J.P.Morgan

Australia and New Zealand - Weekly Prospects

Summary

- Comments from **RBA** Governor Stevens last week, suggesting that it would be a mistake for the Bank to be "too timid" to raise interest rates, prompted financial markets to tip seven interest rate rises in a row. The speech, in our view, though, was an attempt to explain why the RBA kicked off the tightening cycle in early October, and was not intended to signal the timing of future rate moves. Stevens highlighted the uncertain global outlook and that monetary policy settings in Australia needed to ensure that the recovery in the domestic economy is sustainable. This reinforced that the cash rate will be increased "gradually." We acknowledge the significant risk of a November move, but believe the RBA will sit on the sidelines until December. By then, the RBA will have more information on which to gauge the strength of consumers in a post-rate-hike world, more data to assess the strength of the global economy, and can avoid having to explain a rate hike in the wake of what should be a weak CPI report (Oct. 28).
- In **New Zealand**, market speculation that the RBNZ will lift rates in early 2010 picked up last week after 3Q CPI printed on the upside of expectations. Inflation remained in the bottom half of the RBNZ's 1-3%oya target range, however, and the headline, at 1.7%oya, was driven higher by one-off influences. Our forecast is for a 50bp hike in mid-2010 and the RBNZ to shift to a neutral policy stance in December or early 2010, even though financial markets are sceptical of Governor Bollard's commitment to maintaining the OCR "at or below current levels until late 2010."
- The **global economy** has experienced an unprecedented phase of acceleration this year. Global GDP swung from a 7.5% annualized contraction in 1Q09 to an estimated 3.7% advance last quarter. The turn in manufacturing was even more dramatic as output moved from a 28% rate of descent to a 12% pace of gain. Against the backdrop of this rapid shift from deep contraction to above-trend growth, it is not surprising that asset prices and economic projections have also moved materially higher.
- We believe that this **acceleration phase is coming to an end** and a transition from "lift to carry" is under way. GDP growth is expected to remain strong but is not likely to accelerate further. As a result, economic data releases should produce less consistent upside surprises. This transition should be accompanied by a moderation in the pace of manufacturing output growth. However, demand indicators should show signs of broadening across sectors and countries. And this broadening should be accompanied by more balanced income gains as this year's rebound in corporate profits gradually gives way to rising employment and labour income. A successful transition to more broadly based growth in the coming months is the key for sustaining a synchronized expansion through 2010.

Oct 19, 2009

Contents

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This week's highlights

The minutes from the RBA's October meeting (Tuesday) will discuss in more detail the Board's decision to kick off the tightening cycle two weeks ago.

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Data and event previews - Australia and New Zealand

Date	Time [a]	Data/event	Forecast JPMorgan	Forecast Consensus [b]	Previous
Monday, October 19	1.00pm	RBA Assistant Governor Lowe's speech	**na**	na	*na*
Tuesday, October 20	11.30am	RBA Board minutes (Oct.)	**na**	na	*na*
Wednesday, October 21	8.45am	NZ visitor arrivals (%m/m, Sep.)	**na**	na	*-0.8*
Wednesday, October 21	11.00am	Aust. Westpac Leading Index (%m/m, Aug.)	**na**	na	*1.1*
Wednesday, October 21	11.30am	Aust. new motor vehicle sales (%m/m, Sep.)	**na**	na	*0.3*
Wednesday, October 21	1.00pm	NZ credit card spending (%oya, Sep.)	**0.5**	na	*0.1*
Thursday, October 22	11.30am	Aust. CBA-HIA housing affordability (Index, 3Q)	**na**	na	*152.5*
Friday, October 23	11.30am	Aust. import price index (%q/q, 3Q)	**-3.6**	-2.6	*-6.4*
Friday, October 23	11.30am	Aust. export price index (%q/q, 3Q)	**-4.9**	-4.8	*-20.6*

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

Australia

RBA Assistant Governor Lowe's speech - The Assistant Governor (Economic) will deliver a speech to the Citigroup Australia Investment Conference in Sydney. The topic of the speech is, *"The Growth of Asia and Some Implications for Australia"*. There is a Q&A session to follow.

RBA Board minutes (Oct.) - The minutes will discuss in greater detail the decision to hike the cash rate 25bp two weeks ago. The minutes will describe why the RBA has embarked on what will likely be an extended tightening cycle when the global outlook remains uncertain. By tightening policy in October, officials signaled that the "crisis" that led to the cash rate being slashed to a multi-decade low is well and truly over.

Aust. terms of trade (%q/q, 3Q) - Both export and import prices should have fallen further in 3Q. The 3.6%q/q fall we forecast in import prices owes to the stronger currency, with AUD up 10% against the US dollar over the third quarter.

New Zealand

NZ credit card spending (%oya, Sep.) - Credit card spending in August rose 0.1%oya, marking the first increase after nine straight months of decline. In September, growth in credit card spending will remain subdued at 0.5%oya, with consumers feeling less reluctant to use credit in the wake of the end of the recession.

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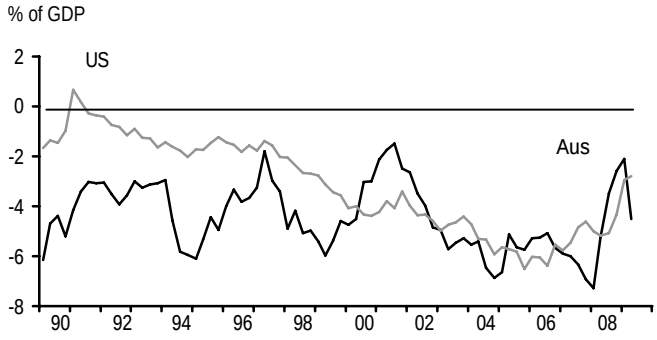
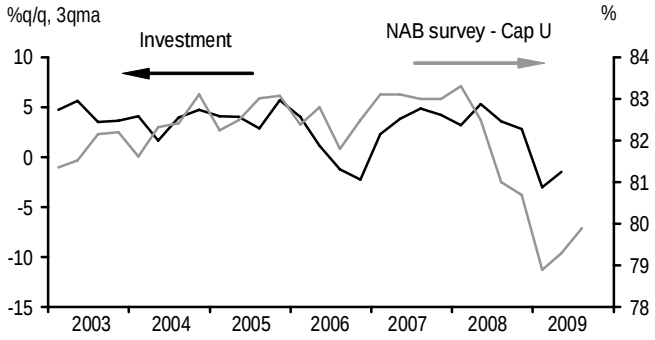
Feature charts

Australia and US: current account balance



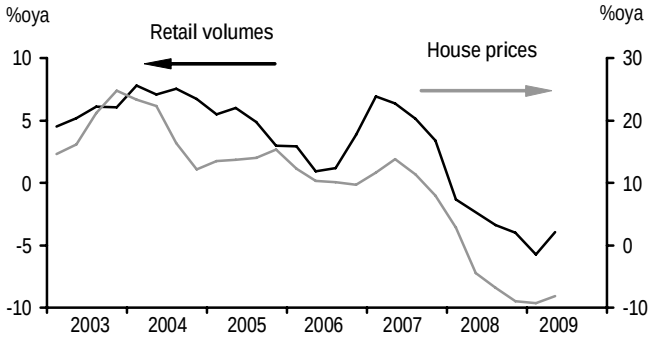
The US current account position deteriorated for many years due to continued support of USD by Asian economies. Australia's current account balance, in contrast, tends to fluctuate countercyclically with the exchange rate. Increases in the yield differential force upward adjustments to AUD, reducing the trade balance component of the current account. This mechanism has proven an important stabilizing influence for Australia, and for many other small open economies.

Australia: plant and machinery investment and capacity utilization



Investment in plant and machinery in 1H was supported by the government's investment allowance. Firms have been quick to capitalize on this tax break, expanding capacity substantially beyond that required given the weak domestic demand outlook they faced at the beginning of the year. This dynamic will contribute to lower capacity utilization levels, thus lower inflation than would have otherwise been predicted given the surprising resilience of the Australian economy to the global recession.

New Zealand: retail sales volumes and house prices



The RBNZ has recently discussed the importance of recognizing channels though which house price appreciation can affect ordinary price inflation. In the RBNZ's modelling, higher house prices reduce loan to value ratios and, therefore, households' borrowing premia. This fuels discretionary spending and inflation.

