J.P.Morgan

Australia and New Zealand - Weekly Prospects

Summary

- The upside surprises in the economic data in **Australia** last week, at the margin, lowered the hurdle for a further rate hike from the RBA next month. New home loans rose in May for the first time in eight months and consumer confidence surged in July. Indeed, the data reaffirmed our view that the RBA will deliver another 25bp rate hike in August, although the 2Q CPI numbers on July 28 will, of course, be important to the RBA's decision making process. There are two key policy events this week, both scheduled for tomorrow: the release of the minutes from the RBA's last Board meeting and a speech by RBA Governor Glenn Stevens. Both will be scoured for clues on the interest rate outlook and the extent of officials' concerns about inflation. On the political front, Prime Minister Julia Gillard on Saturday called an August 21 election, which we flagged last week in a research note entitled "Australia's new PM clearing the decks for early election." Public opinion polls currently have the government holding a 10-point two-party preferred lead at 55-45 over the opposition.

- In **New Zealand**, a slightly softer print on 2Q CPI last week failed to ease concerns that headline inflation will rise significantly in the latter six months of the year. In the June quarter, consumer prices increased 1.8%oya in 2Q, sitting comfortably in the middle of the RBNZ's 1%-3% target range. On our forecast, though, headline inflation will surge beyond 5% in early 2011. The jump in inflation will owe to a number of one-off policy changes. Changes to the Emissions Trading Scheme (July 1) have pushed prices of fuel and electricity higher and the rise in the goods and services tax (October 1) will add around 2%-points to headline CPI. The double-whammy of these policy changes has increased the risk that inflation expectations will rise. The medium-term inflation outlook, particularly the expected rise in underlying inflation, reaffirms our view that the RBNZ will continue tightening policy. We expect four more 25bp hikes to the OCR this year.

- The loss of **global growth** momentum at the end of the second quarter is greater than we had anticipated, led by the US and Chinese economies. What's more, early readings from US July surveys have been weak. In response to these developments, we have lowered forecasts for US GDP growth this year by a percentage point to 2.6% (Q4/Q4). We have made a similar adjustment in China where we are now expecting growth to proceed at about an 8% pace. Even with these adjustments, the global economy is expected to maintain growth close to trend in the coming quarters. However, these forecasts embed the key judgment that the forces producing slower growth do not stall the move toward improving demand and hiring in the private sector.

- The publication of the **EU bank stress test** will be the main global event this week. The motivation behind the bank stress tests is simple: with investors worried about bank capitalizations, the provision of more information about bank performance under various downside scenarios, along with a clear plan of how recapitalization would take place if needed, is designed to ease those concerns. The key to success is thus clear: a set of scenarios that are realistic in the eyes of investors, and a road map for increasing capital as needed.

This week's highlight

The RBA dominates on Tuesday, with the release of the minutes from the last Board meeting and Governor Stevens speaking. Both will be examined for clues on the interest rate outlook.

July 19, 2010

Contents

Data and event previews 2

Research note 4
Labour supply: the missing piece of Australia's vacancy puzzle?

Commentaries
Australia 6
New Zealand 9
GDW Global Essay 11

The JPMorgan view
Global markets 14
AUD & NZD markets 17

Forecasts
Global outlook summary 18
Global central bank watch 19
Australian economy 20
New Zealand economy 21

Data release calendars
Australia and New Zealand 22
Global data diary 23

JPMorgan Australia Ltd., Sydney
www.morganmarkets.com

Stephen Walters
(61-2) 9220-1599
stephen.b.walters@jpmorgan.com

Helen Kevans
(61-2) 9220-3250
helen.e.kevans@jpmorgan.com

Ben Jarman
(61-2) 9220-1669
ben.k.jarman@jpmorgan.com

JPMorgan Australia Ltd., Sydney
Stephen Walters (61-2) 9220-1599
stephen.b.walters@jpmorgan.com
Helen Kevans (61-2) 9220-3250
helen.e.kevans@jpmorgan.com
Ben Jarman (61-2) 9220-1669
ben.k.jarman@jpmorgan.com

Data and event previews - Australia and New Zealand

Date	Time [a]	Data/event	Forecast JPMorgan	Forecast Consensus [b]	*Previous*
Tuesday, July 20	11.30am	RBA Board minutes (Jul.)	**na**	na	*na*
Tuesday, July 20	1.05pm	RBA Governor Stevens' speech	**na**	na	*na*
Wednesday, July 21	8.45am	NZ visitor arrivals (%m/m, Jun.)	**na**	na	*1.0*
Wednesday, July 21	8.45am	NZ net migration (ppl., Jun.)	**na**	na	*250*
Wednesday, July 21	1.00pm	NZ credit card spending (%oya, Jun.)	**2.0**	na	*3.4*
Wednesday, July 21	10.30am	Westpac Leading Index (%m/m, May)	**na**	na	*0.0*
Thursday, July 22	1.00pm	NZ ANZ consumer confidence (%m/m, Jul.)	**-0.2**	na	*3.2*
Friday, July 23	11.30am	Aus. export price index (%q/q, 2Q)	**15.5**	12.0	*3.8*
Friday, July 23	11.30am	Aus. import price index (%q/q, 2Q)	**-0.4**	1.0	*0.3*

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

Australia

RBA Board minutes (Jul.) - The RBA on Tuesday will release the minutes from its July Board meeting, at which officials elected to leave the cash rate steady for the second straight month. Of interest will be the extent of the RBA Board's discussion on the inflation outlook. In the statement two weeks ago, Governor Stevens 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. Inflationary pressures are mounting, however, owing to the elevated terms of trade, firming labour market, and the pickup in wage growth. We continue to forecast an August rate hike, following the 2Q CPI report in late July.

RBA Governor Stevens' speech - The Governor is speaking at the Anika Foundation Luncheon in Sydney on "Some Long-Run Effects of the Financial Crisis." Given the backward looking nature of the subject, and the fact that the minutes are released only an hour or so before, the speech itself should not offer any significant additional guidance on the policy outlook. The scheduled Q&A session, however, could offer up a few nuggets for RBA-watchers.

Export and import prices (%q/q, 2Q) - The June quarter saw the transition to new pricing arrangements for two of Australia's key exports: coal and iron ore. Prices for these commodities now will be settled quarterly, reflecting spot pricing over the previous quarter. Elevated prices from 1Q will, therefore, pass through to a huge boost for export prices in 2Q. Export prices should have risen 15.5%q/q, while a modest 0.4% fall in import prices, owing to stronger AUD in trade-weighted terms, will also have strengthened the terms of trade, which likely rose 16% over the quarter.

JPMorgan Australia Ltd., Sydney
Stephen Walters (61-2) 9220-1599
stephen.b.walters@jpmorgan.com
Helen Kevans (61-2) 9220-3250
helen.e.kevans@jpmorgan.com
Ben Jarman (61-2) 9220-1669
ben.k.jarman@jpmorgan.com

Data previews - Cont'd.

New Zealand

Credit card spending (%oya, Jun.) - We expect a more modest 2%oya rise in credit card spending in June. This would imply relatively firm retail sales growth in the June month, supporting our view that consumers are "bringing forward" spending ahead of the GST-hike later this year. After the rise in the consumption tax, however, households will likely undertake a period of consolidation, having acknowledged their overexposure to property. As recently highlighted by RBNZ Governor Bollard, New Zealand households are "prepared to constrain consumption to improve their savings."

ANZ consumer confidence (%m/m, Jul.) - After jumping more than 3%m/m in May, we suspect that consumer confidence pulled back in June, deteriorating modestly. Expectations of rising interest rates, a drop in the local equity market, a moderation in housing market activity, and heightened global jitters will have all weighed on sentiment.

Research note

Labour supply: the missing piece of Australia's vacancy puzzle?

- **Vacancies remain low relative to employment growth**
- **Shadow inventory of labour is hired informally, but sensitive to vacancies as a signal of hiring conditions**
- **Solid job gains forecast for the remainder of 2010 need not push the jobless rate dramatically lower**

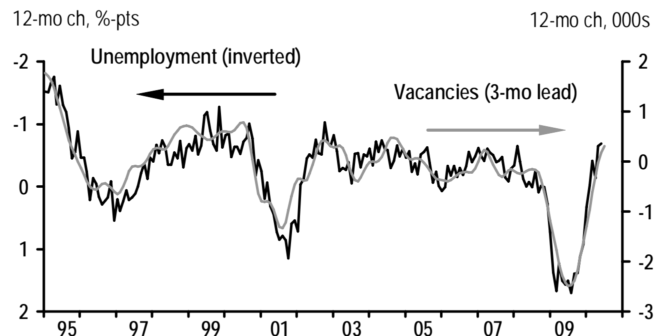
The pace of job creation in the Australian economy in the past two years has been, by several measures, unexpectedly strong. Initially, we couched the outperformance of the labour market in terms of Australia's resilience relative to international peers, many of whom are still suffering the hangover of a deep downturn. Now, even with the domestic recovery well and truly entrenched, the current pace of job growth remains unexpectedly high given the comparatively low level of job vacancies. With this in mind, we take a look at some features of the vacancy-to-employment pipeline in Australia, and suggest some possible explanations for this mismatch.

The black box: from listings to hires

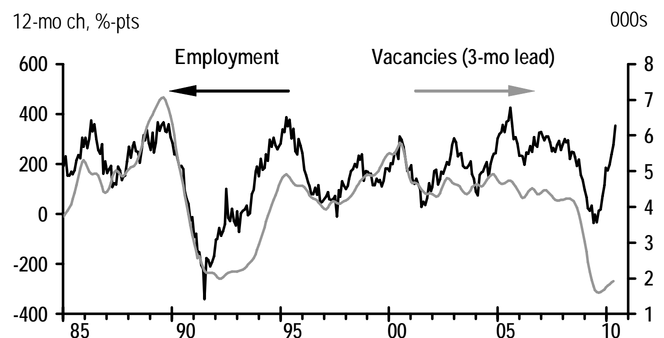
One would expect turns in the labour market to be associated with changes in job listings or vacancies. This has indeed been the case historically (first chart). Yet the utility of this relationship for establishing long-run trends disguises significant shorter-run volatility especially for forecasting employment gains, particularly on a month-by-month basis. Intuitively, job gains observed in the official employment data should be tightly linked to the number of opportunities listed in the preceding months. However, the link between the level of vacancies and employment growth has become increasingly loose in recent years, and may be the culprit behind the continued underestimation of job gains (second and third charts).

The most obvious point that arises in comparing the first and second charts is that the choice of indicators matters.[1] For explaining labour market outcomes, the change in vacancies is more relevant than the level, and the unemployment rate is more tightly bound to vacancy dynamics than are employment gains. We now attempt to explain these two closely related facts, and highlight how they are instructive for the

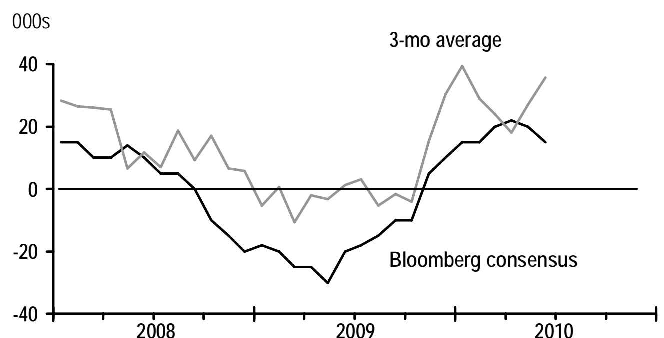
Unemployment and DEEWR skilled vacancies



Employment and DEEWR skilled vacancies



Monthly change in employment



labour market outlook over the remainder of the year.

