

# Business Weekly

## Time for a cuppa

### This Week

Over the last week there has been enough news locally and globally to suggest the RBNZ will take time out from lifting rates at both the September MPS and the October OCR Review. Previously we expected the RBNZ to pause a little later, in October and December. Central banks have to steer between the risk of tightening too soon (and stopping recovery before it gets going) or tightening too late (and having to play catch-up to rampant inflation). Of these two extremes, the RBNZ at present looks more likely to hit the first.

When the RBNZ lifted the OCR in June, one of the assumptions underpinning its interest rate outlook was that trading partner growth continues to be robust. Outwardly, that status appears in place. Consensus forecasts, which the RBNZ looks at for guidance on NZ's trading partner outlook, have held up. However, these forecasts may well soften soon. In particular, the US economy has shown a number of signs it is losing momentum as some of the policy stimuli – particularly for housing – have come to an end. Weaker growth in the US comes at a time when the NZ-centric driver of global recovery – Asia – is actively slowing itself down from an unsustainably strong pace, accompanied by early signs that export commodity prices are cooling. The RBNZ Governor has attended the recent central banker gathering in the US, and will likely come home with a growing sense of caution about the resilience of the developed economies.

We expect the RBNZ will be revising down its NZ growth outlook considerably relative to its June projections. We have long been of the view the RBNZ has been overly optimistic on the pace of recovery, and the RBNZ's recent public statements suggest it is now rapidly reassessing its view. Domestically, growth of late has been coming from recovery in Asia and Australia. But there are still significant pockets of fragility within the economy, with low interest rates still an important financial support for many businesses. Trickle through from the well-performing sectors does not appear to be happening yet, leaving a number of businesses vulnerable to higher interest rates. With the lower growth outlook will come a lower inflation outlook. Furthermore, last week's RBNZ Survey of Expectations will have made the RBNZ more relaxed about inflation given the drop in longer-term inflation expectations.

Our view is the peak in the OCR will be quite low, at 4.5% (the lowest in a recent survey of economists). In pausing now at 3%, we do not see the RBNZ as taking a huge risk of ending up behind the curve. In particular, neither domestic spending nor borrowing showed much sign of life at an OCR of 2.5%, yet it is through suppressing these channels that the RBNZ contains inflation. We think the RBNZ has a window in which it can pause to get a better (and more realistic) handle on the likely pace of NZ's economic recovery without undue risk of choking the recovery nor of letting the inflation genie out of the bottle. We put a 60% chance on the RBNZ pausing in September, and taking a few months off to have a cup of tea.

### Click here for:

#### [Foreign Exchange](#)

- NZD gains on weak USD, little changed on other cross rates.

#### [Interest Rates](#)

- Market continues to price a pause from the RBNZ at the September MPS.

#### [Week Ahead](#)

- RBNZ Business Outlook, RBNZ Credit Aggregates, Building Consents.

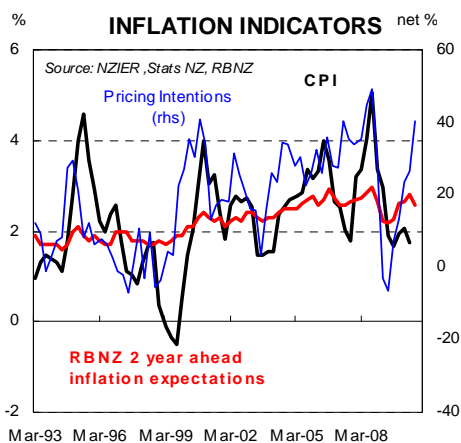
#### [Week in Review](#)

- RBNZ Survey of Expectations was the only local data release last week.

#### [Global Calendars](#)

- Euro CPI, FOMC minutes, Pending Home Sales, US Non-farm Payrolls.

