

### This Week

The RBNZ surprised markets with its acknowledgement that the OCR may not have to be increased as steadily and by as much as it had been expecting at the June MPS. While there had been discussion in the markets of the possibility of a pause sometime in the cycle, given recent data have not lived up to RBNZ's optimistic forecasts, few had expected the July statement would include explicit reference to the "pace and extent of further OCR increases". To the extent the June MPS had implied the OCR would eventually reach 5.75%, the downward revisions now make its forecasts more realistic. Our core expectation remains for the RBNZ to steadily increase the OCR to 5%, but we acknowledge there is now a greater risk of a pause at some point in the cycle.

Indeed, the RBNZ reiterated the fact that it is still firmly in tightening bias given "the level of the OCR is still very supportive of economic activity". Despite some pockets of weakness, overall economic activity is recovering at a sustainable pace. In particular, the latest trade data showed ongoing trade surpluses and surprising strength in export receipts are a testament to the export-led recovery taking place. Furthermore, inflationary pressures are expected to lift in line with increased economic activity, added to which are a raft of Government policy changes which we expect will boost annual headline CPI to well over 5% by mid-2011.

Nonetheless, upcoming data will be useful in determining whether the activity outlook will be weak enough to trigger a pause from the RBNZ. The array of labour market data this week will be a key indicator of whether the economy is on track to a sustainable recovery. Recent business surveys suggest businesses are now confident enough about the recovery to put in place expansion plans, which include hiring more staff. Labour market data are important given the influence of employment prospects on household spending. Over the past two quarters, large changes in the unemployment rate have led markets to make substantial reassessments of the state of the labour market and the health of the NZ economy more generally. We expect a 'technical rebound' in the unemployment rate in Q2 to 6.3%. However, looking past the quarterly volatility we expect unemployment to trend lower, reflecting ongoing recovery in employment.

Across the Tasman, markets have also pared back pricing of policy rate increases in light of the Australian CPI coming in below market expectations. However, it is important to note that the result was actually broadly in line with the RBA's forecasts. The RBA rate announcement this Tuesday will shed further insight into the central bank's take on the economic and inflation outlook for the Australian economy. Both central banks have indicated a tightening bias remains appropriate in order to keep upcoming inflation pressures in check. The key question for the RBNZ is whether there will be enough weakness along the way which will derail their plans for a steady pace of OCR increases.

### Click here for:

[Foreign Exchange](#)

- NZD declines against all major crosses, following a mixed week.

[Interest Rates](#)

- Interest rates fall after RBNZ signals more gradual increase in OCR likely.

[Week Ahead](#)

- Wage growth to remain subdued, employment to improve for second quarter.

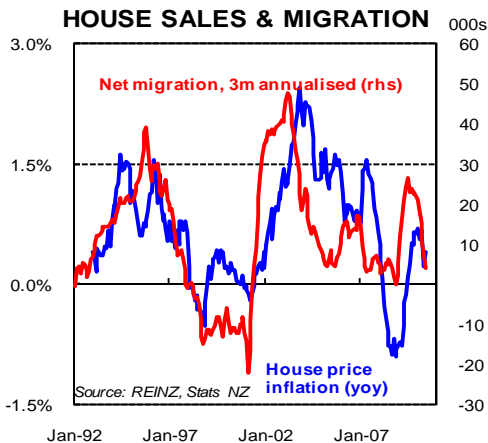
[Week in Review](#)

- RBNZ lifts OCR, another trade surplus in June, consent issuance weak.

[Global Calendars](#)

- RBA rate announcement, US ISM manufacturing and US Non-farm Payrolls.

### Chart of the week



- The RBNZ highlighted in its July statement the recent slowing in net immigration and its expected effects on household spending. This slowing reflected both a decline in new arrivals and a pick up in departures.
- The slowing pace of net immigration means slower population growth, which in turn reduces support for housing demand.
- As a result, we expect house prices to ease over the second half of 2010. House prices have held up through the first half of 2010 surprisingly well despite waning demand, reflecting the offsetting impact from the current low level of listings on the market.
- However, there are signs that the number of listings is starting to pick up. The rising supply of unsold houses is expected to place downward pressure on house prices.

### General Advice Warning

As this report was prepared without taking into account your objectives, financial situation or particular needs, you should not take any action in reliance of this report without considering your particular circumstances and, if necessary, obtaining professional advice.

