

Business Weekly

When Doves Cry

This Week

Last week the RBNZ kept the OCR on hold, the outcome ourselves and a significant minority of forecasters anticipated. As with the April OCR Review, the RBNZ said it expects to keep the OCR at or below its current level until the latter part of 2010.

Market pricing, too, had only a small probability of a cut built in. However, the market reaction to the Monetary Policy Statement was marked, with swap rates soaring on the day. Although the lifts were compounded by resilient Australian labour figures later in the afternoon, the market response looks overdone relative to the message the RBNZ gave.

The RBNZ is disappointed by the market reaction to the MPS. Notwithstanding the on-hold decision, the tone of the June MPS was still on the dovish side. The RBNZ were reasonably dismissive of green shoots (in comparison to the Reserve Bank of Australia, who very much embraced green shoots). The RBNZ emphasized the downside risks to its forecasts and commented that rate cuts are still possible. Moreover, the RBNZ's outlook is built around a very low exchange rate forecast. If the exchange rate does not return to sustaining the very low level the RBNZ assumes, then the growth and inflation outlooks are likely to be significantly weaker than anticipated.

We are in a minority in thinking there is still a good chance RBNZ is going to have to cut again, largely because we expect the NZD will remain substantially firmer over the next year. The NZD, coupled with higher long-term interest rates, will make for monetary conditions remaining much tighter than the RBNZ is happy with. We still expect the economy to be weaker than the RBNZ has forecast, though the RBNZ's forecasts are now more the middle of the pack than March's overly optimistic outlook.

On the day we got the impression that the hurdle for further rate cuts was slightly higher, mainly because the RBNZ demonstrated little desire to try and fight the tide of rising long-term interest rates and NZD. Ironically, the market reaction has increased the odds of further cuts. The RBNZ may consider cutting the OCR to send a message to the markets that rate hikes remain a long way off.

In the immediate wake of the MPS we judged the RBNZ would pause again in July, with further cuts in September and October contingent on the RBNZ getting concerned the NZD would hold up for longer than it is banking on. However, the chance of a July cut has grown, should the post-MPS lift in interest rates be sustained. The RBNZ's on-hold message is either not getting through or simply not being believed.

Click here for:

[Foreign Exchange](#)

- NZD continues to lift on USD weakness.

[Interest Rates](#)

- Swaps surge as RBNZ remains on hold, easing bias ignored by market.

[Week Ahead](#)

- A quiet week, with no major local releases.

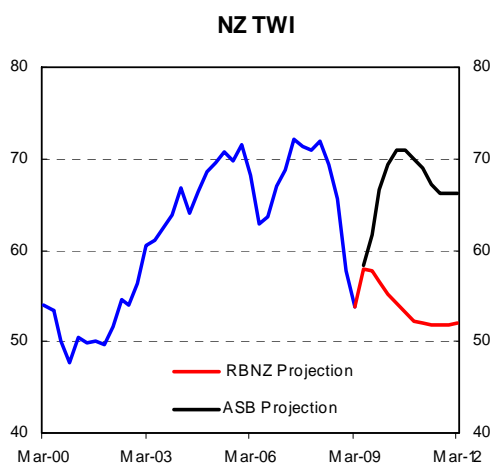
[Week in Review](#)

- RBNZ on hold, but engages in some jawboning of rates, NZD.

[Global Calendars](#)

- US Industrial Production, Home construction data, CPI, & Current Account due.

Chart of the week



- Will the RBNZ cut again or not? That answer will depend partly on the vagaries of the NZ dollar: will it remain strong over the next couple of years, or will it be weak?
- The RBNZ has made the assumption that eventually the focus will go on NZ factors. Specifically NZ's high level of external debt is expected to induce a sustained low NZD to aid correction of that imbalance.
- However, we expect to see a period of structural weakness in the US dollar continuing to dominate, and for the NZD to mildly outperform other currencies.
- Relative fundamentals are what matter. In a world of improving global growth prospects the NZD tends to firm rather than decline.

