21 June 2010

In Parity, Victory

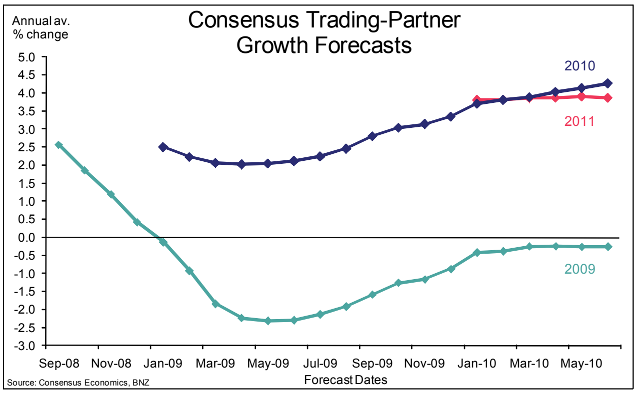
- Global growth expectations resisting European woes
- As East beats West
- Q1 GDP seen at 0.5%, less than RBNZ's 0.8%
- Q1 current account deficit as slim as it gets?
- May's immigration, travel, softer than expected
- Credit billings, merchandise trade, probably OK

When things hold out against the odds, it is like a victory. And we're not just talking about New Zealand's stunning 1-1 draw with football world champions Italy this morning (well done lads – tu bellezza). Global growth expectations have also proved resilient to a big European threat, of burgeoning sovereign debt and deficits.

The robustness in world GDP is thanks to strong growth coming through emerging markets, and not even led by China. Take the Singaporean economy. It's now expected to expand 9.1% this calendar year – according to the very latest Consensus Economics survey - whereas the estimate back in April was 6.4%. Similarly, Malaysia is now seen at 6.9%, previously 5.5%. Taiwan is 6.5%, from 5.3%.

Meanwhile, June's consensus view on Japan's growth for 2010 has been boosted to 3.2%, from 2.2% in April – a reminder that this has been the fastest recovering developed economy to date, including in its 1.2% growth in Q1 of 2010. It obviously helps being hooked into Asia.

And so, despite largely stagnant expectations for the major Western economies, New Zealand's trading-partner GDP growth track has actually strengthened since the European debt issues came to a head in April. We're now looking at 4.3% for 2010, up from 4.0% in April's consensus survey, and with the view on 2011 holding up at a respectable 4.0%.



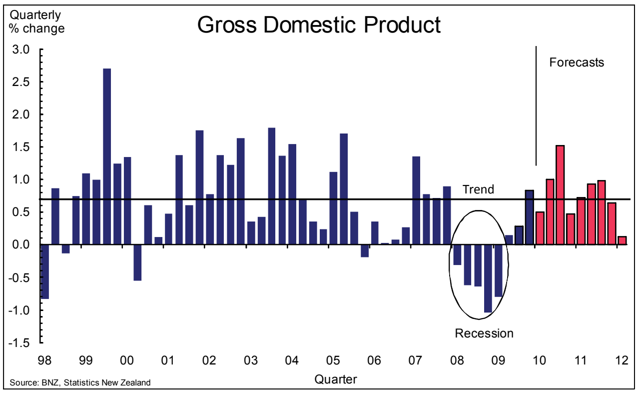
Bolt on the resilience in New Zealand's commodity export prices – including news over the weekend that world dairy prices were still holding up – and the global backdrop for the NZ economy looks solid.

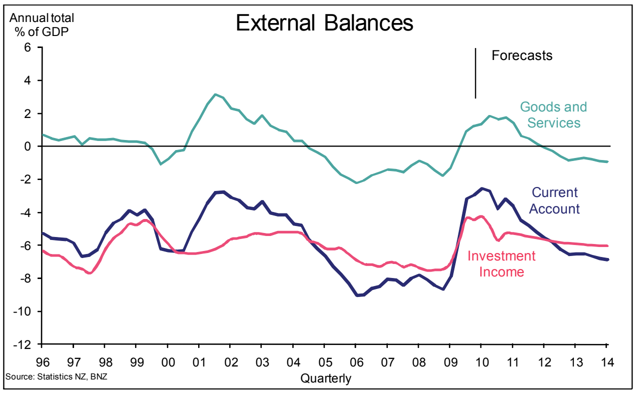
As for how the local economy has performed in the recent past, Thursday's Q1 GDP report will reveal all. The market's expectation for this has been toned right down to 0.5%. Of note, this compares with the 0.8% built into the June MPS (and May's Government Budget, for that matter).

