J.P.Morgan

Australia and New Zealand - Weekly Prospects

Summary

- In **Australia,** the finger prints of the swirling debate over the merits of the proposed 40% tax on the "super" profits of mining companies can be detected on last week's data. Although employment boomed (again) in May, business confidence slumped to an 11-month low, with respondents in the mining industry the most pessimistic. Also, consumer confidence dived for the second straight month, although the RBA's recent rate hikes probably played an important role here. The size of the jobs gain surprised us, as did the drop in the jobless rate to 5.2%. It reminds the market, though, that the RBA probably will be hiking again soon, most likely in August. Today, the RBA's Board minutes should reveal little new information. The only data scheduled for release are the 1Q dwelling starts; we forecast a healthy gain. Financial markets, though, will be looking for a settlement to the unseemly "war" between the government and miners over the profits tax.

- In **New Zealand**, our forecast was for the RBNZ to stand pat last week, owing to pockets of weakness in the domestic economy and the heightened uncertainty offshore. Instead, Governor Bollard hiked the official cash rate (OCR) 25bp. The commentary that accompanied the decision was hawkish, and we expect a 25bp hike at each of the four remaining OCR announcements this year. It seems the RBNZ is comfortable that the shift to a more export-led recovery will be sufficient to overcome still sluggish domestic demand. Households, in particular, remain cautious, and likely will embark on a period of consolidation, although some spending will be bought forward ahead of the GST hike on October 1. Retail sales fell in April, with headline sales declining 0.3%m/m and core sales falling 0.2%.

- Much of our attention in recent weeks has been focused on assessing shocks to **global financial markets**. The rise in global risk aversion and stress in European banking has altered our outlook modestly while generating an important shift in our perception of risk—from a bias to raising growth forecasts to one of lowering them. However, this has not shaken our belief in the underlying forces that will ultimately sustain the economic recovery.

- All signs point to a significant acceleration in the **Euro area** economy this quarter, including last week's upbeat reports on German industrial orders and manufacturing across the region. The economy's momentum is likely to extend into 3Q. But the cyclical lift associated with a turn in the inventory cycle and a shift away from sharp declines in capex will begin to fade later in the summer. Meanwhile, the financial and banking stresses in the region show little sign of abating. As a result, we now expect GDP growth in the region to slide to a 1% pace by year-end. Fiscal tightening is likely to keep growth sluggish through much of 2011.

This week's highlight

In an otherwise quiet week, the highlight will be the release today of the minutes from the RBA's last Board meeting.

Jun 15, 2010

Contents

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Data and event previews - Australia and New Zealand

Date	Time [a]	Data/event	Forecast JPMorgan	Forecast Consensus [b]	***Previous***
Tuesday, June 15	11.30am	RBA Board minutes (Jun.)	**na**	na	*na*
Tuesday, June 15	12.30pm	RBA Deputy Governor Battellino's speech	**na**	na	*na*
Wednesday, June 16	10.30am	Aust. Westpac Leading Index (%m/m, Apr.)	**na**	na	*0.9*
Wednesday, June 16	11.30am	Aust. dwelling starts (%q/q, 1Q)	**6.0**	7.0	*15.1*
Thursday, June 17	1.00pm	NZ ANZ consumer confidence (%m/m, Jun.)	**na**	na	*3.4*

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

Australia

RBA Board minutes (Jun.) - The Reserve Bank will release the minutes from its June Board meeting at which officials elected to leave the cash rate steady. We expect few surprises. The RBA Governor delivered a speech last week reiterating that the outlook for Australia is solid, due to close ties with Asia, but that there are regions of weakness elsewhere. The official commentary from two weeks ago addressed the troubling events in Europe, which officials hinted was a reason for pausing, but the commentary on Australia was extraordinarily short, indicating that little has changed in the minds of officials: the terms of trade will rise further, which has significant, positive income and investment implications. We forecast the RBA’s pause to extend through July, but that the Bank will resume tightening in August. The August Board meeting follows the release in July of the 2Q CPI data, in which we expect a high headline reading and elevated core measures.

RBA Deputy Governor Battellino’s speech - The Deputy Governor speaks at a Financial Executives forum in Sydney on Wednesday. The presentation will be closed to the media, meaning no Q&A session, but the transcript of the speech will be released following the event.

Dwelling starts (%q/q, 1Q) - Dwelling starts bounced 15%q/q in 4Q, having lagged building approvals since the government’s education infrastructure program commenced mid-year. With a significant number of these projects being completed in 4Q and 1Q, any crowding out effects in trade labour and materials should have continued to fade over the first quarter. Over this period, building approvals rose 5%q/q, consumer sentiment lingered around its 2007 highs, and activity was buoyant, with the RBA’s 4Q hikes signaling the economy’s strength, but with rates still historically low.

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Australia

- **Job market still booming—jobless rate fell**
- **RBA Board minutes to maintain balanced tone**
- **Dwelling starts will have continued recovery in 1Q**

The past week in Australia revealed a puzzling diversity in the economic data. Home loans plunged yet again, and both business and consumer confidence dived. The recent increases in interest rates and the unsettling debate over the government's proposed 40% tax on mining company profits are principally to blame. The May employment report, however, showed that another 26,900 jobs were added over the month, taking the aggregate gain to 141,000 this year. Either firms are in denial about strengthening headwinds and are hiring blindly, or the confidence measure overstates the degree of pessimism in the corporate world.

Little new from RBA Board minutes

Today, the Reserve Bank releases the minutes from its June Board meeting at which officials elected to leave the cash rate steady. We expect few surprises. The official commentary from two weeks ago focused mainly on the troubling events in Europe, which officials hinted was a reason for pausing. The commentary on Australia was extraordinarily short, spanning just three lines. Board members cited the stimulatory impact of the strength in the terms of trade, but neglected to mention the housing market, employment, or mining investment, which had been the focus of previous commentary. We take this to mean that Board members believed there was little fresh news to add.

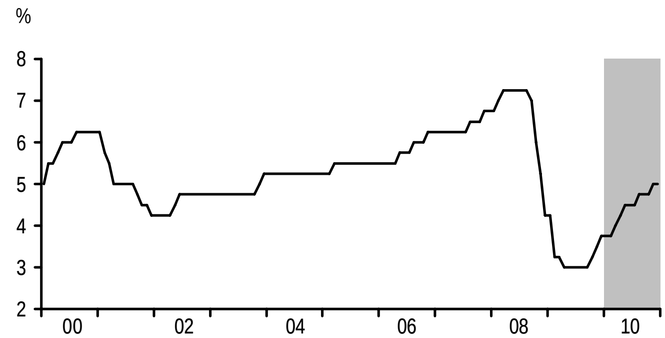
We forecast the RBA's pause to extend through July, but that the Bank will resume tightening in August. The August Board meeting follows the release in late July of the 2Q CPI data. We expect elevated headline and core readings, which should prompt the tightening cycle to start anew.

Another 27K jobs added last motn

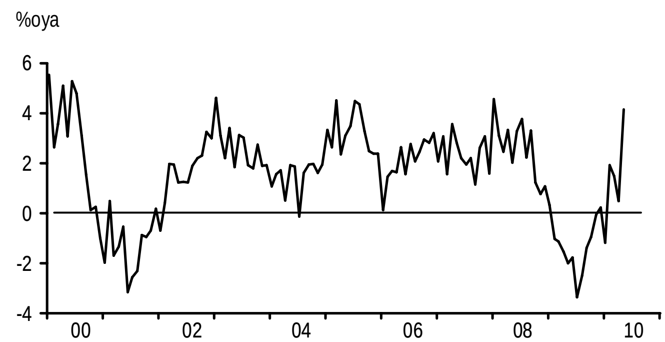
Australia added 26,900 jobs in May, taking average monthly gains in the first five months of the year to 28,200. We had expected that we would see some payback in May, though that wasn't the case. That said, leading indicators of employment, such as the employment component of the NAB business survey, suggest that recent solid job gains will soon moderate, albeit modestly.

The sharp rise in employment in May drove the unemployment rate down to 5.2% from 5.4%, with the participation rate also falling a notch to 65.1% from 65.2%. Even though

Australia: RBA cash target rate



Australia: hours worked



monthly employment gains should remain relatively healthy going forward, providing the positive investment outlook remains intact, the unemployment rate will likely maintain a 5%-handle this year. This owes to an elevated level of labour force participation. The participation rate, we believe, will hold around current levels, remaining underpinned by a number of factors, including the fact that some second income earners are returning to the workforce as households struggle in the face of rising interest rates.

The shift from part- to full-time work continued in May. The rise in employment owed solely to a spike in full-time jobs (+36,400), while part-time employment fell (-9,400), marking the fourth straight monthly decline. The shift generated a sharp rise in workers' hours, which jumped 2.9%m/m in May, marking the fastest increase since August 1988. Tightening labour market conditions will be a growing concern for the RBA, particularly after the government announced in its Budget in May that it expects the economy to approach full employment by mid-2012. Indeed, this highlights the risk of a wages breakout, and will add to looming inflationary pressures.

