

## US stalemate weighs on shares and USD.

**US new home sales fell** by 1pct to a 312,000 annual rate in June. Economists had tipped a result near 320,000. US consumer confidence surprisingly rose from 57.6 to 59.5 in July, ahead of forecasts centred on a result near 56.0. The Case-Shiller home price index for 20 cities was unchanged in seasonally adjusted terms in May but the 10-city index rose 0.1pct. And the Richmond Fed manufacturing index eased from +3 to -1 in July.

**European shares** were mixed on Tuesday as investors across the globe focussed on the budget and debt negotiations between the US Congress and White House. Weak earnings results also weighed on sentiment with shares in Swiss bank UBS down 2.9pct. The FTSEurofirst index fell by 0.3pct but both the German Dax and UK FTSE managed to eke out 0.1pct gains. In London trade shares in BHP Billiton fell by 0.9pct but Rio Tinto rose less than 0.1pct.

**US sharemarkets** slumped on Tuesday, selling off in late trade to finish near the day's lows. Investors remain nervous about the ongoing, and unproductive, budget talks. Earnings results also weighed on markets. Shares in 3M fell by 5.6pct, hurt by weaker sales in its display and graphics division. And shares in Netflix fell 5.2pct after the video rental company reported softer subscriber growth. The Dow Jones fell by 91pts or 0.7pct with the S&P 500 down by 0.4pct and the Nasdaq lower by 0.1pct.

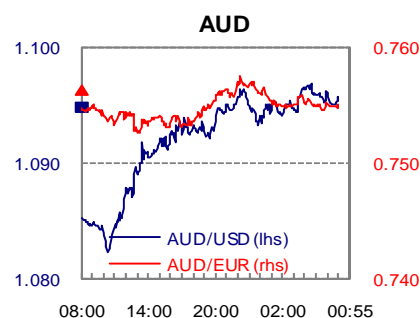
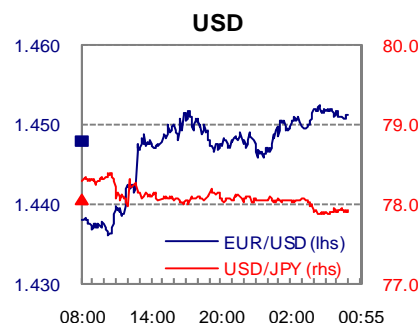
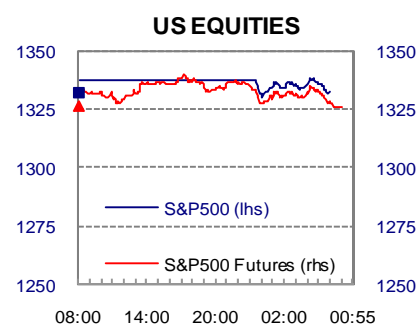
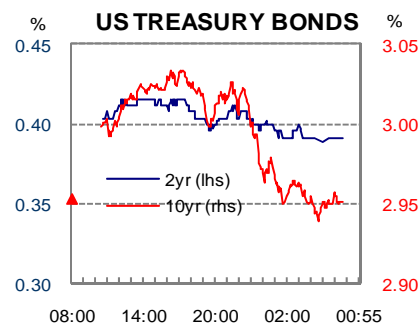
**US treasuries rose** on Tuesday (yields lower), reversing the previous day's losses as traders focussed on the ongoing political wrangling over the budget deficit and debt ceiling. US 2yr yields fell by 1pt to 0.395pct and US 10yr yields fell by 4pts to 2.955pct.

**The US dollar** continued to fall again major currencies on Tuesday on the growing belief that the US credit rating will be downgraded even if a debt and deficit deal is done. The Euro was volatile - falling from US\$1.4520 to US\$1.4455 in European trade before recovering to near the day's highs and then closing in New York at US\$1.4510. The Aussie dollar rose from near US\$1.09.10c to just below US\$1.09.70c, ending US trade near US\$1.09.50c. And the Japanese yen strengthened from near 78.15 yen per US dollar to JPY77.85, before ending US trade near JPY77.90.

