

20 July 2009

## Consensus View Reflects Global Doubts

- Worst of global recession past
- But doubts over strength of rebound remain
- Asian economies to outperform
- So too NZ trading partner growth as a result

That the worst of the global recession is behind us is now almost taken as a given. Since about mid-March, equities, commodity prices and yields have lifted, all consistent with an eventual improvement in growth. Even the apparent reassessment of conditions we saw during June, in which global financial markets tended to lose ground, appears to have been shortlived. Decent corporate earnings reports during the past week have seen US markets regain all of their June losses. The only way, it would seem, is up.

Economic forecasters, in aggregate, tend to agree. The latest poll of forecaster views, released by Consensus Forecasts last week, reflects a steady improvement in outlooks. Indeed, the consensus view is for the global economy to expand over the next twelve months – the first time a positive growth expectation has been recorded since the beginning of the year.

Not that all has turned for the better. Expectations for the UK and Europe have worsened in this latest update, albeit fractionally. But the outlook for the US continues to improve, in forecasters' eyes, and key Asian economies are thought to have expanded in Q2. Globally, overall, conditions are seen to be improving.

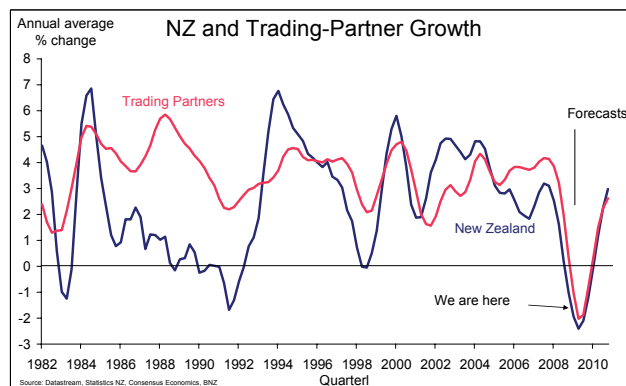
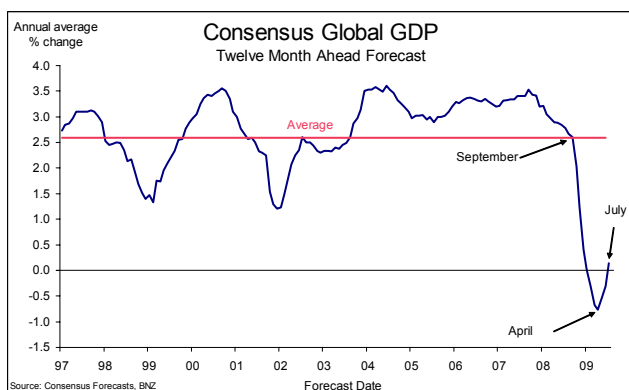
The emphasis amongst markets and forecasters alike has shifted, then, away from worries about how deep the recession will be, and when it will end, to how robust growth will be when it eventuates. In this regard, many doubts remain.

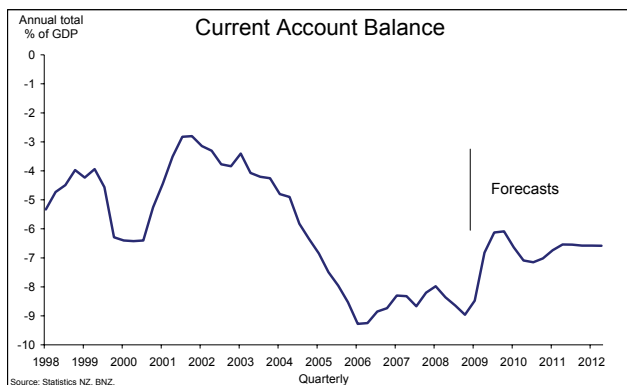
At the very least, trend growth looks likely to be considerably more subdued than it has previously been. Growth in calendar 2010 is expected to be no more than 2.1%, which, on the face of it, might not look too bad, especially compared to 2009's expectation of -2.6%.

But considering 2010 is supposed to be "the" year of recovery – the year when the global economy hits its straps again – the expected 2.1% really doesn't look too flash. It's a long way shy of the rebound growth rates following previous global recessions, which have tended to be characterised by the V-shape so many appear to be wishing for this time round. In fact, the growth outlook for 2010 doesn't even match average global growth, of around 2.6%. The notion that "this time it's different" can be a dangerous one, but it's clear that forecasters expect the recovery from the current global malaise to be much slower than what we have seen in the past.