Making a big impact off the bench

It is tempting to think of labour market outcomes as being purely determined on the demand side. The presence of unemployment indicates insufficient demand for labour, so firms' willingness to list vacancies, being a pure measure of labour demand, should be the deciding factor for the pace of job creation. However, this ignores an important swing group: those not in the labour force. A person is classified as in the labour force if they are employed, or jobless but actively seeking work (the latter being defined as unemployed). As at June, this left 34.8% (the complement of the participation rate) of the working age population classified as being without a job and not seeking one, i.e., they are

1. Throughout the analysis, we use the Department of Education, Employment and Workplace Relations' (DEEWRs') skilled vacancies series, which records advertisements for selected occupations in major metropolitan newspapers, as our measure of job listings. Use of the ANZ (newspaper) job advertisements series achieves similar results. The ANZ (internet) job ads series was found to have a less compelling relationship with trends in the official labor data. The Australian Bureau of Statistics' (ABS) own vacancies series was suspended over the crucial window of August 2008 to August 2009.

outside the labour force. Some of these individuals are discouraged and unlikely to reenter the workforce, but there is an important group who are employable and awaiting more favourable conditions.

We can gauge the importance of this group by looking at the gross flows from the ABS' matched records data. These figures reconcile the status of individuals who are repeat labour force survey respondents over consecutive months. Surprisingly, the number of individuals who classify themselves as unemployed, and who then get a job in the following month, is substantially outweighed by flows from outside the labour force to employment. Over the past five years, these "bench players" have outpaced the formerly unemployed in achieving job gains by a ratio of two to one.[2]

Vacancy growth as a signal for re-entry

To the extent that this pattern is reflected in the aggregate data (the gross flows do capture 80% of the total sample), there appears to be substantial under-reporting of unemployment by Australian households, and therefore a sizeable shadow inventory of employable labour. While the thesis is somewhat conjectural, it suggests a larger role for labour supply fluctuations than is commonly noted, and that there may be important interactions between firms' demand behaviour (vacancies), participation, and job gains.

A rise in job ads represents an improvement in hiring conditions, which would induce more previously unenthused, but employable, workers into the labour force. If this cohort is as large as the ABS data suggest, it would mean that in an upturn, the level of vacancies would be less important than the fact that listings are moving in the right direction. This is because improving opportunities induce greater participation, and presumably allow these individuals to secure work through informal channels. By definition, this is difficult to verify in the data, though it is notable that flows from the shadow inventory into employment turned sharply higher from 4Q09, along with employment gains, just after vacancy growth turned the corner.

No one likes doing fractions

The above story points to *changes* in job listings as the appropriate signal of labour trends. But it also supports the idea that the unemployment rate captures the dynamics better than absolute job gains (recall first chart), because the phenomenon described above involves both a jobs effect and a participation effect: the unemployment rate captures this, but employment gains alone cannot. Finally, as flows into employment of the kind mentioned here continue to accrue, the implications for the unemployment rate are worth noting. The unemployment rate is expressed as the ratio of the unemployed to the size of the labour force. An unemployed individual who gets a job triggers a decrease in the numerator of this equation, but leaves the denominator unchanged, since they were counted in the labour force before and after. For a member of the shadow inventory, however, moving into employment leaves the numerator unchanged, and increases the denominator, since they simultaneously get a job and enter the workforce. The arithmetic guarantees that employment generated through the latter channel results in a smaller reduction in the unemployment rate than through the former. Our forecasts have for some time emphasized that, because of elevated participation, employment gains can remain solid without forcing a large reduction in the unemployment rate. We usually phrase this in terms of high net immigration (see box), but the arguments presented here suggest another channel.

2. The ABS' labour force series is a repeat sample of households that runs for eight months. The gross flows data are not seasonally adjusted, though that cannot explain the persistence of the bench players' contribution over a multi-year period.

Labour survey matched flows: monthly transitions into employment

Could immigration be the key?

An alternative external factor is immigration, which is becoming an increasingly important factor in the Australian labour market. Inclusion in the labour survey is determined by the random sampling of households, which is in principle inclusive of all migrants no matter how recent. Employment gains within this group could therefore turn up in the jobs numbers straight away, but this of itself cannot explain the phenomenon present in the flows data, unless new migrants feel compelled (moreso than existing residents) to claim they are not job seekers until they secure a job. Interestingly, the more likely scenario—where new immigrants declare themselves in the labour force, then get a job—actually puts more upward pressure on the participation rate than would the return of a discouraged worker: new immigrants are counted in the labour force, but inclusion in the resident population takes up to 18 months in order to confirm permanency.

JPMorgan Australia Ltd., Sydney
Stephen Walters (61-2) 9220-1599
stephen.b.walters@jpmorgan.com
Helen Kevans (61-2) 9220-3250
helen.e.kevans@jpmorgan.com
Ben Jarman (61-2) 9220-1669
ben.k.jarman@jpmorgan.com

Australia

- **Budget benefits from higher commodity prices**
- **RBA minutes to offer more colour on inflation picture**
- **Consumer confidence bounces back**

The economic data flow in Australia last week generally surprised on the upside, with home loans and consumer confidence numbers printing above expectations. At the margin, the news lowered the hurdle for a further hike to the official cash rate in August. Indeed, with the economy growing around trend and doing so with little spare capacity, we maintain that this tightening cycle has some way to run.

Inflation outlook a concern for RBA

The RBA on Tuesday will release the minutes from its July Board meeting, at which officials elected to leave the cash rate steady for the second straight month. The statement that accompanied the decision two weeks ago was balanced, with the strength of domestic economic conditions seeming to offset the impact of some weakness offshore. We did, however, detect a subtle shift toward a slightly more upbeat tone on domestic conditions. The minutes will, therefore, provide more colour on the RBA's assessment of the domestic economy, with respect to the terms of trade and investment outlook, in particular.

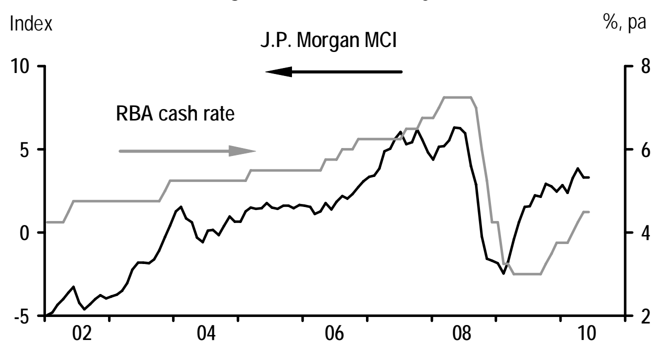
Of interest will be the extent of the RBA Board's discussion on the inflation outlook. In the statement two weeks ago, the RBA sent a veiled warning for the market not to read too much into what seems increasingly likely to be a high headline print later this month. The commentary made explicit mention 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.

We also acknowledge that any deepening of anxiety about the global economic and financial outlook could see the RBA extend the policy pause. That said, we believe neither of these roadblocks will be sufficient to ward off mounting inflationary concerns. We maintain our forecast that the RBA will deliver a further 25bp rate increase next month, since delaying further hikes could result in officials ultimately having to deliver more austerity than would have been the case had they acted more assertively this year.

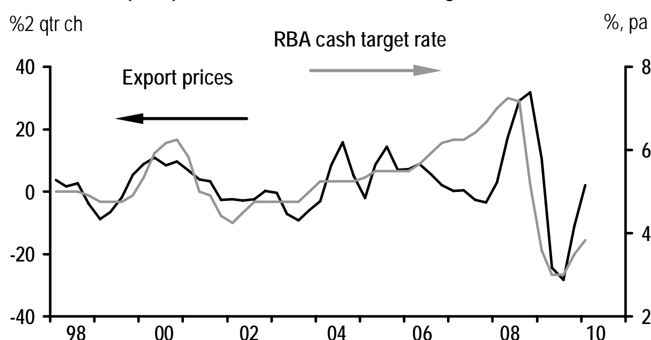
New parameters lift Budget bottom line

The Australian Treasurer last week released updated Commonwealth Budget figures. Swan generally had good news to announce. The Treasury now forecasts that the budget deficits over the next two years will be *slightly smaller* than was the case when the Budget was released in May. For 2010-11, the government's forecast now is for a deficit of A$40.4 billion, down marginally from the A$40.8 billion forecast previously. For 2011-12, the forecast is for a shortfall of A$10 billion, down from A$13 billion. As before, the official forecast is that the Budget will be back in surplus in 2012-13, but the projected buffer now is slightly larger at A$3.1 billion (previously A$1.0 billion).

Australia: RBA cash target rate and monetary conditions



Australia: export price index and RBA cash target rate



The better bottom line is despite the government conceding ground to the mining companies on the contentious resources tax, which kicks in from mid-2012. The government's original projection was that the new tax would raise A$12 billion over the forward estimate period. Now, despite a 30% headline tax rate instead of the proposed 40%, and other concessions on the way the tax works, the updated Budget projects revenue only A$1.5 billion lower than before. The government closed the revenue gap by assuming faster nominal GDP growth, partly owing to higher commodity prices. Indeed, all of the small boost to the fiscal bottom line was from parameter changes. The official forecast now is that the economy will grow 3% in real terms in 2010-11, but nominal GDP should grow 9.25%.

JPMorgan Australia Ltd., Sydney
Stephen Walters (61-2) 9220-1599
stephen.b.walters@jpmorgan.com
Helen Kevans (61-2) 9220-3250
helen.e.kevans@jpmorgan.com
Ben Jarman (61-2) 9220-1669
ben.k.jarman@jpmorgan.com

On inflation, back in May, the Budget forecast stable inflation at 2.5%. This looked unrealistic given the Budget's other assumptions of firm economic growth, full employment, lower unemployment, and rising commodity prices. Even the Reserve Bank's inflation projections were higher. Now, the Treasury forecasts inflation at 2.75% this year and next, but 2.5% thereafter. These are below J.P. Morgan's forecast, but look more plausible than before.

2Q bumper quarter for terms of trade

The June quarter saw the transition to new pricing arrangements for two of Australia's key exports: coal and iron ore. Prices for these key commodities now will be settled quarterly, reflecting spot pricing over the previous quarter. Elevated prices from 1Q will, therefore, pass through to a huge boost for export prices in 2Q, which we have already witnessed in the monthly trade data. Export prices should have risen 15.5%q/q, while a modest 0.4% fall in import prices, owing to stronger AUD in trade-weighted terms, will also have strengthened the terms of trade, which likely rose 16% over the quarter.

