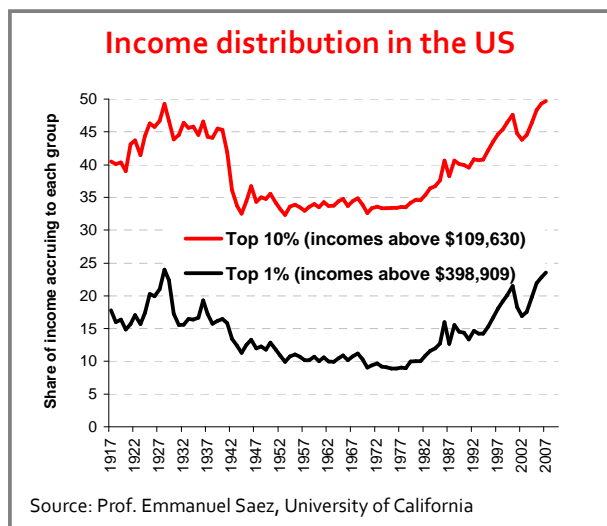


THE ECONOMIC NEWS

Why de-leveraging requires higher income ... and flatter income distribution

In yesterday's lead story we highlighted recent moves in the US savings rate which have been at the heart of the crisis and which will help shape the path of recovery in the coming years.

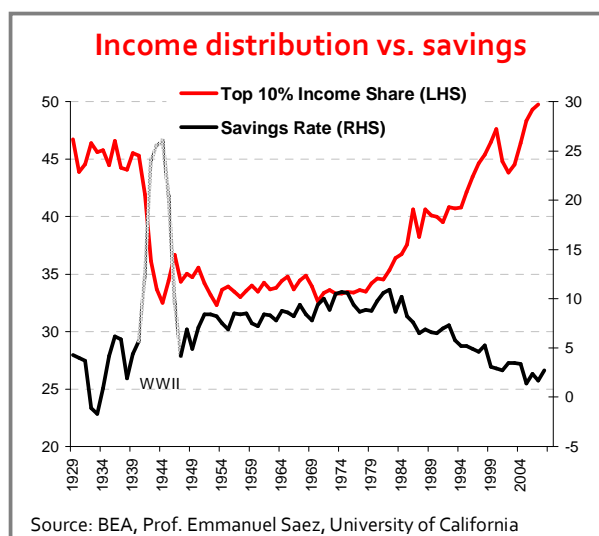
It is a well-established fact that wealth effects have been a dominant driver of the secular decline in savings and the more recent reversal. What is less known, or less discussed, is the relationship between savings and income distribution. Recently, distribution statistics of 2007 income became available, revealing the most skewed income scales in the US since the 1920s, or in some cases even exceeding the 1920s. Below we summarize some key datapoints.



- As of 2007, the top 10% (incomes above \$109,630) took in 49.7% of total US income, the highest on record.
- The top 1% of earners (incomes above \$398,909) took in 23.5% of total income, the highest ratio since 1929.

- The top 0.01% (incomes above \$11,476,646) took in 6% of total income, by far exceeding the previous peak of 5% set in 1929.

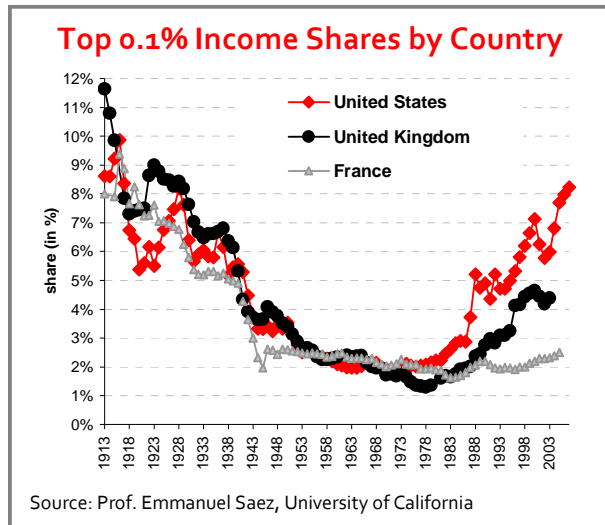
The peaks in income skewness – 1929 and what is likely to be 2007 – tell us that there is something fundamentally unsustainable about an excessively uneven income distribution. Since the rich have a relatively low propensity to consume, consuming all of the country's production in the face of a very skewed income scale can only be sustained via a transfer of savings - i.e. the middle class borrows from the rich. This can continue only to a point, until middle-class incomes can't support any additional debt.



