

## RBNZ prepares for rate hikes in “coming months”

## This Week

The RBNZ reiterated in Thursday's statement it expects to start to lift the official cash rate “in coming months”, following a full year of the OCR sitting at record lows of 2.5%. This essentially confirms the RBNZ will begin to lift to OCR in either June or July while allowing itself some room to manoeuvre. Given the large number of uncertainties clouding the outlook at the minute, the RBNZ is keeping its options open. Europe is currently the biggest dark grey cloud on the horizon (see box below). However, other key areas to watch include the impact from drought, employment data, the May Budget and the very weak demand for credit.

The RBNZ is trying to balance the current dichotomy between the positive commodity price outlook against fairly subdued domestic activity. The RBNZ appears to be putting a lot of weight on the recent lift in commodity prices, with no mention of the current drought and recent run of patchy run of domestic data (in particular retail spending and the housing market). Indeed, we have revised down our economic growth forecasts in recent months, and we were surprised the RBNZ has revised its up. In addition, we remain concerned by the very soggy credit demand, which the RBNZ did acknowledge.

Regardless of whether a rate increase will occur in June or July, the overall message is the OCR tightening cycle will begin shortly (assuming events largely pan out as expected). We are expecting a steady-as-she-goes profile; with a 25 basis point lift at each meeting until interest rates have returned to around neutral levels (an OCR of 5% should achieve this). Experience in Australia suggests there is a risk that the path of rate hikes may not be this smooth. The RBA got underway with the tightening cycle fairly early on, allowing itself to pause every now and then to assess the impact of rate hikes. That might be a tempting strategy for the RBNZ. However, the timing of RBA pauses has been rather difficult to pick. We are up for another “will they/won't they” decision this week, with market pricing slightly in favour of a rate hike.

Back in NZ, this week is set to be another exciting one with the first read on employment for 2010. The last quarter of 2009 coughed up a shocker as unemployment rose unexpectedly to 7.3%. However, indicators and anecdotes for the labour market suggest conditions have improved considerably since the New Year. We are looking for a small increase in employment and a fall in the unemployment rate to 7.1%.

Also on our radar is the UK election later this week. UK government finances are desperately in need of reform, and the risk of a hung parliament is currently weighing on market confidence.

## Click here for:

[Foreign Exchange](#)

- NZD outperformed on all major crosses over the week.

[Interest Rates](#)

- Shorter-term interest rates edge up as RBNZ leaves door open to June hike.

[Week Ahead](#)

- Q1 labour market in focus with unemployment rate and labour cost index.

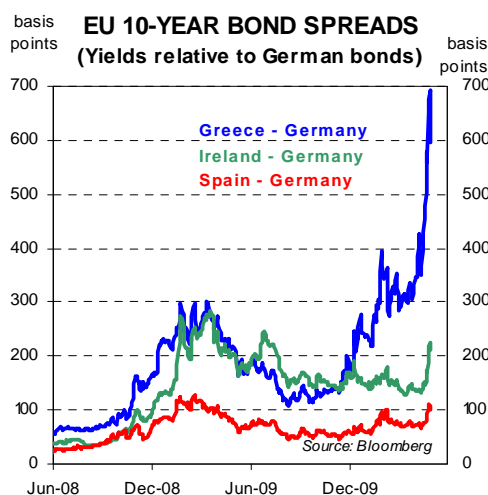
[Week in Review](#)

- RBNZ decision, business confidence, credit aggregates, building consents.

[Global Calendars](#)

- RBA rate decision, US employment data, UK election.

## Chart of the week



- Greece finalised a 110 billion euro three-year bailout deal with the euro-zone countries and IMF over the weekend, ahead of the May 19 deadline for the first repayment of Greek Government debt.
- The agreement follows a volatile week in the markets, with Greece's bond yields rising to close to 700bp over German bond yields after Greece's long-term debt status was downgraded by Standard & Poor's to junk on concerns it would not be able to get out of current fiscal crisis without defaulting.
- Despite the aid, Greece's problems are far from over as it prepares to put in place tough measures to repay its debt. These measures include increasing taxes, slashing public-sector wages, raising the retirement age and cutting pension payments. Already, there have been riots and strikes which will test the resolve of the Greek government.

