J.P.Morgan

Australia and New Zealand - Weekly Prospects

Summary

- The economic data released in **Australia** last week was a mixed bag. Demand for home loans improved (a little) and consumer confidence bounced, but business confidence was soggy. This goes to show that consumers and managers usually react differently to a high and rising AUD, which popped its head briefly above parity with the USD on Friday night. The much-anticipated "parity-party", though lasted only a minute or two. This week sees the release mainly of second tier data, so the focus will be on the release tomorrow of the minutes from the last RBA Board meeting, when members surprised by leaving the cash rate steady; we, like most others, had expected a hike. Hopefully, the minutes will deliver more clarity on why the RBA was inactive. Was it because the rising AUD had done the heavy lifting, or was it anxiety about conditions offshore? We suspect it was more the latter, even though the rise in AUD since July, in real effective terms, has tightened monetary conditions by the equivalent of one quarter point rate hike. Hopefully, all (or at least more) will be revealed tomorrow.
- More evidence came to hand last week that the recovery in **New Zealand** has slowed significantly. The retail sales numbers for August and house price data for September both printed weak results. The data flow added further to the case for RBNZ Governor Bollard to sit on the policy sidelines throughout the remainder of this year, particularly given that inflation is being well-behaved. Indeed, this morning's 3Q CPI data printed comfortably within the RBNZ's 1%-3% target range, providing more scope for Dr. Bollard to leave the OCR unchanged in coming months. While these numbers precede what we expect will be a series of elevated inflation prints, resulting partly from the October 1 GST hike, underlying inflation likely will remain subdued.
- An already large divide among **global policymakers** has widened as the Federal Reserve moves toward a new round of easing next month. The battle lines of the divide lie on the asset side of central bank balance sheets. As the Fed moves toward increasing Treasury holdings, there is pressure building on other central banks in economies where inflation stands below central bank targets. While the ECB is resistant to further active expansion, the Bank of Japan has moved grudgingly in this direction. It remains a close call whether the Bank of England will soon follow. Official holdings of foreign exchange reserves represent another line of division. As Fed easing places downward pressure on the dollar, China is accelerating its pace of foreign reserve accumulation, having already added roughly $200 billion to its position over the last three months.
- **Global manufacturing** activity slowed dramatically in recent months, delivering a blow to the economic recovery. It appears that this slowing will continue to intensify into year-end and prove particularly intense for emerging market economies. A waning boost from inventory dynamics—and its implications for global manufacturing and GDP growth—has long been incorporated in our economic forecast. During the first year of the recovery, manufacturers aggressively raised output to realign the level of production with the level of sales. By the middle of this year, inventory accumulation had resumed and output gains began to slow.

This week's highlight

With the Kiwi CPI data already to hand, the highlight will be tomorrow's RBA Board minutes. We expect more clarity on why the RBA left the cash rate steady. The main reason seems to be lingering global uncertainty.

October 18, 2010

Contents

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	Consensus [b]	*Previous*
Monday, October 18	11.30am	Aust. new motor vehicle sales (%m/m, Sep.)	**na**	na	*0.3*
Tuesday, October 19	11.30am	RBA Board minutes (Oct.)	**na**	na	*na*
Wednesday, October 20	10.10am	RBA Head of Financial Stability Ellis' speech	**na**	na	*na*
Wednesday, October 20	10.30am	Westpac Leading Index (%m/m, Aug.)	**na**	na	*0.4*
Wednesday, October 20	11.30am	Aust. DEWR skilled vacancies (%m/m, Oct.)	**na**	na	*0.1*
Thursday, October 21	8.45am	NZ net migration (ppl., Sep.)	**na**	na	*840*
Thursday, October 21	1.00pm	NZ credit card spending (%m/m, Sep.)	**0.0**	na	*0.5*
Thursday, October 21	1.00pm	NZ ANZ consumer confidence (Index, Oct.)	**na**	na	*116.4*
Thursday, October 21	11.00am	CBA/HIA housing affordability (Index, 3Q)	**na**	na	*108.3*
Friday, October 22	11.30am	Aust. export prices (%q/q, 3Q)	**0.8**	4.0	*16.1*
Friday, October 22	11.30am	Aust. import prices (%q/q, 3Q)	**0.1**	0.0	*1.9*

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

Australia

New motor vehicle sales (%m/m, Sep.) - Car sales firmed in trend terms for the first time in four months in August, in yet another sign that the (then three-month) rate hike reprieve from the RBA has energized consumer attitudes toward discretionary and durables consumption. We expect the trend measure of car sales to have continued pushing up in September, in line with the rise in consumer and business confidence over the preceding months.

RBA Board minutes (Oct.) - Tuesday sees the release of the minutes to the Reserve Bank's October Board meeting, at which officials (unexpectedly) left the cash rate unchanged. Hopefully, this week's minutes will provide some clarity on what some have interpreted as a last-minute change of heart from the RBA: speeches from senior RBA officials had hinted a high probability of a hike, but the statement was minimalist, leaving shocked market participants (including ourselves) with sparse details with which to recalibrate the near-term policy outlook. The main reason for the "unchanged" decision seems to be that the lingering offshore uncertainty argued for caution. Perhaps, though, officials also were conscious of the rising AUD, which is helping to tighten monetary conditions. Hopefully, the minutes will provide additional colour on these important policy considerations.

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Data previews - Cont'd.

RBA event - The RBA's Head of Financial Stability, Luci Ellis, is a panel discussant at the Finsia Annual Financial Services Conference in Sydney on Wednesday morning. No title for the "speech" is available, but the panel includes a Q&A session.

DEWR skilled vacancies (%m/m, Oct.) - Vacancies have flatlined since May. Surprisingly, building and engineering vacancies in particular have been soft over this period, at both the associate and professional level. The possibility remains, however, that employment opportunities actually are relatively plentiful, but are not being formally listed. The fact that monthly employment gains have failed to decelerate supports this idea.

CBA/HIA housing affordability (Index, 3Q) - There is little scope for a further decline in the affordability index near-term, having already corrected sharply as house prices grew at an average of 4%q/q and interest rates rose briskly over 1Q and 2Q. Over the September quarter, the RBA was on hold, and the housing market has posted much softer monthly price growth (including outright price declines in some sectors). Affordability, therefore, will have stabilized in 3Q.

Terms of trade (%q/q, 3Q) - After the dramatic effect of the pass-through to new commodity pricing arrangements for coal and iron ore in 2Q, export price growth will have fallen back to earth in 3Q. In level terms of course, higher prices for these key commodities will continue to support national income for some time yet. Import price growth will remain soft, which will push the terms of trade up 0.7%q/q, after the bumper 14% gain in 2Q.

New Zealand

Credit card spending (%m/m, Sep.) - Credit card spending probably was flat in September. As indicated by the retail sales number last week, households have adopted a much more cautious approach to spending, and instead are choosing to pay down debt. We suspect that this trend will continue given that employment and wage growth remain subdued. This will mean that spending on credit cards remains soft throughout the remainder of the year.

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Australia

- **RBA's rate hike reprieve bolstered Aussie confidence**
- **Board minutes to colour recent rate surprise**
- **Home loans turning stronger at average mortgage rates**

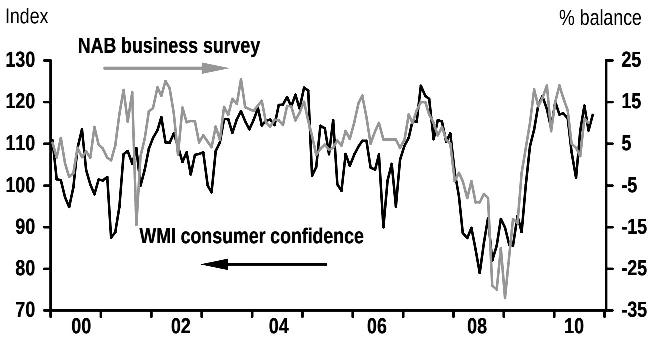
The data flow in Australia last week was, on balance, positive for the growth story. Home loan demand picked up in August and consumers became more upbeat in October, but business confidence eased modestly in September. For RBA officials, probably the most worrying aspect of these results would be the jump in consumer sentiment, particularly regarding views on buying major household items. RBA officials recently have indicated a preference for some austerity among households, to offset the boost stemming from the surging terms of trade and booming corporate and public spending. This survey implies the opposite, even if the result is highly-dependent on RBA decisions.

In the statement accompanying the RBA's surprise decision to leave the cash rate steady two weeks ago, officials discounted the evidence of domestic strength, choosing instead to leave the policy setting unchanged amid global uncertainties. As has been reflected by the approach of AUD toward parity, however, it now is becoming increasingly difficult to dismiss the domestic growth story. Indeed, inflation looks likely to head higher, particularly so if consumption remains healthy at the same time that the terms of trade holds near historic highs and the investment boom gets into full swing. Already, we forecast both headline and core inflation above the RBA's comfort zone in 2011.

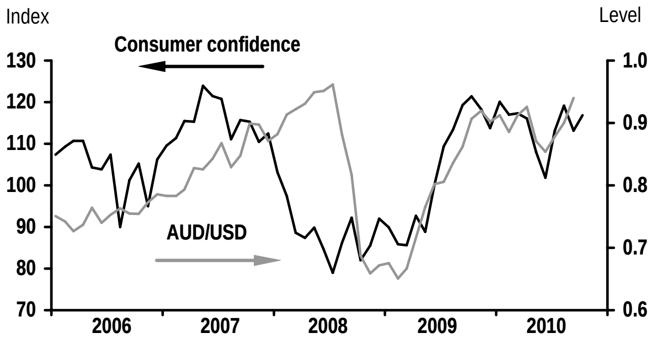
What were RBA officials thinking?

