

# Business Weekly

## Easing back on the throttle

### This Week

The Reserve Bank delivered at the modest end of expectations with its 50bp cut, but also gave a very clear signal that it is not prepared to cut the OCR much further. The RBNZ judges it has made sufficient allowance in its forecast to cover the 'bad news' headlines likely to appear domestically and elsewhere, hence is sharply reining in the pace of OCR cuts.

The RBNZ is expecting that the economy will start rebounding very sharply from the middle of this year. It anticipates private sector demand will stop contracting at that point in time, with strong fiscal expansion driving healthy growth rates in the second half of the year. For the March 2011 year the RBNZ forecasts growth of 4.8%, a marked pick up (though the RBNZ points out past rebounds out of recession have been sharp).

In the short term at least the RBNZ will be taking a softly-softly approach to cutting interest rates from now on, cutting by 25bp each meeting. But the risks are very much one way. The RBNZ is forecasting a much earlier end to the recession and a very rosy rebound than most other forecasters are. It would be – under the current global circumstances – a fantastic outcome for NZ. However, we think there is a lot of hope in the RBNZ's forecasts. We expect the RBNZ's growth outlook will again get revised down over coming months.

Here is the conundrum for our rate outlook. The RBNZ is more resolute on its rate stance, judging it has now done almost enough in response to the global and local economic outlook it anticipates. The OCR is also at a very low level, and getting too much lower risks losing effectiveness. Against these is the continued likelihood the domestic economy is weaker than RBNZ anticipates. Given the low level of the OCR and the apparent reluctance to put it down much further, an eventual trough of 2.5% is what we now lean to. But in our view there is still a strong risk that the OCR goes lower than that: the RBNZ's reluctance to cut much further is likely to be put to the test over time.

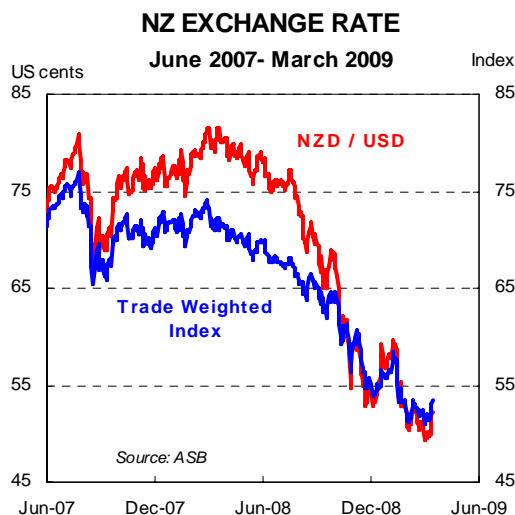
Highlighting the risk bias, Q4 manufacturing sales figures out this morning were weak, suggesting that the slowing of the economy at the end of last year was even more marked than anticipated. We have revised down our Q4 GDP forecast to -1.1% qoq (RBNZ -0.8%).

All is quiet domestically, with just migration and visitor figures left on Friday. Things to watch for will be encouraging signs that the migration net inflow is picking up.

### Click here for:

- [Foreign Exchange](#) • NZD lifts as global risk appetites improve and RBNZ surprises.
- [Interest Rates](#) • Rates rise after RBNZ cuts 50bp and signals it is nearly done.
- [Week Ahead](#) • Quiet local data week with tourism and migration data due.
- [Week in Review](#) • RBNZ, Retail Trade, Overseas Trade Indices, Building Work and Manufacturing.
- [Global Calendars](#) • FOMC and BoJ have rate announcements this week.

### Chart of the week



- RBNZ Governor, Alan Bollard, revealed to the New Zealand Parliamentary Finance and Expenditure Select Committee on 4 March, the RBNZ were in the process of reducing the RBNZ's foreign exchange position from \$5 billion down to a benchmark rate of \$1 billion.
- Bollard also went onto say that the RBNZ aimed to intervene both at the top and bottom of the cycle to try and stabilise the exchange rate.
- The Reserve Bank first confirmed it has intervened in the foreign exchange market to sell New Zealand dollars on 11 June 2007. The TWI was around 73 at the time.
- Today the TWI is around 53 and has dropped nearly 30% on the levels in mid-2007 when the intervention to sell the NZD began.

