RHarding@maybank-ke.com.sg

OVERNIGHT

Investors' appetite for risk also grew after Spanish Prime Minister Mariano Rajoy 's Cabinet yesterday approved a new tax on lottery winnings and a cut in ministries' spending to shrink the euro area's third-biggest budget deficit.

FT markets round-up: "Stocks on both sides of the Atlantic rose, with Wall Street snapping a five-day decline after Spain released much-awaited 2013 budget details and hopes built for additional stimulus measures by China's central bank. The gains came after a surge in eurozone fiscal tensions and a batch of lacklustre economic data weighed on growth assets in the past week. The FTSE 300 closed higher in Europe and the euro resumed gains after details on Spain's 2013 showed the country will focus on spending cuts instead of higher taxes. The single currency was trading 0.4 per cent higher and back above the $1.29 level as the FTSE All-World equity index rose 0.9 per cent. Still, Madrid's Ibex stock index closed 0.2 per cent lower." (Financial Times)

"The Spanish government has announced its fifth round of budget cuts and tax increases in just nine months, as part of a reform package that could pave the way for an EU bailout and sovereign debt purchases by the European Central Bank," reports the FT. (Financial Times)

"The Chinese central bank has injected a record amount of money into the financial system this week to alleviate a cash crunch that had driven up borrowing costs. The People's Bank of China has poured Rmb365bn ($58bn) into money markets over the past three days through reverse repurchase agreements, the largest weekly amount in history," reports the FT. (Financial Times).

This could be merely to inject enough liquidity for the cash demands that will arise from next week's long holiday , or it could be the start of a more serious reflation policy.
Chinese equities have fallen a long way, and are cheap, but what has been missing has been the lack of a giant reflation policy, which would ignite the first phase of a rally, where excess free liquidity pumps up equities , in anticipation of an earnings recovery 6 months down the line.
At present, the over investment cycle, rising costs and falling export demand is leading to overcapacity,low utilisation rates ,falling margins and horrible cash flows.

China is scheduled to release its manufacturing purchasing managers index on Oct. 1, with economists surveyed by Bloomberg News predicting a reading of 50, the level that divides contraction from expansion. A similar private index from HSBC Holdings Plc and Markit Economics is due for release tomorrow.

The data may increase pressure on Chinese Premier Wen Jiabao to try to boost growth ahead of the transfer of power to a new Communist Party leadership that begins later this year.

Has China bottomed,?

the day the Headlines read

"CHART OF THE DAY: The Shanghai Composite Is The Ugliest Chart In The World

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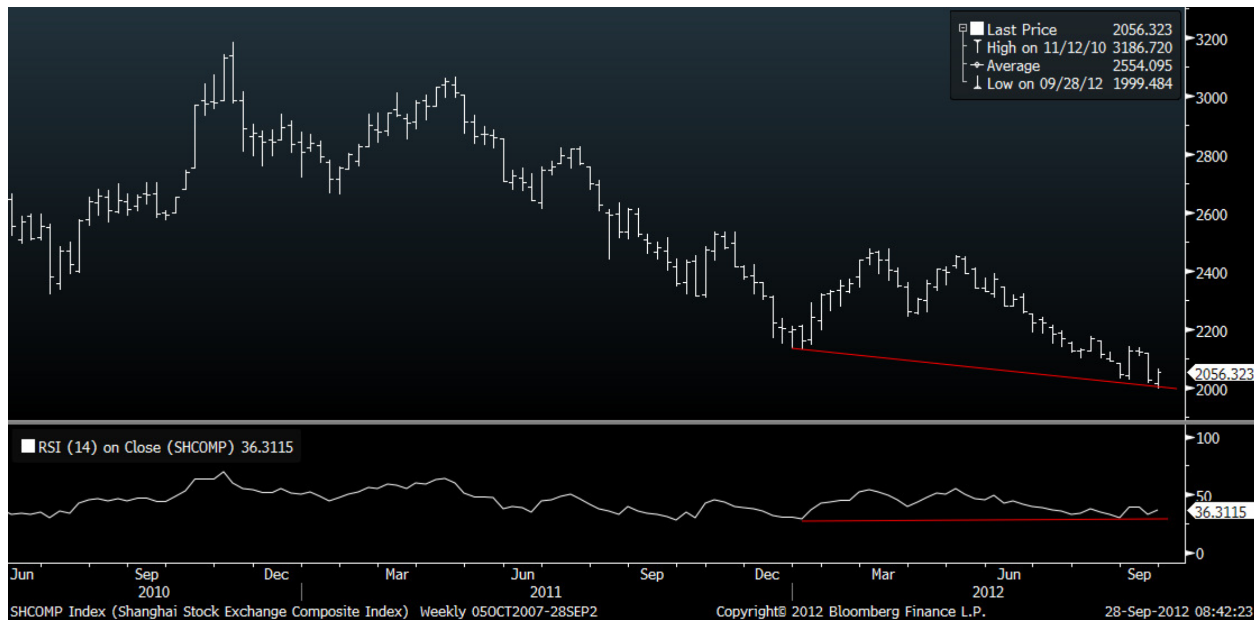
Its possible, with a + RSI Divergence on the weekly chart..

