19 July 2010

Global Growth Expectations Remarkably Robust

- World growth expectations hold recent gains
- Increased NZ PSI and PMI stiffen growth resolve
- June's tourist arrivals likely up, on big Asian recovery
- But net immigration probably thin, as departures reign
- Strong ANZ-RM consumer index has room to dip a bit

With all the talk of double-dip recessions, front-loaded fiscal austerity measures, and even lessening steam from China, one might have expected the very latest Consensus Economics poll to have finally registered a downgrade in global growth expectations. By and large, this didn't happen.

In fact, the survey's world growth forecasts, published late last week, maintained the previous month's slight uplift, with 3.5% for this calendar year and 3.3% for 2011. Broadly speaking, better news from emerging markets was still offsetting reduced optimism toward the US and UK economies, while Euro-zone GDP expectations actually held up, unrevised.

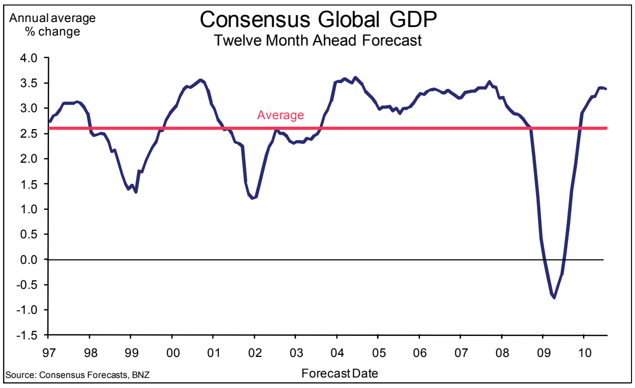
Granted, these numbers might be much easier to fall short of than beat, especially with a fair chance of slowdown in European GDP, from its modest beginnings, and Asian GDP too, as it struggles to maintain recently strong momentum.

And for the world economy as a whole, these are not thunderous numbers the consensus is putting forth, that would make up for the huge hole created over 2008/09. Not even close.

Nonetheless, if they prove accurate, the latest consensus view would see growth in the international economy, over this year and next, of at least "average". As such, they are light years removed from what was experienced during 2008/09.

This very much transposes over to New Zealand's trading-partner growth expectations. It's essentially of maintained solid growth, only mildly slower than the flush we saw into the start of 2010. These are the sorts of core numbers the RBNZ will be feeding into its models, albeit with the alternative scenario being a downside one, one would think.

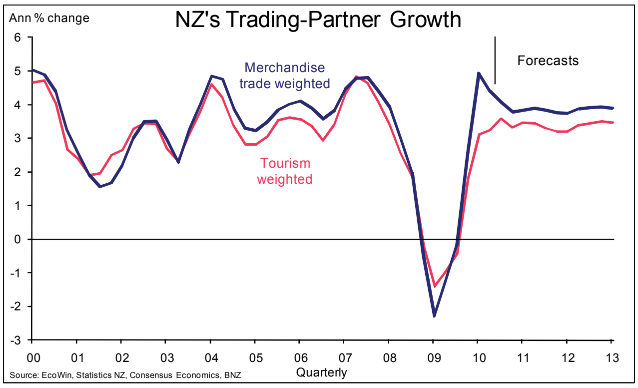
With this global setting, we might also wonder the robustness of NZ growth and recovery. There are no big data releases or events this week to really test this. However, there are a number that will give important insight into the economy, at a time when the strength of the recovery is being questioned.

