

# Business Weekly

## Recovery proceeds with caution

### This Week

A recovery in retail spending appears to be occurring at a glacial pace. While most parts of the economy show signs of a self-sustaining recovery taking shape, the recovery in the household sector has been less convincing. In particular, consumers appear to be shying away from discretionary items, with notable areas of weakness including appliances, recreational goods and eating out. Consumer confidence has lifted off lows but remains subdued, as households feel financially worse off relative to a year ago. The weakness in spending is also unsurprising given the weak wage growth we have seen in recent labour market data. However, the strength in employment growth over Q1 increases our confidence that the recovery in the household sector will build over the remainder of 2010.

The NZ housing market remains in a holding pattern ahead of Budget 2010 this Thursday. Housing turnover remains very low, coming down from the previous spring's short-lived recovery. However, house prices have held up despite the weakness in activity. Our preferred measure, the stratified house price index, lifted 0.2% in seasonally adjusted terms. Prospective house buyers, particularly investors, are possibly remaining on the sidelines until the issue of property tax is addressed. We expect the Government to change tax rules regarding depreciation and property. Over the next 12 months the underlying fundamentals for the housing market are set to deteriorate. On top of tax changes, the RBNZ is readying itself to increase the OCR soon. We also expect net migration to slow (see chart of the week below), which will also reduce some of the demand for new housing.

We are not expecting too many surprises in the Budget this week ([click here for a full preview](#)). The focus will be on the impact of probable changes to the structure of the tax system. The Government has expressed some appetite for the Tax Working Group's findings and recommendations on tax reform. The slightly better economic outlook relative to December, allows the Government some wiggle room with the timing of policy changes. Nonetheless, the continued outlook for fiscal deficits will limit the Government's flexibility within the Budget. Any changes will need to be fiscally neutral.

Absent an unexpected change to the property tax rules (such as ring fencing) the RBNZ is likely to be reasonably relaxed about the Budget. The market sees a rate hike in June as a done deal, following the impressive Q1 recovery in employment. Other than the Budget, the only obstacle to a rate hike would be offshore developments as markets still feel uneasy about the ongoing European sovereign debt saga ([see previously weekly](#)).

### Click here for:

[Foreign Exchange](#)

- NZD continues to lose ground as risk aversion dominates.

[Interest Rates](#)

- Rates lower on weaker data and continued Europe concerns.

[Week Ahead](#)

- Budget 2010 in focus, net migration, consumer confidence and PPI's also out.

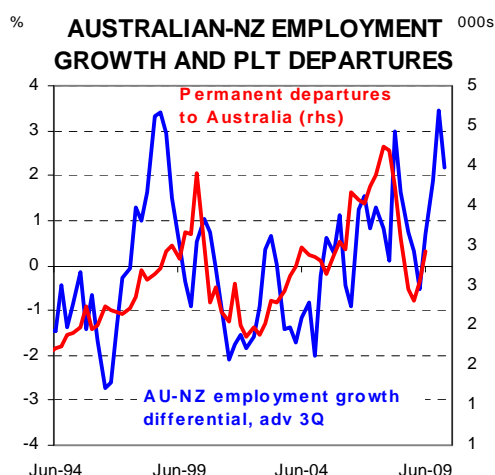
[Week in Review](#)

- Retail volumes weak in Q1, housing market remains in holding pattern.

[Global Calendars](#)

- UK, US and EU inflation. Meeting minutes from BoE, FOMC and RBA.

### Chart of the week



- Permanent departures to Australia from NZ fell sharply during the recession, reflecting decreased job prospects in Australia as the economy slowed.
- However, the Australian economy has recovered quicker than the NZ economy, steadily putting on jobs since September last year. In contrast the NZ labour market has only just started to recover in recent months.
- The difference in annual job growth between Australia and New Zealand provides a rough leading guide on the underlying trend in permanent departures to Australia (see chart opposite).
- The relatively stronger labour market in Australia will continue to attract New Zealander's over the next year. An increase in the number of departures will reduce net migration into NZ.

