

# Business Weekly

## Get by with a little help from my friends

### This Week

Thursday's RBNZ statement was very environmentally friendly, with the Bank recycling many words from its December statement. The run of data over the summer holiday period certainly made the RBNZ's job very easy, evolving closely to its set of forecasts produced in the December *Monetary Policy Statement*. With no surprises from Thursday's assessment, the focus increasingly turns to the eventual exit strategy for the RBNZ. On Thursday the RBNZ stuck to its 'middle of 2010' outlook, which has been broadly interpreted as some time between April and July. We continue to expect the RBNZ to make its first move in April. While inflation pressures remain tame for now, the medium-term outlook is shaping up to be increasingly uncomfortable for the RBNZ. Our own forecasts see non-tradable inflation pressures returning fairly swiftly during the upturn; perhaps something that will become more apparent to the RBNZ as we get another read on inflation, growth and business confidence before the April OCR review.

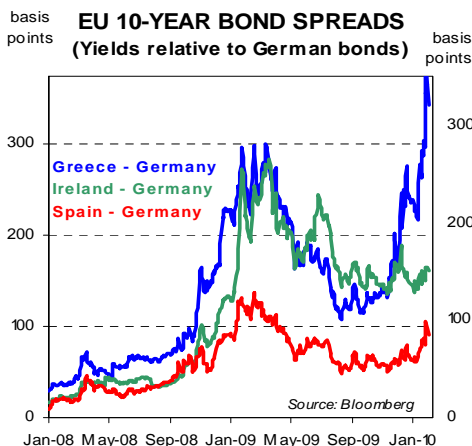
But it's not just when the RBNZ will go, but how far it will go and how fast. The Governor's speech on Friday confirmed our recent change of view. The OCR will not climb as high as would be expected in 'pre-crisis' times and also hikes are likely to be gradual (though "meaty chunks" are possible). The global financial crisis has pushed bank funding costs substantially higher, creating a wedge between the OCR and retail interest rates. To get retail borrowing rates back to neutral level (i.e. not stimulatory or contractionary), we estimate an OCR of only 5% is necessary. Funding costs have already pushed interest rates higher, reducing much of the urgency for aggressive action from the RBNZ. On top of this, the steep normal yield curve shape has increased the sensitivity to interest rate increases. Small increases in the OCR may have a very powerful effect early on and we now think 25 basis point moves should be sufficient.

In addition to a lower neutral cash rate, Dr Bollard's speech made the point that in future the OCR is going to need some friends. In particular, the RBNZ is hoping the new prudential liquidity policy will act as an automatic stabiliser and reduce required OCR hikes during the economic upswing. In addition to this, the RBNZ is hoping for a less distortionary tax system. There were some very direct messages to politicians in Friday's speech. There is a role for fiscal policy to help mop up much of the stimulus in the economy, with the onus now on the Government in May's Budget. But much of the speech appeared a response to recent criticism of the current monetary policy arrangement, with the Labour party breaking the bi-partisan accord on monetary policy. *"Major alternatives that dilute the focus on medium-term inflation and target other macroeconomic outcomes would risk reducing confidence in the future level of prices and would have led to worse overall outcomes at key points over the past 20 years."*

### Click here for:

- [Foreign Exchange](#) • NZD range trading, and little changed on week-ago levels.
- [Interest Rates](#) • Interest rates little changed over the week.
- [Week Ahead](#) • Household Labour Force Survey and migration figures due.
- [Week in Review](#) • RBNZ on hold as expected. A small trade surplus recorded for December
- [Global Calendars](#) • RBA, BoE, ECB rate decisions, US Non-farm Payrolls due.

