

Business Weekly

Casing out a cut

This Week

The RBNZ's Monetary Policy Statement will be released on Thursday morning. The global economy is bottoming out, NZ's housing market on the up, and optimism is rising high. The widespread consensus is for the RBNZ to remain on hold, which market pricing concurs with (a token 10% change of an easing is priced in). However, we believe there is a good case for the RBNZ cutting the OCR.

Notwithstanding the improved sentiment, continued tightening in monetary conditions via rising term rates and the NZD are a threat to the fragile recovery that is barely getting started. Although the housing market is on the mend, many businesses will still find trading conditions tough over the next year. Cutting the OCR, in a very benign inflation environment, will help reduce the risk of the recovery being choked off.

Over the past 5 months the RBNZ has repeatedly expressed concern over the rising NZD and long-term interest rates, and July adopted an explicit easing bias. A key judgement for the RBNZ is whether it remains concerned enough to follow through on that bias, or whether it decides there is little point trying to stand in the way of recent trends. For more details on our thoughts, our full Preview is available [here](#).

The RBNZ has had a bad track record in Monetary Policy Statement releases this year: in March and June it unintentionally triggered jumps in both the NZD and wholesale interest rates. In contrast, the April and July OCR reviews were (briefly) successful attempts to rein in rates. In July the RBNZ steered clear of sounding optimistic, repeated its expectation of keeping interest rates low "until the latter part of 2010", and explicitly adopted an easing bias. In the absence of a rate cut there will be a lot of focus on whether the RBNZ retains both the easing bias and the "low until the latter part of 2010" statement. The removal of either phrase at this meeting will – rightly or wrongly – reinforce perceptions that the RBNZ is moving away from trying to condition expectations it will hold the OCR down for much of 2010.

Stepping back from this week's OCR decision, borrowers should be aware that the rise in term lending rates will continue over time. Rates are being dragged up by the more buoyant global outlook and mounting expectations that central banks will start to reverse the extreme easings of the past year. The impact on lending rates of those expectations is one reason why the RBNZ should consider cutting the OCR. We don't think the RBNZ will be taking much of a risk in doing so. If NZ's recovery (and inflation pressures) subsequently turned out to be more robust than anticipated, the RBNZ will have very little difficulty tightening the thumbscrews. Let's face it, the problem this year has been the opposite!

Click here for:

[Foreign Exchange](#)

- NZD mixed, and continues to hit resistance at USD 0.69.

[Interest Rates](#)

- NZ rates dip over the week.

[Week Ahead](#)

- RBNZ the highlight. Terms of Trade, Value of Building Work Put in Place due.

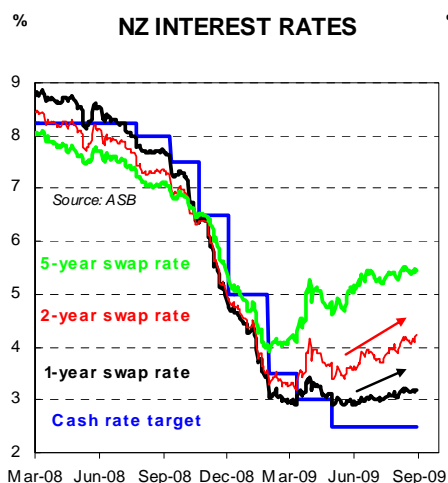
[Week in Review](#)

- Confidence continued to lift in the latest NBNZ business Outlook Survey.

[Global Calendars](#)

- Beige Book, Bank of England rate announcement, US consumer confidence.

Chart of the week



- Further to last week's chart, when we discussed the challenges the high NZ dollar presented to the RBNZ, this week we look at interest rates and the disconnect between the current level of the OCR.
- Longer-term interest rates have been lifting up off their lows for some time now and are back to long-term averages, and can now longer be considered stimulatory.
- The RBNZ has more influence over shorter-term interest rates. However, the credit crisis has resulted in strong competition for domestic funds, muting the pass through of the OCR.
- More recently, the NZ 1-year swap has started to rise, following the lift in Australian markets due to expectations for OCR hikes being brought forward. New Zealand is experiencing a defacto tightening because of Australia's better economic outlook.

General Advice Warning

As this report was prepared without taking into account your objectives, financial situation or particular needs, you should not take any action in reliance of this report without considering your particular circumstances and, if necessary, obtaining professional advice.

