J.P.Morgan

Australia and New Zealand - Weekly Prospects

Summary

- In an otherwise quiet week in **Australia**, the minutes from the RBA's last Board meeting two weeks ago will be released on Tuesday. Hopefully, they will explain in detail the reasons behind the Board's adoption of a more hawkish tone in the statement announcing the decision to leave the cash rate steady at the "emergency" setting of 3%. The retail and employment data last week was on the soft side, but business and consumer confidence bounced, as did job advertisements. We maintain our view, therefore, that the RBA's first rate hike probably will be announced at the next Board meeting in early October. This is provided we see further improvement in conditions offshore and avoid a sharp reversal in key domestic economic indicators. The economy has flown into a post-stimulus "air-pocket", but the longer term outlook is brightening, thanks mainly to a bulging mining investment pipeline. Indeed, this week we are pushing through an upgrade to the 2010 growth forecast to 2.9%, from 2.0%.

- We expect the **RBNZ's** next tightening cycle will not begin until mid-2010. RBNZ Governor Bollard last week maintained a dovish tone in the statement announcing his decision to leave the cash rate steady at 2.5% for the sixth straight month. He reiterated that the official cash rate will remain "at or below" current levels until the end of 2010. Our forecast calls for the first rate hike to be delivered in July next year.

- We are forecasting **US** August core CPI to fall 0.1%m/m this week, an event that would represent the first monthly price decline in more than a quarter century. While price discounts due to the "Cash for Clunkers" scheme are contributing to this decline, the details of the report are likely to reinforce the message that the underlying inflation trend in the developed world remains decidedly downward. For the US and Euro area, core inflation is expected to breach historical lows—falling below 1% next year. In Japan, we also forecast new lows with core prices expected to drop 1.5% in 2010.

- It may seem unusual to anticipate falling core inflation in the **G-3** alongside our expectations of sustained above-trend growth, firming global commodity prices, and a continued fall in G-3 currencies vis a vis emerging markets. But these are unusual times. No expansion during the post-World War II era has taken hold with a sharper contrast between the depressed level of developed world activity and the strong lift in global growth expected over the coming quarters. As a result, the macroeconomic landscape is delivering a number of counterintuitive outcomes.

- **China's** August data provided few surprises, confirming that growth remains strong with a rotation in demand away from public investment underway. Like other countries in EM Asia, China's manufacturing surge is waning, but the August IP reading is putting 3Q09 on track for a still-buoyant quarterly growth rate of 18%ar. CPI deflation eased as expected due to a jump in food prices, while the decline in nonfood prices fell just 2.0%oya. We expect China's headline CPI to start rising later this year, owing to fading base effects, continued resource price liberalization, and food price increases.

This week's highlight

Tuesday's release of the minutes of the RBA's September Board meeting is the modest highlight. The Board meeting pre-dated the flood of data in recent weeks, but delivered a more hawkish tone to the official commentary.

Sep 14, 2009

Contents

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Data and event previews - Australia and New Zealand

Date	Time [a]	Data/event	Forecast JPMorgan	Forecast Consensus [b]	Previous
Tuesday, September 15	8.45am	NZ manufacturing activity (%q/q, 2Q)	**na**	na	*-0.9*
Tuesday, September 15	11.30am	Aust. dwelling starts (%q/q, 2Q)	**6.0**	2.0	*-4.0*
Tuesday, September 15	11.30am	RBA Board minutes (Sep.)	**na**	na	*na*
Wednesday, September 16	11.00am	Aust. Westpac leading index (%m/m, Jul.)	**na**	na	*0.7*
Thursday, September 17	11.30am	RBA Bulletin (Sep.)	**na**	na	*na*

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

Australia

Dwelling starts (%q/q, 2Q) - The number of housing starts probably rose a healthy 6%q/q in 2Q, after five straight quarters of decline. Our forecast derives partly from the solid 6.5%q/q gain in building approvals in the June quarter, the first quarterly rise after five quarters of falls.

RBA Board minutes (Sep.) - The RBA Board minutes will explain the reasons behind the Board's more hawkish tone in the statement announcing the decision to leave the cash rate steady at 3%. We expect the more upbeat verbiage will be justified by improved conditions offshore, an expectation that inflation will fall below the RBA's target range only for a short period, and the improved domestic business investment outlook. Unfortunately, though, the minutes are dated - they pre-date, for example, the extensive run of economic data in recent weeks.

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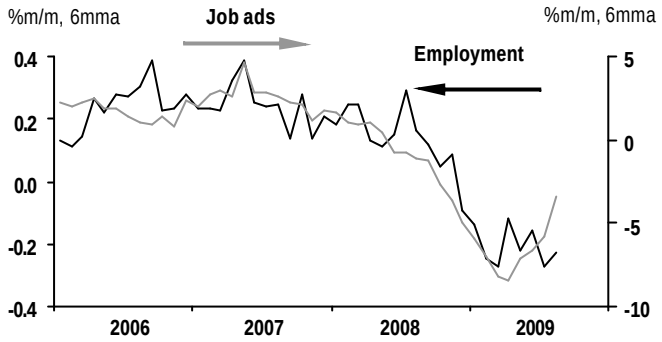
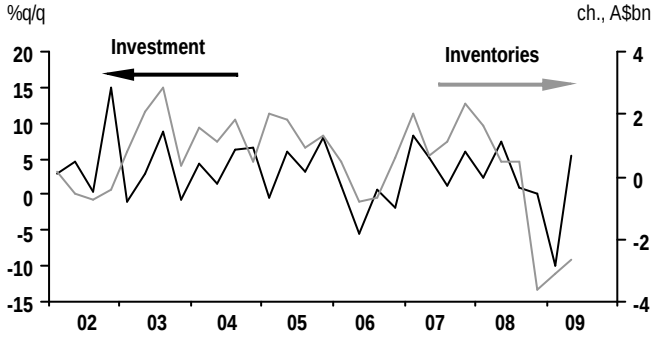
Feature charts

Australia: full-time employment and ANZ job advertisements



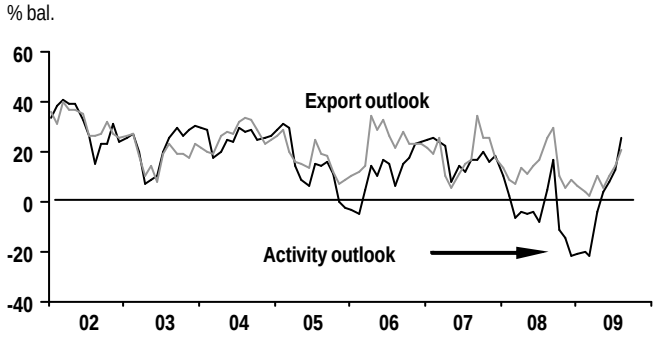
While job shedding has been less intense in Australia than the fall in hours worked, hiring has been weak over the last year. The recent turn in the ANZ job advertisements series, however, signals that employment prospects are firming, in line with recent upgrades to firms' investment spending plans. Growth in new hires in 2010 is vital for capping the rise in the unemployment rate, which will be inflated in the meantime by elevated labour force participation.

Australia: plant and machinery investment and change in inventories



As the economy entered recession in 4Q08, firms cut back on investment and began aggressively reducing inventories in anticipation of weak demand. Investment in plant and equipment then spiked just before the expiry of the government's expanded investment allowance scheme in June. The inventory numbers reaffirm that the strength in investment indeed is stimulus-induced and will be temporary—a significant proportion of the inventory drawdown was by producers of capital goods.

New Zealand: NBNZ business confidence survey



Over the history of the NBNZ business confidence survey, the outlook for exports and general activity have diverged somewhat. While the measures tend to move in the same direction, increasing differences in levels indicate other factors at play, and a reduction in firms' exposure to the external sector. RBNZ Governor Bollard is keen to address this situation, repeatedly voicing that New Zealand's economic recovery should be export-led.

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Australia

- **Consumer data softer than in previous months**
- **But unemployment rate was steady in August**
- **RBA to be unsurprised by weaker data, and will raise rates in October**

The string of consumer-related data in Australia last week was a mixed bag. Strong business and consumer confidence numbers were overshadowed later by weak retail sales and home loans data. The labour force survey unexpectedly showed a steady jobless rate in August, but a sharp fall in full-time jobs. The data generally were in line with our expectations, so have not altered our view that the first RBA rate hike will be delivered early next month.

More hawkish RBA minutes on agenda

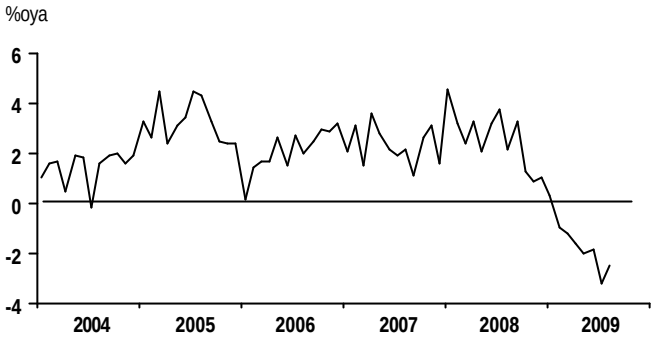
The week ahead is quieter in terms of Aussie data, but the minutes from the RBA's last Board meeting two weeks ago will be released Tuesday. They will explain the reasons behind the Board's more hawkish tone in the statement announcing the decision to leave the cash rate steady at 3%. We expect the more upbeat verbiage will be justified by improved conditions offshore, concerns that inflation will fall below the RBA's target range only for a short period, and the improved domestic business investment outlook.

