J.P.Morgan

Australia and New Zealand - Weekly Prospects

Summary

June 21, 2010

Contents

- A quiet time for data in **Australia** last week is followed by another this week. The modest highlight will be the May car sales results today; we expect a 5%m/m fall after the unexpectedly healthy rise in April. Most market attention will remain focussed of whether there is a truce in the "war" between the government and mining companies over the merits of the planned 40% tax on "super" profits. It could come any day (or maybe not, depending on who you talk to), but the pressure is mounting on the government to give ground as the election nears. On that, we still think October is the most likely timing for the only opinion poll that matters. The risk is that it is later, perhaps even as late as April 2011. The highlight last week was the release of the minutes of the RBA's June Board meeting; the message was that officials are in no rush to hike again. We expect the next move in August.

- **New Zealanders** remain upbeat, but reluctant to spend, according to data released last week. Consumer confidence rose again in 2Q, thanks to the recently announced personal income tax cuts, but retail sales fell in April. We suspect that, barring the likely 'bring forward' of spending ahead of the October 1 GST hike, consumer spending will remain subdued; this is especially true considering the consolidation of household balance sheets expected in the period ahead. RBNZ Governor Alan Bollard highlighted last week that households have acknowledged their overexposure to property and high debt levels, and are "prepared to constrain consumption to improve their savings." The GDP numbers this week will likely confirm that household consumption moderated considerably in the March quarter. Our forecast is for first quarter GDP growth of a healthy 0.7%q/q.

- One underpinning of our optimistic **global growth** forecast has been the positive feedback loop between the real economy and financial markets. The rise in global risk aversion that triggered the May market swoon challenged this outlook. More recently, the improved tone in financial markets hints that investors are gaining conviction that spillover from peripheral Europe will be limited, in line with our world view. That this is occurring against a backdrop of somewhat softer US data on retail sales, housing starts, and jobless claims is notable. Global equity prices have risen almost 6% over the past two weeks, with a comparable-size gain in Europe. Our commodity price index is up by a similar amount, while the dollar has fallen.

- The one-size-fits-all **monetary policy** stance that existed at the outset of the global recovery last year continues to fragment against concerns surrounding the spillover from the Euro sovereign credit crisis. The G-3 central banks appear strongly committed to a low-for-long policy. Last week, we pushed back the first ECB hike beyond 2011 in response a downgrade in our growth outlook for the region. We also delayed the expected onset of Fed tightening to 4Q11. However, unlike our ECB call, this is not motivated by a change in our US growth outlook—which remains intact—but rather reflects growing conviction that inflation will trend lower in the coming quarters and that this will weigh heavily in the Fed's reaction function. Also, an increased commitment to end deflation is now expected to keep the BoJ on hold until 2Q12.

This week's highlight

New Zealand's March quarter GDP numbers will be released on Thursday. We expect GDP to print at 0.7%q/q, or 1.9%oya.

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Data and event previews - Australia and New Zealand

			Forecast		
Date	**Time** [(a)]	**Data/event**	**JPMorgan**	Consensus [(b)]	***Previous***
Monday, June 21	11.30am	Aust. new motor vehicle sales (%m/m, May)	**-5.0**	na	*8.4*
Tuesday, June 22	1.00pm	NZ credit card spending (%m/m, May)	**na**	na	*-1.2*
Wednesday, June 23	8.45am	NZ current account balance (NZ$bn., 1Q)	**-1.4**	-0.25	*-3.6*
Thursday, June 24	8.45am	NZ GDP (%q/q, 1Q)	**0.7**	0.5	*0.8*
Thursday, June 24	10.00am	Conference Board Leading Index (%m/m, Apr.)	**na**	na	*0.3*
Friday, June 25	8.45am	NZ trade balance (NZ$mn., May)	**1000**	767	*656*

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

Australia

New motor vehicle sales (%m/m, May) - We expect car sales to have suffered a payback in May, likely falling 5%m/m. It is tempting to ascribe the prior month's 3%m/m bounce to the looming end of the financial year, though late delivery of vehicles purchased near the end of 2009 (sales are counted on delivery, not contract signing) under the government's investment allowance probably played a greater role.

New Zealand

Credit card spending (%m/m, May) - This volatile series is likely to post a small rise in May, after dropping 1.2%m/m in April. Our forecast calls for a rise in credit card spending of 0.8%m/m last month, although we expect this series to trend south in the foreseeable future amid building evidence that households are becoming increasingly cautious and reluctant to take on debt.

Current account balance (NZ$bn., 1Q) - The CAD will have more than halved in 1Q, owing to the trade balance moving into surplus. After coming in at -NZ$3.6 billion in 4Q, the CAD should have narrowed to NZ$1.4 billion in the March quarter, and account for 3.3% of GDP.

GDP (%q/q, 1Q) - We expect that the New Zealand economy grew 0.7%q/q in 1Q, slowing only slightly from 4Q. Annual GDP growth will print at 1.9%oya, the fastest rate of growth in two years. On our forecasts, inventories, government spending, net exports, and private consumption will have added to growth. Investment, though, will have remained a drag on growth for the seventh straight quarter, owing entirely to nonresidential investment, which posted yet another fall; residential investment rose over the quarter. The belated GDP data will have few implications for near-term policy decisions.

Trade balance (NZ$mn., May) - Our forecast is for the trade balance to have risen to a surplus of NZ$1 billion in May, from NZ$656 million in the previous month. Exports will have crept up, thanks to firm demand for New Zealand's major trading partners in Asia and Australia. Imports will likely have held steady, although underpinned by weaker NZD.

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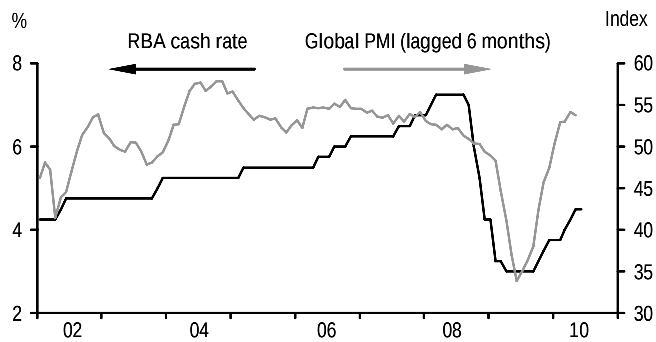
Australia

