

Business Weekly

Midpoint

This Week

Inflation is going to do something it has done only fleetingly in the past 5 years: fall to around the mid-point of the 1% to 3% inflation target band. As petrol prices pulled back from the \$2.20/litre levels of a year ago the spike in *annual* inflation has gone into reverse. The full impact of the price reversal will be felt in Q3, the next read, briefly pushing annual inflation down near 1%.

We expect this week's Q2 results to show a 0.6% qoq increase in the CPI, pulling annual inflation down to 2%; the market median is 0.5% qoq. The key upward influences on *quarterly* inflation are expected to be from the Transport component. Petrol prices increased over the quarter, and this is expected to contribute around 0.24% of the 0.6% CPI increase in Q2, and see the transport component lift after 2 quarters of declines. Food price inflation has been high over recent years. However, with monthly readings for April and May Food price indices (FPI) of -0.6% and +0.3%, food price inflation for now is diminishing. Falling meat prices and lower prices for fruit and vegetables have been a feature of recent FPI reports.

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. The glaring exception was the jump in capacity utilisation in the latest NZIER business opinion survey. However, when stacked up against even greater labour surpluses, it is hard to see how underlying capacity pressures could be a remote threat to the inflation outlook. Rather, the rise suggests firms have made adjustments to lower activity, reducing staff numbers and capital inputs.

Watching non-tradable inflation will be the main gauge of how quickly the economic slowdown is impacting on inflation pressures. Service sector inflation is expected to weaken considerably given the marked turn in the labour market this year. Housing-related inflation is one area to watch closely in this release. Housing construction activity has fallen considerably and materials costs have softened following the end of the commodity price boom. A quality adjustment following stricter building standards helped contain reported construction costs to a flat outcome in the last quarter. This is expected to be a one-off, but housing-related inflation should still continue to moderate over time.

The RBNZ already expects inflation to be very weak in 2009. However, in the subsequent years the risks are that inflation is lower than the RBNZ's June MPS expectations – particularly if the NZ dollar remains higher than the RBNZ has assumed. That does keep the possibility of further OCR cuts on the table.

Click here for:

[Foreign Exchange](#)

- NZD range trades and remains above support at 0.625

[Interest Rates](#)

- Another quiet week, longer-end interest rates continue to ease.

[Week Ahead](#)

- Retail sales (just released) and CPI the key local releases.

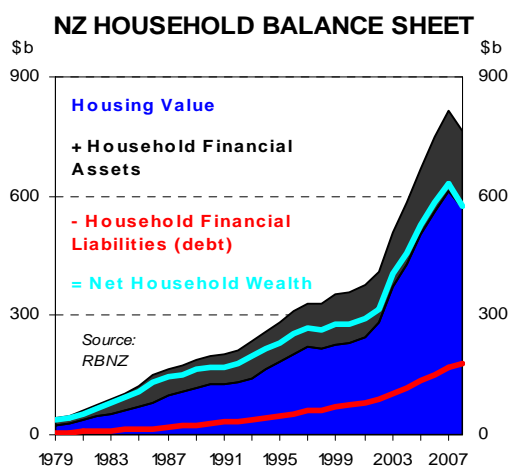
[Week in Review](#)

- NZIER Business Opinion improves, housing market recovery continues.

[Global Calendars](#)

- A heavy data week offshore, but US company reports may be the scene setter.

Chart of the week



- Retail spending surged in May, with winter related spending brought forward by the early cold snap. Electronic card transaction data suggests this strength was a one-off, pointing to a fall in spending over June.
- Underlying consumer demand remains weak, despite tax cuts, falling interest rates and lower petrol prices compared to year-ago levels.
- Consumers are pulling back on the big ticket items, (for example vehicles). Reduced job security is one factor on weighing on consumer confidence.
- In addition, net household wealth has taken a 9.2% hit over 2008 due to falling house prices and equity markets. To restore depleted balance sheets, households are probably increasing savings, at the expense of discretionary consumer spending.

