

Holding out for a better recovery

- Business confidence lifts over Q4, following patchy growth through mid-2010.
- RBNZ likely to hold off rate hikes until September 2011.
- Q4 CPI to be lifted by GST increase.

Business confidence improved over the final quarter of 2010. The lift follows sharp declines in confidence over Q3, along with the economy's disappointing performance over the middle half of 2010. But it now appears the economy is heading in the right direction once again. It was also pleasing to see the turnaround in confidence was reasonably broad based, with business expansion plans still on track. Employment intentions remained reasonably steady in Q4, consistent with further growth in employment. In addition, a pick up in profitability expectations has helped underpin the slight improvement in investment intentions.

While heading in the right direction, the outlook for near-term growth remains reasonably subdued. Confidence is consistent with around 0.4% Q4 GDP growth, which is a comparatively small bounce back following the 0.2% decline in Q3. Furthermore, recent data continues to highlight the subdued nature of recovery in domestic demand. Building consents remain at low levels (although we expect construction activity to pick up over 2011 due to rebuilding in Canterbury). Meanwhile, electronic card transactions point to very subdued consumer spending in December.

The weakness in activity and underlying demand over 2010 came as a surprise to most, following early indicators of a reasonable recovery at the start of 2010. Growth undershot most economists' expectations, including the RBNZ. In its *December Monetary Policy Statement*, the RBNZ noted that it has been surprised by the degree of weakness in domestic activity and credit appetites given the low level of interest rates. As a result, the RBNZ wants to be more confident of a recovery before it lifts rates again, particularly given fears of prematurely lifting rates and choking off the fragile recovery.

We believe there will be three key areas the RBNZ will be looking at for proof of recovery: a strengthening housing market; further recovery in business investment; and a sustained recovery in business credit. We believe it may take until mid-2011 at the earliest for these three factors to show some convincing sign of recovery, and as a result we now see September as the earliest the RBNZ will resume lifting rates ([see full report](#)).

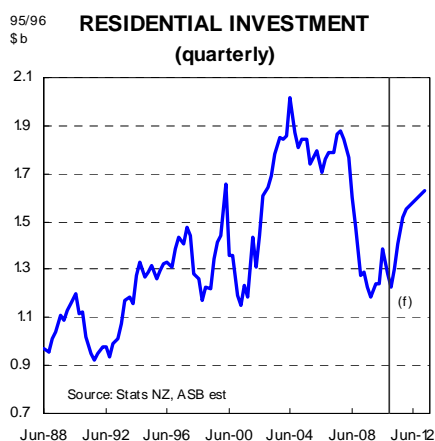
We still believe the RBNZ is underestimating medium-term inflation pressures. However, this is unlikely to become apparent until later this year (and we expect rate hikes will become more frequent in 2012). For the time being, any upside surprise in this week's [release of the Q4 CPI](#) is likely to be largely discounted by the RBNZ, given the degree of uncertainty around the pass through of GST increase. We expect a quarterly increase of 2.5%, while the market and RBNZ expectations are centred on 2.3%.

Click here for:

- [Foreign Exchange](#)
- [Interest Rates](#)
- [Week Ahead](#)
- [Week in Review](#)
- [Global Calendars](#)

- NZD mixed over the past week. Euro recovers as European sentiment improves.
- NZ yield curve flattens in thin trade.
- REINZ, Consumer Price Index, and retail trade data due.
- Q4 NZIER Business Opinion Survey, November building consents and December card transactions.
- US housing data, UK CPI, unemployment and CPI data due. European bond auctions a major focus.

Chart of the Week



Residential investment remains at low levels, reflecting weak underlying demand for new housing construction. The weakness is a result of slowing population growth and falling house prices discouraging new building.

However, we expect that housing construction activity will begin to pick up over 2011, underpinned by rebuilding as a result of damage caused by the Canterbury earthquake. For the time being, anecdotes suggest building demand remains relatively subdued. But activity should pick up as the Earthquake Commission continues with its assessment process and payouts are processed by insurers.

In addition, inspectors are finding that the damage to residential property is greater than initially thought, with estimates suggesting damage totalling around \$3 billion. The large scale of rebuilding will likely stretch Canterbury's construction capacity and rebuilding is likely to take a number of years to complete.

