

Business Weekly

Bollard's conundrum

This Week

We expect the RBNZ will keep the Official Cash Rate (OCR) on hold at 2.5% on Thursday 11th of June. The RBNZ is very close to the end of its easing cycle: its reluctance to cut the OCR below 2.0% leaves only 50 basis points of potential rate cuts up its sleeve. The issue for the upcoming decision is that, even if the RBNZ does want to ease monetary conditions further, cutting the OCR is unlikely to make much difference at this point in time.

In looking at the economic environment, the RBNZ will be very aware of the "green shoots" upon which markets have become fixated of late. And in NZ there are green shoots appearing in the housing market. Nevertheless, the eventual economic recovery will be slow and, green shoots notwithstanding, we have yet to see that the global economy has found the bottom yet.

Even if the RBNZ is comforted by the green shoots, it is unlikely to be comfortable with current levels of the NZ dollar and longer-term fixed interest rates. Both of these factors are largely out of the RBNZ's control. The NZD has been lifting largely as a result of USD weakness. Moreover, the increase in long-term rates is a response to increasing concern about the huge amount of government debt being issued over coming years. The NZ Government will issue around \$NZ50 billion of fresh debt over the next 3 years. However, that volume pales into comparison against US issuance: \$US2 trillion in the current fiscal year, which is roughly equivalent to NZ's 3-year requirement being issued every day!

Current market forces are likely to limit the impact of an OCR cut at the minute: there may be better opportunities in the future if the RBNZ still wants to have some impact. The risks to the RBNZ's inflation outlook remain to the downside and additional monetary stimulus is likely to be needed further down the track. The OCR remains the RBNZ's main tool of choice, but once the OCR is at 2% the RBNZ may have to consider alternative options.

In our [Monetary Policy Statement Preview](#) we canvassed a number of options available to the RBNZ. Many carry risks and some are likely to be ineffective. We don't rule out the RBNZ taking up any of these options this week. However, the RBNZ is likely to remain reluctant to use them at this point, with thresholds for their use high. But the wildcard risk for the day is some action is taken to try and drive interest rates and the exchange rate lower.

Click here for:

[Foreign Exchange](#)

- NZD slips away from recent high.

[Interest Rates](#)

- Markets see RBNZ on hold in June. Long-term rates continue to rise.

[Week Ahead](#)

- All eyes on the RBNZ. We expect the cash rate to remain at 2.5% for now.

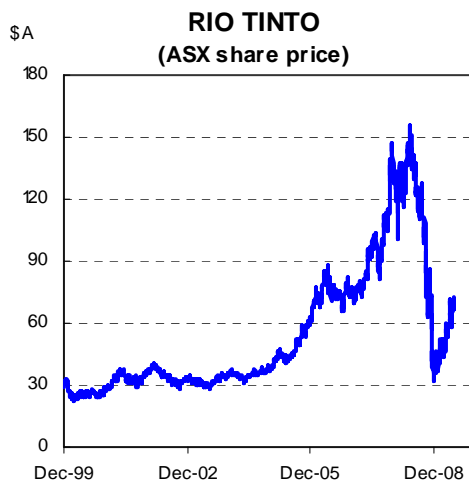
[Week in Review](#)

- Central banks of England, Eurozone, Canada and Australia all on hold.

[Global Calendars](#)

- US Retail Sales, trade figures, confidence and the Fed's Beige Book all due.

Chart of the week



- It isn't just debt issuance that is starting to lift, but equity raisings also as companies shore up their balance sheets.
- Locally we have seen a number of listed companies raise equity through placements or rights issues, including Fletcher Building, Nuplex, Fisher & Paykel Appliances and Kiwi Income Property Trust.
- In Australia, Rio Tinto has announced a \$US15 billion rights issue to raise capital along with a joint venture with BHP-Billiton, after declining to proceed with a \$US19.5 billion capital injection from Chinese company Chinalco.
- The size of that capital raising is huge, amounting to more than the \$NZ15 billion in debt issuance per year that the NZ Government will build up to.

