Global Markets Research

Fixed Income: Weekly Strategy

14 August 2012

New path, same destination of lower Australian bond yields

- We continue to look for Australian bond yields to make new lows, but have adjusted our forecasts after recent events.
- Japanese clients have revealed AUD strength is affecting investment decisions. We buy QTC vs EIB and NSWTC.
- We have added to our overall long position by buying the ACGB Apr-23 vs UT Aug -22.

The sell-off in Australian bonds appears to have stalled for the moment. 3Y bond futures have sold-off 5bp since our last weekly, but are above the lows reached last week. Australian 10Y bond futures are unchanged since our last weekly. A solid rally after poor Chinese trade data on 10 August seems to have halted the selling momentum.

A similar story holds for US Treasuries. The US 10Y yield has sold-off 6bp since our last weekly, but has been rallying over recent days after reaching a peak on 9 August. The market seems to be moving into more of a holding pattern, waiting for the next major impetus.

The tone in Europe remains moderately positive, but cracks are starting to appear. German politicians are making noises about refusing to grant any further aid to Greece. At the same time, the data continues to underline the structural problem in Europe. We believe these structural problems are likely to combine with the strong AUD, the high spread on offer and the lack of new bond supply to create a bid for ACGBs. We have updated our forecasts in light of recent moves, but still expect the same outcome in the medium to longer term. We now forecast a different path to the same conclusion. (See table of forecasts at right.) Alex Stanley explains the nuances of our new bond forecasts on page 3.

In light of our expectation of falling Australian bond yields we have considered an outright long position in Australian bonds. Although that position is attractive at the moment, we think the spread trade of buying ACGB Apr-23 against the US 10Y is a better choice than an outright long position. Our primary expectation is for falling yields which should see both the yields and spreads fall, but there is a risk global recovery sees Australian yields rise and spreads contract. As such, we prefer the spread trade. See page 6 for more details.

Adam Donaldson recently visited Japan and reports that the strength of the Australian dollar is affecting investment decisions there. Moreover, SAFE's move into semis was widely discussed. We move to buy QTC vs both EIB and NSWTC to capture potential QTC outperformance in both risk-on and risk-off environments. (See page 11.)

This week has already seen one major European bond auction (Italy sold €8bn of bills last night) but the Greeks will also attempt to sell €3.125 of bills tonight. Euro-zone wide GDP is also scheduled for this evening, expected to show a slim 0.2% rise in Q2. Later this week Australian consumer confidence and wage price data are scheduled in what is a fairly quiet data week.

In the US, retail sales (scheduled for Tuesday night) will be a focus as will CPI data scheduled for Wednesday night. The Philly Fed and University of Michigan surveys are both expected later in the week (Thursday and Friday, respectively). Consensus is currently looking for a strong bounce in the Philly Fed after the poor result last month.

Contents:

Our new forecasts and the changes made

	Current	Dec-12	Jun-13	Dec-13
RBA Cash (%)	3.50	3.25	3.25	3.25
90d BBSW (%)	3.63	3.10	3.30	3.40
3Y bond (%)	2.71	2.30	2.20	2.60
10Y bond (%)	3.25	2.70	2.50	2.90
3/10Y Curve (bp)	54	40	30	30
US 2Y	0.26	0.25	0.30	0.40
US 10Y	1.66	1.40	1.40	1.80
Changes (bp)				
Official Cash		0	0	0
Aus 3yr bond		50	-10	-20
Aus 10yr bond		20	-25	-10
Aus 3-10yr Curve		-30	-15	10
US 2Y		0	0	0
US 10Y		0	-40	-40

Source: CBA, Bloomberg

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Key Positions

We have added to our long positions this week, buying the ACGB Apr-23 against the UST 10Y (Aug-22). We prefer this to the outright long position because the spread trade should work better if our overall view is wrong and there is a global sell-off.

We have also moved to buy the QTC Jul-22 against both the EIB and NSWTC 10Y bonds. The rationale is that we expect the QTC bond to outperform other semis for credit reasons, but are wary of the impact of risk moves on the trade. To protect against a risk-off move we have bought QTC against EIB since the EIB bond is likely to underperform more than QTC does in a risk-off move.

We have also exited our ACGB Apr-20 to Apr-23 flattener for a small profit. After a long wait the trade was near our target.

Two of our prior "insurance" trades have also expired. The put option on the Oct-14 expired OTM while we have lost money on the conditional bull steepener. The recent sell-off was led by the 3Y and resulted in a flattening overall.

Key Trades

Trade	Entry	Current	Profit	Target	Stop	Comment
Buy the TCV Jun-20 vs NSWTC May-20	0.5bp (16-Nov-11)	+2bp	1.5bp	10bp	-5bp	**Hold:** TCV's AAA is safe and the funding task is modest. NSW is subject to some rating risk.
Buy the ACGB Apr-23 versus the Apr-20.	31bp (12-Jan-12)	23bp	+8bp+2bp carry = 10bp	20bp	37bp	**Take Profit:** RV analysis shows no major cheap/dear results and trade is near target (finally).
Buy a 6M put on the Oct-14 bond at a strike of 4.10%	5bp premium (9-Feb-12)	2.80%	-5bp premium			**Expired OTM:** It looked good for a while, but the bearish side of our paired options trades is redundant now.
Buy a 20bp OTM conditional bull steepener. (2.9 times 3.31% call on Apr-15 and 1.0 times 3.89% call on Jul-22. Implicit slope 58bp).	6bp premium (9-Feb-12)	Expired at 44bp	Slope -14bp, = -20bp total			**Expired for loss:** The outperformance of the 10Y in the sell-off harmed this trade.
Buy the ACGB Aug-15 linker vs the Oct-15 (BEI to widen). Receive fixed in ZCS at 2.65%, creating	250bp (30-Mar-12)					**Hold:** We transformed the original trade by receiving ZCS against it. The trade is now (close to) a 14bp per annum annuity.
Receive 5Y in NZ 2Y/5Y/10Y butterfly	-14bp (15-Jun-12)	-14bp	0bp	-30bp	0bp	**Hold:** The 5Y has lagged in the rally so switch to a 2Y/5Y/10Y fly.
Receive the AUD 5Y Bills-Libor spread	33bp (25-Jun-12)	33bp	0bp	18bp	40bp	**Hold:** We still believe the Bills/Libor should be tighter as the market calms.
Buy the Rabo Apr-15 against the ANZ May-15 on an ASW basis	47bp (4-Jul-12)	47bp	0bp+1bp carry = 1bp	30bp	60bp	**Hold:** We think European risk aversion has pushed the Rabo too wide
Pay 6M*1Y receive 1Y*1Y AUD swap	+6bp (9-Jul-12)	+5bp (including roll)	+1bp	-25bp	+15bp	**Hold:** We think the tone of sentiment is shifting. Hawkish-side surprises from RBA (less easing) should still invert the front end.
Pay the 3Y EFP at 74.5bp	74.5bp (30-Jul-12)	74bp	-0.5bp	90bp	68bp	**Hold:** The longer-term trends towards wider spreads haven't abated.
Buy the WATC Apr-14 against the ACGB Jun-14	52bp (3-Aug-12(	48bp	4bp	25bp	70bp	**Hold:** There is strong carry from buying the WATC against ACGB but also protection from credit widening.
Receive 1Y OIS at 3.15%	3.15% (7-Aug-12)	3.10%	5bp	2.60%	3.30%	**Hold:** We move to receive 1Y ZCS because we doubt the sell-off can continue
Buy QTC Jul-22 bonds ($300) vs EIB Jun-21 ($100) and NSWTC Mar-22 ($200)	Q-N 45bp; E – Q 41bp (10-Aug-12)	45bp	0bp	35bp (Q-N)	50bp (Q-N)	**New Trade:** we believe the QTC credit should outperform. This combination of trades should perform well in either a risk-on or risk-off scenario
Buy ACGB Apr-23 vs UST Aug-22	163bp	164bp	-1bp	140bp	175bp	**New Trade:** We expand our long position to include the ACGB to UST spread. The spread should outperform a straight long position in a global recovery.

Forecast update: a different path to the same destination
(First published on 13 August)

Alex Stanley – Associate Analyst, Fixed Income – 61 2 9118 1125 – alex.stanley@cba.com.au

- We update our forecasts to account for recent events.
- Global factors still support ongoing strength in Australian bonds, despite a less dovish RBA cash rate outlook.
- We still foresee low Australian bond yields over the medium term.

We have outlined in some detail our views that Australian fixed income markets remain an attractive product for global investors. While yields on Commonwealth bonds remain low relative to the cash rate, the spread is high compared to other advanced economies, particularly in real terms. We view this as a compelling investment proposition for foreign investors given Australia's lack of QE, superior AAA credit rating and diminishing supply of government bonds. We continue to expect the spread of Australian bonds to compress towards the very low yields expected to be sustained in advanced economies over the next few years.

As is well known, however, the bond market is also subject to highly variable short term flows which are, in turn, subject to trends in global risk appetite and the near-term RBA outlook. 10Y ACGB yields touched a record low of 2.7% (2022s) just three weeks ago, but have now backed up sharply to 3.2% following commitments from the ECB to underpin the viability of the EUR. The front end of the curve failed to match early June lows as it became apparent the RBA would not cut the cash rate in August as initially expected. A stabilisation in the inflation rate, a bounce in retail sales following government cash handouts and the pickup in broader markets has seen the market pull-back pricing for RBA rate cuts from almost 125bp in June to around 50bp now. 3Y bond yields have increased 50bp since late July and the curve has flattened. The Aus-US 10Y spread has surprisingly widened by 23bp.

