

# Business Weekly

## Large cut is the path of least regret for RBNZ

### This Week

It was another tumultuous time for markets and economics last week, with a huge number of questions ringing out across trading floors: Will the RBA move rates? Have the Chinese announced further stimulus measures? Will the BoE move to Quantitative Easing? What will the ECB do? Did Australia enter a recession? Most of these questions were answered as the week transpired, but not without leaving a battered sense of bewilderment. Central banks did their best to calm the madding crowd, with differing focus points. In expectation of a positive GDP, the RBA opted to pause – a decision that was, for a few short hours, lauded as a show of confidence. Following the first decline in Australian GDP in 8 years the next morning it was consigned to history as a premature pause, as markets moved to reprice further easing. The BoE moved by 50 points to 0.5% - the lowest in the institution's 315 year history - and announced a program to purchase commercial and UK government bonds. The ECB took rates to a record low, cutting 0.5% to 1.5%, and now is the only G7 central bank not to have officially announced some form of quantitative easing.

And now the RBNZ takes centre stage. Right now the world is an ugly place, economically speaking. As Dr Bollard said at the recent jobs summit, 'this is big'. The global economic backdrop has continued to deteriorate rapidly and the RBNZ is very much aware of it. The pace of downward revisions to Consensus forecasts of world growth are accelerating. In just 2 months, forecasts for NZ trading partner growth dropped from expecting a -0.1% contraction over 2009 to -0.9%. And these revisions probably do not capture the implications of how weak the global economy was in Q4. GDP outcomes are dramatically disappointing on the downside. Japan, Taiwan, and US GDP all declined apace. Australia is our biggest trading partner, so the contraction there is hugely important to us. As the world slowly comes to grips with the full economic impact of the credit crisis, NZ's own economic outlook is looking increasingly weak. In the here and now the economy is shaping up for some fairly sizable declines (albeit much smaller than experienced abroad). Our preliminary forecast is for Q4 GDP to contract by a full percent, followed by another full percent in Q1. NZ has been in recession for about a year now, and we do not expect to see positive GDP growth until 2010. Given the bleak outlook, we expect the RBNZ to cut the OCR by 1% this Thursday. There is a risk that the RBNZ may opt for a smaller OCR cut, with the consensus among economists split, and market pricing half way between 50 and 75 basis points. If the RBNZ does cut by less than we expect, then future OCR cuts are likely to more drawn out. We remain convinced a 2.0% cash rate is appropriate for New Zealand.

### Click here for:

#### [Foreign Exchange](#)

- NZD continues to trade around USD 0.50

#### [Interest Rates](#)

- Relatively stable week, as the market awaits the RBNZ.

#### [Week Ahead](#)

- All eyes on the RBNZ on the 12<sup>th</sup>, with opinions divided on the size of OCR cut.

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

- Crown accounts continue to reflect the slowdown.

#### [Global Calendars](#)

- US and Euro retail sales, Canadian employment report and US confidence.

### Chart of the week



- In Australia last week, the national accounts data was released, and revealed real GDP fell by 0.5% in Q4 and was still barely in positive territory in annual terms at 0.3%pa.
- It also confirmed Australia could not avoid collateral damage from the 2008 global economic implosion.
- The odds for a shallow Australian recession (i.e. two consecutive quarters of negative growth) have shortened; now the first leg (i.e. one quarter of negative growth) is in place.
- On a more positive note, there is substantial fiscal and monetary policy stimulus flowing through the local economy – with more to come – and which will underpin domestic activity in 2009.

