

# Business Weekly

## Inflation angst soon to return?

### This Week

There were no major surprises from the RBNZ last week, with the OCR on hold and its expectation to start lifting rates in the 'middle of 2010' unchanged. The RBNZ remained elusive if this should mean June or July, preferring to keep its options over. More telling, there was no softening in tone, despite the weaker data of late. The housing market is swiftly losing momentum, and sovereign debt issues are threatening to destabilise the global economic recovery. Nonetheless, the RBNZ is looking at its medium-term inflation forecast, and after factoring the impact of the emission trading scheme and higher than usual ACC levies, it no longer feels 'comfortable'. In addition to this, the near-term inflation outlook appears a bit undercooked, increasing the upside risks to inflation (already projected to rise to the top end of the target band once including ETS). Over the next few months the RBNZ will be pondering the ability of inflation expectations to remain 'anchored' when they are already adrift towards the upside of the inflation band, and consumers are about to be shocked by a repeated series of 'one-off' price increases.

The market glanced over what was a reasonably hawkish *Monetary Policy Statement*, and preferred to concentrate on the RBNZ's lower medium-term 90-day track. The RBNZ has recognised that bank funding costs are likely to be persistently high relative to the OCR and has lowered its estimate of the neutral level of the OCR. These revisions are in line with our own assessment of neutral settings (see [Finding Neutral](#)).

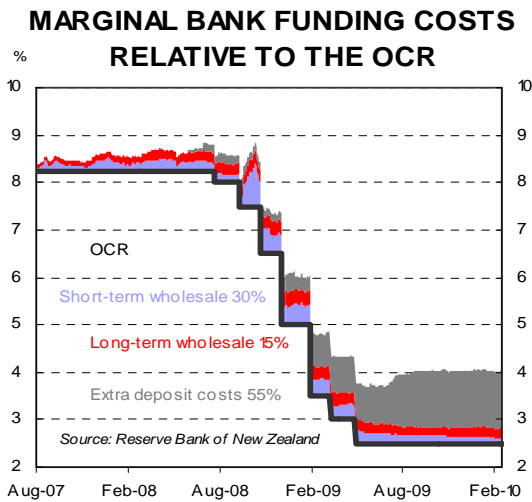
Local data for the past week confirmed there is little urgency to unwind monetary stimulus from the household sector. The housing market is the key reason for the RBNZ's ability to wait till the 'middle of 2010'. The market is now well and truly losing momentum after showing surprising strength through spring and causing some unease for the RBNZ. The Bank has the impending change in tax policy to thank for taming the market's exuberance. Tax changes should even the playing field for investors and owner occupiers, and relieve some of the pressure on house prices. Over the year, rising permanent departures (mostly to Australia, where jobs growth is surging) will also ease population growth, moderating some of the housing market's underlying demand.

Retail spending remains very subdued, recording only very slight growth in January following a very weak December. Spending growth remains sluggish, indicating a high level of caution despite the improvement in consumer confidence. This week's read on consumer confidence may show optimism wavering, with the continued increase in petrol prices and some uncertainty over upcoming changes to tax policy.

### Click here for:

- [Foreign Exchange](#) • NZD/AUD loses further ground, EUR recovers over weekend.
- [Interest Rates](#) • Australian interest rates place upward pressure on NZ interest rates.
- [Week Ahead](#) • Consumer confidence and migration data key for markets.
- [Week in Review](#) • Little change in RBNZ tone, retail sales data once again soft.
- [Global Calendars](#) • RBA meeting minutes and FOMC rate announcement.

### Chart of the week



- The RBNZ has lowered its medium-term 90-day interest rate forecast, recognising that bank funding costs are likely to persist at an elevated level relative to the OCR.
- Higher funding costs are mostly due to increased competition in the term deposit market. The RBNZ's liquidity policy and elevated longer-term wholesale funding credit spreads are driving up term deposit rates relative to wholesale swap rates.
- Higher bank funding costs reduce the amount of stimulus normally associated with a given level of the OCR.
- Overall, looking at its assumption for bank funding costs we think the RBNZ's view of neutral OCR is roughly 120-130 basis points lower than pre-crisis levels (similar to our own findings, see [Finding Neutral](#)).

