

# Business Weekly

## RBNZ begins rate hikes



ECONOMICS

14 Jun. 10

### This Week

The Reserve Bank of New Zealand increased the OCR by 25 basis points to 2.75%, as widely anticipated. Accompanying the move, the RBNZ delivered a reasonably neutral statement. While the RBNZ acknowledged the risks stemming from Europe, it also emphasised the robust economic outlook at home supported by strong NZ export commodity prices and growing risks to price stability.

The RBNZ's inflation outlook remains our key concern, as it is quite low compared to our own and Treasury's. The RBNZ forecasts annual headline CPI inflation to reach a peak of 5.3% by mid-2011. This compares to our forecasts, which have inflation peaking at 5.7%, and the Treasury's which have inflation peaking at 5.9%. Further to this, the RBNZ has made some optimistic assumptions around price and wage setting behaviour remaining unaffected by the Government policy-induced inflation spike. Indeed, the RBNZ themselves noted the staggered nature of the introduction of these policies which means price increases are more likely to become ingrained in medium-term inflation expectations. With 2-year ahead inflation expectations already elevated at 2.8%, we are starting to wonder just when the RBNZ will feel uncomfortable with this assumption and challenge its own inflation forecasts.

Future rate hikes from the RBNZ will be dependent on economic and financial market developments, with the latter potentially prompting a pause from the RBNZ. It will be watching developments in Europe and conditions in credit markets even closer. The RBNZ emphasised the European crisis was most likely to impact NZ via funding markets rather than weaker economic growth. In the June MPS, the RBNZ's forecasts have assumed only Europe will be affected with limited implications for growth in the Asia Pacific. Indeed, downward revisions to growth in the Euro area (which accounts for 8% of our goods trade), has been more than offset by upward revisions to other trading partners. To put things into context, Australian and Asia (excluding Japan) account for 50% of NZ's export revenue.

With the domestic recovery on track and the inflation outlook uncomfortably high, we expect the RBNZ will continue to hike the OCR steadily in 25 basis point moves at each meeting. However, given the event risk posed by Europe and the ongoing uncertainty this region will present to the global economic recovery, there is potential for the RBNZ to pause at some point in the hiking cycle – as was the reality in Australia when the RBA paused to assess the effects of its previous cash rate increases.

### Click here for:

[Foreign Exchange](#)

- NZD flat on the AUD, but posts gains on all the main cross rates monitored.

[Interest Rates](#)

- NZ short-term interest rates higher on OCR increase.

[Week Ahead](#)

- REINZ housing, Consumer Confidence.

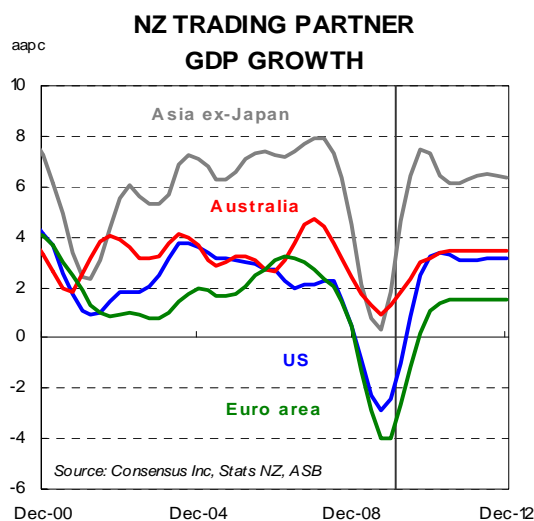
[Week in Review](#)

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

[Global Calendars](#)

- CPI reports due for US, UK, EZ. Industrial Production from JPN, EZ, US.

### Chart of the week



- The RBNZ revised up its forecasts for Trading Partner GDP growth over the next few years, despite incorporating a weaker outlook for the Euro area.
- Trading partner GDP is expected to grow at above-average rates over 2010 and 2011, supported by robust growth in the Asia-Pacific. NZ is expected to continue to benefit from the solid growth in Australia and Asia (excluding Japan).
- The sovereign credit crisis is likely to lower growth prospects for the Euro area, with many countries facing higher debt servicing costs.
- However, the US and Asia-Pacific growth prospects are expected to remain largely unscathed as a result of the crisis. The RBNZ does not expect weaker growth in Euro area will be enough to derail an inter-regional recovery in Asia and Australia.