Foreign Exchange Market

FX Rates	Current*	Week ago	Month ago	6 mths ago	Year ago	ST Bias	Support^	Resistance^
NZD/USD	0.7686	0.7609	0.7420	0.7065	0.7384	FLAT/UP	0.7600	0.7800
NZD/AUD	0.7746	0.7640	0.7477	0.8149	0.7960	FLAT	0.7650	0.7800
NZD/JPY	63.61	63.19	62.19	61.23	67.31	FLAT	63.00	65.00
NZD/EUR	0.5722	0.5896	0.5582	0.5475	0.5116	FLAT/DOWN	0.5600	0.5800
NZD/GBP	0.4841	0.4895	0.4746	0.4615	0.4523	FLAT/DOWN	0.4750	0.4900
TWI	69.1	69.1	67.0	66.6	66.7	FLAT	68.0	70.0

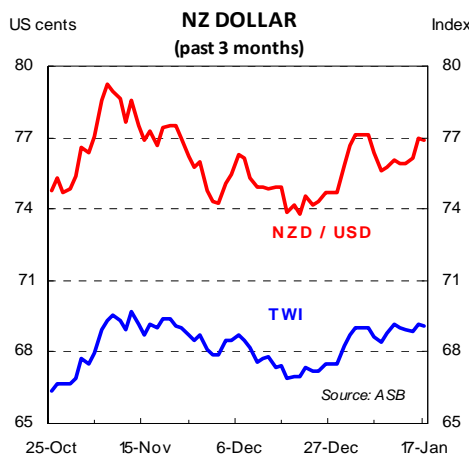
^Weekly support and resistance levels * Current is as at 11.50 am Monday; week ago as at Monday 5pm.

The main focus for markets over recent weeks has been on sovereign debt concerns in Europe. The euro has been under downward pressure, which saw the NZD/EUR lift from 0.56 to a peak of 0.59 last week. Governments in Portugal, Spain and Italy all conducted successful bond sales last week, and the euro recovered slightly in relief. Bond auctions continue to be a focus this week, with Spain, Belgium and Greece bond sales on the 18th and Portugal bond sales on the 19th Jan. EU Finance ministers meet on the 17th & 18th Jan, and positive developments would be supportive for the euro.

Given the lack of US economic data scheduled for release, the improved sentiment about Europe is likely to keep downside pressure on the US dollar - particularly if European finance ministers announce improvements to the bail-out facility. Beyond the US data-sparse week ahead, we still expect the USD to lift against the EUR because we expect the US to economically out-perform Europe.

The AUD and NZD are both down on recent highs achieved on New Year's Eve. AUD has slipped more than the NZD, with the flood concerns not helping the Australian sharemarket or AUD. NZD has lifted back above 0.77 against the AUD.

Short-term outlook: Key data Date Time (NZT) Market



Key data	Date	Time (NZT)	Market
REINZ housing market report	18/1	10.00 am	
NZ Consumer Price Index qoq – Q4	20/1	10.45 am	+2.3%
NZ Retail Sales total mom - November	21/1	10.45 am	+1.2%

Potential local currency movers from offshore this week: Japanese industrial production, UK CPI, US Empire manufacturing survey (18th); UK unemployment, US housing starts, building permits (19th); jobless claims, existing home sales, house prices (20th); UK retail sales (21st).

Fed Speakers: Plosser (17th).

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

The NZD was relatively strong over the holiday period, and is slightly stronger at present than our late 2010/early 2011 forecasts.

We last significantly updated our currency forecasts in late September, when our NZD forecasts were lifted slightly. The lift in the near-term forecasts was driven by rising New Zealand Terms of Trade and USD weakness, rather than the New Zealand economy's domestic strength. We also revised up our forecasts for the AUD and CAD as well as the NZD forecasts. These economies continue to benefit from strong Terms of Trade and upward pressure on local interest rate settings. The AUD in particular is likely to out-perform over the coming months, and has already traded above parity with the USD.