#### 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	0.5030	0.4927	0.5140	0.6820	0.7952	FLAT	0.4950	0.5100
NZD/AUD	0.7854	0.7788	0.7880	0.8195	0.8561	DOWN	0.7700	0.8000
NZD/JPY	49.52	48.08	46.60	74.17	81.71	FLAT/UP	48.50	50.00
NZD/EUR	0.3973	0.3921	0.4010	0.4730	0.5170	FLAT	0.3900	0.4000
NZD/GBP	0.3563	0.3468	0.3536	0.3802	0.3955	FLAT	0.3525	0.3625
TWI	52.0	51.1	52.0	64.5	71.2	FLAT	51.00	53.00

Weekly support and resistance levels \* Current is as at 12pm Tuesday; week ago as at Monday 5pm

- **The NZD** continues to trade around the USD 0.50 mark, dipping below, and then bouncing back above the figure several times over the week. The focus this week is on the RBNZ, and the decision could drive FX in either direction, depending on the RBNZ's stance. However, if our 100bps call proves correct, it will put downside pressure on the NZD.
- **The JPY** has been strengthening through early 2009, but weakened over the past two weeks against many currencies, including against the NZD.
- The **NZD/AUD** is sensitive to differences in interest rates between Australia and New Zealand. This week's interest meeting by RBNZ is likely to deliver a large cut to its policy rate – the main uncertainty is the size of the cut. New Zealand's cash rate will again move below Australia's. Downward pressure on the NZD/AUD is likely to continue.
- We see upside risks to the **USD** this week. The current trend of re-rating the Japanese yen lower versus the US dollar is likely to continue this week as the Japanese current account surplus shrinks (or possibly dips into deficit). The ECB's monthly report is likely to stress continuing weakness in the eurozone. A poor US retail report is likely to provide support for the USD as a 'safe-haven' flow.

### Short-term outlook:

Key data	Date	Time (NZST)	Market expects
Q4 Terms of Trade	11/3	10.45 am	-2.0%
RBNZ Monetary Policy Statement	12/3	9.00 am	3.0%
January Retail Trade Survey	13/3	10.45 am	0.0%

**Potential currency movers from the US this week:** government budget (11th), retail sales, jobless claims (12th), consumer confidence (13th). Speakers: Bernanke (10th).

### Medium term outlook:

As a consequence of the financial market turmoil centred in the United States, USD weakness was expected in early 2009. However, weakness is being offset in part by concerns about other regions.

International credit rating agencies have lowered the long-term foreign currency credit rating outlooks down from stable to negative for New Zealand and Ireland, and downgraded Spain and Greece's credit rating. They have also provided warnings on the ratings outlook for Portugal.

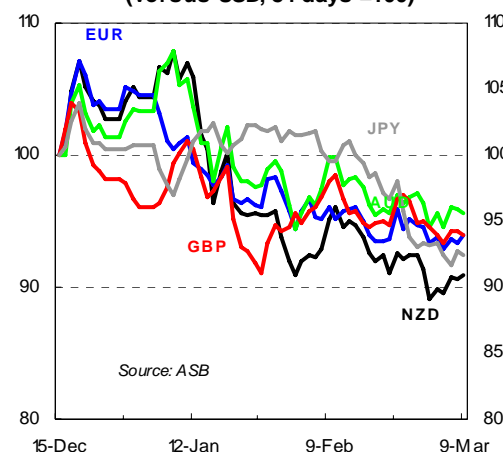
Western European banks' exposures to Central and Eastern Europe are also in the spotlight. We have revised down our forecasts for the EUR and the NZD. We have also lowered our GBP forecasts given the high risk (down) to the UK ratings outlook.

**NZD/USD and AUD/USD** will lift as the USD eventually depreciates. But both the Australian dollar and the New Zealand dollar will remain weak vis-à-vis the major cross rates while global growth remains weak. Ratings concerns add to the weight on the NZD right now.

Until we get a pick-up in the global economy (mid-2009 at best), we are unlikely to see NZD/cross rate or AUD/cross rate strength.

