Global Markets Research

Economics: Daily Alert

26 July 2011

Debt ceiling concerns weigh on sharemarkets.

The Dallas Fed Manufacturing Index contracted at a slower pace in July. Business activity improved from -17.5 to -2 in July. Across the sub indices new orders, production and employment all recorded healthy gains.

US congressional leaders are still unable to reach an agreement to prevent the government defaulting on its debt payments. Democrats and Republicans are now pushing for separate budget proposals in Congress.

European shares fell on Monday for the first time in five sessions. Banking stocks led the declines on ongoing concerns about European sovereign debt. Moody's cut Greece's credit rating further into junk status and said it was almost certain to confirm that the new EU rescue package would still classify as a debt default. The STOXX Europe 600 Banking Index fell 2.8pct The FTSEurofirst index fell by 0.4pct while the German Dax rose 0.3pct and the UK FTSE fell by 0.2pct.

US sharemarkets fell in light volumes on Monday. Investors remained cautious after policymakers failed to reach an agreement on raising the US debt ceiling. The VIX or "fear gauge" jumped 10.5pct. Strong earnings reports continued to offset the weakness. According to Thomson Reuters of the 154 S&P500 companies reported so far 75 per cent have beaten expectations. The Dow Jones fell by 88pts or 0.7pct with the S&P 500 down by 0.6pct and the Nasdaq lower 16pts or 0.6pct.

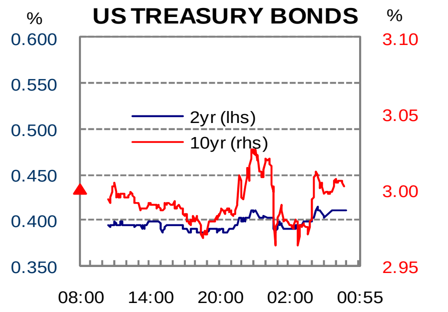
US treasuries fell on Monday (yields higher) as investors sold US debt following the breakdown of bipartisan talks to raise the debt ceiling. US 2yr yields rose by 1pt to 0.408pct and US 10yr yields rose by 3pts to 3.003pct.

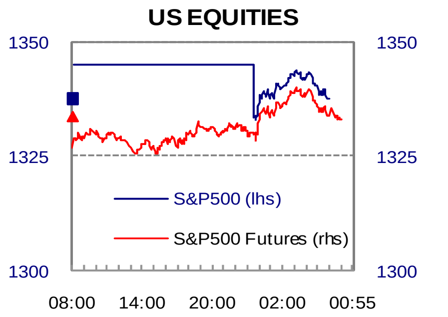
The US dollar weakened against major currencies on Monday after US political leaders failed to reach a deal on raising the US debt ceiling. The Euro hit early highs near US$1.4405 before falling to lows near US$1.4325, ending the US session at US$1.4370. The Aussie dollar rose from US107.90c to US108.75c, ending US trade near US108.45c. And the Japanese yen strengthened from 78.50 yen per US dollar to JPY78.05, before ending US trade near JPY78.30.

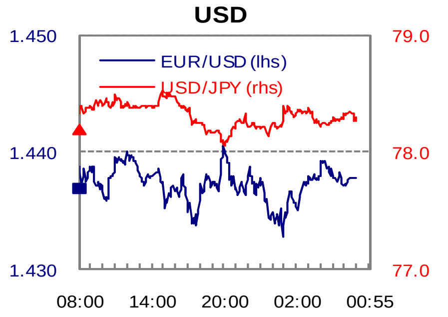
Benchmark crude oil prices fell on Monday as investors remained wary of risky assets following the lack of agreement on raising the US debt ceiling. Nymex crude oil fell by US67c or 0.7pct to US$99.20 a barrel and London Brent crude fell by US73c to US$117.94 a barrel.

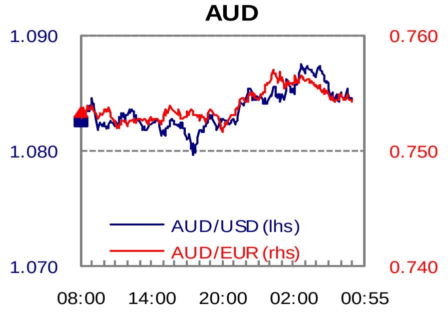
Base metal prices were mostly weaker on the London Metal Exchange on Monday, with the exception of Aluminium which rose 1.2pct. Other metals fell between 0.2-1.1pct. And the gold price rose again on Monday to near record highs. Comex gold rose by US$10.70 an ounce to US$1,612.20.

