

## Australia and New Zealand - Weekly Prospects

### Summary

- Last week, the **RBA** lifted the cash rate for the fifth time in six meetings; on this evidence, the pace of this tightening cycle no longer can be described as “gradual.” The commentary announcing the hike was hawkish, with officials seemingly anxious about the positive impact of the rebound in the terms of trade and “buoyant” conditions in the housing market. With neither of these “hot” policy issues likely to cool in the near term, we look for a third straight hike after the May 4 Board meeting. That said, the 1Q CPI print on April 28 clearly will influence the May decision. Last week saw yet another healthy gain in employment, but a surprise drop in hours worked. The week ahead is likely to see falls in both home loan approvals and consumer confidence (the confidence survey was collected after the rate hike), while Guy Debelle, the RBA’s Assistant Governor (Financial Markets) testifies to a Parliamentary committee this morning on financing conditions for small business.
- The data flow in **New Zealand** has slowed to a trickle in recent weeks. The NZIER QSBO last week was, however, the highlight. Falling in line with other business surveys, the QSBO showed that firms have recently become slightly less upbeat. On the upside, though, investment intentions have surged to above long-run average levels. It is too early to tell whether the increase in investment plans will translate into new hiring, particularly given the recent decline in corporate profitability. New Zealand firms are still finding it difficult to raise prices given that demand remains weak. This supports our view that consumer spending will have remained soft in February, with retail sales numbers this week likely to show a modest rise of 0.3% m/m.
- The economic news continues to signal that **global growth** is picking up this quarter amid a significant broadening in its base. On the heels of a strong gain in our March manufacturing PMI survey, the service sector survey, which had been surprisingly weak, surged last week to the highest level since August 2007. For the first time since last summer, we are raising our sights on 2010 global growth. An upward revision to Asian growth is now complete, with last week’s change in Japan followed by a significant markup to many of the smaller Asian economies this week. Our growth forecasts for the UK and Canada are now on a revision watch. With this week’s US March retail sales report likely to show consumption gaining momentum, the risk to our 4% forecast for US 2Q growth appears to have shifted to the upside.
- Recent political developments have opened the door to a shift in **China’s FX and interest rate policy**, which could happen at any time. Following President Hu’s decision to attend this week’s nuclear security summit in Washington, Treasury Secretary Geithner announced last week that the government’s semiannual FX report would be delayed and then met with the Vice Premier of China in Beijing. With the politics and fundamentals now in alignment, we look for China to allow the resumption of gradual CNY/USD appreciation this month or next, with the rate reaching 6.5 by year-end. We anticipate an initial 27bp interest rate hike during this same time frame. These policy moves, which are expected to be modest and gradual, would supplement existing tightening measures including RRR hikes and credit controls. That said, the overall policy stance will remain growth supportive.

### This week’s highlight

The Aussie consumer confidence numbers on Wednesday should indicate that the RBA’s assertive rate hikes have started to bite.

April 12, 2010

### Contents

<i>Data and event previews</i>	2
<i>Research note</i>	4
RBNZ to look through one-off price effects of GST and ETS	
<i>Commentaries</i>	
Australia	6
New Zealand	9
GDW Global Essay	11
<i>The JPMorgan view</i>	
Global markets	14
AUD and NZD commentary	17
<i>Forecasts</i>	
Global outlook summary	18
Global central bank watch	19
Australian economy	20
New Zealand economy	21
<i>Data release calendars</i>	
Australia and New Zealand	22
Global data diary	23

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## Data and event previews - Australia and New Zealand

Date	Time <sup>(a)</sup>	Data/event	Forecast		
			JPMorgan	Consensus <sup>(b)</sup>	Previous
Monday, April 12	10.15am	RBA Assistant Governor Debelle at Senate Inquiry	na	na	na
Monday, April 12	11.30am	Aust. housing finance (%m/m, Feb.)	-2.0	-1.0	-7.9
Tuesday, April 13	8.45am	NZ card spending (%m/m, Mar.)	na	na	-0.4
Tuesday, April 13	11.30am	NAB business confidence (Index, Mar.)	na	na	19
Wednesday, April 14	8.45am	NZ retail sales (%m/m, Feb.)	0.3	0.2	0.8
Wednesday, April 14	8.45am	NZ retail sales ex-auto. (%m/m, Feb.)	0.1	0.4	0.3
Wednesday, April 14	10.30am	Aust. WMI consumer confidence (%m/m, Apr.)	-3.0	na	0.2
Thursday, April 15	8.30am	NZ business PMI (Index, Mar.)	na	na	53.3
Thursday, April 15	11.00am	Aust. consumer inflation expectation (%m/m, Apr.)	na	na	3.2
Friday, April 16	8.00am	REINZ house sales (%oya, Mar.)	na	na	-3.8
Friday, April 16	8.00am	REINZ house price index (%m/m, Mar.)	-1.0	na	0.4

(a) Australian Eastern Standard Time.

(b) Consensus based on Bloomberg survey.

### Australia

**RBA Assistant Governor Debelle at Senate Inquiry** - The Assistant Governor (Financial Markets) appears at a Senate inquiry into the state of small business finance. We expect Dr. Debelle to emphasize a nascent easing in credit conditions, given that the Statement accompanying last week's official rate hike noted that "the pace of decline in business credit is lessening..." The Assistant Governor's appearance is limited to Q&A, and does not include a prepared speech.

**Housing finance (%m/m, Feb.)** - Home loan approvals hit a nine-year low in January and should fall a further 2% m/m in February. One possible explanation for the discrepancy between Australia's frothy housing market activity and plummeting demand for loans is the relaxation of foreign investment regulations. There has recently been speculation that Chinese capital, for example, which is not borrowed from Australian banks, is pouring into the local market, adding further upward pressure on prices. There is, however, scant data on this development. It is, though, likely that such purchases have only a localized impact, and are insufficient in volume to drive up house prices nationwide. Demand for housing finance is also likely being depressed by the near-vacuum of demand created by the expiry of the expanded First Home Buyers grant.

## Data previews - cont'd.

**NAB business confidence (Index, Mar.)** - We are expecting to see a decline in business confidence in March. The main reason will owe to widespread global jitters, but a deterioration in sentiment will also emerge in payback for the sturdy gains recorded in January and February. Following news that contract prices for Australia's key commodity exports have been negotiated significantly higher for this contract year, we suspect that mining will be the most confident sector and Western Australia the most confident state.

**Westpac-MI consumer confidence (%m/m, Apr.)** - The resilience of the consumer has been remarkable in recent months, but the RBA's rate hike last week should have put a dent in this optimism. After unexpectedly improving in March, we expect that confidence dropped 3% m/m in April. For now, the number of optimists easily outweighs the number of pessimists, though this gap should close in coming months. Mortgage rate increases will soon reach a point where rate hikes have a major impact on confidence. With that in mind, expectations of further rate hikes down the track will weigh on consumer sentiment, particularly that toward family finances.

## New Zealand

**Retail sales (%m/m, Feb.)** - Consumer spending will remain weak near term owing to a myriad of factors. Housing market activity is moderating, labour market conditions remain weak, and households are becoming increasingly cautious owing to expectations that the RBNZ will start to hike interest rates around midyear. Our forecast calls for an increase in sales of just 0.3% m/m in February, with core sales expected to have been up just 0.1%. As indicated by the NZIER business survey last week, firms are still finding it difficult to pass on higher prices to consumers.

**REINZ house price index (%m/m, Mar.)** - House prices probably fell in March and should remain weak near term. Robust gains in house prices toward the end of last year owed mainly to a lack of supply, on top of strong net permanent migration flows and record low interest rates. The spike in house prices in the final months of 2009 enticed other prospective property sellers to put their homes on the market. The flood of new listings has put downward pressure on house prices. We forecast a 1% m/m drop in house prices in March.

## Research note

# RBNZ to look through one-off price effects of GST and ETS

- The introduction of the ETS from July will drive up prices of petrol and electricity
- Also, the government has flagged a potential hike in the GST from 12.5% to “no more” than 15%
- The RBNZ will look through the price effects, provided inflation expectations remain anchored

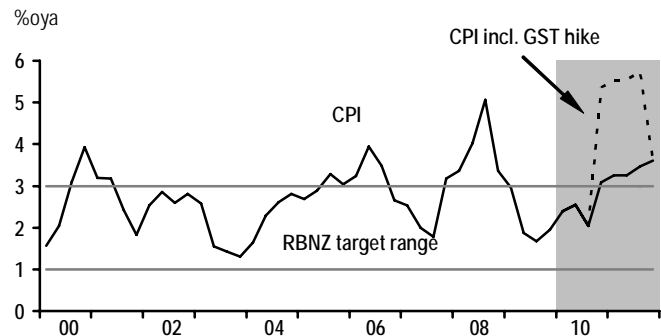
In its last Monetary Policy Statement in March, the RBNZ highlighted that the implementation of the amended Emission Trading Scheme (ETS) from July 1 would boost headline inflation. The Bank made clear, though, that monetary policy would not attempt to offset the first-round price effects of the ETS. Managing inflation expectations will be a growing challenge, however, particularly given the prospective lift to the goods and services tax (GST) on October 1 recently flagged by the government. Failure by consumers to recognize the temporary nature of these one-off boosts to headline inflation could raise inflation expectations. Lingering second-round effects on inflation could prompt more assertive policy action from the RBNZ than we currently forecast.

