

Business Weekly

Similar Refrain

This Week

The RBNZ's OCR review looms on Thursday. We expect the RBNZ to keep the OCR unchanged at 2.5% and a fairly similar tone to December's Monetary Policy Statement, with the assessment of hiking rates "around the middle of 2010" remaining in place.

The RBNZ has some time on its side, which last week's inflation figures demonstrated. The low fourth quarter inflation outturn kept pressure for early action at bay. The 0.2% quarterly dip and annual rate of 2% were bang on the RBNZ's expectations, though the underlying detail showed that inflation pressures were a touch softer than expected. Those expecting the CPI to jolt the RBNZ like a cattle prod into a tougher stance this week will have been disappointed, with January and March hikes virtually ruled out.

The other economic data out since the December MPS also suggest the RBNZ's economic growth outlook will have changed little. Q3 GDP was close to the RBNZ's expectations and the rebound in the housing is showing signs of running out of steam. Credit growth remains sedate, keeping at bay concerns of another debt-fuelled lift in domestic spending. There has also been a defacto tightening in conditions from rising funding costs, which also reduce the need for immediate action.

These developments point to continuing December's message. The past three OCR reviews largely followed Monetary Policy Statements that sent market rates soaring. Consequently the review statements were worded to try and rein in market expectations of OCR hikes. December's MPS was no different in triggering a jump in rates (partly because the RBNZ had sounded so vehement 6 weeks prior about remaining on hold until the second half of 2010 only to change its stance). But with market pricing currently implying less than a full 25bp hike by the April meeting, the gap between the RBNZ's view and market pricing is much smaller this time.

Lurking in the background are some signs that medium-term inflation pressures will be comparatively quick to resurface once the economy has made up the ground lost during the recession. We expect this issue to be more apparent in the RBNZ's view when completes its next comprehensive set of forecasts, in the lead-up to the March MPS. We still expect the RBNZ to deliver a 50 basis point hike in April as it becomes clearer the OCR needs to start moving to a less stimulatory level.

Elsewhere the Federal Reserve precedes the RBNZ by 45 minutes and could sound more upbeat on the economy. The Australian CPI will influence the outcome of the February 2nd rate announcement.

Click here for:

[Foreign Exchange](#)

- NZD slips on CPI data, then offshore risk aversion adds to the down move.

[Interest Rates](#)

- Interest rates ease across the curve.

[Week Ahead](#)

- RBNZ is the highlight on Thursday. Trade figures due Friday

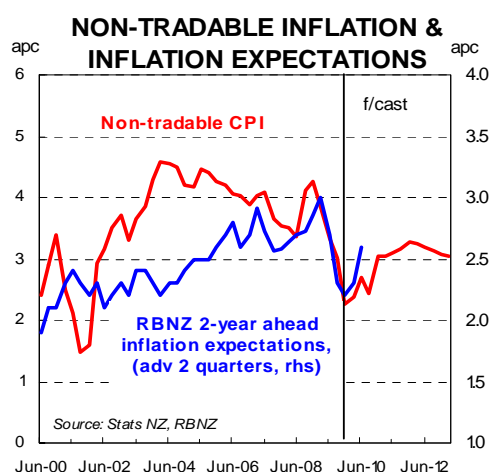
[Week in Review](#)

- CPI meets ASB, RBNZ expectations, but a touch softer than the market view.

[Global Calendars](#)

- UK & US QIV GDP, Bank of Japan, FOMC rate decisions, Australian CPI.

Chart of the week



- December quarter CPI showed a surprisingly small decline in non-tradable inflation, suggesting capacity pressures were subdued towards the end of last year.
- However, the recent increase in 2-year ahead inflation expectations indicates inflation pressures may be contained only in the short term.
- Furthermore, business surveys in recent months have also pointed to a recovery in pricing intentions, as improving demand allow firms to rebuild their margins.
- The RBNZ noted in its *Monetary Policy Statement* its concern at the lack of disinflation during the recession.
- Hence while the Q4 CPI result should allay some concern of acceleration in inflation at the moment, there are signs inflation pressures will build up later in 2010.