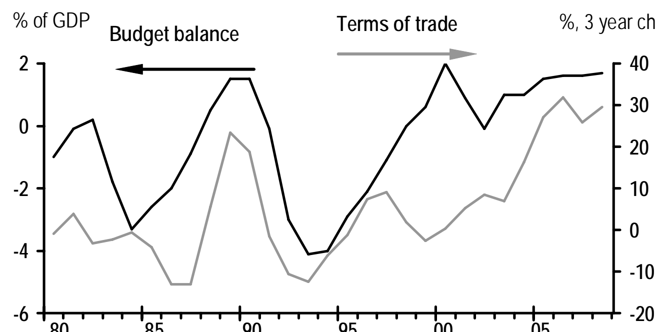
New home loans growing, but only slowly

The number of homes loans issued rose in May for the first time in eight months. Home loan commitments were up 1.9%m/m (J.P. Morgan: 1.5%; consensus: 0.0%), a sharp contrast to the average fall of 4.1% recorded in the previous seven months. The improvement will be short-lived, however. There remain significant drags on loan demand, namely higher interest rates, rising risk-aversion in financial markets, deteriorating home affordability, falling consumer confidence, and the expiration of the expanded portion of the first-home buyers' (FHBs) boost.

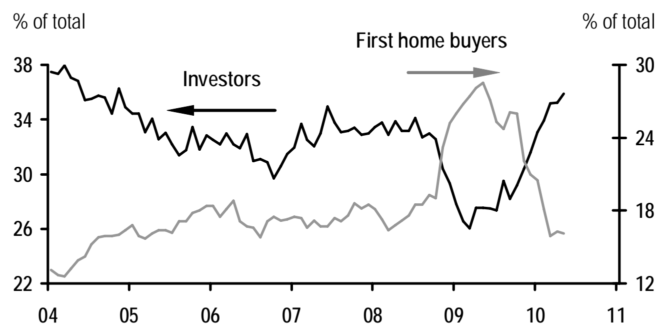
The average loan size across all groups fell 1.3%m/m in May. As we have highlighted previously, we believe that average loan sizes are an important indicator of willingness to pay, such that outright declines in this series suggest underlying loan demand remains depressed. In particular, interest rates have now reached a level that is causing mortgage pain in key demographics. In May, the Westpac-Melbourne Institute (WMI) reported an 8%m/m drop in confidence among people with a mortgage, following the RBA's most recent rate hike earlier that month, significantly more than the average 2% drop following the previous five hikes.

FHBs continued to shy away from home loan commitments in May, as expected. This downtrend has continued since the expanded grant ended on December 31, and since price caps on the original grant became effective on January 1. FHBs accounted for just 16.1% of all loans issued, down from a peak of 29% in May last year. Investors, though, continued to increase their participation in the market. Investors accounted for 36% of all loans issued in May, a six-year high, and up considerably from 27% since early 2009.

Australia: terms of trade and the government budget balance



Australia: housing finance



Conditions ripe for bounce in confidence

Consumer confidence spiked in July, marking the largest rise in 13 months. The WMI consumer confidence index jumped 11.1%m/m (J.P. Morgan: 7.0%; no consensus) to 113.1, holding north of the key index level of 100, which indicates that optimists outweigh pessimists for the thirteenth straight month.

The fact that the dispute over the controversial mining tax has been largely settled was the main reason for the jump in confidence. Back in June, optimists only narrowly outnumbered pessimists due to the confusion surrounding the proposed resource "super" profits tax (RSPT). The WMI index fell 5.6%m/m, with the items most recalled by respondents relating to the "Budget and Tax" category. More than half of survey respondents (55%) recalled these items, the highest proportion since the introduction of the GST, with a clear majority viewing them unfavourably. Since the June WMI survey, however, the government has reached agree-

JPMorgan Australia Ltd., Sydney
Stephen Walters (61-2) 9220-1599
stephen.b.walters@jpmorgan.com
Helen Kevans (61-2) 9220-3250
helen.e.kevans@jpmorgan.com
Ben Jarman (61-2) 9220-1669
ben.k.jarman@jpmorgan.com

ment with large mining companies on a revised framework for the tax. The fierce public debate about the potential impact of the proposed tax, therefore, has abated.

The surge in confidence was also attributed to the easing of sovereign debt concerns in Europe, the stabilization of equity markets and AUD, strong employment growth, and the delivery of personal income tax cuts from July 1.

Data releases and forecasts

Week of July 19 - 23

From Jul 20 11:30am

NAB business confidence
Sa

	3Q09	4Q09	1Q10	2Q10
% balance, sa	16	18	17	__

Wed Jul 21 10:30am

WMI leading index
Sa

	Feb	Mar	Apr	May
%m/m	0.6	1.0	0.0	__

Fri Jul 23 11:30am

Export price index
Nsa

	3Q09	4Q09	1Q10	2Q10
Index	150.5	148.0	153.6	177.4
%q/q	-9.6	-1.7	3.8	15.5
%oya	-20.7	-32.7	-26.8	6.6

Fri Jul 23 11:30am

Import price index
Nsa

	3Q09	4Q09	1Q10	2Q10
Index	120.9	115.7	116.0	115.5
%q/q	-3.0	-4.3	0.3	-0.4
%oya	-2.3	-15.5	-12.9	-7.4

Review of past week's data

Housing finance approvals: owner occupiers
Number of loans, sa

	Mar		Apr		May	
%m/m	~~-2.9~~	*-2.8*	~~-1.8~~	*-1.5*	~~1.5~~	*1.9*
%oya	-22.6		~~-25.3~~	*-25.0*	~~-25.2~~	*-24.4*

NAB monthly business survey
% balance, sa

	Apr		May		Jun	
Business confidence	13		5		~~10~~	*4*

WMI consumer confidence survey
100=neutral, seasonally adjusted

	May		Jun		Jul	
(%m/m)	-7.0		~~-5.6~~	*-5.7*	~~7.0~~	*11.1*

Sales of new motor vehicles
Units, sa

	Apr		May		Jun	
%m/m	~~9.0~~	*8.6*	~~-3.2~~	*-3.9*	__	*-1.2*
%oya	~~29.1~~	*29.2*	~~16.4~~	*16.5*	__	*8.2*

New Zealand

- **Inflation mild.......for now**
- **No pre-GST front-loading evident in May retail sales**
- **Housing market facing headwinds**

As in Australia, the inflation outlook in New Zealand appears to be inconsistent with the current monetary policy settings. We expect the RBNZ to hike the OCR a further 100bp in 2H, owing to the deterioting medium-term inflation outlook and the threat of rising inflation expectations.

NZ CPI in line with target, but not for long

Headline inflation continued to hover around the middle of the RBNZ's 1%-3% target range in the June quarter, although this precedes what we expect will be a series of elevated inflation prints over the coming year. Consumer prices increased 1.8%oya in 2Q (J.P. Morgan and consensus: 1.9%), compared to 2.0% in the previous quarter, marking the fifth straight quarter that headline CPI has remained within the Bank's target.

Headline inflation, though, will rise significantly in 2H. In the current quarter, changes to the ETS (effective July 1) have pushed prices of fuel and electricity higher. A rise in accident compensation levies for motor vehicles and a rise in insurance premia owing to changes to the taxation of insurance companies also have added upward pressure on prices. In the December quarter, the government will increase the goods and services tax (GST) to 15% from 12.5% (effective October 1), which will add around 2%-points to headline CPI. As a result, we forecast headline inflation at an elevated 4.6% in 4Q, but the risks are skewed to a much higher print if inflation expectations do not remain anchored. Indeed, these two policy changes should have only a one-off impact on prices, but given that they are coming into effect within months of each other, the real risk is that inflation expectations rise.

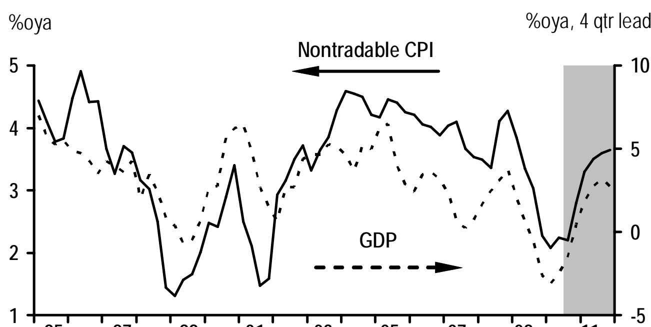
The medium-term inflation outlook, particularly the expected rise in underlying inflation, reaffirms our view that the RBNZ will need to tighten monetary policy further. We expect that Governor Bollard will hike the cash rate four more times this year, provided that economic and financial market developments evolve as expected. We forecast an OCR of 3.75% by year-end.

Retail sales disappointed ahead of GST

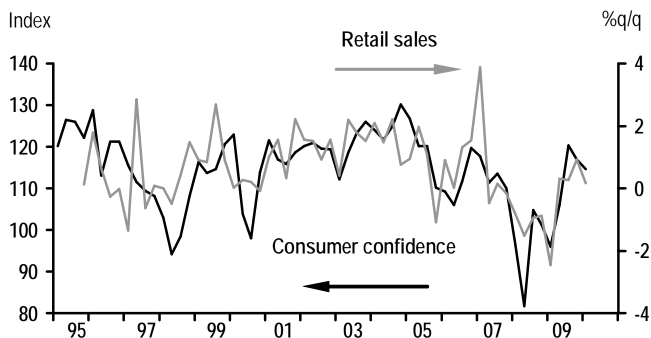
Retail sales were softer than expected in May. Retail sales were up just 0.4% over the month (J.P. Morgan: 0.8%; consensus: 0.5%), after falling 0.3% in April. The details of the data were weak. Total retail sales excluding autos were down 0.2%oya, marking the first decline in this series that we have on record dating back to mid-1995. Indeed, underlying spending was subdued, with core retailing (which excludes vehicle-related industries) falling for the third month this year (down 0.2%m/m). We thought that there would be some "bring forward" of spending after the government announced that the GST would rise, but this was not evident in the May data. The government confirmed in the Budget in May that it would hike the GST from 12.5% to 15% on October 1.

The incentive for consumers to bring forward spending in coming months notwithstanding, consumption likely will be subdued after the introduction of the GST, as households undertake a period of consolidation. RBNZ Governor Alan Bollard believes that households have acknowledged their overexposure to property and are "prepared to constrain consumption to improve their savings." Thus, barring the next few months, we expect a sustained period of sub-trend growth in household consumption.

New Zealand: nontradable CPI and GDP



New Zealand: consumer confidence and retail sales volumes



Housing market activity cooling

According to the REINZ, house prices in New Zealand rose for the first time in three months in June. The median house price increased 0.6%m/m last month to NZ$352,500. Over the year, however, house prices were up just 3.7%, the slowest annual pace in 12 months; house sales were down 24.3%, marking the largest fall since the start of 2009; and the number of days taken to sell a house rose to 45 from 43, having been just 33 days six months earlier.