## 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	0.7292	0.7185	0.7060	0.7205	0.5664	FLAT	0.7150	0.7350
NZD/AUD	0.7890	0.7746	0.7679	0.7972	0.7787	DOWN	0.7800	0.7950
NZD/JPY	68.55	67.70	66.69	64.90	56.02	FLAT	0.6750	0.6950
NZD/EUR	0.5472	0.5377	0.5228	0.4884	0.4268	FLAT	54.00	55.50
NZD/GBP	0.4765	0.4658	0.4641	0.4379	0.3827	FLAT/UP	46.50	48.50
TWI	68.0	66.9	65.8	64.9	56.1	FLAT	66.50	68.50

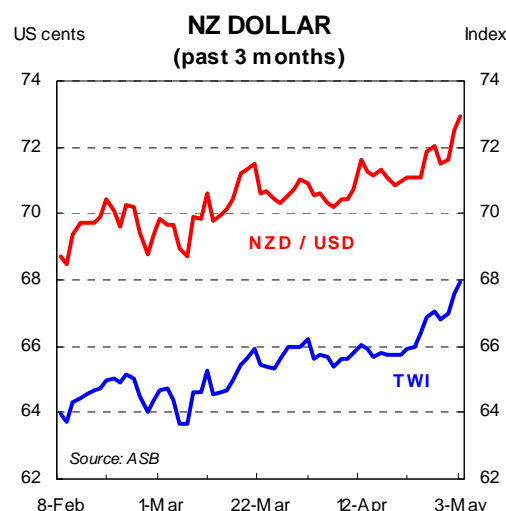
^Weekly support and resistance levels \* Current is as at 10.00 am Monday; week ago as at Monday 5pm

- The NZD finished the week stronger against all the major crosses, with the TWI up to 68 from 66.9.
- The NZD waxed and waned against the USD for most of the week before benefiting from a strong rally (along with most commodity currencies) from late Thursday.
- The AUD came under pressure early on Monday as markets reacted to news that the Australian Government intends to increase taxes on the resource sector. In addition, the Central Bank of China tightened lending conditions over the weekend. The combination of events has markets concerned about the momentum in Australian growth stemming from Chinese demand for commodity resources.
- The weakness in the AUD helped further propel the NZD against the AUD early on Monday morning. However, this strength is likely to unwind over the week as Australian data is likely to outperform NZ's.
- The NZD steadily outperformed the EUR and GBP over the week. The Geek assistance package announced over the weekend could help put a floor under the EUR this week. In contrast, the GBP is likely to remain under pressure heading into the election later this week.

### Short-term outlook:

Key data	Date	Time (NZST)	Market expects
Q1 Labour Cost Index	4/5	10.45 am	+0.4%
Q1 Quarterly Employment Survey	4/5	10.45 am	+0.3%
RBA Rate Announcement	4/5	4.30 pm	4.5%
Q1 HLFS Unemployment Rate	6/5	10.45 am	7.3%

**Potential currency movers from offshore this week:** EUR PMI manufacturing survey, US ISM manufacturing survey (3<sup>rd</sup>); UK PMI manufacturing, UK lending, US factory orders, US pending home sales (4<sup>th</sup>); AU building approvals, EUR PMI services, EUR retail sales, UK consumer confidence, US ADP employment report (5<sup>th</sup>); AU retail trade, AU trade balance, UK Election (6<sup>th</sup>); RBA Statement on Monetary Policy, ECB policy meeting, EU industrial production, US payrolls (7<sup>th</sup>).



