

# Business Weekly

## Outlook still cause for OCR increases

### This Week

The softer than expected 0.3% increase in Q2 CPI would be of some comfort to the RBNZ, if only for the fact that the starting point for inflation is slightly lower than at the June *Monetary Policy Statement*. Following on from some subdued retail sales results in recent months, weak household demand was also reflected in lower prices for household and recreational goods. The small decline of 0.1% in tradable inflation also reflects the lagged effects of the high NZ dollar over late 2009. Meanwhile, the 0.6% increase in non-tradable inflation was largely driven by the excise tax on cigarettes and tobacco. We estimate that excluding for this price effect, non-tradable inflation would have increased around 0.3%. This modest rise reflects the fact that the rebound in housing costs was subdued in the June quarter.

The Q2 CPI result is in line with the subdued level of the prices *paid* measure in the recent NZIER Quarterly Survey of Business Opinion. Such figures may suggest the NZ economy does not require any further interest rate increases. However, looking forward there are clear signs of inflation pressures ahead, which warrant continued reduction of monetary policy stimulus. The implementation of the Emissions Trading Scheme on 1<sup>st</sup> July saw an increase in energy and fuel prices, while the increase in ACC levies means that the increase in car registration fees will be higher than is typical for Q3. Combined with the GST increase in October, we expect annual headline inflation will rise to well over 5% by mid-2011.

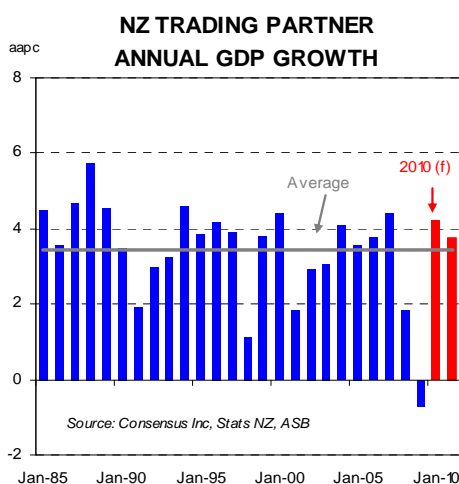
Indeed, forward-looking measures in recent business surveys also indicate growing inflation pressures. Capacity utilisation has trended up over the past year and is currently at elevated levels. In addition, businesses report increased difficulty finding skilled staff, pointing to wage pressures over the coming year. Concerningly, pricing intentions and cost expectations have surged. Granted, part of this likely reflects growing awareness of the high headline CPI over the coming year. Nonetheless, with medium-term inflation expectations already near the top of the RBNZ's inflation target band a key challenge for the RBNZ will be in preventing high headline inflation spilling over to changes in wage and price setting behaviour.

The activity outlook also supports the case for the foot to be eased off the accelerator. The latest set of *Consensus* forecasts shows stronger growth for NZ's trading partners. In particular, growth in ex-Japan Asia has been revised up, largely as a result of the robust outlook for Singapore. Given the country's key role as an importer and exporter of the Asia-Pacific region's tradable commodities, the emphatically strong Q2 GDP result – with annualised growth running at 26% – indicates economic growth in the Asia-Pacific region is in excellent health. This favourable trading partner outlook is expected to keep the NZ economic recovery trucking along, thus leading to further reduction of monetary policy stimulus over the coming year.

### Click here for:

- [Foreign Exchange](#) • NZD mixed: little changed against the USD and AUD; down on JPY, EUR, GBP.
- [Interest Rates](#) • Long-term interest rates ease following CPI and weak offshore sentiment.
- [Week Ahead](#) • June tourism and migration, consumer confidence.
- [Week in Review](#) • June REINZ house sales, May retail sales and June quarter CPI.
- [Global Calendars](#) • US housing data, RBA and Bank of England minutes, UK GDP.