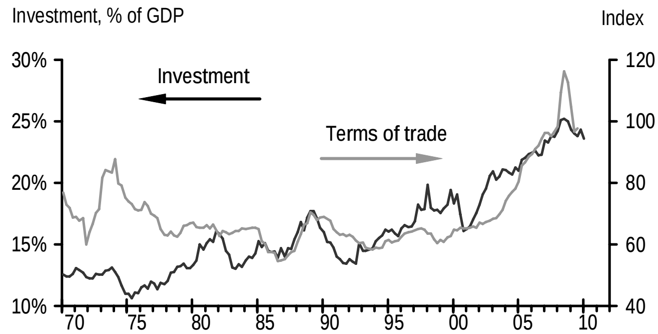
- **RBA Board minutes hint policy on hold near term**
- **Aussie housing starts still growing into new year**
- **Car sales due for some payback in May**

The dataflow in Australia was gentle last week, offering only the June RBA minutes and housing starts for 1Q. Neither of these releases offered any great surprises: the RBA are temporarily on hold having pushed borrowing rates back to "average" levels and given concerns around the global outlook, while dwelling starts posted a solid rise in 1Q, given spillovers from previous solid building approvals numbers, and with low interest rates remaining supportive of investment. This week sees only the solitary Aussie data point of May car sales—which we expect to have declined.

Australia: RBA cash rate and J.P. Morgan global manufacturing PMI



Terms of trade and investment as a share of GDP



RBA Board in "wait and see" mode

The Reserve Bank last week released the minutes from its June Board meeting, at which officials left the cash rate unchanged. There were few surprises. The minutes confirmed that the RBA's decision to pause earlier this month was influenced by the troubling events in Europe. RBA officials decided to await further information on how the recent market uncertainty might affect the global economy, and how conditions locally were adapting to the material change in the stance of RBA policy. This uncertainty seemingly has allowed the RBA scope to adopt a "wait and see" approach, but the forthcoming inflation numbers will likely be the trigger for the next policy move. The minutes explicitly mentioned that the RBA Board was awaiting the new information in the 2Q CPI data.

We expect that the Bank will resume its rate-tightening policy in August after the late-July release of the 2Q CPI data, providing conditions offshore do not deteriorate further. We expect that both headline and core inflation will print at uncomfortably high levels in the June quarter with risks to the upside. Indeed, the near 7% plunge in AUD in trade-weighted terms since early May could place upward pressure on import prices in coming months. RBA officials are also wary that, following recent data on prices and wages, the disinflationary forces in the economy were not quite as strong as previously expected.

On the global economy, RBA officials are on alert that recent events in Europe pose a risk to the global growth outlook, although it is too early to tell what the impact would be. Officials suggested that if the current troubles in Europe were to spill over into the real economy, it would be via traditional trade channels, but also through a sustained effect on global attitudes to risk. For now, however, the Board acknowledged that the recent data on global economic activity had generally been positive, and noted that the global economy was expanding at a firm pace to date this year.

RBA Board members maintain that conditions in Asia, where 60% of Australia's exports are headed, were "quite strong." Growth in Asia had continued to surprise on the upside, mainly owing to improvement in domestic demand. The Board noted that, in China in particular, growth was strong in retail sales, investment, and exports in the first four months of the year, while in the US, economic conditions had continued to improve; this seemed to counterbalance the reference to the recent weakness in Europe.

RBA members noted that the medium-term outlook for the Australian economy remained positive, even though conditions had been mixed. The minutes cited the stimulative impact of the strength in the terms of trade and strong employment growth, but also noted that retail spending had been subdued and there had been signs of slowing in the housing market. Indeed, there is mounting evidence that Aussie households have crossed the interest rate pain threshold, following official rate hikes at six of the previous eight RBA Board meetings. Consumer confidence, for

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example, has slumped, with sentiment among mortgage holders recently falling the most.

Interestingly, the minutes also highlighted that recent business surveys pointed to strong growth in capital spending, "especially in the mining sector." There was no mention, however, of the heated debate over the merits of the government's proposed 40% tax on the "super profits" of mining companies, which currently clouds the investment outlook. Furthermore, the RBA Board noted that the policy changes announced in the Budget in May were broadly neutral, with the projected improvement in the fiscal position owing to the effects of the improving economy (namely the rising terms of trade) and the winding back of stimulus measures.

While the events in Europe, understandably, have become more prominent in RBA decision making, the underlying position on Australia does not appear to have changed materially. The RBA's tightening cycle has paused, not ended. Indeed, our forecast calls for another quarter-point rate hike in August, and for a further hike before the end of the year. The dominant risk, however, is that the RBA stays on hold for longer, but this would only occur if there is clear evidence that the events in Europe had caused a material spillover from financial markets to the real economy.

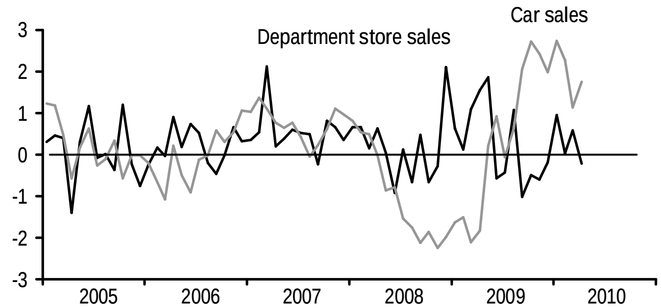
Aussie car sales to come back to earth

We expect car sales to have suffered a payback in May, likely falling around 5%m/m after April's huge 8.4% gain. The surprise upside in April was a 16% spike in sales of SUVs. It is tempting to ascribe this bounce to the looming end of the financial year, though late delivery of vehicles purchased near the end of 2009 (sales are counted on delivery, not contract signing) under the government's investment allowance probably played a greater role.

With the investment allowance winding up at year-end, sales were strong in 2H09, then came off in 1Q10. But there have been reports of delivery lags due to the relative scarcity of right-hand-drive cars rolling off Asian production lines. The preponderance of SUV sales in April fits with the story of business fleet sales (in the mining industry in particular) spilling belatedly into the new year. It is difficult to assess how far this dynamic has yet to run—indeed, the RBA minutes last week noted the recent strength of car sales, without attempting to explain it—but we would expect that any further spillover should be limited.

