

NEW ZEALAND ECONOMICS MARKET FOCUS

22 August 2011

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CREDIT AND CREDIBILITY

ECONOMIC OVERVIEW

Global developments continue to supersede local considerations. Global lead indicators have been weak (not dire) and the next month or so will be critical. The European situation remains the most troubling with markets seeking a circuit breaker. We can see various policy measures doing enough to get by, but the fallout from this is a longer and slower adjustment. We expect NZ to remain an economic out-performer (in a solid as opposed to spectacular growth sense), reversing the 2009 and 2010 experience relative to OECD peers. NZ data remains secondary to global developments at present though a firm tone for retail and elevated inflation expectations should reaffirm the view that the OCR cannot remain this low indefinitely.

FISCAL SUSTAINABILITY

We calculate two simple metrics to examine the sustainability of sovereign debt in some key countries. The first one is the primary gap, which focuses on the latest fiscal balance and what it means for net debt. The second metric is the long-term average primary fiscal surplus required to return net debt to 60 percent of GDP. Some indebted nations such as Greece and Italy look okay on the former measure, due to current austerity measures, as long as interest rates (bailout rates in Greece's case!) stay reasonable. But looking at the latter measure highlights the extreme medium-term challenges they face, given their high debt levels. The need for action in the US is highlighted by the former metric, reflecting their very high current deficit, but they have more flexibility according to the latter.

THE REGIONAL GAP

Our regional output gap measures still show broad-based idle capacity across most regions, with continued regional divergences. Our measures suggest there is enough spare capacity to temporarily accommodate a strengthening in demand, but the durability of the recovery will be under pressure unless action is taken to lift supply side capacity.

INTEREST RATE STRATEGY

Post the Philly Fed, a lot of "bad" economic news is now priced into fixed income markets. While this suggests some counter recoil potential if we see less bad data surprises, uncertainty and financial fear remain powerful drivers, and cloud the market's ability to interpret the outlook. Locally, rate hikes are sufficiently far away that the market is only pricing them as a bias, rather than getting specific about timing. With Australia pricing cuts, and the global outlook still challenging, this only makes for volatility, albeit "low beta" here in NZ.

CURRENCY STRATEGY

Last week's weak Philly Fed reading put currency markets firmly back in "risk off" mode. With the odds of a double-dip recession in the US rising, NZD and AUD will remain vulnerable despite favourable interest rate differentials. However, EUR remains resilient amidst the continuing sovereign debt crisis in Europe, perhaps testament that the economic malaise is on both sides of the Atlantic. This week's Jackson Hole Symposium of global central bankers will be a focus, given that last year's event was the precursor to QE2.

ECONOMIC OVERVIEW

SUMMARY

Global developments continue to supersede local considerations. Given political shenanigans in the US of late we're inclined to discount the extent of weakness apparent in some global lead indicators. The latter have been weak (not dire) and the next month or so will be critical. It is the European situation that remains most troubling with markets seeking a circuit breaker. We can see various policy measures doing enough to get by, but the fallout from this is a longer and slower adjustment. We expect New Zealand to remain an economic out-performer (in a solid as opposed to spectacular growth sense), reversing the 2009 and 2010 experience relative to OECD peers. New Zealand data remains secondary to global developments at present though a firm tone for retail and elevated inflation expectations should reaffirm the view that the OCR cannot remain this low indefinitely.

THIS WEEK'S EVENTS

RBNZ Survey of Expectations – Q3 (Tuesday, August 23, 3:00pm). The key 2-year-ahead CPI inflation reading is expected to come in marginally below 3 percent.

SNZ Merchandise Trade – July (Wednesday, August 24, 10:45am). A deficit of \$170m is expected, with the annual surplus climbing to \$1.04b.

SNZ Retail Trade – Q2 (Thursday, August 25, 10:45am). A 1.8 percent increase in retail values is expected, with core retail values up 2.2 percent. Retail volumes are envisaged to rise 0.9 percent, while core volumes should firm 1.5 percent.

SNZ Food Price Index - July (Thursday, August 25, 10:45am). We expect a 1 percent increase in food prices.

WHAT'S THE VIEW

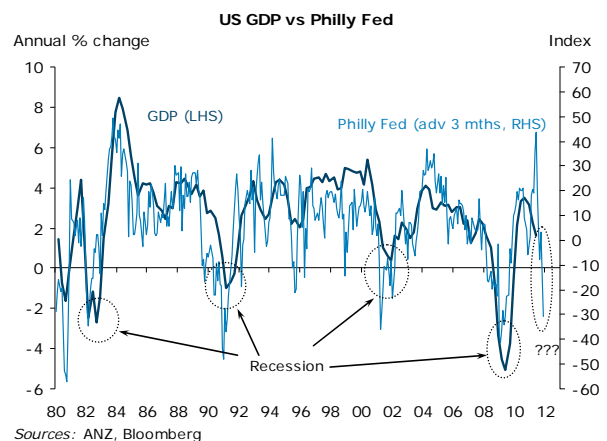
Yuck. There are not too many other ways to describe the global scene. Equities have continued to head south, US 10-year bond yields hit their lowest (1.97 percent) in at least 70 years, European Libor rates continue to push higher (symptomatic of funding pressure), and the dataflow suggests that prospects for another recession in the US has risen. It's not all one-way traffic – sovereign yields in Europe for the likes of Italy and Spain have stabilised following ECB action. **But positive developments are the exception as opposed to the rule.**

Rather than get caught in the rip of such developments from week to week, we're continuing to look at the big picture, which is simple: welcome to the long hard slog of payback from years of excesses, albeit with a fair (and unwelcome) bit

of volatility along the way.

Some aspects trouble us more than others.

We're inclined to discount *the extent* of weakness in indicators such as last week's fall in the US Philly Fed, which was taken when the US debt ceiling shenanigans were taking place, a signal for all businesses to hit the reverse or pause button. Obviously we expect pretty well all similar indicators to follow suit in terms of the poor economic signal. The market now looks to be anticipating weakness so our presumption is that a lot of bad news is already priced in. The real litmus test will be next month. In a normal environment, the US situation itself would be enough to set off warning bells. The fact it's not the central concern is testament to the collective challenges the global economy is facing. We've now become so accustomed to troubling issues globally that the Middle East hardly gets a mention!



It is the European situation that continues to trouble us, a dynamic that has been repeatedly reinforced in our sovereign risk analysis. The past week has seen continued pressure on the interbank market, a troubling sign. Although traditional "indicator" spreads like the OIS-LIBOR spread and the like are elevated, they have not moved higher in the past week. But what is concerning is that the level of distrust in the market among counterparties appears to be growing, which is a negative sign. Talk that some banks in Asia had pulled their credit lines on French banks, and that one bank "tapped" the ECB for funds at a penalty rate last week only got the market more excitable. At this stage the lack of trust is not widespread. But what we learnt from 2008 is that these things can escalate quickly, and as such, we need to be alert to the signs.

The provision of liquidity is a short-term concern, but of more concern to us is the issue of fiscal solvency. On page 6 we calculate two simple metrics to illustrate the sustainability of public debt in some key

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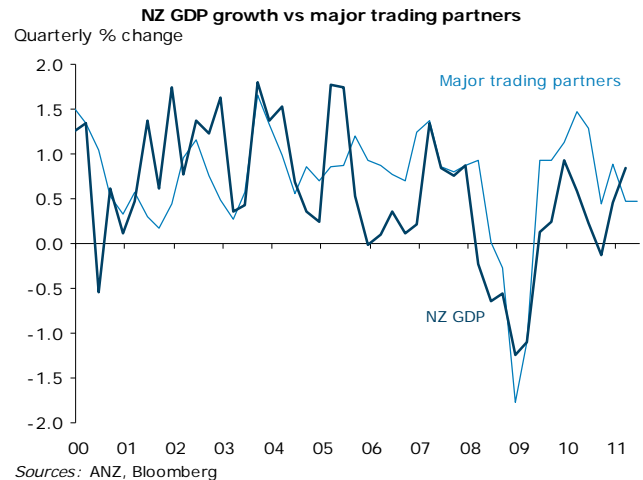
countries. The first measure examines the adjustment in the primary balance required to stabilise the net debt position at current levels, while the second metric calculates the fiscal balances that would be required to stabilise net public debt at a "sustainable level", which we assume to be 60 percent of GDP in 10 year's time.

Apart from spending choices, the fiscal position will depend on the interaction between interest rates and growth. High growth and low interest rates lessen the pressure on the primary balance. Any debt position is sustainable as long as markets are in a relaxed, generous mood. However, when the tide turns, and creditors start to get nervous, borrowers can face an uphill battle. High levels of net public debt and high real interest rates can quickly produce debt spirals.

