

15 March 2010

NZ Data Map to "Around Mid-Year"

- OCR hikes: don't say you haven't been warned
- Starting June, probably
- Although July allows clutch of key data
- This week is sedate, next week has Q4 GDP
- "Neutral" OCR lowered to 4.50-5.00%

This week is a relatively sedate one for local economic reports. Following this morning's better Performance of Services Index (53.7, from January's 53.1, unadjusted), Thursday's ANZ-RM consumer poll is the next in view. We expect it struggled to hold January's relatively firm level of 123.6.

Friday's report on International Travel and Migration will probably affirm another reasonable number on net immigration during February, although the key will be migrant departures. We expect these to rebound this year, from recent extreme lows, which will act as a dampener on population growth.

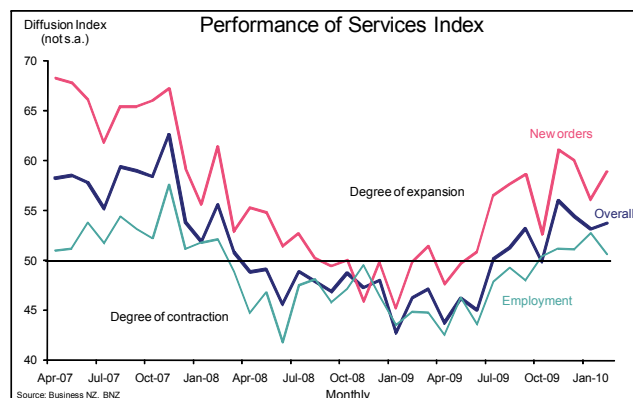
For February's short-term visitor arrivals, we expect to see further good annual gains, in the order of 5%, and with emerging signs that some of the non-Australian markets are recovering, just as growth in tourists from Australia is moderating. Last week's accommodation statistics were certainly good for last month, overall.

The big news of last week, however, was the Reserve Bank affirming we're on track for cash rate hikes starting around the middle of the year. That, of course, means not too far away. Don't say you haven't been warned.

To its credit, the RBNZ has given decent breathing space on interest rates and for private sector debt management over the last eighteen months or so – and importantly so more recently when the markets were demanding tighter policy, much sooner.

But the Bank has recently judged the economy is recovering enough to start nudging the cash rate higher "around the middle of 2010". In the end, there is no use in economic growth being unduly reliant on low interest rates and accumulating debt and leverage. The world tried that over the years 2003-07, underwritten by an overly lax Alan Greenspan, and came unstuck, spectacularly.

Alan Bollard will not want to be lulled into the same trap as his namesake, even if only in mini version. And so NZ companies and households need to realise they don't have too much more time to get their debt, and debt servicing, well set.



With OCR hikes coming into sharper focus, we thought it opportune to outline the broader NZ data flow into mid-year. The sequencing may yet be important for the start point of the RBNZ cycle. We remain inclined toward the June MPS for this. However, as the following list highlights, there is a data case for delaying the first hike until July.

Q4 GDP report (25 March). This is the first big test. We expect production expanded 0.8%. Last week's Monetary Policy Statement factored in 0.6%.

Q1 QSBO (6 April). Following GDP it will be a matter of noting the usual monthly partials, especially from the housing market, until this March quarter Quarterly Survey of Business Opinion hits the wires. It will have its usual wealth of information on activity over the past three months (Q1) and expectations for the near term. Capacity indicators, particularly for the labour market, and the direct inflation gauges, will be as closely watched as the QSBO's GDP indicators.

Q1 CPI (20 April). After the QSBO, the next big domestic report is the 20 April Q1 CPI. At 0.6% we think it will (like GDP) exceed the Reserve Bank's view, which is of a 0.3% advance. Sure, the real stories will be in underlying inflation, which has come right off the boil over the last six months or so. Still, the headline Q1 CPI result will form an important base, given the potential for upside pressures on the CPI later this year, owing to policy changes wider than just (presumably) increased GST.

