ECONOMICS

30 Nov. 09

Business Weekly

Dubai causes a storm

This Week

Economic news has been put to one side and markets have been focusing on financial risk again. A week ago the Ukraine was being briefly murmured about. But late last week Dubai hit the headlines and triggered a bout of risk aversion. Dubai World, a government-sponsored investment vehicle, and its developer subsidiary Nakheel have asked to restructure USD59 billion of debt, delaying its debt obligations 6 months. These debts are reportedly backed by USD99 billion in assets (though in a time of stress the effective value is likely to be less) and account for most of the USD80 billion of Dubai's total debt.

As was the case during the depths of the financial crisis, the main issue boils down to whether or not Dubai World will default on its debts. Dubai is one of seven emirates that make up the United Arab Emirates (UAE). Its main industries are real estate, tourism and finance. This latter industry is very relevant to recent events: Dubai desires to become a world financial centre - even though Dubai World's debts are not government guaranteed, it seems unlikely the Dubai government would allow default. The UAE Government as a whole also seems to have the means to prevent default, with large sovereign wealth funds making the UAE comfortably a net external creditor - Abu Dhabi, the other large UAE member, is very oil rich. The UAE central bank is also putting into place liquidity measures to help support the Emirates' banks.

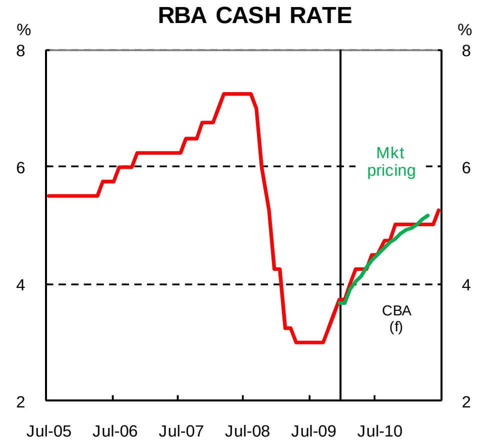
Nevertheless, the developments could continue to cause jitters in market over the next few weeks. Holidays in the Middle East have meant that the full local impact is still uncertain. Equity markets globally have rallied a long way this year and are pricing in a relatively rapid and trouble-free global recovery. Events such as Dubai – even if they involve comparatively 'small' sums – can get people to assess the merits of taking some risk off the table. Financial contagion within the region will be closely watched for.

But to put Dubai's $59 billion problem into perspective, there are other regions to worry about a little more. Eastern Europe continues to face economic and financial stress. The US and UK governments will issue huge amounts of debt in coming years (quite often the US Treasury auctions off more debt in one week than Dubai's outstanding total). And perhaps markets would be better off worrying about California, the world's 8th biggest economy: it may have the Gubernator in charge but it faces a budget deficit of around USD21 billion. California's unusual system of binding citizen referenda severely restricts the ability to manage the state's fiscal position, with the result that spending cuts tend to fall disproportionately on areas the politicians still have control over. California is resorting to welfare and education cuts and letting prisoners out of jail early to save money, and even issued IOUs for a while. Dubai is not quite there yet.

Click here for:

Foreign Exchange	• NZD weakens as investor appetite for risk remains weak.
Interest Rates	• Rates press lower as global sentiment remains weak
Week Ahead	• No data due this week.
Week in Review	• Building consents, NBNZ Business Outlook and trade figures released.
Global Calendars	• Fed's Beige Book, US Non-farm payrolls, RBA& ECB rate announcements.

Chart of the week



- Having removed 50 basis points of the no-longer-required emergency stimulus the RBA has indicated that the pace of further policy normalisation will be data dependent.
- In the intermeeting period the data has oscillated between robust and positive, with the exception of the modest retail sales figures.
- We consider that the RBA board will judge the risk of leaving rates at extremely low levels over this time as potentially "imprudent" and inconsistent with the ensuring the long-run sustainability of growth in economic activity.
- In our view, the data has been sufficiently strong to justify a further 25 basis point hike at the meeting on Tuesday 1st December. It's a long summer break before the next opportunity to raise rates in February.

