JPMorgan

Australia and New Zealand - Weekly Prospects

Summary

- The highlight in **Australia** last week was the RBA's quarterly Statement on Monetary Policy. The central bank's hawkish verbiage signalled clearly that interest rates would rise further. JPMorgan now expects the RBA to raise rates 25bp in March and May. Reinforcing the case for higher interest rates, other data showed that the jobless rate fell to just 4.1% in January, its lowest level since 1974. Tightening labour market conditions mean that this week's labour price index probably will show wage growth accelerating in 4Q. JPMorgan forecasts that wages will grow 1.2%q/q in the December, compared to 1.0% in the previous three months.

- In **New Zealand,** the highlight in what is looking to be a quiet week, will be the RBNZ's inflation expectations survey. The survey is likely to show a slight uptick in inflation expectations in line with rising food and fuel prices. Last week delivered a series of weak data points, with both housing market reports (REINZ and QVNZ) pointing to a severe slowdown in activity and retail sales coming in below market expectations. There is now some downside risk to our conservative 0.6%q/q GDP growth forecast for 4Q. In other data, New Zealand's PPI report showed firms are continuing to pass through higher costs, and there is building inflation in the pipeline.

- As the **US** moves through the first months of the year, growth has stalled but it does not appear that the economy has slipped into recession. In the face of a substantial purchasing power drag from rising energy prices and tighter credit availability, consumption growth has slowed to a crawl. But households are not magnifying the effects of the drags by building precautionary savings. Similarly, firms are cautious and adjusting their hiring and spending plans in the face of weaker growth. However, the sharpest adjustments remain concentrated in sectors and regions related to the housing downturn. Export growth remains a source of strength, bolstering production and corporate balance sheets. While labour demand has softened, a surge in new layoffs that would be the hallmark of a slide into recession is not under way.

- **Japan's** GDP outcome was the big surprise on Friday. A major factor was business equipment spending, which posted a double-digit gain rather than contracting as anticipated. The government indicated that robust auto investment and software spending, which are not counted in core capital goods shipments (which plunged in 4Q), explain the deviation. The main message of the GDP report is that the corporate sector remains an expansionary force in the economy. This squares with the continued strong growth of employment (up 1.7%oya in December) and the high level of corporate profit margins. That said, business spending continues to be paced by large firms, as evidenced by the sharp divergence of large and small firm sentiment. GDP growth is likely to turn soft in the near term as exports and IP lose momentum, but if capex holds up, there is less risk that Japan will tip into recession.

This week's highlight

The Aussie Labour Price Index on Wednesday. The LPI probably will print at 1.2%q/q, a record high, which will push annual wage growth up to 4.3%oya. Building wage pressure adds to the case for the RBA to raise the cash rate in March.

Contents

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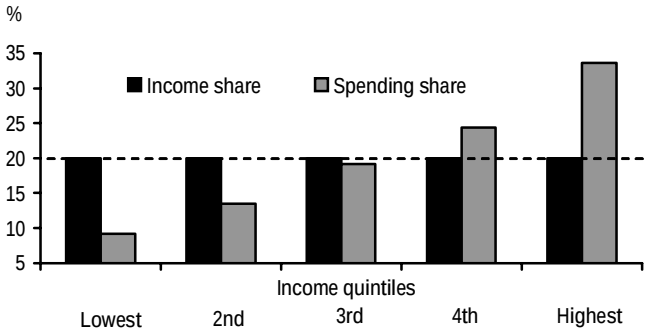
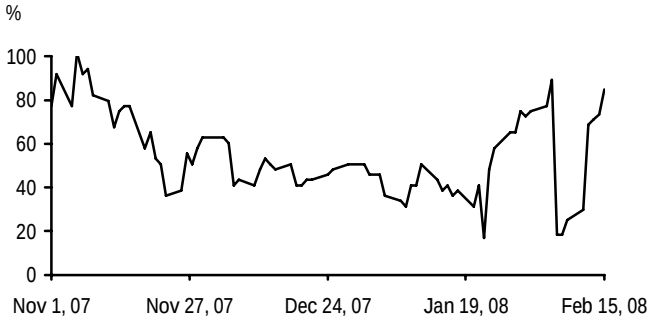
This week's feature charts

Australia: household income and spending - shares of total



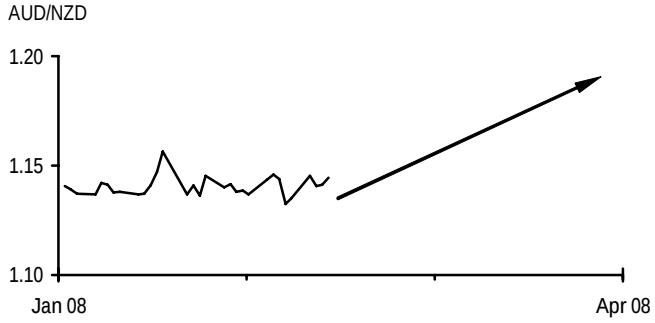
Lower income households are under particular financial pressure from high energy prices and rising interest rates. Lower income households tend to spend a higher proportion of their income on petrol and servicing their mortgages. The chart, though, shows that low income households do a disproportionately low share of aggregate household spending. The bottom 20% of income earners, for example, do only 9% of total spending; the top 20% of income earners do 34% of total spending.

Probably of RBA March rate hike spikes



Market pricing now suggests a 84% chance of an RBA rate hike in March, compared to nearly zero just a week ago. The RBA's quarterly Statement on Monetary Policy on Monday and Thursday's solid employment report clearly boosted the likelihood of an imminent rate hike. The RBA made it clear that "monetary policy is likely to need to be tighter in the period ahead", after upwardly revising its core inflation forecasts above its 2-3% target range out to mid-2010.

Aussie Kiwi cross likely to spike higher on interest rate differentials



AUD/NZD will likely trend higher in coming months as the RBA delivers on promised tightenings, and the RBNZ sits on the sidelines and watches its already assertive monetary policy tightening work its way through. With the data likely to hold up in Australia and deteriorate in New Zealand, the market will begin to price in easings by the RBNZ. The Kiwi currency will weaken against the Aussie as a result.

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Economic Research note

Hawkish RBA to wring inflation from booming Aussie economy

- **The RBA's latest policy statement shows core inflation above target until 2010**
- **We now expect two further 25bp policy tightenings in March and May**
- **The government may be forced to defer promised personal income tax cuts**

The RBA last week released an incendiary quarterly *Statement on Monetary Policy*. The statement explained in fine detail the reasons behind the decision in early February to raise the cash rate to 7%, a 12-year high, but shocked the market with its hawkish tone. In particular, the RBA not only raised the forecast for core inflation for 2008, which was expected, but also indicated that core inflation will be above the RBA's 2-3% target range in 2009. In fact, the RBA now predicts that core inflation will not return to the target range until mid-2010, even though the RBA already has raised the cash rate 11 times since mid-2002. The RBA's unexpectedly hawkish commentary shows clearly that officials are more concerned about the bleak domestic inflation outlook than downside risks to growth arising from weakness offshore.

In the wake of the statement, we have changed our RBA call to include another 25bp rate hike at the RBA's next meeting on March 4. The extended period over which RBA officials believe core inflation will be above target means that we now also forecast a second 25bp rate hike in May, just after the release of the 1Q CPI data. The RBA appears committed to acting early and assertively to prevent rising inflation from becoming entrenched in expectations for price rises and wage negotiations.

RBA upbeat on outlook for Asia

The RBA's commentary was as hawkish as possible without an accompanying rate hike. The punchy tone makes us wonder why the RBA delivered only a 25bp rate in early February. The statement cited rapid growth in Australia's domestic demand, which grew 5.5% in the year to September; the economy's lack of spare capacity; the tight labour market; rapid growth in credit; and ongoing stimulus from the soaring terms of trade, which reached a 45-year high in 2007.

The message from the RBA's statement is that officials believe a "significant moderation in demand" is needed to bring inflation back within the target range. As such, "monetary policy is likely to need to be tighter in the period ahead." Previously, we believed that trouble in key offshore economies would keep the RBA sidelined in the near term. Now, the RBA's acknowledgment of the worsening inflation dynamic means that further rate hikes are likely.

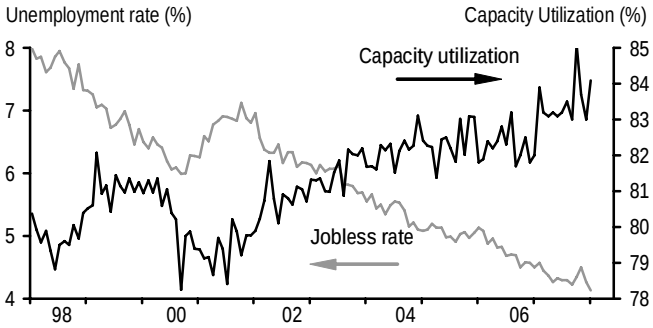
RBA inflation forecasts

Annual % change

	Headline		Underlying	
	Previous	Latest	Previous	Latest
Sep 07	na	1.90	na	3.00
Dec 07	2.75	3.00	3.25	3.60
Jun 08	3.25	3.50	3.25	3.75
Dec 08	3.00	3.50	3.00	3.50
Jun 09	2.75-3.00	3.25	2.75-3.00	3.25
Dec 09	2.75-3.00	3.25	2.75-3.00	3.25
Jun 10	na	3.00	na	3.00

Source: RBA.

Capacity utilization and the jobless rate



Indeed, it seems that only a serious setback for the global economy could keep the RBA sidelined in the near term. The RBA makes clear that developments offshore are the prime source of uncertainty. Note, though, while officials expect subtrend growth in the global economy, growth in China—Australia's largest trading partner—and emerging Asia, should remain robust. This explains why the RBA believes that the stimulus from the terms of trade will be even larger during 2008. That said, weaker global demand caused the RBA to downgrade GDP growth for Australia for 2008 from 3.75% to a slightly below-trend 3.25%.

RBA restraint swamped by fiscal largesse

One domestic concern for officials, however, is that the major policy levers now obviously are pulling in opposing directions. The newly elected Labor government is committed to paying, from July 1, the first instalment of A$31 billion of personal tax cuts promised ahead of the 2007 election. This follows five straight years of tax relief under the previous Coali-

tion government. The RBA highlighted in the statement the income tax relief as a source of support of household income. By tightening policy and talking tough, the RBA is trying to douse the economy's fire while the government empties the fiscal gasoline can.