#### 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	0.7059	0.7216	0.7106	0.7430	0.5925	DOWN	0.6950	0.7150
NZD/AUD	0.7978	0.7996	0.7646	0.7952	0.7801	FLAT	0.7950	0.8050
NZD/JPY	65.22	66.84	65.92	66.57	56.83	DOWN	63.50	66.50
NZD/EUR	0.5716	0.5582	0.5251	0.4965	0.4344	UP	0.5700	0.5750
NZD/GBP	0.4859	0.4847	0.4606	0.4446	0.3890	UP	0.4850	0.4950
TWI	67.9	68.2	65.7	66.1	57.4	FLAT	67.75	68.25

^Weekly support and resistance levels \* Current is as at 10.00 am Monday; week ago as at Monday 5pm

- Risk aversion dominated the week. The NZD gained on the EUR and GBP, tracked sideways against the AUD and steadily lost ground against the USD and JPY.
- This week will be overflowing with key US economic data and events. We expect the USD will appreciate further this week as the economic data in the US confirm the economy is in a better state than the European economy. This would likely ensure the Federal Reserve raise rates before the ECB. In addition, safe-haven inflows to USD Treasury bonds should also support the USD. The market is likely to continue to focus on European events.
- The GBP's relief rally following the formation of a coalition was short-lived as the pound came under renewed pressure during the second part of the week. The Bank of England surprised with its downbeat view on UK inflation, and the GBP suffered as markets see little chance of the Bank raising interest rates soon. These themes are likely to be reinforced by meeting minutes released this week.
- The market also remains jittery over Europe's Sovereign debt drama, with safe haven buying continuing to dominate market direction. Markets remained unconvinced by the Eurozone rescue package announcement (previous Sunday) given the lack of detail. Ongoing fears of contagion in the Eurozone are likely to dominate this week, with further upside risk to the NZD/EUR.

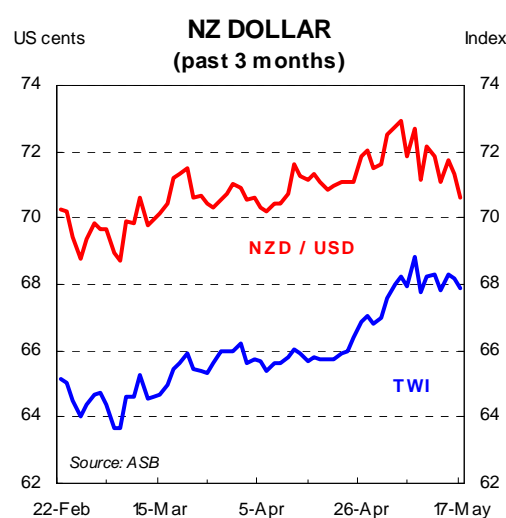
### Short-term outlook:

Key data	Date	Time (NZST)	Market expects
RBNZ Financial Stability Report	19/5	9.00am	-
Budget 2010	20/5	2.00pm	-
May Consumer Confidence	20/5	3.00pm	-
April Travel and Migration	21/5	10.45am	-

**Potential currency movers from offshore this week:** RBA meeting minutes, JP retail sales, UK and EU inflation, EU Zew sentiment surveys, EU trade balance, US housing starts, US building permits (18<sup>th</sup>); AU wage growth, BoE meeting minutes, US inflation (19<sup>th</sup>); JP economic growth, UK retail sales, US FOMC's meeting minutes, US Philadelphia Fed Index (20<sup>th</sup>); JP BoJ monetary policy decision, EU consumer confidence, EU current account, EU PMIs, UK business investment, UK public sector net borrowing (21<sup>st</sup>). Speeches: Pianalto (19<sup>th</sup>).

