Business Weekly

Global growth in the spotlight

ECONOMICS

5 Jul. 10

This Week

Market sentiment has been weighed down over the past week by concerns over how the global recovery is evolving, with murmurs in the financial markets of the possibility of a double-dip recession. Uncertainty in the financial markets intensified ahead of the deadline for European banks to repay €442 billion of twelve-month loans to the ECB at the end of June, with fears of a potential liquidity squeeze upon the maturity of these loans. These fears were eased with the announcement from the ECB of three-month and six-day loans for banks which required funds. Nonetheless, pessimism continues to pervade the financial markets in light of continued question marks over the sustainability of fiscal deficits globally.

Adding to this pessimism have been subdued data on economic activity. In particular, weaker than expected manufacturing surveys in the key economies placed the spotlight on the effects of recent financial market turbulence on real activity. A surprise revision to China's Conference Board leading economic index for the April month – from 1.7% to 0.3% as a result of an initial calculation error – triggered concerns over the sustainability of the rapid growth that had been occurring in the Chinese economy.

The latest US Non-farm Payrolls data also did little to allay growth concerns, as the smaller than expected increase in private non-farm payrolls of 83,000 (which stripped out the volatility related to the hiring of temporary Census workers) indicated the recovery in the US labour market was occurring slowly.

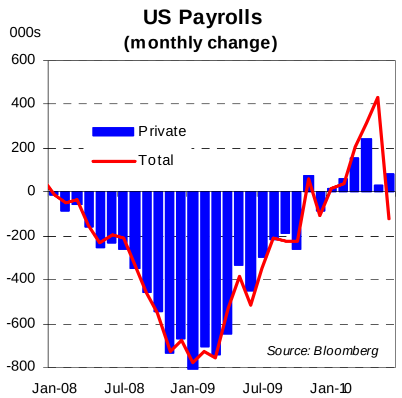
Financial markets also focused on the raft of manufacturing data last week, which showed confidence in the manufacturing sector has eased in many key economies. Over the course of the recession, there was a widespread decline in the manufacturing sector in the major economies. To the extent manufacturing activity has been leading the US recovery, markets see the potential for a pause in manufacturing output due to weakness in demand from abroad as presenting a risk to the US recovery. However, to put these recent developments into context, a slowing in the global economy is only a risk at the moment and the core expectation remains for a continued global economic recovery. Indeed, manufacturing surveys are still indicating expansion in the sector.

In NZ, the manufacturing sector has benefited from a robust Australian economy and the low NZD/AUD in recent quarters. Added to that has been export demand directly from the Asian economies, thus supporting the rebalancing of our economy. The NZIER Quarterly Survey of Business Opinion tomorrow should provide further insight into the state of many manufacturers. The survey will also be a useful gauge on whether businesses remain optimistic over the recovery in demand. This is important for the sustainability of the NZ recovery, as businesses need to be confident of a recovery to put in place expansion plans. With the RBNZ stating its desire to see a recovery in business investment, investment and hiring intentions will be important leading indicators for whether this is occurring.

Click here for:

Foreign Exchange	• NZD loses ground against most major crosses on weak sentiment.
Interest Rates	• Domestic rates follow offshore movements lower.
Week Ahead	• Quarterly Survey of Business Opinion contains important economic indicators.
Week in Review	• June month business confidence dips, Auckland house market remains weak.
Global Calendars	• RBA, BOE and ECB rate announcements, Australia employment report.

Chart of the week



- US Non-farm Payrolls data have always attracted much market attention. However, there has been some confusion in recent months over the volatility as a result of the temporary hiring of Census workers.
- While total non-farm payrolls fell by 125,000 in the June month, this followed a large increase of 433,000 in the previous month.
- Excluding the government sector, payrolls increased 83,000 in June. While smaller than markets had expected, the increase nonetheless points to a continued recovery in the US labour market. This indicates that the US economy remains on track for a sustainable recovery.