### 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	0.5218	0.5022	0.5238	0.6685	0.8151	UP	0.5180	0.5300
NZD/AUD	0.7985	0.7848	0.7956	0.8142	0.8637	FLAT	0.7850	0.8000
NZD/JPY	51.05	49.25	47.67	70.87	81.95	UP	50.00	52.00
NZD/EUR	0.4055	0.3960	0.4049	0.4649	0.5226	FLAT/UP	0.3950	0.4150
NZD/GBP	0.3748	0.3554	0.3641	0.3712	0.4016	FLAT/UP	0.3650	0.3850
TWI	53.4	51.9	52.8	63.2	72.2	UP	52.00	54.00

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

- Financial markets are by and large ignoring the bad news about the global economy as it is already expected. Recently, global stock markets have pushed higher and the NZD and AUD have lifted against the USD. Markets are now starting to price currencies on the basis of relative economic performance.
- The minutes from Reserve Bank of Australia's (RBA) previous interest rate meeting (released Tuesday) are likely to be less downbeat about the risks to the Australian economy and highlight their relatively better position, which should continue to support the AUD. NZD/AUD jumped almost 3 NZ cents last week after the RBNZ cut the official cash rate by 0.50% compared to expectations for a larger cut. We think in time the prospect of further rate cuts in New Zealand will tilt the balance of risks to a lower NZD against the AUD in the coming months.
- There is a small risk the Federal Reserve may this week follow the Bank of England by committing to buy government bonds to lower yields and support the economy. We do not think US bond yields have increased to a level that is likely to prompt Fed action so the Fed's meeting may be a non-event. The current trend of re-rating the Japanese yen lower versus the US dollar is likely to continue this week as the BoJ highlights the weakness in its economy at the Monetary Policy Meetings this week.

### Short-term outlook:

Key data	Date	Time (NZST)	Market expects
RBA meeting minutes	17/3	13.30	-
FOMC Rate Decision	19/3	7.15	0%

**Potential currency movers from the US this week:** industrial production (16th), producer prices, housing starts & permits (17th), Federal Reserve's interest rate meeting, CPI, current account (18th), jobless claims (19th). Speakers: Bernanke (20th).

### 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.

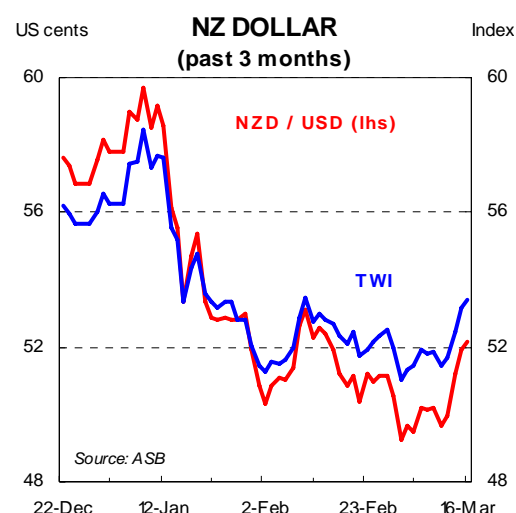
International credit rating agencies have lowered the long-term foreign currency credit rating outlooks down from stable to negative for New Zealand and Ireland, and downgraded Spain and Greece's credit rating. They have also provided warnings on the ratings outlook for Portugal.

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.

RBNZ Governor, Allan Bollard, revealed to the New Zealand Parliamentary Finance and Expenditure Select Committee on 4 March, the RBNZ were in the process of reducing the RBNZ's foreign exchange reserves from \$5 billion down to a benchmark rate of \$1 billion. Bollard also went onto say that the RBNZ aimed to intervene both at the top and bottom of the cycle to try and stabilise the exchange rate.

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.



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

## Interest Rate Market

Wholesale interest rates	Current	Week ago	Month ago	6 mths ago	Year ago	ST Bias
Cash rate	3.00	3.50	3.50	7.50	8.25	FLAT
90-day bank bill	3.24	3.15	3.49	7.74	8.88	FLAT
2-year swap	3.50	3.22	3.35	6.87	8.39	UP
5-year swap	4.47	4.13	4.04	6.80	8.06	UP
11/11 gov't stock	3.94	3.73	3.87	5.67	6.71	UP
NZSX 50	2561	2476	2751	3320	3508	UP

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

- The RBNZ's 50bp OCR cut disappointed the market, which had 68bp priced in leading up to the announcement. The 90-day rate gained almost 30bp points in its initial reaction, but settled back to be 20bp up by Friday.
- We are expecting the next move by the RBNZ will be a 25bp cut in April (followed by another 25bp cut in June). The market currently has a 25bp cut fully priced in.
- Swap rates continue to steadily increase over Friday and this morning, in addition to the initial reaction. The RBNZ sent a strong signal that it is very close to the end of the easing cycle which has promptly increased demand to fix mortgages at current low levels. This demand is placing a lot of pressure on the curve, particularly at the 2-5 year range. Swap rates are likely to continue to grind higher in response to demand to fix.

