

28 September 2009

Firm Confidence to Look More Assured?

- September's NBBO confidence to lift
- Sectoral differences still likely
- Further recovery in residential building consents
- Business borrowing to look weaker yet

There's no doubt confidence is soaring, amongst firms and households. Economy-wide measures for both are now well and truly above their long-term averages. Despite that, though, the surge in optimism has yet to translate into any significant increases in activity. What's more, there are some big differences between the business sectoral readings, with some industries still looking decidedly downbeat. With that in mind, we'll be looking for two things in this Wednesday afternoon's National Bank Business Outlook: a broader base, sectorally, to the improvement in business sentiment; and clearer signs that the upswing in confidence will result in substantial lifts in activity.

Make no bones about it, stronger growth is exactly what we expect. We're forecasting an expansion in GDP of 2.8% over the next year, in annual average terms, very much in line with the growth predicted by own activity expectations gathered in the National Bank survey. If the NBBO is to be believed, however, harder monthly activity indicators will soon need to look appreciably more positive than they currently do.

Amongst these we'd count the Performance of Manufacturing Index which, as of August's update, still depicted a contracting manufacturing sector. That seems at odds with activity expectations amongst manufacturing firms, which are not only strongly positive, but well above historical levels. Something's got to give, it seems. Perhaps Wednesday's survey update will reveal manufacturers aren't quite as hopeful as they were a month earlier. Alternatively, another robust sentiment

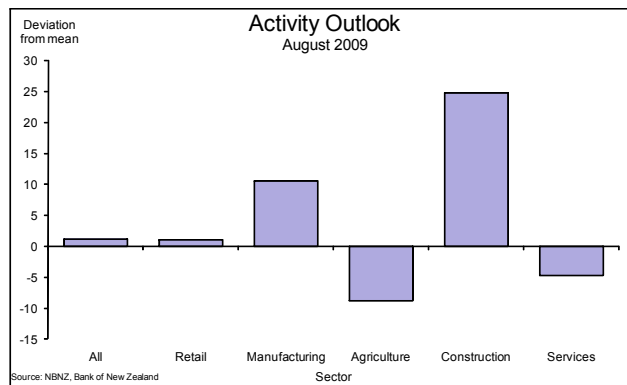
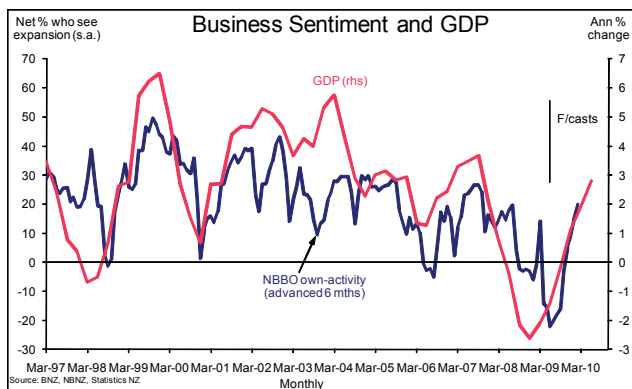
reading would more obviously suggest a genuine turnaround in manufacturing activity is just around the corner.

We're plumping for the latter, but we're also mindful that the currency wasn't doing exporters (of USD-denominated products, anyway) any favours throughout the month of September. During the first two weeks of the month, when most of this survey edition's responses were likely collected, the NZD lifted above 70 cents, something that will have weighed on the minds of firms with an external focus, we're sure.

As well as many manufacturers, this also includes farmers, of course, who were already looking distinctly gloomy, both in comparison to other sectors and agriculture's historical averages. And Fonterra's bonus announcement of an upgrade in this season's payout to \$5.10/kg milksolid, will have been made too late for this survey, we imagine. That will be something to look out for down the track.

By some margin, construction firms are the most upbeat about the way things are unfolding. After the slump in home building during 2008, from which the sector has yet to recover, we can understand why. We wouldn't be surprised if the massive gains in builders' confidence, seen in recent months, held in September's survey. In line with this, we also think tomorrow's building consents data, for August, will continue their run of trend improvement. From January's trough of 911 ex-apartment consents, seasonally adjusted, August's figure could push up toward 1100.

Non-residential building is a different kettle of fish, though. Buoyed to date by infrastructure spending, we suspect the squeeze on business profits and subsequent



curtailment of investment will start to show through more clearly in the value of non-residential building consents, perhaps beginning with August's report.

