

## Australia and New Zealand - Weekly Prospects

### Summary

- **Australian** households probably are breathing a collective sigh of relief. The material downside surprises on the inflation numbers last week significantly reduced the likelihood of an RBA rate hike later today. With the headline, core, and non-tradable measures of inflation having fallen on the downside of market expectations, we pushed out our forecast for an August rate hike to November. RBA officials will likely remain on the policy sidelines until after the late-October release of the 3Q CPI data for confirmation that the June quarter was, in fact, the low point in the inflation cycle. The commentary accompanying the RBA's expected "no change" decision today probably will reinforce the message that significant price pressures are building. The terms of trade, for example, is soaring, the labour market is tight, and wage pressures are on the rise, meaning that the current tightening cycle has further to run. This week's data on retail sales, building approvals, and house prices will, however, provide evidence that the cumulative 150bp of rate hikes already delivered are weighing on the interest rate sensitive sectors of the economy.
- The **RBNZ** delivered on expectations for a 25bp rate hike last week, although the accompanying statement was decisively more dovish. RBNZ Governor Bollard suggested that the "pace and extent of further increases was likely to be more moderate than was projected in the monetary policy statement on June 10" and that the outlook for economic growth had softened. While further rate hikes are likely, owing to the fact that current policy settings are "very supportive," we now expect two only two more 25bp rate moves this year, compared to the three we had expected previously. The RBNZ will likely pause in November in order to assess the impact of the policy rate hikes already delivered. This week's labour market data will likely show that unemployment edged higher in 2Q, paring some of the previous quarters' sharp decline.
- Last week's **US 2Q10 GDP** report—which includes revisions back to 2007—did not materially alter the economy's progression from recession into recovery. A deep downturn now looks somewhat deeper (-4.1% peak-to-trough), and the first year of expansion produced a 3.2% rise in activity. However, the report altered the composition of growth, pointing to a greater imbalance between business and household demand in the early stages of the expansion. The report showed stronger-than-expected increases in capital spending and inventory accumulation on the part of business in 1H10. But revised figures show a more muted revival in consumer spending despite upward revisions to income. This development has pushed the measured saving rate to 6.2%. This divergence in demand is also reflected sectorally where gains in GDP services over the past year were revised away, indicating that growth was highly concentrated in goods-producing industries.
- Two significant forces are expected to weigh on **Euro area growth** over the coming months: the inevitable moderation in manufacturing activity and banking stress surrounding the sovereign credit crisis. Thus far, the news on both of these has been better than we were expecting, raising upside risks around our forecast that growth will slow to 1% later this year.

### This week's highlight

The RBA most probably will leave the cash rate unchanged today. We suspect that the accompanying statement will touch on the soft 2Q CPI data, but will leave open the door for further policy tightening.

August 3, 2010

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## Data and event previews - Australia and New Zealand

Date	Time <sup>(a)</sup>	Data/event	Forecast		Previous
			JPMorgan	Consensus <sup>(b)</sup>	
Tuesday, August 3	11.30am	Aust. retail sales (%m/m, Jun.)	0.2	0.4	0.2
Tuesday, August 3	11.30am	Aust. retail sales ex. inflation (%q/q, 2Q)	0.9	0.7	0.1
Tuesday, August 3	11.30am	Aust. building approvals (%m/m, Jun.)	-3.0	2.0	-6.6
Tuesday, August 3	2.30pm	RBA cash rate announcement (%)	4.50	4.5	4.5
Wednesday, August 4	9.30am	AiG performance of services (Index, Jul.)	na	na	48.8
Wednesday, August 4	11.30am	Aust. trade balance (A\$m., Jun.)	1400	1800	1645
Wednesday, August 4	11.30am	Aust. house price index (%q/q, 2Q)	2.0	2.0	4.8
Thursday, August 5	8.45am	NZ unemployment rate (% , 2Q)	6.4	6.2	6.0
Thursday, August 5	8.45am	NZ participation rate (% , 2Q)	68.1	68.2	68.1
Thursday, August 5	8.45am	NZ employment (%q/q, 2Q)	0.4	0.4	1.0
Friday, August 6	9.30am	AiG performance of construction (Index, Jul.)	na	na	46.4
Friday, August 6	11.30am	RBA Statement on Monetary Policy (3Q)	na	na	na

(a) Australian Eastern Standard Time.

(b) Consensus based on Bloomberg survey.

### Australia

**Retail sales (%m/m, Jun.)** - Retail sales values likely posted another rise in June. Our forecast calls for a 0.2% m/m print this week, the same growth rate as in May. Strong employment growth and the RBA's decision to leave the cash rate steady in May and June should have buoyed spending. That said, the drop in consumer confidence and the fall in equity prices over the month would have led consumers to tighten their purse strings to some extent. Over the quarter, significant discounting would have bolstered retail sales volumes. We expect sales to have risen 0.9% q/q in volume terms, following a mere 0.1% rise in the previous quarter. This suggests that consumption will make a solid contribution to 2Q GDP growth.

**Building approvals (%m/m, Jun.)** - Residential building approvals have borne the drags of rising interest rates and withdrawn stimulus more intensely than have dwelling prices, given the intensity of first home buyer representation in property development. The June numbers should play to that script, with total approvals likely down 3% m/m, with a further fall ex-

## Data previews - Cont'd.

pected in the value of approvals for construction of new dwellings. Softening approvals are indicative of a market that is losing some of its sheen, as we note in our house price forecasts.

**RBA cash rate announcement (%)** - The RBA signaled clearly in the minutes from the last Board meeting that it was awaiting more information on domestic prices. The information, though, in the form of the 2Q CPI data last week, bought the RBA more time to sit on the policy sidelines. The material downside surprises on both the headline and core measures of inflation, alongside a sharp moderation in the non-tradables measure, substantially reduced the likelihood of the RBA pulling the policy rate trigger today. The statement accompanying the RBA's decision probably will touch on the softer CPI data, but will reinforce the message that upward pressure on prices will continue to build. The soaring terms of trade, for one, has been a common theme of the RBA's recent commentary, and will again receive a mention in the August statement, particularly after data last week show the terms of trade spiking 16%q/q in the June quarter.

**Trade balance (A\$bn., Jun.)** - The trade balance will have suffered a modest payback in June, with the surplus likely falling from A\$1.7bn to A\$1.4bn. Preliminary data indicated imports were essentially flat over the month, meaning the narrowing balance will owe to slightly softer exports. Nominal exports have benefited hugely from the transition to new pricing arrangements for key commodities coal and iron ore, and this phenomenon will have continued to bolster sales values in June.

**House price index (%q/q, 2Q)** - The housing market has slowed markedly from the rampant pace of price appreciation witnessed in the first quarter of the year. We expect that the ABS' house price index rose 2%q/q in 2Q, a significant moderation from the near-5% pace set in the first quarter, when momentum garnered from the expanded first home buyers' grant had yet to fade, and the cash rate had yet to breach 4%. The continued normalization of monetary policy over the last few months now leaves borrowing rates near long-run averages, and, combined with the withdrawal of generous subsidies, has seen first home buyers swiftly withdraw from the market.

**RBA Statement on Monetary Policy (3Q)** - We suspect the quarterly Statement on Monetary Policy (SoMP) will offer minimal changes to the RBA's inflation forecasts. In the last SoMP, released in May, the RBA forecast headline inflation as high as 3.25% this year. Even after the downside surprise on 2Q CPI last week, headline inflation still looks likely to venture to 3.25% by year-end. On the growth numbers, the RBA currently forecasts the economy to expand at a well-above-trend pace over the next two years. The recent loss of momentum in the global economy may, however, prompt downgrades to these optimistic forecasts.

## New Zealand

**Unemployment (% , 2Q)** - New Zealand's unemployment rate posted a remarkable fall in 1Q, and we expect some payback in 2Q. The key rate dropped to just 6.0% from 7.1% in 4Q, marking the largest drop since 1986 and the first fall in unemployment in the Kiwi economy in more than two years. We expect, though, that the unemployment rate will creep back up to 6.4% in the June quarter, given hiring intentions remain relatively weak and actual hirings below long-run averages.

## Research note

# First home buyers casting a long shadow over Aussie data

- Stimulus distortions are receding in the loans data
- But structurally lower first home buyer representation will hurt dwelling creation in the medium term
- The implication for prices is mixed, with little relief from the housing shortfall on the horizon

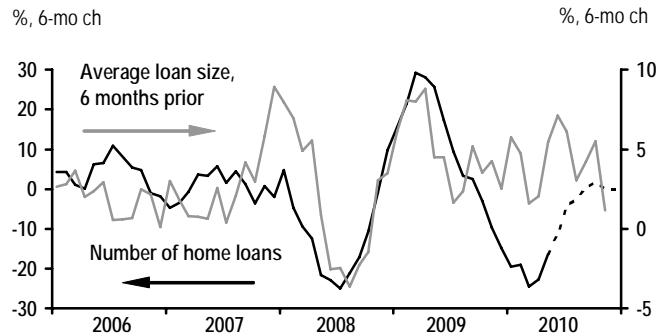
Data released two weeks ago showed Australian housing finance commitments finally turning up in May. Home loan commitments rose 1.9% m/m, the first increase in loans issued in eight months, having bottomed in growth terms at -7.7% in January. The May result is consistent with the fact that the exodus of first home buyers (FHBs)—following the expiration of stimulus support in December 2009—is waning as a downward force on home loans. Indeed, FHBs now account for only 16% of total new loan commitments, meaning further downside risks on that measure are limited. While the stimulus-induced distortion to home loans will continue to fade over the rest of the year, FHBs (or more appropriately, their absence) will cast a longer shadow over the remaining housing market indicators.