Foreign Exchange Market

FX Rates	Current*	Week ago	Month ago	6 mths ago	Year ago	ST Bias	Support^	Resistance^
NZD/USD	0.6884	0.7109	0.6838	0.7225	0.6297	FLAT	0.6800	0.7000
NZD/AUD	0.8177	0.8115	0.8092	0.8079	0.7905	FLAT	0.8100	0.8200
NZD/JPY	60.44	63.57	63.37	66.76	60.44	FLAT	59.00	61.00
NZD/EUR	0.5481	0.5740	0.5613	0.5036	0.4500	FLAT	0.5400	0.5500
NZD/GBP	0.4531	0.4722	0.4670	0.4493	0.3843	FLAT	0.4500	0.4600
TWI	65.9	68.1	66.7	66.1	59.7	FLAT	65.50	66.50

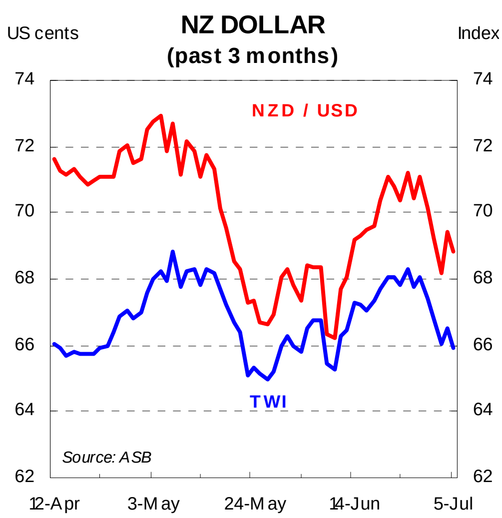
^Weekly support and resistance levels * Current is as at 10.45 am Monday; week ago as at Monday 5pm

- The NZD lost ground against most of the major crosses over the past week, although managed to stay reasonably steady against the AUD. The NZD/AUD is likely to remain fairly stable this week with the balance of risks from data likely to be neutral.
- Both the NZD and AUD came under pressure over the week by the deterioration in market sentiment. News that the Australian Government has backed of the mining super profit tax provided support to the AUD on Friday, dragging the NZD up with it. However, the recovery was not sustained and both currencies came back under pressure over the weekend following the disappointing US labour market report.
- The USD lost popularity following weaker US data, boosting the EUR and GBP. We expect a downward correction in the USD (due to low US bond yields) to continue this week, with any disappointing US news likely to push up the EUR/USD and GBP/USD. Note there is little US data scheduled for release, due to holiday interruptions.

Short-term outlook:

Key data	Date	Time (NZST)	Market expects
Q2 Quarterly Business Opinion	6/7	10.00am	-

Potential currency movers from offshore this week: UK purchasing managers' index, EU retail trade (5th); RBA cash rate decision, US ISM services survey (6th); AU labour force, Japan current account, ECB and BoE policy decision, UK industrial production, US jobless claims (8th). Speakers: Kocherlakota (7th), Trichet (8th).



Medium-term outlook: [Last Quarterly Economic Forecasts]

- We expect the USD will continue to gain support over the remainder of 2010. The US economic outlook continues to improve, with data demonstrating a broader-based expansion. 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. In addition, the AAA-rated US bond market remains the major alterative 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.
- While we have revised down our NZD outlook slightly, we continue to see support 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	2.75	2.75	2.50	2.50	2.50	FLAT
90-day bank bill	3.16	3.11	2.99	2.80	2.80	FLAT
2-year swap	4.19	4.26	4.43	4.63	3.74	FLAT
5-year swap	4.89	4.96	5.26	5.61	5.23	FLAT
5-year benchmark gov't stock	4.73	4.81	4.98	5.53	4.69	FLAT
NZSX 50	2942	3007	3030	3219	2758	FLAT

* Current is as at 10.45 am Monday; week ago as at Tuesday 5pm. Please note that we have recently changed the NZ govt 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 last week (with the exception of 90-day rates), dragged lower by offshore concerns. In particular, global markets were nervous ahead of the June 30 deadline for European banks to repay large loans to the European Central Bank (ECB). There were concerns that liquidity could become strained as some banks struggled to find alternative finance. However, concerns alleviated somewhat after the ECB announced it would extend the 12-month loans for another 3 months.
- The 90-day bank bill lifted over the week. The increase reflects the September OCR announcement (and likely 25 basis point increase) moving further into the 90 day window.
- The market currently has 76% chance of a 25 basis point rate hike priced in for the July OCR announcement. However, pricing beyond July is less confident of further hikes. Markets remain concerned about the strength of the global recovery following weaker US data and ongoing concerns on Europe's economic outlook.