RBNZ OCR Review (29 April). We expect this will be just a fine-tuning exercise for the RBNZ, as it continues to signal an ever-nearing mid-year start to a tightening cycle – sorry, a removal of stimulus cycle (fair enough).

Q1 HLFS (6 May). Published not long after the OCR meeting, this Household Labour Force Survey will be especially important in that its Q4 edition threw up some apparent inconsistencies between as-expected employment and participation, yet a surprisingly big jump in the unemployment rate. The Q1 update should give a better feel for underlying labour market conditions and trends.

RBNZ FSR (19 May). As a reminder of the still-important financial dimensions to the economic struggles, this (six-monthly) Financial Stability Report from the RBNZ can't be overlooked. It will no doubt expand upon the issue of "structurally" higher funding costs for domestic banks, as well as the ongoing travails of the non-bank financial sector, as a backdrop to the economy's credit source.

Budget (20 May). The very next day, namely 20 May, sees the Government's Budget. We believe this will confirm policies that will exert a near-term net stimulus into the economy (even though the broader fiscal impulse peaked around 2008/09). Can the Government afford it? Probably, in that the Treasury has scope to upgrade its conservative macro-economic forecasts of December. They will still entail clear deficits and rising (net) debt, but probably no worse than the last projections.

RBNZ MPS (10 June). Then, lo and behold, we're pretty much looking at the June Monetary Policy Statement. This is where we still think the RBNZ will probably pull the trigger, with a 25bp hike. In many ways this would simply be a culmination of the broad process we've envisaged, presumably supported by the interim local and international news remaining consistent with ongoing recovery. A bit more tightening by the RBA, as we also presume, would only reinforce the case.

Yet there is also a case for the Bank waiting a bit longer. While Statements are complete in the sense of having full forecasts and dozens of pages of explanation, the abbreviated OCR reviews have the distinct advantage of having a lot of big reports under their belt. Consider the following, post the June MPS.

Q1 GDP (24 June). This will be important for gauging whether the economy is not just expanding, but accelerating as much as the RBNZ thinks.

Q2 QSBO (6 July). This will essentially be a proxy for GDP in Q2 and Q3. Enough said.

Q2 CPI (16 July). This June quarter CPI will be the last clean read on inflation, and an important base, with the 1 July introduction of the Emissions Trading Scheme and ACC policy charges hitting Q3, and, presumably, an increase to GST on 1 October affecting the Q4 CPI.

There is even the argument that waiting until the July OCR review to hike gives the RBNZ the full September MPS to stake stock and best manage reactions and expectations

around policy. Might the Bank even delay its start until July, with 25bps, to test the waters, with a mind to shoring it up with as much as a 50bp move in September?

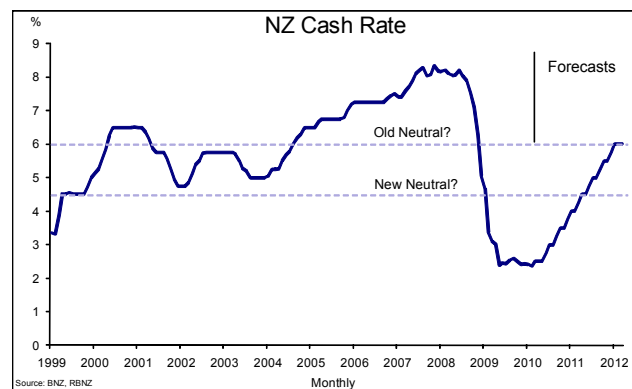
Of course, a lot can happen between now and the middle of the year (and certainly by September). By the same token, it is close enough that we believe the sequencing of the upcoming data, and issues of tightening tactics – as we've broached above – is well worth thinking through.

Even so, the aforementioned are mainly issues of timing. The grander issue is where the RBNZ might get to with its tightening cycle, in the end. In this regard, the Bank dropped clearer hints of a lesser peak in the OCR, all else equal – on the view the increased funding costs of local banks is looking more structural than anything that will naturally abate, as earlier hoped.