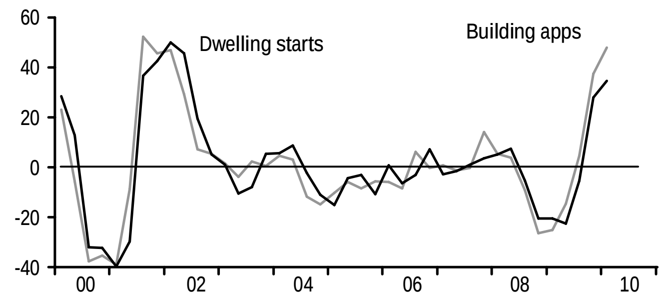
Australia: car sales and department store sales

%m/m, 6mma



Australia: building apps and dwelling starts

%oya



Housing starts strong, tests lie ahead

Dwelling commencements in Australia were pushed higher in 1Q by "other" residential buildings, rising 4.3%q/q (J.P. Morgan: 6.0%; consensus: 7.0%) after surging an upwardly revised 16.8%q/q in 4Q. Starts for "other" residential projects jumped nearly 8% in the first three months of the year, while commencements for new private sector houses were soft (down 2.4%). As in 4Q, the majority of development was concentrated in more populous states, with starts up 9% in both New South Wales and Victoria. Interestingly, there was also a rotation of growth between the resource-dependent states: starts fell 3%q/q in Queensland after surging 12% in the previous quarter, while in Western Australia starts accelerated from 4%q/q to 12% in 1Q.

It is not surprising that the robust pace of improvement in dwelling starts seen at year-end continued in 1Q, given that interest rates remained low, and the government's intervention in the education infrastructure space was still winding down, lessening the capacity constraints that arguably had been weighing on residential building activity.

As we move through to midyear, however, and more trade labour and building materials become available, the burden

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of proof for a resilient recovery in residential investment will shift to the demand side. Indeed, during 2010 favourable base effects will fade, only to be replaced with higher interest rates and a somewhat less sunny climate in the housing market. The expiration of the First Home Buyers' boost, combined with the brisk return of borrowing rates to long-run average levels, has tempered some of the frothier assessments that would have supported new projects coming into 1Q. Based on building approvals data in hand, the signs for 2Q are more sobering: if approvals are broadly flat in May and June (a fairly optimistic assessment given the 7%m/m fall in April), this would leave approvals down over 6% in 2Q, which does not bode well for building activity over the remainder of 2010.

Nevertheless, there has been some good news of late on the policy front. The New South Wales government announced in its annual budget two weeks ago several measures that will cut stamp duty for new housing and will place caps on fees paid by developers to local councils for new developments. These measures will support building activity over the remainder of the year, but it remains to be seen whether they are sufficient to overwhelm rising interest rates and still tight credit conditions that will hamper investment nationwide.

Data releases and forecasts

Week of June 21 - 25

		Feb	Mar	Apr	May
Mon	Sales of new motor vehicles				
Jun 21	Units, sa				
11:30am					
	%m/m	-1.8	-2.8	8.4	-5.0
	%oya	17.4	19.6	28.7	13.4

Review of past week's data

WMI leading index

	Feb		Mar		Apr	
%m/m, sa	~~0.5~~	*0.6*	~~0.9~~	*1.0*	__	*0.0*

Dwelling starts

	3Q09		4Q09		1Q10	
(%q/q,sa)	~~11.0~~	*10.9*	~~15.1~~	*16.8*	~~6.0~~	*4.3*

New Zealand

- **NZ GDP to print at healthy 0.7%q/q in 1Q**
- **Retail sales were soft in April**
- **Consumers maintaining positive outlook, however**

After a quiet week on the data front, the activity ramps up in New Zealand this week. The 1Q reports on the Kiwi GDP and current account will be delivered, as well as trade numbers for May. We expect growth in New Zealand to have remained solid into 2010, moderating only slightly to 0.7%q/q. However, the belated nature of the GDP data means that it will have few implications for the near-term policy deliberations of RBNZ Governor Alan Bollard.

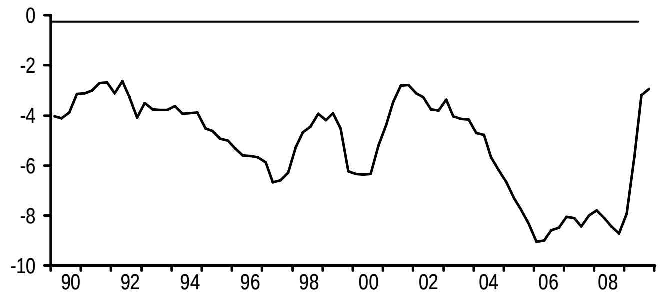
NZ recovery to have continued in 1Q

We expect that the New Zealand economy grew 0.7%q/q in 1Q, slowing from 0.8% in the December quarter, but maintained a healthy rate of expansion. Annual GDP growth will print at 1.9%oya, the fastest rate of growth in two years. On our forecasts, inventories, government spending, net exports, and private consumption will have added to growth, while investment will have remained a drag.

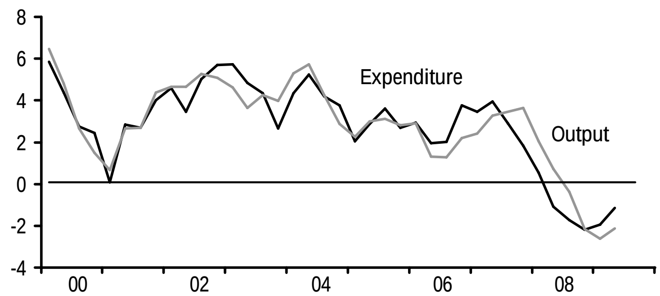
Private consumption, which accounts for two-thirds of the economy, will have slowed significantly in 1Q, however, after three quarters of solid growth. This result partly owes to the subdued rise in retail sales volumes in the March, which were up just 0.2%q/q. Household spending may rebound in 2Q and 3Q, however, as consumers “bring forward” spending ahead of the October 1 GST hike. The government confirmed in May that it would hike the GST to 15% from 12.5%. In 1986, when the GST was introduced, 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, with spending subsequently falling. For retailers, however, this creates the difficult challenge of managing inventory around volatile fluctuations in demand. Post GST hike, however, the vacuum left by the “bring forward” of spending, rising interest rates, and more moderate house price growth should mean household spending weakens considerably.

After subtracting significantly from economic growth in 4Q, net exports finally should add to GDP growth in 1Q. Export volumes were up 3.0%q/q in the March quarter, buoyed by strong growth in the nation’s major trading partners, Asia and Australia, while imports were up 2.8%. Investment, though, will have remained a drag on growth for the seventh straight quarter, owing entirely to nonresidential investment, which posted yet another fall; residential

New Zealand: current account balance
Four-quarter average, % of GDP



New Zealand: GDP
%oya



investment rose over the quarter.

The March quarter current account numbers also are scheduled for release this week. We suspect that the CAD will nearly halve in 1Q, owing to the trade balance moving into surplus. After coming in at -NZ$3.57 billion in 4Q, the CAD should have narrowed to NZ$1.4 billion in the March quarter, and account for 3.3% of GDP.