**Benchmark crude oil prices** rose in line with other commodities on Tuesday as the greenback fell. A weaker US dollar improves the purchasing power of buyers in Europe and Asia. But oil prices were choppy in the thin trading conditions. Nymex crude oil rose by US\$39c or 0.4pct to US\$99.59 a barrel and London Brent crude rose by US\$34c to US\$118.28 a barrel.

**Base metal prices** rose on the London Metal Exchange on Tuesday in response to a weaker US dollar. Metals rose by between 1.3-2.5pct with zinc faring best with aluminium up the least. And the gold price closed at fresh record highs with Comex gold up by US\$4.60 an ounce to US\$1,616.80.

**Ahead:** In Australia, the Consumer Price Index is released. In the US, data on durable goods orders is released.



Currencies			10 Yr Bond Yields (%)			Commodities			Equities		
AUD/USD	1.0948	1.1%	Australia	4.60	0.01	CRB Index	348.75	0.8%	Dow	12,501	-0.7%
NZD/USD	0.8738	1.0%	NZ	5.07	-0.03	GS Index			S&P 500	1,332	-0.4%
EUR/USD	1.4478	0.8%	US	2.95	-0.05	Aluminium \$/t	2627	1.33%	NASDAQ	2,840	-0.1%
USD/JPY	78.06	-0.2%	AU less US	1.64		Copper \$/t	9798	1.71%	FTSE	5,930	0.1%
GBP/USD	1.6401	0.8%	NZ less US	2.11		Lead \$/t	2700	1.74%	Shanghai	2,703	0.5%
USD/CHF	0.8021	-0.3%	<b>AUD Swap Rates (%)</b>			Nickel \$/t	24057	1.27%	H.Seng	22,572	1.3%
AUD/NZD	1.2529	0.1%	3mth	4.99	0.03	Zinc \$/t	2503	2.52%	Nikkei	10,098	0.5%
AUD/JPY	85.46	1.0%	3yr	4.82	0.03	Gold \$/o	1611.2	-0.4%	ASX200	4,573	0.9%
AUD/EUR	0.7562	0.4%	5yr	5.22	0.03	WTI Oil \$/b	99.59	0.6%	NZSX50	3,417	-0.3%

Indicative market rate at 7am Source: Bloomberg

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## Economics: Preview

### AUSTRALIA & NEW ZEALAND

Wednesday 27 July

#### NZ National Bank Business Outlook, June

- **Headline, (46.5 prev)**
- **Own Activity, ,(38.7 prev)**

Business confidence rebounded strongly from the sharp declines seen in the wake of the February Christchurch earthquake, to be higher than pre-quake levels. Businesses are now more optimistic in regards to expansion plans, as reflected in an improvement in investment and hiring intentions. Along with the improvement in activity seen in Q1 GDP, momentum in the underlying economy looks to be kicking in faster and stronger than we initially expected.

However, the improvement in demand has underpinned a jump in pricing intentions in recent months, as businesses look to recoup operating margins. We expect business confidence will remain firm over the remainder of 2011, reflecting the improvement in demand.

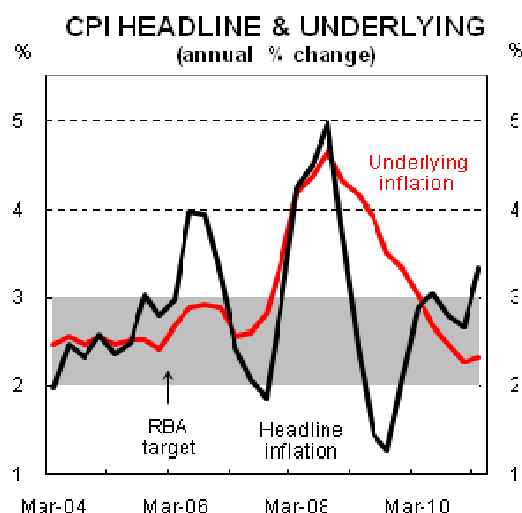
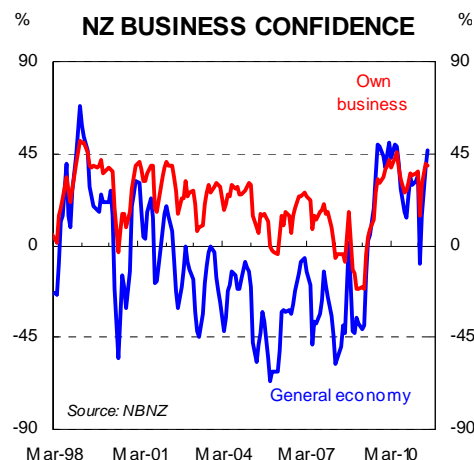
#### AU CPI, QII, q/y%ch, (f) 0.8/3.5 (1.6/3.3 prev)

