27 September 2010

Strained Tea Leaves

- Thursday's business survey a post-quake pointer
- Can it withstand the negatives, overall?
- Second-tier August data also due, likely mixed
- As we soften our Q3 GDP growth estimate to 0.6%
- Still, we forecast stronger growth for 2011

Last week's Q2 GDP report queried the degree of momentum in the economy. We weren't expecting much, but saw even less. Sure, there was largely-predictable damage from the early-2010 drought, an associated eating into inventories and an odd-looking plunge in phone-call minutes. However, these were not to deny the underlying economic pulse was muted and thus a bit worrying.

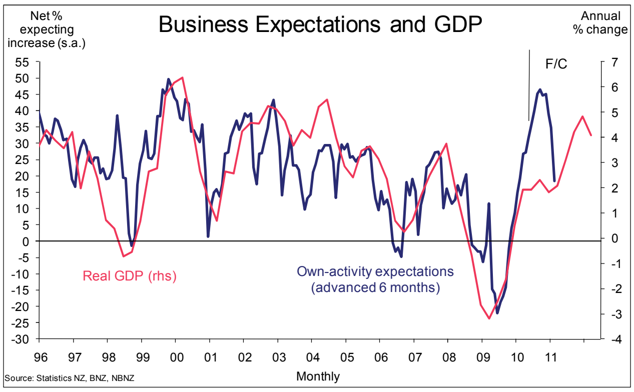
With this, every little bit of information will now be pored over more intently, amid fears the economy might be going flat altogether. For the record, we don't think it is. Well, not fundamentally anyway. Indeed, we still believe growth will pick up to a reasonable, even strong, pace through next year, albeit with the economy battling some material headwinds for the meantime.

As for this week's handful of economic indicators, the most closely watched will no doubt be Thursday afternoon's NBNZ business survey. How is New Zealand's business community seeing the way ahead, especially post the Canterbury earthquake? While there are obvious negatives bearing down on confidence and near-term activity, there are also medium-term positives to factor in (and not just in respect to the construction industry). Our gut feel is that the negatives will probably outweigh the positives in this survey.

Then again, who's to really know the way ahead? Earlier this year the NBNZ survey was signalling a veritable boom in activity was about to ensue. Try 6% growth. This clearly isn't transpiring. It's a reminder that the business sector has been as guilty as any in over-predicting the recovery.

Over more recent months, of course, the business sector's view has been cooling, with August's NBNZ survey readings essentially completing their move back to "average" in respect to economic growth expectations. So which way September?

And while we have taken a relatively conservative approach to the recovery process all along, we have certainly needed to tone down our growth expectations for this year as well. In the wake of last week's downbeat Q2 GDP details, we have specifically scaled back our Q3 growth estimate to 0.6% (while leaving Q4 at 0.5%).



As for whether this sort of pace is in the ball-park, we'll get a few testers this week.

We expect Wednesday's merchandise trade figures for August, for instance, to look reasonable enough with both exports and imports expected to be up 18% on last year's suppressed levels. However, such results would deliver a monthly deficit of $846m, cementing stalled improvements in the trade balance, as part of the increasing trend we believe the current account deficit is on.

For Wednesday afternoon's credit aggregates, there might be a glimmer of expansion, again, in mortgages. But consumer credit and business and rural loans probably struggled to stand still in August. What's not obvious is why. If it reflects wanton de-leveraging, then this should be seen as a very good thing, real progress of a sort. However, if the soggy credit numbers reflect a lack of demand for funds, then they should be taken in a negative light. We believe a bit of both is at play.

The backdrop to Thursday morning's building consents is that July's residential numbers only looked reasonable (+3.2%, seasonally adjusted) because of a flush of apartments. Excluding these, the trend was flattening right off, at a sub-standard level. This does not auger well for August's consents, although we do have our fingers crossed for a slight further increase.

As for non-residential consents, we don't suppose their encouraging flutter of July can keep going in August, meaning the downtrend through 2010 to date will look even more obvious.

But then along came the Canterbury earthquake, which surely altered the path of New Zealand's construction sector. Then again, most everything else has been buffeted, this way and that, in the economy at large. The recently appalling weather in Southland is but another example, which will restrain agriculture production.

