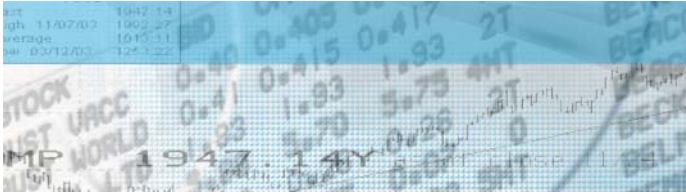


Weekly market & economic update - Week beginning Monday 23 August 2010



Headline developments of the past week

- In Australia, the Federal election has (at least for now) culminated in a hung parliament with independents likely to decide the victor and Greens likely gaining the balance of power in the Senate. At this stage some political pundits see the Coalition as favoured to form government given that three of the independents are conservative and if so this would help allay investor fears of a less business friendly drift in government policy given increased Green power. Such an outcome would also be positive for mining stocks given the Coalition's commitment to dump the mining tax. But this may not be known for days. Coming at a time of renewed concerns regarding the global economic outlook, the Australian election outcome will likely add to local investor nervousness in the short term. Uncertainty over the election outcome as to who will govern, fears of a possible drift towards less business friendly policies reflecting the increased power of the Greens, worries about less decisive policy making and a likely absence of productivity boosting longer term reforms under a minority government will likely add to jitters in the Australian share market and in the Australian dollar in the week ahead.

Major global economic releases and implications

- There was some good news in the US from a survey of bank lending officers which showed that banks are continuing to loosen lending standards on most types of loans. Meanwhile, US economic data was poor. Surveys of manufacturing conditions in the New York and Philadelphia regions were weak, housing starts barely flicked off the bottom in July, permits to build new houses continued to fall and a survey of new home builders showed that demand conditions fell. On top of all this, weekly retail sales data in the US were weak and unemployment claims rose further.
- Japanese June quarter data was weak with just 0.1% GDP growth and a fall in domestic demand. Strong growth continued in Taiwan and Malaysia in the June quarter although peak momentum in both countries looks to have past.

New Zealand economic releases and implications

- The BNZ-Business NZ Performance of Services Index was down 4.6 points in July to 50.5. This was the

lowest level registered since October 2009, but remains in the expansionary range (50 or above).

- The ANZ-Roy Morgan consumer confidence gained modestly in August, although on a seasonally adjusted basis the measure actually recorded a third consecutive monthly decline. It remains broadly in line with the long-run average. Meanwhile, total New Zealand credit card billings data for July were subdued, falling 1.2% for the month following a 1% rise in the previous month.
- Net permanent migration inflow was recorded at 970 in July, up from 140 in June. This was the highest level seen since February but remains well down on the net inflow of 2,220 recorded for July last year.
- Producer Price Index for output prices rose 1.1% in the June quarter to be up 1.3% from a year ago. PPI for input prices was up 1.4% for the quarter and up 2% for the year. The gain in producer prices was dominated by export commodity prices such as dairy and meat, reflecting the flow-through effect from the strong increases that occurred through the middle of the year.

Major market moves

- Despite a bounce earlier in the week and increasing merger and acquisition activity, share markets ended slightly lower on the back of poor US economic data which continued to fuel double dip worries.
- Commodity prices were mixed with the oil price down on growth concerns but copper and gold prices rose. Higher risk aversion led the NZ dollar lower over the week.
- Bond yields continued to fall on the back of the global slowdown and expectations that key policy rates in the US and other major countries will stay around zero for longer.

What to watch in the week ahead?

- In the US, the second estimate of June quarter GDP growth to be released on Friday is likely to show that growth in the quarter has been revised down to just 1.4% at an annual rate, down from the 2.4% pace first reported. This is close to stall speed and will only add to worries about a return to recession in the US. August readings for European business conditions will be watched closely to see whether the surprising strength evident in July has continued.

- There is little in the way of economic data in New Zealand this week, with the September quarter RBNZ Survey of Expectations being the only report due for release.

Outlook for markets

- With worries about a double dip back into global recession now escalating and policy makers in the US and China unlikely to respond immediately, shares are now at high risk of having another leg down, particularly as we head into the normally weak months of September and October. However, beyond the likelihood of another round of near term share market weakness, we remain of the view that a double-dip recession globally will be avoided. With shares very good value, monetary conditions set to remain favourable and China likely to start relaxing its tightening measures sometime in the in the next few months, shares are likely to stage a decent rally in the December quarter and then through 2011.
- The New Zealand dollar is likely to remain volatile in the short term, particularly with double dip fears persisting and the previously expected September interest rate hike in New Zealand being questioned.
- Double dip and deflation worries will keep bond yields low in the short term, but medium term returns are likely to be poor reflecting low yields and excessive public debt levels in many developed countries.