China is closed all week next week, and HK is closed on Monday and Tuesday, so we have a few more days to await further EU woes ,or not and see the size of China's Reflationary efforts, or not.



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Spain's release of the details of its 2013 budget today is a perfect example of where to find it. The budget is constructed around the assumption that Spain's economic output will decline only 0.5 percent next year. But, as many analysts point out, that assumption is wildly unrealistic.

Specifically, Spanish budget minister Cristobal Montoro said today in the press conference introducing the budget that the Spain only expects GDP growth to decline a mere 0.5 percent next year. A merciful recession.

As a result, Spain's budget deficit targets also remain unchanged – 6.3 percent of GDP in 2012 and 4.6 percent of GDP in 2013.

But no one else really thinks Spain is going to escape 2013 with a simple 0.5 percent decline in economic output. It's just not going to happen.

BofA Merrill Lynch economists forecast -1.7 percent GDP growth in Spain in 2013.

SocGen economists expect -2.2 percent.

Citi economists expect -3.2 percent.

Citi's Jose Luis Martinez was pretty frank in making this point after the budget details were revealed. He said, "We see as too optimistic the macroeconomic assumption of 0.5 percent recession for the next year. We see a scenario with a deeper recession and if this were the case, further spending cuts will be needed."

And as the recession deepens, Spanish voters – who have taken to the streets this week to protest austerity measures – will only be more upset when they realize that the plan their government just sold the country is in no way sufficient to move Spain forward.

In His Plot To Save Europe, Mario Draghi Made One Crucial Mistake

By Matthew Boesler

Reuters has a fascinating special report that takes a look inside the internal negotiations on the ECB Governing Council that led to the birth of Mario Draghi's OMT bond-buying plan to save the euro, announced on September 6.

The piece details the negotiations between the Italian ECB chief Mario Draghi and his opponent on the council, Jens Weidmann – the hawkish head of the German Bundesbank.

Weidmann has been staunchly opposed to bond-buying, given Germany's tumultuous monetary history, so Draghi needed to isolate him on the council following the ECB chief's pronouncement in late July that the ECB would do "whatever it takes" to save the euro.

And Draghi almost pulled off his plan perfectly. After all, he ended up getting his bond-buying program.

However, as Reuters correspondents Paul Carrel, Noah Barkin, and Annika Breidthardt point out in their report, Draghi made one crucial mistake:

On August 2, as the council put the finishing touches on the statement Draghi would deliver at an afternoon news conference, Weidmann made a special request. He wanted the ECB president to make clear to reporters that support for bond-buying had not been unanimous. Draghi agreed.

A few hours later, Draghi told reporters in Frankfurt and investors watching screens around the globe that the ECB could soon begin buying bonds to reduce borrowing costs in countries like Spain and Italy. But his lack of specifics disappointed markets. And he made one crucial mistake. Instead of sticking to past practice and remaining vague about who had dissented, he named Weidmann as the lone rebel, infuriating officials at the Bundesbank and on the ECB council who sympathised with the German, according to several sources.

"It wasn't right for him to single out Weidmann," the senior ECB official said.

