

Inflation – think global, act local

- The CPI release tomorrow is the market focus for the week. CBA forecasts +0.7% headline qoq (+0.8% core).
- There is scope for the data to surprise to the low side. PPI and retail data have both shown weakness recently.
- We see an opportunity to buy the Jun-16 against the May-13 and May-21 as an RV trade.

The price action in Australian bonds was unexciting last week. Yields rose 8bp across the curve, tracking the US. But there was a substantial pickup in primary markets. Issuance of AAA Kangaroos (SSAs) is running at a record \$6.5 billion pace so far this year. As detailed last week, we expect this sector to underpin growth in the high-grade sector in 2011. So far this issuance is being easily absorbed. SSA spreads barely moved last week. Nor has the cross-currency basis swap moved yet, though we wouldn't be surprised to see that creep tighter.

AUS-US bond spreads have also been very stable following the powerful sell-off in November and December. We continue to expect the next move will be a widening and are positioned accordingly. That mostly reflects our view that markets are underestimating the extent of likely RBA tightening this year, and that US Treasuries should consolidate following their sell-off. But we have also been cautious that inflation pricing will rise in Australia. This week shapes as a key test for that view. Focus is now squarely on the Q4 CPI data out tomorrow (25-Jan).

Our economists expect a 0.7% quarterly rise in the headline figure (3% p.a.) and a 0.8% rise in the underlying measures (2.75% p.a.). After benign inflation readings in Q2 and Q3 of 2010, we're not expecting the figures to ring any inflation alarm bells for the market or the RBA. They may well treat the data as obsolete ahead of the floods impact that will come through in Q1 (which our economists put at 0.23ppts).

That suggests we should take profit on our longstanding BEI widening trade, which hit our 300bp target on Friday. In fact, the incoming evidence suggests risks may be to the downside; retail sales, import prices, and today's PPI and Woolworth's earning guidance all point to a tough pricing environment in Q4. With economists competing to revise their 2011 inflation calls higher on the back of the floods, we see an opportunity to receive 1-year ZCS today at a high 3.43%. See page 3. Philip Brown's article on page 8 also details a new CGS butterfly trade.

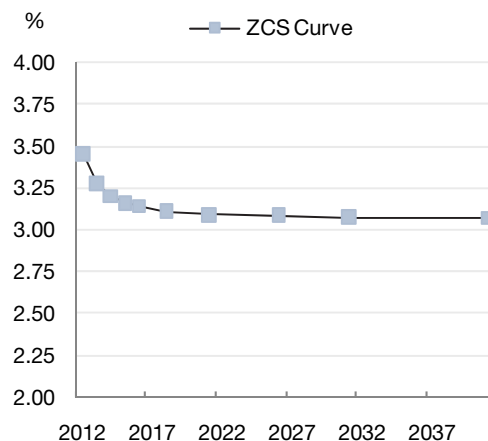
Following last week's benign CPI, focus in New Zealand rests with the RBNZ's OCR review on Thursday. The entire market expects the cash rate to remain 3.0%. CBA expects the next rise to be in September.

In the US, the market is awaiting \$99b of new supply (2y, 5y, 7y) and the first FOMC meeting of the year (Thursday morning Sydney time). We expect the new voting members to maintain similar language to their predecessors and emphasise that they have a high threshold for ending QE2 ahead of schedule. There is an abundance of data for the week, including December home sales and durable orders, January consumer confidence reports and Q4 employment costs. But the highlight will be the first estimate of Q4 GDP due on Friday night. Economists are expecting an annual increase in the pace of growth from 2.6% to 3.5%, not enough to force any major re-think on the US outlook just yet.

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Australian ZCS Curve – too high at the front ?



Source: Bloomberg,



Key Positions

We think the risks to tomorrow's CPI are very much to the low side. Weak retail sales results and the low PPI highlight this risk. We have entered a received 1Y ZCS trade and exited our BEI widening trade.

Our short AUD front end position has performed well, but the spread to the US has moved slightly against us. Most of our other positions are little changed from last week.

We have recommended buying the Jun-16 as part of a 2/5/10 ACGB butterfly. We also take profit on the 10Y/20Y/30Y butterfly which has moved slightly, but not as far as we'd hoped.

Key Trades

Trade	Entry	Curent	Profit	Target	Stop	Comment
Buy the NSWTC Jun-20 (Government Guaranteed) as an ASW	-12bp (3-Feb-10)	-6bp	-6bp	-35bp	0bp	Hold: A long-term buy-and-hold trade. The NSWTC budget suggests borrowing will reduce. QTC has started to consolidate GG bonds.
Pay 3yr AUD EFP	35bp rolls to 27 bp (9 August)	25bp	-2bp (roll was 8bp)	45bp	30bp	Hold: Increased mortgage fixing may force this wider as curve flattens.
10yr ACGB BEI widening	255 bp (18 August)	300bp (21 Jan)	+45bp	300bp	260bp	Take Profit: Spread has widened in the sell-off, inflation expectations growing.
OTM Conditional Steepener. 6M*2Y vs 6M*10Y. Buy 100m 6M*2Y 3.75% receiver. Sell 24.1M 6M*10Y 4.28% receiver.	3.75% and 4.28% 0.4bp premium (25 August)	5.36 and 6.09	-0.4bp (premium)			Hold: An insurance trade for a global double dip. Very unlikely to be used now, but 0.4bp well spent.
Buy the Suncorp Metway Govt Guaranteed Apr-11 Floater.	TM of 29.5bp	17bp	+12.5bp	0bp	40bp	Hold: This bond is Government Guaranteed. It should be much tighter. Repurchases of GG bank bonds becoming common.
Pay the 20Y AUD swap vs 10Y and 30Y in a butterfly	23.5bp (8 Nov)	26bp	+2.5bp	27bp	20bp	Take Profit: The 20Y has moved slightly, but not as far as hoped. Bank a small profit.
Sell 3M, 20bp OTM bond put on Apr-20 ACGB, strike is 5.61%	5.61 / 10bp (15 Nov)	Current yield is 5.61	n/a	n/a	5.71bp	Hold: Bond options are better to sell for investors than swaps. We think the top of the range isn't far away.
Sell the ACGB Apr-20 against the UST 2.625% Nov-20	219bp (19-Jan-11)	216bp	-3bp	250bp	200bp	Hold: We think the US market will rally but see little scope for the Aus market to follow given our RBA call.
Pay AUD 1Y*1Y	5.41% (19-Jan-11)	5.54%	13bp	5.70%	5.20%	Hold: The Australian market is underpricing the RBA.
Receive 1Y AUD ZCS	3.43% (24 Jan)			3.00%	3.60%	New Trade: The market seems to be overestimating the impact of the floods on CPI.
Buy the Jun-16 vs the May-13 and May-21	11bp (24 January)					New Trade: PCA analysis suggests this is likely to fall. A flattening would also assist the trade.
Pay the AUD 10Y swap vs NZ 10Y swap	58bp	65bp	+7bp	90bp	45bp	Hold: The recent rally in AUD seems overdone vs. NZ. Carry is also very attractive at circa 5bp per month.



