J.P.Morgan

Australia and New Zealand - Weekly Prospects

Summary

- In **Australia** last week, the economic data surprised, and mostly on the upside. Retail sales in December were unexpectedly soft, but the job numbers for January were firm (again), and both business and consumer confidence rose (we expected falls in both). What natural disasters? One thing that didn't surprise us was RBA Governor Stevens' testimony to Parliament Friday. The Governor's prepared statement echoed his comments from a week earlier. After all, not much changes in a week. The tone of some of his broader comments, however, stepped up a notch, even though the Governor also gave a nod to current pricing, which is benign. Officials now expect a larger boost from the already elevated terms of trade and an even bigger investment pipeline. Also, the RBA revised up the headline inflation forecasts. To us, far from being dovish, all this contributes to a convincing case for a hike before mid-year. This week's minutes from the February Board meeting, which essentially was a non-event, are unlikely to add much to the debate.

- The weakness in the retail sales numbers in **New Zealand** this morning reaffirmed our view that consumer spending was a drag on growth in the fourth quarter. But even though household consumption accounts for a significant 60% of the economy, we maintain that a second technical recession will be averted. Our forecast is for the Kiwi economy to have expanded 0.2%q/q in 4Q10—an unimpressive result, but one that would avoid a so-called 'double-dip' Throughout 2011, however, there are some positives that should give a much-needed boost to the economy. The Rugby World Cup, higher commodity prices, and strong trading partner growth all will play a role. Cautiousness on the part of consumers should also should abate in the latter six months of the year as labour market conditions improve and wage growth accelerates.

- A significant **upward revision to the Euro area** this week places our projection for first-half global growth at 4% (4.8% using PPP weights). Although this pace is **more than a full percentage point above trend**, it remains below the level signaled by boomy January business surveys. Consistent with this message of upside risks to global growth, the main news from last week's releases was additional evidence from the US and Asia of the reacceleration in global trade flows into year-end. It is natural to view rapid growth and rising commodity prices as precursors of an outbreak of global inflation. However, this pattern has been a regular feature of the global expansions during the past three decades in which inflation has trended lower. Inflation pressures arise when utilization rates are high and generate broad-based cost pressures that include labour—the dominant input cost for firms. Similarly, sufficient pricing power in finished goods is necessary to allow firms to pass on rising costs to a broad range of consumer products.

- Although strong growth and rising commodity prices are not immediate inflation threats for the major developed economies, they are a **"clear and future danger"** for a world with monetary policy stances at the most accommodative on record. The major challenge ahead is to normalize policy at a speed that sustains growth while restraining the buildup in inflation pressures that will surface as the expansion matures.

This week's highlight

The RBA Board minutes will be the high point in a quiet week. The steady flow of RBA communications of late, however, means there are unlikely to be any "bell-ringers".

February 14, 2011

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Forecast changes:

No changes this week.

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Data and event previews - Australia and New Zealand

Date	Time [a]	Data/event	Forecast JPMorgan	Forecast Consensus [b]	*Previous*
Monday, February 14	11.30am	Aust. housing finance (%m/m, Dec.)	**1.5**	2.0	*2.5*
Tuesday, February 15	11.30am	RBA Board minutes (Feb.)	**na**	na	*na*
Wednesday, February 16	10.30am	Westpac Leading Index (%m/m, Dec.)	**na**	na	*0.0*
Wednesday, February 16	11.00am	Aust. DEWR skilled vacancies (%m/m, Feb.)	**na**	na	*-4.6*
Wednesday, February 16	11.30am	Aust. new motor vehicle sales (%m/m, Jan.)	**0.5**	na	*0.8*
Thursday, February 17	8.45am	NZ PPI input (%q/q, 4Q)	**1.8**	na	*0.7*
Thursday, February 17	8.45am	NZ PPI output (%q/q, 4Q)	**1.0**	na	*1.2*

(a) Australian Eastern Standard Time.
(b) Consensus based on Bloomberg survey.

Australia

Housing finance (%m/m, Dec.) - The home loan data have largely worked through their post-FHBs' grant unwind, and are now reflecting the slow, modest growth that we expect given tighter lending conditions and a slow grind up in mortgage rates. Due to composition effects, building approvals (which are very first-homebuyer sensitive) will continue to look soft, whereas we expect dwelling prices to move broadly sideways this year, with a slightly stronger performance from housing finance.

RBA Board minutes - The last two weeks have delivered a monetary policy announcement, the much more expansive quarterly Statement on Monetary Policy, and the always lengthy six-monthly testimony by RBA officials to the House Economics Committee. Despite the ample space afforded to flag any change in the fundamental economic backdrop, the informational content of recent commentary was limited to tinkering with near-term growth and inflation forecasts, following tropical cyclone Yasi. This suggests a Board comfortable with how their view is tracking: the terms of trade still are rising (above previous estimates), investment will continue to climb to unprecedented levels, and the labour market is tightening further.

We feel that this commentary has maintained a definite tightening bias, but do not expect the next rate hike until May. Following the Parliamentary testimony last Friday, the market has taken a more dovish interpretation, apparently viewing the absence of an intent to imminently hike as being equivalent to an indefinite pause. In contrast, we view any response from the Governor on his appraisal of current market pricing essentially as white noise. After all, endorsing (or at least not disputing) current pricing is an attempt to say nothing at all. As the Governor has said before, officials do not commit to, or reveal an intent to adjust policy at any point in the future, so it pays to be "constructively ambiguous" on the topic. We therefore doubt the minutes will endorse the dovish tones perceived by the market - the existing upbeat assessment on the medium term outlook is likely to be maintained.

DEWR skilled vacancies (%m/m, Feb.) - Skilled vacancies have been following a surprisingly steep decline since 3Q10. We certainly expect a deceleration in job gains following the break-neck pace of 2010, but not to the extent implied by the path of

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Data previews - Cont'd.

vacancies. Rather, it is likely that many openings are being filled informally. We expect more weakness from this series in the future, though the February number may get some lift from positions advertised to assist with flood rebuilding.

New Zealand

PPI (%q/q, 4Q) - The PPI results should show a rise in producer prices over the fourth quarter, with input prices forecast to increase 1.8%q/q and output prices 1.0%. The price rises probably will owe mainly to higher prices for livestock and dairy, but will barely register on the periphery of the RBNZ's radar given the more important consumer price data was released weeks ago.

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Research note

Rising food prices: putting Australia in the EM Asia basket

- **Australia is not a big food importer, meaning direct effects from global food price shock should be limited**
- **But, global trends influence domestic pricing behaviour, compounding flood- and cyclone-related inflation**
- **As in EM Asia, food shocks are occurring amid tight factor markets, making monetary policy difficult**

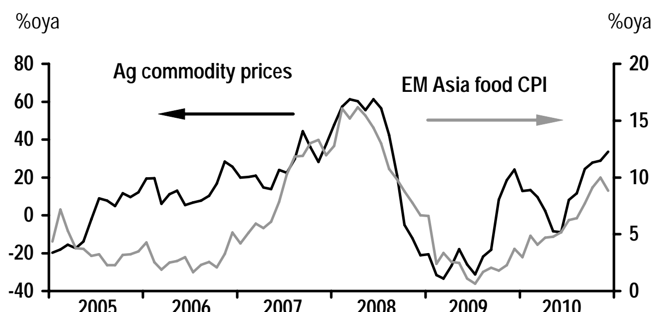
One of our central global themes for 2011 is the building inflation threat in the emerging markets (EM), which contrasts with much more subdued outcomes in the DM. The reasons for this divergence are twofold. First, EM economies are in a far more cyclically advanced position than the majority of developed markets, meaning there is little spare capacity to absorb rising demand. Second, the higher weighting of food in the EM consumption basket increases the sensitivity of EM inflation to recent global food price pressures. On our forecasts, EM inflation could be raised by up to 1%-pt by midyear due to the food price effect, even if agricultural commodity prices stabilize at current levels.

Given that Australia geographically sits near the global inflation hotspot of EM Asia, it is worth considering whether the domestic inflation outlook reflects the country's position in the region. Australia's solid growth performance is continuing within the context of a very elevated terms of trade and bulging capex pipeline. On a cyclical basis, this description fits comfortably with others in the region. However, since food represents only 15% of Australia's consumption basket, far below the approximately 30% weighting in EM, the comparison on the food price front seemingly falls over. But this ignores recent domestic food supply shocks, which are occurring on top of (and perhaps exacerbating) the passthrough of already elevated global food prices. Food price pressures in Australia are therefore more intense than implied by a simple passthrough of global prices into the consumption basket.

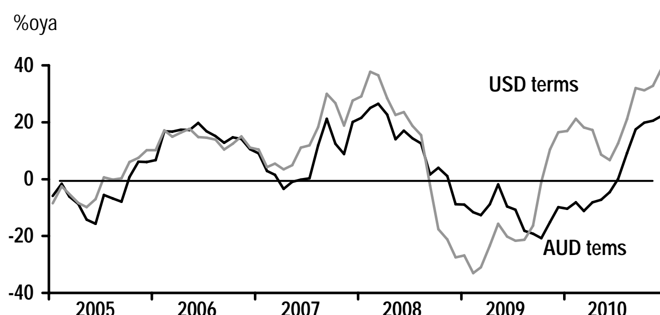
Domestic and global food price effects

In this note, we ask: (1) what is the significance of global food supply shocks to Australia; (2) how is the domestic food inflation outlook shaping up; and (3) what are the domestic policy implications of food inflation? We find that the similarities with EM Asia in terms of the near-term food price outlook are stronger than at first glance, suggesting additional headaches for the RBA in 2011.

Global agricultural commodity prices and EM Asian food CPI



RBA rural commodity price index: AUD and USD terms



Oz largely self-sufficient in food...

Data from the Department of Agriculture, Fisheries, and Forestry (DAFF) shows that Australia generated a food surplus of A$14.2 billion in 2009-10. Taking the trade data at face value gives the impression that the overwhelming majority of food consumed has been domestically produced, since imports represented just 8% of retail food sales over the year (the five-year average share also is 8%). The import share calculation is misleading, though, since some of these goods will have been processed domestically into other foodstuffs. The total value of food consumption *made possible* by imports—and so, the consumer's exposure to global price effects—is almost certainly larger than the 8% weighting mentioned above.

Unfortunately, it is difficult to get a sense of how imports feed through the food production cycle, since the most recent DAFF data on the value chain are from 2006/07. Further, global supply effects are not limited to the imports channel. Local producers may mimic global price patterns as a reference point, opportunistically, or to equate domestic and export revenue trade-offs. Also, the same weather systems that influence global prices could influence domestic supply. To test for such effects, we have pursued an econometric approach, looking at how global agriculture prices feed into food import prices, into food producer prices, and finally into the food CPI. The results (table next page) show

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that global food price shocks "matter" at each stage of production. Moreover, this has occurred at the consumer and producer level over and above the impact one would expect from higher prices for food imports. This suggests a much broader passthrough from global food shocks than simply through imported inflation: correlated supply shocks and opportunistic domestic pricing also seem to play a role.

