

Australia and New Zealand - Weekly Prospects

Summary

- A quiet week in **Australia** last week will be followed by another this week. The only economic data of note scheduled for release is today's motor vehicle sales report for February—we expect a big fall in sales as the impact of the expanded investment allowance fades. The highlight this week, therefore, will be speeches by RBA officials and the RBA's Financial Stability Review. Phil Lowe, Assistant Governor (Economic), speaks to the Australian Industry Group's 10th Annual Economic Forum in Sydney on Thursday, while Governor Stevens speaks to the ACI 2010 4th World Congress the following day. These speeches probably will reinforce the message that, while official interest rates have some way to rise, the RBA has time on its side. We expect the next 25bp rate hike in early May.
- The economic data emerging from **New Zealand** of late has disappointed, putting question marks over the sustainability of the recovery underway. The next key piece of economic news is the fourth quarter GDP report this coming Thursday. This belated release should show GDP rose a decent 0.6%q/q in 4Q09, with private consumption again the key driver of growth. That said, more timely monthly data suggests that consumers are becoming more risk averse. Demand for credit, in particular, continues to slide. Consumer credit growth, for example, has been negative for 11 straight quarters, recently tumbling 4.9%o/a in January. The RBNZ, therefore, also has time on its side. We maintain our forecast for the first rate hike to be delivered in July, later than the consensus call for a June move.
- With **global growth** downshifting somewhat early this year, recent debate has revolved around how well our upbeat growth forecast is tracking. However, an equally important component of our 2010 outlook is that developed world core inflation will fall sharply amid synchronized above-trend growth. Here the news has been quietly decisive as core inflation is steadily sliding. US core consumer prices have stabilized over the past four months and the year-ago rate of change (currently 1.3%o/a) is on track to fall below 1% for the first time since 1966. Meanwhile, Euro area core inflation has already dipped to 0.8%o/a, and Japan is in the midst of its deepest bout of deflation in modern times with core prices now falling at a 1.1% pace.
- The divergence in core inflation trends between developed and **emerging economies** provides further support for the view that movements in utilization rates are playing a key role in shaping the inflation and policy outlook. As a group, emerging markets have more fully recovered pre-recession activity levels. With their economies close to overheating in mid-2008, this rapid recovery has pushed utilization rates slightly above their long-term norms. It is thus no surprise that EM core inflation appears to have already stabilized. This sets the stage for a sustained climb in overall inflation, when combined with the rapid rise in heavily weighted food prices across much of the EM block (measured on a year-ago basis). These inflation dynamics will put added pressure on EM central banks to normalize policy, especially in EM Asia, where asset price inflation already is causing concern.

This week's highlight

RBA Governor Glenn Stevens will speak on Friday at the ACI World Congress in Sydney. Our focus will be on the Q&A session that follows.

March 22, 2010

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Data and event previews - Australia and New Zealand

Date	Time ^(a)	Data/event	Forecast		
			JPMorgan	Consensus ^(b)	Previous
Monday, March 22	11.30am	Aust. new motor vehicle sales (%m/m, Feb.)	-10	na	-3.4
Wednesday, March 24	8.45am	NZ current account balance (NZ\$bn., 4Q)	-2.95	-1.6	-1.413
Wednesday, March 24	11.00am	Aust. DEWR skilled vacancies (%m/m, Mar.)	na	na	1.6
Thursday, March 25	8.45am	NZ GDP (%q/q, 4Q)	0.6	0.8	0.2
Thursday, March 25	10.40am	RBA Assistant Governor Lowe's speech	na	na	na
Thursday, March 25	11.30am	RBA's Financial Stability Review	na	na	na
Friday, March 26	8.45am	NZ trade balance (NZ\$mn., Feb.)	400	433	269
Friday, March 26	9.15am	RBA Governor Stevens' speech	na	na	na
Friday, March 26	10.00am	Conference Board Leading Index (%m/m, Jan.)	na	na	0.6

(a) Australian Eastern Standard Time.

(b) Consensus based on Bloomberg survey.

Australia

New motor vehicle sales (%m/m, Feb.) - We expect a sharp drop in vehicle sales in February as the positive impact of the expanded investment allowance fades. Our forecast is for a 10% drop in car sales over the month, which will mark the first double-digit decline in monthly sales since the start of 2001. Car sales were inflated by the expanded allowance late in 2009, so there probably is weakness ahead. Sales of rental car fleets, in particular, have been rising quickly.

Speeches by the RBA Governor and other RBA officials - The Assistant Governor (Economic) Phil Lowe is delivering a speech to the Australian Industry Group's Annual Economic Forum Thursday. The forum is titled "Managing the Recovery." Dr. Lowe is speaking in the "Inflation versus Growth Risks in 2010" session. On Friday, the Reserve Bank Governor speaks at the ACI World Congress in Sydney. Both speeches will be followed by a Q&A session.

New Zealand

Current account balance (NZ\$bn., 4Q) - We expect a further deterioration in the current account balance, the main reason being the absence of any large company tax transactions. In 2Q09 and 3Q09, the CAD improved markedly owing to a number of one-off tax provisions that resulted in a sharp drop in income on foreign equity investment. These influences, however, will be absent from the fourth quarter outcome, with our forecast looking for the CAD to widen to NZ\$2.95 billion from NZ\$1.41 billion in 3Q. We also expect an improvement in the trade balance, given a healthy rise in exports over the quarter, compared to only a small rise in imports.

Data previews - contd.

GDP (%q/q, 4Q) - We expect fourth quarter GDP growth to print at 0.6%q/q, a threefold increase on growth in the previous quarter, and a marked improvement on the previous five-straight quarterly GDP declines. Private consumption again will be the main driver of economic growth and inventories will be less of a drag. Net exports, though, will have subtracted significantly from GDP growth, with export volumes having slumped 1.2%q/q and import volumes having risen 1.6%.

Trade balance (NZ\$mn., Feb.) - The trade surplus should have risen again in February, printing at NZ\$400 million, up from NZ\$269 million. This result would mark the largest trade surplus since May last year. The improvement will owe to firmer exports, which will benefit increasingly from strengthening demand from Asia this year. Imports probably held up in February, remaining largely unchanged from the previous month, thanks to elevated NZD.

Research note

Restoring productivity growth key to Australia's fiscal health

- **Boosting productivity growth is key to future economic prosperity and fiscal health**
- **Continuation of the current downtrend in productivity growth yields a federal deficit of A\$50bn by 2050**
- **The growing pool of aged persons will drive health costs above revenue by 2.75% of GDP**

Australia's Federal government recently released the findings from the latest Intergenerational Report (IGR)—*Australia to 2050: Future Challenges*. The IGR showed that the central challenge facing the government is countering the economic impact of the aging population. In response, the Rudd government has said that "decisive action" is needed to lift productivity to avert the looming slowdown in GDP growth that would otherwise emerge due to the growing pool of aged persons. The 4Q GDP report highlighted the issue, with productivity, or GDP per hour worked, falling 0.2% q/q, the first fall since mid-2008.

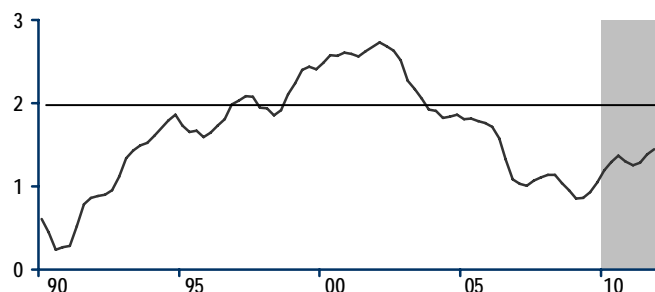
If the current downtrend in productivity growth continues, GDP growth will average 2.7% over the next 40 years, well below the 3.3% average over the last 40 years, according to IGR estimates. This trend needs to be reversed in order to boost economic prosperity and bring the federal budget back to balance more quickly. If not, government revenues will not offset the rising burden on public finances stemming from the aging population. Treasury estimates that economy-wide health costs will exceed government revenue by 2.75% of GDP by 2050, with over half of all government spending going toward health-related services (compared to 20% today, or 5% of GDP). It also suggests that the budget deficit will near A\$50 billion, as there will be proportionately fewer taxpayers to fund the rise in costs.

2%-plus productivity targeted

In response, the government is targeting annual productivity growth around the 2%-plus rates recorded in the 1990s, the decade that marked the longest period of continuous increase in productivity in the Australian economy. The remarkable rate of productivity growth back then owed much to a series of policy reforms, such as floating the currency, a reduction in trade and investment barriers, increased workplace flexibility, and the establishment of an independent inflation-targeting central bank, which helped stabilize the economic cycle. Independently, an IT revolution prompted a wave of new investment in more sophisticated capital, which lifted output per worker. Since then, an-

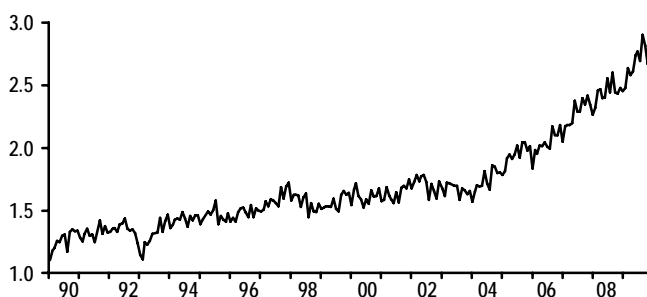
Productivity growth

GDP per hr worked, %oya, four year moving average



Aged workers increasing

% of total workers over 65



nual productivity growth has been on a declining trend—averaging just 1.4% since 2000. Painting an even gloomier picture, multifactor productivity (MFP), which led the charge in the 1990s, declined in the most recent cycle (table, next page). The falls in MFP growth in 2000, for example, were concentrated in construction (probably owing to the introduction of the goods and services tax), but also in those industries which contributed most to the 1990s productivity surge, such as finance and insurance.

It is difficult to explain the recent productivity slowdown. As highlighted in a report by the Productivity Commission, there have been no clear reversals in the drivers of the productivity surge in the 1990s. R&D activity has trended higher, and the economy remains open to trade and investment flows, for example. Also, labour force participation rates among older people continue to rise. The absence of new reform likely explains the productivity slowdown, so further broad-based policy reform, such as a more streamlined federal/state relations and taxation reform, should reinvigorate productivity, especially in the longer term.

