

# Business Weekly

## Inflation: complacency diminishing

### This Week

The last important release ahead of the RBNZ's April OCR review is this Tuesday's CPI. We expect a quarterly increase of 0.5% in Q1 to bring the annual inflation rate up to 2.2%. Our expectation is slightly higher than the RBNZ's 0.3% forecast, in part because of petrol price increases that occurred after the March *Monetary Policy Statement* was released.

The inflation outlook now has a few clouds hanging over it that are going to linger far longer than the current ash cloud over Europe. Our inflation forecasts now exceed 3% for a brief period in 2011. The Emissions Trading Scheme and sharp ACC levy increases are contributing to that sharp lift. But even stripping out these sources of administrative inflation, the underlying picture still has inflation sitting very close to the top of the 3% target ceiling. As the economy picks up the disinflationary effects of recession will dwindle.

A GST increase would push inflation briefly to 5%. And although the RBNZ would look through the direct impact, the timing of such an increase will come when people's perceptions of inflation are already drifting higher. In particular, 2-year-ahead inflation expectations are elevated at 2.7%.

The inflation outlook should be starting to cause a little more concern within the RBNZ. However, those concerns also need to be balanced against uncertainties such as the recent loss of momentum in the housing sector and the impact on the agricultural sector of dry conditions.

Typically, the REINZ housing data were out last week. The market has looked softer so far this year but, notwithstanding all the publicity in recent months about property-related tax changes, the market hasn't fallen off a cliff. In seasonally-adjusted terms, house sales were pretty flat in March after falling substantially in the first couple of months of the year, so turnover remained quite low. But other aspects for the REINZ's figures held up. The median of days to sells edged slightly lower in seasonally-adjusted terms, now around the long-term average once more. Prices also recovered much of the ground they recently lost, even after accounting for compositional changes in the pool of houses sold. Yes, activity has been drying up, but so far prices are relatively resilient. That resilience may not last: although there is little evidence so far that tax talk has prompted a rush of fresh listings, the slower pace of sales to date this year is creating a growing backlog of stock on the market.

One other question mark for household momentum was spongy retail sales in February. Volatility means it is hard to read the trend in spending but sales have been modest recently, as households show some caution.

### Click here for:

#### [Foreign Exchange](#)

- NZD trades over 0.71 most of the week, but dipped on Friday.

#### [Interest Rates](#)

- Weak retail sales and offshore moves help NZ interest rates move lower.

#### [Week Ahead](#)

- Consumer Price Index, Consumer Confidence, Migration, Credit Card Spending.

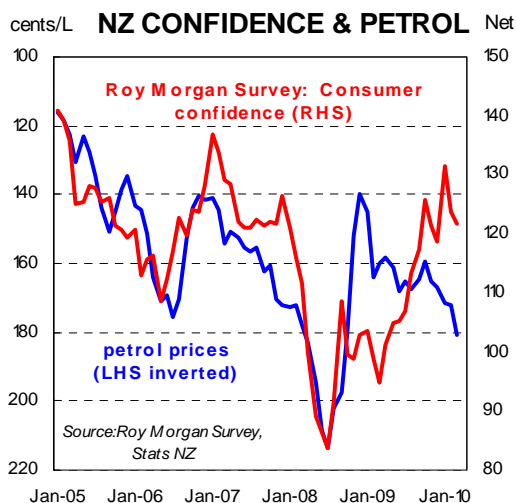
#### [Week in Review](#)

- Retail Trade Survey, REINZ housing data.

#### [Global Calendars](#)

- RBA Minutes, UK CPI, US PPI, US new and existing Home sales.

### Chart of the week



- Up until early 2009, the inverse relationship between petrol prices and consumer confidence was fairly tight – confidence fell as high petrol prices ate into weekly budgets.
- Petrol prices have been on the rise recently, increasing on average over 6% in the March quarter. This is likely to be a factor behind confidence pulling back from 2009 highs. Petrol prices are also expected to make a substantial positive contribution to tradable inflation and the overall Q1 CPI report this week.
- Petrol prices are also important because of their link with inflation expectations. Peoples' view on inflation is often influenced by the things purchased regularly, such as food and fuel.
- We expect petrol prices will increase over the next two years, as oil prices rise and the NZD declines.