Home construction coming back online

Dwelling starts should have risen 6%q/q in 1Q, despite the expiry of the First Home Buyers' (FHBs) boost, which heavily incentivized investment in new housing. Dwelling

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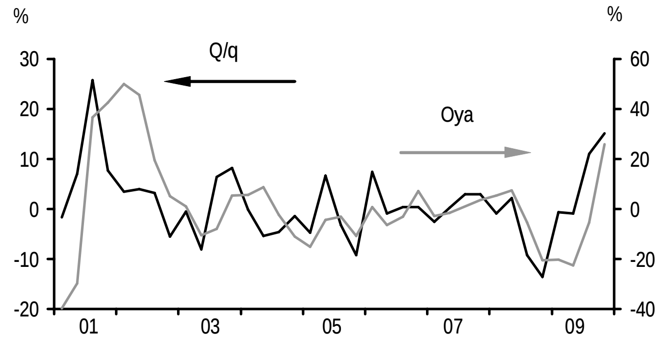
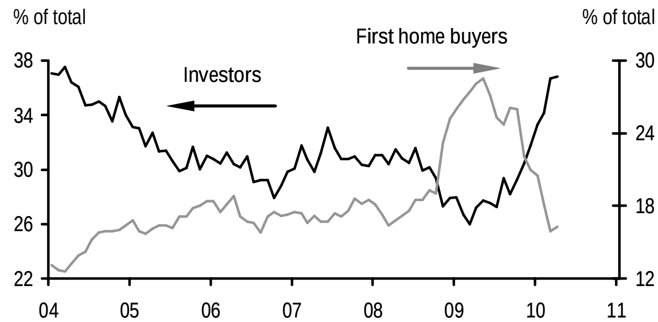
Building activity probably will be dampened somewhat in 2Q by the continuation of rate hikes, and with the crowding out effect fading from the base in housing starts. On the plus side, the government of New South Wales (Australia's most populous state) announced in last week's budget several targeted measures to incentivize home construction, including a cut in stamp duty (i.e., transaction tax) for the purchase of dwellings off the plan, and caps placed on development levies payable to local councils. These measures should support building activity over the remainder of the year.

Australia: dwelling starts



Australia: housing finance



Home loan hangover continued in April

Home loans were weighed down yet again in April by the combined forces of rising interest rates and the lull in activity following the expiration of the FHBs boost. New loan commitments slid a further 1.8%m/m (J.P. Morgan and consensus forecast: -2.0%), and have now been falling in trend terms since July 2009. Since the expanded FHBs' grant was originally expected to expire in June 2009 (it was later extended to end-2009), it is not surprising that the majority of buyers had already taken the plunge into the property market in 1H09. The fact that demand for home loans continued to wane while the grant remained available in 2H09 demonstrates just how intense was the initial binge.

We expect the hangover to ease over the remainder of the year; this expectation is supported by the fact that the pace of decline in trend loan volumes has eased over the past three months. But, even though market pricing suggests further rate hikes may not be forthcoming this year, last week's terrible consumer confidence numbers for June, a month which saw the RBA on hold, demonstrate that borrowing rates already have breached a meaningful threshold. Further rate hikes, or even the expectation thereof, may not be necessary for prospective home buyers to express some hesitation.

It was not all bad news for FHBs, however. The percentage of dwellings financed for FHBs rose to 16.3% from 15.9%, the first increase since September 2009. At the very least, FHBs are now taking a larger piece of a smaller pie, as the withdrawal of other buyer groups intensifies. We expect sluggish demand for home loans over the remainder of 2010, but with prices well supported by a healthy labour market and a chronic undersupply of housing stock.

Aussie consumers still feeling the pinch

Consumer confidence deteriorated more than expected in June, and would have undoubtedly declined further had the RBA not left interest rates on hold two weeks ago. The Westpac-Melbourne Institute (WMI) index of consumer confidence dropped 5.7%m/m in June (J.P. Morgan forecast: -2%), taking the index 16% south of its most recent peak in October last year. The WMI index dropped to a reading of 101.9 in June, approaching the key 100 level, which indicates an equal number of optimists and pessimists. This threshold likely will be tested next month given expectations of further rate hikes, still-elevated sovereign concerns in Europe, further AUD weakness, and lower equity prices.

In the June survey, the WMI asked respondents to recall news items that they viewed favourably or unfavourably. The most recalled items related to the "Budget and Tax" category: 55% of respondents recalled these events, marking the highest proportion since the introduction of the GST, and a clear majority viewed them unfavourably. Other categories which registered high recall were economic conditions (48%) and international conditions (32%); the latter

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was the highest reading since the Asian financial crisis.

The recall score on interest rates was down significantly in June, falling to 34% from 44% in March (the last reading). This reflects the RBA's decision to leave the official cash rate unchanged two weeks ago, but also suggests that interest rates were not the main downward force on sentiment in June, unlike in previous months. Indeed, the recent deterioration in confidence has owed mainly to rising mortgage rates—in May, the WMI reported an 8%m/m drop in confidence among those with a mortgage following the RBA's most recent rate hike, significantly more than the average 2% drop following the previous five hikes to the official cash rate. That said, the RBA's tightening cycle is not over. With the economy growing around trend and doing so with little spare capacity, upward pressure on inflation will continue to build, meaning further rate hikes are likely.

Data releases and forecasts

Week of June 14 - 18

Wed
Jun 16
10:30am

WMI leading index
sa

	Jan	Feb	Mar	Apr
%m/m	0.5	0.5	0.9	—

Wed
Jun 16
11:30am

Dwelling starts
Seasonally adjusted

	2Q09	3Q09	4Q09	1Q10
(%q/q)	-0.9	11.0	15.1	6.0

Review of past week's data

ANZ job advertisements

	Mar	Apr	May
(%m/m,sa)	1.8	-1.2	__ *4.3*

WMI consumer confidence survey
100=neutral, seasonally adjusted

	Apr	May	Jun
(%m/m)	-1.0	-7.0	~~-2.0~~ *-5.6*

NAB monthly business survey
% balance, seasonally adjusted

	Mar	Apr	May
Business confidence	16	13	~~11~~ *5*

Housing finance approvals: owner occupiers
Number of loans, seasonally adjusted

	Feb	Mar	Apr
(%m/m)	~~-2.0~~ *-1.7*	~~-3.4~~ *-2.9*	~~-2.0~~ *-1.8*
(%oya)	-16.4	~~-23.3~~ *-22.6*	~~-25.7~~ *-25.3*

Labour force
Seasonally adjusted

	Mar	Apr	May
Unemployment rate (%)	5.4	5.4	~~5.5~~ *5.2*
Employed (000 m/m)	~~28~~ *30*	~~34~~ *35*	~~-5~~ *27*
Participation rate (%)	65.2	65.2	~~65.2~~ *65.1*

New Zealand

- **RBNZ hiked OCR 25bp and signalled more to come**
- **Officials optimistic on trading partner growth**
- **Retail sales fell in April**

In New Zealand, the RBNZ hiked the cash rate 25bp to 2.75%, the first move in what is likely to be an extended tightening cycle. The associated commentary leaned to the hawkish side, although officials ackowledged that policy changes this time are likely to get more traction than in previous hiking cycles.

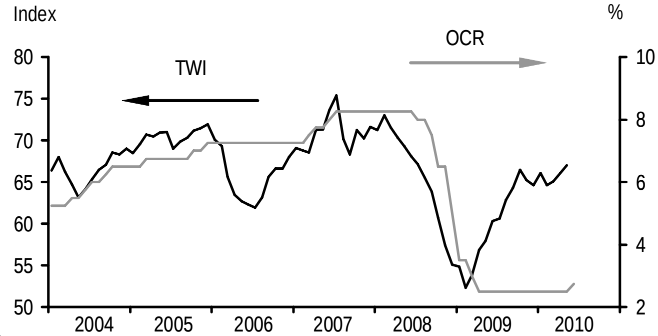
RBNZ hiked OCR 25bp, more to come

The RBNZ last week hiked the official cash rate (OCR) 25bp (J.P. Morgan: no change; consensus: +25bp), marking the first rate hike since mid-2007, and delivered an upbeat statement. To us, each was a surprise. Our forecast was for the RBNZ to deliver the first move in July. We believed there was plenty of scope to sit on the policy sidelines this month given the considerable uncertainty offshore and the pockets of weakness in the domestic recovery. The RBNZ evidently thought otherwise.

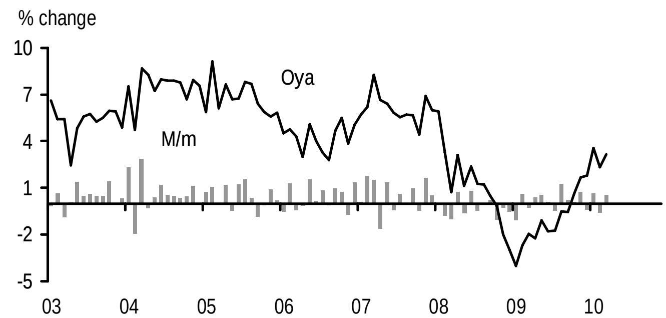
The Bank's forecast for economic growth remained upbeat, with official estimates projecting annual GDP growth of an above trend 3.5% this year and next. The statement noted that trading partner growth had been strong in recent quarters, with activity currently well above that predicted previously. Growth in Asia was described as "particularly strong." Economic growth in Australia and the United States also had helped offset weakness in other export markets, namely Europe, where activity "remains weak." RBNZ Governor Bollard was upbeat on trading partner growth, the outlook for investment, and the improving labour market. But, he expects that households will remain cautious, and expects them to also embark on a period of consolidation in the period ahead, even though they will likely bring forward spending ahead of the GST hike later this year. It seems that RBNZ officials are comfortable that the shift to a more export-led recovery will be sufficient to overcome still sluggish domestic demand.

The RBNZ acknowledged the renewed turmoil in financial markets, stemming from recent troubles in Europe, but said, at this stage, the main impact on New Zealand is coming through "upward pressure on the cost of funds to the banking system." Any spill over of these financial troubles into the real economy, however, would severely affect the recovery under way in New Zealand. This remains a considerable risk, one we had thought would have kept the RBNZ side-

New Zealand: trade weighted index and RBNZ official cash rate



New Zealand: retail trade



lined this month.

