JPMorgan

Australia and New Zealand - Weekly Prospects

Summary

- **Australian** economic data were mixed last week. GDP growth surprised on the upside, the current account and trade deficit narrowed more than expected, and retail sales unexpectedly contracted in April. The RBA's decision to leave interest rates steady was, however, widely anticipated. This week brings the release of more key domestic indicators, including home loans, consumer confidence, and employment. These indicators will probably signal that domestic demand has eased further in 2Q. Home loans are expected to fall again in April, consumer confidence is set to rise only mildly in June, and employment growth is expected to moderate in May.

- In **New Zealand**, the highlight last week was the RBNZ's monetary policy statement, which signalled that the Bank may lower the OCR later this year. The RBNZ left rates steady as expected, amid rapidly slowing economic growth and elevated inflation, but we maintain our forecast that the RBNZ will cut the OCR 25bp in October and December, and again in 1Q09. This week's retail sales data should confirm that consumer spending remains subdued under the weight of record high interest rates.

- The **ECB** signaled that it is willing to raise rates in order to ensure that inflation expectations remain contained. Anchoring inflation expectations is central to every central bank's mission, but it is hard to think of a recent occasion in which a major central bank has tightened policy from a point of rest against the backdrop of a deteriorating growth outlook. In taking this action, the ECB is breaking new ground and challenging our view that central banks would "talk loudly and carry a small stick" through the end of this year.

- Our forecast for **Fed policy** already incorporates much of this thinking. Unlike in the past three recession episodes—when the Fed waited until the US unemployment rate had fallen for 12 months (June 2004); 20 months (February 1994); and 16 months (March 1984)—we expect the Fed this time to begin normalizing policy 3-6 months after the US labour market finds its footing. In our forecast, this places the start of the tightening process in 2Q09. We have not until now seriously considered the possibility that the Fed could choose to take a limited step while the economy is still weak but displaying a lower profile of downside growth risk.

- The emerging economies have released a wave of upside May inflation surprises, including in Asia. This week's reports are likely to show that **China** was an exception. The forecast calls for inflation of 7.7%oya in May, down from 8.5% the previous month. Key is that food inflation, which hit 22%oya in April, finally appears to be coming down, based on our tracking of daily and weekly food price indices. Food price inflation should trend lower in coming months and headline inflation should follow, but only to a point: as headline inflation subsides, the government is expected to resume its price liberalization reform drive later in the year.

This week's highlight

RBA Governor Glenn Stevens' speech on Friday. Mr Stevens will speak about the economic outlook and take questions from the floor.

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Data and event previews - Australia and New Zealand

Date [(a)]	Data/event	Forecast			Comment
		JPMorgan	Consensus	*Previous*	
Tuesday, 10 June (11.30am)	**Aust. housing finance (%m/m, April)**	**2.5**	-2.0	*-6.1*	The number of home loans issued in April should have grown 2.5%m/m, rebounding from a 6.1% fall in March. Demand for home loans recently weakened, owing to rising interest rates and the disproportionate rises in domestic banks' variable loan rates.
Tuesday, 10 June (11.30am)	**Aust. ANZ job ads (May, %m/m)**	**na**	na	*3.1*	The number of newspaper job ads rose in April after two straight monthly declines. Labour is a lagging indicator of the economy and there is plenty of evidence suggesting that the labour market remains tight, so job ads probably still have some room to grow.
Tuesday, 10 June (11.30am)	**Aust. NAB business survey (May, confidence)**	**na**	na	*-8.0*	Business confidence probably rebounded in May. Global financial market conditions have improved, there is less pessimism about the global economic outlook, the federal Budget did not target businesses, and the RBA left interest rates unchanged in May. That said, energy prices are soaring and the high AUD may be hurting the competitiveness of some businesses.
Wednesday, 11 June (10:30am)	**Aust. WMI consumer confidence (May, %m/m)**	**1.0**	na	*2.7*	Consumer confidence should improve mildly, primarily owing to the RBA's decision to leave rates steady, and the generous personal income tax cuts announced in the May Budget. Still, most survey respondents are pessimistic, owing to ongoing global growth concerns, financial market volatility, and rising petrol prices. The June confidence survey was taken amid the furious debate over the extent to which the government can keep a lid on petrol prices.
Thursday, 12 June (8.45am)	**NZ ANZ business survey (May, index)**	**na**	na	*na*	na
Thursday, 12 June (11.30am)	**Aust. employment change (May)**	**5,000**	13,500	*25,400*	After adding 25,400 jobs in April, Australia should add 5,000 jobs in May, pushing the jobless rate up to 4.3%. Despite the recent rise in the jobless rate, the economy has added a massive 250,000 jobs since mid-2007 and labour market conditions remain tight.
Friday, 13 June (8.45am)	**NZ retail sales (April, %m/m)**	**0.20**	0.30	*-1.20*	Retail sales are forecast to grow just 0.2%m/m in April, recovering slightly from a sharp 1.2% slump in March. The household sector remains weak, and the negative wealth effects from the sharp deterioration in the housing market are creating significant headwinds for the household sector, already under pressure from high borrowing costs and rising prices for staples, such as food.
Friday, 13 June (1.10pm)	**Speech by RBA Governor Glenn Stevens**	**na**	na	*na*	Glenn Stevens will deliver a speech on economic conditions to the American Chamber of Commerce in Australian luncheon in Melbourne. The Governor's speech will be followed by a question and answer session. According to AMCHAM's preamble on the speech, "While inflation remains problematic, according to the RBA economic growth is set to slow sharply to around 2.25% in 2008 from 3.9% in 2007 and what is needed now is to tackle inflation despite the short-term pain for households."

(a) Australian Eastern Standard Time.

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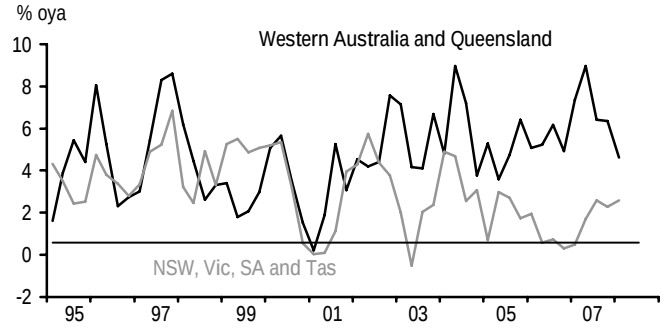
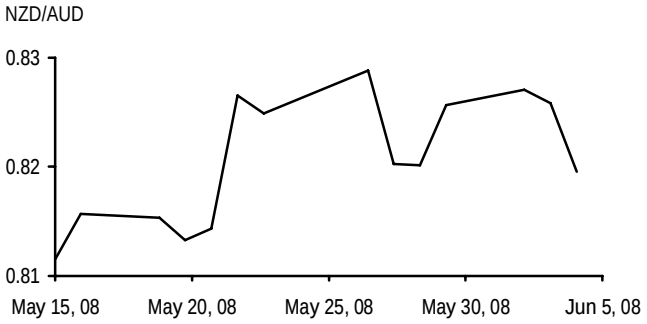
Feature charts

GDP growth by State



The economy expanded a strong 0.6%q/q in 1Q, fuelled by growth in the mining states—Western Australia (+1.4%) and Queensland (+1.1%). In these states, though, growth is clearly slowing. In New South Wales, where GDP grew 0.7% in 1Q, and other consumer-dependent states, tighter credit conditions also are having a significant impact.

Threat of narrower yield advantage weighs on NZD



The RBNZ left the OCR unchanged last week but signalled that it may be in a position to lower the key rate later in the year. The NZD was sold off amid expectations that its yield advantage would soon start to narrow. The Kiwi dollar shed nearly 2% against the US dollar and over one cent against AUD shortly after the RBNZ announcement.

New Zealand: days to sell vs. house prices

REINZ house price data this week is likely to confirm that the Kiwi housing market is still slowing rapidly. House sales in April were down 45%oya, the national median price fell to NZ$345,000, and the number of days to sell a home rose from 40 to 44, confirming that the market was in a slump. Record high interest rates, slowing net immigration, and rising building costs mean that further weakness in the residential property market should be expected.

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Australia

- **Australian GDP grew 0.6%q/q in 1Q**
- **RBA left interest rates steady as expected**
- **Employment growth to slow in May**

Australian economic data were mixed last week. GDP growth surprised on the upside, the current account and trade deficit narrowed more than expected, and retail sales unexpectedly contracted in April. The RBA's decision to leave interest rates steady was, however, widely anticipated. This week brings the release of more key domestic indicators, including home loans, consumer confidence, and employment, which will indicate whether domestic demand eased further in 2Q.

Employment gains likely slowed in May

After adding 25,400 jobs in April, Australia probably added only 5,000 jobs in May, pushing the jobless rate slightly higher to 4.3%. Despite the recent rise in the jobless rate, the economy has added a massive 250,000 jobs since mid-2007 and labour market conditions remain tight. Widespread skill shortages, though, mean wage growth probably will accelerate; the RBA, therefore, may not get the significant moderation in domestic demand it believes is needed to curb inflation. RBA officials still want to see a "significant" slow down in domestic demand growth in order for inflation to return to it's 2-3% target range.