Maintaining market confidence is therefore of primary importance. On the growth side of the ledger, recent data has been alarming. US economic activity has hit stall speed – defined at sub 2 percent y/y growth. Activity in the powerhouse German and French economies effectively stalled in Q2. There are troubling trends in the relationship between real yields and real GDP for a host of nations: a negative gap between the two raises the debt burden even without a change in the primary balance.

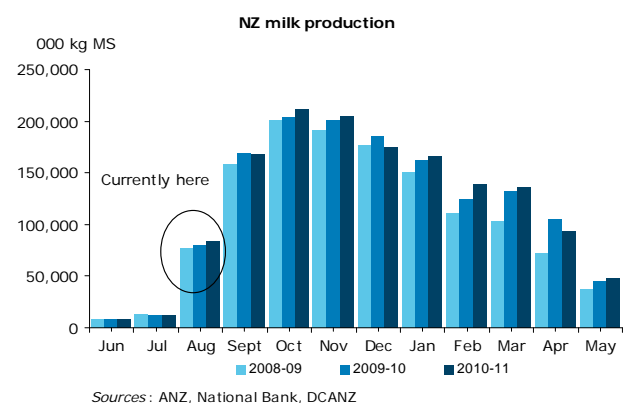
Markets desperately need a circuit breaker. Our baseline case is that policymakers will do what is necessary to avert another 2008 repeat but we won't be popping out the champagne. When we eye the troika that the solution requires, namely politicians delivering austerity (and the public buying it), the ECB following the Fed and delivering QE, and Europe becoming more like the Germans, well give me a fully loaded wheelbarrow and I'll start walking uphill. Welcome to the world of doing enough to get by, but with limited prospects for a mandate to get in place a real solution.

For New Zealand it remains a case of watch, worry and wait, as opposed to pulling down the shutters. Regular readers keep asking us how we can remain so sanguine on local prospects against this backdrop. The reply is simple. We've got non-financial-centric growth courtesy of one-offs in prospect, namely the RWC (hitting at the same time other nations are wrapping themselves in cotton wool) and the earthquake rebuild for 2012. NZ took the penance road in 2009 and 2010, which means we're better placed now. And 4 percent growth in an economy that is still 0.5 percent smaller than in 2007 is hardly bullish: it's simply recovering some ground lost. **Beyond 2011 and 2012 we've still got a contained (i.e. subdued) view of trend growth for NZ.Inc.**



The NZ story continues to stack up well compared to our trading partners. Dairy prices barely budged in the *GlobalDairyTrade* auction and remain at historically high levels. This is a key channel we are watching closely. Historical experience has seen commodity prices tumble on global weakness. We're not seeing that at present, though there's certainly some buyer caution.

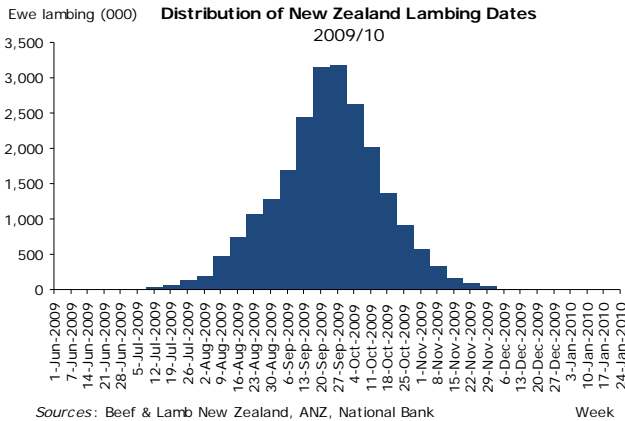
The volatility in New Zealand's weather over the past week is a reminder how influential Mother Nature can be. Part of the weakness in H2 2010 GDP was weather induced (loss of lambs and weak dairy production). This reversed sharply in H2 2011. **Will recent storms cloud H2 2011? We don't think so.** While the recent storms will have affected milk production and resulted in stock losses, these will be relatively minor because we are at an early stage of the production season.



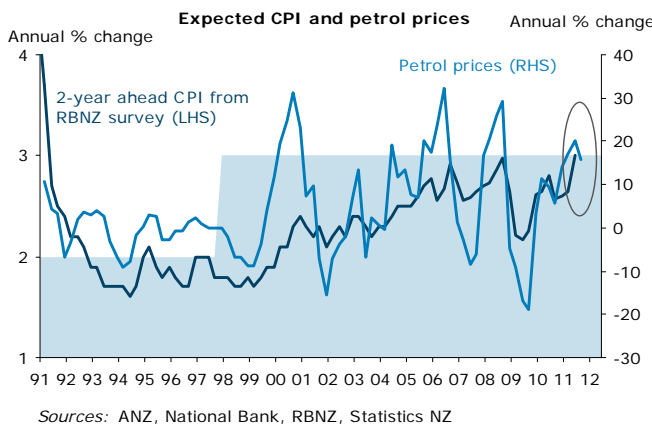
Recent storms hit during the early part of the lambing season, with less than 4 percent of total breeding ewes due to lamb last week. Around three quarters of these breeding ewes were in the North Island, most of which were in the East Coast that appeared to not be as badly

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hit as the South Island. By comparison, adverse weather in the lower North Island and Southland during the peak lambing period last September contributed to the loss of approximately 3 million lambs, or 10 percent of the total lamb crop.

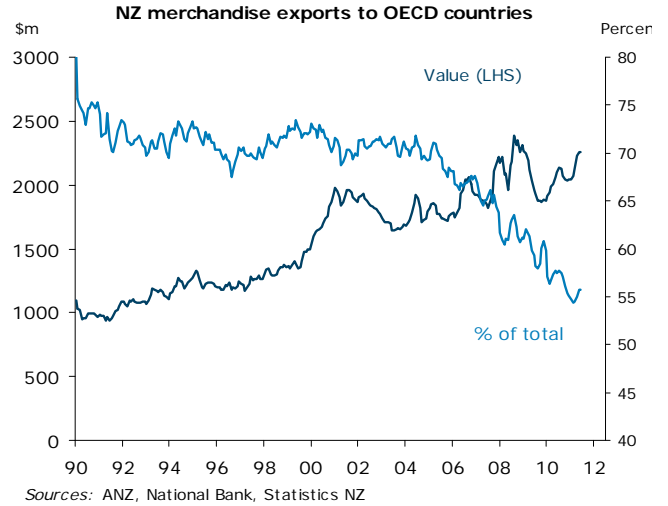


The key event this week is the RBNZ Survey of Expectations. We expect the crucial 2-year-ahead reading for CPI inflation to come in marginally below the 3 percent registered for the Q2 survey. Our work suggests expectations are persistent and are likely to remain considerably above the mid-point of the inflation target for some time. With headline inflation currently above 5 percent, this is not a good look for the RBNZ given the potential impacts on price and wage setting. No wonder the Bank are placing increasing emphasis on their (lower) core inflation measures.



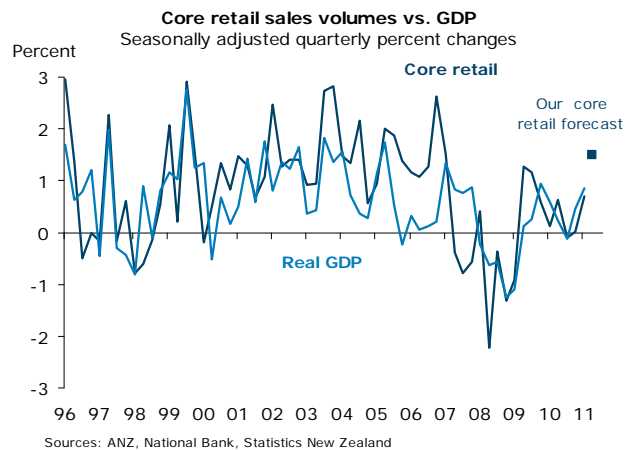
Merchandise Trade data for July is expected to deliver a monthly deficit of \$170m, but this mostly reflects seasonal factors, with a small positive seasonally adjusted trade surplus expected. High export commodity prices continue to provide support. A large chunk of our exports also head for emerging economies, which for the moment at least, are holding up. Free-trade deals hold out the prospect of lifting our market penetration in key markets, with the decision by

the Australian authorities to approve the importation of NZ apples a sign of things to come.



We will continue to closely monitor imports of capital equipment. Encouragingly, our regional output gap estimates (see page 10) showed a decline in surveyed capacity utilisation, buying us some time. If we want to prolong the recovery, a sustained period of capacity building is still needed.