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	0.7137	0.7358	0.7047	0.6565	0.5286	FLAT	0.7050	0.7250
NZD/AUD	0.7890	0.7988	0.8000	0.8000	0.8087	FLAT	0.7825	0.7950
NZD/JPY	64.19	66.87	64.54	62.24	47.03	FLAT	63.00	65.50
NZD/EUR	0.5039	0.5121	0.4915	0.4611	0.4083	FLAT	0.4975	0.5075
NZD/GBP	0.4426	0.4511	0.4414	0.3989	0.3831	FLAT	0.4350	0.4450
TWI	65.0	66.6	64.6	61.4	53.3	FLAT	63.00	65.50

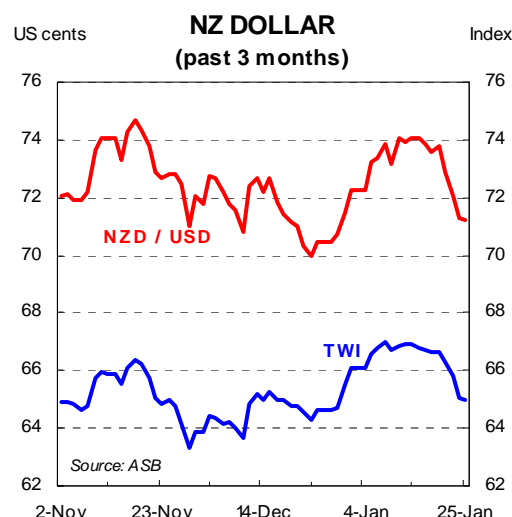
^Weekly support and resistance levels * Current is as at 11am Monday; week ago as at Monday 5pm

- Risk aversion was the dominant theme late last week. The NZD started to slip after a weaker than expected CPI reading on Wednesday tempered expectations of a near-term rate hike from the RBNZ. The move continued over the rest of the week, as offshore developments reduced appetite for NZD. NZD has dropped 3 cents from its high against the USD last week, slipping from 0.74 on the 19th, to a brief low just shy of 0.71 on Friday night.
- Against the AUD, the NZD has fallen over a cent from last week's high of 0.803, to trade around 0.79 on Monday morning. The RBNZ meeting is the main event in New Zealand this week. Australia's CPI report (due Wednesday) should firm up rate hike expectations for next week's RBA decision. Combined, they are likely to present downside risks to NZD against the AUD later this week.
- There is a lot happening in the US this week. We expect economic growth in the QIV 2009 could be as high as 6% annualised compared to expectations near 4½%. Jobless claims are likely to fall substantially after the holiday back-log is worked through. Finally, the Federal Reserve's interest rate meeting is likely to sound more optimistic about an economic recovery. But near-term interest rate increases will likely remain off the agenda. Overall, we think an improved US outlook is likely to support the USD over the latter part of the week.

Short-term outlook:

Key data	Date	Time (NZST)	Market expects
RBNZ OCR Announcement	28/1	9.00 am	2.5%
RBNZ Credit Aggregates – Dec	28/1	3.00 pm	-
Trade Balance – Dec	29/1	10.45 am	-\$100m
Building Consents - Dec	29/1	10.45 am	-

Potential currency movers from offshore this week: US existing home sales (25th), US home prices, consumer confidence, GE IFO Business Climate Survey, UK GDP, EZ current account (26th), Federal Reserve's interest rate decision, US new home sales (27th), US jobless claims, durable goods orders, GE unemployment rate (28th), US GDP, consumer confidence (29th). Speakers: Fed's Kohn (29th).



