

Business Weekly

Enough straws to keep the RBNZ sidelined

This Week

Recent events have been piling up one straw after another on our view of an April OCR rise, and suggest that the RBNZ will start lifting the OCR slightly later. There is no one single event to point to, but together a number of developments suggest a June start to the tightening cycle is slightly more likely than an April start.

One key factor is the slowing of the housing market that started to appear in the November figures. The early indications are the waning of momentum has continued into 2010. One factor behind our April call was an expectation the housing momentum would last a little bit longer and prompt the RBNZ to act to temper it. But, with credit growth also remaining very muted, the threat of a strong housing market triggering a consumer borrowing spree looks slim. Last week's labour market figures showed, encouragingly, that employment was stabilising as expected but that the pool of job-seekers is lifting at a faster pace than anticipated for this stage of the economic recovery. Unemployment is likely to be that much higher than expected, and with that a slower recovery in wages – and slower lift in wage-related CPI inflation.

The experience across the ditch in Australia is interesting to watch. The economy there has been recovering better than expected by many – and recovery there is far more certain than it is here. Inflation pressures are also far more of an immediate concern. Yet, the RBA has lifted interest rates in 25bp amounts and surprised everyone last week by remaining on hold. One reason for the pause was the RBA wanted to have more time to assess the impact of the first 75bp of hikes it did in the closing months of 2009. If anything the developments in Australia reinforce the conclusion of work we did on the likely neutral level of the OCR i.e. that 25bp moves are the more prudent path than 50bp hikes. Dr Bollard might like to use a knife to cut his “meaty chunks” into something the economy will find more readily digestible. We continue to expect the pattern of OCR hikes to be of 25bp, as detailed in our review of the January OCR decision.

Although we are altering our view of the likely start of the OCR tightening cycle, we are still a little more concerned than the RBNZ appears to be about the medium-term inflation impact. Our view is that a given pace of economic recovery will produce a slightly quicker return of inflation pressure than the RBNZ assesses. But here and now the RBNZ remains “comfortable” with the inflation outlook. There is still the possibility of key data in late March and April jolting the RBNZ out of its complacency and prompting an April OCR hike. But, against other recent developments, that scenario is becoming more of a risk than a base case scenario. In particular, the inflation and growth releases ahead of the April OCR review have to be substantially stronger than the RBNZ's expectations to prompt a hike prior to June.

Click here for:

[Foreign Exchange](#)

- NZD hit by disappointing surge in unemployment.

[Interest Rates](#)

- Interest rates fall sharply on RBA and HLFS unemployment rate.

[Week Ahead](#)

- NZ retail sales key domestic data release this week.

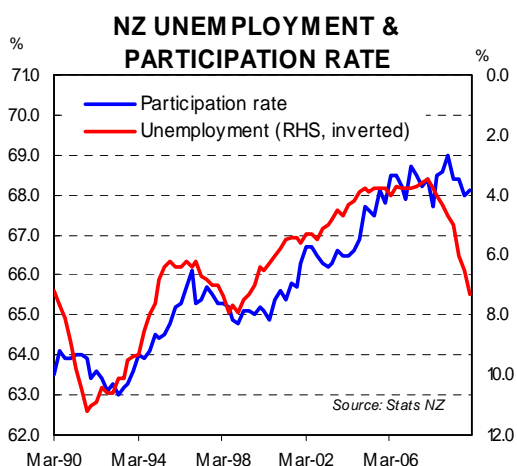
[Week in Review](#)

- Unemployment rate increases sharply, migration shows inflows remain firm.

[Global Calendars](#)

- Australian employment data, BoE inflation report key focus for markets.

Chart of the week



- Traditionally, the discouraged worker effect means the labour participation rate (percentage of working age population working or seeking work) tends to fall when the labour market is weak.
- However, in recent quarters we have seen the participation rate remaining relatively high despite weak employment growth, including a slight lift in the December quarter.
- The relatively high participation rate likely reflects the constrained nature of household balance sheets at the moment, which means people have to continue to look for work (rather than leave the labour force e.g. to study).