On Tuesday, the Reserve Bank releases minutes from the early October Board meeting; we, like most economists, had forecast a hike. The statement announcing the surprise decision instead to leave the cash rate steady highlighted the strength of the domestic economy, but hinted that lingering offshore concerns were keeping the RBA sidelined. Hopefully, this week's minutes will provide some clarity on what some have interpreted as the RBA's last-minute change of heart; earlier speeches from senior RBA officials had suggested a high probability of a hike. Perhaps the RBA's liaison program with corporates, the results of which remain private, revealed that something was amiss. Do RBA officials know something about the global cycle we do not? It is unlikely, but did private members of the RBA Board "roll" the official recommendation for a hike? Has the RBA lowered the official

Australia: consumer and business confidence



Australia: Westpac Melbourne consumer sentiment index and AUD



forecasts? Hopefully, all (or at least more) will be revealed Tuesday.

Consumers upbeat after rate reprieve

The rebound in consumer confidence in Australia in October was not a surprise in the wake of the RBA's unexpected decision to leave interest rates on hold two weeks ago. An early-October rate hike not only was forecast by the majority of market economists, but was flagged in a steady stream of media reports in the lead-up to the October decision. Also, there was widespread speculation that the local commercial banks would out-hike the RBA by as much as 15bp should the official cash rate rise.

With the RBA having held fire, though, market interest rates remained steady, providing an ample amount of relief for households that have watched mortgage repayments increase steadily since October last year, when the RBA's tightening cycle began. Solid employment gains, high AUD, and recent equity market gains also were attributed to the solid 3.3%m/m jump in confidence this month.

Sentiment increased the most toward buying major household items, spiking nearly 10%m/m to a five-year high, signaling that consumer spending will rise in coming months. RBA officials likely will be concerned about this component picking up, having previously indicated their hopes that the challenges posed by the soaring terms of trade and booming investment would be lessened by greater caution from households. There has been little evidence of this caution of late: household consumption underpinned economic growth in the second quarter, pushing the savings rate sharply lower, and recent retail sales data indicated a spike in discretionary spending in August.

Labour market landscape favourable

With the domestic economy booming, and with the RBA having held fire since May, it is hard to see consumers reining in spending to any significant extent anytime soon, particularly given that labour market conditions have tightened significantly. We do, though, expect that monthly job gains will ease heading into year-end from the stellar rates recorded in recent months. Only two weeks ago, the labour force survey showed that another 50,000 jobs were created in September, most of which were full-time. The employment component of the NAB business survey last week confirmed our view. It weakened for the third straight month (falling one point), supporting our view that monthly employment gains will pull back in 4Q, albeit modestly. Even taking this into account, however, a total job gains this year should surpass a remarkable 300,000; this result would be more than double the annual employment gains recorded in any other year.

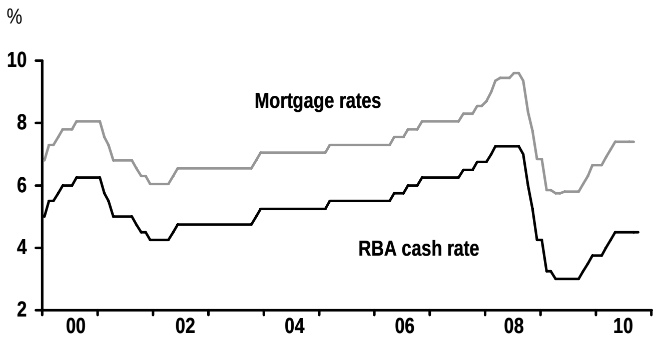
With the unemployment rate set to reach 5% by year-end, and the economy effectively at full employment, the threat of a sharp acceleration in wage inflation is very real. The ABS' quarterly measure of labour costs so far has showed that wage inflation remains contained, but the NAB measure tells a different tale. On a three-month annualized basis, total labour costs, measured by NAB, grew 6.3% in September, the strongest growth rate on record. With certain sectors of the economy such as mining already reporting skills shortages, RBA officials probably will be increasingly anxious that wage pressures will intensify, adding to local inflation woes.

Home loan demand also recovering

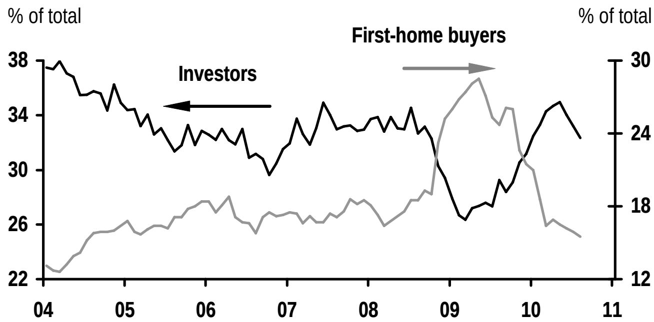
The RBA's extended pause has renewed demand for home loans. The number of home loans issued rose for the second straight month in August (+1.0%m/m), after borrowers were delivered a third consecutive rate hike reprieve. Indeed, only since May, when the RBA delivered its most recent 25bp hike, has the number of home loan commitments increased, having earlier been in steady decline since the RBA's tightening cycle began. The RBA's current pause, which we expect will last only until early November, should be a net positive for loan demand.

Despite the rate hike reprieve, in the absence of government stimulus, demand for home loans continues to wane among first-home buyers (FHBs). This is unsurprising given the expanded FHB grant expired on December 31, price caps on the original grant were introduced at the start of this year, and interest rates have risen significantly over the past 12 months. FHBs, having accounted for nearly 30% of all home loans issued in early 2009, now account for less than 16%. Indeed, those FHBs who entered the market in the low interest rate environment probably are the most affected by rising interest rates given that their mortgages are large as a multiple of their incomes and as a ratio of the value of their homes.

Australia: RBA cash rate vs. standard variable mortgage rates



Australia: housing finance



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Data releases and forecasts

Week of October 18 - 22

Mon
Oct 18
11:30am

Sales of new motor vehicles
Units, sa

	Jun	Jul	Aug	Sep
%m/m	-1.6	-2.6	0.3	—
%oya	7.6	11.6	10.5	—

Fri
Oct 22
11:30am

Terms of trade
Sa

	4Q09	1Q10	2Q10	3Q10
Exports (%q/q)	-1.7	3.8	16.1	0.8
Imports (%q/q)	-4.3	0.3	1.9	0.1

After the dramatic effect of the pass-through to new commodity pricing arrangements for coal and iron ore in 2Q, export growth will have fallen back to earth in 3Q. In level terms of course, higher prices for these key commodities will continue to support national income for some time yet. Import price growth will remain soft.

Review of past week's data

Housing finance approvals: owner occupiers

Number of loans, sa

	Jun		Jul		Aug	
%m/m	~~-3.2~~	*-2.5*	~~1.7~~	*1.8*	~~1.5~~	*1.0*
%oya	~~-28.3~~	*-29.0*	~~-25.0~~	*-25.7*	~~-21.9~~	*-22.8*

The rise in home loans owed mainly to an increase in loans for the purchase of established dwellings (+1.4%). Fading interest among first-home buyers (FHBs) remained, though, the largest drag on aggregate home loan demand. This group now is largely priced out of the market and, having accounted for 21.2% of all loans issued as at end-2009, now accounts for just 15.5%, the lowest level since mid-2004.

NAB monthly business survey

% balance, sa

	Jul	Aug	Sep	
Business confidence	2	11	~~14~~	*10*

The NAB business confidence reading fell a notch in September, although it remained at an elevated level, having posted a sizable gain in August. However, the measure of business conditions increased 2pts to a net balance of +7, to be just above the long-term average. The more favourable environment owes much to the end of the federal election impasse, the RBA's decision to sit on the policy sidelines in recent months, and the stabilization of conditions offshore.

WMI consumer confidence survey

100=neutral, sa

	Aug	Sep	Oct	
%m/m	5.4	-5.0	~~6.0~~	*3.4*

At an elevated 116.9, the index level is well above the key 100-mark where optimists equal pessimists, and well above the long-run average of 101.5. Consumers were most upbeat about buying major household items, with sentiment in this category rising 9.9% over the month to a five-year high, and signaling a near-term rise in consumer spending. Of the remaining components, confidence toward the economy in one and five years' time also improved, rising 7.6%m/m and 1.4%, respectively. Of the five major components, only two declined in October: sentiment toward family finances a year ago (-0.8%) and a year ahead (-3.8%), owing to the rise in market interest rates since October last year, and expectations of the rises to come.

New Zealand

- **Retail sales fail to be boosted by looming GST hike**
- **Housing market reflects "rebalancing" economy**
- **3Q CPI sitting comfortably within RBNZ's target range**

The news out of NZ gets worse

The economic data flow, after a few slow weeks, picked up in New Zealand last week, and once again disappointed. August retail sales and September house price data simply added to the dismal state of affairs in the Shaky Isles. Not even the approaching goods and services tax (GST) hike, which became effective October 1, enticed consumers to bring forward spending into August. Retail sales were flat over the month, with ex. auto sales slumping 0.6%m/m, marking the largest drop since February. While much of the weakness in these numbers can be attributed to the significant discounting that continues among local retailers, which continues to weigh down retail sales in value terms, we suspect that the majority of firms will be unable to lift prices anytime soon. Indeed, the softness in domestic demand suggests that firms will continue to struggle to pass on rising costs to the extent that they would like.