### Chart of the week



- Greece's bond yields spiked recently, with yields rising to 200bp over the German bond yields.
- This sharp increase reflects growing concern about the ability of the Greece government to raise money and its commitment to reining in its large debt.
- These concerns were highlighted when the incoming Greek government released its estimate for the 2009 budget deficit of 12.7% of GDP, twice the outgoing government's estimate.
- Markets also fear Greece's funding pressures could spill over to the other weak members of the eurozone such as Portugal, Italy, Spain and Ireland. As a result, bond yields of these countries have also started to increase.

### 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	0.7085	0.7149	0.7225	0.6627	0.5084	FLAT	0.7000	0.7150
NZD/AUD	0.7949	0.7899	0.8079	0.7908	0.7896	FLAT	0.7825	0.8000
NZD/JPY	64.27	64.43	66.76	62.76	45.42	FLAT	63.50	65.50
NZD/EUR	0.5089	0.5049	0.5036	0.4651	0.3941	FLAT	0.4975	0.5150
NZD/GBP	0.4442	0.4438	0.4493	0.3959	0.3579	FLAT	0.4350	0.4550
TWI	65.2	65.2	66.1	61.6	51.4	FLAT	63.00	65.50

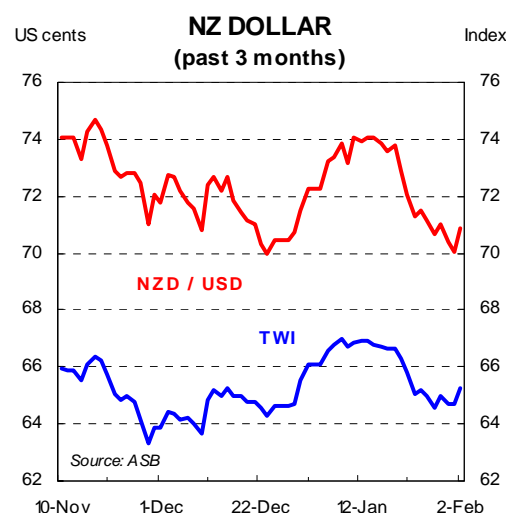
^Weekly support and resistance levels \* Current is as at 1pm Tuesday; week ago as at Monday 5pm

- **NZD** was mixed last week, but little changed on a trade weighted basis. Over the week, the NZD met resistance around 0.715 and found support at 0.70 against the USD. This week the NZD will be influenced by offshore developments, as well as local labour market data. Strong signals that the local labour market is stabilising would be NZD positive.
- It is a big week for the **AUD**, with an RBA interest rate announcement and a swag of Aussie data due. The market has priced a 60% chance that the RBA Board will raise rates by 25 basis points on Tuesday. However, there is a risk the RBA will pause which would be negative for the AUD.
- The **Euro** has been weak recently. The European recovery appears to be stalling, and concerns surrounding the finances of Greece add to the weak tone. This week the ECB's interest rate decision and post-meeting conference will be in focus, and could lead to further **EUR/USD** weakness. The Bank of England also has a rate announcement this week. Leaving the asset purchase target unchanged at £200bln should encourage markets to become more optimistic on the UK economy and support the GBP. The better-than-expected QIV **US GDP** report last week supported the USD as markets become more confident in the US economic recovery. Investor flows are likely to be the main driver of USD strengthening this week as markets focus on concerns for European growth. However, the USD may find additional support from the January Non-farm Payrolls result.

### Short-term outlook:

Key data	Date	Time (NZST)	Market expects
RBA cash rate announcement	2/2	4.30pm	+25bp
December HLFS – unemployment rate	4/2	10.45am	6.8%
December Monthly Net Migration	4/2	10.45am	-

**Potential currency movers from the US this week:** Personal income and spending, Core PCE, ISM manufacturing, pending home sales (2nd), US ADP employment, ISM non-manufacturing, UK & EU PMI, UK consumer confidence, EU retail sales (3rd), US Factory orders, BoE, ECB interest rate meetings (4th), US payrolls (5th). Speakers: Warsh (4th).



