

Business Weekly

The theory of relativity

This Week

Most of the news flow over the course of the past week was better than expected, with economic data beating expectations both domestically and internationally. Numerous earnings reports were favourable, helping equity markets firm, and the latest Consensus Economics estimates for global GDP growth were revised up.

China's economy grew by a faster than expected 7.9% in annual terms in the QII figures released last week. We estimate that China's economy grew by 2.9% in QII alone. This marks a significant acceleration in the economy since QIV 2008, where GDP growth ground to what equates to close to a halt for China.

During the week New Zealand's retail sales figures for May were stronger than expected, and the Consumer Price Index (CPI) rose 0.6%, taking the annual pace of inflation to 1.9%. The quarterly CPI outcomes often give a good guide to this week's Australian inflation figures.

The market was surprised last week when New Zealand's long-term sovereign credit rating outlook was cut to negative from stable by Fitch Ratings. The revision reflects concern about the medium-term growth outlook for New Zealand given its persistently large current account deficit and rising foreign indebtedness. The NZD immediately dropped 50 pips following the announcement of the outlook downgrade, but later recovered to pre-announcement levels, buoyed by an improvement in risk appetite and a rally in US equities.

Last week reports continued to provide investors with a reason to bid stocks higher. Goldman Sachs, JP Morgan, Bank of America all bettered analysts' earnings expectations. Citigroup also surprised the market reporting a profit of 49c per share against expectations of a loss of 37c. All three major US indices closed out their best week in four months, with 7% lifts over the week. However, lingering concerns remain, which this week are centred on the survival prospects of CIT Group Inc, a major provider of finance to small and medium businesses in the US.

On the central bank front, this week we'll see the minutes of the RBA's June meeting. Stronger than anticipated economic outcomes were noted in the statement following the meeting, however, the RBA maintained an easing bias. The Bank of Canada also meets this week – we expect rates will remain on hold, and are likely to stay there until QII 2010. Whilst quantitative and credit easing measures remain a possibility for the BoC, the brightening outlook for the Canadian economy means they are unlikely to be implemented. As well as watching the above-mentioned central bank developments, this week we will continue to keep a close eye on the US reporting season, whilst the data schedule is fairly light.

Click here for:

[Foreign Exchange](#)

- NZD lifts against a weak USD, despite Ratings outlook shock.

[Interest Rates](#)

- Long-term interest rates lift as growth outlook improves.

[Week Ahead](#)

- Light data week. Tourism and migration data, and Credit Card Billings due.

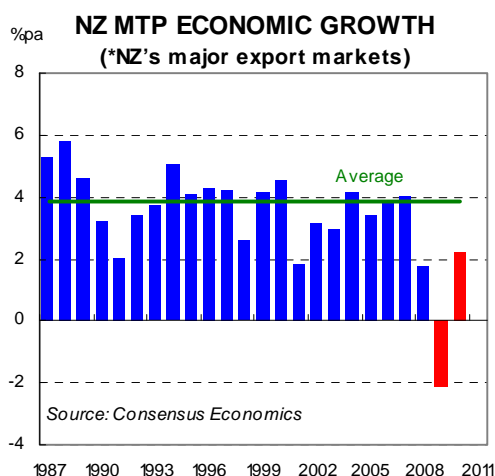
[Week in Review](#)

- CPI inflation in line with our expectations. Retail Trade Survey strong for May.

[Global Calendars](#)

- US company reports hold centre stage UK GDP due Friday.

Chart of the week



Let the upgrade cycle begin

- The latest *Consensus Economic Forecasts* were released last week. The outlook for 2009 world GDP (and industrial economies) has been upgraded for the first time. The breadth of upgrades for 2010 is high.
- World GDP growth in 2010 is expected to be only a little below average (and about the same as 2008).
- Forecasts for Asia in 2009 and 2010 continue to be lifted. New Zealand's major trading partner growth forecast for 2009 has lifted from -2.3% to -2.1% and 2010 forecast has lifted from +2.1 to +2.2
- Economic growth in economies that consume bulk commodities and base metals are now expected to be around average in 2010 – Good news for Australia.