We anticipate that the USD will remain weak over H1 2011, as the Fed continues with its commitment to keep interest rates at extremely low levels for an extended period of time. GBP is forecast to out-perform EUR, reflecting a more rapidly improving UK economy and a healthier banking system. We are holding to our medium-term view that the EUR is likely to exhibit a mild bias to depreciate as selected euro zone sovereign states continue to experience funding pressures and the European Central Bank (ECB) extends "unlimited liquidity" to euro zone banks.

JPY, CHF and SGD are likely to continue to appreciate in the coming months as market participants gravitate toward the "safety" of current account surplus countries' currencies.

Sovereign credit risk has triggered another bout of currency volatility and USD resurgence against the EUR.

Interest Rate Market

Wholesale interest rates	Current	Week ago	Month ago	6 mths ago	Year ago	ST Bias
Cash rate	3.00	3.00	3.00	2.75	2.50	FLAT
90-day bank bill	3.23	3.19	3.17	3.24	2.78	FLAT
2-year swap	3.95	3.82	3.89	4.18	4.61	UP
5-year swap	4.68	4.73	4.84	4.79	5.47	DOWN
5-year benchmark gov't stock	4.57	4.68	4.85	4.69	5.41	DOWN
NZSX 50	3370	3324	3325	2966	3260	FLAT

* Current is as at 11.50 am Monday; week ago as at Monday as at 5pm. Please note we changed the NZ gov't 5-year benchmark bond to the April 2015 maturity (from April 2013), which causes some distortion in the comparison against the previous levels (i.e. 6 months ago).

The NZ yield curve flattened in thin trading over the past week, with higher short-term interest rates attributed to balance sheet paying. The movement reflects unwinding of much of the steepening trades that had occurred over Q4 last year. Market focus turns to the Q4 CPI release this Thursday, with much uncertainty over the degree of pass-through of the GST increase in October.

There was also a flattening of the yield curve in Australia. Markets are contemplating the growth and inflation implications of the Queensland floods.

US interest rates were broadly unchanged over the week, given the mixed data. The squaring up of positions ahead of the holiday weekend saw longer-term interest rates edge up slightly at the end of the week.

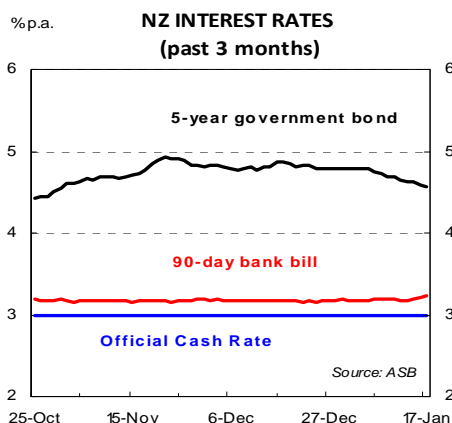
Short-term outlook:

Key data

Date

Time (NZT)

Market



Consumer Price Index qoq – Q4

20/1

10.45 am

+2.3%

Retail Sales total mom - November

21/1

10.45 am

+1.2%

Comment: November retail sales data is released on Friday. However, the key focus for the market this week is the Q4 CPI release on Thursday. There is greater than usual uncertainty over the forecast this quarter. The range of analysts' forecasts are wider than usual for Q4, reflecting uncertainty over the degree of pass-through of the GST increase in October. The focus for the RBNZ will be how much of this spike in headline inflation flows through to changes in price and wage setting behaviour of households and businesses.

Medium-term outlook:

[Last Quarterly Economic Forecasts](#)

The RBNZ kept the OCR unchanged at 3% at the December MPS. However, the tone of the statement was more dovish than expected. Recent data have generally proved weaker than expected, and the RBNZ is particularly concerned about the weakness in the housing market, business investment intentions and business demand for credit. The RBNZ assessed that low interest rates were delivering less stimulus to the economy than previously expected, and as a result pushed back the timing and pace of future OCR increases within its projections.

The RBNZ's growth forecasts in the December MPS were adjusted to incorporate weaker economic data of late, as well as the impact of the Canterbury earthquake, and now look very similar to our own. However, the RBNZ remains very wary of the downside risks, particularly stemming from difficulties in the Eurozone.