### 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	0.7027	0.6993	0.6973	0.6978	0.5194	UP	0.6900	0.7100
NZD/AUD	0.7664	0.7677	0.7837	0.8139	0.7937	DOWN	0.7600	0.7750
NZD/JPY	63.66	63.22	62.53	63.09	50.72	FLAT	62.50	64.50
NZD/EUR	0.5104	0.5112	0.5099	0.4795	0.4018	DOWN	0.5075	0.5175
NZD/GBP	0.4631	0.4610	0.4447	0.4198	0.3731	FLAT	0.4575	0.4675
TWI	64.7	64.6	64.5	63.8	53.1	FLAT	64.50	65.00

^Weekly support and resistance levels \* Current is as at 12.15 pm Monday; week ago as at Monday 5pm

- It was a relatively quiet week for FX markets, with the NZ trade-weighted index barely changed. The NZD finished slightly up on the USD, JPY and GBP, and slightly lower against the EUR and AUD.
- Strong Chinese data underpinned a rally in the NZD over Wednesday afternoon. However, the NZD unwound some of the gain over Thursday, following the RBNZ OCR announcement. The market focused on the lower medium-term 90-day outlook, and increased likelihood of smaller and more gradual rate hikes.
- The NZD continues to steadily lose ground against the AUD. This week's RBA minutes are likely to see this trend continue. The minutes are likely to be bullish about Australia's future, and reiterate the RBA's call for further increases in the cash rate.
- The EUR languished for most of the week, although made a recovery over the weekend underpinned by stronger industrial production data. European finance ministers are meeting Monday and Tuesday to discuss a plan to assist Greece with its debt problems. If ministers deliver a credible plan, the EUR is likely to gain further support. The GBP remains under pressure as market continue to fret about the prospect of a "hung" UK parliament. Although these concerns will remain, the GBP is likely to lift on the coat-tails of the EUR if it receives good news.
- We see downside risks to the USD this week; some soft data can be expected this week as February activity was affected by snow storms. The FOMC is likely to sound 'neutral' on the US economic outlook.

### Short-term outlook:

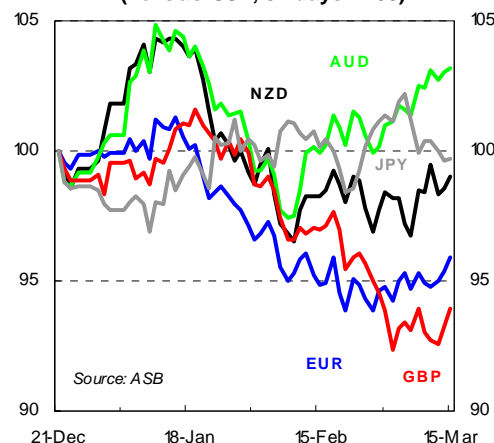
Key data	Date	Time (NZST)	Market expectations
Q1 Westpac McDermott Miller consumer confidence	17/3	3.00pm	-
Mar Roy Morgan consumer confidence	18/3	3.00pm	-
Feb international travel & migration	19/3	10.45am	-
Feb credit card spending	19/3	2.00pm	-

**Potential currency movers this week:** Euro finance ministers meet, EU employment, UK house prices, US industrial production and capacity utilisation (15<sup>th</sup>); RBA meeting minutes, EU inflation, ZEW survey of investors, US housing starts, US building permits, FOMC rate decision (16<sup>th</sup>); BoJ monetary policy meeting (16, 17<sup>th</sup>); BoE meeting minutes, UK labour force (17<sup>th</sup>); US inflation, US current account (18<sup>th</sup>).  
Speakers: Fisher (17<sup>th</sup>), Duke (18<sup>th</sup>), Hoenig, Lacker, Pianalto (19<sup>th</sup>), Bernanke (20<sup>th</sup>).