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

- We continue to expect the NZD to appreciate further against the USD over the first half of 2010. 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 USD weakness in H1 2010 remain similar to the drivers since mid-March 2009, namely:
  - I. 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.
  - II. Diversification out of USD is expected to occur due to concerns about US government debt.
  - III. And, related, concern about the USD's future role as a reserve currency.
- In late 2009 the USD responded positively to strong US data - a change from the pattern of the preceding 8 months. There is a risk that the USD troughs a lower level than our current forecasts imply. The NZD is also likely to mildly outperform other major currencies in the ongoing environment of improving global growth prospects and rising commodity prices. 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 underpin the AUD and, to some degree, the NZD.

## 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	3.50	FLAT
90-day bank bill	2.75	2.77	2.80	2.77	3.66	FLAT
2-year swap	4.46	4.47	4.63	3.89	3.29	FLAT
5-year swap	5.39	5.38	5.61	5.29	3.91	FLAT
5-year benchmark gov't stock	5.20	5.25	5.53	4.80	3.73	FLAT
NZSX 50	3169	3189	3219	3042	2770	DOWN

\* Current is as at 1 pm Tuesday; week ago as at Monday 5pm. Please note that we have recently changed the NZ gov't 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 rates were little changed last week. There were no surprises in the Bank's decision to hold the OCR at 2.5%, and the RBNZ toed a very similar line to the December statement (even going so far as to specifically note that). [Click here for our RBNZ review.](#)
- Interest rates showed little reaction to the RBNZ announcement with swap rates ticking up by only 2-3 basis points on Thursday. Dr Bollard's on the record speech of Friday also had little impact the market (see page 1 for more information). Swap rates dipped 3-4 basis points on Friday, but are now back to similar levels to a week ago. We expect interest rates to trade around similar levels this week.

### Short-term outlook:

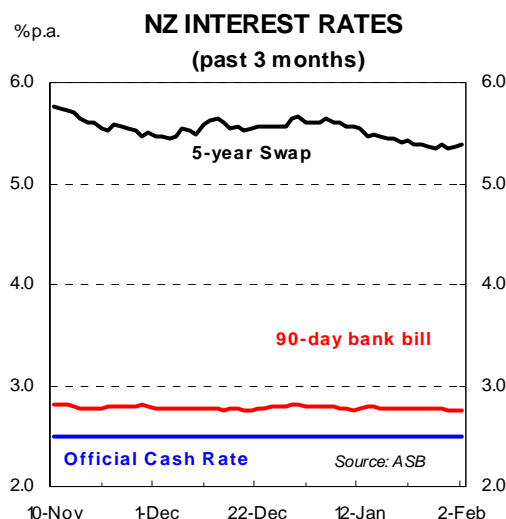
Key data	Date	Time (NZST)	Market expects
RBA cash rate announcement	2/2	4.30pm	+25bp
December HLFS – unemployment rate	4/2	10.45am	6.8%
December Monthly Net Migration	4/2	10.45am	-
January QV House Prices yoy	8/2	12.00am	-

**Comment:** Focus for NZ markets will be on the release of the quarterly Household Labour Force Survey this Thursday. The effects of the recession should still be reflected in weak labour market activity in the December 2009 quarter, although more recent business surveys suggest a recovery in employment will ensue later in 2010.

Turning to economic activity globally, market focus will be on US employment data for signs the US economy is on the mend. Meanwhile, Australian retail sales and building approvals data should shed further insight into the effects of the recent fiscal stimulus on the Australian economy. Also watch Tuesday's RBA meeting, as a 25bp hike is not fully priced in (though economists unanimously expect one).