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

- We have made slight revisions to our NZD forecasts. The USD has not appreciated as much as we anticipated despite a better performing US economy. Persistently low US bond yields and negative net private sector investment into the US are the main reasons why the USD has not strengthened more.
- In addition, the slowing in Eurozone's economy has not dampened global growth as much as we previously expected. The slowdown in the Eurozone has been more than offset by a better performing US economy and robust Asian economies. We anticipate further EUR weakness as the economy struggles to gain traction and sovereign debt issues continue to plague investor and business confidence there.
- We expect the NZD to peak around 0.74 against the USD, with the NZD peaking as the RBNZ begins its tightening cycle in "coming months". We still anticipate that the USD will strengthen in the second half of this year due to a better performing US economy and third-quarter Fed rate hikes. We expect the NZD to trade around 0.72 at the end of 2010.
- We now expect the RBNZ to increase the OCR in July and expect the pace of increase to be gradual, reducing the scope for interest rate driven out-performance for the NZD.
- The NZD is expected to gain on the AUD over the course of 2010 once the RBNZ lifts rates and interest rate differentials with Australia narrow. Firm global growth will also work to drive the NZD/AUD exchange rate higher over the remainder of 2010 as the New Zealand economy benefits more than Australia from a higher export-to-GDP ratio.
- The JPY is expected to slowly weaken this year in response to a stronger USD and a firm global economy.

## 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	2.50	FLAT
90-day bank bill	2.73	2.68	2.70	2.78	2.81	UP
2-year swap	4.41	4.33	4.29	4.53	3.39	FLAT/UP
5-year swap	5.28	5.30	5.26	5.68	4.63	FLAT
5-year benchmark gov't stock	5.23	5.24	5.20	5.08	4.31	FLAT
NZSX 50	3286	3306	3276	3184	2720	FLAT

\* Current is as at 10.00am 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).

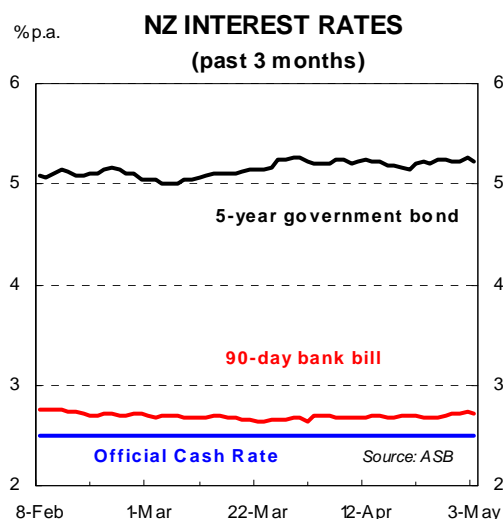
- Shorter-term NZ interest rates continued to edge up over the past week, as the RBNZ OCR Review Statement last Thursday left the door open for tightening to commence in June. The release of the Q1 employment data this week and Budget later this month will be key influences in whether the RBNZ waits until July to increase the OCR.
- Offshore long-term interest rates fell over the past week, as concerns about Greece's debt problems continued to encourage demand for safer assets. Strong demand at the US Treasury auction added to the downward pressure in interest rates.
- Short-term Australian interest rates were boosted by a stronger than expected Q1 CPI report, which saw markets pricing in a greater probability of the RBA increasing its policy rate tomorrow.

### Short-term outlook:

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**Comment:** The RBNZ noted in its OCR Review statement last Thursday that it expects to begin its tightening cycle "over the coming months, provided the economy continues to evolve as projected". Hence the release of Q1 employment data this week is seen as a key influence on whether the OCR will be increased in June.

Meanwhile, the RBA decision is bound to move interest rates given markets remain divided on whether the policy rate will be increased.



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

- The RBNZ held the cash rate at 2.5% at the OCR Review, and indicated monetary policy tightening will commence "over the coming months".
- The RBNZ left its near-term projection for the 90-day interest rate unchanged at the March MPS, but there was a downward revision in its medium-term 90-day track in recognition that current bank funding costs were likely to persist. This supports our expectations that OCR increases will be in 25 basis point increments over the tightening cycle this year.
- Activity data have been soft in recent months. In particular, momentum in housing market activity is waning with housing sales at low levels and days to sell starting to increase. We expect uncertainty over changes to tax policy regarding property investment will weigh on the housing market over 2010. Meanwhile, the recovery in household spending remains very subdued, particularly in the areas of discretionary spending.
- The RBNZ has highlighted its concern about the weakness in business investment and firms' continued reduction of debt. This is in light of credit demand remaining very weak in recent months.
- We continue to see upside risks to the RBNZ's inflation forecasts. The host of upcoming administrative inflation will boost headline CPI and pose risks to price and wage setting behaviour. However, the Q1 outturn was close to the RBNZ's expectation, and the slightly softer than expected non-tradable result (which reflects core domestic inflation pressures) provides the RBNZ with some breathing room to wait a bit longer to assess the current mixed tone in recent data.
- The weak activity data reduces the urgency for the RBNZ to unwind stimulus. Nonetheless, with signs that inflation pressures will build up later this year we expect the RBNZ will begin tightening with a 25 basis point OCR increase in July, and follow this up with further 25 basis point increases in the subsequent meetings.