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

- We continue to expect the NZD to appreciate further against the USD over the first half of 2010. The story remains primarily one of USD weakness, also overlaid by some Downunder strength.
- We expect the USD to remain under pressure until the Federal Reserve starts to unwind its policy stimulus: the earlier that starts the sooner the NZD's rise is likely to be capped.
- The reasons for USD weakness in H1 2010 remain similar to the drivers since mid-March 2009, namely:
 - US residents increase their offshore investment, encouraged by improvement in the global economy, with USD liquidity demand and safe-haven buying also no longer boosting the USD.
 - Diversification out of USD is expected to occur due to concerns about US government debt.
 - And, related, concern about the USD's future role as a reserve currency.
- In late 2009 the USD responded positively to strong US data - a change from the pattern of the preceding 8 months. There is a risk that the USD troughs a lower level than our current forecasts imply.
- The NZD is also likely to mildly outperform other major currencies in the ongoing environment of improving global growth prospects and rising commodity prices. Outright weakness in the Pound will continue to hold the NZD/GBP rate at very elevated levels. The Pound, like the USD, is being weighed down by debt concerns and the state of its financial sector – both of which have ramifications for the future growth rate of the economy.
- The buoyant Australian dollar is also likely to contribute to an overall strengthening of the NZD. The RBA is likely to continue lifting its cash rate back to a less stimulatory level. Rising interest rates there will lift the AUD.

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	5.00	FLAT
90-day bank bill	2.78	2.77	2.79	2.77	4.13	FLAT
2-year swap	4.47	4.60	4.58	3.94	3.56	FLAT
5-year swap	5.38	5.45	5.57	5.40	4.03	FLAT
5-year benchmark gov't stock	5.25	5.38	5.48	4.78	3.77	FLAT
NZSX 50	3181	3290	3206	2998	2707	DOWN

* 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).

- NZ interest rates continued to ease last week, falling another 10 basis points across the swap curve. Q4 CPI printed at the lower end of expectations, with a 0.2% decline. The market put particular emphasis on the softer non-tradable inflation result, seeing less urgency for the RBNZ to hike rates. Market pricing for rate hikes over 2010 has now eased back significantly from post-December MPS levels with hikes no longer priced in for March (compared to 25bp prior to Christmas), and 25bp not even fully priced in for April (compared to 50bp).
- We expect the RBNZ to hold the cash rate unchanged at 2.5% on Thursday, and keep a similar tone as the December Statement with its assessment of hiking rates "around the middle of 2010" remaining in place. Data since the December announcement has evolved closely in line with the RBNZ's outlook. We continue to expect the first hike in the OCR in April, as we remained concerned about the medium-term outlook for inflation. ([Click here for full OCR preview](#))

Short-term outlook:

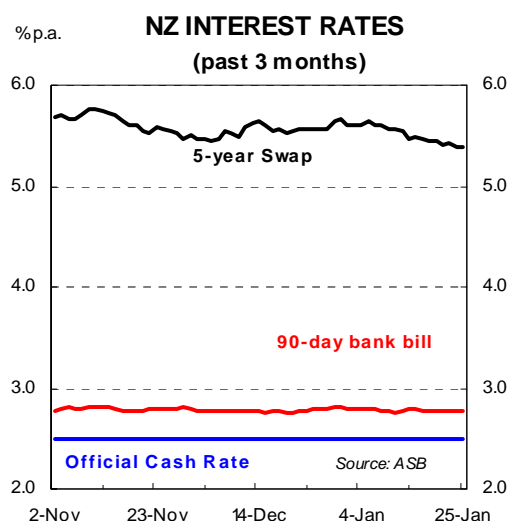
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Trade Balance – Dec	29/1	10.45 am	-\$100m
Building Consents - Dec	29/1	10.45 am	-

Comment: The key event this week is the RBNZ announcement on Thursday. We expect the RBNZ to stick to a similar tone to the previous statement. The market pricing for OCR hikes over 2010 has eased back significantly over recent weeks, and is now likely to be more sensitive if the tone is more hawkish than December.

