

This Week

Central banks take centre stage this week, with the Bank of England, European Central Bank and our own RBNZ announcing their policy rate decisions. Domestic markets will be focused on whether the RBNZ will increase the OCR by 25 basis points this Thursday. Markets are generally expecting the RBNZ will begin removing monetary policy stimulus at this meeting. Domestic data recently points to a self-sustaining recovery falling into place, with a continued improvement in investment and hiring intentions. It appears businesses are now confident enough about the recovery in demand to begin planning for expansion.

The RBNZ will also want to act soon to start keeping inflation pressures in check. Two year ahead inflation expectations have continued to edge towards the top of the RBNZ's target band of 3%. Combined with tobacco excise taxes, higher ACC levies, implementation of Emissions Trading Scheme and GST increase expected to boost annual CPI inflation to 5.7% by mid-2011, the RBNZ's assumption that inflation expectations will remain anchored will be put to the test.

Considering domestic conditions alone make for a relatively straight-forward case for an OCR increase. However, developments in the Euro zone have introduced some uncertainty into the June rate decision. Fears of the sovereign debt crisis in Greece and Spain spreading to other European economies have heightened risk aversion. This in turn has led to emerging pressures in the offshore funding markets, as reflected in the widening LIBOR-OIS spread: the difference between the rate banks pay to lend funds amongst themselves and the rate that captures central bank cash rate expectations. Nonetheless, given the effects of the European sovereign debt crisis on NZ have been limited to date, we expect the RBNZ will proceed with reducing monetary policy stimulus this Thursday. In line with these expectations, markets have priced in just over 70% probability of a June OCR increase. However, the uncertainty from offshore developments has led markets to contemplate the potential for a pause.

Meanwhile, the BoE and ECB are widely expected to keep their policy rates on hold this week. Markets will be looking for each central banks' assessment of recent developments and hence their outlook on growth over the coming years. Given the challenges confronting Euro zone governments we expect the ECB will now keep their policy rate on hold for longer, with the first rate increase not expected until the middle of next year. In Australia, markets are expecting data on Thursday will continue to show robust employment growth in May as businesses expand output to keep up with improving demand.

Click here for:

[Foreign Exchange](#)

- NZD weakness continues as offshore developments continue to concern.

[Interest Rates](#)

- NZ rates ease due to offshore concerns, chances of RBNZ hike pared back.

[Week Ahead](#)

- RBNZ, Trade Indices, Business PMI, Electronic Cards, Food Price Index due.

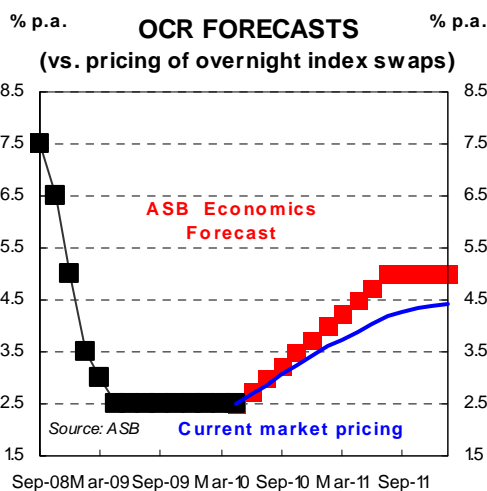
[Week in Review](#)

- Wholesale Trade, Building Work, manufacturing Surveys for Q1 released.

[Global Calendars](#)

- Fed's Beige Book, Bank of England and ECB rate announcements due.

Chart of the week



- Markets are currently pricing in just over a 70% chance of a 25bp OCR increase in the June MPS.
- Volatility in offshore markets has seen market pricing for the probability of a June OCR hike swing from being fully priced in immediately after the strong Q1 employment data to a 40% chance at one point. There has been a stabilisation in conditions more recently.
- While markets now look to be reasonably confident of a June rate increase, they are erring on the side of caution in regards to subsequent rate increases, with the possibility of a pause now implied in market pricing.
- Given the potential for offshore funding pressures to affect domestic funding conditions we also see a greater risk the RBNZ will pause, relative to the risk of a 50bp OCR increase at some point in this cycle.

