

Business Weekly

Greece markets stumble on Fed move

This Week

Financial markets have had a whippy time recently. The ongoing saga over Greece and the likelihood of some sort of rescue from other EU members continued to roll on. But markets got a bit of a surprise when the Federal Reserve announced a 25bp lift in its discount rate to 0.75%. The discount rate is the rate at which the Federal Reserve lends to financial institutions (generally when institutions are struggling to obtain liquidity from more normal sources). It is separate to the Federal Funds target rate, which is the overnight interbank rate the Fed sets for monetary policy purposes.

Fed Chairman Ben Bernanke had earlier signalled that the Federal Reserve would look to lift the discount rate, which, before the financial crisis used to sit 100bp above the Fed Funds rate. During the crisis the discount rate was dropped to be only 25bp higher than the Fed Funds rate (once the Fed Funds rate reached the 0-0.25% band the discount rate sat at 0.5%). The Federal Reserve is now moving to remove a lot of the extra liquidity measures it put in place that are no longer needed. The Fed has emphasised that the lift in the discount rate is linked to unwinding the emergency measures and should not be interpreted as a monetary policy move. However, markets did react sharply to the move, sending US interest rates and the USD up. Probably the reaction was more about how the rate lift was done: the Fed moved the rate up between Committee meetings rather than at the formal media announcement at the conclusion of a meeting. Ben Bernanke is due to make his semi-annual testimony to Congress later this week, which will give an opportunity for further detail on the move, no doubt emphasising the move is not a monetary policy signal.

Last week we released our Regional Scoreboard for 2009Q4, which revealed a bit of a town and country split. Auckland remained the most vibrant region, no doubt aided by the recovery in the region's property prices. Wellington took second spot. But many of the rural-dominated regions became more circumspect – the notable exception was the Bay of Plenty, which enjoyed a sharp surge up the rankings to claim third ranking.

There will be number minor local releases to keep an eye on this week. The Reserve Bank's Survey of Expectations (Wednesday) will get looked at for signs that respondents' expectations of future inflation are ticking up (watch the 2-year inflation expectation measure). NBNZ Business Confidence for February (Thursday) should hold up. Credit growth (Thursday) is likely to remain muted: there has been very little sign that households are returning to their old borrow and spend habits. Dwelling consents (Friday) should trend upwards, and the trade figures should show that the annual deficit is still shrinking for now.

Click here for:

[Foreign Exchange](#)

- Mixed week for Kiwi, marred by volatility at the end of the week.

[Interest Rates](#)

- NZ markets quiet, despite upward interest rate pressure from Australia and US.

[Week Ahead](#)

- Business confidence, inflation expectations, trade balance & building consents.

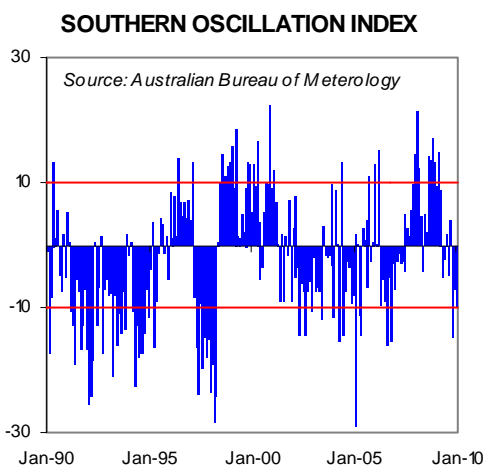
[Week in Review](#)

- Consumer confidence dipped in February, but remains well off its lows.

[Global Calendars](#)

- Ben Bernanke testimony, US housing market, Australian construction.

Chart of the week



- The Southern Oscillation Index suggests El Niño conditions have continued in the New Year. Niwa expects conditions to persist until autumn.
- According to Niwa, typical El Niño conditions during December resulted in sunny skies and more frequent south westerly winds over the country. During January, heavy rainfall and reduced sunshine hours alleviated emerging dry conditions for some, but other areas are still suffering.
- Soil moisture deficit for the first of February points to severe dry conditions existing in Northland, and less than ideal conditions in parts of Taranaki and Canterbury. Ongoing dry conditions will continue to weigh on dairy production in these regions.