Also keep an eye on offshore markets, with Australian CPI due on Wednesday and the FOMC announcement due at 8.15 on Thursday morning.

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

- The RBNZ continues to hold the cash rate at 2.5%. The RBNZ adopted a more hawkish tone at the December Monetary Policy Statement. The RBNZ now recognises the stronger economic outlook and the risks to inflation moving toward the upside. The RBNZ has moved forward its expected tightening to the middle of 2010, with the 90-day interest rate track now increasing from Q3 2010.
- The RBNZ has revised up its view on the economic outlook, with the composition of growth now more household led. The move acknowledges the recent strength in house prices as well as the improvement in consumer and business confidence. The RBNZ notes there is upside risk to spending growth given the strength of house prices, although points the weakness in household credit growth as indicating cautious consumer behaviour.
- The RBNZ has become more concerned on future inflation pressures, noting it has been surprised by the extent non-tradable prices have help up. The recession has not triggered a period of muted inflation; it merely appeared to wipe out the excess inflation pressure from the economy. There is no longer much scope for the RBNZ to absorb upside surprises to the inflation outlook other than to lift rates earlier than currently intended.
- Historical revisions to GDP over 2006 also have some serious implications for monetary policy. The official estimates now suggest growth was very weak over 2006, and yet inflation pressures remained firm through this period. This suggests NZ has a lower non-inflationary growth rate than previous assumed. The RBNZ needs to remain vigilant, as capacity measures already have started to firm very early during the recovery phase.
- The next move in the OCR is up, it's just a matter of when. We continue to expect the RBNZ will hike by April as the strength in the housing market continues to test the RBNZ's patience. The RBNZ has a substantial amount of policy stimulus to unwind, the first steps are likely to be bigger (i.e. 50 basis point moves).



NZ Data Preview: a look at the week ahead

Data	Date	Time (NZST)	Previous	Market expects	ASB expects
RBNZ OCR Review	28/1	9.00 am	2.50%	2.50%	2.50%
RBNZ Credit Aggregates yoy	28/1	3.00pm	+2.8%	-	-
December Monthly Trade Balance	29/1	10.45am	-269m	-100m	-100m
December Building Consent Issuance mom	29/1	10.45 am	+1.2%	+3.0%	+3.8%
Q4 Labour Cost Index	2/2	10.45 am	+0.5%	-	+0.2%
Q4 Quarterly Employment Survey	2/2	10.45am	+1.7%	-	+0.4%

Thursday 28th January

RBNZ OCR Announcement

ASB(f): 2.5% (no change)

We expect the RBNZ to keep the OCR unchanged at 2.5%, with its assessment of hiking rates “around the middle of 2010” remaining in place. The RBNZ has some time on its side, with the low fourth quarter inflation outturn keeping pressure for early action at bay. Defacto tightening in conditions from rising funding costs also reduce the need for immediate action. However, recent data suggest the NZ economy has less spare capacity and a lower non-inflationary speed limit than previously thought.

We still expect the RBNZ to deliver a 50 basis point hike in April. The risks to the inflation outlook for the medium term suggest it will be imprudent to leave monetary policy settings at exceptionally low levels for too much longer.