### Price impacts from ETS to begin in July

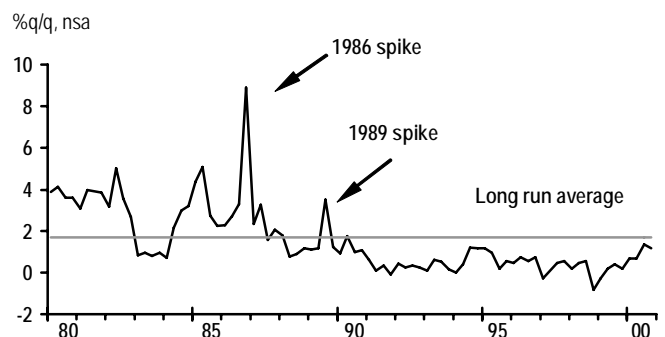
The RBNZ estimates that the first-round impact of the ETS would add 0.4%-pt to the headline CPI inflation in the year to June 2011, as increased costs are passed on to consumers via higher prices. The one-off impact on headline inflation is not, however, reflected in the RBNZ’s forecasts. This is because, according to the central bank, the introduction of the ETS should not affect medium-term inflation “provided price and wage setters recognized the rise in prices as one-off in nature.” This is consistent with the Bank’s Policy Targets Agreement (PTA), which allows the RBNZ the flexibility to look through such “one-offs.” The PTA highlights that headline inflation will vary around the medium-term trend, owing to factors such as significant government policy changes, like the introduction of the ETS.

Worryingly, though, from an annual rate of 2.0% in 4Q09, the RBNZ forecasts headline CPI inflation to reach 2.8% by the end of 2011, close to the upper bound of the 1%-3% target range, without the impact of the new ETS. Our forecast, inclusive of the ETS impact, has headline CPI reaching 3.6% by the end of next year. This forecast also accounts for recent sharp rises in food and petrol prices, combined with the inflationary impact of weaker NZD. In 2011, our forecast has headline CPI running consistently above 3%.

GST hike to add further to inflation on top of ETS



Inflation likely to jump temporarily on GST increase



### Prospective GST hike also an inflation risk

There also is the one-off impact of a possible GST hike to consider, which Prime Minister John Key flagged in February, along with other potential changes to the tax system. The GST was introduced in 1986 at 10% and lifted to 12.5% in 1989. Now, another hike is on the table, with the government considering a rise of “no more” than 2.5%-pts to help offset the drain on tax revenue caused by the prolonged recession from which the economy only recently emerged. The RBNZ will not, however, factor another GST hike into its official forecasts until it is formally adopted as government policy. We suspect this will occur in May, when the government delivers its annual Budget. The government also is likely to announce initiatives compensating individuals for the price rises, such as a reduction in personal tax rates and “working for families” rebates.

The price impact of the GST should be temporary, similar to the experience in July 1989. Statistics New Zealand estimates that lifting the GST to 15% from 12.5% could increase retail prices by 2.2%. There are two reasons the impact would be less than the likely 2.5% GST hike. First, the absence of pricing power means some retailers will not pass on the price rise in full. Second, the GST applies only to 91% of the CPI basket. Factoring in a GST hike from October 1 (bottom chart, previous page) pushes our forecast for annual inflation up to 5.7% during 2011, but it falls sharply to

3.6% by year-end as the effect washes through.

## Retail to bounce around midyear

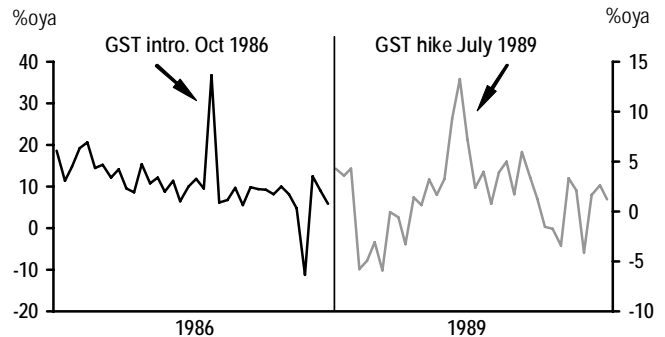
History shows there is an incentive for consumers to spend ahead of an indirect tax rise, even if the anticipated change is small. Consumers, therefore, are likely to bring forward spending into 3Q10; this will be most evident in big ticket items like cars, furniture, and household appliances. In 1986, when the GST was introduced, and in 1989 when it was lifted by 2.5%-pts, albeit by a lesser extent, there was a significant “bring-forward” of spending by consumers in the months immediately before the rise in the consumption tax; this was followed by a subsequent fall (first chart). For retailers, though, this creates the difficult challenge of managing inventory around volatile fluctuations in demand.

In the longer term, the forthcoming GST hike will damage, to a small extent, New Zealand’s competitiveness by weighing on the domestic retail sector. In particular, a new GST rate of 15% would be well above Australia’s 10%. Furthermore, New Zealand does not have a user-friendly Tourist Refund Scheme, such as that in Australia, so visiting tourists may be more inclined to spend elsewhere. In New Zealand, the GST can be refunded to tourists only if the goods are exported or not taken possession by the purchaser within New Zealand. The hassle of retailers having to transport the goods to the airport for collection on departure, or having to post them to customers overseas, is a significant impediment.

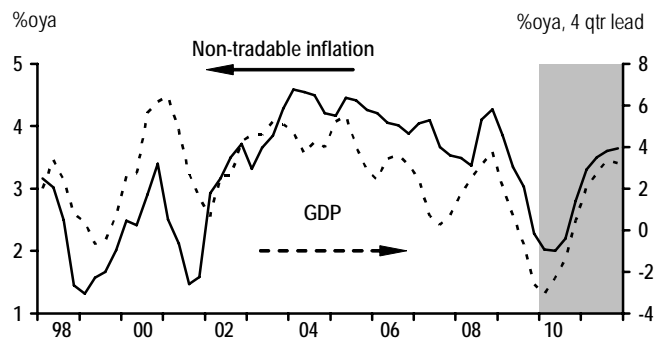
## Inflation expectations the main concern

The RBNZ so far has assumed that inflation expectations will remain anchored, but the introduction of the ETS and the likely GST hike pose risks to this assumption. Although inflation expectations have in recent quarters remained relatively steady, they have done so at an elevated level. Inflation expectations two years out, for example, as measured by the RBNZ, printed at the top end of the Bank’s target range in 1Q at 2.7%, up from 2.6% in 4Q. Indeed, the RBNZ will become increasingly anxious that New Zealand manufacturers, in particular, may alter their expectations about future inflation owing to the GST and ETS regime changes. They may seek to recover higher costs from their customers via higher retail prices. Similarly, employers may face increased wage demands from anxious employees. If second-round inflation pressures build as a result, the medium-term inflation outlook will worsen. This would require more assertive monetary policy tightening in 2011 than we currently project.

Retail sales probably will spike temporarily pre-GST hike



Non-tradable inflation to rise on recovery



The RBNZ will look through the first-round impacts of these one-offs later this year, as officials have indicated, but this does not mean a delay to the start of the next tightening cycle. Our forecast is that the next cycle will commence in July, although we now expect the first move will be 25bp, rather than the 50bp hike we expected previously. This follows the string of unexpectedly soft data prints and comments in March from RBNZ Deputy Governor Grant Spencer, who downplayed the risk of a large adjustment to the OCR. He highlighted the fact that monetary policy in New Zealand is likely to have a sharper impact post crisis, owing to myriad factors, including that New Zealand now has a steeply upward-sloping yield curve. This has enticed more borrowers to move to floating rates or short-term fixed rates, meaning the transmission of changes to the policy rate to mortgage rates will be swifter than was the case pre-crisis. As of January, only 60% of all new home loans were fixed, compared to 68% a year earlier.

The comments from Spencer were in contrast to those delivered earlier in the year by Governor Bollard, who highlighted that the cash rate didn’t come down in 25bp moves, so “meaty chunks” might be delivered on the upside. These “meaty chunks” are, however, quickly becoming less likely.

## Australia

- **RBA continued on path of policy normalization**
- **Employment growth solid in March**
- **A smaller decline in housing finance expected**

The RBA took another step toward policy normalization last week, hiking the cash rate a further 25bp. Our forecast calls for another 25bp hike from the RBA in early May.

### Upbeat RBA lifted cash rate again

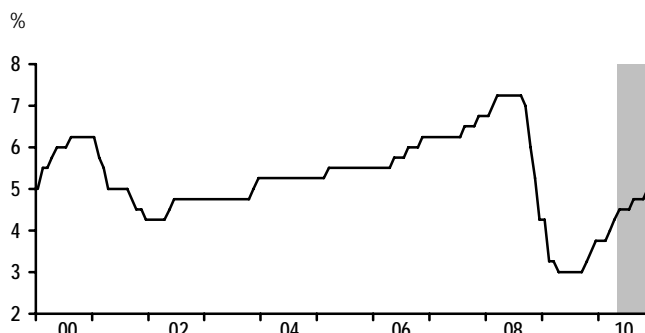
The RBA Board last week lifted the cash rate a quarter point to 4.25%, the second straight monthly hike. With the RBA now having hiked five times since October (helped along by even larger hikes by the major Aussie banks), it is becoming increasingly difficult to describe the pace of tightening as “gradual,” the word used prominently by the RBA in the minutes from the March Board meeting. That said, the RBA has *not* accelerated the pace of tightening; officials merely have resumed the steady pace at which they kicked off the tightening cycle late last year.

The consensus view last week was that the RBA would nudge the cash rate up (market pricing implied a 65% chance of a 25bp rate hike). Our forecast was that RBA officials would wait another month before hiking again, in keeping with the “gradual” and “flexible” approach to the removal of policy accommodation the RBA seemed to have adopted. Significantly, however, these two words were notably absent from last week’s commentary. It seems the RBA is erring on the side of returning policy to more “normal” levels as soon as is reasonably possible. Officials apparently do not want to risk getting “behind the curve” and are taking advantage of decent economic data prints offshore, in particular, to push on with the removal of the remaining policy accommodation.

