ECONOMICS

21 Sep. 09

Business Weekly

Flattening out

This Week

It is that time in the quarter for a wave of data, the key release for the week being GDP. At the worst the figure will show that the pace of economic contraction has eased considerably after the 1% declines in the preceding quarter. At best the result will show that the economy has stopped contracting (at least for now!).

Our forecast is a 0.1% *increase* for the quarter, slightly above the 0.2% contraction that is the median expectation. Given the margins of error around forecasts it is better to view the likely outcome as some stabilisation of the economy.

Any growth that returns in 2009 is likely to be weak. Much of the anticipated momentum is from some confidence returning to households, and impacting more on the housing market than on retail spending. The economy will remain fragile for some time, and recovery won't be truly self-supporting until export earnings start to recover.

So while one of the next two GDP releases should herald an end to economic contraction in a GDP sense, life will remain tough going for some time. Some industries will remain under pressure for a lot longer before they turn the corner. Business profitability will by and large remain under pressure, and unemployment has further to climb. On the road forward awaits some reinvention of the NZ economy, in particular creating an economy less driven by domestic demand and more dependent on exports to earn our way forward. Positive GDP growth, when it does arrive, will perhaps be the end of the beginning rather than the beginning of the end.

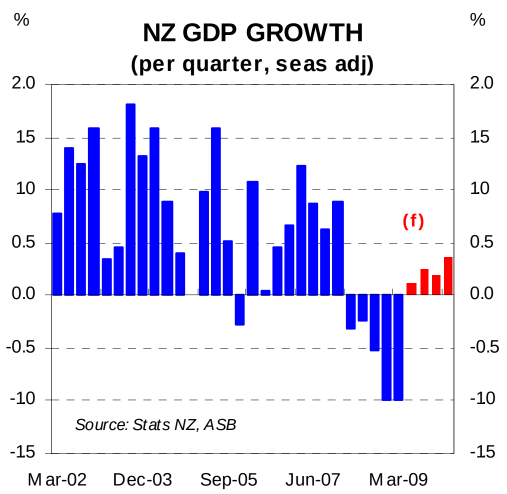
The Q2 current account deficit should narrow on an annual basis to around 7.4% of GDP, aided by a surge in dairy exports. For the quarter we expect a deficit of $1,980mn. During Q2 JetStar imported its fleet for domestic operations and could cause some statistical disruption, depending on the statistical treatment. We have assumed the fleet will be treated as on operational lease and excluded from the current account. However, if Statistics NZ deem there has been an ownership transfer to a NZ entity the fleet will be included and the current account deficit roughly $500mn bigger. If the deficit outcome is wildly different from expectations that will be the first place to look.

Other data out will get less attention given the understandable focus on GDP. Westpac McDermott Miller consumer confidence should lift slightly further if the Roy Morgan survey is anything to go by. And the August trade balance will likely register another deficit now that the pastoral export season is past.

Click here for:

Foreign Exchange	• NZD sets fresh 2009 high against the USD, cracking 0.71 last week.
Interest Rates	• Rates drift higher over the week.
Week Ahead	• Current Account, GDP the data highlights. Consumer confidence also important.
Week in Review	• Non-food related manufacturing remains weak.
Global Calendars	• BoE, BoJ, RBA minutes due; G-20; FOMC rate decisions are the highlights.

Chart of the week



- A number of leading indicators point to economic activity reaching a floor around the middle part of the year. There is a good chance the economy will register positive economic growth in either Q2 or Q3. However, any growth in the short term will have weak foundations, generally driven by isolated strength in a few sectors.
- Our growth forecasts for the remainder of 2009 are so close to flat that there is only a small margin between a slight contraction or a slight expansion. It is quite possible that a further negative quarter is registered at some point during the recovery stage.
- The recovery will likely remain anaemic until growth drivers move beyond household spending to export and business investment activity.

