

Australian weekly

Week beginning 7 September 2009

- Australia: Next week's data critical for RBA's timing.
- Australian data: WBC-MI Consumer Sentiment, retail trade, housing finance & labour force data previewed.
- New Zealand: RBNZ on hold this week; MPS likely to retain dovish 90 day rate projections given concerns over NZD strength.
- New Zealand data: Building work & terms of trade previewed.
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Information contained in this report was current as at 4 September 2009

Next week's data critical for RBA's timing

While the timing of the RBA's first move is occupying a lot of attention (see below). The key force that is likely to dominate the 12 month outlook for financial markets is the attitude which markets adopt toward risk.

Markets remain transfixed with the issue of the risk trade. Through the second half of 2008 markets shunned risk. From around February, markets embraced risk. If investors want to embrace risk they will buy commodities, commodity currencies, credit, swaps (against bonds), and equities. They will sell US Treasuries, bonds issued by commodity economies (margins widen against Treasuries), and US dollars.

The catalyst for determining the risk sentiment is the US equity market. In early June doubts emerged about the sustainability of the US equity market and investors started to move away from risk assets. However the US results season in July revealed that 73% of companies had exceeded market expectations. That was a misleading signal since the overperformance resulted from companies over achieving on cost cutting as evidenced by the sharp rise in the US unemployment rate – generally firms underperformed on revenue. Risk once again became popular for investors.

Developments over the last week are pointing to a possible return to risk aversion. The Dow fell for four consecutive days – the first time since May; the Vix Index of volatility rose by 10%; the Shanghai Share Index closed the month down by 20%; and there was a 15 basis point fall in US long bond rates.

We assess that US equity markets have run ahead of the capacity of the economy to deliver the earnings results required by the current pricing. While the 'bulls' point to USD 2 trillion in uninvested funds waiting to join the market (and we cannot dismiss the possibility of a liquidity led final upswing) we favour the view that US equities are now expensive and the short term growth outlook does not support current pricing. Issues with the undercapitalised financial sector and the overburdened and under employed consumer will remain extreme headwinds for the US economy.

We envisage a period in the second half of 2009 when investors will once again shun risk with the associated falls in US yields, AUD yields, and a widening of swap spreads. However, global growth momentum is likely to attain a more sustainable basis through 2010 which would see a resumption of the risk style trades and a sustainable increases in yields.

Markets are pricing two rate hikes from the RBA by year's end with a near 50% probability of a 25 bp tightening in October. Overall the cash rate is expected to be 125 to 150 bps higher by June next year. We think that the increase by mid next year will be more like 50 to 75 bps with the first move not eventuating until February. However, given that we know the RBA assesses current rates to be too low (at "emergency levels") that will only be the case if the data over the next few weeks shows the economy is losing momentum. Our current growth forecasts favour that assessment.

When the Bank starts to move we assess that the first 100 bps of rate hikes will be relatively comfortably absorbed by the economy, but once the variable mortgage rate exceeds 6.25% (we assess that a significant proportion of borrowers are on rates well below the "standard" variable rate of 5.80%), rate hikes will elicit significant negative responses in confidence and spending. Our analysis of the

response of Consumer Sentiment to rate hikes in previous rate hike cycles indicates that the 'tipping point' (level at which rate hikes really bite) for the variable mortgage rate has decreased over time – 8.75% in 1994, 7.3% in 2000 and 7% in 2003. With household debt to income ratios up from 60% (1994) and 130% (2003) to 165% (2009) the 'tipping point' of the variable mortgage rate will be at an increasingly lower level. That is why we expect the cycle to be measured, to peak at around a cash rate of 5.5% to 6% (variable mortgage rate of 7.5% to 8%) and last for two to three years.

Every Board meeting from now on carries the real risk that the Bank will begin its tightening cycle. Before the next Board meeting it will receive an extensive range of domestic data – two reads on retail sales; two reads on building approvals; GDP; business and consumer confidence; two reads on job ads, employment, new home sales and the other monthly data series.

A key risk that the Bank would like to clarify is how resilient will retail sales be to the cessation of the government's transfer payments? (Note that the June retail sales report showed a 1.4% fall following two very strong reads in April and May.) Has the June report signalled an emerging downtrend in consumer spending or is it just a correction to the excessive strength in April and May? July and August retail sales would be very helpful in settling that uncertainty. We expect that both July (to be released next week on September 9) and August retail sales will be negative.

The next reads of business and consumer confidence will be important. Recall that the increase in consumer sentiment over the last three months is the strongest on record. But as we pointed out in last week's note it seems extraordinary that, for instance, the "5 year outlook" component in the Index is at its highest read on record. With the huge uncertainty enveloping the global economy it seems bizarre that the 5 year outlook could be so strong. Indeed, the expectations component of the Index is near a record high and much higher than the component that measures current conditions. There is also a risk that the consumer will be unnerved by the widespread media discussion of rate hikes. With consumer and business confidence moving so closely together, a solid correction to consumer confidence (which is my expectation) would be important information for the timing of the rate hike decision – recall the Board Minutes referred to the risk of tightening too early and choking off confidence and spending before it had gathered sufficient momentum.

We are forecasting substantial job losses of up to 100,000 through to the end of this year. While we accept that the Bank will have no problems in tightening while the unemployment rate is rising, a sterner test is whether the Bank would be prepared to raise rates while employment was contracting rapidly. Clearly, for our view that the Bank will be on hold in 2009 it is almost compulsory that our expectation of substantial job losses materialises, beginning with our forecast of a loss of 25,000 jobs in August.

