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Australia & New Zealand Economics Weekly

RBNZ to cut 25bp

Week commencing 27 April 2009

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RBNZ to cut

We think 25bp

The OECD and the NZ Government both say further fiscal measures to get the economy out of a recession now in its sixth quarter are undesirable, and both look to RBNZ Governor Alan Bollard to carry on the fight alone. But as the government and the OECD must well know, Dr Bollard has run out of ammunition. After 525 basis points in cuts since last July, New Zealand interest rates are as low as changes to the cash rate will take them. Except at the very short end, rates in New Zealand haven't moved down this year – they've moved up. Despite the 50 basis point cut to the cash rate on 12 March, 90-day bills are above their February lows, 2-year government bonds rates are 10 basis points above the March low, and 10-year yields are 100 basis points above the January low. Lending rates have moved correspondingly. The further away from cash, the bigger the increase. This is very relevant in the New Zealand market, in which four-fifths of home mortgages are on fixed rates.

One thing Dr Bollard will therefore be thinking about as he decides Thursday's cash rate announcement is that he must make the best show he can, even if he privately recognises that monetary policy is once again ineffective. The other issue we know he is thinking about is New Zealand's need for a substantial capital inflow. Its current account deficit is 9% of GDP and foreign liabilities are now around 90% of GDP. As Dr Bollard remarked with the March 12 cut, he needs to maintain a premium to global rates. These two considerations mean he has at most only 50 basis points to go. There is no loss and some advantage in spinning it out. We think these considerations will lead him to announce on April 30 a 25 basis point cut to a cash rate of 2.75%. He knows it will do no good, but it will do no harm. A 50 basis point cut will do no good either, but does raise a risk of harm to global investors' perception of New Zealand rates. Defying market expectations of a 50 basis point cut and announcing 25 basis points Dr Bollard will still have something to offer on Thursday, and he will have kept 25 basis points up his sleeve if continuing weakness in the economy forces him to think about another cut on June 11. (We think Dr Bollard should forget about the cash rate altogether. He should instead buy term securities, focusing on two- to five-year debt. As we have remarked before, it might not work in stabilising rates in that part of the curve but it would be worth trying.)

In the meantime, we doubt there will be any cheerful local economic news. March building approvals are out Thursday. Approvals were up in February but the trend continues down, so March approvals may well be down again. March merchandise trade is out Wednesday. Since the middle of last year, export growth has been weakening on the same month a year ago, and by February exports were 7% down on the previous February. There is no reason to think this pattern changed in March. Imports are falling even faster, so another trade surplus is likely.

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Stevens looks beyond the slump

RBA changes the subject

RBA Governor Glenn Stevens speech on April 21 was unusual in its emphasis on the long term, and unusual also in its discussion of fiscal issues. The Reserve Bank usually leaves fiscal issues to the Treasury and the Treasurer, in the hope that they will leave monetary policy issues to the RBA. Mr Stevens and other RBA officials often discuss long-term issues, but there has been such despondency about the immediate outlook in recent months that some of the media were puzzled that the RBA Governor chose to talk about what sort of economy it would be when the downturn is over. It was as if some in the media considered that he was impolitely changing the preferred subject, with some even seemingly offended by his prediction that demand would pick up by the end of the year, as if a view so improper should not be uttered by the central bank governor. We think Mr Stevens was deliberate in his choice of these themes. He seemed to recognise that the federal government is so disheartened by the deterioration in the Budget numbers that it is reluctant at this point to depict a clear pathway through the downturn. Instead, it seizes on bad economic news as yet more evidence that the budget deficit announced May 12 must be bigger and the economic forecasts must be worse. Locked up as it is in gruelling sessions on revenue and spending, the government may be unaware that financial markets, businesses and households have long been reconciled to the fact that Australia is in a downturn; they know there will be a big budget deficit, and if the polls are right they do not blame the government for it either. They will not be shocked. They have also become accustomed to a relentless flow of bad news, recognising as they do that some of it is exaggerated, misleading, and mischievous. What people would like, however, is for the national leadership to sometimes remind them that Australia will certainly come out of slump, probably sooner rather than later, and that with sensible policies it can come out in good shape. It was to them Mr Stevens spoke last week, and he spoke well.

We have long expected a deficit of around AUD50 billion in the May 12 Budget, and we had expected net Commonwealth debt would increase from nothing now to around AUD200 billion in five years. The net debt figure is now too low, given that the deficits for the next three years are all likely to move up a little more than we expected. But even at AUD300 billion in five years and even assuming average nominal GDP growth of around 6% - markedly below the average of the last decade – net Commonwealth debt as a share of GDP in Australia would be well under 20% in 2014. This compares to net government debt to GDP of 43% in Germany, 33% in the UK and 46% in the US and an average of 42% in the OECD – all these *last* year, not in five years' time. In 2014, each of these net debt to GDP ratios are likely to be much worse.

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Weekly calendar

Events & economic releases

Week commencing Monday, 27 April 2009

Country/ region	Event or economic release		Period	HSBC	Market consensus	Actual previous
Monday, 27 April						
Tuesday, 28 April						
AU	NAB Business Confidence (11.30)		1Q			-42
Wednesday, 29 April						
NZ	Trade Balance (08:45)		Mar	200.0m		489.0m
NZ	NBNZ Business Confidence (13:00)		Apr			-39.3
Thursday, 30 April						
NZ	RBNZ Official Cash Rate (07:00)		Apr 30	2.75%	2.50%	3.00%
NZ	Building Permits (08.:45)	MoM	Mar	-5%		11.6%
AU	Private Sector Credit	MoM%	Mar	0.60%		0.00%
Friday, 1 May						
During the week						

Notes:- p= preliminary, r = revised, nf = not forecast, nsa = not seasonally adjusted, ann = annualised, bn = billion, m = million
Source: Dow Jones, Reuters, Bloomberg

Monthly Calendar

Events & economic releases

Month commencing Monday, 20 April 2009

Monday 04 May	Tuesday 05 May	Wednesday 06 May	Thursday 07 May	Friday 8 May
AU House Price Index 1Q AU ANZ Job Advertisements APR	AU Building Approvals MAR AU RBA Cash Target	AU Retail Sales MAR	NZ Unemployment Rate 1Q NZ Employment Change 1Q AU Employment Change APR	AU Reserve Bank Quarterly Monetary Policy Statement

Monday11 May	Tuesday 12 May	Wednesday 13 May	Thursday 14 May	Friday 15 May
	AU NAB Business Confidence APR AU Home Loans MAR AU NAB Business Conditions APR AU Commonwealth Budget May-12	AU Westpac Consumer Confidence MAY AU Wage Cost Index QoQ 1Q		NZ Retail Sales (MoM) MAR NZ Retail Sales Ex-Auto (MoM) MAR NZ Retail Sales Ex Inflation (QoQ) 1Q

Monday 18 May	Tuesday 19 May	Wednesday 20 May	Thursday 21 May	Friday 22 May
NZ Producer Prices – Inputs QoQ 1Q NZ Producer Prices- Outputs QoQ 1Q	AU RBA Governor Stevens Speaks in Sydney MAY 19	AU Wage Cost Index YoY 1Q		

Monday 25 May	Tuesday 26 May	Wednesday 27 May	Thursday 28 May	Friday 29 May
	NZ Trade Balance APR	NZ Annual Budget MAY 27	AU RBA Deputy Governor Battellino Speaks in Sydney MAY 28 AU Private Capital Expenditure 1Q NZ NBNZ Business Confidence MAY	NZ Building Permits MoM APR AU Private Sector Credit MoM% APR

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