ECONOMICS

Business Weekly

Remembering inflation

This Week

This week we focus on a fairly important economic variable that doesn't get commented on much in these turbulent times: inflation. Friday sees the release of the Q1 CPI, which we expect will register a 0.4% quarterly increase and a 3.1% annual inflation rate.

Inflation is just as relevant in downturns as in the boom times. Inflation trends give a gauge on whether demand in the economy has been running high or low relative to the economy's capacity to produce. Much of the focus falls on rising or high inflation. However, low inflation – or at least the expectation thereof – is a strong signal that the economy is running below its potential and needs boosting. Preventing deflation is just as critical as containing inflation – arguably more so as entrenched deflation is hard to get rid of. For that reason the inflation target has a floor as well, to spur the RBNZ to maintain a positive rate of inflation through easing monetary conditions to stimulate the economy.

Deflation is more of a risk for badly affected countries such as the US, UK and Ireland, and has afflicted Japan off and on for a number of years. It is far less of a risk for NZ, though we expect the RBNZ will be more focused in coming months of the risk that inflation falls too far for comfort.

In 2009 inflation will briefly dip to around 1%, the legacy of reversing last year's petrol price spike. Over the next couple of years inflation is likely to sit in the bottom half of the 1% - 3% inflation target band. Watching non-tradable inflation will be the main gauge of how quickly the economic slowdown is impacting on inflation pressures. Resource constraints are slipping away at a dramatic pace, highlighting that the sustained contraction in the economy will filter through to inflation over time.

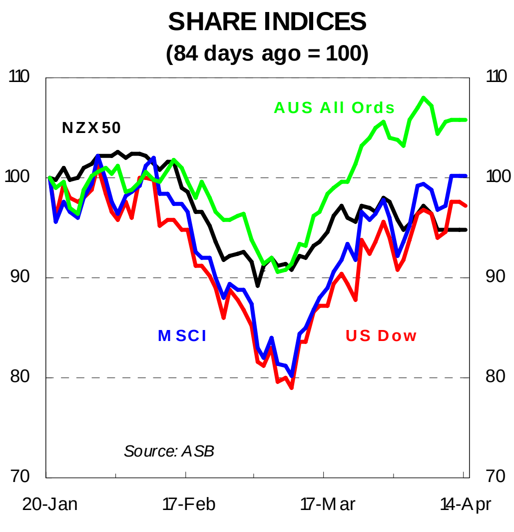
The message from last week's Quarterly Survey of Business Opinion reinforced the likelihood that the economy will be weaker over 2009 than the RBNZ has been expecting, with businesses intending to cut back on investment expenditure and employment to a greater extent than reported in late 2008.

The RBNZ's sharp economic recovery is predicated on monetary conditions being substantially looser than they are currently. Financial market developments and the QSBO results suggest to us the RBNZ should cut the OCR by 50bp on April 30, and we have also reverted to our previous expectation that a 2% end-point for the OCR is likely.

Click here for:

Foreign Exchange	• NZD up on the USD, JPY and Euro. Down a touch against AUD.
Interest Rates	• A relatively steady week, with rates down slightly.
Week Ahead	• Consumer Price Index the highlight. Monday's retail sales near expectations.
Week in Review	• NZIER business sentiment remains weak, and consistent with recession in 2009.
Global Calendars	• CPI readings and industrial production data due in US and Eurozone.

Chart of the week



- Global sharemarket sentiment was poor in early March. There were few signs of improvement in the global economy, investor sentiment remained negative and global share-markets continued to fall. The Dow Jones lost over 7% in the first six trading days.
- But on March 10 Citigroup surprised the market by indicating that it had made a profit in the first two months of the year. Other banks followed with similar comments and investors embraced the positive news.
- On March 23 the US Dow Jones soared almost 7% on the day after the US Government outlined its plan to buy "toxic" assets. There was a bout of profit-taking in late March and sharemarkets lost ground when the US Government rejected restructuring plans by auto-makers.
- Sharemarket gains continued in early April, but the US earnings season is upon us, and the latest quarterly reports will give a quantitative reality check.