To give an example of this, let's assume that the top 10% of the population, which earns 50% of all income, only consumes about half of that income. The rich would then consume 25% of the country's production. The remaining 90% of the population can only consume 50% of output with its current income. This leaves the economy with a 25% oversupply which

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either has to be exported, or in the absence of external demand, has to be purchased on credit.



Cross-sectional data also supports a strong relationship between savings and income distribution. France, with one of the flattest income distributions in the western world happens to be one of the least leveraged economies.

The other side of the story is that the top earners in periods of uneven income distribution have tended to invest their excess savings in very inefficient ways. For example, in recent years the savers have financed the

excess expansion of housing stock via purchases of mortgage bonds and other indirect investments into the financial sector. Had those inefficient investments never been made (or had the savings been channelled into more productive investments), the savings transfer and a build-up of debt would not have gone on as long as it did.

The moral of the story is that at some point an uneven distribution of income becomes unsustainable because there is no-one left to consume. In the end, the market tends to force an adjustment as it did in 1929 and in 2008. Though these adjustment periods are painful for everyone, the wealthy suffer disproportional income losses. These include not only lower pay, but capital gains losses which can wipe accumulated income earned in previous years. When 2008 figures become available, we are likely to see a significant reversal of fortunes.

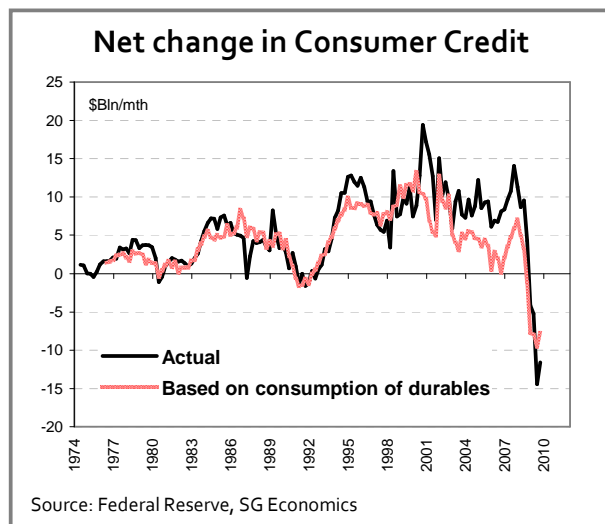
If historic relationships continue to hold, the anticipated secular rise in the savings rate will likely be accompanied by a flattening income distribution. Whether these will be market-driven or policy-driven trends remains to be seen. However, there is little doubt that deleveraging of household balance sheets requires not only higher incomes overall, but in particular for the middle-income households with highest debt burdens.

US consumer credit shrinks

US consumer credit outstanding contracted by \$21.6 bln in July, significantly more than expected. The data does not alter the picture on consumption which was already reported for July and is likely to rise substantially in August on the back of strong auto sales. However it does shed some light on consumer behaviour.

