ECONOMICS

3 Aug. 09

Business Weekly

Focusing on the yellow weeds

This Week

As was widely expected the RBNZ kept the OCR unchanged at 2.5% last Thursday. However, the RBNZ made it pretty clear that it still has an easing bias and that further OCR cuts cannot be ruled out. Anything that could be remotely construed as being a green shoot was left out of the statement: instead the statement was all about potential yellow weeds. The statement was crafted so as to avoid triggering a jump in wholesale rates or the NZ dollar, reactions the RBNZ unwittingly caused in March and June.

Most of the statement focused on the weakness in the export sector, particularly the influence of the high NZ dollar. In addition, the RBNZ highlighted the recent green shoots euphoria that has emerged in China and Australia has not reached New Zealand. NZ exporters, being mostly soft commodity exporters, have not benefited from the recent increase in hard commodity prices.

The RBNZ stated that current levels of the NZ dollar and wholesale interest rates are higher than assumed in its forecasts. "The forecast recovery is based on a further easing in financial conditions. If this easing does not occur, the forecast recovery could be put at risk. In these circumstances we would reassess policy settings." This statement suggests the RBNZ is more willing to cut the OCR in response to the higher NZD.

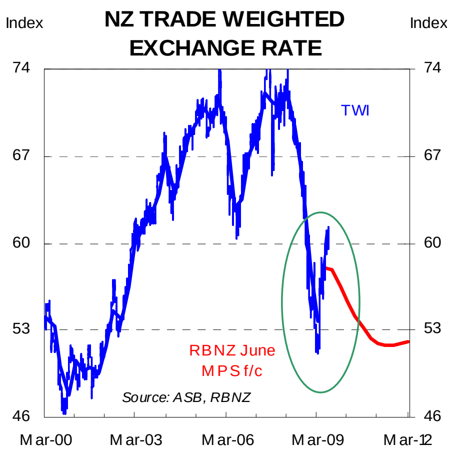
We continue to expect the NZD to be strong over the next year, which does reinforce the prospect of the RBNZ having to cut the OCR further. We retain our view that the RBNZ will cut the OCR by 25bp in both September and October to try and engineer some easing in monetary conditions – a view obviously contingent on the NZD and wholesale rates remaining elevated, relative to RBNZ expectations. However, our view is distinctly a minority view. And, regardless of whether the RBNZ cuts the OCR further or not, we expect little impact on mortgage rates. Deposit rates are unlikely to follow the OCR lower. Furthermore, given the global backdrop long-term rates are more likely to rise than fall over time: any OCR cuts may only temper the pace of increase.

The upcoming week's labour market data will give another clear indicator of how the recession is affecting the economy. Measured employment started to buckle in the first quarter of this year, having been surprisingly resilient over 2008. However, further job losses are likely to be recorded over Q2, and we expect the unemployment rate to lift to 5.5%. Wage figures are also set to show moderating growth. Not only is hiring demand down, there is more flexibility being demonstrated in employment arrangements – wage freezes are becoming more commonplace as a way of containing costs yet also limiting job losses.

Click here for:

Foreign Exchange	• NZD lifts further against a weak USD, US labour market report the next focus.
Interest Rates	• Swap rates eased last week. RBNZ on hold, and beefed up the dovish tones.
Week Ahead	• Labour market reports the focus.
Week in Review	• RBNZ on hold. Business outlook continues to improve. Building consents weak.
Global Calendars	• Manufacturing data due for US, UK, EZ and Australia. US Payrolls the highlight.

Chart of the week



- We think it is completely understandable that the NZD is at the levels it is. Fundamentally, NZ is experiencing a milder recession than many other developed economies. Moreover, it is mainly against the US dollar and the Pound that the NZD is elevated – and says more about the specifics of the US and the UK than NZ.
- We expect the NZD will appreciate slightly further on a broad basis, but strengthen considerably further against the unloved USD.
- The RBNZ, in contrast, assumes that the NZD will weaken considerably from current levels and remain low for an extended period of time. The economic recovery it forecasts hinges on this assumption.
- Unless the NZD drops sharply soon the RBNZ will have to rethink its growth outlook or its interest rate stance.

