

# Weekly guidebook for the global investor

## Macro viewpoint: The domino effect

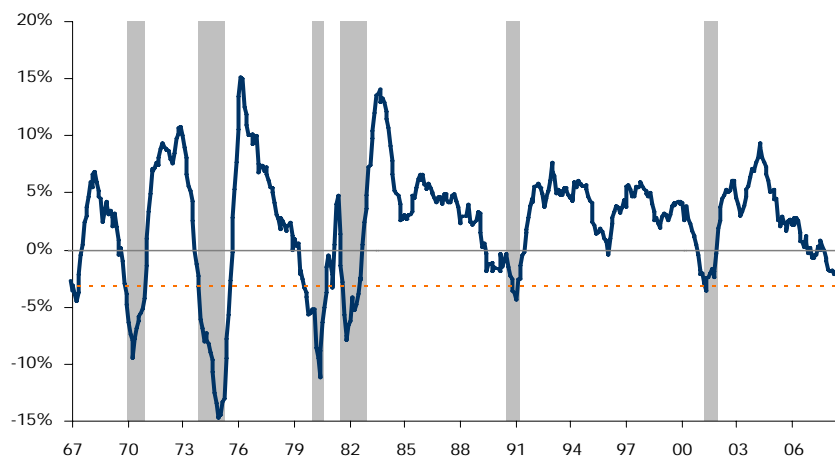
Did we really need a 0.7% MoM decline in the index of leading indicators for July to tell us that the US economy is in recession? The unemployment queue is now the longest since December 2001, according to the weekly claims data. Housing starts look to be closing in on 900,000 in the next couple of months, and even that is so far above demand that there is no dent in month's supply on the horizon. Any wonder that the 10-year note now has a firm grip on the 3-handle and the equity market has not boasted four straight up-days since last May?

## The week ahead: Durable goods orders the highlight

The weekend and early week financial news will be dotted with information flow from the Kansas City Fed's annual Jackson Hole symposium. Otherwise, the Fed speaking calendar is relatively bare, with Atlanta Fed President Lockhart (alternate FOMC member) the lone speaker on the topic of inflation. We'll also be getting reports on home sales and prices, with foreclosure activity likely to be the main factor behind both. The July report on durable goods will probably show a gain in the transportation sector, but the capex portion will probably remain soft.

### Leading indicators clearly in recession terrain

Conference Board index of leading economic indicators (year-over-year % change)



Shaded region represents period of US recession  
Source: Conference Board, Merrill Lynch



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## Recent publications

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[Darker side of the brighter dollar outlook, 19 August 2008](#)

[Budget blues, 19 August 2008](#)

[An inhospitable benchmark revision ahead, 18 August 2008](#)

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## Macro viewpoint

### The domino effect

Did we really need a 0.7% MoM decline in the index of leading indicators for July to tell us that the US economy is in recession? The unemployment queue is now the longest since December 2001, according to the weekly claims data. Housing starts look to be closing in on 900,000 in the next couple of months, and even that is so far above demand that there is no dent in month's supply on the horizon. Any wonder that the 10-year note now has a firm grip on the 3-handle and the equity market has not boasted four straight up-days since last May?

### Housing still posting double digit declines

The housing market was where the economy first started unraveling way back in 2006 and yet there is no sign a recovery is imminent. Housing starts continued to grind lower in July, dipping back below the 1 million mark, and building permits were even lower, leaving residential investment on track for a 13.7% QoQ annualized decline in 3Q. The report also showed that builders put over a million completed homes on the market in July, indicating that months' supply will come in at 9.4 months in the July new home sales report next Tuesday.

### Consumer recession is here

There was no hard news on consumer outlays this week but what we have seen so far this month has not been encouraging. The retail sales numbers up to July have been dismal, in spite of the \$120 billion in tax rebate checks, that we're tracking a 1.5% annualized decline in 3Q. The last of the checks for those that filed a 2007 tax return were sent out by mid-July. The consumer is still facing \$3.80/gallon gasoline prices, job cutbacks, the end of fiscal stimulus and, increasingly, fewer credit options to fall back on.

### Philly Fed says capex set to tumble

The next leg of the economic downturn appears to be falling in place. News of scrapped or scaled back commercial building projects make daily headlines, with capital-strapped banks pulling project funding at the merest hint of revenue uncertainty. The Philly Fed manufacturing survey points to a sharp pullback in capex and commercial construction outlays in the next six months. At this point intended investment cutbacks are not quite as bad as what we saw in 2001, but they are low enough to corroborate our expectation of double digit declines by the end of this year.

### Inventory boost in 3Q, but then what?

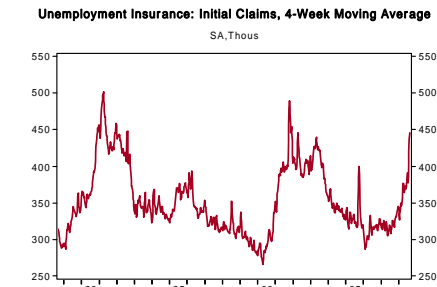
Virtually all of the growth in our 1.2% QoQ annualized 3Q GDP bean count is coming from a positive swing in inventory investment, as the auto sector recovers from the GM parts supplier strike in 2Q. Indeed, the inventory swing is adding almost 2.5 percentage points to top-line growth. However, the prospects of more inventory building in 4Q are pretty slim, with most manufacturing and nonmanufacturing surveys telling us that firms are quite content to let stockpiles run down as they watch the US consumer stumble.

### Whither the export savior?

Meanwhile, we have not yet made any changes to our export profile but our expectation that this sector would be a prop to growth is increasingly uncertain as the US dollar seems to have found a floor and world growth stumbles.

