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Australia and New Zealand - Weekly Prospects

Summary

- After a virtual hiatus last week, the **Aussie** event calendar comes back to life this week with important releases on inflation and the release of minutes from the RBA's July Board meeting. Headline inflation probably accelerated to 0.7%q/q (consensus 0.5%) in the June quarter, with much of the rise owing to a bounce in petrol prices. Core inflation, though, should have eased a notch to 0.9%q/q (consensus 0.7%). With abundant domestic economic slack, inflation pressures should ease in coming quarters, although the core measures will be sticky. This probably will be an irritant for RBA officials; after all, inflation is never on the back-burner for an inflation-targeting central bank. The Board minutes are unlikely to deliver revelations; RBA commentary in recent weeks has been unsurprising, but Governor Glenn Stevens' speech next week looms large as a policy milestone.

- Antipodean economic action was centred in **New Zealand** last week. Retail sales, particularly ex-autos, and the consumer price data printed on the upside of market expectations. New Zealand's core CPI measure accelerated in 2Q, reaffirming our view that a similar scenario will play out in Australia this week. With nontradable inflation, in particular, likely to hover at the upper end of the RBNZ's target range in the foreseeable future, we see little scope for the RBNZ to ease policy further. In fact, we expect the RBNZ to begin tightening in July 2010.

- Incoming releases continue to support our view that the **Americas and Europe** are set to join an already established **Asian** economic upturn this quarter. While the recognition that a recovery is coming has increased, the sharpness of this quarter's growth swing should surprise. After declining at a nearly 10% annualized pace in each region last quarter, industrial production is expected to rise close to 10% in the Americas and 5% in Western Europe this quarter. GDP gains should be close to trend in both regions.

- Accompanying this bounce, **US labour market** and housing indicators should turn materially better. Although a component of the recent collapse in jobless claims reflects noise related to auto factory shutdowns, initial claims are expected to fall below 500,000 this quarter, signaling a moderation in job shedding toward a roughly 150,000 monthly pace. Behind the downshift in jobless claims is a broader move away from retrenchment by businesses, which should dominate incoming economic indicators and provide a catalyst for stabilizing labour income, lifting confidence and improving financial market conditions.

- The coming months are expected to deliver divergent movements in **global headline and core inflation**. The steep decline in headline inflation, which lowered the global rate to an estimated 0.2%oya in June, is nearing a bottom and will reverse course as the massive negative base effect from energy prices disappears. However, even as headline inflation swings higher, core inflation should continue to fall as the extremely low and falling rate of resource utilization gradually permeates the complex of wages and prices.

This week's highlight

Wednesday's Aussie 2Q CPI print should show core inflation remaining uncomfortably high, well above the RBA's target range.

July 20, 2009

Contents

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Data and event previews - Australia and New Zealand

			Forecast		
Date	**Time** [(a)]	**Data/event**	**JPMorgan**	Consensus [(b)]	***Previous***
Monday, July 20	11.30am	Aust. PPI (%q/q, 2Q)	**0.0**	-0.2	*-0.4*
Tuesday, July 21	8.45am	NZ visitor arrivals (%m/m, Jun.)	**na**	na	*0.2*
Tuesday, July 21	11.30am	RBA Board minutes (Jul.)	**na**	na	*na*
Tuesday, July 21	11.30am	Aust. new motor vehicle sales (%m/m, Jun.)	**2.5**	na	*5.4*
Tuesday, July 21	1.00pm	NZ credit card spending (%oya, Jun.)	**na**	na	*-2.4*
Wednesday, July 22	11.00am	Aust. DEWR skilled vacancies (%m/m, Jul.)	**na**	na	*-3.7*
Wednesday, July 22	11.30am	Aust. CPI (%q/q, 2Q)	**0.7**	0.5	*0.1*
Wednesday, July 22	12.00pm	Panel discussion including RBA Assistant Governor Debelle	**na**	na	*na*
Thursday, July 23	5.00pm	RBA Assistant Governor Debelle's remarks	**na**	na	*na*

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

Australia

Aust. PPI (%q/q, 2Q) - The second-quarter PPI numbers should show that pipeline pressures no longer are unwinding - the PPI fell in 1Q. Australian producer prices at the final stage of production probably were flat in 2Q, after a 0.4%q/q drop in 1Q, which marked the first fall since 2003.

RBA Board minutes - The minutes of the RBA's July Board meeting probably will betray few surprises. RBA officials remain content that economic conditions offshore have improved, and that the policy stimulus domestically has paid dividends. The economy is not yet out of the woods, however, partly because the jobless rate will keep climbing; this will be a key test for households.

Aust. CPI (%q/q, 2Q) - The rise in headline inflation in 2Q will be underpinned by higher fuel prices and the financial services component - bank lending rates rose in 2Q but deposit rates broadly were flat, reversing the trend from 1Q. Headline inflation should ease in coming quarters, but the main concern is core inflation, which will remain above, or at least in the upper half of, the RBA's 2-3% target range this year. For this reason, the upcoming 2Q CPI data will be an important driver of RBA policy decisions.

Comments from RBA's Guy Debelle - The RBA's Assistant Governor (Financial Markets) makes two official public appearances this week. At the first on Wednesday, he will be a panel member at the Mortgage Finance Industry Association Industry Leaders Forum in Melbourne. Then, on Thursday, Dr. Debelle will make remarks to the Whitlam Institute Forum in Sydney.

New Zealand

NZ visitor arrivals (%m/m, Jun.) - Competitive airfares probably will boost visitor arrivals. In the year to May, visitor arrivals were down 3%oya, but a record one million visitors arrived from Australia. Should the swine flu pandemic continue to worsen, though, the economy's tourism sector will suffer.

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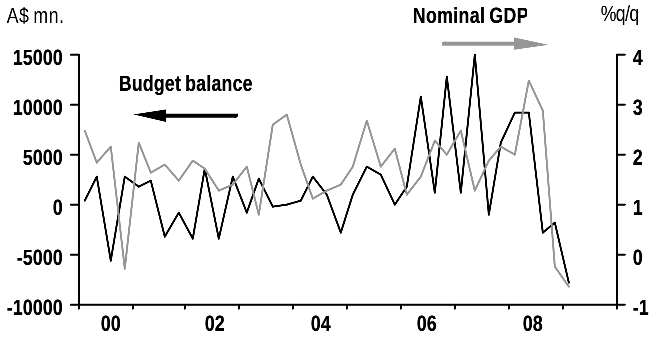
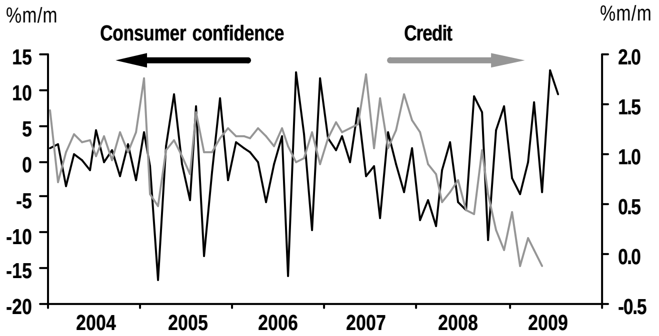
Feature charts

Australia: Commonwealth budget balance and nominal GDP



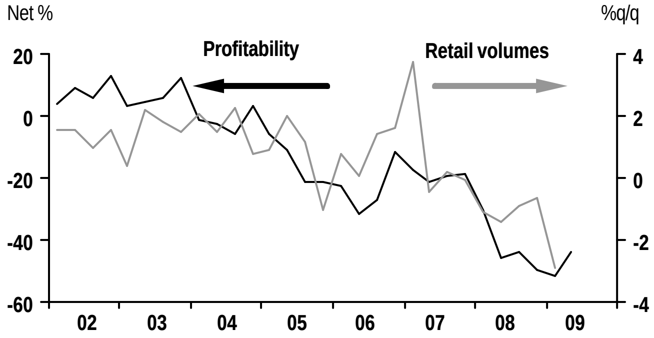
The Australian government significantly downgraded the outlook for Commonwealth finances in May's budget. While the official forecasts for growth in real GDP effectively are at trend levels over the long term, nominal GDP, the main driver of taxation revenue, will be reduced substantially due to a weakening terms of trade.

Australia: WMI consumer confidence and private sector credit



Aussie households expand their use of credit when they have confidence in the state of the economy and their own job security. The importance of the government's stimulus measures is apparent from the recent break in this relationship; cash handouts are subsidizing consumers who, while riding a wave of good sentiment now, apparently are planning for an income squeeze. Also, they have embarked on a program of repairing their balance sheets, which necessarily requires additional austerity. The extent of this pullback will become clearer only as the policy stimulus is withdrawn.

New Zealand: NZIER survey profitability and retail volumes



The RBNZ recently has emphasized the instability of the Kiwi economy's current composition, stating that a sustainable recovery must involve greater private sector savings and an export-driven expansion. For some years, domestic demand has dwindled as a driver of GDP growth, due to weaker immigration and population growth, which have constrained Kiwi firms' profitability. Greater domestic savings would help fund investment and stimulate private consumption.

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Economic Research Note

Inflation should be back on the RBA's policy radar

- **Recent economic data has bettered expectations; RBA probably will revise up GDP and CPI forecasts**
- **Underlying inflation this week to print well above RBA's target range for 2Q**
- **"Sticky" core inflation will concern RBA officials and reaffirm our view that the easing cycle has ended**

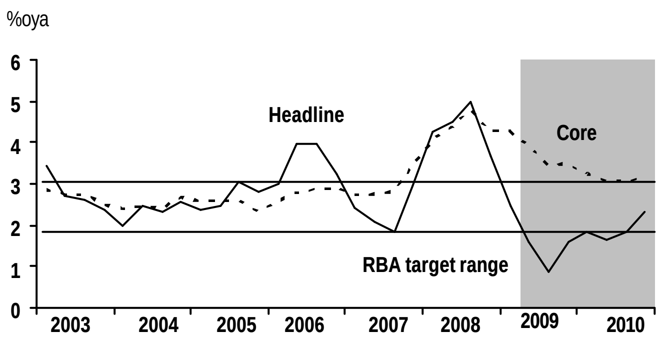
Key economic data in Australia in recent weeks consistently has printed above expectations. Retail sales remain firm (albeit propped up by government cash handouts), business and consumer confidence have bounced, and employment has printed well above admittedly dismal expectations. On this basis, it now looks that Australia has experienced only a shallow recession.

The string of relatively upbeat economic outcomes has curbed market expectations of further RBA policy easing. In fact, market pricing now suggests the RBA will be hiking the cash rate in early 2010 (our forecast also calls for a hike, but not until mid-2010). The RBA recently reiterated, however, that moderating inflation may allow "scope for some further easing of monetary policy." Though this signalled that the door is open to further easing if needed, with the economic outlook having brightened, RBA officials probably will be more nervous about the medium-term inflation outlook. The 2Q CPI data (Wednesday), particularly the core inflation measures, which probably will remain stuck well above the RBA's 2-3% target range, will, therefore, be an important driver of policy decisions. Indeed, contrary to popular opinion, inflation is never on the back burner for an inflation-targeting central bank.