[\[Last Quarterly Economic Forecasts\]](#)

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



## Interest Rate Market

Wholesale interest rates	Current	Week ago	Month ago	6 mths ago	Year ago	ST Bias
Cash rate	3.50	3.50	3.50	8.00	8.25	DOWN
90-day bank bill	3.16	3.04	3.51	8.06	8.85	DOWN
2-year swap	3.29	3.29	3.43	7.28	8.40	DOWN
5-year swap	4.18	4.19	4.09	7.05	8.03	FLAT
11/11 gov't stock	3.80	3.86	3.85	6.00	6.71	FLAT
NZSX 50	2476	2482	2773	3373	3549	DOWN

\* Current is as at 12pm Monday; week ago as at Monday 5pm

- The RBA's decision to leave the cash rate unchanged last week saw the local market pull back expectations for the RBNZ's rate cut announcement this week, pulling 90 day rates up with it.
- The market is now sitting between 50 and 75 basis points for the RBNZ's decision this Thursday, compared to 80 basis points prior to the RBA announcement. We continue to expect a 100 basis point cut, given the degree of deterioration in the global economic outlook.
- Last weeks flow of Australian news drove some volatility in swap rates. The decision to hold initially caused interest rates pick up, but then the much worse than expected GDP result saw this increase unwind later in the week. Also contributing to the spike in swaps was strong demand from corporates to lock in low current low rates.

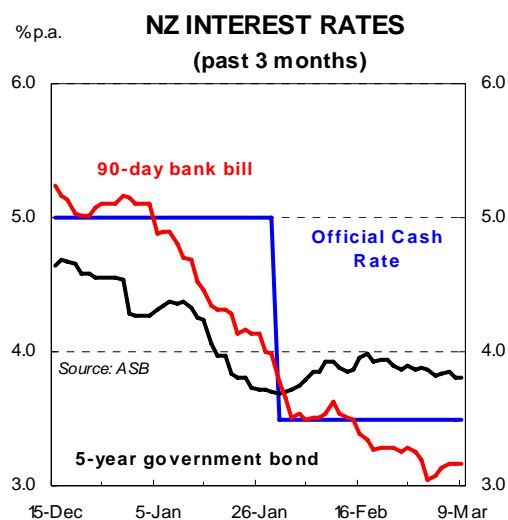
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January Retail Trade Survey	13/3	10.45 am	0.0%

**Comment:** The focus of the week will be the RBNZ OCR Announcement on Thursday. We are expecting a 100bp cut, however the consensus favours a 50bp cut and market pricing is sitting between 50bp and 75bp. The RBNZ may want to save some ammunition for cuts later on, but why wait? Terms of trade and retail sales data take the back seat and will likely be overlooked.

### Medium term outlook:

- The RBNZ cut the OCR by 150bp at the January OCR review, and has now cut 475 basis points off the OCR since commencing the easing cycle in July. The cuts have been in response to ongoing global credit market dysfunction as credit markets remain tight, as well as the resulting deterioration in the global economic outlook, significantly lowering the outlook for exports and the terms of trade.
- We expect another 100bp cut in March, and the cash rate now going to 2.0%. More important are any alternative monetary policy measures the RBNZ may adopt should the effectiveness of the OCR begin to wane. At the January OCR review, the RBNZ emphasised that monetary policy remains effective at current levels, and that there are plenty of tools in the box.
- The global economic outlook continues to deteriorate significantly. In particular the outlook for China and Australia has now also weakened substantially. New Zealand's trading partner GDP is now expected to contract by almost 1%, and we expect further downward revisions to *Consensus* forecasts of global growth. Falling commodity prices will significantly lower NZ's terms of trade and exports are expected to contract.
- The RBNZ is now has confidence that annual inflation will be comfortably inside the target band of 1 to 3 percent over the medium term.
- Considerable support will be delivered to the NZ economy over 2009, in the form of lower interest rates, a lower NZ dollar, lower petrol prices and increased fiscal spending. However, limited supply of credit internationally is likely to continue to constrain growth. We expect the NZ economy to remain in recession over 2009.



