

## Australia and New Zealand - Weekly Prospects

### Summary

- Events in **Australia** last week highlighted the pressing need for the RBA to tighten policy. Employment surged (again), retail spending grew (albeit at a more sluggish pace than before), job advertisements rose, and the offshore risks seemed to recede further towards the tail of the probability distribution. RBA officials, though, discounted the evidence of domestic strength and unexpectedly left the cash rate steady. We, like most punters, had expected a rate hike last Tuesday. It seems, though, that RBA Board members were swayed by the lingering offshore uncertainty. Our view is that they will not be able to discount the unequivocal domestic strength—and the risk this poses to an already worrying inflation outlook—for too much longer. Absent an abrupt change of fortunes, the next rate hike probably will be delivered on Cup Day on the first Tuesday in November. This week should see healthy bounces in consumer (especially) and business confidence, and another rise in demand for home loans (today).
- The data flow in **New Zealand** slowed to a trickle over the last fortnight, but what has come to hand has disappointed. The Quarterly Survey of Business Opinion last week showed firms turned pessimistic after a year of sustained optimism. With firms less upbeat about future prospects and profitability weak, firms have reined in investment and hiring intentions. Pricing intentions are steady despite the recent GST-hike, as persistently weak domestic demand means firms have little to no pricing power. Against this backdrop, and with inflation expectations anchored and inflation remaining comfortably within the RBNZ's target range, there appears little urgency for further policy tightening. Indeed, data this Thursday on house prices and retail sales should confirm that domestic demand has weakened further, reinforcing our call for Governor Bollard to sit on the policy sidelines until March next year.
- Although markets are responding to the commitment by the **Fed and other central banks** to boost nominal growth, the flow of recent data does not suggest that this lift is at hand. Global manufacturing growth looks like it will continue to slow in the coming months, and the contrast between the bounce in our industrial metals price index and activity indicators is striking. Similarly, US equity prices are rising and credit spreads are narrowing against the backdrop of a September employment report that points to continued tepid growth. We are comfortable with our view that the seeds for a reacceleration in global growth are being planted. However, progress is likely to proceed slowly and unevenly. Resilience in private sector behaviour must be maintained and the monetary policy transmission mechanism needs to function to stay on the path.
- The Communist Party of **China** will focus its October 15-18 annual meeting on the 12th five-year plan for China's economic and social development, which begins in 2011. The GDP growth target for the next five years will likely remain unchanged from the 7.5% set in the previous five-year plan. However, emphasis will be given to the composition of growth rather than its magnitude. There will be a greater reliance on domestic consumption given that the medium-term outlook for the G-3 economies, and hence China's export sector, remains cloudy.

### This week's highlight

The Aussie consumer confidence reading Wednesday. Consumers received an unexpected interest rate reprieve last week, and would have enjoyed the bounce in employment. The confidence index should bounce 6%.

October 11, 2010

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### Forecast changes:

None this week.

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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, October 11	11.30am	Aust. housing finance (%m/m, Aug.)	1.5	1.0	1.7
Tuesday, October 12	11.30am	NAB business confidence (Index, Sep.)	14	na	11
Wednesday, October 13	8.45am	NZ food prices (%m/m, Sep.)	na	na	-0.1
Wednesday, October 13	11.30am	WMI consumer confidence (%m/m, Oct.)	6.0	na	-5.0
Thursday, October 14	8.00am	REINZ house prices (%m/m, Sep.)	-1.0	na	0.3
Thursday, October 14	8.00am	REINZ home sales (%oya, Sep.)	na	na	-27.1
Thursday, October 14	8.45am	NZ retail sales (%m/m, Aug.)	0.0	0.3	-0.4
Thursday, October 14	8.45am	NZ retail sales ex auto (%m/m, Aug.)	-0.2	0.3	-0.1
Thursday, October 14	9.30am	NZ Business PMI (Index, Sep.)	na	na	49.3

(a) Australian Eastern Standard Time.

(b) Consensus based on Bloomberg survey.

### Australia

**Housing finance (%m/m, Aug.)** - Housing finance commitments likely rose 1.5% m/m in August, after posting similar-sized gain in July (+1.7%). The seasonal pattern in recent years has been for loan volumes to underperform in August, but we expect a decent number today, despite a small fall in house prices over the month. In the absence of many first home buyers, who now effectively are priced out of the market, we will be watching the involvement of the investor cohort carefully in coming months as a gauge of price momentum.

**NAB business confidence (Index, Sep.)** - The business confidence reading should show a decent gain. Among the factors contributing to the improvement will be the fact that the election impasse has been removed, the RBA was on hold, and global economic conditions appear to be stabilizing. As such, we expect the headline confidence index to rise to +14 from +11—the improvement would be larger had the index not spiked in August.

**Westpac-MI consumer confidence (%m/m, Oct.)** - We expect a 6% m/m bounce in consumer confidence in October, owing mainly to the RBA's surprise decision last week to leave the cash rate unchanged. The RBA failed to deliver on the rate hike expected by the majority of market economists, and flagged in a steady stream of media reports in the weeks ahead of the RBA's October Board meeting. Solid employment gains (particularly in September), high AUD, and recent equity market gains also will have helped.

## Data previews - Cont'd.

### New Zealand

**REINZ house prices (%m/m, Sep.)** - Demand for property has been drying up as more cautious households choose instead to pay down debt. We suspect, therefore, that the REINZ house price series will post a 1.0% m/m decline in September. House prices increased modestly in the August month (to NZ\$350,000 from NZ\$349,000), but house price growth over the year pulled back to just 0.9% oya. On-year-ago growth in September should hold close to that level at 1.0%. Property sales also will remain near decade lows and the number of days taken to sell a house probably rose.

**Retail sales (%m/m, Aug.)** - After falling in July, retail sales probably were flat in August. Ex-auto sales also will have remained weak, falling 0.2% over the month. Significant discounting among retailers continue to weigh down retail sales in value terms, while sales volumes also likely are weaker owing to more cautious consumer behaviour. With employment and wage growth subdued, we suspect that this trend will continue. This will mean that households will use the windfalls from their personal income tax cuts (effective October 1) to pay down debt, or save, rather than spend.

## Australia

- **RBA surprises with cautious approach**
- **Another huge employment gain**
- **Consumer confidence to rebound this week**

The big news in Australia last week was that the RBA surprised the market by leaving the cash rate unchanged at 4.5%. Market economists had been all but unanimous in believing that the cash rate would rise last week—recent official commentary had hinted that a hike was imminent. Instead, RBA officials appear to have erred on the side of caution by opting not to hike, at least not yet. The statement announcing the RBA's surprise decision indicated that the lingering uncertainties offshore, and in financial markets, are more than offsetting more established concerns about the likely upside risks to inflation stemming from the clear strength of the domestic economy.

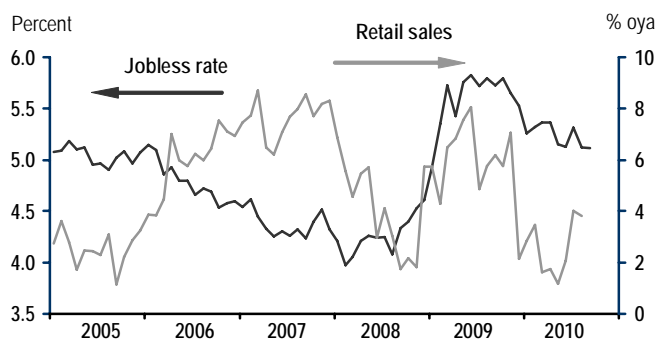
Indeed, just two days after the RBA's decision, Australia printed another huge monthly employment gain, the second in a row. The economy added 50,000 jobs last month, all of them full-time, although the jobless rate was unchanged, at 5.1%, owing to a rise in new entrants to the labour market in search of work. We suspect RBA officials will not be able to diminish, at least in relative terms, the compelling message from the robust domestic story for too much longer. We, like everyone else, were forecasting a hike last week; it now seems likely, though, that the next hike will come at the RBA's early November Board meeting.

### RBA officials in cautious mood

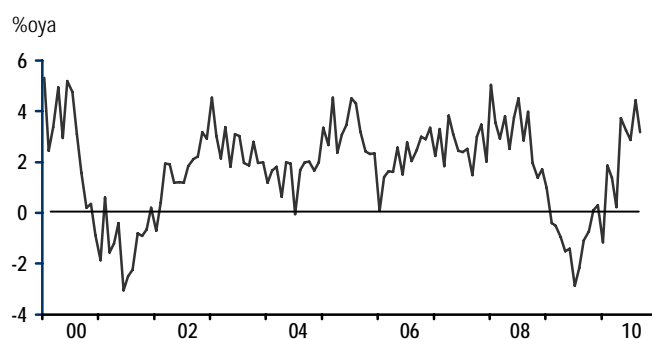
RBA officials now have left the cash rate steady for five straight months, having earlier hiked six times since October 2009. The main reason for caution has been the uncertainties offshore, both in the major economies and in financial markets. Indeed, the domestic story has evolved pretty much in line with what RBA forecasts anticipated—the terms of trade has soared, exports are booming, and the labour market has firmed. In our view, if not for the offshore troubles, the RBA probably would have hiked at least one more time in the past few months.

It was a similar theme last week. Local market economists, including ourselves, expected a quarter-point hike on Tuesday. Instead, the RBA opted for caution and left the cash rate steady at 4.5%. Once again, the reasoning betrayed by the RBA's short statement announcing the decision is that the offshore uncertainties have prevailed. Indeed, the offi-

Australia: retail sales and unemployment rate



Australia: hours worked



cial commentary on the Australian economy was even more upbeat than before. RBA officials probably also want to see what the 3Q inflation print looks like before adjusting policy; the inflation print is due the last week of October.