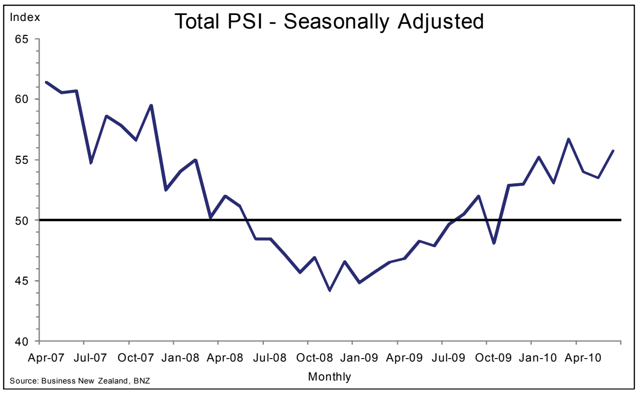


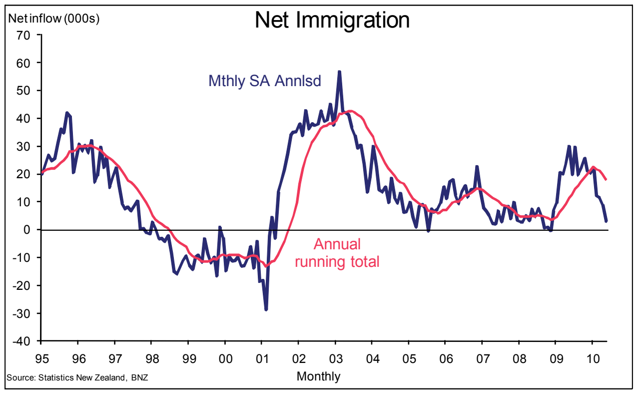
This morning's BNZ Performance of Services Index certainly got things off on the right foot. Its improvement, to a seasonally adjusted 55.3, from May's 53.5, was encouraging on many levels. For starters, its lift better established a good growth pulse - much as we saw from its PMI cousin last Thursday. And these were particularly decent results, given a wave of global despondency that has had many other PSI and PMI indices around the world looking soft.

Also, the improvement in "June's" NZ PSI couldn't have come at a better time, in that it was filled out by respondents around the second week of July. As such, it carries forward the reasonable tones of the last NBNZ business survey and QSBO – which were canvassed back around mid-June – rather than echoing the weak messages in recent anecdotal and sentiment-driven surveys.

While we don't deny economic confidence has come off its highs, and the anecdote is patchy, the more reliable







indicators have always been what firms have said about their own business. In this respect, the increase in June's PSI was more than just a relief. It suggested the recovery was forging on.

We expect a similar theme from Wednesday morning's short-term visitor arrival numbers. Having looked a bit disappointing over previous months, we are picking a solid 6% increase in June, compared to last June. This will reflect recovered visitor inflows from Asia, including an approximate doubling of arrivals from China. It's another example of New Zealand's increasingly diversified export base these days.

However, we are not so confident about June's net immigration figures. For these, we expect another barely positive, with the risk of a first net outflow for a long while. Flat immigration is no doubt part of the reason for the soft retail and housing markets we've been logging of late, but would also seem to explain why labour market slack looks to be abating. The RBNZ will have to take all of it into account when thinking about the balance of risks around inflation.

Speaking of which, we would reiterate that while last Friday's Q2 CPI was exactly as modest as we thought – in headline and underlying terms – the Reserve Bank's main task from here is to keep inflation at bay over the coming period. To get the lags right, this probably requires the Bank to keep removing OCR stimulus over the near term. It's all about looking forward, not backward. A grumpy recovery is disappointing enough. One with inflation would be even worse.

As for Wednesday afternoon's credit card billings, they will only mean something if they are big, or negative, following the severe down and up pattern over April (-1.6%) and May (+1.9%). We already know the broader measure of electronic card transactions continued to struggle in June, and retail sales certainly did so in May.

The more interesting pointer to consumer spending, then, might well come from the last local data item on show this week – Thursday's ANZ-RM consumer confidence index. Sure, it's been over-predicting actual household expenditure for a while now. However, it's the direction that we're interested in. It could reasonably go either way this month, from the strong level of 122.0 it established in June. A moderate fall would be understandable, a rise a very encouraging result in the circumstances.