So what does all this mean for New Zealand? As one might expect, trading partner growth, like that of the world economy more broadly, is expected to be relatively modest, post-recession. It will be that much harder for New Zealand to export its way back to a surer footing, as a result. The current account deficit, one of our most problematic structural imbalances, could face some serious headwinds.

The good news, though, is that New Zealand is relatively well-placed to service the economies that look likely to lead the world out of recession – namely, those of emerging Asia. Generally, in fact, New Zealand's trading partners will fare better than the global averages. The updated consensus view sees trading partner economies shrinking by "only" 1.9% during 2009; the global comparison is -2.6%. In 2010, trading partner





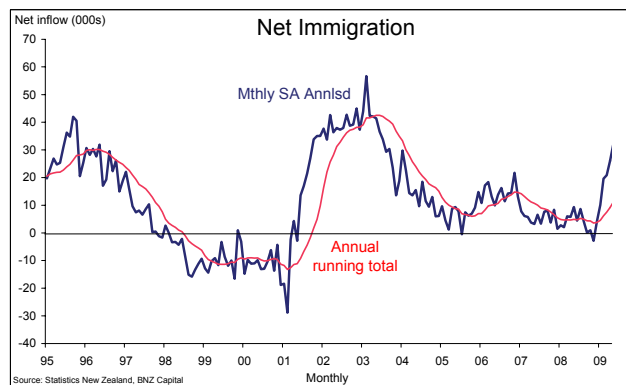
growth is expected to be 2.3% (compared to 2.1% globally), climbing to 3.3% in 2011.

Again, that's a good deal softer than we're used to. But it's important to note that our trading partner growth is being dragged down more by the bigger developed economies of the US, Europe and the UK. Closer markets will perform much better, it's thought, to New Zealand's benefit. Chinese growth already looks to be re-accelerating and Australia – still our biggest trading partner overall – looks the best of all the developed economies. As we've said before, difficult as things are for New Zealand businesses, they could be much worse.

Even here, though, there are ample signs that we've turned the corner. Firms' confidence has lifted appreciably, with expectations massively improved. The question, locally as it is globally, is whether such can be met.

And it's not as though recovery won't bring its own challenges. Warnings, over the past week, from the Reserve Bank Governor and the rating agency Fitch about the need to address the economy's structural imbalances attest to such. The justified fear is that such stresses (including, but certainly not limited to, twin deficits, agricultural borrowing and residual housing market excesses) are never properly relieved, as one might expect they should be during the deepest New Zealand recession in a lifetime. The risk is for a much greater and more painful correction at some future date.

On that note, it was somewhat disturbing to observe, in today's ASB investor confidence survey, that rental



housing has regained favour as an investment option. Sure, the correction in the housing market, broadly, has been underway for the last 18 months or so. But the resulting price correction has been relatively modest in scope, leaving houses still looking overstretched compared to average incomes. A renewed flow of investment money into the sector wouldn't help this rebalancing process.

A more fundamental boost to the housing market is coming, we suspect, by net migration. Tomorrow morning's figures, for June, look likely to continue the solid increases in the number of net migrants (driven mostly by fewer departures) seen of late. As for shorter-term flows (tourists, in other words), these will probably look weak over all, but somewhat mixed in the detail. Australian visitor numbers have been a boon for the tourism sector (notably, ski-field operators) over the past couple of months, but further-travelled tourists (who also tend to be bigger-spending) have stayed away.

The only other data release of note is tomorrow afternoon's credit card billings, for May. These have been all over the place for many months now, so picking June's move seems an exercise in futility. Still, the result might yet be influential in marking our June retail sales pick. We've already downgraded this, on the back of the negative electronic card transactions data (published earlier this month). We might have to go further, if June's credit card billings hit the skids. Conversely, June's retail sales expectations might yet be stabilised by any huge bounce in credit card billings for the month.

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# Domestic Interest Rates

NZ rates saw a sell-off of around 10 basis points on the week, with the major driver a larger sell off in Australian rates. The short end of the curve remains in a very tight range around 2.80% with just a small chance of cuts priced in and hikes first priced for early in 2010. These tight levels will likely stay in place going forward, barring a notable change in sentiment from the Reserve Bank or a significant change in bank bill margins due to a change in credit sentiment.