Recent changes to the way property is taxed, announced by the government in May, will dampen housing market activity further. The Budget included measures to prevent property investors from offsetting their losses against income and other taxes. From April 2011, property investors that rely on claiming depreciation to offset their rental property income also will be negatively impacted. Tax rules for investment property will be tightened, with the tax depreciation rate to be lowered to zero for all buildings with an estimated useful life of 50 years or more.

Data releases and forecasts

Week of July 19 - 23

Wed Jul 21 10:45am — **Visitor arrivals**
Nsa

	Mar	Apr	May	Jun
Total (%m/m)	0.8	-1.8	1.0	__

Wed Jul 21 10:45am — **Net permanent immigration**
Not seasonally adjusted

	Mar	Apr	May	Jun
Monthly (000s)	-0.3	-0.6	0.3	__
12-month sum (000s)	21.0	20.0	18.0	__

Wed Jul 21 3:00pm — **Credit card spending**
% change

	Mar	Apr	May	Jun
%oya	5.2	0.7	3.4	2.0

We expect a more modest 2%oya rise in credit card spending in June. This would imply relatively firm retail sales growth in the June month, supporting our view that consumers are "bringing forward" spending ahead of the GST-hike later this year.

Review of past week's data

QVNZ house prices
%, median

	Apr	May	Jun
(%oya)	6.1	5.6	__ *5.2*

Retail trade

	Mar	Apr	May
%m/m, sa	~~0.5~~ *0.6*	-0.3	~~0.8~~ *0.4*
%oya, sa	3.2	2.4	~~2.6~~ *2.3*

Business PMI

	Apr	May	Jun
Index, sa	~~58.6~~ *58.5*	~~54.5~~ *54.4*	__ *56.2*
%oya, sa	34.3	~~23.6~~ *23.5*	__ *20.1*

Consumer price index

	4Q09	1Q10	2Q10
Headline (%oya, nsa)	2.0	2.0	~~1.9~~ *1.8*
Headline (%q/q, nsa)	-0.2	0.4	~~0.4~~ *0.3*

JPMorgan Chase Bank, New York
Bruce Kasman (1-212) 834-5515
bruce.c.kasman@jpmorgan.com
David Hensley (1-212) 834-5516
david.hensley@jpmorgan.com

Global Essay

- **Manufacturing downshifts abruptly at midyear; Emerging Asia to slow**
- **Upturn in private demand intact but facing financial market headwinds**
- **Revising down US and Chinese growth**
- **Stress test success to be judged by whether bank funding pressures abate**

Stress tests

The results of the European bank stress tests will be published this week, but a much bigger stress test is also taking place. The loss of global growth momentum at the end of the second quarter is greater than we had anticipated, led by the US and Chinese economies. What's more, early readings from US July surveys have been weak. In response to these developments, we have lowered forecasts for US GDP growth this year by a percentage point to 2.6% (Q4/Q4). We have made a similar adjustment in China where we are now expecting growth to proceed at about an 8% pace. Even with these adjustments, the global economy is expected to maintain growth close to trend in the coming quarters. However, these forecasts embed the key judgment that the forces producing slower growth do not stall the move toward improving demand and hiring in the private sector.

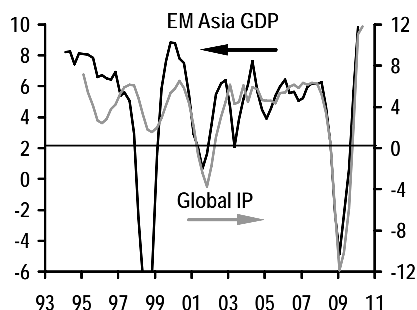
As we assess this view, the downshift in global manufacturing is not, by itself, seen as a challenge to this view. We have highlighted that this is a regular feature of the early stage of economic expansions, reflecting the end of a phase in which production lifts rapidly to align itself with levels of final demand. With the lift in this cycle proving unusually strong—global manufacturing output has risen by more than 12% from its recession low—a phase of sharp slowing in activity growth was expected to take hold around midyear. We have projected a smooth adjustment toward a 5% pace of increase during 2H10, but recognize this adjustment could take place more abruptly and even produce a period of subpar output gains in the midst of an otherwise healthy economic expansion. Indeed, US experience shows a marked deceleration in manufacturing activity—as gauged by the ISM—12 months into a recovery, on average, even as initial claims maintain their general trend downward.

The latest data suggests that we may indeed be moving onto a more abrupt adjustment path. Global production growth appears to have slowed sharply in June, and US regional manufacturing surveys moved lower into July. This week's release of the Euro area July PMI survey and June activity indicators in Asia will help in gauging the contours of this downshift. However, with the US and China at the leading edge of the manufacturing sector downshift, one component of our forecast seems increasingly likely. The currently high-flying economies of Emerging Asia are set to slow sharply. EM Asia excluding China has grown at about a 10% pace during the past year, having reaped large benefits from the global industry upturn. In the face of a sharp moderation of global manufacturing output growth that is likely to range between 5 and 8%-pts, it is reasonable to anticipate that Asia will experience the sharpest downshift in growth momentum in the coming months.

There is no inventory overhang in the global economy that would produce a sustained industrial sector drag on growth. Where data are available, inventories continue to grow more slowly than final demand. Moreover, our global inventory change proxy only moved into a region of outright growth in 1Q10. Consequently, it is the trajectory of final demand that will tell the tale on where the global expansion is heading. On this front, the June retail sales readings showed China and US (core) sales rising in line with our expectations. However, the profile of US spending was revised lower and consumer confidence slumped in early July. As long as firms continue

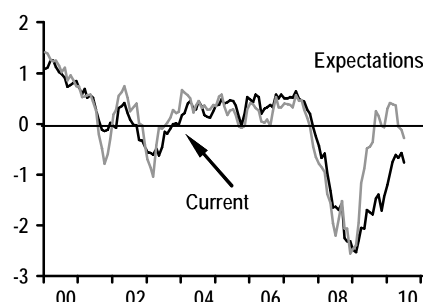
Global IP and EM Asia (ex. China) GDP

% change oya, both scales



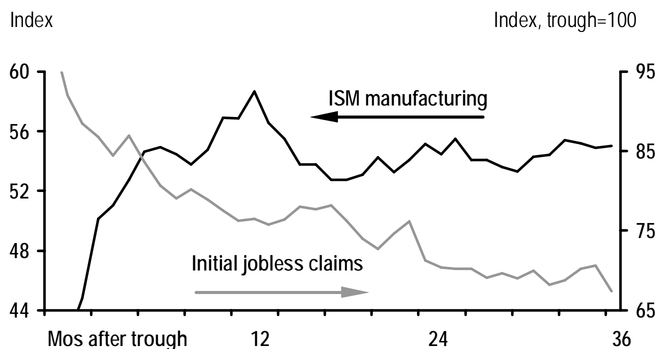
Consumer confidence, dev mkt

Std dev from avg (July is partly forecasted)



JPMorgan Chase Bank, New York
Bruce Kasman (1-212) 834-5515
bruce.c.kasman@jpmorgan.com
David Hensley (1-212) 834-5516
david.hensley@jpmorgan.com

Average ISM-manufacturing and initial claims during US recoveries



Note: average of previous economic upturns from 1975-2002

to shift away from a defensive posture and labour income continues to grow solidly, the recent softness in final demand growth will prove temporary. This should leave eyes focused on upcoming demand and labour indicators as we move through the current quarter.

Much depends on monetary transmission

With fiscal policy turning from a support to a drag and monetary policy already near record levels of support, the remaining channel for stimulus is through the transmission of monetary accommodation to financial markets and more broadly to business and household spending behaviour. It is partly in recognition that this transmission mechanism is coming under renewed stress that we have marked down our growth outlook in recent weeks. Notably however, the rising pessimism spreading through markets has been more measured among monetary authorities.

The FOMC only modestly marked down its 2010 growth forecast in its June meeting minutes and maintained the same qualitative outlook for a "continued, moderate recovery." The committee went on to judge that the minor forecast changes were "not warranting policy accommodation beyond that already in place." In a somewhat more dovish tone, the committee did express a sense of increased downside risk and noted that, in addition to planning for an exit strategy, some contingency planning for more stimulus would also be prudent. In contrast to the FOMC, the Bank of Japan raised its 2010 growth outlook at last week's policy meeting in response to growing global tech demand along with the rising corporate sentiment and profit outlook in the June Tankan report.

Outside the major developed economies, monetary policy normalization has already begun in a number of central banks. Since the start of the year, 13 of the 32 central banks tracked by J.P. Morgan have already hiked. Of these, 11 will continue hiking in 2H10 while four additional will initiate a rate hiking cycle. Two of these early movers will be on display this week. Responding to robust improvements in labour markets and solid domestic demand growth, the Bank of Canada is widely expected to hike 25bp. Similarly, strong domestic demand along with very easy credit conditions in Brazil will lead the COPOM to hike 75bp.

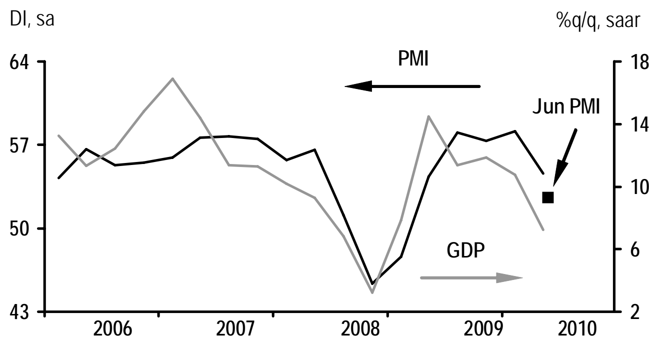
A stressful test for EMU banks

Although this week's flash PMI for July will be important for tracking EMU activity in the current quarter, the publication of the EU bank stress test will be the main event. The motivation behind the bank stress tests is simple: with investors worried about bank capitalizations, the provision of more information about bank performance under various downside scenarios, along with a clear plan of how recapitalization would take place if needed, is designed to ease those concerns. The key to success is thus clear: a set of scenarios that are realistic in the eyes of investors, and a road map for increasing capital as needed.

Achieving these outcomes is easier said than done. Critical in the scenarios is the treatment of sovereign risk. Although the tests will include a markdown of the value of government debt, three uncertainties remain: 1) the extent of the assumed decline in government bond prices, 2) the extent to which this is judged to be temporary (a move in risk premia) or permanent (a debt restructuring), and 3) the extent to which collateral damage to the real economy is acknowledged. At this stage, it looks like the sovereign stress test will assume only a modest decline in bond prices that are judged to be temporary and which have only a moderate impact on the real economy.

Should recapitalization be needed, most sovereigns will be able to finance this on their own. Alternatively, outside financing will be available through the European Financial Stability Facility (the SPV of the European Stabilization Mechanism). However, the details of how this would work are not clear. Given the IMF's involvement, it would likely require a high degree of conditionality.

If the bank stress tests have an impact on funding pressure, it will influence the macro outlook. Banks are able to fund themselves via the ECB, but a shortening of the maturity of liabilities could lead to some deleveraging on the asset side. Our growth outlook is conditioned on the level of funding stress remaining steady. To the extent that funding pres-



sures ease, which would show up as a decline in excess reserves, the growth outlook would be a little brighter.