On inflation, Bollard expects that underlying CPI inflation will track within the Bank's 1%-3%oya target range in the period ahead, owing to widespread spare capacity in the economy, particularly in the housing sector. Headline CPI inflation will be boosted temporarily by the GST hike on October 1, which the Bank estimates will add 2%-pts to quarterly CPI. The RBNZ pointed out, though, that the impact of the GST hike will not have a "lasting impact on inflation" provided that price- and wage-setting behaviour are note affected. Officials will monitor inflation expectations—which already are elevated—very closely for signs of this going forward. The RBNZ has assumed, however, that the GST hike will have no effect on wage bargaining, given that it will be delivered alongside personal income tax cuts.

We expect that the RBNZ will continue to hike the OCR at each of the remaining four meetings this year, provided that economic and financial market developments evolve as expected. With the first OCR hike coming six weeks earlier than we had projected, we now forecast an OCR of 3.75% by year-end, compared to 3.5% previously.

Kiwi retail sales values dropped

Consumer spending pulled backed in April, providing further evidence that households have adopted a more cautious approach to spending. Even though consumer confidence has remained upbeat, this optimism has yet to translate to stronger spending. Retail sales values fell 0.3%m/m (J.P. Morgan: -0.6%, consensus: -0.2%), after bouncing 0.5% in March. Significant competition among retailers, resulting in considerable discounting of goods, also weighed down retail sales values in April. Core retail sales also fell, slipping 0.2%m/m (J.P. Morgan: -0.1%, consensus: -0.4%), after jumping 1.0% in the previous month.

Looking at the breakdown, sales were down in 15 of the 24 retail industries in April, with the largest fall recorded in sales at department stores (-3.3%). All other decreases were relatively subdued, falling by NZ$6 million or less over the month. Posting the largest rise were sales in the accommodation industry (+7.0%).

The retail sector will likely get a lift in the months to come, however. Consumers will bring forward spending ahead of the forthcoming GST hike on October 1; this will be most evident in big ticket items like cars, furniture, and household appliances. Owing to this reason, the retail sector posted the biggest rise in sentiment in the NBNZ survey of business confidence in May, with a 10 point jump. The government confirmed in May that it would hike the GST from 12.5% to 15%. In 1986, when the GST was introduced in New Zealand, and in 1989 when it was lifted by 2.5%-points, there was a significant "bring-forward" of spending by consumers in the months immediately before the rise in the consumption tax; this was followed by a subsequent fall. For retailers, however, this creates the difficult challenge of managing inventory around volatile fluctuations in demand.

Aside from the lift to retail sales expected in the months ahead, household spending thereafter will likely be subdued. As RBNZ Governor Alan Bollard highlighted yesterday, New Zealand households have acknowledged their over exposure to property and high debt levels and are "prepared to constrain consumption to improve their savings." This supports our view that, barring the next few months, we will see a sustained period of sub-trend growth in household consumption in New Zealand, particularly given expectations of higher interest rates.

Data releases and forecasts

Review of past week's data

QVNZ house prices

%, median

	Mar		Apr		May	
(%oya)	6.1		6.1		__	*5.6*

RBNZ cash rate announcement

No change delivered. See main text

Business PMI

	Mar		Apr		May	
Index,sa	~~56.7~~	*56.4*	~~58.9~~	*58.6*	__	*54.5*
(%oya,sa)	~~34.2~~	*34.3*	~~34.2~~	*34.3*	__	*23.6*

Terms of trade

	3Q09		4Q09		1Q10	
(%q/q,sa)	-1.6		~~5.7~~	*5.8*	~~-2.3~~	*5.9*

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Global Essay

- **Core views remain intact although our risk bias has swung sharply**
- **DM budget deficits are set to decline substantially but debt sustainability will remain elusive**
- **China's growth momentum held up well through May**
- **Downward revisions to growth forecasts for Euro area and Central Europe**

This we believe

Much of our attention in recent weeks has been focused on assessing shocks to global financial markets. The rise in global risk aversion and stress in European banking has altered our outlook modestly while generating an important shift in our perception of risk—from a bias to raising growth forecasts to lowering them. However, this has not shaken our belief in the underlying forces that will ultimately sustain the economic recovery.

- **A broadening base for growth promotes resiliency.** A shift toward expansion by the private sector is the main pillar on which our macroeconomic outlook stands. Starting from a highly defensive position, a normalization of sentiment by firms and households should provide fuel for sustained spending and hiring that adds resiliency to the expansion in the face of shocks. This shift is of particular importance in Europe which is at the center of the financial shock now threatening the outlook. We lowered our regional growth forecast again last week in response to building stress, but anticipate enough underlying resiliency to keep the expansion moving forward.

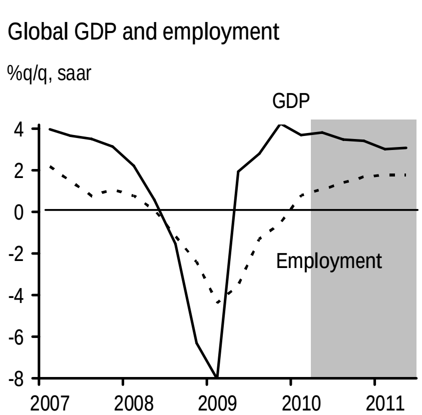
- **Growth momentum peaks this quarter.** The improvement expected in the private sector should produce stronger gains in job growth and capital spending. However, the last three quarters have seen activity gains at lofty heights with global industrial output rising at a 12% pace and GDP rising 4% (over 5% using PPP weights). With supports from fiscal stimulus and a turn in the inventory cycle now fading, global industrial output and GDP are expected to moderate to a still solid 5% and 3% pace, respectively, by early next year.

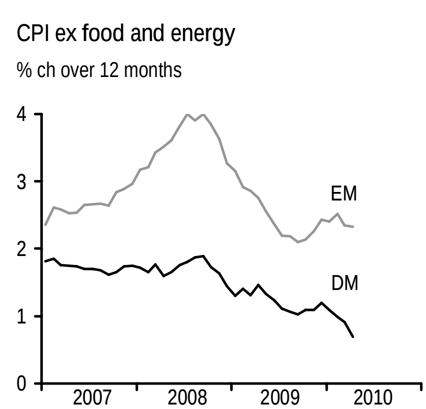
- **A profoundly disinflationary world...** Although growth has been strong, levels of activity remain depressed. Global industry has recovered only 50% of the output losses of the recession, and global unemployment currently stands 3%-pts above its pre-recession level. To be sure, some capacity has been destroyed, and the position of Emerging Asia and commodity countries differs from the G-3. However, in the aggregate, the world remains awash with slack and inflation is moving lower. Core inflation in the G-3 is dangerously low—it is flat over the past six months.

- **... meets powerful reflationary policy stances.** It is against this backdrop that policy stances remain highly accommodative across the globe. Outside Japan, central bankers in the largest economies have done a good job anchoring inflation expectations in the face of disinflation. Their job is not complete and the "low for long" mantra expressed by G-3 central banks will remain in place. The normalization process is expected to proceed across commodity countries and the EM but at a gradual pace. Our forecast incorporates just 50bp of aggregate EM tightening between now and year-end.

Big decline in deficits won't stabilize debt

An important source of recent market turbulence relates to concern about public sector debt sustainability. Last week we published a study on debt sustainability in the developed world that highlights the following points (see our Global Issues, *Government debt sustainability in the age of fiscal activism*, published last week).





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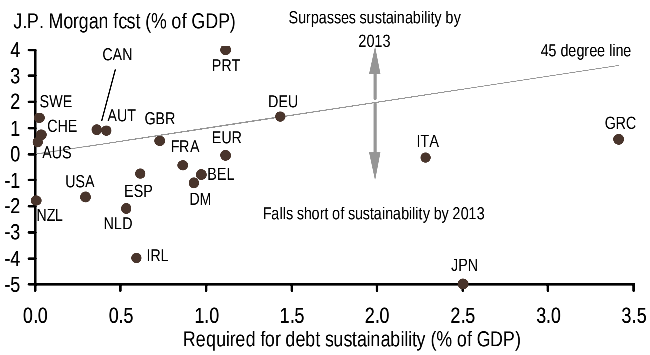
Primary surplus in 2013 required for debt sustainability and fcst



- If solid growth can be sustained, the developed world deficit will likely be halved by 2010 to 4% of GDP. This large adjustment, however, still falls 2%-pts of GDP short of achieving a stable debt position.
- Japan stands the furthest from achieving sustainability in our 2013 forecast, due to its high debt and low nominal growth. The US will be much closer, but still fall short. Both countries have relatively small fiscal footprints, affording opportunities to correct imbalances through raising revenues.
- Among the G-3, the Euro area is likely to stand closest to debt sustainability in 2013. However, its already large public sector limits options for adjustment. And its poor demographics and generous entitlement programs create significant underlying long-term pressures.
- Euro area aggregates mask wide variation within the region. Even accounting for current consolidation plans, Greece and Ireland will stand far from debt stability in 2013. Spain and Italy are closer but also fall short. These countries also face the most severe pressures from aging populations and entitlement spending.
- Outside the G-3 economies, developed world fiscal conditions are relatively good. While none of these economies escaped large deteriorations during the downturn, their strong initial conditions (net lending surpluses and low debt) make debt sustainability easy.

Limited slowing in China so far

The key question for China is whether the policy tightening to date generates a soft landing. We maintain that there is still considerable stimulus in the system and that economic growth will only slow from the robust 12% pace over the four quarters through 1Q10 to a more trend-like 9% to 9.5% pace beginning in the current quarter. Strong gains in consumer spending and exports should cushion the projected slowing in fixed asset investment growth later this year.

Last week’s May activity data were encouraging. Retail sales rose near 2%m/m last month. Equally reassuring, exports soared in May. This outsized gain followed unusual weakness in previous months and restored confidence that global demand for Chinese goods is growing briskly. At the same time, growth in fixed investment has moderated from the blistering 2009 pace, but is still running about 25%oya, similar to 2007-08. Against this solid demand backdrop, it was surprising that IP rose a subpar 0.5%m/m. This is the least reliable of China’s monthly statistics, but it does square with other signs that IP growth is coming off the boil across all of Asia as the inventory cycle wanes.