Retail data for Q2 is expected to confirm resilience. We expect another 0.9 percent increase in retail volumes, with core volumes set to strengthen by 1.5 percent. Electronic Card Transaction data was strong in the June quarter, with the fall in car registrations tempering the likely rise in the retail trade data. Core retail volumes growth is set to outperform, setting the stage for a solid Q2 GDP print. For the moment at least the NZ economy looks to be holding up well, but we are not immune from global chills.



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RECENT LOCAL DATA

ANZ Job Ads – July. Job advertisements climbed 0.9 percent s.a. (+20.6 percent y/y). Internet listings climbed 2.2 percent s.a., which was partly offset by a 3.9 percent s.a. fall in newspaper advertising.

GlobalDairyTrade auction. Overall dairy prices declined 0.9 percent (to US \$3,600/tonne). Whole milk powder prices eased 2.2 percent.

Producer Prices and Capital Goods Price Index – Q2 . Input prices rose 0.9 percent (4.8 percent y/y), with output prices rising 1.4 percent (4.5 percent y/y). Capital goods prices rose 0.5 percent in Q2 (+0.4 percent y/y).

National Bank Regional Trends – Q2. The nationwide measure of economic activity increased 0.8 percent (0.6 percent y/y). Activity rose in 12 of the 14 regions, with activity in Canterbury rising 1.9 percent q/q.

International Travel and Migration – July. A net PLT outflow of 220 persons was recorded in July, the fifth consecutive monthly outflow. Visitor arrivals rose 2 percent in the month, but is down 3.7 percent from a year ago.

RBNZ Credit Card Billings – July. Billings rose a seasonally adjusted 1.0 percent (7.3 percent y/y).

FISCAL SUSTAINABILITY

SUMMARY

We calculate two simple metrics to examine the sustainability of sovereign debt in some key countries. The first one is the primary gap, which focuses on the latest fiscal balance and what it means for net debt. The second metric is the long-term average primary fiscal surplus required to return net debt to 60 percent of GDP. Some indebted nations such as Greece and Italy look okay on the former measure, due to current austerity measures, as long as interest rates (bailout rates in Greece's case!) stay reasonable. But looking at the latter measure highlights the extreme medium-term challenges they face, given their high debt levels. The need for action in the US is highlighted by the former metric, reflecting their very high current deficit, but they have more flexibility according to the latter.

Fiscal sustainability is a term with no clear definition. Any fiscal position is sustainable until the market decides it is not, and unlike corporations, governments seldom go bust. They have the monopoly power to raise taxes and cut spending, though both are judged in the court of public opinion.

With fiscal challenges at the forefront of market woes and Europe the centre of attention, it is appropriate to look at sustainability measures.

There are numerous challenges assessing fiscal sustainability.

- **It requires consistent data.** We rely on OECD information from their 2011 Economic Outlook. This may be somewhat dated but is the most consistent across nations available – though the OECD warn that data definitions vary across countries. Note that the OECD definition of government covers the general government.
- What measure of sustainability is appropriate? The literature is awash with such metrics. We have chosen two. **The “primary gap” measures the adjustment in the primary balance required to stabilise the net debt position.** That is, if the “primary gap” is positive, the net debt position is improving, and vice versa.¹ This keeps you solvent, but doesn't answer the question of longer term sustainability. **We therefore also look at the primary balance required to return net debt to a “sustainable” position.** We define this, for illustrative purposes, as the lower of current levels or 60 percent of GDP. We include the former because some

countries have net debt lower than 60 percent of GDP but markets are mindful of rising trajectories.

- **Both measures depend on the interaction between real interest rates and growth.** High growth and low interest rates lessen the pressure on the primary balance. Conversely, having interest rates above the growth rate can quickly develop into a debt spiral. Both our measures capture this interaction.

PRIMARY GAP

We turn first to the primary gap. The highlighted lines in the tables show where we think various nations' trend growth rates broadly reside, and reasonable assumptions for real 10-year interest rates (assuming the situation doesn't blow up). **Italy looks okay for now**, its saviour being its existing positive primary balance (i.e. it has a fiscal surplus before interest payments). **However**, this comes with a caveat: **the combination of slow growth** (Italy has had an average annual growth rate of not much more than 1 percent for the past two decades) **and high real yields** – recall the market pushed Italian nominal 10 year yields to 6.5 percent (say 4.5 percent real) – **makes the situation unsustainable, with the primary gap negative for some not improbable growth/interest rate combinations.**

ITALY					
REAL 10 YR YIELDS	REAL GDP GROWTH				
	0.00	1.00	2.00	3.00	4.00
5.00	-2.7	-1.7	-0.7	0.3	1.3
4.00	-1.7	-0.7	0.3	1.3	2.3
3.00	-0.7	0.3	1.3	2.3	3.3
2.00	0.3	1.3	2.3	3.3	4.3
1.00	1.3	2.3	3.3	4.3	5.3
0.00	2.3	3.3	4.3	5.3	6.3

% of GDP: primary balance 2011: +2.3%. Net govt debt 2011: 100.6%

The US position (see overleaf) is unsustainable by virtue of its current large primary deficit. The interaction of various real yields (even negative) does not change this proposition. This highlights the imperative of authorities undertaking fiscal consolidation.

¹ Refer Blanchard (1990). The primary gap is defined as the primary surplus – (r-g)debt, where r is the real interest rate and g the real growth rate.

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US					
REAL 10 YR YIELDS	REAL GDP GROWTH				
	0.00	1.00	2.00	3.00	4.00
5.00	-10.6	-9.8	-9.1	-8.3	-7.6
4.00	-9.8	-9.1	-8.3	-7.6	-6.8
3.00	-9.1	-8.3	-7.6	-6.8	-6.1
2.00	-8.3	-7.6	-6.8	-6.1	-5.4
1.00	-7.6	-6.8	-6.1	-5.4	-4.6
0.00	-6.8	-6.1	-5.4	-4.6	-3.9
-1.00	-6.1	-5.4	-4.6	-3.9	-3.1

% of GDP: Primary balance 2011: -6.8%. Net Govt debt 2011: 74.8%

Were Greece to pay market interest rates (around 15 percent) for any length of time their debt levels would quickly explode, which is of course why Greece has had two bailouts. But the table below shows that even with generous bailout terms to prevent Greek net debt growing as a proportion of GDP (not even taking into account the massive economic contraction currently occurring due to the severe austerity measures).

GREECE					
REAL 10 YR YIELDS	REAL GDP GROWTH				
	0.00	1.00	2.00	3.00	4.00
5.00	-3.7	-2.4	-1.2	0.1	1.3
4.00	-2.4	-1.2	0.1	1.3	2.6
3.00	-1.2	0.1	1.3	2.6	3.8
2.00	0.1	1.3	2.6	3.8	5.1
1.00	1.3	2.6	3.8	5.1	6.3
0.00	2.6	3.8	5.1	6.3	7.6

% of GDP: Primary balance 2011: 2.6%. Net gov't debt 2011: 124.8%

The UK mirrors the US. Their current fiscal deficit is so large that no realistic combination of interest rates and growth can absorb it in one year. Hence the stringent fiscal austerity measures we've seen in recent times, with more to come.

UK					
REAL 10 YR YIELDS	REAL GDP GROWTH				
	0.00	1.00	2.00	3.00	4.00
5.00	-7.5	-6.9	-6.3	-5.7	-5.0
4.00	-6.9	-6.3	-5.7	-5.0	-4.4
3.00	-6.3	-5.7	-5.0	-4.4	-3.8
2.00	-5.7	-5.0	-4.4	-3.8	-3.2
1.00	-5.0	-4.4	-3.8	-3.2	-2.5
0.00	-4.4	-3.8	-3.2	-2.5	-1.9

% of GDP: Primary balance 2011: -1.4%. Net Govt debt 2011: 60.2%

France's current primary deficit is not so bad, but even at current lows real 10 year interest rates are high enough to see their net debt

position deteriorate in the near term. That is, the primary gap is negative in virtually all scenarios.

FRANCE					
REAL 10 YR YIELDS	REAL GDP GROWTH				
	0.00	1.00	2.00	3.00	4.00
5.00	-4.4	-3.8	-3.2	-2.6	-2.0
4.00	-3.8	-3.2	-2.6	-2.0	-1.4
3.00	-3.2	-2.6	-2.0	-1.4	-0.8
2.00	-2.6	-2.0	-1.4	-0.8	-0.2
1.00	-2.0	-1.4	-0.8	-0.2	0.4
0.00	-1.4	-0.8	-0.2	0.4	1.0

% of GDP: Primary balance 2011: -1.4%. Net Govt debt 2011: 60.2%

Spain's net debt position is also set to deteriorate, even if the market gives them generous borrowing terms. They also seem an unlikely candidate for growing their way out of trouble.