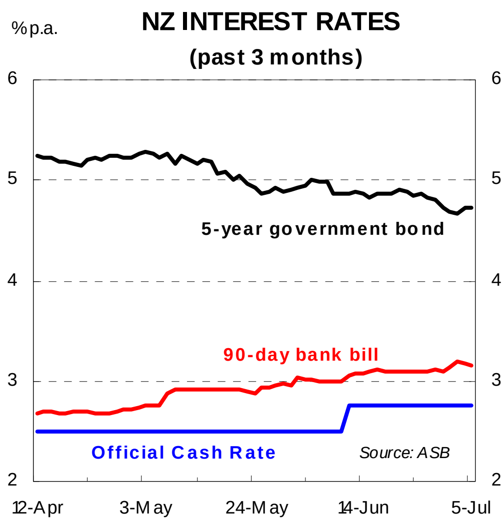
Short-term outlook:

Key data	Date	Time (NZST)	Market expects
Q2 Quarterly Business Opinion	6/7	10.00am	-
RBA Rate Announcement	6/7	4.30 pm	4.5%
AU Employment Report	8/7	1.30 pm	+15k

Comment: Locally the Quarterly Survey of Business Opinion is a key highlight, as it contains a number of important economic indicators. In Australia, the RBA is expected to remain on hold this week, and the June Australian employment figures will also be of interest.

While there are a number of key Australasian releases this week, we expect domestic market is likely to be more focussed on the upcoming CPI due next week. Offshore sentiment will also continue to be a large influence on market direction.

Medium term outlook: [Last Quarterly Economic Forecasts]



- The RBNZ began removing monetary policy stimulus at the June meeting with a 25 basis point OCR increase. 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 left its projection for the 90-day interest rate broadly unchanged at the June *MPS*. It continued to note that higher bank funding costs, upward slope of the yield curve and the fact that a greater proportion of borrowers are now on floating rate mortgages will "reduce the extent to which the OCR will need to be increased relative to previous cycles". This is in line with our expectations that OCR increases will be in 25 basis point increments this year and eventually peak at 5%.
- 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 a peak of 5.7%, and see upside risks to the RBNZ's key assumption that medium-term inflation expectations will remain anchored. This is in light of the fact that two year ahead inflation expectations are already elevated at 2.8%.
- The RBNZ has revised down its NZ economic growth outlook slightly and explicitly notes that if the Eurozone situation deteriorated the main impact on NZ would be via higher bank funding costs. We are less optimistic than the RBNZ that the recent strength in NZ export commodity prices will continue.
- We expect that the OCR will be increased by 25bp at each meeting until the OCR reaches 5%. Given continued uncertainty in the European economy, markets are currently pricing in some risk of a pause at some point in this cycle.

NZ Data Preview: a look at the week ahead

Data	Date	Time (NZST)	Previous	Market expects	ASB expects
Q2 NZIER Quarterly Survey of Business Opinion	6/7	10.00am	21.9	-	-