#### AU Underlying CPI, QII, q/y%ch, (f) 0.7/2.5 (0.9/2.3 prev)

Indications continue to point to a relatively firm QII CPI. We expect the headline CPI to have increased 0.8% (QoQ) in QII, up 3.5% from a year earlier. The extensive natural disasters across Australia's key agricultural regions induced a surge in fruit and vegetable prices in QI. But these disaster related rises will unwind somewhat in QII.

Despite the rise in headline inflation, underlying inflation outcomes are likely to have been a little lower in QII. We expect underlying inflation to rise 0.7% in QII. The RBA tends to look at 6mth annualised underlying inflation. Combining a likely 0.7% rise in QII with QI's underlying CPI rise of 0.9% gives a 6mth annualised rate of 3¼% for HI 2011. This is the sort of number that would start to jangle RBA nerves given it sits above the RBA's 2-3% target band over 2011.

Normally such a number would engender a policy tightening response by the central bank. But given the current volatility in global markets and uncertainty surrounding the European sovereign debt matters, the RBA is likely to sit pat for a few more months until the international environment settles before adjusting policy again.





## INTERNATIONAL

Wednesday 27 July

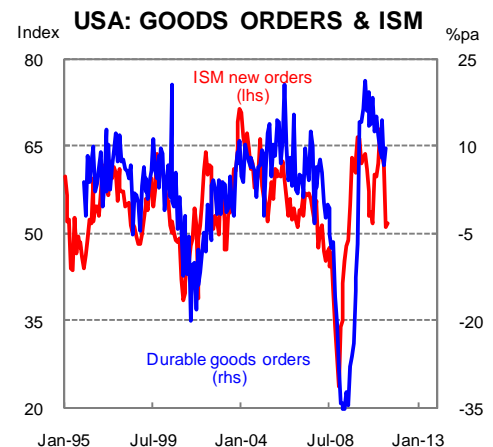
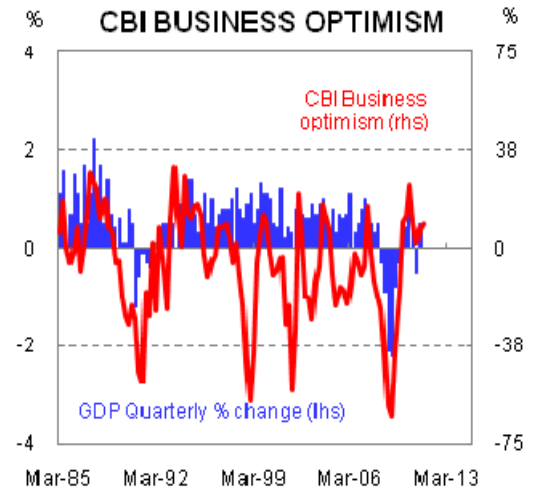
### UK CBI Industrial Trends – Business Optimism/Orders, July, Index, (9/1 prev)

The quarterly UK CBI industrial trends survey is likely to show a sharp fall in confidence amongst UK manufacturing businesses. The last reading was at +9 in April. The regular monthly manufacturing PMI has fallen by over 5 index points over the past four months, to lows last seen in 2009. Rising oil prices and the global soft patch being the main culprits.

The orders balance is likewise expected to head lower from its April reading. The published consensus is looking for a drop from +1 to -3. Risks to this look to the downside given the falls seen in new orders balances in other more frequently published business surveys since Q1.