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	0.6376	0.6251	0.5925	0.5532	0.7500	UP	0.6350	0.6500
NZD/AUD	0.7903	0.7871	0.7801	0.8264	0.7980	FLAT	0.7850	0.7950
NZD/JPY	62.77	61.63	56.83	50.34	80.83	FLAT	62.00	640.00
NZD/EUR	0.4559	0.4480	0.4344	0.4108	0.4858	FLAT	0.4550	0.4650
NZD/GBP	0.3882	0.3918	0.3890	0.3682	0.3852	FLAT	0.3850	0.3950
TWI	60.4	59.6	57.4	54.8	67.6	UP	57.00	59.50

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

- NZD lifted on all the currencies monitored, with the exception being a 0.9% drop against the GBP. A 2% lift against the still-weak USD saw the NZD lift 1.4% on a trade-weighted basis.
- NZD also lifted 1.8% against the JPY and EUR. The AUD showed similar strength, but was outperformed by the NZD, with the NZD/AUD cross rate lifting 0.4%.
- The commodity currencies of New Zealand, Australia and Canada remain in vogue at present. The NZD, AUD and CAD are all close to posting their strongest quarterly gains against the USD.
- Last week RBNZ Governor Dr Alan Bollard described the NZD strength as “unhelpful” and “a real risk to us” as the strength makes an export-led recovery “that much harder”. Similar concerns are held in Canada and Australia. However, the RBNZ is unlikely to intervene at current levels. “We have an exchange rate that is set by market forces. So we are not really in a position to do a lot immediately about that”, Bollard observed.
- With little in the way of data due in New Zealand until the National Accounts are released late next week, the NZD direction this week will be driven largely by offshore themes.

Short-term outlook:

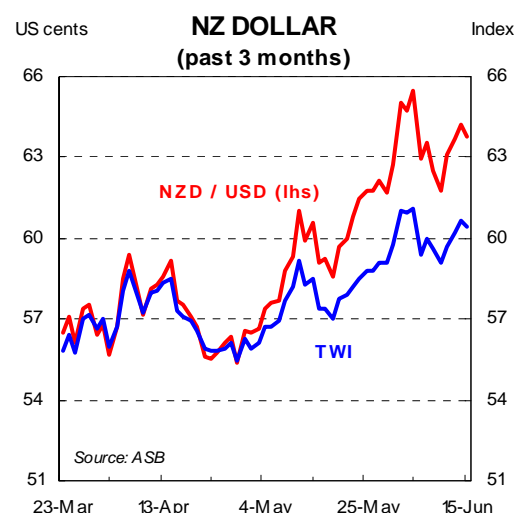
Key data	Date	Time (NZST)	Market expects
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No major local releases.

Potential currency movers from the US this week: TICS Flows (15th), Empire Manufacturing, NAHB Housing Market Index (16th), Producer Price Indices, Housing Starts, Building Permits, Industrial Production (17th) CPI, Current Account (18th).

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

- As a consequence of the financial market turmoil centred in the United States, USD weakness was expected in early 2009. Although this weakness was initially offset in part by concerns about other regions, improved sentiment in financial markets has seen risk appetites improve and the USD weaken.
- Right now, the USD, which has shown countercyclical strength, is under pressure. USD is weakening for the following reasons:
 - US residents increase their offshore investment, encouraged by improvement in the global economy.
 - USD liquidity demand and safe-haven buying of the USD reverses is easing.
 - Diversification out of USD is expected to occur due to concerns about US government debt.
- The arguments for buying EUR, GBP and JPY are strong enough to engineer a reasonable depreciation in the USD, but we do not expect to revisit fresh US TWI lows.
- We are also comfortable with our current forecast that the NZD and AUD have bottomed and will appreciate over the course of 2009, rather than revisit and break through the lows seen in early 2009. Since the Budget the threat of a credit rating downgrade has subsided.
- 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: the NZD will leverage off the global recovery and NZ is in a relatively good position compared to a number of major economies.
- The likelihood of the RBNZ intervening to try and weaken the NZD remains very low given the RBNZ’s acknowledgement that global factors have much to do with the NZD’s lift.



