

Business Weekly

Finding stability

This Week

Last Thursday's Budget showed a sizable lift in Crown debt levels over the next few years, which was to be expected. The fiscal forecasts show that the operating balance is not expected to return to surplus until 2019, making for 10 years of operating deficits. Even to achieve that outcome the Government has scrapped planned tax cuts and chopped Superannuation Fund contributions for around 10 years.

There were few major initiatives, with the Budget mainly about ensuring that the debt dam didn't crack under the strain of financing huge fiscal deficits over the next few years. NZ had experienced a number of years of stronger than expected revenue growth, which resulted in a considerably higher level of government expenditure – some of it poor quality. The strength of past revenue growth has vanished incredibly quickly. In response the Government is not cutting back overall expenditure to match, but it making sure that pre-existing expenditure delivers as much value as possible. The Budget, with the rating agencies looking over its shoulder, has erred on the side of keeping the debt position from getting too unmanageable against the short-term gains of spraying money at the economy.

The understandable lack of much largesse means not too many people will be smiling like a Cheshire cat in the Budget's aftermath. However, unlike the UK's "Alistair in Wonderland" Budget, NZ's rests on more realistic economic growth assumptions. That gives it, and the projected fiscal position, some important credibility.

There was a lot riding on this Budget, particularly whether it would be enough to avoid a potentially expensive credit rating downgrade. It would appear the Government has been successful, with Standard and Poor's putting NZ's credit rating outlook back to stable. The fact that S&P put NZ's rating back to stable outlook rather than merely leaving it on negative outlook was a pleasant surprise. The move also begs the question: why put NZ on negative creditwatch to start with?

But downgrade or not, the current global crisis is a big reminder that if NZ wants to improve its living standard it needs to work on paying its own way in the world. High private sector debt is now going to be joined by high public sector debt, and the next couple of decades is going to be spent trying to live within our means to work off the debt. From a public policy perspective it will be critical to improve NZ's productivity growth which, already lagging behind NZ's peers, has been waning in recent years. Boosting our sustainable growth speed limit will help NZ collectively reduce the debt burden and make it that much easier to live within our means.

Click here for:

[Foreign Exchange](#)

- NZD lifts further on USD weakness, credit rating relief.

[Interest Rates](#)

- Short term interest rates decline. S&P move sovereign outlook back to stable.

[Week Ahead](#)

- Quiet local data week. Wholesale trade Survey on Friday the only release.

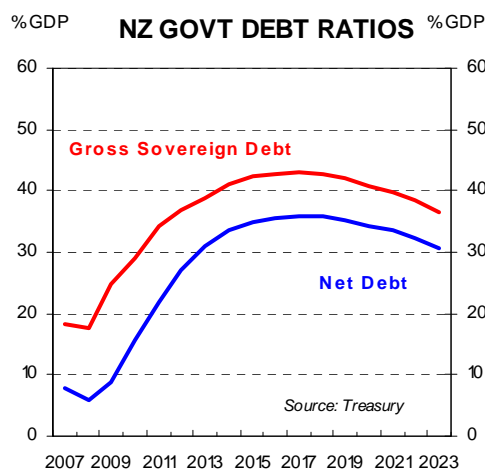
[Week in Review](#)

- NZ Budget 2009 relieves the market. S&P provides the surprise of the week.

[Global Calendars](#)

- RBA, BoE, ECB and BoC rate announcements. Beige Book and Payrolls in US.

Chart of the week



- Soaring government debt is becoming a global pandemic as governments borrow to make up for falling revenues or roll out stimulus packages. In NZ operating surpluses are not expected until 2019.
- NZ's net Government debt is projected to peak at 35.9% of GDP and gross debt issuance at 42.9%.
- In dollar terms net debt will peak in 2022 at \$99 billion, equivalent to \$20,500 per person alive then. At the end of the June 2008 fiscal year net debt per person was \$2,400.
- The extent of the debt burden that many countries will carry in future decades will restrict government policy choices, with debt servicing and repayment to take on increasing prominence in government accounts.

