JPMorgan

Australia and New Zealand - Weekly Prospects

Summary

- In last week's commentary, the **RBA** indicated that the tightening bias remains in place, even after accounting for the likely impact of the intensification of financial market turbulence. We retain our call for a December tightening, even with the Fed now expected to ease, but this is conditional on markets stabilising and the spillover to the real economy being contained. One factor that could keep the RBA sidelined later this year, though, is the disproportionate rise in mortgage rates since the RBA's rate hike, which is doing some of the heavy lifting for the RBA. It is too early to tell, however, where market rates will settle relative to cash. That said, last week's sharp drop in the AUD means the RBA could have an even bigger inflation problem. After last week's frenzied activity, this week looks sleepy, with only the leading index and vehicle sales to trouble the scorers.

- In what will be a quiet week for data, second tier releases on credit card spending and July's trade balance nevertheless will provide valuable insight on the underlying forces brewing in **New Zealand**. Last week's 2Q retail trade report posted its weakest outcome since 3Q97, ahead of the last recession. The report prompted a slight downgrade to the 2Q GDP forecast from 0.5%q/q to 0.4%. Consumption growth over 2Q is likely to have contracted 0.3%q/q. RBNZ officials tried to calm frayed nerves last week by stating there is enough cash in the system and that markets are functioning adequately.

- We have lowered the **US growth forecast** and now expect the **Fed** to ease in September. Friday's FOMC statement represents an important shift in central bankers' response to recent market developments. The previous week, the Fed maintained a sanguine view of the outlook, stating, "the Committee's predominant policy concern remains the risk that inflation will fail to moderate as expected." This has been replaced by the message, "[the Committee] judges that the downside risks to growth have increased appreciably. The Committee is monitoring the situation and is prepared to act as needed to mitigate the adverse effects on the economy arising from the disruptions in financial markets." By shifting its bias and suggesting that there will be adverse effects, it is signalling a change to its growth forecast that will prompt an ease at the September 18 FOMC meeting.

- The US GDP growth forecast has been revised down modestly—to 2.25%q/q, saar for the next two quarters on average—with a Fed ease and a healthy corporate sector enabling the economy to absorb much of this drag. Growth then is expected to rebound, with the Fed expected to take back rate cuts around the middle of next year. We have pushed out the expected tightenings by the **Bank of Japan** and the **ECB** to September and December, respectively, and decided that the **Bank of England** will leave the cash rate unchanged throughout 2008. We now expect the **Bank of Canada** to ease policy in October but, in line with the Fed, to start taking back this ease in 2008.

This week's highlight

The highlight most likely will be somewhere else, like global credit and currency markets. There is little data to be released in Australia or New Zealand, so attention probably will be drawn to the markets to see if conditions have stabilised.

Contents

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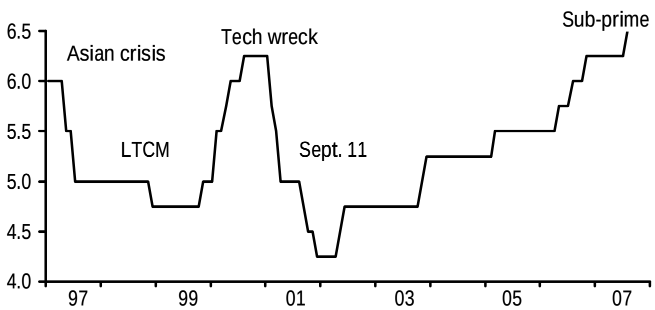
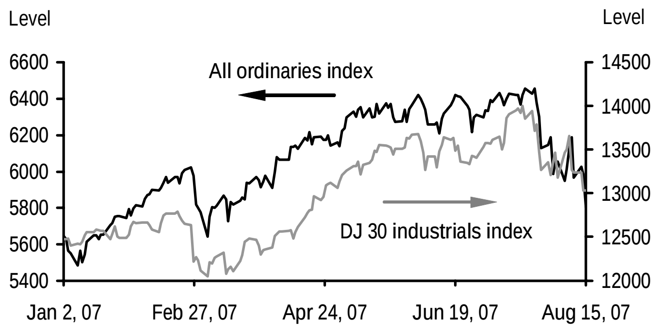
This week's feature charts

RBA cash target rate - Australia
percent per annum, end of period



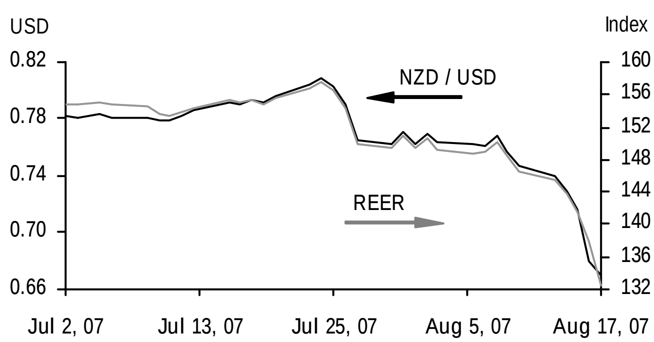
The RBA has cut interest rates around previous events that have shocked financial markets, like LTCM, September 11, the Asian crisis and the 'tech wreck'. For the most part, though, the RBA already had embarked on an easing cycle ahead of the 'event'. This time, RBA Governor Glenn Stevens has indicated that he cannot even contemplate cutting interest rates, even if the US Fed eases. This underscores how closely to full employment RBA officials believe the economy is sailing.

Australian stock market follows Wall Street south



The Australian All Ordinaries index fell to a five month nadir last week, following the lead of Wall Street. Amid credit market turmoil and persistent global financial market volatility, investors fled to the safer haven of government debt. Since mid-year, the Australian share market had shed nearly 8%, a decline sparked by the fallout from the US subprime 'crisis'. The RBA in its quarterly Statement on Monetary Policy last week signalled that it would watch market developments closely.

New Zealand currency



The dramatic fall in NZD over the past two weeks is reflective of both the current financial market turmoil and NZD's overvaluation. The elevated NZD recently was described by RBNZ Governor Bollard as unjustified and exceptionally high. The 'carry trade' unwind also is more dramatic in New Zealand compared to Australia, and explains the AUD/NZD cross hitting 1.20 on Friday, up from 1.09 three weeks ago.

Economic comment

Australian confidence around financial shocks

- **Consumer and business confidence usually fall in the months after a financial shock**
- **The fall in business confidence usually is more profound than for consumers**
- **The corporate sector, therefore, is the place to look for signs of distress in the real economy**

Most commentators agree that the latest instability in global financial markets is a 'crisis of confidence'. It was triggered by banks and mortgage providers finding it more difficult than usual to fund their operations in the interbank and short term commercial paper markets. The fall-out from the resulting re-pricing of risky assets now is cascading through credit, equity and FX markets as the contagion spreads.

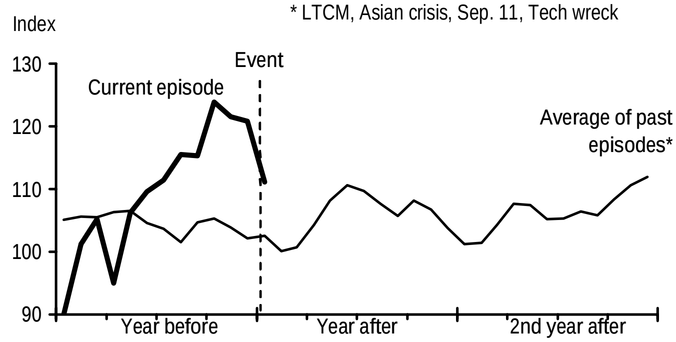
Financial institutions remain disinclined to hold their rivals' commercial paper, which normally is used as a source of short term financing between banks. This is because of fears of undisclosed exposure to the severe problems in the US sub-prime mortgage market and the securitized products backed by mortgage assets. Many increasingly nervous investors in the riskier markets are responding by heading for the exits.

Debate on impact on real economy

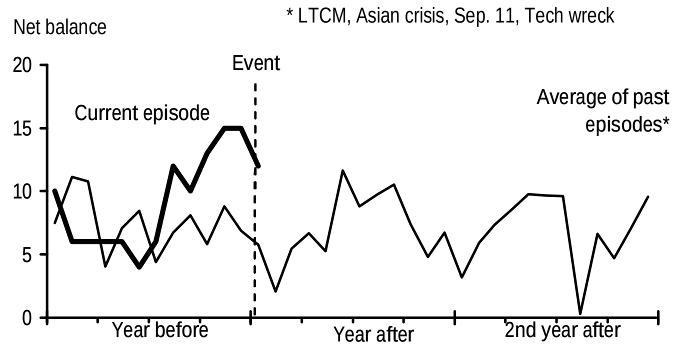
While there is widespread agreement that the negative impact on markets is substantial, there is an active debate about the extent to which this 'crisis' will affect the real economy. Thus far, comments from central bank officials indicate that while the various banks stand ready to pump even more liquidity into markets at risk of seizing up, they believe the spill-over to the real economy will be contained, although the risks have increased. In last week's quarterly statement, for example, the RBA indicated that while the financial market volatility poses increased downside risk to the US economy, it does not materially change the outlook for the global economy.

JPMorgan's key macro forecasts are broadly unchanged, although we have lowered US growth and the risks to growth elsewhere are skewed more to the downside. Also, central banks will be less likely to raise short term interest rates, despite compelling macro-economic arguments for tighter policy.

Consumer confidence



Business confidence



RBA officials have indicated that money markets in Australia are functioning normally and that the local financial system's exposure to poor quality mortgages is substantially smaller than in the US. In fact, in a vote of confidence for local markets and the economy, the RBA raised the cash rate 25bp earlier this month, and last week increased the bank's core inflation forecast, which signalled there is further policy tightening to come. Similarly, central banks in South Africa and Norway raised interest rates last week and, thus far, there is little evidence of financial market dysfunction. In recent days, though, the financial shock has spread from credit markets to equity, commodity and FX markets. The Australian share market has plunged and the AUD has dived against the USD, albeit from an 18-year high. Moreover, the pace of AUD decline has accelerated in recent days.

Increased risk of real economy impact

The spreading contagion across asset classes has increased the risk of this financial event developing into a material speed hump for the Australian economy. Indeed, the deterioration in household balance sheets as the equity market tumbles, and as punters anticipate falling house prices because of higher market interest rates and tightening credit standards, could materially change the behaviour of households and corporates. This change of behaviour, triggered by a loss of confidence, is the most likely transmission mechanism through which this financial event could spill over into the real economy.