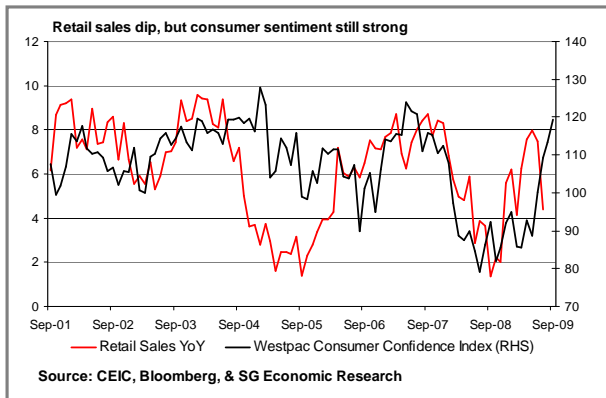
Based on durable consumption in July and standard loan terms (LTV of 92%), we had estimated gross borrowing in July of about \$78 bln. We also estimated scheduled principal repayments of about \$86 bln (this is modelled on the average durable consumption over the past 5 years). As a result, net consumer credit should have contracted by about \$7 bln instead of the \$21.6 bln reported loss.

There are a few possible explanations for the divergence in the data. First, consumer credit data is subject to large revisions and may simply be revised down next month. Second, and equally plausible



explanation is that consumers are paying cash for some large ticket items, including autos. Lastly, some may be making larger than required payments on their outstanding loans. Whether demand- or supply-driven, credit data suggests greater restraint in borrowing than is suggested by consumer spending figures. This continues to be a weak link in the recovery story.

Australian Retail Sales weaker, consumers not so hungry? Consumer Confidence still strong



Quite surprisingly, Australian retail sales contracted 1%MoM in July, vs. a 1.4% fall in June. Expectations were for a 0.5%MoM increase. The weakness in the consumer in July is explained by declines in the sales of food. Retail sales of food declined 1.9%MoM in July, which we believe is a statistical bump in the

road. Consumption of food items generally do not depend on the health of fiscal stimulus – consumers still need to eat and generally in similar quantities each month.

There are suspicions of a weakening in the fiscal stimulus package, but if waning of stimulus package effects is under way, we would see this reflected through sentiment, which has remained strong throughout Q3. Consumer confidence data released shows that consumer sentiment in Australia is still strong.

Consumer confidence gained 5.2% to 119.3 points in September – a 26 month high since July 2007. All five components in the Westpac Consumer Confidence index rose, with expectations for economic conditions over the next 12 months jumping 9.8%.

Home Loans in Australia fell more than expected in July

Home loans data released today declined more than the market had expected, falling 2%MoM in July to 63,259. The consensus was for a 1.5%MoM fall in July. July marks the end of 3 quarters of consecutive gains that were primarily driven by grants of A\$21,000 to first-time home buyers. Fiscal policy is a crucial support to the Australian housing market.

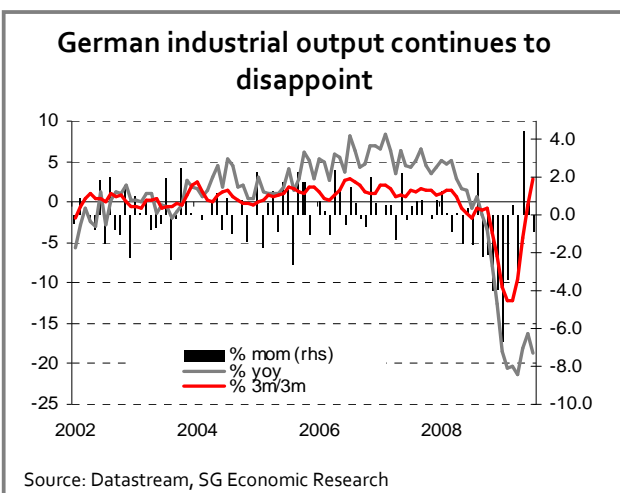
On the monetary side, a total of 425bp of rate cuts have been passed on to variable mortgages and demand for loans (housing finance) has also been recovering.

Australia's housing market continues to set itself apart from other developed high income economies where autonomous price corrections have been the key feature over the past 12-18 months.