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 | 0.6889 | 0.7006 | 0.7314 | 0.6732 | 0.5140 | DOWN | 0.6700 | 0.7000 |
| NZD/AUD | 0.7933 | 0.7944 | 0.7988 | 0.8014 | 0.7880 | FLAT | 0.7850 | 0.8050 |
| NZD/JPY | 61.65 | 63.12 | 68.20 | 65.41 | 46.60 | DOWN | 59.00 | 63.00 |
| NZD/EUR | 0.5041 | 0.5053 | 0.5109 | 0.4737 | 0.4010 | UPSIDE | 0.5000 | 0.5150 |
| NZD/GBP | 0.4418 | 0.4395 | 0.4588 | 0.4026 | 0.3536 | FLAT | 0.4350 | 0.4550 |
| TWI | 63.9 | 64.7 | 66.7 | 62.8 | 52.0 | DOWN | 63.00 | 66.00 |

^Weekly support and resistance levels * Current is as at 10.45 am Monday; week ago as at Monday 5pm

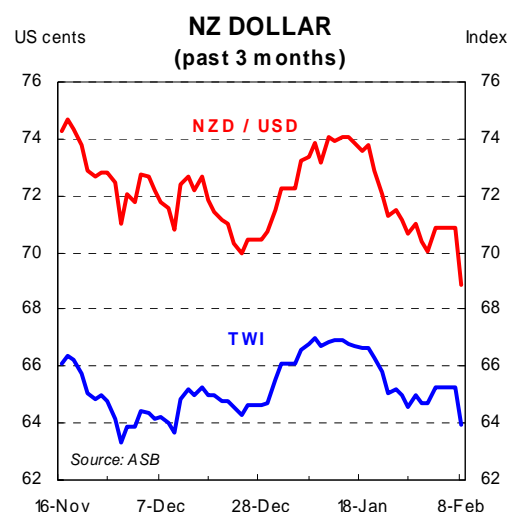
- The NZD underperformed all the major crosses over the past week, with the exception of the Pound. The disappointing increase in the unemployment rate was the key factor behind the weakness.
- The Kiwi recorded its largest falls again the USD and the Yen. The USD continues to strengthen as confidence in US economic recovery continues to improve. This week's key US economic data, retail sales, inventories and consumer confidence are likely to be supportive for the US dollar.
- The underperformance against the AUD was more limited, with the AUD also weighed down by global growth jitters and the RBA surprising the market keeping the cash rate on hold. This week, a strong Australian employment report, followed by strong NZ retail sales volumes could see some 'push and pull' to the NZD/AUD in difference directions over the week.
- The Kiwi started the week stronger against the Pound and the Euro, with European government debt concerns combined with waning momentum in the Eurozone recovery weighing heavily on the EUR and GBP. However, the NZD lost ground later in the week after the disappointing surge in unemployment. Europe's ongoing woes are likely to dominate sentiment this week.

Short-term outlook:

| Key data | Date | Time (NZST) | Market expects |
|---------------------------------|------|-------------|----------------|
| REINZ House Sales - January | 11/2 | 9.30am | - |
| Australian employment - January | 11/2 | 1.30pm | +15,000 |
| NZ Q4 Retail Trade Survey | 12/2 | 10.45am | +1.4% |

Potential currency movers this week: US Wholesale inventories (9th); AU consumer confidence, AU housing finance, US trade balance, US budget statement (10th); AU employment, ECB monthly report, BOE's inflation report, UK industrial production, US retail sales, US jobless claims, US business inventories (11th); EU industrial production, EU GDP, US consumer confidence (12th).

Speakers: Plosser (10th)



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

- We have recently pulled back our NZD outlook, with the NZD now likely to remain relatively steady over the first half of 2010. Further upside to the Kiwi over the next few months is likely to be limited, as the USD has started to strengthen reflecting stronger economic data.
- Adding to the downside pressure has been China's recent attempt to combat inflation pressures. Attempts to slow China has raised concerns on the strength of the global recovery, and the cracks appearing in China's commercial property sector are of some concern.
- In addition, the pace of economic recovery in the Eurozone has slowed. Nervousness surrounding the sustainability government debt levels have put pressure on the euro, which has flowed through to weaken the antipodean currencies.
- We have also pushed back the timing of the first OCR increase from the RBNZ from April to June, and expect the pace of increase to be more gradual, reducing the scope for interest rate driven out-performance.

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 | 2.50 | 3.50 | FLAT |
| 90-day bank bill | 2.76 | 2.75 | 2.78 | 2.78 | 3.51 | FLAT |
| 2-year swap | 3.26 | 4.44 | 4.61 | 4.20 | 3.43 | DOWN |
| 5-year swap | 5.25 | 5.37 | 5.57 | 5.52 | 4.09 | FLAT |
| 5-year benchmark gov't stock | 5.10 | 5.20 | 5.47 | 5.00 | 3.88 | FLAT |
| NZSX 50 | 3110 | 3151 | 3310 | 3083 | 2773 | DOWN |

* Current is as at 10.45 am Monday; week ago as at Monday 5pm. Please note that we have recently changed the NZ govt 5-year benchmark bond to April 2015 maturity (from April 2013). This does cause some distortion in the comparison against the previous levels (i.e. month ago).