Comparing earlier financial shocks

One rudimentary way of measuring the potential extent of the spill-over to the real economy is to look back at the behaviour of consumers and businesses during comparable financial events, like the Asian financial crisis from July 1997, the LTCM hedge fund event in August 1998, the meltdown of the high tech equity market in the US from March 2000, and the September 11 terrorist attacks on the US in 2001. We have examined measures of Australian consumer and business confidence (using the Westpac Melbourne Institute consumer confidence index and the NAB business survey) before, during, and after each of these events and compared them to the current episode. On average, these events triggered only a 2% fall in the consumer confidence index in the months following the event (the largest impact was immediately after September 11), but a sharper drop in the business confidence net balance of positive respondents from around 6 to 2.

Our conclusion is that while **consumer confidence** is likely to suffer in coming months, the fall probably will be mild. Indeed, the analysis above does not take account of the fact that consumers currently have never had it so good, with the jobless rate at a generational low and income growth accelerating. Also, judging by the rebound in the consumer confidence index within 3 months of past shocks, consumers probably will recover their nerve quickly this time. On this basis alone, therefore, there is unlikely to be a sustained dislocation in consumer-related activity in the real economy. Even 12 months after financial shocks, after what seems to be a second leg down in consumer confidence, there usually are more optimists than pessimists.

The fall in **business confidence** after a financial market shock, however, tends to be more profound. In fact, in the past, business confidence typically takes up to six months to regain the lost ground, but then loses it again over the subsequent six months. This hints that the corporate sector feels the pain of financial turmoil more acutely than households.

The corporate sector, therefore, may be the place to watch for signs of distress in the real economy. If corporates are feeling

Month	LTCM	Asian crisis	Tech wreck	Sep 11.
		Consumer confidence - index		
-3	103.5	102.2	107.9	107.5
-2	95.5	100.8	110.9	108.2
-1	100.1	101.9	101.5	105.2
Event	**101.2**	**98.9**	**101.3**	**109.0**
1	101.6	101.7	97.2	100.0
2	100.5	104.0	94.8	103.7
3	105.5	103.3	99.5	108.8
		Business confidence - net balance		
-3	1.8	na	6.6	9.0
-2	-2.5	12.4	8.7	16.5
-1	-4.0	9.2	9.0	13.3
Event	**-0.5**	**10.2**	**-2.9**	**16.2**
1	-3.2	14.4	6.8	-9.7
2	7.2	13.4	-0.6	1.9
3	11.1	17.3	-6.2	4.5

the pinch and finding it more difficult and more expensive to raise finance, for example, managers may be less inclined to hire staff and invest in additional capacity. A deterioration in hiring intentions and, eventually, household income, would be the most obvious transmission mechanism through which corporate pessimism could affect household behaviour.

Important differences this time

There are, however, important differences between the current episode and what has happened in the past. First, both consumer and business confidence currently are substantially higher than was the case before the previous episodes. This may indicate that these measures have much further to fall this time around but, also, it shows that households and businesses rarely have been in better shape than they are now—they appear to have the means to withstand this turmoil. Also, the global economy is much firmer now than at the time of the earlier financial market disruptions—this is why the soaring terms of trade is providing such huge support to Australian households and corporates.

One risk, though, is that households have become more financially savvy and sophisticated, and therefore are more aware of financial market developments. Also, a higher proportion of households are exposed to volatility in the equity market, either directly or through compulsory pension funds, so there is greater incentive for them to stay informed. This means that even if this market turmoil turns out to be smaller and less extended than previous market events, the impact on consumer and businesses could be more pronounced than previous experiences suggest is likely.

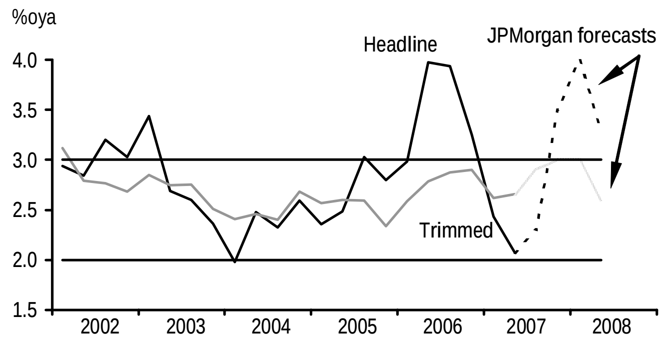
Australia

- **RBA statement unexpectedly raised core inflation forecast to 3.0%, from 2.75%**
- **Governor Stevens maintained a hawkish tone, despite financial market volatility**
- **Wage growth accelerated in 2Q, and should trend north**

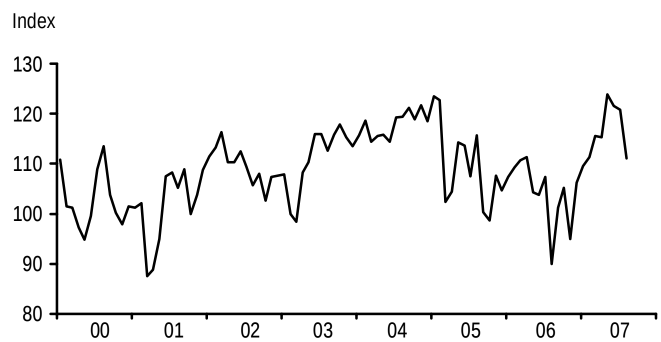
RBA verbiage dominated the Australian economic sphere last week. Last Monday, the RBA released its quarterly Statement on Monetary Policy, which raised the probability of a near-term tightening, with the RBA lifting its inflation forecast from 2.75% to 3.0% for the fiscal year ending June 2008. Then on Friday, the RBA Governor's semiannual testimony to Parliament refinforced the perception that the RBA's tightening bias remains in place.

Economic indicators, meanwhile, came through much in line with expectations, with consumer sentiment slumping in August in the wake of the RBA's interest rate rise, and wage growth accelerating mildly in 2Q amid persistently tight labour market conditions. This coming week's Australian schedule is light, with just the leading index and motor vehicle sales data listed for release.

Australia: headline and trimmed CPI



Australia: Westpac-Melbourne Consumer Sentiment Index



RBA Governor maintained hawkish tone

Last week's quarterly statement and Governor Glenn Stevens' testimony on Friday implied that the RBA retains a clear bias to tighten policy again. This was despite there now being a higher risk of the increased volatility in financial markets spilling over into the real economy. The maintenance of the hawkish tone means we continue to look for another policy tightening in December.

The forecast for further tightening is conditional upon two things. First, that stability has returned to financial markets and, second, that the spillover of re-pricing of risky assets to the real economy will be contained. If markets are still in turmoil by the time the next "live" Board meeting comes around towards the end of this year, which is unlikely, the RBA will not tighten policy as forecast. The severity of the economy's capacity constraints, however, mean that the RBA is very unlikely to lower the cash rate, even if other central banks do loosen policy. The Governor indicated that domestic spending is rising, demand for credit has firmed, household finances are in good shape, demand for exports is rising, and the economy is operating at close to full employment. Moreover, the global economy has surprised with its strength, and the terms of trade continues to provide significant stimulus to the Australian economy.

One mitigating factor the RBA mentioned when raising the cash rate in the previous week was the disinflationary impact of the high AUD which, at the time, was well above 80 US cents. The AUD since has plunged 9% against the USD, which means there now should be less of a dampening impact on inflation in coming quarters from lower import prices. If anything, there could be slightly more upside risk to the RBA's forecast in last Monday's statement that core inflation will be marooned at the top of the target range for an extended period. This means there is a higher chance of the upper band of the RBA's inflation target being breached in coming quarters.

Mortgage rates doing more heavy lifting

One real economy factor that could keep the RBA sidelined, which would be a symptom of the re-pricing of risky assets, would be higher mortgage interest rates, which have risen by much more than the 25bp increase in the cash rate in early August, owing to the liquidity problems currently being faced by local financial institutions and non-bank mortgage providers. The expansion of prevailing market interest rates over cash will do some of the heavy lifting for the RBA and could negate the need for further tightening. It is, however, too early to gauge where market interest rates will settle relative to cash, but the Governor stated that officials would take the spread into account during policy deliberations.

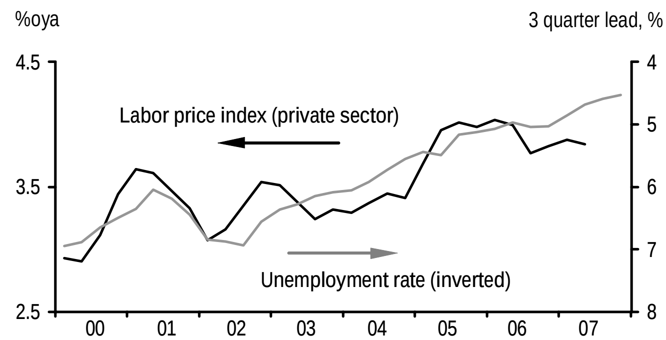
On the timing of the federal election, which we believe will be held on 10 November, the Governor indicated that the poll will not play a role in policy deliberations. In fact, in answer to a question from an MP, the Governor indicated that if a rate rise is needed immediately after the November Board meeting, which is scheduled for what is likely to be the week before the election, it will be delivered. The Governor stated that he believed the RBA would be abdicating its responsibility to the Australian population if it did not tighten policy owing to the timing of the election, despite a compelling case that the cash rate was too low.

In the quarterly statement that preceded the Governor's testimony last week, the RBA unexpectedly raised the forecast for core inflation to 3.0%oya (from 2.75%) for the year ended June 2008, while leaving unchanged the 2.75% projection for the remainder of the forecast period out to June 2009. The RBA said that while headline inflation will remain low in the near term, owing to beneficial annual base effects, it should rise toward the elevated core inflation forecast during 2008. Therefore, there appears a reasonable chance that the upper band of the RBA's 2-3% inflation target range will be breached in coming quarters.

Consumer sentiment slumps on rate rise

Consumer sentiment in Australia slumped 8.1%m/m in August (JPMorgan -9.0%m/m), after falling just 0.6% in July. The Westpac-Melbourne Institute index of consumer sentiment fell from 120.8 in July to 111.1 in August, well below the 123.9 record high touched in May. Still, the index remains comfortably above 100—the neutral level where the number of optimists equals the number of pessimists—and has remained above this level since November. All components of the index fell from a month ago, with the largest falls recorded in sentiment toward buying major household items (-15.1%) and toward current conditions (-10.1%).