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	0.6450	0.6237	0.6384	0.5537	0.7638	FLAT-UP	0.6400	0.6550
NZD/AUD	0.8039	0.8040	0.7962	0.8104	0.7853	FLAT	0.7950	0.8150
NZD/JPY	60.86	57.62	61.62	50.32	81.13	FLAT-UP	60.00	62.00
NZD/EUR	0.4571	0.4480	0.4587	0.4143	0.4814	FLAT-UP	0.4500	0.4650
NZD/GBP	0.3947	0.3871	0.3907	0.3719	0.3820	FLAT-UP	0.3900	0.4000
TWI	60.7	59.2	60.5	54.8	67.6	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 posted gains on the USD last week, despite an unexpected change to NZ's credit rating outlook from Fitch. Fitch Ratings has affirmed New Zealand's Long-term Issuer Default Ratings, but the Outlook on the ratings has been revised to Negative from Stable.
- The main driver of the moves in FX was an ongoing improvement in risk appetite, and the USD and JPY have weakened with this backdrop. The NZD lifted on both these cross rates, as did the AUD. The NZD/AUD cross rate was unchanged on week-ago levels. Small gains were posted against the GBP and euro.
- In sum, the moves saw a 2.5% lift for the local currency on a trade-weighted basis. This is not what we would expect in a week where a downgrade to the NZ ratings outlook changed to negative. However, currency is a relative game, and despite the Negative Outlook from Fitch, New Zealand still stacks up relatively well when judging the woes of the world these days. Ongoing USD weakness remains the dominant theme.
- Volatility in the US sharemarket is low – the VIX index closed below 25 for the first time since Sept 2008. In turn that becomes bullish for commodities, and the riskier currencies, i.e. AUD and NZD. Last week we saw no local follow through from the Jakarta bombings, after the AUD was initially sold on the news.
- The NZD is sitting significantly above the much tested support level at 0.625, and AUD is in a clear channel which looks like it could break higher. Further good news from the equity markets is a likely catalyst for the two units to press higher. The US reporting season remains the focus for the FX market.

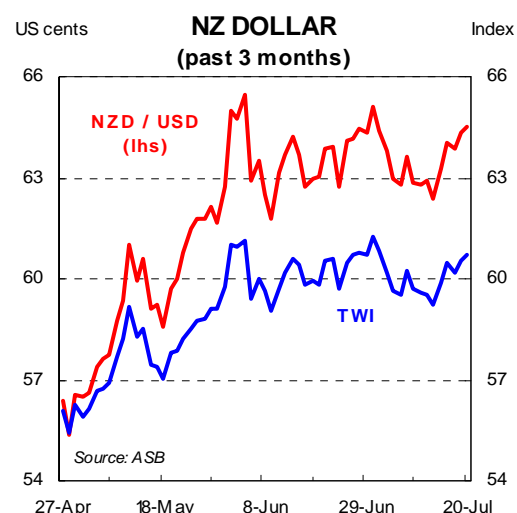
Short-term outlook:

Key data	Date	Time (NZST)	Market expects
June Net Migration	20/7	10.45 am	-

Potential currency movers from the US this week: Leading Indicators (21st) Chicago Fed Index, Consumer Confidence (22nd) House Price Index (23rd) Initial Jobless Claims, Existing Home Sales (24th) Uni Of Michigan Confidence (24th)

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 given the RBNZ's acknowledgement that global factors have much to do with the NZD's lift.



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	5.00	8.25	FLAT
90-day bank bill	2.80	2.80	2.81	4.31	8.43	FLAT
2-year swap	3.84	3.72	3.96	3.87	7.67	FLAT/UP
5-year swap	5.34	5.19	5.46	4.32	7.37	FLAT/UP
11/11 gov't stock	4.68	4.65	4.90	3.97	6.08	FLAT/UP
NZSX 50	2808	2737	2788	2751	3121	UP