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Australia

- **RBA's Stevens reiterates that rates will go higher**
- **Pace of normalization requires careful judgement**
- **Consumers upbeat after fall in unemployment**

The Australian economic data flow slowed to a trickle last week, the highlight being an unexpected rise in consumer confidence. Although consumers remained upbeat in the wake of the first of what should be a series of RBA rate hikes, the improvement in sentiment owed entirely to news of a surprise fall in the unemployment rate in September. The RBA will want more evidence, however, of how consumers have held up in a post-rate-hike world and, thus, will likely sit on the policy sidelines until December.

RBA minutes to confirm that rates will rise

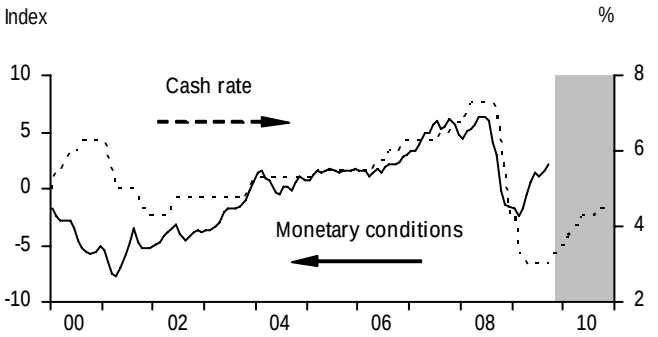
The release Tuesday of the minutes from the RBA's early October policy meeting will discuss in greater detail the decision to hike the cash rate 25bp to 3.25%. The Reserve Bank Board has embarked on what will likely be an extended tightening cycle, as officials move away from "emergency" policy settings. By tightening policy in October, officials signaled that the "crisis" that led to the cash rate being slashed to a multi-decade low is well and truly over.

Governor Stevens last week, in a speech titled "The Conduct of Monetary Policy in Crisis and Recovery," touched on the reasons why the RBA hiked the cash rate in October. The Governor discussed the Board's "risk management" approach. Indeed, the RBA slashed the cash rate 425bp to a low of 3% in the most recent easing cycle in a bid to protect the economy against the emergence of an adverse outcome—an outcome that failed to materialize.

Now that the risk of serious economic weakness has abated, the question is how to "configure monetary policy for the recovery." The insurance policy that was put in place by the RBA needs to be removed, and rates need to be shifted from "emergency" settings to more "normal" levels. That said, there is no mad rush to do so.

The Governor flagged that there are still a number of "important matters of judgment in the timing and pace of how that is done." One important matter to consider is the global outlook, which the Board believes is still very uncertain. Another is the domestic economy. The Board is wary of stunting economic growth. The Governor pointed out that future monetary policy changes must encourage the sustainability of Australia's economic expansion, which it expects will continue into 2010. This reaffirmed our depiction of the first part of the tightening cycle as the RBA lifting its collective

Australia: RBA cash rate and J.P. Morgan MCI



Australia: export and import prices

foot off the policy accelerator, not depressing the brake.

Monetary policy relies also on changes in the cash rate affecting other interest rates, as pointed out by the RBA Governor last week. This was an obvious, but important and timely point for the Governor to make in light of recent announcements from the "Big Four" commercial banks that they will hike their variable mortgage rates by more than the hikes to the RBA cash rate going forward in a bid to compensate for rising bank funding costs. This further justifies the RBA taking a "steady as she goes" approach in coming months, particularly in the near-term if the domestic commercial banks do some of the RBA's hard work.

On inflation, the Governor reiterated that the policy framework is a medium-term target for inflation of 2 to 3%oya, on average. In our forecasts, headline inflation will remain comfortably within the Bank's comfort zone until end-2010 and core inflation will ease toward the midpoint of that target range over the same period. The RBA highlighted, though, that while inflation should be move consistently back to target over a period of time, this is merely, at this point in time, a forecast.

The comments from Governor Stevens confirmed that the RBA will continue to tighten monetary policy in coming quarters, but is in no hurry to do so, particularly given that

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there are still some clouds hovering above the global outlook. By skipping November and delivering the next rate hike in December, the RBA will have more economic data with which to gauge the strength of the global economy. Waiting until December to deliver another rate hike also would enable the RBA to avoid having to explain a rate hike just one week following the release of what will likely be a weak 3Q CPI print (we forecast 0.9%oya on headline CPI) and allow more time to assess the strength of the domestic economy in a post-rate-hike world.

Consumers upbeat after employment data

Consumers were surprisingly more upbeat in October, with the Westpac-Melbourne Institute (WMI) consumer confidence index rising 1.7%q/q to 121.4 in October (J.P. Morgan: -5%). Consumer sentiment rose early this month despite the RBA's decision to initiate the next hiking cycle, a decision that many expected would be postponed until November. The confidence survey was conducted October 5-11 so would have captured consumers' responses to September's surprisingly strong employment report. The labour force survey showed employment jumping 41,000, a small rise in the participation rate, and the unemployment rate falling from 5.8% in August to 5.7%.

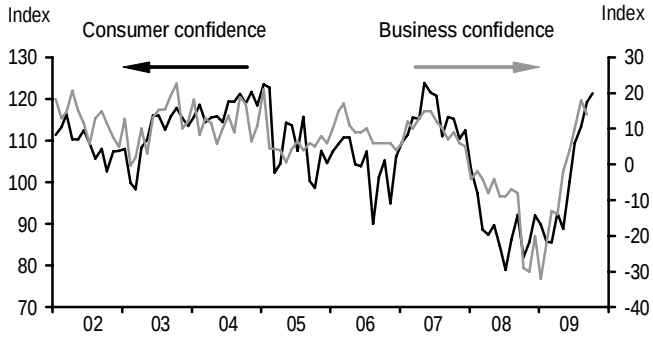
According to the WMI, the rise in confidence following the October rate hike is comparable to the result following the last tightening cycle in 2002 in which only a modest decline in consumer sentiment was recorded. Historically, consumer confidence does tend to suffer greater falls further into the tightening cycle, as pressure on mortgage rates becomes more dramatic. In this month's result, a decline in petrol prices and the continued rally in equity markets since the last survey were also decisive factors driving confidence higher.

Data releases and forecasts

Week of October 19 - 23

Wed Oct 21 10:30am	WMI leading index Seasonally adjusted	May	Jun	Jul	Aug
	(%m/m)	-0.8	0.9	1.1	__

Australia: WMI consumer confidence and NAB business confidence



Wed Oct 21 11:30am	Sales of new motor vehicles Units, seasonally adjusted	Jun	Jul	Aug	Sep
	(%m/m)	6.0	-6.9	0.3	__
	(%oya)	-7.1	10.3	-6.2	__

Fri Oct 23 11:30am	Export price index Not seasonally adjusted	4Q08	1Q09	2Q09	3Q09
	Index	219.9	209.8	166.6	158.3
	(%q/q)	15.9	-4.6	-20.6	-4.9
	(%oya)	54.9	42.8	-0.2	-16.6

Fri Oct 23 11:30am	Import price index Not seasonally adjusted	4Q08	1Q09	2Q09	3Q09
	Index	137.0	133.2	124.7	120.2
	(%q/q)	10.8	-2.8	-6.4	-3.6
	(%oya)	21.1	14.6	5.9	-2.9

Both export and import prices should have fallen further in 3Q, leading the terms of trade down another 16%q/q, after falling 15% in 2Q. In May, the RBA indicated that the terms of trade would fall 25% this year, although the 2Q and 3Q results alone already suggest this forecast will have to be revised lower.

Review of past week's data

NAB monthly business survey
% balance, seasonally adjusted

	Jul	Aug	Sep	
Business confidence	10	18	~~16~~	*14*

WMI consumer confidence survey
100=neutral, seasonally adjusted

	Aug	Sep	Oct	
(%m/m)	3.7	5.2	~~-5.0~~	*1.6*

New Zealand

- **3Q CPI printed on high side of expectations**
- **Nontradable inflation moving down to target range**
- **Retail sales rebounded strongly in August**

In New Zealand, market speculation that the RBNZ will lift rates in early 2010 picked up last week after the third-quarter CPI report printed on the upside of expectations, despite remaining comfortably within the RBNZ's 1-3% target range. With nontradable inflation having moderated significantly in recent quarters, and set to head even further south, we maintain our view that the first official cash rate hike is some way off. Our forecast is for a 50bp hike in mid-2010 and the RBNZ to shift to a neutral policy stance in December or in early 2010.