More reform on the way

The government is targeting four key areas in an effort to lift productivity: investing in infrastructure, such as roads and rail; implementing an education revolution with investment in world-class educational facilities; investing in busi-

ness innovation; and implementing microeconomic reform to cut red tape for businesses. The latter initiative has been highlighted by the OECD as a key area in need of improvement. The OECD has said that Australia should improve business engagement, better analyze regulatory impacts, and improve inter-jurisdictional regulatory governance to boost productivity. This would help reduce unnecessary business costs and ease infrastructure constraints, enabling Australia to take full advantage of solid growth in its major trading partners in Asia. Progress is being made. The federal and various state governments have agreed to step up business deregulation in a bid to slash business costs associated with complying with conflicting regulations across state borders.

Higher skilled immigration could help

Increasing skilled immigration should help ease the growing burden of the aged. The IGR projected the population would rise 13.7 million to 35 million by 2050, nearly double the projected 7.6 million rise projected in the prior IGR three years ago. The immigration intake will need to increase to help pay for higher health costs, which argues in favour of allowing greater skilled immigration, especially as work visa holders tend to be younger than the average Aussie—nearly 90% of people entering Australia are under 40 years old, which helps to slow the rate at which the population ages. The government already has made changes to permanent skilled immigration, making the program demand, rather than supply, driven.

The IGR estimated that the proportion of the population over age 65 will surge from 14% to 23% by 2050, there will be only 2.7 workers for every person over 65 (compared to five today), and labour force participation will fall to just 60% as more baby boomers exit the workforce than Generation-Yers enter. The threat of lower participation led the government to launch a A\$43 million package aimed at encouraging “mature age” participation, retraining and re-skilling older workers, and increasing initiatives to assist older workers at risk of losing their jobs due to poor health. These measures will help, but only at the margin. The amount of funding is tiny relative to the enormous amount of “emergency” stimulus injected into the economy since late-2008. Indeed, just last week, the government announced funding 15 times as large to train new doctors.

Policymakers facing tough times

Providing the government follows through with its structural reforms, productivity growth should rise, but not likely to the 2%-plus rates targeted (chart), or at least not over our

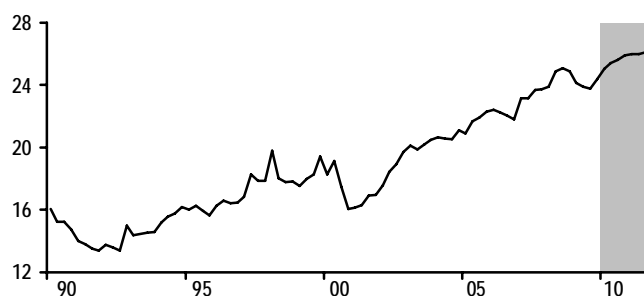
Productivity growth and contributing factors

Productivity cycles	Labor productivity	MFP	Capital deepening
1973-1982	2.1	1.0	1.1
1982-1985	2.3	1.1	1.2
1985-1989	1.0	0.8	0.2
1989-1994	2.2	1.0	1.2
1994-1999	3.3	2.3	1.0
1999-2004	2.2	1.1	1.1
2004-2008	1.1	-0.2	1.4
Average	2.0	1.0	1.0

Source: Australian Chamber of Commerce and Industry

Private business investment

% of GDP



forecast horizon. One reason owes to the fact that Australian employers cut worker hours, rather than sacked staff. These hours will be reinstated over the course of the year, before new hiring is ramped up, which will keep a lid on any improvement in productivity growth.

Perversely, productivity improvements also will be capped near term by booming mining investment, from historical evidence. Underpinned by soaring demand for commodities in Asia, new spending in mining will drive an expected 18% boost to capital spending in the year to June 2011. Owing to long lead times in the mining sector, however, it can take up to five years for a rise in investment in new capacity to translate into higher output. There already is evidence of large wage rises being granted to workers in mining-related sectors which, worryingly, have not been matched by productivity offsets. The associated rise in unit labour costs could discourage further investment.

The main risk is, if productivity remains weak, the forthcoming investment surge may create an inflationary environment that will force interest rates much higher than we currently forecast. As pointed out recently by RBA Deputy Governor Ric Battellino, such booms create challenges for policymakers who need to “ensure flexibility in the economy and maintain disciplined macroeconomic policies in order to contain the inflationary forces generated.”

Australia

- **RBA minutes indicate pace of hikes will ease**
- **Dwelling starts unexpectedly surged 15% at year-end**
- **String of speeches from RBA officials due next week**

Last week in Australia was quiet apart for an unexpected bounce in dwelling starts in 4Q and the release of the minutes from the RBA's March Board meeting, at which officials decided to hike the cash rate 25bp. The former showed that the previously unexplained gap between residential building approvals by local councils and starts is closing. The latter indicated that while RBA officials believe the cash rate has further to rise, there is no hint that the pace of tightening will accelerate. Indeed, we continue to believe that the RBA will pause in April, before hiking in May. Our expectation that the cash rate will be 5% by the end of 2010 is unchanged.

This week is quiet, with just the February vehicle sales data scheduled for release; we expect a large fall as the positive impact of the expanded investment allowance fades. Car sales were inflated by the expanded allowance late in 2009, so there probably is weakness ahead. Sales of rental car fleets, in particular, have been rising quickly.

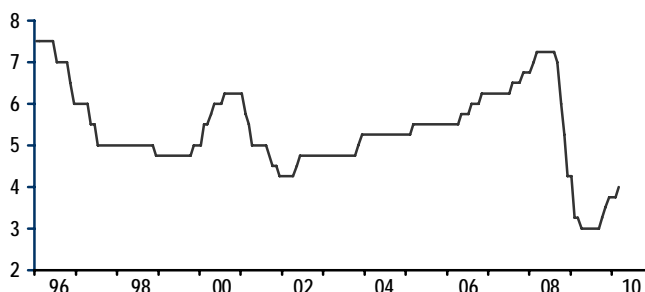
RBA minutes suggest "flexibility"

Australia's Reserve Bank last week released minutes from the early March Board meeting during which members elected to restart the tightening cycle they unexpectedly suspended in February. The tone of these minutes was upbeat, as one would expect given that the Board hiked by 25bp and did not reveal any material surprises. We continue to look for the cash rate to be 5% by the end of 2010, but as highlighted by the February Board minutes, the prompt start to the RBA's policy normalization process in October last year has "subsequently allowed some flexibility" in the pace at which it proceeds. Thus, the precise timing of the Bank's decisions going forward is highly dependent on the ebb and flow of the domestic data and events offshore. In our view, whether or not the RBA hikes again on April 6 remains a coin toss.

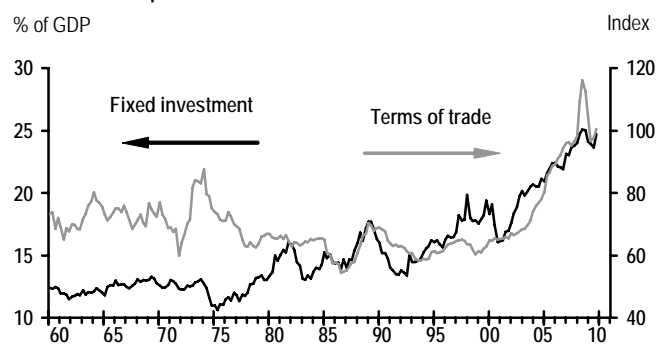
Back in February, when the RBA unexpectedly paused, it seemed the main reason was because Board members were uncertain about how households were coping with the three rate hikes already delivered (and the additional tightening by the Aussie banks). The minutes reveal that, on balance, the domestic indicators have continued to point to a

RBA cash target rate

Percent per annum, end of period



Australia: real private fixed investment and the terms of trade



strengthening in economic activity. In fact, some of these indicators suggest that growth might already be running close to trend, where the RBA Board expects it to remain over the next couple of years.

On the domestic economy, the commentary was upbeat. The slew of data released since the last Board meeting four weeks earlier had tended to be "quite firm." Board members noted that the labour market had remained resilient in January, with the unemployment rate having fallen 0.5%-pt from its peak, but that workers' hours had continued to fall. The Board meeting, though, took place before the release of the February labour force survey, which showed a spike in workers' hours that easily reversed the declines recorded in previous months. It was also acknowledged that the housing market remained buoyant and that consumption spending had held up reasonably well. That said, though consumer confidence remained upbeat, households appeared somewhat cautious toward spending.

Among businesses outside of the mining sector, the RBA Board also acknowledged a degree of caution, such that investment in these sectors was likely to remain subdued. The Bank expected mining investment, however, to increase further from already elevated levels. Interestingly, members noted that it was unlikely that all planned mining projects

would proceed at the rate that firms currently project, mainly owing to capacity constraints. In our view, with the economy likely to be bumping up against the same capacity constraints that blighted the last period of expansion due to under-investment in key infrastructure, upward pressure on inflation will build. Already, in our view, there are signs of skill shortages and wage pressure. That said, the RBA continues to forecast that inflation will be around the middle of the Bank's target 2%-3% range over 2010.

On global conditions, the Board expects the global expansion to continue, but noted significant divergences among regions. Economic growth remains strong in Asia, home to Australia's largest export destinations, with most of the region's economies reporting solid outcomes in the December quarter. Industrial production and exports, in particular, have been strong. In contrast, data from the US economy had been mixed and conditions in Europe remained weak. Regarding the fiscal problems in Europe, the RBA Board acknowledged that if these issues are not resolved "satisfactorily," there could be renewed turmoil in financial markets, which would have implications for the global economy, and therefore, Australia.

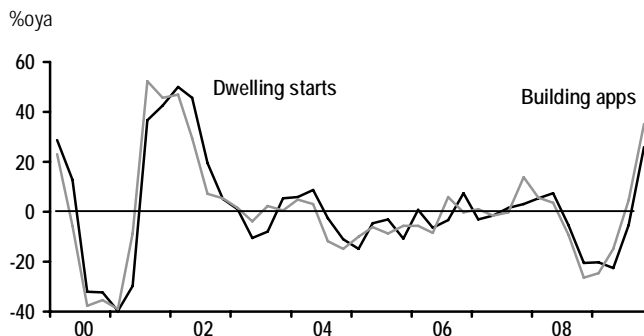
On balance, the RBA Board believes it remains appropriate for interest rates to move gradually towards normal levels. Indeed, additional official interest rate hikes are inevitable. We look for the next hike in the cash rate to come in May, with RBA officials using the intervening two-month period to gauge the strength of the domestic economy in the wake of the 100bp of tightening already delivered.