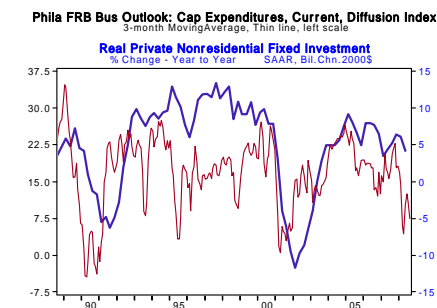
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Chart 1: Unemployment ranks building



Source: Department of Labor, Merrill Lynch.

Chart 2: Capex next to fall



Source: Bureau of Economic Analysis, Federal Reserve, Merrill Lynch.

## Key market movers

### The week ahead

The July report on durable goods will probably show that capex remains soft

The weekend and early week financial news will be dotted with information flow from the Kansas City Fed's annual Jackson Hole symposium. Otherwise, the Fed speaking calendar is relatively bare, with Atlanta Fed President Lockhart (alternate FOMC member) discussing inflation as the lone speaker. We'll also be getting reports on home sales and prices, with foreclosure activity likely to be the main factor behind both. The July report on durable goods will probably show a gain in the transportation sector, but the capex portion will probably remain soft.

The recession in real estate continues unchecked

### No floor in housing

Housing news in the upcoming week will likely be mixed, but indicate the bottom is still at least a year away. Existing home sales are seen rising in July driven by increased turnover of foreclosed properties. Such homes have substantially added to already-bloated inventory levels, so the gain in sales is a welcome development. The latest figures for homes prices by Case Shiller will likely show a larger decline in June than seen in May. Fire sale prices on distressed properties will probably add pressure on competing existing and new homes. Weekly data on mortgage applications continue to fall, credit conditions for mortgages remain record-tight (with little relief in sight before mid-2009) and the consumer is set to show a contraction in spending. Altogether, these trends suggest the recession in real estate continues unchecked.

The first reveal of nation-wide corporate profits in 2Q will probably show a 6% slide from year ago levels

### Profit margins to shrink to three-year low

The upward revision to 2Q real GDP growth from 1.9% to 2.3% will continue to show consumption boosted by stimulus checks and exceptional export growth. The outlook heading into 3Q and beyond is quite changed as consumers are expected to show a contraction in spending and slower external growth begins to weigh on US exports. The first reveal of nation-wide corporate profits in 2Q will probably show a 6% slide from year ago levels and a decline in profits to GDP, a proxy for margins, to a 3-year low of 8.0%.

### Confidence gains will be energy driven and temporary

The Conference Board and University of Michigan release consumer confidence figures for August and both are expected to improve marginally from earlier lows. Consumers appear to have taken comfort from recently lower gasoline prices. However, this could end up being short-lived, as negative news accumulates from steeper declines in employment, the end of fiscal stimulus, still falling home prices, tighter credit conditions and flat equity markets.

### More Fed operations

The Federal Reserve will conduct two operations this week in their continuing campaign to restart US credit markets. On Monday they will conduct a \$75 billion 28-day TAF auction which provides financing for commercial banks. On Wednesday they will offer options on \$25 billion of TSLF loans (swaps) which offer the right to pledge investment-grade securities in exchange for Treasuries. The TSLF options program will be watched as another gauge of how tight financing will be over the quarter end. The TAF program should be watched carefully to see what level of preference commercial banks have for the 84-day funding versus this auction's 28-days. Both underscore that, with a credit crunch effectively raising the economy's interest rate, it is highly unlikely the Fed will move rates higher anytime soon.

## Monday, 25 August

### Existing Home Sales, July—10:00am

	Exp	Cons	Range	History
Existing Home Sales	4.90M	4.91M	4.69 – 5.00m	Jun = 4.86M vs. May = 4.99M

Source: Merrill Lynch, Bloomberg

Existing home sales are forecast to rise 0.8% MoM in July to an annualized pace of 4.9 million units. This uptick is expected to be driven by sales of foreclosed homes, which were noted as a factor in the latest increase in pending home sales data and tend to lead existing sale by 1-2 months. Several states and metro areas have reported preliminary sales figures for July, most notably in California, Florida and Nevada, the states with the highest home foreclosure rates. In these cases, the increase in sales has been driven by distressed properties at fire-sale prices. These homes have added to already-elevated inventories, but are selling on deep price cuts. In-line with these figures, we expect to see a decline in July median existing prices for single-family homes after 4 months of consecutive gains. The outlook for a bottom in housing remains at least a year away, in our view. Lending conditions have tightened for home mortgages and the consumer is set to enter a recession, two factors which will weigh on sales activity, putting further downward pressure on prices.

## Tuesday, 26 August

### Case-Shiller Home Price Index (Composite 20), June—9:00am

	Exp	Cons	Range	History
Case-Shiller June M/M	-1.3%	N/A	N/A	May = -0.9% vs. Apr = -1.3%
CS HPI 2Q YoY %	-16.7%	-16.2%	-17.3 to -15.9%	1Q = -14.1% vs. 4Q = -8.9%

Source: Merrill Lynch, Bloomberg

The Case Shiller home price index for the 20 largest US cities is expected to fall 1.3% MoM in June, marking the 23rd straight month of consecutive declines. Median existing home prices dropped by a similar amount over the month after showing a lighter decline in May. Month-to-date RPX index figures from Radar Logic corroborate our forecast for Case Shiller home prices, they are down 1.2% through mid-month.

2Q national home prices will also be released and are expected to drop 15% from 1Q levels and 16.7% from a year ago. Despite falling nearly 20% from the peak in mid-2006, real estate prices remain over valued and, in our view, have an additional 15-20% to fall through end-2009. The ongoing surge in home foreclosures will put additional pressure on prices as distressed properties are selling at steep discounts. Inventories remain elevated, credit conditions are expected to remain tight and an unfolding recession in consumer spending indicates a bottom in housing is still at least a year away.