### Short-term outlook:

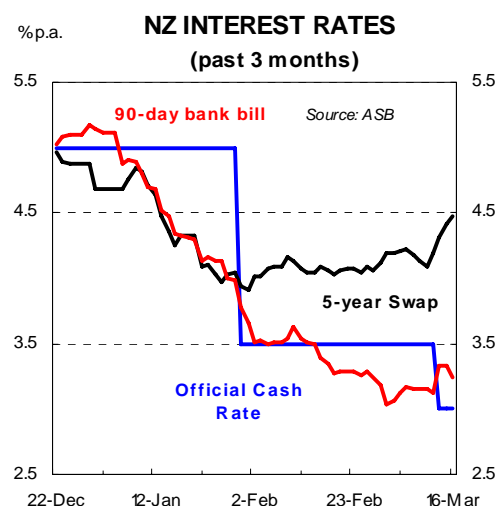
Key data	Date	Time (NZST)	Market expects
RBA meeting minutes	17/3	13.30	-
FOMC Rate Decision	19/3	7.15	0%
Feb Net Migration	20/3	10.45	-

**Comment:** Quiet week ahead. The RBA minutes will be interesting, given that the day after the RBA declined to cut rates further Q4 GDP registered a surprise decline. The risk of a 50bp cut by the RBA in April will increase the market's expectation for a 50bp by the RBNZ. In the US interest rates are now zero bound, so focus is on the monthly statements. We are waiting for the Fed to announce it will make outright purchases of longer-term Treasuries. Locally net migration data is unlikely to have any influence on the market.

### Medium term outlook:

- The RBNZ cut the OCR by 'only' 50 basis points at the March OCR review and Monetary Policy statement. The RBNZ has now cut 525 basis points off the OCR since July. The RBNZ sent a strong signal that it is slowing down the pace of rate cuts and is very reluctant to cut the OCR below 2.5%.
- In our view, the RBNZ's medium-term growth forecasts remain very optimistic, with the economy exiting the recession by mid-2009 (we think early 2010 more likely). However, the RBNZ acknowledged the risk that the recovery may occur later and be more protracted than it anticipates.
- The RBNZ appears to have put a lot of weight on monetary and fiscal stimulus. The RBNZ are hoping for tax cuts, lower interest rates and the lower exchange rate to support the economy throughout the latter part of 2009. In particular the RBNZ has a comparatively shallow downturn in business investment and a very strong recovery in export volumes (particularly given the extent weakness in trading partner demand).
- The RBNZ's forecasts suggest a 2.5% OCR trough and two 25bp cuts over the April and June meetings seems the more likely path the RBNZ will take. Continuing to cut but only moderately buys the RBNZ some time whilst it assesses whether the bad news in coming months is no worse than expected or looking comparatively grimmer. As we think the RBNZ will have to revise down future growth forecasts there remains a possibility of the cash rate still going to 2%.
- Key signals to watch over coming months will remain the world outlook in general relative to RBNZ expectations, more specifically the state of the US housing market, and domestic private sector demand.
- The RBNZ has made it pretty clear it is not currently entertaining the use of alternatives policy measure (such as Quantitative Easing undertaken by other central banks) and has also discounted the likelihood of NZ rates dropping near zero. The RBNZ is expecting extended weakness in the NZ dollar to do much of the work for the Bank.

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



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

Data	Date	Time (NZST)	Previous	Market expects	ASB expects
Feb International Travel and Migration	20/3	10.45	4,538 pa	-	-

### Friday 20 March

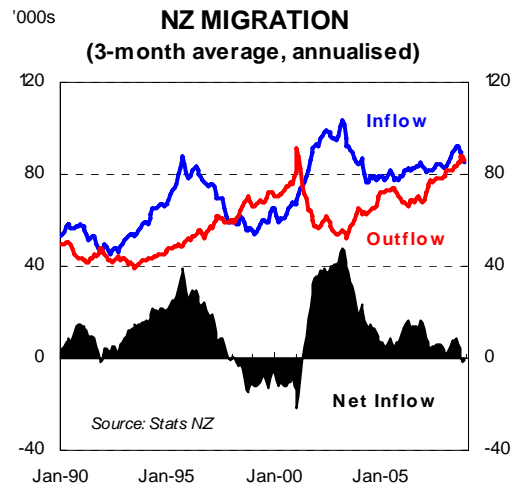
#### February International Travel and Migration

**Previous: 4,538 annual net migration.**

Over late 2008 net migration slowed slightly, as the number of departures remains strong (particularly to Australia) and the number of arrivals has slowed.