Foreign Exchange Market

FX Rates	Current*	Week ago	Month ago	6 mths ago	Year ago	ST Bias	Support^	Resistance^
NZD/USD	0.6892	0.6827	0.6705	0.5022	0.6662	FLAT	0.6750	0.6950
NZD/AUD	0.8084	0.8130	0.7995	0.7848	0.8164	FLAT	0.8000	0.8200
NZD/JPY	64.14	63.31	63.92	49.25	71.08	FLAT	63.00	65.00
NZD/EUR	0.4815	0.4776	0.4667	0.3960	0.4669	FLAT	0.4750	0.4850
NZD/GBP	0.4199	0.4202	0.3995	0.3554	0.3792	FLAT	0.4150	0.4250
TWI	63.6	63.3	62.2	51.9	63.4	FLAT	62.00	64.00

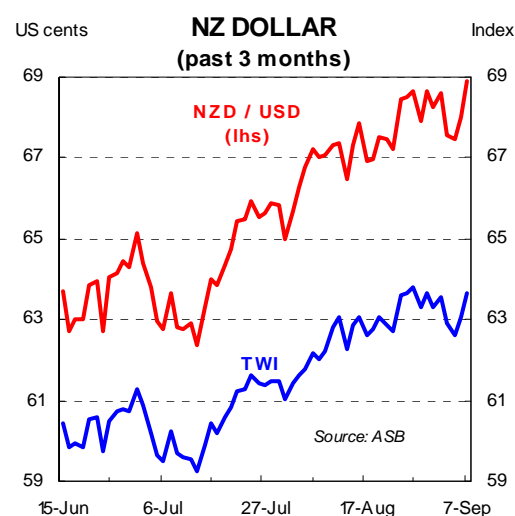
^Weekly support and resistance levels * Current is as at 12pm Monday; week ago as at Monday 5pm

- The NZD lifted slightly on a trade-weighted basis last week. The NZD continues to fail to break through 0.69 against the USD. The NZD lost ground on the AUD, rose against the JPY and Euro, and was little changed against the GBP.
- Whilst NZD/AUD has risen recently in response to changes in expectations for global growth, the interest rate outlook has begun to be reflected in the cross rate. We are going against the market consensus and calling for the Reserve Bank of New Zealand (RBNZ) to cut rates at their meeting this week. Even if the RBNZ do not cut rates, we expect AUD to outperform the NZD as the RBNZ continues to sound dovish in the Monetary Policy Statement (MPS). The RBNZ have already indicated it will discuss the (unwanted) strength of the NZD in the MPS. This will prove pivotal reading for foreign currency investors on Thursday.
- The USD has continued to find some support from better-than-expected US economic data. The USD still remains sensitive to swings in investor risk appetite. The US data calendar is sparse this week with the Fed Beige book being the main event. The Fed is likely to continue to sound cautiously upbeat on the US economy and this event could feed through into some USD strength. In addition, we see a risk that US equity markets falter in the low event-risk environment (as the reporting season has ended and there is little economic data due), and the USD could rise as repatriation and treasury purchases take place.

Short-term outlook:

Key data	Date	Time (NZST)	Market expects
Building Work Put in Place	8/9	10.45 am	-
RBNZ OCR Announcement	10/9	9.00 am	2.5%
Q2 Terms of Trade	10/9	10.45 am	-2.5%
August REINZ House Sales	14/9	10.00 am	-
July Retail Trade Survey	14/9	10.45 am	+0.5%

Potential currency movers from the US this week: Fed's beige book, trade balance (10th). Speakers: Evans (9th), Fisher (10th), Lockhart, Kohn and Treasury's Geithner (11th).