Foreign Exchange Market

FX Rates	Current*	Week ago	Month ago	6 mths ago	Year ago	ST Bias	Support^	Resistance^
NZD/USD	0.7126	0.7265	0.7166	0.6501	0.5514	FLAT	0.7025	0.7225
NZD/AUD	0.7824	0.7899	0.7987	0.8027	0.8400	DOWN	0.7750	0.7900
NZD/JPY	61.77	64.58	64.72	62.80	52.51	FLAT	60.50	63.00
NZD/EUR	0.4759	0.4862	0.4868	0.4591	0.4273	FLAT	0.4700	0.4800
NZD/GBP	0.4323	0.4395	0.4376	0.3959	0.3580	FLAT	0.4250	0.4400
TWI	63.42	64.8	64.7	61.0	55.7	FLAT	62.50	64.50

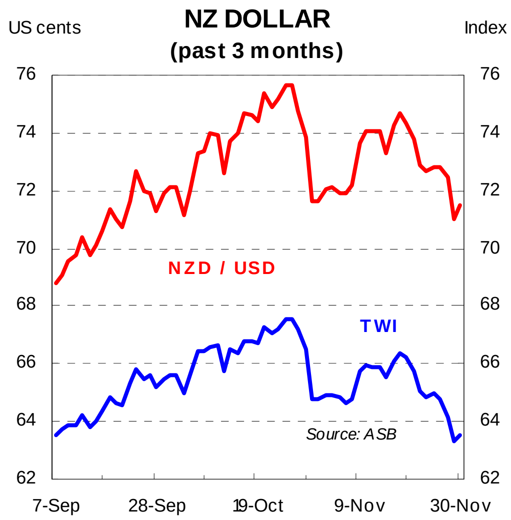
^Weekly support and resistance levels * Current is as at 10.30 am Monday; week ago as at Monday 5pm

- It was another light week for local data, and the NZD continued to be driven by offshore themes. The NZD slipped on all the main cross rates, as risk aversion rose offshore. Financial markets were jittery following last week's news that Dubai World was seeking a six-month delay to its debt obligations. Dubai World is state owned, but the debt is not state guaranteed. The event is small in a global context but nonetheless highlighted ongoing challenges for the global recovery and the fragile nature of market confidence.
- NZD traded over 0.73 against the USD early last week, but slipped to as low as 0.703 in the wake of the Dubai news. AUD has been under similar pressure. As we saw in the previous week, the NZD has underperformed the AUD, and the NZD/AUD cross rate slipped another 0.8c last week.
- The current mood of risk aversion is USD and JPY positive. Confidence remains fragile – and that is the issue with the Dubai development. The biggest risk is contagion of other Gulf States and for global investor confidence to become severely dented. But the likelihood of this occurring on a scale we witnessed in H2 2008 and early 2009 is relatively low. We have not changed our forecasts and strong data offshore would likely cause risk appetites to recover, and see the NZD to lift off current lows.
- **Short-term outlook:**

Key data	Date	Time (NZST)	Market expects

No significant local releases.

Potential currency movers from overseas this week: EZ CPI estimate, German retail sales, Canadian GDP, Chicago purchasing manager index, NAPM-Milwaukee index, and Dallas Fed manuf. index (Mon 30 Nov). US motor vehicle sales, German unemployment, US, UK and Euro PMI manufacturing data and US pending home sales (Tue 01 Dec). Euro unemployment, US ADP employment change and the Fed's Beige Book (Wed 02 Dec), Euro retail sales, GDP, ECB interest rate announcement and US ISM Non-manuf. PMI (Thu 03 Dec). Canadian employment, US Non-farm payrolls and factory orders (Fri 04 Dec).



