Business Weekly

Relax and de-stress

ECONOMICS

11 May. 09

This Week

The US bank stress tests eventually appeared on Friday morning and, after a week of leaks and rumours, were relatively anti-climactic. Out of 19 main banks the US authorities identified 10 of them will require an extra $US75 billion of capital, $34bn alone for Bank of America. The banks will now have 6 months to raise capital privately, with the Government being the back-stop source.

Last week's labour market figures fell in the camp of could have been worse. Employment fell 1.1% over the quarter (24,000 jobs), the largest percentage decline since 1989, and the unemployment rate continued its steady rise to reach 5%. We had expected a slightly larger fall in employment, and the unemployment rate was generally expected to be a little higher. Even though unemployment is on the rise, a rate of 5% is very low by NZ standards – and a rate many Western European countries can only dream of.

However, there are signs of what is called the 'discouraged worker' effect, in which people who might otherwise look for work decide their prospects aren't good and they don't make the effort to look. The labour participation rate (percentage of working population in work or actively seeking work) is moving very sharply in response to changing levels of employment. Although this could mean the unemployment rate doesn't rise as rapidly, it does imply a degree of underemployment – there will be a growing group of people who would like to work if the work was readily available. For example, some people might choose to stay on at school or university for longer to gain greater skills as work prospects dry up: the labour figures do show that job reductions are greater in the youngest age brackets.

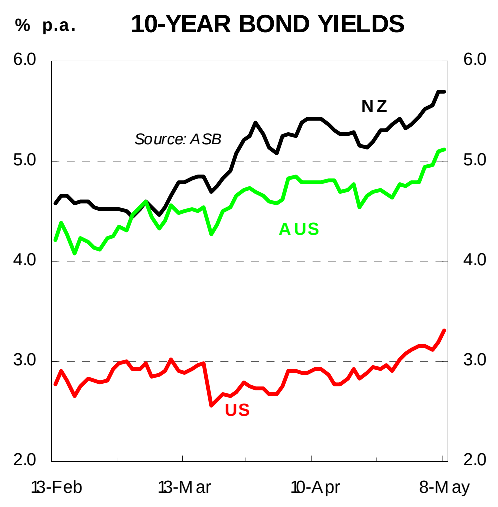
In the US there are very tentative signs that the pace of job losses is slowing, with April Non-farm Payrolls registering a fall of 'only' 539k. However, the pattern of downward revisions to prior months continued, with the previous 4 months averaging 700k lost jobs a month. As with NZ, the labour market will be the last area of the economy to recover, and the unemployment rate – currently 8.9% – will continue to rise over 2010.

Domestically this week two events will capture attention: Q1 retail sales and the RBNZ's Financial Stability Report (FSR). Retail spending volumes will register a sizable contraction (nearly 2%) on continued slump in car sales. Sales excluding the automotive components are still likely to fall, but mildly by comparison (around 0.5%). However, electronic card transactions data for March and April show hints that underlying spending has started to recover. The FSR will undoubtedly discuss on the still-challenging credit environment, though there has been some thawing since October's blow-up.

Click here for:

Foreign Exchange	• NZD appreciation continues, kiwi cracks through US 0.60
Interest Rates	• Longer-end yields rise on expectations for heavy global govt debt issuance
Week Ahead	• Q1 Retail trade volumes to contract sharply, RBNZ Financial Stability report
Week in Review	• Labour market data better than expected, unemployment rate 'only' 5%
Global Calendars	• Australia Budget. US, UK, EZ and JP: trade, industrial production, inflation data.

Chart of the week



- Although the RBNZ dropped the OCR in April, there has since been further tightening of monetary conditions.
- The NZ dollar has continued to lift, clearing USD0.60.
- Long-term interest rates have also pushed higher, partly as 'green shoots' fuel optimism, but also through greater focus on government debt issuance in the wake of the UK Budget.
- The NZ Government will issue an extra $1 billion by the end of June, and the Australian Commonwealth Budget will be released on Tuesday.
- As a consequence, the 5-year swap rate is now higher than it was prior to the RBNZ's April 29 OCR cut. Exerting any further influence over monetary conditions will be an increasing challenge to the RBNZ.