If it is clear from the data over the next month that the economy has sustained its momentum into the September quarter and the jobs market has stabilised, then it is hard to argue with an immediate rate hike given the Bank's concern with its current "emergency" rate setting. Next week will be very important for casting light on these issues.

Bill Evans, Chief Economist

Data wrap

Aug TD–MI inflation gauge

- The TD–Melbourne Institute inflation gauge was unchanged in August following a record 0.9% spike in July (that was exaggerated by stronger than usual seasonal increases in utilities and council rates). In August, sources of higher prices noted included private motoring, alcohol, and fruit and vegetables. These were offset by lower prices for holidays, audio, visual and computing equipment, and financial services. With the flat August result below the 0.13%*mt* rise in the gauge from a year ago, annual growth in the inflation gauge eased to 1.7%*yr* from 1.9%*yr* previously, below the bottom of the 2% to 3% RBA target band for the fourth consecutive month.
- Despite the tepid August result, with the July spike, and May's –0.3%*mt* result dropping out, 3*mt* growth continued to rise to 1.29% from 1.01% previously, the highest since March, and well above the Q2 mid-month-of-the-quarter 3*mt* pace of –0.38%. This affirms our expectation for a higher quarterly headline inflation pace in Q3 than Q2. Our preliminary forecast is for a Q3 headline CPI of 0.9%*qtr* (vs 0.5%*qtr* prev), which would allow a fall in the annual rate to 1.2%*yr* from 1.5%*yr* previously. However, if the Q3 headline CPI prints exactly at the gauge's current 3*mt* pace of 1.3%*qtr*, the annual headline inflation rate would nudge higher to 1.6%*yr* (we caution that the Q2 mid-month-of-the-quarter gauge pace was –0.38%*qtr*, well below the CPI result of 0.5%*qtr*, and the gauge has been oscillating in recent quarters from underestimate to overestimate relative to the CPI result, so the 1.29%*qtr* pace for Q3 is shaping up to be an overestimate of the official headline CPI).
- The detail of the August inflation gauge showed an easing in the breadth of price pressures relative to July, not surprising given the one-off seasonal spikes at the beginning of the new financial year. Prices rose in 28 items (vs 32 prev), were unchanged in 47 items (vs 46 prev), and fell in 15 items (vs 12 prev). This gave a net balance of 13 price increases, down from a net 20 previously. This was well below the net balance from a year ago (+33 rises net in Aug-08). The 6*mt* moving average of this net balance also edged lower to +12.5 from +15, the lowest since Jun-07.

Q2 business indicators

- Two key themes that we anticipated we're evident in the Business Indicators data.
- First, profits were hit hard in the June quarter as the global downturn impacted. Australia experienced a significant decline in national income as commodity prices dropped from record highs. Company profits fell by 7.8%.
- Second, business inventories were run-down sharply in the June quarter. In our view this was largely unintended, with firms caught out by the strength of private spending. This run-down of inventories ties in with the combination of robust sales, sluggish imports and falling hours worked. Inventories declined by 3.4% implying a 0.8*ppts* subtraction from growth.
- As for the implications for Q3, the moving pieces leave considerable uncertainty. We see the potential for large swings in net exports, inventories and sales momentum.

Jul private credit

- Credit to the private sector, after expanding by just 0.3% over the five months to June, increased by 0.2% in July. The drag from declining business credit was less pronounced than in recent months.
- Housing credit growth has stepped up from the low of mid-2008. New lending, housing finance, has rebounded strongly in response to the lowest variable mortgage rates in 41 years and government incentives.
- Investor housing credit growth stirred, increasing by 0.25% in July - up from 0.11% last month.
- Business credit contracted by 0.3%, half that of June.
- Going forward, while the RBA's sharp cuts to interest rates will continue to drive an upswing in new lending to the housing sector, we expect credit growth to be constrained by weak business credit as firms look to lower gearing and given tighter lending standards.

Jul dwelling approvals

- Total dwelling approvals surged 7.7% in July, after a 9.9% bounce in June from an 11.4% drop in May. The result was well above market expectations of a 3.3% gain. Approvals are now up 27.7% from their January low.
- The rise was mainly driven by another big jump in private sector units (includes apartments); +35.3%*mt* after a 30% jump in June from the 44.2% slump in May. A quirk of percent changes – their non-additivity – means this still leaves July approvals down 1.7% on their April level. Over half of the rise in non-seasonally adjusted terms was in buildings with four or more storeys suggesting there may be some easing in the financing problems affecting these developments. However, the extreme volatility clearly makes it hard pinpoint underlying trends.
- The larger, more stable private sector houses segment posted a more subdued 1.5% gain in July though approvals are still up 23% from their December low, with annual growth positive (+4.7%*yr*) for the first time since Jun-08.
- By state, approvals were up 19% in NSW, although private sector houses were off slightly (–0.3%). Vic and Qld also posted solid gains, up 8.6% and 4.3% respectively. Total approvals fell 9.5% in SA and 3.3% in WA. The jump in units was concentrated in NSW and Victoria.
- The value of renovation approvals also jumped in July, +12.8%*mt* after a flat Q2 – tentative evidence perhaps of a quickening in both discretionary consumer spending and housing market activity (i.e. renovations aimed at resale).
- The value of non-res building approvals softened, down 0.3% in July. However this followed an 87.4% spike in June – the massive jump in education sector approvals that drove the June jump was also behind the resilience in July. Indeed approvals in the education sector rose another 16.3% in the month in unadjusted terms.