In the following weeks, a stung Bundesbank would work overtime to undermine Draghi and his plans through a combination of public statements and aggressive leaks.

But Draghi was able to pull it off on September 6, and the OMT has been unveiled and has served to calm markets, so what's the big deal?

Carrel, Barkin, and Breidthardt explain the ultimate consequences of Draghi's crucial mistake: the strong conditionality attached to the OMT program that has caused many on Wall Street to trash the plan.

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More from the report:

At the September 6 policy meeting, all members of the Governing Council bar Weidmann backed the plan to buy sovereign bonds on secondary markets.

But Weidmann's stance and the manoeuvring of others sympathetic to his cause ensured any ECB intervention would come with a strong dose of "conditionality".

Countries who wanted the ECB to intervene must first sign up to a formal aid programme. IMF involvement would be sought and bond purchases restricted to maturities of up to 3 years. The ECB could choose to sell as well as buy bonds - a veiled warning to countries that it might pull the plug if they failed to deliver on their promises.

The conditionality is a big problem because, for example, it could deter countries like Spain where leaders already face voter angst over unpopular austerity measures to sign up for the ECB's rescue plan, rendering it useless.

Morgan Stanley rates strategist Laurence Mutkin said the plan was "quite likely" to deepen Europe's recession because it was like asking countries like Spain and Italy "to sign up for a plan that mandates a 'fiscal cliff'."

Nomura economist Jacques Cailloux said that "tough negotiations around the conditionality are likely to destabilise markets further."

And, pointing to the biggest negative of the plan, BofA economist Laurence Boone wrote that "emphasis on conditionality [is] even stronger than we had expected (as a minimum, ECCL only way to access ECB buying, IMF involvement desired, both significantly lowering the probability that a country will apply for EFSF/ESM support)."

No country in Europe has asked for a bailout yet, but Spain may be getting close. Then, markets may see just how crucial Draghi's mistake back in August proves to be.

US Q2 GDP SLASHED TO 1.3%
By Sam Ro

The third reading on Q2 GDP just came out and the report was ugly.

The headline growth number was revised down to 1.3 percent on an annualized basis.

Economists expected the number to be unchanged at 1.7 percent.

"As we recently noted, you'll need to watch the rear-view mirror to see the recession come into focus," wrote ECRI's Lakshman Achuthan in an email to Business Insider.

"The "third" estimate of the second-quarter percent change in real GDP is 0.4 percentage point, or $16.0 billion, less than the "second" estimate issued last month, primarily reflecting downward revisions to private inventory investment, to personal consumption expenditures, and to exports," wrote the Bureau of Economic Analysis.

The personal consumption component was revised down to 1.5 percent. Economists were expecting it to be unchanged at 1.7 percent.

From the Bureau of Economic Analysis:

Real gross domestic product -- the output of goods and services produced by labor and property located in the United States -- increased at an annual rate of 1.3 percent in the second quarter of 2012 (that is, from the first quarter to the second quarter), according to the "third" estimate released by the Bureau of Economic Analysis. In the first quarter, real GDP increased 2.0 percent.

The GDP estimate released today is based on more complete source data than were available for the "second" estimate issued last month. In the second estimate, the increase in real GDP was 1.7 percent (see "Revisions" on page 3).

The increase in real GDP in the second quarter primarily reflected positive contributions from personal consumption expenditures (PCE), exports, nonresidential fixed investment, and residential fixed investment that were partly offset by negative contributions from private inventory investment and state and local government spending. Imports, which are a subtraction in the calculation of GDP, increased.

The deceleration in real GDP in the second quarter primarily reflected decelerations in PCE, in nonresidential fixed investment, and in residential fixed investment that were partly offset by

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smaller decreases in federal government spending and in state and local government spending and an acceleration in exports.

Motor vehicle output added 0.20 percentage point to the second-quarter change in real GDP after adding 0.72 percentage point to the first-quarter change. Final sales of computers subtracted 0.10 percentage point from the second-quarter change in real GDP after adding 0.02 percentage point to the first-quarter change.