SPAIN					
REAL 10 YR YIELDS	REAL GDP GROWTH				
	0.00	1.00	2.00	3.00	4.00
5.00	-2.9	-2.7	-2.3	-1.8	-1.3
4.00	-2.5	-2.3	-1.8	-1.3	-0.9
3.00	-2.0	-1.8	-1.3	-0.9	-0.4
2.00	-1.6	-1.3	-0.9	-0.4	0.0
1.00	-1.1	-0.9	-0.4	0.0	0.5
0.00	-0.7	-0.4	0.0	0.5	0.9

% of GDP: Primary balance 2011: -0.9%. Net Govt debt 2011: 45.7%

New Zealand looks bad in a primary gap table because of its recent hefty earthquake-related deficit. **Net debt is inevitably going to grow over coming years. However, the saviour, as we will see, is its current low net debt position.**²

NEW ZEALAND					
REAL 10 YR YIELDS	REAL GDP GROWTH				
	0.00	1.00	2.00	3.00	4.00
5.00	-4.5	-4.4	-4.4	-4.3	-4.3
4.00	-4.4	-4.4	-4.3	-4.3	-4.3
3.00	-4.4	-4.3	-4.3	-4.3	-4.2
2.00	-4.3	-4.3	-4.3	-4.2	-4.2
1.00	-4.3	-4.3	-4.2	-4.2	-4.1
0.00	-4.3	-4.2	-4.2	-4.1	-4.1

% of GDP: Primary balance 2011: -4.3%. Net gov't debt 2011: 4.2%

² The OECD measure nets out the assets of the NZ Super Fund.

FISCAL SUSTAINABILITY

SUSTAINABILITY

The primary gap is a partial measure, focusing on the adjustment required to stabilise the debt burden. It's fair to say that markets' focus at present is at least equally much on the stock of debt. **We now turn to simple analysis of the average primary balance that would be required to get net debt down to a "sustainable" position in ten years.** For argument's sake we define "sustainable" as the lower of 60 percent of GDP or current levels.

Italy (over) faces an uphill battle. Even if they were to manage average growth of 2 percent over the next ten years (which would out-do recent history, when they were busily borrowing), at real interest rates north of 3 percent some pretty hefty primary surpluses are required. And at a time of a rapidly ageing population. The maths is not pretty.

ITALY					
Average primary balance required over next decade for sustainable net debt					
REAL 10 YR YIELDS	REAL GDP GROWTH				
	0.00	1.00	2.00	3.00	4.00
5.00	8.3	7.4	6.6	5.7	4.9
4.00	7.4	6.6	5.7	4.9	4.1
3.00	6.6	5.7	4.9	4.1	3.2
2.00	5.7	4.9	4.1	3.2	2.4
1.00	4.9	4.1	3.2	2.4	1.6
0.00	4.1	3.2	2.4	1.6	0.8

% of GDP: Primary balance 2011: +2.3%. Net Govt debt 2011: 100.6%

The numbers for the US are not as ugly. Given the safe-haven status of US Treasuries, borrowing costs are likely to remain very low. At growth of say 2 percent, the government needs to run a roughly balanced budget to return net debt to a more sustainable level over the next decade. But a caveat – this analysis gives the average primary budget balance required over the next ten years. The latest US primary deficit was 7 percent of GDP in 2011. This is a very slow ship to turn. In practice, achieving primary balance over the next 10 years will require some very large surpluses in the second half of the next decade.

If, for example, we use the OECD forecast of net US debt of 80.7 percent of GDP in 2012, and not unrealistically assume the US will take until 2016 to stop adding to its net debt, they would need a whopping primary surplus of 4.3 percent of GDP the following five years to hit the 60 percent net debt target by 2021. If, on the other hand, the 2012 jump in debt is built in, but we generously assume the US manages to stop increasing their net debt as a percent of GDP in 2013, and start reducing it the following year, they would need

a primary surplus of 1.1 percent of GDP over the following 8 years to hit the target.

US					
Average primary balance required over next decade for sustainable net debt					
REAL 10 YR YIELDS	REAL GDP GROWTH				
	0.00	1.00	2.00	3.00	4.00
5.00	4.9	4.2	3.5	2.8	2.2
4.00	4.2	3.5	2.8	2.2	1.5
3.00	3.5	2.8	2.2	1.5	0.8
2.00	2.8	2.2	1.5	0.8	0.1
1.00	2.2	1.5	0.8	0.1	-0.6
0.00	1.5	0.8	0.1	-0.6	-1.2

% of GDP: Primary balance 2011: -6.8%. Net Govt debt 2011: 74.8%

The UK and France find themselves in a similar position. Their long-run situation is not so bad, but both countries need to turn around their current deficits quickly. And again, a massive challenge in both countries is the unfavourable demographic challenge coming with the looming wave of retiring baby boomers.

UK					
Average primary balance required over next decade for sustainable net debt					
REAL 10 YR YIELDS	REAL GDP GROWTH				
	0.00	1.00	2.00	3.00	4.00
5.00	3.3	2.7	2.1	1.5	0.9
4.00	2.7	2.1	1.5	0.9	0.2
3.00	2.1	1.5	0.9	0.2	-0.4
2.00	1.5	0.9	0.2	-0.4	-1.0
1.00	0.9	0.2	-0.4	-1.0	-1.6
0.00	0.2	-0.4	-1.0	-1.6	-2.2

% of GDP: Primary balance 2011: -1.4%. Net Govt debt 2011: 60.2%

FRANCE					
Average primary balance required over next decade for sustainable net debt					
REAL 10 YR YIELDS	REAL GDP GROWTH				
	0.00	1.00	2.00	3.00	4.00
5.00	3.0	2.4	1.8	1.2	0.6
4.00	2.4	1.8	1.2	0.6	0.0
3.00	1.8	1.2	0.6	0.0	-0.6
2.00	1.2	0.6	0.0	-0.6	-1.2
1.00	0.6	0.0	-0.6	-1.2	-1.8
0.00	0.0	-0.6	-1.2	-1.8	-2.4

% of GDP: Primary balance 2011: -1.4%. Net Govt debt 2011: 60.2%

Greece's position is not sustainable. To stabilise their net debt levels would require massive surpluses, even at very low interest rates. And bailout support will run out well before then.

FISCAL SUSTAINABILITY

GREECE					
Average primary balance required over next decade for sustainable net debt					
REAL 10 YR YIELDS	REAL GDP GROWTH				
	0.00	1.00	2.00	3.00	4.00
5.00	11.4	10.4	9.4	8.4	7.4
4.00	10.4	9.4	8.4	7.4	6.5
3.00	9.4	8.4	7.4	6.5	5.5
2.00	8.4	7.4	6.5	5.5	4.6
1.00	7.4	6.5	5.5	4.6	3.7
0.00	6.5	5.5	4.6	3.7	2.7

% of GDP: Primary balance 2011: 2.6%. Net govt debt 2011: 124.8%

Spain needs to deliver surpluses over coming years as well. Like most of the countries we're looking at, they have not had a surplus since 2007. The main risk for Spain is a sustained increase in their borrowing costs.

SPAIN					
Average primary balance required over next decade for sustainable net debt					
REAL 10 YR YIELDS	REAL GDP GROWTH				
	0.00	1.00	2.00	3.00	4.00
5.00	2.3	1.8	1.4	0.9	0.5
4.00	1.8	1.4	0.9	0.5	0.0
3.00	1.4	0.9	0.5	0.0	-0.5
2.00	0.9	0.5	0.0	-0.5	-0.9
1.00	0.5	0.0	-0.5	-0.9	-1.4
0.00	0.0	-0.5	-0.9	-1.4	-1.8

% of GDP: Primary balance 2011: -0.9%. Net Govt debt 2011: 45.7%

Finally, New Zealand's net debt position is good, and so a balanced budget on average is sufficient. But given the challenges of earthquake repair over the next few years, this means decent surpluses are required further out. And New Zealand faces significant demographic challenges too.