We maintain our view that the RBA's first rate hike will be announced at the next Board meeting in early October. We are likely to continue to see sustained improvement in conditions offshore and avoid a sharp reversal in key domestic economic indicators. Indeed, the domestic economic data may have been soft last week in comparison to previous months, but is inconsistent with the current "emergency" setting for official interest rates. We look for a 25bp rate hike in October and another 25bp rate hike before year-end, provided the early stages of the transition to weaker data is orderly, as it has been so far. We forecast weaker consumer-related data given that the positive impact of the government's fiscal stimulus is fading.

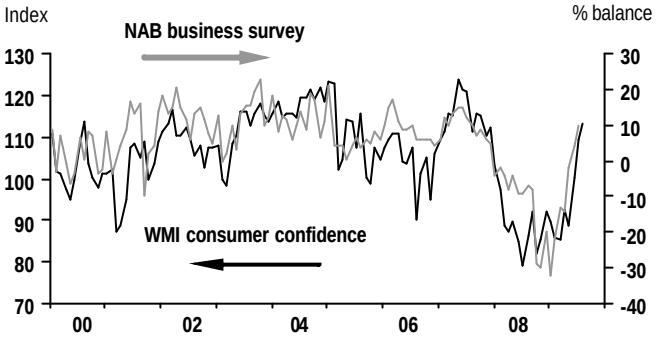
Dwelling starts probably rose solidly in 2Q

The number of housing starts probably rose 6%q/q in 2Q, after five straight quarters of decline. New commencements have, until now, remained under pressure from the lingering impact of the global credit crunch, the dampening impact of excessive red tape in the building sector, and the still sluggish rate of local council approvals. Now, though, housing market activity appears to be picking up. Building approvals, for example, jumped 6.5%q/q in 2Q, finally rising in the wake of the government's decision to expand the first home buyers grant in October last year and following the RBA's assertive interest rate cuts.

Australia: aggregate hours worked



Australia: consumer confidence and business confidence



Full-time jobs continue to be cut

The labour force survey showed that employment in Australia slumped 27,100 in August (J.P. Morgan and consensus -15,000), a payback for the unexpected 33,600 rise in July. The lower than expected participation rate meant the jobless rate held steady at 5.8% for the third straight month, bucking expectations for a mild rise.

The shift from full-time to part-time work continued as expected, with the fall in employment in August owing entirely to a drop in full-time jobs (-30,800). Part-time jobs rose 3,800. With firms becoming more upbeat about the economic outlook, however, this casualization of the labour force should have run its course by year-end. Until then, the number of hours worked will continue to fall, as they have done on a year-ago basis for seven straight months. Hours worked fell another 0.3%m/m in August, or 2.5%oya.

We maintain our forecast that the unemployment rate will rise steadily in coming months, providing that the participation rate remains near current levels of 65.1%. We have flagged for some time that the unemployment rate will be inflated by an elevated level of labour force participation,

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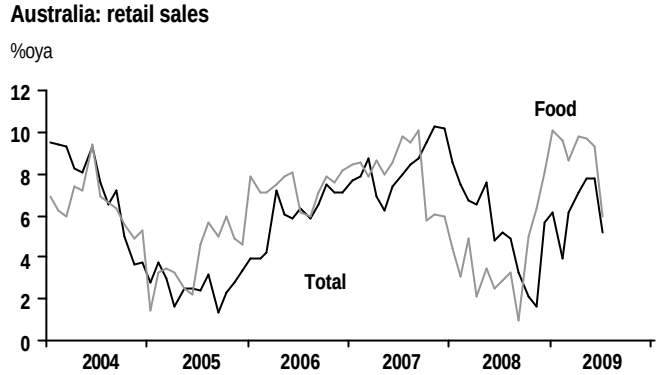
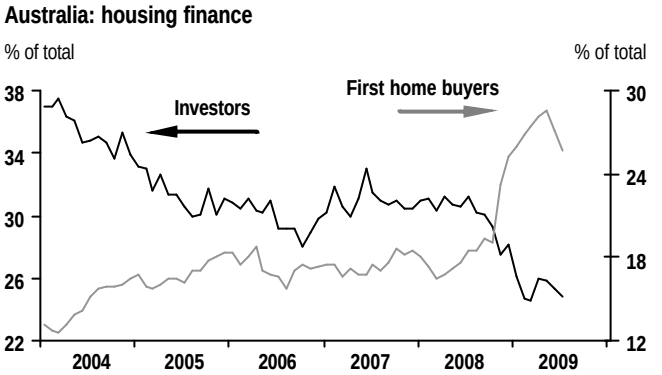
which we think will hold up, owing to older workers staying in the workforce and solid migration inflows. Older workers are staying in the work force for longer in order to resurrect their retirement funds, and migration flows remain solid as workers have returned from offshore, where economic conditions have been much worse than those experienced domestically.

With the light at the end of the economic tunnel becoming brighter, employers probably will retain staff they previously shifted to part-time work during the year. It is more expensive to rehire and retrain new staff, so firms will retain existing staff, in a bid to reduce labour costs further down the track. The other key reason that prompted the downgrade to our peak unemployment rate forecast was that firms are feeling more optimistic about the economic outlook, with managers now expecting private investment to fall "just" 10% in the year ended June 2010, much less than indicated earlier this year. Investment is one of the main drivers of job creation in the economy—the still cautious attitude of many managers means the jobless rate will continue to climb—but the resulting squeeze on labour income may not be as severe a headwind for households as we previously thought.





Lower food prices drag down retail values

After falling 0.8%m/m in June, retail sales values slumped 1.0% in August (J.P. Morgan 0, consensus +0.5%). The weakness again owed to heavy discounting among retailers, rather than tumbling volumes, and also to lower food prices. Food retailing, accounting for 40% of the retail sales index, fell 1.9%m/m in July, marking the biggest fall since January 2005. Ex-food sales, retail sales values were down just 0.5%m/m.

Spending on discretionary items was slightly stronger than in the previous month. Department store sales grew solidly (+2.5%) and clothing sales fell mildly (-0.6%), both recovering from large falls in the previous month. Household goods retailing was down sharply, however, falling 3.6%m/m. With the real test for consumer ahead, discretionary sales probably will pullback going forward. Household spending will be subdued in 2H09, with no new stimulus expected, unemployment to rise, and higher mortgage rates to eat into households' disposable incomes.

Home loan demand finally tumbles

After several months of solid gains, the number of home loans issued tanked 2.0%m/m in July (J.P. Morgan -3.0%, consensus -1.5%), a big contrast to the 3.1% average increase in the nine months since October last year when the first home buyers' (FHBs') was expanded. The impact of the expanded grant is evidenced by the significant rise in the value of home loans for owner-occupiers since October 2008. FHBs accounted for a smaller proportion of all loans issued in July, making up 26% of all loans (down from 27%), but with the expanded portion of the grant to be phased out during the latter six months of the year, bank lending standards remaining tight, and mortgage rates to rise, home loan demand from FHBs should be even more subdued.

More subdued home loan demand will be welcome news to the RBA. RBA officials not too long ago flagged that there were excesses forming at the lower end of the house price spectrum. Governor Stevens highlighted risks in the housing market, suggesting that higher housing demand simply may push up prices, rather than help create new dwellings. Considering the chronic shortage of housing supply in Australia, this would, in the words of Stevens, create more "risks of problems of over-leverage and asset price deflation down the track."

Consumers more upbeat after GDP data

Australia's Westpac-Melbourne Institute (WMI) consumer confidence index stayed well above the neutral level of 100

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in September, rising to 119.3, the highest level since July 2007. Confidence rose 5.4%m/m, bolstered by news last week that the Australian economy expanded a solid 0.6%q/q in the June quarter. The resilient labour market and strong equity market gains would have also buoyed confidence, offsetting the dampening impact of the rising threat of an imminent RBA rate hike.

According to the WMI, the rise in consumer confidence over the last four months (+34%) is the largest in the 35 year history of the index. That said, it will not necessarily translate to higher consumer spending, given the index of current conditions gained a comparatively tame 14% over the same four month period. When headline confidence has reached these levels in the past, consumers' views on current conditions also have been strong, resulting in higher consumer spending. This, though, is not the case this time around, supporting our view that private consumption will moderate in 2H09.