#### 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	0.7073	0.7163	0.7151	0.7440	0.5709	FLAT	0.7000	0.7200
NZD/AUD	0.7679	0.7668	0.7758	0.8099	0.7940	FLAT	0.7600	0.7750
NZD/JPY	65.00	66.66	64.66	67.58	56.78	DOWN	64.00	66.00
NZD/EUR	0.5250	0.5235	0.5247	0.4999	0.4361	FLAT	52.00	53.00
NZD/GBP	0.4630	0.4626	0.4688	0.4553	0.3840	FLAT	0.4575	0.4675
TWI	65.6	66.0	65.9	66.7	57.0	FLAT	65	67

^Weekly support and resistance levels \* Current is as at 11.30 am Monday; week ago as at Monday 5pm

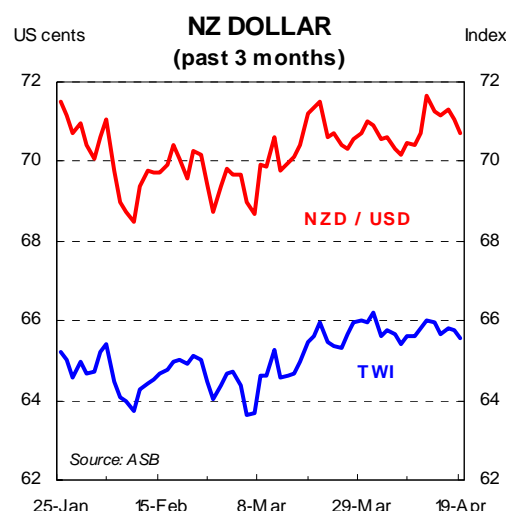
- The NZD spent most of last week trading above 0.71 against the USD, but took a dip below the 0.71 figure on Friday night, as risk aversion dominated trade. The mood change was caused by news of the US Securities and Exchange Commission charging Goldman Sachs with securities fraud over its marketing of a debt product linked to sub-prime mortgages.
- The key event this week for the NZD is the Q1 CPI report. Firming inflation pressures in New Zealand could spark speculation for near-term RBNZ rate hikes, and support the NZD.
- AUD/USD also eased late last week as market sentiment turned sour. We expect the AUD to recover over the coming week. The minutes of the RBA's April monetary policy meeting are likely to suggest further interest rate rises will be needed.
- Market sentiment should improve as the US reporting season continues and the Greece-EC-IMF meeting this week gives some clarity on the Greek debt issue. In addition, Friday's volatility in markets stemming from the Goldman Sachs story should subside, reducing risk aversion, in turn limiting the downside for the NZD.

### Short-term outlook:

Key data	Date	Time (NZST)	Market expects
Q1 Consumer Price Index qoq	20/4	10.45am	0.6%
March Net Migration	23/4	10.45am	-

**Potential currency movers from offshore this week:** UK CPI, EU ZEW Survey of Economic Sentiment (20<sup>th</sup>), Bank of England Minutes (21<sup>st</sup>), US producer price inflation (22<sup>nd</sup>), UK retail sales and advanced GDP US existing home sales, durable goods orders (23<sup>rd</sup>).

**Speeches:** Evans, Bernanke (19th), Duke (20th), Kohn (23rd).



### 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 the middle of this year. We still anticipate that the USD will strengthen in the second half of this year 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 expect the RBNZ to first 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 gain on the AUD over the course of 2010 as the RBNZ lifts rates and interest rate differentials with Australia narrow. 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	3.00	FLAT
90-day bank bill	2.68	2.67	2.66	2.82	3.06	FLAT
2-year swap	4.24	4.32	4.21	4.70	3.72	FLAT
5-year swap	5.26	5.28	5.20	5.67	4.87	FLAT
5-year benchmark gov't stock	5.14	5.24	5.14	5.19	4.38	FLAT
NZSX 50	3311	3314	3230	3221	2711	DOWN

\* Current is as at 11.30am 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 edged lower last week, from offshore movements and weaker domestic data. February retail sales were weaker than markets expected and suggest households remain very cautious. Market focus has now turned to the Q1 CPI release this Tuesday, which is seen as a key influence as to whether the OCR will be increased in June or July.
- US Treasury bond yields fell over the week on safe haven flows. Risk aversion was driven largely by news late in the week that the US Securities and Exchange Commission (SEC) has charged Goldman Sachs with securities fraud over its marketing of a debt product linked to sub-prime mortgages. Adding to the risk aversion were continued concerns over Greek government debt.