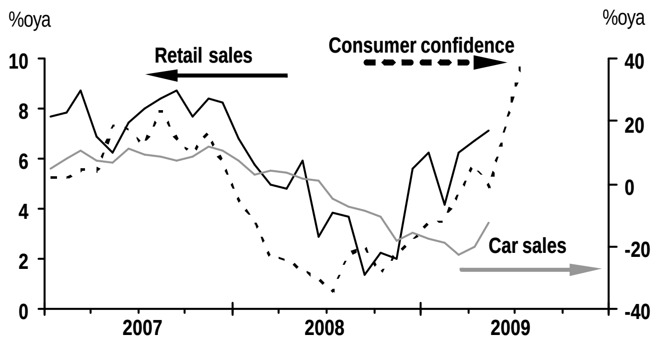
Interest rate margins a key factor

The March quarter CPI data, released in April, suggested inflation was easing, albeit from a high rate. As demand pressures eased, headline inflation printed at 2.5%oya, falling back within RBA's target range for the first time since 3Q07. On a quarterly basis, consumer prices grew a mere 0.1%q/q, dragged lower mainly by falling petrol prices (-8%) and a sharp fall in the deposit and loan facilities component (-14%). The latter owed mainly to a significant narrowing of banks' interest rate margins—the pass-through to loan rates (mortgages and personal loans) of the RBA's 100bp rate cut in February was not matched by a drop in retail deposit rates. Why? The main reason was increased competition among domestic banks for retail deposits. With banks' funding costs surging in the midst of the credit crisis, the domestic banks sought to reduce their reliance on short-term wholesale funds in favour of retail deposits to fund their loan books. The Commonwealth Bank of Australia has said, though, the resulting retail deposit price war has meant that it now can raise funds more cheaply in wholesale markets than from retail customers.

Core inflation will be sticky, as headline falls



Aggressive policy support has turned around consumer variables



At least headline inflation should ease

Inflation pressures will continue to ease as the effects of the global recession increase slack in the domestic economy and unemployment continues to rise. Headline CPI should print at 1.7%oya (0.7%q/q) in 2Q. The petrol and financial services components again will be significant influences on inflation but, this time, in the opposite direction.

Reversing the decline in the previous quarter, the fuel component, accounting for 4% of the CPI, will spike around 9%q/q in 2Q—the surge in global oil prices over the quarter was only partly offset by the 14% AUD appreciation. Meanwhile, we expect a small rise in the deposit and loan facilities component, following the slump in 1Q. The RBA cut the official cash rate again (by 25bp) in April, but higher funding costs meant banks were reluctant to pass on the cut to lending rates, and deposit rates remained steady. The financial services component, accounting for a hefty 8% of the CPI, should, therefore, increase.

But underlying CPI to remain elevated

Core inflation measures, though, will be sticky. After falling sharply in 4Q08, core (trimmed mean) inflation, the RBA's preferred measure, was 4.1%oya in 1Q, well above target for the sixth straight quarter. This prompted the RBA to revise up its near-term core inflation forecasts in the last quarterly Statement of Monetary Policy (SoMP) in May.

Back then, the RBA forecast that underlying inflation would peak at 3.75% in the June quarter, before declining to 3.25% in 4Q, and to 2.5% in 2Q10. These core inflation forecasts probably will be revised higher in the August SoMP, particularly so if the economic data continue to improve and the 2Q CPI report shows underlying inflation uncomfortably high. On our forecasts, core CPI will print at 3.8%oya in 2Q (0.9%q/q), and remain above the RBA's target until end-2010. This is a significantly less benign profile than the RBA forecasts, which currently show core inflation well below target in 2011.

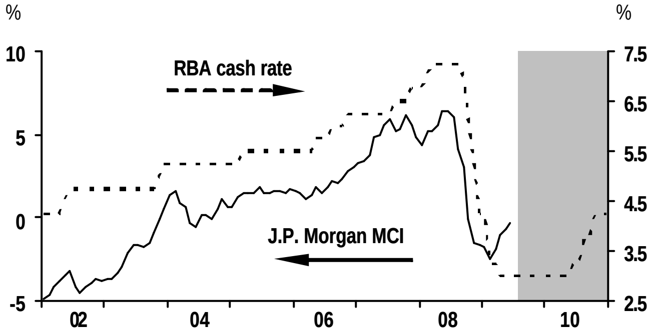
Any revisions to core CPI forecasts probably will coincide with upward revisions to the RBA's growth forecasts. In May, the RBA's GDP forecasts (table) were cut by as much as 1.5% points to include a contraction in GDP; thus, the official forecasts indicated the economy was headed for recession. Since then, "green shoots" of global recovery have emerged and domestic conditions have proved firmer than expected; thus, we expect upgrades to the Bank's GDP forecasts in August, particularly given the economy avoided recession in 1Q, technically at least.

RBA's next move likely up, not down

RBA Deputy Governor Ric Battellino said in May that global central banks easily could reverse some of the massive monetary stimulus injected into economies worldwide if inflation reemerged as a threat. Our call is for the RBA to hike the cash rate mid-2010; this would be a break from historical convention, given it would mean the next tightening cycle would begin before the unemployment rate peaks. Bank officials will be wary of leaving the cash rate too low for too long, or risk fanning inflation, given the unprecedented rate at which the official cash rate was lowered (425bp since September), combined with the significant amount of fiscal policy support also delivered.

Our forecast calls for unemployment to peak at 9% in 3Q10 (the RBA's unpublished forecast probably is lower), but by midyear, RBA officials should be confident that the peak in unemployment is near. This is particularly true given that the lag between the start of the economic downturn and layoffs probably is longer this time around, given the speed at which the downturn took place. This gave employers more incentive to hoard labour amid expectations the trough in the economic downturn was imminent.

Rising AUD means monetary conditions have tightened



RBA output and inflation forecasts (May 2009)

%oya (February RBA forecasts in brackets)

	GDP	Consumer price index	Underlying inflation
Dec 08	0.3 (1.0)	3.7 (3.7)	4.3 (4.3)
Jun 09	-1.25 (0.25)	1.5 (1.75)	3.75 (3.5)
Dec 09	-1.0 (0.5)	2.25 (2.5)	3.25 (3.0)
Jun 10	0.5 (1.25)	2.5 (2.75)	2.5 (2.75)
Dec 10	2 (2.5)	2 (2.5)	2 (2.5)
Jun 11	3.25 (3.25)	1.5 (2.0)	1.5 (2.0)
Dec 11	3.75	1.5	1.5

Source: RBA, ABS.

While our forecast assumes that the easing cycle is over, the RBA still may ease again, but only if the spike in joblessness is unexpectedly abrupt. Thus far, the pace at which the jobless rate has been rising has been modest compared to previous downturns. But, a sudden jump in the unemployment rate could emerge if firms move more deeply into cost saving mode. On that, the RBA in July reiterated its concern about the ongoing decline in business borrowing, as companies postponed investment plans; this, of course, has serious negative implications for the employment outlook.

As we highlighted recently (see "Will the RBA spin its wheels to keep Aussie banks in neutral? *GDW*, July 2), we no longer believe rises in commercial banks' variable mortgage rates will trigger official rate cuts. Variable rate hikes independent of the RBA probably will be viewed favourably by RBA officials, as they would dampen the buoyant first home buyers' market, where activity is approaching boom conditions owing to the expanded government grant.

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Australia

- **CPI data on this week's watch-list**
- **Core inflation will remain uncomfortably high**
- **Terms of trade falling rapidly**

Aussie inflation not on the back burner

Headline inflation in Australia should continue to ease in coming quarters, but the main concern is core inflation, which will remain above, or at least in the upper half of, the RBA's 2-3% target range this year. For this reason, the upcoming 2Q CPI data (Wednesday) will be an important driver of RBA policy decisions (see "Inflation should be back on the RBA's policy radar," page 4).

Headline inflation should moderate to 1.7%oya in 2Q, from 2.5% in the previous three months, holding within the RBA's comfort zone for the second straight quarter. From the previous quarter, consumer price growth will accelerate to 0.7%q/q from just 0.1% in 1Q, owing mainly to the automotive fuel component—the surge in global oil prices over the quarter was only partly offset by the 14% AUD appreciation. Also, we expect a positive contribution from the deposit and loan facilities component, as interest rate margins widened owing to higher loan rates, while deposit rates were steady.

The RBA's preferred core measure of inflation, the trimmed mean, probably was 0.9%q/q in 2Q. This result would reduce the annual core inflation at 3.8%oya, still well above the Bank's target. We forecast core inflation above target throughout 2009, which may unnerve RBA officials, as recent domestic economic data has surprised on the upside. Although the RBA has left the door open to further policy easing if needed, with the economic outlook having brightened, RBA officials may be more nervous about the medium-term inflation outlook.

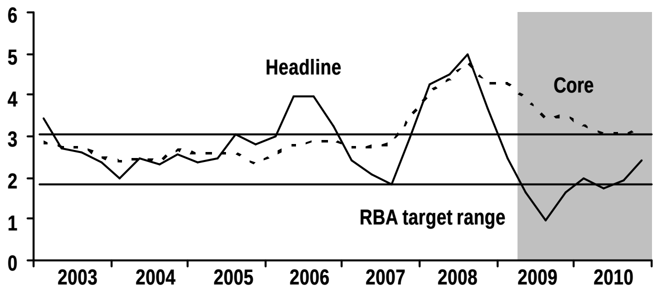
The second-quarter PPI numbers will be released Monday, and should show that pipeline pressures no longer are unwinding—the PPI fell in 1Q. Australian producer prices at the final stage of production probably were flat in 2Q, after falling 0.4%q/q in the March quarter, which marked the first fall since 2003. Growth in prices at the preliminary and intermediate stages of production probably rose, after tumbling in 1Q.

Little new from RBA Board minutes

The minutes of the RBA's July Board meeting, at which members again left the cash rate steady at 3%, are released Tuesday. The commentary announcing the decision on July 7 betrayed few surprises; nor should the minutes. As has been the case for some months, RBA officials are content that economic conditions offshore have improved, particularly in China, and that the policy stimulus domestically has paid dividends. The economy is not yet out of the woods, however, partly because the jobless rate will keep climbing; this will be a key test for households.