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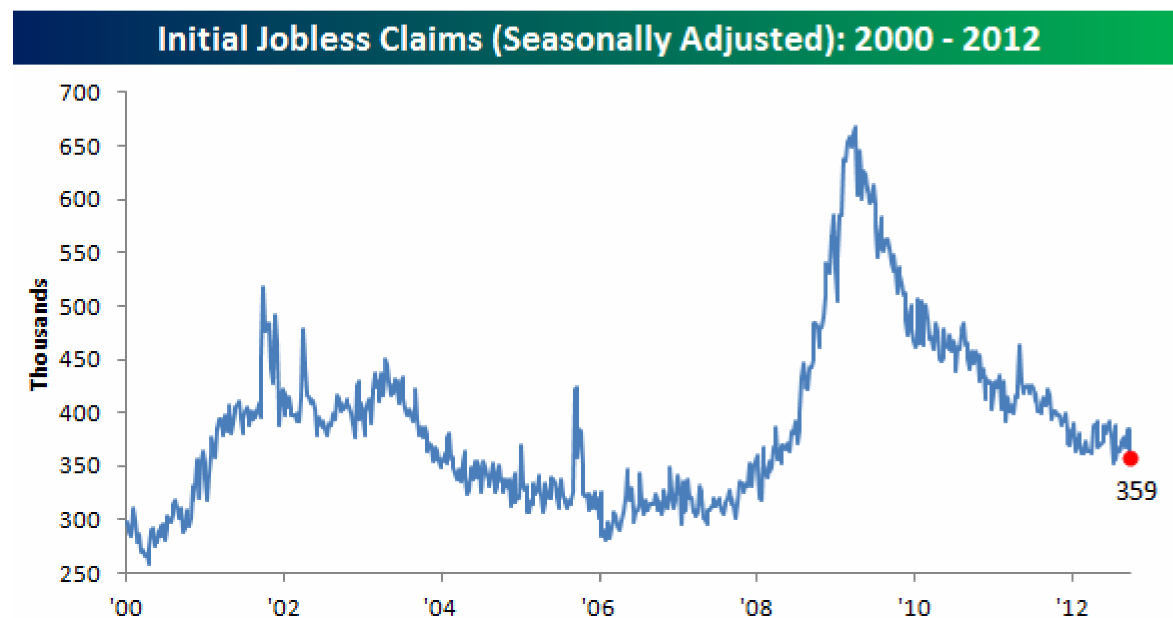
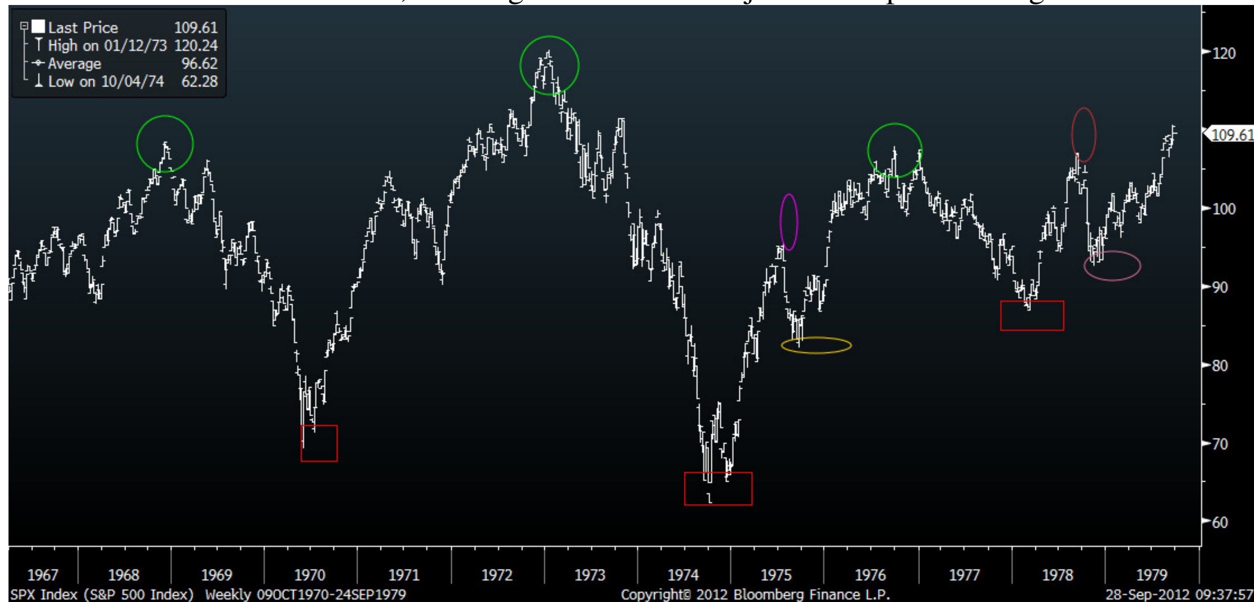
Good news in the lower Jobless Claims

