ANZ RESEARCH

NEW ZEALAND ECONOMICS
MARKET FOCUS

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INSIDE

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NEW ZEALAND'S BETTER HALF

ECONOMIC OVERVIEW

Last week's National Bank Business Outlook continued to hold out the alluring prospect of a strong upswing. Questions continue to surround whether positive expectations will be matched by reality. The general thrust of real time anecdotes suggests so, but some real pockets of weakness remain and this needs to be acknowledged. While GDP takes centre stage this week, we think the QSBO is more important, for it portends tomorrow as opposed to describing yesterday. We expect positive growth signals, but also signs of receding excess capacity and evidence of supply side factor constraints becoming more prevalent.

Q1 GDP PREVIEW

Despite the considerable disruption and destruction of capital caused by the February 22 Christchurch earthquake, strong underlying momentum is expected to contribute to a Q1 increase in economic activity. The GDP report will show sector divergences, with rebounding primary sector output contrasting with mixed readings for the goods and services sector. There are greater than usual uncertainties around our Q1 pick, and details from Statistics New Zealand on the scale of adjustments made to incorporate the earthquake impact may provide more clarity.

A LOOK AT US INFLATION EXPECTATIONS

This article is the second in our series on inflation expectations (see Market Focus 27 June for the first article on New Zealand expectations). We repeat our analysis for the US. The "best" series, in terms of usefulness for forecasting inflation, are those derived from inflation-indexed bond data. However, ironically, the expectations series that were most useful were also the hardest to explain, in terms of what drives them. We find that compared with New Zealand, there is less evidence that food and petrol prices have an impact on inflation expectations beyond their effect on CPI inflation.

INTEREST RATE STRATEGY

The key debate for the interest rate market now is; will US interest rates continue their march higher, or have they done their dash? The move so far has certainly been brutal, and the effects have been felt here. But there is still considerable uncertainty. Although the NZ yield curve has steepened, it should ultimately flatten, tested by domestic data adding weight to the recovery thesis, which will ultimately push short end yields higher. This week's NZIER QSBO and GDP data will be the first of such tests.

CURRENCY STRATEGY

Risk looks to be back on as Greece gets a much needed lifeline and the US ISM headline number beat expectations. But NZD failed to push on, which is telling. Markets are cautious about taking NZD much further in the absence of domestic data to justify it. In that regard, this week's QSBO and GDP print could provide the catalyst for NZD to push above 0.83. However, a weaker underlying tone for global commodity prices will act as a counter on the other side. On balance then, NZD looks to be in consolidation mode for this week. US non-farm payrolls on Friday night will set the tone for the following week.

ECONOMIC OVERVIEW

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THIS WEEK'S EVENTS

ANZ Commodity Price Index – June (Monday, July 4, 1:00pm).

NZIER QSBO – 2011Q2 (Tuesday, July 5, 10:00am). A widespread rebound is expected, with general business confidence, domestic trading activity and investment intentions to move well into positive territory. Pricing intentions are also likely to firm. We'll be paying close attention to indicators of resource pressures.

***GlobalDairyTrade* online auction** (Wednesday, July 6, early am). We expect whole milk power prices to ease slightly more than 2 percent to an average of US $3,800 per tonne. Other dairy product prices are expected to fall by varying degrees.

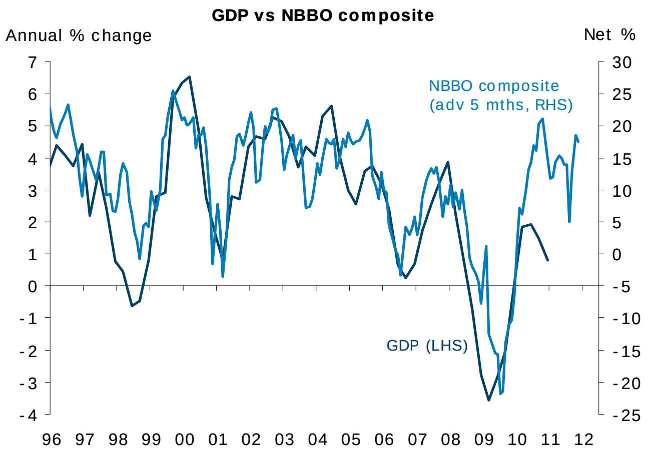
SNZ Gross Domestic Product – 2011Q1 (Thursday, July 7, 10:45am). We expect a 0.4 percent increase in production-based GDP (+0.6 percent y/y). See our preview on page 5.

WHAT'S THE VIEW?

Questions will continue to surround whether buoyant expectations provided by lofty business confidence readings will be matched by reality in terms of the hard data outturns. We only need to cast our minds back to the "head-fake" provided by confidence gauges about this time last year to know that intention does not always translate into reality. A year ago we were not exactly buying into readings coming from business confidence, taking a more sceptical view of the "expected" recovery. "This time it's different" is a graveyard phrase for economists, but a year on **we have a lot more faith in businesses' assessment.** Of course it is much easier to rebound when the starting point is low (we estimate the level of activity in Q1 was still nearly 5 percent below pre-recession levels on a per-capita basis), yet we also know that:

- Another year of circumspect activity and borrowing has improved balance sheets;
- Financial conditions are very supportive;
- Farmers are starting to spend the commodity price windfall, with better real-time anecdotes on this front by the day;
- The Rugby World Cup is just around the corner; and
- There are a host of one-offs, and action by the Government to use its balance sheet to provide support to homeowners in the Red Zone in Christchurch is providing more clarity on the pending construction response.

Rather than shrinking, the list of support factors is growing. Or put another way, the list of problem areas is shrinking. There are still challenges ahead. The New Zealand economy still faces a multi-year deleveraging headwind as the realities of rebalancing and remobilising resources bite. Seismic events complicate the picture and will create tremendous tensions across the economy, working against the rebalancing and deleveraging dynamics in the near term. Problem areas will remain. Yet it's about getting a critical mass of ticks on the positive side of the ledger, and compared to mid 2010, we simply have more on the positive side.

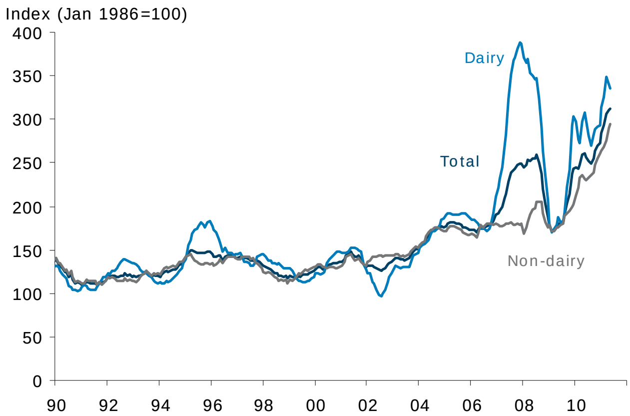


Sources: ANZ, National Bank, Statistics NZ

Looking at the week ahead, we are expecting some pullback in dairy prices in Wednesday's auction, in line with a general cooling in commodity prices globally. Whole milk powder prices are expected to ease towards $3,800/tonne, a level which is still around 70 percent above historical averages. The commodity price story for NZ.Inc has been one of broad-based strength, providing more widespread boost to the primary sector. **Today's ANZ commodity price index will provide a timely update of how export commodity prices are faring.** Whether they go up or down in the month, the message will remain the same. Commodity prices sit at phenomenal highs. The key for the economy will be when rural chequebooks are opened, with our

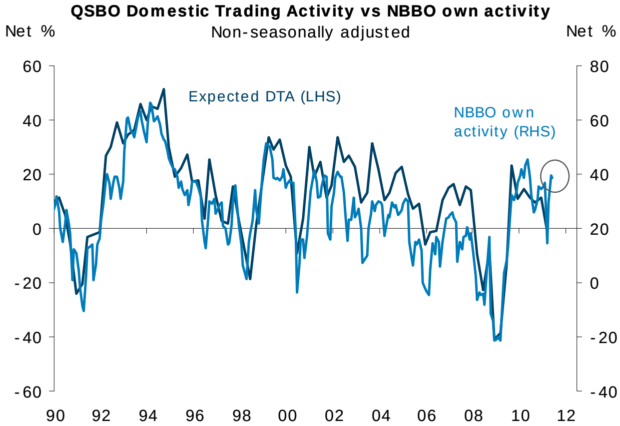
ECONOMIC OVERVIEW

internal anecdotes suggesting higher on-farm spending is starting to percolate through the provinces. This is being funded via retained earnings, with the RBNZ credit aggregates showing an easing back in agricultural credit for May, which will no doubt please the RBNZ.