Conference Board Consumer Confidence, August—10:00am

	Exp	Cons	Range	History
Consumer confidence	53.0	53.0	50 – 55.0	Jul = 51.9 vs. Jun = 51.0

Source: Merrill Lynch, Bloomberg

Consumer confidence, as measured by the Conference Board, is expected to rise slightly in August to 53.0 from 51.9 in July, mired near its 16-year low levels. Recent developments, particularly the drop in gasoline prices to about \$3.75 a gallon, have buoyed other confidence measures, such as the preliminary University of Michigan (the final August measure is due out Friday) and the Bloomberg/L.A. Times poll released earlier this week. Nonetheless, no meaningful rise is expected. Tax rebates have come to an end. Companies, under pressure to cut costs, have been shedding jobs and limiting hours worked, leaving the labor market weak. This is likely to be reflected in the jobs-differential figure (jobs plentiful less hard to get), which, in July, touched its lowest point since December 2003. More broadly, the rising unemployment rate will dampen sentiment, leaving it just off its cycle lows.

New Home Sales, July—10:00am

	Exp	Cons	Range	History
New Home Sales	525K	524K	500 – 570K	Jun = 530K vs. May = 533K

Source: Merrill Lynch, Bloomberg

New home sales will probably fall by 1.0% month over month in July to an annualized pace of 525K units. The latest homebuilder survey showed record lows in July sentiment and no improvement was seen in August. Current and prospective sales for new homes remained depressed, likely worsened by tighter lending standards for home mortgages. The recent Federal Reserve Senior Loan Officer survey also revealed that the outlook for easing in lending standards is not expected until at least mid-2009 – which does not bode well for home sales. The supply of new homes, though expected to drop over the month, is expected to remain a pressing problem for quite some time. New home completions continue to track higher than demand. Homebuilders also face a competing flood of supply from foreclosed homes. We estimate these will add about 60K/month for the next 18 months. As such, we expect steeper declines in home prices in coming months as new homes compete with reduced prices from foreclosed homes.

**Wednesday, 27 August**

Durable Goods Orders, July—8:30am

	Exp	Cons	Range	History
Durable Goods	0.5%	0.1%	-2.1 to 2.2%	Jun = 0.8% vs. May = 0.1%
Durable Goods ex Trans	-0.9%	-0.5%	-2.9 to 1.5%	Jun = 2.0% vs. May = -0.5%

Source: Merrill Lynch, Bloomberg

Manufacturers' new orders for durable goods probably rose 0.5% in July. The transportation sector will likely provide a boost with gains in autos and aircraft orders. After months of declines related to the UAW strike, orders for autos are seen rising in July after a 1.6% gain in June. Boeing reported orders for 70 new civilian aircrafts over the month, up from 62 in June. However, the value of sales was lower and so we expect only a slight rise in private aircraft orders after a 25% decline in June. Outside of transportation, orders are expected to fall 0.9% MoM on declines in metals, machinery and electrical equipment orders. Raw material prices appeared to play a role in the June report, boosting the value of metals-related orders – if July follows suit, declines should unfold as prices have since reversed course. Nondefense ex air capital goods orders, a leading indicator for capex spending, are seen rising 0.5% in July.

## Thursday, 28 August

### Initial Jobless Claims, week ending 08/23/08—8:30am

	Exp	Cons	Range	History
Initial Claims	430K	425K	410 – 450K	Aug 16 <sup>th</sup> = 432k

Source: Merrill Lynch, Bloomberg

Initial claims for unemployment benefits for the week ending August 28th are expected remain essentially unchanged at 430K. This would imply a 4-week moving average of 441K, the highest since December 2001. The upward trend in claims is expected to continue as we head through the balance of 2008, translating into larger declines in payrolls. We are expecting a decline of 140K in the August payroll report (released on September 5th) versus an average -66K per month so far this year. The continuing claims data will likely remain above 3.3M in the upcoming week, a figure which has shown a meaningful rise this year. The Department of Labor is concerned that this figure could be reflecting workers receiving "extended benefits" – a separate state program for ongoing benefits or workers that should be in the separate Federal program recently passed by the Congress. Little data have been collected so far for the Federal extension benefits, but the two weeks we do have show that nearly 1.3M workers are collecting benefits. The bottom line is that continuing claims, extended benefits and the Federal program for ongoing benefits are all rising, reflecting a lengthening duration of unemployment for many workers.

### Real GDP, 2Q (P)—8:30am

	Exp	Cons	Range	History
Real GDP	2.3%	2.7%	2.0 – 3.5%	2Q (A) = 1.9% vs. 1Q = 0.9%
GDP Price Index	1.1%	1.1%	1.0 – 1.5%	2Q (A) = 1.1% vs. 1Q = 2.6%

Source: Merrill Lynch, Bloomberg

Insert Corporate Profits Line above

Real GDP growth, initially reported at 1.9% QoQ annualized growth in 2Q is expected to be revised to 2.3%. The revisions will probably show larger drags from inventories and capex, but both are more than offset by larger gains from trade. The quarter continues to show a rebound in growth led by stimulus-check supported consumer spending and a strong contribution from trade. The most significant revisions will include stronger export growth (now up 15.2% Q/Q from prior reported 9.2%), and a bigger decline in imports. Trade is now seen contributing 3.2ppts to overall growth versus the 2.4ppts initially reported. Inventories, which were cut heavily over the quarter, are expected to show an even steeper drawdown than initially reported. The large draw-down of auto inventories was related to the UAW strike, which shut down manufacturing plants from the end of February through the end of May. Capex is also expected to be revised lower from -3.4% to -6.3% after the latest trade data showed that more investment was exported than consumed domestically.

The GDP price index is unlikely to see a significant revision from the 1.1% quarterly annualized gain previously reported in 2Q. Since the initial report we could see a downward revision of 0.1% to the QoQ core PCE index, still leaving the YoY rate unchanged at 2.2%. Lower medical care service prices over the quarter are the driving factor.