Foreign Exchange Market

FX Rates	Current*	Week ago	Month ago	6 mths ago	Year ago	ST Bias	Support^	Resistance^
NZD/USD	0.6607	0.6565	0.6297	0.5029	0.7271	FLAT-UP	0.6500	0.6700
NZD/AUD	0.7906	0.8000	0.7905	0.7958	0.7764	FLAT-DOWN	0.7800	0.8050
NZD/JPY	62.61	62.24	60.44	45.05	78.26	FLAT-UP	60.00	64.00
NZD/EUR	0.4629	0.4611	0.4500	0.3955	0.4672	FLAT-UP	0.4550	0.4700
NZD/GBP	0.3953	0.3989	0.3843	0.3502	0.3668	FLAT-UP	0.3900	0.4050
TWI	61.4	61.4	59.7	51.3	65.4	FLAT-UP	59.50	62.00

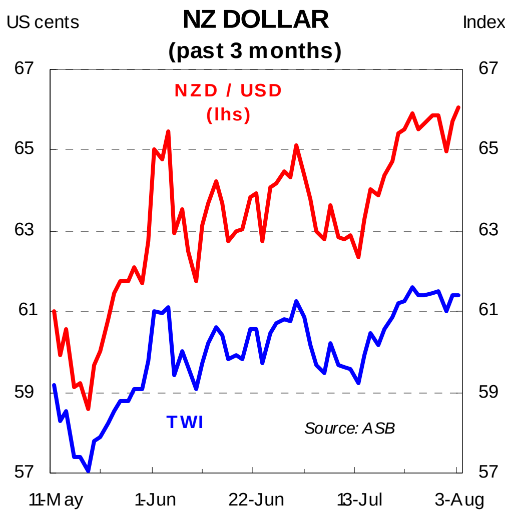
^Weekly support and resistance levels * Current is as at 12pm Monday; week ago as at Monday 5pm

- The NZD dipped against the AUD, and was down slightly on the GBP but posted gains on the other crosses, including the USD last week.
- The RBA Governor's 28 July speech was interpreted by the market as upbeat. In contrast, the RBNZ's statement last week was downbeat. We suspect the New Zealand labour force reports this week will be the catalyst for the market to sell the NZD and price in rate cuts. Should this occur, the NZD will likely slip further against the AUD.
- Financial markets have survived through the US reporting season relatively unscathed. This may give markets further confidence going forward that the global economy is on its way out of recession, which in turn boosts the AUD and NZD. The risk is that Friday's US labour force reports disappoint and NZD/JPY and NZD/USD falls as markets pare back their enthusiasm at the end of the week following earlier gains.
- This week, the focus in the US is on the labour market report due Friday. We suspect that the market has underestimated the number of job losses and the USD may grind higher on the result from some safe-haven flows at the end of the week. However, we expect the recent theme of growing confidence in the global economic recovery and the specific factors weighing on the USD (including high government debt levels, persistent deflation and a slowing of deleveraging flows) will continue to place downside pressure on the USD over the coming week.

Short-term outlook:

Key data	Date	Time (NZST)	Market expects
Labour Cost Indices (private, ordinary, QoQ)	4/8	10:45	0.5%
Household Labour Force Survey (u/e rate)	6/8	10:45	5.7%

Potential currency movers from the US this week: ISM manufacturing, personal income and spending, PCE (4th), pending home sales, ADP employment (5th), factory orders, initial and continuing claims (6th), non-farm payrolls (7th). Speakers: Tarullo (4th).



