

## Australia and New Zealand - Weekly Prospects

### Summary

- In **Australia**, the size of last week's bounce in employment boosted the chances of an August rate hike. We have been calling for an August hike for some time, owing mainly to the worsening inflation outlook—the economy is rapidly using up available capacity. The jobs data showed that this is particularly so in the labour market, where the jobless rate now is broadly consistent with full employment. Wage pressure is building. The 2Q CPI data on July 28 will play an important role in the RBA's August decision, but is not "make-or-break"—the case for further tightening already is strong. In the meantime, the week ahead should see bounces in business and consumer confidence, and a rise in home loans (the first gain since last September). Last week saw more policy "deck-clearing" by our new PM as she edges towards calling the election (see research note on page 3). PM Gillard could call the election as early as this week.
- The tempo picks up in **New Zealand** this week, with the release of 2Q CPI data and May's retail sales. We expect headline inflation to print comfortably in the middle of the RBNZ's 1%-3% target range. That said, CPI probably will print significantly higher in 2H10, owing partly to the impact of the emissions trading changes from July 1 and the GST hike on October 1. The RBNZ, therefore, will be wary that inflation expectations could rise. On the retail numbers, sales should have posted a healthy rise in May, given that credit card statistics suggest that spending on cards increased significantly. A solid result on the retail print (we expect a 0.8% m/m rise) would provide evidence that consumers already are bringing forward spending ahead of the rise in the consumption tax.
- The unique drags facing the **global economy**—notably the unprecedented damage to financial institutions, household balance sheets, and public finances in developed markets—have been a major source of concern during the first year of the global economic expansion. Despite these concerns, the expansion has thus far closely followed the script written by past cycles. The most rapid output gains in over four decades were recorded in the industrial sector while GDP growth has averaged more than a percentage point above its trend. At a pace close to 4%, global GDP has risen more rapidly than at the start of the past two recoveries, but has fallen short of the standard set in recoveries from deep contractions during the mid-1970s and early 1980s. In all, with its first year now complete, the upturn can be aptly described as one in which unique drags tempered but did not short-circuit the normal workings of the business cycle.
- Central to the outlook for the global business cycle expansion will be the direction of **labour market and final demand** indicators. Continued growth in these indicators would signal resilience in private sector behaviour in the face of the latest shocks. It would also suggest that, as in past cycles, a downshift in industry will cloud the transition taking hold to a self-sustaining expansion. It is against this backdrop that the latest demand indicators are sending confusing signals. Having accelerated dramatically into the end of 1Q, our proxy of global final sales stagnated during April and May. If we are right, demand is trending upward somewhere between these two extremes. This week's June retail sale readings for the US and China will provide guidance on this issue.

### This week's highlight

We expect bounces in the Aussie business (Tuesday) and consumer (Wednesday) confidence measures. The RBA has held the cash rate steady, uncertainty over the mining tax has diminished, and sovereign concerns eased offshore.

July 12, 2010

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## Data and event previews - Australia and New Zealand

Date	Time <sup>(a)</sup>	Data/event	Forecast		
			JPMorgan	Consensus <sup>(b)</sup>	Previous
Monday, July 12	11.30am	Aust. housing finance (%m/m, May)	<b>1.5</b>	0.0	-1.8
Tuesday, July 13	8.45am	NZ food prices (%m/m, Jun.)	<b>na</b>	na	-0.7
Tuesday, July 13	11.30am	NAB business confidence (Index, Jun.)	<b>10</b>	na	5
Wednesday, July 14	8.00am	REINZ house prices (%m/m, Jun.)	<b>-0.5</b>	na	-1.4
Wednesday, July 14	8.45am	NZ retail sales (%m/m, May)	<b>0.8</b>	0.5	-0.3
Wednesday, July 14	8.45am	NZ retail sales ex-auto (%m/m, May)	<b>0.2</b>	0.6	-0.2
Wednesday, July 14	10.30am	Aust. Westpac-MI consumer confidence (%m/m, Jul.)	<b>7.0</b>	na	-5.7
Thursday, July 15	8.30am	NZ Business PMI (Index, Jun.)	<b>na</b>	na	54.5
Thursday, July 15	11.00am	Aust. consumer inflation expectation (%m/m, Jul.)	<b>na</b>	na	3.4
Thursday, July 15	11.30am	Aust. new motor vehicle sales (%m/m, Jun.)	<b>na</b>	na	16.4
Friday, July 16	8.45am	NZ CPI (%q/q, 2Q)	<b>0.4</b>	0.5	0.4
Friday, July 16	8.45am	NZ CPI (%o/a, 2Q)	<b>1.9</b>	1.9	2.0

(a) Australian Eastern Standard Time.

(b) Consensus based on Bloomberg survey.

### Australia

**Housing finance (%m/m, May)** - The number of loans approved in May should rise 1.5% m/m. This will be the first rise since September 2009, but there is limited scope for a more meaningful bounce. Indeed, the same drags that have been in place since the start of the year continue to weigh on loan demand. Rising interest rates, higher risk aversion in financial markets, the falls in consumer confidence, and the lack of stimulus support have generated an unhelpful environment for would-be borrowers.

**NAB business confidence (Index, Jun.)** - The fall in the headline rate in May owed largely to the shrill debate over the proposed resource “super profits tax”—there was a 30-point drop in confidence for the mining sector. Now, with the new Prime Minister having moved swiftly toward finding a resolution of the controversial tax, firms should have become more upbeat. Also, sovereign concerns eased in Europe and the RBA held the cash rate steady early in the month.

## Data previews - Cont'd.

**Westpac-MI consumer confidence (%m/m, Jul.)** - Consumer confidence probably spiked in July, with our forecast calling for a rise of 7% m/m. The RBA's decision to leave the cash rate steady last week (and in June), the apparent end of uncertainty over the proposed mining tax, as well as more supportive conditions for equity markets should have triggered a turnaround in sentiment. The unexpected bounce in employment last week also should have helped.

### New Zealand

**REINZ house prices (%m/m, Jun.)** - We expect a 0.5% m/m drop in the REINZ's measure of house prices in June, marking the third straight monthly fall. Recent changes to the way property is taxed, measures that were announced in the Budget in May, have curbed housing market activity. This trend will likely continue, which will weigh on consumption.

**Retail sales (%m/m, May)** - Consumer spending probably rebounded in May, with credit card statistics suggesting that total billings on cards increased significantly. The government also confirmed in May that it would hike the goods and services tax (GST) on October 1. The increase in sales, whether it be funded by cash or cards, will provide the first piece of evidence that consumers are bringing forward spending ahead of the rise in the consumption tax. Our forecast is for retail sales to have jumped 0.8% m/m in May, after falling 0.3% in the previous month.

**CPI (%q/q, 2Q)** - Headline inflation likely continued to hover around the middle of the RBNZ's 1%-3% target range in the June quarter. Consumer prices probably grew 1.9% oya, marking the fifth straight quarter that headline CPI has remained within the Bank's target. This will translate to quarterly growth of 0.4% q/q, the same rate of growth as in the previous quarter. Headline CPI will pick up significantly in 2H10, however, with the implementation of the emissions trading scheme from July 1 boosting the price of fuel and electricity, and the GST hike coming into play on October 1. The concern for the RBNZ will be ensuring that inflation expectations remain anchored.

## Research note

# Australia's new PM clearing the decks for early election

- **Australia's new Prime Minister is edging closer to calling an early election**
- **Recent policy shifts, including on the contentious mining tax, hint that the election is near**
- **Latest opinion polls suggest the Labor government will be re-elected**

The past month has been tumultuous in Australian politics. In late June, for the first time in Australia's political history, a ruling party unseated a *first-term* Prime Minister. Former Prime Minister Kevin Rudd, unpopular even within his own party, had seemed destined to lead Labor to defeat at the upcoming election. Julia Gillard, Rudd's deputy, replaced him to become Australia's first female Prime Minister. Gillard has moved quickly to remove policy roadblocks that had halted progress for the Rudd government, including the controversial mining tax proposal. It seems that she is clearing the decks in readiness for an early election, which the latest opinion polls suggest the government will win.

### Late August poll now looks likely

The timing of the election is up to the government. Given the minimum 33 days required between calling the election and the poll, the earliest the election can be held is August 14. The latest possible date is April 16, 2011. When Rudd was Prime Minister, we favoured an October election. The intervening months would have provided him a window to try to ease his policy headaches and, perhaps, for his party to recover in the polls. Now, with a new Prime Minister in place, we look for a late August election. The speed with which Gillard has neutralized crucial policy problems, and the "honeymoon" bounce she is enjoying in opinion polls, makes it more likely the poll will be held early.

September is unlikely to see the election—politicians know not to distract Aussies from the football finals—and there is an important state election due in November; federal officials will want to give their Victorian state colleagues clear air. End-year is the most common time for elections in Australia—12 of the 42 elections since federation in 1901 have been in December. The PM's recent frenetic activity, however, hints that a late-2010 election is unlikely. Only once before has a federal election been held in August, in 1943: In a positive omen for Gillard, wartime Labor government of PM John Curtin was re-elected. Bookmakers offer shortest odds on an August 28 poll, followed by August 21 and August 14. Late October, when there is

### Australia's Parliament: state of the houses

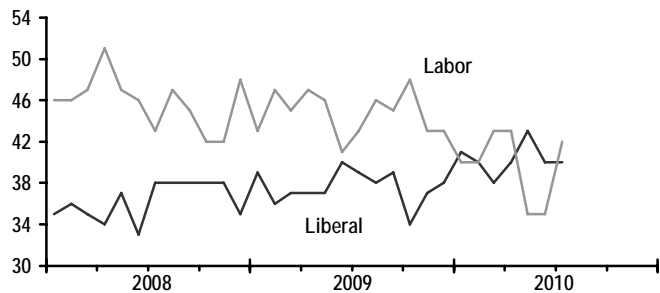
Number of seats

	Lower house	Upper house
Liberal (Coalition)	54	32
Country Liberal (Coalition)	-	1
National (Coalition)	9	4
Labor	83	32
Green	-	5
Family First	-	1
Independent	4	1
Total seats	150	76

Source: Australian Electoral Commission, Parliament.

### Voting intentions: major parties

Percent



no obvious distraction, seems the most likely alternative timing for the poll.

### Clearing the decks like an old hand

The speed with which Gillard has moved to address policy headaches hints strongly that the election is near. Within a week of assuming office, she reached agreement with large mining companies on a revised framework for the mining tax, which had been a weeping sore for the embattled Rudd. The new regime lowers the effective tax rate for miners to 45%, from 57% previously under the discredited Resource Super Profits Tax (RSPT). Smaller miners are unhappy, though, at being left out of the latest round of negotiations, and want further concessions.

Last week, the new PM announced a shift to the right on immigration policy, with the aim of appeasing anxiety in marginal electorates about boat arrivals by asylum seekers. A key issue that needs to be addressed before the election is climate change. Back in April, then-Prime Minister Rudd abandoned his government's commitment to implementing an emissions trading scheme (ETS); many argue that doing so hammered a large nail into his political coffin. Gillard is yet to fill this particular policy black hole, but has indicated a preference for decisive action.