Looking ahead, we have pushed out the timing of our forecast rally in Australian 10Y bonds down to 2.5% by 1-2 quarters. As noted, the big picture still favours that outcome. But the ECB's stance has relieved a sense of crisis in markets that may have taken yields down to this level in 2012. The front end of the curve is even more subject to trends in risk appetite. We have lifted our forecast for Australian 2-3Y bonds slightly and pushed out the timing of the low point until H1 2013. But we continue to believe that global capital inflows are playing a key role in boosting the AUD and tightening financial conditions as well as suppressing yields and credit spreads. This should lower Australia's yield structure over time as we face a declining terms of trade and the looming

Figure 1: Changes in forecasts

	Current	Dec-12	Jun-13	Dec-13
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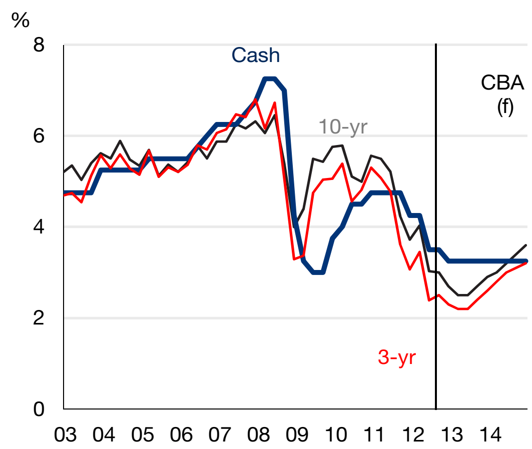
US 10Y		0	-40	-40

Source: CBA, Bloomberg

Figure 2: Australian bond yields history and forecast



Source: CBA, Bloomberg

"pothole" in the business capex cycle.

Australian bond yields to stay low in the medium term

We view pricing for 50bp of easing as an opportunity to enter long positions at the front end of the curve. We identified receiving OIS as just one way to play the current optimistic market pricing structure in the short term.

The structural support for Australian bonds remains strong.

In the medium to long term, we continue to see plenty of reasons for bond yields to stay low. In late June, we released a long term focused piece called *"Making sense of low bond yields"*. We won't repeat all the analysis from that article here. Instead, we note the key supports for bonds we've previously identified aren't changed by the recent sell-off. In particular, we cite the following key factors:

The RBA may be forced to react to a high currency with lower rates.

- *A strong AUD*. The AUD has recently proven resilient to the lower cash rate, falling terms of trade and downgrades to the global growth outlook (Figure 4). The high currency is exerting pressure on trade-exposed sectors of the economy. The RBA are likely to eventually respond to this tightness in financial conditions, albeit possibly reactively (as we've seen over the past year).

Bond yields should stay low in other developed economies.

- *Anaemic developed world growth outlook*. Q2 GDP reports show that many large developed economies have slowed sharply. More recent data such as PMIs point to further disappointment. Monetary and fiscal policy is running close to limits in many countries and will have a diminishing marginal ability to reflate growth. Longer term constraints on many G7 countries include: unfavourable demographics, fiscal austerity, deleveraging, and internal competitiveness imbalances (in Europe). This should keep bond yields very low in core, quality, advanced economies.

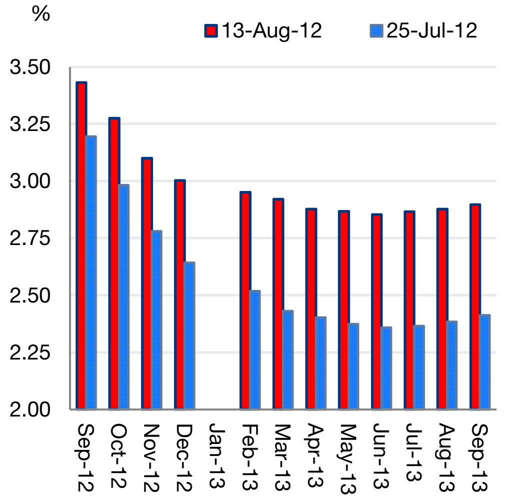
Australian real and nominal yield spreads to the US are wide.

- *Strong relative value.* The aforementioned factors signal that many developed economy sovereign yields will be less attractive to investors on a risk/reward basis than Australian yields for the foreseeable future. Australian yields still look attractive when compared to the diminishing pool of AAA rated peers (Figure 5). The 10Y spread to the US is actually near a 15Y high in real terms (Figure 6).

New CGS issuance is falling.

- *Diminishing new supply.* The Government's shift to a surplus means that new CGS supply will drop-off sharply this year. AOFM currently projects new funding will fall to just $11bn this year from $46bn in 2011-12. Total issuance is

Figure 3: Cash rate pricing

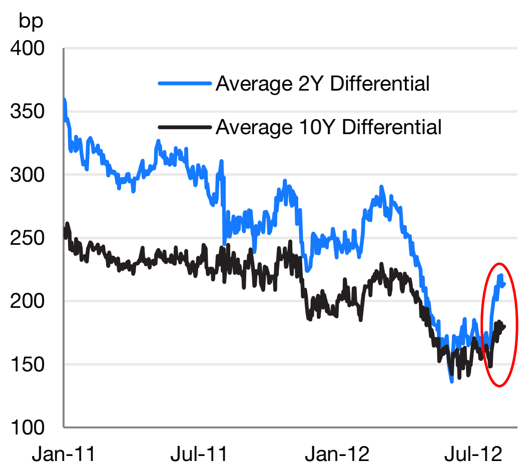


Source: CBA, Bloomberg

Figure 4: AUD Trade-weighted Index

Source: CBA, Bloomberg

Figure 5: Australia yield spread to AAA peers



Source: CBA, Bloomberg

set to fall from $60bn to $37bn this financial year and then to around $20bn by 2015-16 (Figure 7).

US Treasury yields to stay low through 2012

US yields have pushed higher in recent weeks, largely on account of the improvement in risk appetite. However, the economic and policy outlook means US yields are likely to fall back and not rise as quickly as our previous forecasts suggested.

Momentum in the US economy has slowed.

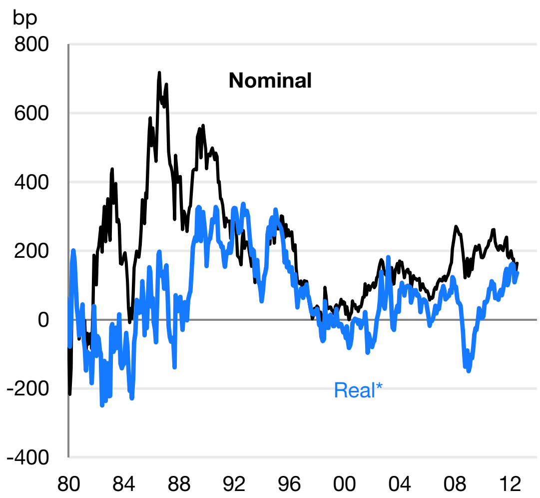
Momentum in the US economy has clearly slowed. There is some support coming through from the long-awaited turnaround in the housing sector. But this doesn't seem sufficient to counteract many other current and potential negatives. First, payrolls growth is still insufficient to bring down the unemployment rate. Second, recent surveys show the manufacturing sector has slowed. Also, the US growth outlook is subject to considerable downside risks because of the looming fiscal cliff (which implies a rapid tightening in US fiscal policy by up to 4% GDP).

The Fed is likely to ease policy further.

The Fed is widely expected to embark on further easing by the end of the year. This easing could take many forms, but QE3 still seems a likely option. While some Fed buying is already priced into Treasuries, the prospect of ongoing policy support means US bonds are likely to stay well supported through 2012 and 2013. We've upgraded our US 10Y yield forecasts slightly for the September 2012 quarter. But thereafter, we've delayed the pickup in yields until a more meaningful recovery in the US economy takes hold in the second half of 2013. We expect QE and tighter fiscal policy to cap moves in the interim period.

This subdues backdrop for benchmark US Treasuries is clearly a critical rationale for expecting Australian yields to press lower over time.

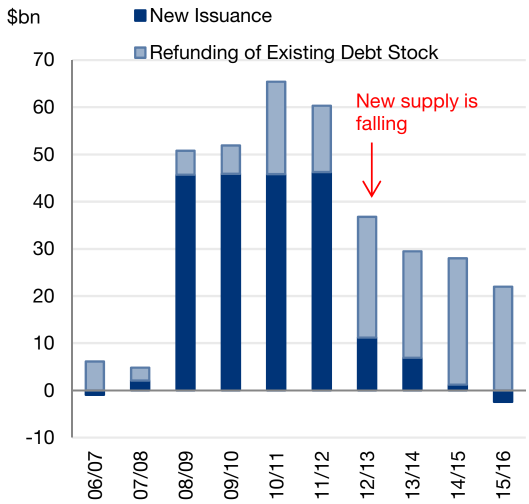
Figure 6: Aus-US 10Y yield spread*



Source: CBA, Bloomberg

**Real yield deflated using respective core CPI measures*

Figure 7: New CGS Supply



Source: CBA, AOFM

Table: New Bond Yield Forecasts

Australia	13-Aug	Sep-12	Dec-12	Mar-13	Jun-13	Sep-13	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14
2-yr bond yield	2.83	2.60	2.40	2.30	2.30	2.50	2.60	2.70	2.70	3.00	3.10
3-yr bond yield	2.67	2.50	2.30	2.20	2.20	2.40	2.60	2.80	3.00	3.10	3.20
10-yr bond yield	3.26	3.00	2.70	2.50	2.50	2.70	2.90	3.00	3.20	3.40	3.60
US	**13-Aug**	**Sep-12**	**Dec-12**	**Mar-13**	**Jun-13**	**Sep-13**	**Dec-13**	**Mar-14**	**Jun-14**	**Sep-14**	**Dec-14**
10-yr bond yield	1.63	1.50	1.40	1.40	1.40	1.60	1.80	2.00	2.25	2.50	2.75

Pulling the trigger on Aus-US 10Y bond spread
(First published on 13 August)

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- We have been looking for the right entry point for a long bond position for a while now.
- With the RBA meeting and SOMP out of the way, we think the time is right to enter a long position now.
- We prefer the spread because it would perform better in a continued recovery. We receive the spread at 163bp.

We have held an AUS-US spread narrowing view and position for most of this year. That has been a profitable stance. But the trade was stopped out a couple of weeks ago (using a trailing stop) amid the sell-off that followed Mario Draghi's pledge to do whatever it takes.