### Chart of the week



- NZ trading partner GDP is expected to grow 4.2% over 2010. To highlight how strong this is, since 1990 NZ trading partner GDP has only recorded stronger growth in three other years, 2007 (4.4%), 2000 (4.4%) and 1994 (4.6%).
- Back in May 2009, Consensus expected NZ trading partner GDP would only grow 2.2% over 2010. Since then, forecasts on the global outlook have been steadily revised up. The most recent upward revisions have been largely due to stronger than expected Q1 growth in Asia (excluding Japan).
- Recent data suggest Chinese growth is decelerating. According to our seasonally-adjusted estimates, China expanded at a 1.5% quarterly pace over Q2. Despite the recent deceleration, *Consensus* forecasts are still consistent with growth of 2.3% per quarter over the next year.

### 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	0.7090	0.7088	0.7038	0.7358	0.6436	FLAT	0.7000	0.7200
NZD/AUD	0.8182	0.8101	0.8095	0.7988	0.8046	FLAT	0.8000	0.8200
NZD/JPY	61.40	63.10	63.88	66.87	60.30	FLAT	61.00	64.50
NZD/EUR	0.5496	0.5625	0.5678	0.5121	0.4559	FLAT	0.5575	0.5675
NZD/GBP	0.4637	0.4716	0.4747	0.4511	0.3928	FLAT	0.4650	0.4750
TWI	68.8	67.5	67.7	66.6	60.6	FLAT	67.00	68.00

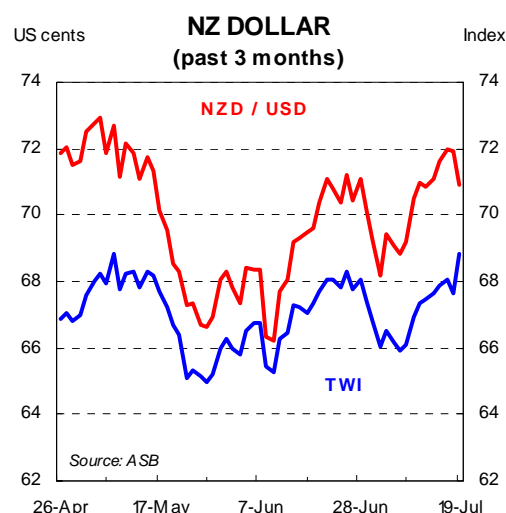
^Weekly support and resistance levels \* Current is as at 10.00 am Monday; week ago as at Monday 5pm

- The NZD was little changed against the USD and AUD last week, but lost ground on the JPY, EUR and GBP.
- The JPY is strong on a trade-weighted basis, in part benefitting from repatriation of funds during the current bout of negative global economic sentiment. If Europe's bank stress tests (released this Friday) are not well received and the US economic data underwhelms, JPY is likely to strengthen further. Against the USD, the JPY is approaching levels at which Japanese officials are likely to be concerned about too much strength.
- There are no influential New Zealand economic reports scheduled for release this week, so the NZD direction will most likely come from offshore themes. The USD has been sliding against most currencies since early June. Weakness in US housing and retail sales have sparked worries about a 'double dip' and pushed the USD and US bond yields lower. We see downside risks to the three housing indicators scheduled for release this week. Given the current sensitivity of the US dollar to bad economic news, we see downside risks to the USD at present.

### Short-term outlook:

Key data	Date	Time (NZST)	Market expects
June Net Migration	21/7	10.45 am	-
July Consumer Confidence	22/7	3.00pm	-

**Potential currency movers from offshore this week:** US NAHB housing market index (19<sup>th</sup>); US housing starts and building permits (20<sup>th</sup>); Bank of England minutes (21<sup>st</sup>); EU consumer confidence, UK retail sales, US jobless claims, existing home sales, house prices, leading index (22<sup>nd</sup>); UK GDP (23<sup>rd</sup>). **Fed speeches:** Duke (19<sup>th</sup>).