## Foreign Exchange Market

FX Rates	Current*	Week ago	Month ago	6 mths ago	Year ago	ST Bias	Support^	Resistance^
NZD/USD	0.7269	0.7276	0.6940	0.7006	0.6569	FLAT	0.7200	0.7350
NZD/AUD	0.8026	0.8131	0.8185	0.7944	0.7921	FLAT	0.7950	0.8050
NZD/JPY	62.82	63.69	61.02	63.12	62.64	FLAT	62.50	63.50
NZD/EUR	0.5567	0.5629	0.5544	0.5053	0.4648	FLAT	0.5550	0.5650
NZD/GBP	0.4631	0.4711	0.4572	0.4395	0.3969	FLAT	0.4600	0.4700
TWI	67.5	68.1	66.5	64.7	61.4	FLAT	67.25	68.25

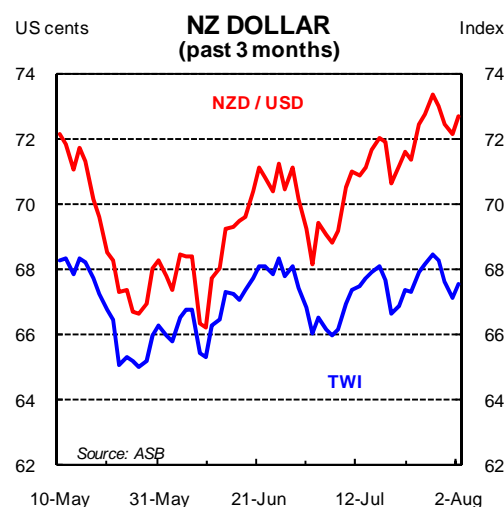
^Weekly support and resistance levels \* Current is as at 10.35 am Monday; week ago as at Monday 5pm

- The NZD finished lower against all the major crosses, following a mixed week.
- The NZD started the week off strongly against the USD, riding high on strong offshore sentiment following upbeat US Q2 earnings results. However, the kiwi started to lose ground from Wednesday as the gains in offshore equity markets started to slow. The NZD then dropped sharply following the RBNZ's OCR announcement as the statement had a softer tone than expected. In addition, the RBNZ attempted to explicitly jawbone the NZD lower, suggesting the recent strength in the NZD was 'inconsistent' with commodity prices and the NZ economic outlook.
- The NZD also had a mixed week against the AUD, briefly lifting against the AUD following the weaker than expected Australian CPI. However, the appreciation was short-lived, with the NZD taking a dive following the RBNZ's OCR announcement.
- We have a relatively neutral outlook for the NZD this week. There is scope for the NZD to drift higher over the first part of the week, although direction will largely remain dependent on offshore sentiment. The key data events are the RBA announcement on Tuesday and the NZ unemployment rate on Thursday. The labour market data could bring confusion in the market, with employment rising, but unemployment rate also increasing on a technical correction. With a market currently over-sensitive to negative news, a sharper than expected increase may trigger some over-reaction.

### Short-term outlook:

Key data	Date	Time (NZST)	Market expects
Labour Cost Index	3/8	10.45 am	+0.4
Quarterly Employment Survey	3/8	10.45 am	+0.6
Unemployment Rate	5/8	10.45 am	6.4%

**Potential currency movers from offshore this week:** AU retail sales, AU building approvals, RBA Cash Rate announcement, US personal income, US factory orders, US pending home sales (3<sup>rd</sup>); AU trade balance, EU and UK PMI services, US ISM non-manufacturing, US ADP employment (4<sup>th</sup>); BOE and ECB rate announcement (5<sup>th</sup>); AU Quarterly Monetary Policy Statement, UK industrial production, US non-farm payrolls (6<sup>th</sup>).