Kiwi consumers lacking conviction

Consumer spending retreated 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 into stronger spending. Retail sales values fell 0.3%m/m in April (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. Core retail sales also fell, slipping 0.2%m/m (J.P. Morgan: -0.1%; consensus: -0.4%) after jumping 1.0% in March.

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

Consumer sentiment upbeat in 2Q

New Zealanders remain upbeat, however. The Westpac-McDermott Miller consumer confidence index rose to 119.3 in 2Q from 114.7 in 1Q. The rise in confidence probably owes to the personal income tax cuts announced by the government in May. This was reflected in consumers' perceptions of their purchasing power, which improved the most over the second quarter. Consumers also were more optimistic about both current and future conditions.

Whether this upbeat sentiment translates to stronger spending down the track is uncertain. The retail sector will likely get a lift in the months to come as consumers will bring forward spending ahead of the forthcoming GST hike; this will be most evident in big-ticket items like cars, furniture, and household appliances. After the GST hike, however, spending will likely be subdued.

RBNZ Governor Alan Bollard highlighted again last week, in a speech entitled "A balancing act for New Zealand's economic recovery", that households in New Zealand remain the most obvious source of imbalance in the economy. Households' balance sheets, he said, remained heavily skewed to housing, high debt ratios, and low savings. Now, however, he believes that households have acknowledged their overexposure 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 subtrend growth in household consumption in New Zealand, particularly given expectations of higher interest rates.

Data releases and forecasts

Week of June 21 - 25

Mon Jun 21 10:45am	**Visitor arrivals** Nsa	Feb	Mar	Apr	May
	Total (%m/m)	-2.1	0.8	-1.8	__
Mon Jun 21 10:45am	**Net permanent immigration** Nsa	Feb	Mar	Apr	May
	Monthly (000s)	2.6	-0.3	-0.6	__
	12-month sum (000s)	21.6	21.0	20.0	__
Tue Jun 22 3:00pm	**Credit card spending** % change	Feb	Mar	Apr	May
	%oya	1.1	6.2	1.9	__
Wed Jun 23 10:45am	**Balance of payments** NZ$ mn nsa	2Q09	3Q09	4Q09	1Q10
	Current account	367	-1586	-3574	-1400
Thu Jun 24 10:45am	**Real GDP** Sa, production-based	2Q09	3Q09	4Q09	1Q10
	%oya	-2.3	-1.4	0.4	1.9
	%q/q	0.1	0.3	0.8	0.7
Fri Jun 25 10:45am	**Trade balance** Nsa	Feb	Mar	Apr	May
	Trade balance (NZ$ mn)	334	590	656	1000

Review of past week's data

Retail trade
Seasonally adjusted

	Feb		Mar	Apr	
(%m/m)	~~-0.6~~	*-0.5*	0.5	~~-0.6~~	*-0.3*
(%oya)	2.3		3.2	~~2.1~~	*2.4*

Westpac-McDermott-Miller consumer confidence
Not seasonally adjusted

	4Q09	1Q10	2Q10	
Index (neutral=100)	116.9	114.7	__	*119.3*

Global Essay

- **Recent calming of fear must extend further to validate our growth outlook**
- **Cooling in IP boom will lead 2H moderation in global expansion**
- **FX moves are stabilizing growth in global economy**
- **With onset of G-3 rate hikes pushed back, policy normalization has slowed but not stopped**

Blockbuster IP gains mark crest in global growth

One underpinning of our optimistic global growth forecast has been the positive feedback loop between the real economy and financial markets. The rise in global risk aversion that triggered the May market swoon challenged this outlook. More recently, the improved tone in financial markets hints that investors are gaining conviction that spillover from peripheral Europe will be limited, in line with our world view. That this is occurring against a backdrop of somewhat softer US data on retail sales, housing starts, and jobless claims is notable. Global equity prices have risen almost 6% over the past two weeks, with a comparable-size gain in Europe. Our commodity price index is up by a similar amount, while the dollar has fallen.

Although the trajectory of our global economic forecast has not changed much, we recognize that growth momentum probably was cresting into midyear. Incoming data confirm that global IP is set for another blockbuster gain in the current quarter that is likely to rival the record 12.9%q/q saar gain recorded in 1Q10, culminating in the largest six-month increase in over three decades. As highlighted by last week's reports, this strength reflects an important rotation from Asia—which led the global recovery—to the US and Europe.

Looking ahead, policy tightening is producing a downshift in China, which will reverberate through Asia and more broadly. At the same time, we have scaled back expectations for growth across Europe to reflect likely damage done by the debt crisis. The global economy also is going to lose support from the industry cycle. The recovery in global demand has been heavily focused in the goods sector, including capex, autos, and other consumer durables. In addition, the robust growth of final demand has been leveraged by the inventory cycle, as companies gradually shifted from cutting to accumulating stocks. This one-two punch will lose strength in coming months as the growth of final demand moderates somewhat alongside the maturation of the inventory cycle. Thus, the pace of global IP growth is forecast to slow to a 6% annual rate in this year's second half—a pace that is still strong, but just half of what was seen in 1H10.

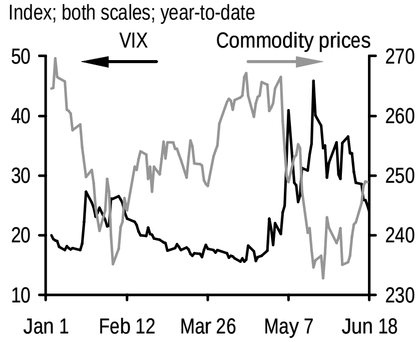
The anticipated moderation in IP will be one of the most striking features of the macro landscape. Ignoring the influence of the inventory cycle would incorrectly attribute the moderation in output to a slowing in final demand growth. At the same time, the global economy is becoming less dependent on goods demand as the expansion broadens to the services sector. This sectoral rebalancing means that GDP growth can remain relatively strong even against the backdrop of a significant slowing in the pace of manufacturing activity.