Foreign Exchange Market

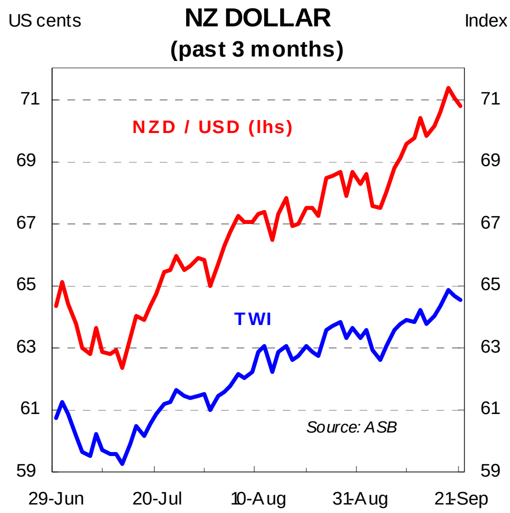
FX Rates	Current*	Week ago	Month ago	6 mths ago	Year ago	ST Bias	Support^	Resistance^
NZD/USD	0.7078	0.6978	0.6721	0.5650	0.6731	DOWN	0.6900	0.7150
NZD/AUD	0.8170	0.8139	0.8168	0.8100	0.8332	DOWN	0.8000	0.8200
NZD/JPY	64.66	63.09	62.90	54.42	72.14	DOWN	64.00	66.00
NZD/EUR	0.4816	0.4795	0.4728	0.4134	0.4758	DOWN	0.4750	0.4900
NZD/GBP	0.4366	0.4198	0.4089	0.3893	0.3744	DOWN	0.4250	0.4400
TWI	64.6	63.8	62.7	55.9	64.2	DOWN	63.00	65.50

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

- The NZD continued to press higher last week, lifting against all the cross rates monitored. Against the weak USD, the NZD traded below 0.70 early in the week, but pressed higher on the 16th. The NZD got as high as 0.715 on the 17th, before easing back to trade just shy of 0.71 level by Friday.
- The USD stumbled to new 2009 lows last week, despite the assertion from the Federal Reserve Chairman, Bernanke, that the US recession is likely over. This week, the USD may recover some ground, particularly as the formal commentary from the Fed (following their interest rate meeting Thursday 6am NZT) is likely to reflect this renewed confidence in the US economy. There is some chance the Fed begins to indicate that interest rates are very low and will need to lift at some stage. We expect this would support the USD.
- The G20 meeting (24th and 25th) is likely to have a muted impact on the currency market. We expect the communiqué to reiterate that it is still too early to remove fiscal stimulus.
- A better than expected NZ QIIGDP result could surprise the market, and provide some upside risk for the NZD this week. However, on balance we expect the NZD will continue to drift off its recent high this week.
- **Short-term outlook:**

Key data	Date	Time (NZST)	Market expects
Current Account (% of GDP)	22/9	10.45 am	-7.2%
GDP (qoq)	23/9	10.45 am	-0.2%
WMM Consumer Confidence	24/9	10.00 am	-
Merchandise Trade Balance	25/9	10.45 am	-$273m

Potential currency movers from the US this week: FOMC interest rate decision (24th), existing home sales and durable goods orders (25th). Speakers: Evans (25th), Warsh (26th).



Medium-term outlook: [Last Quarterly Economic Forecasts]

- We expect the NZD to appreciate a little further against the USD over the next 6-9 months, topping out around USD 0.74. Much of that story is about the USD, not the NZD.
- We continue to expect the USD to reamin weak into 2010. The reasons for the expected USD weakness remain similar to the drivers in place since mid-March, namely:
  - US residents increase their offshore investment, encouraged by improvement in the global economy.
  - USD liquidity demand and safe-haven buying of the USD is reversing.
  - Diversification out of USD is expected to occur due to concerns about US government debt.
- Against the expected backdrop of USD weakness we also expect some moderate and broad-based NZD outperformance. Despite being mired in recession since the start of 2008, NZ's economy is holding up well compared to those of many key trading partners. Over time the NZD is likely to be buoyed by the rising tide of improving confidence in the global economic recovery and firmer commodity prices. Moreover, a buoyant AUD, on improved prospects for its resource exports and speculation of early 2010 rate hikes, will drag the NZD along on its coat-tails.
- 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. However, the likelihood of the RBNZ intervening to try and weaken the NZD remains low given the NZD itself is not particularly elevated relative to both underlying economic fundamentals and past movements.
- The September MPS made it pretty clear the RBNZ is unlikely to cut the OCR to try dampening the NZD. Direct FX intervention also appears unlikely with the dominant driver of the high NZD being the weak USD.

