

## Glass two-thirds full or one-third empty?

### This Week

The NZIER's quarterly business survey was unremarkable in its results, but remarkable for some of the headlines it generated. The survey results, even with a slight softening, are still at quite decent levels. The activity components are generally spread above, around, and below average levels. If anything, perhaps, respondents have become more realistic about the likely pace of recovery. The responses suggest the economy has been, and will continue, expanding at a respectable pace. They don't suggest the economy is on fire, but they certainly don't suggest it has come to a crashing halt either. The survey also followed the European debt crisis and straddled the June OCR increase, neither of which were likely to boost optimism.

However, the accompanying commentary was quite downbeat: "recovery showed signs of stalling". Another commentator implied there was no economic recovery underway, in particular citing some export receipt figures. However, comparing 12-month periods to the preceding 12-month period – as he did – means it can take around a year until improvement and deterioration alike become evident.

For the record, we have seen economic recovery get underway over the past year. Off their respective lows: GDP is up 1.9%; consumption volumes up 2.3%; residential construction up 5.3%; export volumes up 5.6%. Our CBA NZ dollar Commodity Price Index is up 58% from its extreme low. May's \$4.2 billion in export receipts was the highest monthly value ever recorded. Employment has started to recover.

*Recovering*, as the economy is doing, is different from being *recovered*. The economy is still smaller than it was at the end of 2007, employment is lower and unemployment is still higher. By our estimate the economy won't reach its pre-recession size until the end of the year. Many businesses still face tough trading conditions as recovery is not evenly spread. It is tough going in household-related sectors, while many manufacturing/export industries are increasingly benefiting from strong growth in Asia and Australia.

This week the focus goes on the Q2 CPI inflation figures – and we hope they will be less contentious! We expect annual inflation to edge down slightly to 1.9%, from 2.0%. Though inflation is benign now, it will be less so in the future – hence the RBNZ's recent decision to lift the OCR. Accordingly, we think households and businesses would be prudent to plan on interest rates gradually rising over the next year. The recent drop in fixed rates provides a window of opportunity to get some cheap certainty out to 2 years.

Economic recovery or not? Looming inflation problem or not? Perhaps we really need Paul the octopus to settle the debate! But unless he says something different, our view remains that the economic recovery will continue, steadily not spectacularly. Meanwhile, let's try not to talk ourselves out of having one.

### Click here for:

#### [Foreign Exchange](#)

- NZD lifted by upbeat offshore sentiment.

#### [Interest Rates](#)

- Interest rates up on improved global sentiment and Australian employment.

#### [Week Ahead](#)

- June REINZ house sales, May retail sales and June quarter CPI.

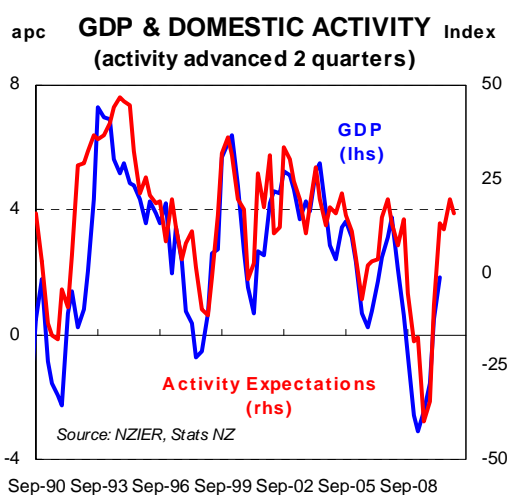
#### [Week in Review](#)

- Business confidence continues to point to healthy pace of economic growth.

#### [Global Calendars](#)

- Focus on Chinese data for June, as well as a range of US indicators.