FX moves cushioning global economy

In contrast to developments in the equity and bond markets, changes in the foreign exchange market typically are not thought to have an important influence on the global business cycle, since gains in one currency come at the expense of another. Nonetheless, FX adjustments are not a zero-sum game. Movements in currencies that cushion shocks are a

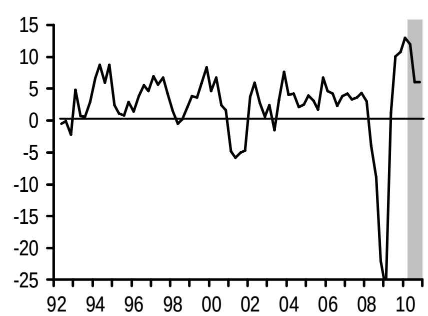
VIX and J.P. Morgan commodity price index

Index; both scales; year-to-date



Global industrial production

%q/q, saar



Currency changes since recent euro peak
% ch since Dec 01, 2009

	Euro cross	NEER (TWI)
Euro area	n.a.	-12.8
Europe		
United Kingdom	8.7	-0.3
Norway	7.6	-0.5
Sweden	8.9	1.5
Hungary	-3.1	-8.0
Poland	1.0	-3.3
Rest of World		
United States	21.7	5.0
Japan	15.9	-0.5
Canada	23.8	4.2
Brazil	17.8	4.3
China	21.7	5.5
India	22.1	8.4

positive force in the global economy, whereas those that magnify them are not. Viewed this way, recent developments in FX markets generally have been constructive, by delivering support to Europe—where recovery already was tepid before the latest shock—at the expense of stronger regions of the globe.

Dating back to last December, the euro's decline has run wide and deep, with losses of 20% or more against many currencies. The exception is the rest of Europe. The remaining Western European currencies have posted more modest gains against the euro, while currencies in central Europe have not appreciated at all versus the euro. This pattern extends to the broad, trade-weighted exchange rates (TWIs), which are what matters for a country's competitive position. The steep, 12.7% decline in the euro TWI has been matched by widespread gains outside of Europe, although the burden has not landed too heavily in any one place. In contrast, broad exchange rates in the rest of Europe range from up slightly to down.

EMU stresses contained, not resolved

The standoff between financial markets and Euro area policy makers continued last week. Fueled by rumours that Spain was about to seek financial support from the EU and IMF, Spanish government bond yields rose sharply before falling after Spain's successful bond auction and the passing of an EU summit without significant announcements. Responding to growing concerns, however, Spain unilaterally announced it will publish bank stress test results and still plans to carry out any recapitalizations using a domestic bank restructuring fund. This move has encouraged others to follow, with Germany now agreeing to publish bank stress test results by the end of July.

Fiscal consolidations are progressing—as highlighted by the favourable EC/ECB/IMF interim report on Greece—but the road will be long and painful. With financial market anxiety and bank funding stresses likely to persist, Euro area growth is projected to decelerate to a 1% pace by the end of the year as the current cyclical lift gradually fades. Consistent with this, we would expect the composite PMI to fall gradually by around 5-6 points by year-end from the May level. This week's June business surveys will give a first sense of how bumpy this road will be.

Central banks parting ways

The one-size-fits-all monetary policy stance that existed at the outset of the global recovery last year continues to fragment against concerns surrounding the spillover from the Euro sovereign credit crisis. The G-3 central banks appear strongly committed to a low-for-long policy. Last week, we pushed back the first ECB hike beyond 2011 in response a downgrade in our growth outlook for the region.

We also delayed the expected onset of Fed tightening to 4Q11. However, unlike our ECB call, this is not motivated by a change in our US growth outlook—which remains intact—but rather reflects growing conviction that inflation will trend lower in the coming quarters and that this will weigh heavily in the Fed's reaction function. Also, an increased commitment to end deflation is now expected to keep the BoJ on hold until 2Q12.

Heightened uncertainties and the potential impact from fiscal tightening are dominating the scene in Europe. Rate hikes expected from the Riksbank and the Norges Bank have been pushed back from 3Q10 to 4Q10, while the tone of last week's CBRT policy statement was notably dovish. In the UK, diminished growth prospects are increasing the likelihood that the first MPC rate hike comes later in 2011 than currently projected. The exception is the SNB, which intimated last week that it has reached a limit in its FX interventions and the impact it is having on its balance sheet.

Outside Europe, a number of central banks are looking through the sovereign credit crisis roiling the EMU and have not altered their paths toward gradual policy normalization. Strong domestic demand growth has already induced policy rate hikes in most of the commodity-producing countries, including Australia, New Zealand, Canada,

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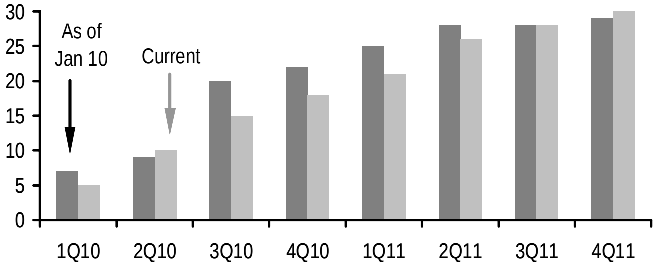
First central bank hikes, J.P. Morgan forecast

Number of central banks expected to have raised rates by quarter



and Norway. In Brazil, the latest COPOM minutes were relatively hawkish, pointing to depleted economic slack against robust demand growth.

Policy tightening has been more gradual in EM Asia as the gains in economic activity appear set to come off the boil. Most notably, China has yet to hike rates or relax its currency peg. Coupled with modest inflation and a still soft labour market, we see little chance of a rate hike in Taiwan this week and may push out our call for a September hike. India remains the exception. In response to a 20-year high in industrial production growth in April and a third double-digit WPI inflation reading in May, the normalization process will continue with policy rates being increased 25bp before July's policy review followed by a 25bp increase at that meeting.

UK belt-tightening to limit growth

Recent downward revisions to our Euro area forecast already suggest that UK growth will slow somewhat into early 2011, taking our forecast for 2011 as a whole down to near 2.5% from 3%. The extent of near-term fiscal tightening—details of which will be provided in Tuesday's budget announcement—will determine whether a deeper downgrade in our growth outlook is required. The European sovereign debt crisis has emboldened the new Chancellor to reverse an increasing debt to GDP ratio by the end of the current Parliament. The outgoing administration had already planned a near 3% of GDP structural tightening in the budget balance over this year and next. The forecast has assumed this rises to near 4% of GDP, with a hike in VAT in early 2011 the main new net tightening measure. But risks are for a larger and more front-loaded tightening.

Japan's two-front assault on deflation

Even as the economic recovery continues to broaden, policy makers in Japan are becoming more proactive. According to the Reuters Tankan, current business sentiment among both manufacturers and nonmanufacturers improved markedly in June, with the outlook showing further improvement into September. Nevertheless, the government's updated growth strategy was more aggressive than anticipated and included a significant cut in the corporate tax rate along with measures to open the economy more to foreign firms. The medium-term fiscal outlook is to be published early this week.