Australia: labor price index and unemployment



The RBA's decision to lift interest rates on August 8 undoubtedly put the largest dent in consumer sentiment. Reflective of this, confidence among consumers with a mortgage slumped 14%, and confidence as to whether current conditions present a good time to buy a house tumbled 19.6%, according to the Westpac-Melbourne Institute report. Simultaneously, a myriad of other factors—the declining stock market, depreciating AUD, still-elevated gasoline prices, global financial market volatility, the ongoing deterioration in housing affordability, and growing uncertainty about the outcome of the forthcoming election—also dampened confidence. The only upside is that unemployment remained at multi-decade lows.

There appears further downside risk to consumer sentiment. Not only are interest rates set to rise again this year amid burgeoning inflation pressures, but also the uncertainty surrounding the outcome of the forthcoming federal election will concern consumers, many of whom are already worried about deteriorating levels of housing affordability and rising levels of debt relative to their disposable incomes. Moreover, with some local lenders now suffering in the wake of the US subprime fallout, there appears to be even more downside to consumer confidence in the near term.

Wage growth accelerates, albeit mildly

Wage growth picked up mildly in 2Q, with the labour cost index rising 1.1%q/q (JPMorgan 1.2%, consensus 1.1%), matching a record high. Growth in hourly wages rates decelerated slightly in the private sector, from 1.1% in 1Q to 1.0% in 2Q, although it picked up in the public sector, to 1.1% from 0.8% previously. Note, though, that the slowdown in wage growth in the public sector in 1Q was primarily attributed to the update in the expenditure weights that were implemented to account for the change

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of sector for the Telstra Corporation (effectively privatized on November 20).

The labour cost index will trend higher if upside pressure on wages persists. The unemployment rate is at a 33-year low, skill shortages remain widespread, and the influx of skilled migrants will at some point start to subside, leading to a shortage of labour supply. Considering also anecdotal evidence suggesting that wages are rising, JPMorgan anticipates that the labour price index will accelerate further (albeit mildly) during 2H, particularly in the final three months of the year, given that the Federal Minimum Wage decision announced in July will become effective on October 1.

Australia:
Data releases and forecasts

Week of August 20 - 24

Wed
Aug 22
10:30am

WMI leading index
Seasonally adjusted

	Mar	Apr	May	Jun
(%m/m)	0.2	0.6	0.2	__

Wed
Aug 22
11:30am

Sales of new motor vehicles
Units, seasonally adjusted

	Apr	May	Jun	Jul
(%m/m)	-1.2	-0.4	2.2	__
(%oya)	7.7	6.7	11.3	__

Review of past week's data

RBA Statement on Monetary Policy (Aug 13)

See main essay.

NAB monthly business survey (Aug 14)

% balance, seasonally adjusted

	May	Jun	Jul	
Business confidence	15	15	__	*12*

WMI consumer sentiment index (Aug 15)

100=neutral, seasonally adjusted

	Jun	Jul	Aug	
(%m/m)	-1.9	-0.6	~~-9.0~~	*-8.1*

Labor price index (Aug 15)

Seasonally adjusted

	4Q06	1Q07	2Q07	
(%q/q)	1.1	1.0	~~1.2~~	*1.1*
(%oya)	4.0	4.1	~~4.2~~	*4.0*

New Zealand

- **Retail sales disappointed in 2Q**
- **Downgrade to 2Q GDP growth forecast**
- **RBNZ tries to calm fraying nerves**

New Zealand's 2Q retail trade report posted its weakest quarterly outcome since 3Q97, preceding the last recession in 1998. The report prompted JPMorgan to downgrade slightly the 2Q GDP forecast from 0.5%q/q to 0.4%. Consumption growth over the second quarter is likely to have contracted 0.3%q/q. Amid another volatile week in the financial markets, the RBNZ set about calming nerves by stating that officials believe there is enough cash in the system and that markets are functioning adequately.

This week's data preview

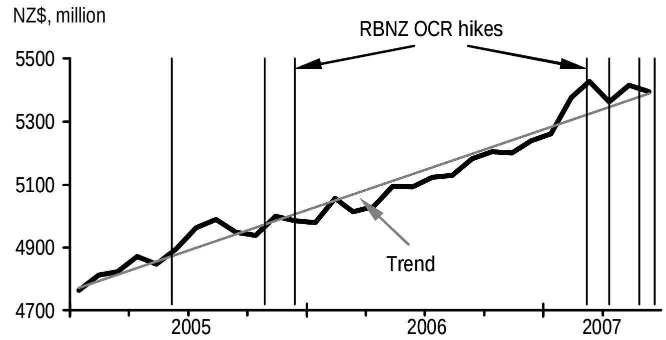
In what is likely to be a quiet week on the macroeconomic data front, second tier data releases credit card spending and July's trade balance, will provide some valuable insights into the underlying forces brewing in the economy. Credit card spending will give a weak read into retail activity over the month of July—unfortunately the series has a poor correlation to retail sales. The trade balance will provide our first insight into the strength of exports in 3Q.

NZ's retail trade volumes fell 0.6%q/q in 2Q

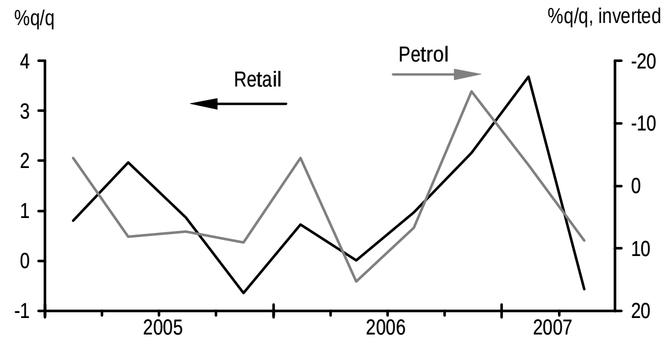
Retail trade posted its weakest quarterly outcome since 3Q97, preceding the last recession in 1998. Retail trade over 2Q posted a much weaker than expected contraction of 0.6%q/q (JPMorgan -0.1%q/q, consensus +0.1%q/q). The strong, negative correlation between retail trade and gasoline prices continues to undermine the trend in spend (chart); the 3.3%q/q rise in spending on fuel assisted in the overall decline in retail sales volume. According to *StatsNZ*, the biggest contributors to the fall were the appliance, accommodation, and motor vehicle retailing industries. Supermarket and grocery stores, and automotive fuel retailing had the largest rises in sales volumes.

The report should be taken with a grain of salt, however, as the quarterly decline is providing some payback for the 3.7%q/q spike in 1Q (a mirror image to that seen in 1997, where the 3Q decline of 0.6% followed a sharp increase of 2.9% in 2Q). Adverse weather conditions in recent months also dragged spending lower.

New Zealand: retail sales value, sa



New Zealand: gasoline price and retail trade



The weak quarterly outcome was undoubtedly pushed down by the rapid rise in mortgage rates, which is finally beginning to take its toll on housing, confidence, and retailing. The RBNZ has hiked the policy rate four times since March this year to a record 8.25%, pushing mortgage rates higher across the curve (the majority of mortgages are taken out with a two- to five-year fixed-term horizon). The softening in retail spending is set to continue into the third quarter. July's RBNZ rate hike has yet to be included in the data (chart), the housing market is showing signs of turning, and recent financial market volatility will plague consumer confidence.

Downgrade to 2Q GDP forecast

The retail report adds more downside risk to the RBNZ's forecast of 0.8%q/q for the second quarter. As a result of the report—which came in below JPMorgan's forecast—we have lowered our forecast to 0.4%q/q (previously 0.5%). The retail report suggests a contraction in consumption growth of around 0.3%q/q.

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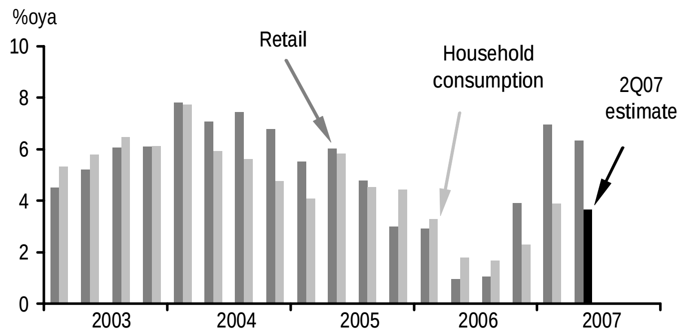
The moderation in consumer spending, the decline in confidence (both business and consumer), and the recent turn in housing market activity (and early signs of falling house prices) will all be welcomed by the RBNZ, and supports the Bank's remaining on hold. Should the data continue to track the trend towards softer activity that has developed over the last two months, JPMorgan expects the RBNZ to remain on hold until the second half of 2008 before it contemplates easing policy (excluding any dramatic external shock like that seen in financial markets), as officials remain adamant in their resolve to win the four-year war on inflation. Thus, interest rates are expected to have peaked at 8.25% in the current tightening cycle.

New Zealand: retail trade and consumption growth (from GDP)



RBNZ calms fraying nerves

The RBNZ last week attempted to calm market nerves with a statement enforcing its belief that there is enough liquidity in the market. Acting Governor Grant Spencer (Head of Financial Stability) said:

> Following the recent disruptions in global credit markets, the Reserve Bank has been closely monitoring the impact on the domestic markets and liquidity conditions. While some additional pressures have been present, we believe the level of cash within the banking system is adequate and markets continue to function satisfactorily. The Bank will continue to monitor conditions closely and stands ready to provide additional liquidity should that be necessary.

