Bank of New Zealand

# BNZ Weekly Overview

21 February 2008



**FINANCIAL MARKETS DATA**

| | This week | Week ago | 4 wks ago | 3 months ago | Yr ago | 10 yr average |
|---|---|---|---|---|---|---|
| Official Cash Rate | 8.25% | 8.25 | 8.25 | 8.25 | 7.25 | 6.2 |
| 90-day bank bill | 8.87% | 8.81 | 8.72 | 8.73 | 7.79 | 6.4 |
| 10 year govt. bond | 6.43% | 6.34 | 6.20 | 6.26 | 5.92 | 6.5 |
| 1 year swap | 8.89% | 8.86 | 8.74 | 8.77 | 7.96 | 6.6 |
| 5 year swap | 8.25% | 8.16 | 8.03 | 8.16 | 7.40 | 7.0 |

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## Rates Rising

Its been a very quiet week as far as data release go locally but wholesale interest rates have climbed on rising worries around the globe about inflation. The NZD has traded above US 80 cents for a while riding on the coat-tails of a soaring Aussie dollar, an improved US sharemarket leading to some renewed interest in the carry trade, and expectations that rising mineral commodity prices will work their way through to higher soft commodities like meat and dairy.

The outlook overseas remains as fraught as ever but we retain our warnings about ongoing strength in the NZD and lack of scope for NZ interest rates to sustainably decline for a long period of time.

# NZ ECONOMIC DEVELOPMENTS

**Friday 15**

## Weak Retail Spending Growth

Every year as we go into Christmas the media become focused on how much people are spending with the underlying implication being that increasing spending is somehow a bad thing and we are all building up debt and will be hit with large credit card debts come February. Maybe. And every year the company Paymark involved in the processing of electronic transactions produces figures showing that spending using cards is well ahead of a year earlier. And every year we warn the media that there is an upward bias to the rate of growth in the Paymark numbers compared with retail data eventually belatedly released by Statistics NZ –yet every year those warnings get ignored and the high numbers are discussed in hand wringing terms as if buying stuff is a bad thing.

This December was no exception with the volume of spending transactions for the first week of December reported as 12% higher than a year earlier, the second week 8%, and the three days leading into Christmas 7%. http://www.paymark.co.nz/cms_display.php?sn=107&st=1&pg=840

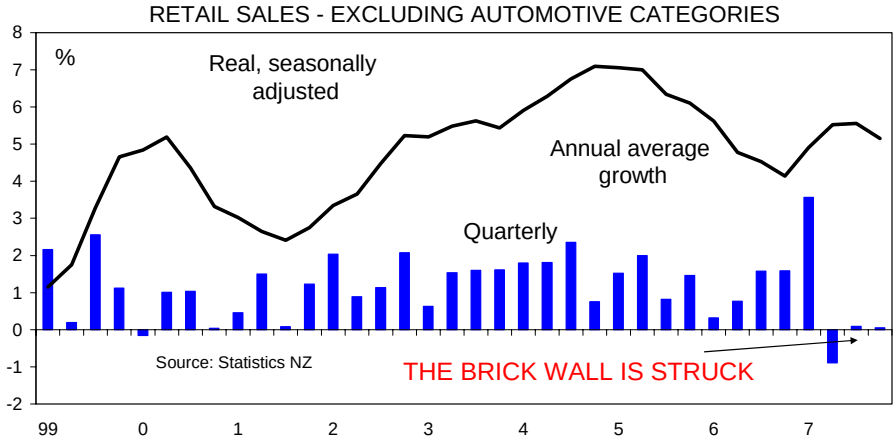
But data just released by Statistics NZ show that nominal retail spending in December was just 3.9% ahead of a year ago which is near smack on the 4% number we threw out to journalists around Christmas.

We don't wish to imply for a second that the data being released by Paymark are inaccurate. They are not and one will find that detailed analysis of their data can be extremely useful to many businesses. However as they note themselves "Note: History shows that changes in Paymark transactions are not always consistent with Retail Sales, as released by Statistics NZ, but they do provide a wide measure of household spending." http://www.paymark.co.nz/cms_show_download.php?id=78
Good stuff.

So this diatribe is not a criticism of Paymark but a message to journalists to back up what we repeatedly said over the phones two months ago. Just because electronic transactions growth is strong does not mean actual retail spending is doing the same thing. Be cautious.

And now to finish off our discussion about the retail trade numbers released this week, in nominal seasonally adjusted terms excluding the volatile automotives sector retail spending in December grew only 0.3%. That's a very weak growth rate but the number that probably really matters to retailers is the one we noted above of 3.9% growth from December 2006. Allowing for price increases that indicates minimal if any volume growth.

