J.P.Morgan

Australia and New Zealand - Weekly Prospects

Summary

- We have dragged forward the timing of the next **RBA** rate hike to next Tuesday, from February. A month ago, we pushed out the timing of the next hike owing to the growing risks of a second leg down for the global economy, and after growth downgrades by our colleagues offshore. We believed the RBA would engage in near-term risk management, standing pat in 4Q to see how the global risks evolved, before resuming the hiking cycle next year. Now, though, with the clouds lifting from the global outlook and the tone of the official commentary stepping up a notch, it seems the RBA is ready to move. We learned last October, when the RBA hiked for the first time in this cycle, that when officials believe a hike is necessary, they don't wait for further data, including an inflation print. We continue to forecast four further hikes in 2011. The speed at which they are delivered ultimately will be determined by the extent to which the Aussie banks "super-size" the RBA's moves and, at the margin, the level of **AUD**, which we now forecast at parity with the greenback. The fact that the RBA is poised to hike despite lingering offshore troubles highlights the robustness of the domestic macro "story", and the extent to which the outlook for inflation has deteriorated.

- We recently highlighted the growing risk that **RBNZ** Governor Bollard would sit on the policy sidelines for the remainder of the year. A string of disappointing data, the drag from the recent earthquake in Canterbury, and a drop in inflation expectations reduced the chances of Dr. Bollard delivering on the December rate hike we had pencilled-in. Last week's GDP data was the final straw; there now is less chance of a rate hike this year. The economy grew just 0.2%m/m in the June quarter, prompting a significant downgrade to our annual 2010 GDP growth forecast, from 2.7% to 2.0%. The Governor now probably will stand pat until March, leaving current accommodative policy settings in place in a bid to rescue the recovery that has all but stalled.

- A **rotation in regional growth** continues to be an important global theme. Recent weeks have brought hopeful signs that growth in the United States and China is stabilizing after a sharp downshift in 2Q. At the same time, the Euro area was expected to slow this quarter after having accelerated into midyear. Last week's report of a steep drop in the September Euro area PMI was a confirming sign. It does not appear that 3Q growth fell materially below our 2% forecast, as the PMI had been elevated relative to our expectations. In addition, the continued resilience of national business sentiment suggests that downside risks are limited. To this point, it will be important to watch the German consumer. The surge in the retail component of the IFO survey offers hope that household spending growth will be more robust in this expansion.

- The shift taking place at the Fed was mirrored by more modest movements at other large **central banks**. By year-end it is possible that both the Bank of England and Bank of Japan will engage in further QE. The official statement from the BoJ on the recent unsterilized currency intervention gave an impression that it is easing only reluctantly. However, board member Miyao suggested last week that the BoJ appears to be ready for further easing through the outright purchase of JGBs. While it is premature to assume that the BoJ has decided to increase JGB purchases from the current yearly JPY21.6 trillion, the FOMC statement has increased the odds of BoJ action.

This week's highlight

In a quiet week, the Aussie credit numbers Thursday are the only material data point released ahead of the RBA's Board meeting next Tuesday. Credit growth probably remained subdued in August.

September 27, 2010

Contents

Forecast changes:

We have brought forward the timing of the next RBA move—we now expect a 25bp hike next Tuesday. We have, however, pushed out the timing of the next RBNZ hike to March 2011, from December.

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Data and event previews - Australia and New Zealand

Date	Time (a)	Data/event	Forecast JPMorgan	Forecast Consensus (b)	*Previous*
Wednesday, September 29	8.45am	NZ trade balance (NZ$mn., Aug.)	**-100**	na	*-186*
Wednesday, September 29	10.00am	Aust. Conference Board Leading Index (%m/m, Jul.)	**na**	na	*0.1*
Thursday, September 30	8.45am	NZ building permits (%m/m, Aug.)	**na**	na	*3.1*
Thursday, September 30	11.00am	HIA new home sales (%m/m, Aug.)	**na**	na	*-7.0*
Thursday, September 30	11.30am	Aust. building approvals (%m/m, Aug.)	**2.5**	0.0	*2.3*
Thursday, September 30	11.30am	Aust. private sector credit (%m/m, Aug.)	**0.2**	0.3	*0.1*
Thursday, September 30	11.30am	Aust. RP/Rismark median house price (%m/m, Aug.)	**na**	na	*0.1*
Thursday, September 30	11.30am	RBA Financial Stability Review	**na**	na	*na*
Thursday, September 30	12.00pm	NBNZ business confidence (Index, Sep.)	**9.0**	na	*16.4*

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

Australia

Building approvals (%m/m, Aug.) - Approvals probably got a mild lift in August, rising 2.5%m/m following another rate-hike reprieve from the RBA and a resulting surge in consumer confidence, although the soft underlying trend will remain in place. The negative seasonal adjustment for August also will limit the upside in the private sector approvals number.

Private sector credit (%m/m, Aug.) - The credit data are a key focus of RBA officials, and happen to be the only leading data point scheduled for release ahead of the October Board meeting. This week’s numbers should show that credit growth remained subdued in August, rising just 0.2%m/m. Growth in housing credit likely will have softened further owing to higher interest rates and the absence of the expanded first-home buyers’ grant. Personal credit in particular will be interesting to watch, given that the recent decline in this series is in contrast to the message from the 2Q GDP numbers, which showed a sharp drop in the savings rate.

RPData-Rismark median house price (%m/m, Aug.) - The mid-year slowdown in the housing market saw house prices decline by 1% in June, and hold flat in July. The stabilization in auction clearance rates suggest the market has negotiated this downshift fairly successfully, though the absence of rate hikes in 3Q will have been a substantial factor there. We therefore suspect the index pushed up in August, but the market likely will find it tough to eke out gains in 4Q though, following the rate hike we forecast in October, and the possibility of a ‘top-up’ to borrowing rates from the domestic banks.

New Zealand

Trade balance (NZ$mn., Aug.) - The trade deficit should improve marginally owing to a larger drop in imports. Exports also will be lower than in the previous month owing to softer external demand, although will hold up thanks to exports of dairy

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Data previews - Cont'd.

goods, such as milk powder, butter, and cheese. We suspect that the trade balance will soon return to surplus. While the trend in imports appears to be flattening out, we suspect the trend in exports, which has increased significantly this year, to meander higher. Demand from Australia and China, in particular, will likely underpin growth in New Zealand's exports in coming months.

Building permits (%m/m, Aug.) - We forecast another rise in building permits in August, but total permits will remain well down from their peak in June 2007. We expect only 4,496 permits were issued in August, just half the number issued at the most recent peak. The more modest rise in permits will signal that the recovery in residential investment will be softer than it has been in previous quarters. After a long running decline, residential investment increased in the December and March quarters, rising 4.7%q/q and 0.6%, respectively. We forecast that residential investment will grow in coming quarters, but at a very subdued pace.

NBNZ business confidence (Index, Sep.) - The NBNZ business confidence index probably fell further in September. Marking the fifth straight monthly fall, the index probably fell around 7 points to suggest that only a net 9% of respondents expect business conditions to improve over the next 12 months. The decline will owe mainly to concerns about the strength of the recovery in New Zealand and the drop in sentiment following the recent earthquake in Canterbury. The firms' own activity outlook index also will be significantly lower, reaffirming our view that economic growth will moderate in the final stages of the year.

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Australia

- **Next RBA rate hike in October, not February**
- **Officials anticipating "robust upswing"**
- **Aussie credit growth probably soft in August**

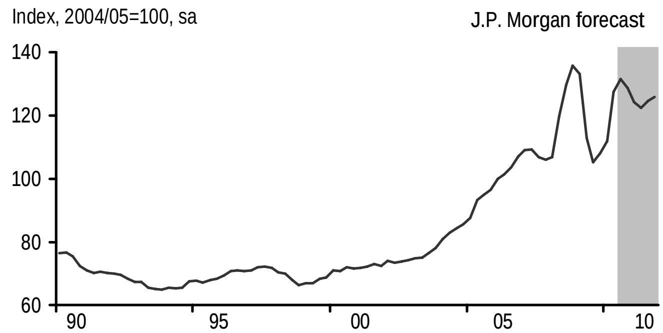
The economic data flow was light in Australia last week, but there was plenty of hype around the timing of the RBA's next rate move. An upbeat speech by RBA Governor Glenn Stevens, followed by the upbeat minutes from the Board's most recent meeting, bolstered futures market betting on an imminent rate rise—a full quarter-point hike now is priced in by December. Local market economists now are unanimous in believing that the next rate will be delivered before year-end. In recent weeks, we have flagged the risks of a further RBA rate hike in 4Q, while maintaining our forecast for the RBA to remain sidelined until February amid heightened uncertainty around the global outlook. Now, though, we believe the next hike will be delivered on 5 October. This week's rhetoric from the RBA Governor sent a strong message that a hike is not far off.

Managing a "fairly robust upswing"

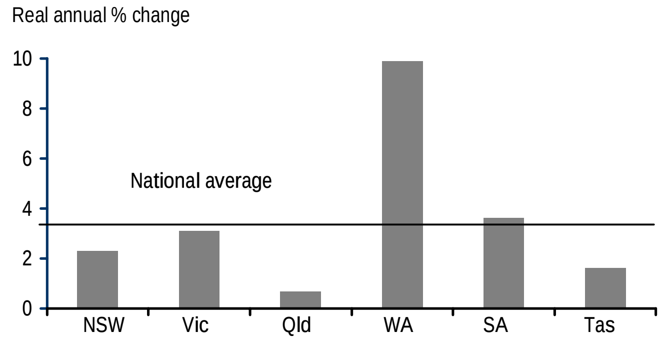
The RBA Governor spent much of his speech last week, entitled "Monetary Policy and the Regions," discussing the solid performance of the Aussie economy. While other economies are only in the early stages of recovery, growth in Australia has been "quite solid," the unemployment rate is low and has been falling for about a year, and inflation is unlikely to decline much further. Should the Australian economy continue to perform strongly, in the absence of any adverse events (e.g., a sharper-than-expected slowdown in China), the RBA would have to manage a "fairly robust upswing."