Foreign Exchange Market

FX Rates	Current*	Week ago	Month ago	6 mth's ago	Year ago	ST Bias	Support^	Resistance^
NZD/USD	0.5920	0.5816	0.5194	0.6219	0.7871	FLATDOWN	0.5800	0.6050
NZD/AUD	0.8090	0.8158	0.7937	0.8781	0.8541	FLAT/DOWN	0.8000	0.8400
NZD/JPY	59.26	58.56	50.72	63.63	79.45	FLAT	57.00	61.00
NZD/EUR	0.4430	0.4351	0.4018	0.4546	0.5010	FLAT/DOWN	0.4350	0.4500
NZD/GBP	0.3987	0.3961	0.3731	0.3546	0.3992	FLAT/DOWN	0.3900	0.4050
TWI	58.5	57.9	53.1	61.1	70.1	FLAT/DOWN	57.00	60.00

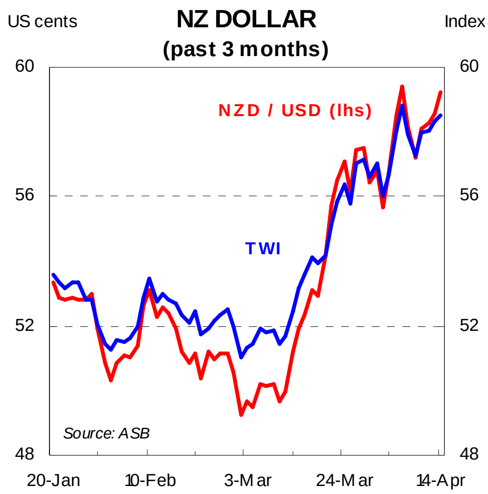
Weekly support and resistance levels * Current is as at 12pm Tuesday; week ago as at Monday 5pm

- The NZD pattern of the preceding week continued, as the local currency lifted against the USD, Euro and JPY again. The NZD was little changed over the week against the GBP, and down slightly on the AUD.
- The increased optimism about the world economy has pushed the USD lower, except against the JPY. The currency market appears to be ignoring the poor US economic data when it is released and instead focusing on the improving economic data coming from China. But this week's US earnings reports from non-financial companies is likely to provide a reality check for markets. Negative news on US corperates would hurt the recent apetite for risk, and bost the countercyclical USD.
- NZD has been up to its highest levels since Dec 08, trading near US $0.60. However, the kiwi is running into strong headwinds again at these levels, with lots of previous rally tops and the 200 Day moving Average just above US $0.60 providing a technical barrier for the currency. We think the overall bias is downward over the next week for the NZD.

Short-term outlook:

Key data	Date	Time (NZST)	Market expects
Q1 CPI	17/4	10.45 am	+0.3%
Fed's Beige Book	16/4	6.00 am	-

Potential currency movers from the US this week: retail sales, producer prices, business inventories (14th), CPI, industrial production, Beige Book (15th), housing starts, building permits, jobless claims (16th), consumer confidence (17th). Speakers: Evans, Stern (14th), Lockhart, Yellen (16th).



Medium term outlook:

- As a consequence of the financial market turmoil centred in the United States, USD weakness was expected in early 2009. Although this weakness was initially offset in part by concerns about other regions, improved sentiment in financial markets has seen risk appetites improve and the USD weaken.
- It is likely there has been an over-reaction by both the bond and currency market to the announcement the Fed will begin buying $300 billion of long-term US Treasuries as part of its quantitative easing (or credit easing) policy. Markets have also reflected a wave of optimism, which may get put to the test in the coming months.
- Recent influences suggest a risk the EUR, GBP, and JPY retrace some of March's large gains. We are also likely to see a pullback in the NZD/USD and to a lesser extent the NZD/AUD.
- However, we are also comfortable with our current forecast that the NZD and AUD are finding a bottom and will begin a slow appreciation over the course of 2009, rather than revisit and break through the lows seen in early 2009.
- 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 will weigh on the NZD over the next 2-3 months, and a rating downgrade is a key downside risk to our forecast.
- 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 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.