Medium term outlook: [Last Quarterly Economic Forecasts](#)

- We expect the NZD to appreciate further against the USD over the next 6-9 months. Much of that story is about the USD, not the NZD.
- We continue to expect the USD to weaken into 2010. The reasons for the expected USD depreciation remain similar to the drivers in place since mid-March, namely:
 - US residents increase their offshore investment, encouraged by improvement in the global economy.
 - USD liquidity demand and safe-haven buying of the USD is reversing.
 - Diversification out of USD is expected to occur due to concerns about US government debt.
- Against the expected backdrop of USD weakness we also expect some moderate and broad-based NZD outperformance. Despite being mired in recession since the start of 2008, NZ's economy is holding up well compared to those of many key trading partners. Over time the NZD is likely to be buoyed by the rising tide of improving confidence in the global economic recovery and firmer commodity prices. Moreover, a buoyant AUD, on improved prospects for its resource exports and speculation of early 2010 rate hikes, will drag the NZD along on its coat-tails.
- We expect the NZD to firm noticeably against the USD and yen as those currencies remain under sustained pressure. Against other key currencies the NZD is likely to appreciate but to a more modest extent. However, the likelihood of the RBNZ intervening to try and weaken the NZD remains low given the NZD itself is not particularly elevated relative to both underlying economic fundamentals and past movements.

Interest Rate Market

Wholesale interest rates	Current	Week ago	Month ago	6 mths ago	Year ago	ST Bias
Cash rate	2.50	2.50	2.50	3.50	8.00	DOWN
90-day bank bill	2.75	2.78	2.76	3.15	8.09	DOWN
2-year swap	4.12	4.22	4.04	3.22	7.27	DOWN
5-year swap	5.40	5.47	5.40	4.13	7.04	DOWN
11/11 gov't stock	4.83	4.91	4.87	3.73	5.93	FLAT
NZSX 50	3116	3098	3063	2476	3334	FLAT

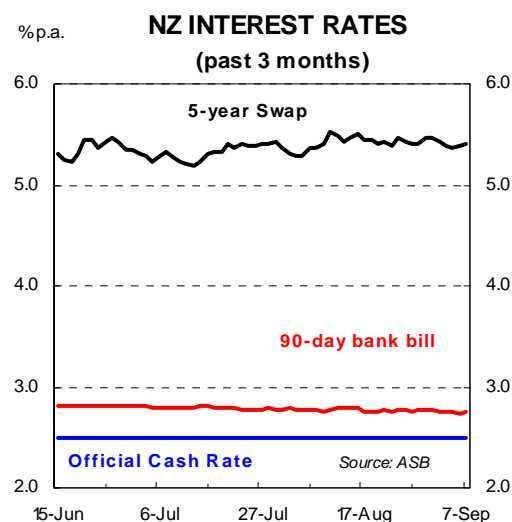
* Current is as at 12pm Monday; week ago as at Monday 5pm

- NZ interest rates dipped lower in sync with the decline in Australian markets following the RBA's cash rate announcement that was accompanied with a more dovish than expected statement.
- The market expects the RBNZ will keep the cash rate unchanged at 2.5% and possibly even remove its easing bias in response to improved economic outlook, both domestically and globally. However, the RBNZ faces a challenge to keep the market's OCR expectations contained. The market doesn't believe the RBNZ will remain on hold until the later part of 2010, it already has 100 basis points of hikes by June 2010 priced in and does not need any more encouragement. The markets response on Thursday will be very asymmetric. Without an OCR cut, a dovish statement will be largely ignored. Meanwhile anything perceived as slightly neutral will result in expectations for OCR hikes brought further forward.
- Given the asymmetry of the market, the fragility of the recovery and the unwarranted tightening in monetary conditions since July, we think the RBNZ should deliver an OCR cut. A bold and unexpected move will send a very clear statement to the market about the RBNZ's resolve to keep the OCR low for an extended period. It would also clearly differentiate the economic outlook and monetary policy in NZ and Australia.

Short-term outlook:

Key data	Date	Time (NZST)	Market expects
Building Work Put in Place	8/9	10.45 am	-
RBNZ OCR Announcement	10/9	9.00 am	2.5%
Q2 Terms of Trade	10/9	10.45 am	-2.5%
August REINZ House Sales	14/9	10.00 am	-
July Retail Trade Survey	14/9	10.45 am	+0.5%

Comment: All eyes on the RBNZ this week. While we think the RBNZ should cut the OCR, odds are that the Bank will stay on hold. If the Bank delivers the market what it expects, the RBNZ are going to struggle to keep OCR expectations contained. If the easing bias is removed (as some are speculating), the market will be quick to further front load rate hikes for early next year.



