

Business Weekly

The good, the not so good and the bad.

This Week

Last week was a mixture of the surprisingly strong (retailing), the unsurprisingly soft (housing) and the surprisingly weak (manufacturing survey).

Retailing volumes were very upbeat, rising 1.3% over Q2. Growth in spending was broad based, including in discretionary categories, so cannot simply be put down to early bird pre-GST spending. People are being enticed to buy more, though discounting remains prevalent. We expect to see a pre-GST pick-up in durable goods spending over Q3, followed by a matching lull after October 1st.

Housing market activity in July was, unsurprisingly, soft – continuing the recent pattern of low turnover reported by the REINZ. House prices were surprisingly resilient in the first half of the year given slowing migration and growing focus on both impending tax changes and interest rate increases. However, we expect prices will slip 3-4% by mid-2011 (see [Housing Confidence](#) survey for more details on the outlook).

One of the drivers of a soft housing market over the next year will be the reduced inflow of net migration. Fairly predictably, the outflow of New Zealanders to Australia has picked up as Australian economic expansion has triggered strong jobs growth. But the inflow of fresh immigrants has started to slow quite noticeably in recent months, particularly in the work permit category. We expect the monthly net inflow (seasonally adjusted) to be flat for the remainder of 2010, which will contribute to a period of below-average population growth. Friday's figures are likely to show July's migration flows were also weak.

The economy is rebalancing away from being driven by households. Future growth will be shaped more by businesses' capital spending and by NZ businesses selling more to foreigners. Exports and manufacturing output have been showing strong benefits from the rebound in Asian and Australian economies. However, last week's BNZ/Business NZ manufacturing survey showed a slower pace of expansion and implied contraction in new orders. During the upturn the survey has generally indicated a softer recovery in core manufacturing than what has occurred in reality. However, the dip is a cautionary tale that the recent momentum may be waning, which further softness would reinforce.

The short-term visitor figures (for release with the migration figures) will give some indication of the recovery in tourism. Long-haul visitors from Europe and the US have still been declining and are unlikely to recover in the immediate future. Australian visitors and some recovery in Asian visitors have partly offset weakness elsewhere. Visitor numbers from the Asia-Pacific have started to flatten off.

The US economy is back in the spotlight with momentum slowing and the Federal Reserve to now reinvest maturing debt proceeds back into Treasuries. Housing and industrial activity are on the radar for this week.

Click here for:

[Foreign Exchange](#)

- NZD falls against most major crosses, except the euro.

[Interest Rates](#)

- Interest rates ease on weak offshore sentiment.

[Week Ahead](#)

- Consumer confidence and net migration likely to remain subdued.

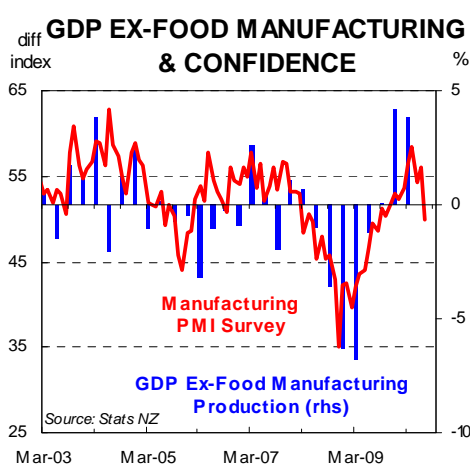
[Week in Review](#)

- Q2 retail trade surprisingly strong, housing market remains weak as expected.

[Global Calendars](#)

- US industrial production and housing market data, EU and UK CPI.

Chart of the week



- Trends in the BNZ/Business NZ Performance of Manufacturing Index loosely track reported non-food manufacturing output, though during the recent uptick the PMI has been modest in comparison to measured manufacturing output.
- The July survey reported across-the-board drops in all of the 5 component categories, pushing the overall index down to 49.9 – a fraction below the 50 expansion/contraction level.
- In particular, the new orders component dropped sharply to 47.6 to 57.4.
- Even though the PMI is seasonally adjusted, it can still bounce around from one month to the next. Nevertheless, another weak result would suggest manufacturing is losing steam, in the second half of 2010 after rebounding strongly from late 2009.