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

- The RBNZ continued to hold the cash rate at 2.5% at the January *OCR Review*, and noted economic developments have generally turned out as it expected at the time of the December Monetary Policy Statement. As such, the Bank continue to expect to raise the OCR by around the middle of 2010.
- While acknowledging recent data has shown an improvement in household spending, the subdued nature of household credit growth is allaying fears that household debt levels will rise to unsustainably high levels.
- Furthermore, the reinstatement of the word "comfortable" in its assessment of inflation suggests the RBNZ is more relaxed about the inflation outlook following the subdued non-tradable inflation outturn in Q4.
- Nonetheless, we see inflation pressures building up in the non-tradable sector over the coming year, with our medium-term inflation outlook pushing closer to the top of the band. In particular, recent business surveys have shown a rebound in capacity utilisation and the re-emergence of skills shortages. Hence while the subdued non-tradable inflation outturn in Q4 pointed to excess capacity in the NZ economy over late 2009, recent business surveys suggest this excess capacity is diminishing quickly.
- We continue to expect the RBNZ to begin tightening in April. However, we expect this tightening to occur at a slower pace, with OCR increases of 25bp instead of 50bp at the initial meetings. The key factor behind our view change is that the relationship between the OCR and lending rates is likely to be a lot firmer than we previously assessed. We expect the large wedge that currently exists between the OCR and bank funding costs to remain, and as such now see an OCR of 5% (lower than our previous estimate of 5.5%) will be sufficient to remove the stimulus short-term rates provide.



## NZ Data Preview: a look at the week ahead

Data	Date	Time (NZST)	Previous	Market expects	ASB expects
December HLFS – unemployment rate	4/2	10.45am	6.5%	-	6.7%
December Monthly Net Migration	4/2	10.45am	20,021	-	-
January QV House Prices yoy	8/2	12.00am	2.8%	-	-

### Thursday 4<sup>th</sup> February

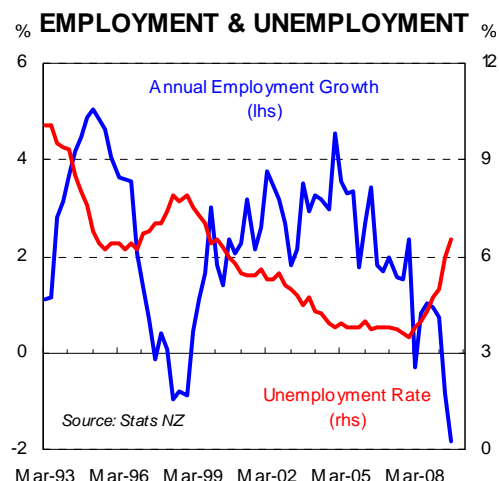
#### Household Labour Force Survey

**Unemployment Rate: previous: 6.5%, ASB(f): 6.7%**

We expect that total employment will remain unchanged over the final quarter of 2009. However, we expect a strong pick-up in population growth will see the net number of unemployed increase, pushing the unemployment rate up to 6.7%.

The recovery in the labour market tends to lag economic activity, which suggests employment growth could remain quite weak. In addition, the labour market fared comparatively well throughout the downturn, in part owing to a significant amount of labour hoarding.

This is likely to mute the growth in employment during the upswing. Nonetheless, employment intentions have bounced back strongly, suggesting the labour market is close to bottoming out.



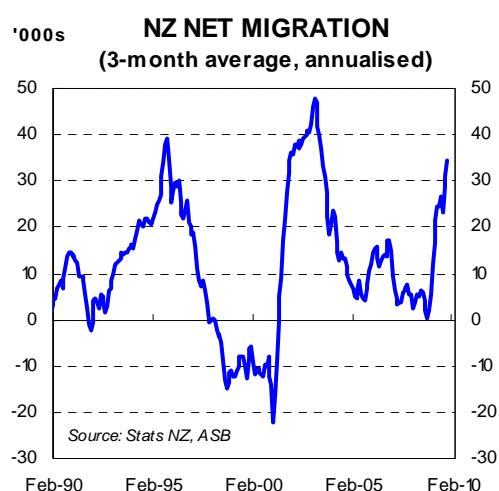
### Thursday 4<sup>th</sup> February

#### Net Migration - December

**Previous: 20,021 net migrants (12 months to November)**

Net migration inflows have picked up 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 weaker labour market in Australia deterred New Zealanders from heading across the Tasman. We expect these trends to continue into early 2010, supporting a modest pick-up in net migration over the year, to over 20,000 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 weakened world growth reduces demand for international travel.