We were always guarded on Q1 GDP growth, and have simply fine-tuned our final judgement to 0.5% (1.8% y/y) following the run of patchy partials over the last couple of weeks. While such a quarterly result, following the 0.8% result of Q4, would not necessarily represent a slow-down, in our view, it would certainly be another knock for those who have been quick to presume a typically strong recovery. Because of the big structural and financial issues at play, we still believe it will be a lagged pick-up, with strong growth having to wait past mid-year.

The standouts in Q1 GDP will probably be forestry and coal output, with most other components battling it out for minor rewards. Weak spots are likely in on-farm output (because of the emerging drought at the time), local government, and perhaps even real estate and financial services.

From the expenditure lens, consumption growth will probably be muted, along with public spending, however business investment will more than likely be showing further recuperation, while exports will be boosted by forestry products, and early meat processing in light of the drought.



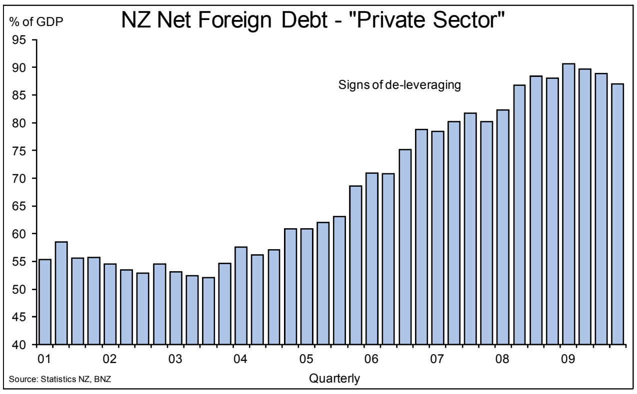


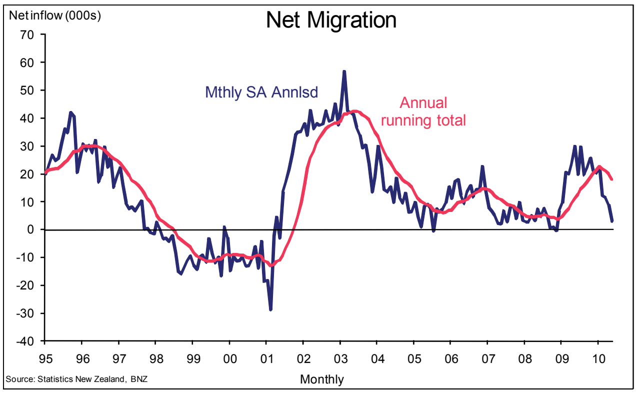
Ahead of GDP, Wednesday's Q1 current account will be the next most watched result of the week. It's primed to be another good-looker, with the year-to-March deficit reducing even further, to around 2.6/2.7% of GDP, from 2.9%. Indeed, the March quarter balance could well be close to, well, balanced. But bear in mind this will be flattered by seasonally high exports and seasonally low imports.

The bigger point we'd make, however, is that the nation's external deficit is set toward renewed expansion from about here on. This will eventually bring back on the radar the nation's extremely high net liabilities to the wider world (figures for which will be updated in Wednesday's Balance of Payments). This negative position mainly reflects the large amount of household debt that has been accumulated since 2003, which has essentially been funded from abroad.

In respect of a re-bloating in the external accounts, there might even be signs of exhausted improvement in Friday's merchandise trade figures for May. The market is anticipating a (largely-seasonal) surplus of $835m, simply to hold the annual surplus in marginally positive territory.

We are looking for a $734m May trade surplus, comprising goods exports of $4,279 (+8% y/y) and imports of $3,545m (+16% y/y). If there is any lack in exports, it could well reflect a hole in agriculture production as a consequence of the late-summer drought.