With the economy approaching capacity, it is not surprising that RBA officials have become increasingly concerned that the resources boom will put further upward pressure on inflation; this would pose "significant challenges" for economic policy. These challenges already seem to be on their way, with the Australia Bureau of Agricultural and Resource Economics (ABARE) now forecasting total commodity exports to rise 26% in the 2010-11 year, with export earnings to reach a record high A$215 billion. This surge will owe predominantly to higher prices for iron ore and coal, Australia's two largest commodity exports, as Australia rides out, in the words of the Governor, "the largest minerals boom since the late 19th century."

Australia: terms of trade



Australia: 2Q GDP growth by state



Two-speed economy creates challenges

Australia's "two-speed" economy has reemerged with a vengeance, with the commodities boom bolstering the mining states, such as Western Australia, and the manufacturing- and consumer-oriented states falling behind. This has been evidenced by industry data showing considerable divergences across different sectors. Confidence in the mining sector now is testing pre-crisis levels, and is tracking well above that in manufacturing and construction.

But, as Stevens highlighted last week, changes to monetary policy settings will be based, as always, on "average" conditions across Australia. The Governor acknowledged that monetary policy is often dubbed a "blunt instrument" in that it cannot be set at different levels across the various regions and industries. The mining boom impacts regions and industries to markedly different extents, owing mainly to the simple fact that mineral resources are not found in every state and territory. Western Australia, for example, where mining accounts for a quarter of production, will get a much bigger boost from the current "shock" than, say, Victoria, where mining accounts for only 2% of production. The boom already is having a positive impact on WA, with

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growth in 2Q rising markedly relative to that in the other states (bottom chart).

New era of austerity?

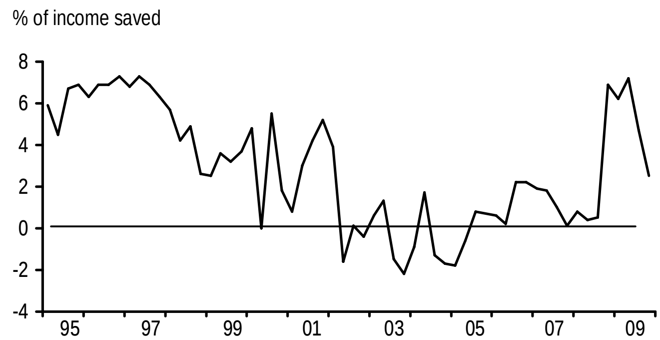
Should higher resource utilization, the boom in investment, and the elevated terms of trade coincide with continued strength in consumption, the RBA would have to tighten policy more than we currently forecast (+100bp) in 2011. RBA officials have assumed, though, that we are living in a new era of austerity, where challenges posed by the soaring terms of trade and booming investment outlook would be lessened by greater conservatism among households.

There are mixed signals emerging on this front, however. On the one hand, household consumption underpinned 2Q GDP growth, pushing the savings rate sharply lower (first chart), and retail sales recently have firmed on the back of an increase in discretionary spending. On the other hand, more timely data, such as the Westpac Melbourne Institute (WMI) consumer sentiment index released a fortnight ago, suggest that households have started to tread more cautiously. The WMI found that more people were opting to pay down debt (21% in 3Q compared to 16% in 2Q), which may provide a more accurate signal that households are, in fact, becoming more conservative. Households' appetite for debt also has softened, with housing credit growth recently easing and credit card repayments picking up.

Credit demand still subdued

The credit data are a key focus of RBA officials, and happen to be the only leading data point scheduled for release ahead of the early-October Board meeting. This week's numbers should show that credit growth remained subdued in August, rising just 0.2%m/m. This would mean that on a three-month annualized basis, credit growth will have declined sharply, to 2.0% from 3.3% in July and 3.8% in June. This series has slowed markedly this year after venturing as high as 5.1% in February, providing evidence that the cumulative impact of the RBA's policy tightening has indeed damped demand. Growth in housing credit, by far the largest pool, likely will have softened further owing to higher interest rates and the absence of the expanded first-home buyers' grant. Personal credit probably was flat in August, while business credit likely declined for the third straight month, with small- and medium-sized firms still struggling to obtain finance from the domestic banks.

Australia: household savings rate



Data releases and forecasts

Week of September 27 - October 1

		May	Jun	Jul	Aug
Thu Sep 30 11:30am	Private sector credit Sa				
	%m/m	0.5	0.2	0.1	0.2
	%oya	2.8	2.9	2.8	2.8

		May	Jun	Jul	Aug
Thu Sep 30 11:30am	Building approvals Sa				
	%m/m	-7.0	-3.3	2.3	2.5
	%oya	31.1	14.2	11.0	13.4

Building approvals probably got a mild lift in August, rising 2.5%m/m following a third successive rate-hike reprieve from the RBA and a resulting surge in consumer confidence, although the soft underlying trend will remain in place. There is little evidence to suggest that approvals for private sector houses in particular, which are down nearly 8%3m/3m, are due for any sort of meaningful bounceback. Total approvals will likely remain depressed this year owing to structurally lower first-home buyer representation in the housing market. We expect permits for private sector houses to have been flat over the month, while the always volatile higher-density category will continue to be the swing factor that determines whether the headline over- or undershoots consensus. This category posted a solid gain 7%m/m print in July, but even that still left the three-month moving average in the red.

Review of past week's data

WMI leading index

	May		Jun		Jul	
%m/m, sa	~~0.3~~	*0.5*	~~0.0~~	*-0.1*	__	*0.4*

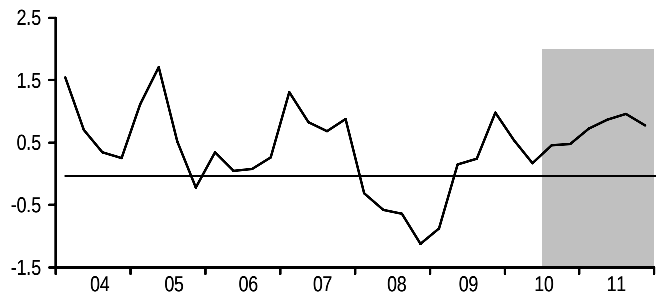
New Zealand

- **2Q GDP growth in NZ fell well below expectations**
- **RBNZ on hold until March 2011**
- **Business confidence to have deteriorated further**

In New Zealand, the GDP data showed the economy expanded a mere 0.2%q/q in the June quarter. The surprise weakness in the GDP numbers, combined with the damping impact on economic activity of the recent earthquake in Canterbury, means there is no urgency to step away from current accommodative policy settings. The recent decline in inflation expectations also added to the case for a pause. In contrast to the RBA, therefore, we now expect that RBNZ Governor Alan Bollard will leave the cash rate unchanged until at least March next year, with the risks skewed toward a later move should economic conditions deteriorate further.

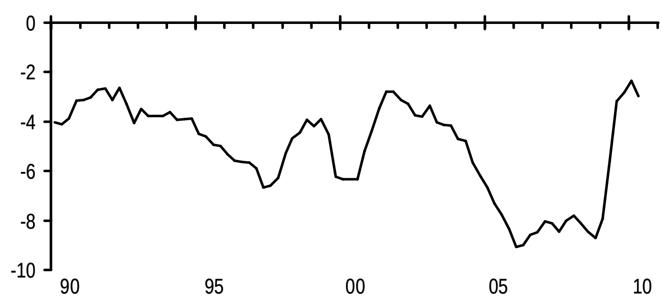
New Zealand: real GDP

%oya



New Zealand: current account balance

Four quarter average, % of GDP



More signs of weakness in NZ

Economic growth in New Zealand slowed to a crawl in 2Q. The GDP numbers showed the economy expanded just 0.2%q/q, compared to 0.5% in 1Q (which was downwardly revised from 0.6%). The GDP print also fell short of the RBNZ's 0.9%q/q forecast and adds to the case for Governor Bollard to sit on the sidelines for the time being. Just two weeks ago the Governor left the official cash rate (OCR) unchanged and signaled that future rate rises would likely be slower than previously expected. With that guidance in mind, combined with last week's exceptionally weak GDP print and other monthly data showing that the economy has continued to shed momentum in the current quarter, we now expect that Bollard will leave the cash rate unchanged for the remainder of the year.

The biggest downside surprise in the GDP numbers, among the expenditure components, was the mere 0.1%q/q rise in household consumption. Household consumption, which accounts for nearly 60% of the economy, did not contribute to the headline. With retail sales volumes having bounced 1.3%q/q in 2Q, we had expected a decent rise in this component. Higher spending on durable goods was, however, offset by lower spending on services, with the 0.6%q/q decline in that category marking the largest drop in 10 years.