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

- Longer-end interest rates picked up over the first half of last week, driven by an improvement in sentiment that also saw US equity markets rally over the week. NZ 5-year government bond yields increased 3 basis points, and the 5-year swap rate went 15 basis points with it. The NZ government bond market outperformed offshore markets (i.e. a smaller sell-off was observed here), in part aided by the maturity of the July 2009 bond, supporting demand for other long-dated NZ Government Bonds.
- We expect the RBNZ to keep the OCR on hold at 2.5% at the July OCR review (Thursday 30th July). The market expectation has pared back slightly, to just 16% chance of a cut priced in (25% last week). We expect no change in tone, with the RBNZ continuing to emphasise its easing bias and expectations to hold rates at or below current levels until mid-2010.
- The RBNZ may be frustrated by the strength in the NZD and market pricing for rate hikes earlier than the RBNZ has signalled. With the economic outlook still fragile, we continue to see scope for further rate cuts, possibly in September and October.

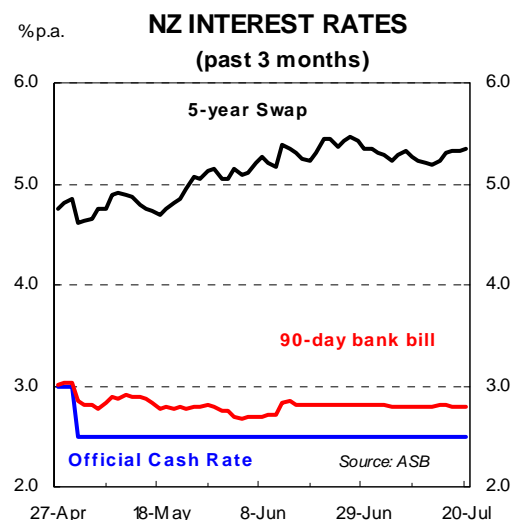
Short-term outlook:

Key data	Date	Time (NZST)	Market expects
June Net Migration	20/7	10.45 am	-

Comment: Sustained improvement in net migration is one risk to watch. A pick-up in population growth is one positive for the NZ economy and ongoing strength may see market pricing reduce expectations for further cuts this year, or bring forward timing of rate hikes in 2010. With little in the way of local data, offshore sentiment remains a key driver of local movements. Continued confidence in the US equity market is likely to see further lifts in NZ longer term interest rates.

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

- The RBNZ left the cash rate unchanged at 2.5% at the June OCR announcement. 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 June statement was dovish, playing down green shoots optimism and highlighting the downside risks to the economic outlook. The RBNZ maintained an explicit easing bias, mentioning the potential for the OCR to move lower and restated it continues to expect to hold the OCR at current levels until the latter part of 2010.
- The RBNZ revised down its growth outlook in June, and as a result inflation pressures are considerably weaker. The RBNZ forecasts CPI inflation to briefly fall through the bottom of the target band later this year, then recover to remain 'comfortably' in the middle of the target band.
- The RBNZ's export-led recovery is heavily dependent on the trade-weighted exchange rate remaining below average for an extended period. In our view, the RBNZ's exchange rate assumption is reasonably heroic, and differs from our own view of US dollar weakness remaining a dominant driver of the NZ dollar. The assumption leaves the RBNZ vulnerable to the risk inflation falls uncomfortably low. There remains downside risk to the RBNZ's economic outlook, and the RBNZ is likely to want to deliver further monetary policy stimulus.
- 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. The RBNZ is disappointed with this reaction. The longer that interest rates and the NZ dollar remain above the RBNZ's assumptions, the more pressure the RBNZ will feel for further cuts to remind the markets of its position. 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
International Travel and Migration	21/7	10.45 am	11,202 p.a.	-	-

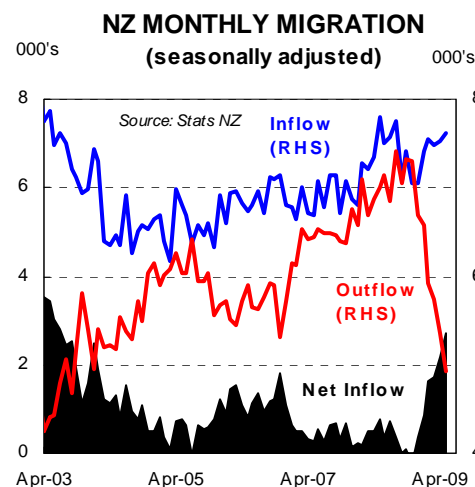
Tuesday 21 July

June International Travel and Migration

Previous: 11,202 net migrants (May 2009 year)