There has been sufficient data released for the month of July that has lead us to believe Australia will move to a tightening bias during the RBA's next meeting in October. The question now is the timing of tightening, which we believe will start November and December of this year.

German manufacturing refuses to follow orders' lead

For the second month in succession, German industrial output data have disappointed expectations, and sharply underperformed new orders. Indeed, in July industrial output fell outright by 0.9% mom (median +1.6%, SG 1.0%), albeit from a substantially upwardly revised June (now +0.8% mom from -0.1% previously). That said, the less volatile 3m-on-3m comparison shows the sharp shift upward in momentum, with the rate for overall industrial output rising to +2.9% from -0.5% in June, and for manufacturing to +3.1% from -0.5%.



Weakness on a mom basis was widely spread across the main sectors of industry, with manufacturing down 0.5% mom, construction down 2.3% mom, and energy down 3.9%. However, much of that weakness does reflect short-term volatility, except in

construction, where orders data suggest some

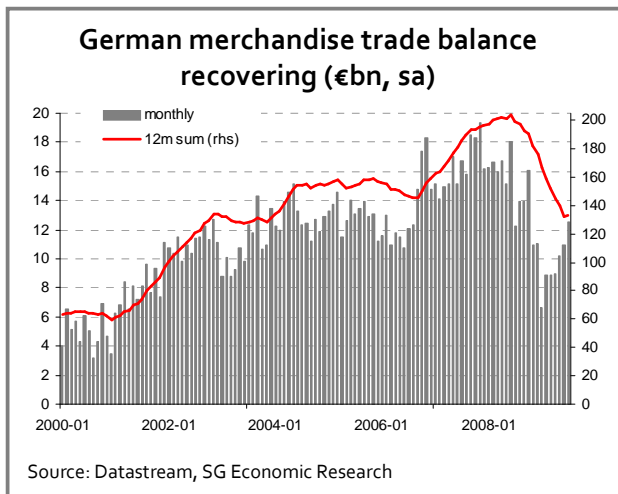
weakness ahead after a strong second quarter.

In the manufacturing sector, weakness in the month was concentrated in capital goods production (-3.2% mom), but after an exceptional jump in May (+9.0% mom); the 3m-o-3m rate of change still jumped to 3.4% from -1.0%. The only manufacturing sub-sector to show expansion was intermediate goods (+1.8% mom, +4.7% 3m-o-3m), consistent with an easing of the downward inventory adjustment. The cyclical laggard in terms of shorter-term momentum remains the consumer non-durables sector (-1.0% 3m-o-3m).

SG While disappointing, the July level of IP was still up 1.1% from the Q2 average, and thus consistent with a strong Q3 GDP expansion – we expect +1.0% qoq (4% saar). Moreover, survey evidence strongly points to gains in coming months, with, for example, the manufacturing PMI output measure at 54.3 in August. Similarly, the strong gains in manufacturing new orders over the past five months will also support higher output levels.

German trade surplus at 9-month high

Strong exports do the work



Germany's exports extended their recovery in July, rising 2.3% mom (s.a.) after 6.1% in June, and thus above expectations (median 1.2%, SG 0.5%). In contrast, imports were weaker than generally expected, stagnating compared with June after a big rise of 5.9% in June (median 1.0%, SG 0.0%). Consequently, the trade balance (s.a.) rose to €12.5bn from €10.9bn, the highest level in nine months. It was also the first time in a year that the trade balance rose on a yoy basis, thereby stabilizing the 12-month

cumulative surplus at just short of €133bn, compared with a peak of €203bn in mid-2008. That said, trade volumes were still down from year-ago levels, with exports off 18.7%, and imports down 22.3%.

A full regional breakdown of trade is not available at this stage, but on the export side the recovery is reasonably evenly distributed across EMU members, non-EMU EU members and the rest of the world. Imports, meanwhile, were particularly weak from the rest of the world, with EU trade holding up better.