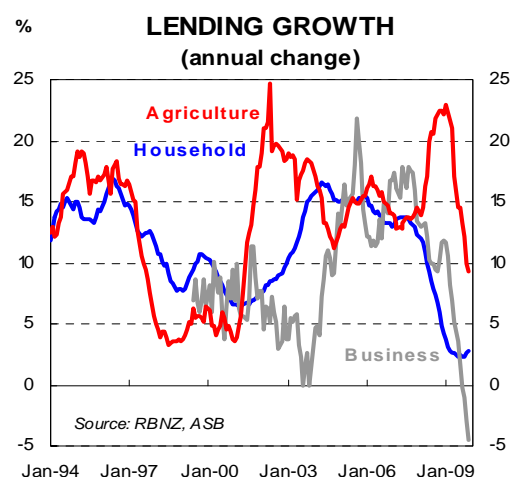
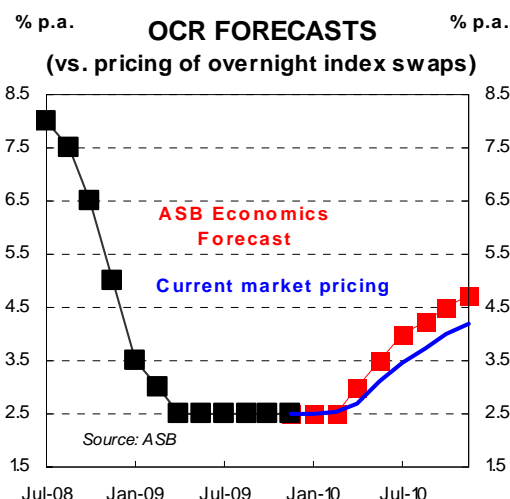
Thursday 28th January

RBNZ Credit Aggregates - December

Household Credit Growth – previous: +2.8% yoy

Annual growth in household lending has started to turn, supported by a lift in lending against housing. Nonetheless, housing lending growth remains subdued in line with the weak level of house sales. Annual growth in consumer lending remains deeply negative, reflecting the added caution that has gripped consumers.

The RBNZ will continue to monitor developments in household credit growth closely, although subdued demand to date is unlikely to concern the RBNZ much.



Friday 29th January

Trade Balance - December

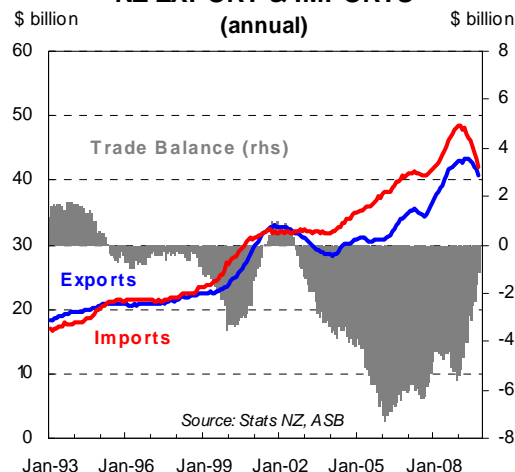
Previous: -\$269m ASB f/c: -\$100m

The trade deficit typically narrows during the end of the year, with the seasonal increase in dairy and meat combined with the seasonal decline in imports. We expect a trade deficit of \$100 million in December, bringing the annual deficit down to just \$605 million.

Abstracting from the typical seasonal pattern, underlying dairy exports are starting to improve due to stronger prices. In addition, the recent QSBO survey suggests that manufactured exports will rebound, supported by the low NZ dollar against the Australian dollar.

Underlying demand for imports is likely to be stabilising as domestic demand begins to firm.

**NZ EXPORT & IMPORTS
(annual)**



Friday 29th January

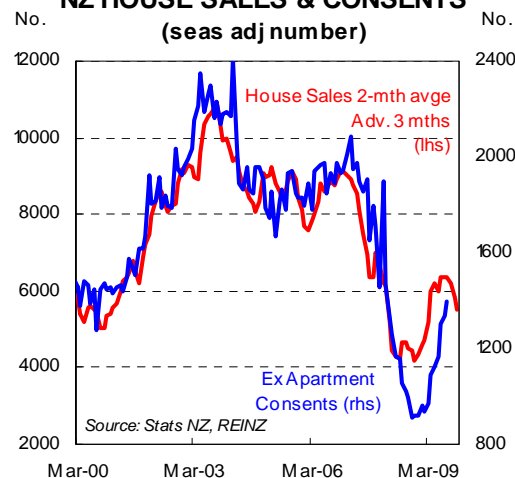
Building Consents - December

Previous: Total (s.a.)+1.1% mom ASB f/c: +3.8 mom

Dwelling consent issuance continues to make slow improvement. Total consent issuance increased 21% in November on year-ago levels, and were up 1.1% against October. November's ex-apartment consents were up 31.5% on year-ago levels, and up 3.1% on October. Core consent issuance has picked up significantly from the lows in early 2009. However, the recovery in residential construction is sluggish compared to the recovery in house prices and demand. Low interest rates, improving sentiment and an increase in net migration have underpinned a lift in demand for housing.