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	0.6283	0.6278	0.6424	0.5860	0.7575	FLAT	0.6250	0.6450
NZD/AUD	0.8058	0.7897	0.7892	0.8449	0.7887	FLAT	0.7900	0.8100
NZD/JPY	58.08	59.92	62.87	52.77	81.16	FLAT	57.50	60.00
NZD/EUR	0.4504	0.4491	0.4563	0.4375	0.4803	FLAT	0.4450	0.4550
NZD/GBP	0.3882	0.3853	0.3886	0.3880	0.3832	FLAT	0.3800	0.3950
TWI	59.5	59.5	60.6	57.6	67.5	FLAT	59.00	61.00

Weekly support and resistance levels * Current is as at 12pm Tuesday; week ago as at Monday 5pm

- The NZD was little changed on week-ago levels, and traded in a reasonably narrow range between 0.62 and 0.639 against the USD over the week. The NZD outperformed the AUD, and gained a cent on this cross rate.
- Two crucial economic reports are scheduled for release in New Zealand this week that may move NZD. The first, already released, showed retail sales increased solidly but has so far only had a mild supportive influence on NZD (see report on page 5). We expect the New Zealand CPI report to print higher than the market expects (ASB f/c 0.6%, Market 0.5% qoq CPI). The improving trend in New Zealand's economic data provides some support to the NZD at present.
- There are a number of important economic reports released in the US this week, but the biggest currency mover may be US company earnings. There is room for company earnings (and outlook) to disappoint; particularly after the surprisingly strong earnings reports last quarter were based on cost-cutting rather than revenue growth. We think a sub-par earnings season will see a rush to "safe haven" bonds and the USD at the expense of other asset markets.
- Confidence has certainly returned to financial markets, but the US company earnings season could see a re-emergence investor risk aversion this week. NZD and AUD/JPY is very sensitive to heightened risk aversion. There is room for earnings reports to disappoint and cause a spike in volatility (which still remains surprisingly low). This in turn would support the JPY against the AUD and NZD.

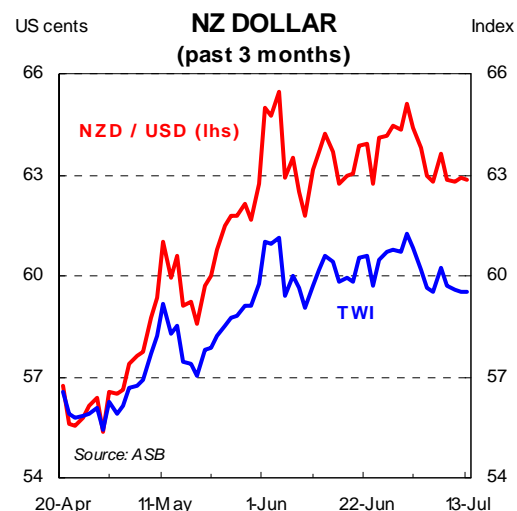
Short-term outlook:

Key data	Date	Time (NZST)	Market expects
Q2 Consumers Price Index	16/7	10.45 am	+0.5%

Potential currency movers from the US this week: monthly budget statement (13th), retail sales, business inventories (14th), FOMC minutes from previous meeting, CPI, industrial production (15th), jobless claims, TIC capital flows (16th), housing starts and permits (17th).

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. Since the May Budget the threat of a credit rating downgrade has subsided.
- 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	2.81	2.80	2.86	4.69	8.47	FLAT
2-year swap	3.71	3.76	3.90	4.25	7.73	FLAT
5-year swap	5.20	5.28	5.35	4.65	7.42	FLAT
11/11 gov't stock	4.61	4.63	4.85	4.34	6.08	FLAT
NZSX 50	2738	2743	2800	2771	3118	DOWN

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

- The NZ market remained very quiet last week, with NZ and Australian data posting within expectations. A rally in bond markets is seeing some softening in longer-end interest rates. Demand for NZ Government Bonds remains strong, particularly with the July 2009 maturity this week.
- With US share markets weak, US Government Bonds were able to extend their rally (prices higher, yields lower) for a fifth week. This is the longest rally so far in 2009. Ten-year note yields touched the lowest level in 7 weeks, and dropped 20 basis points last week to yield 3.30%.
- The RBNZ is widely expected to keep the OCR on hold at 2.5% at the July OCR review (30th July). The market has a 25% chance of a rate cut priced in, acknowledging the RBNZ's easing bias. Nonetheless, we expect that the RBNZ will take time to pause and assess the impact of rate cuts to date. With the economic outlook still fragile, we continue to see scope for further rate cuts, possibly in September and October. The RBNZ may be frustrated by the strength in the NZD and market pricing for rate hikes earlier than the RBNZ has signalled.