### Chart of the week



- Recent measures of medium-term inflation expectations will be of some comfort to the RBNZ. Shorter-term inflation expectations and pricing intentions have picked up, reflecting the GST-induced surge in inflation over the next 12 months. However, 2-year ahead inflation expectations have actually eased, suggesting that the impact from GST on prices will be treated as transient, and this removes some risk of spill-over effects into wage and price setting behaviour.
- The RBNZ is facing an uncomfortable inflation outlook: we expect headline inflation will peak at over 5%, threatening to drag up underlying inflation pressures. However, well-anchored inflation expectations will help minimise the lift in underlying inflation and reduce the work the RBNZ needs to do in terms of increasing interest rates to prevent the raft of Government charges spilling over to generalised inflation.

### 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	0.7133	0.7066	0.7212	0.6984	0.6864	FLAT/UP	0.6950	0.7250
NZD/AUD	0.7903	0.7921	0.8012	0.7781	0.8175	FLAT	0.7850	0.8000
NZD/JPY	60.99	60.31	62.32	62.21	64.30	UP	60.00	62.00
NZD/EUR	0.5592	0.5553	0.5515	0.5132	0.4779	FLAT	0.5500	0.5650
NZD/GBP	0.4592	0.4538	0.4613	0.4606	0.4215	FLAT	0.4500	0.4650
TWI	66.7	66.2	67.1	64.7	63.7	FLAT/UP	65.50	67.00

^Weekly support and resistance levels \* Current is as at 11.10 am Monday; week ago as at Monday 5pm

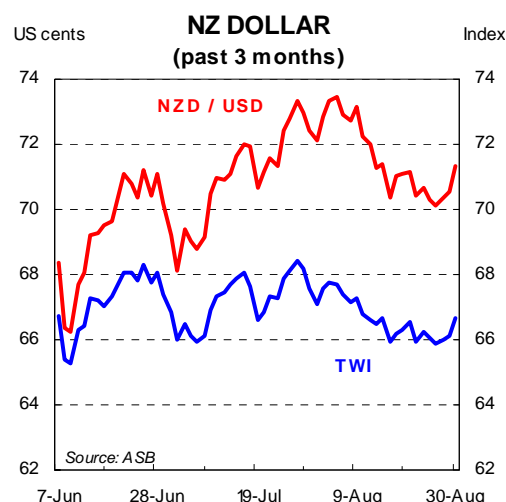
- The euro and commodity currencies, including the NZD, rose against the greenback late last week as investors moved away from safe-haven assets. This morning the Aussie pushed through USD 0.90, and the NZD has pushed back above USD 0.71. The stronger lift in the AUD has seen the NZD/AUD cross ease a fraction compared to a week ago.
- Having held above USD 0.695 support last week, the NZD has quickly got back to trade around 0.715, and could this week head back towards previous resistance in the 0.7200-0.7250 area.
- The euro has lifted to USD 1.276 this morning after Chinese authorities indicated that they would maintain "appropriately loose" economic policy settings.
- The JPY has appreciated against the majors over recent weeks, and is at a 15-year high against the USD. Bank of Japan Governor Shirakawa returned home a day early from the Jackson Hole Central Bankers summit to attend a special Board meeting. The Governor and his board are meeting today "to discuss monetary control matters based on recent economic and financial developments," the BoJ has announced. The Governor returned early after the Japanese Prime Minister Naoto Kan said he expected the BoJ to implement policy "swiftly." The JPY has eased this morning after the announcement.

### Short-term outlook:

Key data	Date	Time (NZST)	Market expects
August NBNZ Business Outlook	30/8	3.00 pm	-
July RBNZ Credit Aggregates	30/8	3.00pm	-
July Building Consents	31/8	10.45am	-

**Potential currency movers from offshore this week:** EUR Business Climate Indicator; US Personal Consumption and Income data, PCE Deflator (30<sup>th</sup>); Japan Retail Trade, EUR CPI, employment (31<sup>st</sup>); US Case Schiller Home Price Index, FOMC minutes (1<sup>st</sup>); ADP Employment Change, ISM Manufacturing (2<sup>nd</sup>); US Pending home sales (3<sup>rd</sup>); US Non-Farm Payrolls (4<sup>th</sup>).