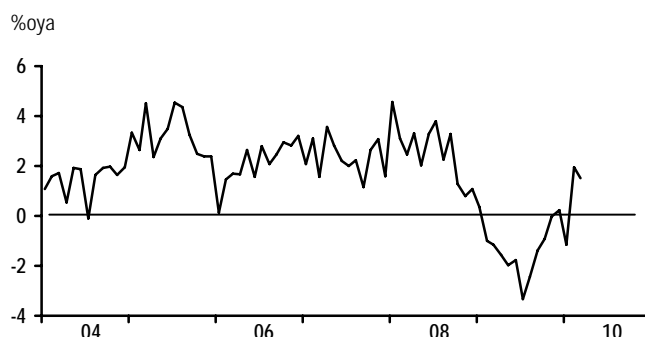
The next hike could come as early as the next Board meeting in May—this is our base case—but equally, if the data should soften, the RBA could wait until June before hiking again. We view 4.5%—the lower bound of the broad range of a neutral policy stance—as the near-term “target” for the RBA, but continue to look for a cash rate 5% by year-end. With the medium-term inflation outlook deteriorating, policy will become increasingly restrictive in 2011.

The tone of last week’s commentary was upbeat, as one would expect and was broadly similar to the verbiage that accompanied the March hike. There were, however, two material changes in the commentary worth highlighting. The first was that the comment on domestic conditions began

Australia: RBA cash target rate



Australia: aggregate hours worked



with a reference to the rising terms of trade and the positive impact this has on incomes and investment; there was no such reference in March. Second, the statement described conditions in the established housing market as “buoyant;” we read this as a natural extension of the message delivered by the Governor, unexpectedly and unusually, on breakfast TV two weeks ago.

Interestingly, there was no explicit mention in last week’s commentary of recent domestic economic data prints, some of which have been mixed (notably, the unexpected plunge in retail sales in February). This strategy neatly sidesteps the discomfort of officials having to simultaneously explain a rate hike and weak data. RBA officials clearly remain focussed on medium-term pressures building in the economy, including in the housing market, and will continue to push the cash rate back to more normal settings.

One thing confirmed by last week’s outcome is that the RBA’s deliberate tactic of using “open mouth operations” to help cool exuberance in the housing market is *not* independent of movements in the cash rate. Officials clearly believed the cautionary message delivered by the Governor last week needed to be endorsed by a rate hike last week. The problem with this tactic, though, is that the RBA now is at risk of appearing to target asset (i.e., house) prices with

rate hikes. This was something we believed officials would want to avoid. Given what we know now, it would be unwise to judge further actions of the Governor or other senior officials to wave a rhetorical stick at home-buyers, in particular, in the form of an implied threat of official rate hikes if the excesses in housing persist, as discrete from the actions of the Board.

On the domestic economy, the statement was an echo of the last. The investment pipeline is swelling, business credit is poised to rebound, activity in housing is firm, the jobless rate has peaked, and output growth this year will be stronger than last year. On global conditions, while the expansion is "hesitant" in the major countries, owing to excess capacity, buoyant conditions in Asia are putting upward pressure on prices of raw materials. As a commodity exporter, this clearly is a significant positive for Australia.

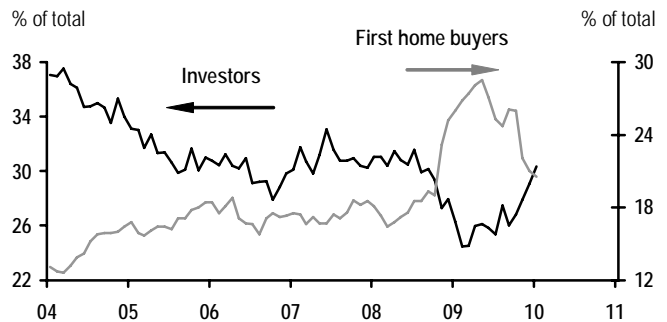
On inflation, the RBA continues to assume that inflation will be consistent with target in 2010. The recent downward trend in inflation has been helped along by high AUD, well-contained labour costs and the lagged impact of slower growth in domestic demand. It seems very likely, though, that with the Australian economy having moved back onto a trend-like growth path with very limited spare capacity, inflation pressures are building. The clear improvement in the growth outlook in recent months means the official growth and inflation forecasts likely will be revised higher (again) when the RBA releases the next quarterly statement on May 7.

### Aussie economy gained another 20K jobs

The Aussie economy added 19,600 jobs last month, taking total employment gains since September last year to a whopping 215,000. A downward revision to the 400 gain in employment in February to a fall of 4,700 meant, however, that the string of positive employment gains since September 2009 had been broken. With leading indicators such as the employment component of the NAB business survey recently easing, we expect monthly job gains will slow near term, albeit mildly.

The gain in employment in March was driven by a solid 30,100 increase in full-time employment, the seventh straight monthly rise, while part-time employment fell 10,600. We suspect that this shift from part- to full-time work will continue as workers' hours, which were cut significantly in 2009, are gradually reinstated. That said, we did see some payback in March in the number of hours worked. After spiking 2.2% m/m in February, hours worked fell 0.6% over

Australia: housing finance



Australia: consumer and business confidence



the month. In over-year-ago terms, however, after falling consistently throughout 2009, hours worked have increased significantly over the last two months, rising 1.9% in February and a further 1.5% in March.

The unemployment rate remained at 5.3% for the second straight month, even with the participation rate falling from 65.2% to 65.1%. We suspect that the unemployment rate, which peaked in this cycle at 5.8%, will oscillate around current levels near term, owing to an anticipated rise in workforce participation. Small rises in the unemployment rate were recorded in New South Wales, Western Australia, and Victoria in March. The unemployment rate jumped sharply higher in South Australia, however (from 4.8% to 5.4%), although fell in the remaining states and territories.

The labour market should continue to tighten throughout 2010, particularly in the latter months of the year. The swelling investment pipeline and strong demand for Australia's key commodity exports means that significant employment gains are likely to be recorded in the resource-rich states in 2H10. Already in Western Australia, for example, the unemployment rate is just 5.1%. Indeed, the latest official survey of firms' investment intentions indicated that firms intend to boost investment 20% in the year ended June 2011, which will have substantial positive implications for employment.

## Slump in housing finance to ease

The reality for the Australian housing market likely is a more mixed story than that implied by recent exuberant anecdotal commentary from the media. Recent data has shown a remarkable slowing in many of Australia's housing market indicators, which suggests the price "bubble" story is overblown. Building approvals are down 8% since December, and home loan commitments are tracking 20% below September 2009 levels, which accompanied the phasing down of the expanded First Home Buyers' (FHBs') grant. In January, approvals for purchase of established dwellings hit a nine-year low. We forecast a further 2% m/m decline in housing finance in February.

With economic and labour market fundamentals still supportive, however, it is hard to see significant further softening in home loan commitments. We expect the exodus of FHBs from the home loan figures to slow, while growth in loans to other owner occupiers and investors should be sufficient to stop further significant falls in housing finance.

## Consumer confidence easing post-hike

Consumer confidence in Australia, as measured by the Westpac-Melbourne Institute, probably fell in April, owing to the RBA's decision to hike the cash rate last week. After unexpectedly improving in March, we expect that confidence dropped 3.0% m/m, although the index level of 113.8 will still indicate that optimists outnumber pessimists.

Given that the majority of mortgage holders maintained their monthly repayments over the course of the RBA's easing cycle, mortgage rate increases have yet to reach the point where rate hikes have a major impact on confidence. This dynamic, though, is nearing an end, and a growing number of mortgage holders now will be facing the reality that the RBA's rate hikes will start to bite. Expectations of further rate hikes will weigh on consumer sentiment near term, particularly toward family finances. The anticipated tightening in the labour market should, however, offset to some extent the negative impact of rising interest rates.

## Data releases and forecasts

### Week of April 12 - 16

Mon Apr 12 11:30am	Housing finance approvals: owner occupiers Number of loans, sa	Nov	Dec	Jan	Feb
	%m/m	-6.2	-5.1	-7.9	<u>-2.0</u>
	%oya	13.3	0.2	-12.0	<u>-16.6</u>

Tue Apr 13 11:30am	NAB monthly business survey % balance, sa	Dec	Jan	Feb	Mar
	Business confidence	8	15	19	—

After a sharp improvement in January and an impressive gain in February, we suspect that business confidence eased in March, owing mainly to widespread global jitters. Mining will likely remain the most confident sector and Western Australia the most confident state.

Wed Apr 14 10:30am	WMI consumer confidence survey 100=neutral, sa	Jan	Feb	Mar	Apr
	%m/m	5.5	-2.6	0.2	<u>-3.0</u>

## Review of past week's data

### RBA cash rate announcement

25bp hike delivered (see main text).

### ANZ job advertisements

	Jan	Feb	Mar	
(%m/m, sa)	-8.1	19.1	—	1.8

### Labor force

	Jan	Feb	Mar	
Unemployment rate (% , sa)	5.2	5.3	<u>5.4</u>	5.3
Employed (000 m/m, sa)	<u>56.5</u>	59.4	0.4	-4.7
Participation rate (% , sa)	65.3	65.2	<u>65.1</u>	



## New Zealand

- Retail sales growth likely weakened in February
- Firms still upbeat but unable to lift prices
- Price pressures still subdued

The data flow in New Zealand has slowed to a trickle in recent weeks. The NZIER QSBO last week was, however, the highlight. Falling in line with other business surveys, the QSBO showed that firms have recently become slightly less upbeat.

