

# THE CREDIT CYCLE

## CONTENTS

### Page 2: Economic overview

- The fortunes of the local rates market and the NZD continue to be driven by fickle offshore sentiment. But the focus should start to shift closer to home as we get closer to the Reserve Bank's September *Monetary Policy Statement*.

### Page 3: Economic comment – jobs versus credit

- The labour market is a factor supporting the housing market, and easing job growth is presented as a prerequisite for a turn in the housing market. However, statistically, it has been the availability of credit and risk appetites that has been more significant since 1999.

### Page 4: Interest rate strategy

- Local rates market to be dictated by flows and offshore developments this week. It looks to be a case of range trading heading into next week's *Monetary Policy Statement*, with no one wanting to take a big position given current volatility.

### Page 5: Interest rate comment – monetary policy under uncertainty

- The current global financial market turmoil has introduced greater than usual uncertainty into monetary policy decision making. For the Reserve Bank, it boils down to making a call over which risk the Bank sees as more of a threat – inflation or growth – and which offers the path of least regret if events turn out differently.

### Page 6: Currency strategy

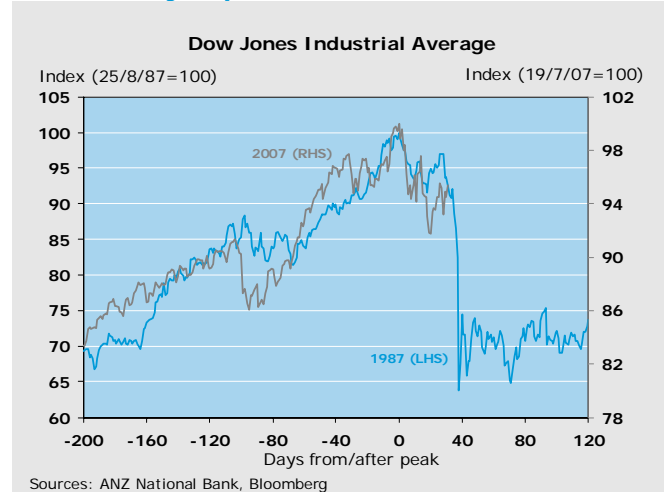
- The NZD will remain hostage to overseas developments as volatility looks set to continue. Australian Q2 GDP, interest rate announcements in Australia, UK and Europe and the Fed's Beige Book will be key to watch.

### Page 7: Data timetable

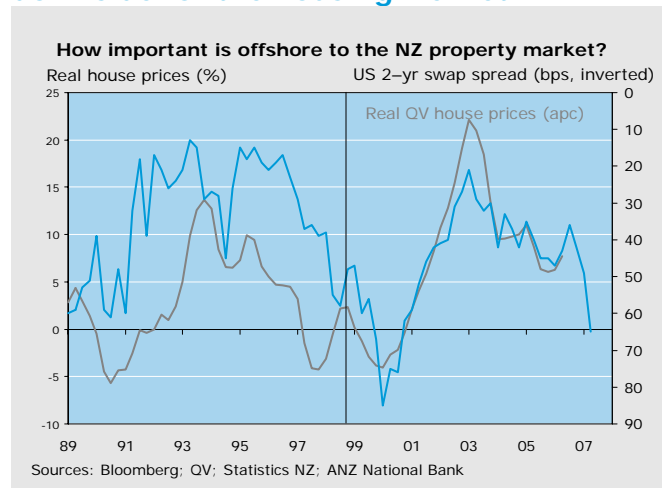
### Page 9: Data watch

### Page 10: Key forecasts

## Will history repeat?



## A turn in the credit cycle spells further downside for the housing market.



## ECONOMIC OVERVIEW

**The fortunes of the local rates market and the NZD continue to be driven by fickle offshore sentiment. But the focus should start to shift closer to home as we get closer to the Reserve Bank's September *Monetary Policy Statement*.**

### What's ahead...

- NZ June quarter Wholesale Trade Survey (Thursday 1045 NZST). Soft outturn expected mirroring weak retail sales outturn.
- NZ ANZ Commodity Price Index (Thursday 1500 NZST).
- NZ June quarter Value of Building Work Put in Place (Friday 1045 NZST). Residential activity to show a rebound while non-residential activity to remain robust.
- NZ June quarter Capital Goods Price Index (Friday 1045 NZST). Imported capital goods to benefit from high NZD but construction prices to remain elevated.

### What's the view

Global volatility is still very much the driving force at present, with US equities setting the tone and direction for other markets including the NZD. The wild gyrations seen in the Dow last week illustrates that investor sentiment remains very fragile. There is still a strong safe haven flow undertone judging by the strong demand in recent US Treasury auctions, which attracted high bid-to-cover ratios. Some of the safe haven flows found its way into the NZ bond market, exaggerating the movements in what is already a relatively illiquid market.