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

- We have made slight revisions to our NZD forecasts. The USD has not appreciated as much as we anticipated despite a better performing US economy. Persistently low US bond yields and negative net private sector investment into the US are the main reasons why the USD has not strengthened more.
- In addition, the slowing in Eurozone's economy has not dampened global growth as much as we previously expected. The slowdown in the Eurozone has been more than offset by a better performing US economy and robust Asian economies. We anticipate further EUR weakness as the economy struggles to gain traction and sovereign debt issues continue to plague investor and business confidence there.
- We expect the NZD to peak around 0.74 against the USD, with the NZD peaking as the RBNZ begins its tightening cycle in "coming months". We anticipate the USD will strengthen in H2 2010 due to a better performing US economy and third-quarter Fed rate hikes. We expect the NZD to trade around 0.72 at the end of 2010.
- We now expect the RBNZ to increase the OCR in June and expect the pace of increase to be gradual, reducing the scope for interest rate driven out-performance for the NZD. The NZD is expected to continue to gain on the AUD as the RBNZ lifts rates and interest rate differential with Australia narrows. Firm global growth will also work to drive the NZD/AUD exchange rate higher over the remainder of 2010 as the New Zealand economy benefits more than Australia from a higher export-to-GDP ratio.
- The JPY is expected to slowly weaken this year in response to a stronger USD and a firm global economy.



## Interest Rate Market

Wholesale interest rates	Current	Week ago	Month ago	6 mths ago	Year ago	ST Bias
Cash rate	2.50	2.50	2.50	2.50	2.50	FLAT
90-day bank bill	2.93	2.92	2.68	2.78	2.84	DOWN
2-year swap	4.50	4.65	4.25	4.54	3.45	DOWN
5-year swap	5.35	5.45	5.26	5.65	4.73	DOWN
5-year benchmark gov't stock	5.15	5.24	5.18	5.51	4.39	DOWN
NZSX 50	3191	3174	3316	3174	2791	FLAT

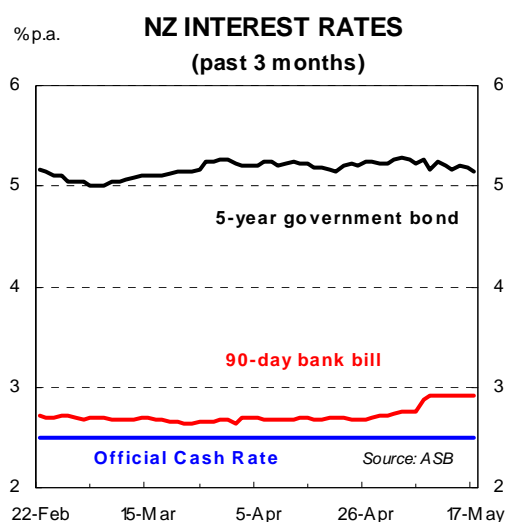
\* Current is as at 10.00am Monday; week ago as at Monday 5pm. Please note that we have recently changed the NZ govt 5-year benchmark bond to April 2015 maturity (from April 2013). This does cause some distortion in the comparison against the previous levels (i.e. month ago).

- NZ interest rates fell towards the end of last week, as subdued April REINZ house sales and a weak Q1 retail sales result added to downbeat offshore developments.
- Concerns about European debt contagion continued to weigh on markets globally. Meanwhile, news that the Securities and Exchange Commission (SEC) was widening its investigations into various investment bank's sales of mortgage bank bonds to clients also underpinned risk aversion in the markets.
- Despite domestic interest rates ending the week lower, markets are continuing to price in around 75% probability of an OCR increase in June and also see a substantial chance of a 25bp follow-up rate increase in July. The release of the Budget this Thursday will have a key influence on domestic interest rates. Markets are currently expecting the Budget to include tax changes which will be negative for investment property, so interest rates will likely bounce if any changes are seen to result in little effect on the housing market.

### Short-term outlook:

Key data	Date	Time (NZST)	Market expects
RBA Minutes	18/5	1.30pm	-
RBNZ Financial Stability Report	19/5	9.00am	-
Budget 2010	20/5	2.00pm	-
May Consumer Confidence	20/5	3.00pm	-
April Travel and Migration	21/5	10.45am	-

**Comment:** Markets remain jittery, as concerns about European debt contagion continue to weigh on sentiment. The release of the Budget this Thursday will also have a key influence on domestic interest rates, given the potential for tax changes to have a negative effect on investment property and thus housing market activity.



