JPMorgan

Australia and New Zealand - Weekly Prospects

Summary

- Last week's **Australian** economic calendar was quiet, but this week the schedule expands significantly to include business investment, retail sales, private credit, and the current account. Firms most likely will estimate a 10% rise in investment spending for the year ended June 2008—if realized, this will drive spending 70% above its level of just three years ago. Retail sales probably advanced only 0.5%m/m in July (consensus 0.6%) as the negative impact of high petrol prices more than offset the boost from the latest round of personal income tax cuts. We are sticking with our call for a December RBA tightening, even though we expect the Fed to ease twice in coming months. We have, however, lowered the probability of the RBA's move from 75% to 60% to reflect increased risk that the global economy will falter.

- **New Zealand's** streak of weak economic data continued in July. Net permanent migration flows slowed to a trickle, which points to weaker demand for housing and easing consumption growth. Electronic card transactions (a coincident indicator of retail spending) also declined, illustrating a slowdown in consumption momentum into 3Q, following what is likely to be a 0.3%q/q contraction in consumption growth in 2Q. On the positive side, though, Fonterra, NZ's largest dairy cooperative, last Friday announced an increased payout to farmers of 87 cents to NZ$6.40 per kilogram of milk solids for the 2007/08 season. This unexpectedly large payout will boost farm income in the year ahead. This week's NBNZ business confidence survey for August will be the highlight.

- **Global financial market conditions** settled somewhat last week, raising hopes that the spillover effects from the severe lack of liquidity in money markets will be modest. If the financial shakeout continues in an orderly manner, focus will shift toward assessing the macroeconomic impact of a sustained widening of risk spreads in an environment of tight capacity constraints. At root, the turbulence of the past month represents a disorderly move toward repricing credit risk, which is being magnified by a loss of confidence in the ratings system for asset-backed securities. This adjustment is set to reduce the availability and increase the price of credit for both corporates and households.

- The key issue for the months ahead will be to figure out the impact of tighter credit conditions on economic growth. In making this assessment, it is easy to lose sight of the message from recent data about where the **global economy** stood as the financial shockwaves hit. To a large extent, the key themes of the JPMorgan outlook are playing to script; namely, that global growth remains above trend amid a significant rotation in the sources of growth.

This week's highlight

Thursday's Aussie business investment survey. Firms likely will reinforce earlier expectations that the investment boom has further to run. Those interested should ignore the most recent quarterly outcome and focus on the expectations component.

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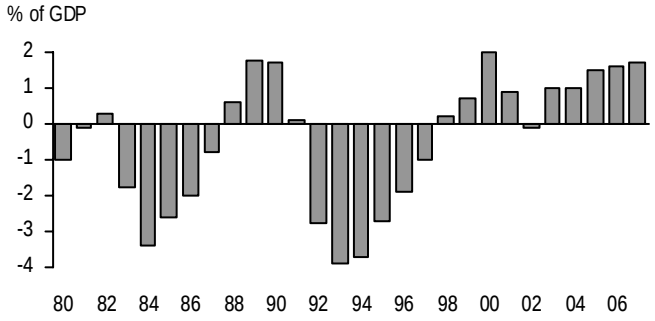
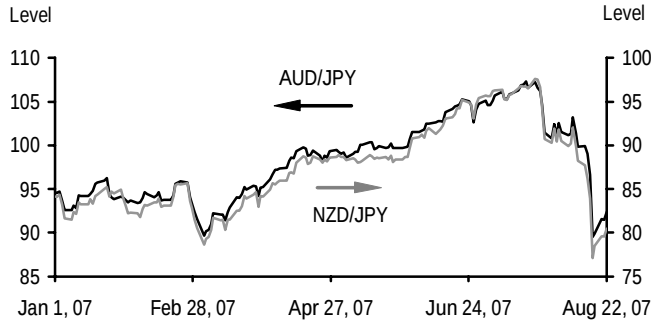
This week's feature charts

Australia: central Government Budget balance



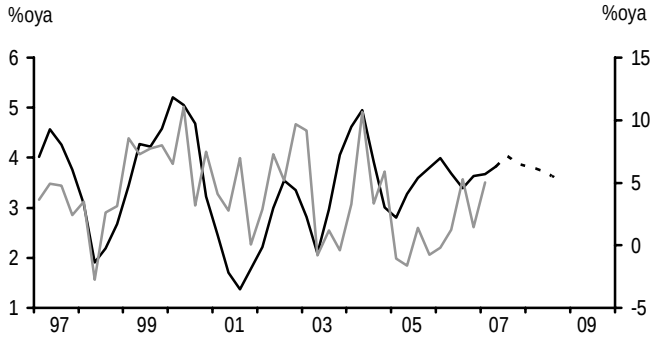
The Government last week announced a bumper 2006-07 budget outcome of more than A$17 billion (1.7% of GDP, the highest since 1999-00). The majority of these funds will be locked away in the Future Fund, or in discreet funds specifically to be used for health and education. The huge fiscal dividend from the booming economy, though, means the Government will have plenty of spare cash for the election campaign. The Coalition still needs to close the yawning gap in opinion polls in favour of the Labor opposition.

AUD and NZD carry trade starts to rebuild



Recent global financial market volatility has seen investors shun high-yielding currencies, such as AUD and NZD, in favour of low-yielding, less risky currencies, such as the yen. The allure of the so called carry trade has, however, already started to rebuild, gathering further momentum following the BoJ's monetary policy meeting last Thursday. The BoJ left interest rates on hold as expected, and signalled to markets that officials would allow time to assess how recent market developments may effect the real economy.

New Zealand export growth and trading partner growth



Despite July's poor trade report, which showed the value of exports had dropped 13%oya, the outlook for export volumes remains promising. World commodity prices are improving (not just in the dairy industry which has seen a dramatic run up in prices—Fonterra, NZ's largest dairy co-operative, on Friday increased its predicted 2007/08 payout to a whopping NZ$6.40 kg/MS) and the NZD has fallen sharply. More importantly, global growth remains supportive, and NZ's trading partners continue to grow strongly.

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Economic comment

RBA still expected to tighten policy in December

- **We retain our forecast for a December RBA tightening ...**
- **... despite expectations that the Fed will ease at the September and October FOMC meetings**
- **Australia's direct exposure to the subprime mortgage problems is tiny**

Our US team expects the Fed to ease 25bp at both the September and October FOMC meetings. These anticipated moves can be characterised as the Fed taking out insurance to mitigate against the increased downside risks to growth in the US economy in the wake of the sub-prime mortgage mess and the spreading contagion across asset markets.

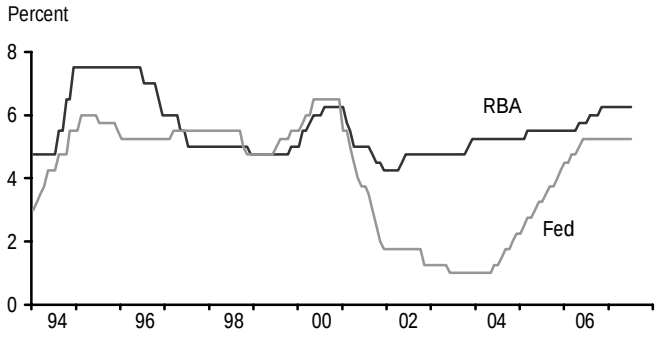
Also, we have lowered the average US growth forecast for the coming two quarters to reflect the expected macro-economic fall-out from the spreading crisis, and trimmed expected growth in Japan. We recently pushed back the expected timing of tightening by the Bank of Japan and the ECB to November and December, respectively, changed the Bank of England call to 'rates on hold' from an expected tightening, and put an October ease in the Bank of Canada profile.

RBA to tighten on December 5

We have not, however, changed our call that the RBA will raise the cash rate 25bp in December. In the wake of the change to the Fed call, however, we have lowered the probability of this move from 75% to 60% to reflect increased risk that the previously upbeat global economy, which has been a key source of support for Australia's economy, via the soaring terms of trade, will falter. We retain our call for a December RBA rate hike for a number of reasons:

Although we expect the Fed to ease the funds rate twice in coming months, we expect the Fed subsequently to raise the funds rate three times from June 2008. This requirement for a tightening of monetary conditions next year reinforces our view that the US economy fundamentally is in good shape, and that the macro-economic fallout from the sub-prime mortgage crisis, while material, will be relatively contained. Indeed, our forecast for growth in the world economy remains broadly

RBA cash rate target and the Fed funds rate



unchanged (down to 3.3% for 2007, from 3.4% previously), even with the downgrade to US and Japan growth, although the risks now are skewed more to the downside than before. The still healthy global outlook means that the terms of trade support for Australia's economy is likely to remain a key driver of national income.