Economic growth in the third quarter also will be subpar. The devastating earthquake in Canterbury, which accounts for roughly 15% of GDP, will have a negative near-term impact on economic activity. We estimate that it will knock 0.2%-pt off 3Q GDP growth as consumer and business sentiment take a hit, employees are left unable to work, and consumer spending is reined in further. In the medium term, though, the disaster should boost GDP growth via higher construction, greater government spending, and increased employment, which will have a positive impact on sentiment, household incomes, and spending.

Kiwis need to show more austerity

Earlier in the year, we had believed that household consumption would remain strong leading into 3Q, ahead of the GST hike on October 1, but as a result of the earthquake, households probably will consolidate spending earlier than we previously expected. This is particularly likely given the persistent weakness in the labour market, with the unemployment rate actually rising again in 2Q, and with wage growth remaining slow.

The consolidation is a much-needed development, however, with the 2Q current account data bringing to the fore the need for the nation to cut its high debt and bolster savings to turn around the imbalances in the economy. The CAD rose to 3.0% of GDP from 2.4% in 1Q and will likely track higher over the foreseeable future, particularly in 2011 as

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imports rise in order to feed the reconstruction of the Canterbury region.

Forthcoming policy changes should assist in promoting saving. When the government announced in the Budget in May that it would raise the GST, it also announced cuts to income taxes, the combination of which should encourage households to save. The tax bill of someone with an annual income of NZ$120,000, for example, would fall around NZ$4,600 as a result of the cuts to personal income tax rates, but with the GST hike to discourage spending, much of the tax reduction would most likely be saved. This should, to a small extent, help reduce the vulnerabilities to swelling foreign debt. New Zealand is significantly in debt to foreigners, with the country's net debtor position totaling 86.5% of GDP, owing mainly to foreign holdings of private sector debt reflecting households' perennially low levels of saving.

Data releases and forecasts

Week of September 27 - October 1

Wed
Sep 29
10:45am

Trade balance

Nsa

	May	Jun	Jul	Aug
Trade balance (NZ$ mn)	765	214	-186	-100

The trade deficit should improve marginally owing to a larger drop in imports. Exports also will be lower than in the previous month owing to softer external demand.

Thu
Sep 30
10:45am

Building consents

Sa

	May	Jun	Jul	Aug
%m/m	-9.2	3.3	3.2	2.0
%oya	11.1	27.9	26.5	25.6

We forecast another rise in building permits in August, but total permits will remain well down from their peak in June 2007. We expect only 4,496 permits were issued in August, just half the number issued at the most recent peak.

Thu
Sep 30
2:00pm

NBNZ business confidence

Nsa

	Jun	Jul	Aug	Sep
Index	40.2	27.9	16.4	9.0

The NBNZ business confidence index probably fell further in September. Marking the fifth straight monthly fall, the index probably fell around 7 points to suggest that only a net 9% of respondents expect business conditions to improve over the next 12 months. The decline will owe mainly to concerns about the strength of the recovery in New Zealand and the drop in sentiment following the recent earthquake in Canterbury. The firms' own activity outlook index also will be significantly lower, suggesting that economic growth will moderate in the final stages of the year.

Review of past week's data

Visitor arrivals

	Jun		Jul		Aug	
Total (%m/m,nsa)	~~0.7~~	*1.4*	~~1.4~~	*0.8*	__	*0.6*

Net permanent immigration

	Jun	Jul	Aug	
Monthly (000s,nsa)	-0.7	1.4	__	*0.9*
12 month sum (000s,nsa)	16.5	15.2	__	*14.5*

Credit card spending

	Jun		Jul		Aug	
%oya	~~4.4~~	*4.5*	~~2.7~~	*2.6*	__	*2.0*

Balance of payments

NZ$ mn, nsa

	4Q09		1Q10		2Q10	
Current account	~~-3414~~	*-3332*	~~176~~	*159*	~~-600~~	*-880*

As a percentage of GDP, the annual current account deficit (CAD) printed at 3.0%, compared to 2.4% in the previous quarter. The marked worsening of the annual CAD was expected given the absence of one-off company tax transactions that led to the significant improvement in the CAD in the year to March 2010. In the absence of these transactions, the CAD would have been much wider in 1Q, at NZ$6.1 billion, or 3.3% of GDP. We suspect that the current account deficit will rise toward 4% of GDP by year-end, before worsening significantly in 2011 as the recovery picks up.

Real GDP

Sa, production-based

	4Q09		1Q10		2Q10	
%oya	0.5		1.9		~~2.8~~	*1.9*
%q/q	~~0.9~~	*1.0*	~~0.6~~	*0.5*	~~1.0~~	*0.2*

GDP growth of 0.2%q/q fell well below expectations (J.P. Morgan: 1.0%; consensus: 0.7%). The biggest downside surprise was in household consumption, which made zero contribution to the headline rate. Government spending rose 0.5%q/q, investment spiked 6.2%, and net exports added 0.2%-pt to GDP growth. Export volumes increased 1.3%q/q, contributing to the rundown in inventories. Import volumes were up 0.6%q/q, bolstered by a surge in imports of passenger vehicles (+23.1%). Across the industries, manufacturing recorded the largest decline, falling 4.0%q/q and subtracting 0.5%-pt from GDP growth. Manufacturing inventories were down NZ$437 million, accounting for most of the decline in total inventories (down NZ$530 million).

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Global Essay

- **FOMC moves toward QE and signals firm commitment to reflation**
- **The ECB is resistant to additional QE while BoJ and BoE are likely to act**
- **Global growth rotation is proceeding apace; Europe slows as US stabilizes**
- **High inflation allows India to accept currency appreciation**
- **Next RBA rate hike moved up to October**

Whip-up Inflation Now

On one level, last week's FOMC meeting merely met expectations, as the committee did not engage in further asset purchases while signaling a heightened readiness to ease. We maintain that the Fed will resume large-scale asset purchases (LSAP) of Treasuries, most likely at its November meeting. However, the committee went further than signaling that it might take out insurance against downside risks to growth. For the first time, the FOMC statement expressed a view that underlying inflation is running below its mandate, and that the Fed is committed to moving it higher.

The statement linked the inflation outlook to two key variables—slack and inflation expectations—whose movements will now guide its path through QE2. Although there is a divide within the committee on the role high unemployment plays in the inflation process, US experience shows that the level of slack has been a key determinant of cyclical swings in inflation. This message has been reinforced by recent US and global performance. The strong correlation between output gaps and inflation movements across the globe this year is particularly notable. As evidence reinforces this relationship, the policy prescription is clear: The FOMC needs to deliver sustained growth well above trend if it is going to avoid the threat that inflation drifts further from its objective.

There is less debate about the importance of aligning inflation expectations with Fed objectives. However, expectations are hard to measure. The FOMC statement reiterated the view that expectations remain stable, but the slide in breakeven spreads since early this year and the recent fall in one-year consumer expectations have likely contributed to the Fed's willingness to consider action at this point.

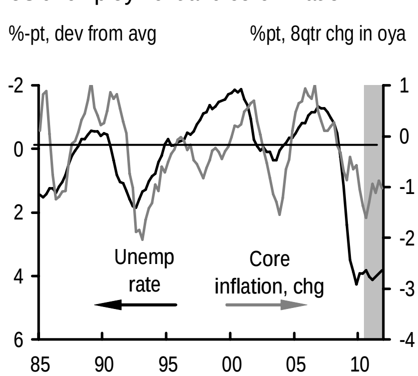
Given the considerable skepticism about the effectiveness of monetary policy once the lower policy rate bound has been reached, it is encouraging to see that financial markets are moving in a manner consistent with the Fed's policy shift —which began with Chairman Bernanke's August 27 speech. Over the past month, real interest rates and the dollar have moved lower while inflation expectations and risky asset values have moved higher.

More hands on deck

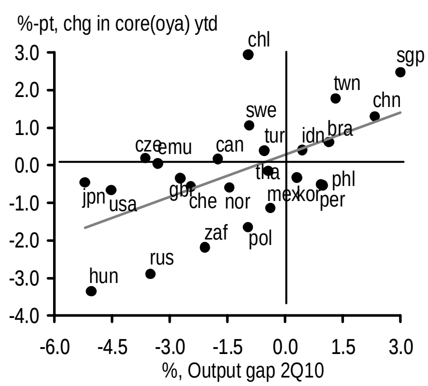
The shift taking place at the Fed was mirrored by more modest movements at other large central banks. By year-end it is possible that both the Bank of England and Bank of Japan will engage in further QE. The official statement from the BoJ on the recent unsterilized currency intervention gave an impression that it is easing only reluctantly. However, board member Miyao suggested last week that the BoJ appears to be ready for further easing through the outright purchase of JGBs. While it is premature to assume that the BoJ has decided to increase JGB purchases from the current yearly JPY21.6 trillion, the FOMC statement has increased the odds of BoJ action.

The release of the August MPC minutes last week shows that some BoE members are edging toward more QE as

US unemployment and core inflation

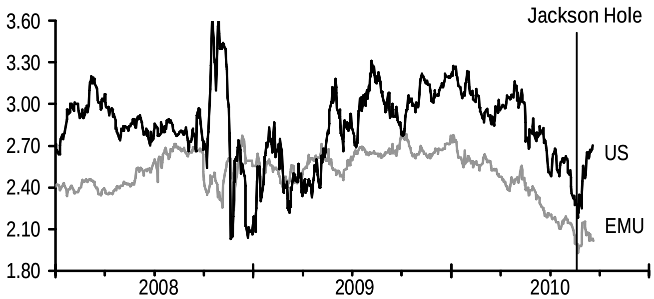


Global slack and inflation



5yr/5yr forward inflation expectations

% p.a.; US is Fed breakeven measure, EMU based on swaps



growth momentum slows. However, concerns about the continued high level of inflation make it a close call whether a consensus will form around our view of a £25 billion extension of QE in November.