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	0.6590	0.6781	0.7112	0.7153	0.6251	FLAT	0.6450	0.6850
NZD/AUD	0.8139	0.8076	0.7986	0.7819	0.7871	FLAT	0.7950	0.8200
NZD/JPY	60.19	61.81	65.52	63.63	61.63	FLAT	58.00	62.00
NZD/EUR	0.5530	0.5524	0.5602	0.4818	0.4480	FLAT	0.5450	0.5600
NZD/GBP	0.4554	0.4680	0.4822	0.4347	0.3918	FLAT	0.4450	0.4700
TWI	65.2	66.0	67.8	64.0	59.6	FLAT	64.5	66.5

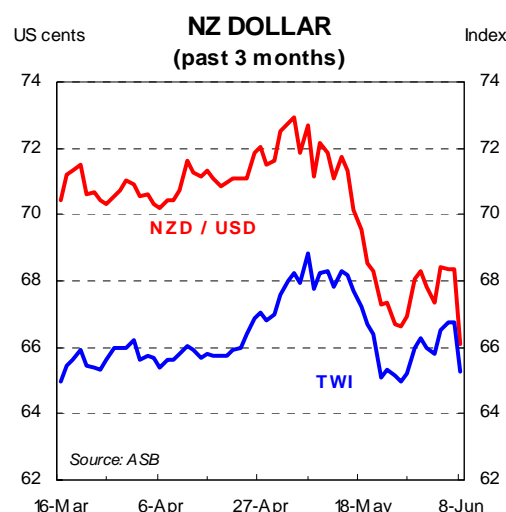
^Weekly support and resistance levels * Current is as at 12.00 pm Tuesday; week ago as at Monday 5pm

- A lack of local data last week meant the NZD moves were dominated by offshore themes and developments. The overall direction has been down for the NZD over the past week, with offshore uncertainty weighing on both the NZD and AUD against the USD. The AUD has been worse hit by the current negative sentiment. This has in turn has seen the NZD/AUD cross rate rise. The NZD/AUD could receive a further boost this week if the RBNZ delivers a rate hike on Thursday, although we think the NZD will struggle to get through 0.82 against the AUD.
- In contrast to the weakness in the AUD and NZD, concerns over Europe's government debt are keeping the USD supported as market participants switch out of EUR into USD.
- This week we expect the NZD will continue to be influenced by the opposing forces of offshore uncertainty, and the possible rate hike from the RBNZ. NZD buying interest should pick up if the RBNZ hikes rates on Thursday, but even a rate hike may not be enough to overcome the general negative sentiment in the market at present – we therefore expect wide ranges in FX markets this week.

Short-term outlook:

Key data	Date	Time (NZST)	Market expects
RBNZ OCR Announcement	10/6	9.00 am	2.75%
May NZ Business PMI	10.6	10.00 am	-
Q1 Terms of Trade	10/6	10.45 am	+6.2%
AU Employment	10/6	1.30 pm	+20,000
April Retail Trade Survey	14/6	10.45 am	0.0

Potential currency movers from offshore this week: US Federal Reserve's Beige book of business conditions, US wholesale inventories, UK Trade Balance (9th); US trade balance, jobless claims, BoE, ECD rate announcements (10th); US retail sales, consumer confidence, business inventories, Chinese data (11th); **Speeches:** Bernanke (7th), Hoenig, Evans, Duke (8th), Bernanke (9th), Plosser, Kocherlakota (11th).