The problem now is that, by waiting, RBA officials will face an even more complicated decision in early November. Not only is the 3Q inflation print now "in play," but other central banks may be actively engaging in another round of quantitative easing—the Fed and the Bank of England, for example, will announce policy changes, if any, the week before the RBA decision. As we have said for some time, it would be awkward for the RBA to hike while other central banks are moving policy in the opposite direction. That said, the RBA not hiking before the end of the year would risk inflation becoming even more of a problem next year, necessitating an even more assertive policy response than we currently forecast.

### Other official comments follow same path

A speech Friday by the RBA's Deputy Governor Ric Battellino followed a similar path to the policy announcement earlier in the week. The tone of Mr. Battellino's comments on the Australian economy, in particular, was upbeat.

The speech highlighted that the economy already is operating at full capacity. It follows, then, that if the economy evolves in line with the RBA's current thinking, interest rates will have to rise. In the context of the announcement after the RBA's Board meeting earlier in the week, though, none of this is a revelation.

The next official commentary (apart from the release of the minutes from last week's Board meeting in two weeks' time) is a speech on October 25 by RBA Governor Glenn Stevens, two days before the next CPI release. With most of the data on the domestic economy still printing on the firmer side of market (and official) expectations, the theme of domestic strength counterbalanced by offshore weakness is unlikely to have changed too much by the time the Governor steps up to the microphone. One thing he may have to do is explain in more convincing detail why the RBA did not take the bolder option of hiking the cash rate last week.

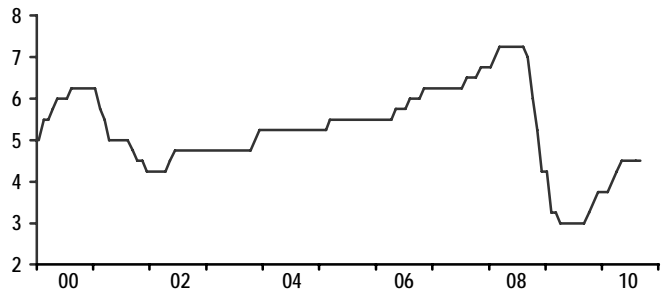
### Another huge Aussie employment gain

Another month, another huge gain in employment in Australia. This time (September), the job gain was a massive 49,500, more than even the most upbeat forecaster in the local consensus. This follows a similar (upwardly revised) gain in August, and means that Australia has added 270,000 jobs in CY2010. All of the jobs "created" in September were full-time; part-time employment slipped a little. It was a similar theme in August, although the fall in part-time employment back then was larger. Hours worked, though, dipped 0.1% m/m, perhaps reflecting the fact that existing workers may have reached their limit of working hours. Employees have rebuilt the hours they lost during the downturn, but now may be content that they are working sufficient hours to make ends meet. If true, and employees have had their fill, employers will have to keep hiring in order to boost output.

Without an unanticipated rise in the participation rate to 65.6%, the jobless rate would have dropped below 5% in September. As it is, the jobless rate was steady at 5.1% (J.P. Morgan and consensus: 5.1%). This level of unemployment effectively is consistent with full employment. Wage pressures are starting to emerge as the recent outsized gains in employment drain the already shallow pool of available labour. If the current rate of job gains is extended, a drop in the jobless rate below 5% probably is closer than we currently forecast.

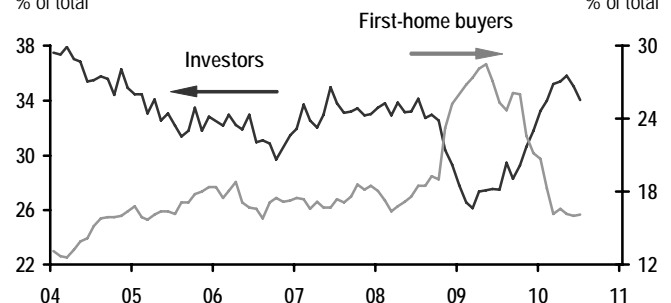
### Australia: RBA cash rate target

% per annum, end of period



### Australia: housing finance

% of total



### Consumers cautious, but still spending

It was not all "beer and skittles" in Australia last week; the news on consumers was more sobering, although the reference month for retail sales predated the employment surge. While retail sales grew 0.3% in August—in line with the J.P. Morgan forecast—this was a step down from the 0.7% gain in July. Discretionary spending unexpectedly held up better than spending on staples in July, with spending in cafes and restaurants, in particular, outperforming spending in other sectors. On the weight of this evidence, RBA officials may be getting some of the caution they have been asking households to exercise.

With interest rates holding steady in subsequent months, though, and with the job market firming, this caution by households may be short-lived. Confidence almost certainly will bounce following the RBA's surprise "on hold" decision (see below), and, importantly, household income is set to rise at a decent clip. The savings rate rose sharply in 2Q, but probably is drifting down again.

### This week: home loans and confidence

The week ahead in Australia sees important data releases on business and consumer confidence, and the latest read-

ing on home loans. With the RBA surprising by leaving the cash rate steady, consumer confidence is likely to bounce, particularly given last week's surge in employment. High AUD and recent equity market gains also will have helped. Consumer confidence unexpectedly dropped in September, but this loss is likely to be at least regained this week. The business confidence reading is for the month of September, but also is likely to show a decent gain. Among the factors contributing to the improvement will be the fact that the election impasses have been removed, the RBA also was on hold last month, and global economic conditions appear to be stabilizing. As such, we expect the headline confidence index to rise to 11 from 14—the improvement would be larger had the index not spiked in August.

Housing finance commitments likely increased 1.5% m/m again in August, after posting a welcome gain in July (+1.7%). Domestically, the same arguments for a renewed pickup in loan demand that were present in the previous month can be made for August. That is, employment gains were solid and the RBA's official rate pause continued, but global uncertainties also ramped up a notch, which might have led some households to hold off on adding debt. Intuitively, the reasons behind the RBA's recent policy pause may be a bit prosaic to overcome the direct financial benefit of interest rates being on hold, so we expect the latter effect to dominate. But, taken in combination with already slowing momentum in the housing market, evidenced by lower housing transactions and the 0.2% m/m drop in house prices over the month, uncertainty probably was sufficiently high to prevent a more solid rise in loan activity in August.

## Data releases and forecasts

### Week of October 11 - 15

Mon Oct 11 11:30am	Housing finance approvals: owner occupiers Number of loans, sa	May	Jun	Jul	Aug
	%m/m	2.9	-3.2	1.7	<u>1.5</u>
	%oya	-25.1	-28.3	-25.0	<u>-21.9</u>
Tue Oct 12 11:30am	NAB monthly business survey % balance, sa	Jun	Jul	Aug	Sep
	Business confidence	4	2	11	<u>14</u>
Wed Oct 13 10:30am	WMI consumer confidence survey 100=neutral, sa	Jul	Aug	Sep	Oct
	%m/m	11.1	5.4	-5.0	<u>6.0</u>

## Review of past week's data

### ANZ job advertisements

	Jul	Aug	Sep
%m/m sa	1.4	2.6	<u>1.5</u> 0.7

### Retail trade

	Jun	Jul	Aug
%m/m sa	0.4	0.7	<u>0.3</u>
%oya sa	2.0	4.0	<u>3.8</u>

### Trade balance

	Jun	Jul	Aug
A\$ mn, sa	3438	<del>1888</del> 1743	<u>3500</u> 2346

### RBA cash rate announcement

No change delivered. See main text.

### Labor force

	Jul	Aug	Sep
Unemployment rate (% sa)	5.3	5.1	<u>5.1</u>
Employed (000 m/m sa)	25	31	<u>15</u> 49.5
Participation rate (% sa)	65.5	65.4	<u>65.4</u> 65.6

## New Zealand

- NZ retail sales to be soggy this week
- Business outlook softened further
- GDP growth to be hampered in 2H

### A quiet week in the Shaky Isles

In contrast to Australia, the data flow in New Zealand has slowed to a trickle over the past two weeks, although what has come to hand has disappointed. The Quarterly Survey of Business Opinion (QSBO) last week showed businesses turned pessimistic after a year of sustained optimism. With firms less upbeat about future prospects and profitability weak, investment plans and hiring intentions have been reined in. Pricing intentions remain steady, despite the October 1 GST hike, as persistently weak domestic demand has meant that firms have little to no pricing power.

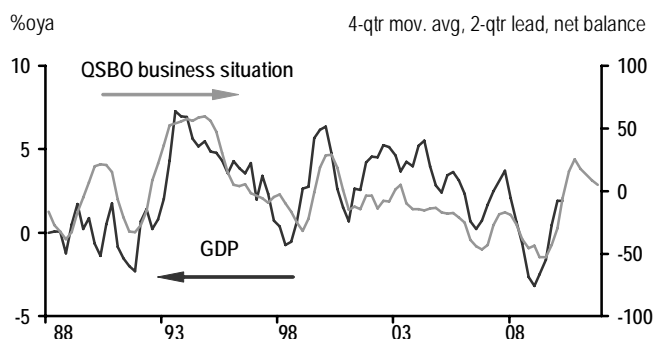
Against this backdrop, and with inflation expectations anchored and inflation comfortably within the RBNZ's target range, there is little urgency for further tightening in New Zealand. Indeed, in the QSBO survey, firms' expectations of higher interest rates eased in 3Q. "Only" 65% of firms surveyed expected that interest rates would be higher over the next year, down from 88% in the previous survey. Our forecast is for the RBNZ to deliver the next hike in March 2011, although the risks are skewed toward a later move, should the data continue to disappoint.