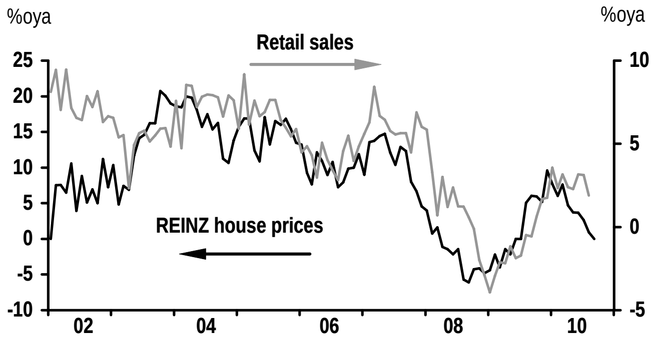
Sales likely will remain weak in volumes terms, too. Subdued employment and wage growth will mean that households will use the windfalls from their personal income tax cuts (also effective October 1) to pay down debt, or save, rather than spend. Thus, retailers hoping for a boost ahead of the festive season are likely to be left disappointed.

Housing market heading south

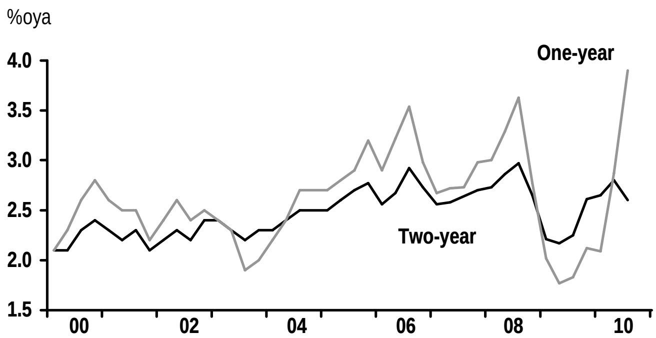
The fall in house prices in September (-0.3%m/m) added to growing evidence that the recovery under way in New Zealand has all but stalled. Property demand has weakened significantly in recent months amid higher interest rates, easing migration flows, and changes to the way property is taxed (announced in May). The relatively new tax measures prevent property investors from offsetting their losses against income and other taxes, making investing in property much less appealing than it was before.

With borrowing for housing rising just 2.4%oya in August, marking the slowest pace on record since 1999, property demand will remain subdued, particularly given that New Zealanders have adopted a more cautious approach to spending, unlike their Aussie counterparts. As households realign their spending patterns and consolidate their balance sheets, which have historically been too leveraged to

New Zealand: retail sales and house prices



New Zealand: RBNZ inflation expectations



housing debt, demand for property will continue to ebb. Already, it is taking, on average, 43 days to sell a property, although in coming months it likely will take much longer.

CPI gives RBNZ more reason to hold fire

The retail and house price data added further to the case for RBNZ Governor Bollard to stand pat for the time being. The weakness on the domestic front, anchored inflation expectations, and the uncertainty surrounding the global outlook suggest that there is little urgency to hike the official cash rate (OCR). The early September earthquake in the Canterbury region also will have a negative impact on short-term activity. As such, we believe that the OCR will be left unchanged, at 3%, at least until March 2011, although the next rate hike may be delayed if the economic data flow continues to disappoint.

The key data release this week was the 3Q CPI numbers this morning. Headline inflation printed comfortably within the middle of the RBNZ's 1%-3% target range, reaffirming our view that Dr. Bollard will remain on the policy sidelines for the remainder of the year. The consumer price index rose 1.1%q/q, or 1.5%oya, marking the slowest annual growth rate since 4Q03. The components of the CPI were largely as expected, with food prices rising sharply, energy and utility prices heading higher, and prices for clothing and footwear declining over the quarter.

In 4Q, though, the GST hike to 15% from 12.5% will add 2%-pts to headline CPI. As a result, we forecast inflation at an elevated 4.8%oya in 4Q, but the risks are skewed to a much higher print if inflation expectations do not remain anchored. To date, inflation expectations have remained tame. In 3Q, inflation expectations edged lower, at least over the two-year horizon. Respondents to the RBNZ's survey expected that inflation in two years' time would average 2.6%oya, compared to 2.8% previously. Expectations over the one-year horizon shot sharply higher, though this was expected given the string of one-off policy changes. Respondents' inflation expectations one year ahead surged a full percentage point, to 3.9%oya, the highest since 1Q91.

Data releases and forecasts

Week of October 18 - 22

Mon
Oct 18
10:45am

Consumer price index
Nsa

	4Q09	1Q10	2Q10	3Q10
Headline (%oya)	2.0	2.0	1.8	1.1
Headline (%q/q)	-0.2	0.4	0.3	1.5

See main text.

Thurs
Oct 21
10:45am

Visitor arrivals
Nsa

	Jun	Jul	Aug	Sep
Total (%m/m)	1.4	0.8	0.6	__

Thurs
Oct 21
10:45am

Net permanent immigration
Nsa

	Jun	Jul	Aug	Sep
Monthly (000s)	-0.7	1.4	0.9	__
12-month sum (000s)	16.5	15.2	14.5	__

Thurs
Oct 21
3:00pm

Credit card spending
% change

	Jun	Jul	Aug	Sep
%oya	4.5	2.6	2.0	__

Review of past week's data

QVNZ house prices

%, median

	Jul	Aug	Sep	
(%oya)	4.1	3.1	__	*2.0*

Retail trade

	Jun	Jul		Aug
%m/m, sa	1.0	~~-0.4~~	*-0.5*	*0.0*
%oya, sa	3.2	3.1		*1.9*

The largest declines in retail sales over the month were in hardware retailing (-5.8%), appliance retailing (-2.2%), and sales of fresh produce (-3.6%) and liquor (-2.4%). Supermarket and grocery store sales, which account for nearly one-third of the core sales index, fell slightly (-0.3%). The largest increase was in other food retailing (+6.2%), while sales of motor vehicles and automotive fuel also posted decent gains, both rising just over 2%m/m.

Business PMI

	Jul	Aug	Sep	
Index, sa	50.3	49.3	__	*49.2*
(%oya, sa)	0.9	1.1	__	*-3.8*

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Global Essay

- **The US Fed and Chinese policymakers go for growth**
- **Firming growth in final demand will limit severity of inventory correction**
- **King speech, MPC minutes to shed light on next move by BoE**

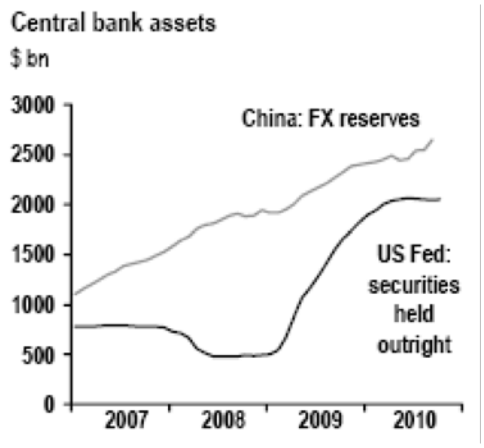
Across the growth divide

An already large divide among global policymakers has widened as the Federal Reserve moves toward a new round of easing next month. The battle lines of the divide lie on the asset side of central bank balance sheets. As the Fed moves toward increasing Treasury holdings, there is pressure building on other central banks in economies where inflation stands below central bank targets. While the ECB is resistant to further active expansion, the Bank of Japan has moved grudgingly in this direction. It remains a close call whether the Bank of England will soon follow. Official holdings of foreign exchange reserves represent another line of division. As Fed easing places downward pressure on the dollar, China is accelerating its pace of foreign reserve accumulation, having already added roughly $200 billion to its position over the last three months. With China actively offsetting the dollar decline, other central banks face currency appreciation against the dollar and renminbi. This pressure has led the charge toward reserve accumulation across the emerging market economies.

Behind these balance sheet divisions lies a more fundamental divide regarding growth objectives. Both the Federal Reserve and Chinese authorities view strong growth as their primary objective. For the Fed, where inflation stands below target and the unemployment rate is close to 10%, above-trend growth is a necessary condition for achieving its dual mandate. However, the FOMC also sees growth as promoting financial stability in an environment in which unwanted disinflation would add further stress to financial sector adjustment. China stands at a very different juncture at which strong lending and upward pressure on property prices is a concern. However, it continues to use administrative tools to contain these excesses while keeping macroeconomics levers geared to promoting domestic demand and a stable currency. In this regard, it is notable that the renminbi has moved up more quickly against the dollar in recent weeks, but has moved lower in trade-weighted terms.

We have been highlighting the role that Chinese and US policy is playing in exporting easier policy stances across the globe. The effects are most evident in Emerging Asia. Despite budding inflation pressure across the region, policy rates have not moved materially from their recession lows. And Emerging Asia's trade-weighted exchange index has remained remarkably stable throughout this year.

Among those less aggressive in promoting growth, the ECB stands out. It looks likely to remain resistant to further easing, even if it faces further upward pressure on its currency. This resistance is partly related to macroeconomic performance— officials have not been disappointed by growth thus far and expect core inflation to drift higher over the coming year. However, there are broader considerations making growth a less pressing objective. The ECB views a significant portion of output lost in the recession as permanent as pre-crisis levels of activity and employment were unsustainably elevated— particularly in those economies where credit booms were strongest. Thus, it is less concerned than the Fed that sluggish growth will undermine the region's ability to return to full employment. It is more concerned, however, that the aggressive use of the central bank balance sheet will slow needed balance sheet adjustments by banks and fiscal authorities.