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	0.6480	0.6176	0.5664	0.5410	0.7802	FLAT/UP	0.6400	0.6600
NZD/AUD	0.7997	0.7916	0.7787	0.8355	0.8161	FLAT/UP	0.7950	0.8100
NZD/JPY	62.50	58.52	56.02	51.56	82.27	FLAT/UP	61.00	63.50
NZD/EUR	0.4574	0.4413	0.4268	0.4271	0.5026	FLAT/UP	0.4500	0.4600
NZD/GBP	0.3939	0.3888	0.3827	0.3531	0.3948	FLAT/UP	0.3900	0.4000
TWI	61.0	58.8	56.1	55.1	69.7	FLAT/UP	60.0	62.0

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

- It's all about the US Dollar at the moment. The greenback is weak across the board against most currencies.
- Right now the commodity currencies are the stars of the show, and have strengthened noticeably. The NZD was up 3 cents since the close of trade in NZ on Friday night.
- The NZD peaked around USD0.655, and in doing so reached just above the 50% retracement mark of the whole drop from its USD0.82 high.
- Our forecasts are for the NZD to press higher still over the next 12 months, but at the current levels we expect to see plenty of NZD selling by importers, so USD0.65 should provide some resistance.
- The AUD also roaring higher - we have the RBA rate announcement this afternoon. No change is expected, but the statement from the RBA will provide some direction to the interest and FX markets.

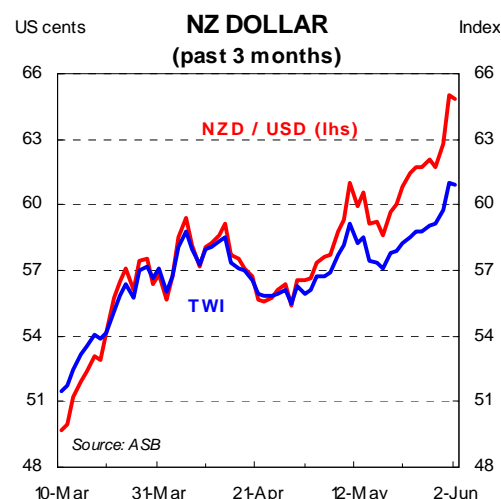
Short-term outlook:

Key data	Date	Time (NZST)	Market expects
RBA Rate Announcement	2/6	4.30 pm	3.0%
AU Q1 GDP	3/6	1.30 pm	-0.2%
US Non Farm Payrolls	6/6	12.30 am	-520k

Potential currency movers from the US this week: Pending home sales, Consumer Confidence, vehicle sales (3rd) ADP Employment Change, ISM non-manufacturing index, Factory Orders (4th) Non-farm productivity, Unit Labor Costs, Weekly Jobless Claims, Chain Store Sales (5th) Non-farm payrolls, Consumer Credit (6th)

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.
- Right now, the USD, which has shown countercyclical strength, is under pressure. USD is weakening for the following reasons:
 - US residents increase their offshore investment, encouraged by improvement in the global economy.
 - USD liquidity demand and safe-haven buying of the USD reverses is easing.
 - Diversification out of USD is expected to occur due to concerns about US government debt.
- The arguments for buying EUR, GBP and JPY are strong enough to engineer a reasonable depreciation in the USD, but we do not expect to revisit fresh US TWI lows.
- 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 depreciates. But both the Australian dollar and the New Zealand dollar will remain relatively weak vis-à-vis the major cross rates while global growth remains weak.
- Following the release of the Budget last week, S&P revised NZ's foreign currency sovereign credit rating from negative to stable, removing a key risk to our NZD forecasts for the time being.



Interest Rate Market

Wholesale interest rates	Current	Week ago	Month ago	6 mths ago	Year ago	ST Bias
Cash rate	2.50	2.50	2.50	6.50	8.25	FLAT
90-day bank bill	2.69	2.80	2.81	5.47	8.71	FLAT
2-year swap	3.59	3.61	3.39	5.01	8.12	UP
5-year swap	5.09	5.06	4.63	5.43	7.72	UP
11/11 gov't stock	4.58	4.60	4.28	4.75	6.57	UP
NZSX 50	2788	2741	2720	2683	3613	UP

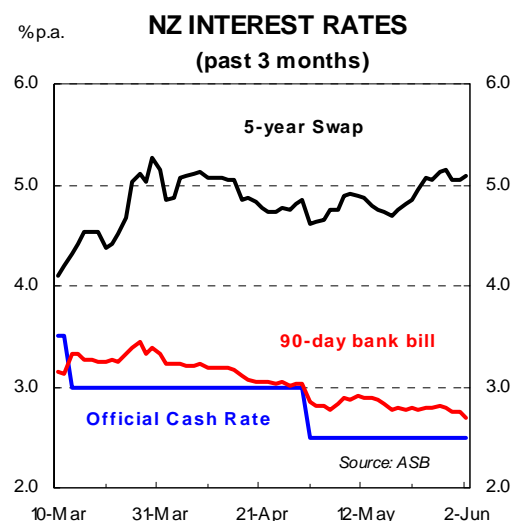
* Current is as at 12pm Tuesday; week ago as at Monday 5pm