[\[Last Quarterly Economic Forecasts\]](#)

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

Data	Date	Time (NZST)	Previous	Market expects	ASB expects
February Electronic Card Transactions	10/3	10.45 am	-0.6%	-	-
Q4 Terms of Trade	11/3	10.45 am	-2.3%	-2.0%	-1.9%
RBNZ Monetary Policy Statement	12/3	9.00 am	3.5%	3.0%	2.5%
February Food Price Index	12/3	10.45 am	+0.8%	-	-
January Retail Trade Survey	13/3	10.45 am	-1.0%	0.0%	-0.1%
February REINZ House Sales	-	-	-9.4%	-	-
Q4 Economic Survey of Manufacturing	16/3	10.45 am	-2.3%	-	-

### Wednesday 11 March

#### Q4 Terms of Trade

##### ASB (f) -1.9%

New Zealand's Terms of Trade declined 2.3% over Q3. Export prices lifted a strong 8.6% aided by increasing foreign currency commodity prices (particularly meat) and the falling exchange rate. However, the increase in export prices was more than offset by a surge in import prices, up 11%. Large price increases for fuel and other intermediates (particularly fertiliser), along with the lower NZD were behind the rise.

In Q4 we expect a 1.9% decline in the Terms of Trade, with a 3% increase in export prices offset by a 5% increase in import prices. The large fall in the exchange rate over Q4 should boost export prices, although there is some offset from lower foreign currency commodity prices. Import prices are also boosted by the falling currency. While lower oil prices will provide some offset it may be too early to see prices falling amongst intermediate goods.

### Thursday 12 March

#### RBNZ OCR Announcement

##### ASB (f) 2.5%

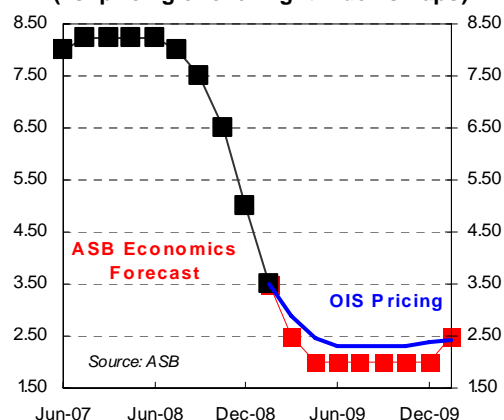
We expect the RBNZ to cut the OCR by 100 basis points at the March MPS, on the back of further deterioration in the global economic outlook. Forecasts for global growth continue to be revised down and ongoing pessimistic data point to further downside risk. At home, the economic outlook also continues to deteriorate, with NZ set for some sizable falls in GDP over the next few quarters. Compared to Australia, monetary policy is less immediately potent and fiscal stimulus more constrained, pointing to the need for lower interest rates. There is a risk that the RBNZ may opt for a smaller OCR cut, with market pricing sitting between a 50 and 75 basis point cut.

Index **NZ TERMS OF TRADE**



Mar-93 Mar-96 Mar-99 Mar-02 Mar-05 Mar-08

% p.a. **OCR FORECASTS** % p.a.  
(vs. pricing of overnight index swaps)



Jun-07 Jun-08 Dec-08 Jun-09 Dec-09

**Friday 13 March**

**January Retail Sales**

**ASB (f) -0.1% mom -3.0% yoy**

We expect total retail sales to decline by 0.1% in January, bringing sales down 3% on year-ago levels. Over the past four months the auto component has been exceptionally weak due to the combination of falling petrol prices as well as a collapse in auto sales. Petrol prices increased over January, which will partially offset further declines in auto sales. Vehicle registrations are now down 37% on year-ago levels.

Ex-auto spending fell 0.6% in December, confirming anecdotes of a very weak Christmas sales period. We expect ex-auto retail sales to remain flat over January. Going forward, consumer confidence started to slip in February as the labour market has materially deteriorated. We expect consumers will continue to watch their spending habits very closely.