Data wrap

- Overall the recovery in dwelling approvals continues to run in fits and starts and is still lagging a long way behind other indicators, particularly housing finance approvals. The divergence partly reflects difficulties in securing developer finance. We suspect it is also a delayed response – First Home Buyers in particular require a signed contract to be eligible for Govt bonus payments and would have had more urgency in securing finance than building approval. As such, there is clearly more recovery to come with upside potential if developer financing problems start to ease.
- While markets were not expecting a move, they have been confidently anticipating a move in October and a further move in November/December. The Bank has given them little encouragement in today's Statement for an imminent move.

Q2 current account balance & net exports

- The Q2 current account deficit more than doubled to \$13.347bn from \$6.346bn (mkt \$10.7bn, WBC f/c \$11.0bn). Using our forecast of Q2 GDP, this lifted the deficit to 4.5% of GDP from 2.1%, the highest since 2008Q2, while the rolling annual deficit fell to 3.2% of GDP from 3.4%.
- The trade balance fell from a surplus of \$4.267bn to a deficit of \$1.667bn, as the terms of trade deteriorated 7.4%qtr and import volumes rose after 6 months of weakness.
- Export values fell 14.9% with prices down 15.8%, but volumes up 1.0% (2nd consecutive rise). Rural exports saw a price driven 9.0% fall, while volumes rose 1.2% (3rd consecutive rise). Non-rural exports saw a price driven 18.1% plunge, but volumes rose 4.0% to their highest level in a year. "Other" goods exports plunged 37.1%, with volumes down 27.9% (vs +14.1% prev) driven by volatile non-monetary gold.
- Import values fell 7.2% as the 14.4%qtr AUD/USD surge saw prices fall 9.1%. Consumption goods volumes bounced 11.4% consistent with H1 consumption strength amidst the fiscal handouts. However, affirming that the rise in Q2 equipment investment came largely from inventories, capital goods volumes fell 6.2%. Intermediate goods volumes rose 1.7%. Total goods import volumes rose 0.2% in line with revised guidance from the ABS, however, a 9.6% jump in service volumes (led by a 15.7% jump in travel service volumes and a 12.3% rise in "other" services) saw total import volumes rise a stronger than expected 2.1% after a 7.6% plunge previously and a cumulative 14.9% fall over Q4 and Q1.
- With export values weaker than implied by the monthly data, and the constraining influence of the fall in non-monetary gold volumes, total export volumes were tempered to a 1.0% rise. Add in the service driven upside in import volumes and net exports have reverted to being a deduction from GDP growth in Q2 having made a cumulative +3.9ppt contribution over the prior two quarters. Net exports will detract 0.2ppts from growth.
- The net income deficit rose \$1.064bn to \$11.489bn. A greater Australian equity market performance vs the US (after adj for A\$ jump) relative to Q1 saw net equity income outflows jump as expected (+29.8%). However, despite the strong A\$ and lower USD 3mth rates, net debt income outflows surprisingly also increased (+3.3%).
- The key sentence in the final paragraph of the Governor's Statement was slightly moderated. In August, he referred to "present accommodative setting of monetary policy is appropriate" and now he refers to "present accommodative setting of monetary policy remains appropriate for the time being." The final sentence in the Statement has changed to indicate that the Board is now actively considering rate hikes, consistent with the August Board meeting minutes which noted "In discussing the timing and process of removing some of the current expansionary policy setting ...". The final sentence in the Statement now begins "The Board will continue to adjust monetary policy" rather than "The Board will continue to monitor how economic and financial conditions unfold ..."
- However, it is certainly not committing itself to a move in the near future.
- The detailed changes in this Statement relative to August centred mainly around a more upbeat view on business investment.
- The Bank still believes that in the near term spending is likely to soften, although the description of "sluggish output" has not been repeated.
- The Bank's sentiment with regard to the global economy has strengthened a little, with optimism on China and the region, and the removal of the word "tentative" with regard to the major economies approaching a turning point. However, the Statement continues to highlight ongoing concern about the impact of financial balance sheets on the growth profile of the developed economies.
- We have not changed our view that the data flow over the next few months will not provide the Bank with a sufficient case to tighten before the end of the year. The sentiment in this Statement is consistent with our view that the Bank is keeping its options open and in no way intends to signal a likely imminent rate hike.

Q2 GDP

- Australia's quarterly growth rate increased from 0.4% in the March quarter to 0.6% in the June quarter. Consumer spending growth increased from 0.5% in March to 0.8% in June. Plant and equipment investment recovered from a 10% contraction in March to grow by 5.7% in June and while dwelling investment contracted at a slightly faster pace (5.5% in June compared to 4% in March) overall domestic demand expanded by 0.8% compared to a contraction of 1.1% in March. A key driver behind the acceleration in spending growth was the Government's fiscal stimulus package which supported both consumer and business spending.
- The overall GDP growth number was considerably higher than market expectations (0.2%) and our own forecast (0.1%). However the "surprises" were not in the core spending components but in the softer than expected rundown in

Data wrap

private stock levels (subtracted 0.4% from GDP rather than the estimated 0.8%) and a modest rise in public stocks (likely to be defence and state government activities in utilities) which reversed a long sequence of falls to add 0.5% to GDP growth.