## It's the (Aussie) economy, stupid

All that said, as always, the economy and, by extension, interest rates, will be crucial in determining the election outcome. The ruling government gets credit for seeing Australia through the financial crisis with only minor damage, but the opposition Liberal Party traditionally is regarded by voters as the better economic manager. The government loses some attraction to voters over the recent blowout in the deficit and debt, and for errors and wastage in many fiscal stimulus programs. The latter will be a key target for the Opposition when the election is called.

Interest rates have played a key role in election outcomes in the past: the RBA's decision to hike the cash rate three weeks before the November 2007 election, when Rudd was elected, helped sink John Howard's coalition government. Our forecast of a rate hike in early August, weeks out from our preferred election timing, is, however, unlikely to inflict lasting damage on the Gillard government. Unlike Howard, who promised to keep interest rates low and suffered politically when they rose, Gillard has avoided the interest rate debate. A stumble for the economy, however, would help the Opposition's chances.

## Polls: Labor government to be returned

Before Labor's leadership change, published opinion polls showed the Rudd government trailing the Opposition and on the road to electoral defeat. Gillard's ascension, though, triggered an abrupt reversal. The Labor government now leads the Tony Abbott-led Liberal Party by 53% to 47%, after distribution of preferences of minor parties (coincidentally, this matches the November 2007 election outcome). Gillard also holds an advantage as preferred Prime Minister. The bookies, who arguably have a better track record picking election outcomes than the pollsters, have Labor at short odds to be re-elected.

Indeed, changes of government in Australia are rare. Since federation, only 12 of 42 federal elections have seen voters dump a sitting government; only six of these changes have been since World War II. The Gillard government holds a comfortable 16-seat majority in the Lower House of Parliament, where the party of government is determined. Just nine seats, therefore, have to change hands for the Coalition to be elected. The latest poll result, however, hints the sitting government could even increase its majority.

Half of the seats in the Upper House of Parliament also are up for grabs in this election. With Labor's poor showing in the 2004 election dropping out (elected Senators serve six-year terms), a re-elected Gillard government probably will enjoy the benefits of a more convivial configuration of par-

## Past five changes of government and the economy<sup>(a)</sup>

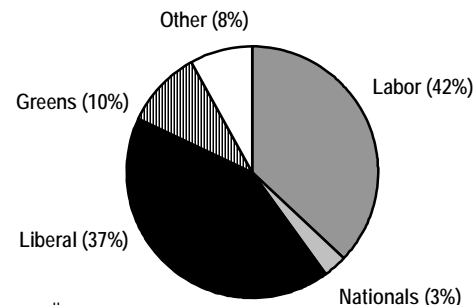
Election date	GDP growth	Inflation	U/E rate
2 December 1972	1.9	6.0	2.6
13 December 1975	1.9	15.2	4.9
5 March 1983	-0.5	10.1	10.0
2 March 1996	4.3	2.6	8.2
24 November 2007	4.8	2.3	4.4
Average	2.5	7.2	6.0
<i>Latest</i>	2.7	3.6	5.7

Source: Australian Electoral Commission, ABS.

(a) In the year of the election.

## Voting intentions: all parties

Percent



Source: Newspoll

ties in the Senate. In particular, from July 1, 2011, when the new Senate sits, there almost certainly will be more senators from the Green Party, for which polls show record levels of popularity. On the political spectrum, the Greens sit well to the left of the left-leaning Gillard government.

## Policy shifts under a Gillard government

Some voters resent the brutal manner in which Rudd was deposed and Gillard anointed; this will be a drag on Labor's chances in the election. Indeed, in an unprecedented move, "faceless" factional operatives of the ruling party, not voters, decided the toxically unpopular Rudd had to go. Gillard is, therefore, an unelected Prime Minister.

Gillard's need for a mandate helps justify the early election. A fresh mandate for the government likely will see further policy shifts. Addressing climate change will be a priority—Labor's backflip on the ETS triggered the surge in support for the Greens. So, too, will be moves to clean up untidy stimulus measures, particularly the waste in the school-building program. Also, Gillard will announce details on the shift to offshore processing of asylum seekers. With Wayne Swan staying on as Treasurer, though, there is unlikely to be material changes in economic management; the government forecasts the budget to return to surplus within three years.



## Research note

# New Zealand's difficult household rebalancing act

- There's been significant dissaving among households
- Incentives to boost saving are forthcoming
- Necessary rebalancing already is underway

The attention on debt and deficits during the global financial crisis brought to the fore, once again, one of New Zealand's long standing imbalances. The Shaky Isles still relies heavily on foreign borrowing because of perennially low household saving, which has left the economy somewhat lopsided. One key challenge for policymakers, therefore, is to rebalance the mix of economic growth. A prerogative should be to tilt the drivers of economic growth away from borrowing for consumption toward saving for investment. Indeed, the indebtedness of households leaves the economy exposed to the vagaries of external financial conditions.

## The rise and rise of household debt

Household indebtedness has risen significantly over the past decade as household savings tumbled, so households have become the most obvious source of imbalance in the Kiwi economy. Household debt was equivalent to 156% of disposable income at the end of 2009, compared with just 104% in 2000. Further, since the early 1990s, households have been consuming well in excess of their disposable income (see chart, top right), with the savings rate persistently negative. Household dissaving rose to NZ\$12.8 billion in 2009, or an unprecedented 13% of households' disposable income; this compared to just 4% a decade earlier, and a positive 4% (indicating saving) a decade prior to that.

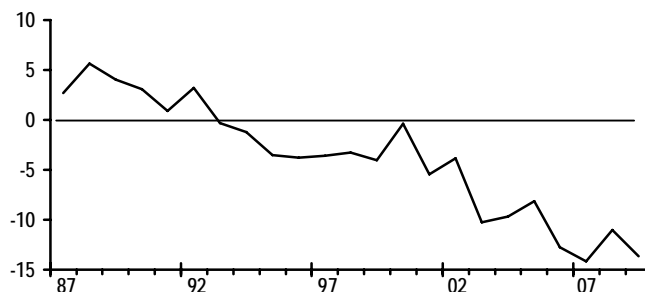
## Incentives to save

In a bid to rectify these significant imbalances, the government, in its annual budget released in May, adjusted the tax mix in a bid to tilt households back toward saving. The government announced across the board personal income tax cuts, a hike to the goods and services tax (GST), and a reduction in tax rates on savings, all effective October 1. The net impact on households' disposable income of these new measures is summarized in the table.

- **Personal income tax rates.** These tax cuts are worth NZ\$14.3 billion over the next four years. Importantly, those that save the most as a proportion of their income will benefit the most—higher income earners will receive a larger reduction in income tax, with the top marginal tax rate lowered from 38% to 33%. Increasing the incen-

### Household sector has been dissaving

Household saving, % of disposable income



### Impact of tax package (% of disposable income)

	Household income (NZ\$)		
	< 40,000	40,000-85,000	> 85,000
Personal income tax cut	0.9	2.8	4.2
GST rise	-2.5	-2.5	-2.6
Compensation measures	2.6	0.6	0.1
Other measures in package	-0.3	-0.5	-1.0
<b>Net impact</b>	<b>0.7</b>	<b>0.4</b>	<b>0.7</b>

Source: NZ Treasury

tive for people to save during their working years should help ease the growing fiscal burden, which will worsen as the population ages and retires. Statistics New Zealand estimates that the number of people aged 65+ will increase from half a million in 2005 to 1.33 million in 2051, so there will be fewer workers relative to retirees.

- **Goods and services tax hike.** The GST will be lifted from 12.5% to 15%. The GST hike will raise the relative price of consumption goods and lower households' marginal propensity to consume, such that households have more incentive to save. Most income earners will be better off following the GST hike given the across the board reductions in personal income taxes. The government estimates that the total taxes paid by someone earning NZ\$44,000, for example, will fall by NZ\$593 a year.
- **Lower savings tax rates.** The top tax rate for most portfolio investment entities (PIEs), including unit trusts, group investment funds, and life insurance, will be lowered from 30% to 28%. According to government estimates, as a result of the lower tax rate on PIEs, a worker earning NZ\$48,000 a year who joined KiwiSaver—a voluntary savings scheme for retirement savings—at age 25 will pay NZ\$11,700 less tax on investment income through retirement at age 65. NZ Treasury also estimates that if the same worker put all of his or her personal tax cuts into a term deposit they would be NZ\$78,000 better off upon retirement.

## Consumer spending subdued

Recent data suggests that the rebalancing of the New Zealand economy already is underway, with consumption subdued but a stronger export performance. In fact, consumer spending has stalled, providing further evidence that households have adopted a more cautious approach. Even though consumer confidence remains high (probably owing to the recently announced tax cuts), this optimism has failed to translate to stronger spending. Retail sales values, for example, fell 0.3% m/m in April, marking the third monthly fall in just five months. Significant competition among retailers, which has resulted in considerable discounting of goods, also would have weighed down retail sales values.

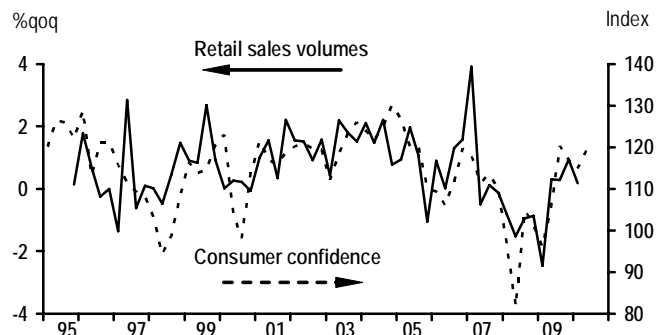
The retail sector should get a near-term lift as consumers bring forward spending ahead of the GST hike, but spending thereafter will be subdued. The RBNZ expects that households will undertake a period of consolidation on the assumption of a significant behavioral shift away from spending in favour of saving. Governor Alan Bollard has said that households have acknowledged their overexposure to residential property and debt, and are “prepared to constrain consumption to improve their savings.” Indeed, the significant rise in household debt in recent years coincided with rapid house price appreciation. Housing accounted for 74% of all households’ assets in 2009 and the associated debt a whopping 94% of all liabilities.

## Current account improved dramatically

The 1Q current account data also provided evidence of rebalancing. The current account balance returned to surplus in the March quarter, leading to a further narrowing in the annual CAD from 2.9% to 2.4% of GDP, the smallest deficit in more than 20 years. Much of the improvement owed to the trade balance, which moved to a surplus of NZ\$1.5 billion from a NZ\$219 million deficit. This owed to higher export prices on top of the strong recovery in trading partner activity, with New Zealand benefiting from increased penetration into Asian economies, as well as continued exposure to Australia, New Zealand’s largest trading partner.

