

Australia and New Zealand - Weekly Prospects

Summary

- The resilient **Aussie** economy powered ahead in the June quarter. In fact, last week's GDP print showed that growth accelerated in 2Q, with households leading the charge. Higher household income (thanks to a buoyant job market) fed into stronger spending, causing a drop in the savings rate. RBA officials flagged the hope that challenges posed by the soaring terms of trade and strong investment spending would be lessened by continued caution by households - clearly, the latter is yet to play out. Indeed, the July retail sales data last week showed a surge in discretionary spending. The RBA Board will, however, leave the cash rate steady tomorrow. The accompanying statement will likely talk up the strength of the domestic economy, but highlight the lingering downside risks offshore. In fact, anxiety about the durability of the global cycle probably will see the RBA inactive until early next year.
- In contrast, recent evidence suggests the recovery in the **New Zealand** economy has shed considerable momentum. Business confidence has deteriorated, house price growth has eased, non-residential construction has hit a wall, and net migration has slowed. These factors provide RBNZ Governor Alan Bollard with even more scope to sit on the policy sidelines. Indeed, we expect that Dr. Bollard will leave the cash rate steady on September 16, particularly given that inflation expectations have eased and pricing intentions remain steady. These developments are a welcome surprise ahead of the forthcoming GST hike on October 1. The earthquake in Christchurch on the weekend will provide further reason for the Governor to hold fire in the near-term. There are after-shocks hitting the area now, and it is too early to quantify the economic impact of the disaster.
- The data flow continues to underscore a downshift in **global growth**. Last week, our August all-industry PMI survey fell for the fourth consecutive month, moving to a level broadly consistent with trend-like global GDP growth. With the PMI orders/inventory ratio still falling, it is likely that we have not seen the bottom in the survey. What's more, a deceleration in production and trade flows is gathering steam across the globe. The downshift in industrial production growth has been most pronounced in emerging market economies, where gains have slipped below a 3% pace over the past three months.
- Economic activity in **EM Asia** outside China and India is being buffeted by numerous crosscurrents. Industrial activity has downshifted sharply with regional output expanding 5% annualized in the three months through July as opposed to the 20%-30% pace posted earlier this year. The August manufacturing output PMI, which dipped below 50 for the first time since February 2009, points to a further deceleration. At the same time, robust gains in domestic demand have helped to soften the growth slowdown. On net, GDP is projected to slow to a below trend pace in 2H10.
- Consistent with more encouraging news, **risky asset prices** lifted last week. This positive financial response to signs of sustained modest growth—along with a fading of drags from manufacturing and fiscal policy—is part of the recipe for lifting global growth above trend as we move into 2011.

This week's highlight

The RBA decision tomorrow. It will be interesting to see if RBA officials again make reference to household behaviour, given households do not appear to have become more cautious, as they had hoped.

September 6, 2010

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Data and event previews - Australia and New Zealand

Date	Time ^(a)	Data/event	Forecast		
			JPMorgan	Consensus ^(b)	Previous
Monday, September 6	10.30am	Aust. TD Securities Inflation Gauge (%m/m, Aug.)	na	na	2.8
Monday, September 6	11.30am	ANZ job advertisements (%m/m, Aug.)	1.0	na	1.3
Tuesday, September 7	2.30pm	RBA cash rate announcement (% , Sep.)	4.50	4.50	4.50
Wednesday, September 8	8.45am	NZ manufacturing activity (%q/q, 2Q)	na	na	0.9
Wednesday, September 8	11.30am	Aust. housing finance (%m/m, Jul.)	0.5	1.0	-3.9
Thursday, September 9	8.45am	NZ card spending (%m/m, Aug.)	na	na	-0.1
Thursday, September 9	11.30am	Aust. employment (000s ch., Aug.)	25	25	23.5
Thursday, September 9	11.30am	Aust. unemployment rate (% , Aug.)	5.2	5.2	5.3
Thursday, September 9	11.30am	Aust. labour force participation rate (% , Aug.)	65.4	65.5	65.5
Thursday, September 9	1.00pm	RBA Assistant Governor Debelle's speech	na	na	na
Friday, September 10	8.45am	NZ terms of trade (%q/q, 2Q)	5.8	4.5	5.9

(a) Australian Eastern Standard Time.

(b) Consensus based on Bloomberg survey.

Australia

ANZ job advertisements (%m/m, Aug.) - Vacancies have been easing in growth terms in recent months, which is not surprising given the rapid pace of job creation in the last year. The July employment report, though, showed that, for the first time in the recent upswing, the labour market failed to accommodate a significant rise in participation. The jobless rate, therefore, spiked up to 5.3%. This signals that the “free lunch” period of easily-achieved employment for new private sector job seekers may be behind us. As the labour market tightens further, we expect job growth and job ads to slow moving into the fourth quarter.

RBA cash rate announcement (% , Sep.) - RBA officials likely will show a steady hand this week, looking through the robust 2Q GDP numbers, and leave the cash rate at 4.5% for the fourth straight month. Indeed, the RBA’s recent pause has had little to do with domestic conditions. Rather, the threat of a sharper-than-expected slowdown in global growth means the RBA likely will continue to tread cautiously in coming months. RBA Assistant Governor Guy Debelle last week flagged the non-trivial risk that the world could again fall into recession—comments that indicate that RBA officials at least are weighing up the possibility of such an event. This will keep the RBA in “wait and see” mode for the time being.

Data previews - Cont'd.

Housing finance (%m/m, Jul.) - We forecast another soft result for home loans. While the withdrawal of grant-sensitive buyers, following the expiration of the expanded First-Home Buyers' grant, likely has run its course, there remain significant drags on loan demand, such as the lagged effect of the RBA's policy tightening and worsening housing affordability.

Employment (000s ch., Aug.) - The August employment numbers will be bolstered by a rise in temporary workers associated with the Federal election campaign. Taking that into account, we forecast a rise of 25,000 in employment and, with the participation rate falling a notch to 65.4%, a slightly lower unemployment rate of 5.2%. Job creation likely will be more subdued going forward relative to 1H10, but the absence of a significant hangover after prior robust gains is representative of looming supply side pressures.

RBA Assistant Governor Debelle's speech - The Assistant Governor (Financial markets) speaks at the Westpac Research and Strategy Forum in Sydney on Thursday afternoon. The title for the speech is yet to be announced, but there will be a Q&A session to follow.

New Zealand

Card spending (%m/m, Aug.) - We suspect that spending on cards will have risen 0.7% m/m in August. There already is evidence that consumers are bringing forward spending ahead of the forthcoming GST hike. Recent retail sales data has spiked higher, with sales values surging 0.9% m/m in June. This 'bring forward' of spending will likely continue ahead of the GST hike on October 1.

Terms of trade (%q/q, 2Q) - The terms of trade likely will rise a further 5.8% q/q, adding to the 5.9% increase recorded in 1Q. Export prices likely will be up strongly, arising 7%, although slow from the double-digit pace recorded in the previous quarter. Import prices also should rise, with our forecast calling for a 1.1% increase.

Australia

- Aussie GDP growth bolstered by consumer spending
- RBA to remain on policy sidelines next week
- Election hires will have boosted employment in August

The so-called “Lucky Country” continues to live up to its reputation. The slew of economic data released last week, including the June quarter GDP numbers, confirmed that the Australian economy remains on a very solid footing. Indeed, the biggest threat to the economic outlook continues to stem from the external sector. It primarily is for this reason that the RBA Board likely will leave the cash rate steady Tuesday.

RBA in “wait and see” mode

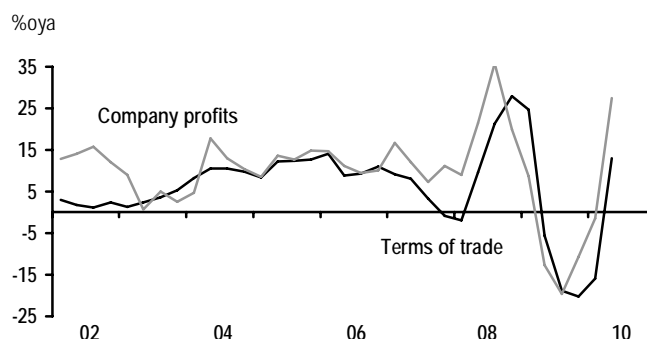
The 2Q GDP numbers showed that the Australian economy is booming, but the RBA likely will stand pat this week, leaving the cash rate at 4.5% for the fourth straight month. The threat of a sharper-than-expected slowdown in global growth means that the RBA likely will tread cautiously in coming months. Not only is there increased risk that the US may slip back into recession, but the economic data emerging from Asia also have taken on a softer tone.

Indeed, RBA Assistant Governor Guy Debelle last week flagged the risk that the world could again fall into recession (our global team puts the risk of this at 30%). Debelle said this risk is “somewhat unquantifiable,” but the comments prove that RBA officials have started to factor in the prospect of such an event. This will keep the RBA in “wait and see” mode for the time being. That all said, had the global picture not deteriorated so significantly in recent weeks, RBA officials would certainly be in the position to tighten policy further in the very near term.