### 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 have 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 RBNZ OCR increase from April to June, and expect the pace of increase to be gradual, reducing the scope for interest rate driven out-performance.

EXCHANGE RATE INDICES  
(versus USD, 84 days =100)



## 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	3.00	FLAT
90-day bank bill	2.71	2.67	2.74	2.78	3.33	FLAT
2-year swap	4.19	4.17	4.29	3.99	3.48	FLAT
5-year swap	5.17	5.15	5.29	5.30	4.42	FLAT
5-year benchmark gov't stock	5.09	5.04	5.12	4.74	3.98	FLAT
NZSX 50	3232	3223	3080	3129	2523	FLAT

\* Current is as at 12.15 pm 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).

- NZ interest rates ended the week slightly higher despite the small fall in interest rates shortly after the release of the RBNZ March MPS. Upward pressure on domestic interest rates came from the continued increase in Australian interest rates.
- US interest rates ended the week broadly unchanged, with data released over the week mixed. The surprisingly broad-based improvement in ex-auto retail sales was offset by the decline in consumer confidence in the University of Michigan survey.
- Australian interest rates continued their march higher, with markets increasingly expecting the RBA will raise its policy rate by 25 basis point at the April meeting. While employment growth was not as stellar as markets had been expecting, markets focused on the sharp increase in hours worked over February.

### Short-term outlook:

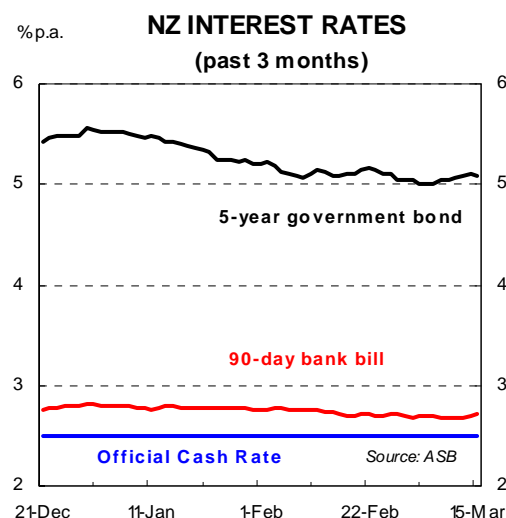
Key data				Date	Time (NZST)	Market expects
Q1	Westpac	McDermott	Consumer Confidence	17/3	3.00pm	-
March	Roy Morgan	Consumer Confidence		18/3	3.00pm	-
Feb	international travel & migration			19/3	10.45am	-
Feb	credit card spending			19/3	2.00pm	-

**Comment:** Domestic markets will likely be fairly quiet, with consumer confidence data this week and Q4 GDP next week not expected to change the view that the OCR will remain on hold at the April meeting. Beyond the April meeting, Q1 CPI data will be a key determinant as to whether the RBNZ commences its tightening cycle in June or July.

The release of the RBA March meeting minutes will shed further insight into the likely pace of the tightening cycle for Australian monetary policy. Focus for offshore markets will be on the FOMC rate announcement.