### Medium-term outlook: [\[Last Quarterly Economic Forecasts\]](#)

- The momentum in the US economy appears to have slowed recently and, given the current sensitivity of the US dollar to bad economic news, we see downside risks to the USD in the short term.
- We expect the USD will gain support in later in the year and over 2011. Despite the current soft patch, we believe the US economic outlook will continue to improve. We expect that US bond yields will eventually adjust higher reflecting the firmer US economy. As a result, the higher US bond yields will support the USD. The opposite is happening in mid-2010 - yields are falling - after a period of rising bond yields since early 2009. Importantly, the AAA-rated US bond market remains the major alternative to the Eurozone government bond market.
- We have revised down our EUR forecasts four times this year. Eurozone GDP growth is expected to under perform the US economy over 2010 and 2011. The deterioration in the EU growth outlook will see the differential between US and Eurozone interest rates widen, reducing support for the euro. In addition, more than half of Eurozone government debt is no longer AAA rated, with uncertainty continuing to cloud the outlook and reducing investor appetite.
- We continue to see support for the NZD coming from strong commodity prices and the RBNZ tightening cycle. In addition, NZ's relatively healthier outlook for net government debt will make the NZD look favourable relative to European and US peers.
- Relative to the AUD, the NZD has already made up quite a bit of ground. The NZD is likely to continue to modestly outperform the AUD as the RBNZ continues to lift rates and the interest rate differential narrows slightly.

## Interest Rate Market

Wholesale interest rates	Current	Week ago	Month ago	6 mths ago	Year ago	ST Bias
Cash rate	3.00	2.75	2.75	2.50	3.00	FLAT
90-day bank bill	3.28	3.28	3.18	2.75	3.28	FLAT
2-year swap	4.01	4.27	4.19	4.44	4.01	FLAT
5-year swap	4.67	4.86	4.89	5.37	4.67	FLAT
5-year benchmark gov't stock	4.64	4.77	4.73	5.20	4.64	FLAT
NZSX 50	3035	3021	2938	3151	3035	FLAT

\* Current is as at 10.35 am Monday; week ago as at Tuesday 5pm. Please note that we have recently changed the NZ gov't 5-year benchmark bond to April 2015 maturity (from April 2013). This does cause some distortion in the comparison against the previous levels (i.e. month ago).

- NZ interest rates fell across the curve over the week, following a softer tone from the RBNZ and weaker than expected Australian CPI.
- The RBNZ increased the OCR to 3% as expected. However, the RBNZ also noted that “the pace and extent of further OCR increases is likely to be more moderate than was projected in the June Statement.” Swap rates immediately declined following the release, as the market moved to price in a greater likelihood on a pause later in the year. We continue to expect the RBNZ to steadily increase the OCR at each meeting over the next year. While we acknowledge the growing risk of a pause, we continue to see upside risk to the RBNZ’s inflation outlook.
- Prior to the RBNZ decision on Thursday morning, NZ interest rates were already under pressure following the weaker than expected Q2 Australian CPI result. The Australian market promptly reduced the pricing for another rate hike this year, despite the CPI being in line with RBA expectations.

### Short-term outlook:

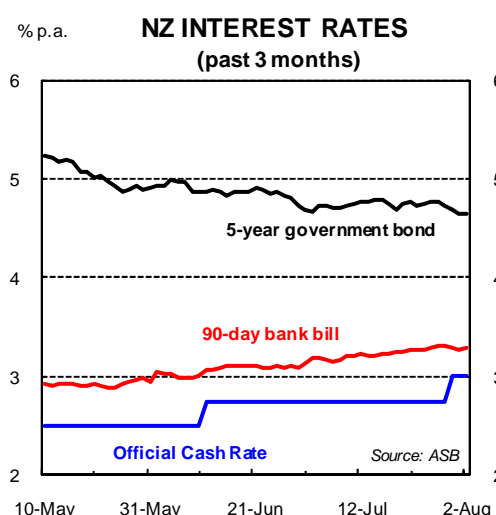
Key data	Date	Time (NZST)	Market expects
Labour Cost Index	3/8	10.45 am	+0.4%
Quarterly Employment Survey	3/8	10.45 am	+0.6%
RBA Rate Announcement	3/8	4.30 pm	4.5%
Unemployment Rate	5/8	10.45 am	6.4%

**Comment:** The focus of the local market will be on Thursday’s Household Labour Force Survey. The market is expecting a technical correction in the unemployment rate. However, we note there are risks for even greater payback (see preview next page) and a higher unemployment rate may knock an already downbeat market.

Tuesday’s RBA rate decision will also be on the radar. Following the weaker than expected CPI, the market sees a rate hike as unlikely over the next few months.