### Chart of the week



- Businesses' views on how they expect to trade in the near future have an uncanny knack of giving a strong steer on how economic growth will track.
- The last couple of years have brought huge swings in businesses' perceptions of their future trading conditions – and equally large swings in the economy.
- To date the swings in sentiment have been quite accurate in signalling a return to economic growth after the recession.
- The most recent result, for Q2, edged down very slightly. However, it remains at a level that is consistent with the economy returning to a respectable pace of growth.
- We expect the economy to continue gradually recovering – and there is little in the NZIER survey to suggest the economy has stopped growing.

### 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	0.7107	0.6884	0.6806	0.7404	0.6291	FLAT/DOWN	0.7000	0.7200
NZD/AUD	0.8100	0.8177	0.8061	0.7945	0.8035	FLAT	0.8000	0.8200
NZD/JPY	63.00	60.44	62.40	68.24	58.48	FLAT/DOWN	61.00	64.50
NZD/EUR	0.5622	0.5481	0.5627	0.5095	0.4498	FLAT	0.5575	0.5675
NZD/GBP	0.4717	0.4531	0.4631	0.4599	0.3855	FLAT	0.4650	0.4750
TWI	67.5	65.9	66.4	66.9	59.6	FLAT/DOWN	67.00	68.00

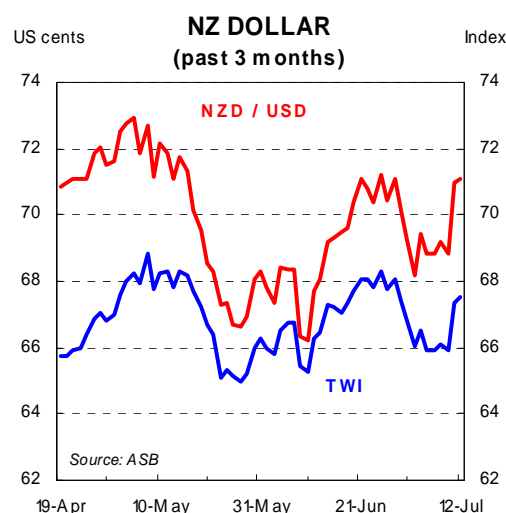
^Weekly support and resistance levels \* Current is as at 10.15 am Monday; week ago as at Monday 5pm

- Offshore confidence was buoyant last week, underpinning demand for the NZD. Even the weaker global Dairy Trade auction, with dairy prices falling 14% in July, failed to derail demand for the NZD, which outperformed against most major crosses.
- We see downside risks to the NZD and AUD against the USD this week. Chinese lending is likely to show the effects of policy tightening, leaving the AUD and NZD vulnerable to downside surprises. In addition, the US company earnings season kicks off later this week, with any disappointment likely to see equity markets and the AUD/USD and NZD/USD ease. Meanwhile, the Greek government is seeking to re-enter the bond market, once again with any disappointment likely to reignite worries about debt vulnerabilities.
- The NZD underperformed against the AUD over the week. The NZD lost ground on Thursday following the much stronger than expected Australian employment report. We see neutral risks to the NZD/AUD this week, with the potential for slightly weaker NZ data likely to be offset by a decline in offshore sentiment (which typically results in the AUD underperforming the NZD).

### Short-term outlook:

Key data	Date	Time (NZST)	Market expects
June REINZ House Sales	14/7	10.00am	-
May Retail Sales	14/7	10.45am	+0.5%
Q2 Consumer Price Index	16/7	10.45am	+0.5%

**Potential currency movers from offshore this week:** AU housing finance, UK GDP (12<sup>th</sup>); AU business conditions, EU ZEW survey of investors, UK CPI, US trade (13<sup>th</sup>); AU consumer confidence, EU CPI, EU industrial production, UK consumer confidence, UK unemployment, FOMC meeting minutes, US retail sales (14<sup>th</sup>); BoJ policy meeting, US producer prices, US jobless claims, US industrial production (15<sup>th</sup>); EU trade balance, US consumer confidence, US CPI (16<sup>th</sup>).  
Speeches: Bernanke, Duke, Lacker (12<sup>th</sup>), Lacker (15<sup>th</sup>).