Ahead: In Australia, no economic data is released. Reserve Bank Governor Stevens delivers a speech. In the US, home prices, new home sales and the Richmond Fed index are released.









Currencies		10 Yr Bond Yields (%)		Commodities		Equities	
AUD/USD	1.0845	Australia	4.58	CRB Index	345.89	Dow	12,593
NZD/USD	0.8641	NZ	5.09	GS Index		S&P 500	1,337
EUR/USD	1.4377	US	3.00	Aluminium $/t	2593	NASDAQ	2,843
USD/JPY	78.29	*AU less US*	1.58	Copper $/t	9633	FTSE	5,925
GBP/USD	1.6277	*NZ less US*	2.09	Lead $/t	2654	Shanghai	2,689
USD/CHF	0.8061	**AUD Swap Rates (%)**		Nickel $/t	23756	H.Seng	22,293
AUD/NZD	1.2546	3mth	4.96	Zinc $/t	2441	Nikkei	10,050
AUD/JPY	84.91	3yr	4.80	Gold $/o	1614.2	ASX200	4,530
AUD/EUR	0.7544	5yr	5.18	WTI Oil $/b	99.15	NZSX50	3,428

Indicative market rate at 7am Source: Bloomberg

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Economics: Preview

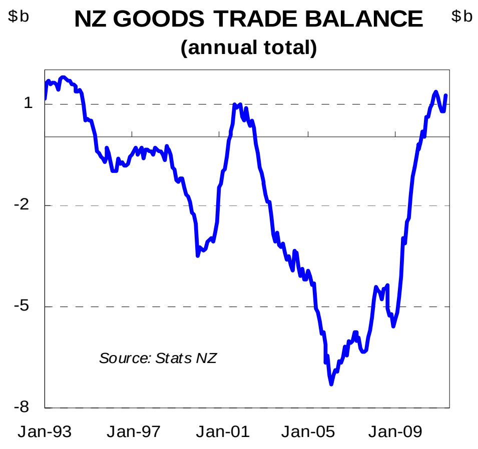
AUSTRALIA & NEW ZEALAND

Tuesday 26 July

NZ Trade Balance, June, NZD mn, (f) 400 (600 prev)

The Trade balance in May was less than expected, due to a decline in dairy export volumes, a spike in oil imports and the 'one-off' import of aircraft parts. We expect to see an underlying improvement in the trade balance over June as these factors reverse out. However, at the same time, the seasonal decline in agricultural exports will result in a smaller trade surplus in June of NZ$400 million.

Over the first half of 2011 both commodity and manufactured exports have performed very well, and highlighting the export-led nature of the NZ economic recovery. Going forward, we may see exports start to ease, particularly as Chinese demand has started to slow over recent months.



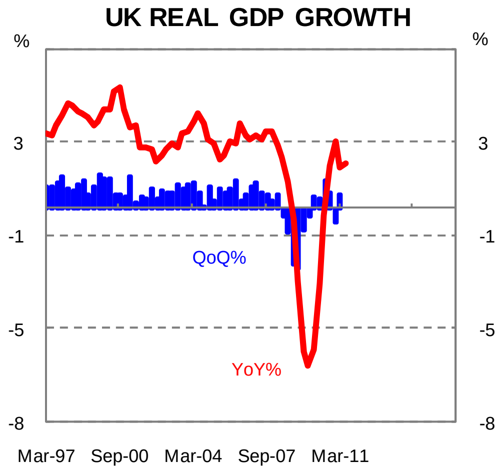
INTERNATIONAL

Tuesday 26 July

UK GDP, QII, q/y%ch, (0.5/1.6 prev)

