10 August 2009

Signs of Solace for Recessive Retailers

- Retail sales slump starts to ease
- Stimulus measures help
- But time for celebration some way off
- Further business confidence gains expected
- Though tourism sector continues to hurt

Friday's retail sales data for the month, and quarter, of June are likely to be the highlight of the local releases this week. And we are expecting these series to continue on from the recent string of domestic data which, on the one hand reveals that the economy is slowly clawing its way out of the mire but, on the other, still suggests that New Zealand remains in a very poorly and vulnerable state.

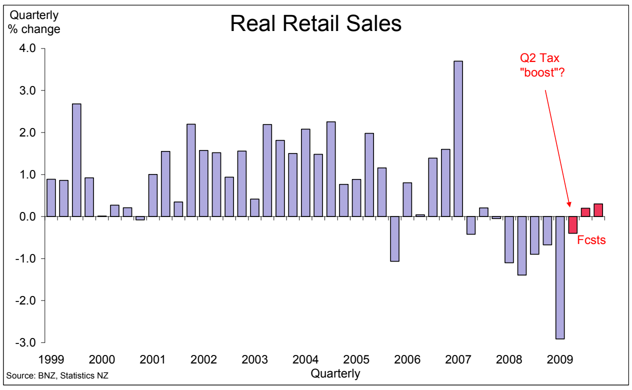
We are forecasting that real retail sales fell 0.4% through the June quarter. If so, it will be the seventh consecutive decline and will mean that sales levels for the quarter will be 5.4% down from the peak reported in Q3 2007.

If we exclude the volatile auto component, the picture looks a bit better with sales forecast to rise 0.3% and down just 1.0% for the year. The difference between the two series highlights the massive fall in car sales that the economy has witnessed. Indicative of this, car registrations in the three months ended June were 34.7% down on the same period a year earlier with both new and used sales down by a similar amount. The car companies tell us that this makes New Zealand one of the worst performing markets in the world.

There is definitely a glass half full/glass half empty aspect to the June quarter data. Even at -0.4% the total sales performance will be the strongest in seven quarters. However, given the support that sales received through Q2 it's actually a fairly miserable outturn.

Not only were folk benefiting from substantial falls in interest rates and heavy discounting on some product lines but, also, April 1 saw a substantial tax cut delivered to households. Because of these factors, we had originally believed that Q2 would produce quite a healthy result but, clearly, the partial indicators say otherwise. One can only wonder just how bad these data would have looked had the respective stimuli not been present.

Clearly, spending remains severely constrained by the deteriorating job market, as evidenced in last week's labour market data. Not only will this restrict incomes available for expenditure but also the risk aversion



accompanying a rising unemployment rate should also encourage a higher savings ratio.

We should note that there are extreme risks around our central projection for real retail sales largely revolving around our monthly nominal sales pick for June and our assumption as to the retail sales deflator. Small differences in each of these assumptions can have quite marked impacts on the final sales estimate. Consequently, the fact that our pick is lower than the market consensus of no change in total sales volumes should not be interpreted as us having a substantially different view of the world than the consensus.

For the record, we are looking at a flat month for total sales and a 1.0% drop in the ex-auto aggregate. Our drop in ex-auto sales is largely due to the fact that in the previous month a massive surge in clothing sales was reported that seems unlikely to be repeated. In addition, the very thing that is supporting the total sales figure, rising petrol prices, will adversely impact spending elsewhere. A drop of the magnitude we are suggesting is also consistent with what we saw in the June data for electronic card transactions.

On the deflator front, a breakdown of the retail components of the CPI suggests that inflation wasrelatively strong across the quarter. However, this flies in the face of the observed evidence that there was a mass of discounting going on. If indeed such discounting was as rife as appeared to be the case, it may well be that volumes prove not nearly as weak as we have forecast.

Be that as it may, our general conclusions about the economy's progress are unlikely to shift much unless our nominal sales projection for the June month proves to be very wrong.

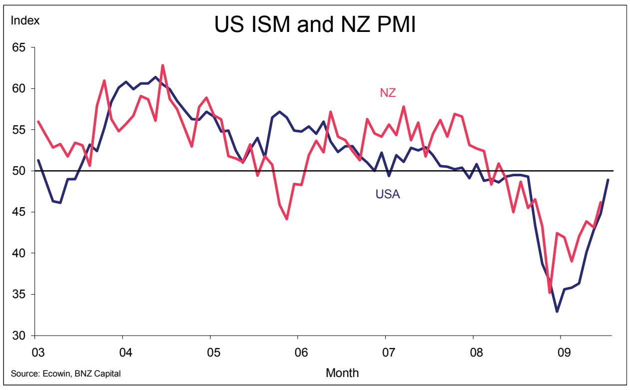
Accordingly, we believe that the retail recession will come to an end in the third quarter, for which we forecast modest growth. For a first look at this we get July's Electronic Card Transactions data on Tuesday. We reckon that this is likely to print with a positive number.