In recent weeks, however, the government appears to have received a clear message from RBA officials: that it faces a worsening inflation problem in its first term of office. In response, the government quickly announced a five-point plan to fight inflation and a round of public expenditure savings worth A$643 million—funding for the long-promised *Fishing Hall of Fame* was a notable casualty. The Treasurer also promised an austere Budget in May. The announced savings, however, are a drop in the ocean compared to the promised personal tax relief. The tax cuts will add A$80 per month to income for the average household; this more than compensates for the A$52 per month absorbed by the latest rise in interest rates.

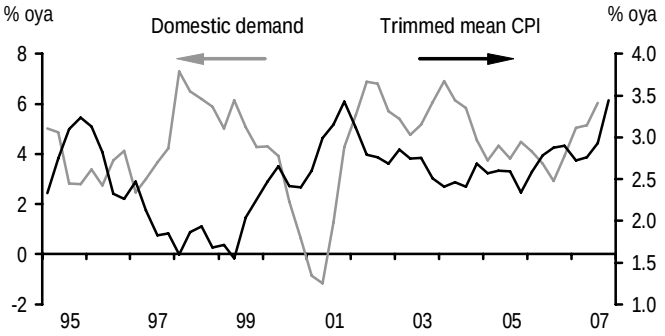
Labor's tax cuts should be deferred

Following the hawkish RBA commentary, though, deferring the personal tax cuts makes good economic sense—without them, fiscal policy would not be pulling as hard in the opposite direction from monetary policy. Labor won last year's election partly by winning the debate over economic management, traditionally a strong point of the previous government. Labor, therefore, could claim the high moral ground as prudent managers of the economy by making the hard decision to defer the tax cuts. This probably would spare households even more interest rate pain.

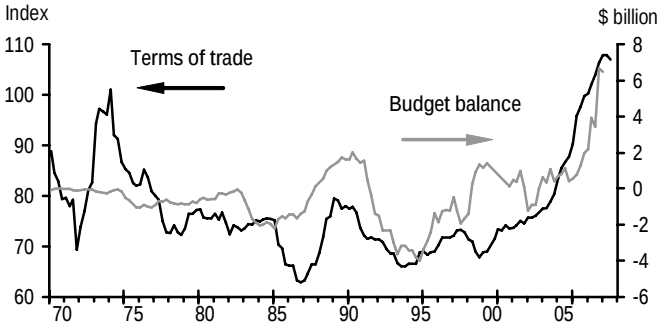
Reneging on the tax cuts, however, would be political suicide for the new government. Labor was elected last November partly on a mandate of delivering lower taxes; at the next election in 2010, the opposition parties would have lethal ammunition to attack the government in the form of a broken tax promise. The government, therefore, probably will plow on with the tax relief, but will have to take the blame for stimulating an economy not in need of a boost. Indeed, the political damage done by a succession of interest rate rises, triggered in part by unnecessary fiscal largesse, could be as damaging as a broken tax promise.

There is, however, another option. A prominent trade union official recently called for half the tax cuts to be paid directly into employees' pension funds. Half the tax relief would be locked away and could not be spent. The drawback is that many households suffering amid rising interest rates and high energy prices are relying on July's tax relief to make ends meet. They would get their cake, but could eat only half of it.

Domestic demand and core inflation



Terms of trade and government budget balance



The government could, of course, blame the tax reversal on the previous government which, in hindsight, let the economy run too hot for too long.

Fiscal, monetary restraint spells trouble

The combination of simultaneous monetary and fiscal austerity would raise the risk that Australia's economy could suffer an extended period of weakness as the authorities wring inflation from the economy. Already, our forecast is that Australia's GDP growth will slow to a subtrend 2.5% in 2009. With the RBA likely to push the cash rate even further into restrictive territory at the same time that demand for Australian export commodities slows, the risks to our 2009 GDP forecast are skewed to the downside.

Weaker growth in Australia's trade partners probably would result in some softness in commodity prices, and the resulting lower AUD would push up import prices. The boost to national income from the terms of trade, therefore, will start to unwind at the same time that growth in domestic demand slows. In fact, with RBA officials apparently determined to win the war against inflation, which has opened up on unexpected fronts; and an inexperienced government in charge of fiscal policy and industrial relations, where major policy change is imminent, the seeds of Australia's next recession may already have been sown.

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Australia

- **RBA expected to raise interest rates again in March**
- **Unemployment rate fell to just 4.1% in January**
- **Wages growth likely to accelerate in 4Q**

The highlight in Australia last week undoubtedly was the RBA's quarterly Statement on Monetary Policy. The central bank's hawkish verbiage signalled clearly that interest rates would rise further. JPMorgan expects the RBA to raise rates 25bp in March and May. Reinforcing the case for higher interest rates, other data showed that the jobless rate fell to just 4.1% in January, its lowest level since 1974. Tightening labour market conditions mean that this week's labour price index probably will show wage growth accelerating in 4Q.

Labour cost index expected to rise in 4Q

Wage growth in Australia is forecast to accelerate in 4Q to 1.2%q/q from 1.0% in 3Q amid tight labour market conditions and widespread skill shortages. Anecdotal evidence also suggests that labour costs are rising. There is upside risk to our forecast, however, given that the Federal Minimum Wage decision announced in July became effective on October 1. From a year ago, wage growth will likely rise to 4.3%oya from 4.2%, providing additional justification for the RBA to raise interest rates again.

Imminent rate hike likely for RBA

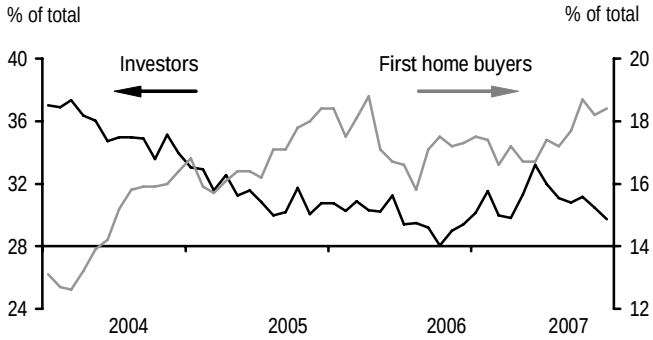
The RBA last Monday released its quarterly Statement on Monetary Policy (SMP). The SMP was considerably more hawkish than the statement following the central bank's decision to hike the cash rate 25bp to 7% in early February.

Upward revisions to the RBA's inflation forecasts were the focus of the SMP. Annual headline inflation now is forecast by the RBA at 3.5% in 2008 and a still-elevated 3.25% in 2009. By June 2010, the RBA estimates that headline inflation will moderate only slightly to 3%, sitting uncomfortably at the top end of its 2-3% target range. More importantly, though, the RBA also raised its underlying inflation forecasts. By June 2008, the RBA forecasts underlying inflation at 3.75%, and at 3.5% by December 2008, before slowing modestly to 3.25% in 2009 and 3% by June 2010.

Following the significant upward adjustment to the RBA's inflation forecasts, we now believe the RBA will lift interest rates again in March. Before the SMP, we had expected the RBA to sit on the policy sidelines, mainly owing to

Australia: labor price index and unemployment

Australia: housing finance



deteriorating economic conditions offshore and the policy tightening already in the pipeline. The RBA acknowledged the weakening outlook for global growth, particularly in the US, but also noted that the weakness in developing countries was less pronounced, particularly in China, India and other east Asian economies, where economic growth remains strong.

The RBA expects GDP growth of 3.25% in 2008. Domestic demand is strong, owing to rapid household income growth, the labour market is tight, and capacity usage is high. The terms of trade is expected to remain a significant stimulus to domestic income, with contract prices for many commodities forecast to rise in 2008, although the RBA expects global growth to be below trend. Furthermore, solid business investment will help alleviate the bottlenecks that have limited activity in recent years, adding to the economy's productive potential.

The hawkish tone of the SMP signalled that interest rates probably will rise more than once in coming months. We now expect the RBA to hike rates 25bp in March and May, taking the key rate to 7.5%. RBA officials will, though, be watching for signs of a sharp than expected downturn in global growth

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and further tightening in credit conditions that could restrain demand. In the absence of adverse developments, however, the RBA believes that "monetary policy is likely to need to be tighter in the period ahead."

Demand for housing finance moderates

The number of home loans issued in Australia in December rose 0.1%m/m (JPMorgan and consensus -1.0%) after spiking 3.3% in November. In value terms, loans rose 0.5%m/m, slowing from 1.3% in November. Refinancing of established dwellings continued to drive growth in loans, with the total value of housing finance excluding refinancing falling 1.6%m/m in December after November's 0.4% fall.

Demand for fixed home loans probably will remain solid going forward amid expectations of higher interest rates. Fixed loans as a percentage of all dwellings financed have risen from 15% in mid-2007 to nearly 24% in December. Investors, meanwhile, who accounted for 30% of all loans in December, will continue to drive demand for home loans. These investors are usually existing property owners able to receive significant tax benefits from buying investment property—via negative gearing, for example, which enables them to lower their assessable income and enhance after-tax returns. First home buyers battling record low housing affordability accounted for just 18.4% of loans in December.

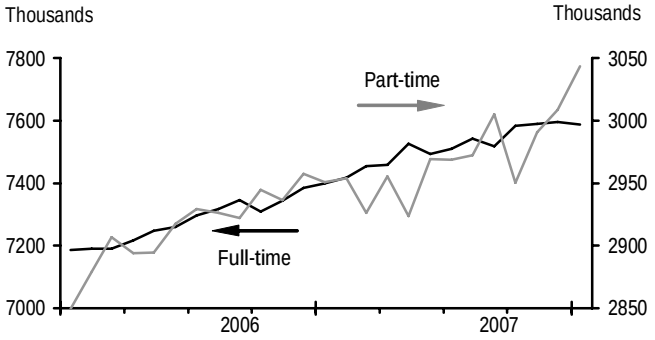
Employment growth set to ease

Australia added 26,800 jobs in January (JPMorgan 7,500, consensus 15,000) after recording a solid 24,800 gain in December. The participation rate remained unchanged at 65.2%, so the unemployment rate fell from 4.3% to 4.1%, the lowest since the final quarter of 1974, when it was 3.9%.

