23 November 2009

(Re)Mixed Messages Justify RBNZ Caution

- November's NBNZ business survey peaking?
- Dairy prices continue to strengthen
- October's immigration, tourist numbers, look good
- But latest merchandise trade, credit, likely still restrained
- Meat export prices well off 2008/09 season highs

Thursday's NBNZ business survey will be the big domestic focal point this week. It will provide an independent summary of the economic news of late, which, on balance, looks to be losing some of its earlier gumption.

That's not to deny a number of positive threads still emerging. In support of sentiment and growth, we have such things as the higher dairy payout, a (supposedly) recovering housing market and a solid head-count by way of immigration as well as tourism.

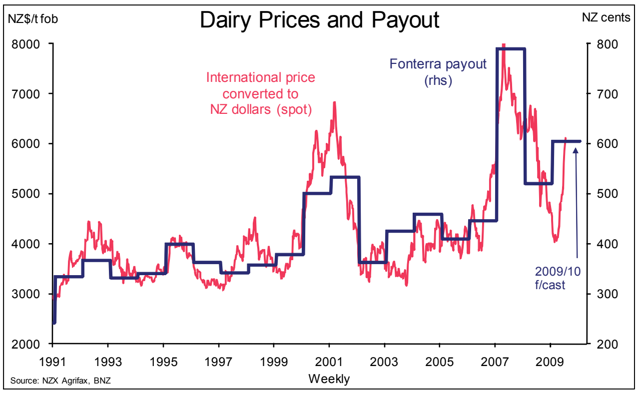
But, as a drag, we have the impression of patchy times in merchandise trade, ongoing restraint in credit, little evidence of spending improvements to date, amid warnings of slower recovery by way of the very latest BNZ PMI and PSI reports, and in some of the anecdote we're picking up.

The international news has been turning more mixed as well, with decent streams from Australia and emerging markets barely offsetting not so good news from wider Europe and, especially, the US.

Overall, then, we can imagine Thursday's business survey will have as much trouble pressing on with the recovery story as it will have losing the plot. Its details could thus be more significant than its headline results.

As for dairy prices, well they just continue to go from strength to strength. It has been a remarkable recovery over recent months. Even in the context of a broadly higher NZD/USD, international dairy prices have gained enough now to largely justify the $6.05 upgraded dairy payout that looked a bit of a stretch, to our mind, even a month or two ago.

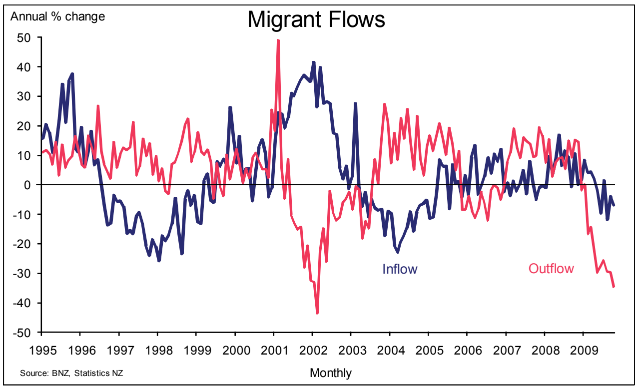
Since mid-October alone, our weighted-average dairy spot price indicator has increased about 20% – with ongoing gains in world indices shining through more clearly as the NZ dollar loses some of its pruning effect. We still wonder how some of the international dairy market dynamics will play out in full. However, there's no denying local dairy prices are significantly better underpinned at present.



Another positive for domestic spending is head-count. This morning's migration statistics cemented this theme. Net inward migration was a seasonally adjusted 2,120 in October – around the average of the previous six months or so. It's clearly improved since being about flat last year, to be aiding population growth in no small measure.

However, there are some caveats. While higher, immigration is hardly strong. And it's probably close to peaking. Most importantly, the gains have been the net result of departures (-37% y/y) continuing to fall at a much faster rate than migrant arrivals (-7% y/y) – a trend we believe can't persist for much longer. And, eventually, it will reverse, dragging population growth back down.

The trends in tourist arrival numbers are arguably more pleasing. October's total was 7.7% higher than a year ago – a fantastic achievement through a very nasty international recession, not to mention "swine flu" ructions. Moreover, the month to month trend was still moving higher.