With the world economy rapidly deteriorating over the second half of this year, we expect this trend to start to reverse. Net migration picked up 5% in January from December. The very weak labour market in the UK may deter departures, and possibly even send expats back to NZ. Likewise, slowing job growth in Australia will start to curb the net outflow across the Tasman. A boost to net migration will provide some underlying support to NZ's flagging housing construction sector.

Overseas short-term visitor arrivals are also expected to slow over the next year, as weakening world growth reduces demand for international travel.



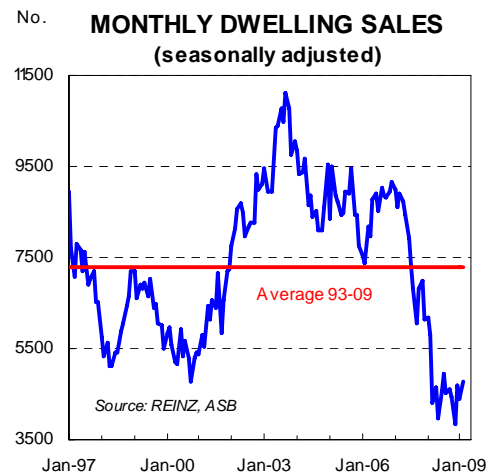
## NZ Data Review: weekly recap

### February REINZ House Sales

REINZ national house sales picked up 40% over February, reflecting the usual bounce post holiday period. Adjusting for this seasonal pick up, house sales recovered 8.3% (following from the previous month's 6.8% fall) but remain 18% below year-ago levels. We place little weight on this month's recovery, the trend in house sales remains flat (despite some monthly volatility) with housing demand yet to make a convincing recovery.

The median number of days to sell increased strongly, up to 55 days (seasonally adjusted), suggesting there remains a large mismatch between demand and supply. The housing market remains oversupplied and we expect this to continue to push house prices lower.

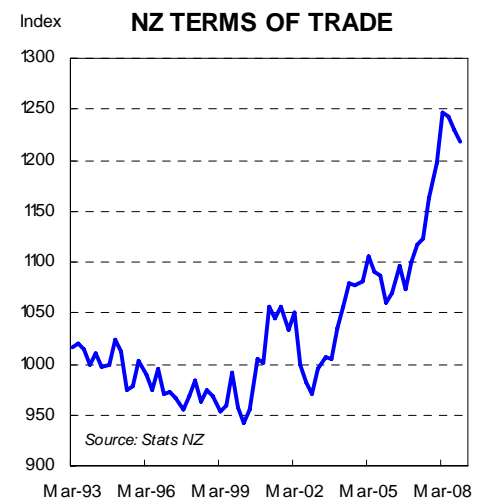
REINZ median house price remains fairly steady at \$330,000, down only 2.2% on year-ago levels.



### Q4 Terms of Trade

The terms of trade declined 0.9%, with the 3.4% rise in import prices outpacing the 2.4% increase in export prices. The increase in export prices was fairly broad based and Statistics NZ noted that the depreciation in the exchange rate was the main driver of the overall rise in export prices (the trade weighted currency index fell 11.8% over Q4). Import prices increased 3.4%, again with the depreciation in the NZD having a significant contribution. This increase was partially offset by a 22.4% decline in prices for petroleum products, as oil prices plummeted during Q4.

Export volumes fell for the 4<sup>th</sup> consecutive quarter, and are now 11% lower than the peak reached in December 2007. Given the deteriorating outlook for our major trading partners, we expect the decline in export volumes to continue in 2009. Import volumes fell 4.8% over Q4. The passenger motor cars index and capital goods index were the main contributors to the fall.



### RBNZ OCR Review and Monetary Policy Statement

The RBNZ cut the OCR by 50 basis points, bringing the cash rate to 3.0%. The 50bp cut was less than the 100bp we expected and less than the 68bp the market had priced in. However, more of a surprise to markets was the change in tone. The RBNZ is now sending a strong signal that it is slowing down the pace of cuts, and is reasonably reluctant to cut by too much more. The RBNZ also sees NZ's interest rates remaining relatively high in an environment of constrained credit globally and the lower NZD is helping to do the work for them.

