17 August 2009

Enough Good News to Keep RBNZ from Cutting

- Household indicators improving
- Global growth forecasts also not so weak
- But dairy prices aren't that much better
- On balance, odds of further OCR cut hemmed

There is a real ding dong battle for the Reserve Bank's affections at the moment in the markets. While background issues still counsel substantial caution, for a good while longer, some of the more immediate news is arguing against the need for another OCR cut for the meanwhile.

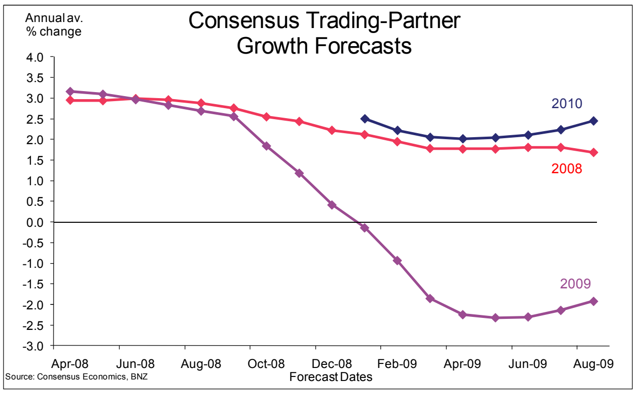
Last week, for example, we saw more definite signs of household recuperation. Retail sales looked to be stabilising, even expanding a tad in real terms. Nation-wide housing statistics were a little perkier than the steady REINZ headlines suggested. And consumer confidence moved into genuinely positive territory.

While these domestic indicators were no great surprise, they do, combined, suggest consumer expenditure might recover by more than we already expect over the second half of this year.

Also, global growth forecasts were revised higher last week. Expectations for this calendar year's GDP growth were upgraded to -2.5%, from -2.6%. More significantly, world GDP is now seen expanding by 2.3% in calendar 2010, rather than the 2.1% envisaged a month ago. While still a number well below average – when something around double this pace is needed to start getting the world economy out of its deep hole – it's an encouraging trend.

More to the point, current global growth forecasts are now running well ahead of the June Monetary Policy Statement expectations. The latter, of course, were set deliberately sombre by the RBNZ, with trading-partner GDP growth of -2.6% for 2009 and 1.4% for calendar 2010. These are now looking more like -1.9% and 2.5% respectively, on our estimates.

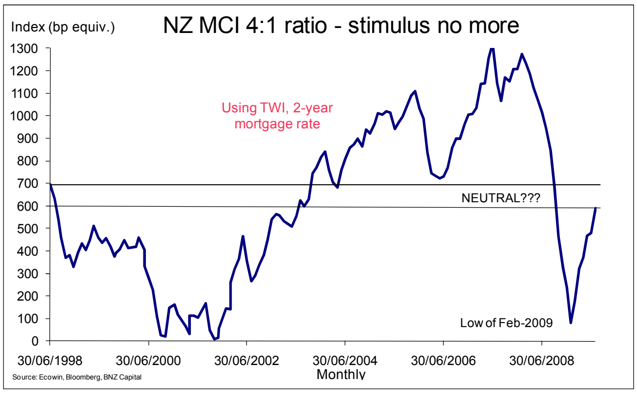
Such big upgrades to global growth will be an important buffer to the Reserve Bank's upcoming, September MPS, forecasts. As will the domestic signs of life – not just from the aforementioned household indicators but the many business surveys over recent months as well. This morning's Performance of Services Index, which essentially clawed its way back to flat, was but the latest example.



But then these trends of improvement have been implicit in the Bank's GDP forecasts, and many of the turning point considerations would have been under the Bank's belt by the time of its late-July OCR review, when it decided to issue a commentary a lot more relaxed than many were anticipating (rather like the Fed did last week, and the Bank of England did in extended its QE programme –interesting "moves" amid supposedly clear recoveries).