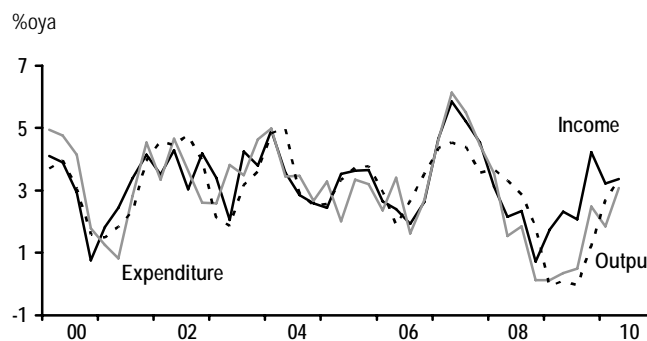
The commentary accompanying what we believe will be a “no change” decision this week probably, if anything, will be slightly more dovish than what we have become accustomed to. In recent months, the RBA has balanced the strength of the domestic economy against the impact of some signs of weakness offshore. While the first part of that equation remains intact, thanks to the booming terms of trade and positive investment outlook, the RBA likely will have downgraded its assessment of the global economy, which it previously forecast would grow around trend in the year ahead.

Our forecast is for the next rate move to be delivered in February. The deteriorating inflation outlook will mean, though,

Australia: company profits and terms of trade



Australia: GDP components



that after an extended pause the RBA will tighten policy steadily throughout 2011. The soaring terms of trade and booming investment will pose the biggest challenges for the RBA Board. Indeed, as indicated by the national accounts last week, real gross domestic income jumped 4%q/q in 2Q, reflecting the higher terms of trade, which was up 12.5% over the quarter. This marked the largest quarterly growth in gross domestic income since 1Q73.

Aussie economy powering ahead

The June quarter national accounts were by all means impressive. Having recorded GDP growth of 0.7%q/q in 1Q, the economy expanded at a rapid clip of 1.2% in the three months to June. Household consumption and net exports made the largest positive contributions to the robust performance, while the change in inventories was a major drag.

It is important to note that GDP is the average of three measures: output, expenditure, and income. The 2Q GDP result largely reflected higher income. The income side of the national accounts spiked 1.4%q/q thanks to the soaring terms of trade, which bolstered mining profits 63%q/q in 2Q. However, in attempting to get a measure of “real” profits, rather than nominal, for the GDP income calculation, a broader price deflator could not purge all of these export-specific

price effects. This is in contrast to the expenditure calculation, where export volumes can be more rigorously derived from export values by the use of a specific export price deflator. As a result, more of the nominal growth was designated as “real” in the income measure of GDP, than on the expenditure side. This meant that the estimate of average GDP, relative to what was predicted from the expenditure data, was significantly higher in 2Q. While the average of the three measures of GDP rose 1.2% q/q as the headline indicated, the expenditure measure rose 1.0%.

Household consumption will moderate

Private demand accelerated with a vengeance in the June quarter. Indeed, the largest positive contributor to 2Q GDP growth was household consumption, which added 0.9%-pt to the headline. This coincided with the savings rate dropping to 1.5% from 3.4%. While the significant discounting occurring among local retailers has weighed down sales in value terms, in volume terms sales have remained exceptionally strong. That said, the monthly retail sales data last week, which is in value terms, showed a 0.7% m/m spike in August, thanks to strong sales of discretionary items.

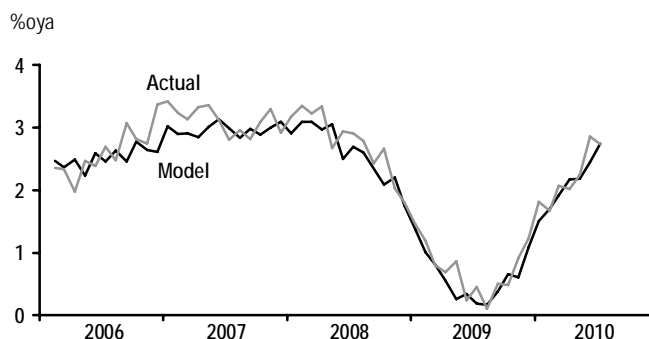
Household consumption likely will moderate, particularly in areas of discretionary spending. The lagged effect of the policy tightening already delivered by the RBA (150bp between October 2009 and May 2010), the waning impact of the fiscal stimulus, and the adoption of a more cautious approach among households amid heightened concerns over the global outlook, will mean that consumers rein in spending in the near term. Such austerity on the part of households remains a key element of our growth forecasts.

Election campaign to boost jobs

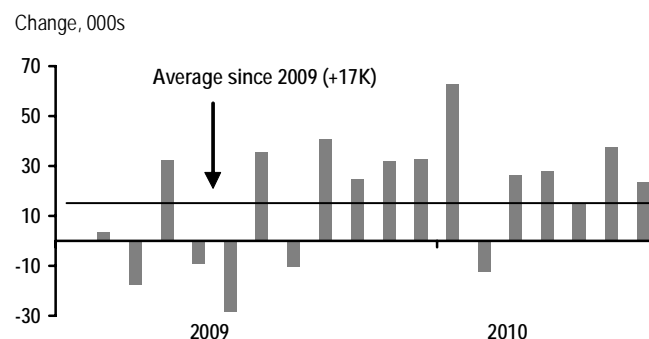
The recent strength in household consumption also can be attributed to the remarkable improvement in the labour market. The economy added a whopping 180,000 jobs in the first seven months of 2010—an average of more than 25,000 per month. Following these strong job gains, we expect to see a moderation in employment growth. That said, the August employment numbers will be bolstered by a rise in temporary workers associated with the Federal election campaign. Taking that into account, we forecast a rise of 25,000 in employment and, with the participation rate falling a notch to 65.4%, an unemployment rate of 5.2%, compared to 5.3% in the previous month.

Job creation likely will be more subdued going forward relative to 1H10, but the absence of a significant hangover after

Australia: employment



Australia: monthly employment



prior robust gains is representative of looming supply side pressures. The labour market remains in a regime of structurally faster employment growth than that witnessed in recent years. The unemployment rate will, though, on our forecasts, maintain a 5%-handle this year thanks to an elevated level of labour force participation.

Data releases and forecasts

Week of September 6 - 10

Mon Sep 6 11:30am	ANZ job advertisements Sa	May	Jun	Jul	Aug
	%m/m	2.7	2.8	1.3	<u>1.0</u>
Tue Sep 7 2:30pm	RBA cash rate announcement	No change expected. See main text.			
Wed Sep 8 11:30am	Housing finance approvals: owner occupiers Number of loans, sa	Apr	May	Jun	Jul
	%m/m	-1.9	3.0	-3.9	<u>0.5</u>
	%oya	-26.3	-25.0	-28.6	<u>-26.4</u>

We forecast another soft result for home loans. While the withdrawal of grant-sensitive buyers, following the expiration of the expanded First-Home Buyers' grant, likely has run its course, there remain significant drags on loan demand, such as the lagged effect of the RBA's policy tightening and worsening housing affordability.

Thu Sep 9 11:30am	Labor force Sa	May	Jun	Jul	Aug
	Unemployment rate (%)	5.2	5.1	5.3	<u>5.2</u>
	Employed (000 m/m)	15	37	23	<u>25</u>
	Participation rate (%)	65.2	65.3	65.5	<u>65.4</u>

See main text.

Review of past week's data

Inventories

	4Q09	1Q10	2Q10		
%q/q,sa	0.4	0.5	0.9	<u>0.2</u>	-0.5
%oya,sa	-2.7	-1.2	-0.9	<u>1.2</u>	0.6

Company operating profits (business indicators)

Nominal, gross operating, sa

	4Q09	1Q10	2Q10		
%q/q	3.2	3.8	3.9	4.3	<u>1.0</u> 18.9
%oya	-10.7	-1.3	-1.6	<u>6.7</u>	27.5

The monumental rise in company operating profits owed to a surge in profits in the mining sector (+63%q/q) thanks to higher contract commodity prices.

Current account balance

A\$ bn, sa

	4Q09	1Q10	2Q10		
Current account (A\$ bn)	-18.5	-19.3	-16.6	-16.5	<u>-5.6</u>
% of GDP	-5.8	-6.0	-5.1	-5.0	<u>-1.7</u>

The CA balance improved on the back of the booming export earnings that already have been witnessed in record monthly trade surpluses and quarterly profit growth. The CAD dwindled to around 1.7% of GDP. The trade balance printed in positive territory for the first time in five quarters, at A\$6.5 billion, with goods exports very strong, up 27%q/q. Exports of nonfarm goods posted a huge rise, ahead 29%q/q, but farm goods were no laggard, pushing up 6%.

Private sector credit

	May	Jun	Jul		
%m/m,sa	0.5	0.2	<u>0.2</u>	0.1	
%oya,sa	2.7	2.8	2.8	2.9	<u>2.8</u>

The modest 0.1% m/m rise in the total amount of credit outstanding was the slowest rate since November last year, thanks to a sharp drop in business credit. The business com-

ponent declined 0.4% m/m, marking the second straight monthly decline. Housing credit, by far the largest pool, picked up unexpectedly, rising 0.5% m/m despite the withdrawal of first-home buyers. Personal credit was flat.

Retail trade

	May	Jun	Jul		
%m/m,sa	0.2	0.4	0.2	0.4	<u>0.4</u> 0.7
%oya,sa	1.1	1.2	1.9	2.0	<u>3.2</u> 4.0

There was a surprisingly strong increase in sales of discretionary items (+0.9% m/m), owing to a jump in sales at cafes and restaurants. Sales at departments stores and of household goods were down, probably owing to the significant amount of discounting still being delivered by local retailers. Sales of non-discretionary items, such as food, posted a slightly smaller, but still solid, 0.6% m/m gain.