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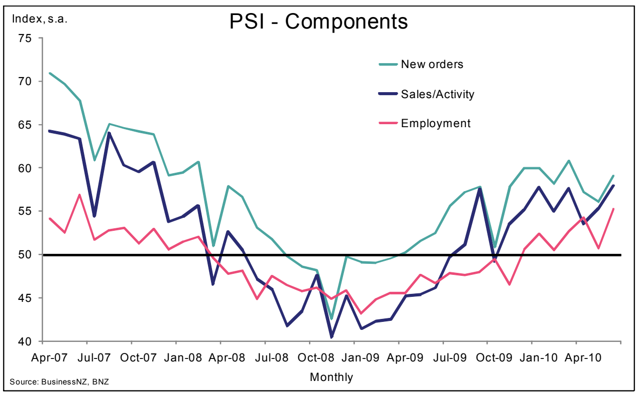

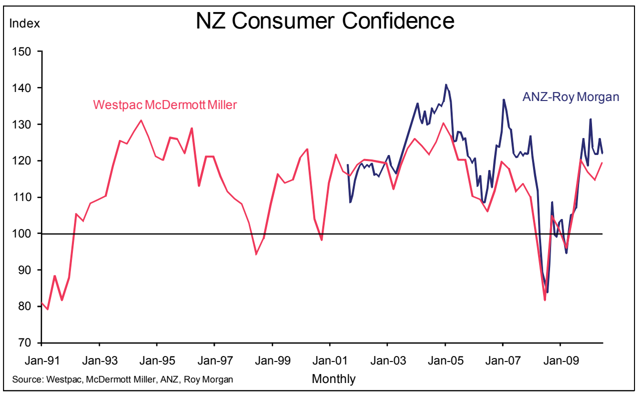

Domestic Interest Rates

Reuters pgs BNZL BNZM

New Zealand interest rates saw a relatively quiet week as the curve rallied and flattened somewhat on fears of continuing anaemic growth around the world. The major mover at the front of the curve was Friday's CPI number. It was a subdued 0.3% vs expectation of +0.5%. This saw a gentle rally in the bill futures market and we are left with a curve that almost fully prices a 25 bp hike to the OCR at next week's meeting, followed by reduced amounts priced for each subsequent meeting. The OCR following the December meeting is now priced at around 3.40%, while further out the curve it is expected to be around 4.00% by the middle of 2011.

The bond market was fairly subdued on the week, but the tender was reasonably well supported with respectable bid to cover ratios. The 2017 maturity bonds saw a good bid towards the end of the week, which was probably due to this point on the curve trading above the swap rate to the same date (negative EFP), where the rest of the government curve trades at a lower yield than the swap rate. As a result we expect this bond to outperform over the coming week.

	90 day bills	04/13 NZGS	05/21 NZGS	2yr swaps s/a	10yr swaps s/a	2yr/10yr swaps(bps)
9-Jul-10	3.02%	4.24%	5.42%	4.22%	5.40%	118
16-Jul-10	3.23%	4.26%	5.37%	4.19%	5.31%	112
Change (bps)	**21**	**2**	**-5**	**-3**	**-9**	**-6**

The swaps market continued its flattening pressure over the week as the back end of the curve continued its near relentless rally. This was driven by further worries about the offshore recovery and a continued lack of payside interest. This general lack of payers was particularly notable in light of the significant reduction of retail mortgage rates recently. The upcoming week will likely still be dominated by offshore movements, although the upcoming OCR review next week will also be starting to weigh on minds.

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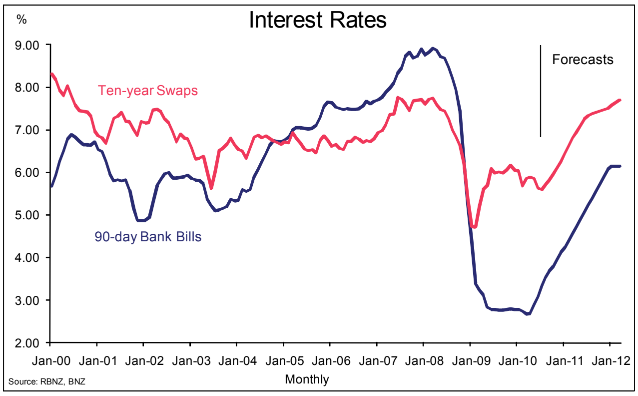

Interest Rate Technicals

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NZD 5yr Swap Rate

Outlook: Lower
MT Resistance: 4.95%
MT Support: 4.53%

The market is trending down towards the target of 4.53%.