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

Data	Date	Time (NZST)	Previous	Market expects	ASB expects
Q1 Labour Cost Index – all sectors qoq	4/5	10.45am	+0.3%	+0.3%	+0.4%
Q1 Quarterly Employment Survey – private qoq	4/5	10.45am	-0.4%	+0.4%	+0.3%
Q1 Household Labour Force Survey – unemployment	6/5	10.45am	7.3%	7.3%	7.1%

### Tuesday 4 May

#### Q1 Labour Cost Index and Quarterly Employment Survey

##### Labour Cost Index (all sectors, ordinary time, qoq)

Previous: +0.3%, f/c: 0.4%

##### QES Average hourly earnings (private sector, ordinary time, qoq)

Previous: -0.4%, f/c: 0.3%

We expect wage inflation to remain subdued over Q1, with the labour cost index expected to rise 0.4% qoq but the annual pace to slow to 1.6% from 1.8% previously. The QES tends to be more volatile as it does not adjust for compositional shifts. Nonetheless, we expect it to show annual earnings growth slowing to 2.4% from 3.1%.

Wage inflation slowed swiftly over 2009, with many firms opting for lower wage increases (or wages freezes) in order to minimise job losses during the downturn. We expect wage inflation pressures to remain reasonably subdued over 2010, reinforced by a weak labour market and slower rate of inflation.

### Thursday 6 May

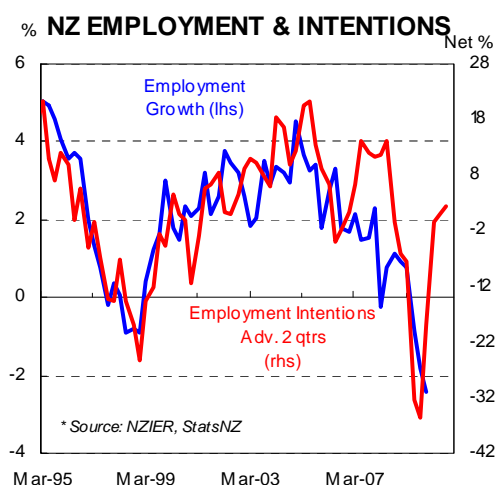
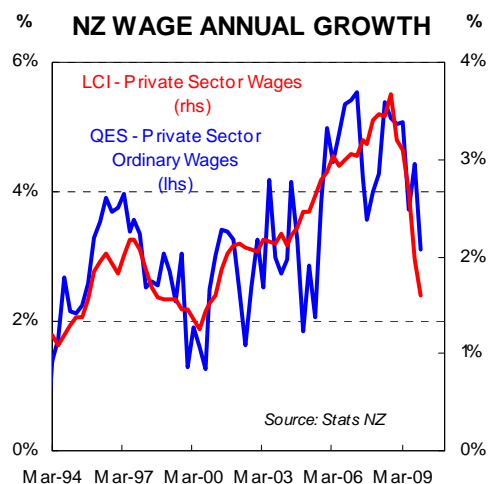
#### Q1 Household Labour Force Survey

##### Unemployment Rate:

Previous: 7.3%, f/c: 7.1%

We expect employment to post the first increase in over a year, with a lift of 0.3% in Q1. With the turn around in economic growth well underway, lagged GDP points to a lift in employment. Labour productivity has recovered, suggesting increased pressure to recruit. In addition, anecdotes certainly suggest the labour market started to warm up following the summer holidays.

We expect the pick up in employment (and flat participation) will see the unemployment rate to fall to 7.1% from 7.3%.



## NZ Data Review: weekly recap

### April National Bank Business Outlook

The improvement in both businesses' assessment of general economic conditions and own activity points to a sustained economic recovery remaining on track. It appears the improvement in firm profitability is encouraging businesses to expand their operations, as reflected in the increase in both investment and hiring intentions. This supports our expectations of a recovery in employment and overall business investment over 2010, and we have already seen a rebound in plant and machinery investment in the recent Q4 GDP data.