While there are many cross-currents in the news, the biggest issue for the RBNZ, it would seem, is the bolshie NZ dollar. And who can blame the central bankers for their concern on this? The currency, in being around average, is not exactly stimulating for New Zealand's tradables sector (and, which combined with term retail interest rates not that far from norms, tells of overall monetary conditions about neutral for the country at the moment).

Indeed, the TWI has kept creeping higher since late-July, to now be 9% loftier than the Bank assumed for 2009 Q3. And while issues of valuation dog it, there is little guarantee the TWI will naturally drift down to the



52.0 level the Bank assumes by 2011 Q1, especially if the projected recoveries in the NZ and world economies keep going (as seems the trend). Even running with a flat exchange rate from here would imply substantial downward pressure on the Bank's next set of GDP and inflation forecasts.

And it's not as though New Zealand is enjoying rising terms of trade as an offset – a point the RBNZ made patent in its last Statement, to dissociate this country from the rebound in base metal prices, and the wider benefits this is affording the Australian economy.

New Zealand's key export price, of course, is for dairy prices. And these are hardly improving from recent lows. Yes, it was good to see Fonterra's last auction for whole-milk powders registering a big jump in USD prices. However, the more general indicators we monitor (including Agri-fax's from just last week) remain mixed, particularly when converted in local currency.

Where the latest powder auction result was important, in our view, was that it improved the chances of Fonterra being able to meet its current forecast payout of $4.55 per kilogram of milk-solids, rather than having to revise down. And, let's not forget, even a $5.00 payout would hardly be a good result for most dairy farmers.

For the week ahead, there is not much ground-shaking local news on show. Australia's pretty quiet too. So NZ markets will no doubt chop around depending on how global equities and data pan out.

Of the domestic data there are, Wednesday's producer prices kick the show off. As has been the case for many quarters now, these economy-wide prices will be very difficult to second-guess, given the swings in commodity prices, the exchange rate and even volatility in wholesale electricity generation prices because of the weather.

For the record, we're looking for a 0.2% increase in Q2 producer output prices, which will reduce their annual pace to 3.0%, from 6.5%. And we're picking a 0.5% rise in input prices, which would not be enough to prevent annual deflation, to the tune of -0.7%. The messages from the PPI reports should thus be of disinflation, with undercurrents of a margin recovery, from recent big hits.

As for the accompanying Q2 capital goods price index, the stronger exchange rate will be helping reduce the cost of imported plant, machinery and transport equipment. But the real interest for us is how subdued building costs will prove, especially in the area of non-residential construction, where core activity is beginning to fade.

Also watch for the NBNZ Regional Trends survey, due Thursday afternoon. As a rough indicator of economic activity, it might give some important colour to Q2 GDP estimates, given a number of other data of late suggesting it might well fall by more than the 0.2% we expect.

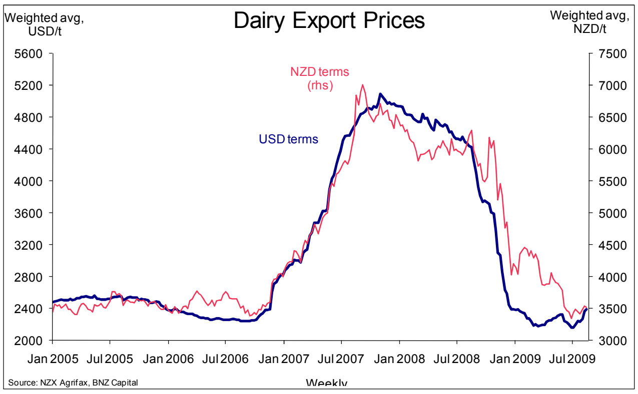
For Friday's migration figures, we expect July's international visitor arrivals will be propped up by Australians, but with major offsets coming through long-haul, especially Asian, markets. The real test for the tourism industry will be after winter, when the Australian market traditionally has less weight.