Medium term outlook: [Last Quarterly Economic Forecasts]

- As a consequence of the financial market turmoil centred in the United States, USD weakness was expected in early 2009. Although this weakness was initially offset in part by concerns about other regions, improved sentiment in financial markets has seen risk appetites improve and the USD weaken. Right now, the USD, which had shown countercyclical strength, is under pressure. The USD is weakening for the following reasons:
  - US residents increase their offshore investment, encouraged by improvement in the global economy.
  - USD liquidity demand and safe-haven buying of the USD reverses is easing.
  - Diversification out of USD is expected to occur due to concerns about US government debt.
- The arguments for buying EUR, GBP and JPY are strong enough to engineer a reasonable depreciation in the USD, but we do not expect to revisit fresh US TWI lows.
- We are also comfortable with our current forecast that the NZD and AUD have bottomed and will appreciate over the course of 2009, rather than revisit and break through the lows seen in early 2009. However, Fitch has put the threat of a credit rating downgrade back on the table.
- We expect the NZD to firm noticeably against the USD and yen as those currencies remain under sustained pressure. Against other key currencies the NZD is likely to appreciate but to a more modest extent: the NZD will leverage off the global recovery and NZ is in a relatively good position compared to a number of economies. The likelihood of the RBNZ intervening to try and weaken the NZD remains very low.

Interest Rate Market

Wholesale interest rates	Current	Week ago	Month ago	6 mths ago	Year ago	ST Bias
Cash rate	2.50	2.50	2.50	3.50	8.00	FLAT
90-day bank bill	2.80	2.77	2.80	3.51	8.28	FLAT
2-year swap	3.92	3.94	3.74	3.36	7.30	FLAT
5-year swap	5.31	5.40	5.23	4.01	7.11	FLAT
11/11 gov't stock	4.77	4.75	4.66	3.71	6.10	FLAT
NZSX 50	3016	2998	2758	2771	3300	FLAT

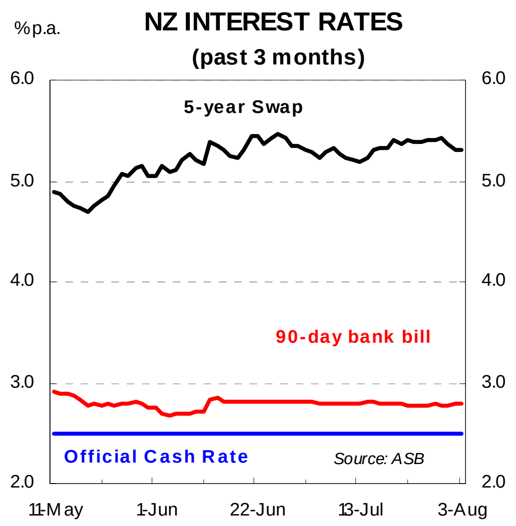
* Current is as at 12pm Monday; week ago as at Monday 5pm

- The RBNZ kept the OCR on hold at 2.5%, but delivered a slightly more dovish statement than the market expected. The Bank reiterated it could still move the OCR modestly lower over coming quarters and it expects to keep the OCR at or below current levels through to the latter part of 2010. The Bank effectively stepped up its easing bias by stating its willingness to "reassess policy settings" if the NZ dollar and wholesale interest rates remain at current levels.
- The RBNZ's statement was consistent with our view the RBNZ will deliver further cuts later this year if the NZ dollar remains elevated (relative to the RBNZ'a assumption). We still have 25 basis point cuts penciled in for September and October this year. The market currently only has 8% chance of a rate cut priced in for September.
- Swap rates had spiked higher ahead of the OCR announcement on Thursday only to more than unwind this surge following the dovish statement, winding up lower on week-ago levels.

Short-term outlook:

Key data	Date	Time (NZST)	Market expects
Labour Cost Indices (private, ordinary, QoQ)	4/8	10:45	0.5%
Household Labour Force Survey (unemployment rate)	6/8	10:45	5.7%

Comment: The focus turns to Australia this week, with the RBA scheduled for Tuesday afternoon. The RBA have been more upbeat recently, which is likely to be reflected in stronger growth forecast in this Friday's Statement of Monetary Policy. Thursday will be important, with the release of both NZ's and Australia's unemployment rate. A sharper than expected increase in the unemployment rate would see the market take the RBNZ's easing bias more seriously.