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	0.6060	0.5738	0.5825	0.5975	0.7722	UP	0.5950	0.6120
NZD/AUD	0.7911	0.7800	0.8100	0.8717	0.8207	FLAT	0.7800	0.7950
NZD/JPY	59.60	57.06	58.46	59.21	79.93	FLAT	58.50	60.50
NZD/EUR	0.4445	0.4308	0.4425	0.4660	0.5010	FLAT	0.4400	0.4500
NZD/GBP	0.3978	0.3837	0.3977	0.3779	0.3950	FLAT	0.3900	0.4050
TWI	58.8	56.7	58.1	60.2	69.2	FLAT	57.00	60.00

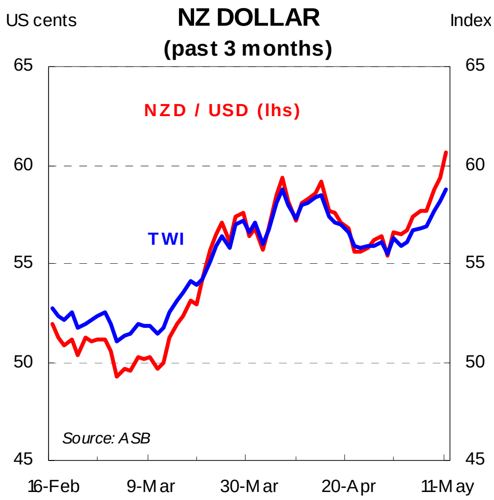
Weekly support and resistance levels * Current is as at 12pm Tuesday; week ago as at Monday 5pm

- The NZD lifted on all the crosses last week. We think the recent rally in the local currency is starting to look overdone, and the currency is set for a downward correction. For now, however, the trend is up.
- The NZD has appreciated well ahead of the underlying rise in dairy prices and ahead of our more-reliable indicator, the weighted-average NZ-trading partner two-year interest rate swap spread. The extent of the correction in the NZD is difficult to determine, but a decline to 0.5550 is possible over coming weeks, below the 30-day moving average of 0.5740.
- The apparent stabilisation in the major economies has guided the USD lower as investors seek out higher risk, higher return investments. The release this week of the US retail and industrial production reports for April will validate or question the recent run-up in risk assets such as commodities and equities.

Short-term outlook:

Key data	Date	Time (NZST)	Market expects
AU Budget	12/5		-
RBNZ Financial Stability Report	13/5	9.00 am	-
Q1 Retail Trade Survey	15/5	10.45 am	-1.5%

Potential currency movers from the US this week: monthly budget (12th), retail sales (13th), producer prices, jobless claims (14th), CPI, industrial production, consumer confidence (15th). Speakers: Bernanke (11th), Rosengren (12th) Lockhart (13th).



Medium term outlook: [Last Quarterly Economic Forecasts]

- 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.
- Recent influences suggest a risk the EUR, GBP, and JPY retrace some of March's large gains. We are also likely to see further 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 onto say that the RBNZ aimed to intervene both at the top and bottom of the cycle to try and stabilise the exchange rate.

Interest Rate Market

Wholesale interest rates	Current	Week ago	Month ago	6 mths ago	Year ago	ST Bias
Cash rate	2.50	2.50	3.00	6.50	8.25	FLAT
90-day bank bill	2.93	2.81	3.19	6.61	8.64	FLAT
2-year swap	3.60	3.41	3.89	5.96	7.77	FLAT
5-year swap	4.89	4.65	5.07	6.28	7.49	FLAT
11/11 gov't stock	4.56	4.32	4.51	5.78	6.46	UP
NZSX 50	2865	2766	2571	2838	3601	DOWN

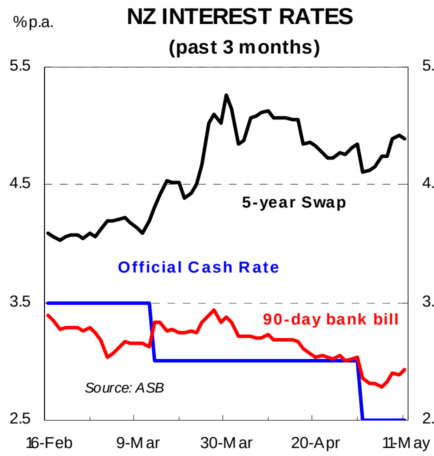
* Current is as at 12pm Monday; week ago as at Monday 5pm

- The yield curve steepened over the past week, led by a sharp pick-up in longer end rates. Government bond yields led the charge, following the global theme of rising yields on government debt. Since the blatantly optimistic UK Budget global markets have become very mindful of the substantial government debt issuance likely over the next few years. Also pushing up longer-end government bond yields in NZ was the new issuance of a May 2021 bond.
- The RBA kept the cash rate on hold at 3% as expected, although the accompanying statement sent the signal the RBA is in wait and see mode and further cuts are likely to be more data dependent. At home, markets are also less confident on further cuts by the RBNZ, particularly as the OCR appears to have lost traction. Mortgage rates have remained largely unchanged and financial market conditions have tightened further since the RBNZ's dovish statement.