'Subprime' problem is tiny in Australia

The Australian residential property market's exposure to lower quality mortgages is much smaller than the exposure in the US, so there is less need for the RBA to place a floor under growth via rate cuts. The equivalent segment of 'subprime' (i.e. no-doc) mortgages in Australia, for example, represents just 1-2% of total loans, compared to around 12% in the US, although neat comparisons are difficult because of definitional differences. Also, RBA Governor Glenn Stevens indicated the week before last that a smaller percentage of these lower quality loans here are in arrears than the 14% in the US. This means that the direct impact in Australia of the mess in the low quality mortgage market will be small.

The RBA's commentary has been unexpectedly upbeat and indicates that the RBA's tightening bias remains in place. This was even after officials had taken account of the increasingly disorderly nature of global financial markets and the downside risks to global growth. In fact, the RBA this month unexpectedly raised the official forecast for core inflation from 2.75% to 3.0%—the top of the RBA's target range. While the RBA's commentary was delivered before the Fed cut the discount rate, officials have signalled that they share our view that global growth is built on sound foundations. Governor Stevens indicated during his Parliamentary testimony that he could not contemplate cutting the cash rate any time soon, even if the Fed eased, as we now expect.

The dislocation in global markets will do nothing to ease Australia's lingering capacity constraints, which are putting upward pressure on prices. This is particularly so in the labour market, where the corporate sector is having to dip into the remaining puddles at the bottom of the pool of available employees to fill vacancies. Governor Stevens described the economy as operating at close to full employment, and recent economic data indicate that momentum was strong heading into Q3.

RBA's inflation problem is now worse

The plunge in AUD in recent weeks means Australia now has more of an inflation problem than before. When raising the cash rate 25bp on August 8, the RBA mentioned the elevated AUD as one factor mitigating against the upside risks to inflation. The dive in AUD, though, which, admittedly has partly rebounded, means that mitigating factor for inflation has deteriorated somewhat, and import prices even could be rising in coming quarters. Previously, the forecast had anticipated lower import prices owing to the elevated AUD.

All that said, the re-pricing of credit in domestic markets means mortgage rates on some of the lower quality loans are likely to rise in coming months by more than the 25bp increase in the cash rate earlier this month, as spreads widen. This disproportionate rise in some market interest rates will do some of the heavy lifting for the RBA, although it is too early to tell where market mortgage rates will settle relative to cash. Signs of even more household distress - a record number of households already exhibit mortgage stress - owing to higher mortgage rates could prompt the RBA to stay on the sidelines indefinitely

Credit tightening the main risk

At this stage, however, we still call for a 25bp tightening in early December, one month after the federal election. This forecast remains, however, 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 is contained. If markets are still in turmoil by the time the next 'live' Board meeting comes around, which is unlikely, the RBA will not tighten policy. Similarly, the RBA will not tighten if the real economy spillover turns out to be more pronounced than anticipated. In particular, RBA officials will be watching closely to gauge whether the downside risks to global growth have intensified.

For the record, there are plenty of times in the past when the RBA has left the cash rate unchanged while the Fed eased but, admittedly, few times when the RBA has tightened as the Fed eased. The most recent such episode was in 2002, when the RBA embarked on a tightening cycle when the Fed was still on the way to lowering the funds rate to a record low of 1%. Back then, the RBA tightened policy twice ahead of two eases by the Fed, and tightened twice more while the Fed funds rate was anchored at 1%. An RBA tightening in December after two Fed eases would not, therefore, be unprecedented.

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Australia

- **Retail sales and credit growth set to moderate in July**
- **Australian budget outcome in 2006-07 exceeded forecast**
- **Thursday's investment survey this week's highlight**

With little data on the Australian economic front last week, market pundits continued to digest RBA Governor Glenn Stevens' recent semiannual testimony to Parliament, while keeping one eye on financial market developments. Despite recent market volatility, the Governor maintained a vigilant tone, and reaffirmed expectations that the current tightening cycle has further to run. This week, a plethora of top-tier economic data is scheduled for release, including 2Q current account and capital expenditure figures, alongside retail sales, private sector credit, and foreign trade data for July.

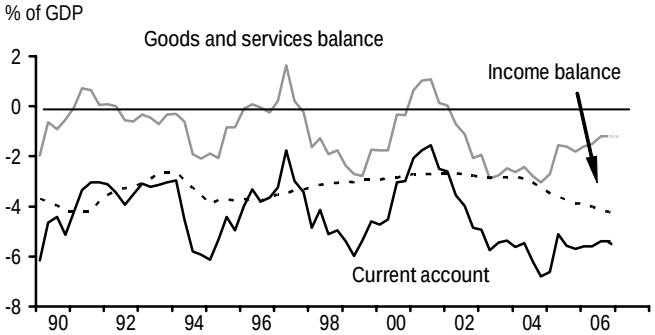
Preview: 2Q capex and current account

As always, this week's private business investment survey for 2Q will attract much attention, assuming financial markets have calmed. Investment in the June quarter likely dropped slightly in real terms, but this follows the 9% surge in 1Q which, admittedly, was inflated by a change from public to private ownership of Telstra, Australia's largest telecommunications company. Firms' estimates of spending in the year ended June 2007 are likely to imply a healthy 7% rise from the previous year. Firms likely will estimate that spending in the year ended June 2008 will rise around 10%, broadly unchanged from the 1Q survey. If realized, this will mean that private investment spending will have risen nearly 70% since the year ended June 2004.

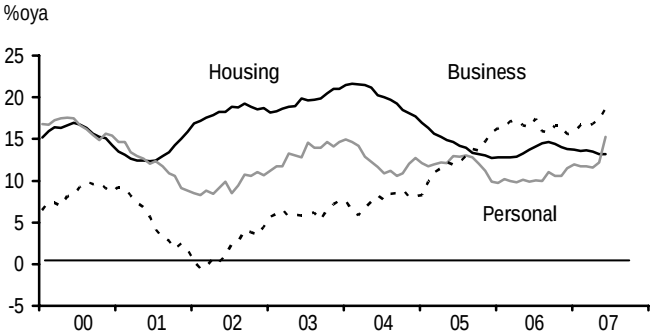
The current account deficit, meanwhile, will likely worsen in 2Q from an unexpectedly large A$15.4 billion deficit in the March quarter. The deficit is forecast to blow out to 5.9% of GDP (from 5.7% previously) owing primarily to a deterioration in the trade balance. The income deficit also will likely worsen, hovering around a record A$12 billion.

Looking ahead, the imminent rise in export volumes and slower growth in imports as the investment boom eases (Australia imports the lion's share of its capital goods) should see the trade balance move back into surplus in coming quarters, allowing the current account gap to narrow. Furthermore, amid recent financial market volatility, corporates may feel less inclined to raise debt offshore, allowing the net income deficit to improve mildly. In the longer term, though, the income gap will widen as global interest rates rise and Australian firms once again tap into deeper and more liquid offshore capital markets. The burgeoning current account deficit of near 6% of GDP eventually will be a headwind for AUD.

Australia: current account deficit



Australia: private sector credit aggregates



Preview: credit growth to slow steeply

Private sector credit aggregates in Australia in June surged 1.8%m/m, up from 1.3% in May. While business lending again grew solidly, rising 1.9%m/m, housing and personal credit spiked 1.5% and 3.6%, respectively. The jump in personal and household lending in June emerged as borrowers demanded more credit to fund one-off superannuation contributions ahead of changes to superannuation laws at the end of June. In response, demand for credit likely will slow in July, rising just 0.9%m/m, or 14.9%oya (compared to 15.4% previously).