NEW ZEALAND					
Average primary balance required over next decade for sustainable net debt					
REAL 10 YR YIELDS	REAL GDP GROWTH				
	0.00	1.00	2.00	3.00	4.00
5.00	0.2	0.2	0.1	0.1	0.0
4.00	0.2	0.1	0.1	0.0	0.0
3.00	0.1	0.1	0.0	0.0	0.0
2.00	0.1	0.0	0.0	0.0	-0.1
1.00	0.0	0.0	0.0	-0.1	-0.1
0.00	0.0	0.0	-0.1	-0.1	-0.2

% of GDP: Primary balance 2011: -4.3%. Net govt debt 2011: 4.2%

THE UPSHOT

This analysis is deliberately simplistic, to highlight various themes impacting on fiscal solvency. There are many complicating factors:

- As alluded to with the US scenarios, our sustainable-in-ten-years analysis assumes that countries can start reducing their net debt from next year. Quickly turning around the fiscal position is difficult given lags in fiscal policy. **As such, a near-term deterioration in the net debt position in many countries is a done deal.** OECD forecasts for 2012 show rising net public debt for most key nations including US: +5.8%, UK: +4.7%, NZ: +5.5%, Greece: +5.0%, Spain: +3.3%, France: +2.6%. In practice, then, the job at hand is even tougher than our numbers indicate.
- There are other dynamics at play. Our financial conditions index (see last week's Market Focus) showed that financial conditions are proving a heavy drag on growth for the likes of Italy, whereas the US is experiencing looser conditions, which are providing a useful economic buffer.
- As mentioned, **demographics are deeply unfavourable for government debt in nearly all Western nations.**
- What interest rate will be payable, and what funds available, for some of these nations is becoming a political question rather than a market one. The risks around politics are impossible to measure!
- Our debt sustainability measure gives an average primary balance required over the next decade. But many countries are starting from a position of a large primary deficit. The rate of change in the deficit has a large impact on GDP growth. **Severe austerity can cause a marked reduction in GDP growth that can cause the debt to GDP ratio to blow out even more than a bit more spending might have done.** But too slow fiscal consolidation risks undermining credibility with markets. It can be difficult to strike the right balance between the two, even ignoring the short-termism inherent in a democratic political system.
- What is clear is that for countries with significant debt stocks, when the real interest rate on that debt starts to outpace GDP growth, you're fighting an uphill battle.** Maintaining market confidence is therefore of primary importance. Any debt position is sustainable as long as markets are in a relaxed, generous mood. But when the tide goes out, some nations can find themselves a long way from their towel.

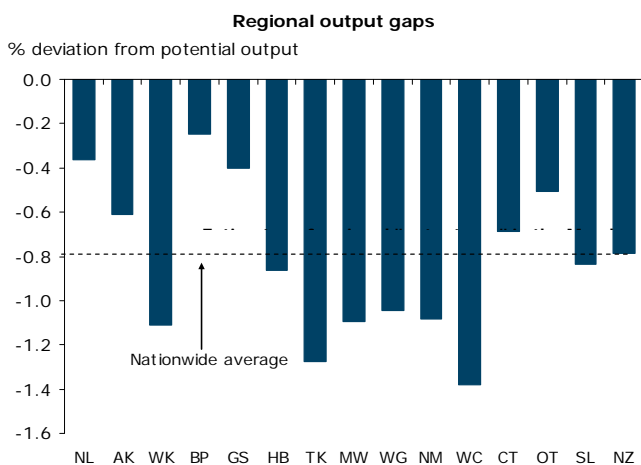
THE REGIONAL GAP

SUMMARY

Our regional output gap measures still show broad-based idle capacity across most regions, with continued regional divergences. Stronger regional activity contributed to a slight narrowing in most of our regional output gaps. Encouragingly, capacity based measures were broadly unchanged, but continue to indicate a smaller amount of economic slack than demand-based approaches. Our measures suggest there is enough spare capacity to temporarily accommodate a strengthening in demand, but the durability of the recovery will be under pressure unless action is taken to lift supply side capacity.

THE REGIONAL GAP

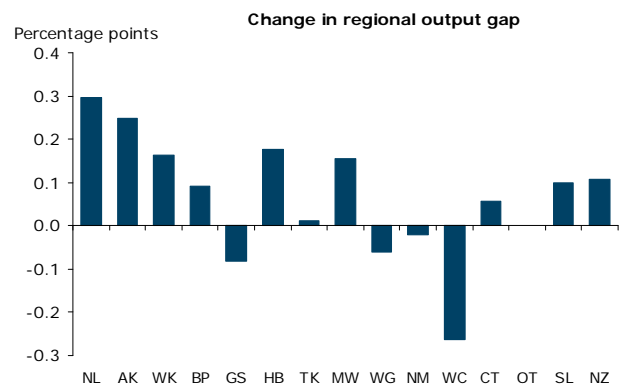
We present our updated regional output gap measures for the June 2011 quarter.³ **The regional measures provide us with a richer picture of how geographically concentrated nationwide trends are.** Regional measures are prone to a larger degree of uncertainty than nationwide data. But it is the broad trends and the regional variations that are the main focus.



³ Our regional output gap estimates are generated using economic activity data from the National Bank *Regional Trends*, unemployment rates from Statistics NZ's *HLFS*, and capacity utilisation measures from the National Bank *Business Outlook* survey. We chose a broad approach for two reasons. First, it minimises some of the error that typically surrounds statistics at the regional level. Second, the RBNZ uses a similar combination to derive its multivariate filter measure of the output gap for the entire economy. For the unemployment rate, activity, and surveyed capacity utilisation, we use a band-pass filter to derive trend estimates. The regional unemployment rates are advanced two quarters prior to filtering, as this is a lagging indicator. Individual activity, unemployment and capacity utilisation gaps for each region are then given an equal weighting.

Key points from the updated analysis are:

- **There is still idle capacity across most regions.** All regions continued to experience a negative output gap for the tenth consecutive quarter. The West Coast, Taranaki and Waikato are regions with the largest negative output gap. Regions with the narrowest output gap are the Bay of Plenty, Northland and Gisborne.
- **At the nationwide level the negative output gap narrowed by 0.1 percentage point.** There remain regional divergences, with nine of the 14 regions experiencing a narrowing margin of spare capacity. Auckland and Northland experienced the largest narrowing in their regional output gap, while the West Coast, Gisborne and Wellington experienced a widening (i.e. more negative) output gap.



Note: NL = Northland, AK = Auckland, WK = Waikato, BP = Bay of Plenty, GS = Gisborne, HB = Hawke's Bay, TK = Taranaki, MW = Manawatu-Whanganui, WG = Wellington, NM = Nelson-Marlborough, WC = West Coast, CT = Canterbury, OT = Otago, SL = Southland.

- **This narrowing was largely driven by stronger demand.** Regional activity from the NBNZ *Regional Trends* climbed 0.8 percent nationwide, but there were regional divergences with quarterly growth rates in a -1.1 to +2.1 percent range. Regions experiencing strong quarterly activity (such as Southland, Manawatu/Whanganui, Waikato and Taranaki) tended to see more sizeable declines in their negative activity gaps. Regions experiencing more negative activity gaps (notably Wellington) tended to be those achieving more subdued activity over the first half of the year.
- **Capacity-based metrics were largely offsetting.** The degree of labour market slack narrowed slightly. Labour-based measures showed less spare capacity for eight regions, particularly Auckland, the Waikato and Canterbury. A greater margin of slack is evident for four regions,

THE REGIONAL GAP

particularly Taranaki and Otago. Surveyed capacity utilisation declined nationwide, and was down for 12 regions. The largest declines were for the West Coast, Auckland, Manawatu/Whanganui and Wellington, whereas capacity utilisation actually rose in the Waikato and Southland.

- **Output gap estimates for Canterbury narrowed slightly.** There is a narrower margin of spare capacity in Canterbury than the rest of the country. Activity gaps in Canterbury are wider than the nationwide average, and barely budged, despite the 1.9 percent Q2 increase in regional activity, with activity levels still 0.7 percent below end of 2010 levels and 1.8 percent below historic peaks. Capacity-based metrics for the Canterbury region showed mixed readings. Surveyed capacity utilisation eased in Q2, but remains at high levels on account of the destruction of capital stock caused by the Canterbury earthquakes.

THE UPSHOT

Our regional output gap estimates show idle capacity remains in most regions that will be sufficient to absorb a modest pick-up in demand.

Whether this will be sufficient to accommodate the boost to demand pressures provided by a cyclical recovery from low levels, reinforced by the earthquake reconstruction and Rugby World Cup boost, remains to be seen.

There remain marked differences depending on the capacity indicator used. Demand-based approaches (NBNZ Regional Trends) continue to show a much greater margin of spare capacity than more supply-side approaches (i.e. NBBO capacity utilisation and the HLFS unemployment rate). Encouragingly, capacity-based measures did not tighten in Q2, despite the strengthening in demand. However, we will need to see more evidence of capacity building to be assuaged over concerns we have over truncated supply-side capacity. A key challenge will be rebuilding supply-side capacity in Christchurch, without significantly impeding resource allocation in other regions/sectors, which could truncate the durability of the recovery.