Notably absent from the group moving toward QE is the ECB. In part, this reflects the ECB's forecast that underlying inflation will move higher over the next year despite modest growth and a depressed utilization rate. However, relative to the Fed, the ECB also views the benefits of QE as more limited and the risks as higher. Regarding risks, the central bank worries about anchoring inflation expectations in an environment in which budget deficits are very wide and the region is struggling to impose an appropriate medium-term framework for fiscal discipline. In addition, the ECB worries that further stimulus will prevent the very balance sheet adjustments that are necessary to return to health. It is thus not surprising to observe the divergence in movements of financial market measures of inflation expectations in recent weeks.

Growth rotations are on track

A rotation in regional growth continues to be an important global theme. Recent weeks have brought hopeful signs that growth in the United States and China is stabilizing after a sharp downshift in 2Q. At the same time, the Euro area was expected to slow this quarter after having accelerated into midyear. Last week's report of a steep drop in the September Euro area PMI was a confirming sign. It does not appear that 3Q growth fell materially below our 2% forecast, as the PMI had been elevated relative to our expectations. In addition, the continued resilience of national business sentiment—which is a broader gauge of business health—suggests that downside risks are limited. To this point, it will be important to watch the German consumer. The surge in the retail component of the IFO survey offers hope that household spending growth will be more robust in this expansion.

A challenge to growth in the Euro area comes from stress in the periphery. This is coinciding with the beginning of the budgetary round for 2011. All Euro area countries have multi-year fiscal adjustment plans, and as budgets get released in the coming weeks, most of the region simply will confirm the objectives that have already been set. The key information in the budgets will be the details about how the objectives will be met. However, the situations in Portugal and Ireland are different. Portugal is under pressure to arrest some slippage in meeting this year's objective, while Ireland is under pressure to front-load some of the adjustment that was planned for future years.

Elsewhere, we are on guard for a growth downshift in Japan. Current-quarter activity received a temporary boost from fiscal stimulus and unusually warm weather. We look for growth to stall as these effects wear off and the tightening in domestic financial conditions (yen, Nikkei) takes hold. The most important guidance in this week's reports will come from the forward-looking business surveys (September Shoko Chukin and manufacturing PMI, quarterly Tankan) and the August IP report, which will include manufacturers' production plans for September and October.

India leading Asian policy normalization

EM Asian policymakers are still running very loose policy despite an impressive rebound in growth that already has lifted resource utilization back above average and produced a rise in core inflation. This stance is reflected in the relatively meager rise in both policy interest rates and trade-weighted exchange rates across the region. Over the past year, for example, EM Asian policy interest rates have increased 26bp, while the region's real TWI is up 6%.

The region's two biggest economies, China and India, bracket the range of regional policy tightening. Chinese officials have not raised interest rates since late 2007. Meanwhile, they have maintained a tight grip on the currency, notwithstanding this month's 3% rise versus the dollar. US frustration with this policy spilled over last week in the form of draft legislation that would allow US companies to petition for higher duties on imports from China to compensate for the effect of the weak yuan. The House of Representatives is expected to vote on this legislation this week.

Reluctant to allow their currencies to appreciate versus the yuan, policymakers elsewhere in the region have been holding back on raising interest rates, while intervening heavily in the FX markets. The notable exception to this trend has

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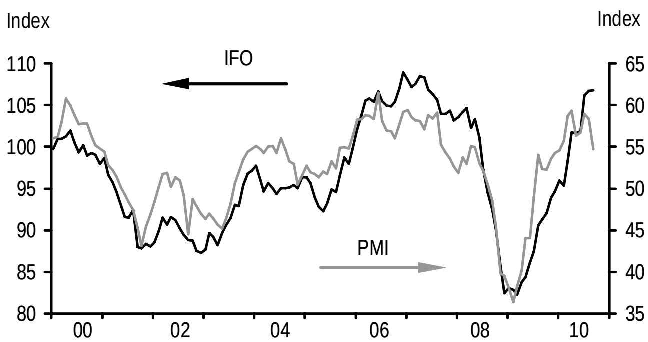
German IFO and composite PMI



been India. In the year-to-date the RBI has raised its policy rate 125bp. Moreover, because of tight bank liquidity, the overnight call rate has jumped from the bottom of the policy corridor to the top, implying an effective tightening of 275bp. As it has raised rates, the RBI has refrained from FX intervention. Thus, India's real TWI has increased about 10% over the past year, versus about a 4% gain in the rest of EM Asia, including China.

India's more aggressive policy action is motivated by high inflation. Although the inflation rate has eased modestly over the last two months, it remains in a range of 8% to 9%. Barring a more significant decline in inflation, we expect Indian officials to continue tightening, although at a less rapid pace. As such, India will continue to lead the process of policy normalization in the region.

Shifting timetables for RBA, RBNZ action

The RBA sent a strong message last week that a further rate hike is imminent. The Governor said that the task ahead "is likely to be on managing a fairly robust upswing." Above-trend growth is the likely outcome for the Australian economy in 2011, which will push the limits on resource usage and thus feed inflation. As the central bank gains confidence that the global backdrop is stabilizing, it is likely to determine that delaying further policy tightening until 2011 would be a mistake. We have therefore brought forward our forecast for the next RBA hike to October. In contrast, we are pushing out an expected December rate hike in New Zealand to March of next year. The surprise weakness in the GDP numbers last week, falling inflation expectations, and the damping impact of the recent earthquake in Canterbury on economic activity mean there is no urgency for the RBNZ to step away from its accommodative policy.

CEEMEA central banks to stay on hold

Although several CEEMEA central banks sent more hawkish messages last week, we maintain our call that rate normalization will not get under way in the region until 2Q11. MPC minutes in Poland showed that a motion for a 50bp rate hike was put forward at the August meeting, while one MPC member in the Czech Republic voted to raise rates 25bp last week. Turkey's central bank raised reserve requirements on TRY and FX deposits to restrain loan growth. Nonetheless, the combination of uncertainty over the Euro area growth outlook, low inflation, and continued upward pressure on FX rates argues against preemptive rate hikes. Indeed, in South Africa, continued currency strength raises the likelihood of another rate cut in November. The Bank of Israel is the odd one out. It is already in the midst of a tightening cycle, and we expect another 25bp rate hike this week.

Latin governments push for fiscal restraint

In Latin America, the current budget season is drawing attention to a shift away from stimulative fiscal policies. In Mexico, the opposition is seeking to reduce the VAT, but the government intends to keep the current lid on fiscal policy in place in 2011, lowering the deficit to just over 2% of GDP. In Argentina, opposition proposals to raise pensions and lower export taxes are unlikely to advance. In Brazil, markets are anticipating that a cabinet led by ex-Finance Minister Palocci will deliver a moderate improvement in the primary balance, although reining in lending by BNDES, the main development bank, will be a challenge. Chile's government is reviewing the definition of the structural fiscal rule, which will imply a reining in of stimulus even as earthquake reconstruction proceeds, bringing the structural deficit from 3% of GDP to 1% by the end of its mandate. Colombia's new administration is eager to adopt a structural fiscal rule like Chile's. The challenge is to have Congress approve the reform without watering it down.

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JPMorgan View - Global Markets

Central banks are boosting confidence

- **Economics:** Activity data are tracking our forecast of growth close to potential.
- **Asset allocation:** QE boosts investor confidence. Add risk.
- **Fixed income:** QE on the horizon supports core bond markets, but look for Australia and Canada to decouple.
- **Equities:** Negative pre-announcements point to a worse EPS outcome in 3Q relative to 2Q, but seem largely priced in. Short covering has further to go.
- **Credit:** Medium-term strategy remains long credit, favoring EM over DM, corporate over state, and US over Europe.
- **FX:** Add to USD shorts.
- **Commodities:** Much stronger-than-expected demand for crude oil leads us to raise price forecasts, from $75 to $81 average for 4Q. Go long crude oil.

In a week when economic data were OK, but not great and just confirmed stabilization, the important event was a clear enough statement from the Fed that it will do what it can with its balance sheet to reflate the economy. Together with the Bank of England and the Bank of Japan, the Fed is telling us that **low growth is not acceptable, deflation risks are rising, and it stands ready to move to a second phase of asset purchases to reflate the global economy and asset markets**.

Investors are becoming more hopeful, but remain skeptical on what central banks can achieve, taking a "show me that it works" attitude before joining the reflation trade. Recent global activity data are telling us that downside risk of a double dip has been curtailed, but that there is as yet no reason to see upside risk. The majority of investors believe that the developed economies have entered a seven-year famine of weak growth, high unemployment, and high fiscal deficits. And most believe that emerging economies will escape much of this malaise. We have expressed similar views but are more open on how long this malaise will last and how bad it will be. This is because policymakers and governments are under massive pressure to end the malaise and reflate the world economy.

Hyperactive policymakers have the tools that can help turn the world economy around, but the **risk is that such actions will do more bad than good**. Negative impacts could come from overstimulating the world, and thus quickly turning deflation into inflation risks. This is one reason the ECB remains more conservative. A second danger is that hyperaction turns into beggar-thy-neighbor policies—aimed at helping one country at the expense of others, and likely the overall world economy. One country may increase the size of its piece of the pie, but the pie itself will shrink. These measures include currency intervention and trade restrictions. The good news is that, so far, most countries are staying away from destructive protectionism. Asia, however, continues to protect itself against currency appreciation, with Japan having joined in recently. There is a danger this becomes a currency war, but Europe and the US are so far not taking the bait. If anything, Asian currency intervention has had the growth-positive impact of importing US easy monetary policy. We conclude that **trade, monetary, and currency policies are in aggregate a boost to growth**.

