22 February 2010

Fiscal Stimulus to Provoke OCR Tweaks?

- Consumer confidence down from highs
- Surging listings to challenge housing market
- Building consents, credit, also test recovery hopes
- Thursday's business survey probably off a fraction
- But will Budget beef keep RBNZ tightening on plan
- As support for Government endures tax proposals

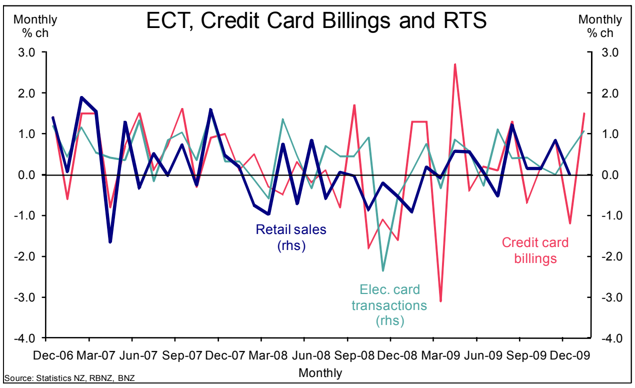
The near-term economic indicators look to be losing steam, notably so in housing. However, the broader case for the RBNZ to start removing policy stimulus, starting around mid year, remains a reasonable one, given the likelihood of a net-expansionary Budget, to be delivered in May.

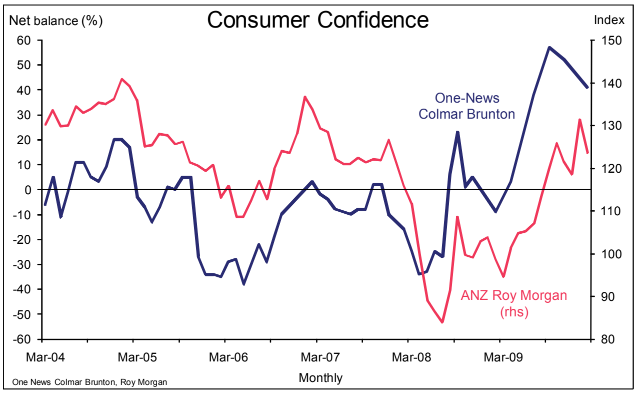
As for the near-term indicators, one of the signs of lost momentum has come through consumer confidence. It's not as upbeat as it was. The ANZ Roy Morgan poll, for example, published last week, slipped to 123.6, from its puffy 131.4 of January. The One News Colmar-Brunton poll, released over the weekend, registered a net drop of 11 points, to +41, from its last reading, back in November.

Yes, these are still positive results in a levels sense (consistent with the sort of forward momentum established in last week's solid bounce in credit card billings, suggesting a similar thing for January's retail sales). However, there are definite signs of realism creeping in.

The moderation in consumer confidence certainly made sense alongside a housing market that continues to double dip.

Not that we've seen any further hard evidence since January's various housing reports were issued.





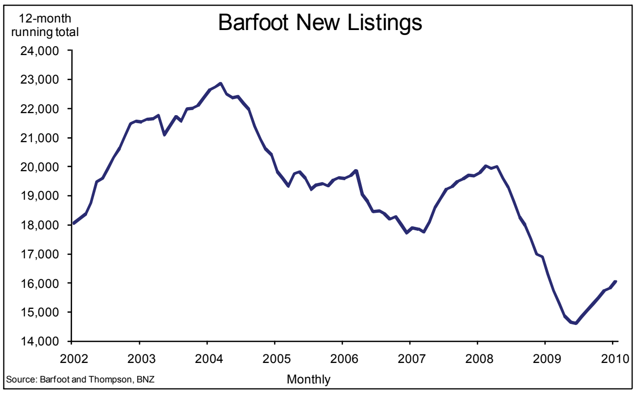
However, Thursday's credit aggregates will no doubt confirm a still-slow advance in mortgages (amid stalled borrowing in agriculture and further declines in business and consumer credit). And we know mortgage approvals continue to soften in February, along with the housing sector anecdote.

Note also that by this time next week we will probably have seen some of February's key housing statistics, as published in usual quick time by the website realestate.co.nz. Its asking-price series will be interesting to note – as its moderation over recent months has been a good steer on the softness in the range of other home price measures of late. We suspect further price falls are in the offing.