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 | 0.6251 | 0.6501 | 0.5934 | 0.5320 | 0.7670 | FLAT** | 0.6050 | 0.6350 |
| NZD/AUD | 0.7871 | 0.8027 | 0.7866 | 0.8158 | 0.7985 | FLAT** | 0.7800 | 0.7950 |
| NZD/JPY | 61.63 | 62.80 | 58.86 | 49.41 | 81.36 | FLAT** | 60.00 | 62.00 |
| NZD/EUR | 0.4480 | 0.4591 | 0.4431 | 0.4165 | 0.4923 | FLAT* | 0.4350 | 0.4450 |
| NZD/GBP | 0.3918 | 0.3959 | 0.3952 | 0.3607 | 0.3918 | FLAT** | 0.3850 | 0.4000 |
| TWI | 59.6 | 61.0 | 58.2 | 54.1 | 68.5 | FLAT** | 58.50 | 61.00 |

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

- **This week the major focus in New Zealand is the RBNZ Monetary Policy Statement on Thursday. We expect the RBNZ will hold the Official Cash Rate at this meeting. However, the Bank is likely to be uncomfortable with current levels of the NZ dollar and longer-term interest rates. Interest rates and the exchange rates could potentially move in either direction on the day, but an on hold decision is unlikely to trigger much volatility. Until Thursday morning, we expect the NZD to trade sideways.
- The New Zealand Dollar peaked at 0.669 against the US dollar on 2 June, but pulled back over the rest of the week. The kiwi has traded between 0.625 and 0.64 since 3rd June, and is at the bottom of that range at the time of writing.
- Against the AUD, the NZD traded around 0.80 at the start of last week, but has pulled back and is trading around 1.5 cents lower at the start of this week.
- On Friday night a better-than-expected Non-farms Payrolls report in the USA saw the USD get bought against the major currencies.

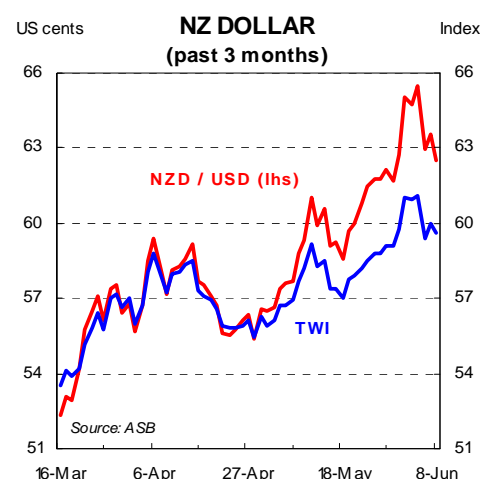
Short-term outlook:

| Key data | Date | Time (NZST) | Market expects |
|-------------------------------|------|-------------|----------------|
| Q1 Building work put in place | 9/6 | 10.45 am | - |
| Q1 Terms of Trade | 10/6 | 10.45 am | -3.7% |
| RBNZ OCR Announcement | 11/6 | 9.00 am | 2.25% |
| AU unemployment rate | 11/6 | 1.30 pm | 5.4% |
| April Retail Trade Survey | 12/6 | 10.45am | +0.2% |

Potential currency movers from the US this week: Wholesale Inventories (8th) Trade Balance (10th) Beige Book, Jobless Claims, Retail Sales, Business Inventories(11th) Uni of Michigan Consumer Confidence (12th)

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.
- 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 the 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. But a further depreciation is likely. It is not usual for the USD to grind out swings of +/- 10% as it bottoms out following major depreciation cycles. It is highly likely that when the Fed eventually begins raising interest rates in 2011 (our current forecast), the USD will undergo a broad-based appreciation.
- The lower USD profile also lifts our NZD forecasts. Our previous December 2009 forecast profile had the NZD at US\$0.6500. We now see the NZD at US\$0.7000 by year-end. It is worth noting that a weaker USD is the main reason for the change of forecasts.
- 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 | 5.00 | 8.25 | FLAT |
| 90-day bank bill | 2.69 | 2.75 | 2.88 | 5.35 | 8.68 | UP |
| 2-year swap | 3.73 | 3.55 | 3.62 | 4.79 | 7.87 | UP |
| 5-year swap | 5.28 | 5.05 | 4.92 | 5.11 | 7.56 | UP |
| 11/11 gov't stock | 4.77 | 4.58 | 4.56 | 4.55 | 6.47 | UP |
| NZSX 50 | 2827 | 2754 | 2873 | 2707 | 3543 | DOWN |

