31 January 2011

Rebalancing Hampering Recovery for Now

- Building consents much worse than expected
- But December's trade data good enough, ex-aircraft
- Commodity export prices look improved through January
- Q4 jobs probably up a tad, jobless rate steady at 6.4%
- Bollard speech not quite as firm as OCR commentary

New Zealand's economic rebalancing is proving a painful process, hampering any material pick-up in GDP for the meantime. This morning's December building consents proved awful, for instance, although the month's exports were reasonably positive. Commodity export prices look to be even stronger into the New Year – while the credit aggregates reflect the unfortunately slow economy-wide averages, but also improved private-sector savings and balance sheets. We're getting there, but it's a tortuous, and torturous, process.

In respect to December's building consents, yes, some of their fall reflected apartment consents coming back down to earth, with 85, from November's 226 spike. But ex-apartment residential consents were very weak, dropping a seasonally adjusted 11% in the month, to be down 28% on a year prior, in adjusted terms. The trend augurs badly for home-building activity into the early part of 2011.

While we didn't expect any bounce in the December residential consents, and were conscious of November's apartment spike washing out, we certainly weren't expecting anything like the size of the fall we witnessed.

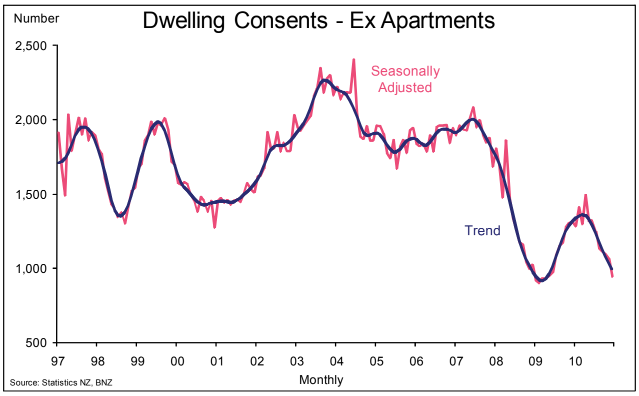
For the record, there were a number of consents related to the Canterbury earthquake. But these were the paltry sum of 30, valued at $10m; so just a drop in the boat-load of the billions that will have to show up in the not too distant future. Moreover, there weren't any signs of life yet in consents for alterations and additions, by which a lot of the post-earthquake rebuilding will show up as, when they do. For December 2010, they were down.

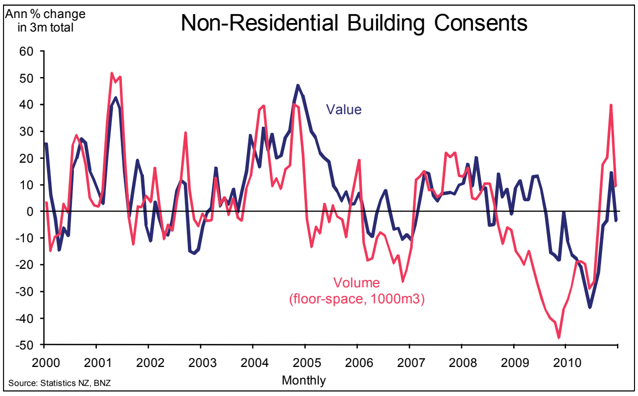
Non-residential consents also rubbed salt into the wound for now. Their 18% fall (in value) from a year ago, dampened the hopes that November's 23% y/y rise entertained. Likewise, the amount of non-residential floor-space consented fell on its face during December, after seemingly finding some footing the month beforehand.

As for this morning's merchandise trade figures, these were actually not too bad. The bigger than expected deficit (-$250m), compared to market expectations (of between -$100m to +$50m), probably reflected the large aircraft import hitting the accounts (which we thought would happen). This was worth about $230m, according to Statistics NZ. Excluding the aircraft import, the trade figures looked close enough to expectations.

Compared to what we were looking for, imports were pretty close, and continued to reflect a nice skew towards core capital imports (a feature the RBNZ noted last week). And while exports did undershoot our expectations in nominal terms, there was enough in the volume-based indicators to support our view that real merchandise exports bounced a bit during Q4, largely on the back of improved primary-sector processing.