The recent increase in house prices should help stimulate new construction. Our residential forecasts are based on a steady pick-up in consent issuance over the next six months. Non-residential consents have remained comparatively steady over the past 18 months, and we expect this to continue.

**NZ HOUSE SALES & CONSENTS
(seas adj number)**



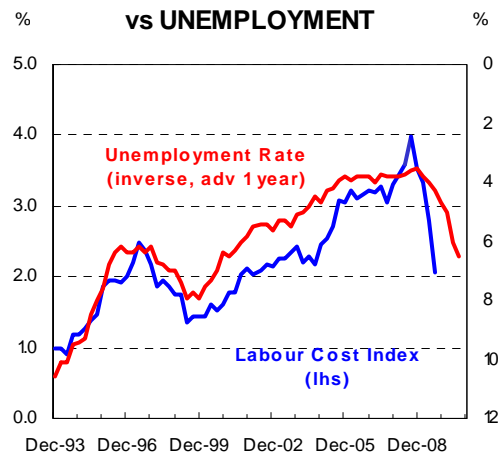
Tuesday 2 February

Labour Cost Index – Q4

Previous: +0.5% qoq ASB f/c: +0.2% qoq

We expect LCI wage inflation to increase 0.2% over Q4, with the annual rate slowing to 1.6% from 2.1% (all sectors including overtime). Wage inflation has slowed swiftly over 2009, with many firms opting for lower wage increases (or wage freezes) in order to minimise job losses during the peak of the downturn. We expect wage inflation pressures to remain weak over 2010. The cost of living (a significant driver of wage increase) is now rising at a much slower rate. In addition, there remains a large degree of surplus in the labour market, which reduces the intensity of competition for labour. Firms continue to report it being relatively easy to find labour and the unemployment rate has increased sharply over the past 2 years, from a low of 3.5% in 2007 to 6.5% in Q3 2009.

**NZ LABOUR COSTS
vs UNEMPLOYMENT**



Tuesday 2 February

Quarterly Employment Survey – Q4

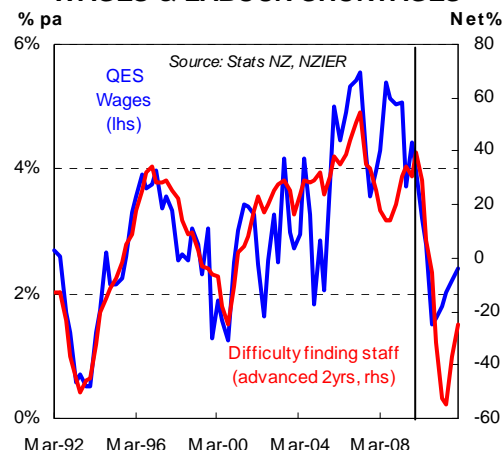
Previous: Private Sector Wages: +1.7% qoq ASB f/c: +0.4% qoq

We expect the QES average wage to increase 0.4% over Q4, slowing the annual increase to 4.0% (from 4.4%). However, the QES wage measures are less useful given that compositional shifts can make the quarter-to-quarter results very volatile.

The QES survey also contains job-related figures. These may give some steer as to the strength of employment, though there has been considerable divergence recently between the QES job figures and the HLFs measure of employment.