We generally favour a bond rally from here, and would expect Aussie bonds to outperform in this environment (effectively unwinding moves of the past two weeks). We have argued (in *Strategy Weekly* 7 August) that the market was likely to rally in the medium term, once short-term impacts have run their course.

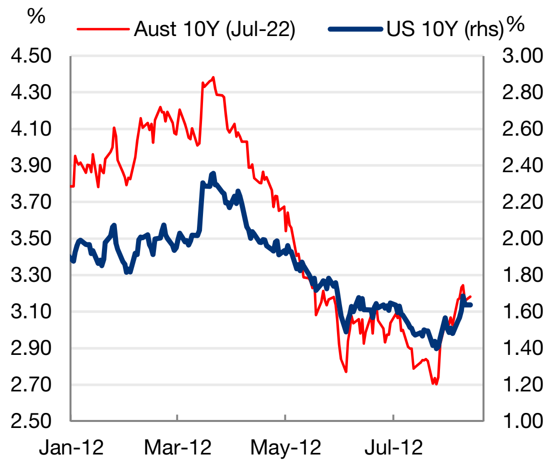
RBA pricing has now shifted back to more neutral levels, leaving ample room to rally. With the RBA meeting, the SoMP and employment data out of the way, we are establishing a long position. But timing the entry point on outright trades is currently challenging given strong momentum in the market, event risk and sheer uncertainty over the global outlook.

Both Australian 10Y and Aust-US 10Y spread near recent highs, but we prefer the spread

We think positioning with a spread contraction (rather than an outright long) offers extra protection in a sell-off. The experience in March shows how this could unfold. Moreover, a prolonged 'risk-on' move would probably push the AUD to painfully high levels and invoke market expectations for an RBA response. That would most likely be in the form of lower rates rather than direct intervention. So Australian bonds should out-perform in that environment.

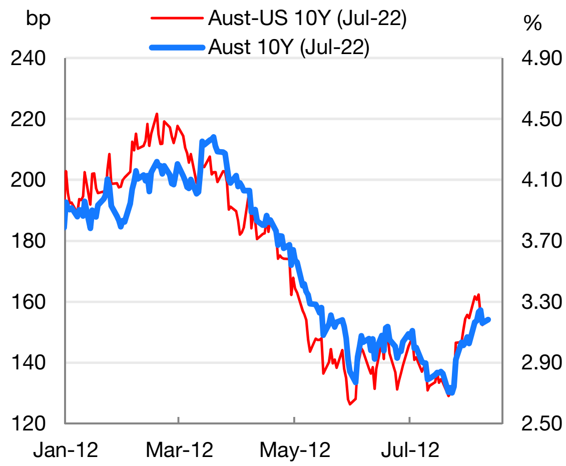
Although both the ACCGB 10Y and the spread have increased recently and tend to be highly correlated (Figure 1 and 2), we choose to take a long position using the ACGB 10Y vs US 10Y at 163bp. We target 140bp in the short-term with a stop at 175bp.

Figure 1: Australian and 10Y bond yields



Source: CBA, Bloomberg

Figure 2: Spread and 10Y yield highly linked



Source: CBA, Bloomberg

We favour long positions and fading the sell-off

We generally favour long bond positions on a global basis. We are nervous that the current Draghi master plan remains more plan than actuality. Problems in Europe are structural and any bond buying program would treat the symptoms, but not the underlying disease.

Europe remains a concern

Spain and Italy - and the Eurozone more generally - have too much debt and too much deficit to handle. They cannot "grow their way out" because they're competitiveness is compromised by the euro – essentially a fixed exchange rate regime.

Draghi's plan will treat symptoms by lowering the borrowing costs of Italy and Spain, but it cannot change the fundamental problems. As we saw with the LTRO, any treatment that focusses only on Government borrowing costs is destined to fail because it only buys more time without fixing the actual problem.

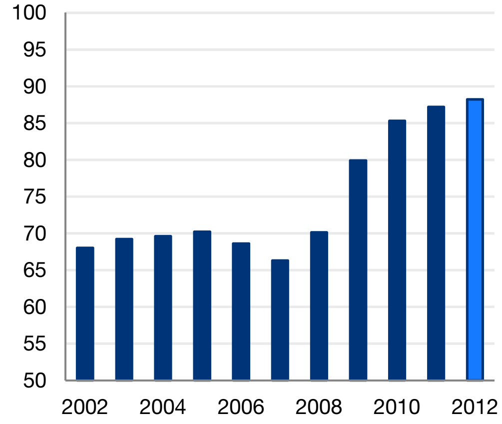
We suspect Draghi's plan, when it is eventually revealed, will tie Europe together even more tightly. As we wrote last week (*Daily Wrap*, 6 August), tying Germany and Spain together more tightly will help Spain and harm Germany. Significantly, the limiting factor may not be Germany's politicians or Central Bankers – it may be Germany's overall fiscal sustainability. Moody's placed Germany on negative outlook because of such fears.

Europe as a whole is suffering, not just individual countries

Considered as a whole, the Euro-zone is of questionable solvency. Figure 3 shows that the total Euro-zone debt/GDP ratio is sitting perilously close to the 90% borderline identified by Reinhart and Rogoff. Italy and Spain will struggle to grow from here against the backdrop of austerity, but so will the Eurozone as a whole. Italian GDP data released on 7 August showed a 2.5% p.a. contraction in the year to Q2. The first estimate of Q2 Euro-zone wide GDP will be released on Tuesday evening Australian time.

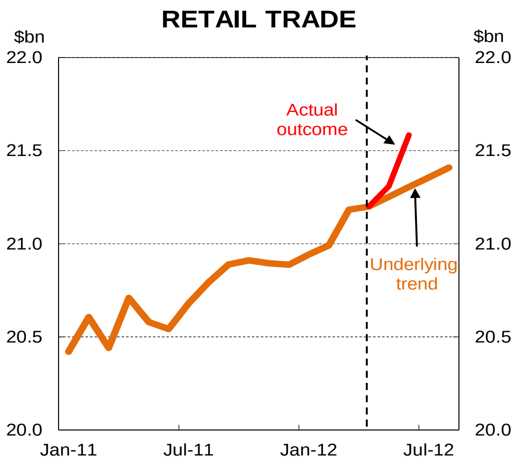
We generally think long positions are best following the recent sell-off. But the market is volatile and fickle, so we have contained exposure to the front end of the curve (receiving 1Y OIS in the *Strategy Weekly* of 7 August). Today we add an Aus-US 10Y bond spread trade – this has generally been correlated to outright moves in yields and should narrow in any rally. But we also identify a number of reasons that suggest the domestic economy in Australia could weaken separately from the world scenario (allowing ACGBs to outperform). This means the spread should also narrow if the general global sell-off continues from here.

Figure 3: Euro-zone total debt/GDP approaching the 90% point of no return



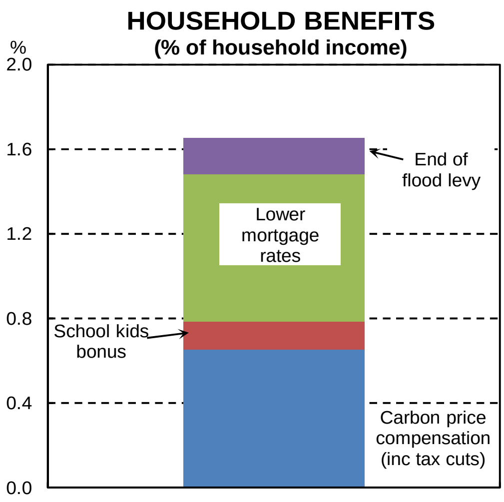
Source: CBA, Eurostat

Figure 4: Retail Sales May/June bump



Source: CBA, Bloomberg

Figure 5: Most, but not all, assistance is carbon tax related



Source: CBA, Bloomberg

Domestic data poised to turn

Purely domestic drivers of Australian bonds haven't been influential recently, but do appear to be poised to turn after perhaps amplifying the domestic sell-off.

Australia's domestic data has been helped by Government decisions

The recent retail sales data was strongly influenced by the Government's assistance package for the Carbon tax. Importantly, the assistance started in May and June, before the carbon tax itself began in July. May and June's retail sales results were very strong (+0.8% and +1.0% respectively) and that could extend for another month or two. But the market is likely to discount such data from here on.

The vast bulk of the assistance that is going to come through already has. Most of the assistance provided so far has been in the form of a single, lump-sum payment to eligible households. There were also some income tax adjustments that began on 1 July 2012, but the changes to most Government payments have been prepaid in May and June. Ongoing payments have not yet risen and won't until July 2013.

Retail sales in July could be rather weak. Our economists have prepared an estimate of underlying retail sales and the blip caused by the stimulus payments. (See Figure 4.) The tax cuts and rate cuts will assist future retail sales prints, but there is still a significant temporary bump to counteract.

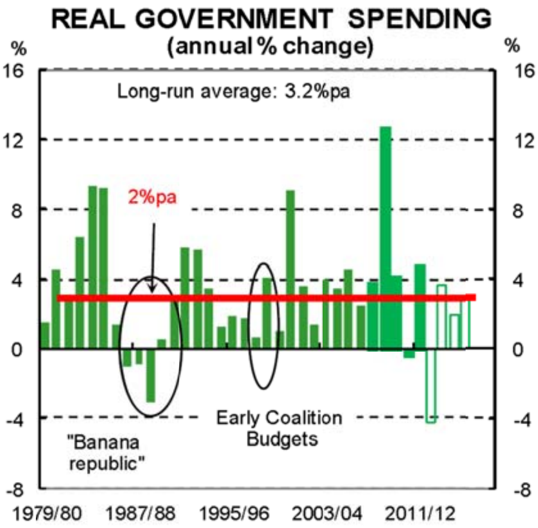
But this may change in coming months

Part of the reason for the pre-payment of the assistance package was to ensure that the Government ran a surplus in 2012-13. That return to surplus is the more meaningful medium-term driver of bonds. It will contribute to a rally by reducing economic growth directly. Figure 6 shows that the most recent Budget was amongst the most contractionary ever. Second, the reduction in the supply of bonds will make ACGBs richen. Not only compared to Australian swaps (we're paid EFPs too), but also when compared to USTs, of which there seems to be an ample supply.