...but global prices are very important

In the first equation, food import inflation rises with global agriculture inflation (measured by the UN's FAO index) and falls as the Australian dollar appreciates. But, the food PPI equation shows that even after allowing shocks to the FAO to push import prices higher, global food prices also have a direct influence on domestic producer prices. This could be because the weather effects that influence global food supply affect domestic supply as well, or because food producers price partly according to global trends.

Similarly, in the food CPI equation, even after controlling for the passthrough of global prices into imports, imports into PPI, and global prices into PPI, there is a remaining direct transmission from global food prices into food CPI. Food retailers therefore also seem to be influenced by global pricing, whether or not they have direct cost exposure. So even after purging all contributions from import prices through the value chain, global agriculture prices remain correlated with domestic food price pressure in Australia. This is worrying since, as we move through 1Q11, previous rises in global food prices will be feeding through just as domestic flood and cyclone shocks hit home. The confluence of events, occurring against an already advanced cyclical backdrop, could have an effect on inflation expectations that is greater than the sum of its parts.

Flood, cyclone effects accumulating

Earlier, we upgraded our inflation forecasts following the loss of crops in Queensland, New South Wales, and Victoria due to severe flooding in December and January. Two weeks ago, even as the floodwaters had yet to fully recede, tropical cyclone Yasi hit North Queensland. This event significantly impacts sugar cane and fruit prices (as opposed to the floods, which were concentrated in the vegetable-producing regions further south). Following the cyclone, the impact of the price surge in bananas, in particular, will feed through to a substantial further rise in headline inflation.

As a guide, tropical cyclone Larry, which devastated the same region (though, it seems, with a slightly greater "banana effect") in 2006, added 0.5%-pt and 0.3%-pt, respectively, to quarterly headline inflation in the two quarters following the cyclone, before fading out after four quarters. Assuming a similar-shaped profile for fruit prices, but downscaling the magnitude slightly, we have boosted our 2011 inflation forecasts yet again, from 3.3% to 3.6%. After several years of disinflation, food therefore looks to be an important catalyst for broader inflation pressure in 2011, as it is in EM Asia.

Food price chain

	Coeff	P-value
Import price equation (%oya, lags in parentheses)		
Constant	-7.336	0.054
Agriculture, %oya (-3)	0.176	0.031
Oil, %oya (-3)	0.037	0.148
Agriculture*Oil (-6)	-0.002	0.076
AUD, %oya (-3)	-0.175	0.023
R-sq	0.320	
Producer price equation (%oya, lags in parentheses)		
Constant	0.789	0.025
Import prices, %oya (-2)	0.211	0.000
Agriculture, %oya (-2)	0.291	0.000
R-sq	0.863	
Consumer price equation (%oya, lags in parentheses)		
Constant	3.172	0.000
Producer prices, %oya (-3)	-0.105	0.421
Import prices, %oya (-2)	0.187	0.017
Agriculture, %oya (-2)	0.061	0.021
R-sq	0.291	

Note: Following similar work by our Western Europe colleagues, the lags here have been selected to maximize the fit of the equations, and to avoid interdependence between the regressors. Also note that the fit of the CPI equation is not great, since the variables fail to pick up (at any lag length) the food price spike from the Cyclone Larry banana price surge in 2006. Controlling for this event dramatically improves the model, but is somewhat ad hoc.

"Looking through" supply shocks

The RBA's February statement noted that "as on past occasions" officials would "look through the estimated effects" of natural disasters. We appreciate that policy does not move in a mechanical knee-jerk fashion following elevated CPI prints. But adding the cyclone effects on top of the floods, the economy faces a substantial, broad-based burst of food inflation, following a two-year window of favourable weather in which food inflation was particularly benign. When enough of these events accumulate against an advanced cyclical position, the risk of inflation persistence through opportunistic pricing and contagion to consumers' expectations becomes meaningful. This is the difficulty facing EM Asian policymakers at present—how to parse the interrelationship of supply shocks, the passthrough to expectations, and robust demand backdrops—and it is one with which RBA officials will become familiar in 2011.

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Australia

- **Consumers more upbeat despite floods and cyclone**
- **Wage growth will follow after solid job gains**
- **Employment rebounded in January after soft year-end**

While there is no doubt that the recent floods and then the cyclone that hit Queensland two weeks ago have depressed activity in Australia, the underlying fundamentals supporting the economy remain in place. The negative impact on growth from the natural disasters will be temporary, but will occur against a backdrop of robust private business investment and a booming terms of trade. In this macro environment, with the economy running at close to full capacity, underlying inflation pressures probably will build. The likely deterioration in the medium-term inflation outlook likely will prompt the resumption of the RBA's tightening cycle before midyear.

Terms of trade the running theme in Oz

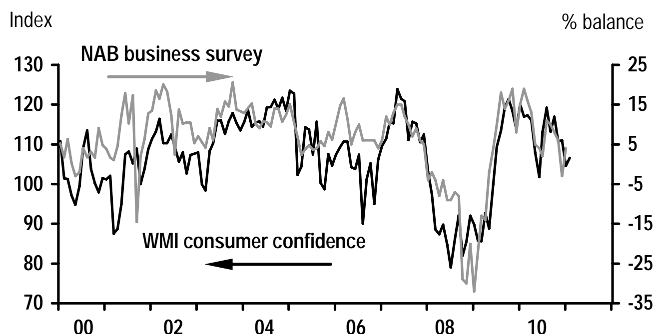
The statement delivered by RBA Governor Stevens to a Parliamentary committee Friday once again highlighted the supportive impact of the high terms of trade and the growing private investment pipeline; these will be key themes in the minutes from the RBA's last Board meeting when they are released this week.

Our view is that, if anything, the implied "theme" of the economy bumping up against capacity constraints from the second half of 2011 onward has firmed a little in recent commentary. This is particularly so in reference to the terms of trade-related boost to growth in national income, which the RBA now believes will be even larger than before. Also, the private investment pipeline continues to swell, led by the booming mining sector, which will lift demand for labour and materials.

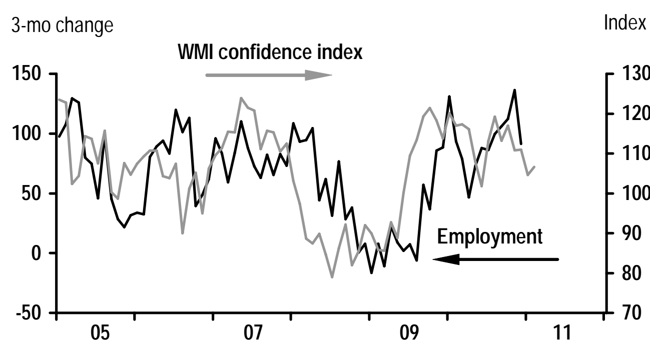
RBA officials have pushed through a further upgrade to the headline inflation forecasts owing to cyclone Yasi, the impact of which the RBA had not had a chance to add to the previous week's quarterly statement. The RBA now forecasts headline inflation at 3% by mid-2011, up from 2.5% before. A key issue will be the extent to which higher headline inflation feeds into higher expectations of future inflation. The Governor was sanguine about this, believing households will see the inflation spike as temporary.

Our overall assessment, though, remains that the dominant medium term theme is the risk of overheating once the dislocation from the floods and cyclone—the combined impact of which the RBA estimates could be close to 1% of GDP—is behind us. On this basis, official interest rates probably have further to rise.

Australia: consumer and business confidence



Australia: confidence and employment



What natural disasters?

The biggest surprises last week in Australia were the consumer and business sentiment numbers, which both, unexpectedly, showed improvement,. despite the floods and cyclone. Consumer sentiment edged up in February, with the Westpac-Melbourne Institute's (WMI) measure rising 1.9%m/m. We thought consumers would have been less upbeat, but the negative impact of the floods failed to have a lasting impact. Nor did cyclone Yasi.

Another factor we thought would have dented confidence was the announcement of the proposed "flood levy" debated in Parliament last week. WMI suggested, though, that households may have viewed in a positive light the government's decision to fund the rebuilding programs associated with the floods using a combination of levy and spending cuts. This suggests consumers are more concerned about the government's medium-term fiscal position than their own hip pockets, which we doubt is the case.

Good time to buy but not to spend

The biggest surprise within the WMI report was the rise in sentiment toward "buying major household items." This measure, at 140.5, stands well above the headline measure of con-

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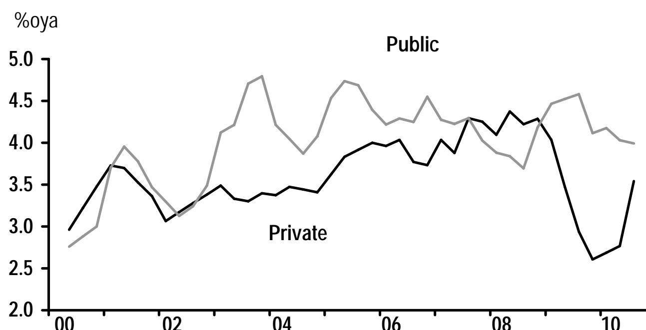
fidence (106.6), and above all other components of the index. The WMI highlighted that this component has averaged 141.5 over the last six months, on par with the highest sustained levels of the last 25 years. Immediately, one would assume this would bring some cheer to retailers in light of recent sluggishness in sales. But, in our view, while consumers are thinking now is an opportune time to buy big-ticket items, owing to the significant discounting among retailers, many will continue to refrain from spending.

The realization that the tightening cycle has further to run, plus rising living costs, will curb consumption, which we think will remain below trend this year. A jump in food, fuel, and electricity prices will eat further into disposable incomes, which already have been squeezed by higher mortgage repayments. Indeed, higher market interest rates likely were the main factor curbing retail spending into year-end. The RBA's most recent rate hike in November pushed market interest rates through what we believe is the "pain barrier" for many households. In response, retail sales suffered in December, rising just 0.2%m/m. Even sales volumes fell over the quarter, dropping 0.3%q/q, despite significant discounting that many retailers continue to offer.

Australia: labor price index



Australia: unemployment rate

Business confidence also rebounded

Business sentiment also surprised on the upside last week, with the NAB index of business confidence rebounding in January from a 19-month low. The confidence index pushed up from -3 to +4 as firms became optimistic that the economy will recover from recent adverse events. In fact, business confidence rebounded the most in Queensland, which was hit hardest by the natural disasters, surging 31pts to +10. The ex. Queensland measure ticked up only mildly, from +2 to +3.

The January NAB business report also included a special survey on aspects of the Queensland floods. As one would expect, the construction, retail, agribusiness, and mining industries are the most severely impacted. In particular, firms were asked how the demand for various goods and services had been affected, what the likely cost of rebuilding would be, and of the extent of closures of medium- to large-sized businesses. National revenue for medium- to large-sized firms was estimated by the NAB to have fallen 5.1%m/m in January. Capacity utilization also fell by just under 6% over this period. On the basis of firms' responses, though, the majority of these impacts can be quarantined as a January story. Only 20% of firms claimed they will need more than a month to recover.

Beyond the recent disasters, competition for skilled labour likely will be one of the larger issues to affect business conditions this year. Labour demand remains strong, with job availability continuing to increase in the month of January. The ANZ job advertisements series posted a 2.4%m/m rise, marking the twelfth straight monthly increase. Job ads were marginally down in newspapers, but internet ads spiked 2.5%m/m. This leading indicator of employment suggests that recent job gains will continue, and not necessarily at a significantly more modest pace.