### Business confidence unsteady in NZ

The QSBO signaled that while the recovery under way continues, it is advancing at a sharply slower pace than firms expected when last surveyed three months ago. The headline reading eased back from +18 in 2Q to +6 (J.P. Morgan: +12) in 3Q, meaning that only a net 6% of firms surveyed expect the economy to improve in the next six months.

Indeed, after two solid quarters of GDP growth, with the economy having expanded 1.0%q/q in 4Q and 0.5% in 1Q, economic growth moderated in the June quarter, and will likely remain subdued in the final six months of the year. The 2Q GDP data (which printed a mere 0.2%q/q increase) were the latest in a string of disappointing data released providing evidence the recovery has stalled. With households indicating more austerity, and taking into account the recent earthquake in the Canterbury region, we pushed our 3Q GDP growth forecast 0.2%-pt lower.

New Zealand: GDP and QSBO expectations for the economy



### NZ retail sales to have flatlined in August

This week, we forecast flat retail sales in August, after a sharp fall in July. Ex. autos sales probably will have remained weak, falling 0.2%.m/m The pull-forward of consumer spending ahead of the GST hike has largely run its course, but discounting and the deleveraging of household balance sheets are pulling the headline in the other direction.

### Data releases and forecasts

Week of October 11 - 15

Mon Oct 11	QVNZ house prices %, median	Jun	Jul	Aug	Sep
	%oya	5.2	4.1	3.1	—
Thu Oct 14 10:45am	Retail trade Sa	May	Jun	Jul	Aug
	%m/m	0.4	1.0	-0.4	<u>0.0</u>
	%oya	2.3	3.2	3.1	<u>1.9</u>
Thu Oct 14 10:30am	Business PMI Sa	Jun	Jul	Aug	Sep
	Index	55.4	50.3	49.3	—
	%oya	20.1	0.9	1.1	—

### Review of past week's data

#### ANZ commodity price series

Nsa	Jul	Aug	Sep
Index-world prices (%m/m)	-0.8	-1.4	— 2.9
Index-NZD (%m/m)	-2.8	-1.5	— 1.2

#### NZIER QSBO

% balance of respondents	1Q10	2Q10	3Q10
Headline index	22	18	<u>12</u> 6

## Global Essay

- **Markets rise with central bank shift, but lift in growth will take time**
- **No war: a managed dollar slide is the norm among EM policymakers**
- **Commodity prices are increasing broadly and should raise EM inflation**

### Comprehensive easing

Over the past two months, the Federal Reserve has laid the foundation for a new round of large scale asset purchases (LSAPs). It was the Bank of Japan, however, that led the latest round of easing last week by announcing a wide ranging asset purchase plan. While the BoJ actions reflect domestic considerations, its decision was influenced by the Fed. With the latest economic news reinforcing the case for the Fed and BoE to join the BoJ at their November meetings, shifts in policy by these large central banks—and the notable absence of a response by the ECB—are reverberating through the global policy and financial market landscape.

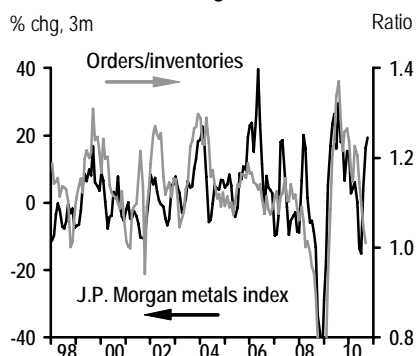
We have emphasized that the most powerful element of the Fed’s policy shift is its signal of intent. The FOMC is entering into something more extensive than an insurance policy against the recent growth disappointment. They are publicly committing to reflate the US economy by delivering sustained above-trend growth sufficient to raise the rate of inflation. It is this commitment, and not their choice of instruments, that explains financial market movements since Chairman Bernanke’s Jackson Hole Speech. They have succeeded in pushing the dollar and real interest rates lower, alongside rising inflation expectations and equity prices—checking off all the items central bankers look for when they are engaged in reflationary policy.

In this regard, the comparison between the Fed and BoJ is instructive. The BoJ moved on multiple fronts, cutting its policy rate and announcing the purchase of a range of assets, including JGBs, corporates bonds, ETFs, and J-REITs. While the BoJ is casting a far wider net in its asset purchase plan, the signal it is sending about policy commitment is, at this stage, more tentative. The total amount of the BoJ’s purchase of unconventional assets is just ¥5 trillion, and the motivation for action is partly to respond to the mounting pressure from the government and lawmakers. In addition, the BoJ was equivocal in its commitment to ending deflation, noting that its goal of price stability would be sustained “on the condition that no problem will be identified in examining risk factors, including the accumulation of financial imbalances.” Governor Shirakawa did emphasize in his press conference that the BoJ could expand the facility in the future. Given our expectations of a contraction in Japanese growth into year-end, the case for further easing looks good. However, it was the stronger signal from the Fed that was dominant in currency markets as the yen ended this week strengthening against the dollar (see “BoJ’s comprehensive easing involves real asset purchases” in *GDW*).

### You can lead a market to water

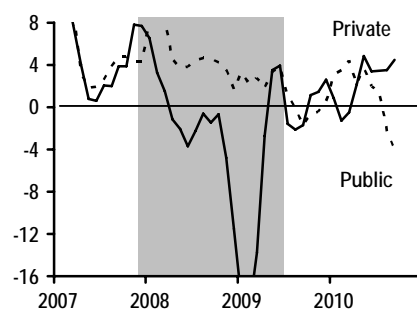
Although markets are responding to the commitment by the Fed and other central banks to boost nominal growth, the flow of recent data does not suggest that this lift is at hand. Global manufacturing growth looks like it will continue to slow in the coming months, and the contrast between the bounce in our industrial metals price index and activity indicators is striking. Similarly, US equity prices are rising and credit spreads are narrowing against the backdrop of a September employment report that points to continued tepid growth. We are comfortable with our view that the seeds for a reacceleration in global growth are being planted. However, progress is likely to proceed slowly and unevenly. Re-

Industrial metals and global PMI



US wage and salary income

% ch saar over 3m, Sep fcst based on payroll report





silence in private sector behaviour must be maintained and the monetary policy transmission mechanism needs to function to stay on the path. This week's key reports—US retail sales and international trade for China and the US—are anticipated to be encouraging, showing solid gains in US spending and trade flows unwinding the midyear surge of Chinese exports.

### No accord, just a managed dollar slide

As the Fed moves most aggressively toward another round of LSAPs, a weaker dollar is a natural by-product of this policy. The falling dollar is causing headaches for policymakers elsewhere, particularly given the still slow ascent of the Chinese renminbi. The idea of coordinating currency policy will be a topic of discussion at the various G-20 gatherings planned in the coming weeks. However, it is highly unlikely that there will be any formal agreement. What might emerge is an informal agreement in which countries are allowed to manage the dollar decline imposed by a renewed Fed easing cycle.

For the vast majority of countries, the first step in this management process entails a pause in policy rate normalization. Just last week, seven central banks met and not one tightened. This includes central banks in Australia and Peru, each of which was widely expected to raise rates. In addition, an increasing number of central banks are intervening in FX markets in a more overt effort to limit appreciation of their currencies. Our FX strategists estimate that Japan spent \$20 billion on intervention in FX markets in September and emerging-market governments spent about \$50 billion. By comparison, from mid-2003 to mid-2004, EM governments accumulated reserves at a similar monthly pace, while Japan bought \$60 billion in some months to counter inflows.

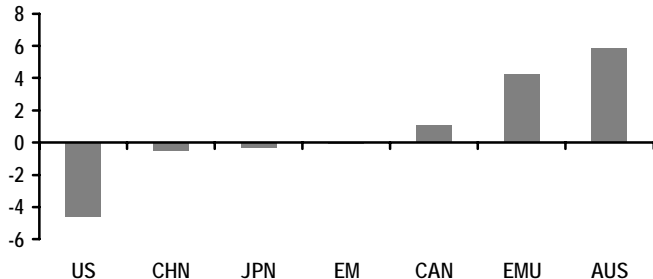
There will also be pressure placed on China to speed the pace of renminbi appreciation. The renminbi is up 2% since the beginning of September and as China calibrates its currency policy with one eye on the value of its trade-weighted basket, a sliding dollar will likely be support a faster past of appreciation. However, a meaningful shift in China's currency policy is not in the cards. Some countries may opt for transactions taxes or even capital controls—underscored last week by announcements by Brazil and Korea. However, the tolerance for these actions by the global community is likely to be limited.

### Latin inflation risks rising

With net trade projected to reduce 2010 GDP growth in the region by 1.8%-point, Latin American governments are ac-

### Real effective exchange rate

% change since Aug 27, 2010



tively working to dampen their currency appreciation. This week, Brazil doubled the IOF tax on foreign investment in fixed income market to 4%. Chilean authorities also expressed currency concerns in a “verbal intervention,” while Peru's central bank surprised markets by deciding to pause its rate hiking cycle.

Despite the desire to protect export sectors, the recent sharp rise in commodity prices is providing policymakers with motivation for greater flexibility. Since June, the J.P. Morgan agricultural commodity price index is up 20% relative to the Latin America currency index. Given the relatively high weight of food in the region's consumer basket, the pipeline inflation pressures are thus significant absent a material rise in currencies.

Inflation risks vary across the region. Brazil and Mexico each posted a significant acceleration in September CPI mainly due to higher food inflation. However, Mexico is still growing below trend and underlying inflation is tame. The rise in food prices will likely be viewed as transitory by Banxico. By contrast, Brazil's growth has been much stronger, with mounting evidence of overheating (particularly in the labour market) and with core inflation already 50bp above the COPOM's target midpoint. This means that the pass-through from food inflation could prompt higher underlying price pressures than currently estimated by the authorities.