This is not to deny the relative lack of new homes being built - something Friday's building consents will probably make clear, even with the chance of a bit more of a trend recovery from their extreme lows of early 2009.

However, many would seem to be under-appreciating the extent to which listings of existing homes, in also collapsing over the last couple of years, "supported" transacted home sale prices as well. And as the next realestate.co.nz data will probably show, listings have every potential to ramp up, simply to get back to normal. This "supply" will help reveal the true clearing price of the housing market, following the recent squeeze.

To the extent listings actually surge above normal levels – perhaps driven by leveraged landlords selling up, given the proposals to abolish depreciation allowances, with fainter hopes of obvious capital gain in any case – then the downward pressure on home prices could be strong.

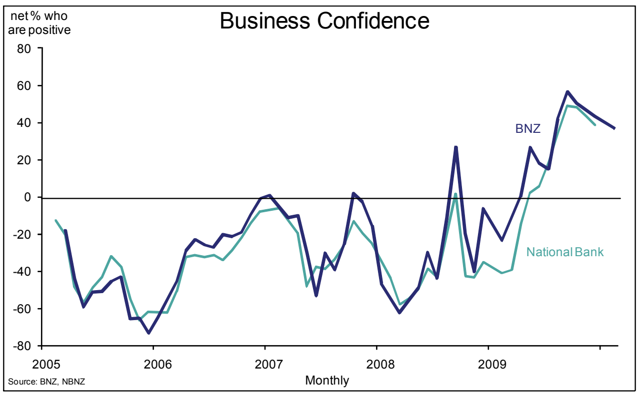


While housing is softening and consumer confidence is coming off highs, we might wonder if the business indicators are going the same way. We'll get some answers on this from Thursday's NBNZ business survey – the first comprehensive one of its type conducted in the New Year.

While net confidence probably came off a bit in February, the net changes in the core activity readings are much more difficult to predict. Broadly speaking, we don't expect any material shifts, from December's encouraging levels. But we'll certainly be on guard for any "news" in Thursday's business survey.

The other pieces of NZ data for this week, not already mentioned, include;

- Tuesday's RBNZ survey of inflation expectations. This should echo the generally weak undertones to inflation, but with the risk respondents are now building in a GST hike in terms of their headline CPI projections for the coming twelve months.
- Friday's merchandise trade result for January. While the market is picking a slight deficit (of $100m), we're looking for a marginal surplus (of $70m), essentially on the view imports prove a bit weaker (-12% y/y), with exports relatively better (-7% y/y).



This week's data are thus likely to paint a picture of an economy recovering, overall, but gradually so, and not without its weak spots.

In theory, this should leave the RBNZ relatively relaxed in its tightening outlook. From what we know at the moment there is even a case forming for the Bank to delay past the mid-year zone that even the markets have now moved along to.

However, the May Budget has the potential to keep the Bank firmly on its stated path. The details will be crucial. The prospect of personal tax cuts on 1 October, combined with a flush of spending ahead of a likely hike to GST, could well spark some good-looking data, beginning Q3.

Not all of this could be dismissed as transitory. And so the Bank could become a bit wary of having interest rates a tad too low, especially if it only encourages more folk to leverage into short-term debt and interest rates. The Bank could well be seeing the Budget as being a net stimulus, in effect – albeit front-loaded. We are.

In this respect, it was interesting that a couple of political polls published over the weekend had support for the Government essentially un-dented, despite the economic reforms outlined at the opening of Parliament almost two weeks ago. While one might have imagined a backlash from the proposal to increase GST and abolish depreciation allowances on property investment, it would seem the income tax reduction part of the package has been a significant counterbalance.

Yet we also note that any reinforcement the May Budget might provide to the Reserve Bank beginning to tighten, as planned, it would not necessarily justify a sustained withdrawal of stimulus. Indeed, if the Bank did feel compelled to move around the middle of the year, it might not get too far before its impacts are felt pretty hard in the economy. There are a great many households and businesses relying on relatively lower short-term rates at present.

So we might well end up with a bit of tweaking in the OCR – under the cover of Budget-fuelled demand – rather than an ongoing tightening cycle, as such. While this is not our formal view, it's something worth contemplating.