Job data flood-affected, but still strong

Australia's economy added a record 364,000 jobs last year, the vast majority being full-time, and the labour market appears to have carried some of this momentum into 2011. The economy added another 24,000 jobs in January; even a rise in the participation rate in January failed to budge the unemployment rate from 5%, a level we believe to be consistent with full employment.

The Australian Bureau of Statistics (ABS) suggested, though, that these numbers should be treated with a degree of caution. The impact of the recent flooding meant that a number of households in Queensland that had previously been included in the labour force survey (LFS) could not be interviewed, such that the ABS had to compensate for the sample loss by inflating the survey weights elsewhere. Estimation of aggregate hours worked (-0.8%m/m) was particularly problematic, so we look toward the February results for a cleaner read. The focus for now, therefore, should be on

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the trend estimates, and again these numbers painted a healthy picture of the labour market in January. Trend employment was up 21,600, and the unemployment rate remained at 5.1% despite a similar sized 0.1%-pt rise in the participation rate (to 66.0%).

Interestingly, considering the disruption to economic activity in Queensland, the unemployment rate fell in the north-eastern state, from 6.0% to 5.6%. This owed mainly to a significant 0.5%-pt drop in the participation rate, which managed to offset the drop in total employment (-5,100). It is too difficult to decipher, though, what portion of this decline in employment was flood-related. Indeed, floodwaters resulted in some businesses closing their doors, while in other cases employees were unable to get to work. Whether or not these workers were part of the labour force survey, we simply don't know. We suspect, though, that rebuilding activity in QLD in the aftermath of the floods and cyclone will result in a strong pull of labour into QLD in coming months. This pull will further intensify upward pressure on wages as widespread skills shortages reemerge.

Wage growth to accelerate

These labour market credentials highlight the well-established dangers in the inflation outlook Australia faces leading into the next leg of the resources boom. So far, though, wage growth has remained contained. Annual wage growth has maintained a 3.0%-handle (despite briefly edging down to 2.9%) since mid-2009 even as the labour market continued to tighten. The fourth-quarter wage inflation numbers due later this month probably will show a considerable uptick in wage growth, however. Annual wage growth may even hit or push through the 4%-mark that tends to create unease among RBA officials. Indeed, wages will become a key channel through which inflation will be generated throughout 2011, reinforcing our view that the RBA's job is far from over. Current market pricing suggests that only 30bp of tightening will be delivered by year-end, compared to our forecast of 75bp.

Data releases and forecasts

Week of February 14 - 18

Mon
Feb 14
11:30am

Housing finance
Sa

	Sep	Oct	Nov	Dec
%m/m	1.1	2.2	2.5	1.5
%oya	-24.3	-20.7	-11.5	-4.0

The home loan data have largely worked through their post-FHBs' grant unwind, and are now reflecting the slow, modest growth that we expect given tighter lending conditions and a slow grind up in mortgage rates. Due to composition effects, building approvals (which are very first-homebuyer sensitive) will continue to look soft, whereas we expect dwelling prices to move broadly sideways this year, with a slightly stronger performance from housing finance.

Wed
Feb 16
11:30am

New motor vehicle sales
Sa

	Oct	Nov	Dec	Jan
%m/m	-0.8	0.5	0.8	__

Review of past week's data

Retail sales
Sa

	Oct		Nov		Dec	
%m/m	~~-0.8~~	*-0.9*	~~0.3~~	*0.4*	0.2	
%oya	2.3		~~1.3~~	*1.2*	~~2.2~~	*2.1*

The results were mixed across the major retail sales groups. The largest component, food, posted a second straight monthly decline (-0.5%). With food prices to rise sharply from here, owing to the hit to nationwide food supplies from recent natural disasters, this category soon will head higher in value terms. Importantly the food component accounts for 40% of the retail sales index, so the impact will be material. Lower sales also were recorded at department stores (-1.2%) and in other retailing (-0.8%). Preventing an outright decline in total revenues were sales of clothing and soft goods, which shot sharply higher in December (+2.7%). Sales of household goods also were up (+1.5%), with sales at cafes and restaurants following closely behind (+0.8%).

Retail sales ex inflation
Sa

	2Q10	3Q10	4Q10	
%oya	8.5	2.8	~~1.6~~	*1.5*
%q/q	1.0	0.7	~~-0.2~~	*-0.3*

Westpac-MI consumer confidence
Sa

	Dec	Jan	Feb	
%m/m	0.2	-5.6	~~-3.0~~	*1.9*

Optimists continued to outweigh pessimists (the WMI index is at 106.6) with a number of factors buoying sentiment: no RBA rate action since November, the unemployment rate having hit 5% (a level consistent with full employment), and a backdrop of improving global conditions. By far the largest increase in confidence was toward the economy in five years' time (+10.2%).

Labour force
Sa

	Nov	Dec	Jan	
Employment change (000s)	56	2	~~15~~	*24*
Unemployment rate (%)	5.2	5.0	5.0	
Participation rate (%)	66.0	65.8	~~65.8~~	*65.9*

New Zealand

- **NZ retail sales probably fell in December and 4Q**
- **Labour market malaise is slowing consumer spending**
- **Outlook for 2H11 better**

In New Zealand, consumers are even more reluctant to spend than their Aussie counterparts, despite the current level of interest rates being highly stimulatory. The official cash rate (OCR) in New Zealand is still 150bp below what we consider neutral. Kiwi households, though, continue to consolidate their balance sheets. The ratio of debt to disposable income now has fallen for seven straight quarters and likely will fall further, particularly given the weakness in the labour market. With consumers saving more and spending less, the retail sector has suffered. Today's retail sales numbers showed an outright fall in sales values in December, and a drop in volumes in 4Q.

No cheer for New Zealand retailers

Retail sales tanked in New Zealand in December, falling much more than expected. After a 1.5%m/m rise in November, which was entirely an autos story, retail sales values gave back 1.1% (J.P. Morgan: -0.2%m/m, consensus: -0.4%m/m). Ex-auto sales were down a similarly worrying 1.2%. Given that the weak underlying trend in core sales values followed the October boost to the GST, the implied volumes growth for the quarter always was going to be weak. In the event, the decline of 0.4%q/q is not quite as bad as we anticipated (-0.8%q/q), but nevertheless gets the 4Q growth arithmetic off to a very poor start.

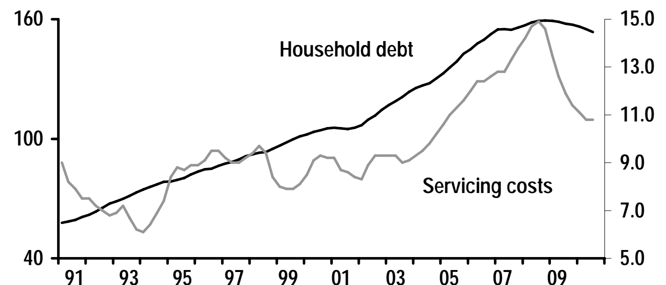
In December, sales fell in eight of the thirteen core industries. Hardware, building and garden supplies were particularly hard-hit, sinking 11.3%m/m. Supermarket and grocery stores also were weak, falling 2.9%m/m, which is not surprising given the softness of domestic food prices post the GST spike (down 0.8% and 0.6% in December and November respectively). The remaining categories posted modest moves, save for pharmaceutical retailing, up 7%m/m.

In a development that can only make a somewhat opaque domestic demand story even more so, the December report will be our last detailed monthly retail sales read, with Statistics NZ moving to quarterly publishing on retail values and volumes. From here on, the existing card transactions data will become the de facto measure of monthly retail expenditures.

While the headline volumes number was negative, a slim majority of industries, eight of fifteen, posted stronger sales

New Zealand: households' balance sheet repair continues

% of disposable income



in the December quarter. Core retail volumes actually were up 0.1%q/q, and have eked out gains for seven consecutive quarters. Rather, it was motor vehicle-related sales that suffered in 4Q, down over 8%q/q. Some hangover in this component was inevitable, having recorded the strongest gains by sector for the last three quarters.

The RBNZ, along with government officials, have emphasized the need to for growth to be rebalanced away from household consumption. Despite this objective, the retail sales data of late will have been disappointing on two fronts. One, the consumer has been shown to be outright weak, rather than merely subdued. Second, this has occurred against a backdrop of a frustratingly slow labour market recovery. Having been stuck in this holding pattern since exiting recession, the New Zealand economy is badly in need of an external catalyst to growth. Higher prices for food exports, accelerating growth in the region, and the tourism and sentiment boost from the Rugby World Cup loom as supportive elements later in 2011, but for now the outlook remains uninspiring.

Data releases and forecasts

Week of February 14 - 18

Thu Nov 17 8:45am — **Producer price index**
Nsa

	1Q10	2Q10	3Q10	4Q10
Inputs (%q/q)	1.3	1.4	0.7	1.8
Outputs (%q/q)	1.8	1.1	1.2	1.0

Review of past week's data

Retail trade
Sa

	Oct		Nov		Dec	
%m/m	~~2.4~~	*-2.1*	~~1.5~~	*1.2*	~~0.2~~	*-1.1*
%oya	~~1.5~~	*-1.3*	~~0.8~~	-0.9	~~0.5~~	*-1.5*

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Global Essay

- **Upside risks to growth now complemented by upside risks to inflation, complicating the path toward policy normalization**
- **EM Asia fuels underlying inflation by cushioning food price shock**
- **Major upward revision to Euro area forecast; ECB to hike in 4Q**

Policy normalization is the key challenge

A significant upward revision to the Euro area this week places our projection for first-half global growth at 4% (4.8% using PPP weights). Although this pace is more than a full percentage point above trend, it remains below the level signaled by boomy January business surveys. Consistent with this message of upside risks to global growth, the main news from last week's releases was additional evidence from the US and Asia of the reacceleration in global trade flows into year-end.

There is even greater upside risk to our first-half consumer price inflation forecasts. Business surveys, along with further increases in commodity prices, point to building pipeline cost pressures. Agricultural prices have soared nearly 80% from their mid-2010 low, with the strong monthly rate of increase continuing through January. Oil prices eased some last week but remain up 8% on the year and are 46% above their mid-2010 level. The passthrough of food prices to headline inflation rates should be particularly powerful in emerging market economies that are intensive consumers of unprocessed food.

It is natural to view rapid growth and rising commodity prices as precursors of an outbreak of global inflation. However, this pattern has been a regular feature of the global expansions during the past three decades in which inflation has trended lower. Inflation pressures arise when utilization rates are high and generate broad-based cost pressures that include labour—the dominant input cost for firms. Similarly, sufficient pricing power in finished goods is necessary to allow firms to pass on rising costs to a broad range of consumer products.