RBA speeches and banking stability

The Reserve Bank also is active this week; it releases the *Financial Stability Review* on Thursday, and there are speeches scheduled for key officials. The review once again will affirm that Australia's banking system is in great shape, particularly relative to systems elsewhere. Once again, there probably will be a renewed focus on the latest trends in bank funding costs, given their important role in influencing policy decisions in recent months.

Phil Lowe, the RBA's Assistant Governor (Economic), speaks to the Australian Industry Group's 10th Annual Economic Forum in Sydney on Thursday, while Governor Glenn Stevens speaks to the ACI 2010 4th World Congress the following day. These speeches probably will reinforce the message that, while official interest rates have some way to rise, the RBA has time on its side.

Australia: building apps and dwelling starts



Housing starts boomed in 4Q

Dwelling commencements spiked 15% q/q in 4Q (J.P. Morgan: 5%), after bouncing 11% in 3Q. The rise in commencements was led by "other" residential building (up 19% q/q), although new private sector houses were also very strong (up 13%). The majority of development was concentrated in the Eastern states, with starts increasing 17% q/q in New South Wales, 16% in Victoria, and 13% in Queensland.

We expected a significant rise in commencements given that building approvals through local councils were up 13% over the quarter. Starts have been lagging the improvement in approvals that has transpired over the past year partly as a result of the expanded First Home Buyers' grant. We had expected starts to steadily ameliorate this gap over the coming quarters. On last week's evidence, however, it appears that building activity already had caught up to the pace of approvals by year-end.

It is difficult to pinpoint a specific cause for this sudden bounce-back: it is not obvious that financing conditions, for example, would have been dramatically easier in the fourth quarter (particularly for higher density dwellings), given the RBA's three consecutive rate hikes. One possibility is that starts for approved projects had been postponed earlier in the year due to a shortage of available labour—the Government's public infrastructure programs in the education and health sectors may have crowded out residential building. Since the profile of Government spending on these projects is decreasing (at least in growth terms), such labour constraints may have eased at year-end.

The data are a positive for economic activity in the fourth quarter and beyond, but will also help to ease persistent supply pressures in the Australian housing market. With house prices continuing to rise, in stark contrast to those in

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developed markets overseas, housing has become an increasingly hot topic with RBA officials. A lingering question raised by the US experience leading up to the financial crisis is where the central bank's responsibilities lie when faced with rapidly expanding asset prices. While the current price dynamic in Australia does not yet represent cause for concern, and officials remain unlikely to react to house price appreciation except at the margin, the best case scenario is that flexible supply allows market imbalances to correct themselves over time. The data should provide some relief on that front.

Data releases and forecasts

Week of March 22 - 26

Mon	Sales of new motor vehicles				
Mar 22	Units, sa	Nov	Dec	Jan	Feb
11:30am					
	%m/m	5.9	3.1	-3.4	<u>-10</u>
	%oya	16.2	17.0	15.6	<u>7.3</u>

Review of past week's data

WMI leading index

	Nov	Dec	Jan
%m/m sa	1.0 0.9	0.5 0.6	— 0.2

Dwelling starts

	2Q09	3Q09	4Q09
%q/q sa	-1.9 -0.9	9.4 11.0	5.0 15.1

New Zealand

- **Kiwi economy probably expanded 0.6%q/q in 4Q**
- **Current account deficit to have widened**
- **Monthly trade balance probably remained positive**

There were no major data releases last week in New Zealand, but this week sees the belated release of the 4Q GDP data. We expect the economy to have expanded 2.4% saar, the strongest rate of expansion since mid-2007.

Kiwi growth to have picked up in 4Q

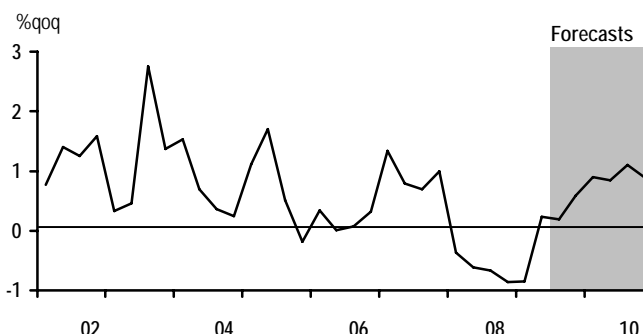
We recently downgraded our 4Q GDP forecast for New Zealand to 0.6%q/q (from 0.9% previously) following data showing that net exports would subtract significantly more from economic growth in 4Q than originally anticipated. Despite solid demand for exports from New Zealand's major trading partners in Asia, and of course Australia, falls in petroleum products, dairy, and fruit and vegetables drove export volumes significantly lower in 4Q. Export volumes declined 1.2%q/q, and import volumes rose 1.6%.

The 4Q GDP result will, however, be a marked improvement on the 0.2%q/q rate of expansion recorded in 3Q, and the five straight quarterly GDP declines before then. The main driver of growth will again be private consumption, given retail sales volumes rose solidly in 4Q (up 1.0%q/q). Record-low interest rates, strong net immigration flows, and strong house price growth in the final three months of last year likely offset the negative impact on spending of rising unemployment and softer wage growth. Government spending should have also firmed, and a pick up in residential construction would have managed to offset the drag from other residential building work put in place over the quarter.

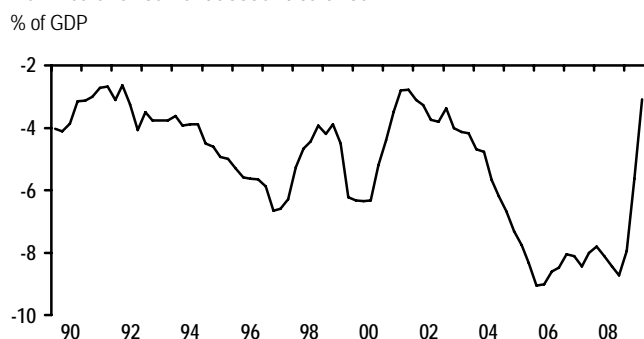
CAD probably doubled in 4Q

New Zealand's current account balance likely deteriorated further in 4Q, falling to a deficit of NZ\$2.95 billion from NZ\$1.41 billion in 3Q and a small surplus in 2Q. The main reason for the widening current account gap will be the absence of large company tax transactions in the final three months of last year. In previous quarters, the marked improvement in the CAD owed much to a number of one-off tax provisions that resulted in a sharp drop in income on foreign equity investment. In the 3Q, for example, Westpac made a provision for NZ\$918 million, ASB made a provision for NZ\$208 million, and ANZ made a provision for NZ\$240 million. As a result of the NZ\$1.366 billion of company tax

New Zealand: real GDP



New Zealand: current account balance



transactions in the banking sector, the investment income balance was a deficit of NZ\$574 million. These influences, however, will be absent from the fourth quarter outcome.

Our CAD forecast includes an improvement in the trade balance, however, given a healthy rise in exports over the quarter, compared to only a small rise in imports.

Data releases and forecasts

Week of March 22 -26

Wed	Balance of payments				
Mar 24	NZ\$ mn nsa				
10:45am		1Q09	2Q09	3Q09	4Q09
	Current account	-681	367	-1413	<u>-2950</u>
Thu	Real GDP				
Mar 25	sa, production-based				
10:45am		1Q09	2Q09	3Q09	4Q09
	(%oya)	-3.0	-2.1	-1.3	<u>0.1</u>
	(%q/q)	-0.8	0.1	0.2	<u>0.6</u>

Fri Trade balance

Mar 26 nsa
10:45am

	Nov	Dec	Jan	Feb
Trade balance (NZ\$ mn)	-275	-32	269	<u>400</u>

The trade surplus should have risen again. The improvement will owe to firmer exports, while imports probably held steady.

Review of past week's data

Visitor arrivals

	Dec	Jan	Feb			
Total (%m/m, nsa)	8.0	6.7	-2.4	-2.3	<u>-4.0</u>	-1.9

Net permanent immigration

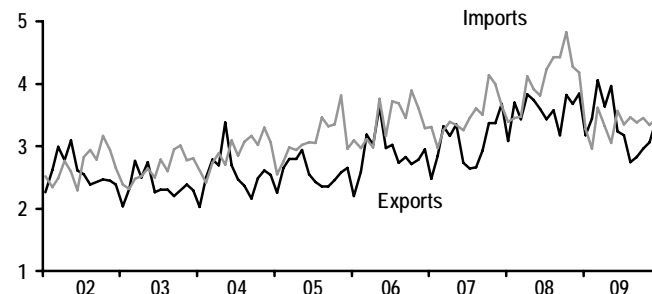
	Dec	Jan	Feb	
Monthly (000s, nsa)	1.4	2.5	—	2.6
12 month sum (000s, nsa)	21.3	22.6	—	21.6

Credit card spending

	Dec	Jan	Feb			
%oya	1.9	1.8	2.6	2.7	—	1.1

New Zealand: exports and imports

NZ\$ bn, nsa



Global Essay

- **Historic slide in core inflation in developed economies will reverberate through economy, policy, and markets in 2010**
- **Inflation dynamics are quite different in the EM, where central banks are inching toward policy normalization**
- **Europe heading toward showdown over Greece aid at this week's summit**

This time is not different

With global growth downshifting somewhat early this year, recent debate has revolved around how well our upbeat growth forecast is tracking. However, an equally important component of our 2010 outlook is that developed world core inflation will fall sharply amid synchronized above-trend growth. Here the news has been quietly decisive as core inflation is steadily sliding. US core consumer prices have stabilized over the past four months and the year-ago rate of change (currently at 1.3% oya) is on track to fall below 1% for the first time since 1966. Meanwhile, Euro area core inflation has already dipped to 0.8% oya, and Japan is in the midst of its deepest bout of deflation in modern times with core prices (ex. food and energy) now falling at a 1.1% pace.

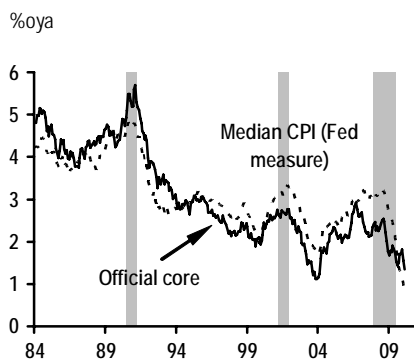
That core inflation is sliding despite above-trend growth and rising global commodity prices is no mystery. Although economic slack is a notoriously difficult concept to measure accurately, standard gauges of resource utilization fell to record lows across the developed world last year. It thus does not require fine instruments to recognize that the recession has deeply depressed pricing power and labour cost growth. Inflation fell sharply in the aftermath of deep recessions during the 1970s and 1980s, and we can now state unequivocally that this time is not different.