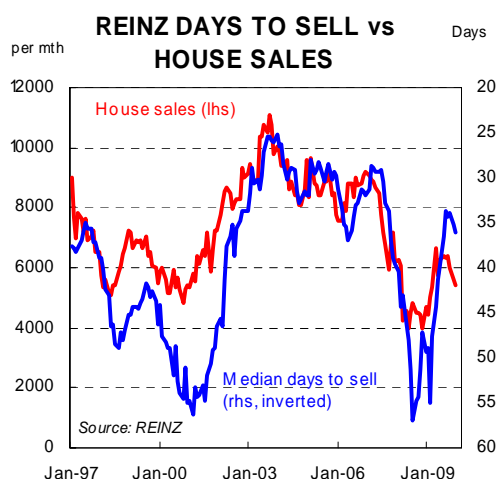


### Monday 8<sup>th</sup> February

#### QV House Prices - January

We expect January data on the housing market – with QV released on Monday and REINZ the Thursday following – to show some puff coming out of the housing market, with activity levels weakening from the pick up observed in spring.

Over the three months to December REINZ has shown increase in house prices of 2.8%, with prices 3.8% below the peak reached two years ago. Seasonally-adjusted sales turnover fell 3.5% over the December month, well below average levels. At this stage, data suggest the demand pressure may be ebbing after a period of recovering demand outstripping modest supply.



## NZ Data Review: weekly recap

### RBNZ OCR Review

The RBNZ left the OCR on hold at 2.5%, as expected. In addition, the RBNZ confirmed that the outlook for the NZ economy continues to evolve in line with its projections in the December *Monetary Policy Statement*. The RBNZ maintained its expectation to start OCR hikes around “middle of 2010”.

The RBNZ has brought back its ‘comfortable’ assessment on CPI inflation forecast. This was absent in December. The RBNZ is potentially feeling more relaxed about the inflation outlook following the subdued Q4 CPI outcome. Nonetheless, we are slightly more concerned about non-tradable inflation pressures as our medium-term inflation outlook is now pushing closer toward the top of the band, with upside risks becoming increasingly evident.

We continue to expect the RBNZ to start removing the stimulus in April: the medium-term inflation outlook will appear less “comfortable” over time.

### RBNZ Credit Aggregates - December

Household credit growth edged up 0.2% over December, with annual growth remaining steady at 2.7%. The momentum in housing credit appears to have slowed, with the annual pace of growth steady at 3.3%. This easing is likely to reflect the lower volume of house sales. In addition, indicators suggest some of the heat is fading out of the housing market, which is likely to ease pressure on house price inflation. The credit figures are unlikely to concern the RBNZ.

Business credit growth remains very weak, consistent with the substantial drop in business investment. However, confidence has improved substantially over the second half of 2009. As activity and profitability begins to improve over 2010, investment plans are likely to be put into action over the second half of 2010.

With the momentum in the housing market beginning to fade, we no longer see as much urgency for aggressive action by the RBNZ. We continue to expect the RBNZ to hike in April, but only by 25bp.