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	3.00	7.50	FLAT
90-day bank bill	2.79	2.78	2.76	3.25	7.85	FLAT
2-year swap	4.09	3.99	4.07	3.52	6.91	UP
5-year swap	5.39	5.30	5.39	4.51	6.81	UP
11/11 gov't stock	4.79	4.71	4.88	3.99	5.62	UP
NZSX 50	3156	3129	3035	2591	3187	FLAT

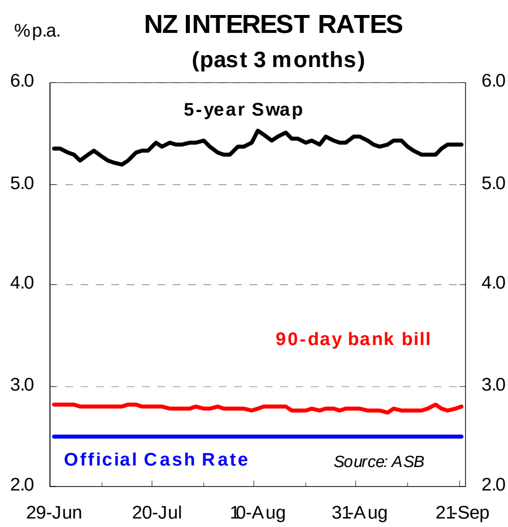
* Current is as at 12pm Monday; week ago as at Monday 5pm

- The data calendars in Australia and NZ were relatively light last week, with sentiment continuing to be driven by offshore movements. NZ 1 year swaps lifted 9 bp to 3.16%, the 5-year rate lifted the same amount to 5.39%.
- US data, on balance, proved better than expected, although much of this was related to the 'cash-for-clunkers' program boosting industrial production and retail sales. Stronger data, combined with US investor sentiment saw US Treasury yields move higher over the week.
- Global investors are perhaps a little cautious ahead of this week's record issuance of $112 billion of US 2-year, 5-year and 7-year notes. Over the past week, US 10-year yields rose by 15 points and US 2-year yields were up 9 points.

Short-term outlook:

Key data	Date	Time (NZST)	Market expects
RBNZ Credit Card Billings	21/9	3.00 pm	-
Current Account (% of GDP)	22/9	10.45 am	-7.2%
GDP (qoq)	23/9	10.45 am	-0.2%
WMM Consumer Confidence	24/9	10.00 am	-
Merchandise Trade Balance	25/9	10.45 am	-$273m

Comment: The current account deficit and GDP are the highlights on a reasonably busy domestic data calendar this week. The market reaction to GDP is likely to be asymmetric, with a weaker than expected result being largely ignored and the market only reacting to a stronger than expected outcome. We see scope for an upside surprise, as we are expecting GDP to increase by 0.1% compared to the market median of a 0.2% decline.



Medium term outlook: [Last Quarterly Economic Forecasts]