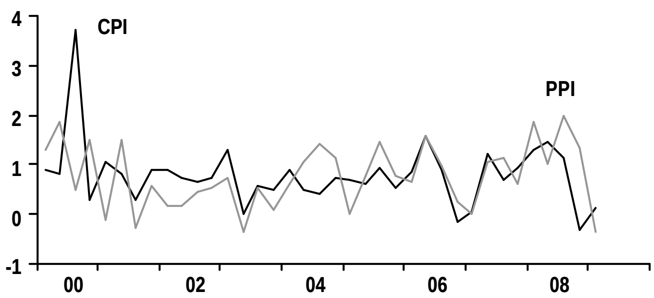
Australia: CPI

%oya



Australia: CPI and PPI

%q/q



The RBA's statement earlier this month made clear that officials stand ready to ease policy again if necessary. This, though, seems more a means of underpinning still fragile consumer confidence than a genuine belief that further rate cuts are likely. Indeed, we forecast that the next move from the RBA will be a rate hike, although not until mid-2010.

Terms of trade to be a drag on income

Both export and import prices tumbled in 2Q, causing the terms of trade to sink another 15%q/q, after falling 2% in the previous quarter. On our forecast, the terms of trade will fall at least 30% from peak to trough, draining national income, although it now appears the squeeze will be worse than we currently forecast. Indeed, it looks likely that the decline also will be larger than the RBA currently predicts. In May, the RBA indicated that the terms of trade would fall 25% this year, a forecast now likely to be revised lower. Export prices slumped 21%q/q, marking the largest

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quarterly decline on record, after falling 5% in 1Q. As expected, the decline was mainly owing to prices for coal, coke and briquettes (-37%). The fall in import prices, down 6%q/q, was mild in comparison, but again the largest on record. The stronger AUD played a key role in this fall, as did lower prices for iron and steel imports (-23%).

The surprise on import prices (we expected a smaller drop) failed to have a material impact on our 2Q CPI forecast (the data is due for release Wednesday). Our forecast calls for the consumer price index to rise 0.7%q/q (1.0%oya) in 2Q. The core measure should print at 0.9%q/q (3.8%oya). With the economic outlook having brightened recently, RBA officials probably will be more nervous about the medium-term inflation outlook.

Thus, the CPI data will be an important driver of RBA policy decisions, particularly with the core inflation measures remaining stuck well above the RBA's 2-3% target range. Contrary to popular opinion, inflation is never on the back burner for an inflation targeting central bank.

Aussie businesses more upbeat

In the NAB business survey last week, Australian business confidence rose from -2 in May to +4 in June (J.P. Morgan +2); this marked the first positive reading since December 2007. The improvement resulted from more "green shoots" offshore, the stronger AUD, still-strong consumer spending, and improved access to equity capital. The employment component bounced from -25 in May to -7 in June. The improvement is in contrast to the slump in the ANZ job advertisements series, which tumbled 7%m/m in June, and was down 51%oya. Our forecast calls for the jobless rate to peak at 9% in 2010, although the risks to this forecast now are tilted to the downside. The employment data has reported a string of unexpectedly healthy outcomes in recent months, barring the 21,000 drop in June.

Looking at the NAB employment measure and changes in employment, it's beginning to look like employment will not contract as much as anticipated in 2009 and 2010. The government's cash handouts no longer are propping up the retail sector, so job shedding in this large employers should accelerate. Also, the expanded first home buyers' grant will be phased down from September, weighing on housing-related employment.

Australia: terms of trade

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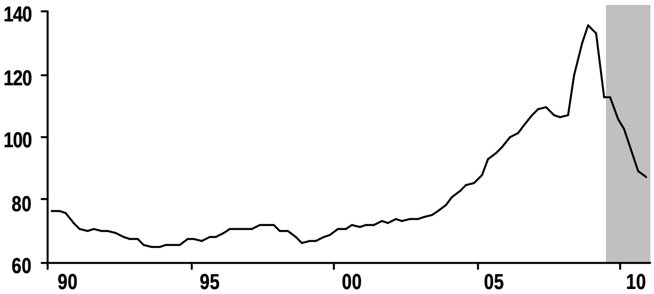

Australia: NAB survey and employment growth

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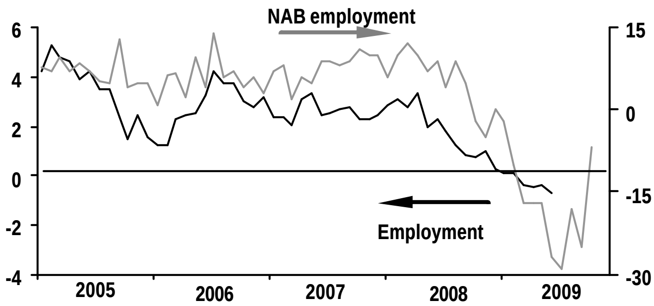

Data releases and forecasts

Week of July 20 - 24

Mon Jul 20 11:30am	**Producer price index** Percentage change	**3Q08**	**4Q08**	**1Q09**	**2Q09**
	%oya	5.6	6.4	4.0	3.0
	%q/q	2.0	1.3	-0.4	0.0
Tue Jul 21 11:30am	**Sales of new motor vehicles** Units, seasonally adjusted	**Mar**	**Apr**	**May**	**Jun**
	(%m/m)	-3.2	1.7	5.4	2.5
	(%oya)	-22.4	-19.8	-12.6	__
Wed Jul 22 11:30am	**Consumer price index** Percentage change	**3Q08**	**4Q08**	**1Q09**	**2Q09**
	Headline				
	%oya	5.0	3.7	2.5	1.7
	%q/q	1.2	-0.3	0.1	0.7
	Core (trimmed mean)				
	%oya	4.8	4.3	4.1	3.8

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%q/q	1.2	0.6	0.1	0.9

Review of past week's data

NAB monthly business survey

% balance, seasonally adjusted

	Apr	May	Jun	
Business confidence	-14	-2	~~2~~	*4*

WMI leading index

Seasonally adjusted

	Mar	Apr	May	
(%m/m)	0.4	0.7	__	*-0.2*

Export price index

Not seasonally adjusted

	4Q08	1Q09	2Q09	
Index	219.9	209.8	~~182~~	*166.6*
(%q/q)	15.9	-4.6	~~-13.3~~	*-20.6*
(%oya)	54.9	42.8	~~9.1~~	*-0.2*

Import price index

Not seasonally adjusted

	4Q08	1Q09	2Q09	
Index	137.0	133.2	~~131.9~~	*124.7*
(%q/q)	10.8	-2.8	~~-1.0~~	*-6.4*
(%oya)	21.1	14.6	~~11.9~~	*5.9*

New Zealand

- **Retail sales remain strong**
- **CPI printed unexpectedly high in 2Q**
- **RBNZ's next move will be up**

Antipodean economic action was centred in New Zealand last week. Retail sales, particularly ex-auto sales, and the consumer price data printed on the upside of market expectations. The core CPI measure accelerated in 2Q, raising the risk of a similar scenario playing out in the Australian 2Q CPI numbers this week.

Kiwi retail strength will be short-lived

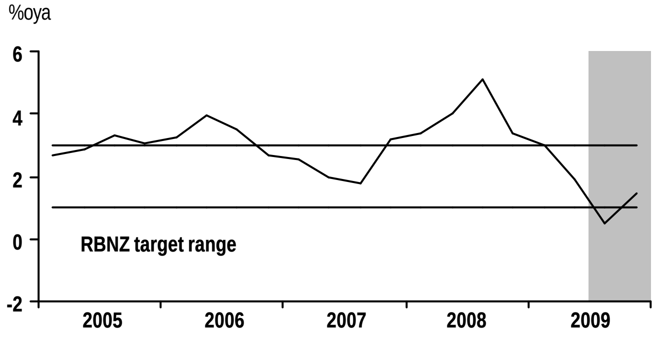
Retail sales values were unexpectedly strong in May, rising 0.8%m/m (J.P. Morgan -0.2%, consensus 0.2%), the largest monthly increase since November 2007. Indeed, the strength in spending was surprising. Remember, the retail numbers are in value terms and, partly because of this, we had expected a mild fall in sales values given the heavy discounting by Kiwi retailers in recent months. The series has been particularly volatile, however, owing to the car sales component. The 1.6%m/m rise in core retailing in May was the largest since February 2007, underpinned by solid sales at supermarket and grocery stores (+2%) and clothing and soft goods retailing (+13%).

We have our doubts, though, as to whether such strong retail numbers will be sustained. It appears that New Zealand retailers suffered a big setback in June, with data showing that monthly electronic card transactions slumped 1.2%m/m, marking the biggest monthly drop in the core retail sales figures since October 2007. Total electronic card transactions were down 0.4%m/m, while all retail industries (including fuel and automotive) were down 1%.

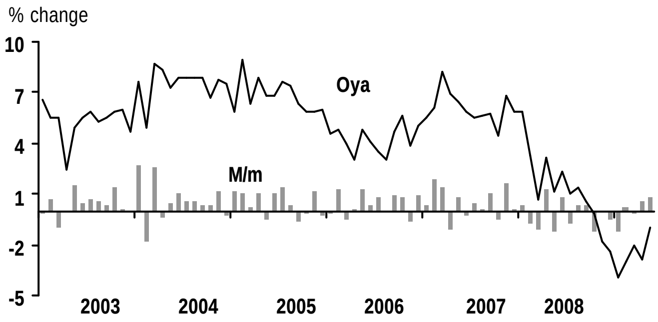
Widespread anxiety about job security will throw another wrench in the works. Rising unemployment probably is the biggest headwind facing Kiwi consumers and, with the business surveys pointing to more firms shedding workers, the unemployment rate will continue to rise—in our forecast, approaching close to 8% in 2010. The resulting fall in labour income combined with rising petrol prices will eat into households' disposable incomes, supporting our view that private consumption will contract in 2009.

Net migration and signs of stabilization in the housing market should soften the blow. An independent survey by Roy Morgan (released last week) showed that consumers are less pessimistic about their future wealth, thanks to lower interest rates and recent signs of stabilization in the housing market. Housing market turnover has increased and other

New Zealand: CPI



New Zealand: retail trade



indicators, such as home loan approvals, are pointing to signs of recovery. Consumers also should feel fairly confident that the cash rate will remain near record lows for the remainder of the year.

Nontradable inflation remains elevated

Inflation in New Zealand accelerated in the second quarter. Consumer prices grew 0.6%q/q (J.P. Morgan 0.2%, consensus 0.5%), compared to 0.3% in 1Q. Higher food prices were the major upward force on headline CPI, rising 0.9%q/q. The other main positive contribution came from the transport group, where prices rose 0.6%q/q in 2Q, owing to higher petrol prices. From a year ago, consumer price growth fell markedly, however, to 1.9%oya from 3.0%, marking the smallest rise since 3Q07 and falling comfortably back into the RBNZ's 1-3% target range.

But, while the headline measure is back within the RBNZ's comfort zone, the nontradable measure—inflation generated domestically and not influenced by the exchange rate—is not. Nontradable inflation, at 3.3%oya, eased considerably in 2Q, but still is hovering above the Bank's target, as it has done since early 2001. Significant upward contributions came from electricity, local authority rates and payments, rentals for housing, and beer. The strength in nontradable inflation has continued to surprise on the upside, given the persistent weakness in the domestic economy, which was in a homegrown recession before the worst of the international troubles unfolded. The tradable component increased just 0.2%oya in 2Q.