Despite the expected moderation, credit expansion remains solid, which will unnerve RBA officials. In his semiannual testimony to the House of Representatives Standing Committee just over a week ago, Governor Glenn Stevens implied that the RBA retains a clear bias to tighten policy again, citing solid demand for finance, amid strong business and consumer sen-

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timment, and above-trend economic growth. Thus, in the absence of any spill-over from the recent global market turmoil to the real economy, amid expectations that core inflation will remain at the top of the RBA's 2-3% target range in the near-term, JPMorgan maintains that the RBA will lift official interest rates to 6.75% in December.

Preview: retail sales to moderate in July

Growth in consumer spending is expected to moderate to 0.5%m/m in July after jumping 1.4% in June—when consumers rushed to the stores to stock up on winter goods and apparel as unusually cold weather spread across the nation. Discretionary spending was likely reined in last month amid expectations of an imminent rate hike (which came to fruition in early August), still-elevated petrol prices, and a pickup in financial market volatility toward month-end.

That said, underlying fundamentals in the retail sector remain supportive. Consumer confidence is near a record high, the unemployment rate remains at a 33-year low, wage growth is rising (albeit mildly), and the government's fiscal boost is growing almost by the day ahead of the election (expected in November). Also, income tax cuts became effective on July 1, boosting disposable incomes and encouraging further consumer spending.

Government finds extra funds to spend

Government Treasurer Peter Costello announced last Tuesday Australia's budget outcome for the 2006-07 fiscal year. The underlying cash surplus of A$17.3 billion (1.7% of GDP) was unexpectedly large, and substantially higher than the A$13.6 billion surplus forecast in May.

The Treasurer indicated that around A$2 billion of the additional cash came from lower than budgeted spending. In particular, welfare payments were lower owing to the robust economy. The remaining A$1.7 billion of the additional cash came from unexpectedly high tax receipts, most of which were from companies. Superannuation fund tax receipts also were higher than anticipated, owing to unexpectedly healthy realized gains from pension funds.

The government immediately will transfer A$7 billion of the accumulated surplus to the Future Fund, which sets aside funds to meet expected public sector pension liabilities, and will add another A$1 billion to the Higher Education Endowment Fund. It will also establish a Health and Medical Investment fund with an initial injection of A$2.5 billion. This still leaves available, however, a generous pool of funds. As such, given that the government still trails far behind the Labor opposition in the public opinion polls, the government will likely announce carefully targeted fiscal largesse as the election nears.

Australia: underlying cash budget balance (A$ billion)

	Final outcome	Updated budget estimate	Difference
2002-03	7.5	3.9	3.6
2003-04	8.0	4.6	3.4
2004-05	13.6	9.2	4.4
2005-06	15.8	14.8	1.0
2006-07	17.3	13.6	3.7

Source: Australian Treasury

Moreover, even though RBA officials have indicated that small changes in the Budget balance are not material in deciding the direction of monetary policy, with the economy already bumping up against capacity constraints and inflation pressure building, the economy is hardly in need of stimulus. Thus, the RBA will be on the lookout for signs that the fiscal boost is triggering additional inflation pressure.

Data releases and forecasts

Week of August 27 - 31

Wed Aug 29 11:30am — **Construction work done**
Seasonally adjusted

	3Q	4Q	1Q	2Q
(%q/q)	-2.7	3.8	2.7	__
(%oya)	2.7	6.6	8.9	__

Thu Aug 30 11:30am — **Current account balance**
A$ billion, seasonally adjusted

	3Q06	4Q06	1Q07	2Q07
Current account (A$ bn)	-12.8	-15.5	-15.4	-15.9
As a % of GDP	-5.1	-6.0	-5.8	-5.9

Thu Aug 30 11:30am — **Private new capital expenditure**
Seasonally adjusted

	3Q06	4Q06	1Q07	2Q07
(%q/q)	-5.3	1.0	9.1	-1.0
(%oya)	8.4	-1.3	4.7	2.2

Spending likely dropped slightly in 2Q. Firms' estimate of spending in the year ended June 2008 needs to print at A$78.5 billion to imply the same annual growth rate (10%) implied in the previous survey.

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Fri
Aug 31
11:30

Retail trade

Seasonally adjusted

	Apr	May	Jun	Jul
(%m/m)	-0.3	-0.3	1.4	0.5
(%oya)	6.1	5.7	6.7	6.5

Fri
Aug 31
11:30am

Private-sector credit

Seasonally adjusted

	Apr	May	Jun	Jul
(%m/m)	1.3	1.3	1.8	0.9
(%oya)	14.5	14.5	15.4	14.9

Fri
Aug 31
11:30

Trade balance

Seasonally adjusted

	Apr	May	Jun	Jul
Exports (A$ bn)	18.1	18.6	18.0	18.2
Imports (A$ bn)	19.2	19.6	19.7	19.1
Trade balance (A$ mn)	-1051	-970	-1751	-811

After widening considerably in June, the trade deficit will narrow in July as exports grow 2%m/m and imports fall 3%. Nonrural shipments will pick up as trading resumes from the nation's largest export harbor, while rural exports will increase on the back of recent rainfall. Demand for imports, mainly from consumers, will slow amid expectations of higher interest rates.

Review of past week's data

WMI leading index

Seasonally adjusted

	Apr	May	Jun	
(%m/m)	0.7	0.2	—	*1.0*

Sales of new motor vehicles

Units, seasonally adjusted

	May		Jun	Jul	
(%m/m)	~~-0.4~~	-0.2	2.2	—	*0.6*
(%oya)	6.7		11.3	—	*8.7*

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New Zealand

- **NZ business confidence to post modest decline next week**
- **RBNZ are not in a position to contemplate easing policy**
- **The value of NZ trade disappointed in July**

New Zealand's streak of weak economic data continued in July. Net permanent immigration flows slowed to a trickle, pointing to weaker demand for housing and easing consumption growth. Electronic card transactions (a coincident indicator of retail spending) also declined, illustrating a slowdown in consumption momentum into 3Q—following what is likely to be a 0.3%q/q contraction in consumption growth in 2Q. Ending the week, the July trade deficit widened as a result of the high NZD. On a positive note, Fonterra announced an increased payout of 87 cents to NZ$6.40 per kilogram of milksolids for the 2007/08 season. This week's NBNZ business confidence survey for August will be the highlight.

NZ's business confidence to decline

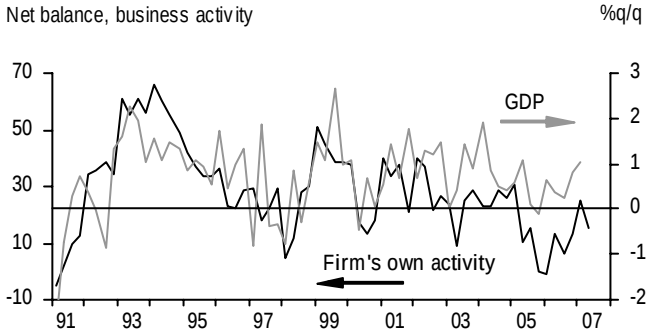
Following the financial market turbulence of the past two weeks and global concerns of the potential passthrough impact to real economic growth, this week's NBNZ business confidence survey for August will be a real test of business confidence and expectations. JPMorgan expects confidence to have dropped only modestly over the month. The financial market turmoil has induced a flight to quality—temporarily stalling the carry trade—and taken the wind from beneath the kiwi's wings (the NZ currency has fallen dramatically from the high of $0.8110). The decline in the dollar will be broadly welcomed by kiwi businesses, and should largely offset concerns over the financial market madness.

RBNZ reviews financial market not policy

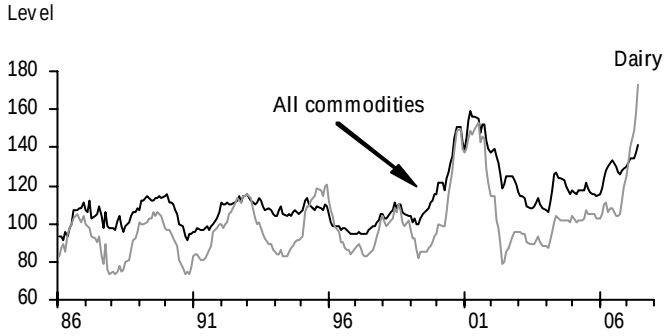
The RBNZ announced that it will accept bank bills as collateral in its overnight repurchase facility to ease pressure on liquidity in the financial system. The RBNZ usually accepts only government securities in the repo facility. Bank bill yields tumbled after the news. Yields on 3-month bank bills spiked to 9.2% on Wednesday, but fell back to 8.8% on Thursday after Deputy Governor Grant Spencer's statement:

> Pressures have persisted over the past week warranting steps to ease liquidity conditions in the interbank market. As a temporary measure, the bank will now accept New Zealand bank bills in its overnight reverse repurchase facility.