### US Durable Goods Orders, June, m%ch, (2.1 prev)

US manufacturing continues to recover, albeit at a slower growth rate. The ISM new orders index suggests some further slowing in durable goods orders is in prospect in coming months. Consumer spending in the US has slowed appreciably in the past few months. Judging by US exports, foreign demand has also started to wane after a sharp lift in February.



## Economics: Review

### AUSTRALIA & NEW ZEALAND

#### Australia

Governor Stevens delivered a speech yesterday, that dwelt on the longer term trends in Australian household incomes, spending and saving. His basic view is that there are many reasons to be optimistic about Australia's medium term growth outlook. He noted that higher levels of consumer anxiety have produced much weaker consumer confidence. This is despite the favourable global growth outcomes delivering very high terms of trade or "a once in a century event" for Australia. The disparate factors raising concerns for consumers and weakening confidence are: the natural disasters over the past summer; talk of ever higher interest rates and its impact on mortgage holders; bitter national political debates over different issues; uncertainty over the outlook for global and Chinese economies; and, discussion of the structural changes in the global and domestic economies. Another factor mentioned later in the speech is that growth in households' wealth or asset positions are performing relatively poorly in the last few years, compared to the prosperous 1995 to 2005 period. The result of these factors has been a shift to more consumer caution. It is evidenced in softer traditional retail conditions and a return to 1980s style household savings rates.

The RBA sees a shift to higher consumption spending is likely. Mainly because households will finally reach a point where they have adjusted their savings and debts to levels they are more comfortable with. He noted that the rise in the savings rate over the past few years was "the biggest adjustment of its kind we have had in the history" of the ABS data.



He concluded that a return to more “normal” levels was most probably closer than if the shift to higher levels of savings was more drawn out. But the future “normal” may not be as buoyant.

The Governor indicated that the level of savings is now back in line with longer term outcomes. Which means that consumers may keep savings at current levels. And that means that current levels of consumption can only rise if there is another burst of national income growth. But that looks improbable, since the terms of trade is unlikely to rise much from current 60 year highs. It would require another surge in iron ore and coal prices. But the terms of trade may stay near current levels for a prolonged period.

The Governor finished with the observation that higher productivity growth was another source of higher real per capita incomes. And Australia’s performance on that front had been reasonably poor in recent years. Australia’s challenge is to lift productivity at the same time that its terms of trade are high.

### 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 Q1 2012.*

### New Zealand

#### NZ Trade Balance - June

Exports surged 4.5% over Q2 (seasonally adjusted), building further on strong growth recorded over the previous 2 quarters. The lift over the quarter was underpinned by stronger exports of dairy and meat, largely due to stronger prices. Exports of manufactured goods also expanded strongly, with exports of mechanical machinery and equipment up 7.7% and exports of electrical machinery and equipment up 9%. Exports of logs started to ease back over Q2, following a surge in Q1 Demand from China has eased recently, which could weigh on forestry exports over H2 2011.

Imports fell 1% over the quarter, with declines led by capital and transport goods as well as motor vehicles. The large decline in transport goods reflects the bulky nature of aircraft imports: The import of 3 Boeing 777 aircraft over Q4 2010 and Q1 2011 providing a temporary boost to imports, which was unwound over Q2. Meanwhile, the 2.5% decline in plant and machinery imports may largely be a price effect, rather than reduced investment demand, given the high NZD over Q2 compared to the previous quarter. The Overseas Trade Indices, released in late August, will provide better insight into import volume and price splits. Imports of passenger cars fell 8%, following a 4% decline in Q1.

Strong export commodity prices were a key feature in underpinning the trade surplus over Q2. More recently, dairy prices have been easing over recent months and the appreciation in the NZD has further reduced prices in NZD terms. Meanwhile, the recent lift in the NZD/AUD will take the edge off the strong competitiveness of the NZ manufacturing sector in the Australian market. Also concerning are anecdotes of slowing demand in China, particularly for raw commodities such as forestry. NZ’s economic recovery has been supported by stronger export incomes over H1 2011. However, there are concerns that support for export incomes may wane over the second half of the year, as commodity prices moderate from elevated levels and global growth goes through a soft patch.