In a sea of weaker than expected reports this morning, jobless claims provided a glimmer of hope. While economists were forecasting weekly claims to come in at a level of 379K, actual claims came in at 359K, which was the lowest reading since July 20th.

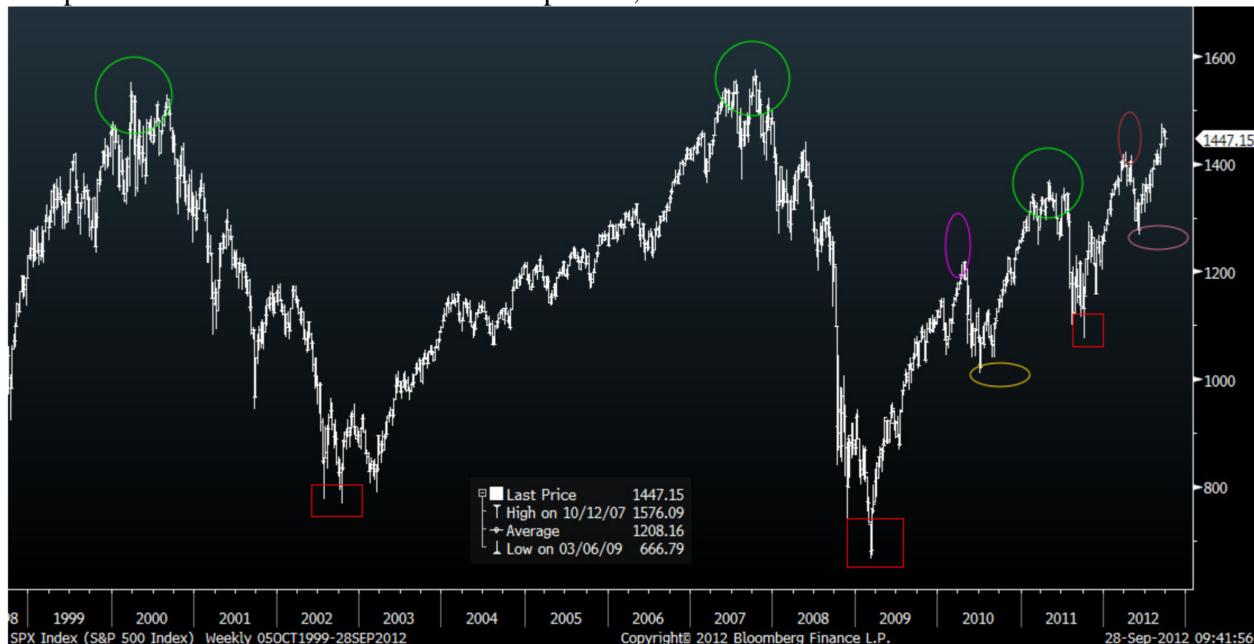


ROADMAP

Long time readers will recognise the below chart, which shows the Secular Bear market of the 1970's…this one ends in 1979, showing that the Index is just below previous highs.