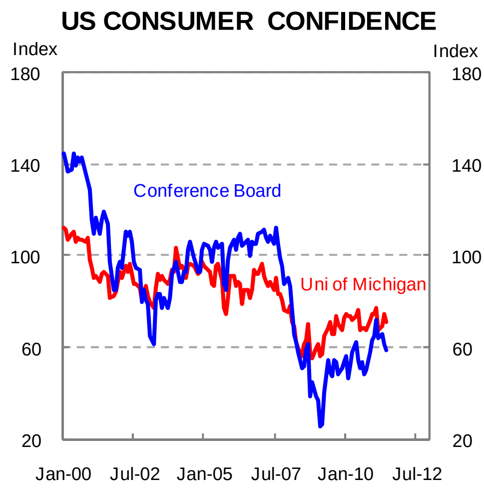
UK GDP is expected to fall back from the firm 0.5% (QoQ) reading recorded in QI. This was partly a rebound due to weakness resulting from adverse weather in QIV 2010. Real GDP over the QIV/QI period, combined, was flat, despite the fact that nominal GDP expanded by a brisk 2.8% over the six-month period.

The NIESR publishes a running update of GDP based on monthly data. This measure indicated GDP growth of just 0.1% in the three-month period to June, i.e. QII. While not always completely in line with the official GDP print, the measure has become increasingly accurate over the past few years (the average divergence is under 0.1% over the past two years). A range of monthly indicators also suggest a very weak QII GDP performance. A 0.1% (QoQ) outcome looks plausible. Such a result would take the annual rate back under 1%.



US Conference Board Consumer Confidence, July, Index, (58.5 prev)

The US consumer confidence indicators remain weak. Bearing down on consumer confidence – and ability to spend – is a 27% increase in retail petrol prices. We estimate retail petrol prices have increased by 4% so far in July. Also hurting confidence is the very weak labour market. Overall, we see downside risks to US confidence this week.



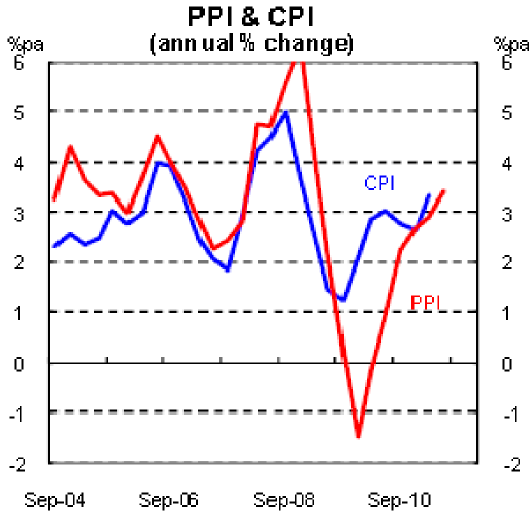
Economics: Review

AUSTRALIA & NEW ZEALAND

Australia

AU PPI meets expectations, focus is on Wednesday's CPI

The Q2 Australian Producer Price Index was right on consensus, rising 0.8% in the quarter, to be 3.4% higher over the last year. The annual lift was the highest since early 2009. Within the detail of PPI release was a 1.4% quarterly fall in imported prices, driven by a high Aussie dollar.Import prices are down 5.2% over 12 months. Final stage prices for domestically produced goods rose 1.1%.



CPI on Wednesday will be more decisive for the market than PPI. Most Economists are calling for rate hikes and the market is pricing rate cuts. Recent RBA commentary has made explicit reference to the CPI data, but have been less explicitly hawkish. CBA Economists, along with the consensus, are looking for a Q2 headline CPI increase of 0.8% (3.5%pa) and 0.7% in underlying terms (2.5%pa).

In calmer circumstances, an underlying rate of around 0.8% is normally high enough to trigger an RBA rate rise. However, against the backdrop of continuing uncertainty about European and US defaults, the RBA is less likely to respond this time around. However, with the market currently pricing rate cuts, a high CPI could easily trigger a sell off. Wednesday's CPI data is one of the few domestic releases with the ability to break through the offshore news and influence Australian markets.

RBA view

The RBA has raised its inflation and growth outlook despite downward pressure from the high $A. Further rate rises are likely. We expect a rate rise in November. The cash rate is expected to reach 5.25% by QI 2012.

New Zealand

No major releases.

RBNZ view

In response to domestic economic weakness and the Christchurch earthquake, the RBNZ delivered a 50bpt rate cut at the 10 March policy meeting. We expect the RBNZ's tightening cycle to resume in QIV 2011.