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	5.00	8.25	FLAT
90-day bank bill	2.86	2.70	2.84	5.24	8.70	FLAT/DOWN
2-year swap	3.90	3.73	3.45	4.74	7.96	FLAT/UP
5-year swap	5.35	5.28	4.73	5.08	7.60	FLAT/UP
11/11 gov't stock	4.84	4.78	4.36	4.64	6.49	UP
NZSX 50	2810	2827	2791	2684	3411	DOWN

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

- The RBNZ kept the OCR on hold at 2.5% as expected. With the market only pricing in 8bp of cuts, the surprise should have been minimal. However, the market over-reacted. Despite delivering a dovish statement and an explicit easing bias, many have interpreted the June MPS as the end of the easing cycle. As a result, swap rates immediately gained 25bp in 3-4 year space, although pared back some of this rise on Friday.
- Some market watchers have (prematurely?) called the end of the easing cycle, which has the potential to trigger another round of fixing demand. This demand could put upward pressure on swap rates over the next few weeks. However, we note the RBNZ has since been reasonably vocal in reminding the market of its easing bias, which may help maintain receivers' confidence in the market.

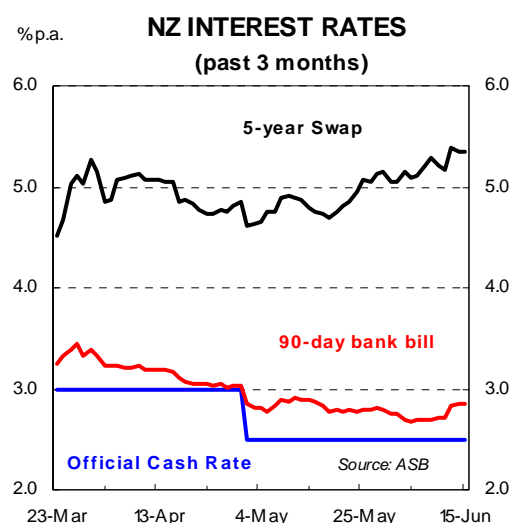
Short-term outlook:

Key data	Date	Time (NZST)	Market expects
International Travel and Migration	22/6	10.45 am	-

Comment: NZ and Australian data calendar is extremely light this week, with only the RBA minutes on Tuesday worth a mention. Offshore sentiment will continue to dominate, with US data out this week including housing data, industrial production and CPI.

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

- The RBNZ left the cash rate unchanged at 2.5% at the June OCR announcement. The RBNZ has cut the cash rate 575 basis points in less than a year in response to the financial crisis offshore. The RBNZ has previously expressed reluctance to cut the OCR below 2%, which leaves just 50 basis points worth of rate cuts up its sleeve.
- The RBNZ's June statement was dovish, playing down green shoots optimism and highlighting the downside risks to the economic outlook. The RBNZ maintained an explicit easing bias, mentioning the potential for the OCR to move lower and restated it continues to expect to hold the OCR at current levels until the latter part of 2010.
- The RBNZ revised down its growth outlook in June, and as a result inflation pressures are considerably weaker. The RBNZ forecasts CPI inflation to briefly fall through the bottom of the target band later this year, then recover to remain 'comfortably' in the middle of the target band.
- The RBNZ's export-led recovery is heavily dependent on the trade weighted exchange rate remaining below average for an extended period. In our view, the RBNZ's exchange rate assumption is reasonably heroic, and differs from our own view of US dollar weakness remaining a dominant driver of the NZ dollar. The assumption leaves the RBNZ vulnerable to the risk inflation falls uncomfortably low. There remains large downside risk to the economic outlook, and the RBNZ is likely to want to deliver further monetary policy stimulus.
- The market has underestimated the RBNZ's willingness to cut further, with market pricing implying the easing cycle is over – and that the OCR will increase as early as the start of 2010. The RBNZ is disappointed with this reaction. The longer that interest rates and the NZ dollar remain above the RBNZ's assumptions, the more pressure the RBNZ will feel for further cuts to remind the markets of its position. We have pencilled in two 25 basis point cuts for September and October, although the timing of these are partly dependent on the NZ dollar. Currently, risks are pointing to a cut in July should the market continue to doubt the RBNZ's easing bias.
- The OCR remains the RBNZ's primary tool, although it has started to lose traction at very low levels. While the RBNZ has investigated other options, it remains very reluctant to use them while there is potential to cut the OCR further.