### Medium term outlook: [Last Quarterly Economic Forecasts](#)

- The RBNZ continues to remove monetary policy stimulus, with a second 25 basis point OCR increase in July. In addition, the RBNZ indicated it will look to continue to increase the OCR over the coming year as economic and financial market conditions allow.
- The RBNZ noted the outlook for economic growth had softened since its June forecasts. In particular, it noted the outlook for trading partner growth had deteriorated, commodity prices had moderated, and net migration was slowing.
- Reflecting the weaker growth outlook, the RBNZ stated that “the pace and extent of further OCR increases is likely to be more moderate than was projected in the June Statement.” It pays to bear in mind that the RBNZ did previously have a cash rate of 5.75% implied in its 90-day forecasts. Given ongoing funding costs, we never saw a peak this high as realistic. Nonetheless, the tone of the July statement does bring into question when and if the RBNZ will pause during the hiking cycle.
- The RBNZ forecasts headline CPI inflation to peak at 5.3% in June 2011, boosted by a raft of Government policy changes including tobacco excise tax, the implementation of the Emissions Trading Scheme and increase in GST to 15%. We expect these changes will boost headline inflation to well over 5%, and hence pose upside risks to the RBNZ’s key assumption that medium-term inflation expectations will remain anchored.
- We expect that the OCR will be increased by 25bp at each meeting until the OCR reaches 5%. While we acknowledge there is risk of a pause sometime this year, as the market has factored in, we remain wary of the upside risks to the RBNZ’s inflation forecast. In our view, data over the next few months will need to be weaker, particularly around inflation pressures, to warrant a pause later this year.



## NZ Data Preview: a look at the week ahead

Data	Date	Time (NZST)	Previous	Market expects	ASB expects
Q2 Labour Cost Index qoq	3/8	10.45am	+0.3%	+0.4%	+0.4%
Q2 Quarterly Employment Survey hourly earnings	3/8	10.45am	-0.4%	+0.7%	+0.5%
Q2 Household Labour Force Survey - unemployment	5/8	10.45am	6.0%	6.4%	6.3%

### Tuesday 3 August

#### Q2 Labour Cost Index and Quarterly Employment Survey

##### Labour Cost Index (all sectors, ordinary time, qoq)

Previous: +0.3%, f/c: 0.4%

##### QES Average hourly earnings (private sector, ordinary time, qoq)

Previous: -0.4%, f/c: 0.5%

Wage inflation has been very subdued over the past year, as firms have looked to contain costs during the recession. While we expect wage inflation to start to lift off very low levels in line with the recovering economy, wage inflation pressures will remain relatively weak over 2010 reinforced by above-average unemployment and a moderate rate of inflation.

We expect the Labour Cost Index to lift 0.4% over the June quarter, which will see the annual pace of growth of 1.4%. The corresponding QES measure tends to be more volatile as it does not adjust for compositional shifts. Nonetheless, we expect it to show annual earnings growth slowing to 1.3% over the June quarter from 1.6%.

### Thursday 5 August

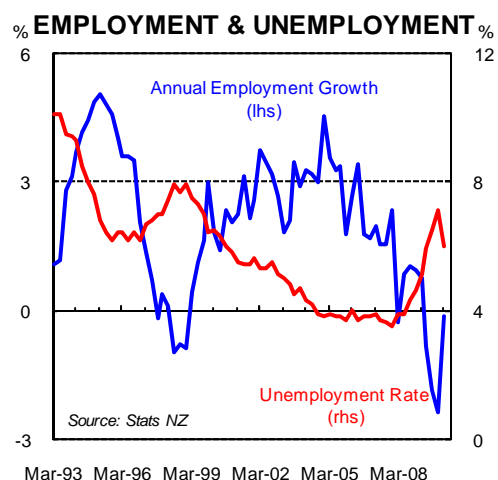
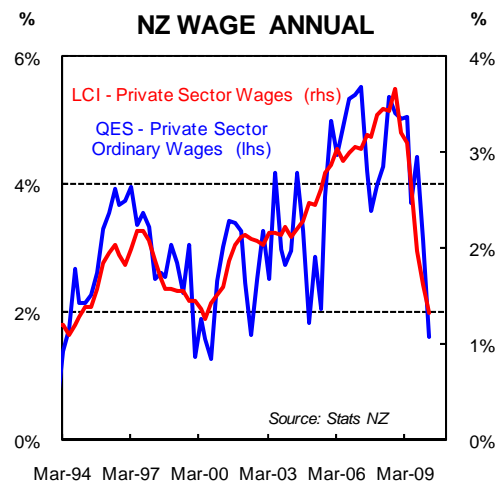
#### Q2 Household Labour Force Survey

##### Unemployment Rate:

Previous: 6.0%, f/c: 6.3%

With the economic recovery now gathering momentum, labour demand is now also recovering. Employment recovered strongly over the first quarter of 2010, rising 1%, while hours worked also lifted strongly, up 1.7%. We expect this recovery to continue, and anticipate employment growth of 0.4% over the June quarter.