Medium term outlook: [Last Quarterly Economic Forecasts]

- The RBNZ continues to hold the cash rate at 2.5%, although has a very strong easing bias. The RBNZ has cut the cash rate 575 basis points in less than a year in response to the financial crisis offshore. The RBNZ has previously expressed reluctance to cut the OCR below 2%, which leaves just 50 bp of rate cuts up its sleeve.
- The RBNZ's July statement was extremely dovish, choosing to ignore any green shoots or positive developments and highlighting the vulnerabilities in the export sector. The RBNZ also stepped up its easing bias, repeating the potential for the OCR to move lower and its expectation to hold the OCR at current levels until the latter part of 2010. In addition, the RBNZ explicitly stated its willingness to "reassess policy settings" if the NZ dollar and wholesale interest rates remain at current levels.
- The RBNZ June MPS forecasts have CPI inflation fall briefly through the bottom of the target band later this year then recover to remain 'comfortably' in the middle of the target band. In contrast, our higher NZ dollar outlook suggests considerable downside risk to the inflation outlook.
- The market has underestimated the RBNZ's willingness to cut further, with market pricing implying the easing cycle is over – and that the OCR will increase as early as the start of 2010. This is despite the RBNZ becoming more explicit, expressing its intention to cut the OCR further if wholesale interest rates and the NZ dollar remain elevated at current levels. In our view, the NZ dollar is likely to remain strong and we have pencilled in two 25 basis point cuts for September and October, although the timing of these are partly dependent on the NZ dollar.
- The OCR remains the RBNZ's primary tool, although it has started to lose traction at very low levels. While the RBNZ has investigated other options, it remains very reluctant to use them while there is potential to cut the OCR further.

NZ Data Preview: a look at the week ahead

Data	Date	Time (NZST)	Previous	Market expects	ASB expects
Labour Cost Indices (private, ordinary, QoQ)	4/8	10:45	0.5%	0.5%	0.6%
HLFS Unemployment Rate	6/8	10:45	5%	5.7%	5.5%
HLFS Employment Growth	6/8	10.45	-1.1%	-0.8%	-1.3%

Tuesday 4th August

Q2 Wages

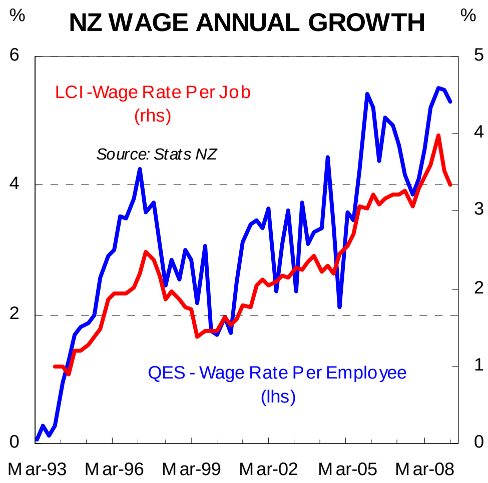
Previous Labour Costs: 0.6% ASB f/c 0.6% (private, ord)

Previous QES wages: 0.3% ASB f/c 0.6% (private, ord)

The balance of the labour market has swung sharply over the past year in response to the ongoing recession. Hiring has dropped off and unemployment has started to rise more noticeably. These influences are now starting to show through in moderating wage growth after a sustained period of skill shortages and strong wage growth.

We expect the closer-watched LCI (private sector, ordinary time) to register a 0.6% qoq increase, pulling the annual rate down to 3.2%. We expect the equivalent measure in the more volatile Quarterly Employment Survey to also register a 0.6% qoq increase, which would drop the annual rate sharply down to 3.7%. Anecdotally, wage freezes are becoming more commonplace, and as these take effect wage growth is likely to slow more noticeably.

The QES survey also contains job-related figures. These may give some steer as to the strength of employment, though there has been considerable divergence recently between the QES job figures and the HLFS measure of employment.