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Domestic Interest Rates

Reuters pgs BNZL BNZM

New Zealand interest rates have held the same tight range for another week with relatively little volatility seen in the market. The 3-mth bank bills have rallied a little further as bank bill margins have continued to crunch in. With the duel risks of a hike in the OCR or an increase in credit margins evident, it seems unlikely that there is too much potential for a further rally in the physical bank bills. The futures strip has rallied a little further from last week, with the April meeting now almost completely priced out and a 25 basis points hike priced for the June meeting.

The Government bond market was also quiet on the week, with good bids still evident. Our volatility is low currently and while we are still taking the lead from offshore the movements are distinctly smaller. The tender was reasonably well supported, although the size of the tenders is still on the small side. We seem likely to hold this pattern for the next week, with offshore likely to lead the market.

	90 day bills	11/11 NZGS	12/17 NZGS	2yr swaps s/a	10yr swaps s/a	2yr/10yr swaps(bps)
12-Feb-10	2.74%	3.86%	5.55%	4.25%	5.89%	164
19-Feb-10	2.72%	3.81%	5.58%	4.22%	5.86%	164
Change (bps)	**-2**	**-5**	**3**	**-3**	**-3**	**0**

The swaps market was also very quiet on the week and is still holding a tight range. The 4.20% level is still important in 2-yr swap, with strong payside interest still seen below there. It seems likely we will hold this range for the next week, although a move from offshore could spur the market into action. At current pricing levels it still seems likely the larger risk is for a move towards higher rates from here.

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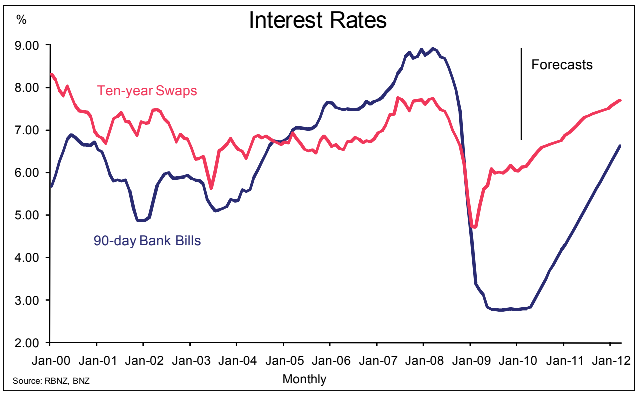

Interest Rate Technicals

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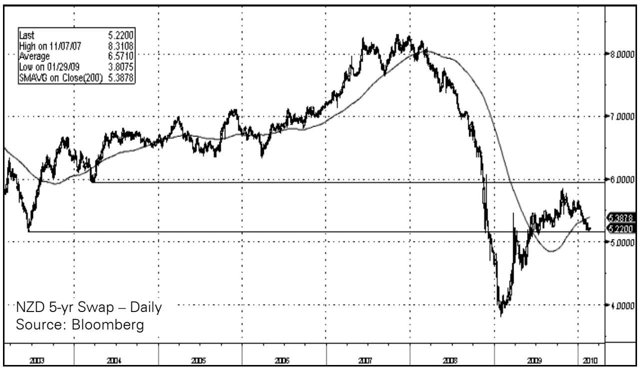
NZD 5yr Swap Rate

Outlook: Consolidating
MT Resistance: 5.90%
MT Support: 5.20%

The market is very close to medium term support at 5.20%. We expect this to hold, however a break would open up 5.09%, even 4.90%.



NZ 2yr-5yr Swap Spread (yield curve)

Outlook: Rangebound
MT Resistance: +122
MT Support: +98

The market is oscillating in the medium term range at present and only a break at either end will make us put a position on.

Foreign Exchange Market

Reuters pg BNZWFWDS

The NZD/USD spent most of last week in a 0.6930-0.7080 range.

Early in the week, easing fears about the global recovery allowed 'growth-sensitive' currencies like the NZD to recover. The release of the EU's plan to sort out Greece's fiscal woes underpinned a broad recovery in global risk appetite. While an explicit bailout was ruled out, investors were at least provided with a clear timeline for Greece's deficit slashing plans. Our risk appetite index (which has a scale of 0-100%) rose from 52.7% to around 60% by the middle of the week, and NZD/USD jumped from 0.6950 to almost 0.7080.