The unemployment rate has been exceptionally volatile over recent quarters, and has not been a reliable gauge on the underlying state of the labour market. In the previous quarter, the unemployment rate fell sharply to 6% from 7.1%. In the June quarter, we are expecting some 'technical correction' in the unemployment rate, to 6.3%. There is some upside risk to this number, given the scope for a large rebound in labour participation. Looking past the recent volatility, we continue to expect unemployment to trend lower over the coming year.



## NZ Data Review: weekly recap

### July NBBO

While there was a broad-based decline in business confidence in the July month, the results are not as weak as the decline in headline business confidence suggest. Headline business confidence fell to 27.9 (from 40.2 in the previous month), but firms' assessment of their own conditions remained relatively resilient at 32.4 (38.5 previously). Both measures are well above the long-term average, and the level of own activity still suggests a reasonably healthy quarterly increase in GDP in Q3.

The easing in business confidence is likely to have been driven by constrained profitability, with another decline in the proportion of businesses reporting an increase in profitability. Furthermore, investment and hiring intentions eased in July. Nonetheless, given a net proportion of businesses are still indicating they are looking to increase investment and staff numbers we continue to expect a recovery in business investment and employment over the coming year.

Inflation indicators were mixed, with a smaller proportion of businesses indicating they would raise prices, while inflation expectations continued to edge up to 3.2%.

### RBNZ OCR Announcement

The RBNZ increased the OCR by 25 basis points to 3%, as expected. However, the RBNZ flagged the likelihood of a more gradual tightening cycle than implied by its June MPS.

Given the economic recovery remains intact and "inflation pressures are expected to pick up", the RBNZ see some further removal of monetary policy stimulus is appropriate. However, given the growth outlook has softened relative to the RBNZ's previous forecasts, it has questioned the pace and extent of these increases.

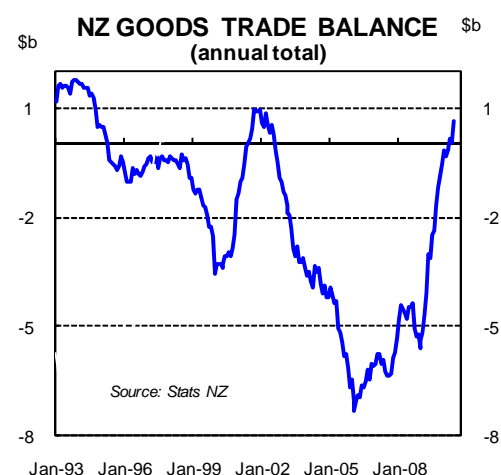
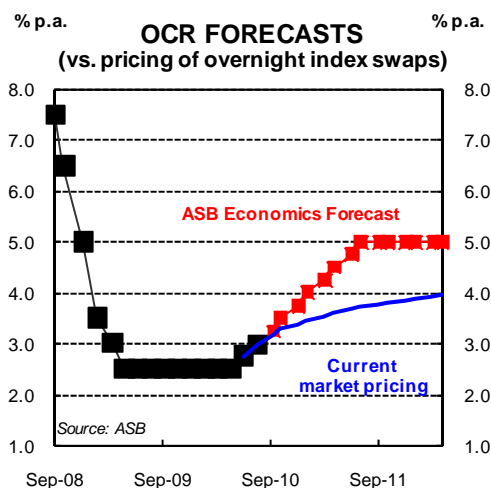
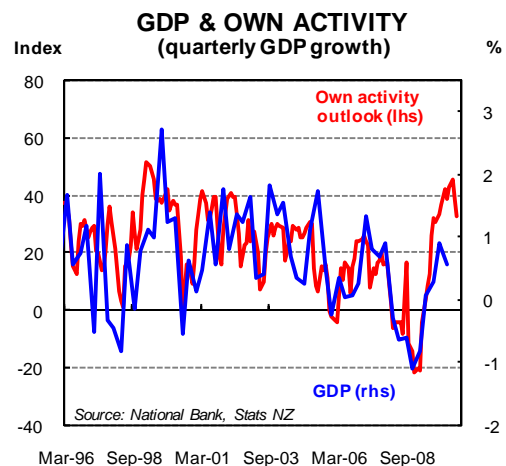
Whether or not economic data soften further prior to the RBNZ reassessing the stubbornness of future inflation will be one key factor in determining if there is a pause.