### 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	0.6907	0.6634	0.7131	0.7216	0.6424	FLAT	0.6850	0.7050
NZD/AUD	0.8105	0.8104	0.7953	0.7958	0.7892	FLAT	0.8050	0.8200
NZD/JPY	63.39	60.79	66.25	63.84	62.87	FLAT	62.00	64.00
NZD/EUR	0.5698	0.5545	0.5685	0.4933	0.4563	FLAT/DOWN	0.5650	0.5750
NZD/GBP	0.4743	0.4575	0.4876	0.4456	0.3886	FLAT/DOWN	0.4700	0.4800
TWI	67.3	65.4	68.2	65.0	60.6	FLAT/DOWN	64.5	66.5

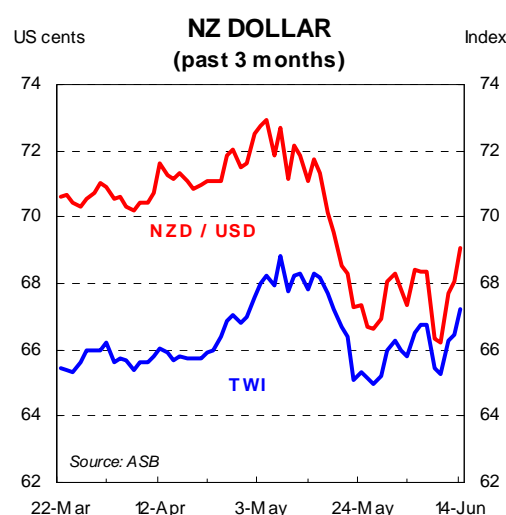
^Weekly support and resistance levels \* Current is as at 12.00 pm Tuesday; week ago as at Monday 5pm

- The NZD recovered from its June lows against the USD last week, lifting from around 0.6575 on 8th June, to trade around 0.69 by the end of the week. The RBNZ rate hike on 10 June helped boost the NZD. An increase in risk appetites offshore, reflected in a 2.5% lift in the S&P 500 over the week, also helped the NZD.
- The NZD lifted against the AUD after the RBNZ decision, recovering ground lost since the start of the week.
- The NZD steadily gained against the EUR, lifting from 0.55 to 0.57 over the week. Likewise, the NZD posted steady gains against the GBP, and is back trading around 0.475 against a weak Pound.
- Given the extent to which the NZD has appreciated over the past week, we think will struggle to press higher this week. A strong consumer confidence report on Wednesday would help the NZD hold onto last week's gains, as would ongoing confidence in offshore sharemarkets.

### Short-term outlook:

Key data	Date	Time (NZST)	Market expects
May REINZ House Sales	15/6	10.00am	-
RBA Meeting Minutes	15/6	1.30pm	-
Q2 WMM Consumer Confidence	16/6	2.00pm	-
May International Travel & Migration	21/6	10.45am	-

**Potential currency movers from offshore this week:** Euro industrial production (14<sup>th</sup>); Bank of Japan rate decision, Euro employment, ZEW Survey, US Empire Manufacturing (15<sup>th</sup>); UK ILO Unemployment Rate; Euro CPI, US industrial production, building permits, housing starts (16<sup>th</sup>); UK retail sales, US CPI, Philly Fed survey (17<sup>th</sup>).