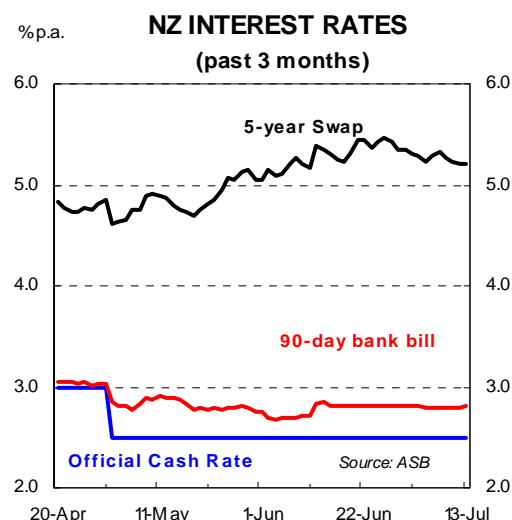
Short-term outlook:

Key data	Date	Time (NZST)	Market expects
Q2 Consumers Price Index	16/7	10.45 am	+0.5%

Comment: CPI is the highlight of the week in NZ, with the market expectation is centred around +0.5%. However, it would take quite a surprise to jolt the market out of its current holding pattern. The US data calendar is a bit busier with US retail sales, industrial production, CPI and housing data. FOMC June meeting minutes are out on Thursday morning.

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 large downside risk to the 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
Q2 Consumers Price Index (qoq)	16/7	10.45 am	+0.3%	0.5%	0.6%
June Food Price Index (yoy)	16/7	10.45 am	6.8%	-	-
June Business NZ PMI (index)	16/7	10.30 am	42.7	-	-

Thursday 16 July

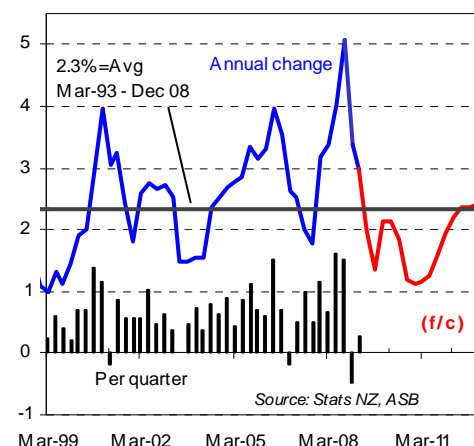
Q2 Consumer Price Index

ASB f/c 0.6% qoq, 2% yoy.

The NZ Q1 CPI will be released on Thursday 16 July. We expect a 0.6% qoq increase, which would pull annual inflation down to 2%. The market median expectation is 0.5% qoq, and 1.8% yoy.

The RBNZ's June MPS forecast was 0.4% qoq and 1.7% yoy. 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, with inflation risks largely on the downside. The disinflationary forces of the global recession are the greatest focus for the inflation outlook. Over the next couple of years we expect inflation will remain in the bottom half of the RBNZ's 1-3% target band. A sustained period of economic weakness will drag down domestically-generated inflation considerably. Tradable inflation will reflect a mix of global disinflationary forces, combined with the NZ dollar, which at this stage looks likely to be stronger over the coming years than during previous New Zealand recessions.

NZ CPI INFLATION



NZ Data Review: weekly recap

NZIER Quarterly Survey of Business Opinion

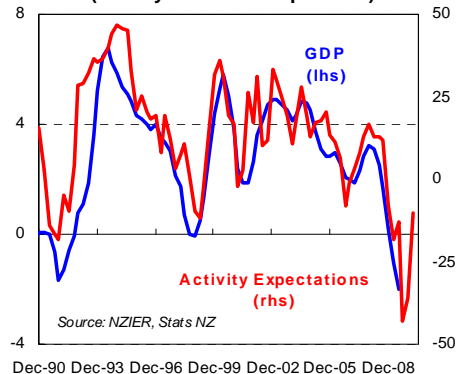
Business confidence improved over Q2, although not enough to lift itself out of recession territory. The thrust of activity indicators are consistent with the pace of contraction in GDP slowing through the middle of 2009 and the economy remains poised to stage a recovery later in the year. Firms' reported own activity over Q2 remains consistent with our expectation of a 0.5% decline in Q2 GDP. Demand remains weak and profits under pressure, and employment and investment plans will continue to be trimmed back in response.

Investment intentions picked up off its lows, although also remain in negative territory. A net 23% expect to reduce plant and machinery investment and a net 29% expect to reduce building investment.