While the economy stabilised over the middle of 2009, we expect some lingering weakness to remain in the labour market which typically lags economic activity. We expect the pace of decline in total paid hours to slow over Q4, and forecast a decline of 0.4%. Hours worked/paid is a key variable to watch for confirmation of improving labour demand, as it tends to lead the increase in employment growth (as firms draw upon idle capacity among existing staff).

WAGES & LABOUR SHORTAGES



NZ Data Review: weekly recap

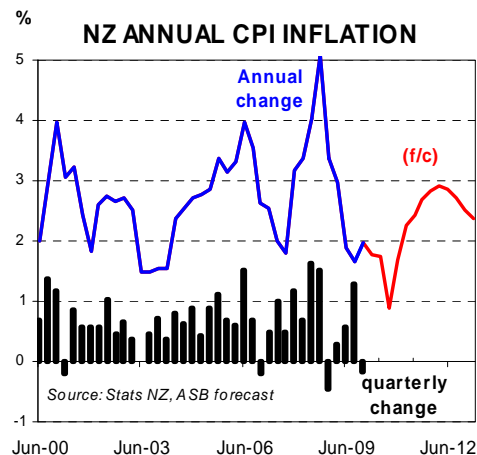
Q4 Inflation

Headline inflation fell 0.2% in the December quarter. In particular, the softer non-tradable inflation result – with an increase of only 0.1% - suggests capacity pressures remained subdued towards the end of last year. Inflation in the housing and utilities group appears to be contained for now, with construction costs only increasing 0.4%.

As expected, weak food prices drove the decline in tradable inflation, retracing the gains in vegetable prices from the previous quarter. However, this was partly offset by a reasonably strong increase in clothing prices, perhaps reflecting improved demand which means businesses have seen increased scope to raise prices. Furthermore, vehicle prices continued to recover following large falls seen last year. This suggests improved household demand is allowing some retailers to recover some of the margin squeezing seen earlier in 2009.

The key implication for the RBNZ is that near-term inflation is benign enough to keep the RBNZ comfortable in the short term.

NZ ANNUAL CPI INFLATION



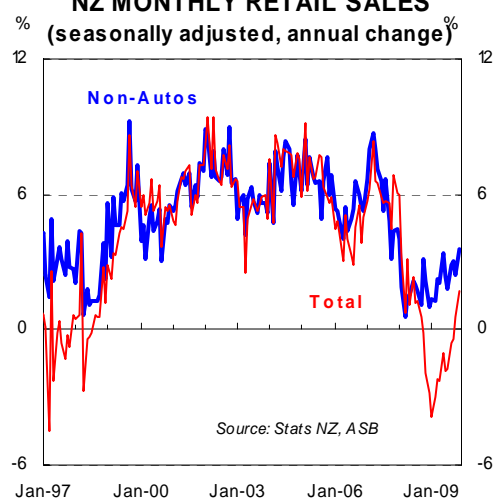
November Retail Trade

The 0.8% increase in both headline and core November retail sales pointed to signs of a recovery in household demand, with gains in the department stores and clothing groups. Furthermore, the continued increase in spending in bars and clubs likely reflected the large number of Australian tourists over late 2009.

Despite consumer confidence surveys revealing in recent months a greater inclination to buy big-ticket items, spending on durable goods was mixed. Spending on furniture declined but spending on appliances increased. We expect demand for housing-related categories will recover over 2010 in line with stronger housing construction activity.

Although the retail sales figures were a touch stronger than expected, they don't alter our view that the pick-up in spending growth will remain gradual. The trend growth rate has remained steady for a number of months and remains consistent with the overall economy gradually recovering.