However, again, there are provisos to the good-looking headlines. The annual gains in tourist numbers have been heavily reliant on arrivals from Australia (+22% y/y). Many other source markets have been experiencing deep (albeit lessening) falls. Also, the make-up of the arrivals, and the generally higher NZ dollar, would seem to be paring the purchasing power of those tourists turning up.

We detected this, for example, in last week's credit card billings, which, for foreign-issued cards was just 1.4% up over the twelve months to October 2009.

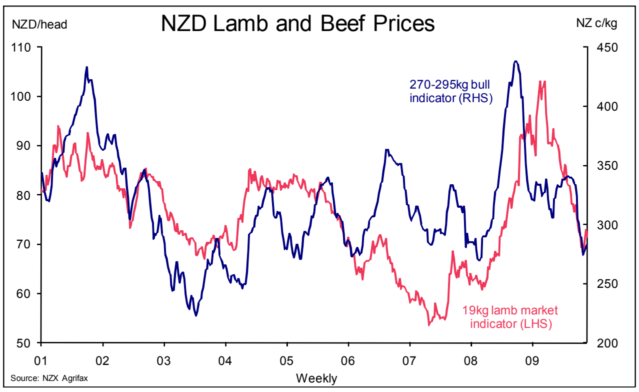
And it wasn't as if spending on locally-issued credit cards was any more encouraging. This rebounded an underwhelming 0.3%, from September's 0.9% dip, to leave the underlying trend as mild as we've already seen in electronic card transactions. This leaves us of the view October's retail sales will increase in a tepid fashion, rather than prove any tasty entrée to the impending festive season.

As for Friday's merchandise trade figures, we suspect they will continue the theme of the waxing and waning we're beginning to see in the broader data. Dairy prices will presumably be supportive, although production is hardly moving higher – as mixed fortunes on the weather front stymie any overall gains from last season's recovered (post-drought) levels. Oil exports may well lend further juice to October's trade accounts.

At the same time, we have to wonder how well the bulk of manufacturing exports is recovering – or how the rest of the primary export sector is looking, for that matter.

On the latter, we note meat producers are facing prices, which, while not that bad, are certainly lower than last season's plump ones. This is where the high NZD relative to USD and GBP is really hitting home. Couple this income drag with sheep and beef farm values having fallen quite a bit since last year and the fast approaching processing season could be a testing one.

In respect to the overall numbers, we expect October's merchandise exports to be down around 18% on a year ago, and imports to be 24% lower, y/y. This is a reminder of the fact the trade-weighted exchange rate is now about 10% higher than last October, with this annual comparison likely to hit 30% by Q1 of next year (a reminder of how low the NZ dollar was, initially at least, as a consequence of the global rout).



Our export and import figures deliver a monthly deficit of \$526m (compared to the market's median expectation on -\$480m). This would very much leave intact the trend lessening in the annual deficit, implying further core shrinkage in the current account deficit. Indeed, it would suggest, along with "accounting" impacts (to do with tax-case charges on more local banks), that New Zealand's headline external deficit may well get down to 3.0% as a percentage of nominal GDP this calendar year. It won't be nearly that benign, underneath. But for many international observers, the difference will probably not matter all that much for the meantime.

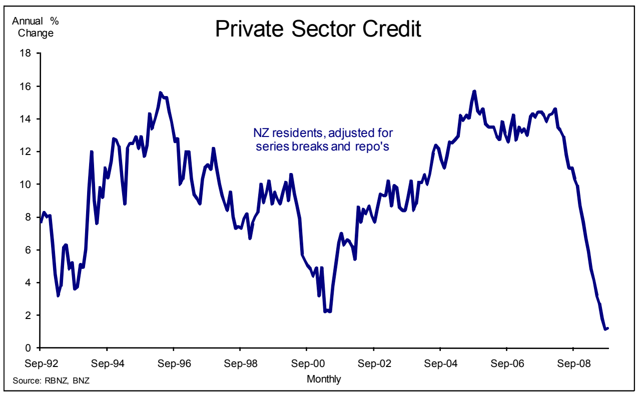
Rest assured, though, our central bank remains concerned by New Zealand's underlying vulnerabilities to overseas markets and financial system.

The RBNZ is also, it would seem, paying very close attention to the local money and credit aggregates. So ignore their October readings, published Friday afternoon, at your peril. We believe these will leave the Bank satisfied than households and businesses are not exploiting relatively low interest rates to re-leverage.

To be sure, mortgage lending is likely to have maintained positive growth in October. But hardly faster than the 0.3% monthly trend over the prior few months, and thus well shy of normal, let alone anything hot to trot.

