# Weekly Commentary

24 August 2009

# Comings and goings

It was a fairly slow week on the domestic front, with the main release of international travel and migration turning out much as expected.

Net migration was strong again in July, with a seasonally adjusted inflow of 2,470 people. The surge in net migration to date this year has primarily been driven by fewer New Zealanders leaving for Australia, with permanent and long-term departures down 42% on a year ago. However, in the last few months we have also seen a strong increase in the number of New Zealanders returning from overseas – a trend that we expect to strengthen further.

Arrivals of overseas migrants resumed their upward trend, with a seasonally adjusted inflow of 7,580. Arrivals had dropped sharply in June, but in the absence of any obvious driver we took this simply as monthly volatility, which turned out to be the case.

Overall, these figures leave us more confident in our forecast of a rising trend for net migration, with the annual total exceeding 20,000 this year.

As we've discussed before, the pickup in net migration is an important part of our forecast for a 'people-led' economic recovery. It's particularly important for residential construction, as faster population growth adds to the demand pressure for new home building, which was already running at an unsustainably slow pace. Net migration also tends to boost retail spending, particularly for big-ticket items – though perhaps less so in this cycle, which is driven by fewer people departing more so than newly arrived migrants setting up home.

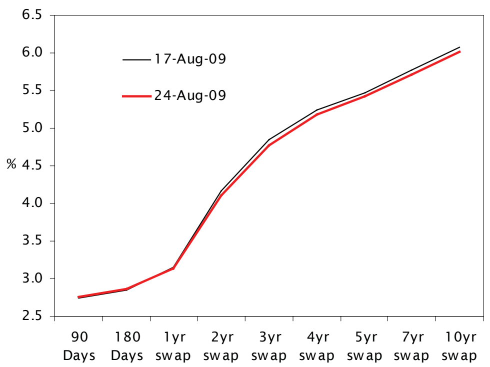
July also saw a 3.9% increase in short-term visitor arrivals, bringing year-on-year growth back into positive territory (just). Helped by good snow conditions, arrivals from Australia continued to be strong; however, they tend to stay for shorter periods and spend less per person. In contrast, arrivals from the US, the UK and key Asian markets have remained weak for many months.

Producer prices were soft in Q2, with input prices flat and output prices down 0.7%. The fall in output prices was led by dairy, as the high contracted prices from the previous season continue to roll off (this will also be evident in the terms of trade, released next month). Construction prices were down 0.2%, a reflection of the housing market correction.

Central bankers maintained a note of cautious optimism at the Fed's annual Jackson Hole symposium over the weekend. Fed Chairman Bernanke said that "prospects for a return to growth in the near term appear good", but noted that the rebound is likely to be slow at first, and that financial markets are still under some strain. ECB President Trichet was more cautious on the sustainability of recovery, and defended against criticisms that the ECB has acted too slowly. Interestingly, there were a few papers presented which argued that central banks will need to move quickly once they do start tightening, but it remains to be seen whether this will have any influence on the thinking of the major central banks.

The data calendar remains relatively light this week. First up is the RBNZ's inflation expectations survey on Tuesday. The survey has lost its significance to the market in the last year, as the focus has turned from inflation to combating the global financial crisis. But it still has value for the RBNZ; after all, their sole monetary policy mandate is inflation, and demonstrating that inflation pressures remain subdued even with record-low

***NZ Interest Rates***




**Yield curve is yields on bank bills to 180 days, fixed interest rate swaps for 1year onwards.*



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interest rates is probably their best hope for reining in interest rate markets, if they feel that pricing for hikes is excessive. We expect inflation expectations two years ahead to be similar to the 2.2% read in May, which would put them well within the RBNZ's comfort zone.

Monthly merchandise trade (Friday) has passed the seasonal peak, and we expect a $480m deficit for July. And while the annual total is set to improve due to base effects, there are signs that this will soon run its course – an inevitable by-product of recovery. Consumer imports are likely to pick up as retailers re-stock, car imports have risen strongly from the extreme lows seen earlier this year, and rising oil prices will further add to the import bill.