We agree with this approach. Better to revise lower one's view on the "neutral" OCR and be proved wrong on account of the recovery surprising on the strong side for a while, than presume neutral is the same as in the recent past, only to be taken aback by how much the "lesser stimulus" cuts the recovery off at its knees, in effect.

Accordingly, we have formally instituted what we had recently thought about – that is, lowering our estimate of the "neutral" nominal OCR to the range of 4.50-5.00% from the long-standing 5.50-6.00%. This is not owing to any updated econometric analysis (perish the thought, with the recently volatile data points). It's simply to acknowledge the likelihood that bank funding costs are likely to remain relatively high for the foreseeable future, principally based on a number of regulatory factors the RBNZ itself is driving through.

This shouldn't affect when OCR hikes should begin, as this is mainly a cyclical economic issue. And the view of a lower pinch-point in the cash rate does not need to make money expensive for businesses and households. It just means the RBNZ needs to be careful about how far it goes with its OCR, in total, lest it forces retail rates to be too high in relation to the stage of the economic recovery.



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Domestic Interest Rates

New Zealand interest rates ended the week lower, as the minor back up ahead of Thursday's RBNZ Monetary Policy Statement ran out of steam. The market sold off heading into the Statement, as market participants appeared to be taking profit from earlier long positions. The MPS confirmed the RBNZ's optimism in the New Zealand economy and continued to point to a tightening cycle beginning mid year. Currently the OIS curve is pricing in a 25bps hike in June, and additional hikes of 25 bps throughout the year, marking the OCR at 3.75% by the end of the year. The statement also highlighted the effects of increased bank funding costs that are effectively tightening monetary conditions, implying the neutral cash rate is probably lower at 4.50-5.00%, rather than 5.50-6.00%. This suggests future interest rate hikes may be capped, but not postponed.

NZ Government bonds have performed well over the past month and endured a back up ahead of the MPS, and the curve ended the week a touch flatter overall. With two tenders last week, the market managed to absorb the additional supply fairly well. Given the build-up

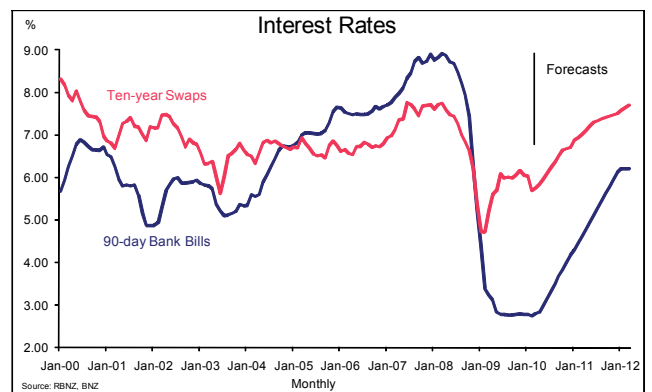
	90 day bills	11/11 NZGS	12/17 NZGS	2yr swaps s/a	10yr swaps s/a	2yr/10yr swaps(bps)
5-Mar-10	2.69%	3.67%	5.44%	4.09%	5.76%	167
12-Mar-10	2.70%	3.75%	5.57%	4.20%	5.83%	163
Change (bps)	1	7	13	11	7	-4

Reuters pgs BNZL BNZM

of supply in the kiwi market at present, we feel that any rally going forward will be limited.

The swaps market followed suit and also sold off heading into the MPS. The curve flattened a touch with yields backing up about 10 bps in the short end and 7 bps in the long end. With no natural payside interest in the market from domestic balance sheets and minimal corporate flow, the move higher last week perhaps reflected profit taking. This week with no material domestic data, the market will look to offshore markets for direction, most notably the RBA minutes and the FOMC decision. We see the current range in 2-year swap to be 4.10-4.30%.

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Interest Rate Technicals

NZD 5yr Swap Rate

Outlook: Higher
 ST Resistance: 5.50%
 ST Support: 5.03%

The market has tested the downside and failed. We are likely in a fairly tight range but we look for support at 5.03% to hold and a gradual move higher towards 5.50% resistance.