- The smaller than expected rundown in stocks in the June quarter means that the likely upturn in the stock cycle in the September will be more mild than previously expected. The rebuilding of stocks could add around 1.2ppt's to GDP growth next quarter. That will be needed to offset the likely contraction in consumer spending in the aftermath of the cessation of the government's transfer payments and a further likely contraction in dwelling investment. With imports likely to increase further as companies rebuild stock levels we see a genuine risk of a negative read for the September despite the inventory rebuild.
- These issues will undoubtedly focus the attention of the Reserve Bank as it plans the timing of its first rate hike. Today's numbers will not surprise the Bank while the fortuitous outcome on stocks which comfortably averted a negative print for GDP growth is critical for maintaining Confidence levels. Consumers would have been decidedly shaken by a negative read. Our risk of a negative read in the September quarter is centred around our negative view on consumer spending. The July and August retail sales prints which will be available prior to the next RBA Board meeting will be key inputs into that view.

Jul international trade balance

- The trade deficit was much higher than expected in July, rising \$1.018bn to \$1.556bn, the highest since May 2008 (consensus f/c \$880mn, Westpac f/c \$1.15bn).
- Exports fell 1.4% weighed down by a 27% fall in volatile non-monetary gold and a 3.6% fall in rural goods. However, non-rural exports showed further resilience, rising 1.1%, led by a 5% rise in metal ores and minerals.
- Imports were strong, rising 3.5%, slowing their downtrend to just -0.2% mth (strongest since Oct-08). Gains were seen across consumer (2.3%), capital (5.0%) and intermediate (5.0%) goods, although the rise in capital goods was exaggerated by aircraft, and the rise in intermediate concentrated in volatile fuels and lubricants.
- The underlying trade themes were as we expected: ongoing strength in non-rural exports (the China story); a continuing downtrend in capital goods imports, consistent with falling business equipment investment in Q3 after strength was brought-forward into Q2 by tax incentives; but an accelerating uptrend in consumer imports as retailers restock after being caught out by the strength of H1 spending.

Round-up of local data released last week

Date	Release	Previous	Latest	Mkt f/c
Mon 31	Aug TD-MI inflation gauge	0.9%	0.0%	-
	Q2 company profits	-6.1%	-7.8%	-4.5%
	Q2 inventories	-1.4%	-3.4%	-1.1%
	Jul private credit	0.1%	0.2%	0.2%
Tue 1	Aug AiG PMI	44.5	51.7	-
	Jul dwelling approvals	9.9%	7.7%	3.3%
	Q2 current account balance, AUDbn	-6.3	-13.3	-10.7
	Q2 net export contribution to GDP, ppts	2.2	-0.2	0.3
	RBA policy announcement	3.00%	3.00%	3.00%
Wed 2	Q2 GDP	0.4%	0.6%	0.2%
Thu	Jul international trade balance, AUDbn	-0.54	-1.56	-0.88

Past performance is not a reliable indicator of future performance. The forecasts given above are predictive in character. Whilst every effort has been taken to ensure that the assumptions on which the forecasts are based are reasonable, the forecasts may be affected by incorrect assumptions or by known or unknown risks and uncertainties. The results ultimately achieved may differ substantially from these forecasts.

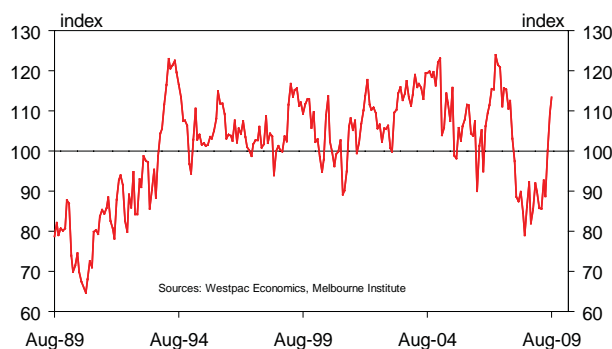
Data previews

Aus Sep Westpac-MI Consumer Sentiment

Sep 9, Last: 113.4

- The Westpac-Melbourne Institute Index of Consumer Sentiment Index increased by 3.7% in August from 109.4 in July to 113.4. The extraordinary 27.8% jump since May is the biggest three month gain since the survey began in 1975, and by a wide margin. It also takes sentiment into solidly optimistic territory.
- The September survey is in the field the week ended September 6. Sentiment is likely to be impacted by: the RBA's decision to leave rates on hold at its September meeting, albeit with more shades of a tightening bias; better than expected Q2 GDP figures showing the economy continued to expand; more gains in equities (ASX200 up another 3.3% since the August survey and over 40% from its March low); and generally improved news on economic conditions abroad.

Consumer Sentiment

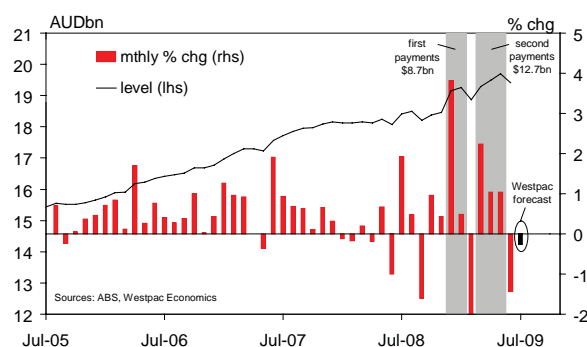


Aus Jul retail trade

Sep 9, Last: -1.4% (sa, trend series suspended), WBC f/c: -0.2%
Mkt f/c: 0.5%, Range: -0.5% to 1.5%

- Retail sales fell 1.4% in June after three strong months (+2.2% in March, and +1.0% in April and May). The pattern reflects the substantial boost from the Govt's second round of fiscal stimulus payments.
- The fall-back from this boost is expected to carry into July with a further 0.2% dip in sales. However, there is major uncertainty around this. On the one hand the post-policy-boost 'let-down' may be larger as sales in June were still at high levels (up 5.2% on November's pre-stimulus levels) and incomes remain under pressure. Against this, households may do more to 'smooth' spending using fiscal payments held in reserve (Westpac's consumer survey suggests as much as \$6bn was still unspent in early August). The record surge in sentiment in May to August also suggests some 'freeing up' in discretionary spending.