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

- The momentum in the US economy appears to have slowed recently and, given the current sensitivity of the US dollar to bad economic news, we see downside risks to the USD in the short term.
- We expect the USD will gain support in later in the year and over 2011. Despite the current soft patch, we believe the US economic outlook will continue to improve. We expect that US bond yields will eventually adjust higher reflecting the firmer US economy. As a result, the higher US bond yields will support the USD. The opposite is happening in mid-2010 - yields are falling - after a period of rising bond yields since early 2009. Importantly, the AAA-rated US bond market remains the major alternative to the Eurozone government bond market.
- We have revised down our EUR forecasts four times this year. Eurozone GDP growth is expected to under perform the US economy over 2010 and 2011. The deterioration in the EU growth outlook will see the differential between US and Eurozone interest rates widen, reducing support for the euro. In addition, more than half of Eurozone government debt is no longer AAA rated, with uncertainty continuing to cloud the outlook and reducing investor appetite.
- We continue to see support for the NZD coming from strong commodity prices and the RBNZ tightening cycle. In addition, NZ's relatively healthier outlook for net government debt will make the NZD look favourable relative to European and US peers.
- Relative to the AUD, the NZD has already made up quite a bit of ground. The NZD is likely to continue to modestly outperform the AUD as the RBNZ continues to lift rates and the interest rate differential narrows slightly.

## Interest Rate Market

Wholesale interest rates	Current	Week ago	Month ago	6 mths ago	Year ago	ST Bias
Cash rate	2.75	2.75	2.75	2.50	2.50	FLAT
90-day bank bill	3.23	3.22	3.10	2.77	2.80	FLAT
2-year swap	4.23	4.29	4.34	4.60	3.84	FLAT
5-year swap	4.84	4.94	5.08	5.45	5.32	FLAT
5-year benchmark gov't stock	4.70	4.70	4.87	5.38	4.72	FLAT
NZSX 50	2986	3012	3048	3249	2804	DOWN

\* Current is as at 10.00 am Monday; week ago as at Tuesday 5pm. Please note that we have recently changed the NZ gov't 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).

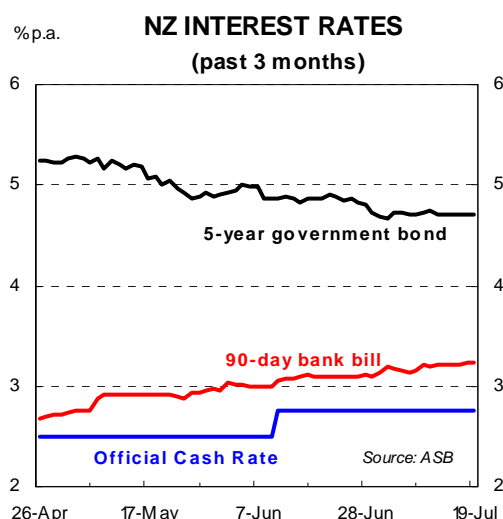
- NZ interest rates eased last week following the weaker than expected CPI result. The market continues to expect the RBNZ to hike in July, with an 84% chance of a 25 basis point rate hike priced in. However, with domestic inflation pressures remaining subdued combined with a run of softer offshore data the market is starting to increasingly expect the RBNZ will pause at some stage during the hiking cycle. As a result the declines in swap interest rates have been greatest in the 3-5 year range.
- US interest rates came under pressure over the weekend, following weaker than expected consumer confidence and mixed company earnings results. Yields on US Treasury bonds remain at extremely low levels as the market continues to fret about the possibility of a 'double dip' recession.

### Short-term outlook:

Key data	Date	Time (NZST)	Market expects
June Net Migration	21/7	10.45 am	-
July Consumer Confidence	22/7	3.00pm	-

**Comment:** A quiet week on the data calendar, the NZ market is likely to remain relatively steady ahead of the RBNZ decision on the 29<sup>th</sup> of July. Nonetheless, the local market will remain vulnerable to offshore sentiment. The majority of US data due out this week is housing related. Housing market data are likely to weaken, with support reduced following the expiration of the home buyers tax credit. The weaker run of data is likely to reinforce the current downbeat mood in the market.