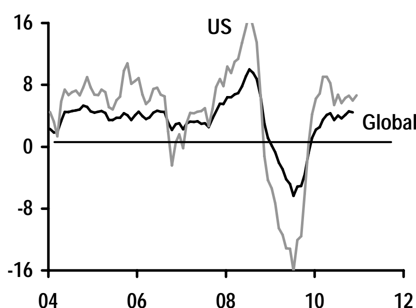
A clear reading on global core finished goods prices is difficult to obtain as most measures of producer and traded goods prices incorporate intermediate and raw commodities. However, the evidence available from key producers points to a large wedge between rapidly growing input prices and stable and low core finished goods inflation. The risk that commodity price pressures will generate cost-push inflation (or erode margins) is limited by evidence that labour bargaining power remains subdued. Unit labor costs across the G-4 have decelerated sharply since the end of the last expansion and have been essentially stable as of the latest readings. Last week's wage negotiations out of Germany, pointing to modest increases of closer to 3% this year opposed to demands of 6%-7%, underscore the impact economic slack is having on containing the largest component of business costs in the developed economies.

Although strong growth and rising commodity prices are not immediate inflation threats for the major developed economies, they are a "clear and future danger" for a world with monetary policy stances at the most accommodative on record. The major challenge ahead is to normalize policy at a speed that sustains growth while restraining the buildup in inflation pressures that will surface as the expansion matures.

To a large degree, global measures of underlying inflation are dominated by the developed economies. Core inflation already has risen to 2007 levels in Emerging Asia and Latin America—regions where utilization rates are high and the risk of passthrough from surging commodity prices is increasing. Agricultural prices comprise a relatively large share of the value added in EM consumer food prices as well as a larger share of the consumer basket. Consequently, headline inflation rates are set to ramp up in the

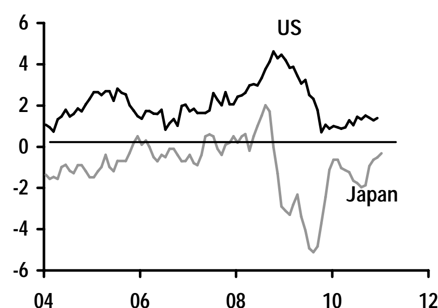
All-commodity producer prices

% change oya



Core finished producer prices

% oya



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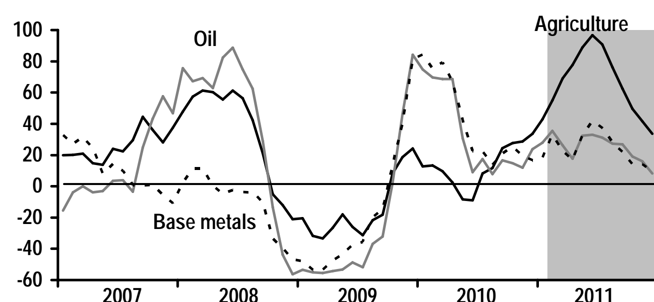
Global commodity prices

%oya; Agriculture 4%/mos through Jul11, flat thereafter; Oil and metal flat all year



coming months. Policymakers have responded with earlier-than-expected rate hikes and other tightening measures. However, the pace remains gradual as policymakers are assuming the agricultural price shock is temporary and its impact will fade quickly in coming months. This has yet to be proven true, and recent developments suggest continued price increases through at least midyear.

Food price pressure cooker

Hopes of a stabilization in global agriculture prices are fading. The supply and demand balances for soy, corn, and wheat look extremely tight. The drought in Russia last year along with the floods in Australia has left inventories lean, while unusually adverse weather conditions in China and the US are impacting new production. With little margin to expand output materially before midyear, strong sequential gains in grain prices are likely. Assuming a deceleration to a still-robust 4% monthly increase between now and July (the average pace since June 2010 has been 7%), the year-on-year change in a basket of agriculture prices could peak near 100% by June, 40%-pts above the spike in 2008.

Supply and demand conditions are more favourable in the oil market. Although levels of oil demand have surpassed their 2008 highs when the price touched above $150/bbl, more capacity is now available from Saudi Arabia and Kuwait while the UAE and Iraq are rapidly raising output. OPEC have raised output in response to higher prices and consequently, the recent jump in the price of oil is likely to level off, with future sequential price gains contained through next year even under our robust growth outlook. Moreover, the refining bottlenecks in 2008 that exacerbated the impact on end-use fuel prices have abated. This is encouraging as the purchasing power hit from rising oil prices is largest in the developed markets where the recovery is still building. Although risk from contagion of geopolitical events in the Middle East is difficult to gauge, in a notable piece of irony, the social unrest in this key energy-producing region has been fueled by rising food prices.

EM Asia cushions growth from inflation

For EM Asia, where underlying price pressures are building most rapidly in response to tight resource utilization, the most obvious tool to fight imported inflation is to allow undervalued currencies to appreciate. Instead, the region is offsetting the growth impact by ramping up fiscal stimulus. Import tariff cuts, price controls and subsidies, and similar measures have been used in the past in Asia, so it should not be a surprise that they are being rolled out again. The region has the fiscal firepower to easily absorb the upturn in food and energy prices, which policymakers currently perceive to be temporary. The impact of these measures is varied. Price controls will clearly limit inflation at the cost of reduced business profitability, while subsidies merely offset inflation by damping the hit to purchasing power. In either case, the measures are stimulative at a time when the cyclical backdrop is calling for the opposite.

As the regional heavyweight and an important nominal anchor for currency-setting policies, the tone for the region is being set by China. In response to the drought in major wheat-producing regions, last week the State Council in China announced direct subsidies to farmers and pledged additional fiscal resources to boost emergency water supplies and irrigation resources. Korea reduced import tariffs last month on a number of food- and energy-related products. A similar move is planned in Taiwan, while Indonesia has put a hold on electricity fees in 2011. Last week, Thailand extended diesel subsidies, while previously announced subsidy cuts for LPG are being rolled back for households and transport use.

China ushers in new year with a hike

China hiked rates last week on the last day of the Lunar New Year holiday, the third such hike since October. This latest rate decision was not a surprise. An unexpectedly large surge in new loan growth in January, on the heels of the supercharged 4Q GDP report, has gotten policymakers' attention. We look for continued monetary policy normalization in coming quarters, including two more RRR hikes, at least two more interest rate hikes in 2011, and further CNY appreciation (with the year-end USD/CNY forecast at 6.3) with policy action likely front loaded. This week's inflation report will probably show that consumer prices accelerated to a 5.3%oya pace in response to colder-than-usual weather and the usual rise in prices in the run-up to the Lunar New

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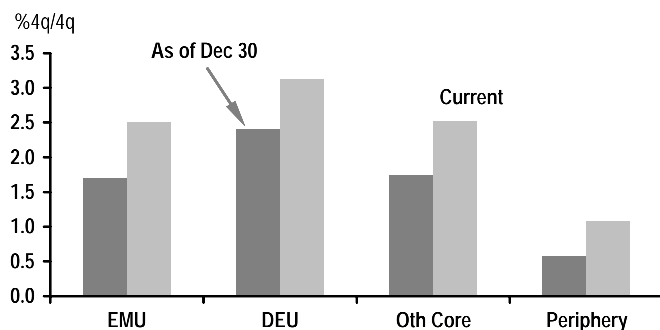

Year holiday. At the same time, China's merchandise trade report for January is expected to show a solid pickup in exports on the back of last month's decline, accelerating global demand, and some front-loading ahead of the Lunar New Year. Because of the holiday, the other usual activity data will be delayed until early March, when the combined January-February figures will be reported.

EMU forecast raised, ECB to hike in 4Q

After highlighting upside risks for many weeks, we are making material changes to our EMU forecast this week. We now expect GDP in the region to expand 2.5% this year (4q/4q), an 0.8%-pt revision. We also see core inflation printing 1.2%oya by year-end, 0.2%-pt higher. As a consequence, we now look for the ECB to begin tightening this December.

Our forecast had anticipated that growth would slow through the middle of 2011 as fiscal tightening and bank funding stress weighed heavily on the periphery, and as a softer global economy damped growth in the core. This week's GDP report is likely to show that 4Q10 growth was near this pace. Judging by the high-frequency indicator flow, however, the economy is reaccelerating as we start the new year. The strongest signal comes from the business surveys; for example, the composite PMI has risen 3pts since October to a level consistent with growth running at around twice the pace of our previous forecast.

In addition to the benefits of a stronger global economy, the core of the region is enjoying cyclical lift as corporates turn more expansionary, and the periphery is managing to tread water. Although we raised forecasts in a range of countries, they were focused in Germany and the rest of the core, whereas the revisions to the periphery were relatively minor aside from a boost to the outlook for Spanish growth. As the recovery unfolded, it turned out that core inflation bottomed earlier than we anticipated and has been creeping higher since last spring. We expect this very gradual rising trend to continue. By contrast, headline inflation is expected to fade as the year unfolds as the commodity price surge loses momentum.

With a decent recovery in growth and some uptrend in core inflation, the ECB is likely to hike its policy rate late this year. This is six months earlier than in our previous forecast. In addition to the normal inputs into the central bank's reaction function, the ECB has two other issues on its mind: it is uncomfortable with maintaining an extremely accommodative policy stance for too long, but it is also aware of its responsibility for financial stability especially around the periphery. Our new forecasts for growth and the central bank assume that the sovereign stress is contained by next month's comprehensive policy package.

Brazil announces fiscal measures

With inflation approaching the target ceiling in January, the government is belatedly announcing austerity measures on the fiscal side that, if implemented, would reduce the need for monetary tightening. Last week's announced budget cuts of R$50 billion (or 1.5% of GDP) were more significant than expected, and would increase the likelihood of meeting the 3% of GDP primary surplus target. However, since the budget is not binding in Brazil, and the pressure from social and infrastructure demands is high, the delivery of a budget adjustment of this magnitude is a challenge. Thus, following last year's spending spree, the degree of fiscal adjustment remains to be seen.

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JPMorgan View - Global Markets

Prefer equity over credit risk

- **Economics:** A significant upgrade to our Euro area growth forecast raises our 2011 global growth projection by another notch. This six-month run of growth upgrades is probably not over.
- **Asset allocation:** With credit rapidly nearing our spread targets, long-only investors should have larger overweights in equities and commodities.
- **Fixed income:** Stay short Treasuries. Position for flatter curves in EM.
- **Equities:** EM inflation worries and a narrower growth gap with DM keep us underweight EM vs. DM equities.
- **Credit:** Double-digit return in AAA CMBS for the rest of the year.
- **FX:** Any USD rally should be short-lived.
- **Commodities:** Stay long Corn as US inventories are at the lowest since 1995 and demand remains strong.

Riskier asset classes continue to rally powerfully to new cycle highs, while government debt is drifting down further. The drivers of this move remain rising growth optimism, stronger corporate earnings, and a modest fading of some of the near-term threats that were keeping investors in cash and safe bonds. We stay significantly long risky assets, but monitor value exhaustion, stretched positions, and local risk factors to rotate within the risk world.

The global drivers of growth continue to signal upside risks. This week, these led to a dramatic upgrade of our **Euro area** growth projections—by 0.6%-pt this year and 0.4%-pt next year. In short, the economy has suffered a lot less from fiscal tightening and sovereign stress than we had thought. Banks have not cut back on lending and confidence has rebounded better than hoped. This raises our 2011 global GDP forecast another notch to 3.6%, up 0.7%-pt over the past six months (chart, next page).