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	0.7000	0.6973	0.7127	0.6848	0.5036	FLAT	0.6900	0.7100
NZD/AUD	0.7774	0.7852	0.7893	0.8166	0.7874	FLAT	0.7700	0.7850
NZD/JPY	64.17	62.88	64.04	64.90	47.40	FLAT	63.00	66.00
NZD/EUR	0.5140	0.5121	0.5046	0.4776	0.3991	FLAT	0.5100	0.5200
NZD/GBP	0.4530	0.4450	0.4394	0.4143	0.3537	FLAT	0.4500	0.4600
TWI	64.9	64.7	65.0	63.6	51.7	FLAT	64.0	66.00

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

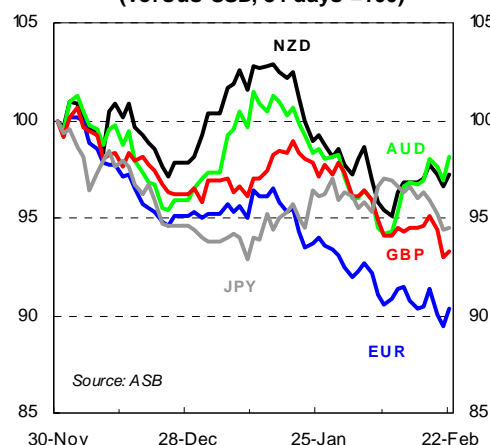
- The NZ dollar was mixed last week. Although the NZD is up against the USD over the week, the Kiwi took quite a hit on Friday when the market was surprised by the unexpected lift in the US Federal Reserve's Discount Rate. The NZD is very weak against the AUD, but posted gains on the JPY, GBP and EUR last week.
- This week the local data will likely take a back seat to offshore developments. NZ data has been fairly soft of late, so the latest business confidence report from NBNZ will be gleaned for signs of any deterioration in outlook.
- Offshore, Australian economic reports are likely to be mixed this week: wages soft but construction and capital spending strong, in sum providing neutral risks for the AUD. The US economic data this time of year can be impacted by climatic issues, which makes January and February data hard to read. There is no such problem for interpreting Bernanke's testimony to Congress on 24th and 25th. Bernanke is likely to provide reassurance the Fed Funds Rate is on hold for an extended period, but given last week's lift in the discount rate, many will be looking for a more bullish update from the Fed Chairman. The USD would be supported by a bullish update.

Short-term outlook:

Key data	Date	Time (NZST)	Market expects
RBNZ Inflation Expectations	24/2	3.00 pm	-
NBNZ Business Outlook Survey	25/2	3.00 pm	-
RBNZ Credit Aggregates	25/2	3.00 pm	-
Trade Balance	26/2	10.45 am	-\$100m
Building Consents	26/2	10.45 am	-

Potential currency movers this week: US home prices, consumer confidence (23rd); US new home sales (24th); AU CAPEX, US durable goods, initial jobless claims, home prices (25th); US economic growth, consumer confidence, existing home sales, UK growth, consumer confidence (26th). Speakers: Yellen (22nd), Geithner, Bernanke (24th), Bernanke, Bullard (25th), Dudley (26th).

EXCHANGE RATE INDICES
(versus USD, 84 days =100)



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

- We have recently pulled back our NZD outlook, with the NZD now likely to remain relatively steady over the first half of 2010. Further upside to the Kiwi over the next few months is likely to be limited, as the USD has started to strengthen reflecting stronger economic data.
- Adding to the downside pressure has been China's recent attempt to combat inflation pressures. Attempts to slow China have raised concerns on the strength of the global recovery, and the cracks appearing in China's commercial property sector are of some concern.
- In addition, the pace of economic recovery in the Eurozone has slowed. Nervousness surrounding the sustainability government debt levels have put pressure on the euro, which has flowed through to weaken the antipodean currencies.
- We have also pushed back the timing of the first RBNZ OCR increase from April to June, and expect the pace of increase to be more gradual, reducing the scope for interest rate driven out-performance.