### 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 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.
- 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	2.75	2.50	2.50	FLAT
90-day bank bill	3.20	3.16	3.07	2.76	2.80	UP
2-year swap	4.23	4.19	4.37	4.62	3.72	UP
5-year swap	4.89	4.90	5.11	5.57	5.21	UP
5-year benchmark gov't stock	4.70	4.73	4.89	5.48	4.64	UP
NZSX 50	2943	2942	3031	3304	2738	UP

\* Current is as at 10.15 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 ended the week generally higher, as interest rates was dragged higher by the much stronger than expected Australian employment data, which more than offset the decline in interest rates earlier in the week from a weak interpretation of the Q2 NZIER Quarterly Survey of Business Opinion. Markets are currently pricing in around an 85% chance of an OCR increase in the July meeting.
- The much stronger than expected increase in Australian employment saw Australian interest rates rise around 6-10 basis points across the curve. The RBA left its cash rate on hold as widely expected, and there was little interest rate reaction to its accompanying statement.
- There has been a general improvement in market sentiment with interest rates rising accordingly, as focus turns to the upcoming earnings reporting season. There are expectations for some solid earnings results.

### Short-term outlook:

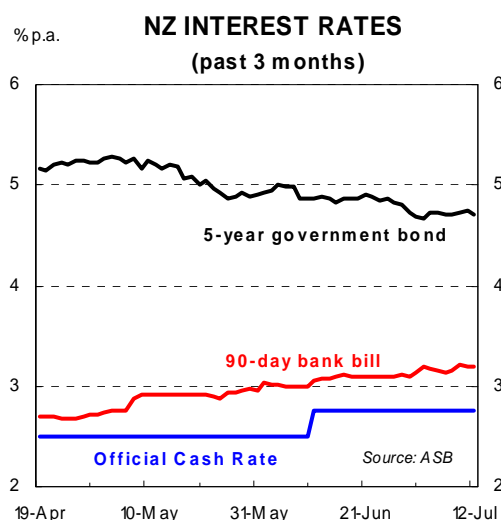
Key data	Date	Time (NZST)	Market expects
June REINZ House Sales	14/7	10.00am	-
May Retail Sales	14/7	10.45am	+0.5%
Q2 Consumer Price Index	16/7	10.45am	+0.5%

**Comment:** Focus in domestic markets turns squarely to the Q2 CPI released this Friday. While expectations are for a modest increase in prices for the June quarter, there will be interest in the extent to which capacity pressures in the economy are flowing through to non-tradable inflation. This is particularly in light of the raft of Government policy charges over the coming year, which will add to the lift in underlying inflation pressures as economic activity continues to improve.

June REINZ house sales and May retail sales data will also be of interest.

### 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 well over 5%, and hence pose 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
June Food Price Index mom	13/7	10.45am	-0.7%	-	-
June REINZ House Sales mom	14/7	10.00am	-4.6%	-	-
May Retail Sales mom	14/7	10.45am	-0.3%	+0.5%	+0.1%
Q2 Consumer Price Index qoq	16/7	10.45am	+0.4%	+0.5%	+0.4%

### Wednesday 14 July

#### May Retail Sales

**Total: previous -0.3%, f/c +0.1% mom**

**Ex-auto: previous -0.2%, f/c +0.2% mom**

We expect a continued recovery in retail spending, as slowing momentum in housing market activity is offset by improving employment prospects. There was a substantial contraction in the retail sector over the course of the recession, as households cut back on spending in light of deteriorating labour market conditions.

While the recovery to date has been gradual, recent business surveys point to increasing optimism amongst retailers. Indeed, consumer confidence surveys indicate a growing proportion of households which consider now a good time to purchase a major household item. We expect sales of big-ticket items will rise in the coming months as households bring forward purchases ahead of the GST increase on 1st October.