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

- The USD has firmed slightly earlier than we had previously anticipated. We expect the USD will continue to gain support. The US economic outlook continues to improve, with recent data demonstrating a broader-based expansion. We expect that US bond yields will eventually adjust higher reflecting the firmer US economy. As a result, the higher US bond yields will support the USD. In addition, the AAA-rated US bond market remains the major alternative to the Eurozone government bond market.
- We have already revised down our EUR forecasts three times this year, and have revised down the outlook once again for the same reasons. Eurozone GDP growth is expected to under perform the US economy over 2010 and 2011. The deterioration in the EU growth outlook will see the differential between US and Eurozone interest rates widen, reducing support for the Euro. In addition, more than half of Eurozone government debt is no longer AAA rated, with uncertainty continuing to cloud the outlook and reducing investor appetite.
- While we have revised down our NZD outlook slightly, we continue to see support coming from strong commodity prices and the looming RBNZ tightening cycle. In addition, NZ's relatively healthier outlook for net government debt will make the NZD look favourable relative to European and US peers.
- Relative to the AUD, the NZD has already made up quite a bit of ground. The NZD is likely to continue to modestly outperform the AUD as the RBNZ starts to lift rates and the interest rate differential narrows slightly.

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	2.50	UP
90-day bank bill	2.97	3.04	2.92	2.77	2.70	UP
2-year swap	4.31	4.44	4.57	4.43	3.72	UP
5-year swap	5.15	5.29	5.40	5.53	5.26	FLAT
5-year benchmark gov't stock	4.90	4.94	5.17	5.41	4.81	FLAT
NZSX 50	3030	3055	3168	3137	2817	DOWN

* Current is as at 9.00 am Tuesday; week ago as at Tuesday 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).

- The RBNZ is expected to increase the OCR 25 basis points this Thursday. Market pricing is at around 70% of a 25bp hike, while around three in four economists are expecting such a move. Ongoing uncertainty around the fall out from the Europe sovereign debt crisis has introduced some doubt around the decision. However, domestic conditions are improving and increasingly point to the need for less stimulatory monetary settings.
- There were few surprises from central banks last week. The RBA kept the cash rate on hold, as expected. Meanwhile, the Bank of Canada increased its cash rate for the first time, boosting market perceptions that the RBNZ will follow this week.
- Offshore interest rates fell sharply over the weekend, triggered by a disappointing US Payrolls figure and fears that Hungary now joins the list of potential defaulters. The decline in sentiment caused a drop in NZ interest rates, with the swap curve flattening.

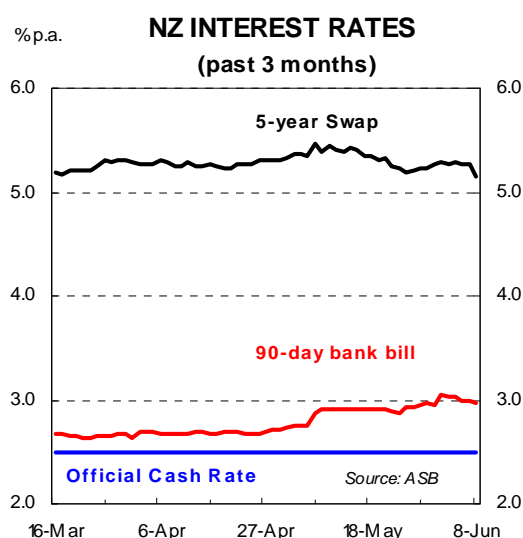
Short-term outlook:

Key data	Date	Time (NZST)	Market expects
RBNZ OCR Announcement	10/6	9.00 am	2.75%
May NZ Business PMI	10.6	10.00 am	-
Q1 Terms of Trade	10/6	10.45 am	+6.2%
AU Employment	10/6	1.30 pm	+20,000
May Food Price Index	11/6	10.45 am	-
April Retail Trade Survey	14/6	10.45 am	0.0

Comment: Thursday is when all the action happens; with the RBNZ's statement the focus of the day – the market is looking for a fairly balanced statement. The terms of trade are likely to surprise on the upside of market expectations. Australian employment could also be a key driver of market movements during the afternoon.