Pricing intentions in the construction sector has eased slightly from high levels. Nonetheless, given the extent to which pricing intentions in the construction sector has increased since the beginning of the year we continue to expect a rebound in construction costs over the coming year. Furthermore, with overall pricing intentions and inflation expectations continuing to tick up we expect inflation pressures to escalate, particularly over 2011.

### April OCR Review

The RBNZ kept the cash rate unchanged at 2.5% and delivered a statement close to expectations. The RBNZ replaced its previous expectation to lift rates "around middle of 2010" with "coming months", which is just another way of saying the same thing.

The RBNZ remains wary of the current dichotomy between the stronger export outlook and sluggish domestic demand. In particular, the Bank remains concerned by the weakness in business spending and reduction of debt in this area. The Bank is possibly looking for more concrete evidence that businesses are willing to translate upbeat confidence into action, such as increased investment and employment.

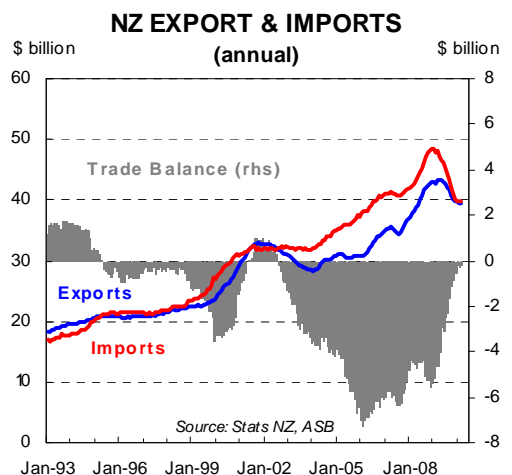
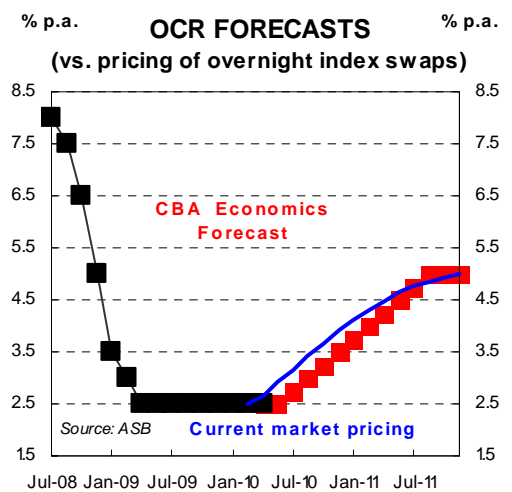
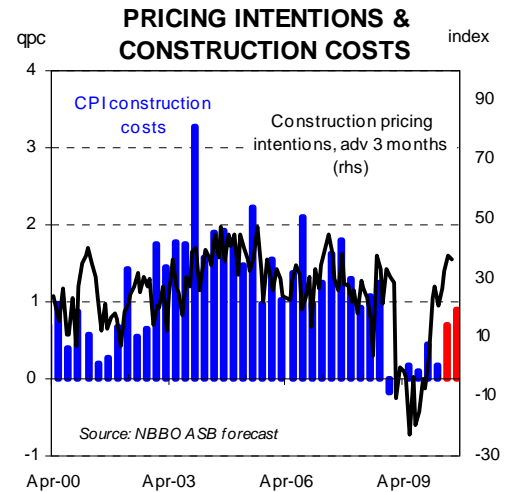
There are a number of wild card factors over the next few months, including employment, the Budget, the housing market and consumer spending, and also the recent developments in Europe. Hence we favour a July increase, given the number of uncertainties arising.

### March Trade Balance

March served up a stronger than expected trade surplus of \$567 million. The trade balance typically posts strong surplus during the first few months of the year. Nonetheless, in seasonally-adjusted terms the surplus for the March quarter was \$233 million.

