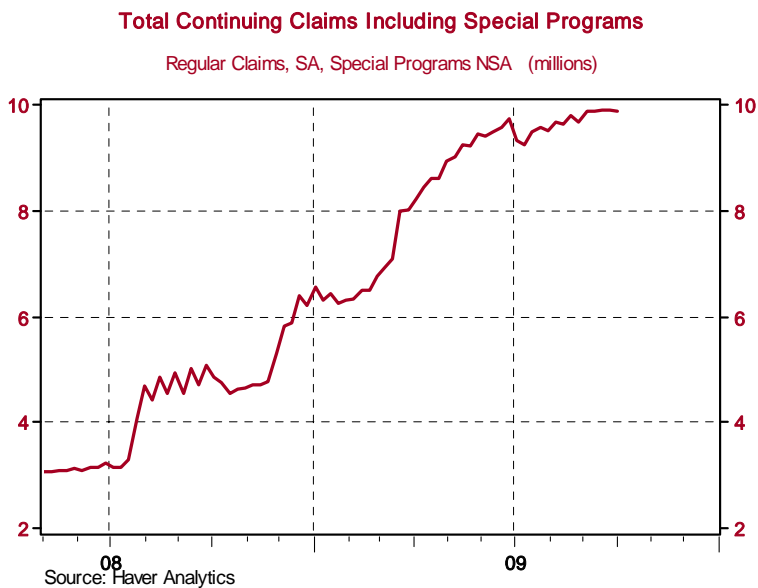
Initial jobless claims rose 11,000 to 531,000 during the week ended October 17. The four-week moving average at 532,250 is the lowest since January 17, 2009. Continuing claims, which lag initial claims by one week, fell 98,000 to 5.923 million.

Chart 2



Total claims including continuing claims and claims under the Extended Benefits Program and Emergency Unemployment Compensation Program have stopped moving up rapidly (see chart 3). These claims have held between 9.876 million and 9.898 million for the five weeks ended October 3, with the latest weekly reading at the lower end of this range.

Chart 3



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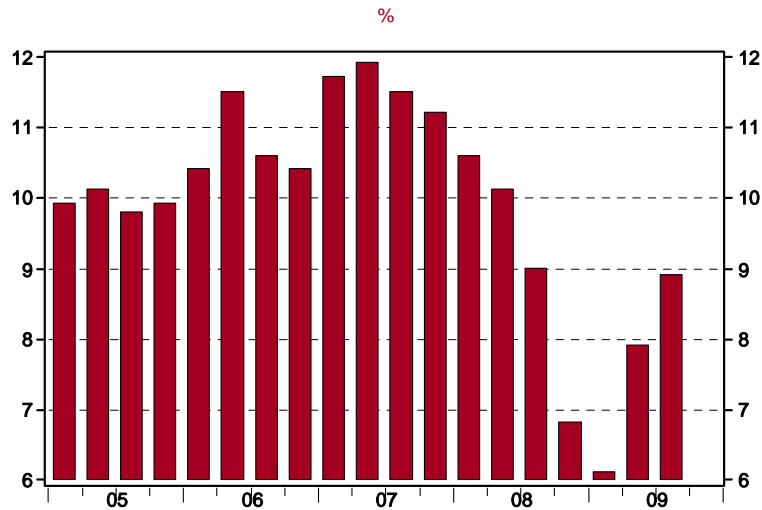
## China Is Still China, For Better Or Worse

This morning's data release from China's National Bureau of Statistics (NBS) confirmed what most people either already knew or had deduced from the many hints dropped by government officials. In short, Q3 GDP showed further gains while the domestic economy gained momentum, industry performed better, deflation eased, and the government's huge stimulus package continued to benefit the economy. Other than last week's announcement of a less-than-impressive performance for exports (for which the rest of the world is to blame), this deluge of data basically confirms what Beijing has been saying for the past few months. Unfortunately, it also affirms what we have been saying for the past few months, which is less than assuring.

First, the heart of the matter – GDP. For Q3, GDP expanded by 8.9% from the previous year as most analysts expected and as the government suggested. Growth has been driven by implementation of the government's massive stimulus package issued about one year ago, along with a dramatic easing of lending policies. Accompanying statements from the NBS expressed full confidence that the economy would meet its 8.0% growth target for 2009 as a whole, and we have little doubt that the final GDP release for 2009 (due in late-January 2010) will be at or above that level. Officially, we are placing our bets on 8.2%, with changes likely to be higher if the government suggests as much.

