



## European Weekly Focus

31<sup>st</sup> March 2008

printed on 28<sup>th</sup> March

Audrey Childe-Freeman  
Senior European Economist  
+44 (0) 207 234 6676

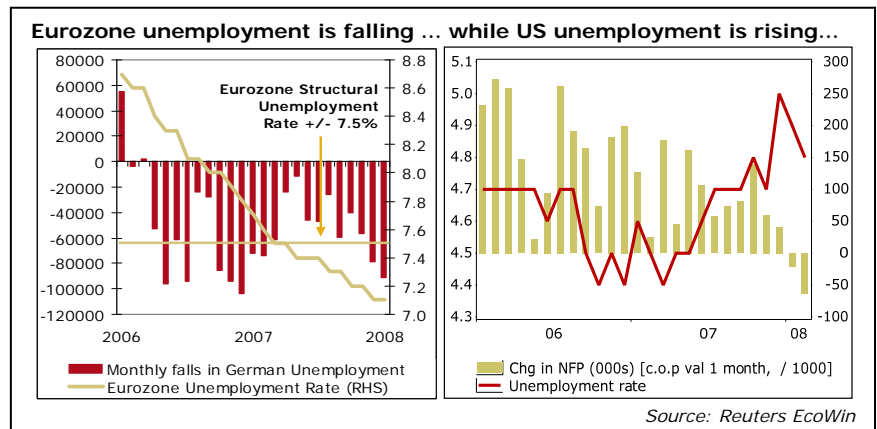
Jodie Tiller  
European Economist  
+44 (0) 207 234 7325

QUOTE OF THE WEEK Asked whether the MPC was more predisposed to cut Bank rate, Bank of England Governor King said, "Yes".  
In his testimony before the Treasury Select Committee, March 26<sup>th</sup> 2008

### US/Euro labour markets: it is a different story now

For decades, the labour market has been a prime problem for the Eurozone economy, in contrast with a remarkably healthy US labour market environment. The Eurozone unemployment rate (currently at 7.1%) remains well above the US' unemployment rate (which we expect at 5% in March), capturing persistent structural differences. **However, there has been a change in trend of late and expect this to be confirmed by this week's data.** Indeed, we expect the Eurozone February unemployment rate to report a further decline while we see another negative reading for the US March Non Farm Payrolls figures (CIBC call at -75k), which would translate into a rise in the unemployment rate, to 5%.

The improvement in the Eurozone labour market has been broad-based across regions, but **the improvement has been particularly impressive in Germany.** Indeed, unemployment has fallen by a cumulative 616k in Germany over the past twelve months, with the unemployment rate now standing at an October 1992 low of 7.9% (from a high of 12.2% only two years ago). This week, Germany's March unemployment is expected to report a further 45k monthly decline (adding to a 75k monthly fall in February). The sharp



swing in Germany's labour market trend has resulted from past structural reforms finally paying off, coupled with cyclical declines in unemployment. Moreover, it has not been just a German story: in France, the unemployment rate currently stands at a low 7.8%, down from a high 8.4% only a year ago. We believe that the US/Eurozone decoupling story cannot last forever but recent Eurozone indicators (see Germany's March IFO index in particular) have proven highly resilient and given the lagging nature of the labour market, **we would expect continued declines in Eurozone unemployment over the next few months**, with an unemployment rate likely to fall further below its structural rate, in turn keeping ECB's hawks alert.

**Of course, it is a different story in the US.** Indeed, we expect the March Non Farm Payrolls data (due on Friday) to report its third consecutive monthly decline (by 75k), which would be the first time this happens since the February-June 2003 negative run. Moreover, there is very little hope for change in the near-term: the US economy is clearly in a recession environment and we do not expect much improvement before Q3 at the earliest, which means that the **labour market (a lagging indicator) is likely to continue to struggle for some time to come.** In turn, this also implies that the diverging trends between the Eurozone and the US labour market profiles will most likely persevere over the next few months; **this will not be just a temporary phenomenon.**

This week's Eurozone and US latest employment data will highlight a different story altogether when it comes to the labour market. This is consistent with a US economy that is now in recession while the Eurozone economy is showing continued resilience. Moreover, given the lagging nature of the labour market, we believe that a contrasted US/Eurozone jobless environment is here to stay. In this context and with regards to monetary policy, a rising US unemployment is in line with an easing monetary policy outlook for the Fed, while continued declines in Eurozone unemployment and associated concern over wage inflation will keep ECB's hawks reluctant to cutting interest rates any time soon. **Needless to say that all this highlights a supportive eur/dlr macroeconomic environment:** it may only be a matter of time before eur/dlr tests the crucial 1.60 mark again and this week's respective labour market figures could give be seen as a good opportunity for eur/dlr bulls.