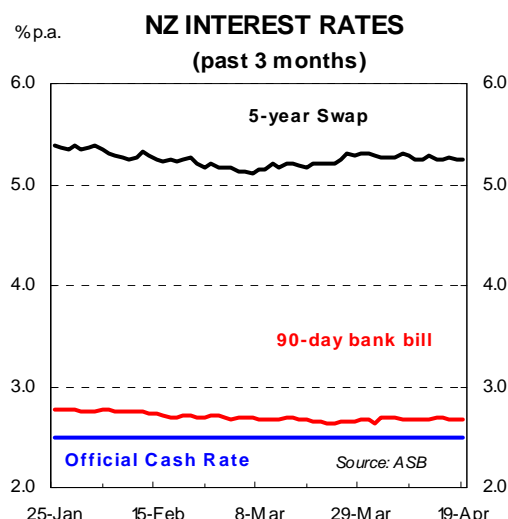
### Short-term outlook:

Key data	Date	Time (NZST)	Market expects
Q1 Consumer Price Index qoq	20/4	10.45am	0.6%
March Net Migration	23/4	10.45am	-

**Comment:** Market focus will be on the release of Q1 CPI this Tuesday. Markets generally expect the quarterly result to be stronger than RBNZ forecasts given the continued increase in petrol prices. However, the non-tradable CPI outturn will largely determine how much inflation breathing space the RBNZ has over 2010.

Markets have pared back expectations of an OCR increase in June slightly over the week, but the CPI is seen as a key influence to the timing of the first tightening.

**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.
- Although 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. 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, 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 points 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. Implementation of the Emissions Trading Scheme, which the RBNZ has not explicitly included, will push inflation above 3%.
- 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 Consumer Price Index qoq	20/4	10.45am	-0.2%	+0.6%	+0.5%
April Roy Morgan Consumer Confidence	22/4	3.00pm	121.8	-	-
March Net Migration – annual total	23/4	10.45am	21,618	-	-
March Credit Card Spending mom	23/4	3.00pm	-0.3%	-	-

### Tuesday 20 April

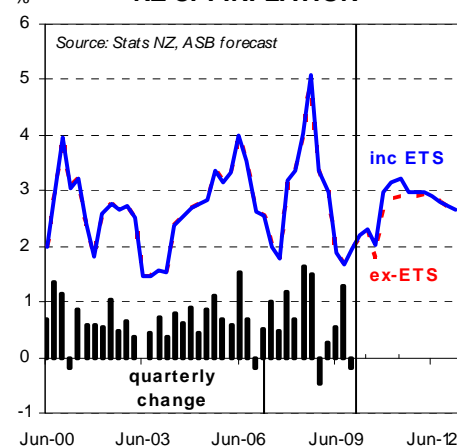
#### Q1 Consumer Price Index

**Previous: -0.2% qoq, f/c: +0.5% qoq**

We expect higher food and petrol prices and housing costs to drive a 0.5% increase in the CPI in the March quarter, thus bringing annual inflation to 2.2%. The continued increase in petrol prices means that the CPI is likely to be stronger than the 0.3% increase forecast in the RBNZ March *Monetary Policy Statement*. Furthermore, we expect non-tradable inflation will recover faster than the RBNZ expects over the coming quarters, driven by a modest rebound in construction costs.

It appears the RBNZ is now less comfortable with the medium-term inflation outlook. This is unsurprising in light of the fact that even excluding for the price effects of the Emissions Trading Scheme (ETS) the RBNZ forecast annual inflation to track close to the top of the target band of 3% over the coming years. There is now little room for upside inflation surprises, all the more concerning given recent data indicates inflation pressures will build up over the coming year.