Sources: ANZ, National Bank

Tomorrow's QSBO is a key release this week, because of its coverage both in terms of momentum (confidence, activity, employment, investment) **but also wider capacity metrics** such as skill shortages and factor constraints. While most forecasters are basing their interest rate expectations off the demand side of the equation (i.e. the RBNZ will start hiking as the recovery in activity gains traction) we're equally mindful of the limited ability of supply side capacity to accommodate this upswing in demand. The supply-side capacity of NZ.Inc is simply not what it was before the Canterbury earthquakes and will take time to rebuild. Throw in the need for the economy to rebalance towards the earning side of the economy amidst a backdrop of weak business credit growth and low productivity and the list of challenges start to stack up.



Sources: ANZ, National Bank, NZIER

Momentum gauges are expected to mimic the National Bank Business Outlook (NBBO), flagging solid growth. Of course there will be divergences we need to acknowledge, specifically that the QSBO does not survey the rural sector *directly*. The *indirect* flow-on from the rural sector to the service economy will appear, but might lag the NBBO a bit. In terms of results, we expect general business confidence to move back firmly into positive territory after slumping to –27 in Q1 (the immediate post-quake aftermath). We expect domestic trading activity (past and expected) and investment intentions to move well into positive territory, consistent with Q2 GDP growth of around 0.8 percent. We will be closely watching gauges for investment, particularly architects' work in their own offices to get a sense of the impending construction sector impact.

The QSBO should give interesting insights about capacity pressures. The June *MPS* commented that business surveys had highlighted increasing capacity pressures, with the difficulty in finding labour halfway back to its previous peak. Limited capacity has edged higher but is still near its trough. While we expect limited demand will still be the predominant constraint to firms increasing production, limited capacity will likely increasingly feature as a constraint. We also expect QSBO readings on the difficulty in finding labour to move higher, consistent with the recovery we are seeing in the demand for labour.

Metrics for the pricing side of the economy are also expected to pick up, suggesting that the inflation environment is not as benign as the RBNZ likes to portray it, and we will closely watch skill shortages to see how supply-side capacity is holding up. A point of difference with the NBBO will be the timing of the surveys. The NBBO did not capture the impact of the June 13 aftershocks nor the June 20 Government announcement, and it will be useful to see how these opposing influences play out.

We are paying particular attention to the labour market and will be looking for the normal update on benefit numbers (for June) this week. There has now been some tightening in eligibility but we still find it to be useful real-time information. Volatility in the HLFS makes timely monthly labour market barometers such as benefit numbers and jobs ads key to watch. The past couple of months have seen the number of persons on the unemployment benefit fall by around two thousand persons in seasonally adjusted terms, and we expect this improving trend to continue.

ECONOMIC OVERVIEW

Thursday, somewhat belatedly, gives guidance on how the New Zealand economy fared in the first quarter of this year. There is a greater degree of uncertainty around these numbers than usual, with the likelihood that Statistics New Zealand will make adjustments to the figures to incorporate earthquake disruptions missed by their surveys. Nevertheless, GDP is sometimes a hollow concept and does not accurately capture economic wellbeing.

We expect a small positive read which we'll be taking heart from. Rather than go into the details (refer to page 5) we'll make a couple of general observations:

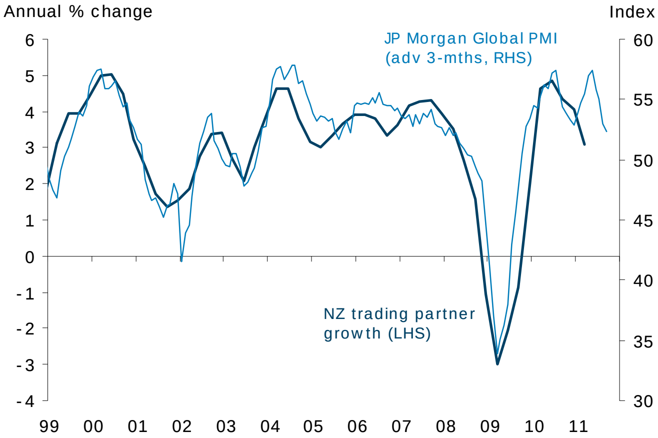
- There is a base effect at work. We saw little growth in H2 2010, so momentum in early 2011 was easier to achieve. The same concept applies when we eye the potential for building consents to really lift strongly going forward, with the last couple of months showing signs of a turning point being reached. The lift is growth but we need to remember the starting position.
- To record positive growth in Q1 is still a strong achievement. Excluding seismic events a 1 percent quarter was probably on offer.

GDP can be a hollow indicator when navigating through balance sheet shocks, and this is something we are very mindful of going into 2012. Christchurch alone will deliver around 2 percentage points of growth to the economy when the earthquake reconstruction gets going. The Canterbury region will probably grow 10 percent. This is bigger than Ben Hur, but of course it's simply rebuilding destroyed capital so is hardly "progress".

There are a number of overseas Central Bank decisions next week, with the RBA, Bank of England and ECB all meeting. The return of the "strong vigilance" comment by ECB members makes it clear they view interest rate hikes as likely over the next few months, despite the economic outlook not looking as promising as it did a few months ago. Our Australian colleagues expect the RBA to remain on the sidelines, but for the next move in rates to be up. The loss of global momentum implied by the slide in leading indicators could further dent trading partner growth and New Zealand's economic rebalancing. However, although there are a number of challenges for the global economy, we are not yet at the stage where we are talking about a protracted global slowdown.

With sovereign debt concerns in Europe temporarily abating, the one key issue markets are grappling with at present is whether the softening in global leading indicators reflect supply disruptions (which are likely to have a temporary impact), versus something more enduring and significant. Manufacturing gauges worldwide have ticked down, though last week saw two US manufacturing indicators tick up. This looked partly inventory related but still suggests supply disruptions are starting to abate. Markets are giving the US economy the benefit of the doubt for the moment, with the NZD taken along for the ride. We remain optimistic that the hiccup we are seeing at present will prove to be temporary, which will avert the need for the FOMC to embark on QE3. We caution, however that the road ahead will be bumpy, and markets look set for more volatility until clearer signs emerge.

NZ trading partner growth



Sources: ANZ, National Bank, Bloomberg

RECENT LOCAL DATA

SNZ Merchandise Trade – May. A monthly surplus of $605m was registered, with the annual surplus narrowing to $1,067m.

SNZ Building Consents – May. The number of residential consents issued rose by a seasonally adjusted 2.2 percent (+0.9 percent ex-apartments) to be 16.3 percent lower than 12 months earlier. Non-residential construction consents worth $350m were issued, up 17 percent on a year earlier.

National Bank Business Outlook – June. General Business Confidence rose 9 points to +47. Own activity (-1 to +39), and investment (+15) intentions were broadly unchanged, while employment intentions (-3 to +10) fell and export intentions (+3 to +31) rose. Pricing intentions and inflation expectations measures eased (to +27 and 3.2 percent respectively).

RBNZ Credit Aggregates – May. Private Sector Credit (R) ex-repo increased by 0.9 percent in the 12 months to May. Agricultural credit rose 0.2 percent, with business and household credit up 0.8 percent and 1.2 percent respectively over the last 12 months.

2011Q1 GDP PREVIEW

SUMMARY

Despite the considerable disruption and destruction of capital caused by the February 22 Christchurch earthquake, strong underlying momentum is expected to contribute to a Q1 increase in economic activity. The GDP report will show sector divergences, with rebounding primary sector output contrasting with mixed readings for the goods and services sector. There are greater than usual uncertainties around our Q1 pick, and details from Statistics New Zealand on the scale of adjustments made to incorporate the earthquake impact may provide more clarity.

MOVING FORWARD

GDP – March 2011 quarter

(due Thursday 7 July, 10.45am)

GDP	ANZ	RBNZ	Market
QoQ	**+0.4%**	+0.3%	+0.4%
YoY	**+0.6%**	+0.4%	+0.5%
Ann. Ave.	**+1.2%**	+1.2%	+1.2%

We expect headline production GDP to show economic activity moving forward despite the considerable disruption and destruction of nationwide capital stock caused by the February 22 earthquake. Moving forward is somewhat of a misnomer because we are now in July and commenting on the March quarter! Nonetheless, the base is a useful historical benchmark, and abstracting from seismic events many indicators suggest the economy started the year with good momentum.