### Kiwi retail sales will come back to earth

Growth in retail sales values likely slowed in February. After spiking 0.8% m/m in January, our forecast calls for an increase in sales of 0.3% in February, with core sales expected to have been up just 0.1% over the month. Indeed, the upside surprise in total sales in January was driven by vehicle-related industries, thanks to continual gains in petrol prices.

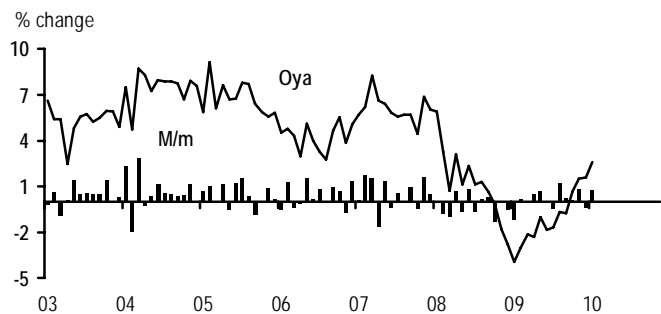
As reported by the NZIER last week, New Zealand firms are finding it difficult to raise prices, with weak demand reducing firms' pricing power. Households are becoming more cautious, so retail sales will likely remain subdued. The weakness in core retailing, in particular, reaffirms our view that any recovery in consumer spending will be benign, especially given that housing market activity has moderated and labour market conditions remain weak.

### NZIER survey showed little price pressure

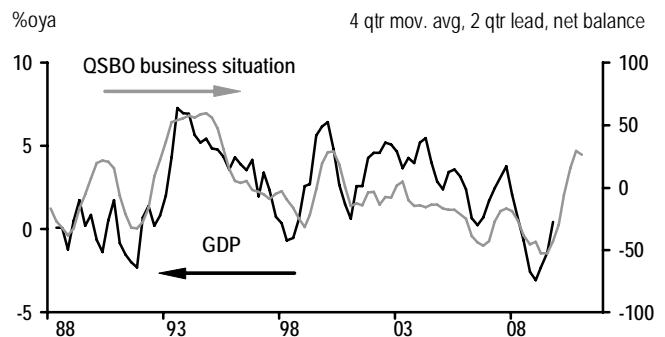
The NZIER Quarterly Survey of Business Opinion (QSBO) signaled that the recovery underway in New Zealand continues, although at a slower pace than firms expected when last surveyed three months ago. The headline reading eased back from +31 in the December quarter to +22 (J.P. Morgan: +25) in 1Q, meaning that a net 22% of firms surveyed expect the economy to improve in the next six months. As the chart above suggests, however, 1Q and 2Q GDP growth should print at healthy levels, with our forecast calling for annual growth to return to 2%-plus rates in both quarters.

The QSBO showed that investment intentions surged in the March quarter to above long-run average levels. Intentions to invest in buildings improved (to -5% from -15%) and plant investment intentions moved into positive territory (to +9% from -2%). Even though investment intentions picked up, it remains unclear as to whether this translates into new hiring. The survey showed that, although hiring intentions

New Zealand: retail trade



New Zealand: GDP and QSBO expectations for the economy



have been marginally positive in recent quarters (+2% in 1Q and +1% in 4Q), actual hiring is still below long-run averages. Further weakness in the labour market is expected, particularly given the decline in profitability in 1Q (to -19% from -14%), which suggests that a significant pick up in new hiring may be delayed.

The survey also showed that price pressures remain contained given that firms are not able to raise prices to the extent they would like. That said, more than a quarter (27%) of firms expect to increase selling prices in the next three months. Capacity utilization fell slightly to 90.5% from 91.1% in the previous quarter, although NZIER highlighted the recent volatility in this indicator.

An overwhelming 94% of firms surveyed in 1Q expect interest rates to be higher over the next twelve months. Indeed, we believe the first rate hike will be delivered in July. Our feeling is that Governor Bollard wants hard evidence that the recovery is sustainable, and so will sit on the policy sidelines until after the late-June release of the 1Q GDP report. The disappointing reads on the recent economic data mean, though, that the risks to our July OCR call are skewed toward an even later move.

**Data releases and forecasts**

**Week of April 12 - 16**

Mon Apr 12	<b>QVNZ house prices</b> %, median	Dec	Jan	Feb	Mar
	%oya	2.8	4.4	5.5	—
Wed Apr 14 10:45am	<b>Retail trade</b> sa	Nov	Dec	Jan	Feb
	%m/m	0.9	-0.4	0.8	<u>0.3</u>
	%oya	1.7	1.8	3.6	<u>3.6</u>
Thu Apr 15 10:30am	<b>Business PMI</b> sa	Dec	Jan	Feb	Mar
	Index	53.0	52.1	53.3	—
	%oya	25.4	23.0	35.5	—

**Review of past week's data**

<b>NZIER QSBO</b>				
% balance of respondents				
	3Q09	4Q09	1Q10	
Headline index	36	31	<u>25</u>	22
<b>ANZ commodity price series</b>				
Not seasonally adjusted				
	Jan	Feb	Mar	
Index - world prices (%m/m)	0.4	3.8	—	1.8
Index - NZD (%m/m)	-1.2	7.9	—	0.4

## Global Essay

- **Surge in services lifts our global PMI to highest level in almost three years**
- **Despite widespread above-trend growth, wide differences in activity levels will produce very different policy outcomes across the globe**
- **The stage is set for a policy shift in China, opening the door to a broader move across the EM**
- **EU moving to activate support mechanism for Greece**

### Synchronized growth sets stage for policy decoupling

The economic news continues to signal that global growth is picking up this quarter amid a significant broadening in its base. On the heels of a strong gain in our March manufacturing PMI survey, the service sector survey, which had been surprisingly weak, surged last week to the highest level since August 2007. For the first time since last summer, we are raising our sights on 2010 global growth. An upward revision to Asian growth is now complete, with last week's change in Japan followed by a significant markup to many of the smaller Asian economies this week. Our growth forecasts for the UK and Canada are now on a revision watch. With this week's US March retail sales report likely to show consumption gaining momentum, the risk to our 4% forecast for US current-quarter growth appears to have shifted to the upside.

Alongside increasing conviction in synchronized, above-trend global growth, our forecast maintains that divergences in the *level* of activity will produce widely different policy responses in different areas of the globe this year (see "Central bank exits and FX performance," *Global Issues*, December 18, 2009). Although G-3 growth is now

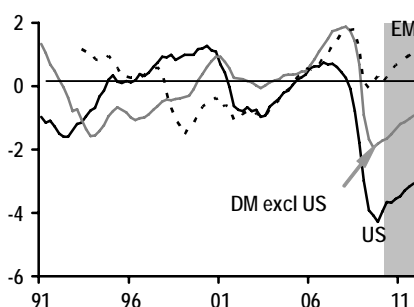
strong enough to generate jobs, the recession's deep imprint on resource utilization and inflation dynamics will require central banks to remain on hold for some time to come. It is true that following previous deep downturns, US and European central bankers began the rate normalization process well before disinflation ended. However, in those periods core inflation was elevated when the expansions began and disinflation was a welcome development. With core inflation below target and falling, and policy rates already near zero, the risk profile facing policymakers is quite different this time around.

This different risk profile was reflected in the latest FOMC minutes, in which policymakers expressed surprise at the pace and breadth of the fall in core inflation. Indeed, some members highlighted that the risks of tightening too early exceeded those associated with a later start since the Fed has no room to lower policy rates. The situation is much more extreme in Japan, where core prices are falling in excess of 1% oya. The BoJ continues to be under intense pressure to do more to end deflation, as seen in last week's unexpected meeting between Prime Minister Hatoyama and the BoJ's Shirakawa. Consequently, the odds are rising that the BoJ will take another step toward unconventional easing by June, when the government is expected to publish the medium-term fiscal outlook and the details of its growth strategy.

By contrast, business cycle conditions are very different in Emerging Asia and in the major commodity-producing nations. As a group, these economies entered recession later than the G-3 and did so with operating rates well above historical norms. With the early stage of the global recovery supported by large gains in global manufacturing output and commodity prices, these economies generally have been at the head of the global growth table over the past year and are now seeing utilization rates return to normal and core inflation bottom. However, with the notable excep-

Resource utilization

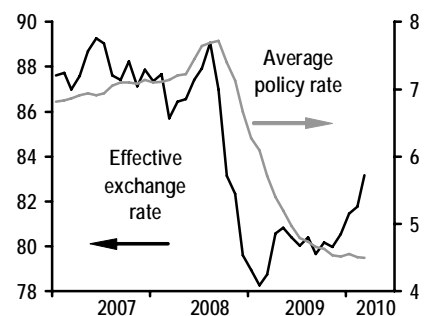
Standard deviations from long-term average



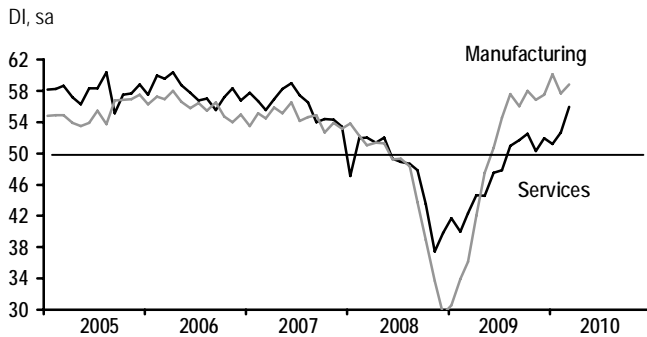
EM monetary conditions

2000 = 100

% p.a.



J.P. Morgan global PMI output indexes



tion of Australia, which delivered another 25bp rate hike last week (the fifth since September), central banks in these countries have taken back very little of the extreme accommodation put in place during the recession.