The remainder of the credit aggregates are likely to be still slowing (agriculture), flat (business), or actually contracting (consumer finance).

Finally for the week, also note Friday afternoon's inflation expectation surveys (of the RBNZ and Marketscope variety). These should hardly be an issue. Any stickiness for the near-term view will probably be related to base impacts of the "strong" 2009 Q3 CPI. More generally, we continue to believe the inflation pulse is diminishing – in the core data to date, and in the projections into 2011.



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Domestic Interest Rates

Reuters pgs BNZL BNZM

NZD interest rates followed the general sentiment of offshore and rallied strongly in the last week, with yields lower throughout the curve. The tone of offshore markets in rates land seemed to be "buy anything, wear diamonds" as the projected hiking cycles of central banks were pushed back significantly. We followed along here with market pricing of the RBNZ's coming hiking cycle delayed further with the first hike now only 50% priced for March 2010 and around 200 total points of tightening priced for the 2010 calendar year.

The bond market followed offshore moves and rallied well on the week, with the front end of the curve performing particularly well. There was some reasonable two-way flow in the market with the short bonds in particular very well bid while supply continues to weigh somewhat on the back end. This should continue for the coming week, particularly if offshore rates continue to rally.

The swaps market saw a good rally through the curve and a general change in sentiment with bids few and far between through the week. Notably, the curve didn't steepen as much as one would expect given the size of the move, but this was consistent with a strong performance in long end yields offshore. We are coming up on some strong trendline resistance in both 2-yr and 1yr-1yr forward swaps and have seen significant profit taking down at these levels. It will probably take a significant additional move offshore to push the NZD swaps market further down in the coming week.

	90 day bills	11/11 NZGS	12/17 NZGS	2yr swaps s/a	10yr swaps s/a	2yr/10yr swaps(bps)
13-Nov-09	2.81%	4.34%	5.78%	4.54%	6.17%	163
20-Nov-09	2.80%	4.12%	5.68%	4.34%	6.04%	170
Change (bps)	**-1**	**-22**	**-10**	**-20**	**-13**	**7**

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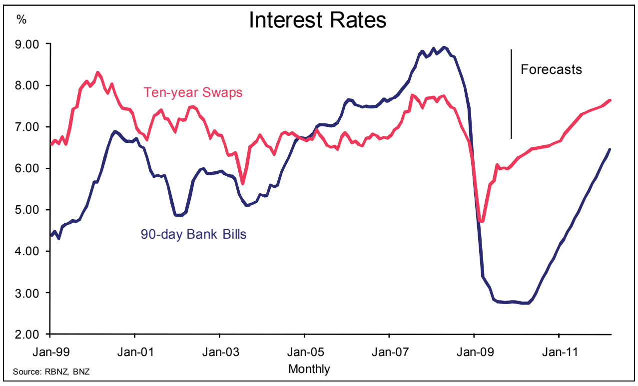

Interest Rate Technicals

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NZD 5yr Swap Rate

Outlook:	Consolidation
LT Resistance:	5.95%
LT Support:	5.14%

Last week's rally went down to our support of 5.50% dipping just below that level. This week will be important to see if it holds below that level. If it does, it will take us into a new range of 5.50/5.14 % but we will await confirmation of this. A failure to hold below the 5.50% level will mean we are back to the previous range of 5.95/5.50%.

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

Outlook:	Flattening
MT Resistance:	+122
MT Support:	+61

The +122 level continues to hold. We expect the +122/+98 range to remain in play, near term, but with an eventual break of +98 targeted, and trend support coming in at +61.

Foreign Exchange Market

Reuters pg BNZWFWDS

The NZD was among the worst performing currencies last week. Having started the week around 0.7450, a rapid unwinding of investors' risk appetite saw NZD/USD finish the week closer to 0.7250.

Over the latter part of last week, fears about the strength and durability of the global recovery resurfaced. These fears were driven in part by a sense the future pace of global growth will not be able to sustain the current rally in equity markets and 'risky currencies'. The somewhat mixed nature of recent data has not really helped in this regard. And equity valuation metrics are certainly looking a little stretched – the P/E ratio of the S&P500 is sitting at 22.