With nontradable inflation likely to hover at the upper end of the RBNZ's target range in the foreseeable future, we see little scope for the RBNZ to ease policy further, especially when the economic data (both domestic and offshore) recently has printed on the upside of expectations. We believe that the OCR already has bottomed at 2.5% in the current easing cycle, with the next move is likely to be a rate hike in mid-2010. The main risk is that the RBNZ will hike before then, if nontradable inflation remains high throughout 2H09 and the global recovery continues to gather steam.

Kiwi recovery not far away

We believe that the New Zealand economy will start to recover in 4Q, thanks to the significant monetary and fiscal policy easing. The main risk to the recovery we forecast to commence later this year is the strengthening NZ dollar, which currently is dampening the chances of an export-led recovery as global demand picks up. Domestically, net migration and signs of stabilization in the housing market bode well for the resumption of growth later this year.

Data releases and forecasts

Week of July 20 - 24

Tue Jul 21 10:45am

Visitor arrivals
Non seasonally adjusted

	Mar	Apr	May	Jun
Total (%m/m)	-0.2	2.5	0.2	__

Tue Jul 21 10:45am

Net permanent immigration
Non seasonally adjusted

	Mar	Apr	May	Jun
Monthly (000s)	0.3	2.2	2.7	__
12 month sum (000s)	7.5	9.2	11.2	__

Tue Jul 21 03:00pm

Credit card spending
Percentage change

	Mar	Apr	May	Jun
%oya	-4.8	-1.6	-2.4	__

Review of past week's data

Retail trade
Seasonally adjusted

	Mar		Apr		May	
(%m/m)	~~-0.2~~	*-0.1*	0.5		~~-0.2~~	*0.8*
(%oya)	-2.1		~~-2.4~~	*-2.3*	~~0.3~~	*-1.0*

Business PMI
Seasonally adjusted

	Apr	May	Jun	
Index	43.7	42.7	__	*46.2*
(%oya)	-13.9	-12.3	__	*2.2*

Consumer price index
Not seasonally adjusted

	4Q08	1Q09	2Q09	
Headline (%oya)	3.4	3.0	~~1.5~~	*1.9*
Headline (%q/q)	-0.5	0.3	~~0.2~~	*0.6*

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Global Essay

- **We are gaining confidence in our call for a sustained, simultaneous expansion in the G3 economies beginning this quarter**
- **Tight credit conditions will temper, but not prevent, a bounce in credit-sensitive durables expenditures**
- **Decline in core inflation to pick up pace even as headline inflation turns up**
- **China's boom to roll on amid slightly toned-down policy support aimed more toward consumption**
- **Likely power shift in Japan also would shift policy support to consumers**

Giving credit where credit is due

Incoming releases continue to support our view that the Americas and Europe are set to join an already established Asian economic upturn this quarter. While the recognition that a recovery is coming has increased, the sharpness of this quarter's growth swing should surprise. After declining at a nearly 10% annualized pace in each region last quarter, industrial production is expected to rise close to 10% in the Americas and 5% in Western Europe this quarter. GDP gains should be close to trend in both regions. Accompanying this bounce, US labour market and housing indicators should turn materially better. Although a component of the recent collapse in jobless claims reflects noise related to auto factory shutdowns, initial claims are expected to fall below 500,000 this quarter, signaling a moderation in job shedding toward a roughly 150,000 monthly pace. Residential construction appears to be swinging from decline to modest growth this quarter, with a big increase possible by 4Q. Behind the downshift in jobless claims is a broader move away from retrenchment by businesses, which should dominate incoming economic indicators and provide a catalyst for stabilizing labour income, lifting confidence and improving financial market conditions.

While economic momentum is expected to build and produce above-trend global GDP gains next year, the forecast represents a balance between powerful forces promoting cyclical lift and those that temper recovery. Chief among the tempering forces is the expectation that tight credit conditions will limit growth in interest-sensitive demand. Indeed, despite expectations that the US economy will grow at a 3.6%4q/4q pace in 2010, the early stage of the recovery is likely to produce a much weaker GDP gain than in the aftermath of earlier deep recessions. As a result, the US unemployment rate is expected to remain above 9% at the end of 2010, a full six quarters into the economic recovery. Globally, industrial production is set to bounce over the coming year and generate gains as fast as anytime in the past two decades. Still, manufacturing output is forecast to retrace only about 50% of its peak to trough decline by the end of 2010.

While credit conditions are expected to temper the upturn, it is important to recognize that credit-sensitive demand for housing, autos, and other durable goods will likely be the fastest growing components of demand in coming quarters. When considering the role of credit in the early stage of the expansion, three points need to be made:

- **Credit-sensitive demand already is rebounding.** During the first half of 2009, global auto sales rose 20% while other components of durable spending look to have eked out modest gains. Meanwhile, US and UK home sales have stabilized in recent months. While fiscal incentives have helped support household demand, the behavior of credit-sensitive spending suggests that the drag from the severe tightening in credit availability has faded and that good-quality credits are able to access funds.
- **US credit-sensitive spending can bounce with limited new borrowing.** With credit-sensitive spending at de-

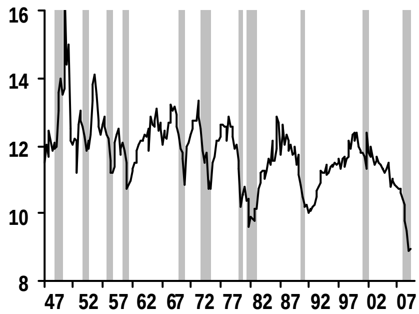
US GDP contractions and recoveries

	Total decline (%)	Gain in 1st yr of recovery (%)	Ratio
1948-49	-1.8	7.3	4.1
1953-54	-2.7	6.2	2.3
1957-58	-3.7	7.3	1.9
1960-61	-1.6	6.3	3.8
1970	-1.1	4.5	4.2
1973-75	-3.1	6.1	2.0
1980	-2.2	4.4	2.0
1981-82	-2.9	7.7	2.7
1990-91	-1.3	2.7	2.1
2001	-0.2	2.2	13.3
2008-09	-3.3	2.9	0.9

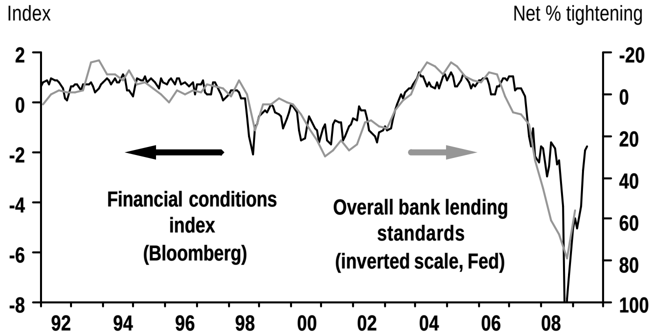
Decline is peak to trough drop in GDP associated with designated recession.

US consumer spending on durables

Percent of disposable income



Bloomberg US FCI and US bank lending standards



pressed levels, the flow of mortgage amortization and repayment of consumer debt is running above new borrowing (i.e., the stock of private-sector debt is contracting). This implies that housing and durable spending can post substantial gains in coming quarters with little or no increase in the level of private-sector debt.

- **Growth is medicinal for credit markets.** Credit conditions are dynamic and a recovery in growth should benefit credit supply and demand. The past relationship between broader financial conditions and the Fed's bank lending survey suggests that improvements already established in financial markets should be reflected in a moderation in credit tightening when the July survey is released next month.

Decline in core inflation to pick up pace

The coming months are expected to deliver divergent movements in global headline and core inflation. The steep decline in headline inflation, which lowered the global rate to an estimated 0.2%oya in June, is nearing a bottom and will reverse course as the massive negative base effect from energy prices disappears. However, even as headline inflation swings higher, core inflation should continue to fall as the extremely low and falling rate of resource utilization gradually permeates the complex of wages and prices. Indeed, by late next year, the forecast looks for core inflation to slide to nearly zero in the developed economies.

Global core inflation fell substantially during the latter part of last year, falling from a peak of 2.3%oya in September 2008 to 1.6% in January 2009. That said, a portion of the runup in core inflation in 2008 and the subsequent decline almost certainly reflects passthrough from commodity prices, especially in the US.

The decline in core inflation in the year to date has been much more gradual. In the DM, core inflation continued to fall during 1H09 in Japan, but there was only a small move down in Western Europe and core inflation did not decline at all in the US. The US story is more nuanced than that, however: core inflation has continued to drift lower after excluding recent tobacco tax hikes, notwithstanding somewhat higher sequential (i.e., %m/m) readings than expected, in the latest quarter. In the EM, core inflation fell steadily in 1H09, but this reflects a sharp dichotomy among regions, with core inflation coming down sharply in EM Asia, whereas there has been no net reduction in CEEMEA or in Latin America.

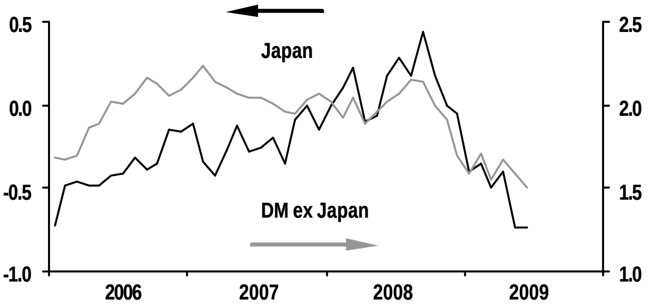
The recent stickiness in core inflation in some regions is not in conflict with our macro forecast. The 1H09 rise in global energy prices may be limiting the fall in core inflation. More important is that core inflation usually lags the business cycle, hitting its low as resource utilization returns to its long-term norm and well after the recession has ended. This certainly was the case in the previous downturn, when global core inflation did not bottom until early 2004, well after the turn in global growth. Our forecast anticipates a similar lag in this cycle.

Our forecast will be challenged if DM core inflation does not take a more convincing leg down in 2H09, led by the US and the Euro area. Should core inflation defy our forecast and remain stable, this would have important implications for monetary policy. We are forecasting that policy interest rates will remain stable across much of the globe in 2010 despite a return to above-trend growth. This policy call is premised on a substantial fall in core inflation. Stable inflation would call into question either the magnitude of the output gap or its transmission to pricing; either way, monetary policymakers will not maintain aggressive stimulus against a backdrop of above-trend growth and stable core inflation.