Medium term outlook: [\[Last Quarterly Economic Forecasts\]](#)

- The RBNZ continues to hold the cash rate at 2.5%, although has a very strong easing bias. The RBNZ has cut the cash rate 575 basis points in less than a year in response to the financial crisis offshore.
- The RBNZ's July statement was extremely dovish, choosing to ignore any green shoots or positive developments and highlighting the vulnerabilities in the export sector. The RBNZ also stepped up its easing bias, repeating the potential for the OCR to move lower and its expectation to hold the OCR at current levels until the latter part of 2010. In addition, the RBNZ explicitly stated its willingness to "reassess policy settings" if the NZ dollar and wholesale interest rates remain at current levels.
- The RBNZ June MPS forecasts have CPI inflation falling briefly through the bottom of the target band later this year then recovering to remain 'comfortably' in the middle of the target band. In contrast, our higher NZ dollar outlook suggests considerable downside risk to the medium-term inflation outlook.
- The market does not believe the RBNZ will remain on hold until the latter part of 2010. Indeed the market has 100 basis points of rate hikes priced in by June 2010. This is despite the RBNZ becoming more explicit in July, expressing its intention to cut the OCR further if wholesale interest rates and the NZ dollar remain elevated at then-current levels (both have subsequently *increased*). Given the unwarranted tightening in monetary conditions, we believe the RBNZ should cut the OCR by 25 basis points in September.

NZ Data Preview: a look at the week ahead

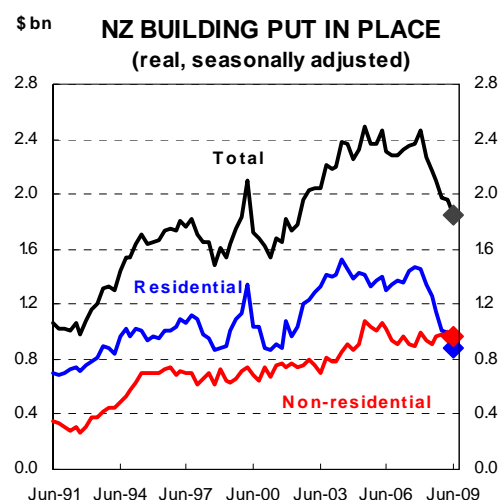
Data	Date	Time (NZST)	Previous	Market expects	ASB expects
Q2 Work Put in Place	8/9	10.45 am	-0.7%	-	-6.1%
August Electronic Card Transactions	9/9	10.45 am	+0.8%	-	-
RBNZ OCR Announcement	10/9	9.00 am	2.5%	2.5%	2.25%
Q2 Terms of Trade	10/9	10.45 am	-3.0%	-2.5%	-3.5%
August Food Price Index	11/9	10.45 am	+0.6%	-	-
August REINZ House Sales	14/9	10.00 am	+4.9%	-	-
July Retail Trade Survey	14/9	10.45 am	+0.1%	+0.5%	+0.6%

Q2 Building Work Put in Place

Previous: -0.7% ASB(f) -6.1%

We expect the real value of building work put in place to decline 6.1% over Q2. The building work put in place survey provides an excellent guide on the construction component of GDP. The fall in construction activity over Q2 is likely to be led by a 12% decline in residential building activity. Construction held up surprisingly well over the March quarter, falling just 0.4% despite a 13% decline in ex-apartment consents over the previous quarter. Ex-apartment consents declined a further 11% over the March quarter, and the weakness in housing demand is likely catch up with activity over Q2. More recently consent issuance has picked up, and suggests that construction activity will stabilise in Q3.

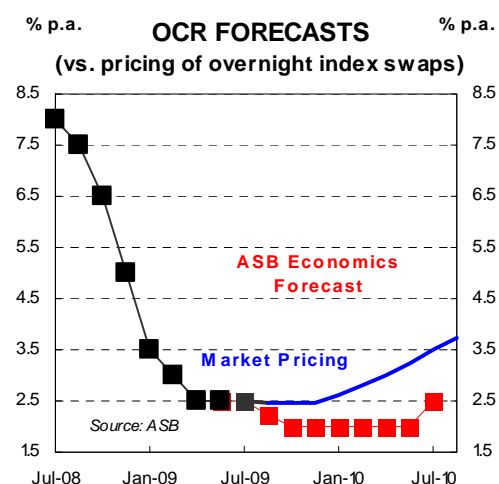
We expect non-residential construction activity to remain steady over Q2, given that consent issuance has held up well.