The tide is about to turn, however. Our forecast envisions a nearly unanimous round of interest rate increases in the commodity block and across EM Asia in the next few months, including Canada, Australia, Norway, Brazil, India, Korea, and Taiwan, that will mark the onset of a gradual normalization process. The most important shift will occur in China, which appears close to launching a new phase of policy normalization that will include a stronger RMB and higher interest rates. A shift in Chinese currency policy will be a landmark development. Since China froze the CNY exchange rate nearly two years ago, many of its neighbours have resisted letting their currencies appreciate versus the dollar. This desire to contain currency appreciation, in turn, has deterred these same central banks from raising interest rates, although some have employed alternative tightening measures including liquidity-draining operations and raising banks' reserve requirements.

### China readies for policy shift

Recent political developments have opened the door to a shift in China's FX and interest rate policy, which could happen at any time. Following President Hu's decision to attend this week's nuclear security summit in Washington, Treasury Secretary Geithner announced last week that the government's semiannual FX report would be delayed and then met with the Vice Premier of China in Beijing. With the politics and fundamentals now in alignment, we look for China to allow the resumption of gradual CNY/USD appreciation this month or next, with the rate reaching 6.5 by year-end. We anticipate an initial 27bp interest rate hike during this same time frame. These policy moves, which are expected to be modest and gradual, would supplement exist-

ing tightening measures including RRR hikes and credit controls. That said, the overall policy stance will remain growth supportive, and we look for the economy to expand at a 9%-10% annual rate through year-end.

The fundamental case for additional policy normalization has been building for some time. Supported by a massive easing of policy, China's economy has been cruising at high altitude, with strong gains in domestic demand recently supplemented by a rebound in exports. The economy's strength will be on display in this week's activity reports. The 1Q GDP report is expected to show that the economy expanded at a 9.8%q/q annual rate, or 11.3% oya. March data should show that the economy retained good momentum heading into the current quarter, notwithstanding continued volatility related to the Lunar New Year holidays and adverse winter weather.

In particular, we look for a sharp, but temporary, acceleration in IP and a downward correction in exports (and possibly a small deficit the trade balance) that will leave intact the strong trend advance in these data. Inflation likely stabilized at 2.6% oya in March, reflecting payback for a holiday-related surge in food prices. Nonetheless, the inflation rate is expected to resume rising in April, topping 3% this month. While officials are on guard for a general rise in inflation expectations, their principal concern lies with the property market. Despite tighter controls on mortgage lending, property transaction volume picked up significantly in March and prices rose still further.

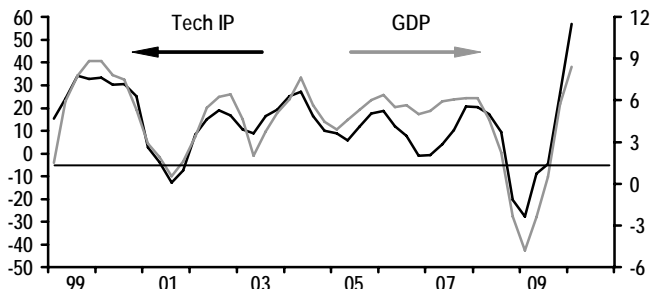
### Greece calls for help

With Greek government bond yields having risen sharply over the past week, and concerns about market liquidity and deposit outflows from the banks mounting, it looks likely that the Greek government will ask for the EU/IMF support mechanism outlined two weeks ago to be activated. The support mechanism has two objectives: first, to give Greece some breathing room to achieve the necessary fiscal consolidation away from the pressure of the financial markets; and second, to limit contagion risk both to other sovereign debt markets and to the financial system across the region.

In our view, the activation of the support mechanism will achieve the first objective. Clearly, the region has the fiscal capacity to provide support to Greece. Indeed, of the major economies around the world, the Euro area as a whole has by far the strongest fiscal position. It is less clear whether the activation of the support mechanism will eliminate all contagion risk. One problem is that other fiscally stressed countries

**EM Asia ex China and India: high tech output and real GDP**

%ch over 4 qtrs; both scales; w/ 1Q10 est



will be contributing to the funding, although the amounts are very small. For example, with an overall Euro area contribution of €25 billion, Spain would be expected to contribute €3.06 billion, which is only 0.29% of Spanish GDP.

Although there is uncertainty about exactly how the support mechanism will work, the broad contours seem clear. First, Greece has to request the help. Then the European Commission and ECB will provide an opinion on whether a disbursement of funds is appropriate. And finally, the rest of the Euro area will decide by unanimity whether to activate the mechanism. The mechanism will involve bilateral loans from the rest of the Euro area and financing from the IMF, but the majority of the money will come from the Euro area. Given the ECB's role in giving an opinion on the activation of the package, it is noteworthy that the press reported that the ECB governing council was having a teleconference call Friday evening as we went to print. Since the governing council met in Frankfurt only the day before, it is hard to see why it would need to talk again unless it had been asked for its opinion about supporting Greece.

It is important to stress that the activation of the support mechanism does not resolve the fundamental problem of Greece achieving debt sustainability, which is key to the

question of whether the country will ultimately restructure its debt. The support mechanism will reduce the marginal borrowing cost, but a huge part of the unstable debt dynamics reflects the large primary deficit. To stabilize the debt trajectory, the primary position has to move into surplus. Thus, while the mechanism helps, the heavy lifting still has to be done by the Greeks.

**ASEAN growth marked up on tech**

Following the slew of strong regional production data in 1Q10, combined with a positive outlook for manufacturing, 1H10 GDP growth forecasts for the ASEAN region have been revised up. These changes lift J.P. Morgan's growth forecast for the ASEAN countries to 6.7% oya from 6% previously and even further above the consensus forecast of 5.4%. The main forecast changes are in the tech-producing countries, including Malaysia, Singapore, and Thailand, where electronics production has surprised on the upside. In the case of Indonesia, domestic demand appears to be broadening, which is expected to continue into 2Q10. Although it is not part of ASEAN, we raised our 2010 Taiwan GDP growth forecast to 8.2% this week.

For ASEAN, we left 2H10 GDP forecasts unchanged and note that this forecast assumes some modest payback for the strong 1H10 upturn, with the expected 2H10 run-rate still below the average rates seen in the last cycle. This suggests that there is upside risk to growth in 2H10, especially if the investment cycle moves into higher gear. As noted above, the continued rapid growth of activity should prompt the region's central banks to kick-start the process of policy normalization during this quarter. In the next week, the Monetary Authority of Singapore is expected to announce a modest tightening in its exchange-rate-based monetary policy.

## JPMorgan View - Global Markets

### Four sources of momentum

- **Asset allocation:** We stay long risky assets on positive momentum in asset prices, buying flows, economic forecasts, and the success of bullish analysts.
- **Economics:** We raise growth forecasts for the UK and EM Asia. Upside risk bias on US forecasts.
- **Fixed income:** Greek debt tumbled last week, making borrowing from the EU/IMF backstop more likely. This should remove near-term liquidity risks. Stay moderately short duration in core bond markets and selectively long in EM.
- **Equities:** Reduced sensitivity to Greece reinforces our view that Greece is a local problem. But it raises the risk of continued underperformance of European versus US banks.
- **Credit:** HY default volume in March fell to the lowest level since December 2007. Stay long US HY.
- **FX:** Euro and sterling in political binds.
- **Commodities:** We are medium-term bullish crude oil, but expect a return to the \$80-85 range near term.

Another week of **equities, credit, and commodities rallying**, while bonds were broadly flat. The dollar is slightly down. The world did not look less risky last week, but economic data are again starting to come in stronger than we have been hoping, forcing us toward **higher growth forecasts**. We remain long risky assets and trade bonds from the short side.

The important economic news of the last few weeks is the **broadening** of the recovery across sectors (in Europe and Japan), regions (toward services), and types of spending (jobs). This increases our confidence in the longevity of the recovery, but is now also making us recognize that data are running ahead of some of our forecasts. We have in recent weeks raised forecasts for Japan, EM Asia and the UK, and signal increasing upside risks for the US in 2Q. The upgrades are not yet big enough to move our global growth forecasts, but this seems likely over the coming month.

**Three areas of uncertainty** have kept investors from fully committing to risky assets—the **end of QE, Chinese tightening, and the Greek debt crisis**. QE is now over and bonds are not collapsing. China seems increasingly likely to raise rates and its currency any moment now. This should continue to hold Chinese and other EM Asian equities back for another few months, but should not drag world equities down. The Greek debt crisis intensified last week, but the increasing risk now

that the bond market is closing on Greece is at the same time making it possible for Greece to ask for IMF/EU funding support. Adding up these uncertainties, we remain of the view that market risk is slowly coming down from admittedly high levels, toward more normal conditions.

We have found in our *Investment Strategies* methodology series that various **sources of momentum** are more reliable signals of near-term market moves than any deep concepts of value. The types of momentum we have relied on are those in **prices, flows, views, and the success of analysts**. Each remains bullish for risky assets. Our weekly *Flows & Liquidity* reports that investor flow data continue to show a shift toward riskier assets—rising inflows to equity and HY funds and more recently again in commodities; record high-yield bond issuance in March; and steady rises in M&A activity and equity buybacks.

### Fixed income

**Greek government bonds tumbled last week.** Two-year spreads to Germany rose around 2%, driven by growing uncertainty over the terms of the EU/IMF lending facility, combined with the poor secondary market performance of the 7-year bond issued by Greece two weeks ago. Greek bonds recovered some of their losses today on speculation that the details of the support package had been agreed, with interest rates significantly below market yields.