Residential building consents (Friday) will, as always, be influenced by the volatile apartments component, but we expect a continued improvement in the underlying trend. However, much more will be needed over the next year or so, if the building industry is to heed the signals of growing demand coming from the real estate market. RBA Governor Stevens put it very well in a recent speech: "Given the circumstances – the economy moving to a position of less than full employment, with labour shortages lessening and reduced pressure on prices for raw material inputs – this ought to be the time when we can add to the dwelling stock without a major run-up in prices. If we fail to do that – if all we end up with is higher prices and not many more dwellings – then it will be very disappointing, indeed quite disturbing."

***Fixed vs. floating:*** Interest rates have bottomed and are likely to trend higher over coming years, although the RBNZ's intention to keep the OCR low suggests little pressure for short-term rates to rise any time soon. We recommend fixing for six months to one year, which remain easily the most favourable rates on offer. While a strategy of fixing for short terms creates more uncertainty about future cash flows, borrowers can reduce this uncertainty by repaying more than the minimum amount while interest rates are at the lower end of the cycle.

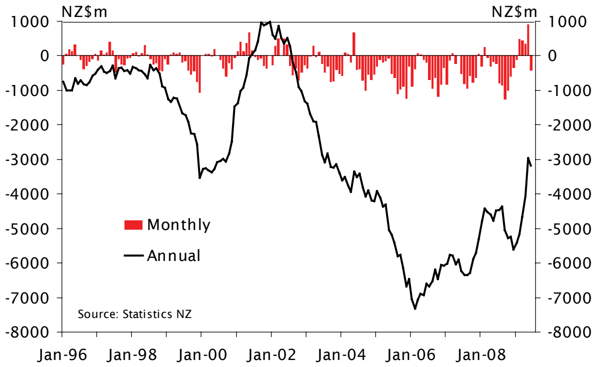
## Key Data Previews

### NZ Jul merchandise trade NZDm

**Aug 27, Last: –418, WBC f/c: –480**

- The merchandise trade balance has been on a rising trend over the past nine months, at first due to falling imports and more recently due to exports recovering more quickly than imports.
- We expect the July trade numbers to mark the start of a new trend towards a deteriorating trade balance. Consumers are making a comeback. Retailers may have cleared excess stock, so consumer imports are likely to be rising again. Car imports for July were double the February number. And the rising price of oil will have increased expenditure on imported oil. By contrast, soft commodity prices have been rising only slowly, so export revenue is improving only gradually.
- Rising imports and stable exports lead to a balance forecast of –$480m. However, that would still be the smallest July deficit since 2004, and the annual balance is expected to continue improving on base effects.

*NZ merchandise trade balance*

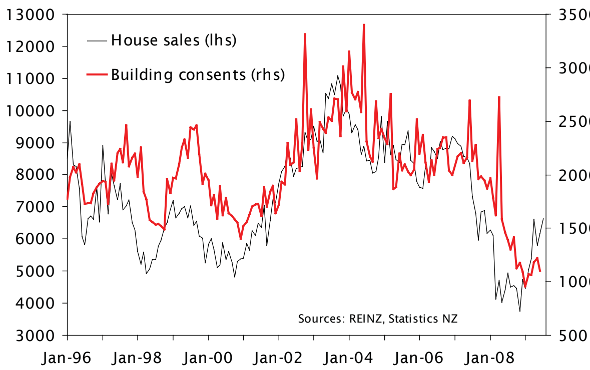



### NZ Jul building consents s.a.

**Aug 28, Last: –9.5%, WBC f/c: +9.0%**

- Dwelling consents continued their recent see-saw pattern in June, with total consents falling 9.5% m/m. However, excluding the volatile apartment component, the trend in consent issuance has clearly turned, rising for the third consecutive month in June.
- We remain of the view that consents should continue to trend higher from here, supported by strong net migration, still low mortgage rates and improving sentiment in the housing market.
- The trend value of non-residential consent has been weak in recent months, but is possibly being overstated by Statistics NZ removing 'one-offs' from the trend series. On an unadjusted basis, non-residential consents have averaged around 9% y/y growth since January 2009. Still, investment intentions point to very weak building investment over 2009H2.