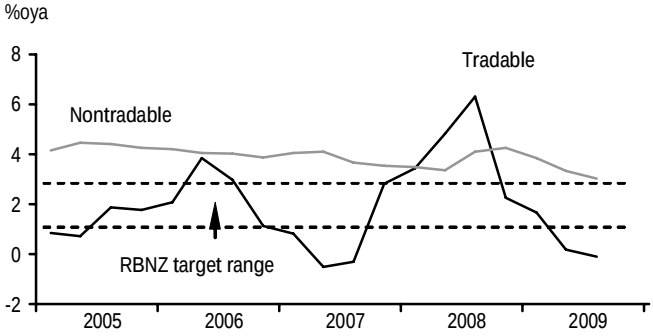
One-off factors behind CPI surprise

Inflation remained in the bottom half of the RBNZ's 1-3%oya target range in the third quarter. The headline, at 1.7%oya, was higher than expected, but this owed largely to one-off influences that pushed prices higher. The nontradable measure—inflation generated domestically and not influenced by the exchange rate—remained elevated. That said, nontradable inflation has come down significantly in recent quarters and should meander even lower, which reaffirms our view that the RBNZ's tightening cycle is some way off, even though financial markets do not believe Governor Bollard is committed to maintaining the OCR "at or below current levels until late 2010."

Consumer prices rose 1.3%q/q (J.P. Morgan and consensus: 0.8%), or 1.7%oya, marking the lowest annual increase in over five years. Smaller annual increases in petrol prices, thanks to a stronger NZD, were offset by higher prices for food, electricity, and local authority rates. The 5.4%oya rise in food prices accounted for well over half of the CPI annual increase. There were a few one-off influences on headline CPI. Vehicle re-licensing fees rose 16.2%oya, owing to an increase in levies, and alcoholic beverages rose 2.5%, owing to a higher excise duty from July. We still believe that 1.7%oya was the low point for inflation in this cycle, but acknowledge that one-off factors pushed headline CPI higher in 3Q.

Nontradable inflation, which printed at 3%oya in the September quarter, remained at the very top of the RBNZ's comfort zone. The result owes to significant upward contributions from electricity and local authority rates, which rose 4.5%oya and 6.6%, respectively. This is the first time, though, that nontradable inflation has been within (or at least on the edge of) the Bank's target since early 2002.

New Zealand: nontradable and tradable inflation



New Zealand: consumer confidence and retail sales volumes

Thanks to the elevated NZD, the tradables component fell 0.1%oya in 3Q; the first fall in two years.

Although financial markets do not believe that RBNZ Governor Bollard is committed to maintaining the OCR "at or below current levels until late 2010," we believe it will take a significant upside surprise in the economic data to prompt an earlier move. The RBNZ also will find it some comfort that inflation expectations remain contained, with stronger activity yet to translate into expectations of higher prices. Inflation expectations have eased sharply since 2H08—the RBNZ's own inflation measures, which are at 1.8%oya one year out, are their lowest since 1999.

Kiwi retail sales spiked in August

Retail sales values surged 1.1%m/m in August (J.P. Morgan: 0.2%; consensus: 0.5%), rebounding strongly from a 0.5% decline in the previous month. Underlying sales were firm, with the ex. auto measure jumping 1.2%m/m. With last week's retail numbers surpassing even the most optimistic forecasts, the RBNZ certainly will be feeling uneasy about its commitment to keeping the OCR "at or below" current levels until the end of 2010.

Positive net immigration flows and the recent pickup in housing market indicators appear to be underpinning con-

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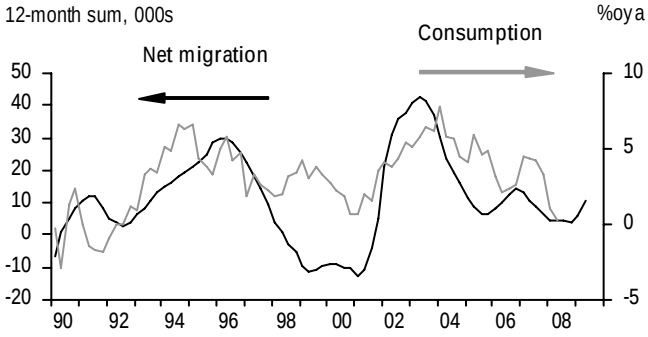
sumer spending. Two-thirds of all retail industries showed increases in August, with the largest rise in clothing and soft goods retailing (+6.5%m/m). This was attributed to unusually warm weather conditions, with August being the warmest month on record.

Although we will not see the 3Q retail volumes data until November 12, it appears that household consumption will make another positive contribution to GDP growth in the third quarter, after increasing 0.4%q/q in the second quarter. The recent spike in consumer confidence to a four-year high supports this view. We acknowledge that further labour market weakness will cap the upside, particularly in 2010, with our forecast calling for unemployment in New Zealand to peak at 7.8% in mid-2010.

New Zealand: net permanent migration and consumption growth



Data releases and forecasts

Week of October 19 - 23

Wed Oct 21 10:45am	**Visitor arrivals** Not seasonally adjusted	Jun	Jul	Aug	Sep
	Total (%m/m)	-3.8	3.9	-0.8	__
Wed Oct 21 10:45am	**Net permanent immigration** Not seasonally adjusted	Jun	Jul	Aug	Sep
	Monthly (000s)	0.7	2.7	1.6	__
	12-month sum (000s)	12.5	14.5	15.6	__
Wed Oct 21 3:00pm	**Credit card spending** Percentage change	Jun	Jul	Aug	Sep
	%oya	-2.1	-1.9	0.1	0.5

Credit card spending in August rose 0.1%oya, marking the first increase after nine straight months of decline. In September, growth in credit card spending will remain subdued at 0.5%oya, with consumers feeling less reluctant to use credit in the wake of the end of the recession.

Review of past week's data

QVNZ house prices
%, median

	Jul		Aug		Sep	
(%oya)	-5.0		-2.8		__	*1.1*

Retail trade
Seasonally adjusted

	Jun		Jul		Aug	
(%m/m)	~~-0.1~~	*0.0*	-0.5		~~0.2~~	*1.1*
(%oya)	~~-1.8~~	*-1.7*	-1.7		~~-1.6~~	*-0.6*

Business PMI
Seasonally adjusted

	Jul		Aug		Sep	
Index	49.6		~~48.7~~	*48.8*	__	*51.7*
(%oya)	3.2		7.2		__	*12.1*

Consumer price index
Not seasonally adjusted

	1Q09		2Q09		3Q09	
Headline (%oya)	3.0		1.9		~~1.1~~	*1.7*
Headline (%q/q)	0.3		0.6		~~0.8~~	*1.3*

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Global Essay

- **Global manufacturing rose at a double-digit pace last quarter for the first time in 30 years**
- **The global economy is no longer accelerating but a transition toward a broadening base of growth has begun**
- **EM consumers now spend more than their US counterparts but maintain high rates of saving**
- **This week should deliver strong 3Q09 GDP gains in Korea and China along with a weak reading in the UK**

From lift to carry

The global economy has experienced an unprecedented phase of acceleration this year. Global GDP swung from a 7.5% annualized contraction in 1Q09 to an estimated 3.7% advance last quarter. The turn in manufacturing was even more dramatic as output moved from a 28% rate of descent to a 12% pace of gain. Against the backdrop of this rapid shift from deep contraction to above-trend growth, it is not surprising that asset prices and economic projections have also moved materially higher.

We believe that this acceleration phase is coming to an end and a transition from "lift to carry" is under way. GDP growth is expected to remain strong but is not likely to accelerate further. As a result, economic data releases should produce less consistent upside surprises. This transition should be accompanied by a moderation in the pace of manufacturing output growth. However, demand indicators should show signs of broadening across sectors and countries. And this broadening should be accompanied by more balanced income gains as this year's rebound in corporate profits gradually gives way to rising employment and labour income. A successful transition to more broadly based growth in the coming months is the key for sustaining a synchronized expansion through 2010.