What is different this time is the prospect for record low levels of developed world core inflation during the first year of an economic expansion. With inflation remaining above acceptable levels in the mid-1970s and early 1980s it was reasonable for central banks to begin normalizing policy while resource utilization rates were still low and before disinflation abated. The current environment poses a unique challenge for central bankers that need to defend against an unwanted fall in inflation expectations when core inflation is likely to remain below target levels for some time to come.

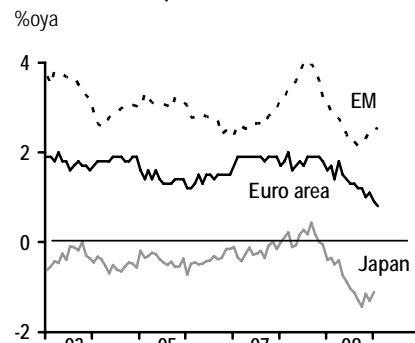
Japan's experience provides a cautionary tale of the damage that can be wrought if deflation takes hold. With a deflationary psychology already established, Japanese policymakers need to be particularly aggressive even if, as expected, the expansion gains traction in the coming quarters. It is thus encouraging to see the BoJ taking fresh action last week, increasing the scope of the short-term lending program it established in December from JPY10 trillion to JPY20 trillion. The plan is intended to bring further reductions in term rates in the interbank market, and, thus in bank lending rates and possibly the yen as well. That said, this is a relatively modest initiative, and the Japanese policy stance in whole may not be sufficient to stabilize inflation expectations, much less induce them to rise.

The more aggressive stance taken by the Federal Reserve over the past two years has been successful in anchoring medium-term inflation expectations thus far. However, the slide in core inflation will underscore that this battle is not over. The good news is that the FOMC appears to understand this and is expressing a clear willingness to maintain its current policy stance until the expansion becomes firmly

US core consumer prices

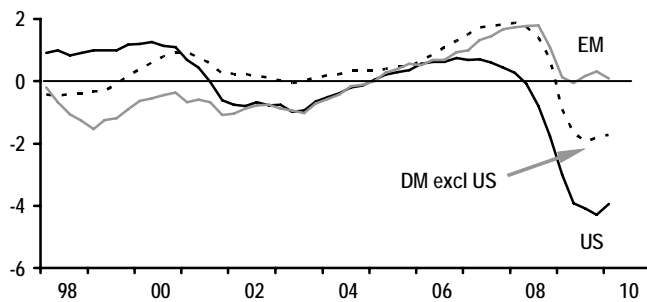


Core consumer prices



Resource utilization

Standard deviations from long-term average; w/t 1Q10 est



established and threat of deflation passes. If, as expected, US core inflation falls below 1% later this year, the Fed will remain extremely cautious and is very unlikely to raise policy rates this year.

EM inching toward policy normalization

The divergence in core inflation trends between developed and emerging economies provides further support for the view that movements in utilization rates are playing a key role in shaping the inflation and policy outlook. As a group, emerging markets have more fully recovered pre-recession activity levels. With their economies close to overheating in mid-2008, this rapid recovery has pushed utilization rates slightly above their long-term norms. It is thus no surprise that EM core inflation appears to have already stabilized. This sets the stage for a sustained climb in overall inflation, when combined with the rapid rise in heavily weighted food prices across much of the EM block (measured on a year-ago basis). These inflation dynamics will put added pressure on EM central banks to normalize policy, especially in EM Asia, where asset price inflation already is causing concern. However, EM central banks must balance their inflation concerns with their skepticism about the sustainability of G-3 growth, especially with EM export levels well below “potential,” and with the unwanted pressure that higher domestic interest rates will put on their currencies. In our view, the outcome of these conflicting forces will be a broadly based, but slow, normalization in policy, which will leave policy more accommodative than it should be in 2010. Last week’s central bank meetings were consistent with this view:

With last week’s 25bp hike in the repo rate to 5%, India followed Israel and Malaysia to become the third EM central bank to begin a rate-tightening cycle. The move, which came a month earlier than expected, was prompted by last

week’s news that WPI inflation reached 9.89% in February. India’s economy is expanding rapidly, and it is one of the few economies that avoided a recession. At the April 20 policy review, we expect another 25bp repo rate hike, together with a 50bp boost to the cash reserve ratio, followed by another 25bp policy rate hike at the July policy meeting.

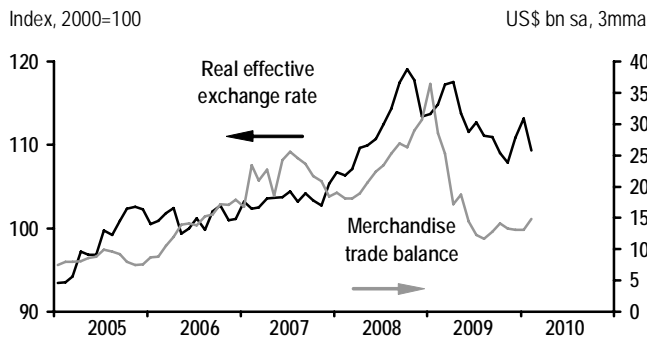
More surprising, Brazil’s COPOM was expected to launch a rate tightening cycle last week but did not. Brazil is the most prominent example of an emerging economy that is beginning to overheat against a backdrop of high utilization rates, strong final demand, and inflation expectations above target that would have produced a rate hike using the parameters of past cycles. This week’s minutes will give guidance on the factors behind this decision, and whether the COPOM has become more tolerant of inflation risk. For now, we assume that the normalization process will begin in April, with rates ending the year at 11.75%, as before. The fact that there may be a reshuffling in the BCB soon, with Chairman Meirelles possibly stepping down to run for public office, is an added complication for predicting policy.

Whereas robust economic recoveries in EM Asia and Latin America are putting pressure on central banks to adjust policy, most CEEMEA countries lie at the other end of the spectrum. Their weaker economic position reflects a number of factors, including less accommodative policy stances, impaired banking systems, and stronger ties to the lackluster Euro area economy. Turkey is a case in point: the economy is recovering but the output gap is substantial and growth remains below trend. The central bank has eased massively and clearly would like to maintain its current stance, yet it faces a dilemma: although core inflation is well-contained and below target, headline inflation has spiked on the back of a surge in food prices. At last week’s meeting, the central bank tried to split the difference, leaving its policy rate at 6.5% as expected, while adopting somewhat more hawkish rhetoric aimed at preserving its credibility and containing the rise in inflation expectations. We think this will buy the CBRT time to remain on hold until at least 3Q while the recovery gathers momentum.

Renewed friction over China’s FX policy

As discussed in last week’s Greater China *GDW* essay, Chinese officials are expected to move on a range of fronts in the next few months, raising banks’ required reserve ratio and policy interest rates, while loosening their grip on the CNY/USD exchange rate. Last weekend, Premier Wen stated his

China: real exchange rate and trade balance



belief that the yuan is not undervalued, which we take as an indication that the probability of a significant, one-off CNY revaluation is very low. To be sure, officials do not want it to appear that they are allowing the currency to appreciate in response to external political pressure. However, with a strong export recovery under way and imported inflation emerging as a concern, we expect CNY/USD to resume a gradual appreciation path in late 2Q and reach 6.5 by the end of this year. Critical stepping stones will include the March activity data, as well as next month's US semiannual foreign currency report. We do not expect the US Treasury to name China as a currency manipulator, and further communication during the US-China strategic economic dialogue in early May will help ease tensions.

Greeks force showdown at EU summit

After the Ecofin meeting early last week, the situation regarding Greece looked reasonably clear. The rest of the region expected Greece to continue to finance its deficit and roll over its debt in the capital markets, but that if a genuine liquidity crisis occurred a financial support package would be available, although only as a last resort and not at a subsidized interest rate. But, during the course of the week, it became clear that Greece is unhappy with this. After announcing a very sizeable fiscal tightening, the Greek government has been disappointed by the limited extent to which spreads have narrowed: it appears that the government feels

that it has done its part, but that the other governments in the union have not done theirs. The Greeks are not asking for money at the moment. Rather, they want a sufficiently clear proposal from the rest of the region to encourage a significant narrowing of spreads ahead of the refinancing that needs to be done over the next couple of months. In order to get the rest of the region to come up with more, Greece is threatening to go to the IMF.

The Greek position has highlighted some significant disagreements within the Euro area. The German position emphasizes stability and the fiscal discipline needed to achieve that; other positions are more focused on solidarity with a clear desire to step in earlier despite the moral hazard involved. Views on whether IMF financial support would be appropriate are also becoming clear, again with significant disagreements. This brinkmanship between Greece and the rest of the region is likely to come to a head this week: EU heads of state hold another summit on March 25. If the rest of the region does not propose something that is acceptable to the Greeks at this summit, then the Greeks may well go to the IMF.

UK Budget 2010: more heat than light

This week's UK budget will be a curtain raiser to a likely general election on May 6. Politicians emphasize the divide between the incumbent Labour government's desire to sustain fiscal stimulus and the Conservative opposition's desire to implement fiscal consolidation quickly. In truth, the Labour government is already tightening while Conservative plans to tighten faster are deliberately ambiguous. While the budget will generate more shadow-boxing over fiscal tightening, the more serious issue of where public spending priorities should lie will unfortunately remain confined to the background. A credible consolidation plan has to face these difficult choices, and we doubt a hung parliament would prevent them being made. To date, currency and bond markets appear to have been prepared to give the UK the benefit of any doubt despite the concerns raised by the crisis in Greece. This week's budget will continue to lean on accumulated credibility and the market's patience.

JPMorgan View - Global Markets

Disinflation, not deflation

- **Asset allocation:** Falling inflation is still a support for risky markets. A fall into global deflation would be a negative, but we do not expect it.
- **Economics:** Core inflation is reaching new historic lows across developed economies and should stay between 0% and 1% over at least the next year.
- **Fixed income:** Stay short duration in the UK but long in local EM debt.
- **Equities:** Solid economic activity data, rising earnings forecasts, and stronger inflows into funds point to a continuation of the rally.
- **Credit:** Overweight high-spread versus low-spread sectors.
- **FX:** CAD and CHF are our favourite longs.
- **Commodities:** Strong manufacturing growth and restocking should support base metal prices in 1H.

A week of little economic news and low market volatility saw further outflows from mutual funds, gently nudging up most asset classes—equities, credit, and commodities, as well as bonds. We call this the **asset reflation** trade. It relies on slowly fading uncertainty and central banks staying on hold for long, in the presence of no return on cash. It remains the main reason we are long risky assets, while only trading bonds from the short side instead of being aggressively short duration.