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	3.50	FLAT
90-day bank bill	2.72	2.73	2.77	2.77	3.29	FLAT
2-year swap	4.27	4.25	4.47	4.16	3.33	FLAT
5-year swap	5.26	5.24	5.38	5.47	4.08	FLAT
5-year benchmark gov't stock	5.14	5.09	5.25	4.95	3.96	UP
NZSX 50	3112	3060	3190	3068	2579	FLAT

* Current is as at 11.00 am 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).

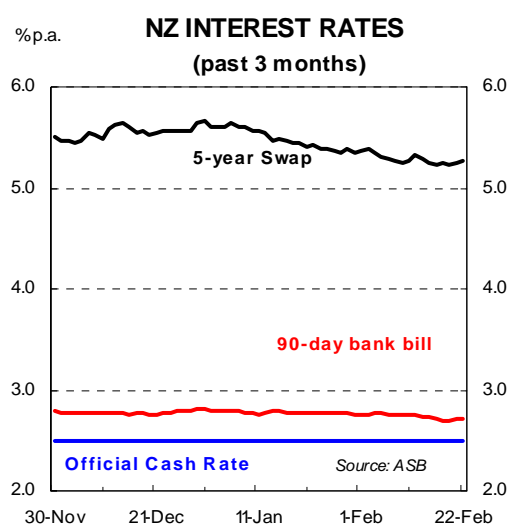
- It was a relatively quiet week locally, interest rates markets now sees very little chance of the RBNZ lifting rates before the June meeting. Nonetheless, NZ interest rates were dragged up slightly by strong rate lifts offshore.
- The RBA minutes suggest the RBA are keeping the door open to further rate hikes. A relatively hawkish testimony from Governor Stevens helped buoy further increases in Australian rates. The global economic outlook remains key to the pace of future rate hikes in Australia.
- The Federal Reserve started to return the discount rate towards pre-crisis levels last week, lifting the rate from 50 basis points to 75 bps above the Fed Funds Rate (was 1% pre-crisis). The increase by itself does not tighten monetary conditions. However, in practice, when the Fed signals it is comfortable enough with the financial situation to remove the liquidity supports, that is interpreted as signalling the Fed is closer to being comfortable with raising the target rate. The market reacted strongly to the move, with a strong lift in interest rates across the curve.

Short-term outlook:

Key data	Date	Time (NZST)	Market expects
RBNZ Inflation Expectations	24/2	3.00 pm	-
NBNZ Business Outlook Survey	25/2	3.00 pm	-
RBNZ Credit Aggregates	25/2	3.00 pm	-
Trade Balance	26/2	10.45 am	-\$100m
Building Consents	26/2	10.45 am	-

Comment: Range of 2nd tier NZ data later this week, with nothing likely to upset the markets. The National Bank survey contains the first read on business confidence for the year. Offshore, US data also relatively unexciting, although the US Treasury will issue a record US \$126 billion of debt this week, which could put some further upward pressure on Treasury yields.