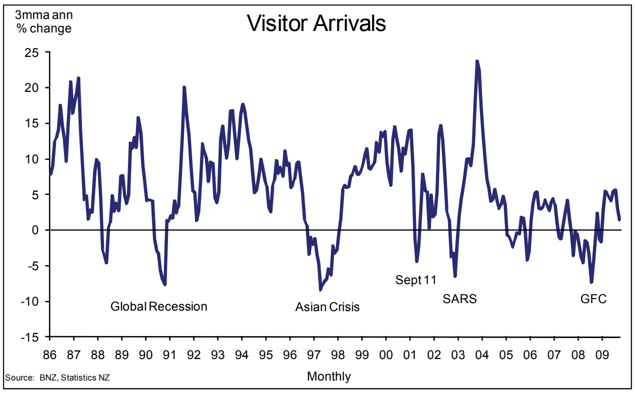
As for the remainder of the (second-tier) NZ data, this morning has already dished up May's international travel and migration statistics. They were each a bit weaker than we anticipated.

In particular, we had expected migrant arrivals to recover a tad, on the assumption their weakness in April was partly owing to the travel disruptions from the Icelandic volcano. Instead, permanent and long-term arrivals sagged even further. And even though we've been warning a pick-up on the departure side of the ledger, the extent of it in May (+24% y/y) caught us by surprise.

So, net immigration was a miserly 250 in number. This might help explain some of the recent weakness in consumer spending and the housing market. However, it would also warn of a tightening supply of available labour. The RBNZ will thus be caught betwixt and between.

As for the short-term visitor flows, they were still bouncing around a flat trend. Broadly speaking, while visitor arrivals from many parts of Asia continued to pick up from year-ago lows, those from Australia were now beginning to fall short of last year's boom levels, while arrivals from European markets simply kept contracting.

For tomorrow afternoon's May credit card billings we're hoping to a better bounce-back, from April weakness, than we witnessed for the month's electronic card transactions.



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Domestic Interest Rates

Reuters pgs BNZL BNZM

New Zealand interest rates had a steady week, with no domestic data or significant developments offshore to push the market in any direction. With global markets taking a breather last week from the ensuing carnage emanating from Europe over the last month, New Zealand interest rates were fairly tame over the last few sessions, trading tight ranges. Current market OIS pricing sees an 84% chance of a 25bps hike in July, with an additional 50bps priced in by year end.

The Bond market had a quiet week, with very little to report. The market continues to move in beat with the swap market, while keeping a close eye on offshore developments. The market seems to be well supported given the recent issues aborad, but with limited supply weighing in, further gains will be limited.

The swaps market had a very quiet week, the most notable point of interest being the continued flattening around the mid part of the curve. In what seems to be continued receiving interest in forward starting swap structures from offshore investors who see value in the kiwi curve given the turmoil unfolding abroad. The 2s5s10s butterfly level rallied as low as 9bps, before the market realised how ridiculous the move was, snapping back to close the week at 19bps. This week we have a bit more data to help drive the market with the current account and GDP print to perhaps give the market some guidance, alongside any domestic flows from mortgage books or corporates. This week we see the current range in 2-year swap to be 4.25%-4.40%.

	90 day bills	04/13 NZGS	05/21 NZGS	2yr swaps s/a	10yr swaps s/a	2yr/10yr swaps(bps)
11-Jun-10	3.07%	4.40%	5.51%	4.33%	5.62%	129
18-Jun-10	3.11%	4.37%	5.52%	4.30%	5.59%	129
Change (bps)	**4**	**-3**	**1**	**-3**	**-4**	**0**