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

- The RBNZ held the cash rate at 2.5% at the April OCR Review, and indicated monetary policy tightening will commence “over the coming months”.
- The RBNZ left its near-term projection for the 90-day interest rate unchanged at the March MPS, but there was a downward revision in its medium-term 90-day track in recognition that current bank funding costs were likely to persist. This supports our expectation that OCR increases will be in 25 basis point increments over the tightening cycle this year. Furthermore, in a recent speech Governor Bollard validated the current market pricing, which assumed a similar profile for rate hikes.
- Inflation in the here and now has remained subdued, allowing the RBNZ some breathing room to assess recent trends. However, we expect inflation to lift to almost 6% over the next year, with a host of upcoming administrative inflation (including GST) boosting headline CPI, and thus posing a risk to price and wage setting behaviour. This is particularly in light of the latest inflation expectations survey result shows medium-term expectations of CPI annual inflation ticking up to 2.8%.
- Activity data have been mixed. The external outlook remains upbeat, with commodity prices strengthening. However, retail sales have been surprisingly subdued and the RBNZ remains concerned about the weakness in business credit demand. Nonetheless, the unequivocal strength in Q1 employment data should alleviate the RBNZ concerns on the underlying strength in the domestic recovery.
- The RBNZ expects to begin removing monetary stimulus in “coming months” assuming the economy evolves as expected. We expect the RBNZ to increase interest rates at this week's announcement.



NZ Data Preview: a look at the week ahead

Data	Date	Time (NZST)	Previous	Market expects	ASB expects
RBNZ June Monetary Policy Statement	10/6	9.00am	2.50%	2.75%	2.75%
Q1 Terms of Trade – qoq	10/6	10.45am	+5.8%	-	+9.0%
May Food Price Index – mom	11/6	10.45am	-0.5%	-	+0.9%
April Retail Trade Survey - mom	14/6	10.45am	+0.5%	-	0.0%

Thursday 10 June

RBNZ June Monetary Policy Statement

Previous: 2.50%, f/c 2.75%

The inflation and growth outlook alone would indicate overwhelmingly that the OCR will be increased in the June meeting. ACC levies, tobacco excise taxes, implementation of Emissions Trading Scheme and the increase in GST are expected to boost annual headline inflation close to 6% by the middle of next year. The RBNZ is allowed to look through the first round effects of the government charges. However, with medium-term inflation expectations already close to the top of the RBNZ's target band of 3%, the high headline result poses a very real risk to the RBNZ's key assumption that inflation expectations will be unanchored.

However, recent developments in Euro zone introduce some uncertainty into the June rate decision. The potential for the debt crisis to spread to other major economies has seen markets pare back the extent of OCR increases over the coming years.

Thursday 10 June

NZ Q1 Terms of Trade

Previous: +5.8% qoq, f/c +9% qoq

We expect the Terms of Trade increased 9% over Q1, adding to the previous quarter's recovery to bring the Terms up Trade up 2.7% on year-ago levels. We expect that the recovery will continue throughout the year, with the Terms of Trade recovering to pre-financial crisis levels.

We are expecting a sharp increase in export prices of 10.7% to underpin the increase in Terms of Trade. NZ export commodity prices have staged a strong recovery, supported by improving global demand. Reflecting this, the increase in prices has been reasonably broad-based across different commodity groups. In addition, the recent increase in international dairy prices, caused by a squeeze on supply, has added extra strength to exporter revenues. The strong outlook for export income is a key reason we expect the RBNZ to increase the OCR at this weeks announcement.