### June Trade Balance

The June trade surplus was slightly softer than the market expected, at \$276 million. Nonetheless, the trade balance has performed strongly over the past 3 months, with a seasonally-adjusted surplus of \$389 million recorded.

Export receipts lifted 6.8% over the quarter (seasonally adjusted) with a 17% increase in dairy export receipts accounting for half of the increase. Most of the increase in dairy returns was due to higher prices, reflecting a tight global trade market over this period. Dairy prices have since moderated as supply issues have alleviated, but nonetheless remain at strong levels.

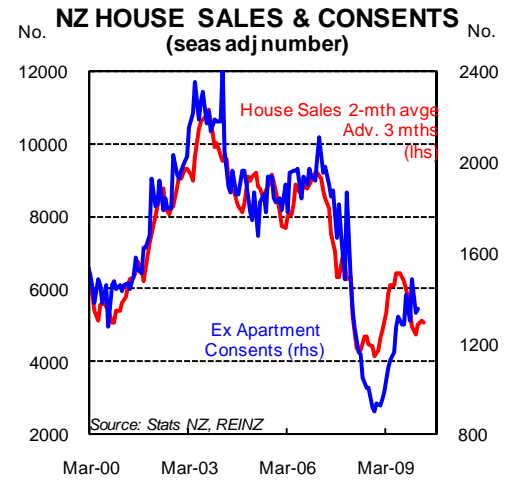
Ongoing trade surpluses and the surprising strength in export receipts are a testament to the export-led recovery taking place. While stronger dairy prices was a key driver for the June quarter's strength, it was encouraging to see the strength in seasonally-adjusted exports was relatively broad based with dairy, meat, forestry and manufacturing all performing well over the quarter.



### June Building Consents

Dwelling consent issuance remained very weak in June, just lifting 3.5% following a 9.5% decline in the previous month. Excluding the more volatile apartment component, core consent issuance remains extremely subdued, lifting just 1.7% following the previous month's 10% decline. Demand for housing remains very weak, despite low shorter-term interest rates. In particular, the recent sharp slowdown in net migration and resulting slower population growth will weigh on the outlook for new construction demand.

Non-residential consent issuance fell 21.2% in the June month, to bring it to a decline of 26% relative to a year earlier. There was some rebound in consent issuance for shops and restaurants from the previous month's decline. However, issuance of office buildings remains weak, indicating continued softness in private non-residential construction in the near term. This is in line with recent business surveys, which indicate commercial construction will remain soft over the coming quarters as businesses continue to show some caution over expansion plans.



## Global Data Calendars

Note: Calendar 2 is in UK times. Add 11 hours for NZ times.