Medium-term outlook: [Last Quarterly Economic Forecasts]

- We continue to expect the NZD to appreciate further against the USD over the next 6-9 months. We have revised up our expected peak to USD 0.82.
- The story remains primarily one of USD weakness, also overlaid by some Downunder strength. We expect the USD to remain under pressure until the Federal Reserve starts to unwind its policy stimulus: the earlier that starts the sooner the NZD's rise is likely to be capped.
- 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, with USD liquidity demand and safe-haven buying also no longer boosting the USD.
  - Diversification out of USD is expected to occur due to concerns about US government debt.
  - And, related, concern about the USD's future role as a reserve currency.
- The NZD is also likely to mildly outperform other major currencies in the ongoing environment of improving global growth prospects and rising commodity prices. Outright weakness in the Pound will continue to hold the NZD/GBP rate at very elevated levels. The Pound, like the USD, is being weighed down by debt concerns and the state of its financial sector – both of which have ramifications for the future growth rate of the economy.
- The buoyant Australian dollar is also likely to contribute to an overall strengthening of the NZD. The RBA is likely to continue lifting its cash rate back to a less stimulatory level. Rising interest rates there will lift the AUD. The NZD will be caught in the middle: weakening slightly against the AUD but up against other currencies.
- For more on the relative fundamentals driving the NZD see our Economic Note "NZD: The Flighty Bird".
- The RBNZ is not expected to cut the OCR to try dampening the NZD. Direct FX intervention also appears unlikely (at the least, very risky) 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	2.50	6.50	FLAT
90-day bank bill	2.82	2.79	2.79	2.75	5.80	FLAT
2-year swap	4.37	4.44	4.56	3.55	5.12	FLAT
5-year swap	5.50	5.58	5.67	5.05	5.53	FLAT
5-year benchmark gov't stock	4.73	4.81	5.14	4.58	4.83	FLAT
NZSX 50	3094	3113	3196	2754	2686	DOWN

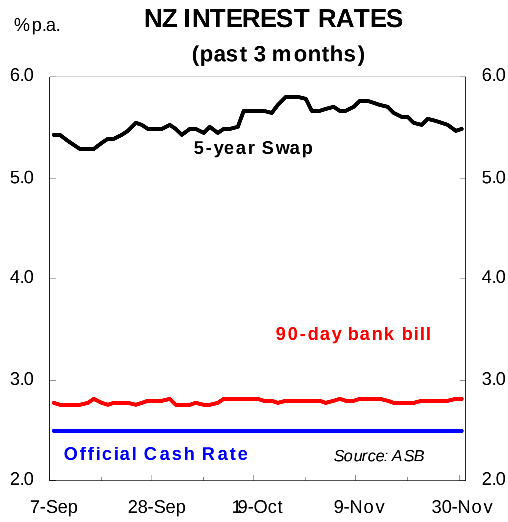
* Current is as at 10.30 am Monday; week ago as at Monday 5pm. Please note that we have recently changed the NZ govt 5-year benchmark bond to April 2015 maturity (from April 2013). This does cause some distortion in the comparison against the previous levels (i.e. month ago).

- Global interest rates fell over the latter past of last week, taking NZ interest rates lower as well. Risk aversion dominated during the week, with the Dubai debt announcement adding to the downbeat mood in markets.
- US Treasury yields moved lower over the week. Results from US Treasury bond auctions indicated strong demand continued to comfortably absorb the high level of debt issuance. In particular, the 5-year bond auction received the strongest demand in 2 years with increases in take up from indirect bidders (generally foreign buyers). The Dubai announcement triggered a shift in demand away from equities into safer assets, benefiting US Treasuries and driving a sharp fall in yields on Friday.
- In Australia, the disappointing decline in Q3 capital expenditure raised doubts whether the RBA would increase rates at the December meeting (tomorrow). We still expect the RBA to increase 25 bp, although the market only has 70% chance of a hike priced in.

