

Business Weekly

Play it again, Alan

This Week

This week the RBNZ will release its *Monetary Policy Statement*. The Official Cash Rate will undoubtedly be left unchanged – the focus will be on the message the RBNZ delivers. Back in October the RBNZ was very direct in its comments about market pricing, expressing strong disagreement with the 25bp hike then implied for the January meeting. The message was effective as markets have since backed off expectations of such an early rate hike, a result the RBNZ will be pleased with. Markets have currently priced in a 25 basis point OCR increase for April and another one by June.

From a strategic point of view, the RBNZ will want to continue dampening down expectations that a rate increase will be occurring earlier, in order to encourage households to move onto floating interest rates over the coming months. We expect the RBNZ to continue with its deliberately dovish tone in both the December and January announcements. Particularly, this week the RBNZ will reiterate its expectation the OCR will remain unchanged until the second half of 2010. But the longer the RBNZ sticks to that script in a generally-improving environment, the more rapid the eventual shift in stance is likely to be. Over time the inflation outlook will start to look less benign and continued recovery in house prices will take on more importance. The strength of recovery in house prices is a threat to the RBNZ for two reasons. Firstly, the strength in house prices has inflationary consequences and could once again stimulate consumption via the wealth effect. Secondly, a return to borrowing excessively against housing would undermine the much needed rebalancing of the economy the RBNZ continues to push for. The run of the housing market will eventually come to an end, but there are very few factors likely to close the yawning gap between demand and supply within a few months.

By March, patience with the housing market will likely wear thin, and we expect cracks in the RBNZ's façade to appear. By April the RBNZ is likely to find itself in a position where it will need to slow the housing market via a higher OCR to prevent further aggravation of New Zealand's imbalances and vulnerabilities (not to mention anticipation of inflation). But right now the RBNZ is unlikely to prompt more aggressive pricing of OCR hikes even though market pricing is behind – rather than ahead – of our OCR outlook,

Markets are getting over their Dubai wobbles (though the saga of restructuring the debts in question is not finished). Getting a few eyebrows raised now instead were the surprisingly strong (almost suspiciously so!) US Non-farm Payrolls figures, which showed barely any job losses at all in the US over November. Chart of the Week has more details on this development.

Click here for:

[Foreign Exchange](#)

- NZD mixed. Lifting slightly on a TWI basis. USD strengthens sharply on Friday.

[Interest Rates](#)

- Rates rise sharply following US Non-farm payrolls surprise.

[Week Ahead](#)

- RBNZ the highlight. Trade Indices, Manufacturing & Building Work reports due.

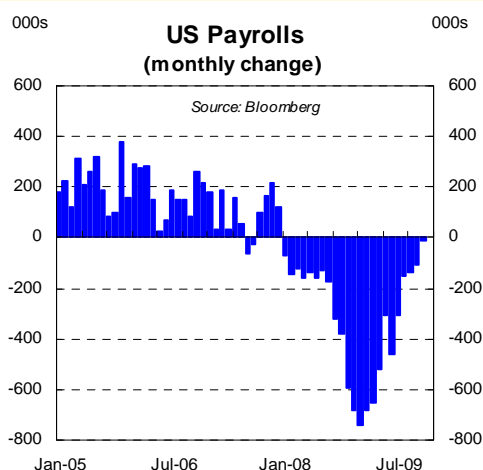
[Week in Review](#)

- Building consents the only local release (reviewed in last week's report)

[Global Calendars](#)

- Bank of Canada and England rate decisions. University of Michigan confidence.

Chart of the week



- The US Non-farm Payrolls report stunned the market on Friday. Payrolls fell by only -11k and a big upward revision to October's survey was made from -190k to -111k. Expectations were centred on a -125k drop.
- The unemployment rate eased from 10.2% to 10.0%. We are sceptical the US labour market has stabilised already – we think that is more a story for H1 2010.
- However, if it has then the USD is likely to keep rising (against almost all currencies) as markets bring forward rate hikes by the Federal Reserve.
- The market reaction was swift, with the USD strengthening and US Treasury bond yields jumping around 10bp.