China is booming; stimulus being tempered with more focus on consumption

China's economy boomed in 2Q, expanding 14.9%q/q, saar (our seasonal adjustment), in line with our recently upwardly revised forecast. The June activity reports confirm continued robust domestic demand growth alongside sluggish exports. Industrial production expanded at a record pace of 40% last quarter, with inventory dynamics amplifying the bounce. Indeed, after shaving 3 points off the headline real GDP growth in 1Q09, there are reports of widespread restocking in sectors including autos and industrial metals last quarter. Following the sharp bounce, we expect more moderate growth in coming quarters as the lifts from fiscal stimulus and the inventory cycle moderate. Even so, continued rapid growth in private investment and consump-

Developed economies - CPI excluding all food and energy
%oya, both axes; US excludes tobacco



tion, together with a recovery in external demand, will sustain above-trend growth in 2H09.

Concern is rising about potential overheating and aggressive policy tightening in China. However, policymakers are unlikely to significantly alter their highly accommodative stance so long as the export engine is still sputtering and inflation pressures remained subdued. Instead, they are likely to introduce more targeted measures to temper the pace of credit creation. The central bank recently has relied more on open market operations to manage liquidity, and will increase scrutiny of new bank loans—especially short-term loans and bill financing, and use targeted central bank bills and/or window guidance to curb bank loan growth. Commercial banks in areas where property transaction volumes have recently surged have started normalizing terms for second-home buying, which were relaxed late last year. Where fiscal policy is concerned, the government is likely to shift the focus of stimulus from investment toward consumption. This would include tax or spending measures to boost employment and household income, and additional support to social infrastructure, such as health care, even as policymakers take a more cautious stance on new government construction and investment projects.

Japan on track for early election

Following the LDP's loss of the Tokyo local election, PM Aso reportedly has decided to call for the dissolution of the Diet (or Lower House) on July 21 and to schedule the general election for August 30. Odds are rising that the opposition DPJ (Democratic Party of Japan) will win, as in Tokyo. While the DPJ has not yet published its manifesto, it is expected to alter the composition of the administration's fiscal plan, emphasizing social support, including Medicare, children's programs, and education, at the expense of public works. The biggest beneficiaries of this shift would be low- to middle-income earners. Relative to the current plan, the DPJ also would increase spending in FY2010 by transferring more income to households. This might include halving the petrol tax, which likely would shave 0.5% pts from the inflation rate (in %oya terms) and eliminating highway tolls. Such measures would boost consumption in 2010, tempering our concerns that household spending will lose steam next year. One downside of such a program is increased government borrowing, and the possible knock-on effect this might have on long-term government bond yields.

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JPMorgan View - Global Markets

Patience pays

- **Portfolio strategy:** positive news and a surplus of skepticism suggest that the correction to the recovery trade is over.
- **Fixed income:** stay long EU vs US on relative supply.
- **Equities:** a positive start to the 2Q reporting season. Stay long cyclicals vs. defensives, small-cap vs. large-cap, and EM vs. DM equities.
- **Credit:** global net new issuance of corporate bonds to collapse to almost zero in 2H, from $190bn a month in 1H. We lower our year-end US HG bond spread forecast to 225bp, 55bp below today.
- **Fx:** add to dollar shorts by buying GBP, HUF and CAD.

After a month-long correction, more induced by profit-taking than a reversal of fortunes, **risky markets rallied again** last week, approaching their previous highs. US earnings surprised strongly on the upside, building on the string of supportive economic data of the past few months.

We remain in the recovery trade, which includes being outright long equities, and overweight equities and credit against government bonds. It similarly includes shorting the dollar and overweighting cyclical and higher-beta sectors and countries.

Our **comfort** with the recovery trade is not just because it is working. We find that many market participants remain skeptical and convinced there remains significant downside risks from continued deleveraging by an overstretched US consumer. We recognize this risk, but our global and data-intensive approach makes us equally aware of upside risks emanating from spending outside the US, in EM, Japan, and Europe. This implies to us that there remain a lot of investors who will be induced—through positive economic and earnings news—to join the recovery train in coming months.

We titled our last weekly "Good fundamentals, bad technicals." The impulsive nature of last week's rally in equities—gapping between Tuesday and Wednesday— and its impressive breadth—a very high ratio of advancing to declining stocks—are negating these bad technicals. It shows there are likely more shorts than we feared. As a result, our Chief Technical Strategist, Michael Krauss, believes **the correction in equities is over**.

10-yr Government bond yields

	Current	Sep 09	Dec 09	Mar 10	Jun 10
United States	3.63	3.25	3.00	3.25	3.50
Euro area	3.40	3.20	3.25	3.35	3.40
United Kingdom	3.81	4.10	4.25	4.50	4.55
Japan	1.32	1.50	1.45	1.40	1.30

Foreign exchange

	Current	Sep 09	Dec 09	Mar 10	Jun 10
EUR/USD	1.41	1.43	1.50	1.47	1.45
USD/JPY	94.1	94	96	100	103
GBP/USD	1.63	1.74	1.85	1.77	1.73

Commodities - quarterly average

	Current	3Q09	4Q09	1Q10
WTI ($/bbl)	63	60	65	65
Gold ($/oz)	938	975	1000	-
Copper($/m ton)	5271	4500	4250	-
Corn ($/Bu)	3.28	4.90	4.70	5.00

Source: J.P. Morgan, Bloomberg, Datastream.

Every bond and currency trader knows they are now in reality only trading stocks. And indeed, there seems to be only one trade out there—the recovery trade, which you can choose to buy, or sell. This lack of diversification is forcing market participants to keep position sizes low, contributing to low market liquidity. We still believe it makes sense to try and mix up risk by adding long-carry positions as implied volatility, term, and risk premia remain high relative to the likely ranges in markets. We remain long the short end of yield and credit curves, where carry is best, and overweight higher-yielding currencies.

The main capital flow in the world remains from cash to bonds, rather than to equities. But massive supply from both corporates and governments has blunted some of the price impact of this flow. Government bond supply will remain massive in 2H, at about $290bn a month by our forecasts . That said, the bond buyer is yield focused, likely slowing down the selloff in bonds once the 10-year UST yield approaches 4% again.

Much of the flow from cash to bonds has targeted **corporate** bonds. Companies and especially banks have used this opportunity to issue a lot more bonds than they needed. Our analysts report that this opportunistic issuance is likely over, and that net new corporate issuance is collapsing. In our forecasts, **net new issuance of corporate bonds across the world should drop from $190bn a month in 1H to virtually zero in 2H, putting further downward pressure on spreads.**

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Fixed income

Bonds sold off last week, largely owing to the rally in equities, but also because of ongoing supply pressures, particularly in the US. Given high uncertainty on long-term inflation, we remain **neutral on yield levels.**

Instead, we see **more clarity at the short end of curves**. In the US and Europe, low capacity utilization rates should keep policy rates low for long, while in the UK, rising inflation should force the MPC to hike rates early next year. Accordingly, **go short the short end in the UK**, and **go long the short end in the US**. In the **Euro area**, the 2-year is already pricing in low for long, and so go long the 5-year instead, which still offers attractive carry.

Equities

Stocks rebounded sharply last week helped by a good start to the **US 2Q reporting season**. Of the 43 companies in the S&P 500 that have reported so far, 29 beat estimates with a median surprise of +4%, the second consecutive quarter of bottom-line beats. Five have matched estimates, and only 9 have missed estimates.

In addition, US reporting companies are producing better **revenue** growth than expected, with median revenue growth up 5% sequentially. The topline tends to move in sync with global GDP which, by our estimates, grew at a 1% annualized pace in 2Q following a sharp contraction of 7.3% in 1Q.

Guidance has also improved. Of the companies that reported in the past two weeks, most affirmed or raised full-year earnings guidance. Only two have lowered guidance relative to prior expectations. These improvements have been more significant in Technology and Consumer Discretionary sectors, for which we continue to recommend an overweight allocation.

We continue to favour **cyclicals over defensives**, **small-cap over large-cap**, and **EM over DM** equities. EM valuations may look less compelling given the 30% outperformance vs DM since the start of the year, but this is not a reason for us to change our positive stance. We have found that valuation metrics such as PE ratios are poor trading signals for EM equities. Return momentum and IP momentum, two signals that we found to be useful, still favor EM vs DM equities. Within EM, our focus is on EM Asia and on exporters and business discretionaries, for which we see a higher chance of a positive growth surprise.

Credit

We stay **positive on US HG** owing to improving economic and earnings growth, continued strong demand for credit, with insufficient supply to meet this demand, and still attractive valuations versus historical levels.

Issuance is set to decline into 2H09 owing to fewer M&A deals to fund, cash-rich balance sheets for both banks and nonfinancials following the surge in precautionary funding in 1H, and low capital spending plans. We expect gross issuance to fall from $615bn in 1H to $300bn in 2H. More importantly for spreads, net new issuance, after redemptions, should fall from $271bn to almost zero. Lower supply and continued strong demand favour further tightening in credit spreads. As a result, we revise our year-end HG bond spread forecast to 225bp, 55bp below the current index level and 50bp below our previous forecast of 275bp. We expect the search for yield to favour financials and other wider-spread sectors.

In **Europe**, in contrast, we expect **net new issuance to rise** €25bn **, putting upward pressure on spreads**. We expect that gross new gross issuance will fall to €215bn in 2H, down from €269bn in 1H. But redemptions will fall even more. We calculate 2H redemptions (including coupon payments) to fall to €161bn from €239bn in 1H. This should put upward pressure on new issue premia in Europe, which are currently close to zero or even negative in some cases.

Alternatives

Commodities gained last week, but the rally in oil was timid compared to the jump in stock prices. Total crude and product stocks remain in surplus as demand has been unable to meet refinery output. We prefer to **remain short oil**. It is unlikely that US petrol demand will show a significant increase for the remainder of the summer driving season. We will continue to see substantial stock builds until additional production cuts are put in place.

Hedge fund regulation took centre stage once again this week as the Obama administration released details on its plan for alternative investment funds. As expected, the proposal requires SEC registration and imposes disclosure of substantial fund information on a confidential basis, including leverage. In Europe, institutional investors are turning more vocal against the current draft, as the proposed Directive effectively restricts investment options to European regulated funds. We expect US and European proposals to converge to a common structure as the discussion progresses, allowing US-managed funds to be marketed in Europe.

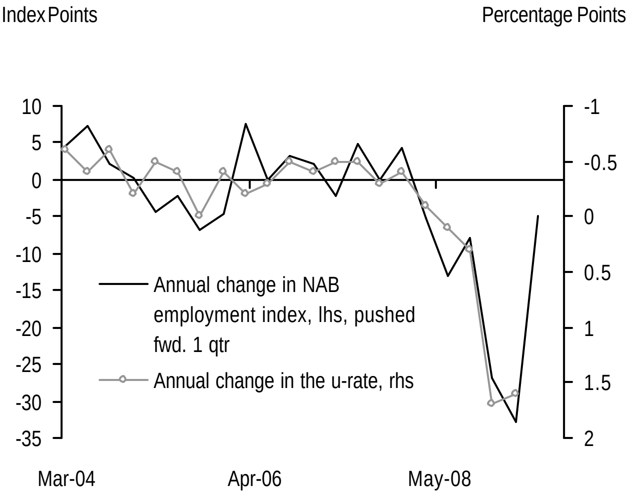
Markets - Australia and New Zealand

Below is a summary of *The Antipodean Strategist*, published weekly. The full version can be found on Morgan Markets.