Indeed, we are really heartened by the consumer spending data that we are privy to which also reveals an improving trend. For the first time in nine months, BNZ MarketView figures show consumer spending in July to be marginally ahead of last year's levels. This represents a continued improvement in this series which we expect to see flow through into the official statistics in due course.

The increase in sales that we are starting to see is also consistent with the recent improvement in consumer confidence, which has been mirrored by rising business sentiment. We'll get more evidence on the latter this week.

The BNZ's business confidence survey, which has been a very good leading indicator of the National Bank Survey, is due for release any time now. Our suspicion is that this will continue to reflect the trend improvement seen over recent months. Confirmation of this will certainly support our wider view that Q3 GDP will print positive.

Thursday's PMI will also lend further evidence on this front. Given the reported improvement in PMIs globally that we have already seen over the month, we would be surprised if a similar sentiment was not witnessed for New Zealand. Again, we will be looking closely at the employment indicator in this series to see if any hoped for growth is starting to have a dampening effect on the number of lay offs currently being experienced. As we have noted in the past, for the forecast economic recovery to be sustained it will require an improvement in corporate profitability, in the first instance, and, then, employment



intentions. Other surveys are showing just this so we are looking for more of the same in order to keep our forecast peak in the unemployment rate capped at 7.5%.

Thursday also sees the Food Price Index (FPI) for July released. After the huge surge in vegetable prices in June, which saw the FPI surge 2.8%, we are looking for some consolidation in July. Food prices represent 17.8% of the CPI and are already looking to make a major contribution to an enlarged Q3 CPI. If prices do not consolidate then the pressure on the CPI reading will be even greater. Assuming a 0.1% FPI increase in July helps deliver us a 1.0% increase in the September CPI.

To round things off, we get the June accommodation survey on Wednesday. This should, of course, reflect the ongoing pressure on the tourism sector from slumping global incomes and adversely impacted inbound tourist numbers. However, the figures will prove better than might otherwise be the case thanks to the influx of our trans-tasman cousins taking advantage of our very good ski season.

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Domestic Interest Rates

Reuters pgs BNZL BNZM

Domestic interest rates saw a sell-off over the past week as significant offshore moves pushed our yields higher. The Australian market was the biggest mover as its generally upbeat data had it pricing RBA hikes, beginning even earlier, in November. The NZ market hasn't priced RBNZ hikes anywhere near as aggressively, as the NZ economy continues to look far less buoyant, but hikes continue to be priced starting very early in 2010.

The bond market was heavy for the week with offshore sell-offs the driver, although our market was a major outperformer, seeing reasonable demand in a smaller tender. We feel our short-dated bonds seem expensive to offshore, although longer-dated maturities still seem good value. For the upcoming week we will again take our lead from offshore, although we feel that a buy zone is approaching.

	90 day bills	11/11 NZGS	12/17 NZGS	2yr swaps s/a	10yr swaps s/a	2yr/10yr swaps(bps)
31-Jul-09	2.79%	3.83%	5.75%	3.88%	5.94%	206
7-Aug-09	2.76%	3.90%	5.86%	4.00%	6.00%	200
Change (bps)	**-3**	**7**	**11**	**12**	**6**	**-6**

The swap market sold-off and flattened on the week, with offshore rates again the primary driver. And a flattening continued with 2s10s now down nearly 50bps from the high. It feels like this move might be somewhat overdone, with receiving 2s10s now offering more than 20bps of carry for 3 months with the RBNZ still with an easing bias, it feels like a significant curve flattening from here would be premature.

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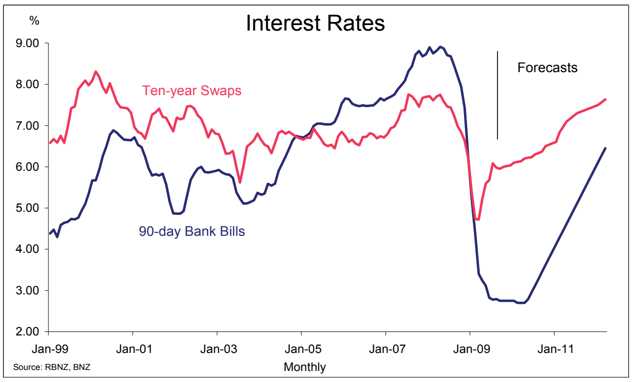

Interest Rate Technicals

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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.