On the assumption Statistics NZ removes December's aircraft from the Balance of Payments (and GDP investment/imports) – as tends to be the accounting treatment – today's trade data suggest New Zealand's current account deficit will slim to about 2.4% of GDP for the full calendar-year 2010, compared to the 3.1% result reported for the year to September (which included the benefits of the earthquake re-insurance money from abroad).





As context to this afternoon's credit aggregates, while we expect them to tell of a still-slow economic advance, we also note there is increasing indication their stalling reflects, to some extent at least, much-repaired savings rates and balance sheets in the household and business sectors. It's progress, of a different sort than GDP.

For Tuesday's wage reports, the background is that the September quarter numbers turned up – earlier, and more noticeably, than we expected. We expect December quarter's wage and salary data to avow this turning point, with the private-sector Labour Cost Index the most important series to mark in this respect. We reckon this unit labour cost proxy expanded 0.5% in Q4, strengthening its annual pace to 1.8% (much as the market expects too).

The QES nominal wage and salary measures, as usual, will most probably be very noisy. And even the survey's filled-jobs measure – often a ball-park pointer to HLFS employment – has lost this confidence for now, in that it did not give any inkling of the 1% jump in Q3 jobs that occurred in the September quarter HLFS.

For more definite leads of where the economy is at, we estimate the ANZ world-price commodity index (published Tuesday afternoon) increased a further 3% or so, in doing so setting a new all-time high. Hot on its heels, we expect Fonterra's latest fortnightly auction – conducted in the early hours of New Zealand's Wednesday morning – will achieve a solid outcome, at least holding the strong gains of the last couple of months. The latter result, especially, will be an immediate test of how international worries about food supply, and general food inflation, are translating into prices directly relevant to the New Zealand economy.

As for the Thursday's HLFS, we are basically looking for this to consolidate its recent improvement. While the 0.2% increase in Q4 employment we anticipate doesn't sound much, it would effectively be a solid follow-on from Q3's 1.0% gain. This would deliver a steady 6.4% for the unemployment rate, on the basis of fractional dip in the participation rate (to 68.2%, from 68.3%). Our expectations on HLFS employment and unemployment happen to be right in line with the market medians.

Even if there are some hiccups in the HLFS data, we note the bulk of the forward-looking indicators on New Zealand's labour market are reasonably positive.

Finishing the local data week, Friday's net immigration result for December should be another mild, but positive, one, but annual growth in short-term visitor arrivals will probably dip back into the red.

Just running through all the ups and downs of this week's data gives a good sense of the churn out there in the local economy, the difficulties in reading it and the ongoing uncertainties in forecasting the whole kit and caboodle.

This was precisely the theme of Alan Bollard's first on-the-record speech of the year, last Friday. But while essentially pointing out that "anything could happen", the Governor left us with the impression he is more concerned about what could turn out softer than expected on the GDP and inflation fronts than heated on either account. His detailed, risk-focussed, speech thus came across as not quite as firmly inclined as his central-focussed OCR commentary the very day before it.

So while we have elected to persevere with idea of the RBNZ bumping the OCR up in June, we concede the risks remain for a delay to the process. Equally, much still depends on the news between now and mid-year. On this we fully agree with the Bank. As we mentioned in last week's Markets Outlook, it feels like this will be the real crunch year, with all of the easy options, related to expensive policy support, having been largely drawn upon over 2008-10.

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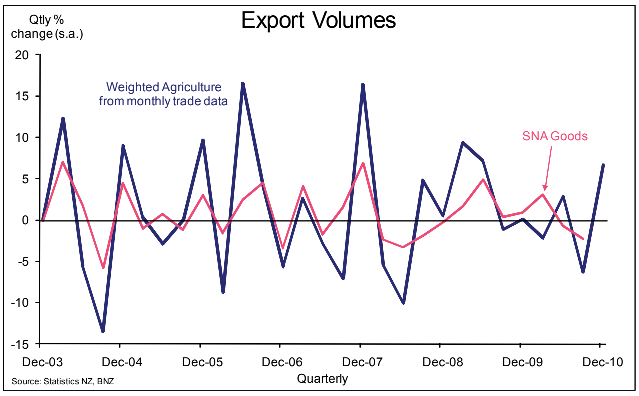