China downshifts into midyear

China's GDP growth slowed significantly to 7.2% annualized (10.3% oya) from 10.8% in 1Q. This slowdown is most visible in the manufacturing sector, which showed gains averaging just 0.4% m/m in 2Q, including a contraction in June. The composite PMI also has been moving down quite swiftly of late. The explanation is apparently a deceleration in investment, since net trade and consumption advanced strongly in 2Q, including solid increases in June, based on merchandise trade and retail sales data. The exact mix of the investment slowdown is unclear, however. It is widely believed that fixed investment is slowing as a result of previous policy tightening and other administrative measures, and the slowdown in bank lending certainly points in this direction. That said, official data on fixed asset investment do not point to a sudden deceleration in 2Q. An additional possibility is that China is undergoing an inventory correction. With the global growth forecast having been marked down and additional slowing in investment still likely, we marked down the 2H GDP growth forecast by almost 1%-pt to 8.4%. Along with the growth revision, we trimmed our 2010 inflation forecast to 2.8% oya (4q/4q), and now see the PBOC policy rate unchanged until 4Q10 or later.

Japanese election to affect policy

The ruling parties in Japan suffered defeat in the Upper House election, leaving a hung parliament that will make it difficult for the DPJ to pass legislation. Although political uncertainty remains high, Sunday's election has several concrete implications for policy. Since it is widely believed that Prime Minister Kan's handling of the consumption tax played an important role in the election outcome, this issue is likely to be tabled until after the general election is held in 2013. As a result, Japan's fiscal position is likely to be worse than previously expected. In addition, political pressure on the BoJ looks likely to increase. The Your Party, which performed well in the election, plans to submit legislation that would impose an inflation target on the BoJ and hold the central bank accountable for achieving this target.

CEEMEA fiscal goulash

Fiscal performance this year has varied among CEEMEA countries. In Poland, stronger economic growth should result in significant outperformance of the fiscal target. Yet, a spending overshoot at the local government level is likely to erase most of the revenue gains, while the government has also been hesitant to reduce the structural deficit ahead of the parliamentary elections next year. In Hungary, the government has approved a series of tightening measures, including a hefty tax on banks and public sector wage cuts to ensure that the deficit does not overshoot the target set with multilateral creditors. By contrast, Romania's failure to emerge from recession and the consequent deterioration in the fiscal situation has led the IMF to request further action to cut the deficit.

With its primary surplus running well above the official target, Turkey stands out. The weakening in growth prospects could lead to some worsening in fiscal performance in 2H, but the performance achieved so far this year has created a strong buffer. In Russia, the year-to-date budget deficit is on track to come in well under forecast for 2010. Similarly, strong fiscal performance suggests a sizable fall in the budget deficit in South Africa.

JPMorgan Securities Ltd., London
Jan Loeys (44-20) 7325-5473
jan.loeys@jpmorgan.com
John Normand (44-20) 7325-5222
john.normand@jpmorgan.com

JPMorgan View - Global Markets

Trading the range in risk

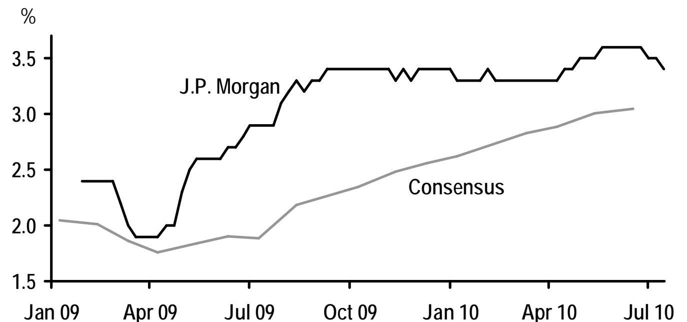
- **Economics:** Global growth forecasts have been trimmed by 0.1% for 2010 and 2011.
- **Asset allocation:** We are overall flat on risky assets, overweight credit versus equities and EM versus DM, and are long carry.
- **Fixed income:** Central bank tightening looks increasingly remote. Add carry trades.
- **Equities:** Near-term risks are skewed to downside given negative momentum. Within EM, we downgrade both South Africa and Mexico from overweight to neutral, and upgrade ASEAN to overweight.
- **Credit:** We favour US and EM corporates versus those of Europe.
- **FX:** Move EUR longs from JPY to USD.
- **Commodities:** Underweight industrial metals on slower manufacturing growth.

Risky markets—equities, credit, commodities, EM, and non-core European sovereigns—rallied early last week, but fell again Friday to be on net largely unchanged. The impact of strong US earnings reports is being offset by weaker global economic activity data.

In effect, risky markets remain within their two-month range and are today no higher that the levels reached last fall. Our best guess is that risk markets are set to **stay within their 2-month ranges**, even as we maintain bullish longer-term forecasts. Our investment strategy is **neutral overall risky assets**, and aims to exploit relative value and momentum across and within asset assets. As common themes, we are **long EM versus DM risk, credit versus equity risk, and long positive carry positions**.

During the 13-month rally in risky markets—from March last year through April of this year—we chose to look through infrequent corrections as we judged there was strong fundamental growth momentum. That is, over this period, analysts were steadily raising growth forecasts for economies and earnings. In May, we chose to stay long risk as we saw consensus forecasts still edging up. That did not last, though. Second-quarter activity data in many countries have been disappointing, and are now inducing economists to trim growth forecasts. **Our global GDP forecast for this year is down 0.2% from its peak** (chart). This week, we also lowered 2011 by 0.1%-pt. Equity analysts have also begun to shave their profit forecasts with consensus EPS projections

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



for MSCI AC World down 1.4% and 2.2% for 2010 and 2011, respectively, since April.

These lowered projections bring forecasts to levels that are still very supportive to risky asset prices. The level of the projections is not the problem. **The change is the problem**, as history shows that once we start cutting forecasts, odds are that we keep doing this again and again. This risk depends very much, though, on what is pushing activity numbers down. And this is where things become murky. It is possible that consumers and companies are turning more cautious in anticipation of dramatic global fiscal tightening over the next few years. But it is equally possible that we are just observing a natural inventory-driven downshift in industry that will be offset in one to two quarters by stronger final demand growth. Without a clear smoking gun on the downshift in growth, we prefer not to express a strong view and keep macro risk light.

The **bullish case for risky markets** must rest squarely on value, or the prevalence of **high risk premia** relative to zero-return cash. Risk premia can only remain this high if risk *perceptions* stay elevated, inducing investors to remain heavily invested in cash. Our strong impression is that near-term uncertainty, through year-end, is falling steadily as monetary policy in most countries is squarely on hold, US bank reform is out of the way, and funding pressures on non-core Euro governments are softening. **But farther out, uncertainty—the endgame question on public debt and central bank balance sheets—is not fading.** Investors are starting to consider more seriously the risk that Europe and the US follow Japan into a debilitating deflation, even as they accept that policymakers will do the unthinkable to prevent this. The record wide gap between short- and long-term implied equity vol bears witness to this divergence in uncertainty. For our purposes, high long-term uncertainty now seems likely to keep investors from equity markets, despite strong earnings.

How should active investors position in range trading mar-

JPMorgan Securities Ltd., London
Jan Loeys (44-20) 7325-5473
jan.loeys@jpmorgan.com
John Normand (44-20) 7325-5222
john.normand@jpmorgan.com

kets? If we knew the tops and bottoms of these ranges, then we just buy low and sell high. But we do not have clear value signals to clearly define the ranges. Hence, we focus instead on relative value and momentum across and within asset classes. We are bullish **EM** in each class on flow momentum and their better debt, deflation, and demographic fundamentals. Wariness about high equity volatility and deflation risk will likely support strong flows into fixed income. And these flows clearly **favour credit over equity risk**. But the sticker shock of record low yields will likely push investors into **better yield bonds and positive carry positions**. We except non-core European bonds from this recommendation given the remaining overhang of holdings here by global bond managers.

Fixed income

Bonds rose slightly, boosted by weaker data in the US and China. EM bonds kept pace with DM, while Euro area peripherals outperformed the core slightly.

Disappointing US data prompted us to reduce our GDP growth forecast. Meanwhile, the Fed pared its inflation forecasts, and core inflation printed below 1% in the US and the Euro area. **The strengthening themes of a slowing economy and continued disinflation should keep G-4 central banks on hold for longer, and bolster bonds.** We thus go long duration in Europe, where we expect much of the recent rise in money markets rates—sparked by the expiry of the ECB's one-year lending to banks—to be reversed.

The prospect of central banks on perma-hold is likely to keep bond volatility subdued. Indeed, implied volatility is already below its long-term average, unlike equity volatility. **Diminished volatility and the meager return on cash favour carry trades.** We expect curves—still historically steep—to flatten further, with the belly outperforming, as investors extend duration. And we stay long EM bonds, which continue to benefit from robust inflows.

With increasing concerns among both investors and policymakers that low inflation will become entrenched, our latest **Inflation Expectations Survey** includes questions on inflation and deflation tail risks. We invite you to participate on http://www.surveymonkey.com/s/inflationsurvey.

Equities

Equities were unchanged last week, as weak economic data offset better-than-expected earnings reports. **What have we learned so far from the 2Q reporting season?** That 70% of companies beat revenue bottom-up estimates, and 81% beat EPS, similar to what we observed over the past four quarters. Revenues are on course to rise by 12% in 2Q (ex-Financials), the second consecutive quarter of double-digit growth. Two-thirds of this revenue growth is driven by Cyclicals and Energy, with diminished contributions from Defensives (see *Q2 10 Preview*, Tom Lee, July 15). This portrays a business sector that benefited from above-trend global GDP growth in 2Q and was still able to generate robust revenue growth and margin expansion.

But further out into 2011, profit expectations are being lowered. According to the Blue Chip consensus survey, US economic profit forecasts for 2011 have been lowered for two consecutive months to 7.0% oya in July versus 8.1% in May. Bottom-up estimates for the 2011 EPS of MSCI AC World have been also drifting lower and are 2.2% below their end-April peak.

Negative momentum and bearish technicals (equities remain stubbornly below their 200-day moving averages) point to further downside for the near term. We stay underweight in small caps and in sectors that are most sensitive to the downshifting in global manufacturing, i.e., Industrials and Materials.

We continue to overweight EM equities. EM economies are relative immune from European funding problems and policymakers have more room for maneuver relative to their DM counterparts. Within EM, we downgrade both South Africa and Mexico from overweight to neutral, and upgrade ASEAN to overweight. Growth momentum appears to be downshifting into 2H in South Africa and Mexico but remains strong for the ASEAN region (se *EM Equity Strategy*, Adrian Mowat, July 15).

Credit

A key event last week was the **passage of the US Financial reform bill**. The bill will alter how investors trade credit derivatives. Most CDS will now need to clear through a clearinghouse, and they will be traded on an exchange or executed through a swap execution facility. For non-cleared trades, investors can request collateral segregation. FDIC insured banks will be required to spin off the trading of certain credit derivatives such as HY and ABS CDS to a separately capitalized entity. For more details, see *Financial Reform: Impact on CDS*, Eric Beinstein.