Will these policies succeed in stimulating growth and thus risk assets? Much of the slower growth we are seeing is due not only to delevering, but also to broad macro and micro uncertainty that is holding companies and households back from responding to easy money. The clear move by three major central banks to commit their balance sheets to reflation should make economic agents on the margin less uncertain and thus more willing to invest and spend. **This is the reason to raise allocations to riskier assets.**

Fixed income

Bond markets are priced for significant further easing, and central banks brought that easing closer last week, pushing yields lower across the globe. The BoE's minutes showed a committee edging toward more QE. And more importantly, the **FOMC adopted a very explicit easing bias, pledging to take action if inflation stays subdued**. Instead of a big-bang announcement of a huge target for bond purchases, QE2 seems set to take a more flexible course, with the Fed setting a modest target for the first few months, and waiting for the data to see if more is needed. Ultra-loose monetary policy remains supportive of bond markets, and we **stay bullish and in flatteners**.

More easing in the US, UK, and perhaps Japan raises the prospect of a more pronounced decoupling from bond markets in the smaller developed economies, which have recovered more smartly from the global recession. Indeed, hawkish comments by RBA Governor Stevens last week prompted the market to fully price another rate hike by year-end. We favour flatteners on the Australian money market curve (see *GFIMS Australia and New Zealand*). Similarly, we expect the Bank of Canada gradually to move policy away from its emergency setting, even in the face of somewhat slower growth, and stay short in Canada versus the US.

European peripherals underperformed last week, led once again by Ireland and Portugal. Peripheral bonds have three potential supports. The first and most important is a narrowing of fiscal deficits, but this will take time, and Portugal for one appears to be falling behind its targets. The second is the prospect of support from the EU and IMF. Yet even though Greece has secured funding for the next three years, its 2-year yields are still at 9%, indicating that the market remains skeptical that EU/IMF support removes default risk. The third is the potential for more aggressive ECB buying, though the central bank's purchases have now been below €400 million for 10 weeks in a row. Thus we stay neutral overall on peripherals, even at these wide spreads, while **looking for short-dated Greek paper to continue its recent rally, and for Spanish spreads to drift wider into supply**.

Equities

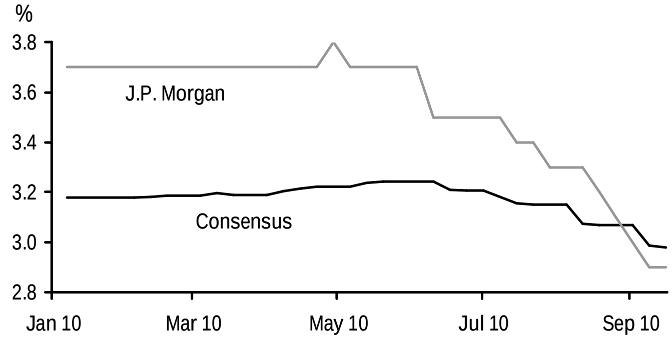
Equities rose for a fourth straight week on dovish central bank comments and slightly better economic data. Our **US Economic Activity Surprise Index** (EASI), which tends to correlate well with equities and tracks data surprises over a six-week rolling window, has risen to zero after spending almost three months in negative territory.

Equity fund flows continued to be positive for a third straight week driven once again by ETFs. In contrast, funds continue to flow out of non-exchange-traded equity mutual funds. As explained last week, this suggests that it was mostly hedge funds rather than retail investors behind this month's rally. The still low level of their 21-day rolling equity beta suggests that macro hedge funds are still far from fully covering their shorts in equities.

Equity prices have been above the important technical level of 200-day moving averages for two straight weeks, longer than the one week in early August. The longer equity prices stay above the 200-day moving average, the more likely it becomes that momentum-driven investors will chase the equity rally.

The 3Q reporting season is set to kick off in two weeks. **Pre-announcements and guidance so far have been more negative compared to 2Q.** Negative pre-announcements are running at 59% of total, compared with 50% for the 2Q reporting season and 55% for 1Q. Negative pre-announcements and guidance were concentrated in Cyclical sectors,

2011 global GDP growth forecasts: J.P. Morgan versus consensus



especially the Technology sector. We are thus reluctant to chase the recent rally in Technology stocks and prefer to focus our sectoral exposure on Banks.

Overall, negative earnings pre-announcements point to **a worse EPS outcome in 3Q relative to 2Q**, but this is **largely priced in**. Bottom-up projections for 3Q S&P 500 EPS show a large 4% drop from 2Q, a magnitude only seen during past financial crises or recessions.

Across regions, we continue to focus our exposure on EM. Indeed, **EM equities resumed their outperformance in September**. Our EM vs. DM equity allocation model favours an EM overweight, as both 2-month return momentum and relative IP growth (i.e., the difference between the oya rates in EM IP vs. DM IP) are supportive. See The *EM vs Developed Markets equity allocation*, Koo and Panigirtzoglou, April 2009, for details.

Credit

Corporates bonds were up on the week in price terms, but spreads have lagged the equity rally due to the rapid fall in government yields. Unlike equities, credit does not benefit from a short base, with most managers being overweight. Near term, this benefits equities over credit, despite our preference for credit in a low-growth world.

Our medium strategy is to be **long credit**, but to be selective, favouring sectors and regions least vulnerable to a slow growth environment. This means **favouring EM over DM, corporate over sovereign, and US over Europe**.

Foreign exchange

We published several forecast changes in Wednesday's *World Financial Markets*, and in view of the Fed's imminent re-launch of large-scale asset purchases. **EUR/USD still looks to be in a range**, though we move the midpoint from

1.25, where we set it during the last round of forecast revisions in May, to 1.30. As the major reserve currency alternative to the dollar, **the euro would benefit unambiguously from Fed QE were it not for Europe's growth slowdown in 4Q, an event that could revive sovereign stress**. This upgrade to EUR/USD's forecast also lifts the GBP/USD range from a previous low 1.40s to the high 1.40s. The outlook for EUR/GBP is unchanged, however. We still expect the cross to reach 0.87 by end-2010 and 0.88 by 1Q11.

Commodity currency forecasts are raised through year-end. We had expected these currencies to slump in 4Q10 as the global economy downshifted, but Asia has stabilized more quickly than expected and Chinese data are showing some signs of reacceleration. AUD, NZD, and CAD should, therefore, range around current levels in 4Q before trending higher in 2011 on the back of further rate rises. The **USD/JPY forecast for a new all-time low at 79 by December 2010 is unchanged**, even in the face of intervention risks.

The signal from the Fed that further QE is required is not just the message that inflationary pressures remain weak but that US growth momentum is stalling. Though a further suppression in US yields and added monetary stimulus by the Fed should be broadly negative for USD versus all major currencies, stalling growth is likely to see some disparity between the performance of high-beta currencies such as NZD, which are likely to underperform, and defensive currencies such as CHF and JPY, which should continue to outperform. This week we are moving to a more defensive stance, adding further **short USD exposure (vs. CHF) while extending CHF longs (vs. NZD, GBP, and EUR)**.

With the Fed having shown its hand, we expect that the BoE will be the next central bank to pull the trigger on QE2 in the months ahead. A triumvirate of spending cuts, housing market slowdown, and further monetary stimulus provide the perfect storm for **sustained GBP downside**. Add GBP shorts vs. European currencies where fundamental divergences are starkest (NOK, CHF).

Commodities

Recent data show **a much stronger-than-expected increase in demand for crude oil in 3Q10**, driven almost entirely by emerging markets, particularly China. This coincides with the view from our economists that while demand growth is likely to remain at subdued levels, **the global manufacturing downshift is now over**, and with China's economy projected to expand by 8.6% next year, we expect demand to remain strong. These two developments, coupled with probable

Ten-year Government bond yields

	Current	Dec 10	Mar 11	Jun 11	Sep 11
United States	2.61	2.25	2.25	2.25	2.25
Euro area	2.34	2.15	2.20	2.30	2.30
United Kingdom	3.04	3.00	3.00	3.10	3.25
Japan	1.00	0.80	0.80	0.90	0.95
GBI-EM	6.33	7.90			

Credit markets

	Current	YTD Return
US high grade (bp over UST)	165	10.3%
Euro high grade (bp over Euro gov)	170	5.2%
USD high yield (bp vs. UST)	669	10.7%
Euro high yield (bp over Euro gov)	629	11.7%
EMBIG (bp vs. UST)	306	12.7%
EM Corporates (bp vs. UST)	351	12.5%

Foreign exchange

	Current	Dec 10	Mar 11	Jun 11	Sep 11
EUR/USD	1.35	1.30	1.30	1.30	1.30
USD/JPY	84.4	79	81	83	85
GBP/USD	1.58	1.49	1.48	1.48	1.49

Commodities - quarterly average

	Current	10Q4	11Q1	11Q2	11Q3
WTI ($/bbl)	76	75	75	77	80
Gold ($/oz)	1297	1275	1250	1250	1250
Copper($/m ton)	7883	6750	6750	7000	6800
Corn ($/Bu)	5.22	5.25	5.30	5.15	5.10

Source: J.P. Morgan, Bloomberg, Datastream

further weakness in the dollar following on from an expected second round of QE, lead us to revise up our oil price forecast from an average price of $75 in 4Q to $81. As such, **we move from neutral to outright long crude oil**.