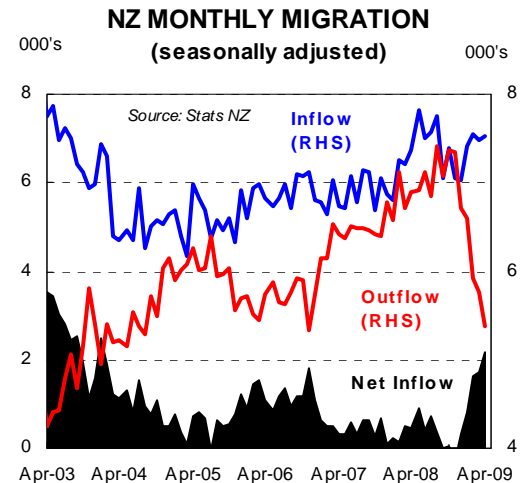
NZ Data Preview: a look at the week ahead

Data	Date	Time (NZST)	Previous	Market expects	ASB expects
International Travel and Migration	22/6	10.45 am	9,176	-	-
May Credit Card Billings	22/6	3.00 pm	+2.3%	-	-

May International Travel and Migration

Net Migration has picked up strongly on the back of a sharp drop in the number of departures. Over the past 12 months NZ has recorded an additional 9,176 net migrants. The swift change comes as the number leaving to Australia has fallen sharply. Australia has not been immune to the global economic downturn and has seen unemployment pick up roughly in line with NZ. We expect current trends to continue and for annual net migration to reach around 20,000 towards the end of the year. The boost to the population will help provide some timely support for the retail and housing activity, helping to curb the recent fall in demand.

Short-term visitor arrivals have remained relatively firm, buoyed by strong tourist arrivals from Australia. However, the number of visitors from the US, UK and Japan have started to fall.



Q1 Economic Survey of Manufacturing

Manufacturing sales were surprising resilient over Q1, although the strength appears to have come from dairy and meat production. Manufacturing sales volumes increased 0.2%, with a 23% surge in meat and dairy sales volumes offsetting the 6.5% decline in the remainder of manufacturing sales.

The strength in dairy and meat sales comes as dairy production recovers from the previous season's drought. As a result, the gain is likely to be temporary with next quarter's manufacturing sales likely to be very weak in contrast. The result echoes the composition of export data, with strong agricultural production masking the underlying weakness in the rest of manufacturing. The remainder of the manufacturing sector experienced broad-based weakness, reflecting the sharp drop in both domestic and foreign demand given the synchronised nature of the global recession. While we underestimated the boost dairy would provide over Q1, the underlying manufacturing sector is much weaker than we anticipated.

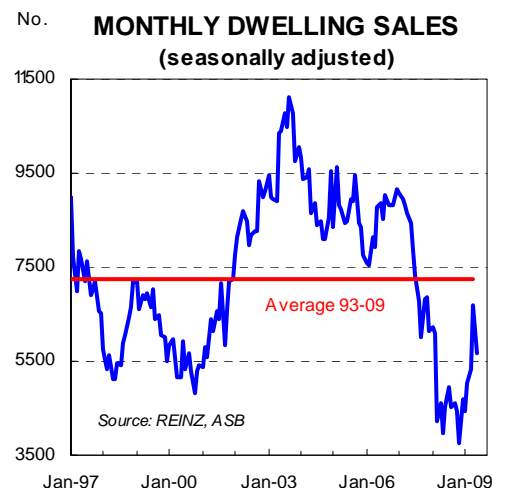


NZ Data Review: weekly recap

May REINZ house sales

On a seasonally-adjusted basis house sales have recovered over the past few months, although today's figures show a bit of a pull back in demand over May (a 15% fall following on from April's 25% surge). April's increase may have been exaggerated by a rush by borrowers to lock in low longer-term interest rates. Although the pace of mortgage approvals has since slowed, low shorter-term interest rates will continue to hold housing demand off its previous lows.

Another positive sign for the housing market is the continued decline in days to sell – back to 41 days on a seasonally-adjusted basis having eased considerably since the start of the year. The number of days to sell reflects the balance between supply and demand and suggests some of the excess supply is starting to move as demand begins to recover.



Q1 Building Work Put in Place

Construction activity remained surprisingly resilient over Q1, falling only 0.7% compared to our expectations of another large 7% decline. The main source of the surprise was in the volume of residential construction, falling 0.4% over Q1 – compared to our expectations of a 10% fall. Building consents plummeted over the second half of 2008 and continued to steadily fall over the early months of 2009. Allowing for some lag between building consents being issued and construction activity starting, we had expected to see another sharp fall in residential building activity. With construction demand drying up so dramatically, we are a bit surprised that the level of activity managed to remain so robust. In our view, the decline is inevitable and we are now expecting a larger drop to show up in second quarter of the year.