**Speeches:** Bullard (31<sup>st</sup>); Duke, Fisher, Evans (2<sup>nd</sup>); Rosengren, Pianalto (3<sup>rd</sup>); Lockhart (4<sup>th</sup>).



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

- Our late 2010/early 2011 outlook for the NZD has been revised up recently, reflecting a number of factors. Nonetheless, we continue to expect the NZD will trend slightly lower over the next year.
- Contributing to the revision is our weaker view on the US dollar. The weakness in the US dollar now appears less transient than initially thought. The US economy has lost some of the momentum that it demonstrated in the early part of 2010. As a result, we have pushed out the timing of the first Fed Funds rate hike from the end of 2010 to mid-2011. US bond yields have declined to unattractive levels which will likely to weigh on investor appetite to hold US dollar dominated assets.
- The NZ dollar has held up relatively well despite the weaker run of domestic data, in part due to the US dollar weakness. However, adding to our view of a resilient NZ dollar is the likelihood that market has under-priced further RBNZ rate hikes. The 12 month OIS market has less than 40 basis points of rate hikes priced in. However, we believe the RBNZ will deliver more than 50 basis points of rate hikes over the next twelve months, and our NZD forecasts reflect that likelihood.
- Question marks are being raised about the momentum of New Zealand's economy. In contrast, the Australian economy is performing better. The likely pause in the RBNZ tightening cycle will leave the bulk of the New Zealand yield curve below the Australian yield curve for longer than previously forecast. This has led us to revise lower our NZD/AUD forecasts, with the NZD recovering against the AUD at a more gradual pace over the next year.

## Interest Rate Market

Wholesale interest rates	Current	Week ago	Month ago	6 mths ago	Year ago	ST Bias
Cash rate	3.00	3.00	3.00	2.50	2.50	FLAT
90-day bank bill	3.24	3.24	3.27	2.70	2.77	FLAT
2-year swap	3.78	3.82	4.02	4.18	4.19	FLAT
5-year swap	4.28	4.25	4.68	5.18	5.47	FLAT
5-year benchmark gov't stock	4.43	4.47	4.64	5.04	4.94	FLAT
NZSX 50	3028	3017	3037	3164	3104	FLAT

\* Current is as at 11.10 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.6 months ago).

- Domestic short-term interest rates continued to edge lower over the past week, as markets increasingly expect a pause from the RBNZ in the September meeting. These expectations were supported by the release of the RBNZ survey on Tuesday which showed an easing in 2-year ahead inflation expectations to 2.6%. Markets are now pricing just over 25% chance of an OCR increase in September.
- Australian interest rates were mixed, with markets lacking in direction given the weaker Capital Expenditure data, which contrasted with the strong Construction Work result. These data are key for the RBA in ascertaining whether the private sector is stepping in with investment activity as fiscal stimulus is withdrawn.
- US bond yields rebounded late last week, reflecting a decline in bond prices given Fed Chairman Bernanke did not indicate the Fed would increase purchases of Treasuries to support activity in the US economy at the Jackson Hole conference for central bankers over the weekend. This follows the substantial decline in bond yields in previous weeks, as markets speculated on the possibility the Fed would expand its quantitative easing programme.

### Short-term outlook:

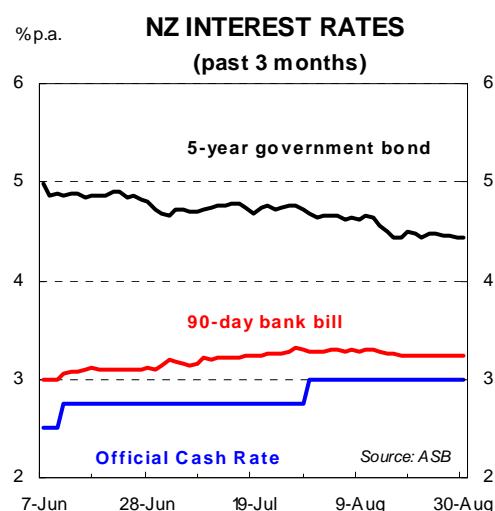
Key data	Date	Time (NZST)	Market expects
August NBNZ Business Outlook	30/8	3.00 pm	-
July RBNZ Credit Aggregates	30/8	3.00pm	-
July Building Consents	31/8	10.45am	-

**Comment:** Domestic data this week will provide further insight into how the recovery in the NZ economy is evolving. In particular, there will be much interest in whether caution remains amongst businesses over expansion plans, which will affect investment and hiring decisions. Building consents data will reveal whether the softness in private non-residential investment continues into the second half of 2010.