Short-term outlook:

Key data	Date	Time (NZST)	Market expects
RBA Rate Announcement	1/12	4.30 pm	3.75%
US Non-Farm Payrolls	5/12	2.30 am	-120k

Comment: There is no local data due out this week and the focus remains offshore until the RBNZ's announcement due Thursday 10th December. Our outlook for this week is very conditional on the RBA announcement; we are expecting the RBA to hike by 25 bps. The market would be surprised if the Bank does remain on hold, resulting in a large rally (yields lower) adding to the bearish sentiment in global markets. While concerns for Dubai may blow over, the US market is likely to remain downbeat absent any strong data. Other key offshore data includes US ISM Manufacturing Index (1st Dec), Australian retail sales (3rd Dec), US Non-Farm Payrolls (4th Dec).

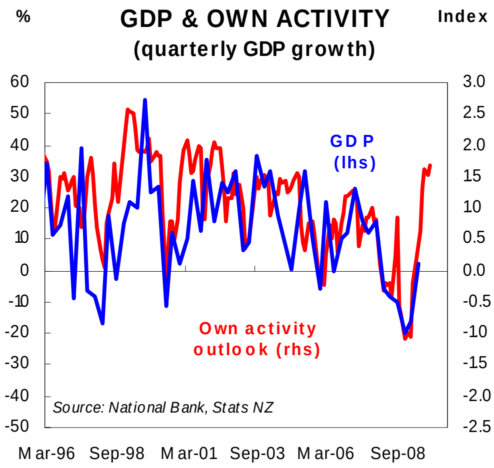


Medium term outlook: [Last Quarterly Economic Forecasts]

- The RBNZ continues to hold the cash rate at 2.5%. While the RBNZ has backed off its easing bias, it maintains a very dovish tone. The Bank has stated it sees no urgency to withdraw monetary stimulus, and expects to keep the OCR at the current level until the second half of 2010. However, given the recent improvement in the outlook, we see that stance becoming untenable in time.
- The RBNZ's overall growth and inflation forecasts were unchanged at the September MPS, 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.
- October's statement suggest some change in the RBNZ's outlook, though not enough to convince the RBNZ it is likely to hike in the first half of 2010. World demand has stabilised and the outlook for 2010 continues to improve. Dairy prices have lifted off lows and have led Fonterra to revise up its forecast payout significantly. Net migration continues at a robust pace, and continues to provide support to housing demand in a tight market. Housing supply has been slow to respond, resulting in a surprisingly strong lift in house prices over the past 6 months which is likely to make the RBNZ uncomfortable. Business and consumer confidence has surged pointing to an earlier recovery in growth than previously thought. Meanwhile, the downside risks to inflation have also abated.
- The next move in the OCR is up, it's just a matter of when. We expect the RBNZ will hike by April next year (previously June). 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 Review: weekly recap

November National Bank Business Outlook

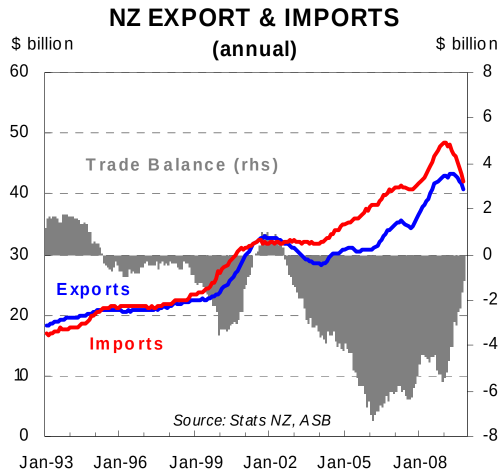


While headline business confidence eased for the second consecutive month, businesses' expectations of their own activity outlook improved. This suggests a recovery in economic activity over the coming year.

Other details of the survey were also encouraging, with an improvement in export intentions, profitability and employment and investment intentions. Given the lagged nature with which intentions flow through to real activity the recovery is still expected to be gradual.