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

- The RBNZ held its cash rate at 2.5% at the March MPS, and continued to point to the “middle of 2010” as to when the tightening in monetary policy will commence. However, there was no further indication of whether the OCR will be increased in the June or July meeting.
- While the RBNZ left its near-term projection for the 90-day interest rate unchanged, there was a downward revision in its medium-term 90-day track in recognition that current bank funding costs were likely to persist (see our discussion on the first page). This supports our expectations that OCR increases will be in 25 basis point increments over the tightening cycle this year.
- While the RBNZ has revised up its inflation forecasts, largely reflecting higher ACC levies and the implementation of the Emissions Trading Scheme, we believe there remains upside risks to inflation particularly in the near-term. The continued increase in petrol prices in recent months will underpin tradable inflation, while the continued rise in pricing intentions in the construction sector point to a rebound in construction costs and hence non-tradable inflation over 2010. With 2 year-ahead inflation expectations already elevated at 2.7%, there is little room for further upside inflation surprises.
- In contrast, activity data have been soft. In particular, momentum in housing market activity is waning with housing sales at low levels and days to sell starting to increase. We expect uncertainty over changes to tax policy regarding property investment will weigh on the housing market over 2010. Meanwhile, the recovery in household spending remains very subdued, particularly in the areas of discretionary spending.
- The weak activity data reduce the urgency for the RBNZ to unwind stimulus. Nonetheless, with signs that inflation pressures will build up later this year we expect the RBNZ will begin tightening with a 25 basis point OCR increase in June, and follow this up with further 25 basis point increases in the subsequent meetings.



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

Data	Date	Time (NZST)	Previous	Market expects	ASB expects
Q1 Westpac MM Consumer Confidence	17/3	3.00pm	116.9	-	-
March Roy Morgan Consumer Confidence	18/3	3.00pm	123.6	-	-
Feb international travel & migration – ann. total	19/3	10.45am	22,588	-	-
Feb credit card spending - mom	19/3	2.00pm	+1.5%	-	-

### Wednesday 17 March

#### Q1 Westpac MM Consumer Confidence

### Thursday 18 March

#### March Roy Morgan Consumer Confidence

There has been a substantial improvement in consumer confidence over the past year. Given the continued increase in petrol prices and uncertainty over upcoming changes to tax policy we expect consumer confidence to edge slightly lower in March.

Nonetheless, the increase in the Roy Morgan survey of consumer confidence in recent months indicates the Westpac McDermott Miller consumer survey will show an improvement in consumer confidence over the March quarter. However, recent retail spending and consumer credit point to the recovery in household spending being much more subdued.

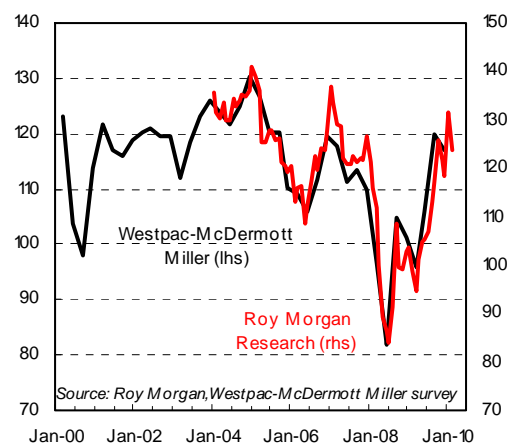
### Friday 19 March

#### February international travel and migration

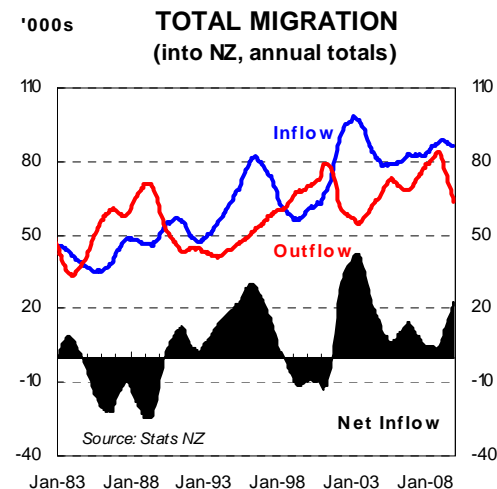
Net migration has surged over the past year, as arrivals remained steady and the number departures fell sharply (in particular to Australia). However, we expect the increase in net migration will slow over 2010. As the economic recovery in Australia continues to gain momentum ahead of the NZ recovery, the number of permanent departures to Australia is likely to increase sharply over 2010.