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



- The RBNZ began removing monetary policy stimulus at the June meeting with a 25 basis point OCR increase. In addition, the RBNZ indicated it will look to continue to increase the OCR over the coming year as economic and financial market conditions allow.
- The RBNZ left its projection for the 90-day interest rate broadly unchanged at the June MPS. It continued to note that higher bank funding costs, upward slope of the yield curve and the fact that a greater proportion of borrowers are now on floating rate mortgages will "reduce the extent to which the OCR will need to be increased relative to previous cycles". This is in line with our expectations that OCR increases will be in 25 basis point increments this year and eventually peak at 5%.
- The RBNZ forecasts headline CPI inflation to peak at 5.3% in June 2011, boosted by a raft of Government policy changes including tobacco excise tax, the implementation of the Emissions Trading Scheme and increase in GST to 15%. We expect these changes will boost headline inflation to well over 5%, and hence pose upside risks to the RBNZ's key assumption that medium-term inflation expectations will remain anchored. This is in light of the fact that two year ahead inflation expectations are already elevated at 2.8%.
- The RBNZ has revised down its NZ economic growth outlook slightly and explicitly notes that if the Eurozone situation deteriorated the main impact on NZ would be via higher bank funding costs. We are less optimistic than the RBNZ that the recent strength in NZ export commodity prices will continue, and dairy prices have started to soften recently.
- We expect that the OCR will be increased by 25bp at each meeting until the OCR reaches 5%. Given continued uncertainty in the European economy, markets are currently pricing in some risk of a pause at some point in this cycle.

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

Data	Date	Time (NZST)	Previous	Market expects	ASB expects
June International Tourism and Migration – net inflow	21/7	10.45am	250	-	-
July Roy Morgan Consumer Confidence	22/7	3.00pm	122	-	-

### Wednesday 21 July

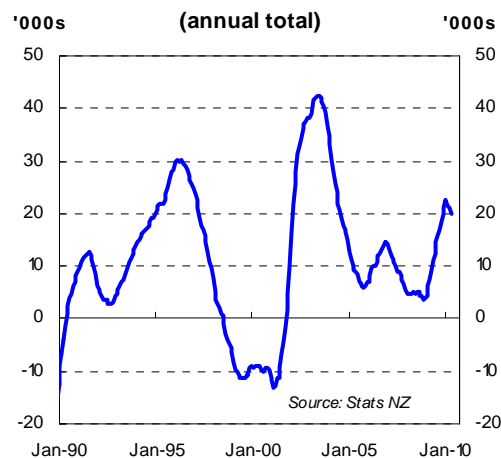
#### NZ International Tourism and Migration

##### Previous: net monthly PLT inflow +250

The pace of net migration is starting to slow after reaching a peak in January. The number of departures has started to pick up (albeit from low levels), as the stronger Australian employment market proves attractive to New Zealanders. Arrivals have also started to soften, particularly arrivals on work permits reflecting NZ's weaker labour market. We expect net migration will slow further 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 NET MIGRATION



## NZ Data Review: weekly recap

### June REINZ House Sales

Housing market activity remained soft in June. The number of days taken to sell a house continued to edge up and is now higher than the long-term average. Meanwhile, seasonally-adjusted house sales fell 5% in the month. However, despite the softer activity, prices are holding relatively steady. The stratified price index, which takes into account the composition of house sales, is 4.2% higher on year-ago levels, but remains 3.7% off the 2007 peak.

The tax changes announced in May do not seem to be triggering a wave of sellers, or additional listings. Other housing data show listings remain very low. Tight supply of houses for sale, combined with a low level of housing construction, mean that the market is not oversupplied with property. This is helpful for preventing a large drop in prices. On balance, we expect prices to decline slightly over the year and for sales activity to remain muted.

### May Retail Sales

The recovery in retail spending continues to be very gradual, with the 0.4% increase in total sales driven by a substantial rebound in vehicle sales. It appears that sales of motor vehicles are now catching up to the rebound in vehicle registrations which had occurred earlier this year.