- 90-day rates slipped 10 basis points lower over the week. The fall was partly driven by the easing in LIBOR rates seen overseas, as the premium built into the 90-day bank bill edged down as global risk aversion eased.
- Swap rates initially spiked up over the first part of the week, continuing with the global trend of rising longer-term interest rates. However, rates came off sharply (more so at the shorter end) following the release of the Budget which resulted in S&P taking NZ's foreign currency sovereign credit rating off negative watch.
- We are expecting the RBNZ to keep the cash rate at 2.5% on Thursday next week, and to reiterate its outlook for the OCR to remain at or below current levels till mid 2010. After delivering a large amount of monetary policy stimulus over a relatively short period, the RBNZ should take its time in delivering the final 2 cuts to the OCR. April's 50bp cut turned out relatively ineffective given the headwinds from market sentiment and now may not be the most opportune time for another 25bp cut.

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Comment: No local data this week, so the focus will be on offshore events. The RBA is widely expected to keep rates on hold today (4.30pm). Previous statements have suggested a degree of optimism and a similar tone is expected this afternoon and in Governor Glen Stevens' speech on Thursday. Q1 Australian GDP should confirm a technical recession in Australia. Bank of England and ECB are due for rate announcements later this week. Further announcements to credit easing measures could impact interest rates in those markets. RBNZ's turn next Thursday, we expect no change on the OCR.



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.
- The RBNZ's March MPS forecasts were optimistic, and the tone of April's statement suggests that the RBNZ has revised down its 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.
- The RBNZ's ability to deliver further monetary stimulus is facing multiple headwinds. The OCR is losing traction on retail interest rates (as deposit rates become sticky). In addition, financial conditions continue to tighten, with the NZ dollar remaining elevated and global yields continuing to push higher on debt issuance concerns.
- We expect the RBNZ will remain on hold in June, pausing to assess the impact of recent rate cuts. Current financial conditions are likely to limit the effectiveness of further rate cuts. Nonetheless, in our view further monetary policy stimulus is warranted and we continue to expect another 50 basis points of rate cuts to be delivered over the next 3-6 months.
- With the OCR losing traction, the RBNZ must more seriously consider alternative measures. Although the RBNZ has signalled it has been investigating different options, it remains very reluctant to implement these. Such measures may well be needed to put additional downward pressure on long-term rates and the NZ dollar.

NZ Data Review: weekly recap

April Trade Balance

The trade balance recorded a \$276m surplus, in line with our expectations and close to market expectations of a \$350m surplus. The third consecutive surplus aided an improvement in the annual trade deficit to \$4.1 billion (from \$4.7 billion in March). The improvement in NZ's trade position is mostly owed to the sharp contraction in imports over the past few months.

Imports continue to slip in line with weakening demand. Imports of vehicles are down 33% on year-ago levels, consistent with the fall in sales seen in retail trade data

Exports are down on year-ago levels, although the fall has been mitigated somewhat by strength in agricultural production. Dairy exports remain supported by a recovery in production levels following last season's drought. Fruit exports are benefiting from a very strong start to the kiwifruit season. Meat exports remain firm, with strong prices helping to cushion the decline in production (as slaughter volumes have started to decline).

Q2 RBNZ Inflation Expectations

Inflation expectations eased slightly over the past quarter, with one year-ahead expectations dropping to 1.8% from 2.2% and 2 year-ahead expectations falling to 2.2% from 2.3%. Inflation expectations are easing back towards the centre of the RBNZ's target band of 1-3% over the medium term, following very elevated inflation expectations during a period of intense resource strain. However, with the recession deepening in NZ and globally, pressures on resources have eased rapidly. Coupled with the fall in oil prices, inflation pressure and inflation expectations have eased substantially.