***Housing activity*** *(monthly, seasonally adjusted)*

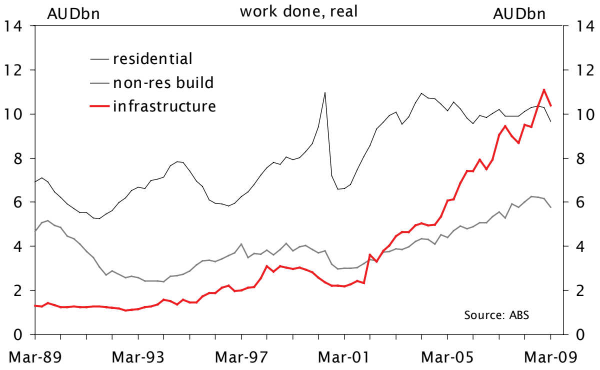


## Aus Q2 construction work done

**Aug 26, Last: –3.7%, WBC f/c: –3.0%, Mkt f/c: –3.0%, Range: –6.0% to 2.0%**

- Construction activity is moderating in 2009 as the shockwaves from the global recession impact. We expect a 3.0% decline in Q2, little different from the 3.7% drop in Q1.
- We anticipate widespread weakness in private sector construction – as in Q1. While new residential building approvals did begin to rebound in Q2, we expect the boost to work to emerge during the second half of 2009. Non-residential building is set to remain weak for some time with approvals down 50%.
- Public construction work is likely to provide only a partial offset. There will be a burst of school construction but that will begin in Q3 – the jump in approvals for education projects was first evident in the June month.

***Private construction moderates in 2009***

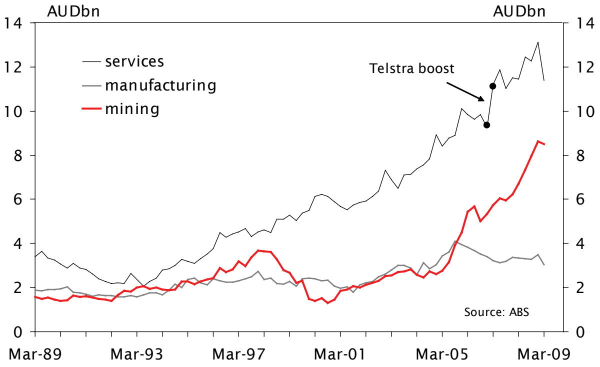



## Aus Q2 CAPEX

**Aug 27, Last: –8.9%, WBC f/c: –7.0%, Mkt f/c: –5.0%, Range: –8.5% to 4.1%**

- The CAPEX survey is expected to show that private business cut capital spending sharply for a second consecutive quarter. We're forecasting a 7% decline after a near 9% fall in Q1.
- On the plus side, the Government taxation incentive triggered a burst of vehicle sales. "Other" vehicle sales rebounded 12% in the quarter, reversing the Q1 slump. This poses an upside risk to our forecast – with the extent of any run-down of vehicle inventories unknown at this stage.
- Despite higher vehicle sales, capital imports were particularly weak in the period – tumbling 14% in value terms (half of which we expect to be due to lower volumes).
- Non-residential construction is also expected to decline significantly – consistent with lower approvals.