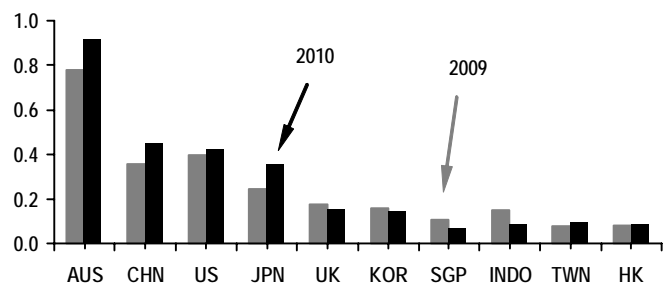
China, in particular, will play a key role in New Zealand’s export outlook, having last year overtaken Japan to become the nation’s second largest trading partner. Changes in consumer preferences and dietary patterns have led to rapid increases in Chinese consumption of dairy products—New Zealand’s main exported product, accounting for one fifth of total exports. The value of New Zealand’s exports to

Confidence rising but spending softening



New Zealand exports to China increasing

NZ\$ bn, May exports



China surged 43% in 2009 and probably will venture even higher this year as the stronger yuan stokes Chinese demand for imports. China’s demand for logs also has increased since Russia introduced a tax on its exports, with New Zealand exports of timber and other wood articles increasing 20% m/m in May, or 11% oya.

Higher commodity prices also have been a supportive factor. Export prices rose by the most in almost ten years in the March quarter, owing to higher demand for dairy products (+32% q/q), which took the value of dairy exports to their highest level since 4Q08. Export commodity prices reached another record high in May, continuing the strength that was apparent last decade before being interrupted by the global financial crisis.

Policymakers appear comfortable that the shift to more export-led growth will be sufficient to overcome still sluggish domestic demand. The RBNZ expects GDP growth of around 3% this year and next, with higher export prices and volumes among the key drivers. Our forecast is for softer GDP growth of 2.6% in 2010 and a return to trend-like growth of 2.9% in 2011. The current account balance will likely deteriorate as the recovery continues, although not to the worrying levels around the 10% of GDP recorded in recent years.

## Australia

- **RBA on hold, but officials affirmed inflation anxiety**
- **Aussie employment engine still firing on all cylinders**
- **Business and consumer confidence to bounce**

The RBA stood pat last week, as was widely expected, but the associated commentary was more upbeat than before, particularly on the domestic economy. In particular, the RBA explicitly mentioned the improvement in the labour market and the recent pickup in wage growth. In this context, officials will be acutely aware of the implications of last week's unexpectedly large June employment print. With the labour market continuing to tighten (nearly 46,000 jobs were added in June, taking the tally so far in 2010 to a mammoth 185,000), wage growth will continue to rise. An acceleration in wage growth will add to broader, and significant, inflation pressure, supporting our view that the RBA will resume tightening policy in early August.

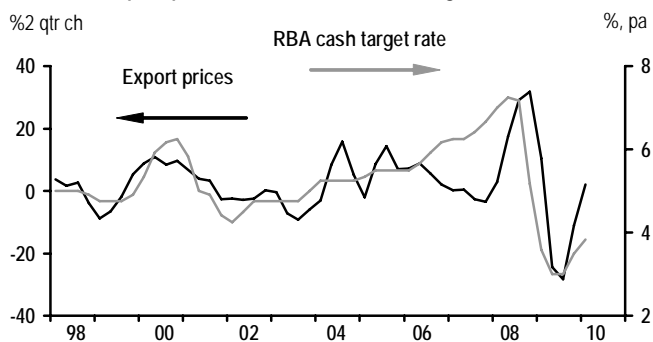
### RBA: inflation pressures still present

The Reserve Bank Board last week decided to leave the cash rate steady at 4.5%, as we and consensus had expected—this follows the 150bp of tightening since last October. The commentary announcing last week's decision was balanced, with the strength of domestic economic conditions seeming to counterbalance the impact of some signs of weakness offshore, including in financial markets, which the commentary mentioned in some length.

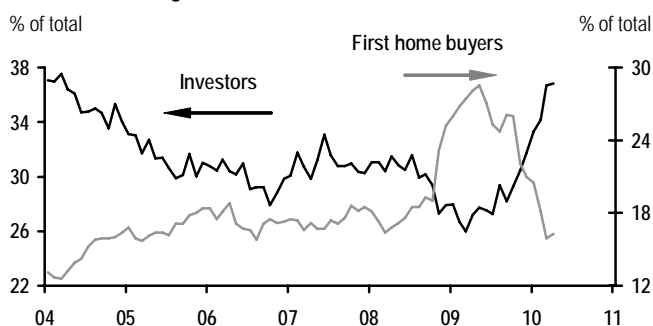
That said, beneath the surface, we detected a subtle shift toward a slightly more upbeat tone on domestic conditions, which hints that the RBA retains a mild tightening bias. Indeed, our main takeaway is that the key themes for the RBA do not seem to have changed much at all in recent months. That is, the Aussie economy is traveling along nicely and inflation is stubbornly high. As such, we believe this tightening cycle still has some way to run. Our view is that the next move from the RBA will be a rate hike at the early August Board meeting, following the release of what we forecast will be an elevated CPI print in the last week of July. We expect a further quarter-point hike in the final quarter of this year.

On domestic conditions, the bouncing terms of trade (and the resultant boost to national income) remains the dominant theme. In fact, the RBA mentioned the terms of trade twice. Aside from that, most of the sentiments were upbeat, except perhaps when the RBA referred to the housing market, where prices are rising "more slowly." Consumer

Australia: export price index and RBA cash target rate



Australia: housing finance



spending is enjoying "modest growth," but the previous upbeat thoughts on business investment have returned, now that the mining tax debacle has been settled (at least with the large mining companies). The statement also was somewhat upbeat on global conditions, even for Europe, where the RBA believes prospects are "uncertain," not gloomy.

While the CPI data on July 28 are important, as always, the decision will not be explicitly conditional on a historical print. Our forecast is for an elevated 1.1%q/q outcome for headline inflation and, more importantly, for 0.7%q/q on the core measures. An outcome close to this on the core, which will leave the annual rate troublingly high, should be sufficient to convince officials that another tap on the policy brake is warranted. Last week's commentary, though, sent a veiled warning for the market not to read too much into what seems increasingly likely to be a high headline print later this month. The RBA's commentary makes explicit mention of the boost to inflation from the abrupt rise in tobacco taxes back in April and from higher regulated utility prices. In other words, a high headline print alone would not be sufficient to trigger an August hike.



On the flip side, any deepening of anxiety about the global economic and financial outlook could see the RBA extend this policy pause. However, this is not our base case. Indeed, delaying further hikes until 2011 could result in officials ultimately having to deliver more austerity than would have been the case had they acted more assertively this year.

### New home loans still a hard sell

There is little scope for a meaningful bounce back in home loans in May, with the same drags that have been in place since the start of the year continuing to weigh on loan demand. We expect new loan commitments to have risen just 1.5% over the month, with rising interest rates, rising risk aversion in financial markets, falling consumer confidence, and the lack of stimulus support generating a toxic environment for would-be borrowers.

Home loans have been on a steady downward trajectory since the expiry of the expanded First Home Buyers' (FHB) grant in January. We expect representation in that group to continue to dwindle over the coming months.

### Consumer confidence not low for long

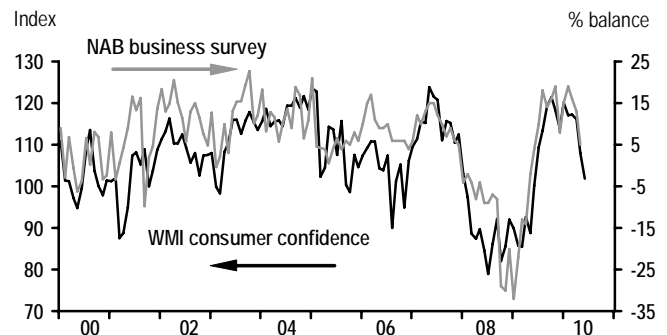
Consumer confidence probably spiked in July, with our forecast calling for the Westpac-Melbourne Institute (WMI) consumer confidence index to increase 7% m/m. The improvement will owe to myriad factors: the RBA's decision to leave the cash rate steady last week (and in June); the stabilization of equity markets; the movement toward resolution on the controversial resource "super" profits tax; and, last but not least, the change in national leadership, with new Prime Minister Julia Gillard doing well in published opinion polls.

The rise in confidence will follow a near 6% m/m drop in June, which took the WMI index to 101.9; the deterioration in confidence in recent months has owed mainly to rising mortgage rates. Following the last rate increase in May, the WMI reported an 8% m/m drop in confidence among those respondents with a mortgage; this was significantly more than the average 2% drop among this group following the previous five hikes to the official cash rate since October last year. This suggests that interest rates have reached a level that has started to hit home.

### No end in sight for Aussie job gains

The resilient Aussie economy added another 45,900 jobs last month, more than double the job gains of 22,800 in

Australia: consumer and business confidence



Australia: unemployment rate



May. This means that an astounding 185,000 jobs were added in 1H10, or 31,000 on average each month. The 45,900 increase in jobs in June matched a 45,700 increase in the labor force. This could be indicative of a number of factors, such as a rise in new migrants looking for work, or second income earners returning to the workforce from households struggling amid higher interest rates. For these reasons, among others, labour force participation will remain elevated this year; this will keep upward pressure on the unemployment rate. The unemployment rate held steady at June at 5.1%, even with a slight rise in the participation rate to 65.2% from 65.1%.

The positive investment outlook means solid employment gains are likely in 2H10, but most likely at a more moderate pace. Leading indicators of employment are pointing in different directions. The employment component of the NAB business survey, for example, has pulled back in recent months, suggesting that recent solid job gains will ease, albeit modestly. This is in contrast to the ANZ job advertisements series. The ANZ job ads report for June showed that the total number of job ads placed rose a healthy 2.7% m/m, the same rate as in May.

## Data releases and forecasts

### Week of July 12 - 16

Mon Jul 12 11:30am	Housing finance approvals: owner occupiers Number of loans, sa	Feb	Mar	Apr	May
	%m/m	-1.7	-2.9	-1.8	<u>1.5</u>
	%oya	-16.4	-22.6	-25.3	<u>-25.2</u>

Tue Jul 13 11:30am	NAB monthly business survey % balance, sa	Mar	Apr	May	Jun
	Business confidence	16	13	5	<u>10</u>

The fall in the headline rate in May owed largely to the debate over the resource “super profits tax”—there was a 30-pt drop in confidence for the mining sector. With the new Prime Minister having moved swiftly on working toward a resolution of the controversial tax toward the end of June, firms should have become more upbeat. Sovereign concerns also eased in Europe and the RBA held the cash rate steady early in the month.

Wed Jul 14 10:30am	WMI consumer confidence survey 100=neutral, sa	Apr	May	Jun	Jul
	%m/m	-1.0	-7.0	-5.6	<u>7.0</u>

Thu Jul 15 11:30am	Sales of new motor vehicles Units, sa	Mar	Apr	May	Jun
	%m/m	-2.8	9.0	-3.2	—
	%oya	19.5	29.1	16.4	—

## Review of past week's data

ANZ job advertisements (%m/m,sa)	Apr	May	Jun			
	-1.2	-0.3	4.3	2.7	—	2.7

Trade balance Trade balance (A\$ mn,sa)	Mar	Apr	May			
	-2040	-1769	134	1123	<u>700</u>	1645

## RBA cash rate announcement

No change delivered. See main text.