Position for downside risk in tomorrow's CPI release

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- Australia's weak retail sales results and PPI suggest there is downside risk to tomorrow's CPI.
- The market is priced for a significant increase in the medium term CPI. We take profit on our BEI widening trade.
- We believe the market has gone too far and would position for a retracement in short-term ZCS.

The ABS is scheduled to release the Q4-10 Australian CPI data tomorrow. Our economists forecast a headline figure of 0.7% qoq and 3.0% yoy, below market consensus of 0.8% qoq. Also, our economists forecast an underlying rate of 0.8% qoq and 2.75% yoy. (The full preview of the CPI release is on page 8.)

Breakeven Inflation has moved to 3%

The Australian linker market moved to a 10Y (Breakeven Inflation) of 3.00% on Friday (See Figure 1). We had previously recommended a BEI widening trade and 3.00% was our target. Our original rationale reflected the view that the structural challenges facing Australia indicate medium term inflation is a significant risk. Australia already has an unemployment rate of 5.0% (strictly speaking, just under) and the global recovery is only just beginning.

The floods will affect Q1-11 CPI, not Q4-10

The BEI has risen significantly over the past few months and, we believe, it has now gone far enough. There is a real risk of a surprise to the low side at tomorrow's CPI release. The floods will increase headline price changes beginning in the March quarter, not in the Q4 data scheduled for release tomorrow. Our economists expect the floods to add 0.23ppt to CPI. The market has moved to price a 1Y ZCS rate of nearly 3.5%. We think this is excessive. (See Figure 2.)

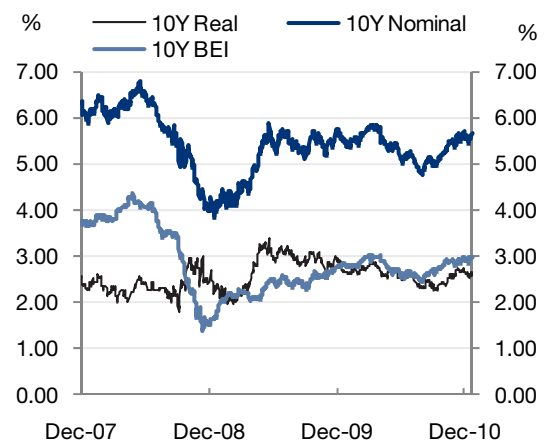
Although the Australian economy is strong, we have seen a number of hints that the CPI outlook is not as strong as the market currently expects. Our economists are forecasting an uptick in CPI to account for the floods, but are also expecting this to fall away in future quarters (Please see Figure 3.)

Retail sales is weak

The retail sales data for October was very weak at -0.8% (revised) and the November data showed a small bounce to +0.3%. The ongoing conundrum in the Australian economy is why consumers are not spending as strongly as might be expected, given the low unemployment rate. This reluctance to spend and the discounting it is encouraging could easily show up in the CPI figures too.

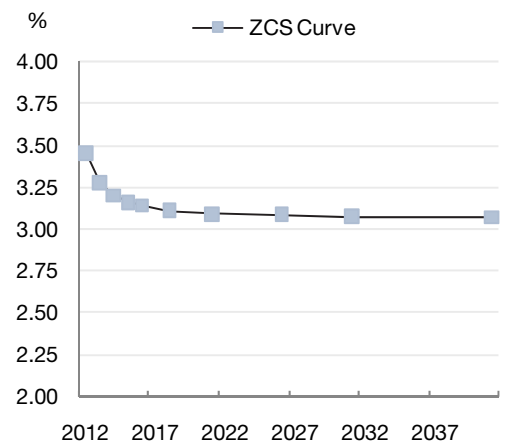
Take a look at the retail price chart in Michael Blythe's preview (page 8) or CBA's credit card spending indicator (Figure 4). This measure suggests a CPI of only 0.5% or 0.6% in Q4.

Figure 1 –Australian BEI graph



Source: Bloomberg, CBA

Figure 2 – Australian ZCS Curve



Source: Bloomberg,



PPI and Woolworths data suggest risks to downside in CPI

This highlights the risk of lower than expected CPI tomorrow.

Woolworths has today also released a surprise announcement noting, amongst other things, that in their first half of financial year 2010-2011 (i.e. Q3 and Q4 of 2010) prices fell 3.8%. The link between Woolworths' prices and total CPI is moderate, but the depressed retail environment is a significant risk factor in tomorrow's CPI release.

Finally, the PPI data released today shows that the upstream inflation was not as high as many anticipated. The PPI rose 0.1% in the quarter and 2.7% in the year – well below consensus economic forecasts. That was driven by a 4.4% drop in import prices, showing the high AUD is continuing to have an impact. While preceding the floods, the PPI still shows that the baseline data wasn't as strong as the market has feared.

Inflation will likely be a dominant theme in Australia and globally

In our view, inflation is likely to be a very important theme for this year, not just in Australia, but in many countries. We think it's wise to review trends in relevant offshore markets before making firm conclusions on inflation pricing in Australia.

New Zealand: CPI shows the effect of the GST increase

The New Zealand Government increased the GST from 12.5% to 15% on October 1. The CPI for Q4 showed a spike of 2.3% quarter on quarter and 4.0% year on year.

Our NZ economists were expecting a slightly higher reading for Q4 CPI of 2.5%. They are now doubly reassured that the RBNZ will remain on hold for a significant period. After updating their view last week, they expect the RBNZ to look through the effect of the GST rise and leave rates unchanged until September.