Building approvals

	May	Jun	Jul		
%m/m, sa	-6.4	-7.0	-3.3	<u>-4.5</u>	2.3
%oya, sa	29.7	31.1	13.2	14.2	<u>2.2</u> 11.0

The rise in approvals is a welcome development, but there is little in the detail or in the trajectory of the series to argue that building activity has broken from the structural malaise already in place. With the signal in the data becoming increasingly clear—house approvals being soft and growth in the higher density continuing along a downward path—we view the broad downtrend in building activity as being fairly well entrenched. Further, we see few macro triggers that could reverse this underwhelming performance. Monetary conditions are likely to stay on the tighter side of neutral, and the absence of first-home buyers, who are particularly levered to new construction, will be an impediment.

Real GDP

Chain volume, sa

	4Q09	1Q10	2Q10		
%oya	1.1	1.0	0.5	0.7	<u>0.5</u> 1.2
%q/q	2.8	2.6	2.7	2.6	<u>2.3</u> 3.3

The solid expansion stemmed primarily from household consumption and net exports, while the change in inventories was a major drag. See main text for additional commentary.

Trade balance

	May	Jun	Jul		
Trade balance (A\$ mn,sa)	1825	1901	3539	3438	<u>2800</u> 1888

The trade balance retreated sharply from the record high surplus recorded in June. The surplus would not have narrowed so much had a one-off government purchase of six aircraft not been recorded in the July month. Exports fell 4% m/m, due to a drop in nonfarm exports, while imports were up 2%. The rise in imports owed to higher intermediate goods (+9%), which were bolstered by the purchase of six "Super Hornets" by the Department of Defence.

New Zealand

- **Confidence in NZ recovery continues to wane**
- **Kiwi firms not planning price rises**
- **High-profile bankruptcy to further undermine sentiment**

We expect that RBNZ Governor, Alan Bollard, will leave the official cash rate (OCR) unchanged on September 16. But unlike his contemporary across the ditch, the decision also will owe to building evidence that the recovery underway in New Zealand has come to a standstill.

Outlook for residential investment at risk

Question marks have arisen over the pace of recovery in residential investment in particular. While we had expected that the number of building permits would steadily increase after an extended period of weak activity, the uptrend in permits appears to be leveling off. It seems that the slowdown in net migration and higher interest rates are curbing activity in the housing market. This suggests that the recovery in residential investment will be softer than it has been in prior quarters, and poses downside risks to our forecast.

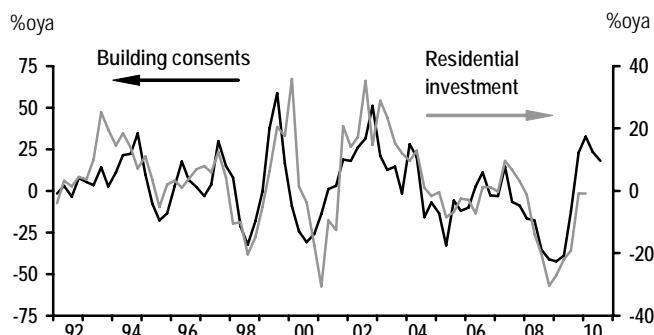
Further, the results of the NBNZ survey of business confidence last week confirmed that the outlook for the building sector appears to be deteriorating. The survey showed that the largest fall in confidence in August was recorded in the residential construction sector—a net 11% of those surveyed now expect that conditions in that sector will worsen. In the previous survey, a net 10% of respondents had expected that conditions in this sector would improve.

Price pressures contained in NZ

The information on firms' pricing intentions revealed in the NBNZ survey would have been welcomed by RBNZ officials, however. Governor Bollard recently flagged his concerns that households and businesses may increase margins and wages in response to the forthcoming GST hike. The NBNZ survey showed, though, that pricing intentions remained largely steady in August, with a net 32% of respondents expecting to increase prices in the next 12 months, compared to 31% previously.

One would expect pricing intentions would be rising significantly ahead of the forthcoming GST hike, but the lack of pricing power among firms means that prices will, if anything, rise only modestly going forward. With pricing intentions steady, and with inflation expectations easing, Bollard has acquired more time to sit on the policy sidelines. Our forecast

New Zealand: building consents and residential investment



is for the next rate hike to be delivered in December, although the risks are skewed to a longer pause should the global picture take a further turn for the worse.

NZ confidence hit from all angles

Confidence in the economic recovery under way in New Zealand likely should deteriorate further in the wake of the news that the country's second-largest finance company, South Canterbury Finance, was put into receivership last week. The Treasury already has paid the finance company NZ\$1.6 billion under the government guarantee. It is understood the payment will cover all investors as well as some ineligible for payment under the guarantee scheme. The government has taken swift steps to repay depositors, and limit the disruption to the economy, but confidence will surely have taken a significant hit.

Data releases and forecasts

Week of September 6 - 10

Wed Sep 8	QVNZ house prices %, median	May	Jun	Jul	Aug
	%oya	5.6	5.2	4.1	—
Fri Sep 10 10:45am	Terms of trade Sa	3Q09	4Q09	1Q10	2Q10
	%q/q	-1.6	5.8	5.9	<u>5.8</u>

Review of past week's data

NBNZ business confidence	Jun	Jul	Aug
% balance of respondents	40.2	27.9	<u>25</u> 16.4

The headline reading has declined 34-pts since February. The decline in the activity outlook suggests that economic growth will moderate later this year. This is in line with our forecast that GDP growth will slow from the 1.1%q/q we expect in 2Q to 0.9% and 0.5% in 3Q and 4Q, respectively. Indeed, the second- and third-quarter GDP results will be bolstered by the efforts of consumers to “bring forward” spending ahead of the hike to the GST hike on October 1.

Building consents

	May		Jun		Jul	
%m/m,sa	-9.5	-9.2	3.5	3.3	—	3.2
%oya,sa	11.2	11.1	27.7	27.9	—	26.5

The rise in the number of permits was slightly stronger than expected in July, owing to a rise in apartment units authorized (203, with over half being retirement units). Excluding the volatile apartment category, the number of new housing units dropped 5.3% m/m. Total permits, at 1,473, were still well down from their peak in June 2007 of around 2,700.

ANZ commodity price series

Not seasonally adjusted

	Jun	Jul	Aug
Index - world prices (%m/m)	-1.6	-0.8	— -1.4
Index - NZD (%m/m)	-0.4	-2.8	— -1.5

Global Essay

- **Global growth settling below trend in 2H10**
- **Encouraging signs that weakness is not intensifying**
- **EM domestic demand holds up as manufacturing sector slows sharply**
- **This week: Looking for rate hikes from the BoC and BoK; expecting the RBI to pause on September 16**

Steady as she slows

The data flow continues to underscore a downshift in global growth. Last week, our August all-industry PMI survey fell for the fourth consecutive month, moving to a level broadly consistent with trend-like global GDP growth. With the PMI orders/inventory ratio still falling, it is likely that we have not seen the bottom in the survey. What's more, a deceleration in production and trade flows is gathering steam across the globe. The downshift in industrial production growth has been most pronounced in emerging market economies, where gains have slipped below a 3% pace over the past three months.

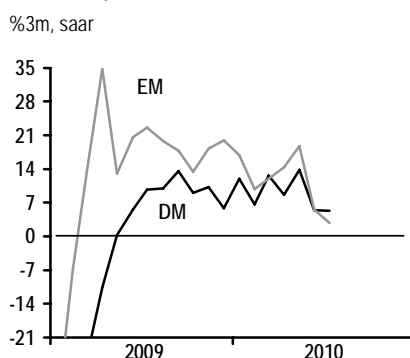
A substantial slowing in EM production growth had been expected, reflecting the region's role as a supplier of industrial materials and finished manufactured goods. EM growth ramped up over the past year as firms across the globe adjusted their depressed production levels upward as the recovery took hold. With production and final demand more closely aligned, the period of double-digit production gains is over. Unfortunately, this downshift also reflects more fundamental disappointments. Chinese growth slowed more than expected last quarter, and it appears that a significant inventory correction has taken hold. At the same time, DM retail sales volume gains stalled into midyear. A fading of fiscal policy supports contributed to this outcome. However, there has also been a deterioration in household sentiment, concentrated in the US. The message from surveys is that the

manufacturing sector downshift is continuing and is being reinforced by adjustments by firms to weaker-than-expected demand, signaling that global GDP growth will stay below trend during the second half of 2010.

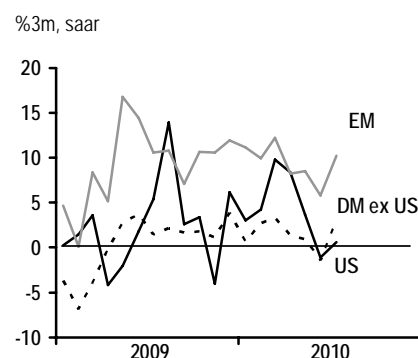
While recent developments have disappointed, we believe there are fundamental supports that will cushion the slowdown. If they hold, drags will gradually fade, setting the stage for a resumption of above-trend growth early next year. The latest news has been modestly encouraging on a number of fronts.