## Taking it all for granted

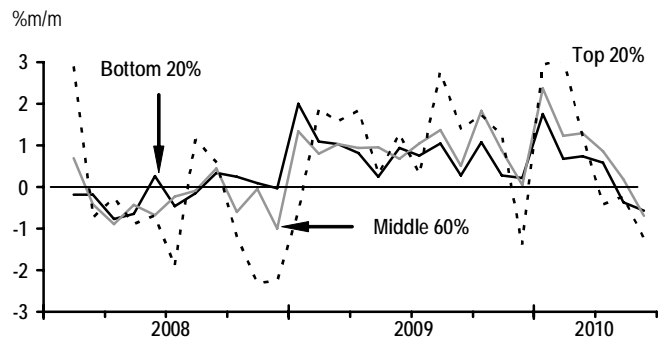
During the life of the expanded FHBs' grant (box), dwelling prices and building activity staged a rapid turnaround: house prices rose 13.5% between 4Q08 and 4Q09, and building approvals rose 38%. The outcomes for loan activity were not as monotonic, however. After initially spiking, new loan commitments began to fall steadily from July 2009, well before the expiry of the expanded grant at year-end. At that time, the prospect of increasing interest rates was not yet on the radar, so the likely explanation is that the original planned expiration date of June 30 had induced the lion's share of "grant-sensitive" buyers to take the plunge in 1H09. By the fourth quarter, brisk interest rate hikes from the RBA (some of which were super-sized by the banks) were accelerating the downward path of new loans by forcing out the remaining prospective FHBs.

The implication is that the stimulus-related wrinkles have largely worked their way through the loans data, but have yet to do so in the other housing market indicators. Dwelling prices in particular have managed, until recently, to shrug off the weakness in new loan activity, benefiting over the last year from composition effects (repeat buyers purchase higher-priced dwellings than do FHBs), and as the rally itself snowballed into a phenomenon greater than just FHBs. This phenomenon persisted amidst dwindling

Australia: home loans and average loan size



Australia: dwelling price growth stratified by price level



Source: RP Data-Rismark

## The first home owners' boost

In October 2008, the Commonwealth government's vanilla First Home Buyers' (FHBs') grant (introduced in 2000) was expanded from its original level of A\$7,000 to A\$14,000 for purchase of existing dwellings and to A\$21,000 for new dwellings. The planned expiration date for the boost was June 30, 2009, but appetite for the program saw its tenure extended by the government to December 31, 2009. In January this year, the additional support was eliminated, with the grant returning to pre-crisis levels, and various price caps applied on a state by state basis.

home loan numbers since repeat buyers rely less intensively on external finance than do FHBs. Now that borrowing rates have returned to average levels, however, prices have begun to noticeably moderate. The most up to date monthly housing data (from RP Data-Rismark) show a slowing in dwelling price momentum going into midyear, with price falls registered in all price groups in June.

## Dwelling price outlook mixed

In terms of the outlook for the rest of the year, we expect the near-vacuum of FHBs, so heavily represented in the lower end of the price spectrum, to disproportionately weigh on price growth in this category. System-wide median price measures (like the ABS's quarterly series) will

be more resilient however, being only partially levered to this cohort. Put another way, the more limited representation of FHBs in the belly of the price distribution will support the official price index. A broader, and more fundamental factor underpinning our conviction that the housing finance numbers have not been flagging a correction in prices is the fact that average loan sizes have continued to grow solidly (first chart, previous page). New buyers are willing to take on similar levels of debt to those in the preceding six months, indicating fundamental demand conditions have not deteriorated significantly.<sup>1</sup>

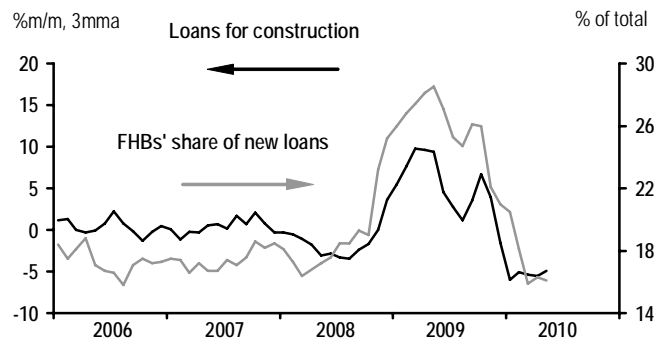
For these reasons, we do not envisage a substantial house price correction in the coming quarters. In the loans data, this means that the loan size and volume measures should converge again as the FHB cohort drag fades. The projection (first chart, previous page) shows how this reconciliation will track if housing finance approvals remain flat on a monthly basis for the remainder of the year. But the combined headwinds of rising interest rates and the withdrawal of stimulus support do mean a structurally lower level of FHBs entering the market than would otherwise be the case, which presents more persistent issues for dwelling construction. Perversely, lower supply, of course, also is supportive for the price outlook over the medium term.

### Construction must prosper without FHBs

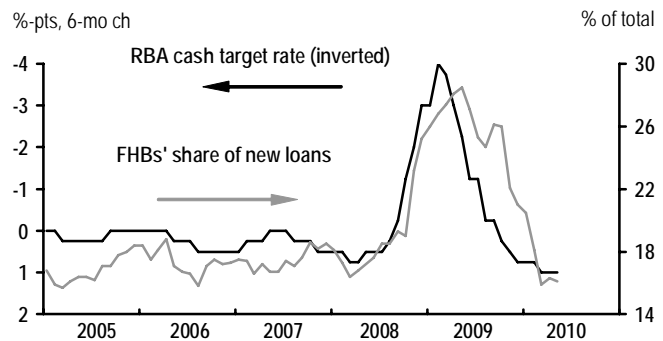
Perhaps the most concerning legacy of fewer FHBs is that this group has been hugely influential in the last two years in kicking building activity out of its multi year malaise. First home buyers typically have lower incomes, and so are more sensitive to subsidies and debt servicing costs than repeat purchasers. FHBs also have been very influential in taking loans for the construction or purchase of new dwellings (top chart). The kink in the top chart following the unexpected extension of the grant in mid-2009 makes very clear how tight this relationship has been, and suggests that without stimulus support there may be little impetus for a continued recovery in building activity.

Rising interest rates also will act to trim construction. The correlation through the FHB channel here is not quite as tight (bottom chart), and may in fact be partly spurious due to the simultaneity of the monetary policy adjustments and the grant's life cycle. But the price elasticity for FHBs is undoubtedly higher than for the market in general, and the

Australia: loans for dwelling construction and FHB representation



Australia: RBA cash rate and FHB representation



fact that the fiscal and monetary policy measures have been “in-phase” emphasizes the point that the withdrawal of stimulus will bite with particular force. Similarly, on the structural side, there are few impulses to fill the FHB gap: while Australia’s most populous state, New South Wales, is overdue for a recovery in building, and gradual removal of tax impediments is a positive, neighboring Victoria probably has exhausted its upside potential after a building boom induced by progressive land relief programs.

### Foreign buyers: the silver bullet?

In April 2010, the government tightened its grip on oversight of residential property purchases by foreign buyers. The rules, however, still allow non-residents to purchase properties off the plan. Since foreign buyers often fund purchases without recourse to the domestic banking system, greater foreign buyer representation in the housing market could simultaneously circumvent the housing finance numbers (i.e. keeping housing finance depressed), promote dwelling investment, and support prices. Media anecdotes of late citing prominent developers claim that tightening measures in Asian property markets are forcing buyers to look elsewhere, including Australia. If these anecdotes hold water, greater foreign buyer representation would help compensate for the dearth of FHB activity.

1. The fact that average loan values have led loan volumes throughout these fluctuations follows from the intuition that when willingness to pay and borrow rises, those “in the market” will borrow more, while it takes relatively longer to entice a previously uninterested borrower to take the plunge.

## Australia

- **RBA to leave cash rate unchanged this week**
- **2Q CPI printed on the downside of expectations**
- **Credit growth pulled back in June**

The delivery of soft PPI and CPI data in Australia last week prompted us to alter our near-term outlook for the RBA. Following the downside surprise both the headline and core CPI numbers, we no longer expect an RBA rate hike the cash rate today. Indeed, the impetus to deliver further policy tightening has abated.

### RBA to remain on the policy sidelines

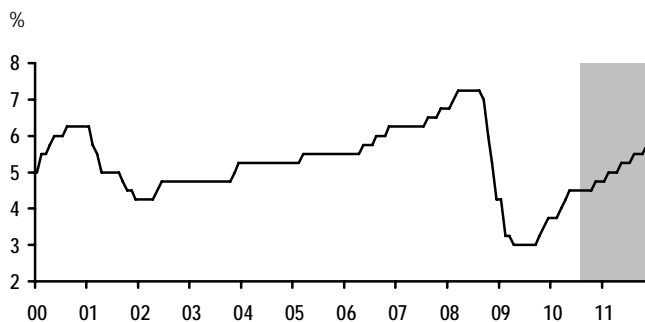
With the 2Q CPI numbers falling significantly on the downside of expectations (see details below), we no longer expect the RBA to hike the cash rate today. The Reserve Bank signaled clearly in the minutes from the last Board meeting that it was awaiting more information on domestic prices. The information, though, has bought the RBA more time to sit on the policy sidelines. The material downside surprises on both the headline and core measures of inflation, alongside a sharp moderation in the non-tradables measure, substantially reduced the likelihood of the RBA pulling the policy rate trigger this week.

That is not to say that the RBA will remain on the policy sidelines for the remainder of the year, however. The soaring terms of trade, the narrowing output gap, the tight labour market, and building wage pressure will halt the downward descent of core inflation and result in a lofty base for 2011, when capacity constraints will really start to bite. Indeed, our forecast is for headline inflation to remain above the RBA's 2%-3% target range over the forecast horizon, and for the core measure to be above target in early 2011. The RBA forecasts that annual underlying inflation will accelerate to 3% by mid-2012, a forecast based on the assumption that the cash rate will rise by 1%-pt over the next 12 months.

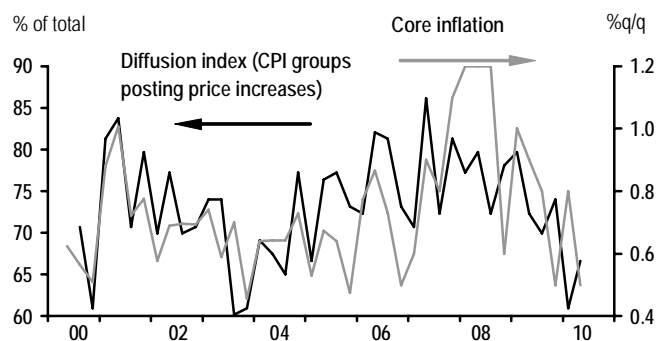
With the medium-term outlook for inflation deteriorating, we expect at least one more rate hike this year. In our view, the most likely month for the next rate move is November. Following the downside surprise on the 2Q CPI numbers last week, RBA officials will want hard evidence that inflation is on an upward trajectory. This means the RBA probably will remain on the policy sidelines until the late-October release of 3Q CPI data, which will likely show that the June quarter was the low point in the inflation cycle.