Short-term outlook:

Key data	Date	Time (NZST)	Market expects
AU Budget	12/5		-
RBNZ Financial Stability Report	13/5	9.00 am	-
Q1 Retail Trade Survey	15/5	10.45 am	-1.5%

Comment: Relatively quiet week ahead on the domestic front, with a light data calendar until Friday's quarterly retail trade survey (shaping up to be dismal). The Australian Budget will be the highlight of the week. RBNZ will bring us its Financial Stability report on Wednesday and assure us NZ is well placed to weather the global storm.



Medium term outlook: [Last Quarterly Economic Forecasts]

- The RBNZ cut the OCR by 50 basis points to 2.5% at the April OCR review, and delivered a commitment to hold the cash rate at or below current levels until the latter part of 2010.
- April's statement was designed to combat the recent rise in monetary conditions, i.e. the rise in longer-term interest rates and the exchange rate. In particular, the RBNZ's expectation it will hold the OCR low until mid-2010 should help to anchor longer-term interest rate expectations. The message to borrowers is that there is no real hurry to fix rates, as there is still potential for further OCR cuts and longer-term interest rates will also remain low a little longer yet.
- April's more dovish statement countered the surprisingly hawkish statement delivered in March. In March the RBNZ sent a strong signal it was slowing down the pace of rate cuts and was reluctant to cut the OCR below 2.5%. By indicating that the end of the easing cycle was near, the RBNZ triggered a rush of demand by borrowers to lock in long-term rates at low levels. The strong increase in fixing demand saw longer-term interest rates rise in wholesale markets.
- The RBNZ's March MPS forecasts were optimistic, and the tone of April's statement suggests that the RBNZ has revised down is outlook somewhat. We expect economic output to continue to contract throughout much or all of 2009, although the recent NBNZ business outlook suggests we can expect the pace of decline to ease over the second half of 2009.
- We expect the RBNZ will cut the OCR by 25bp in both June and July. With the exchange rate remaining relatively buoyant and fiscal policy constrained, the onus lies with monetary policy to deliver to the stimulus the NZ economy needs. The OCR itself will lose its direct potency over retail deposit funding costs, meaning that continuing to influence long-term rates will take on greater importance.
- The RBNZ 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. However, it has signalled it has been investigating different options and making contingency plans would be a prudent step. Such measures may well be needed to put additional downward pressure on long-term rates and the NZ dollar.

NZ Data Preview: a look at the week ahead

Data	Date	Time (NZST)	Previous	Market expects	ASB expects
April Food Price Index	12/5	10.45 am	+0.5%	-	-
RBNZ Financial Stability Report	13/5	9.00 am	-	-	-
Q1 Retail Trade Survey (Total volumes)	15/5	10.45 am	-0.6%	-1.5%	-1.9%

Friday 15th May

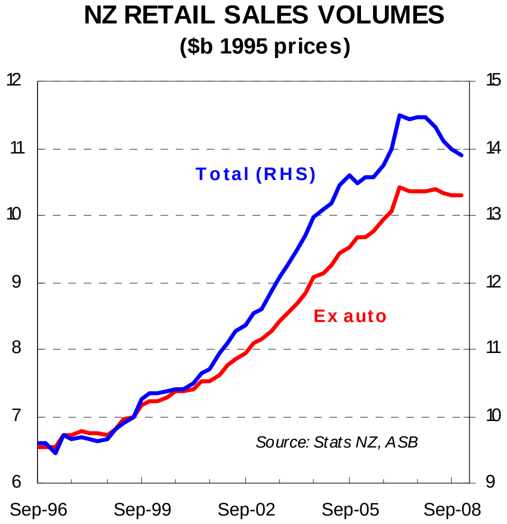
Q1 Retail Trade Survey

ASB f/c Total Volumes -1.9%, Ex-Auto Volumes -0.5%

We expect total retail spending to contract 1.4% over Q1. Adjusting for prices, we expect a 1.9% decline in volumes. We expect the Q1 weakness in retail spending will be centred in auto sales, which contracted sharply over January and February. Vehicle registrations remain weak, and point to further declines in auto sales over the next few months. The decline reflects consumer caution, as big ticket purchases are put on hold with households' fall in employment confidence.

Excluding the auto components, we expect core retail spending remained relatively flat, although accounting for prices this represents a slight decline in volumes.

A large component of retail is supermarket sales, which we expect will have remained firm. However, other categories, such as bars, restaurant and cafes, furniture etc have started to weaken noticeably.