Seasonally adjusted, exports increased 10.4% over the March quarter, staging a strong come back following steady declines since December 2008. Dairy exports led the way, rising 29.2% over the quarter due to stronger prices. Dairy prices have been steadily recovering since the second half of 2009, which are now being realised on export contracts. The strong commodity price outlook and firm trading partner growth (particularly from Asia) should help buoy export prospects through 2010.

Imports increased 6.8% (seasonally adjusted) over the quarter, registering the first quarterly increase in over a year. The improvement was reasonably widespread across categories.



### RBNZ Credit Aggregates

Household credit growth remains very subdued, increasing just 0.1% in March and up just 2.8% on year-ago levels. The trend in credit growth has clearly decelerated in recent months, largely as housing market activity has slowed once again. In addition, consumer credit demand remains weak, and is down 4% on year-ago levels. A large degree of caution remains within the household sector, as unemployment remains high and wage growth weak.

Agricultural lending growth continues to decelerate, easing to 5.7% annual growth compared to 7% in February. The recent improvement in commodity prices and agricultural prospects may help underpin demand for agricultural credit going forward. Nonetheless, we are still expecting growth to remain subdued.

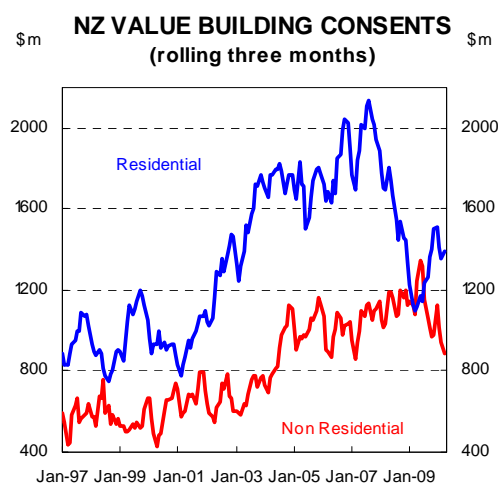
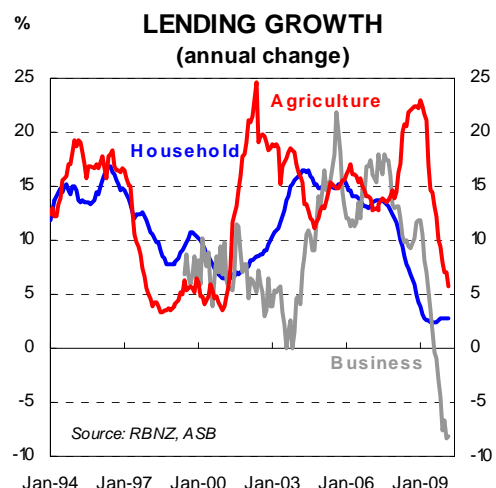
Business credit remains very weak, down 8.2% on year-ago levels. The RBNZ indicated it remains concerned about the weak demand for business credit, and this is likely to remain an important factor in determining the timing of the first rate increase.

### March Building Consents

Total building consents were reasonably stable in March, but once excluding the volatile apartment component core consents fell 8.4%. It appears the slowdown observed in the property market over recent months may be holding back building intentions. Uncertainty over the taxation of property should be clarified in the May budget. But right now it is contributing to a soft 2010 housing market, and in turn, weak building intentions.

Non residential consent issuance has been muted so far for 2010. Non-residential consents for the three months to March are down 18% on year-ago levels.

We expect overall building activity will pick up over 2010, having been in retreat for much of the preceding 2 years as housing construction shrank. We expect housing construction will recover to a degree over 2010 and provide a boost to GDP growth. However, the modest level of consent issuance has raised a question mark over the strength of this recovery.