Developments in the US also will be key for tracking our global outlook. In particular, we are looking for confirmation that the business sector is expanding in a healthy way once again. In this vein, last week’s data were mixed. The continued stickiness of initial jobless claims is disappointing, since the current level hints at a pace of job growth near 100,000 per month, which is below our forecast and the three-month average. A decline to 430,000 would be more consistent with our forecast that job growth will pick up to 175,000 per month in 3Q. At the same time, the soft reading on core retail sales raises caution but still keeps outlays on track to grow 2.5% this quarter, which is not much below our forecast. The continued advance in consumer confidence in June was positive.

As growth outlook darkens, ECB fades

All signs point to a significant acceleration in the Euro area economy this quarter, including last week’s upbeat reports on German industrial orders and manufacturing across the region. The economy’s momentum is likely to extend into 3Q. But the cyclical lift associated with a turn in the inventory cycle and a shift away from sharp declines in capex will begin to fade later in the summer. Meanwhile, the financial and banking stresses in the region show little sign of abating. As a result, we now expect GDP growth in the region to slide to a 1% pace by year-end. Fiscal tightening is likely to keep growth sluggish through much of 2011.

The banking system is not at a breaking point, but significant points of stress remain. Although there has been some issuance of bank debt in core countries, this is falling well short of what is maturing, and banks have approximately another €400 billion of debt to refinance over the remainder of this year. This will increase their reliance on the ECB as a backstop. In addition, of the roughly €850 billion of bank

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China fixed asset investment and exports

% change over 12 months; both scales

funding being provided by the ECB, €442 billion was through the one-year tender that expires on July 1. At its policy meeting last week, the ECB could have announced significantly expanded liquidity support. Instead, it simply switched back to unlimited allotment at upcoming three-month tenders through the end of September. Banks will be able to fund themselves at the ECB, but the maturity of this funding will shorten to a maximum of three months. For now, the situation remains fluid and poses a downside risk.

Spillover likely to the rest of Europe

As in the Euro area, UK growth appears to have stepped up to about 3% annualized this quarter. But both the direct effects of weaker Euro area growth through trade linkages, and the spillover of stress into financial conditions in the UK, warrant a modest downward revision to the forecast. We are postponing a change as the new government's emergency budget looms, and risks are tilted toward a more front-loaded fiscal tightening that may impact our outlook. Next week, the UK Budget is delivered, which will frame the steps required to achieve the deficit forecasts issued by the newly created Office for Budgetary Responsibility.

Given Central Europe's sluggish domestic demand, the recovery there remains highly dependent upon developments in the core Euro area countries. In making downward revisions last week, we trimmed Poland's forecast the least, given its lower export intensity and comparatively stronger domestic demand, whereas Hungary and Romania are likely to be hit harder. Likewise, we envision less policy tightening in Poland and the Czech Republic next year. At the other end of the spectrum, rates cuts no longer are expected in Hungary and Romania, as officials will need to guard against downward pressure on currencies due to the high share of FX liabilities.

The Hungarian government's economic action plan helped calm markets last week. The plan includes a hefty tax on banks and cuts to public sector wages, while postponing a planned income tax cut until next year. If fully implemented, these measures would allow the outgoing government's 3.8% of GDP deficit target to be met.

Latin America reining in stimulus

Even as the storm clouds have gathered over the global economy, strong growth and underlying inflation pressures are pushing Latin policymakers to rein in stimulus. The strong pace of growth reflects the rapid expansion of domestic demand as well as exports. With slack limited in many countries, this is putting upward pressure on core inflation, even as headline rates moderate on the back of smaller base effects from food and energy prices. Last week, Brazil raised its policy rate 75bp for the second consecutive month in response to signs of overheating, including news that GDP soared at an 11.4% annualized pace in 1Q. As the leader of the regional recovery, it is easy to view Brazil as anticipating the risks that neighboring economies might face down the road. Peru also raised its policy rate (25 bp) last week, and Chile is expected to do likewise this week. However, these latter economies face overheating risk that is less intense than in Brazil, and their authorities hope to carry out a more gradual policy adjustment.

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JPMorgan View - Global Markets

Market vs. economy—Who will win?

- **Asset allocation:** We believe a resilient world economy will beat the market correction, and force an eventual market realignment toward higher prices for risky assets.
- **Economics:** European growth forecasts are cut. Initial data flow shows the world economy is absorbing the market correction well.
- **Fixed income:** Stay short in the US and Australia.
- **Equities:** Underweight banks and small caps globally; overweight US, India, and Mexico.
- **Credit:** Downgrade US HG from overweight to neutral.
- **FX:** Buy SEK/NOK.
- **Commodities:** The inventory and supply picture is positive for oil prices. Remain long crude.

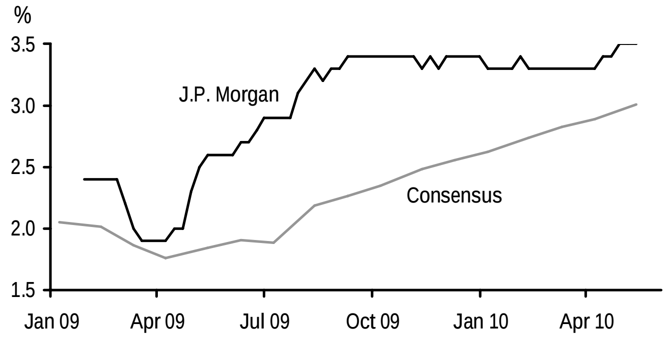
Volatility remains high, but for the first time in many weeks, conditions in risky assets have improved. Equities and commodities have rebounded, although credit was mixed. Government yields are up, and intra-EMU spreads are down. Some €28 billion of EMU government bonds was issued with relative success, and the first European non-covered bank bonds were issued in seven weeks.

We maintain a cautious net long in risky assets, planning to add more risk as volatility abates. Risk is focused on the US and EM.

The big battle is not between the bulls and the bears. It is instead between the economy and the markets. Economic activity data indicate a world economy that continues to grow nicely, seemingly ignoring the turmoil in markets. Risky markets and bond yields have fallen back to where they were some nine months ago, seemingly pricing in a double-dip recession. Obviously, Wall Street and Main Street do not live on different planets and are fully aware of each other. It is our strong perception that markets do not reflect an investor view of a major slowdown in growth. Instead, risky markets have fallen as greater uncertainty and volatility forced a rapid unwinding of bullish positions. “It’s the risk managers who forced us” is a common explanation we have heard from investors. The **dominant view** among investors is neither bearish nor bullish. Instead, it is **“don’t know.”**

The implication is that positive surprises, while welcome, are not necessary to turn risky markets around. Instead, it is a non-realization of these risks, forcing position unwinds, that

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



Source: J.P. Morgan, Bloomberg. J.P. Morgan forecast is current, last observation for consensus is early May. Bloomberg forecasts are for regions and countries that we averaged using the same 5-year rolling USD GDP weights that we use for our own global growth forecast. Previous charts used *Consensus Economics* which used very different weights than J.P. Morgan global forecasts.

is sufficient for a rebound in risky markets. The three uncertainties that have been dogging investors are Chinese tightening, US financial reform, and the Euro sovereign debt crisis. The first two are in the process of clarifying themselves. The US financial reform bill will likely pass Congress over the next two weeks and should focus more on common-sense risk control than on cutting the banks down to size. China is moving from overheating to a soft landing over the coming months. The gradual fading of these uncertainties is supportive of risk.

The third uncertainty, **the Euro sovereign debt crisis, remains highly acute and will not fade soon**. It is more fundamental and does not lend itself to simple value-at-risk assessment. The Euro area has a massive amount of work left to do to create a political center around a unified fiscal policy to support, if not rescue, its existing unified monetary policy. The crisis has made clear that the EMU needs both to survive. The move to fiscal policy integration will require both the stick (rules and penalties) and the carrot (mutual support). This effort could take years and markets are impatient for quick results. Hence our pessimism on an early resolution.

The rapid sell-off in risky markets over the past six weeks has planted a fourth uncertainty among investors, namely, **what damage has the correction imparted on what is still a fragile recovery?** This is the negative feedback question. We have discussed how this feedback goes through wealth, uncertainty, and funding channels. The news on this feedback last week is on net a relief. On the positive side, equity values are up; four European banks issued non-covered bonds; seven EMU governments rolled over debt; trade and car sales are well up; and the consensus raised its 2010 US growth forecast in June, in the midst of the sell-off. But on the negative side, fiscal tightening is spreading in Europe, our economists slashed growth forecasts across Europe, and US retail sales

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in May were disappointing.

The aggregate impact of these uncertainties supports our current strategy of a small net long position in risky assets, but an underweight of Europe (currencies and credit). European equities, in euros, should benefit from the cheaper euro. We maintain a neutral position on EM versus DM equities, but are itching to get back into long EM as the Chinese soft landing approaches.

Fixed income

Government bonds fell very slightly as risky assets recovered somewhat. Notably, **Euro area peripheral government bonds outperformed the core** for the first time since the ECB-induced rally in mid-May. In part, this reflected the successful issuance of a raft of debt, as seven Euro area governments—Spain, Portugal, and Italy among them—sold a combined €28 billion of bonds. The moderation in intra-EMU spreads is encouraging and tallies with other signs of calming markets such as falling money market spreads.

Concerns over sovereign risk have been heavily focused on Europe, but **government debt to GDP ratios are likely to keep growing across the developed world for the next five years at least** (see Lupton and Hensley, *Government debt sustainability in the age of fiscal activism*). Even though Japan faces the most daunting fiscal adjustment of all, elevated private sector saving has thus far kept Japanese yields very low. Similarly, high-deficit Euro area governments will likely be highly dependent on increased buying from domestic investors to absorb heavy issuance.