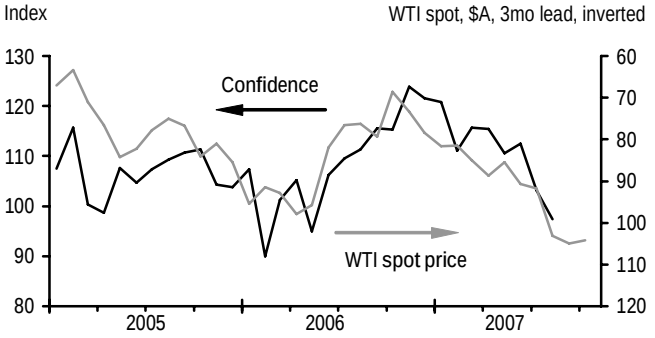
The gain in employment was attributed to growth in part-time jobs (+34,600), while the number of full-time jobs fell (-7,800). The number of part-time jobs has surged by more than 90,000 over the last three months, while full-time jobs have risen just 4,000. The surprisingly strong rise in part-time jobs may be partly attributed to the Welfare to Work scheme effective July 1, 2007, which aims to help more than 200,000 people previously on welfare return to work.

The jobs data will concern RBA officials. Nearly 170,000 jobs have been added since mid-2007, pushing the jobless rate down from 4.3% to 4.1%. Combined with widespread skills

Australia: employment



Australia: consumer sentiment and gasoline prices



shortages, healthy corporate pricing power and firm domestic demand, the tightening labour market will help push wages higher, adding to inflation pressure.

Consumers less upbeat in February

Consumer confidence fell 5.5%m/m in February after slumping 8.3% in January. The Westpac-Melbourne Institute's consumer sentiment index declined from 103.1 to 97.4, falling below 100 (where optimists equal pessimists) for the first time since November 2006.

Confidence deteriorated in February as the RBA hiked interest rates to a 12-year high of 7%, and domestic banks hiked their rates on variable mortgages 25bp or more. Several of these domestic banks had already raised their variable mortgage rates (an average 0.15%) in early January in the absence of a rise in the RBA cash rate. They did this in an attempt to alleviate the pressure on their spreads resulting from higher market funding costs. The growing risk of a US recession also dampened confidence, as did rising petrol prices and high financial market volatility.

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Data releases and forecasts

Week of February 18 - 22

Wed Feb 20 10:30am — **WMI leading index**
Seasonally adjusted

	Sep	Oct	Nov	Dec
(%m/m)	0.5	0.5	1.0	__

Wed Feb 20 11:30am — **Labor price index**
Seasonally adjusted

	1Q07	2Q07	3Q07	4Q07
(%q/q)	1.0	1.1	1.0	1.2
(%oya)	4.1	4.0	4.2	4.3

Thu Feb 21 11:30am — **Sales of new motor vehicles**
Units, seasonally adjusted

	Oct	Nov	Dec	Jan
(%m/m)	1.4	1.5	1.1	__
(%oya)	8.9	10.6	11.6	__

Review of past week's data

ANZ job advertisements
Seasonally adjusted

	Nov	Dec		Jan	
(%m/m)	0.7	~~7.1~~	*4.9*	__	*1.8*

Housing finance approvals: owner occupiers
Number of loans, seasonally adjusted

	Oct	Nov		Dec	
(%m/m)	-0.5	~~4.0~~	*3.3*	~~-1.0~~	*0.1*
(%oya)	-0.8	3.8		~~2.7~~	*2.8*

NAB monthly business survey
% balance, seasonally adjusted

	Nov	Dec		Jan	
Business confidence	6	5		__	*-4*

WMI consumer sentiment index
100=neutral, seasonally adjusted

	Dec	Jan		Feb	
(%m/m)	1.8	~~-8.3~~	*-8.4*	~~-10.0~~	*-5.5*

Labor force
Seasonally adjusted

	Nov	Dec		Jan	
Unemployment rate (%)	4.5	4.3		~~4.4~~	*4.1*
Employed (000 m/m)	48	~~20~~	*24.8*	~~7.5~~	*26.8*
Participation rate (%)	65.3	65.2		*65.2*	

New Zealand

- **Retail sales disappointed in December quarter**
- **Housing market sliding deeper into darkness**
- **PPI report still points to inflation pressure in pipeline**

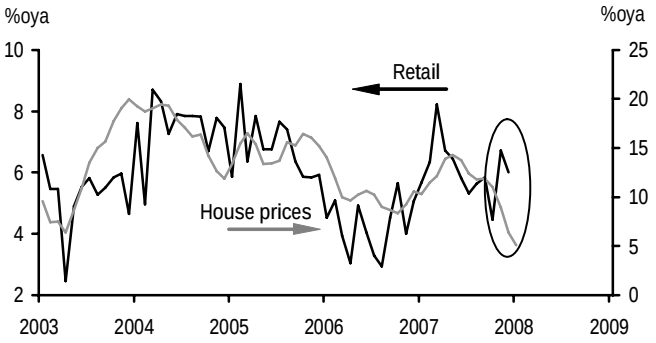
The data last week made a decided turn for the worse. Retail sales came in below the market and RBNZ expectations; in particular, surging petrol and food prices and elevated interest rates dented the consumer purse. Furthermore, the PPI report showed a larger than expected increase in price pressure in the pipeline, and an increased need for firms to pass through higher costs. This week brings two interesting data points: the RBNZ's inflation expectations survey and credit card spending for January. Inflation expectations are likely to have ticked up with food and petrol prices, worsening the RBNZ's perception of the inflation outlook.

Retail trade lower than expectations

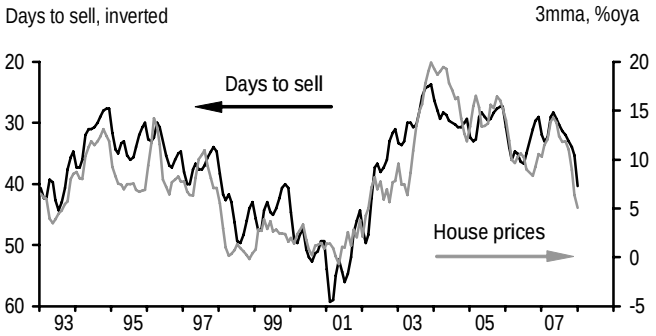
Retail sales growth came in below expectations in 4Q. Retail trade volumes rose just 0.3%q/q (JPMorgan 0.5%, consensus 0.6%), after a weak 0.2% gain in 3Q. Retail trade in New Zealand continues to track changes in petrol prices, and the weaker than expected report adds downside risk to our conservative 4Q GDP growth forecast of 0.6%q/q. It appears the lethal cocktail of rising fuel and food prices, mixed with elevated interest rates, is crimping demand. The main contributor over the quarter was again automotive fuel retailing, with prices in the industry at their highest level since mid-2006. Clothing and soft-goods also recorded a solid gain in volumes. In value terms, retail sales rose 1.9%q/q, after a 0.6% gain in 3Q. The core retailing group (excluding vehicle-related industries), rose 0.4%q/q.

Retail trade and broader consumption growth is definitely slowing. The faltering housing market (chart) and current drought in New Zealand's key dairy producing regions is also causing the consumer to tighten their purse strings. The recent run of weak data and rising concerns around the dairy industry has significantly reduced the chance of a further RBNZ rate rise in this cycle. That said, it is still far too early to call for an RBNZ easing. New Zealand's inflation trajectory—and inflation expectations—compounded by the government's expansionary fiscal stance are still two key concerns for the central bank.

New Zealand: retail sales and REINZ house prices



New Zealand: days to sell vs. house prices



NZ housing market more likely to contract

The doors have closed on New Zealand's housing market boom. Signs that the housing market may actually contract in 2008 are growing by the week, shocking most Kiwis' sensibilities. It has long been our view that New Zealand's housing market will buckle under the weight of high and rising interest rates and the reduction net-permanent migration. The question now is just how far, and fast, will the market fall? According to the latest REINZ report, the market is being sucked into a black hole, at a phenomenal rate.

According to the REINZ's January report, the median house price fell from NZ$345,000 to NZ$340,000, and is down NZ$12,000 from the November peak. More worrisome for the housing outlook, however, was the substantial drop in sales volumes and spike in days to sell a property. The number of sales has dropped 31%oya and is now at the lowest level since January 2001, before the housing boom began. The number of days to sell a property spiked to 49 days in January, up from 36 days in December, and points to a further decline in the median house price (chart). The annual rate of house price appreciation has now dropped to just 4%.

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The REINZ report followed the QVNZ report Monday. The QVNZ report showed a slight increase in the median house price in January, but the annual rate of price appreciation continued to decline. It is important to note that the QVNZ data is recorded at the date of settlement (not contract), and owing to the three-month moving average methodology, is a smoother, slower turning, lagging indicator. The REINZ data is more timely and faster to reflect turning points in the market, but is more volatile as a result. The RBNZ probably will keep interest rates on hold at an elevated 8.25% for at least the next two quarters, with the one material risk being another rate rise to 8.5% before the October/November parliamentary election. New Zealand's housing market is seven months into what is going to be a prolonged slowdown. At best, house prices is likely to track sideways (0%oya), if not post a small contraction, in 2008.

NZ PPI stronger than expectations

PPI output prices posted a 1.5%q/q gain in 4Q (JPMorgan and consensus 1.0%). The increase in output prices was higher than the increase in input prices, suggesting that producers are passing through higher costs and regaining lost margins. Input prices rose 1.3%q/q. The annual growth in output prices is now running at 4% (up from 2.1% in 3Q), and input prices are up 3.4% (from 1.7% in 3Q). Higher oil prices paid by fuel wholesalers caused the largest contribution to the increase in input prices. Meanwhile, higher dairy prices caused the dairy product manufacturing index to bounce 15%q/q, the largest quarterly rise since the series was constructed in 1994, making the largest contribution to the output index.

Over the past year, the restoration of producer margins has led to a greater passthrough of input costs, and the inflation build up in the pipeline continues to grow. The key question is whether firms pass these increased costs to the consumer. To date, the passthrough of higher producer prices to the department store shelves has been muted, reflecting a squeeze in firm's margins. Food and petrol prices are soaring, and are being passed directly to the consumer (the 4Q CPI report recorded a 1.5%q/q increase in food prices, and a 5.2% jump in fuel prices). The report merely backs up the CPI report already released for 4Q (CPI rose 1.2%q/q in 4Q), showing that headline inflation is above the RBNZ's 1-3% target band at 3.2%oya.