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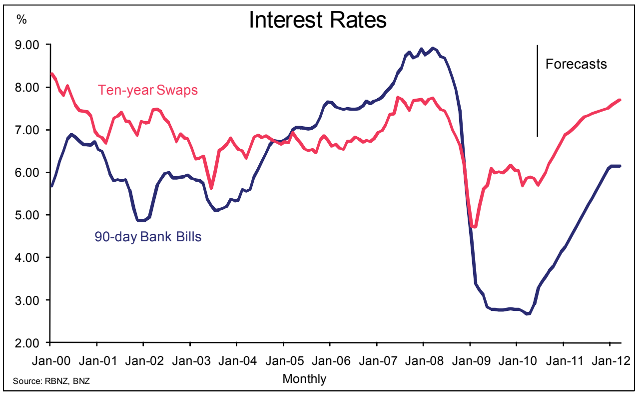

Interest Rate Technicals

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NZD 5yr Swap Rate

Outlook: Higher
MT Resistance: 5.86%
MT Support: 4.98%

We maintain a move higher in yield towards 5.86% resistance. Only a move below the downward sloping support line will negate this outlook.

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

Outlook: Rangebound
MT Resistance: +110
MT Support: +46

We expect the range trade to continue. Risks remain for a move towards support at +46.

Foreign Exchange Market

Reuters pg BNZWFWDS

The NZD was one of the strongest performing currencies last week. NZD/USD jumped from a smidge below 0.6900 to 1-month highs around 0.7050 as easing fears about a Europe led global slump reawakened investors' risk appetite.

On Saturday, the People Bank of China (PBOC) announced it would gradually make the Yuan more flexible: "It is desirable to proceed further with reform of RMB exchange rate regime and increase RMB exchange rate flexibility". The PBOC cited a gradually recovering global economy and the solid Chinese economic upturn for the timing of the move. Still, the PBOC cautioned against expecting a major revaluation of the Yuan, with the emphasis on a gradual appreciation.

Coming a week before the G20 leaders' summit in Toronto, China's announcement that it will seek a more flexible Yuan should cool trade tensions with the US, a positive for investor sentiment. A stronger Yuan will also lower China's import costs, helping to sustain strong commodities demand. No surprises then that 'commodity-linked' currencies like the AUD and NZD have so far responded positively to China's announcement on the Yuan. Indeed, NZD/USD has started the week about 1% stronger.

For this week, global risk appetite will remain key to the fortunes of the NZD, but there are also a few important events to keep an eye on locally. The market's expectation for Thursday's Q1 GDP growth has been toned right down to 0.5%, which compares with the 0.8% built into the RBNZ's June MPS. We were always guarded on Q1 GDP, and have settled on 0.5% (1.8% y/y), to follow the 0.8% result of Q4. Wednesday's current account will probably be another good-looker, with the annual deficit reducing even further, to around 2.6/2.7% of GDP, from 2.9%.

While global markets remain in a positive frame of mind, we wouldn't be surprised to see the NZD extend its gains. Our risk-appetite index has rebounded to 49%, from 34% two weeks ago, just below the long-run average of 50%. Momentum is now in the NZD/USD's favour and a test of resistance around 0.7200 looks likely.

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Foreign Exchange Technicals

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NZD/USD

Outlook: Buy a dip
ST Resistance: 0.7200 (ahead of 0.7305)
ST Support: 0.7065 (ahead of 0.6965)

The breach of the 0.7021 resistance level saw momentum indicators turn positive. The daily RSI is not yet in 'overbought' territory so further gains are expected.

NZD/AUD

Outlook: Consolidation
ST Resistance: 0.8150 (ahead of 0.8195)
ST Support: 0.8050 (ahead of 0.8000)

With resistance around 0.8200 holding, more range-trading looks likely near-term. Buy a dip towards 0.8000.

Key Upcoming Events

	Forecast	Median	Last
Monday 21 June			
NZ, External Migration, May s.a.			+770
Aus, Vehicle Sales, May y/y			+28.7%
Jpn, All Industry Index, April		+2.0%	-0.8%
Tuesday 22 June			
NZ, Credit Card Billings, May			-1.2%
UK, UK Budget, Post-Election Update			
US, Existing Home Sales, May		6.15m	5.77m
Germ, IFO Index, June		101.2	101.5
Wednesday 23 June			
NZ, WMM Employee Confidence (circa), Q2			103.6
NZ, Balance of Payments, Q1	-2.6%	-2.7%	-2.9%
UK, CBI Dist Trade Survey, June			-18
UK, BBA Home Loans, May		36.0k	35.7k
UK, BOE Minutes, 9/10 Jun Meeting			
US, FOMC Policy Announcement	0.25%	0.25%	0.25%
US, New Home Sales, May		410k	504k
Euro, PMI Services, June 1st est		55.9	56.2
Euro, PMI Manufacturing, June 1st est		55.3	55.8