The first reveal of nation-wide corporate profits in 2Q will probably show a 6% slide from year ago levels and a decline in profits to GDP, a proxy for margins, to a 3-year low of 8.0%.

## Friday, 29 August

### Personal Income & Outlays, July—8:30am

	Exp	Cons	Range	History
Personal Income	0.6%	0.0%	-1.0 to 0.6%	Jun = 0.1% vs. May = 1.8%
Personal Spending	0.2%	0.3%	-0.1 to 0.5%	Jun = 0.6% vs. May = 0.8%
Core PCE (YoY)	2.5%	2.4%	2.2 – 2.5%	Jun = 2.3% vs. May = 2.2%

Source: Merrill Lynch, Bloomberg

The core PCE price index is expected to post a 0.3% gain over the month in July in step with the gain posted in the core CPI. The resulting YoY gain could show a rise from 2.3% in June to 2.5% in July. However, we anticipate that inflation is nearing its peak, after which, a deceleration will unfold. Similarly, the headline PCE index, expected to rise 0.6% over the month to 4.5% YoY is poised to retreat in August on lower energy prices.

Consumer spending, expected to rise by 0.2% over the month in nominal terms, is seen contracting after prices are taken into account. Real spending likely fell 0.4% in July with broad-based category weakness, building on a 0.2% decline in June. Despite the delivery of close to \$30B in stimulus checks through mid-month (and over \$100B in total from May), July will mark the second straight month of disappointing spending. These results reflect a more financially strained consumer.

Personal income probably rose 0.6% MoM in July after a flat reading in June. Consensus estimates currently expect a flat reading, in-line with the no growth in wages and salaries. However, about 15% of the stimulus recipients who are very low income consumers register a gain in personal income as opposed to lower net tax payments when they receive their checks. This category likely rose by 1.4% in July and will provide a boost to disposable personal income (DPI), seen rising 0.9% MoM. Taking prices into account, real DPI should post a more modest gain of 0.2%. The savings rate, still benefiting from stimulus payments, is expected to come in at 3.2% in July after a peak of 4.9% in May. This compares with the 1Q average savings rate of 0.3%.

### Chicago PMI, August—9:45am

	Exp	Cons	Range	History
Chicago PMI	49.5	50.0	48.0 – 51.5	Jul = 50.8 vs. Jun = 49.6

Source: Merrill Lynch, Bloomberg

The Chicago Purchasing Managers Index is expected to fall to 49.5 in August from 50.8 in July, marking the eighth consecutive month this index will be at or below 50. The heavily concentrated areas of auto and metal manufacturing have shown little improvement of late, and weakness in economic growth around the world is expected to dampen export orders. The prices components are expected to ease from the 28-year high of 90.7, in line with tumbling commodity prices. It would not be surprising to see this drop back to the low-80s. Regional manufacturing surveys have been mixed to date, suggesting that the upcoming ISM will be stagnant at around 50.0.

**University of Michigan Index of Consumer Sentiment, August (F)—10:00am**


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	Exp	Cons	Range	History
Consumer Sentiment	61.9	62.0	60.5 – 63.0	Aug (P) = 61.7vs. Jul = 61.2

Source: Merrill Lynch, Bloomberg

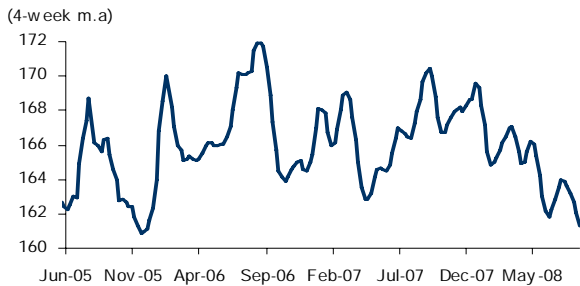
The final read of the University of Michigan confidence index is unlikely to change much from the preliminary read of 61.7. We look for a marginal improvement to 61.9. Over the past two weeks, gasoline prices have fallen further, though equity markets have weakened somewhat. Inflation expectations have also begun to ease, with near-term expectations dropping to 4.8% y/y from 5.1% in July, and long term expectations holding steady at 3.2%. As concerns over the economy begin to overtake inflation, it will be increasingly important to monitor consumers' sentiments regarding their financial state and buying intentions. In both cases, these have remained weak.

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## Merrill Lynch proprietary indicators

The Merrill Lynch production index



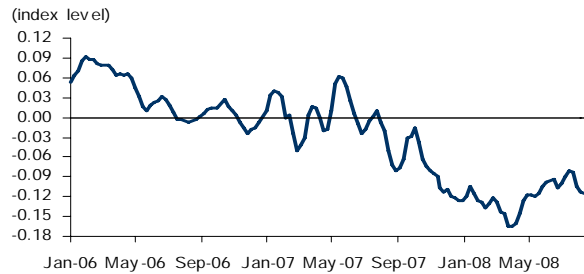
Our production index dropped for the sixth week in a row to its lowest level since late 2005. Our index is off 1.4% against the July average indicating soft industrial production for August. We saw declines across most of the components. Electrical production, which has the largest weight in our index, dropped 0.3% on top of a 0.8% decline last week. Truck production was off 6.8%, the fifth decline in a row and a sign of the rapid shift underway in motor vehicles away from trucks. Coal production was off as well, dropping 0.7% after a string of five increases in a row. Crude oil production fell as well, sinking 0.4% after a 0.1% increase the week before. Finally, railcar loadings dropped 0.3% for the third consecutive weekly decline. We did see raw steel manage to post an increase, however, rising 1.1% in the latest week.