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	NZD/USD	0.7063	0.7318	0.7191	0.6973	DOWN	0.6950	0.7150
NZD/AUD	NZD/AUD	0.7897	0.7966	0.8213	0.7852	DOWN	0.7850	0.8000
NZD/JPY	NZD/JPY	60.84	62.51	62.59	62.88	DOWN	60.00	61.50
NZD/EUR	NZD/EUR	0.5529	0.5511	0.5571	0.5121	DOWN	0.5475	0.5575
NZD/GBP	NZD/GBP	0.4528	0.4581	0.4666	0.4450	DOWN	0.4475	0.4550
TWI	TWI	66.2	67.3	67.7	64.7	DOWN	65.50	66.50

^Weekly support and resistance levels * Current is as at 11.10 am Monday; week ago as at Monday 5pm

- The NZD lost ground against all the major crosses except the euro. US dollar strength was the key theme of the week, with the US dollar index (DXY) up 3.17%, and the euro being the worst performer against the US dollar (down almost 4%) followed by the NZD (down 3.7%).
- With weak offshore sentiment dominating, the NZ dollar steadily declined against the US dollar. The stronger than expected NZ retail trade report on Friday resulted in some temporary strength in the NZD, roaring up from 0.7090 to 0.7150. However, the gains were short-lived and were steadily unwound over the weekend.
- Now that the US company reporting season is almost over, we think the equity market will adjust lower to reflect soft US economic data and fade as a support for the AUD and NZD. In addition, we expect the recent run of soft US data to continue this week. The NZD/USD is likely to suffer as the USD lifts on 'safe haven' demand and softer global growth expectations.
- We also see downside risk to the NZD/AUD this week. The RBA Governor and deputy Governor are likely to talk positively about the Australian economy, further highlighting the Australian economy is outperforming New Zealand's.

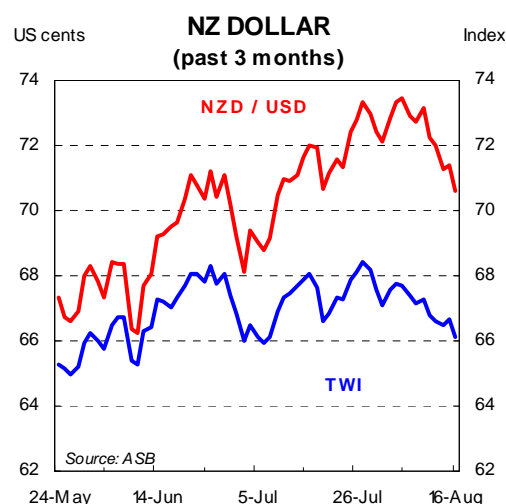
Short-term outlook:

Key data	Date	Time (NZST)	Market expects
August Consumer Confidence	19/8	3.00 pm	-
July Net Migration	20/8	10.45 am	-

Potential currency movers from offshore this week: Eurozone CPI, UK house prices, Japan GDP (16th); RBA minutes, RBA Governor speech, Eurozone ZEW survey of investors, UK CPI, US producer prices, US housing starts, US building permits, US industrial production (17th); minutes from BoE's policy meeting (18th); UK retail trade, UK mortgage approvals, jobless claims (19th); RBA deputy Governor speech (20th).

Speakers: Geithner, Kocherlakota (17th); Bullard, Evans (19th).

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



- Our late 2010/early 2011 outlook for the NZD has been revised up recently, reflecting a number of factors. Nonetheless, we continue to expect the NZD will trend slightly lower over the next year.
- Contributing to the revision is our weaker view on the US dollar. The weakness in the US dollar now appears less transient than initially thought. The US economy has lost some of the earlier momentum that it demonstrated in the early part of 2010. As a result, we have pushed out the timing of the first Fed Funds rate hike from the end of 2010 to mid-2011. US bond yields have declined to unattractive levels which will likely to weigh on investor appetite to hold US dollar dominated assets.
- The NZ dollar has held up relatively well despite the weaker run of domestic data, in part due to the US dollar weakness. However, adding to our view of a resilient NZ dollar is the likelihood that market has under-priced further RBNZ rate hikes. The 12 month OIS market has less than 45 basis points of rate hikes priced in. However, we believe the RBNZ will deliver more than 50 basis points of rate hikes over the next twelve months, and our NZD forecasts reflect that likelihood.
- Question marks are being raised about the momentum of New Zealand's economy. In contrast, the Australian economy is performing better. The likely pause in the RBNZ tightening cycle will leave the bulk of the New Zealand yield curve below the Australian yield curve for longer than previously forecast. This has led us to revise lower our NZD/AUD forecasts, with the NZD recovering against the AUD at a more gradual pace over the next year.