The fall in the supply of bonds is likely to have a relatively strong impact, because most of the supply in 2012-13 will be refunding of maturities in the existing debt stock. A relative small amount of new bonds will be issued (Figure 7). This impact probably hasn't come to the fore yet, because the AOFM is maintaining a relatively strong issuance schedule of around $1bn per week at present. The AOFM does not need this much per week on a yearly basis.

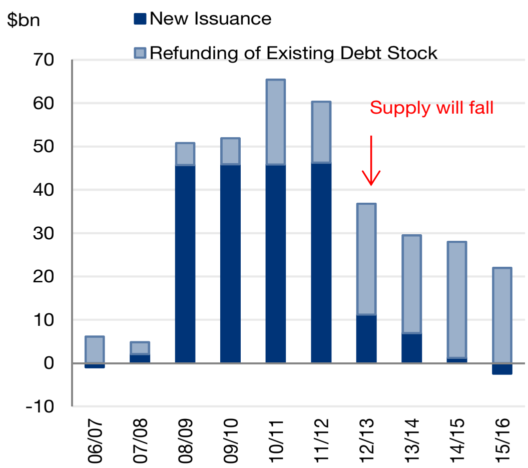
Australian household credit growth is also sitting near the lowest levels on record. The low level of household credit creation is preventing the economy from growing quickly. Combined with fiscal tightening and very tight monetary

Figure 6: Fiscal Contraction



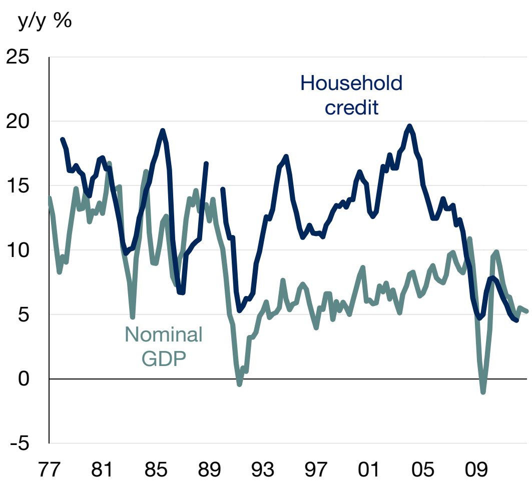
Source: CBA, Bloomberg

Figure 7: Bond Supply Contraction



Source: CBA, Bloomberg

Figure 8: Credit contraction generally



Source: CBA, Bloomberg

conditions caused by the high AUD, it is clear the Australian economy is facing headwinds.

So far we have mostly used domestic arguments as to why the Australian bond yields should fall. Arguing for domestic reasons to lower bond yields in Australia implies that both the outright long position and the spread compression trade should work well. However, to really justify using the spread trade rather than a straight long position, you need to consider when the spread trade will outperform. We think the relative positioning of the US market compared to Australia provides that answer.

International balance of risks suggests spread is better choice

Australia's market pricing has moved much further than global counterparts

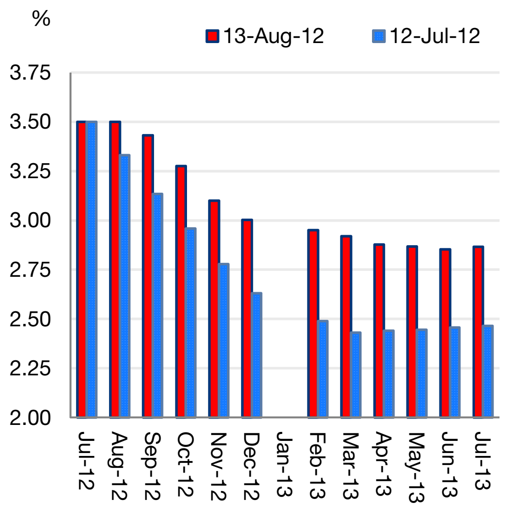
RBA pricing has changed significantly over recent weeks. Figures 9 and 10 show the impact of that change. Not only has the slope of the implied RBA trajectory adjusted significantly, but the difference between the cash rate and the implied rate on the 12th IB future has increased to only -55bp. Other than a short period in late March, the spread has been below -80bp for most of the past year (and the March period isn't a coincidence as discussed below). If the recent improvement in sentiment turns, there will be a significant rally in Australia – essentially reversing the moves of the last few weeks. The Australian bonds will rally and outperform the US.

While there is space for RBA expectations to move back, there has been little change in implied pricing for the Fed. That pricing suggests almost no change in the cash rate between now and late 2014 – for fairly obvious reasons. The Fed still promises to keep cash rates low "at least through late 2014" at every FOMC meeting. The odds of further QE have also been shortening. But we sense that extension of the 'risk on' trend would nevertheless prompt a more decisive move away from defensive Treasuries as the market began to question the appropriateness and sustainability of those policies.

Spread outperforms straight long position in a sell-off

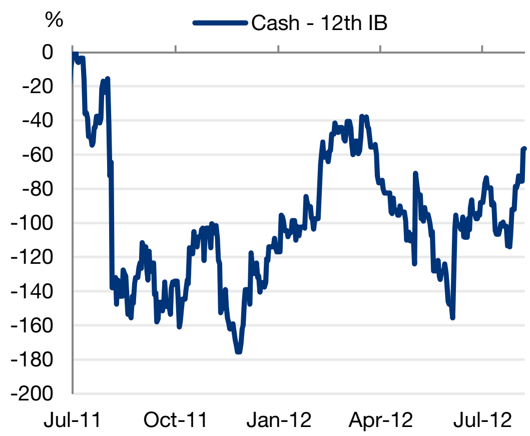
The market last repriced an improving US outlook in March. (See Figures 1 and 2 again.) Australian bonds echoed the sell-off in US Treasuries over this period, but the spread contracted. If our long-run expectation of a rally turns out to be wrong, we would far prefer to own an Aus-US spread trade than to hold an Australian bond outright. In a global recovery, the Aus-US spread would likely contract because of a sharp US sell-off, like it did in March.

Figure 9: Massive repricing of RBA outlook



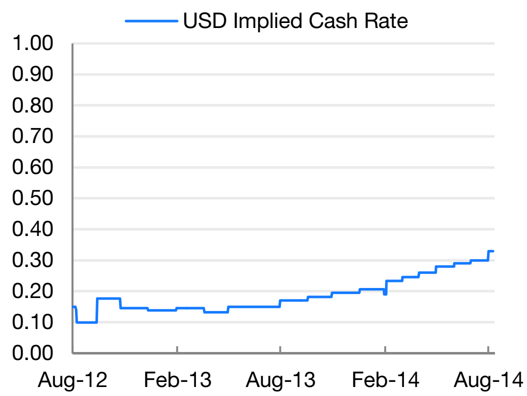
Source: CBA, Bloomberg

Figure 10: Massive repricing of RBA outlook



Source: CBA, Bloomberg

Figure 11: Fed Repricing? Not so much.



Source: CBA, Bloomberg

AUD considerations

The AUD should also perform well if the market prices for recovery in a prolonged ‘risk on’ rally. However, recovery in USD or EUR (depending on the source of the pick-up) could temporarily be larger – the AUD actually fell against the USD and TWI in March. As highlighted, this didn’t stop the AUS-US bond spread contracting during this period.

Terms of trade weakening is not being reflected in AUD pricing

Figure 12 shows that the terms of trade has weakened but that the AUD has not. This combination reduces the competitiveness of the Australian economy and is starting to attract the attention of some policy heavy hitters. The RBA statement has started to note the discrepancy in more and more pointed ways over recent communications. Warwick McKibbin – freed from the shackles of being an actual RBA board member – suggested direct RBA intervention in the FX market may be warranted.

A continued global recovery would likely see the AUD rise further and would, eventually, be likely to draw some reaction from the RBA. This could be reactive, after the depressing impact on inflation and demand has become visible. But, from a 2% inflation starting point, we suspect the RBA would attempt to weaken demand for the AUD earlier by reducing Australia’s interest rate gap.

In a global recovery, the ACGB to UST spread trade is clearly preferable

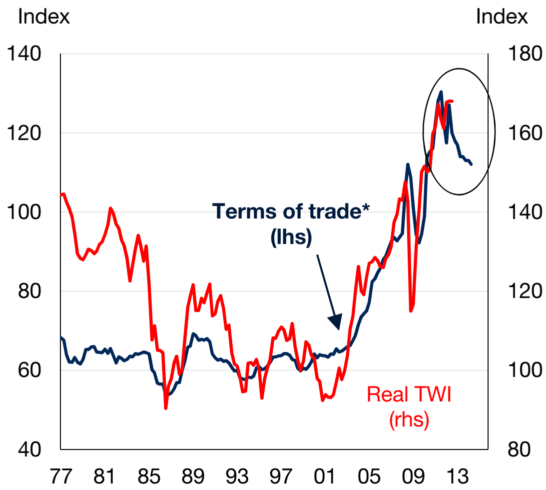
In a continued global down-turn, or a localised downturn, a long ACGB position and a long Aus-US spread position are probably equally attractive. However, in a global recovery, the spread trade is clearly preferable.

As Friday’s data showed, the possibility of a Chinese slowdown pulling down Australian yields and tightening the spreads remains real too.

Hence, we buy the ACGB Apr-23 against the US 10Y bond at the current spread of 163bp. We target a move back to 140bp in the short-term, but in the long term a move to 90bp is possible. We set a stop at 175bp.