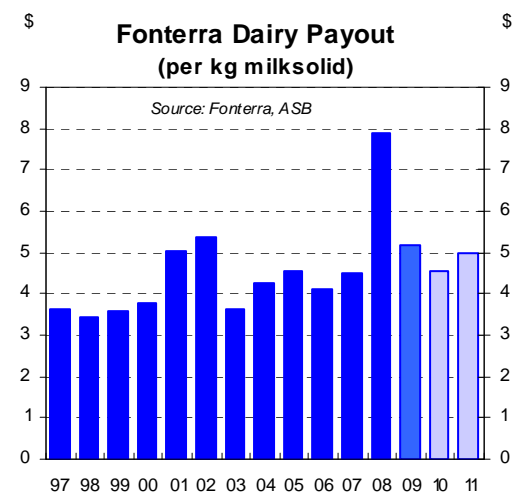
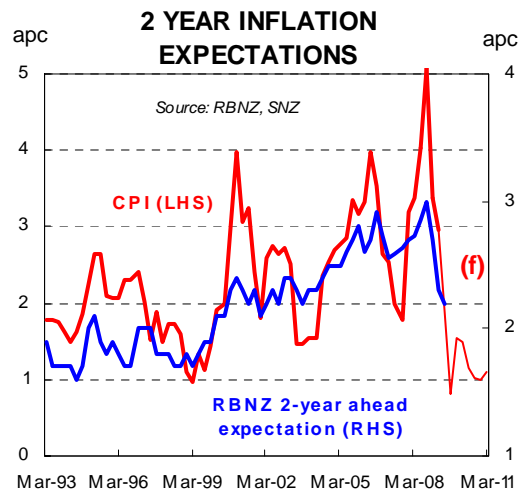
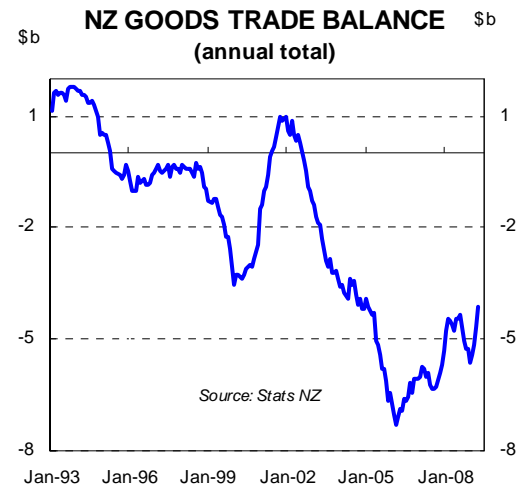
Indicators for non-tradable inflation (the more sticky component of inflation) are easing rapidly and our forecasts suggest inflation could fall to 1% by the end of 2010. Given the severity of the recession, concerns are shifting towards inflation falling through the bottom of the target band. However, last week's data show inflation expectations are sitting firmly in the middle part of the target band and deflation pressures is not yet an issue the RBNZ needs to worry about.

Fonterra Forecast Payout

Fonterra Co-operative Group forecast for the 2008/09 season dairy payout to remain at \$5.20 kg per milk solid. However, its forecast for the 2009/10 season was disappointing at just \$4.55 kgms (comprising \$4.10 milk price and 45c value add). The lower payment reflects weak international dairy prices, which have fallen from September 2007 highs back to long-term average levels. Also weighing on dairy returns is the pick up in the NZ dollar, Fonterra have assumed an average of 59 cents compared to ASB's assumed hedging rate of 62 cents over the next season.

After adjusting for the expectation of higher production next year, this is likely to mean a contraction in total dairy income of around \$650m for the 2009/10 season.

Of some financial assistance to farmers, Fonterra has brought forward 20 cents of the value add return payment to August 2009 (previously deferred until October 2009).



May NBNZ Business Confidence

Business optimists outnumber pessimists for the first time since September 2008. Both the overall outlook and own activity indicators within the National Bank's Business Outlook survey have moved into positive territory. A net 2% expect general business conditions to improve over the next 12 months, and firms' expectations of their own activity is back in positive territory with a net 4% of firms expect better times ahead. If own activity expectations continue to improve that would signal a likely return to weak growth in the second half of 2009.

Confidence was up across all sectors, with retail being the notable sector where pessimists still outnumber optimists in terms of their own activity expectations. Profit, investment and employment intentions all remain negative, below Asian crisis levels, but did improve in the latest survey. Pricing intentions remain weak, with a net 12.4% of firms intending to raise prices, down from 17% last month, and well off the 41% peak in mid-2008. Pricing intentions point to lower inflation in the year ahead.

Budget 2009

The Budget showed a sizable lift in Crown debt levels over the next few years, which was to be expected. The fiscal forecasts show that the operating balance is not expected to return to surplus until 2019, making for 10 years of operating deficits. Even to achieve that outcome the Government has scrapped planned tax cuts and chopped Superannuation Fund contributions for around 10 years.