Non-residential construction activity fell 1%, compared to our expectation of a 4% decline. Non-residential construction has held up well throughout this recession, possibly aided by strength in public investment. Statistics New Zealand notes that construction activity was boosted by work on stadiums and justice system buildings. All other categories (excluding education) actually recorded a decrease.

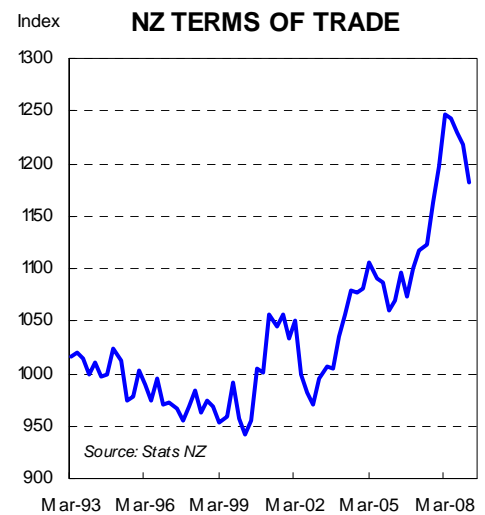
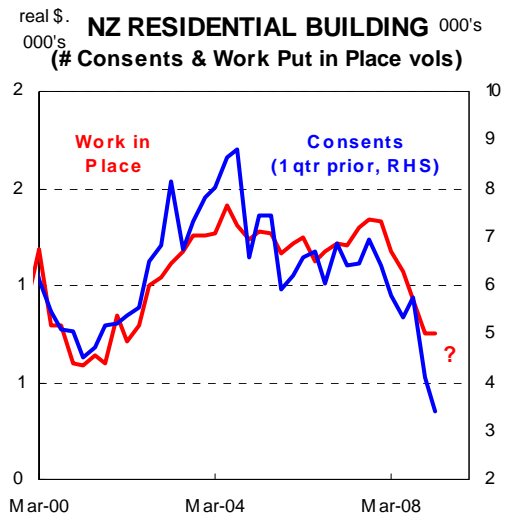
Q1 Terms of Trade

Merchandise Terms of Trade fell 3% over Q1, with export prices plunging 8.2%, partly offset by a 5.4% fall in import prices. The 3% fall follows a 1% decline in Q4, and is the largest decline since the 4.7% fall in Q2 20002.

The dramatic 8.2% decline in export prices was the largest fall since December 1957, led by a decline in dairy and oil prices. Despite the fall in the NZ dollar, most of the published export price indices recorded declines (with the exception of fish and meat), reflecting the weakness in global demand and world prices.

The fall in import prices was led by 36% fall in petroleum and related products. Excluding this group, the remaining import price index increased 2.8%.

Export volumes increased 2%, on the back of a 14% recovery in dairy exports (post-drought recovery). Most agricultural-related exports performed well, cushioning the weakness in demand for manufactures. Meanwhile, import volumes fell 9.8% over Q1, the decline was relatively broad-based, reflects the weakness in domestic demand, reducing the need for imported capital, intermediate and consumption goods.



RBNZ OCR Announcement and June MPS

The RBNZ kept the OCR on hold at 2.5% as we were expecting, in addition the tone of the RBNZ's statement delivered few surprises. The RBNZ acknowledged signs of so-called green shoots, noting international economic activity is stabilising and international financial conditions are improving. The RBNZ also noted the recovery in the housing market and net migration. Nonetheless, the RBNZ continued to emphasise the weak economic outlook and see risks remain weighted to the downside. Inflation pressures are lower than previously expected and CPI inflation is likely to briefly fall through the bottom of the target band later this year. In our view, the RBNZ's exchange rate assumption is too weak, and leaves the RBNZ vulnerable to the risk inflation falls uncomfortably low.

Although on hold, the RBNZ has an explicit easing bias in place. There remains large downside risk to the economic outlook, and we anticipate further OCR cuts. The timing of these are likely to be heavily dependent of the NZ dollar: the longer it remains stronger than the RBNZ's assumption, the more pressure there will be to cut further. We have pencilled in two 25bp cuts in for September and October.