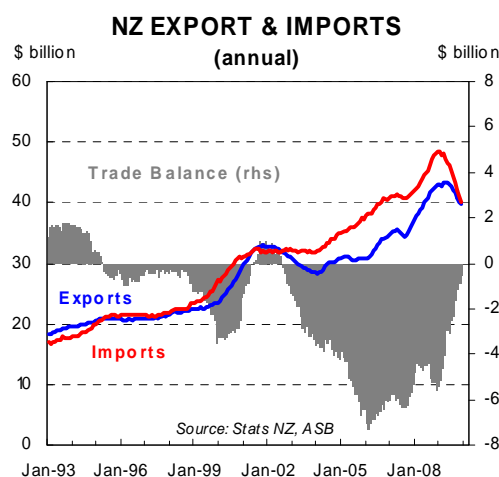
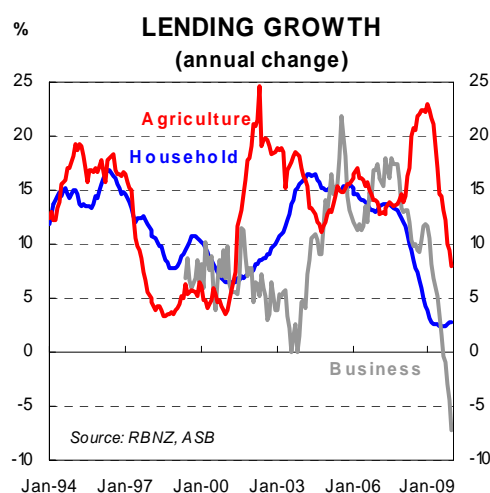
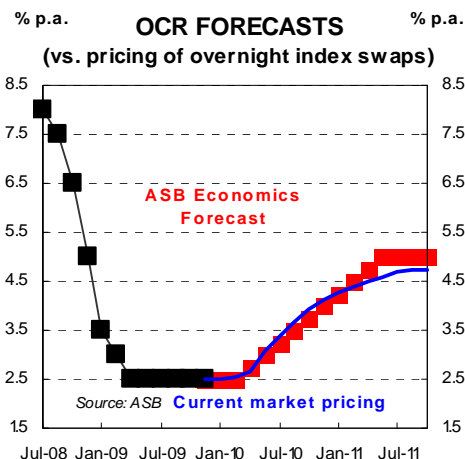
### Monthly Trade Balance – December

The trade balance recorded a surplus of \$2 million in the December month, and \$170 million deficit (seasonally adjusted) over the December quarter.

Lower dairy and oil exports drove the decline in exports. While prices should start to improve over 2010, reflecting the improvement in prices on spot markets, volumes are likely to remain subdued due to tight on-farm spending and poor conditions for dairy production.

Meanwhile, lower capital and intermediate goods drove the decline in imports, reflecting the effects of the recession on business investment. With investment intentions having recovered over the second half of 2009 we expect investment to recover later this year.

New Zealand’s current account deficit has narrowed significantly as a result of the recession. We expect these trends to reverse over 2010 as the economic recovery takes hold. Import demand is likely to improve, particularly once investment appetites return.



## Monthly Building Consent Issuance – December

Dwelling consent issuance posted a small dip of 2.4% for the December month, against expectations of a small gain. Given the volatility of the monthly series we continue to expect an improvement from the very low level of issuance in early 2009, as the recent recovery in the housing market and ongoing demand from population growth encourages residential investment.

While there was an increase in non-residential building consent issuance this was largely due to non-market non-residential projects.

We expect the recent and fairly flat pattern for non-residential work to continue over early 2010 as business confidence recovers - public project activity continues to look robust, whilst businesses continue to show some caution. The slowdown over 2008 and 2009 has created vacancies commercial buildings around the country and businesses remain somewhat cautious about investing, despite a significant lift in overall confidence. Last month's NZIER Quarterly Survey of Business Opinion showed further recovery in building investment intentions, but the indicator remains at a relatively weak level.

## Q4 Labour Cost Index

### Labour Cost Indices

The Labour Cost Indices (LCI) show an ongoing slowdown in the rate of wage increases. The All Sector Labour Cost Index (including Overtime) increased 0.4% in the December quarter, to be 1.8% higher than a year ago. Both the rate of quarterly change and annual change are down significantly from the high rates recorded pre-recession.