NZ headline CPI correlates with Australia – but not with GST changes

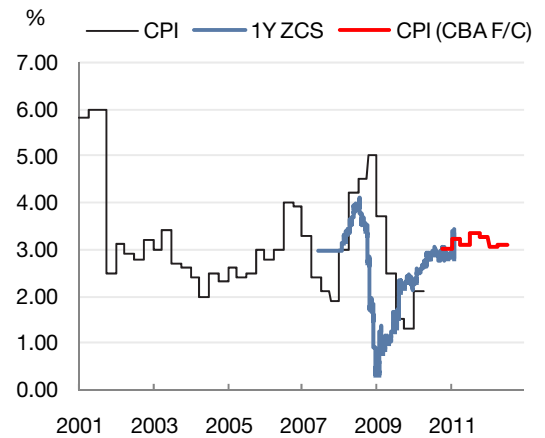
Many market participants look for the NZ CPI to provide a clue to the Australian CPI. We would like to remind you of our views on the matter. There is a strong link between the annual level of CPI in NZ and Australia (see Figure 5). Of course, when one of the two countries introduces a one-off effect, like the GST change, the relationship breaks down. In 2000, Australia introduced the GST and our CPI temporarily spiked a lot higher. The NZ spike in CPI in Q4 will not affect the Australian outcome.

The negative surprise in NZ is of little information for Australia

Some look to the surprise in the NZ CPI as a clue (the surprise is the difference between expectations and actual data). We believe there is very little information to be gained from the "surprise" in New Zealand CPI.

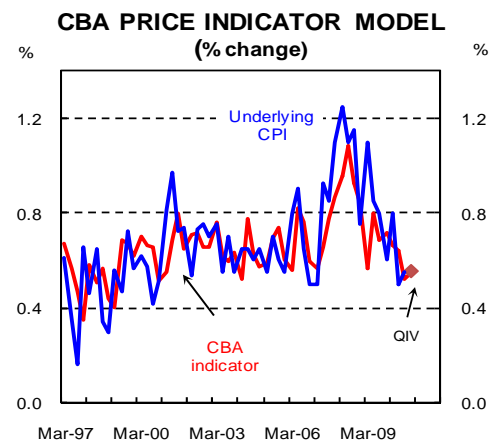
We show in Figure 5 that there is almost no relationship between the NZ surprise in CPI and

Figure 3 – Australian CPI forecasts



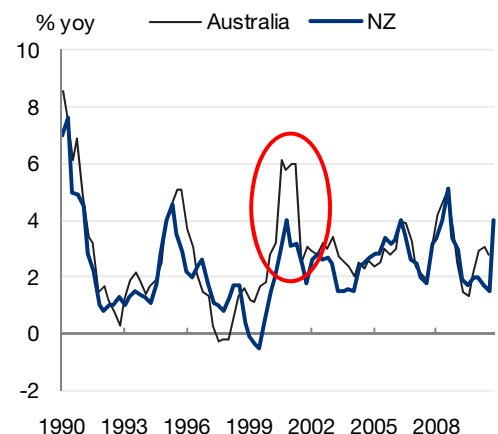
Source: Bloomberg, CBA

Figure 4 – Credit Card Indicator



Source: CBA

Figure 5 – Australia and NZ CPI



Source: Bloomberg, CBA



the Australian surprise in CPI. There is a slightly positive correlation of 0.07, but this is so close to zero that the effect is essentially immaterial. But if there's a risk in Q4, it would appear to be to the downside.

United States: The CPI is awkwardly low, but expectations are mixed

The Fed remains concerned about deflation

In the US, the Federal Reserve remains concerned that inflation is too low. The CPI ex food and energy registered just 0.8% growth in the year to December (Figure 7).

The Fed responded to the threat of low inflation by instituting further Quantitative Easing (QE2). Despite the significant sell-off since November, we still believe the US market is showing obvious signs of the QE program. We have, in the past, used the spread between the US 10Y bond and the US 10Y ZCS to measure the implied bond term premium over and above inflation. The measure shows the yield over and above expected inflation that is present in the 10Y US bond.

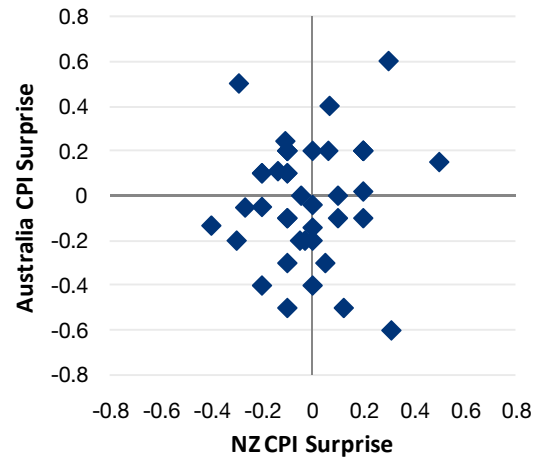
The spread between UST and ZXS suggests the Fed is influencing prices

The spread between the US 10Y Treasury and the US 10Y ZCS has also risen as the Treasuries sold off over the past two months. Although the spread has risen from its low of zero to around 70bp, the spread remains low compared to historical precedent. The market generally sets this spread somewhere between 150bp and 200bp. Over 2008 and 2009 the Fed's intervention's kept the spread low.

The Fed is still buying around \$110bn of Treasuries each month. We think the current level of the spread between UST and ZCS shows the influence of the Fed. We believe the Fed's actions are keeping this spread lower than it would otherwise be without intervention.

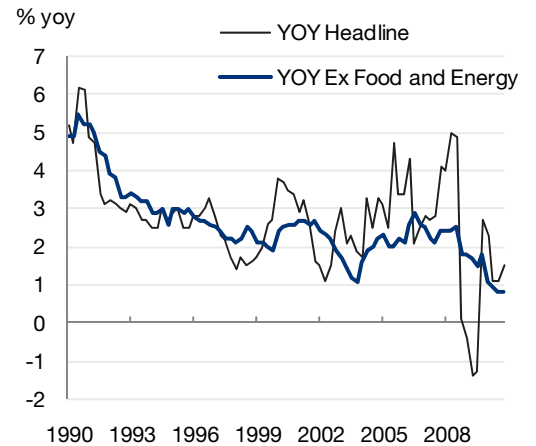
We would like to draw your attention to a second important point: the outright level of 10Y ZCS is actually quite high. The 10Y ZCS is only marginally lower now than it was for most of the 2000s. Given that current CPI is so low the market is suggesting that the medium term outlook for US inflation is biased to the high side. In short, while the Fed is deeply concerned about deflation, the market seems to be equally concerned about deflation and inflation. The ZCS shows the expected inflation rate is at about normal levels. However, the market is pricing the expectation, not the most likely outcome. There is a very small chance of a breakout of CPI in the US because of the Fed "printing money" via QE. The ZCS reflects the small chance of a very high outcome. We doubt any inflation can take hold in the US while the market has as much slack as it currently does.