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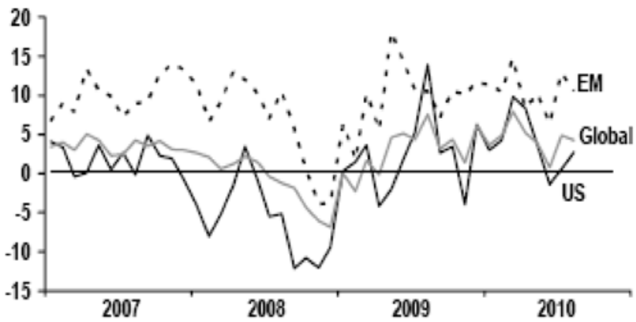
Retail sales volume

%3m, saar; US is real goods PCE



A global inventory correction is under way

Global manufacturing activity slowed dramatically in recent months, delivering a blow to the economic recovery. It appears that this slowing will continue to intensify into yearend and prove particularly intense for emerging market economies. A waning boost from inventory dynamics—and its implications for global manufacturing and GDP growth—has long been incorporated in our economic forecast. During the first year of the recovery, manufacturers aggressively raised output to realign the level of production with the level of sales. By the middle of this year, inventory accumulation had resumed and output gains began to slow.

However, two factors were not anticipated that are magnifying this adjustment. First, the pace of production gains remained unusually robust into midyear—with global output expanding at a double-digit pace during 2Q10. At the same time, final goods expenditure growth slowed, with the advance of both retail sales volume and capital good shipments moderating in the second quarter. With final demand slowing against the backdrop of rapid production gains, inventories have likely built rapidly in recent months. It does not appear that inventory levels are high, but manufacturers are now curtailing the rate of inventory accumulation. Global IP growth slowed to just 2% annualized in the three months through August and should slow even more based on the decline in our global PMI in September.

The depth and duration of this production adjustment will be determined by final demand. On this score, the recent news is reassuring. The midyear slowing in final sales growth did not snowball. Instead, our global sales proxy has continued to grow in recent months, albeit at a more moderate pace. The growth of retail sales has picked up lately, led by an acceleration in the US and continued strong gains in the EM, notably China and Brazil. Capital goods orders growth turned sharply higher during 3Q10, pointing to faster spending growth into year-end. If final sales growth firms near the current pace, the rate of inventory accumulation should fall rather quickly, clearing the way for a fading of this drag as the global economy turns into the new year.

Divergent price pressures in EMU

Core inflation in the Euro area moved up from 0.8% in May to 1% in July, and has remained at that level through September. Some of this move reflects a temporary lift from tax hikes, but the underlying trend appears to have flattened out. This is hard to square with the depressed level of resource utilization. Capacity utilization and labour shortages in the manufacturing sector are still well below normal and this should be putting downward pressure on prices. At the same time, however, reports of equipment shortages are now above normal. In addition to foreshadowing a pickup in capital expenditures from their current low level, it also raises the possibility of some production bottlenecks that could impact pricing decisions despite overall soft capacity utilization.

These developments mask the considerable variation in the region, making it difficult to gauge inflation pressures. In Germany, resource use is quickly moving back to pre-recession levels. Unemployment rates are back down, capacity utilization has almost returned to its previous expansion average, and reports of equipment shortages are above historical norms. By contrast, the unemployment rate in Spain continues to hover at around 20%, more than double the pre-recession level, and capacity utilization and labour shortages have barely moved off the recession trough. Given these extremes, our forecast for the region continues to anticipate a further slide in core inflation, but the magnitude is not large and nor is our conviction.

QE a close call for Bank of England

Whereas it is all systems go for renewed QE in the US, the odds are much closer on our call for a November announcement in the UK. Last week's CPI report showed that inflation remained at a stubbornly high 3.1%oya in September, though most MPC members have been inclined to attribute this to the VAT hike and past sterling depreciation. Meanwhile, a lift in construction output likely

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Manufacturing production
%3m, saar

	Dec 09	Mar 10	Jun 10	Jul 10	Aug 10
Global	8.8	13.0	6.1	5.3	1.9
Developed	5.9	12.7	6.4	5.1	2.1
US	4.9	7.1	6.3	5.7	2.3
Euro area	-0.6	15.8	9.4	7.4	4.8
Japan	30.4	20.9	0.8	-4.5	-6.1
Emerging	17.4	13.8	5.2	6.1	1.1
EM Asia X	20.0	29.3	7.4	2.1	-9.0
China	19.7	15.8	4.4	3.6	6.8
Latam	17.2	8.9	4.0	1.6	0.4
CEEMEA	9.9	12.4	8.5	7.7	0.9

Note: EM Asia X excludes China and India

produced another solid gain in GDP last quarter, with survey data suggesting that underlying growth is slowing to a subtrend pace. Although the MPC is likely to revise down its growth forecast at the next Inflation Report, last week's commentary from middle-ground MPC members did not indicate clear support for additional asset purchases. Tuesday's speech from Governor King will be important, along with the minutes of the October MPC meeting.

Strong rand to prompt SARB rate cut

It now appears likely that South Africa's central bank will extend its easing cycle with a 50bp rate cut in November. The additional rise in the currency—which is up 10% on a real trade weighted basis in the year-to-date, better-thanexpected inflation results, and disappointing activity data each factored into our change in view. However, the rise in the rand also increases the possibility of intervention, and this presents the main risk to both our inflation outlook and the November rate call. Possible measures include a relaxation in the offshore limits of local pension funds, an increase in offshore allowances of residents, and a tax on portfolio inflows. An increase in the offshore limit or introduction of an inflow tax could temporarily weaken the rand, which could lead to a postponement in the rate cut until January 2011, though the longer-term real appreciation trend will likely remain intact.

Domestic demand picking up in China

External demand weakness continues to weigh on China, with last week's export data posting a fourth consecutive monthly decline in September. While part of the decline reflects continued payback from a subsidy-induced spike in May, it is also driven by softening global demand. By contrast, this week's reports are likely show that domestic final demand is strengthening and the midyear inventory correction has faded. Indeed, the rise in the September manufacturing PMIs along with solid gains in imports and stabilizing FAI growth points to a further acceleration in factory output. We project industrial production rose 1.5%m/m sa in September, following a strong 1.2% gain in August.

Meanwhile, headline CPI inflation in China is likely to stay elevated in September at 3.5%oya. However, Chinese authorities continue to be concerned about the global economic outlook and so have restricted their actions to sectorspecific administrative measures. Last week's reported record quarterly jump in FX reserves coupled with continued strong gains in money growth suggests that the PBoC's sterilization policies and targeted reserve requirement hikes are largely ineffective and underscores the highly accommodative stance of monetary policy.

China paves easy street for rest of region

China's reluctance to normalize policy is setting the tone for the region. Despite the region's relatively strong cyclical position, policymakers are focused squarely on their growth outlook and the potential fallout from rising currencies against USD and CNY. Consequently, the regional policy rate has risen a mere 27bp from its lows, leaving it 240bp below pre-recession levels. Less than 50bp of tightening is expected by the middle of next year. Last week, the Bank of Korea's MPC kept the base rate at 2.25% for the third consecutive month. While recognizing strong domestic demand growth and building inflation pressures, Governor Kim emphasized concerns over the external environment, global capital flows, and FX market volatility.

Only where demand-side pressures are too great to ignore are central banks taking action. This has been the case in India for some months now: the RBI has hiked rates 125bp since March. Last week in Singapore, the MAS surprised markets at its semiannual policy meeting by steepening the appreciation slope of the SGD NEER and widening the band in response to rising inflation pressures and outstanding growth in economic activity this year.

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JPMorgan View - Global Markets

Who is closest to a bubble: EM, HY, JPY, or USTs?

- **Economics:** Forecasts of weaker 4Q global growth are on track.
- **Asset allocation:** Our overweights in EM, HY, and UST duration, and short USD are consensus trades, but aside from USTs, are not yet near a bubble.
- **Fixed income:** Fed easing combined with ECB inaction should see US Treasuries outperform German Bunds.
- **Equities:** Positive momentum and the prospect of more business-friendly policies post US midterm elections should sustain the rally into November.
- **Credit:** Overweight CLO mezzanine and subordinates in both US and Europe, with over 10% expected return over next six months.
- **FX:** INR and KRW are our preferred longs vs. USD in Asia.
- **Commodities:** Pace of Chinese crude oil imports is increasing. Stay long oil.

Economic uncertainty remains sky-high, with investors flipping back and forth between inflation and deflation risks. And yet there is **strong agreement on what to invest in**. We find most market participants are bullish and overweight EM assets, high-yield bonds, and US bond duration, while negative the dollar. Given our respect for flow momentum, and strong fundamentals behind these positions, we are in the same boat. But when markets move fast and consensus is building, one should always question whether the sought-after assets have become too expensive and positions are dangerously overstretched. Some investors are starting to argue that these assets have reached bubble territory and it is time to take some profit. **What is the evidence?**

Bubbles are started by good fundamentals that are taken to extremes through the combination of easy money, leverage, momentum, and the comfort of groupthink. Much as we have tried, we have not yet found the magic signal that warns us it is five minutes to midnight, and the crash is coming. But we know that risks of a turnaround are high when valuations are excessive, leverage is high, carry is negative, and news emerges that challenges the fundamentals behind the rally.

By these signals, **EM equities and currencies are furthest from bubble territory, followed in order by high-yield, USD, and EM fixed income, with US Treasuries coming closest**. EM equities are furthest from bubble risk as they do not appear that expensive. Their multiples remain below those of DM equities. The gap is narrower than average, but only by half a standard deviation. There is little leverage in EM holdings, although there is some in EM FX. Carry remains positive and is unlikely to turn negative soon. And the fundamentals of higher growth expectations are only getting better. Consensus on 2010 EM growth has widened against DM in recent months (chart, next page).