Australia

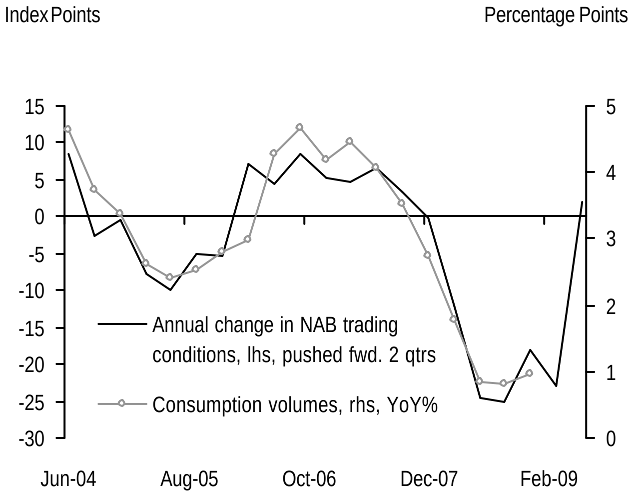
- The Australian data continues to print on the better side of expectations. Last week, the monthly NAB business survey revealed strong gains in a number of leading indicators (business conditions, employment and trading conditions). These data suggest upside risks to the labour market and consumption outcomes in coming quarters. More broadly, they add weight to the view that the next move in rates in Australia is up. Debate should now focus on when the tightening cycle will commence. The RBA Governor is speaking on 28 July. We suspect he may use this opportunity to update the market on the near term policy outlook.
- Yields have moved sharply higher as longs have been stopped out and the market failed to break key technical levels. The market remains in a medium term bearish trend; near term we prefer to play the market from the short side tactically, with the risk that 3-years trade towards the figure. This would be consistent with the market pricing in some chance of a rate hike by year end. In this context we would view Dec-09 bills as cheap at 96.50. However, risks to our short view could emerge should banks deliver a rise in variable mortgage rates or if the H1N1 pandemic escalates.
- This week, we also provide an update on the bond basis mis-pricing. Bond futures contracts continue to remain rich relative to cash bonds (around 10.5bps in 10s and 10.8bps in 3s). We continue to see a material risk of a sharp sell-off in yields ahead of or around the September futures roll. This risk reinforces our view that 10-year swap spreads should narrow, and that the AUS-US 10-year spread should widen.
- This week, we take a look at the Australian inflation market. While 10-year inflation has rallied off the lows seen earlier this year, we still remain strategic buyers of inflation. The potential for a sharp sell off in 10-year yields into the futures roll reinforces this view, given the strong correlation between 10-year nominal yields and 10-year inflation. Longer term, our analysis suggests that 10-year inflation tends to rally into the first rate hike of the cycle. Once the tightening cycle has started, investors should look to fade the rally in inflation.

There has been a marked improvement in the NAB employment index (using quarterly data)



Source: J.P. Morgan and Bloomberg

Likewise the improvement in trading conditions suggests upside for consumer spending (using quarterly data)



Source: J.P. Morgan and Bloomberg

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Global Economic Outlook Summary

	Real GDP % over a year ago			Real GDP % over previous period, saar							Consumer prices % over a year ago			
	2008	2009	2010	4Q08	1Q09	2Q09	3Q09	4Q09	1Q10	2Q10	1Q09	2Q09	4Q09	4Q10
The Americas														
United States	1.1	**-2.3**	**2.8**	-6.3	-5.5	**-1.0**	2.5	2.0	3.0	4.0	-0.2	-0.9	**1.1**	0.7
Canada	0.4	-2.3	2.3	-3.7	-5.4	-3.0	1.0	2.0	3.0	3.0	1.2	0.0	1.2	2.3
Latin America	3.8	-2.9	3.3	-8.9	**-10.1**	0.2	9.9	2.0	3.0	3.1	7.5	6.8	5.8	6.5
Argentina	6.8	-3.0	2.0	-2.0	0.2	-6.0	0.0	-4.0	6.0	6.0	6.6	7.0	6.0	10.2
Brazil	5.1	-1.0	3.5	-13.8	-3.3	4.3	5.0	3.5	3.0	3.0	5.8	5.2	4.3	4.5
Chile	3.2	-1.5	3.2	-7.9	-2.5	0.0	3.0	4.0	4.0	3.5	5.6	2.0	0.5	3.2
Colombia	2.5	-0.5	3.0	-5.9	0.9	0.0	0.8	2.1	3.5	4.3	6.6	4.6	4.1	4.5
Ecuador	6.5	-2.0	0.5	-1.0	**-6.3**	**-4.0**	-4.0	0.0	1.5	2.5	7.9	**5.5**	4.8	4.1
Mexico	1.3	-5.5	3.8	-9.8	-21.5	-1.0	21.6	2.0	2.0	2.0	6.2	6.0	4.2	3.4
Peru	9.8	2.2	4.7	-1.2	-6.2	2.5	5.5	5.0	4.8	5.5	5.6	3.5	1.5	2.0
Venezuela	4.8	-2.5	1.5	1.4	-9.3	-4.0	-2.0	0.0	2.0	3.5	29.5	28.4	31.5	37.4
Asia/Pacific														
Japan	-0.7	-5.6	2.3	-13.5	-14.2	4.5	2.0	3.5	3.0	-0.5	-0.1	-0.7	-1.3	-0.8
Australia	2.3	0.3	1.7	-2.2	1.5	2.0	-2.2	1.2	2.9	1.6	2.5	1.4	1.5	2.8
New Zealand	0.2	-2.2	2.3	-3.9	-3.9	-1.2	-0.4	2.5	3.4	2.7	3.0	1.5	1.1	2.3
Asia ex. Japan	5.8	**3.6**	6.8	**-5.2**	**2.7**	**11.2**	7.4	6.6	6.4	7.0	2.6	**1.2**	2.0	2.9
China	9.0	7.8	9.0	**1.9**	**8.3**	**14.9**	9.5	9.1	8.7	8.7	-0.6	**-1.5**	1.7	1.9
Hong Kong	2.4	-4.0	4.8	-7.4	-16.1	6.8	6.6	5.0	4.5	4.3	1.7	0.3	0.4	2.6
India	6.1	6.2	7.2	2.3	6.4	3.9	6.5	7.5	8.0	9.4	9.4	7.5	4.2	4.6
Indonesia	6.1	3.5	4.5	1.5	4.8	3.0	3.0	2.0	5.0	6.0	8.6	5.6	3.5	6.2
Korea	2.2	-1.1	3.9	-18.8	0.5	10.0	4.0	3.5	3.5	3.5	3.9	2.8	2.6	3.5
Malaysia	4.6	-3.0	4.4	-10.1	-15.1	10.0	6.1	4.5	1.6	4.9	3.7	1.5	0.3	2.4
Philippines	3.8	1.3	5.0	1.1	-8.9	8.0	6.0	6.0	5.0	4.0	6.9	4.7	3.0	3.7
Singapore	1.1	**-2.8**	**4.9**	-16.4	-14.6	**20.4**	**7.8**	2.0	0.4	4.1	2.1	-0.4	-0.7	3.6
Taiwan	0.1	-3.8	5.0	-23.8	-3.4	12.8	8.0	5.0	4.3	3.5	0.0	-0.6	0.3	2.1
Thailand	2.6	-2.6	6.1	-22.1	-7.3	13.4	7.8	4.9	3.2	8.2	-0.2	-2.7	0.5	2.4
Africa														
South Africa	3.1	-2.0	2.5	-1.8	-6.4	-2.9	1.0	2.2	3.6	4.1	8.4	7.8	6.2	4.2
Europe														
Euro area	0.6	**-4.5**	1.7	-6.9	-9.7	**-4.0**	1.5	2.0	2.5	2.0	1.0	0.2	0.6	1.1
Germany	1.0	-6.0	2.0	-8.6	-14.4	-3.0	2.0	2.5	3.0	2.0	0.8	0.1	0.3	0.3
France	0.3	-2.7	1.8	-5.7	-4.8	-2.5	1.5	2.0	2.5	2.0	0.7	-0.1	0.6	0.7
Italy	-1.0	-5.1	1.3	-8.3	-10.1	-3.5	1.0	1.5	2.0	1.5	1.4	1.0	1.0	1.0
Norway	2.5	-1.3	2.1	-3.0	-3.9	-1.0	1.5	2.0	2.5	2.5	2.4	2.7	1.0	0.4
Sweden	-0.4	-4.7	2.4	-18.5	-3.6	-1.0	2.0	3.0	3.0	2.5	0.8	-0.4	0.0	0.1
Switzerland	1.6	-1.4	1.9	-2.2	-3.2	-2.0	1.8	2.3	2.5	2.0	0.0	-0.6	0.1	0.4
United Kingdom	0.7	-4.1	1.9	-7.0	-9.3	-1.0	1.0	1.5	2.0	2.5	3.0	2.0	1.4	2.1
Emerging Europe	4.1	-5.4	**2.9**	-7.7	-17.1	**-1.5**	3.1	**3.6**	2.8	2.9	8.7	7.7	**7.0**	**5.9**
Bulgaria	6.1	**-5.0**	**-1.5**	...	...	...	...	...	...	...	...	...	...	...
Czech Republic	3.0	-3.0	2.0	-6.8	-12.9	-1.0	2.5	3.0	1.5	2.5	2.1	1.5	1.3	3.6
Hungary	0.6	-6.0	-0.5	-7.2	-9.6	-4.5	-3.2	-1.0	0.0	1.0	3.0	3.7	7.2	2.4
Poland	4.9	-1.0	1.8	0.0	1.6	-4.0	-1.0	0.0	2.5	3.0	3.3	3.8	3.0	2.2
Romania	7.1	-4.0	1.5	...	...	...	...	...	...	...	6.8	6.3	7.0	6.5
Russia	5.6	-8.5	4.5	-11.6	-30.3	0.0	6.5	6.5	4.0	3.5	13.9	12.5	11.0	9.2
Turkey	1.1	-4.7	3.0	...	...	...	...	...	...	...	8.4	5.7	5.0	4.9
Global	1.5	-2.7	2.9	-7.3	**-7.2**	**0.5**	3.0	2.8	3.2	3.1	1.4	0.6	**1.3**	1.5
Developed markets	0.7	**-3.5**	2.3	-7.5	-8.1	**-1.1**	1.9	2.2	2.8	2.5	0.5	-0.3	**0.6**	0.8
Emerging markets	4.9	0.3	5.2	**-6.4**	**-3.5**	6.3	7.3	4.9	5.0	5.3	5.0	3.9	3.9	**4.3**