- The RBNZ continues to hold the cash rate at 2.5%, although has now backed off its easing bias. The market did not see a strong easing bias as credible given the number of stronger than expected indicators of late. The RBNZ continues to expect it will hold the cash rate at or below current levels until the latter part of 2010.
- The RBNZ declined to cut the cash rate at the September meeting, despite financial conditions tightening since its July statement. The Bank steered away from its earlier threat to cut should financial conditions not ease. This action has signaled the RBNZ is extremely unlikely to ever cut the OCR further in this downturn.
- The RBNZ has resigned itself to the role of spectator, accepting the current levels of the NZ dollar and interest rates. The RBNZ finally incorporated more realistic NZ dollar outlook (although still depreciating from current levels, in contrast to our view of further increase).
- The RBNZ's overall growth and inflation forecasts were unchanged, despite incorporating significantly stronger monetary conditions. The RBNZ sees more inflation pressure in the economy stemming from a less weak global outlook, a pick up in net migration supporting the housing market, and improved business confidence.
- The next move in the OCR is up, it's just a matter of when. We expect the RBNZ will hike by June next year (previously July). However, the risks are skewed to an earlier start. The RBNZ has a substantial amount of policy stimulus to unwind, the first steps are likely to be bigger (i.e. 50 basis point moves).

NZ Data Preview: a look at the week ahead

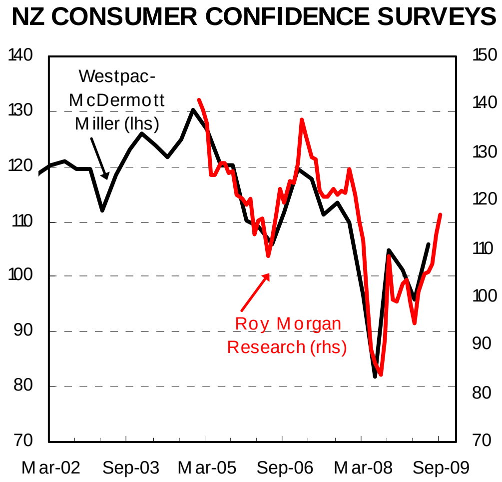
Data	Date	Time (NZST)	Previous	Market expects	ASB expects
Q2 Current Account (ann.% of GDP)	22/9	10.45am	-8.5%	-7.2%	-7.4%
Q2 GDP (qoq)	23/9	10.45am	-1.0%	-0.2	+0.1%
Westpac McDermott Miller Consumer Confidence	24/9	10.00 am	106	-	-
August Trade Balance	25/9	10.45am	-$163M	-$273M	-$350M

Tuesday 22 September

Q3 Westpac McDermott Miller Consumer Confidence

The quarterly Westpac McDermott Miller consumer confidence survey showed a slight recovery in consumer optimism over Q2. Much of the lift in the Q2 headline index came from reduced anxiety on the general economic outlook over the next year. Questions relating to individuals' own outlook showed less improvement.

Confidence has picked up off its June 2008 low (which coincided with the peak in petrol prices). Since then households have benefited from lower petrol prices, falling interest rates and tax cuts. However, this pick up in cash flow has been greeted with a muted recovery in confidence as households remain cautious on the employment outlook. Since June, sentiment in the fortnightly Roy Morgan Survey has lifted, suggesting we should see another lift in the higher profile quarterly Westpac survey.



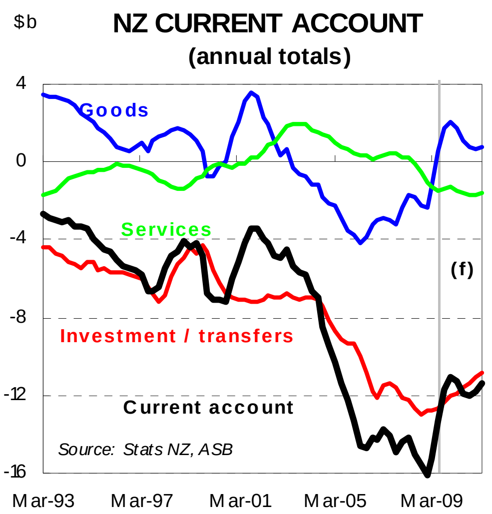
Tuesday 22 September

Q2 Current Account

Previous: -8.5% of GDP. ASB forecast -7.4 of GDP%.