We retain the view that solid growth will push yields higher in the stronger developed economies. As such, we **stay short the front end in the US, and particularly in Australia**, where only one further rate increase is priced in over the next year, whereas our base case if for the RBA to hike again as soon as August, and keep going (see *GFIMS Australia and New Zealand*).

EM local markets have weathered the storm of increased market volatility relatively well, outperforming DM for the past three weeks, and by around 1% year-to-date. Flows into EM slackened in May, but have recovered over the past two weeks. Meanwhile, a slowing in expected central bank tightening in Emerging Asia should support local markets, making us favor long positions in Korea and Singapore (see *Emerging Markets Outlook and Strategy*).

Equities

Good economic data, good auction results in peripheral euro countries, and a rise in European bank issuance all boosted equity markets last week. Euro area stocks outperformed, driven by short covering. This was also evident inside the Euro area with the IBEX 35 Index up by 4% on Friday versus a decline of -0.2% for DAX.

Continued high uncertainty about the impact of the Euro debt crisis on the real economy and a still challenging funding environment for European banks and governments suggest a cautious stance near term. In particular, we emphasize three trading themes:

Overweighting countries that are remote from Europe: We like US equities, especially industry groups with little euro exposure, and India and Mexico within EM. We are not yet recommending an overall overweight in EM versus DM equities, given there is still uncertainty regarding China and downside risks to commodity producers.

Underweight small caps: Small caps peaked in mid-May versus large caps globally and have been underperforming since then. Small caps have three main properties versus large caps: a higher beta, lower liquidity, and higher domestic exposure. For Europe all three factors are negative for small caps. Outside Europe, the first two factors are negative for small caps while the third is positive.

Underweight banks: banks have been underperforming globally since last October. Near term, the funding crisis in European banking poses downside risks. Medium term, regulations and tax policies represent a significant headwind for banks. The Basel III proposals—currently under discussion—regarding capital requirements and liquidity have the potential to inflict long-lasting damage to banks' profitability and exacerbate the funding problems of European banks by forcing them to issue even bigger amounts of long-term debt.

Credit

Corporate spreads widened to new highs since late November last week. Uncertainty remains elevated and we see few near-term positive drivers to push markets up. Investors are sidelined despite improving valuation in credit and are waiting for risky markets to stabilize before buying credit. Thus, we take little directional risk and focus on underweighting the "hot spots," i.e., **underweight European credit and Eu-**

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ropean banks.

Last week, we lowered European growth forecasts. Banking stress is expected to persist with growth sliding below its potential pace. In this environment, we anticipate **cyclical credits to underperform in Europe** and underweight European cyclicals versus defensive sectors.

For US corporates, the strong dollar would negatively affect multinationals, and the recent trend of positive earnings surprises may slow due to a volatile market in 2Q. Thus, we **downgrade US HG from overweight to neutral** despite our medium-term bullish view.

However, demand from retail investors remains positive for HG bond funds and EM bond funds. **Outflows from HY funds are slowing**, and our latest European HY investor survey shows that almost half of the investors are looking to increase exposure over the next three months. This week, we also saw **improvements in the primary market for European banks** as issuance of covered bonds continued to rise and a good €3.6 billion of European bank bonds was issued, which is an improvement from almost nothing over the past seven weeks.

Foreign exchange

Despite gains in equities, a decline in the dollar, and a plunge in front-end vols last week, currency markets still look unstable this summer. The hurdle is bond issuance. European sovereigns and financials must redeem more debt in June/July than in any other two-month period over the next two years. This funding hump implies two paths for FX. The **smooth scenario** results in modest spread widening and modestly lower EUR/USD and a weaker euro on the crosses. Late summer would see EUR/USD retrace as risky market rally. The **disruptive scenario** looks more like May: significant widening, a steep EUR/USD decline, but EUR strength versus commodity currencies and high-yielders as volatility surges again and carry is unwound.

Handicapping the odds around each scenario is close to guesswork. Issuance levels are low, but policy options to smooth the process are obvious and easy to implement quickly. The environment is thus too fluid for bold forecasts or trades, so we make few changes this week. The EUR/USD forecast for 3Q remains at 1.25 on a view that the currency will stabilize after this financing hump and retrace a few cents higher with equities. USD/JPY should range trade with rates markets, and will have little momentum in either direction while low inflation constrains the sell-off in US rates and significant deleveraging already has reduced yen shorts. On trades, we hold little risk, adding a long in SEK versus NOK to an existing short in EUR/CHF.

Ten-year Government bond yields

	Current	Jun 10	Sep 10	Dec 10	Mar 11
United States	3.23	3.30	3.60	4.00	4.25
Euro area	2.57	2.60	2.90	3.15	3.25
United Kingdom	3.46	3.55	3.75	3.95	4.15
Japan	1.23	1.40	1.50	1.55	1.55
GBI-EM	6.88			7.90	

Credit markets

	Current	YTD Return
US high grade (bp over UST)	184	3.6%
Euro high grade (bp over Euro gov)	212	2.8%
USD high yield (bp vs. UST)	731	2.8%
Euro high yield (bp over Euro gov)	793	2.6%
EMBIG (bp vs. UST)	345	3.5%
EM Corporates (bp vs. UST)	373	3.6%

Foreign exchange

	Current	Jun 10	Sep 10	Dec 10	Mar 11
EUR/USD	1.21	1.25	1.25	1.20	1.18
USD/JPY	91.7	87	90	93	96
GBP/USD	1.45	1.44	1.39	1.35	1.34

Commodities - quarterly average

	Current	10Q2	10Q3	10Q4	11Q1
WTI ($/bbl)	74	86	94	93	90
Gold ($/oz)	1226	1150	1250	1200	1175
Copper($/m ton)	6382	8000	7150	6750	6500
Corn ($/Bu)	3.71	3.75	3.90	3.80	4.00

Source: J.P. Morgan, Bloomberg, Datastream

Commodities

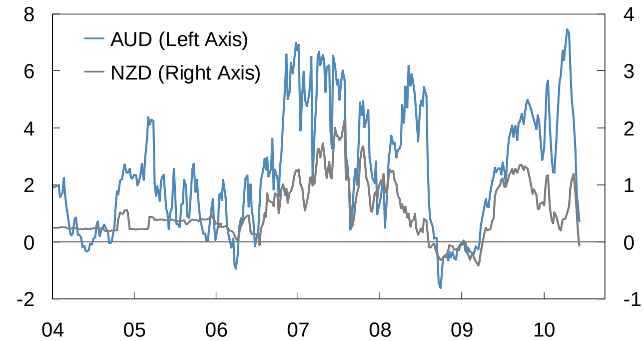
Commodities were up just over 3% last week, driven largely by oil and industrial metals. Our continuing view remains that financial market turmoil will not feed through to the global economy. **We remain bullish medium term, on the strength of global manufacturing and the economic recovery.**

Oil is now around $74, an increase of 3.5% for the week, as data on inventories in the US showed a decline and pressure increased on the oil industry following the Macondo spill in the Gulf of Mexico. The UK announced a review of procedures in the North Sea and Norway said it will not allow any new deep water drilling until it fully understands the cause of the oil spill in the Gulf. **Be long crude oil.**

AUD and NZD Commentary

- **The crisis in Europe is far from over, with heavy sovereign and financial refundings ahead in June and July. Yet, financial strains should ease over time, possibly reflecting more aggressive policy actions.**
- **Far-advanced deleveraging suggests AUD, NZD are well place to gain from further easing of financial strains.**
- **ST ranges are intact for AUD/USD and NZD/USD as the early-June highs/May breakdown levels should define whether a deeper corrective phase is underway.**

Chart1: AUD & NZD speculatiive net longs on the IMM
USD billion



Source: J.P. Morgan

AUD/USD - Daily chart

- AUD and NZD were among the best-performing major currencies over the past week, rising 3¼% and 2.9% vs the USD, respectively, as equities posted broadbased gains amid signs of easing of credit and funding stresses in the Euro area.
- However, the crisis in the euro area is far from over. The hurdle is bond issuance. European sovereigns and financials must redeem more debt in June/July than in any other two-month period over the next two years. At a time when sovereign credibility runs thin, refundings could become disorderly, renewing the systemic stress which drives high-beta currencies lower, particularly against the USD and the JPY.
- The policy options to ease funding strains are obvious - an extension of ECB repos, asset purchases and government guarantees for bank debt issuance. Thus, while the ECB failed to take decisive policy initiative to ease funding pressures for sovereigns or the banks last week, we still anticipate a gradual easing of European financial strains that would support high-beta G10 currencies. Moreover, deleveraging already has run a long way, suggesting that AUD and NZD are well-placed to ride ot renewed financial makrte tensions and to benefit from further easing of strains (Chart 1).

Technical analysis

- The short term range action continues to develop for both AUD/USD and NZD/USD after holding several key medium term support levels. As key resistance levels continue to cap the upside, there is still no confirmation of a short term low for both pairs. Still, there are several factors that suggest an improving backdrop. In that regard, the medium term momentum setup is as oversold as the March '09 timeframe coinciding with the broad risk recovery phase. Moreover, last week's price action confirmed upside reversal weeks for both AUD/USD and NZD/USD while raising the risk that additional upside follow-through can develop. Importantly, the critical levels remain well-defined which should be broken for confirmation of the improved backdrop.
- For AUD/USD, the key test enters at the .8555/.8600 resistance zone which represents the early-June high and the May breakdown area. Above would confirm the potential double bottom (May/June lows) and suggest a deeper short term retracement initially into the .8700 area, if not the .9000 area. For NZD/USD, the key levels start at the .6900/15 zone as breaks here confirm a deeper retracement into the .7130/.7200 zone. Failures at these levels will maintain the range bias and leave the door open to new lows.