While in aggregate a 0.4 percent increase in real seasonally adjusted production-based GDP is expected, we expect Thursday's report to highlight ongoing differences in sector performance.

- Primary sector output is expected to increase 1.2 percent, led by higher agricultural and forestry production. A massive improvement in climatic conditions between H2 2010 and H1 2011 is significant for GDP.
- Output in goods-producing sectors is expected to be a mixed bag, with more electricity value-added and ex-primary food manufacturing being offset by weaker construction sector activity.
- Services sector output is expected to be back in the black, with positive growth, but with contrasts. Strengthening retail, real estate and business services are expected to be partly offset by weaker transport and storage activity, with wholesale trade activity unlikely to recoup much of its Q4 decline.

There is a greater than usual degree of uncertainty around our Q1 pick. Much of this relates to how comprehensively the economic disruption caused by the February 22 earthquake was captured by the Statistics New Zealand surveys. This is of particular relevance for the "hard to measure" services sector, with some of the key surveys (the March Quarterly Employment Survey in particular) ending before the earthquake hit. As they did prior to the Q1 Balance of Payments release, **we expect Statistics NZ to release a paper outlining the adjustments they have made to account for the earthquake impact on Q1 GDP.** While we have made some adjustments for this possibility in our Q1 pick, if Statistics NZ's adjustments are more substantive than we have assumed, the upshot could be a lower reading for Q1 GDP.

Sector divergences are also expected in the expenditure measure of GDP. Largely on the basis of a rebound in durables consumption we expect a moderate increase in private consumption. Durables consumption and services activity are expected to be broadly flat, although falls in the latter (in particular) are certainly possible given Canterbury earthquake disruptions. Residential investment volumes are expected to ease, with falls in work put in place volumes partly offset by a higher volume of house sales. Declining business investment will be driven by weaker non-residential construction and transport equipment, which will offset strengthening plant and machinery investment. Higher paid hours are expected to translate into higher government consumption. Less of a build-up in inventories is expected to make a negative contribution to growth, with exports to be broadly unchanged but import volumes to ease in Q1.

FINANCIAL MARKET IMPLICATIONS

While the market consensus is close to the June *MPS* pick, we expect the market will partly discount a weaker than expected GDP result on account of earthquake disruptions. A stronger than expected number may be harder to brush off.

The focus will be on the economic outlook over 2011 and beyond. The recent dataflow has been reasonably upbeat and suggests a strengthening in economic activity in Q2. Pending earthquake construction work will add to the string of growth positive developments (including accommodative financial conditions, the Rugby World Cup and the tendency for activity to "springboard" from cyclical lows during an economic recovery), which are set to see activity accelerate further from the second half of this year. While there is still time to wait, a steadily improving economic outlook will be a key factor in the RBNZ reducing interest rate stimulus before the end of the year.

A LOOK AT US INFLATION EXPECTATIONS

SUMMARY

This article is the second in our series on inflation expectations (see Market Focus 27 June for the first article on New Zealand expectations). We repeat our analysis for the US. The "best" series, in terms of usefulness for forecasting inflation, are those derived from inflation-indexed bond data. However, ironically, the expectations series that were most useful were also the hardest to explain, in terms of what drives them. We find that compared with New Zealand, there is less evidence that food and petrol prices have an impact on inflation expectations beyond their effect on CPI inflation.

As discussed in the initial paper in last week's *Market Focus*, inflation expectations matter enormously for inflation targeting central banks. If expectations are not particularly well-anchored (US does not have target), then the central bank has to work a lot harder, because inflation expectations can become self-fulfilling. The Federal Reserve watches inflation expectations closely:

- "Survey data suggest that surging prices for gasoline and food have pushed up households' near-term inflation expectations." Vice Chair Janet Yellen, 11 April 2011.
- "The Committee anticipates that inflation will subside… However, the Committee will continue to pay close attention to the evolution of inflation and inflation expectations." FOMC SOMP Press Release, 22 June 2011.

As before, we examine two questions:

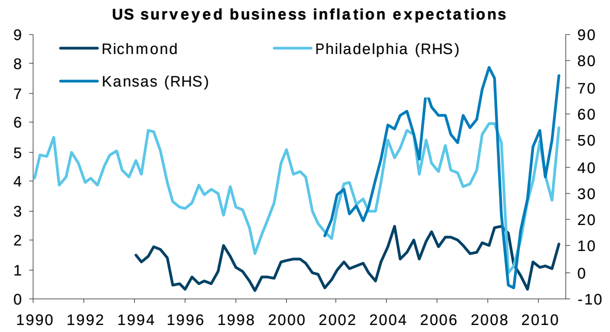
- What impact do inflation expectations have on future CPI inflation? i.e. how useful are various measures.
- Can we identify some statistical drivers of inflation expectations?

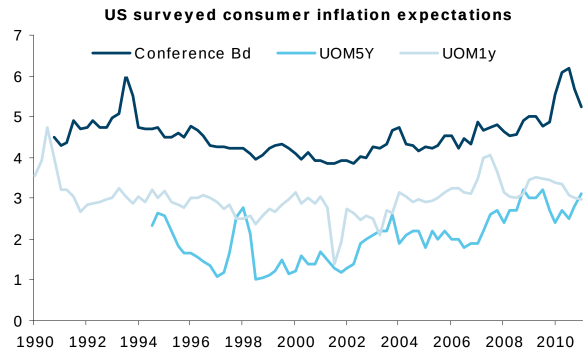
MEASURES OF INFLATION EXPECTATIONS

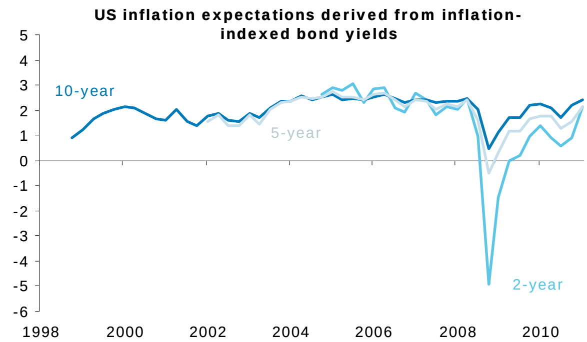
We look at a range of surveyed expectations of consumers, businesses and analysts. The start dates refer to the start date of our analysis, not necessarily the start date of the historical series.

Though they are not strictly inflation expectations, we examine the surveyed outlook for "prices paid next 6 months" from three manufacturing surveys, as well as two surveys of consumers. The liquid inflation-indexed bond market also provides a proxy measure of inflation expectations.

- **Philadelphia Fed Survey**, a monthly survey of 300 manufacturing purchasing managers in three states. *Start: 1990q1*
- **Kansas City Fed Manufacturing Survey**, a monthly survey of manufacturers. *Start: 2001Q3*
- **Richmond Fed Manufacturing Survey**, a monthly survey of about 100 manufacturers. *Start: 1994Q1*
- **University of Michigan Consumer Sentiment Survey**, median expected inflation 1 or 5 years ahead. A monthly survey of at least 500 consumers. *Start: 1990Q1*
- **Conference Board Consumer Confidence Survey**, average expected inflation 1 year ahead. A monthly mail survey of 3000 consumers. *Start: 1990Q1*
- **The difference between nominal and inflation-adjusted Treasury bond (TIPS) yields** 2, 5 and 10 years ahead. *Start: 2004Q4, 2002Q1 and 1998Q4 respectively.*



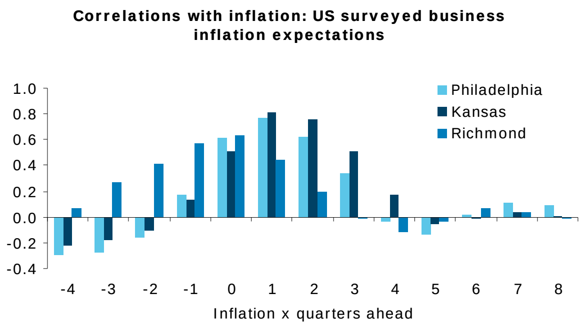


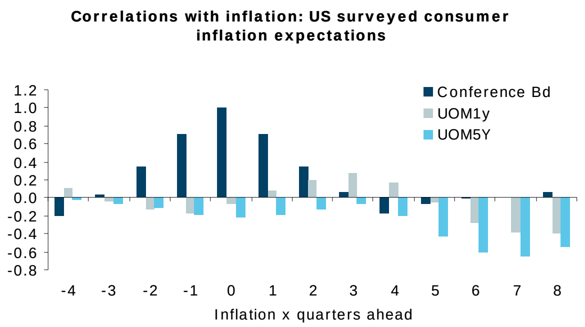


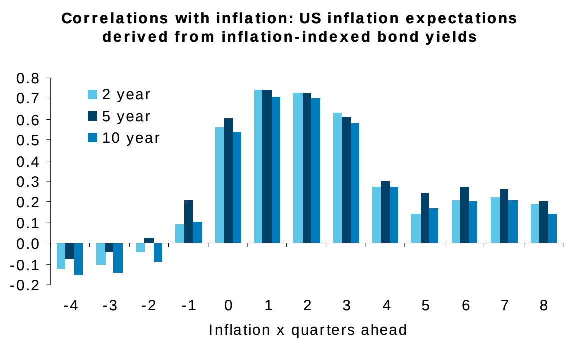
A LOOK AT US INFLATION EXPECTATIONS

QUESTION 1: WHICH SURVEYS MATTER?