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Global Central Bank Watch

	Official interest rate	Current	Change from Aug '07 (bp)	Last change	Next meeting	Forecast next change	Sep 09	Dec 09	Mar 10	Jun 10	Dec 10
Global	GDP-weighted average	1.36	-335				1.33	1.32	1.34	1.36	1.45
excluding US	GDP-weighted average	1.94	-249				1.90	1.89	1.91	1.94	2.07
Developed	GDP-weighted average	0.48	-366				0.48	0.48	0.50	0.52	0.57
Emerging	GDP-weighted average	4.85	-215				4.70	4.67	4.68	4.71	4.92
Latin America	GDP-weighted average	6.00	-281				5.79	5.79	5.79	5.82	5.96
CEEMEA	GDP-weighted average	5.93	-108				5.55	5.41	5.47	5.55	5.67
EM Asia	GDP-weighted average	4.01	-231				3.97	3.97	3.97	3.97	4.24
The Americas	GDP-weighted average	0.78	-481				0.76	0.76	0.76	0.76	0.77
United States	Federal funds rate	0.125	-512.5	16 Dec 08 (-87.5bp)	12 Aug 09	on hold	0.125	0.125	0.125	0.125	0.125
Canada	Overnight funding rate	0.25	-425	21 Apr 09 (-25bp)	21 Jul 09	on hold	0.25	0.25	0.25	0.25	0.25
Brazil	SELIC overnight rate	9.25	-225	10 Jun 09 (-100bp)	22 Jul 09	22 Jul 09 (-50bp)	8.75	8.75	8.75	8.75	8.75
Mexico	Repo rate	**4.50**	-275	**17 Jul 09 (-25bp)**	21 Aug 09	**on hold**	4.50	4.50	4.50	4.50	4.50
Chile	Discount rate	0.50	-500	9 Jul 09 (-25bp)	13 Aug 09	on hold	0.50	0.50	0.50	1.00	3.50
Colombia	Repo rate	4.50	-475	19 Jun 09 (-50bp)	24 Jul 09	on hold	4.50	4.50	4.50	4.50	4.50
Peru	Reference rate	2.00	-275	9 Jul 09 (-100bp)	6 Aug 09	6 Aug 09 (-50bp)	1.50	1.50	1.50	1.50	1.50
Europe/Africa	GDP-weighted average	1.50	-309				1.45	1.44	1.48	1.53	1.62
Euro area	Refi rate	1.00	-300	7 May 09 (-25bp)	6 Aug 09	on hold	1.00	1.00	1.00	1.00	1.00
United Kingdom	Repo rate	0.50	-525	5 Mar 09 (-50bp)	6 Aug 09	1Q 10 (+25bp)	0.50	0.50	0.75	1.00	1.50
Sweden	Repo rate	0.25	-325	2 Jul 09 (-25bp)	3 Sep 09	on hold	0.25	0.25	0.25	0.25	0.25
Norway	Deposit rate	1.25	-350	17 Jun 09 (-25bp)	12 Aug 09	on hold	1.25	1.25	1.25	1.25	1.25
Czech Republic	2-week repo rate	1.50	-175	7 May 09 (-25bp)	6 Aug 09	6 Aug 09 (-25bp)	1.25	1.25	1.75	2.50	3.50
Hungary	2-week deposit rate	9.50	175	19 Jan 09 (-50bp)	27 Jul 09	27 Jul 09 (-50bp)	8.50	8.00	7.50	7.00	7.00
Israel	Base rate	0.50	-350	23 Mar 09 (-25bp)	27 Jul 09	4Q 09 (+50bp)	0.50	1.00	2.00	3.00	4.00
Poland	7-day intervention rate	3.50	-125	24 Jun 09 (-25bp)	29 Jul 09	30 Sep 09 (-25bp)	3.25	3.25	3.25	3.25	3.25
Romania	Base rate	9.00	200	30 Jun 09 (-50bp)	4 Aug 09	4 Aug 09 (-50bp)	8.50	8.50	8.00	7.50	7.00
Russia	1-week deposit rate	6.75	350	4 Jun 09 (-50bp)	3Q 09	3Q 09 (-50bp)	6.25	5.75	5.75	5.75	5.75
South Africa	Repo rate	7.50	-250	28 May 09 (-100bp)	13 Aug 09	on hold	7.50	7.50	7.50	7.50	7.50
Switzerland	3-month Swiss Libor	0.25	-225	12 Mar 09 (-25bp)	17 Sep 09	on hold	0.25	0.25	0.25	0.25	0.25
Turkey	Overnight borrowing rate	**8.25**	-925	**16 Jul 09 (-50bp)**	18 Aug 09	**18 Aug 09 (-25bp)**	8.00	8.00	8.00	8.00	8.00
Asia/Pacific	GDP-weighted average	2.05	-149				2.03	2.03	2.03	2.05	2.24
Australia	Cash rate	3.00	-350	7 Apr 09 (-25bp)	4 Aug 09	1 Jun 10 (+25bp)	3.00	3.00	3.00	3.25	4.25
New Zealand	Cash rate	2.50	-575	30 Apr 09 (-50bp)	30 Jul 09	8 Jul 10 (+25bp)	2.50	2.50	2.50	2.50	3.50
Japan	Overnight call rate	0.10	-40	19 Dec 08 (-20bp)	11 Aug 09	on hold	0.10	0.10	0.10	0.10	0.10
Hong Kong	Discount window base	0.50	-625	17 Dec 08 (-100bp)	13 Aug 09	on hold	0.50	0.50	0.50	0.50	0.50
China	1-year working capital	5.31	-171	22 Dec 08 (-27bp)	2Q 09	4Q 10 (+27bp)	5.31	5.31	5.31	5.31	5.58
Korea	Base rate	2.00	-300	12 Feb 09 (-50bp)	11 Aug 09	on hold	2.00	2.00	2.00	2.00	2.50
Indonesia	BI rate	6.75	-150	3 Jul 09 (-25bp)	3 Aug 09	on hold	6.75	6.75	6.75	6.75	6.75
India	Repo rate	4.75	-300	21 Apr 09 (-25bp)	28 Jul 09	28 Jul 09 (-25bp)	4.50	4.50	4.50	4.50	5.00
Malaysia	Overnight policy rate	2.00	-150	24 Feb 09 (-50bp)	29 Jul 09	on hold	2.00	2.00	2.00	2.00	2.00
Philippines	Reverse repo rate	4.00	-200	9 Jul 09 (-25bp)	20 Aug 09	on hold	4.00	4.00	4.00	4.00	4.00
Thailand	1-day repo rate	1.25	-200	8 Apr 09 (-25bp)	26 Aug 09	on hold	1.25	1.25	1.25	1.25	1.25
Taiwan	Official discount rate	1.25	-188	18 Feb 09 (-25bp)	3Q 09	on hold	1.25	1.25	1.25	1.25	1.25

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

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Economic forecasts - Australia

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

				2008			2009				2010			
	2008	2009	2010	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Chain volume GDP	2.3	0.3	1.7	1.4	0.9	-2.2	1.5	2.0	-2.2	1.2	2.9	1.6	2.9	3.6
Private consumption	2.2	0.5	0.6	-0.5	0.3	1.2	2.3	0.0	-2.4	-0.8	1.2	1.6	2.4	2.0
Construction investment	5.2	-3.2	2.6	1.7	6.5	-0.5	-11.5	-6.0	0.0	3.0	3.3	2.0	4.9	9.8
Equipment investment	15.7	-15.9	-9.7	36.8	1.4	-1.7	-33.1	-28.2	-19.3	-4.1	-10.0	-12.0	0.0	8.6
Public investment	12.0	-0.8	9.6	3.7	18.9	-11.1	-9.5	2.4	5.4	7.1	9.7	11.9	14.4	15.3
Government consumption	3.7	1.4	4.2	5.3	2.3	1.0	1.4	0.1	0.5	3.7	5.6	6.0	5.0	4.7
Exports of goods & services	3.9	-2.5	0.3	10.5	-3.4	-3.3	11.1	-16.8	-7.8	-3.9	2.0	6.1	8.2	10.4
Imports of goods & services	10.3	-11.3	0.5	15.7	2.6	-27.0	-25.2	4.1	-2.0	-7.8	-3.9	4.1	8.2	21.6
Contributions to GDP growth:														
Domestic final sales	4.4	-1.7	1.6	4.9	2.5	-3.6	-7.1	2.5	-2.5	0.7	1.9	2.0	3.8	4.8
Inventories	-0.6	-0.2	0.1	-1.9	-0.2	-5.4	0.1	4.2	1.5	-0.4	-0.3	-0.7	-0.7	1.1
Net trade	-1.5	2.2	0.0	-1.5	-1.4	7.1	9.0	-4.6	-1.2	0.9	1.2	0.3	-0.1	-2.2
GDP deflator (%oya)	6.7	2.0	1.8	6.7	8.5	7.5	5.1	2.5	0.3	0.3	1.8	1.7	1.7	2.0
Consumer prices (%oya)	4.4	1.5	2.4	4.5	5.0	3.7	2.5	1.4	0.7	1.5	2.1	2.3	2.6	2.8
Producer prices (%oya)	8.3	-3.5	0.7	8.7	10.9	6.7	-1.0	-4.4	-5.4	-2.8	1.1	0.5	0.4	1.0
Trade balance (A$ bil, sa)	-4.2	-13.3	-25.2	-2.1	1.4	4.4	4.6	-4.6	-6.3	-7.1	-7.3	-6.2	-5.9	-5.8
Current account (A$ bil, sa)	-67.0	-59.6	-74.2	-14.8	-9.7	-6.4	-4.6	-16.8	-18.7	-19.6	-19.8	-19.2	-17.9	-17.3
as % of GDP	-6.2	-4.9	-5.9	-5.0	-3.2	-2.1	-1.5	-5.5	-6.2	-6.4	-6.4	-6.2	-5.7	-5.4
3m eurodeposit rate (%)*	6.0	3.6	4.9	7.8	7.0	4.1	3.1	3.2	4.1	4.0	4.6	4.7	5.0	5.1
10-year bond yield (%)*	5.6	5.1	5.7	6.5	5.4	4.0	4.4	5.4	5.4	5.4	5.8	5.6	5.7	5.7
US$/A$*	0.75	0.77	0.86	0.74	0.77	0.65	0.68	0.75	0.82	0.83	0.84	0.85	0.86	0.87
Commonwealth budget (FY, A$ bil)	13.5	-35.0	-68.0											
as % of GDP	1.1	-2.9	-5.4											
Unemployment rate	4.2	6.4	8.7	4.2	4.3	4.5	5.3	5.7	6.9	7.7	8.3	8.7	8.9	9.0
Industrial production	2.0	-7.4	3.5	-0.1	-4.9	-17.3	-12.7	-2.0	1.0	3.0	6.0	4.0	2.0	0.0

*All financial variables are period averages

Australia - summary of main macro views

- Australia is in **recession** even though we avoided back-to-back falls in GDP—GDP probably will fall in 3Q in the absence of new fiscal stimulus, and as other support (i.e. the investment allowance) is wound back.
- We expect a **sustained fall in business investment**, particularly mining, which will force down employment.
- With **labour force participation falling** only slowly, the jobless rate will soar to 9% by end-2010. The sustained fall in hours worked is a leading indicator of firms trimming employment.
- On **housing**, the expanded first home owners' grant has sucked forward buyers from 2010. The mini-boom will end in tears in 2010 as the jobless rate rises and house prices fall.
- The still **fragile consumer** is yet to be fully tested—households have been on financial "life support" from the RBA and the government's fiscal support.
- **Export volumes** have held up owing mainly to firm demand from Asia, but the terms of trade is tumbling.
- The **RBA** is comfortably on hold, but the next move in the official cash rate will be up in the middle of 2010, even though the jobless rate will not yet have peaked.
- Having front-loaded the **policy support**, the government is unlikely to deliver more significant fiscal stimulus.