Data releases and forecasts

Week of September 14 - 18

Tue Sep 15 11:30am	**Dwelling starts** Seasonally adjusted	**3Q08**	**4Q08**	**1Q09**	**2Q09**
	(%q/q)	-8.6	-11.5	-4.0	6.0
Wed Sep 16 10:30am	**WMI leading index** Seasonally adjusted	**Apr**	**May**	**Jun**	**Jul**
	(%m/m)	0.2	-0.4	0.7	__

Review of past week's data

ANZ job advertisements

Seasonally adjusted

	Jun		Jul		Aug	
(%m/m)	-6.7		-1.7		__	*4.1*

NAB monthly business survey

% balance, seasonally adjusted

	Jun		Jul		Aug	
Business confidence	4		10		~~12~~	*18*

WMI consumer confidence survey

100=neutral, seasonally adjusted

	Jul		Aug		Sep	
(%m/m)	9.3		3.7		~~1.0~~	*5.2*

Retail trade

Seasonally adjusted

	May		Jun		Jul	
(%m/m)	~~1.0~~	*1.2*	~~-1.4~~	*-0.8*	~~0.0~~	*-1.0*
(%oya)	~~8.0~~	*7.8*	~~7.5~~	*7.7*	~~5.5~~	*5.2*

Housing finance approvals: owner occupiers

Number of loans, seasonally adjusted

	May		Jun		Jul	
(%m/m)	~~2.2~~	*2.1*	~~1.1~~	*0.4*	~~-3.0~~	*-2.0*
(%oya)	~~24.4~~	*24.3*	~~29.2~~	*28.9*	~~26.3~~	*25.7*

Labour force

Seasonally adjusted

	Jun		Jul		Aug	
Unemployment rate (%)	5.8		5.8		~~5.9~~	*5.8*
Employed (ch,000 m/m)	~~-23.1~~	*-26.2*	~~32.2~~	*33.6*	~~-15~~	*-27.1*
Participation rate (%)	~~65.3~~	*65.2*	65.3		~~65.2~~	*65.1*

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New Zealand

- **RBNZ to remove explicit easing bias early in 2010**
- **Current commentary remains dovish**
- **Retail sales to continue recent upswing**

In contrast to their contemporaries across the Tasman, we expect the RBNZ's next tightening cycle will not begin until mid-2010. Though Governor Bollard last week maintained a dovish tone, our forecast calls for the first rate hike to be delivered in July next year, with the explicit easing bias to be removed in early 2010.

RBNZ still dovish, but not for much longer

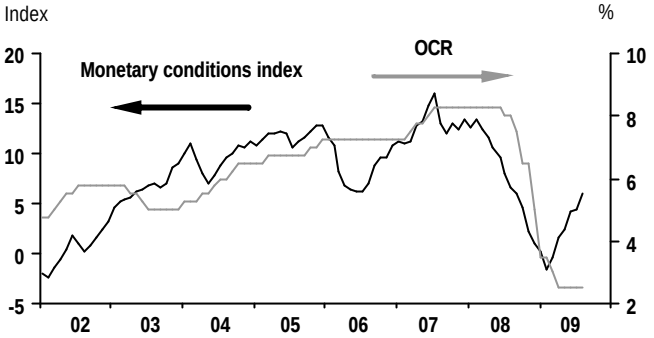
The RBNZ left the OCR unchanged at 2.5% last Thursday, as expected. The accompanying commentary offered few surprises, remaining dovish, with Governor Bollard reiterating that the OCR will remain "at or below" current levels until the end of 2010. While the RBNZ will likely maintain this current dovish tone in the statements accompanying the upcoming October and December OCR announcements, we do expect that Bollard will shift away from the current easing bias in early 2010. The RBNZ said in this month's OCR statement that "until the risks and uncertainties about the outlook have acceptably reduced we anticipate keeping the OCR low." By year-end, though, we believe the synchronized global economic recovery will be gathering steam, and the domestic economy would have begun to expand; thus, we maintain our forecast that the first OCR rate hike will be delivered in July next year.

On the global outlook, the RBNZ now expects a faster recovery in New Zealand's major trading partners. On the domestic front, though, Bollard remained cautious about recent positive developments, such as the significant improvement in business confidence. Instead, he highlighted that business profits remain under pressure, which has negative implications for investment and employment.

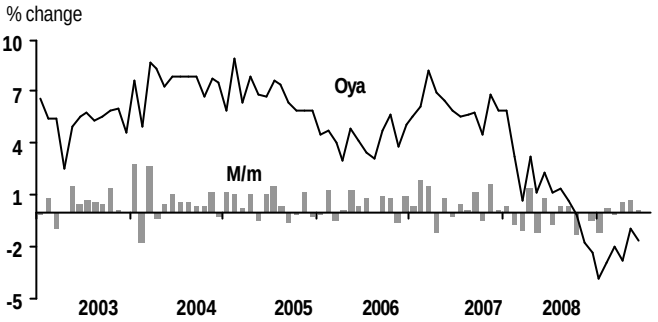
The RBNZ maintained its forecast that a recovery will get underway in New Zealand toward year-end. Following data last week showing that net exports should contribute to growth in 2Q, our forecast now is that the recession probably ended in 1H09. The RBNZ said, though, that the forecast recovery is based on an easing in monetary conditions, which have tightened considerably due to NZD appreciation. If monetary conditions fail to ease, the recovery forecast to get underway will be "put at risk" and the RBNZ would need to "reassess policy settings."

Indeed, stronger NZD is the main risk to the recovery. High NZD is hampering a prospective export-led recovery and the much-needed rebalancing of growth away from debt-

New Zealand: RBNZ official cash rate (OCR) and J.P. Morgan MCI



New Zealand: retail trade



fuelled household spending. In recent months, the Governor has reiterated his concern that, amid signs that the prolonged downturn has bottomed, consumers may revert to their old "borrow to spend" habits; this, in our view, is a key argument not to lower the OCR any further.

Data releases and forecasts

Week of September 14 - 18

Mon Sep 14 10:45am	**Retail trade** Seasonally adjusted	Apr	May	Jun	Jul
	(%m/m)	0.5	0.7	0.1	*-0.5*
	(%oya)	-2.3	-1.0	-1.8	*-1.5*

Review of past week's data

QVNZ house prices

%, median

	Jun	Jul	Aug	
(%oya)	-7.1	-5.0	__	*-2.8*

RBNZ cash rate announcement

No change.

Terms of trade

Seasonally adjusted

	4Q08	1Q09		2Q09	
(%q/q)	-1.0	~~-3.0~~	-2.7	~~-2.3~~	*-9.0*

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Global Essay

- **Expecting a drop in August US core CPI; trends point to sub-1% inflation**
- **The juxtaposition of strong growth from depressed levels of activity generate counterintuitive economic outcomes**
- **Rebound in shipments suggests global capital spending may be stabilizing**
- **Outside China, rising asset prices may produce earlier monetary tightening**

Implications of lifting from unprecedented lows

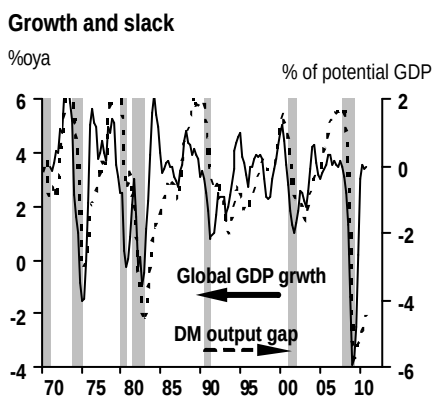
We are forecasting US August core CPI to fall 0.1%m/m this week, an event that would represent the first monthly price decline in more than a quarter century. While price discounts due to the "Cash for Clunkers" scheme are contributing to this decline, the details of the report are likely to reinforce the message that the underlying inflation trend in the developed world remains decidedly downward. For the US and Euro area, core inflation is expected to breach historical lows—falling below 1% next year. In Japan, we also forecast new lows with core prices expected to drop 1.5% in 2010.

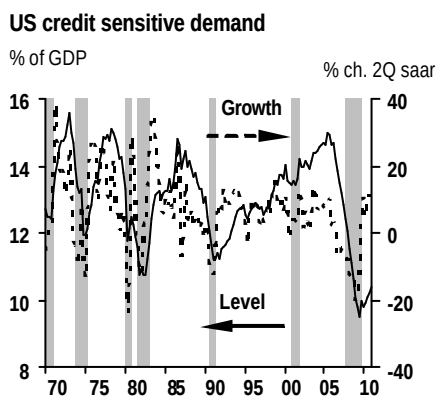
It may seem unusual to anticipate falling core inflation in the G-3 alongside our expectations of sustained above-trend growth, firming global commodity prices, and a continued fall in G-3 currencies vis a vis emerging markets. But these are unusual times. No expansion during the post-World War II era has taken hold with a sharper contrast between the depressed level of developed world activity and the strong lift in global growth expected over the coming quarters. As a result, the macroeconomic landscape is delivering a number of counterintuitive outcomes.

- **Finished goods prices fall while commodity prices firm.** The early recovery of emerging market domestic demand and a highly accommodative global monetary policy stance are boosting prices in a wide range of commodities. While higher commodity prices increase costs of production, depressed factory utilization rates and weak labour markets are set to diminish price pressures for finished consumer goods and services for some time to come.
- **Production bounces amid destocking.** The 16% peak-to-trough fall in global manufacturing output proved to be an overshoot for firms that had anticipated far worse demand conditions at the start of the year. As a result, levels of production need to rise significantly before inventories stop declining. In Asia, where a production bounce is already established, inventory levels may stabilize in the coming months. In the Americas and Europe, production only started growing around midyear, and inventories are likely to move lower into year-end.
- **US credit-sensitive demand rises while credit contracts.** The level of US credit-sensitive spending—consumer durables and residential investment—reached a record low as a share of GDP last quarter. With credit-sensitive demand so depressed, the repayment flow of existing loans is higher than new credit creation. This gap combines with rising saving to explain why net credit outstanding is falling (and likely to continue to fall) even as credit-sensitive demand recovers during the second half of this year.

A surprising turn in capital good shipments

With July readings now available, G-3 capital goods orders and shipments are on track to post significant gains this quarter—for the first time since late 2007. Given the volatile nature of these data, it may be premature to draw strong conclusions. However, it suggests that the dramatic drop in global capital expenditures may now be giving way to solid gains.