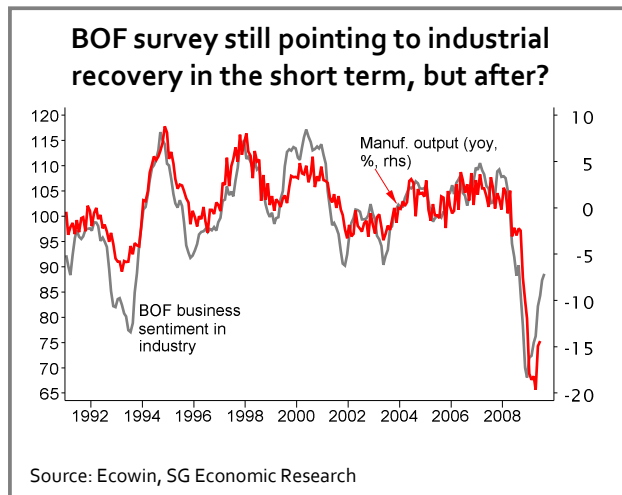
SG The data suggest that foreign trade will again contribute positively to GDP in Q3, after a 1.6ppt quarterly boost in Q2. But in contrast to Q2 when weak imports were the driver, the third quarter net trade contribution is likely to reflect a stronger expansion in exports than in imports. In July, exports rose by 6.5% from the Q2 average, while imports were up 3.1%. Survey evidence as well as export orders data suggests the improving export trend will be maintained for the next few months at least, while imports are likely to lag as private consumption in particular slows. But milder contractions in inventories will support import growth.

Mixed messages from the Bank of France survey

The business climate index in industry increased again in August from 87 to 89, which is still far below its long-term average of 100 but also 21 points above its lowest point touched in December 2008. In services, the improvement still looks much more muted, as business confidence increased by 1 point in August to 82, which remains very close to the bottom (77 in April 2009). This divergence mirrors the trends seen in the

PMI surveys, for which the improvement in the manufacturing sector has been much more pronounced than in services.

The Bank of France said its survey was consistent with a 0.3% GDP increase in Q3 (SG forecast is +0.4%), thus confirming the exit from recession after already +0.3%

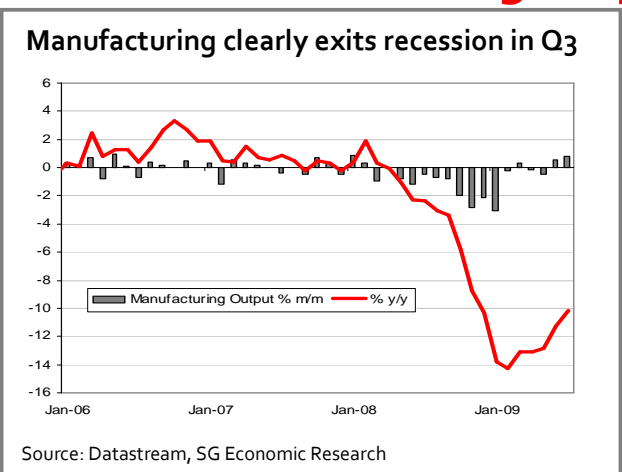


in Q2. Nevertheless, the breakdown of the survey is a bit disappointing and is likely to fuel some worries about future activity trends after this period of mechanical rebound widely explained by inventory

movements and the key role of the car sector. Indeed, new orders and orders in hand again showed very limited improvement in August. The production component fell in August from 0 to -2 and forecasts for September eased further to -3. The capacity utilization rate corroborated the lack of recovery in activity, remaining stable and very low at 70.7. For services, indicators look less stable and reliable but activity is also expected to weaken in September to -5 from +6.