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	0.7155	0.7203	0.7222	0.6251	0.5335	FLAT/ DOWN	0.7050	0.7250
NZD/AUD	0.7826	0.7841	0.7905	0.7871	0.8266	FLAT/ DOWN	0.7750	0.7900
NZD/JPY	64.67	62.39	65.50	61.63	49.36	FLAT/ DOWN	62.00	66.00
NZD/EUR	0.4815	0.4780	0.4854	0.4480	0.4178	FLAT/ DOWN	0.4750	0.4850
NZD/GBP	0.4355	0.4343	0.4348	0.3918	0.3633	FLAT/ DOWN	0.4300	0.4400
TWI	64.2	63.9	64.8	59.6	54.1	FLAT/ DOWN	63.00	65.00

^Weekly support and resistance levels * Current is as at 10.30 am Monday; week ago as at Monday 5pm

- The NZD was mixed last week, declining against the USD and AUD, but posting gains on the JPY, GBP and Euro. The net result was a small lift in the NZD on a trade weighted basis. There was a dearth of local data, and once again the NZD was driven by offshore themes.
- The NZD strengthened to nearly 0.73 against the USD on December 3rd, but dropped over a cent on December 4th as the USD strengthened. Major currencies slumped against the US dollar on Friday following the much stronger than expected Payrolls report in the US. Investors began to factor in job growth in the US in coming months and the potential for higher interest rates. In the wake of the report, the EUR lost 2 US cents, AUD lost 1.5 cents, and USD/JPY gained almost 2 yen.
- This week the focus is back onshore, with the focus firmly on the RBNZ meeting on Thursday morning. We think the NZD will drift until Thursday. As is always the case, the RBNZ meeting has the potential to move the NZD in either direction. However, we expect the RBNZ to deliver a similar message to their last announcement, and the downward drift of the NZD should continue.

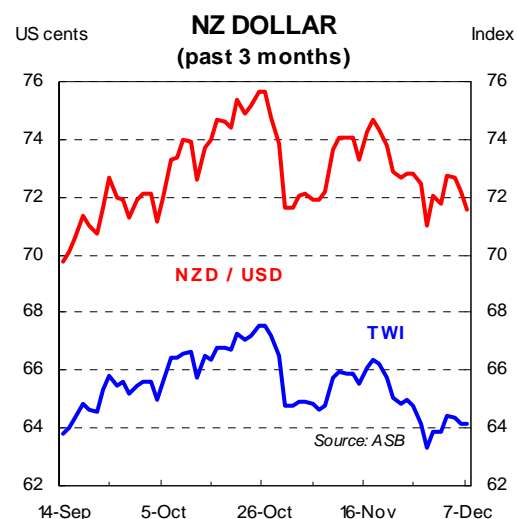
Short-term outlook:

Key data	Date	Time (NZST)	Market expects
Building Work Put in Place	8/12	10.45 am	
Manufacturing Survey	8/12	10.45 am	-
RBNZ OCR Announcement	10/12	9.00 am	2.5
Terms of Trade	10/12	10.45 am	+ 0.5%
AU Employment Report	10/12	1.30 pm	+5,000

Potential currency movers from overseas this week: German Factory orders, US consumer credit (Mon 7th). UK house prices and UK & German industrial production, Bank of Canada Rate decision (Tue 8th). German trade balance and current account, UK trade balance, US wholesale inventories (Wed 9th). ECB monthly report, BoE announces rates & asset purchase target, US trade balance, initial jobless claims (Thur 10th). US retail sales, Uni of Michigan confidence, business inventories (Fri 11th).

Medium-term outlook: [\[Last Quarterly Economic Forecasts\]](#)

- We continue to expect the NZD to appreciate further against the USD over the next 6-9 months. We have revised up our expected peak to USD 0.82.
- The story remains primarily one of USD weakness, also overlaid by some Downunder strength. We expect the USD to remain under pressure until the Federal Reserve starts to unwind its policy stimulus: the earlier that starts the sooner the NZD's rise is likely to be capped.
- The reasons for the expected USD weakness remain similar to the drivers in place since mid-March, namely:
 - US residents increase their offshore investment, encouraged by improvement in the global economy, with USD liquidity demand and safe-haven buying also no longer boosting the USD.
 - Diversification out of USD is expected to occur due to concerns about US government debt.
 - And, related, concern about the USD's future role as a reserve currency.
- The NZD is also likely to mildly outperform other major currencies in the ongoing environment of improving global growth prospects and rising commodity prices. Outright weakness in the Pound will continue to hold the NZD/GBP rate at very elevated levels. The Pound, like the USD, is being weighed down by debt concerns and the state of its financial sector – both of which have ramifications for the future growth rate of the economy.
- The buoyant Australian dollar is also likely to contribute to an overall strengthening of the NZD. The RBA is likely to continue lifting its cash rate back to a less stimulatory level. Rising interest rates there will lift the AUD. The NZD will be caught in the middle: weakening slightly against the AUD but up against other currencies.