In tracking this transition through high-frequency releases, there is much to be comforted by. Activity releases for August and September confirm that the production bounce that began in Asia during 2Q09 is now established in Europe and the Americas. Perhaps most importantly, final demand indicators delivered a major surprise last quarter. Our global final sales proxy rose at a 4% annual rate, close to its most rapid pace of the past decade. As a result of this upside surprise to demand, global inventories continue to be drawn down at an unprecedented pace despite rising levels of production, a development that is very positive for current quarter growth.

An important element of last quarter's demand growth represents a temporary lift from fiscal incentives, notably in the auto industry. Final sales gains will likely slow sharply this quarter as these incentives fade, with global consumption spending moderating most noticeably. However, it is encouraging to a see a broadening base for demand begin to take hold in recent months. Global capital goods shipments appear to be stabilizing and nonauto retail sales have posted solid gains across a wide range of countries. A turn in housing activity also looks to be taking hold in the UK and US.

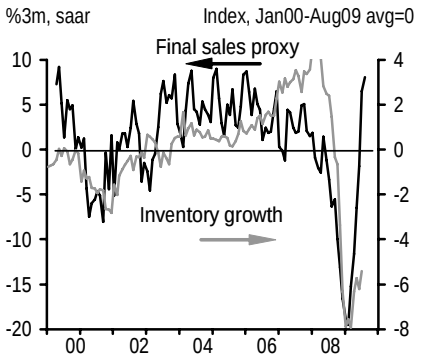
The initial releases for the month of September—notably our global PMI survey and US payrolls—raised concern that the transition to more broadly based growth might be stalling. However, the last two weeks have provided a wave of upbeat September activity readings on balance. Notably, Asian trade flows have been strong and US retail sales and production readings delivered solid underlying gains. Early US October readings—from regional business surveys and jobless claims—also send an upbeat message.

Manufacturing output, %q/q saar

	4Q08	1Q09	2Q09	3Q09
Global	-23.0	-28.2	4.8	11.8
Developed	-23.6	-32.2	0.3	10.4
US	-18.1	-22.0	-8.7	7.1
Euro area	-26.1	-34.6	-3.7	9.4
Japan	-38.0	-63.3	37.6	30.4
Emerging	-20.6	-12.1	23.4	17.7
EM Asia	-18.8	-4.6	39.9	22.3
China	-4.6	4.4	35.3	17.6
ex-China	-31.0	-12.5	43.8	26.5
Latam	-19.8	-22.4	3.1	11.5
CEEMEA	-27.0	-20.5	1.5	12.0

Euro area derived as weighted avg of national data.
3Q based on September estimates.

Global final sales and inventories



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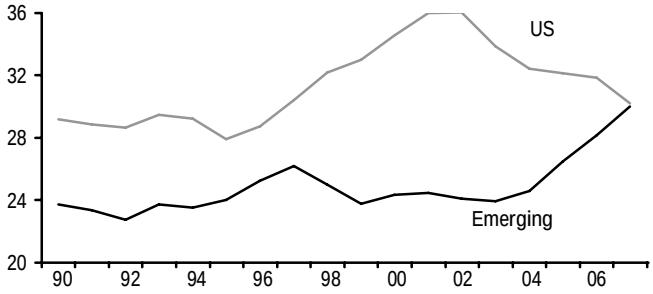
Global consumption share, 1990-2007

%, share of global nominal consumer spending (USD)



Caution related to the speed of adjustment in labour markets remains, particularly with US consumer confidence depressed and energy prices moving higher again.

Moreover, last week's weaker than expected August trade release from the Euro area makes this week's October flash PMI an important marker for gauging whether we are right that the Euro area will remain a key contributor to above-trend global growth. The Euro area composite PMI, which was 51.1 in September, needs to move to the mid-50s or higher to be consistent with sustained growth at 2.5%-3%. We expect a move up further to 52.5 in the October flash report this week, but the journey is not yet complete.

EM consumers eclipse the US

The recent G-20 summit meeting heightened the focus on the need for global rebalancing. One solution that is often mentioned is the substitution of EM consumption for US consumption as an engine of global growth. The rebalancing debate often fails to note that EM consumers already have become a force in their own right. Based on available data through 2007, our calculations show that EM consumption had grown to be about equal to US consumption, each totaling about 30% of global GDP (in nominal US dollars). In all likelihood, EM consumption has overtaken US consumption since that time, considering the relative severity of the US recession.

EM consumption outpaced both US and global consumption in the 2000s expansion, although EM GDP outdistanced global GDP by an even greater margin. This is consistent with the rapid growth of EM net exports, reflecting both the dramatic improvement in the terms of trade for net commodity exporters and the rapid growth of export volume from EM Asian manufacturers. Growth in EM fixed investment also outpaced consumption.

Notably, the developed world's average propensity to consume equals 62% of GDP. This is far above the EM average of just over 52%, which reflects a very low percentage in China. The very low propensity to consume in the EM holds out the potential for rapid gains in EM household spending in the years to come. This is especially true if EM governments enact policies designed to promote consumption, which include stronger FX rates and increased social safety nets. One impediment is that the 2008/09 recession reinforced EM policymakers' belief in the importance of maintaining a war chest of FX reserves to have on hand when trouble strikes.

UK recovery is lagging, not faltering

Western Europe appears to be contributing to the synchronized global upswing in an uneven manner. The Euro area looks on track for a 3% ar GDP gain in the third quarter, supported by a surge in manufacturing output. In contrast, this week's GDP report in the UK is expected to show a meager 0.5% ar gain. Even though UK growth was sluggish in the third quarter, the recent data flow has generally been positive. Last week saw further improvements in key surveys. Our tracking model points to a good gain in household spending in September, while the housing market is showing clear improvement. Last week's reports also showed that corporates are responding to the improving demand and financial backdrop with reduced job shedding. The current quarter thus looks likely to see the UK step up to enjoy a growth rate similar to that seen in the Euro area and elsewhere.

EM Asia: still strong but set to moderate

As usual, Singapore was the first Asian economy out of the blocks with its 3Q09 GDP report, and the advance estimate showed that the economy expanded at a 14.9% annualized rate, even after the near 21% surge in 2Q. Korea and China report this week, and should also deliver strong results. We have revised up our Korean forecast to 8.5% (from 4%), and China may well surprise on the high side, too, with a second straight quarter of double-digit growth. Equally important, activity data are strong heading into the current quarter. Monthly export gains have been impressive in all the countries that have reported in September. IP reports for last month begin with China and Taiwan this week, and they are likely to deliver a similar message.

Although the data flow remains strong, it is consistent with a gradual moderation in GDP growth in the current quarter. This moderation is likely to be particularly noticeable in

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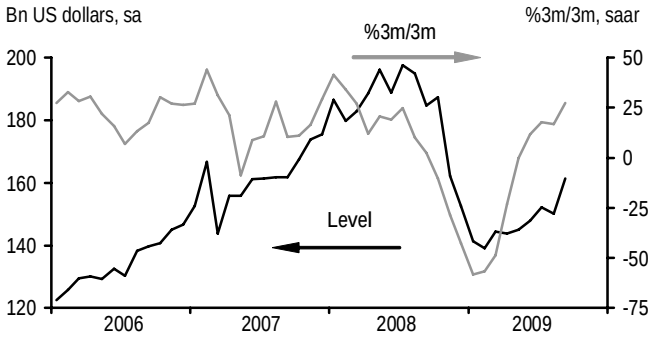
EM Asian exports (China, Taiwan, Korea, Singapore)



some high-beta countries including Singapore, Malaysia, and Korea. Skepticism about the prospects for DM growth, and the recognition that Asian growth may turn out to be choppy, is likely to keep regional central banks cautious. Indeed, last week's dovish statement from the Monetary Authority of Singapore, following a pause in the hawkish rhetoric from the Bank of Korea, is evidence of this. Thus, while EM Asian central banks will likely set the monetary tightening cycle in motion in 2010, rate hikes are expected to be incremental and gradual.

BoJ points to an earlier end to QE

In last week's press conference, Governor Shirakawa signaled that the BoJ's program to purchase commercial paper and corporate bonds is likely to expire on schedule in December. The BoJ will likely make this decision and corresponding announcement at the October 30 policy meeting, when it publishes its semiannual *Outlook Report*. In a surprise, Shirakawa also indicated that the BoJ is reviewing its special loan program. He also indicated that other unconventional measures such as paying interest payments on excess reserves and the expansion of eligible collateral need to be reviewed soon.