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

Reuters pg BNZWFWDS

The NZD had the dubious honour of being the best performing currency last week. NZD/USD climbed from below 0.6600 to briefly above 0.6800.

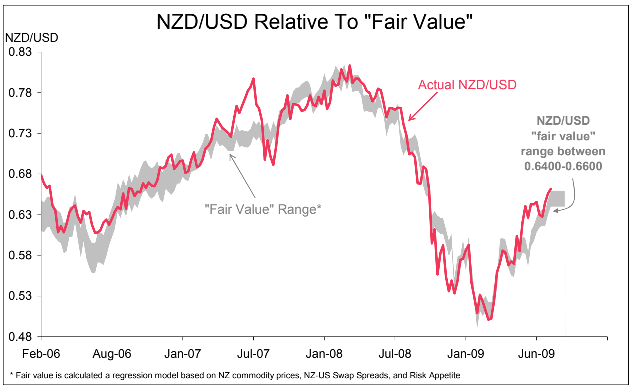
Much of the recent strength in the NZD is attributable to an improvement in global sentiment. Investors have become more convinced the worst of the global recession is behind us and the outlook for 2010 has brightened meaningfully. Not only have global equities rebounded some 50% from the lows seen in early March, but our risk appetite index has climbed to around 48% – within a whisker of the long-term average of 50% and well above the 4% low seen in October 2008.

Growing conviction about a global recovery and improving risk saw investors trim "safe-haven" positions in the USD and JPY in favour of growth sensitive currencies like the NZD. A stronger than expected result from Fonterra's online milk auction (average whole milk prices rose 25.8% from last month) also helped bolster NZD sentiment. Despite the NZ unemployment rate rising to a 9-year high of 6.0%, NZD/USD pushed up above 0.6800 – a fresh 10-month high.

However, NZD/USD spent little time above 0.6800. A sharp rise in US interest rates in the wake of July's better-than-expected US non-farm gave the USD a major boost as investors became more convinced the US will lead the global recovery rather than drag it down.

The USD Index rose 1.5% from 77.70 to above 79.00 and NZD/USD was knocked back towards 0.6700.

The real question this week is whether or not this shift to buying USD on relatively better US economic news continues. This week's US data include retail sales and industrial production, but the key event will probably be the FOMC decision. While the US data has tended to surprise on the upside, we suspect those looking for hints as to when and how the FOMC will exit it quantitative easing program will be disappointed. As such, while the USD may stay firm early in the week, we suspect the USD Index will struggle to break 79.50 and as a result NZD/USD will likely stay well supported on dips towards 0.6550-0.6600.



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Foreign Exchange Technicals

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NZD/USD

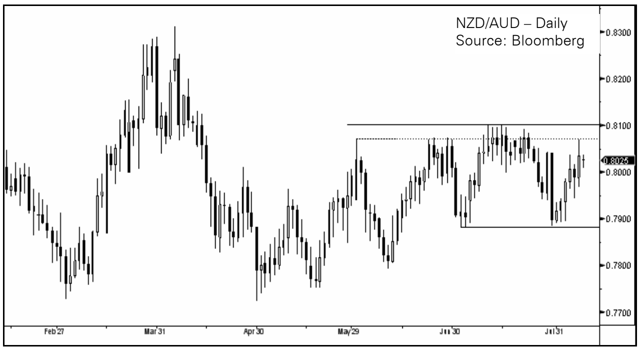
Outlook:	Buy a dip
ST Resistance:	0.6770 (ahead of 0.6850)
ST Support:	0.6645 (ahead of 0.6590)

Momentum indicators are bullish, but with the daily RSI approaching "over-bought" territory we'd wait for dips before buying.

NZD/AUD

Outlook:	Consolidation
ST Resistance:	0.8080 (ahead of 0.8110)
ST Support:	0.7890 (ahead of 0.7750)

The market has been trading choppily within familiar ranges. We'd view a failure to break above 0.8100 as a sell signal.