Many fundamental investors are uncomfortable with a **rally driven by cheap money**. We understand this unease, but still want to ride this rally, as stimulative policies are required to get the economy going. We would prefer higher asset prices driven by a stronger economy, but accept that we will likely get the reverse—a stronger economy driven by higher asset prices.

What **economic activity news** we did receive last week was broadly **consistent with our forecasts, again** holding our 2010 global growth forecast on hold, even as we retain an upside risk bias for 1Q. Japanese data were impressive and EM Asia data were fine, while the US data were mixed.

More important news was confirmation of our economists' long-standing forecast that **core inflation** in developed economies will fall below 1% this year and next. Euro area core inflation has fallen to a record low of 0.8% oya, and the

US fell at the same rate over the past six months (only 1.3% over the past 12 months). Japan's deflation rate has fallen to a record low.

Disinflation is good for risky markets to the extent that it keeps central banks near zero policy rates and depresses corporate costs, thus pushing up profit margins. But inflation falling below 1% is **bad** for risky assets to the extent it brings us to the verge of **Japanese-style deflation**. The fact that consensus forecasts of US profits have been rising steadily over the past year (chart, next page), even as core inflation has surprised on the downside keeps us thinking of disinflation as supportive for risky assets. But we cannot deny that every 0.1%-pt drop in core inflation brings us closer to the quicksand of deflation.

The force that determines whether disinflation becomes deflation is **expectations**. Policymakers fully understand this and have done a great job anchoring expectations so far. But we are seeing some investors becoming concerned, and hedging against a dramatic fall in rates (largely insurers for whom deflation would be a disaster). The cost of hedging against very low rates through options, however, has not become overly expensive yet, indicating that these fears are not widespread.

Our view is that **disinflation will not turn into deflation, in either North America or Europe**, although the Euro area is probably more at risk. Central banks will continue to threaten to use the printing press more aggressively if deflationary expectations emerge. In addition, Japan's deflation was ultimately brought on by two decades of corporate delevering to undo the damage to their balance sheets from collapses in equity and real estate prices. European and US companies, in contrast, hold significantly fewer of these assets and are in much better health. They have started to expand again through capex and now likely also through hiring and inventories.

Fixed income

Bonds rallied slightly last week, as major central banks once again signaled they are in **no hurry to remove policy stimulus**. The Fed maintained its commitment to keep rates low, while the Bank of Japan increased its term lending to banks in an attempt to reduce money market rates. EM central banks will be quicker to tighten, as evidenced by India's rate increase last week. But even in EM, the pace of rate hikes should be moderated by a desire to avoid exchange

rate appreciation with the G-3 on hold. Indeed, Brazil left rates unchanged despite rising growth and inflation.

We remain somewhat **bearish on duration in core markets**, as bond supply should outweigh demand following the end of QE. Despite government borrowing undershooting expectations slightly last week, the supply-demand imbalance appears most marked in the UK, our preferred short.

By contrast, we favour **long positions in local EM debt**, which is underpinned by continuing flows into higher-yielding assets in an environment of low volatility and declining risk premia. Our preferred markets are South Africa, which offers some of the highest yields in EM, and Russia, where we expect further central bank easing. We are also long Brazilian index-linked debt, which should benefit from rising inflation expectations.

Greece continues to be the exception to the general lack of volatility in government bond markets. Speculation over IMF assistance caused **Greek government bonds** to underperform last week. We stay long, given spreads of close to 4%-pts, though last week's developments make Greek debt less attractive to investors wary of volatility.

Equities

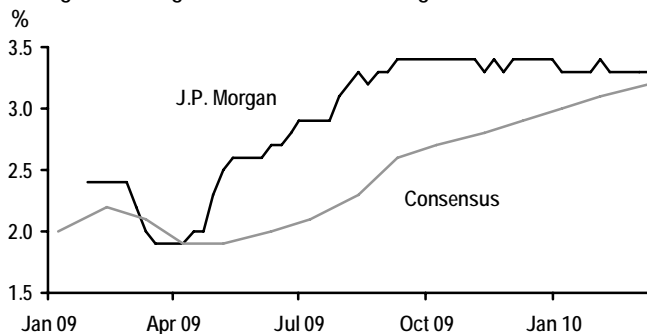
Equities rose for a third straight week, despite renewed worries about Greece. Equities have now recaptured all of their losses incurred between mid-January and mid-February. Solid economic activity data, upward revisions to earnings forecasts, and stronger inflows to equity mutual funds point to a continuation of the equity rally.

The **US Economic Activity Surprise Index (EASI), which has exhibited a close relationship with equity returns**, has risen back into positive territory. The EASI is likely to increase further over coming weeks given the upside risks we see to 1Q US GDP growth.

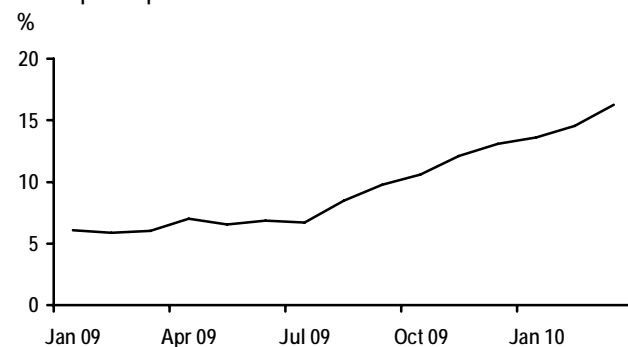
Consensus forecasts for the 2010 US corporate profit growth increased further to 13.9% oya in March versus 11.9% in February, and have **been rising steadily since the summer** (second chart). We see a similar picture if we look at top-down projections by US strategists for the S&P 500 2010 EPS. The average forecast has risen to \$76.8 vs \$74.5 at the beginning of the year. We expect the top-down consensus for the S&P 500 2010 EPS to increase further over the coming months toward our own forecast of \$81.

The recent **acceleration in inflows to equity mutual funds/**

2010 global GDP growth forecasts: J.P. Morgan versus consensus



US corporate profit forecasts



ETFs is also a positive signal. As shown in our weekly *Flows & Liquidity* dated March 12, the US Flow of Funds data show that over the past 10 years, the equity market was more likely to outperform cash in quarters when mutual funds were buying equities. Equally, when mutual funds were selling, equities were more likely than usual to fall.

We stay long equities **focusing on cyclical sectors and small caps on momentum**. We are neutral in EM versus DM equities given negative momentum over the past two months and uncertainty regarding China.

Credit

Credit markets continued to rally, especially EM corporates and US Financials. Demand for credit remains strong, with consistent inflows to both HG and HY corporate bond funds and EM bonds. With improvements in the economy and corporate fundamentals, stay overweight credit, focusing on high-spread sectors such as HY and super-senior CMBS.

Our US HG team last week released a study on corporate credit fundamentals, showing further improvements in 4Q09. Revenue, earnings, profits, and cash positions have all

trended up over the past 12 months. Balance sheets were strengthening with falling debt levels, and leverage has likely peaked in 2Q (See *High Grade Credit Fundamentals: 4Q 2009*, Eric Beinstein).

We stay overweight US HG, even as there is now less upside with the current HG spread only 20bp above our year-end target of 125bp. We continue to try to exploit relative value opportunities, focusing on US Financials, especially Banks and Life Insurance companies, due to their improving fundamentals and lower investment losses (see *High Grade Monthly Credit Sector Review*, Arun Kumar, March 19).

Similarly in Europe, we stay overweight Financials versus Industrials as the former offer superior value. We also expect **outperformance by subordinated Financials** where yields remain attractive versus senior bank bonds.

Foreign exchange

Last week, we bought **EUR/USD**—clearly too soon—thinking that Greece had stabilized and that the euro would retain its positive correlation with risky markets. The German-Greek spat has revived uncertainty. We are keeping the trade on a view that this week's EU leaders summit will announce some face-saving compromise, perhaps a set of bilateral loans excluding Germany.

The bulk of our portfolio is **dollar-neutral** and focused on crossrates, where cyclical divergences are starker. **CHF and CAD remain the best trades.** The Swiss franc still looks like Europe's renminbi: a cheap currency supported by a massive current account surplus—10% of GDP—which appreciates daily in the absence of central bank intervention. We have been long against a range of currencies since November, and now re-enter a long versus **GBP** to complement a long versus EUR. A 1.40 level on EUR/CHF is easily achievable when the Swiss trade balance and rate spreads are pressing to new 20-yr highs. Within the commodity bloc, the Canadian economy continues to show the most momentum, whether measured by high-frequency data, inflation prints, or rate spread movements. **Stay long CAD versus AUD, NZD, and GBP.**

Commodities

Commodities were only slightly, but the intra-sector dispersion is quite high, with large price moves up in nickel, palladium, and soybeans but large losses in sugar and natural gas. Nickel remains the outperformer among base metals, up

Ten-year Government bond yields

	Current	Jun 10	Sep 10	Dec 10	Mar 11
United States	3.69	4.10	4.25	4.50	4.70
Euro area	3.11	3.30	3.45	3.60	3.90
United Kingdom	3.96	4.40	4.55	4.65	4.80
Japan	1.36	1.40	1.50	1.55	1.55
GBI-EM	7.04				7.70

Credit markets

	Current	YTD Return
US high grade (bp over UST)	152	2.6%
Euro high grade (bp over Euro gov)	145	2.2%
USD high yield (bp vs. UST)	628	4.2%
Euro high yield (bp over Euro gov)	633	6.7%
EMBIG (bp vs. UST)	269	4.3%
EM Corporates (bp vs. UST)	308	4.8%

Foreign exchange

	Current	Jun 10	Sep 10	Dec 10	Mar 11
EUR/USD	1.35	1.42	1.45	1.40	1.35
USD/JPY	90.6	87	90	93	96
GBP/USD	1.50	1.51	1.58	1.54	1.50

Commodities - quarterly average

	Current	10Q1	10Q2	10Q3	10Q4
WTI (\$/bbl)	81	77	82	85	90
Gold (\$/oz)	1106	1250	1400	1300	1200
Copper(\$/m ton)	7451	7350	8000	6800	6250
Corn (\$/Bu)	3.75	3.85	4.05	3.95	3.90

Source: J.P. Morgan, Bloomberg, Datastream

22% ytd, as demand rises solidly. We remain long industrial metals on restocking in the Western world. We continue to see the base metals space—particularly aluminum, nickel, and to a lesser extent copper—testing range highs and extending higher into 2Q.