The RBNZ remains remarkably comfortable on inflation pressures in the economy. We continue to view the RBNZ's inflation forecasts as optimistic, particularly around its relaxed attitude to inflation expectations over the next year. We expect the RBNZ will become less comfortable with the inflation picture over the coming year.

Nonetheless, with recent activity data generally disappointing and inflation indicators suggesting inflation pressures are subdued for now there looks to be little urgency for the RBNZ to lift the OCR. This is particularly in light of the fact the RBNZ has highlighted it would like to become more confident the recovery is underway and inflation pressures are lifting before it resumes the reduction of monetary policy stimulus.

We now expect the RBNZ will wait until September to increase the OCR (previously June). In addition, we expect the initial phases of tightening will be gradual, with the first few tightenings occurring at the September, December 2011 and March 2012 Monetary Policy Statement releases. Beyond that, we expect the tightening cycle to pick up pace as inflation concerns elevate.

Data Preview: a look at the week ahead

Data	Date	Time (NZT)	Previous	Market expects	ASB expects
REINZ housing market report – Dec (ann. turnover change)	18/1	10.00am	-15%	-	-
NZ Consumer Price Index qoq – Q4	20/1	10.45am	+1.1%	+2.3%	+2.6%
NZ Retail Sales total - November	21/1	10.45am	-2.5%	+1.2%	+1.1%

New Zealand Data Previews

Tuesday 18 January

REINZ Housing Report

Previous: seasonally adjusted turnover +19.8% mom, -15% yoy.

November nationwide housing activity picked up from October's extremely weak level. Despite remaining weak when compared to a year ago, the pick-up over November provided some comfort that the market is not deteriorating further.

The amount of inventory on the market remains high relative to turnover. Combined with the long average length of time taken to sell property at present, the market continues to remain tipped in favour of buyers.

Accordingly, we continue to expect softness in prices over the months ahead, with prices remaining down around 3% on year-ago levels, and around 5% off the 2007 peak.

The housing market slows over the holiday season, and this impacts sales volumes in December and January. However, beyond this seasonal quietness, we expect the caution shown by households in 2010 housing data will continue over the coming months. Auckland housing sales figures for December suggest that REINZ turnover in December will be reasonably steady compared to November, but low when compared to year-ago levels.

Thursday 20 January

Q4 Consumer Price Index

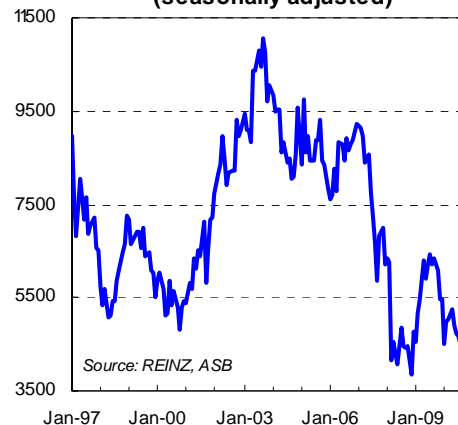
Previous: +1.1% qoq, ASB forecast: +2.5% qoq

The increase in GST from 12.5% to 15% at the beginning of October drives the substantial increase in the Q4 CPI. As a result, we expect the annual rate of headline CPI will peak at 5.2% by the middle of this year.

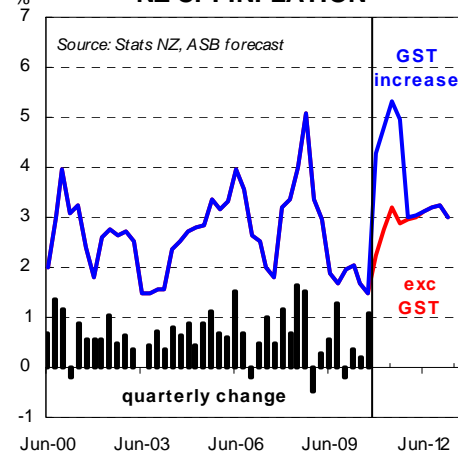
Beyond the boost from the GST increase, the continued rise in petrol prices in recent months is driving tradable inflation higher. Higher prices for international airfares and food are also expected to underpin the increase in tradable inflation.