June Consensus Forecasts

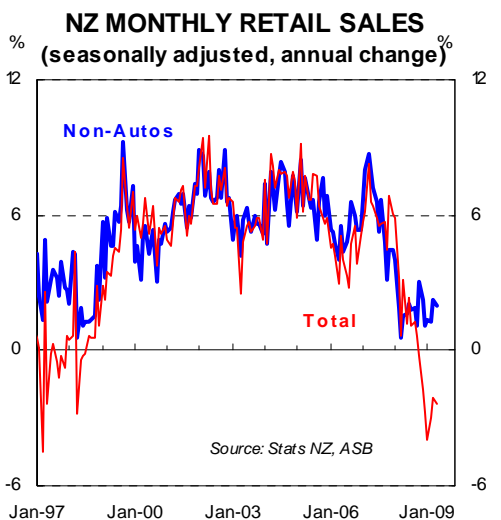
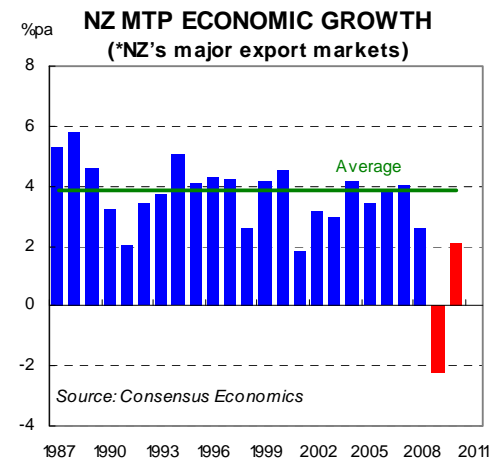
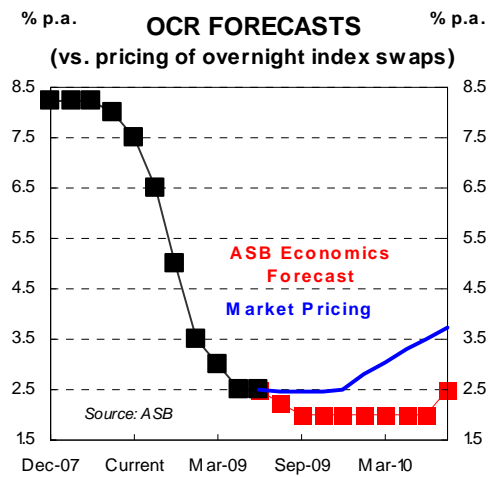
Green shoots optimism has now filtered through to economic forecasts, with many countries' 2009 GDP outlooks being revised up (more correctly, the size of the expected contraction has been slightly scaled back). The largest upward revision was for Australia, as Q1 GDP came out much stronger than initially expected (with the lucky country avoiding a technical recession). However, these small upward revisions across a large number of countries were offset by some large downward revisions to a few (the lift in sentiment didn't reach Japan, Eurozone, Hong Kong and Malaysia). Consensus forecasts for 2009 NZ Trading Partner Growth remained unchanged at -2.3%. Forecasts for 2010 recovery were nudged up to 2.1% (from 2.0%) with all countries' GDP forecasts either remaining unchanged or slightly higher.

However, we remain more cautious on the outlook and we continue to expect downward revisions to GDP forecasts, and expect Trading Partner GDP will contract 2.5% over 2009, and lift only 1.5% over 2010. The RBNZ's are also expecting downward revisions, with forecasts in the June Monetary Policy Statement very similar to our own.

April Retail Trade Survey

Total retail sales were boosted by strength in the auto component, a brief reversal of past 6 months' trend where weakness in the auto sector has dragged on overall retail spending. Motor vehicle sales lifted 3.5% over the month, although this is likely to be a temporary lift with vehicle registrations data remaining very weak and implying further declines in sales.

We were expecting to see a lift in core retailing, on the back of tax cuts and a lift in consumer sentiment. However, the figures disappointed with core retail sales falling 0.1% and large declines noticed in a range of retail groups. Overall the evidence points to continued caution by the consumer. The effect of falling household wealth and outlook for rising unemployment has seen a shift in sentiment, with households either paying down debt or increasing precautionary savings. Nonetheless, electronic card data suggest a large pick-up in spending over May, possibly supported by recent tax cuts (and a few lucky New Zealanders benefiting from Australia's tax rebate as well).