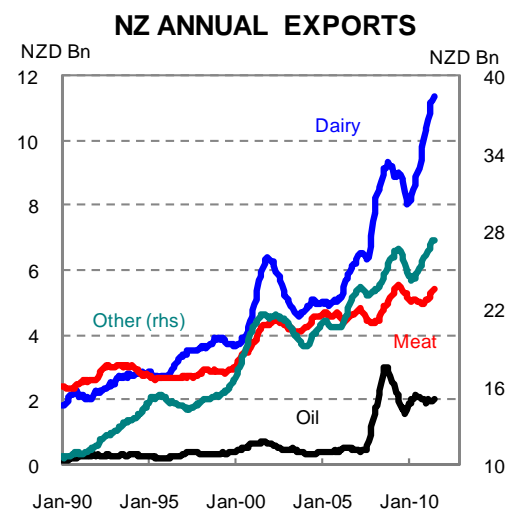
### RBNZ view

*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

**US President Obama and House Republican leader Boehner** gave public addresses about the lack of progress in raising the debt ceiling at 11am AEST yesterday. Details emerged about competing deals in the preceding night, but the proposals and follow-up speeches only underscore the ongoing divide amongst lawmakers. Compromise is needed, and quickly, as the looming debt ceiling deadline of August 2nd approaches. Obama warned of the potential for a “deep economic crisis” and aptly summed up the need for compromise, quoting Thomas Jefferson: “Every man cannot have his way in all things”.





Exchange rates reacted sharply to the speeches, with the US dollar immediately under downward pressure. The currency fell against all major currencies, with the US dollar index now hovering around 73.50. There were no indications of progress on the ongoing Federal debt discussions in Washington overnight.

The **Conference Board consumer confidence** indicator edged higher to 59.5, contrary to consensus expectations of a small fall, but remains near lows for the year recorded in June of 57.6.

The **Richmond Fed index** dipped back into negative territory to -1 in July from +3 in June. Consensus had expected a small increase to +5. The new orders index dropped 5 points to -5, with capacity utilisation reading also dropping.

The **US housing market** remains in the doldrums. The S&P Case-Shiller 20 city index dropped 4.5% in the year ended May, while new home sales were again broadly flat at 312k in June. The price decline was the most since late 2009, whilst the new home sales data follows readings of 315k, 317k and 305k in the previous 3 months.

### 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

No major releases.

### 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

### UK

First estimates of UK Q2 GDP suggest only modest expansion of output of 0.2% q/q, in line with consensus expectations. The annual growth of GDP dropped to 0.7% y/y accordingly, a fairly underwhelming outturn.

In terms of a breakdown of the numbers, weakness was centred on the industrial sector, with services and construction performing reasonably. Both service sector and construction output increased by 0.5% q/q, with production down by 1.4% the clear drag to output growth in Q2. Within the production industries manufacturing output fell 0.3% q/q, while output in the mining, quarrying and gas extraction industries plunged 6.6% q/q and output of the utilities sector was down by 3.1% q/q.

GBP took the release positively given the sources of weakness in the data. According to the statisticians at National Statistics one-off factors including additional holidays due to the Royal Wedding, supply disruptions from the Japanese earthquake and unseasonably warm weather combined to depress GDP by up to 0.5% q/q. This very much fits in with the BoE's assessment that there is a soft "patch" in the economy and reacceleration is to be expected in H2 2011.

### Europe

French consumer confidence ticked up to a 7-month high according to the INSEE indicator. The reading of 86 is still relatively low by historical standards, but now back in line with readings recorded through much of H2 2010 when household spending growth was reasonable in the 0.4%-0.5% q/q area.

### 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		Event	Period	Unit	Last	Forecast	
	AEST	Econ					Market	CBA
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	<b>Consumer prices</b>	<b>QII</b>	<b>q%ch</b>	<b>1.6</b>	<b>0.7</b>	<b>0.8</b>
					<b>y%ch</b>	<b>3.3</b>	<b>3.4</b>	<b>3.5</b>
	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 &amp; Europe

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

Date	UK		Event	Period	Unit	Last	Forecast	
	Time	Econ					Market	CBA
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	~	



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