### 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 recently 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 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 continues 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	2.75	2.50	2.50	2.50	2.50	UP
90-day bank bill	3.08	2.99	2.92	2.78	2.86	UP
2-year swap	4.32	4.32	4.56	4.72	3.90	UP
5-year swap	5.06	5.15	5.41	5.64	5.35	UP
5-year benchmark gov't stock	4.87	4.87	5.18	5.51	4.88	UP
NZSX 50	3041	2989	3190	3095	2800	FLAT

\* 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 increased the OCR by 25 basis points last week, as widely expected. This provided a boost to short-term interest rates. Longer-term interest rates generally followed offshore movements higher towards the end of the week. Markets are currently pricing in around a 75% chance of another 25bp OCR increase in July.
- Offshore interest rates were once again volatile last week in line with changing risk sentiment. The Federal Reserve's Beige book continued to paint the picture of a modest recovery in US economic activity.
- Australian interest rates increased over the week, with continued strong employment data supporting a healthy outlook for the Australian economy.

### Short-term outlook:

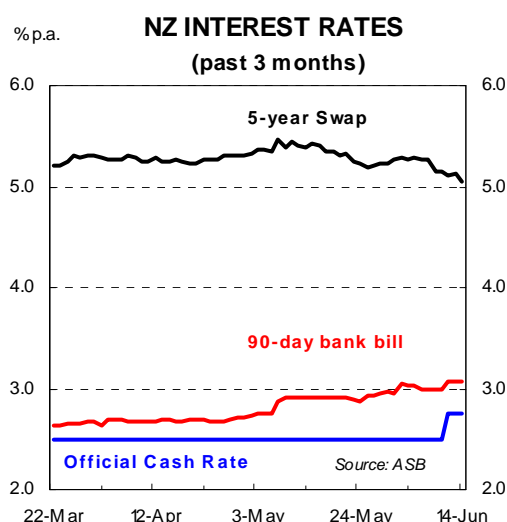
Key data	Date	Time (NZST)	Market expects
May REINZ House Sales	15/6	10.00am	-
RBA Meeting Minutes	15/6	1.30pm	-
Q2 WMM Consumer Confidence	16/6	2.00pm	-
May International Travel & Migration	21/6	10.45am	-

**Comment:** With signs of easing risk aversion in offshore markets, domestic interest rates are likely to edge up this week. We expect REINZ house sales to show a continued slowing in housing market momentum.

Meanwhile, the release of the minutes of the RBA June meeting should provide further insight behind their decision to keep the cash rate on hold while they wait and assess the effects of the previous rate increases.

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

- The RBNZ began removing monetary policy stimulus at the June meeting with a 25 basis point OCR increase. In addition, the RBNZ indicated it will look to continue to increase the OCR over the coming year as economic and financial market conditions allow.
- The RBNZ left its projection for the 90-day interest rate broadly unchanged at the June MPS. It continued to note that higher bank funding costs, upward slope of the yield curve and the fact that a greater proportion of borrowers are now on floating rate mortgages will "reduce the extent to which the OCR will need to be increased relative to previous cycles". This is in line with our expectations that OCR increases will be in 25 basis point increments this year and eventually peak at 5%.
- The RBNZ forecasts headline CPI inflation to peak at 5.3% in June 2011, boosted by a raft of Government policy changes including tobacco excise tax, the implementation of the Emissions Trading Scheme and increase in GST to 15%. We expect these changes will boost headline inflation to a peak of 5.7%, and see upside risks to the RBNZ's key assumption that medium-term inflation expectations will remain anchored. This is in light of the fact that two year ahead inflation expectations are already elevated at 2.8%.
- The RBNZ has revised down its NZ economic growth outlook slightly and explicitly notes that if the Eurozone situation deteriorated the main impact on NZ would be via higher bank funding costs. We are less optimistic than the RBNZ that the recent strength in NZ export commodity prices will continue.
- We expect that the OCR will be increased by 25bp at each meeting until the OCR reaches 5%. Given continued uncertainty in the European economy, markets are currently pricing in some risk of a pause at some point in this cycle.