***Investment by industry** (CAPEX survey)*

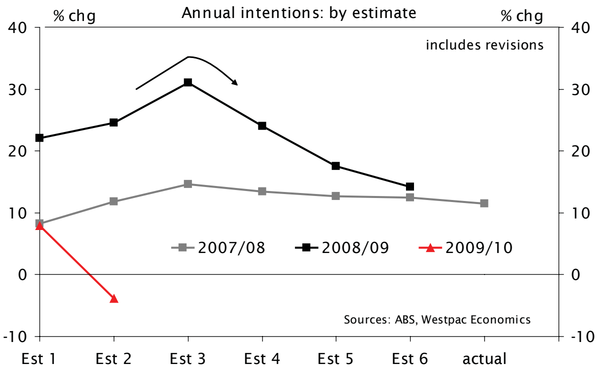



## Aus 2009/10 CAPEX intentions

**Aug 27, Last: $76.9bn**

- The last CAPEX survey of three months ago reported the 2nd estimate of business capital spending plans for 2009/10. Not surprisingly, firms had cut their spending plans against the backdrop of a global recession.
- A further downgrade of investment plans is a real risk. The 2nd estimate for 2009/10 of $76.9bn implied a 4% decline in capital spending from that of last year. That represented a downgrade from a 8% rise implied by the revised 1st estimate.
- Anecdotes suggest that firms are beginning to review the size of planned cuts. However, it may be that these considerations are not far enough advanced to translate into the numbers printed in this survey. The very recent recovery in business sentiment to the positive zone is more likely to boost investment prospects for the 2010/11 financial year.

***CAPEX intentions***

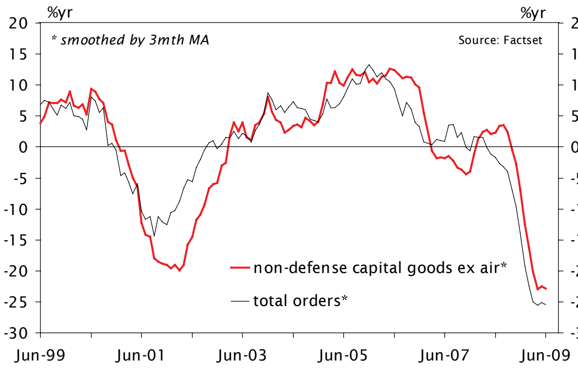


## US July durable goods orders jump on autos

**Aug 26, Last: –2.5%, WBC f/c: 3.0%, Mkt f/c: 3.0%**

- Durable orders posted back to back gains in April-May, the first consecutive rises in orders since mid 2008, adding to the body of evidence pointing to a stabilising economy. However orders fell 2.5%, mainly due a pull-back in defence and civilian aircraft, and ongoing weakness in autos, although core capital goods orders posted another gain.
- July orders are shaping up well. The July ISM factory index orders component surged from 49 to 55; factory hours worked rose 0.4% in July (including 12% in auto factories!); auto sales surged thanks to the "cash for clunkers" scheme; Boeing orders more than doubled in number, and were skewed towards higher valued 777s rather than the 737s that dominated in June.
- Putting all this together we expect June orders to jump 3.0% restoring the recent positive trend.