Audrey Childe-Freeman, Senior European Economist



**This Week in the EUROZONE**

Weekly Market Barometer	Latest Trading Level (as at 14.00 GMT on Mar 28)	Near-Term Outlook *	Medium-Term Outlook *
<b>Eur/Dlr</b>	<b>1.5768</b>	<b>Positive</b>	<b>Positive</b>
<b>Euribor (Jun 2008 contract)</b>	<b>95.485</b>	<b>Neutral</b>	<b>Neutral</b>
<b>Bunds (Jun 2008 contract)</b>	<b>115.80</b>	<b>Small Negative</b>	<b>Small Negative</b>

\* Near-Term = 1 week ahead  
\* Medium-Term = 1 month ahead

**February M3 money supply (Monday)**

**Strong monetary growth used to be one of the main threats to inflation**, but that role has been overtaken by high food and energy prices, among others, in the recent past.

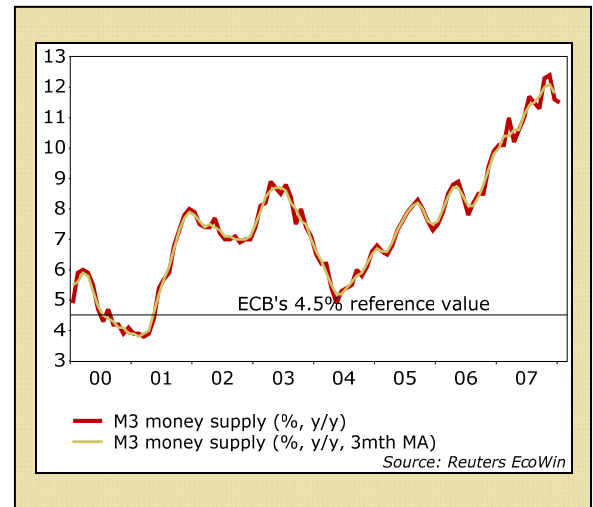
The increased financial market uncertainty had led investors to become more risk averse and prefer to hold less risky assets, with M3 money supply trending higher, before tailing off recently.

Loans to the private sector and non-financial corps have decelerated in recent months, but they remain relatively high on a historical basis. Loans for home purchases may be expected to continue to slow as the credit crunch tightens its grip and as the housing market across some parts of Europe slows.

**M3 money supply is expected to remain at January's level in February, at 11.5% y/y**, corresponding to a three month moving average of 11.6% from 11.8%.

Jodie Tiller

**M3 money supply**



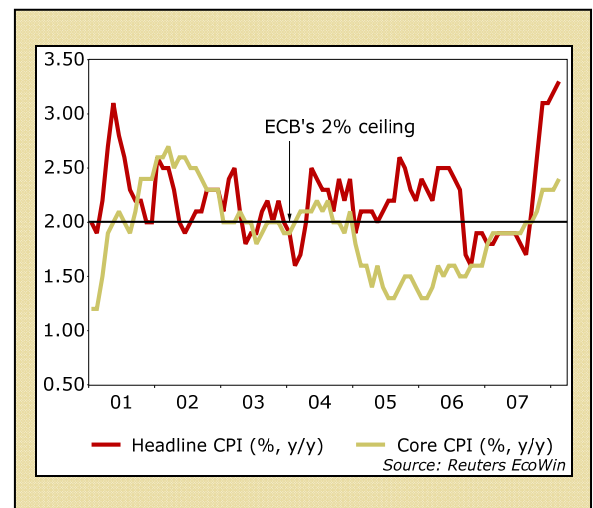
**March CPI (flash estimate) (Monday)**

**The ECB has admitted that headline inflation is likely to remain elevated and above the ECB's 2% ceiling for longer than previously anticipated.** High food and energy (oil) prices remain the main culprits to high inflation, but they are not the sole story. The risks posed from a strong labour market in the form of stronger than expected wage growth remains one element that the monetary authorities are keeping a close eye on and perhaps more importantly, elevated inflation expectations remain a cause for concern at the Bank.