US & CANADA

United States

The main focus of attention in the US remains the ongoing deadlock in Washington in discussions to agree a compromise fiscal package in time to raise the Federal debt ceiling next week. The August 2nd deadline looms. There were no positive announcements yesterday, but various different plans are still being pushed about as the political jostling continues.

Two of the less closely watched regional Fed surveys were published yesterday. Both the Dallas Fed and Chicago Fed surveys recovered, the former posting a reading for July, the latter only for June. Interestingly the Dallas Fed index rebounded more, following the pattern of the Philly Fed and to a lesser extent NY Empire surveys, rising from -17.5 to -2.0 in July. These may be the first tentative signs of activity gaining traction from the Q2 soft patch.

Gold rose to record highs on concerns about a US ratings downgrade or default. However, other commodities declined, with the CRB index down 0.6% (Source: Reuters).

Fed view

Given the loss of momentum in the US economy, particularly in the labour market, we expect the Fed to maintain the size of its balance sheet until March 2011. The first Fed funds hike is not expected until June 2012.

Canada

dfgfsd.

Bank of Canada view

The Canadian economy is recovering, and the BoC has begun to remove stimulus. We expect a slow and steady removal of policy accommodation to ensue.

EUROZONE & UK

The new week started as the old one finished off with a ratings agency focusing in on Greece. This time it was Moody's Investor Services who following the EU bailout announcement late last week, promptly downgraded Greece 3 notches to Ca, the second lowest rating available.

The justification given for the move to "orderly default" was that the combination of the announced EU program and the debt exchange proposals to be undertaken by financial institutions implied that private creditors would experience substantial losses on their holdings. Peripheral bonds generally came under pressure, bunds rallying in a classic core-periphery spread widening.

There was no important European or UK economic data during the day.

ECB view

Elevated inflation in the Eurozone has led to the ECB re-commencing tightening in an effort to pre-empt the onset of second round inflation effects. With the ECB forecasting 2011 inflation at 2.6%, we expect a further rate hike in QIV.

Bank of England view

The MPC continues to stress that the high UK inflation is transitory. Hence given the subdued outlook for the UK economy, we expect the BoE to remain on hold until QII 2012.

CHINA & JAPAN

Japan

No major releases.

Bank of Japan

In response to the recent natural disasters, the Bank of Japan has implemented further quantitative easing measures. Monetary policy in Japan is likely to remain accommodative for some time.

China

No major releases.

People's Bank of China

We expect the PBoC to undertake further policy action in 2011. While we are not forecasting any more hikes to the benchmark 1 year lending rate, we are anticipating the Required Reserve Ratio to rise by an additional 1.5% by year-end.

The Week Ahead

Calendar - Australasia, Japan and China

Date	Time AEST	Econ	Event	Period	Unit	Last	Forecast Market	Forecast CBA
Tue 26 Jul	~	JP	Small business confidence	Jul	Index	43.1	~	~
	08.45	NZ	Trade balance	Jun	NZ$mn	605.0	400.0	400.0
	08.45	NZ	Exports	Jun	NZ$bn	4.6	4.3	~
	08.45	NZ	Imports	Jun	NZ$bn	4.0	3.8	~
	09.50	JP	Corporate service price index	Jul	y%ch	-0.9	-0.9	~
	10.00	AU	Conference board leading index	May	%	0.1	~	~
	13.05	AU	RBA Governor Glenn Stevens speaks in Sydney					
Wed 27 Jul	11.00	NZ	NBNZ business confidence	Jul	Index	46.5	~	~
	11.00	NZ	NBNZ activity outlook	Jul	Index	38.7	~	~
	11.30	**AU**	**Consumer prices**	**QII**	**q%ch**	**1.6**	**0.7**	**0.8**
					y%ch	**3.3**	**3.4**	**3.5**
	11.30	AU	RBA trimmed mean	QII	q%ch	0.9	0.7	0.7
					y%ch	2.3	2.5	2.5
	11.30	AU	RBA weighted median	QII	q%ch	0.8	0.7	0.7
					y%ch	2.2	2.5	2.5
Thu 28 Jul	07.00	NZ	RBNZ official cash rate	Jul	%	2.5	2.5	2.5
	09.50	JP	Retail trade	Jun	m%ch	2.4	1.5	~
Fri 29 Jul	08.45	NZ	Building permits	Jun	m%ch	2.2	3.0	~
	09.15	JP	Market/JMMA manufacturing PMI	Jul	Index	50.7	~	~
	09.30	JP	Jobless rate	Jun	%	4.5	4.6	~
	09.30	JP	National CPI	Jun	y%ch	0.3	0.2	~
	09.30	JP	National CPI ex-fresh food	Jun	y%ch	0.6	0.5	
	09.30	JP	National CPI ex food, energy	Jun	y%ch	0.1	~0.1	~
	09.30	JP	Industrial production	Jun P	m%ch	6.2	4.5	~
					y%ch	-5.5	-1.2	~
	11.30	AU	Private sector credit	Jun	m%ch	0.3	0.4	0.2
					y%ch	3.1	3.2	2.9
	14.00	JP	Vehicle production	Jun	y%ch	-30.9	~	~
	15.00	JP	Construction orders	Jun	y%ch	25.5	~	~
	15.00	JP	Annualized housing starts	Jun	mn	0.8	0.8	~
	15.00	JP	Housing starts	Jun	y%ch	6.4	5.0	~