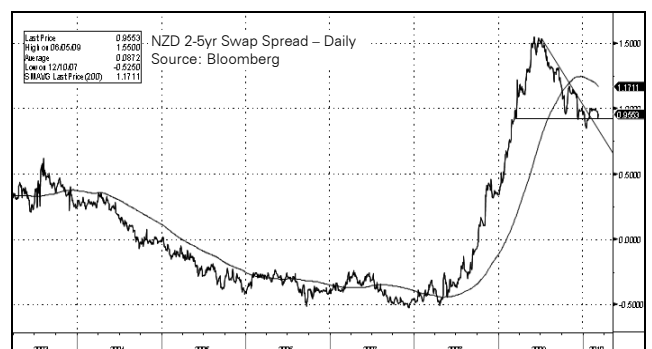


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NZ 2yr-5yr Swap Spread (yield curve)

Outlook: Rangebound
 MT Resistance: +122
 MT Support: +92

Trendline from mid 09 has been broken suggesting a near-term steepening. However expect resistance at +122 to hold.



Foreign Exchange Market

Reuters pg BNZFWDS

The NZD/USD spent most of last week chopping broadly sideways in a relatively tight 0.6950-0.7100 range.

The global outlook has become more NZD supportive over the past couple of weeks. Forecasts for the global economic expansion continue to rise and concerns around Greece, and its potential implications for global markets, have diminished (without disappearing entirely). The associated gains in investors' risk appetite helped pitch NZD/USD to a 5-week high of nearly 0.7100 last week. Our risk appetite index (which has a scale of 0-100%) finished the week at 70% - the highest since May 2008.

Still, last week's RBNZ Statement proved a tad more dovish than market expectations, knocking the NZD from its highs. While the Bank maintained its expectation to "begin removing policy stimulus around the middle of 2010", markets were more interested in the Bank's comments higher bank funding costs will reduce the work the Bank will have to do via a higher OCR. Policy rate expectations were trimmed accordingly. The chances of a June 25bps rate hike were reduced to 75% (from 100%) and NZ-US 3-year swap spreads dipped below 290bps.

Following the flood of data last week, the local calendar is relatively sparse over the coming week. As such, offshore events and the performance of the USD will be key to the fortunes of the NZD over coming days. While the Eurozone finance ministers are meeting early in the week (weekend press reports again speculated about a bailout for Greece), the FOMC meeting on Wednesday morning (NZT) will likely dominate sentiment. The Fed will likely confirm MBS and Agency debt buying will finish at the end of March. If any further policy 'normalisation' steps are announced, expect a bounce in the USD and a slide in NZD/USD.

Our short-term valuation model suggests NZD/USD is undervalued at current levels. The current combination of risk appetite, NZ-US 3-year swap spreads and commodity prices suggests a 'fair-value' range of 0.7100-0.7300. We suspect a move into this range is likely in coming weeks, in the absence of another bout of risk aversion or a worsening in concerns about European sovereign risk. In the short-term, a daily close above 0.7070 is needed to signal an upside breakout of NZD/USD's recent 0.6950-0.7100 range. Any dips towards 0.6950 are expected to be short-lived over the week.

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Foreign Exchange Technicals

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NZD/USD

Outlook: Consolidation
 ST Resistance: 0.7070 (ahead of 0.7120)
 ST Support: 0.6830 (ahead of 0.6780)

A re-test of resistance around 0.7070 looks likely in coming sessions. A daily close above this level would pave the way for a move back towards 0.7200.



NZD/AUD

Outlook: Consolidation
 ST Resistance: 0.7710 (ahead of 0.7760)
 ST Support: 0.7630

Momentum will remain negative while the currency trades below 0.7836. A daily close above 0.7730 would suggest the downtrend has stalled.