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	2.50	5.00	FLAT
90-day bank bill	2.79	2.80	2.80	2.70	5.33	FLAT/UP
2-year swap	4.41	4.38	4.54	3.72	4.82	FLAT/UP
5-year swap	5.52	5.50	5.71	5.26	5.16	FLAT/UP
5-year benchmark gov't stock	5.35	5.31	5.09	4.81	4.58	FLAT/UP
NZSX 50	3147	3123	3160	2817	2708	UP

* Current is as at 10.30 am Monday; week ago as at Monday 5pm. Please note that we have recently changed the NZ govt 5-year benchmark bond to April 2015 maturity (from April 2013). This does cause some distortion in the comparison against the previous levels (i.e. month ago).

- Local interest rate markets remained relatively quiet over the week. NZ yields came under slight pressure at the start of the week, dragged lower by declines in Australian shorter-term interest rates after the RBA decision on Tuesday afternoon. The RBA remained vague on the future moves in the cash rate, leaving the market to assume future rates are data dependent.
- NZ interest rates then lifted on the open this morning, following the stronger than expected US employment report over the weekend. US Treasuries sold off (yields higher) aggressively following the release.
- The RBNZ is widely expected to remain on hold at this week's announcement. Despite recent improvement in the economic outlook, we expect that the RBNZ will 'stick to the script' and deliver a statement similar in tone to October's dovish stance.

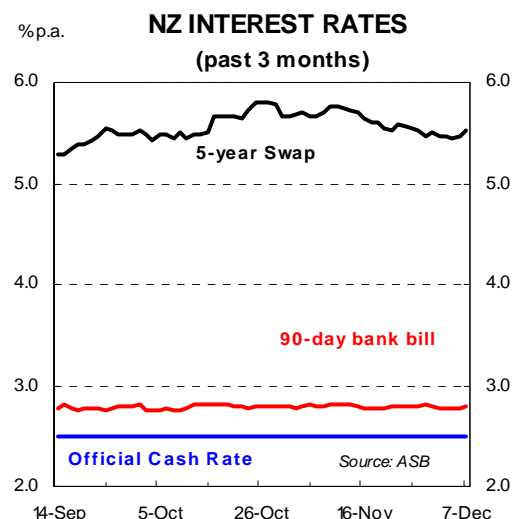
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AU Employment Report	10/12	1.30 pm	+5,000

Comment: On Tuesday we get 2 key inputs into our final forecast for Q3 GDP. However, Thursday is shaping up to be the focus of the week. To kick off the RBNZ is expected to remain on hold, but watch the tone closely. While we expect the RBNZ to stick to October's message, the risk is that the RBNZ comes across as more upbeat, with interest rates lifting on the day. Later that morning the Terms of Trade are likely to remain subdued. The Australian Employment report will be a key fixture in Australasian markets, with further RBA hikes now considered as data dependent.

Medium term outlook: [\[Last Quarterly Economic Forecasts\]](#)

- The RBNZ continues to hold the cash rate at 2.5%. While the RBNZ has backed off its easing bias, it maintains a very dovish tone. The Bank has stated it sees no urgency to withdraw monetary stimulus, and expects to keep the OCR at the current level until the second half of 2010. However, given the recent improvement in the outlook, we see that stance becoming untenable in time.
- The RBNZ's overall growth and inflation forecasts were unchanged at the September MPS, despite incorporating significantly stronger monetary conditions. The RBNZ sees more inflation pressure in the economy stemming from a less weak global outlook, a pick up in net migration supporting the housing market, and improved business confidence.
- October's statement suggest some change in the RBNZ's outlook, though not enough to convince the RBNZ it is likely to hike in the first half of 2010. World demand has stabilised and the outlook for 2010 continues to improve. Dairy prices have lifted off lows and have led Fonterra to revise up its forecast payout significantly. Net migration continues at a robust pace, and continues to provide support to housing demand in a tight market. Housing supply has been slow to respond, resulting in a surprisingly strong lift in house prices over the past 6 months which is likely to make the RBNZ uncomfortable. Business and consumer confidence has surged pointing to an earlier recovery in growth than previously thought. Meanwhile, the downside risks to inflation have also abated.
- The next move in the OCR is up, it's just a matter of when. We expect the RBNZ will hike by April next year (previously June). The RBNZ has a substantial amount of policy stimulus to unwind, the first steps are likely to be bigger (i.e. 50 basis point moves).