New Zealand:
Data releases and forecasts

Week of February 18 - 22

Thu Feb 21 03:00pm	Credit card spending Seasonally adjusted				
		Oct	Nov	Dec	Jan
	(%oya)	7.7	9.5	7.6	__

Review of past week's data

QVNZ house prices
%, median

	Nov	Dec	Jan	
(%oya)	11.4	10.0	~~8.5~~	*8.9*

Producer price index
nsa

	2Q07	3Q07	4Q07	
(%q/q)	1.2	1.6	~~1.0~~	*1.5*
(%oya)	1.5	2.1	~~3.6~~	*4.0*

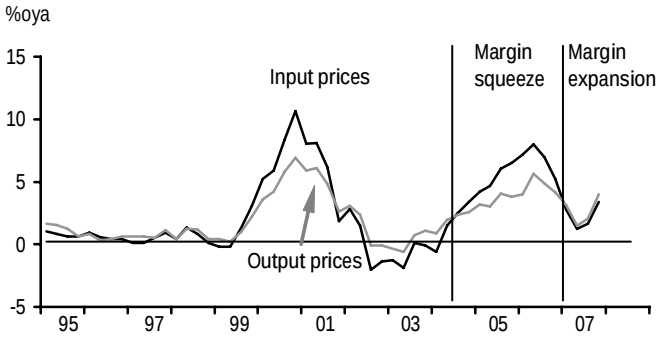
Business PMI
Seasonally adjusted

	Nov	Dec		Jan	
Index	56.7	~~53.8~~	*53.6*	__	*53.3*
(%oya)	2.0	~~-0.8~~	*-1.0*	__	*-2.8*

Retail trade
Seasonally adjusted

	Oct		Nov		Dec	
(%m/m)	~~-0.6~~	*-0.4*	~~1.9~~	*1.7*	~~0.7~~	*0.1*
(%oya)	~~4.2~~	*4.7*	6.7		~~6.7~~	*6.1*

New Zealand: PPI input vs. output prices



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Global essay

- **US economy crawls forward as further credit tightening and sentiment slide keep recession risk high**
- **Food prices weigh on EM consumers much more than energy price rises**
- **Japanese GDP surprise suggests that businesses are still expanding**
- **Chinese inflation to hit 7% in January, but policymakers showing patience**

Impressive resilience, persistent drags

As the US moves through the first months of the year, growth has stalled but it does not appear that the economy has slipped into recession. In the face of a substantial purchasing power drag from rising energy prices and tighter credit availability, consumption growth has slowed to a crawl. But households are not magnifying the effects of the drags by building precautionary savings. Similarly, firms are cautious and adjusting their hiring and spending plans in the face of weaker growth. However, the sharpest adjustments remain concentrated in sectors and regions related to the housing downturn. Export growth remains a source of strength, bolstering production and corporate balance sheets. While labour demand has softened, a surge in new layoffs that would be the hallmark of a slide into recession is not under way.

The cushions from healthy corporate balance sheets and foreign demand appear to be operating as expected, but the drags from tightening credit conditions and high energy prices have not diminished. Notably, many private sector borrowing rates have moved higher this year, despite a 125bp Fed easing in January. Sentiment indicators have also deteriorated in a troubling manner. Thus, any comfort taken from the economy's continued resilience is offset by the dangerous mix of sliding sentiment and sustained financial stress. We maintain a forecast that the economy skirts recession, but our level of conviction is not high.

Absent significant relief from credit market stress, the Fed will continue to operate like a risk manager on steroids. We now believe that a 50bp ease is the most likely outcome of the March FOMC meeting. This action would lower the real fed funds rate close to zero, a stance that the Fed has only adopted at the end of a recession episode.

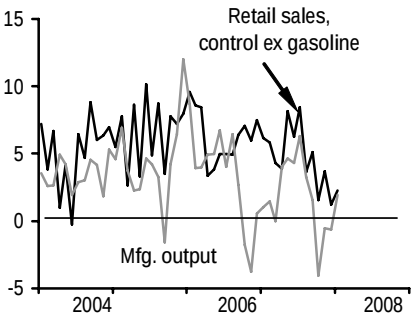
It's a US recession for global exporters

Shocks to US demand reverberate across the globe through multiple channels. In part, economies are linked by the common nature of shocks. Indeed, the tightening in US credit has extended to Canada and Western Europe while the drag from rising energy prices is being felt by consumers worldwide. However, there are also links through trade flows, terms-of-trade effects, and asset price movements that transmit shocks.

On the trade flow side, industrial sectors are closely linked and producers across the globe have already experienced recession-like behaviour from the US. With the US slowdown concentrated in traded goods and the dollar slide altering competitiveness, US nonpetroleum import volumes have contracted at a 5% pace over the past six months. This drag has been offset so far by strong demand elsewhere, but the picture is changing as the US economy remains weak and demand slows in the other developed economies. We expect global industrial activity to stagnate during the first half of 2008, a downshift that already was well under way in the latest quarter. This adjustment will become harder to track in the coming weeks, as the timing of the lunar new year creates a sharp up and down pattern in Asian industrial activity in January and February.

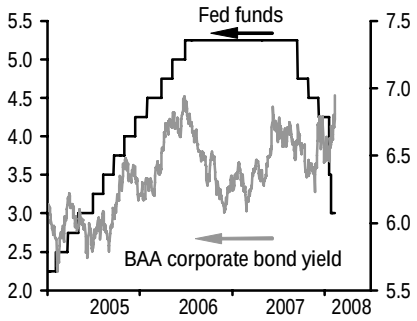
US retail sales and manufacturing output

% change over 3m, saar



US interest rates

% p.a., both scales



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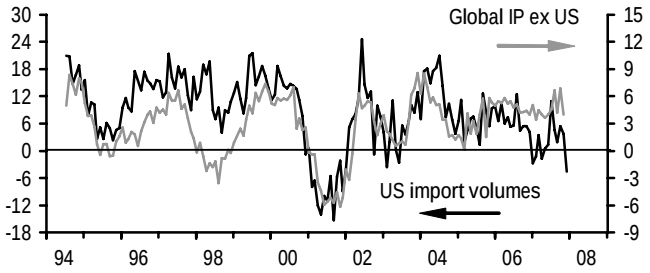
Global industry and US imports

% change over 6 months, saar, both scales



While trade linkages are transmitting negative shocks in the normal fashion, other channels are operating differently than in the past. The emerging economies as a group find themselves in the unique position of being far removed from financial stress and continued beneficiaries of capital inflows. This dynamic is being reinforced by the fact that the group's terms of trade are boosted as commodity prices continue to rise. JPMorgan's commodity price index is up 8% since the start of the year—a remarkable development for a global economy that is braced for a US recession. All subcategories have posted gains, led by agricultural prices, which are up over 15%, and industrial metals prices, which have increased 11% despite the slowdown in global manufacturing.

Higher commodity prices have been a boon for emerging economy producers and helped boost EM asset prices. They have had limited consequences for EM consumer purchasing power (relative to those in the developed world) because energy prices are still regulated by most governments. But the recent rise in food prices changes the equation as EM households have bigger expenditure shares on food—particularly grains and other unprocessed agricultural products whose prices are now rising rapidly (see "Food and energy prices haunt consumers and central bankers," p. 9). The region likely to be most sensitive to rising food prices is Emerging Asia, where food prices are rising fast and where there is relatively limited domestic production.

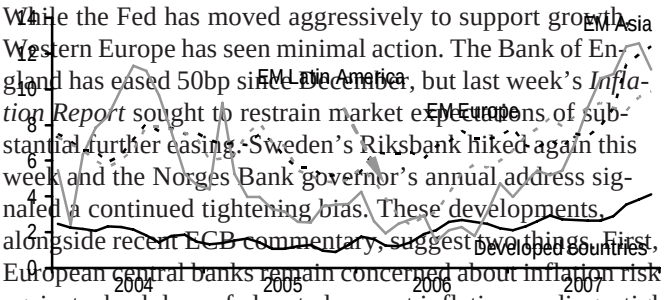
Japan delivers positive capex surprise

Last week delivered a series of positive surprises on fourth-quarter growth. In Japan, the government reported that real GDP expanded a brisk 3.7%q/q, saar, far above our estimate of 0.5%. Euro area growth also beat our forecast, coming in at 1.7%, compared with our estimate of 1.2%. The latest reports suggest that US GDP rose 0.8% in 4Q07, compared with the government's initial estimate of 0.6%. All told, this raises our estimate of 4Q global growth from 2.2% to 2.7%— which is just below trend.

Japan's GDP outcome was the big surprise. A major factor was business equipment spending, which posted a double-digit gain rather than contracting as anticipated. The government indicated that robust auto investment and software spending, which are not counted in core capital goods shipments (which plunged in 4Q), explain the deviation. The capex figure will be revisited once the MoF corporate survey is released on March 5. But if it did expand last quarter, the main message of the GDP report is that the corporate sector remains an expansionary force in the economy. This squares with the continued strong growth of employment (up 1.7%oya in December) and the high level of corporate profit margins. That said, business spending continues to be paced by large firms, as evidenced by the sharp divergence of large and small firm sentiment. GDP growth is likely to turn soft in the near term as exports and IP lose momentum, but if capex holds up, there is less risk that Japan will tip into recession.

Consumer food prices

% change over 12 months



Europeans less worried than the Fed

While the Fed has moved aggressively to support growth, Western Europe has seen minimal action. The Bank of England has eased 50bp since December, but last week's *Inflation Report* sought to restrain market expectations of substantial further easing. Sweden's Riksbank hiked again this week and the Norges Bank governor's annual address signaled a continued tightening bias. These developments, alongside recent ECB commentary, suggest two things. First, European central banks remain concerned about inflation risk against a backdrop of elevated current inflation readings, tight

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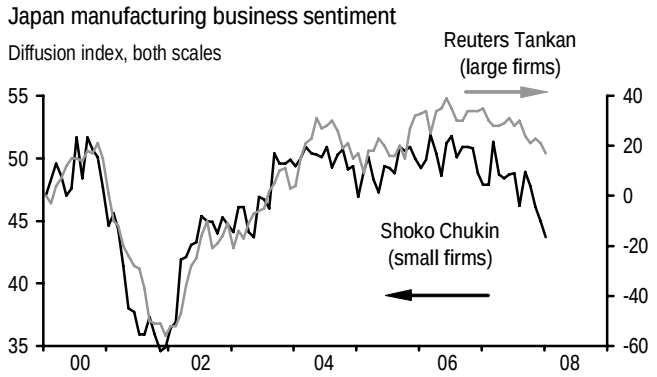

resource use, and worrisome inflation expectations. Moreover, these central banks do not share the Fed's anxiety about domestic growth. Although European officials recognize that tighter credit conditions will weigh on demand, they are not convinced that the effect will be significant or long-lasting.