Inflation expectations should, in principle, lead inflation. The charts below show correlations with CPI inflation from 2001 (except TIPS 2 years ahead: from end-2004, and TIPS 5 years ahead: from 2002). In all cases the strongest correlation is at a lead less than the expectations purport to look – typically 1 quarter lead to inflation, or lagging. The Philadelphia and Kansas Fed surveys appear the most forward looking. For TIPS inflation expectations derived from yields on inflation-indexed bonds, the strongest correlations are with inflation 1 quarter ahead. Of the consumer surveys, the Conference Board survey is the most correlated with inflation.







We run regressions examining the contribution inflation expectations measures can make to explaining inflation since 2003 (the earliest date from which all series are available). We use data 1 to 8 quarters ahead, explaining CPI using past CPI inflation and past inflation expectations. If the coefficients were incorrectly signed or insignificant they are omitted.

US business surveys: increase in R^2 from including inflation expectations in a regression of CPI inflation on its own lags

Q ahead	Phil	Kansas	Richmond	TIPS5	TIPS10
1	**0.20**	**0.27**	--	**0.21**	**0.19**
2	**0.25**	**0.37**	--	**0.43**	**0.37**
3	0.09	**0.26**	--	**0.72**	**0.49**
4	--	**0.31**	--	**0.80**	**0.60**
5	--	--	--	**0.37**	**0.22**
6	--	--	--	**0.20**	**0.15**
7	--	--	--	0.06	--
8	--	--	--	--	--

Of the business surveys, the Kansas Fed survey was the most useful, though the Philadelphia Fed also added value 1 and 2 quarters ahead. **The outstanding performers are the inflation expectations derived from inflation-indexed bonds**, particularly 5-years ahead (there was insufficient data on 2-year bonds). Of the consumer surveys, the best was the University of Michigan 1-year-ahead. None added value beyond 3 quarters.

US consumer surveys: increase in R^2 from including inflation expectations in a regression of CPI inflation on its own lags

Q ahead	UoM1Y	UoM5Y	Conf1Y
1	**0.19**	--	**0.17**
2	**0.43**	--	--
3	**0.51**	--	--

A tougher test is whether inflation expectations add value in forecasting CPI inflation when other drivers of inflation are included. We add into the equation the real 90 day interest rate, the annual percent change in the trade-weighted exchange rate, and the output gap (percentage deviations from an HP1600 trend).

US business surveys: increase in R^2 from including inflation expectations in a regression of CPI inflation on a range of variables

Q ahead	Phil	Kansas	Richmond	TIPS5	TIPS10
1	0.08	**0.12**	--	0.04	0.05
2	0.08	0.02	--	0.02	0.01
3	0.04	--	--	0.01	--
4	--	--	--	0.01	0.05
5	--	--	--	**0.10**	--
6	--	--	--	**0.10**	**0.10**
7	--	--	--	**0.32**	**0.11**
8	--	**0.12**	--	0.07	--

The TIPS expectations are again the most useful, though there is some value for the business surveys at short horizons. The consumer inflation surveys were of some use in the very near term:

US consumer surveys: increase in R^2 from including inflation expectations in a regression of CPI inflation on a range of variables

Q ahead	UoM1Y	UoM5Y	Conf1Y
1	0.07	--	0.09
2	0.01	--	0.03
3	--	--	--
4	--	--	0.03

A LOOK AT US INFLATION EXPECTATIONS

QUESTION 2: DRIVERS OF EXPECTATIONS

We regress the expectations measures on their own lag, past CPI inflation (1 to 4 lags), the annual change in the exchange rate (0 to 4 lags), annual LCI wage growth (0 to 4 lags), the output gap (1 to 4 lags), and 90-day interest rates (1 to 4 lags)[1]. We examine the possibility that highly visible prices could have an outsized impact on expectations, trying petrol and food in the regressions (then using a CPI measure that excludes these components).[2] Other candidates such as electricity prices and narrower definitions of food were examined but had little to offer. We use quarterly data in annual change terms (except the output gap). Standard errors are adjusted for any moving average process in the residuals that occurs as a result.

PHILADELPHIA FED BUSINESS SURVEY

The output gap and petrol prices were usually significant with the correct sign. 90 day rates (-) were typically significant at a fairly short lag. Past CPI inflation (+) and the TWI (-) always had the right sign, but were not always significant. Wages and food were not robust across specifications. Preferred equation:

$$\begin{aligned}
Phil6m &= \underset{(0.00)}{14.0} + \underset{(0.00)}{0.34}Phil6m(-1) + \underset{(0.00)}{4.1}ygap(-1) \\
&\quad - \underset{(0.01)}{2.78}ygap(-4) - \underset{(0.03)}{0.32}twi - \underset{(0.00)}{2.3790}d(-4) \\
&\quad + \underset{(0.00)}{0.38}petrol - \underset{(0.01)}{0.26}petrol(-1) + \underset{(0.00)}{7.33}CPIxp(-2) \\
R^2 &= 0.70 \quad DW = 1.734 \quad \text{Sample 1991Q1 - 2010Q4}
\end{aligned}$$

This series was not one of the more useful series for picking future inflation, but its drivers matched the theory nicely!

RICHMOND FED BUSINESS SURVEY

Past CPI inflation (+), the output gap (+), 90-day rates (-) and food prices (+) had sensible coefficients and were consistently significant. Wages and the TWI did not have robust coefficients. Petrol prices were not useful. Preferred equation:

$$\begin{aligned}
Rich6m &= \underset{(0.00)}{1.39} + \underset{(0.00)}{0.37}ygap(-1) - \underset{(0.03)}{0.02}TWI(-1) \\
&\quad - \underset{(0.00)}{0.20}r90d(-3) + \underset{(0.00)}{0.11}CPI(-3) + \underset{(0.00)}{0.15}food(-3) \\
R^2 &= 0.71 \quad DW = 1.42 \quad \text{Sample 1994Q1 - 2010Q4}
\end{aligned}$$

KANSAS FED BUSINESS SURVEY

This series was the most useful of the survey measures for picking future CPI inflation, but proved difficult to model. Past CPI inflation (-) and the output gap (-) typically had the wrong sign. Petrol, food and wages were not helpful. 90-day rates were sometimes significant, albeit with see-sawing coefficients over the lags. The TWI (-) generally had the right sign, but was often insignificant. There was no specification worth reporting.

UNIVERSITY OF MICHIGAN 1Y AHEAD

Past CPI inflation and petrol prices typically had the wrong sign. The output gap and 90 day rates were usually insignificant. The TWI and food prices usually had the right sign and were significant, though food price significance was unduly impacted by the choice of other variables. Wages usually had the right sign but were not consistently significant. Preferred equation:

$$\begin{aligned}
UOM1Y &= \underset{(0.00)}{0.89} + \underset{(0.00)}{0.65}UOM1Y(-1) + \underset{(0.02)}{0.04}wages(-3) \\
&\quad + \underset{(0.05)}{0.08}food - \underset{(0.06)}{0.12}food(-2) + \underset{(0.03)}{0.10}food(-3) \\
&\quad - \underset{(0.04)}{0.04}r90d(-4) \\
R^2 &= 0.59 \quad DW = 1.67 \quad \text{Sample 1991Q1 - 2010Q4}
\end{aligned}$$

UNIVERSITY OF MICHIGAN 5Y AHEAD

Past CPI was generally correctly signed but insignificant. The output gap tended to have the wrong sign and be insignificant. Food and petrol prices had no explanatory power. Wages typically had the right sign and were significant. 90 day rates (-) had a net small coefficient. The coefficient on its own lag was typically very large. Preferred equation:

$$\begin{aligned}
UOM5Y &= \underset{(0.00)}{0.31} + \underset{(0.00)}{0.89}UOM5Y(-1) + \underset{(0.03)}{0.02}wages(-2) \\
&\quad + \underset{(0.04)}{0.036}r90d(-2) - \underset{(0.03)}{0.041}r90d(-2) \\
R^2 &= 0.94 \quad DW = 2.08 \quad \text{Sample 1991Q1 - 2010Q4}
\end{aligned}$$

Wages and interest rates between them added only 0.004 to the explanatory power of the equation (the R^2) versus only a constant and own lag! Essentially, the series remains unexplained.