**This week**

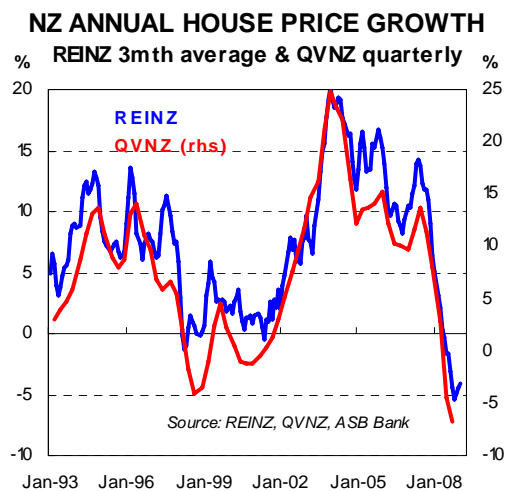
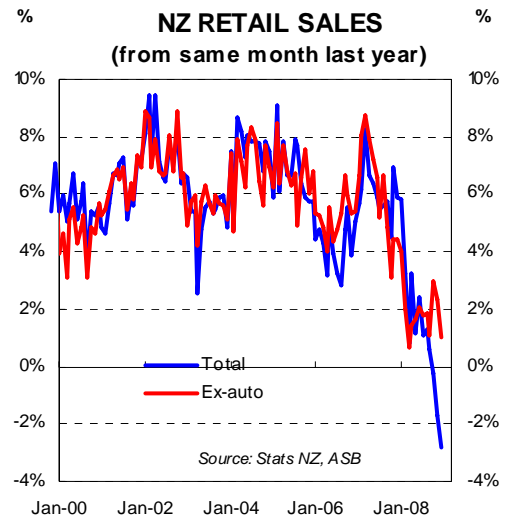
**February REINZ House Sales**

**Previous: turnover -9.4% mom -28.5% yoy**

Housing turnover has been sitting at low levels for the past six months or so, and we expect this weakness to continue into February.

Prices are declining nationwide, and we expect the rate of annual decline to continue to pick up over the coming months. Agent data shows listings are significantly up on year-ago levels, and a large overhang of unsold housing stock remains. It is a buyer's market, and we expect price declines to reflect these conditions. We are expecting REINZ data to show annual price declines in the 5-10% range.

Meanwhile, **QVNZ house prices** released today showed national annual prices declined 8.9% in the year to February. Average sale prices have declined less over the past year (2%) than the QV index. This is due to fewer low value properties selling, which leaves average (and median) sales prices higher.



## NZ Data Review: weekly recap

### January Crown Accounts

The Operating Balance excluding gains/loss (OBEGAL) for the 7 months to January 2009 was \$839mn behind the dated forecasts published in October (for the 6 months to December 2008 the balance was \$1.1 billion behind forecast). Consequently, the residual cash balance is running at a deficit of \$5,776m (\$8.26bn to Dec) and is \$1,069mn behind forecast (\$856mn to Dec). *These forecast comparisons are relative to very outdated Pre-Election Update from early October, NOT the December Update. (The Treasury is required by law to report against the latest full economic and fiscal update, and the December Update was only partial)*

Core Crown revenues are running \$858mn behind forecast (\$1,185mn behind to Dec). Net core crown debt ex-Super Fund, at \$1.74bn, was again actually lower than forecast despite the higher cash deficit. A temporary increase in money in circulation has partly unwound but is still \$426mn higher than forecast. Valuations to DMO and RBNZ assets/liabilities reduced net debt by \$2.3bn.