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

- Yield curve steepening continues, with longer-end yields continuing to rise and 90-day rates nudging slightly lower. Trends in offshore markets, the US in particular, are driving local movements at the longer end. Longer-end yields continue to rise on positive economic data and ongoing concerns on the large issuance of government debt expected over the next few years.
- We expect the RBNZ will keep the cash rate unchanged at 2.5% on Thursday. Economists' views are split, with the majority slightly in favour of a 25 basis point cut. However, the market has only priced in a 1/3 chance of a cut. In our view, a 25 basis point cut would have very little impact on monetary conditions, given the headwinds from current market sentiment. Now is a good time to pause and assess the effect of previous rate cuts and save the remaining 50 basis points of OCR cuts for a more opportune time. The RBNZ is likely to be uncomfortable with current levels of the NZ dollar and longer-term interest rates. However, any actions are likely to be futile against offshore drivers. We expect a large amount of jawboning instead.

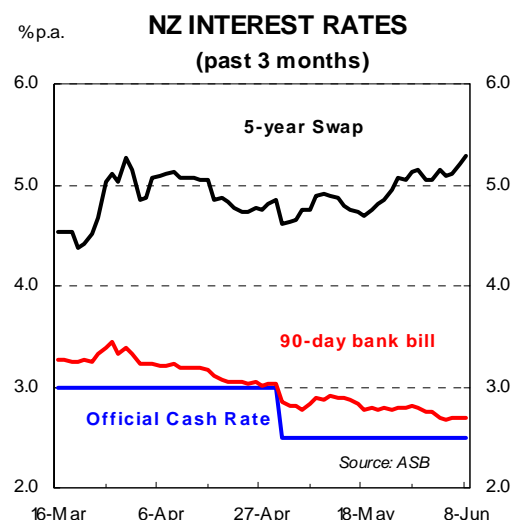
Short-term outlook:

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| April Retail Trade Survey | 12/6 | 10.45am | +0.2% |

Comment: This week's data is kicked off with Q1 construction activity on Tuesday and Terms of Trade on Wednesday. However, the focus will be on the RBNZ: the market favours the cash to remain unchanged, although the slightly majority of economists expect a 25 basis point cut. Australian employment figures for May will also get some attention on Thursday afternoon.

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 was 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 RBNZ 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 Preview: a look at the week ahead

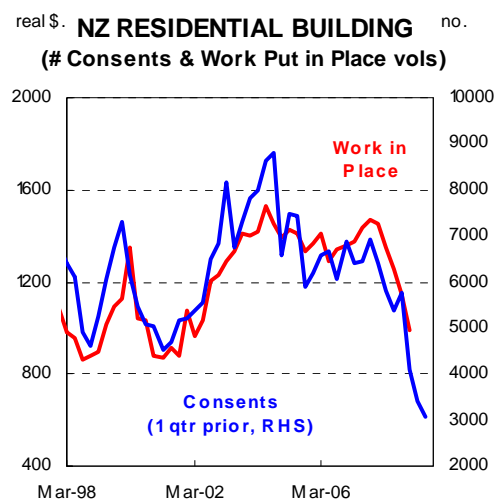
| Data | Date | Time (NZST) | Previous | Market expects | ASB expects |
|--|------|-------------|----------|----------------|-------------|
| Q1 Building Work Put in Place (Total, qoq) | 9/6 | 10.45 am | -6.5% | - | -7% |
| Q1 Terms of Trade | 10/6 | 10.45 am | -0.9% | -3.7% | -3.8% |
| May Electronic Card Transactions (mom) | 10/6 | 10.45am | 0.3% | - | - |
| RBNZ OCR Announcement | 11/6 | 9.00 am | 2.5% | 2.25% | 2.5% |
| April Retail Trade Survey (Total mom) | 12/6 | 10.45 am | -0.4% | +0.2% | +0.2% |
| May Food Price Index (mom) | 12/6 | 10.45 am | -0.6% | - | - |
| May REINZ House Sales (mom s.a.) | | | +25% | - | - |

Q1 Value of Building Work Put In Place

Previous: -6.5% qoq ASB f/c: -7% qoq (real)

The building work put in place survey measures construction activity over the quarter. We expect a 7% decline in the volume of construction activity, led by a 10% decline in residential construction activity. Residential construction activity has fallen over 30% since September 2007. Building consent issuance remains weak and points to further falls over the first half of 2009.

Non-residential construction consent issuance started to soften over the last part of 2008 and early 2009, and we expect to see activity fall by 4% over Q1.