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
Mon 15 Jun	13.30	AU	Lending finance	Apr				
Tue 16 Jun	~	AU	NSW and Qld State Budget	~				
	~	JP	BoJ target rate	Jun	%	0.1	0.1	
	13.30	AU	Reserve Bank's Board June minutes					
	15.00	NZ	Non resident bond holdings	May	%	71.3	~	~
Wed 17 Jun	16.00	JP	Tokyo condominium sales	May	y%ch	-8.5	~	~
	~	JP	Cabinet office monthly report	Jun	~	~	~	~
	13.00	AU	Westpac leading index	Apr	m%ch	0.3	~	~
	13.30	AU	Dwelling commencement	Q1	q%ch	-9.9	~	-9.0
	17.00	JP	BoJ monthly report	Jun	~	~	~	~
	18.00	JP	Machine tool orders	May	y%ch	-79.3	~	~
Thu 18 Jun	13.30	AU	International merch. imports	May	\$mn	16.2	~	~
	13.30	AU	RBA Bulletin	Jun	~	~	~	~
	13.30	AU	Labour Force, quarterly	May	~	~	~	~
Fri 19 Jun	11.50	JP	BoJ monetary policy meeting minutes for May					

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 15 Jun	10.00	EZ	Employment	Q1	q%ch	-0.3	~	~
					y%ch	0.0	~	~
	13.30	CA	Manufacturing shipments	Apr	%	-2.7	-1.0	~
	13.30	US	Empire manufacturing	Jun	Index	-4.6	-6.4	~
	14.00	US	Net long-term TIC flows	Apr	\$bn	55.8	60.0	~
Tue 16 Jun	18.00	US	NAHB housing market index	Jun	Index	16.0	17.0	~
	09.30	UK	CPI	May	m%ch	0.2	~	~
					y%ch	2.3	~	~
	10.00	EZ	CPI	May	m%ch	0.4	~	~
y%ch					0.6	~	~	
10.00	EZ	Labour costs	Q1	y%ch	3.8	~	~	
Date	time		Econ Event	Period	Unit	Last	Market	CBA
	10.00	EZ	ZEW survey (eco sentiment)	Jun	Index	28.5	~	~

	10.00	GE	ZEW survey (eco sentiment)	Jun	Index	31.1	~	~
	13.30	CA	Labour productivity	QI	q%ch	-0.5	~	~
	13.30	US	Producer price index	May	m%ch	0.3	0.6	~
					y%cjh	-3.7	-4.4	~
	13.30	US	Housing starts	May	'000	458	480	~
	13.30	US	Building permits	May	'000	498	500	~
	14.15	US	Industrial production	May	%	-0.5	-0.8	~
	14.15	US	Capacity utilisation	May	%	69.1	68.5	~
Wed 17 Jun	09.30	UK	Bank of England minutes	June	~	~	~	~
	10.00	EZ	Trade balance	Apr	€bn	-2.1	~	~
	10.00	EZ	Construction output	Apr	m%ch	-1.0	~	~
					y%ch	-8.7	~	~
	13.30	CA	Wholesale sales	Apr	m%ch	-0.6	~	~
	13.30	CA	Leading indicators	May	m%ch	-1.1	~	~
	13.30	US	CPI	May	m%ch	0.0	0.3	~
					y%ch	-0.7	-0.9	~
	13.30	US	Current account balance	QI	\$bn	-132.8	-85.0	~
Thu 18 Jun	09.30	UK	Retail sales	May	m%ch	0.9	~	~
					y%ch	~	~	~
	12.00	CA	CPI	May	m%ch	-0.1	~	~
					y%ch	0.4	~	~
	13.30	CA	Retail sales	Apr	m%ch	0.3	~	~
	13.30	US	Initial jobless and continuing claims					
	15.00	US	Leading indicators	May	%	1.0	0.9	~
	15.00	US	Philadelphia Fed	Jun	Index	-22.6	-18.0	~
Fri 19 Jun	07.00	GE	Producer prices	May	m%ch	-1.4	~	~
					y%ch			

ASB ECONOMICS
Level 9, 135 Albert Street, Auckland

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

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