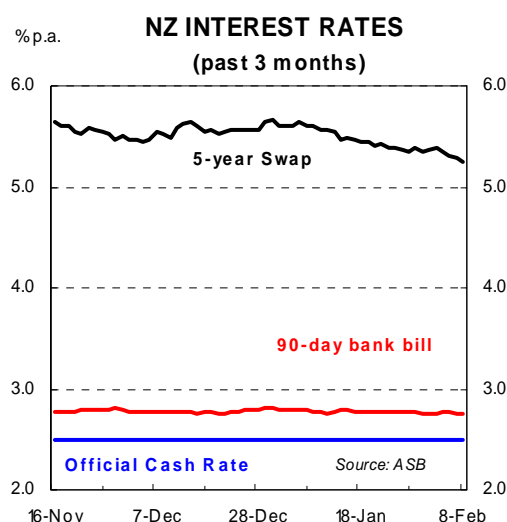
- Local interest rates fell sharply following the RBA's surprise decision to keep its policy rate unchanged, and the release of Q4 HLFS which showed a much larger than expected increase in the unemployment rate. These two events were seen as reducing the urgency for the RBNZ to commence its tightening cycle.
- As a result, markets have pared back interest rates expectations over the past week, with a 25 basis point OCR increase priced in for the June meeting, and 150 basis points of tightening by the end of the year.
- The NZ yield curve steepened as a result of this fall in shorter-term interest rates.

Short-term outlook:

| Key data | Date | Time (NZST) | Market expects |
|---------------------------------|------|-------------|----------------|
| REINZ House Sales - January | 11/2 | 9.30am | - |
| Australian employment - January | 11/2 | 1.30pm | +15,000 |
| NZ Q4 Retail Trade Survey | 12/2 | 10.45am | +1.4% |

Comment: Following a week of surprises (primarily from the RBA and HLFS), NZ markets will be looking to the Retail Trade Survey to see if the weak labour market has affected household spending over Q4. REINZ House Sales data should also provide further insight into the housing market. Meanwhile, the Australian employment report for January is released this Thursday, and markets will be interested to see if recent strength in their labour market will continue.

Elsewhere, the Bank of England releases their inflation report this week.



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

- The RBNZ continued to hold the cash rate at 2.5% at the January *OCR Review*, and noted economic developments have generally turned out as it expected at the time of the December Monetary Policy Statement. As such, the Bank continue to expect to raise the OCR by around the middle of 2010.
- While acknowledging recent data has shown an improvement in household spending, the subdued nature of household credit growth is allaying fears that household debt levels will rise to unsustainably high levels.
- Furthermore, the reinstatement of the word "comfortable" in its assessment of inflation suggests the RBNZ is more relaxed about the inflation outlook following the subdued non-tradable inflation outturn in Q4. Nonetheless, we see inflation pressures building up in the non-tradable sector over the coming year, with our medium-term inflation outlook pushing closer to the top of the band. In particular, recent business surveys have shown a rebound in capacity utilisation and the re-emergence of skills shortages.
- Recent softer data (unemployment and waning momentum in the housing market) has reduced some of the urgency to unwind stimulus. We now expect the RBNZ is likely to lift rates in June and we expect this tightening to occur at a slower pace, with OCR increases of 25bp instead of 50bp at the initial meetings.
- The relationship between the OCR and lending rates is likely to be a lot firmer than we previously assessed. We expect the large wedge that currently exists between the OCR and bank funding costs to remain, and as such now see an OCR of 5% (lower than our previous estimate of 5.5%) will be sufficient to remove the stimulus short-term rates provide. The likelihood of a relatively low OCR peak, coupled with uncertainty over the impact of OCR hikes, point to 25bp moves being most appropriate.

NZ Data Preview: a look at the week ahead

| Data | Date | Time (NZST) | Previous | Market expects | ASB expects |
|--|------|-------------|----------|----------------|-------------|
| January Electronic Card Transactions (mom) | 10/2 | 10.45am | +0.7% | - | - |
| January REINZ House Sales (mom) | 11/2 | 10.00am | -5% | - | - |
| January Manufacturing PMI | 11/2 | 10.30am | 52.9 | - | - |
| January Food Price Index (mom) | 11/2 | 10.45am | -0.3% | - | +0.1% |
| Q4 Retail Trade Survey (qoq) | 12/2 | 10.45am | +0.5% | 1.4% | 1.4% |

Thursday 11 December

January REINZ House Sales and Prices

Previous: House Sales: -5% mom, s.a.