RBNZ OCR Announcement

Previous: 2.5% ASB(f): 2.25%

We expect the RBNZ to cut 25 basis points next Thursday. In July the Bank stated that continued tightness in monetary conditions could lead to a reassessment of its policy stance. Since July, conditions have tightened further, with both the NZ dollar and longer-term interest rates drifting higher. If the RBNZ is still concerned about tight monetary conditions it now has to decide whether it will follow through on its implied threat and cut, or whether it resigns itself to the role of spectator. A related issue is that the RBNZ's assumption that the NZD will drop and sustain a low level is increasingly shaky and needs to be reassessed. We are tipping our hat to a 25bp cut on September 10, but we freely acknowledge that we are in a distinct minority in suggesting the RBNZ will cut. Market pricing implies only a 10% chance of a cut. At the very least, the RBNZ is likely to try and reinforce that OCR increases are a lot further off than the market is pricing in. However, without action to accompany this stance, continued jawboning will fall on deaf ears.



Q2 Terms of Trade

Previous: -3.0% ASB(f): -3.5%

The quarterly overseas trade indexes are likely to be slightly overlooked given the focus on the RBNZ's Monetary Policy Statement.

We expect the terms of trade to fall 3.5%, led by sharp 7.5% decline in export prices partially offset by a 4% decline in import prices. The lagged effect of falling dairy prices are set to push export prices lower over Q2, with the 7.5% decline in export prices following an 8% decline in Q1. Meanwhile, import prices are also likely to fall, influenced by the pick up in the NZ dollar since April.

Export volumes are likely to fare well over Q2, possibly registering a modest increase buoyed by a recovery in dairy volumes (bouncing back from drought). Monthly merchandise trade also point to a strong pick up in commodities such as logs, wine, oil and aluminium. We expect import volumes to level out, which would result in another positive contribution from net imports.

August REINZ House Sales

Previous: +4.9% (house sales seasonally adjusted)

Previous: +2.2% (Stratified median house price, 3 month moving average)

Housing demand has remained buoyant over the past few months, and demand is likely to remain firm in August, as implied by Auckland house sales data and national mortgage approvals. The pick up in house demand reflects low interest rates and the pick up in population growth.

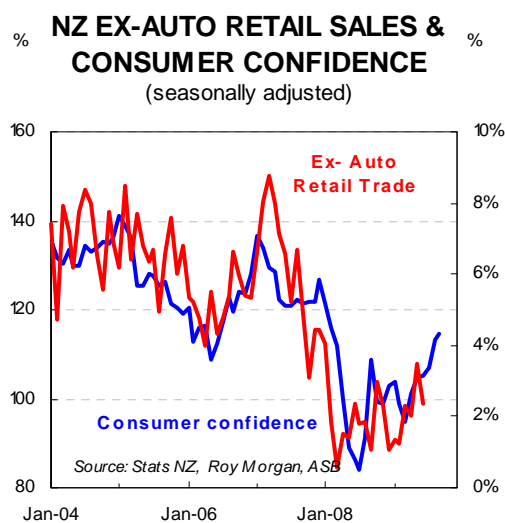
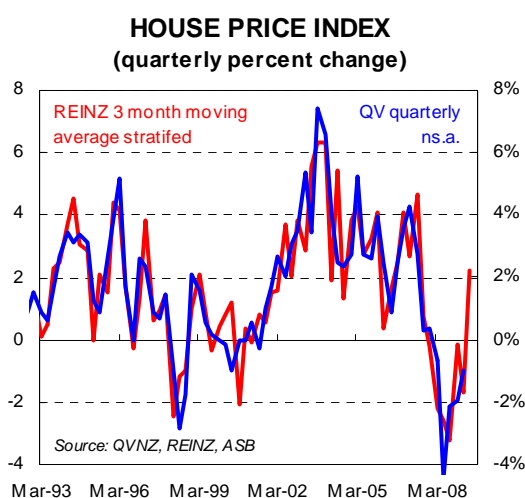
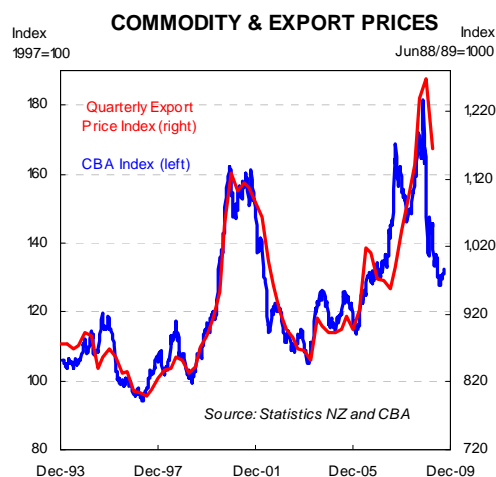
REINZ new stratified median house price series showed house prices increased 2.2% over the 3 months to July. The strength of the recovery is slightly surprising, reflecting the combination of pent-up demand being released at a time when new listings are low. The improved balance in the housing market is likely to encourage more new listings onto the market. In addition, the improved economic outlook in Australia may see a resumption in departures to Australia over the next year which will temper the recent increase in population growth.