Chart 4

China: Real GDP: Year-to-Year Percent Change

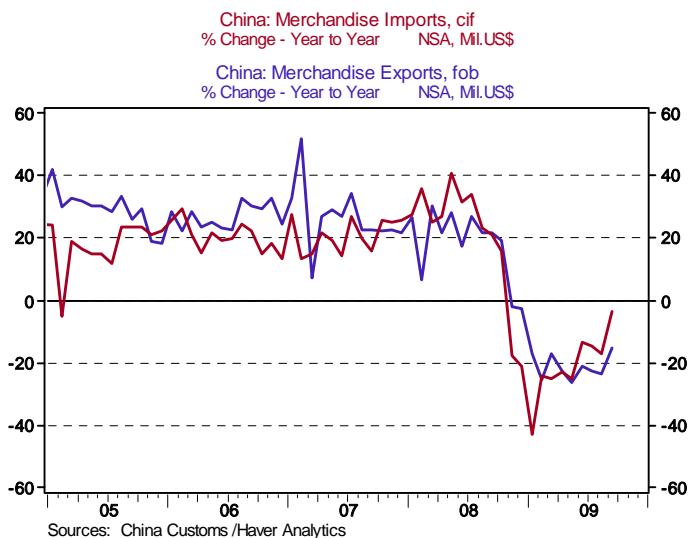


Source: China National Bureau of Statistics /Haver Analytics

While GDP may be performing well due to the sharp rise in government spending, one area that is not rebounding as dramatically is the export market. Over the past 12 months the trade balance has narrowed significantly, and while stimulus has put some energy into the import side of the trade ledger, exports have lagged in the recovery. Since the Chinese export market accounts for fully one-third of GDP, a rebound is all the more important. Until that recovery happens, net exports will actually be a detractor to GDP growth.

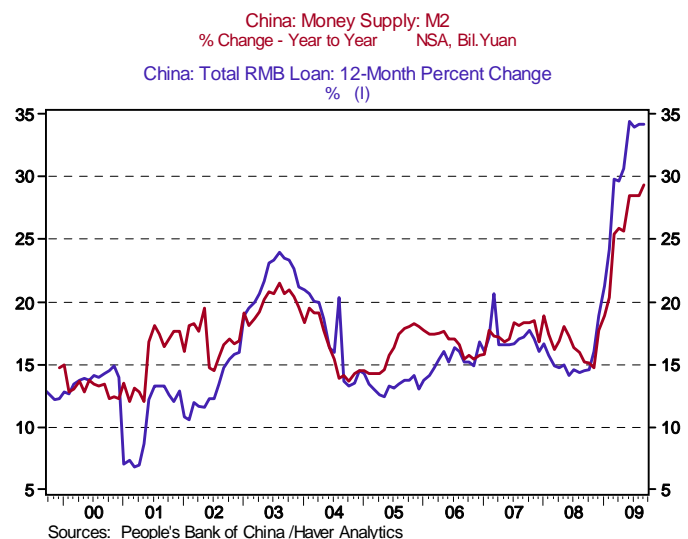
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Chart 5



For now, however, we will let Beijing tout its impressive growth figures and let the markets respond accordingly. As this piece might suggest, we are somewhat cynical about the quality of GDP figures and their usefulness in gauging an economy's performance. Compiled surveys of production on many levels plus several assumed inputs and some high-caliber statistical configuring make any country's GDP figures somewhat suspect, and China's indicators do carry a reputation in that regard. When possible, however, we prefer monetary figures that are less prone to error and influence. While they cannot necessarily indicate rates of production, they are very good predictors of price pressures and potential imbalances. Witness the two series of particular concern of late – M2 growth and credit growth, both on a year-over-year basis.

Chart 6



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Developing markets can sustain money and credit growth close to 20% for prolonged periods, just as China had been doing for years as it turned investment into gainful production. However, growth has accelerated to twice the rates of a year ago as stimulus programs kicked in and banks issued more and more state-directed loans. This amounts to a lot of yuan flooding into the economy in a short amount of time, and raises a lot of questions about how this will impact future prospects. The prime concern is consumer price inflation, which as we know is a monetary phenomenon, but another concern is asset inflation, as in a stock market bubble. Monetary spikes have taken a toll on price stability in the past, so we are concerned that further volatility awaits in 2010. And discussion of a possible bubble in the domestic Shenzhen and Shanghai stock markets has returned now that the year-long bear market has reversed in dramatic fashion.

Chart 7

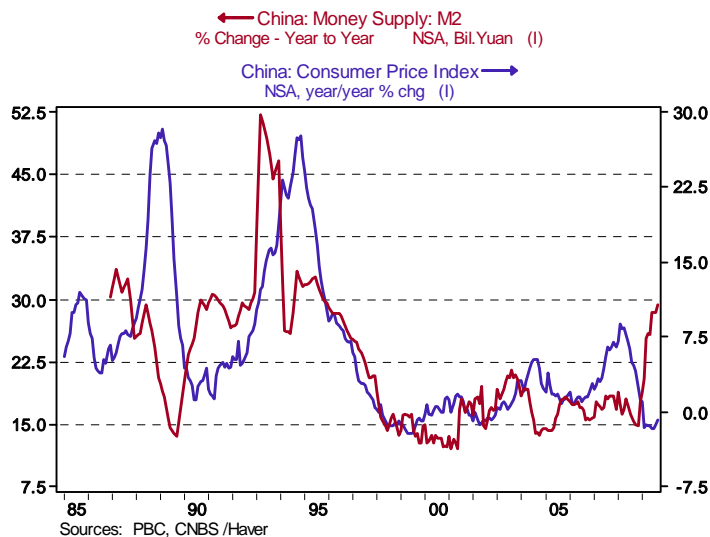



Chart 8



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For now, we accept that the Chinese economy is in recovery mode and should post some impressive figures through end-2009. Looking forward, our concern is firmly rooted in the possible aftereffects of a massive dose of fiscal adrenalin, both relating to the impact on price stability and on the possible bursting (or re-bursting) of a stock market bubble. We consider both of these as possibilities for 2010, and neither one suggests that next year will be as good as Beijing implies.

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