We expect the annual current account deficit to narrow to 7.4% of GDP, based off a quarterly deficit of $1,980mn. Relative to a year earlier the good balance has lifted strongly into surplus as dairy exports rebounded from last year's drought. In contrast the services trade deficit is likely to be a touch weaker, reflecting weakening tourism earnings. The investment income deficit should shrink relative to a year ago, dominated by weaker outflows from domestic corporate profits and lower debt-servicing costs.

A key uncertainty will be the statistical treatment of JetStar's fleet, which landed over the quarter. We have assumed that the planes will be treated as on an operational lease and, hence, will be excluded from the Balance of Payments. If the fleet was included our forecast current account deficit would be around $500mn larger.

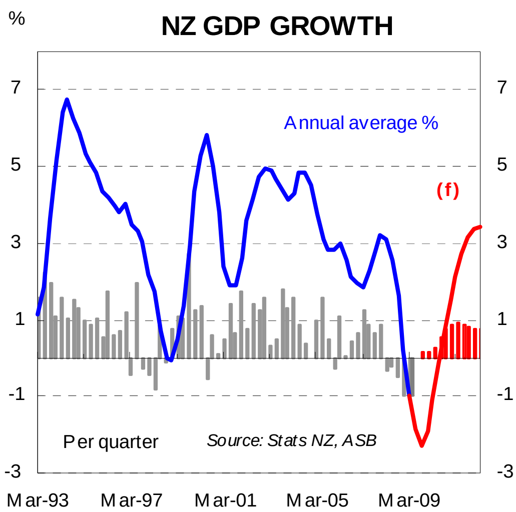


Wednesday 23 September

Q2 Gross Domestic Product

Previous: -1% qoq ASB forecast +0.1%.

We expect GDP increased 0.1% over Q2. While indicators of underlying economic growth pointed to another contraction, key data have not been as weak as initially expected. Manufacturing and construction will remain a drag on activity, although to a lesser extent than previously assumed. An increase in finance, insurance and business services will provide most of the offset – underpinned by the recovery in house sales. There remains some uncertainty around large components (in particular manufacturing and wholesale trade), which have scope to surprise. Given the margin for error we are sitting just a mere fraction between a weak expansion or contraction. What is more important is that the economy is likely to have stabilised and will remain steady over the following quarters.



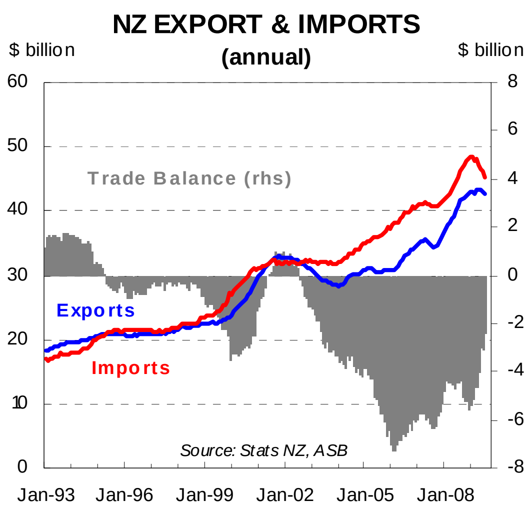
Friday 25 September

August Merchandise Trade Balance

Previous -$163 Mil. ASB Forecast -$350 Mil.

We expect a trade deficit of $350 million in August. NZ typically starts to register larger trade deficits around the 3rd quarter of the year. Agricultural exports start to weaken as the dairy production season comes to an end and meat slaughter falls off. The seasonal decline in agricultural production is also being exacerbated by weak commodity prices. Meanwhile, imports tend to seasonally increase over August through to November. On a seasonally-adjusted basis, import values are likely to be stabilising. Import volumes should start to improve over the next few months along with improved domestic demand. However, the rise in the NZ dollar will put downward on import prices.