The forecast OBEGAL peaks at a deficit of 5.1% of GDP in the 2011 year, falling to 4.2% of GDP by 2013. We had expected operating surpluses to sit around 5% of GDP over 2011 through 2013. Net Government debt is expected to peak at 35.9% of GDP in 2017 (including NZ Superannuation Fund assets net debt peaks at 26.2% of GDP). Gross Sovereign debt is expected to reach 42.9% of GDP in 2016.

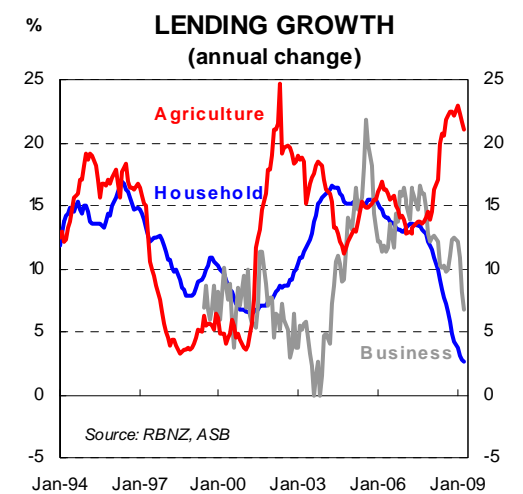
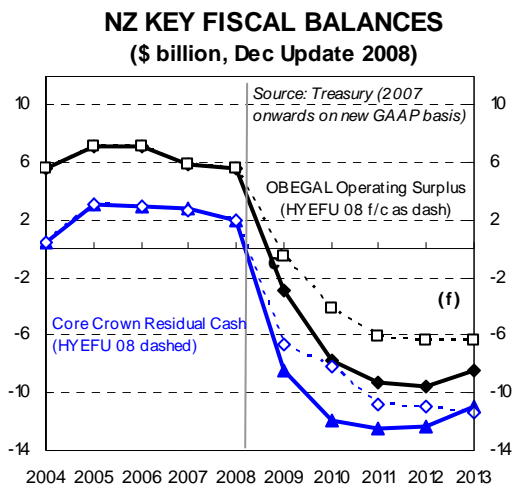
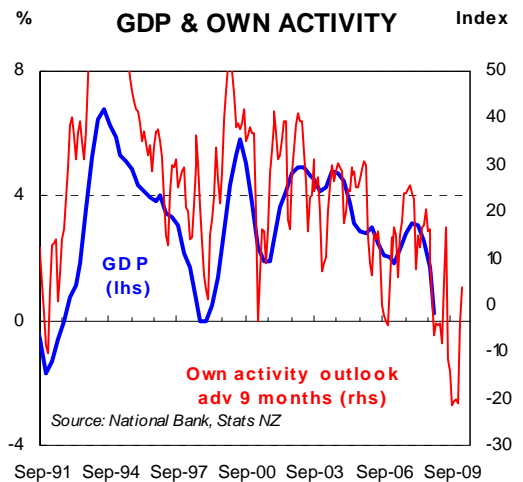
There was a lot riding on this Budget, particularly whether it would be enough to avoid a potentially expensive credit rating downgrade. It would appear the Government has been successful, with Standard and Poor's putting NZ's credit rating outlook back to stable.

April RBNZ Credit Aggregates

Mortgage lending had another relatively robust month in April, with net lending up \$488mn. That experience is in keeping with the surge in mortgage applications seen in late March and early April. However, that spike has abated, so the recent pace of new mortgage lending may not be sustained. In contrast, consumer lending continued to contract slightly on an annual basis. Overall household lending rose 0.2% seasonally adjusted, with that pace roughly steady since December. Growth in household lending is likely to remain muted as households focus more on saving.

Business lending growth has started to slow more noticeably in recent months. Moderation in growth is likely to continue. Customer demand is weak, profits are under pressure, and capital investment is consequently being pared back.

Agricultural lending growth remains surprisingly resilient. Nevertheless, lending growth in this sector is likely to slow noticeably. In particular, the low dairy payout for the upcoming section reinforces that on-farm investment is likely to be muted.