***US durable goods orders***



## Key Data and Events

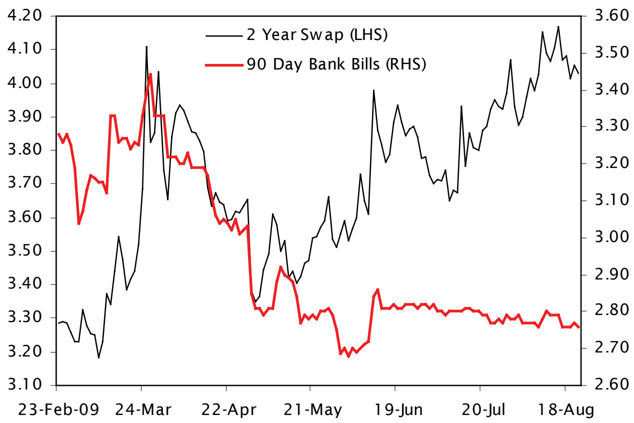
| | | Last | Market Median | Westpac Forecast | Comments |
|---|---|---|---|---|---|
| **Mon 24 Aug** | | | | | |
| Aus | Jul New Motor Vehicle Sales | 5.7% | – | -4.0% | Industry figs showed reversal in July as tax-break induced surge eased. |
| Eur | Jun Industrial Orders | -0.2% | 1.8% | – | Factory orders still falling – but pace of decline slowed dramatically. |
| UK | Aug House Prices %yr | -6.2% | -3.9% | – | Nationwide index. +1% or more in 4 of past 5 mths. (tbr 24-28/8) |
| Can | Jun Retail Sales | 1.2% | 0.2% | – | May up on a 2.4% jump in auto sales + generally +ve reports elsewhere. |
| **Tue 25 Aug** | | | | | |
| NZ | Q3 RBNZ 2yr Inflation Expectations | 2.2% | – | 2.3% | Inflation expectations to remain close to the RBNZ's sweet spot. |
| US | Aug Consumer Confidence | 46.6 | 47.6 | 46 | Partial reversal last 2mths. View on jobs mkt at new cyclical low. |
| | Aug Richmond Fed Index | 14 | 17 | – | First & only regional factory surveys back into +ve territory. |
| | Jun S&P Case-Shiller House Prices %yr | -17.1% | -16.4% | -16.5% | Posted its first monthly rise since July 2006!! |
| | Jun FHFA House Price Index %mth | 0.9% | 0.4% | 0.5% | Good news from lesser watched index, with prices up in May. |
| Ger | Q2 GDP (F) | 0.3% a | 0.3% | – | Provide detail on modest expansion in Q2. |
| UK | Jul BBA Mortgage Approvals, £bn | 35.2 | 37.8 | – | Hit a new 2009 year high in June, loans somewhat less difficult to get. |
| **Wed 26 Aug** | | | | | |
| Aus | Q2 Construction Work Done | -3.7% | -3.0% | -3.0% | Private sector weakness (res & non-res) only partially offset by public. |
| US | Jul Durable Goods Orders | -2.5% | 3.0% | 3.0% | Rise to restore recent +ve trend. July factory ISM orders rose to 55. |
| | Jul New Home Sales | 11.0% | 1.6% | 3% | Up 16.7% from Jan low, sign that housing sector turning the corner. |
| | Fedspeak | – | – | – | Lockhart on economy. |
| Jpn | Jul Trade Balance ¥bn sa | 438 | 298 | – | Exports out of tail spin, import demand weak. |
| | Jul Corp. Services Prices %yr | -3.2% | -3.4% | – | Corporates slashing discretionary spending. |
| | Aug Small Business Confidence | 41.1 | – | – | Upstream firms still adjusting stocks. |
| Ger | Aug IFO Business Climate Index | 87.3 | 89.0 | – | Fourth mthly rise & in July there was a solid rise in current index. |
| **Thu 27 Aug** | | | | | |
| NZ | Jul Merchandise Trade NZDm | -418 | – | -480 | Rising imports mark beginning of trend deterioration in trade balance. |
| Aus | Q2 Capex | -8.9% | -5.0% | -7.0% | Capital imports down sharply. But tax incentives boost vehicle sales. |
| | 2009/10 CAPEX Intentions A$bn | 76.9 | – | – | Firms cutting investment. But now reviewing size of likely cuts. |
| US | Q2 GDP Prelim (1st rev) % ann'lsd | -1.0% a | -1.4% | -1.7% | Slight downward revision to Q2 GDP anticipated. |
| | Initial Jobless Claims w/e 23/8 | 576k | 565k | 565k | Past auto retooling volatility but seasons still more volatile than usual. |
| | Fedspeak | – | – | – | Bullard to speak at University in Little Rock. |
| Eur | Jul Money Supply M3 %yr | 3.5% | 3.2% | – | Growth slowing & considered, by ECB, too low for health of economy. |
| Ger | Aug CPI Prelim %yr | -0.7% | -0.4% | – | Upside bias to future annual numbers as last yr's energy falls drop out. |
| | Sep GfK Consumer Confidence | 3.5 | 3.6 | – | Continues its recovery as German economy contracts at slower pace. |
| UK | Q2 Business Investment | -7.6% | -3.6% | – | Clue to any possible revision of Q2 GDP. |
| **Fri 28 Aug** | | | | | |
| NZ | Jul Building Consents. | -9.5% | – | 9.0% | Apartment component highly volatile, but overall trend should be up. |
| US | Jul Personal Income | -1.3% | 0.1% | flat | Rising labour income offset by the unwinding of stimulus payments. |
| | Jul Personal Spending | 0.4% | 0.2% | flat | Ex auto sales have been very weak, "cash for clunkers" boosting autos. |
| | Jul Core PCE Deflator | 0.2% | 0.1% | 0.1% | Similar gain expected to the July rise in core CPI. |
| | Aug Uni of Michigan Confidence (F) | 63.2 | 64.0 | 64 | Other surveys have bounced this month suggesting +ve revision. |
| Jpn | Jul National CPI %yr | -1.8% | -2.2% | – | Huge output gap undermines the price level. |
| | Aug Tokyo CPI %yr | -1.8% | -1.8% | – | Services weakness catching up to durables. |
| | Jul Unemployment Rate | 5.4% | 5.5% | – | On its way north to record levels. |
| | Jul Household Spending %yr | 0.2% | -0.6% | – | Real spending measure – nominal decidedly negative. |
| | Aug Nomura PMI | 50.4 | – | – | Have improved sequentially in '09, due to level out. |
| Eur | Aug Business Climate Indicator | -2.71 | -2.50 | – | Euroland household and business confidence surveys continue to |
| | Aug Consumer Confidence | -23 | -21 | – | improve, adding to sense that European recession is diminishing in |
| | Aug Economic Confidence | 76.0 | 78.0 | – | depth. Although most surveys remain at low levels historically. |
| UK | Q2 GDP Revision | -0.8% a | -0.8% | – | The 5th quarter of recession. Improvement from -Q1's 2.4% slump. |
| | Aug GfK Consumer Confidence | -25 | -24 | – | Unchanged in July, at highest level since April 2008 – slump is easing. |
| Can | Q2 Current Account C$bn | -9.1 | -11.3 | – | Q4 2008 saw the first deficit since the late 1990s. |
| | Jul Industrial Product Prices | 0.7% | -0.5% | – | First gain for 3mths. However, ex petroleum & coal prices fell 0.3%. |