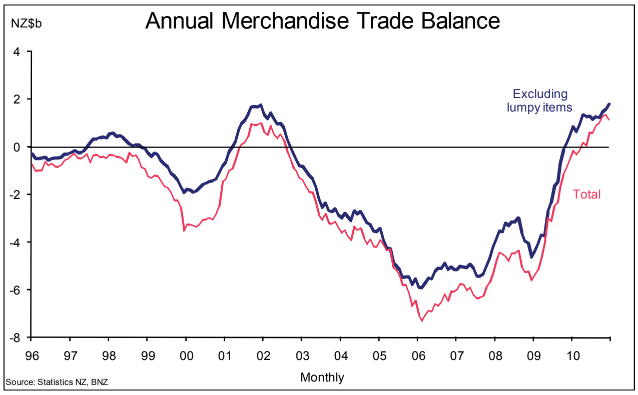

Domestic Interest Rates

Reuters pgs BNZL BNZM

Governor Bollard made no change to the OCR on Thursday which came as no surprise to the market. The statement was pretty standard with the sentiment coming out slightly less dovish than expected. Straight off the bat, we saw a 4bp sell off in short end rates. The OIS curve also moved on OCR day with 22bps and 70bps now priced in for the next four meetings and 12 months respectively. The chance of a 25bp hike in the July meeting now stands at 92%. Over the week 90 day bills have traded up 3bps with 3-month BKBM setting at 3.21% on Friday. The bank bill margin is currently 19bps.

The flattening theme has continued on the swap curve during the week with a large rally in the 10-yr causing the yield to fall 10bps to 5.36%. There was less action in the 2-yr with a 1bp decrease to 3.86%. On OCR day, we saw the 2-yr get bid all the way up to 3.90% but trading in only a small amount. Out the back of the curve, there were a decent amount of offers and we saw the 10-yr yield decrease by 6bps on the day. Due to the movement in the 10-yr over the week, we have seen the 2s10s come in by 9bps to now sit at 159bps.

	90 day bills	04/13 NZGS	05/21 NZGS	2yr swaps s/a	10yr swaps s/a	2yr/10yr swaps(bps)
21-Jan-11	3.18%	3.96%	5.58%	3.87%	5.46%	159
28-Jan-11	3.21%	3.90%	5.50%	3.86%	5.36%	150
Change (bps)	**3**	**-6**	**-8**	**-1**	**-10**	**-9**

Last week saw a small rally in the New Zealand government bond market. Thursday's $550m tender showed good demand. The yield in the 13s decreased 6bps, closing at 3.90%, and the yield in the 21s decreased 8bps, closing at 5.50%. Looking ahead for the week, direction will come from offshore events, with focus on the current situation in Egypt. We also have US non-farm payrolls on Friday. The local data highlight with the potential to move bond yields will be Thursday's Employment/Unemployment rate data.

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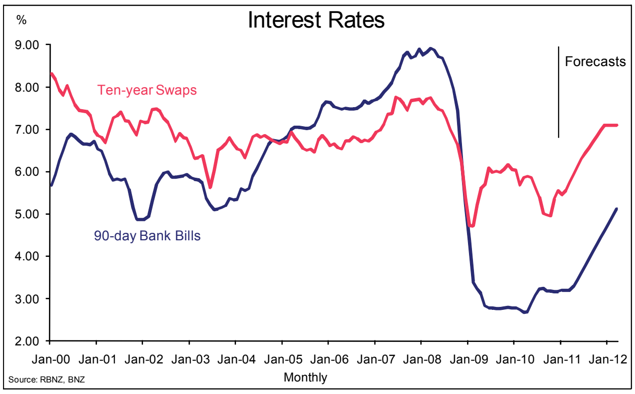

Interest Rate Technicals

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NZD 5yr Swap Rate

Outlook: Neutral
MT Resistance: 4.95%
MT Support: 4.26%

The market is consolidating around current levels. ST support is at 4.55/4.58 and expect this to hold near term. A break of this level will open up 4.26%.

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

Outlook: Neutral
MT Resistance: +100
MT Support: +63

The market is now mid range. We await a break of horizontal lines before initiating a new trade.

Foreign Exchange Market

Reuters pg BNZWFWDS

The NZD/USD was the strongest performing currency last week, rising almost 1.4%. A more upbeat statement from the RBNZ on Thursday helped to underpin the NZD, especially in the backdrop of some negative surprises elsewhere, most notably weak UK Q4 GDP (-0.5% q/q versus an expectation of 0.5%).