TIPS5

The 2-year-ahead TIPS inflation expectations proxy was too short to model econometrically. The TIPS 5

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[1] The contemporaneous 90-day rate is observable, but excluded. There is dual causality: higher inflation expectations possibly prompt rate rises, while rate hikes should lower inflation expectations. The coefficient on rates is thus ambiguous. It is the latter effect we are interested in, which is likely to be slower. Omitting the contemporaneous impact may go some way to isolating the causality we are interested in.

[2] CPI ex petrol and food was not available. The closest proxy was "CPI ex volatile items", which excludes automotive fuels and fruit and vegetables. CPI ex petrol was not available either; the nearest was CPI excluding the transport group.

A LOOK AT US INFLATION EXPECTATIONS

and 10 year ahead series proved difficult to model. The output gap, petrol prices, food prices and past inflation tended to have the wrong sign and/or be insignificant. The financial variables, the TWI and 90 day rates, turned out to be the most consistently useful regressors, but even for them there were warning signs of spuriousness, such as equally sized opposite-signed coefficients across lags. Preferred equation:

$$\underset{}{TIPS5Y} = \underset{(0.00)}{1.94} - \underset{(0.00)}{0.08TWI} + \underset{(0.00)}{0.04TWI(-3)}$$
$$- \underset{(0.00)}{0.06TWI(-4)} + \underset{(0.00)}{0.90r90d(-3)} - \underset{(0.00)}{0.95r90d(-4)}$$
$$R^2 = 0.87 \quad DW = 1.391 \quad \text{Sample 2003Q1 - 2010Q4}$$

TIPS10

Again, all non-financial variables were not consistent with theoretical priors and/or insignificant. 90-day rates were highly significant, but the coefficients across lags were exactly offsetting, leaving a net coefficient of zero – typically a sign that the results are not to be trusted. Preferred equation:

$$TIPS10Y = \underset{(0.00)}{0.93} + \underset{(0.00)}{0.53TIPS10Y(-1)} - \underset{(0.03)}{0.06TWI}$$
$$+ \underset{(0.10)}{0.04TWI(-1)} - \underset{(0.06)}{0.01TWI(-3)}$$
$$R^2 = 0.67 \quad DW = 2.09 \quad \text{Sample 1999Q1 - 2010Q4}$$

An interesting question for all these regressions, but particularly the two TIPS series, is how much of the significance of the TWI comes from a correlation, but not causation, between the USD and inflation expectations when the global financial crisis hit. The USD strengthened sharply on safe-haven flows, while the TIPS measures of inflation expectations (particularly 5-years ahead) plunged. The annual percent change of the USD TWI we are using, and inflation expectations, reversed these moves quickly. But it seems intuitively unlikely that the anticipated disinflationary impact of the TWI was the key driver of the plunge in inflation expectations.

To test this, we re-ran the regressions for a sample ending in 2008Q2 just before the crisis hit. We found the TWI remained a significant regressor with a correctly signed (-) coefficient. As an aside, petrol price inflation was a significant, correctly signed (+) variable for TIPS5 for the shorter sample.

CONFERENCE BOARD 1 YEAR AHEAD

Wages and past CPI inflation were unreliable. The TWI generally had the right sign and was significant. The 90-day rate, petrol prices, the output gap and food were usually insignificant across different specifications. Preferred equation:

$$Conf1Y = \underset{(0.02)}{0.81} + \underset{(0.00)}{0.83Conf1Y(-1)} - \underset{(0.01)}{0.02TWI(-4)}$$
$$R^2 = 0.84 \quad DW = 1.54 \quad \text{Sample 1991Q1 - 2010Q4}$$

PETROL PRICE LEVEL

In the NZ data, we found high correlations with the level of petrol prices. This of course does not indicate causation; just that both petrol prices and inflation expectations had an upward trend in our sample. But it provides food for thought. The same did not prove true in the US data. The Conference Board series of inflation expectations is the only one for which the correlation with the level of petrol prices is markedly higher than that with the annual percent change.

SUMMARY

	Phil	Rich	Kan	UM1	UM5	TIPS5	TIPS10	Conf1
Coefficient on own lag	0.34			0.65	0.89		0.53	0.83
Output gap	**	**						
APC TWI	*			*		*	**	**
APC LCI wages					*			
90 day rates	**	**		*	*	*	*	
CPI (definition varies)	*	**			*			
Food		**						
Petrol	**					*		

** Strong evidence   * Some evidence

In brief, **the more useful a US inflation expectations series was for predicting inflation, the less easy it typically proved to explain!** Interest rates and exchange rates were the most consistently reliable explanatory variables - though some of this may reflect correlation rather than causation. **There was less evidence than there was in the NZ data that food or petrol prices have a larger impact on inflation expectations than just via their impact on CPI inflation.**

So what do our results mean for policymakers such as the Fed? Inflation expectations clearly matter. **The "expectations" derived from yields on inflation-indexed bonds appear particularly useful in forecasting future inflation, and the Fed is right to keep a close eye on them.**

But ironically, it is not so easy to work out what is driving these expectations, with regression analysis of the theoretical drivers not proving particularly successful. This clouds the policymakers' reaction function further and reinforces the importance of the "art" to decision making, in association of course with the science. **For the Fed, therefore, it appears to remain a case of "watch, worry and wait".**

INTEREST RATE STRATEGY

SUMMARY

The key debate for the interest rate market now is; will US interest rates continue their march higher, or have they done their dash? The move so far has certainly been brutal, and the effects have been felt here. But there is still considerable uncertainty. Although the NZ yield curve has steepened, it should ultimately flatten, tested by domestic data adding weight to the recovery thesis, which will ultimately push short end yields higher. This week's NZIER QSBO and GDP data will be the first of such tests.

MARKET THEMES

- Global price action has been very much dominated by the "risk-on" theme in the past week, driving interest rates higher in most major markets including NZ.
- New Zealand faces challenges of its own, and we expect this week's data to echo upbeat themes picked up in anecdotes and in leading indicators.
- Nervousness has crept back into the NZGS market after bids for 2023s were under-accepted at last week's tender, and on wider sovereign debt concerns.

REVIEW AND OUTLOOK

Last week's spectacular rise in US 10yr Treasury yields was the clear standout market move of the week, and it has wreaked a degree of havoc on our market too. The long end has been particularly hard hit, with local 10yr swap yields up around 25bps since the lows around two weeks ago. The short end has also been hit, but this has always been more responsive to local factors, most notably improving business confidence. As such, the yield curve has steepened.

At this stage of the cycle, we would normally expect the yield curve to start flattening as the short end responds to the likelihood of rate hikes, and the long end contemplates the resultant moderation in growth and inflation. Over the long term, this remains the most likely outcome. However, US Treasury bond yields had rallied so aggressively, and now that they are on the move (higher), they are threatening to push local long end rates higher. By contrast, the market is reluctant to get too short the short end on account of punitive carry. **As such, we may be in for a period of uncharacteristic yield curve steepening**.

But it may not last long – for we would need to see an aggressive rise in US bonds for things to get serious traction. The problem is, the market is starting to question how strong last week's ISM data really was. Furthermore, we have payrolls this week, and the jobless claims trends suggest it won't be strong. **Domestically, the challenge is in the opposite direction** – from what we expect to be robust QSBO and GDP data.

Price action in the bond markets is also getting interesting. Demand has been strong, and NZ is clearly not in the same fiscal boat as Greece and the likes. **But when risk appetite gets really strained, we do tend to suffer. Despite NZ's better fundamentals, we can't afford to be too smug**.