#### NZ CPI INFLATION



### Friday 23 April

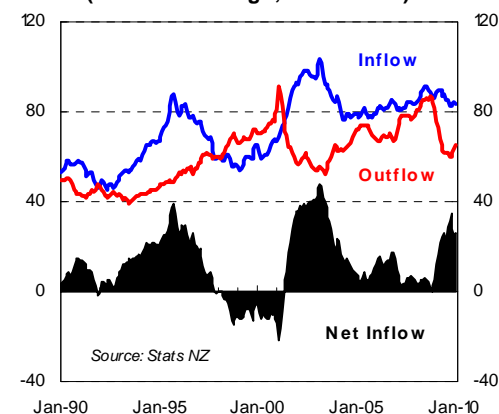
#### March International Travel and Migration

**Net Migration: Previous 21,618 (year to Feb 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 MIGRATION (3-month average, annualised)



## NZ Data Review: weekly recap

### March REINZ house sales

The soft patch for housing turnover continues, with the latest REINZ turnover figures showing little recovery after falling sharply at the start of the year. Seasonally-adjusted turnover lifted 0.9% from February, but remains well below average, and well down on year-ago levels when super-low interest rates were providing a spur for the housing market as the economy came out of recession. Although activity levels remain low, prices and days taken to sell were resilient.

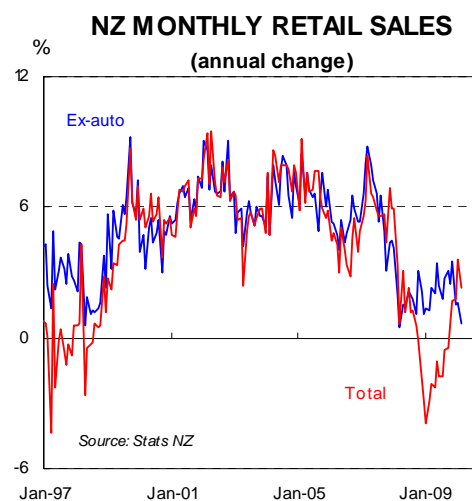
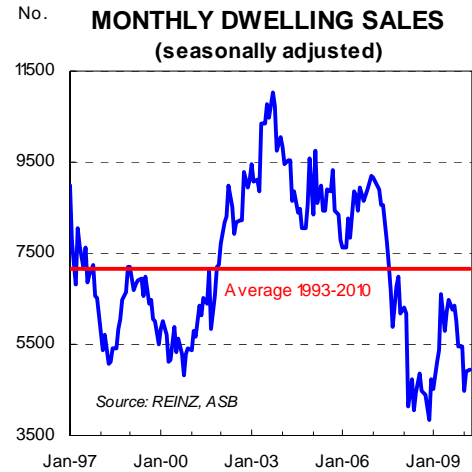
Days to sell are now sitting right on the long-run average of 38 days. This measure has widened since spring – days to sell ranged between 34-36 from August to December, but remain significantly lower than the 43-57 days to sell range between March 2008 and March 2009. By this measure, the housing market looks balanced. However, by factoring in listings data from other surveys, we would tip the balance in favour of buyers at present, given the supply of inventory is ample relative to the modest turnover over 2010.

### February Retail Sales

Both total and ex-auto retail sales in February were much weaker than both our and market expectations. Whilst this monthly series is typically volatile, the fact that it follows some weak results over the past few months points to very subdued household spending. Part of the weak result can be attributed to lower prices, given the earlier release of Food Price Index showed a decline in food prices of 1.3% in February, thus helping drive supermarket sales lower. Meanwhile, lower tourist numbers appear to have played a part in weaker spending in the hospitality industry.

Nonetheless, leaving these factors aside, household spending is weaker than we expected, particularly in light of the declines in spending on big-ticket items. Furthermore, car sales declined, indicating that the recovery in the vehicle industry still has a long way to go following the substantial declines over the recession.