The NZD/USD spent the week on a gradual uptrend, rising from around 0.7600 to a high of just under 0.7800 on Friday. However, news and graphic coverage of political unrest in Egypt on Friday night saw the NZD/USD slide to 0.7700, as risk aversion rose. Our composite risk appetite index (which has a scale from 0-100%) fell sharply on Friday to 63% from 75% the previous day. Historically the NZD/USD has a relatively close relationship to our risk appetite index, falling as the index falls.

The rise in risk aversion more broadly was reflected in equity market weakness, a spike in the VIX index, and demand for 'safe haven' assets such as US 10-year bonds and gold. As a 'risky asset' the NZD may come under further pressure early this week, if the situation in Egypt remains unresolved, or deteriorates, sparking fears of contagion in the region.

The NZD gained ground on most of the crosses last week. Relative to the AUD, the NZD rose on Friday afternoon to a 2-month high above 0.7800, before finishing the night below 0.7780. In the week ahead, on Tuesday we will get the RBA cash announcement. While we do not expect any change in policy, commentary is likely to focus on the recent impact of floods, and update growth and inflation forecasts. Our expectation is for the RBA to hike rates again in H2, after the next hike that we expect from the RBNZ in June.

The NZD/GBP ended last week higher, closing at almost 0.4900. The relative growth outlook continues to favour the NZD over the GBP, as does the interest rate differential which remains large on historical standards, and has the potential to widen further, in our view. We do not expect any drift lower in the NZD/GBP until well into H2.

Relative to the EUR, the NZD gained on Friday night from around 0.5630 to close above 0.5680. The broad weakening of the EUR late in the night suggests its proximity to the unrest in Egypt on Friday may have taken a toll.

This week it's fairly quiet on the data front locally. After today's building permits and trade balance data, LCI/QES wage reports and employment data will be released later in the week. International events may be the more prominent driver of NZD this week. The situation in Egypt may well exert further downward pressure on the NZD/USD this week given its status as a 'risky asset'. There is also a slew of data out of the US this week, from the ISM manufacturing index, to unit labour costs and change in non-farm payrolls, which will help to broaden the picture on US growth.

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Foreign Exchange Technicals

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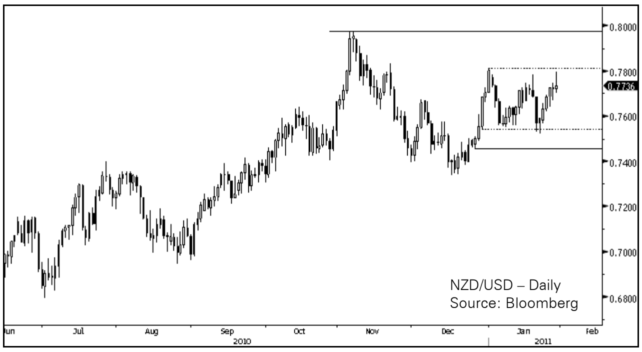
NZD/USD

Outlook: Buy a dip.
ST Resistance: 0.7810 (ahead of 0.7980)
ST Support: 0.7540 (ahead of 0.7455)

A lack of momentum and direction means more rangy trading is expected near-term. The 0.7550-0.7800 range looks well entrenched.



NZD/USD – Daily
Source: Bloomberg

NZD/AUD

Outlook: Buy a dip.
ST Resistance: 0.7790 (ahead of 0.7895)
ST Support: 0.7640 (ahead of 0.7570)

Momentum is positive and dips should be viewed as buying opportunities. A daily close above 0.7790 is still needed to confirm the uptrend.

NZD/AUD – Daily
Source: Bloomberg

Key Upcoming Events

	Forecast	Median	Last
Monday 31 January			
NZ, Household Credit, December y/y			+1.8%
NZ, Merchandise Trade, December	-$106m	-$100m	-$186m
NZ, Building Consents, Dec (res, #)			+8.8%
Aus, Private Sector Credit, Dec	+0.2%	+0.2%	+0.3%
Jpn, Industrial Production, Dec 1st est		+2.8%	+1.0%
Euro, CPI, Jan y/y 1st est.		+2.3%	+2.2%
US, Chicago PMI, January		64.5	66.8
US, Personal Spending, December		+0.5%	+0.4%
Tuesday 1 February			
NZ, ANZ Comdty Prices ($NZ), January			+4.5%
NZ, LCI Priv Ord Wages, Q4 y/y	+1.8%	+1.8%	+1.6%
Aus, NAB Business Survey, December			
Aus, RBA Policy Announcement	4.75%	4.75%	4.75%
Aus, House Prices, Q3	-0.5%	-0.2%	+0.1%
China, PMI (NBS), January		53.5	53.9
Euro, Unemployment Rate, December		10.1%	10.1%
UK, CIPS Manuf Survey, January		58.0	58.3
US, Construction Spending, December		+0.1%	+0.4%
US, ISM Manufacturing, January		58.0	58.5