### USD weakness less concern to CEE

The CEEMEA currencies also appreciated sharply against the USD in recent weeks. However, the strengthening has largely been one of USD weakness and so relative moves against the EUR—the region's larger trading partner—have been more modest. Indeed, those in CE-4 (Czech Rep., Hungary, Poland, Romania) have been largely unfazed by the USD weakness as most trade transactions in these countries are based in EUR. In Russia, the CBR has a mechanism to keep the ruble in a tight range against a basket of USD and EUR, but the Bank has not faced any need to use this re-

cently. Moving further out from central Europe, the pressures are somewhat larger. In Turkey, the CBRT does not sound concerned about the level of the lira but has changed its daily dollar purchasing auction system to allow higher purchases. In Israel, the BOI has been buying dollars since spring 2008 and has doubled its FX reserves during this time. In South Africa, the SARB has stepped up its FX purchases since July and may ease its policy rate soon along with relaxing outward bound foreign exchange controls.

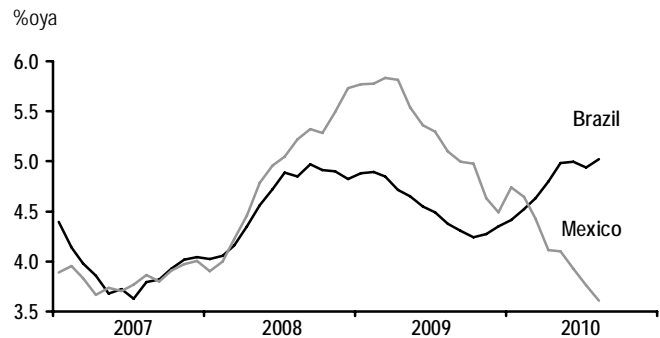
### High-yield Europe releases fiscal budgets

According to the 2011 fiscal budgets now being released in Europe, governments across the periphery are fine tuning their budget projections for this year and clarifying objectives for next year. Last week, Greece nudged up its estimated fiscal positions for this year and next, with projected deficits to be slightly less than previously anticipated. Still, despite the considerable progress, the EC/IMF program anticipates that Greece will need to achieve a primary surplus of close to 6% of GDP in 2014, a long way from the expected 2011 primary deficit of 0.2%.

Ireland is due to present an updated four-year fiscal plan in November, followed by the publication of the 2011 budget on December 7. The recent announcement by the Finance Minister that this year's headline deficit could reach 32% of GDP highlighted the direct fiscal cost of the banking crisis. The capital injections to banks amount to almost 20% of GDP this year. Excluding these banking related costs, the underlying fiscal deficit is tracking the government's objective. Nevertheless, there is the issue of whether recent market pressure will prompt the government to move its budgetary objectives in a more aggressive direction. At the moment, the government's plans anticipate a decline in the underlying deficit from 11.6% of GDP this year to 10% of GDP next year. It is possible that the government will announce a narrower objective for next year.

Portugal is due to release its 2011 budget on October 15 but market pressure has already forced the government to an-

Core consumer prices



nounce additional measures to ensure that this year's budgetary objective is achieved. These measures involve the freezing of public expenditure between now and year-end and frontloading some of the tightening measures anticipated for next year. In Spain, the 2011 budget simply provided further detail on how the deficit will be reduced next year. It left unchanged the target for the deficit and the underlying growth assumption.

### China's new 5-year plan to push demand

The Communist Party of China will focus its October 15-18 annual meeting on the 12th five-year plan for China's economic and social development, which begins in 2011. The GDP growth target for the next five years will likely remain unchanged from the 7.5% set in the previous five-year plan. However, emphasis will be given to the composition of growth rather than its magnitude. There will be a greater reliance on domestic consumption given that the medium-term outlook for the G-3 economies, and hence China's export sector, remains cloudy. Attention will also be given to income inequality, urbanization, and infrastructure as important ingredients to promoting stronger household spending. Combined with already robust gains in economic activity, a potential early jump in local government spending on any new projects set out in the new plan increases the risk of overheating by early next year.

## JPMorgan View - Global Markets

### Asset reflation and the Bernanke put

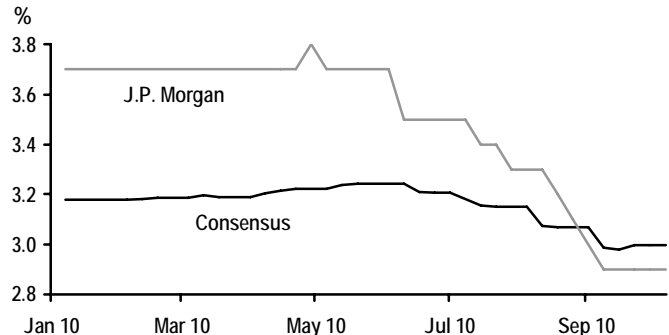
- **Economics:** Japan starts next phase of LSAPs, including equities, with Fed and BoE set to follow this year, though only in bonds.
- **Asset allocation:** Central bank commitments to do what it takes to reflate economies by boosting asset prices are bullish for asset prices, keeping us long duration and long risky assets.
- **Fixed income:** Asset purchase speculation reaches fever pitch; stay long Treasuries.
- **Equities:** Central bank asset purchases expand to equities. The BoJ is the first central bank to purchase equities since the HKMA in 1998.
- **Credit:** Renewal of the asset reflation trade is supportive of credit. Stay overweight credit focusing on high yield and AAACMBS.
- **FX:** LSAPs remain a negative for the dollar.
- **Commodities:** Stay long commodities on supply concerns, strong EM demand, and a weak dollar.

Both safe and riskier markets are continuing to gain last week on increasing hopes that economic conditions are now so bad that central banks will be forced into large-scale asset purchases (**LSAPs**) as a last-ditch effort to boost the world economy through **asset-price reflation**. We believe central banks are now more clearly recognizing the risk of deflation, and are telling us that they **will do what it takes** to boost nominal growth. That is greatly reducing downside risk in asset markets and is increasing upside potential. **It merits raising long positions in risky assets, while staying long duration in bond portfolios.**

The Bank of Japan announced it will buy ¥5 trillion of assets, of which ¥3.5 trillion government debt, ¥1 trillion CP, ABCP, and corporate bonds, and the rest ETFs and J-REITs, i.e., equities. A number of speeches and other hints are telling us that **both the Federal Reserve and the Bank of England** will later this year join the Bank's of Japan into a second phase of large scale asset purchases, informally known as QE2. But unlike the BoJ, they are set to **buy only government debt, and possibly mortgages.**

**Will LSAPs work to reflate the world economy?** Given how low bond yields are already, and the deleveraging going on

2011 global GDP growth forecasts: J.P. Morgan versus consensus



among US households, if not large companies, it is **not clear** that buying bonds to lower borrowing costs will succeed in stimulating private spending. But if central banks are committed to reflation, what more will they need to do? The BoJ is recognizing LSAPs ultimately need to move to prices of real assets, such as equities and real estate. Increasing the value of real assets is arguably a quicker and more efficient way to prevent excessive deleveraging than lowering the cost of debt. Their planned purchases are too small to matter, but the announcement effect is important, and it is fairly easy to expand this program.

**The Fed and BoE have said nothing about buying equities,** aside from BoE MPC member Adam Posen suggesting the MPC should start buying “real assets.” The BoJ likely acted because they were under pressure from having done too little against deflation. The Fed arguably is under the opposite pressure, for having done too much. It would thus require a severe worsening of economic conditions, or a new financial crisis, for the Fed or the Treasury to move to outright equity purchases. But in a crisis, it would. Remember how, two years ago, then Treasury Secretary Hank Paulson quickly used the \$700bn in TARP he received from Congress to buy bank equity instead of toxic bank debt, as he had promised earlier, in order to have greater leverage in markets.

Likely more important than clarity about what and how much central banks will buy, is the implied statement that three large policy makers—the ECB remaining on the sidelines, for the moment—recognize that more needs to be done to prevent deflation, and they are taking off their gloves. The implications for markets is that central banks are close to **writing the risky markets a put**. We thus have in recent weeks been adding risk in equities, which should benefit more than credit from this move. It keeps us aggressively short the US dollar and long most commodities. For the moment, it keeps us long duration in the US and in flat-

teners, even as we recognize that success in reflation will eventually push bond yields up dramatically.

## Fixed income

**Bonds rallied again last week, as the BoJ announced more asset purchases, and speculation that the Fed and BoE would follow suit reached fever pitch.** The Fed is conducting a very public discussion over its next steps. Three FOMC members have voiced disquiet about buying more bonds, but others—Dudley and Evans—have mooted the radical possibility of price level targeting, aiming to make up for low inflation outturns with high inflation in the future.

Tallying yield movements on days of significant news about asset purchases (e.g., central bank minutes and speeches) suggests that bonds already incorporate some LSAP impact. Nonetheless, we think that yields are biased somewhat lower if, as we expect, the Fed and BoE announce more bond buying next month. And our duration surveys suggest that though bond managers are long, positions are not particularly unbalanced. Thus **we stay long and in flat-teners, favouring Treasuries.**

Persistent spare capacity in the G-4 will keep monetary policy loose in those countries for the foreseeable future. And the gravitational pull of the G-4 will keep monetary policy looser elsewhere, not least to limit currency appreciation against the majors. **Yet, we still expect the smaller developed markets and EM to diverge bit by bit from the major economies.** We look for Canadian yields to continue to grind slowly higher than Treasuries, and for the RBA to resume its tightening cycle by year end, flattening the AUD money market curve. And after preferring EM bonds to DM all year, we now hold only a small long (less than DM) on yield-seeking inflows.