Everybody we speak to loves **high-yield bonds** and is long. So are we. The 2010 default rate will likely to fall to a historic low of 0.3%. And the spread to USTs at 637bp remains twice its mean during economic expansions. Buying seems mostly from long-only, and there is thus little leverage, with carry remaining high. But the outright yield at 7.5% is well below its decade mean of 10.5%, even though it has been below 7% before. The record-low default is a great positive, even though it is brought on by liquidity and the ease of refinancing (thus largely postponing credit problems). Overall, **still quite far from bubble territory**.

The US **dollar** has fallen significantly, but in trade-weighted terms remains well above past lows. Carry will remain a support for dollar shorts. And there is little sign of an imminent pickup in US growth. No clear sign of a bubble.

A more valid question can be raised on **EM fixed income** risk as stronger EM growth will induce rate hikes in EM well before DM, lowering carry. Positions have built, and GBI-EM yields are below their decade mean, but not greatly so. Also, relative value is not excessive as EM local bond yields are only at their average gap of the past decade with respect to DM (GBI) yields. **EM credit**, both sovereign and corporate, is very tight relative to DM sovereign CDS spreads. We have all seen the eye-popping numbers, with Kazakhstan trading below Spanish CDS and Lebanon below Portugal. A sign of worry, maybe, but also possibly a sign of a changed world, where the assumption that DM government bonds are default free and EM borrowers are serial defaulters just cannot be maintained given higher debt loads and slower growth in DM. Neither EM equities nor fixed income is near bubble territory, but fixed income is surely closer, making us prefer equities among the EM asset classes.

USTs are arguably closer to a bubble. Real yields are near all-time lows. Leverage by central banks, FX reserve managers, and commercial banks is massive, even as carry is not about to turn negative. The fundamentals of the rally have worsened from two months ago, as central banks have since committed to reflation. Investors buy them in anticipation of large-scale buying by the Fed, MPC, and BoJ, but must recognize that the aim of this policy is to redress deflation and the economy. The more successful the policy, the more bond yields will eventually rise again. Buyers beware, and keep a short horizon.

Fixed income

Bonds fell heavily, as the FOMC minutes stoked expectations of price level targeting, and so higher US inflation. Both the minutes and Bernanke's speech last week all but confirmed that the Fed will embark on further easing next month. Bonds will thus be supported by Fed purchases, but undermined by fears of higher inflation. We still expect the former to dominate near term, and are long Treasuries, both outright and against German Bunds.

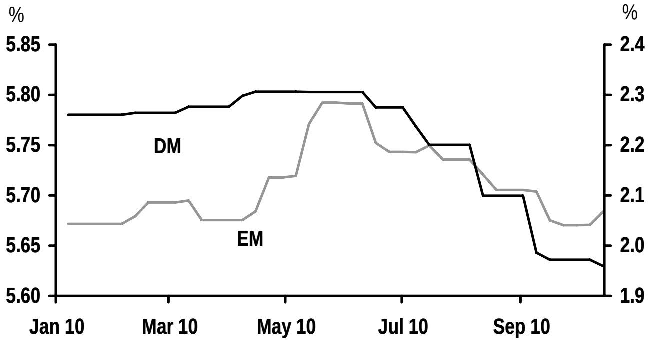
In stark contrast to the Fed, Bundesbank President Weber last week advocated a move away from the ECB's crisis measures. This divergence of Fed and ECB policy is not unusual. Historically, the ECB has moved less aggressively than the Fed, both in the amplitude of rate cycles and the size of asset purchases. It has also tended to follow the Fed's lead in monetary policy cycles, albeit with a considerable lag of close to a year on average. But there are major barriers to this pattern repeating itself—for one, it is much harder to conduct large-scale asset purchases across 16 government bond markets of varying credit quality. In the meantime, **Fed buying should see Treasuries continuing to outperform Bunds** (see Friday's *GFIMS* and D. Mackie, "The case against more QE: the ECB lays out its views").

European peripherals rallied across the board, pushing spreads to their tightest since mid-August. Peripherals have been bolstered by suggestions that EU/IMF support for Greece will be extended, Friday's Portuguese austerity budget, and the reduced reliance of peripheral banks (Ireland apart) on ECB funding. We remain neutral overall on peripherals, but are becoming more positive, as both the outperformance of risky assets and the prospect of more fiscal consolidation from Ireland next month are supportive.

Equities

Equities rose further helped by **better-than-expected US 3Q earnings** announcements. From the 39 companies of the

Global GDP growth forecasts for 2011: EM vs. DM



S&P 500 index that have reported so far, 79% beat expectations with an average EPS beat of 7.7%. This compares to a 10% average EPS beat recorded in the 2Q reporting season.

Tom Lee, our US equity strategist, raised his forecast for 2010 S&P 500 EPS to $84.50 from $84.00 previously. This is above both top-down strategists ($81.50) and bottom-up analysts ($83.37). We maintain $90 for 2011E EPS. Central to our 2011 forecast is a reacceleration of US GDP growth to above trend in 2H11. This makes us bullish on equities longer term for 2011.

Near term, positive momentum and the prospect of more business-friendly policies post US midterm elections should sustain the rally into November. But the pace will likely be slower than the past few weeks as two other supports, **hedge fund short covering and the 3Q reporting season, are fading**.

Indeed, macro hedge funds have raised their equity exposure sharply over the past month, moving from a heavy short equity position in August to long in September. In terms of the reporting season, the support tends to fade during the second half of the reporting month. The average S&P 500 gain during the first half of the reporting month over the past six reporting seasons (each of which delivered a positive earnings surprise) was much higher than in the second half.

Our preference is for EM over DM. **LSAPs and low growth in DM are pushing investors into EM assets**, in search for higher yield and stronger growth. Flows into both EM equities and bonds have accelerated over the past month. The four-week average flow into EM equity funds reached its highest level since October 2007 (see today's *Flows & Liquidity*). Across sectors we most like **Commodity sectors**.

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Commodity sectors are benefiting from strong demand by China. Chinese equities have started outperforming since the beginning of October, suggesting an improvement in growth prospects for China.

Credit

Credit markets continue to rally, especially in EM. Both EM external debt and EM dollar-denominated corporate bonds gained with spreads tightening 23bp and 15bp, respectively. EM credits are rapidly approaching our year-end targets of 275bp for EM external debt and 300bp for EM corporates, but we are seeing little sign of slowing flows.

US corporate bonds underperformed other credits last week, as **bank spreads** are pressured by news surrounding mortgage put-back risks and foreclosure practices. Our credit banking analyst, Kabir Caprihan, believes that the mortgage put-back risk is a longer-term earnings issue rather than a near-term capital event. The recent widening of bank spreads is largely driven by fear and current levels are attractive. See *Mortgage Market Turmoil, overreaction, or something bigger to come?* Kabir Caprihan, 15 Oct.

As the demand of higher-yielding assets rises, we turn **Overweight CLO mezzanine and subordinates** (single-As, BBBs, BBs) and **stay overweight AAA CLOs**. The current yields of 8%-15% on originally rated single-A, BBB, and BB CLOs in US and Europe are attractive given the strong conditions in the leveraged loan and HY bond markets. CLO net issuance will continue to be negative in the foreseeable future and we see returns of more than 10% over the next six months. Our price targets are \$80s for single-As, \$70s for BBBs, and \$60s for BBs from the current price of \$72, \$65, \$52, respectively.

Ten-year Government bond yields

	Current	Dec 10	Mar 11	Jun 11	Sep 11
United States	2.58	2.25	2.25	2.25	2.25
Euro area	2.37	2.30	2.20	2.30	2.40
United Kingdom	2.95	2.95	2.95	3.05	3.20
Japan	0.88	0.80	0.80	0.90	0.95
GBI-EM	6.12	7.90			

Credit markets

	Current	YTD Return
US high grade (bp over UST)	158	11.0%
Euro high grade (bp over Euro gov)	167	5.6%
USD high yield (bp vs. UST)	637	13.2%
Euro high yield (bp over Euro gov)	583	13.8%
EMBIG (bp vs. UST)	271	16.4%
EM Corporates (bp vs. UST)	324	15.1%

Foreign exchange

	Current	Dec 10	Mar 11	Jun 11	Sep 11
EUR/USD	1.40	1.30	1.30	1.30	1.30
USD/JPY	81.4	79	81	83	85
GBP/USD	1.60	1.49	1.48	1.48	1.49

Commodities - quarterly average

	Current	10Q4	11Q1	11Q2	11Q3
WTI (\$/bbl)	81	81	78	81	83
Gold (\$/oz)	1367	1350	1425	1425	1450
Copper(\$/m ton)	8387	8200	8600	8500	8750
Corn (\$/Bu)	5.67	5.25	5.30	5.15	5.10

Source: J.P. Morgan, Bloomberg, Datastream

Foreign exchange

With each week that the dollar declines, the **G-20's unwritten currency agreement** becomes more apparent. The US will weaken its currency indirectly though Fed easing, and the rest of the world will manage the consequences through whatever policies suit domestic circumstances—acquiescence, intervention, rate cuts, or transaction taxes. The only rule of the road is that countries cannot peg their currencies or drive the dollar higher, since doing so could invite a trade war. Having trimmed short USD exposure last week, we are content to hold the current **basket of dollar shorts** going into next weekend's key G-20 finance ministers' meeting.

In addition to the general dollar-trend, **INR** has been a beneficiary of IPO-related inflows from foreign investors. In our estimation probably slightly less than half of the flow has been done so far (\$2-3 billion), so we will look to hold this position for another week before covering as the unsuccessful IPO bidders will be refunded eventually and part of the inflow into INR will be reversed. Within Asia, also stay long **KRW**.