As US equities beat a hasty retreat over Thursday and Friday last week (the S&P500 fell 1.7%), risk appetite was knocked from its highs. As a result, the USD and the JPY were the strongest performing currencies over the week as investors rushed back into 'safe-haven' assets. Indeed, 2-year US Treasury yields fell to the lowest level this year on Friday (0.67%) as safe-haven flows picked up. In contrast, heavy selling by both model and speculative accounts took a toll on 'growth-sensitive' currencies like NZD and AUD, and NZD/USD finished the week down 2.6%.

A reassessment of monetary policy expectations also weighed on NZD and AUD last week. Australian markets significantly reduced the pace of expected tightening from the RBA following the November RBA Board minutes. And this, combined with some hefty falls in offshore interest rates, saw local markets pare back the extent of RBNZ tightening. Around 140bps of RBNZ hikes are now expected by September, down from about170bps at the beginning of the week.

Despite last week's sharp falls in the NZD, not a lot has changed on the fundamental front. At 54%, our risk appetite index (which has a scale of 0-100%) remains above the long-run average of 50%. Meanwhile, our short-term valuation model (which is based on commodity prices, NZ-US interest rate differentials, global growth expectations, and risk appetite) suggests a 'fair-value' range in NZD/USD of

0.7300-0.7500. All up, this suggests the NZD should again head higher at some point. However, momentum has clearly shifted to the downside for now, and many are wary of taking positions in 'risky' currencies like the NZD ahead of month-end and the US holiday on Thursday. If the current dour sentiment continues to hang over global equity markets we wouldn't rule out further falls in NZD/USD towards 0.7160. A breach of this support could open up a deeper correction back towards 0.7080.

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Foreign Exchange Technicals

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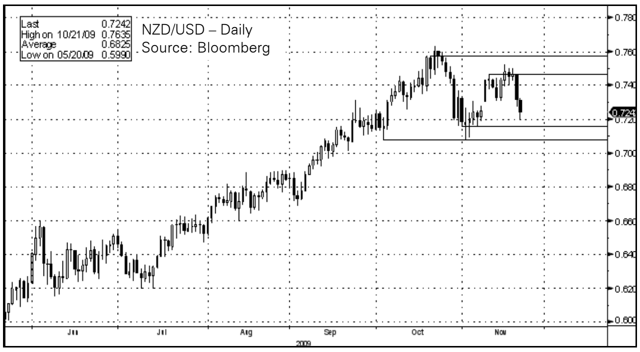
NZD/USD

Outlook:	Consolidation
ST Resistance:	0.7460 (ahead of 0.7570)
ST Support:	0.7155 (ahead of 0.7080)

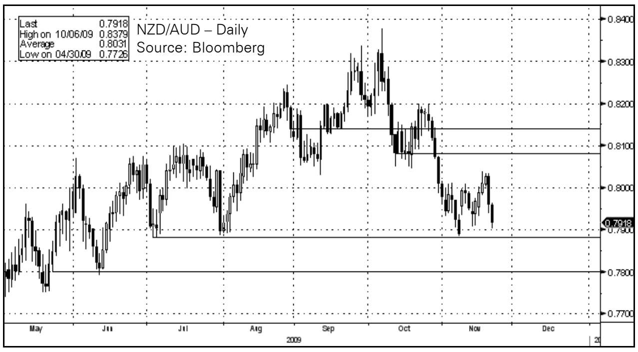
Momentum indicators are turning negative but are not yet firmly so. A break below 0.7155 would signal a deeper correction towards 0.7080 is on the cards. But a failure to break below 0.7155 would be consistent with a rebound back towards 0.7450.



NZD/AUD

Outlook:	Buy a dip
ST Resistance:	0.8080 (ahead of 0.8130)
ST Support:	0.7885 (ahead of 0.7800)

Momentum indicators remain neutral for now but a break below 0.7885 would signal renewed downward momentum. We'd view a failure to break convincingly below 0.7885 as an opportunity to enter long positions.