## Equities

Equities rose helped by BoJ's announcement of large-scale asset purchases. **The BoJ's announcement had a direct and strong impact on equity markets given that its large-scale asset purchase program involves equities,** the first central bank to do so since the HKMA in 1998.

Dovish central banks coupled with an expectation of a solid 3Q reporting season and an anticipation of more business-friendly policies in the US post midterm elections, should sustain the equity rally over the coming weeks.

**The short covering force is still in place but is fading somewhat.** Flows into equity ETFs are gradually declining

### Ten-year Government bond yields

	Current	Dec 10	Mar 11	Jun 11	Sep 11
United States	2.35	2.25	2.25	2.25	2.25
Euro area	2.26	2.30	2.20	2.30	2.40
United Kingdom	2.86	3.00	3.00	3.10	3.25
Japan	0.86	0.80	0.80	0.90	0.95
GBI-EM	6.19	7.90			

### Credit markets

	Current	YTD Return
US high grade (bp over UST)	158	11.7%
Euro high grade (bp over Euro gov)	168	5.4%
USD high yield (bp vs. UST)	649	12.6%
Euro high yield (bp over Euro gov)	596	13.1%
EMBIG (bp vs. UST)	299	15.3%
EM Corporates (bp vs. UST)	336	14.7%

### Foreign exchange

	Current	Dec 10	Mar 11	Jun 11	Sep 11
EUR/USD	1.39	1.30	1.30	1.30	1.30
USD/JPY	81.9	79	81	83	85
GBP/USD	1.59	1.49	1.48	1.48	1.49

### Commodities - quarterly average

	Current	10Q4	11Q1	11Q2	11Q3
WTI (\$/bbl)	83	81	78	81	83
Gold (\$/oz)	1345	1350	1425	1425	1450
Copper(\$/m ton)	8087	8200	8600	8500	8750
Corn (\$/Bu)	5.28	5.25	5.30	5.15	5.10

Source: J.P. Morgan, Bloomberg, Datastream

and Macro hedge funds, which were very bearish at the end of August, have already moved to a long equity position.

Our preference is for EM across regions. **EM** equities are benefiting from very strong inflows, as investors seek to take advantage of dollar depreciation and stronger growth in EM. Across sectors we like **Commodity sectors** and **Banks**. Commodity sectors are benefiting from strong demand by China. Banks are supported by central bank easing. Central bank large-scale asset purchases, by lowering interest rates, are making household and corporate refinancing easier, making it more likely that bank credit losses will continue to improve even in a low economic growth environment. The risk to the Bank overweight lies with US Banks for the near term, due to renewed talk about government intervention in mortgage refinancing in the US.

**Correlations between stocks are currently at the highest level in recent history.** This is a result of the macro environment, record use of index derivatives such as futures and to a lesser extent ETFs, and high-frequency trading. The op-

tion-implied price of correlation is even higher, a result of an inadequate supply of index put options and oversupply of stock options via overwriting. We believe that correlation levels are in a bubble-like regime and are bound to decline. **Investors can monetize the high correlation levels by trading dispersion via volatility swaps or vanilla options.** For more details see, *Why We Have a Correlation Bubble*, Marco Kolanovic and Davide Silvestrini, Oct 5.

## Credit

Asset reflation triggered by LSAPs is positive for risky assets including credit. Credit spreads tightened significantly across the board following the BoJ's announcement.

Despite strong demand, **new issuance of US credit products is quite low.** Net new issuance of structured credit is negative, offsetting new issuance of corporate bonds. This imbalance between strong demand and low credit supply is expected to persist and we therefore stay overweight in credit. We continue to **favor higher-yielding assets**, both for their higher return potential and their appeal to equity investors. **Our top picks are high-yield bonds and high-quality CMBS.**

Strong issuance of HY bonds year-to-date has helped companies refinance a large part of their near-term maturities, which in turn reduced the risk of a near-term default. The amount of HY bonds maturing over the next two years has fallen by over 40% as a result of the heavy pace of refinancing since early 2009. This has cut down the **US HY bond default rate to a historic low** of 0.34% so far this year. We expect the default rate to rise to only 2% over the next two years. Hence, the current spread of 650bp remains very attractive.

We believe CMBS will soon start rallying again as the **delinquency rate first stabilizes and then starts declining.** In our view, many investors are still assuming losses that are too severe. As loan performance stabilizes over coming months, many of the bonds lower down in the capital structure, that are currently trading at a discount, should rise towards par.

## Foreign Exchange

As **G-20 officials** begin a month-long blitz from Washington to Seoul, the cacophony around currency policy can only build. Unfortunately, most of what has been said so

far—that a **currency war** is underway and that uncoordinated actions threaten financial stability—exaggerates the point. By mid-Nov when these sessions conclude, two operating principles should be clear: that the **G-20 will not agree formally to manage FX markets, and that countries will be allowed to manage a dollar decline imposed by a Fed easing cycle.** The result will look more like the Plaza Accord (to weaken the dollar in 1985) than the Louvre (to support it in 1987), even if the arrangement is imposed rather than agreed. This outcome may be sub-optimal, but it isn't analogous to an immiserizing trade war.

The currency consequences are threefold: the dollar will continue its decline, volatility should ease in those currencies which will remain managed (Asia, Latin America), and it should rise in those currencies which are not. Thus, there is little reason to reduce USD shorts other than the sheer prudence of taking profits after such an extraordinary run. IMMs show very large USD shorts but on other metrics the dollar is not yet oversold. We take profit on short USD/NOK but stay long EUR, SEK, AUD, INR, and KRW.

## Commodities

The three key drivers of commodity prices are currently supply concerns caused by extreme weather and production cuts, stronger than expected demand from EM, and a weaker dollar in anticipation of LSAPs. Last week, we turned net long commodities as we believe these three conditions are likely to persist well into next year. **We now expect a 17% total return for the GSCI over the next 12 months** (see *CMOS*, Colin Fenton).

The commodities we feel offer the best upside potential are **crude oil, copper, gold, palladium, corn, and sugar.** Oil, copper, and palladium are supported by increased physical demand, particularly from EM while the current tight supply appears likely to continue. Further USD weakness and continued uncertainty about the economy and the direction of risky assets should support gold prices where momentum in both flows and prices remain strong. Sugar has rallied 33% since the end of August, and blockages at key ports in Brazil continue to reflect the scarcity of available inventory in the rest of the world. Corn is up 6% today as the USDA reduced its supply estimates. We continue to believe that demand will outpace supply well into next year as weather has significantly damaged yields this year, creating an increase in demand for US grain which has seen lower yields than expected.