**ECB hawks will not be comfortable to see headline inflation ticking even higher in March, with the flash estimate expected at a new all-time high of 3.3% y/y** from 3.2% y/y previously and confirming that high inflation is here to stay for a while longer yet.

Jodie Tiller

**Headline and Core CPI (% y/y)**





**This Week in the UK**

Weekly Market Barometer	Latest Trading Level (as at 14.00 GMT on Mar 28)	Near-Term Outlook *	Medium-Term Outlook *
Cable	1.9953	Neutral	Small Positive
S-Sterling (Jun 2008 contract)	94.490	Small Positive	Positive
Gilts (Jun 2008 contract)	110.70	Neutral	Small Positive

\* Near-Term = 1 week ahead  
\* Medium-Term = 1 month ahead

**March Manufacturing PMI (Tuesday)**

It looks as if a weaker sterling will take some time to feed through positively onto the manufacturing sector, with no sign of that benefit feeding through just yet.

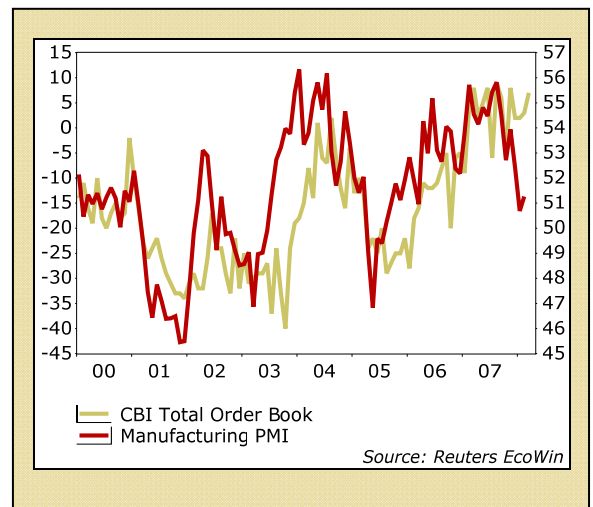
The manufacturing PMI has trended lower from the 55-56 levels achieved last year, to around 51 in the past couple of months, still in expanding territory, but nowhere near the levels seen back in 1999 or 2004 for example.

High input prices (see high oil in particular) and costlier credit may be hampering manufacturer's profit margins, while the softer domestic and to some extent foreign demand cannot be helping either. The brighter spot looks to be the potential positive benefits from a softer pound for export-orientated manufacturers, but that may take time to feed through.

The manufacturing PMI is expected to soften in March, with the headline activity index declining slightly to +51.0 from +51.3.

Jodie Tiller

**Manufacturing PMI & CBI Order Book**



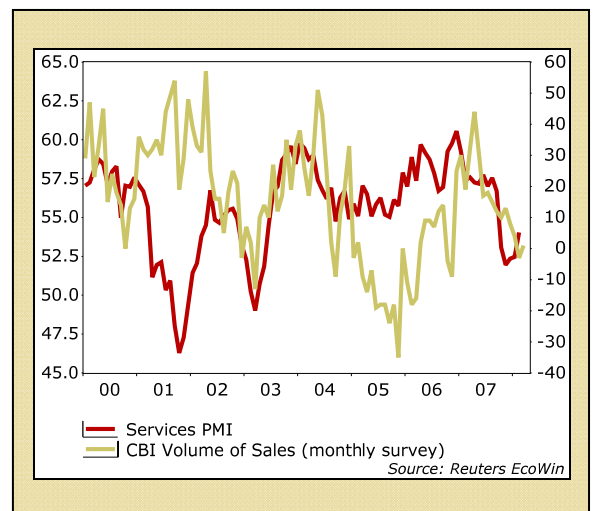
**March Services PMI (Thursday)**

While consumer confidence indicators (see Gfk dipping to a fourteen year low and the Nationwide index reported at a record (four year) low) have tended to suggest downside risks to the UK consumer sector outlook, that sector has continued to surpass expectations, with retail sales persistently surprising to the upside.