### Wednesday 14 July

#### June REINZ house sales

**House sales: previous -4.6% mom s.a., -17.2% yoy**

**House Prices: previous -1.4% mom s.a., +2.3% yoy**

The property market was very quiet in early 2010, with the much discussed changes to property tax laws blamed for some of the inertia. With the Budget out of the way, buyers now have clarity on the matter of tax. The changes do reduce some of the attractiveness of owning rental properties. Indeed, Auckland sales data point to activity remaining very weak in June.

We do not think the property tax changes announced in the Budget will trigger a landslide of sellers, with new listings remaining very weak to date.

With rising interest rates and slowing population growth, we expect the property market to remain soft over the remainder of 2010, and prices could moderate in the months ahead.

### Friday 16 July

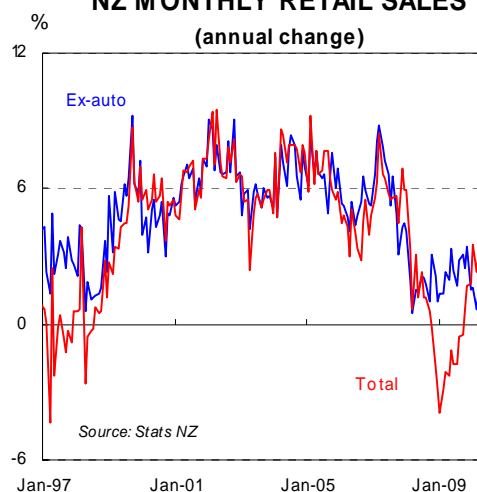
#### Q2 Consumer Price Index

**Previous: +0.4%, f/c +0.4% qoq**

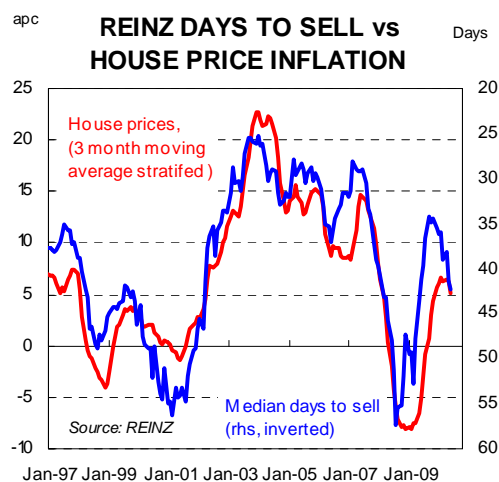
We expect a 0.4% increase in the CPI in the June quarter. Looking at the detail, we expect tradable inflation to have largely been flat over the quarter reflecting the lagged effects of the appreciation in the NZ dollar over late 2009. Meanwhile, we expect the recovery in domestic conditions – along with a rise in the tobacco excise tax – to drive a modest rebound in non-tradable inflation.

With the NZ economy entering its second year of recovery, underlying inflation is expected to lift over the coming year. Added to this, a raft of Government policy changes will boost annual headline CPI to well over 5% by the middle of 2011. We believe there are substantial risks to the RBNZ's assumption that this high headline inflation will not change price and wage setting behaviour.

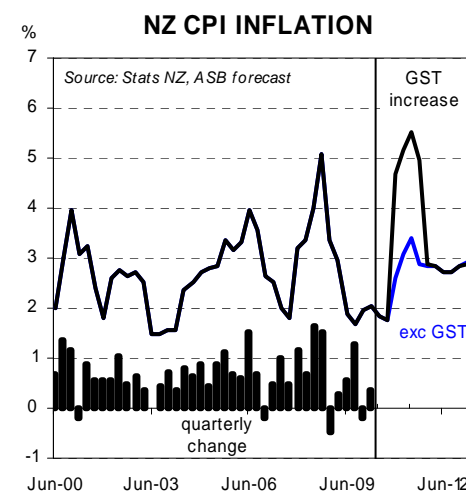
**NZ MONTHLY RETAIL SALES**  
(annual change)