With recent business surveys pointing to inflation pressures in the NZ economy looking subdued for now, the increase in non-tradable inflation is expected to be fairly modest over Q4. We expect the rise in non-tradable inflation to pick up pace over 2011 in line with the recovery in economic activity, driven in particular by recovery in rents and construction costs.

No. **MONTHLY DWELLING SALES**
(seasonally adjusted)



% **NZ CPI INFLATION**



Friday 21 January

Retail Sales - November

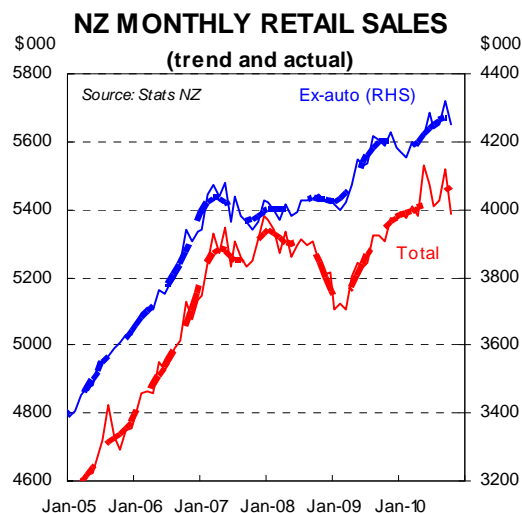
Previous total (s.a.): -2.5% mom, ASB forecast: +1.1% mom

Previous core (s.a.): -1.7% mom, ASB forecast: +0.4% mom

The substantial decline in retail sales in October suggested the increase in September had indeed been the result of households bringing forward the purchase of major items ahead of the GST increase in October.

We expect a modest increase in retail sales in November. There are signs that households' discretionary spending is improving, albeit at a very gradual pace. Meanwhile, sales in the fuel group is expected to increase in line with the rise in petrol prices over the month.

Going forward, we expect a continued recovery in the labour market will support an improvement in consumer confidence. This should underpin a gradual recovery in retail spending over the coming year.



NZ Data Recap: weekly recap

Q4 NZIER Quarterly Survey of Business Opinion

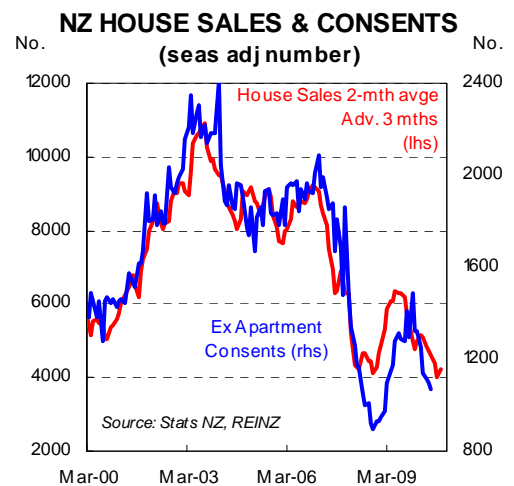
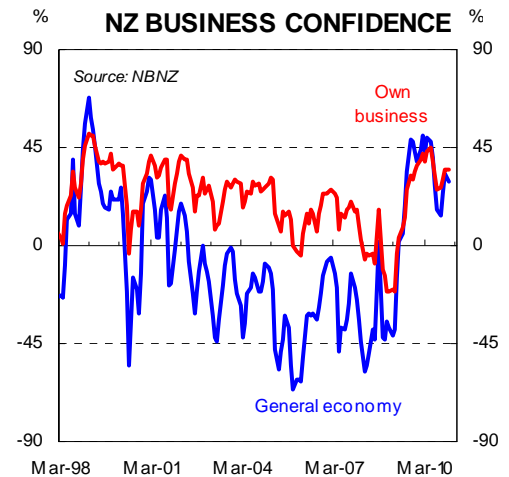
The Q4 result paints a picture of NZ economic activity gradually improving, while inflation pressures remain contained for now. Our indicator from the experienced own activity measure is in line with a 0.4% increase in GDP over Q4. The report notes the Canterbury earthquake had a negative impact on experienced own activity. Meanwhile, improved profitability underpinned higher business confidence over Q4. Encouragingly, the improvement in activity was broad-based across the sectors.