At the same time, the BoJ published details of its new bank lending scheme that provides 0.1% fixed-rate funds for one year (with rollover for an additional three years possible) to targeted industries. Although its impact on the economy will be limited—the total size of the new lending scheme is just 1% of total bank lending and both banks and firms have abundant liquidity— both the government and the BoJ appear more committed to ending deflation sooner by promoting faster growth.

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J.P.Morgan

JPMorgan View - Global Markets

Economy 2, Markets 1—but the match is not over

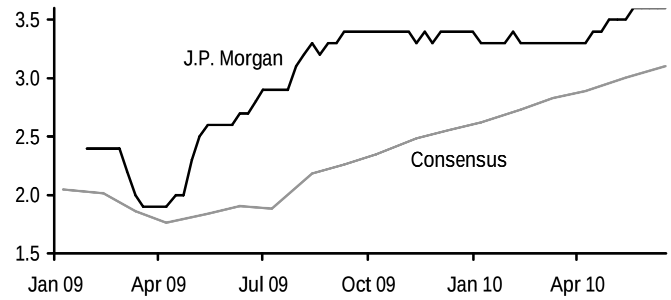
- **Economics:** The world economy is showing strong resilience to the onslaught of the market correction. Neither forecasts nor the data are budging. We would say 2-1 for the world economy, although the match is not over.
- **Asset allocation:** Resilience of economies and the non-delivery of feared event risks are inducing investors to return to risky assets. We remain long risk, with a modest increase from light positions.
- **Fixed income:** Solid domestic buying supports Italian government bonds.
- **Equities:** US banks are likely to outperform near term. We are reluctant to chase the rally in peripheral country equities. Stay OW Dax versus EuroStoxx50.
- **Credit:** Relative funding pressures favour European versus US, HY versus HG, and EM versus DM corporate credit.
- **FX:** Add risk—INR and CAD versus USD.
- **Commodities:** The Gulf spill is unlikely to have much impact on price fundamentals. Stay long crude, on the end of the Asian refinery maintenance season.

Risky markets continue to rebound from their lows last week, despite only mixed economic news, supporting the view that it is the nondelivery of tail risks, rather than great economic news, that will be driving investors back into riskier assets. We retain a long exposure, and add modestly, to risky assets—equities, credit, EM, and commodities—but are selective.

The **core bullish forces** for risky markets are the resilience of the global recovery and the lack of a decent return on risk-free assets—cash and Treasuries. The **main bearish counterforce is uncertainty about the aftermath of the financial crisis** that started two years ago. This aftermath relates largely to how governments will unwind the massive amounts of debt they issued during the crisis. By our reckoning, even in three years' time, developed market public debt to GDP ratios will not have stabilized yet, forcing governments to keep raising tax burdens and lowering their spending plans (Joseph Lupton, *Government debt sustainability in the age of fiscal activism*, June 11).

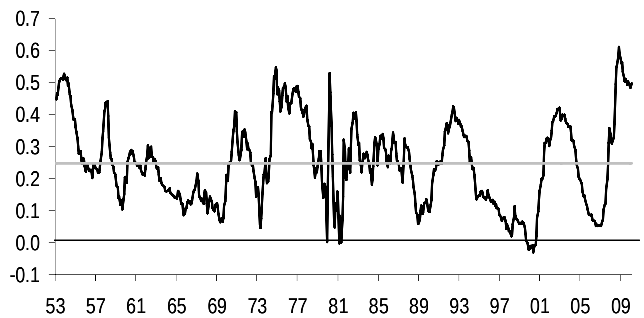
Sustained long-term uncertainty should keep risk premia well above the lows seen in past economic expansions. That is the easy conclusion. The issue is by how much. The composite risk premium on US assets (from its

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.

Slope of the US market risk-return tradeoff line
Required return per unit of risk



Source: J.P. Morgan. The slope is calculated by applying a linear regression of the IRR of US cash, USTs, high-grade bonds, and US equities. The IRR for cash and USTs are their yield. The HG IRR is its yield minus its long-term expected loss due to default. The Equity IRR is its earnngs yield vs. trend EPS plus expected long-term inflation.

risk-return trade off line) remains near historic highs, despite the rally over the past year, and remains double its mean of the past half century (second chart). To us, uncertain as the aftermath of the financial crisis is, risk premia should not be double their historic mean.

Over the next one to two months, risky markets should recover further, not so much in response to fantastic economic news, but more to a gradual softening of the worries that preoccupy market participants. US bank reform will be decided upon over the next two weeks. The slowing of the Chinese economy, toward a soft landing, should become obvious over the next one to two months. And the concern that the fall in risky markets will in turn drag the economy down, just as happened two years ago, has turned out to be wrong, so far.

As a single measure of this resilience, **economists across the world have maintained their global GDP forecasts for 2010 over the past month.** If anything, a big rise in Japanese forecasts lifted the global forecast another 0.1% (second

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chart). Equity analysts are similarly maintaining earnings forecasts. We saw the same pattern of continued trending up in consensus growth forecasts during the June/July 2009 and the Jan/Feb 2010 corrections in risky markets, making us comfortable with the view that **April/June of this year was just one more correction in a medium-term bull market**.

One jarring uncertainty that will haunt markets for some time is the **European sovereign debt crisis**, preventing a fall in risk premia to normal levels. Policy makers have made tremendous progress in lining up funding and cutting deficits in the periphery countries. But a lot of hard work remains to be done, and both economic and political implementation risks remain high. On the margin, funding conditions in Europe have improved from bad to less bad. Deposits at the ECB have risen to €325 billion, while its gross lending has grown to €845 billion. Spain and Ireland issued successfully, but, aside from Italy, there remains little real investor buying of periphery debt.

Fixed income

Bonds fell as equities rose, but with Treasuries a notable exception in taking their cue instead from weakish data. European peripherals endured a week of two halves, first selling off sharply on Moody's downgrade of Greece to speculative grade and worries over Spanish banks, before reversing course after Spain successfully sold 10- and 30-year bonds. We estimate that the Greek downgrade may lead to €20 billion of selling from indexed investors (see *GFIMS Euro Cash*). Much of this will likely find its way into the arms of the ECB. But the question of who will buy the spate of Euro area non-core issuance in the months and years to come remains an unanswered one.