House Prices: +1.4% mom

Days to Sell: 36, s.a.

We expect January data on the housing market – with QV released on Monday and REINZ the Thursday following – to show some puff coming out of the housing market, with activity levels weakening from the pick-up observed in spring.

Recent Barfoot and Thompson sales data for January shows sales turnover remaining at low levels in seasonally-adjusted terms. The demand pressure may be ebbing after a period of recovering demand outstripping modest supply. This is also reflected in mortgage approvals data from the RBNZ, which continue to suggest low activity levels.

Friday 12 December

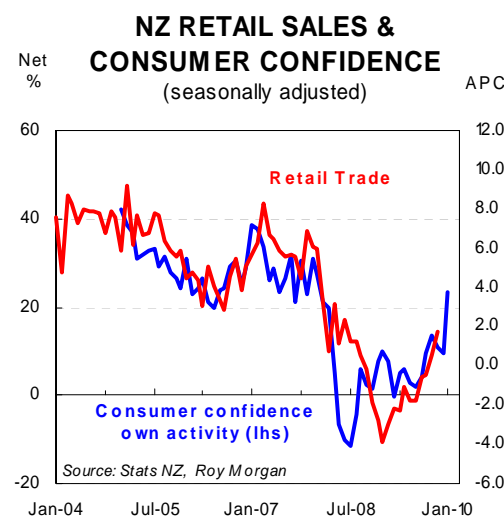
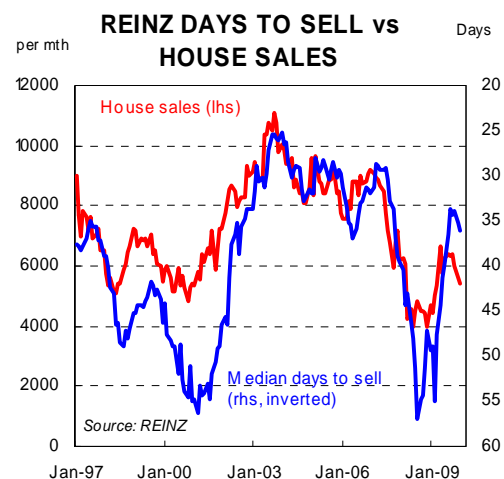
Q4 Retail Sales

Total: ASB f/c: +1.4% qoq, Q3: +0.5% qoq

Ex-auto: ASB f/c: +1.6% qoq, Q3: +0.6% qoq

Recent monthly retail trade data have indicated a pick up in household spending. The continued improvement in consumer confidence suggests retail sales will continue to recover over the coming months. In particular, consumers have indicated a greater willingness to purchase big-ticket items. We expect spending on vehicles to show tentative signs of recovery after the sharp decline in the previous quarter. Over the December quarter, retail sale volumes are expected to build on the increase made in the previous quarter.

Beyond December, we expect a gradual recovery in household spending over 2010. Subdued wage growth and a constrained household balance sheet are likely to limit the extent of the recovery in household spending.



NZ Data Review: weekly recap

Q4 Household Labour Force Survey

The headline unemployment number of 7.3% was surprisingly weak, largely because of a sharp lift in numbers seeking employment. Meanwhile, the participation rate (the percentage of the working age population working or available for work) lifted to 68.1%, slightly higher than most expected. The result was a 16,000 lift in the labour force (those with work or actively seeking work), which was a bigger lift than markets expected.

The widespread jobs losses seen in previous quarters have definitely slowed as the economy has recovered. However, the 2,000 jobs lost, combined with the 16,000 person increase in the labour force meant the number of unemployed lifted by 18,000. This was behind the surprisingly high unemployment rate.

Nonetheless, Q4's headline unemployment rate is disappointingly high, and suggests there is still a lot of slack in the labour market. This is likely to constrain wage increases in the near-term.