New Zealand: NBNZ business outlook survey and GDP growth



New Zealand: ANZ commodity price index - in NZD



The RBNZ tightened policy just last month and maintained a conditional tightening bias, so market pricing implying a rate cut by September is not only bold but incorrect. In the absence of a clear spillover to the real economy from the recent financial market turmoil, the RBNZ will remain on hold into 2008. Indeed, the expected action by major central banks around the globe, including two 25bp Fed eases in coming months, has merely halved the probability of further RBNZ tightening (not easing) to 10-15% from 20-30%.

RBNZ officials remain focused on surging dairy prices (now amplified by last week's NZD drop), a stubbornly resilient housing market, the tight labor market, high capacity usage, and rising food prices as "sustained inflationary pressures." With these factors still in play, the RBNZ will remain on hold until there are clear signs that the recent decline in sentiment is translating into reduced activity and inflation pressure. It would take a significant leg down in economic activity and severe disruptions to local markets to prompt an RBNZ ease.

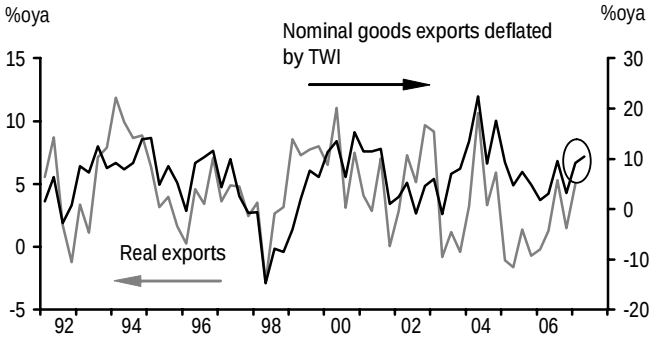
Exports grounded as Kiwi flies high in July

The rapid appreciation of the Kiwi dollar—which hit a record US 0.81 in July—has continued to dilute the value of exports. Indeed, the trade deficit worsened in July as the value of exports fell and imports rose. The annual trade deficit now stands at a whopping NZ$6.32 billion, thanks primarily to a 13%oya fall in export values (imports are down 7.6%oya).

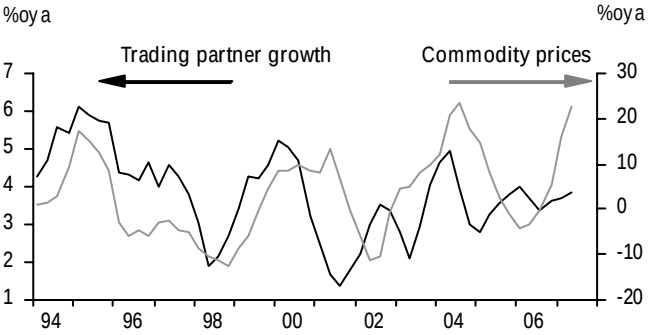
New Zealand's TWI rose to a record 75.4 in July, up over 20%oya, and is pushing down the value of exports. Deflating the nominal value of exports by the TWI points to an increase in volumes in 2Q and July (chart). JPMorgan believes the outlook for export growth (in volume and value terms) remains positive. The significant run-up in commodity prices (led by New Zealand's cash cow: dairy), the recent drop in NZD, and a solid growth outlook for key trading partners will be supportive of export growth.

According to Statistics New Zealand, the July monthly trade deficit of $791 million was 30% of exports; this was the highest July percentage since 1976. Exports of meat were down 21.8%oya thanks predominantly to falling prices, as the drought in Australia forced local farmers to cull live stock, which in turn drove down the price of meat. This trend will reverse as supply is soaked up. Imports of aircraft were down 89%oya due to large aircraft imported in July 2006.

New Zealand: export volumes (GDP) and nominal trade (deflated by TWI)



New Zealand: trading partner growth and commodity prices

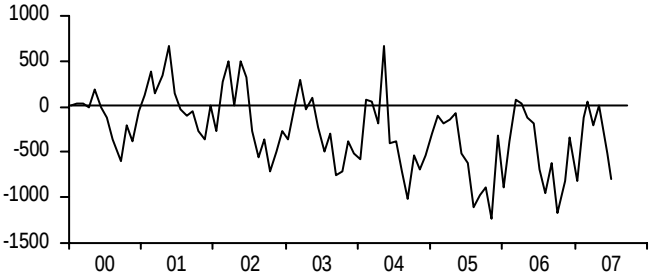


Migration flows point to drop in demand

Net permanent and long-term migration was just 9,000 in the year to July, down from the net gain of 12,100 in the July 2006 year. This is the first time that annual net PLT migration has been below 10,000 since March 2006. Significant swings in migration flows have a profound impact on housing demand and consumption, and have provided a floor under economic activity over the past few years. The easing pressure on domestic demand, brought about by more departures, not reduced arrivals, will be welcomed by the RBNZ, and reduces the inflation trajectory.

New Zealand: trade balance

NZ$ million, nsa



Electronic transactions short out in July

According to the relatively new and experimental electronic card transaction series released by Statistics New Zealand, the total value of transactions in July fell 0.1%m/m. The trend in transactions was up 8%oya, but this represented the smallest annual increase in the series since it began in October 2002. In the retail industries, the value of card transactions fell 0.4%m/m in July. Although far from perfect, the transaction series provides a reasonable reading on the level of retail activity over the month (chart), and points to weak retail trade in July. The Electronic Card and points to weak retail trade in July. The Electronic Card Transaction series measures the number and value of debit, credit and charge card transactions with merchants.

In other data, the RBNZ's credit card statistics showed a 0.2%m/m decline in the amount of spending financed on credit cards in July, supporting the results of the StatsNZ electronic transaction series, and points to a reduction in the momentum of consumption into the third quarter. The last RBNZ OCR announcement signalled the end in the prolonged tightening cycle with the conditional statement that New Zealanders must continue to moderate their borrowing. From the RBNZ's viewpoint, the showdown in credit card debt accumulation is a step in the right direction.

Data releases and forecasts

Week of August 27 - 31

Thu Aug 30 10:45 — **Building consents**
Seasonally adjusted

	Apr	May	Jun	Jul
(%m/m)	1.1	5.8	15.8	-13.0
(%oya)	9.4	2.4	34.3	3.2

Thu Aug 31 10:45 — **NBNZ business confidence**

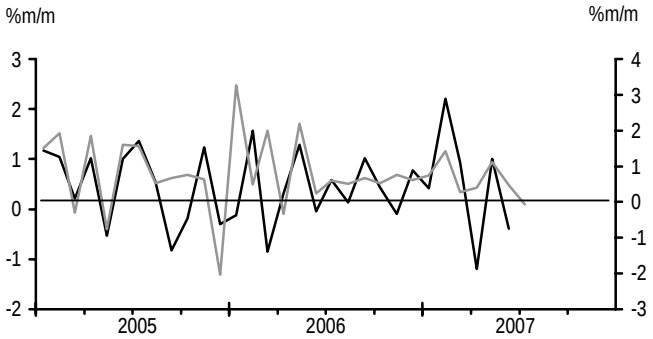
	May	Jun	Jul	Aug
(Net % of respondents)	-48.3	-37.2	-38.5	-39.5

Review of past week's data

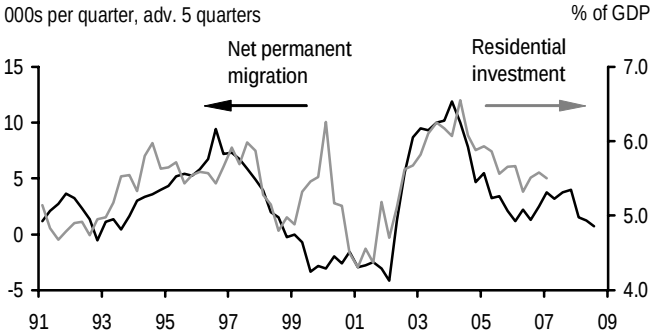
Credit card spending
Seasonally adjusted