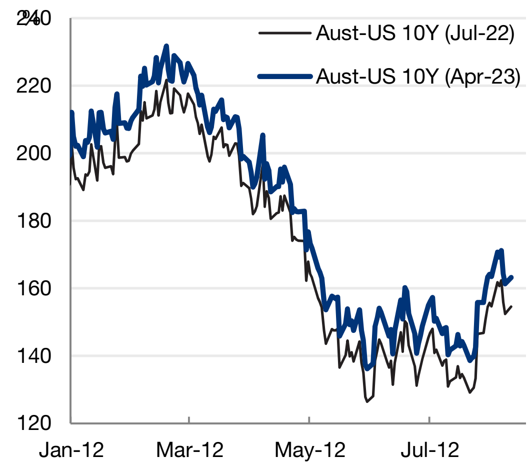
This trade has slight negative carry. The Australian bond has 3M carry that is effectively zero (-0.4bp per 3m), but the steepness of the USD curve gives the short US 10Y position negative carry of around 4bp per three months.

Figure 12: TWI not reflecting the terms of trade



Source: CBA, Bloomberg

Figure 13: ACGB Spread to 10Y US



Source: CBA, Bloomberg

The view from Japan suggests buying QTC against EIB and NSWTC
(First published on 10 August)

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- After visiting clients in Tokyo we feel better equipped to explain the recent underperformance of front-end ACGBs.
- The AUD is so strong that Japanese investors are resisting buying ACGBs (or even outright selling) for currency reasons.
- If continued strength in the AUD does force an RBA cut, OIS is likely to outperform ACGBs (Japanese clients will sell).
- We think QTC bonds will outperform. We buy QTC against EIB and NSWTC to cover both risk-on and risk-off scenarios.

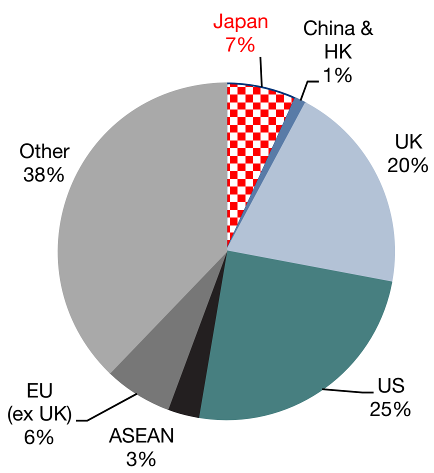
We visited clients in Tokyo last week, calling in on the largest real money managers, life insurers, banks and securities houses. Europe has been the main driver of Australian markets in recent months and is likely to remain so, but the impact of Japanese flows on the Australian market is probably larger than most give it credit for. The Japanese flows are likely to be an important counterpoint to European issues in coming weeks.

Japanese investors hold around 6% of long-term debt securities

Data on just how much paper foreign investors hold is notoriously poor – the official figure for Japan is around 7%, which is about 3.5% of total debt outstanding (Figure 1). But the total includes vast foreign currency issuance by banks and corporates into the US and UK capital markets, including money markets. We estimate Japan holds about 6% of long-term AUD debt securities, and an even larger share of the high-grade bond market. A number of Australian fund managers also manage large funds on behalf of Japanese clients.

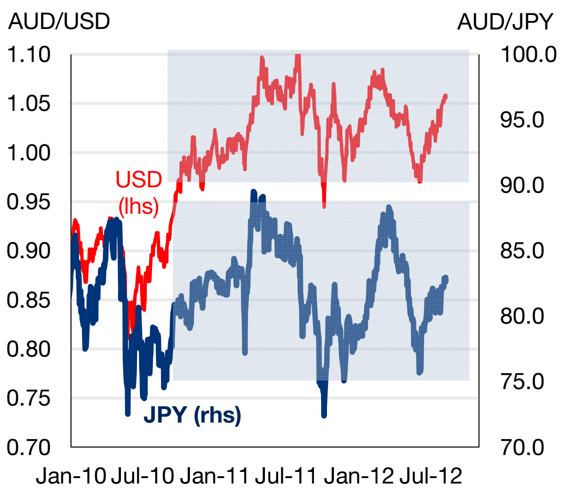
Engagement and appetite for AUD fixed income remains strong. But growth seems to have plateaued for the time being as the AUD has lifted. Feedback indicates that further moves up in the AUD toward USD1.10 or JPY85 (now close following the recent rally) may prompt a bout of profit taking among the Japanese global funds and insurance clients. Our sense is that it could take some time for the AUD to breach those levels, but while the AUD stays strong Japanese accounts will be contributing to the pressure on ACGBs to sell-off. However, we also saw reason to buy QTC bonds against EIB and NSWTC.

Figure 1: Japan a major holder of Australian debt securities



Source: ABS, CBA

Figure 2: AUD nearing sell territory for Japanese investors



Source: Bloomberg, CBA

They are impacted by the currency moves

Currency impacts (and opportunities) on the yield curve

Currency-related selling presents an interesting challenge for investors in the AUD fixed income market. We suspect it can alter the dynamics of the yield curve, particularly the relativities between instruments.

The front end of the AUD curve has sold off sharply over recent weeks due to a combination of factors:

- The RBA not easing policy in August as generally expected before July;
- Pricing of future rate cuts has been pared back amid generally positive RBA commentary and domestic economic data;

Risk appetite improving markedly since ECB Chief Mario Draghi committed to do 'whatever it takes', denting the flight to quality bid for short-term AUD bonds.

But demand for the back-end of the curve initially held firm due to ongoing central bank allocations and general demand for the high relative yield on offer. As we wrote in June, the 'real' 10-year AUS-US bond spread actually remains close to its widest level in 15 years (see Figure 3). ACGBs remain attractive given:

- Commonwealth bond supply is slowing sharply (whether a surplus is achieved this year or not);
- The Commonwealth's AAA rating remains very secure amid a rapidly declining set of global AAA peers;
- The AUD trades as proxy for developing economies, which are expected to outperform advanced economies in coming years

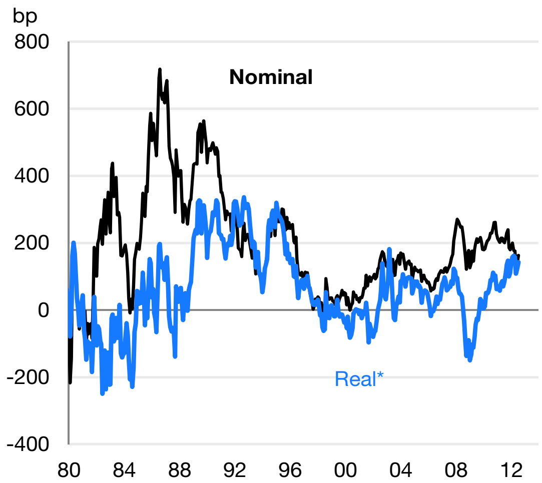
The fact the AUD has withstood a number of negative forces to remain around record levels highlights the powerful impact of these capital flows (and adds to the AUD's recent popularity among investors). But, as has been well documented over the past week, the high AUD also presents headwinds for the economy and major challenges for policy-makers. (The RBA has commented on the currency again in today's SoMP.)

AUD is unable to play its shock-absorber role, creating overly tight financial conditions

We found little disagreement in Tokyo to our view that capital inflows are preventing the AUD from playing its normal 'shock absorbing' role. As the RBA highlighted this week, the AUD "has remained high, despite the observed decline in the terms of trade and the weaker global outlook." (See Figure 4). This is contributing to excessively tight financial conditions given:

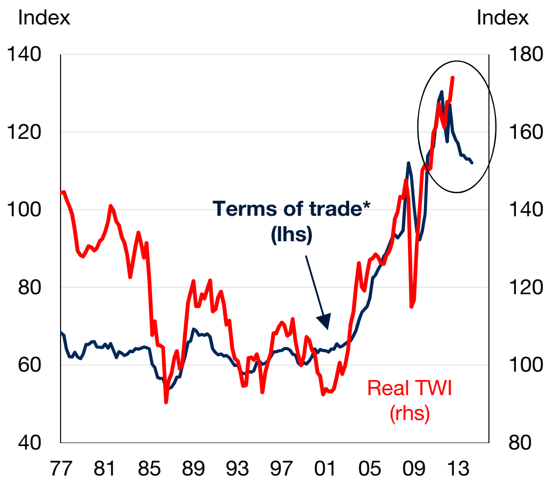
- significant fiscal consolidation (notwithstanding the May/June cash splash);
- borrowing rates still near average; and
- deleveraging pressures keeping household and business credit growth subdued (though this may be turning).

Figure 3: Attractive AUS-US 10yr spread



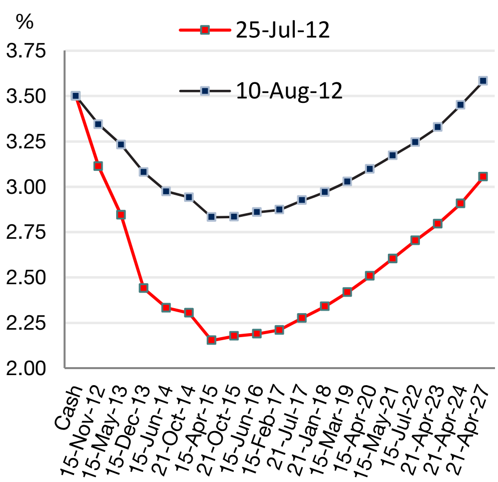
*Source: Bloomberg, CBA * deflated by core CPIs*

Figure 4: AUD rising despite Terms of Trade



Source: RBA, ABS, CBA
** Commonwealth Budget forecasts*

Figure 5: High cost of ACGB carry



Source: Bloomberg, CBA

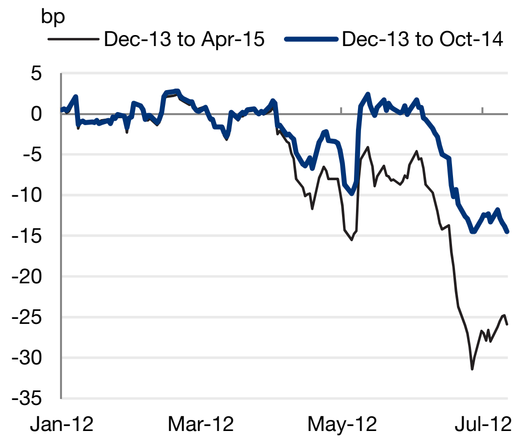
The RBA is starting to notice

While there is no doubt the RBA is currently comfortable on the sidelines, there is a growing chorus questioning whether such tight financial conditions are appropriate given:

- slowing global growth;
- the declining terms of trade;
- a looming 'pot-hole' in capex beyond 2013; and
- structural pressures on consumer spending that are intensified by the high AUD.