Commodities

Agriculture continues to gain, rallying a further 4% driven largely by corn, which still benefits from very tight supply conditions. We expect demand on US stocks to rise further into next year as consumer countries experience difficulties obtaining the necessary supplies from non-US producers who have suffered supply shocks from severe weather. There is the added risk that current tight supply conditions and high prices cause some countries to begin to hoard key foodstuffs like corn and sugar as a hedge against any further price increases or threats to supply. **Stay long corn and sugar.**

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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			
	2009	2010	2011	2Q10	3Q10	4Q10	1Q11	2Q11	3Q11	4Q11	2Q10	4Q10	2Q11	4Q11
The Americas														
United States	-2.6	**2.7** ↑	2.4	1.7	**1.7** ↑	2.0	2.5	2.5	3.0	4.0	1.8	0.9	1.2	**1.0** ↓
Canada	-2.5	3.1	2.2	2.0	2.2	2.0	2.3	2.0	2.4	2.6	1.4	1.9	2.1	2.1
Latin America	-2.4	5.7	4.1	9.0	1.0	2.7	4.4	6.0	3.5	4.2	6.6	7.1	7.2	7.3
Argentina	-2.0	8.5	5.5	12.6	0.0	2.0	6.0	8.0	8.0	6.0	10.6	10.5	11.0	12.0
Brazil	-0.2	7.5	4.5	5.1	2.3	3.2	5.7	4.7	5.0	5.2	5.1	5.0	5.1	5.1
Chile	-1.5	5.5	6.0	18.4	11.0	6.0	4.0	4.0	4.0	4.0	1.2	3.8	3.6	3.4
Colombia	0.8	4.5	4.1	3.9	3.7	4.0	4.0	4.1	5.0	5.5	2.1	2.6	3.1	4.0
Ecuador	0.4	2.5	3.0	7.7	2.5	3.0	3.0	2.5	2.5	2.0	3.2	3.6	3.8	3.8
Mexico	-6.5	4.5	3.5	13.5	-3.6	3.1	2.9	9.2	-0.1	2.7	4.0	5.1	4.5	4.0
Peru	0.9	8.2	6.0	12.7	4.8	3.5	5.8	6.7	7.2	6.5	1.2	2.6	2.2	2.7
Venezuela	-3.3	-2.2	1.0	5.2	3.0	-5.0	2.0	1.0	1.5	1.5	31.9	31.6	34.7	35.1
Asia/Pacific														
Japan	-5.2	2.9	0.9	1.5	2.5	-1.5	0.5	1.5	1.8	2.0	-0.9	-0.8	-0.2	-0.3
Australia	1.2	3.2	3.6	4.9	3.3	2.4	3.4	4.9	3.2	5.2	3.1	3.3	3.8	3.4
New Zealand	-1.7	2.0	2.8	0.7	2.5	2.5	2.6	3.1	4.2	2.8	1.8	4.9	5.6	3.2
Asia ex Japan	5.6	8.7	7.0	7.4	**5.2** ↓	6.4	7.4	7.3	7.5	7.7	4.5	4.1	3.9	3.9
China	9.1	9.8	8.6	7.2	7.5	8.1	9.1	8.9	9.1	9.3	2.9	2.8	2.7	2.6
Hong Kong	-2.8	6.6	4.1	5.7	3.0	3.5	4.2	4.3	4.7	5.0	2.6	2.5	2.2	2.4
India	7.4	8.3	8.5	8.5	8.0	8.9	8.0	8.5	8.6	8.9	13.7	11.0	10.1	10.2
Indonesia	4.5	6.0	5.4	7.5	4.5	5.0	5.3	5.2	5.0	5.0	4.4	6.1	5.6	4.8
Korea	0.2	6.1	4.0	5.8	2.5	3.8	4.0	4.0	4.5	4.5	2.6	2.9	3.4	3.4
Malaysia	-1.2	**6.8** ↓	4.6	7.2	**0.0** ↓	**2.0** ↓	4.9	4.9	4.5	4.5	1.6	1.1	1.4	2.4
Philippines	0.9	7.0	3.9	7.7	0.8	1.6	4.9	4.9	4.9	4.9	4.2	2.7	1.9	2.7
Singapore	-1.3	**13.6** ↓	**4.1** ↓	24.0	**-20.0** ↓	-2.0	**12.6** ↑	**8.2** ↑	7.4	7.4	3.1	3.5	1.8	1.6
Taiwan	-1.9	9.9	4.1	7.2	1.5	2.3	4.2	4.6	5.5	5.8	1.1	2.0	1.8	1.7
Thailand	-2.2	8.5	4.0	0.6	2.8	2.8	4.9	4.9	4.9	4.9	3.2	2.0	2.5	1.8
Africa/Middle East														
Israel	0.8	3.5	4.5	4.6	3.0	3.0	4.0	5.0	5.5	5.5	2.8	2.6	3.0	2.8
South Africa	-1.8	2.9	3.1	3.2	3.1	3.2	3.1	3.1	3.4	2.9	4.5	**3.9** ↓	**4.1** ↓	**4.9** ↓
Europe														
Euro area	-4.0	1.7	1.5	3.9	2.0	1.0	1.0	1.0	1.8	2.0	1.5	1.7	1.1	1.0
Germany	-4.7	3.3	2.4	9.0	3.0	2.0	2.0	1.5	2.0	2.0	1.0	1.2	0.6	0.7
France	-2.5	1.6	1.5	2.8	2.0	1.5	1.0	1.0	1.5	2.0	1.8	1.3	0.7	1.1
Italy	-5.1	1.2	1.3	1.8	2.0	1.0	1.0	1.0	1.5	2.0	1.6	1.7	1.4	1.5
Norway	-1.2	1.5	2.3	1.9	3.0	2.5	2.0	2.0	2.5	2.5	2.6	2.1	1.3	1.3
Sweden	-5.1	4.5	3.1	8.0	4.5	3.0	2.3	2.3	2.8	2.8	1.0	1.5	1.6	1.8
Switzerland	-1.9	2.9	2.0	3.5	2.5	2.0	1.5	1.5	2.3	2.8	1.0	0.4	0.1	0.7
United Kingdom	-4.9	1.7	2.2	4.9	2.5	1.5	1.0	2.5	3.0	3.0	3.5	2.6	1.9	2.1
Emerging Europe	-5.3	4.1	4.1	3.8	2.4	3.8	3.9	4.2	4.6	4.7	5.7	6.4	6.5	5.6
Bulgaria	-5.0	-0.5	4.0	...	...	...	...	...	...	...	...	...	...	...
Czech Republic	-4.1	2.0	3.2	3.8	2.5	2.3	2.5	3.0	5.0	6.0	1.2	2.8	2.7	2.6
Hungary	-6.3	1.0	2.8	0.0	2.0	2.0	2.0	3.0	3.5	3.5	5.4	4.4	3.4	3.6
Poland	1.7	3.5	3.8	4.5	3.5	3.5	3.0	3.5	4.0	4.0	2.3	2.6	2.7	2.9
Romania	-7.1	-2.0	1.5	...	...	...	...	...	...	...	4.4	8.0	7.2	4.0
Russia	-7.9	4.3	4.7	4.3	2.5	5.0	5.0	5.0	5.0	5.0	5.9	7.6	8.4	7.1
Turkey	-4.7	7.1	4.3	...	...	...	...	...	...	...	9.2	7.5	7.0	6.2
Global	-2.2	3.6	2.9	3.9	2.5	2.2	2.8	3.1	3.4	3.8	2.5	2.3	**2.2** ↓	2.1
Developed markets	-3.5	**2.4** ↑	1.9	2.8	**2.1** ↑	1.2	1.6	1.9	2.4	3.0	1.5	1.2	1.1	1.0
Emerging markets	1.3	6.9	5.6	7.1	**3.7** ↓	5.0	6.0	6.4	5.9	6.2	5.2	5.3	5.2	**5.0** ↓
Memo:														
Global — PPP weighted	-0.8	4.6	3.8	4.7	3.1	3.1	3.8	4.0	4.2	4.6	3.2	3.0	3.0	2.8

