

Business Weekly

Inflation's foundations crumble

This Week

Inflation is steadily on the wane from last year's dizzying heights. Q1 figures showed a moderate 0.3% qoq increase, bringing the annual inflation rate back down to 3% - the top of the RBNZ's target band. In six months time annual inflation will briefly dip to around 1% before settling in a likely range of 1% - 2% through to the end of 2011.

In the media some attention was given to the strong (8.8%) increase in food prices over the past year, though much of it was due to past weather impacts on crops and the relative strength of international meat prices. What stood out to us was the composition of inflation, which reinforced that underlying inflation pressures are likely to fall relatively rapidly over the next year. Non-tradables inflation is now easing noticeably, primarily as housing-related inflation belatedly starts to reflect the weakness of housing construction activity (more details in Chart of the Week). If the widespread weakness in this category continues, non-tradables inflation has the potential to reduce rapidly. Some offset to the downward trend in non-tradable inflation was evident impact from the weaker NZ dollar. However, this impact is transitory and to some extent muted by weak demand.

Given the recent jump in the NZD and long-term interest rates, the sharp economic recovery the RBNZ expects is under threat. A 50bp cut on April 30 is likely, with inflation risks skewed to the downside. As our forecasts stand inflation is likely to be close to the floor of the 1% - 3% target band over 2010 and 2011.

It will be a quiet week in NZ, with just migration and credit card figures. Net migration figures have started to reflect reduced outflows to Australia as well as the UK as people increasingly realise that the grass can be greener in NZ. As these trends develop, population growth will be slightly faster than otherwise, aiding the demand side of the economy – particularly retailing and housing.

After a bit of overstimulation last week the international calendar is also quieter. The Green Shoots searchers will be watching existing and new home sales in the US for signs of stabilisation. One or two green shoots even appeared in the UK housing market, and further attention will go on other UK data this week including Friday's GDP and retail sales. Central bank minutes and Canada's cash rate decision are also due.

Consensus forecasts of NZ's main trading partner growth were released over the weekend and imply a 2.2% decline in trading partner economic activity. That is weaker than the 1.9% contraction implied in the March survey, but the pace of downward revision is the slowest since the credit crisis blew up – a positive of sorts!

Click here for:

[Foreign Exchange](#)

- NZD down on all the crosses monitored.

[Interest Rates](#)

- Interest rates lower, as market starts to focus on next RBNZ meeting.

[Week Ahead](#)

- Quiet local data week: Tourism, migration and credit card data due.

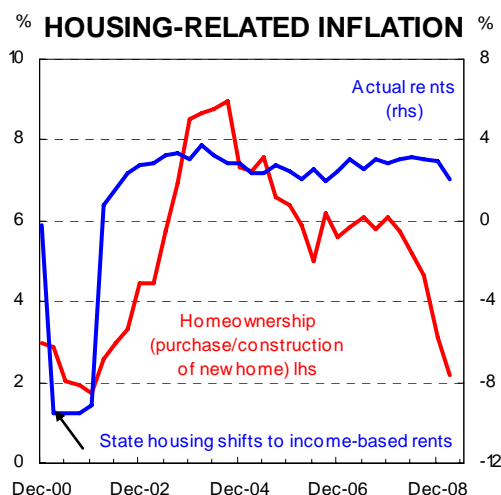
[Week in Review](#)

- Inflation printed near expectations, Retail trade remains weak.

[Global Calendars](#)

- IMF Global Outlook, BoC rate announcement, US housing data the highlights.

Chart of the week



- Housing-related costs in the inflation figures were quite weak, a belated response to the decline in construction activity that began in late 2007.
- Part of the impact relates to higher insulation standards for newly-constructed homes, for which quality adjustment helped contain reported construction costs to a flat quarterly outcome. These 'statistical' impacts are one reason for the weak Homeownership component, but won't be the only one.
- Other housing components also moderated: rents were up only 0.3%; property maintenance services were flat (the first time they haven't risen in over 10 years).
- The main exception was maintenance materials, which rose steadily but may have been affected by the sizable fall in the NZD. If so, that impact is likely to be relatively short-lived.