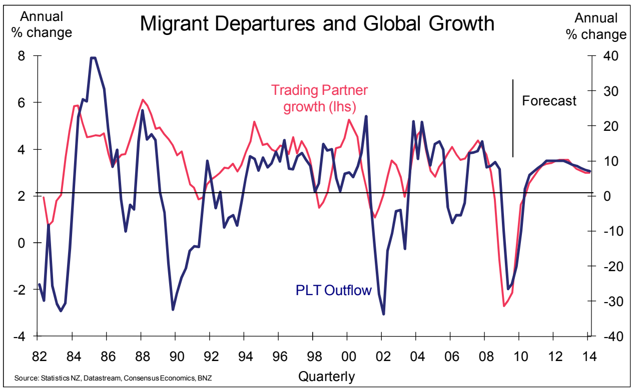
July's net immigration number will be interesting to note in detail too. As we've predicted, and seen, the bulk of the pick-up in "immigration" has actually been from a big fall-off in departures and a mild rise in returning ex-pats. July's migrant arrivals, generally speaking, were actually down on year-ago levels.

While we may well see sustained positive results for net immigration over the coming months, thus boosting population growth, we also get the feeling this impulse will peak this year then abate over 2010 and 2011 – mainly as locals who delayed their moves abroad amid the recent global fears follow through on their plans to emigrate.

The local data week is rounded out on Friday afternoon, with July's credit card billings. If these are very strong, we might have to give a bigger nod to the recovered ECT data we witnessed for July, and bump up the gains we expect for July's retail sales.

craig_ebert@bnz.co.nz





Domestic Interest Rates

Reuters pgs BNZL BNZM

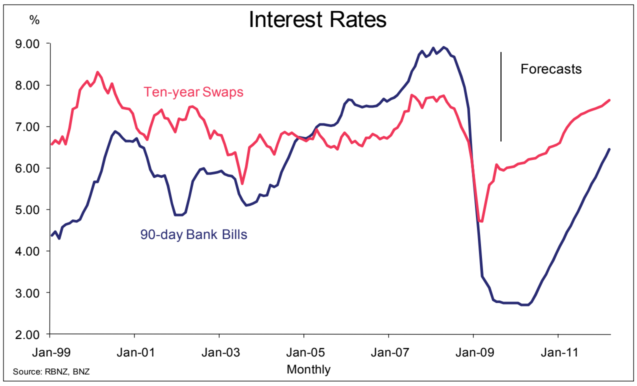
NZD interest rates continued their general bearish tone of recent times with a generally higher and flatter curve. The front end remains largely in the same place, with the small increase in the 3-month bill rate to do with the end of the early bucket. The futures and OIS curve remains largely unchanged reflecting just a small chance of cuts to the OCR priced and hikes priced from early in 2010. There has been some more movement in the futures further out on the curve, with a somewhat more aggressive hiking cycle priced, coinciding with the higher 2-yr swap rate.

The bond market was relatively quiet over the past week and a general lack of buyers in the short end pushed rates up somewhat. The general flattening tone seen offshore fed through here and the back end saw significantly better bids. We feel the shorter bonds remain somewhat expensive relative to their Australian equivalents but that the back end still holds reasonable value.

	90 day bills	11/11 NZGS	12/17 NZGS	2yr swaps s/a	10yr swaps s/a	2yr/10yr swaps(bps)
7-Aug-09	2.76%	3.90%	5.86%	4.00%	6.00%	200
14-Aug-09	2.79%	4.03%	5.90%	4.17%	6.08%	191
Change (bps)	**3**	**13**	**4**	**17**	**8**	**-9**

The swaps market continues to see relentless paying interest, pushed on somewhat in the past week by an increase in mortgage rates leading to further fixing and therefore more paying. The belly of the curve underperformed somewhat on the week, with 2s5s10s generally well bid and leading to an increased bowing of the curve. The 2-year swap is near support levels now as the 4.20% level was reached, equating to the same level seen in the March sell-off. How strong the support at this level is will be a key question for the week ahead.

nick_webb@bnz.co.nz



Interest Rate Technicals

pete_mason@bnz.co.nz

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 and we are very near that level now.