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



- The RBNZ continued to hold the cash rate at 2.5% at the January *OCR Review*, and noted economic developments have generally turned out as it expected at the time of the December Monetary Policy Statement. As such, the Bank continue to expect to raise the OCR by around the middle of 2010.
- While acknowledging recent data have shown an improvement in household spending, the subdued nature of household credit growth is allaying fears that household debt levels will rise to unsustainably high levels.
- Furthermore, the reinstatement of the word “comfortable” in its assessment of inflation suggests the RBNZ is more relaxed about the inflation outlook following the subdued non-tradable inflation outturn in Q4. Nonetheless, we see inflation pressures building up in the non-tradable sector over the coming year, with our medium-term inflation outlook pushing closer to the top of the band. In particular, recent business surveys have shown a rebound in capacity utilisation and the re-emergence of skills shortages.
- Recent softer data (unemployment and waning momentum in the housing market) have reduced some of the urgency to unwind stimulus. We now expect the RBNZ is likely to lift rates in June and we expect this tightening to occur at a slower pace, with OCR increases of 25bp instead of 50bp at the initial meetings.
- The relationship between the OCR and lending rates is likely to be a lot firmer than we previously assessed. We expect the large wedge that currently exists between the OCR and bank funding costs to largely remain, and as such now see an OCR of 5% (lower than our previous estimate of 5.5%) will be sufficient to remove the stimulus short-term rates provide. The likelihood of a relatively low OCR peak, coupled with uncertainty over the impact of OCR hikes, point to 25bp moves being most appropriate.

NZ Data Preview: a look at the week ahead

Data	Date	Time (NZST)	Previous	Market expects	ASB expects
Q1 RBNZ Inflation Expectations	24/2	3.00pm	2.6%	-	-
February National Bank Business Outlook	25/2	3.00pm	38.5	-	-
January RBNZ Credit Aggregates yoy	25/2	3.00pm	2.7%	-	-
January Trade Balance	26/2	10.45am	+1.9m	-\$100 m	-\$200 m
January Building Consents mom	26/2	10.45am	-2.4%	-	+2.0%

Q1 RBNZ Inflation Expectations

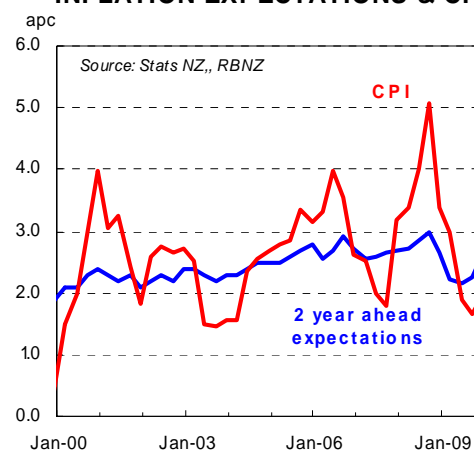
2-year ahead annual inflation: previous 2.6%

The increase in 2-year ahead annual inflation expectations for the December quarter to 2.6% was stronger than market expectations. The outturn indicated that, while headline inflation has eased sharply over the second half of 2009, underlying inflation is more persistent.

Although the Q4 CPI suggested inflation is subdued in the near-term, timelier data point to a building up of inflation pressures later in the year. In particular, the increase in pricing intentions in the construction sector in recent months suggests construction cost inflation will rebound in line with the recovery in construction activity.

The RBNZ will be wary of inflation expectations becoming unanchored. Hence a continued increase in the 2-year ahead inflation expectations measure will be of concern to it.

INFLATION EXPECTATIONS & CPI



February National Bank Business Outlook

Headline: previous

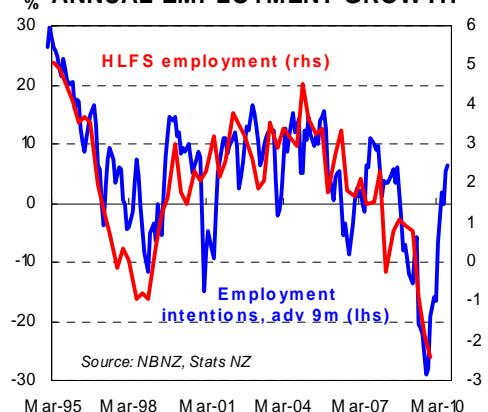
Own activity: previous 36.9

Although headline business confidence edged back slightly for the second month in a row in December, there was a continued improvement in businesses' own activity expectations. Encouragingly, further gradual improvement in profitability expectations, investment and employment intentions suggest the recovery is gaining traction.

We expect the February survey to show business confidence continuing to improve. Improved demand has seen businesses more confident about expanding their operations, and we expect this to flow to a recovery in investment and employment later this year.