On an annual basis the trade balance continues to improve, supported by the strength in dairy production volumes timed with a sharp fall in import demand. However, terms of trade are now starting to fall which will make further improvement in the trade balance limited as net export volumes also begin to falter



NZ Data Review: weekly recap

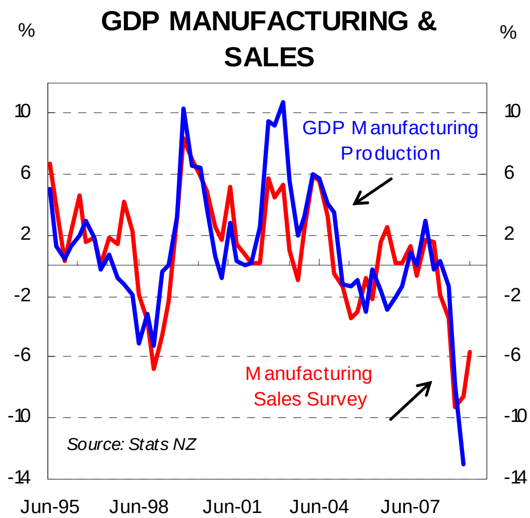
QII Survey of Manufacturing

- Manufacturing sales -4.8% qoq
- Manufacturing sales volumes +1.8% qoq
- Food Manufacturing sales volumes +6.4% qoq
- Non-Food Manufacturing sales volumes -1.4% qoq

Manufacturing sales fell 4.8%, due to low prices for meat and dairy products. Manufacturing sales volumes increased 1.8% on the back of a 7.4% increase in meat and dairy volumes. The strength in volumes, in particular meat and dairy, was more than we had expected. Last quarter the manufacturing survey also indicated an increase in both sales and stocks of meat and dairy, only to see a sharp decline in the GDP production measure of food manufacturing. The source of the difference is not obvious (and is likely to be technical), and as a result we are tentative in incorporating all the strength of the dairy manufacturing component.

Excluding food-related manufacturing, volumes fell 1.4%. This is the fourth consecutive decline in non-food manufacturing, with sales stunted by the downturn in both domestic and global demand.

On balance, this report is stronger than we expected and we have nudged up our forecast for Q2 GDP to +0.1% (from -0.1% previously). Better than expected data so far suggest there is a chance that New Zealand's recession may have ended earlier than previously thought.



Tourism and Migration – August.

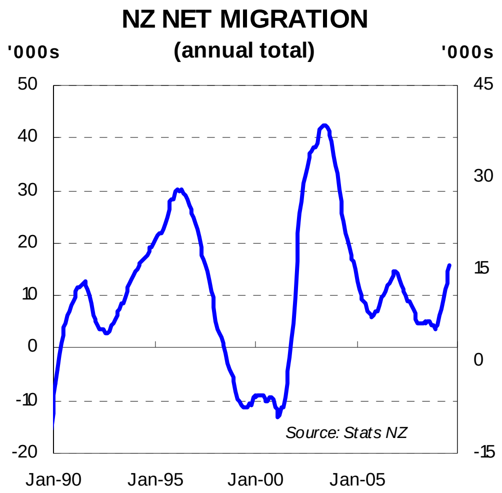
Net migration continues at a solid rate, with 1600 net new arrivals in August (seasonally adjusted) bringing the annual increase up to 15,600. The pick up in net migration over the past 6 months has been a result of fewer permanent departures to Australia and the UK.

The global economic downturn has seen unemployment rise in both countries, deterring New Zealanders from relocating. However, Australia has fared though the downturn comparatively well, and appears to be making an early recovery. It is possible that departures could start to recover within the next 12 months, although this is dependent on the Australian labour market which is likely to remain weak for some time.

Permanent arrivals remain firm, with an increase in arrivals from Australia offsetting a fall in arrivals from the UK.

The pick up in net migration will act to underpin retail spending and housing demand over the next 12 months. The RBNZ factored in a higher net migration assumption in the September MPS, and August's result is unlikely to surprise.

Short-term arrivals fell 0.9% over August following the previous month's 3.4% increase. Abstracting from the monthly volatility, visitor arrivals have held up well considering the global economic downturn. However, a fall in visitors from long-haul destinations (who tend to stay longer and spend more) will continue to weigh on tourism earnings.