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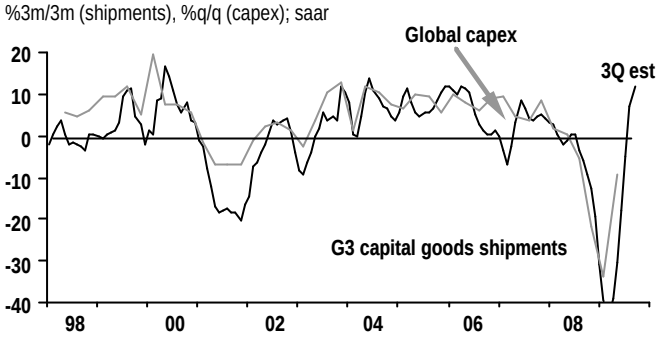
G3 capital goods shipments and global capital expenditures

%3m/3m (shipments), %q/q (capex); saar



As discussed above, an early return to growth in capital spending alongside low operating rates reflects the unusual position of the global economy. The level of investment represents the gross change in the global capital stock. From its current position, capital deepening has likely stalled, and firms will soon need to increase investment spending, if only to replace depreciating equipment. The latest data suggest this adjustment may be coming earlier than expected. More broadly, this turn is the latest signal that business behavior is in the midst of a behavioral shift that includes decisions on inventory management and employment. The positive impact of this shift on labour incomes, financial conditions, and confidence is key to our view that the current rebound in growth can be sustained into 2010.

Yen's rise stands out in volatile FX markets

The dollar lost fresh ground last week, extending its slide over the past six months to over 10%. This move is big enough to have some impact on trade flows and inflation. The same can be said for the rapid appreciation in many other currencies over this same period. Nonetheless, in most instances, these moves probably are not of much concern to policymakers.

A look back at past performance helps explain why. Since the onset of the global financial crisis in the summer of 2007, the dollar's value has tended to wax and wane with investor risk appetite. The dollar fell during the initial "decoupling" phase of the crisis, which lasted from September 2007 to August 2008. During this period it was widely believed that the fallout from the US subprime debacle would be limited and emerging market economies would weather the storm. The second phase of the crisis began in September 2008, when a worldwide panic in financial markets and a collapse in confidence sent the global economy into a deep tailspin. Investors fled risk assets (which often were financed by borrowing in dollars or yen) in favour of safe harbours like US Treasuries, bolstering the dollar and the yen.

The panic ended in early March, partly due to an unprecedented policy response, which included massive assistance directly targeted at global funding markets and the banks. In this latest phase, risk appetite has staged a gradual recovery, symbolized by the bounce in global equity and commodity prices and in the corresponding flow of capital out of previous "safe harbours."

Over this entire two-year period, the value of the US dollar has changed little. Likewise,the value of the euro is about even with its value at the onset of the crisis. Elsewhere, this year's gains follow severe losses during the previous six months that leave most currencies in the red for the entire two-year span. The standout exception is the yen, which is up about 20% in trade-weighted terms over the past two years. Although the yen appreciated from a very low level, significant further gains might at least provoke an oral response from policymakers struggling to support an economy already burdened with a large output gap and significant deflation.

No angst about Germany's upswing

German IP fell in July, and while it is still tracking a 4% annualized gain this quarter, this poses downside risk to our current-quarter forecast of a strong 5% of GDP bounce. One important sector that held back production was autos. Output in this sector may already have peaked given that orders already had begun to ebb in advance of the official closing of the car scrappage scheme last week. Any payback is likely to be moderate, however. For one thing, output did not bounce all that much in the sector in the first place. In addition, only around a quarter of the 2 million applications have been processed; it may take until early 2010 for the remainder to be processed and for the car sales and deliveries to be completed. Finally, as time passes, higher corporate spending on autos and higher exports are likely to offset some of the slack created by payback in household purchases.

Aside from autos, all the other indicators point to a period of strong growth ahead. German orders and exports continue to surge, with July levels up 34%ar and 29%ar over the second quarter. We have not seen orders growth of this strength since reunification, and past relationships suggests that these gains could deliver a six-month run of double-digit IP growth. The German PMI orders to inventory ratio sends a similar message. With other indicators across the region starting to spring up—French exports were up 9% in July, putting the level up 45%ar over the second quarter—this is no time to develop angst about the German upswing.

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Broad trade-weighted exchange rates

Percent change over specified period

	Sep 07-Aug 08	Sep 08-Feb 09	Feb 09-present	Entire period
US	-5.2	21.6	-10.3	3.4
Japan	1.3	24.1	-4.5	20.1
Euro area	5.3	-7.0	3.5	1.3
UK	-14.2	-9.7	5.8	-18.0
Canada	-10.7	-12.6	10.9	-13.4
Australia	5.2	-21.5	18.6	-2.1
Brazil	26.5	-22.2	16.0	14.2
Mexico	8.1	-27.2	10.0	-13.5
Russia	7.0	-12.2	8.6	2.0
South Africa	3.8	-14.6	18.9	5.4
Turkey	8.7	-15.3	-3.7	-11.4
China	12.0	1.6	-6.5	6.3
Korea	-13.2	-26.2	17.9	-24.6
Taiwan	-1.9	-11.5	-1.8	-14.8
Memo: S&P500	-13.0	-42.7	42.0	-29.2

Outside China, Asia considers tightening

China's August data provided few surprises, confirming that growth remains strong with a rotation in demand away from public investment underway. Like other countries in EM Asia, China's manufacturing surge is waning, but the August IP reading is putting 3Q09 on track for a still-buoyant quarterly growth rate of 18%ar. CPI deflation eased as expected due to a jump in food prices, while the decline in nonfood prices fell just 2.0%oya. We expect China's headline CPI to start rising later this year, owing to fading base effects, continued resource price liberalization, and food price increases.

Against this benign macro backdrop, China's policymakers are in no rush to tighten policy. Risks of an early monetary tightening were never very high and now have been reduced by the August correction in the Shanghai A-share market and a drop in property transactions due to a tightening of mortgage standards. The use of such targeted, sector-specific measures will remain an important tool of policymakers for the coming months. However, it is only when a recovery in exports is well established and inflation resumes that reserve requirements and policy rates will be hiked. The first 27bp hike in the policy rate is not expected until the middle of next year.

Our outlook for China's gradual move toward a policy adjustment, awaiting a broader increase in growth and inflation, contrasts with our thinking on the Bank of Korea (BoK) and the Reserve Bank of India (RBI). Both central banks will put more weight on financial conditions when contemplating policy normalization—a focus that could deliver tightening this year.

Last week, the BoK delivered a distinctly more hawkish tone even though the MPC statement and Governor Lee's comments made clear that CPI inflation is not a concern. The BoK is openly worried about continued increases in housing loans and property prices, which have both moved higher despite micro measures that have been put in place recently. In India, RBI governor Subbarao's comments on the need to preserve financial stability echo the BoK's unwillingness to be straightjacketed into a strictly defined inflation-targeting framework, driven by output gap analysis.

The policy implication of important EM Asian central banks openly expressing concerns that excess liquidity might jeopardize financial stability is that the timing of monetary policy tightening may be brought forward. In Korea, we expect 100bp of rate hikes in 2010, but there is a significant risk that the first hike will happen before year-end if newly strengthened microlevel measures fail to cool the Seoul housing market. In India, moral suasion from the regulators may keep non-oil credit growth from heating up and finding its way into the property market. But if it fails to do so, the RBI is making it increasingly clear that it will tighten earlier, possibly much earlier, than the market currently expects.

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JPMorgan View - Global Markets

The asset reflation trade

- **Portfolio strategy:** The recovery trade is still there, but the asset reflation trade is starting to grab more attention. Under the asset reflation trade, one is short cash and long both equities and fixed income (especially credit).
- **Fixed Income:** Move to overall short duration, through short end of Europe.
- **Equities:** Stay overweight Cyclical sectors.
- **Credit:** Overweight US HG as valuations remain attractive, demand is strong, and corporate fundamentals are improving.
- **Fx:** The strongest currencies this year (AUD, NOK, BRL) have a lot further to run as policy gaps widen.
- **Alternatives:** Hedge fund inflows remained mildly positive in August, but likely to accelerate in Q4.

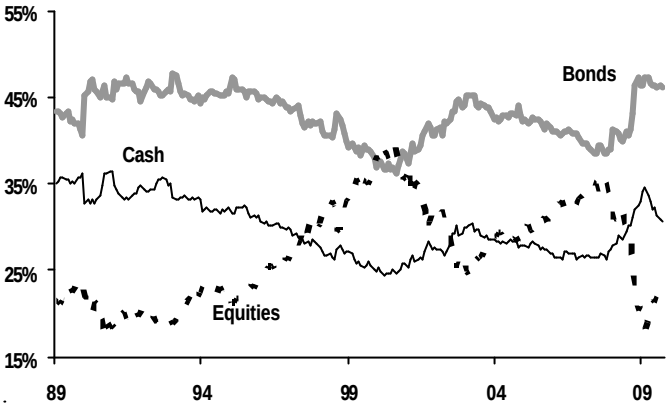
All assets are rallying. That is great news, but if we are in a recovery trade, are bonds not supposed to be going down? They are rallying instead, despite massive supply. Isn't a rally in government debt supposed to be a sign of a flight to quality in the face of rising economic risks? Yes, and yes should be our answers, if the recovery trade were the only force driving markets.