SG All in all, despite the positive message regarding Q3 GDP growth, this survey looks disappointing and tends to confirm our fears that the current recovery is mainly mechanical and has a lot to do with car purchase incentives. This is clearly not a survey pointing to a broad-based recovery. We continue to think growth should fade in Q4 (SG forecast is +0.2%) and even see a risk of renewed contraction in Q1 2010 (SG forecast: 0).

UK manufacturing output storms ahead in July



Manufacturing output far exceeded expectations with an increase of 0.9% mom. Also the June reading was revised up from 0.4% mom to 0.6% mom. The main areas of growth in July were transport equipment (3.8% mom), chemicals & man-made fibres (3.3%), and rubber & plastics (3.4% mom). We can thus see that the cash for clunkers programme is having an effect, and that should make us a little wary of the size of the increase in overall manufacturing output as a representation of the trend.

The breakdown by main industrial grouping, looking at 3mth on 3mth growth rates, shows consumer durables rising by 1.9%, non-durables falling by 0.6%

and capital goods rising by 0.5%. This is an odd mix of data. The upturn in capital goods output fits with what we are seeing in continental Europe and supports the story of a much earlier than expected revival in global investment. The consumer durables category includes cars so, again, the current strength of this category flatters the underlying trend which is better represented by the falling non-durables output.

SG Industrial production grew by less (0.5% mom) than manufacturing output because of falls of 1.0% mom in the output of mining & quarrying and of 0.2% mom in utilities. However, there too the June IP figure was revised up from 0.5% mom to 0.6% mom. If IP just holds at the July figure for the rest of the quarter then it will have risen by 0.8% qoq after a fall of 0.5% qoq in Q2. This should help to cement the UK's exit from recession in Q3.

The latest data fit much better than hitherto with the output series in the main business surveys. Until this month's data, the official data had been much weaker than the survey data. That is no longer the case for the manufacturing PMI survey and that survey remains strong, although we have concerns about the latest weakening of orders. Overall, this is a very strong set of data.

Calendar of Economic Releases

Tuesday 8-Sep-2009

		GMT	Period	Previous	SG Forecasts	Consensus/ Actual
UK	BRC Retail Sales Monitor (00:01 BST)	23:01	AUG			
	RICS House Price Balance (00:01 BST)	23:01	AUG	-8.1%	na	-3.0%
Japan	Adjusted Current Account Total, JPY bln (00:50 BST)	23:50	JUL	1798.8	na	1159.0A
	Current Account Total, JPY bln (00:50 BST)	23:50	JUL	1152.5	na	1265.6A
	Trade Balance - BOP Basis, JPY bln (00:50 BST)	23:50	JUL	602.2	na	437.3A
	Bank Lending incl Trusts (YoY) (00:50 BST)	23:50	AUG	2.1%	na	1.8%A
	Japan Money Stock M2 (YoY) (00:50 BST)	23:50	AUG	2.7%	na	2.8%A
Japan	Bankruptcies (YoY)	4:30	AUG	1.0%	na	-1.0%A
	Eco Watchers Survey: Current	5:00	AUG	42.4	na	41.7A
	Eco Watchers Survey: Outlook	5:00	AUG	44.9	na	44.0A
Norway	Consumer Confidence	5:00	3Q	0.5R	na	11.7A
Switzerland	Unemployment Rate s.a.	5:45	AUG	3.9%	na	4.0%A
Germany	Current Account, EUR bln	6:00	JUL	13.5R	na	11.0A
	Exports s.a. (MoM)	6:00	JUL	6.1%R	0.5%	2.3%A
	Imports s.a. (MoM)	6:00	JUL	5.9%R	0.0%	0.0%A
	Trade Balance s.a., EUR bln	6:00	JUL	10.9	11.3	12.5A
Spain	Industrial Output n.s.a. (YoY)	7:00	JUL	-14.3%R	na	-16.7%A
	Industrial Output w.d.a. (YoY)	7:00	JUL	-16.0%R	na	-17.4%A
Sweden	Current Account, SEK bln	7:30	2Q	54.7R	na	67.9A
UK	Industrial Production (MoM)	8:30	JUL	0.6%R	0.4%	0.5%A
	Industrial Production (YoY)	8:30	JUL	-10.7%R	-9.9%	-9.3%A
	Manufacturing Production (MoM)	8:30	JUL	0.6%R	0.4%	0.9%A
	Manufacturing Production (YoY)	8:30	JUL	-11.3%R	-11.0%	-10.1%A
Germany	Industrial Production s.a. (MoM)	10:00	JUL	0.8%R	1.0%	-0.9%A
	Industrial Prod. s.a. (YoY)	10:00	JUL	-16.2%	-17.8%	-18.8%A
US	Consumer Credit, USD bln	19:00	JUL	-10.3	na	-4.0
	ABC Consumer Confidence	21:00	6-Sep			