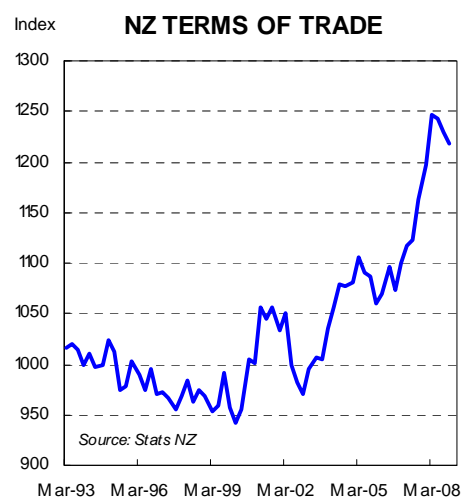


Q1 Terms of Trade

Previous: -0.9% ASB f/c: -3.8%

The Terms of Trade represent New Zealand's purchasing power with the rest of the world. Over recent quarters, the Terms of Trade have started to record modest declines following the large dairy-induced increase over 2007. The Terms of Trade are likely to have deteriorated further over Q1 falling 3.8%, with export prices falling 2% and import prices rising 1.8%.

Despite the lower NZ dollar, export prices were weighed down by sharp declines in international commodity prices – dairy in particular. Meanwhile import prices are set to rise modestly, with the impact of the 7% depreciation in the NZ dollar muted by falling commodity prices, oil in particular.



RBNZ OCR Announcement

ASB f/c: 2.5% - no change

We expect the RBNZ will keep the cash rate on hold in June. Global markets have become more confident with signs of economic activity stabilising. There have also been positive signs at home, with a recovery in the housing market and business confidence returning to neutral levels.

The RBNZ may be concerned by the lift in the NZ dollar and longer-term interest rates. However, the drivers for the movements have come from offshore and domestic monetary policy currently has little influence on these markets.

To date the RBNZ has cut 5.75 percentage points off the OCR in a relatively short period of time, and is not prepared to cut below 2%. Now is a good time to pause and assess the effectiveness of rate cuts to date, as right now further OCR cuts will achieve little. Nonetheless, the risks to the inflation outlook remain to the downside and we expect the RBNZ will have to deliver some form of stimulus in the future. For that reason we still envisage an OCR of 2.0%, though it is quite possible the RBNZ does consider some alternative actions.

April Retail Sales

Previous: -0.4% ASB f/c: +0.2%

We expect retail spending will increase 0.2% over April, led by a 0.4% increase in core retail spending. Tax cuts took effect in April, which should provide a small lift to spending over April and May. Consumer confidence also started to improve slightly over April and May, although remains at relatively subdued levels. Growth in core consumer spending is likely to remain weak over the rest of the year despite tax cuts, lower interest rates and lower petrol prices. Rising unemployment and economic uncertainty continue to weigh on consumers' minds and as a result we are seeing more cautious spending patterns and slowing growth in debt.

The auto component is likely to show some further softness, with vehicle registrations remaining weak and pointing to further declines in sales. Demand for new vehicles has fallen sharply, as consumers have cut back on big-ticket items. May vehicle registrations are down 33% on year-ago levels.

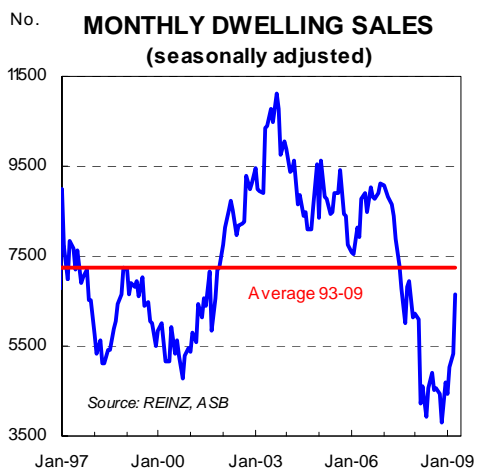
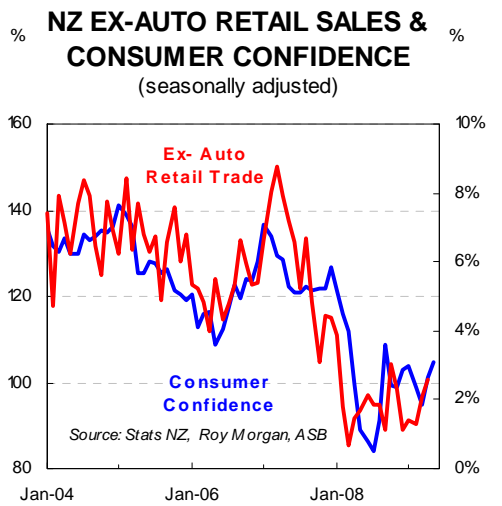
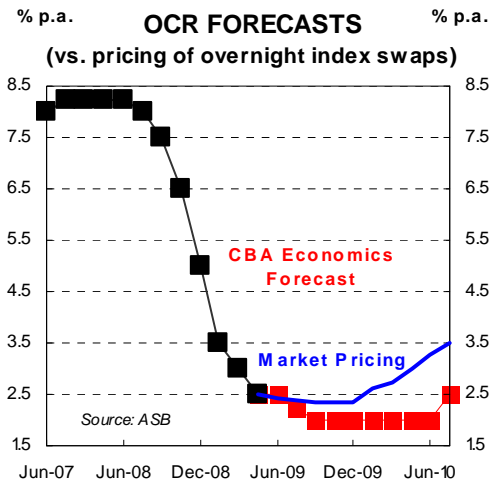
May REINZ house sales