Figure 6 – Australia and NZ CPI surprises



Source: Bloomberg, CBA

Figure 7 – US Inflation low – even lower core



Source: Bloomberg, CBA

Figure 8 – US Treasuries and ZCS

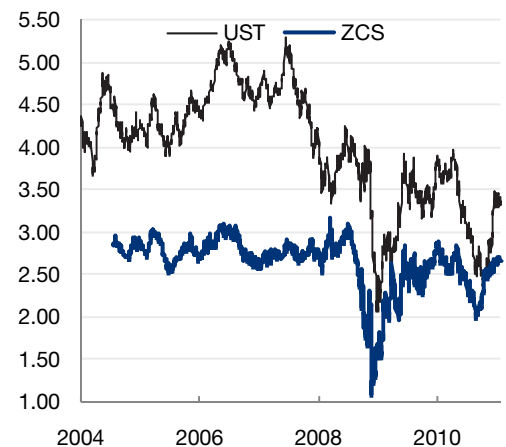




Figure 10 shows the same measure (Treasury vs ZCS) for the Australian market. The Australian market has not had any QE, of course. The spread in AUD is much better behaved.

China: CPI is awkwardly high

Chinese CPI is high

China released their December CPI on Thursday. The headline figure was at expectations at 4.6% (down from 5.1% in November). China also released a stronger than expected GDP result at the same time. The Chinese authorities are likely to continue with their efforts to curb inflation, which remains worryingly high. This could have some conflicting implications for Australia.

- Diminishing the export of deflation to Australia, which has probably helped to keep ‘tradeables’ inflation low over the past decade (Figure 11);
- Prompt China’s policy-makers (and possibly Australia’s if they perceive on-going boom) to tighten policy further. This would ultimately dampen the stimulus that is currently providing so much support to Australia’s economy.

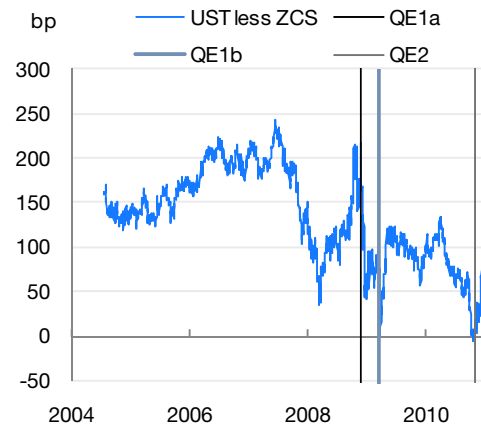
Can they manage the slowdown?

The question here is the whether China’s authorities can manage the age-old problem of dampening an excessive expansion without prompting a major downturn. At this stage the view is that they will succeed. However, the risk profile does mean we should be cautious about assuming Australia will also experiencing on-going high inflation (as currently priced into the BEI market).

Conclusions

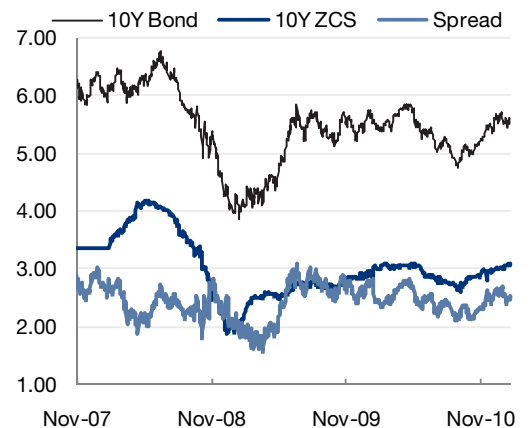
We think that the short term risk is clearly that tomorrow’s Australian CPI surprises to the downside. We would position for this by receiving the 1Y ZCS. In the medium term there are risks that suggest inflation will increase. On the domestic front, Australia’s employment situation remains strong and there is not much slack in the Australian economy. However, the market is already pricing a significant increase in CPI and we think the market has moved as far as it is likely to in the short term.

Figure 9 – US spreads show QE still affecting market



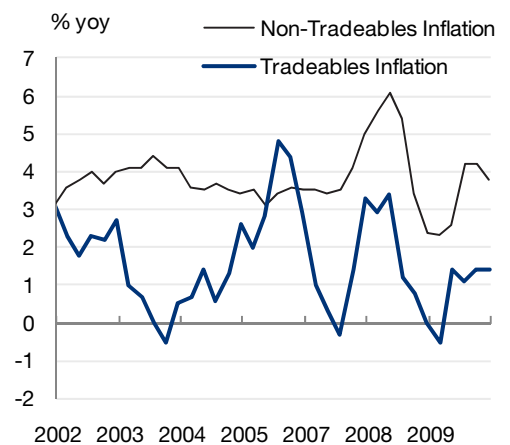
Source: Bloomberg, CBA

Figure 10 – Australian spread between Bonds and ZCS



Source: Bloomberg, CBA

Figure 11: Australian CPI breakdown



Source: ABS, Bloomberg, CBA



Jun-16 looking cheap in a butterfly trade against May-13 and May-21

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- PCA analysis suggests the Jun-16 is cheap while the May-13 and May-21 are dear.
- The butterfly is at a short term peak and should fall over coming weeks.
- We also look for the curve to flatten, which should see the butterfly fall.

Our statistical scan has identified an opportunity to buy the Jun-16 bond vs the May-13 and May-21.

PCA shows the Jun-16 is cheap compared to the May-13 and May-21.

PCA analysis shows that the Jun-16 bond is too cheap while the May-13 and May-21 bonds are both too dear. (See Figure 1.) We suggest the best approach here is to buy the Jun-16 against the other two bonds in a standard butterfly. Currently, this butterfly is at about 11bp.

Our PCA approach finds bonds which differ from their **average** position on the curve. Bonds which are historically cheap to the curve will not be recorded as cheap unless they are cheaper than normal. We are heartened that the Jun-16 shows as cheap despite its fairly short history. As a general rule, new bonds will start very cheap to the curve and slowly richen. As such, bonds which are a few months old tend to look dear on a PCA analysis, because they are dearer than their recent history.

The overall shape is supportive.