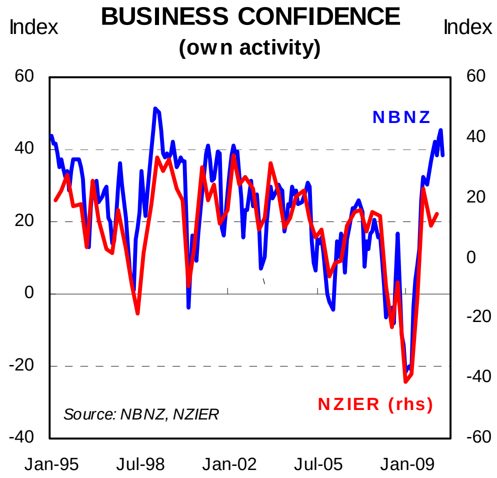
Tuesday 6 July

Q2 NZIER Quarterly Survey of Business Opinion

Previous: headline 21.9, own activity 14.5

The monthly NBNZ business confidence survey suggests the Q2 NZIER QSBO will show a modest improvement. The level of business confidence suggests businesses see the recovery in demand as enough to warrant putting in place expansion plans. As such, we expect continued improvement in investment and hiring intentions.

Capacity utilisation will provide useful insight into the degree of inflation pressures in the economy. Looking beyond the volatility in recent quarters capacity utilisation has been generally trending up, suggesting inflation pressures are building up. With headline inflation expected to reach close to 6% by the middle of next year this poses a risk that Government policy-induced inflation will spill over to generalised inflation.

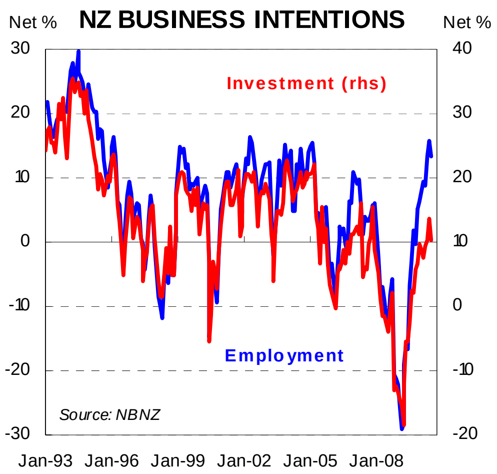


NZ Data Review: weekly recap

June NBNZ Business Outlook

There was a dip in both headline business confidence and businesses' assessment of their own situation in the June month. Softer business profitability looks to have played a part in the weaker business sentiment. As a result, businesses are now slightly less confident about expanding their operations, with modest declines in both investment and hiring intentions. That said, business confidence is still at reasonably high levels, and a net proportion of businesses continue to expect to increase investment and staff numbers.

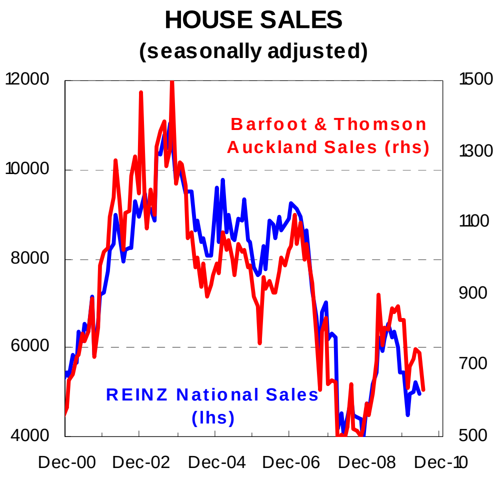
Meanwhile, pricing intentions have surged, likely reflecting increased awareness of the high headline CPI inflation which will result from the raft of Government charges due to come through over the year. We expect the combination of Emissions Trading Scheme, higher ACC levies, tobacco excise tax and GST increase will push headline CPI inflation to around 5.7% by mid-2011.



June Barfoot and Thompson Auckland House Sales

Housing market activity remained very weak in June, with the number of Barfoot and Thompson Auckland house sales falling 15% (seasonally adjusted). The tax changes to deprecation rules on investment property announced in the May Budget did not trigger a rush of listings, with the number of new listings actually *falling* 5% on a seasonally-adjusted basis in June. New listings have remained very subdued for some time. The total number of available listings eased slightly in June, remaining around average levels.

The average weekly rent charged increased in June: although this series is very volatile it will be interesting to monitor the trend over the next few months. Recent anecdotes suggest landlords intend to increase rents in reaction to tax changes in Budget 2010. However, the ability to increase rents may be limited by prospective tenants' ability to pay given the weakness in wage growth over the past year.