We have been underweight base metals for over a month, as we expected a dramatic slowdown in global industrial growth to translate into a slowdown in demand for raw materials like metals. This slower demand growth has not materialized and with the manufacturing slowdown now over and Chinese demand growth stabilizing at healthy levels, we see a more balanced supply and demand picture. As a result, **we turn neutral base metals**.

It is tempting to jump on the current rally in gold as momentum and flows are clearly supportive. However, gold supply appears healthy, and industrial and consumer demand has weakened this year while buying by ETFs has increased to account for almost 30% of global demand, raising the tail risk that a change in investor attitudes could cause a significant correction in gold prices. As such, we prefer not to chase this rally, and **we remain neutral gold**.

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Global Economic Outlook Summary

	Real GDP % over a year ago			Real GDP % over previous period, saar							Consumer prices % over a year ago			
	2009	2010	2011	1Q10	2Q10	3Q10	4Q10	1Q11	2Q11	3Q11	2Q10	4Q10	2Q11	4Q11
The Americas														
United States	-2.6	2.6	2.4	3.7	1.6	1.5	2.0	2.5	2.5	3.0	1.8	0.9	1.2	1.1
Canada	-2.5	3.1	2.2	5.8	2.0	2.2	2.0	2.3	2.0	2.4	1.4	1.9 ↓	2.1	2.1
Latin America	-2.4	5.7 ↑	4.1 ↑	4.9 ↓	8.9 ↓	1.0 ↓	2.7 ↓	4.4 ↑	6.0 ↑	3.5	6.6 ↑	7.1	7.3	7.3
Argentina	-2.0	8.5	5.5 ↑	13.4 ↑	12.6 ↓	0.0 ↓	2.0 ↓	6.0 ↑	8.0 ↑	8.0	10.6 ↑	10.5 ↑	11.0	12.0
Brazil	-0.2	7.5	4.5	11.3	5.1	2.3	3.2	5.7	4.7	5.0	5.1	5.0	5.1	5.1
Chile	-1.5	5.5 ↑	6.0	-6.0	18.4	11.0 ↓	6.0 ↓	4.0 ↑	4.0 ↑	4.0	1.2	3.8	3.6 ↓	3.4 ↓
Colombia	0.8	4.5	4.1	3.3 ↓	3.9 ↓	3.7	4.0	4.0	4.1	5.0	2.1	2.8	3.3	4.0
Ecuador	0.4	2.0	3.0	1.3	3.5	4.0	4.5	3.0	2.5	2.5	3.3	3.9	4.1	3.9
Mexico	-6.5	4.5	3.5	-2.5	13.5	-3.6	3.1	2.9	9.2	-0.1	4.0	5.1	4.5	4.0
Peru	0.9	8.2	6.0	8.0	12.7	4.8	3.5	5.8	6.7	7.2	1.2	2.6	2.2	2.7
Venezuela	-3.3	-2.2	1.0	-2.0	5.2	3.0	-5.0	2.0	1.0	1.5	31.9	31.6	34.7	35.1
Asia/Pacific														
Japan	-5.2	3.0	1.1	5.0	1.5	2.5	-0.5	0.5	1.5	1.8	-0.9	-0.7	0.1	-0.1
Australia	1.2	3.1	3.2	2.7	4.9	2.4	2.8	3.1	4.0	3.0	3.1	3.3	3.8	3.4
New Zealand	-1.7	2.0 ↓	2.8 ↓	2.2 ↓	0.7 ↓	2.5 ↓	2.5 ↓	2.6 ↓	3.1 ↓	4.2 ↑	1.8	4.9	5.6	3.2
Asia ex Japan	5.6	8.7	7.0	10.5	7.4	5.5	6.4	7.4	7.3	7.5	4.5	4.1 ↓	3.9 ↓	3.9
China	9.1	9.8	8.6	10.8	7.2	7.5	8.1	9.1	8.9	9.1	2.9	2.8	2.7	2.6
Hong Kong	-2.8	6.6	4.1	8.7	5.7	3.0	3.5	4.2	4.3	4.7	2.6	2.5	2.2	2.4
India	7.4	8.3	8.5	9.2	8.5	8.0	8.9	8.0	8.5	8.6	13.7	11.0	10.1	10.2
Indonesia	4.5	6.0	5.4	3.0	7.5	4.5	5.0	5.3	5.2	5.0	4.4	6.8	6.6	4.8
Korea	0.2	6.1	4.0	8.8	5.8	2.5	3.8	4.0	4.0	4.5	2.6	2.9 ↓	3.4 ↓	3.4 ↑
Malaysia	-1.2	7.2	4.6	4.8	7.2	3.0	3.5	4.9	4.9	4.5	1.6	1.1	1.3	2.4
Philippines	1.1	7.0	3.9	11.9	7.7	0.8	1.6	4.9	4.9	4.9	4.2	1.8	1.5	3.5
Singapore	-1.3	14.8	4.2	45.7	24.0	-11.5	-2.0	8.7	6.6	7.4	3.1	3.0	1.4	1.6
Taiwan	-1.9	9.9	4.1	10.9	7.2	1.5	2.3	4.2	4.6	5.5	1.1	2.0	1.8	1.7
Thailand	-2.2	8.5	5.0	13.9	0.6	2.8	2.8	6.0	5.5	4.0	3.2	1.1	1.5	1.8
Africa/Middle East														
Israel	0.8	3.5	4.5	3.8	4.6	3.0	3.0	4.0	5.0	5.5	2.8	2.6	3.0	2.8
South Africa	-1.8	2.9	3.1	4.6	3.2	3.1	3.2	3.1	3.1	3.4	4.5	4.5	4.7	5.9
Europe														
Euro area	-4.0	1.7	1.5	1.3	3.9	2.0	1.0	1.0	1.0	1.8	1.5	1.7	1.1	1.0
Germany	-4.7	3.3	2.4	1.9	9.0	3.0	2.0	2.0	1.5	2.0	1.0	1.2	0.6	0.7
France	-2.5	1.6	1.5 ↑	0.7	2.8 ↑	2.0	1.5	1.0	1.0	1.5	1.8	1.3	0.7	1.1
Italy	-5.1	1.2 ↑	1.3	1.7 ↑	1.8 ↑	2.0	1.0	1.0	1.0	1.5	1.6	1.7	1.4	1.5
Norway	-1.2	1.5	2.3	0.7	1.9	3.0	2.5	2.0	2.0	2.5	2.6	2.1	1.3	1.3
Sweden	-5.1	4.5	3.1	6.0	8.0	4.5	3.0	2.3	2.3	2.8	1.0	1.5	1.6	1.8
Switzerland	-1.9	2.9	2.0	4.2	3.5	2.5	2.0	1.5	1.5	2.3	1.0	0.4	0.1	0.7
United Kingdom	-4.9	1.7	2.2	1.3	4.9	2.5	1.5	1.0	2.5	3.0	3.5	2.6	1.9	2.1
Emerging Europe	-5.3	3.9	4.2	2.7	3.8	2.4	3.8	3.9	4.2	4.6	5.7	6.4	6.5	5.6
Bulgaria	-5.0	-0.5	4.0	...	...	...	...	...	...	...	...	...	...	...
Czech Republic	-4.1	2.0	3.2	1.5	3.8	2.5	2.3	2.5	3.0	5.0	1.2	2.8	2.7	2.6
Hungary	-6.3	1.0	2.8	2.4	0.0	2.0	2.0	2.0	3.0	3.5	5.4	4.4	3.4	3.6
Poland	1.7 ↓	3.5	3.8	2.8	4.5	3.5	3.5	3.0	3.5	4.0	2.3	2.6	2.7	2.9
Romania	-7.1	-2.0	1.5	...	...	...	...	...	...	...	4.4	8.0	7.2	4.0
Russia	-7.9	4.3	4.7	3.3	4.3	2.5	5.0	5.0	5.0	5.0	5.9	7.6	8.4	7.1
Turkey	-4.7	6.4	4.7	...	...	...	...	...	...	...	9.2	7.5	7.0	6.2
Global	-2.2	3.6	2.9	4.2	3.9	2.5	2.3	2.8	3.1 ↑	3.3	2.5	2.3	2.3	2.2
Developed markets	-3.5	2.3	1.9	3.0	2.8	2.0	1.4	1.6	1.9	2.4	1.5	1.2	1.2	1.1
Emerging markets	1.3	6.9	5.7	7.7	7.1	3.8 ↓	5.0 ↓	6.0 ↑	6.4 ↑	5.9	5.2	5.3	5.2 ↓	5.1
Memo:														
Global — PPP weighted	-0.8	4.5	3.8	5.2	4.6 ↓	3.1	3.2	3.8 ↑	4.0	4.2	3.2	3.0	3.0	2.9