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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	4Q09	1Q10	2Q10	3Q10	4Q10	1Q11	2Q11	1Q10	2Q10	4Q10	2Q11
The Americas														
United States	-2.4	3.5	3.1	5.6	3.0	4.0	4.0	3.5	2.5	2.5	2.4	1.8	0.9	1.1
Canada	-2.5	3.6	2.9	4.9	6.1	3.3	3.2	3.5	3.0	2.0	1.6	1.3	1.8	2.1
Latin America	-2.9	5.1 ↑	3.8	7.3 ↑	4.0 ↑	4.5	2.5 ↓	3.9 ↓	4.3	5.2 ↓	6.0	6.5	7.3	7.1
Argentina	-2.0	6.0	4.0	7.9	10.0	8.0	3.0	4.0	3.0	4.0	9.0	9.0	10.0	11.0
Brazil	-0.2	7.5 ↑	4.0	9.3 ↑	11.4 ↑	6.0 ↓	4.0 ↓	3.3 ↓	3.8	4.2	4.9	5.3	5.8	4.5
Chile	-1.5	5.0	6.0	6.2	-5.9	10.0	20.0	10.0	2.0	0.0	-0.3	3.3	4.0	3.8
Colombia	0.4	4.0 ↑	4.1	4.7	4.9 ↑	4.2 ↑	3.8 ↑	3.0 ↓	4.0 ↓	4.1 ↓	2.0	2.1	3.3	3.6
Ecuador	0.4	2.0	3.0	1.3	2.0	3.5	4.0	4.5	3.0	2.5	4.1	3.9	4.7	4.4
Mexico	-6.5	4.5	3.5	7.9	-1.4	3.2	-1.8	4.2	5.7	7.9	4.8	4.4	5.1	4.5
Peru	0.9	6.5	6.0	10.2 ↓	7.3	4.5	4.1	4.0	7.0	6.9	0.7	1.0	2.1	2.2
Venezuela	-3.3	-4.0	1.0	-5.3	-5.6	-5.0	5.0	1.0	1.0	1.0	27.4	31.8	33.7	39.3
Asia/Pacific														
Japan	-5.3 ↓	3.6 ↑	2.2	4.6 ↑	5.0 ↑	2.5	2.7	2.7	2.2	2.0	-1.2	-1.4	-0.7	0.1
Australia	1.3	2.9	3.5	4.5	2.0	2.7	4.1	4.2	3.1	3.2	2.9	3.6	3.8	3.6
New Zealand	-1.6	2.8 ↑	3.0 ↑	3.3	2.7 ↑	3.4 ↓	3.7	3.3 ↑	2.5 ↑	2.3	2.0	2.2	4.8 ↑	5.3 ↑
Asia ex Japan	4.6	8.9	7.2	8.6	11.6	6.7	6.3	6.8	7.1	7.4	4.3	5.1	5.0	4.1
China	8.7	10.8	9.4	10.8	13.1	9.4	9.3	9.0	9.1	9.5	2.2	3.2	3.1	2.4
Hong Kong	-2.8	6.8	4.2	10.0	10.0	4.3	4.0	3.8	4.2	4.3	1.9	2.4	2.3	1.9
India	7.2	8.3	8.5	6.9	9.1	7.8	7.4	8.7	8.0	8.3	15.3	16.3	14.5	11.4
Indonesia	4.5	6.2	5.8	6.2	5.4	6.0	4.0	5.0	6.5	6.5	3.7	5.3	6.3	4.9
Korea	0.2	5.9	4.0	0.7	8.8	4.0	3.8	3.8	4.0	4.0	2.7	2.8	3.4	3.6
Malaysia	-1.7	7.7	4.8	8.2	5.0	4.0	5.0	5.0	4.9	4.9	1.3	1.7	2.4	2.4
Philippines	1.1	6.8	4.3	7.6	12.9	3.6	4.9	4.0	4.5	4.5	4.3	5.0	5.2	4.9
Singapore	-1.3	10.5	4.3	-1.0	38.6	5.7	-11.5	4.9	7.4	7.4	0.9	3.4	4.7	3.7
Taiwan	-1.9	9.2	4.8	16.7	11.3	3.3	3.5	3.5	5.0	5.3	1.3	0.9	2.0	1.8
Thailand	-2.2	8.5	4.0	17.0	16.0	-2.0	2.8	2.8	6.0	5.5	3.7	5.5	4.4	3.0
Africa/Middle East														
Israel	0.7	3.0	4.5	4.8	3.3	3.5	3.0	3.0	4.0	5.0	3.5	3.0	3.0	3.2
South Africa	-1.8	3.0	3.5	3.2	4.6	4.0	3.5	3.7	3.6	2.8	5.7	4.9	5.8	5.7
Europe														
Euro area	-4.1	1.3 ↓	1.4 ↓	0.5	0.8	3.0	2.0	1.0 ↓	1.0 ↓	1.0 ↓	1.1	1.5	1.5	0.9
Germany	-4.9	2.2 ↑	2.2 ↓	0.7	0.6	5.0 ↑	3.0	2.0 ↓	2.0 ↓	1.5 ↓	0.8	1.0	1.2	0.9
France	-2.5	1.5 ↓	1.4 ↓	2.2	0.5	2.5 ↓	2.0	1.5 ↓	1.0 ↓	1.0 ↓	1.5	1.8	1.3	0.6
Italy	-5.1	1.2 ↓	1.3 ↓	-0.3 ↓	1.7 ↓	2.0 ↓	2.0 ↑	1.0 ↓	1.0 ↓	1.0 ↓	1.3	1.5	1.5	1.1
Norway	-1.5	1.7	2.7	1.6	0.6	2.5	3.0	3.0	2.5	2.5	2.9	3.0	1.6	0.7
Sweden	-5.1	3.6	3.0	1.7	5.9	4.5	3.5	3.0	2.8	2.8	1.0	0.8	1.8	2.8
Switzerland	-1.5	2.3 ↓	2.5 ↓	3.5	1.6	2.8	2.5 ↓	2.3 ↓	2.3 ↓	2.5 ↓	1.1	1.1 ↑	0.9	0.6 ↓
United Kingdom	-4.9	1.5	3.0	1.8	1.2	3.0	3.0	3.5	2.5	3.0	3.3	3.5	2.6	1.7
Emerging Europe	-4.9 ↑	4.2	4.4 ↓	2.3	2.1 ↑	7.9 ↓	3.1 ↓	3.2 ↓	4.0	4.2 ↓	6.1	5.4 ↑	5.5	5.4
Bulgaria	-5.0	-0.5	4.0 ↓	...	...	...	...	...	...	...	...	...	...	...
Czech Republic	-4.1 ↑	2.0	3.2 ↓	2.2 ↓	2.0 ↑	2.5 ↓	2.5	2.3 ↑	2.5 ↓	3.0 ↓	0.7	1.3	2.8	2.7 ↓
Hungary	-6.3	0.8	3.0 ↓	0.8	3.6	2.0	2.0	1.0 ↓	3.5	2.5 ↓	6.0	5.3 ↑	4.1 ↑	3.3 ↑
Poland	1.8	3.2	3.7 ↓	4.5	2.0	3.0 ↓	2.5 ↓	2.5 ↓	3.0	4.0	3.0	2.3 ↑	2.6	2.6 ↓
Romania	-7.1	1.0	2.8 ↓	...	...	...	...	...	...	...	4.6	4.4	4.7	4.5
Russia	-7.9	5.5	5.0	2.7	2.2	13.5	4.0	4.0	5.0	5.0	7.2	5.8	6.7	7.0
Turkey	-4.7	5.9	5.0	...	...	...	...	...	...	...	9.3	9.3	7.5	6.7
Global	-2.5	3.6	3.1 ↓	4.3 ↑	3.7	3.9 ↓	3.4 ↓	3.2 ↓	2.8 ↓	2.9 ↓	2.2	2.2	2.0	1.8 ↓
Developed markets	-3.5	2.7	2.5 ↓	3.5	2.6	3.3	3.1	2.6 ↓	2.0 ↓	2.0 ↓	1.5	1.4	1.0	1.0
Emerging markets	1.0	7.0 ↑	5.8	7.1 ↑	7.9 ↑	6.3	4.7 ↓	5.4	5.8	6.2	5.1	5.4	5.6	5.0
Memo:														
Global — PPP weighted	-0.8	4.8	4.2	5.3	5.3	5.0	4.3	4.2	4.0	4.0	3.3	3.5	3.3	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	Jun 10	Sep 10	Dec 10	Mar 11	Jun 11
Global	GDP-weighted average	1.33	-333				1.34	1.41	1.49	1.56	1.76
excluding US	GDP-weighted average	1.90	-245				1.91	2.02	2.13	2.24	2.36
Developed	GDP-weighted average	0.53	-359				0.53	0.55	0.58	0.63	0.83
Emerging	GDP-weighted average	4.55	-231				4.57	4.85	5.09	5.29	5.50
Latin America	GDP-weighted average	6.29	-264				6.30	6.85	7.31	7.49	7.77
CEEMEA	GDP-weighted average	4.05	-281				4.05	4.07	4.22	4.24	4.53
EM Asia	GDP-weighted average	4.09	-201				4.13	4.40	4.59	4.87	5.01
The Americas	GDP-weighted average	0.83	-476				0.83	0.92	1.00	1.06	1.43
United States	Federal funds rate	0.125	-512.5	16 Dec 08 (-87.5bp)	23 Jun 10	2Q 11 (+25bp)	0.125	0.125	0.125	0.125	0.50
Canada	Overnight funding rate	0.50	-375	1 Jun 10 (+25bp)	20 Jul 10	20 Jul 10 (+25bp)	0.50	1.00	1.50	2.00	2.50
Brazil	SELIC overnight rate	10.25	-175	**9 Jun 10 (+75bp)**	21 Jul 10	21 Jul 10 (+75bp)	10.25	11.50	12.50	12.50	12.50
Mexico	Repo rate	4.50	-270	17 Jul 09 (-25bp)	18 Jun 10	2Q 11 (+25bp)	4.50	4.50	4.50	4.50	4.75
Chile	Discount rate	0.50	-450	9 Jul 09 (-25bp)	15 Jun 10	15 Jun 10 (+25bp)	0.75	1.50	2.25	3.75	5.00
Colombia	Repo rate	3.00	-600	30 Apr 10 (-50bp)	18 Jun 10	1Q 11 (+50bp)	3.00	3.00	3.00	4.00	5.00
Peru	Reference rate	1.75	-275	**10 Jun 10 (+25bp)**	8 Jul 10	8 Jul 10 (+25bp)	1.75	2.25	3.00	3.75	4.50
Europe/Africa	GDP-weighted average	1.28	-325				1.28	1.29	1.33	1.38	1.48
Euro area	Refi rate	1.00	-300	7 May 09 (-25bp)	8 Jul 10	On hold	1.00	1.00	1.00	1.00	1.00
United Kingdom	Repo rate	0.50	-500	5 Mar 09 (-50bp)	8 Jul 10	10 Feb 11 (+25bp)	0.50	0.50	0.50	0.75	1.00
Sweden	Repo rate	0.25	-325	2 Jul 09 (-25bp)	1 Jul 10	1 Jul 10 (+25bp)	0.25	0.75	1.00	1.25	1.50
Norway	Deposit rate	2.00	-250	5 May 10 (+25bp)	23 Jun 10	22 Sep 10 (+25bp)	2.00	2.25	2.50	2.75	3.25
Czech Republic	2-week repo rate	0.75	-200	6 May 10 (-25bp)	23 Jun 10	2Q 11 (+25bp)	0.75	0.75	0.75	0.75	1.00
Hungary	2-week deposit rate	5.25	-250	26 Apr 10 (-25bp)	21 Jun 10	**3Q 11 (+25bp)**	5.25	5.25	5.25	5.25	5.25
Israel	Base rate	1.50	-250	28 Mar 10 (+25bp)	28 Jun 10	3Q 10 (+25bp)	1.50	1.75	2.00	2.25	2.50
Poland	7-day intervention rate	3.50	-100	24 Jun 09 (-25bp)	30 Jun 10	**2Q 11 (+25bp)**	3.50	3.50	3.50	3.50	3.75
Romania	Base rate	6.25	-75	4 May 10 (-25bp)	30 Jun 10	**3Q 11 (+25bp)**	6.25	6.25	6.25	6.25	6.25
Russia	1-week deposit rate	2.75	-25	31 May 10 (-50bp)	Jun 10	2Q 11 (+25bp)	2.75	2.75	2.75	2.75	3.25
South Africa	Repo rate	6.50	-300	25 Mar 10 (-50bp)	22 Jul 10	2Q 11 (+50bp)	6.50	6.50	6.50	6.50	7.00
Switzerland	3-month Swiss Libor	0.25	-225	12 Mar 09 (-25bp)	17 Jun 10	16 Dec 10 (+25bp)	0.25	0.25	0.50	0.75	1.00
Turkey	1-week repo rate	7.00	-1050	-	17 Jun 10	14 Oct 10 (+25bp)	7.00	7.00	7.75	7.75	7.75
Asia/Pacific	GDP-weighted average	2.18	-126				2.20	2.34	2.44	2.59	2.67
Australia	Cash rate	4.50	-175	4 May 10 (+25bp)	6 Jul 10	Aug 10 (+25bp)	4.50	4.75	5.00	5.25	5.50
New Zealand	Cash rate	2.75	-525	**10 Jun 10 (+25bp)**	28 Jul 10	29 Jul 10 (+25bp)	2.75	3.25	3.75	4.25	4.50
Japan	Overnight call rate	0.10	-43	19 Dec 08 (-20bp)	15 Jun 10	4Q 11 (+15bp)	0.10	0.10	0.10	0.10	0.10
Hong Kong	Discount window base	0.50	-625	17 Dec 08 (-100bp)	24 Jun 10	2Q 11 (+25bp)	0.50	0.50	0.50	0.50	1.00
China	1-year working capital	5.31	-126	22 Dec 08 (-27bp)	2Q 10	3Q 10 (+27bp)	5.31	5.58	5.85	6.12	6.12
Korea	Base rate	2.00	-250	12 Feb 09 (-50bp)	8 Jul 10	3Q 10 (+25bp)	2.00	2.25	2.50	2.75	3.00
Indonesia	BI rate	6.50	-200	5 Aug 09 (-25bp)	5 Jul 10	1Q 11 (+25bp)	6.50	6.50	6.50	6.75	7.00
India	Repo rate	5.25	-250	20 Apr 10 (+25bp)	27 Jul 10	2Q 10 (+25bp)	5.50	6.00	6.00	6.50	6.75
Malaysia	Overnight policy rate	2.50	-100	13 May 10 (+25bp)	8 Jul 10	3Q 10 (+25bp)	2.50	3.00	3.00	3.00	3.00
Philippines	Reverse repo rate	4.00	-350	9 Jul 09 (-25bp)	15 Jul 10	24 Aug 10 (+25bp)	4.00	4.25	4.25	4.50	4.75
Thailand	1-day repo rate	1.25	-200	8 Apr 09 (-25bp)	14 Jul 10	20 Oct 10 (+25bp)	1.25	1.25	1.75	2.00	2.25
Taiwan	Official discount rate	1.25	-188	18 Feb 09 (-25bp)	2Q 10	3Q 10 (+25bp)	1.25	1.50	1.75	2.00	2.25