The slowdown in wage growth was observed in the both private and public measures of labour costs. Both the Private and Public indices (including overtime) increased by 0.3% over the quarter.

The distribution of LCI increases points to an increasing proportion of labour costs being unchanged from a year ago and smaller proportions receiving annual wage increases of 3% or more.

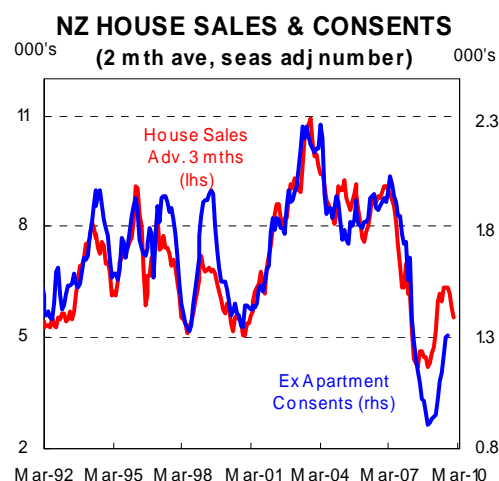
Although we expect the unemployment rate will track higher over 2010, there is likely to be some pick-up in wage growth this year. However, the Q4 figures show wage growth tracking within or even a small fraction below RBNZ expectations.

## Q4 Quarterly Employment Survey

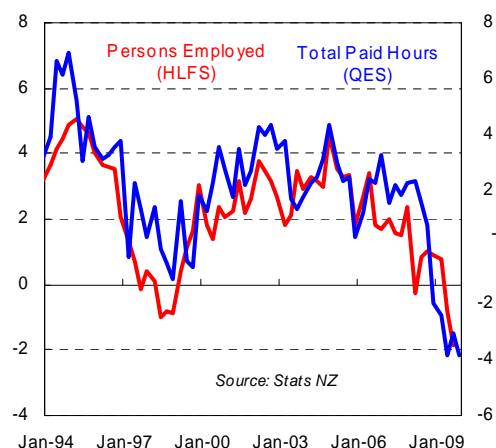
The QES reflected the continued weak state of the labour market, although there are signs that employment is nearing its trough with a slowing in the decline in hours paid. By our estimate seasonally adjusted full-time equivalent employees (down 0.2%) suggest a flat outcome for employment growth in this Thursday's HLFS.

An improvement in employment in the retail sector drove the increase in filled jobs and full-time equivalents in Q4, and also provided a positive contribution to hours paid. This is in line with recent business surveys pointing to an improvement in the retail sector outlook, albeit from very weak levels.

Meanwhile, the QES measure of average hourly earnings (which is subject to composition change within the work force) fell 0.4% in Q4. Over the past year, positive contributions from the professional, scientific, technical and support services have underpinned the increase in average hourly earnings

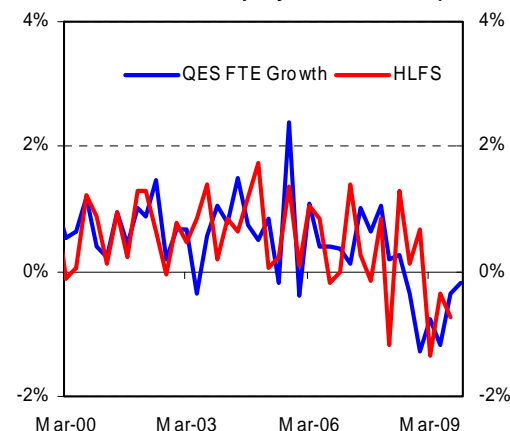


## EMPLOYMENT ANNUAL GROWTH



## QUARTERLY EMPLOYMENT

(QES Full Time Equivalents (s.a.) and HLFS Employment Growth)