Interest Rate Market

Wholesale interest rates	Current	Week ago	Month ago	6 mths ago	Year ago	ST Bias
Cash rate	3.00	3.00	2.75	2.50	2.50	FLAT
90-day bank bill	3.25	3.27	3.23	2.73	2.79	FLAT
2-year swap	3.88	3.96	4.23	4.25	4.21	DOWN
5-year swap	4.44	4.54	4.83	5.24	5.51	DOWN
5-year benchmark gov't stock	4.46	4.61	4.74	5.09	4.99	DOWN
NZSX 50	3016	3054	2986	3060	3151	DOWN

* Current is as at 11.10 am Monday; week ago as at Monday 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.6 months ago).

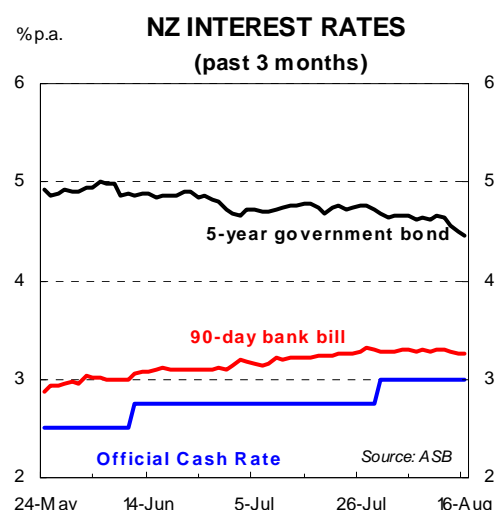
- Interest rates fell across the curve over the week, led by further declines in offshore sentiment. The FOMC statement on Wednesday morning was relatively downbeat, noting that the pace of recovery in output and employment has slowed in recent months. In light of the slower than expected recovery, the Federal Reserve will hold the size of its balance sheet constant, by rolling over holdings of US Treasury securities as they mature, rather than allowing the balance sheet to decline slowly. As a result, yields on US Treasuries continued to decline over the rest of the week. US 10-year Treasury yields fell 18 basis points over the week, to 2.65%. Meanwhile, the 2-year yield fell to record lows, at just 0.53%.
- NZ interest rates were led lower by developments offshore. Even the stronger than expected retail trade report failed to arrest the downbeat mood of the market. Markets currently have around 54% priced in for a September rate hike, compared to 64% a week ago.

Short-term outlook:

Key data	Date	Time (NZST)	Market expects
August Consumer Confidence	19/8	3.00 pm	-
July Net Migration	20/8	10.45 am	-

Comment: Local data releases are relatively light this week. While consumer confidence and net migration are both key to the outlook, monthly data are often too volatile to generate much market reaction. As a result, offshore data are likely to drive market sentiment this week. In the US, we expect the recent run of soft data to continue. Meanwhile in the UK, we see a risk the minutes of the previous MPC meeting may reveal a three-way split, which the market may see as a sign policy-makers are moving towards less restrictive monetary policy settings.

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



- The RBNZ continued 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 brought into focus 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.
- Nonetheless, the Fonterra’s announcement of a likely downward revision to its payout for the 2010/11 season, and the weaker than expected Q2 employment data, lead us to believe the RBNZ will pause later this year. In addition, we now expect the OCR will reach 4.5% next year instead of 5%.

NZ Data Preview: a look at the week ahead

Data	Date	Time (NZST)	Previous	Market expects	ASB expects
Q2 Producer Price Index – inputs QoQ	19/8	10.45am	+1.3%	-	-
Q2 Capital Goods Price Index QoQ	19/8	10.45am	-0.1%	-	-
August Consumer Confidence	19/8	3.00pm	115.6	-	-
July International Travel & Migration – net migration	20/8	10.45am	+70	-	-