This Friday the RBA will release its quarterly Statement on

Australia: RBA cash target rate



Australia: CPI diffusion index and core inflation



Monetary Policy (SoMP). We suspect that there will be few changes to the RBA's inflation forecasts. In the last SoMP, released in May, the RBA forecast headline inflation as high as 3.25% this year. Even after the downside surprise on 2Q CPI, headline inflation still looks likely to venture to 3.25% by year-end. On the growth numbers, the RBA currently forecasts the economy to expand at a well-above-trend pace over the next two years. The recent loss of momentum in the global economy may, however, prompt downgrades to these optimistic forecasts.

### Big downside surprise on inflation

Headline inflation printed at a much lower than expected 0.6%q/q in 2Q (J.P. Morgan: 1.1%; consensus: 1.0%), or 3.1% oya; this marked the first time headline inflation has ventured beyond the top end of the RBA's target 2%-3% range since 4Q08. As expected, the most significant price rise was in prices of tobacco (+15.4%q/q) following the 25% hike in the excise tax on tobacco in April; this pushed up prices in the alcohol and tobacco component by 5.9%.

More importantly, underlying inflation printed at 0.5%q/q (J.P. Morgan: 0.7%; consensus: 0.8%) in 2Q. Annual core inflation printed at 2.7% oya, marking the first time in three

years that annual core inflation has fallen below the upper end of the RBA's target range. We expect, however, that the core measure will meander higher, breaching the top end of the RBA's target rate in 2Q11. For now, though, the lower-than-expected reading on core inflation, coupled with the significant drop in non-tradable inflation, provides the RBA with plenty of scope to sit on the policy sidelines in the near term. The nontradable component, which measures domestically generated price pressures, rose just 0.3%q/q in 2Q, having risen 1.5% in the previous quarter.

### Retail sales to creep up marginally

Retail sales values likely posted another rise in June. Our forecast calls for a 0.2% m/m print this week, the same growth rate as in May. Strong employment growth and the RBA's decision to leave the cash rate steady in May and June should have buoyed spending. That said, the drop in consumer confidence and the fall in equity prices over the month would have led consumers to tighten their purse strings to some extent.

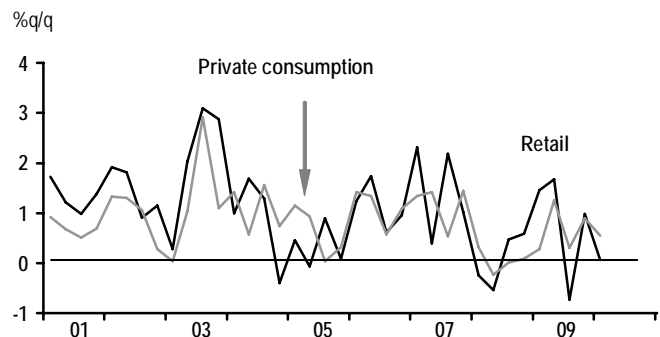
We expect that the cumulative impact of the RBA's 150bp of tightening since October last year and the waning impact of the government's fiscal stimulus will dampen retail spending in coming months. Indeed, the deterioration in confidence of late is mainly attributed to the impact of higher mortgage rates on household balance sheets. This has led consumers to adopt a more conservative approach to spending, and has forced retailers to significantly discount goods, which has weighed down retail sales values even further. Retailers now, though, probably are breathing a sigh of relief amid expectations that the RBA will sit on the policy sidelines, at least in the very near term.

Over the quarter, significant discounting would have bolstered retail sales volumes. We expect sales to have risen 0.9%q/q in volume terms, following a mere 0.1% rise in the previous quarter. This suggests that household consumption will make a solid contribution to 2Q GDP growth.

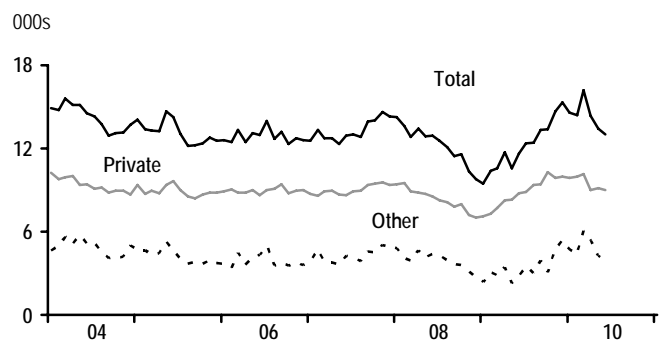
### Housing market data to have softened

The housing market has slowed markedly from the rampant pace of price appreciation witnessed in the first quarter of the year. We expect that the ABS's house price index rose 2%q/q in 2Q, a significant moderation from the near-5% pace set in 1Q, when momentum garnered from the expanded first-home buyers' (FHBs) grant had yet to fade and the cash rate had yet to breach 4%.

Australia: private consumption and retail trade volumes



Australia: building approvals



With borrowing rates near long-run averages and the withdrawal of generous subsidies, FHBs have swiftly withdrawn from the market. While investors are filling the breach in some regions, there has been a material slowing in momentum in the broader price trend. We expect this slower pace of capital appreciation to be the predominant dynamic over the rest of the year. In a thinning market, there is the risk of outright monthly price falls, though we expect this to be washed out in the quarterly price series, which should show modest positive growth in 2H10.

Residential building approvals have borne the burden of rising interest rates and withdrawn stimulus even more intensely than have dwelling prices, given the predominance of FHB representation in property development. The June numbers should play to that script, with total approvals likely down 3% m/m, with a further fall expected in the value of approvals for construction of new dwellings.

### Credit growth pulled back sharply

The RBA's credit aggregates showed that credit growth slowed markedly in June. After rising 0.5% m/m in May, the pool of credit rose just 0.2% (J.P. Morgan: 0.5%, consensus: 0.4%), with housing credit, by far the largest pool,

the main laggard. We had expected that demand for housing credit would have eased, owing to higher interest rates and the absence of the FHBs' grant, though the slowdown was more marked than we had anticipated. Having expanded at rates of 0.6%-0.8% since early 2009, the amount of housing credit outstanding grew just 0.4% m/m in June. The moderation owed to a drop in demand from owner-occupiers, reflecting the withdrawal of FHBs from the market, whereas credit to investors slowed only modestly.

The business component was flat, having increased a solid 0.4% m/m in May. We had attributed the rise in May to the fact that larger firms probably had been discouraged from accessing global capital markets in light of recent volatility, so returned to the domestic banks. This dynamic was absent in June. That said, it may also be the case that small- and medium- sized businesses are still struggling to obtain finance from banks. Personal credit declined again, falling 0.3% m/m, owing to expectations of higher interest rates.

## Data releases and forecasts

### Week of August 2 - 6

Tue Aug 3 11:30am	Building approvals Sa	Mar	Apr	May	Jun
	%m/m	16.8	-14.8	-6.6	<u>-3.0</u>
	%oya	54.4	22.6	26.6	<u>11.7</u>
Tue Aug 3 11:30am	Retail trade Sa	Mar	Apr	May	Jun
	%m/m	0.8	0.6	0.2	<u>0.2</u>
	%oya	1.6	1.9	1.2	<u>2.0</u>
	Retail trade ex inflation	3Q09	4Q09	1Q10	2Q10
	%q/q	3.2	1.0	0.1	<u>0.9</u>
	%oya	7.0	7.4	6.4	<u>5.3</u>

Tue Aug 3 11:30am	ANZ job advertisements Sa	Apr	May	Jun	Jul
	%m/m	-0.3	2.7	2.7	—

Tue Aug 3 2:30pm	RBA cash rate announcement
	No change expected. See main text.

Thu Aug 5 11:30am	Trade balance Sa	Mar	Apr	May	Jun
	Trade balance (A\$ mn)	-1769	1123	1645	<u>1400</u>

Preliminary data indicate imports were essentially flat, meaning the narrowing balance owes to slightly softer exports, particularly in the farm sector.

Thu Aug 5 11:30am	House price index: eight capital cities Weighted average	3Q09	4Q09	1Q10	2Q10
	%q/q	4.4	5.1	4.8	<u>2.0</u>
	%oya	6.6	13.5	20.0	<u>17.3</u>

## Review of past week's data

Producer price index	4Q09	1Q10	2Q10
%oya	-1.5	-0.1	<del>1.4</del> 1.0
%q/q	-0.4	1.0	<del>0.8</del> 0.3
Consumer price index	4Q09	1Q10	2Q10
Headline			
%oya	2.1	2.9	<del>3.6</del> 3.1
%q/q	0.5	0.9	<del>1.1</del> 0.6
Core (trimmed mean)			
%oya	3.2	3.0	<del>2.8</del> 2.6
%q/q	0.6	0.8	<del>0.7</del> 0.5
Private sector credit	Apr	May	Jun
%m/m,sa	0.2	0.5	<del>0.5</del> 0.2
%oya,sa	2.1	2.7	<del>3.2</del> 2.8



## New Zealand

- RBNZ signaled pace of policy tightening to slow
- Unemployment rate should push higher
- Firms' sentiment tumbled in July

In New Zealand, while the RBNZ governor hiked the cash rate 25bp, the accompanying commentary was slightly more dovish. Governor Bollard signaled that the pace of policy tightening may be more moderate than previously expected; thus, we now expect a pause in the current tightening cycle later this year.

### RBNZ hiked, but pace will slow from here

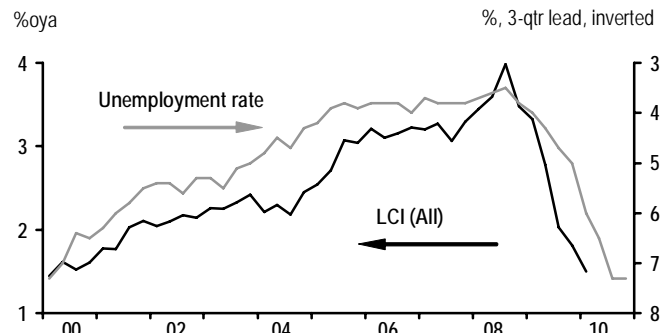
The RBNZ last week hiked the official cash rate (OCR) a further 25bp (J.P. Morgan and consensus: +25bp) as unanimously forecast by all economists surveyed by Bloomberg. The move, which took the OCR to 3%, followed the 25bp hike delivered six weeks ago, which had marked the start of the RBNZ's current tightening cycle. RBNZ Governor Alan Bollard maintained a tightening bias in the accompanying statement, although toned it down somewhat, suggesting that "the pace and extent of further OCR increases is likely to be more moderate than was projected" in June.