Monthly retail sales

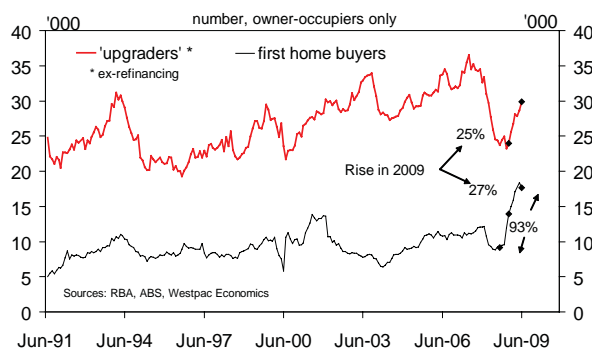


Aus Jul housing finance

Sep 9, Last: 1.1%, WBC f/c: -3.0%
Mkt f/c: -1.5%, Range: -4.5% to 2.0%

- Housing finance has surged. Lending to owner-occupiers is at historic highs in response to 41 year lows in variable mortgage rates and government incentives.
- However, we're forecasting the number of loans to drop 3% in July with anecdotes suggesting there was a moderation.
- The first home buyer segment is, as expected, starting to lose altitude. We estimate that lending to FHBs fell 4% in June, after doubling over the previous nine months. Lending to upgraders, up 25% this year, is set to strengthen further.
- Investors have yet to play a major role in this cycle – with tighter lending standards a constraint. The durability of this upswing will require greater participation by investors.

Housing finance to FHBs to moderate



Data previews

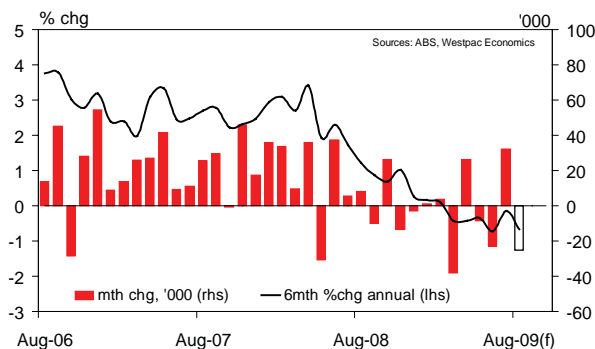
Aus Aug employment chg

Sep 10, Last: +32.2k, WBC f/c: -25k

Mkt f/c: -15k, Range: -25k to 20k

- Employment surprised significantly on the upside in July, rising 32.2k. However, demonstrating the continued reduction in labour utilisation via hours worked, full-time employment fell 16.0k (9th fall in a year) while part-time employment rose 48.2k. Total trend jobs growth fell to -0.1%yr (weakest since Mar-93), but full-time trend growth fell to a considerably weaker -1.9%yr.
- Job ads continue to fall, with their trend -52.6%yr, and their detrended level is historically consistent with annual jobs growth falling to around -1¾%yr at end-2009. However, our view is for growth to trough at a more resilient -1%yr with the focus of employers on reducing hours worked. We expect jobs to see payback weakness in August for the surprise July jump, forecasting -25k, although business surveys imply upside risk.

Aust jobs: payback in prospect for August



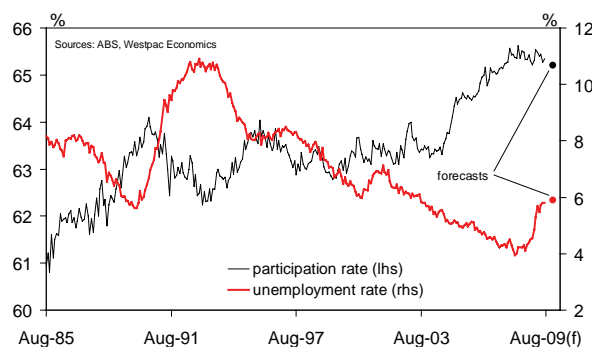
Aus Aug unemployment rate

Sep 10, Last: 5.8%, WBC f/c: 5.9%

Mkt f/c: 5.9%, Range: 5.8% to 6.1%

- As usually seen in months of jobs gains, the participation rate also rose in July by 0.1ppts to 65.3% (unrounded from 65.267% to 65.347%). But the jobs jump was sufficient to offset resulting stronger labour force growth, allowing the unemployment rate to remain unchanged at 5.8%. The trend rate continued to rise, but very gradually to 5.9% from 5.8%.
- With an expected pullback in August employment, we expect to see some participation reversal also. We forecast -0.1ppt to 65.2%. This would only partially offset the expected jobs dip, lifting the unemployment rate to 5.9%, the highest since July 2003. While short term leads from business surveys suggest risk of a lesser jobs fall than forecast, any upside would be accompanied by participation resilience, leaving risks to our unemployment rate forecast balanced.