Monday 14 June

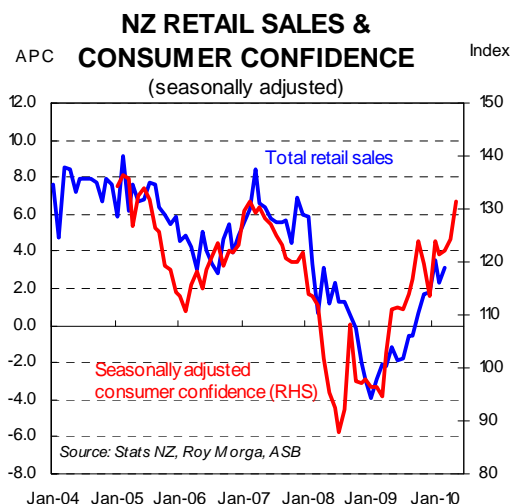
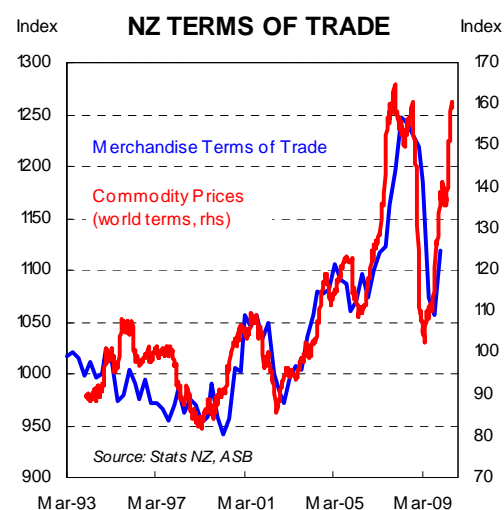
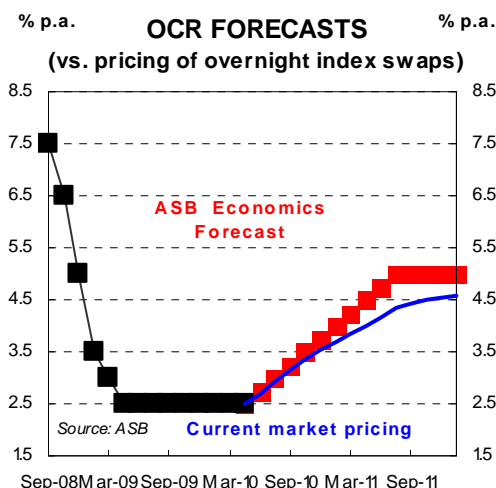
April Retail Trade Survey

Previous: +0.5% mom, f/c 0.0%

We expect a flat result for total retail sales in April. While there was a rebound in retail sales in the previous month, April electronic card transactions data point to subdued sales in April. Weakness in household spending is likely due to the current low level of wage growth, and continued consumer caution.

Meanwhile, the increase in GST to 15% in October may see a spike in retail sales over the coming months as households bring forward purchases of big-ticket items. Already, consumer confidence surveys have shown a sharp increase in the net number of households who consider now a good time to buy a major household item.

Retailers are also optimistic of an improvement in sales over the coming months. This optimism is reflected in the substantial improvement in retailers' assessment of their own activity in recent business surveys.



NZ Data Review: weekly recap

May National Bank Business Outlook

Although there was a slight dip in headline business confidence, businesses' assessment of their own activity outlook improved. Encouragingly, businesses are continuing to plan for an expansion of operations, with further increases in both investment and employment intentions. This improvement is in line with our expectations of a rebound in business investment and continued employment growth over 2010.

Retailers' assessment of their own activity outlook improved sharply. Q1 retail sales data released earlier this month had shown weakness in household spending, but it appears that demand has started to pick up more recently. Meanwhile, there was further improvement in export expectations of manufacturers, likely reflecting the spill-over effects of the strong Australian economy.

Pricing intentions continued to tick up. Following on from the increase in medium-term inflation expectations reported in the Q2 Survey of Expectations, this all points to a building up of inflation pressures.

Q1 Value of Work Put in Place

Construction activity was below our expectations in the March quarter. Residential building work has recovered over the past two quarters including Q1's 2% increase, albeit not to quite the extent we had expected. There have been a number of issues that have been impacting residential property, including a subdued property market over the past six months, and ongoing finance difficulties for builders due to the collapse of finance companies who provide development finance.

In non-residential activity, there tends to be a longer lag between consent issuance and construction activity. Non-residential consent issuance was patchy over 2009 and early 2010. Activity declined by 0.8% over Q1, which is the fifth consecutive quarterly decline.