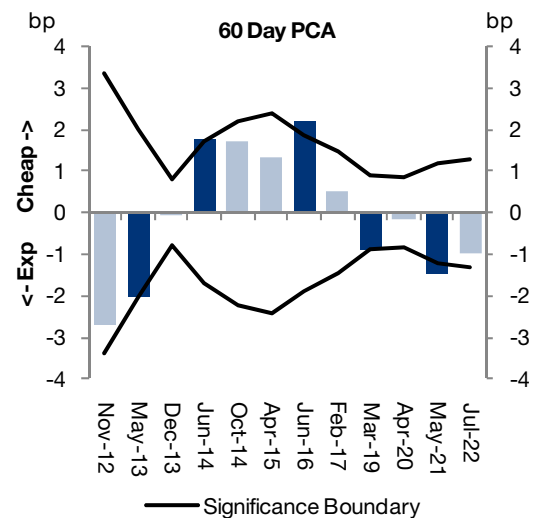
We are also happy to recommend the trade because the Jun-16 is just one of a number of bonds in the 2014-2016 area which are showing as cheap on this analysis.

As the slope flattens the butterfly usually falls.

Our final reason for recommending the trade is that we are also looking for the Australian curve to flatten. In general, the 2Y/5Y/10Y butterfly is positively correlated with the 2Y/10Y slope. The trend in Figure 2 shows that the correlation is broadly true. Recently, the extreme movements in the 10Y part of the curve driven by the US market have caused a temporary breakdown in the relationship. In the longer term, the relationship almost always holds and we are confident it will return.

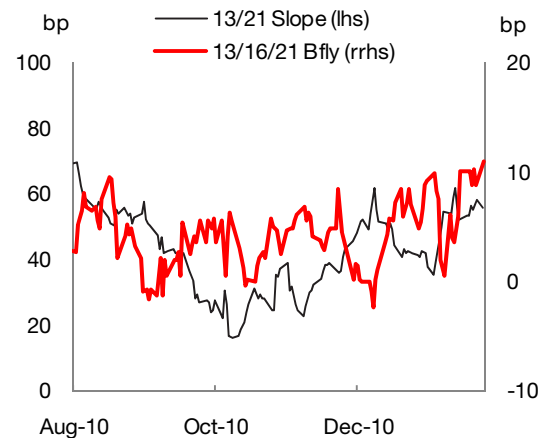
In summary, the butterfly is at a short term peak and the PCA analysis is suggesting it is too high. We look for the butterfly to move back towards a value of around 3bp as the curve flattens and the butterfly reverts.

Figure 1: Bond PCA cheap/dear



Source: Bloomberg, CBA

Figure 2: Butterfly and Slope



Source: Bloomberg, CBA



Preview - The QIV CPI

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- We expect the headline CPI to rise by 0.7% in QIV (3.0%pa).
- The underlying CPI on our forecasts will print at 0.8% (2.7%pa).
- Inflation readings at the end of 2010 look benign but the risks for 2011 are on the high side.

CPI readings at end 2010 should look benign.

The market focus on the QIV suite of price readings is less marked than usual. The evolving flood emergency is very much front of mind. The floods will depress growth and boost inflation for a time. But these are issues for the first half of 2011.

The inflation readings for the December quarter are set to show a continuation of the relatively benign outcomes evident for most of 2010:

- We expect the *headline* inflation rate to print at 0.7% in the quarter and 3.0% over the year.
- A rise in the RBA’s statistically-derived measures of *underlying* inflation of 0.8% in the quarter and 2.7% over the year would be consistent with the headline result.

The forecasts.

The RBA also often focuses on the CPI excluding volatile items such as petrol, fruit & veg and deposit & loan facilities when assessing underlying inflation. This measure should also return benign readings.

As a result, we expect the RBA to characterise the underlying inflation rate at the end of 2010 at 2¾%, comfortably within the 2-3% target range.

Some price indicators are flashing warning signs for 2011.

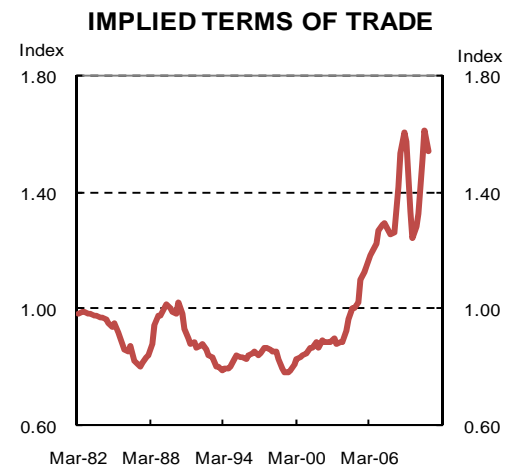
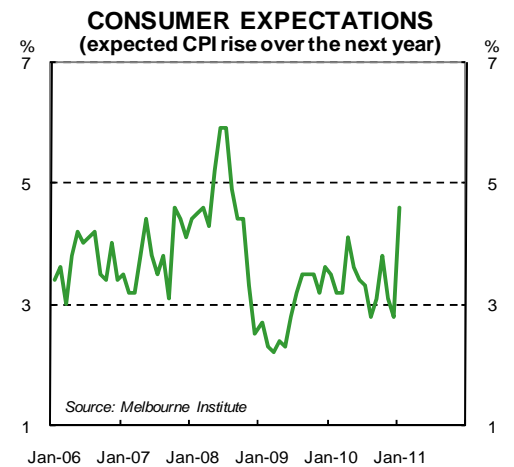
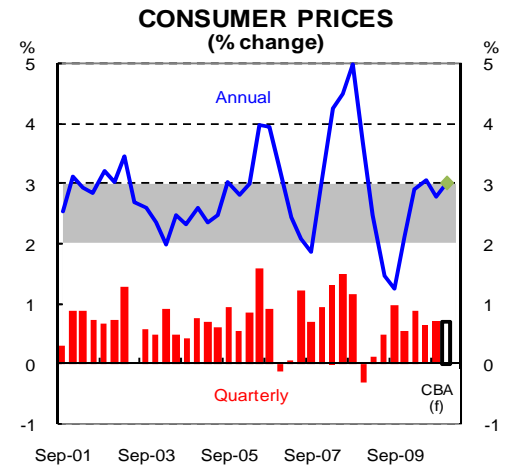
Other key price measures are, or should, show a more mixed inflation picture. The recent lift in consumer’s inflation expectations is one example. These expectations for the inflation rate in the year ahead jumped to 4.6% in January after averaging 3.3% in 2010.

The outcomes from the QIV trade price data are another case in point. The data suggest that Australia’s terms-of-trade remained at elevated levels in the final months of 2010. The substantial injection of income into the (full-employed) economy from high commodity prices continues.

The PPI.