Previous: +25% mom seasonally adjusted

House sales surged over March and April, in part as potential buyers finally stepped in off the sidelines as interest rates reached very low levels. The lift in sales over April may have been exaggerated, and mortgage approvals and Auckland house sales figures point to a small pull back in sales over May.

Going forward, low interest rates and a turn around in net migration should continue to provide support to housing demand. However any recovery is likely to be muted by low affordability and rising unemployment.

House sales provide a 3-6 month lead on house prices and, with housing demand picking up off its lows, house prices are likely to soon stabilise. QV house sales data for May shows house prices are down 8.1% for the 3-month period to May compared to the same period last year. This is up from -9% in April.



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 | | | | | |
| Mon 8 Jun | 17.00 | JP | Eco watchers survey: outlook | May | Index | 39.7 | ~ | ~ | | | | | |
| Tue 9 Jun | 13.30 | AU | NAB business conditions | May | Index | -10.0 | ~ | ~ | | | | | |
| | 13.30 | AU | ANZ job ads | May | m%ch | -7.5 | ~ | ~ | | | | | |
| | 17.00 | JP | Leading index CI | Apr | Index | 76.3 | ~ | ~ | | | | | |
| | 17.00 | JP | Coincident index CI | Apr | Index | 85.1 | ~ | ~ | | | | | |
| | 18.00 | JP | Machine tool orders | May | y%ch | -80.4 | ~ | ~ | | | | | |
| Wed 10 Jun | 10.45 | NZ | Terms of trade index | Q1 | q%ch | -0.9 | ~ | ~ | | | | | |
| | 10.45 | NZ | Card spending | May | m%ch | 0.3 | ~ | ~ | | | | | |
| | 11.50 | JP | Machine orders | Apr | m%ch | -1.3 | ~ | ~ | | | | | |
| | | | | | | | | | y%ch | -22.2 | ~ | ~ | |
| | 11.50 | JP | Domestic CGPI | May | m%ch | -0.4 | ~ | ~ | | | | | |
| | | | | | | | | | y%ch | -3.8 | ~ | ~ | |
| | 13.00 | AU | MI/WBC consumer sentiment | Jun | Index | 88.8 | ~ | ~ | | | | | |
| | 13.30 | AU | Housing finance | Apr | m%ch | 6.7 | ~ | 2.0 | | | | | |
| | | | | | | | | | Value of all loans | m%ch | 5.1 | ~ | -1.0 |
| | | | | | | | | | | | | | |
| 14.00 | CH | Producer price index | May | y%ch | -6.6 | ~ | ~ | | | | | | |
| 14.00 | CH | CPI | May | y%ch | -1.5 | ~ | ~ | | | | | | |
| Thu 11 Jun | ~ | CH | Trade balance | May | USD bn | 13.1 | ~ | ~ | | | | | |
| | ~ | NZ | Business PMI | May | Index | 43.7 | ~ | ~ | | | | | |
| | 09.00 | NZ | RBNZ official cash rate | Jun | % | 2.5 | 2.25 | 2.5 | | | | | |
| | 11.50 | JP | GDP | Q1 | q%ch | -4.0 | ~ | ~ | | | | | |
| | 13.00 | AU | MI Cons. Inf. expectation | May | % | 2.3 | ~ | ~ | | | | | |
| | 13.00 | AU | MI Unemployment expect. | May | % | 27.1 | ~ | ~ | | | | | |
| | 13.30 | AU | Employment change | May | '000 | 36.5 | ~ | -20.0 | | | | | |
| | 13.30 | AU | Unemployment rate | May | % | 5.4 | ~ | 5.6 | | | | | |
| | 13.30 | AU | Participation rate | May | % | 65.4 | ~ | 65.3 | | | | | |
| | 14.00 | CH | Fixed assets inv urban | May | Ytd y%ch | 30.5 | ~ | ~ | | | | | |
| Fri 12 Jun | 10.45 | NZ | Retail sales | Apr | m%ch | -0.4 | ~ | ~ | | | | | |
| | 14.00 | CH | Retail sales | May | y%ch | 14.8 | ~ | ~ | | | | | |
| | | | | | | | | | ytd y%ch | 15.0 | ~ | ~ | |
| | 14.00 | CH | Industrial production | May | y%ch | 7.3 | ~ | ~ | | | | | |
| | | | | | | | | | ytd y%ch | 5.5 | ~ | ~ | |
| 16.30 | JP | Industrial production | Apr | m%ch | 5.2 | ~ | ~ | | | | | | |
| 17.00 | JP | Consumer confidence | May | Index | 33.2 | ~ | ~ | | | | | | |