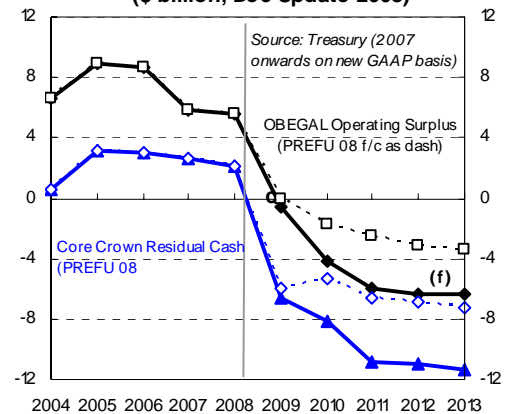
The fiscal position continues to track below the very dated Pre-Election forecasts, which should be no surprise. Again the to-date variance between actual and the October forecasts is slightly larger than the variance between the full-year October PREFU and December Update forecasts. The to-date variance for the operating balance has changed little, though the residual cash balance variance is slightly higher. From month to month there will be timing issues, so there seems little significant change in these latest figures.

### Q4 Value of Building Work Put in Place

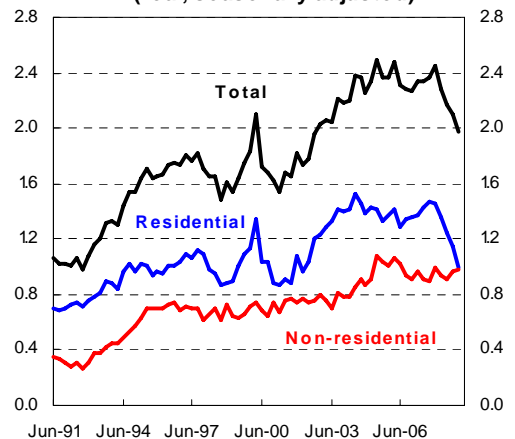
The decline in residential construction continues to accelerate, falling 13.4% over Q4 (the 5<sup>th</sup> consecutive quarter of decline) and now down 31.4% on year-ago levels. Given the massive 24% decline in core dwelling consent issuance over the preceding quarter, we were expecting a very large fall. Continued declines in dwelling consent issuance over Q4 points to further falls in construction activity over the first quarter of 2009.

Non-residential construction increased 1.6% over Q4, better than we had expected. Following on from the previous quarters 5.2% increase, the non-residential construction sector has fared comparatively well. Non-residential consent issuance has also remained robust, although given the swift change in the economic climate since October 2008 we expect that some of these consented projects may not proceed.

**NZ KEY FISCAL BALANCES**  
(\$ billion, Dec Update 2008)



**NZ BUILDING PUT IN PLACE**  
(real, seasonally adjusted)



## 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	
	AEST						Market	ASB/CBA
Mon 9 Mar	12.50	JP	Current account total	Jan	¥bn	125.4	~	~
	18.00	JP	Eco watchers survey: outlook	Feb	Index	22.1	~	~
Tue 10 Mar	13.30	AU	NAB business confidence	Feb	Index	-32.0	~	~
	13.30	AU	ANZ job ads	Feb	m%ch	-6.3	~	~
	15.00	CH	Producer price index	Feb	y%ch	-3.3	~	~
	15.00	CH	CPI	Feb	y%ch	1.0	~	~
	18.00	JP	Leading index CI	Jan	Index	80.0	~	~
	18.00	JP	Coincident index CI	Jan	Index	92.4	~	~
	19.00	JP	Machine tool orders	Feb	y%ch	-84.1	~	~
Wed 11 Mar	~	CH	Trade balance	Feb	USD bn	39.1	~	~
	10.45	NZ	Terms of trade index	QIV	q%ch	-2.3	~	-1.9
	12.50	JP	Machine orders	Jan	m%ch	-1.7	~	~
					y%ch	-26.8	~	~
	12.50	JP	Domestic CGPI	Jan	m%ch	-1.0	~	~
					y%ch	-0.2	~	~
Thu 12 Mar	13.00	AU	MI/WBC consumer sentiment	Mar	Index	85.8	~	~
	13.30	AU	Housing Finance (Own-Occ)	Jan	m%ch	6.4	~	6.0
	9.00	NZ	RBNZ official cash rate	Mar	%	3.5	2.75	2.5
	10.30	NZ	Business PMI	Feb	Index	42.0	~	~
	10.45	NZ	Food prices	Feb	m%ch	0.8	~	~
Fri 13 Mar	12.50	JP	Nominal GDP	QIV	q%ch	-1.7	~	~
	12.50	JP	GDP deflator	QIV	q%ch	-1.6	~	~
	13.00	AU	MI/WBC cons. inflation exp.	Mar	%	2.3	~	~
	13.00	AU	MI/WBC unemployment exp.	Mar	Index	83.1	~	~
	13.30	AU	Employment change	Jan	'000	1.2	~	-10.0
	13.30	AU	Unemployment rate	Jan	%	4.8	~	4.9
	13.30	AU	Participation rate	Jan	%	65.1	~	65.0
	15.00	CH	Retail sales	Feb	y%ch	~	~	~
	15.00	CH	Industrial production	Feb	y%ch	~	~	~
	10.45	NZ	Retail sales	Jan	m%ch	-1.0	~	-0.1
Fri 13 Mar	17.30	JP	Industrial production	Jan	m%ch	-10.0	~	~
					y%ch	-30.8	~	~
	17.30	JP	Capacity utilisation	Jan	m%ch	-11.8	~	~
	18.00	JP	Consumer confidence	Feb	~	27.0	~	~
Sat 14 Mar	11.30	AU	Liberal party meeting					