Home loans probably rose in April

The number of home loans issued in April should have declined 2.5%m/m, only slightly less than the 6.1% fall in March and a 6.8% drop in February. Demand for home loans recently weakened, owing to rising interest rates and the disproportionate rises in domestic banks' variable loan rates.

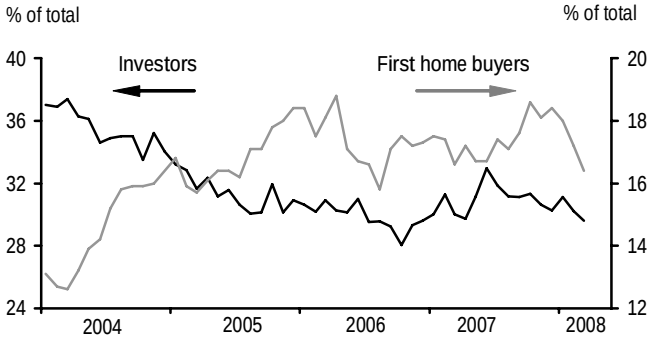
Investors, however, probably will continue to withdraw from the property market. Investors—usually existing property owners able to receive significant tax benefits from buying property—have accounted a significant portion of the demand for home loans for some time, although they now appear to be in a less favourable position than owner-occupiers who are more resilient in the face of 12-year high interest rates, owing to solid growth in household earnings. The big drop in interest rates in the 1990s boosted their capacity to borrow at the same time that house prices soared. First home buyers, though, continue to suffer amid record low levels of housing affordability.

Consumer confidence to improve mildly

Consumer confidence probably will increase 1.0%m/m in June, after rising 2.7% in May. The Westpac-Melbourne Institute's

Australia: labor price index and unemployment

Australia: housing finance



consumer sentiment index should rise to 90.7, although this still is 27% lower than its May 2007 peak. Furthermore, the index reading remains well below the 100 level where the number of optimists equals pessimists.

The mild improvement in sentiment is primarily owing to the RBA's decision to leave interest rates on hold, and also the generous personal income tax cuts announced in the May Budget. Still, most survey respondents are pessimistic, owing to ongoing global growth concerns, financial market volatility, and rising petrol prices. The June confidence survey was taken amid the furious debate over the extent to which the government can keep a lid on petrol prices.

RBA left cash rate unchanged

As widely expected, the RBA left the cash rate steady at 7.25% last week for the third straight month. The accompanying commentary delivered no surprises. The two notable differences from the previous statement were that the RBA highlighted the strength of the labour market, and referred to the weakening in credit growth as "significant."

The RBA again acknowledged the "opposing forces" at work in the economy—domestic demand has cooled amid tighter

credit conditions and higher interest rates, although this is being offset to some extent by the soaring terms of trade. The boost to national income from the rising terms of trade, the stimulus from the generous personal income tax cuts, and still low unemployment could trigger a rebound in domestic demand in 2H. Consumer and business inflation expectations could also rise, which could lead to higher wages and prices.

We retain our forecast that the RBA will leave the cash rate unchanged for the remainder of 2008. With inflation to remain above target for an extended period, rate cuts any time soon are out of the question.

GDP growth unexpectedly firm in 1Q

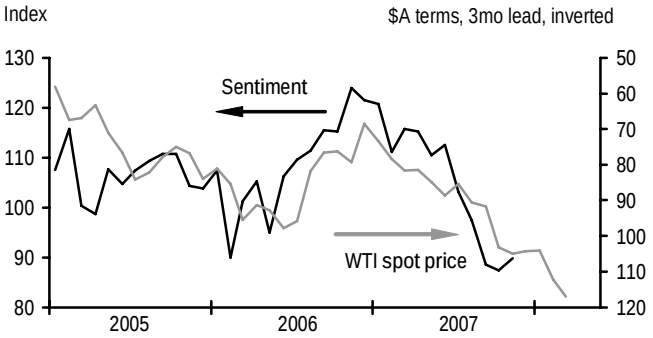
Australia's GDP growth surprised on the upside in 1Q, rising 0.6%q/q (JPMorgan -0.1%, consensus +0.3%) from 0.7% in 4Q. Annual GDP growth slowed from a significantly revised 4.3% in 4Q (previously 3.9%) to an above- potential 3.6% in the final three months of the year.

The statistical discrepancy amounted to 0.5%q/q; expenditure-based GDP grew a subdued 0.1% in 1Q. Production and income based GDP accounted for the lion's share of the GDP increase, most of which can be attributed to the impact of the rapidly rising terms of trade. This was the largest statistical discrepancy since 4Q03.

Of the expenditure components, household consumption offered the biggest upside surprise in 1Q (+0.7%q/q). Despite the 50bp rise in the official cash rate in the March quarter and elevated prices for staple goods, such as food, consumption remained surprisingly firm, buoyed by solid employment growth and rising household incomes. Also making healthy positive contributions to 1Q GDP growth were new engineering construction and public capital expenditure (mainly defense)—both added 0.3% points. Net exports subtracted 0.7% points from GDP, again the primary growth laggard. Our forecast calls for net exports to make a positive contribution to GDP growth in late 2008 as solid investment boosts productivity capacity, allowing export volumes to rise, and farm exports to improve.

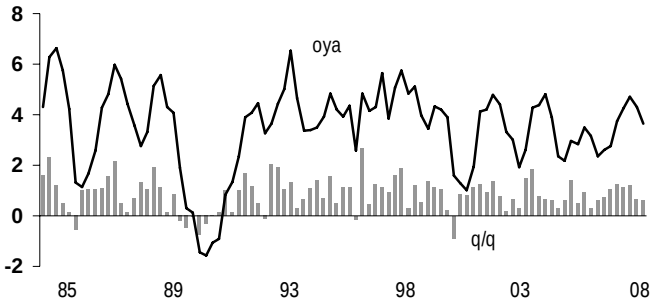
Price pressures in the economy moderated slightly, with the implicit price deflator for GDP increasing 0.8% compared to 1.3% previously. The gap between actual and potential GDP growth means, though, that upward pressure on inflation persists, reaffirming expectations that annual inflation will remain above target for an extended period.

Australia: consumer sentiment and crude oil price



Australia: GDP growth

%, chain volume



Current account widened again in 1Q

Australia's current account deficit widened to A$19.5 billion in 1Q (JPMorgan A$20.3 billion, consensus A$20.5 billion) from A$18.7 billion in 4Q. According to the ABS, the deficit now accounts for 6.5% of GDP, based on average GDP over the preceding four quarters.

The trade gap spiked to A$8 billion, owing to higher imports (+7%q/q), fuelled by a spike in the nonmonetary gold component, while exports also logged a healthy rise (+6%). Exports of farm goods were strong thanks to recent rainfall in key growing areas, while nonfarm good exports were also solid despite adverse weather conditions in early 2008 that curbed output from some of Queensland's coal mines. Also, while the income gap narrowed slightly to A$11.4 billion, the gap between income payments and income received still remained significant at around 4% of GDP.

Falling food prices weighed down sales

Australia's retail sales values fell unexpectedly in April, declining 0.2%m/m (JPMorgan 0.3%, consensus 0.2%) after rising 0.2% in March. The surprise fall was primarily attributed to

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a drop in the largest category of the index, food, which was down 1.1%m/m. Excluding food, sales were up 0.5%m/m.

While the trend in sales remained flat in April for the second straight month, consumers still face significant headwinds. Higher interest rates and elevated petrol prices are offsetting the positive effects on consumer spending of solid job growth and rising incomes. Consumer confidence is near a 15-year low and higher borrowing costs are eating into households' disposable incomes. The personal income tax cuts to be delivered on July 1 may help spending to recover mildly in 2H08.

Aussie trade deficit shrank, approvals up

The trade gap shrank significantly in April, narrowing to A$957 million (JPMorgan A$2.4 bn, consensus A$1.7 bn) from A$2.5 billion. This is the first time the deficit has fallen below A$1 billion since early 2007. Exports were surprisingly strong (+5.8%m/m), while imports contracted (-2.2%). We expect the trade gap to narrow further in 2008. Farm exports should remain solid owing to recent rainfall, and exports of nonfarm goods should rise as solid business investment continues to alleviate the capacity constraints and infrastructure bottlenecks that have restricted export volumes. Import growth will probably remain subdued in the near term as domestic demand eases further.

Also, building approvals spiked 7.8%m/m in April (JPMorgan 1.0%, consensus -0.5%) after slumping 5.5% in March. The near term outlook for the building sector is negative, however. Building and material costs in the residential construction sector are elevated, there is excessive red tape, and higher interest rates deter new home building.