PREFERRED BORROWING STRATEGIES

As we noted in Friday's *Borrower's Strategy*, if we were being clinical, we could point to the fact that 1-3 year swap rates are well below where they ought to be if the market was to "subscribe" to the Reserve Bank's 90 day bill projection as proof of value. The problem is, there's more to it than just the numbers, and as noted above, uncertainty is having an abnormally large impact on interest rates. Had it not been for global uncertainty, we would have a strong preference for fixing at these levels, particularly given our upbeat domestic view. But it remains to be seen if we are through the worst of the choppy waters as far as global market sentiment is concerned, and steep yield curves mean paying fixed remains expensive. Until we see some consistency, both locally and globally, time still looks to be on borrowers' side.

GAUGES FOR NZ INTEREST RATES

GAUGE	DIRECTION	COMMENT
RBNZ / OCR	↔	One word: Macro-prudential.
NZ data	↑	Data this week likely to reinforce upbeat view.
Fed Funds / front end	↔/↓	ISM data pleasing, but detail not as upbeat. Jobs scene the real test for the Fed.
RBA	↔/↑	Cuts have been priced out.
US 10 year	↔	Massive turn around in yields. Can it continue? We doubt it.
NZ swap curve	↔/↑	Contrarian steepening in the very short term likely.
Flow	↔/↑	More paying evident.
Technicals	↔	Range trading.

MARKET EXPECTATIONS FOR RBNZ OCR (BPS)

OCR DATES	LAST WEEK	THIS WEEK
Thu 28-Jul-11	0	0
Thu 15-Sep-11	0	0
Thu 27-Oct-11	+5	+1
Thu 8-Dec-11	+16	+14
Thu 26-Jan-12	+26	+28
Thu 8-Mar-12	+38	+41
Thu 26-Apr-12	+50	+56

TRADING THEMES WE FAVOUR AT PRESENT

We're not inclined to lean against the trend in the short term, but we are viewing the recent steepening of the curve as an opportunity to instigate strategic flatteners on an upbeat domestic and circumspect global view. Swap spread normalisation is likely to pause for a while on the back of higher US yields and fragmented NZGS tender outcomes.

CURRENCY STRATEGY

SUMMARY

Risk looks to be back on as Greece gets a much needed lifeline and the US ISM headline number beat expectations. But NZD failed to push on, which is telling. Markets are cautious about taking NZD much further in the absence of domestic data to justify it. In that regard, this week's QSBO and GDP print could provide the catalyst for NZD to push above 0.83. However, a weaker underlying tone for global commodity prices will act as a counter on the other side. On balance then, NZD looks to be in consolidation mode for this week. US non-farm payrolls on Friday night will set the tone for the following week.

MARKET THEMES

- Greece approves austerity measures and will get their bailout, keeping the wolves from the door for now.
- Global data releases keep us wary on the outlook.
- Despite equities rallying, commodity price weakness to weigh on NZD and AUD.
- NZ data should be NZD positive. RBA cash rate announcement likely to keep AUD range bound.

REVIEW AND OUTLOOK

The NZDUSD continues to be range bound between 0.8000 and 0.8300. **This week's QSBO (Tuesday) and GDP (Thursday) releases will be the key domestic event, and we suspect both will be NZD positive on the whole.** Business confidence in the QSBO is likely to follow the NBBO's lead and post a strong rebound. But it is the indicators of resource pressures that will get the market moving, if it shows a tightening as we expect. And while Q1 GDP may be historical, a print in line with market expectations will still confirm that the NZ economy had more momentum at the start of this year than anyone expected. Together with the resolution of the Greek debt crisis (for now anyway), you would expect risk appetites to emerge, which is typically NZD positive.

However, the unfolding weakness in commodities could prove to be the more dominant factor this week, as the market's focus shifts towards concerns over the global outlook. The US ISM data may have exceeded expectations at the headline level, but the details are not as encouraging, particularly the increase in inventories which is likely of an involuntary nature. Together with weaker PMI data from China, market focus will likely shift away from Greece towards prospects for the global economy. But while commodity prices have been soft, the notable exception has been copper, suggesting that perhaps concerns over global growth are being overplayed.

Key offshore event risk this week are the RBA, BoE and ECB decisions and US non-farm payrolls on Friday night. ECB is widely tipped to hike, which will keep EUR bid. RBA and BoE will be standing pat, with the key focus for AUD being on the tone of the RBA statement and the upcoming employment report.

Technically speaking NZDUSD reached a new post float high of 0.8319 last week, but is demonstrating bearish divergence suggesting weakness could be on the horizon. After a strong run-up last week, there is a reluctance to push NZD too far from here.

NZD VS AUD: MONTHLY DIRECTIONAL GAUGES

GAUGE	DIRECTION	COMMENT
Fair value	↑	Close to our fair value estimates.
Yield	↔/↑	Yield convergence favouring AUD less.
Commodities	↔	Weak commodities leave NZD and AUD vulnerable.
Partial indicators	↔/↑	NZ business and consumer confidence on the up.
Technicals	↑	Support at 0.7650.
Sentiment	↔	Risk off.
Other	↔	Quiet week ahead. External factors to provide direction.
On balance	↔↑	**Trending higher 0.7650 - 0.7780.**

NZD VS USD: MONTHLY DIRECTIONAL GAUGES

GAUGE	DIRECTION	COMMENT
Fair value – long-term	↓	Above structural fair value of 0.67.
Fair value – short-term	↔/↓	Still above our cyclical fair value estimates.
Yield	↑	NZ Bonds have more fun.
Commodities	↓	Commodities have turned down.
Risk aversion	↑	Equities rebound strongly.
Partial indicators	↑	NZ data better, US data worsening.
Technicals	↓	Bearish divergence.
AUD	↔/↓	AUD in correction mode.
Sentiment	↔	Post float highs encourage sellers.
Other	↔	External factors to drive NZD this week.
On balance	↔↓	**Weaker commodities to weigh on NZD.**

DATA EVENT CALENDAR

DATE	COUNTRY	DATA / EVENT	MKT.	LAST	NZ TIME
4-Jul	US	Independence Day Holiday - markets closed	- -	- -	- -
	AU	TD Securities Inflation MoM% - JUN	- -	0.2%	12:30
	AU	TD Securities Inflation YoY% - JUN	- -	3.3%	12:30
	NZ	ANZ Commodity Price - JUN	- -	0.3%	13:00
	AU	Building Approvals (MoM) - MAY	-0.5%	-1.3%	13:30
	AU	Building Approvals (YoY) - MAY	-5.6%	-11.5%	13:30
	AU	ANZ Job Advertisements (MoM) - JUN	- -	-6.5%	13:30
	AU	Retail Sales s.a. (MoM) - MAY	0.3%	1.1%	13:30
	UK	PMI Construction - JUN	53.8	54.0	20:30
	UK	BoE Housing Equity Withdrawal - 1Q	-£6.5B	-£7.0B	20:30
	EC	Sentix Investor Confidence - JUL	0.6	3.5	20:30
	EC	Euro-Zone PPI (MoM) - MAY	-0.1%	0.9%	21:00
	EC	Euro-Zone PPI (YoY) - MAY	6.3%	6.7%	21:00
	UK	Halifax House Prices sa (MoM) - JUN	0.0%	0.1%	UNCONFIRMED
	UK	Halifax House Price 3Mths/Year - JUN	-4.2%	-4.2%	UNCONFIRMED
5-Jul	NZ	NZIER Business Opinion Survey - 2Q	- -	-27	10:00
	AU	AiG Performance of Service Index - JUN	- -	49.9	11:30
	AU	Trade Balance - MAY	1900M	1597M	13:30
	JN	Labor Cash Earnings YoY - MAY	-0.5%	-1.4%	13:30
	CH	China HSBC Services PMI - JUN	- -	54.3	14:30
	AU	RBA CASH TARGET - JUL	4.75%	4.75%	16:30
	GE	PMI Services - JUN F	58.3	58.3	19:55
	EC	PMI Composite - JUN F	53.6	53.6	20:00
	EC	PMI Services - JUN F	54.2	54.2	20:00
	UK	PMI Services - JUN	53.5	53.8	20:30
	UK	Official Reserves (Changes) - JUN	- -	-$103M	20:30
	EC	Euro-Zone Retail Sales (MoM) - MAY	-1.0%	0.9%	21:00
	EC	Euro-Zone Retail Sales (YoY) - MAY	-0.6%	1.1%	21:00
6-Jul	US	Factory Orders - MAY	1.0%	-1.2%	02:00
	UK	BRC Shop Price Index YoY - JUN	- -	2.3%	11:01
	JN	Leading Index CI - MAY P	99.8	96.2	17:00
	GE	Factory Orders YoY (nsa) - MAY	9.5%	10.5%	22:00
	GE	Factory Orders MoM (sa) - MAY	-0.5%	2.8%	22:00
	US	Challenger Job Cuts YoY - JUN	- -	-4.3%	23:30
	UK	New Car Registrations (YoY) - JUN	- -	-1.7%	UNCONFIRMED
7-Jul	US	ISM Non-Manf. Composite - JUN	53.6	54.6	02:00
	NZ	GDP QoQ - 1Q	0.3%	0.2%	10:45
	NZ	GDP YoY - 1Q	0.5%	0.8%	10:45
	AU	AiG Perf of Construction Index - JUN	- -	39.6	11:30
	AU	Employment Change - JUN	15.0K	7.8K	13:30
	AU	Full Time Employment Change - JUN	- -	-22.0K	13:30
	AU	Part Time Employment Change - JUN	- -	29.8K	13:30
	AU	Participation Rate - JUN	65.6%	65.6%	13:30
	AU	Unemployment Rate - JUN	4.9%	4.9%	13:30
	AU	Foreign Reserves - JUN	- -	A$40.3B	18:30
	UK	Industrial Production (MoM) - MAY	1.1%	-1.7%	20:30
	UK	Industrial Production (YoY) - MAY	-0.5%	-1.2%	20:30
	UK	Manufacturing Production (MoM) - MAY	1.0%	-1.5%	20:30