The Producer Price Index (PPI) is published on Monday. The risk is that this measure of upstream price pressures lifts further. Information on input costs from the CBA-AiGroup Performance of Services Index (PSI) is consistent with a 0.8% rise in the QIV PPI.

That sort of increase would push the annual rate of growth up to 3.4%.





The model.

A top-down modelling approach shows the QIV CPI outcome driven by a lift in unit labour costs. Falling import prices and a smallish output gap are providing some offset.

The risks.

The main risks to our CPI forecasts are the degree of flow through of lower import prices to the retail level. And the extent of retail discounting. The trade price data showed that the price of imported consumer durables fell by 4.1% in QIV. Information from the CBA-AiGroup PSI suggests that downward pressure on retail prices remained intense in QIV.

The detail.

The volatile items that often influence headline outcomes should have a significant impact in QIV. Petrol prices, fruit & veg prices and deposit & loan facilities charges all appear to be up sharply in QIV. These items are set to contribute 0.29ppts to CPI growth in the quarter.

Food prices overall look to be a significant source of CPI growth in QIV. These increases pre date the flooding in key agricultural regions. They highlight the global food price inflation story that should be a key upside inflation risk in 2011. The flood impact on fruit & veg prices will come through in the Q1 2011 CPI data.

Housing will make another significant contribution to QIV CPI growth. The contribution should be smaller than seen in recent quarters, however. The housing market has cooled and the large rise in utilities charges in QIII won't be repeated. Rents should keep growing strongly given the strength of underlying housing demand.

Price discounting will restrain the contribution to CPI growth from clothing, holiday travel & accommodation, motor vehicles and other consumer durables. The trend decline in some CPI components such as audio, visual & computing equipment will accentuate the impact of discounting.

Seasonally low outcomes in some categories like education and pharmaceuticals will also help.

The sensitivity.

On a six-month-ended basis, which smooths out some of the quarterly volatility, a 0.8% rise in the underlying CPI will signal that inflation has bottomed out and turned higher. It would take a rise of only 0.5% to keep underlying inflation running at the bottom end of the 2-3% target range.

The price data will prompt the usual RBA re-assessment of the inflation trajectory from here. The results will be published in the next *Statement on Monetary Policy* (SMP) due on 4 February.

	Release date	CBA (f)	Market consensus	Market range
CPI	25 Jan	0.7% (3.0%pa)	na	na
Underlying CPI	25 Jan	0.8% (2.7%pa)	na	na

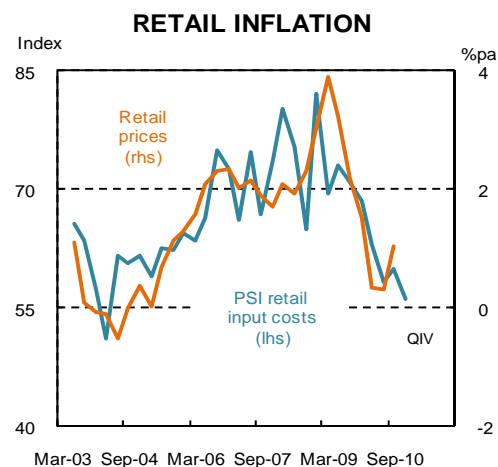
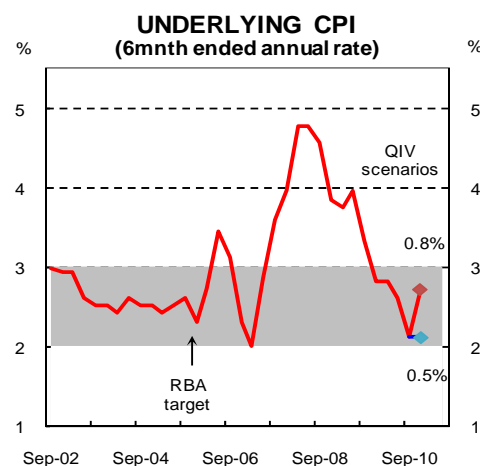


Table: CPI Components – QIV 2010

	% change	Contrib (ppts)
Food	1.0	0.17
Alcohol & tobacco	1.3	0.10
Clothing	0.2	0.01
Housing	0.6	0.13
H/hold contents	-0.1	-0.01
Health	-0.2	-0.01
Transportation	0.7	0.09
Communication	0.2	0.01
Recreation	0.4	0.04
Education	0.0	0.00
Fin & Insurance	1.7	0.15





Key Views

United States		Tactical (<1 mth)	Strategic (>3 mths)
<p>The outlook for US yields is more uncertain than usual. The Fed worries about excess capacity in product and particularly the labour market and concentrating on warding off deflation risks. But the data is brighter and the market is embracing recovery, while concerned about the fiscal backdrop and potential inflation impacts of QE.</p> <p>Overall, we expect a stronger economic recovery to take hold in 2011 and for bond yields to head higher as the situation becomes clearer. But the market has run far quickly, and appears to be pricing an excessive inflation profile given the risks and capacity at hand. We look for a pull-back in the near-term as data continues to unveil a weak pricing an employment environment. The Fed is likely to be very slow to adjust its views and respond to such a recovery with tighter policy. When it does, we see room for the curve to flatten markedly.</p> <p>In the near term, positive sentiment about the prospects for an improved funding package for highly-indebted European governments is likely to push EUR/USD into the high 1.30s. But we think over a medium-term view, the market is too optimistic. Within the next few weeks, we expect the market to refocus on the fiscal risks in Europe and push EUR/USD back down to the low 1.30s. We expect USD/JPY to remain relatively firm and stable because the still uncertain situation in Europe is appears to be discouraging Japanese offshore investment and fuelling further repatriation.</p>	Policy rate	0.1%	0.1%
	10yr bond	3.10%	3.00%
	2/10 curve	240bp	250bp
	USD/JPY	81.5	83
	EUR/USD	1.39	1.33
Australia		Tactical (<1 mth)	Strategic (>3 mths)
<p>Australia's economic health continues to stand in stark contrast to the rest of the advanced world. RBA tightening in 2010 put substantial flattening pressure on the domestic curve and saw spreads to the US benchmark widen noticeably. But the impact of that tightening on the retail sector and the AUD has curbed inflation pressure and contributed to a change in market trend in late 2010 (together with the US bond sell-off).</p> <p>The main dynamic in the domestic markets is tension between a comparatively weak current picture of the economy and a very strong medium term outlook. And between a very strong labour market and consumers' reluctance to spend. We see the fundamental strength exerted by high commodity prices and booming investment as dominating over the year and pushing the RBA to tighten another 75bp this year to ward off inflation pressure generated by the tight labour market. However, with no "smoking gun" likely in the near term, timing on rate rises is harder to predict.</p> <p>Relative to the subdued picture, this outlook points to a flatter curve and wider AUS-US bond spreads ahead. We also favour a paid 1Y/1Y position to directly capture the lack of RBA risk being priced. But with the 10Y BEI having widened out to 3%, we are cautious about the near-term potential for softer inflation data to keep a bid-tone in the market.</p> <p>The headlines about floods made a small dent in AUD, but that impact has now passed. We expect AUD to fluctuate around parity (0.97-1.02) over the next few months. In the medium term, we expect the AUD to begin easing once the Fed indicates it is preparing to withdraw its loose policy stance and the USD firms.</p>	Policy rate	4.75%	5.00%
	10yr bond	5.50%	5.50%
	3/10 curve	40bp	25bp
	10yr EFP	52bp	55bp
	10yr v US	240	250
	AUD/USD	1.02	0.99
New Zealand		Tactical (<1 mth)	Strategic (>3 mths)
<p>The RBNZ is on hold and our economists believe it will remain so until the third quarter. The income boost coming through from growth in Asia points to extension of the cycle and further RBNZ tightening thereafter. Our economists expect the RBNZ statement, released Thursday, to retain the same cautious tone present in the December MPS.</p> <p>While the USD is currently on the back foot, we think the NZD can make further gains. We think the soft NZ economy is likely to be reflected in gains in AUD/NZD and expect the recent dip in AUD/NZD to have been exhausted. We see upside risks to AUD/NZD this week.</p>	Policy rate	3.00%	3.00%
	10yr bond	5.50%	5.50%
	2/10 swap curve	145bp	145bp
	10yr v US	260	250
	10yr v AUS	+10	0
	NZD/USD	0.77	0.76
	AUD/NZD	1.31	1.34