US credit demand remains strong as we saw decent inflows into HY funds, very strong inflows into US HG bond funds,

JPMorgan Securities Ltd., London
Jan Loeys (44-20) 7325-5473
jan.loeys@jpmorgan.com
John Normand (44-20) 7325-5222
john.normand@jpmorgan.com

and higher primary issuance in both HG and HY corporate bonds. Although US HG spreads of 172bp are above our year-end target of 150bp, we **stay neutral** vs. USTs as economic data weaken and the current yield is not particularly attractive. The rally in USTs has helped push the US HG yield to a new cycle low of 4.68% last week.

Comparing corporate bonds across regions, we **favour US and EM versus Europe**. The European sovereign debt crisis continues to put pressure on the region and term funding markets in peripheral countries remain impaired. With some European sovereign debt yielding 5%-10%, demand for European corporates is weak. In May, European HG bond funds saw the first outflow since November 2008.

Within EM corporates, we stay relatively defensive and overweight HG and higher-quality HY EM corporate bonds until momentum clearly turns and flows into EM strengthen. We prefer Latin American issues given the region's strong growth and fundamentals, and the better trends in ratings and defaults versus other regions.

Foreign exchange

FX markets came back to life last week with a number of competing influences serving to weaken the debilitating influence of risk markets of recent months. Commodity currencies remain largely subservient to the weekly vagaries of stock markets but for most other currencies the correlations are falling, and in some cases quite sharply, most noticeably EUR, GBP, and JPY. **The euro short squeeze is set to continue** as sovereign concerns recede and bank stress tests are unlikely to prove a game-changer.

What is driving this return to a more independent FX market? A quick summary would be to say a lessening of euro tail risks and an intensification of the independent, albeit more traditional macroeconomic, risks to the US dollar, as evidence cumulates of weaker US growth and a Fed that is digging in for the long haul. The market arguably finds itself having to rethink the dominant paradigm of the last six months. In short, it may be using the wrong funding currency, which at a minimum supports further short-covering in the euro.

We stay long EUR but rotate from EUR/JPY to long EUR/USD, keeping long EUR/GBP. We are short EUR/CHF and USD/CAD in options, short USD/INR in cash.

Ten-year Government bond yields

	Current	Sep 10	Dec 10	Mar 11	Jun 11
United States	2.93	3.45	3.85	4.15	4.50
Euro area	2.61	2.90	3.15	3.25	3.35
United Kingdom	3.33	3.55	3.90	4.10	4.25
Japan	1.09	1.30	1.40	1.50	1.55
GBI-EM	6.73			7.90	

Credit markets

	Current	YTD Return
US high grade (bp over UST)	172	6.7%
Euro high grade (bp over Euro gov)	196	3.0%
USD high yield (bp vs. UST)	700	6.6%
Euro high yield (bp over Euro gov)	720	5.3%
EMBIG (bp vs. UST)	336	7.3%
EM Corporates (bp vs. UST)	368	7.4%

Foreign exchange

	Current	Sep 10	Dec 10	Mar 11	Jun 11
EUR/USD	1.29	1.25	1.25	1.25	1.25
USD/JPY	86.7	90	93	93	93
GBP/USD	1.53	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)	1190	1250	1275	1250	1250
Copper($/m ton)	6662	6500	6750	6750	7000
Corn ($/Bu)	4.07	3.90	3.80	4.00	4.20

Source: J.P. Morgan, Bloomberg, Datastream

Commodities

Industrial metals were down 3% last week. Weaker economic activity data provided further evidence of the slowdown in global growth, pushing both metals and oil lower. We expect commodities to move broadly in a range over the summer but **underweight industrial metals** against the GSCI as the slowdown in manufacturing growth should continue to put pressure on base metal prices.

Gold has come down over the last few weeks on falling long-term inflation expectations, as evidenced by lower breakeven rates. **We moved from long to neutral Gold** last week, and remain so, as the impact of further drops in inflation fears could easily offset strong demand by central banks. **Agriculture was up 4% last week** as inventory data continued to come in weaker than expected and worsening weather conditions are threatening supply in the key grain producing countries. We **overweight agriculture** as it is less likely to be affected by the economic slowdown and in our opinion, risks to supply remain elevated.

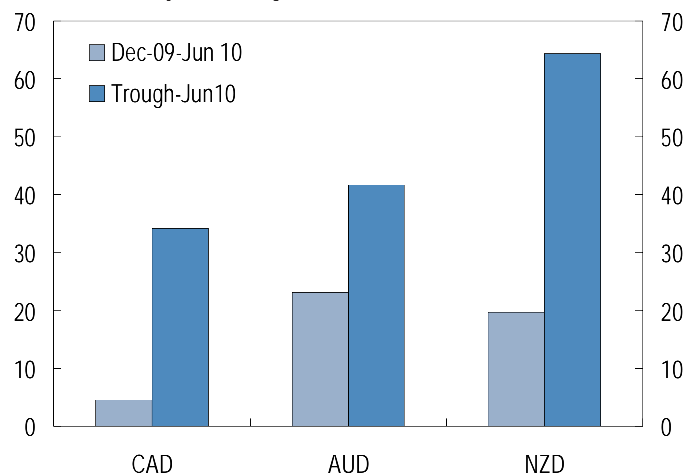
AUD and NZD Commentary

- **Economic data disappointments in the US and China have elevated downside risks to the global economic recovery, undercutting high-beta FX.**
- **AUD and NZD have a stronger commodity-price foundation than CAD and positions are light, suggesting that AUD and NZD will outperform once double-dip fears subside.**
- **AUD/USD and NZD/USD are vulnerable to some retracement after testing the next line of key resistance levels; note that both look vulnerable to additional underperformance against EUR.**
- The negative news came thick and fast at the end of last week: In China, economic activity slowed to a 7.2% annualized clip in 2Q from 10.8% in 1Q. And in the US, downwards revisions took the steam out of consumer demand, while early readings on July business sentiment turned sharply lower, along with the biggest drop in the University of Michigan's consumer sentiment since Oct 2008.
- The news triggered another a round of liquidation of cyclical exposures, with the G-10 commodity currencies - AUD, CAD and NZD bearing the brunt of the sell-off.
- The ongoing flurry of downwards forecast revisions likely has some way to run -- the full retail sales downdraft from weak US home sales and the impact of tighter financial conditions (lower equities, wider risk spreads) have not yet been felt. Thus we recommend defensive positioning in risk markets. But we still forecast near-trend global growth led by EM demand, consistent with a stabilization in risk markets. Against such a backdrop, we expect long commodity FX positions to perform well over time.
- AUD and NZD should lead the way among the G-10 commodity currencies. AUD and NZD commodity prices have far outpaced Canadian commodities in the cyclical revival and will continue to support profits, incomes and domestic demand (Chart 1). Strong demand eventually will drive more aggressive policy tightening than markets currently price in both Australia and New Zealand.
- Modest long AUD and NZD positions on the IMM suggest that the scope for an agressive squeeze has diminished.

Technical analysis

- The late-week reversals for both AUD/USD and NZD/USD suggest some pullback is likely to develop after approaching the next line of important resistance levels amid an overbought setup. In turn, we see an important test for both as the quality of any additional retracement from here will define whether a deeper upside retracement is underway, or prices are shifting back to the July/June lows. Note that the underperformance against the European currencies appears set to continue with a number of crosses positioned for an extension of the advances from the June lows.
- Note that AUD/USD failed to extend above the key .8860 resistance area and the June highs. Pullbacks should find support at .8665 and then .8565. While intact, the risks for additional upside will remain intact.
- For NZD/USD, last week's rally finally stalled against the key .7300/.7330 resistance zone and April highs while suggesting some short term consolidation can develop. Still, the .7035 level, as well as the key .6975/35 zone will define whether a more sustained break of the April highs can develop.

Australian, Canadian and New Zealaand Commodity Price increases from cyclical trough and Dec09



Source: J.P. Morgan

NZD/USD - Daily chart

JPMorgan Chase Bank, New York
David Hensley (1-212) 834-5516
david.hensley@jpmorgan.com
Carlton Strong (1-212) 834-5612
carlton.m.strong@jpmorgan.com

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	1Q10	2Q10	3Q10	4Q10	1Q11	2Q11	3Q11	1Q10	2Q10	4Q10	2Q11
The Americas														
United States	-2.4	**2.8** ↓	**2.7** ↓	2.7	**2.1** ↓	**2.5** ↓	**3.0** ↓	2.5	2.5	3.0	2.4	1.8	**0.8** ↓	**1.1** ↓
Canada	-2.5	3.6	2.7	6.1	3.5	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	4.7	2.5	4.0	4.3	5.2	1.7	6.0	6.5	7.0	6.9
Argentina	-2.0	6.0	4.0	12.5	8.0	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	6.0	4.0	3.3	3.8	4.2	4.1	4.9	5.1	5.3	5.4
Colombia	0.8	4.5	4.1	5.3	4.8	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	3.5	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	3.2	-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	9.5	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	-5.0	5.0	1.0	1.0	1.0	1.5	27.4	32.1	32.1	32.1
Asia/Pacific														
Japan	-5.3	3.6	2.2	5.0	2.8	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	2.7	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	3.8	2.9	1.9	3.0	3.4	3.5	2.0	2.2	4.8	5.3
Asia ex Japan	4.8	**8.6** ↓	**7.0** ↓	**10.8** ↓	**6.4** ↓	**6.0** ↓	**6.5** ↓	**7.4** ↑	**7.2** ↓	**7.1** ↓	4.3	**4.6** ↓	**4.5** ↓	**4.0** ↑
China	9.1	**10.0** ↓	**8.8** ↓	**10.8** ↓	**7.2** ↓	**8.2** ↓	**8.6** ↓	**9.5** ↑	**9.1** ↓	**8.7** ↓	2.2	**2.9** ↓	**2.8** ↓	**2.7** ↑
Hong Kong	-2.8	6.8	4.2	8.7	4.3	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	8.1	8.0	8.9	8.0	8.5	8.6	15.3	13.6	11.8	10.1
Indonesia	4.5	6.2	5.7	5.4	7.0	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	4.0	3.8	3.8	4.0	4.0	4.5	2.7	**2.6** ↓	**3.2** ↓	**3.5** ↓
Malaysia	-1.7	7.7	4.8	5.0	4.0	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	3.6	4.9	4.0	4.5	4.5	4.5	4.3	5.0	5.2	4.9
Singapore	-1.3	**14.5** ↑	**5.2** ↑	**46.0** ↑	**26.0** ↑	**-14.5** ↑	**-2.0** ↓	**12.6** ↑	**6.1** ↓	**9.0** ↑	0.9	3.4	4.7	3.7
Taiwan	-1.9	9.2	4.8	11.3	3.3	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	-2.0	2.8	2.8	6.0	5.5	4.0	3.7	5.5	4.4	3.0
Africa/Middle East														
Israel	0.7	3.0	4.5	3.3	3.5	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	3.9	2.8	3.4	3.7	3.1	3.6	5.7	4.6	5.4	5.6
Europe														
Euro area	-4.1	1.3	1.4	0.8	3.0	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	5.0	3.0	2.0	2.0	1.5	2.0	0.8	1.0	1.2	0.9
France	-2.5	1.6	1.4	0.5	2.5	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	2.0	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	2.0	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	5.0	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	2.8	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	**1.3** ↑	3.0	2.5	2.5	2.0	2.5	3.0	3.3	3.5	**2.5** ↓	1.7
Emerging Europe	-4.9	4.1	**4.3** ↓	2.1	**7.8** ↓	**2.9** ↓	**2.8** ↓	**3.7** ↓	**4.0** ↓	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	2.5	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	2.0	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	3.0	2.5	2.5	3.0	4.0	4.0	3.0	2.3	2.6	2.6
Romania	-7.1	**-2.0** ↓	**1.5** ↓	...	...	...	...	...	...	...	4.6	4.4	8.0	7.2
Russia	-7.9	5.5	5.0	2.2	13.5	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
Global	-2.5	**3.4** ↓	**3.0** ↓	3.6	**3.4** ↓	**2.9** ↓	**2.9** ↓	2.8	2.8	3.0	2.2	**2.1** ↓	1.9	1.8
Developed markets	-3.5	**2.4** ↓	2.3	2.5	**2.6** ↓	**2.4** ↓	**2.3** ↓	2.0	2.0	2.4	1.5	**1.3** ↓	**1.0** ↓	1.0
Emerging markets	1.1	**6.8** ↓	**5.6** ↓	**7.5** ↓	**6.1** ↓	**4.5** ↓	**5.2** ↓	**5.9** ↑	**6.0** ↓	**5.2** ↓	5.1	**5.1** ↓	**5.2** ↓	**4.9** ↑
Memo:														
Global — PPP weighted	-0.7	**4.6** ↓	**4.0** ↓	5.0	**4.4** ↓	**3.8** ↓	**3.9** ↓	4.0	4.0	4.0	3.3	3.3	3.1	2.9