The robust 2.1% increase in March electronic card transactions points to the potential for a rebound that month.



## 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 19 Apr	15.00	JP	Consumer confidence	Mar	Index	40.0	~	~
	15.00	JP	Consumer confidence households	Mar	Index	39.8	~	~
Tue 20 Apr	08.45	NZ	Food prices	Mar	m%ch	-1.3	~	~
	08.45	NZ	Consumer prices	QI	q%ch	-0.2	0.6	0.5
						2.0	2.3	2.2
	09.50	JP	Tertiary industry index	Feb	m%ch	2.9	~	~
	11.30	AU	Reserve Bank Board minutes for April					
	16.00	JP	Machine tool orders	Mar	y%ch	262.1	~	~
	17.00	JP	Convenience store sales	Mar	y%ch	-4.7	~	~
Wed 21 Apr	~	AU	IMF world economic outlook forecasts					
	10.30	AU	Westpac leading index	Feb	m%ch	0.2	~	~
	11.00	AU	DEWR skilled vacancies	Apr	m%ch	2.4	~	~
	15.00	JP	Leading index CI	Feb	Index	97.9	~	~
	15.00	JP	Coincident index CI	Feb	Index	100.7	~	~
Thu 22 Apr	09.50	JP	Merchandise trade balance total	Mar	¥bn	649.6	552.8	~
	09.50	JP	Adjusted merchandise trade balance	Mar	¥bn	470.5	408.9	~
	09.50	JP	Merchandise trade exports	Mar	y%ch	45.3	45.9	~
	09.50	JP	Merchandise trade imports	Mar	y%ch	29.5	33.1	~
	11.30	AU	New motor vehicle sales	Mar	m%ch	-1.9	~	~
y%ch						17.1	~	~
Fri 23 Apr	08.45	NZ	Visitor arrivals	Mar	m%ch	-1.9	~	~

## 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 19 Apr	10.00	EZ	Construction output	Feb	m%ch	-2.2	~	~
	15.00	US	Leading indicators	Mar	m%ch	0.1	1.0	~
Tue 20 Apr	07.00	GE	Producer prices	Mar	m%ch	0.0	~	~
	09.30	UK	CPI	Mar	m%ch	0.4	~	~
	10.00	EZ	ZEW survey (econ. sentiment)	Apr	Index	37.9	~	~
	14.00	CA	Bank of Canada rate	Apr	%	0.25	0.25	0.25
Wed 21 Apr	09.30	UK	Bank of England minutes					
	09.30	UK	ILO unemployment rate (3mths)	Mar	%	7.8	~	~
Thu 22 Apr	08.30	GE	PMI Services	Apr	Index	54.9	~	~
	08.30	GE	PMI Manufacturing	Apr	Index	60.2	~	~
	09.00	EZ	PMI composite	Apr	Index	55.9	~	~
	09.30	UK	Retail sales	Mar	m%ch	2.1	~	~
	13.30	CA	Leading indicators	Mar	m%ch	0.8	~	~
	13.30	US	Producer price index	Mar	m%ch	-0.6	0.5	~
	13.30	US	Initial jobless and continuing claims	Apr	~	~	~	~
	13.30	US	Existing home sales	Mar	mn	5.0	5.3	~
	15.00	EZ	Euro-Zone consumer confidence	Apr	Index	-17.0	~	~
	Fri 23 Apr	09.00	GE	IFO - business climate	Apr	Index	98.1	~
09.30		UK	GDP	Q1	q%ch	0.4	~	~
					y%ch	-3.1	~	~
10.00		EZ	Industrial new orders	Feb	m%ch	-1.6	~	~
12.00		CA	CPI	Mar	m%ch	0.4	~	~
13.30		CA	Retail sales	Feb	m%ch	0.7	~	~
13.30		US	Durable goods orders	Mar	m%ch	0.9	0.0	~
13.30		US	New home sales	Mar	m%ch	-2.2	4.7	~
Mon 19 Apr	10.00	EZ	Construction output	Feb	m%ch	-2.2	~	~
	15.00	US	Leading indicators	Mar	m%ch	0.1	1.0	~

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