While Shirakawa's comment suggests that the BoJ is becoming more aggressive in ending its unconventional measures, he reiterated that the BoJ will maintain its ultra-low interest rate policy for a long period of time, emphasizing that termination of some unconventional measures would not reflect a change in monetary policy stance. We believe that the BoJ will maintain a "low for long" policy with the 0.1% policy rate unchanged throughout 2010, as core price deflation intensifies.

Fiscal reform set for approval in Mexico

Financial markets and rating agencies have grown increasingly concerned about Mexico's fiscal outlook and creditworthiness since the crisis intensified last year. Consequently, this week's Lower House vote on fiscal reform will be keenly watched. Although the ruling PAN party clearly supports the fiscal package, the opposition PRI and the PRD parties have yet to reveal their positions. The main point of contention is a proposed 2% sales tax. If modified to exclude food and medicine, the PRI, which holds 47% of the seats in the House, will likely provide its support for the fiscal package, particularly as its controlled state governments stands to gain from the package's increased federal transfers.

Russia to move slowly on privatization

Although Russia's recovery is proceeding in line with expectations, with 2H09 and early 2010 expected to register above-trend growth, the forecast anticipates that growth will subside to a subpar 4% pace thereafter. One of the key factors behind this is that international investors are less likely to be willing to finance the growth of Russian corporates and banks than in the past. A move by Russia to intensify privatization efforts and attract more FDI, including to the energy sector, would help to overcome this obstacle. Although officials have indicated publicly that privatization and a new openness to inward FDI will be important for Russian growth, in reality, this year's rise in global oil prices has made this unlikely. Minority stakes in Russian companies will be available, but investors may be cautious about such positions given the recent track record.

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JPMorgan View - Global Markets

Cash is the new benchmark of value

- **Portfolio strategy:** The flight out of cash is set to continue, even if there are no further upside surprises on the economy. The low return on cash has become the new benchmark for value and should keep pushing other values up.
- **Fixed Income:** A return to the middle of the range allows us to go long duration to earn carry and benefit from asset reflation.
- **Equities:** Cost cutting and lower funding costs are creating a V-shaped recovery in profit margins.
- **Credit:** Stay long credit in both the US and Europe. In Europe, we focus our long on Financials, especially Lower Tier 2.
- **FX:** No dollar crisis yet, but hedging against it can be done cheaply.
- **Alternatives:** Re-enter short in crude oil, as drop in gasoline stocks is not demand driven.

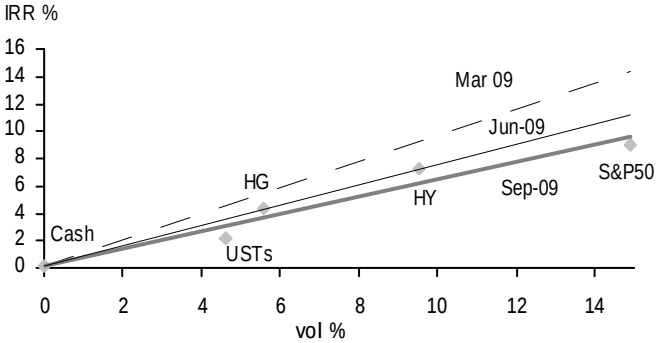
Last week felt like a carbon copy of the week before. **Risky assets—equities, credit, and commodities—were up, while bonds and the dollar were down. It's a classic recovery trade**, and fully supported by a nice set of economic activity reports over the last two weeks.

Economic data have improved over the past two weeks, after the wobbles in September, showing us a better demand side, greater inventory reductions, and a slowing in private sector job cuts. Our forecasts are tracking, raising confidence, but not yet signaling upside risk bias. We stay with a view of just-above-trend global growth over the coming year, though one that keeps the world economy operating well below capacity.

With economic recovery no longer the main surprise factor for markets, we have diversified over the past month to a **broader set of investment themes**—asset reflation, G-3 disinflation, policy normalization in the periphery, EM strength, banking revival, delevering, the search for yield and carry, and the threat to the equity culture (see last week's View and our monthly *GMOS*).

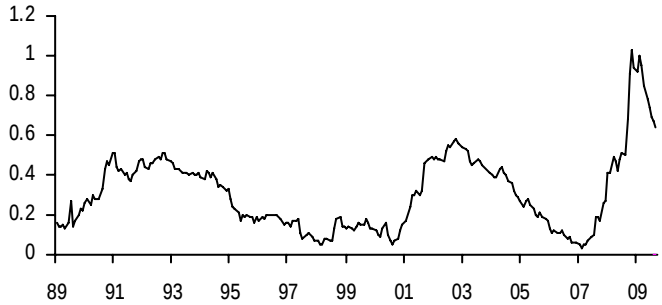
The driver with the most immediate impact is clearly **asset reflation**, or the pain of zero return on cash that is pushing investors into any other assets with positive yields. Unlike

Risk-return tradeoff line



Note: IRRs are calculated as current yield, minus expected default or downgrade losses in the case of credit. The IRR for equities is earnings yield, based on trend earnings for either operating earnings, plus the expected long-term rate of inflation. The x-axis is historical vol.

Slope of the risk-return tradeoff line



Note: The slope is calculated by applying a linear regression of the IRR of various assets against their historical vol.

the basis recovery trade, asset reflation is positive not only for equities and credit, but also for low-risk bonds. But unlike the former, the asset reflation trade is no support for commodities, which still have negative yields (roll). It is one reason why we turn short crude and have bearish forecasts for gold. **The rally in gold does not sit well with our themes of asset reflation, the search for yield, disinflation, and banking revival.** Price momentum in gold is strong, but we hate chasing a rally that makes little sense to us. **We stay out.**

Asset reflation is a term for broad-based price appreciation of virtually all assets, driven by the expensiveness of cash. Its impact can be seen at work through a traditional **risk-return trade-off** line depicted for the US in the chart above. It shows the internal rate of return (Sharpe ratio, or slope) of equities and various fixed income categories versus historical volatility.

In March, the return to historical risk was at its highest in decades. Since then, the steady flight out of cash, which has zero return and zero risk, continuously flattened the curve by pushing up asset prices and lowering IRRs. Even after this year's rally, the 60bp excess return per 100bp extra risk remains double its historical mean. As long as the

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return on cash remains pegged near zero, and investors continue to see uncertainty falling, money will keep flowing from cash into positive yield assets, and the curve will continue to flatten. Consideration of the outright value of any of these assets against their historical IRRs has little relevance. **Cash, as the hinge of the risk-return curve, has become the global benchmark of value. If the return on cash does not move, then other assets' values need to fall in line with the expensiveness of cash.**

Fixed income

Government bonds backed up last week to the middle of their five-month trading range. This allows us to move to our medium-term asset reflation and carry themes and to thus add duration. We go outright long in 2-years in Euros, and take profit on the tactical short we put on two weeks ago in the US. Elsewhere, the majority of our trade recommendations come down to earning carry and outperformance of higher-yielding bonds.

Equities

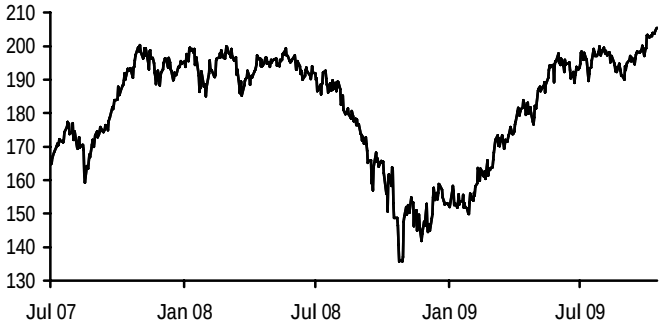
Equities rose for a second straight week, reaching new highs for the year. Third-quarter earnings are coming in better than expected with an average EPS beat of 18% for the 41 companies of the S&P500 that reported so far. We project a 3Q EPS of $16.30 for the S&P 500, around 10% above the bottom-up consensus. This will represent the third consecutive quarter of positive surprises and should validate a trajectory toward our 2010 $75 EPS. The $75 EPS forecast for 2010 is 25% higher than this year's $60, implying a much faster rise in earnings than nominal GDP, i.e., an **expansion in profit margins.**

The profit share of US GDP, a proxy for profit margins, peaked in 1Q06 at 10%. It has been falling steadily since then by around 0.5-1%-pt per year, but the decline accelerated in the second half of 2008, during which the profit share of US GDP dropped by a massive 3%-pts. In response to the sharp fall in demand and reduction in profitability in 4Q08, companies embarked on a **cost-cutting** exercise that is creating a **V-shaped recovery in profit margins**. Labour shedding coupled with subdued wage inflation and rapidly declining funding costs is helping companies to restore profitability back to levels seen prior to the Lehman bankruptcy.