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

- The RBNZ held the cash rate at 2.5% at the April OCR Review, and indicated monetary policy tightening will commence "over the coming months".
- The RBNZ left its near-term projection for the 90-day interest rate unchanged at the March MPS, but there was a downward revision in its medium-term 90-day track in recognition that current bank funding costs were likely to persist. This supports our expectations that OCR increases will be in 25 basis point increments over the tightening cycle this year. Further, in a recent speech Governor Bollard validated the current market pricing, which assumed a similar profile for rate hikes.
- Inflation in the here and now has remained subdued, allowing the RBNZ some breathing room to assess recent trends. However, we see some upside risks to the RBNZ's medium term inflation forecasts, with a host of upcoming administrative inflation boosting headline CPI, posing a risk to price and wage setting behaviour.
- Activity data has been mixed. The external outlook remains upbeat, with commodity prices strengthening. However, retail sales have been surprisingly subdued and the RBNZ remains concerned about the weakness in business credit demand. Nonetheless, the unequivocal strength in Q1 employment data should alleviate the RBNZ concerns on the underlying strength in the domestic recovery.
- The RBNZ expects to begin removing monetary stimulus in "coming months" assuming the economy evolves as expected. We now expect the first rate hike in June, barring a substantial deterioration in liquidity triggered by the European sovereign debt crisis and a large surprise in the Budget.

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

Data	Date	Time (NZST)	Previous	Market expects	ASB expects
Q1 Producer Prices – inputs qoq	18/5	10.45am	+0.3%	-	-
RBNZ Financial Stability Report	19/5	9.00am	-	-	-
Budget 2010	20/5	2.00pm	-	-	-
May Roy Morgan Consumer Confidence	20/5	3.00pm	121.9	-	-
April International Travel and Migration - annual	21/5	10.45am	20,973	-	-

### Thursday 20 May

#### NZ Budget 2010

The focus will be on the impact of probable changes to the structure of the tax system. The Government has expressed some appetite for the Tax Working Group's findings and recommendations on tax reform. The motivation behind the reform is to reduce distortions which have been affecting work and investment decisions. Included in these changes, we are expecting the Government will lift GST to 15% (from 12.5% currently) and lower income tax rates across the board, while changing the tax policy around residential investment property.

The Government faces a far more favourable economic back-drop compared to this time last year. The economic outlook has improved considerably between May 2009 and December 2009. The December update showed fiscal deficits reducing at a much swifter pace. Since December, the outlook has continued to improve, allowing the government more wiggle room with the timing of policy (perhaps delivering some income tax cuts ahead of revenue-raising initiatives).

### Friday 23 April

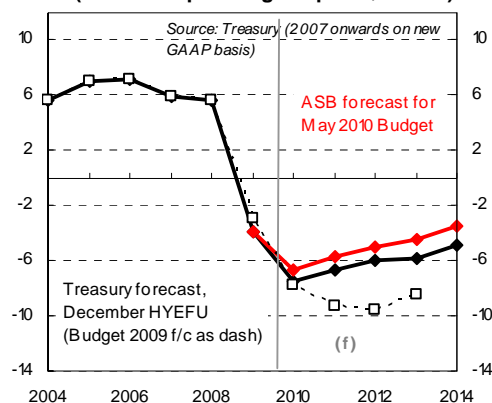
#### NZ April International Travel and Migration

##### Net Migration: Previous 20,973 (year to March 2010)

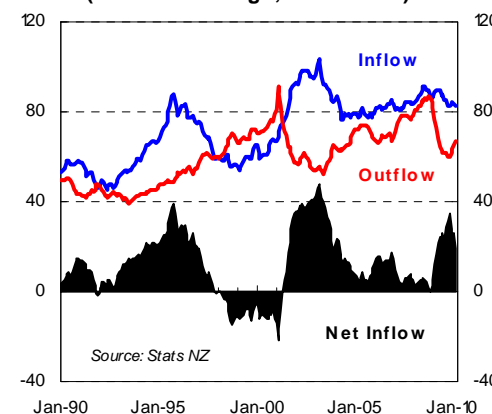
Net migration has surged over the past year, as arrivals remained steady and the number departures fell sharply (in particular to Australia). However, we expect the increase in net migration will slow over 2010. As the economic recovery in Australia continues to gain momentum ahead of the NZ recovery,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

Tourism numbers have remained 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 KEY FISCAL BALANCES**  
(OBEGAL Operating Surplus \$ billion)



**NZ MIGRATION**  
(3-month average, annualised)



## NZ Data Review: weekly recap

### April REINZ House Sales

The housing market continued to lose momentum in April, with house sales remaining well below last spring's and year-ago levels. As a result days to sell is continuing to creep up – at a seasonally adjusted 41 days it is now taking longer than average to sell a home.