Tourism numbers have remained resilient 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 CONSUMER CONFIDENCE SURVEYS



### TOTAL MIGRATION (into NZ, annual totals)



## NZ Data Review: weekly recap

### Q4 Overseas Trade Indices

The improvement in the terms of trade was driven by a larger fall in import prices, relative to the fall in export prices.

The decline in export volumes was driven by a fall in oil exports, reflecting the tapering off of oil production at Maari (after operating at full capacity in the prior quarters). Meanwhile, the improvement in the manufacturing sector was reflected in a continued increase in non-food manufactured exports, likely underpinned by strong Australian growth and the low NZD/AUD cross rate.

Turning to import volumes, the stabilisation in capital goods imports is encouraging and points to a slightly more robust plant and machinery investment outlook. The small increase in consumer goods imports points to the recovery in household spending remaining sluggish.

Over the past year the trade balance, and current account balance, have narrowed on the back of weak import demand and ongoing robust agricultural export volumes. Q4's numbers point to early signs of this trend reversing: in particular, the lift in capital goods was encouraging. As the economic recovery gains momentum, we expect import demand to improve and see the trade balance begin to widen over 2010.

### RBNZ March Monetary Policy Statement

The RBNZ kept the OCR unchanged at 2.5% and delivered very little change in tone. The RBNZ left its near-term projection for the 90-day interest rate unchanged. More importantly, the RBNZ has lowered the longer-term outlook for the 90-day track. The Bank now assumes that bank funding costs will remain elevated, which reduces the amount of stimulus normally associated with a given level of the OCR. The Bank notes that this will reduce the extent of future increases in the OCR.

The inflation track has been revised higher, mostly on revised expectations for higher ACC charges. Although the RBNZ excludes the impact of the Emissions Trading Scheme on inflation when setting monetary policy, it notes that the combination of the ETS and ACC charges will push inflation toward the top of the target range. Once it includes the impact of a GST increase, we expect the RBNZ will become increasingly uncomfortable with the upside risks to underlying inflation. The RBNZ is assuming that inflation expectations will remain anchored, but this series of one-off events poses a risk to this assumption.

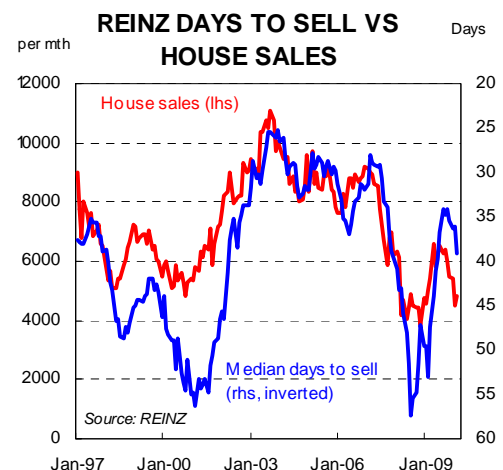
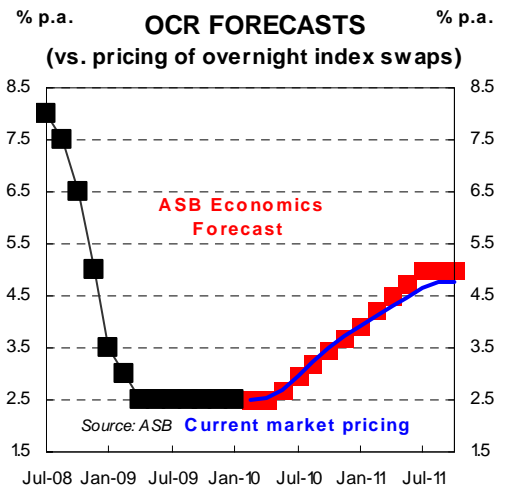
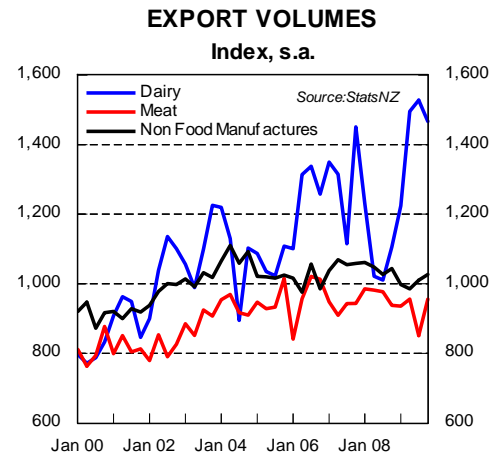
Larger hikes than 25bp have not been ruled out, but the RBNZ will stick with 25bp moves unless events suggest larger hikes are warranted.