Continued on following page

DATA EVENT CALENDAR

DATE	COUNTRY	DATA/EVENT	MKT.	LAST	NZ TIME
7-Jul	UK	Manufacturing Production (YoY) - MAY	2.1%	1.3%	20:30
	GE	Industrial Prod. YoY (nsa wda) - MAY	7.0%	9.6%	22:00
	GE	Industrial Production MoM (sa) - MAY	0.7%	-0.6%	22:00
	UK	BOE Asset Purchase Target - JUL	200B	200B	23:00
	UK	BOE ANNOUNCES RATES - JUL	0.50%	0.50%	23:00
	EC	ECB Announces Interest Rates - JUL	1.50%	1.25%	23:45
	UK	NIESR GDP Estimate - JUN	- -	0.4%	UNCONFIRMED
8-Jul	US	RBC Consumer Outlook Index - JUL	- -	46.7	00:00
	US	ADP Employment Change - JUN	80K	38K	00:15
	US	Initial Jobless Claims - 2 JUL	420K	428K	00:30
	US	Continuing Claims - 25 JUN	3700K	3702K	00:30
	JN	Current Account Total - MAY	¥306.0B	¥405.6B	11:50
	JN	Adjusted Current Account Total - MAY	¥180.0B	¥546.3B	11:50
	JN	Trade Balance - BOP Basis - MAY	-¥764.0B	-¥417.5B	11:50
	CH	Business Climate Index - 2Q	- -	133.8	14:00
	CH	Entrepreneur Confidence Index - 2Q	- -	137.4	14:00
	GE	Exports SA (MoM) - MAY	1.5%	-5.5%	18:00
	GE	Imports SA (MoM) - MAY	1.5%	-2.5%	18:00
	GE	Current Account (EURO) - MAY	7.0B	8.8B	18:00
	GE	Trade Balance - MAY	12.2B	10.9B	18:00
	UK	PPI Input NSA (MoM) - JUN	-0.1%	-2.0%	20:30
	UK	PPI Input NSA (YoY) - JUN	16.1%	15.7%	20:30
	UK	PPI Output n.s.a. (MoM) - JUN	0.1%	0.2%	20:30
	UK	PPI Output n.s.a. (YoY) - JUN	5.5%	5.3%	20:30
	UK	PPI Output Core NSA (MoM) - JUN	0.2%	0.2%	20:30
	UK	PPI Output Core NSA (YoY) - JUN	3.3%	3.4%	20:30
9-Jul	US	Change in Nonfarm Payrolls - JUN	100K	54K	00:30
	US	Change in Private Payrolls - JUN	125K	83K	00:30
	US	Change in Manufact. Payrolls - JUN	3K	-5K	00:30
	US	Unemployment Rate - JUN	9.1%	9.1%	00:30
	US	Avg Hourly Earning MOM All Emp - JUN	0.2%	0.3%	00:30
	US	Avg Hourly Earning YOY All Emp - JUN	1.9%	1.8%	00:30
	US	Avg Weekly Hours All Employees - JUN	34.4	34.4	00:30
	US	Chg in Household Survey Emply - JUN	- -	105	00:30
	US	Wholesale Inventories - MAY	0.7%	0.8%	02:00
	US	Consumer Credit - MAY	$3.500B	$6.247B	07:00
	CH	Trade Balance (USD) - JUN	$14.75B	$13.05B	14:00
	CH	Exports YoY% - JUN	17.4%	19.4%	14:00
	CH	Imports YoY% - JUN	24.5%	28.4%	14:00

Key: AU: Australia, EC: Euro-zone, GE: Germany, JN: Japan, NZ: New Zealand, UK: United Kingdom, US: United States, CH: China.

Sources: Dow Jones, Reuters, Bloomberg, ANZ, National Bank. All $ values in local currency.

Note: All surveys are preliminary and subject to change.

LOCAL DATA WATCH

Key focus over the next few weeks: Last week's National Bank Business Outlook survey showed a considerable amount of resilience within the economy. The week's QSBO should show a similar theme, but our main focus will be on the indicators of resource pressures. The Q1 GDP data is expected to show the economy starting the year with enough momentum to offset the considerable disruption caused by the February 22 Christchurch earthquake. Data over the coming months should show continued improvement, albeit with global ructions and uncertainties over the pace of earthquake reconstruction suggest a bumpy road ahead.

DATE	DATA/EVENT	ECONOMIC SIGNAL	COMMENT
Mon 4 July (1:00pm)	ANZ Commodity Price Index – June	- -	- -
Tue 5 July (10:00am)	NZIER QSBO Q2	Moving up	A rebound in general business confidence, domestic trading activity and investment intentions is expected. Pricing gauges to firm, as will resource pressures.
Wed 6 July (6:00am)	*globalDairyTrade* auction	Lower	Given the move lower in the global soft commodity prices of late, the *globalDairyTrade* auction prices will likely follow suit.
Thur 7 July (10:45am)	Gross Domestic Product – 2011Q1	Building	We expect a 0.4 percent rise in activity. Sector performance will be mixed, with solid retail and manufacturing offset by weaker construction activity. Services sector activity will be mixed.
Mon 11 July (10:45am)	Electronic Card Transactions - June	Up	Retail spending to rise 0.4 percent, with lower petrol prices preventing a more sizeable increase. Core ECT spending is expected to rise 0.8 percent.
Wed 13 July (10:45am)	Food Price Index – June	Heading higher	Seasonal increases and storm-affected increases in tomato prices will underpin a 0.7 percent monthly increase.
Thur July (10:00am)	REINZ Housing Market data – June	Inching up	Prices flat, with increasing property listings expected to translate into a 1 to 2 percent increase in sales volumes.
Thur 14 July (10:30am)	Manufacturing PMI – June	Expansion	We expect a headline measure in the low 50's but are conscious of weakness in overseas gauges.
Mon 18 July (10:45am)	Consumers Price Index – 2011Q2	5 percent+	A 0.8 percent increase is expected, taking annual CPI inflation to 5.1 percent. Annual inflation ex one-offs should hit 2.6 percent.
Thur 21 July (10:45am)	International Travel and Migration - June	Down	We expect a net outflow of 200 persons. Ash clouds and not much snow will contribute to a 2 percent fall in visitor numbers.
Thur 21 July (1:00pm)	ANZ/Roy Morgan Consumer Confidence	- -	- -
Thur 21 July (1:00pm)	RBNZ Credit Statistics – June	Up	A monthly increase of approximately 0.5 percent is envisaged. Spending on overseas cards should fall.
Tue 26 July (10:45am)	Overseas Merchandise Trade - June	Another surplus	We expect a monthly surplus of $500m, with the annual surplus to widen towards $1800m.
Wed 27 July (1:00pm)	National bank Business Outlook - June	- -	- -
Thur 28 July (9:00am)	RBNZ OCR Review	On hold	We expect the OCR to be maintained at 2.5 percent. We expect the first RBNZ hike at the December *MPS*.
Fri 29 July (10:45am)	Building Consents – June	Climbing	We expect a 3 percent increase in residential consent numbers.
Fri 29 July (3:00pm)	RBNZ Credit Aggregates -June	Flat	Low annual rates of credit growth expected, with business credit climbing and agricultural credit easing.
On Balance		**On the up**	**Soft leading gauges and less uncertainty over the future of Christchurch point towards a better Q2 and beyond.**