- **EM domestic demand holds firm.** Although EM growth is slowing sharply in the face of a global manufacturing downshift, domestic demand continues to grow at a solid pace. In part, this reflects the sustained strong capital inflows into the region. In addition, policymakers across the region are pausing on the path of rate normalization as they take out insurance against the risks of weakness elsewhere. The growing importance of EM demand as a driver of the global outcomes should not be missed. EM consumer demand now likely accounts for about 35% of overall global spending.
- **China downshift looks to be over.** The abrupt deceleration in China is expected to end this quarter. Although export growth is likely to slow sharply in the coming months—as the front-loading of activity ahead of the reduction in export VAT rebates effective July 15 unwinds—the continued solid pace of domestic demand gains has allowed an inventory correction to progress quickly. The stage appears set for production gains to stabilize. Last week's unexpected rise in the August manufacturing PMI (following seven straight monthly declines) in the headline index bolsters confidence in this view. China's shifting activity mix should provide a positive impulse for its major trading partners. The surge in US imports last quarter,

Industrial production

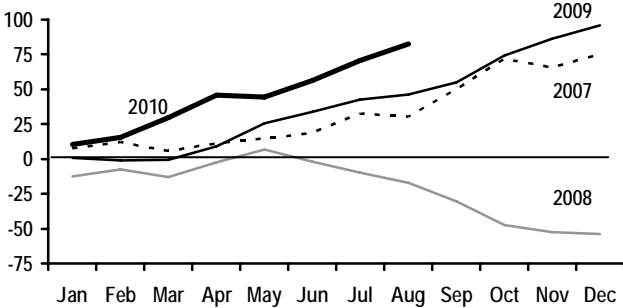


Retail sales volume



EM net capital inflows

US\$ bn, cumulative to date



in particular, looks to be partly related to this front-loading of exports and is likely to be unwound.

- **US corporates bend but don't break.** Economic reports for August are generally consistent with our forecast of a subpar US GDP gain this quarter but have also reduced concern that weakness is intensifying. Importantly, private sector hiring has been sustained at a 78,000 monthly pace in the last three months and the upward trajectory in hours and labour income remains intact through the soft patch. Sustained income growth is a key to sustaining consumer spending gains, and last week's readings on July and August spending point to real consumption gains holding close to a 2% pace this quarter.

Consistent with more encouraging news, risky asset prices lifted last week. This positive financial response to signs of sustained modest growth—along with a fading of drags from manufacturing and fiscal policy—is part of the recipe for lifting global growth above trend as we move into 2011.

Japan: symbolic easing, subdued growth

The BoJ eased at an emergency meeting on Monday amid signs of slowing domestic and external growth, weaker financial conditions (rising yen, falling equity market), and government pressure to act. The move coincided with the government's announcement of a new fiscal stimulus package. As discussed last week, these measures are largely symbolic. With the BoJ expected to remain on hold at this week's regular meeting, the next important policy development is the DPJ presidential election on September 14. Should Ozawa win, the new administration will push for more aggressive fiscal and monetary policy support.

Last week's data provided some good news. The MoF corporate survey suggests that 2Q GDP growth will get revised up to about 1.5% based on stronger capex. At the same time,

July retail sales were firm and August auto registration skyrocketed before the expiration of the government's incentive program. IP unexpectedly rose in July, and manufacturers projected additional gains in August and September. The Shoko Chukin small business survey edged higher. In all, current quarter GDP is now tracking above our 1.8% forecast. However, this quarter's consumption is temporary as auto sales are set to tumble with the end of subsidies, and the extremely hot summer—which boosted seasonal spending—draws to a close. Moreover, the export backdrop is worsening due to slower global growth and the strong yen.

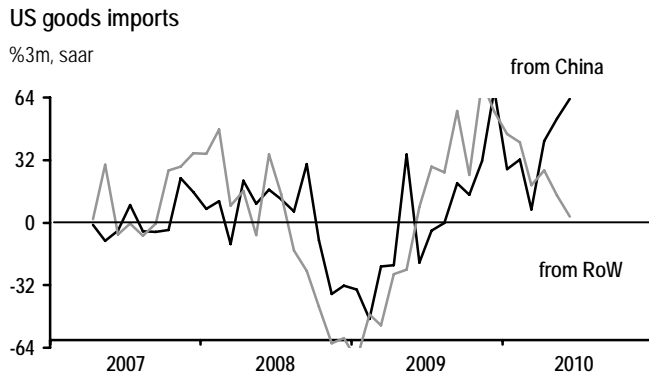
Further downshift still to come in EM Asia

Economic activity in EM Asia outside China and India is being buffeted by numerous crosscurrents. Industrial activity has downshifted sharply with regional output expanding 5% annualized in the three months through July as opposed to the 20%-30% pace posted earlier this year. The August manufacturing output PMI, which dipped below 50 for the first time since February 2009, points to a further deceleration. At the same time, robust gains in domestic demand have helped to soften the growth slowdown. On net, GDP is projected to slow to a below trend pace in 2H10.

The Bank of Korea will have to gauge the relative magnitudes of these crosscurrents at its policy meeting this week. After hiking the base rate by 25bp in July, the BoK kept rates unchanged last month, but maintained its hawkish tone. Whether it follows through with a second rate hike Thursday or waits until after the Chuseok holidays in late September is a close call, but better-than-expected US data releases on balance last week tilt the risks toward more immediate action.

RBI to turn cautious on growth outlook

India had stayed largely immune from the downshift in regional growth that started last quarter, but the sustainability of this momentum is now in question. As reported last week, GDP rose 8.5% annualized in 2Q10, down only slightly from the previous quarter's pace. However, government spending was a key support last quarter, while private consumption continues to languish and softening G-3 demand has weighed on export growth through July. Against this backdrop, we now expect the RBI to pause at its September 16 mid-quarter policy review. However, the delay will only be temporary insurance against a material weakening in growth. Inflation remains double-digit, driven by a sustained acceleration in core prices. With real interest rates



still negative, further tightening is required. We expect another 50-75bp of hikes before the middle of next year.

RBA to hold while BoC hikes this week

Having dodged the global recession, Australia's central bank moved early and aggressively to normalize policy rates. However, last week's data on 2Q GDP and July retail sales show that the economy continues to run fast, boosted by rising terms of trade. Although the outlook argues for additional rate hikes, we have changed our policy call to expect rates on hold for the remainder of 2010, reflecting the RBA's uncertainty about the global outlook.

The BoC also meets this week. As a major commodity exporter, Canada has much in common with Australia, including the powerful boost to domestic demand from rising terms of trade. However, Canada's fortunes are more closely tied to a more sluggish US recovery whereas Australia has been propelled by the Asian blastoff. Nonetheless, domestic demand in Canada has rebounded this year and prompted the BoC in June to follow the RBA's lead and raise its policy rate. It has only just begun, however, raising its overnight rate twice (25bp each) since June. We look for another 25bp rate hike to 1.00% this week as the BoC continues to gradually take its foot off the monetary accelerator. The sharpness of the 2Q growth slowdown—due to a

large net trade drag—and the growing uncertainty over the US outlook may slow the pace of normalization going forward, as it already has in Australia. The language in this week's announcement will be key to gauging the BoC's views.

Odds of a rate hike rising in Hungary

The Swiss franc reached a new high against the Hungarian forint last week, prompting the National Bank of Hungary (NBH) to raise the prospects of a rate hike. A further rise in CHF/HUF would pose downside risks to growth, through its impact on foreign currency borrowers, and could force some banks to seek additional capital. Further pressure comes from the government's refusal to sign a new loan agreement with the IMF after the current one expires in October. Investors are particularly nervous about the country's high level of debt, and the government's refusal to commit to a sub-3% deficit target. At the same time, upside risks to the NBH's inflation target are rising, owing in part to the weaker currency. We believe that building market pressure will force the government to reengage with the IMF after the October 3 municipal elections.

Brazil domestic demand motors along

As in Emerging Asia, strong domestic demand growth is cushioning the slowdown in industry across Latin America. Brazil is a prime example. Although manufacturing has slowed sharply, unemployment is at historical lows, bank credit is expanding briskly, and consumer optimism is at a record high. This backdrop will continue to support household consumption in the second half, already apparent in the recovery of vehicle sales in August to historical high levels. Government spending also is surging in advance of October's elections. Having hiked 200bp since April, the central bank announced it was going on hold in response to the more mixed tone of data. However, we think the economy will outperform the central bank's expectations. This will produce a further rise in inflation, forcing the COPOM to resume tightening in early 2011.

JPMorgan View - Global Markets

Relief, but not out of trouble

- **Economics:** US payrolls and ISM reduce the downside risk for the economy, but do not yet create upside risk. No change in forecasts. The main scenario for the world is growth slowing to potential, without a double dip.
- **Asset allocation:** Slowing but still positive growth is good for bond duration and curve flatteners. It favours credit over equity exposure. With greater risk in the US, we stay overweight EM across asset classes.
- **Fixed income:** Overweight Euro area high-yielders, EM local bonds, and US MBS.
- **Equities:** Overweight Banks and EM equities. Underweight Industrials and Cyclical sectors.
- **Credit:** Stabilizing economic activities and strong fundamentals are keeping us overweight in credit, focused on higher-yielding sectors.
- **FX:** We stay long JPY vs. USD and CHF vs. EUR.
- **Commodities:** Stay underweight crude oil and overweight agriculture.