Wednesday 9-Sep-2009

		GMT	Period	Previous	SG Forecasts	Consensus/ Actual
UK	Nationwide Consumer Confidence (00:01 BST)	23:01	AUG	60	na	61
Australia	Investment Lending	1:30	JUL	-1.8%	na	na
	Retail Sales s.a. (MoM)	1:30	JUL	-1.4%	na	0.5%
Japan	BOJ Board Member Miyako Suda to Speak in Nagasaki City	1:30				
	Coincident Index CI	5:00	JUL P	88.0	na	89.0
	Leading Index CI	5:00	JUL P	79.9	na	81.9
	Machine Tool Orders (YoY)	6:00	AUG P	-72.3%	na	na
Germany	CPI - EU Harmonised (MoM)	6:00	AUG F	-0.1%	0.4%	0.4%
	CPI - EU Harmonised (YoY)	6:00	AUG F	-0.7%	0.0%	0.0%
	Consumer Price Index (MoM)	6:00	AUG F	0.0%	0.2%	0.2%
	Consumer Price Index (YoY)	6:00	AUG F	-0.5%	0.0%	0.0%
Sweden	Industrial Orders s.a. (MoM)	7:30	JUL	-4.2%	na	na
	Industrial Orders n.s.a. (YoY)	7:30	JUL	-21.3%	na	na
	Industrial Prod. s.a. (MoM)	7:30	JUL	-2.5%	na	na
	Industrial Prod. n.s.a. (YoY)	7:30	JUL	-20.8%	na	na
UK	Total Trade Balance, GBP mln	8:30	JUL	-2176	na	-2000
	Visible Trade Balance, GBP mln	8:30	JUL	-6451	na	-6350
	BRC Shop Price Index	9:30	AUG	na	na	na
US	MBA Mortgage Applications	11:00	4-Sep	-2.2%	na	na
	Fed's Evans to Speak in New York about the Inflation Debate	12:00				
Canada	Housing Starts, K	12:15	AUG	132.1	na	135.0
US	Fed's Fisher Speaks in Dallas on U.S. Economic Challenges	17:55				
	Fed Releases Beige Book Economic Report	18:00				

Source: Bloomberg, SG Economic Research

Market Movements

Equity markets	Value	% Change				
		-1day	-1week	-1month	-3months	Year to date
Americas						
S&P 500 Index	1025.4	0.9%	0.5%	1.5%	9.1%	13.5%
Nasdaq Composite Index	2037.8	0.9%	1.4%	1.9%	10.2%	29.2%
Canadian S&P/TSX Composite Index	11105.3	0.8%	2.2%	2.0%	5.1%	23.6%
Mexico Bolsa Index	29190.8	2.1%	5.2%	3.6%	17.1%	30.4%
Europe						
DJ Euro Stoxx 50 Index	2786.3	0.1%	2.6%	3.0%	12.9%	13.8%
FTSE 100 Index	4947.3	0.3%	2.6%	4.6%	12.3%	11.6%
CAC 40 Index	3661.0	0.2%	2.2%	4.0%	11.3%	13.8%
Dax Index	5481.7	0.3%	2.9%	0.4%	9.5%	14.0%
Asia/Pacific						
Nikkei 225 Index	10393.2	0.7%	-1.3%	-0.2%	6.2%	17.3%
HK Hang Seng Index	21069.8	2.1%	6.0%	3.4%	16.7%	46.4%
Shanghai SE Composite Index	2930.5	1.7%	9.2%	-10.1%	5.1%	60.9%
Bombay Sensex 30 index	16123.7	0.7%	3.7%	6.4%	9.9%	67.1%