The recovery in activity means that businesses are keeping expansion plans on track, with a slight improvement in investment intentions (which are still around historical averages) and a net number of businesses continuing to indicate intentions to expand their workforce. Businesses are indicating increased difficulty in finding skilled labour, and we expect this will flow through to emerging wage pressures over the coming year. Meanwhile, businesses reported easing cost pressures, and fewer businesses are reporting they intend to raise prices. These measures suggest inflation pressures remain contained for now.

November Building Consents

Residential consent issuance remains weak, with the November total only held up by a high number of apartment consents. The current level of consent issuance is broadly consistent with our weak residential construction forecasts for late 2010 and early 2011. However, if we do not see a pick-up in consent issuance over the coming year, there is a significant risk of a housing shortage in the years ahead. Earthquake reconstruction in the Canterbury region is one positive for residential construction. We expect that it will take many months to assess the damaged houses in Canterbury and it is likely that the actual consents to build replacement houses will flow through into consents issued over the coming year.

Non-residential consent issuance was high in November, with the value of consents issued the highest since May 2009. The value of consents issued for the three months to November are now up 14.5% on the corresponding period a year earlier. The lift is encouraging, given the very low value of non-residential consents issued during most other months in 2010.



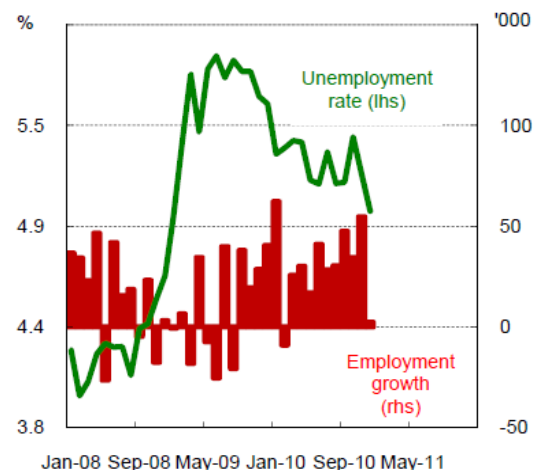
Offshore Data Recap

December Australian Employment

The overall labour market picture remains very strong. December's weaker outcome is likely statistical payback after a string of much stronger than expected employment outcomes in H2 2010. For example, in November, 54.6k jobs were created driven by a 55.4k surge in full-time jobs. And indeed, despite the soft December employment outcome, in the year to December some 364k jobs (+3.3%) were created, including 300.4k full-time positions (+3.9%).

The recent massive and broad ranging floods in Queensland will exacerbate already evident shortages of skilled labour across the nation as a huge number of skilled trades-people, engineers and other skilled workers will be required for a massive reconstruction program in 2011. Queensland homes, business and basic public infrastructure like roads, rail and river and sea port facilities will need to be rebuilt as quickly as possible. This will be occurring against the backdrop of already robust demand for skilled labour for what is turning out to be the largest mining investment boom since the 1960s, not to mention likely increased dwelling investment and construction in 2011.