Another week, another yo-yo. **Economic data were far from fantastic, but they were enough to arrest the downward momentum.** A sigh of relief went through markets, and risky assets bounced back toward the middle of the trading range they have been holding for almost four months now. Bonds sold off, but remain well up on a month ago.

The third derivative is our main support. All attention last week was on ISM and payrolls, with fears that these would support indications from earlier data releases that US companies are starting to retrench. Last week's data confirm that growth is moderating, but show that activity is clearly not retrenching. Downside risk on the economy—the so-called double dip—has fallen, supporting the bounce back in risky markets. A reduced pace of decline in the economy's growth pace is the third derivative of activity: growth is the first derivative; the change in growth is the second; and the change in the pace of growth rate decline is the third. This is to underline that one should not be over-optimistic on last week's data.

On net, US data releases over the last two weeks are in line with our forecasts and do thus not require forecast changes. **We reduce downside risk on the US and world economy, but see little to signal any upside risk bias.**

The reduced risk of a double dip does not create an economic boom. **We remain in a slowing growth environment.** Over the next year, we see the world economy growing at its potential rate. This thus fails to eliminate excess capacity, especially in the older economies. Deflation tail risks remain in place, and we retain a number of positions that gain from rising deflation risk—long duration, curve flattening, long JPY and CHF, and long spread product. These fears will also strengthen a yield-focus in equities. This already started three months ago. Over this period, major equity indices are flat, but bondlike equities have done much better. US preferreds are up 11%; US convertibles are up 3%, Utilities 7%, Telecoms 15%, and global high-dividend stocks (MSCI) are up 5%. Watch the performance of these bondlike equities as a signal of bond mentality invading the equity world. Investors worried about low growth and deflation should focus on these.

Intense market attention on US data makes one miss the surprising resilience of activity data in the Euro area. Industrial data, PMIs, and confidence have been quite resilient over the past few months. At one point, one could just dismiss this with the argument that Europe would just follow US weakness, as it always has. But this argument has become strained, with recent data clearly running ahead of our forecasts. Given the markets' dismissiveness of Euro area data, this may not create significant outperformance of EU asset equities and credit. We are actually underweight in EU credit. But one place where we do expect some support is for EMU periphery bond markets. We retain a small overweight.

Fixed income

Bond markets fell badly, on better-than-feared US activity data. Bond investors have not turned bullish on world growth. But they are pricing out the chance that the Fed will announce a new QE buying package on USTs. We do not want to change our long duration here. Positions are not overly long, aside from Japanese banks, which have bought heavily in recent months. Price momentum, which we assess on a four-week rolling return basis, has not yet turned negative. And growth is still falling in the world, which will further depress any remaining inflation, while we are as yet not raising growth forecasts. Stay long and in flatteners.

EM local bonds continue to perform strongly, rising by just over 1% in August for a YTD gain of close to 8%. We like EM bonds for three reasons. First, low rates on the safest assets will keep on pushing investors to look elsewhere; this is evident in the continued solid inflows into EM bonds, which we expect to reach \$70-75 billion for the year,

far above last year's previous record of \$46 billion. Second, EM governments on the whole have stronger balance sheets than their DM counterparts, making them better insulated against the sovereign credit risk worries that have roiled the Euro area. Third, just as in DM, the global economy's loss of momentum is tempering EM central banks' desire to normalize policy, and will prompt further easing in some cases (e.g., we expect South Africa to cut this week, and possibly again in November).

Equities

Better-than-expected US economic data last week triggered a 3% rally, helping equities to rise toward the upper part of their three-month trading range. What do we need to see for equities to break out of this range?

First, we need economic data to stop surprising to the downside. While we had one week of somewhat better data, the overall picture for US economic data over the past month looks rather disappointing. Indeed, our **US Economic Activity Surprise Index** (EASI), which tends to correlate well with equities and tracks data surprises over a six-week rolling window, remains in negative territory.

Second, we need to see an improvement in flows. The **flow picture**, which we track in our weekly publication *Flows & Liquidity*, remains rather negative. In terms of end-investor flows—retail and real money investors—the most recent data continue to show heavy selling of equities and buying of bonds. The flow picture is more mixed in terms of corporate flows. M&A and LBO volumes picked up over the past two months, but share buyback activity has slowed.

A still negative EASI and a rather negative flow picture make us focus recommendations on relative rather than outright equity trades. Across regions, we avoid the US and Japan, where most of the economic weakness is currently being felt, and **focus our exposure on EM**. Indeed, EM equities resumed their outperformance over the past month.

Across sectors we continue to avoid Industrials and other Cyclical sectors as they are being hurt by the downturn in manufacturing and their low dividend yields.

Our overweight in **Banks** suffered a heavy loss in August driven by steep declines in US bank stocks. The KBW US bank index plummeted by 11% in August due to worries of US government intervention in the mortgage refinancing market, concerns about a new loan loss reserve methodol-

ogy, and fears that sustained economic weakness will slow the improvement in credit losses and accelerate the shrinkage of bank loan books. While we have some sympathy with the last concern, the first two are rather overblown. **Stay overweight in Banks globally.**

Credit

We continue to keep small overweights in credit, focused on higher-yielding sectors of high yield, top-quality CMBS, and subordinated ABS.

Still declining default rates are providing a strong value anchor for US high-yield bonds. The 12-month rolling default rate for HY bonds fell to 2.6% in August, its lowest level since December 2008, and is set to decline to 2% by year-end (see *Default Monitor*, P. Acciavatti, Sep 1). Low refinancing needs for US HY companies imply that the default rate will stay low at 2% at least until the end of 2011. This makes US HY corporate bonds attractive from a carry standpoint.

CMBS prices continue to reflect overly pessimistic loss expectations, in our opinion. Benchmark cash bonds are currently implying cumulative losses of 15%-20% while we expect losses to be in the range of 9%-12%. With supportive demand and supply dynamics and stabilizing fundamentals, we **stay overweight in cash CMBS at or near the top of the capital structure.**

ABS fundamentals should be stable even in a weak growth environment, given the structural enhancements that took place during the recession. Over the summer months, top-tier ABS spreads have narrowed while non-benchmark spreads were largely unchanged. This creates an opportunity to add risk in the subordinated sectors that have lagged the rally. Our top picks include **AAA Retail Cards, and subordinated Cards and Autos** (See *ABS, USFIMS*, A. Sze, Aug 27).

There is a strong perception that the Euro area economy will lag the global cycle and that upcoming European economic data will soften despite recent strength. We recommend **underweighting European cyclicals vs. defensive credits** as the cyclical premium remains too low. The cyclical premium, i.e., the spread between cyclicals versus non-cyclicals as a percentage of the non-cyclical credit spread, is currently close to the lows seen in late 2007 to early 2008 (see *Trading the slowdown*, T. Zhang et al, Sep 3).

Foreign exchange

Our core views and trades haven't changed post payrolls. The message from last week's data is that the major regions are stabilizing at variable growth rates—US below trend, Europe above trend, and Asia at trend. That environment should be dollar negative through all the usual channels—higher stocks, renewed carry trades—but most currencies still look destined to range rather than trend.

For **EUR/USD**, the obstacle to a sustained break of 1.30 is the suspicion that a European growth slowdown is imminent. Add to that a heavy sovereign refunding calendar for the periphery in September—€67 billion, the heaviest month this year—and buying into this EUR/USD uptrend is risky. Technical resistance is also close (see *A game plan for EUR/USD*, T. Anthonj, Sep 3).

If Europe's economy also slows to below trend, **commodity currencies** would struggle to make new highs for the year. And since none of these currencies reached cheap levels during the August sell-off nor did position measures fall to below-average levels, there is little reason to own them. We were stopped out of short NZD/JPY last week at a profit of 1.75%, and stay neutral in this bloc.

The **yen** and **Swiss franc** still look like the only buy-and-holds. It is telling that USD/JPY was unchanged in a week when stocks rallied 4% and the US 10-year Treasury sold off 25bp. The key, however, is fed funds expectations, which will remain flat until jobs growth accelerates meaningfully—private payrolls above +100k. **We stay short USD/JPY. EUR/CHF** is a more extreme version of USD/JPY—spread compression and a trade surplus—so we stay short here too in cash and options (1.25 June 2011 at-expiry digital).