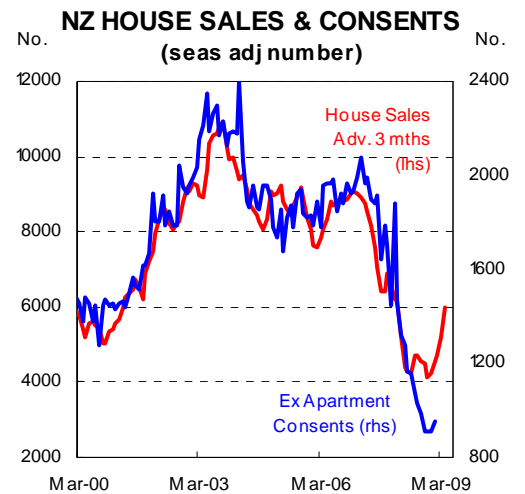


April Building Consents

Consent issuance rose 11.2% in April, with a 4.5% pick up in core issuance further boosted by a rebound in the number of apartment consents issued (which are typically very lumpy month to month).

Core consent issuance finally showed a modest increase after months of declines or flat results. Nonetheless, the size of the pick up is very small and the level of consent issuance remains very weak and continues to under perform house sales (an indicator of housing demand). Demand for residential construction has fallen considerably on the back of falling house prices and low rates of population growth. Looking ahead, low interest rates and a turn around in net migration should help building demand lift off these very low levels.

Non-residential consent issuance surged in April due to the Christchurch International Airport development. Prior to April, non-residential consent issuance had started to slow, albeit modestly, as weakening economic activity saw investment demand slow. Excluding the Christchurch Airport consent, issuance was likely to be weak as many components are noticeably lower on the previous year's issuance (including shops, factories and storage).



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	
	NZT						Market	ASB/CBA
Tue 2 Jun	11.50	JP	Monetary base	May	y%ch	8.2	~	~
	13.30	AU	Current account balance net export cont to QI GDP	QI	\$mn	-6,499	-5,425	-5,500
					ppts	1.5	~	0.8
	13.30	AU	Building approvals	Apr	m%ch	3.5	2.0	5.0
y%ch					-16.5	-21.7	-20.5	
16.30	AU	RBA cash target	Jun	%	3.00	3.00	3.00	
Wed 3 Jun	11.30	AU	CBA/Ai Group PSI	May	Index	39.8	~	~
	13.30	AU	GDP	QI	q%ch	-0.5	-0.2	-0.1
y%ch					0.3	-0.4	-0.3	
Thu 4 Jun	11.50	JP	Capital spending	QI	%	-17.3	~	~
	13.30	AU	Trade balance	Apr	\$mn	2,498	1,700	1,000
	14.30	AU	RBA Governor Stevens Speech in Townsville					
Fri 5 Jun	10.45	NZ	Wholesale trade Survey	QI	~	~	~	~
	11.30	AU	Ai Group construction index	May	Index	36.5	~	~
Sun 7 Jun	~	NZ	QV house prices	May	y%ch	-9.2	~	~

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
Tue 2 Jun	09.30	UK PMI construction	May	Index	38.1	~	~
	15.00	US Pending home sales	Apr	m%ch	3.2	0.3	~
Wed 3 Jun	08.55	EZ PMI services	May	Index	46.0	~	~
	09.00	EZ PMI services	May	Index	44.7	~	~
	09.00	EZ PMI composite	May	Index	43.9	~	~
	09.30	UK PMI services	May	Index	48.7	~	~
	10.00	EZ PPI	Apr	y%ch	-3.1	~	~
	10.00	EZ GDP	Q1	q%ch	-2.5	~	~
				y%ch	-4.6	~	~
	13.15	US ADP employment change	May	'000	-491	-555	~
15.00	US ISM non-manufact. composite	May	Index	43.7	45.0	~	
15.00	US Factory orders	Apr	%	-0.9	0.3	~	
Thu 4 Jun	10.00	EZ Retail sales	Apr	m%ch	-0.6	~	~
				y%ch	-4.2	~	~
	12.00	UK BoE announces rates	Jun	%	0.5	0.5	0.5
	12.45	EZ ECB announces interest rates	Jun	%	1.00	1.00	1.00
	13.30	CA Building permits	Apr	m%ch	23.5	-7.5	~
	13.30	US Initial jobless and continuing claims					
	14.00	CA Bank of Canada rate	Jun	%	0.25	0.25	0.25
	15.00	CA Ivey PMI	May	Index	53.7	55.0	~
Fri 5 Jun	09.30	UK PPI	May	~	~	~	~
	12.00	CA Unemployment rate	May	%	8.0	~	~
	13.30	US Change in non-farm payrolls	May	'000	-539	-530	~
	13.30	US Unemployment rate	May	%	8.9	9.2	~

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