CBA Forecasts:

Cash rate	24-Jan	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12
US	0.25	0.25	0.25	0.25	0.50	0.75	1.00	1.25	1.50
Australia	4.75	4.75	5.00	5.25	5.50	5.75	5.75	5.75	5.75
New Zealand	3.00	3.00	3.00	3.25	3.50	3.75	4.25	4.50	4.50
United Kingdom	0.50	0.50	0.50	0.50	0.75	1.00	1.25	1.50	1.75
Eurozone	1.00	1.00	1.00	1.00	1.00	1.25	1.50	1.75	2.00
Japan	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
2-yr bond yield	24-Jan	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12
US	0.63	0.50	0.80	1.10	1.40	1.70	2.00	2.30	2.50
Australia	5.07	5.10	5.40	5.60	5.70	5.70	5.70	5.65	5.60
New Zealand	3.80	3.80	4.00	4.20	4.60	4.90	5.00	4.80	4.80
United Kingdom	1.37	1.20	1.20	1.40	1.60	1.80	1.90	2.00	2.10
Eurozone	1.29	0.90	1.00	1.20	1.40	1.70	2.00	2.30	2.50
Japan	0.20	0.15	0.15	0.20	0.20	0.30	0.60	0.70	0.70
10-yr bond yield	24-Jan	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12
US	3.43	3.00	3.10	3.30	3.50	3.70	3.80	3.90	4.00
Australia	5.62	5.50	5.60	5.70	5.75	5.80	5.75	5.70	5.70
New Zealand	5.59	5.50	5.70	5.80	5.90	5.90	5.90	5.80	5.80
United Kingdom	3.72	3.30	3.30	3.50	3.60	3.60	3.70	3.80	4.00
Eurozone	3.18	2.80	2.80	2.90	2.90	3.00	3.10	3.20	3.30
Japan	1.25	1.00	1.10	1.10	1.20	1.30	1.40	1.60	1.70
AUD Swap Rates	24-Jan	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12
2-year	5.33	5.45	5.75	6.00	6.15	6.10	6.00	6.05	6.00
3-year	5.47	5.60	5.85	6.05	6.20	6.25	6.20	6.10	6.05
5-year	5.83	5.85	6.05	6.25	6.30	6.25	6.15	6.15	6.15
10-year	6.12	6.05	6.20	6.35	6.40	6.40	6.35	6.30	6.30
NZD Swap Rates	24-Jan	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12
2-year	3.87	3.80	3.95	4.30	4.70	5.20	5.30	5.20	5.20
3-year	4.21	4.25	4.40	4.80	5.15	5.30	5.20	5.25	5.15
5-year	4.68	4.70	4.90	5.21	5.49	5.57	5.52	5.52	5.47
10-year	5.47	5.25	5.50	5.70	5.90	5.90	5.90	5.85	5.85