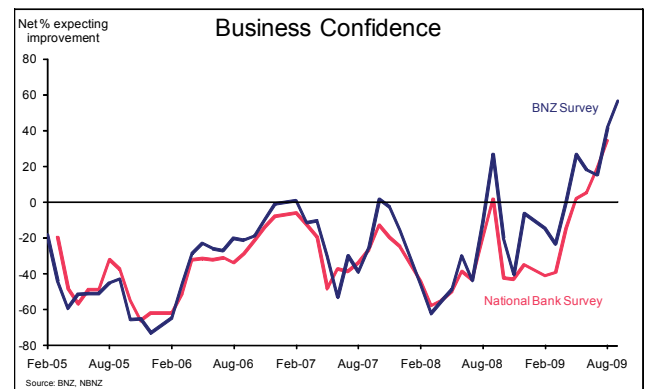
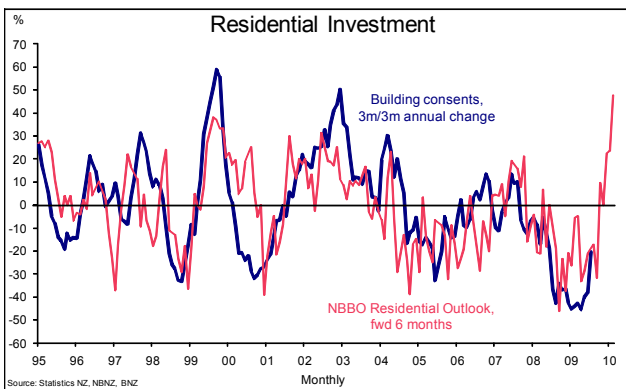
Consistent with falling business investment, growth in firm-level borrowing has plunged over the past year. If that pace of decline continues, the annual uptake of business borrowing could dip meaningfully below zero for the first time in the RBNZ's sectoral borrowing data, for August, out tomorrow afternoon. Household borrowing will probably confirm the worst of the crunch is past, while agriculture could dip lower from its still high pace of 15% y/y.

August's data on business (including agriculture) borrowing will be a telling reminder of the lags inherent in the economy. The recession may be over, but we suspect that weak profits will plague firms for some

time yet. Indeed, business profitability will be a crucial determinant of growth in investment and employment over the next year. As of a month ago NBBO profit expectations were flat, though improving rapidly, but with most sectors still reporting weaker expectations than historically normal. It will be interesting to see what September's update reveals in this regard.

Whatever the September edition of the NBBO reveals in its detail, the headline confidence reading looks set to push higher yet. That's the strong (and historically reliable) signal sent by our own, informal survey, anyway. On the basis of this predictor, the NBBO measure could shift up to above 50. That'd put it on its strongest footing since 1999.

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Domestic Interest Rates

New Zealand interest rates saw a sizable lift over the previous week. Yields pushed higher on the back of stronger current account data, a revised milk solids pay out forecast and GDP data officially confirming the recession is behind us. Fonterra really kicked things off last week, with a surprise announcement that it had bumped its milk solids payout forecast from an initial \$4.55/kg to \$5.10/kg which saw yields sell off quickly. The market continued to sell off with additional momentum from Q2 GDP data that was slightly higher than what the market was anticipating at +0.1%, affirming that New Zealand has pulled out of recession. The bank bill futures continue to price in a full 25bp hike in March.

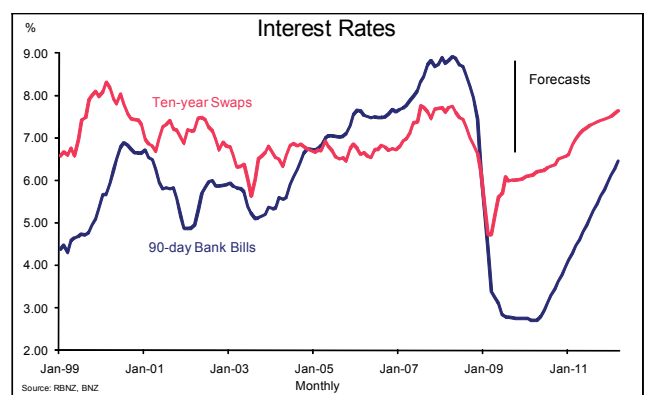
The bond market was fairly quiet last week. With the strong data being printed the curve flattened overall as shorter dated bonds sold off and longer dated bonds rallied. The \$350m up for tender found good support with a strong bid to cover ratio. Continued offshore demand has helped keep the market buoyant.