## New Zealand Economic and Financial Forecasts

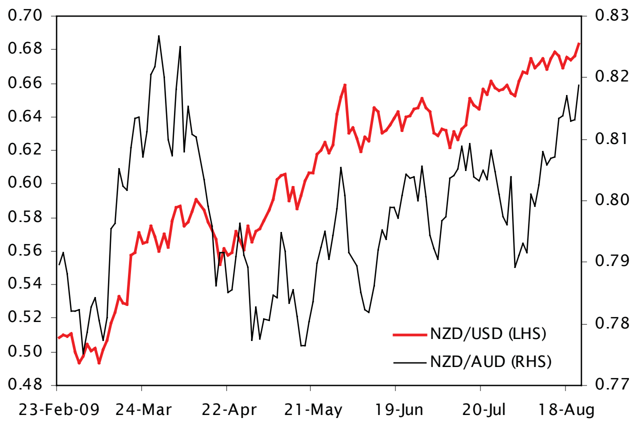
| Economic Growth Forecasts | March years | | | | Calendar years | | | |
|---|---|---|---|---|---|---|---|---|
| % change | 2008 | 2009 | 2010f | 2011f | 2008 | 2009f | 2010f | 2011f |
| GDP (Production) ann avg | 3.1 | -1.0 | -1.2 | 3.2 | 0.2 | -2.1 | 2.6 | 3.6 |
| Employment | -0.3 | 0.7 | -1.3 | 1.1 | 0.9 | -2.5 | 0.8 | 1.4 |
| Unemployment Rate % s.a. | 3.8 | 5.0 | 7.0 | 6.8 | 4.7 | 6.9 | 6.9 | 6.6 |
| CPI | 3.4 | 3.0 | 2.0 | 1.6 | 3.4 | 2.1 | 1.2 | 2.1 |
| Current Account Balance % of GDP | -8.0 | -8.5 | -4.7 | -5.7 | -9.0 | -4.9 | -5.5 | -6.5 |