Key Upcoming Events

	Forecast	Median	Last		Forecast	Median	Last
Monday 15 March				Wednesday 17 March <i>continued...</i>			
NZ, BNZ PSI (Services), February			53.1	UK, BOE Minutes, 3/4 Mar Meeting			
Aus, RBA's Edey Speaks				Euro, Labour Costs, Q4 y/y	+2.7%		+3.2%
US, NAHB Housing Index, February		17	17	US, PPI ex-food/energy, February y/y	+1.0%		+1.0%
US, Empire Manufacturing, March	+22.00		+24.91	Thursday 18 March			
US, Industrial Production, February		flat	+0.9%	NZ, ANZ-RM Consumer Confidence, March			123.6
Tuesday 16 March				UK, CBI Industrial Trends, March			-36
Aus, RBA Minutes, 2 Mar Meeting				Jpn, BOJ Economic Report			
Euro, CPI, Feb y/y 2nd est.		+0.9%	+0.9%P	Jpn, MOF Business Survey, Q1			-1.9
US, FOMC Policy Announcement	0.25%	0.25%	0.25%	Euro, Trade Balance, January (s.a.)	+€5.5b		+€7.0b
US, Housing Starts, February		570k	591k	US, CPI ex food/energy, February	+1.4%		+1.6%
US, Import Prices, February		-0.2%	+1.4%	US, Jobless Claims, week ended 13/03		455k	462k
Germ, ZEW Sentiment, March		+43.5	+45.1	US, Current Account, Q4 s.a.	-\$119.8b		-\$108.0b
Wednesday 17 March				US, Philly Fed Index, March		+17.0	+17.6
Aus, Westpac Leading Index, January			+0.5%	US, Leading Indicator, February		+0.1%	+0.3%
Aus, Dwelling Commencements, Q4			+8.9%	Friday 19 March			
Jpn, Tertiary Industry Index, January	+1.3%		-0.9%	NZ, External Migration, February s.a.			+1,950
Jpn, BOJ Policy Announcement	0.10%	0.10%	0.10%	NZ, Credit Card Billings, February			+1.5%
UK, Unemployment rate (ILO), January		7.9%	7.8%	Jpn, All Industry Index, January	+1.5%		-0.3%
UK, Weekly Earnings, January 3m y/y	+1.7%		+0.8%	Germ, PPI, February y/y	-2.8%		-3.4%

Historical Data

	Today	Week Ago	Month Ago	Year Ago		Today	Week Ago	Month Ago	Year Ago
CASH & BANK BILLS					FOREIGN EXCHANGE				
Call	2.50	2.50	2.50	3.00	NZD/USD	0.7038	0.6947	0.6953	0.5220
1 mth	2.65	2.67	2.72	3.47	NZD/AUD	0.7662	0.7657	0.7828	0.7974
2 mth	2.67	2.69	2.74	3.40	NZD/JPY	63.92	62.81	62.60	51.08
3 mth	2.71	2.67	2.74	3.24	NZD/EUR	0.5108	0.5096	0.5108	0.4049
6 mth	2.86	2.86	2.94	3.13	NZD/GBP	0.4639	0.4591	0.4436	0.3739
GOVERNMENT STOCK					NZD/CAD	0.7160	0.7147	0.7308	0.6662
11/11	3.74	3.69	3.85	3.45	TWI	64.81	64.31	64.52	53.45
04/13	4.53	4.45	4.59	3.95	NZD Outlook				
04/15	5.09	4.99	5.08	4.34	New Zealand Dollar				
12/17	5.57	5.46	5.55	4.76					
05/21	5.86	5.76	6.53	-	<p>Source: BNZ, RBNZ</p>				
CORPORATE BONDS									
BNZ 09/10	3.44	3.46	3.59	-					
BNZ 05/15	6.39	6.32	6.50	-					
GEN 03/14	6.48	6.39	6.56	-					
GEN 03/16	7.12	7.03	7.18	-					
TRP 12/10	3.82	3.81	3.94	4.34					
TRP 06/20	7.12	7.05	7.16	6.62					
SWAP RATES									
2 years	4.21	4.11	4.21	3.47					
3 years	4.66	4.57	4.70	3.90					
5 years	5.17	5.09	5.20	4.44					
10 years	5.84	5.78	5.85	5.18					

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