Offshore, US personal income and spending data will be useful in ascertaining the sustainability of the US economic recovery given the key role of the household sector for the economy.

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

- The RBNZ continued to remove monetary policy stimulus, with a second 25 basis point OCR increase in July. 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 noted the outlook for economic growth had softened since its June forecasts. In particular, it noted the outlook for trading partner growth had deteriorated, commodity prices had moderated, and net migration was slowing.
- Reflecting the weaker growth outlook, the RBNZ stated that “the pace and extent of further OCR increases is likely to be more moderate than was projected in the June Statement.” It pays to bear in mind that the RBNZ did previously have a cash rate of 5.75% implied in its 90-day forecasts. Given ongoing funding costs, we never saw a peak this high as realistic. Nonetheless, the tone of the July statement brought into focus when and if the RBNZ will pause during the hiking cycle.
- More recently, the RBNZ has indicated it has revised down its inflation projection and now forecasts headline CPI to peak at or just under 5% by mid-2011. We expect Government charges will boost headline inflation to well over 5%, and pose upside risks to the RBNZ’s key assumption that medium-term inflation expectations will remain anchored.
- Nonetheless, the patchiness of economic activity and easing in 2-year ahead inflation expectations lead us to believe the RBNZ will pause in September. Although Fonterra recently reaffirmed its forecast payout range of \$6.90-\$7.10 for the 2010/11 season, contingent on its expectations of strengthening of international dairy prices from recent sharp declines, we see downside risk to this forecast payout. We now expect the OCR will reach 4.5% next year instead of 5%.



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

Data	Date	Time (NZST)	Previous	Market expects	ASB expects
August NBNZ Business Outlook	30/8	3.00 pm	27.9	-	-
July RBNZ Credit Aggregates yoy	30/8	3.00pm	-3.3%	-	-
July Building Consents – non-residential yoy	31/8	10.45am	-26%	-	-

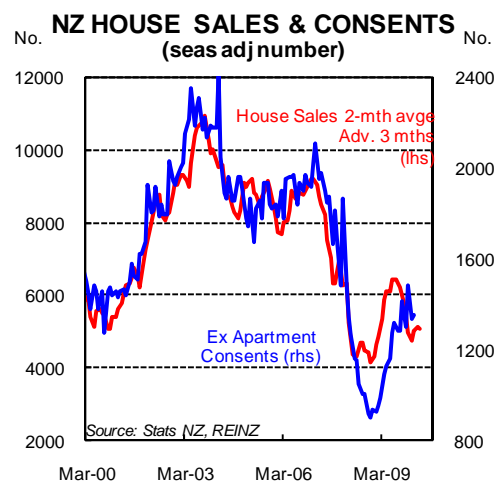
### Tuesday 31 August

#### NZ Building Consents – July

Demand for housing remains very weak, despite low shorter-term interest rates. In particular, the recent sharp slowdown in net migration and resulting slower population growth will weigh on the outlook for new construction demand.

In June core consent issuance remained extremely subdued, lifting just 1.7% following the previous month's 10% decline. We expect the low level of residential consent issuance to continue in July.

Non-residential consent issuance fell 21.2% in the June month, to bring it to a decline of 26% relative to a year earlier. Public projects are providing some offset to soft private activity. We expect continued softness in private non-residential construction in the near term. This is in line with recent business surveys, which indicate commercial construction will remain soft over the coming quarters as businesses continue to show some caution over expansion plans.