Net migration inflows have picked strongly over the past few months, mostly owing to a dramatic fall in the number of departures, particularly to Australia. The deterioration in the world economy is likely to be behind the decline in departures as a weakening labour market in Australia has deterred New Zealanders from heading across the Tasman. We expect these trends to continue, supporting a modest pick up in net migration over the year, to around 20,000 net new migrants per annum. A boost to net migration will provide some underlying support to NZ's flagging housing construction sector.

Overseas short-term visitor arrivals are also expected to slow over the next year as weakening world growth reduces demand for international travel.



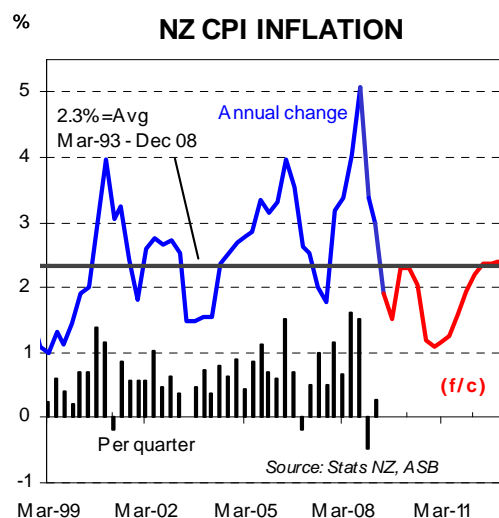
NZ Data Review: weekly recap

Q2 CPI

CPI inflation showed a 0.6% qoq increase, bringing annual inflation down to 1.9%. The annual increase is the smallest since the September 2007 quarter. We expected a 0.6% qoq increase, slightly stronger than the market median expectation of 0.5%. The RBNZ's June MPS forecast was 0.4% qoq.

Non-tradable inflation lifted 3.3% yoy, slightly weaker than our forecast 3.8% and the RBNZ's 3.4% forecast. Significant influences over the quarter were food and transportation.

Given the depth of the current recession, we expect the RBNZ will have some tolerance for inflation printing stronger than its June expectations. Inflation below the target band is a greater concern in the near-term for central banks. Resource constraints are slipping away at a dramatic pace, highlighting that the sustained contraction in the economy will filter through to inflation over time. Most indicators within recent business surveys point to subdued price and cost pressures over 2009.



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	Last	Forecast				
	NZT						Market	ASB/CBA			
Mon 20 Jul	13.30	AU	PPI	QII	q%ch	-0.4	-0.1	0.3			
					y%ch	4.0	2.8	3.2			
Tue 21 Jul	10.45	NZ	Visitor arrivals	Jun	%	0.2	~	~			
			11.50	JP	BoJ monetary policy meeting minutes for May						
			13.30	AU	New motor vehicle sales	Jun	m%ch	5.4	~	10.0	
							y%ch	-12.6	~	-5.2	
			13.30	AU	Reserve Bank's Board July minutes						
15.00	NZ	Credit card spending	Jun	y%ch	-2.4	~	~				
Wed 22 Jul	13.00	AU	DEWR skilled vacancies	Jul	m%ch	-3.7	~	~			
			13.30	AU	CPI	Headline	QII	q%ch	0.1	0.6	0.6
						y%ch	2.5	1.6	1.6		
						Underlying	q%ch	1.1	0.7	0.7	
y%ch	4.2	3.8	3.8								
14.00	AU	Reserve Bank Asst Gov. (Financial Market) Debelle - MFIA Panel discussion.									
Thu 23 Jul	11.50	JP	Merchandise trade balance	Jun	¥bn	298.2	~	~			
			Adjusted merch. trade bal	Jun	¥bn	222.4	~	~			
			Merchandise trade exports	Jun	y%ch	-40.9	~	~			
			Merchandise trade imports	Jun	y%ch	-42.4	~	~			
			19.00	AU	Reserve Bank Asst Gov. (Financial Markets) Debelle speaks at University Forum.						
Fri 24 Jul	16.30	JP	All industry activity index	May	m%ch	2.6	~	~			