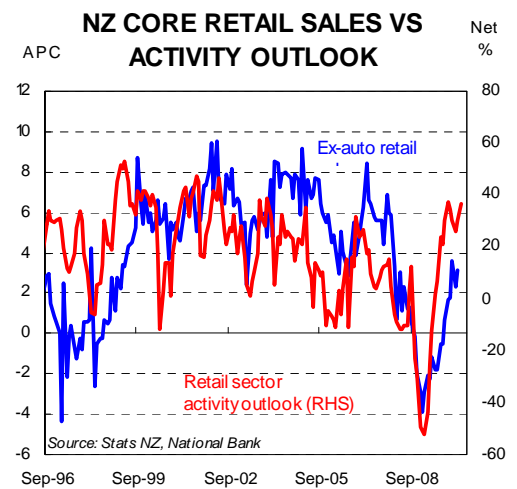
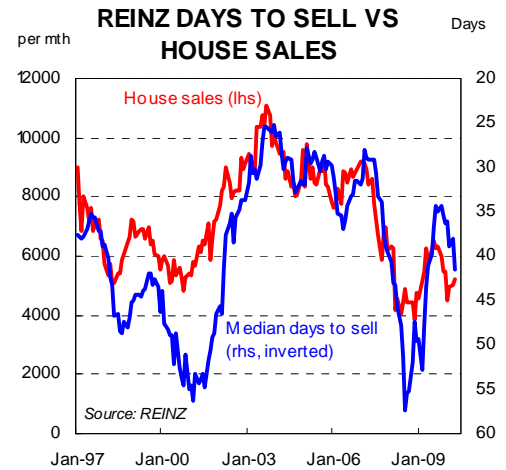
Prices are fairly steady, up on year-ago levels but shy of all time highs. The stratified index, which takes into account the changing composition of the houses sold, lifted 0.2% in April on seasonally adjusted terms.

The uncertainty of what the Government might introduce in the way of changes to property tax is causing some caution in the market. Likewise, the expectation of interest rate increases in the coming months may be weighing on the minds of potential home buyers. Budget 2010 will be keenly watched, and will be a key influence on the direction for the property market over the coming months.

### Q1 Retail Sales

While there was a recovery in retail spending values in the March month, over the March quarter spending was subdued. The 0.2% increase in retail volumes largely reflects the weak spending over January and February. The areas of weakness were in spending on appliances, recreational goods, and eating out, reflecting the recovery in spending on discretionary items remaining very subdued.

Stock levels were up 1.3% on year-ago levels, the first positive quarter following a year of declines. The recession and sharp decline in retail spending triggered many retailers to cut back on stock levels. This quarter's pick up in stock levels provides further evidence of growing confidence among businesses of a recovery in sales. We expect the restocking phase of the recovery to underpin economic growth over the next few quarters. Nonetheless, the improvement in stock levels remains patchy, with only 10 out of 24 retail industries showing an increase in stocks. We expect the recovery in retail spending to become more widespread as consumer confidence steadily improves over the year, underpinned by a firming labour market. This recovery in turn will encourage further rebuilding of stocks in the retail industry.