December Migration and Visitor Arrivals

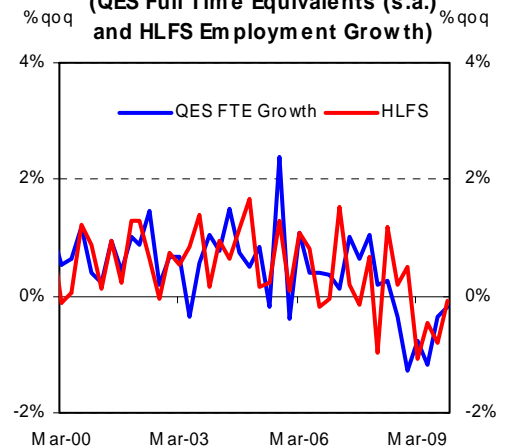
Monthly net migration remained firm in December, with departures remaining low compared to arrivals. However, there are signs departures to Australia are starting to pick up again. Australian labour market data released in recent months have been very strong, and this is likely to encourage more departures to Australia over the coming year as Australia seeks workers.

Annual net migration inflows remain above 20,000 in December, underpinned by the fall in departures over the past year.

Monthly visitor arrivals of 341,300 (not seasonally adjusted) were the highest ever recorded for a month, led by continued high number of tourists from Australia. Added to that, tourists from other countries rebounded, including a pick-up in tourists from Asia as fears of the H1N1 influenza subsided. As long-haul passengers tend to stay longer in NZ and spend more, this broad-based increase in overseas visitors is a large positive for the tourism industry.

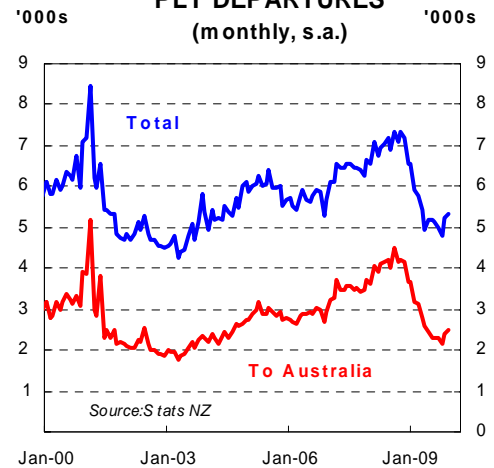
QUARTERLY EMPLOYMENT

(QES Full Time Equivalents (s.a.) and HLFS Employment Growth) % qoq



PLT DEPARTURES

(monthly, s.a.) '000s



Global Data Calendars

Note: Calendar 2 is in UK times. Add 13 hours for NZ times.

Calendar - Australasia, Japan and China

| Date | Time | | Econ Event | Period | Unit | Last | Forecast | |
|------------|-------|---------------|---------------------------------------|--------|-------|-------|----------|---------|
| | NZT | | | | | | Market | ASB/CBA |
| Mon 8 Feb | 12.50 | JP | Current account balance | Dec | ¥bn | 1,305 | ~ | ~ |
| | 12.50 | JP | Trade Balance | Dec | ¥bn | 491 | ~ | ~ |
| | 18.00 | JP | Eco watchers survey: current | Jan | Index | 35.4 | ~ | ~ |
| | 18.00 | JP | Eco watchers survey: outlook | Jan | Index | 36.3 | ~ | ~ |
| Tue 9 Feb | 13.30 | AU | NAB business confidence/conditions | Jan | Index | ~ | ~ | ~ |
| | 19.00 | JP | Machine tool orders | Jan | y%ch | 63.4 | ~ | ~ |
| Wed 10 Feb | 12.30 | AU | MI/WBC Consumer confidence | Feb | % | 5.6 | ~ | ~ |
| | 12.30 | AU | MI/WBC Consumer sentiment | Feb | index | 120.1 | ~ | ~ |
| | 12.50 | JP | Machine orders | Dec | m%ch | -11.3 | ~ | ~ |
| | | | | | y%ch | -20.5 | ~ | ~ |
| | 12.50 | JP | Domestic CGPI | Jan | m%ch | 0.1 | ~ | ~ |
| | | | | | y%ch | -3.9 | ~ | ~ |
| | 13.30 | AU | No. of owner-occupiers | Dec | m%ch | -5.6 | ~ | -6.0 |
| | 13.30 | AU | Value of all loans | Dec | m%ch | -2.9 | ~ | -3.0 |
| 17.00 | CH | Trade balance | Jan | USD bn | 18.4 | ~ | ~ | |
| Thu 11 Feb | 10.30 | NZ | Business NZ PMI | Jan | index | 52.9 | ~ | ~ |
| | 10.45 | NZ | Food prices | Jan | m%ch | -0.3 | ~ | ~ |
| | 13.00 | AU | MI/WBC Consumer inflation expectation | Feb | % | 3.5 | ~ | ~ |
| | 13.00 | AU | MI/WBC Unemployment expectation | Feb | index | 100.6 | ~ | ~ |
| | 13.30 | AU | Employment change | Jan | '000 | 35.2 | ~ | 25.0 |
| | 13.30 | AU | Unemployment rate | Jan | % | 5.5 | ~ | 5.5 |
| | 13.30 | AU | Participation rate | Jan | % | 65.2 | ~ | 65.2 |
| Fri 12 Feb | 10.00 | NZ | REINZ House sales | Jan | y%ch | 15.2 | ~ | ~ |
| | 10.00 | NZ | REINZ Housing price index | Jan | index | 3,253 | ~ | ~ |
| | 10.45 | NZ | Retail sales | Dec | m%ch | 0.8 | ~ | ~ |
| | 10.45 | NZ | Retail sales ex-auto | Dec | m%ch | 0.8 | ~ | ~ |
| | 18.00 | JP | Consumer confidence | Jan | Index | 37.9 | ~ | ~ |
| | 16.00 | JP | Consumer confidence households | Jan | Index | 37.6 | ~ | ~ |