## NZ Data Review: weekly recap

### Q3 RBNZ inflation expectations

The RBNZ 2-year ahead inflation expectations measure eased slightly in the September quarter to 2.6% (2.8% previously). This measure often provides a useful indication of medium-term inflation pressures in the economy. The result should be of some comfort to the RBNZ as it suggests medium-term inflation expectations are stable for now, in spite of the boost from a host of Government charges over the second half of 2010. Indeed, RBNZ Governor Bollard's recent speech noted the RBNZ was "comfortable" with the inflation outlook, and it is likely the RBNZ received an advance reading of the inflation expectations result prior to the speech.

Unsurprisingly, 1-year ahead expectations surged to 3.9%, reflecting the host of Government charges in the coming quarters. We expect the combination of the Emissions Trading Scheme, ACC levies, tobacco excise tax and the GST increase will boost headline annual CPI to well over 5% by mid-2011. What is key for the RBNZ will be whether this high headline rate leads to changes in wage and price setting behaviour. The inflation expectations result, and the partial retracement in pricing intentions in July's business survey, suggests any flow-through effects are muted for now.

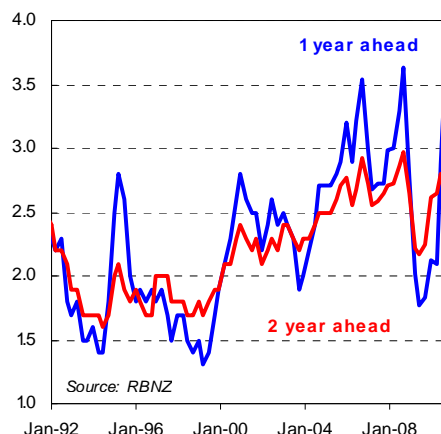
### July Trade Balance

The trade balance recorded a deficit of \$186 million in July, slightly weaker than the \$40 million deficit expected by the market due to slightly softer exports than expected. Nonetheless, export receipts remained relatively firm, with a record high level of exports receipts for a July month and up 12.4% on year-ago levels. Indeed, reflecting the strong performance of exports over the past year the annual trade balance remains in surplus.

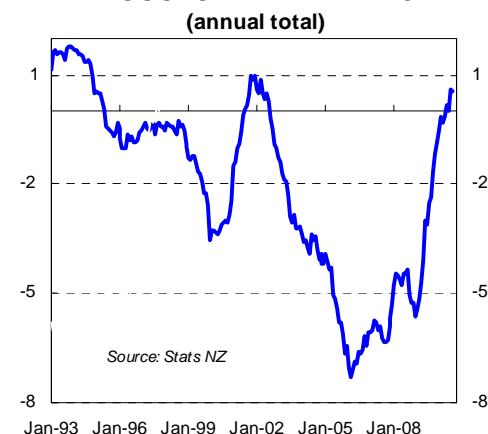
Dairy exports are up 32% on year-ago levels, mostly due to higher prices. Meanwhile, forestry exports are up 24%, led by an increase in logs and sawn or chipped pinus radiate. However, exports of meat were relatively subdued, down 8.3% on year-ago levels, due to lower frozen lamb cuts likely reflecting the very low levels of lamb slaughter.

Imports are up 12% on year-ago levels. Stats NZ noted that the trend in imports has been improving over the past 10 months, although recently it appears this trend is flattening out.