The current illiquid and volatile market conditions make it more difficult for Greece to issue in the primary market, although two Treasury bill auctions are planned for this week. Indeed, Fitch cited market volatility as one reason for its **two-notch downgrade of Greece** today, to BBB-. In any case, borrowing at current market interest rates would increase the fiscal adjustment needed for Greece to make its debt burden sustainable.

**This makes it increasingly likely that Greece will make use of the EU/IMF borrowing facility** at some point ahead of its \$8 billion bond redemption in mid-May. Access to these funds makes it highly unlikely that Greece will face a near-term liquidity crisis. Beyond that, the prospects for Greek debt will depend on the progress of the government's fiscal consolidation. That will take time to become clear, although the 1Q deficit was very encouraging.

Core bond markets fell slightly last week. **Bunds underperformed Treasuries**, reflecting a reversal of European flight-to-quality flows on Friday. We remain moderately bearish on core markets, and short Treasuries against Bunds, as heavy supply should push yields higher, particularly in the US and UK.

We also remain **selectively long local EM debt**. EM continues to be supported by heavy inflows, but we are mindful of the risk that strengthening growth will push policy rates higher. This is most likely to occur in Asia, whereas several CEEMEA central banks have cut rates over the past month, including South Africa and Russia, where we are long. We are also long in Brazil, but with a careful eye on the pace of the tightening cycle likely to begin this month.

## Equities

Global equities continue to edge up despite renewed fears about Greece. The **reduced sensitivity of equity markets to Greece** last week is encouraging and reinforces our view that Greece is a local problem and not a reason to change our positive stance on global equities. We do recognize, though, that the **Greek debt crisis has implications for regional performance**. To the extent that uncertainty regarding the activation and details of the support mechanisms for Greece lingers until the May 9 German provincial election, European stocks, especially banks, should underperform.

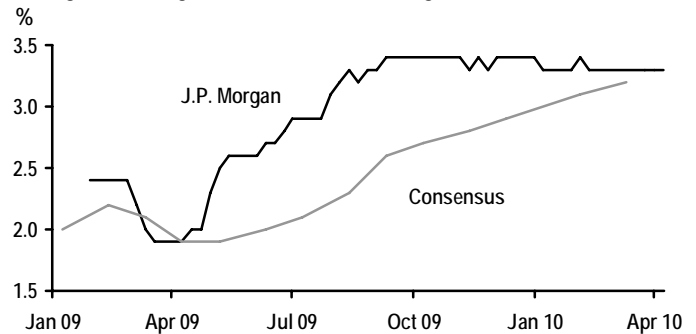
The major driver for equities in April should be the **1Q reporting season** that kicks off this week. An improved positive-to-negative pre-announcements ratio (of 0.79 in 1Q10 versus 0.67 in 4Q09) points to another positive profit surprise. There remains positive momentum in top-down earnings forecasts.

We stay long equities, focusing on cyclical sectors and small caps on momentum. Our global **sector momentum** strategy, which buys the three best performing sectors over the past year against the three worst, posted a strong gain in March for a second straight month. Before January's loss, the strategy had gained for five straight months. Sector momentum tends to do well in the aftermath of US recessions.

The momentum strategy is currently **long Materials, Financials, and Industrials** and **short Telecoms, Utilities, and Energy**. This means it has a strong cyclical bias consistent with continued economic outperformance of manufacturing versus services. The preference for Materials vs. Energy is also consistent with our more positive view for base metals versus oil. Financials should be supported by a confirmation by the 1Q reporting season that credit losses are on a downtrend.

MSCI EM has been in a range versus MSCI World since last October. Uncertainty regarding China and policy tight-

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



ening in **EM** continue to suggest a neutral stance. We hope to re-enter our EM overweight later this quarter as more clarity emerges on the inflation and policy fronts.

## Credit

**US corporate bond spreads in both HG and HY tightened to new lows** last week. With the US HG spread at 134bp over Treasuries, it is only 9bp above our year-end target of 125bp. Still, with strong demand, we retain a minimal long in US HG as spreads are likely to tighten more, although the return potential is now quite small.

**Stay overweight US HY** as spreads remain very attractive at 600bp, fundamentals are improving and our mutual fund flow trading signal suggests a long. The **March default volume is the lowest** dollar volume of defaults since December 2007. The default rate fell to only an annualized 0.2% rate during 1Q, bringing the 12-month rolling default rate for high-yield bonds to 6.3% from 7.4% in February. We continue to forecast a high-yield bond default rate of 2% by year-end. With **recovery rates** back to the historical average of 40% versus the low of 22% in 2009, fundamentals of HY bonds are strengthening and spreads are expected to tighten another 100bp by year-end.

With both economic and credit fundamentals improving, investor demand has been tilting to **lower-quality credit** as shown in the recent *JPM European HG Credit Investor Survey* and US mutual fund flow data. We follow these flows and increase exposure by rotating to riskier credit sectors.

In **consumer ABS**, we advise buying subordinated paper as it offers high credit quality with better upside than similarly rated credits and supply is limited. For investors able to tolerate volatility and illiquidity, we also advise **rotating from super-senior CMBS to AM class CMBS bonds**. AM class

bonds should outperform super-senior CMBS given their limited supply and strong demand from PPIP fund managers who are searching for yields.

## Foreign exchange

The pivotal issue for **EUR/USD** this week will be whether Greece calls on the **EU/IMF lending facility** given that rates have risen to punitive levels and the bond market is becoming dysfunctional. The **April 17-18 EcoFin** meeting could be the venue for a request. Short covering could drive EUR/USD up a few cents on an announcement, but until it is clearer that Greece does not require debt restructuring—its progress toward generating a primary surplus is the key issue—the euro will remain hostage to headlines.

If one story in currency markets could rival Greece for drama over the next month, it is **UK elections**. UK public finances are almost as poor as Greece's, the endgame scenario is equally unclear, and investor pessimism seems as extreme. There is one key difference, however: sterling has already fallen 25% trade-weighted from its 2007 peak, whereas the euro is only down 10% trade-weighted from its 2008 highs.

**Do the polls matter? It depends on the horizon.** Over the next month, sterling will rise and fall on pre-election polls. But voting intentions are no guarantee of the outcome, as was learned in 1992. On election day, a Conservative win would be more positive than Labour continuity or a hung parliament. But sterling strength has its limits. Whoever wins in May will be faced with a dilemma: delay fiscal tightening and court a rating downgrade and a funding crisis, or front-load fiscal tightening and guarantee the slow growth/low interest rate environment that tends to weaken currencies of debtor countries. Given the election wildcard, prepositioning around May 6 is only justified where the risk premium is excessive. This cushion is more obvious in options than in cash, which argues for selling sterling vol on a spread basis (short 6-month GBP/USD versus USD/CHF vol) rather than cash.

## Commodities

**Commodities were flat last week** with precious and base metals outperforming. We remain overall **bullish**, but now **move most of our risk to base and precious metals**, our preferred sectors since early this year. We stay with a medium-term bullish view on oil, but have reduced our allocation this week, as prices are moving too fast relative to our expectations.

### Ten-year Government bond yields

	Current	Jun 10	Sep 10	Dec 10	Mar 11
United States	3.90	4.10	4.25	4.50	4.70
Euro area	3.17	3.30	3.45	3.60	3.90
United Kingdom	4.05	4.40	4.55	4.65	4.80
Japan	1.39	1.40	1.50	1.55	1.55
GBI-EM	6.90				7.70

### Credit markets

	Current	YTD Return
US high grade (bp over UST)	141	2.3%
Euro high grade (bp over Euro gov)	142	2.5%
USD high yield (bp vs. UST)	599	5.2%
Euro high yield (bp over Euro gov)	609	8.4%
EMBIG (bp vs. UST)	251	4.5%
EM Corporates (bp vs. UST)	292	5.1%

### 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	93.2	87	90	93	96
GBP/USD	1.54	1.51	1.58	1.54	1.50

### Commodities - quarterly average

	Current	10Q1	10Q2	10Q3	10Q4
WTI (\$/bbl)	85	77	82	85	90
Gold (\$/oz)	1163	1250	1400	1300	1200
Copper(\$/m ton)	7861	7350	8000	6800	6250
Corn (\$/Bu)	3.58	3.85	4.05	3.95	3.90

Source: J.P. Morgan, Bloomberg, Datastream

**Crude** prices are now above the \$80-85 range seen since early March and much closer to our year-end target of \$90. We still see reasons to be long oil, and also see upside risks to our price forecasts. Our final demand forecasts show strong growth, so the oil market is likely to keep tightening until the end of the year. Moreover, OPEC seems reluctant to release existing inventories into the market and is likely to react slowly to demand increases. The OPEC oil basket price is almost \$5 lower than WTI due to a widening in the spread, so the incentives to react are not there yet.

We prefer to **reduce allocation to oil** waiting for a correction as fundamental headwinds will be strong in coming weeks. We expect a severe weakening in refinery margins due to increased product inventories, temporarily reducing oil demand. A collapse in prices is, however, very unlikely as the medium-term demand outlook is supportive. The **path to \$90 remains in place**, but a return to the old \$80-85 range near term is more likely now. On the relative value side, we prefer Brent versus WTI and short gasoline and distillate cracks.