Thursday 6th August

Q2 Household Labour Force Survey

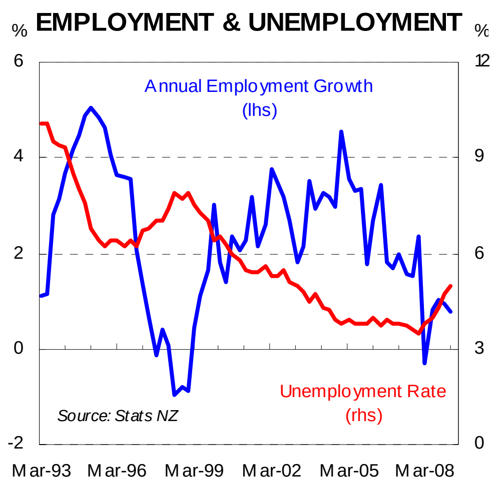
Previous employment: -1.1% qoq ASB f/c -1.3% qoq

Previous unemployment rate: 5.0% ASB f/c 5.5%

The HLFS employment figures have only recently started to reflect the impact of the prolonged recession NZ has been in since the start of 2008. We expect Q2 to register a substantial (1.3%) decline in employment, in keeping with the sharper focus businesses have brought to downsizing their operations since the full force of the global financial crisis erupted late last year.

As employment prospects have deteriorated and employment begun falling, labour participation has started to drop. We expect a repeat in Q2, with the labour participation rate falling to 67.6% of the labour force (from 68.4%). Reduced participation will blunt the impact of fewer jobs on the unemployment rate, which we expect will increase to 5.5% (currently 5%).

The RBNZ's June MPS forecasts incorporate a slightly weaker labour market over Q2 than the market median expectations, with the RBNZ expecting a 1.3% fall in employment and a 5.9% unemployment rate.



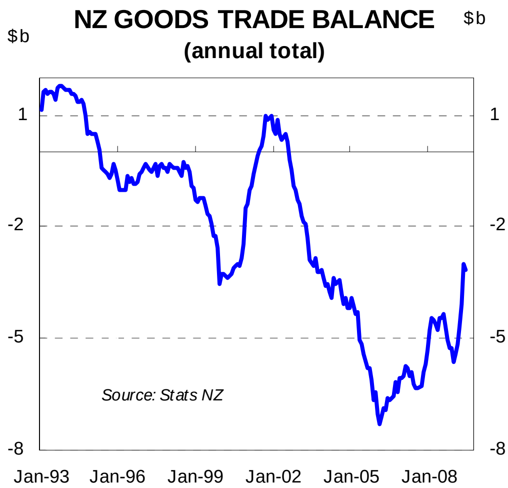
NZ Data Review: weekly recap

June Trade Balance

The trade balance came in at a surprising deficit of $471 million, compared to market expectations of $260 million. However, imports were boosted by the one-off import of aircraft (the Jetstar fleet) worth $571 million. Excluding these, the trade balance would have registered a $154 million surplus (closer to expectations).

Exports came in slightly below our own expectations at $3.2 billion for June. Dairy exports started to ease as expected, in line with the typical seasonal decline. The decline is being exacerbated by falling export dairy prices. Meat exports are also starting to slow with falling slaughter volumes.

Imports, excluding the Jetstar aircraft, came in slightly weaker than our expectations over the June month. For the quarter, seasonally-adjusted imports fell 3.4%, excluding the aircraft seasonally-adjusted imports would have fallen 8.7% over the quarter. The decline in imports was led by intermediate goods, and while the declines were relatively broad based across categories, declines in fertiliser imports were particularly prominent.

