

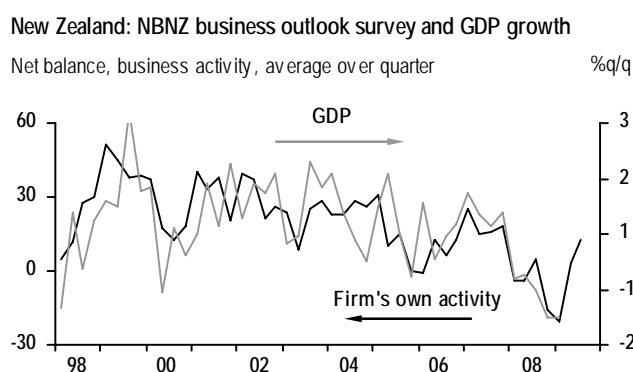
New Zealand Economic Update

NBNZ business confidence

- **Business confidence improved markedly in July**
- **Prolonged recession nearing an end**
- **No more OCR cuts likely; next cash rate move to be up**

The NBNZ business confidence survey improved again in July. The headline reading jumped to +18.7 from +5.5 in June, meaning a net 18.7% of respondents expect business conditions to improve in the coming year. Though this was a small portion of those 412 businesses surveyed last month, the improvement is encouraging given the end to New Zealand's prolonged recession is within reach (we expect a return to positive growth in 4Q), and firmer confidence is key to the prospective recovery becoming self-fulfilling.

Importantly, firms' own activity expectations also increased, signaling that any contraction in 3Q GDP growth will be mild and the economy should finally start to expand in 4Q (see chart). The reading of firms' own activity expectations rose to +12.6 in July from +8.3. Our forecast is for the economy to contract just 0.1%q/q in 3Q, marking the seventh straight quarter of negative GDP growth, before expanding 0.6% in the December quarter.

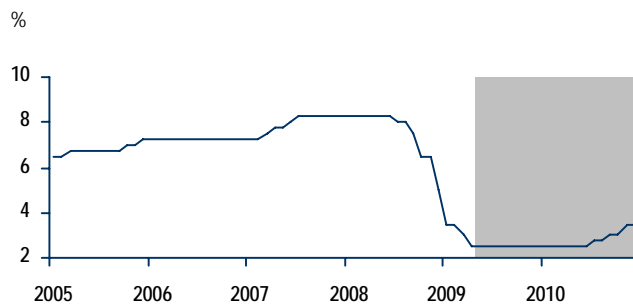


The biggest change in sentiment over the month was toward profits. "Only" a net 13.8% of companies surveyed expected profits to decline over the next year, compared to a net 24.2% in the previous survey. Marked improvements were also recorded in sentiment toward employment and commercial construction. Residential construction also improved, with a net 23.5% of firms expecting to see improvements in the sector in the next 12 months; this improvement coincides with other recent data showing house prices increasing, market turnover rising, and the number of days to sell a house heading south.

Our attention now turns to the RBNZ's OCR announcement early tomorrow. Our forecast is for Governor Alan Bollard to leave the OCR at a record low 2.5%, citing improving global economic conditions, rising business and consumer confidence, signs of stabilization in the housing market, and a strong turnaround in net migration. The Governor will, though, flag continued NZD strength as a key risk to New Zealand's economic outlook. For this reason, and given the considerable uncertainties still surrounding the economic outlook, the RBNZ will certainly level the door open to further policy easing, reiterating that the OCR will remain "at or below" current levels until the end of 2010. Our forecast calls for rate hikes from mid-2010.

With respect to this, the NBNZ survey highlighted another significant change in the interest rate outlook in July. A net 23% of those surveyed expect the RBNZ to hike the cash rate in the next 12 months, compared to just 15% in June, and the net 8% in May who expected a rate cut.

New Zealand: RBNZ official cash rate



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