The labour market has eased significantly, with a surplus of labour becoming more evident. On balance, firms continue to expect to reduce staff levels and it has become historically easy for firms to find necessary labour.

The weakness of demand and labour market indicators suggest there remains a significant amount of slack in the economy which will continue to see inflation pressures abate. Pricing intentions, although improved, remain very low.

GDP & DOMESTIC ACTIVITY Index
(activity advanced 3 quarters)



REINZ House Sales

The housing market held on to its recent recovery over June. Adjusting for seasonality, house sales recovered 9% over June (following May's 14% dip), with monthly turnover essentially holding steady in a range of 5500-6500 sales over the past few months. Recent increased activity in the housing market comes from a pick up in housing confidence, as low interest rates encourage buyers back into the market. The recent turnaround in net migration will also continue to support housing demand.

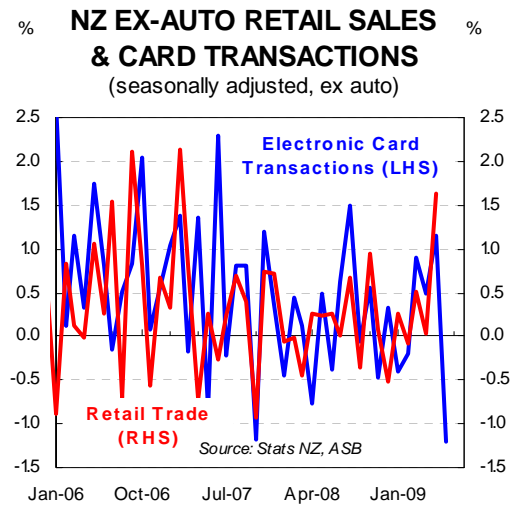
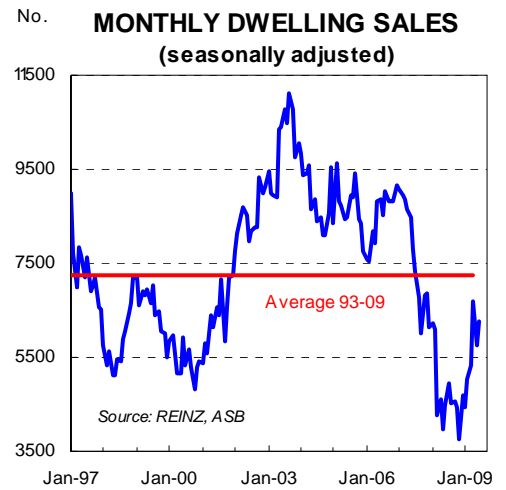
While house sales have lifted 40% off the lows recorded last year, housing turnover remains slightly below average levels. Demand, although improved, will continue to remain subdued as the employment outlook continues to deteriorate and some households remain cautious about large purchases.

The median number of days to sell fell back to 39.6 days (seasonally adjusted) and is now close to average levels. The decline in the time to sell suggests the balance between supply and demand is continuing to improve, and we expect that house prices will start to stabilise soon if they haven't already.

Retail Trade Survey

Retail sales increased 0.8% over May (much stronger than expected), buoyed by a 1.6% increase in ex-auto spending. The cold snap sent shoppers indoors to the mall and boosted clothing sales over May. Clothing sales recorded a whopping 12.6% increase over the month, possibly due to the early timing of winter sending shoppers to stock up on winter woollies one month earlier than usual. While clothing was a stand out, strength was also evident in appliance and hardware retailing. These categories are tied to the housing market, and some improvement likely came on the back of some recovery in house sales over April and May.

Electronic card transaction data suggests that the strength over May was likely to be a one off, pointing to a fall in spending over June. This pattern would be consistent with bad weather bringing forward winter related purchases. There were some tentative sign of housing related spending picking up, although this is from a low base and the pick up in housing demand has been relatively modest to date. Looking through the clothing one-off and housing related spending, the retail trade survey suggests that underlying consumer demand remains reasonably subdued.