Unemployment and participation rates

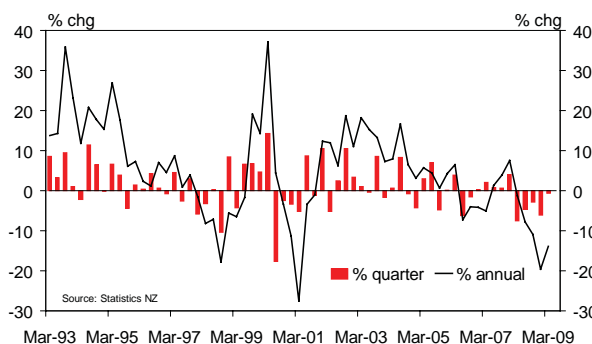


NZ Q2 Building work put in place

Sep 8, Last: -0.7%

- Total building work was surprisingly resilient in the first quarter of 2009, with both residential and non-residential building falling less than expected. However, we suspect some payback in Q2.
- Dwelling consents point to a large decline in residential construction in Q2 (in the order of 5-8%), as well as a sizeable contraction in non-residential building work.
- More recent consents data suggest that building work should begin to add to growth (albeit modestly) from the third quarter of 2009. We expect a more sustained upturn in the construction sector from early 2010, led by residential.

NZ Real Building Work Put in Place



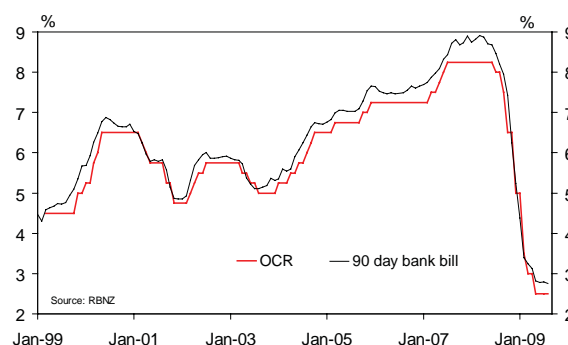
Data previews

NZ RBNZ Monetary Policy Statement

Sep 10, Last: 2.50%, WBC f/c: 2.50%, Mkt f/c: 2.50%

- Global and domestic data since July has further bolstered the recovery story. In particular, a 56% jump in milk powder prices at auction will allay the RBNZ's fears that New Zealand's soft commodity exports were missing out on the global upturn.
- However, the RBNZ continues to raise concerns about the strength of the NZ dollar, which plays a significant role in their inflation forecasts – probably more than the market appreciates.
- The RBNZ will continue to signal no rate increases before the latter part of 2010. We are torn as to whether the explicit easing bias will remain: the data justifies its removal but the RBNZ's heavy focus on the exchange rate may see them reluctant to alter their message.

NZ OCR and 90 day rate

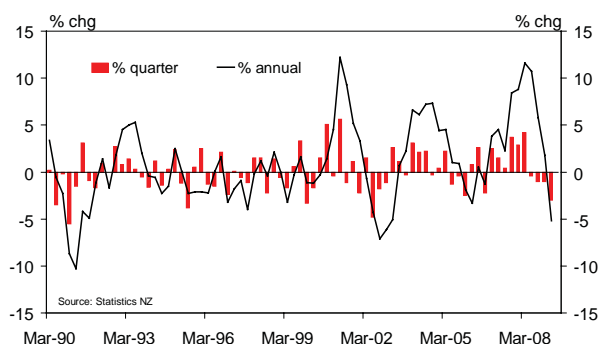


NZ Q2 terms of trade

Jun 10, Last: -3.0%, WBC f/c: -5.8%

- We expect a 7.7% drop in export prices, dominated by a 25% fall for dairy products. Sales volumes for milk powder remain very strong, but this has crystallised the fall in contract prices paid to Fonterra. Aside from crude oil, other export prices are expected to be weaker as a result of the higher NZD.
- We expect a 2.0% fall in import prices. Again, the stronger NZD points to broad-based price declines with the exception of fuel.
- Given the already-published data on trade values, our terms of trade forecast implies a 4.5% increase in export volumes and a 2% drop in import volumes. Net exports have made a significant positive contribution to GDP during the recession, but this is likely to reverse course as the recovery drives a pickup in import demand.

NZ terms of trade



US July trade deficit to widen further

Sep 10, Last: -\$27.0bn, WBC f/c: -\$28.5bn

- The trade deficit has narrowed dramatically this year, from \$60+bn in mid 2008 to less than half that a year later, reflecting the collapse in global trade, weak domestic demand and sharply lower imported oil prices. Since Feb this year, the deficit has settled in a \$25-30bn range.
- In June, the deficit widened by £1bn as import growth (2.3%) outpaced exports (2.0%), with higher oil prices a key factor at play. In July, import prices fell 0.7% (mainly due to oil), but ports and customs data suggest that import volumes picked up (autos likely a big component of that). Export prices fell a little in July and Boeing sales were down, but shipments data and business survey export indices suggest some gains likely.
- A 1.4% jump in imports and a 0.5% exports gain would push the July deficit back to \$28.5bn.

US trade: imports slump more than exports



Data previews

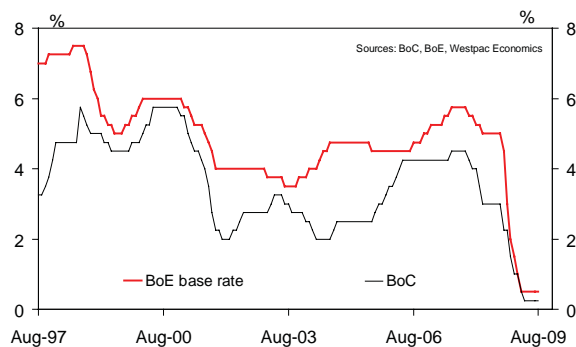
Bank of Canada and Bank of England

Sep 10, BoE Last: 0.5%, WBC f/c: 0.5%

Sep 10, BoC Last: 0.25%, WBC f/c: 0.25%

- The BoE policy committee voted 6:3 in August to extend the QE program by £50bn; the minority, including the Governor, preferred a £75bn extension - evidence of still deep concern about the outlook. Economic data since then has been mixed, with retail, industrial production and trade figures pointing to positive Q3 GDP growth, but credit growth soft, especially to households (turning negative). That suggests any Q3 GDP bounce may not be sustainable, so we expect no change to rates or the QE program at this stage.
- The BoC maintained the target at 0.25% and reiterated the conditional commitment to hold current policy rate until the end of the second quarter of 2010 at the July 21 window. There has not been a material change in the outlook since then so we expect essentially the same announcement on Sep 10.