Liquidity pressures remain in the global financial system, as revealed by UK banks accessing the BoE's standing facility and LIBOR spreads to the cash rate remaining wide. In NZ, the spread between the 90-day rate and the OCR, at over 37bps, remains unduly high despite the Reserve Bank extending eligibility for bank bills to be used as repo. While the carry trade will intermittently switch off and on, it is unlikely to be back in force for a while. The current environment is just too hostile for such a strategy.

Business confidence proved surprisingly resilient over August, despite the global turmoil. It is difficult to go past surging commodity prices and the fall in the NZD from its July highs as reasons for the improving sentiment. Certainly, the Reserve Bank will be viewing the confidence survey as being consistent with a relatively soft landing for the economy, which implies continued persistent inflationary pressure. The Reserve Bank would have been a bit disappointed that their own inflation expectations survey remained sticky and elevated. It showed the 2-year ahead expectations remaining unchanged at 2.6 percent (though ticking up slightly when unrounded).

But there are contrasting forces at work. While the positives in the form of dairy prices and fiscal policy are well recognised, the counter to them is only starting to emerge and have the potential to surprise. NZ's reliance on offshore funding will come under increasing pressure in the current environment of risk repricing and aversion. The difficult times facing the finance company sector, with another company placed in receivership late last week bringing the total to seven since last year, is adding a huge layer of uncertainty.

Although the entire domestically owned finance company sector accounts for a small proportion of household's financial assets (around 3 percent), the spillover impact should not be underestimated. This sector has been a source of lending growth for consumer finance and higher risk property development, injecting \$2.5 billion worth of credit growth into the economy over the past 12 months. A drying up of credit will see spending (particularly on durables) and certain types of construction activity slow substantially.

The effects from the turn in the credit cycle are not just limited to those that rely on finance companies for funding. Borrowing costs for corporate NZ have increased courtesy of wider swap and credit spreads. The attraction of corporate paper to investors has reduced despite being offered higher rates, forcing the Yellow Pages Group to halve its bond issue last week. These represent a tightening in financial conditions for businesses at a time when domestic demand is set to ease further.

The local dataflow starts to get heavy towards the end of this week. While work put in place and wholesale trade data will allow us to firm up our estimate for Q2 GDP, they are historical and of limited relevance given the current environment. The ANZ Commodity Price Index due on Thursday will reveal whether the prices for NZ's main export commodities held up amidst the global turmoil.

The main focus offshore will be on the interest rate announcements by the RBA, ECB and BoE. None are expected to move their policy rates, but markets will be awaiting any steer on their reading of current developments. Of the three, only the ECB is likely to provide any guidance since it is common policy for the RBA and BoE not to issue a statement when rates are left unchanged.

### Recent data...

- **NZ RBNZ Survey of Expectations (Q3).** Both the one and two year ahead inflation expectations were unchanged at 2.7 and 2.6 percent respectively.
- **NZ Building Consents (July)** posted a 15.5 percent fall, a large pullback from June.
- **NZ Credit Growth (July).** Lending to households slowed to 0.9 percent.
- **NZ National Bank *Business Outlook* (Aug).** Both business confidence and own activity posted further small improvements.

## JOBS VERSUS CREDIT

**The labour market is a factor supporting the housing market, and easing job growth is presented as a prerequisite for a turn in the housing market. However, statistically, it has been the availability of credit and risk appetites that has been more significant since 1999.**

The conventional wisdom is that a turn in the labour market is a prerequisite to moderating housing demand. The rationale is simple. In an environment where jobs are aplenty and income growth strong, households remain confident about their ability to take on debt, and the debt constraint from rising interest rates lacks punch.

Yet conventional income or employment based measures fail to capture the massive deterioration in housing affordability, with the ratio of house prices to income rising by over 50 percent since 2000, and sitting at a historical high. Migration and restrictions on land use have admittedly played roles. Yet the former is well down from its peak reached in 2003, and the latter is by-and-large limited to a few regions, whereas strong house price gains have been strong across the entire country.

Stepping back, one variable stands out as being influential. Credit – in terms of its availability from both the demand and supply side (risk appetites), and price – has been a key source of house price growth, and its role has been a global phenomenon.