[Last Quarterly Economic Forecasts]

Interest Rate Market

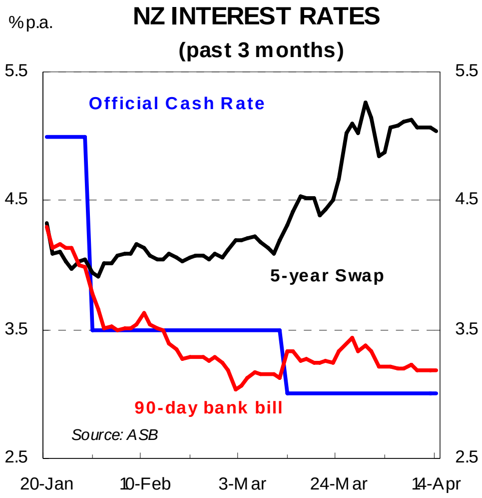
Wholesale interest rates	Current	Week ago	Month ago	6 mths ago	Year ago	ST Bias
Cash rate	3.00	3.00	3.00	7.50	8.25	FLAT
90-day bank bill	3.19	3.20	3.33	7.35	8.83	FLAT
2-year swap	3.86	3.94	3.48	6.53	8.16	FLAT
5-year swap	5.04	5.11	4.42	6.62	7.78	FLAT
11/11 gov't stock	4.50	4.41	3.95	6.00	6.46	FLAT
NZSX 50	2571	2612	2523	2949	3533	FLAT

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

- The RBA delivered a 25 basis point cut last week, midway between split expectations of no change and a 50bp cut and delivering minimal disruption to the markets.
- Swap markets remained relatively steady over the week before dropping on Friday to end up with 1-year swaps down 9 basis points compared to Monday and 5-year swaps down 5 basis points.
- Markets were relatively more subdued compared to the previous few weeks' volatility. The flows of fixing demand have eased significantly allowing swap markets to settle. Since the RBNZ signalled the end of the easing cycle is close, there has been large demand from borrowers to lock in below average rates at longer terms. This has driven 4-5 year swap rates up by 80 basis points since the March MPS.
- Following last week's dismal QSBO survey and the tightening in monetary conditions since the March MPS, we now expect the RBNZ to cut the OCR by 50 basis points in April.

Short-term outlook:

Key data	Date	Time (NZST)	Market expects
Q1 CPI	17/4	10.45 am	+0.3%
Fed's Beige Book	16/4	6.00 am	-



Comment: A relatively quiet week ahead, with little in the way of data that is likely to budge market expectations. Friday will bring the latest read on inflation. However, this is likely to be largely ignored as inflation concerns have dropped of the radar and the market's attention is fixated on more forward-looking growth indicators. The Federal Reserve's Beige Book gives the Fed's latest update on the US economic activity. US housing starts and building permits (Thursday night) will see markets look for further evidence of the US housing market stabilising.

- **Medium term outlook:**
- The RBNZ cut the OCR by 'only' 50 basis points at the March OCR review and Monetary Policy statement. Sending a strong signal that it was slowing down the pace of rate cuts and was reluctant to cut the OCR below 2.5%. The RBNZ has now cut 525 basis points off the OCR since July.
- The RBNZ's growth forecasts are optimistic, with the economy exiting the recession by mid-2009 and rebounding sharply. We think end-2009 is more likely, a view which is supported by the most recent Quarterly Survey of Business Opinion. Importantly, that survey revealed further deterioration in employment and investment intentions as well as a very sharp decline in capacity utilisation. These indicators point to downside risk to the RBNZ's March MPS economic projections.
- In addition, 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 is expecting extended weakness in the NZD to do much of the work for the Bank. Current levels of the NZD and longer-term interest rates undermine the projected recovery.
- On April 1st the RBNZ took the unusual step to issue an intra-meeting statement expressing its view that the rise in long-term swap rates was unwarranted and inconsistent with its monetary policy outlook. The RBNZ's statement signalled a level of frustration and we believe they will now seriously consider a 50bp cut. The RBNZ may be very reluctant to do so as it had strongly signalled slowing the pace of rate cuts down in March. However, the best option the RBNZ has to cap upward pressure on interest rates is to deliver another aggressive cut along with a very clear commitment to holding the cash rate down for a long time. We also expect the RBNZ will have to cut cash rate to 2.0% by July.
- 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.