	May	Jun		Jul	
(%m/m)	0.5	1.9		—	*-0.2*
(%oya)	5.7	~~9.1~~	*9.2*	—	*7.8*

New Zealand: electronic card transactions and retail trade



New Zealand: net permanent migration and residential investment



Trade balance
Not seasonally adjusted

	May	Jun	Jul
Exports ($NZ mn)	3355	2750	—
Imports ($NZ mn)	3345	3275	—
Trade balance ($NZ mn)	11	-524	—

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Global essay

- **Amid continued stress in money markets, risky assets rebound**
- **US business demand picks up and GDP is tracking a 3% gain this quarter**
- **Central banks to grapple with growth forecasts as policymakers debate lasting impact of tighter credit conditions**
- **This week: Trichet and Bernanke to speak**

Still in the woods

Global financial market conditions settled somewhat last week, raising hopes that the spillover effects from the severe lack of liquidity in money markets will be modest. In a week that brought a further "product recall" of US asset backed commercial paper—outstandings declined $125 billion over the past two weeks—no broader rush to liquidity in risky assets emerged; the stability of local emerging markets sends this message. Notably, Brazilian fx flows for the month through August 21 show that total nonbank inflows reached $6.1billion, down only modestly from the $8.2 billion received in the first three weeks of July. A similar picture emerges in Mexico, where capital inflows have continued and international reserves increased $700 million between July 13 and August 17. This message is reinforced by the rebound in emerging market currencies and a 7% in rise EM equities during the week.

But this modest ebbing of risk aversion globally should not be taken as a sign that all is well. As a number of issuers in the US and Europe found themselves unable to roll over commercial paper last week, banks took underlying exposures onto their balance sheets. The speed and magnitude of this unwinding is stretching the capacity of the banking system and promoting a significant aversion to extending credit within the interbank market. Central banks, for their part, continue to work hard to ensure that ample liquidity is available to banks. Indeed, the ECB conducted a supplementary three-month refinancing operation while the Fed made further adjustments to expand access to its discount window. Given the size of the over $1 trillion asset backed commercial paper market, the risks remain significant that its unwinding will do more damage to global financial markets.

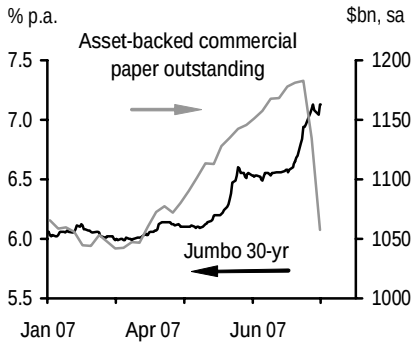
If the financial shakeout continues in an orderly manner, focus will shift toward assessing the macroeconomic impact of a sustained widening of risk spreads in an environment of tight capacity constraints. At root, the turbulence of the past month represents a disorderly move toward repricing credit risk, which is being magnified by a loss of confidence in the ratings system for asset-backed securities. This adjustment is set to reduce the availability and increase the price of credit for both corporates and households. The key issue for the months ahead will be to figure out the impact of tighter credit conditions on economic growth.

And now a word from the data

In making this assessment, it is easy to lose sight of the message from recent data about where the global economy stood as the financial shockwaves hit. To a large extent, the key themes of the JPMorgan outlook are playing to script; namely, that global growth remains above trend amid a significant rotation in the sources of growth.

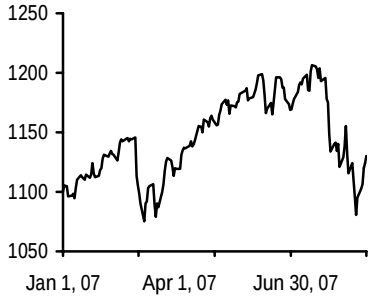
This week's release is likely to show that the US economy grew at a faster than 4% annualized pace in 2Q07, and the news from other indicators points to a 3% gain in the current quarter. Growth is rebounding on the back of stronger business spending on capital equipment and inventories

Jumbo mortgage rates and ABCPs



Global equities

Jan 1, 70=100, local currency



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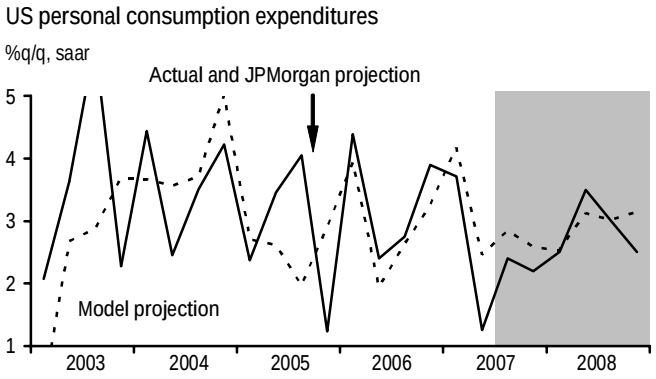

and a fading drag on consumers from gasoline prices. Indeed, retail gasoline prices have fallen 43 cents/US gallon from their mid-May peak and a further decline is in store if crude oil prices remain near Friday's levels.

A pickup in US high-tech spending has been expected to spur activity gains in tech-producing countries across Asia. Tech activity downshifted sharply in the region in early 2007 due to sluggish global business demand, resulting in excess inventory. Growth in manufacturing activity in EM Asia ex China ground to a halt as a result. With US demand regaining momentum and regional inventories back in line with sales, manufacturing output has surged. Last week's data from Taiwan highlighted the shift, with export orders and IP growing at double-digit rates. Taiwan's gains are matched by those on exports and output coming from China and Korea.

On the other side of the equation, China's growth has been expected to moderate in response to government measures aimed at putting the brakes on investment spending. However, the jury is out as to how much the economy is slowing. Investment spending and industrial production were soft in July, but this followed several months of strong gains. The pace of bank lending, which should be a barometer of investment spending, accelerated last month. The pace of retail sales and exports also remains robust. Indeed, it was the lack of tangible evidence that growth is moderating that prompted the PBoC to hike interest rates last week.

In the Euro area and Japan, the message from the data flow is less clear-cut. A pickup in current-quarter growth has been expected after both regions posted subpar GDP gains in 2Q. However, the downward drift in the business surveys in the Euro area and Japan indicates that a portion of the slowing from last quarter will continue. In the Euro area, business equipment spending appears solid but consumer spending remains lackluster Japanese growth remained sluggish through June based on weak consumer spending and a surprise drop in domestic capital goods orders. This week brings many of the July indicators, which will help set the tone for the current quarter.

Central banks grapple with uncertainty

The tension between upbeat current growth readings and a tightening in financial market conditions will be the key issue with which central banks must grapple as they meet in the coming weeks. The Fed has already signalled that it is inclined to adjust its growth forecast downward in response to recent financial market developments. While this should be sufficient to prompt a 25bp rate cut in September, the decision is still sensitive to both the data flow and financial market developments. A key issue will be how willing the Fed will be to project a downshift in consumption into year end beyond what would be expected based on income and wealth trends. On the view that credit tightening will slow spending, we have lowered our forecast of consumption growth more than 0.5% point relative to model estimates similar in construction to those used by the Fed staff. Chairman Bernanke speaks Friday and may provide guidance on how significantly the Fed's growth outlook has changed.

At last week's policy meeting, the Bank of Japan set aside previous plans to tighten and left rates unchanged at 0.5%. In his press conference, Governor Fukui emphasized that the BoJ will need some time to assess how market developments may affect the economy. The BoJ's September Tankan survey will be a key economic barometer. So will the September activity data, to be released in October. Pending confirmation that the economic expansion remains on track and that financial market conditions have settled, these should put the BoJ on track for a rate hike in November.