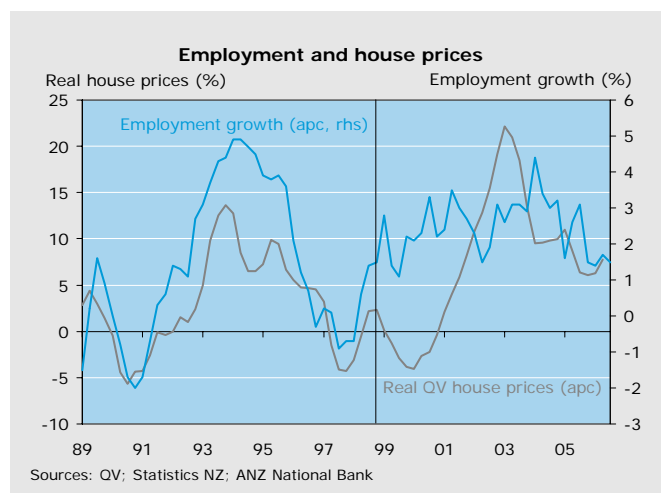
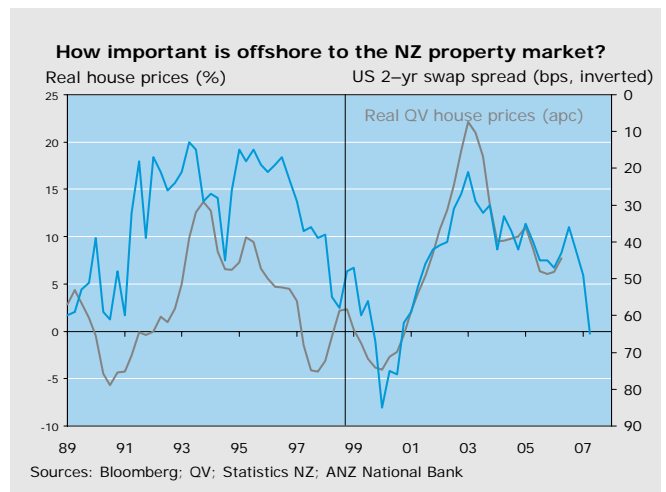
We can proxy credit – both the cost and supply - by looking at swap spreads. Swap spreads are the difference between the swap yield and the yield on government stock. It represents the credit spread over the government stock rate that high quality borrowers pay in the market. The size of the swap spread is determined, like any other price, by the balance of demand and supply. Swap spreads are in essence the risk premium of the banking system as a whole and perceived medium-term credit risk. A widening in spreads signals not only a tightening in financial conditions, but also a fundamental shift in risk appetites, both in terms of supply and potential demand. (Note: certain peculiarities in the NZ bond market limit the usefulness of NZ swap spreads. Rather we rely on the US equivalent as a better bellwether for credit conditions).

So what can we say about the link between US swap spreads and the New Zealand property market:

- Simple OLS (ocular least squares) confirms the close relationship since 1999. This simple graphical relationship has been stronger than the labour market.
- Statistically (after controlling for other influences including employment), a 10 basis point movement in the US swap spread has

been associated with just under a 2 percent movement in real house prices since 1990. However, since 1999 the relationship (coefficient) has doubled, while the significance of employment has diminished.

- The US 2-year swap spread has widened by 30 basis points in the past two months, which based on the relationship over the past few years, has the ability to knock 5-10 percent off house price growth! Of course, this sounds a little extreme to us, and we are wary of what could be a spurious relationship. However, it nonetheless reinforces the significant role a change in risk appetites and global conditions could have on the New Zealand property market.



### The upshot

A turn in the labour market is not a pre-condition to the housing market easing, as the US experience currently shows. The real driver and issue is credit: its availability, cost, and risk appetites of supply and demand. We expect the recent turn in the global credit cycle, and difficulties emanating domestically from non-bank financial institutions (our own mini subprime) to have a material influence on activity.

## INTEREST RATE STRATEGY

**Local rates market to be dictated by flows and offshore developments this week. It looks to be a case of range trading heading into next week's *Monetary Policy Statement*, with no one wanting to take a big position given current volatility.**

### Market themes...

- Cash squeeze continues despite RBNZ temporarily allowing bank bills to be eligible for repo, though not as bad as in the previous week.
- Mortgage paying starting to ease in line with slowing housing market. Liquidity an issue.
- 2-year swap yields look to be trading within a new range of 8.1 to 8.3 percent.

### Outlook...

Market pricing for the OCR has shifted closer to our core economic view in recent days. The odds of a 25bps cut has now shifted to 30:70 by the end of this year, rising to close to 50:50 in January 2008 and a full rate cut almost fully priced in by March 2008. Inflation remains a sticking point to a rate cut this year, and last week's inflation expectations survey remained too elevated for the RBNZ's liking.

For the local rates market this week, we are not expecting much activity. Although the local data calendar gets busy towards the end of the week, they are mostly second tier data and relate mainly to Q2 – which is expected to show robust activity but slowing growth. The data is unlikely to provide a direction either way, and the market will not be wanting to take a big position prior to next week's *Monetary Policy Statement*.

This suggests a week of range trading ahead, with the 2-year swap yield trading within its new 8.1 to 8.3 percent range. The bias will be to steepen for the 2s10s swap curve, though early attempts have so far proven short-lived. With the 90-day rate holding up, the carry cost is preventing the 2-year swap yield from heading lower – keeping the curve close to support at -80pts. For swap spreads, the pressure is for further widening given offshore credit concerns. But we think they are close to reaching extremes (partly due to month end) and expect them to narrow on the back of bond moves.