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

NZD/USD climbed to nearly an 11-month high of just under 0.6900 last week.

Over recent weeks, investors have become more optimistic on the outlook for global growth. Not only did last week's Q2 Eurozone GDP data suggest the recession in Germany and France was over, but the Fed acknowledged that US "economic activity is levelling out" – its clearest indication yet that the US recession may be bottoming out. As risk appetite has improved, investors have tended to pare back "safe-haven" positions in USD and JPY in favour of growth sensitive currencies like NZD.

The NZD has also benefited from a general sense that the NZ economy has weathered the global recession in relatively good shape. Last week's quarterly retail sales report gave a strong sense that household spending was stabilising and July's REINZ report was consistent with an increase in housing activity. The NZ economy looks on track to claw its way out of recession through the second half of this year and the outlook for GDP in 2010 is brighter than many of our trading partners.

NZ interest rates nudged higher last week, partly lifted by the moves seen across the Tasman (in the wake of RBA Governor Stevens' upbeat assessment) and partly because investors are preoccupied by picking the timing of the first RBNZ rate hike. Despite RBNZ assurances that the OCR will remain low until the latter half of 2010, current market pricing is consistent with the first hike in January and about 100-125bps of hikes over the next twelve months. The upward pressure on NZ interest rates, and associated widening of NZ-US yield spreads, saw the "fair value" level implied by our short-term valuation model climb to 0.6600-0.6900 last week.

However, the global optimism started to falter late last week. Lacklustre US consumer confidence data cast doubts over whether consumer spending will be able to lead the US out of recession. Meantime, many investors are concerned that Chinese growth will struggle as the government clamps down on lending in order to prevent asset bubbles. As a result, investors are starting to reassess the strength and timing of the anticipated global recovery. The S&P500 finished the week 0.6% lower (its first drop in five weeks) and the Shanghai index fell 6.5%.

For the coming week, with global growth expectations and risk appetite now starting to look a little shaky, NZD/USD looks vulnerable to a correction lower. This week's string of second tier NZ data releases (including the National Bank's regional trends survey and PPI) are unlikely to have a material influence on NZD sentiment. We suspect NZD/USD will struggle to break above last week's 0.6880 high and look for a correction back towards the 0.6600 region.

danica_hampton@bnz.co.nz

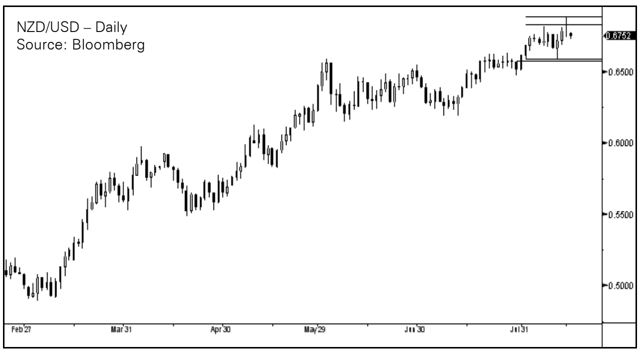
Foreign Exchange Technicals

danica_hampton@bnz.co.nz

NZD/USD

Outlook: Sell a rally
ST Resistance: 0.6840 (ahead of 0.6885)
ST Support: 0.6645 (ahead of 0.6590)

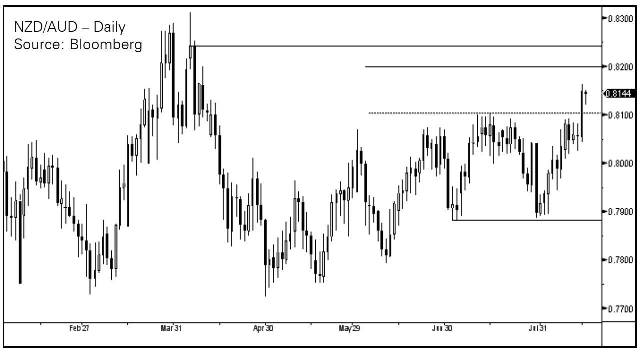
The uptrend is starting to look exhaustive, which, combined with daily RSI approaching "over-sold" territory, suggests a correction lower is on the cards. We'd view a failure towards 0.6800 as a selling opportunity.