In coming months, a further downshift in domestic demand growth is likely to cause European policymakers to take downside growth risks more seriously. In this environment, the Bank of England will continue to ease, with the ECB and the SNB likely joining in. But, the amount of easing is likely to be quite limited absent evidence that growth is stalling. Meanwhile, the Riksbank and the Norges Bank are expected to be on hold, while softening their hawkish rhetoric.

PBoC to ignore January inflation spike

China's exports jumped in January, echoing the results for Taiwan and Korea, and confirming that regional activity accelerated sharply ahead of the lunar new year holidays. Export and IP growth will be correspondingly weak in February. January and February data for IP, fixed investment, and retail sales will be released together in mid-March, so this month's data reports will be limited. January CPI data are due this week, however. Inflation is expected to reach a new cycle high of 7%oya, reflecting the dual impact of the approaching holidays and recent snowstorms. The central bank is not expected to respond to this development, recognizing that the inflation spurt is temporary. Indeed, policymakers recently have been emphasizing the need to maintain stable growth amid a deteriorating external backdrop, rather than focusing on inflation and overheating risks as before.

Inflation worries ease in Brazil and Mexico

Brazil's surprisingly low January inflation and the convergence of inflation expectations to the official target supports JPMorgan's view that the central bank will hold its policy rate at 11.25%. Inflation also surprised on the downside in Mexico. However, Banxico did not acknowledge this in the policy statement and retained its inflation risk bias. Nonetheless, with US and Canadian growth having stalled, the downside risks to Mexico's economy are increasing. JPMorgan has brought forward the expected timing of Banxico's first 25bp rate cut to the July 18 meeting (from Aug) and the second cut to September 19 (from Oct). The risk now is that Banxico will cut more than the total of 50bp forecasted for 2008.

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JPMorgan View - Global Markets

Credit market problems rising and spreading

- With the exception of credit markets, last week saw a **modest rebound in risky markets and carry trades**, with gains in equity markets, rises in bond yields, stronger commodity prices, and a weaker yen. Positive economic data earlier in the week led to some improvement in investor sentiment. But inventory problems and continued unwinding of unwanted loss-generating positions continued to put pressure on credit markets, which saw strong demand for credit protection and further widening in credit spreads.

- We stay with a **recession bias in our near-term strategies**, recommending bearish or defensive trades across asset classes. US economic indicators have moved closer to recession territory and **momentum in consensus expectations remains negative.** Economists keep lowering their growth forecasts for the US and have started marking down their forecasts for other countries and regions including EM economies. Equity analysts keep revising down their earnings forecasts for the companies they cover, with the upgrade/downgrade ratio in a freefall for the companies under the MSCI World index.

- **Momentum in flows is also negative**. Last week saw further outflows from equity funds both in developed markets and EM, and further outflows from HY and EM bond funds; and US retail investors continued to pour money into money market and government bond funds.

- More importantly, **market conditions are getting worse in credit** with weakness spreading to the municipal bond market. Last summer witnessed a crisis in the $1tn asset-backed commercial paper market. This time, the $300bn auction-rate securities market, a form of short-term funding for longer maturity municipal securities, is in crisis, posing a threat for money markets and banks and brokers that hold a large portion of these securities. This suggests keeping shorts in financials and in credit vs equities.

Fixed income

- Bonds sold off last week with 10-year yields up by around 10bp in major markets. We saw broad-based steepening, but the move was more pronounced in the US, where we saw heavy **convexity paying**. The USTs 2s10s steepened 20bp on the week, rising to 192bp. This is still below the 250bp peak in steepness seen after the 1991 and 2001 recessions, so by historical standards the **steepening trend has further to go.**

10-yr Government bond yields

	Current	Mar 08	Jun 08	Sep 08	Dec 08
United States	3.77	3.80	3.95	4.10	4.15
Euro area	3.96	3.85	3.75	3.90	4.05
United Kingdom	4.65	4.45	4.45	4.80	5.05
Japan	1.46	1.30	1.45	1.60	1.85

Equities

	Current	YTD Return (local currency)
S&P	1342	-7.9%
Topix	1335	-9.7%
FTSE 100	5791	-8.7%
MSCI Eurozone	213	-12.4%
MSCI Europe	1370	-11.1%

Credit markets

	Current	Jun-08	Dec 08
US high grade (bp over UST)	225	175	
US high grade (bp over swaps)	140	100	
Euro HG corp (bp over swaps)	82		65
USD high yield (bp vs. UST)	731	800	650
EMBIG (bp vs. UST)	290	250	200

Foreign exchange

	Current	Mar 08	Jun 08	Sep 08	Dec 08
EUR/USD	1.47	1.54	1.55	1.55	1.54
USD/JPY	108	98	101	101	103
GBP/USD	1.96	2.03	2.04	2.05	2.05

Commodities

		Quarterly Average			
	Current	Mar 08	Jun 08	Sep 08	Dec 08
WTI oil $/bbl	96.2	86.0	72.0	72.0	76.0
Gold ($/oz)	909	920	920	915	900
Copper($/m ton)	7700	8000	7300	6500	6000
Corn ($/Bu)	5.14	4.90	4.70	4.30	4.80

Source: JPMorgan, Bloomberg, Datastream

- Convexity paying pushed 10-year **swap spreads** up by 10bp in the US. As with steepeners, swap spreads have shown an asymmetric response to market moves. They tend to widen in both bear markets, owing to convexity paying, and bull markets, owing to flight to quality. We thus stay with a swap spread-widening recommendation, which is supported by quarter-end funding issues that US broker/dealers are currently facing. These funding issues are currently putting some flattening pressure on the swap spread curve, but once the quarter end is over in two weeks' time we expect the swap curve to re-steepen.

- Our longs at the short end of the EU and UK curve, both outright and against the US, suffered last week due to hawkish central-bank surprises in **Europe**. We stay with these medium-term trades though, as we believe we are at the early stage of a trend that will involve further repricing of central bank expectations in Europe vs the US. We also

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maintain steepeners in Europe, consistent with our bullish view at the short end and our expectation of continued steepening in the US. In **Japan**, where we were in duration longs and in flatteners, we recommend concentrating exposures in duration longs as last week's rise in yields provides a good entry point.

Equities

- World equities reversed some recent losses, rising around 2% last week. The VIX index, a proxy of investor sentiment, declined by 3% to 25%. We stay with a near term bearish view **focusing risk on defensive sectors**, for the reasons explained in the previous page. Medium term, though, into year end, we have bullish targets, driven by the view that even if the US economy experiences a recession it will be relatively short-lived and contained within the US.

- **EM and Japan** outperformed last week for a second straight week. EM benefited from higher commodity prices while Japanese equities rallied after the strong 4Q GDP report. We stay long both EM and Japan against MSCI World, currency unhedged. With economic weakness likely spreading to the Euro area and European policy makers resisting monetary or fiscal stimulus, we believe that **Euro area equities will continue to underperform the US**. We also reiterate our preference for UK over EU equities in both small and large caps.

- With financials underperforming last week, value posted a heavy loss vs growth, reversing the gains made during January. We **stay long growth vs value globally.** Historical evidence shows that growth tends to outperform value into recessions. A reversal of this trend takes place in the middle of a recession or immediately after. This means that the growth vs value overweight has at least a few more months to run as recession risks materialize.

Credit

- Credit spreads widened with CDS indices underperforming again. The sharp rise in CDS spreads continues to be driven by position unwinding by leveraged credit investors, that have recently experienced heavy losses especially in their loan portfolios, and synthetic structures that hit price triggers forcing them to unwind or restructure. This creates a vicious circle as higher CDS spreads lead to further losses in structures such as synthetic CDOs and CPDOs, raising the risk for more rating downgrades and unwinding in coming weeks. We stay **bearish in credit, underweighting credit vs equities and underweighting financials.**

- Fears of monolines and synthetic structure unwinds keep investors focused on buying protection higher up the capital structure in the mezzanine and senior space. This force will likely remain, keeping implied **correlation high** even if rising defaults, elevated portfolio dispersion, and closing of long equity tranche risk positions push correlation down at times.

- Euro high yield bonds have been underperforming the US since early January. There has been a similar trend in the loan market. Last week, while US loans are unchanged, European loans are down by around 3pts. With European investors continuing to struggle to recycle their unwanted bond and loan positions, we believe that **Europe will continue to underperform the US in both HY and HG credit.**

Foreign exchange

- The **dollar was mixed**, falling against European and commodity currencies but rising modestly versus the yen. This pattern suggests a tentative return to growth optimism as higher yielders generally rose and volatility declined.

- **EUR/USD and USD/JPY should settle into ranges near-term.** Money markets in the US, Euro area, and UK either fully or mostly discount the cash rates which would prevail in a recession, which in turn suggests stable spreads and minimal rate direction for currencies. Position shifts year to date have also been considerable, which reduces the scope for further liquidation of EUR longs or accumulation of JPY longs. Our forecasts for the dollar remain bearish, and while we have been too aggressive in our expectations for dollar weakness in 1Q, we continue to think the currency will suffer a relapse before midyear.

- **The commodity currencies are more interesting, particularly AUD/USD.** Australia offers the most compelling decoupling story in the G-10, given the RBA's bias to tighten and the external support from rallying metals and bulk commodity prices. Combined with light positions—longs on the IMM are only 1/3 off all-time highs—AUD should be the outperformer within G-10.

Commodities

- Last has been kind to most metals, with platinum the star performer—up 10% on the back of power shortages in South Africa. A new all-time high over $2000/oz likely sets the stage for a move towards $2500. Base metals have also remained solid due to further short covering. Aluminium traded at a multi-month high of $2875/mt but abundant stock levels will likely cap further gains in the near term.

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Markets - Australia and New Zealand

- **Hawkish RBA signals clearly that interest rates have further to rise**
- **We now forecast 25bp rate hikes in March and May**
- **RBNZ inflation expectations survey out Tuesday**

Market commentary

Australia

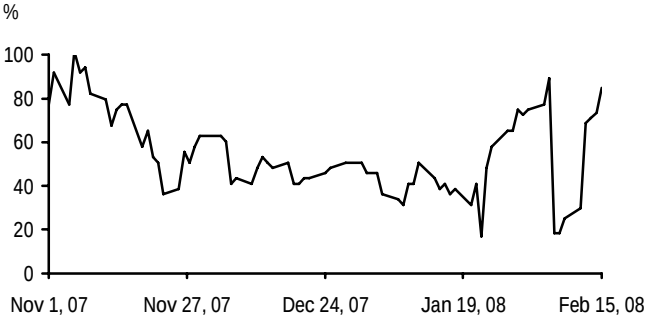
Last week's hawkish statement by the RBA quickly realigned market pricing in favour of more policy tightening. The market now prices an 84% chance of a March rate hike, up sharply from the previous week (chart). In its quarterly commentary, the RBA raised the forecast for core inflation to the extent that officials now believe that annual core inflation will be above the 2-3% target range until mid-2010. This is the clearest possible signal the RBA could send that the tightening cycle is not yet over. Our forecast is that the RBA will raise the cash rate 25bp on March 4 and again in May to 7.5%, just after the release of the 1Q CPI data, which will show another elevated inflation reading.