## 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	1Q10	2Q10	3Q10	4Q10	1Q11	2Q11	3Q11	2Q10	4Q10	2Q11	4Q11
<b>The Americas</b>														
United States	-2.6	2.6	2.4	3.7	1.7	<u>1.5</u>	2.0	2.5	2.5	3.0	1.8	0.9	1.2	1.1
Canada	-2.5	3.1	2.2	5.8	2.0	<u>2.2</u>	2.0	2.3	2.0	2.4	1.4	1.9	2.1	2.1
Latin America	-2.4	5.7	4.1	4.9	9.0	<u>1.0</u>	2.7	4.4	6.0	3.5	6.6	7.1	<b>7.2 ↓</b>	7.3
Argentina	-2.0	8.5	5.5	13.4	12.6	<u>0.0</u>	2.0	6.0	8.0	8.0	10.6	10.5	11.0	12.0
Brazil	-0.2	7.5	4.5	11.3	5.1	<u>2.3</u>	3.2	5.7	4.7	5.0	5.1	5.0	5.1	5.1
Chile	-1.5	5.5	6.0	-6.0	18.4	<u>11.0</u>	6.0	4.0	4.0	4.0	1.2	3.8	3.6	3.4
Colombia	0.8	4.5	4.1	3.3	3.9	<u>3.7</u>	4.0	4.0	4.1	5.0	2.1	<b>2.6 ↓</b>	<b>3.1 ↓</b>	4.0
Ecuador	0.4	2.5	3.0	2.1	7.7	<u>2.5</u>	3.0	3.0	2.5	2.5	3.2	3.6	3.8	3.8
Mexico	-6.5	4.5	3.5	-2.5	13.5	<u>-3.6</u>	3.1	2.9	9.2	-0.1	4.0	5.1	4.5	4.0
Peru	0.9	8.2	6.0	8.0	12.7	<u>4.8</u>	3.5	5.8	6.7	7.2	1.2	2.6	2.2	2.7
Venezuela	-3.3	-2.2	1.0	-2.0	5.2	<u>3.0</u>	-5.0	2.0	1.0	1.5	31.9	31.6	34.7	35.1
<b>Asia/Pacific</b>														
Japan	-5.2	2.9	0.9	5.0	1.5	<u>2.5</u>	-1.5	0.5	1.5	1.8	-0.9	-0.8	-0.2	-0.3
Australia	1.2	<b>3.2 ↑</b>	<b>3.6 ↑</b>	2.7	4.9	<b>3.3 ↑</b>	<b>2.4 ↓</b>	<b>3.4 ↑</b>	<b>4.9 ↑</b>	<b>3.2 ↑</b>	3.1	3.3	3.8	3.4
New Zealand	-1.7	2.0	2.8	2.2	0.7	<u>2.5</u>	2.5	2.6	3.1	4.2	1.8	4.9	5.6	3.2
Asia ex Japan	5.6	8.7	7.0	10.5	7.4	<u>5.5</u>	6.4	7.4	7.3	7.5	4.5	4.1	3.9	3.9
China	9.1	9.8	8.6	10.8	7.2	<u>7.5</u>	8.1	9.1	8.9	9.1	2.9	2.8	2.7	2.6
Hong Kong	-2.8	6.6	4.1	8.7	5.7	<u>3.0</u>	3.5	4.2	4.3	4.7	2.6	2.5	2.2	2.4
India	7.4	8.3	8.5	9.2	8.5	<u>8.0</u>	8.9	8.0	8.5	8.6	13.7	11.0	10.1	10.2
Indonesia	4.5	6.0	5.4	3.0	7.5	<u>4.5</u>	5.0	5.3	5.2	5.0	4.4	<b>6.1 ↓</b>	<b>5.6 ↓</b>	4.8
Korea	0.2	6.1	4.0	8.8	5.8	<u>2.5</u>	3.8	4.0	4.0	4.5	2.6	2.9	3.4	3.4
Malaysia	-1.2	7.2	4.6	4.8	7.2	<u>3.0</u>	3.5	4.9	4.9	4.5	1.6	1.1	<b>1.4 ↑</b>	2.4
Philippines	<b>0.9 ↓</b>	7.0	3.9	11.9	7.7	<u>0.8</u>	1.6	4.9	4.9	4.9	4.2	<b>2.7 ↑</b>	<b>1.9 ↑</b>	<b>2.7 ↓</b>
Singapore	-1.3	14.8	4.2	45.7	24.0	<u>-11.5</u>	-2.0	8.7	6.6	7.4	3.1	<b>3.5 ↑</b>	<b>1.8 ↑</b>	1.6
Taiwan	-1.9	9.9	4.1	10.9	7.2	<u>1.5</u>	2.3	4.2	4.6	5.5	1.1	2.0	1.8	1.7
Thailand	-2.2	8.5	<b>4.0 ↓</b>	13.9	0.6	<u>2.8</u>	2.8	<b>4.9 ↓</b>	<b>4.9 ↓</b>	<b>4.9 ↑</b>	3.2	<b>2.0 ↑</b>	<b>2.5 ↑</b>	1.8
<b>Africa/Middle East</b>														
Israel	0.8	3.5	4.5	3.8	4.6	<u>3.0</u>	3.0	4.0	5.0	5.5	2.8	2.6	3.0	2.8
South Africa	-1.8	2.9	3.1	4.6	3.2	<u>3.1</u>	3.2	3.1	3.1	3.4	4.5	4.5	4.7	5.9
<b>Europe</b>														
Euro area	-4.0	1.7	1.5	<b>1.4 ↑</b>	3.9	<u>2.0</u>	1.0	1.0	1.0	1.8	1.5	1.7	1.1	1.0
Germany	-4.7	3.3	2.4	1.9	9.0	<u>3.0</u>	2.0	2.0	1.5	2.0	1.0	1.2	0.6	0.7
France	-2.5	1.6	1.5	0.7	2.8	<u>2.0</u>	1.5	1.0	1.0	1.5	1.8	1.3	0.7	1.1
Italy	-5.1	1.2	1.3	1.7	1.8	<u>2.0</u>	1.0	1.0	1.0	1.5	1.6	1.7	1.4	1.5
Norway	-1.2	1.5	2.3	0.7	1.9	<u>3.0</u>	2.5	2.0	2.0	2.5	2.6	2.1	1.3	1.3
Sweden	-5.1	4.5	3.1	6.0	8.0	<u>4.5</u>	3.0	2.3	2.3	2.8	1.0	1.5	1.6	1.8
Switzerland	-1.9	2.9	2.0	4.2	3.5	<u>2.5</u>	2.0	1.5	1.5	2.3	1.0	0.4	0.1	0.7
United Kingdom	-4.9	1.7	2.2	1.3	4.9	<u>2.5</u>	1.5	1.0	2.5	3.0	3.5	2.6	1.9	2.1
Emerging Europe	-5.3	<b>4.1 ↑</b>	<b>4.1 ↓</b>	2.7	3.8	<u>2.4</u>	3.8	3.9	4.2	4.6	5.7	6.4	6.5	5.6
Bulgaria	-5.0	-0.5	4.0	...	...	...	...	...	...	...	...	...	...	...
Czech Republic	-4.1	2.0	3.2	1.5	3.8	<u>2.5</u>	2.3	2.5	3.0	5.0	1.2	2.8	2.7	2.6
Hungary	-6.3	1.0	2.8	2.4	0.0	<u>2.0</u>	2.0	2.0	3.0	3.5	5.4	4.4	3.4	3.6
Poland	1.7	3.5	3.8	2.8	4.5	<u>3.5</u>	3.5	3.0	3.5	4.0	2.3	2.6	2.7	2.9
Romania	-7.1	-2.0	1.5	...	...	...	...	...	...	...	4.4	8.0	7.2	4.0
Russia	-7.9	4.3	4.7	3.3	4.3	<u>2.5</u>	5.0	5.0	5.0	5.0	5.9	7.6	8.4	7.1
Turkey	-4.7	<b>7.1 ↑</b>	<b>4.3 ↓</b>	...	...	...	...	...	...	...	9.2	7.5	7.0	6.2
Global	-2.2	3.6	2.9	4.2	3.9	<u>2.5</u>	2.2	2.8	3.1	<b>3.4 ↑</b>	2.5	2.3	<b>2.3 ↑</b>	2.1
Developed markets	-3.5	2.3	1.9	3.0	2.8	<u>2.0</u>	1.2	1.6	1.9	2.4	1.5	1.2	1.1	1.0
Emerging markets	1.3	6.9	<b>5.6 ↓</b>	7.7	7.1	<u>3.8</u>	5.0	6.0	6.4	5.9	5.2	5.3	5.2	5.1
Memo:														
Global — PPP weighted	-0.8	<b>4.6 ↑</b>	3.8	<b>5.3 ↑</b>	4.7	<u>3.1</u>	3.1	3.8	4.0	4.2	3.2	3.0	3.0	<b>2.8 ↓</b>

## Global Central Bank Watch

	Official interest rate	Change from			Next meeting	Forecast next change	Forecast				
		Current	Aug '07 (bp)	Last change			Dec 10	Mar 11	Jun 11	Sep 11	Dec 11
Global	GDP-weighted average	1.76	-319				1.81	1.86	1.93	1.97	2.04
excluding US	GDP-weighted average	2.39	-241				2.45	2.53	2.63	2.68	2.78
Developed	GDP-weighted average	0.60	-358				0.62	0.63	0.65	0.68	0.72
Emerging	GDP-weighted average	5.00	-210				5.14	5.28	5.51	5.59	5.75
Latin America	GDP-weighted average	7.22	-218				7.29	7.79	8.38	8.42	8.42
CEEMEA	GDP-weighted average	4.08	-294				4.10	4.11	4.17	4.36	4.85
EM Asia	GDP-weighted average	4.55	-170				4.76	4.83	4.99	5.04	5.12
The Americas	GDP-weighted average	1.28	-453				1.29	1.38	1.49	1.52	1.56
United States	Federal funds rate	0.125	-512.5	16 Dec 08 (-87.5bp)	3 Nov 10	On hold	0.125	0.125	0.125	0.125	0.125
Canada	Overnight funding rate	1.00	-325	8 Sep 10 (+25bp)	19 Oct 10	1 Mar 11 (+25bp)	1.00	1.25	1.50	1.75	2.25
Brazil	SELIC overnight rate	10.75	-125	21 Jul 10 (+50bp)	20 Oct 10	Jan 11 (+25bp)	10.75	11.50	12.50	12.50	12.50
Mexico	Repo rate	4.50	-270	17 Jul 09 (-25bp)	<u>15 Oct 10</u>	On hold	4.50	4.50	4.50	4.50	4.50
Chile	Discount rate	2.50	-250	16 Sep 10 (+50bp)	<u>14 Oct 10</u>	14 Oct 10 (+25bp)	3.25	4.00	4.50	4.50	4.50
Colombia	Repo rate	3.00	-600	30 Apr 10 (-50bp)	29 Oct 10	1Q 11 (+50bp)	3.00	4.00	5.00	5.50	5.50
Peru	Reference rate	3.00	-150	9 Sep 10 (+50bp)	11 Nov 10	7 Oct 10 (+25bp)	3.50	4.25	4.50	4.50	4.50
Europe/Africa	GDP-weighted average	1.44	-322				1.45	1.46	1.47	1.52	1.63
Euro area	Refi rate	1.00	-300	7 May 09 (-25bp)	4 Nov 10	On hold	1.00	1.00	1.00	1.00	1.00
United Kingdom	Repo rate	0.50	-500	5 Mar 09 (-50bp)	4 Nov 10	On hold	0.50	0.50	0.50	0.50	0.50
Sweden	Repo rate	0.75	-275	2 Sep 10 (+25bp)	26 Oct 10	26 Oct 10 (+25bp)	1.25	1.25	1.25	1.50	2.00
Norway	Deposit rate	2.00	-250	5 May 10 (+25bp)	27 Oct 10	3Q 11 (+25bp)	2.00	2.00	2.00	2.25	2.75
Switzerland	3-month Swiss Libor	0.25	-225	12 Mar 09 (-25bp)	4Q 10	Jun 11 (+25bp)	0.25	0.25	0.50	0.75	1.00
Czech Republic	2-week repo rate	0.75	-200	6 May 10 (-25bp)	4 Nov 10	2Q 11 (+25bp)	0.75	0.75	1.00	1.25	1.75
Hungary	2-week deposit rate	5.25	-250	26 Apr 10 (-25bp)	25 Oct 10	3Q 11 (+25bp)	5.25	5.25	5.25	5.50	5.75
Israel	Base rate	2.00	-200	27 Sep 10 (+25bp)	25 Oct 10	22 Nov 10 (+25bp)	2.25	2.50	2.75	3.25	3.50
Poland	7-day intervention rate	3.50	-100	24 Jun 09 (-25bp)	Oct 10	2Q 11 (+25bp)	3.50	3.50	3.75	4.00	4.25
Romania	Base rate	6.25	-75	4 May 10 (-25bp)	2 Nov 10	3Q 11 (+25bp)	6.25	6.25	6.25	6.50	6.75
Russia	1-week deposit rate	2.75	-25	31 May 10 (-50bp)	Oct 10	3Q 11 (+25bp)	2.75	2.75	2.75	3.00	3.50
South Africa	Repo rate	6.00	-350	9 Sep 10 (-50bp)	18 Nov 10	On hold	6.00	6.00	6.00	6.00	6.00
Turkey	1-week repo rate	7.00	-1050	-	<u>14 Oct 10</u>	4Q 11 (+50bp)	7.00	7.00	7.00	7.00	8.00
Asia/Pacific	GDP-weighted average	2.90	-129				3.04	3.10	3.20	3.25	3.31
Australia	Cash rate	4.50	-175	4 May 10 (+25bp)	1 Nov 10	<b>1 Nov 10 (+25bp)</b>	4.75	5.00	5.25	5.50	5.75
New Zealand	Cash rate	3.00	-500	29 Jul 10 (+25bp)	27 Oct 10	10 Mar 11 (+25bp)	3.00	3.25	3.50	3.75	4.00
Japan	Overnight call rate	0.05	-48	<b>5 Oct 10 (-5bp)</b>	28 Oct 10	On hold	<b>0.05</b>	<b>0.05</b>	<b>0.05</b>	<b>0.05</b>	<b>0.05</b>
Hong Kong	Discount window base	0.50	-625	17 Dec 08 (-100bp)	4 Nov 10	On hold	0.50	0.50	0.50	0.50	0.50
China	1-year working capital	5.31	-126	22 Dec 08 (-27bp)	4Q 10	4Q 10 (+27bp)	5.58	5.58	5.85	5.85	5.85
Korea	Base rate	2.25	-225	9 Jul 10 (+25bp)	<u>14 Oct 10</u>	4Q 10 (+25bp)	2.50	2.75	2.75	2.75	3.00
Indonesia	BI rate	6.50	-200	5 Aug 09 (-25bp)	4 Nov 10	2Q 11 (+25bp)	6.50	6.50	6.75	6.75	6.75
India	Repo rate	6.00	-175	16 Sep 10 (+25bp)	2 Nov 10	2 Nov 10 (+25bp)	6.25	6.50	6.50	6.75	7.00
Malaysia	Overnight policy rate	2.75	-75	8 Jul 10 (+25bp)	12 Nov 10	On hold	2.75	2.75	2.75	2.75	2.75
Philippines	Reverse repo rate	4.00	-350	9 Jul 09 (-25bp)	18 Nov 10	2Q 11 (+25bp)	4.00	4.00	4.25	4.50	4.50
Thailand	1-day repo rate	1.75	-150	26 Aug 10 (+25bp)	20 Oct 10	20 Oct 10 (+25bp)	2.00	2.00	2.00	2.00	2.00
Taiwan	Official discount rate	1.50	-163	30 Sep 10 (+12.5bp)	23 Dec 10	3Q 11 (+12.5bp)	1.50	1.50	1.50	1.625	1.75