The international calendar is busy, with Australian and Euro Q2 GDP data, and interest rate announcements from the RBA, ECB and BoE. In addition, the Fed's Beige Book (due on 6 September at 0600 NZST) will take on added importance as we find out how US businesses fared throughout the financial market turmoil in August. This will play a significant role in the FOMC's decision on September 18.

### Gauges for NZ interest rates yields

Gauge	Direction	Comment
RBNZ	↔	RBNZ is done hiking but lack of inflation headroom makes near-term easings unlikely. Balance of risks starting to shift towards lower rates.
NZ data	↔/↓	Second tier data this week to show Q2 growth robust but slowing.
Fed Funds/front end	↔/↓	Fed prepared to act but not before FOMC meeting on 18 September. This week's Beige Book key.
RBA	↔/↑	Strong Australian data mean another hike cannot be ruled out, but global developments a sticking point.
US 10 year	↔	Safe haven flows big driver as sentiment waxes and wanes.
NZ swap spreads	↔/↓	Spreads are favoured to narrow but is very dependent on bond flows.
Flow	↔	We expect flows to be lighter than previously seen, with direction dictated to by offshore moves.
Technicals	↔/↓	Swap yields appear to be trading at the bottom of a new (lower) range, awaiting next development.

### Borrowing strategies we favour at present

While the global yield curve has stabilised over the last week the risk profile is still skewed for further falls in NZ yields. Borrowers with existing debt maturing in 2008/09 will find rates becoming attractive to forward fix swaps out of their maturity dates and should be aware the steeper the yield curve gets the more benefit in these trades. Borrowers with existing long dated cover at good rates may want to look at taking some profit from these trades and shortening duration.

### Probability of 25bps increase as implied by market pricing

OCR dates	Last week	This week
Thu 13-Sep-07	0	0
Thu 25-Oct-07	-4	-12
Thu 6-Dec-07	-8	-32
Thu 24-Jan-08	-36	-48
Thu 6-Mar-08	-48	-92
Thu 24-Apr-08	-72	-104
Thu 5-Jun-08	-128	-104

### Trading themes we favour at present

We continue to favour curve steepener trades. However, in the near-term a global rally could see the curve invert given the 2-year remains anchored within current tight ranges.

## MONETARY POLICY UNDER UNCERTAINTY

**The current global financial market turmoil has introduced greater than usual uncertainty into monetary policy decision making. For the Reserve Bank, it boils down to making a call over which risk the Bank sees as more of a threat – inflation or growth – and which offers the path of least regret if events turn out differently.**

*“Uncertainty is not just an important feature of the monetary policy landscape; it is the defining characteristic of that landscape.”*

Alan Greenspan, 2003

Central banks operate under uncertainty in setting monetary policy at the best of times. Where is the economy at present given lags in the economic data? How does the economy respond to shocks, what new shocks are emerging, and what are the transmission channels from various shocks? How long does monetary policy take to impact? These are all sources of uncertainty that central banks need to take into account when formulating policy. In the absence of such uncertainty, monetary policy would be merely a mechanical exercise that could be run by a spreadsheet.

But what is a central bank to do when the current environment is more uncertain than usual? As much as monetary policy around the world has evolved since NZ first started inflation-targeting in the late 1980s, it is perhaps unsurprising that no general rules about how to respond to uncertainty have been discovered. As uncertainty cannot be mechanically incorporated into the policymaking process, the international literature suggests that some types of uncertainty calls for policymakers to “do less”, while other types call for no moderation. In short, it ultimately boils down to judgement.

The Reserve Bank’s own research suggests that the optimal way in which policymakers should respond to uncertainty about an event is to base their actions on the expected nature of the event. Under this approach, monetary policy follows a “middle of the road course” in which the risks associated with the outcome of the event are evenly balanced.<sup>1</sup>

However, the problem of applying this approach to the current environment is that the potential impact from the financial market volatility is asymmetric. If markets stabilise and normality resume, then the impact on the NZ economy is likely to be minimal. Should financial markets deteriorate substantially and events lead to a global credit crunch, the impact on NZ, which is heavily reliant on foreign funding, would be much more severe.

The Reserve Bank’s current concern about inflation is well known, as are the upside risks to inflation from a forecast record dairy payout, potential fiscal stimulus next year and a falling NZD. But how does and should the Reserve Bank treat the offsetting shock from the current financial market volatility? Should the Reserve Bank ignore it like they did the February global market correction earlier this year or should greater weight be put on it?

Certainly, in our view, current events are turning out to be bigger and potentially more systemic than February, with possible implications for the real economy. The difficulty is that there is no general agreement in the economic literature on how financial market volatility impacts on real economic activity and inflation. While the general view is that the repricing of risk currently underway is healthy and long overdue, the tendency for markets to overreact and spillover is itself a key risk.