NZ MONTHLY RETAIL SALES (seasonally adjusted, annual change)%



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 25 Jan	13.30	AU	Producer Prices	QIV	q%ch	0.1	~	0.5	
					y%ch	0.2	~	-0.6	
	17.00	JP	BoJ monetary policy meeting						
Tue 26 Jan	~	AU	Australia Day Holiday						
				JP	BoJ Target rate	~	%	0.1	0.1
	15.00	NZ	Credit card spending	Dec	m%ch	0.8	~	~	
Wed 27 Jan	12.50	JP	Trade Balance	Dec	¥bln	492.4	~	~	
					AU	CPI	QIV	q%ch	1.0
					y%ch	1.3	~	2.3	
	13.30	AU	Underlying CPI	QIV	q%ch	0.8	~	0.8	
					y%ch	3.5	~	3.6	
	18.00	JP	BoJ monthly report						
Thurs 28 Jan	9.00	NZ	RBNZ Cash rate	~	%	2.5	2.5	2.5	
					JP	Retail trade	Dec	m%ch	0.2
Fri 29 Jan	10.45	NZ	Trade balance	Dec	NZ\$ mln	-269	~	-100	
	10.45	NZ	Imports	Dec	NZ\$ mln	3.07	~	~	
	10.45	NZ	Exports	Dec	NZ\$ mln	3.34	~	~	
	10.45	NZ	Building permits	Dec	m%ch	1.2	~	~	
	12.30	JP	Jobless rate	Dec	%	5.2	~	~	
	12.30	JP	Job-to-applicant ratio	Dec	%	0.45	~	~	
	12.30	JP	Household spending	Dec	y%ch	2.2	~	~	
	12.30	JP	CPI	Dec	y%ch	-1.9	~	~	
				ex food and energy		y%ch	-1.0	~	~
	12.50	JP	Industrial production	Dec	m%ch	2.2	~	~	
13.30	AU	Private sector credit	Dec	m%ch	0.8	~	0.1		
18.00	JP	Housing starts	Dec	y%ch	-19.1	~	~		

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 25 Jan	07.00	GE	Gfk consumer confidence	Feb	Index	3.3	3.3	~	
	15.00	US	Existing home sales	Dec	m%ch	7.4	-7.8	~	
	15.30	US	Dallas Fed Manufacturing	Jan	Index	3.8	~	~	
Tue 26 Jan	09.00	GE	IFO – Business Climate	Jan	Index	94.7	95.1	~	
	09.00	GE	IFO – Current Situation	Jan	Index	90.5	~	~	
	09.00	GE	IFO – Expectations	Jan	Index	99.1	~	~	
	09.00	EZ	Current account	Nov	€bn	-4.6	~	~	
	09.30	UK	GDP	QIV	q%ch y%ch	-0.2 -5.1	~ ~	~ ~	
	14.00	US	S&P/CS HPI (comp-20)	Nov	m%ch	0.4	~	~	
	15.00	US	Consumer confidence	Jan	Index	52.9	53.5	~	
	15.00	US	Richmond Fed Index	Jan	Index	-4	~	~	
	Wed 27 Jan	~	GE	CPI (EU Harmonised)	Jan	m%ch	0.9	-0.4	~
		15.00	US	New home sales	Dec	m%ch	-11.3	4.2	~
19.15		US	FOMC rate decision	~	%	0.25	0.25	0.25	
Thurs 28 Jan	08.55	GE	Unemployment change	Jan	000	-3	20	~	
	08.55	GE	Unemployment rate	Jan	%	8.1	8.2	~	
	10.00	EZ	Business confidence	Jan	Index	~	~	~	
	13.30	US	Chicago Fed Index	Dec	Index	-0.32	~	~	
	13.30	US	Durable goods orders	Dec	m%ch	0.2	1.6	~	
	13.30	US	Initial jobless and continuing claims						
Fri 29 Jan	10.00	EZ	Unemployment rate	Dec	%	10.0	10.1	~	
	10.00	EZ	CPI estimate	Jan	y%ch	0.9	1.2	~	
	13.30	US	GDP (advanced)	QIV	q%ch saar	2.2	4.5	~	
	14.45	US	Chicago PMI	Jan	Index	58.7	56.5	~	
	14.55	US	UoM confidence (f)	Jan	Index	72.8	73	~	

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