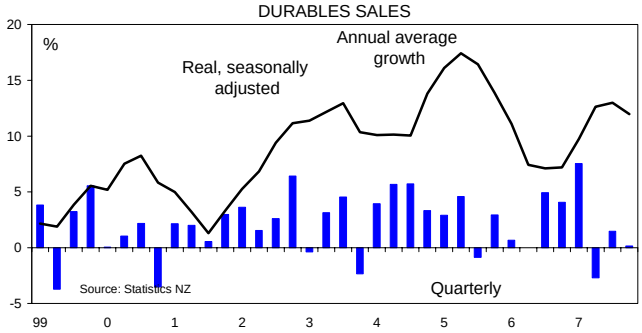
For volume growth however we need to look at quarterly numbers and those are the only retail numbers we should look at in New Zealand because the monthly numbers are simply too volatile. Not only that but there is no way anyone should look at regional retailing figures on anything less than a quarterly basis and possibly six monthly basis given the normal statistical standard errors involved.

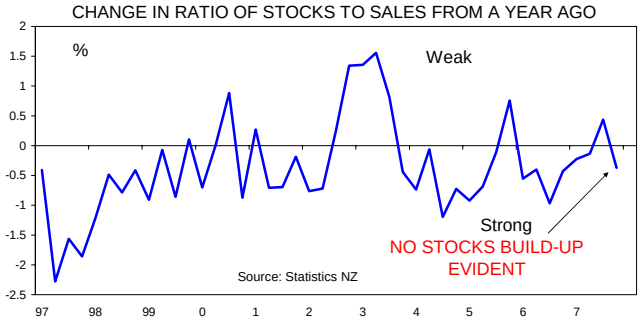



In real seasonally adjusted terms retail spending in the December quarter excluding the volatile automotives sector grew by nothing after growth of only 0.1% in the September quarter. In other words retail spending growth has ceased. The volume of spending in the quarter was up 2.8% from a year earlier.

Weakness in the willingness of consumers to spend is seen in expenditure on durable goods rising just 0.2% in the quarter though this was a good increase of 6.3% from a year earlier.

Overall the numbers unequivocally show weakness in retail spending in New Zealand which is exactly what the Reserve Bank wants to see.

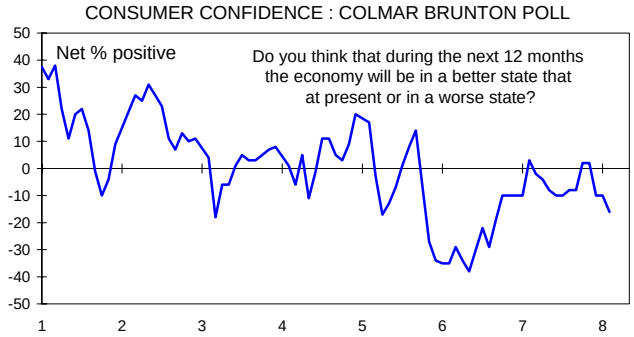


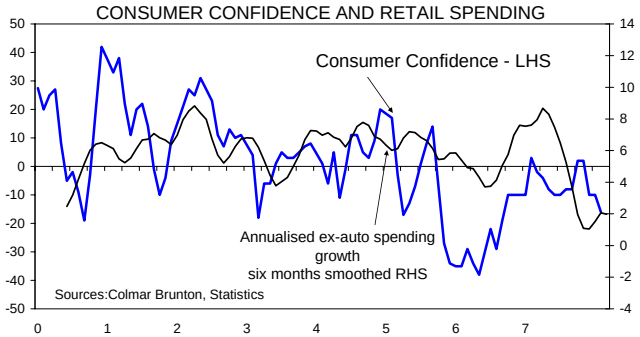




**Sunday 17**

## Consumer Sentiment Weakens

The One News Colmar Brunton poll for February, the first of the year, showed consumer confidence at a net 16% pessimistic compared with the previous reading of a net 10% pessimistic in December. The graph shows that sentiment has been fairly weak over the past couple of years but also gives a slight cause for confusion. Retail spending growth was exceptionally strong in late 2006 and early 2007 yet the sentiment readings were still relatively poor. This just illustrates that using consumer confidence measures to predict what is going to happen with retail spending can get one in a lot of trouble.