Commodities

We have been overweight agriculture since the beginning of July as we saw significant supply risks to grains from adverse weather conditions across the globe. Since then, the GSCI Agriculture index has gained 30%, and we continue to believe **supply conditions are tight**. Last week, Rus-

Ten-year Government bond yields

	Current	Sep 10	Dec 10	Mar 11	Jun 11
United States	2.71	2.65	2.50	2.50	2.50
Euro area	2.35	2.10	2.15	2.20	2.30
United Kingdom	3.01	2.90	2.90	3.00	3.10
Japan	1.15	0.85	0.80	0.80	0.90
GBI-EM	6.41			7.90	

Credit markets

	Current	YTD Return
US high grade (bp over UST)	169	9.6%
Euro high grade (bp over Euro gov)	178	5.6%
USD high yield (bp vs. UST)	697	8.8%
Euro high yield (bp over Euro gov)	685	9.0%
EMBIG (bp vs. UST)	299	12.5%
EM Corporates (bp vs. UST)	352	11.4%

Foreign exchange

	Current	Sep 10	Dec 10	Mar 11	Jun 11
EUR/USD	1.29	1.25	1.25	1.25	1.25
USD/JPY	84.4	80	79	81	83
GBP/USD	1.54	1.47	1.44	1.42	1.42

Commodities - quarterly average

	Current	10Q3	10Q4	11Q1	11Q2
WTI (\$/bbl)	74	75	75	75	77
Gold (\$/oz)	1249	1250	1275	1250	1250
Copper(\$/m ton)	7623	6500	6750	6750	7000
Corn (\$/Bu)	4.65	3.90	3.80	4.00	4.20

Source: J.P. Morgan, Bloomberg, Datastream

sia extended its ban on grain exports causing a further rally in wheat prices. In addition, significant supply constraints are likely to remain an issue in the softs market, particularly in sugar and cotton, which have seen sharp price rises this week. **Stay overweight Agriculture.**

Spot oil prices have fallen nearly 11% since their peak at the start of August as weaker-than-expected economic data and a stronger dollar weighed on the front end of the forward curve. **We remain underweight crude oil** as we believe that with upside supply potential from the US and Iraq and global manufacturing growth set to halve into the end of the year, the risks are still biased to the downside.

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	1Q10	2Q10	4Q10	2Q11
The Americas														
United States	-2.6	2.6	2.4	3.7	1.6	<u>1.5</u>	2.0	2.5	2.5	3.0	2.4	1.8	0.9	1.2
Canada	-2.5	3.3 ↓	2.6 ↓	5.8 ↓	2.0 ↓	<u>3.2</u>	3.2	2.7	2.0	2.4	1.6	1.4	1.7	1.9
Latin America	-2.4 ↑	5.6 ↑	3.8	5.0 ↑	<u>9.0</u>	2.2 ↓	3.4 ↑	3.2	5.3 ↓	3.1 ↑	6.2 ↑	6.5 ↑	7.2 ↑	7.4 ↑
Argentina	-2.0	8.5	4.5	12.5	<u>13.0</u>	4.0	4.0	2.0	4.0	8.0	9.0	9.0	10.0	11.0
Brazil	-0.2	7.5	4.0	11.3 ↓	5.1 ↑	3.3 ↓	4.1 ↑	3.8	4.2	4.1	4.9	5.1	5.3	5.4
Chile	-1.5	5.0	6.0	-6.0	18.4	<u>20.0</u>	10.0	2.0	0.0	4.0	-0.3	1.2	3.8	3.8
Colombia	0.8	4.5	4.1	5.3	<u>4.8</u>	3.7	4.0	4.0	4.1	5.0	2.0	2.1	2.8	3.3
Ecuador	0.4	2.0	3.0	1.3	<u>3.5</u>	4.0	4.5	3.0	2.5	2.5	4.0	3.3	3.9	4.1
Mexico	-6.5	4.5	3.5	-2.5	13.5	<u>-3.6</u>	3.1	2.9	9.2	-0.1	4.8	4.0	5.1	4.5
Peru	0.9	8.2	6.0	8.0	12.7	<u>4.8</u>	3.5	5.8	6.7	7.2	0.7	1.2	2.6	2.2
Venezuela	-3.3	-2.2	1.0	-2.0	5.2	<u>3.0</u>	-5.0	2.0	1.0	1.5	27.4	31.9	31.6	34.7
Asia/Pacific														
Japan	-5.2	2.7	1.3	4.4	0.4	<u>1.8</u>	1.0	1.0	1.5	1.8	-1.2	-0.9	-0.7	0.1
Australia	1.2 ↓	3.1 ↑	2.9 ↓	2.7 ↑	4.9 ↑	2.4 ↓	2.7 ↓	2.1 ↓	3.4 ↑	3.0 ↓	2.9	3.1	3.3	3.8
New Zealand	-1.7	2.9	2.7	2.3	<u>4.4</u>	3.8	2.2	2.0	2.8	2.9	2.0	1.8	4.9	5.6
Asia ex Japan	5.6 ↑	8.7 ↑	7.0 ↑	10.5	7.4 ↑	5.5 ↑	6.4 ↑	7.4 ↑	7.3 ↑	7.5 ↑	4.3	4.5 ↑	4.3 ↑	4.0 ↑
China	9.1	9.8	8.6	10.8	7.2	<u>7.5</u>	8.1	9.1	8.9	9.1	2.2	2.9	2.8	2.7
Hong Kong	-2.8	6.6	4.1	8.7	5.7	<u>3.0</u>	3.5	4.2	4.3	4.7	1.9	2.6	2.5	2.2
India	7.4	8.3	8.5	9.2	8.5 ↑	<u>8.0</u>	8.9	8.0	8.5	8.6	15.3	13.7 ↑	11.8	10.1
Indonesia	4.5	6.0	5.4	3.0	7.5	<u>4.5</u>	5.0	5.3	5.2	5.0	3.7	4.4	6.8	6.6
Korea	0.2	6.1	4.0	8.8	5.8 ↓	<u>2.5</u>	3.8	4.0	4.0	4.5	2.7	2.6	3.2	3.5
Malaysia	-1.2	7.2	4.6	4.8	7.2	<u>3.0</u>	3.5	4.9	4.9	4.5	1.3	1.6	1.1	1.3
Philippines	1.1	7.0	3.9	11.9	7.7	<u>0.8</u>	1.6	4.9	4.9	4.9	4.3	4.2	1.8	1.5
Singapore	-1.3	14.8	4.2	45.7	24.0	<u>-11.5</u>	-2.0	8.7	6.6	7.4	0.9	3.1	3.0	1.4
Taiwan	-1.9	9.9	4.1	10.9	7.2	<u>1.5</u>	2.3	4.2	4.6	5.5	1.3	1.1	2.0	1.8
Thailand	-2.2	8.5	5.0	13.9	0.6	<u>2.8</u>	2.8	6.0	5.5	4.0	3.7	3.2	1.1	1.5
Africa/Middle East														
Israel	0.8	3.5	4.5	3.6	4.7	<u>3.0</u>	3.0	4.0	5.0	5.5	3.5	2.8	2.6	3.0
South Africa	-1.8	2.9	3.1	4.6	3.2	<u>3.1</u>	3.2	3.1	3.1	3.4	5.7	4.5	4.5	4.7
Europe														
Euro area	-4.0 ↑	1.7 ↑	1.5	1.3 ↑	3.9	<u>2.0</u>	1.0	1.0	1.0	1.8	1.1	1.5	1.6	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	0.8	1.0	1.2	0.9
France	-2.5	1.6	1.4	0.7	2.5	<u>2.0</u>	1.5	1.0	1.0	1.5	1.5	1.8	1.3	0.6
Italy	-5.1	1.1	1.3	1.6	1.5	<u>2.0</u>	1.0	1.0	1.0	1.5	1.3	1.6	1.5	1.1
Norway	-1.2	1.5	2.3	0.7	1.9	<u>3.0</u>	2.8	2.0	2.0	2.5	2.9	2.6	1.4	1.0
Sweden	-5.1	3.8	2.7	6.2	4.7	<u>3.5</u>	2.8	2.3	2.3	2.8	1.0	1.0	2.3	2.4
Switzerland	-1.9 ↓	2.9 ↑	2.5	4.2 ↑	3.5 ↑	<u>2.5</u>	2.3	2.3	2.5	2.8	1.1	1.0 ↓	0.8 ↓	0.6
United Kingdom	-4.9	1.7	2.2	1.3	4.9	<u>2.5</u>	1.5	1.0	2.5	3.0	3.3	3.5	2.6	1.9
Emerging Europe	-5.3 ↓	4.1 ↑	4.4 ↑	2.8 ↑	4.7 ↑	3.0 ↑	4.4 ↑	3.8 ↑	4.2 ↑	4.6 ↑	6.4 ↑	5.7 ↑	6.2 ↑	6.3 ↑
Bulgaria	-5.0	-0.5	4.0	...	...	...	...	...	...	...	...	...	...	...
Czech Republic	-4.1	2.0	3.2	2.0	3.2	<u>2.5</u>	2.3	2.5	3.0	5.0	0.7	1.2	2.8	2.7
Hungary	-6.3	1.0	3.0	2.4	0.0	<u>2.0</u>	2.0	2.0	3.0	3.5	6.0	5.4	4.6	3.7
Poland	1.8	3.5	3.8	2.8 ↑	4.5 ↑	<u>3.5</u>	3.5	3.0	3.5	4.0	3.0	2.3	2.6	2.6
Romania	-7.1	-2.0	1.5	...	...	...	...	...	...	...	4.6	4.4	8.0	7.2
Russia	-7.9	5.0	5.0	3.4	5.9	<u>3.5</u>	6.0	4.8	5.0	5.0	7.2	5.9	7.2	8.0
Turkey	-4.7	5.9	5.0	...	...	...	...	...	...	...	9.3	9.3	7.5	6.7
Global														
Global	-2.2 ↑	3.6 ↑	3.0 ↑	4.2 ↑	3.8 ↑	2.5 ↑	2.6 ↑	2.7 ↑	3.0 ↑	3.3 ↑	2.5 ↑	2.5 ↑	2.3 ↑	2.3 ↑
Developed markets	-3.5	2.3	2.0	2.9 ↑	2.6 ↑	<u>1.9</u>	1.6	1.7	1.9	2.4	1.5	1.5 ↑	1.2 ↑	1.2 ↑
Emerging markets	1.3 ↑	6.9 ↑	5.7 ↑	7.7 ↑	7.3 ↑	4.2 ↑	5.3 ↑	5.7 ↑	6.2 ↑	5.8 ↑	5.2 ↑	5.2 ↑	5.3 ↑	5.2 ↑
Memo:														
Global — PPP weighted	-0.8	4.5	3.8	5.2 ↑	4.6 ↑	3.2 ↓	3.4	3.7	4.0	4.2	3.3	3.2	3.1	3.0