This view has been complicated by a spate of better than expected US and Australian economic data. RBA rate-cut pricing has been pared to just 50bp from closer to 100bp a few weeks ago. But we suspect that trend can't extend much further as the AUD presses higher. We took profit on an options-based short bond position this week and moved to receive 1-year OIS at 3.15%. It is notable that the curve has stopped flattening despite the continued 'risk-on' bond sell off this week. We judge the AUD consequences of 'risk-on' have begun to outweigh direct domestic interest rate impacts.

Figure 6: Front-end slopes holding steady in recent sell-off



Source: Bloomberg, CBA

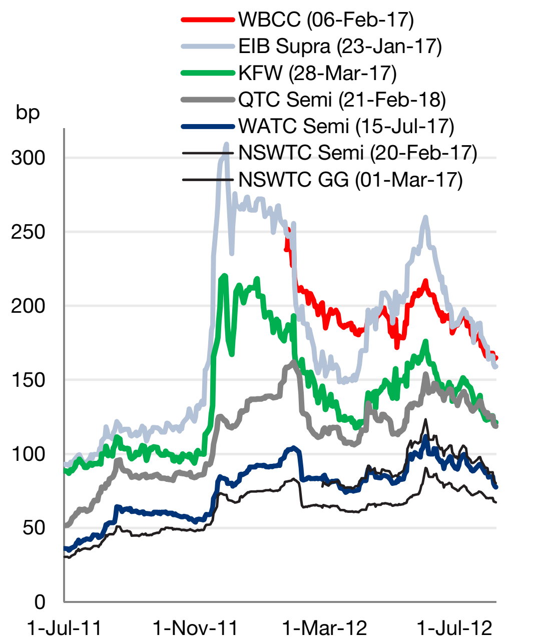
Currency-related selling is impacting bonds

At the same time, though, bonds have continued to weaken across the Commonwealth curve without pause. We think AUS-US bond spreads have not proved as resilient as anticipated due to the currency-related selling noted above. In reality, we should probably label that a lack of buying given the structural bid for ACGBs. But that's been enough to cause carnage when the entire yield curve has been so far below cash (Figure 5).

If we accept that the high AUD is likely to constrain new offshore buying for now, the key question is when domestic investors will step up to the plate and take advantage of the cheapening in bonds. That's not been a notable trait for the past couple of years. But the fact that the high AUD makes RBA rate cuts more likely and that many local investors are short, suggests it should be quite soon. This gives us confidence that AUS-US bond spreads can stabilise and start to narrow.

Although we have shifted towards long rate positions in the last week, we have avoided buying bonds outright, preferring to receive OIS. At the time we identified the possibility of further movement in bonds but thought the move in OIS had run its course. (See *Strategy Weekly* of 7 August). We can now flesh out the explanation some more. While the AUD remains strong there is the prospect of Japanese profit taking by selling bonds. At the same time, the strength in the currency

Figure 7: 5yr high-grade bond spread to ACGB



Source: Bloomberg, CBA

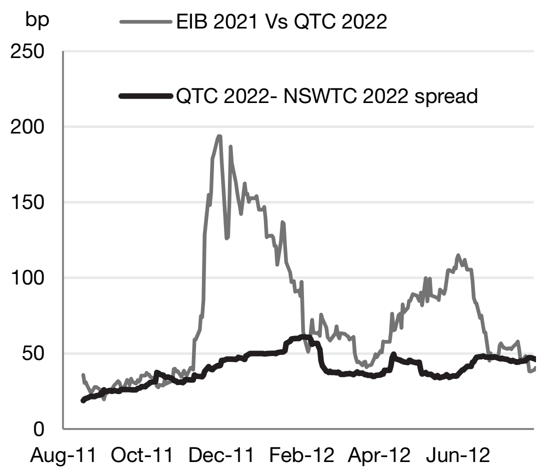
suggests the RBA may need to cut rates. In this circumstance, the front-end bonds would likely continue to underperform OIS – as they have been doing in recent weeks.

The search for yield

Japanese clients still favour yield

The search for yield is most obvious in Japan's continued appetite for Supranationals. This is widespread, including for European names. That partly reflects perceptions large issue sizes equate to decent liquidity, though that was not the case last year. Fund inflows mean managers haven't faced much in the way of redemptions, so they typically haven't had to sell into the difficult and illiquid markets prevailing over the past year. Meanwhile, competition amongst funds has become more credit focussed.

Figure 8: QTC spreads slow to narrow



Source: Bloomberg, CBA

However, most funds still prefer to market the AAA badge, so the highest-yielding SSA bonds attract plenty of demand. Queensland's downgrade a few years ago seems to still be inhibiting appetite for semi-government bonds, even though they are so cheap versus Commonwealth bonds (Figure 7).

However, there is recognition that the new Government in Queensland offers a 'turnaround' story (and that the new NSW Government is also credit positive). There was significant interest in our view that the period ahead of the Queensland Budget on September 11 is the right time to buy into this story. The Reuters report of SAFE's engagement with semi-government issuers captured plenty of attention. With spreads of the largest European SSAs having now converged significantly relative to semi-governments, our sense is that appetite may start to shift somewhat.

We see room for QTC paper to outperform the rest of the semi-governments in this environment. However, that trade has proved to effectively be a risk-on or risk-off bet, which we find difficult to be completely confident of in this environment. In a related development, we also see limited room for EIB to tighten much further relative to QTC, unless the QTC is also tightening relative to NSWTC at the same time. (Figure 8.)

Buying QTC against EIB and NSWTC

We suggest a three-way trade, deliberately buying 10Y QTC against both NSWTC and EIB. Figure 8 shows that, currently, the QTC to NSWTC spread is about the same level as the EIB to QTC spread. From here, we expect QTC to outperform (but they could widen in a general risk-off move). However, Figure 8 also shows that, in a risk-off move, the EIB to QTC spread tends to widen much faster than the QTC to NSWTC spread does. A quick regression suggests the EIB to QTC spread tends to move about 2.25 times as fast as the QTC to NSWTC spread on average. But, as Figure 8 confirms, EIB has widened much faster than that in sharp, risk-off, moves. We suggest assuming a 2:1 ratio between the EIB-QTC spread and the QTC-NSWTC spread. Namely: Sell $100 of EIB against buying $100 of QTC and then buy another $200 of QTC against selling $200 of NSWTC. All up, this is a 1:3:2 ratio.

This combined position would perform well if the slow grinding tightening continues. The fact we have more of the QTC to NSWTC spread would make that spread dominate the overall trade and our position would perform well in a risk-on move.

The combined position should also perform well in sharp risk-off move, since the movement in EIB to QTC spreads would likely be far larger than the move in QTC to NSWTC. If the EIB widens twice as fast (or more) than the QTC does, then the EIB to QTC spread will dominate the overall position and the position as a whole makes money.

Our 1:3:2 trade is not overly exposed to global risk-on or risk-off moves, but is exposed to a QTC-specific credit event. However, that was the point! We think QTC bonds will outperform in a relative sense (even if this implies widening less in a general risk-off move).

We will manage our target and stop with reference to the QTC to NSWTC spread. That spread is currently 45bp, we expect it to move back into recent lows of around 35bp. We set a stop at 50bp.

Key Views

United States

Momentum in the US economy has slowed. Q2 GDP figures showed that growth is running at a sub-trend pace of just 1.5% (annualised), down from 1.9% in Q1. Notwithstanding an improvement in July, payrolls growth has disappointed and the unemployment rate is high at 8.3%. The FOMC has extended its duration extension program until the end of 2012, which should help keep US long end yields low and real yields negative. QE3 should follow at some point. But US inflation is roughly in line with the Fed's mandate, limiting room for break-evens to fall and putting a floor under bond yields.

The 'Fiscal Cliff' will be a growing issue towards the end of 2012, even if the European crisis shows a more sustained improvement. The ongoing crisis in Europe is likely to continue to drive flows into safer bond markets. European leaders and the ECB have announced they will "preserve the euro", but purchases of short-dated bonds seems like only a temporary solution. Implementation risks remain high and there are no plans in place to meet Europe's significant structural economic and fiscal challenges. This back-drop points to sustained low bond yields in core, quality markets

Volatility in financial markets is low. Offshore events have the potential to lift volatility, and change sentiment. In particular, Eurozone GDP data is expected to show the region contracted over Q2. Greece returns to the bond market this week, which will bring concerns about that country back to the fore, while Spain remains an ongoing issue. US data is expected to highlight the healthier state of the US economy, and weigh on EUR/USD. More generally, volatility is expected to pick up as the northern hemisphere holiday seasons end. USD/JPY is unlikely to lift in the near-term, with US yields low, and weak global growth momentum.

	Tactical (<1 mth)	Strategic (>3 mths)
Policy rate	0.1%	0.1%
10yr bond	1.50%	1.40%
2/10 curve	125bp	115bp
USD/JPY	78.50	78.50
EUR/USD	1.2200	1.2400

Australia

The RBA has the cash rate on hold in July and August, after cutting 75bp over May and June. In maintaining an easing bias, the RBA cite a lower inflation outlook and subdued global growth, along with a high AUD. There are some positive trends in some recent domestic economic data. However, that reflects stimulus and end of financial year factors, and is offset by on-going weakness in other parts of the economy. The potential for further RBA rate cuts later in 2012 and capital flight from Europe should keep Aussie bonds well bid in the medium-term. The recent shift in ECB rhetoric has allowed Australian bonds to sell-off sharply. We look for the 10Y AUS-US spread to narrow and for the curve to flatten over the long-term.