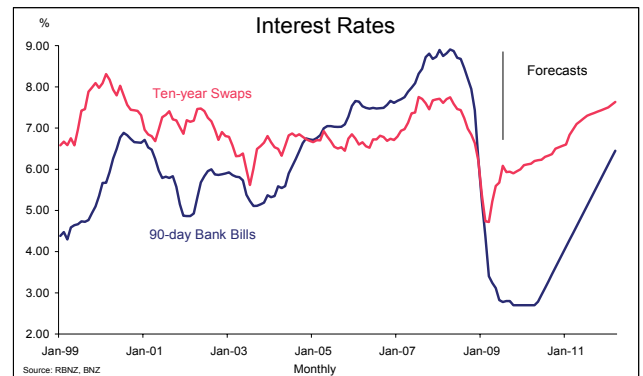
The bond market saw reasonable liquidity on the week with the maturity of the July 2009 bonds leaving a solid amount of money in the market. As a result, the bond tender was able to get away \$350 million across four different maturities. Good buying was seen out of Asia as holders moved their investments out along the curve. The maturity of the 2009's has likely left the market somewhat short of stock which should help to support the local market in the coming week, although offshore moves will continue to be a major influence.

	90 day bills	11/11 NZGS	12/17 NZGS	2yr swaps s/a	10yr swaps s/a	2yr/10yr swaps(bps)
10-Jul-09	2.80%	3.65%	5.63%	3.68%	5.85%	217
17-Jul-09	2.80%	3.74%	5.71%	3.80%	5.98%	218
<b>Change (bps)</b>	<b>0</b>	<b>9</b>	<b>8</b>	<b>12</b>	<b>13</b>	<b>1</b>

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The swaps market died a slow and quiet death last week with low volume trading. The sell-off was primarily caused by the sell-off seen in Australia pushing an otherwise indifferent market upwards in yield. The steepness of the yield curve seems to be pushing the majority of borrowers towards short-dated maturities where they are relatively easily digested by the market and keeping interest and liquidity down. The thin market looks likely to continue for this quiet NZ data week, with Australian rates again providing the lead.

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## Interest Rate Technicals

### NZD 5yr Swap Rate

Outlook: Consolidation  
 ST Resistance: 5.48%  
 ST Support: 5.15%

The short-term range is in place and we look to trade a break of either. Our previous view of a break higher still seems the more likely scenario.



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### NZ 2yr-5yr Swap Spread (yield curve)

Outlook: Steepening  
 ST Support: +122

The market has taken a breather here, but has not pulled back far. We therefore expect the steepening trend to continue.



## Foreign Exchange Market

The past week was another in which offshore data and events, rather than their local equivalents, were the driving influences on the NZD. Though the kiwi took a step backwards in the wake of Fitch's surprise downgrade to New Zealand's sovereign rating (to negative, from stable), steadily improving global sentiment dominated the week overall. NZD/USD gained nearly two cents as a result, to open this morning around 0.6440.

Indeed, much of the gloom that pervaded US equity markets since the beginning of June looks now to have evaporated. Better-than-expected earnings reports from US corporates saw the Dow Jones Industrial Average lift 7.3% over the week, recovering virtually all of the losses seen during the previous month.

The investment mood was further lightened by signs from the US that the housing market there may be stabilising. Second-hand home sales were reported to have lifted in June, on top of last week's news that housing starts are also lifting. This all served to boost investor sentiment, generally, with commodity currencies at the forefront.

Unwittingly, perhaps, the RBNZ Governor provided extra impetus to the NZD in a speech simply entitled "Economic Recovery". Though its broader themes were cautionary in nature, reflecting the New Zealand economy's stubborn imbalances, the speech had its upbeat moments (including "New Zealand looks likely to start recovering ahead of the pack") and it was these that

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caught the imagination of investors. At the same time, NAB's business survey showed that Australian business confidence pushed into positive territory for the first time since late 2007, providing additional support for AUD and NZD.

Fitch clearly shares Bollard's concerns regarding some of New Zealand's more intractable economic problems. In pulling back NZ's sovereign rating outlook to negative (while maintaining the rating itself, at AA+), the rating agency noted the risks that the current account deficit will not be able to be reduced to "more sustainable" levels. Fitch's statement caught currency markets on the hop (particularly given Standard and Poor's post-Budget decision to take NZ off negative watch), sending the NZD/USD almost a cent lower. Within 24 hours, though, growing appetite for risk saw the kiwi all-but regain lost ground.

But despite the general lift in attitude toward risk – our risk appetite index is now at its highest level since the Lehman's collapse last September – the NZD/USD still looks overdone. Our short-term valuation model (based on risk appetite, NZ-US swap spreads and commodity prices) suggests a fair-value range of 0.5924-0.6124. That said, immediate support exists at the recently tested 0.6400 level, with resistance at 0.6525.

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## Foreign Exchange Technicals

### NZD/USD

Outlook: Sell a rally  
 ST Resistance: 0.6525/50 (ahead of 0.6600)  
 ST Support: 0.6450/25 (ahead of 0.6325/50)

Solid resistance at 0.6600 favours selling rallies. A breach of 0.6425 would open up the downside toward 0.6325.