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Global Central Bank Watch

	Official interest rate	Current	Change from Aug '07 (bp)	Last change	Next meeting	Forecast next change	Sep 10	Dec 10	Mar 11	Jun 11	Sep 11
Global	GDP-weighted average	1.76	-319				1.77	1.82	1.87	1.94	1.98
excluding US	GDP-weighted average	2.40	-241				2.40	2.47	2.54	2.64	2.70
Developed	GDP-weighted average	0.61	-358				0.61	0.63	0.65	0.67	0.69
Emerging	GDP-weighted average	4.99	-211				5.00	5.14	5.29	5.51	5.59
Latin America	GDP-weighted average	7.22	-218				7.22	7.31	7.80	8.38	8.42
CEEMEA	GDP-weighted average	4.07	-295				4.08	4.10	4.11	4.17	4.36
EM Asia	GDP-weighted average	4.54	-171				4.55	4.76	4.84	5.00	5.05
The Americas	GDP-weighted average	1.28	-453				1.28	1.31	1.40	1.51	1.54
United States	Federal funds rate	0.125	-512.5	16 Dec 08 (-87.5bp)	3 Nov 10	On hold	0.125	0.125	0.125	0.125	0.125
Canada	Overnight funding rate	1.00	-325	8 Sep 10 (+25bp)	19 Oct 10	19 Oct 10 (+25bp)	1.00	1.25	1.50	1.75	2.00
Brazil	SELIC overnight rate	10.75	-125	21 Jul 10 (+50bp)	20 Oct 10	Jan 11 (+25bp)	10.75	10.75	11.50	12.50	12.50
Mexico	Repo rate	4.50	-270	17 Jul 09 (-25bp)	15 Oct 10	On hold	4.50	4.50	4.50	4.50	4.50
Chile	Discount rate	2.50	-250	16 Sep 10 (+50bp)	14 Oct 10	16 Sep 10 (+50bp)	2.50	3.25	4.00	4.50	4.50
Colombia	Repo rate	3.00	-600	30 Apr 10 (-50bp)	24 Sep 10	1Q 11 (+50bp)	3.00	3.00	4.00	5.00	5.50
Peru	Reference rate	3.00	-150	9 Sep 10 (+50bp)	7 Oct 10	4Q 10 (+50bp)	3.00	4.00	4.50	4.50	4.50
Europe/Africa	GDP-weighted average	1.44	-322				1.44	1.45	1.46	1.47	1.52
Euro area	Refi rate	1.00	-300	7 May 09 (-25bp)	7 Oct 10	On hold	1.00	1.00	1.00	1.00	1.00
United Kingdom	Repo rate	0.50	-500	5 Mar 09 (-50bp)	7 Oct 10	On hold	0.50	0.50	0.50	0.50	0.50
Sweden	Repo rate	0.75	-275	2 Sep 10 (+25bp)	26 Oct 10	26 Oct 10 (+25bp)	0.75	1.25	1.25	1.25	1.50
Norway	Deposit rate	2.00	-250	5 May 10 (+25bp)	27 Oct 10	3Q 11 (+25bp)	2.00	2.00	2.00	2.00	2.25
Czech Republic	2-week repo rate	0.75	-200	6 May 10 (-25bp)	4 Nov 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)	27 Sep 10	3Q 11 (+25bp)	5.25	5.25	5.25	5.25	5.50
Israel	Base rate	1.75	-225	26 Jul 10 (+25bp)	27 Sep 10	27 Sep 10 (+25bp)	2.00	2.25	2.50	2.75	3.25
Poland	7-day intervention rate	3.50	-100	24 Jun 09 (-25bp)	29 Sep 10	2Q 11 (+25bp)	3.50	3.50	3.50	3.75	4.00
Romania	Base rate	6.25	-75	4 May 10 (-25bp)	29 Sep 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)	Sep 10	3Q 11 (+25bp)	2.75	2.75	2.75	2.75	3.00
South Africa	Repo rate	6.00	-350	9 Sep 10 (-50bp)	18 Nov 10	On hold	6.00	6.00	6.00	6.00	6.00
Switzerland	3-month Swiss Libor	0.25	-225	12 Mar 09 (-25bp)	4Q 10	Jun 11 (+25bp)	0.25	0.25	0.25	0.50	0.75
Turkey	1-week repo rate	7.00	-1050	-	14 Oct 10	4Q 11 (+50bp)	7.00	7.00	7.00	7.00	7.00
Asia/Pacific	GDP-weighted average	2.92	-128				2.92	3.06	3.12	3.23	3.27
Australia	Cash rate	4.50	-175	4 May 10 (+25bp)	5 Oct 10	**5 Oct 10 (+25bp)**	4.50	4.75	5.00	5.25	5.50
New Zealand	Cash rate	3.00	-500	29 Jul 10 (+25bp)	27 Oct 10	**10 Mar 11 (+25bp)**	3.00	3.00	3.25	3.50	3.75
Japan	Overnight call rate	0.10	-43	19 Dec 08 (-20bp)	5 Oct 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)	4 Nov 10	On hold	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)	14 Oct 10	4Q 10 (+25bp)	2.25	2.50	2.75	2.75	2.75
Indonesia	BI rate	6.50	-200	5 Aug 09 (-25bp)	5 Oct 10	2Q 11 (+25bp)	6.50	6.50	6.50	6.75	6.75
India	Repo rate	6.00	-175	16 Sep 10 (+25bp)	2 Nov 10	4Q 10 (+25bp)	6.00	6.25	6.50	6.50	6.75
Malaysia	Overnight policy rate	2.75	-75	8 Jul 10 (+25bp)	12 Nov 10	On hold	2.75	2.75	2.75	2.75	2.75
Philippines	Reverse repo rate	4.00	-350	9 Jul 09 (-25bp)	7 Oct 10	1Q 11 (+25bp)	4.00	4.00	4.25	4.75	5.00
Thailand	1-day repo rate	1.75	-150	26 Aug 10 (+25bp)	20 Oct 10	20 Oct 10 (+25bp)	1.75	2.00	2.00	2.00	2.00
Taiwan	Official discount rate	1.375	-175	24 Jun 10 (+12.5bp)	30 Sep 10	30 Sep 10 (+12.5bp)	1.50	1.50	1.50	1.50	1.625

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

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Economic forecasts - Australia

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

				2009			2010				2011			
	2009	2010	2011	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Chain volume GDP	1.2	3.1	3.2	2.2	1.3	4.2	2.7	4.9	2.4	2.8	3.1	4.0	3.0	3.4
Private consumption	1.7	3.2	2.4	5.2	1.3	3.3	1.9	6.5	2.4	1.6	2.0	1.6	2.8	3.2
Construction investment	-0.5	2.3	4.7	-3.7	2.4	2.6	-3.1	9.9	3.6	5.3	5.1	2.1	5.2	5.5
Equipment investment	-6.6	-0.9	7.9	-18.0	-5.9	60.3	-26.0	-12.0	13.0	13.0	8.7	6.4	6.4	8.6
Public investment	4.4	32.5	8.9	13.3	43.9	40.6	81.2	0.1	10.2	10.9	7.0	12.4	7.1	10.1
Government consumption	2.8	5.2	4.3	3.2	5.4	7.7	4.8	7.2	2.0	2.0	4.5	8.0	4.3	0.8
Exports of goods & services	0.9	4.6	4.4	4.5	-9.2	9.7	-2.8	24.2	1.6	2.0	4.1	4.1	3.6	3.2
Imports of goods & services	-8.3	13.1	6.2	0.3	18.8	32.7	6.6	12.8	6.1	5.7	6.1	4.1	7.4	5.7
Contributions to GDP growth:														
Inventories	-0.5	-0.5	-1.0	0.7	2.8	0.8	1.4	-2.9	-5.9	-0.1	-0.2	0.1	-0.2	-0.1
Net trade	2.0	-1.8	-0.5	0.8	-5.2	-4.1	-1.9	1.7	-1.0	-0.9	-0.6	-0.1	-0.9	-0.6
GDP deflator (%oya)	0.3	5.0	2.9	0.1	-1.9	-1.3	2.0	6.6	6.0	5.5	4.2	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	2.5	3.8	-6.4	-7.2	-6.8	-0.2	2.5	2.3	5.2	3.7	3.5	4.0	4.0
Trade balance (A$ bil, sa)	-6.8	20.2	16.7	-0.9	-4.1	-4.9	-2.7	7.4	8.7	6.8	4.5	3.6	4.2	4.5
Current account (A$ bil, sa)	-51.4	-24.3	-40.8	-13.8	-14.6	-19.3	-16.5	-5.6	4.7	-7.0	-9.5	-10.6	-10.4	-10.3
as % of GDP	-4.1	-1.8	-2.8	-4.4	-4.7	-6.0	-5.0	-1.7	1.4	-2.0	-2.7	-3.0	-2.8	-2.8
3m eurodeposit rate (%)*	6.0	4.6	5.3	3.5	3.4	4.1	4.3	4.8	4.8	4.8	5.0	5.3	5.5	5.5
10-year bond yield (%)*	5.6	5.3	5.2	5.5	5.1	5.8	5.6	5.5	5.2	5.0	5.2	5.3	5.2	5.3
US$/A$*	0.75	0.92	0.98	0.82	0.88	0.91	0.94	0.84	0.96	0.93	0.95	0.99	1.01	0.98
Commonwealth budget (FY, A$ bil)	-27.0	-51.0	-32.0											
as % of GDP	-2.1	-3.7	-2.2											
Unemployment rate	5.6	5.3	5.0	5.7	5.8	5.6	5.3	5.2	5.2	5.1	5.0	5.0	4.9	4.8
Industrial production	-7.9	4.8	1.5	5.3	-3.8	21.3	4.6	2.0	-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. GDP expanded at a rapid clip in 2Q, with households leading the way.
- **Business investment** probably will rise strongly in 2010-11, with mining leading the way, particularly with the mining tax roadblock being "dismantled". There will be an even bigger rise in 2011-12.
- 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. The index rebounded in July and August, but fell in September. Optimists, though, 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, but then paused. We now forecast a rate hike at the October Board meeting, and a further four hikes during 2011.
- The **Labor government** has been "reelected," even though it secured a smaller share of the headline vote and won fewer seats in the Lower House. A fragile government kept in place by independents risks delivering policy timidity.