Last week's January jobs data highlighted one of the RBA's problems. The increasingly tight labour market means wage pressure is building at the same time that household income growth already is strong. High energy prices and rising interest rates are a squeeze for many households, but underlying income growth is firm. This week's labour price index probably will show an acceleration in wage growth. In fact, the 1.2%q/q rise we expect will be the biggest in the history of the labour price index.

The AUD was broadly stable, ending the week just above 90 US cents. AUD dropped below 90 US cents mid week on the back of concerns about the durability of global economic growth, but regained ground at week's end. The surprise, though, was that AUD didn't make larger gains in the wake of the RBA's hawkish commentary. The RBA is one of the few central banks raising cash rates while others ease. Also, the RBA spoke of the likelihood that the terms of trade will rise in 2008, which also should support AUD. The local equity market also ended the week broadly unchanged from last week, despite an avalanche of company announcements as reporting season kicked in.

The Aussie 3s 10s curve flattened over the week, following the RBA's commentary. The short end of the curve is pegged

Probably of RBA March rate hike spikes



by expectations that the RBA will tighten policy at least once more, but the longer end is captive to trends offshore.

New Zealand

This week looks relatively quiet on the economic data front, but the RBNZ inflation expectations survey, out Tuesday, should gather some interest. The inflation expectations survey is a major input in the RBNZ's inflation model, and expectations are likely to have risen. Inflation expectations tend to track oil and food prices, both of which have increased substantially in recent months. Rising inflation expectations will worsen the inflation outlook, and keep the possibility of an interest rate easing off the table.

In light of recent developments (i.e. a clear downtrend in retail spending, a stumbling housing market and the current drought in New Zealand's major dairy producing regions) we expect the RBNZ to tone down its hawkish rhetoric in upcoming statements. The RBNZ will, however, continue to express concern over the inflation trajectory, and more importantly, air the continual frustrations over the government's expansionary fiscal policy. It seems the drought and a weakening housing market, has given the government the green light to put on it's shining fiscal armour and ride in to save the day just short of this year's election. One thing is certain, the government has loads of cash, is behind in the polls and is looking for any excuse to spray money into the economy ahead of the October/November election.

The market basically tracked sideways last week, despite the weakening local data, and our short Kiwi 3 month into 2 year strangle is comfortably in its range and remains on track. The NZD also slid sideways over the week, and followed movements in the AUD. AUD/NZD has traded in a narrow 75pt range over the week, between 1.1400 to 1.1475. NZD was

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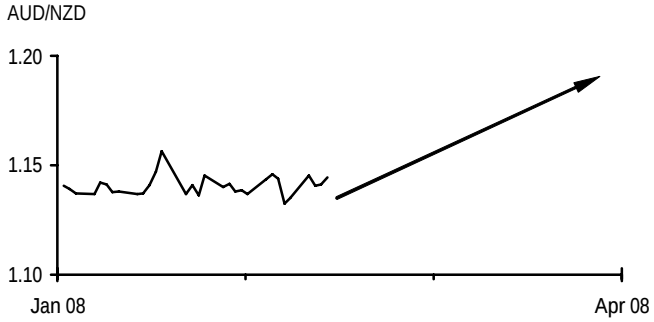
dragged higher with the AUD after Australia's stronger than expected employment number, and has fallen back since. We see the AUD/NZD rising back towards 1.20 on narrowing interest rate differentials—the RBA is likely to raise rates twice more in coming months to 7.5%, while the RBNZ is likely to keep the official cash rate unchanged at 8.25%.

Trade recommendations

- Hold long Aussie Mar08 bank bills vs. short Jun08 bills in futures. Established at 1bp two weeks ago (with target of 10 and a stop loss at -4), the position has traded to 8bp, for a 7bp gain.
- Hold short Kiwi 3 month into 2 year strangle using strikes 8.75% to 8.55%. Pick up 44pts with breakeven points at 8.99% and 8.31%. The position is back to trading in the middle of the range.

Aussie Kiwi cross likely to spike higher on interest rate differentials



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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	3Q07	4Q07	1Q08	2Q08	3Q08	4Q08	1Q09	4Q07	2Q08	4Q08	2Q09
The Americas														
United States	2.9	2.2	1.9	4.9	0.6	0.0	2.0	**3.5 ↑**	**2.5 ↓**	3.5	4.0	**3.1 ↑**	2.3	2.3
Canada	2.8	2.5	1.3	2.9	**0.8 ↓**	-1.0	1.5	2.8	2.8	3.0	2.4	1.0	1.6	1.7
Latin America	5.3	5.1	4.3	6.8	4.8	3.3	3.4	3.9	4.6	4.5	5.6	6.2	6.0	5.9
Argentina	8.5	**8.7 ↑**	6.5	11.8	**10.4 ↑**	**3.2 ↓**	4.9	4.1	4.1	4.1	**8.5 ↑**	8.6	9.7	11.0
Brazil	3.8	5.4	4.9	6.9	5.3	4.9	4.3	3.7	4.2	4.1	4.2	4.2	4.2	4.3
Chile	4.0	5.2	4.0	-2.5	8.0	5.0	3.0	3.0	5.0	5.0	7.2	8.2	4.8	3.1
Colombia	6.8	6.8	5.5	6.9	5.0	5.0	5.5	6.5	6.5	4.5	5.4	4.5	4.5	4.0
Ecuador	3.9	2.0	2.5	4.4	5.0	2.0	1.5	1.0	1.0	2.5	2.8	4.1	3.3	3.3
Mexico	4.8	3.1	2.7	5.9	1.0	1.0	2.0	4.1	4.9	4.9	3.8	4.7	4.1	3.3
Peru	7.6	8.4	7.0	15.9	12.0	6.0	3.5	2.0	6.0	6.5	3.5	3.3	2.3	2.0
Venezuela	10.3	8.3	6.0	7.0	10.0	5.0	4.0	4.0	3.5	4.0	20.2	24.8	26.6	29.3
Asia/Pacific														
Japan	2.4	**2.1 ↑**	**1.7 ↑**	**1.3 ↓**	**3.7 ↑**	0.5	2.0	2.3	2.3	2.4	**0.5 ↓**	0.8	0.7	0.5
Australia	2.8	3.8	3.5	4.1	3.1	3.2	4.4	2.5	4.1	3.6	3.0	2.9	2.4	2.6
New Zealand	1.5	3.0	2.5	2.1	2.9	2.5	2.7	1.8	2.2	2.9	3.2	3.1	2.9	2.8
Asia ex. Japan	8.5	8.5	7.7	8.2	6.5	7.5	7.7	**7.8 ↑**	**8.2 ↑**	8.0	5.3	5.1	3.8	4.1
China	11.1	11.4	10.5	8.9	9.1	10.8	11.2	10.4	10.4	10.8	6.6	5.6	3.5	4.1
Hong Kong	6.8	6.0	5.3	7.0	5.0	4.0	5.2	5.5	5.5	5.2	3.4	3.4	2.7	3.8
India	9.6	8.7	7.5	8.4	5.3	8.2	7.0	7.5	8.2	8.2	5.5	6.3	5.9	5.2
Indonesia	5.5	**6.3 ↑**	6.2	**7.8 ↑**	**6.9 ↑**	6.0	6.0	6.0	6.0	5.0	**6.7 ↓**	6.9	7.4	7.8
Korea	5.0	4.9	4.8	5.4	6.3	3.0	4.0	5.5	6.0	5.0	3.4	3.4	3.1	3.2
Malaysia	5.9	6.0	5.3	9.7	3.2	4.1	5.7	5.7	6.6	6.1	**2.2 ↑**	3.3	3.8	3.3
Philippines	5.4	7.1	6.1	4.0	7.4	6.0	5.0	5.5	6.0	5.8	3.3	3.2	2.4	2.4
Singapore	**8.2 ↑**	**7.7 ↑**	4.6	**5.1 ↑**	**-4.8 ↓**	6.6	4.1	**8.7 ↑**	**9.5 ↑**	**5.7 ↓**	**4.1 ↑**	5.1	2.8	2.8
Taiwan	4.9	5.6	4.2	13.6	0.5	2.0	3.2	3.6	5.2	5.0	4.0	4.0	1.7	2.4
Thailand	5.1	4.2	5.1	5.8	4.0	6.0	6.0	6.0	5.0	4.5	2.9	4.4	3.8	3.0
Africa														
South Africa	5.4	5.0	3.7	4.7	3.6	2.8	3.8	4.1	4.0	3.7	8.4	8.3	6.1	5.0
Europe														
Euro area	2.9	**2.7 ↑**	**1.7 ↑**	3.1	**1.7 ↑**	1.2	1.2	2.3	2.3	2.5	2.9	2.7	2.3	2.3
Germany	3.1	2.6	**1.6 ↓**	**2.7 ↓**	**1.1 ↓**	1.3	1.3	2.3	2.3	2.5	3.1	2.0	1.4	1.5
France	2.2	1.9	1.8	3.2	**1.4 ↑**	1.5	1.3	2.3	2.3	2.3	2.5	2.4	1.8	2.0
Italy	1.9	1.7	**0.7 ↓**	1.7	**-0.8 ↓**	0.5	0.5	2.0	2.0	2.3	2.6	2.6	2.2	2.3
Norway	4.3	5.7	3.8	7.7	**3.5 ↑**	3.0	2.5	3.0	3.0	3.5	**1.4 ↑**	**5.0 ↑**	3.4	2.2
Sweden	4.4	2.8	**2.4 ↓**	2.4	**2.8 ↓**	2.0	2.0	3.0	3.0	3.5	**3.1 ↓**	3.6	3.0	2.5
Switzerland	3.2	2.8	**1.8 ↓**	3.3	2.0	1.3	**1.1 ↓**	1.8	1.8	2.0	1.7	**1.6 ↓**	1.5	**1.3 ↑**
United Kingdom	2.9	3.1	2.0	2.7	2.4	1.2	1.6	2.0	2.3	2.5	2.1	2.4	2.7	2.1
Emerging Europe[1]	6.6	**6.6 ↑**	**5.7 ↓**	**6.4 ↓**	**10.2 ↑**	**0.4 ↓**	**7.5 ↓**	**5.7 ↓**	8.4	**1.2 ↓**	**8.1 ↑**	**8.6 ↑**	**7.0 ↑**	5.8
Bulgaria	6.1	6.1	5.2	...	...	...	...	...	...	...	...	...	...	...
Czech Republic	6.4	**6.6 ↑**	**5.0 ↓**	5.8	**7.8 ↑**	**3.5 ↓**	**4.5 ↓**	**3.5 ↓**	**4.5 ↓**	5.5	4.8	**7.1 ↑**	**5.5 ↑**	**3.0 ↓**
Hungary	3.9	**1.3 ↓**	**2.0 ↓**	**0.8 ↓**	**0.4 ↓**	**2.8 ↑**	**2.8 ↑**	**3.0 ↑**	3.0	**3.0 ↓**	**7.1 ↑**	**5.9 ↑**	**4.3 ↑**	3.7
Poland	6.2	6.5	**5.5 ↓**	4.9	**8.2 ↓**	**4.5 ↓**	**4.8 ↓**	5.3	5.5	5.8	3.5	**4.1 ↑**	**3.8 ↑**	**3.3 ↑**
Slovak Republic	8.5	**10.3 ↑**	7.0	9.2	**17.9 ↑**	**-2.0 ↓**	**6.0 ↓**	**7.0 ↑**	**7.0 ↑**	**4.0 ↓**	**3.3 ↑**	**4.3 ↑**	**3.6 ↓**	**4.0 ↓**
Romania	7.7	6.0	5.6	...	...	...	...	...	...	...	6.7	6.5	5.5	5.3
Russia	7.4	8.1	6.8	7.4	13.0	-2.5	10.5	6.5	12.0	-2.5	11.5	12.6	10.1	8.8
Turkey	6.1	5.0	5.0	...	...	...	...	...	...	...	8.2	7.4	6.2	4.1
Global	3.7	3.4	2.7	4.4	**2.7 ↑**	**1.5 ↓**	2.8	**3.5 ↑**	**3.4 ↓**	**3.5 ↓**	3.5	**3.2 ↑**	2.7	2.6
Developed markets	2.8	**2.5 ↑**	**1.9 ↑**	3.6	**1.6 ↑**	0.6	1.8	**2.8 ↑**	**2.4 ↓**	2.9	2.9	**2.5 ↑**	2.1	2.0
Emerging markets	7.0	7.0	6.1	7.5	6.6	**5.1 ↓**	6.5	6.4	7.2	5.9	5.9	6.0	**5.0 ↑**	4.8