Global Central Bank Watch

	Official interest rate	Change from			Next meeting	Forecast next change	Forecast				
		Current	Aug '07 (bp)	Last change			Sep 10	Dec 10	Mar 11	Jun 11	Sep 11
Global	GDP-weighted average	1.75	-320				1.76	1.82	1.88	1.97	2.02
excluding US	GDP-weighted average	2.38	-242				2.39	2.47	2.55	2.69	2.75
Developed	GDP-weighted average	0.60	-359				0.61	0.63	0.66	0.69	0.71
Emerging	GDP-weighted average	4.97	-213				4.98	5.14	5.29	5.56	5.67
Latin America	GDP-weighted average	7.18	-223				7.22	7.31	7.80	8.39	8.47
CEEMEA	GDP-weighted average	4.11	-291				4.08	4.10	4.11	4.36	4.65
EM Asia	GDP-weighted average	4.50	-176				4.51	4.76	4.84	5.00	5.05
The Americas	GDP-weighted average	1.25	-456				1.28	1.33	1.44	1.57	1.58
United States	Federal funds rate	0.125	-512.5	16 Dec 08 (-87.5bp)	21 Sep 10	On hold	0.125	0.125	0.125	0.125	0.125
Canada	Overnight funding rate	0.75	-350	20 Jul 10 (+25bp)	<u>8 Sep 10</u>	8 Sep 10 (+25bp)	1.00	1.50	2.00	2.50	2.50
Brazil	SELIC overnight rate	10.75	-125	21 Jul 10 (+50bp)	20 Oct 10	Jan 11 (+25bp)	10.75	10.75	11.50	12.50	12.50
Mexico	Repo rate	4.50	-270	17 Jul 09 (-25bp)	24 Sep 10	On hold	4.50	4.50	4.50	4.50	4.50
Chile	Discount rate	2.00	-300	12 Aug 10 (+50bp)	16 Sep 10	16 Sep 10 (+50bp)	2.50	3.25	4.00	4.75	5.50
Colombia	Repo rate	3.00	-600	30 Apr 10 (-50bp)	24 Sep 10	1Q 11 (+50bp)	3.00	3.00	4.00	5.00	5.50
Peru	Reference rate	2.50	-200	5 Aug 10 (+50bp)	<u>9 Sep 10</u>	9 Sep 10 (+50bp)	3.00	4.00	4.50	4.50	4.50
Europe/Africa	GDP-weighted average	1.44	-322				1.44	1.45	1.45	1.51	1.57
Euro area	Refi rate	1.00	-300	7 May 09 (-25bp)	7 Oct 10	On hold	1.00	1.00	1.00	1.00	1.00
United Kingdom	Repo rate	0.50	-500	5 Mar 09 (-50bp)	<u>9 Sep 10</u>	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)	0.75	1.00	1.00	1.25	1.50
Norway	Deposit rate	2.00	-250	5 May 10 (+25bp)	22 Sep 10	2Q 11 (+25bp)	2.00	2.00	2.00	2.25	2.50
Czech Republic	2-week repo rate	0.75	-200	6 May 10 (-25bp)	23 Sep 10	2Q 11 (+25bp)	0.75	0.75	0.75	1.00	1.25
Hungary	2-week deposit rate	5.25	-250	26 Apr 10 (-25bp)	27 Sep 10	3Q 11 (+25bp)	5.25	5.25	5.25	5.25	5.50
Israel	Base rate	1.75	-225	26 Jul 10 (+25bp)	27 Sep 10	27 Sep 10 (+25bp)	2.00	2.25	2.50	2.75	3.25
Poland	7-day intervention rate	3.50	-100	24 Jun 09 (-25bp)	Sep 10	2Q 11 (+25bp)	3.50	3.50	3.50	3.75	4.00
Romania	Base rate	6.25	-75	4 May 10 (-25bp)	29 Sep 10	3Q 11 (+25bp)	6.25	6.25	6.25	6.25	6.50
Russia	1-week deposit rate	2.75	-25	31 May 10 (-50bp)	Sep 10	2Q 11 (+25bp)	2.75	2.75	2.75	3.25	3.75
South Africa	Repo rate	6.50	-300	25 Mar 10 (-50bp)	<u>9 Sep 10</u>	9 Sep 10 (-50bp)	6.00	6.00	6.00	6.00	6.00
Switzerland	3-month Swiss Libor	0.25	-225	12 Mar 09 (-25bp)	16 Sep 10	Jun 11 (+25bp)	0.25	0.25	0.25	0.50	0.75
Turkey	1-week repo rate	7.00	-1050	-	16 Sep 10	4Q 11 (+50bp)	7.00	7.00	7.00	7.00	7.00
Asia/Pacific	GDP-weighted average	2.89	-131				2.90	3.04	3.11	3.21	3.26
Australia	Cash rate	4.50	-175	4 May 10 (+25bp)	<u>7 Sep 10</u>	Feb 11 (+25bp)	4.50	4.50	4.75	5.00	5.25
New Zealand	Cash rate	3.00	-500	29 Jul 10 (+25bp)	15 Sep 10	Dec 10 (+25bp)	3.00	3.25	3.75	4.00	4.25
Japan	Overnight call rate	0.10	-43	19 Dec 08 (-20bp)	<u>7 Sep 10</u>	On hold	0.10	0.10	0.10	0.10	0.10
Hong Kong	Discount window base	0.50	-625	17 Dec 08 (-100bp)	22 Sep 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)	3Q 10	4Q 10 (+27bp)	5.31	5.58	5.58	5.85	5.85
Korea	Base rate	2.25	-225	9 Jul 10 (+25bp)	<u>8 Sep 10</u>	4Q 10 (+25bp)	2.25	2.50	2.75	2.75	2.75
Indonesia	BI rate	6.50	-200	5 Aug 09 (-25bp)	5 Oct 10	2Q 11 (+25bp)	6.50	6.50	6.50	6.75	6.75
India	Repo rate	5.75	-200	27 Jul 10 (+25bp)	16 Sep 10	4Q 10 (+25bp)	5.75	6.25	6.50	6.50	6.75
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)	7 Oct 10	1Q 11 (+25bp)	4.00	4.00	4.25	4.75	5.00
Thailand	1-day repo rate	1.50	-175	14 Jul 10 (+25bp)	20 Oct 10	20 Oct 10 (+25bp)	1.75	2.00	2.00	2.00	2.00
Taiwan	Official discount rate	1.375	-175	24 Jun 10 (+12.5bp)	3Q 10	3Q 10 (+12.5bp)	1.50	1.50	1.50	1.50	1.625

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

Economic forecasts - Australia

Australia: economic projections <i>percentage change over previous period, seasonally adjusted annual rates, ur</i>														
	2009			2010			2011							
	2009	2010	2011	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Chain volume GDP	1.2	3.1	3.2	2.2	1.3	4.2	2.7	4.9	2.4	2.8	3.1	4.0	3.0	3.4
Private consumption	1.7	3.2	2.4	5.2	1.3	3.3	1.9	6.5	2.4	1.6	2.0	1.6	2.8	3.2
Construction investment	-0.5	2.3	4.7	-3.7	2.4	2.6	-3.1	9.9	3.6	5.3	5.1	2.1	5.2	5.5
Equipment investment	-6.6	-0.9	7.9	-18.0	-5.9	60.3	-26.0	-12.0	13.0	13.0	8.7	6.4	6.4	8.6
Public investment	4.4	32.5	8.9	13.3	43.9	40.6	81.2	0.1	10.2	10.9	7.0	12.4	7.1	10.1
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	4.6	4.4	4.5	-9.2	9.7	-2.8	24.2	1.6	2.0	4.1	4.1	3.6	3.2
Imports of goods & services	-8.3	13.1	6.2	0.3	18.8	32.7	6.6	12.8	6.1	5.7	6.1	4.1	7.4	5.7
Contributions to GDP growth:														
Inventories	-0.5	-0.5	-1.0	0.7	2.8	0.8	1.4	-2.9	-5.9	-0.1	-0.2	0.1	-0.2	-0.1
Net trade	2.0	-1.8	-0.5	0.8	-5.2	-4.1	-1.9	1.7	-1.0	-0.9	-0.6	-0.1	-0.9	-0.6
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	19.3	29.4	-0.9	-4.1	-4.9	-2.7	7.4	7.2	7.3	7.4	7.4	7.7	6.9
Current account (A\$ bil, sa)	-51.4	-9.1	22.1	-13.8	-14.6	-19.3	-16.5	-5.6	7.3	5.7	5.4	5.7	5.8	5.1
as % of GDP	-4.1	-0.7	1.5	-4.4	-4.7	-6.0	-5.0	-1.7	2.1	1.6	1.5	1.6	1.6	1.4
3m eurodeposit rate (%)*	6.0	4.7	5.4	3.5	3.4	4.1	4.3	4.8	4.8	5.0	5.3	5.3	5.4	5.5
10-year bond yield (%)*	5.6	5.3	5.3	5.5	5.1	5.8	5.6	5.5	5.0	5.0	5.2	5.3	5.3	5.4
US\$/A\$*	0.75	0.88	0.90	0.82	0.88	0.91	0.94	0.84	0.88	0.86	0.88	0.92	0.90	0.89
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. The savings rate dropped.
- **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 a 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, but the index rebounded in July, and rose again in August. Optimists 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. The Bank will likely remain on the sidelines for the remainder of the year. We expect four rate hikes throughout 2011.
- **Australian voters** delivered a hung Parliament, the first since 1940. The outcome of the election should be known within days, with key independents to announce which party will be able to form a government.