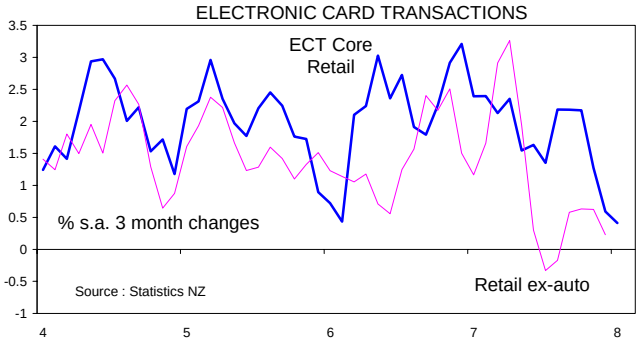



**Thursday 21**

## Electronic Transactions Data Suggests Weak January For Retailing

Just to back up our concerns about the relevance of electronic card transactions (ECT) data to what is actually happening with retail spending – today Statistics NZ released their ECT series. The core retail component showed a seasonally adjusted fall of 0.6% after rising 0.3% in December and 1.0% in November. The actual retail numbers came in close to the November and December readings with gains of 0.8% and 0.3%. But on many occasions the two series diverge substantially. We show this not by graphing the monthly changes but graphing three monthly changes below. This should smooth out monthly fluctuations inherent to a small economy like ours. It is clear that the divergence is sometimes quite large.

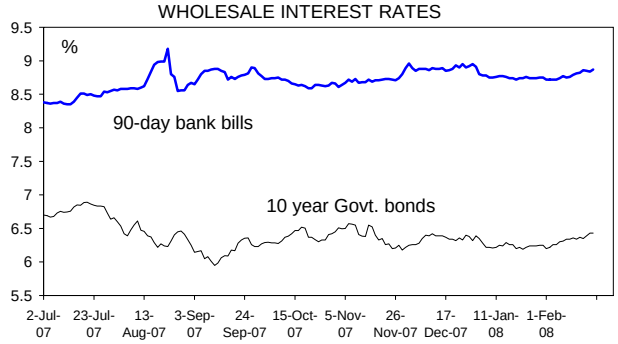


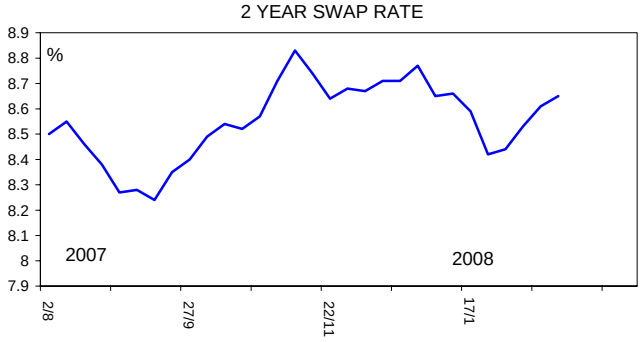
# INTEREST RATES

Wholesale interest rates have risen in New Zealand this week in response to growing worries about inflation sweeping the world and the Reserve Bank of Australia making even more hawkish comments about their inflation fighting resolve. During the week inflation hit an 11 year high of 7.1% in China, it is running at 3.2% in the Euro area, underlying inflation in Australia is above 3.5%, our own rate is 3.2% and headline inflation in the United States was last night revealed as 4.4%.

We have made reference to inflation concerns many times in our Overview publications in recent weeks with the implication that scope for falls in longer term interest rates in particular may be quite limited later this year. Borrowers should be very cautious in their assumptions about where debt servicing costs will go over the next two years. At a minimum borrowers should consider that for four years now the common view has been that monetary policy easing in NZ is just a year out – and such views have been completely wrong. Be wary of interest rate optimism this year.

The yield on 90-day bank bills has ended the week near 8.87% from 8.81% last week and 8.72% a month ago. The two year swap rate has ended near 8.65% from 8.61% last week and 8.43% a month ago. Note that the wave of worries about inflation over the week helps explain why longer term borrowing costs have risen relatively more this week. The five year swap rate has jumped to 8.25% from 8.16% last week and 8.03% a month ago.