[Last Quarterly Economic Forecasts]

NZ Data Preview: a look at the week ahead

Data	Date	Time (NZST)	Previous	Market expects	ASB expects
Q1 CPI (qoq)	17/4	10.45 am	-0.5%	0.3%	0.4%
March Food Price Index (yoy)	17/4	10.45 am	8.8%	-	-

Friday 17 April

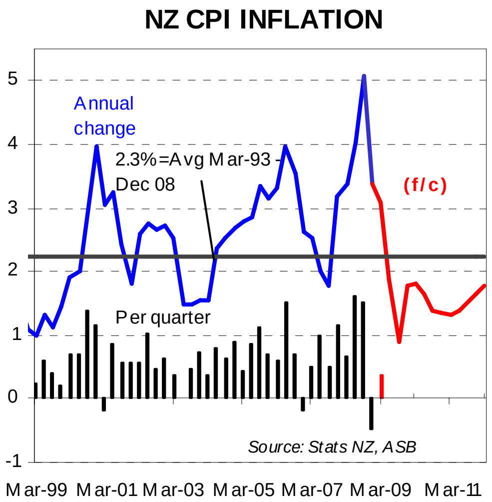
Q1 CPI

ASB f/c: 0.4% qoq, 3.1% yoy

Annual inflation will decline to 3.1% in Q1, on the way to a short-lived dip to around 1% later in 2009. The reversal of last year's petrol price spike remains a significant factor driving inflation down in the short term.

Over Q1 the key drivers of inflation are expected to be food prices (up 1.1%), Alcohol/Tobacco (1.3%), Housing/Utilities (1.0%). Transportation (-1.6%) will be the main influence containing inflation through lower petrol and car prices and a seasonal drop in international airfares.

Over the next couple of years we expect inflation will remain in the bottom half of the band. There will be a degree of imported inflation over the next year, but a sustained period of economic weakness will drag down domestically-generated inflation considerably.



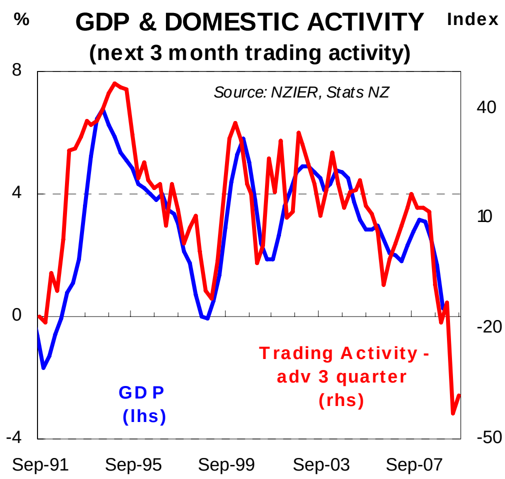
NZ Data Review: weekly recap

NZIER Q1 Survey of Business Opinion

The Q1 QSBO survey delivered a disappointing result, overall suggesting the economy continued to struggle over Q1 and with few indications of stabilisation in the near-term outlook. The headline confidence figures posted a small recovery, but remain very weak and consistent with a Q1 GDP result as weak as the -0.9% decline in Q4 2008 GDP.

However, the main source of our concern lies in the sharp decline in capacity utilisation and further deterioration of employment conditions and investment expectations. Capacity utilisation fell sharply over Q1 down to 86.3% from 88.8%, one of the largest quarterly movements we have seen for some time. The extent of the drop reinforces the likelihood of another sizable GDP contraction. The labour market also continues to push down towards lows last seen in the early 1990s. Net 34% reduced employment levels over the past 3 months, and net 35% are expecting to do so over the next 3 months. Investment intentions continued to decline with net 46% expecting to cut back on building investment, and net 43% expecting to cut back on plant and machinery investment.

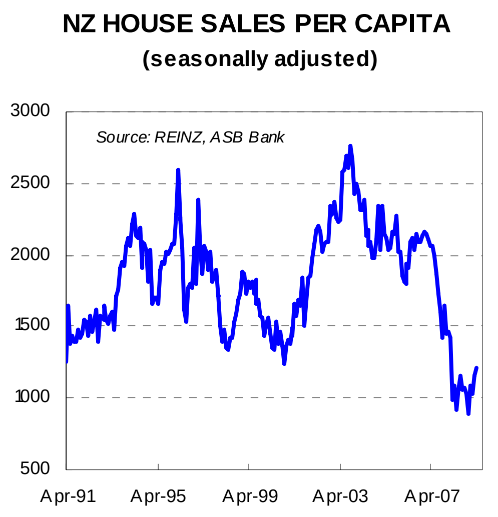
The survey probably also disappointed the RBNZ, which now have to take a closer look at its assumption of a strong recovery in the second half of 2009.