Economic forecasts - New Zealand

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

				2008			2009				2010			
	2008	2009	2010	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Real GDP (1995-96 prices)	0.2	-2.2	2.3	-0.9	-2.0	-3.9	-3.9	-1.2	-0.4	2.5	3.4	2.7	3.2	3.7
Private consumption	0.1	-1.6	1.7	-0.9	-0.5	-1.0	-5.3	-3.1	2.2	5.2	1.0	0.5	1.2	2.5
Fixed Investment	-3.7	-19.7	-1.1	5.6	-26.2	-22.5	-27.0	-19.7	-10.6	-4.6	2.5	4.6	5.8	7.7
Residential construction	-17.1	-18.2	3.6	-27.2	-25.6	-45.8	-1.2	-8.0	-4.0	2.0	4.8	7.2	10.0	8.0
Other fixed investment	-0.3	-20.1	-2.1	14.7	-26	-16.7	-31.2	-22.0	-12.0	-6.0	2.0	4.0	4.8	7.6
Inventory change (NZ$ bil, saar)	1.4	-0.2	0.4	0.3	0.5	0.2	-0.2	0.0	0.0	0.1	0.1	0.1	0.1	0.1
Government spending	3.9	2.2	1.8	1.6	1.6	6.2	1.4	0.8	1.2	2.0	1.6	2.0	2.8	1.2
Exports of goods & services	-1.5	-3.5	7.2	0.4	-11.5	-11.9	2.3	-1.1	-2.5	5.2	10.0	15.0	7.0	9.0
Imports of goods & services	2.5	-17.0	3.4	13.4	-24.4	-23.6	-30.2	-10.0	-1.0	6.5	4.0	5.0	5.0	8.0
Contributions to GDP growth:														
Domestic final sales	1.3	-6.4	0.8	5.0	-11.0	-6.1	-11.6	-6.3	-0.8	2.6	1.4	-0.4	2.4	3.3
Inventories	0.4	-1.2	0.5	-0.9	2.4	-3.7	-4.8	2.1	0.9	0.4	0.3	0.2	0.2	0.1
Net trade	-1.4	5.4	1.1	-4.8	7.3	6.1	13.7	3.1	-0.5	-0.5	1.7	2.9	0.6	0.3
GDP deflator (%oya)	3.6	3.7	3.0	3.7	2.1	2.5	2.4	3.9	5.4	3.1	2.8	3.0	3.1	3.1
Consumer prices	4.0	1.1	1.7	6.7	6.2	-1.8	1.1	0.7	0.7	2.0	1.3	1.7	2.4	3.8
%oya	4.0	1.4	1.7	4.0	5.1	3.4	3.0	1.5	0.2	1.1	1.2	1.4	1.8	2.3
Trade balance (NZ$ bil, sa)	-2.2	-2.6	1.5	-1.1	-0.8	-0.1	0.9	-0.5	-1.3	-1.7	-1.3	0.1	1.3	1.4
Current account (NZ$ bil, sa)	-16.0	-13.5	-17.4	-4.7	-4.0	-3.7	-4.1	-2.7	-3.1	-3.6	-4.4	-5.2	-4.4	-3.4
as % of GDP	-9.0	-7.6	-7.1	-10.5	-9.1	-8.3	-6.0	-6.8	-8.0	-9.6	-9.5	-7.1	-5.4	-6.5
Yield on 90-day bank bill (%)*	7.9	2.8	3.1	8.8	8.2	6.0	2.8	2.8	2.8	2.8	3.0	3.1	3.1	3.1
10-year bond yield (%)*	6.0	5.0	5.8	6.5	5.9	5.3	4.1	5.4	5.4	5.1	5.5	6.0	6.0	6.0
US$/NZ$*	0.71	0.60	0.66	0.78	0.71	0.58	0.51	0.64	0.62	0.64	0.65	0.66	0.67	0.67
Commonwealth budget (NZ$ bil)	-3.0	-8.9	-9.8											
as % of GDP	-1.7	-4.9	-5.1											
Unemployment rate	4.2	6.1	7.6	4.0	4.3	4.7	5.0	5.8	6.5	7.1	7.5	7.7	7.8	7.5

*All financial variables are period averages

New Zealand - summary of main macro views

- The New Zealand economy was in a homegrown **recession** before the worst of the international troubles unfolded.
- The economy already has contracted for five straight quarters. We forecast another two quarters of negative GDP growth, with mild positive growth forecast for 4Q.
- **Business confidence** recently has improved, though firms' investment will remain a drag on GDP growth; this, of course, has negative implications for the employment outlook.
- The prolonged decline in **private consumption** is set to continue for some time yet. The recession has altered consumer behaviour, leading consumers toward increased saving rather than spending.
- **Increased anxiety about job security** probably is the strongest headwind facing consumers. We expect the unemployment rate to peak close to 8% in 2010.
- The **RBNZ** has delivered 575bp of policy easing since mid-2008. We believe that the OCR, currently at 2.5%, is the terminal cash rate in this cycle, and the RBNZ will begin tightening policy in mid-2010.

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Australia and New Zealand economic calendar

Monday	Tuesday	Wednesday	Thursday	Friday
20 Jul **Australia :** PPI (11:30 am) 2Q 3.0 %oya	**21 Jul** **Australia :** New motor vehicles sale (11.30 am) Jun **New Zealand :** Visitor arrivals (10:45 am) Jun Credit card spending (3:00 pm) Jun	**22 Jul** **Australia :** CPI (11:30 pm) 2Q 1.7%oya	**23 Jul**	**24 Jul**
27 Jul	**28 Jul** **New Zealand :** Trade balance (10:45 am) Jun	**29 Jul** **New Zealand :** NBNZ business conf. (3:00 pm) Jul Building permits (10:45 am) Jun	**30 Jul** **Australia :** Building approvals (11:30 am) Jun **New Zealand :** RBNZ official cash rate (9:00 am) Jul	**31 Jul** **Australia :** Pvt. sector credit (11:30 am) Jun
3 Aug **Australia :** ANZ job ads (11:30 am) Jul Retail sales (11:30am) Jun	**4 Aug** **Australia :** House price index (11:30 am) 2Q RBA cash target (2:30 pm) Aug **New Zealand :** ANZ comm. Price (3:00 pm) Jul Private sector labor cost index (10:45 am) 2Q	**5 Aug** **Australia :** Trade balance (11:30 am) Jun	**6 Aug** **Australia :** Unemployment rate (11:30 am) Jul **New Zealand :** Unemployment rate (10:45 am) 2Q	**7 Aug**
10 Aug **Australia :** Housing finance approvals (11:00 am) Jun **New Zealand :** QV house prices Jul	**11 Aug** **Australia:** NAB bus. Confidence (11:30 am) Jul	**12 Aug** **Australia :** Westpac consumer confidence (10:30 am) Aug Labor price index (11:30 am) 2Q	**13 Aug** **Australia :** Consumer inflation expectation (11:00 am) Aug	**14 Aug** **New Zealand :** Retail sales (10:45 am) Jun

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Global Data Diary

Week / Weekend	Monday	Tuesday	Wednesday	Thursday	Friday
20 - 24 July	**20 July**	**21 July**	**22 July**	**23 July**	**24 July**
	Russia • Retail sales (Jun)	**Canada** • BoC meeting **Japan** • Department store sales (Jun) • BoJ minutes **United States** • Bernanke presents semiannual monetary policy report to the House	**Australia** • CPI (2Q) **Brazil** • COPOM meeting **Euro area** • Industrial orders (May) **France** • Cons of mfg goods (Jun) **Japan** • BoJ bank loan officers survey (2Q) **United Kingdom** • MPC minutes **United States** • FHFA HPI (May) • Bernanke presents semiannual monetary policy report to Senate	**Belgium** • BNB bus survey (Jul) **France** • INSEE bus survey (Jul) **Japan** • Trade balance (Jun) **Poland** • Retail sales (Jun) **Taiwan** • Export orders (Jun) • IP (Jun) **United Kingdom** • Retail sales (Jun) **United States** • Existing home sales (Jun)	**Colombia** • BanRep meeting **Euro area** • PMI flash (Jul) **Germany** • IFO bus survey (Jul) **Japan** • All sector activity (May) **Korea** • GDP (2Q) **United Kingdom** • GDP advance (2Q) **United States** • Consumer sent (Jul) • Bernanke town hall on Sunday
27 - 31 July	**27 July**	**28 July**	**29 July**	**30 July**	**31 July**
China • PMI mfg (Jul) **United Kingdom** • Nationwide HPI (Jul)	**Euro area** • M3 (Jun) **Germany** • CPI prelim (Jul) **Hungary** • NBH meeting **Israel** • BoI meeting **United States** • New home sales (Jun)	**India** • RBI meeting **United States** • S&P/C-S HPI (May)	**Euro area** • Bank lending surv (2Q) **Italy** • ISAE bus survey (Jul) **Japan** • Retail sales (Jun) • Shoko Chukin (Jul) **Malaysia** • BNM meeting **Poland** • NBP meeting **South Africa** • CPI (Jun) **United Kingdom** • M4 lending (Jun) **United States** • Beige Book • Durable goods (Jun)	**Euro area** • EC bus survey (Jul) • EC cap util (3Q) **Germany** • Labor mkt report (Jul) **Japan** • IP prelim (Jun) **New Zealand** • RBNZ meeting	**Canada** • Monthly GDP (May) **Euro area** • HICP flash (Jul) • Unemployment (Jun) **Japan** • CPI (Jun) • Hhold spending (Jun) • PMI mfg (Jul) • Unemployment (Jun) **Korea** • IP (Jun) **Sweden** • GDP prelim (2Q) **United States** • Chicago PMI (Jul) • Employ cost index (2Q) • GDP advance (2Q)

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