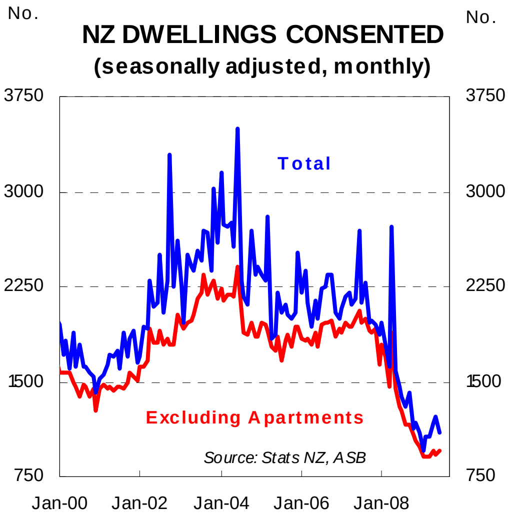


June Building Consents

Dwelling consent issuance fell 9.5%, once again due to a fall in lumpy apartment consent issuance. Over the past few months the trend in apartment consent issuance has picked up (although remains at weak levels), with retirement village units apparently a more significant driver of apartment consents this year.

Excluding apartments, dwelling consents increased 3%, and essentially have remained steady at very low levels over the past few months. We expect core consent issuance to start to improve with the lift in housing demand, as indicated by the rise in house sales. A stabilisation in house prices and the recent lift in net migration should also help underpin demand for housing construction, and we expect consent issuance to pick up off its lows over the second half of 2009.

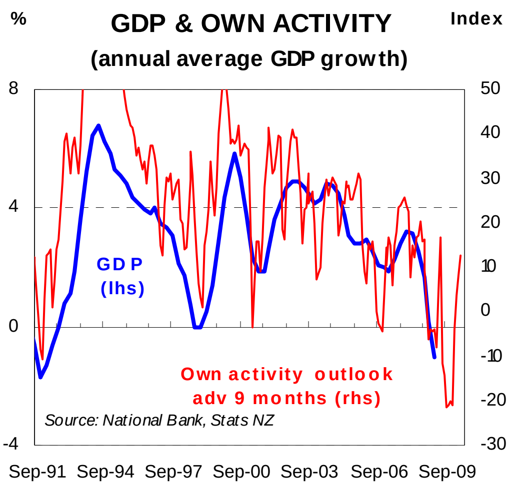
Non-residential consent issuance fell in June, although this follows some large one-offs in April and May (including Christchurch Airport developments). For the 3 months to June, consent issuance was up 13% on the same period in the previous year.



July NBNZ Business Outlook

Business confidence continued to improve over July, with net 18.7% expecting business conditions to improve over the next 12 months, up from net 5.5% in June. The outlook for firms' own activity over the next 12 months (the better predictor of GDP growth) also lifted, up to net 12.6% from 8.3% previously. The improvement was broad based across sectors – except agriculture – with services, retail and manufacturing all lifting substantially. The improvement suggests that demand has started to stabilise and growth is set to resume, albeit at a slow pace.

The investment and employment outlooks, while improving from the previous month, remain comparatively sluggish with firms still looking to reduce staff numbers and reduce investment. Profitability also remains under pressure, with net 14% expecting profits to decline over the next 12 months. While demand appears to have stabilised, the lagged effects of the recession are still being felt throughout the economy.

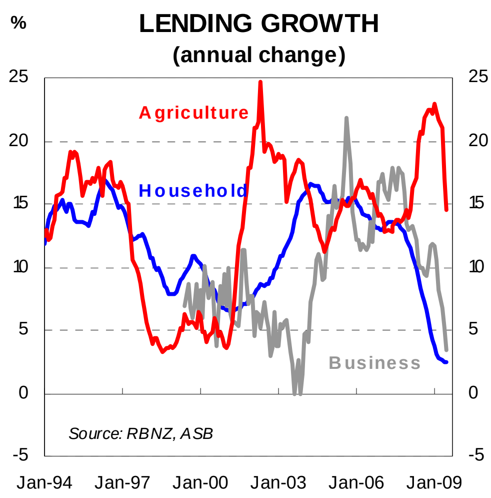


June Credit Aggregates

Household lending increased only 0.1% seasonally adjusted over June, weaker than we had expected given the resilience in house sales over May and June. However, May figures may have been boosted by frenzied sales activity over April and after averaging May and June together lending remains consistent with a modest pick up in housing lending growth. The housing turnover, although up off its late 2008 lows, still remains below average. We expect the housing market to hold onto its gains, although the recovery is likely to be a muted one and lending growth is likely to remain modest. Stabilisation in house prices should help reduce the drag on housing credit lending.