The near-term indicators are promising to be even more problematic to interpret, in other words. It wasn't so long ago we thought it would mainly be this week's (1 October) GST rise and personal tax cuts that would cause the "noise". Oh for it to be that straightforward.

Nevertheless, we should at least be clear about our medium-term prognosis for the economy. And on this we still see good reason to be relatively positive. Indeed, growth potential for calendar 2011 might be getting legs from the very obstacles and delays the economy is working its way through at the moment. Strained as the recent tea leaves have become, they do not portend the end of the recovery.

craig_ebert@bnz.co.nz

Domestic Interest Rates

Reuters pgs BNZL BNZM

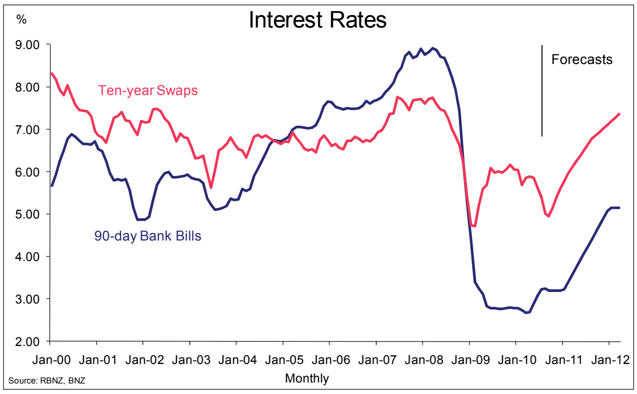
New Zealand interest rates posted another rally last week despite a sell off in rates abroad, namely Australia. A significantly weak GDP print well below market expectations saw yields fall about 10 bps on the week, the market pricing out any chance of a hike by the years end, and only 19 bps of tightening priced until March next year. With yields at or near their lows, the risk at present is that too little is now priced into the curve and tightening cycle going forward.

The bond market has performed well, longer dated bonds finally out performing equivalent swap yields bringing EFP inward from previously extreme levels. Kiwi bonds out performed relative to our Australian counterparts, as their rates saw a sizeable sell off with the RBA back in play. Kiwi bonds have seen good investor demand after the weak GDP figure. A fairly well bid tender saw the market soak up the 450m of bonds on offer. There's a chance that the DMO may issue a new 2019 bond in this week's tender.

	90 day bills	04/13 NZGS	05/21 NZGS	2yr swaps s/a	10yr swaps s/a	2yr/10yr swaps(bps)
17-Sep-10	3.17%	4.05%	5.28%	3.80%	5.00%	120
17-Sep-10	3.18%	3.91%	5.14%	3.71%	4.90%	119
Change (bps)	**1**	**-14**	**-15**	**-9**	**-10**	**-1**

The swaps market has been fairly subdued following much of the aforementioned on very light volume. With the RBNZ on hold, there has been very little interest in fixed rate paying. The gradual move lower was accentuated with the weaker than expected GDP print. The curve movement has been relatively small; the spread between 2 year and 10 year has flattened a touch to 119bps. From a technical perspective 2 year swap looks like there's good support around the 3.70% level.

james_d_chin@bnz.co.nz



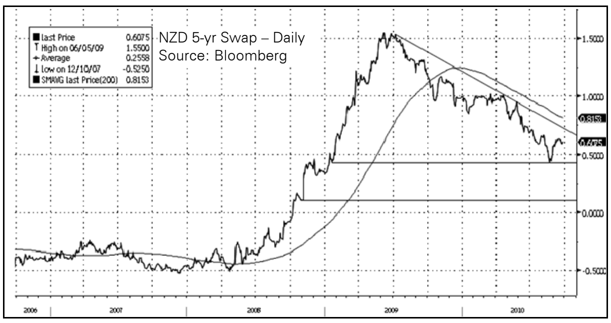
Interest Rate Technicals

pete_mason@bnz.co.nz

NZD 5yr Swap Rate

Outlook: Neutral
MT Resistance: 4.45%
MT Support: 4.06%

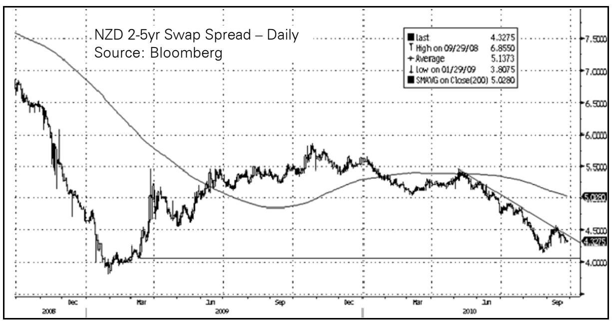
Market is staying below downward sloping resistance now coming in at 4.45%. Look for break of range before taking a position.