March REINZ House Sales

House sales picked up over March (5% mom seasonally adjusted) but still remain very weak. We caution reading too much into the latest sales figures, in particular when making comparisons to March 2008. Easter fell in March last year (compared to usual timing of April) and dampened sales turnover, so year-on-year comparisons are misleading. Per-capita house sales remain very subdued. Nevertheless, there is good news, with housing turnover improving for the second consecutive month. Housing turnover is likely to have now bottomed out and small recovery is likely to be underway over 2009 (albeit a weak one).

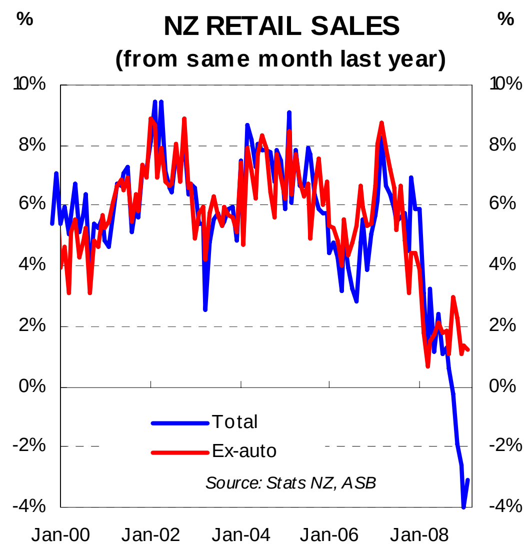
The REINZ median house price picked up 1.5%, but remains 4% below year-ago levels. We prefer to look at house price figures that are adjusted for the composition of sales, such as the QV house price figures. The equivalent QVNZ release revealed that house prices are down 9.3% (for the 3 months to March compared to the same period a year ago). House prices can lag housing turnover by around 3-6 months, so we expect that a bottom in house prices will be reached later this year.



February Retail Trade Survey

Retail spending increased 0.2% over February, slightly better than the market expectation of -0.5% and ASB's forecast of 0.0%. The ex-auto component came in line with market expectations, down -0.1%, offset by an increase in the volatile auto component. A price-induced 6.7% increase in fuel retailing offset another decline in auto sales. Motor vehicle sales are now down 23% on year-ago levels while February car registrations are down 44% on year-ago levels, pointing to further weakness to come.

Interestingly, the retail trade survey revealed that the nation is collectively enjoying a cheap night at home, perhaps enjoying a home cooked meal, bottle of wine and a DVD rather than a big night out. In the face of the recession, households are changing their spending patterns and looking for cheaper entertainment options. Supermarket spending remains strong, with spending growth outpacing the monthly increase in food prices. The trend in liquor retailing has been flat while spending at restaurants and bars is down. Meanwhile, personal and household goods hiring, of which video hire is a key component, has been growing strongly, up 9.5% mom in January followed up by a 9.3% increase in February, suggesting DVD stores have been reasonably busy over the past few months.



Global Data Calendars

Note: Calendar 2 is in UK times. Add 11 hours for NZ times.