Ultimately, for the Reserve Bank it boils down to making a judgement about the probabilities, costs and benefits of the various possible outcomes, and under alternative policy choices. It is also about making a call over which risk the Bank sees as more of a threat – inflation or growth – and which of these two offer the path of least regret if events turn out differently.

The September *Monetary Policy Statement* is shaping up to be a tough one – not because of the actual policy decision itself (it is almost certain that rates will remain on hold) – but for how they weigh up the risks and what they should convey to the market about the future policy outlook given all the uncertainty. In this respect, we will be looking for:

- A reduced role in the actual projections itself, including the 90-day profile. It is difficult to put too much weight on hard forecast numbers when developments are unfolding quickly.
- More discussion, particularly in the “Overview and key policy judgements” section, on how the Reserve Bank sees the current setting and its view of the likely transmission channel.
- What type of scenarios the Reserve Bank presents. This will perhaps contain the most useful guide for the market to assess the Bank’s likely policy bias.

While the current environment urges caution, the Reserve Bank would also be mindful not to give the rates market an excuse to rally. With the market looking for a chance to test an early easing theme, they will likely latch on to any signs of a softening in tone. In this regard, the US Federal Reserve Chairman Ben Bernanke’s comments over the weekend may be revealing. The Fed Chairman said that it is not the responsibility of central banks to bail out lenders and investors from the consequences of their financial decisions, and that monetary policy would react not to the financial market volatility itself but to the broader economic effects outside of the markets. We suspect the Reserve Bank will take a similar line.

<sup>1</sup> Conway, P. (2000) *Monetary policy in an uncertain world*, Reserve Bank of New Zealand Bulletin, 63(3).

## CURRENCY STRATEGY

**The NZD will remain hostage to overseas developments as volatility looks set to continue. Australian Q2 GDP, interest rate announcements in Australia, UK and Europe and the Fed's Beige Book will be key to watch.**

### Market themes...

- Offshore developments will continue to dominate.
- Fed's Beige Book and Australian Q2 GDP will be key to watch.

### Outlook...

The past week was indicative of the type of trading conditions that we can expect to continue for some time. The New Zealand dollar fluctuated within a 4 cent range (0.7275 to 0.6870) as the market's appetite for risk vacillated, and is generally weaker than a week ago. Carry trades, which had started to make a come back late the previous week, were generally unwound as US data and fresh news of hedge fund difficulties suggested that subprime difficulties and credit concerns were far from over.

While these conditions prevail, a "heavy" volatility looks set to continue. The broader fortunes of the NZ dollar will be determined by offshore developments, with any indications of credit difficulties or further fallout from the subprime collapse likely to impact on risk appetites and weigh on the NZ dollar. But the news from offshore is unlikely to all be bad, and squeezes to the topside can still be expected, but as the past few weeks have shown, these should be treated as opportunities to sell.

Against the still tenuous global backdrop, local market news has provided few reasons to buy the NZ dollar. A slight improvement in business confidence (engendered by the increased dairy payout forecast and a lower NZ dollar) were more than offset by news of further difficulties in the NZ finance company sector, falling building consent issuance, and slowing credit growth, leaving the NZ dollar feeling heavy.

Apart from the continued focus on equity markets, Australian Q2 GDP this week is expected to reinforce that the Australian economy is on a different growth path to NZ and that the kiwi will continue to under-perform its Aussie neighbour. The Fed's Beige Book, released on Thursday (NZST) should give a more up-to-date view of the state of the US economy in the face of the financial sector woes and markets will look to it for further signs of potential interest rate cuts. Interest rate announcements in Australia, UK and Europe will also be key to watch.

NZD starts the week near the bottom of its current range with the market looking for a break of either 0.6980 or 0.7100 for direction. Next levels of support and resistance are at 0.6880 and 0.7270 respectively and these will be looked upon now as the major breakout. Expect model/momentum traders to follow through on a break of either level. For the NZD/AUD cross, the resistance at 0.8640 now looks formidable and a break of 0.8560 should see 0.8520 retested.

NZD vs AUD: monthly directional gauges		
Gauge	Direction	Comment
Fair value	↓	Growth differentials favouring AUD.
Yield	↔/↑	Yields converged last week but still favour NZ.
Commodities	↔	Still supportive of both.
Partial indicators	↓	Aussie ahead of us in the terms of trade cycle.
Technicals	↓	Test of bottom of range expected.
Sentiment	↓	AUD data is better.
Other	↓	Australian economy is stronger.
<b>On balance</b>	↓	<b>0.8640 top for moves lower.</b>