Friday 20 August

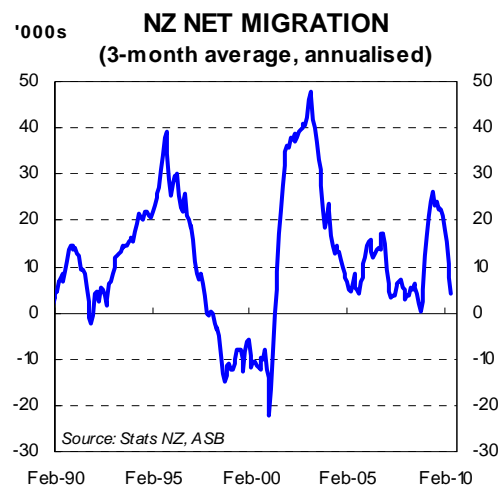
July International Travel and Migration

Net Migration: previous 16,504 (year to June)

Short-term Visitor Arrivals: +6.7% yoy

The pace of net migration has slowed rapidly in recent months. The number of departures has started to pick up (albeit from low levels), as the stronger Australian employment market proves attractive to New Zealanders. Arrivals have also started to soften, particularly arrivals on work permits reflecting NZ's weaker labour market. We expect net migration will remain subdued over 2010.

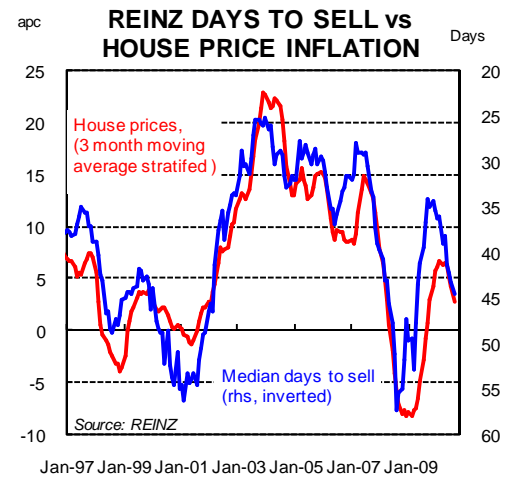
Tourism numbers have remained firm throughout the recession, with a surge in visitor arrivals from Australia offsetting declines in visitors from other areas. We expect arrivals from Australia to remain robust, while a recovery in visitor numbers from Asia appears to be developing.



NZ Data Review: weekly recap

July REINZ House Sales

The REINZ housing figures confirmed housing market activity remained subdued during July. House sales remained steady over the month on a seasonally-adjusted basis, and remain at very low levels. Meanwhile, house prices slipped 1% over the month, with prices now only 1.8% higher on year-ago levels. House prices held up surprisingly well over the first half of 2010, given the weakness in demand during this time. Given the weakened fundamentals for housing demand, including slowing population growth, rising interest rates and change in tax policy, we expect house prices will come under pressure over the second half of the year, falling around 3% over the next year.

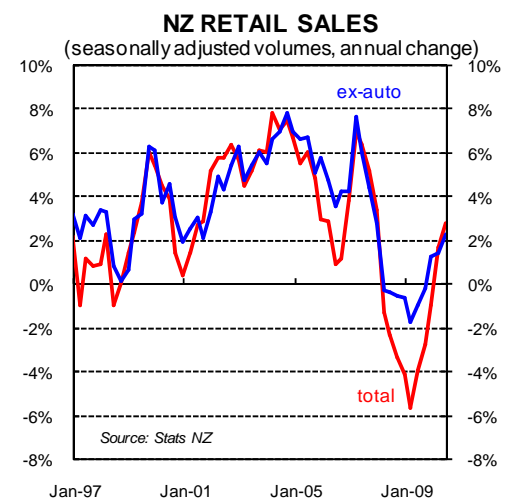


June Retail Sales

The bounce-back in retail sales for the June month suggests some willingness on the part of households to spend again. Over the June quarter, total retail sales volumes increased by a larger than expected 1.3%. Nonetheless, discounting looks to have played a part in encouraging sales, particularly that for appliances. This is in line with earlier Q2 CPI data which had shown price declines in recreational and electrical goods.

Vehicle sales continue to recover from the very weak levels of the recession, and were a key contributor to the increase in total sales volumes. Some of this might reflect households bringing forward the purchase of big-ticket items ahead of the impending GST increase.

Nonetheless, the relatively broad-based increase in sales, particularly the decent increase in clothing and footwear sales volumes, suggests a genuine recovery in discretionary spending on the part of households, beyond the bringing forward of sales in anticipation of the GST increase in October.