LME nickel prices still have further upside near term, with a move toward the \$25,000-\$26,000 area quite probable. Nevertheless, the rally is unlikely to be sustained beyond 1H. On the demand side, the boost to nickel consumption in the West is primarily coming from restocking of nickel units at service centers and distributors, while underlying demand for stainless remains soft.

Raw sugar is in the other extreme of the return spectrum, extending its YTD losses to 27% after a 3% decline in the previous week. We keep a short position in front-dated raw sugar versus October 2010 white sugar. Among the large movers, we also remain long palladium and platinum due to strong investment demand and problems in mine supply.

Global Economic Outlook Summary

	Real GDP			Real GDP							Consumer prices			
	% over a year ago			% over previous period, saar							% over a year ago			
	2009	2010	2011	3Q09	4Q09	1Q10	2Q10	3Q10	4Q10	1Q11	4Q09	2Q10	4Q10	2Q11
The Americas														
United States	-2.4	3.4	3.1	2.2	5.9	<u>2.5</u>	4.0	4.0	3.5	2.5	1.5	2.2	1.1	0.9
Canada	-2.6	3.2	3.3 ↓	0.9	5.0	<u>4.5</u>	3.0	3.3 ↓	4.0	4.0	0.8	1.4	1.9	2.1
Latin America	-3.1	4.6	3.8	6.5 ↑	6.5 ↓	4.4 ↑	4.2 ↓	2.7 ↓	4.5 ↑	4.0 ↑	5.3	6.3	7.0	6.9
Argentina	-4.0	4.5	3.0	0.2	<u>1.0</u>	8.0	8.0	3.0	3.0	2.0	7.1	8.0	10.0	10.0
Brazil	-0.2	6.2	4.0	7.0	8.4	<u>6.3</u>	5.0	5.1	4.0	3.8	4.2	4.9	5.0	4.5
Chile	-1.5 ↑	5.5	5.5	6.6 ↑	5.9 ↓	<u>-6.0</u>	8.0	22.0	18.0	-2.0	-3.0	3.3	4.1	3.8
Colombia	0.3	3.0	4.1	0.9	<u>3.7</u>	3.0	3.5	3.7	4.0	4.2	2.4	2.1	3.7	2.9
Ecuador	-1.0	2.0	3.0	1.1	<u>-2.0</u>	2.0	3.5	4.0	4.5	3.0	3.9	3.9	4.7	4.4
Mexico	-6.5	4.5	3.5	10.4	8.4	5.0 ↑	3.2 ↓	-3.8 ↓	4.2 ↑	5.7 ↑	4.0	4.4	5.1	4.5
Peru	0.9	5.5	6.0	10.0	11.5	<u>3.0</u>	3.5	4.0	5.0	6.0	0.4	1.0	2.0	2.2
Venezuela	-3.3	-1.5	2.5	-7.4	-4.6	<u>-4.0</u>	-2.0	12.5	1.5	1.5	28.1	31.8	33.7	39.3
Asia/Pacific														
Japan	-5.2	2.1	1.9	-0.6	3.8	<u>1.8</u>	1.5	2.0	2.2	1.8	-2.0	-1.9	-1.2	-0.1
Australia	1.3	3.1	3.6	1.1	3.7	<u>3.0</u>	3.3	3.8	3.9	3.1	2.1	2.5	2.6	3.0
New Zealand	-1.6 ↓	2.9	2.8	0.8	2.4 ↓	3.6 ↓	3.4 ↑	4.5 ↑	3.7 ↑	1.5 ↓	2.0	2.3	2.5	2.8
Asia ex Japan	4.6	7.9	7.2	10.7	7.2	<u>7.3</u>	7.1	7.1	6.8	7.0	2.9	4.4	3.8	3.2
China	8.6	10.0	9.4	10.3	10.0	<u>9.8</u>	9.4	9.5	9.0	9.1	0.7	3.2	3.1	2.4
Hong Kong	-2.7	5.3	4.2	1.6	9.5	<u>4.5</u>	4.3	4.0	3.8	4.2	1.3	2.4	2.3	1.9
India	7.2	8.0	8.3	15.0	-2.0	<u>10.4</u>	8.1	7.0	8.7	7.9	13.3	11.9	6.2	5.5
Indonesia	4.5	5.5	6.6	5.8	9.6	<u>6.0</u>	4.0	8.5	5.0	6.0	2.6	5.3	6.3	4.9
Korea	0.2	5.3	4.1	13.6	0.7	<u>3.6</u>	4.2	4.2	3.5	4.0	2.4	3.1	3.6	3.4
Malaysia	-1.7	6.8	4.8	10.4	15.4	<u>1.2</u>	4.9	4.9	4.9	4.9	-0.2	1.7	2.4	2.4
Philippines	0.9	4.5	4.3	3.1	3.5	<u>6.0</u>	5.0	3.5	4.0	4.5	3.0	5.0	5.2	4.9
Singapore	-2.0	6.8	4.8	11.5	-2.8	<u>11.2</u>	7.0	4.9	4.9	4.1	-0.3	2.0	2.6	2.1
Taiwan	-1.9	7.0	4.8	10.2	18.0	<u>1.2</u>	3.5	3.8	4.0	5.0	-1.3	0.9	2.0	1.8
Thailand	-2.3	6.5	4.0	6.9	15.3	<u>2.8</u>	5.3	3.6	3.6	4.1	1.9	5.5	4.4	3.0
Africa/Middle East														
Israel	0.7	3.0	4.5	3.6	4.9	3.5 ↑	3.5	3.0 ↓	3.0 ↓	4.0	3.6	2.7 ↓	2.7 ↓	3.1
South Africa	-1.8	3.0	3.5	0.9	3.2	<u>4.4</u>	4.3	4.3	4.9	3.6	6.0	4.3	5.3	5.8
Europe														
Euro area	-4.0	1.6	2.1	1.7	0.5	<u>1.5</u>	3.0	2.3	2.0	2.0	0.4	1.3	1.3	0.8
Germany	-4.9	1.7	2.1	2.9	0.0	<u>1.0</u>	3.0	2.0	2.0	2.0	0.3	0.9	1.3	1.3
France	-2.2	2.0	2.2	0.7	2.4	<u>1.5</u>	3.0	2.0	2.5	2.0	0.4	1.4	0.9	0.9
Italy	-4.9	1.1	1.7	2.4	-0.8	<u>1.0</u>	2.5	1.5	2.0	1.5	0.7	1.1	1.1	1.1
Norway	-1.4	2.3	2.8	1.4	1.3	<u>3.0</u>	3.0	3.0	3.0	2.8	1.4	3.2 ↑	1.7	0.7 ↓
Sweden	-4.7	1.6	3.0	-0.4	-2.2	<u>3.5</u>	3.5	3.0	3.0	3.0	-0.4	1.6 ↑	1.2 ↑	1.9
Switzerland	-1.5	2.5	2.8	2.0	3.0	<u>2.5</u>	2.8	3.0	3.0	2.8	-0.2	0.9	0.8	0.7
United Kingdom	-5.0	1.2	3.1	-1.2	1.1	<u>1.2</u>	2.5	2.8	3.5	2.8	2.1	2.6	1.9	1.9
Emerging Europe	-5.1	3.9	4.7	4.3	<u>6.1</u>	3.8 ↑	3.5 ↓	3.2	3.8 ↓	4.1	6.2	5.7	5.6 ↓	5.2
Bulgaria	-5.0	-1.5	4.5	...	...	...	...	...	...	...	...	...	...	...
Czech Republic	-4.2	2.0	4.0	2.3	3.0	2.5 ↑	2.5 ↓	2.0 ↓	2.0 ↓	3.5	0.4	1.2 ↓	2.8 ↓	2.8 ↓
Hungary	-6.3	0.5	4.0	-4.7	-1.7	<u>1.5</u>	2.5	2.0	2.0	4.0	5.2	4.8	3.7	2.8
Poland	1.7	3.2	4.2	2.4	4.9	<u>3.0</u>	4.0	2.7	3.0	3.0	3.3	2.0	2.6	2.8
Romania	-7.1	1.5	4.0	...	...	...	...	...	...	...	4.6	4.5	4.5 ↓	4.5
Russia	-7.9	5.5	5.0	7.9	<u>10.5</u>	5.0	4.0	4.0	5.0	5.0	9.2	6.7	7.2	6.9
Turkey	-5.3	4.3	5.5	...	...	...	...	...	...	...	5.7	9.6	7.5	5.8
Global														
Global	-2.5	3.3	3.3	2.8 ↑	4.1	2.9	3.7	3.5 ↓	3.4	3.0	1.3	2.1	1.7	1.6
Developed markets	-3.4	2.5	2.6	1.3	<u>3.4</u>	2.1	3.1	3.0	2.9	2.3	0.6	1.3	0.9	0.9
Emerging markets	0.9	6.3	5.8	8.3 ↑	6.7 ↓	5.9 ↑	5.7 ↓	5.2 ↓	5.7 ↑	5.7 ↑	4.0	5.0	4.8 ↓	4.4
Memo:														
Global — PPP weighted	-0.9	4.4	4.4	4.4	4.8	3.9	4.3	4.1	4.2	3.8	2.4	3.2	2.7	2.5