NZD vs USD: monthly directional gauges		
Gauge	Direction	Comment
Fair value – long-term	↓	Fair value 0.65 (and rising) given a structural shift in commodity prices.
Fair value – short-term	↔	Equity driven.
Yield	↑	Yield differential widening on credit concerns.
Commodities	↑	Higher commodity prices remain supportive. Fonterra announcement was expected, but still nice.
Risk aversion	↓	Talk of round 2 starting.
Partial indicators	↔	Neutral here.
Technicals	↔	Support at 0.6980/6880, resistance at 0.7100/7250.
AUD	↔	Fundamentals solid across the Tasman. AUD doing well.
Sentiment	↔	Investment houses hate it – retail banks love it.
Other	↔	Massive volatility negates carry benefit but calmer waters see renewed interest.
<b>On balance</b>	↔/↓	<b>Wait and see this week – fairly priced to us. But stormy times ahead.</b>

## DATA AND EVENT CALENDAR

Date	Country	Data/Event	Mkt.	Last	Time (NZST)
Sep 3	US	US Markets Closed for Labor Day	-	-	-
	AU	TD Securities Inflation (Aug) - mom	-	0.6%	12:30
		TD Securities Inflation (Aug) - yoy	-	3.0%	12:30
		ANZ Job Advertisements (Aug)	-	-0.5%	13:30
		Company Operating Profit (Q2)	-	7.6%	13:30
		Building Approvals (Jul) - mom	-	7.5%	13:30
		Building Approvals (Jul) - yoy	-	0.9%	13:30
		RBA Commodity Index SDR (Aug) - yoy	-	4.4%	18:30
	UK	PMI Manufacturing (Aug)	55.0	55.7	20:30
	JN	Capital Spending (Q2)	-	13.6%	11:50
		Labour Cash Earnings (Jul)	-0.5%	-1.1%	13:30
	GE	PMI Manufacturing (Aug)	56.2	56.8	19:55
	EC	PMI Manufacturing (Aug F)	54.2	54.2	20:00
Sep 4	AU	GDP (Q2) - qoq	0.6%	1.6%	13:30
		GDP (Q2) - yoy	3.8%	3.8%	13:30
	UK	PMI Construction (Aug)	60.6	61.8	20:30
	EC	Euro-Zone PPI (Jul) - mom	0.1%	0.1%	21:00
		Euro-Zone PPI (Jul) - yoy	1.7%	2.3%	21:00
		Euro-Zone Retail Sales (Jul) - mom	0.3%	0.4%	21:00
		Euro-Zone Retail Sales (Jul) - yoy	1.1%	0.9%	21:00
		Euro-Zone GDP (Q2 P) - qoq	0.3%	0.3%	21:00
		Euro-Zone GDP (Q2 P) - yoy	2.5%	2.5%	21:00
Sep 5	AU	RBA Cash Rate announcement	6.5%	6.5%	11:30
	US	ISM Manufacturing (Aug)	53.0	53.8	02:00
		ISM Prices Paid (Aug)	63.0	65.0	02:00
		Construction Spending (Jul)	0.0%	-0.3%	02:00
	UK	Nationwide Consumer Confidence (Aug)	94	96	11:01
		PMI Services (Aug)	56.5	57.0	20:30
	GE	PMI Services (Aug)	58.1	58.5	19:55
	EC	PMI Services (Aug F)	57.9	57.9	20:00
		PMI Composite (Aug F)	-	57.2	20:00
Sep 6	<b>NZ</b>	<b>Wholesale Trade Survey (Q2)</b>	-	<b>1.7%</b>	<b>10:45</b>
		<b>ANZ Commodity Price Index (Aug)</b>	-	<b>4.7%</b>	<b>15:00</b>
	AU	Employment Change (Aug)	17.5k	21.8k	13:30
		Unemployment Rate (Aug)	4.3%	4.3%	13:30
		Participation Rate (Aug)	65.1%	65.0%	13:30
	US	ADP Employment Change (Aug)	80k	48k	00:15