Calendar – North America & Europe

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

Date	UK		Econ Event	Period	Unit	Last	Forecast	
	time						Market	CBA
Mon 20 Jul	00.01	UK	Rightmove house prices	Jul	m%ch	-0.4	~	~
					y%ch	-5.5	~	~
	07.00	GE	Producer prices	Jun	m%ch	0.0	~	~
					y%ch	-3.6	~	~
	13.30	CA	Wholesale sales	May	m%ch	-0.6	~	~
	15.00	US	Leading indicators	Jun	%	1.2	0.5	~

Date	time	Econ	Event	Period	Unit	Last	Market	CBA	
Tue 21 Jul	09.30	UK	Public finances (PSNCR)	Jun	£bn	18.8	~	~	
	09.30	UK	Public sector net borrowing	Jun	£bn	19.9	~	~	
	13.30	US	Chicago Fed activity index	Jun	Index	-2.3	~	~	
	14.00	CA	Bank of Canada rate	Jul	%	0.25	~	0.25	
Wed 22 Jul	09.30	UK	Bank of England minutes	~	~	~	~	~	
	10.00	EZ	Industrial new orders	May	m%ch	-1.0	~	~	
					y%ch	-35.5	~	~	
	11.00	UK	CBI quarterly industrial trends total orders						
	13.30	CA	Retail sales	May	m%ch	-0.8	~	~	
	13.30	CA	Retail sales less autos	May	m%ch	-0.5	~	~	
	15.00	US	House price index	May	m%ch	-0.1	~	~	
Thu 23 Jul	09.00	EZ	ECB current account	May	€bn	-5.9	~	~	
	09.30	UK	Retail sales	Jun	m%ch	-0.6	~	~	
					y%ch	-1.6	~	~	
	14.00	US	RPX composite 28dy	May	y%ch	-19.7	~	~	
	15.00	US	Existing home sales	Jun	\$mn	4.8	4.8	~	
					m%ch	2.4	0.6	~	
13.30	US	Initial jobless and continuing claims							
15.30	CA	Bank of Canada monetary policy report							
Fri 24 Jul	08.30	GE	PMI manufacturing	Jul	Index	40.9	~	~	
	08.30	GE	PMI services	Jul	Index	45.2	~	~	
	09.00	EZ	PMI manufacturing	Jul	Index	42.6	~	~	
	09.00	EZ	PMI services	Jul	Index	44.7	~	~	
	09.00	EZ	PMI composite	Jul	Index	44.6	~	~	
	09.00	GE	IFO – business climate	Jul	~	85.9	~	~	
	09.00	GE	IFO – current assessment	Jul	~	82.4	~	~	
	09.00	GE	IFO – expectations	Jul	~	89.5	~	~	
	09.30	UK	Index of services (3mth/3mth)	May	%	-1.2	~	~	
	09.30	UK	GDP	QII	q%ch	-2.4	~	~	
y%ch					-4.9	~	~		
15.00	US	Uni of Michigan confidence	Jul	~	64.6	~	~		

ASB ECONOMICS
Level 9, 135 Albert Street, Auckland

ASB ECONOMICS

PHONE

FAX

Economics

Chief Economist	Nick Tuffley	nick.tuffley@asb.co.nz	(649) 374-8604	(649) 302 0992
ASB Economist	Jane Turner	jane.turner@asb.co.nz	(649) 374-8185	
CBA NZ Economist	Chris Tennent-Brown	chris.tennent-brown@asb.co.nz	(649) 374 8819	

DISCLAIMER

Views expressed in this report are those of the authors as at the date of this report and are based on information and sources believed but not warranted to be correct. Any views or information, while given in good faith, do not necessarily reflect the views of ASB and are subject to change without notice. Neither ASB Bank Limited nor any person involved in preparing this report accepts any liability for any loss or damage whatsoever that may directly or indirectly result from any views, information or omission contained in this report.