## 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 9 Mar	09.30	EZ	Sentix investor confidence	Mar	~	-36.1	~	~
	12.15	CA	Housing starts	Feb	'000	153.5	147.0	~
Tue 10 Mar	00.01	UK	RICS house price balance	Feb	%	-76.0	~	~
	07.00	GE	CPI	Feb	m%ch	-0.5	~	~
					y%ch	0.9	~	~
	07.00	GE	Trade balance	Jan	€bn	6.9	~	~
	07.00	GE	Current account	Jan	€bn	12.3	~	~
	07.00	GE	CPI – EU harmonised	Feb	m%ch	0.7	~	~
					y%ch	1.0	~	~
	09.30	UK	Industrial production	Jan	m%ch	-1.7	~	~
					y%ch	-9.4	~	~
	10.00	EZ	PPI	Jan	m%ch	1.8	0.7	~
y%ch					-1.3	-0.1	~	
14.00	US	Wholesale inventories	Jan	%	-1.4	-1.0	~	
								IBD/TIPP economic optimism
Wed 11 Mar	00.01	UK	NIESR GDP estimate	Feb	%	-1.7	~	~
	09.30	UK	Trade balance (total)	Jan	£mn	3,611	~	~
	11.00	GE	Factory orders	Jan	m%ch	-6.9	~	~
					y%ch	-25.1	~	~
12.30	CA	New housing price index	Jan	m%ch	-0.1	-0.3	~	
Thu 12 Mar	10.00	EZ	Industrial production	Jan	m%ch	-2.6	~	~
					y%ch	-12.0	~	~
	11.00	GE	Industrial production	Jan	m%ch	-4.6	~	~
					y%ch	-12.0	~	~
	12.30	US	Retail sales	Feb	%	1.0	-0.4	~
14.00	US	Business inventories	Jan	%	-1.3	-1.1	~	
Fri 13 Mar	10.00	EZ	Labour costs	QIV	y%ch	4.0	~	~
	10.00	EZ	Retail sales	Jan	m%ch	0.0	0.2	~
					y%ch	-1.6	-1.9	~
	11.00	CA	Unemployment rate	Feb	%	7.2	~	~
	11.00	CA	Net change in employment	Feb	'000	-129.0	~	~
	12.30	CA	Int'l merchandise trade	Jan	C\$bn	-0.5	~	~
	12.30	US	Trade balance	Jan	\$bn	-39.9	38.2	~
	12.30	US	Import price index	Feb	m%ch	-1.1	-0.8	~
y%ch					-12.5	~	~	
14.00	US	Uni of Michigan confidence	Mar	~	56.3	56.3	~	

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