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	1.2	3.2	3.6	2.2	1.3	4.2	2.7	4.9	3.3	2.4	3.4	4.9	3.2	5.2
Private consumption	1.7	3.0	1.9	5.2	1.3	3.3	1.9	6.5	1.6	0.8	1.2	1.6	2.4	3.2
Construction investment	-0.5	2.7	6.5	-3.7	2.4	2.6	-3.1	9.9	8.3	2.3	7.1	6.9	6.9	7.8
Equipment investment	-6.6	0.4	15.7	-18.0	-5.9	60.3	-26.0	-12.0	22.5	17.6	8.6	27.6	15.4	22.5
Public investment	4.4	32.4	8.4	13.3	43.9	40.6	81.2	0.1	9.7	10.4	6.6	11.6	6.7	9.5
Government consumption	2.8	5.2	4.3	3.2	5.4	7.7	4.8	7.2	2.0	2.0	4.5	8.0	4.3	0.8
Exports of goods & services	0.9	4.4	4.8	4.5	-9.2	9.7	-2.8	24.2	0.8	1.2	6.1	4.1	4.9	3.2
Imports of goods & services	-8.3	12.8	7.5	0.3	18.8	32.7	6.6	12.8	4.9	4.1	6.1	10.4	12.6	5.7
Contributions to GDP growth:														
Inventories	-0.5	-0.4	-0.9	0.7	2.8	0.8	1.4	-2.9	-5.9	0.0	-0.2	0.3	0.1	0.3
Net trade	2.0	-1.7	-0.7	0.8	-5.2	-4.1	-1.9	1.7	-0.9	-0.7	-0.1	-1.4	-1.8	-0.7
GDP deflator (%oya)	0.3	5.0	2.9	0.1	-1.9	-1.3	2.0	6.6	6.0	5.5	4.2	2.4	2.5	2.5
Consumer prices (%oya)	1.8	3.1	3.6	1.5	1.3	2.1	2.9	3.1	3.0	3.3	3.5	3.8	3.6	3.4
Producer prices (%oya)	-5.4	2.5	3.8	-6.4	-7.2	-6.8	-0.2	2.5	2.3	5.2	3.7	3.5	4.0	4.0
Trade balance (A\$ bil, sa)	-6.8	20.2	16.7	-0.9	-4.1	-4.9	-2.7	7.4	8.7	6.8	4.5	3.6	4.2	4.5
Current account (A\$ bil, sa)	-51.4	-24.3	-40.8	-13.8	-14.6	-19.3	-16.5	-5.6	4.7	-7.0	-9.5	-10.6	-10.4	-10.3
as % of GDP	-4.1	-1.8	-2.8	-4.4	-4.7	-6.0	-5.0	-1.7	1.4	-2.0	-2.7	-2.9	-2.8	-2.8
3m eurodeposit rate (%)*	6.0	4.7	5.6	3.5	3.4	4.1	4.3	4.8	4.8	5.0	5.3	5.5	5.8	5.8
10-year bond yield (%)*	5.6	5.3	5.0	5.5	5.1	5.8	5.6	5.5	5.2	4.9	5.1	5.1	5.0	5.0
US\$/A\$*	0.75	0.92	0.98	0.82	0.88	0.91	0.94	0.84	0.96	0.93	0.95	0.99	1.01	0.98
Commonwealth budget (FY, A\$ bil)	-27.0	-51.0	-32.0											
as % of GDP	-2.1	-3.7	-2.2											
Unemployment rate	5.6	5.3	5.0	5.7	5.8	5.6	5.3	5.2	5.2	5.1	5.0	5.0	4.9	4.8
Industrial production	-7.9	4.8	1.5	5.3	-3.8	21.3	4.6	2.0	-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** emerged from the global downturn largely unscathed. GDP expanded at a rapid clip in 2Q, with households leading the way. We recently upgraded the growth forecast for 2011 to 3.6%.
- **Business investment** probably will rise strongly in 2010-11, with mining leading the way, particularly with the mining tax roadblock being “dismantled”. There will be an even bigger rise in 2011-12.
- 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.
- **Consumer confidence** deteriorated sharply earlier this year as mortgage rates rose. The index rebounded in July and August, but fell in September. Optimists, though, easily outnumber pessimists.
- **Export volumes** have held up owing mainly to firm demand from China, and the terms of trade has bounced thanks mainly to higher bulk commodity prices.
- The **RBA** hiked the cash rate six times between October and May, but then paused. We forecast a rate hike at the 2 November Board meeting, and a further four hikes during 2011.
- The **Labor government** was “reelected,” but governs in the lower house of Parliament only via the support of key independents. A fragile minority government risks delivering policy timidity.