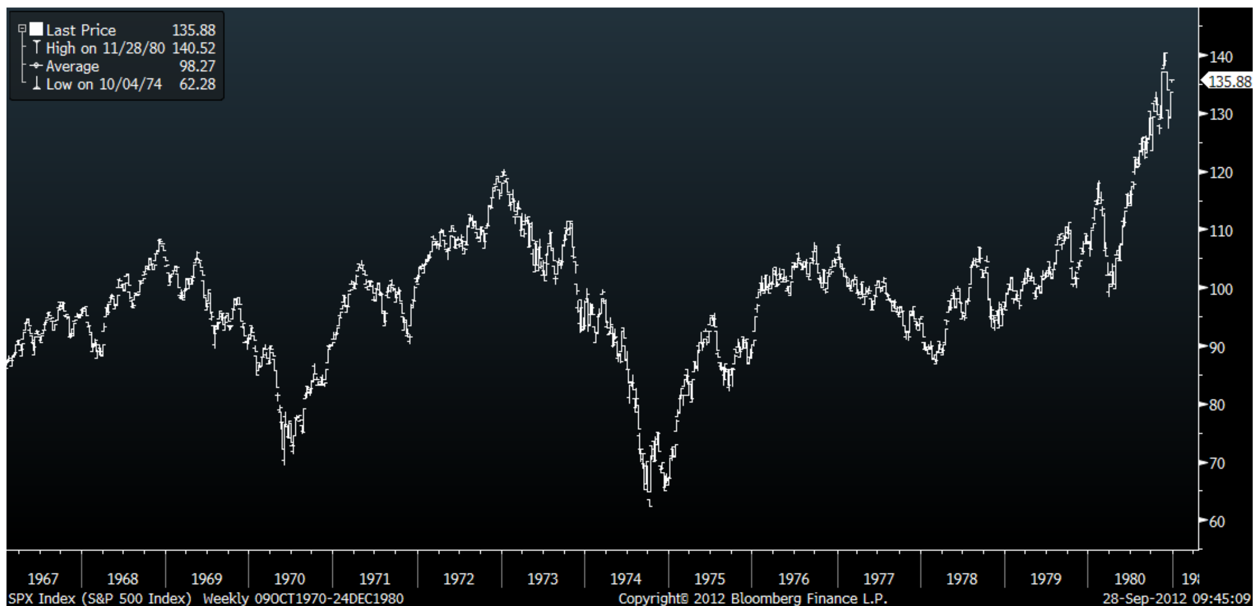
Note the coloured shapes at the various highs and lows in the 1970's chart above, and then compare those with the CURRENT chart pattern,seen below…SPOOKY ?



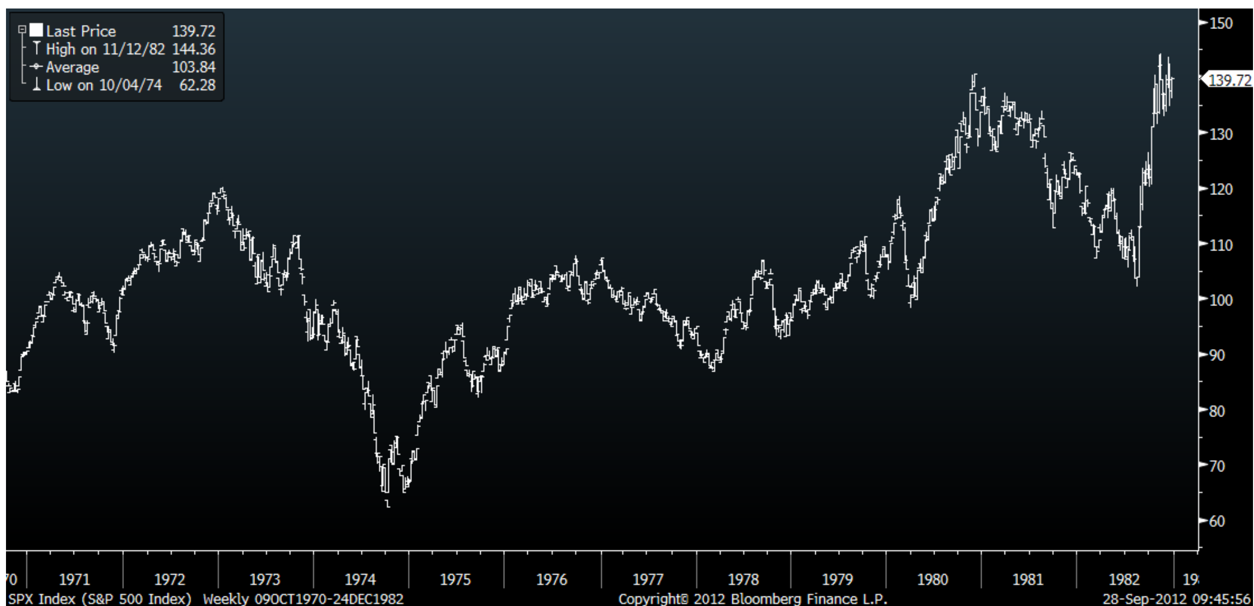
Despite that Secular Bear being an INFLATIONARY one , whilst this one is a DEFLATIONARY one, the pattern appears reasonably similar.