As we have been arguing here, a more powerful force that is grabbing attention away from the pure recovery trade is the **asset reflation trade**, or the pain of earning no return on cash in a world where all assets are beating cash and uncertainty is receding. Raising cash holdings is the right strategy during times of high uncertainty, in our view. The chart shows how the share of cash (M2) in the world portfolio grew significantly last year, but has since been falling. We have updated our data sources and find that cash holdings remain 0.7 percentage points above their 20-year average share of 30%. Hence, **the global investor remains** overweight cash.

We continue to see strong flows out of money market funds. **The lion share of these outflows are headed to fixed income.** YTD, some $4.5 trillion of bonds have been issued, net of redemptions. By any standard, this should have hurt bond prices. But we find that the average price of these bonds has risen 3% YTD, and the yield is down half a percent to 3.25%. Demand for bonds this year must thus have exceeded $4.5 trillion. Our chart shows that bond holdings are now at their highest share in 20 years.

At what point will investors have their fill of bonds and start moving more into equities? The answer is that we do

Global portfolio weighting of fixed income, equities, and cash
% of total portfolios; J.P. Morgan estimates from Mar09



	Outstandings	Estim. 10 Sep	Average	Gap
Cash	$46	30.6%	29.9%	0.7%
Equity	$35	23.3%	27.3%	-3.9%
Bonds	$69	46.1%	42.9%	3.2%
of which				
Govt Bonds	$34	22.9%	20.8%	2.1%
Spread	$35	23.2%	22.1%	1.1%

Source: J.P. Morgan, BIS, Datastream. Global FI is proxied by the sum of the global domestic debt securities reported by BIS and J.P. Morgan's EMBIG index for external debt. For equities, we used the Datastream world equity index. Global cash is an aggregated M2 (or close proxy of M2) of developed and developing countries.

not know. If strategic benchmarks have not changed, then the move from cash to bonds is just an interim stage in portfolio re-risking, towards the eventual move into equities when the recession is truly behind us. But there are signs that some end investors have soured on the equity asset class. Retail and HNW investors are showing little appetite to get back into equities. And a number of US and European defined benefit pension funds have lowered their equity benchmarks in favour of bonds and alternatives. It may be too early to declare the equity culture dead, but it is clearly under threat. We remain long equities versus cash, but are on the lookout for stronger signs of an erosion of equity benchmarks.

The asset reflation trade implies one should be short cash and long all other assets, including the overall fixed **income asset class.** As a strategy team, we have problems applying this to government bonds, though. Our world portfolio above shows that global investors are most long in government bonds and less so in spread product (largely credit). We continue to see strong demand for corporate bonds, including from pension funds whose liabilities are discounted by corporate yields. Corporates and banks have net issued $1.5 trillion YTD. They have used much of this to strengthen their balance sheets, reducing shorter-dated debt and raise cash holdings, which has been a very nega-

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tive carry trade. We thus expect issuance to fall dramatically, while demand stays strong. **We thus stay long credit.**

Fixed income

Government bonds have rallied and are now at the top of their 4-month trading range. During this time, the market steadily raised economic growth forecasts. We are very far from forecasting rate hikes by the Big 3 central banks, but the passage of time makes the eventual rate hikes come closer. We have thus in recent weeks decided to go **short** duration in fixed income by shorting the short ends of most bond markets.

Government bond issuance will stay elevated this year and next. With world investors holding a more overweight position in government bonds than in spread product, and market volatility continuing to fall, our most important asset allocation remains to be **short government bonds against better yielding spread products**. In the Euro area, we stay with our long established overweight of higher-yielding countries, especially Greece and Italy.

Equities

Equities rose to a new year high as fears about China subsided and as economic data came in better than expected. Our US **Economic Activity Surprise Index** currently stands at the upper end of its recent range and it has been positive for almost 6 straight months. Better than expected loan growth data in **China** last week helped to reduce fears of policy tightening. We believe that China has prefunded its growth and that slower or even negative loan growth does not indicate a tightening in monetary policy. Investors should fear inflation, not higher interest rates. It was anti-inflation policy measures in 2007 that ended the bull market. But China does not have an inflation problem today.

Strong 4% GDP growth in the US in Q3 and a surge in global IP set the stage for another surprise for Cyclical sectors in the Q3 reporting season. Stay **overweight in Cyclical sectors**. A trading rule that goes long Global Cyclical vs Defensive sectors if the global manufacturing PMI **new orders-to-stocks ratio** rises also favours Cyclical sectors. This rule has produced an information ratio of 0.65 since 1998 and has been overweight Cyclicals since Feb 1.

Credit

The credit market is coming back to life after the Labor Day holiday. Issuance of corporate bond picked up last week from its late August low and credit spreads are tightening once again. We stay **overweight US HG** as valuations remain attractive, demand is strong and corporate fundamentals are improving.

HG spreads are still above previous recessions' peaks and are pricing in a default/downgrade risk that is more than three times the worst historical experience since 1980. The current spread implies a cumulative 10-year default rate of 21-27%, more than 4 times the 5% default rate between 1982-1991. In terms of loss upon downgrade, current spreads imply that 70% of HG companies will be downgraded to HY over the next 10 years vs 27% over 1999-2008. Hence, the current spread of 217bp leaves plenty of room for further spread tightening.

Foreign Exchange

The underpinnings of our call for a **broad dollar decline to new cycle lows** are steadily falling into place, even if happening one month or so sooner than anticipated. The fall in the dollar last week, while abrupt, has not stretched the USD's valuation on a trade-weighted basis, suggesting it may be the first move down. The USD appears cheap against the EUR, but remains close to fairly valued on a trade-weighted basis relative to a standard menu of drivers (interest-rate spreads, equity prices, and volatility).

The incoming data flow is cementing the case that the global economy is in the early stages of a powerful upturn. But investors are still concerned about both the pace and sustainability of the recovery, leaving scope for upside surprises on economic data and corporate earnings. Steady **upward** growth and earnings revisions should support risk **markets, including high-beta fx**, and undercut the USD over the next six months. From an interest-rate differential and flow perspective, we see vulnerability in USD/JPY. Traditionally, the market might have relied upon the Japanese authorities to underpin USD/JPY but this seems less likely than ever with a new government whose agenda emphasizes the interests of consumers over producers. Market positioning (short yen) is still too skewed in view of these new fx and monetary policy realities.

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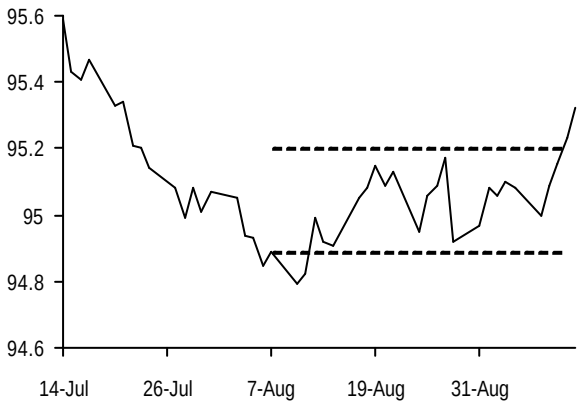
Markets - Australia and New Zealand

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

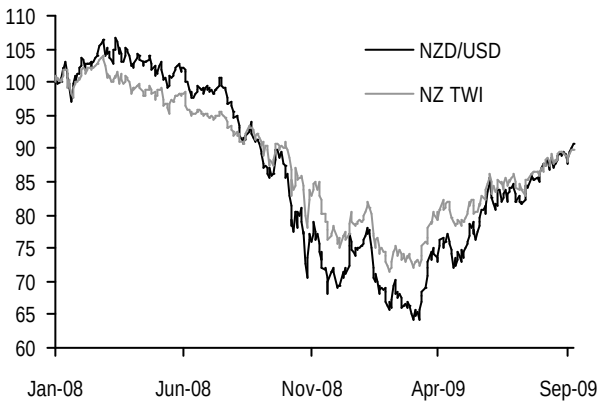
- The front end of the Australian yield curve has broken to the upside. A bias towards short positioning and some softer retail sales and employment data have largely prevented a move higher in yields near term.
- We still favour positioning for higher yields as the October board meeting approaches. We would look to sell into the recent rally and see value in being short October-09 30-day interbank futures contracts at current levels.
- The RBNZ OCR and *Monetary Policy Statement* offered little new last week. This should keep carry and roll investors happy because it is compatible with a range trading environment for front end swap yields.
- We also highlight some structural changes to the NZD mortgage market. With a 40-year low in the variable mortgage rate and steep front end curve, there should be less payside mortgage flow and greater effectiveness in monetary policy adjustments when they eventuate.
- We take a look at forward swap curves in AUD and NZD and assess what they imply about expectations for the cash rate in Australia and New Zealand in a year's time. Either the AUD forward swap curves are not flat enough, or the bill strip has too much tightening priced in over the next twelve months. One way in which to trade this view would be via a butterfly trade (long Sep-10 bills, paid 1y2y and received 1y10y), in our view.
- In New Zealand the analysis suggests the reverse – the NZD forward 2s10s curves look too flat, or alternatively, that the very front end has too little priced in over the next 12 months. An alternative interpretation is that the AUD-NZD 2-year spread can move wider from here, while the 5-year and 10-year spreads should continue to narrow.
- Finally, we look at the behaviour of swap spreads around RBA rate hikes. Front-end swap spreads are the most sensitive to rate hikes, highlighting our view of a flatter 3s10s swap/efp curve. But we also note that swap spreads have become more sensitive to RBA rate hikes since Q3 07. This is probably due to a combination of increased hedging flows and heightened risk and liquidity premia.