The ECB indicated last week that it is not necessarily ready to join the BoJ in delaying a hike. In announcing Thursday's supplementary refinancing operation, the ECB reiterated that "the position of the Governing Council of the ECB on its monetary policy stance was expressed by its President on August 2, 2007." This referred to Trichet's use of the phrase "strong vigilance" to signal that the ECB was on track to raise rates at the September 6 meeting. The ECB's reluctance to postpone the next rate hike can be understood in light of its ongoing commitment to fight what it sees as increasing inflation risks

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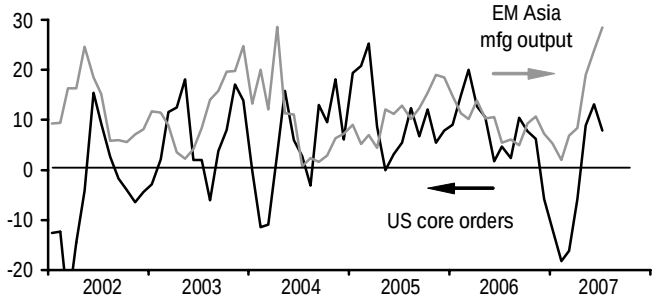
US core capital goods orders and EM Asia IP (China, Korea, Taiwan)

%3m/3m, saar; assumes 0.3%m/m gain in Korea in Jul 07



and to avoid moral hazard in financial markets. That said, it seems very unlikely that the ECB will hike rates next week considering the extraordinary steps it is taking to calm European money markets. We may get more color from Trichet when he speaks in Budapest tonight.

PBoC bucks shift away from hikes

China's central bank bucked the expected trend toward easier global monetary policy last week, raising its key lending and deposit rates for the fourth time this year. Policymakers probably were not satisfied with signs of economic moderation in the July activity data. At the same time, officials likely were concerned that the soaring stock market will be fueled by a further inflow from bank deposits now that real deposit rates have fallen into negative territory.

While policymakers are closely watching global financial markets, China enjoys a degree of insulation from recent developments that no other major economy can claim. Its financial markets are relatively closed, limiting the possibility of contagion. And China is a large external creditor with a large pool of domestic saving to support spending. The main concern officials have is that the downturn in global markets will undermine external demand growth and deal a blow to China's booming export sector.

For now, Chinese policymakers appear cautiously confident about the global growth outlook. This means that they will continue to focus on the domestic excess liquidity situation, the asset bubble, and the overheating risk in the real economy. The PBoC will continue to manage liquidity in the financial system through sterilization and open-market operations. We expect another 27bp policy rate hike in the next six months. The government also will employ administrative controls on credit and land supply to prevent overheating. Fundamentally, we see faster RMB appreciation as an essential tool to contain the trade surplus and tighten overall monetary conditions.

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JPMorgan View - Global Markets

Hope springs eternal

- **Cross-markets:** confidence is high that good fundamentals and supportive central banks will offset problems around financial intermediation, but we are more fearful about downside risk.

Investors look to central banks for help

- **Riskier asset classes rebounded** last week after significant losses over the previous month, as investors became more hopeful that central banks will save the day. The **dominant sentiment is that corporate fundamentals are excellent** and that any existing problems in the fixed income world are largely technical and fixable by the application of a sufficient amount of monetary easing. All this despite clear signals from central banks that they are willing to be quite easy with the quantity of liquidity provision, but not with its price.

- We are bothered that many investors base their positive sentiment on a remembrance of how rate cuts during the **LTCM** crisis seemingly set off a massive rally in global equities, including a tripling of the NASDAQ. This is creating a support to equity and emerging markets. **Central banks remember the same episode, but with fewer fond memories.** Hence, their strong stated reluctance to cut rates. One of these two parties—the markets and the central banks—will have to change its mind.

- Despite a much better tone in equity and credit markets, there **remain severe distortions in the fixed income markets** that are keeping us uncomfortable. A significant number of commercial paper issuers were unable to roll over their paper last week, thus leading to another $76bn contraction in outstandings. A continued confidence crisis in the value of ratings on asset-backed securities will likely keep the commercial paper market under pressure. As a result, bank balance sheets are starting to inflate. A continuation of this trend will induce a contraction in credit availability, as banks try to restore balance sheet discipline, which will force central banks to intervene by cutting rates significantly. It is our forecast, and hope, that this will not happen (aside from two Fed easings), but this risks are biased this way.

Fixed income

- **G-10 bond markets moved in a wide range,** ending largely unchanged last week. Curves flattened violently on profit-taking. EM local bonds rebounded strongly in line with rallies in all riskier assets.

Government bond yields

		Current	Sep 07	Dec 07	Mar 08	Jun 08
United States	2-yr	4.31	3.85	4.20	4.50	5.00
	10-yr	4.63	4.45	4.75	4.90	5.35
Euro area	2-yr	4.26	3.85	3.80	3.90	4.00
	10-yr	4.26	4.15	4.30	4.50	4.60
United Kingdom	2-yr	5.07	5.35	5.35	5.40	5.40
	10-yr	5.09	5.00	5.20	5.20	5.20
Japan	2-yr	0.88	0.75	0.90	1.10	1.35
	10-yr	1.59	1.65	1.80	2.00	2.10
Canada	10-yr	4.39	4.35	4.85	5.10	5.50
Australia	10-yr	5.96	5.70	5.85	5.95	6.20
Korea	5-yr	5.30	5.40	5.50	5.60	5.50
Mexico	10-yr	7.85	7.70	7.70	7.80	7.80
Singapore	10-yr	2.84	3.50	3.75	3.90	4.00
South Africa	10-yr	8.40	8.65	8.60	8.50	8.45
Sweden	10-yr	4.19	4.10	4.10	4.15	4.15

Equities

	Current	Ytd return (local currency)
S&P	1465	4.3%
Topix	1586	-4.7%
FTSE 100	6220	2.3%
MSCI Eurozone	238	5.8%
MSCI Europe	1517	4.3%
DAX	7507	13.9%
CAC	5569	2.1%

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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- We stay long bonds, as we believe that the confidence crisis around asset-backed securities, which are an important part of financial intermediation, will be severe and last long enough to require Fed easing. We keep curve steepeners on, despite recent flattening.

Equities

- Does last week's rebound—the strongest weekly gain since March—represent the start of a new trend for equity markets? Probably not. The liquidity crisis has further to run, at least a few more weeks. This should keep equity markets and riskier assets more generally under pressure. Into September, we are thus likely to see a pattern similar to that in August, with small caps underper-forming large caps, EM stocks underperforming G-7, and cyclical stocks underperforming noncyclicals. Financials held relatively well in August, but we foresee renewed pressure on the sector, as the failure of some commercial paper issuers to roll over their liabilities is likely to stretch their balance sheets, and as uncertainty about their 3Q earnings remains very high.

- **LBO activity, a key market support in 1H, has ceased.** M&A ex-LBO has slowed dramatically as well to one third of last May's peak. In contrast, share buyback activity has picked up slightly as more companies find the current entry point attractive enough to buy their stock.

Credit

- **Credit markets** activity slowed further last week with little trading. Even in CDS, where trading was intense, volumes declined. Primary activity is shut down in ABS and HY, but HG issuance picked up in August to almost $60bn in the US, from $35bn in July. CDS index spreads were tighter on the week, outperforming bonds. We continue to see weakness in bonds and loans as investors have not sold them, having only hedged them through CDS indices. Despite some bargain hunting, overall demand remains weak, with HY funds reporting outflows for 11 consecutive weeks.

- The balance of risks remains skewed to the downside for credit in the near term. We expect volatility to stay high. A potential recovery in HY issuance post Labor Day should help trading, but, absent a Fed cut, higher issuance is likely to put renewed pressure on cash bonds. We currently focus on relative trades and recommend a long European credit vs the US and underweighting financials against industrials. Similarly in EM external debt, we are near-term neutral the EMBIG index, despite our year-end target of 185bp. We focus on relative value by over-weighting Venezuela against Argentina on a better fiscal outlook.