Calendar – Australasia, Japan and China

Date	Time NZT	Econ	Event	Period	Unit	Last	Forecast Market	Forecast ASB/CBA
Tue 14 Apr	13.30	AU	Lending Finance	Feb	m%ch	2.3	~	~
	13:30	AU	NAB Business Confidence	Mar	%	-22	~	~
	13:30	AU	NAB Business Conditions	Mar	%	-20	~	~
Wed 15 Apr	~	CH	Actual FDI YTD	MAR	y%ch	-26.2	~	~
	11:15	AU	RBA Head of Financial Stability Ellis Speaks in Melbourne					
	12:30	AU	Westpac Leading Index	Feb	m%ch	-0.2	~	~
	16:00	JP	Tokyo Condominium Sales	Mar	y%ch	-27.5	~	~
	16:30	JP	Industrial Production	Feb	m%ch	-9.4	~	~
					y%ch	-38.4	~	~
	16:30	JP	Capacity Utilization	Feb	m%ch	-12.9	~	~
Thu 16 Apr	13.30	AU	RBA Bulletin	Apr	~	~	~	~
	14:00	CH	Real GDP	QI	y%ch	6.8	6.1	~
	14:00	CH	Producer Price Index	Mar	y%ch	-4.5	-5.5	~
	14:00	CH	Purchasing Price Index	Mar	y%ch	-7.1	~	~
	14:00	CH	Consumer Price Index	Mar	y%ch	-1.6	-1.3	~
	14:00	CH	Retail Sales	Mar	y%ch	~	14.5	~
	14:00	CH	Industrial Production	Mar	y%ch	11.0	6.0	~
	14:00	CH	Fixed Asset Investment	Mar	y%ch	26.5	~	~
	18:00	JP	Machine Tool Orders	Mar	~	~	~	~
Fri 17 Apr	10:45	NZ	Food Prices	Mar	m%ch	0.2	~	~
	10:45	NZ	Consumer Prices	QI	q%ch	-0.5	0.3	~
					y%ch	3.4	3.0	~
	11:50	JP	Tertiary Industry Index	Feb	m%ch	0.40	~	~
	13.30	AU	Building activity	QIV	m%ch	-1.2	~	~
					y%ch	0.7	~	~
	13:30	AU	Import price index	QI	q%ch	10.8	~	-0.3
	13:30	AU	Export price index	QI	q%ch	15.9	~	-0.4
	17:00	JP	Consumer Confidence	Mar	%	27.6	~	~
	17:00	JP	Consumer Confidence Households	Mar	%	26.7	~	~

Calendar – North America & Europe

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

Date	UK time	Econ	Event	Period	Unit	Last	Forecast Market	Forecast CBA
Tue 14 Apr	13.30	US	Producer price index	Mar	m%ch	0.1	0.0	~
	13.30	US	Advance retail sales	Mar	%	-0.1	0.3	~
	15:00	US	Business Inventories	Feb	%	-1.1	-0.9	~
Wed 15 Apr	00:01	UK	RICS House Price Balance	Feb	%	-78.0	-77.0	~
	09:30	UK	DCLG UK House Prices	Feb	y%ch	-11.5	~	~
	13:30	CA	New Motor Vehicle Sales	Feb	m%ch	5.5	~	~
	13:30	US	Consumer Price Index	Mar	m%ch y%ch	0.40 0.2	0.2 0.0	~
	13:30	US	Empire Manufacturing	Mar	%	-38.2	-35.0	~
	14:00	US	Net Long-term TIC Flows	Feb	$bn	-$43.0	~	~
	14:00	US	Total Net TIC Flows	Feb	$bn	-$148.9	~	~
	14:15	US	Industrial Production	Feb	%	-1.5	-1.0	~
	14:15	US	Capacity Utilization	Feb	%	70.2	69.7	~
	18:00	US	NAHB Housing Market Index	Feb	Index	9.0	10.0	~
	19:00	US	Fed's Beige Book	Apr	%	~	~	~
Thu 16 Apr	00:01	UK	BRC March Retail Sales Monitor					
	07:00	EZ	New Car Registrations	Mar	%	-18.0	~	~
	10:00	EZ	CPI	Mar	y%ch	1.2	0.6	~
	10:00	EZ	Industrial Production	Mar	y%ch	-17.3	-17.6	~
	13:30	CA	Manufacturing Shipments	Feb	m%ch	-5.4	~	~
	13:30	US	Housing Starts	Feb	'000	583.0	543.0	~
	13:30	US	Building Permits	Feb	'000	564.0	549.0	~
	13:30	US	Initial Jobless and continuing Claims					
	15:00	US	Philadelphia Fed.	Apr	%	-35.0	-32.0	~
Fri 17 Apr	10:00	EZ	Trade Balance sa	Feb	€bn	-5.5	~	~
	10:00	EZ	Construction Output SA	Feb	m%ch	1.3	~	~
	12:00	CA	Consumer Price Index	Mar	y%ch	1.4	~	~
	15:00	US	U. of Michigan Confidence	Apr	%	57.3	58.5	~

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