Data releases and forecasts

Week of Jun 2 - 6

Tue Jun 10 11:30am — **Housing finance approvals: owner occupiers**
Number of loans, seasonally adjusted

	Jan	Feb	Mar	Apr
(%m/m)	3.8	-6.8	-6.1	-3.0
(%oya)	7.3	-0.4	-8.4	-13.9

Tue Jun 10 11:30am — **ANZ job advertisements**
Seasonally adjusted

	Feb	Mar	Apr	May
(%m/m)	-2.1	-0.7	3.1	__

Tue Jun 10 11:30am — **NAB monthly business survey**
% balance, seasonally adjusted

	Feb	Mar	Apr	May
Business confidence	-2	-4	-8	__

Wed Jun 11 10:30am — **WMI consumer sentiment index**
100=neutral, seasonally adjusted

	Mar	Apr	May	Jun
(%m/m)	-9.0	-1.4	2.7	1.0

Thu Jun 12 11:30am — **Labor force**
Seasonally adjusted

	Feb	Mar	Apr	May
Unemployment rate (%)	4.0	4.1	4.2	4.3
Employed (000 m/m)	39	18	25	5
Participation rate (%)	65.2	65.3	65.4	65.4

Review of past week's data

Inventories
Seasonally adjusted

	3Q07	4Q07		1Q08	
(%q/q)	1.3	~~0.7~~	*0.8*	~~-0.5~~	*0.9*
(%oya)	3.2	~~4.0~~	*3.9*	~~1.9~~	*3.6*

Company operating profits (business indicators)
Nominal, gross operating, seasonally adjusted

	3Q07	4Q07		1Q08	
(%q/q)	-1.4	~~3.9~~	*4.1*	~~-2.5~~	*2.2*
(%oya)	9.0	11.7		~~1.9~~	*7.0*

Retail trade
Seasonally adjusted

	Feb	Mar		Apr	
(%m/m)	-0.1	~~0.5~~	*0.2*	~~0.3~~	*-0.2*
(%oya)	5.8	5.1		~~5.9~~	*4.7*

Current account balance
A$ billion, seasonally adjusted

	3Q07		4Q07		1Q08	
Current account (A$ bn)	~~-16.4~~	*-16.3*	~~-19.3~~	*-18.7*	~~-20.3~~	*-19.5*
As a % of GDP	-6.0		~~-7.0~~	*-6.7*	~~-7.2~~	*-6.5*

Building approvals
Seasonally adjusted

	Feb		Mar		Apr	
(%m/m)	~~-0.8~~	*-0.1*	~~-5.7~~	*-5.5*	~~1.0~~	*7.8*
(%oya)	~~0.6~~	*0.9*	~~-0.7~~	*0.7*	~~-1.3~~	*5.2*

RBA cash rate announcement
See main essay.

Real GDP
Chain volume, seasonally adjusted

	3Q07		4Q07		1Q08	
(%q/q)	~~1.1~~	*1.2*	~~0.6~~	*0.7*	~~-0.2~~	*0.6*
(%oya)	~~4.3~~	*4.7*	~~3.9~~	*4.3*	~~2.3~~	*3.6*

Trade balance
Seasonally adjusted

	Feb		Mar		Apr	
Exports (A$ bn)	18.4		~~19.2~~	*19.3*	~~19.0~~	*20.5*
Imports (A$ bn)	21.6		21.9		*21.4*	
Trade balance (A$ mn)	~~-3261~~	*-3221*	~~-2736~~	*2548*	~~-2400~~	*-957*

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New Zealand

- **OCR remained unchanged at 8.25% last week**
- **RBNZ signals it will lower OCR by year end**
- **Retail sales to grow 0.2%m/m in April**

In New Zealand, the highlight last week was the RBNZ's monetary policy statement, which signalled that the Bank may lower the official cash rate (OCR) later this year. The RBNZ left rates steady as expected, amid rapidly slowing economic growth and elevated inflation. This week's retail sales data should confirm that consumer spending remains subdued.

RBNZ left OCR at record high

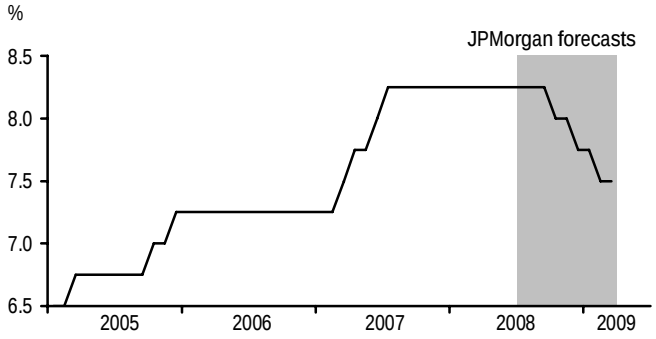
The RBNZ left the OCR steady at a record 8.25% as expected last week, citing upside risks to inflation and downside risks to economic growth. The RBNZ expects, though, that it is "likely to be in a position to lower the OCR later this year" if the economy "evolves" in line with its projection. We maintain our forecast that the RBNZ will cut the OCR 25bp in October and December, and again in 1Q09, although acknowledge the risk of an earlier easing.

The RBNZ expects annual CPI to peak at 4.7% in 3Q, mainly owing to higher food and energy prices, before returning to within the target 1-3% band in the medium term. This forecast, though, is based on expectations that "commodity prices stop rising, inflation expectations remain anchored, and weakening economic activity contributes to an easing in nontradables inflation." Governor Bollard highlighted that economic activity had recently weakened further, and forecast GDP growth of just 0.9% in the March 2009 year.

The household sector remains weak, and the negative wealth effects from the sharp deterioration in the housing market are creating significant headwinds for the household sector, already under pressure from high borrowing costs and rising prices for staples, such as food. Retail sales (due Friday) are, therefore, forecast to remain subdued in April, growing just 0.2%m/m following a sharp 1.2% slump in March.

As upside pressure on inflation persists, economic growth will soon slow to a standstill. Bollard said a recession is possible, even though it is not officially forecast by the RBNZ. We currently forecast two negative quarters of growth in 1Q and 2Q. But, although economic growth will probably stall, widespread inflation pressures will prevent the RBNZ from easing monetary policy prior to 4Q. Pipeline pressures continue to build, nontradables inflation remains elevated, and inflation expectations are rising.

New Zealand: RBNZ official cash rate



Data releases and forecasts

Week of Jun 2 - 6

Mon Jun 9	QVNZ house prices %, median				
		Feb	Mar	Apr	May
	(%oya)	7.7	6.5	4.9	__
Wed Jun 11 10:45am	Terms of trade Seasonally adjusted				
		2Q07	3Q07	4Q07	1Q08
	(%q/q)	0.5	3.6	2.9	__
Thu Jun 12 12:00pm	Business PMI Seasonally adjusted				
		Feb	Mar	Apr	May
	Index	51.9	48.7	51.4	__
	(%oya)	-3.9	-16.1	-5.0	__
Fri Jun 13 10:45am	Retail trade Seasonally adjusted				
		Jan	Feb	Mar	Apr
	(%m/m)	0.2	-0.6	-1.2	0.2
	(%oya)	5.8	3.3	0.8	2.3

Review of past week's data

ANZ commodity price series
Not seasonally adjusted

	Mar	Apr	May	
Index - world prices (%m/m)	2.0	-0.3	__	*1.0*
Index - NZD (%m/m)	2.1	1.1	__	*2.5*

RBNZ cash rate announcement

See main essay.

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Global essay

- **ECB prepares the ground for a rate hike to anchor inflation expectations**
- **Absent a sharper deterioration in US growth, the pressure for an early normalization in Fed policy will build**
- **EM economies show significant upward pressure on labour costs**
- **EM inflation-targeting regimes face credibility test**
- **Looking for Chinese inflation to fall in May**

The ECB provides food for thought

The ECB signaled last week that it is willing to raise rates in order to ensure that inflation expectations remain contained. Anchoring inflation expectations is central to every central bank's mission, but it is hard to think of a recent occasion in which a major central bank has tightened policy from a point of rest against the backdrop of a deteriorating growth outlook. In taking this action, the ECB is breaking new ground and challenging our view that central banks would "talk loudly and carry a small stick" through the end of this year.

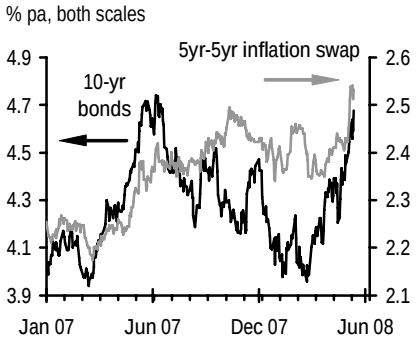
To a large degree, last week's signal should be seen through a Euro area-specific lens. Despite a downshift in growth, the ECB staff projects inflation to remain well above acceptable levels this year and next. And in contrast to other major central banks facing sustained overshoots in inflation (the Fed and the Bank of England), the Euro area economy is perceived by the ECB to be at relatively low risk of sliding into recession. It would be wrong, however, to interpret the ECB signal as an isolated event that has no bearing on other central banks. In particular, the logic that underlies the ECB's action is important when thinking about the Fed and other central banks.

- In signalling a rate hike, the ECB is arguing that a modest move to reinforce its commitment to inflation control will promote financial stability and lower long-term interest rates. Whether this will succeed remains to be seen. However, it is important to recognize that a desire to maintain supportive financial conditions motivates the low level of the fed funds rate and the reluctance to act on the part of many central banks facing high inflation. To the extent that central bankers view rising inflation expectations as promoting a tightening in conditions, the policy equation changes. Note here that the characteristic patience of the Federal Reserve following past US recessions is closely connected to the fact that recessions have produced sustained periods of disinflation and falling long-term interest rates.