Key Upcoming Events

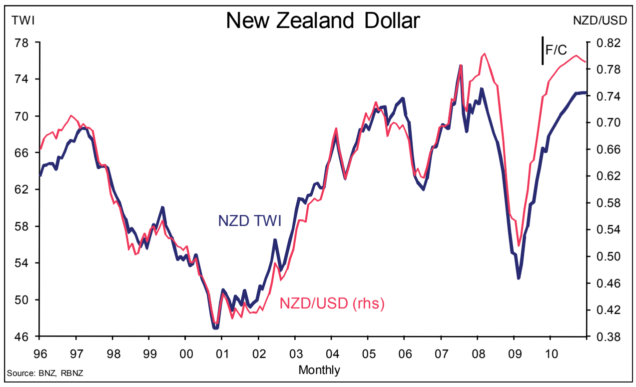
	Forecast	Median	Last
Monday 23 November			
NZ, External Migration, October s.a.			+1,800
Euro, PMI Services, November 1st est		52.9	52.6
Euro, PMI Manufacturing, November 1st est		51.2	50.7
US, Existing Home Sales, October		5.70m	5.57m
Tuesday 24 November			
Jpn, BOJ Monthly Report			
UK, BBA Home Loans, October		44.0k	42.1k
Euro, Industrial Orders, September		+1.0%	+2.0%
US, Shiller Home Price Index, Sep y/y		-9.1%	-11.3%
US, GDP, Q3 saar 2nd est		+2.9%	+3.5%P
US, Consumer Confidence, November		47.5	47.7
Germ, IFO Index, November		92.5	91.9
Germ, GDP, Q3 2nd est		+0.7%	+0.7%P
Wednesday 25 November			
Aus, RBA's Battellino Speaks, Housing			
Aus, Building Work Done, Q3	-1.0%	-0.5%	-0.1%
Jpn, Merchandise Trade Balance, Oct		+¥466b	+¥525b
UK, GDP, Q3 2nd est		-0.3%	-0.4%
US, Jobless Claims, week ended 21/11		500k	505k
Wednesday 25 November *continued...*			
US, Personal Spending, October		+0.5%	-0.5%
US, Durables Orders, October		+0.5%	+1.4%
US, Mich Cons Confidence, November 2nd est		67.0	66.0P
US, New Home Sales, October		405k	402k
US, FOMC Minutes, 3/4 Nov Meeting			
Thursday 26 November			
NZ, NBNZ Business Survey, November			+48.2
Aus, Private New Capex, Q3	+2.0%	flat	+3.3%
Jpn, BOJ Minutes, 30 Oct Meeting			
Euro, M3, October y/y		+0.8%	+1.8%
US, Holiday, Thanksgiving Day			
Friday 27 November			
NZ, RBNZ Survey of Expectations, Nov (2-yr ahead)			+2.3%
NZ, Household Credit, October y/y			+2.3%
NZ, Merchandise Trade, October	-$526m	-$480m	-$424m
Jpn, Household Spending, October y/y (real)		+0.6%	+1.0%
Jpn, Unemployment Rate, October		5.4%	5.3%
Jpn, CPI, October y/y		-2.4%	-2.2%
Euro, Economic Confidence, November		88.0	86.2

Historical Data

	Today	Week Ago	Month Ago	Year Ago
CASH & BANK BILLS				
Call	2.50	2.50	2.50	6.50
1 mth	2.77	2.80	2.80	6.30
2 mth	2.77	2.79	2.78	6.04
3 mth	2.78	2.78	2.82	5.85
6 mth	2.88	2.90	2.99	5.56
GOVERNMENT STOCK				
11/11	4.12	4.34	4.38	4.92
04/13	4.82	5.08	5.16	5.11
04/15	5.35	5.52	5.52	5.32
12/17	5.68	5.78	5.74	5.39
05/21	5.99	6.08	6.53	-
CORPORATE BONDS				
BNZ 09/10	3.80	3.90	4.13	-
BNZ 05/15	6.64	6.82	6.77	-
GEN 03/14	6.64	6.83	6.87	-
GEN 03/16	7.08	7.24	7.20	-
TRP 12/10	4.25	4.39	4.72	5.40
TRP 06/20	7.38	7.50	7.37	6.49
SWAP RATES				
2 years	4.34	4.54	4.66	5.14
3 years	4.90	5.10	5.19	5.34
5 years	5.48	5.66	5.63	5.57
10 years	6.04	6.17	6.02	5.90

	Today	Week Ago	Month Ago	Year Ago
FOREIGN EXCHANGE				
NZD/USD	0.7233	0.7430	0.7385	0.5391
NZD/AUD	0.7904	0.7955	0.8075	0.8503
NZD/JPY	64.24	66.60	67.17	51.67
NZD/EUR	0.4864	0.4975	0.4958	0.4279
NZD/GBP	0.4380	0.4444	0.4525	0.3611
NZD/CAD	0.7739	0.7828	0.7673	0.6831
TWI	64.72	66.15	66.32	55.31

NZD Outlook



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