NZD/AUD

Outlook: Sell a rally
ST Resistance: 0.8195 (ahead of 0.8250)
ST Support: 0.7890 (ahead of 0.7790)

The convincing break above 0.8100 saw momentum indicators turn bullish. With the daily RSI not yet in "oversold" territory, we'd prefer to wait for bounces towards 0.8200 before entering shorts. Alternatively, a daily close below 0.8100 would also signal the uptrend has stalled.



Key Upcoming Events

	Forecast	Median	Last
Monday 17 August			
Jpn, GDP, Q2 1st est		+1.0%	-3.8%
Euro, Trade Balance, June (s.a.)		+€1.3b	+€0.8b
US, NAHB Housing Index, August		18	17
US, Empire Manufacturing, August		+3.0	-0.6
Tuesday 18 August			
US, PPI ex-food/energy, July y/y		+2.8%	+3.3%
Aus, RBA Minutes, 4 Aug Meeting			
UK, CPI, July y/y			+1.8%
US, Housing Starts, July		598k	582k
Germ, ZEW Sentiment, August			+39.5
Wednesday 19 August			
NZ, PPI Outputs, Q2 y/y		+2.3%	+6.5%
NZ, PPI Inputs, Q2 y/y		-1.3%	+4.7%
NZ, Capital Goods Price Index, Q2 y/y			+4.9%
Aus, Westpac Leading Index, June			-0.2%
Aus, RBA's Edey Speaks			

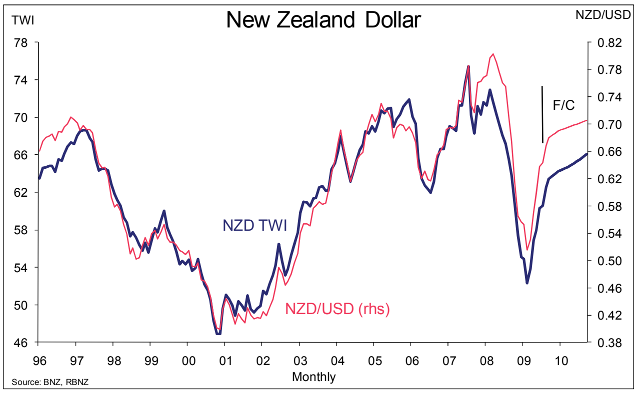
	Forecast	Median	Last
Wednesday 19 August			
Jpn, All Industry Index, June		+0.3%	+0.7%
UK, BOE Minutes, 5/6 Aug Meeting			
Germ, PPI, July y/y			-4.6%
Thursday 20 August			
NZ, NBNZ Regional Trends, Q2			-1.2%
UK, Retail Sales vol., June			+1.2%
US, Jobless Claims, week ended 15/08		550k	558k
US, Philly Fed Index, August		-2.0	-7.5
US, Leading Indicator, July		+0.7%	+0.7%
Friday 21 August			
NZ, External Migration, July s.a.			+1,730
NZ, Credit Card Billings, July			+0.2%
Euro, PMI Manufacturing, July 1st est		47.5	46.3
Euro, PMI Services, August 1st est		46.5	45.7
US, Bernanke Speaks (Jackson Hole), "A Year in Crisis"			
US, Existing Home Sales, July		5.00m	4.89m