APC INFLATION EXPECTATIONS



\$b NZ GOODS TRADE BALANCE \$b



## 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
Mon 30 Aug	13.00	AU	HIA new home sales	Jul	m%ch	-5.1	~	~
	15.00	NZ	NBNZ business confidence	Aug	Index	27.9	~	~
	15.00	NZ	NBNZ activity outlook	Aug	Index	32.4	~	~
Tue 31 Aug	11.15	JP	Nomura/JMMA manufacturing PMI	Aug	Index	52.8	~	~
	11.50	JP	Industrial production	Jul	m%ch	-1.1	~	~
					y%ch	17.3	~	~
	13.50	JP	Retail trade	Jul	m%ch	0.4	~	~
					y%ch	3.3	~	~
	13.30	AU	Private sector credit	Jul	m%ch	0.2	~	0.2
					y%ch	2.8	~	2.9
	13.30	AU	Retail sales	Jul	m%ch	0.2	~	0.4
	13.30	AU	Building approvals	Jul	m%ch	-3.3	~	1.5
					y%ch	13.2	~	8.9
13.30	AU	Current account balance	QII	\$mn	-16,551	~	--5,500	
15.00	NZ	Building permits	Jul	m%ch	3.5	~	~	
16.00	JP	Vehicle production	Jul	y%ch	25.9	~	~	
17.00	JP	Housing starts	Jul	y%ch	0.6	~	~	
Wed 1 Sep	11.30	AU	Ai Group PMI	Aug	Index	54.4	~	~
	13.00	CH	PMI manufacturing	Aug	Index	51.2	~	~
	13.30	AU	GDP	QII	q%ch	0.5	~	1.1
					y%ch	2.7	~	3.0
17.00	JP	Vehicle sales	Aug	y%ch	15.0	~	~	
Thu 2 Sep	13.30	AU	Trade balance	QII	\$mn	3,539	~	4,000
Fri 3 Sep	11.30	AU	CBA Ai Group PSI	Aug	Index	46.6	~	~
	10.50	JP	Capital spending excl software	QII	%	-12.9	~	~
						-11.5	~	~
	13.00	CH	Non-manufacturing PMI	Aug	Index	60.1	~	~
	13.30	AU	Overseas arrivals and departure	Jul	~	~	~	~

## Calendar – North America & Europe

Please note all days and times are UK time, not local release day/times

Date	UK		Event	Period	Unit	Last	Forecast	
	Time	Econ					Market	CBA
Mon 30 Aug	10.00	EZ	Business CLIMATE INDICATOR	Aug	~	0.7	~	~
	10.00	EZ	Industrial confidence	Aug	Index	-4.0	~	~
	10.00	EZ	Consumer confidence	Aug	Index	-12.0	~	~
	10.00	EZ	Economic confidence	Aug	Index	101.3	~	~
	10.00	EZ	Services confidence	Aug	Index	6.0	~	~
	13.30	CA	Current account (BOP)	QII	C\$bn	7.8	~	~
	13.30	CA	Industrial product price	Jul	m%ch	-0.9	~	~
	13.30	CA	Raw materials price index	Jul	m%ch	-0.3	~	~
	13.30	US	Personal income	Jul	%	0.0	0.3	
	13.30	US	Personal spending	Jul	%	0.0	0.3	~
	13.30	US	PCE deflator	Jul	y%ch	1.4	1.4	~
	15.30	US	Dallas Fed manufacturing activity	Aug	%	-21.0	~	~
Tue 31 Aug	08.55	GE	Unemployment change	Aug	'000	-20.0	~	~
	08.55	GE	Unemployment rate	Aug	%	7.6	~	~
	09.30	UK	Net consumer credit	Jul	£bn	-0.1	~	~
	09.30	UK	Net lending sec. on dwellings	Jul	£bn	0.7	~	~
	09.30	UK	Mortgage approvals	Jul	'000	47.6	~	~
	10.00	EZ	CPI estimate	Aug	y%ch	1.7	~	~
	10.00	EZ	Unemployment rate	Jul	%	10.0	~	~
	13.30	CA	GDP	Jun	m%ch	0.1	0.2	~
	13.30	CA	Quarterly GDP annualized	QII	%	6.1	3.2	~
	14.00	US	S&P/CaseShiller home price index	Jun	Index	146.4	~	~
	14.00	US	S&P/CS 20 city	Jun	m%ch	0.5	~	~
	14.00	US	S&P/CS composite-20	Jun	y%ch	4.6	3.9	~
	14.00	US	S&P/Case-Shiller US HPI	QII	Index	131.8	~	~
					y%ch	2.0	~	~
	14.45	US	Chicago purchasing manager	Aug	Index	62.3	57.5	~
	15.00	US	Consumer confidence	Aug	Index	50.4	51.5	~
	15.00	US	NAPM-Milwaukee	Aug	Index	66.0	~	~
19.00	US	Minutes of FOMC meeting	Aug	~	~	~	~	

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