## Global Data Calendars

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

### Calendar – Australasia, Japan and China

Date	Time		Econ Event	Period	Unit	Last	Forecast	
	NZT						Market	ASB/CBA
Tue 2 Feb	13.30	AU	NAB Business conditions	Dec	index	19.0	~	~
	14.30	JP	Labour Cash Earnings	Dec	%	-2.8	~	~
	16.30	AU	RBA cash target	Feb	%	3.75	4.00	4.00
Wed 3 Feb	11.30	AU	Ai Group PSI	Jan	index	50.0	~	~
	13.30	AU	Trade Balance	Dec	\$mn	-1,700	-2,400	-2,500
Thu 4 Feb	10.45	NZ	Unemployment Rate	QIV	%	6.5	~	6.7
	10.45	NZ	Participation Rate	QIV	q%ch	68.0	~	~
	10.45	NZ	Employment Change	QIV	y%ch	-1.8	~	~
	10.45	NZ	Visitor Arrivals	Dec	%	-3.7	~	~
	13.30	AU	Building Approvals	Dec	m%ch y%ch	5.9 33.3	0.0 38.2	2.0 42.1
Fri 5 Feb	13.30	AU	Retail Sales	Dec	m%ch	1.4	0.2	-0.5
	11.30	AU	Ai Group PCI	Jan	index	49.3	~	~
	13.30	AU	Reserve Bank Quarterly Monetary Policy Statement					
	18.00	JP	Leading Index	Dec	index	90.7	~	~
	18.00	JP	Coincident Index	Dec	index	96.0	~	~
Mon 8 Feb	00.01	NZ	QV House Prices	Jan	y%ch	2.8	~	~

## 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 Feb	08.55	GE PMI Services	Jan	index	51.2	~	~
	09.30	UK PMI Construction	Jan	index	47.1	~	~
	10.00	EZ PPI	Dec	y%ch	-4.4	~	~
	15.00	US Pending Home Sales	Dec	m%ch	-16.0	1.6	~
					y%ch	19.3	~
22.00	US Total Vehicle Sales	Jan	mn	11.2	11.3	~	
Wed 3 Feb	09.00	EZ PMI Composite	Jan	index	53.6	~	~
	09.30	UK PMI Services	Jan	index	56.8	~	~
	10.00	EZ Retail Sales	Dec	m%ch	-1.2	~	~
	13.15	US ADP Employment Change	Jan	'000	-84.0	-20.0	~
	15.00	US ISM Non-Manufacturing	Jan	index	50.1	51.0	~
Thu 4 Feb	11.00	GE Factory Orders	Dec	m%ch	2.8	~	~
					y%ch	4.5	~
	12.00	UK BoE announces rates	Feb	%	0.50	0.50	0.50
	12.45	EZ ECB announces rates	Feb	%	1.00	1.00	1.00
	13.30	CA Building Permits	Dec	%	-4.6	~	~
	13.30	US Nonfarm Productivity	QIV	%	8.1	5.4	~
	13.30	US Unit Labor Costs	QIV	%	-2.5	-2.1	~
	13.30	US Initial jobless and continuing claims					
	15.00	CA Ivey PMI	Jan	index	48.4	~	~
	15.00	US Factory Orders	Dec	%	1.1	1.1	~
Fri 5 Feb	09.30	UK PPI (Output)	Jan	m%ch	0.5	~	~
	11.00	GE Industrial Production	Dec	m%ch	0.7	~	~
	12.00	CA Net Change in Employment	Jan	'000	-2.6	~	~
	12.00	CA Unemployment Rate	Jan	%	8.5	~	~
	13.30	US Change in Nonfarm Payrolls	Jan	'000	-85.0	27.0	~
	13.30	US Unemployment Rate	Jan	%	10.0	10.0	~
	13.30	US Average Hourly Earnings	Jan	m%ch	0.2	0.2	~
	13.30	US Consumer Credit	Jan	\$bn	-17.5	-8.4	~

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