## NZ Data Preview: a look at the week ahead

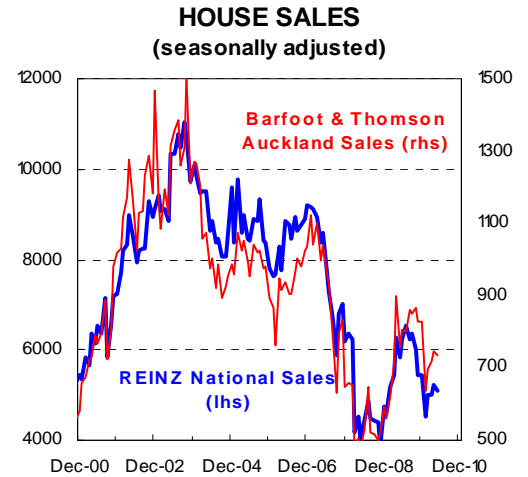
Data	Date	Time (NZST)	Previous	Market expects	ASB expects
May REINZ House Sales mom, seasonally adjusted	15/6	10.00am	+4%	-	0%
Q2 WMM Consumer Confidence	16/6	2.00pm	114.7	-	-
May International Travel & Migration – net migration	21/6	10.45am	770	-	-

### Tuesday 15 June

#### NZ May REINZ house sales.

**Previous housing turnover mom (sa): +4%, f/c 0.0%**

The property market was very quiet in early 2010, with the much discussed changes to property tax laws blamed for some of the inertia. With the Budget out of the way, buyers now have clarity on the matter of tax. Buyers also seem tuned into the likelihood of mortgage rate rises in the coming months. In ASB's latest housing survey, taken prior to the RBNZ rate hike, a net 59% of respondents expected interest rates to rise in the next twelve months. We do not think the property tax changes announced in the Budget will trigger a landslide of sellers. However, changes do reduce some of the attractiveness of owning rental properties. Overall we expect the property market to remain soft over the remainder of 2010, and prices could moderate in the months ahead.



### Wednesday 16 June

#### NZ Q2 WMM Consumer Confidence

**Previous: 114.7**

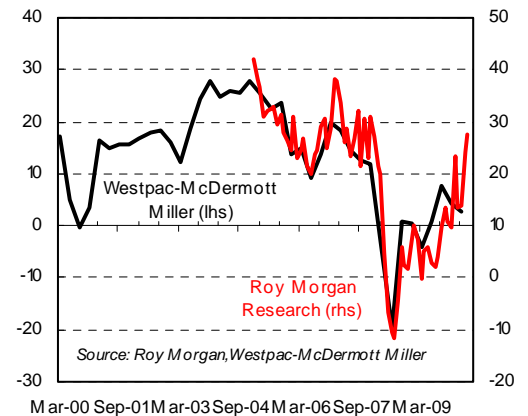
Consumer confidence surveys have shown some volatility in recent months. This is not surprising in light of the uncertainty surrounding tax reforms prior to the Budget release on May 20. Nonetheless, the monthly Roy Morgan survey has shown consumer confidence continues to trend higher, particularly in regards to households' assessment of their own situation.

In line with this, we expect the WMM consumer confidence survey will show an increase in sentiment over the June quarter. The recent improvement in labour demand will help increase household's perceptions of job security.

However, there are some potential offsetting factors, including the recent slowing momentum in housing market activity. The expected Government charges induced inflation spike to over 5% also has the potential to weigh on consumer sentiment over the coming year, particularly if households feel they would not be adequately compensated via income increases.

#### NZ CONSUMER CONFIDENCE SURVEYS

(OWN ACTIVITY)



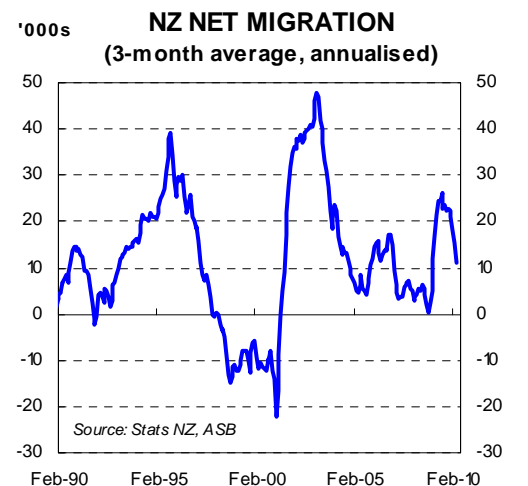
### Monday 21 June

#### May International Travel and Migration

**Previous net PLT migration: +19,954 (year to April)**

The pace of net migration is starting to slow after reaching a peak in January. While the number of arrivals remains firm, the number of departures has started to pick up (albeit from low levels). We expect net migration will continue slow over 2010. We expect the number of permanent departures to Australia will continue to rise over 2010 as the economic recovery in Australia continues to gain momentum ahead of the more sluggish NZ recovery.