## 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	Forecast		
	NZT					Last	Market	ASB/CBA
Mon 3 May	11.30	AU	Ai Group PMI	Apr	Index	50.2	~	~
	12.30	AU	TD securities inflation	Apr	m%ch	0.5	~	~
					y%ch	2.5	~	~
	13.30	AU	House price index	QI	q%ch	5.2	~	~
					y%ch	13.6	~	~
Tue 4 May	14.30	CH	HSBC manufacturing PMI	Apr	Index	57.0	~	~
	18.30	AU	RBA commodity index SDR	Apr	y%ch	1.4	~	~
	10.45	NZ	Private wages include overtime	QI	q%ch	0.3	~	~
	10.45	NZ	Private wages exclude overtime	QI	q%ch	0.3	~	0.4
	10.45	NZ	Average hourly earnings	QI	q%ch	-0.4	~	0.3
Wed 5 May	16.30	AU	RBA cash target	May	%	4.25	4.50	4.25
	14.30	AU	Treasurer Swan speaks in Sydney					
	11.30	AU	CBA/Ai Group PSI	Apr	Index	48.4	~	~
Thu 6 May	13.30	AU	Building approvals	Mar	m%ch	-3.3	~	4.0
	10.45	NZ	Unemployment rate	QI	%	7.3	~	7.1
Fri 7 May	10.45	NZ	Participation rate	QI	q%ch	68.1	~	~
	10.45	NZ	Employment change	QI	q%ch	-0.1	~	~
					y%ch	-2.4	~	~
	13.30	AU	Trade balance	Mar	\$mn	-1,924	~	-2,500
	13.30	AU	Retail trade	Mar	m%ch	-1.4	~	1.5
	13.30	AU	Retail trade ex inflation	QI	q%ch	1.1	~	0.8
	11.30	AU	Ai Group PCI	Apr	Index	48.7	~	~
	13.30	AU	RBA Statement on Monetary Policy					

### Calendar – North America & Europe

Please note all days and times are UK time, not local release day/times

Date	UK			Period	Unit	Forecast		
	Time	Econ	Event			Last	Market	CBA
Mon 3 May	08.55	GE	PMI manufacturing	Apr	Index	61.3	~	~
	09.00	EZ	PMI manufacturing	Apr	Index	57.5	~	~
	13.30	US	Personal income	Mar	m%ch	0.0	0.3	~
	13.30	US	Personal spending	Mar	m%ch	0.3	0.6	~
	13.30	US	PCE deflator	Mar	y%ch	1.8	0.6	~
	15.00	US	ISM manufacturing	Apr	Index	59.6	59.6	~
	15.00	US	ISM prices paid	Apr	Index	75.0	74.0	~
	15.00	US	Construction spending	Apr	m%ch	-1.3	-0.5	~

Tue 4 May	~	EZ	European Commission releases Spring economic forecasts						
	09.30	UK	Mortgage approvals	Mar	'000	47.1	~	~	
	09.30	UK	PMI manufacturing	Apr	Index	57.2	~	~	
	15.00	US	Factory orders	Mar	m%ch	0.6	0.0	~	
	15.00	US	Pending home sales	Mar	m%ch	8.2	17.3	~	
Wed 5 May	00.01	UK	Nationwide consumer confidence	Apr	Index	72.0	~	~	
	09.00	EZ	PMI composite	Apr	Index	57.3	~	~	
	09.30	UK	PMI construction	Apr	Index	53.1	~	~	
	10.00	EZ	Retail sales	Apr	m%ch	-0.6	~	~	
	13.15	US	ADP employment change	Apr	'000	-23.0	-25.0	~	
	15.00	US	ISM non-manufacturing composite	Apr	Index	55.4	56.0	~	
Thu 6 May	09.30	UK	PMI services	Apr	Index	56.5	~	~	
	12.45	EZ	ECB announces interest rates	May	%	1.0	1.0	1.0	
	13.30	CA	Building Permits	Mar	m%ch	-0.5	~	~	
	13.30	US	Non-farm productivity	QI	q%ch	6.9	2.5	~	
	13.30	US	Unit labor costs	QI	q%ch	-5.9	-0.5	~	
	13.30	US	Initial jobless and continuing claims	~	~	~	~	~	
	15.00	CA	Ivey purchasing managers index	Apr	Index	57.8	~	~	
Fri 7 May	09.30	UK	PPI	Apr	~	~	~	~	
	11.00	EZ	Industrial production	Mar	m%ch	0.0	~	~	
	12.00	CA	Net change in employment	Apr	'000	17.9	~	~	
	12.00	CA	Unemployment rate	Apr	%	8.2	~	~	
	13.30	US	Unemployment rate	Apr	%	9.7	9.7	~	
	13.30	US	Change in Nonfarm Payrolls	Apr	'000	162.0	175.0	~	

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