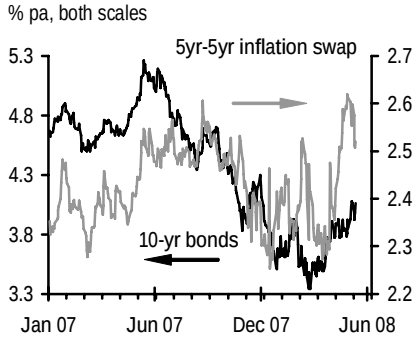
- Over the past two decades, policymakers have embraced inertia and have only begun a tightening cycle when they saw a significant task ahead. They have eschewed small adjustments from a point of rest—out of aversion to reversing course and their desire to maintain a predictable and steady policy path. In acting now, the ECB is reinforcing the significance of the break in the Fed's reaction function marked by the large discrete policy steps taken over the past year.

Our forecast for Fed policy already incorporates much of this thinking. Unlike in the past three recession episodes—when the Fed waited until the US unemployment rate had fallen for 12 months (June 2004); 20 months (February 1994); and 16 months (March 1984)—we expect the Fed this time to begin normalizing policy 3-6 months after the US labor market finds its footing. In our forecast, this places the start of the tightening process in 2Q09. We have not until now seriously considered the possibility that the Fed could choose to take a limited step while the economy is still weak but displaying a lower profile of downside growth risk. With the ECB taking the plunge and FOMC hawks starting to argue that symmetry in

Euro area interest rates



US interest rates



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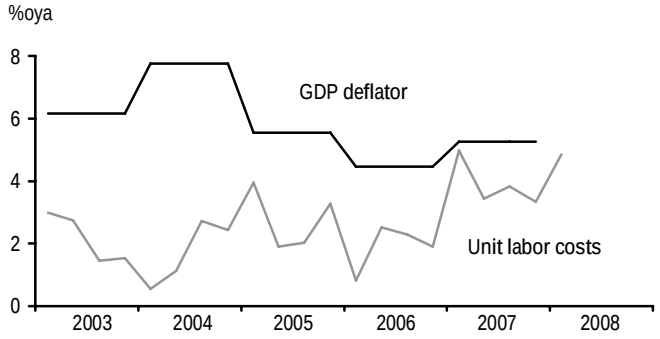
EM GDP deflator and unit labor costs



the policy reaction function warrants an early step on the policy normalization path, we now see a meaningful possibility of an adjustment later this year.

EM cost pressures on the rise

EM inflation has escalated rapidly to a level well above that in the advanced economies. The most recent surge in consumer prices is particularly vexing to policymakers, as it threatens price stability while also damping consumer purchasing power. Although inflation will rise a bit further in the next few months, an expected leveling off of commodity prices should usher in a period of lower headline inflation in 2H08. However, short of a substantial slowing in growth, underlying inflation pressures show little sign of letting up and point to a more pernicious problem for a number of emerging economies.

Excluding food and energy prices, EM inflation has risen about 1.5%oya points over the past 18 months. What's more, most EM economies are already operating above full employment and wage inflation has accelerated sharply over the past two years. Over this expansion, faster gains in productivity have offset much of the acceleration in wages. However, even as EM economies receive a cyclical boost to productivity along with strong growth, overall unit labour cost gains are moving higher. From an average pace of gain of about 2% p.a. in 2003-06, unit labour costs are now rising at close to a 5% pace.

This raises two concerns for the EM group. One is the risk that a wage-price acceleration is unfolding that will ultimately require a major policy tightening. With downside risks to growth still elevated, such decisive action will likely not take place until next year, at which time the inflation backdrop may have deteriorated further. The second is a threat to EM corporate profitability. For most of this expansion, unit labour cost increases have fallen short of the rise in prices charged for domestically produced goods and services. However, the margin between the growth of final prices and unit labour costs has since narrowed and may close entirely in 2008, particularly against the backdrop of a stabilization in commodity prices.

Corporate profits nosedive in Japan

Corporate profits are under greater pressure in the advanced economies, where growth has fallen below trend and it is much harder for companies to pass along higher input costs. That said, recent data point to significantly different outcomes in the United States and Japan. US economic growth has slowed to a crawl in recent quarters, yet corporate profits rose 2% in 1Q08 versus 1Q07. To be sure, US profits have been bolstered by overseas earnings, but even domestic profits were down just 6% over this period. This performance is primarily because of companies' quick action to contain labour costs, highlighted by five straight months of job-shedding. Japanese companies also have moved to curb labour cost growth, but more tentatively. The consequences were visible in last week's MoF corporate survey, in which domestic earnings fell almost 20% in 1Q08 versus 1Q07.

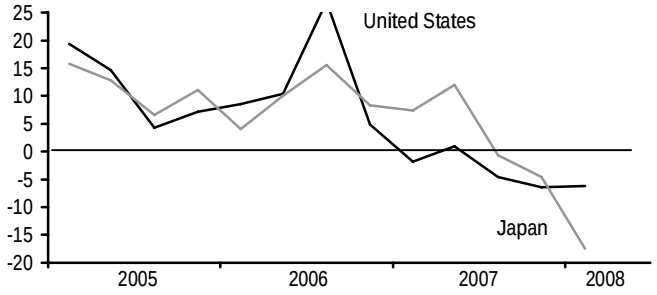
This nosedive in profits now appears to be spurring a more aggressive corporate response. Japan's employer survey shows that payrolls have stagnated since February after impressive gains throughout 2007. This follows a downturn in the more cyclically sensitive labour force survey. Although decisive corporate action will prevent the need for an even more disruptive adjustment later on, it does raise the risk of a negative feedback loop between consumer and business spending. Underscoring this point, last week's April CAO consumption index—a close proxy of NIPA-based consumer spending—was 4% annualized below the 1Q average.

Inflation challenges EM policy credibility

The adoption of inflation-targeting regimes in emerging market economies occurred in most cases on the eve of a golden and unprecedented period of rapid EM growth and falling inflation that resulted in a further ratcheting down of official inflation targets in the 2000s. With EM inflation now having turned sharply higher, the credibility of these regimes is being tested. Continued upside inflation surprises are steepening local yield curves. This puts pressure on central banks to tighten policy despite their concerns about falling export

Corporate earnings from domestic operations

% ch over 4 quarters



growth and a domestic purchasing power squeeze. Just this week, JPMorgan raised its policy rate calls for a range of countries including Hungary, the Czech Republic, Malaysia, Colombia, and Chile. Yet the average amount of EM tightening envisioned for the remainder of the year is just 50bp.

The credibility of EM inflation-targeting regimes took an additional hit last week after Turkey's central bank decided to raise its inflation targets for each of the next three years. Presumably, the CBRT hopes that it will have a better chance of meeting the easier targets and thus regaining some credibility. The Bank said that rising food and energy prices are behind the target revision and suggested that unexpectedly good outcomes for food and energy prices or in other global factors will provide an opportunity to bring down inflation faster than is implied by the revised target path. Turkey's risky strategy, which may cast doubt about the CBRT's commitment to low inflation, will likely trigger a debate about the merits of such a move elsewhere, as seen in Colombia last week.

China's inflation likely peaked in April

The emerging economies have released a wave of upside May inflation surprises, including in Asia. This week's reports are likely to show that China was an exception. The forecast calls for inflation of 7.7%oya in May, down from 8.5% the previous month. Key is that food inflation, which hit 22%oya in April, finally appears to be coming down, based on our tracking of daily and weekly food price indices. Food price inflation should trend lower in coming months and headline inflation should follow, but only to a point: as headline inflation subsides, the government is expected to resume its price liberalization reform drive later in the year.

The decline in food price inflation should spread across EM Asia in 2H08. With food accounting for almost one third of the EM Asian consumption basket, this will be a powerful disinflationary impulse in the region. However, working in the opposite direction in some countries, including India, Taiwan, the Philippines, Thailand, and Malaysia, will be the recent reduction in domestic energy subsidies. In these cases, inflation will jump in the next few months, followed by a downtrend into the fourth quarter, assuming global commodity prices rise no higher.

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JPMorgan View - Global Markets

Keep your eye on the global inflation danger

- We believe that the global economy is actually **weakening, but probably not as much as many market participants fear**, thus supporting riskier assets against bonds. The current quarter on our forecast should be the weakest spot this year, to be followed by a gradual rebound. Investors feel caught between the remaining up-front risk of a credit-crisis-induced global slowdown, and the more distant risk of an inflation-fighting-caused global recession. Both concerns are valid. Our strategy is based on trying to time the two risks and our observation that markets find it difficult to price in risks that are more than six months away.

- For much of the past ten months, we have focused on recession trades, mostly curve steepeners and bearish credit and equity exposures. From April on, we started to mix these with **recovery-anticipation trades**, going long credit and equity risk, and reducing duration longs. With hindsight, we should have moved more aggressively. By now, as investors slowly fade focus on imminent recession risk, and ponder the likely restart of monetary tightening in major economies, our global asset allocation is overall short duration in bonds, concentrated in EM. We consider it **too early to sell equities and credit** on an anticipation of the eventual damage that monetary tightening will do to growth and earnings. The ECB may register a token protest against rising inflation next month, but significant tightening across regions is more a risk for next year and the eventual impact on global growth is more an issue for late 2009, if not 2010. There is enough uncertainty around this scenario that it should not drive capital flows until it shouts at us more clearly. We thus stay with tactically long credit and equity exposures.