BoE & BoC policy rates: all done



Key data & event risk for the week ahead

		Last	Market median	Westpac forecast	Risk/Comment
Mon 7					
Aus	Aug ANZ job ads	-1.7%	-	-	Downtrend rapid at -3.5%mtth & -52.6%yr = H2'09 jobs weakness.
NZ	Q2 wholesale trade survey	-5.9%	-	-3.0%	Ongoing weakness in consumption combined with falling prices.
Eur	Sep Sentix investor sentiment	-17.0	-	-15.0	Jumped sharply in Aug; equity mkts up since then, but less sharply.
Ger	Jul factory orders	4.5%	2.0%	2.0%	Up four months running and Jul-Aug surge in PMI suggests further rise.
US	Labor Day	-	-	-	Markets closed.
Tue 8					
Aus	Aug NAB business survey	1.0	-	-	Cond. up 3pts to +1 in Jul. Retail step down offset by strength elsewhere.
NZ	Q2 building work put in place	-0.7%	-	-	Consents data point to contraction in Q2.
Jpn	Jul current account ¥bn s/adj	1799	1443	-	Income surplus to widen, trade to improve also.
	Aug bank lending %yr	2.1%	1.9%	-	Decelerating as extreme working capital demands wane.
Eur	Sep ECB bulletin	-	-	-	Will include detailed revised ECB staff projections.
Ger	Jul industrial production	-0.1%	1.6%	2.0%	Orders and PMI strength point to imminent factory output upswing.
UK	Aug BRC retail monitor %yr	1.8%	-	-	Same store sales measure.
	Aug RICS house price net balance %	-8.1%	-5.0%	-	Balance of surveyors reporting lower prices; down from 94% in 4/08.
	Jul industrial production	0.5%	0.2%	0.4%	Surveys suggest first back to back monthly gains since Q3 2006!
US	Jul consumer credit \$bn	-10.3	-4.0	-	Debt still being paid off quicker than new loans being approved.
Can	Jul building permits	1.0%	-0.5%	-	Volatile data during Q1 and Q2 but trend improving.
Wed 9					
Aus	Sep Westpac-MI Consumer Sentiment	113.4	-	-	Rates on hold + more good economic news vs RBA 'sabre-rattling'.
	Jul retail sales	-1.4%	0.5%	-0.2%	Post fiscal boost let-down to continue. Of intense interest for RBA.
	Jul housing finance	1.1%	-1.5%	-3.0%	Moderation following strong run. FHB segment set to lose altitude.
NZ	Aug electronic card transactions	1.2%	-	-	Indicator to Aug retail sales; positive result expected.
UK	Aug consumer confidence	60	-	-	Nationwide index.
	Jul trade balance £bn	-6.5	-6.3	-	Trend narrowing in deficit since mid 2008.
	Aug BRC shop price index %yr	0.5%	-	-	Early clue to part of CPI basket.
US	Fed beige book	-	-	-	Regional economic assessment prepared ahead of 23/9 FOMC decision.
	Fedspeak	-	-	-	Evans on inflation; Fisher on economic challenges.
Can	Aug housing starts	-4.1%	+2.2%	-	Volatile data during Q1 and Q2 but trend improving.
Thu 10					
Aus	Aug employment chg	32.2k	-15k	-25k	Unwind of rogue rise; job ads imply H2 falls; bus. surveys imply upside risk.
	Aug unemployment rate	5.8%	5.9%	5.9%	Jobs fall partially offset by 0.1ppt participation rate fall to 65.2%.
	Sep WBC-MI unemployment expectations	-13.9%	-	-	Trending down (improving) since Feb, implying Q4'09 low for emp%yr.
	Sep MI inflation expectations	3.5%	-	-	Renewed uptrend since Mar with activity resilience; trend now 3.25%.
NZ	RBNZ Monetary Policy Statement	2.50%	2.50%	2.50%	On hold for an extended period.
	Q2 terms of trade	-3.0%	-	-5.8%	A sharp drop as lower contracted dairy prices flow through.
Jpn	Jul machinery orders	9.7%	-4.0%	-	Recent turnaround predicts modest capex growth in Q4.
Kor	Bank of Korea meeting	2.00%	2.00%	2.00%	Activity has rebounded nicely, but accommodation still appropriate.
UK	BoE policy announcement	0.50%	0.50%	0.50%	No rate change or change to £175bn QE program expected.
US	Jul trade balance \$bn	-27.0	-27.0	-28.5	Imports growth to outpace exports again. See text box.
	US initial jobless claims w/e 5/9	570k	556k	560k	Claims drifting lower as labour market gradually improves.
	Fedspeak	-	-	-	Lockhart on global interactions; Kohn on unconventional policies.
Can	Jul trade balance C\$bn	-0.1	-0.2	-	Q2 saw first quarterly trade deficit in decades.
	Bank of Canada rate decision	0.25%	0.25%	0.25%	On hold policy commitment to be maintained.
Fri 11					
NZ	Aug food prices	0.6%	-	0.1%	Fruit and veg key - due to come off seasonal highs.
Jpn	Q2 GDP second estimate %saar	3.7%	-	-	Updated estimates on capital spending and inventories.
Chn	Aug trade balance USDbn	10.6	13.2	-	Imports to SEZs predict a rally in exports vis-a-vis imports in August.
	Aug industrial value-added %yr	10.8%	11.7%	-	PMI production indices point to decent gains for IVA.
	Aug fixed investment %ytd	32.9%	32.4%	-	Rotation towards the private sector more important than headline.
	Aug retail sales %yr	15.2%	15.2%	-	Volumes still accelerating with CPI negative.
	Aug consumer prices %yr	-1.8%	-1.2%	-	Grinding back towards zero. Durables supply is still in glut territory.
	Aug producer prices %yr	-8.2%	-7.8%	-	Energy and raw materials prices still well down on year ago levels.
	Aug M2 money supply %yr	28.4%	28.2%	-	Decelerating from around decade highs.
	Aug new loans RMBbn	356	285	-	Don't panic! First half loans were 52% of GDP - liquidity is ample.
Inr	Jul industrial production %yr	7.8%	-	-	Infrastructure segment growth dipped in July; headline vulnerable.
UK	Aug producer prices %yr	0.2%	-	-	Core output measure.
US	Sep U of M consumer confidence, prelim.	65.7	67.3	68.0	Catch-up to other confidence indices which out-performed Aug UoM.
	Aug import prices	-0.7%	1.0%	1.4%	Oil prices on the rise again.
	Jul wholesale inventories	-1.7%	-1.0%	-0.8%	Pace of inventory rundown slowing.
	Aug budget statement \$bn	-111.9	-174.0	-	Deficit continuing to widen sharply.
Can	Jul new house prices	-0.2%	-0.1%	-	Down every month since Oct last year.