The three asset classes for which we have been projecting double-digit returns—**equities, commodities, and high-yield debt/CMBS**—have been steaming ahead at a much faster pace, and with much less volatility than one should expect for the full year. The first quarter of last year was also deceptively fast and smooth, then corrected badly in 2Q. The rest of this year is unlikely to be as fast and as smooth as the first six weeks, but we remain bullish on these assets. We find it very hard to trade short-term correction, and thus prefer to focus on the medium-term drivers, which are clearly positive.

The rally in equities and commodities has been strong and to us is not exhausted yet. We argue below that equities remain cheap versus debt, and fair valued versus earnings. The average investor in the world is probably not long equities yet. Commodities remain more a supply- than a demand-driven rally. But high-yield debt is now probably near the point where we will not earn much more than the coupon, which still has an 8% handle. AAA CMBS is to us still a double-digit return asset class (see below). **On net, investors should have their largest overweights in equities, followed by commodities and then credit.**

EM equities continue to lag on fears that their central banks are behind the curve on inflation. We agree, but do not expect them to suddenly stamp on the brake and drive their economies sharply down. We thus use EM inflation risk as an argument to underweight EM equities and be short duration in EM bonds, without pushing us wholesale out of risky assets. The **Egyptian uprising** is so far developing in a “friendly” manner for the rest of the world, but is clearly not over yet and continues to spread to the rest of the Middle East. We stay underweight EM equities.

Fixed income

Bonds continue to drift down. We stay short in Treasuries, as the momentum in activity data is undimmed, and also **keep bearish flatteners at the long end of the sterling curve**, with a BoE tightening cycle on the horizon. We turn **overweight on US MBS**, as valuations are attractive and the US Treasury’s new proposals on housing finance signal lower Agency MBS issuance (see *USFIMS* MBS).

Euro area peripherals underperformed, driven by Portuguese supply and reported disagreements among EU leaders about how to modify the EFSF rescue fund. Uncertainty over what EU leaders will decide keeps us neutral on peripherals. Within the sector, **we like short-dated Greek bonds, on elevated carry and slide, but think long-dated French and Belgian spreads look too narrow** (see *GFIMS* Euro Cash).

EM local bonds were flat vs. DM both last week and YTD, even as EM equities (currency unhedged) have underperformed DM by some 10% this year. Retail flows into EM bonds and equities tend to rise and fall together (see this week’s *Flows & Liquidity*), and EM bonds and especially equities have seen outflows in the past few weeks. Episodes of sharp EM equity underperformance in

recent years have typically coincided with marked underperformance by EM local bonds. But those episodes occurred when uncertainty was high, DM equities were falling, and core bond markets were rallying. This time, strong growth and rising inflation have pushed EM and DM yields up together.

Indeed, we think inflation concerns will continue to **push EM yields higher**. We also favour flatteners in EM, both as a more carry-efficient way to position for higher rates (e.g., Mexico, Chile) and simply to take advantage of steep curves in markets where we are more positive on duration (South Africa, Poland). See this week's *Emerging Markets Outlook and Strategy*.

Equities

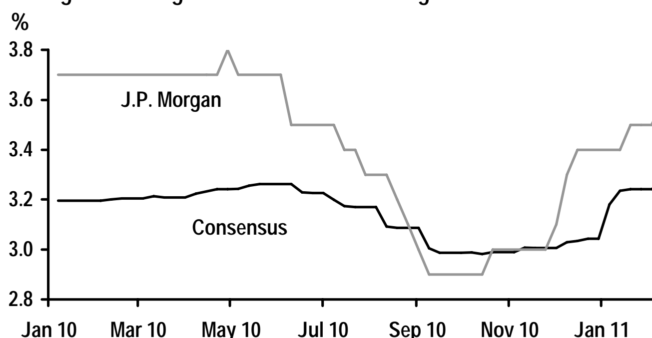
The 20% rise in equities since the end of August is the strongest and longest rally since 2009, raising **questions about overextension and sustainability of the equity rally**. In particular, the close to 50% cumulative rise of the S&P 500 index since the end of the US recession in June 2009 seems extreme relative to the average 20%-30% seen in previous recessions.

We do not think this means that the rally is over. First, the cumulative rise in equity prices is indeed much higher relative to the average of previous US recessions, but so was the decline that preceded it (40% vs. a 10% average fall in previous US recessions). Second, **the 50% rise in the S&P 500 since mid-2009 has trailed the 70% rise in earnings** (i.e., 4-quarter rolling EPS) over the same period. Third, **equities still look cheap relative to bonds**. Our fair value model for the S&P 500 (*A Fair Value Model for US Bonds, Credit, and Equities* , Panigirtzoglou and Loeys, June 2005) shows that even as the S&P 500 equity yield gap over bonds has narrowed sharply by 1.7%-pt over the past six months, at a level of 4.5% it is high compared to the past 50 years' average of 2.7%. And more important, the flow picture suggests that this elevated yield gap continues to be exploited by both corporates and investors.

Around this bullish overall view, we do see important **regional divergences**. Last year, the Euro area underperformed. This year, EM is lagging behind so far. By our reckoning, **the drivers of this underperformance are not exhausted, and we thus stay tactically underweight EM, even as we see EM doing better over the next year**.

Rising concerns on inflation and monetary tightening are one driver of weaker EM equities. With food prices already

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



10% up YTD, we see a **high risk of more problematic inflation figures and more monetary tightening surprises in EM** in coming months. A **narrowing EM/DM growth gap** has been a second driver. Past episodes of EM equity underperformance lasted around three months, and 13%. The latest EM underperformance is now four months old and has grown to 12%, in line with the previous episodes' average. In summary, the first signal is still negative for EM equities, while the second and third are neutral-ish. We stay UW EM vs. DM equities.

Credit

EM credit also underperformed developed market credit last week. Despite a strong rally in corporate bonds in the US and Europe, EM corporate spreads are unchanged. We expect EM corporate spreads (CEMBI) to stay rangebound near term on heavy supply and continued worries about EM monetary bank tightening.

In contrast, US corporates are benefiting from strong economic data and strong investor buying. US high-yield bond funds saw accelerated inflows last week of $1.3 billion, more than double the average weekly pace YTD. This helped push HY spreads down another 12bp last week and 75bp tighter since December 31.

Given the powerful credit rally YTD, we revisit our return projections for the rest of the year. For US HG, spreads are currently only 11bp above our year-end target, bringing the total return to year-end to about 2%. High-yield bonds and high-quality CMBS continue to show more return potential. For HY, the spread-tightening potential is shrinking rapidly, leaving HY investors with mostly carry gains. Investors in HY should expect a total return of 7% for the rest of the year. **The best return potential lies in high-quality CMBS.** With AAA CMBS spreads expected to tighten to 90bp by year-end versus the current level of 180bp, we forecast a return of 10.8% for the remainder of the year (see *CMBS*,

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Foreign exchange

Global inflation continues to torture currency markets, and the pain looks set to continue. Last week delivered another rate hike by China, an aborted tightening by Korea, inflation undershoots in Norway and Switzerland, and dollar strength versus almost all global currencies but Indonesia. The unpredictable behaviour of central banks and the irregular path of inflation prints is delivering more week-to-week reversals in FX than in core asset markets, and the absence of durable trends is compromising manager returns. By several metrics, currency managers are down year-to-date by at least 1%, so lagging the performance of global macro and emerging markets funds.

These erratic patterns will persist for longer still. We have argued previously that global inflation would dominate markets until midyear, which is the time required for central banks to generate positive—or higher—real rates and for activity data to confirm that the cost to growth will be minor. We still think the **beneficiaries of this inflation cycle will be currencies that deliver higher real rates (AUD, CAD, Scandis, EUR)**, and that the losers will be those that don't (USD, GBP). But the week-to-week movements in FX markets will remain much more reversal-prone than other asset markets, since few countries offer the ideal combination for currencies of high rates, strong growth, rising inflation, and a hawkish central bank.

Currencies vulnerable to a downside surprise on inflation are those where last year's currency strength has dampened inflation yet the money market curve still discounts significant rate hikes (at least 75bp over the next year). SEK fits this template currently, and we take profits on a SEK/JPY long. CAD looks vulnerable, too, though we hold longs given that the view isn't based solely on higher BoC rates. It is also a function of the trade balance, which has moved quickly into surplus as the US economy accelerates and oil price rises. Stay short USD/CAD and AUD/CAD.

Currencies vulnerable to an upside surprise are those where last year's weakness supports prices yet the money market discounts little tightening (less than 50bp over the next year). The **dollar** fits this profile heading into this week, but dollar rallies on stronger inflation prints should be short-lived.

Commodities

The USDA last week lowered estimated **US corn inventories** considerably below market expectations and to the lowest level since 1995. Any further reduction would likely result in actual physical shortages until the next harvest. We continue to see upside risk to demand as production outside the US is still suffering from bad weather, and we expect further price rises from here. We also raise our spot price forecasts from $5.90 to $7 for 2Q11 (See *Grains & Oilseeds Monthly*, Lewis Hagedorn, Feb 2011).

Brent was up 2% last week largely on continued uncertainty in the Middle East. Protests have now spread to Algeria, Yemen, Jordan, Iran, and even Saudi Arabia. OPEC members worried about civil unrest will likely increase food subsidies and stock up on key foodstuffs in order to reduce the risk of an uprising. This provides an incentive to gradually increase oil production in order to maximize government revenues, which means we will likely see more supply near term. This signals a **significant risk of a correction short term**. Medium term, we remain bullish as demand should grow steadily as the global economic recovery gathers pace.

Ten-year Government bond yields

	Current	Mar 11	Jun 11	Sep 11	Dec 11
United States	3.66	3.80	3.80	3.75	3.70
Euro area	3.29	3.25	3.25	3.35	3.40
United Kingdom	3.87	3.95	4.10	4.20	4.30
Japan	1.30	1.15	1.25	1.30	1.35
GBI-EM	7.09				7.00

Credit markets

	Current	YTD Return
US high grade (bp over UST)	132	-0.9%
Euro high grade (bp over Euro gov)	165	-0.8%
USD high yield (bp vs. UST)	502	3.0%
Euro high yield (bp over Euro gov)	498	3.0%
EMBIG (bp vs. UST)	280	-0.9%
EM Corporates (bp vs. UST)	262	0.0%

Foreign exchange

	Current	Mar 11	Jun 11	Sep 11	Dec 11
EUR/USD	1.35	1.40	1.43	1.45	1.48
USD/JPY	83.6	81	80	79	78
GBP/USD	1.60	1.61	1.61	1.63	1.68

Commodities - quarterly average

	Current	11Q1	11Q2	11Q3	11Q4
Brent ($/bbl)	101	95	95	90	100
Gold ($/oz)	1355	1425	1475	1450	1500
Copper($/m ton)	9950	9650	9450	9750	10000
Corn ($/Bu)	7.11	6.60	7.00	6.75	6.10