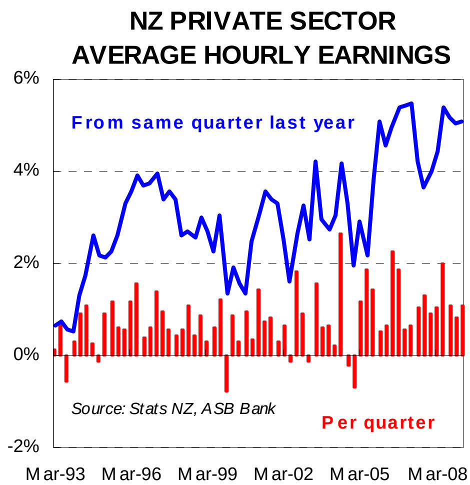


NZ Data Review: weekly recap

Quarterly Employment Survey

Ordinary time wage growth in the Quarterly Employment Survey remained relatively robust given the backdrop of recession since the start of 2008. However, the QES survey is not adjusted for changing composition within the labour force and is less reliable than the Labour Cost Index as a gauge of how wages are faring in the weakening economy.

Jobs measures in the QES survey pointed to further weakness in the labour market over Q1 after suggesting considerable weakness in 2008 Q4 also. There are clear trends emerging within the QES level of hours worked, once adjusted for seasonality. Hours worked in the construction and finance & insurance sectors have been steadily trending down. The hospitality sector has started feeling the pinch of consumer caution and softening tourist spending. Manufacturing hours are very weak, reflecting both weak domestic and global economic activity. Service sectors have generally fared better, though flattening off is evident in a number of areas. Strength continues in health & community and education, and property & business services have recovered slightly.

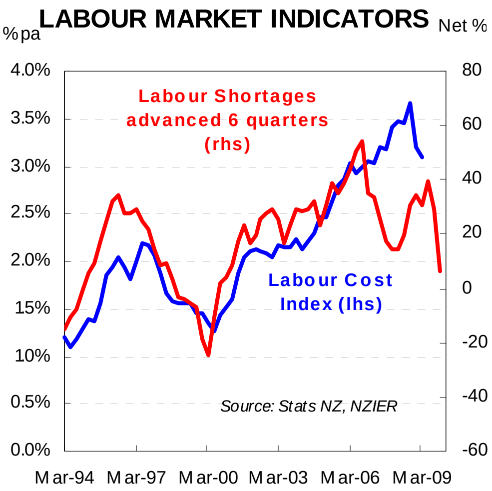


Labour Cost Index

The Labour Cost Index showed more concerted signs of moderating growth than were evident in the Quarterly Employment Survey. Private sector salary and wages (overtime inclusive) rose 0.6% over the quarter and 3.1% over the year, exactly matching the RBNZ's forecast made for the March Monetary Policy Statement.

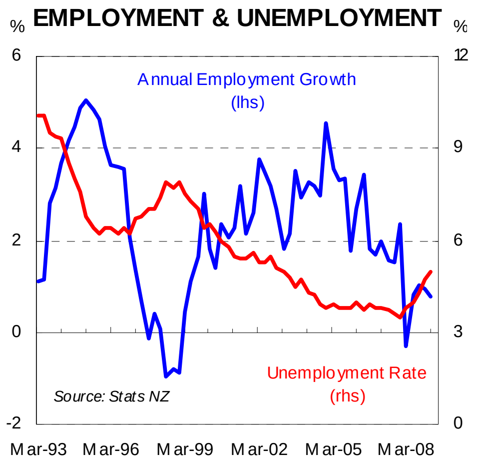
Annual Labour Cost growth remains strongest in the central government sector, though quarterly growth is moderating to be more in line with private sector movements. The sectors experiencing the strongest wage cost growth were Education and Health, with collective wage agreements taking effect.

The proportion of wage rates recording increase over the past year remained steady on Q4 at 60%. However, the proportion receiving an increase of 5% p.a. or more has edged down to 22% from a recent peak of 26%.



Household Labour Force Survey

The labour market fared slightly better than we expected over the first quarter. The unemployment picked up to 5.0%, from 4.7% over the first quarter of this year, better than the 5.3% expected. Employment declined 1.1%, as expected given the weakness in the economy over the past nine months. Participation also declined, albeit from very high levels, falling to 68.4% from a record high of 69.1%. The degree of withdrawal from the labour market was more than many expected, and helped mute the rise in unemployment. However, there remains evidence of underutilisation in the labour market and we expect that employment will continue to be scaled back over the next year. The unemployment rate may ultimately approach 8%.