Last week, the CBI's headline total sales balance reported a rise for March, but the data breakdown painted a different picture, with a majority of indices actually falling and some to rather low levels historically. The risks to the UK consumer sector are clearly pointing to the downside, but when the consumer pulls back on spending in light of higher utility bills, higher mortgage repayments, costlier credit and a subdued labour market remains to be seen. The services PMI is expected to bring to a halt the past three months of straight rises and edge lower, to +53.0 in March from +54.0.

Jodie Tiller

**Services PMI & CBI Total Sales**





**This Week in the US**

Weekly Market Barometer	Latest Trading Level (as at 14.00 GMT on Mar 28)	Near-Term Outlook *	Medium-Term Outlook *
Dir/Yen	100.01	Small Negative	Negative
Eurodollars (Jun 2008 contract)	97.720	Positive	Positive
US Treasuries (Long Bond)	118-12	Small Positive	Small Positive

\* Near-Term = 1 week ahead  
\* Medium-Term = 1 month ahead

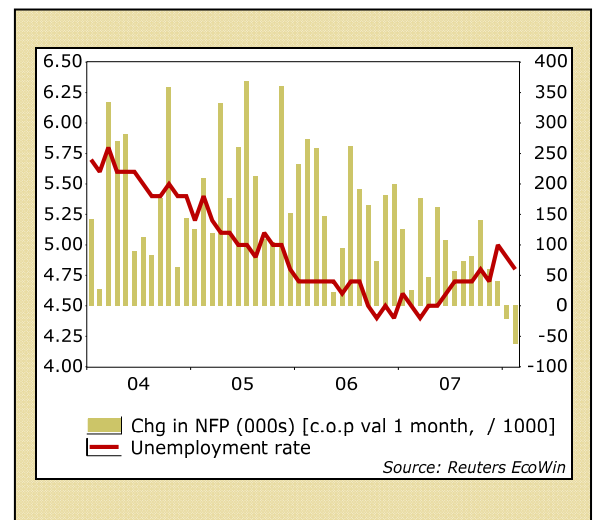
**March Non-Farm Payrolls (Friday)**

February’s nonfarm payroll report provided a clear and reliable recessionary signal, which has subsequently been confirmed by a number of other important economic indicators. After falling by 22K jobs in January, February witnessed an additional decline of 63K positions. This pushed the 3 month moving average down to -15K, and we believe that March’s figures will only confirm this downward trend. Recessions typically see job losses in the 200K range, but we have scaled our call back to -75K due to the fact that the claims numbers, although elevated, are not quite where we would expect them to be considering our negative growth outlook. Despite the sour employment numbers, February’s unemployment rate actually improved as more people left the workforce. However, as can be expected, this dip is temporary and we should see the jobless rate move back up to 5.0% this time around.

The declines in the US payroll data are certainly consistent with a negative print for Q1 real GDP growth. All of the past six US recessions have seen the 3-month moving average of payroll growth fall below zero, and this happened last month.

Meny Grauman

**Non-Farm Payrolls & Unemployment Rate**

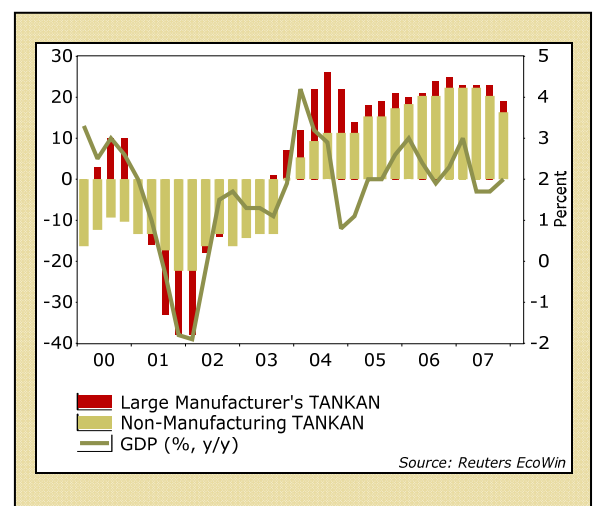


**This Week in Japan**

Japan’s Tankan indices will be closely watched for clues on the strength of the Japanese economy and the likely direction of GDP growth in the coming months. The news emerging from the Japanese economy has not painted a particularly bright picture, and hence the large manufacturer’s Tankan index is expected to report yet another decline in Q1, to +13 from +19. Likewise the non-manufacturer’s Tankan index is seen edging lower, to +12 from +16. What will be key will be the view on capex in the months ahead and firms’ ability and willingness to invest. The capex index is expected to slow notably from the levels reported at the end of last year. Overall, a soft headline Tankan index – likely to be reported at over a two year low – could open the doors for a softer tone from some BoJ members.