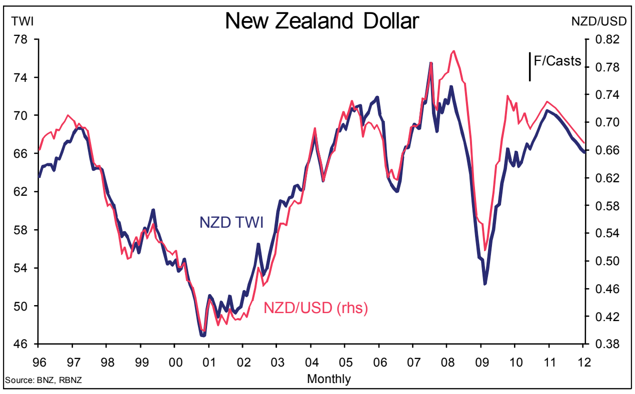
	Forecast	Median	Last
Thursday 24 June			
NZ, GDP, Q1	+0.5%	+0.5%	+0.8%
Jpn, Merchandise Trade Balance, May		+¥480.0b	+¥740.5b
US, Durables Orders, May		-1.3%	+2.8%
Euro, Industrial Orders, April		+1.6%	+5.5%
Friday 25 June			
NZ, Merchandise Trade, May	+$734m	+$835m	+$656m
Jpn, CPI, May y/y		-1.1%	-1.2%
US, Mich Cons Confidence, June 2nd est		75.5	75.5P
US, GDP, Q1 saar 3rd est		+3.0%	+3.0%P
Monday 28 June			
NZ, NBNZ Business Survey, June			+48.2
Jpn, Retail Trade, May y/y			+4.9%
US, Chicago Fed Nat Activity Index, May			0.29
US, Personal Spending, May			0.0%
Euro, M3, May y/y			-0.1%
Germ, Retail Sales - vol (circa), May			1.0%

Historical Data

	Today	Week Ago	Month Ago	Year Ago
CASH & BANK BILLS				
Call	2.75	2.75	2.50	2.50
1 mth	2.90	2.94	2.70	2.77
2 mth	3.00	3.01	2.79	2.79
3 mth	3.05	3.07	2.88	2.76
6 mth	3.37	3.30	3.06	2.82
GOVERNMENT STOCK				
11/11	3.77	3.76	3.71	3.90
04/13	4.37	4.40	4.42	4.90
04/15	4.84	4.86	4.93	5.54
12/17	5.29	5.29	5.38	6.06
05/21	5.52	5.51	6.53	-
CORPORATE BONDS				
BNZ 09/10	3.63	3.63	3.51	4.30
BNZ 05/15	6.43	6.50	6.54	7.40
GEN 03/14	6.28	6.32	6.37	7.19
GEN 03/16	6.83	6.91	7.00	7.98
TRP 12/10	4.03	3.99	3.79	4.65
TRP 06/20	6.82	6.86	6.95	7.93
SWAP RATES				
2 years	4.31	4.32	4.29	3.92
3 years	4.63	4.65	4.72	4.67
5 years	5.05	5.06	5.20	5.42
10 years	5.60	5.61	5.78	6.20

	Today	Week Ago	Month Ago	Year Ago
FOREIGN EXCHANGE				
NZD/USD	0.7111	0.6902	0.6760	0.6426
NZD/AUD	0.8068	0.8104	0.8129	0.7983
NZD/JPY	64.25	63.28	60.98	61.82
NZD/EUR	0.5718	0.5694	0.5387	0.4605
NZD/GBP	0.4787	0.4741	0.4672	0.3893
NZD/CAD	0.7249	0.7133	0.7180	0.7294
TWI	68.06	67.23	65.42	60.78

NZD Outlook



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