It is therefore, in our minds, less likely that the RBNZ will hike the cash rate at each of the remaining three OCR announcements this year. While every meeting will be "live," we now expect a further 50bp of tightening this year, rather than the 75bp we had forecast previously. The tightening cycle will, however, extend well into 2011, given the "extraordinary level of support" still in place.

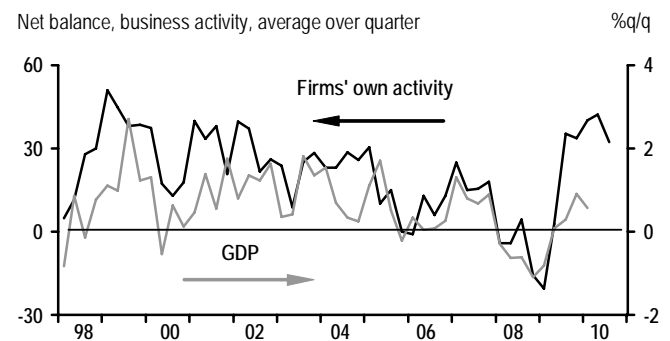
The pace of tightening will ultimately depend on three key factors: the outlook for trading partner growth, the rate at which households consolidate their balance sheets, and, importantly, the behaviour of inflation expectations. The RBNZ has acknowledged that one-off policy changes, including the GST hike in October, will temporarily push headline inflation above the top end of the RBNZ's 1%-3% target range. The key challenge for the RBNZ will be to prevent elevated inflation spilling over to changes in price- and wage-setting behaviour. The Bank said that it will monitor the "price- and wage-setting behaviour of firms and households" for evidence of an increase in inflation expectations. Indeed, a rise in already-elevated inflation expectations has the potential to have a lasting impact on reported inflation.

On the domestic front, the Governor highlighted the recent

New Zealand: LCI and unemployment



New Zealand: RBNZ business outlook survey and GDP growth



weakness in the domestic data. Households have adopted a cautious approach to spending, but retail sales likely will suffer further owing to the slowing in net immigration. Indeed, the recent string of weaker data adds to the case for a pause later this year. Dr. Bollard also appeared more cautious on the outlook for the global economy, describing it as "fragile." Growth in New Zealand's major trading partners in Asia had, however, surprised on the upside.

### Payback expected in unemployment

New Zealand's unemployment rate posted a remarkable fall in 1Q, and we expect some payback in 2Q. The key rate dropped to just 6.0% from 7.1% in 4Q, marking the largest drop since 1986 and the first fall in unemployment in the Kiwi economy in more than two years. We expect, though, that the unemployment rate will creep back up to 6.4% in the June quarter, given hiring intentions remain relatively weak and actual hirings below long-run averages.

The wages data released this morning showed a slight acceleration in private sector wage growth in 2Q. The private sector labour cost index (LCI), excluding overtime, rose 0.4%q/q (J.P. Morgan and consensus: 0.4%), compared to

0.3% in the March quarter. This translated to annual growth of 1.4% oya. The good news is that demand for labour has started to pick up. The Quarterly Employment Survey (QES) showed that the number of filled jobs increased 1.4% q/q in 2Q, after an extended period of decline, total paid hours rose 1.2%, and average total hourly earnings increased 0.6%.

The RBNZ probably will be comfortable knowing that wage inflation probably won't march significantly higher until late-2010 or early-2011. Indeed, soft labour market conditions and excess capacity in the labour market will keep wage inflation under control.

### Kiwi firms' sentiment took a big hit in July

The headline reading on the NBNZ business confidence index slid significantly lower in July. A net 27.9% of respondents now expect that business conditions in New Zealand will improve over the next 12 months, down from 40.2% in June and 48.2% in May. Optimists had previously held a decisive majority within the survey group, but the headline index now is testing the long-run average of 25. The firms' own activity outlook index also posted a marked decline, falling to 32.4 from 38.5, suggesting economic growth will moderate in the latter half of the year.

### Data releases and forecasts

#### Week of August 2 - 6

Thu Aug 5 10:45am	Labour force survey Sa	3Q09	4Q09	1Q10	2Q10
	Unemployment rate (%)	6.5	7.1	6.0	<u>6.4</u>
	Employment (000, q/q)	-15	1	22	<u>4.4</u>
	Participation rate (%)	68.0	68.1	68.1	<u>68.1</u>

### Review of past week's data

#### NBNZ business confidence

	May	Jun	Jul
% balance of respondents	48.2	40.2	— 27.9

#### RBNZ cash rate announcement

A 25bp hike delivered. See main text.

#### Trade balance

	Apr	May	Jun
Trade balance (NZ\$ mn,nsa)	<del>665</del> 652	<del>814</del> 768	<del>650</del> 276

#### Building consents

	Apr	May	Jun
%m/m,sa	<del>8.3</del> 8.6	-9.5	<del>1.1</del> 3.5
%oya,sa	<del>32.0</del> 32.2	<del>11.7</del> 11.2	<del>24.0</del> 27.7

## Global Essay

- **Through crosscurrents and moderation, above-trend global growth likely to be sustained**
- **US revisions show sluggish consumers and strong business spending**
- **Extra easy EM monetary policy serves as a global insurance policy**
- **Euro area indicators continue to deliver upside surprises**

### A summer reading list

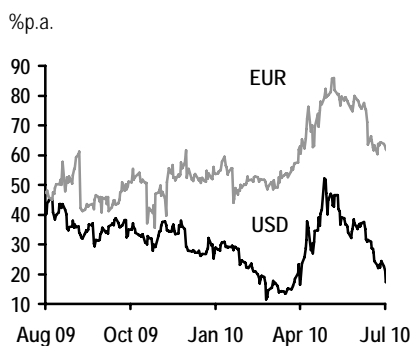
Although temperatures are hitting record highs and the beach beckons, this is not the time for serious data watchers to take a vacation. The flow of recent releases displays numerous crosscurrents, which raise important questions about where we are headed. If we are right, these crosscurrents will persist for some time amid a moderation in 2H10 global growth. However, the data in the coming months are likely to confirm that the expansion's underpinnings remain intact and that it is likely to move forward into next year. In this regard, we provide three recommendations for summer data reading lists:

- **Slouching Towards Bethlehem (the manufacturing downshift).** Following a year of 11% growth, a deceleration in global factory output should be expected as levels of activity align with final demand (see our Special report, "Gravity bites: the global manufacturing downshift has begun," July 29). However, the slide in our June global PMI survey and the outright decline in production in US and Asia last month raise concerns that a more pronounced adjustment may be taking hold. This week's US employment report is expected to be consistent with our forecast that manufacturing activity is likely to continue

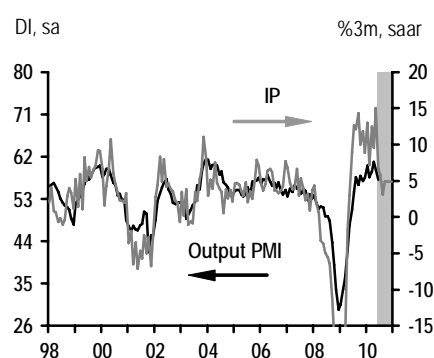
to expand at a still solid 3%-6% pace during 2H10.

- **Sentimental Education (the shock to confidence).** Last quarter saw the positive feedback loop between growth and financial conditions short-circuit in an environment of rising concerns about Europe and the direction of global fiscal and regulatory policies. Our downward forecast revisions to 2H10 global growth assumed a dip in consumer sentiment and a material tightening in European credit availability during the summer months. Thus far, the news on this front has been comforting. Sentiment readings in Europe and Asia have held up well, and funding pressures on sovereigns and banks in the Euro area have eased. In addition, the latest Euro area bank lending survey points to only modest tightening in standards as the crisis raged. This global message needs to be tempered by a larger-than-expected slide in US consumer confidence. Our view that US households continue on a cautious expansion path will therefore be tested in the coming months—with this week's July auto sales report (11.7 million saar) expected to send a positive signal.
- **The Little Engine That Could (the corporate lift).** The lift to growth as firms shift away from paring inventories is now largely spent. But cash-rich firms should continue to provide the major fuel for global growth in the coming quarters. In emerging market and commodity producing nations, high utilization rates and strong domestic consumer fundamentals support expansion. In the G-3, growth is supported by a shift away from a defensive posture in which capital spending and employment remain at depressed levels. The first half of the year has seen recoveries in global labour markets and capital spending take hold. This week's US employment report (private payrolls 120,000) leads off a round of July releases on this issue.

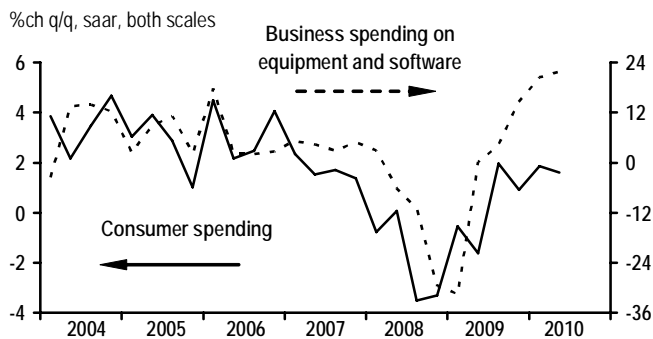
Swap rates, 2-year



Global manufacturing output PMI and IP



### US: real consumer spending and real spending on business equipment



### A year of unbalanced 3.2% US growth

Last week's US 2Q10 GDP report—which includes revisions back to 2007—did not materially alter the economy's progression from recession into recovery. A deep downturn now looks somewhat deeper (-4.1% peak-to-trough), and the first year of expansion produced a 3.2% rise in activity. However, the report altered the composition of growth, pointing to a greater imbalance between business and household demand in the early stages of the expansion. The report showed stronger-than-expected increases in capital spending and inventory accumulation on the part of business in 1H10. But revised figures show a more muted revival in consumer spending despite upward revisions to income. This development has pushed the measured saving rate to 6.2%. This divergence in demand is also reflected sectorally where gains in GDP services over the past year were revised away, indicating that growth was highly concentrated in goods-producing industries.