However, the burgeoning NZD recovery hit a speed bump on Friday in the form of the Fed's surprise decision to increase its discount rate 25bps to 0.75%. While the move had been widely flagged, the timing caught markets off-guard. US interest rates and the USD soared as investors anticipated an earlier start to the Fed tightening cycle, sending NZD/USD tumbling back towards 0.6950.

The NZD spent Friday night licking its wounds. A veritable chorus of Fed officials hit the wires slamming talk of earlier Fed rate increases as "overblown". Weak January US inflation data served to reinforce these sentiments. Having started the night in negative territory, US stocks managed to close in the black (to be up 3.1% for the week), and NZD/USD drifted up to nearly 0.7000.

Looking ahead, the highlight of this week's local data schedule looks set to be Thursday's NBNZ business survey. This will be supported by a broad range of largely second tier indicators, including inflation expectations, merchandise trade and building consents. All up, we expect this week's data to show signs of ongoing economic recovery, even if a bit more caution creeps in. Should this pan out, we'd expect the NZD to remain well supported over the week. However, we suspect the resurgent USD will limit any bounces to the 0.7200 region in the short-term. As such, expect a bit more range trading in NZD/USD this week.

The more interesting currency stories, in our view, are currently playing out amongst the NZD crosses. The NZD posted solid gains against the EUR, JPY and GBP last week, as various titbits of data and official comments highlighted the fact that, in a relative sense, the NZ economy exited the financial crisis in pretty good shape. We look for the trend for a stronger NZD/EUR and NZD/JPY to become more entrenched in coming weeks. In contrast, NZD/AUD presented an obvious weak spot, sliding to 9-month lows around 0.7770. NZ markets have gravitated towards our view for a June start for RBNZ tightening. But if Australian markets are indeed underpricing the chances of near-term RBA hikes, as we suspect, we may see further (limited) downside in NZD/AUD this week.

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Foreign Exchange Technicals

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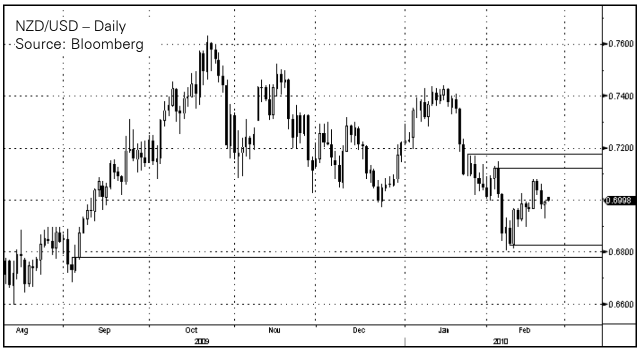
NZD/USD

Outlook:	Buy a dip
ST Resistance:	0.7120 (ahead of 0.7170)
ST Support:	0.6820 (ahead of 0.6780)

The failure to sustain dips towards 0.6950 suggests the downward momentum has stalled. A daily close above 0.7070 would be consistent with a rebound back towards 0.7200.



NZD/AUD

Outlook:	Sell a rally
ST Resistance:	0.7870 (ahead of 0.7910)
ST Support:	0.7750 (ahead of 0.7730)

The break below 0.7835 saw momentum indicators turn negative. Combined with Friday's close below the 3 December low of 0.7785, this suggests a test of support around 0.7750 is in the offing.

Key Upcoming Events

	Forecast	Median	Last
Monday 22 February			
US, Fed's Yellen Speaks			
Tuesday 23 February			
Aus, RBA's Battelino Speaks			
Jpn, BOJ Minutes, 25/26 Jan meeting			
UK, BOE Officials Testify, Re Inflation			
US, Shiller Home Price Index, December y/y		-3.0%	-5.3%
US, Consumer Confidence, February		55.0	55.9
Germ, IFO Index, February		96.1	95.8
Wednesday 24 February			
NZ, RBNZ Survey of Expectations, Feb (2-yr ahead)			+2.6%
Aus, Labour Price Index, Q4	+0.8%	+0.8%	+0.7%
Jpn, Merchandise Trade Balance, January		-¥136b	+¥544b
Euro, Industrial Orders, December		-1.0%	+2.7%
US, New Home Sales, January		355k	342k
US, Bernanke Testifies, Six-monthly			
Germ, GDP, Q4 2nd est		flat	+flat(P)
Thursday 25 February			
NZ, Household Credit, January y/y			+2.7%
NZ, NBNZ Business Survey, February			+38.5