With pricing intentions remaining at subdued levels, near-term inflation pressures look to be muted in the near term. However, the increase in capacity utilisation points to the potential for inflation pressures to develop later in 2010.

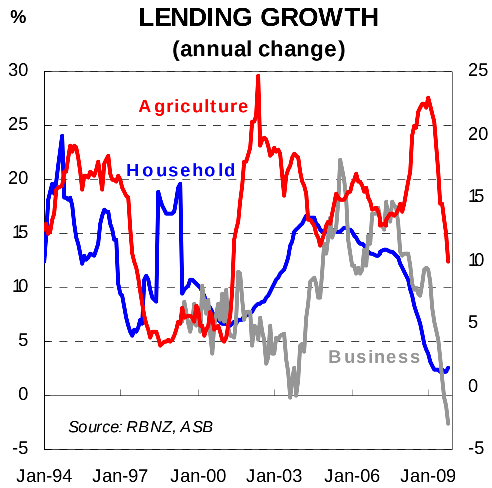
October Trade Balance



The trade deficit of $487 million for October brought the annual deficit to $1.16 billion. The annual trade deficit has declined sharply over the past year, from $5.3 billion in October 2008 to just over $1 billion now, as the sharp fall in import demand from the second half of 2008 and easing in oil prices last year's peak drove a sharp decline in import values.

However, the improvement in the trade balance is unlikely to continue, as import demand recovers in line with the rebound in domestic demand. Furthermore, Exporters in American and European markets will face challenging times contending with the strong NZD and weak demand in these markets.

October Credit Statistics



Mortgage lending growth continues to gradually accelerate, with annual growth having bottomed out at 2.8%. Meanwhile, the contraction in consumer credit appears to be stabilising. Overall household credit growth is recovering but the lift to date is very modest and outright growth is still very subdued.

Business credit dipped once again over the month after posting an increase over September. On an annual basis business credit continues to shrink, given weak capital investment by businesses in response to decisions made during the recession.

Household credit trends will be important to watch going forward, as a return to stronger growth would test the RBNZ's patience at some point. The business credit figures are a reminder to be wary of reading too much into the sharp improvement in business confidence, with only tentative signs at the moment of higher confidence flowing through to real activity.

Global Data Calendars

Note: Calendar 2 is in UK times. Add 13 hours for NZ times.

Calendar – Australasia, Japan and China

	Time						Forecast	
Date	**NZST**	**Econ**	**Event**	**Period**	**Unit**	**Last**	**Market**	**ASB/CBA**
Mon 30 Nov	12.15	JP	Nomura/JMMA manuf. PMI	Nov	Index	54.3	~	~
	12.30	AU	TD securities inflation	Nov	m%ch	-0.3	~	~
					y%ch	1.2	~	~
	12.50	JP	Industrial production	Oct	m%ch	2.1	~	~
					y%ch	-18.4	~	~
	13.00	AU	HIA new home sales	Oct	m%ch	-4.5	~	~
	13.30	AU	Private sector credit	Oct	m%ch	-0.2	~	0.3
					y%ch	1.7	~	1.6
	13.30	AU	Company operating profit	QIII	q%ch	-7.8	~	-0.2
	13.30	AU	Inventories	QIII	q%ch	-3.4	~	-1.7
	14.30	JP	Labour cash earnings	Oct	y%ch	-1.8	~	~
	17.00	JP	Vehicle production	Oct	y%ch	-21.6	~	~
	18.00	JP	Housing starts	Oct	y%ch	-37.0	~	~
	18.00	JP	Annualised housing starts	Oct	mn	0.7	~	~
	18.00	JP	Construction orders	Oct	y%ch	-14.0	~	~
Tue 01 Dec	11.30	AU	Ai Group PMI	Nov	Index	51.7	~	~
	13.30	AU	Building approvals	Oct	m%ch	2.7	~	4.0
					y%ch	11.7	~	12.3
	14.00	CH	PMI manufacturing	Nov	Index	55.2	56.0	~
	16.30	AU	RBA cash target	Dec	%	3.50	3.75	3.75
	18.00	JP	Vehicle sales	Nov	%	12.6	~	~
Thu 03 Dec	11.30	AU	Ai Group PSI	Nov	Index	54.8	~	~
	12.50	JP	Capital spending	QIII	%	-21.7	~	~
	12.50	JP	Capital spending ex software	QIII	%	-22.2	~	~
	13.30	AU	Retail sales	Oct	m%ch	-0.2	~	0.5