New Zealand:
Data releases and forecasts

Week of August 20 - 24

Tue
Aug 21
03:00pm

Credit card spending
Seasonally adjusted

	Apr	May	Jun	Jul
(%m/m)	-0.9	0.5	1.9	__
(%oya)	8.0	5.7	9.1	__

Fri
Aug 24
10:45pm

Trade balance
Not seasonally adjusted

	Apr	May	Jun	Jul
Exports ($NZ mn)	3171	3355	2750	__
Imports ($NZ mn)	3386	3345	3275	__
Trade balance ($NZ mn)	-215	11	-524	__

Review of past week's data

Retail trade (Aug 14)
Seasonally adjusted

	Apr	May		Jun	
(%m/m)	-1.2	~~1.2~~	*1.0*	~~0.4~~	*-0.4*
(%oya)	6.6	6.5		~~7.2~~	*5.9*

Producer price index (Aug 15)
nsa

	4Q06	1Q07	2Q07
(%q/q)	-0.5	-0.2	__
(%oya)	3.6	2.7	__

In July 2007, Statistics New Zealand initiated a quality control review and analysis of previously published Producer Price Index (PPI) releases. This review, which is not yet completed, has identified some errors that will require revisions to be made to previously published PPI data. The extent of these revisions is still being determined. StatsNZ will announce a new date for the 2Q PPI release when this review is completed.

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Global essay

- **The Fed signals a September ease in response to a rising wave of risk aversion**
- **The BoJ and European central banks are expected to remain on hold**
- **US midyear growth is strong; modest softening into year end**
- **Emerging markets show their vulnerability to US financial market stress**

Bernanke blinks

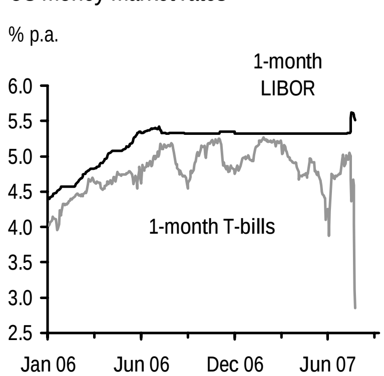
Global financial market conditions deteriorated last week, producing a shift in the Federal Reserve's policy stance. At the source of this deterioration is a rising wave of risk aversion, prompted in part by the liquidity problems in money markets. With demand having evaporated for all but the highest quality credit, the US asset-backed commercial paper is contracting and existing bank lending facilities are being drawn upon. The decline in the financial sector's short-term liquidity is also manifest in a sharp widening in the spread between interbank lending rates and government bill rates. However, the spreading of risk aversion across the globe was the new event last week. Global equity markets moved sharply lower, falling more than 3% through to last Thursday. Emerging market currencies and debt also came under pressure. Not surprisingly, the yen jumped, reflecting the role that low Japanese interest rates have played in supporting financial risk-taking in recent years.

Central banks have responded to liquidity problems by working hard to ensure that their daily operations are sufficient to maintain overnight rates at targeted levels. Some central banks have gone further to address an aversion to taking credit risk in money markets. The Bank of Canada has expanded the list of collateral it accepts in its open market operations. The Federal Reserve has lowered its discount rate and expanded the term at which it is willing to lend at this window—a facility that accepts a wide range of collateral for borrowing by depository institutions. But until Friday, there has been no signal from major central banks that the path of policy would be altered by recent developments. In fact, the Bank of Norway and the South African Reserve Bank delivered on anticipated rate hikes last week.

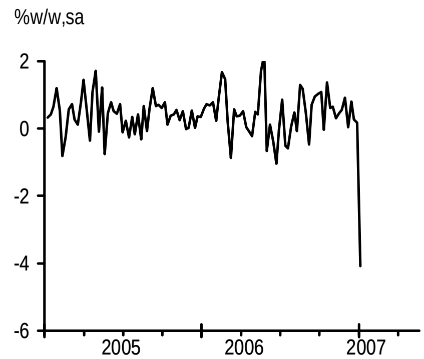
The FOMC statement represents an important shift in central bankers' response to market developments. The previous week, the Fed maintained a sanguine view of the outlook, stating, "the Committee's predominant policy concern remains the risk that inflation will fail to moderate as expected." This has been replaced by the message, "[the Committee] judges that the downside risks to growth have increased appreciably. The Committee is monitoring the situation and is prepared to act as needed to mitigate the adverse effects on the economy arising from the disruptions in financial markets." By shifting its bias and suggesting that there will be adverse effects, it is signalling a change to its growth forecast that will prompt an ease at the September 18 FOMC meeting. We now expect a 25bp cut from the Fed at both the September and October meetings.

The Fed is not the only central bank likely to change its policy path behind recent developments. A number of central banks that we had projected to raise rates in the coming weeks—including the BoJ, the BoC, the ECB, and the SNB—are now expected to remain on hold. In addition, a BoC rate cut is now anticipated in October. Overall, these changes represent an ease of roughly 35bp in developed country policy rates through year end relative to earlier expectations.

US money market rates



US asset-backed commercial paper



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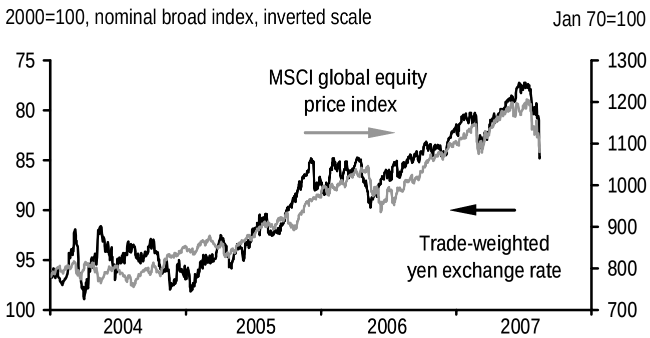
Trade-weighted yen and global equity prices

2000=100, nominal broad index, inverted scale



Anticipating a modest drag on US growth

The past two episodes in which the FOMC eased following an abrupt shift in its growth forecast turned out very differently. In 2001, growth momentum slipped far faster than the Fed expected as the economy fell into a mild recession. In contrast, the US economy grew at a vigorous 4.4% pace in the four quarters following the first Fed ease in September 1998. In hindsight, it is easy to contrast a sound fundamental backdrop in 1998 with an overextended corporate sector and equity price bubble in 2000. In real time, however, assessments of fundamentals are rarely clear cut.

Our US growth forecast starts with a view that the business cycle is centrally driven by the behavior of firms. And the position of the corporate sector as the economy entered the third quarter was solid. With profits having rebounded from last year's slide, inventories lean, and global demand strong, growth is rebounding. Despite a significant drag on consumption from higher gasoline prices, GDP growth looks set to be revised above 4% (q/q, saar) for 2Q07. Early reports for the current quarter suggest that activity will be weighed down by further weakness in housing, but growth still looks to be tracking at about a 3% pace.

With substantial labour income gains and gasoline prices falling, the stage is set for a modest rebound in consumer spending. However, housing market weakness will be intensified by a new round of tightening in mortgage credit availability. This will likely weigh on household demand, as will the pullback in equities. Accordingly, the US GDP growth forecast has been revised down modestly—to 2.25%q/q, saar for the next two quarters on average—with a Fed ease and a healthy corporate sector enabling the economy to absorb much of this drag. Growth then is expected to rebound, with the Fed expected to take back rate cuts around the middle of next year.

Will the virtuous circle be unbroken?

As we noted in a recent *GDW* cover essay, EM economies for a time were relatively unscathed by the turmoil in international financial markets, reflecting the group's strong cyclical position and relative isolation from US credit market woes, as well as the structural improvements made to their own economies and policies over the past decade. Conditions worsened last week, however, as the selling of risk assets extended to EM currency, equity, and local interest rate markets. Ironically, while financial stress emanating from the US is likely to produce easier monetary policy in the developed world, it poses a threat of tighter policies in EM.

A reduction in global risk appetite will curb net capital inflows into EM asset markets, placing further downward pressure on currencies and, in turn, exacerbating inflation concerns among a group of central banks that already was moving into the tightening camp. Thirteen of the twenty-two EM economies we cover are already in tightening mode. This will also limit the scope for further rate cuts in the handful of countries where central banks are easing policy. Already, we have delayed an anticipated rate cut in Indonesia to 4Q07. An expected easing move in Turkey in October also is subject to delay. In addition, policymakers in a range of countries are expected to react to currency weakness by selling US dollar reserves to help stabilize their currencies. Just as intervention through a period of dollar decline was not fully sterilized, representing an ease in monetary conditions, pressure in the other direction will represent a tightening.

Whether a meaningful shift toward tighter policies in EM unfolds depends on how far the current move toward risk reduction runs. As a result, the virtuous circle in place in EM countries—whereby solid macro fundamentals have attracted capital inflows that have promoted accommodative policies—should be viewed as sensitive to a sustained shift in financial market conditions in the developed world.

Mixed signals from Asia's heavyweights

The two biggest economies in Asia continue to grow on very different tracks. After posting blockbuster, double-digit growth in the first half of this year, expectations were that China's growth rate would slow materially. This forecast anticipated that the recent spate of policy tightening measures

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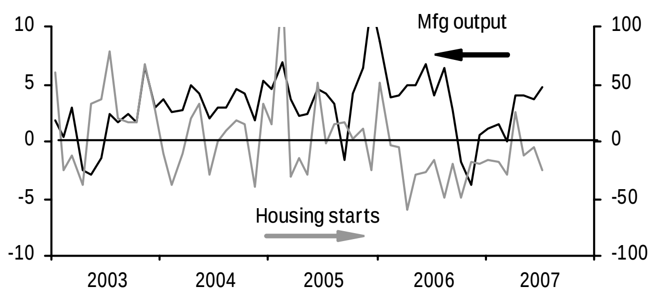
US manufacturing and housing starts

% change over 3 months, saar both scales



would slow growth in fixed investment and industrial production. There also was an expectation that exports had been front-loaded ahead of the expiration of tax rebates on July 1.

At least through July, however, any slowing in the Chinese economy appears to have been marginal. Retail sales boomed last month, as did exports. The growth rate of fixed investment moderated slightly from the June pace, but stayed strong; so did the pace of bank lending. These data are likely to frustrate policymakers who are concerned about overheating in the economy and asset markets. JPMorgan now anticipates two additional rate hikes in 4Q07 and 1Q08, conditional on a stabilization in global financial markets and still-solid growth in the global economy.

While China's economy continues to barrel ahead, the evidence points to continued sluggish growth in Japan. The economy ended 2Q on a soft note, with a pickup in industrial production and exports offset by weakness in consumer spending and a surprise drop in core capital goods orders. In turn, the monthly business surveys lost ground in July, partly because of the Chuetsu earthquake which likely disrupted economic activity (especially industrial production).