Continued over page

Date	Country	Data/Event	Mkt.	Last	Time (NZST)	
Sep 6 cont	US	Pending Home Sales (Jul)	-2.0%	5.0%	02:00	
		US Federal Reserve Beige Book	-	-	06:00	
	UK	Industrial Production (Jul) - mom	0.2%	0.1%	20:30	
		Industrial Production (Jul) - yoy	1.0%	0.8%	20:30	
		Manufacturing Production (Jul) - mom	0.2%	0.2%	20:30	
		Manufacturing Production (Jul) - yoy	1.2%	0.9%	20:30	
		BoE Interest Rate announcement	5.75%	5.75%	23:00	
		JN	Machine Tool Orders (Aug P)	-	18.8%	18:00
	GE	Factory Orders (Jul) - mom	-2.5%	4.6%	22:00	
		Factory Orders (Jul) - yoy	10.5%	15.9%	22:00	
	EC	ECB Interest Rate announcement	4.00%	4.00%	23:45	
Sep 7	NZ	<b>Value of Building Work Put in Place (Q2)</b>	-	<b>2.5%</b>	<b>10:45</b>	
		<b>Capital Goods Price Index (Q2)</b>	-	<b>0.4%</b>	<b>10:45</b>	
	AU	Sydney Holiday for APEC Summit. Physical bond and swap markets closed.	-	-	-	
	US	Nonfarm Productivity (Q2 F)	2.3%	1.8%	00:30	
		Unit Labour Costs (Q2 F)	1.6%	2.1%	00:30	
		Initial Jobless Claims (Sep 2)	330k	334k	00:30	
		Continuing Claims (Aug 26)	2575k	2579k	00:30	
			ISM Non-manufacturing (Aug)	54.5	55.8	02:00
			Fed's Yellen, Kroszner Speak at San Francisco Conference	-	-	03:30
			Fed's Poole Speaks About European Jobs & Trade in London	-	-	04:00
			Fed's Lockhart Speaks on US Economic Outlook in Atlanta	-	-	04:25
		JN	Leading Economic Index	-	72.7	17:00
			Coincident Index	-	80.0	17:00
		EU	ECB's Trichet, Stark, Weber, and Papademos Speak at a Conference in Frankfurt	-	-	19:30
		GE	Trade Balance (Jul)	15.6B	16.5B	18:00
			Current Account (July) - Euro	12.2B	16.6B	18:00
			Imports (Jul)	-0.4%	6.7%	18:00
Exports (Jul)			1.0%	2.1%	18:00	
Industrial Production (Jul) - mom			0.9%	-0.4%	22:00	
Industrial Production (Jul) - yoy			4.9%	5.1%	22:00	
Sep 8	US	Nonfarm Payrolls (Aug)	109k	92k	00:30	
		Unemployment Rate (Aug)	4.6%	4.6%	00:30	
		Change in Manufacturing Payrolls (Aug)	-14k	-2k	00:30	
		Average Hourly Earnings (Aug) - mom	0.3%	0.3%	00:30	
		Average Hourly Earnings (Aug) - yoy	3.9%	3.9%	00:30	
		Average Weekly Hours (Aug)	33.8	33.8	00:30	
		Wholesale Inventories (Jul)	0.4%	0.5%	02:00	

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

Sources: Dow Jones, Reuters, Bloomberg, ANZ National Bank. All \$ values in local currency. (Note: all surveys are preliminary and subject to change).

## NEW ZEALAND DATA WATCH

**Key focus over the next four weeks:** Further signs of softening growth for Q3 will start to emerge in the partial indicators, starting with the REINZ housing market report next week. The RBNZ's September *MPS* will likely highlight increased uncertainty about the economic outlook and a downgrading of growth projections, which markets will take to prod an easing theme.

Date	Data/Event	Economic Signal	Comment
Thu 6 Sep (10.45)	Wholesale Trade Survey (Jun qtr)	Flat	We expect flat quarterly retail sales growth in June after the strong increase in March. Wholesale trade is expected to mirror this pattern.
Thu 6 Sep (15.00)	ANZ Commodity Price Index (Aug)	-	-
Fri 7 Sep (10.45)	Value of Building Work Put in Place (Jun qtr)	Holding up	Residential work put in place to post a rebound following Q1's fall. Non-residential work put in place to remain elevated.
Fri 7 Sep (10.45)	Capital Goods Price Index (Jun qtr)	Mixed	Prices for imported plant and machinery to show declines courtesy of a higher NZD, but non-residential building costs to remain elevated.
Circa 10 Sep	REINZ Housing Report (Aug)	Softening	Further signs of softening are expected in August with interest rate increases this year now fully manifesting.
Mon 10 Sep (10.45)	Producers Price Index (Jun qtr)	Margin rebuild	Lower input prices courtesy of NZD, which firms will take advantage of to rebuild margins.
Tue 11 Sep (10.45)	Overseas Trade Indices (Jun qtr)	Terms of trade up	Strong increases in commodity prices, particularly dairy, are expected to contribute to a large increase in the terms of trade.
Thu 13 Sep (09.00)	Reserve Bank <i>Monetary Policy Statement</i>	On hold	The RBNZ is in neutral mode, signalling that they believe they have done enough to contain inflation. The Bank will likely highlight increased uncertainty about the economic outlook and downgrade their growth projections.
Thu 13 Sep (10.45)	Retail Trade (Jul)	Soft	Another soft month expected, pointing to ongoing moderation in consumer spending.
Fri 14 Sep (10.45)	Economic Survey of Manufacturing (Jun qtr)	Modest	Based on the PMI, we are expecting modest growth in production volumes.
Thu 20 Sep (10.45)	Balance of Payments (Jun qtr)	Modest improvement	We expect the annual current account deficit to show a modest improvement, but the quarterly seasonally adjusted deficit to worsen.
Fri 21 Sep (10.45)	External Migration (Aug)	Easing	Another modest monthly net gain expected, but the annual net migration total to continue easing.
Fri 21 Sep (15.00)	Credit Card Billings (Aug)	Moderation	A modest rebound expected following July's decline, but the overall direction is for further moderation in consumer spending.
Wed 26 Sep (10.45)	Overseas Merchandise Trade (Aug)	Imbalanced	Trade balance yet to show signs of the surge in dairy prices. But a fall in the NZD over August should help export values.
Wed 26 Sep (02.00)	Westpac McDermott Miller Consumer Confidence (Sep qtr)	Down	Given global market volatility and finance company failures at home, not to mention higher mortgage rates, consumer confidence expected to take a hit.
<b>On Balance</b>		<b>Slowing</b>	<b>Dairy versus housing. We are backing the latter.</b>