| Financial Forecasts | Sep-09 | Dec-09 | Mar-10 | Jun-10 | Sep-10 | Dec-10 | Mar-11 |
|---|---|---|---|---|---|---|---|
| Cash | 2.50 | 2.50 | 2.50 | 2.50 | 3.00 | 4.00 | 5.00 |
| 90 Day bill | 2.80 | 2.80 | 2.80 | 2.90 | 3.60 | 4.60 | 5.50 |
| 2 Year Swap | 3.90 | 4.10 | 4.30 | 4.60 | 5.00 | 5.40 | 5.85 |
| 5 Year Swap | 5.30 | 5.40 | 5.50 | 5.60 | 5.80 | 6.00 | 6.30 |
| 10 Year Bond | 5.80 | 5.90 | 6.00 | 6.10 | 6.20 | 6.30 | 6.40 |
| NZD/USD | 0.69 | 0.63 | 0.67 | 0.69 | 0.71 | 0.74 | 0.73 |
| NZD/AUD | 0.80 | 0.79 | 0.81 | 0.81 | 0.82 | 0.83 | 0.85 |
| NZD/JPY | 66.9 | 58.0 | 63.0 | 66.2 | 70.7 | 76.2 | 77.4 |
| NZD/EUR | 0.47 | 0.45 | 0.47 | 0.48 | 0.49 | 0.50 | 0.50 |
| NZD/GBP | 0.40 | 0.39 | 0.40 | 0.40 | 0.41 | 0.40 | 0.39 |
| TWI | 63.7 | 59.4 | 62.6 | 64.0 | 65.9 | 67.8 | 67.8 |

### *2 Year Swap and 90 Day Bank Bills*




### *NZD/USD and NZD/AUD*




### NZ interest rates as at market open on Monday 24 August 2009

| Interest Rates | Current | Two Weeks Ago | One Month Ago |
|---|---|---|---|
| Cash | 2.50% | 2.50% | 2.50% |
| 30 Days | 2.79% | 2.80% | 2.78% |
| 60 Days | 2.81% | 2.80% | 2.78% |
| 90 Days | 2.76% | 2.78% | 2.78% |
| 2 Year Swap | 4.10% | 4.15% | 3.93% |
| 5 Year Swap | 5.42% | 5.48% | 5.36% |

### NZ foreign currency midrates as at Monday 24 August 2009

| Exchange Rates | Current | Two Weeks Ago | One Month Ago |
|---|---|---|---|
| NZD/USD | 0.6847 | 0.6747 | 0.6555 |
| NZD/EUR | 0.4773 | 0.4774 | 0.4612 |
| NZD/GBP | 0.4145 | 0.4098 | 0.3984 |
| NZD/JPY | 64.690 | 65.490 | 62.170 |
| NZD/AUD | 0.8176 | 0.8079 | 0.8011 |
| TWI | 63.550 | 63.170 | 61.320 |