NZ Data Preview: a look at the week ahead

Data	Date	Time (NZST)	Previous	Market expects	ASB expects
Q3 Building Work Put in Place (qoq)	8/12	10.45 am	-4.5%	-	-1%
Q3 Economic Survey of Manufacturing (qoq)	8/12	10.45 am	-4.8%	-	-
December RBNZ OCR announcement	10/12	9 am	2.5%	2.5%	2.5%
Q3 Terms of Trade (qoq)	10/12	10.45am	-8.9%	-	+0.5%
November Food Price Index (mom)	11/12	10.45am	-1.5%	-	-

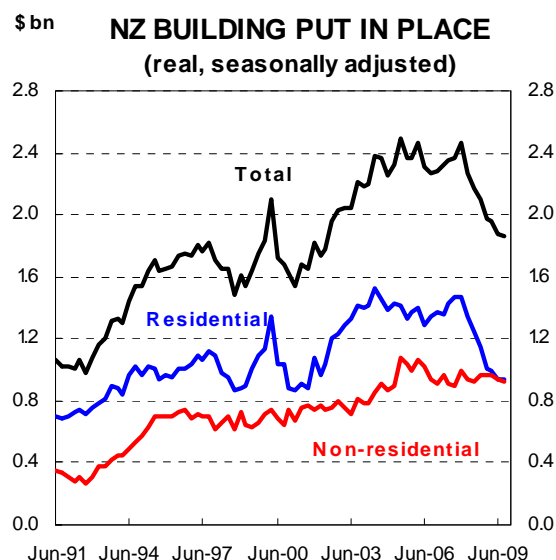
Q3 Value of Building Work Put in Place

ASB (f) -1%

Previous -4.5%,

Earlier data on consent issuance for both residential and non-residential construction point to a stabilisation in construction activity over Q3. This follows substantial declines over the past two years.

Turning to the break-down, we expect flat residential and a small decline in non-residential construction over the quarter. While there have been spikes in non-residential consent issuance in recent months these can largely be attributed to large projects, hence we expect it to show up in non-residential construction activity in 2010 rather than Q3.

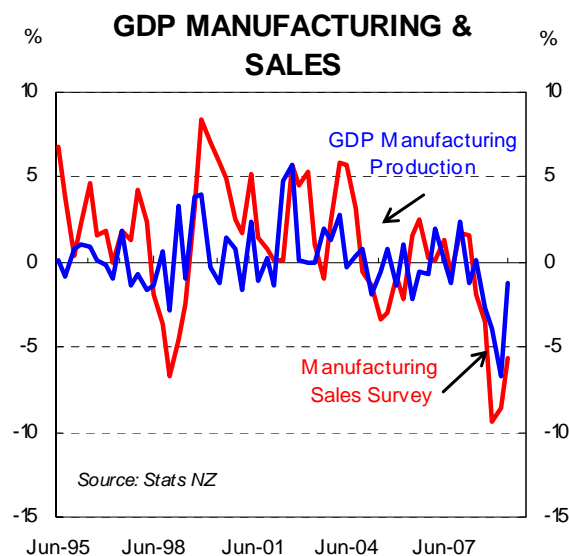


Q3 Economic Survey of Manufacturing

Total: previous -4.8%

We expect manufacturing activity to decline slightly over the quarter, with the declines coming from a steady result for food manufacturing and dip in non-food manufacturing. This follows a year of substantial decline in the manufacturing sector, particularly for non-food manufacturing.

There has been an improvement in manufacturing confidence, although it remained at low levels through much of Q3. This points to a stabilisation in manufacturing activity over Q3, and a pick up in Q4.



RBNZ Statement of Monetary Policy

ASB (f) 2.50%

The economic outlook has improved considerably over the 12 weeks following the September MPS, and even the last 6 weeks since the October OCR review. On the whole, we have seen stronger than expected developments both here and abroad which will see RBNZ reconsider the economic outlook outlined in September. We expect the RBNZ to remain on hold at 2.5% until April 2010, with the view the RBNZ will want to confirm and be confident growth has become sustainable before lifting the cash rate. Indications of a change in stance are likely a story for the January or March RBNZ meetings. For now, we expect the RBNZ to toe the line of holding the current setting until the second half of 2010. When they come, we expect initial rate hikes to be aggressive (50 basis point steps) to promptly lift the cash rate off emergency settings.