## 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 17 May	11.50	JP	Machine orders	Mar	m%ch	-5.4	~	~
					y%ch	-3.3	~	~
	11.50	JP	Domestic CGPI	Apr	m%ch	0.2	~	~
					y%ch	-1.3	~	~
Tue 18 May	10.45	NZ	Producer prices- inputs	QI	q%ch	0.3	~	~
					q%ch	-0.4	~	~
	11.50	JP	Tertiary industry index	Mar	m%ch	-0.2	~	~
	12.30	AU	CBAHIA house affordability	QI	Index	120.1	~	~
	13.30	AU	Reserve Bank's Board May minutes	~	~	~	~	~
14.30	AU	Dr Ken Henry speech – Federal Budget10/11: Annual post-Budget address	~	~	~	~	~	
17.00	JP	Consumer confidence	Apr	~	41.0	~	~	
17.00	JP	Consumer confidence households	Apr	~	40.9	~	~	
Wed 19 May	13.00	AU	MI/WBC consumer confidence	May	%	-1.0	~	~
					Index	116.1	~	~
	13.00	AU	DEWR skilled vacancies	May	%	1.3	~	~
	13.30	AU	Wage price index	QI	q%ch	0.6	~	0.9
16.30	JP	Industrial production	Mar	m%ch	0.3	~	~	
16.30	JP	Capacity utilization	Mar	m%ch	0.0	~	~	
Thu 20 May	11.50	JP	Housing loans	QI	q%ch	1.6	~	~
	11.50	JP	GDP	QI	q%ch	0.9	1.4	~
	11.50	JP	BoJ Monetary Policy Meeting	~	~	~	~	~
	13.00	AU	MI/WBC consumer inflation expectation	May	%	4.1	~	~
13.00	AU	MI/WBC unemployment expectation	May	Index	102.9	~	~	
13.30	AU	AWE	Feb	q%ch	2.0	~	0.9	
14.00	NZ	NZ Budget	~	~	~	~	~	
14.30	AU	Mr Neil Hyden speech, Chief Executive Officer "Australian Government Debt in interesting times"	~	~	~	~	~	
Fri 21 May	~	JP	BoJ target rate	May	%	0.1	~	~
	10.45	NZ	Visitor arrivals	Apr	%	1.1	~	~
	10.45	NZ	Net migration	Apr	Persons	980	~	~
15.00	NZ	Credit card spending	Apr	m%ch	6.3	~	~	
17.00	JP	Leading Index CI and Coincident Index CI	Mar	Index	~	~	~	

## 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 17 May	18.00	US	NAHB housing market index	Mar	Index	19.0	20.0	~					
Tue 18 May	09.30	UK	CPI	Apr	m%ch	0.6	~	~					
					y%ch	3.4	~	~					
	09.30	UK	Core CPI	Apr	y%ch	3.0	~	~					
						10.00	EZ	CPI	Apr	m%ch	0.9	0.4	~
	10.00	EZ	ZEW survey (econ. sentiment)	May	~	46.0				~	~		
						10.00	EZ	Trade balance	Mar	€bn	3.3	~	~
	10.00	GE	ZEW survey (econ. sentiment)	May	Index						53.0	45.0	~
						13.30	US	Producer price index	Apr	m%ch	0.7	0.2	~
	13.30	US	Housing starts	Apr	'000						680.0	680.0	~
						13.30	US	Building permits	Apr	m%ch	6.8	0.0	~
Wed 19 May	09.30	UK	Bank of England minutes	May	Index						~	~	~
						10.00	EZ	Construction output	Mar	m%ch	-3.3	~	~
	10.00	EZ	Construction output	Mar	y%ch					-15.2	~	~	
						13.30	US	CPI	Apr	m%ch	0.1	0.1	~
13.30	US	CPI	Apr	y%ch	2.3					2.5	~		
					19.00	US	Minutes of FOMC meeting	May	~	~	~	~	
Thu 20 May	09.30	UK	Retail sales	Apr						m%ch	0.4	~	~
					13.30	CA	Leading indicators	Apr	m%ch		1.0	~	~
											15.00	US	Leading indicators
Fri 21 May	07.00	GE	GDP	Q1	q%ch	0.0	~	~					
						08.30	GE	PMI manufacturing	May	Index	61.5	61.0	~
	09.30	UK	Total business investment	Q1	q%ch						-4.3	~	~
						12.00	CA	CPI	Apr	m%ch	0.0	0.3	~
	12.00	CA	CPI	Apr	y%ch					1.4	1.8	~	
						13.30	CA	Retail sales	Apr	m%ch	0.5	~	~
	09.00	EZ	ECB Euro-Zone current account	Mar	€bn						-3.9	~	~
						09.00	EZ	PMI composite	May	Index	57.3	56.6	~
09.00	GE	IFO - business climate	May	Index	101.6						101.9	~	

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