In our view, the RBNZ's growth forecasts are far too optimistic. Based on their current assessment of the economy we would anticipate two 25 basis point cuts in April and June, with the cash rate finishing at 2.5%. However, as we think the RBNZ will have to revise down future growth forecasts there remains a possibility of the cash rate still going to 2%.

### January Retail Sales

Retail sales fell 1.1% due to another large fall in motor vehicle retailing (down 11%) as well as further declines in fuel retailing (-2.6%) likely due to declines in diesel prices over January.

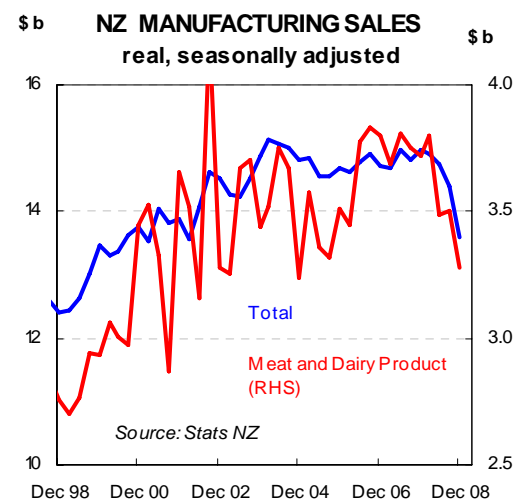
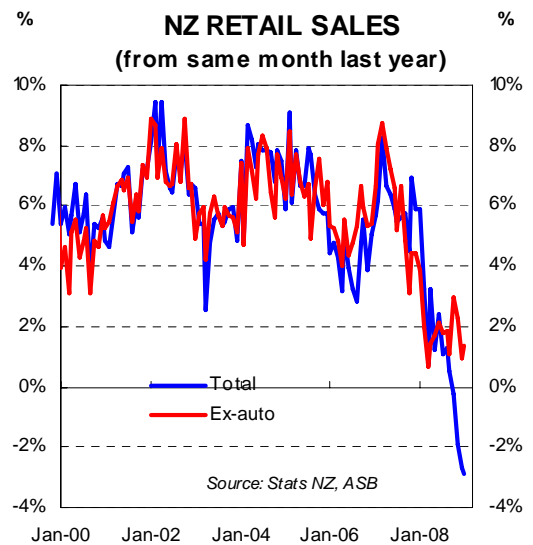
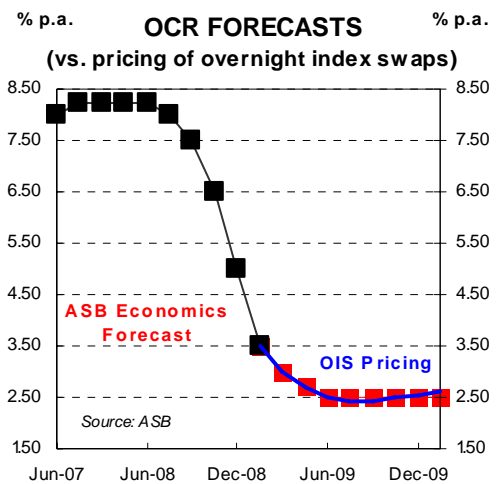
Excluding the auto component, retail trade picked up 0.3%, coming off the previous month's -0.7% decline. Much of this strength appears to have come from supermarket sales. Food price inflation likely accounts for a significant component of the strength in supermarket sales. Grocery prices were up 0.4% in January, and are up 10% in the year to January.

In contrast to the pick up in supermarket sales, large declines were noticeable across a range of other sectors, including department stores, furniture retailing and hardware retailing. The trend in retail spending is fairly flat, and once taking account of rising prices (particularly with the price pressure coming from the Q4 New Zealand dollar depreciation), volumes are likely to be contracting.

### Q4 Economic Survey of Manufacturing

Q4 Manufacturing sales volumes were very weak, declining 5.6% (the largest quarterly decline recorded since the series begun in 1994). The decline in sales volumes was reasonably broad based across manufacturing industries. The largest contributions to the fall came from meat and dairy (-6%) and petroleum and industrial chemical manufacturing (-30%), basic metal manufacturing (-28%) and transport equipment (-18%). The fall in volumes was offset by an increase in prices for dairy, fertilizers, chemicals and transport equipment, holding overall dollar value of sales flat.