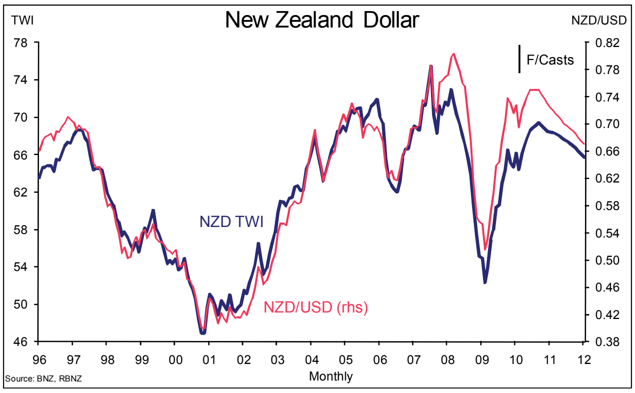
	Forecast	Median	Last
Thursday 25 February *continued...*			
Aus, Private New Capex, Q4	+1.0%	+1.5%	-3.9%
Aus, Building Work Done, Q4	+5.0%	+2.0%	+2.2%
UK, Business Investment, Q4 1st est	+0.1%	-0.6%P	
Euro, M3, January y/y		flat	-0.2%
Euro, Economic Confidence, February		96.4	95.7
US, Durables Orders, January		+1.5%	+1.0%
Germ, Unemployment, February sa		8.2%	8.2%
Friday 26 February			
NZ, Merchandise Trade, January	+$70m	-$100m	+$2m
NZ, Building Consents, January (res, #)			-2.4%
Aus, Private Sector Credit, January	+0.2%	+0.2%	+0.3%
Jpn, Retail Trade, January y/y		-0.2%	-0.2%
Jpn, Industrial Production, January 1st est		+1.0%	+1.9%P
Jpn, CPI, January y/y		-1.4%	-1.7%
UK, GDP, Q4 2nd est		+0.2%	+0.1%P
US, Existing Home Sales, January		5.50m	5.45m
US, GDP, Q1 saar 2nd est		+5.7%	+5.7%P
US, Chicago PMI, February		59.0	61.5

Historical Data

	Today	Week Ago	Month Ago	Year Ago
CASH & BANK BILLS				
Call	2.50	2.50	2.50	3.50
1 mth	2.67	2.72	2.71	3.64
2 mth	2.73	2.74	2.75	3.44
3 mth	2.71	2.74	2.77	3.28
6 mth	2.90	2.94	3.01	3.07
GOVERNMENT STOCK				
11/11	3.82	3.85	4.05	3.53
04/13	4.63	4.59	4.74	3.92
04/15	5.13	5.08	5.22	4.26
12/17	5.59	5.55	5.65	4.55
05/21	5.87	5.85	6.53	-
CORPORATE BONDS				
BNZ 09/10	3.54	3.59	3.79	-
BNZ 05/15	6.49	6.50	6.58	-
GEN 03/14	6.55	6.56	6.60	-
GEN 03/16	7.17	7.18	7.27	-
TRP 12/10	3.90	3.94	4.23	3.97
TRP 06/20	7.16	7.16	7.24	5.80
SWAP RATES				
2 years	4.23	4.21	4.42	3.25
3 years	4.72	4.70	4.87	3.61
5 years	5.22	5.20	5.33	4.00
10 years	5.87	5.85	5.90	4.68

	Today	Week Ago	Month Ago	Year Ago
FOREIGN EXCHANGE				
NZD/USD	0.6999	0.6953	0.7140	0.5081
NZD/AUD	0.7772	0.7828	0.7889	0.7902
NZD/JPY	64.03	62.60	64.43	47.52
NZD/EUR	0.5136	0.5108	0.5045	0.3976
NZD/GBP	0.4523	0.4436	0.4397	0.3532
NZD/CAD	0.7268	0.7308	0.7554	0.6362
TWI	64.93	64.52	65.11	51.88

NZD Outlook



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