Source: J.P. Morgan, Bloomberg, Datastream

AUD and NZD Commentary

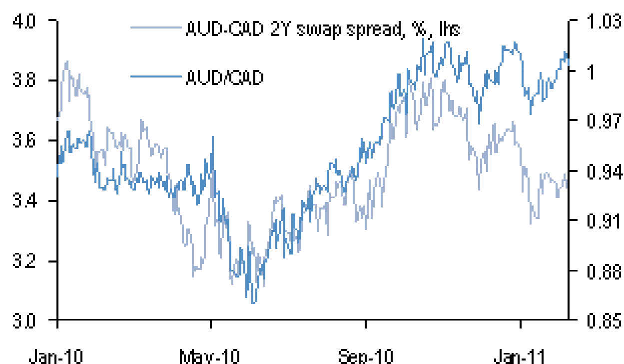
- **The global inflation fixation is delivering much less trend in currencies than in core asset markets.**
- **This erratic pattern will persist, since few countries offer the ideal combination for currencies of high rates, strong growth, rising inflation and a hawkish central bank.**
- **Technicals- Failure at key resistance levels maintain the short term range bias for AUD/USD and NZD/USD.**

- Global inflation continues to torture currency markets, and the pain looks set to continue. Last week delivered another rate hike by China, an aborted tightening by Korea, inflation undershoots in Norway and Switzerland, and dollar strength versus almost all global currencies but Indonesia. The unpredictable behavior of central banks and the irregular path of inflation prints is delivering more week-to-week reversals in FX than in core asset markets, and the absence of durable trends is compromising manager returns.
- In our portfolio we stay short AUD/CAD. AUD/CAD continues to whip around with little net direction. Nonetheless, as the US closes the growth gap to China, AUD/CAD should eventually rotate lower. The growing economic case for a break lower in AUD/CAD was reinforced by the tightening in the 2Y AUD-CAD swap spread last week by 20bp, to its lowest levels in six months (chart 1). For NZD, we present no strong bias in the current environment. Some disappointing 4Q data has been weighing down the kiwi, but we remain optimistic that economic indicators will turn more positive for NZD in 2011.

Technical Analysis

- Both AUD/USD and NZD/USD failed to extend through key resistance and suggest a continuation of the recent range action is likely to develop. As such, while the short term setup suggests additional two-sided action particularly given the current overbought setup for both, note the medium term setup remains bullish while suggesting new highs are on the way.
- For AUD/USD, the failure below the important 1.0200/1.0258 area which includes the important December peak led to a violation of the last week's key 1.0080 breakout level as the near term risks suggest additional weakness. Initial support enters at the .9935 trendline from the December low as violations should take prices back to the important .9865/04 short term range lows from January. Note that a violation here would shift the focus back to the .9600/.9537 area which includes the December low and should be where prices base. The medium term bias continues to call for new highs with deeper targets resting at 1.0330 and then 1.0550.
- As NZD/USD once again failed at the important .7800/27resistance area and short term range highs, note the near term risks point to additional weakness. Support at .7525 will now be an important pivot level followed by the critical .7482 trendline support from the March 2009 cycle low. Violations imply a deeper pullback into the .7343 December low and likely basing zone. Strength above the .7827 high should allow for a closer test and then break of the .7978 November peak.

Chart 1: AUD-CAD interest rate differentials have fallen to near a 6-month low, increasing the scope for AUD/CAD to break lower



Source: J.P. Morgan

NZD/USD - Daily chart

Source: CQG Inc. © 2011 All rights reserved worldwide   Fri Feb 11 2011 15:50:02

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Global Economic Outlook Summary

	Real GDP % over a year ago			Real GDP % over previous period, saar							Consumer prices % over a year ago			
	2010	2011	2012	3Q10	4Q10	1Q11	2Q11	3Q11	4Q11	1Q12	4Q10	2Q11	4Q11	2Q12
The Americas														
United States	2.9	3.4	3.0	2.6	3.2	4.0	4.0	3.5	3.0	2.0	1.2	**2.2** ↑	**1.8** ↑	**1.3** ↑
Canada	2.9	2.0	2.7	1.0	2.0	2.0	1.9	2.2	2.8	2.8	2.2	2.3	1.9	2.0
Latin America	6.0	4.5	4.1	2.6	3.9	4.4	5.6	3.9	4.3	3.9	6.7	6.9	7.5	7.6
Argentina	8.5	5.5	5.0	1.6	2.0	6.0	8.0	8.0	6.0	3.0	10.5	11.0	12.0	12.0
Brazil	7.7	4.5	4.5	2.1	4.2	5.4	4.4	4.0	5.2	5.0	5.6	5.9	5.9	6.2
Chile	5.3	6.0	4.5	8.1	4.0	5.0	5.0	5.0	4.5	4.5	2.5	4.2	5.5	5.0
Colombia	4.0	4.5	4.0	0.9	5.0	6.0	5.0	4.5	4.7	4.0	2.7	3.1	3.6	3.5
Ecuador	3.0	3.5	3.0	6.5	3.0	3.0	2.5	2.5	2.0	3.5	3.3	3.5	3.8	3.6
Mexico	5.4	4.5	3.5	3.0	4.1	3.0	8.0	2.8	3.1	2.5	4.2	3.6	3.7	3.6
Peru	8.8	6.5	6.0	6.7	8.0	5.5	5.0	5.5	5.0	7.0	2.1	2.5	2.4	2.8
Venezuela	-1.5	1.5	3.0	0.1	1.0	1.0	1.5	1.5	1.5	3.0	27.3	29.0	33.8	34.6
Asia/Pacific														
Japan	4.3	1.9	1.8	4.5	-1.2	2.2	2.2	2.5	2.0	1.8	0.1	0.0	-0.2	-0.2
Australia	2.7	3.1	4.4	0.8	2.7	1.7	4.4	5.5	5.1	4.8	3.2	3.9	3.8	3.7
New Zealand	1.4	2.0	3.2	-0.6	0.7	2.0	2.6	5.2	4.8	1.1	2.8	4.9	4.7	4.1
Asia ex Japan	9.0	7.7	7.5	**7.3** ↑	8.1	8.1	7.8	8.1	7.1	7.1	5.0	5.2	4.4	3.9
China	10.3	9.6	9.0	9.9	12.7	9.5	9.0	8.7	8.7	9.3	4.7	5.1	3.3	2.9
Hong Kong	6.6	4.1	4.8	2.8	3.5	4.2	4.3	4.7	5.0	5.2	2.5	2.2	2.4	3.2
India	8.5	8.8	8.4	14.2	2.5	8.0	10.0	14.0	6.0	5.0	9.5	8.1	8.7	8.3
Indonesia	**6.1** ↑	5.4	6.7	**6.7** ↑	**7.5** ↑	5.3	5.2	4.5	5.0	7.0	6.3	8.2	7.6	5.5
Korea	6.1	4.2	4.5	3.0	2.2	5.5	4.0	4.5	5.5	4.0	3.6	3.8	3.4	3.1
Malaysia	6.8	4.2	4.4	-1.3	5.0	5.5	5.3	5.0	4.5	5.5	1.9	2.7	3.1	3.0
Philippines	7.3	5.3	5.0	-3.1	12.7	4.9	6.1	4.1	4.1	5.3	2.9	3.9	3.4	2.9
Singapore	14.7	5.0	5.6	-18.7	6.6	8.7	7.8	7.0	6.6	4.9	4.0	3.6	3.2	2.7
Taiwan	10.5	5.0	5.4	0.9	0.8	9.0	6.5	5.8	6.0	5.5	1.1	1.8	2.9	2.1
Thailand	7.9	5.0	4.8	-0.9	5.0	7.5	6.0	5.5	5.5	4.5	2.9	4.8	4.6	4.5
Africa/Middle East														
Israel	4.0	4.5	4.0	**4.4** ↑	4.0	4.0	5.0	5.5	5.0	4.5	2.5	**3.2** ↑	**3.2** ↑	3.0
South Africa	2.7	3.5	3.7	2.6	4.0	3.3	3.9	3.9	3.8	4.2	3.5	4.1	5.7	5.6
Europe														
Euro area	1.7	**2.3** ↑	**2.3** ↑	1.4	1.5	**3.0** ↑	**2.5** ↑	**2.0** ↑	**2.5** ↑	**2.3** ↑	2.0	2.1	**2.0** ↑	**1.5** ↑
Germany	**3.5** ↓	**3.5** ↑	2.2	2.8	**2.0** ↓	**4.5** ↑	**3.0** ↑	**2.5** ↑	**2.5** ↑	**2.0** ↓	1.6	**2.0** ↑	**2.0** ↑	**1.4** ↑
France	1.5	**2.5** ↑	**2.6** ↑	1.2	2.0	**3.5** ↑	**2.5** ↑	**2.5** ↑	**3.0** ↑	**2.5** ↑	1.9	2.1	**2.2** ↑	**1.6** ↑
Italy	**1.0** ↓	**1.5** ↑	**2.2** ↑	1.0	**0.5** ↓	1.5	**2.0** ↑	**2.0** ↑	**2.5** ↑	**2.5** ↑	2.0	**2.2** ↑	**2.0** ↑	**1.8** ↑
Norway	2.0	**3.4** ↑	**3.0** ↑	3.7	3.5	**3.5** ↑	**3.5** ↑	**3.3** ↑	**3.0** ↑	**3.0** ↑	2.2	2.1	1.5	0.9
Sweden	5.3	**4.6** ↑	**3.0** ↑	8.7	4.0	**4.0** ↑	**3.5** ↑	**3.5** ↑	3.0	**3.0** ↑	1.9	3.2	3.2	2.6
United Kingdom	1.4	1.8	2.7	2.9	-2.0	2.8	2.0	2.5	3.0	2.5	3.4	3.9	3.5	2.1
Emerging Europe	**4.3** ↑	**4.1** ↑	4.6	-0.8	**9.5** ↑	**3.2** ↓	**3.2** ↓	**3.7** ↓	**4.9** ↑	**5.1** ↑	6.6	**7.6** ↑	**6.9** ↑	5.9
Bulgaria	0.1	3.5	4.0	...	...	...	...	...	...	...	...	...	...	...
Czech Republic	2.5	3.0	3.5	3.9	3.0	1.5	3.0	3.5	4.0	3.5	2.1	**2.0** ↓	**2.5** ↓	**2.6** ↑
Hungary	1.2	2.8	3.5	3.2	2.0	2.5	3.0	3.5	3.5	3.5	4.4	4.2	4.4	3.6
Poland	3.8	4.0	4.2	5.3	3.8	3.5	4.0	4.5	4.5	4.2	2.9	3.4	3.1	2.8
Romania	-2.0	1.5	3.0	...	...	...	...	...	...	...	8.0	7.2	4.0	4.2
Russia	**4.0** ↑	**4.5** ↑	5.0	-3.8	**14.5** ↑	**3.5** ↓	**3.0** ↓	**3.5** ↓	**5.5** ↑	**6.0** ↑	8.2	**10.9** ↑	**9.7** ↑	**7.9** ↑
Turkey	**8.3** ↑	4.5	5.0	...	...	...	...	...	...	...	7.4	6.4	6.4	6.1
Global	**3.9** ↑	**3.6** ↑	3.5	3.0	**3.1** ↑	**4.0** ↑	**3.9** ↑	3.7	**3.6** ↑	**3.2** ↑	2.7	**3.2** ↑	**2.8** ↑	**2.4** ↑
Developed markets	2.6	**2.7** ↑	**2.6** ↑	2.4	1.6	**3.2** ↑	**3.0** ↑	**2.8** ↑	**2.8** ↑	**2.2** ↑	1.6	**2.1** ↑	**1.8** ↑	**1.3** ↑
Emerging markets	7.2	6.1	6.0	**4.7** ↑	**7.1** ↑	6.3	**6.4** ↓	**6.3** ↓	5.9	**5.9** ↑	5.6	6.0	5.6	5.2
Memo:														
Global — PPP weighted	4.8	**4.5** ↑	**4.5** ↑	3.9	**4.3** ↑	**4.8** ↑	**4.8** ↑	4.7	**4.3** ↑	**4.3** ↑	3.4	**3.9** ↑	**3.5** ↑	3.0