Global Central Bank Watch

	Official interest rate	Change from			Forecast		Mar 10	Jun 10	Sep 10	Dec 10	Jun 11
		Current	Aug '07 (bp)	Last change	Next meeting	next change					
Global	GDP-weighted average	1.30	-336				1.30	1.33	1.41	1.50	1.96
excluding US	GDP-weighted average	1.86	-250				1.85	1.90	2.02	2.15	2.65
Developed	GDP-weighted average	0.51	-361				0.51	0.51	0.54	0.59	1.04
Emerging	GDP-weighted average	4.48	-239				4.46	4.61	4.86	5.16	5.64
Latin America	GDP-weighted average	5.72	-321				5.72	6.11	6.53	7.21	7.82
CEEMEA	GDP-weighted average	4.41	-245				4.31	4.15	4.37	4.61	5.14
EM Asia	GDP-weighted average	4.04	-205				4.04	4.22	4.43	4.61	5.01
The Americas	GDP-weighted average	0.75	-484				0.75	0.79	0.87	0.98	1.39
United States	Federal funds rate	0.125	-512.5	16 Dec 08 (-87.5bp)	28 Apr 10	2Q 11 (+25bp)	0.125	0.125	0.125	0.125	0.50
Canada	Overnight funding rate	0.25	-400	21 Apr 09 (-25bp)	20 Apr 10	20 Jul 10 (+25bp)	0.25	0.25	0.75	1.25	1.75
Brazil	SELIC overnight rate	8.75	-325	22 Jul 09 (-50bp)	28 Apr 10	28 Apr 10 (+50bp)	8.75	9.75	10.75	11.75	11.75
Mexico	Repo rate	4.50	-270	17 Jul 09 (-25bp)	16 Apr 10	Oct 10 (+25bp)	4.50	4.50	4.50	5.00	5.75
Chile	Discount rate	0.50	-450	9 Jul 09 (-25bp)	15 Apr 10	Nov 10 (+25bp)	0.50	0.50	0.50	1.00	2.50
Colombia	Repo rate	3.50	-550	23 Nov 09 (-50bp)	<u>26 Mar 10</u>	1Q 11 (+50bp)	3.50	3.50	3.50	3.50	5.50
Peru	Reference rate	1.25	-325	6 Aug 09 (-75bp)	8 Apr 10	10 Jun 10 (+25bp)	1.25	1.50	2.25	3.00	4.50
Europe/Africa	GDP-weighted average	1.31	-321				1.30	1.29	1.32	1.40	2.08
Euro area	Refi rate	1.00	-300	7 May 09 (-25bp)	8 Apr 10	1Q 11 (+25bp)	1.00	1.00	1.00	1.00	1.75
United Kingdom	Repo rate	0.50	-500	5 Mar 09 (-50bp)	8 Apr 10	Nov 10 (+25bp)	0.50	0.50	0.50	0.75	1.25
Sweden	Repo rate	0.25	-325	2 Jul 09 (-25bp)	20 Apr 10	1Q 11 (+25bp)	0.25	0.25	0.25	0.25	0.75
Norway	Deposit rate	1.75	-275	16 Dec 09 (+25bp)	<u>24 Mar 10</u>	5 May 10 (+25bp)	1.75	2.00	2.25	2.50	3.25
Czech Republic	2-week repo rate	1.00	-175	16 Dec 09 (-25bp)	<u>25 Mar 10</u>	4 Nov 10 (+25bp)	1.00	1.00	1.00	1.25	2.25
Hungary	2-week deposit rate	5.75	-200	22 Feb 10 (-25bp)	29 Mar 10	29 Mar 10 (-25bp)	5.50	5.50	5.50	5.50	5.50
Israel	Base rate	1.25	-275	28 Dec 09 (+25bp)	28 Mar 10	28 Mar 10 (+25bp)	1.50	1.75	2.25	2.75	3.75
Poland	7-day intervention rate	3.50	-100	24 Jun 09 (-25bp)	31 Mar 10	Sep 10 (+25bp)	3.50	3.50	3.75	4.00	5.00
Romania	Base rate	7.00	0	3 Feb 10 (-50bp)	29 Mar 10	29 Mar 10 (-50bp)	6.50	6.00	5.50	5.50	6.50
Russia	1-week deposit rate	3.75	75	19 Feb 10 (-25bp)	Mar 10	Mar 10 (-25bp)	3.50	3.00	3.00	3.00	3.50
South Africa	Repo rate	7.00	-250	13 Aug 09 (-50bp)	<u>25 Mar 10</u>	4Q 10 (+50bp)	7.00	7.00	7.00	7.50	8.50
Switzerland	3-month Swiss Libor	0.25	-225	12 Mar 09 (-25bp)	Jun 10	Sep 10 (+25bp)	0.25	0.25	0.50	0.75	1.25
Turkey	Overnight borrowing rate	6.50	-1100	19 Nov 09 (-25bp)	13 Apr 10	3Q 10 (+50bp)	6.50	6.50	7.50	8.00	7.50
Asia/Pacific	GDP-weighted average	2.13	-131				2.13	2.22	2.35	2.45	2.67
Australia	Cash rate	4.00	-225	2 Mar 10 (+25bp)	6 Apr 10	4 May 10 (+25bp)	4.00	4.25	4.75	5.00	5.50
New Zealand	Cash rate	2.50	-550	30 Apr 09 (-50bp)	29 Apr 10	29 Jul 10 (+50bp)	2.50	2.50	3.50	4.00	4.75
Japan	Overnight call rate	0.10	-43	19 Dec 08 (-20bp)	7 Apr 10	4Q 11 (+15bp)	0.10	0.10	0.10	0.10	0.10
Hong Kong	Discount window base	0.50	-625	17 Dec 08 (-100bp)	29 Apr 10	2Q 11 (+25bp)	0.50	0.50	0.50	0.50	1.00
China	1-year working capital	5.31	-126	22 Dec 08 (-27bp)	1Q 10	2Q 10 (+27bp)	5.31	5.58	5.85	6.12	6.39
Korea	Base rate	2.00	-250	12 Feb 09 (-50bp)	8 Apr 10	3Q 10 (+25bp)	2.00	2.00	2.25	2.50	3.00
Indonesia	BI rate	6.50	-200	5 Aug 09 (-25bp)	6 Apr 10	4Q 11 (-25bp)	6.50	6.50	6.50	6.50	6.50
India	Repo rate	5.00	-275	19 Mar 09 (+25bp)	2Q 10	2Q 10 (+25bp)	5.00	5.25	5.50	5.50	6.50
Malaysia	Overnight policy rate	2.25	-125	4 Mar 10 (+25bp)	13 May 10	13 May 10 (+25bp)	2.25	2.50	2.75	2.75	2.75
Philippines	Reverse repo rate	4.00	-350	9 Jul 09 (-25bp)	22 Apr 10	Jun 10 (+25bp)	4.00	4.25	4.75	5.00	5.00
Thailand	1-day repo rate	1.25	-200	8 Apr 09 (-25bp)	21 Apr 10	2 Jun 10 (+25bp)	1.25	1.50	1.50	1.75	2.25
Taiwan	Official discount rate	1.25	-188	18 Feb 09 (-25bp)	<u>25 Mar 10</u>	4Q 10 (+12.5bp)	1.25	1.25	1.25	1.375	1.625

Bold denotes move since last GDW and forecast changes. Underline denotes policy meeting during upcoming week.

Economic forecasts - Australia

Australia: economic projections <i>percentage change over previous period, seasonally adjusted annual rates, un</i>														
	2009			2009			2010				2011			
	2009	2010	2011	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Chain volume GDP	1.3	3.1	3.6	2.9	1.1	3.7	3.0	3.3	3.8	3.9	3.1	4.2	4.2	1.8
Private consumption	2.2	1.7	2.1	3.5	3.0	2.6	1.2	0.8	0.4	1.2	3.2	2.8	2.4	2.0
Construction investment	-0.3	2.9	4.6	-2.8	3.4	1.7	3.6	3.4	4.5	3.5	4.3	5.1	6.0	6.2
Equipment investment	-3.4	22.1	9.3	4.3	-11.0	51.2	32.6	22.5	13.0	17.6	5.1	3.4	6.4	8.6
Public investment	3.8	21.3	10.7	18.3	28.3	47.7	17.0	9.5	15.1	11.2	7.4	14.0	7.4	11.8
Government consumption	2.9	3.7	1.7	3.6	5.7	7.2	3.9	0.1	3.9	0.1	0.1	3.8	3.8	0.4
Exports of goods & services	0.5	3.7	4.6	3.3	-9.1	7.0	6.6	4.9	3.2	7.4	4.1	4.1	4.1	4.1
Imports of goods & services	-7.7	11.6	4.1	3.0	18.5	34.6	8.2	4.1	2.0	4.1	4.1	4.1	2.0	12.6
Contributions to GDP growth:														
Inventories	-0.5	-1.9	-0.1	1.1	2.6	0.4	-8.9	-0.2	-0.1	-0.1	-0.2	0.0	-0.3	-0.1
Net trade	1.8	-1.7	0.0	0.1	-5.2	-4.9	-0.5	0.1	0.2	0.5	-0.1	-0.1	0.3	-1.8
GDP deflator (%oya)	0.4	1.8	2.4	0.3	-2.0	-1.4	0.1	2.9	2.4	2.0	2.2	2.4	2.5	2.5
Consumer prices (%oya)	1.8	2.5	2.8	1.5	1.3	2.1	2.5	2.5	2.4	2.6	2.7	3.0	2.8	2.6
Producer prices (%oya)	-5.4	-1.4	3.5	-6.4	-7.2	-6.8	-3.1	-1.6	-1.9	1.0	2.5	3.5	4.0	4.0
Trade balance (A\$ bil, sa)	-6.7	-23.4	-23.3	-0.9	-4.3	-5.7	-6.0	-6.0	-5.9	-5.6	-5.6	-5.7	-5.5	-6.6
Current account (A\$ bil, sa)	-67.0	-72.1	-74.6	-13.1	-14.7	-17.5	-18.0	-18.1	-18.1	-17.9	-18.1	-18.4	-18.3	-19.9
as % of GDP	-6.2	-5.4	-5.3	-4.2	-4.7	-5.4	-5.5	-5.5	-5.4	-5.3	-5.3	-5.3	-5.2	-5.6
3m eurodeposit rate (%)*	6.0	4.9	5.4	3.5	3.4	4.1	4.3	4.8	5.0	5.4	5.6	5.4	5.4	5.4
10-year bond yield (%)*	5.6	5.8	6.0	5.5	5.1	5.8	5.7	5.8	5.8	5.9	5.9	6.0	6.0	6.0
US\$/A\$*	0.75	0.96	0.92	0.82	0.88	0.91	0.94	0.95	0.99	0.97	0.95	0.92	0.91	0.90
Commonwealth budget (FY, A\$ bil)	-27.0	-43.0	-29.0											
as % of GDP	-2.1	-3.2	-2.1											
Unemployment rate	5.6	5.5	5.5	5.7	5.7	5.6	5.4	5.6	5.7	5.7	5.5	5.4	5.4	5.3
Industrial production	-7.8	3.3	1.5	5.2	-5.5	21.8	1.0	0.0	-1.0	-2.0	0.0	1.0	2.0	3.0

*All financial variables are period averages

Australia - summary of main macro views

- The Australian **economy** powered out of the global downturn largely unscathed. GDP growth was a solid 0.9%q/q in Q4, although the government's stimulus fingerprints were obvious. Growth will soften near-term.
- **Business investment** will be broadly unchanged at elevated levels in the year to June now that firms have upgraded their spending plans. Spending probably will rise close to 20% in 2010-11, with mining leading the way.
- On **housing**, with the expanded first home owners' grant now having expired and price caps on the basic grant in place, house price growth should cool, particularly at the low and middle-end of the price spectrum.
- The **consumer** has remained remarkably resilient in the absence of further fiscal support from the government. Consumer confidence quickly returned to pre-crisis highs, but has fallen in recent months in the wake of the RBA's rate hikes.
- **Export volumes** have held up owing mainly to firm demand from Asia, but the terms of trade tumbled. This decline is poised to reverse, though, thanks mainly to higher bulk commodity prices.
- The **RBA** was the first central bank in the G20 to tighten monetary policy, with officials anxious about the lack of spare capacity. We expect another hike in May, and a cash rate of 5% by the end of the year.
- Having front-loaded the **policy support**, the government is winding back the fiscal stimulus. With an election looming, though, the temptation will be to reverse course, particularly if the polls continue to tighten.