Note: For some emerging economies, 2010-2011 quarterly forecasts are not available and/or seasonally adjusted GDP data are estimated by J.P. Morgan.
Bold denotes changes from last edition of *Global Data Watch*, with arrows showing the direction of changes. Underline indicates beginning of J.P. Morgan forecasts.

J.P. Morgan Chase Bank, New York
David Hensley (1-212) 834-5516
david.hensley@jpmorgan.com
Sam Conway (1-212) 834-9123
samuel.e.conway@jpmorgan.com

Global Central Bank Watch

	Official interest rate	Current	Change from Aug '07 (bp)	Last change	Next meeting	Forecast next change	Sep 10	Dec 10	Mar 11	Jun 11	Sep 11
Global	GDP-weighted average	1.35	-332				1.40	1.47	1.51	1.58	1.63
excluding US	GDP-weighted average	1.92	-243				2.01	2.10	2.16	2.27	2.35
Developed	GDP-weighted average	0.53	-358				0.55	0.58	0.60	0.65	0.68
Emerging	GDP-weighted average	4.61	-225				4.81	5.01	5.13	5.31	5.46
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	4.35	4.84
EM Asia	GDP-weighted average	4.18	-191				4.30	4.47	4.62	4.80	4.85
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)	20 Aug 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	4.00	5.00	5.50
Peru	Reference rate	2.00	-250	8 Jul 10 (+25bp)	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	1.39	1.50
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	27 Sep 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	**4Q 11 (+50bp)**	6.50	6.50	6.50	**6.50**	**6.50**
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	-	19 Aug 10	Jul 11 (+50bp)	7.00	7.00	7.00	7.00	8.25
Asia/Pacific	GDP-weighted average	2.22	-122				2.29	2.39	2.48	2.58	2.61
Australia	Cash rate	4.50	-175	4 May 10 (+25bp)	3 Aug 10	3 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)	10 Aug 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)	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	**4Q 10 (+27bp)**	**5.31**	**5.58**	**5.58**	**5.85**	**5.85**
Korea	Base rate	2.25	-225	9 Jul 10 (+25bp)	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	2.75	-75	8 Jul 10 (+25bp)	2 Sep 10	On hold	2.75	2.75	2.75	2.75	2.75
Philippines	Reverse repo rate	4.00	-350	9 Jul 09 (-25bp)	26 Aug 10	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)	25 Aug 10	25 Aug 10 (+25bp)	**1.75**	**2.00**	2.00	2.00	2.00
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.

JPMorgan Australia Ltd., Sydney
Stephen Walters (61-2) 9220-1599
stephen.b.walters@jpmorgan.com

Economic forecasts - Australia

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

				2009			2010				2011			
	2009	2010	2011	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Chain volume GDP	1.3	2.9	3.5	3.4	1.1	4.5	2.0	2.7	4.1	4.2	3.1	3.2	4.2	2.8
Private consumption	1.6	2.0	2.0	5.1	1.3	3.6	2.3	0.8	0.4	1.6	2.8	2.4	2.4	2.0
Construction investment	-0.5	1.5	6.0	-2.8	2.6	1.1	-3.3	4.7	6.2	6.4	5.5	5.0	7.9	7.8
Equipment investment	-3.4	8.5	10.0	0.1	-13.1	46.8	-20.9	37.6	12.9	17.5	5.1	3.4	6.4	8.6
Public investment	4.9	32.3	9.7	13.5	43.6	49.7	55.4	14.7	10.3	10.9	7.1	11.8	7.1	10.1
Government consumption	2.8	3.6	1.7	3.4	5.4	7.5	3.3	0.1	3.9	0.2	0.1	3.7	3.7	0.4
Exports of goods & services	1.4	2.5	4.2	8.4	-6.5	8.3	-2.0	4.1	6.1	4.9	4.1	2.8	4.1	4.1
Imports of goods & services	-7.8	10.9	4.1	3.5	18.0	36.6	7.3	0.0	3.2	3.2	4.1	6.1	3.2	8.2
Contributions to GDP growth:														
Inventories	-0.5	-0.9	-0.6	0.9	2.9	0.7	0.7	-8.1	0.0	-0.1	-0.2	0.1	-0.2	-0.1
Net trade	2.0	-1.7	-0.1	0.9	-4.6	-5.0	-2.0	0.8	0.5	0.2	-0.1	-0.8	0.1	-1.0
GDP deflator (%oya)	0.2	3.1	2.4	0.1	-2.1	-1.5	1.4	4.1	3.7	3.2	2.2	2.4	2.5	2.5
Consumer prices (%oya)	1.8	3.4	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 diminished.
- 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 has called an August 21election. The recent leadership change appears to be paying off. Since the election was called, the Government has held a commanding lead over the Opposition.

Economic forecasts - New Zealand

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

				2009			2010				2011			
	2009	2010	2011	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Real GDP (1995-96 prices)	-1.7	2.6	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	5.7	5.3	0.8	0.7	0.3	0.9	1.6	1.5	1.6	1.5	1.3	1.3	1.2
Current account (NZ$ bil, sa)	-5.5	-5.0	-11.9	-0.4	0.1	-2.9	-1.2	-1.3	-1.0	-0.6	-2.1	-5.2	-3.6	-3.5
as % of GDP	-3.0	-2.6	-6.0	-0.9	0.1	-6.5	-2.8	-2.1	-1.3	-4.4	-7.3	-7.0	-5.4	-4.2
Yield on 90-day bank bill (%)*	3.0	3.2	4.8	2.8	2.8	2.8	2.7	2.8	3.5	3.8	4.3	4.8	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.
- Headline **inflation** continued to hover around the middle of the RBNZ's 1%-3% target range in the June quarter, although this precedes what we expect will be a series of elevated inflation prints over the coming year.
- Managing **inflation expectations** will be a growing challenge for the RBNZ, given the July 1 introduction of the amended ETS and the GST hike on October 1.

JPMorgan Australia Ltd., Sydney
Stephen Walters (61-2) 9220-1599
stephen.b.walters@jpmorgan.com
Helen Kevans (61-2) 9220-3250
helen.e.kevans@jpmorgan.com

Australia and New Zealand economic calendar

Monday	Tuesday	Wednesday	Thursday	Friday
19 Jul	20 Jul	21 Jul Australia: Westpac leading index (11:30 am) May New Zealand: Visitor arrivals (10:45 am) Jun Credit card spending (3:00 pm) Jun 2.0%oya	22 Jul	23 Jul Australia: Export price index (11:30 am) 2Q 6.6%oya Import price index (11:30 am) 2Q -7.4%oya
26 Jul Australia: PPI (11:30 am) 2Q	27 Jul	28 Jul Australia: CPI (11:30 am) 2Q New Zealand: NBNZ business confidence (3:00 pm) Jul	29 Jul New Zealand: RBNZ official cash rate Jul Trade balance (10:45 am) Jun	30 Jul Australia: Pvt. Sector credit (11:30 am) Jun New Zealand: Building permits (10:45 am) Jun
2 Aug	3 Aug	4 Aug New Zealand: ANZ commodity price (3:00 pm) Jul	5 Aug 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 RBA cash target (2:30 pm) Aug New Zealand: Private wages (10:45 am) 2Q	6 Aug Australia: Trade balance (11:30 am) Jun HPI (11:30 am) 2Q
9 Aug	10 Aug New Zealand: QV house prices Jul	11 Aug Australia: NAB business conditions (11:30 am) Jul Housing finance (11:30 am) Jun	12 Aug	13 Aug Australia: Westpac consumer confidence (11:30 am) Aug

Global Data Diary

Week / Weekend	Monday	Tuesday	Wednesday	Thursday	Friday
19 - 23 July	19 July	20 July	21 July	22 July	23 July
Australia • NAB bus conf (2Q)	**Hungary** • NBH mtg: no chg **Poland** • IP (Jun) **United States** • NAHB surv (Jun)	**Belgium** • BNB cons conf (Jul) **Canada** • BoC mtg: +25bp **Netherlands** • CBS cons conf (Jul) **Taiwan** • Export orders (Jun) **United States** • Housing starts (Jun)	**Brazil** • COPOM mtg: +75bp **Japan** • MPM minutes (Jun) **United Kingdom** • MPC minutes (Jun) **United States** • Bernanke testimony	**Euro area** • PMI flash (Jul) • EC cons conf (Jul) **France** • INSEE bus conf (Jul) **Japan** • All sector act index (May) **South Africa** • SARB mtg: no chg **United Kingdom** • Retail sales (Jun) **United States** • Existing home sales (Jun) • Leading indicators (Jun)	**Belgium** • BNB bus conf (Jul) **Canada** • CPI (Jun) **Colombia** • BanRep mtg: no chg **Germany** • IFO bus surv (Jul) **Taiwan** • IP (Jun) **United Kingdom** • GDP (2Q)
26 - 30 July	26 July	27 July	28 July	29 July	30 July
	Israel • BoI mtg: no chg **Japan** • Trade balance (Jun) **Korea** • GDP (2Q) **Poland** • NBP mtg: no chg **Singapore** • IP (Jun) **United States** • New home sales (Jun) • Dallas Fed surv (Jul)	**India** • RBI mtg: +25bp **Netherlands** • CBS bus conf (Jul) **United States** • Case-Shiller HPI (May) • CB cons conf (Jul) • Richmond Fed surv (Jul)	**Australia** • CPI (2Q) **Germany** • CPI (Jul) **Japan** • Shoko Chukin surv (Jul) **United States** • Durable goods (Jun) • Beige book	**Euro area** • EC bus onf (Jul) **Germany** • Labor mkt report (Jul) **Japan** • Retail sales (Jun) **New Zealand** • RBNZ mtg: +25bp **Spain** • HICP (Jul) **United States** • KC Fed surv (Jul)	**Euro area** • Unemploy rate (Jul) • HICP (Jul) **Japan** • Mfg PMI (Jul) • Hhold spending, unemployment rate, core CPI, IP (Jun) **Korea** • IP (Jun) **United Kingdom** • GFK cons conf (Jul) **United States** • GDP (2Q) • Chicago PMI (Jul) • UM cons conf final (Jul)