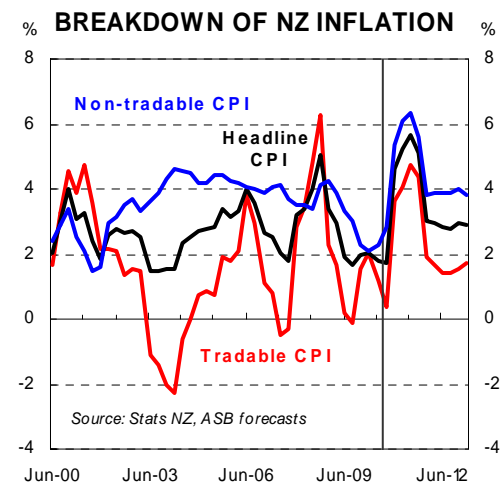
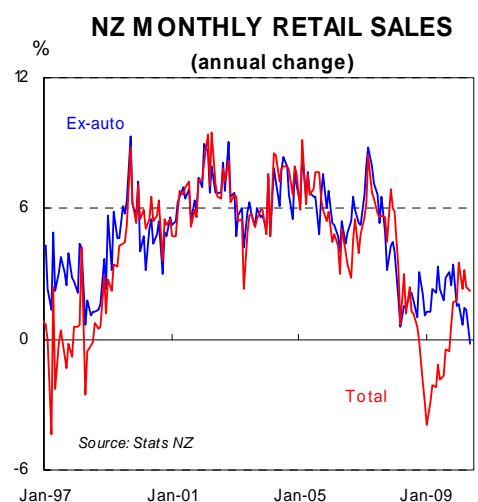
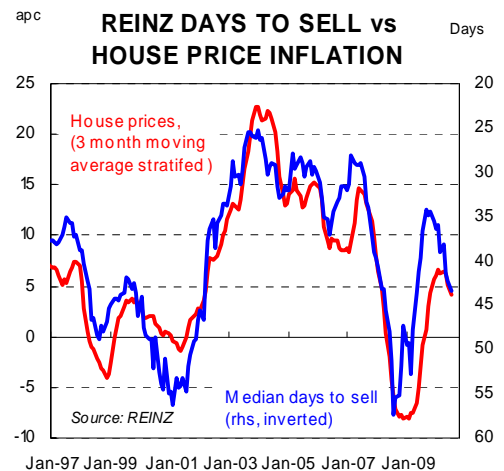
In addition, appliance sales were up 3.9% in May, suggesting that households may be starting to bring forward the purchase of big-ticket items ahead of the GST increase on 1st October this year. Indeed, recent consumer confidence surveys have pointed to an increasing number of households which considered now a good time for a major household purchase. Recent business surveys also point to growing optimism of rising sales amongst retailers.

### Q2 Consumer Price Index

The 0.3% increase in inflation over the June quarter was largely driven by an increase in excise tax in late April. If tobacco and cigarette prices had been unchanged, the CPI would have increase only 0.1% for the quarter. Leaving this group aside, the increase in non-tradable inflation was muted, reflected the modest increase in housing costs.

Meanwhile, the lagged effects of the high NZ dollar late last year continued to flow through to the price of imported goods. In particular, it appears subdued household demand means retailers are having to discount the price of many household and recreational goods to encourage sales.

Despite the benign Q2 result, we see growing inflation pressures ahead. A host of Government policy changes is expected to boost annual headline inflation to well over 5% by mid-2011. More recently, we have seen a surge in pricing intentions and cost expectations. The key challenge for the RBNZ will be in preventing the high headline inflation spilling over to changes in price and wage setting behaviour.



## Global Data Calendars

Note: Calendar 2 is in UK times. Add 11 hours for NZ times.