EMPLOYMENT INTENTIONS &

ANNUAL EMPLOYMENT GROWTH



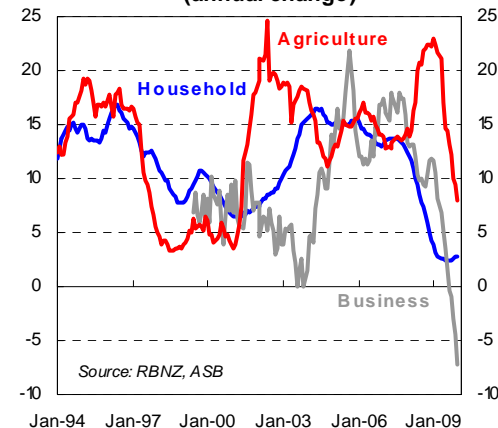
January Credit Aggregates

Household credit growth: previous +2.7% yoy

Household credit growth remains very subdued, with the pace of monthly growth slowing toward the end of the year. Weaker momentum comes from a combination of lower house sales as well as very weak demand for consumer credit. Households remain wary of increasing debt levels.

The slow pace of household credit growth will be welcomed by the RBNZ. The Bank was wary of a housing-led recovery exacerbating New Zealand's indebtedness. Slow growth in household debt, along with very weak lending to businesses and agriculture sectors reduce the urgency for unwinding monetary stimulus by the RBNZ.

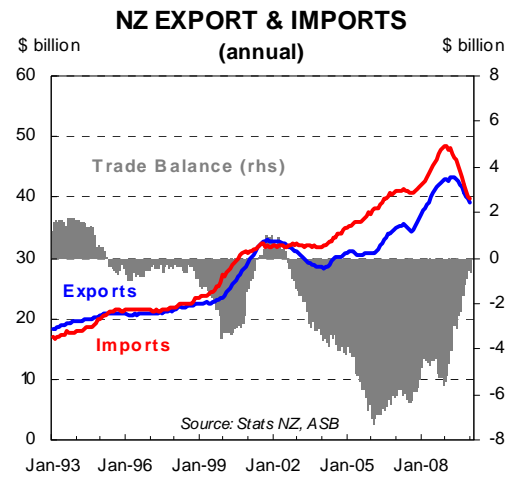
LENDING GROWTH (annual change)



January Trade Balance

Previous: +\$1.9 million, ASB f/c: -\$200 m

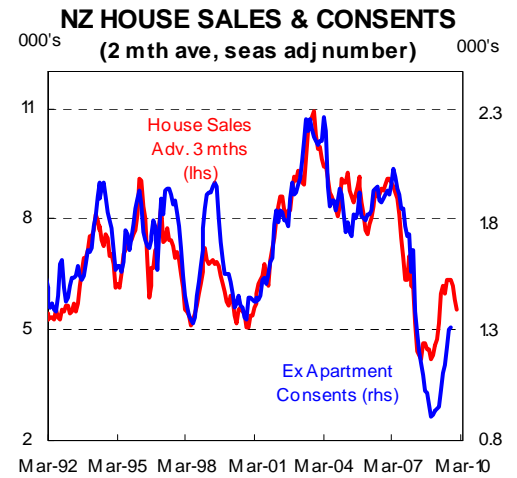
We expect a trade deficit of \$200 million in January. Monthly export and import values are typically weak in January, possibly affected by disruption by the Christmas and New Year holiday period. Nonetheless, the summer period typically sees in smaller deficits or even trade surpluses as dairy exports peak. The trade deficit declined substantially over 2009, as agricultural production remained strong and import demand was very weak. Over 2010, we expect these trends to reverse. Agriculture production has been subdued, while import demand will gradually recover with economic activity.