Low volatility, the RBA's decision to hold the cash rate steady, as well as optimism regarding progress in Europe has combined to provide a significant boost to AUD. The AUD is always somewhat vulnerable to weak Chinese data, and more broadly, concerns about global growth. However, we think the Chinese economic cycle has bottomed. AUD should be supported near current levels over H2 2012 by stabilising global growth, driven by a re-acceleration in China; firmer commodity prices; and demand for Australia's high yielding AAA rated sovereign bonds.

	Tactical (<1 mth)	Strategic (>3 mths)
Policy rate	3.50%	3.25%
10yr bond	3.00%	2.70%
3/10 curve	50bp	40bp
10yr EFP	80bp	90bp
10yr v US	150bp	130bp
AUD/USD	1.0500	1.0400

New Zealand

The RBNZ continue to keep the OCR at a historically low 2.5%. The RBNZ recently revised down its NZ growth outlook to factor in weaker export incomes and tighter fiscal policy than earlier forecasts. The risk of a rate cut largely emanates from offshore, particularly from Europe. NZ rates are likely to remain low and the curve to flatten, largely reflecting global downside risks. Our economics team pushed out the timing of the first hike from Q1-13 to Q2.

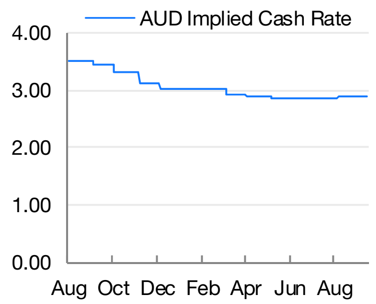
Like AUD, we expect NZD to consolidate, given the recent strength it has displayed, and the lingering question mark over the Chinese and broader global growth outlook. However, over the year ahead we think an improving global economic outlook, driven by Asia, should support NZ-specific commodity prices. These developments, coupled with ongoing reinsurance inflows related to the Christchurch earthquake should support the NZD. AUD/NZD is typically very sensitive to interest rate differentials between Australia and New Zealand. We expect the cross rate to drift lower over the coming months, if the market continues to factor in some risk of an RBA rate cut while the RBNZ remains on hold.

	Tactical (<1 mth)	Strategic (>3 mths)
Policy rate	2.50%	2.50%
10yr bond	3.60%	3.40%
2/10 curve	110bp	100bp
10yr v US	210bp	200bp
10yr v AU	60bp	70bp
NZD/USD	0.8100	0.8200
AUD/NZD	1.2960	1.2680

Cash Rate Pricing

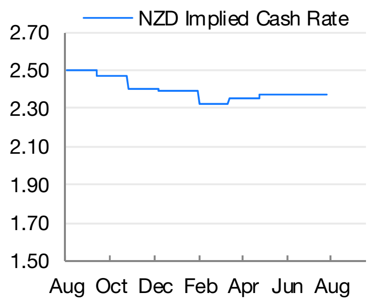
Australian Cash Rate Pricing

	Rate	Cum. % chance of +25bp
Current	3.50	0
4-Sep-12	3.43	-28
2-Oct-12	3.30	-79
6-Nov-12	3.11	-158
4-Dec-12	3.01	-196
5-Feb-13	3.01	-196
5-Mar-13	2.91	-237
2-Apr-13	2.87	-251
7-May-13	2.86	-255
4-Jun-13	2.85	-258



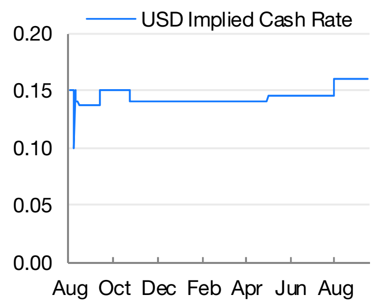
New Zealand OCR Pricing

	Rate	Cum. % chance of +25bp
Current	2.50	0
13-Sep-12	2.47	-11
25-Oct-12	2.41	-37
6-Dec-12	2.39	-43
31-Jan-13	2.32	-72
14-Mar-13	2.35	-1,276



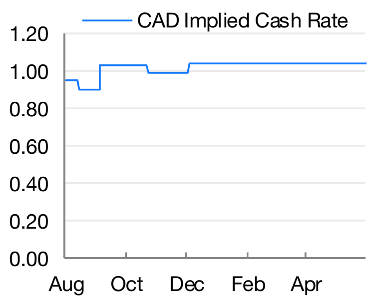
US Fed Funds Pricing

	Rate	Cum. % chance of +25bp
Current	0.14	0
1-Aug-12	0.15	-1
13-Sep-12	0.15	4
24-Oct-12	0.14	0
11-Dec-12	0.14	0
30-Jan-13	0.14	0
20-Mar-13	0.14	0
1-May-13	0.14	2
19-Jun-13	0.14	2
31-Jul-13	0.16	8



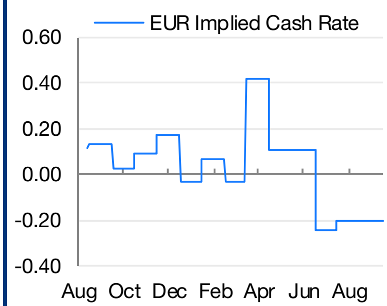
Candian Rate Pricing

	Rate	Cum. % chance of +25bp
Current	0.90	0
5-Jun-12	0.95	-20
17-Jul-12	0.95	-20
5-Sep-12	1.04	34
23-Oct-12	0.99	16
4-Dec-12	1.04	38
6-Sep-13	1.10	38



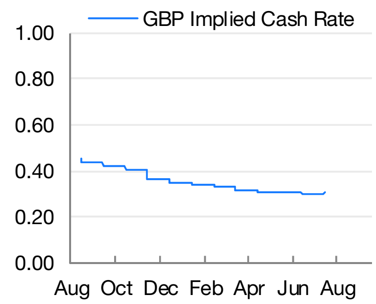
EUR EONIA Pricing

	Rate	Cum. % chance of +25bp
Current	0.01	
6-Sep-12	0.13	50
4-Oct-12	0.03	7
8-Nov-12	0.17	32
6-Dec-12	0.17	65
10-Jan-13	0.07	-18
7-Feb-13	-0.03	23
7-Mar-13	0.42	-18
7-Feb-13	-0.03	23
7-Mar-13	0.42	-18



UK SONIA Pricing

	Rate	Cum. % chance of +25bp
Current	0.44	0
6-Sep-12	0.44	0
4-Oct-12	0.42	-8
8-Nov-12	0.40	-16
6-Dec-12	0.36	-32
10-Jan-13	0.34	-39
27-Jan-12	0.46	7
15-May-13	0.30	-54
15-May-13	0.30	-54
8-Jun-13	0.30	-54



Source: All data sourced from Bloomberg. Rates displayed are calculated using IB Futures (Australia), FF Futures (US) and OIS in all other currencies.

CBA Forecasts:

Cash rate	14-Aug	Sep-12	Dec-12	Mar-13	Jun-13	Sep-13	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14
US	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
Australia	3.50	3.50	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25
New Zealand	2.50	2.50	2.50	2.50	2.75	3.00	3.25	3.50	3.75	4.00	4.00
United Kingdom	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Germany	0.75	0.75	0.75	0.75	0.75	0.75	0.75	1.00	1.25	1.25	1.25
Japan	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
Canada	1.00	1.00	1.00	1.25	1.25	1.50	1.75	1.75	2.00	2.00	2.00
2-yr bond yield	**14-Aug**	**Sep-12**	**Dec-12**	**Mar-13**	**Jun-13**	**Sep-13**	**Dec-13**	**Mar-14**	**Jun-14**	**Sep-14**	**Dec-14**
US	0.26	0.25	0.25	0.30	0.30	0.30	0.35	0.40	0.50	0.70	0.90
Australia	2.87	2.60	2.40	2.30	2.30	2.50	2.60	2.70	2.70	3.00	3.10
New Zealand	2.58	2.40	2.20	2.30	2.40	2.70	3.20	3.40	3.60	3.70	3.70
United Kingdom	0.13	0.20	0.20	0.30	0.40	0.50	0.70	0.90	1.30	1.50	1.70
Germany	-0.05	0.00	0.00	0.10	0.20	0.40	0.60	0.70	0.80	0.90	1.00
Japan	0.09	0.10	0.15	0.20	0.20	0.25	0.25	0.30	0.35	0.35	0.35
Canada	1.14	0.90	1.00	1.10	1.30	1.50	1.80	2.10	2.20	2.20	2.20
10-yr bond yield	**14-Aug**	**Sep-12**	**Dec-12**	**Mar-13**	**Jun-13**	**Sep-13**	**Dec-13**	**Mar-14**	**Jun-14**	**Sep-14**	**Dec-14**
US	1.66	1.50	1.40	1.40	1.40	1.60	1.80	2.00	2.25	2.50	2.75
Australia	3.31	3.00	2.70	2.50	2.50	2.70	2.90	3.00	3.20	3.40	3.60
New Zealand	3.64	3.60	3.40	3.30	3.15	3.40	3.70	4.00	4.20	4.20	4.20
United Kingdom	1.56	1.50	1.40	1.30	1.50	1.70	2.00	2.30	2.50	2.75	3.00
Germany	1.40	1.20	1.00	1.00	1.20	1.40	1.60	1.80	1.90	2.00	2.00
Japan	0.79	0.90	1.00	1.10	1.10	1.10	1.20	1.20	1.30	1.30	1.30
Canada	1.80	1.70	1.70	1.70	1.80	2.00	2.30	2.50	2.70	3.00	3.00