### Calendar - Australasia, Japan and China

Date	Time		Event	Period	Unit	Forecast		
	NZT	Econ				Last	Market	ASB/CBA
Tue 20 Jul	13.30	AU	Reserve Bank's Board July minutes	~	~	~	~	~
	17.00	JP	Leading index CI	May	Index	98.7	~	~
	17.00	JP	Coincident index CI	May	Index	101.2	~	~
	19.00	JP	Convenience store sales	Jun	y%ch	-3.2	~	~
Wed 21 Jul	10.45	NZ	Visitor arrivals	Jun	%	1.0	~	~
	10.45	NZ	Net migration	Jun	~	250.0	~	~
	12.30	AU	Westpac leading index	May	m%ch	0.0	~	~
	15.00	NZ	Credit card spending	Jun	m%ch y%ch	1.9 3.4	~	~
Thu 22 Jul	15.00	NZ	Consumer confidence index	Jul	Index m%ch	122.0 -3.2	~	~
	16.30	JP	All industry activity index	May	m%ch	1.8	~	~
Fri 23 Jul	13.30	AU	Import price index	QII	q%ch	0.3	~	-0.5
	13.30	AU	Export price index	QII	q%ch	3.8	~	10.0

## 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 Jul	00.01	UK	Rightmove house prices	May	m%ch y%ch	0.3 5.0	~ ~	~ ~
	09.00	EZ	ECB Euro-Zone current account	May	€bn	-5.1	~	~
	10.00	EZ	Construction output	May	m%ch y%ch	-0.3 -6.1	~ ~	~ ~
	15.00	US	NAHB housing market index	Jul	Index	17.0	16.0	~
Tue 20 Jul	07.00	GE	Producer prices	Jun	m%ch y%ch	0.3 0.9	~ ~	~ ~
	09.30	UK	Public sector net borrowing	Jun	£bn	16.0	~	~
	13.30	US	Housing starts	Jul	'000 m%ch	593.0 -10.0	575.0 -3.0	~ ~
	13.30	US	Building permits	Jun	'000 m%ch	574.0 -5.9	568.0 -1.1	~ ~
	14.00	CA	Bank of Canada rate	Jul	%	0.50	0.75	0.75
Wed 21 Jul	09.30	UK	Bank of England minutes	Jul	~	~	~	~
	13.30	CA	Wholesale sales	May	m%ch	-0.3	~	~
Thu 22 Jul	08.00	EZ	PMI composite	Jul	Index	56.0	~	~
	09.30	UK	Retail sales	Jun	m%ch y%ch	0.6 2.2	~ ~	~ ~
	10.00	EZ	Industrial new orders	May	m%ch y%ch	0.6 21.8	~ ~	~ ~
	13.30	CA	Retail sales	May	m%ch	-2.0	~	~
	13.30	US	Initial jobless and continuing claims	Jul	~	~	~	~
	15.00	EZ	Consumer confidence	Jul	Index	-17.0	~	~
	15.00	US	Leading indicators	Jun	%	0.4	-0.3	~
	15.00	US	Existing home sales	Jun	\$mn m%ch	5.7 -2.2	5.2 -8.1	~ ~
Fri 23 Jul	09.00	GE	IFO - business climate	Jul	Index	101.8	~	~
	09.30	UK	GDP	QII	q%ch y%ch	0.3 -0.2	~ ~	~ ~
	09.30	UK	Index of services (3mth/3mth)	May	%	0.6	~	~
	09.30	UK	BBA loans for house purchase	Jun	~	36,709	~	~
	12.00	CA	Consumer price index	Jun	m%ch y%ch	0.3 1.4	~ ~	~ ~

ASB ECONOMICS & RESEARCH			PHONE	FAX
<b>Economics</b>				
Chief Economist	Nick Tuffley	nick.tuffley@asb.co.nz	(649) 374 8604	(649) 302 0992
Economist	Jane Turner	jane.turner@asb.co.nz	(649) 374 8185	
Economist	Christina Leung	christina.leung@asb.co.nz	(649) 369 4421	
CBA NZ Economist	Chris Tennent-Brown	chris.tennent-brown@asb.co.nz	(649) 374 8819	

**DISCLAIMER**  
Views expressed in this report are those of the authors as at the date of this report and are based on information and sources believed but not warranted to be correct. Any views or information, while given in good faith, do not necessarily reflect the views of ASB and are subject to change without notice. Neither ASB Bank Limited nor any person involved in preparing this report accepts any liability for any loss or damage whatsoever that may directly or indirectly result from any views, information or omission contained in this report.