**REINZ DAYS TO SELL vs HOUSE PRICE INFLATION**



**NZ CPI INFLATION**

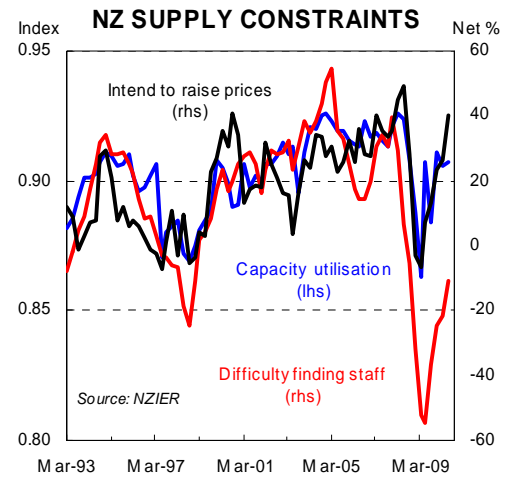


## NZ Data Review: weekly recap

### Q2 NZIER Quarterly Survey of Business Opinion

NZIER Quarterly Survey of Business Opinion paints a picture of slightly softer economic growth, against a backdrop of continued inflation pressures in the economy. Both headline business confidence and firms' own assessment of trading conditions dipped in Q2, and profitability remains subdued. Nonetheless, the current level of firms' assessment of own activity still suggest reasonably healthy economic growth over 2010.

Despite the slightly softer activity outlook, inflation pressures still clearly exist. This is reflected in the surge in firms' pricing intentions and cost expectations. Part of this surge is likely to reflect greater awareness of the higher headline inflation over the coming year as a result of the raft of Government charges. However, the elevated level of the capacity utilisation measure suggests firms continue to face capacity pressures. In addition, despite lower hiring intentions, firms are noting increased difficulty in finding both skilled and unskilled staff, thus pointing to wage pressures over the coming year.



## 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 12 Jul	11.50	JP	Domestic Capital Goods Price Index.	Jun	m%ch	0.1	~	~
					y%ch	0.4	~	~
	13.30	AU	No. Of own-occupiers	May	m%ch	-1.8	1.5	1.0
Tue 13 Jul	13.30	AU	Value of all loans	May	m%ch	0.6	~	2.0
	10.45	NZ	Food prices	Jun	m%ch	-0.7	~	+1.5
	13.30	AU	NAB business conditions	Jun	Index	6.0	~	~
	13.30	AU	NAB business confidence	Jun	Index	5.0	~	~
	16.30	JP	Industrial production	May	m%ch	-0.1	~	~
	16.30	JP	Capacity utilization	May	m%ch	0.0	~	~
	17.00	JP	Consumer Confidence	Jun	Index	42.7	~	~
Wed 14 Jul	10.00	NZ	REINZ house sales	Jun	y%ch	-17.2	~	~
	10.00	NZ	REINZ housing price index	Jun	m%ch Index	-1.4 3,210	~	~
	10.45	NZ	Retail sales	Jun	m%ch	-0.3	~	+0.1
	10.45	NZ	Retail sales ex-auto	Jun	m%ch	-0.2	~	+0.2
	12.30	AU	MI/WBC consumer confidence	Jul	%	-5.7	~	~
	12.30	AU	MI/WBC consumer sentiment index	Jul	Index	101.9	~	~
	13.00	AU	DEWR skilled vacancies	Jul	m%ch	-0.3	~	~
16.00	JP	BoJ monetary policy meeting	Jul	~	~	~	~	
Thu 15 Jul	~	JP	BOJ target rate	Jul	%	0.1	~	0.1
	10.30	NZ	Business NZ PMI	Jun	Index	54.5	~	~
	13.00	AU	Consumer inflation expectation	Jul	%	3.4	~	~
	13.30	AU	New motor vehicle sales	May	m%ch	-3.2	~	~
					y%ch	16.4	~	~
	17.00	CH	Real GDP	QII	y%ch	11.9	10.4	~
	17.00	CH	Producer price index	Jun	y%ch	7.1	6.8	~
	17.00	CH	Purchasing price index	Jun	y%ch	12.2	11.6	~
	17.00	CH	Consumer price index	Jun	y%ch	3.1	3.3	~
	17.00	CH	Retail sales	Jun	y%ch	18.7	18.8	~
ytd					18.2	18.3	~	
17.00	CH	Industrial production	Jun	y%ch	16.5	15.5	~	
				ytd	18.5	18.2	~	
Fri 16 Jul	10.45	NZ	Consumer prices	QI	q%ch	0.4	~	0.4
				y%ch	2.0	~	1.9	
	11.50	JP	Tertiary industry index	May	m%ch	2.1	~	~