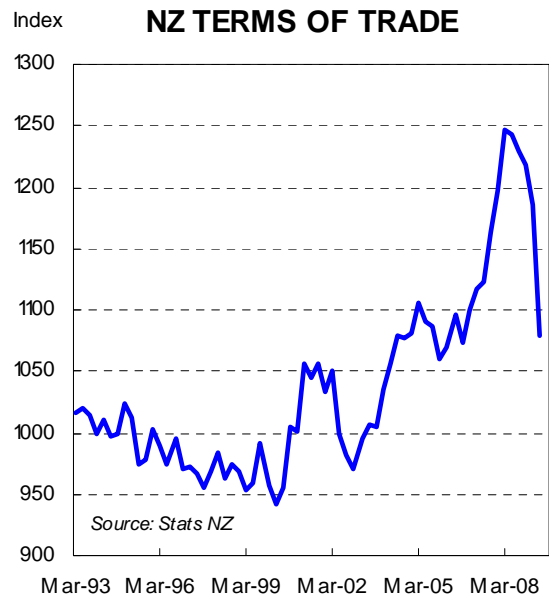
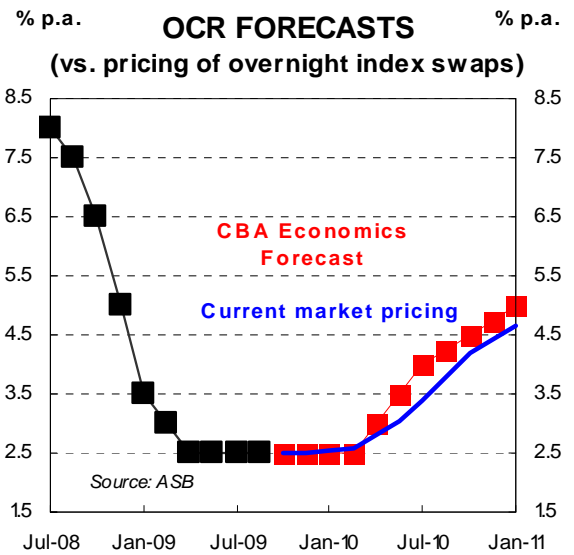
Q3 Terms of Trade

ASB (f) +0.5% qoq

We expect stabilisation in NZ's Terms of Trade over Q3, as the declines in export and import prices largely offset each other.

In foreign currency terms, commodity prices generally improved over Q3 in line with the improving global economic outlook. However, these lifts were more than offset by the increase in the NZ dollar over the same period. More recently, our NZ commodity price index has made more sizable gains which are likely to translate into stronger export prices in coming quarters, with dairy being a key driver.

On the volumes side, we expect a mild 0.5% decline in export volumes with falls in dairy, meat and manufactures offset by increases in logs, oil and aluminum volumes. Import volumes may show signs of recovery, in line with improving domestic demand.



Global Data Calendars

Note: Calendar 2 is in UK times. Add 13 hours for NZ times.