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	2.9	2.7	0.3	1.2	3.7	2.3	4.4	3.8	2.2	2.0	2.8	2.9	1.9
Private consumption	-0.6	2.6	1.7	1.2	3.8	3.2	0.9	4.3	3.6	0.4	1.0	1.0	2.2	3.5
Fixed Investment	-12.5	0.1	4.1	7.1	-10.4	-7.2	3.3	4.5	4.6	4.1	2.2	4.1	6.0	7.3
Residential construction	-18.5	2.8	4.2	-8.4	-14.7	20.3	2.2	3.2	3.6	4.4	3.2	4.8	6.0	4.0
Other fixed investment	-11.3	-0.4	4.1	10.2	-10	-11.6	3.5	4.8	4.8	4.0	2.0	4.0	6.0	8.0
Inventory change (NZ\$ bil, saar)	-1.8	0.7	0.7	-1.1	-0.7	0.2	0.1	0.2	0.2	0.2	0.2	0.2	0.2	0.1
Government spending	1.7	3.4	1.9	-3.9	2.6	4.5	6.7	2.4	1.6	2.4	1.6	2.4	2.0	0.4
Exports of goods & services	0.0	5.0	7.2	19.2	0.6	-2.7	5.5	8.0	8.0	8.0	7.0	7.0	6.0	6.0
Imports of goods & services	-15.2	8.9	5.8	-11.2	6.3	25.5	7.4	7.0	7.0	6.0	4.0	5.0	7.0	9.0
Contributions to GDP growth:														
Domestic final sales	-5.0	2.4	2.3	1.4	-1.9	1.1	4.0	4.1	3.5	1.6	1.4	2.0	3.1	4.0
Inventories	-2.6	1.9	0.0	-10.2	5.0	11.6	-0.9	0.2	0.1	0.1	-0.2	0.2	0.2	-0.9
Net trade	5.9	-1.4	0.3	9.9	-1.8	-8.3	-0.8	0.1	0.1	0.5	0.9	0.5	-0.5	-1.2
GDP deflator (%oya)	2.0	2.4	2.2	3.3	2.5	-0.1	1.0	1.9	2.8	3.9	2.8	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)	2.5	5.7	5.3	0.8	0.7	0.3	0.9	1.6	1.5	1.6	1.5	1.3	1.3	1.2
Current account (NZ\$ bil, sa)	-5.5	-5.0	-11.9	-0.4	0.1	-2.9	-1.2	-1.3	-1.0	-0.6	-2.1	-5.2	-3.6	-3.5
as % of GDP	-3.0	-2.6	-6.0	-0.9	0.1	-6.5	-2.8	-2.1	-1.3	-4.4	-7.3	-7.0	-5.4	-4.2
Yield on 90-day bank bill (%)*	3.0	3.1	4.0	2.8	2.8	2.8	2.7	2.9	3.3	3.5	3.8	4.0	4.0	4.1
10-year bond yield (%)*	5.5	5.5	5.0	5.7	5.7	5.9	5.9	5.7	5.3	5.1	5.1	4.9	4.9	4.9
US\$/NZ\$*	0.64	0.70	0.70	0.60	0.68	0.73	0.71	0.70	0.70	0.67	0.68	0.72	0.71	0.70
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 at a healthy clip of 0.6%q/q in 1Q. Economic growth should remain strong in 2Q and 3Q, underpinned by consumer spending, with consumers likely to bring forward spending ahead of the October 1 GST hike.
- Thereafter, households are set to undergo a period of **consolidation**. As a result, private consumption will be sub-trend post GST hike, particularly given higher interest rates and softer house price growth.
- 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** hiked the OCR 25bp in July. The accompanying commentary suggested that the pace and extent of further tightening will be more moderate than previously forecast. We expect that Governor Bollard will sit on the policy sidelines until December.
- 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.

Australia and New Zealand economic calendar

Monday	Tuesday	Wednesday	Thursday	Friday
<p>6 Sep</p> <p>Australia: ANZ job advertisements (11:30 am) Aug <u>1.0%/m, sa</u></p> <p>New Zealand: QV house prices Aug</p>	<p>7 Sep</p> <p>Australia: RBA cash target (2:30 pm) Sep <u>no change</u></p>	<p>8 Sep</p> <p>Australia: Housing finance (11:30 am) Jul <u>0.5%/m, sa</u></p> <p>New Zealand: Manufacturing activity (10:45 am) 2Q</p>	<p>9 Sep</p> <p>Australia: Unemployment rate (11:30 am) Aug <u>5.2%, sa</u></p>	<p>10 Sep</p> <p>New Zealand: Terms of trade (10:45 am) 2Q <u>5.8%/q, sa</u></p>
<p>13 Sep</p>	<p>14 Sep</p> <p>Australia: NAB business confidence (11:30 am) Aug</p> <p>New Zealand: Retail sales (10:45 am) Jul</p>	<p>15 Sep</p> <p>Australia: Westpac consumer confidence (10:30 am) Sep Dwelling starts (11:30 am) 2Q</p>	<p>16 Sep</p> <p>New Zealand: Business NZ PMI Aug RBNZ official cash rate Aug</p>	<p>17 Sep</p>
<p>20 Sep</p>	<p>21 Sep</p>	<p>22 Sep</p> <p>Australia: Westpac leading index (10:30 am) Jul</p> <p>New Zealand: Credit card spending (10:45 am) Aug</p>	<p>23 Sep</p> <p>New Zealand: GDP 2Q</p>	<p>24 Sep</p>
<p>27 Sep</p>	<p>28 Sep</p>	<p>29 Sep</p> <p>New Zealand: Trade balance (9:45 am) Aug</p>	<p>30 Sep</p> <p>Australia: Private sector credit(11:30am) Aug Building approvals (11:30 am) Aug</p> <p>New Zealand: Building permits (11:30 am) Aug</p>	<p>1 Oct</p>

Global Data Diary

Week / Weekend	Monday	Tuesday	Wednesday	Thursday	Friday
6 - 10 September	6 September	7 September	8 September	9 September	10 September
Japan • Cabinet Office private consumption index (Jul)	Brazil • Auto sales (Aug)	Australia • RBA mtg: no chg	Canada • BoC meeting: +25bp	Brazil • CPI (Aug) • Capacity utilization (Jul)	Canada • Employment (Aug)
	Euro area • Foreign trade (Jul)	Germany • Mfg orders (Jul)	Germany • Trade balance (Jul) • IP (Jul)	Germany • CPI final (Aug)	China • Trade balance (Aug)
	United Kingdom • Auto regs (Aug)	Japan • BoJ MPM: no chg	Japan • Private mach orders (Jul) • Econ Watcher surv (Aug)	Japan • Consumer sent (Aug)	France • IP (Jul)
	United States • Labor day; markets closed	Taiwan • Exports (Aug)	United Kingdom • IP (Jul)	Korea • BoK mtg: +25bp	India • IP (Jul)
		Turkey • IP (Jul)	United States • JOLTS (Jul) • Beige book • Consumer credit (Jul)	Peru • BCRP mtg: no chg	Italy • IP (Jul)
				South Africa • SARB mtg: no chg	Japan • GDP 2nd est (2Q) • BoJ MPM minutes (Aug)
				United Kingdom • BoE mtg: no chg	Sweden • IP (Jul)
				United States • International trade (Jul)	
13 - 17 September	13 September	14 September	15 September	16 September	17 September
United Kingdom • Consumer conf (Aug)	China • CPI (Aug) • FAI (Aug) • Retail sales (Aug) • IP (Aug)	Brazil • Retail sales (Jul)	Euro area • HICP final (Aug) • Employment (2Q)	Chile • BCCh mtg: +50bps	Argentina • GDP (2Q)
	Euro area • IP (Jul)	Euro area • Labor costs (2Q)	New Zealand • RBNZ mtg: no chg	India • RBI mtg: no chg	Poland • IP (Aug)
	Mexico • IP (Jul)	Germany • ZEW bus surv (Sep)	Russia • IP (Aug)	Japan: Reuters Tankan (Sep)	Singapore • NODX (Aug)
		India: WPI (Aug)	United Kingdom • Labor market report (Aug)	Switzerland • SNB mtg: no chg	United States • CPI (Aug)
		Turkey: GDP (2Q)	United States • NY Fed surv (Sep) • IP (Aug)	Turkey • CBRT mtg: no chg	• UMich cons conf (Sep)
		United Kingdom: CPI (Aug)		United Kingdom • Retail sales (Aug)	
		United States • NFIB surv (Aug) • Retail sales (Aug)		United States • Philly Fed surv (Sep) • Current accounts (2Q)	

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