KEY FORECASTS AND RATES

	Dec-10	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13
GDP (% qoq)	0.2	**0.4**	**0.7**	**1.5**	**1.8**	**0.7**	**0.9**	**0.9**	**0.8**	**0.7**
GDP (% yoy)	0.8	**0.6**	**1.1**	**2.8**	**4.5**	**4.8**	**5.0**	**4.4**	**3.3**	**3.3**
CPI (% qoq)	2.3	0.8	**0.8**	**0.8**	**0.7**	**0.6**	**0.8**	**0.7**	**0.6**	**0.8**
CPI (% yoy)	4.0	4.5	**5.1**	**4.8**	**3.1**	**2.9**	**2.9**	**2.7**	**2.6**	**2.9**
Employment (% qoq)	-0.4	1.4	**-0.2**	**0.4**	**0.5**	**0.5**	**0.4**	**0.5**	**0.4**	**0.4**
Employment (% yoy)	1.3	1.8	**1.8**	**1.2**	**2.1**	**1.2**	**1.8**	**1.9**	**1.8**	**1.7**
Unemployment Rate (% sa)	6.7	6.6	**6.6**	**6.3**	**6.3**	**6.2**	**6.2**	**6.0**	**6.0**	**6.0**
Current Account (% GDP)	-4.1	-4.3	**-4.8**	**-4.8**	**-4.3**	**-4.3**	**-4.4**	**-4.7**	**-4.9**	**-5.0**
Terms of Trade (% qoq)	0.8	0.9	**3.0**	**3.0**	**1.0**	**-0.8**	**-0.9**	**-0.8**	**-0.8**	**-0.8**
Terms of Trade (% yoy)	12.3	6.8	**7.9**	**7.9**	**8.0**	**6.2**	**2.2**	**-1.6**	**-3.2**	**-3.3**

	Sep-10	Oct-10	Nov-10	Dec-10	Jan-11	Feb-11	Mar-11	Apr-11	May-11	Jun-11
Retail ECT (% mom)	2.2	0.8	1.0	-0.8	2.4	-0.1	1.4	1.5	-0.8	..
Retail ECT (% yoy)	5.0	4.8	6.3	4.4	5.7	6.2	6.6	10.0	6.8	..
Credit Card Billings (% mom)	1.1	0.6	0.1	-1.8	3.7	-0.4	-1.3	1.8	0.6	..
Credit Card Billings (% yoy)	4.3	4.6	3.8	2.0	5.6	5.3	1.7	6.1	5.1	..
Car registrations (% mom)	2.6	-3.9	12.8	-8.3	0.9	-1.7	-0.3	-5.6	3.2	..
Car registrations (% yoy)	19.2	9.4	23.5	6.4	6.8	2.8	-1.0	-10.5	-3.7	..
Building consents (% mom)	0.7	-1.8	8.5	-18.8	9.2	-9.6	2.5	-1.2	2.3	..
Building consents (% yoy)	-9.4	-17.5	-8.9	-26.4	-14.9	-28.9	-26.2	-32.2	-22.0	..
REINZ House Price Index (% yoy)	-1.3	-3.5	-1.9	-1.6	-2.6	-0.7	-1.8	-0.4	-0.7	..
Household Lending Growth (% mom)	0.2	0.1	0.0	0.0	0.1	0.1	-0.1	0.2	0.1	..
Household Lending Growth (% yoy)	2.3	2.0	1.8	1.6	1.6	1.5	1.2	1.2	1.2	..
ANZ Roy Morgan Consumer Confidence	116.4	113.6	114.5	112.2	117.1	108.1	101.4	101.4	103.3	112.5
NBNZ Business Confidence	13.5	23.7	33.2	29.5	..	34.5	-8.7	14.2	38.3	46.5
NBNZ Own Activity Outlook	26.7	30.5	35.3	34.5	..	36.6	14.7	29.5	39.7	38.7
Trade Balance ($m)	-455	-220	-177	-218	9	184	586	1148	605	..
Trade Balance ($m ann)	978	1259	1363	1172	909	765	744	1232	1067	..
ANZ World Commodity Price Index (% mom)	2.6	3.0	2.1	1.6	4.3	2.7	4.7	1.6	0.3	..
ANZ World Commodity Price Index (% yoy)	25.1	23.1	13.1	12.1	16.3	20.3	23.5	19.8	19.5	..
Net migration (sa)	1000	400	600	720	440	450	-520	-120	-350	..
Net migration (annual)	13914	12610	11519	10451	8689	8249	6554	5508	4625	..

Figures in bold are forecasts. mom: Month-on-Month qoq: Quarter-on-Quarter yoy: Year-on-Year

KEY MARKET FORECASTS AND RATES

	ACTUAL			Forecast (end month)						
FX RATES	Apr-11	May-11	Today	Sep-11	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13
NZD/USD	0.810	0.824	0.828	0.80	0.81	0.79	0.77	0.75	0.73	0.73
NZD/AUD	0.738	0.772	0.768	0.74	0.75	0.75	0.75	0.74	0.74	0.74
NZD/EUR	0.547	0.572	0.570	0.58	0.60	0.59	0.57	0.55	0.53	0.54
NZD/JPY	65.75	67.16	66.92	68.0	70.5	70.3	70.1	69.8	69.4	70.1
NZD/GBP	0.485	0.501	0.516	0.50	0.52	0.51	0.49	0.47	0.46	0.46
NZ$ TWI	68.6	70.9	71.1	70.4	71.8	70.9	69.4	67.8	66.4	66.8
INTEREST RATES	Apr-11	May-11	Today	Sep-11	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13
NZ OCR	2.50	2.50	2.50	2.50	2.75	3.25	3.50	3.75	4.00	4.25
NZ 90 day bill	2.68	2.69	2.66	2.70	3.10	3.70	3.80	4.20	4.30	4.80
NZ 10-yr bond	5.44	5.11	5.13	5.60	5.80	6.00	6.10	6.20	6.10	6.20
US Fed funds	0.25	0.25	0.25	0.25	0.25	0.75	1.50	2.00	2.00	2.50
US 3-mth	0.27	0.25	0.25	0.35	0.35	0.85	1.60	2.10	2.10	2.60
AU Cash Rate	4.75	4.75	4.75	5.00	5.25	5.25	5.50	5.75	5.75	5.75
AU 3-mth	4.92	5.02	4.98	5.30	5.50	5.60	5.80	6.00	6.00	6.00

	1 Jun	27 Jun	28 Jun	29 Jun	30 Jun	1 Jul
Official Cash Rate	2.50	2.50	2.50	2.50	2.50	2.50
90 day bank bill	2.67	2.67	2.68	2.68	2.66	2.65
NZGB 04/13	3.32	3.17	3.19	3.19	3.20	3.21
NZGB 04/15	4.15	3.91	3.93	3.94	3.97	4.03
NZGB 03/19	4.95	4.73	4.76	4.80	4.87	4.95
NZGB 05/21	5.14	4.93	4.96	5.00	5.07	5.15
2 year swap	3.46	3.31	3.31	3.33	3.36	3.38
5 year swap	4.45	4.29	4.29	4.32	4.38	4.44
RBNZ TWI	70.7	70.0	69.8	70.3	71.3	71.0
NZD/USD	0.8221	0.8028	0.8039	0.8119	0.8307	0.8259
NZD/AUD	0.7649	0.7699	0.7694	0.7704	0.7730	0.7717
NZD/JPY	66.78	64.82	64.98	65.81	66.80	66.68
NZD/GBP	0.4990	0.5041	0.5034	0.5075	0.5157	0.5144
NZD/EUR	0.5698	0.5685	0.5625	0.5653	0.5725	0.5692
AUD/USD	1.0748	1.0428	1.0448	1.0539	1.0746	1.0703
EUR/USD	1.4428	1.4122	1.4291	1.4362	1.4510	1.4510
USD/JPY	81.23	80.74	80.83	81.06	80.42	80.74
GBP/USD	1.6474	1.5925	1.5970	1.5999	1.6109	1.6056
Oil (US$/bbl)	102.70	90.65	90.65	92.90	94.85	95.30
Gold (US$/oz)	1531.20	1495.50	1498.70	1504.65	1512.95	1499.65
Electricity (Haywards)	3.16	5.31	5.65	7.34	6.02	4.87
Baltic Dry Freight Index	1485	1442	1438	1420	1413	1422
Milk futures (USD)	162	162	162	162	162	156

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