Calendar – North America & Europe

Please note all days and times are UK time, not local release day/times

	UK						Forecast	
Date	**Time**	**Econ**	**Event**	**Period**	**Unit**	**Last**	**Market**	**CBA**
Tue 26 Jul	07.00	GE	GfK consumer confidence survey	Aug	Index	5.7	5.6	~
	09.30	UK	GDP	QII	q%ch	0.5	0.1	~
					y%ch	1.6	0.7	~
	14.00	US	S&P/Case Shiller composite-20 city home price	May	y%ch	-4.0	-4.6	~
	15.00	US	Consumer confidence	Jul	Index	58.5	57.9	~
	15.00	US	Richmond Fed manufacturing index	Jul	Index	3.0	5	~
	15.00	US	New home sales	Jun	'000	319.0	320.0	~
Wed 27 Jul	08.00	GE	Consumer price index	Jul	m%ch	0.1	0.3	~
	11.00	UK	CBI business optimism	Jul	Index	9.0	~	~
	13.30	US	Durable goods orders	Jun	m%ch	2.1	0.3	~
	13.30	US	Durables ex transportation	Jun	m%ch	0.7	0.5	~
	13.30	US	Cap goods orders nondefence ex air	Jun	m%ch	1.6	0.6	~
	13.30	US	Cap goods ship nondefence ex air	Jun	m%ch	1.4	~	~
	19.00	US	Fed's Beige book	~	~	~	~	~
Thu 28 Jul	08.55	GE	Unemployment rate	Jul	%	7.0	7.0	~
	10.00	EZ	Business climate indicator	Jul	Index	0.9	0.8	~
	10.00	EZ	Economic confidence	Jul	Index	105.1	104.0	~
	13.30	US	Initial jobless and continuing claims	Jul	'000	~	~	~
	15.00	US	Pending home sales	Jun	m%ch	8.2	-2.0	~
Fri 29 Jul	00.01	UK	GfK consumer confidence survey	Jul	Index	-25.0	-24.0	~
	09.30	UK	Net consumer credit	Jun	£bn	0.2	0.3	~
	10.00	EZ	CPI estimate	Jul	%	2.7	2.7	~
	13.30	CA	GDP	May	m%ch	0.0	0.1	~
					y%ch	2.8	~	~
	13.30	US	Employment cost index	QII	q%ch	0.6	0.5	~
	13.30	US	GDP (annualized)	QII	q%ch saar	1.9	1.7	~
	13.30	US	Personal consumption	QII	q%ch saar	2.2	1.0	~
	13.30	US	GDP Price index	QII	q%ch saar	2.0	2.0	~
	13.30	US	Core PCE	QII	q%ch saar	1.6	2.2	~
	14.45	US	Chicago purchasing manager	Jul	Index	61.1	61.1	~
	14.55	US	University of Michigan confidence	Jul	Index	63.8	64.0	~

Unless otherwise noted, all data is sourced from Australian Bureau of Statistics material (www.abs.gov.au).

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