Fixed income

- Bond markets continue to sell off and their returns are now significantly below cash ytd in most markets. Our global bond strategy is short duration, concentrated in local **EM bonds** where central banks are starting to fight **inflation** more seriously. But we also see downside in the overall **US** market where **heavy supply** is pushing intermediate yields up. The US market is going through a structural move from short-dated to long-dated, fixed-rate funding, in the aftermath of the credit/liquidity crisis, which showcased the dangers of overreliance on short-dated funding.

- There is value at the short ends of the OECD curves, but outside Japan, momentum and positions caution us against buying 2s. Stay neutral. We got stopped out of European steepeners weeks ago, but stay in a **US barbell** (selling the belly, and 5s and 10s against 2s and 30s).

- Despite recent volatility induced by an ECB warning that it is set to hike rates next month, we remain biased to earn carry and **remain long spread products** against government debt in most markets, especially so in the US. We have held two macro-based country allocations in our portfolios: long UK vs EU and long EU vs USTs, based on relative economic performance. We keep the **UK overweight**, but are closing the EU overweight vs the US given an ECB rate hike next month.

Equities

- **Inflation concerns** weighed on equity markets last week, with Europe and EM, where inflation is triggering central bank action, down 2-3%. We recognize that rising inflation

10-yr government bond yields

	Current	Sep 08	Dec 08	Mar 09
United States	3.93	4.05	4.10	4.15
Euro area	4.42	4.45	4.35	4.25
United Kingdom	5.00	4.90	4.90	4.90
Japan	1.78	1.50	1.60	1.60

Equities

	Current	YTD return (local currency)
S&P	1371	-3.5%
Topix	1428	-2.5%
FTSE 100	5907	-5.0%
MSCI Eurozone	209	-11.5%
MSCI Europe	1370	-8.8%

Credit markets

	Current	Jun 08	Dec 08
US high grade (bp over UST)	227	200	
US high grade (bp over swaps)	142	150	
Euro HG corp (bp over swaps)	85		65
USD high yield (bp vs. UST)	654	700	800
EMBIG (bp vs. UST)	272	275	250

Foreign exchange

	Current	Jun 08	Sep 08	Dec 08	Mar 09
EUR/USD	1.58	1.60	1.57	1.53	1.50
USD/JPY	105	100	101	103	105
GBP/USD	1.97	1.95	1.91	1.86	1.85

Commodities

		Quarterly average		
	Current	Jun 08	Sep 08	Dec 08
WTI oil $/bbl	137	105	95	92
Gold ($/oz)	899	920	915	900
Copper($/m ton)	7950	8600	8800	8000
Corn ($/Bu)	6.52	6.05	6.15	6.30

Source: JPMorgan, Bloomberg, Datastream.

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is putting pressure on global central banks to raise policy rates, but this becomes **a problem for equity markets only when central banks move to tight policy** and growth suffers as a result. We see little chance of this happening this year. The expected ECB hike next month is likely to be a one-off move aimed at containing inflation expectations, rather than depressing growth. And there is not much chance that other major central banks will follow the ECB's lead in 2H. In the EM, where growth and inflation are much faster, some central banks are indeed raising rates but there is a general reluctance to move aggressively, and we expect no change in the EM real policy rate to year end.

- We thus stay **long equities**. In addition to accommodative monetary policies globally, equities are supported by still-elevated cash balances and excessive pessimism among investors. Equity hedge funds appear to have cut their equity exposure recently to well below the level at the start of the year. Similarly, speculative shorts on S&P500 futures and options traded in CME, remain elevated and are well above the lows at the end of last year.

- We **underweight European equities vs the US** as the former are facing the double whammy of slippage in European economic activity and a more acute central bank threat than in the US. In **EM**, we keep a long vs developed markets, as growth appears to be holding up well so far, but we advise **avoiding countries where central banks are hiking aggressively**; i.e., Brazil, South Africa, Turkey, and Poland.

Credit

- **Credit spreads continued to trade within their recent ranges**. CDS indices underperformed as investors put on hedges on worries about impending earnings announcements by brokers, the fate of monolines, and continued rating downgrades. The offsetting forces of robust investor demand on one side and higher exposures and issuance on the other, are likely to continue to keep spreads within their recent ranges over the coming weeks. We expect only modest gains in the near term, mostly resulting from carry.

- Last week's **Credit Client Surveys** confirmed that investors have significantly increased their exposure to credit and lowered their cash positions over the past two months in both the US and Europe. In the US survey, where we have more history, investors' overall exposure stands at the highest level for more than a year, but admittedly it remains well below the average since 2001, when the survey started. In contrast to high-grade credit, investors appear to have reduced their exposure to high-yield credit; i.e., they used the rally over the past two months to shift their exposure to higher quality assets.

Foreign exchange

- Hawkish comments from Bernanke and the ECB are strapping **EUR/USD into a range** around 1.55 which we expect to persist for this summer. Friday's payroll report gives the euro slight upside, but we doubt that this will become a runaway move in an environment where Europe is slowing too, the ECB's July hike is likely to be a one-off, and G-7 officials are signaling discomfort with destabilizing dollar declines.

- Headlines around G-3 intervention will surely build in coming weeks but physical intervention to drive the dollar higher still looks unlikely. The April G-7 statement was the most significant in five years, in that it finally jettisoned boilerplate language labeling disorderly movements undesirable, and shifted toward warning against the risks that sharp currency fluctuations compromise economic and financial stability. Bernanke appeared to have lowered the bar for intervention by another notch when he commented that the Fed was attentive to the impact of a weaker dollar on US inflation.

- With the next round of **G-7** finance ministers scheduled for June 13-14 in Japan, some will anticipate another expression of official discomfort with a relapse into dollar weakness. More concerted rhetoric to deter heavy bets against the currency is possible, given that dollar weakness has been cited officially—but in our view narrowly—as driving record commodity prices. We suspect that the G-7 will stop at verbal intervention for the same reasons it has refrained from buying dollars previously. A weaker euro runs counter to the ECB's inflation target, and would have little sustainable impact unless reinforced by Fed tightening and/or ECB easing (both unlikely).

Commodities

- Over the past couple of weeks, a number of Asian countries (India, Malaysia, Indonesia, Taiwan) have announced reduction in fuel subsidies, which should crimp demand and push global oil prices lower. But as long as **China** resists raising fuel prices meaningfully and the dollar trades in a range, crude oil prices should stay high. Metals rebounded on dollar weakness, but we still advocate selectivity. Only **copper has decent upside** within base metals. Platinum and palladium, which are less dollar-sensitive and enjoy strong industrial demand, will outperform gold.

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Markets - Australia and New Zealand

- **Market now fully prices an RBA rate hike by December**
- **Aussie 3s 10s curve to steepen from here**
- **RBNZ to cut cash rate later this year**

Market commentary

Australia

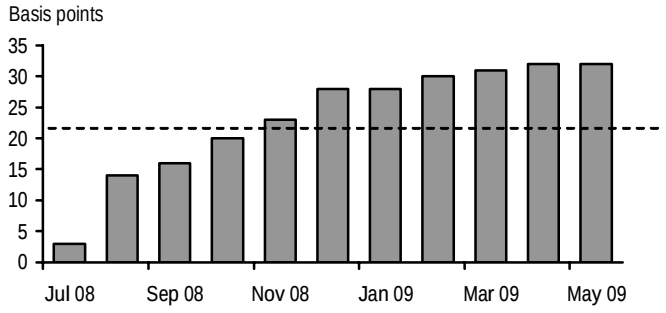
Last week's avalanche of Aussie economic data implied that the while economic growth was firm in the March quarter, the RBA has successfully engineered a slowdown in growth in the second quarter. GDP growth was unexpectedly firm at 0.6%q/q (triple market expectations), but retail sales dropped in April—unexpectedly dragged lower by a plunge in food prices. This follows recent data showing a sharp decline in the demand for home loans and a plunge in credit growth.

RBA officials want to see what they describe as a "significant" slowing in growth in domestic demand. In last week's commentary announcing an unchanged cash rate, the RBA once again highlighted the opposing forces driving the outlook for the economy. On the one hand, growth in domestic demand clearly has cooled, in part owing to a tightening in credit conditions and higher interest rates. On the other hand, however, the forces driving the slow down in domestic spending are being offset to some extent by the soaring terms of trade, which is sending a powerful income pulse through the arteries of the economy.

Once again, the RBA hinted that the risks to the growth and policy outlook are not two-sided. The dominant risk appears to be that officials are anxious about whether domestic demand growth will slow to the extent expected. In our view, the boost to national income from the rising terms of trade, when combined with the stimulus from the generous personal income tax cuts paid from July and still low unemployment, could trigger a rebound in domestic demand in the second half of 2008.

Some in the market interpreted the unexpectedly firm GDP growth as evidence that a rate hike in Australia now is more likely. In our view, though, the RBA will discount the data on the basis that it is old, and that the more recent data shows that the economy has slowed sharply in the second quarter. That said, market pricing now implies that the RBA will raise the cash rate 25bp by the end of the year—this still looks unlikely, even though inflation is likely to track well above the 2-3% target range for some time yet.