### Calendar - Australasia, Japan and China

Date	Time		Event	Period	Unit	Forecast		
	NZT	Econ				Last	Market	ASB/CBA
Mon 2 Aug	~	AU	AU Bank Holiday (NSW, ACT)	~	~	~	~	~
	11.30	AU	Ai Group performance of manufacturing index	Jul	Index	52.9	~	~
	12.30	AU	TD securities inflation	Jul	m%ch y%ch	0.3 3.6	~ ~	~ ~
	13.30	JP	Labor cash earnings	Jun	y%ch	0.1	~	~
	14.30	CH	HSBC manufacturing PMI	Jul	Index	50.4	~	~
	17.00	JP	Vehicle sales	Jun	y%ch	20.6	~	~
Tue 3 Aug	10.45	NZ	LCI Private wages inc overtime	QII	q%ch	0.3	0.4	0.4
	10.45	NZ	LCI Private wages exc overtime	QII	q%ch	0.3	0.4	0.4
	10.45	NZ	QES average hourly earnings	QII	q%ch	-0.4	0.7	0.5
	13.00	CH	Non-manufacturing PMI	Jul	Index	57.4	~	~
	13.30	AU	ANZ Job advertisements	Jul	m%ch	2.7	~	~
	13.30	AU	Retail sales	Jun	m%ch	0.2	0.4	0.4
	13.30	AU	Retail sales ex inflation	QII	q%ch	0.1	0.7	0.4
	13.30	AU	Building approvals	Jun	m%ch y%ch	-6.6 26.6	2.0 16.0	5.0 21.0
	16.30	AU	RBA cash target	Aug	%	4.50	4.50	4.50
Wed 4 Aug	11.30	AU	CBA Ai Group PSI	Jul	Index	48.8	~	~
	13.30	AU	Trade balance	Jun	'000	1,645	1,645	2,000
	13.30	AU	House price index	Jun	q%ch y%ch	4.8 20.0	2.0 17.0	~ ~
	14.30	CH	HSBC services PMI	Jul	Index	55.6	~	~
Thu 5 Aug	10.45	NZ	Unemployment rate	QII	%	6.0	6.4	6.3
	10.45	NZ	Participation rate	QII	%	68.1	68.2	68.2
	10.45	NZ	Employment change	QII	q%ch y%ch	1.1 -0.1	0.4 0.8	0.4 0.8
Fri 6 Aug	17.00	JP	Leading index CI	Jun	Index	98.6	~	~
	17.00	JP	Coincident index CI	Jun	Index	101.2	~	~
	11.30	AU	Ai Group performance of construction index	Jul	Index	46.4	~	~
	13.30	AU	RBA Quarterly Monetary Policy Statement	~	~	~	~	~

## Calendar – North America & Europe

Please note all days and times are UK time, not local release day/times

Date	UK			Period	Unit	Last	Forecast	
	Time	Econ	Event				Market	CBA
Mon 2 Aug	09.00	EZ	PMI manufacturing	Jul	Index	56.5	~	~
	09.00	GE	PMI manufacturing	Jul	Index	56.5	~	~
	09.30	UK	PMI manufacturing	Jul	Index	57.5	~	~
	15.00	US	ISM manufacturing	Jul	Index	56.2	54.2	~
	15.00	US	Construction spending	Jun	m%ch	-0.2	-0.5	~
Tue 3 Aug	10.00	EZ	PPI	Jun	y%ch	3.1	~	~
	13.30	US	Personal income	Jun	m%ch	0.4	0.2	~
	13.30	US	PCE deflator	Jun	y%ch	1.9	~	~
	13.30	US	Factory orders	Jun	%	-1.4	0.5	~
	15.00	US	Pending home sales	Jun	m%ch	-30.0	4.0	~
					y%ch	-15.6	~	~
	22.00	US	Total vehicle sales	Jul	mn	11.1	11.4	~
Wed 4 Aug	08.55	GE	PMI services	Jul	Index	57.3	~	~
	09.00	EZ	PMI services	Jul	Index	56.0	~	~
	09.30	UK	PMI services	Jul	Index	54.4	~	~
	13.15	US	ADP employment change	Jul	'000	13.0	35.0	~
	15.00	US	ISM non-manufacturing	Jul	Index	53.8	53.5	~
Thu 5 Aug	11.00	GE	Factory orders	Jun	m%ch	-0.5	~	~
					y%ch	24.8	~	~
	12.00	UK	BOE announces rates	Aug	%	0.5	0.5	~
	12.45	EZ	ECB announces interest rates	Aug	%	1.0	1.0	~
	13.30	CA	Building permits	Jun	m%c	-10.8	-1.0	~
	13.30	US	Initial jobless and continuing claims	Jul	~	~	~	~
Fri 6 Aug	09.30	UK	PPI Output	Jul	m%ch	-0.3	~	~
	09.30	UK	Industrial production	Jul	m%ch	0.7	~	~
	11.00	GE	Industrial production	Jul	m%ch	2.6	~	~
	12.00	CA	Net change in employment	Jul	'000	93.2	~	~
	13.30	US	Change in non-farm payrolls	Jul	'000	-125	-100	~
	13.30	US	Unemployment rate	Jul	%	9.5	9.6	~
	15.00	CA	Ivey purchasing managers index	Jul	Index	58.9	~	~
	20.00	US	Consumer credit	Jun	\$bn	-9.1	-5.5	~

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