AUS 3-years have broken to the upside of recent trading ranges
Price



Source: J.P. Morgan and Bloomberg

The market has not been listening to the RBNZ!
Index; 1-Jan-08 = 100



Source: J.P. Morgan and Bloomberg

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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			
	2008	2009	2010	1Q09	2Q09	3Q09	4Q09	1Q10	2Q10	3Q10	2Q09	4Q09	2Q10	4Q10
The Americas														
United States	0.4	-2.4	3.2	-6.4	-1.0	4.0	3.0	3.0	4.0	4.0	-0.9	1.2	2.0	0.9
Canada	0.4	-2.5	2.4	-6.1	-3.4	2.0	2.0	3.0	3.0	3.5	0.1	1.3	1.9	2.3
Latin America	3.8	-3.1	**4.5** -	**-10.0** ¯	**-1.3** ¯	**7.7** ¯	**4.2** -	**5.1** -	**4.9** -	**3.8** -	**6.7** ¯	**5.4** ¯	**6.5** ¯	**6.5** -
Argentina	6.8	**-4.5** ¯	**2.5** -	0.2	**-18.0** ¯	**-10.0** ¯	-4.0	**12.0** -	**10.0** -	**6.0** -	**5.5** ¯	6.0	10.0	10.2
Brazil	5.1	**0.0** -	**5.0** -	**-3.8** ¯	**7.8** -	**6.5** -	**5.0** -	**4.3** -	5.0	**4.0** -	5.2	4.2	**4.5** ¯	**4.7** -
Chile	3.2	-1.5	**5.0** -	-3.0	-1.4	**8.0** -	6.0	**6.0** -	**5.0** -	**3.0** ¯	3.1	**-1.5** ¯	2.0	**3.0** ¯
Colombia	2.5	-0.5	3.0	0.9	-2.0	1.9	3.2	3.5	4.3	5.5	4.8	3.3	3.9	4.3
Ecuador	6.5	**-1.5** -	**1.5** -	-6.3	-4.0	**0.0** -	**2.0** -	**2.0** -	2.5	3.0	5.5	**3.5** ¯	**2.4** ¯	**4.0** ¯
Mexico	1.3	-6.5	5.0	-21.2	-4.4	15.5	5.0	5.0	4.0	3.0	6.0	**4.0** ¯	**3.3** ¯	**3.5** -
Peru	9.8	1.0	5.4	-6.3	-1.6	8.0	13.0	3.0	3.5	3.5	4.0	1.1	1.5	2.0
Venezuela	4.8	**-1.5** -	**2.0** -	-7.3	-3.3	**0.0** -	**2.0** -	2.0	3.5	4.5	28.2	**29.5** ¯	**41.5** ¯	**36.7** ¯
Asia/Pacific														
Japan	-0.7	**-5.6** ¯	**2.2** ¯	**-12.4** ¯	**2.3** ¯	3.0	3.0	2.5	1.0	1.5	-1.0	-2.0	-2.2	-1.5
Australia	2.4	**0.8** -	**2.0** -	1.6	2.5	**0.9** -	**2.2** ¯	**1.0** ¯	**2.0** ¯	**3.2** ¯	1.5	1.5	**1.9** ¯	**2.6** -
New Zealand	0.2	**-1.7** -	**1.7** ¯	-3.9	**1.2** -	**0.9** -	**0.8** ¯	**1.4** ¯	**2.5** ¯	**3.0** ¯	1.9	**1.8** -	**1.6** -	**1.7** ¯
Asia ex. Japan	5.8	4.0	**7.2** -	2.5	12.6	**7.6** -	**6.9** -	**6.4** -	**6.9** -	**6.8** -	1.3	**2.0** ¯	**3.2** ¯	**3.1** -
China	9.0	8.4	**9.5** -	8.3	14.9	9.5	**9.1** -	**9.0** -	**9.3** -	**9.2** -	-1.5	**0.9** ¯	**3.2** ¯	**2.7** -
Hong Kong	2.4	-2.6	5.3	-16.1	13.9	9.0	5.0	4.2	4.0	3.8	-0.1	**-0.4** -	**0.6** -	**2.1** ¯
India	6.1	6.2	7.2	8.2	6.7	5.7	6.4	7.1	7.7	7.5	8.9	7.9	4.9	3.7
Indonesia	6.1	4.1	5.0	5.4	3.8	**4.0** -	**4.0** -	5.0	6.0	6.0	5.6	**2.4** ¯	**4.6** ¯	**6.0** ¯
Korea	2.2	-0.8	4.0	0.5	11.0	4.0	3.5	3.5	3.5	3.5	2.8	2.5	3.0	3.3
Malaysia	4.6	-3.0	**5.0** -	-17.7	12.8	6.1	4.5	1.6	4.9	4.9	1.3	**-1.2** ¯	**0.5** ¯	**1.5** ¯
Philippines	3.8	1.5	5.0	-8.1	10.0	4.0	4.0	5.0	5.0	5.0	3.2	3.0	3.6	3.7
Singapore	1.1	**-1.8** -	**7.0** -	-12.2	20.7	**12.6** -	**7.0** -	**3.6** -	**4.9** -	6.1	-0.5	**-0.8** ¯	**1.9** ¯	**1.8** ¯
Taiwan	0.1	-3.8	5.5	-10.2	20.7	9.5	8.0	3.0	3.0	2.0	-0.8	**-1.0** ¯	**1.8** -	2.1
Thailand	2.6	-3.1	**5.5** ¯	-7.2	9.6	7.0	5.3	4.9	5.7	7.0	-2.8	**1.4** -	**4.6** -	**4.0** ¯
Africa														
South Africa	3.1	-2.0	3.0	-6.4	-3.0	0.6	3.4	4.5	3.7	3.6	7.7	6.3	4.5	4.1
Europe														
Euro area	0.6	-3.6	2.7	-9.5	-0.5	3.0	2.5	3.0	3.0	3.0	0.2	0.6	1.1	1.1
Germany	1.0	-4.6	3.6	-13.4	1.3	5.0	4.0	3.5	3.5	3.5	0.2	0.3	0.5	0.3
France	0.3	-1.9	2.7	-5.3	1.3	2.8	2.5	3.0	3.0	3.0	-0.2	0.6	1.0	0.7
Italy	-1.0	-4.9	1.5	**-10.4** ¯	**-2.0** ¯	1.5	1.0	2.0	2.0	2.0	0.9	1.0	1.4	1.0
Norway	2.5	-1.1	**2.8** -	-5.0	1.3	2.5	3.0	3.0	**3.0** -	**3.0** -	3.1	**1.2** ¯	1.0	0.4
Sweden	-0.4	**-4.5** ¯	**3.2** -	**-3.7** ¯	**0.6** -	**1.0** ¯	4.0	4.0	**3.5** -	**3.5** -	-0.4	**-0.2** ¯	**0.9** ¯	**0.5** -
Switzerland	1.8	-1.3	2.2	-3.5	-1.0	1.8	2.3	2.5	2.5	3.0	-0.7	**-0.3** ¯	**0.7** -	**0.7** -
United Kingdom	0.7	-4.2	2.1	-9.3	-2.6	1.5	3.0	2.0	2.5	2.8	2.1	1.8	2.2	1.8
Emerging Europe	4.1	**-5.3** ¯	**3.9** -	**-19.3** ¯	**1.9** ¯	**5.4** -	**4.7** -	**3.5** -	**3.4** -	3.3	7.7	**6.8** ¯	**6.3** ¯	6.0
Bulgaria	6.1	-5.0	-1.5	...	...	...	...	...	...	...	...	...	...	...
Czech Republic	**2.7** ¯	**-4.0** ¯	**3.0** -	**-17.9** ¯	**0.4** ¯	**4.5** -	**5.0** -	**3.0** -	**3.0** -	**2.5** ¯	1.4	**1.0** ¯	**2.4** ¯	**3.5** ¯
Hungary	0.6	**-6.2** ¯	**1.0** -	-10.0	**-7.9** -	**-2.0** ¯	**2.0** ¯	2.0	**2.0** -	**2.5** -	3.6	**5.5** ¯	**3.9** ¯	2.4
Poland	4.9	**1.2** -	**3.0** -	1.2	2.0	2.2	**2.5** -	**3.2** -	**3.5** -	3.5	3.7	**3.7** -	**2.7** -	**2.5** -
Romania	7.1	-6.0	2.0	...	...	...	...	...	...	...	6.1	6.0	6.2	6.5
Russia	5.6	-8.5	5.0	-33.6	4.9	9.0	6.5	4.5	4.0	4.0	12.6	**10.6** ¯	**9.1** ¯	9.2
Turkey	**0.9** ¯	**-5.3** ¯	**5.0** -	...	...	...	...	...	...	...	5.7	5.0	**6.3** -	**5.2** -
Global	1.3	-2.5	**3.4** -	**-7.3** ¯	**1.2** ¯	4.0	3.4	**3.4** -	**3.6** -	**3.7** -	0.6	**1.2** ¯	**1.8** ¯	1.5
Developed markets	0.4	-3.3	2.8	**-8.2** ¯	**-0.4** ¯	**3.2** -	2.8	2.8	3.0	3.2	-0.3	0.5	1.1	0.7
Emerging markets	4.9	0.5	**5.8** -	**-3.9** ¯	**7.2** ¯	**7.1** ¯	**5.8** -	**5.7** -	**5.8** -	**5.5** -	3.9	**3.8** ¯	**4.6** ¯	**4.5** -