## Labour force

Seasonally adjusted	Apr	May	Jun			
Unemployment rate (%)	<del>5.4</del>	5.3	<del>5.2</del>	5.1	<del>5.3</del>	5.1
Employed (000 m/m)	35	36	27	23	5	46
Participation rate (%)	65.2	65.1			<u>65.1</u>	65.2

## New Zealand

- **Kiwi 2Q CPI to print on RBNZ target**
- **Retail sales coming back, but will be subdued in 2H**
- **Kiwi firms' sentiment reflects gradual recovery**

Across the Tasman, the NZIER *Quarterly Survey of Business Opinion* signaled that the recovery is slowing, with fewer respondents expecting conditions to improve over the next 12 months. A majority of respondents, however, still expect that interest rates will rise. This week's CPI data likely will show headline inflation printing in the middle of the RBNZ's target band, but nontradables inflation heading north. RBNZ Governor Bollard, therefore, probably will deliver further tightening in coming months.

### NZ 2Q CPI to stay in the sweet spot

We suspect that headline inflation in New Zealand continued to hover around the middle of the RBNZ's 1%-3% target range in the June quarter. Consumer prices probably grew 1.9% oya, compared to 2.0% in 1Q, marking the fifth straight quarter that headline CPI has remained within the Bank's target. This will translate to quarterly growth of 0.4% q/q, the same rate of growth as in the previous quarter.

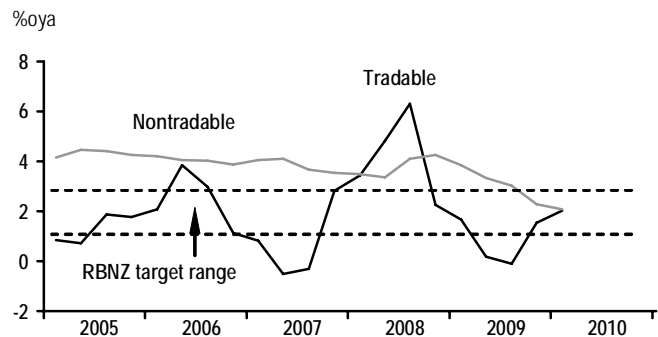
Headline CPI will pick up significantly in 2H10, however. The inclusion of the stationary energy sector in the ETS from July 1 will boost the price of fuel and electricity, before the GST hike comes into play on October 1. Although these two policy changes should, individually, have only a temporary impact on prices, given that they are coming into effect within months of each other, the real risk is that inflation expectations rise. Indeed, consumers and businesses may start to reassess their expectations of medium-term inflation and, as a result, price and wage setting behaviour may change. Our forecast is for headline inflation at an elevated 4.7% oya in 4Q, but the risks are skewed to much higher inflation if expectations do not remain anchored.

The medium-term inflation outlook, particularly the expected rise in underlying inflation, reaffirms our view that the RBNZ will need to tighten monetary policy further. 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. We forecast an OCR of 3.75% by year-end.

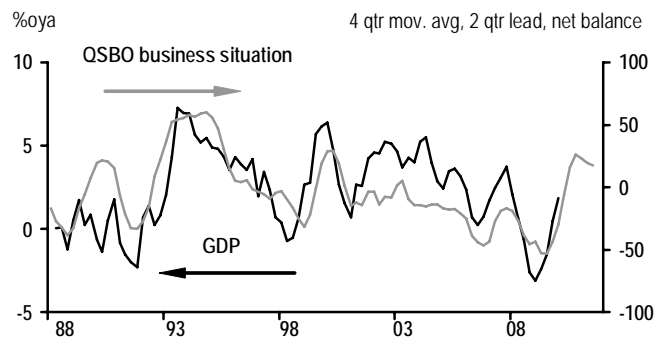
### Retail sales to have rebounded

Consumer spending probably rebounded in May, with credit card statistics suggesting that total billings on cards

New Zealand: nontradable and tradable inflation



New Zealand: GDP and QSBO expectations for the economy



increased significantly. The government also confirmed in May that it would hike the goods and services tax (GST) from 12.5% to 15.0% on October 1, so the increase in sales, whether it be owing to cash or card sales, will provide the first piece of evidence that consumers are bringing forward spending ahead of the rise in the consumption tax. Indeed, it was for this reason we believe that the retail sector posted the biggest rise in sentiment in the NBNZ survey of business confidence in May, with a 10-point jump. Our forecast is for retail sales to have jumped 0.8% m/m in May, after falling 0.3% in the previous month. We also expect that core retail sales rose 0.2% m/m.

Aside from the lift to retail sales expected in the months ahead, household spending thereafter will likely be subdued. As RBNZ Governor Alan Bollard recently highlighted, households are set to undertake a period of consolidation. Bollard has reinforced the message that New Zealand households remain the most obvious source of imbalance in the economy, with balance sheets heavily skewed to housing, high debt ratios, and low savings. He believes that households have acknowledged their overexposure to property and high debt levels, however, 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.

### Kiwi firms on the slow road to recovery

The NZIER Quarterly Survey of Business Opinion (QSBO) signaled that the recovery under way in New Zealand continues, although at a slower pace than firms expected when last surveyed three months ago. The headline reading eased back to +18 (J.P. Morgan: +20) in 2Q from +22 in 1Q, meaning that a net 18% of firms surveyed expect the economy to improve in the next six months. Investment intentions declined after a year of improvement, but remain above long-run average levels. These levels are still consistent with a recovery in investment, but any further decline in investment intentions will create downside risks around the employment outlook. That said, the labour market outlook strengthened in June. The QSBO survey showed that hiring intentions remained marginally positive (at +1%), alongside improvements in actual hiring, overtime worked, and labour turnover. That said, all of these indicators remain well below long-run averages.

The survey also showed that price pressures remain contained given that weak domestic demand is reducing firms' pricing power. That said, a significant 40% of firms expect to increase selling prices in the next three months. Elevated pricing intentions probably reflect the one-off policy measures that have come into play or are on the near-term agenda, such as the GST hike. This partly explains why a massive 88% of firms surveyed expect interest rates to rise further. The NZIER warned last week, though, that in this fragile economic environment, the RBNZ needs to "take care not to stifle already anaemic domestic demand and derail a fragile export recovery."

### Data releases and forecasts

#### Week of July 12 - 16

Wed Jul 14 10:45am	Retail trade Sa	Feb	Mar	Apr	May
	%m/m	-0.5	0.5	-0.3	<u>0.8</u>
	%oya	2.3	3.2	2.4	<u>2.6</u>
Thu Jul 15 10:30am	Business PMI Sa	Mar	Apr	May	Jun
	Index	56.4	58.6	54.5	—
	%oya	34.3	34.3	23.6	—
Fri Jul 16 10:45am	Consumer price index Nsa	3Q09	4Q09	1Q10	2Q10
	Headline (%oya)	1.7	2.0	2.0	<u>1.9</u>
	Headline (%q/q)	1.3	-0.2	0.4	<u>0.4</u>

### Review of past week's data

#### NZIER QSBO

% balance of respondents	4Q09	1Q10	2Q10	
Headline index	31	22	<u>20</u>	18

## Global Essay

- **As manufacturing comes off the boil demand and labor indicators become the keys**
- **The European growth bounce has arrived but is likely to be short-lived**
- **This week's China releases likely to signal downshift toward 8% growth**
- **Headline inflation is dropping fast; will temper EM policy normalization**

### Happy birthday, global expansion

The unique drags facing the global economy—notably the unprecedented damage to financial institutions, household balance sheets, and public finances in developed markets—have been a major source of concern throughout the first year of the global economic expansion. Despite these concerns, the expansion has thus far closely followed the script written by past cycles. From a depressed starting point, activity has been lifted solidly for a full year. The most rapid output gains in over four decades were recorded in the industrial sector while GDP growth has averaged more than a percentage point above its trend. At a pace close to 4%, global GDP has risen more rapidly than at the start of the past two recoveries, but has fallen short of the standard set in recoveries from deep contractions during the mid-1970s and early 1980s. In all, with its first year now complete, the upturn can be aptly described as one in which unique drags tempered but did not short-circuit the normal workings of the business cycle.

The terms of debate are, in many respects, the same as the global economy embarks on a second year of expansion. Evidence that firms have resumed hiring and are increasing

capital spending bolsters confidence that the expansion is finding firmer footing and can withstand the removal of fiscal supports. However, additional drags have entered the picture as a result of European sovereign stress and a reduction in global risk appetite. What is different from last year is the direction of the business cycle arrow. The historical script suggests that the initial acceleration phase following a recession is short-lived and that a moderation in overall pace of growth should be expected over the coming quarters.

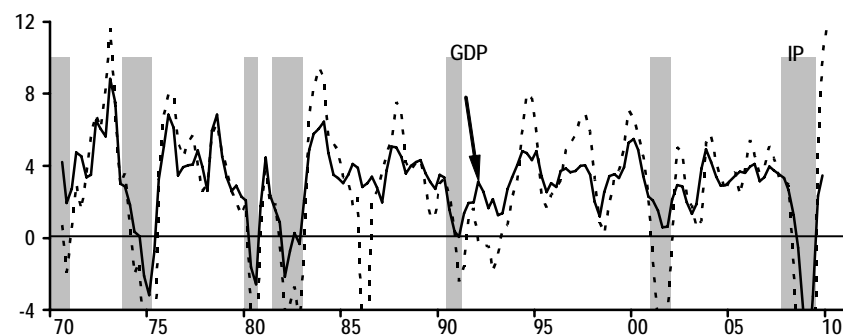
This downshift is usually concentrated in manufacturing as an important element of the early cycle lift to growth comes from the realignment of depressed levels of production with demand. This lift was particularly powerful this time but all indications are that levels of production are aligning with demand with inventories now building. With global final demand expected to rise at about a 3% pace in the coming quarters the current double-digit pace of output gains is clearly not sustainable. Our forecast expects a continued desire to build inventories to sustain production gains at about a 5% pace. But experience shows that it is common for output growth to downshift below the pace of demand even in the midst of a healthy economic expansion. Uncertainty about the contours of this adjustment will make it hard to gauge the health of the business cycle through the lens of manufacturing sector indicators in the coming months.

More central to the outlook for the second year of the global business cycle expansion will be the direction of labour market and final demand indicators. Continued growth in these indicators would signal resilience in private sector behaviour in the face of the latest shocks. It would also suggest that, as in past cycles, a downshift in industry will cloud the transition taking hold to a self-sustaining expansion.

It is against this backdrop that the latest demand indicators are sending confusing signals. Having accelerated dramatically into the end of the first quarter, our proxy of global

Global GDP and industrial output

% change over 2q, saar





#### Global activity indicators

%m/m	Jan	Feb	Mar	Apr	May	Jun-Sep fcst
Goods consumption	0.0	0.6	1.1	-0.5	0.3	
US	0.2	1.0	1.3	-0.1	0.2	
Cap. goods shipments	1.8	3.2	2.1	1.6	-0.5	
US	-1.2	2.3	2.3	0.4	1.4	
Global goods sales proxy	0.4	1.1	1.1	0.1	0.0	0.3
Global mfg. output	1.2	-0.1	1.8	0.7	0.8	0.4
US	0.9	-0.2	1.1	0.8	1.1	
US prv payrolls (ch 000s)	16	62	158	241	33	150

final sales stagnated during April and May. If we are right, demand is trending upward somewhere between these two extremes. This week's June retail sale readings for the US and China will provide guidance on this issue.