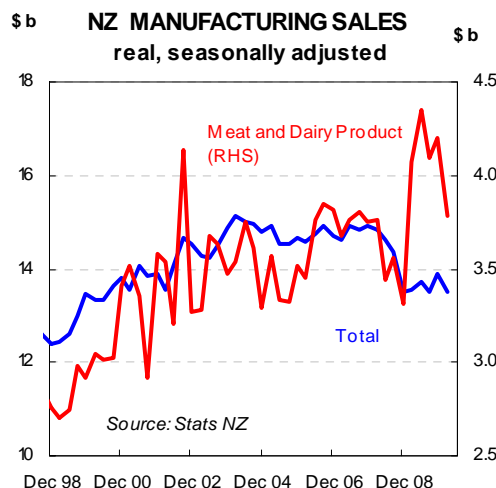
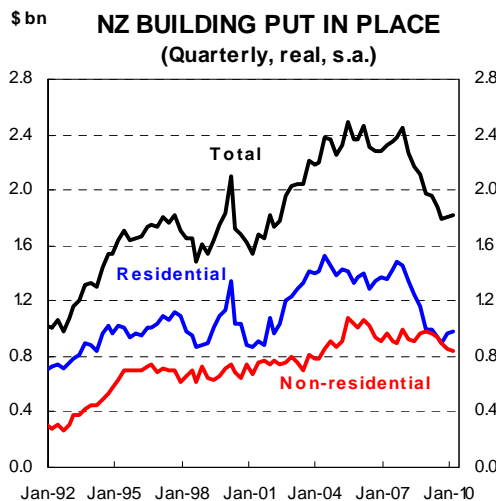
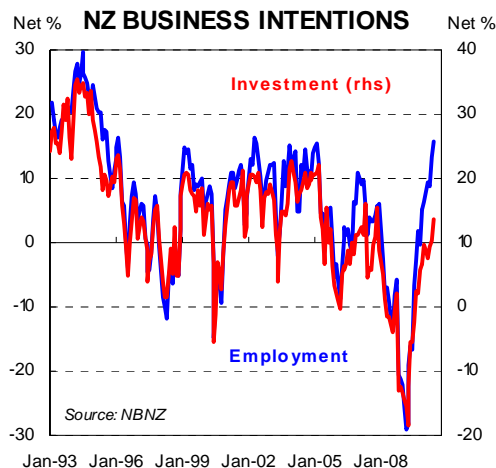
We expect residential construction to continue to gradually improve over 2010. Private non-residential construction should pick up later this year as business intentions flow through to activity.

Q1 Economic Survey of Manufacturing

The manufacturing survey was very weak, with sales volumes down 2.7% over the March quarter. Most of the weakness was attributed to a decline in agricultural production, with meat and dairy sales volumes down 10.1%. The impact of the drought in Northland over the first part of 2010 clearly weighed on processing activity.

Excluding the volatile and weather-affected food component, non-food manufacturing sales increased 1.3%. Core manufacturing demand continues to improve, as both the domestic recovery and the recovery in Australia and China continue to gain traction.

The continued improvement in manufacturing sector confidence suggests there will be further modest improvements in core manufacturing activity over the remainder of 2010.