## Calendar – North America & Europe

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

Date	UK			Period	Unit	Forecast		
	Time	Econ	Event			Last	Market	CBA
Mon 12 Jul	11.30	UK	GDP	QI	q%ch	0.3	0.3	~
					y%ch	-0.2	-0.2	~
	11.30	UK	Current account	QI	£bn	-1.7	-4.5	~
Tue 13 Jul	17.30	CA	BoC senior loan officer survey	QII	Index	-18.7	~	~
	~	UK	RICS house price balance	Jun	%	22.0	~	~
	11.30	UK	CPI	Jun	m%ch	0.2	~	~
					y%ch	3.4	~	~
	12.00	EZ	ZEW survey (econ. sentiment)	Jul	Index	18.8	~	~
	12.00	GE	ZEW survey (econ. sentiment)	Jul	Index	28.7	~	~
	15.30	CA	International merchandise trade	May	C\$bn	0.2	~	~
	15.30	US	Trade balance	May	\$bn	-40.3	-39.5	~
	21.00	US	Monthly budget statement	Jun	\$bn	135.9	-75.0	~
Wed 14 Jul	11.30	UK	Jobless claims change	Jun	'000	-30.9	~	~
	11.30	UK	ILO unemployment rate (3mths)	May	%	7.9	~	~
	12.00	EZ	CPI	Jun	m%ch	0.1	~	~
	12.00	EZ	Industrial production	May	m%ch	0.8	~	~
					y%ch	9.5	~	~
	15.30	US	Import price index	Jun	m%ch	-0.6	-0.2	~
					y%ch	8.6	~	~
	15.30	US	Retail sales	Jun	%	-1.2	0.1	~
17.00	US	Business inventories	May	%	0.4	0.5	~	
21.00	US	Minutes of FOMC meeting	Jul					
Thu 15 Jul	11.00	EZ	ECB publishes July monthly report					
	11.30	UK	BoE housing equity withdrawal	QI	£bn	4.0	~	~
	15.30	CA	New motor vehicle sales	May	m%ch	-4.7	~	~
	15.30	CA	Manufacturing sales	May	m%ch	0.2	~	~
	15.00	US	Producer price index	Jun	m%ch	-0.3	-0.1	~
					y%ch	5.3	3.2	~
	15.00	US	Initial jobless and continuing claims	Jul	~	~	~	~
	16.15	US	Industrial production	Jun	%	1.3	0.0	~
	16.15	US	Capacity utilization	Jun	%	74.1	74.2	~
17.00	US	Senate Holds Hearing on Nominations of Yellen, Raskin, Diamond						
Fri 16 Jul	12.00	EZ	Trade balance	May	€bn	1.6	~	~
	15.30	US	Consumer price index	Jun	m%ch	-0.2	0.0	~
					y%ch	2.0	1.2	~
16.00	US	Net long-term TIC flows	May	\$bn	83.0	~	~	

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