### February REINZ house sales

February REINZ housing data confirmed the housing market is losing momentum. While house sales picked up slightly (+7% s.a.), the level of sales remains low. More telling was the rise in days to sell (39 seasonally adjusted, from 36 days previously). The steady climb in days to sell from October's lows suggests the balance between supply and demand is returning to normal, following a period of under-supply through spring.

The lift in supply should reduce pressure in the market, and house prices are likely to ease over 2010 following surprisingly strong gains in 2009. REINZ new stratified house price index showed a 0.4% increase in house prices. However, seasonally adjusting this figure prices actually declined 1.1% during February.

We expect house sales and prices will be weighed down by uncertainty over tax changes until the Budget at the end of May.

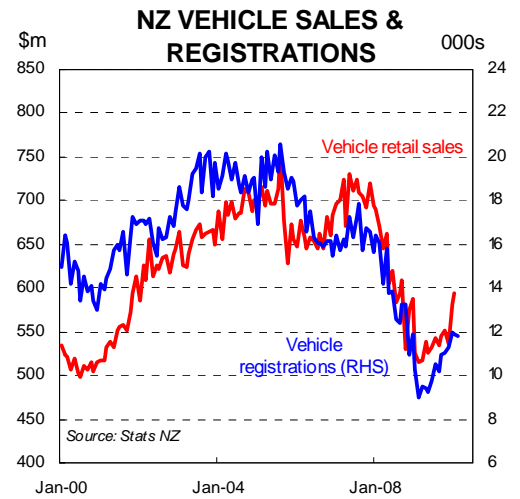


### January Retail Trade Survey

January's figures continue to point to a very subdued recovery in consumer spending. Although, January total retail sales were higher than market expectations, core spending was softer. Of note has the downward revision to the already very weak result in the December month.

There was a rebound in vehicle sales over December and January, in line with the improvement in vehicle registrations over this period. Outside of the auto sector, core spending remains weak, particularly in the areas of discretionary spending, with appliance and clothing sales languishing at low levels. In addition, spending on eating out continued to decline.

More recent data suggest this trend will continue over the coming months, with electronic card transactions still weak and consumer confidence dipping in February. Furthermore, the improvement in vehicle registrations (an indicator of vehicle sales) looks to have plateaued. January's data added to the recent slew of data which has removed the urgency for the RBNZ to commence its tightening cycle.