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Global Central Bank Watch

	Official interest rate	Current	Change from Aug '07 (bp)	Last change	Next meeting	Forecast next change	Mar 11	Jun 11	Sep 11	Dec 11	Mar 12
Global	GDP-weighted average	1.88	-309				1.92	2.03	2.12	2.25	2.35
excluding US	GDP-weighted average	2.57	-226				2.63	2.77	2.90	3.08	3.23
Developed	GDP-weighted average	0.62	-358				0.63	0.67	0.71	0.83	0.95
Emerging	GDP-weighted average	5.37	-173				5.51	5.79	6.02	6.17	6.25
Latin America	GDP-weighted average	7.53	-188				7.80	8.31	8.50	8.53	8.53
CEEMEA	GDP-weighted average	4.07	-295				4.26	4.42	4.75	5.19	5.49
EM Asia	GDP-weighted average	5.10	-115				5.17	5.42	5.62	5.70	5.71
The Americas	GDP-weighted average	1.32	-449				1.37	1.46	1.51	1.53	1.55
United States	Federal funds rate	0.125	-512.5	16 Dec 08 (-87.5bp)	15 Mar 11	On hold	0.125	0.125	0.125	0.125	0.125
Canada	Overnight funding rate	1.00	-325	8 Sep 10 (+25bp)	1 Mar 11	12 Apr 11 (+25bp)	1.00	1.25	1.50	1.75	2.00
Brazil	SELIC overnight rate	11.25	-75	19 Jan 11 (+50bp)	2 Mar 11	2 Mar 11 (+50bp)	11.75	12.50	12.50	12.50	12.50
Mexico	Repo rate	4.50	-270	17 Jul 09 (-25bp)	4 Mar 11	2Q 12 (+25bp)	4.50	4.50	4.50	4.50	4.50
Chile	Discount rate	3.25	-175	16 Dec 10 (+25bp)	17 Feb 11	17 Feb 11 (+25bp)	3.75	4.50	6.00	6.50	6.50
Colombia	Repo rate	3.00	-600	30 Apr 10 (-50bp)	25 Feb 11	Apr 11 (+25bp)	3.00	4.00	5.50	5.50	5.50
Peru	Reference rate	**3.50**	-100	**10 Feb 11 (+25bp)**	10 Mar 11	**10 Mar 11 (+25bp)**	**3.75**	**4.50**	4.50	4.50	4.50
Europe/Africa	GDP-weighted average	1.48	-324				1.52	1.59	1.70	1.98	2.24
Euro area	Refi rate	1.00	-300	7 May 09 (-25bp)	18 Mar 11	**Dec 11 (+25bp)**	1.00	1.00	1.00	**1.25**	**1.50**
United Kingdom	Bank rate	0.50	-500	5 Mar 09 (-50bp)	10 Mar 11	May 11 (+25bp)	0.50	0.75	1.00	1.25	1.50
Sweden	Repo rate	1.25	-225	15 Dec 10 (+25bp)	15 Feb 11	15 Feb 11 (+25bp)	1.50	1.75	2.25	2.75	3.00
Norway	Deposit rate	2.00	-250	5 May 10 (+25bp)	16 Mar 11	16 Mar 11 (+25bp)	2.25	2.50	2.75	2.75	3.00
Czech Republic	2-week repo rate	0.75	-200	6 May 10 (-25bp)	24 Mar 11	23 Jun 11 (+25bp)	0.75	1.00	1.25	1.75	2.00
Hungary	2-week deposit rate	6.00	-175	24 Jan 11 (+25bp)	21 Feb 11	4Q 11 (+25bp)	6.00	6.00	6.00	6.25	6.50
Israel	Base rate	2.25	-175	24 Jan 11 (+25bp)	21 Feb 11	2Q 11 (+25bp)	2.25	2.50	3.00	3.50	4.00
Poland	7-day intervention rate	3.75	-75	19 Jan 11 (+25bp)	2 Mar 11	2Q 11 (+25bp)	3.75	4.00	4.25	4.50	4.50
Romania	Base rate	6.25	-75	4 May 10 (-25bp)	Mar 11	3Q 11 (+25bp)	6.25	6.25	6.50	6.75	7.00
Russia	1-week deposit rate	3.00	0	24 Dec 10 (+25bp)	Feb 11	Feb 11 (+25bp)	3.50	3.75	4.00	4.25	4.50
South Africa	Repo rate	5.50	-400	18 Nov 10 (-50bp)	24 Mar 11	Nov 11 (+50bp)	5.50	5.50	5.50	6.00	6.50
Turkey	1-week repo rate	6.25	-1125	20 Jan 11 (-25bp)	15 Feb 11	**Aug 11 (+50bp)**	**6.25**	**6.25**	7.00	8.00	8.50
Asia/Pacific	GDP-weighted average	3.23	-96				3.27	3.42	3.56	3.62	3.62
Australia	Cash rate	4.75	-150	2 Nov 10 (+25bp)	28 Feb 11	May 11 (+25bp)	4.75	5.00	5.25	5.50	5.50
New Zealand	Cash rate	3.00	-500	29 Jul 10 (+25bp)	9 Mar 11	9 Jun 11 (+25bp)	3.00	3.25	3.50	3.75	3.75
Japan	Overnight call rate	0.05	-45	5 Oct 10 (-5bp)	15 Feb 11	On hold	0.05	0.05	0.05	0.05	0.05
Hong Kong	Discount window base	0.50	-625	17 Dec 08 (-100bp)	16 Mar 11	On hold	0.50	0.50	0.50	0.50	0.50
China	1-year working capital	**6.06**	-51	**9 Feb 11 (+25bp)**	-	2Q 11 (+25bp)	6.06	6.31	6.56	6.56	6.56
Korea	Base rate	2.75	-175	13 Jan 11 (+25bp)	9 Mar 11	Apr 11 (+25bp)	2.75	3.00	3.25	3.50	3.50
Indonesia	BI rate	6.75	-175	4 Feb 11 (+25bp)	4 Mar 11	4 Mar 11 (+25bp)	7.00	7.25	7.25	7.25	7.25
India	Repo rate	6.50	-125	25 Jan 11 (+25bp)	17 Mar 11	17 Mar 11 (+25bp)	6.75	7.00	7.25	7.50	7.50
Malaysia	Overnight policy rate	2.75	-75	8 Jul 10 (+25bp)	11 Mar 11	5 May 11 (+25bp)	2.75	3.00	3.00	3.00	3.00
Philippines	Reverse repo rate	4.00	-350	9 Jul 09 (-25bp)	24 Mar 11	**5 May 11 (+25bp)**	4.00	**4.25**	**4.50**	**4.50**	**4.50**
Thailand	1-day repo rate	2.25	-100	12 Jan 11 (+25bp)	9 Mar 11	9 Mar 11 (+25bp)	2.50	3.00	3.00	3.00	3.00
Taiwan	Official discount rate	1.625	-150	30 Dec 10 (+12.5bp)	Mar 11	Mar 11 (+12.5bp)	1.75	1.875	2.00	2.125	2.25

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

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Economic forecasts - Australia

Australia: economic projections *percentage change over previous period, seasonally adjusted annual rates, un*

				2010			2011				2012			
	2010	2011	2012	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Chain volume GDP	2.7	3.0	4.3	4.6	0.8	2.7	1.7	4.4	5.5	5.1	4.8	3.1	3.4	4.1
Private consumption	2.6	2.3	1.9	5.9	2.4	0.8	2.0	0.4	6.1	3.2	0.8	1.2	0.4	0.8
Construction investment	2.9	7.0	6.1	11.9	4.5	8.3	4.6	9.7	6.7	5.9	4.7	7.1	6.4	4.8
Equipment investment	-3.9	1.9	6.6	-16.9	-3.6	26.2	8.2	-7.8	-15.1	12.6	12.6	8.2	12.6	12.6
Public investment	28.6	9.2	3.3	-15.0	7.9	10.6	12.3	13.5	8.7	10.6	3.1	-11.3	5.6	6.4
Government consumption	3.3	1.9	7.2	6.6	1.8	2.0	-0.8	2.8	2.9	4.1	9.4	10.4	8.6	8.2
Exports of goods & services	4.6	3.1	6.6	25.6	-9.3	0.0	0.0	8.2	8.2	6.1	4.9	8.2	6.6	5.7
Imports of goods & services	12.4	2.1	5.2	16.5	-2.2	4.1	-3.2	4.1	4.1	4.1	6.1	4.1	9.1	3.2
Contributions to GDP growth:														
Inventories	0.2	-0.5	0.1	-2.1	-0.8	0.3	-2.0	0.8	0.1	-0.2	1.3	-1.0	0.0	-0.4
Net trade	-1.6	0.2	0.4	1.8	-1.8	-0.9	0.8	0.9	0.9	0.5	-0.2	0.9	-0.5	0.6
GDP deflator (%oya)	4.8	3.3	2.7	5.4	6.8	5.9	4.8	3.1	2.7	2.7	2.7	2.7	2.8	2.7
Consumer prices (%oya)	2.8	3.3	3.3	3.1	2.8	2.6	2.9	3.2	3.3	3.6	3.3	3.4	3.3	3.3
Producer prices (%oya)	2.1	3.4	4.0	2.5	1.5	4.5	2.9	2.7	4.0	4.0	4.0	4.0	4.0	4.0
Trade balance (A$ bil, sa)	-6.8	24.0	30.4	7.0	6.5	4.8	4.9	5.5	6.4	7.2	7.7	7.2	7.4	8.1
Current account (A$ bil, sa)	-51.4	-33.5	-29.6	-5.4	-7.8	-8.9	-9.1	-8.7	-8.2	-7.6	-7.3	-7.8	-7.6	-6.9
as % of GDP	-4.1	-2.3	-1.9	-1.6	-2.3	-2.6	-2.6	-2.4	-2.3	-2.1	-1.9	-2.0	-2.0	-1.8
3m eurodeposit rate (%)*	6.0	5.4	5.9	3.5	4.3	4.9	5.0	5.3	5.5	5.8	5.9	5.9	6.0	6.0
10-year bond yield (%)*	5.6	5.7	5.5	5.5	5.1	5.5	5.8	5.9	5.7	5.6	5.6	5.6	5.5	5.5
US$/A$*	0.75	1.02	0.97	0.82	0.88	1.01	1.00	1.01	1.03	1.04	1.02	0.98	0.95	0.92
Commonwealth budget (FY, A$ bil)	-51.0	-26.0	-8.0											
as % of GDP	-3.8	-1.8	-0.5											
Unemployment rate	5.3	5.3	4.9	5.2	5.2	5.3	5.3	5.2	5.1	5.0	4.9	4.9	4.8	4.8
Industrial production	4.6	0.0	1.0	-4.1	0.6	-2.0	0.0	1.0	2.0	3.0	1.0	2.0	-2.0	3.0

*All financial variables are period averages

Australia - summary of main macro views

- We trimmed our 2011 **GDP growth** forecast to 3.0% owing to the impact of the floods and cyclone in Queensland. We are comfortable with the investment outlook (particularly in mining), but remain cautious on consumers, who face more interest rate pain. We lifted the 2012 forecast to 4.3% as exports will rebound.
- **Business investment** probably will rise strongly in 2011, with mining leading the way (again), particularly with some of the mining tax roadblocks being "dismantled".
- On **housing**, with the expanded first home owners' grant now having expired and price caps on the basic grant in place, house price growth has cooled, particularly at the low end of the price spectrum.
- **Consumer confidence** deteriorated in 2010 as mortgage rates rose. The index fell 5.7%m/m in January, but rebounded 1.9%m/m in February. Optimists outnumber pessimists, but rate hikes are hurting.
- **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.
- We expect the next **RBA** rate hike in May. Officials have been tightening ahead of the substantial boost to national income from the booming terms of trade; that particular story remains on track, even though officials likely will tread carefully in the near term owing to the impact of the recent natural disasters.
- The **Federal government** is sticking with its promise to deliver a Budget surplus next fiscal year. A proposed levy and targeted spending cuts will help plug the hole caused by the flood/cyclone rebuilding effort.