## Economic and Financial Forecasts

| Economic Forecasts (Calendar Years) | 2004 | 2005 | 2006 | 2007 | 2008 | 2009f | 2010f |
|---|---|---|---|---|---|---|---|
| **Australia** | | | | | | | |
| Real GDP % yr | 3.8 | 2.8 | 2.9 | 4.0 | 2.3 | 0.2 | 1.8 |
| CPI inflation % annual | 2.6 | 2.8 | 3.3 | 3.0 | 3.7 | 1.9 | 2.0 |
| Unemployment % | 5.4 | 5.1 | 4.8 | 4.4 | 4.3 | 5.9 | 7.3 |
| Current Account % GDP | -6.1 | -5.8 | -5.3 | -6.2 | -4.3 | -3.7 | -4.8 |
| **United States** | | | | | | | |
| Real GDP %yr | 3.9 | 3.1 | 2.8 | 2.1 | 0.4 | -2.9 | 1.2 |
| Consumer Prices %yr | 2.6 | 3.4 | 3.2 | 2.9 | 3.8 | -0.8 | 1.1 |
| Unemployment Rate % | 5.5 | 5.1 | 4.6 | 4.6 | 5.8 | 9.5 | 11.1 |
| Current Account %GDP | -5.7 | -6.1 | -6.0 | -5.2 | -4.9 | -2.8 | -2.5 |
| **Japan** | | | | | | | |
| Real GDP %yr | 2.3 | 1.9 | 2.8 | 2.1 | -0.8 | -6.6 | 1.5 |
| Consumer Prices %yr | -0.1 | -0.3 | 0.2 | 0.1 | 1.4 | -1.1 | -0.6 |
| Unemployment Rate % | 4.5 | 4.4 | 4.1 | 3.9 | 4.0 | 5.1 | 6.6 |
| Current Account %GDP | 3.3 | 3.6 | 3.9 | 4.8 | 3.2 | 2.4 | 2.5 |
| **Euroland** | | | | | | | |
| Real GDP %yr | 1.9 | 1.8 | 3.1 | 2.7 | 0.6 | -4.9 | -0.2 |
| Consumer Prices %yr | 2.1 | 2.5 | 2.0 | 3.1 | 1.6 | 0.3 | 0.7 |
| Unemployment Rate % | 9.0 | 8.8 | 7.9 | 7.3 | 7.8 | 10.0 | 11.5 |
| Current Account %GDP | 0.0 | -0.2 | -0.5 | 0.0 | -0.2 | 0.0 | 0.4 |
| **United Kingdom** | | | | | | | |
| Real GDP %yr | 3.0 | 2.2 | 2.9 | 2.6 | 0.7 | -4.6 | 0.4 |
| Consumer Prices %yr | 1.3 | 2.1 | 3.0 | 2.1 | 3.5 | 1.0 | 1.2 |
| Unemployment Rate % | 2.8 | 2.8 | 3.0 | 2.5 | 3.1 | 5.5 | 7.0 |
| Current Account %GDP | -1.9 | -2.6 | -3.0 | -2.8 | -2.3 | -6.0 | -5.5 |

Forecasts finalised 7 August 2009

| Interest Rate Forecasts | Latest (Aug 24) | Sep-09 | Dec-09 | Mar-10 | Jun-10 | Sep-10 |
|---|---|---|---|---|---|---|
| **Australia** | | | | | | |
| Cash | 3.00 | 3.00 | 3.00 | 3.25 | 3.50 | 3.75 |
| 90 Day Bill | 3.27 | 3.35 | 3.40 | 3.75 | 4.00 | 4.25 |
| 10 Year Bond | 5.53 | 5.40 | 5.50 | 5.80 | 6.25 | 6.25 |
| **International** | | | | | | |
| Fed Funds | 0.125 | 0.125 | 0.125 | 0.125 | 0.125 | 0.125 |
| US 10 Year Bond | 3.57 | 3.50 | 3.40 | 3.75 | 4.00 | 4.25 |
| ECB Repo Rate | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 |

| Exchange Rate Forecasts | Latest (Aug 24) | Sep-09 | Dec-09 | Mar-10 | Jun-10 | Sep-10 |
|---|---|---|---|---|---|---|
| AUD/USD | 0.8374 | 0.86 | 0.80 | 0.83 | 0.85 | 0.87 |
| USD/JPY | 94.49 | 97 | 92 | 94 | 96 | 99 |
| EUR/USD | 1.4345 | 1.46 | 1.40 | 1.42 | 1.44 | 1.46 |
| AUD/NZD | 1.2230 | 1.25 | 1.27 | 1.24 | 1.23 | 1.22 |