July Retail Trade Survey

Previous: 0.1% ASB(f): +0.6%

We expect retail sales to increase by 0.6% in July, bringing annual sales down just 0.4% on year-ago levels. Retail sales are now stabilising, making small monthly gains following large vehicle led declines over late 2008/early 2009. Car registrations data suggest demand has now stabilised and even point to some slight recovery over the next few months. The increase in petrol prices over May and June has also added to the pick up in retail spending.

Excluding the volatile auto component, we are expecting core retail sales to increase a relatively modest 0.4% over July. A cold snap in early May saw clothing and appliance sales brought forward, which is dampening demand in latter winter months. Looking ahead to August, unusually warm weather may have dampened spending and electronic card transaction data, out on Wednesday, may confirm this weakness. Looking through the monthly volatility, the steady increase in consumer confidence points toward a modest recovery in retail spending.

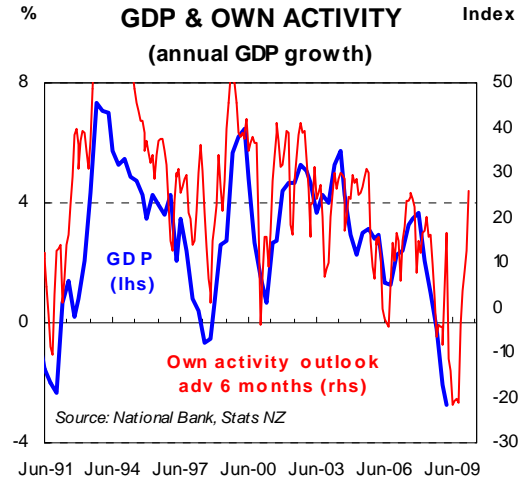


NZ Data Review: weekly recap

August Business Confidence

The August NBNZ business opinion survey confirmed that the vast majority believe that the recession is largely behind us and the NZ economy is now poised to make a recovery. General business confidence and own activity expectations surged in August. Net 34% expect better times over the next 12 months, up from 19% in July. Net 26% expect to see their own businesses activity to improve over the next 12 months, implying a firm rebound in economic growth.

The improvement in confidence was universal across retailing, manufacturing, agriculture, construction and services. Export expectations lifted strongly, likely reflecting the stabilisation in world demand led by firm economic activity in key trading partners such as Australia and Non-Japan Asia. While the NZD remains challenging, the cross rate against the Australian dollar remains reasonably weak and exporters into Australian markets are likely to be benefiting.



Global Data Calendars

Note: Calendar 2 is in UK times. Add 11 hours for NZ times.