The Merrill Lynch housing index



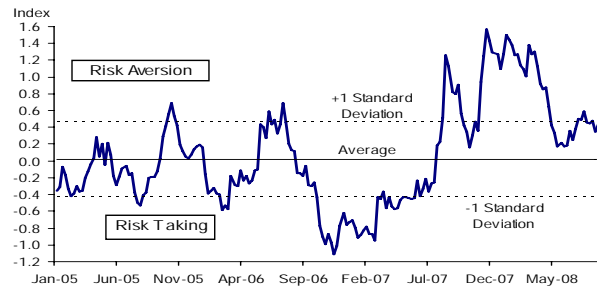
Our housing index fell for the third week in a row and has dropped four of the last five weeks. This performance indicates that the housing market remains weak and is far from carving out a bottom. For starters, the labor market remains soft. The four-week moving average on continuing claims rose for the fourth week in a row to a level not seen since December 2003. Meanwhile, the MBA's purchase index continues to run below the levels of a year-ago. That indicates a significant pullback in the demand for new housing. Credit continues to remain tight as well. Real estate loans from commercial banks are running below their one-year trend. And, in a sign of how the credit crunch is clogging the monetary transmission mechanism, the contract rate on 30-year conventional mortgages is on the rise and just 20 bps below the levels of a year ago.

The Merrill Lynch consumer index



Our consumer index sank for the fourth consecutive week to its lowest level since May. Having spent over a year in negative territory, the index reflects a weak consumer that continues to cope with an array of headwinds. First, the labor market remains soft. The four-week moving average on initial claims rose to the highest level since December 2001, which was a time the US economy was crawling its way out of recession. Meanwhile, energy prices remain high. Crude oil hovering at \$120 per barrel will keep gasoline prices elevated and act as a drag on discretionary spending in coming quarters. Consumer confidence remains at depressed levels as well, running at a 16-year low. And, despite this latest bear market rally, consumers continue to watch their equity assets deflate. The level of the S&P 500 is actually south of its two-year average.

The Merrill Lynch financial stress index



Our financial stress index rose in the latest week, to just above the cut-off mark for risk aversion territory. This indicates that financial market conditions have yet to normalize. Credit spreads have widened across the board. Baa spreads widened to their highest level since April while two-year swap spreads spiked to 101 bps, the highest since early March. TED spreads widened too and, at 129 bps, remain well above normal. Gold, which has long been viewed as a safety play, rose for the first time in five weeks. We also saw investors rotate away from equities as Treasuries outperformed the S&P 500 in the latest week. And, within the equity market we saw consumer staples outperform technology stocks.

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## Debt issuance

### Treasury financing (billions of \$)

<u>Announcement date</u>	<u>Auction date</u>	<u>Settlement date</u>	<u>Issue</u>	<u>Size</u>	<u>New cash</u>
21-Aug	25-Aug	28-Aug	3-month	28	
21-Aug	25-Aug	28-Aug	6-month	27	
25-Aug	26-Aug	28-Aug	4-week	28*	
21-Aug	26-Aug	28-Aug	1-year	20	27*
28-Aug	2-Sep	4-Sep	3-month	28*	
28-Aug	2-Sep	4-Sep	6-month	27*	
2-Sep	8-Sep	10-Sep	4-week	20*	1*
4-Sep	8-Sep	11-Sep	3-month	26*	
4-Sep	8-Sep	11-Sep	6-month	25*	
8-Sep	9-Sep	11-Sep	4-week	14*	(9)*
11-Sep	15-Sep	18-Sep	3-month	24*	
11-Sep	15-Sep	18-Sep	6-month	23*	
15-Sep	16-Sep	18-Sep	4-week	10*	(50)***

\* Estimate. ( ) = Paydown. (R) = Reopening. \*\*\*Includes CMB. New cash is for the settlement data  
Source: Bloomberg, U.S. Treasury, Merrill Lynch

### Agency financing (billions of \$)

<u>Announcement date</u>	<u>Auction date</u>	<u>Settlement date</u>	<u>Issue</u>	<u>Size</u>
25-Aug	27-Aug	28-Aug	FNM 3-month	
25-Aug	27-Aug	28-Aug	FNM 6-month	
29-Aug	3-Sep	4-Sep	FNM 3-month	
29-Aug	3-Sep	4-Sep	FNM 6-month	
29-Aug	2-Sep	3-Sep	FRE 3-month	
29-Aug	2-Sep	3-Sep	FRE 6-month	

FRE = Freddie Mac, FNM = Fannie Mae, (R) = Reopening  
Source: Bloomberg, Freddie Mac, Fannie Mae.

## Policy speakers

### Key speaking engagements and news events\*

<u>Monday, August 25</u>	<i>None scheduled at this point</i>	
<u>Tuesday, August 26</u>	<i>None scheduled at this point</i>	
<u>Wednesday, Aug 27</u>	8:35 am	Atlanta Fed President Lockhart (non-voter) speaks on inflation and inflationary pressures in the US economy
<u>Thursday, August 28</u>	<i>None scheduled at this point</i>	
<u>Friday, August 29</u>	<i>None scheduled at this point</i>	