A rise in the US profit to GDP ratio to 8%-9% would be consistent with an EPS level of $18-$19 per quarter set for early 2010. This would be consistent with an EPS of $75 for 2010. But the cyclical drivers of corporate profitability from cost cutting and declining funding costs should fade

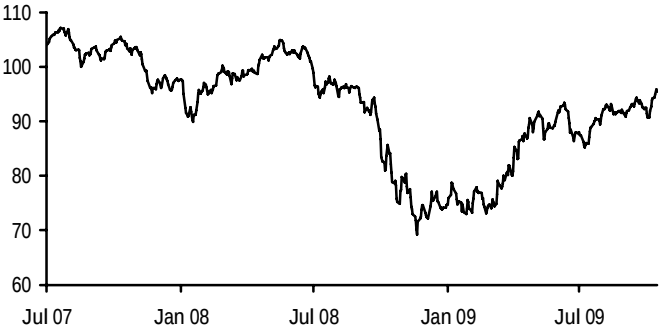
EM versus DM equities

Relative total return index, using MSCI World$ and MSCI EM$ indices



World Cyclical versus non-Cyclical equities

Relative total return index, using MSCI World$ sector indices



from mid-2010 and structural headwinds are likely to surface. As explained in our global issues piece *Bouncing towards malaise*, May 7, chronically high unemployment rates have the potential to prompt government changes in labour markets and tax laws, likely raising the tax burden on corporates. Our best guess is that the **profit share of GDP will begin plateauing from next year**, implying a rise in earnings roughly in line with nominal GDP beyond 2010.

Credit

Credit spreads tightened last week as equities rallied. We stay long credit due to declining default and downgrade rates and continued strong demand. We expect spreads to continue narrowing toward our **year-end target of 175bp for US HG and see further declines in 2010**.

Lipper FMI data in Europe show that European bond fund flows have peaked and slowed in August, contrary to the record buying pace in the US. The divergence is likely due to the different cash rates and bond yields in the two regions. Compared to the European bond yield of 4% and policy rate of 0.5%-1%, US HG bonds are offering yields of 5.3% with zero return in cash. Thus the pickup in yield by investing in corporate bonds is at least 1.5% higher in the US than in Europe. Nevertheless, with HG bond yields fall-

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ing, it is likely the retail flows into HG will slow in the US as well. However, demand from institutional investors, the majority of HG bond holders, is likely to remain high as part of the demand is driven by a shift in long-term target bond allocations and a desire to reduce the asset/liability duration mismatch.

In Europe, we focus our long on Financials, especially Lower Tier 2 in quasi-distressed German and Irish bank paper. In credit derivatives, spreads in the tranched market have yet to normalize and **short-dated junior mezzanine offer the best risk-adjusted return**.

Foreign Exchange

Our core views are unchanged: We expect a weaker dollar this month as the recovery motivates further use of the greenback as the world's preferred funding currency. We would call it quits on this move if we thought the growth story would slacken or US rates trend higher. Neither is likely in a season of strong corporate profits but low inflation. **Stay short USD versus CAD and versus JPY.** Stay long other cyclical currencies that will lead the rate normalization process, such as NOK versus EUR and versus NZD.

More broadly, hardly a week passes without someone, somewhere forecasting the **inevitable dollar crisis**. These predictions are nothing new; neither have they been accurate. It is true the dollar has fallen in six of the past eight years, but a dollar bear market is not a dollar crisis. If a dollar crisis is defined similarly to the dozens of currency crises that have occurred over the past 40 years, it must entail the following: a simultaneous decline in a country's currency, bond market, and equity market and a significant rise in volatility.

This week's *FX Markets Weekly* examines the optimal hedge for this event, which is low-likelihood but cheap. Since 1971 the US has experienced 20 months when the trade-weighted dollar, bonds, and equities have sold off simultaneously, usually due to rising inflation. The most consistent hedges are EUR, CHF, copper, and gold, which rallied in at least 75% of those months. The most profitable hedges have been the same four but in a different order—copper, gold, EUR, and CHF, which returned 3.5%-5% in those crisis-like months. The yen is a good hedge, but inferior to owning EUR, CHF, or gold, possibly because some of the oil shocks that accompanied these events were more damaging to Japan's balance of payments than to Europe's. Unsurprisingly, commodity currencies are poor hedges since the rise in volatility could undermine cyclical assets and the carry trade. **We recommend EUR/USD call spreads or USD/CHF put spreads as the best hedges for this tail risk.**

Ten-year Government bond yields

	Current	Dec 09	Mar 10	Jun 10	Sep 10
United States	3.43	3.50	3.75	4.00	4.25
Euro area	3.29	3.25	3.30	3.40	3.45
United Kingdom	3.60	3.70	3.95	4.10	4.30
Japan	1.33	1.45	1.40	1.30	1.40

Foreign exchange

	Current	Dec 09	Mar 10	Jun 10	Sep 10
EUR/USD	1.49	1.50	1.50	1.47	1.45
USD/JPY	91.0	89	91	97	100
GBP/USD	1.64	1.63	1.60	1.58	1.58

Commodities - quarterly average

	Current	09Q4	10Q1	10Q2	10Q3
WTI ($/bbl)	78	70	70	65	70
Gold ($/oz)	1052	1000	-	-	-
Copper($/m ton)	6270	5950	-	-	-
Corn ($/Bu)	3.73	3.65	4.00	4.15	4.05

Source: J.P. Morgan, Bloomberg, Datastream

Alternatives

Commodity prices rose significantly last week due to a rally in energy prices. Crude oil moved above the implicit OPEC target level of $75, which has been an important technical in the past few months. This move triggered our stop loss last Wednesday, but we feel confident this increase is only temporary, **and re-enter our tactical short**. Total crude and products inventories remain at high levels and the recent stock draw in gasoline/distillates was mostly driven by refinery maintenance, not by a marked improvement in demand.

Hedge funds are on their way to another positive month, delivering more than 1% so far in October. Performance is also consistent across styles, as all main strategies are posting positive returns. Nevertheless, the focus remains on hedge fund regulation. An updated European Directive is now under discussion. This proposal is believed to contain compromises on many of its controversial points such as leverage and capital requirements, but many key issues are still to be sorted out. The pressure from industry, investors, and interested countries for significant changes has increased in the past weeks.