Currencies	14-Aug	Sep-12	Dec-12	Mar-13	Jun-13	Sep-13	Dec-13	Mar-14
AUD/USD	1.05	1.03	1.05	1.04	1.04	1.04	1.04	1.04
AUD/JPY	82.57	81.37	82.95	83.20	84.24	85.28	86.32	87.36
AUD/EUR	0.85	0.84	0.84	0.82	0.80	0.79	0.79	0.78
AUD/GBP	0.67	0.66	0.66	0.65	0.64	0.63	0.63	0.63
AUD/CAD	1.04	1.05	1.07	1.03	1.03	1.02	1.02	1.03
AUD/NZD	1.30	1.26	1.27	1.25	1.24	1.27	1.27	1.27
USD/JPY	78.44	79.00	79.00	80.00	81.00	82.00	83.00	84.00
EUR/USD	1.23	1.22	1.25	1.27	1.30	1.31	1.32	1.33
GBP/USD	1.57	1.56	1.58	1.60	1.62	1.64	1.64	1.64
USD/CAD	0.99	1.02	1.02	0.99	0.99	0.98	0.98	0.99
NZD/USD	0.81	0.82	0.83	0.83	0.84	0.82	0.82	0.82

Calendar – August 2012

Monday	*Tuesday*	*Wednesday*	*Thursday*	*Friday*
Early September AU Business Indicators (3 September) AU Retail Trade (3 September) AU RBA Board Meeting (4 September) AU Balance of Payments (4 September) AU GDP (5 September) AU Labour Force (6 September)	***Central Bank Meetings*** US FOMC (1 August) EZ ECB (2 August) UK BOE (2 August) AU RBA (7 August) JP BoJ (9 August) CA Bank of Canada (5 September) NZ RBNZ (13 September) IN RBI (30 October)	**1** **AU AI-Group PMI, Jul, Index, (47.2)** **AU ABS House price indexes, QII, q%ch, (-1.1)** NZ Labour Cost - Priv Sect, QII, q%ch, (0.5) CH PMI Manufacturing, Jul, Index, (50.2) JP Vehicle sales, Jul, m%ch, (40.9) EU/GE/UK PMI manufacturing, Jul, Index, (49.0/43.3/48.6) US ISM manufacturing, Jul, Index, (49.7) US Construction spending, Jun, m%ch, (0.9) US FOMC rate decision, %, 0-¼ (0.25)	**2** **AU RP Data house prices, Jul, m%ch, (1)** **AU Trade balance Jun, $bn, 0.0, (-0.3)** **AU Retail trade, Jun, m%ch, 0.9, (0.5)** **AU Retail sales ex inflation, QII, q%ch, 1.5, (1.8)** EU PPI, Jun, m/y%ch, (-0.5/2.3) EU ECB announces int. rate, %, 0.75, (0.75) UK PMI construction, Jul, Index, (48.2) UK BoE announces rates, %, 0.5, (0.5) US Factory orders, Jun, m%ch, (0.7)	**3** **AU CBA/Ai-Group Perf of Serv Index, Jul, (48.8)** CH Non-Manuf PMI Jul, Index, (56.7) EU PMI services/composite, Jul, Index EU Retail sales, Jun, m/y%ch, (0.6/-17) GE/UK PMI services, Jul, Index, (49.7/51.3) US Non-farm payrolls, Jul, '000, (80) US Unemployment rate, Jul, %, (8.2) US ISM non-manufacturing, Jul, Index, (52.1)
6 **AU TD inflat gauge Jul, m/y%ch, (-0.2/1.6)** **AU ANZ Job ads, Aug, m%ch, (-1.2)** JP Leading / Coincident index CI, Jun, (95.2/95.8)	**7** **AU RBA cash rate, %, 3.50, (3.5)** NZ Avg Hourly Earnings, QII, q%ch, (13) GE Factory orders, Jun, m/y%ch, (0.6/-5.4) UK Industrial production, Jun, m/y%ch, (10/-16) UK NIESR GDP, Jul, m%ch, (-0.2) US Consumer credit, Jun, $bn, (17.1) CA Building permits, Jun, m%ch, (7.4)	**8** **AU Ai-Group PCI, Jul, Index, (34.8)** **AU Housing Finance, June** **No. of own-occupiers, %, 3.0, (-1.2)** **Value of all loans, %, 2.0, (0.2)** NZ Building permits, Jul JP Curr a/c total/adjusted, Jun, ¥bn, (215.1/282.2) GE Trade bal, Jun, €bn, (15.3) GE Industrial production, Jun, m/y%ch, (16/0) UK Bank of England Inflation Report	**9** **AU Labour Force, July** **employment, '000, 12, (-27.0)** **unemployment rate, %, 5.2, (5.2)** **participation rate, %, 65.2, (65.2)** NZ Unemployment Rate, QII, %, (6.7) CH PPI/CPI, Jul, y%ch, (-2.1/2.2) CH Industrial production/Retail Sales, Jul, y%ch, (9.5/13.7) JP Machine orders/Machine tool orders, Jun, y%ch, (1/-15.5) JP BoJ target rate, %, 0-0.10, (0.1) UK Total trade balance, Jun, £bn, (-2.8) US Trade balance, Jun, $bn, (-48.7) CA Housing starts, Jul, '000, (222.7) CA Trade balance Jun, C$bn, (-0.8)	**10** **AU RBA Statement on Monetary Policy** NZ Credit card spending, Jul, m%ch, (0.3) CH Trade balance Jul, US$bn, (317) IN Industrial production, Jun, y%ch, (2.4) JP Domestic CGPI, Jul, m/y%ch, (-0.6/-13) JP Capacity utilisation, Jun, m%ch, (-2.2) JP Industrial production, Jun UK PPI Input/Output/core, Jul, y%ch, (-2.3/2.3/2) US Import price index, Jul, m/y%ch, (-2.7/-2.6) CA Unemployment rate, Jul, %, (7.2) CA Net change in employment, Jul, '000, (7.3)
13 NZ Food prices, Jul, m%ch, (14) JP GDP, QII, q%ch, (12)	**14** **AU Motor veh. sales, Jul, m/y%ch, (-0.6/18.4)** **AU NAB Bus conf/cond, Jul, Index, (-3/-1)** NZ Retail sales ex inflation, QII, q%ch, (-0.6) EU GDP, QII, y%ch, (-0.1) EU Industrial production Jun, m/y%ch, (0.6/-2.8) EU/GE ZEW survey (econ. sentiment), Aug, (-22.3/-19.6) GE GDP, QII, q%ch, (0.5) UK CPI, Jul, m/y%ch, (-0.4/2.4); Core, y%ch, (2.1) US Producer price index Jul, m/y%ch, (0.1/0.7) US Retail sales, Jul, m%ch, (-0.5)	**15** **AU MI/WBC Consumer Sent, Aug, Index, (99.1)** **AU WPI QII, q/y%ch, 1.0/3.7, (0.9/3.6)** UK Bank of England minutes, August UK ILO unemployment rate (3mths), Jun, %, (8.1) US CPI, Jul, m/y%ch, (0/17); Core, m/y%ch, (0.2/2.2) US Empire manufacturing, Aug, Index, (7.4) US Industrial production, Jul, m%ch, (0.4) US Capacity utilisation, Jul, %, (78.9) US NAHB housing market index, Aug, (35)	**16** **AU Unemployment Expectations, Aug, %, (148.1)** **AU MI Consumer Inflation Expectations Aug, %, (3.3)** **AU AWE May, q/y%ch, 0.8/3.2, (1.1/4.4)** NZ Business PMI, Jul, Index, (50.2) EU CPI, Jul, m%ch, (-0.1); Core, y%ch (16) UK Retail sales, Jul, m/y%ch, (0.1/16) US Housing starts/Building permits, Jul, '000, (760/755) US Philadelphia Federal Index, Aug, (-12.9)	**17** NZ Producer prices, inputs/outputs, QII, q%ch, (0.3/-0.1) EU Current account/Trade balance, Jun, €bn, (10.9/6.3) GE Producer prices, Jul, m/y%ch, (-0.4/16) US Uni. Of Michigan confidence, Aug US Leading indicators, Jul, m%ch, (-0.3) CA CPI, Jul, m/y%ch, (-0.4/15)
20 NZ PSI, Jul, Index, (54.3) IN CPI, Jul, y%ch, (10) JP Leading / Coincident index, Jun EU Construction output, Jun, m/y%ch, (0.1/-8.4)	**21** **AU HIA Housing Affordability Index, QII, Index, (61.8)** **AU RBA Board Minutes, August** NZ Card spending, Jul, m/y%ch, (0.8/4.6) US FOMC Minutes, August CA Wholesale sales, Jun, m%ch, (0.9)	**22** **AU DEWR skilled vacancies, Jul** JP Trade bal total/adj, Jul US Existing home sales, Jul, mn/m%ch, (4.4/-5.4) CA Retail sales, Jun, m%ch, (-0.5)	**23** GE GDP, QII US New home sales, Jul, mn/m%ch, (369/7.6) US Initial/Continuing Jobless Claims	**24** **AU RBA Gov. Stevens parliamentary testimony** NZ Trade balance, Jul UK GDP, QII UK Total bus investment, QII, q/y%ch, (19/14.8) US Durable goods orders, Jul
27 GE IFO - Business climate, Aug US Dallas Fed, Aug	**28** US S&P/Case-Shiller home price index, Jun US Richmond Fed, Aug EU Money Supply M3, Jul	**29** **AU Prelim. Construction work done, QII, q%ch, -1.5, (5.5)** GE CPI, Aug US GDP, QII US Pending home sales, Jul US Federal Reserve Beige Book CA Teranet House Prices, Jul	**30** **AU HIA new home sales, Jul** **AU Capex, QII, q%ch, 4.0, (6.1)** **AU Building approvals, Jul** NZ NBNZ Business confidence, Aug JP Industrial production, Jul UK Net consumer credit, Jul US Personal income/spending, Jul US PCE deflator/core, Jul CA Current account, QII, $Cbn, (-10.3)	**31** **AU Private sector credit, Jul** IN GDP. QII, y%ch, (0.053) JP CPI, Jul JP Vehicle production/Construction Orders/Housing Starts, Jul UK GfK consumer confidence survey, Aug US Uni. Of Michigan confidence, Aug US Factory orders, Jul CA GDP, QII, q%chsaar, (19)

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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