\*Time and date subject to change

Source: Bloomberg, Market News, Merrill Lynch

22 August 2008

## Economic forecast summary

Real Economic Activity, % SAAR	4Q2007	1Q2008	2Q2008	3Q2008	4Q2008	1Q2009	2Q2009	3Q2009	4Q2009	2007	2008F	2009F
Real GDP	-0.2	0.9	2.3	1.2	-2.0	-2.0	-0.5	2.0	2.5	2.0	1.5	-0.3
% Change, Year Ago	2.3	2.5	1.9	1.0	0.6	-0.2	-0.8	-0.6	0.5			
Final Sales	0.8	0.9	3.8	-1.2	-1.3	-2.0	-0.1	1.4	2.5	2.4	1.6	-0.3
Domestic Demand	-0.1	0.1	1.3	-1.3	-1.4	-3.0	-0.8	1.1	2.3	1.8	0.4	-1.0
Consumer Spending	1.0	0.9	1.5	-1.5	-1.5	-2.0	0.0	1.8	2.5	2.8	0.8	-0.5
Durables	0.4	-4.3	-2.9	-5.5	-10.3	-5.7	0.5	2.5	3.5	4.8	-2.3	-3.7
Nondurables	0.3	-0.4	4.1	-4.0	-4.0	-3.5	-3.0	1.5	2.0	2.5	0.2	-2.2
Services	1.4	2.4	1.1	0.5	1.3	-0.5	1.3	1.8	2.5	2.6	1.6	0.9
Residential Investment	-27.0	-25.0	-15.6	-13.7	-20.2	-21.0	-7.9	4.4	5.1	-17.9	-20.7	-12.9
Nonresidential Investment	3.4	2.4	2.4	-1.4	-1.2	-12.3	-8.7	-5.5	1.6	4.9	3.1	-5.7
Structures	8.6	8.7	13.9	-5.1	-9.0	-10.8	-8.0	-5.0	1.0	12.7	8.5	-6.4
Equipment and Software	1.0	-0.5	-6.3	0.5	3.0	-13.0	-9.0	-5.8	2.0	1.7	-0.1	-5.5
Government	0.8	1.9	3.6	1.5	1.9	1.7	1.8	1.8	1.6	2.1	2.3	1.9
Exports	4.4	5.1	15.2	5.2	4.8	3.0	2.8	3.2	2.4	8.4	9.1	4.3
Imports	-2.3	-0.8	-6.5	2.6	2.5	-4.0	-2.4	1.0	1.5	2.2	-1.3	-0.9
Net Exports (Bil 00\$)	-484.5	-462.0	-375.3	-367.9	-361.4	-329.4	-306.6	-298.6	-296.1	-546.5	-391.6	-307.7
Inventory Accumulation (Bil \$)	-8.1	-10.2	-65.7	3.8	-15.4	-15.9	-28.2	-12.0	-13.1	-2.5	-21.9	-17.3
Nominal GDP (Bil \$)	14031	14151	14257	14428	14489	14496	14496	14593	14721	13808	14331	14577
% SAAR	2.3	3.5	3.0	4.9	1.7	0.2	0.0	2.7	3.6	4.8	3.8	1.7
% Change, Year Ago	4.9	4.7	3.8	3.4	3.3	2.4	1.7	1.1	1.6			
<b>Key Indicators</b>												
Industrial Production (% SAAR)	0.2	0.6	-3.2	0.0	-7.8	-7.0	-2.7	0.9	1.5	1.7	-0.3	-3.8
Capacity Utilization (%)	81.0	80.6	79.8	79.4	77.5	75.8	74.9	74.8	74.8	81.0	79.3	75.1
Civilian Unemployment Rate (%)	4.8	4.9	5.3	6.2	6.5	6.7	7.0	7.0	6.8	4.6	5.7	6.9
Productivity (% SAAR)	0.8	2.6	2.7	3.2	-0.7	0.4	2.5	3.1	2.5	1.4	1.6	2.6
% Change, Year Ago	2.7	3.3	3.0	2.3	1.9	1.4	1.3	1.3	2.1			
Real Disp. Personal Inc. (% SAAR)	0.6	-0.1	11.3	-3.5	-2.8	1.0	2.2	2.9	3.0	2.8	1.8	0.9
% Change, Year Ago	1.8	0.7	3.6	1.9	1.0	1.3	-0.8	0.8	2.3			
Personal Savings Rate (%)	0.4	0.3	2.6	2.0	1.4	1.3	1.9	2.3	2.7	0.6	1.6	2.1
Light Vehicle Sales (Millions SAAR)	16.0	15.3	14.2	12.8	12.8	12.8	13.5	13.8	14.0	16.4	13.7	13.5
Housing Starts (Thous. SAAR)	1151	1053	1016	880	730	675	750	795	820	1341	920	760
Current Account (Bil \$)	-167.2	-176.4	-184.3	-205.8	-201.5	-192.2	-178.5	-177.6	-182.4	-731.2	-768.0	-730.7
U.S. Budget Balance (Bil \$)										-163	-440	-500
<b>Corporate Profits and Earnings</b>												
Operating Corp. Profits After Tax (Bil \$)	1177.6	1190.6	1133.6	987.7	854.9	896.5	910.8	940.8	993.2	1192.1	1041.7	935.3
% Change, Year Ago	-0.6	1.8	-5.9	-18.9	-27.4	-24.7	-19.7	-4.8	16.2	-0.6	-12.6	-10.2
S&P 500 Reported EPS (\$)	7.8	15.5	17.0	12.5	10.7	12.2	12.6	12.3	14.0	66.2	55.8	51.0
% Change, Year Ago	-61.4	-27.1	-22.3	-17.5	37.1	-21.7	-25.8	-1.7	30.3	-18.8	-15.7	-8.5
S&P 500 Operating EPS (\$)	15.2	16.6	18.2	16.7	15.8	15.0	15.5	15.7	16.8	82.5	67.3	63.0
% Change, Year Ago	-30.8	-25.8	-24.4	-20.0	3.8	-9.7	-14.8	-6.0	6.6	-5.9	-18.4	-6.4
<b>Inflation</b>												
GDP Price Index (% SAAR)	2.8	2.6	1.1	3.7	3.7	2.2	0.5	0.7	1.1	2.7	2.4	2.0
% Change, Year Ago	2.6	2.3	2.0	2.6	2.8	2.7	2.5	1.8	1.1			
CPI, Consumer Prices (% SAAR)	5.0	4.3	5.0	7.3	2.2	2.0	0.3	0.7	1.1	2.9	4.7	2.3
% Change, Year Ago	4.0	4.2	4.3	5.4	4.7	4.1	2.9	1.3	1.0			
CPI ex Food & Energy (% SAAR)	2.5	2.5	1.9	3.1	2.5	2.0	1.4	1.4	1.7	2.3	2.4	2.0
% Change, Year Ago	2.3	2.4	2.3	2.5	2.5	2.4	2.2	1.8	1.6			