Credit markets

	Current	Dec 07
US high grade (bp over swaps)	73	40
Euro HG industrials (bp over swaps)	44	40
USD high yield (bp vs. UST)	452	500
EMBIG (bp vs. UST)	240	185

Commodities

		Quarterly average			
	Current	07Q3	07Q4	08Q1	08Q2
WTI oil $/bbl	70.8	67.0	60.0	56.0	52.0
Gold ($/oz)	668	660	675	700	715

Foreign exchange

	Current	Dec 07	Mar 08	Jul 08
EUR/USD	1.37	1.40	1.39	1.38
USD/JPY	116	120	122	122
GBP/USD	2.01	2.09	2.11	2.09

Foreign exchange

- **Carry trades staged a tentative rally last week,** with several high-yielders (USD/JPY, AUD/USD, NZD/USD) posting gains of 1.5-3.0%. Emerging markets such as TRY and ZAR rallied similar amounts. The decline in volatility has been much sharper, however. JPMorgan's VXY and EM-VXY indices of implied volatility have retraced more than half of last week's spike.

- Despite signs of normalization in money and credit markets, we recommend **staying short carry.** There is still a decent risk of another liquidity squeeze in coming weeks, and positions in high-yield currencies are still sizable among Japanese retail investors, even if institutional positions appear clean. We are long JPY vs AUD and NZD, and long CHF vs GBP and EUR. We hold no longs in the emerging market high-yielders.

- **EUR/USD** rallied 1% last week and is catching up to the levels implied by the compression of US/European rate spreads since early August. There is two-way risk in the euro given European banks' potential demand for dollar funding in the near term, but the currency should reach 1.40 by year end. The medium-term driver of EUR/USD is US-European rate convergence, and the US subprime problem will keep this theme in play for some time.

Commodities

- **Metal** markets continue to move in line with risky markets. We would buy gold, as dollar weakness will likely prevail once short-term position adjustments are complete.

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Markets - Australia and New Zealand

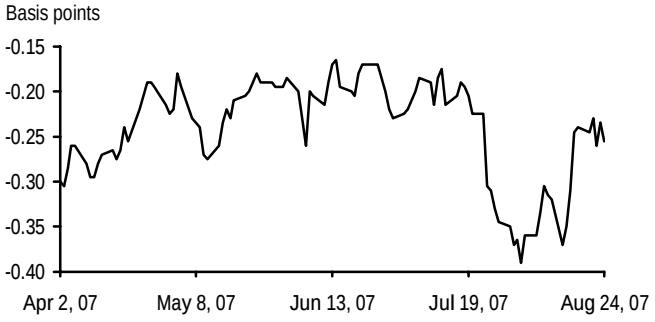
Main events for markets

- The **Australian** retail sales data on Friday. Sales in June were huge owing to the onset of colder weather, but July should see weaker sales growth owing to high petrol prices and increased uncertainty in financial markets.
- For the AUD, the 2Q **Aussie** current account deficit data on Thursday. The previously published deterioration in the monthly trade deficits should push the quarterly current account deficit back out to 5.9% of GDP.
- Friday's **Aussie** credit data probably means most for RBA policy expectations. Credit growth soared in June as punters borrowed to make additional pension payments, but July's growth should be a more modest 0.9%.
- **In New Zealand,** the NBNZ business confidence survey should attract the most attention. Following the financial market turbulence of the past few weeks, business confidence will be tested. We expect confidence to have dropped modestly in August—the temporary stalling of the carry trade has taken the wind from beneath the kiwi's wings, which should ease some of firms' anxiety over financial market instability.

Market commentary

- A degree of stability returned to local markets last week, with the equity market delivering one of its largest weekly gains of the last three-decades and the AUD spiking more than 5%. Also, money markets were more liquid, although nowhere near back to the healthy levels of a few weeks ago.
- Local markets still price a low probability of RBA tightenings in coming months. Bill futures pricing, for example, implies there is just a 15% probability of a December tightening. The market prices a June 2008 tightening at just 28%.
- Aussie bond yields rose through most of last week, despite falling yields offshore as the flight to quality remained attractive. The Aussie 10-year yield finished the week at 5.95%, 15bp up from the previous week's close. Equivalent yields in the US finished the week down 8bp.

Aussie 3s 10s curve



- The local 3s10s curve is broadly unchanged at -25.5bp, albeit 1 point flatter than the previous week. The range last week was -22 to -28. Our curve-steepening trade from the 8 August GMOS publication reached target (see below).

Trade recommendations from GMOS (published 22 August)

- **Reached target on 3s/10s Aussie steepener in futures (from previous GMOS).**
  - The curve steepened as longer-dated yields dived. Estd. at -37, the position traded to -30 for a 7bp gain.
- **Reached target on short Aussie Dec'07 bills in futures.**
  - Established last GMOS at 93.25, the position traded to 93.15 for a 10bp gain.
- **Pay 3 month forward 1yr in Kiwi.**
  - Established at 8.39% last GMOS to roll up the curve and take the carry, with a view the RBNZ will not ease. Currently at 8.355% (stop loss at 8.35%). 3 months of carry is worth roughly 20bp.
- **Stopped out on 1 yr (receive) 3 yr (pay) spread in Kiwi.**
  - Established at -35pts, the position traded to -44pts due to credit market turmoil and a lack of liquidity, for a loss of 5bp (stop was -40).

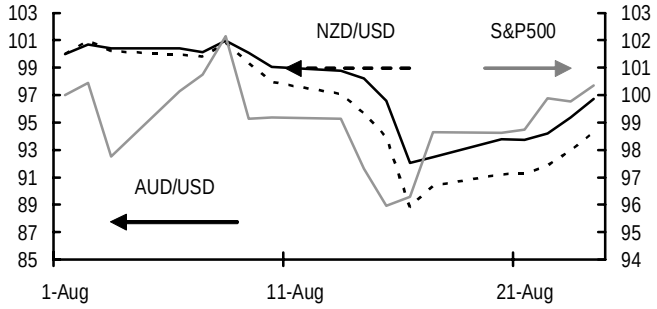
AUD and NZD Commentary

- **AUD and NZD stage healthy bounce in latest week**
- **Whether gains continue depends heavily on policymaker biases in week ahead – we remain cautious**
- **Technicals: Medium term bearish shift likely to continue for AUD/USD and NZD/USD**

Strategy comments

- Both AUD and NZD staged healthy rallies last week, alongside a tentative recovery in risk appetite (our Risk Tolerance Index edged out of "risk averse" mode Thursday). AUD/USD and NZD/USD rose 4.6% and 4.4%, respectively, on the week. Gains versus JPY were even more striking, at 6.6% and 6.3%, respectively. What helped risk appetite, both for FX and equity markets (see chart) were hopes by investors that central banks would continue to keep liquidity spigots open to avoid a seizing up of credit markets. Better-than-expected US data (durable goods orders and new home sales) also helped the sentiment recovery.
- This week brings speeches by key central bankers, including Fed Chairman Bernanke (Aug. 31) and ECB President Trichet (Aug. 27). Depending on how investors perceive these bankers to be leaning—avoiding moral hazard or ensuring a well-functioning financial system via ample liquidity—will help determine whether the recent FX carry trade bounce continues or not. Any sign that the liquidity spigots may not stay fully open (recall two Fed eases are now discounted by year-end) could lead to a fresh bout of carry unwinding.
- Which way the bankers lean depends in part on how much the market turmoil is spilling over to underlying economies. This week brings some important markers on this front, including Germany's Ifo survey, US consumer confidence and weekly jobless claims, New Zealand business confidence and Japan's Shoko Chukin small business sentiment survey. All data are for August and should at least partially reflect the latest bout of financial turmoil. A separate marker, but one also worth watching, will be US housing prices for Q2. While more backward looking, the data will still get market attention given the focus on the US housing market as the epicenter of the latest financial earthquake.
- Signs that markets are feeding into the "real" economies could bias policymakers relatively more towards keeping liquidity spigots wide open. However, any significant downside surprises in data could also worsen risk appetite – for carry trades the end result will depend on whether investor hope or fear dominates. Given the relatively illiquid month of August (including a UK bank holiday Monday) and the tendency of risk averse periods to last more than a week or two, and given our bias that central bankers will be cautious about being too accomodative, we belive the risk is towards negative market sentiment persisting awhile longer. Keep overall FX risk low, and AUD and NZD positions defensive—don't chase the carry-trade bounce just yet.