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 mth's ago	Year ago	ST Bias	Support^	Resistance^
NZD/USD	0.5648	0.5860	0.5573	0.6119	0.7909	FLAT	0.5550	0.5750
NZD/AUD	0.7874	0.8110	0.8105	0.8785	0.8440	FLAT	0.7800	0.8000
NZD/JPY	56.05	59.32	52.68	62.20	81.00	FLAT	54.50	56.50
NZD/EUR	0.4350	0.4432	0.4078	0.4545	0.4975	FLAT	0.4300	0.4400
NZD/GBP	0.3833	0.3989	0.3845	0.3525	0.3974	FLAT	0.3800	0.3900
TWI	56.5	58.3	55.1	60.5	70.1	FLAT	56.00	57.00

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

- The NZD continued to ease back from recent highs last week, and is down on all the main crosses. There is no market moving economic data scheduled for release in New Zealand this week. Global economic trends are likely to be the main influence on NZD until next week when the focus shifts to the RBNZ's next interest rate announcement.
- NZD/JPY is being supported by improving expectations for the world economy. The currency market continues to re-rate the JPY lower against many currencies, including against the NZD, although the NZD pulled back from its recent high against the JPY last week.
- The better-than-expected company earnings reports released in the US over the past two weeks have supported "risk assets" such as equities, with the improving global growth view, supporting currencies like NZD. The USD has increased against JPY and EUR. We are sceptical that these trends can continue. The release by the International Monetary Fund of its latest set of world economic forecasts may provide a "reality check" for markets.

Short-term outlook:

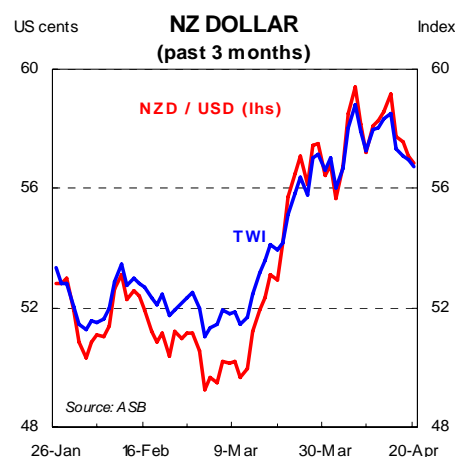
Key data	Date	Time (NZST)	Market expects
----------	------	-------------	----------------

No major local releases. - - -

Potential currency movers from the US this week: International Monetary Fund releases World Economic Outlook, house prices (22nd), jobless claims, existing home sales (23rd), Treasury's Geithner to host G-7 Finance Ministers/Central Bank governors' meeting, durable goods orders, new home sales (24th). Speakers: Kohn (20th), Hoenig (21st).

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 was 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.
- However, we are also comfortable with our current forecast that the NZD and AUD have bottomed 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 on to 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	3.06	3.19	3.26	7.05	8.90	FLAT/DOWN
2-year swap	3.72	3.89	3.48	6.33	8.18	FLAT/DOWN
5-year swap	4.87	5.07	4.43	6.47	7.69	FLAT/DOWN
11/11 gov't stock	4.33	4.51	3.92	5.75	6.60	FLAT
NZSX 50	2711	2571	2599	2886	3557	FLAT

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

- Swap markets rallied over the week with the whole curve shifting around 15-20 basis point lower, partly led by a similar rally across the Tasman. There was little in the way of economic news, although one factor for the easing in yields is the dramatic slowing in fixing demand from borrowers, removing some upward pressure on yields.
- Markets (and borrowers) also have one eye on next weeks RBNZ decision, with a 50 basis point cut being flagged by economists as the most likely outcome. Interest rates could fall further if the RBNZ does choose to deliver 50bp, which is not yet fully priced in the market.

Short-term outlook:

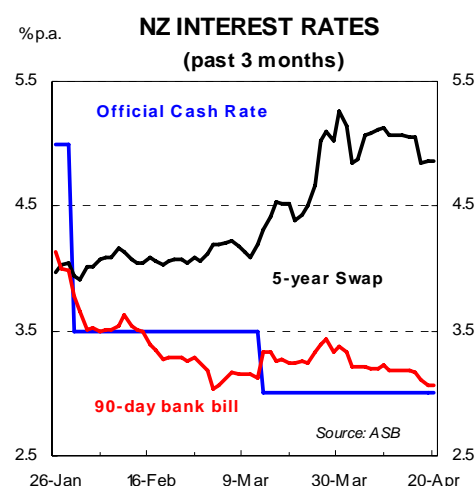
Key data	Date	Time (NZST)	Market expects
International Travel and Migration	21/4	10.45 am	-

Comment: Light on the data in NZ, with the focus now turning to the RBNZ announcement Thursday next week. Overseas sentiment remains important, and key will be some US housing market data out this week (US house prices Wed night, Home Sales Thurs and Fri night). The housing market has been showing some tentative signs of stabilisation, which is considered a pre-requisite for financial and economic recovery. RBA minutes are out on Tuesday, although often do not reveal any more insight beyond the RBA's official statement.