Economic forecasts - New Zealand

New Zealand: economic projections <i>percentage change over previous period, seas. adjusted annual rates, unless stated</i>														
				2009			2010				2011			
	2009	2010	2011	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Real GDP (1995-96 prices)	-1.6	2.9	2.8	0.9	0.8	2.4	3.6	3.4	4.5	3.7	1.5	2.7	2.4	2.3
Private consumption	-0.7	2.4	1.3	1.5	3.0	4.1	2.8	1.4	1.2	1.0	1.0	1.5	2.0	1.5
Fixed Investment	-13.5	-3.2	4.5	-2.8	-6.0	-17.6	-2.0	5.3	4.5	5.7	2.2	4.1	6.0	7.3
Residential construction	-18.8	2.7	4.5	-8.7	-18.6	29.6	-2.0	4.0	3.2	6.0	3.2	4.8	6.0	4.0
Other fixed investment	-12.4	-4.3	4.5	-1.6	-3	-24.4	-2.0	5.6	4.8	5.6	2.0	4.0	6.0	8.0
Inventory change (NZ\$ bil, saar)	-2.2	0.1	0.2	-1.0	-0.7	-0.2	-0.1	0.0	0.1	0.1	0.0	0.1	0.1	0.1
Government spending	1.3	1.5	0.7	-5.8	1.5	4.1	2.0	1.0	1.6	0.8	0.4	0.8	0.0	0.2
Exports of goods & services	0.0	6.2	9.0	20.0	0.1	-4.8	8.0	10.0	12.0	10.0	8.0	7.0	10.0	8.0
Imports of goods & services	-16.4	5.2	6.6	-9.3	2.7	6.4	7.0	8.0	6.0	5.0	5.0	8.0	9.0	9.0
Contributions to GDP growth:														
Domestic final sales	-5.2	0.9	1.9	0.8	-1.6	-0.6	1.5	2.1	2.2	2.0	1.1	1.9	2.5	2.6
Inventories	-2.7	1.7	0.1	-8.6	3.2	6.8	1.8	0.7	0.5	0.1	-0.6	1.0	-0.5	0.0
Net trade	6.3	0.3	0.8	9.4	-0.8	-3.6	0.2	0.5	1.8	1.6	1.0	-0.3	0.4	-0.3
GDP deflator (%oya)	2.1	2.0	2.2	2.0	2.9	0.9	0.7	2.0	2.6	2.8	2.8	2.4	1.9	1.6
Consumer prices	2.1	2.5	3.0	2.3	5.3	-0.7	2.2	2.7	2.1	2.9	3.3	2.9	3.2	3.6
%oya	2.1	2.2	3.0	1.9	1.7	2.0	2.2	2.3	1.6	2.5	2.7	2.8	3.1	3.2
Trade balance (NZ\$ bil, sa)	2.2	-3.5	-6.1	0.8	0.7	-0.2	-0.5	-0.6	-1.0	-1.3	-1.3	-1.4	-1.6	-1.8
Current account (NZ\$ bil, sa)	-3.6	-10.9	-14.3	-0.4	0.3	-1.4	-1.2	-1.7	-2.7	-3.2	-3.3	-5.2	-3.4	-3.0
as % of GDP	-2.0	-5.7	-7.2	-0.9	0.8	-3.1	-3.7	-5.7	-6.7	-6.8	-7.0	-6.1	-7.2	-8.4
Yield on 90-day bank bill (%)*	3.0	3.6	5.3	2.8	2.8	2.8	2.7	3.3	4.0	4.4	5.1	5.2	5.3	5.5
10-year bond yield (%)*	5.5	5.9	6.2	5.7	5.7	5.9	5.7	6.0	6.0	6.1	6.1	6.1	6.2	6.3
US\$/NZ\$*	0.64	0.73	0.70	0.60	0.68	0.73	0.73	0.72	0.74	0.72	0.71	0.70	0.70	0.68
Commonwealth budget (NZ\$ bil)	-4.0	-7.2	-7.1											
as % of GDP	-2.2	-3.8	-3.6											
Unemployment rate	6.2	7.0	6.0	6.0	6.5	7.3	7.3	7.1	6.9	6.6	6.4	6.2	6.0	5.5

*All financial variables are period averages

New Zealand - summary of main macro views

- The **New Zealand economy expanded a mere 0.2%q/q in 3Q**, the same rate as in the previous three months. This marked the second straight quarter of expansion following five quarters of GDP declines.
- **Business confidence** has improved markedly. This mainly owes to continued improvement in economic conditions in Australia and New Zealand's other major trading partners in Asia.
- Even though firms are becoming more upbeat, **investment** will remain a drag on GDP growth this year; this, of course, weigh on the improvement in the labour market.
- The **unemployment** rate probably peaked in 4Q, however. Hiring intentions are picking up, and as employment growth accelerates, wage growth should follow suit.
- **The RBNZ will begin tightening policy in July.** Waiting for hard evidence that the economic recovery underway is sustainable, however, means that the RBNZ will have to tighten more aggressively. The first move will be a 50bp hike.
- **Inflation** fell in the final three months of 2009, with headline CPI slipping 0.2%q/q. Medium term inflation pressures are, however, a concern, given diminishing excess capacity and firms' intentions to raise domestic prices.

Australia and New Zealand economic calendar

Monday	Tuesday	Wednesday	Thursday	Friday
<p>22 Mar</p> <p>Australia: New motor vehicle sales (10: 30 am) Feb <u>-10.0 %m/m, sa</u></p>	<p>23 Mar</p>	<p>24 Mar</p> <p>New Zealand: Current account 4Q <u>-2950 NZ\$ mn,nsa</u></p>	<p>25 Mar</p> <p>New Zealand: GDP (10:45 am) 4Q <u>0.1 %oya</u></p>	<p>26 Mar</p> <p>New Zealand: Trade balance (10:45 am) Feb <u>400 NZ \$mn</u></p>
<p>29 Mar</p>	<p>30 Mar</p> <p>New Zealand: Building permits (10:45 am) Feb</p>	<p>31 Mar</p> <p>Australia: Building approvals (11:30 am) Feb Retail sales (11:30am) Feb Pvt. Sector credit (11:30 am) Feb</p> <p>New Zealand: NBNZ business confidence (2: 00 pm) Mar</p>	<p>1 Apr</p> <p>Australia: Trade balance (12:30 am) Feb</p>	<p>2 Apr</p> <p><i>Holiday Australia, New Zealand,</i></p>
<p>5 Apr</p> <p><i>Holiday Australia, New Zealand</i></p>	<p>6 Apr</p> <p>Australia: RBI cash target (3:30 pm) Apr ANZ job ads Mar</p> <p>New Zealand: ANZ commodity price (2:00 pm) Mar</p>	<p>7 Apr</p>	<p>8 Apr</p> <p>Australia: Unemployment rate (11:00 am) Mar</p>	<p>9 Apr</p>
<p>12 Apr</p> <p>Australia: Housing finance approvals (11:30 am)Feb</p>	<p>13 Apr</p> <p>Australia: NAB bus. Confidence (11: 30 am)</p>	<p>14 Apr</p> <p>Australia: Westpac consumer confidence (10: 30 am) Apr</p> <p>New Zealand: Retail sales (10:45 am) Feb</p>	<p>15 Apr</p> <p>New Zealand: Business NZ PMI (10:30 pm) Mar</p>	<p>16 Apr</p>

Global Data Diary

Week / Weekend	Monday	Tuesday	Wednesday	Thursday	Friday
22 - 26 March	22 March	23 March	24 March	25 March	26 March
	Euro area • Trichet speech	Belgium: BNB surv (Mar) France: INSEE surv (Mar) Japan • Flow of funds (4Q) • MPM minutes South Africa • GDP details (4Q) Taiwan: IP (Feb) UK: CPI (Feb) United States • Exist. home sales (Feb) • FHFA HPI (Jan) • Richmond Fed surv (Mar)	Euro area • Industrial orders (Jan) • PMI flash (Mar) Germany • IFO bus survey (Mar) Japan • Trade balance (Feb) Norway • Norges Bank: No Chg South Africa • CPI (Feb) United States • Durable goods (Feb) • New home sales (Feb)	Brazil: COPOM minutes Czech Republic • CNB mtg: No Chg Euro area • M3 (Feb) • Trichet speech France: Goods cons (Feb) Italy: ISAE bus surv (Mar) South Africa • SARB mtg: No Chg Taiwan: CBC mtg: No Chg UK: Retail sales (Feb) US: Bernanke on exit strat	Colombia • BanRep mtg: No Chg Euro area • Trichet speech Japan • CPI (Feb) United States • Consumer sent (Mar) • Real GDP third est (4Q)
29 Mar - 2 Apr	29 March	30 March	31 March	1 April	2 April
	Euro area • EC bus survey (Mar) Germany • CPI prelim (Mar) Hungary: NBH mtg: -25bp Israel: Bol mtg: +25bp Japan • Retail sales (Feb) Romania: NBR mtg: -50bp United Kingdom • Mortgage approvals (Feb) United States • Personal income (Feb)	Japan • Hhold spending (Feb) • IP prelim (Feb) • Unemployment (Feb) United Kingdom • GDP final (4Q) United States • S&P/C-S HPI (Jan)	Australia: Retail sales (Feb) Canada: Mthly GDP (Jan) Euro area • HICP flash (Mar) • Unemployment (Feb) Germany • Labor mkt report (Mar) Japan • PMI mfg, Shoko Chukin Korea: IP (Feb) Poland: NBP mtg: No Chg United States • ADP employment (Mar) • Chicago PMI (Mar) • Factory orders (Feb)	Brazil: IP (Feb) China: PMI mfg (Mar) Euro area • PMI mfg final (Mar) Japan • Auto regs (Mar) • BoJ Tankan (1Q) Korea • CPI, Trade bal (Mar) United Kingdom • BoE credit conditions survey (1Q) • PMI mfg (Mar) United States • Construction spend (Feb) • ISM mfg (Mar) • LV sales (Mar)	United States • Employment (Mar)

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