The increased volatility and perceived credit risk of Euro area peripheral debt have dulled foreign demand for these bonds, making governments more dependent on domestic investors. Banks are by far the largest domestic investors in Spanish government debt, but may be hampered from increasing their holdings by a difficult bank funding environment. **Italian government bonds, in contrast, have benefited from steady domestic buying**, contributing to a sharp divergence between Spanish and Italian spreads over the past few weeks. Ultimately, the prospects for European peripheral debt likely depend on whether domestic private saving can counterbalance government deficits. This bodes well for Ireland and Italy, where the current account is relatively close to flat, but less so for Spain and Portugal.

Monetary policy renormalization continues in the stronger economies—chiefly, EM and the commodity countries. We continue to hold curve flatteners. And we **stay short in Australia, where we expect rising inflation to push the RBA to resume its hiking cycle**.

Equities

Equities rose for a second straight week driven by good auction results in peripheral euro countries and continued improvement in funding markets. The technical picture has also improved with the S&P500 rising above its 200-day moving average. **Our best guess is that while volatility is not gone, equity markets should on net be up over the next few months.**

Short covering has amplified the recent equity move as evidenced by the outperformance of European equities, especially those in peripheral countries. Real money investor surveys also suggest that underweights of European equities have been cut in recent weeks, albeit modestly. There has probably been more extensive short covering with short-term investors. Last week saw a sharp inflow into equity ETFs, which reversed 90% of the outflows seen in the previous four weeks. In contrast, equity mutual funds continued to see outflows. This suggests that most of the tactical shorts put through ETFs have been unwound.

Within Europe, we are reluctant to chase the rally in peripheral equities and stay overweight in core versus peripheral European equities. That is, we remain **OW Dax versus. EuroStoxx50**. We see three drivers for this trade: 1) Germany has a more benign fiscal position compared to the rest of the Euro area; 2) the euro weakness is a significant tailwind for Germany as it has twice the export exposure of other main countries, at 40% exports share of GDP. Dax is benefiting the most from euro weakness as 36% of its revenues come from outside Europe; and 3) Germany is a beneficiary of the global upcycle, with pro-Cyclical sector composition. See Mislav Matejka, *European Equity Strategy*, for more details.

One area where uncertainty is falling is US bank regulation as the financial reform bill continues to advance in the reconciliation process between the House and the Senate. The chances of an acceptable outcome for US banks are increasing, making us turn positive on US banks for the near term.

Credit

Credit also rallied last week driven by CDS indices, as short covering intensified especially in Europe. **We have a**

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small net long in credit, though high-yield. Apart from the heavy refinancing schedule, another factor that could constrain credit near term is positions, which according to our most recent client surveys remain sizable.

We continue to **favour European versus US, HY versus HG, and EM versus DM corporate credit**. These relative calls are based on relative funding pressures: refinancing needs are heavier in Europe versus the US, HG versus HY, and DM versus EM.

EM corporates are returning to the primary market after issuance all but stalled in May. A large euro/sterling US$3 billion equivalent multi-tranche bond issue last week—the first Latin American issue since late April—is a sign that the market is open for business and given the demand and pricing achieved, is likely to encourage more issuers to test investor demand over the coming weeks. EM corporates have little net financing need for the remainder of the year.

Foreign exchange

For the first time in several months, **something seems to be sticking in Europe**. Periphery spreads are narrowing, European stocks are outperforming, and EUR/USD is delivering its best weekly performance since November. That the euro rallied versus Emerging Asia and Latin America suggests a broader rethink around the region could be under way. While extreme pessimism like the parity forecasts now popping up ignore how much Europe has done to stabilize markets, it is too soon to signal the all-clear.

EUR/USD still looks set for a volatile range in the 1.20s as it scales a funding hump this summer. For the next two weeks, the issuance calendar is light enough to allow high-yield and commodity currencies to extend their gains versus the dollar. We **continue scaling into risk** but keep exposure below average. Sell **USD/INR** and re-enter short USD/CAD in options. Stay short EUR/CHF in cash and options, and NOK/SEK in cash.

Commodities

Commodities were up nearly 4% last week, as oil and precious metals rallied strongly. Industrial metals are broadly flat in spite of strong US IP data. This is partly to do with seasonally weak demand but also due to fears around China.

Ten-year Government bond yields

	Current	Sep 10	Dec 10	Mar 11	Jun 11
United States	3.21	3.45	3.85	4.15	4.50
Euro area	2.73	2.90	3.15	3.25	3.35
United Kingdom	3.54	3.70	3.90	4.05	4.30
Japan	1.20	1.30	1.40	1.50	1.55
GBI-EM	6.87			7.90	

Credit markets

	Current	YTD Return
US high grade (bp over UST)	185	4.4%
Euro high grade (bp over Euro gov)	205	2.5%
USD high yield (bp vs. UST)	713	4.4%
Euro high yield (bp over Euro gov)	758	3.9%
EMBIG (bp vs. UST)	328	4.9%
EM Corporates (bp vs. UST)	365	5.0%

Foreign exchange

	Current	Sep 10	Dec 10	Mar 11	Jun 11
EUR/USD	1.24	1.25	1.20	1.18	1.18
USD/JPY	90.8	90	93	96	100
GBP/USD	1.48	1.39	1.35	1.34	1.33

Commodities - quarterly average

	Current	10Q3	10Q4	11Q1	11Q2
WTI ($/bbl)	77	94	93	90	85
Gold ($/oz)	1257	1250	1200	1175	1175
Copper($/m ton)	6420	7150	6750	6500	6500
Corn ($/Bu)	3.82	3.90	3.80	4.00	4.20

Source: J.P. Morgan, Bloomberg, Datastream

We recognize there is the potential for volatility in the next one to three months but we retain the view that the economic recovery will win over the markets, and commodities should benefit from this through the second half of the year.

Oil was up over 4% last week to $77. Oil benefited from a general recovery in risky assets over the past week but, additionally, the Asian refinery maintenance season is likely nearing completion and our oil analysts expect this to bring increased demand for crude over the coming months. Stay long crude oil. We believe the **spill in the Gulf of Mexico is unlikely to cause any notable change in crude prices**. OPEC has more than enough spare capacity to absorb any short-term supply issues. Also, while regulatory changes are likely to slightly increase the breakeven point for drilling in the Gulf, at current prices it is unlikely to have any significant impact on revenues. **Stay long crude oil.**