Medium term outlook:

- The RBNZ cut the OCR by 'only' 50 basis points at the March OCR review and Monetary Policy statement. It sent 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 2008.
- 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
March International Travel and Net Migration	21/4	10.45 am	6,610 (p.a.)	-	-

Tuesday 21 April

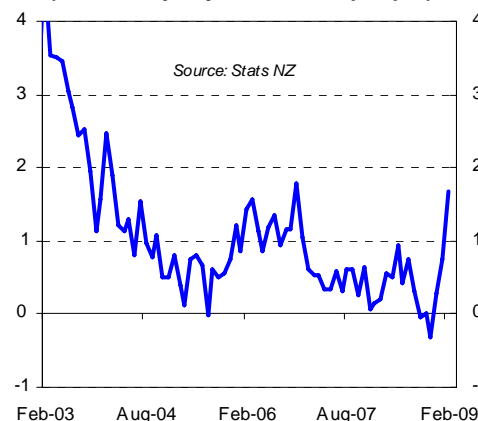
March International Travel and Migration

Previous: +6,160 per annum

Net migration inflows have picked strongly over the past few months, mostly owing to a dramatic fall in the number of departures, particularly to Australia. The deterioration in the world economy is likely to be behind the decline in departures as a weakening labour market in Australia has deterred New Zealanders from heading across the Tasman. We expect these trends to continue, supporting a modest pick up in net migration over the year, to around 10-15,000 net new migrants per annum. 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 MONTHLY NET MIGRATION
(seasonally adjusted, 000's people)



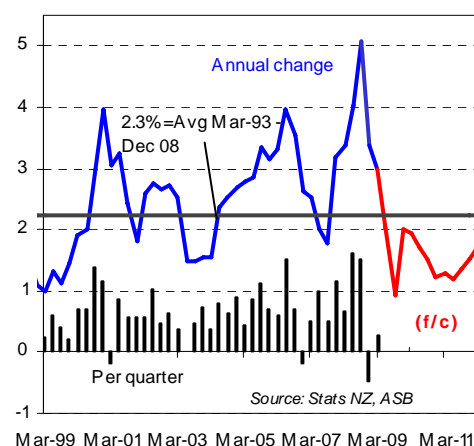
NZ Data Review: weekly recap

Q1 Consumer Price Index

The Q1 CPI rose 0.3% qoq and 3.0% yoy, bang on market expectations. Non-tradable inflation lifted 3.8% yoy, slightly weaker than the RBNZ's 3.9% forecast as housing-related costs came in on the weak side, partly on regulation changes. The other main influences over the quarter were food, transportation, and the NZD.

The composition of inflation did reinforce that underlying inflation pressures are likely to ease relatively rapidly over the next year. Non-tradables inflation is now easing noticeably, primarily as housing-related inflation belatedly starts to reflect the weakness of housing construction activity. If the widespread weakness in this category continues, non-tradables inflation has the potential to reduce rapidly. Some offset to the downward trend in non-tradable inflation was evident impact from the weaker NZ dollar. However, this impact is transitory and to some extent muted by weak demand.

NZ CPI INFLATION

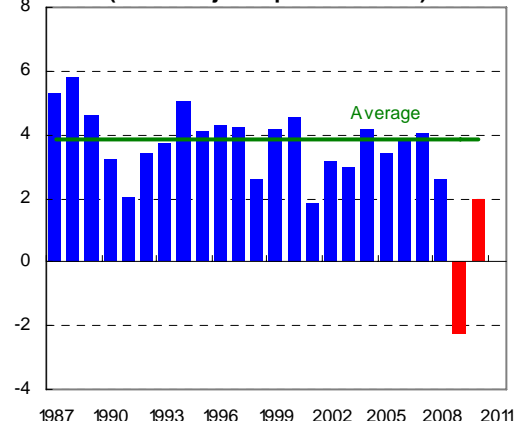


April Consensus Forecasts

April's Consensus Forecasts Survey showed the pace of downward revisions to the economic outlook has slowed significantly. This result is not too surprising, given the international flow of bad news started to abate, accompanied by a lift in optimism by the markets. Importantly, indicators for the US economy have started to stabilise, notably housing market data, which has led to the economic outlook for the US economy to be revised up marginally.

Overall, forecasts for New Zealand's main trading partners have been revised down with 2009 GDP is expected to contract 2.2% (previously -1.9%). The largest downward revisions came from Japan and the Eurozone, while the outlook for the US was revised up very slightly. The 2010 outlook is unchanged with growth of 2.0% expected.