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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	1.33	-339				1.32	1.32	1.34	1.37	1.47
excluding US	GDP-weighted average	1.90	-254				1.88	1.88	1.91	1.96	2.11
Developed	GDP-weighted average	0.48	-366				0.48	0.49	0.50	0.52	0.57
Emerging	GDP-weighted average	4.69	-231				4.64	4.61	4.64	4.73	5.07
Latin America	GDP-weighted average	5.78	-303				5.78	5.78	5.78	5.81	6.33
CEEMEA	GDP-weighted average	5.46	-155				5.22	5.09	5.13	5.23	5.56
EM Asia	GDP-weighted average	4.00	-232				4.00	4.00	4.04	4.13	4.40
The Americas	GDP-weighted average	0.75	-484				0.75	0.75	0.75	0.76	0.82
United States	Federal funds rate	0.125	-512.5	16 Dec 08 (-87.5bp)	23 Sep 09	on hold	0.125	0.125	0.125	0.125	0.125
Canada	Overnight funding rate	0.25	-425	21 Apr 09 (-25bp)	20 Oct 09	on hold	0.25	0.25	0.25	0.25	0.25
Brazil	SELIC overnight rate	8.75	-275	22 Jul 09 (-50bp)	21 Oct 09	**Oct 10 (+50bp)**	8.75	8.75	8.75	8.75	**9.75**
Mexico	Repo rate	4.50	-275	17 Jul 09 (-25bp)	18 Sep 09	on hold	4.50	4.50	4.50	4.50	4.50
Chile	Discount rate	0.50	-500	9 Jul 09 (-25bp)	8 Oct 09	2Q 10 (+50bp)	0.50	0.50	0.50	1.00	3.50
Colombia	Repo rate	4.50	-475	19 Jun 09 (-50bp)	25 Sep 09	on hold	4.50	4.50	4.50	4.50	4.50
Peru	Reference rate	1.25	-350	6 Aug 09 (-75bp)	7 Oct 09	on hold	1.25	1.25	1.25	1.25	1.25
Europe/Africa	GDP-weighted average	1.44	-315				1.41	1.40	1.41	1.46	1.57
Euro area	Refi rate	1.00	-300	7 May 09 (-25bp)	8 Oct 09	on hold	1.00	1.00	1.00	1.00	1.00
United Kingdom	Repo rate	0.50	-525	5 Mar 09 (-50bp)	8 Oct 09	2Q 10 (+25bp)	0.50	0.50	0.50	0.75	1.25
Sweden	Repo rate	0.25	-325	2 Jul 09 (-25bp)	22 Oct 09	on hold	0.25	0.25	0.25	0.25	0.25
Norway	Deposit rate	1.25	-350	17 Jun 09 (-25bp)	23 Sep 09	24 Mar 10 (+25bp)	1.25	1.25	1.50	1.50	1.75
Czech Republic	2-week repo rate	1.25	-200	6 Aug 09 (-25bp)	24 Sep 09	1Q 10 (+25bp)	1.25	1.25	1.75	2.50	3.50
Hungary	2-week deposit rate	8.00	25	24 Aug 09 (-50bp)	28 Sep 09	28 Sep 09 (-50bp)	7.50	**6.50**	**6.00**	**6.00**	**6.00**
Israel	Base rate	0.75	-325	24 Aug 09 (+25bp)	29 Sep 09	29 Sep 09 (+25bp)	1.00	1.50	2.00	3.00	4.00
Poland	7-day intervention rate	3.50	-125	24 Jun 09 (-25bp)	30 Sep 09	3Q 10 (+25bp)	3.50	3.50	3.50	3.50	4.50
Romania	Base rate	8.50	150	4 Aug 09 (-50bp)	29 Sep 09	29 Sep 09 (-50bp)	8.00	8.00	8.00	7.50	7.00
Russia	1-week deposit rate	6.00	275	7 Aug 09 (-25bp)	3Q 09	3Q 09 (-25bp)	5.75	5.50	5.50	5.50	5.50
South Africa	Repo rate	7.00	-300	13 Aug 09 (-50bp)	22 Sep 09	4Q 10 (+50bp)	7.00	7.00	7.00	7.00	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	7.75	-975	18 Aug 09 (-50bp)	17 Sep 09	17 Sep 09 (-50bp)	7.25	7.00	7.00	7.00	7.00
Asia/Pacific	GDP-weighted average	2.05	-150				2.05	2.08	2.12	2.18	2.33
Australia	Cash rate	3.00	-350	7 Apr 09 (-25bp)	6 Oct 09	6 Oct 09 (+25bp)	3.00	3.50	4.00	4.25	4.50
New Zealand	Cash rate	2.50	-575	30 Apr 09 (-50bp)	28 Oct 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)	17 Sep 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)	24 Sep 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)	9 Oct 09	1Q 10 (+25bp)	2.00	2.00	2.25	2.50	3.00
Indonesia	BI rate	6.50	-175	5 Aug 09 (-25bp)	5 Oct 09	on hold	6.50	6.50	6.50	6.50	6.50
India	Repo rate	4.75	-300	21 Apr 09 (-25bp)	27 Oct 09	**2Q 10 (+25bp)**	4.75	4.75	4.75	**5.00**	5.25
Malaysia	Overnight policy rate	2.00	-150	24 Feb 09 (-50bp)	28 Oct 09	**2Q 10 (+25bp)**	2.00	2.00	2.00	**2.25**	**3.00**
Philippines	Reverse repo rate	4.00	-200	9 Jul 09 (-25bp)	1 Oct 09	4Q 10 (+25bp)	4.00	4.00	4.00	4.00	4.25
Thailand	1-day repo rate	1.25	-200	8 Apr 09 (-25bp)	21 Oct 09	**2Q 10 (+25bp)**	1.25	1.25	1.25	**1.50**	**2.00**
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	2.4	1.0	2.9	1.4	1.3	-2.8	1.6	2.5	1.2	3.8	2.1	2.4	4.4	6.2
Private consumption	2.6	1.0	1.3	-0.1	0.8	0.5	2.0	3.4	-2.8	0.0	2.4	2.0	2.8	2.4
Construction investment	5.4	-3.4	3.6	4.2	5.9	0.2	-8.9	-6.9	-7.4	2.8	1.9	7.7	12.4	17.9
Equipment investment	15.6	-7.4	-4.7	33.7	3.7	0.3	-34.6	24.2	-22.8	-4.1	-10.1	-8.1	8.7	17.8
Public investment	14.6	-1.3	6.1	7.3	36.9	-8.9	-14.2	3.3	-4.5	0.0	2.6	16.3	18.2	11.6
Government consumption	4.1	2.2	4.1	4.6	4.4	1.7	1.0	3.2	-0.4	3.7	5.6	4.9	5.0	4.7
Exports of goods & services	3.8	1.4	3.6	13.0	-6.8	-5.1	8.2	3.9	-1.6	0.0	4.9	8.2	5.1	3.2
Imports of goods & services	11.3	-9.8	5.8	20.6	0.1	-27.9	-27.2	8.6	7.0	3.2	2.4	8.2	8.2	10.4
Contributions to GDP growth:														
Domestic final sales	4.8	-1.1	2.9	5.2	2.8	-3.7	-7.8	2.8	2.7	0.8	1.9	3.3	5.9	6.8
Inventories	-0.7	-0.6	0.6	-1.7	0.0	-5.9	0.8	0.7	0.4	3.7	-0.3	-0.7	-0.7	1.1
Net trade	-1.8	2.7	-0.5	-2.1	-1.5	7.1	9.1	-1.0	-1.8	-0.7	0.5	-0.1	-0.7	-1.6
GDP deflator (%oya)	6.7	0.3	1.1	6.5	8.4	7.5	5.3	0.3	-2.0	-2.2	-0.9	1.7	1.7	2.0
Consumer prices (%oya)	4.4	1.5	2.2	4.5	5.0	3.7	2.5	1.5	0.7	1.5	1.9	1.9	2.3	2.6
Producer prices (%oya)	8.3	-5.0	0.2	8.7	10.9	6.7	-1.0	-6.4	-7.4	-4.8	-1.0	0.5	0.4	1.0
Trade balance (A$ bil, sa)	-4.3	-4.0	-14.6	-2.1	1.4	4.3	4.4	-1.9	-2.9	-3.6	-3.6	-3.3	-3.3	-4.4
Current account (A$ bil, sa)	-67.0	-50.3	-65.2	-15.3	-10.6	-7.9	-6.3	-13.3	-14.8	-15.9	-16.0	-15.8	-15.9	-17.5
as % of GDP	-6.2	-4.2	-5.2	-5.2	-3.5	-2.6	-2.1	-4.5	-4.9	-5.2	-5.2	-5.1	-5.1	-5.5
3m eurodeposit rate (%)*	6.0	3.4	4.5	7.8	7.0	4.1	3.4	3.2	3.4	3.8	4.3	4.5	4.6	4.8
10-year bond yield (%)*	5.6	5.2	5.9	6.5	5.4	4.0	4.2	5.1	5.4	5.9	5.9	5.8	5.8	6.0
US$/A$*	0.75	0.77	0.86	0.74	0.77	0.65	0.66	0.76	0.82	0.83	0.84	0.85	0.86	0.87
Commonwealth budget (FY, A$ bil)	13.5	-29.0	-48.0											
as % of GDP	1.1	-2.4	-3.8											
Unemployment rate	4.3	5.9	7.3	4.2	4.2	4.5	5.3	5.7	5.9	6.9	7.3	7.4	7.3	7.0
Industrial production	2.0	-5.6	1.3	0.5	-5.2	-17.8	-10.3	2.9	5.0	3.0	0.0	-1.0	-2.0	0.0

*All financial variables are period averages

Australia - summary of main macro views

- The Australian economy has emerged from the global downturn largely unscathed as one of the few economies to **avoid back-to-back falls in GDP**.
- We expect only a mild **fall in business investment** in 2009-10, following the 2Q business investment survey, which showed firms are more optimistic about the outlook, both domestic and offshore.
- With **labour force participation falling** slowly, the jobless rate will continue rising. That said, the fall in hours worked is spreading the pain.
- On **housing**, the expanded first home owners' grant has sucked forward buyers from 2010. The mini-boom will end in tears as the jobless rate rises, along with interest rates.
- The **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** has become more hawkish, particularly with respect to the global outlook, domestic investment prospects, and the domestic inflation outlook. We suspect the first rate hike will come in October 2009.
- Having front-loaded the **policy support**, the government is unlikely to deliver more significant fiscal stimulus.