## 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 15 Mar	~	JP	Cabinet Office March Economic Report					
	10.30	NZ	Performance Services Index	Feb	index	53.1	~	~
	11.00	AU	RBA Deputy Bank Governor Edey speaks in Sydney					
	18.00	JP	Consumer Confidence	Feb	Index	39.4	~	~
	18.00	JP	Consumer Confidence Households	Feb	Index	39.0	~	~
Tue 16 Mar	13.30	AU	Reserve Bank's Board March Minutes	Mar	~	~	~	~
	15.00	NZ	Non Resident Bond Holdings	Feb	%	63.6	~	~
	17.00	JP	BoJ Monetary Policy Meeting	Mar				
	19.00	JP	Machine Tool Orders	Feb	y%ch	217	~	~
Wed 17 Mar	~	JP	BOJ Target Rate	Mar	%	0.1	0.1	0.1
	12.30	AU	Westpac leading index	Jan	m%ch	0.5	~	~
	12.50	JP	Tertiary Industry Index	Jan	m%ch	-0.9	1.3	~
	13.30	AU	Dwelling commencement	QVI	q%ch	9.4	~	10.0
	14.00	AU	RBA Deputy Bank Governor Debelle: Panel Discussant - Melbourne					
Thu 18 Mar	12.50	JP	BSI Large All Industry	QI	q%ch	-1.9	~	~
	12.50	JP	BSI Large Manufacturing	QI	q%ch	13.2	~	~
	15.00	NZ	ANZ Consumer Confidence	Mar	index	123.6	~	~
					m%ch	-5.9	~	~
	18.00	JP	Leading Index CI	Jan	index	94.3	~	~
	18.00	JP	Coincident Index CI	Jan	index	97.6	~	~
Fri 19 Mar	10.45	NZ	Visitor Arrivals	Feb	%	-2.4	~	~
	15.00	NZ	Credit Card Spending	Feb	m%ch	1.5	~	~
					y%ch	2.6	~	~
	17.30	JP	All Industry Activity Index	Jan	%	-0.3	1.8	~

## Calendar – North America & Europe

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

UK				Forecast					
Date	Time	Econ	Event	Period	Unit	Last	Market	CBA	
Mon 15 Mar	12.30	CA	New Motor Vehicle Sales	Jan	%	2.6	0.0	~	
	12.30	US	Empire Manufacturing	Mar	Index	24.9	21.0	~	
	13.00	US	Net Long-term TIC Flows	Jan	\$bn	63.3	~	~	
	13.15	US	Industrial Production	Feb	%	0.9	0.1	~	
	13.15	US	Capacity Utilization	Feb	%	72.6	72.6	~	
	17.00	US	NAHB Housing Market Index	Mar	index	17.0	17.0	~	
Tue 16 Mar	10.00	EZ	Euro-Zone CPI	Feb	m%ch	-0.8	~	~	
						y%ch	1.0	~	~
	10.00	GE	ZEW Survey (Econ. Sentiment)	Mar	~	45.1	44.0	~	
	12.30	CA	Manufacturing Sales	Jan	m%ch	1.6	~	~	
	12.30	US	Import Price Index	Feb	m%ch	1.4	-0.2	~	
						y%ch	11.5	~	~
	12.30	US	Housing Starts	Feb	'000	591	570	~	
						m%ch	2.8	-3.6	~
12.30	US	Building Permits	Feb	'000	622	610	~		
					m%ch	-4.7	-1.9	~	
18.15	US	FOMC Rate Decision	Mar	%	0-0.25	0-0.25	0-0.25		
Wed 17 Mar	09.30	UK	Bank of England Minutes						
	09.30	UK	ILO Unemployment Rate (3mths)	Jan	%	7.8	7.9	~	
	10.00	EZ	Construction Output	Jan	m%ch	0.5	~	~	
						y%ch	-3.1	~	~
	12.30	CA	Wholesale Sales	Jan	m%ch	0.7	~	~	
12.30	US	Producer Price Index	Feb	m%ch	1.4	-0.2	~		
					y%ch	4.6	5.1	~	
Thu 18 Mar	09.00	EZ	ECB Euro-Zone Current Account	Jan	€bn	1.9	~	~	
	12.30	US	Consumer Price Index	Feb	m%ch	0.2	0.1	~	
						y%ch	2.6	2.3	~
						index	217	~	~
	12.30	US	Initial Jobless Claims	Mar	'000	462	455	~	
	12.30	US	Current Account Balance	QIV	\$bn	-109	-120	~	
	14.00	US	Philadelphia Fed.	Mar	~	17.6	17.0	~	
14.00	US	Leading Indicators	Feb	%	0.3	0.1	~		
Fri 19 Mar	11.00	CA	Consumer Price Index	Feb	m%ch	0.3	0.3	~	
						y%ch	1.9	1.4	~
	12.30	CA	Retail Sales	Jan	m%ch	0.4	0.5	~	

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