Calendar – North America & Europe

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

	UK						Forecast	
Date	**time**	**Econ**	**Event**	**Period**	**Unit**	**Last**	**Market**	**CBA**
Mon 30 Nov	00.01	UK	Gfk cons conf. survey	Nov	Index	-13.0	~	~
	09.30	UK	Net consumer credit	Oct	£bn	-0.3	~	~
	10.00	EZ	CPI estimate	Nov	y%ch	-0.1	~	~
	12.05	GE	Retail sales	Oct	m%ch	-0.2	~	~
	13.30	CA	Quarterly GDP annualised	QIII	%	-3.4	1.0	~

Date	time	Econ	Event	Period	Unit	Last	Market	CBA
	14.45	US	Chicago purchasing manager	Nov	Index	54.2	53.0	~
	15.00	US	NAPM-Milwaukee	Nov	Index	50.0	~	~
	15.30	US	Dallas Fed manuf. index	Nov	%	-3.3	0.0	~
Tue 01 Dec	~	US	Motor vehicle sales	Nov	mn	10.5	10.5	~
	07.00	UK	Nationwide house prices	Nov	m%ch	0.4	0.3	~
					y%ch	2.0	2.4	~
	08.55	GE	PMI manufacturing	Nov	Index	52.0	~	~
	08.55	GE	Unemployment change	Nov	'000	-26.0	~	~
	09.00	EZ	PMI manufacturing	Nov	Index	51.0	~	~
	09.30	UK	PMI manufacturing	Nov	Index	53.7	~	~
	15.00	US	ISM manufacturing	Nov	Index	55.7	54.8	~
	15.00	US	Pending home sales	Oct	m%ch	6.1	-0.8	~
					y%ch	19.8	~	~
	15.00	US	Construction spending	Oct	m%ch	0.8	-0.5	~
Wed 02 Dec	10.00	EZ	Unemployment rate	Oct	%	9.7	9.8	~
	10.00	EZ	PPI	Oct	m%ch	-0.4	~	~
					y%ch	-7.7	~	~
	13.15	US	ADP employment change	Nov	'000	-203	-148	~
	19.00	US	Fed's Beige book	Dec	~	~	~	~
Thu 03 Dec	09.00	EZ	PMI composite	Nov	Index	53.7	~	~
	09.30	UK	PMI services	Nov	Index	56.9	~	~
	10.00	EZ	Retail sales	Oct	m%ch	-0.7	~	~
					y%ch	-3.6	~	~
	10.00	EZ	GDP	QIII	q%ch	0.4	0.4	~
					y%ch	-4.1	-4.1	~
	12.45	EZ	ECB announces interest rates	Dec	%	1.0	~	1.0
	13.30	US	Non-farm productivity	QIII	%	9.5	8.5	~
	13.30	US	Unit labour costs	QIII	%	-5.2	-4.3	~
	15.00	US	ISM Non-manuf. PMI	Nov	Index	50.6	51.2	~
Fri 04 Dec	12.00	CA	Net change in employment	Nov	'000	-43.2	~	~
	13.30	US	Non-farm payrolls	Nov	'000	-190	-125	~
	15.00	CA	Ivey PMI	Nov	Index	61.2	~	~
	15.00	US	Factory orders	Oct	%	0.9	0.5	~

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