Economic & financial forecasts

Interest rate forecasts

	Latest (Sep 4)	Dec 09	Mar 10	Jun 10	Sep 10	Dec 10
Cash	3.00	3.00	3.25	3.50	3.75	4.00
90 Day Bill	3.37	3.40	3.75	4.00	4.25	4.50
3 Year Swap	5.20	5.25	6.00	6.50	6.75	6.80
10 Year Bond	5.32	5.50	5.80	6.25	6.25	6.35
10 Year Spread to US (bps)	201	210	205	225	200	185

International

Fed Funds	0.125	0.125	0.125	0.125	0.125	0.125
US 10 Year Bond	3.31	3.40	3.75	4.00	4.25	4.50
ECB Repo Rate	1.00	1.00	1.00	1.00	1.00	1.25

New Zealand

Cash	2.50	2.50	2.50	2.50	3.00	4.00
90 day bill	2.75	2.80	2.80	2.90	3.60	4.60
2 year swap	4.03	4.10	4.30	4.60	5.00	5.40
10 Year Bond	5.59	5.80	5.90	6.00	6.20	6.30
10 Year spread to US	228	240	215	200	195	180

Exchange rate forecasts

	Latest (Sep 4)	Dec 09	Mar 10	Jun 10	Sep 10	Sep 10
AUD/USD	0.8405	0.80	0.83	0.85	0.87	0.89
NZD/USD	0.6780	0.63	0.67	0.69	0.71	0.74
USD/JPY	92.65	90	93	96	99	103
EUR/USD	1.4254	1.40	1.42	1.44	1.46	1.49
AUD/NZD	1.2398	1.27	1.24	1.23	1.22	1.20

Australian economic growth forecasts

	2009				2010			Calendar years			
	Q1	Q2	Q3f	Q4f	Q1f	Q2f	Q3f	2007	2008	2009f	2010f
% change											
GDP	0.4	0.6	0.2	0.2	0.6	0.7	1.2	4.0	2.4	0.7	2.5
ann chg	0.3	0.6	0.5	1.4	1.6	1.8	2.9	-	-	-	-
Unemployment rate	5.3	5.7	6.0	6.7	7.1	7.3	7.4	4.4	4.3	5.9	7.3
CPI headline	0.1	0.5	0.9	0.4	0.4	0.6	0.6	-	-	-	-
ann chg	2.5	1.5	1.2	1.9	2.2	2.3	2.0	3.0	3.7	1.9	2.0
CPI core	1.1	0.8	0.8	0.6	0.5	0.5	0.5	-	-	-	-
ann chg	4.2	3.9	3.5	3.4	2.8	2.4	2.1	3.6	4.3	3.4	2.0

New Zealand economic growth forecasts

	2008			2009				Calendar years			
	Q2	Q3	Q4	Q1	Q2e	Q3f	Q4f	2007	2008	2009f	2010f
GDP % qtr	-0.2	-0.5	-1.0	-1.0	-0.4	0.2	0.1	-	-	-	-
Annual avg change	2.5	1.6	0.2	-1.0	-2.0	-2.4	-2.1	3.2	0.2	-2.1	2.6
Unemployment rate %	4.0	4.3	4.7	5.0	6.0	6.6	6.9	3.5	4.7	6.9	6.9
CPI %qtr	1.6	1.5	-0.5	0.3	0.6	0.7	0.6	-	-	-	-
Annual change	4.0	5.1	3.4	3.0	1.9	1.1	2.1	3.2	3.4	2.1	1.2

Past performance is not a reliable indicator of future performance. The forecasts given above are predictive in character. Whilst every effort has been taken to ensure that the assumptions on which the forecasts are based are reasonable, the forecasts may be affected by incorrect assumptions or by known or unknown risks and uncertainties. The results ultimately achieved may differ substantially from these forecasts.