### Euro area growth picked up smartly in 2Q

For some time now, we have expected the Euro area to deliver a strong 3%q/q saar GDP gain in the second quarter, led by a very strong 5%q/q saar bounce in Germany. In part, Germany was expected to rebound strongest from the weather-related setback to construction activity suffered during the harsh winter. In addition, the German economy is thought to be highly leveraged to the regional turn in the inventory cycle and shift in private sector demand.

Last week's data for May have been so impressive that they now raise upside risk to our already strong expectation for German. Industrial output and exports are tracking record quarterly gains of 18% and 30% annualized, respectively, and construction output is up a huge 75% annualized. With the exception of Greece, growth also picked up in the periphery in 2Q10, although far less spectacularly than in Germany.

While the official activity data through May are confirming the anticipated growth bounce, the June business surveys suggest that it will be short lived. We do not expect the region to fall back into recession, but we do expect growth to slow to 2%q/q saar in Germany and to 1%q/q saar in the region as a whole by year-end, as the cyclical lift fades and the sovereign stress weighs on growth.

### Preparing to revise down China 2H growth

China will report its 2Q GDP and June activity data this week. Following a year in which the economy expanded 12%, we think that sequential growth moderated to 9.4%q/q, saar last quarter. Moreover, June data releases are likely to hint at a loss of momentum through the quarter. Fixed investment growth likely eased, while exports probably re-

treated after spiking in May. Only June retail sales are expected to remain robust. If this week's reports meet our expectations, we will revise down the 2H10 growth forecast—most likely towards 8%.

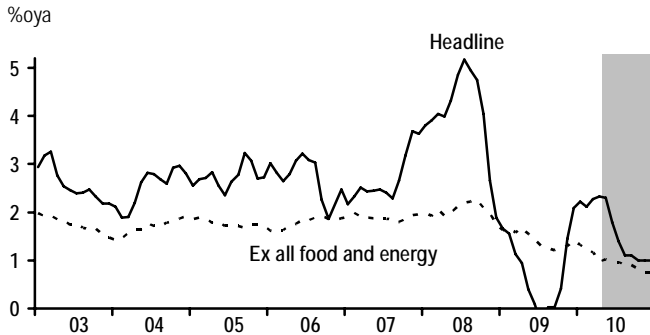
China is coming off the boil, but it is unlikely that growth will slip well below trend as long as the government policy remains biased towards growth. This week, the central bank reiterated the need for an “appropriately accommodative” monetary policy stance during the rest of the year and has now injected liquidity through open market operations for seven straight weeks. Meanwhile, NDRC announced a RMB682 billion investment plan for 23 major infrastructure projects. Initial indications are that these will largely be new projects, not simply “fast-tracking” of existing ones. The announcement was somewhat of a surprise to the market given that the government has been reluctant to approve new infrastructure projects since late last year due to concerns about overinvestment and the quality of bank assets associated with local government borrowing. Although we believe the direct impact on the economy from the investment program is likely to be very limited in 2010, the initiative is an important signal that the government remains vigilant in setting policies that deliver solid growth.

### Disinflation to reinforce EM policy divide

Around the world, headline CPI inflation is set to slide as the positive base effects from energy and food prices fade with the stabilization in commodity prices. As of May, global headline inflation was running 2.3%oya, even as core inflation reached a record low of 1.0%. Assuming commodity prices remain near current levels, this positive wedge largely will disappear during the current quarter. The leading edge of this process already is visible in June data, where most inflation reports have registered some decline. When all the results are in, we look for headline inflation to fall 0.5%-pt to 1.8% in June. This includes a nearly 1%-pt drop in the US to 1.2%oya in this week's reports.

The decline in headline inflation will be a welcome relief to EM central bankers, although its effect on policy will vary according to perceptions of resource slack and the outlook for core inflation. The gradual normalization process is expected to continue in most of Emerging Asia and Latin America, where slack is more limited and core inflation is firming. In just the past seven days, central banks in India, Korea, and Malaysia have raised policy interest rates. This is expected to be followed by a move in Thailand this week. With that said, policy rates remain very low in EM Asia and the net amount of tightening has been less than 25bp on a GDP-weighted basis so far this cycle.

### Global consumer prices



In Latin America, Brazil's central bank is unlikely to be deterred by a decline in headline inflation. Last week we trimmed our forecast for year-end inflation to 5.5% from 5.9%. Beneath the surface, however, core inflation is expected to continue climbing because of a steady rise in services inflation, particularly against the backdrop of a tight labour market. Thus, we maintain our call that the COPOM will hike another 225bp this year, bringing the Selic rate to 12.50% by December. In addition, Peru's central bank hiked again in an environment of robust growth and rising inflation (contrary to most elsewhere, food inflation is rising in Peru).

Emerging Europe stands apart. Most countries in the region have gotten off to a slow recovery, similar to Western Eu-

rope. Slack is abundant and core inflation is falling. With policymakers already wary of spillover from the debt crisis in the Euro area, a decline in headline inflation will reinforce their inclination to remain on hold. Turkey is a case in point. The inflation scare from early this year is now unwinding, with both headline and core inflation receding, prompting us to lower our end-2010 headline CPI forecast to 6.9% oya. In addition to lower food and energy prices, the improvement in fiscal performance, currency strength, and the increased credibility of the CBRT and its inflation targets lie behind the better inflation performance. With inflation falling and the outlook for exports softening, we have pushed back the expected onset of policy tightening to 2H11.

### Japan downshifts amid elections

The moderation in global economic activity into midyear is also evident in Japan. Last week's reports provided additional evidence in this regard, including the declines in the June services PMI and the Economy Watchers survey, along with May machinery orders. The downshift in the recovery is fueling concerns among policymakers. Although the BoJ is expected to stay on hold next week, a senior BoJ official urged domestic banks this week to lower TIBOR, which is used as the benchmark for banks' lending rates. No doubt, the persistence of deflation along with the recent appreciation of the yen played some role in this unusual request.

## JPMorgan View - Global Markets

### Waiting for the stress test

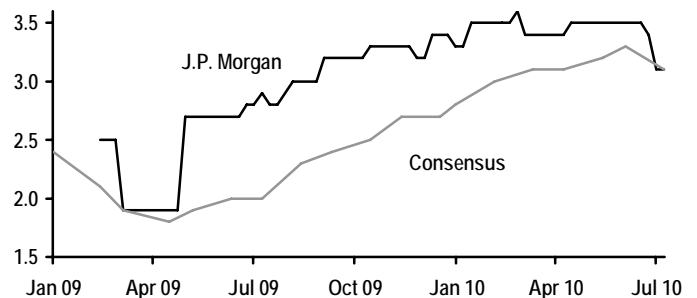
- **Economics:** Global GDP growth is slowing toward trend. Economic uncertainty is unlikely to be resolved before early autumn.
- **Asset allocation:** Overweight Emerging versus Developed Markets, Credit versus Equities, and Services versus Manufacturing.
- **Fixed income:** Robust domestic growth to trump global uncertainty, and push yields higher in Canada and Australia.
- **Equities:** OW banks, UW small caps, OW EM, UW Industrials.
- **Credit:** Overweight long maturity taxable municipal bonds versus similar US corporates.
- **FX:** The short squeeze on the euro has further to run. Add to the euro long by buying EUR/JPY.
- **Commodities:** Gold is suffering as investor concerns about deflation increase. Turn neutral.

Markets focus has shifted to two main events: the **Euro-pank stress test** due on July 23 and the 2Q reporting season that kicks off next week in the US. Each event should provide some relief for risky markets, but they are unlikely to resolve the uncertainty around the two main issues that bother investors: the downshifting in economic growth and the funding problems in Europe.

Our colleagues in equity research (*European Banks: Opportunities in the sector ahead of a stress test* Francesca Tondi et al July 7) estimate a €7 billion capital requirement for listed European banks (i.e., excluding Spanish savings banks and German Landesbanks). This figure results from a comprehensive stress scenario that includes an economic recession and substantial sovereign haircuts. The €7 billion represents 8% of the market cap and compares to a 16% loss in equity values over the past three months. In our opinion, this capital shortfall is manageable and has been largely discounted.

There is likely to be a large capital shortfall for German Landesbanks but there is still €50 billion of untapped capital support from SOFFIN, which should be sufficient. The risk lies with the stress test for **Spanish savings banks**. The stress test has the potential to increase market worries either because the capital shortfall is too small and thus not

2010 US GDP growth forecasts: J.P. Morgan versus consensus  
%



credible, or too big, worsening the funding problem for Spain. The approval today by the Spanish Cabinet of the savings banks law, which allows cajas to raise capital from investors by selling shares with voting rights, is encouraging. It opens the door for sources of capital outside FROB, the vehicle created by the government last year to recapitalize the banking sector, and has the potential to reduce the pressure on the Spanish government to issue more debt.

In terms of the **2Q US reporting season**, we see a high chance for an EPS beat. The first signs from preannouncements are encouraging. Negative preannouncements have only been 50% in the US, a three-year low. The risk lies with company guidance regarding future earnings. Guidance will be even more closely watched over the coming weeks for clues on how the crisis is affecting business expectations and behaviour.

**Economic uncertainty is unlikely to be resolved before early autumn.** Although we see only a small, 15% chance of global GDP growth falling below 1%, we acknowledge that investors will remain for some time unable to distinguish between a slowing in global growth toward trend (our own forecast) or the early stages of a more serious downturn or double dip. Key to watch is consumer and corporate demand. Final demand needs to hold up for our own forecast to play out. The early signs from final demand indicators, i.e., retail sales and capex shipments, have not been encouraging. The **momentum in economic forecasts has turned negative** as a result with both J.P. Morgan and the consensus reducing 2H GDP growth forecasts over the past two weeks.

High uncertainty and negative momentum have induced us to keep overall directional risk low and to focus exposure on relative value or momentum trades across and within asset classes: **Overweight Emerging versus Developed markets, Credit versus Equities, Services versus Manufacturing, and Large versus Small caps.**

**Could extreme investor positions trigger a market reversal?** Not in our opinion. Uncertainty has indeed induced investors to cut exposure on risky markets but not massively so. Investors are still overweight risky assets and their exposures are very far from the underweight levels seen in late 2008 and early 2009. By looking at recent fund manager surveys, real money investors' exposure to equities is at 70% on a scale of positioning between the lows in early 2009 and the bull market levels of 2006/2007. Hedge fund equity exposures are lower at halfway, judging by the rolling beta of their daily returns to equities. Similarly, credit positions are halfway between the highs and the lows of the past 10 years based on our US credit client survey.

## Fixed income

**Bonds fell slightly, as further details on the forthcoming European bank stress tests bolstered risky assets.** European peripherals rallied in the wake of an oversubscribed Spanish bond issue, even as ECB buying appeared to settle at around €4 billion per week (see chart), well below the pace of purchases in May.