LABOUR MARKET



Global Data Calendars

Calendar - Australasia, Japan and China

Date	Time (NZT)	Eco	Event	Period	Unit	Last	Forecast	
							Market	ASB
Mon 17 Jan	10.00	NZ	REINZ housing price index	Dec	~	~	~	~
	10.00	NZ	REINZ house sales	Dec	~	~	~	~
	10.45	NZ	Food prices	Dec	m%ch	-0.6	~	~
	12.30	AU	TD securities inflation	Dec	m%ch	0.4	~	~
	13.30	AU	New motor vehicle sales	Dec	m%ch	0.2	~	~
	13.30	AU	Lending finance	Nov	m%ch	3.1	~	~
	18.00	JP	Consumer confidence	Dec	Index	40.6	~	~
	18.00	JP	Consumer confidence households	Dec	Index	40.4	~	~
Tue 18 Jan	17.30	JP	Industrial production	Nov	m%ch	1.0	~	~
	17.30	JP	Capacity utilization	Nov	m%ch	-2.3	~	~
	19.00	JP	Machine tool orders	Dec	~	~	~	~
Wed 19 Jan	12.50	JP	Tertiary industry index	Nov	m%ch	0.5	~	~
	13.00	AU	DEWR skilled vacancies	Jan	~	~	~	~
	13.00	AU	MI/WBC consumer sentiment	Jan	Index	111.0	~	~
	13.30	AU	International merchandise imports	Dec	\$mn	-19.2		
	13.30	AU	Engineering construction activity	QIII	q%ch	1.8	~	~
	17.00	JP	Tokyo condominium sales	Dec	y%ch	0.8	~	~
Thu 20 Jan	10.30	NZ	Business NZ PMI	Dec	Index	52.7	~	~
	10.45	NZ	Consumer prices	QIV	q%ch	1.1	~	~
	13.00	AU	MI/WBC consumer inflation expectation	Jan	m%ch	2.8	~	~
	13.30	AU	Building activity	QIII	q%ch	5.7	~	~
	15.00	CH	Real GDP	QIV	y%ch	9.6	9.4	~
	15.00	CH	GDP	QIV	ytd	10.6	10.2	~
	15.00	CH	CPI	Dec	y%ch	5.1	4.6	~
	15.00	CH	Producer price index	Dec	y%ch	6.1	5.6	~
	15.00	CH	Industrial production	Dec	ytd	15.8	15.5	~
Fri 21 Jan	13.30	AU	Trade price indices	QIV				

Calendar - North America & Europe

Please note all days and times are UK time. Add 13 hours for NZ times.

Date	Time (UK)	Eco	Event	Period	Unit	Last	Forecast	
							Market	ASB
Mon 17 Jan	00.01	UK	Rightmove house prices	Jan	m%ch	-3.0	~	~
	13.30	CA	International securities transactions	Nov	€bn	9.5	~	~
Tue 18 Jan	00.01	UK	Nationwide consumer confidence	Dec	Index	45.0	~	~
	00.01	UK	RICS house price balance	Dec	%	-44.0	-44.0	~
	09.30	UK	DCLG UK house prices	Dec	y%ch	5.5	~	~
	09.30	UK	CPI	Dec	m%ch	0.4	~	~
	9.30	UK	Core CPI	Dec	y%ch	2.7	~	~
	09.30	UK	Retail price index	Dec	m%ch	0.4	~	~
	10.00	EZ	ZEW survey (econ. sentiment)	Jan	Index	15.5	~	~
	10.00	GE	ZEW survey (econ. sentiment)	Jan	Index	4.3	~	~
	13.30	US	Empire manufacturing	Jan	Index	10.6	12.0	~
	14.00	CA	Bank of Canada Rate	Jan	%	1.0	1.0	1.0
	14.00	US	Net long-term TIC flows	Nov	\$bn	27.6	~	~
	15.00	US	NAHB housing market index	Jan	Index	16.0	17.0	~
	22.00	US	ABC consumer confidence	Jan	Index	-40.0	~	~
Wed 19 Jan	09.00	EZ	ECB Euro-Zone current account	Nov	€bn	-9.8	~	~
	09.00	EZ	Construction output	Nov	m%ch	0.0	~	~
	09.30	UK	ILO unemployment rate (3mths)	Nov	%	7.9	~	~
	09.30	UK	Jobless claims change	Dec	'000	-1.2	~	~
	09.30	UK	Claimant count rate	Dec	%	4.5	~	~
	13.30	CA	Manufacturing sales	Nov	m%ch	1.7	~	~
	15.30	CA	Monetary policy report	Jan	~	~	~	~
	13.00	US	Housing starts	Dec	'000	555.0	552.0	~
Thu 20 Jan	13.00	US	Building permits	Dec	'000	544.0	555.0	~
	07.00	GE	Producer prices	Dec	m%ch	0.2	~	~
	10.00	UK	CBI business optimism	Jan	~	2.0	~	~
	10.00	UK	CBI trends total orders	Jan	~	-3.0	~	~
	13.30	CA	Leading indicators	Dec	%	0.3	~	~

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