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Global Central Bank Watch

	Official interest rate	Current	Change from Aug '07 (bp)	Last change	Next meeting	Forecast next change	Dec 10	Mar 11	Jun 11	Sep 11	Dec 11
Global	GDP-weighted average	1.76	-319				1.80	1.85	1.93	1.97	2.04
excluding US	GDP-weighted average	2.39	-241				2.45	2.52	2.62	2.68	2.77
Developed	GDP-weighted average	0.60	-358				0.62	0.63	0.65	0.68	0.72
Emerging	GDP-weighted average	5.00	-210				5.12	5.27	5.49	5.57	5.73
Latin America	GDP-weighted average	7.24	-217				7.27	7.77	8.37	8.40	8.40
CEEMEA	GDP-weighted average	4.08	-294				4.05	4.07	4.13	4.32	4.80
EM Asia	GDP-weighted average	4.55	-170				4.76	4.83	4.99	5.04	5.12
The Americas	GDP-weighted average	1.28	-453				1.29	1.38	1.49	1.52	1.55
United States	Federal funds rate	0.125	-512.5	16 Dec 08 (-87.5bp)	3 Nov 10	On hold	0.125	0.125	0.125	0.125	0.125
Canada	Overnight funding rate	1.00	-325	8 Sep 10 (+25bp)	19 Oct 10	1 Mar 11 (+25bp)	1.00	1.25	1.50	1.75	2.25
Brazil	SELIC overnight rate	10.75	-125	21 Jul 10 (+50bp)	20 Oct 10	**Mar 11 (+25bp)**	10.75	11.50	12.50	12.50	12.50
Mexico	Repo rate	4.50	-270	17 Jul 09 (-25bp)	26 Nov 10	On hold	4.50	4.50	4.50	4.50	4.50
Chile	Discount rate	2.75	-225	16 Sep 10 (+50bp)	16 Nov 10	16 Nov 10 (+25bp)	3.25	4.00	**4.25**	**4.25**	**4.25**
Colombia	Repo rate	3.00	-600	30 Apr 10 (-50bp)	29 Oct 10	1Q 11 (+50bp)	3.00	4.00	5.00	5.50	5.50
Peru	Reference rate	3.00	-150	9 Sep 10 (+50bp)	11 Nov 10	**Jan 11 (+25bp)**	**3.00**	**3.75**	4.50	4.50	4.50
Europe/Africa	GDP-weighted average	1.44	-322				1.45	1.45	1.46	1.51	1.62
Euro area	Refi rate	1.00	-300	7 May 09 (-25bp)	4 Nov 10	On hold	1.00	1.00	1.00	1.00	1.00
United Kingdom	Repo rate	0.50	-500	5 Mar 09 (-50bp)	4 Nov 10	On hold	0.50	0.50	0.50	0.50	0.50
Sweden	Repo rate	0.75	-275	2 Sep 10 (+25bp)	26 Oct 10	26 Oct 10 (+25bp)	1.25	1.25	1.25	1.50	2.00
Norway	Deposit rate	2.00	-250	5 May 10 (+25bp)	27 Oct 10	3Q 11 (+25bp)	2.00	2.00	2.00	2.25	2.75
Switzerland	3-month Swiss Libor	0.25	-225	12 Mar 09 (-25bp)	4Q 10	Jun 11 (+25bp)	0.25	0.25	0.50	0.75	1.00
Czech Republic	2-week repo rate	0.75	-200	6 May 10 (-25bp)	4 Nov 10	2Q 11 (+25bp)	0.75	0.75	1.00	1.25	1.75
Hungary	2-week deposit rate	5.25	-250	26 Apr 10 (-25bp)	25 Oct 10	3Q 11 (+25bp)	5.25	5.25	5.25	5.50	5.75
Israel	Base rate	2.00	-200	27 Sep 10 (+25bp)	25 Oct 10	22 Nov 10 (+25bp)	2.25	2.50	2.75	3.25	3.50
Poland	7-day intervention rate	3.50	-100	24 Jun 09 (-25bp)	27 Oct 10	2Q 11 (+25bp)	3.50	3.50	3.75	4.00	4.25
Romania	Base rate	6.25	-75	4 May 10 (-25bp)	2 Nov 10	3Q 11 (+25bp)	6.25	6.25	6.25	6.50	6.75
Russia	1-week deposit rate	2.75	-25	31 May 10 (-50bp)	Oct 10	3Q 11 (+25bp)	2.75	2.75	2.75	3.00	3.50
South Africa	Repo rate	6.00	-350	9 Sep 10 (-50bp)	18 Nov 10	**18 Nov 10 (-50bp)**	**5.50**	**5.50**	**5.50**	**5.50**	**5.50**
Turkey	1-week repo rate	7.00	-1050	-	11 Nov 10	4Q 11 (+50bp)	7.00	7.00	7.00	7.00	8.00
Asia/Pacific	GDP-weighted average	2.90	-129				3.04	3.10	3.20	3.25	3.31
Australia	Cash rate	4.50	-175	4 May 10 (+25bp)	1 Nov 10	1 Nov 10 (+25bp)	4.75	5.00	5.25	5.50	5.75
New Zealand	Cash rate	3.00	-500	29 Jul 10 (+25bp)	27 Oct 10	10 Mar 11 (+25bp)	3.00	3.25	3.50	3.75	4.00
Japan	Overnight call rate	0.05	-48	5 Oct 10 (-5bp)	28 Oct 10	On hold	0.05	0.05	0.05	0.05	0.05
Hong Kong	Discount window base	0.50	-625	17 Dec 08 (-100bp)	4 Nov 10	On hold	0.50	0.50	0.50	0.50	0.50
China	1-year working capital	5.31	-126	22 Dec 08 (-27bp)	4Q 10	4Q 10 (+27bp)	5.58	5.58	5.85	5.85	5.85
Korea	Base rate	2.25	-225	9 Jul 10 (+25bp)	15 Nov 10	4Q 10 (+25bp)	2.50	2.75	2.75	2.75	3.00
Indonesia	BI rate	6.50	-200	5 Aug 09 (-25bp)	4 Nov 10	2Q 11 (+25bp)	6.50	6.50	6.75	6.75	6.75
India	Repo rate	6.00	-175	16 Sep 10 (+25bp)	2 Nov 10	2 Nov 10 (+25bp)	6.25	6.50	6.50	6.75	7.00
Malaysia	Overnight policy rate	2.75	-75	8 Jul 10 (+25bp)	12 Nov 10	On hold	2.75	2.75	2.75	2.75	2.75
Philippines	Reverse repo rate	4.00	-350	9 Jul 09 (-25bp)	18 Nov 10	2Q 11 (+25bp)	4.00	4.00	4.25	4.50	4.50
Thailand	1-day repo rate	1.75	-150	26 Aug 10 (+25bp)	20 Oct 10	20 Oct 10 (+25bp)	2.00	2.00	2.00	2.00	2.00
Taiwan	Official discount rate	1.50	-163	30 Sep 10 (+12.5bp)	23 Dec 10	3Q 11 (+12.5bp)	1.50	1.50	1.50	1.625	1.75

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

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Economic forecasts - Australia

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

				2009			2010				2011			
	2009	2010	2011	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Chain volume GDP	1.2	3.2	3.6	2.2	1.3	4.2	2.7	4.9	3.3	2.4	3.4	4.9	3.2	5.2
Private consumption	1.7	3.0	1.9	5.2	1.3	3.3	1.9	6.5	1.6	0.8	1.2	1.6	2.4	3.2
Construction investment	-0.5	2.7	6.5	-3.7	2.4	2.6	-3.1	9.9	8.3	2.3	7.1	6.9	6.9	7.8
Equipment investment	-6.6	0.4	15.7	-18.0	-5.9	60.3	-26.0	-12.0	22.5	17.6	8.6	27.6	15.4	22.5
Public investment	4.4	32.4	8.4	13.3	43.9	40.6	81.2	0.1	9.7	10.4	6.6	11.6	6.7	9.5
Government consumption	2.8	5.2	4.3	3.2	5.4	7.7	4.8	7.2	2.0	2.0	4.5	8.0	4.3	0.8
Exports of goods & services	0.9	4.4	4.8	4.5	-9.2	9.7	-2.8	24.2	0.8	1.2	6.1	4.1	4.9	3.2
Imports of goods & services	-8.3	12.8	7.5	0.3	18.8	32.7	6.6	12.8	4.9	4.1	6.1	10.4	12.6	5.7
Contributions to GDP growth:														
Inventories	-0.5	-0.4	-0.9	0.7	2.8	0.8	1.4	-2.9	-5.9	0.0	-0.2	0.3	0.1	0.3
Net trade	2.0	-1.7	-0.7	0.8	-5.2	-4.1	-1.9	1.7	-0.9	-0.7	-0.1	-1.4	-1.8	-0.7
GDP deflator (%oya)	0.3	5.0	2.9	0.1	-1.9	-1.3	2.0	6.6	6.0	5.5	4.2	2.4	2.5	2.5
Consumer prices (%oya)	1.8	3.1	3.6	1.5	1.3	2.1	2.9	3.1	3.0	3.3	3.5	3.8	3.6	3.4
Producer prices (%oya)	-5.4	2.5	3.8	-6.4	-7.2	-6.8	-0.2	2.5	2.3	5.2	3.7	3.5	4.0	4.0
Trade balance (A$ bil, sa)	-6.8	20.2	16.7	-0.9	-4.1	-4.9	-2.7	7.4	8.7	6.8	4.5	3.6	4.2	4.5
Current account (A$ bil, sa)	-51.4	-24.3	-40.8	-13.8	-14.6	-19.3	-16.5	-5.6	4.7	-7.0	-9.5	-10.6	-10.4	-10.3
as % of GDP	-4.1	-1.8	-2.8	-4.4	-4.7	-6.0	-5.0	-1.7	1.4	-2.0	-2.7	-2.9	-2.8	-2.8
3m eurodeposit rate (%)*	6.0	4.7	5.6	3.5	3.4	4.1	4.3	4.8	4.8	5.0	5.3	5.5	5.8	5.8
10-year bond yield (%)*	5.6	5.3	5.0	5.5	5.1	5.8	5.6	5.5	5.2	4.9	5.1	5.1	5.0	5.0
US$/A$*	0.75	0.92	0.98	0.82	0.88	0.91	0.94	0.84	0.96	0.93	0.95	0.99	1.01	0.98
Commonwealth budget (FY, A$ bil)	-27.0	-51.0	-32.0											
as % of GDP	-2.1	-3.7	-2.2											
Unemployment rate	5.6	5.3	5.0	5.7	5.8	5.6	5.3	5.2	5.2	5.1	5.0	5.0	4.9	4.8
Industrial production	-7.9	4.8	1.5	5.3	-3.8	21.3	4.6	2.0	-1.0	-2.0	0.0	1.0	2.0	3.0

*All financial variables are period averages

Australia - summary of main macro views

- We recently upgraded the 2011 **GDP growth** forecast to 3.6%, from 3.2%. We are even more comfortable with the corporate investment outlook (particularly in mining), but remain cautious on consumers, who face some interest rate pain.
- **Business investment** probably will rise strongly in 2010-11, with mining leading the way, particularly with the mining tax roadblock being "dismantled". There will be an even bigger rise in 2011-12.
- On **housing**, with the expanded first home owners' grant now having expired and price caps on the basic grant in place, house price growth should cool, particularly at the low- and middle-end of the price spectrum.
- **Consumer confidence** deteriorated sharply earlier this year as mortgage rates rose. The index rebounded in October, having fallen in September. 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. We forecast a rate hike at the 2 November Board meeting, and a further four hikes during 2011.
- The **Labor government** was "reelected," but governs in the lower house of Parliament only via the support of key independents. A fragile minority government risks delivering policy timidity.