**Concerns about the European banking sector have boosted bonds not just by increasing demand for the safest assets, but also by limiting the supply of duration.** Banks have been forced to replace maturing bonds with short-term borrowing, including from the ECB. Indeed, European net financial bond issuance has been very negative recently. If the stress tests reestablish confidence in Euro area banks, an increase in duration supply will likely amplify the reversal of the flight to quality, pushing yields higher.

Short rates moved smartly higher in Australia and Canada last week, reflecting strong employment data. In both countries, central banks are caught between robust domestic growth, suggesting higher rates, and uncertainty about the global economy and financial system, suggesting caution. We expect the former to dominate over time, and thus **stay short Canada versus the US, and short outright in Australia.**

Many EM central banks face the same conundrum. For example, strong growth pushed the Bank of Korea to start hiking today, a month before the market had expected. Earlier central bank tightening is a risk to EM bonds. But we expect it to be trumped by continued robust inflows into EM, and stay long.

## Equities

Equity markets rebounded last week helped by optimism

regarding the European bank stress test results to be released on July 23. As explained above, we expect these results to be positive for listed European banks. This is supportive of our **bank overweight** globally, which we initiated two weeks ago as a softened version of the US financial reform bill was agreed by Congress and as global regulators appear to be watering down onerous liquidity requirements under Basel III.

**Small caps continued to underperform**, falling by another 1% on the week, despite the rebound in equity markets. As we emphasized before, the trade could work under both a bullish and bearish environment near term. Investors so far refrained from selling their more illiquid small cap holdings. This means that they are overweight small caps. If the equity sell-off continues into the coming months, a flight to liquidity will likely force equity investors to start selling their more illiquid small cap holdings. If, on the other hand, equity markets go up, investors are more likely to buy large caps that were hit the worst over the past months.

We continue to overweight markets that are more remote from the epicenter of the crisis focusing on **EM**. EM is relative immune from European funding problems and the outperformance of Chinese equities over the past two months suggests that uncertainty regarding China is receding. Our EM versus DM equity allocation model also favors an EM overweight, as both 2-month return momentum and relative IP growth (i.e., the difference between the oya rates in EM IP versus DM IP) are supportive. See *The EM vs. Developed Markets equity allocation*, Grace Koo and Nikolaos Panigirtzoglou, April 2009, for more details.

## Credit

Credit markets rallied along with equity markets. Financial bonds benefited from positive news on European bank stress tests and outperformed Industrial bonds over the week.

We **remain positive on credit in the medium term**, especially on higher yielding assets with strong fundamentals such as US high-yield and high-quality CMBS. With low yields in HG corporate bonds, we stay neutral in HG credit.

The spreads of **Build America Bonds (BABs)** have widened substantially versus US corporates over the past few weeks, as investors fear that a US local/state sovereign debt crisis is brewing. We believe BAB spreads are relatively cheap at the current level and recommend **overweighting long maturity (10+) A-rated BAB spreads versus similar US corporates**. Muni issuers are very diverse and the



total tax-supported debt from state issuers is actually only 15% of the entire muni bond universe. In addition, most states have low deficit and refinancing risks. The spread difference between similarly rated and similar-maturity corporate and taxable muni bonds can be partly explained by the lower liquidity and market fragmentation of the muni market. However, based on our analysts' estimate, the fair value of this structural difference is around 15-20bp, leaving an additional compensation of 50bp. See *US Municipal Strategy*, Alex Roever.

## Foreign exchange

As summer doldrums go, 2010 is not following the usual script. While global equities, credit, and commodities are almost unchanged since the beginning of June, **the dollar has fallen versus most currencies and is down 3% trade-weighted**, which does not at all look like the range we expected. The surprise has come from US rates: they are flat-to-lower as most other government bond markets sell off, highlighting how stretched optimism toward the US and pessimism toward Europe had become.

It would be hasty to think that the dollar's decline over the past month signals a more stable world. The extent of the US slowdown will not be known for at least another month, and Europe's bank funding squeeze in the periphery still has no obvious solution (beyond credit contraction, which is euro-negative over the medium term). This environment is still best described as fluid and trends still look tentative. Thus our forecasts this summer for a EUR/USD range around 1.25, USD/JPY around 90, and commodity currencies within a few cents of current levels. The very near-term bias is a weaker dollar, however, since corporate profits should dominate the weak US data flow as 2Q earnings are announced over the next three weeks.

We are short EUR/CHF and USD/CAD in options, short USD/INR in cash and long EUR/GBP in cash. **Add to the euro long by buying EUR/JPY**, more for belief that the short squeeze on the euro has further to run this month than a belief that Europe has resolved its bank funding dilemma (it has not). The short base in euro is still substantial at least judging from IMM positions, only 35% of which have been covered.

## Ten-year Government bond yields

	Current	Sep 10	Dec 10	Mar 11	Jun 11
United States	3.05	3.45	3.85	4.15	4.50
Euro area	2.63	2.90	3.15	3.25	3.35
United Kingdom	3.33	3.55	3.90	4.10	4.25
Japan	1.15	1.30	1.40	1.50	1.55
GBI-EM	6.74			7.90	

## Credit markets

	Current	YTD Return
US high grade (bp over UST)	179	6.0%
Euro high grade (bp over Euro gov)	204	3.0%
USD high yield (bp vs. UST)	719	5.3%
Euro high yield (bp over Euro gov)	764	4.0%
EMBIG (bp vs. UST)	335	6.3%
EM Corporates (bp vs. UST)	371	6.7%

## Foreign exchange

	Current	Sep 10	Dec 10	Mar 11	Jun 11
EUR/USD	1.26	1.25	1.25	1.25	1.25
USD/JPY	88.5	90	93	93	93
GBP/USD	1.51	1.47	1.44	1.42	1.42

## Commodities - quarterly average

	Current	10Q3	10Q4	11Q1	11Q2
WTI (\$/bbl)	76	85	85	90	85
Gold (\$/oz)	1209	1250	1200	1175	1175
Copper(\$/m ton)	6593	7150	6750	6500	6500
Corn (\$/Bu)	3.97	3.90	3.80	4.00	4.20

Source: J.P. Morgan, Bloomberg, Datastream

## Commodities

**Commodities rose 4% last week** as risky markets rallied across the board. Crude oil and industrial metals are both up around 5% while the sell-off in gold continued. Corn prices continued to benefit from supply concerns as the world agricultural supply and demand report from the USDA showed increased demand and a decline in stocks. We continue to believe that supply estimates are on the optimistic side and leave little room for any shortfall. **Stay long corn.**

**Gold has now fallen nearly 5% from its peak at the end of June.** As global growth slows and investor concerns about deflation increase, gold is likely to continue to suffer. Given speculative positions are also close to all-time highs, continued selling is likely until growth and inflation expectations stabilize. **We turn neutral gold.**



## Global Economic Outlook Summary

	Real GDP			Real GDP						Consumer prices				
	% over a year ago			% over previous period, saar						% over a year ago				
	2009	2010	2011	1Q10	2Q10	3Q10	4Q10	1Q11	2Q11	3Q11	1Q10	2Q10	4Q10	2Q11
<b>The Americas</b>														
United States	-2.4	3.1	2.9	2.7	<u>3.2</u>	3.0	3.5	2.5	2.5	3.0	2.4	1.8	0.9	1.2
Canada	-2.5	3.6	2.7	6.1	<u>3.5</u>	3.4	3.2	2.7	2.0	2.4	1.6	1.5	1.8	1.9
Latin America	-2.9	5.2	3.8	4.2	<u>4.7</u>	2.5	4.0	4.3	5.2	1.7	6.0	6.5	<b>7.0 ↓</b>	<b>6.9 ↑</b>
Argentina	-2.0	6.0	4.0	12.5	<u>8.0</u>	3.0	4.0	3.0	4.0	5.0	9.0	9.0	10.0	11.0
Brazil	-0.2	7.5	4.0	11.4	<u>6.0</u>	4.0	3.3	3.8	4.2	4.1	4.9	<b>5.1 ↓</b>	<b>5.3 ↓</b>	<b>5.4 ↑</b>
Colombia	0.8	4.5	4.1	5.3	<u>4.8</u>	3.7	4.0	4.0	4.1	5.0	2.0	2.1	3.3	3.6
Ecuador	0.4	2.0	3.0	1.3	<u>3.5</u>	4.0	4.5	3.0	2.5	2.5	4.0	3.3	3.9	4.1
Mexico	-6.5	4.5	3.5	-1.4	<u>3.2</u>	-1.8	4.2	5.7	7.9	-2.3	4.8	4.4	5.1	4.5
Peru	0.9	7.3	6.0	7.3	<u>9.5</u>	4.0	4.5	6.0	6.7	7.2	0.7	1.0	2.1	2.2
Venezuela	-3.3	-4.0	1.0	-5.6	<u>-5.0</u>	5.0	1.0	1.0	1.0	1.5	27.4	32.1	32.1	32.1
<b>Asia/Pacific</b>														
Japan	-5.3	3.6	2.2	5.0	<u>2.8</u>	2.5	2.5	2.2	2.0	1.5	-1.2	-1.4	-0.7	0.1
Australia	1.3	2.9	3.5	2.0	<u>2.7</u>	4.1	4.2	3.1	3.2	4.2	2.9	3.6	3.8	3.6
New Zealand	-1.7	2.6	2.9	2.3	<u>3.8</u>	2.9	1.9	3.0	3.4	3.5	2.0	2.2	4.8	5.3
Asia ex Japan	<b>4.8 ↑</b>	8.9	7.2	<b>11.1 ↓</b>	<b>7.2 ↑</b>	<b>6.3 ↓</b>	6.9	<b>7.2 ↑</b>	7.4	7.5	4.3	<b>4.7 ↑</b>	<b>4.6 ↑</b>	<b>3.9 ↑</b>
China	<b>9.1 ↑</b>	<b>10.7 ↓</b>	9.4	<b>11.9 ↓</b>	<u>9.4</u>	9.3	9.0	9.1	9.5	9.7	2.2	3.2	3.1	2.4
Hong Kong	-2.8	6.8	4.2	8.7	<u>4.3</u>	4.0	3.8	4.2	4.3	4.7	1.9	2.6	2.5	2.2
India	7.4	8.3	8.5	9.2	<u>8.1</u>	8.0	8.9	8.0	8.5	8.6	15.3	<b>13.6 ↑</b>	<b>11.8 ↑</b>	<b>10.1 ↑</b>
Indonesia	4.5	6.2	5.7	5.4	<u>7.0</u>	6.0	6.0	5.5	5.8	5.0	3.7	5.3	6.3	4.9
Korea	0.2	5.9	4.0	8.8	<u>4.0</u>	3.8	3.8	4.0	4.0	4.5	2.7	2.8	3.4	3.6
Malaysia	-1.7	7.7	4.8	5.0	<u>4.0</u>	5.0	5.0	4.9	4.9	4.5	1.3	1.7	2.4	2.4
Philippines	1.1	6.8	4.3	12.9	<u>3.6</u>	4.9	4.0	4.5	4.5	4.5	4.3	5.0	5.2	4.9
Singapore	-1.3	12.5	5.1	38.6	<b>22.0 ↑</b>	<b>-17.9 ↓</b>	4.9	<b>10.8 ↑</b>	7.4	7.4	0.9	3.4	4.7	3.7
Taiwan	-1.9	9.2	4.8	11.3	<u>3.3</u>	3.5	3.5	5.0	5.3	5.5	1.3	0.9	2.0	1.8
Thailand	-2.2	8.5	5.0	16.0	<u>-2.0</u>	2.8	2.8	6.0	5.5	4.0	3.7	5.5	4.4	3.0
<b>Africa/Middle East</b>														
Israel	0.7	3.0	4.5	3.3	<u>3.5</u>	3.0	3.0	4.0	5.0	5.5	3.5	3.0	3.0	3.2
South Africa	-1.8	3.0	3.5	4.6	<u>3.9</u>	2.8	3.4	3.7	3.1	3.6	5.7	4.6	5.4	5.6
<b>Europe</b>														
Euro area	-4.1	1.3	1.4	0.8	<u>3.0</u>	2.0	1.0	1.0	1.0	1.8	1.1	1.5	1.5	0.9
Germany	-4.9	2.2	2.2	0.6	<u>5.0</u>	3.0	2.0	2.0	1.5	2.0	0.8	1.0	1.2	0.9
France	-2.5	<b>1.6 ↑</b>	1.4	0.5	<u>2.5</u>	2.0	1.5	1.0	1.0	1.5	1.5	1.8	1.3	0.6
Italy	-5.1	1.2	1.3	1.7	<u>2.0</u>	2.0	1.0	1.0	1.0	1.5	1.3	1.5	1.5	1.1
Norway	-1.5	1.6	2.4	0.6	<u>2.0</u>	3.0	2.8	2.0	2.0	2.5	2.9	2.5	1.3	1.0
Sweden	-5.1	3.7	2.8	5.9	<u>5.0</u>	3.5	2.8	2.3	2.3	2.8	1.0	1.0	2.3	2.4
Switzerland	-1.5	2.3	2.5	1.6	<u>2.8</u>	2.5	2.3	2.3	2.5	2.8	1.1	1.1	0.9	0.6
United Kingdom	-4.9	1.4	2.5	1.2	<u>3.0</u>	2.5	2.5	2.0	2.5	3.0	3.3	3.5	2.6	1.7
Emerging Europe	-4.9	4.1	4.4	2.1	<u>7.9</u>	3.0	2.9	3.9	4.1	4.1	6.1	5.4	5.7	5.5
Bulgaria	-5.0	-0.5	4.0	...	...	...	...	...	...	...	...	...	...	...
Czech Republic	-4.1	2.0	3.2	2.0	<u>2.5</u>	2.5	2.3	2.5	3.0	5.0	0.7	1.3	2.8	2.7
Hungary	-6.3	0.8	3.0	3.6	<u>2.0</u>	2.0	1.0	3.5	2.5	3.0	6.0	5.3	4.1	3.3
Poland	1.8	3.2	3.7	2.0	<u>3.0</u>	2.5	2.5	3.0	4.0	4.0	3.0	2.3	2.6	2.6
Romania	-7.1	-1.0	2.5	...	...	...	...	...	...	...	4.6	4.4	8.0	7.2
Russia	-7.9	5.5	5.0	2.2	<u>13.5</u>	4.0	4.0	5.0	5.0	4.5	7.2	5.8	6.7	7.0
Turkey	-4.7	5.9	5.0	...	...	...	...	...	...	...	9.3	9.3	7.5	6.7
<b>Global</b>	-2.5	3.5	3.1	3.6	<u>3.8</u>	3.1	3.1	2.8	2.8	3.0	2.2	<b>2.2 ↑</b>	1.9	1.8
Developed markets	-3.5	<b>2.6 ↑</b>	2.3	2.5	<u>3.1</u>	2.6	2.5	2.0	2.0	2.4	1.5	1.4	1.1	1.0
Emerging markets	<b>1.1 ↑</b>	7.0	5.8	<b>7.7 ↓</b>	<b>6.6 ↑</b>	<b>4.7 ↓</b>	5.4	<b>5.8 ↑</b>	6.2	5.4	5.1	<b>5.2 ↑</b>	<b>5.3 ↑</b>	<b>4.8 ↑</b>
Memo:														
Global — PPP weighted	-0.7	4.8	4.2	5.1	4.9	4.0	4.1	3.9	4.1	4.2	3.3	3.3	3.1	2.9