Key Upcoming Events

	Forecast	Median	Last
Monday 10 August			
Aus, Housing Finance, June	+2.0%	+1.8%	+2.2%
Jpn, Machinery Orders, June		+2.6%	-3.0%
China, CPI, July y/y		-1.6%	-1.7%
Tuesday 11 August			
NZ, Electronic Card Transactions, July			-0.4%
Aus, NAB Business Survey, July			
Jpn, BOJ Policy Announcement	0.10%	0.10%	0.10%
UK, Trade Balance, June		-£2.30b	-£2.17b
UK, RICS Housing Survey, July		-10%	-18%
US, FOMC Policy Announcement	0.25%	0.25%	0.25%
US, Productivity (non-farm), Q2 saar 1st est		+5.4%	+1.6%
China, Trade Balance ($US), July		+$10.60b	+$8.25b
China, Fixed Investment (Urban), Jul ytd y/y		+34.0%	+33.6%
Wednesday 12 August			
Aus, Wage Price Index, Q2	+0.7%	+0.8%	+0.8%
Aus, Consumer Sentiment - Wpac, Aug			109.4
Jpn, BOJ Monthly Report			
UK, BOE Inflation Report			
UK, Unemployment rate (ILO), June		7.7%	7.6%

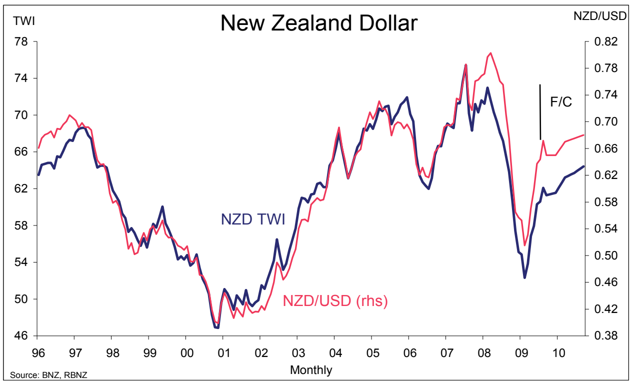
	Forecast	Median	Last
Wednesday 12 August *continued...*			
Euro, Industrial Production, June		+0.2%	+0.5%
US, International Trade, June		-$28.5b	-$26.0b
China, Industrial Production, Jul y/y		+11.5%	+10.7%
China, Retail Sales, Jul y/y		+15.0%	+15.0%
Thursday 13 August			
NZ, BNZ PMI (Manufacturing), July s.a.			46.2
NZ, Food Price Index, July	+0.1%		+2.8%
Euro, GDP, Q2 1st est		-0.5%	-2.5%
Euro, ECB Monthly Bulletin			
US, Business Inventories, June		-0.9%	-1.0%
US, Retail Sales, July		+0.7%	+0.6%
US, Jobless Claims, week ended 08/08		545k	550k
Friday 14 August			
NZ, Retail Trade, Q2 vol s.a.	-0.4%	flat	-2.9%
NZ, Retail Trade, June	-0.1%	-0.3%	+0.8%
Aus, Stevens Testifies, Semi-annual			
Jpn, BOJ Minutes, 14/15 Jul Meeting			
US, CPI ex food/energy, July y/y		+1.6%	+1.7%
US, Industrial Production, July		+0.4%	-0.4%
US, Mich Cons Confidence, August 1st est		69.0	66.0

Historical Data

	Today	Week Ago	Month Ago	Year Ago
CASH & BANK BILLS				
Call	2.50	2.50	2.50	8.00
1 mth	2.79	2.78	2.80	8.30
2 mth	2.79	2.79	2.80	8.32
3 mth	2.78	2.77	2.78	8.22
6 mth	2.82	2.82	2.82	8.06
GOVERNMENT STOCK				
11/11	3.94	3.81	3.69	6.19
04/13	4.92	4.75	4.68	6.19
04/15	5.43	5.26	5.28	6.17
12/17	5.90	5.73	5.79	6.17
05/21	6.39	6.21	6.53	-
CORPORATE BONDS				
BNZ 09/10	4.03	3.92	3.95	-
BNZ 05/15	7.05	6.84	6.97	-
GEN 03/14	4.70	7.02	4.50	-
GEN 03/16	7.84	7.51	7.64	-
TRP 12/10	6.97	4.48	7.71	7.39
TRP 06/20	7.44	7.63	7.62	7.49
SWAP RATES				
2 years	4.06	3.86	3.72	7.24
3 years	4.78	4.58	4.45	7.09
5 years	5.40	5.25	5.22	7.00
10 years	6.04	5.92	5.88	6.98

	Today	Week Ago	Month Ago	Year Ago
FOREIGN EXCHANGE				
NZD/USD	0.6687	0.6599	0.6279	0.7006
NZD/AUD	0.8023	0.7899	0.7898	0.7901
NZD/JPY	65.27	62.51	60.23	77.35
NZD/EUR	0.4715	0.4625	0.4496	0.4692
NZD/GBP	0.4011	0.3946	0.3849	0.3664
NZD/CAD	0.7239	0.7103	0.7293	0.7478
TWI	62.62	61.34	59.57	64.77

NZD Outlook



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