Calendar – Australasia, Japan and China

Date	Time		Econ Event	Period	Unit	Last	Forecast	
	NZT						Market	ASB/CBA
Tue 8 Sep	11.50	JP	Current account - Adjusted	Jul	¥bn	1,799	~	~
	11.50	JP	Trade balance – BOP basis	Jul	¥bn	602	~	~
	13.30	AU	NAB business conditions	Aug	Index	1.0	~	~
	13.30	AU	NAB business confidence	Aug	Index	10.0	~	~
	17.00	JP	Eco watchers survey: current	Aug	Index	42.4	~	~
	17.00	JP	Eco watchers survey: outlook	Aug	Index	44.9	~	~
Wed 9 Sep	10.45	NZ	Credit card spending	Aug	m%ch	0.8	~	~
	13.00	AU	MI/WBC Cons. confidence	Sep	%	3.7	~	~
	13.30	AU	Retail trade	Jul	m%ch	-1.4	0.5	0.5
	13.30	AU	Value of all loans	Jul	m%ch	1.0	~	Flat
	13.30	AU	No of own-occupiers	Jul	m%ch	1.1	-1.5	-1.0
	17.00	JP	Leading index CI	Jul	Index	79.9	~	~
Thu 10 Sep	18.00	JP	Machine tool orders	Aug	y%ch	-72.3	~	~
	09.00	NZ	RBNZ official cash rate	Sep	%	2.5	2.5	2.25
	10.45	NZ	Terms of Trade index	QII	q%ch	-3.0	~	~
	11.50	JP	Machine orders	Jul	m%ch	9.7	~	~
					y%ch	-29.7	~	~
	11.50	JP	Domestic CGPI	Aug	m%ch	0.4	~	~
					y%ch	-8.5	~	~
	13.00	AU	MI/WBC Unemp.expectations	Sep	Index	136.5	~	~
13.00	AU	MI/WBC Cons. inflation exp.	Sep	%	3.5	~	~	
13.30	AU	Labour force	Aug	Employment	'000	32.2	-15.0	-15.0
				Unemployment rate	%	5.8	5.9	5.8
				Participation rate	%	65.3	65.3	65.2
Fri 11 Sep	~	CH	Trade balance	Aug	USD bn	10.6	~	~
	~	CH	Exports	Aug	y%ch	-23.0	~	~
	~	CH	Imports	Aug	y%ch	-15.0	~	~
	10.45	NZ	Food prices	Aug	m%ch	0.6	~	~
	11.50	JP	GDP	QII	q%ch	0.9	~	~
	14.00	CH	PPI	Aug	y%ch	-8.2	~	~
	14.00	CH	CPI	Aug	y%ch	-1.8	~	~
	14.00	CH	Retail sales	Aug	y%ch	15.2	~	~
	14.00	CH	Industrial production	Aug	y%ch	10.8	~	~
	17.00	JP	Consumer confidence	Aug	Index	39.7	~	~

Calendar – North America & Europe

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

Date	UK		Econ Event	Period	Unit	Last	Forecast	
	time						Market	CBA
Mon 7 Sep	09.30	EZ	Sentix investor confidence	Sep	~	17.0	~	~
	11.00	GE	Factory orders	Jul	m%ch y%ch	4.5 -25.3	~ ~	~ ~
Tue 8 Sep	00.01	UK	BRC August retail sales monitor					
	00.01	UK	RICS house price balance	Aug	%	-8.1	~	~
	07.00	GE	Trade balance	Jul	€bn	12.2	~	~
	07.00	GE	Current account	Jul	€bn	13.3	~	~
	09.30	UK	Industrial production	Jul	m%ch	0.5	~	~
					y%ch	-11.1	~	~
	11.00	GE	Industrial production	Jul	m%ch	-0.1	~	~
					y%ch	-18.1	~	~
13.30	CA	Building permits	Jul	m%ch	1.0	~	~	
20.00	US	Consumer credit	Jul	\$bn	10.3	-4.0	~	
Wed 9 Sep	07.00	GE	CPI	Aug	m%ch	0.2	~	~
					y%ch	0.0	~	~
	09.30	UK	Total trade balance	Jul	£mn	2,176	~	~
	13.15	CA	Housing starts	Aug	'000	134.2	135.0	~
19.00	US	Fed's Beige book	Sep	~	~	~	~	
Thu 10 Sep	00.01	UK	NIESR GDP estimate	Aug	%	-0.4	~	~
	12.00	UK	BOE announces rates	Sep	%	0.5	0.5	0.5
	13.30	CA	Trade balance	Jul	\$bn	-0.1	-0.5	~
	13.30	US	Trade balance	Jul	\$bn	27.0	27.5	~
	13.30	US	Initial jobless and continuing claims					
	14.00	CA	Bank of Canada rate	Sep	%	0.25	0.25	0.25
	09.30	UK	PPI output core	Aug	m%ch	0.5	~	~
	13.30	CA	New housing price index	Jul	m%ch	-0.2	-0.1	~
	13.30	US	Import price index	Aug	m%ch	-0.7	0.9	~
	15.00	US	Wholesale inventories	Jul	%	-1.7	-1.0	~
15.00	US	Uni. Of Michigan confidence	Sep	Index	65.7	66.8	~	

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