WHAT HAPPENED NEXT?

As we wind the top chart forwards, from end 1979 to end 1980, the S&P did break through to new highs… it ran up 28% to 140 from 109 in the top chart above.



But , it later fell all the way back to that 109 level in 1982… which was the low in PER terms for that secular bear cycle.



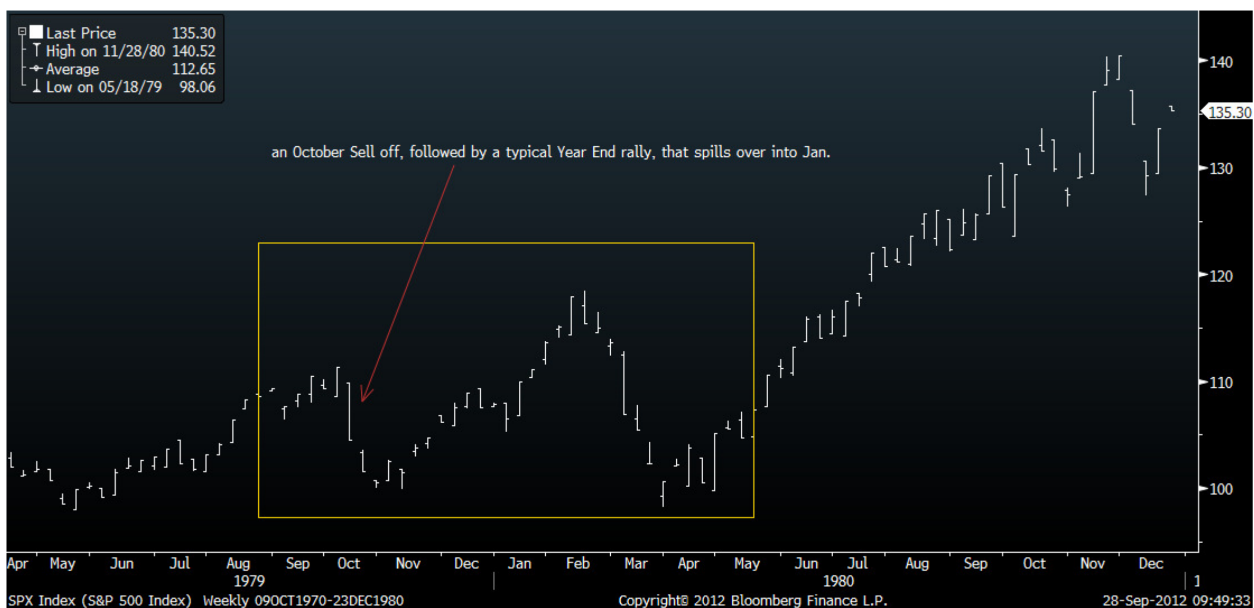
Should history rhyme, what will happen next in the short term?

Looking back and standing at end Sept 1979, we saw

1/ an Oct 1979 sell off of about 10%..110 to 100…

2/ a 19% rally from Oct lows to mid Feb 1980 highs…

3/ then a steep sell off of about 17% back just below 100 into end March.



Lets see if this can be replicated..!

For those not familiar with the ROADMAP,, below it is, showing 100 year chart with the Secular Bear (red dotted rectangles) where markets go sideways for roughly 16 years and Secular Bull cycles.
The Secular Bear cycles alternate between Inflationary Bear (1910's and 1970's) and Deflationary Bear (1930's and 2000"s)