### EM central banks provide insurance

With economic activity decelerating at midyear, the debate over policy stimulus has intensified. Attention has understandably centered on the major developed economies, where the recovery has been modest relative to the depth of the downturn. Unfortunately, options for policy support are limited. Faced with record deficits and rising debt, fiscal policy is tightening broadly. Meanwhile, monetary policy has effectively reached the lower bound on interest rates, and central banks are understandably hesitant to use unconventional measures preemptively.

A different story is unfolding in the emerging markets where monetary authorities appear willing and able to provide insurance. Although rate normalization has begun across a number of countries, the magnitude of these moves

has been limited and will continue to be gradual in light of uncertainties surrounding the global recovery. Combined with stable-to-rising rates of underlying inflation, real policy rates at the end of the last quarter remain considerably below their pre-crisis levels despite the region's marked cyclical improvement over the past year. Moreover, although economic conditions are projected to continue improving, real policy rates are expected to edge down by the middle of next year.

Notwithstanding the impact of tightening resource utilization domestically, continued levels of strong accommodation in the EM may be the right insurance policy from a global perspective. As argued in these pages in recent months, there are important questions about the effectiveness of monetary transmission in developed markets where credit channels are impaired. What's more, unconventional actions remain untested in dealing with deflationary psychology or faltering growth. With monetary transmission arguably getting much better traction in EM, easy money and stronger EM demand offer the much needed "Plan B" to support global growth and inflation expectations that is not easily available in the developed world.

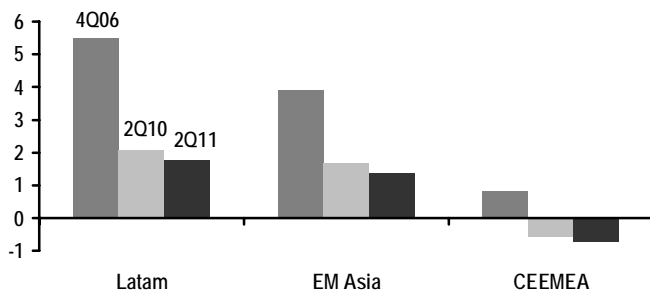
### Early movers, early pausers

A number of central banks that have embarked on a path toward policy normalization are now set to slow or pause. This includes Brazil, where a dovish set of minutes from the surprising 50bp hike two weeks ago (rather than the expected 75bp) suggests the COPOM's monetary tightening is close to an end. We now expect a 25bp rate hike in September before a pause. An additional 150bp is still expected next year, in response to extremely robust fundamentals for domestic demand. On the heels of the RBA's 150bp of hikes since October of last year, a soft 2Q Australian CPI report significantly diminished the likelihood of a rate hike this week. Its pause is likely to be brief, however, as a narrowing of the output gap and building wage pressure will lead to a less benign 3Q inflation report—pushing the RBA to hike 25bp in November. In New Zealand, the RBNZ followed up its inaugural June hike with another 25bp hike last week. However, the statement was decidedly dovish, and we now forecast a further 50bp of tightening before year-end, rather than the 75bp we expected previously.

By contrast, the Reserve Bank of India hiked 25bp last week and is expected to continue tightening for some time to come. With resource utilization tight along with inflation

### Real policy rate, emerging markets

%p.a.; nominal rate less core inflation (oya), 2Q11 J.P. Morgan forecast



surging and only expected to moderate some in the coming months, the RBI's 100bp of tightening this year is arguably well behind the curve, and the case for more aggressive action is strong despite the fact that overnight rates have moved up 250bp thus far.

### EMU: from crisis, to recovery, to resilience

Two significant forces are expected to weigh on Euro area growth over the coming months: the inevitable moderation in manufacturing activity and banking stress surrounding the sovereign credit crisis. Thus far, the news on both of these has been better than we were expecting, raising upside risks around our forecast that growth will slow to 1% later this year.

The recent good news is concentrated in Germany, where the industrial sector boom has spilled over into other sectors. In July, business confidence in the service and retail sectors was higher than at any time in the last business cycle, and consumer confidence, while still below the previous cyclical peak, was well above the long-run average. Moreover, the German labour market has remained remarkably resilient despite a fading of the short-time working scheme. The unemployment rate at midyear has returned to its pre-recession trough—the lowest level since the early 1990s.

Economic activity on the periphery is also holding up better than expected. Business sentiment is moving down in Spain and Portugal, but not by much. Consumer confidence has been relatively resilient in Spain, although it has fallen noticeably in Portugal. While the ECB's bank lending survey points to a sharp tightening in standards in Portugal,

there was no tightening in Ireland. For the region as a whole, the tightening has been modest (Spain and Greece have not released national data). This could change in the coming months, but the positive shift in financial market sentiment toward peripheral sovereigns and banks raises the possibility that funding pressures will ease.

### Lowering our sights on Japan

The data flow last week out of Japan was mixed but largely warranted the downward revision to second-half growth we signaled in last week's *GDW*. We now see GDP expanding at a 1.7% annualized pace in 2H10 rather than 2.5%. Industrial production has already begun decelerating from the boomy 20% pace in the year through May, as reflected in Friday's report that output fell 1.5% last month and a roughly 1pt step down in the manufacturing PMI. At the same time, consumer spending appears to be holding up well at midyear, as highlighted by Friday's solid household spending report. Last week's BoJ trade report, which showed real imports continuing to rise in June even as real exports declined for the first time since February 2009. That the Shoko Chukin small business survey rose in July was an encouraging sign that the deceleration in activity is not pointing to a more fundamental break in the recovery.

### CEE getting help where it's wanted

Parts of Central and Eastern Europe were quick to draw upon IMF help during the downturn. However, some are now charting their own course. Both Turkey and Hungary have governments with strong majorities that could push through measures required for IMF support, yet neither country is willing to embark on another IMF program. While Hungary could well be faced with ratings downgrades for its determination to implement its own policy priorities, Turkey, on the other hand, appears to have long outgrown the need for an IMF umbrella. By contrast, the Ukrainian government has agreed to reduce its budget deficit, raise natural gas prices, and implement long-delayed reforms in exchange for IMF support. Last week, the IMF's Executive Board approved a 29-month US\$15.5 billion (+11% of GDP) Stand-By Arrangement. This endorsement led S&P to raise the Ukraine's long-term foreign currency rating to B+ from B, four steps below investment grade.

## JPMorgan View - Global Markets

### Near-term uncertainties fading—add risk via carry

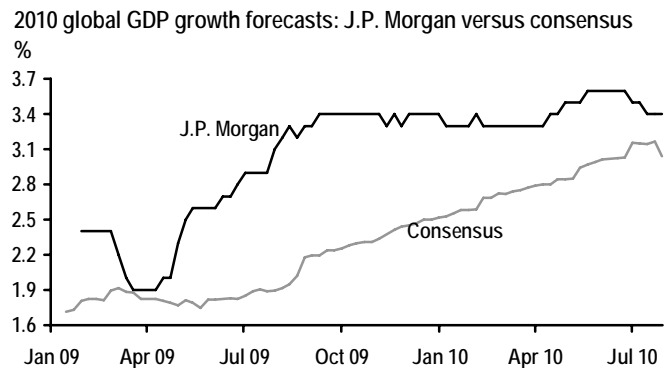
- **Economics:** Japan 2H growth forecast cut to 1.7% from 2.5%. Downshift in global industry not a precursor to a double dip.
- **Asset allocation:** We move from flat to net long on risky assets by adding in credit through HY and non-core EMU.
- **Fixed income:** Mildly long duration in Europe and EM. Hold carry positions, adding EMU non-core bonds. Hold swap spread wideners in USD and EUR.
- **Equities:** Overweight EM, underweight small caps, underweight manufacturing sensitive sectors, overweight banks.
- **Credit:** With industrial HG bond yields at a record low, we favour higher yielding credits such as high yield and subordinated bonds.
- **FX:** Dollar to weaken further against EUR and JPY.
- **Commodities:** Stay overweight agriculture on increased risks to supply.

Equities were flat on the week, as weaker US economic data prevented a break out from the three-month trading range. Our preferred riskier asset classes—credit and EM—edged up, joined by periphery European bonds. Government bonds rallied further, with yields falling to new record lows.

We have been overall flat versus risky assets, while overweighting corporate credit and EM, given their better balance sheets and flow support. High risk premia relative to record low yields on cash and bonds should favour riskier assets, but the recent reversal in global growth forecasts has counterbalanced this bullish value force in recent months.

We would like to make a case to again **add exposure to risky assets on the basis of two arguments:** The recent slipping in growth forecasts is part of the natural ebb and flow in industrial growth and should not put us on the slippery slope towards a double dip. In addition, near-term uncertainty around the three event risks that have been vexing investors—regulatory overkill on banks, China, and Europe's sovereign funding problems—has faded dramatically, making high premia on risk assets attractive again to investors.

We and the consensus have trimmed our 2011 global GDP



growth forecasts over the past two months (chart), in response to weaker activity data. Given the trending behaviour of past forecast revisions, this creates a risk bias towards further forecast reductions. We see a decent probability, though, that this will not be the case. Much of the recent weakness is driven by an **earlier and deeper downshift in manufacturing**. A special report, *Gravity bites: the global manufacturing downshift has begun* (Kasman, Hensley, and Lupton, July 29) argues this slowing is a natural pattern after the record 11% growth pace of the past 12 months, and by itself does not create a decisive downside risk bias to our forecasts.

Probably more importantly, the **value driver** for risky markets is gaining strength, not because they have cheapened a lot, but because of fading near-term uncertainties, for which risk premia are a compensation. The proposed Basel III rules—following on Dodd-Frank in the US and Europe's bank stress tests—are softer and start much later than had been expected, probably as governments recognize that today is not the time to entice further bank delevering. China is slowing but domestic investors reckon this means an end to policy tightening. And EMU's sovereign and bank funding problems are fading for the moment. Non-core EMU banks rolled over 100% of their maturing bonds this month, and their government's bond auctions went well (see *Flows & Liquidity*, Panigirtzoglou et al.). European bond managers are covering their periphery underweights, if not going outright overweight (see today's *Global Fixed Income Markets*, Wadhwa and Bassi).

The longer-term uncertainties about the current business cycle remain in place and will not go away soon. How long will the cycle last and will it end in deflation or inflation? But falling near-term uncertainties should make investors interested again in better paying assets. Our best guess is that it is **safer to add risk in credit and EM than in equities**, given deflationary pressures and the low growth outlook. This week, we also add long exposures to EMU's

non-core government bonds to our long-carry position.