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

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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	1.3	2.9	3.5	3.4	1.1	4.5	2.0	2.7	4.1	4.2	3.1	3.2	4.2	2.8
Private consumption	1.6	2.0	2.0	5.1	1.3	3.6	2.3	0.8	0.4	1.6	2.8	2.4	2.4	2.0
Construction investment	-0.5	1.5	6.0	-2.8	2.6	1.1	-3.3	4.7	6.2	6.4	5.5	5.0	7.9	7.8
Equipment investment	-3.4	8.5	10.0	0.1	-13.1	46.8	-20.9	37.6	12.9	17.5	5.1	3.4	6.4	8.6
Public investment	4.9	32.3	9.7	13.5	43.6	49.7	55.4	14.7	10.3	10.9	7.1	11.8	7.1	10.1
Government consumption	2.8	3.6	1.7	3.4	5.4	7.5	3.3	0.1	3.9	0.2	0.1	3.7	3.7	0.4
Exports of goods & services	1.4	2.5	4.2	8.4	-6.5	8.3	-2.0	4.1	6.1	4.9	4.1	2.8	4.1	4.1
Imports of goods & services	-7.8	10.9	4.1	3.5	18.0	36.6	7.3	0.0	3.2	3.2	4.1	6.1	3.2	8.2
Contributions to GDP growth:														
Inventories	-0.5	-0.9	-0.6	0.9	2.9	0.7	0.7	-8.1	0.0	-0.1	-0.2	0.1	-0.2	-0.1
Net trade	2.0	-1.7	-0.1	0.9	-4.6	-5.0	-2.0	0.8	0.5	0.2	-0.1	-0.8	0.1	-1.0
GDP deflator (%oya)	0.2	3.1	2.4	0.1	-2.1	-1.5	1.4	4.1	3.7	3.2	2.2	2.4	2.5	2.5
Consumer prices (%oya)	1.8	3.5	3.6	1.5	1.3	2.1	2.9	3.6	3.5	3.8	3.8	3.6	3.6	3.7
Producer prices (%oya)	-5.4	1.6	3.5	-6.4	-7.2	-6.8	-0.2	1.4	1.1	4.0	2.5	3.5	4.0	4.0
Trade balance (A$ bil, sa)	-6.8	-20.2	-22.2	-0.9	-4.1	-5.0	-4.0	-5.1	-5.6	-5.5	-5.5	-5.3	-5.0	-6.4
Current account (A$ bil, sa)	-51.4	-69.6	-73.9	-12.7	-13.8	-18.5	-16.6	-17.2	-17.9	-17.9	-18.2	-18.1	-18.0	-19.6
as % of GDP	-4.1	-5.2	-5.2	-4.1	-4.4	-5.8	-5.1	-5.2	-5.3	-5.3	-5.3	-5.2	-5.0	-5.4
3m eurodeposit rate (%)*	6.0	4.9	5.7	3.5	3.4	4.1	4.2	4.8	5.3	5.5	5.7	5.7	5.8	5.8
10-year bond yield (%)*	5.6	5.8	6.0	5.5	5.1	5.8	5.5	5.9	5.9	6.1	6.0	6.0	6.0	6.0
US$/A$*	0.75	0.89	0.87	0.82	0.88	0.91	0.94	0.82	0.87	0.92	0.90	0.88	0.86	0.84
Commonwealth budget (FY, A$ bil)	-27.0	-57.1	-27.0											
as % of GDP	-2.1	-4.3	-1.9											
Unemployment rate	5.6	5.4	5.3	5.7	5.8	5.6	5.3	5.4	5.5	5.5	5.4	5.3	5.2	5.0
Industrial production	-7.9	3.3	1.5	4.8	-4.2	22.1	0.2	0.0	-1.0	-2.0	0.0	1.0	2.0	3.0

*All financial variables are period averages

Australia - summary of main macro views

- The Australian **economy** powered out of the global downturn largely unscathed. Growth probably will be close to trend in 2010, but above trend in 2011, despite the further withdrawal of policy support.
- **Business investment** will be down slightly in the year to June, but investment spending probably will rise close to 20% in 2010-11, with mining leading the way.
- On **housing**, with the expanded first home owners' grant now having expired and price caps on the basic grant in place, house price growth should cool, particularly at the low and middle-end of the price spectrum.
- **Consumer confidence** has deteriorated sharply owing mainly to rising mortgage rates. The consumer confidence index has shed 16% since October 2009, when the RBA starting tightening policy.
- **Export volumes** have held up owing mainly to firm demand from China, but the terms of trade tumbled.This decline is reversing, thanks mainly to higher bulk commodity prices; we forecast a 25% rise.
- The **RBA** was the first central bank in the G20 to tighten policy and has hiked six times since last October. We now expect a pause, which will be extended if recent financial troubles spill over to real economies.
- The recent **Commonwealth budget** was "beige", with bolder policy announcements probably delayed until closer to this year's Federal election.