## Global Central Bank Watch

	Official interest rate	Change from			Next meeting	Forecast next change	Forecast				
		Current	Aug '07 (bp)	Last change			Sep 10	Dec 10	Mar 11	Jun 11	Sep 11
Global	GDP-weighted average	1.35	-332				1.42	1.48	1.54	1.60	1.66
excluding US	GDP-weighted average	1.92	-243				2.03	2.12	2.20	2.29	2.38
Developed	GDP-weighted average	0.53	-358				0.55	0.58	0.60	0.65	0.68
Emerging	GDP-weighted average	4.61	-225				4.87	5.07	5.26	5.39	5.56
Latin America	GDP-weighted average	6.33	-260				6.90	7.37	7.50	7.64	7.71
CEEMEA	GDP-weighted average	4.05	-281				4.07	4.09	4.11	4.41	5.01
EM Asia	GDP-weighted average	4.18	-191				4.41	4.58	4.85	4.92	4.96
The Americas	GDP-weighted average	0.83	-476				0.93	1.01	1.06	1.11	1.11
United States	Federal funds rate	0.125	-512.5	16 Dec 08 (-87.5bp)	10 Aug 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)	1.00	1.50	2.00	2.50	2.50
Brazil	SELIC overnight rate	10.25	-175	9 Jun 10 (+75bp)	21 Jul 10	21 Jul 10 (+75bp)	11.50	12.50	12.50	12.50	12.50
Mexico	Repo rate	4.50	-270	17 Jul 09 (-25bp)	<u>16 Jul 10</u>	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	4.00	5.00	5.50
Peru	Reference rate	<b>2.00</b>	-250	<b>8 Jul 10 (+25bp)</b>	5 Aug 10	9 Sep 10 (+25bp)	2.25	3.00	3.75	4.50	4.50
Europe/Africa	GDP-weighted average	1.28	-325				1.29	1.30	1.31	1.40	1.52
Euro area	Refi rate	1.00	-300	7 May 09 (-25bp)	5 Aug 10	On hold	1.00	1.00	1.00	1.00	1.00
United Kingdom	Repo rate	0.50	-500	5 Mar 09 (-50bp)	5 Aug 10	May 11 (+25bp)	0.50	0.50	0.50	0.75	1.00
Sweden	Repo rate	0.50	-300	1 Jul 10 (+25bp)	2 Sep 10	2 Sep 10 (+25bp)	0.75	0.75	0.75	1.00	1.25
Norway	Deposit rate	2.00	-250	5 May 10 (+25bp)	11 Aug 10	2Q 11 (+25bp)	2.00	2.00	2.00	2.25	2.50
Czech Republic	2-week repo rate	0.75	-200	6 May 10 (-25bp)	5 Aug 10	2Q 11 (+25bp)	0.75	0.75	0.75	1.00	1.25
Hungary	2-week deposit rate	5.25	-250	26 Apr 10 (-25bp)	19 Jul 10	3Q 11 (+25bp)	5.25	5.25	5.25	5.25	5.50
Israel	Base rate	1.50	-250	28 Mar 10 (+25bp)	26 Jul 10	3Q 10 (+25bp)	1.75	2.00	2.25	2.50	3.00
Poland	7-day intervention rate	3.50	-100	24 Jun 09 (-25bp)	31 Jul 10	2Q 11 (+25bp)	3.50	3.50	3.50	3.75	4.00
Romania	Base rate	6.25	-75	4 May 10 (-25bp)	4 Aug 10	3Q 11 (+25bp)	6.25	6.25	6.25	6.25	6.50
Russia	1-week deposit rate	2.75	-25	31 May 10 (-50bp)	Jul 10	2Q 11 (+25bp)	2.75	2.75	2.75	3.25	3.75
South Africa	Repo rate	6.50	-300	25 Mar 10 (-50bp)	22 Jul 10	2Q 11 (+50bp)	6.50	6.50	6.50	7.00	8.00
Switzerland	3-month Swiss Libor	0.25	-225	12 Mar 09 (-25bp)	16 Sep 10	16 Dec 10 (+25bp)	0.25	0.50	0.75	1.00	1.25
Turkey	1-week repo rate	7.00	-1050	-	<u>15 Jul 10</u>	<b>Jul 11 (+50bp)</b>	7.00	<b>7.00</b>	<b>7.00</b>	<b>7.00</b>	<b>8.25</b>
Asia/Pacific	GDP-weighted average	2.22	-122				2.34	2.44	2.58	2.63	2.66
Australia	Cash rate	4.50	-175	4 May 10 (+25bp)	3 Aug 10	Aug 10 (+25bp)	4.75	5.00	5.25	5.50	5.75
New Zealand	Cash rate	2.75	-525	10 Jun 10 (+25bp)	29 Jul 10	29 Jul 10 (+25bp)	3.25	3.75	4.25	4.50	4.75
Japan	Overnight call rate	0.10	-43	19 Dec 08 (-20bp)	<u>15 Jul 10</u>	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)	11 Aug 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)	3Q 10	3Q 10 (+27bp)	5.58	5.85	6.12	6.12	6.12
Korea	Base rate	<b>2.25</b>	-225	<b>9 Jul 10 (+25bp)</b>	11 Aug 10	4Q 10 (+25bp)	2.25	2.50	2.75	2.75	2.75
Indonesia	BI rate	6.50	-200	5 Aug 09 (-25bp)	4 Aug 10	1Q 11 (+25bp)	6.50	6.50	6.75	7.00	7.00
India	Repo rate	5.50	-225	2 Jul 10 (+25bp)	27 Jul 10	27 Jul 10 (+25bp)	6.00	6.00	6.50	6.75	7.00
Malaysia	Overnight policy rate	<b>2.75</b>	-75	<b>8 Jul 10 (+25bp)</b>	2 Sep 10	<b>On hold</b>	<b>2.75</b>	<b>2.75</b>	<b>2.75</b>	<b>2.75</b>	<b>2.75</b>
Philippines	Reverse repo rate	4.00	-350	9 Jul 09 (-25bp)	<u>15 Jul 10</u>	24 Aug 10 (+25bp)	4.25	4.25	4.50	4.75	5.00
Thailand	1-day repo rate	1.25	-200	8 Apr 09 (-25bp)	<u>14 Jul 10</u>	14 Jul 10 (+25bp)	1.50	1.75	2.00	<b>2.00</b>	<b>2.00</b>
Taiwan	Official discount rate	1.375	-175	24 Jun 10 (+12.5bp)	3Q 10	3Q 10 (+25bp)	1.625	1.750	1.875	2.000	2.000

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

## Economic forecasts - Australia

Australia: economic projections <i>percentage change over previous period, seasonally adjusted annual rates, un</i>														
	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	3.4	4.0	1.5	1.3	2.1	2.9	3.5	3.5	3.8	4.2	4.1	3.9	3.9
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	-18.7	-21.4	-0.9	-4.1	-5.0	-4.0	-4.7	-5.0	-5.0	-5.1	-5.2	-5.1	-6.0
Current account (A\$ bil, sa)	-51.4	-35.7	-28.8	-12.7	-13.8	-18.5	-16.6	-7.6	-4.9	-6.7	-7.1	-7.0	-7.0	-7.7
as % of GDP	-4.1	-2.7	-2.0	-4.1	-4.4	-5.8	-5.1	-2.3	-1.5	-2.0	-2.0	-2.0	-2.0	-2.1
3m eurodeposit rate (%)*	6.0	4.9	5.7	3.5	3.4	4.1	4.2	5.1	5.1	5.3	5.5	5.8	5.8	5.8
10-year bond yield (%)*	5.6	5.5	5.9	5.5	5.1	5.8	5.6	5.5	5.5	5.7	5.8	5.9	5.9	5.9
US\$/A\$*	0.75	0.90	0.92	0.82	0.88	0.91	0.94	0.84	0.90	0.91	0.92	0.94	0.92	0.90
Commonwealth budget (FY, A\$ bil)	-27.0	-57.1	-27.0											
as % of GDP	-2.1	-4.3	-1.9											
Unemployment rate	5.6	5.3	4.8	5.7	5.8	5.6	5.3	5.2	5.2	5.1	5.0	4.7	4.7	4.5
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** emerged from 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 probably will rise close to 20% in 2010-11, with mining leading the way, particularly with the mining tax road-block being removed.
- 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.
- **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. The Bank since has paused, but we expect a resumption of the tightening cycle in August.
- The newly-installed Prime Minister is clearing the decks for an **early election**, probably in late August. Ms. Gillard has "solved" the mining tax impasse and has moved to address contentious immigration policy.