NZ MTP ECONOMIC GROWTH
(*NZ's major export markets)



Global Data Calendars

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

Calendar – Australasia, Japan and China

Date	Time		Econ Event	Period	Unit	Last	Forecast	
	NZST						Market	ASB/CBA
Mon 20 Apr	13.30	AU	Producer price index	QI	q%ch	1.3	~	0.6
					y%ch	6.4	~	5.0
	17.00	JP	Leading index CI	Feb	Index	75.2	~	~
	17.00	JP	Coincident index CI	Feb	Index	86.8	~	~
Tue 21 Apr	10.45	NZ	Visitor arrivals	Mar	%	2.9	~	~
	13.30	AU	RBA board April minutes	~	~	~	~	~
	15.30	AU	RBA Governor Stevens speaks in Adelaide					
Wed 22 Apr	11.50	JP	Merchandise trade balance	Mar	¥bn	82.1	17.5	~
	11.50	JP	Adj merchandise trade bal	Mar	¥bn	-43.3	-84.0	~
	11.50	JP	Merchandise trade exports	Mar	y%ch	-49.4	-46	~
	11.50	JP	Merchandise trade imports	Mar	y%ch	-43.0	-37.1	~
	13.00	AU	DEWR skilled vacancies	Apr	m%ch	-10.8	~	~
	13.30	AU	Consumer prices	QI	q%ch	-0.3	~	0.5
					y%ch	3.7	~	2.8
	13.30	AU	RBA trimmed mean	QI	q%ch	0.6	~	0.8
					y%ch	4.2	~	3.8
13.30	AU	RBA weighted median	QI	q%ch	0.9	~	0.8	
				y%ch	4.5	~	4.0	
Thu 23 Apr	13.30	AU	New motor vehicle sales	Mar	m%ch	-3.5	~	~
					y%ch	-18.6	~	~
	15.00	NZ	Credit card spending	Mar	y%ch	-1.9	~	~
Fri 24 Apr	11.50	JP	All industry activity index	Feb	m%ch	-1.7	-2.2	~
	11.50	JP	Corporate service price	Mar	y%ch	-2.6	~	~

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
Tue 21 Apr	07.00	GE Producer prices	Mar	y%ch	0.9	0.0	~
	09.30	UK CPI	Mar	y%ch	3.2	2.9	~
	10.00	EZ ZEW (econ sentiment)	Apr	~	-6.5	~	~
	14.00	CA Bank of Canada rate	Apr	%	0.5	0.5	0.25
Wed 22 Apr	~	~ IMF releases World Economic Outlook					
	~	UK Budget Statement	~	~	~	~	~
	09.30	UK Bank of England minutes	~	~	~	~	~
	09.30	UK ILO unemployment rate	Feb	%	6.5	~	~
	13.30	CA Leading indicators	Mar	m%ch	-1.1	~	~
	15.00	US House price index	Feb	m%ch	1.7	~	~
Thu 23 Apr	08.30	GE PMI manufacturing	Apr	Index	32.4	33.2	~
	08.30	GE PMI services	Apr	Index	42.3	42.5	~
	09.00	EZ ECB current account	Feb	€bn	-12.7	~	~
	09.00	EZ PMI manufacturing	Apr	Index	33.9	35.4	~
	09.00	EZ Current account	Feb	€bn	-18.2	~	~
	09.00	EZ PMI services	Apr	Index	40.9	41.5	~
	09.00	EZ PMI composite	Apr	Index	38.3	~	~
	13.30	CA Retail sales	Feb	m%ch	1.9	-0.3	~
	13.30	US Initial jobless and continuing claims					
	15.00	US Existing home sales	Mar	m%ch	5.1	-0.4	~
	15.30	CA Bank of Canada monetary policy report					
Fri 24 Apr	09.00	GE IFO	Apr	~	~	~	~
	09.30	UK GDP	Q1	q%ch	-1.6	-1.5	~
				y%ch	-2.0	-3.8	~
	09.30	UK Retail sales	Mar	m%ch	-1.9	-0.5	~
	13.30	US Durable goods orders	Mar	%	3.4	-1.4	~
15.00	US New home sales	Mar	m%ch	4.7	0.9	~	

ASB ECONOMICS
Level 9, 135 Albert Street, Auckland

ASB ECONOMICS

PHONE

FAX

Economics

Chief Economist	Nick Tuffley	nick.tuffley@asb.co.nz	(649) 374-8604	(649) 302 0992
ASB Economist	Jane Turner	jane.turner@asb.co.nz	(649) 374-8185	
CBA NZ Economist	Chris Tennent-Brown	chris.tennent-brown@asb.co.nz	(649) 374 8819	

DISCLAIMER

Views expressed in this report are those of the authors as at the date of this report and are based on information and sources believed but not warranted to be correct. Any views or information, while given in good faith, do not necessarily reflect the views of ASB and are subject to change without notice. Neither ASB Bank Limited nor any person involved in preparing this report accepts any liability for any loss or damage whatsoever that may directly or indirectly result from any views, information or omission contained in this report.