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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	4.7 ↑	2.5	3.9	4.3	5.2	6.0	6.5	7.2 ↓	6.6 ↓
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
Colombia	0.4	4.0	4.1	4.7	4.9	4.8 ↑	3.2 ↓	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	4.0 ↓	3.3 ↓	3.9 ↓	4.1 ↓
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	7.3 ↑	6.0	10.2	7.3	9.5 ↑	4.0 ↓	4.5 ↑	6.0 ↓	6.7 ↓	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	32.1 ↑	32.1 ↓	32.1 ↓
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	4.7 ↑	8.9	7.2	8.6	11.6	6.8 ↑	6.5 ↑	6.9 ↑	7.1	7.4	4.3	5.0 ↓	4.8 ↓	4.0 ↓
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	7.4 ↑	8.3	8.5	6.9	9.2 ↑	8.1 ↑	8.0 ↑	8.9 ↑	8.0	8.5 ↑	15.3	15.5 ↓	13.1 ↓	10.5 ↓
Indonesia	4.5	6.2	5.7 ↓	6.2	5.4	7.0 ↑	6.0 ↑	6.0 ↑	5.5 ↓	5.8 ↓	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	5.0 ↑	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	1.6 ↓	2.4 ↓	1.6	0.6	2.0 ↓	3.0	2.8 ↓	2.0 ↓	2.0 ↓	2.9	2.5 ↓	1.3 ↓	1.0 ↑
Sweden	-5.1	3.7 ↑	2.8 ↓	1.7	5.9	5.0 ↑	3.5	2.8 ↓	2.3 ↓	2.3 ↓	1.0	1.0 ↑	2.3 ↑	2.4 ↓
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	4.0 ↑	3.5 ↑	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	6.4 ↑	4.8 ↑	5.4	5.8	6.2	5.1	5.3 ↓	5.4 ↓	4.8 ↓
Memo:														
Global — PPP weighted	-0.8	4.8	4.2	5.3	5.3	5.0	4.3	4.2	3.9	3.9	3.3	3.4	3.2	2.9

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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	1.42	1.49	1.56	1.63
excluding US	GDP-weighted average	1.90	-245				1.91	2.02	2.13	2.23	2.33
Developed	GDP-weighted average	0.53	-359				0.53	0.55	0.58	0.62	0.67
Emerging	GDP-weighted average	4.55	-231				4.58	4.86	5.10	5.29	5.46
Latin America	GDP-weighted average	6.32	-261				6.32	6.90	7.37	7.50	7.64
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	4.99
The Americas	GDP-weighted average	0.83	-476				0.83	0.93	1.01	1.06	1.11
United States	Federal funds rate	0.125	-512.5	16 Dec 08 (-87.5bp)	23 Jun 10	**4Q 11 (+37.5bp)**	0.125	0.125	0.125	0.125	0.125
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)	16 Jul 10	**4Q 11 (+25bp)**	4.50	4.50	4.50	4.50	4.50
Colombia	Repo rate	3.00	-600	30 Apr 10 (-50bp)	23 Jul 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	1.32	1.36	1.45
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	0.75	0.75	1.00
Norway	Deposit rate	2.00	-250	5 May 10 (+25bp)	23 Jun 10	**4Q 10 (+25bp)**	2.00	2.00	2.25	2.25	2.50
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)	16 Sep 10	16 Dec 10 (+25bp)	0.25	0.25	0.50	0.75	1.00
Turkey	1-week repo rate	7.00	-1050	-	15 Jul 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	2.66
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 Jul 10	**2Q 12 (+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	**4Q 11 (+37.5bp)**	0.50	0.50	0.50	0.50	0.50
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.

Economic forecasts - Australia

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

				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	5.0	5.9	3.5	3.4	4.1	4.2	5.1	5.3	5.5	5.8	5.8	5.9	6.0
10-year bond yield (%)*	5.6	5.6	6.0	5.5	5.1	5.8	5.6	5.5	5.7	5.8	5.9	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	3.7	5.1	2.8	2.8	2.8	2.7	3.5	4.0	4.5	5.0	5.0	5.1	5.1
10-year bond yield (%)*	5.5	5.7	6.1	5.7	5.7	5.9	5.9	5.5	5.7	5.8	6.0	6.1	6.1	6.2
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 upbeat 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
21 Jun Australia: New motor vehicle sales (11:30 am) May -5.0%m/m, sa 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 -1400NZ$mn,nsa	24 Jun New Zealand: GDP (10:45 am) 1Q 1.9%oya	25 Jun New Zealand: Trade balance (10:45 am) May 1000 NZ$mn
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
12 Jul Australia: Housing finance approvals (11:30 am) May	13 Jul Australia: NAB business confidence (11:30 am) Jun	14 Jul Australia: Westpac consumer confidence (10:30 am) Jul New Zealand: Retail sales (10:45 am) May	15 Jul Australia: New motor vehicle sales (11:30 am) Jun New Zealand: Business NZ PMI (10:30 am) Jun	16 Jul New Zealand: CPI (10:45 am) 2Q

Highlighted data are scheduled for release on or after the date shown. Times shown are local.

Global Data Diary

Week / Weekend	Monday	Tuesday	Wednesday	Thursday	Friday
21 - 25 June	21 June	22 June	23 June	24 June	25 June
	Euro area • Trichet speech Hungary • NBH mtg: no chg Japan • All sector act index (Apr)	Canada • CPI (May) Euro area • EC consumer conf (Jun) Germany • IFO bus surv (Jun) United Kingdom • Budget report United States • Existing home sales (May) • Richmond Fed surv (Jun)	Belgium • BNB bus conf (Jun) Czech Republic • CNB mtg: no chg Euro area • PMI flash (Jun) France • INSEE bus conf (Jun) Germany • GfK cons conf (Jul) Italy • ISAE bus conf (Jun) Norway • Norges bank mtg: no chg 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 • Capacity 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)
28 June - 2 July	28 June	29 June	30 June	1 July	2 July
Germany • Retail sales (May) Russia • CBR mtg: no chg	Germany • CPI prelim (Jun) Israel • BoI mtg: no chg United States • Dallas Fed surv (Jun)	Euro area • EC business conf (Jun) France • INSEE cons conf (Jun) Japan • Unemployment rate (May) • IP prelim (May) • Shko Chkn sm bus (Jun) Spain • HICP flash (Jun) United States • Consumer conf (Jun) • Case-Shiller HPI (Apr)	Euro area • HICP flash (Jun) Italy • ISAE bus conf (Jun) Japan • Mfg PMI (Jun) Korea • IP (May) Poland • NBP mtg: no chg Romania • BNR mtg: no chg United States • Chicago PMI (Jun)	China • Mfg PMI (Jun) Euro area • Mfg PMI (Jun) Sweden • Riksbank mtg: +25bp United Kingdom • Mfg PMI (Jun) United States • Mfg ISM (Jun) • Pending home sales (May) • Auto sales (Jun)	Euro area • Unemployment (May) United States • Employment (Jun) • Factory orders (May)

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