Our approach emphasises the importance of also examining the supply side of the economy when assessing the degree of medium-term inflationary pressure. There are also differences in resource pressures by region. Monetary policy can do little to assist the supply side, so there is a greater role for other policies (including regulatory) to help alleviate resource bottlenecks.

INTEREST RATE STRATEGY

SUMMARY

Post the Philly Fed, a lot of “bad” economic news is now priced into fixed income markets. While this suggests some counter recoil potential if we see less bad data surprises, uncertainty and financial fear remain powerful drivers, and cloud the market’s ability to interpret the outlook. Locally, rate hikes are sufficiently far away that the market is only pricing them as a bias, rather than getting specific about timing. With Australia pricing cuts, and the global outlook still challenging, this only makes for volatility, albeit “low beta” here in NZ.

MARKET THEMES

- Markets are priced for financial tail-risk economic bad news and. The former is real, but the data needs to printer even poorer to validate further movements.
- Markets are eagerly awaiting Fed chair Ben Bernanke’s Jackson Hole speech, hopeful QE3 will be announced.
- The disconnect between NZ and Australian monetary policy expectations remains a key differentiator, and is set to be a “battleground” over the next few weeks.

REVIEW AND OUTLOOK

Two themes dominate the global outlook. The first is the potential for a double-dip recession in the US, and the second is the sovereign debt crisis in Europe. We won’t dwell on the how these issues may unfold given our lack of comparative advantage in that arena. The collapse in the Philly Fed index was nothing short of jaw-dropping though how much was fear versus substance remains to be seen. Suffice to say that fixed income markets now need the economic data to print as poorly or worse to validate further moves lower, in the absence of a financial meltdown.

There is one factor that unifies both issues –and that’s QE. The market is certainly gunning for the Fed to do it, and all eyes are on Jackson Hole. But questions remain as to whether it would be effective, or whether doing so would be consistent with the inflation outlook. **Whatever happens, the one growing theme developing in the market is that bonds will be well supported either way. That is, the Fed either pursue QE, which would be good for bonds, or they don’t, and the economy falters, which would also be good for bonds!**

Markets are also gunning for the ECB to “do QE” too, but for different reasons. Indeed, whereas the Fed may do so to “honestly” bolster growth, the ECB may do it to monetize bad debts. With no magic potions available, and a strong desire on the part of Germany to avoid full liability and moral hazard, we certainly look to be going down the “muddle through” path, putting more pressure on the ECB. Japan may also “do” QE, again for different reasons. Their intent: weakening the yen.

All of this brings us to the issue of liquidity, and the impact it may have on markets here. **Although it may have been global turmoil (normally bad for NZ) that brought it about, if the solution is liquidity, we need to be careful when we make assumptions on how that will impact Australasia.** Australia and NZ certainly stand out for their high yields, performing economies and high credit ratings. This only makes the environment more difficult to read. With domestic data still upbeat, and the Australian market gunning for cuts, our suspicion is that markets local markets will be range-bound. **It certainly seems a step to far for the NZ market to move to price in cuts. But by the same token, we can’t see the market upping odds of hikes in the strained global environment.** Brace for more volatility, the low beta version.

PREFERRED BORROWING STRATEGIES

Markets remain schizophrenic and volatile, with yields rising on strong data and improved sentiment one day, only to collapse the next. The current episode of global uncertainty and markets stress is typical of the challenges we always expected to buffet the economy, and in the near term, it is yet another reason to be cautious. As such, we continue to favour sticking to floating for the time being. Time certainly is on the borrower’s side.

GAUGES FOR NZ INTEREST RATES

GAUGE	DIRECTION	COMMENT
RBNZ / OCR	↔/↑	Rate hike in Dec still likely.
NZ data	↑	Tone still fairly upbeat.
Fed Funds / front end	↔/↓	All eyes on Bernanke speech on Friday. Will he adopt QE3?
RBA	↔	RBA very well placed, unlikely to alter market pricing.
US 10 year	↔/↓	Carry to support yields.
NZ swap curve	↔/↓	Neutral, with a mild steepening bias.
Flow	↔	Quiet. All bets off, literally!
Technicals	↔/↑	2yr 3.10/3.40% range.

MARKET EXPECTATIONS FOR RBNZ OCR (BPS)

OCR DATES	LAST WEEK	THIS WEEK
Thu 15-Sep-11	+6	+4
Thu 27-Oct-11	+12	+10
Thu 8-Dec-11	+21	+18
Thu 26-Jan-12	+31	+25
Thu 8-Mar-12	+35	+29
Thu 26-Apr-12	+38	+38
Thu 14-Jun-12	+45	+39

TRADING THEMES WE FAVOUR AT PRESENT

We still like R+C supported RV trades like the NZ/AU 2yr spread. Policy biases can’t diverge for much longer. Although it seems odd to call it, the short end probably had more scope to adjust than the long end should things get really ugly, leading us to conclude that steepening is more likely than flattening.

CURRENCY STRATEGY

SUMMARY

Last week's weak Philly Fed reading put currency markets firmly back in "risk off" mode. With the odds of a double-dip recession in the US rising, NZD and AUD will remain vulnerable despite favourable interest rate differentials. However, EUR remains resilient amidst the continuing sovereign debt crisis in Europe, perhaps testament that the economic malaise is on both sides of the Atlantic. This week's Jackson Hole Symposium of global central bankers will be a focus, given that last year's event was the precursor to QE2.

MARKET THEMES

- Double-dip recession on the cards for the US.
- EUR stable despite crisis headwinds.
- Jackson Hole central bank symposium a focus for this week.
- NZD and AUD to suffer from "risk off" sentiment.
- JPY hits a new post WWII high. Watch for BOJ activity.

REVIEW AND OUTLOOK

The prospect of a double-dip recession in the US has brought the "risk off" theme back into focus, weighing on the NZD. NZD performance remains tied to global equity market movements. With the MSCI World Equity Index down 13.25 percent month-to-date, it is not surprising that the NZD has fallen by 7 percent over the same period. This week's NZ data calendar should lend some support to the NZD, with our expectation that the RBNZ survey 2-year ahead inflation print will remain high and the Q2 retail sales figures will point to a solid Q2 GDP outturn. However, expect any rally in NZD to be short-lived as global developments will be the dominating influence.

The Jackson Hole Symposium for the world's central bankers will be a focus for all markets this week. US bond markets seem to be pricing in the prospect of QE3 based on last year's experience and the continuing poor economic performance in the US. In our view QE3 could be a bridge too far given the current inflation outlook, but there is a chance that (in "Helicopter Ben's" priorities) inflation is playing second fiddle to growth. It seems we are not allowed recessions anymore. From a currency perspective QE3 would see renewed USD selling.

The European sovereign debt situation remains dire but this is having very little impact on the EUR at this stage. No doubt this is a function of the

fact there are similar issues on the other side of the Atlantic. It is a case of which is the worse-looking currency at present – USD or EUR?

Watch for further central bank activity in the currency market this week. With the JPY reaching a post WWII high, the prospect of more BoJ intervention this week cannot be ignored. In addition, speculation is rife that the Swiss National Bank could look to peg the Swiss franc in an attempt to halt the currency's appreciation.

NZD VS AUD: MONTHLY DIRECTIONAL GAUGES		
GAUGE	DIRECTION	COMMENT
Fair value	↔	Close to our fair value estimates.
Yield	↑	Opposing policy direction favours NZD.
Commodities	↔	Wary of cracks appearing here.
Partial indicators	↔/↑	Data still good in NZ.
Technicals	↔/↓	Short-term weakness.
Sentiment	↔	Risk off.
Other	↔	Global sentiment big driver.
On balance	↑	Yield and undervaluation support NZD.

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	↑	September hike off for now but yield still supports.
Commodities	↔	Starting to be wary of turns in key NZ-related commodities.
Risk aversion	↓	US double-dip recession prospect driving risk off.
Partial indicators	↑	NZ data better, US data worsening.
Technicals	↔	Trend turning.
AUD	↔	AUD at resistance.
Sentiment	↔	Underlying positive. However cracks appearing.
Other	↑	USD weakness the key driver for NZD this week.
On balance	↔/↓	Equity markets the key influence driving "risk off" weakness.