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

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

We expect the recent 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 few currencies to lose ground against the otherwise sliding USD last week, as investor risk appetite deteriorated into the end of the week. This is contrary to the previous week where the AUD, CAD and NZD were the best performers. A slightly lower growth rate in China; another batch of weak US data and a cautious Fed minutes undermined investor sentiment despite a week of generally positive US earnings reports. A weak NZ inflation report also took the wind from the sails of the NZD on Friday. The NZD was also undermined by position adjustments after heavy buying seen earlier in the week. With equities faltering sharply on Friday many of these positions unwound with little in the way of fresh buying interest evident despite the relatively large intraday move.

All of the above suggests that investors were put off by the events of last week and appetite for risk currencies has diminished again. The ongoing trail of weak US data and some very cautious words from the Fed has the USD trailing badly in the G3 “ugly sister” contest. The JPY is the "go to" currency at times of heightened risk aversion while the EUR continued to benefit from calming sovereign debt markets in Europe and short covering.

We continue to view the EUR’s recent gains as a position-led move, which has been exaggerated by the break above the 1.27-1.28 area and amid some unsubstantiated discussion of the return of sovereign bids. As such we would expect the EUR to suffer against the JPY and CHF in a risk-averse environment.

The NZD will likely remain at the mercy of investor risk appetite and there are a number of event risks in the coming week that might keep investors sidelined. Bernanke will give testimony about the US economy to US lawmakers on Wednesday while the much awaited results of the EU stress tests on European banks will be released on Friday.

We would expect NZD to find solid resistance now near 0.7180 with a further push lower towards the 0.7000-50 area the greater risk. While there are no big NZ data releases or events this week, there are a number that will give important insight into the economy, at a time when the strength of the recovery is being questioned.

This morning’s BNZ Performance of Services Index followed its PMI cousin higher in June, suggesting there is still a solid-enough growth pulse. As for the rest of the week, local data is limited to June’s tourist arrival numbers, due Wednesday, which should be up around 6% y/y, on much recovered Asian inflows. However, we are not so confident about the month’s net immigration, expecting another soft result, with a risk of a first negative for a long while. Also, keep an eye out for Wednesday afternoon’s credit card billings and the ANZ-Roy Morgan consumer confidence index on Thursday. So, all second-tier stuff meaning major direction will be again coming from offshore.

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Foreign Exchange Technicals

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NZD/USD

Outlook:	Buy a dip
ST Resistance:	0.7150 (ahead of 0.7305)
ST Support:	0.6970 (ahead of 0.6790)

The uptrend over the last week has been emphatically broken. Heavy resistance appeared above 0.7300. This looks like the beginning of a corrective move lower.

NZD/AUD

Outlook:	Consolidation with lower bias.
ST Resistance:	0.8190 (ahead of 0.8260)
ST Support:	0.8110 (ahead of 0.8060)

NZD/AUD encountered heavy resistance above 0.8240 last week. It will take a break of the established ranges for new direction to be found.

Key Upcoming Events

	Forecast	Median	Last
Monday 19 July			
NZ, BNZ PSI (Services), June s.a.			53.3
US, NAHB Housing Index, July		16	17
Tuesday 20 July			
US, Housing Starts, June		580k	593k
Aus, RBA Minutes, 6 July Meeting			
Aus, Stevens Speaks, The Financial Crisis			
Germ, PPI, June y/y		+1.1%	+0.9%
Can, BOC Policy Announcement			0.50%
Wednesday 21 July			
NZ, Credit Card Billings, June			+1.9%
NZ, External Migration, June s.a.			+250
US, Bernanke Testifies, Six-monthly			
Aus, Westpac Leading Index, May			flat
UK, BOE Minutes, 7/8 Jul Meeting			
Jpn, BOJ Minutes, 14/15 Jun Meeting			