## 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)	-1.7	2.0	2.8	0.6	0.9	4.0	2.2	0.7	2.5	2.5	2.6	3.1	4.2	2.8
Private consumption	-0.7	1.9	1.3	1.1	3.8	3.7	1.7	0.3	1.2	0.2	1.0	2.0	2.5	3.0
Fixed Investment	-13.3	3.8	6.2	0.7	-9.8	-1.6	0.5	27.1	3.5	4.0	5.1	5.6	6.4	6.3
Residential construction	-18.4	11.4	7.2	-12.9	-13.3	20.7	5.8	52.2	2.8	4.0	4.8	5.6	6.4	5.6
Other fixed investment	-12.2	2.4	6.0	3.6	-9	-5.5	-0.5	22.4	3.6	4.0	5.2	5.6	6.4	6.4
Inventory change (NZ\$ bil, saar)	-1.9	-0.8	0.4	-1.0	-0.7	0.1	0.1	-0.5	-0.3	-0.1	0.1	0.1	0.2	0.1
Government spending	1.5	3.2	2.0	-3.9	1.8	4.3	7.0	2.2	1.6	1.6	2.0	2.8	2.4	0.8
Exports of goods & services	0.4	3.8	4.7	16.5	2.7	-1.8	5.0	5.5	3.0	3.0	4.0	6.0	7.0	7.0
Imports of goods & services	-15.1	8.2	6.7	-10.2	5.8	25.1	6.8	2.5	9.0	8.0	6.0	7.0	6.0	6.0
Contributions to GDP growth:														
Domestic final sales	-5.1	2.8	2.7	0.1	-1.4	2.0	3.8	7.0	1.8	1.3	2.2	3.1	3.5	3.5
Inventories	-2.6	0.8	0.9	-7.7	3.3	10.5	-0.9	-6.8	2.8	3.0	1.2	0.6	0.6	-0.8
Net trade	5.9	-1.5	-0.8	8.7	-1.0	-7.9	-0.7	0.9	-2.1	-1.8	-0.8	-0.5	0.1	0.1
GDP deflator (%oya)	2.0	2.7	2.3	3.2	2.3	0.2	1.0	2.3	3.4	4.1	3.2	2.4	1.9	1.6
Consumer prices	2.1	5.0	3.2	2.3	5.3	-0.7	1.5	1.1	5.5	12.1	3.3	1.8	3.9	3.8
%oya	2.1	2.6	4.9	1.9	1.7	2.0	2.0	1.8	1.8	4.9	5.4	5.6	5.2	3.2
Trade balance (NZ\$ bil, sa)	2.3	5.3	5.1	0.7	0.6	0.3	0.9	1.2	1.5	1.6	1.4	1.3	1.2	1.2
Current account (NZ\$ bil, sa)	-5.3	-5.8	-12.0	-0.6	0.1	-2.8	-1.2	-1.3	-1.8	-0.6	-2.1	-5.2	-3.6	-3.5
as % of GDP	-3.0	-3.1	-6.1	-1.3	0.2	-6.2	-2.7	-3.9	-1.3	-4.5	-7.4	-7.2	-5.5	-4.3
Yield on 90-day bank bill (%)*	3.0	3.0	3.8	2.8	2.8	2.8	2.7	2.9	3.3	3.2	3.4	3.7	4.0	4.0
10-year bond yield (%)*	5.5	5.4	4.7	5.7	5.7	5.9	5.9	5.7	5.3	4.9	4.9	4.8	4.7	4.7
US\$/NZ\$*	0.64	0.71	0.75	0.60	0.68	0.73	0.71	0.70	0.70	0.71	0.72	0.76	0.77	0.74
Commonwealth budget (NZ\$ bil)	-4.0	-7.2	-7.1											
as % of GDP	-2.2	-3.8	-3.6											
Unemployment rate	6.1	6.5	5.8	5.9	6.5	7.1	6.0	6.8	6.7	6.4	6.0	5.9	5.7	5.7

\*All financial variables are period averages

### New Zealand - summary of main macro views

- The **New Zealand economy** expanded just 0.2%q/q in 2Q, compared to 0.5% in 1Q. The slowdown mainly owed to a sharp drop in manufacturing, which coincided with an unanticipated run-down of inventories, and a flat read on household consumption.
- The devastating **earthquake** will have a negative, near-term impact on activity. We estimate that it will knock 0.2%-points off 3Q GDP growth as consumer and business sentiment take a hit, employees are left unable to work, and consumer spending is reined in further.
- The **unemployment** rate shot up to 6.8% in 2Q from 6.0% in 1Q, and probably will maintain a 6%-handle in the foreseeable future. Actual hiring remains well-below long run averages and, with corporate profitability down, new hiring will likely be postponed.
- The **RBNZ** left the OCR unchanged in September and delivered a more downbeat assessment of the economy, owing mainly to the weakness on the domestic front. We expect the next rate hike to be delivered in March.
- Headline **inflation** continued to hover around the middle of the RBNZ's 1%-3% target range in the June quarter, although this precedes what we expect will be a series of elevated inflation prints over the coming year.
- Managing **inflation expectations** will be a growing challenge for the RBNZ, given the July 1 introduction of the amended ETS and the GST hike on October 1. Two-year inflation expectations recently fell in 3Q, however, with respondents expecting inflation in two-years' time to average 2.6%oya.

## Australia and New Zealand economic calendar

Monday	Tuesday	Wednesday	Thursday	Friday
<p><b>11 Oct</b></p> <p><b>Australia:</b>                      Housing finance (11:30 am)                      Aug <u>1.5%</u>m/m, sa</p>	<p><b>12 Oct</b></p> <p><b>Australia:</b>                      NAB business confidence                      Sep <u>14 %</u>bal, sa</p>	<p><b>13 Oct</b></p> <p><b>Australia:</b>                      Westpac consumer confidence                      (10:30 am)                      Oct <u>6.0%</u>m/m, sa</p>	<p><b>14 Oct</b></p> <p><b>New Zealand:</b>                      Retail sales (10:45 am)                      Aug <u>0.0%</u>m/m, sa                      Business NZ PMI (11:30 am) Sep</p>	<p><b>15 Oct</b></p>
<p><b>18 Oct</b></p> <p><b>Australia:</b>                      New motor vehicle sale (10:30 am)                      Sep</p> <p><b>New Zealand:</b>                      CPI (10:45 am) 2Q</p>	<p><b>19 Oct</b></p>	<p><b>20 Oct</b></p> <p><b>Australia:</b> Westpac leading index                      (10:30 am) Aug</p>	<p><b>21 Oct</b></p> <p><b>New Zealand:</b> Credit card                      spending (2:00 pm) Sep</p>	<p><b>22 Oct</b></p>
<p><b>25 Oct</b></p> <p><i>Holiday: New Zealand</i></p>	<p><b>26 Oct</b></p>	<p><b>27 Oct</b></p> <p><b>Australia:</b>                      CPI (11:30 am) 3Q</p> <p><b>New Zealand:</b>                      NBNZ business confidence                      (2:00 pm) Oct</p>	<p><b>28 Oct</b></p> <p><b>New Zealand:</b>                      RBNZ official cash rate (2:00 pm)                      Oct</p>	<p><b>29 Oct</b></p> <p><b>Australia:</b>                      Pvt. sector credit (11:30 am) Sep</p> <p><b>New Zealand:</b>                      Building permits (10:45 am) Sep                      Trade balance (10:45 am) Sep</p>
<p><b>1 Nov</b></p> <p><b>Australia:</b> NAB business                      confidence (11:30 am) Oct</p> <p><b>New Zealand:</b> ANZ commodity                      prices (2:00 pm) Oct</p>	<p><b>2 Nov</b></p> <p><b>Australia:</b>                      RBA cash target rate (2:30 pm)                      Nov</p>	<p><b>3 Nov</b></p> <p><b>Australia:</b>                      Building approvals (11:30 am) Sep</p>	<p><b>4 Nov</b></p>	<p><b>5 Nov</b></p> <p><b>Australia:</b>                      RBA quarterly monetary policy                      meeting</p>

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
11 - 15 October	11 October	12 October	13 October	14 October	15 October
<b>China</b> • FDI (Sep)  <b>United Kingdom</b> • Nationwide cons conf (Sep)	<b>France</b> • IP (Aug)  <b>Italy</b> • IP (Aug)  <b>United States</b> • Columbus Day: bond markets closed	<b>Australia</b> • NAB bus conf (Sep)  <b>Germany</b> • CPI final (Sep)  <b>India</b> • IP (Aug)  <b>Japan</b> • Consumer conf (Sep)  <b>Mexico</b> • IP (Aug)  <b>United Kingdom</b> • CPI (Sep)  <b>United States</b> • NFIB survey (Sep) • FOMC minutes (Sep)	<b>China</b> • Trade balance (Sep)  <b>Euro area</b> • IP (Aug)  <b>Japan</b> • Private mach orders (Aug)  <b>United Kingdom</b> • Labor mkt report (Sep)  <b>United States</b> • Bernanke speech	<b>Brazil</b> • Retail sales (Aug)  <b>Chile</b> • BCCCh mtg: +25bps  <b>India</b> • WPI (Sep)  <b>Korea</b> • BoK mtg: no chg  <b>Russia</b> • IP (Sep)  <b>Turkey</b> • CBRT mtg: no chg  <b>United States</b> • International trade (Aug)	<b>Euro area</b> • HICP final (Sep) • Trade balance (Aug)  <b>Japan</b> • Shirakawa speech  <b>Mexico</b> • Banxico mtg: no chg  <b>Singapore</b> • NODX (Aug)  <b>United States</b> • Retail sales (Sep) • CPI (Sep) • NY Fed surv (Oct) • UMich cons conf (Oct) • Business invtrs (Aug) • Bernanke speech
18 - 22 October	18 October	19 October	20 October	21 October	22 October
	<b>Japan</b> • Reuters Tankan (Oct)  <b>United States</b> • IP (Sep) • NAHB surv (Oct)	<b>Canada</b> • BoC mtg: no chg  <b>Germany</b> • ZEW bus surv (Oct)  <b>Poland</b> • IP (Sep)  <b>United States</b> • Housing starts (Sep) • NY Fed President Dudley speaks	<b>Brazil</b> • COPOM mtg: no chg  <b>Russia</b> • Retail sales (Sep)  <b>Taiwan</b> • Export orders (Sep)  <b>Thailand</b> • BoT mtg: +25bps  <b>United Kingdom</b> • MPC minutes (Oct)  <b>United States</b> • Beige book	<b>China</b> • GDP (3Q) • CPI, FAI, retail, IP (Sep)  <b>Euro area</b> • PMI flash (Oct) • EC cons conf prel (Oct)  <b>France</b> • INSEE bus conf (Oct)  <b>Japan</b> • BoJ loan officers surv (3Q)  <b>United Kingdom</b> • Retail sales (Sep)  <b>United States</b> • Philly Fed surv (Oct)	<b>Argentina</b> • IP (Sep)  <b>Canada</b> • CPI (Sep)  <b>Germany</b> • IFO bus surv (Oct)

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