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Economic forecasts - New Zealand

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

				2009			2010				2011			
	2009	2010	2011	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Real GDP (1995-96 prices)	-1.7	2.0	2.8	0.6	0.9	4.0	2.2	0.7	2.5	2.5	2.6	3.1	4.2	2.8
Private consumption	-0.7	1.9	1.3	1.1	3.8	3.7	1.7	0.3	1.2	0.2	1.0	2.0	2.5	3.0
Fixed Investment	-13.3	3.8	6.2	0.7	-9.8	-1.6	0.5	27.1	3.5	4.0	5.1	5.6	6.4	6.3
Residential construction	-18.4	11.4	7.2	-12.9	-13.3	20.7	5.8	52.2	2.8	4.0	4.8	5.6	6.4	5.6
Other fixed investment	-12.2	2.4	6.0	3.6	-9	-5.5	-0.5	22.4	3.6	4.0	5.2	5.6	6.4	6.4
Inventory change (NZ$ bil, saar)	-1.9	-0.8	0.4	-1.0	-0.7	0.1	0.1	-0.5	-0.3	-0.1	0.1	0.1	0.2	0.1
Government spending	1.5	3.2	2.0	-3.9	1.8	4.3	7.0	2.2	1.6	1.6	2.0	2.8	2.4	0.8
Exports of goods & services	0.4	3.8	4.7	16.5	2.7	-1.8	5.0	5.5	3.0	3.0	4.0	6.0	7.0	7.0
Imports of goods & services	-15.1	8.2	6.7	-10.2	5.8	25.1	6.8	2.5	9.0	8.0	6.0	7.0	6.0	6.0
Contributions to GDP growth:														
Domestic final sales	-5.1	2.8	2.7	0.1	-1.4	2.0	3.8	7.0	1.8	1.3	2.2	3.1	3.5	3.5
Inventories	-2.6	0.8	0.9	-7.7	3.3	10.5	-0.9	-6.8	2.8	3.0	1.2	0.6	0.6	-0.8
Net trade	5.9	-1.5	-0.8	8.7	-1.0	-7.9	-0.7	0.9	-2.1	-1.8	-0.8	-0.5	0.1	0.1
GDP deflator (%oya)	2.0	2.7	2.3	3.2	2.3	0.2	1.0	2.3	3.4	4.1	3.2	2.4	1.9	1.6
Consumer prices	2.1	5.0	3.2	2.3	5.3	-0.7	1.5	1.1	5.5	12.1	3.3	1.8	3.9	3.8
%oya	2.1	2.6	4.9	1.9	1.7	2.0	2.0	1.8	1.8	4.9	5.4	5.6	5.2	3.2
Trade balance (NZ$ bil, sa)	2.3	5.3	5.1	0.7	0.6	0.3	0.9	1.2	1.5	1.6	1.4	1.3	1.2	1.2
Current account (NZ$ bil, sa)	-5.3	-5.8	-12.0	-0.6	0.1	-2.8	-1.2	-1.3	-1.8	-0.6	-2.1	-5.2	-3.6	-3.5
as % of GDP	-3.0	-3.1	-6.1	-1.3	0.2	-6.2	-2.7	-3.9	-1.3	-4.5	-7.4	-7.2	-5.5	-4.3
Yield on 90-day bank bill (%)*	3.0	3.0	3.8	2.8	2.8	2.8	2.7	2.9	3.3	3.2	3.4	3.7	4.0	4.0
10-year bond yield (%)*	5.5	5.4	4.7	5.7	5.7	5.9	5.9	5.7	5.3	4.9	4.9	4.8	4.7	4.7
US$/NZ$*	0.64	0.71	0.75	0.60	0.68	0.73	0.71	0.70	0.70	0.71	0.72	0.76	0.77	0.74
Commonwealth budget (NZ$ bil)	-4.0	-7.2	-7.1											
as % of GDP	-2.2	-3.8	-3.6											
Unemployment rate	6.1	6.5	5.8	5.9	6.5	7.1	6.0	6.8	6.7	6.4	6.0	5.9	5.7	5.7

*All financial variables are period averages

New Zealand - summary of main macro views

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

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Australia and New Zealand economic calendar

Monday	Tuesday	Wednesday	Thursday	Friday
18 Oct **Australia:** New motor vehicle sales (11:30 am) Sep **New Zealand:** CPI (10:45 am) 3Q 1.2%oya	**19 Oct**	**20 Oct** **Australia:** Westpac leading index (10:30 am) Aug	**21 Oct** **New Zealand:** Credit card spending Sep Visitor arrivals (10:45am) Sep	**22 Oct** **Australia:** Exports 3Q 0.8%q/q, sa Imports 3Q 0.1%q/q, sa
25 Oct **Australia:** PPI (11:30 am) 3Q *Holiday: New Zealand*	**26 Oct**	**27 Oct** **Australia:** CPI (11:30 am) 3Q **New Zealand:** NBNZ business confidence (2:00 pm) Oct	**28 Oct** **New Zealand:** RBNZ official cash rate (3:00 pm) Oct	**29 Oct** **Australia:** Pvt. Sector credit (11:30 am) Sep **New Zealand:** Building permits (10:45 am) Sep Trade balance (10:45 am) Sep
1 Nov **Australia:** NAB business confidence (11:30 am) Oct HPI 3Q **New Zealand:** ANZ commodity prices (2:00 pm) Oct	**2 Nov** **Australia:** RBA cash target rate (2:30 pm) Nov	**3 Nov** **Australia:** Building approvals (11:30 am) Sep	**4 Nov** **Australia:** Retail sales (11:30 am) Sep **New Zealand:** Unemployment rate (10:45 am) 3Q	**5 Nov** **Australia:** RBA quarterly monetary policy meeting
8 Nov **Australia:** ANZ job ads. (10:30 pm) Oct **New Zealand:** QV house prices Oct	**9 Nov**	**10 Nov** **Australia:** Westpac consumer confidence (10:30 am) Oct Housing finance (10:30 am) Sep	**11 Nov** **Australia:** Unemployment rate (10:30 am) Oct **New Zealand:** PMI (10:30 am) Oct	**12 Nov**

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Global Data Diary

Week / Weekend	Monday	Tuesday	Wednesday	Thursday	Friday
18 - 22 October	**18 October**	**19 October**	**20 October**	**21 October**	**22 October**
	Japan • Reuters Tankan (Oct) **United States** • IP (Sep) • NAHB survey (Oct)	**Canada** • BoC mtg: no chg **Euro area** • Trichet speech **Germany** • ZEW bus survey (Oct) **Poland** • IP (Sep) **United States** • Housing starts (Sep) • NY Fed President Dudley speaks	**Brazil** • COPOM mtg: no chg **Russia** • Retail sales (Sep) **Taiwan** • Export orders (Sep) **Thailand** • BoT mtg: +25bps **United Kingdom** • MPC minutes (Oct) **United States** • Beige book	**China** • GDP (3Q) • CPI, FAI, retail sales, IP (Sep) **Euro area** • PMI flash (Oct) • EC cons conf prelim (Oct) **Japan** • BoJ loan officers surv (3Q) **United Kingdom** • Retail sales (Sep) **United States** • Philly Fed survey (Oct)	**Argentina** • IP (Sep) **Canada** • CPI (Sep) **Germany** • IFO bus survey (Oct)
25 - 29 October	**25 October**	**26 October**	**27 October**	**28 October**	**29 October**
Korea • GDP (3Q)	**Euro area** • Industrial orders (Aug) **Hungary** • HNB meeting: no chg **Israel** • BoI meeting: no chg **Japan** • Trade balance (Sep) **Taiwan** • IP (Sep) **United States** • Existing home sales (Sep) • Dallas Fed survey (Oct) • Bernanke speaks • NY Fed President Dudley speaks	**France** • INSEE cons conf (Nov) **Germany** • GfK consumer conf (Nov) **Italy** • ISAE cons conf (Oct) **Sweden** • Riksbank meeting: +25bps **United Kingdom** • GDP (3Q) **United States** • Case-Shiller HPI (Aug) • CB consumer conf (Oct) • Richmond Fed sur (Oct) • NY Fed Pres Dudley speaks	**Australia** • CPI (3Q) **Belgium** • GDP (3Q) **Germany** • CPI prelim (Oct) **Italy** • ISAE business conf (Oct) **Japan** • Shoko Chukin surv (Oct) **Norway** • Norges Bank mtg: no chg **United States** • Durable goods (Sep) • New home sales (Sep) • NY Fed President Dudley speaks	**Chile** • IP (Sep) **Euro area** • EC business conf (Oct) • EC consumer conf final (Oct) **Germany** • Labor mkt report (Sep/Oct) **Japan** • Retail sales (Sep) • BoJ MPM: no chg **New Zealand** • RBNZ meeting: no chg **United States** • KC Fed survey (Oct)	**Colombia** • BanRep meeting: no chg **Euro area** • Unemployment rate (Sep) • HICP flash (Oct) **Japan** • Core CPI (Sep) • IP prelim (Sep) • PMI mfg (Oct) • Unemployment rate (Sep) **United States** • GDP (3Q) • ECI (3Q) • Chicago PMI (Oct) • UMich cons sent fina(Oct)

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