

New Zealand

UOB Economics Projections	2008	2009	2010F	2011F
GDP	-0.5	0.2	2.7	3.5
CPI (average, y/y)	4.0	2.2	2.8	2.9
Unemployment rate (%)	4.2	6.2	7.0	6.5
Current account (% of GDP)	-8.7	-2.9	-7.0	-8.2

- *The New Zealand economy continues to show signs of recovery although business and consumer confidence remains weak, tempering employment and the sustainability of recovery.*
- *Mindful that a shift in risk sentiment could stoke increased volatility in the New Zealand dollar, the NZD/USD pair should enjoy a bid-bias in tandem to the Australian dollar, though gains are expected to be capped by tepid economic growth.*
- *We will continue to look for evidence that the generally positive economic indicators so far continues to be converted into increased spending and activity, as is required for the Reserve Bank of New Zealand to begin raising the OCR "around the middle of 2010".*

New Zealand Economy Continues to Recover Albeit Tepidly

Real GDP in the three months through December 2009 printed in line with expectations, adding 0.8% to mark the largest quarterly increase in two years. The economy gained 0.4% from a year ago, the first positive print in the annual growth rate since the second quarter of 2008. The increase was driven by increases in private and government consumption, both of which added 0.9% from the previous quarter.

However, in a worrying sign, business investment fell 2.5%, marking the largest decline since the first quarter of last year, suggesting that business sentiment remains cautious. Latest numbers show that New Zealand business confidence fell in March. A net 38.6% of companies surveyed expect sales and profits will increase over the next 12 months, down from 41.9% in February, according to a survey by ANZ National Bank Ltd. released on March 31. The net figure subtracts the number of pessimists from the number of optimists. On the consumer front, consumer confidence declined for a second month in March, falling to 121.8 from 123.6 in February. All of these bode ill for employment and the sustainability of recovery. Indeed, the job market remains bleak. Unemployment rate has been climbing since 2008 and the latest reading of 7.3% (in 4Q09) represented the highest level since 2Q99.

Prime Minister John Key will unveil his budget in May

and it is expected that he will remedy the situation by introducing tax cuts and infrastructure spending to boost investment with offsetting increases in sales duties to trim consumption. Finance Minister Bill English said the scheme will "lift economic growth by tilting the playing field toward productive investment, exports and new jobs." RBNZ has forecast GDP growth to reach 3.2% in 2010 and 4.2% in 2011. These are in contrast to our forecasts of 2.7% and 3.5% respectively.

Kiwi Looking Less Rosy

Last year, the New Zealand dollar surged in tandem with the Australian dollar as well as commodity prices. NZD/USD, at the time of our last quarterly report, was trading around the 0.7200-levels. Since then, the changes in risk appetite have seen the USD appreciating strongly, and that has sent the NZD in lower ranges. Having hit lows of 0.6803 in early February, the pair has found some support around the 0.700-handle, but has then found little direction in either side.

The NZD has also been undermined by its fellow peer's rate hike cycle, and going forward, Australia is likely to maintain its rate outlook advantage over New Zealand. Besides, interest rate expectations have lost their influence as markets have begun to accept or have priced in that the central bank's target of a mid-year hike will most likely be kept.

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Nevertheless, we are looking for the NZD to be supported in 2010, though gains are expected to be capped by tepid economic growth. In addition, despite its lower exposure than its peer (Australia) to the Chinese economy, concerns that growth in China will be slowed down and further tightening measures by the Chinese government, should also exert some pressure on the Kiwi currency. It is worth noting that the New Zealand dollar actually performed worse than the Australian dollar after China announced its cooling measures.

But unless we do not see broader risk aversion growing, trades in the NZD/USD should still enjoy a bid-bias in tandem to the Australian dollar, mindful at the same time, though, that a shift in risk sentiment could stoke increased volatility in the pair. We are projecting the currency pair to trade comfortably around the 0.720-levels by the end of the quarter.

RBNZ Carries Forward Plan to Raise Rates

The RBNZ reduced its OCR by -575 bps to 2.5% during the period of June 2008 and April 2009. At the same time, the central bank also facilitated liquidity through measures including Term Auction Facility, which enabled banks to borrow funds using bills, bonds and mortgage-backed securities as collateral.

Since April 2009, the RBNZ has mentioned in the post-

meeting statement that there's no urgency to begin withdrawing monetary policy stimulus, and "we expect to keep the OCR at the current level until the second half of 2010". However, the tone has turned less dovish since December and the RBNZ stated that "if the economy continues to recover, conditions may support beginning to remove monetary stimulus around the middle of 2010". And the Bank concluded the latest March statement whereby "we continue to expect to begin removing policy stimulus around the middle of 2010".

We had expected that the RBNZ, at some point, will probably indicate the need to "normalize" rates. And it seems that we were right to think that it was going to take a "gradual" approach in terms of setting up markets for a rate hike, preferring to prepare markets well before it lays the groundwork for any rate hikes. We have not changed our view that the RBNZ will begin taking rates up somewhere in the second quarter of this year.

That said, there are still signs that the central bank may remain cautious, given that the recovery in New Zealand is not as strong as many had expected, and the economy remains fragile domestically. As such, we will continue to look for evidence that the generally positive economic indicators so far continues to be converted into increased spending and activity, as is required for the RBNZ to begin raising the OCR.