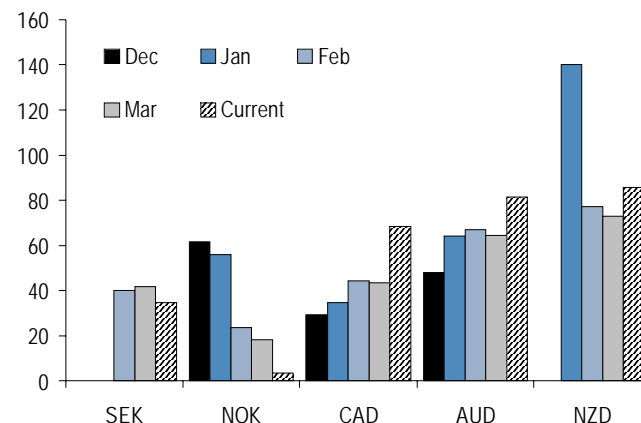
## AUD and NZD Commentary

- **High-beta currencies have diverged since October, largely reflecting shifts in market pricing relative to fundamentals, rather than trends in fundamentals alone. The divergence creates some scope for catchup by the laggards NZD, NOK and SEK.**
- **Near-term divergence likely will reflect more shifts in policy expectations. A late-May shift in RBNZ rhetoric could deal a body blow to NZD.**
- **AUD/USD extends into the medium term range highs as the medium term backdrop supports higher prices; NZD/USD confirms a short term low above the .7200 area.**
- The stars appear aligned for high-beta FX out-performance into 2H10. The economic data flow has highlighted the broadening of the global economic recovery from EM Asia, the US and Latin America to Europe and from a narrow inventory-driven manufacturing surge to broad-based growth including services. Finally, stirrings in labour markets have allayed concerns about the recovery's durability. Looking beyond current valuations, further shifts of interest rate expectations should be the key near-term driver of relative performance within the G10 high-risk currency group.
- Since early January 2010, rate hike expectations for Norway and New Zealand have fallen by 58 and 54 basis points relative to policy rate expectations for the Fed, consistent with NZD and NOK underperformance in the high-beta camp. Moreover, for the two outperformers, CAD and AUD, rate expectations rose by 39 and 33 basis points, respectively, relative to market views on the Fed, while expectations for the Riksbank moved roughly in tandem with expectations for the FOMC (Chart 1). CAD and NZD appear most susceptible to more repricing of policy rate prospects as the BoC and RBNZ fine-tune the language of their conditional commitments on rates. We expect that another hawkish tilt by the BoC and a soft-pedaling of policy tightening by the RBNZ could fuel another leg lower in NZD/CAD.
- In cash, stay short NZD/CAD (from 0.7280), opened February 19.

### Technical analysis

- A bullish shift is underway for AUD/USD as the break above the key .9225/55 resistance zone suggests a higher risk that prices can extend above the key .9407 November peak and medium term range highs. Note that Friday's late-rally pushed through the January peak in line with the potential bullish shift. Note that while the short term setup is overbought, the price action maintains an overall

Chart 1: Expected 2010 increase in the policy rate spread vs the US measured on the 8th of the month (bp), Dec 09-Apr 10



AUD/USD - Daily chart



bullish bias. In that regard, the .9165 and .8980 support levels will now maintain the short term upside bias for a test of the medium term range highs, if not higher. Note that we see upside targets closer to the .9600 area.

- While NZD/USD remains quite range-bound, the late-week outperformance suggests a growing risk that some catch up is finally due. The key test enters at the .7180/.7200 resistance zone which includes the recent range highs and the 61.8% retracement from the January peak. Above here and the .7246 downtrendline from the October '09 high would confirm a bullish shift and deeper correction into the .7400/.7443 area. Importantly, the .7000/.6960 support area will maintain the short term bullish bias.



## Global Central Bank Watch

	Official interest rate	Change from			Next meeting	Forecast next change	Forecast				
		Current	Aug '07 (bp)	Last change			Jun 10	Sep 10	Dec 10	Mar 11	Jun 11
Global	GDP-weighted average	1.30	-336				1.35	1.43	1.52	1.66	1.99
excluding US	GDP-weighted average	1.85	-250				1.92	2.04	2.17	2.39	2.69
Developed	GDP-weighted average	0.51	-360				0.52	0.54	0.59	0.70	1.04
Emerging	GDP-weighted average	4.44	-242				4.66	4.95	5.22	5.50	5.77
Latin America	GDP-weighted average	5.72	-321				6.13	6.59	7.28	7.65	8.15
CEEMEA	GDP-weighted average	4.25	-260				4.25	4.41	4.51	4.77	5.22
EM Asia	GDP-weighted average	4.04	-205				4.26	4.54	4.72	4.97	5.09
The Americas	GDP-weighted average	0.75	-484				0.79	0.88	0.98	1.04	1.42
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	0.75	1.25	1.50	1.75
Brazil	SELIC overnight rate	8.75	-325	22 Jul 09 (-50bp)	28 Apr 10	28 Apr 10 (+50bp)	9.75	10.75	11.75	12.25	12.25
Mexico	Repo rate	4.50	-270	17 Jul 09 (-25bp)	<u>16 Apr 10</u>	Oct 10 (+25bp)	4.50	4.50	5.00	5.00	5.75
Chile	Discount rate	0.50	-450	9 Jul 09 (-25bp)	<u>15 Apr 10</u>	<b>Jun 10 (+25bp)</b>	<b>0.75</b>	<b>1.50</b>	<b>2.25</b>	<b>3.75</b>	<b>5.00</b>
Colombia	Repo rate	3.50	-550	23 Nov 09 (-50bp)	30 Apr 10	1Q 11 (+50bp)	3.50	3.50	3.50	4.50	5.50
Peru	Reference rate	1.25	-325	6 Aug 09 (-75bp)	6 May 10	10 Jun 10 (+25bp)	1.50	2.25	3.00	3.75	4.50
Europe/Africa	GDP-weighted average	1.30	-323				1.30	1.33	1.39	1.64	2.09
Euro area	Refi rate	1.00	-300	7 May 09 (-25bp)	6 May 10	1Q 11 (+25bp)	1.00	1.00	1.00	1.25	1.75
United Kingdom	Repo rate	0.50	-500	5 Mar 09 (-50bp)	10 May 10	Nov 10 (+25bp)	0.50	0.50	0.75	1.00	1.25
Sweden	Repo rate	0.25	-325	2 Jul 09 (-25bp)	20 Apr 10	1Q 11 (+25bp)	0.25	0.25	0.25	0.50	0.75
Norway	Deposit rate	1.75	-275	16 Dec 09 (+25bp)	5 May 10	5 May 10 (+25bp)	2.00	2.25	2.50	2.75	3.25
Czech Republic	2-week repo rate	1.00	-175	16 Dec 09 (-25bp)	6 May 10	4 Nov 10 (+25bp)	1.00	1.00	1.25	1.75	2.25
Hungary	2-week deposit rate	5.50	-225	30 Mar 10 (-25bp)	26 Apr 10	31 May 10 (-25bp)	5.25	5.00	5.00	5.00	5.00
Israel	Base rate	1.50	-250	28 Mar (+25bp)	26 Apr 10	26 Apr 10 (+25bp)	2.00	2.25	2.75	3.25	3.75
Poland	7-day intervention rate	3.50	-100	24 Jun 09 (-25bp)	28 Apr 10	4Q 10 (+25bp)	3.50	3.50	3.75	4.50	5.00
Romania	Base rate	6.50	-50	29 Mar 10 (-50bp)	4 May 10	4 May 10 (-50bp)	5.75	5.50	5.50	6.00	6.50
Russia	1-week deposit rate	3.50	50	26 Mar 10 (-25bp)	Apr 10	Apr 10 (-25bp)	3.00	3.00	3.00	3.00	3.50
South Africa	Repo rate	6.50	-300	25 Mar 10 (-50bp)	13 May 10	1Q 11 (+50bp)	6.50	6.50	6.50	7.00	8.00
Switzerland	3-month Swiss Libor	0.25	-225	12 Mar 09 (-25bp)	Jun 10	Sep 10 (+25bp)	0.25	0.50	0.75	1.00	1.25
Turkey	Overnight borrowing rate	6.50	-1100	19 Nov 09 (-25bp)	<u>13 Apr 10</u>	<b>13 Apr 10 (+100bp)</b>	<b>7.50</b>	<b>8.50</b>	<b>8.50</b>	<b>8.50</b>	<b>8.50</b>
Asia/Pacific	GDP-weighted average	2.14	-130				2.26	2.40	2.50	2.63	2.70
Australia	Cash rate	<b>4.25</b>	-200	<b>6 Apr 10 (+25bp)</b>	4 May 10	4 May 10 (+25bp)	<b>4.50</b>	4.75	5.00	5.25	5.50
New Zealand	Cash rate	2.50	-550	30 Apr 09 (-50bp)	29 Apr 10	29 Jul 10 (+25bp)	2.50	<b>3.00</b>	<b>3.50</b>	<b>4.00</b>	<b>4.25</b>
Japan	Overnight call rate	0.10	-43	19 Dec 08 (-20bp)	29 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)	2Q 10	2Q 10 (+27bp)	5.58	5.85	6.12	6.39	6.39
Korea	Base rate	2.00	-250	12 Feb 09 (-50bp)	11 May 10	3Q 10 (+25bp)	2.00	2.25	2.50	2.75	3.00
Indonesia	BI rate	6.50	-200	5 Aug 09 (-25bp)	5 May 10	4Q 11 (-25bp)	6.50	6.50	6.50	6.50	6.50
India	Repo rate	5.00	-275	19 Mar 10 (+25bp)	20 Apr 10	<b>20 Apr 10 (+50bp)</b>	<b>5.50</b>	<b>6.00</b>	<b>6.00</b>	<b>6.50</b>	<b>6.75</b>
Malaysia	Overnight policy rate	2.25	-125	4 Mar 10 (+25bp)	13 May 10	13 May 10 (+25bp)	2.50	2.75	2.75	2.75	2.75
Philippines	Reverse repo rate	4.00	-350	9 Jul 09 (-25bp)	22 Apr 10	Jun 10 (+25bp)	4.25	4.75	5.00	5.00	5.00
Thailand	1-day repo rate	1.25	-200	8 Apr 09 (-25bp)	21 Apr 10	21 Apr 10 (+25bp)	1.75	2.00	2.00	2.00	2.00
Taiwan	Official discount rate	1.25	-188	18 Feb 09 (-25bp)	2Q 10	3Q 10 (+25bp)	1.25	1.50	1.75	2.00	2.25