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

Outlook: Rangebound
MT Resistance: +73
MT Support: +10

Market rejected near term support at +42. Look for a range trade between +42 and downward sloping resistance now coming in at +73. A break of either of these lines will give us the next move.



Foreign Exchange Market

The NZD/USD climbed to an 8-month high above 0.7400 last week. But it was hardly an inspiring performance. More evidence of a lacklustre NZ economic recovery ensured the NZD fell against all of the other majors. Indeed, on a trade-weighted basis, the currency ended the week down 0.5%.

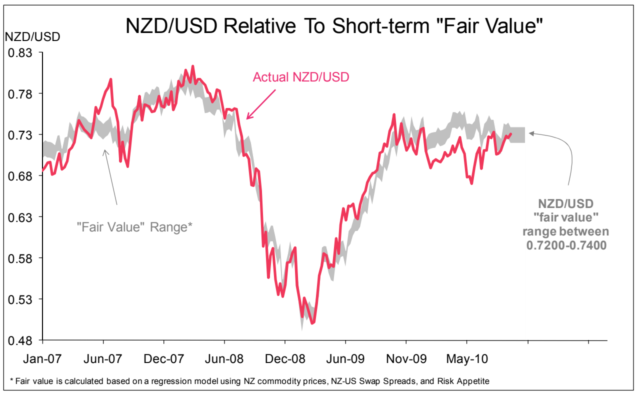
Last week's data provided further confirmation, if any more was needed, that the NZ recovery is a slow and bumpy one. Not only did the annual current account deficit increase from 2.4% of GDP to 3.0% in Q2, but June's meagre 0.2% GDP expansion undershot market and RBNZ expectations by a clear margin.

Despite this, the up-thrust from a broad-based weakening in the USD ensured the NZD/USD spent most of the week on the ascendancy. Indeed, US markets' growing expectation the Fed will usher in a fresh round of quantitative easing saw the USD slide to 7-month lows last week.

Looking ahead, this week's mostly second tier data offering looks set to continue the recent dreary tone. Perhaps the most important release for the week will be Thursday afternoon's NBNZ business survey. On balance, our gut feel is businesses' optimism will ease a bit further.

So the domestic picture should remain a drag on the NZD/USD this week. However, we suspect a supportive global backdrop will limit any dips to the 0.7200 region. Not only is USD sentiment in the doldrums, but investors' risk appetite finished last week on a buoyant note. The MSCI World Equity Index recorded its fourth straight weekly gain and our risk appetite index (which has a scale of 0-100%) jumped from 51.5% to 57.5% on Friday. Appetite for "growth-sensitive" currencies like the NZD/USD is likely to remain solid early in the week as a result.

Our short-term valuation model currently implies a NZD/USD "fair-value" range of 0.7200-0.7400. We suspect the NZD/USD will spend most of the week trading within this range.



mike_s_jones@bnz.co.nz

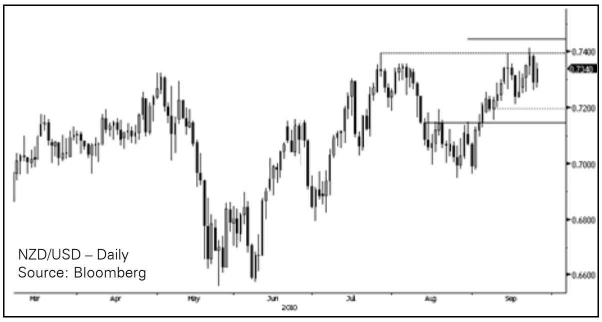
Foreign Exchange Technicals

mike_s_jones@bnz.co.nz

NZD/USD

Outlook: Consolidation
ST Resistance: 0.7395 (ahead of 0.7445)
ST Support: 0.7200 (ahead of 0.7145)