Calendar – Australasia, Japan and China

Date	Time	NZST	Econ Event	Period	Unit	Last	Forecast	
							Market	ASB/CBA
Mon 07 Dec	13.30	AU	ANZ Job ads	Nov	m%ch	-1.7	~	~
Tue 08 Dec	10.45	NZ	Manufacturing activity	QIII	%	-4.8	~	~
	10.45	NZ	Value of Building Work	QIII	q%ch	-4.5%	~	-1%
	12.50	JP	Adjusted current account total	Oct	¥bn	1,338	~	~
	13.30	AU	NAB business conditions	Nov	Index	12.0	~	~
	13.30	AU	NAB business confidence	Nov	Index	16.0	~	~
	13.30	AU	Current account balance	QIII	\$Bn	-13.3	~	-16.5
	13.30	AU	Annual national accounts 2008-09					
	21.15	AU	RBA Governor Stevens speaks in Sydney					
	Wed 09 Dec	10.45	NZ	Card spending	Nov	m%ch	-0.2	~
12.50		JP	GDP	QIII	q%ch	1.2	~	~
13.00		AU	MI consumer sentiment	Dec	Index	118.3	~	~
13.30		AU	Trade balance	Oct	\$bn	-1.85	~	-1.85
13.30		AU	Housing finance	Oct				
				Value of loans		m%ch	6.7	~
			No owner occupier		m%ch	5.1	~	-4.0
Thu 10 Dec	19.00	JP	Machine tool orders	Nov	y%ch	-42.5	~	~
	09.00	NZ	RBNZ official cash rate	Dec	%	2.5	2.5	2.5
	10.45	NZ	Terms of trade index	QIII	q%ch	-9.0	~	~
	12.50	JP	Machine orders	Oct	m%ch	10.5	~	~
	12.50	JP	Domestic CGPI	Nov	m%ch	-0.7	~	~
	13.00	AU	MI Consumer inflation exp	Dec	%	3.2	~	~
	13.30	AU	Employment rate	Nov	'000	24.5	~	15.0
	13.30	AU	Unemployment rate	Nov	%	5.8	~	6.0
	13.30	AU	Participation rate	Nov	%	65.2	~	65.3
	14.45	AU	RBA Assistant Governor Debelle speaks in Sydney					
	Fri 11 Dec	~	CH	Trade balance	Nov	USD bn	24.0	~
~		CH	Exports	Nov	y%ch	-13.8	~	~
~		CH	Imports	Nov	y%ch	-6.4	~	~
10.45		NZ	Food prices	Nov	m%ch	-1.5	~	~
13.30		AU	State accounts 2008-09					
15.00		CH	Producer price index	Nov	y%ch	-5.8	~	~
15.00		CH	CPI	Nov	y%ch	-0.5	~	~
15.00		CH	Retail sales	Nov	y%ch	16.2	~	~
15.00		CH	Industrial production	Nov	y%ch	16.1	~	~
15.00		CH	Fixed assets inv urban	Nov	ytd y%ch	33.1	~	~

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 07 Dec	11.00	GE Factory orders	Oct	m%ch y%ch	0.9 -13.1	~ ~	~ ~	
	13.30	CA Building permits	Oct	m%ch	1.6	~	~	
	20.00	US Consumer credit	Oct	\$bn	-14.8	-9.7	~	
Tue 08 Dec	~	UK NIESR GDP estimate	Nov	%	-0.4	~	~	
	00.01	UK RICS house price balance	Nov	%	34.0	~	~	
	09.30	UK Industrial production	Oct	m%ch y%ch	1.6 -10.3	~ ~	~ ~	
	11.00	GE Industrial production	Oct	m%ch y%ch	2.7 -12.9	~ ~	~ ~	
	13.15	CA Housing starts	Nov	'000	157.4	156.0	~	
	14.00	CA Bank of Canada rate	Dec	%	0.25	0.25	0.25	
	15.00	US IBD/TIPP economic optimism	Dec	Index	47.9	~	~	
Wed 09 Dec	00.01	UK Nationwide cons. confidence	Nov	Index	72.0	~	~	
	07.00	GE Trade balance	Oct	€bn	10.6	~	~	
	07.00	GE CPI – EU harmonised	Nov	m%ch y%ch	-0.1 0.4	~ ~	~ ~	
	07.00	GE Current account	Oct	€bn	9.4	~	~	
	07.00	GE Imports	Oct	m%ch	5.8	~	~	
	07.00	GE Exports	Oct	m%ch	3.8	~	~	
	09.30	UK Visible trade balance	Oct	£mn	-7,194	~	~	
	09.30	UK Trade balance non EU	Oct	£mn	-3,783	~	~	
Thu 10 Dec	15.00	US Wholesale inventories	Oct	%	-0.9	-0.6	~	
	09.00	EZ ECB publishes Dec monthly report (text)						
	12.00	UK BoE announces rates	Dec	%	0.50	0.50	0.50	
	12.00	UK BoE asset purchase target	Dec	£bln	200	~	~	
	13.30	CA International merch trade	Oct	\$bn	-0.9	~	~	
	13.30	US Trade balance	Oct	\$bn	-36.5	-36.7	~	
	13.30	US Initial jobless and continuing claims						
Fri 11 Dec	09.30	UK PPI input	Nov	~	~	~	~	
	13.30	CA New housing price index	Oct	m%ch	0.5	~	~	
	13.30	US Import price index	Nov	m%ch y%ch	0.7 -5.7	1.3 ~	~ ~	
	13.30	US Advance retail sales	Nov	%	1.4	0.5	~	
	13.30	US Retail sales less autos	Nov	%	0.2	0.5	~	
	13.30	US Retail sales ex autos & gas	Nov	%	0.3	~	~	
	15.00	US Uni of Michigan confidence	Dec	Index	67.4	~	~	
	15.00	US Business inventories	Oct	Index	-0.4	-0.2	~	

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