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Economic forecasts - New Zealand

New Zealand: economic projections *percentage change over previous period, seas. adjusted annual rates, unless stated*

				2010			2011				2012			
	2010	2011	2012	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Real GDP (1995-96 prices)	1.4	2.0	3.2	0.5	-0.6	0.7	2.0	2.6	5.2	4.8	1.1	3.0	4.3	2.3
Private consumption	2.1	2.0	2.8	0.6	2.0	1.0	2.0	2.0	4.0	2.5	2.6	2.8	3.0	3.0
Fixed Investment	2.2	5.1	5.3	26.8	-6.9	6.5	5.6	4.7	5.1	5.5	6.3	4.9	5.0	4.0
Residential construction	6.3	6.9	4.8	53.7	-26.4	20.0	12.0	4.4	4.4	4.8	5.6	5.2	4.0	4.0
Other fixed investment	1.4	4.7	5.4	22.0	-2	4.0	4.4	4.8	5.2	5.6	6.4	4.8	5.2	4.0
Inventory change (NZ$ bil, saar)	-0.5	0.2	0.3	-0.7	0.1	0.1	0.1	0.0	0.1	0.1	-0.1	0.0	0.2	0.2
Government spending	2.0	1.3	1.3	2.0	-2.9	1.1	2.2	2.2	2.2	2.2	0.8	0.8	0.8	0.8
Exports of goods & services	2.5	4.5	5.8	2.3	-4.5	3.0	6.0	7.0	8.0	9.0	4.0	5.0	4.0	5.0
Imports of goods & services	8.3	6.8	5.6	1.2	12.5	8.0	7.0	6.0	5.0	4.0	6.0	6.0	6.0	8.0
Contributions to GDP growth:														
Domestic final sales	2.5	2.5	3.3	8.1	-3.6	2.4	3.0	2.8	4.1	3.2	3.4	3.1	3.2	3.0
Inventories	0.9	0.5	0.1	-7.6	9.1	0.1	-0.5	-0.3	0.3	0.1	-1.4	0.5	1.9	0.6
Net trade	-2.0	-1.0	-0.1	0.3	-5.6	-1.8	-0.6	0.1	0.8	1.5	-0.8	-0.5	-0.9	-1.3
GDP deflator (%oya)	1.8	2.0	1.6	1.6	2.2	3.3	2.6	2.1	1.9	1.6	1.1	1.5	1.9	2.0
Consumer prices	2.3	3.2	2.2	0.7	4.4	9.7	3.3	1.8	3.9	3.8	2.0	1.7	2.6	2.3
%oya	2.3	4.3	2.6	1.7	1.5	4.0	4.5	4.8	4.6	3.2	2.9	2.8	2.5	2.2
Trade balance (NZ$ bil, sa)	3.1	1.8	2.1	1.2	0.8	0.1	0.2	0.5	0.6	0.5	0.6	0.4	0.4	0.7
Current account (NZ$ bil, sa)	-6.6	-5.5	-1.1	-1.9	0.0	-3.5	-1.2	-3.3	-1.3	-0.7	-0.2	-5.2	-0.2	-0.8
as % of GDP	-3.6	-2.8	-0.5	-4.1	0.1	-7.4	-6.9	-2.6	-1.5	-0.4	-0.4	-1.6	-1.0	0.9
Yield on 90-day bank bill (%)*	3.0	3.6	4.1	2.9	3.2	3.2	3.2	3.5	3.8	4.0	4.1	4.1	4.2	4.2
10-year bond yield (%)*	5.5	5.5	5.2	5.6	5.2	5.5	5.8	5.6	5.5	5.3	5.3	5.2	5.2	5.1
US$/NZ$*	0.72	0.79	0.78	0.70	0.72	0.76	0.77	0.78	0.79	0.80	0.80	0.78	0.76	0.76
Commonwealth budget (NZ$ bil)	-7.2	-9.8	-5.0											
as % of GDP	-3.9	-5.1	-2.5											
Unemployment rate	6.4	6.2	5.3	6.9	6.4	6.8	6.5	6.3	6.0	6.0	5.7	5.4	5.0	5.1

*All financial variables are period averages

New Zealand - summary of main macro views

- The **New Zealand economy** contracted 0.2%q/q in 3Q. The economy has expanded less than 2% since it exited recession more than a year ago.
- Post-earthquake reconstruction work, higher export volumes and elevated commodity prices, and the positive economic effects related to the Rugby World Cup will help **GDP accelerate in 2011.**
- The recent surge in imports of capital goods—up 30% over the last six months—suggests that **business investment** will pick up; hence, the recovery in the labour market should gain traction.
- The **unemployment** rate spiked 0.4%-points to 6.8% in 4Q. Had it not been for a sharp drop in the participation rate, the unemployment rate would have probably surpassed the post-recession peak of 7.0%.
- The **RBNZ** left the OCR unchanged in January and needs to see a pick up in economic growth and underlying inflation before pushing the cash rate closer to neutral. We expect the next rate hike to be delivered in June, but the risks are skewed toward a later move.
- Headline **inflation** printed at 1.5%oya in 3Q, below the middle of the RBNZ's 1%-3% target range. The 4Q result was boosted by the October GST hike, but even that had a limited pass-through: underlying inflation was just 0.3%q/q.
- **Inflation expectations** have remained anchored despite the October 1 GST hike. Two-year inflation expectations held steady in 4Q, with respondents expecting inflation in two-years' time to average 2.6%oya.

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Australia and New Zealand economic calendar

Monday	Tuesday	Wednesday	Thursday	Friday
14 Feb **Australia:** Housing finance Dec 1.5%m/m, sa **New Zealand:** Retail trade (10:45 am) Dec -0.2%m/m, sa Retail trade ex inflation 4Q -0.8%q/q, sa	**15 Feb**	**16 Feb** **Australia:** New motor vehicle sales (10:30 am) Jan	**17 Feb** **New Zealand:** PPI (10:45 am) 4Q 1.8% q/q, nsa	**18 Feb**
21 Feb **New Zealand:** Credit card spending Jan	**22 Feb**	**23 Feb** **Australia:** Construction work done (11:30 pm) 4Q Wage price index (11:30 pm) 4Q	**24 Feb** **Australia:** Capital expenditure (11:30am) 4Q	**25 Feb**
28 Feb **Australia:** Pvt. sector credit Jan Company profits 4Q Business inventories 4Q **New Zealand:** Trade balance Jan Building consents Jan	**1 Mar** **Australia:** Current account 4Q Retail trade Jan RBA board meeting **New Zealand:** Terms of trade index 4Q	**2 Mar** **Australia:** GDP 4Q	**3 Mar** **Australia:** Building approvals (11:30 am) Jan Trade balance (11:30 am) Jan	**4 Mar**
7 Mar	**8 Mar** **Australia:** NAB business confidence Feb	**9 Mar** **Australia:** Westpac consumer confidence Mar Housing finance Jan	**10 Mar** **Australia:** Unemployment rate Feb **China:** Trade balance Feb	**11 Mar**

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Global Data Diary

Week / Weekend	Monday	Tuesday	Wednesday	Thursday	Friday
12 - 18 February	14 February	15 February	16 February	17 February	18 February
	China • Trade report (Jan) **Euro area** • IP (Dec) **India** • WPI (Jan) **Japan** • GDP (4Q)	**Brazil** • Retail sales (Dec) **China**: CPI (Jan) **Euro area** • GDP (4Q) • Trade report (Dec) **Japan** • BoJ MPM: no chg **Sweden** • Riksbank mtg: +25bp **Turkey**: CBRT mtg: no chg **United Kingdom**: CPI (Jan) **United States** • Retail sales (Jan) • NY Fed surv (Feb) • Business inventories (Dec) • NAHB surv (Feb)	**Russia** • IP (Jan) **United Kingdom** • Labor market report (Jan) • BoE inflation report (1Q) **United States** • Housing starts (Jan) • IP (Jan) • FOMC minutes (Jan)	**Chile** • BCCh mtg: +25bp **Euro area** • EC cons conf prelim (Feb) **Japan** • Reuters Tankan (Feb) **Singapore** • NODX (Jan) **Taiwan** • GDP (4Q) **United States** • CPI (Jan) • Philly Fed surv (Feb) • Bernanke testifies on Dodd-Frank bill	**Canada** • CPI (Jan) **Japan** • MPM minutes (Jan) **Poland** • IP (Jan) **United Kingdom** • Retail sales (Jan) • King speech **United States** • Bernanke speech
19 - 25 February	21 February	22 February	23 February	24 February	25 February
	Euro area • PMI flash (Feb) **Germany** • IFO bus surv (Feb) **Hungary** • NBH mtg: no chg **Israel** • BoI mtg: no chg **Mexico** • GDP (4Q) **Taiwan** • Export orders (Jan) **United States** • Presidents' Day; markets closed	**Hong Kong** • CPI (Jan) **United States** • Case-Shiller HPI (Dec) • CB cons conf (Feb)	**Euro area** • Industrl new orders (Dec) **Japan** • GDP (4Q) **Singapore** • CPI (Jan) **Taiwan** • IP (Jan) **United Kingdom** • MPC minutes (Feb) **United States** • Exstng home sales (Jan)	**Euro area** • EC bus conf (Feb) **Russia** • GDP (4Q) **United States** • Durable goods (Jan) • New home sales (Jan)	**Colombia** • BanRep mtg: no chg **Germany** • CPI prelim (Feb) **Singapore** • IP (Jan) **United Kingdom** • GDP revision (4Q) **United States** • GDP revision (4Q) • UMich cons sent fnl (Feb)

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