The biggest surprise this past quarter has been **stronger economic activity data in Europe versus weaker data in the US**. As a result, Europe's currencies, credit, and equities gained versus the US and its core government bonds underperformed. This move probably has a little further to go, but is unlikely to last more than 1-2 months. We have joined the long euro move vs. USD, cover our underweight in European banks, and add EMU risk exposures through its non-core bonds.

## Fixed income

Bonds are continuing to grind up, with YTD returns approaching 5% on our GBI, dollar-hedged. Local EM bonds are already over 6% YTD. We hold a **mildly bullish position**—on momentum and rising deflation fears—in EM and Europe, while retaining a value-based short in 2-year USTs where the yield has hit a new record low. Do help us in gauging deflation versus inflation fears by participating in our **Inflation Expectations Survey**, which runs through August 3.

**Low yields, the lack of any inflation, and central banks-on-hold are very supportive to positive carry positions.**

See *US and Global Fixed Income Markets* for a wide choice of trades. This week, in response to further fading of Euro sovereign funding problems, we add longs in **Greece, Portugal, and Italy** to our set of carry trades. We also stay in swap spread wideners (short swaps vs. govies) in euros (10s) and dollars (2s and 5s).

## Equities

Mixed US economic data are preventing equities from breaking out of their two-month range despite improvements in European funding markets, softer than expected Basel III regulatory proposals, a better than expected 2Q reporting season, and greater confidence on Chinese growth.

We look for **range trading near term** until uncertainty regarding US economic data is resolved, likely early autumn. We maintain our bullish year-end equity targets, looking for 15-20% upside from current levels. The 2Q reporting season has made the value argument even more compelling for equities. Our US equity strategist Tom Lee is raising our full year EPS forecast for the S&P500 to \$84 from \$81, implying a PE ratio of 12.8, well below the historical average of around 15.

Our trading themes remain unchanged: we **overweight EM, underweight small caps, underweight manufacturing sensitive sectors, and overweight banks**.

Industrial and commodity sectors are the most sensitive to the global manufacturing downshift, which should last at least six months. Asia is the most levered to the global manufacturing cycle, especially Japan and EM Asia ex. China and India.

Our overweight on **banks** worked well over the past month. Our motivation for the bank overweight globally was the rather softened version of the US financial reform bill, coupled with speculation that global regulators were likely to soften or postpone onerous capital and liquidity requirements under Basel III. We got a confirmation of this early last week with an announcement of a revision to the Basel III framework. The biggest positive surprise was in liquidity requirements, which are not only relaxed but their implementation was also pushed back to 2018.

## Credit

Credit markets continued to rally last week despite unchanged equity markets. The rally is particularly strong in European banks as investors cover their short positions.

Recent positive news flow has induced investors to **short cover**, in spite of the fact that the news itself is unlikely to change the **poor medium term outlook for European banks**. The European stress tests did improve the transparency of the banking sector, especially for Spanish saving banks. The term funding market for peripheral banks is reopening with Spanish banks first issuing a sizable covered bond last week followed by €2.75bn of unsecured senior bank debt issuance. The latest version of Basel III is also supportive of European banks as it gives more time for banks to comply with the new liquidity and capital requirements.

Despite these improvements, we continue to maintain the medium term view that the **heavy pipeline of European senior bank debt supply** and a **reduced investor base** will keep pressure on European bank spreads. The spread outlook for senior unsecured European bank debt remains poor, but with powerful short covering underway, we turn neutral.

The spread of taxable municipal bonds—Build America

Bonds—has widened significantly since May. It remains elevated despite the recent rally in credit markets and light supply. The spread difference between BABs and similar US HG bonds remains too wide, in our opinion. Hence, we recommend investors to **overweight long maturity A and AA-rated taxable munis versus both US Treasury and similar US corporates**.

In a higher volatility and lower growth environment, investors are likely to allocate more capital to credit instead of equity, as credit is less dependent on high growth. With industrial bond yields at their lowest since 1973, the total return valuation is not very attractive. Thus, we focus our overweights in **higher yielding credit** such as HY and subordinated bonds.

## Foreign Exchange

**As earnings seasons go, 2Q was one of the worst for the dollar in a decade.** The cross-market pattern—higher equities, lower dollar, higher commodity prices, and lower vol—has been textbook. It's the magnitude of these moves which was extreme. Compared to average market moves during earnings season when corporate profits surprise to the upside, recent moves have been much larger: 4% - 6% USD declines versus many currencies and 2-3pt declines in implied volatility. The typical pattern entailed 1% declines in the dollar and half point declines in vol, which makes this earnings season one of the most damaging to the dollar and option prices in a decade, and more aggressive than we flagged three weeks ago.

**August should unfold differently.** The global slowdown is dollar-positive versus the commodity currencies and the high-yielders, and technical indicators are showing some exhaustion in the dollar's downtrend. The wrinkle in this otherwise familiar story is the euro: strong European data and chatter around further QE can keep EUR/USD above 1.30 and extend its gains on the crosses this month. Expect a narrower dollar decline this month centered on JPY and EUR. Other currencies should slip within their recent ranges.

The flat yield environment which accompanies this Fed discussion is obviously yen-positive. As we have argued all year, Japan's debt dynamics are irrelevant for the currency while Japan remains in deflation and continues to post an external surplus. And that surplus would strengthen the yen until US-Japan rate spreads widen sufficiently to offset trade flows. Last week's US GDP report heightens the odds of low US yields for a very long time, and thus a further a de-

## Ten-year Government bond yields

	Current	Sep 10	Dec 10	Mar 11	Jun 11
United States	2.91	3.45	3.85	4.15	4.50
Euro area	2.67	2.90	3.15	3.25	3.35
United Kingdom	3.33	3.30	3.50	3.85	4.20
Japan	1.06	1.30	1.40	1.50	1.55
GBI-EM	6.62			7.90	

## Credit markets

	Current	YTD Return
US high grade (bp over UST)	163	7.3%
Euro high grade (bp over Euro gov)	175	3.4%
USD high yield (bp vs. UST)	675	8.2%
Euro high yield (bp over Euro gov)	671	7.4%
EMBIG (bp vs. UST)	305	9.6%
EM Corporates (bp vs. UST)	349	8.9%

## Foreign exchange

	Current	Sep 10	Dec 10	Mar 11	Jun 11
EUR/USD	1.31	1.25	1.25	1.25	1.25
USD/JPY	86.4	90	93	93	93
GBP/USD	1.57	1.47	1.44	1.42	1.42

## Commodities - quarterly average

	Current	10Q3	10Q4	11Q1	11Q2
WTI (\$/bbl)	78	77	75	75	77
Gold (\$/oz)	1180	1250	1275	1250	1250
Copper(\$/m ton)	7208	6500	6750	6750	7000
Corn (\$/Bu)	4.03	3.90	3.80	4.00	4.20

Source: J.P. Morgan, Bloomberg, Datastream

cline in **USD/JPY. Expect a move below 85 this summer.**

Our recommendations this month have centered on two themes: earnings strength (long CAD and INR) and a short squeeze on the euro (long EUR/USD). August is a month to position defensively. Sell NZD/JPY and buy EUR/NZD in anticipation of a downturn in risky markets; add short USD/CHF to long EUR/USD for a short-term continuation of decent European data; and resell EUR/CHF following this month's substantial position liquidation.

## Commodities

**Commodities were flat last week** with oil and gold falling 1.5% while industrial metals and agriculture rallied over 5%. Industrial metals have risen 12% over the past two weeks as supply was threatened by production problems at a number of key copper mines around the world while inventories on the LME continued to fall. We believe these supply issues will be resolved shortly and production will return to more normal levels. **Stay underweight industrial metals** on the slowdown in global demand and economic growth.



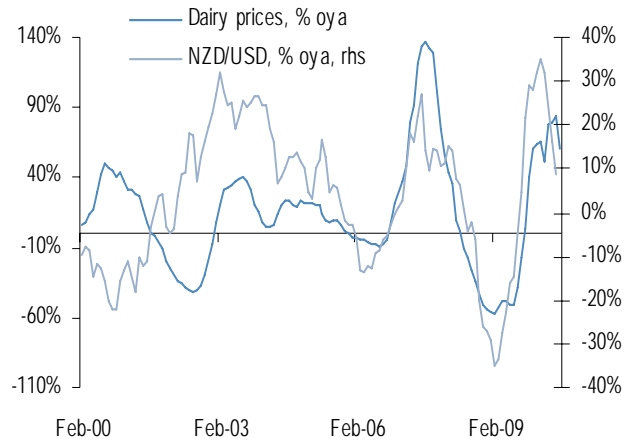
## AUD and NZD Commentary

- **We sell NZD vs JPY and EUR as a defensive play to benefit from a global manufacturing downshift in 2H10 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 G-10 commodity currencies were the stand-out beneficiaries from the bullish US earnings season, with AUD and NZD rallying by 7.7% and 6.1%, respectively, against the USD since the end of June. Now, their outperformance leaves them vulnerable in the earnings season's fading afterglow, as markets refocus on the macroeconomic drag from the global manufacturing sector's bump in the second half.
- The domestic interest rate support for the AUD, CAD and NZD also is waning. In Australia's case lower than expected inflation is the main driver of this trend. In Canada it is a rapid deceleration of activity reflecting the close integration of Canadian and US industry. In New Zealand domestic interest-rate support for the currency also has dropped, with a surprisingly sharp dovish turn by the RBNZ the key driver. The RBNZ's rhetorical shift pushed 2Y rate expectations down by 25bp last week despite a 25bp hike in the official cash rate.
- In addition, the global growth slowdown has hit New Zealand's terms of trade faster and harder than we might have anticipated. From this perspective, Fonterra's next monthly dairy auction on Tuesday is a significant event risk. At the previous auction in early July the average auction price fell 13%, the second consecutive monthly decline. As Chart 1 highlights, the near doubling in dairy prices from the recession's low boosted NZD. But it appears that dairy prices may be a drag on Kiwi near term, rather than a source of lift. Buy EUR/NZD at 1.8020 with a stop at 1.7119, sell NZD/JPY at 62.40 with a stop at 65.52.