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	Forecast		
	NZT					Last	Market	ASB/CBA
Tue 8 Jun	11.50	JP	current account	Apr	¥bn	1,773.1	~	~
	11.50	JP	Trade balance (BoP basis)	Apr	¥bn	1,074.7	~	~
Wed 9 Jun	~	AU	RBA Governor Stevens speaks in Sydney					
	11.50	JP	Machine orders	Apr	m%ch	5.4	~	~
					y%ch	1.2	~	~
	13.00	AU	WBC/MI consumer confidence	Jun	m%ch	-7.0	~	~
	13.30	AU	Home loans	Apr	m%ch	-3.4	~	-1.0
	13.30	AU	Value of all loans	Apr	m%ch	-3.4	~	3.0
	13.30	AU	NAB business conditions	May	Index	8.0	~	~
	13.30	AU	NAB business confidence	May	Index	13.0	~	~
	18.00	JP	Machine tool orders	Apr	y%ch	220.9	~	~
Thu 10 Jun	~	CH	Trade balance (USD)	May	\$bn	1.7	6.6	
	09.00	NZ	RBNZ official cash rate	Jun	%	2.50	2.75	2.75
	10.30	NZ	Business NZ PMI	May	Index	58.9	~	~
	10.45	NZ	Terms of trade index	QI	q%ch	5.7	~	~
	10.45	NZ	Card spending	May	m%ch	-1.7	~	~
	11.50	JP	GDP	QI	q%ch	1.2	~	~
	11.50	JP	Domestic CGPI	May	m%ch	0.4	~	~
					y%ch	-0.2	~	~
	13.30	AU	Consumer inflation expectation	Jun	%	3.6	~	~
	13.30	AU	Employment change	May	'000	33.7	~	20.0
	13.30	AU	Unemployment rate	May	%	5.4	~	5.5
13.30	AU	Participation rate	May	%	65.2	~	65.2	
Fri 11 Jun	10.45	NZ	Food prices	May	m%ch	-0.5	~	~
	14.00	CH	Producer price index	May	y%ch	6.8	6.8	~
	14.00	CH	Purchasing price index	May	y%ch	12.0	~	~
	14.00	CH	Consumer price index	May	y%ch	2.8	3.0	~
	14.00	CH	Retail sales	May	y%ch	18.5	18.7	~
					ytd	18.1	18.2	~
	14.00	CH	Industrial production	May	y%ch	17.8	17.3	~
					ytd	19.1	17.7	~
14.00	CH	Fixed assets inv urban	May	ytd y%ch	26.1	25.8	~	

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
Tue 8 Jun	15.15	CA	Housing starts	May	'000	200.7	~	~
Wed 9 Jun	11.30	UK	Total trade balance	Apr	£mn	3,683	~	~
	17.00	US	Wholesale inventories	Apr	m%ch	0.4	0.7	~
	21.00	US	Fed's Beige book	Jun	~	~	~	~
Thu 10 Jun	09.00	GE	CPI - EU harmonised	May	m%ch	0.1	~	~
					y%ch	1.2	~	~
	14.00	UK	BoE announces rates	Jun	%	0.5	0.5	~
	14.45	EZ	ECB announces interest rates	Jun	%	1.0	1.0	~
	15.30	CA	New housing price index	Apr	m%ch	0.3	~	~
	15.30	CA	International merchandise trade	Apr	\$bn	0.3	~	~
	15.30	US	Trade balance	Apr	\$bn	-40.8	-41.0	~
	15.30	US	Initial jobless claims and continuing claims					
	21.00	US	Monthly Budget Statement	May	\$bn	~	-140.0	
Fri 11 Jun	~	UK	NIESR GDP estimate	May	%	0.5	~	~
	11.30	UK	PPI	May	~	~	~	~
	11.30	UK	Industrial production	Apr	m%ch	2.2	~	~
					y%ch	2.2	~	~

For more ASB reports <http://reports.asb.co.nz/index.html>

ASB ECONOMICS & RESEARCH				PHONE	FAX
Economics					
Chief Economist	Nick Tuffley	nick.tuffley@asb.co.nz		(649) 374 8604	(649) 302 0992
Economist	Jane Turner	jane.turner@asb.co.nz		(649) 374 8185	
Economist	Christina Leung	christina.leung@asb.co.nz		(649) 369 4421	
CBA NZ Economist	Chris Tennent-Brown	chris.tennent-brown@asb.co.nz		(649) 374 8819	

DISCLAIMER

Views expressed in this report are those of the authors as at the date of this report and are based on information and sources believed but not warranted to be correct. Any views or information, while given in good faith, do not necessarily reflect the views of ASB and are subject to change without notice. Neither ASB Bank Limited nor any person involved in preparing this report accepts any liability for any loss or damage whatsoever that may directly or indirectly result from any views, information or omission contained in this report.