Until very recently, the Bank of Japan probably was prepared to look through this near-term soft patch and tighten this week. First-half growth on the whole was 2.5%—well above the BoJ's estimate of trend—and Bank officials have been conditioned to discount the ups and downs in the high-frequency data. However, with the slide in global financial markets continuing through last week—capped off by a 5.4% slide in the Nikkei stock price index today—the odds of a near-term rate hike have faded. We now tentatively look for the BoJ to hike rates at the September policy meeting, with the risk being that policy is left on hold even longer.

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JPMorgan View - Global Markets

The Bernanke put arrives

- **Cross-markets:** parallels to 1998 easings are imperfect but still provide near-term support to equities. Other risky markets (credit, EM, fx carry) can gain too, but much less given positions and unfinished deleveraging.
- **Fixed income:** be long duration and steepeners.
- **Equities:** these are best positioned to gain from the parallels with the 1998 easings.
- **Credit:** modest further rebound in credit prices, but overhangs on positions and continued wariness on value of rating systems are capping upside.

Fed needs to deliver to maintain positive momentum

- Last week brought the **eye of the liquidity storm,** with rising price distortions showing evidence of indiscriminate selling. Earlier liquidity injections by central banks had little impact. Market participants **were screaming for a Fed rate cut.** The cut in the discount rate helps, but is not enough. News flow around the US housing crash will remain ugly and we fear that more skeletons will emerge from bank and hedge fund closets.
- **The Fed will thus need to deliver actual rate cuts**. Economic data, continued market turmoil, and further threats to the global economy will likely force the Fed's hand and keep other central banks from tightening. This keeps us **long duration in bonds and in curve steepeners.** Risk deleveraging is not over and this poses the greatest threat for positions that were favoured earlier this year, such as overweights in EM and carry trades in fx. Renewed hopes of Fed easing provide a short-term tonic for risky markets. Equities should benefit most as positions seem lighter here than in credit. For one thing, equities do not suffer from bank overhangs of unsold high-yield debt.
- The consensus remains sanguine on the outlook for global growth and is convinced we are seeing a repeat of the 1998 LTCM crisis. We are hopeful that this is all we face, and use this episode to guide us on tactical trading. But we are aware that history never fully repeats itself. We thus retain a low profile on risk taking.

Fixed income

- **Bond markets remain volatile,** rallying strongly early last week as global equities fell and the liquidity crisis intensi-

Government bond yields

		Current	Sep 07	Dec 07	Mar 08	Jun 08
United States	2-yr	4.17	3.85	4.20	4.50	5.00
	10-yr	4.67	4.45	4.75	4.90	5.35
Euro area	2-yr	3.97	3.85	3.75	4.00	4.00
	10-yr	4.30	4.15	4.30	4.50	4.60
United Kingdom	2-yr	5.33	5.35	5.35	5.35	5.40
	10-yr	5.08	5.00	5.20	5.20	5.20
Japan	2-yr	0.82	0.85	1.00	1.20	1.30
	10-yr	1.58	1.65	1.80	2.00	2.10
Canada	10-yr	4.41	4.35	4.85	5.10	5.50
Australia	10-yr	5.82	5.80	6.05	6.10	6.35
Korea	5-yr	5.28	5.40	5.50	5.60	5.50
Mexico	10-yr	7.75	7.60	7.60	7.70	7.70
Singapore	10-yr	2.85	2.90	3.75	3.90	4.00
South Africa	10-yr	8.49	8.55	8.60	8.50	8.45
Sweden	10-yr	4.20	4.15	4.55	4.50	4.45

Equities

	Current	Ytd return (local currency)
S&P	1436	0.7%
Topix	1480	-6.2%
FTSE 100	6058	-3.4%
MSCI Eurozone	228	1.4%
MSCI Europe	1448	-0.5%
DAX	7389	10.2%
CAC	5364	-2.6%

Sector allocation for equities

	Deviation	Recommendation[1]
Energy	3.0%	Overweight
Materials	-1.5%	Underweight
Industrials	0.9%	Neutral
Consumer discretionary	-2.6%	Underweight
Consumer staples	4.4%	Overweight
Healthcare	3.4%	Overweight
Financials	-7.0%	Underweight
Information technology	-1.9%	Underweight
Telecommunications	2.8%	Overweight
Utilities	-1.9%	Underweight

1. Recommendations reflect current stance, which can change over the year.

Regional allocation for equities

	Deviation	Recommendation
North America	2.3%	Overweight
United Kingdom	-3.1%	Underweight
Eurozone	-2.2%	Underweight
Rest of Europe	-0.4%	Neutral
Japan	3.5%	Overweight
Asia ex Japan	-0.1%	Neutral

Source: JPMorgan.

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fied. The Fed discount rate cut then led to profit taking, but bonds are still up on the week. Our Global Government Bond Index for G-10 has gained 3% in recent months from its lows, but remains some 75bp below cash return ytd.

- Our new forecasts of two 25bp rate cuts by the Fed are largely in the price, with the money market discounting even two subsequent rate cuts into next year. We do not expect that much, but are still **tactically long duration,** as bonds tend to continue to rally into an expected Fed ease. This implies that **inflation linkers** are set to continue to underperform. Medium term, we believe rate cut expectations to be too aggressive and see a rebound from current growth risk perceptions. We thus keep **medium-term bearish views on bonds.**

- **Curves** have steepened over the past month in major markets. We believe this is not over. Curves tend to continue to steepen through Fed easing periods as the short end extrapolates further cuts. **We like 2s30s steepeners in US, 2s10s in euros, and 5s10s in sterling.**

Equities

- **Equity markets fell sharply early last week**, with developed markets losing over 3% and EM equities falling twice that much. Friday's cut in the Fed discount rate helped the former recover a large part of these losses, but came too late to help most emerging equity markets. Cyclicals and financials outperformed Friday as the Fed move is seen as friendly to them and many investors probably covered underweights in these sectors.

- Over the next month, we are likely to see a **modest rebound** in stock markets as investors draw parallels with the LTCM easing in 1998 which heralded a 60% rally in G-10 large caps and a tripling in the Nasdaq. It is the memory of this massive rally that is similarly making central bankers wary of restoking the global equity rally. But for the time being, investors will feel that they have the Fed on their side and are likely to buy again. We do not expect this year's highs to be broken, as economic and credit news is unlikely to be helpful and 3Q earnings will be weakened by falls among the financials. EM equities have good value to us from a longer-term perspective, but they have been the strong favorite among most asset managers. We thus need to see some position squaring before EM can outperform again.

Credit

- **Credit markets** had another volatile week last week, with high-grade spreads, in particular on financials, widening out further. HY spreads had been coming back in previous weeks, admittedly on very little volume, but rewidened earlier last week. As with all risky markets, credit recovered part of its losses in the wake of the Fed's discount rate cut.

Credit markets

	Current	Dec 07
US high grade (bp over swaps)	73	35-40
Euro HG industrials (bp over swaps)	38	35-40
USD high yield (bp vs. UST)	471	500
EMBIG (bp vs. UST)	243	200

Commodities

		Quarterly average			
	Current	07Q3	07Q4	08Q1	08Q2
WTI oil $/bbl	71.7	67.0	60.0	56.0	52.0
Gold ($/oz)	657	660	675	700	715

Foreign exchange

	Current	Sep 07	Dec 07	Mar 08	Jul 08
EUR/USD	1.35	1.42	1.40	1.39	1.38
USD/JPY	114	119	120	122	122
GBP/USD	1.98	2.12	2.09	2.11	2.09

- **Activity remains very weak** in credit. No high-yield bonds were priced last week, and we will likely have to wait until September to see some activity. Commercial paper (CP) has also come under severe pressure, with asset-backed CP seeing an outright 5% decline in outstandings. Continued wariness among end investors about the value of ratings on asset-backed securities means this market will remain weak. This will have an impact on the broader corporate credit market. The investor community will remain worried about the overhang of unsold bridge-loans among major banks. Hence, any rally in credit will likely be short-lived and credit will likely underperform equities over the coming month.

Foreign exchange

- **Carry trades** pared losses and **European currencies** gained versus the dollar following the Fed's discount rate cut. While the perception that the Fed is also close to cutting the funds rate should ease the sense of panic that engulfed carry trades early last week, **we are not convinced that Friday's decision draws a line under the carry shakeout.** There is still a sizable overhang of retail shorts in yen. In addition, the experience of 1998 cautions against jumping back into carry at the first sign of Fed easing. Back then, following a kneejerk rally on the day of the first cut, USD/JPY collapsed 25 yen in the next one and a half weeks. Hence, we hold on to our defensive portfolio of short NZD/JPY, long USD/CAD, and long CHF/NOK. We are reviewing forecasts and will issue new ones this week.

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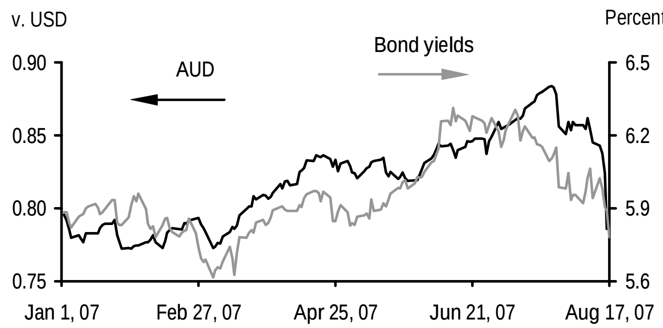
Markets - Australia and New Zealand

Main events for fixed income markets

- The **Australian** data schedule for this week is very light, so market attention largely will be focussed offshore to gauge the impact of the Fed's surprise rate cut on Friday. Neither the vehicle sales data or the leading index (both released on Wednesday) is likely to have any impact on markets.
- **In New Zealand,** in what is likely to be a quiet week on the macroeconomic data front, second tier data releases on credit card spending and July's trade balance will provide valuable insight into the underlying forces brewing in the economy.

Australian dollar and 10-year bond yields



Market commentary

- Like other central banks, **the RBA** has been acting to ensure sufficient liquidity in short term money markets. The RBA's capital injections have been tiny relative to other central banks, however, which indicates that the local money markets have been operating normally.
- **Aussie bond yields** plunged last week in line with US yields. The flight to quality out of the riskier assets continued, with the local share market taking a battering. The Fed's discount rate cut on Friday triggered a rebound on Wall Street that probably will be repeated here. We still look for the Fed to tighten in 2008, which means the Aussie spread over US bonds should narrow.
- In the wake of last week's market turmoil, the **local bills futures market** prices only a 5% chance of an RBA rate hike in December, down from 27% last week. This drop is despite Governor Glenn Stevens' hawkish commentary last week. The market prices only a 28% chance of a rate hike by June 2008, down from 80% last week.
- As expected, the **Aussie 3s 10s curve** steepened dramatically last week to 25bp (from 37 last week). The front end of the Aussie curve remains anchored by expectations that the RBA will not ease policy even though the Fed is edging closer to an ease, but longer-dated bonds are rallying on the flight to quality.