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	CBA	
Mon 13 Jul	~	CH	Trade balance	Jun	USD bn	13.4	~	~	
	~	CH	Exports	Jun	y%ch	-26.4	~	~	
	~	CH	Imports	Jun	y%ch	-25.2	~	~	
	13.30	AU	Lending finance	May	m%ch	1.9	~	~	
	16.30	JP	Industrial production	May	m%ch	5.9	~	~	
					y%ch	-29.5	~	~	
	16.30	JP	Capacity utilisation	May	m%ch	10.2	~	~	
	17.00	JP	Consumer confidence	Jun	Index	36.3	~	~	
	17.00	JP	Consumer confidence h/holds	Jun	Index	35.7	~	~	
Tue 14 Jul	13.30	AU	NAB business conditions	Jun	Index	-14.0	~	~	
	13.30	AU	NAB business confidence	Jun	Index	-2.0	~	~	
Wed 15 Jul	~	JP	BoJ target rate	Jul	%	0.1	0.1	0.1	
	13.00	AU	Westpac leading index	May	m%ch	0.7	~	~	
	13.30	AU	Building activity	QI	q%ch	-1.6	~	~	
Thu 16 Jul	10.30	NZ	Business NZ PMI	Jun	Index	42.7	~	~	
	10.30	NZ	Food prices	Jun	m%ch	0.3	~	~	
	10.45	NZ	CPI	QII	q%ch	0.3	~	0.6	
					y%ch	3.0	~	2.0	
	11.50	JP	Tertiary industry index	May	m%ch	2.2	~	~	
	13.30	AU	RBA Bulletin	Jul	~	~	~	~	
	14.00	CH	Real GDP	QII	y%ch	6.1	~	~	
	Fri 17 Jul	13.30	AU	Import price index	QII	q%ch	-2.8	~	-10.0
		13.30	AU	Export price index	QII	q%ch	-4.6	~	-15.0
14.00		CH	CPI	Jun	y%ch	-1.4	~	~	
14.00		CH	Purchasing price index	Jun	y%ch	-10.4	~	~	
14.00		CH	Producer price index	Jun	y%ch	-7.2	~	~	
14.00		CH	Retail sales	Jun	y%ch	15.2	~	~	
					ytd y%ch	15.0	~	~	
14.00		CH	Industrial production	Jun	y%ch	8.9	~	~	
					ytd y%ch	6.3	~	~	
14.00	CH	Fixed asset invest. urban	Jun	ytd y%ch	32.9	~	~		
17.00	JP	Coincident index CI	May	Index	86.9	~	~		
17.00	JP	Leading index CI	May	Index	77.0	~	~		

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 13 Jul	15.30	CA Business outlook future sales	QII	Index	-22.0	~	~
	19.00	US Monthly Budget Statement	Jun	\$bn	~	57.9	~
Tue 14 Jul	00.01	UK RICS house price balance	Jun	%	-44.1	~	~
	09.30	UK CPI	Jun	y%ch	2.2	~	~
	10.00	EZ ZEW survey (econ sent)	Jul	Index	42.7	~	~
	10.00	EZ Industrial production	Jul	y%ch	-21.6	~	~
	13.30	CA New motor vehicle sales	May	m%ch	0.0	~	~
	13.30	US Producer price index	Jun	y%ch	-5.0	-5.4	~
	13.30	US Retail sales	Jun	m%ch	0.5	0.4	~
	15.00	US Business inventories	May	m%ch	-1.1	-1.0	~
	Wed 15 Jul	09.30	UK Jobless claims change	Jun	'000	39.3	~
09.30		UK ILO unemployment rate	May	%	7.2	~	~
10.00		EZ CPI	Jun	y%ch	0.0	~	~
13.30		CA Manufacturing shipments	May	m%ch	-0.1	~	~
13.30		US CPI	Jun	y%ch	-1.3	~	~
13.30		US Empire manufacturing	Jul	Index	-9.4	-5.0	~
14.15		US Industrial production	Jun	m%ch	-1.1	-0.7	~
14.15		US Capacity utilisation	Jun	%	68.3	67.8	~
19.00		US Minutes of June 24 FOMC meeting					
Thu 16 Jul	14.00	US Net long-term TIC flows	May	\$bn	11.2	~	~
	15.00	US Philadelphia Fed Survey	Jul	Index	-2.2	-5.0	~
	18.00	US NAHB housing market index	Jul	Index	15.0	16.0	~
Fri 17 Jul	10.00	EZ Trade balance	May	€bn	-0.3	~	~
	10.00	EZ Construction output	May	m%ch	0.6	~	~
	12.00	CA Consumer price index	Jun	m%ch	0.7	~	~
	13.30	CA Leading indicators	Jun	m%ch	-0.1	~	~
	13.30	US Housing starts	Jun	'000	532.0	528.0	~
	13.30	US Building permits	Jun	'000	518.0	520.0	~

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	

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