Analysts' Compensation: The research analysts responsible for the preparation of this report receive compensation based upon various factors, including the quality and accuracy of research, client feedback, competitive factors and overall firm revenues. The firm's overall revenues include revenues from its investment banking and fixed income business units. **Principal Trading:** JPMorgan and/or its affiliates normally make a market and trade as principal in fixed income securities discussed in this report. **Legal Entities:** J.P. Morgan is the global brand name for J.P. Morgan Securities Inc. (JPMSI) and its non-US affiliates worldwide. J.P. Morgan Cazenove is a brand name for equity research produced by J.P. Morgan Securities Ltd.; J.P. Morgan Equities Limited; JPMorgan Chase Bank, N.A., Dubai Branch; and J.P. Morgan Bank International LLC. J.P.Morgan Securities Inc. is a member of NYSE and SIPC. JPMorgan Chase Bank, N.A. is a member of FDIC and is authorized and regulated in the UK by the Financial Services Authority. J.P. Morgan Futures Inc., is a member of the NFA. J.P. Morgan Securities Ltd. (JPMSL) is a member of the London Stock Exchange and is authorized and regulated by the Financial Services Authority. J.P. Morgan Equities Limited is a member of the Johannesburg Securities Exchange and is regulated by the FSB. J.P. Morgan Securities (Asia Pacific) Limited (CE number AAJ321) is regulated by the Hong Kong Monetary Authority. JPMorgan Chase Bank, Singapore branch is regulated by the Monetary Authority of Singapore. J.P. Morgan Securities Asia Private Limited is regulated by the MAS and the Financial Services Agency in Japan. J.P. Morgan Australia Limited (ABN 52 002 888 011/AFS Licence No: 238188) (JPMSAL) is a licensed securities dealer. J.P.Morgan Saudi Arabia Ltd. is authorized by the Capital Market Authority of the Kingdom of Saudi Arabia (CMA), licence number 35-07079. **General:** Information has been obtained from sources believed to be reliable but JPMorgan does not warrant its completeness or accuracy except with respect to disclosures relative to JPMSI and/or its affiliates and the analyst's involvement with the issuer. Opinions and estimates constitute our judgment at the date of this material and are subject to change without notice. Past performance is not indicative of future results. The investments and strategies discussed may not be suitable for all investors; if you have any doubts you should consult your investment advisor. The investments discussed may fluctuate in price or value. Changes in rates of exchange may have an adverse effect on the value of investments. This material is not intended as an offer or solicitation for the purchase or sale of any financial instrument. JPMorgan and/or its affiliates and employees may act as placement agent, advisor or lender with respect to securities or issuers referenced in this report.. Clients should contact analysts at and execute transactions through a JPMorgan entity in their home jurisdiction unless governing law permits otherwise. This report should not be distributed to others or replicated in any form without prior consent of JPMorgan. **U.K. and European Economic Area (EEA):** Investment research issued by JPMSL has been prepared in accordance with JPMSL's Policies for Managing Conflicts of Interest in Connection with Investment Research. This report has been issued in the U.K. only to persons of a kind described in Article 19 (5), 38, 47 and 49 of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2001 (all such persons being referred to as "relevant persons"). This document must not be acted on or relied on by persons who are not relevant. Any investment or investment activity to which this document relates is only available to relevant persons and will be engaged in only with these persons. In other EEA countries, the report has been issued to persons regarded as professional investors (or equivalent) in their home jurisdiction. **Australia:** This material is issued and distributed by JPMSAL in Australia to "wholesale clients" only. JPMSAL does not issue or distribute this material to "retail clients." The recipient of this material must not distribute it to any third party or outside Australia without the prior written consent of JPMSAL. For the purposes of this paragraph the terms "wholesale client" and "retail client" have the meanings given to them in section 761G of the Corporations Act 2001. **Canada:** The information contained herein is not, and under no circumstances is to be construed as, a prospectus, an advertisement, a public offering, an offer to sell securities described herein, or solicitation of an offer to buy securities described herein, in Canada or any province or territory thereof. Any offer or sale of the securities described herein in Canada will be made only under an exemption from the requirements to file a prospectus with the relevant Canadian securities regulators and only by a dealer properly registered under applicable securities laws or, alternatively, pursuant to an exemption from the dealer registration requirement in the relevant province or territory of Canada in which such offer or sale is made. The information contained herein is under no circumstances to be construed as investment advice in any province or territory of Canada and is not tailored to the needs of the recipient. To the extent that the information contained herein references securities of an issuer incorporated, formed or created under the laws of Canada or a province or territory of Canada, any trades in such securities must be conducted through a dealer registered in Canada. No securities commission or similar regulatory authority in Canada has reviewed or in any way passed judgment upon these materials, the information contained herein or the merits of the securities described herein, and any representation to the contrary is an offense. **Korea**: This report may have been edited or contributed to from time to time by affiliates of J.P. Morgan Securities (Far East) Ltd, Seoul branch. Revised March 1, 2010. Copyright 2010 JPMorgan Chase Co. All rights reserved. Additional

Economic Research, Emerging Markets Research and Global FX Strategy at JPMorgan

Global Economics

Chief Economist
Bruce Kasman, New York (1-212) 834-5515

Economics: Global

David Hensley (1-212) 834-5516
Joseph Lupton (1-212) 834-5735
Sam Conway (1-212) 834-9123

Data and Forecast Systems

Carlton Strong (1-212) 834-5612
Donald Martis (1-212) 834-5667
Silvana Dimino (1-212) 834-5684

Economics: United States and Canada

United States

Robert Mellman, New York (1-212) 834-5517
Michael Feroli (1-212) 834-5523
Abiel Reinhart (1-212) 834-5614

Canada

Sandy Batten, New York (1-212) 834-9645

Economics: Latin America

Brazil

Fabio Hashizume, São Paulo
(55-11) 3048-3634
Julio Callegari, São Paulo (55-11) 3048-3369

Colombia, Ecuador, Venezuela, Peru

Luis Oganes, New York (1-212) 834-4326
Benjamin Ramsey, New York
(1-212) 834-4308
Julio Callegari, São Paulo (55-11) 3048-3369

Argentina, Chile
Vladimir Werning, New York
(1-212) 834-8144
Mexico
Alfredo Thorne, Mexico City (525) 540-9558

Economics: Asia/Pacific

Head of Japan
Masaaki Kanno, Tokyo (81-3) 6736-1166
Japan

Masamichi Adachi, Tokyo (81-3) 6736-1172
Miwako Nakamura, Tokyo (81-3) 6736-1167

Australia, New Zealand

Stephen Walters, Sydney (61-2) 9220-1599
Helen Kevans, Sydney (61-2) 9220-3250
Ben Jarman, Sydney (61-2) 9220-1669

Emerging Markets Research

Head of Emerging Markets Research
Joyce Chang (1-212) 834-4203
Head of Emerging Asia Economic Research
David G. Fernandez, Singapore,
(65) 6882-2461

Greater China

Qian Wang, Hong Kong (852) 2800-7009
Grace Ng, Hong Kong (852) 2800-7002

Korea
Jiwon Lim, Seoul (822) 758-5509
James Lee, Seoul (822) 758-5512

India
Jahangir Aziz, Mumbai (91-22) 6639-8033
Gunjan Gulati, Mumbai (91-22) 6639-3125

Indonesia, Malaysia, Philippines, Singapore, Thailand

Matt Hildebrandt (65) 6882-2253
Sin Beng Ong (65) 6882-1623

Emerging Markets FX Strategy
Claudio Piron (65) 6882-2218
Yen Ping Ho (65) 6882-2216

Economics: Europe/Africa

Head of Western Europe
David Mackie, London (44-20) 7325-5040

United Kingdom, Switzerland

Malcolm Barr, London (44-20) 7777-1080
Allan Monks, London (44-20) 7777-1188

Euro area

Marta Bastoni, London (44-20) 7325-9114
Greg Fuzesi London (44-20) 7777-4792

Scandinavia

Nicola Mai, London (44-20) 7777-3467

Czech Republic, Hungary, Poland, Slovakia

Nora Szentivanyi, London (44-20) 7777-3981
Miroslav Plohjar, London
(44-20) 7325-0745

CEEMEA

Michael Marrese, New York
(1-212) 834-4876
Eva Sanchez, New York (1-212) 834-8217

Turkey, Bulgaria, the Baltics

Yarkin Cebeci, Istanbul (90-212) 326-8590

Russia, Ukraine, Bulgaria, Kazakhstan

Nina Chebotareva, Moscow
(7-095) 937-7321
Anatoliy Shal (7-495) 937-7321

Africa
Graham Stock (44-20) 7777-3430
Sonja Keller (27-11) 507-0376

Global FX Strategy

Global Head
John Normand (44-20) 7325-5222

Global FX Strategy, New York

Gabriel De Kock (1-212) 834-4254
Kenneth Landon (1-212) 834-2391
Arindam Sandilya (1-212) 834-2304

FX & Commodity Technical Strategy
Niall O'Connor (1-212) 834-5108

Global FX Strategy, London

Paul Meggyesi (44-20) 7859-6714
Kamal Sharma (44-20) 7777-1729
Talis Bauer (44-20) 7777-5276

Emerging Markets FX Strategy
Robert Beange (44-20) 7777-3246

Global FX Strategy: Asia

Tohru Sasaki (81-3) 5570-7717
Junya Tanase (81-3) 5570-7718

Commodity Strategy

Head of Commodites Research
Lawrence Eagles (1-212) 834-8107
Global Energy Strategy
Scott Speaker (1-212) 834-3878
Shikha Chaturvedi (1-212) 834-3245
Mark Gravener (1-212) 834-3089
Sung Yoo (1-212) 834-7045
Kristi Jones (1-212) 834-2835

Global Metals Strategy
Michael Jansen (44-20) 7325-5882

Agricultural Commodity Strategy
Lewis Hagedorn (1-312) 325-6409

Commodity Index Research
Jennie Byun (44-20) 7777-0070