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## SUMMARY OF KEY MARKET FORECASTS

NZ FX rates	Actual		Current	Forecast (end month)						
	Jul 07	Aug 07	3 Sep 07	Dec 07	Mar 08	Jun 08	Sep 08	Dec 08	Mar 09	Jun 09
NZD/USD	0.786	0.703	0.700	0.680	0.650	0.620	0.620	0.610	0.590	0.590
NZD/AUD	0.907	0.858	0.858	0.829	0.783	0.765	0.775	0.782	0.776	0.776
NZD/EUR	0.573	0.515	0.513	0.496	0.478	0.463	0.470	0.469	0.465	0.465
NZD/JPY	95.6	81.7	81.0	80.2	77.4	74.4	74.4	72.0	69.6	69.6
NZD/GBP	0.386	0.349	0.347	0.342	0.332	0.320	0.323	0.323	0.316	0.316
NZ\$ TWI	75.6	67.9	67.6	65.8	63.0	60.8	61.2	60.6	59.3	59.3
NZ interest rates	Jul 07	Aug 07	3 Sep 07	Dec 07	Mar 08	Jun 08	Sep 08	Dec 08	Mar 09	Jun 09
OCR	8.18	8.25	8.25	8.25	8.00	7.50	7.50	7.50	7.25	7.25
90 day bill	8.44	8.70	8.62	8.50	8.00	7.70	7.70	7.70	7.20	7.20
10 year bond	6.79	6.39	6.16	6.50	6.40	6.40	6.50	6.70	6.70	6.70
International	Jul 07	Aug 07	3 Sep 07	Dec 07	Mar 08	Jun 08	Sep 08	Dec 08	Mar 09	Jun 09
US Fed funds	5.25	5.25	5.25	5.00	5.00	5.00	5.00	5.00	5.50	5.50
US 3-mth	5.36	5.58	5.62	5.00	5.15	5.25	5.25	5.50	5.75	5.75
AU cash	6.25	6.50	6.25	6.50	6.75	6.75	6.75	6.75	6.75	6.75
AU 3-mth	6.62	6.89	6.89	6.70	6.90	6.90	6.90	6.90	6.90	6.90

## KEY RATES

	31 Jul	27 Aug	28 Aug	29 Aug	30 Aug	31 Aug
Official Cash Rate	8.25	8.25	8.25	8.25	8.25	8.25
30 day bank bill	8.45	8.51	8.51	8.50	8.50	8.52
90 day bank bill	8.55	8.54	8.56	8.59	8.62	8.62
NZGB 07/09	7.83	7.47	7.43	7.33	7.25	7.11
NZGB 11/11	7.33	6.97	6.94	6.83	6.78	6.64
NZGB 04/13	7.12	6.83	6.80	6.68	6.64	6.50
NZGB 12/17	6.63	6.46	6.45	6.33	6.29	6.15
1 year swap	8.63	8.47	8.47	8.45	8.46	8.47
2 year swap	8.44	8.27	8.24	8.18	8.19	8.18
5 year swap	8.05	7.88	7.84	7.78	7.79	7.75
RBNZ TWI	73.9	69.5	67.9	67.0	67.7	67.9
NZD/USD	0.7713	0.7227	0.7048	0.6938	0.7017	0.7043
NZD/AUD	0.8959	0.8704	0.8582	0.8574	0.8589	0.8585
NZD/JPY	91.77	83.99	81.31	79.41	81.17	81.90
NZD/GBP	0.3796	0.3586	0.3514	0.3465	0.3483	0.3495
NZD/EUR	0.5625	0.5286	0.5173	0.5104	0.5138	0.5154
AUD/USD	0.8609	0.8303	0.8213	0.8092	0.8170	0.8204
EUR/USD	1.3712	1.3673	1.3625	1.3594	1.3658	1.3666
USD/JPY	118.98	116.22	115.36	114.45	115.67	116.29
GBP/USD	2.0321	2.0153	2.0058	2.0022	2.0146	2.0149
Oil	76.82	71.17	71.98	71.79	73.52	73.37
Gold	666.15	667.70	666.70	663.50	665.95	667.10
Electricity Price Index	6.00	4.99	4.98	5.01	5.04	5.07

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