	90 day bills	11/11 NZGS	12/17 NZGS	2yr swaps s/a	10yr swaps s/a	2yr/10yr swaps(bps)
18-Sep-09	2.78%	3.94%	5.625%	4.035%	5.930%	189.5
25-Sep-09	2.79%	4.04%	5.590%	4.220%	5.975%	175.5
Change (bps)	1	10	-3.5	18.5	4.5	-14

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NZD interest rate swaps sold off considerably last week under minimal mortgage book paying and thin corporate flow. The market was driven by the (aforementioned) strong domestic data rather than offshore flow. Swap yields were pushed to the top of their ranges early in the week, while the robust GDP data, in particular, provided enough ammunition for swaps to finally break through these ranges. We now see 2-year swap trading near the middle of its new range of 4.10%-4.40%.

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Interest Rate Technicals

NZD 5yr Swap Rate

Outlook: Consolidation
 ST Resistance: 5.50%
 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, testing +122 but holding above. We therefore expect the steepening trend to continue. Should our support at +122 be solidly breached this will be the end of the steepening trend.



Foreign Exchange Market

It was a wild ride in the NZD last week. From lows around 0.7000 early in the week, NZD/USD soared to a fresh 13-month high above 0.7300 for a brief period, before settling back to around 0.7200.

With the USD generally caught in a sideways shuffle, it was last week's batch of 'good news' on the NZ economy that really lit a rocket under the NZD. First up was Q2 balance of payments data which revealed the current account deficit shrank to a much better-than-expected 5.9% of GDP. Fonterra then surprised all and sundry by bumping up its payout forecast for the current season by 12% to NZ\$5.10 per kg/ms. And, lastly, June quarter GDP data brought a technical end to NZ's 15-month long recession by eking out a 0.1% gain.

All of this tended to support investors' view that NZ has emerged from the global recession in better shape than most, which sent the NZD higher. The NZD gains have not only been relative to the ailing USD. Even on a trade-weighted basis, the NZD increased around 1.3% last week. NZD/GBP has recently scaled 12-year highs above 0.4500 and NZD/AUD remains stubbornly above 0.8250.

However, sentiment shifted slightly over the latter part of last week. The NZD generally drifted off its highs as investors' reassessed just how strong last week's NZ

Reuters pg BNZFWDS

data was and weakening equity markets saw risk appetite pared back a touch. Indeed, despite the G20's assurances to keep stimulus measures in place, investors seem to have gotten a little more cautious on the global outlook. Our risk appetite index has slipped to 43% (after rising above 50% last week). With global equities rebounding some 50% from the lows seen in March, and many equity indices now looking stretched relative to underlying earnings, this week's batch of global data will need to print strong to justify the upbeat global outlook currently priced into markets. Any hint of weakness across global equities, or a spike higher in risk aversion, should support the USD at the expense of growth sensitive currencies like NZD. As a result, we suspect further gains in NZD/USD will be limited this week.

A widening of NZ-US interest rate differentials (to around 300bps) in the wake of last week's strong data has pushed out the 'fair value' range for the NZD/USD (as suggested by our short-term valuation model) to 0.6950-0.7150. Nevertheless, the model suggests, from a fundamental standpoint, there is little reason to buy the NZD above 0.7200. For this week, we suspect sellers will emerge on rallies towards 0.7250.

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Foreign Exchange Technicals

NZD/USD

Outlook: Buy a dip
 ST Resistance: 0.7250 (ahead of 0.7275)
 ST Support: 0.6965 (ahead of 0.6885)

Momentum indicators remain positive, but with the daily RSI close to "over-bought" territory we'd wait for dips before buying. A daily close below 0.6900 will suggest the uptrend is stalled.

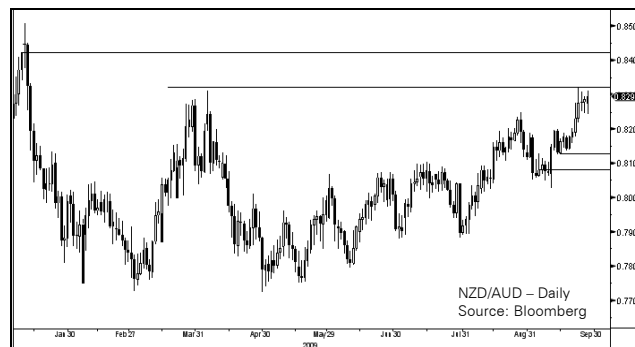


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NZD/AUD

Outlook: Buy a dip
 ST Resistance: 0.8340 (ahead of 0.8420)
 ST Support: 0.8110 (ahead of 0.8080)

The break above 0.8250 has seen momentum indicators turn positive. However, with the market approaching "overbought" levels, we'd prefer to wait for dips before initiating long positions.