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
Mon 11 May	18.00	JP	Machine tool orders	Apr	y%ch	-85.2	~	~
Tue 12 May	~	CH	Trade balance	Apr	USD bn	18.6	21.2	~
	~	CH	Exports	Apr	y%ch	-17.1	-15.2	~
	~	CH	Imports	Apr	y%ch	-25.1	-22.0	~
	10.45	NZ	Food prices	Apr	m%ch	0.5	~	~
	13.30	AU	Home loans	Mar	m%ch	0.4	~	7.0
	13.30	AU	Value of loans	Mar	m%ch	2.7	~	8.0
	17.00	JP	Leading index CI	Mar	Index	75.0	77.0	~
	17.00	JP	Coincident index CI	Mar	Index	86.0	85.8	~
	21.30	AU	Federal Budget 2009-10					
Wed 13 May	11.50	JP	Current account total	Mar	¥bn	1,117	1,206	~
	11.50	JP	Adj current account total	Mar	¥bn	673.4	497.9	~
	11.50	JP	Trade balance – BOP basis	Mar	¥bn	202.1	137.1	~
	12.30	AU	MI-WBC Cons. confidence	May	%	8.3	~	~
	14.00	CH	Retail sales	Apr	y%ch	14.7	13.9	~
					ytd	15.0	~	~
	14.00	CH	Industrial production	Apr	y%ch	8.3	5.1	~
					ytd	7.8	~	~
	17.00	JP	Eco watchers survey: current	Apr	Index	28.4	~	~
	17.00	JP	Eco watchers survey: outlook	Apr	Index	35.8	~	~
Thu 14 May	13.00	AU	Cons. inflation expectation	May	%	2.4	~	~
	13.30	AU	Lending finance	Mar	m%ch	2.7	~	~
Fri 15 May	10.45	NZ	Retail sales	Mar	m%ch	0.2	~	~
	10.45	NZ	Retail sales ex-auto	Mar	m%ch	-0.1	~	~
	10.45	NZ	Retail sales ex inflation	Mar	m%ch	-0.6	~	~
	11.50	JP	Machine orders	Mar	m%ch	1.4	-5.0	~
					y%ch	-30.1	-28.5	~
	11.50	JP	Domestic CGPI	Apr	m%ch	-0.2	0.1	~
					y%ch	-2.2	-3.0	~

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
Mon 11 May	13.30	CA	New housing price index	Mar	m%ch	-0.7	~	~
Tue 12 May	00.01	UK	BRC April retail sales monitor	~	~	~	~	~
	00.01	UK	RICS house price balance	Apr	%	-73.1	~	~
	09.30	UK	DCLG UK house prices	Mar	y%ch	-12.3	~	~
	09.30	UK	Trade balance	Mar	£mn	3,248	~	~
	09.30	UK	Industrial production	Mar	m%ch	-1.0	~	~
					y%ch	-12.5	~	~
	13.30	CA	Trade balance	Mar	C$bn	0.1	~	~
	13.30	US	Trade balance	Mar	US$bn	-26.0	-29.2	~
	19.00	US	Monthly Budget Statement	Apr	US$bn	159.3	-62.5	~
Wed 13 May	00.01	UK	NIESR GDP estimate	Apr	%	-1.5	~	~
	09.30	UK	ILO unemp. rate (3mths)	Mar	%	6.7	~	~
	10.00	EZ	Industrial production	Mar	y%ch	-18.4	~	~
	10.30	UK	Bank of England quarterly inflation report					
	13.30	US	Import price index	Apr	m%ch	0.5	0.4	~
					y%ch	-14.9	~	~
	13.30	US	Advance retail sales	Apr	%	-1.2	0.0	~
	15.00	US	Business inventories	Mar	%	-1.3	-1.1	~
Thu 14 May	09.00	EZ	ECB publishes May monthly report					
	13.30	US	Producer price index	Apr	m%ch	-1.2	0.1	~
	13.30	US	Initial jobless and continuing claims					
Fri 15 May	07.00	GE	GDP	QI	y%ch	-1.7	~	~
	10.00	EZ	CPI	Apr	m%ch	0.4	~	~
	10.00	EZ	GDP	QI	q%ch	-1.6	~	~
	13.30	CA	Manufacturing shipments	Mar	m%ch	2.2	~	~
	13.30	US	CPI	Apr	m%ch	-0.1	0.0	~
	13.30	US	Empire manufacturing	May	Index	-14.7	-15.0	~
	14.15	US	Industrial production	Apr	%	-1.5	-0.5	~
	14.15	US	Capacity utilisation	Apr	%	69.3	68.9	~
	15.00	US	Uni of Michigan confidence	May	Index	65.1	64.0	~

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	

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