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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	-1.7	1.7	-0.9	-2.0	-3.9	-3.9	1.2	0.9	0.8	1.4	2.5	3.0	2.9
Private consumption	0.1	-1.3	1.5	-0.9	-0.5	-1.0	-5.3	0.2	2.1	1.1	1.5	1.7	1.5	1.8
Fixed Investment	-3.7	-19.3	-2.3	5.6	-26.2	-22.5	-27.0	-18.2	-9.4	-4.7	0.0	2.0	4.0	3.7
Residential construction	-17.1	-23.5	-4.6	-27.2	-25.6	-45.8	-1.2	-28.0	-16.0	-8.0	0.0	2.0	4.0	6.0
Other fixed investment	-0.3	-18.4	-1.9	14.7	-26	-16.7	-31.2	-16.0	-8.0	-4.0	0.0	2.0	4.0	3.2
Inventory change (NZ$ bil, saar)	1.4	-0.4	0.3	0.3	0.5	0.2	-0.2	-0.2	-0.1	0.0	0.1	0.1	0.1	0.1
Government spending	3.9	2.1	1.5	1.6	1.6	6.2	1.4	0.4	1.2	1.6	0.8	2.8	2.4	0.8
Exports of goods & services	-1.5	1.6	4.5	0.4	-11.5	-11.9	2.3	31.0	-2.0	2.0	3.0	4.0	6.0	7.0
Imports of goods & services	2.5	-15.9	2.9	13.4	-24.4	-23.6	-30.2	-7.5	7.0	2.0	3.0	3.0	4.0	5.0
Contributions to GDP growth:														
Domestic final sales	1.3	-6.9	0.6	5.0	-11.0	-6.1	-11.6	-9.8	1.9	-0.1	1.0	1.9	2.1	2.0
Inventories	0.4	-1.4	0.6	-0.9	2.4	-3.7	-4.8	0.2	1.8	0.8	0.4	0.2	0.2	0.2
Net trade	-1.4	6.6	0.5	-4.8	7.3	6.1	13.7	11.7	-2.8	0.0	0.0	0.3	0.6	0.6
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	1.8	1.7	6.7	6.2	-1.8	1.1	2.3	2.0	1.6	1.4	1.4	1.7	2.3
%oya	4.0	1.9	1.7	4.0	5.1	3.4	3.0	1.9	0.9	1.8	1.8	1.6	1.6	1.7
Trade balance (NZ$ bil, sa)	-2.2	2.3	-0.9	-1.1	-0.8	-0.1	0.9	0.9	0.5	0.1	-0.1	-0.2	-0.3	-0.3
Current account (NZ$ bil, sa)	-16.0	-7.4	-14.9	-4.7	-4.0	-3.7	-1.2	-2.7	-1.7	-1.8	-2.7	-5.2	-3.4	-3.6
as % of GDP	-9.0	-4.9	-8.0	-10.5	-9.1	-8.3	-6.0	-3.8	-3.9	-5.9	-7.3	-7.6	-7.8	-9.2
Yield on 90-day bank bill (%)*	7.9	2.9	3.2	8.8	8.2	6.0	3.4	2.8	2.8	2.8	3.0	3.1	3.2	3.3
10-year bond yield (%)*	6.0	5.5	6.0	6.5	5.9	5.3	4.7	5.7	5.6	5.8	6.0	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	-8.1	-8.9											
as % of GDP	-1.7	-4.4	-4.7											
Unemployment rate	4.2	6.2	7.6	4.0	4.3	4.7	5.0	6.0	6.6	7.1	7.5	7.8	7.6	7.4

*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. GDP growth should turn positive by year-end.
- **Business confidence** has improved markedly, though investment will remain a drag on GDP growth this year; this, of course, has negative implications for the employment outlook.
- The prolonged decline in **private consumption** will continue, particularly given the recent deterioration in the labour market. 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. In the June quarter, wage growth slowed to a standstill and unemployment jumped a full percent to 6%.
- 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
14 Sep **New Zealand:** Retail sales (10:45 am) Jul 0.3 % m/m, sa	**15 Sep** **Australia:** Dwelling starts (11:30am) 2Q 6.0 %q/q, sa **New Zealand:** Mfg. activity (10:45 am) 2Q	**16 Sep** **Australia:** Westpac leading index (10:30 am) Jul	**17 Sep** **New Zealand:** Business NZ PMI (10: 30 am) Aug	**18 Sep**
21 Sep **Australia:** New motor vehicles sale (11.30 am) Aug **New Zealand:** Visitor arrivals (10:45 am) Aug Credit card spending (3:00 pm) Aug	**22 Sep** **New Zealand:** Current account (10:45 am) 2Q Westpac NZ consumer Confidence (2:00 pm) 3Q	**23 Sep** **New Zealand:** GDP (10:45 am) 2Q	**24 Sep**	**25 Sep** **New Zealand:** Trade balance (10:45 am) Aug
28 Sep	**29 Sep** **New Zealand:** Building permits (10:45 am) Aug	**30 Sep** **Australia:** Building approvals (11:30 am) Aug Pvt. Sector credit (11:30 am) Aug Retail sales (11:30am) Aug **New Zealand :** NBNZ business conf.(2:00 pm) Sep	**1 Oct**	**2 Oct**
5 Oct **Australia:** ANZ job ads (11:30 am) Sep **New Zealand:** ANZ commodity price (%m/m, nsa) Sep	**6 Oct** **Australia:** Trade balance (11: 30 am) Aug RBA cash target (2:30 pm) Oct **New Zealand:** NZIER bus. opinion survey (%bal) (11:00 am) 3Q	**7 Oct** **Australia:** Housing finance approvals (11:00 am) Aug	**8 Oct** **Australia:** Unemployment rate (11:00 am) Sep	**9 Oct**

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Global Data Diary

Week / Weekend	Monday	Tuesday	Wednesday	Thursday	Friday
14 - 18 Sep	**14 September**	**15 September**	**16 September**	**17 September**	**18 September**
China • Money supply (Aug) **Japan** • Department store sales (Aug)	**Euro area** • Employment (2Q) • IP (Jul) **Japan** • IP final (Jul)	**Brazil** • Retail sales (Jul) **Euro area** • Labor costs (2Q) **France** • CPI (Aug) **Germany** • ZEW business surv (Sep) **Poland** • CPI (Aug) **Russia:** IP (Aug) **United Kingdom** • CPI (Aug) **United States** • Business inventories (Jul) • NY Fed survey (Sep) • PPI (Aug) • Retail sales (Aug) • Bernanke speech	**Euro area** • HICP final (Aug) **United Kingdom** • Labor mkt report (Aug) **United States** • CPI (Aug) • IP (Aug) • NAHB survey (Sep)	**Canada** • CPI (Aug) **Euro area** • Foreign trade (Jul) **Japan** • Flow of funds (2Q) • MoF bus outlook surv (3Q) • Reuters Tankan (Sep) • Tertiary sect activity (Jul) • BoJ meeting **Switzerland** • SNB meeting **Turkey** • CBRT meeting **United Kingdom** • Retail sales (Aug) **United States** • Flow of funds (2Q) • Housing starts (Aug) • Philly Fed survey (Sep)	**Mexico** • Banxico meeting
21 - 25 Sep	**21 September**	**22 September**	**23 September**	**24 September**	**25 September**
United Kingdom • Nat'wide HPI (Sep) **Taiwan** • CBC meeting		**South Africa** • CPI (Aug) • SARB meeting **United States** • FHFA HPI (Jul) • Richmond Fed surv (Sep)	**Belgium** • BNB bus survey (Sep) **Euro area** • Industrial orders (Jul) • PMI flash (Sep) **France** • Cons of mfg goods (Aug) • INSEE bus survey (Sep) **Norway** • Norges bank meeting **Taiwan** • Export orders, IP (Aug) **United Kingdom** • MPC minutes **United States** • FOMC meeting	**Czech Republic** • CNB meeting **Germany** • IFO bus survey (Sep) **Israel** • BoI meeting **Japan** • All sector activity (Jul) • Trade balance (Aug) **Mexico** • Trade balance prov (Aug) **United States** • Existing home sales (Aug)	**Colombia** • BanRep meeting **Euro area** • M3 (Aug) **United Kingdom** • Bus investment final (2Q) **United States** • Consumer sent (Sep) • Durable goods (Aug) • New home sales (Aug)

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