Key Upcoming Events

	Forecast	Median	Last		Forecast	Median	Last
Tuesday 29 September				Thursday 1 October			
NZ, Building Consents, August (res, #)			+5.0%	US, Personal Spending, August	+1.0%		+0.2%
NZ, Household Credit, August y/y			+2.4%	US, Construction Spending, August		-0.3%	-0.2%
US, Consumer Confidence, September		57.0	54.1	US, Pending Home Sales, August	+0.9%		+3.2%
UK, Mortgage Approvals, August		52.0k	50.1k	US, ISM Manufacturing, September		54.0	52.9
UK, CBI Dist Trade Survey, September			-16	US, Jobless Claims, week ended 26/09			530k
UK, GDP, Q2 2nd est		-0.7%	-0.7%P	Aus, Manufacturing PMI (AiG), September			51.7
Jpn, CPI, August y/y		-2.4%	-2.2%	UK, CIPS Manuf Survey, September			49.7
Euro, Economic Confidence, August		82.2	80.6	UK, BOE Credit Conditions Survey (circa), Q3			
Wednesday 30 September				Friday 2 October			
NZ, NBNZ Business Survey, September			+34.2	Jpn, Retail Trade, August y/y		-2.4%	-2.5%
US, GDP, Q2 saar 3rd est		-1.1%	-1.0%P	Jpn, Tankan (Ige manuf), Q3		-33	-48
US, Chicago PMI, September		52.0	50.0	Euro, Unemployment Rate, August		9.6%	9.5%
US, ADP Employment, September		-200k	-298k	Euro, PMI Manufacturing, September 2nd est		49.0	49.0
Aus, Building Approvals, August	+1.0%	+2.5%	+7.7%	China, PMI (NBS), September			54.0
Aus, Private Sector Credit, August	+0.2%	+0.2%	+0.2%	Friday 2 October			
Aus, Retail Trade, August s.a.	+0.5%	+0.5%	-1.0%	US, Unemployment Rate, August			9.7%
UK, Index of Services, July 3m/3m			-0.6%	US, Factory Orders, August			+1.3%
Jpn, Industrial Production, Aug 1st est		+1.8%	+2.1%	US, Non-Farm Payrolls, September			-216k
Euro, CPI, Sept y/y 1st est		-0.2%	-0.2%	Aus, TD Inflation Gauge, September y/y			+1.7%
Germ, Unemployment, September		8.4%	8.3%	Jpn, Unemployment Rate, August			5.7%
Germ, Retail Sales - vol, August		+0.1%	+0.7%	Jpn, Household Spending, August y/y (real)			-2.0%
				Euro, PPI, August y/y			-8.5%

Historical Data

	Today	Week Ago	Month Ago	Year Ago		Today	Week Ago	Month Ago	Year Ago
CASH & BANK BILLS					FOREIGN EXCHANGE				
Call	2.50	2.50	2.50	7.50	NZD/USD	0.7177	0.7076	0.6842	0.6857
1 mth	2.81	2.75	2.77	8.17	NZD/AUD	0.8262	0.8168	0.8126	0.8229
2 mth	2.80	2.82	2.78	8.12	NZD/JPY	64.27	64.66	63.88	72.67
3 mth	2.79	2.76	2.79	8.08	NZD/EUR	0.4877	0.4814	0.4781	0.4700
6 mth	2.90	2.85	2.85	7.62	NZD/GBP	0.4491	0.4358	0.4206	0.3727
GOVERNMENT STOCK					NZD/CAD	0.7828	0.7573	0.7467	0.7083
11/11	4.04	3.96	4.05	5.60	TWI	65.32	64.56	63.45	64.32
04/13	4.85	4.82	4.92	5.64	NZD Outlook				
04/15	5.26	5.26	5.34	5.71					
12/17	5.59	5.65	5.70	5.72	<p>Source: BNZ, RBNZ</p>				
05/21	5.95	6.05	6.53	-					
CORPORATE BONDS									
BNZ 09/10	3.81	3.82	3.90	-					
BNZ 05/15	6.63	6.68	6.68	-					
GEN 03/14	6.57	6.75	6.82	-					
GEN 03/16	6.89	7.25	7.31	-					
TRP 12/10	4.44	4.62	4.67	7.07					
TRP 06/20	7.30	7.59	7.78	7.22					
SWAP RATES									
2 years	4.22	4.05	4.17	6.88					
3 years	4.84	4.70	4.83	6.83					
5 years	5.44	5.35	5.43	6.81					
10 years	5.98	5.95	6.01	6.73					

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