RBA rate hikes implied by 30-day IB contracts



The clear risk, though, in the wake of the RBA's commentary, is that a rebound in consumer spending in the second half of the year could be enough to push the RBA over the line. Rate cuts any time soon are out of the question.

The 3s10s curve continued to flatten last week, from -19.5 at the end of the previous week to -22 on Friday. This, in part, reflected the market's assessment that a rate hike now is slightly more likely than before. It will, however, take a sustained run of unexpectedly firm economic data to push the RBA closer to a tightening. The key data points to watch for policy guidance are retail spending, demand for home loans, and the consumer and business confidence readings.

We are sticking with our curve steepener trade on the basis that the RBA is unlikely to tighten policy any time soon, despite elevated inflaiton readings, and central banks globally appear more concerned about inflation than growth. This shift in central bank verbiage should help to push up Aussie longer-dated bond yields.

New Zealand

The RBNZ left rates steady as expected last week amid rapidly slowing economic growth and elevated inflation. Dr. Bollard, though, signalled clearly that the RBNZ will likely "be in a position to lower the OCR later this year" if the economy "evolves" in line with its projection.

In light of the commentary, we maintain our forecast that the RBNZ will cut the OCR 25bp in October and December, and again in 1Q09. We do, however, acknowledge the risk of an earlier easing prior to 4Q. That said, widespread and building inflation pressures will prevent the RBNZ from easing monetary policy in coming months. Pipeline pressures continue to

build, nontradables inflation remains elevated, and inflation expectations are rising. Moreover, the RBNZ expects annual CPI to peak at 4.7% in 3Q, well above the Bank's 1-3% target range.

As upside pressure on inflation persists, economic growth will soon slow to a standstill. Bollard said a recession is possible, even though it is not officially forecast by the RBNZ. We currently forecast two negative quarters of growth in 1Q and 2Q. The household sector remains weak, and the negative wealth effects from the sharp deterioration in the housing market are creating significant headwinds for the household sector, already under pressure from high borrowing costs and rising prices for staples, such as food.

Amid firming speculation that the Kiwi yield advantage would soon narrow, the NZD shed nearly 2% against the US dollar immediately following the announcement and over one cent against AUD. The NZD bought over A$0.82 at the start of the week, although finished the week below A$0.80. Meanwhile, the threat of lower official interest rates sent the yield on 90-day bank bills down from 8.73% to 8.67%.

Trade recommendations

- Establish long Dec'08 bank bills at 91.85. The contract currently prices in too much probability of an RBA rate hike. Establish long with stop loss at 91.80, target 92.00.
- Hold 3s 10s curve steepener at -23.5 (target -10, stop loss at -25). The curve has flattened on expectations that the RBA may need to tighten policy again this year. Near term data, though, will be weak, so the curve should steepen.
- Take loss on paying NZ 3m 1yr at 8.25%, receive US 3m 1yr at 3.23%, at a current spread of 502pts. Spot 1yr at 549pts. Target 532 pts, stop loss 487pts. We stopped out for a loss of 15bp.

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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			
	2007	2008	2009	4Q07	1Q08	2Q08	3Q08	4Q08	1Q09	2Q09	1Q08	2Q08	4Q08	2Q09
The Americas														
United States	2.2	1.6 ↑	2.1	0.6	0.9	1.0 ↑	1.5	1.0	2.0	3.0	4.2	4.0	3.9	2.6
Canada	2.7	0.8	2.3	0.8	-0.3	-0.4	1.5	2.3	2.5	2.8	1.8	1.9	2.4	1.9
Latin America	5.3	4.0	4.0	5.7	1.9	2.9	3.4	4.4	4.0	4.2	6.3	7.2	7.1 ↑	6.1
Argentina	8.7	6.5	3.0	8.0	2.0	8.2	2.8	6.1	2.8	1.6	8.5	9.1	9.1	8.9
Brazil	5.4	4.4	4.0	6.6	2.5	2.5	4.6	4.4	4.1	3.8	4.6	5.4	5.8	5.3
Chile	5.1	3.5	5.0	3.4	5.8	5.0	1.0	5.0	5.0	6.0	8.0	8.5 ↑	6.4 ↑	4.3 ↑
Colombia	7.5	5.0	5.0	6.8	6.0	5.5	5.5	4.5	4.5	5.0	6.1	5.3	5.2	4.4
Ecuador	2.0	2.5	2.5	5.0	2.0	1.5	1.0	1.0	2.5	3.5	5.3	8.5	8.3	4.2
Mexico	3.3	2.6	4.0	3.0	2.0	1.0	2.0	3.0	4.9	4.9	3.9	5.0	4.5	3.0
Peru	9.0	7.7	6.0	10.5	7.9	5.0	3.0	4.5	6.5	7.0	4.7	5.2	4.3	2.8
Venezuela	8.4	3.5	3.5	13.1	-12.5	4.5	7.5	10.0	-2.5	2.5	26.2	29.3	30.0	30.5
Asia/Pacific														
Japan	2.0	1.2	1.4	2.6	3.3	-1.5	0.8	1.3	1.8	1.8	1.0	1.3	1.5	1.2
Australia	4.3 ↑	3.3 ↑	2.7	2.7 ↑	2.5 ↑	4.0 ↑	2.9 ↑	3.4	2.9	1.6	4.2	3.8	3.7	2.7
New Zealand	3.1	1.0 ↓	1.9 ↓	4.1	-0.4 ↓	-1.3 ↓	0.0 ↓	1.5 ↓	2.0 ↓	3.4	3.4	3.0	2.9	3.2
Asia ex. Japan	8.8	7.4	7.5	7.3	7.9 ↑	6.3 ↓	7.5 ↓	7.1 ↓	7.0	7.5 ↓	6.3	7.0 ↑	5.4 ↑	3.9 ↑
China	11.9	10.5	9.8	9.2	10.5	10.8	11.7	10.2	9.1	9.1	8.0	7.7	4.4	3.4
Hong Kong	6.4	4.8	5.0	6.6	7.3	-1.0	3.5	3.0	5.5	8.0	4.6	5.4	3.1	2.4
India	9.0	7.0	8.0	8.5	8.8	6.4 ↓	6.0 ↓	5.6 ↓	5.9 ↓	8.0 ↓	6.3	7.8 ↑	7.8 ↑	5.6 ↑
Indonesia	6.3	5.4	5.2	5.1	5.9	5.0	3.0	4.5	5.0	5.0	7.6	12.4	14.2	8.3
Korea	5.0	4.4	5.0	6.4	3.3 ↑	2.5 ↓	3.5	4.5	5.5	5.5	3.8	4.7 ↑	4.1 ↑	3.1
Malaysia	6.3	5.2 ↓	5.5 ↑	7.0	6.4	2.4	2.0 ↓	2.4 ↓	7.4 ↑	7.4 ↑	2.6	4.0 ↑	5.9 ↑	4.7 ↑
Philippines	7.2	4.0	4.5	5.1	4.3	2.0	4.0	4.0	4.0	5.9	5.5	8.5	8.0	4.3
Singapore	7.7	4.6	5.7	-4.8	14.6	-1.6	5.3	4.5	7.0	7.0	6.6	6.8	4.9	1.9
Taiwan	5.7	4.3	5.0	2.3	3.0	0.5	5.8	6.5	4.8	4.8	3.6	4.1	2.1	2.8
Thailand	4.8	4.6	5.0	7.4	5.6	3.0	5.0	6.0	4.5	4.5	5.0	6.0	5.9	4.5
Africa														
South Africa	5.1	3.3	3.5	5.3	2.1	3.5	1.7	1.3	4.3	4.1	9.9	11.1	11.3	7.6
Europe														
Euro area	2.6	1.8	1.3	1.3 ↓	3.2 ↑	0.5	1.2	1.2	1.0	1.5	3.4	3.5	3.2	2.3
Germany	2.6	2.2	1.6	1.1	6.3	-0.8	1.5	1.6	1.8	2.0	3.1	3.0	2.8	1.9
France	2.1	1.8	1.6	1.4	2.6	1.0	1.5	1.4	1.5	1.8	3.3	3.4	2.9	2.1
Italy	1.4	0.4	1.0	-1.7	1.6	0.5	0.5	0.8	1.0	1.2	3.3	3.7	3.5	2.6
Norway	6.3	3.2	2.4	4.4	0.8	2.5	2.0	2.2	2.5	2.5	3.5	3.0	2.2	3.2
Sweden	2.9	2.0	2.3	2.8	1.6	1.7	1.5	2.3	2.5	2.5	3.2	3.2	2.5	2.3
Switzerland	3.1	2.1 ↓	1.4 ↓	3.8 ↓	1.3 ↓	1.0	1.0	1.3	1.3 ↓	1.5 ↓	2.5	2.7 ↑	2.9 ↑	1.9 ↑
United Kingdom	3.0	1.7	1.2	2.5	1.6	1.0	0.5	0.5	1.0	2.0	2.4	3.0	4.1	3.0
Emerging Europe[1]	6.5	6.0	5.8	12.8 ↑	1.3 ↑	7.9	4.3	10.8	0.8	7.4	9.2	10.1	8.8	6.9
Bulgaria	6.2	5.2	5.5	...	...	...	...	...	...	...	...	...	...	...
Czech Republic	6.5	5.0	4.8	7.0	3.6	4.5	3.5	4.5	5.5	5.0	7.4	7.1	5.5	3.0
Hungary	1.3	2.0	2.8	0.3 ↓	1.3 ↑	3.0	2.8	2.9	2.8	2.8	6.9	6.5	5.3	3.9
Poland	6.6	5.8	5.3	7.4	5.7	5.0	4.5	5.5	5.3	5.5	4.1	4.2	4.1	3.7
Slovak Republic	10.4	7.0	5.5	14.0 ↑	-3.1 ↓	6.0	7.0	7.0	4.0	5.0	4.0	4.3	3.6	4.0
Romania	6.0	5.5	3.5	...	...	...	...	...	...	...	8.0 ↑	8.2	6.2	5.5
Russia	8.1	7.8	7.0	19.1	-2.2	11.2	4.0	17.0	-3.0	10.3	12.9	14.8	13.2	11.4
Turkey	4.5	4.4	6.0	...	...	...	...	...	...	...	9.5	10.0	8.3	4.1
Global	3.5	2.6 ↑	2.7 ↑	2.7	2.7 ↑	1.6 ↑	2.2	2.4	2.4	3.1 ↓	4.0	4.2 ↑	3.9 ↑	2.9
Developed markets	2.5 ↑	1.6	1.7	1.4	2.0 ↑	0.5 ↑	1.2	1.2	1.6	2.2	3.2	3.2	3.2	2.3
Emerging markets	7.5	6.2	6.3	7.8	5.2 ↑	5.7 ↓	5.8 ↓	7.0	5.1 ↓	6.6	6.9	7.7 ↑	6.5 ↑	5.1 ↑