Source: Merrill Lynch

## Interest rate forecast summary

(% EOP)	4Q 07	1Q 08	2Q 08	3Q 08	4Q 08	1Q 09	2Q 09	3Q 09	4Q 09	2007	2008	2009
Fed Funds	4.25	2.25	2.00	2.00	2.00	1.50	1.50	1.50	2.00	4.25	2.00	2.00
3-Month T-Bill	3.36	1.38	1.74	1.65	1.60	1.40	1.25	1.45	1.90	3.36	1.60	1.90
3-Month LIBOR	4.85	2.95	2.78	2.80	2.75	2.15	2.05	1.95	2.35	4.85	2.75	2.35
2-Year T-Note	3.04	1.62	2.62	2.60	2.25	1.95	1.65	2.05	2.30	3.04	2.25	2.30
5-Year T-Note	3.45	2.46	3.33	3.45	3.20	2.75	2.40	2.60	2.85	3.45	3.20	2.85
10-Year T-Note	4.05	3.45	3.97	4.15	3.90	3.65	3.25	3.50	3.65	4.05	3.90	3.65
30-Year T-Bond	4.45	4.30	4.53	4.75	4.50	4.25	3.75	3.90	4.00	4.45	4.50	4.00

Shaded regions represent Merrill Lynch forecast.  
Source: Merrill Lynch

## Monthly CPI forecast update

	Total CPI					Core CPI			
	(nsa)			(sa)		(nsa)		(sa)	
	Level	m/m	y/y	m/m	y/y	m/m	y/y	m/m	y/y
2008: Apr	214.823	0.61	3.9	0.21	3.9	0.09	2.3	0.10	2.3
2008: May	216.632	0.84	4.2	0.65	4.1	0.06	2.3	0.20	2.3
2008: Jun	218.815	1.01	5.0	1.06	4.9	0.17	2.4	0.32	2.4
2008: Jul	219.964	0.53	5.6	0.82	5.5	0.23	2.5	0.33	2.5
2008: Aug	219.266	-0.32	5.5	-0.04	5.5	0.13	2.5	0.11	2.5
2008: Sep	219.503	0.11	5.3	0.20	5.3	0.26	2.5	0.24	2.5
2008: Oct	219.931	0.20	5.3	0.24	5.3	0.38	2.5	0.23	2.5
2008: Nov	219.652	-0.13	4.5	0.17	4.5	0.00	2.5	0.19	2.5
2008: Dec	219.205	-0.20	4.4	0.22	4.4	-0.08	2.4	0.18	2.4
2009: Jan	219.808	0.28	4.1	0.17	4.1	0.23	2.3	0.17	2.3
2009: Feb	220.736	0.42	4.3	0.16	4.3	0.43	2.4	0.13	2.4
2009: Mar	221.978	0.56	4.0	0.04	4.0	0.45	2.4	0.14	2.4

nsa: not seasonally adjusted, sa: seasonally adjusted  
Source: Merrill Lynch

## FX rate forecast summary

(end of period)		Spot	Sep 08	Dec 08	Mar 09	Jun 09	Sep 09	Dec 09
Euroland Euro	US\$/Euro	1.48	1.51	1.48	1.42	1.40	1.38	1.33
Japanese Yen	¥/US\$	110	103	102	100	98	98	98
	¥/Euro	163	156	151	142	137	135	130
British Pound	US\$/£	1.85	1.91	1.87	1.82	1.82	1.82	1.75
	£/Euro	0.80	0.79	0.79	0.78	0.77	0.76	0.76
Swiss Franc	SF/US\$	1.10	1.05	1.07	1.10	1.10	1.12	1.16
	SF/Euro	1.62	1.59	1.58	1.56	1.54	1.54	1.54
Canadian \$	C\$/US\$	1.05	1.04	1.06	1.08	1.11	1.12	1.12
Australian \$	US\$/A\$	0.87	0.91	0.84	0.80	0.74	0.72	0.70
Chinese Renminbi	RMB/US\$	6.83	6.75	6.70	6.60	6.60	6.50	6.50
Hong Kong \$	HK\$/US\$	7.81	7.75	7.75	7.75	7.75	7.75	7.75
Korean Won	KRW/US\$	1065	1000	975	950	975	1000	1000
Singapore \$	SGD/US\$	1.41	1.33	1.32	1.32	1.32	1.32	1.33
Taiwan \$	TWD/US\$	31.38	30.25	30.00	30.25	30.50	30.75	31.00
Brazilian Real	BRL/US\$	1.62	1.65	1.70	1.75	1.75	1.80	1.80
Mexican Peso	MXN/US\$	10.13	10.90	10.80	10.90	11.00	11.20	11.00

Spot prices are as of Friday morning  
Source: Merrill Lynch FX Strategy Team., Bloomberg