Calendar – January 2011

Monday	Tuesday	Wednesday	Thursday	Friday
<p>3</p> <p>AU New Years Day public holiday EU/GE PMI manufacturing, Dec, Index US Construction spending, Nov, m%ch, (0.7) US ISM manufacturing, Dec, Index, (56.6)</p>	<p>4</p> <p>AU AI-Group PMI, Dec, Index, (47.6) UK PMI manufacturing, Dec, Index, (58) UK Net consumer credit, Nov, £bn, (0.3) US Factory orders, Nov, m%ch, (-0.9) US FOMC Minutes US Total vehicle sales, Dec, mn, (12.26)</p>	<p>5</p> <p>JP Vehicle sales, Dec, y%ch, (-30.7) EU PMI services/composite, Dec, Index EU Industrial new orders, Oct, m/y%ch, (-3.9/13.3) EU PPI, Nov, m/y%ch, (0.4/4.4) GE PMI services, Dec, Index, (59.2) UK PMI construction, Dec, Index, (518) US ISM non-manufacturing, Dec, Index, (55)</p>	<p>6</p> <p>AU CBA/AI-Group PSI, Index, Dec, (46.2) AU Build approv, Nov, m%ch, -2.0, (9.3) EU Retail sales, Nov, m/y%ch, (0.5/1.8) GE Factory orders, Nov, y/y%ch, (0.179) GE Factory orders, Nov, m/y%ch, (1.6/17.9) UK PMI services, Dec, Index, (53) CA Ivey purchasing manager index, Dec, (57.5)</p>	<p>7</p> <p>EU GDP, QIII, q/y%ch, (0.4/1.9) GE Trade bal, Nov, €n, (14.2) GE Industrial production, Nov, m/y%ch, (2.9/11.7) US Avg hourly earnings, Dec, m/y%ch, (0.0/1.6) US Non-farm payrolls, Dec, '000, (39) US Unemployment rate, Dec, % (9.8) US Consumer credit, Nov, \$bn, (3.4) CA Net change in employment, Dec, '000, (15.2) CA Unemployment rate, Dec, % (7.6)</p>
<p>10</p> <p>AU Retail trade, Nov, m%ch, 1.0, (-1.1) NZ Trade balance, Nov CA Building permits, Nov, m%ch, (-6.5)</p>	<p>11</p> <p>AU Trade balance Nov, \$bn, 2.0 (2.6) NZ NZIER Business opinion survey QIV NZ Building permits, Nov JP Leading / Coincident index CI, Nov US Wholesale inventories, Nov, m%ch, (1.9) CA Housing starts, Dec, '000, (187.2)</p>	<p>12</p> <p>AU Housing finance, Nov, m%ch Value of all loans, %, -0.5, (2.8) No. of own-occupiers, %, +0.5, (1.9) AU Job vacancies, Nov JP Curr a/c total/adjusted, Nov, ¥bn, (1436.2/1462.6) JP Trade balance - BOP basis, Nov, ¥bn, (912.9) EU Industrial production Nov, m/y%ch, (0.7/6.9) UK Total trade balance, Nov, £bn, (-3.946) US Import price index, Dec, m/y%ch, (1.3/3.7) CA Housing price index, Nov, m%ch, (0.1)</p>	<p>13</p> <p>AU Labour force, Dec employment, '000, 25, (54.6) participation rate, %, 66.0, (66.1) unemployment rate, %, 5.0, (5.2) NZ Card spending, Dec JP Machine orders, Nov, m/y%ch, (-14/7.0) EU ECB announces int. rate, %, 100, (100) UK Industrial production, Nov, m/y%ch, (-0.2/3.3) UK BoE announces rates, %, 0.50, (0.50) US Producer price index Dec, m/y%ch, (0.8/3.5) US Trade balance, Nov, \$bn, (-38.7)</p>	<p>14</p> <p>JP Domestic CGPI, Dec, m/y%ch, (0.1/0.9) EU CPI, Dec, m/y%ch, (0.1/1.9); core, y%ch, (1.1) EU Trade balance Nov, €n GE CPI, Dec UK PPI Input/Output/core, Dec, y%ch, (9.0/3.9/3.3) US CPI, Dec, m/y%ch, (0.1/1.1); core (0.1/0.8) US Retail sales, Dec, m%ch, (0.8) US Capacity utilisation, Dec, % (75.2) US Industrial production, Dec, m%ch, (0.4) US Uni. Of Michigan confidence, Jan, Index US Business inventories, Nov, m%ch, (0.7)</p>
<p>17</p> <p>AU Lending finance, Nov AU Motor veh. sales, Dec, m/y%ch, (0.2/-0.9) NZ Food prices, Dec JP Consumer confidence, Dec, Index, (40.6)</p>	<p>18</p> <p>JP Industrial production, Nov JP Capacity utilisation, Nov, m%ch, (-2.3) JP Machine tool orders, Dec GE ZEW survey (econ. sentiment), Jan, (4.3) UK CPI, Dec, m/y%ch, (0.4/3.3); core, y%ch, (2.7) US NAHB housing market index, Jan, (16) CA Bank of Canada, % 100, (100)</p>	<p>19</p> <p>AU MI/WBC Consumer Sent, Jan, Index, (111) AU Engineering Construction Activity, QIII EU Construction output, Nov UK ILO unemployment rate (3mths), Nov, % (7.9) US Building permits, Dec, '000, (530) US Housing starts, Dec, '000, (555) CA Bank of Canada Monetary Policy Report</p>	<p>20</p> <p>AU MI Unemp. Exp., Jan, Index (108.8) AU MI Consumer Inf. Exp, Jan, %, (2.8) AU Building activity, QIII NZ CPI, QIV, q/y%ch, (1.1/1.5) JP Leading / Coincident index CI, Nov, GE Producer prices, Dec US Existing home sales, Dec CA Wholesale sales, Nov</p>	<p>21</p> <p>AU Int'l trade price indexes, QIV, q%ch export prices, -1.0, (7.8) import prices, -0.9, (0.7) NZ Retail sales, Nov CH GDP, QIV, y%ch, (9.6) UK Retail sales, Dec, m/y%ch, (0.3/1.1) CA Retail sales, Nov</p>
<p>24</p> <p>AU PPI QIV, q/y%ch, 0.8/3.4, (1.3/2.2)</p>	<p>25</p> <p>AU CPI, QIV, q/y%ch Headline, 0.7/3.0, (0.7/2.8) RBA Underlying, 0.8/2.7 (0.6/2.5) JP BoJ target rate, %, 0-0.10, (0-10) UK GDP, QIV US S&P/Case-Shiller home price ind., Nov, CA CPI, Dec</p>	<p>26</p> <p>AU Australia Day public holiday UK Bank of England minutes US New home sales, Dec US FOMC rate decision, %, 0-¼, (0-¼) CA Teranet House Prices, Nov</p>	<p>27</p> <p>NZ RBNZ official cash rate, %, 3.00, (3.00) JP Trade bal total/adj, Dec US Durable goods orders, Dec US Pending home sales, Dec</p>	<p>28</p> <p>JP CPI, Dec, JP Retail sales, Dec US Employment cost index, QIV, q%ch, (0.4) US GDP, QIV US Uni. Of Michigan confidence, Jan, Index</p>
<p>31</p> <p>AU Private sector credit, Dec NZ Building permits, Dec NZ Trade balance, Dec JP Industrial/vehicle production, Dec JP Housing starts/construction orders, Dec UK GfK consumer confidence survey, Jan, Index</p>			<p>Early February AU House price indexes, QIV (1 Feb) AU Building approvals, Dec (3 Feb) AU Trade in Goods & Services, Dec (3 Feb) AU Retail trade, Dec (7 Feb) AU Labour force, Jan (10 Feb) AU Housing finance, Dec (14 Feb)</p>	<p>Central Bank Meetings UK BOE (13 Jan) EZ ECB (13 Jan) CA Bank of Canada (18 Jan) JP BoJ (25 Jan) US FOMC (26 Jan) NZ RBNZ (27 Jan) AU RBA (4 Feb)</p>

Note: Figures in brackets represent previous result (if available). All information is preliminary and subject to revision. Chief Economist: Michael Blythe ph: 9118-1101 Economist: James McIntyre: 9118-1100



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