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Global Central Bank Watch

	Official interest rate	Current	Change from Aug 07 (bp)	Last change	Forecast next change	Jun 08	Sep 08	Dec 08	Mar 09	Jun 09
Global	GDP-weighted average	3.66	-105			3.66	3.77	3.81	3.80	3.98
excluding US	GDP-weighted average	4.44	-1			4.46	4.62	4.67	4.66	4.68
Developed	GDP-weighted average	2.77	-137			2.76	2.84	2.83	2.83	3.07
Emerging	GDP-weighted average	7.27	22			7.35	7.61	7.79	7.75	7.69
The Americas	GDP-weighted average	2.87	-273			2.86	2.90	2.93	2.93	3.34
United States	Federal funds rate	2.00	-325	30 Apr 08 (-25bp)	2Q 09 (+25bp)	2.00	2.00	2.00	2.00	2.50
Canada	Overnight funding rate	3.00	-150	22 Apr 08 (-50bp)	10 Jun 08 (-25bp)	2.75	2.75	2.75	2.75	2.75
Brazil	SELIC overnight rate	**12.25**	75	**4 Jun 08 (+50bp)**	**23 Jul 08 (+50bp)**	12.25	13.25	14.00	14.00	14.00
Mexico	Repo rate	7.50	25	26 Oct 07 (+25bp)	on hold	7.50	7.50	7.50	7.50	7.50
Chile	Discount rate	6.25	75	10 Jan 08 (+25bp)	**on hold**	6.25	6.25	6.25	6.25	6.25
Colombia	Repo rate	9.75	50	22 Feb 08 (+25bp)	**27 Jun 08 (+25bp)**	10.00	10.00	10.00	9.75	9.50
Peru	Reference rate	5.50	75	10 Apr 08 (+25bp)	**10 Jul 08 (+25bp)**	5.50	5.75	6.00	6.00	5.75
Europe/Africa	GDP-weighted average	4.54	-3			4.58	4.79	4.80	4.80	4.78
Euro area	Refi rate	4.00	0	6 Jun 07 (+25bp)	**3 Jul 08 (+25bp)**	4.00	4.25	4.25	4.25	4.25
United Kingdom	Repo rate	5.00	-75	10 Apr 08 (-25bp)	on hold	5.00	5.00	5.00	5.00	5.00
Sweden	Repo rate	4.25	75	13 Feb 08 (+25bp)	on hold	4.25	4.25	4.25	4.25	4.25
Norway	Deposit rate	5.50	75	23 Apr 08 (+25bp)	on hold	5.50	5.50	5.50	5.50	5.50
Czech Republic	2-week repo rate	3.75	50	7 Feb 08 (+25bp)	**Sep 08 (+25bp)**	3.75	4.00	4.00	3.75	3.75
Hungary	2-week deposit rate	8.50	75	26 May 08 (+25bp)	**Aug 08 (+25bp)**	8.50	8.75	8.75	8.75	8.50
Poland	7-day intervention rate	5.75	100	26 Mar 08 (+25bp)	25 Jun 08 (+25bp)	6.00	6.25	6.25	6.25	6.00
Russia	1-week deposit rate	3.75	50	29 Apr 08 (+25bp)	Jun 08 (+25bp)	4.00	4.25	4.50	4.75	4.75
Slovak Republic	2-week repo rate	4.25	0	27 Apr 07 (-25bp)	**on hold**	4.25	4.25	4.25	4.25	4.25
South Africa	Repo rate	11.50	150	10 Apr 08 (+50bp)	12 Jun 08 (+100bp)	12.50	13.00	13.00	13.00	12.50
Switzerland	3-month Swiss Libor	2.75	25	13 Sep 07 (+25bp)	on hold	2.75	2.75	2.75	2.75	2.75
Turkey	Overnight borrowing rate	15.75	-175	15 May 08 (+50bp)	16 Jun 08 (+50bp)	16.25	16.75	16.75	16.75	16.00
Asia/Pacific	GDP-weighted average	3.63	8			3.63	3.71	3.78	3.74	3.86
Australia	Cash rate	7.25	75	4 Mar 08 (+25bp)	on hold	7.25	7.25	7.25	7.25	7.25
New Zealand	Cash rate	8.25	0	26 July 07 (+25bp)	23 Oct 08 (-25bp)	8.25	8.25	7.75	7.50	7.50
Japan	Overnight call rate	0.50	0	21 Feb 07 (+25bp)	Jun 09 (+25bp)	0.50	0.50	0.50	0.50	0.75
Hong Kong	Discount window base	3.50	-325	1 May 08 (-25bp)	2Q 09 (+25bp)	3.50	3.50	3.50	3.50	4.00
China	1-year working capital	7.47	45	20 Dec 07 (+18bp)	3Q 08 (+27bp)	7.47	7.74	8.19	8.19	8.19
Korea	Base rate	5.00	0	9 Aug 07 (+25bp)	**Nov 08 (-25bp)**	5.00	5.00	4.75	4.50	4.50
Indonesia	BI rate	**8.50**	25	**5 Jun 08 (+25bp)**	**3 Jul 08 (+25bp)**	8.50	9.00	9.00	9.00	9.00
India	Repo rate	7.75	0	30 Mar 07 (+25bp)	1Q 09 (-25bp)	7.75	7.75	7.75	7.50	7.25
Malaysia	Overnight policy rate	3.50	0	26 Apr 06 (+25bp)	**25 Jul 08 (+25bp)**	3.50	4.00	4.00	4.00	4.00
Philippines	Reverse repo rate	**5.25**	-75	**5 Jun 08 (+25bp)**	**17 Jul 08 (+25bp)**	5.25	5.50	5.50	5.50	5.50
Thailand	1-day repo rate	3.25	0	18 July 07 (-25bp)	16 Jul 08 (+25bp)	3.25	3.50	3.75	3.75	3.75
Taiwan	Official discount rate	3.50	38	27 Mar 08 (+12.5bp)	Jun 08 (+12.5bp)	3.625	3.75	3.75	3.75	3.875