Tourism numbers have remained firm throughout the recession, with a surge in visitor arrivals from Australia offsetting declines in visitors from other areas. We expect arrivals from Australia to remain robust, while a recovery in visitor numbers from Asia appears to be developing.



## NZ Data Review: weekly recap

### RBNZ June Monetary Policy Statement

The RBNZ increased the OCR by 25 basis points to 2.75%, as widely expected. With the domestic recovery on track, we expect the RBNZ will continue to hike the OCR steadily in 25 basis point moves at each meeting, barring a substantial deterioration in NZ funding costs as a result of the European sovereign debt crisis.

The OCR increase and the RBNZ's accompanying statement held few surprises. As is the case with all RBNZ decisions, each and every one is always conditional on events leading up to it. Europe remains the main event risk that could make the RBNZ pause at some point in the near term.

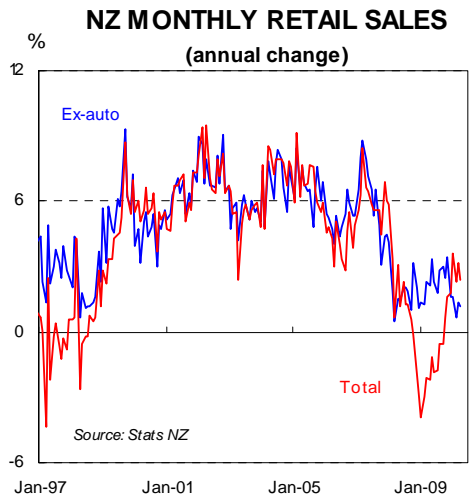
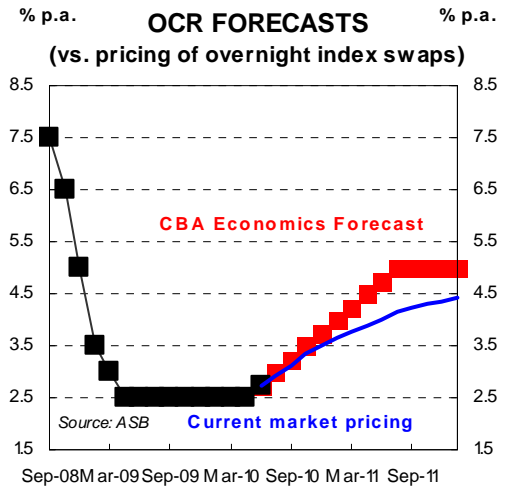
We continue to expect the RBNZ will lift the OCR by 25bp at each meeting until the OCR reaches 5%. Although our expectation is lower than that implied by the RBNZ's forecasts (near 6%), it is still higher than market pricing for the end point. Given the event risk posed by Europe, pricing in some risk of a pause in the tightening cycle is warranted - and has been the reality in Australia where meetings are more frequent. Nevertheless, there is still scope for market expectations of the peak OCR to increase when the risk environment is calmer.

### April Retail Sales

The recovery in retail spending remains subdued. The decline in April retail sales was led by a fall in department store sales, which is likely to reflect some unwinding of the strong growth seen in March.

Spending in the durable goods categories was mixed, with a recovery in spending on furniture and floor coverings and appliances but a decline in spending on hardware. Nonetheless, looking at the overall trend in recent months, spending on appliances remains weak. In addition, there was a further decline in motor vehicle spending despite the recent rebound in vehicle registrations. We expect spending on durable goods to increase in the coming months as households bring forward their spending on big-ticket items ahead of the GST increase on 1st October. Already, recent consumer confidence surveys have seen a substantial increase in the proportion of households who think now is a good time to buy big-ticket items.