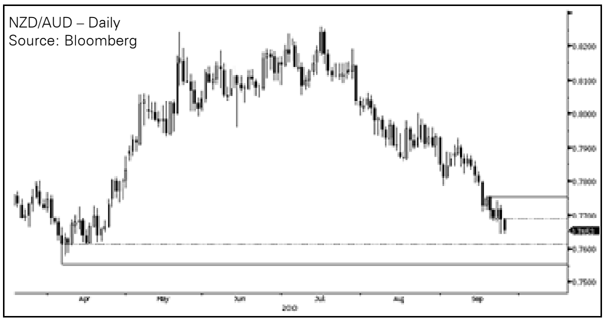
Repeated failures to sustain rallies towards 0.7395 suggest the uptrend is running out of steam, but momentum will remain positive while 0.7200 holds.



NZD/AUD

Outlook: Sell a rally
ST Resistance: 0.7690 (ahead of 0.7755)
ST Support: 0.7615 (ahead of 0.7555)

The downtrend remains intact and we look for further downside in the short-term. However, with the daily RSI close to "oversold" levels we'd expect 0.7615 support to hold near-term.



Key Upcoming Events

	Forecast	Median	Last
Monday 27 September			
Jpn, Merchandise Trade Balance, August		+Y522b	+Y610b
Euro, M3, August y/y		+0.3%	+0.2%
Tuesday 28 September			
US, Consumer Confidence, September		52.3	53.5
US, Shiller Home Price Index, July y/y		+3.1%	+4.2%
UK, GDP, Q3 1st est		+1.2%	+1.2%P
UK, CBI Dist Trade Survey, September		+28	+35
Wednesday 29 September			
NZ, Household Credit, August y/y		+2.3%	
NZ, Merchandise Trade, August	-$846m	-$500m	-$186m
Jpn, Tankan (lge manuf), Q3		+7	+1
Euro, Economic Confidence, September		101.3	101.8
Thursday 30 September			
NZ, Building Consents, August (res, #)			+3.1%
NZ, NBNZ Business Survey, September			+16.4
Aus, Building Approvals, August	+1.0%	flat	+2.3%
Aus, Private Sector Credit, August	+0.5%	+0.3%	+0.1%
Aus, Financial Stability Review			
Jpn, Retail Trade, August y/y		+4.7%	+3.8%

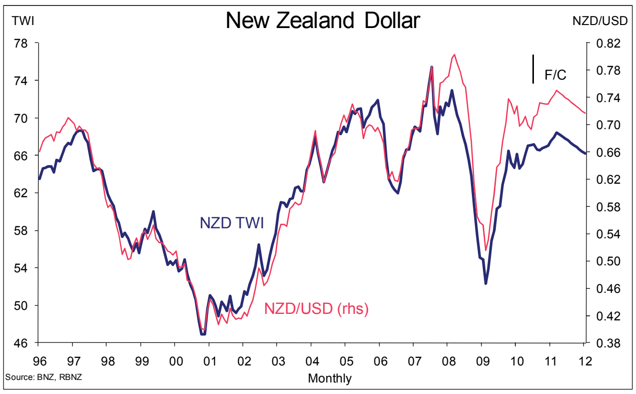
	Forecast	Median	Last
Thursday 30 September *continuted ...*			
Jpn, Industrial Production, August 1st est		+1.1%	-0.2%
US, GDP, Q3 3rd est		+1.6%	+1.6%P
US, Chicago PMI, September		56.0	56.7
UK, BOE Credit Conditions Survey, Q3			
Euro, CPI, Sept y/y 1st est.		+1.8%	+1.6%
Germ, Unemployment, September s.a.		7.6%	7.6%
Friday 1 October			
Jpn, CPI, August y/y		-0.9%	-0.9%
Jpn, Unemployment Rate, August		5.1%	5.2%
China, PMI (NBS), September		52.8	51.7
US, Personal Spending, August		+0.4%	+0.4%
US, ISM Manufacturing, September		54.5	56.3
UK, CIPS Manuf Survey, September		53.8	54.3
US, Construction Spending, August		-0.4%	-1.0%
Euro, Unemployment Rate, August		10.0%	10.0%
Germ, Retail Sales, August		+0.4%	-0.1%
Sunday 3 October			
China, Non-manufacturing PMI, September			60.1