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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)	-1.6	2.8	3.0	0.6	1.1	3.3	2.7	3.4	3.7	3.3	2.5	2.3	3.7	3.2
Private consumption	-0.6	2.2	1.7	1.6	3.5	3.4	1.0	3.1	1.1	0.5	2.0	1.5	2.0	3.5
Fixed Investment	-13.5	0.1	4.6	-1.6	-6.2	-3.5	-1.4	5.3	5.5	5.7	2.2	4.1	6.0	7.3
Residential construction	-18.7	4.6	4.7	-9.3	-15.3	21.1	8.0	4.0	4.8	6.0	3.2	4.8	6.0	4.0
Other fixed investment	-12.4	-0.8	4.6	0.0	-4	-7.6	-3.2	5.6	5.6	5.6	2.0	4.0	6.0	8.0
Inventory change (NZ$ bil, saar)	-1.7	0.9	0.4	-1.0	-0.7	0.2	0.3	0.2	0.2	0.2	0.1	0.1	0.1	0.1
Government spending	1.5	2.4	1.9	-5.0	2.4	3.6	3.6	2.4	1.6	2.4	1.6	2.4	2.0	0.4
Exports of goods & services	0.0	7.9	8.8	19.8	0.7	-3.4	12.5	12.0	11.0	10.0	8.0	7.0	8.0	8.0
Imports of goods & services	-15.2	10.1	5.6	-10.3	6.2	26.4	11.5	8.0	5.0	6.0	4.0	5.0	7.0	9.0
Contributions to GDP growth:														
Domestic final sales	-5.0	1.6	2.4	0.6	-0.4	1.7	0.9	3.5	2.1	2.7	1.9	1.6	3.6	3.2
Inventories	-2.5	2.0	-0.4	-9.0	3.3	11.1	1.8	-1.2	-0.2	-0.6	-0.6	0.1	-0.2	0.5
Net trade	5.9	-0.8	1.0	9.7	-1.7	-8.8	0.0	1.0	1.8	1.2	1.3	0.6	0.3	-0.4
GDP deflator (%oya)	1.9	1.3	2.2	2.0	2.7	0.1	-0.2	1.0	1.8	2.8	2.8	2.4	1.9	1.6
Consumer prices	2.1	4.9	3.5	2.3	5.3	-0.7	1.5	2.8	3.3	12.1	3.3	2.9	3.9	3.8
%oya	2.1	2.7	4.9	1.9	1.7	2.0	2.0	2.2	1.7	4.8	5.3	5.3	5.5	3.5
Trade balance (NZ$ bil, sa)	2.5	2.5	1.2	0.8	0.6	0.2	1.2	0.4	0.4	0.6	0.5	0.3	0.3	0.1
Current account (NZ$ bil, sa)	-5.6	-12.1	-12.9	-0.4	0.0	-3.1	-1.2	-2.8	-4.3	-3.1	-1.9	-5.2	-2.7	-2.5
as % of GDP	-3.1	-6.5	-6.5	-0.9	0.1	-6.9	-6.2	-9.4	-6.5	-3.9	-5.5	-5.2	-7.4	-8.1
Yield on 90-day bank bill (%)*	3.0	3.1	4.4	2.8	2.8	2.8	2.7	2.8	3.3	3.8	4.3	4.4	4.5	4.5
10-year bond yield (%)*	5.5	5.9	6.1	5.7	5.7	5.9	5.7	6.0	6.0	6.1	6.1	6.1	6.0	6.0
US$/NZ$*	0.64	0.72	0.72	0.60	0.68	0.73	0.73	0.67	0.71	0.75	0.73	0.71	0.71	0.71
Commonwealth budget (NZ$ bil)	-4.0	-7.2	-7.1											
as % of GDP	-2.2	-3.8	-3.6											
Unemployment rate	6.1	6.1	5.4	5.9	6.5	7.1	6.0	6.3	6.3	5.9	5.7	5.4	5.3	5.2

*All financial variables are period averages

New Zealand - summary of main macro views

- The **New Zealand economy** expanded at a healthy clip of 0.8%q/q in 4Q, driven again by firm private consumption. Inventories, though, were not the drag on growth we expected. In fact, inventories were built up by NZ$172 million, after three quarters of run downs.
- **Business confidence** is elevated and investment plans firm. Investment will, though, remain a drag on GDP growth this year.
- The **unemployment** rate tumbled to 6% in 1Q (from 7.1%), although is unlikely to fall far below this level in the near-term. Actual hiring remains well-below long run averages, and with corporate profitability fall in 1Q, new hiring will likely be postponed.
- **The RBNZ hiked the OCR 25bp in June.** The accompanying commentary was hawkish and we expect a 25bp rate hike at each of the remaining four announcements this year, taking the OCR to 3.75% by year end.
- **Inflation** returned to positive territory in 1Q, after falling in the final three months of 2009. Medium term inflation pressures are a concern, given diminishing excess capacity and firms' intentions to raise domestic prices.
- Managing **inflation expectations** will be a growing challenge for the RBNZ, given the July 1 introduction of the amended ETS and the GST hike on October 1.

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Australia and New Zealand economic calendar

Monday	Tuesday	Wednesday	Thursday	Friday
14 Jun New Zealand: Retail sales (10:45 am) Apr -0.6%m/m, sa *Holiday Australia*	15 Jun Australia: RBA Board minutes (11.30am) Jun	16 Jun Australia: Westpac leading index (10: 30 am) Apr Dwelling starts (11:30 am) 1Q 6.0%q/q, sa	17 Jun	18 Jun
21 Jun Australia: New motor vehicle sales (11:30 am) May New Zealand: Visitor arrivals (10:45 am) May	22 Jun New Zealand: Credit card spending (3:00 pm) May	23 Jun New Zealand: Current account balance (10:45 am) 1Q	24 Jun New Zealand: GDP (10:45 am) 1Q	25 Jun New Zealand: Trade balance (10:45 am) May
28 Jun	29 Jun New Zealand: Building permits (10:45 am) May	30 Jun Australia: Pvt. Sector credit (11:30 am) May	1 Jul Australia: Retail sales (11: 30 am) May Building approvals (11:30 am) May New Zealand: ANZ commodity prices (3:00 pm) Jun	2 Jul
5 Jul Australia: ANZ job ads (11:30 am) Jun	6 Jul Australia: Trade balance (11:30 am) May RBA cash target (2:30 pm) Jul	7 Jul	8 Jul Australia: Unemployment rate (11:30 am) Jun	9 Jul

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Global Data Diary

Week / Weekend	Monday	Tuesday	Wednesday	Thursday	Friday
14 - 18 June	14 June	15 June	16 June	17 June	18 June
United Kingdom • Consumer confidence (May)	Euro area • IP (Apr) India • WPI (May) Japan • IP final (Apr)	Chile • BCCh mtg: +25bp Euro area • Foreign trade (Apr) • Employment (1Q) Germany • ZEW bus surv (Jun) Japan • BoJ MPM mtg: no chg • Shirakawa press conf United Kingdom • CPI (May) United States • Empire State surv (Jun) • NAHB surv (Jun)	Brazil • Retail sales (Apr) Euro area • Labor costs (1Q) • HICP final (May) Israel • GDP, 2nd rel (1Q) Russia • IP (May) United Kingdom • Labor mkt report (May) United States • Housing starts (May) • IP (May) • Bernanke speech	Japan • Reuters Tankan (Jun) Switzerland • SNB mtg: no chg Turkey • CBRT mtg: no chg United Kingdom • Retail sales (May) United States • CPI (May) • Philly Fed surv (Jun) • Leading indicators (May)	Argentina • IP (May) • GDP (1Q) Belgium • BNB cons conf (Jun) Colombia • BanRep mtg: no chg Japan • MPM mtg minutes (May) Mexico • Banxico mtg: no chg Netherlands • CBS cons conf (Jun) Poland • IP (May)
21 - 25 June	21 June	22 June	23 June	24 June	25 June
	Hungary • NBH mtg: no chg Japan • All sector act index (Apr)	Canada • CPI (May) Euro area • Cons conf (Jun) Germany • IFO bus surv (Jun) United Kingdom • Budget report United States • Existing home sales (May) • Richmond Fed surv (Jun)	Czech Republic • CNB mtg: no chg Euro area • PMI flash (Jun) France • INSEE bus conf (Jun) Germany • GfK cons conf (Jul) Norway • Norges bank: no chg United Kingdom • MPC minutes United States • New home sales (May) • FOMC mtg: no chg	Japan • Trade balance (May) Netherlands • CBS bus conf (Jun) Taiwan • CBC mtg: no chg Turkey • Cap utilization (May) United States • Durable goods (May) • KC Fed surv (Jun)	Japan • Core CPI (May) Singapore • IP (May) United States • GDP, 3rd rel (1Q) • Cons sent final (Jun)

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