## Economic forecasts - New Zealand

				2009			2010				2011			
	2009	2010	2011	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Real GDP (1995-96 prices)	-1.7	2.6	2.9	0.3	1.2	3.7	2.3	3.8	2.9	1.9	3.0	3.4	3.5	2.5
Private consumption	-0.6	2.0	1.4	1.2	3.8	3.2	0.9	1.8	1.9	0.4	1.0	1.0	2.2	3.5
Fixed Investment	-12.5	0.5	4.6	7.1	-10.4	-7.2	3.3	5.3	5.5	5.7	2.2	4.1	6.0	7.3
Residential construction	-18.5	3.2	4.7	-8.4	-14.7	20.3	2.2	4.0	4.8	6.0	3.2	4.8	6.0	4.0
Other fixed investment	-11.3	-0.1	4.6	10.2	-10	-11.6	3.5	5.6	5.6	5.6	2.0	4.0	6.0	8.0
Inventory change (NZ\$ bil, saar)	-1.8	0.7	0.4	-1.1	-0.7	0.2	0.1	0.2	0.2	0.2	0.1	0.1	0.1	0.1
Government spending	1.7	3.4	1.9	-3.9	2.6	4.5	6.7	2.4	1.6	2.4	1.6	2.4	2.0	0.4
Exports of goods & services	0.0	5.2	8.6	19.2	0.6	-2.7	5.5	8.0	9.0	8.0	9.0	9.0	8.0	8.0
Imports of goods & services	-15.2	8.9	5.8	-11.2	6.3	25.5	7.4	7.0	7.0	6.0	4.0	5.0	7.0	9.0
Contributions to GDP growth:														
Domestic final sales	-5.0	2.0	2.4	1.4	-1.9	1.1	4.0	2.7	2.7	2.0	2.1	2.1	3.5	2.5
Inventories	-2.6	1.9	-0.2	-10.2	5.0	11.6	-0.9	0.9	-0.2	-0.6	-0.6	0.1	-0.2	0.5
Net trade	5.9	-1.3	0.8	9.9	-1.8	-8.3	-0.8	0.1	0.4	0.5	1.5	1.2	0.2	-0.5
GDP deflator (%oya)	2.0	2.4	2.2	3.3	2.5	-0.1	1.0	1.9	2.8	3.9	2.8	2.4	1.9	1.6
Consumer prices	2.1	4.6	3.5	2.3	5.3	-0.7	1.5	1.7	3.3	12.1	3.3	2.8	3.9	3.8
%oya	2.1	2.5	4.8	1.9	1.7	2.0	2.0	1.9	1.4	4.5	5.0	5.3	5.5	3.5
Trade balance (NZ\$ bil, sa)	2.5	3.4	3.0	0.8	0.7	0.3	0.9	0.8	0.8	0.9	0.9	0.8	0.8	0.6
Current account (NZ\$ bil, sa)	-5.5	-5.7	-7.1	-0.4	0.1	-2.9	-1.2	-1.3	-1.0	-0.9	-2.5	-5.2	-4.3	-1.9
as % of GDP	-3.0	-3.0	-3.6	-0.9	0.1	-6.5	-2.8	-2.1	-1.9	-5.2	-8.9	-3.8	-1.9	0.0
Yield on 90-day bank bill (%)*	3.0	3.2	4.9	2.8	2.8	2.8	2.7	2.8	3.5	4.0	4.5	5.0	5.0	5.0
10-year bond yield (%)*	5.5	5.7	6.0	5.7	5.7	5.9	5.7	6.0	5.5	5.7	5.8	6.0	6.0	6.0
US\$/NZ\$*	0.64	0.73	0.75	0.60	0.68	0.73	0.73	0.69	0.73	0.75	0.76	0.77	0.75	0.73
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 0.6%q/q in 1Q. Economic growth should remain strong in 2Q and 3Q, underpinned by consumer spending, with consumers likely to bring forward spending ahead of the October 1 GST hike.
- That said, households are set to undergo a period of **consolidation**. As a result, private consumption will be sub-trend post GST hike. Furthermore, rising interest rates and more moderate house price growth, should mean household spending weakens considerably.
- 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.

## Australia and New Zealand economic calendar

Monday	Tuesday	Wednesday	Thursday	Friday
<b>12 Jul</b>  Australia: Housing finance approvals (11:30 am) May <u>1.5%<i>m,m,sa</i></u>	<b>13 Jul</b>  Australia: NAB business confidence (11:30 am) Jun <u>10%<i>bal,sa</i></u>	<b>14 Jul</b>  Australia: Westpac consumer confidence (10:30 am) Jul <u>7.0%<i>m,m,sa</i></u>  New Zealand: Retail sales (10:45 am) May <u>0.8%<i>m,m,sa</i></u>	<b>15 Jul</b>  Australia: New motor vehicle sales (11:30 am) Jun  New Zealand: Business NZ PMI (10:30 am) Jun	<b>16 Jul</b>  New Zealand: CPI (10:45 am) 2Q <u>1.9%<i>oya</i></u>
<b>19 Jul</b>	<b>20 Jul</b>	<b>21 Jul</b>  Australia: Westpac leading index (11:30 am) May  New Zealand: Visitor arrivals (10:45 am) Jun Credit card spending (3:00 pm) Jun	<b>22 Jul</b>	<b>23 Jul</b>  Australia: Export price index (11:30 am) 2Q Import price index (11:30 am) 2Q
<b>26 Jul</b>  Australia: PPI (11:30 am) 2Q	<b>27 Jul</b>	<b>28 Jul</b>  Australia: CPI (11:30 am) 2Q  New Zealand: NBNZ business confidence (3:00 pm) Jul	<b>29 Jul</b>  New Zealand: RBNZ official cash rate Jul Trade balance (10:45 am) Jun	<b>30 Jul</b>  Australia: Pvt. Sector credit (11:30 am) Jun  New Zealand: Building permits (10:45 am) Jun
<b>31 Jul</b>	<b>1 Aug</b>	<b>2 Aug</b>  New Zealand: ANZ commodity price (3:00 pm) Jul	<b>3 Aug</b>  Australia: ANZ job ads.(11:30 am) Jul Retail sales (11:30 am) Jun Retail sales ex inflation (11:30 am) 2Q Building approvals (11:30 am) Jun  New Zealand: Private wages (10:45 am) 2Q	<b>4 Aug</b>  Australia: Trade balance (11:30 am) Jun HPI (11:30 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
12 - 16 July	12 July	13 July	14 July	15 July	16 July
<b>China</b> • FDI (Jun) • Trade balance (Jun) <b>United Kingdom</b> • Consumer conf (Jun)	<b>Brazil</b> • Auto sales (Jun) <b>India</b> • IP (May) <b>Japan</b> • Reuters Tankan (Jul) <b>Mexico</b> • IP (May) <b>United States</b> • Bernanke speech	<b>Australia</b> • NAB bus conf (Jun) <b>Brazil</b> • Retail sales (May) <b>Germany</b> • ZEW bus surv (Jul) <b>Japan</b> • IP final (May) • Consumer sent (Jun) <b>United Kingdom</b> • CPI (Jun) <b>United States</b> • International trade (May) • JOLTS (May)	<b>Euro area</b> • IP (May) • HICP final (Jun) <b>India</b> • WPI (Jun) <b>Russia</b> • IP (Jun) <b>Singapore</b> • GDP adv (2Q) <b>Thailand</b> • BoT mtg: +25bp <b>United Kingdom</b> • Labor mkt report (Jun) • Cons conf (Jun) <b>United States</b> • Retail sales (Jun) • FOMC minutes (Jun) • Bus inventories (Jun)	<b>China</b> • GDP (2Q) • CPI, retail sales, IP (Jun) <b>Japan</b> • BoJ MPM: no chg • Shirakawa press conf <b>Philippines</b> • BSP mtg: no chg <b>Turkey</b> • CBRT mtg: no chg <b>United States</b> • Empire State surv (Jul) • IP (Jun) • Philly Fed surv (Jul)	<b>Euro area</b> • International trade (May) <b>Mexico</b> • Banxico mtg: no chg <b>Singapore</b> • Exports (Jun) <b>United States</b> • CPI (Jun) • Consumer sent (Jul)
19 - 23 July	19 July	20 July	21 July	22 July	23 July
<b>Korea</b> • GDP (2Q)	<b>Hungary</b> • NBH mtg: no chg <b>Poland</b> • IP (Jun) <b>United States</b> • NAHB surv (Jun)	<b>Belgium</b> • BNB cons conf (Jul) <b>Canada</b> • BoC mtg: +25bp <b>Netherlands</b> • CBS cons conf (Jul) <b>Taiwan</b> • Export orders (Jun) <b>United States</b> • Housing starts (Jun)	<b>Brazil</b> • COPOM mtg: +75bp <b>Japan</b> • MPM minutes (Jun) <b>United Kingdom</b> • MPC minutes (Jun)	<b>Euro area</b> • PMI flash (Jul) • EC cons conf (Jul) <b>France</b> • INSEE bus conf (Jul) <b>Japan</b> • All sector act index (May) <b>South Africa</b> • SARB mtg: no chg <b>United Kingdom</b> • Retail sales (Jun) <b>United States</b> • Existing home sales (Jun) • Leading indicators (Jun)	<b>Belgium</b> • BNB bus conf (Jul) <b>Canada</b> • CPI (Jun) <b>Colombia</b> • BanRep mtg: no chg <b>Germany</b> • IFO bus surv (Jul) <b>Taiwan</b> • IP (Jun) <b>United Kingdom</b> • GDP adv (2Q)

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