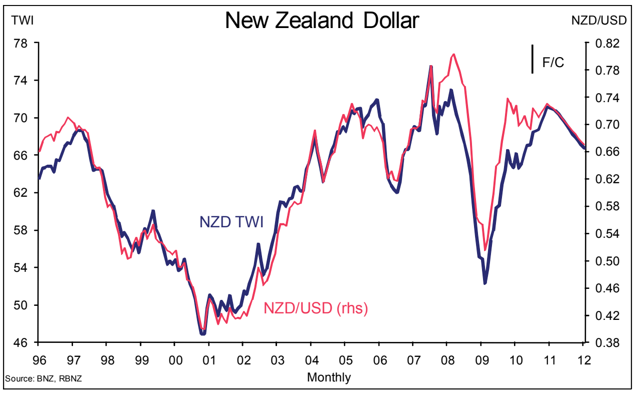
	Forecast	Median	Last
Thursday 22 July			
NZ, ANZ-RM Consumer Confidence, July			122.0
US, Leading Indicator, June		-0.3%	+0.4%
US, Existing Home Sales, June		5.10m	5.66m
US, Bernanke Testifies, Six-monthly 2nd day			
US, Jobless Claims, week ended 14/07		445k	429k
Aus, NAB Business Survey, Q2			
UK, Retail Sales vol., June		+0.5%	+0.6%
Jpn, All Industry Index, May		-0.4%	+1.8%
Euro, PMI Services, July 1st est		55.0	55.4
Euro, Industrial Orders, May		-0.1%	+0.6%
Euro, PMI Manufacturing, July 1st est		55.1	55.6
Can, BOC Qtly Policy Report			
Friday 23 July			
Aus, Terms of Trade, Q2		+11.0%	+3.5%
UK, BBA Home Loans, June		37.0k	36.7k
UK, GDP, Q2 1st est		+0.6%	+0.3%
Germ, IFO Index, July		101.5	101.8

Historical Data

	Today	Week Ago	Month Ago	Year Ago
CASH & BANK BILLS				
Call	2.75	2.75	2.75	2.50
1 mth	2.97	2.92	2.90	2.77
2 mth	3.09	3.02	3.00	2.79
3 mth	3.24	3.22	3.05	2.76
6 mth	3.45	3.42	3.37	2.82
GOVERNMENT STOCK				
11/11	3.75	3.75	3.77	3.90
04/13	4.25	4.24	4.37	4.90
04/15	4.70	4.71	4.84	5.54
12/17	5.11	5.18	5.29	6.06
05/21	5.36	5.42	6.53	-
CORPORATE BONDS				
BNZ 09/10	3.66	3.62	3.63	4.30
BNZ 05/15	6.29	6.39	6.43	7.40
GEN 03/14	6.05	6.14	6.28	7.19
GEN 03/16	6.50	6.60	6.83	7.98
TRP 12/10	4.05	3.99	4.03	4.65
TRP 06/20	6.63	6.95	6.82	7.93
SWAP RATES				
2 years	4.17	4.22	4.31	3.92
3 years	4.43	4.51	4.63	4.67
5 years	4.78	4.88	5.05	5.42
10 years	5.30	5.40	5.60	6.20

	Today	Week Ago	Month Ago	Year Ago
FOREIGN EXCHANGE				
NZD/USD	0.7084	0.7105	0.7111	0.6426
NZD/AUD	0.8174	0.8097	0.8068	0.7983
NZD/JPY	61.33	62.9800	64.25	61.82
NZD/EUR	0.5494	0.5619	0.5718	0.4605
NZD/GBP	0.4632	0.4718	0.4787	0.3893
NZD/CAD	0.7490	0.7332	0.7249	0.7294
TWI	66.80	67.49	68.06	60.78

NZD Outlook



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