**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			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	5.4	5.3	5.7	5.7	5.6	5.3	5.4	5.5	5.5	5.4	5.3	5.2	5.0
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 4Q, 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. Retail sales were very weak in February.
- **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; we forecast a 25% rise.
- The **RBA** was the first central bank in the G20 to tighten policy, with officials anxious about the lack of spare capacity. We expect another hike in May, driven partly by recent developments regarding the terms of trade.
- Having front-loaded the **policy support**, the government is winding back the fiscal stimulus, albeit slowly. 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	2.8	2.5	0.6	1.1	3.3	3.2	3.2	3.7	2.9	1.3	2.3	2.7	3.8
Private consumption	-0.6	2.4	1.6	1.6	3.5	3.4	2.5	1.5	1.1	2.0	1.0	1.5	2.0	3.5
Fixed Investment	-13.5	-1.0	4.6	-1.6	-6.2	-3.5	-5.4	5.3	5.5	5.7	2.2	4.1	6.0	7.3
Residential construction	-18.7	4.6	4.7	-9.3	-15.3	21.1	8.0	4.0	4.8	6.0	3.2	4.8	6.0	4.0
Other fixed investment	-12.4	-2.1	4.6	0.0	-4	-7.6	-8.0	5.6	5.6	5.6	2.0	4.0	6.0	8.0
Inventory change (NZ\$ bil, saar)	-1.7	0.8	0.4	-1.0	-0.7	0.2	0.3	0.2	0.2	0.2	0.1	0.1	0.1	0.1
Government spending	1.5	2.2	1.7	-5.0	2.4	3.6	3.2	2.4	1.6	2.4	0.9	3.2	0.8	0.2
Exports of goods & services	0.0	7.2	9.0	19.8	0.7	-3.4	10.0	12.0	11.0	10.0	8.0	7.0	10.0	8.0
Imports of goods & services	-15.2	8.5	7.1	-10.3	6.2	26.4	5.0	8.0	5.0	8.0	5.0	8.0	9.0	9.0
Contributions to GDP growth:														
Domestic final sales	-5.0	1.4	2.3	0.6	-0.4	1.7	0.8	2.5	2.1	3.0	1.2	2.5	2.7	3.8
Inventories	-2.5	1.9	-0.3	-9.0	3.3	11.1	0.9	-0.4	-0.2	-0.6	-0.8	0.2	-0.2	0.5
Net trade	5.9	-0.5	0.5	9.7	-1.7	-8.8	1.4	1.0	1.8	0.5	0.9	-0.4	0.2	-0.4
GDP deflator (%oya)	1.9	1.3	2.2	2.0	2.7	0.1	-0.2	1.0	1.8	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)	2.5	-2.2	-4.1	0.8	0.6	0.2	-0.5	-0.4	-0.6	-0.7	-0.8	-1.0	-1.1	-1.3
Current account (NZ\$ bil, sa)	-5.6	-20.2	-24.7	-0.4	0.0	-3.1	-1.2	-4.3	-5.4	-5.4	-5.1	-5.2	-5.9	-5.3
as % of GDP	-3.1	-10.8	-12.6	-0.9	0.1	-6.9	-9.4	-11.7	-11.4	-10.6	-12.2	-10.9	-13.3	-13.8
Yield on 90-day bank bill (%)*	3.0	3.1	4.4	2.8	2.8	2.8	2.7	2.8	3.3	3.8	4.3	4.4	4.5	4.5
10-year bond yield (%)*	5.5	5.9	6.1	5.7	5.7	5.9	5.7	6.0	6.0	6.1	6.1	6.1	6.0	6.0
US\$/NZ\$*	0.64	0.75	0.70	0.60	0.68	0.73	0.73	0.76	0.75	0.74	0.72	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 at a healthy clip of 0.8%q/q in 4Q, driven again by firm private consumption. Inventories, though, were not the drag on growth we expected. In fact, inventories were built up by NZ\$172 million, after three quarters of run downs.
- **Business confidence** is elevated and investment plans firms. Investment will, though, 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.** The RBNZ has said that the policy stimulus may start to be removed “around the middle of 2010” but the string of weaker than expected data has diminished the risk of a June move.
- **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.
- Managing **inflation expectations** will be a growing challenge for the RBNZ, given the July 1 introduction of the amended ETS and a prospective lift to the GST on October 1.

## Australia and New Zealand economic calendar

Monday	Tuesday	Wednesday	Thursday	Friday
<b>12 Apr</b> <b>Australia:</b> Housing finance approvals (11:30 am) Feb <u>-2.0 %m/m, sa</u> <b>New Zealand:</b> QVNZ house prices Mar	<b>13 Apr</b> <b>Australia:</b> NAB bus. Confidence (11: 30 am) Mar	<b>14 Apr</b> <b>Australia:</b> Westpac consumer confidence (10: 30 am) Apr <u>-3.0 %m/m, sa</u> <b>New Zealand:</b> Retail sales (10:45 am) Feb <u>0.3 %m/m, sa</u>	<b>15 Apr</b> <b>New Zealand:</b> Business NZ PMI (10:30 pm) Mar	<b>16 Apr</b>
<b>19 Apr</b>	<b>20 Apr</b> <b>New Zealand:</b> CPI (10:45 am) 1Q	<b>21 Apr</b> <b>Australia:</b> Westpac leading index (10: 30 am) Feb	<b>22 Apr</b> <b>Australia:</b> New motor vehicle sales (10: 30 am) Mar	<b>23 Apr</b> <b>Australia:</b> Export, Import price index (12:30 pm) 4Q <b>New Zealand:</b> Visitor arrivals (10:45 am) Mar Credit card spending (2:00 pm) Mar
<b>26 Apr</b>  <i>Holiday Australia</i>	<b>27 Apr</b> <b>Australia:</b> PPI (11:30 am) 1Q Feb	<b>28 Apr</b> <b>Australia:</b> CPI (11:30 am) 1Q <b>New Zealand:</b> NBNZ business confidence (2: 00 pm) Apr	<b>29 Apr</b> <b>New Zealand:</b> RBNZ official cash rate (9:00 am) Apr Trade balance (10:45 am) Mar	<b>30 Apr</b> <b>Australia:</b> Pvt. Sector credit (11:30 am) Mar
<b>3 May</b> <b>Australia:</b> RBA cash target (3:30 pm) May HPI (11:30 am) 1Q <b>New Zealand:</b> ANZ commodity price (2:00 pm) Apr	<b>4 May</b>	<b>5 May</b> <b>Australia:</b> Building approvals (11:30 am) Mar <b>New Zealand:</b> Unemployment rate (10:45 am) 1Q	<b>6 May</b> <b>Australia:</b> Retail sales (11:30am) Mar	<b>7 May</b> <b>Australia:</b> Quarterly monetary policy statement

Highlighted data are scheduled for release on or after the date shown. Times shown are local.

## Global Data Diary

Week / Weekend	Monday	Tuesday	Wednesday	Thursday	Friday
12 - 16 April	12 April	13 April	14 April	15 April	16 April
China • M2 (Mar)	Canada • BoC Business Outlook Survey (1Q) • BoC Loan Officer Survey (1Q)  Mexico • IP (Feb)  Japan • BoJ MPM minutes	France • CPI (Mar)  Germany • CPI final (Mar)  Turkey • CBRT mtg: +100bp  United Kingdom • Trade balance (Feb)  United States • Import prices (Mar) • International trade (Feb) • Bernanke speech	Brazil • Retail sales (Feb)  Euro area • IP (Feb)  Japan • Shirakawa speech  Russia • IP (Mar)  Singapore • GDP adv (1Q)  United States • Beige book • Bus inventories (Feb) • CPI, Retail sales (Mar) • Bernanke testifies	Chile • BCCh mtg: No Chg  China • GDP (1Q) • CPI, FAI, Retail sales, IP (Mar)  Japan • Reuters Tankan (Apr) • IP final (Feb) • Shirakawa speech  United States • IP (Mar) • NAHB survey (Apr) • NY Fed bus surv (Apr) • Philly Fed bus surv (Apr)	Euro area • Foreign trade (Feb) • HICP final (Mar)  Mexico • Banxico mtg: No Chg  United States • Consumer sent (Apr) • Housing starts (Mar)
19 - 23 April	19 April	20 April	21 April	22 April	23 April
Korea • GDP (1Q)		Canada • BoC mtg: No Chg  India • RBI mtg: +50bp  Germany • ZEW survey (Apr)  Taiwan • Export orders (Mar)  United Kingdom • CPI (Mar)  Sweden • Riksbank mtg: No Chg	Japan • BoJ loan officers survey (1Q)  Thailand • BoT mtg: +25bp  United Kingdom • MPC minutes • Labor mkt report (Mar)	Euro area • PMI flash (Apr)  France • INSEE survey (Apr)  Japan • Trade balance (Mar)  Philippines • BSP mtg: No Chg  United States • PPI (Mar) • Existing home sales (Mar) • FHFA HPI (Feb)	Canada • CPI (Mar)  Euro area • IP new orders (Feb)  France • Consumption of mfg goods (Mar)  Germany • IFO survey (Apr)  Taiwan • IP (Mar)  United Kingdom • GDP advance (1Q) • Retail sales (Mar)  United States • Durable goods (Mar) • New home sales (Mar)

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