Overall, we expect a continued recovery in the labour market this year will underpin a recovery in household spending over the second half 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
Mon 14 Jun	~	AU	Queen's Birthday Public Holiday (ex WA)					
	16.00	JP	BoJ monetary policy meeting	Jun	~	~	~	~
	16.30	JP	Industrial production	Apr	m%ch y%ch	1.3 31.8	~ ~	~ ~
	16.30	JP	Capacity utilization	Apr	m%ch	0.6	~	~
Tue 15 Jun	~	AU	RBA Deputy Governor Battellino speaks in Sydney					
	~	JP	BoJ target rate	Jun	%	0.10	0.10	0.10
	10.00	NZ	REINZ house sales	May	y%ch	-16.2	~	~
	10.00	NZ	REINZ housing price index	May	m%ch	-0.4	~	~
	13.30	AU	Reserve Bank's Board June minutes					
	15.00	NZ	Non resident bond holdings	May	%	63.2	~	~
Wed 16 Jun	11.50	JP	Tertiary industry index	Apr	m%ch	-3.0	~	~
	12.30	AU	Westpac leading index	Apr	m%ch	0.9	~	~
	13.30	AU	Dwelling commencement	QI	q%ch	15.1	~	~
Thu 17 Jun	17.00	JP	Leading index CI	Apr	Index	101.7	~	~
	17.00	JP	Coincident index CI	Apr	Index	101.6	~	~
Fri 18 Jun	11.50	JP	BoJ monetary policy meeting minutes for May					
	15.30	AU	Unemployment rate	May	%	5.4	~	5.5
	15.30	AU	Participation rate	May	%	65.2	~	65.2

## 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 14 Jun	10.00	EZ	Industrial production	Apr	m%ch	1.2	~	~
Tue 15 Jun	~	UK	RICS house price balance	May	%	17.0	~	~
	09.30	UK	CPI	May	m%ch	0.6	~	~
					y%ch	3.7	~	~
	09.30	UK	Core CPI	May	y%ch	3.1	~	~
	10.00	EZ	ZEW survey (econ. sentiment)	Jun	Index	37.6	~	~
	10.00	EZ	Trade balance	Apr	€bn	0.6	~	~
	10.00	EZ	Employment	Q1	q%ch	-0.3	~	~
	13.30	US	Empire manufacturing	Jun	Index	19.1	20.0	~
	14.00	US	Net long-term TIC flows	Apr	\$bn	140.5	~	~
	15.00	US	NAHB housing market index	Jun	Index	22.0	22.0	~
Wed 16 Jun	09.30	UK	ILO unemployment rate (3mths)	Apr	%	8.0	~	~
	10.00	EZ	CPI	May	m%ch	0.5	~	~
	13.30	US	Producer price index	May	m%ch	-1.0	-0.5	~
	13.30	US	Housing starts	May	'000	672.0	652.0	~
	13.30	US	Building permits	May	'000	610.0	630.0	~
	14.15	UK	Industrial production	May	%	0.8	0.9	~
	14.15	UK	Capacity utilization	May	%	73.7	74.5	~
Thu 17 Jun	09.30	UK	Retail sales ex auto fuel	May	m%ch	0.3	~	~
	13.30	US	Consumer price index	May	m%ch	-0.1	-0.2	~
					y%ch	2.2	2.0	~
	13.30	US	CPI ex food & energy	May	m%ch	0.0	0.1	~
					y%ch	0.9	0.9	~
	13.30	US	Initial jobless and continuing claims	Jun	~	~	~	~
	13.30	US	Current account balance	Q1	\$bn	-115.6	-118.6	~
	15.00	US	Philadelphia Fed.	Jun	Index	21.4	21.0	~
15.00	US	Leading indicators	May	m%ch	-0.1	0.3	~	
Fri 18 Jun	09.30	UK	Public finances (PSNCR)	May	£bn	8.8	~	~
	09.30	UK	Public sector net borrowing	May	£bn	10.0	~	~

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