Trade recommendations from GMOS (published 8 Aug.)

- **Short Aussie Dec'07 bills in futures.**
  - At the time of the last GMOS, the market priced only a 30% chance of a second tightening. Established at 93.25 (target 93.15, stop 93.30), the position is trading at 93.26.
- **Stopped out on 1 yr (receive) 3 yr (pay) spread in Kiwi for a loss of 5pts.**
  - Was established at -35pts with a stop loss of -40pts. Currently trading -44pts due to recent credit market turmoil and lack of liquidity.

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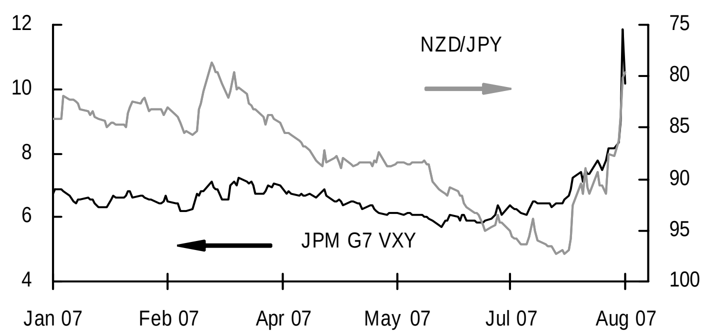
AUD and NZD Commentary

- **AUD and NZD fall dramatically as risk is reduced broadly due to global liquidity crunch**
- **News from the Fed and general market sentiment remain key in week ahead; hold short NZD/JPY**
- **Technicals: Medium term bearish shift likely to continue for AUD/USD and NZD/USD**

Strategy comments

- Volatility in G7 FX markets spiked to its highest level since September 11, 2001 (according to the JPM VXY G7 index) and carry FX fell dramatically in the past week as global market liquidity conditions tightened further, encouraging risk reduction across the board. The Fed brought some relief to the market at the end of the week by cutting the discount rate by 50bps and adopting an easing bias, limiting the blow to equity markets (the S&P 500 ended the week only marginally lower). However, the damage among high-yielding FX was significant. AUD and NZD fell 5.5% and 6.3% versus USD, respectively. The dollar itself, while up broadly among the G10, fell more than 3% versus JPY; leaving NZD and AUD a whopping 9% lower versus JPY (see chart).
- The decline in AUD and NZD last week was historically signficant: Thursday was the greatest one-day fall in NZD/JPY since December 1985. It was also noteworthy that AUD and NZD fared worse than any other currency, even relative to BRL, ZAR, and TRY, the latter which has also been plagued by political uncertainty. One of the reasons that the Antipodeans have been more vulnerable than EM FX in this most recent downtrade is due in part to the currencies that they are held against, namely the yen. Approximately half of the outstanding Japanese margin trader short positions were cleared in the yen rally of the last two days (JPY3.5trln), suggesting NZD and AUD selling pressure. Given a still sizeable overhang of retail short positions in the yen, significant yen appreciation from current levels is possible.
- We continue to look for AUD and NZD underperformance in the near-term. Despite the Fed's shift to an easing bias, markets remain very unsettled, and we expect this to remain the case for the next several weeks as the market evaluates the likelihood of a Fed ease at the September meeting, which we expect. In addition to the yen, we also believe there is further room for USD broadly to benefit as long as liquidity remains the foremost concern for markets. In such an environment, both AUD and NZD will remain vulnerable. We would highlight relatively greater risks for NZD given New Zealand's tenous financing position (foreign debt liabilities total NZD168bln) and its less liquid status.

NZD/JPY plummeted nearly 10% as FX volatility spiked



Technical analysis

- Last week's declines in AUD/USD and NZD/USD confirmed a more significant bearish shift amid the backdrop of global credit crisis and flight-to-quality. With medium term tops now in place at the July highs, the interim bias will remain bearish. However, from a shorter term perspective Friday's upside reversals argue for a short term corrective phase to this week's collapse in prices.
- For AUD/USD, note last week's low effectively held the .7700/.7680 support area, which should act as range lows for any short term consolidation. Note the upside will be limited to the .8000/.8100 zone. Strength above here would question the view for new lows deeper into the .7600/.7400 targets.
- For NZD/USD, we see a similar setup with the short term bias suggesting a consolidation phase before the bear trend extends. Resistance starts at .7000 and then .7125, with deeper targets located at .6525/.6400.

AUD/USD - Daily technical chart

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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			
	2006	2007	2008	1Q07	2Q07	3Q07	4Q07	1Q08	2Q08	3Q08	1Q07	2Q07	4Q07	2Q08
The Americas														
United States	2.9	2.0	2.8 ↓	0.6	3.4	3.0	2.0 ↓	2.5 ↓	3.5 ↑	3.0	2.4	2.7	3.4	2.2
Canada	2.8	2.3 ↓	2.7	3.7	2.8 ↓	1.5 ↓	3.0 ↑	3.0 ↑	3.0	2.8	1.8	2.2	3.0	2.0
Latin America	5.3	4.7	4.7	3.0 ↑	5.7 ↑	5.5	5.2	4.9	4.5	4.4	5.0	5.1	5.2	5.8
Argentina	8.5	8.0	6.0	3.9	10.8	8.2	8.2	5.3	4.1	4.1	9.5	8.8	8.1	9.5
Brazil	3.7	5.0	4.7	3.1	5.6	5.2	4.8	5.3	4.8	4.4	3.0	3.3	3.8	3.7
Chile	4.0	6.0	5.0	9.5	5.5	4.0	4.0	5.5	5.5	5.5	2.7	2.6	3.6	3.1
Colombia	6.8	6.8	5.5	10.3	6.9	5.0	5.0	5.5	5.5	6.0	5.2	6.3	5.7	4.7
Ecuador	3.9	3.0	2.0	0.3	5.0	6.5	5.0	1.5	0.0	-2.0	2.1	1.7	2.1	3.4
Mexico	4.8	2.8	4.5	0.6	4.1	4.9	4.9	4.9	4.5	4.5	4.1	4.0	4.0	4.1
Peru	7.8	7.0	6.0	3.5	4.0	8.0	5.0	4.5	5.5	9.0	0.4	0.7	2.1	2.1
Venezuela	10.3	7.0	3.5	4.4 ↑	8.7 ↑	6.0	6.5	2.5	2.0	1.5	19.1	19.5	19.1	27.3
Asia/Pacific														
Japan	2.2	2.4 ↓	2.3 ↓	3.2 ↓	0.5 ↓	2.0 ↓	2.5 ↓	2.7 ↑	2.5 ↑	2.0	-0.1	-0.1 ↓	0.1	0.4
Australia	2.7	4.1	3.4	6.6	2.8	3.7	3.8	4.5	2.8	2.3	2.4	2.1	3.7	3.7
New Zealand	1.5	2.7 ↓	2.5	4.2	1.7 ↓	2.4 ↓	2.5 ↑	2.5	2.8	2.2	2.5	1.7	1.9	2.4
Asia ex. Japan	8.4	8.2	7.8	9.3 ↑	10.7 ↑	6.8 ↓	5.9	8.8	8.4	7.4	3.2	3.4	3.6 ↑	3.7 ↑
China	11.1	11.3	10.5	13.6	15.7	8.2	6.1	13.0	12.6	10.4	2.7	3.6	3.6 ↑	3.4 ↑
Hong Kong	6.9	5.8 ↑	4.6	2.4 ↑	8.2 ↑	5.5 ↓	5.1 ↓	4.5	3.8	3.5	1.7	1.3	2.0	3.1
India	9.4	8.0	7.5	11.4	6.6	7.4	7.0	8.7	7.0	7.0	7.0	6.0	5.1	5.4
Indonesia	5.4	6.2	6.0	7.1	6.0	5.5	5.5	6.0	5.0	5.0	6.4	6.2	6.8	6.8
Korea	5.0	4.6	5.1	3.6	7.0	4.2	5.0	4.5	5.0	5.0	2.0	2.4	2.9	3.2
Malaysia	5.9	5.8	5.6	5.4	6.0 ↓	6.6 ↑	6.6 ↑	5.3	5.3	5.3	2.6	1.5 ↓	2.2	2.2
Philippines	5.4	6.7	5.9	10.2	6.5	6.6	6.5	6.0	5.0	5.5	2.9	3.3	3.7	3.7
Singapore	7.9	8.0 ↑	5.4 ↑	8.8	14.4	4.8 ↓	4.8 ↓	4.8 ↑	4.8 ↑	4.8	0.5	1.0	2.0	1.3
Taiwan	4.7	4.7	4.8	0.4	7.2	6.3	5.7	4.2	4.0	3.8	1.0	0.2	2.2	2.3
Thailand	5.0	4.2	5.1	4.9	4.5	5.6	5.5	5.5	5.5	5.0	2.5	2.0	2.4	2.4
Africa														
South Africa	5.0	4.8	4.9	4.7	4.5	4.4	4.2	4.9	5.8	5.4	5.9	6.8	5.9	4.8
Europe														
Euro area	2.9	2.7 ↓	2.1	2.9	1.4 ↓	3.0	2.5	1.8	1.8	1.8	1.9	1.9	2.3	2.0
Germany	3.1 ↑	2.7 ↓	2.1 ↓	2.2 ↑	1.0 ↓	3.0	2.8	1.8	1.8	1.8	1.9	2.0 ↑	2.1 ↑	1.2
France	2.2	1.8 ↓	2.1	2.2	1.3 ↓	2.6	2.3	2.0	2.0	2.0	1.3	1.3	2.0	1.7
Italy	1.9	1.9	1.6	1.1	0.4	2.0	1.8	1.6	1.6	1.6	2.0	1.9	1.9	1.9
Norway	4.6	4.6 ↑	3.1	5.7	4.0 ↑	3.5	3.5	3.0	3.0	2.5	1.0	0.3	0.4	2.4
Sweden	4.5	3.5	3.1	2.8	3.9	4.0	3.5	3.0	2.5	2.5	1.9	1.8	2.8	2.6
Switzerland	2.7	2.4	1.9	3.2	2.5	2.3	2.0	1.8	1.8	1.8	0.0	0.5	1.1	1.0
United Kingdom	2.8	3.0 ↑	2.6	2.8	3.2 ↑	2.8	2.8	2.7	2.5	2.3	2.9	2.6 ↑	2.1	1.9 ↓
Emerging Europe[1]	6.3	6.2	6.1	4.9	6.2	5.5	8.0	5.1	7.4	6.5	6.5	6.6 ↑	5.9	5.3
Bulgaria	6.1	6.1	5.4	...	...	...	...	...	...	...	...	...	...	...
Czech Republic	6.4	5.8	5.5	6.1	5.0	5.0	5.0	5.5	6.0	6.0	1.5	2.3	3.4	3.2
Hungary	3.9	2.8	3.3	1.6 ↓	0.8 ↓	3.5	3.5	3.2	3.0	3.5	8.5	8.6	5.5	3.5
Poland	6.1	6.5	6.0	7.0	5.0	5.5	5.8	6.3	6.3	6.5	2.0	2.4	2.7	2.5
Slovak Republic	8.3	9.0	7.5	9.2 ↑	9.9 ↑	7.5	7.5	7.5	7.5	7.5	2.8	2.5 ↑	2.6	2.4
Romania	7.7	6.5	6.0	...	...	...	...	...	...	...	3.8	5.7	5.2	5.0
Russia	6.7	7.2	6.8	3.7	7.0	4.0	12.0	3.5	8.0	5.5	7.9	7.8	7.7	7.3
Turkey	6.1	5.0	6.0	...	...	...	...	...	...	...	10.3	9.6	7.3	5.7
Global	3.6	3.3 ↓	3.3 ↓	3.1	3.6 ↓	3.5 ↓	3.1 ↓	3.4 ↓	3.6 ↑	3.2	2.3	2.4 ↓	2.8	2.4
Developed markets	2.8	2.4 ↓	2.5 ↓	2.1	2.3 ↓	2.8 ↓	2.4 ↓	2.4 ↓	2.7 ↑	2.4	1.8	1.9	2.4	1.9
Emerging markets	6.9	6.6	6.4	6.8	8.5 ↑	6.2 ↓	6.1	7.1	7.2	6.5	4.3	4.4	4.5 ↑	4.5 ↑