Consumer credit continued to weaken in June, down 3% on year-ago levels. Households have possibly become more cautious about taking on debt when the economic and employment outlook remains challenging.

Business credit lending has weakened considerably over the past few months, now only up 3.4% on year-ago levels, down from a pace of annual growth of 10% earlier this year. The slowdown in growth reflects the weak economic environment, with investment plans significantly scaled back reducing the need for finance. Similarly, agricultural lending is also slowing from very elevated levels.

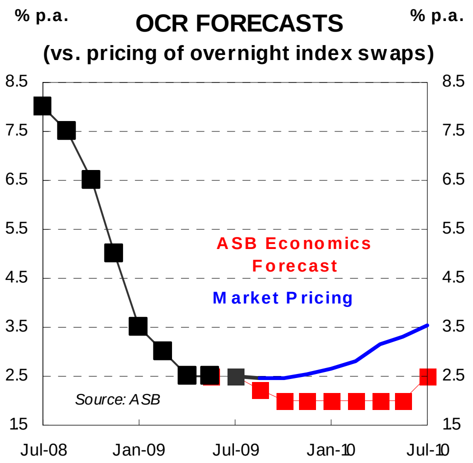


RBNZ OCR Announcement

The RBNZ kept the OCR unchanged at 2.5%, and beefed up its easing bias. The RBNZ focused the statement on the downside risks to growth, with most discussion centred on the weakness in the export sector. As well as the high NZ dollar, the RBNZ highlighted the recent green shoots euphoria that has emerged in China and Australia has not reached New Zealand. NZ exporters, being mostly soft commodity exporters, have not benefited from the recent increase in hard commodity prices.

The RBNZ sent a very clear message to markets by excluding mention on the pick up in net migration and housing, reinforcing its easing bias.

The RBNZ left the final paragraph of its press release unchanged: it could still move the OCR modestly lower over coming quarters and it expects to keep the OCR at or below current levels through to the latter part of 2010. However, key was the explicit willingness to "reassess policy settings" if the NZ dollar and wholesale interest rates remain at current levels.



Global Data Calendars

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

Calendar – Australasia, Japan and China

	Time						Forecast	
Date	**NZT**	**Econ**	**Event**	**Period**	**Unit**	**Last**	**Market**	**ASB/CBA**
Mon 3 Aug	11.30	AU	AiGroup PMI	Jul	Index	38.4	~	~
	13.30	AU	Job advertisements	Jul	m%ch	-6.7	~	~
	13.30	JN	Labour cash earnings	Jun	y%ch	-2.5	~	~
	17.30	AU	RBA commodity price index	Jul	y%ch	-29.3	~	~
Tue 4 Aug	~	AU	CBA/ACCI Business survey	QII	Index	31.7	~	~
	10.45	NZ	Wages including overtime	QII	q%ch	0.6	~	
	10.45	NZ	Wages excluding overtime	QII	q%ch	0.5	~	0.6
	10.45	NZ	Average hourly earnings	QII	q%ch	1.1	~	0.6
	13.30	AU	House prices	QII	q%ch	-2.2	~	~
					y%ch	-6.9	~	~
	13.30	AU	Retail sales	Jun	m%ch	1.0	~	0.2
	16.30	AU	RBA announce rates	Aug	%	3.00	3.00	3.00
Wed 5 Aug	11.30	AU	CBA/AiGroup PSI	Jul	Index	50.2	~	~
	13.30	AU	Trade balance	Jun	A$mln	-556	~	-0.8
Thur 6 Aug	10.45	NZ	Employment change	QII	q%ch	-1.1	-0.8	-1.3
					y%ch	0.8	-1.1	~
	10.45	NZ	Participation rate	QII	%	68.4	-68.2	67.6
	10.45	NZ	Unemployment rate	QII	%	5.0	5.6	5.5
	13.30	AU	Employment change	Jul	000	-21.4	~	-20
	13.30	AU	Participation rate	Jul	%	65.3	~	65.2
	13.30	AU	Unemployment rate	Jul	%	5.8	~	5.9
	17.00	JN	Leading index (p)	Jun	Index	76.9	~	~
	17.00	JN	Coincident index (p)	Jun	Index	87.1	~	~
Fri 7 Aug	11.30	AU	AiGroup PCI	Jul	Index	42.6	~	~
	13.30	AU	RBA Quarterly Statement on Monetary Policy					
Sun 9 Aug	00.00	NZ	QV house prices	Jul	y%ch	-7.1	~	~