Interest rates futures	Yields	Bp Change				
		-1day	-1week	-1month	-3months	Year to date
Americas						
90 day Euro\$ Future Sep09	0.31	-2 bp	-2 bp	-19 bp	-59 bp	-95 bp
Fed Fund 30d Sep09	0.16	0 bp	-2 bp	-4 bp	-13 bp	-33 bp
Canadian Bank Accept Future Sep09	0.44	0 bp	0 bp	-2 bp	0 bp	-34 bp
Mexican TIE Sep09	4.92	1 bp	2 bp	-4 bp	-38 bp	-286 bp
Brazilian One day bank dep Jan10	8.65	1 bp	3 bp	-2 bp	-50 bp	-351 bp
Europe						
3Month Euro Euribor Sep09	0.77	0 bp	-2 bp	-11 bp	-56 bp	-123 bp
3Month £Libor Sep09	0.59	-1 bp	-2 bp	-21 bp	-74 bp	-116 bp
Asia/Pacific						
3Month Euroyen Future Sep09	0.53	0 bp	0 bp	1 bp	4 bp	9 bp

Bonds	Yields	Bp Change				
		-1day	-1week	-1month	-3months	Year to date
North America						
US Generic Govt 10yr Bond	3.48	4 bp	12 bp	-37 bp	-39 bp	127 bp
Europe						
German Generic Govt 10yr Bond	3.27	4 bp	3 bp	-24 bp	-40 bp	32 bp
French Generic Govt 10yr Bond	3.62	4 bp	8 bp	-13 bp	-38 bp	21 bp
UK Generic Govt 10yr Bond	3.68	4 bp	12 bp	-12 bp	-19 bp	66 bp
Swedish Generic Govt 10yr Bond	3.35	7 bp	2 bp	-17 bp	-39 bp	94 bp
Asia/Pacific						
Japanese Generic Govt 10yr Bond	1.34	-3 bp	4 bp	-11 bp	-19 bp	16 bp

Foreign Exchange	Value	% Change				
		-1day	-1week	-1month	-3months	Year to date
EUR (EUR-USD)	1.449	1.1%	1.8%	2.4%	4.1%	3.6%
JPY (USD-JPY)	92.270	0.9%	0.7%	5.3%	6.7%	-1.8%
GBP (GBP-USD)	1.650	0.9%	2.0%	0.1%	2.7%	11.5%

Commodities	Value	% Change				
		-1day	-1week	-1month	-3months	Year to date
Energy						
WTI Cushing Crude Oil Spot	71.1	4.5%	1.6%	0.2%	4.4%	59.4%
Natural Gas Carthage Texas Spot	2.4	34.6%	3.9%	-30.7%	-28.1%	-57.3%
Metals						
Gold Spot \$/OZ	999.3	0.4%	2.1%	4.6%	4.7%	13.3%
Copper Future Sep09	293.5	3.2%	4.5%	5.3%	29.6%	104.9%
Soft						
Corn Future May09	302.8	0.7%	-7.2%	-6.0%	-31.9%	-30.9%
Wheat Future (CBT) Sep09	431.5	-2.8%	-8.4%	-11.8%	-31.1%	-34.0%
Baltic Dry Index	2462.0	1.4%	1.6%	-11.2%	-32.5%	218.1%

Source: Bloomberg

All data taken at US close on 08 Sep 2009

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