Note: For some emerging economies, 2006-2008 quarterly forecasts are not available and/or seasonally adjusted GDP data are estimated by JPMorgan.
Bold denotes changes from last edition of *Global Data Watch*, with arrows showing the direction of changes.

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Global Central Bank Watch

	Official interest rate	Current	Change from Jun 04 (bp)	Last change	Forecast next change	Sep 07	Dec 07	Mar 08	Jun 08	Dec 08
Global	GDP-weighted average	4.66	224			4.65	4.64	4.74	4.89	5.10
excluding US	GDP-weighted average	4.39	128			4.44	4.54	4.69	4.79	4.86
Developed	GDP-weighted average	4.14	263			4.08	4.05	4.17	4.37	4.62
Emerging	GDP-weighted average	6.98	68			7.01	7.04	7.06	7.02	7.04
The Americas	GDP-weighted average	5.51	354			5.39	5.15	5.13	5.36	5.80
United States	Federal funds rate	5.25	425	29 Jun 06 (+25bp)	18 Sep 07 (-25bp)	5.00	4.75	4.75	5.00	5.50
Canada	Overnight funding rate	4.50	250	10 July 07 (+25bp)	**16 Oct 07 (-25bp)**	4.50	4.25	4.25	4.75	5.25
Brazil	SELIC overnight rate	11.50	-450	18 July 07 (-50bp)	5 Sep 07 (-25bp)	11.25	10.75	10.25	10.00	10.00
Mexico	Repo rate	7.25	75	27 Apr 07 (+25bp)	21 Sep 07 (+25bp)	7.50	7.50	7.50	7.50	7.50
Chile	Discount rate	5.50	375	9 Aug 07 (+25bp)	13 Sep 07 (+25bp)	5.75	6.00	6.25	6.25	6.25
Colombia	Repo rate	9.25	250	27 July 07 (+25bp)	24 Aug 07 (+25bp)	9.50	9.50	9.50	9.50	9.00
Peru	Reference rate	4.75	225	5 July 07 (+25bp)	4Q 07 (+25bp)	4.75	5.00	5.25	5.25	5.25
Europe/Africa	GDP-weighted average	4.57	166			4.58	4.77	4.95	5.12	5.13
Euro area	Refi rate	4.00	200	6 June 07 (+25bp)	**6 Dec 07 (+25bp)**	4.00	4.25	4.50	4.75	4.75
United Kingdom	Repo rate	5.75	125	5 July 07 (+25bp)	**on hold**	5.75	5.75	5.75	5.75	5.75
Sweden	Repo rate	3.50	150	20 Jun 07 (+25bp)	**19 Dec 07 (+25bp)**	3.50	3.75	4.00	4.25	4.25
Norway	Deposit rate	4.75	300	**15 Aug 07 (+25bp)**	**12 Dec 07 (+25bp)**	4.75	5.00	5.25	5.50	5.75
Czech Republic	2-week repo rate	3.00	75	26 Jul 07 (+25bp)	27 Sep 07 (+25bp)	3.25	3.50	3.75	4.00	4.50
Hungary	2-week deposit rate	7.75	-375	25 June 07 (-25bp)	27 Aug 07 (-25bp)	7.50	7.00	6.50	6.50	6.50
Poland	7-day intervention rate	4.50	-75	27 Jun 07 (+25bp)	29 Aug 07 (+25bp)	4.75	5.00	5.25	5.50	6.00
Russia[1]	1-week deposit rate	3.25	225	**14 Aug 07 (+25bp)**	**Dec 07 (+25bp)**	3.25	3.50	3.50	3.50	3.75
Slovak Republic	2-week repo rate	4.25	-75	27 Apr 07 (-25bp)	18 Dec 07 (+25bp)	4.25	4.50	4.50	4.50	4.50
South Africa	Repo rate	9.50	150	7 Jun 07 (+50bp)	16 Aug 07 (+50bp)	10.00	10.50	10.50	10.50	10.50
Switzerland	3-month Swiss Libor	2.50	200	14 Jun 07 (+25bp)	**13 Dec 07 (+25bp)**	2.50	2.75	3.00	3.00	3.00
Turkey	Overnight borrowing rate	17.50	-450	20 Jul 06 (+25bp)	16 Oct 07 (-25bp)	17.50	16.75	16.00	15.25	14.25
Asia/Pacific	GDP-weighted average	3.51	104			3.62	3.68	3.86	3.86	3.99
Australia	Cash rate	6.50	125	8 Aug 07 (+25bp)	5 Dec 07 (+25bp)	6.50	6.75	6.75	6.75	6.75
New Zealand	Cash rate	8.25	250	26 July 07 (+25bp)	3Q 08 (-25bp)	8.25	8.25	8.25	8.25	7.75
Japan	Overnight call rate	0.50	50	21 Feb 07 (+25bp)	**19 Sep 07 (+25bp)**	0.75	0.75	1.00	1.00	1.25
Hong Kong	Discount window base	6.75	425	30 Jun 06 (+25bp)	26 Jun 08 (+25bp)	6.50	6.25	6.25	6.50	7.00
China	1-year working capital	6.84	153	20 July 07 (+27bp)	**4Q 07 (+27bp)**	6.84	7.11	7.38	7.38	7.38
Korea	Overnight call rate	5.00	125	9 Aug 07 (+25bp)	on hold	5.00	5.00	5.00	5.00	5.00
Indonesia	BI rate	8.25	91	5 July 07 (-25bp)	**4Q 07 (-25bp)**	8.25	8.00	8.00	7.75	8.00
India	Repo rate	7.75	175	30 Mar 07 (+25bp)	on hold	7.75	7.75	7.75	7.75	7.75
Malaysia	Overnight policy rate	3.50	80	26 Apr 06 (+25bp)	on hold	3.50	3.50	3.50	3.50	3.50
Philippines	Reverse repo rate	6.00	-75	12 Jul 07 (-150bp)	on hold	6.00	6.00	6.00	6.00	6.00
Thailand	1-day repo rate	3.25	200	18 July 07 (-25bp)	29 Aug 07 (-25bp)	3.00	3.00	3.00	3.00	3.00
Taiwan	Official discount rate	3.125	175	21 Jun 07 (+25bp)	late Sep 07 (+12.5bp)	3.25	3.375	3.50	3.50	3.50

[1]Rather than the refi rate, we now display the 1-wk dep rate, which better represents CBR policy stance and is closer to interbank market rates.

Bold denotes move this week and forecast changes

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Forecasts - Australia and New Zealand