Global Data Calendars

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

Calendar - Australasia, Japan and China

Date	Time NZT	Econ	Event	Period	Unit	Last	Forecast Market	Forecast ASB/CBA
Mon 5 Jul	11.30	AU	CBA/Ai Group Performance of Service Index	Jun	Index	47.5	~	~
	12.30	AU	TD securities inflation gauge	Jun	m%ch	0.5	~	~
					y%ch	3.7	~	~
	13.30	AU	ANZ job advertisements	Jun	m%ch	4.3	~	~
Tue 6 Jul	~	NZ	NZIER business opinion survey	QII	~	22.0	~	~
	13.30	AU	Trade balance	May	$mn	134.0	500	500
	16.30	AU	RBA cash target	Jul	%	4.50	4.50	4.50
	17.00	JP	Leading index CI	May	Index	101.7	~	~
	17.00	JP	Coincident index CI	May	Index	101.3	~	~
Wed 7 Jul	11.30	AU	Ai Group Performance of Construction Index	Jun	Index	53.2	~	~
Thu 8 Jul	~	JP	Eco watchers survey: current	Jun	Index	47.7	~	~
	~	JP	Eco watchers survey: outlook	Jun	Index	48.7	~	~
	11.50	JP	Machine orders	May	m%ch	4.0	~	~
					y%ch	9.4	~	~
	11.50	JP	Trade balance (BoP basis)	May	¥bn	859.1	~	~
	11.50	JP	Adjusted current account total	May	¥bn	1,379.6	~	~
	13.30	AU	Employment change	Jun	'000	26.9	15	20.0
	13.30	AU	Unemployment rate	Jun	%	5.2	5.2	5.2
	13.30	AU	Participation rate	Jun	%	65.1	65.1	65.1
	18.00	JP	Machine tool orders	Jun	y%ch	192.5	~	~
Fri 9 Jul	10.45	NZ	NZ card spending	Jun	m%ch	0.4	~	~
	14.00	CH	Entrepreneur confidence index	QII	Index	135.8	~	~
	14.00	CH	Business climate index	QII	Index	132.9	~	~

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 5 Jul	10.55	GE	PMI services	Jun	Index	54.6	~	~
	11.00	EZ	PMI services	Jun	Index	55.4	~	~
	11.30	EZ	Sentix investor confidence	Jul	~	-4.1	~	~
	11.30	UK	PMI services	Jun	Index	55.4	~	~
	12.00	EZ	Retail sales	May	m%ch	-1.5	~	~
					y%ch	-1.8	~	~
Tue 6 Jul	~	UK	New car registrations	Jun	y%ch	13.5	~	~
	15.30	CA	Building permits	May	m%ch	5.4	~	~
	17.00	US	ISM non-manufacturing composite	Jun	Index	55.4	55.4	~
Wed 7 Jul	12.00	EZ	GDP	QI	q%ch	0.2	~	~
					y%ch	0.6	~	~
	13.00	GE	Factory orders	May	m%ch	2.8	~	~
					y%ch	29.6	~	~
	17.00	CA	Ivey purchasing managers index	Jun	Index	62.7	~	~
Thu 8 Jul	~	UK	NIESR GDP estimate	Jun	%	0.6	~	~
	09.00	GE	Trade balance	May	€bn	13.4	~	~
	09.00	GE	Current account	May	€bn	11.8	~	~
	11.30	UK	Industrial production	May	m%ch	-0.4	~	~
					y%ch	2.1	~	~
	13.00	GE	Industrial production	May	m%ch	0.9	~	~
					y%ch	13.3	~	~
	14.00	UK	BOE announces rates	Jul	%	0.50	0.50	0.50
	14.45	EZ	ECB announces interest rates	Jul	%	1.0	1.00	1.00
	15.30	CA	New housing price index	May	m%ch	0.3	~	~
	15.30	US	Initial jobless and continuing claims	Jul	~	~	~	~

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