Calendar – North America & Europe

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

Date	UK time	Econ	Event	Period	Unit	Last	Forecast Market	Forecast CBA
Mon 3 Aug	08.55	GE	PMI manufacturing (f)	Jul	Index	45.2	~	~
	09.00	EC	PMI manufacturing (f)	Jul	Index	46	~	~
	09.30	UK	PMI manufacturing	Jul	Index	47	~	~
	15.00	US	ISM manufacturing	Jul	Index	44.8	46.5	~
	15.00	US	ISM prices paid	Jul	Index	50	50.5	~
	15.00	US	Construction spending	Jun	m%ch	-0.9	-0.6	~
Tue 4 Aug	09.30	UK	PMI construction	Jul	Index	44.5	~	~
	10.00	EC	PPI	Jun	~	~	~	~
	13.30	US	Personal income	Jun	m%ch	1.4	-1.0	~
	13.30	US	Personal spending	Jun	m%ch	0.3	0.2	~
	13.30	US	Core PCE	Jun	m%ch	0.1	0.2	~
					y%ch	1.8	1.7	~
	15.00	US	Pending home sales	Jun	m%ch	0.1	0.3	~
Wed 5 Aug	08.55	GE	PMI Services (f)	Jul	Index	48.4	~	~
	09.00	EC	PMI composite (f)	Jul	Index	46.8	~	~
	09.30	UK	PMI services	Jul	Index	51.6	~	~
	09.30	UK	Industrial production	Jun	m%ch	-0.6	~	~
					y%ch	-11.9	~	~
	10.00	EC	Retail sales	Jun	m%ch	-0.4	~	~
	13.15	US	ADP employment	Jul	000	-473	-330	~
	15.00	US	ISM non-manufacturing	Jul	Index	47	48	~
	15.00	US	Factory orders	Jun	m%ch	1.2	0.5	~
Thu 6 Aug	00.01	UK	NIESR GDP estimate	Jul	%	-0.4	~	~
	12.00	UK	BoE announce rates	Aug	%	0.5	0.5	0.5
	12.45	EC	ECB announce rates	Aug	%	1.0	1.0	1.0
	13.30	CA	Building permits	Jun	m%ch	14.8	1.0	~
	13.30	US	Initial and continuing claims					
Fri 7 Aug	07.00	GE	Trade balance	Jun	€bln	9.6	~	~
	07.00	GE	Current account	Jun	€bln	3.7	~	~
	07.00	GE	Industrial production	Jun	m%ch	3.7	~	~
	09.30	UK	PPI	Jul	~	~	~	~
	12.00	CA	Change in Employment	Jul	000	-7.4	-20	~
	12.00	CA	Unemployment rate	Jul	%	8.6	~	~
	13.30	US	Non-farm payrolls	Jul	000	-467	-325	~
	13.30	US	Unemployment rate	Jul	%	9.5	9.6	~
	15.00	CA	Ivey PMI	Jul	Index	58.2	~	~
	20.00	US	Consumer credit	Jun	$bln	-3.2	-4.2	~

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