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	Mar 08	Jun 08	Sep 08	Dec 08	Mar 09
Global	GDP-weighted average	3.98	145			3.81	3.56	3.56	3.60	3.67
excluding US	GDP-weighted average	4.44	130			4.42	4.19	4.18	4.24	4.34
Developed	GDP-weighted average	3.21	160			3.00	2.70	2.70	2.74	2.83
Emerging	GDP-weighted average	7.11	80			7.09	7.10	7.08	7.11	7.10
The Americas	GDP-weighted average	3.71	145			3.27	3.01	3.00	2.99	3.00
United States	Federal funds rate	3.00	175	30 Jan 08 (-50bp)	**18 Mar 08 (-50bp)**	2.50	2.25	2.25	2.25	2.25
Canada	Overnight funding rate	4.00	200	22 Jan 08 (-25bp)	4 Mar 08 (-50bp)	3.50	2.75	2.75	2.75	3.00
Brazil	SELIC overnight rate	11.25	-475	5 Sep 07 (-25bp)	2Q 09 (-25bp)	11.25	11.25	11.25	11.25	11.25
Mexico	Repo rate	7.50	100	26 Oct 07 (+25bp)	15 Aug 08 (-25bp)	7.50	7.50	7.25	7.00	7.00
Chile	Discount rate	6.25	450	10 Jan 08 (+25bp)	10 Jul 08 (-25bp)	6.25	6.25	6.00	5.75	5.75
Colombia	Repo rate	9.50	275	23 Nov 07 (+25bp)	1Q 09 (-25bp)	9.50	9.50	9.50	9.50	9.25
Peru	Reference rate	5.25	275	10 Jan 08 (+25bp)	on hold	5.25	5.25	5.25	5.25	5.25
Europe/Africa	GDP-weighted average	4.53	166			4.54	4.10	4.09	4.10	4.26
Euro area	Refi rate	4.00	200	6 Jun 07 (+25bp)	10 Apr 08 (-25bp)	4.00	3.50	3.50	3.50	3.75
United Kingdom	Repo rate	5.25	75	7 Feb 08 (-25bp)	10 Apr 08 (-25bp)	5.25	4.75	4.75	4.75	4.75
Sweden	Repo rate	**4.25**	225	**13 Feb 08 (+25bp)**	**17 Dec 08 (+25bp)**	**4.25**	**4.25**	**4.25**	**4.50**	**4.75**
Norway	Deposit rate	5.25	350	12 Dec 07 (+25bp)	3Q 08 (+25bp)	5.25	5.25	5.50	5.75	5.75
Czech Republic	2-week repo rate	3.75	150	7 Feb 08 (+25bp)	26 Mar 08 (+25bp)	4.00	4.00	4.00	3.75	3.50
Hungary	2-week deposit rate	7.50	-400	24 Sep 07 (-25bp)	3Q 08 (-25bp)	7.50	7.50	7.25	7.00	6.75
Poland	7-day intervention rate	5.25	0	30 Jan 08 (+25bp)	26 Mar 08 (+25bp)	5.50	5.50	5.75	6.00	6.00
Russia	1-week deposit rate	3.50	250	4 Feb 08 (+25bp)	1Q 09 (+25bp)	3.50	3.50	3.50	3.50	3.75
Slovak Republic	2-week repo rate	4.25	-75	27 Apr 07 (-25bp)	2Q 08 (-75bp)	4.25	3.50	3.50	3.50	3.75
South Africa	Repo rate	11.00	300	6 Dec 07 (+50bp)	Dec 08 (-50bp)	11.00	11.00	11.00	10.50	10.00
Switzerland	3-month Swiss Libor	2.75	225	13 Sep 07 (+25bp)	Jun 08 (-25bp)	2.75	2.50	2.50	2.50	2.50
Turkey	Overnight borrowing rate	**15.25**	-675	**14 Feb 08 (-25bp)**	**19 Mar 08 (-25bp)**	15.00	14.00	13.50	13.50	13.00
Asia/Pacific	GDP-weighted average	3.61	114			3.61	3.66	3.68	3.85	3.86
Australia	Cash rate	7.00	175	5 Feb 08 (+25bp)	4 Mar 08 (+25bp)	7.25	7.50	7.50	7.50	7.50
New Zealand	Cash rate	8.25	250	26 July 07 (+25bp)	1Q 09 (-25bp)	8.25	8.25	8.25	8.25	8.00
Japan	Overnight call rate	0.50	50	21 Feb 07 (+25bp)	4Q 08 (+25bp)	0.50	0.50	0.50	0.75	0.75
Hong Kong	Discount window base	4.50	200	23 Jan 08 (-75bp)	**19 Mar 08 (-50bp)**	4.00	3.75	3.75	3.75	3.75
China	1-year working capital	7.47	216	20 Dec 07 (+18bp)	2Q 08 (+27bp)	7.47	7.74	7.92	8.19	8.19
Korea	Overnight call rate	5.00	125	9 Aug 07 (+25bp)	1Q 09 (+25bp)	5.00	5.00	5.00	5.00	5.25
Indonesia	BI rate	8.00	66	6 Dec 07 (-25bp)	**3 Apr 08 (-25bp)**	8.00	7.75	7.75	7.75	7.75
India	Repo rate	7.75	175	30 Mar 07 (+25bp)	Jul 08 (-25bp)	7.75	7.75	7.50	7.50	7.25
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	5.00	-175	31 Jan 08 (-25bp)	**on hold**	5.00	5.00	5.00	5.00	5.00
Thailand	1-day repo rate	3.25	200	18 July 07 (-25bp)	27 Feb 08 (-25bp)	3.00	2.75	2.75	2.75	2.75
Taiwan	Official discount rate	3.375	200	20 Dec 07 (+12.5bp)	1Q 09 (+12.5bp)	3.375	3.375	3.375	3.375	3.50

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*

				2007			2008				2009			
	2007	2008	2009	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Chain volume GDP	3.8	3.5	3.2	2.8	4.1	3.1	3.2	4.4	2.5	4.1	3.6	2.8	3.1	0.6
Private consumption	4.0	3.5	2.6	1.5	5.0	3.2	4.1	3.2	2.8	2.8	2.4	2.8	2.0	1.6
Construction investment	10.2	3.0	1.3	4.3	5.3	1.9	2.8	4.2	0.5	3.1	2.1	-1.2	0.4	1.4
Equipment investment	7.1	2.4	-2.3	20.7	-8.9	4.2	2.1	8.6	-4.1	0.0	-2.1	-4.1	-8.1	0.0
Public investment	4.0	6.8	6.2	90.3	-8.7	4.2	4.7	5.2	5.4	5.8	6.2	6.6	7.0	7.5
Government consumption	2.7	3.4	2.8	0.7	4.2	2.2	4.4	3.7	3.3	2.9	3.5	2.2	1.8	2.2
Exports of goods & services	4.0	5.8	7.6	2.5	9.4	4.1	6.1	6.1	4.1	8.2	8.2	8.2	10.4	4.1
Imports of goods & services	10.0	4.8	2.6	5.8	9.4	5.1	6.1	2.0	1.6	3.2	3.2	2.4	1.8	3.2
Contributions to GDP growth:														
Domestic final sales	4.6	3.7	2.3	5.6	3.1	4.1	3.9	4.1	2.2	2.9	2.4	1.8	1.2	1.8
Inventories	0.7	-0.3	0.0	-1.8	1.3	-0.6	-0.5	-0.4	-0.1	0.3	0.3	-0.2	0.2	-1.3
Net trade	-1.4	0.1	1.0	-0.8	-0.3	-0.4	-0.2	0.8	0.5	0.9	0.9	1.1	1.7	0.1
GDP deflator (%oya)	3.7	2.8	2.6	4.4	3.1	2.9	2.9	2.9	2.9	2.7	2.6	2.6	2.6	2.5
Consumer prices (%oya)	2.3	3.8	2.9	2.1	1.9	3.0	4.1	3.7	3.8	3.5	3.1	3.0	2.8	2.8
Producer prices (%oya)	2.1	2.6	2.5	1.5	0.8	2.5	3.5	1.7	2.7	2.6	2.5	2.5	2.5	2.5
Trade balance (A$ bil, sa)	-19.2	-22.3	-14.6	-4.4	-5.0	-5.9	-6.1	-5.8	-5.6	-4.8	-4.5	-3.9	-3.2	-3.1
Current account (A$ bil, sa)	-65.4	-73.3	-68.6	-15.6	-15.6	-18.9	-18.6	-18.8	-18.6	-17.3	-18.0	-17.9	-16.7	-16.1
as % of GDP	-6.0	-6.4	-5.6	-5.8	-5.7	-6.8	-6.6	-6.6	-6.4	-5.9	-6.0	-5.9	-5.4	-5.2
3m eurodeposit rate (%)*	6.0	7.3	6.8	5.8	7.1	7.2	7.3	7.3	7.3	7.1	6.9	6.8	6.8	6.7
10-year bond yield (%)*	5.6	6.4	6.3	5.6	5.7	6.4	6.5	6.5	6.5	6.3	6.3	6.3	6.3	6.3
US$/A$*	0.75	0.90	0.84	0.74	0.77	0.88	0.88	0.90	0.91	0.90	0.88	0.85	0.82	0.79
Commonwealth budget (FY, A$ bil)	13.6	8.5	6.0											
as % of GDP	1.3	0.7	0.5											
Unemployment rate	4.3	4.7	5.5	4.3	4.3	4.3	4.5	4.6	4.8	5.0	5.3	5.4	5.6	5.7
Industrial production	2.8	0.7	0.8	1.7	-0.5	-1.0	0.0	1.0	3.0	4.0	-1.0	-2.0	-3.0	0.0