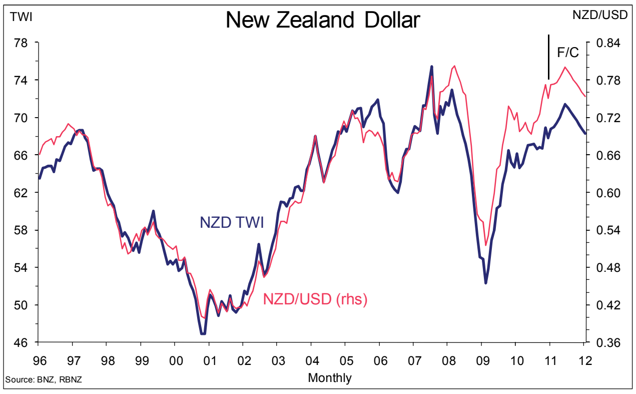
	Forecast	Median	Last
Wednesday 2 February			
NZ, Fonterra Auction			+1.2%
Euro, PPI, December y/y		+5.2%	+4.5%
US, ADP Employment, January		+150k	+297k
Thursday 3 February			
NZ, HLFS Unemployment Rate, Q4	6.4%	6.4%	6.4%
NZ, HLFS Employment, Q4	+0.2%	+0.2%	+1.0%
Aus, Building Approvals, December	+2.0%	+1.0%	-4.2%
Aus, International Trade, December	+$1.70b	+$1.60b	+$1.92b
China, Non-manufacturing PMI, Dec			56.5
Euro, ECB Policy Announcement	1.00%	1.00%	1.00%
UK, CIPS Services, January		51.3	49.7
US, Factory Orders, December		-0.4%	+0.7%
US, ISM Non-Manuf, January		57.0	57.1
US, Bernanke Speaks			
Friday 4 February			
NZ, External Migration, December s.a.			+630
Aus, RBA Quarterly Statement			
US, Non-Farm Payrolls, January		+140k	+103k

Historical Data

	Today	Week Ago	Month Ago	Year Ago
CASH & BANK BILLS				
Call	3.00	3.00	3.00	2.50
1 mth	3.16	3.13	3.10	2.72
2 mth	3.17	3.17	3.13	2.75
3 mth	3.21	3.18	3.19	2.75
6 mth	3.24	3.24	3.22	3.01
GOVERNMENT STOCK				
11/11	3.32	3.32	3.36	3.99
04/13	3.89	3.96	4.00	4.70
04/15	4.54	4.63	4.76	5.18
12/17	5.11	5.21	5.43	5.62
05/21	5.49	5.59	6.53	-
CORPORATE BONDS				
BNZ 05/13	5.05	5.07	5.04	-
BNZ 09/16	6.41	6.46	6.54	-
FON 04/14	5.69	5.71	5.71	-
FON 03/16	6.20	6.24	6.31	-
GEN 03/14	5.62	5.64	5.63	7.25
GEN 03/16	6.26	6.30	6.41	7.65
TRP 06/20	6.63	6.72	6.85	6.95
SWAP RATES				
2 years	3.86	3.87	3.80	4.38
3 years	4.19	4.21	4.18	4.84
5 years	4.64	4.67	4.73	5.30
10 years	5.36	5.46	5.53	5.88

	Today	Week Ago	Month Ago	Year Ago
FOREIGN EXCHANGE				
NZD/USD	0.7697	0.7630	0.7569	0.7002
NZD/AUD	0.7779	0.7647	0.7497	0.7958
NZD/JPY	63.11	62.93	62.39	63.00
NZD/EUR	0.5662	0.5592	0.5770	0.5053
NZD/GBP	0.4862	0.4770	0.4920	0.4390
NZD/CAD	0.7708	0.7592	0.7568	0.7502
TWI	68.80	68.02	68.21	64.69

NZD Outlook



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