Jodie Tiller

**Tankan Survey**



## Legal Disclaimer

This publication is being distributed by (i) in Canada, CIBC World Markets Inc., a member of the Investment Dealers Association, the Toronto Stock Exchange, the TSX Venture Exchange and CIPF, (ii) in the European Union, CIBC World Markets plc, which is regulated in the United Kingdom by the Financial Services Authority, (iii) by CIBC World Markets affiliates in other jurisdictions in compliance with local rules and regulations (collectively, "CIBC World Markets"). This publication is provided for general informational purposes only to institutional and professional investors and does not constitute an offer or solicitation to buy or sell any specific securities or other investments discussed herein

The information, opinions and statistical data contained herein has been prepared by CIBC World Markets solely for informational purposes based upon sources believed to be reliable, however, CIBC World Markets does not represent or warrant the completeness or accuracy of any such information, opinions and statistical data. Any opinions, estimates and projections contained herein are subject to change without notice, and are provided by CIBC World Markets in good faith but with no legal responsibility or liability whatsoever. Changes in assumptions may have a material impact on any returns detailed. The securities and other investments listed reflect indicative terms only and may change in price and yield and market conditions.

The securities and investments mentioned in this publication may not be suitable for all types of investors. This publication does not take into account the investment objectives, financial situation or specific needs of any recipient or particular client of CIBC World Markets. Recipients should consider this publication as only a single factor in making an investment decision and should not rely solely on investment recommendations contained herein, if any, as a substitution for the exercise of independent judgment of the merits and risks of investments. Nothing in this publication constitutes legal, accounting or tax advice, and recipients should independently evaluate the financial, market, legal, regulatory, credit, tax and accounting risks and consequences involved, and specific to the recipient's situation, before entering into a transaction.

Past performance is not a guarantee of future results, and no representation or warranty, express or implied, is made regarding the future performance of any security or investment mentioned in this publication. The price of the securities and other investment mentioned in this publication and the income they produce may fluctuate and/or be adversely affected by exchange rates, and investors may realize losses on investments in such securities, including the loss of investment principal. CIBC World Markets accepts no liability for any loss arising from the use of information contained in this publication, except to the extent that liability may arise under specific statutes or regulations applicable to CIBC World Markets.

CIBC World Markets and its affiliates may have an investment banking or other relationship with some or all of the issuers mentioned herein and may trade in any of the securities and investments mentioned herein either for their own account or the accounts of their customers. CIBC World Markets and its affiliates may at any time deal as principal in or have a long or short position in any security or investment mentioned herein, or any option, future or other derivative based thereon. Any products or services mentioned herein are made available only in accordance with local legal and regulatory requirements. As a result, the securities and investments discussed herein may not be eligible for sale in some jurisdictions.

CIBC World Markets Inc., and CIBC World Markets plc are wholly owned subsidiaries of Canadian Imperial Bank of Commerce, ("CIBC"), but each is solely responsible for its contractual obligations and commitments. Any securities products offered or recommended to or purchased or sold in any client accounts (i) will not be insured by the Federal Deposit Insurance Corporation, the Canada Deposit Insurance Corporation or other similar deposit insurance, (ii) will not be deposits or other obligations of CIBC, (iii) will not be endorsed or guaranteed by CIBC, and (iv) will be subject to investment risks, including possible loss of the principal invested. The CIBC trademark is used under license.

This report may provide addresses of, or contain hyperlinks to, Internet web sites. CIBC World Markets has not reviewed the linked Internet web site of any third party and takes no responsibility for the contents thereof. Each such address or hyperlink is provided solely for the recipient's convenience and information, and the content of linked third party web sites is not in any way incorporated into this document. Recipients who choose to access such third-party web sites or follow such hyperlinks do so at their own risk.

© 2007 CIBC World Markets. All rights reserved. Unauthorized use, distribution, duplication or disclosure without the prior written permission of CIBC World Markets is prohibited by law and may result in prosecution.