Global Data Calendars

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

Calendar – Australasia, Japan and China

Date	Time NZT	Econ	Event	Period	Unit	Last	Forecast Market	Forecast ASB/CBA
Mon 21 Sep	12.30	AU	New motor vehicle sales	Aug	m%ch	-6.9	~	2.0
					y%ch	-10.4	~	-5.3
	15.00	NZ	Credit card spending	Aug	y%ch	-2.0	~	~
Tue 22 Sep	10.45	NZ	Current account balance	QII	$bn	-1.2	-1.98	~
	10.45	NZ	Account deficit-GDP ratio	QII	%	-8.5	-7.4	-7.4
Wed 23 Sep	10.45	NZ	GDP	QII	q%ch	-1.0	-0.2	0.1
					y%ch	-2.7	-2.6	-1.8
	13.00	AU	DEWR skilled vacancies	Sep	m%ch	1.0	~	~
Thu 24 Sep	11.50	JP	Merchandise trade balance	Aug	¥bn	377.9	~	~
	13.00	AU	HIA new home sales	Aug	m%ch	0.1	~	~
	13.30	AU	Reserve Bank releases Financial Stability Review					
	16.30	JP	All industry activity index	Jul	m%ch	0.1	~	~
Fri 25 Sep	10.45	NZ	Trade balance	Aug	$mn	-163	-329	-350
	10.50	JP	BoJ monetary policy meeting minutes for May					
	10.50	JP	Corporate service price	Aug	y%ch	-3.4	~	~
	13.30	AU	Financial accounts	QII	~	~	~	~
Sun 27 Sep	14.00	CH	Industrial profits	Aug	ytd y%ch	-22.9	~	~

Calendar – North America & Europe

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

Date	UK time	Econ	Event	Period	Unit	Last	Forecast Market	Forecast CBA
Mon 21 Sep	00.01	UK	Rightmove house prices	Sep	m%ch	-2.2	~	~
	15.00	US	Leading indicators	Aug	m%ch	0.6	0.7	~
Tue 22 Sep	13.30	CA	Retail sales	Jul	m%ch	1.0	0.7	~
	13.30	CA	Retail sales less autos	Jul	m%ch	1.0	0.2	~
	15.00	US	Richmond Fed manuf. index	Sep	Index	14.0	14.0	~
	15.00	US	House price index	Jul	m%ch	0.5	~	~
Wed 23 Sep	08.30	GE	PMI manufacturing	Sep	Index	49.2	~	~
	08.30	GE	PMI services	Sep	Index	53.8	~	~
	09.00	EZ	PMI manufacturing	Sep	Index	48.2	~	~
	09.00	EZ	PMI services	Sep	Index	49.9	~	~
	09.00	EZ	PMI composite	Sep	Index	50.4	~	~
	09.30	UK	Bank of England minutes	Sep	~	~	~	~
	10.00	EZ	Industrial new orders	Jul	y%ch	-25.1	~	~
	19.15	US	FOMC rate decision	Sep	%	0.25	~	~
Thu 24 Sep	09.00	GE	IFO – business climate	Sep	Index	90.5	~	~
	09.00	GE	IFO – current assessment	Sep	Index	86.1	~	~
	09.00	GE	IFO – expectations	Sep	Index	95.0	~	~
	~	US	G20 Meeting – Pittsburgh – 24-25th September					
	13.30	US	Initial jobless and continuing claims					
	15.00	US	Existing home sales	Aug	$mn m%ch	5.2 7.2	5.3 1.6	~ ~
Fri 25 Sep	09.30	UK	Total business investment	QII	q%ch y%ch	-10.4 -18.4	~ ~	~ ~
	13.30	US	Durable goods orders	Aug	%	5.1	0.1	~
	13.30	US	Durables ex transportation	Aug	%	1.1	0.8	~
	15.00	US	New home sales	Aug	'000	433	435	~
	15.00	US	Uni of Michigan confidence	Sep	Index	70.2	70.0	~
	15.00	US	New home sales	Aug	m%ch	9.6	0.5	~

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