January Building Consents

Previous: Total (s.a.) -2.4% mom ASB f/c: 2%mom

Dwelling consent issuance posted a small dip of 2.4% for the December month, against expectations of a small gain. Given the volatility of the monthly series we continue to expect an improvement from the very low level of issuance in early 2009, as the recent recovery in the housing market and ongoing demand from population growth encourages residential investment. We expect the recent and fairly flat pattern for non-residential work to continue over early 2010 as business confidence recovers - public project activity continues to look robust, whilst businesses continue to show some caution. The 2008-9 slowdown has created vacancies in commercial buildings around the country and businesses remain somewhat cautious about investing, despite a significant lift in overall confidence. Last month's NZIER Survey of Business Opinion showed further recovery in building investment intentions, but the indicator remains at a relatively weak level.



NZ Data Review: weekly recap

Q4 Producer Price Index

Producer Output prices fell 0.4%, while Input prices rose 0.3% in the December quarter.

The sharp decline in meat and meat products manufacturing drove the decline in output prices, reflecting lower NZD-denominated export prices for boneless beef and frozen sheep meat. An increase in farm-gate prices for whole milk offset some of these declines. Note that this quarter incorporates a change in methodology whereby changes in the most recently published milk payout *forecast* is now recorded each quarter (from the previous method whereby change in the payout was shown in each Sept quarter).

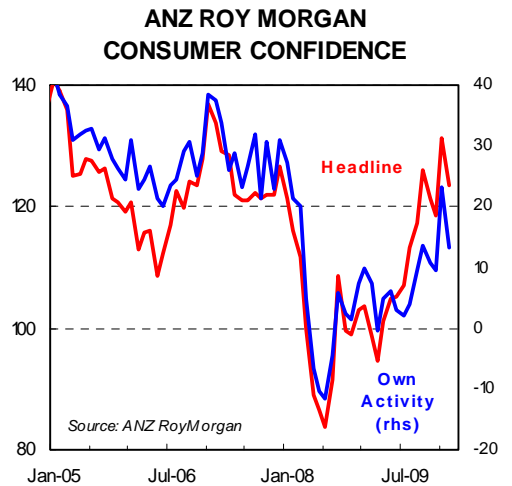
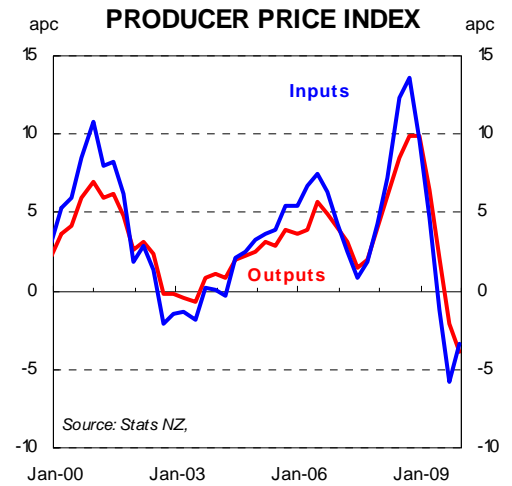
An increase in dairy product manufacturing from higher whole-milk prices drove the increase in input prices (also incorporating the new methodology). The decline in the electricity to commercial consumers reflected lower retail electricity prices for businesses.

Overall, the outturns indicate cost pressures were subdued for businesses at the end of last year.

February Roy Morgan Consumer Confidence

Consumer confidence dipped in February to 123.6 (from the three-year high of 131.4 in January), although it remains higher than December levels (of 118.6).

Similarly, there was a dip in our own activity indicator. It appears the sharp increase in consumer confidence that occurred in January has not been sustained, suggesting some caution is creeping back into household spending. Nonetheless, consumer confidence remains substantially higher than its lows, in line with our expectations for a gradual recovery in household spending – the net proportion of households considering now a good time to buy a major household item still at higher levels than at Dec.



Global Data Calendars

Note: Calendar 2 is in UK times. Add 13 hours for NZ times.