DATA EVENT CALENDAR

DATE	COUNTRY	DATA/EVENT	MKT.	LAST	NZ TIME
23-Aug	US	Chicago Fed Nat Activity Index - JUL	-0.48	-0.46	00:30
	US	Mortgage Delinquencies - 2Q	--	8.32%	02:00
	US	MBA Mortgage Foreclosures - 2Q	--	4.52%	02:00
	CH	HSBC Flash China Manufacturing PMI - AUG	--	48.9	14:30
	NZ	RBNZ 2yr Inflation Expectation - 3Q	--	3.0%	15:00
	GE	PMI Manufacturing - AUG A	50.6	52	19:30
	GE	PMI Services - AUG A	52.0	52.9	19:30
	EC	PMI Composite - AUG A	50.0	51.1	20:00
	EC	PMI Manufacturing - AUG A	49.5	50.4	20:00
	EC	PMI Services - AUG A	50.9	51.6	20:00
	UK	BBA Loans for House Purchase - JUL	31750	31747	20:30
	GE	Zew Survey (Current Situation) - AUG	85.0	90.6	21:00
	EC	ZEW Survey (Econ. Sentiment) - AUG	--	-7.0	21:00
	GE	ZEW Survey (Econ. Sentiment) - AUG	-26.0	-15.1	21:00
	UK	CBI Trends Total Orders - AUG	-12	-10	22:00
	UK	CBI Trends Selling Prices - AUG	--	4	22:00
24-Aug	EC	Euro-Zone Consumer Confidence - AUG A	-12.4	-11.2	02:00
	US	New Home Sales - JUL	312K	312K	02:00
	US	New Home Sales MoM - JUL	0.0%	-1.0%	02:00
	US	Richmond Fed Manufact. Index - AUG	-7	-1	02:00
	NZ	Trade Balance - JUL	-100M	230M	10:45
	NZ	Exports - JUL	3.85B	3.97B	10:45
	NZ	Imports - JUL	3.90B	3.74B	10:45
	NZ	Trade Balance 12 Mth YTD - JUL	1104	1021	10:45
	JN	Corp Service Price Index (YoY) - JUL	-0.5%	-0.7%	11:50
	AU	Conference Board Leading Index - JUN	--	-0.1%	12:00
	AU	Construction Work Done - 2Q	1.0%	0.7%	13:30
	GE	IFO - Business Climate - AUG	111.0	112.9	20:00
	GE	IFO - Current Assessment - AUG	119.8	121.4	20:00
	GE	IFO - Expectations - AUG	102.8	105.0	20:00
	EC	Industrial New Orders NSA (YoY) - JUN	11.9%	15.5%	21:00
	EC	Industrial New Orders SA (MoM) - JUN	0.4%	3.6%	21:00
25-Aug	US	Durable Goods Orders - JUL	2.1%	-1.9%	00:30
	US	Durables Ex Transportation - JUL	-0.5%	0.4%	00:30
	US	Cap Goods Orders Nondef Ex Air - JUL	-1.6%	0.4%	00:30
	US	Cap Goods Ship Nondef Ex Air - JUL	--	1.1%	00:30
	US	House Price Purchase Index QoQ - 2Q	-0.1%	-2.5%	02:00
	US	House Price Index MoM - JUN	0.2%	0.4%	02:00
	NZ	Food Prices (MoM) - JUL	--	1.4%	10:45
	NZ	Retail Sales Ex Inflation(QoQ) - 2Q	--	0.9%	10:45
	UK	Nationwide Consumer Confidence - JUL	45	51	11:01
	AU	CBAHIA House Affordability - 2Q	--	55.7	13:00
	GE	GfK Consumer Confidence Survey - SEP	5.1	5.4	18:00
	UK	CBI Reported Sales - AUG	-10	-5	22:00
	CH	Leading Index - JUL	--	101.76	UNCONFIRMED
	GE	Import Price Index (MoM) - JUL	0.3%	-0.6%	UNCONFIRMED
	GE	Import Price Index (YoY) - JUL	7.0%	6.5%	UNCONFIRMED

Continued on following page

DATA EVENT CALENDAR

DATE	COUNTRY	DATA/EVENT	MKT.	LAST	NZ TIME
25-Aug	UK	Nat'wide House prices sa (MoM) - AUG	- -	0.2%	UNCONFIRMED
	UK	Nat'wide House prices nsa(YoY) - AUG	- -	-0.4%	UNCONFIRMED
26-Aug	US	Initial Jobless Claims - 20-AUG	405K	408K	00:30
	US	Continuing Claims - 13-AUG	3700K	3702K	00:30
	JN	Tokyo CPI YoY - AUG	-0.2%	0.5%	11:30
	JN	Tokyo CPI Ex-Fresh Food YoY - AUG	-0.1%	0.4%	11:30
	JN	Tokyo CPI Ex Food, Energy YoY - AUG	-0.6%	0.3%	11:30
	JN	Natl CPI YoY - JUL	0.0%	-0.4%	11:30
	JN	Natl CPI Ex-Fresh Food YoY - JUL	-0.1%	-0.2%	11:30
	JN	Natl CPI Ex Food, Energy YoY - JUL	-0.6%	-0.8%	11:30
	EC	Euro-Zone M3 s.a. 3 mth ave. - JUL	2.3%	2.2%	20:00
	EC	Euro-Zone M3 s.a. (YoY) - JUL	2.2%	2.1%	20:00
	UK	GDP (QoQ) - 2Q P	0.2%	0.2%	20:30
	UK	GDP (YoY) - 2Q P	0.7%	0.7%	20:30
	UK	Index of Services (MoM) - JUN	-0.1%	1.6%	20:30
	UK	Index of Services (3mth/3mth) - JUN	0.5%	1.2%	20:30
	GE	Retail Sales (MoM) - JUL	- -	4.5%	UNCONFIRMED
	GE	Retail Sales (YoY) - JUL	- -	-1.0%	UNCONFIRMED
27-Aug	US	GDP QoQ (Annualized) - 2Q S	1.1%	1.3%	00:30
	US	Personal Consumption - 2Q S	0.2%	0.1%	00:30
	US	GDP Price Index - 2Q S	2.3%	2.3%	00:30
	US	Core PCE QoQ - 2Q S	2.1%	2.1%	00:30
	US	U. of Michigan Confidence - AUG F	56.0	54.9	01:55
	CH	Industrial Profits YTD YoY - JUL	- -	28.7%	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: Global market ructions intensified further last week. Encouragingly for NZ, Inc, export commodity prices held firm and migration outflows have stabilised at low levels. We expect this week's RBNZ Survey of Expectations to show inflation expectations remaining considerably above the midpoint of the inflation target, with Q2 data for retail confirming the resilience of consumer spending. We expect a hike in the December *MPS*, but this is conditional on global volatility subsiding.

DATE	DATA/EVENT	ECONOMIC SIGNAL	COMMENT
Tue 23 Aug (3:00pm)	RBNZ Survey of Expectations – Q3	High	The critical 2-year-ahead CPI inflation measure should remain around 3 percent.
Wed 24 Aug (10:45am)	Overseas Merchandise Trade – July	Into the red	We expect a trade deficit of around \$170m for July, with the annual surplus to remain around \$1bn.
Thur 25 Aug (10:45am)	Food Price Index - July	Up	A 1 percent increase is expected, with annual food price inflation easing to 6.5 percent.
Thur 25 Aug (10:45am)	Retail Trade Survey– Q2	Resilience	Nominal total retail values are expected to rise 1.8 percent (+2.2 percent for core retail). Retail volumes are expected to rise 0.9 percent (+1.5 percent for core).
Tue30 Aug (10:45am)	Building Consents – July	Building	A 2 percent increase in residential consents is envisaged. Stronger increases are expected for ex-apartments.
Wes 31 Aug (1:00pm)	National Bank Business Outlook – Aug	- -	- -
Wed 31 Aug (3:00pm)	RBNZ Credit Aggregates - July	Ongoing deleveraging	We expect household and business credit growth in the 1 percent annual range, with a fall in agricultural credit.
Thur 1 Sep (10:45am)	Overseas Trade Indexes - Q2	Peaking?	The OTI terms of trade is forecast to rise 1.5 percent. A 2 percent rise in export and 2 percent fall in import volumes is forecast.
Thur 1 Sep (1:00pm)	ANZ Commodity Price Index - Aug	- -	- -
Wed 7 Sep (early am)	<i>GlobalDairyTrade</i> dairy auction	Holding	We expect overall dairy prices to stabilise following recent declines.
Wed 7 Sep (10:45am)	SNZ Wholesale Trade Survey – Q2	Up	We expect a 1.5 percent increase in wholesale sales, with volumes rising approximately 0.8 percent.
Thur 8 Sep (10:45am)	SNZ Economic Survey of Manufacturing – Q2	Sector differences	Ex-primary manufacturing volumes are forecast to fall 1 percent q/q, with primary manufacturing volumes up 3 percent q/q.
Thur 8 Sep; (10:45am)	SNZ Value of Building Work Put in Place – Q2	Down	Residential and non-residential volumes are expected to decline 2 percent.
Thur 8 Sep (1:00pm)	ANZ Job Ads - August	- -	- -
Fri 9 Sep (10:45am)	SNZ Electronic Card Transactions - Aug	Increasing	A 0.4 percent increase in retail ECT spending is expected, while core ECT spending is envisaged to rise by 0.5 percent.
Tue 13 Sep (10:45am)	SNZ Food Price Index	Flat	No change is expected. Announced cuts to dairy prices should push down grocery prices. Other price components to lift.
Thur 15 Sep (9:00am)	RBNZ September MPS	On hold for now	Global considerations will encourage patience. Providing global ructions subside we expect a 50 basis point hike in the Dec MPS.
Fri 16 Sep (1:00pm)	ANZ Roy Morgan Consumer Confidence	- -	- -
On Balance		Local vs global	Domestic gauges still resilient, but global concerns suggest some caution further out.