## Rolling Calendar of Business Indicators

Monday	Tuesday	Wednesday	Thursday	Friday
<b>25 August</b> 10:00 am: Existing Home Sales May ..... 4.99mn Jun ..... 4.86mn Jul ..... 4.90mn*	<b>26 August</b> ABC/Washington Post Consumer Comfort Survey —(week ending 8/23/08) <b>LJR Redbook</b> —(week ending 8/22/08) <b>9:00 am: Case-Shiller Home Price Index (Composite 20)</b> Apr ..... -1.3% May ..... -0.9% Jun ..... -1.3%* <b>10:00 am: Consumer Confidence</b> Jun ..... 51.0 Jul ..... 51.9 Aug ..... 53.0* <b>10:00 am: OFHEO Home Price Index – 2Q</b> 4Q ..... 0.3% 1Q ..... -0.2% <b>10:00 am: New Home Sales – Jul</b> May ..... 533k Jun ..... 530k Jul ..... 525k* <b>2:00 pm: Minutes from the August 5 FOMC Meeting Released</b>	<b>27 August</b> MBA Mortgage Applications —(week ending 8/22/08) <b>8:30 am: Durable Goods Orders</b> May ..... 0.1% Jun ..... 0.8% Jul ..... 0.5%* <b>8:30 am: Durable Goods ex Transportation</b> May ..... -0.5% Jun ..... 2.0% Jul ..... -0.9%*	<b>28 August</b> <b>8:30 am: Initial Jobless Claims</b> —(week ending 8/23/08) – 430k* <b>8:30 am: Real GDP</b> 1Q ..... 0.9% 2Q (A) ..... 1.9% 2Q (P) ..... 2.3%* <b>8:30 am: GDP Price Index</b> 1Q ..... 2.6% 2Q (A) ..... 1.1% 2Q (P) ..... 1.1%*	<b>29 August</b> <b>8:30 am: Personal Income</b> May ..... 1.8% Jun ..... 0.1% Jul ..... 0.6%* <b>8:30 am: Personal Spending</b> May ..... 0.8% Jun ..... 0.6% Jul ..... 0.2%* <b>8:30 am: Core PCE (YoY)</b> May ..... 2.2% Jun ..... 2.3% Jul ..... 2.5%* <b>10:00 am: Chicago PMI</b> Jun ..... 49.6 Jul ..... 50.8 Aug ..... 49.5* <b>10:00 am: University of Michigan Consumer Sentiment</b> Jun ..... 56.4 Jul ..... 61.2 Aug (P) ..... 61.7 Aug (F) ..... 61.9*
<b>1 September</b> <i>Labor Day (Holiday Observed)</i>	<b>2 September</b> ABC/Washington Post Consumer Comfort Survey —(week ending 8/30/08) <b>LJR Redbook</b> —(week ending 8/29/08) <b>10:00 am: ISM Manufacturing Index</b> Jun ..... 50.2 Jul ..... 50.0 Aug ..... 50.0* <b>10:00 am: Construction Spending</b> May ..... 0.0% Jun ..... -0.4% Jul ..... -0.4%* <b>All-day: Vehicle Sales</b> Jun ..... 13.7mn Jul ..... 12.6mn Aug ..... 12.8mn*	<b>3 September</b> MBA Mortgage Applications —(week ending 8/29/08) <b>10:00 am: Factory Orders</b> May ..... 0.9% Jun ..... 1.7% Jul ..... 0.4%* <b>2:00 pm: Fed release Beige Book</b>	<b>4 September</b> <b>8:30 am: Initial Jobless Claims</b> —(week ending 8/30/08) <b>8:15 am: ADP Employment</b> Jun ..... -77k Jul ..... 9k Aug ..... -17k* <b>8:30 am: Nonfarm Productivity</b> 1Q ..... 2.6% 2Q (P) ..... 2.2% 2Q (F) ..... 2.7%* <b>8:30 am: Unit Labor Costs</b> 1Q ..... 2.5% 2Q (P) ..... 1.3% 2Q (F) ..... 0.9%* <b>10:00 am: ISM Non-manufacturing Index</b> Jun ..... 48.2 Jul ..... 49.5 Aug ..... 53.0*	<b>5 September</b> <b>8:30 am: Nonfarm Payrolls</b> Jun ..... -51k Jul ..... -51k Aug ..... -140k* <b>8:30 am: Unemployment Rate</b> Jun ..... 5.5% Jul ..... 5.7% Aug ..... 5.8%* <b>8:30 am: Average Weekly Hours</b> Jun ..... 33.7 Jul ..... 33.6 Aug ..... 33.6* <b>8:30 am: Average Hourly Earnings</b> Jun ..... 0.3% Jul ..... 0.3% Aug ..... 0.4%*
<b>8 September</b> <b>3:00 pm: Consumer Credit – Jul</b> May ..... \$8.0bn Jun ..... \$14.3bn	<b>9 September</b> ABC/Washington Post Consumer Comfort Survey —(week ending 9/6/08) <b>LJR Redbook</b> —(week ending 9/5/08) <b>10:00 am: Wholesale Inventories – Jul</b> May ..... 0.9% Jun ..... 1.1% <b>10:00 am: Pending Home Sales – Jul</b> May ..... -4.9% Jun ..... 5.3%	<b>10 September</b> MBA Mortgage Applications —(week ending 9/5/08)	<b>11 September</b> <b>8:30 am: Initial Jobless Claims</b> —(week ending 9/6/08) <b>8:30 am: Trade Balance – Jul</b> May ..... -\$59.2bn Jun ..... -\$56.8bn <b>8:30 am: Import Prices – Aug</b> Jun ..... 2.9% Jul ..... 1.7% <b>2:00 pm: Treasury Statement – Aug 2007</b> ..... -\$117.0bn	<b>12 September</b> <b>8:30 am: PPI – Aug</b> Jun ..... 1.8% Jul ..... 1.2% <b>8:30 am: Core PPI – Aug</b> Jun ..... 0.2% Jul ..... 0.7% <b>8:30 am: Retail Sales – Aug</b> Jun ..... 0.3% Jul ..... -0.1% <b>8:30 am: Retail Sales ex Autos – Aug</b> Jun ..... 0.9% Jul ..... 0.4% <b>10:00 am: Business Inventories – Jul</b> May ..... 0.4% Jun ..... 0.7% <b>10:00 am: University of Michigan Consumer Sentiment – Sep (P)</b> Jul ..... 61.2 Aug (P) ..... 61.7
*Projections—subject to revision as additional data become available during the month. (R) denotes reopening.				

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