The fall in sales occurred against the backdrop of the global financial crisis and a sudden deterioration in credit markets which saw international trade flows severely disrupted. As a result it's not too surprising to see a large drop in manufacturing sales. However, given the sudden drop in demand which occurred, we had expected to see a pick up in inventory levels. However, our estimates suggest that stocks fell on a seasonally adjusted basis. This implies that production was also very weak. The Economic Survey of Manufacturing is not a very reliable indicator of the manufacturing production component of GDP. Nonetheless the dismal result does suggest some downside risk to our preliminary Q4 GDP forecast, and as a result we are now expecting Q4 GDP to contract by 1.1%.



## 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
Tue 17 Mar	12.50	JP	Tertiary industry index	Jan	m%ch	-1.6	~	~
	13.30	AU	RBA Board's minutes for March					
	19.00	JP	Machine tool orders	Feb	y%ch	-83.9	~	~
Wed 18 Mar	~	JP	BoJ target rate	March	%	0.1	0.1	0.1
	12.30	AU	Westpac leading index	Jan	m%ch	-0.4	~	~
	18.00	JP	Leading index CI	Jan	Index	77.1	~	~
	18.00	JP	Coincident index CI	Jan	Index	89.6	~	~
	18.00	JP	BoJ monthly report	Mar	~	~	~	~
Thu 19 Mar	09.15	AU	RBA Assistant Governor Edey gives speech in Sydney					
	12.50	JP	All industry activity index	Jan	m%ch	-2.7	-2.3	~
	13.30	AU	RBA Bulletin	Mar	~	~	~	~
	13.30	AU	New motor vehicle sales	Feb	m%ch	-1.1	~	~
					y%ch	-16.9	~	~
	13.30	AU	Dwelling commencements	QIV	q%ch	-10.7	~	-15.0
	13.30	AU	Int'l merchandise imports	Feb	m%ch	-8.0	~	
13.30	AU	Labour force	QIV	~	~	~	~	
Fri 20 Mar	10.45	NZ	Visitor arrivals	Feb	%	-3.0	~	~
	15.00	NZ	Credit card spending	Feb	y%ch	-2.2	~	~

## 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 16 Mar	10.00	EZ	CPI	Feb	m%ch	-0.8	0.4	~
	10.00	EZ	Employment	QIV	q%ch	-0.1	~	~
	12.30	US	Empire manufacturing	Mar	Index	-34.7	-33.0	~
	13.00	US	Net long-term TIC flows	Jan	\$bn	34.8	~	~
	13.15	US	Industrial production	Feb	%	-1.8	-1.3	~
	13.15	US	Capacity utilisation	Feb	%	72.0	71.0	~
	17.00	US	NAHB housing market index	Mar	Index	9.0	9.0	~
Tue 17 Mar	10.00	EZ	ZEW survey (econ sentiment)	Mar	Index	-8.7	~	~
	10.00	GE	ZEW survey (econ sentiment)	Mar	Index	-5.8	~	~
	10.00	GE	ZEW survey (current)	Mar	Index	-86.2	~	~
	12.30	US	Producer price index	Feb	m%ch	0.8	0.3	~
	12.30	US	Housing starts	Feb	'000	466.0	453.0	~
	12.30	US	Building permits	Feb	'000	531.0	505.0	~
Wed 18 Mar	09.30	UK	Bank of England minutes	~	~	~	~	~
	09.30	UK	ILO unemployment rate	Jan	%	6.3	6.5	~
	12.30	CA	Wholesale sales	Jan	m%ch	-3.4	~	~
	12.30	US	CPI	Feb	m%ch	0.3	0.3	~
					y%ch	0.0	0.0	~
	12.30	US	Current account balance	QIV	\$bn	~	137.4	~
12.30	US	FOMC rate decision	Mar	%	0.25	0.25	0.25	
Thu 19 Mar	09.30	UK	Public sector net borrowing	Feb	£bn	-3.3	7.5	~
	10.00	EZ	Industrial production	Jan	m%ch	-2.6	-1.5	~
	11.00	CA	CPI	Feb	m%ch	-0.3	~	~
	11.00	UK	CBI March industrial trends	~	~	~	~	~
	12.30	US	Initial jobless and continuing claims					
	14.00	US	Philadelphia Fed	Mar	Index	-40.0	-41.3	~
Fri 20 Mar	10.00	EZ	Trade balance	Jan	€bn	-0.3	~	~
	12.30	CA	Retail sales	Jan	m%ch	-5.4	~	~
	12.30	CA	Retail sales less autos	Jan	m%ch	-3.2	~	~

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