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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	3.3 ↑	-6.4	-0.7	3.5 ↓	3.5 ↑	3.0	4.0	4.0	-0.9	1.2	2.0	0.9
Canada	0.4	-2.4	2.6	-6.1	-3.4	2.0	3.0	3.0	3.0	3.5	0.1	1.3	1.9	2.3
Latin America	3.8	-3.2	3.9	-10.0	0.8	5.7	5.1	4.7	3.2	3.9	6.7	5.6	7.0	7.2
Argentina	6.8	-4.5	2.5	0.2	1.1	-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	2.4	-0.5	3.0	1.1	2.7	1.9	3.2	3.5	4.3	5.5	4.8	3.3	3.9	4.3
Ecuador	6.5	-1.0	1.5	-5.1	-1.0	-2.0	0.0	2.0	2.5	4.0	5.5	3.5	2.4	4.0
Mexico	1.3	-7.0	3.5	-21.2	-4.4	10.1	7.5	3.7	-0.6	3.3	6.0	4.6	5.3	5.2
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	2.5	-7.3	-3.3	0.0	2.0	3.0	4.0	4.0	28.2	29.5	36.4	37.1
Asia/Pacific														
Japan	-0.7	-5.6	2.2	-12.4	2.3	3.0	2.5	2.5	1.5	1.5	-1.0	-2.0	-2.2	-1.5
Australia	2.4	1.0	2.9	1.6	2.5	1.2	3.8	2.1	2.4	4.4	1.5	1.5	1.9	2.6
New Zealand	0.1	-1.3	2.8	-3.0	0.3	2.5	2.1	2.6	4.3	3.4	1.9	1.8	1.6	1.7
Asia ex Japan	5.8	4.0 ↑	7.2	2.5	12.6	8.2 ↑	6.4 ↓	6.4 ↓	7.0	7.0 ↑	1.3	2.0	3.5	3.2
China	9.0	8.4	9.5	8.3	14.9	9.5	9.1	9.0	9.5	9.3	-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	6.0	7.5	8.2	6.7	5.2	5.6	7.0	7.7	8.3	8.9	7.4	6.3	4.7
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	-0.4 ↑	4.2 ↑	0.5	11.0	8.0 ↑	2.5 ↓	3.0 ↓	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	-2.0 ↓	6.5	-12.2	20.7	14.9 ↑	-2.0 ↓	4.1 ↑	7.4 ↑	8.2 ↑	-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	6.1	-7.2	9.6	7.0	5.3	4.9	5.7	7.0	-2.8	1.4	4.6	4.0
Africa/Middle East														
Israel	4.0	0.0	3.0	-3.2	1.0	1.5	2.5	3.0	3.0	3.0	3.2	3.3	3.4	3.3
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	-3.7	2.6	-9.6	-0.7	3.0	2.5	3.0	3.0	3.0	0.2	0.3	0.9	1.2
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	-2.0	2.7	-5.4	1.1	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	0.6	-4.4	2.0	-9.6	-2.3	0.5	3.0	2.0	2.5	2.8	2.1	2.2	2.3	1.4
Emerging Europe	4.1	-5.3	3.9	-19.3	1.9	5.4	4.7	3.5	3.3	3.3	7.7	6.8	6.3	6.0
Bulgaria	6.1	-5.0	-1.5	...	...	...	...	...	...	...	...	...	...	...
Czech Republic	2.7	-4.0	2.5	-17.9	0.4	4.5	5.0	2.8	2.5	2.2	1.4	1.0	2.7	3.4
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	-7.5	1.3	3.7 ↓	3.5 ↑	3.4	3.6	3.7	0.6	1.1 ↓	1.8	1.5
Developed markets	0.4	-3.3	2.8	-8.3	-0.4	2.9 ↓	3.0 ↑	2.8	3.1	3.2	-0.3	0.5	1.0	0.7
Emerging markets	4.9	0.5	5.7	-3.9	7.5	6.8 ↑	5.7 ↓	5.4	5.3	5.5	3.8	3.7	4.7	4.6

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Global Central Bank Watch

	Official interest rate	Current	Change from Aug '07 (bp)	Last change	Next meeting	Forecast next change	Dec 09	Mar 10	Jun 10	Sep 10	Dec 10
Global	GDP-weighted average	1.31	-340				1.31	1.33	1.38	1.44	1.50
excluding US	GDP-weighted average	1.87	-256				1.86	1.90	1.97	2.06	2.14
Developed	GDP-weighted average	0.49	-365				0.49	0.51	0.51	0.54	0.56
Emerging	GDP-weighted average	4.59	-241				4.54	4.63	4.82	5.04	5.23
Latin America	GDP-weighted average	5.75	-306				5.75	6.13	6.66	6.94	7.03
CEEMEA	GDP-weighted average	5.01	-199				4.77	4.61	4.71	5.02	5.29
EM Asia	GDP-weighted average	4.00	-232				4.00	4.07	4.17	4.34	4.53
The Americas	GDP-weighted average	0.75	-484				0.75	0.79	0.85	0.88	0.89
United States	Federal funds rate	0.125	-512.5	16 Dec 08 (-87.5bp)	4 Nov 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	Jan 10 (+50bp)	8.75	9.75	10.75	10.75	10.75
Mexico	Repo rate	4.50	-275	17 Jul 09 (-25bp)	27 Nov 09	**Jun 10 (+25bp)**	4.50	4.50	**4.75**	**5.25**	**5.25**
Chile	Discount rate	0.50	-500	9 Jul 09 (-25bp)	12 Nov 09	2Q 10 (+50bp)	0.50	0.50	1.00	2.00	3.50
Colombia	Repo rate	4.00	-525	25 Sep 09 (-50bp)	23 Oct 09	on hold	4.00	4.00	4.00	4.00	4.00
Peru	Reference rate	1.25	-350	6 Aug 09 (-75bp)	5 Nov 09	on hold	1.25	1.25	1.25	1.25	1.25
Europe/Africa	GDP-weighted average	1.39	-321				1.36	1.35	1.36	1.44	1.51
Euro area	Refi rate	1.00	-300	7 May 09 (-25bp)	5 Nov 09	on hold	1.00	1.00	1.00	1.00	1.00
United Kingdom	Repo rate	0.50	-525	5 Mar 09 (-50bp)	5 Nov 09	3Q 10 (+25bp)	0.50	0.50	0.50	0.75	1.00
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)	28 Oct 09	28 Oct 09 (+25bp)	1.50	1.75	2.00	2.00	2.25
Czech Republic	2-week repo rate	1.25	-200	6 Aug 09 (-25bp)	5 Nov 09	2Q 10 (+25bp)	1.25	1.25	1.75	2.50	3.00
Hungary	2-week deposit rate	7.50	-25	28 Sep 09 (-50bp)	19 Oct 09	19 Oct 09 (-50bp)	6.50	6.00	6.00	6.00	6.00
Israel	Base rate	0.75	-325	24 Aug 09 (+25bp)	26 Oct 09	26 Oct 09 (+25bp)	1.50	2.00	3.00	3.50	4.00
Poland	7-day intervention rate	3.50	-125	24 Jun 09 (-25bp)	28 Oct 09	3Q 10 (+25bp)	3.50	3.50	3.50	4.00	4.50
Romania	Base rate	8.00	100	29 Sep 09 (-50bp)	3 Nov 09	1Q 10 (-25bp)	8.00	7.75	7.50	7.25	7.00
Russia	1-week deposit rate	5.25	200	29 Sep 09 (-50bp)	4Q 09	4Q 09 (-50bp)	4.75	4.25	4.25	4.25	4.25
South Africa	Repo rate	7.00	-300	13 Aug 09 (-50bp)	22 Oct 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)	10 Dec 09	on hold	0.25	0.25	0.25	0.25	0.25
Turkey	Overnight borrowing rate	**6.75**	-1075	**15 Oct 09 (-50bp)**	19 Nov 09	**19 Nov 09 (-25bp)**	6.50	6.50	6.50	7.50	8.00
Asia/Pacific	GDP-weighted average	2.06	-149				2.08	2.14	2.20	2.30	2.39
Australia	Cash rate	3.25	-325	6 Oct 09 (+25bp)	2 Nov 09	Dec 09 (+25bp)	3.50	4.00	4.25	4.50	4.50
New Zealand	Cash rate	2.50	-575	30 Apr 09 (-50bp)	28 Oct 09	8 Jul 10 (+50bp)	2.50	2.50	2.50	3.50	4.00
Japan	Overnight call rate	0.10	-40	19 Dec 08 (-20bp)	30 Oct 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)	5 Nov 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	3Q 10 (+27bp)	5.31	5.31	5.31	5.58	5.85
Korea	Base rate	2.00	-300	12 Feb 09 (-50bp)	12 Nov 09	1Q 10 (+25bp)	2.00	2.25	2.50	2.75	3.00
Indonesia	BI rate	6.50	-175	5 Aug 09 (-25bp)	4 Nov 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	**1Q 10 (+25bp)**	4.75	**5.00**	**5.25**	5.25	5.25
Malaysia	Overnight policy rate	2.00	-150	24 Feb 09 (-50bp)	28 Oct 09	2Q 10 (+25bp)	2.00	2.00	2.25	2.50	3.00
Philippines	Reverse repo rate	4.00	-200	9 Jul 09 (-25bp)	5 Nov 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	1.50	1.75	2.00
Taiwan	Official discount rate	1.25	-188	18 Feb 09 (-25bp)	4Q 09	4Q 10 (+12.5bp)	1.25	1.25	1.25	1.25	1.375