### NZD/AUD

Outlook: Consolidation  
 ST Resistance: 0.8100 (ahead of 0.8250)  
 ST Support: 0.7950 (ahead of 0.7850)

Consolidation continues, but selling rallies now looks an increasingly attractive option. Near support is seen at 0.7950.



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## Key Upcoming Events

	Forecast	Median	Last		Forecast	Median	Last
<b>Monday 20 July</b>				<b>Wednesday 22 July</b>			
NZ, BNZ PSI (Services), May			46.2	UK, CBI Industrial Trends, July		-40	-51
Aus, Producer Prices, Q2 y/y	+2.9%	+4.0%		Euro, Industrial Orders, May	+1.9%		-1.0%
US, Leading Indicator, May	+0.5%	+1.2%		US, Bernanke Testifies, MPR - Day Two			
US, Fed's Lockhart Speaks, Economic Outlook				Germ, IFO Index, June		86.5	85.9
Germ, PPI, June y/y	-4.1%	-3.6%		<b>Thursday 23 July</b>			
<b>Tuesday 21 July</b>				Jpn, Merchandise Trade Balance, June	+¥610b	+¥298b	
NZ, External Migration, June s.a.		+2,690		UK, Retail Sales vol., June	+0.3%		-0.6%
NZ, Credit Card Billings, June		-0.4%		UK, BBA Home Loans, June			31,162
Aus, RBA Minutes, 7 Jul Meeting				US, Existing Home Sales, June	4.83m	4.77m	
Jpn, BOJ Minutes, 15/16 June Meeting				US, Jobless Claims, week ended 18/07	560k	522k	
US, Bernanke Testifies, Mon. Policy Report				Can, BOC Qtly Policy Report			
Can, BOC Policy Announcement	0.25%	0.25%	0.25%	<b>Friday 24 July</b>			
<b>Wednesday 22 July</b>				Jpn, All Industry Index, May	+0.9%	+2.6%	
Aus, RBA's DeBelle Speaks, Mortgage Industry				UK, GDP, Q2 1st est	-0.3%	-2.4%	
Aus, CPI - weighted median, Q2	+0.8%	+0.7%	+1.2%	Euro, PMI Manufacturing, July 1st est	43.5	42.6	
Aus, CPI, Q2	+0.8%	+0.6%	+0.1%	Euro, PMI Services, July 1st est	45.2	44.7	
UK, BOE Minutes, 8/9 Jul Meeting				US, Mich Cons Confidence, July 2nd est	65.0	64.6P	

## Historical Data

	Today	Week Ago	Month Ago	Year Ago		Today	Week Ago	Month Ago	Year Ago
<b>CASH &amp; BANK BILLS</b>					<b>FOREIGN EXCHANGE</b>				
Call	2.50	2.50	2.50	8.25	NZD/USD	0.6446	0.6279	0.6426	0.7609
1 mth	2.79	2.80	2.80	8.40	NZD/AUD	0.8032	0.7898	0.7983	0.7823
2 mth	2.80	2.80	2.84	8.46	NZD/JPY	60.79	60.23	61.8200	81.37
3 mth	2.79	2.78	2.81	8.45	NZD/EUR	0.4568	0.4496	0.4605	0.4804
6 mth	2.82	2.82	2.82	8.34	NZD/GBP	0.3945	0.3849	0.3893	0.3813
<b>GOVERNMENT STOCK</b>					NZD/CAD	0.7189	0.7293	0.7294	0.7655
11/11	3.76	3.69	3.90	6.20	TWI	60.69	59.57	60.78	67.49
04/13	4.71	4.68	4.90	6.15	<b>NZD Outlook</b>				
04/15	5.24	5.28	5.54	6.09					
12/17	5.73	5.79	6.06	6.09					
15/21	6.22	6.14	6.66	-					
<b>CORPORATE BONDS</b>									
BNZ 09/10	4.02	3.95	4.30	-					
BNZ 05/15	7.10	6.97	7.40	-					
GEN 03/14	7.34	4.50	7.19	-					
GEN 03/16	7.69	7.64	7.98	-					
TRP 12/10	4.61	7.71	4.65	7.79					
TRP 06/20	7.83	7.62	7.93	7.72					
<b>SWAP RATES</b>									
2 years	3.85	3.72	3.92	7.64					
3 years	4.58	4.45	4.67	7.48					
5 years	5.33	5.22	5.42	7.35					
10 years	6.03	5.88	6.20	7.25					

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