Historical Data

	Today	Week Ago	Month Ago	Year Ago
CASH & BANK BILLS				
Call	3.00	3.00	3.00	3.00
1 mth	3.12	3.12	3.09	3.14
2 mth	3.17	3.20	3.20	3.23
3 mth	3.16	3.15	3.24	3.28
6 mth	3.22	3.24	3.32	3.34
GOVERNMENT STOCK				
11/11	3.53	3.63	3.58	3.90
04/13	3.92	4.05	3.98	4.90
04/15	4.42	4.56	4.43	5.54
12/17	4.87	5.01	4.83	6.06
05/21	5.15	5.28	6.53	-
CORPORATE BONDS				
BNZ 05/13	5.05	5.10	5.05	-
BNZ 09/16	6.09	6.18	6.00	-
FON 04/14	5.56	5.65	5.58	-
FON 03/16	6.09	6.18	6.08	-
GEN 03/14	5.54	5.63	5.53	7.19
GEN 03/16	6.15	6.23	6.06	7.98
TRP 06/20	6.29	6.39	6.24	7.93
SWAP RATES			-	
2 years	3.72	3.80	3.79	3.92
3 years	3.95	4.04	3.98	4.67
5 years	4.32	4.42	4.28	5.42
10 years	4.91	5.00	4.85	6.20

	Today	Week Ago	Month Ago	Year Ago
FOREIGN EXCHANGE				
NZD/USD	0.7353	0.7266	0.7120	0.6426
NZD/AUD	0.7643	0.7739	0.7898	0.7983
NZD/JPY	62.00	62.29	60.76	61.82
NZD/EUR	0.5452	0.5567	0.5576	0.4605
NZD/GBP	0.4646	0.4640	0.4582	0.3893
NZD/CAD	0.7532	0.7496	0.7472	0.7294
TWI	66.54	66.93	66.56	60.78

NZD Outlook



Contact Details

BNZ Research

Stephen Toplis
Head of Research
+(64 4) 474 6905

Craig Ebert
Senior Economist
+(64 4) 474 6799

Doug Steel
Economist
+(64 4) 474 6923

Mike Jones
Strategist
+(64 4) 472 4767

Main Offices

Wellington
60 Waterloo Quay
Private Bag 39806
Wellington Mail Centre
Lower Hutt 5045
New Zealand
Phone: +(64 4) 474 6145
FI: 0800 283 269
Fax: +(64 4) 474 6266

Auckland
80 Queen Street
Private Bag 92208
Auckland 1142
New Zealand
Phone: +(64 9) 976 5762
Toll Free: 0800 081 167

Christchurch
129 Hereford Street
PO Box 1461
Christchurch 8140
New Zealand
Phone: +(64 3) 353 2219
Toll Free: 0800 854 854

National Australia Bank

Peter Jolly
Head of Research
+(61 2) 9237 1406

Alan Oster
Group Chief Economist
+(61 3) 8634 2927

Rob Henderson
Chief Economist, Markets
+(61 2) 9237 1836

John Kyriakopoulos
Currency Strategist
+(61 2) 9237 1903

Wellington
Foreign Exchange +800 642 222
Fixed Income/Derivatives +800 283 269

Sydney
Foreign Exchange +800 9295 1100
Fixed Income/Derivatives +(61 2) 9295 1166

London
Foreign Exchange +800 333 00 333
Fixed Income/Derivatives +(44 20) 7796 4761

New York
Foreign Exchange +1 800 125 602
Fixed Income/Derivatives +1877 377 5480

Hong Kong
Foreign Exchange +(85 2) 2526 5891
Fixed Income/Derivatives +(85 2) 2526 5891

24 HOUR FOREIGN EXCHANGE SERVICE

Phone Toll Free	6am to 10pm NZT – Wellington Office
0800 739 707	10pm to 6am NZT – London Office – Sam Hehir