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 | |
| Mon 8 Jun | 09.30 | EZ Sentix investor confidence | Jun | Index | -34.3 | ~ | ~ | |
| | 11.00 | GE Factory orders | Apr | y%ch | -26.7 | ~ | ~ | |
| | 13.15 | CA Housing starts | May | '000 | 117.6 | 130.6 | ~ | |
| | 15.00 | US Wholesale inventories | Apr | % | -1.6 | -1.0 | ~ | |
| Tue 9 Jun | 00.01 | UK RICS house price balance | May | % | -59.9 | ~ | ~ | |
| | 00.01 | UK BRC May retail sales monitor | ~ | Index | ~ | ~ | ~ | |
| | 07.00 | GE Trade balance | Apr | €bn | 11.3 | ~ | ~ | |
| | 07.00 | GE Current account | Apr | €bn | 10.2 | ~ | ~ | |
| | 09.30 | UK DCLG UK house prices | Apr | y%ch | -13.6 | ~ | ~ | |
| | 11.00 | GE Industrial production | Apr | y%ch | -20.4 | ~ | ~ | |
| Wed 10 Jun | 07.00 | GE CPI | May | y%ch | 0.7 | ~ | ~ | |
| | 07.00 | GE CPI – EU harmonised | May | y%ch | -0.1 | ~ | ~ | |
| | 09.30 | UK Trade balance | Apr | £mn | 2,537 | ~ | ~ | |
| | 09.30 | UK Industrial production | Apr | y%ch | -12.4 | ~ | ~ | |
| | 13.30 | CA Trade Balance | Apr | \$bn | 1.1 | ~ | ~ | |
| | 13.30 | CA New housing price index | Apr | m%ch | -0.5 | ~ | ~ | |
| | 13.30 | US Trade balance | Apr | \$bn | 27.6 | 28.7 | ~ | |
| | 19.00 | US Fed's Beige book | ~ | ~ | ~ | ~ | ~ | |
| | 19.00 | US Monthly Budget Statement | May | \$bn | -165.9 | -175.0 | ~ | |
| Thu 11 Jun | 00.01 | UK NIESR GDP estimate | May | % | -1.5 | ~ | ~ | |
| | 09.00 | ECB publishes June monthly report | | | | | | |
| | 13.30 | US Retail sales | May | % | -0.4 | 0.3 | ~ | |
| | 13.30 | US Initial jobless and continuing claims | | | | | | |
| | 15.00 | US Business inventories | Apr | % | -1.0 | -1.0 | ~ | |
| Fri 12 Jun | ~ | US Fed flow of funds | Q1 | ~ | ~ | ~ | ~ | |
| | 10.00 | EZ Industrial production | Apr | y%ch | -20.2 | ~ | ~ | |
| | 13.30 | US Import price index | May | m%ch | 1.6 | 1.2 | ~ | |
| | | | | y%ch | -16.3 | ~ | ~ | |
| 15.00 | US Uni of Michigan confidence | Jun | Index | 68.7 | 68.6 | ~ | | |

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