*All financial variables are period averages

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

				2007			2008				2009			
	2007	2008	2009	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Real GDP (1995-96 prices)	3.0	2.5	2.8	3.3	2.1	2.9	2.5	2.7	1.8	2.2	2.9	3.5	3.3	2.6
Private consumption	4.1	1.3	1.6	1.8	1.3	1.2	1.1	1.2	1.4	1.5	1.6	1.8	1.9	2.0
Fixed Investment	3.1	0.4	2.3	-2.9	-0.9	1.6	0.6	0.4	0.5	1.7	2.9	2.9	3.2	4.0
Residential construction	4.9	-0.8	-1.5	14.8	7.9	1.6	-3.2	-4.0	-8.0	-4.0	-1.6	1.6	3.2	4.0
Other fixed investment	2.6	0.7	3.3	-6.9	-3	1.6	1.6	1.6	2.8	3.2	4.0	3.2	3.2	4.0
Inventory change (NZ$ bil, saar)	0.9	0.4	0.5	0.4	0.3	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Government spending	4.1	5.9	4.0	4.2	8.8	4.4	5.6	6.9	5.8	4.7	2.4	4.4	2.9	2.4
Exports of goods & services	2.5	3.6	4.4	-3.2	-2.3	8.0	5.0	3.6	4.0	4.2	4.5	4.8	5.0	4.5
Imports of goods & services	7.5	2.7	3.0	10.8	0.9	2.2	2.4	2.2	3.0	3.0	3.5	3.0	2.5	3.0
Contributions to GDP growth:														
Domestic final sales	4.3	2.8	2.4	3.5	4.4	4.1	1.9	2.1	2.1	2.3	2.3	2.9	2.5	2.3
Inventories	0.6	-0.4	0.1	4.7	-1.1	-2.7	0.0	0.2	-0.5	-0.2	0.5	0.2	0.1	0.0
Net trade	-1.9	0.1	0.3	-4.8	-1.1	1.6	0.7	0.3	0.2	0.2	0.1	0.4	0.7	0.3
GDP deflator (%oya)	3.7	3.3	2.8	4.1	3.8	3.8	3.8	3.2	3.0	3.0	2.9	2.8	2.7	2.7
Consumer prices	2.4	3.2	2.7	4.0	2.0	4.8	3.0	2.7	3.1	2.8	2.7	2.6	2.7	2.5
%oya	2.4	3.2	2.7	2.0	1.8	3.2	3.4	3.1	3.4	2.9	2.8	2.8	2.7	2.6
Trade balance (NZ$ bil, sa)	-3.7	-5.3	-4.1	-0.8	-0.8	-1.3	-1.3	-1.3	-1.3	-1.3	-1.3	-1.1	-1.0	-0.8
Current account (NZ$ bil, sa)	-14.5	-14.8	-13.5	-3.5	-3.6	-3.8	-3.7	-3.7	-3.6	-3.7	-3.7	-3.5	-3.3	-3.0
as % of GDP	-8.5	-8.2	-7.1	-8.3	-8.5	-8.7	-8.4	-8.2	-8.1	-8.2	-8.0	-7.5	-6.8	-6.1
Yield on 90-day bank bill (%)*	8.4	8.4	7.8	8.2	8.7	8.8	8.4	8.4	8.4	8.4	8.0	7.9	7.6	7.5
10-year bond yield (%)*	6.3	6.6	7.0	6.4	6.4	6.4	6.5	6.6	6.7	6.8	7.0	7.1	7.0	7.0
US$/NZ$*	0.74	0.76	0.67	0.74	0.74	0.76	0.76	0.76	0.76	0.75	0.68	0.65	0.67	0.68
Commonwealth budget (NZ$ bil)	6.4	5.3	5.0											
as % of GDP	3.8	2.9	2.6											
Unemployment rate	3.6	4.0	4.5	3.6	3.5	3.7	3.8	3.9	4.1	4.2	4.3	4.5	4.6	4.7

*All financial variables are period averages

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Australia and New Zealand economic calendar

Monday	Tuesday	Wednesday	Thursday	Friday
18 Feb	19 Feb Australia: BoP imports prelim. (11:30am) Jan	20 Feb Australia: Westpac leading Index (10:30am) Dec Wage cost index (11:30am) 4Q 4.3 %oya	21 Feb Australia: New motor vehicles sales (11:30am) Jan New Zealand: Credit card spending (03:00pm) Jan	22 Feb
25 Feb	26 Feb	27 Feb Australia: Construction work done (11:30am) 4Q New Zealand: Building permits (10:45am) Jan NBNZ business conf. (03:00pm) Feb	28 Feb Australia: Private capital expenditure (11:30am) 4Q New Zealand: Visitor arrivals (10:45am) Jan Money supply (03:00pm) Jan	29 Feb Australia: Pvt. sector credit (11:30am) Jan New Zealand: Trade balance (10:45am) Jan
3 Mar Australia: Inventories (11:30am) 4Q Company profits (11:30am) 4Q RBA comm. index (04:30pm) Feb	4 Mar Australia: Retail sales (11:30am) Jan Current account (11:30am) 4Q RBA cash target (02:30pm) Mar New Zealand: ANZ comm. price (03:00pm) Feb	5 Mar Australia: GDP (11:30am) 4Q	6 Mar Australia: Building approvals (11:30am) Jan New Zealand: RBNZ official cash rate (09:00am) Feb	7 Mar Australia: Foreign reserves (04:30pm) Feb
10 Mar Australia: ANZ job advertisements (11:30am) Feb New Zealand: QV house prices Feb	11 Mar Australia: Housing finance (11:30am) Jan New Zealand: Terms of trade (10:45am) 4Q	12 Mar Australia: Westpac consumer confidence (10:30am) Mar	13 Mar Australia: Consumer inflation expectation (10:30am) Mar Unemployment rate (11:30am) Feb New Zealand: PMI Feb	14 Mar

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
18 - 22 Feb	18 Feb	19 Feb	20 Feb	21 Feb	22 Feb
Japan • Fukui speech on Saturday, Feb 23	Japan • Construction spending (Dec) • Tertiary sector activity index (Dec)	Canada • CPI (Jan) China • CPI (Jan) Japan • Nationwide dept store sales (Jan) Mexico • GDP (4Q) Sweden • CPI (Jan) United States • NAHB survey (Feb)	Japan • BoJ minutes: Jan 21-22 United Kingdom • BoE minutes United States • CPI (Jan) • Housing starts (Jan) • FOMC minutes	France • CPI (Jan) Japan • Trade balance (Jan) Norway • GDP (4Q) Taiwan • GDP (4Q) United Kingdom • Retail sales (Jan) United States • Philly Fed bus survey (Feb)	Belgium • BNB bus survey (Feb) Colombia • BanRep meeting Euro area • Industrial new orders (Dec) • PMI flash (Feb) France • INSEE bus survey (Feb) Japan • Fukui speech Mexico • CPI (Feb) • Trade balance prelim (Jan)
25 - 29 Feb	25 Feb	26 Feb	27 Feb	28 Feb	29 Feb
United Kingdom • Nationwide HPI (Feb)	Hungary • MNB meeting Malaysia • BNM meeting United States • Existing home sales (Jan)	Canada • Payrolls (Dec) Germany • CPI 6 states and prelim (Feb) • GDP final (4Q) • IFO bus survey (Feb) Italy • ISAE bus survey (Feb) Japan • Shoko Chukin small bus survey (Feb) Netherlands • CBS bus survey (Feb) Slovak Republic • NBS meeting Taiwan • Export orders, IP (Jan) United States • OFHEO HPI (4Q) • PPI (Jan) • S&P/C-S HPI (Dec, 4Q)	Euro area • M3 (Jan) Poland • NBP meeting Thailand • BoT meeting United Kingdom • GDP prelim (4Q) United States • Durable goods (Jan) • New home sales (Jan) • Bernanke delivers semiannual monetary policy report to Congress (tentative)	Germany • Employment (Jan) • Retail sales (Jan) • Unemployment (Feb) Japan • IP prelim (Jan) • Retail sales (Jan) United States • GDP prelim (4Q) • Bernanke delivers semiannual monetary policy report to Congress (tentative)	China • PMI mfg (Feb) Euro area • EC bus survey (Feb) • HICP final (Jan) • Unemployment (Jan) Germany • CPI final (Jan) Japan • Core CPI (Jan) • Household spending (Jan) • Housing starts (Jan) • PMI mfg (Feb) • Unemployment rate (Jan) Sweden • GDP (4Q) United States • Chicago bus survey (Feb) • Consumer sent final (Feb) • Personal income (Jan)

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