### Technical analysis

- The short term setup suggests an important test for both AUD/USD and NZD/USD following the rallies from the June/July lows. As both pairs are testing the next line of important resistance levels, the risks suggest a consolidation phase is due. Importantly, this is in line with the short term overbought and diverging momentum setup.
- For AUD/USD, the rally has extended into the key .9075/.9110 resistance zone which includes the 76.4%

Chart 1: Commodity price support for NZD is declining



Source: Fonterra; J.P. Morgan

AUD/USD - Daily chart



retracement from the April high as well as the equal swing target from the May low and should be where prices struggle. Note that near term dips should find support at the .8940/00 area which includes the July uptrendline and last week's low. Still, the .8870/60 zone should continue to hold to argue for additional upside and a sustained break of the .9110 area.

- Last week's bearish reversal in NZD/USD is in line with a short term corrective phase as well. This follows the failure to sustain above the key .7300/.7330 resistance zone and April highs, while failing against the key .7380/.7445 zone (76.4% retrace and January high). In turn, support at .7200 and then the .7105/.7050 area should hold to maintain the short term upside bias. For the crosses, note that the short term base breakout in AUD/NZD and impulsive rally in EUR/NZD over the past few days hints at additional NZD underperformance.

## Global Economic Outlook Summary

	Real GDP			Real GDP							Consumer prices			
	% over a year ago			% over previous period, saar							% over a year ago			
	2009	2010	2011	1Q10	2Q10	3Q10	4Q10	1Q11	2Q11	3Q11	1Q10	2Q10	4Q10	2Q11
<b>The Americas</b>														
United States	-2.6 ↓	3.0 ↑	2.7 ↓	3.7 ↑	2.4 ↓	2.5	3.0	2.5	2.5	3.0	2.4	1.8	0.9	1.2
Canada	-2.5	3.4 ↓	2.7	6.1	2.6 ↓	3.2 ↓	3.2	2.7	2.0	2.4	1.6	1.4 ↓	1.7 ↓	1.9
Latin America	-2.9	5.4	3.8	4.2	4.0	3.3	4.0	4.2	5.2	2.0	6.0	6.5	7.0	6.9
Argentina	-2.0	8.5	4.5	12.5	13.0	4.0	4.0	2.0	4.0	8.0	9.0	9.0	10.0	11.0
Brazil	-0.2	7.5	4.0	11.4	2.6	6.2	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
<b>Asia/Pacific</b>														
Japan	-5.3	3.4 ↓	1.8 ↓	5.0	2.8	1.8 ↓	1.6 ↓	1.5 ↓	2.2 ↑	1.8 ↑	-1.2	-0.9 ↑	-0.7	0.1
Australia	1.3	2.7	3.2	2.0	1.9	3.3	3.8	2.7	3.2	4.0	2.9	3.5	3.8	4.1
New Zealand	-1.7	2.5	2.7	2.3	3.5	2.3	1.9	2.7	3.4	3.2	2.0	1.8	4.9	5.6
Asia ex Japan	4.8	8.6	6.9	10.8	6.6 ↑	5.6 ↓	6.5	7.3	7.1	7.1	4.3	4.5 ↓	4.4 ↓	4.1 ↑
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	6.0 ↓	5.4 ↓	5.4	7.0	4.5 ↓	5.0 ↓	5.3 ↓	5.2 ↓	5.0	3.7	4.4 ↓	5.8 ↓	5.5 ↑
Korea	0.2	6.1 ↑	4.0	8.8	6.0 ↑	2.5 ↓	3.8	4.0	4.0	4.5	2.7	2.6	3.2	3.5
Malaysia	-1.7	7.2 ↓	4.6 ↓	5.0	5.0 ↑	4.0 ↓	4.0 ↓	4.9	4.9	4.5	1.3	1.6 ↓	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	4.2 ↓	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	8.8	4.2	11.3	2.0	3.0	3.5	4.2	4.6	5.5	1.3	1.1	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
<b>Africa/Middle East</b>														
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	4.5 ↓	4.7 ↓	4.9 ↓
<b>Europe</b>														
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	3.8 ↑	2.7 ↓	6.2 ↑	4.7 ↓	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	1.6	2.6	1.3	4.5	2.5	2.5	2.0	2.5	3.0	3.3	3.5	2.5	1.7
Emerging Europe	-4.9	3.9	4.3	2.1	7.1 ↑	3.1 ↑	3.3 ↑	3.6 ↓	4.0	4.1	6.1	5.5 ↑	5.7 ↑	5.6 ↑
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	1.0 ↑	3.0	3.6	3.0 ↑	2.0	2.0 ↑	2.0 ↓	3.0 ↑	3.5 ↑	6.0	5.4 ↑	4.6 ↑	3.7 ↑
Poland	1.8	3.5 ↑	3.8 ↑	2.0	4.0 ↑	3.5 ↑	3.5 ↑	3.0	3.5 ↓	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	5.0	5.0	2.2	11.5	4.0	4.5	5.0	5.0	4.5	7.2	5.9	6.6	7.0
Turkey	-4.7	5.9	5.0	...	...	...	...	...	...	...	9.3	9.3	7.5	6.7
<b>Global</b>	-2.6 ↓	3.4	2.9 ↓	3.9 ↑	3.5	2.8 ↓	2.8 ↓	2.7 ↓	2.8	3.0	2.2	2.2 ↑	1.9	1.9
Developed markets	-3.5	2.5	2.2 ↓	2.9 ↑	2.8 ↓	2.3 ↓	2.2 ↓	1.9 ↓	2.0	2.5 ↑	1.5	1.4 ↑	1.0 ↓	1.0 ↓
Emerging markets	1.1	6.9 ↑	5.6	7.5	6.0 ↑	4.5 ↓	5.2	5.8	6.0	5.3 ↑	5.1	5.1	5.2	4.9
<b>Memo:</b>														
Global — PPP weighted	-0.8 ↓	4.6	4.0	5.2 ↑	4.4	3.7 ↓	3.9	3.9 ↓	4.0	4.1 ↑	3.3	3.3	3.1	2.9

## Global Central Bank Watch

	Official interest rate	Current	Change from		Next meeting	Forecast next change	Forecast				
			Aug '07 (bp)	Last change			Sep 10	Dec 10	Mar 11	Jun 11	Sep 11
Global	GDP-weighted average	1.37	-329				1.39	1.44	1.49	1.58	1.63
excluding US	GDP-weighted average	1.95	-240				1.99	2.06	2.13	2.26	2.34
Developed	GDP-weighted average	0.54	-357				0.55	0.57	0.60	0.64	0.67
Emerging	GDP-weighted average	4.68	-218				4.77	4.91	5.04	5.31	5.45
Latin America	GDP-weighted average	6.55	-238				6.72	6.79	7.12	7.64	7.71
CEEMEA	GDP-weighted average	4.07	-279				4.09	4.11	4.13	4.37	4.86
EM Asia	GDP-weighted average	4.22	-188				4.30	4.51	4.61	4.79	4.83
The Americas	GDP-weighted average	0.87	-472				0.91	0.95	1.02	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	0.75	-350	20 Jul 10 (+25bp)	8 Sep 10	8 Sep 10 (+25bp)	1.00	1.50	2.00	2.50	2.50
Brazil	SELIC overnight rate	10.75	-125	21 Jul 10 (+50bp)	1 Sep 10	<b>1 Sep 10 (+25bp)</b>	<b>11.00</b>	<b>11.00</b>	<b>11.50</b>	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)	20 Aug 10	1Q 11 (+50bp)	3.00	3.00	4.00	5.00	5.50
Peru	Reference rate	2.00	-250	8 Jul 10 (+25bp)	<u>5 Aug 10</u>	<b>5 Aug 10 (+25bp)</b>	<b>2.50</b>	3.00	3.75	4.50	4.50
Europe/Africa	GDP-weighted average	1.28	-324				1.29	1.30	1.31	1.39	1.51
Euro area	Refi rate	1.00	-300	7 May 09 (-25bp)	<u>5 Aug 10</u>	On hold	1.00	1.00	1.00	1.00	1.00
United Kingdom	Repo rate	0.50	-500	5 Mar 09 (-50bp)	<u>5 Aug 10</u>	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)	<u>5 Aug 10</u>	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)	23 Aug 10	3Q 11 (+25bp)	5.25	5.25	5.25	5.25	5.50
Israel	Base rate	<b>1.75</b>	-225	<b>26 Jul 10 (+25bp)</b>	23 Aug 10	27 Sep 10 (+25bp)	<b>2.00</b>	<b>2.25</b>	<b>2.50</b>	<b>2.75</b>	<b>3.25</b>
Poland	7-day intervention rate	3.50	-100	24 Jun 09 (-25bp)	24 Aug 10	2Q 11 (+25bp)	3.50	3.50	3.50	3.75	4.00
Romania	Base rate	6.25	-75	4 May 10 (-25bp)	<u>4 Aug 10</u>	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)	Aug 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)	9 Sep 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	2.24	-120				2.28	2.39	2.45	2.55	2.59
Australia	Cash rate	4.50	-175	4 May 10 (+25bp)	<u>3 Aug 10</u>	Nov 10 (+25bp)	<b>4.50</b>	<b>4.75</b>	<b>5.00</b>	<b>5.25</b>	<b>5.50</b>
New Zealand	Cash rate	<b>3.00</b>	-500	<b>29 Jul 10 (+25bp)</b>	29 Jul 10	Sep 10 (+25bp)	3.25	<b>3.50</b>	<b>4.00</b>	<b>4.25</b>	<b>4.50</b>
Japan	Overnight call rate	0.10	-43	19 Dec 08 (-20bp)	10 Aug 10	On hold	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)	12 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)	<u>4 Aug 10</u>	<b>2Q 11 (+25bp)</b>	6.50	6.50	<b>6.50</b>	<b>6.75</b>	<b>6.75</b>
India	Repo rate	<b>5.75</b>	-200	<b>27 Jul 10 (+25bp)</b>	16 Sep 10	16 Sep 10 (+25bp)	6.00	6.25	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	26 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.