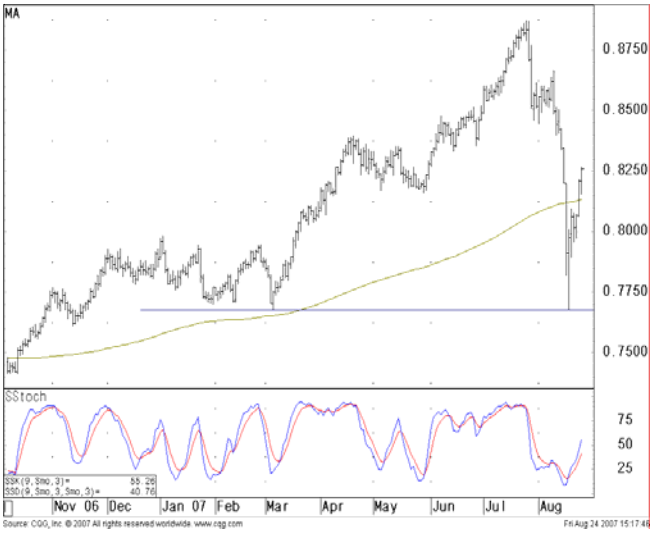
AUD/USD, NZD/USD and S&P500, indexed (Aug. 1)



Technical analysis

- The short-term recovery phase continues to develop for AUD/USD and NZD/USD following last Friday's reversal. While the action reflects a better tone, the interim bearish risks remain intact for both. In that regard, we view the recovery as a short-term corrective phase before a retest, and likely break, of the recent lows develops.
- AUD/USD is quickly approaching key resistance in the 0.8285/0.8300 zone, which should allow for some pause. However, the 0.8400/0.8450 breakdown zone will maintain the bearish bias for new lows. The 0.8130/0.8100 initial support area will be key, as breaks should set the stage for the bearish scenario.
- With regards to NZD/USD, we see resistance at 0.7260/0.7300, which should act as a short term cap. Importantly, the 0.7500/35 area will maintain the bearish bias. A break of the 0.7000 zone argues for a retest of the lows.

AUD/USD - Daily technical chart



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Global Economic Outlook Summary

	Real GDP			Real GDP							Consumer prices			
	% over a year ago			% over previous period, saar							% 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	3.2 ↓	2.0 ↓
Canada	2.8	2.2 ↓	2.6 ↓	3.7	2.8	1.0 ↓	2.5 ↓	3.0	3.3 ↑	2.8	1.8	2.2	3.0	2.0
Latin America	5.3	4.7	4.7	2.9 ↓	5.7	5.4 ↓	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	9.1 ↓	6.5 ↑	3.0 ↓	3.0 ↓	6.0 ↑	6.0 ↑	6.0 ↑	2.7	2.9 ↑	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	2.0 ↓	3.2	0.5	2.0	1.8 ↓	2.0 ↓	2.5	2.3 ↑	-0.1	-0.1	-0.2 ↓	0.1 ↓
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	10.5 ↓	6.8	5.9	8.8	8.4	7.5 ↑	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	5.5 ↑	6.2	6.0	7.1	5.2 ↓	5.5	5.5	6.0	5.0	5.0	6.4	6.0 ↓	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	4.5 ↓	4.6 ↓	1.3 ↑	5.8 ↓	6.3	4.5 ↓	4.0 ↓	4.2 ↑	4.5 ↑	1.0	0.3 ↑	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	5.2 ↑	3.2 ↑	6.4 ↑	5.4 ↑	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	3.4 ↑	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	3.0 ↓	3.3 ↓	3.7 ↑	3.3 ↑	2.3	2.4	2.7 ↓	2.3 ↓
Developed markets	2.8	2.4	2.4 ↓	2.1	2.3	2.8	2.2 ↓	2.3 ↓	2.7	2.4	1.8	1.9	2.3 ↓	1.7 ↓
Emerging markets	6.9	6.6	6.4	6.9 ↑	8.5	6.2	6.0 ↓	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	4.68	225			4.63	4.65	4.70	4.88	5.09
excluding US	GDP-weighted average	4.40	130			4.41	4.55	4.63	4.78	4.85
Developed	GDP-weighted average	4.14	263			4.04	4.05	4.14	4.37	4.62
Emerging	GDP-weighted average	7.04	74			7.05	7.08	7.02	6.99	7.01
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	6.00	6.00	6.00
Colombia	Repo rate	9.25	250	27 July 07 (+25bp)	**21 Sep 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	4.58	167			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)	**25 Oct 07 (+25bp)**	3.00	3.50	3.75	4.00	4.50
Hungary	2-week deposit rate	7.75	-375	25 June 07 (-25bp)	**24 Sep 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	10.00	200	**16 Aug 07 (+50bp)**	**11 Oct 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	3.54	108			3.54	3.72	3.72	3.84	3.97
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)	**13 Nov 07 (+25bp)**	0.50	0.75	0.75	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	7.02	171	**21 Aug 07 (+18bp)**	4Q 07 (+27bp)	7.02	7.29	7.29	7.29	7.29
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	8.00	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	3.25	3.25	3.25	3.375

[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	6.8	6.9	6.9	6.8	6.8	6.8
10-year bond yield (%)*	5.6	5.8	6.2	5.6	5.7	5.7	5.9	5.9	5.7	5.9	6.0	6.2	6.2	6.3
US$/A$*	0.75	0.83	0.82	0.74	0.77	0.77	0.80	0.83	0.83	0.87	0.85	0.85	0.80	0.78
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	6.3	5.8	5.8	5.8	6.0	6.4	6.5	6.4	6.5	6.4	6.3	6.2
US$/NZ$*	0.65	0.75	0.68	0.62	0.64	0.67	0.70	0.74	0.79	0.77	0.75	0.71	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
27 Aug	28 Aug	29 Aug Australia: Construction work done (11:30am) 2Q	30 Aug Australia: Current acc (11:30am) 2Q Pvt cap expend (11:30am) 2Q New Zealand: Building permits (10:45am) Jul -13.0 %m/m Money supply (03:00pm) Jul NBNZ bus conf (03:00pm) Aug -39.5 %	31 Aug Australia: Retail sales (11:30am) Jul 0.5 %m/m Pvt sector credit (11:30am) Jul 1.1 %m/m Trade balance (11:30am) Jul -811 A$mn
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
17 Sep	18 Sep	19 Sep Australia: Westpac leading index (10:30am) Jul	20 Sep New Zealand: Current account (10:45am) 2Q	21 Sep Australia: New passenger car sales (11:30am) Aug New Zealand: Visitor arrivals (10:45am) Aug Credit card spending (03:00pm) Aug

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
27 - 31 August	27 Aug	28 Aug	29 Aug	30 Aug	31 Aug
	Euro Area • Trichet speaks in Budapest 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 United States • Consumer confidence (Aug) • S&P/Case-Shiller HPI (2Q, Jun) • 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 (Jul) 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) Italy • ISEA bus survey (Aug) Japan • Household spending, IP, 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 at Jackson Hole symposium
3 - 7 September	3 Sep	4 Sep	5 Sep	6 Sep	7 Sep
Japan • Cabinet Office private consumption (Jul)	China • PMI mfg (Aug) Euro Area • PMI mfg (Aug) Japan • MoF corporate survey (2Q) Korea • CPI (Aug) • Trade balance (Aug) United Kingdom • PMI mfg (Aug)	Euro Area • GDP 1st release (2Q) • Retail sales (Jul) Singapore • PMI mfg (Aug) United States • Construction spend (Jul) • ISM mfg (Aug) • Light vehicle sales (Aug)	Australia • GDP (2Q) • RBA meeting Brazil • COPOM meeting Canada • BoC meeting Euro Area • PMI services (Aug) Taiwan • CPI (Aug) United Kingdom • PMI services (Aug) United States • Beige book • Pend home sales (Jul)	Australia • Unemployment rate (Aug) Canada • Ivey PMI (Aug) Germany • Industrial orders (Jul) United States • ISM nonmfg (Aug) • Productivity and costs (2Q) Central bank meetings • Euro Area • Indonesia • Peru • United Kingdom	Germany • IP (Jul) • Trade balance (Jul) Korea • BoK meeting Mexico • CPI (Aug) Sweden • Riksbank meeting Taiwan • Trade balance (Aug) United States • Employment report (Aug) • Wholesale trade (Jul)

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