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	4.3	3.3	2.7	4.5	4.9	2.7	2.5	4.0	2.9	3.4	2.9	1.6	2.5	2.3
Private consumption	4.6	3.3	1.9	3.3	4.7	6.3	2.8	1.6	1.6	2.0	2.4	1.6	2.0	1.6
Construction investment	9.7	3.6	3.7	4.1	10.0	-5.5	7.9	1.8	6.1	3.0	5.1	2.0	1.9	5.9
Equipment investment	7.7	2.3	-1.8	26.7	-11.2	16.1	-6.0	8.6	-4.1	0.0	-2.1	-4.1	-8.1	8.7
Public investment	5.4	12.1	6.0	82.8	-29.8	28.0	25.9	5.0	5.2	5.6	6.0	6.4	6.8	7.2
Government consumption	2.2	3.4	2.8	0.6	5.8	6.5	1.4	2.8	2.9	3.0	3.5	2.2	1.9	2.2
Exports of goods & services	3.2	3.5	6.2	3.5	8.1	-2.8	2.1	4.9	7.2	7.8	4.1	6.1	7.2	8.2
Imports of goods & services	10.6	8.8	2.7	7.4	10.0	14.3	14.6	2.4	2.0	3.2	3.2	2.4	1.8	3.2
Contributions to GDP growth:														
Domestic final sales	5.2	3.8	2.1	6.5	4.1	7.2	5.6	-1.1	2.3	2.4	2.9	1.6	1.5	3.2
Inventories	0.7	0.9	0.1	-1.0	1.4	-0.5	-0.1	4.8	-0.3	0.2	0.0	-0.6	0.0	-1.8
Net trade	-1.7	-1.4	0.6	-1.0	-0.7	-3.7	-2.9	0.4	0.9	0.8	0.0	0.6	1.0	0.9
GDP deflator (%oya)	3.8	3.3	2.6	4.1	3.3	3.5	3.5	3.7	3.4	2.8	2.6	2.6	2.6	2.5
Consumer prices (%oya)	2.3	3.9	2.7	2.1	1.9	3.0	4.2	3.8	4.0	3.7	3.0	2.7	2.6	2.5
Producer prices (%oya)	2.3	5.7	2.5	1.5	0.8	3.4	6.9	5.0	6.0	5.0	2.5	2.5	2.5	2.5
Trade balance (A$ bil, sa)	-20.7	-29.9	-19.0	-4.5	-5.4	-7.0	-8.3	-7.7	-7.3	-6.5	-6.1	-5.3	-4.0	-3.7
Current account (A$ bil, sa)	-67.0	-82.5	-82.1	-16.0	-16.3	-18.7	-19.5	-21.2	-20.8	-20.9	-21.1	-21.1	-20.5	-19.5
as % of GDP	-6.2	-7.1	-6.7	-6.0	-6.0	-6.7	-6.9	-7.4	-7.1	-7.1	-7.0	-6.9	-6.7	-6.3
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	0.94	0.84	0.74	0.77	0.91	0.95	0.95	0.93	0.91	0.88	0.85	0.82	0.79
Commonwealth budget (FY, A$ bil)	17.2	16.8	21.7											
as % of GDP	1.6	1.5	1.8											
Unemployment rate	4.4	4.5	5.3	4.3	4.3	4.3	4.1	4.4	4.6	4.9	5.1	5.2	5.3	5.4
Industrial production	3.2	3.7	0.8	3.0	-0.1	5.5	6.7	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)	3.1	1.0	1.9	3.6	2.0	4.1	-0.4	-1.3	0.0	1.5	2.0	3.4	2.4	3.6
Private consumption	4.3	-0.5	1.2	2.2	1.5	2.0	-4.6	-0.1	-0.5	0.5	0.7	2.1	2.9	3.3
Fixed Investment	4.5	0.1	0.9	-2.7	1.5	19.4	-6.2	-6.8	-2.7	0.3	2.0	2.8	3.1	3.9
Residential construction	4.3	-9.8	-1.7	13.3	7.7	-6.1	-22.0	-18.0	-6.0	-2.0	0.0	0.8	2.8	3.2
Other fixed investment	4.6	2.6	1.5	-6.4	0	26.9	-2.0	-4.0	-2.0	0.8	2.4	3.2	3.2	4.0
Inventory change (NZ$ bil, saar)	0.8	0.1	-0.1	0.4	0.3	0.0	0.1	0.1	0.0	-0.1	0.0	0.0	-0.1	-0.1
Government spending	4.0	7.4	1.9	4.7	8.5	1.5	19.0	4.2	1.9	4.1	-2.0	3.2	2.9	2.5
Exports of goods & services	3.5	4.1	2.8	-3.3	-0.4	23.2	-1.5	1.5	2.5	2.5	2.5	3.1	3.6	3.7
Imports of goods & services	8.8	4.6	1.0	11.0	2.9	18.5	0.6	0.6	0.2	0.5	0.5	1.5	2.2	2.5
Contributions to GDP growth:														
Domestic final sales	4.6	1.9	1.4	4.6	4.7	7.8	-0.8	-1.7	0.7	1.1	0.5	2.6	3.1	3.5
Inventories	0.5	-0.5	-0.1	4.0	-1.5	-3.6	1.1	0.1	-1.4	-0.2	0.8	0.4	-1.0	-0.1
Net trade	-2.0	-0.4	0.5	-4.9	-1.2	0.2	-0.7	0.3	0.7	0.6	0.6	0.4	0.3	0.3
GDP deflator (%oya)	4.0	4.4	2.8	4.0	3.7	5.4	5.3	4.7	4.5	3.0	2.9	2.8	2.7	2.7
Consumer prices	2.4	4.2	3.6	4.0	2.0	4.8	2.7	5.9	5.8	4.5	1.5	3.5	3.5	3.2
%oya	2.4	4.2	3.6	2.0	1.8	3.2	3.4	3.8	4.8	4.7	4.4	3.8	3.3	2.9
Trade balance (NZ$ bil, sa)	-2.3	-0.8	0.8	-0.8	-0.7	0.1	-0.2	-0.2	-0.2	-0.2	-0.1	0.1	0.3	0.5
Current account (NZ$ bil, sa)	-13.8	-10.2	-8.5	-3.5	-3.6	-3.1	-2.6	-2.5	-2.5	-2.6	-2.5	-2.3	-2.0	-1.7
as % of GDP	-8.1	-5.7	-4.5	-8.4	-8.4	-7.0	-5.8	-5.7	-5.6	-5.7	-5.5	-5.0	-4.3	-3.5
Yield on 90-day bank bill (%)*	8.4	8.5	7.8	8.2	8.7	8.8	8.8	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	6.4	6.6	6.7	6.8	7.0	7.1	7.0	7.0
US$/NZ$*	0.74	0.80	0.68	0.74	0.74	0.76	0.79	0.83	0.80	0.78	0.72	0.66	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	3.9	4.5	3.6	3.5	3.4	3.6	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
9 Jun New Zealand: QV house price May *Holiday Australia*	10 Jun Australia: Housing finance (11:30am) Apr -3.0 %m/m, sa ANZ job ads (11:30am) May NAB business confidence (11:30am) May	11 Jun Australia: Westpac consumer confidence (10:30am) Jun 1.0 %m/m, sa New Zealand: Terms of trade (10:45am) 1Q	12 Jun Australia: Consumer inflation expectation (10:30am) Jun Unemployment rate (11:30am) May 4.3 %, sa New Zealand: PMI (12:00pm) May	13 Jun New Zealand: Retail sales (10:45am) Apr 0.2 %m/m, sa
16 Jun New Zealand: Manufacturing activity (10:45am) 1Q	17 Jun	18 Jun Australia: Westpac leading index (10:30am) Apr	19 Jun	20 Jun New Zealand: Visitor arrivals (10:45am) May
23 Jun Australia: New motor vehicles sales (11:30am) May New Zealand: Credit card spending (03:00am) May	24 Jun	25 Jun	26 Jun New Zealand: Current account (10:45am) 1Q	27 Jun New Zealand: Trade balance (10:45am) May GDP (10:45am) 1Q Money supply (03:00pm) May
30 Jun Australia: Pvt. sector credit (11:30am) May New Zealand: Building permits (10:45am) May NBNZ business conf. (03:00pm) Jun	1 Jul Australia: RBA cash target (02:30pm) Jul RBA comm. index (04:30pm) Jun	2 Jul Australia: Building approvals (11:30am) May Retail sales (11:30am) May	3 Jul Australia: Trade balance (11:30am) May New Zealand: ANZ commodity price (03:00pm) Jun	4 Jul

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
9 - 13 June	**9 June**	**10 June**	**11 June**	**12 June**	**13 June**
China • Money supply (May) • Trade balance (May)	Euro area • Trichet speech Germany • Trade balance (Apr) Japan • Economy watcher survey (May) Mexico • CPI (May) Taiwan • Trade balance (May) Turkey • IP (Apr) United States • Pend home sales (Apr) • Bernanke speech	Canada • Trade balance (Apr) • BoC meeting Chile • BCCh meeting Japan • Private machinery orders (Apr) Norway • CPI (May) Sweden • CPI (May) United States • Manpower survey (3Q) • Trade balance (Apr)	Brazil • IPCA (May) France • CPI (May) Japan • GDP 2nd est. (1Q) United Kingdom • Labor mkt report (May) • Trade balance (Apr) United States • Beige book	China • CPI (May) Euro area • IP (Apr) France • Employment fiinal (1Q) United States • Business inventories (Apr) • Retail sales (May) Central bank meetings • Korea • Peru • South Africa	China • Retail sales (May) Euro area • Employment (1Q) • Labor costs (1Q) Germany • CPI final (May) Japan • Consumer sent (May) • IP final (Apr) • BoJ meeting Poland • CPI (May) United States • CPI (May) • Consumer sent prelim (Jun)
16 - 20 June	**16 June**	**17 June**	**18 June**	**19 June**	**20 June**
Japan • Nationwide dept store sales (May) Taiwan • CBC meeting	China • IP (May) Euro area • HICP final (May) Japan • Flow of funds (1Q) Turkey • CBRT meeting United States • NAHB survey (Jun) • NY Fed survey (Jun) • Bernanke speech	China • FAI (May) Euro area • Trade balance (Apr) Germany • ZEW business surv (Jun) Japan • Tertiary sector act index (Apr) Mexico • IP (Apr) Russia • GDP (1Q) United Kingdom • CPI (May) United States • Housing starts (May) • IP (May) • PPI (May)	Japan • BoJ minutes Poland • IP (May) United Kingdom • BoE minutes	Canada • CPI (May) Japan • All sector act index (Apr) • Reuters Tankan (Jun) Russia • IP (May) United Kingdom • Retail sales (May) United States • Philly Fed survey (Jun)	Mexico • Banxico meeting

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