## Economic forecasts - Australia

Australia: economic projections <i>percentage change over previous period, seasonally adjusted annual rates, un</i>														
	2009			2010				2011						
	2009	2010	2011	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Chain volume GDP	1.3	2.7	3.2	3.4	1.1	4.5	2.0	1.9	3.3	3.8	2.7	3.2	4.0	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	6.9	9.5	0.1	-13.1	46.8	-20.9	27.3	12.9	17.5	5.1	3.4	6.4	8.6
Public investment	4.9	32.1	9.3	13.5	43.6	49.7	55.4	14.2	10.0	10.6	6.8	11.2	6.8	9.6
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	1.7	2.7	8.4	-6.5	8.3	-2.0	3.2	2.4	2.8	2.0	2.8	3.2	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	-1.9	-0.4	0.9	-4.6	-5.0	-2.0	0.6	-0.2	-0.2	-0.5	-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	3.1	3.6	1.5	1.3	2.1	2.9	3.1	3.0	3.3	3.5	3.8	3.6	3.4
Producer prices (%oya)	-5.4	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	-2.1	-2.0	-2.0	-2.2
3m eurodeposit rate (%)*	6.0	4.7	5.6	3.5	3.4	4.1	4.3	4.8	4.8	5.1	5.4	5.6	5.6	5.7
10-year bond yield (%)*	5.6	5.7	6.3	5.5	5.1	5.8	5.6	5.5	5.9	6.1	6.2	6.3	6.4	6.4
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	-51.0	-32.0											
as % of GDP	-2.1	-3.8	-2.3											
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. That said, we have downgraded expected GDP growth following recent downgrades for the US and China.
- **Business investment** probably will rise close to 20% in 2010-11, with mining leading the way, particularly with the mining tax roadblock being dismantled.
- On **housing**, with the expanded first home owners' grant now having expired and price caps on the basic grant in place, house price growth should cool, particularly at the low- and middle-end of the price spectrum.
- **Consumer confidence** deteriorated sharply earlier this year as mortgage rates rose, but the index rebounded in July. Optimists now easily outnumber pessimists.
- **Export volumes** have held up owing mainly to firm demand from China, and the terms of trade has bounced thanks mainly to higher bulk commodity prices.
- The **RBA** hiked the cash rate six times between October and May. The Bank will likely remain on the sidelines until November, following the late-October release of the 3Q CPI data.
- Newly-installed Prime Minister Gillard has called an August 21 **election**. The leadership change appears to be paying off, although the Government's lead over the Opposition in opinion polls is shrinking.

## Economic forecasts - New Zealand

New Zealand: economic projections <i>percentage change over previous period, seas. adjusted annual rates, unless stated</i>														
				2009			2010				2011			
	2009	2010	2011	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Real GDP (1995-96 prices)	-1.7	2.5	2.7	0.3	1.2	3.7	2.3	3.5	2.3	1.9	2.7	3.4	3.2	2.2
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	4.7	7.8	19.2	0.6	-2.7	5.5	7.0	7.0	8.0	8.0	9.0	7.0	7.0
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	3.6	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	-1.5	0.5	9.9	-1.8	-8.3	-0.8	-0.2	-0.2	0.5	1.2	1.2	-0.1	-0.8
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	5.0	3.2	2.3	5.3	-0.7	1.5	1.1	5.5	12.1	3.3	1.8	3.9	3.8
%oya	2.1	2.6	4.9	1.9	1.7	2.0	2.0	1.8	1.8	4.9	5.4	5.6	5.2	3.2
Trade balance (NZ\$ bil, sa)	2.5	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	-7.1	-5.4	-4.2
Yield on 90-day bank bill (%)*	3.0	3.2	4.7	2.8	2.8	2.8	2.7	2.8	3.5	3.8	4.3	4.8	4.9	5.0
10-year bond yield (%)*	5.5	5.7	6.0	5.7	5.7	5.9	5.9	5.7	5.5	5.7	5.8	6.0	6.1	6.1
US\$/NZ\$*	0.64	0.72	0.75	0.60	0.68	0.73	0.71	0.70	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, particularly given higher interest rates and softer house price growth.
- 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 down, new hiring will likely be postponed.
- The **RBNZ** hiked the OCR 25bp in July. The accompanying commentary was dovish, suggesting that the pace and extent of further tightening may be more moderate than previously forecast. We expect another 50bp of tightening this year.
- 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.

## Australia and New Zealand economic calendar

Monday	Tuesday	Wednesday	Thursday	Friday
<p><b>2 Aug</b></p> <p><b>New Zealand:</b> ANZ commodity price (3:00 pm) Jul</p> <p><i>Holiday Australia</i></p>	<p><b>3 Aug</b></p> <p><b>Australia:</b> Retail sales (11:30 am) Jun <u>0.2%<del>m/m</del>,<del>sa</del></u> Retail sales ex inflation (11:30 am) 2Q <u>0.9%<del>q/q</del></u> Building approvals (11:30 am) Jun <u>-3.0%<del>m/m</del>,<del>sa</del></u> RBA cash target (2:30 pm) Aug <u>no change</u></p> <p><b>New Zealand:</b> Private wages (10:45 am) 2Q <u>0.4%<del>q/q</del>,<del>sa</del></u></p>	<p><b>4 Aug</b></p> <p><b>Australia:</b> Trade balance (11:30 am) Jun 2Q <u>1400 A\$ mn,<del>sa</del></u> HPI (11:30 am) <u>2.0%<del>q/q</del></u></p>	<p><b>5 Aug</b></p> <p><b>New Zealand:</b> Unemployment rate 2Q <u>6.4%<del>,<del>sa</del></del></u></p>	<p><b>6 Aug</b></p>
<p><b>9 Aug</b></p> <p><b>Australia:</b> ANZ job ads. (11:30 am) Jul NAB business conditions (11:30 am) Jul Housing finance (11:30 am) Jun</p> <p><b>New Zealand:</b> QV house prices Jul</p>	<p><b>10 Aug</b></p>	<p><b>11 Aug</b></p> <p><b>Australia:</b> Westpac consumer confidence (10:30 am) Aug Money supply (12:00 pm) Jun</p>	<p><b>12 Aug</b></p> <p><b>Australia:</b> Unemployment rate Jul</p> <p><b>New Zealand:</b> Business NZ PMI (10:30 am) Jul</p>	<p><b>13 Aug</b></p> <p><b>New Zealand:</b> Retail sales (10:45 am) Jun Retail sales ex inflation (10:45 am) 2Q</p>
<p><b>16 Aug</b></p> <p><b>Australia:</b> New motor vehicle sales (11:30am) Jul</p>	<p><b>17 Aug</b></p>	<p><b>18 Aug</b></p> <p><b>Australia:</b> Westpac leading index (11:30 am) Jun Wage cost index (11:30 am) 2Q</p>	<p><b>19 Aug</b></p> <p><b>New Zealand:</b> PPI (10:45 am) 2Q</p>	<p><b>20 Aug</b></p> <p><b>New Zealand:</b> Credit card spending (3:00pm) Jul</p>
<p><b>23 Aug</b></p>	<p><b>24 Aug</b></p> <p><b>New Zealand:</b> RBNZ 2 year inflation expectation 3Q</p>	<p><b>25 Aug</b></p> <p><b>Australia:</b> Construction work done (11:30 am) 2Q</p>	<p><b>26 Aug</b></p>	<p><b>27 Aug</b></p>

## Global Data Diary

Week / Weekend	Monday	Tuesday	Wednesday	Thursday	Friday
<b>2 - 6 August</b>	<b>2 August</b>	<b>3 August</b>	<b>4 August</b>	<b>5 August</b>	<b>6 August</b>
<b>China</b> • PMI mfg (Jul) (Sunday, Aug 1)  <b>Japan</b> • Cabinet Office private consumption index (Jun)	<b>India</b> • Trade balance (Jun)  <b>Japan</b> • Auto regs (Jul)  <b>Korea</b> • Trade balance (Jul)  <b>United States</b> • ISM mfg (Jul) • Bernanke speech  <b>Global mfg PMI (Jul)</b>	<b>Australia</b> • RBA mtg: no chg  <b>Brazil</b> • CPI (Jul) • IP (Jun)  <b>United States</b> • Personal income (Jun) • Pending home sales (Jun) • Factory orders (Jun) • Auto sales (Jul)	<b>Euro area</b> • Retail sales (Jun)  <b>Indonesia</b> • BI mtg: no chg  <b>Romania</b> • BNR mtg: no chg  <b>United States</b> • ADP employment (Jul) • ISM nonmfg (Jul)  <b>Global services PMI (Jul)</b>	<b>Brazil</b> • Auto sales (Jul)  <b>Czech Republic</b> • CNB mtg: no chg  <b>Euro area</b> • ECB mtg: no chg  <b>Germany</b> • Mfg orders (Jun)  <b>Indonesia</b> • GDP (2Q)  <b>Peru</b> • BCRP mtg: no chg  <b>United Kingdom</b> • BoE MPC mtg: no chg • Auto regs (Jul)	<b>Canada</b> • Employment (Jul)  <b>Euro area</b> • Trichet speech  <b>Germany</b> • IP (Jun)  <b>Italy</b> • GDP (2Q) • IP (Jun)  <b>United Kingdom</b> • IP (Jun)  <b>United States</b> • Labor market report (Jul) • Consumer credit (Jun)
<b>9 - 13 August</b>	<b>9 August</b>	<b>10 August</b>	<b>11 August</b>	<b>12 August</b>	<b>13 August</b>
<b>China</b> • FDI (Jul)  <b>Russia</b> • IP (Jul)  <b>United Kingdom</b> • Consumer conf (Jul)	<b>Australia</b> • NAB bus conf (Jul)  <b>Germany</b> • Trade balance (Jun)  <b>Japan</b> • Econ Watcher surv (Jul)  <b>Turkey</b> • IP (Jun)	<b>China</b> • Trade balance (Jul)  <b>France</b> • IP (Jun)  <b>Japan</b> • BoJ MPM: no chg  <b>United States</b> • NFIB survey (Jul) • Productivity and costs (2Q) • FOMC mtg: no chg	<b>Australia</b> • Westpac cons conf (Aug)  <b>Brazil: Retail sales (Jun)</b>  <b>China</b> • CPI, FAI, ret sales, IP (Jul)  <b>Japan</b> • Private mach orders (Jun)  <b>Norway</b> • Norges bank mtg: no chg  <b>United Kingdom</b> • Labor market report (Jul)  <b>United States</b> • Trade balance (Jun) • JOLTS (Jun)	<b>Euro area</b> • IP (Jun)  <b>India</b> • IP (Jun)  <b>Japan</b> • IP final (Jun) • Consumer conf (Jul)  <b>Korea</b> • BoK mtg: no chg	<b>Euro area</b> • GDP (2Q) • Trade balance (Jun)  <b>Japan</b> • Reuters Tankan (Aug) • MPM minutes (Jul)  <b>United States</b> • Retail sales (Jul) • CPI (Jul) • UMich cons conf (Aug) • Business inventories (Jun)

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