Calendar – North America & Europe

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

| Date | UK | | Period | Unit | Last | Forecast | | |
|------------|---------------------------------|---|---------------------|------|--------|----------|-----|---|
| | Time | Econ Event | | | | Market | CBA | |
| Mon 8 Feb | 09.30 | EZ Sentix investor confidence | Feb | ~ | -3.7 | ~ | ~ | |
| | 13.15 | CA Housing Starts | Jan | '000 | 175 | 179 | ~ | |
| Tue 9 Feb | 00.01 | UK RICS house price balance | Jan | % | 30.0 | ~ | ~ | |
| | 00.01 | UK BRC January retail sales monitor | Feb | ~ | ~ | ~ | ~ | |
| | 07.00 | GE Trade balance | Dec | €bn | 17.4 | ~ | ~ | |
| | 07.00 | GE Current account | Dec | €bn | 18.1 | ~ | ~ | |
| | 07.00 | GE | CPI – EU harmonised | Jan | m%ch | -0.7 | ~ | ~ |
| | | | | | y%ch | 0.7 | ~ | ~ |
| | 09.30 | UK Total trade balance | Dec | £mn | -2,912 | ~ | ~ | |
| 12.30 | US NFIB small business optimism | Jan | Index | 88.0 | ~ | ~ | | |
| 15.00 | US Wholesale inventories | Dec | % | 1.5 | 0.6 | ~ | | |
| Wed 10 Feb | ~ | UK NIESR GDP estimate | Jan | % | 0.3 | ~ | ~ | |
| | 09.30 | UK Industrial production | Dec | m%ch | 0.4 | ~ | ~ | |
| | 10.30 | UK Bank of England quarterly inflation report | Feb | ~ | ~ | ~ | ~ | |
| | 13.30 | CA International merchandise trade | Dec | \$bn | -0.3 | ~ | ~ | |
| | 13.30 | US Trade balance | Dec | \$bn | -36.4 | -35.0 | ~ | |
| | 19.00 | US Monthly budget statement | Jan | \$bn | -91.9 | -60.0 | ~ | |
| Thu 11 Feb | 09.00 | EZ ECB publishes Feb monthly report | Feb | ~ | ~ | ~ | ~ | |
| | 13.30 | CA New housing price index | Dec | m%ch | 0.4 | ~ | ~ | |
| | 13.30 | CA New motor vehicle sales | Dec | m%ch | -6.0 | ~ | ~ | |
| | 13.30 | US Advance retail sales | Jan | m%ch | -0.3 | 0.3 | ~ | |
| | 13.30 | US Retail sales less autos | Jan | m%ch | -0.2 | 0.4 | ~ | |
| | 13.30 | US Retail sales ex auto and gas | Jan | m%ch | -0.3 | 0.3 | ~ | |
| | 13.30 | US Initial jobless and continuing claims | Jan | ~ | ~ | ~ | ~ | |
| | 15.00 | US Business inventories | Dec | % | 0.4 | 0.4 | ~ | |
| Fri 12 Feb | 07.00 | GE GDP | QIV | ~ | ~ | ~ | ~ | |
| | 10.00 | EZ Industrial production | Dec | m%ch | 1.0 | ~ | ~ | |
| | 10.00 | EZ GDP | QIV | q%ch | 0.4 | ~ | ~ | |
| | 14.55 | US Uni of Michigan confidence | Feb | 74.4 | 74.5 | ~ | ~ | |

Economics

| | | | | |
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