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

				2006			2007				2008			
	2006	2007	2008	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Chain volume GDP	2.7	4.1	3.4	2.5	1.9	4.3	6.6	2.8	3.7	3.8	4.5	2.8	2.3	2.7
Private consumption	3.1	3.7	2.3	2.8	2.9	5.0	6.0	2.0	1.6	2.0	2.4	2.4	2.8	2.8
Construction investment	5.1	9.8	4.5	17.4	-4.5	7.4	25.7	3.8	8.5	3.2	4.3	4.4	3.0	6.4
Equipment investment	6.2	5.3	0.8	-8.7	-8.6	-2.9	24.9	4.3	6.4	4.3	0.0	0.0	-4.1	-8.1
Public investment	12.5	-5.5	5.2	2.9	22.4	53.3	-52.3	7.2	6.1	4.2	4.6	5.2	5.4	5.8
Government consumption	4.0	2.3	1.9	8.4	7.2	-4.4	3.3	2.8	2.4	2.0	2.0	1.6	1.6	1.6
Exports of goods & services	3.4	6.5	8.7	8.3	0.8	3.9	5.8	10.0	10.4	8.2	12.6	6.1	4.1	8.2
Imports of goods & services	7.6	9.0	3.7	11.8	-2.2	28.7	9.0	5.1	2.0	3.0	4.1	4.1	3.2	6.1
Contributions to GDP growth:														
Domestic final sales	4.3	4.3	2.7	5.9	1.4	6.8	5.4	2.8	3.5	2.5	2.6	2.6	2.3	2.5
Inventories	-0.6	0.6	0.0	-2.2	-0.1	2.7	2.1	-0.6	-1.2	0.4	0.4	0.0	0.0	0.0
Net trade	-1.0	-0.8	0.8	-1.0	0.6	-5.0	-1.0	0.6	1.4	0.8	1.4	0.2	0.0	0.2
GDP deflator (%oya)	4.7	3.6	2.5	4.6	5.1	4.5	4.8	4.0	3.0	2.6	2.5	2.5	2.5	2.5
Consumer prices (%oya)	3.5	2.6	3.5	4.0	3.9	3.3	2.4	2.1	2.3	3.5	3.9	3.2	3.0	2.6
Producer prices (%oya)	7.9	2.7	3.2	9.9	7.9	6.1	3.8	1.5	2.0	3.8	4.7	2.9	2.7	2.5
Trade balance (A$ bil, sa)	-13.3	-14.7	-14.2	-3.5	-2.0	-4.1	-4.1	-3.6	-3.4	-3.7	-3.1	-3.4	-3.8	-3.9
Current account (A$ bil, sa)	-54.9	-62.8	-65.2	-13.4	-12.8	-15.5	-15.4	-15.4	-15.4	-16.7	-15.6	-16.4	-16.8	-16.4
as % of GDP	-5.5	-5.8	-5.7	-5.4	-5.1	-6.0	-5.8	-5.7	-5.6	-6.0	-5.6	-5.7	-5.8	-5.6
3m eurodeposit rate (%)*	6.0	6.4	6.8	5.8	6.2	6.2	6.4	6.3	6.3	6.4	6.5	6.8	6.8	6.8
10-year bond yield (%)*	5.6	5.9	6.3	5.6	5.7	5.7	5.9	5.9	6.0	6.0	6.1	6.2	6.2	6.3
US$/A$*	0.75	0.80	0.74	0.74	0.77	0.77	0.80	0.83	0.80	0.79	0.77	0.76	0.75	0.74
Commonwealth budget (FY, A$ bil)	15.8	13.6	8.5											
as % of GDP	1.6	1.3	0.7											
Unemployment rate	4.8	4.6	5.2	4.9	4.7	4.6	4.5	4.3	4.6	4.8	5.0	5.1	5.3	5.5
Industrial production	-0.6	0.9	0.0	0.2	7.3	8.3	-2.1	-2.0	-4.0	-1.0	1.0	3.0	4.0	0.0

*All financial variables are period averages

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

				2006			2007				2008			
	2006	2007	2008	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Real GDP (1995-96 prices)	1.5	2.7	2.5	1.6	1.0	3.3	4.2	1.7	2.4	2.5	2.5	2.8	2.2	2.2
Private consumption	2.3	3.3	1.0	-0.3	1.6	5.6	8.8	-1.0	0.8	1.1	1.1	1.2	1.3	1.2
Fixed Investment	-2.4	4.1	0.4	-19.8	5.1	4.2	17.1	0.0	0.1	0.4	0.3	0.5	0.6	0.7
Residential construction	-2.7	1.9	0.8	-21.3	16.8	8.2	-1.3	1.0	0.8	1.0	0.7	0.9	0.8	0.9
Other fixed investment	-2.3	4.6	0.2	-19.4	2	3.2	22.6	-0.2	-0.1	0.2	0.2	0.4	0.5	0.6
Inventory change (NZ$ bil, saar)	0.0	-0.1	0.1	-0.1	-0.2	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.1
Government spending	4.8	3.0	3.7	7.4	4.0	1.0	3.6	2.3	2.6	4.0	4.8	4.3	1.9	4.2
Exports of goods & services	1.9	2.4	4.1	11.3	11.0	-9.2	8.3	-3.8	4.8	5.0	5.0	4.2	4.2	4.0
Imports of goods & services	-2.5	5.5	2.1	-5.0	2.7	6.5	18.4	-2.4	2.0	2.2	2.4	2.2	3.0	3.0
Contributions to GDP growth:														
Domestic final sales	0.7	4.0	1.7	-0.8	-0.4	4.5	10.8	1.8	1.8	1.6	1.4	2.0	1.8	2.0
Inventories	-0.8	-0.1	0.2	-2.9	-1.1	4.3	-2.5	0.2	-0.1	0.1	0.4	0.3	0.1	0.1
Net trade	1.6	-1.2	0.5	5.4	2.5	-5.4	-3.7	-0.3	0.8	0.8	0.7	0.5	0.2	0.2
GDP deflator (%oya)	2.4	2.8	2.1	2.0	2.7	2.9	3.2	3.2	2.5	2.4	2.1	2.1	2.1	2.1
Consumer prices	3.4	1.9	2.5	6.2	2.8	-0.8	2.0	2.7	1.9	0.8	3.2	4.0	2.6	0.7
%oya	3.4	1.9	2.5	4.0	3.5	2.7	2.5	1.7	1.5	1.9	2.1	2.4	2.6	2.6
Trade balance (NZ$ bil, sa)	-3.2	-4.5	-4.9	-0.7	-0.7	-0.8	-0.9	-1.2	-1.2	-1.2	-1.2	-1.2	-1.2	-1.2
Current account (NZ$ bil, sa)	-14.4	-14.4	-14.3	-3.5	-3.2	-3.6	-3.6	-3.6	-3.6	-3.5	-3.5	-3.6	-3.6	-3.6
as % of GDP	-9.2	-8.7	-8.3	-9.2	-8.1	-9.0	-8.9	-8.8	-8.7	-8.4	-8.3	-8.3	-8.2	-8.2
Yield on 90-day bank bill (%)*	7.5	8.2	8.1	7.5	7.5	7.7	7.8	8.2	8.4	8.3	8.3	8.3	8.1	7.8
10-year bond yield (%)*	5.8	6.3	6.2	5.8	5.8	5.8	6.0	6.4	6.4	6.4	6.3	6.3	6.2	6.2
US$/NZ$*	0.65	0.75	0.68	0.62	0.64	0.67	0.70	0.74	0.78	0.77	0.73	0.72	0.64	0.63
Commonwealth budget (NZ$ bil)	6.5	6.4	5.7											
as % of GDP	4.2	3.9	3.3											
Unemployment rate	3.8	4.0	4.4	3.6	3.8	3.7	3.8	3.9	4.0	4.1	4.2	4.3	4.4	4.5

*All financial variables are period averages

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Australasian economic calendar

Monday	Tuesday	Wednesday	Thursday	Friday
20 Aug	21 Aug New Zealand: Credit card spending (03:00pm) Jul	22 Aug Australia: Westpac leading index (10:30am) Jun New passenger car sales (11:30am) Jul	23 Aug	24 Aug New Zealand: Trade balance (10:45am) Jul
27 Aug	28 Aug	29 Aug Australia: Construction work done (11:30am) 2Q	30 Aug Australia: Current account (11:30am) 2Q Pvt cap expend (11:30am) 2Q New Zealand: Building permits (10:45am) Jul Money supply (03:00pm) Jul NBNZ business confidence (03:00pm) Aug	31 Aug Australia: Retail sales (11:30am) Jul Pvt sector credit (11:30am) Jul Trade balance (11:30am) Jul
3 Sep Australia: Inventories (11:30am) 2Q Building approvals (11:30am) Jul Company profits (11:30am) 2Q ANZ job ads (11:30am) Aug	4 Sep	5 Sep Australia: RBA Cash target (09:30am) Sep GDP (11:30am) 2Q	6 Sep Australia: Unemployment rate (11:30am) Aug	7 Sep
10 Sep Australia: Housing finance (11:30am) Jul	11 Sep Australia: NAB business survey (11:30am) Aug New Zealand: Terms of trade index (10:45am) 2Q	12 Sep Australia: Westpac consumer confidence (10:30am) Sep	13 Sep Australia: Consumer inflation expectation (10:30am) Sep New Zealand: RBNZ official cash rate (09:00am) Retail sales (10:45am) Jul	14 Sep New Zealand: Manufacturing activity (10:45am) 2Q

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

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Global Data Diary

Week / Weekend	Monday	Tuesday	Wednesday	Thursday	Friday
20 - 24 August	20 Aug	21 Aug	22 Aug	23 Aug	24 Aug
	Euro Area • Trade balance (Jun)	Belgium • BNB business confidence (Aug) Canada • CPI (Jul) • Retail sales (Jun) Germany • Zew business survey (Aug)	Euro Area • Industrial orders (Jun) Japan • Trade balance (Jul) Taiwan • Unemployment (Jul)	Belgium • BNB bus survey (Aug) Germany • GDP final (2Q) Japan • BoJ announcemrnt Norway • GDP (2Q) Philippines • BSP meeting Taiwan • Export orders (Jul) • IP (Jul) • GDP (2Q) United Kingdom • Business investment (2Q)	Colombia • BanRep meeting Euro Area • PMI flash (Aug) Japan • CSPI (Jul) Malaysia • BNM meeting Netherlands • CBS bus survey (Aug) United Kingdom • GDP (2Q 2nd release) United States • Durable goods (Jul) • New home sales (Jul)
27 - 31 August	27 Aug	28 Aug	29 Aug	30 Aug	31 Aug
	Germany • CPI 6 states prelim (Aug) Hungary • NBH meeting United States • Existing home sales (Jul)	Canada • Payrolls (Jun) Euro area • M3 (Jul) Germany • IFO business survey (Aug) Japan • MPM minutes (Jul 11-12) Slovak Republic • NBS meeting South Africa • GDP (2Q) United States • Consumer confidence (Aug) • FOMC minutes (Aug 7)	France • INSEE business survey (Aug) Korea • IP (Jul) Poland • NBP meeting Spain • GDP (2Q final) Thailand • BoT meeting	Czech Republic • CNB meeting Euro Area • PMI retail (Aug) Germany • Unemployment (Jull) France • Unemployment (Jul) Japan • Retail sales (Jul) • Shoko Chukin (Aug) United States • OFHEO HPI (2Q) • Real GDP prelim (2Q)	Canada • Real GDP (2Q) Euro Area • EC bus survey (Aug) • HICP flash (Aug) • Unemployment (Jul) Japan • Household spending (Jul) • IP (Jul) • Nationwide CPI (Jul) • PMI mfg (Aug) • Unemployment rate (Jul) United States • Chicago PMI (Aug) • Consumer sent (Aug final) • Factory orders (Jul) • Personal income (Jul) • Bernanke speaks in Jackson Hole

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