Historical Data

	Today	Week Ago	Month Ago	Year Ago
CASH & BANK BILLS				
Call	2.50	2.50	2.50	8.00
1 mth	2.80	2.79	2.79	8.33
2 mth	2.80	2.79	2.80	8.29
3 mth	2.73	2.78	2.79	8.15
6 mth	2.85	2.82	2.82	8.03
GOVERNMENT STOCK				
11/11	4.01	3.94	3.76	6.25
04/13	4.94	4.92	4.71	6.25
04/15	5.42	5.43	5.24	6.20
12/17	5.86	5.90	5.73	6.18
05/21	6.32	6.39	6.53	-
CORPORATE BONDS				
BNZ 09/10	4.05	4.03	4.02	-
BNZ 05/15	6.91	7.05	7.10	-
GEN 03/14	6.85	4.70	7.34	-
GEN 03/16	7.33	7.84	7.69	-
TRP 12/10	4.72	6.97	4.61	7.40
TRP 06/20	7.83	7.44	7.83	7.44
SWAP RATES				
2 years	4.15	4.06	3.85	7.25
3 years	4.83	4.78	4.58	7.09
5 years	5.45	5.40	5.33	7.00
10 years	6.05	6.04	6.03	6.94

	Today	Week Ago	Month Ago	Year Ago
FOREIGN EXCHANGE				
NZD/USD	0.6743	0.6687	0.6446	0.7047
NZD/AUD	0.8134	0.8023	0.8032	0.8127
NZD/JPY	63.84	65.27	60.79	77.88
NZD/EUR	0.4762	0.4715	0.4568	0.4798
NZD/GBP	0.4093	0.4011	0.3945	0.3780
NZD/CAD	0.7435	0.7239	0.7189	0.7465
TWI	63.00	62.62	60.69	65.85

NZD Outlook



Contact Details

BNZ Capital

bnzcapital

Stephen Toplis	**Craig Ebert**	**Mark Walton**	**Danica Hampton**	**Mike Jones**
Head of Research	Senior Economist	Economist	Senior Strategist	Strategist
+(64 4) 474 6905	+(64 4) 474 6799	+(64 4) 474 6923	+(64 4) 472 4767	+(64 4) 472 4767

Main Offices

Wellington	**Auckland**	**Christchurch**
1 Willis Street	125 Queen Street	129 Hereford Street
PO Box 2392	PO Box 2139	PO Box 1461
Wellington 6140	Auckland 1140	Christchurch 8140
New Zealand	New Zealand	New Zealand
Phone: +(64 4) 474 6145	Phone: +(64 9) 976 5762	Phone: +(64 3) 353 2219
FI: 0800 283 269	Toll Free: 0800 081 167	Toll Free: 0800 854 854
Fax: +(64 4) 474 6266		

National Australia Bank

National Australia Bank

Peter Jolly	**Alan Oster**	**Rob Henderson**	**John Kyriakopoulos**
Head of Research	Group Chief Economist	Chief Economist, Markets	Currency Strategist
+(61 2) 9295 1199	+(61 3) 8634 2927	+(61 2) 9237 1836	+(61 2) 9237 1903

Contact Phone Numbers

Wellington		**New York**	
Foreign Exchange	+800 642 222	Foreign Exchange	+1 800 125 602
Fixed Income/Derivatives	+800 283 269	Fixed Income/Derivatives	+1877 377 5480
Sydney		**Hong Kong**	
Foreign Exchange	+800 9295 1100	Foreign Exchange	+(85 2) 2526 5891
Fixed Income/Derivatives	+(61 2) 9295 1166	Fixed Income/Derivatives	+(85 2) 2526 5891
London			
Foreign Exchange	+800 333 00 333		
Fixed Income/Derivatives	+(44 20) 7796 4761		

24 HOUR FOREIGN EXCHANGE SERVICE	
Phone Toll Free	6am to 10pm NZT – Wellington Office
0800 739 707	10pm to 6am NZT – London Office – Olivia Core