Global Data Calendars

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

Calendar - Australasia, Japan and China

Date	Time		Econ Event	Period	Unit	Forecast		
	NZT					Last	Market	ASB/CBA
Mon 16 Aug	14.00	CH	Conference Board China June leading economic index					
Tue 17 Aug	~	AU	RBA Governor Stevens speaks in Perth	~	~	~	~	~
	13.30	AU	Reserve Bank's Board August minutes	Aug	~	~	~	~
Wed 18 Aug	13.00	AU	Westpac leading index	Aug	m%ch	0.2	~	~
	13.00	AU	DEWR skilled vacancies	Aug	m%ch	0.3	~	~
	13.00	AU	CBAHIA house affordability	QII	Index	118.8	~	~
	13.30	AU	Wage cost index	QII	q%ch	0.9	~	0.9
					y%ch	3.0	~	3.1
	17.00	JP	Leading index CI	Jun	Index	98.9	~	~
	17.00	JP	Coincident index CI	Jun	Index	101.3	~	~
Thu 19 Aug	10.45	NZ	Producer prices- outputs	QII	q%ch	1.8	~	~
	10.45	NZ	Producer prices- inputs	QII	q%ch	1.3	~	~
	16.30	JP	All industry activity index	Jun	m%ch	0.2	~	~
	13.30	AU	Average Weekly Earnings	May	q%ch	1.1	~	1.2
					y%ch	5.8	~	5.7
15.00	NZ	ANZ consumer confidence index	Aug	Index	115.6	~	~	
Fri 20 Aug	10.45	NZ	Net migration	Jul	~	70.0	~	~
	13.45	AU	RBA Deputy Governor Ric Battellino speaks in Brisbane					
	15.00	NZ	Credit card spending	Jul	m%ch	4.5	~	~
					y%ch	1.0	~	~
19.00	JP	Convenience store sales	Jul	y%ch	-1.5	~	~	
Sat 21 Aug	~	AU	Australian Federal Election					

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 16 Aug	10.00	EZ	CPI	Jul	q%ch	0.0	~	~
	13.30	US	Empire manufacturing	Aug	~	5.1	10.0	~
	14.00	US	Net long-term TIC flows	Jun	\$bn	35.4	~	~
	15.00	US	NAHB housing market index	Aug	Index	14.0	15.0	~
Tue 17 Aug	09.00	EZ	ECB current account	Jul	€bn	-5.8	~	~
	09.30	UK	CPI	Jul	m%ch	0.1	~	~
					y%ch	3.2	~	~
	10.00	EZ	ZEW survey (econ. sentiment)	Aug	Index	10.7	~	~
	13.30	CA	Manufacturing sales	Jun	m%ch	0.4	~	~
	13.30	US	Producer price index	Jul	m%ch	-0.5	0.2	~
					y%ch	2.8	4.2	~
	13.30	US	Housing starts	Jul	'000	549.0	561.0	~
					m%ch	-5.0	2.1	~
	13.30	US	Building permits	Jul	'000	583.0	580.0	~
				m%ch	2.1	-0.5	~	
14.15	US	Industrial production	Jul	%	0.1	0.6	~	
14.15	US	Capacity utilization	Jul	%	74.1	74.6	~	
Wed 18 Aug	09.30	UK	Bank of England minutes	Aug	~	~	~	~
	10.00	EZ	Construction output	Jun	m%ch	-1.0	~	~
					y%ch	-6.3	~	~
Thu 19 Aug	07.00	GE	Producer prices	Jul	m%ch	0.6	~	~
					y%ch	1.7	~	~
	09.30	UK	Retail sales	Jul	m%ch	0.7	~	~
					y%ch	1.3	~	~
	09.30	UK	Public sector net borrowing	Jul	£bn	14.5	~	~
	13.30	CA	Leading indicators	Jul	m%ch	1.0	~	~
	13.30	CA	Wholesale sales	Jun	m%ch	-0.1	~	~
	13.30	US	Initial jobless and continuing claims	Aug	~	~	~	~
	15.00	US	Philadelphia Fed.	Aug	~	5.1	7.5	~
	15.00	US	Leading indicators	Jul	%	-0.2	0.1	~
Fri 20 Aug	12.00	CA	CPI	Jul	m%ch	-0.1	~	~
					y%ch	1.0	~	~

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