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)	0.5	0.8	0.7	1.1	1.5	0.7	1.0	0.9	0.8	0.7
GDP (% yoy)	1.1	1.4	1.9	3.1	4.2	4.1	4.4	4.2	3.4	3.4
CPI (% qoq)	2.3	0.8	1.0	0.8	0.7	0.6	0.8	0.7	0.6	0.8
CPI (% yoy)	4.0	4.5	5.3	5.0	3.3	3.1	2.9	2.8	2.7	2.9
Employment (% qoq)	-0.3	1.3	0.0	0.7	0.6	0.7	0.5	0.5	0.4	0.4
Employment (% yoy)	1.3	1.8	2.0	1.7	2.6	2.0	2.5	2.3	2.1	1.8
Unemployment Rate (% sa)	6.7	6.5	6.5	6.2	5.9	5.6	5.5	5.3	5.3	5.3
Current Account (% GDP)	-4.1	-4.2	-4.2	-4.2	-3.6	-3.9	-4.2	-4.6	-4.9	-5.0
Terms of Trade (% qoq)	0.8	0.9	1.5	3.0	1.1	-0.7	-0.8	-0.8	-0.9	-0.7
Terms of Trade (% yoy)	12.3	6.8	6.3	6.3	6.5	4.8	2.4	-1.3	-3.2	-3.2

	Nov-10	Dec-10	Jan-11	Feb-11	Mar-11	Apr-11	May-11	Jun-11	Jul-11	Aug-11
Retail ECT (% mom)	1.0	-0.8	2.4	-0.2	1.4	1.5	-0.7	1.1	0.4	..
Retail ECT (% yoy)	6.3	4.4	5.7	6.2	6.6	10.0	6.8	9.0	8.0	..
Credit Card Billings (% mom)	0.1	-1.7	3.9	-0.5	-1.2	1.8	0.4	0.5	1.0	..
Credit Card Billings (% yoy)	4.3	2.4	6.2	5.9	2.1	6.6	5.5	4.6	7.3	..
Car registrations (% mom)	13.2	-8.9	1.1	-1.8	0.0	-5.6	3.3	-2.3	-1.9	..
Car registrations (% yoy)	23.5	6.4	6.8	2.8	-1.0	-10.5	-3.7	-9.5	-6.0	..
Building consents (% mom)	8.3	-18.5	9.2	-9.7	2.5	-1.2	2.3	-1.4	..	..
Building consents (% yoy)	-8.9	-26.4	-14.9	-28.8	-26.1	-32.1	-21.9	-25.7	..	..
REINZ House Price Index (% yoy)	-1.9	-1.6	-2.6	-0.7	-1.8	-0.4	-0.7	0.0	0.5	..
Household Lending Growth (% mom)	0.0	0.1	0.1	0.1	-0.1	0.2	0.1	0.1	..	..
Household Lending Growth (% yoy)	1.8	1.6	1.5	1.5	1.2	1.2	1.2	1.1	..	..
ANZ Roy Morgan Consumer Confidence	114.5	112.2	117.1	108.1	101.4	101.4	103.3	112.5	109.4	113.3
NBNZ Business Confidence	33.2	29.5	..	34.5	-8.7	14.2	38.3	46.5	47.6	..
NBNZ Own Activity Outlook	35.3	34.5	..	36.6	14.7	29.5	39.7	38.7	43.7	..
Trade Balance (\$m)	-177	-218	9	184	583	1149	551	230	..	..
Trade Balance (\$m ann)	1363	1172	909	765	741	1230	1012	1021	..	..
ANZ World Commodity Price Index (% mom)	2.1	1.6	4.3	2.7	4.7	1.6	0.4	-1.2	-0.1	..
ANZ World Commodity Price Index (% yoy)	13.1	12.1	16.3	20.3	23.5	19.8	19.6	20.6	22.3	..
Net migration (sa)	600	700	420	440	-530	-120	-320	-290	-220	..
Net migration (annual)	11519	10451	8689	8249	6554	5508	4625	3867	2867	..

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	May-11	Jun-11	Today	Sep-11	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13
NZD/USD	0.824	0.829	0.834	0.88	0.91	0.92	0.93	0.93	0.93	0.92
NZD/AUD	0.772	0.773	0.804	0.80	0.81	0.82	0.83	0.82	0.82	0.82
NZD/EUR	0.572	0.572	0.585	0.60	0.61	0.61	0.61	0.60	0.60	0.60
NZD/JPY	67.16	66.80	64.04	66.0	68.3	69.0	67.0	67.0	67.0	68.1
NZD/GBP	0.501	0.517	0.511	0.53	0.55	0.54	0.55	0.53	0.53	0.53
NZ\$ TWI	70.9	71.2	72.0	74.1	75.9	76.3	76.7	75.8	75.8	75.7
INTEREST RATES	May-11	Jun-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	3.00	3.25	3.50	3.75	4.00	4.50
NZ 90 day bill	2.69	2.67	2.96	2.80	3.40	3.50	3.90	4.00	4.40	4.90
NZ 10-yr bond	5.11	5.07	4.46	4.40	4.40	4.50	4.60	4.80	4.90	5.00
US Fed funds	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
US 3-mth	0.25	0.25	0.29	0.35	0.35	0.35	0.35	0.35	0.35	0.35
AU Cash Rate	4.75	4.75	4.75	4.75	4.75	4.75	4.75	4.75	4.75	4.75
AU 3-mth	5.02	5.03	4.83	4.90	4.90	4.90	4.90	4.90	4.90	4.90

	19 Jul	15 Aug	16 Aug	17 Aug	18 Aug	19 Aug
Official Cash Rate	2.50	2.50	2.50	2.50	2.50	2.50
90 day bank bill	2.67	3.01	2.94	2.94	2.89	2.87
NZGB 04/13	3.36	2.97	3.01	2.97	3.00	2.94
NZGB 04/15	4.05	3.56	3.60	3.56	3.57	3.51
NZGB 03/19	4.84	4.31	4.35	4.31	4.31	4.25
NZGB 05/21	5.03	4.48	4.52	4.48	4.48	4.42
2 year swap	3.51	3.37	3.41	3.38	3.35	3.27
5 year swap	4.41	4.20	4.23	4.19	4.15	4.08
RBNZ TWI	73.3	72.2	71.4	71.5	71.4	70.8
NZD/USD	0.8463	0.8372	0.8322	0.8339	0.8326	0.8221
NZD/AUD	0.7971	0.8038	0.7944	0.7956	0.7941	0.7932
NZD/JPY	66.92	64.31	63.95	63.97	63.81	62.92
NZD/GBP	0.5264	0.5140	0.5083	0.5076	0.5042	0.4989
NZD/EUR	0.5997	0.5856	0.5768	0.5791	0.5786	0.5746
AUD/USD	1.0617	1.0416	1.0476	1.0482	1.0485	1.0364
EUR/USD	1.4112	1.4296	1.4428	1.4399	1.4390	1.4307
USD/JPY	79.07	76.81	76.84	76.71	76.64	76.53
GBP/USD	1.6076	1.6288	1.6371	1.6428	1.6514	1.6478
Oil (US\$/bbl)	95.94	87.82	87.82	86.67	87.55	82.41
Gold (US\$/oz)	1604.30	1763.55	1765.40	1785.40	1791.15	1843.55
Electricity (Haywards)	4.30	15.07	22.50	18.60	8.12	8.07
Baltic Dry Freight Index	1330	1306	1344	1371	1414	1462
Milk futures (USD)	154	147	147	149	151	151

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