Calendar - Australasia, Japan and China

Date	Time		Econ Event	Period	Unit	Last	Forecast	
	NZT						Market	ASB/CBA
Mon 22 Feb	13.30	AU	New motor vehicle sales	Jan	m%ch	3.3	~	~
Tue 23 Feb	~	JN	Cabinet Office Monthly Report					
	12.50	JN	BoJ monetary policy meeting minutes for January					
	20.00	AU	RBA Deputy Governor Battellino speaks					
Wed 24 Feb	12.50	JN	Merchandise trade balance	Jan	¥bln	522.8	~	~
	12.50	JN	Exports	Jan	y%ch	12	~	~
	12.50	JN	Imports	Jan	y%ch	-5.5	~	~
	13.30	AU	Construction work done	QIV	q%ch	2.2	~	2.0
	13.30	AU	Wage cost index	QIV	q%ch	0.7	~	0.8
	15.00	NZ	RBNZ 2yr inflation expectations	QI	%	2.6	~	~
Thu 25 Feb	13.30	AU	Private capital expenditure	QIV	q%ch	-3.9	~	5.0
	13.30	AU	Average weekly earnings	QIV	q%ch	0.9	~	1.0
	15.00	NZ	Money supply	Jan	y%ch	-1.1	~	~
	15.00	NZ	NBNZ business confidence	Feb	Index	38.5	~	~
Fri 26 Feb	10.45	NZ	Trade balance	Jan	NZ\$mIn	2.0	-100	-200
	10.45	NZ	Building permits	Jan	m%ch	-2.4	~	2.0
	12.50	JN	CPI	Jan	y%ch	-1.7	~	~
	12.50	JN	Industrial production	Jan	m%ch	1.9	~	~
	12.50	JN	Retail trade	Jan	m%ch	-1.1	~	~
	13.30	AU	Private sector credit	Jan	m%ch	0.3	~	0.2

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 22 Feb	13.30	US	Chicago Fed National Activity Index	Jan	Index	-0.61	~	~
	15.30	US	Dallas Fed Manufacturing Index	Feb	m%ch	8.3	~	~
Tue 23 Feb	09.00	GE	IFO	Feb	Index	~	~	~
	14.00	US	S&P/Case Shiller 20 city HPI	Dec	m%ch	0.24	0.1	~
	15.00	US	Richmond Fed Manufacturing Index	Feb	Index	-2	~	~
Wed 24 Feb	07.00	GE	GDP	QIV	q%ch	~	~	~
	10.00	EC	Industrial new orders	Dec	m%ch	2.7	~	~
	15.00	US	New home sales	Jan	m%ch	-7.6	2.3	
Thu 25 Feb	08.55	GE	Unemployment change	Feb	000	6.0	~	~
	08.55	GE	Unemployment rate	Feb	%	8.2	~	~
	09.30	UK	Business investment	QIV	q%ch	-0.6	~	~
	13.30	US	Durable goods orders	Jan	m%ch	1.00	1.5	~
	13.30	US	Initial and continuing jobless claims					
	15.00	US	House prices	Dec	m%ch	0.7	~	~
Fri 26 Feb	~	GE	CPI EU Harmonised	Feb	~	~	~	~
	00.01	UK	Gfk consumer confidence	Feb	Index	-17	~	~
	09.30	UK	GDP	QIV	q%ch	0.1	~	~
	10.00	EC	CPI	Jan	m%ch	0.3	~	~
	13.30	CA	Current Account balance	QIV	CA\$bln	-13.1	~	~
	13.30	US	GDP	QIV	q%ch saar	5.7	5.7	~
	14.45	US	Chicago PMI	Feb	Index	61.5	59	~
	14.55	US	UoM Confidence	Feb	Index	73.7	73.7	~
	15.00	US	Existing home sales	Jan	m%ch	-16.7	0.9	~
	15.00	US	NAPM Milwaukee	Feb	Index	56	~	~

<http://www1.asbbank.co.nz/reports>

<http://www.research.comsec.com.au>

ASB ECONOMICS & RESEARCH

PHONE

FAX

Economics

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.