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	3.3	3.8	4.3	4.5	4.6	4.7
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	5.9	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	5.8	6.9	4.2	4.2	4.5	5.3	5.7	5.9	6.5	6.8	7.0	7.0	6.8
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. The longer term investment outlook has brightened significantly.
- With **labour force participation falling** slowly, the jobless rate, however, 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** kicked off the tightening cycle with a 25bp rate hike in October, making it the first central bank in the G20 to tighten policy. We expect another 25bp rate hike in December.
- 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)	0.1	-1.3	2.8	-1.7	-1.9	-3.8	-3.0	0.3	2.3	3.3	2.9	3.0	3.7	2.7
Private consumption	-0.1	-0.8	2.1	-2.0	-0.1	-0.6	-4.8	1.7	2.1	2.4	1.8	2.3	2.1	1.5
Fixed Investment	-4.3	-14.8	-2.2	7.0	-29.9	-17.8	-20.4	0.3	-15.0	-7.7	-1.0	4.3	4.0	4.7
Residential construction	-16.7	-19.7	0.4	-32.8	-24.6	-46.6	0.6	-10.0	-9.6	-6.0	4.0	6.0	8.0	8.0
Other fixed investment	-1.1	-13.7	-2.7	18.9	-31	-10.3	-24.0	2.5	-16.0	-8.0	-2.0	4.0	3.2	4.0
Inventory change (NZ$ bil, saar)	1.4	-2.4	0.0	0.3	0.5	0.2	-0.2	-1.1	-0.7	-0.4	-0.2	0.0	0.1	0.1
Government spending	3.8	0.3	-1.3	2.8	-0.1	6.6	1.4	-4.0	-3.9	-2.0	-0.8	0.0	0.4	0.4
Exports of goods & services	-1.2	2.2	7.6	-2.7	-9.2	-12.4	2.6	20.3	11.0	10.0	4.0	4.0	7.0	9.0
Imports of goods & services	2.5	-16.3	5.7	4.8	-20.6	-24.3	-29.2	-14.2	9.0	9.0	4.0	9.0	7.0	6.0
Contributions to GDP growth:														
Domestic final sales	1.0	-5.4	0.4	1.8	-10.0	-6.4	-9.7	-0.4	-3.0	-0.7	0.5	2.2	2.1	2.0
Inventories	0.3	-2.8	1.8	-0.7	2.6	-3.4	-5.5	-9.8	4.8	3.6	2.4	2.3	1.5	-0.2
Net trade	-1.3	7.0	0.6	-2.7	6.1	6.3	13.3	11.3	0.7	0.4	0.0	-1.5	0.0	1.0
GDP deflator (%oya)	3.6	2.5	2.6	3.8	2.2	2.4	2.4	2.1	3.7	1.6	1.4	3.0	3.1	3.1
Consumer prices	4.0	2.6	2.4	6.7	6.2	-1.8	1.1	2.3	5.3	1.6	2.0	2.0	2.5	2.5
%oya	4.0	2.3	2.5	4.0	5.1	3.4	3.0	1.9	1.7	2.6	2.8	2.7	2.0	2.3
Trade balance (NZ$ bil, sa)	-2.3	4.3	2.2	-1.1	-0.8	-0.1	0.8	0.8	1.5	1.1	0.7	0.6	0.5	0.4
Current account (NZ$ bil, sa)	-15.9	-3.7	-8.3	-4.6	-4.1	-3.6	-1.2	-2.1	-0.6	0.2	-0.4	-5.2	-0.8	-1.9
as % of GDP	-8.9	-1.6	-4.0	-10.4	-9.2	-8.1	-4.7	-1.4	0.5	-0.8	-1.7	-4.0	-4.9	-5.1
Yield on 90-day bank bill (%)*	7.9	3.0	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	5.7	5.8	6.0	6.0	6.1	6.1
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	-4.5	-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 expanded** in the June quarter, after five straight quarters of contraction. The sharp run down in inventories in the June quarter is positive news for GDP growth in 3Q and 4Q.
- **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.
- **Private consumption** will remain subdued, 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.
- **Inflation** remained in the bottom half of the RBNZ's 1-3%oya target range in 3Q. The 1.7%oya headline was lifted by one-off influences that pushed prices higher. Nontradable inflation remained elevated but has come down significantly in recent quarters and should meander even lower.

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Australia and New Zealand economic calendar

Monday	Tuesday	Wednesday	Thursday	Friday
19 Oct	20 Oct	21 Oct Australia: Westpac leading index (10:30 am) Aug New motor vehicles sale (11.30 am) Sep New Zealand: Visitor arrivals (10:45 am) Sep Credit card spending (2:00 pm) Sep 0.5 %oya	22 Oct	23 Oct Australia: Export price index (12:30 pm) 3Q -4.9 %q/q Import price index (12:30 pm) 3Q -3.6 %q/q
26 Oct Australia : PPI (11:30 am) 3Q *Holiday New Zealand*	27 Oct	28 Oct Australia : CPI (11:30 am) 3Q New Zealand : NBNZ business conf.(2:00 pm) Oct	29 Oct New Zealand: Trade balance (10:45 am) Sep RBNZ official cash rate (9:00 am) Oct	30 Oct Australia: Pvt. Sector credit (11:30 am) Sep New Zealand: Building permits (10:45 am) Sep
2 Nov Australia: HPI (11:30 am) 3Q	3 Nov Australia: RBA cash target (2:30 pm) Nov New Zealand: Labor cost index (10:45 am) 3Q ANZ commodity price (2:00 pm) Oct	4 Nov Australia: Building approvals (11:30 am) Sep Retail sales (11:30am) Sep	5 Nov Australia: Trade balance (11: 30 am) Sep New Zealand: Unemployment rate (10:45 am) 3Q	6 Nov
9 Nov Australia: ANZ job ads (11:30 am) Oct Housing finance approvals (11:00 am) Sep New Zealand: QV house prices Oct	10 Nov Australia: NAB bus. Confidence (11: 30 am) Oct	11 Nov Australia: Westpac consumer confidence (10: 30 am) Nov	12 Nov Australia: Unemployment rate (11:00 am) Oct New Zealand: Retail sales (10:45 am) Sep	13 Nov

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Global Data Diary

Week / Weekend	Monday	Tuesday	Wednesday	Thursday	Friday
12 Oct - 16 Oct	12 October	13 October	14 October	15 October	16 October
China • Money supply (Sep)	Mexico • Auto report (Sep) • IP (Aug) Singapore • GDP adv (3Q)	Chile • BCCh meeting France • CPI (Sep) Germany • ZEW bus survey (Oct) Sweden • CPI (Sep) United Kingdom • CPI (Sep) United States • Kohn speaks on economy	China • Trade balance (Sep) Euro area • IP (Aug) Japan • Consumer sent (Sep) • BoJ meeting Poland • CPI (Sep) United Kingdom • Labor mkt report (Sep) United States • Bus inventories (Aug) • Import prices (Sep) • Retail sales (Sep) • FOMC minutes	Brazil • Retail sales (Aug) Euro area • HICP final (Sep) • Trichet speech Japan • IP final (Aug) • Reuters Tankan (Oct) Turkey • CBRT meeting United States • CPI (Sep) • NY Fed survey (Oct) • Philly Fed survey (Oct)	Canada • CPI (Sep) Euro area • Foreign trade (Aug) Japan • Shirakawa speech Mexico • Banxico meeting United States • Consumer sent (Oct) • IP (Sep)
19 Oct - 23 Oct	19 October	20 October	21 October	22 October	23 October
Japan • Department store sales (Sep)	Hungary • NBH meeting Japan • Tertiary sect activity (Aug) • BoJ minutes • Shirakawa speech Poland • IP (Sep) United States • NAHB survey (Oct) • Bernanke speaks on economy	Canada • BoC meeting United States • Housing starts (Sep) • PPI (Sep)	Brazil • COPOM meeting Japan • BoJ bank loan officers survey (4Q) Thailand • BoT meeting United States • Beige book United Kingdom • MPC minutes	Belgium • BNB bus survey (Oct) Brazil: U-rate (Sep) China • CPI, FAI, IP, Retail sales (Sep) • GDP (3Q) France • INSEE bus survey (Oct) Japan • All sector activity (Aug) • Trade balance (Sep) South Africa • SARB meeting Sweden • Riksbank meeting UK: Retail sales (Sep) United States • FHFA HPI (Aug)	Colombia • BanRep meeting Euro area • Industrial orders (Aug) • PMI flash (Oct) France • Cons of mfg goods (Sep) Germany • IFO bus survey (Oct) Korea • GDP prelim (3Q) Taiwan • Export orders, IP (Sep) United Kingdom • BBA mort lending (Sep) • GDP prelim (3Q) United States • Exist home sales (Sep) • Bernanke and Kohn speak at Boston Fed

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