Economic forecasts - New Zealand

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

	2009	2010	2011	2009 Q2	2009 Q3	2009 Q4	2010 Q1	2010 Q2	2010 Q3	2010 Q4	2011 Q1	2011 Q2	2011 Q3	2011 Q4
Real GDP (1995-96 prices)	-1.7	2.0	2.8	0.6	0.9	4.0	2.2	0.7	2.5	2.5	2.6	3.1	4.2	2.8
Private consumption	-0.7	1.9	1.3	1.1	3.8	3.7	1.7	0.3	1.2	0.2	1.0	2.0	2.5	3.0
Fixed Investment	-13.3	3.8	6.2	0.7	-9.8	-1.6	0.5	27.1	3.5	4.0	5.1	5.6	6.4	6.3
Residential construction	-18.4	11.4	7.2	-12.9	-13.3	20.7	5.8	52.2	2.8	4.0	4.8	5.6	6.4	5.6
Other fixed investment	-12.2	2.4	6.0	3.6	-9	-5.5	-0.5	22.4	3.6	4.0	5.2	5.6	6.4	6.4
Inventory change (NZ$ bil, saar)	-1.9	-0.8	0.4	-1.0	-0.7	0.1	0.1	-0.5	-0.3	-0.1	0.1	0.1	0.2	0.1
Government spending	1.5	3.2	2.0	-3.9	1.8	4.3	7.0	2.2	1.6	1.6	2.0	2.8	2.4	0.8
Exports of goods & services	0.4	3.8	4.7	16.5	2.7	-1.8	5.0	5.5	3.0	3.0	4.0	6.0	7.0	7.0
Imports of goods & services	-15.1	8.2	6.7	-10.2	5.8	25.1	6.8	2.5	9.0	8.0	6.0	7.0	6.0	6.0
Contributions to GDP growth:														
Domestic final sales	-5.1	2.8	2.7	0.1	-1.4	2.0	3.8	7.0	1.8	1.3	2.2	3.1	3.5	3.5
Inventories	-2.6	0.8	0.9	-7.7	3.3	10.5	-0.9	-6.8	2.8	3.0	1.2	0.6	0.6	-0.8
Net trade	5.9	-1.5	-0.8	8.7	-1.0	-7.9	-0.7	0.9	-2.1	-1.8	-0.8	-0.5	0.1	0.1
GDP deflator (%oya)	2.0	2.7	2.3	3.2	2.3	0.2	1.0	2.3	3.4	4.1	3.2	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)	2.3	5.3	5.1	0.7	0.6	0.3	0.9	1.2	1.5	1.6	1.4	1.3	1.2	1.2
Current account (NZ$ bil, sa)	-5.3	-5.8	-12.0	-0.6	0.1	-2.8	-1.2	-1.3	-1.8	-0.6	-2.1	-5.2	-3.6	-3.5
as % of GDP	-3.0	-3.1	-6.1	-1.3	0.2	-6.2	-2.7	-3.9	-1.3	-4.5	-7.4	-7.2	-5.5	-4.3
Yield on 90-day bank bill (%)*	3.0	3.1	4.1	2.8	2.8	2.8	2.7	2.9	3.3	3.5	3.8	4.0	4.3	4.3
10-year bond yield (%)*	5.5	5.5	4.9	5.7	5.7	5.9	5.9	5.7	5.3	5.1	5.1	4.9	4.8	4.8
US$/NZ$*	0.64	0.71	0.75	0.60	0.68	0.73	0.71	0.70	0.70	0.71	0.72	0.76	0.77	0.74
Commonwealth budget (NZ$ bil)	-4.0	-7.2	-7.1											
as % of GDP	-2.2	-3.8	-3.6											
Unemployment rate	6.1	6.5	5.8	5.9	6.5	7.1	6.0	6.8	6.7	6.4	6.0	5.9	5.7	5.7

*All financial variables are period averages

New Zealand - summary of main macro views

- The **New Zealand economy** expanded just 0.2%q/q in 2Q, compared to 0.5% in 1Q. The slowdown mainly owed to a sharp drop in manufacturing, which coincided with an unanticipated run-down of inventories, and a flat read on household consumption**.**
- The devastating **earthquake** will have a negative, near-term impact on activity. We estimate that it will knock 0.2%-points off 3Q GDP growth as consumer and business sentiment take a hit, employees are left unable to work, and consumer spending is reined in further.
- The **unemployment** rate shot up to 6.8% in 2Q from 6.0% in 1Q, and probably will maintain a 6%-handle in the foreseeable future. Actual hiring remains well-below long run averages and, with corporate profitability down, new hiring will likely be postponed.
- The **RBNZ** left the OCR unchanged in September and delivered a more downbeat assessment of the economy, owing mainly to the weakness on the domestic front. We expect the next rate hike to be delivered in March.
- 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. Two-year inflation expectations recently fell in 3Q, however, with respondents expecting inflation in two-years' time to average 2.6%oya.

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Australia and New Zealand economic calendar

Monday	Tuesday	Wednesday	Thursday	Friday
27 Sep	28 Sep	29 Sep New Zealand: Trade balance (10:45 am) Aug -100NZ$mn	30 Sep Australia: Private sector credit (11:30 am) Aug 0.2%m/m,sa Building approvals (11:30 am) Aug 2.5%m/m, sa New Zealand: Building permits (11:30 am) Aug 2.0%m/m, sa NBNZ business confidence (2:00 pm) 9.0 Index, nsa	1 Oct
4 Oct New Zealand: ANZ commodity prices Sep NZIER business opinion survey 3Q *Holiday Australia*	5 Oct Australia: ANZ job ads. (10:30 am) Sep NAB business confidence Sep Retail sales (10:30 am) Aug RBA cash target (1:30 pm)Oct	6 Oct	7 Oct Australia: Unemployment rate (10:30 am) Sep	8 Oct
11 Oct Australia: Housing finance (11:30 am) Aug New Zealand: QV house prices Sep	12 Oct	13 Oct Australia: Westpac consumer confidence (10:30 am) Oct	14 Oct New Zealand: Retail sales (10:45 am) Aug Business NZ PMI Sep	15 Oct
18 Oct New Zealand: CPI (10:45 am) 2Q	19 Oct	20 Oct Australia: Westpac leading index (10:30 am) Aug	21 Oct New Zealand: Credit card spending (2:00 pm) Sep	22 Oct

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Global Data Diary

Week / Weekend	Monday	Tuesday	Wednesday	Thursday	Friday
27 Sep - 1 Oct	27 September	28 September	29 September	30 September	1 October
Russia • CBR mtg: no chg • CPI (Sep)	Euro area • Trichet speech Hungary • HNB mtg: no chg Israel • BoI mtg: +25bps Japan • Trade bal (Aug) • Shirakawa speech United States • Dallas Fed surv (Sep)	Germany • CPI prelim (Sep) • GfK cons conf (Oct) Italy • ISAE cons conf (Sep) Japan • Shoko Chukin surv (Sep) United Kingdom • GDP final (2Q) United States • C-S HPI (Jul) • CB cons conf (Sep) • Richmond Fed surv (Sep)	Euro area • EC bus conf (Sep) • EC cons conf final (Sep) France • INSEE cons conf (Sep) Italy • ISAE bus conf (Sep) Japan • BoJ Tankan (3Q) Poland • NBP mtg: no chg Romania • BNR mtg: no chg United Kingdom • Mortgage approvals (Aug)	Euro area • HICP flash (Sep) Germany • Labor mkt reprt (Aug/Sep) Japan • PMI mfg (Sep) • Retail sales (Aug) • IP prelim (Aug) Taiwan • CBC mtg: +12.5bps United Kingdom • GfK cons conf (Sep) United States • GDP 3rd print (2Q) • KC Fed surv (Sep)	Euro area • Unemployment rate (Aug) Germany • Retail sales (Aug) Japan • Unemployment rate (Aug) • Core CPI (Aug) • Auto regs (Sep) United States • Personal income (Aug) • UMich cons conf fin (Sep) • Auto sales (Sep) Global • Mfg PMIs (Sep)
4 - 8 October	4 October	5 October	6 October	7 October	8 October
Japan • Cabinet Office private consumption index (Aug)	Turkey • CPI (Sep) United States • Pending homes sales (Aug) • Factory orders (Aug)	Australia • NAB bus conf (Sep) • RBA mtg: +25bps Euro area • Retail sales (Aug) Indonesia • BI mtg: no chg Japan • BoJ MPM: no chg Global • Services PMIs (Sep)	Brazil • Auto sales (Sep) Euro area • GDP final (2Q) Germany • Mfg orders (Aug) United Kingdom • Auto regs (Sep) United States • ADP employment (Sep)	Australia • Unemployment rate (Sep) Brazil: CPI (Sep) Euro area • ECB mtg: no chg Germany: IP (Aug) Peru: BCRP mtg: no chg Philippines • BSP mtg: no chg Taiwan: Exports (Sep) United Kingdom • MPC mtg: no chg • IP (Aug)	Canada • Employment (Sep) Germany • Foreign trade (Aug) Japan • Eco Watchers sur (Sep) • MPM mins (Aug/Sep) Netherlands • IP (Aug) Sweden • IP (Aug) Turkey • IP (Aug) United States • Employment (Sep)

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