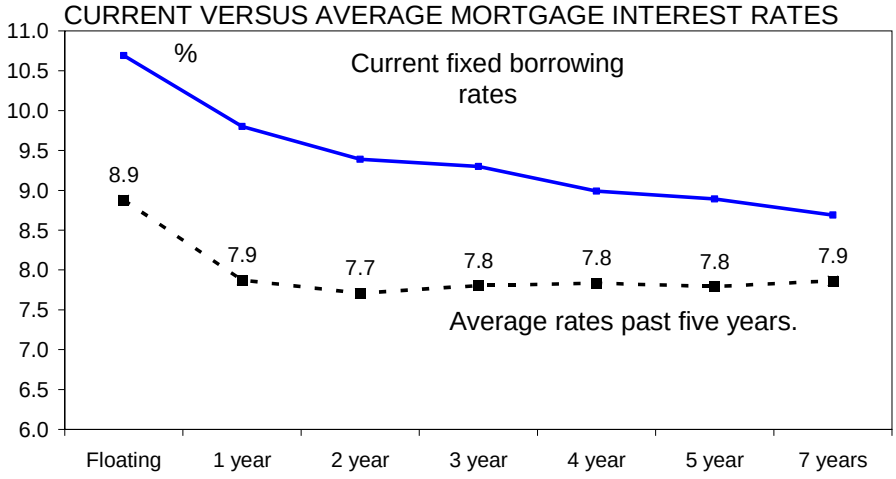

## If I Were a Borrower What Would I Do?

Not be optimistic about rates falling in the near future. Later this year there is a chance fixed rates edge a tad lower and floating rates might fall over 1% in 2009. But these are risky views. They rely on the slowing growth in our economy freeing up resources like people and machinery and that seems a low probability outcome. It relies on export commodity prices falling so farmers in particular rein in their spending. It relies on global inflation doing exactly the opposite of what it is doing now – going down in other words. It relies on the carbon emissions trading scheme next year having minimal inflation impact. It relies also on wage and salary earners deciding not to take advantage of their best bargaining position in decades and instead doing their bosses a favour and exercising restraint. Frankly the worst thing that could happen in our economy is if wages growth stays low.

We need wages in general to rise to reflect the scarcity of this most valuable of resources so that people are reallocated away from low profit activities toward high profit ones. And yes, that means low profit firms closing down – hopefully quickly so their resources can be more efficiently used. This resource reallocation process is where economic growth per capita comes from and its our best hope of preventing further ground being lost against our Australian cousins given that we don't have their mineral resources. The falling interest rate scenario also relies on the government restraining its loosening of fiscal policy – yeah right!

Personally I'd look around for anyone offering a nice discounted fixed rate below 9% in the two year area. One year is too expensive. Three years is possible but I'd want a rate below 8.8%. Given that the cost to us banks of borrowing money to lend three years at the moment is 8.5% that doesn't seem likely.

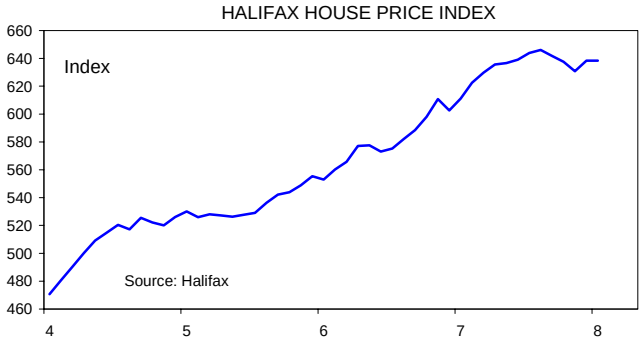
So I'd fix two years and try my best to acknowledge that just because the housing market is weakening does not mean interest rates are going to soon enter nice low territory. These painful rates will only slowly disappear. Grin and bear it.

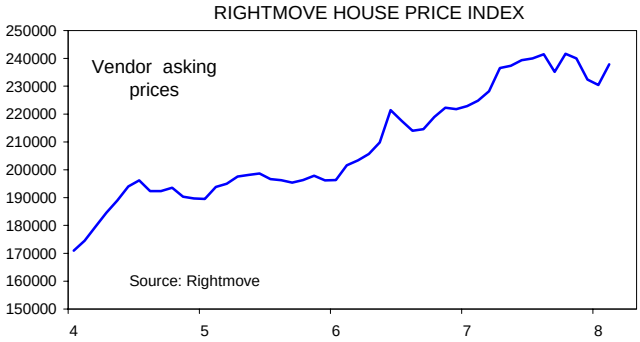



# HOUSING MARKET UPDATE

## Ups and Downs

Just because house prices measured in the REINZ monthly release have fallen for two months in a row does not mean they will keep falling. In the United Kingdom for instance the Halifax house price measure fell 0.6% in September, 0.7% in October, then 1.3% in November. It then rose 1.4% in December and was flat in January. A different index measuring what sellers are asking for rather than what properties sold at showed a 3.2% rise in January after falling in each of the previous three months.




## Remember the Fundamentals

Here is a thought. Does the collapse of developers unable to get finance to keep building increase or decrease the supply of dwellings? It decreases it.

Does the recent 11% seasonally adjusted fall in dwelling consents mean there will be fewer or more dwellings coming onto the market over the next nine months? Fewer.

Does the fact that annual dwelling consent numbers have tracked their ten year average level over the past three years imply that there has been recently created an oversupply of dwellings? No.

Does the anecdotal evidence of a shortage of rental accommodation mean there is growing or shrinking demand generally for housing? Growing.

Does the comment in newspapers a week ago from officials advising the PM that they estimate 18,000 more houses needing to be built p.a. to satisfy underlying demand mean that pressure on prices is upward or downward? Upward.

Does the increasing concern about inflation around the world mean inflation-protecting assets like commodities and property face more demand or less? More.

Is domestically generated population growth in New Zealand and therefore demand for larger and more family friendly dwellings accelerating or decelerating? It is accelerating.

Are government efforts to improve housing affordability focussed on concrete measures to boost demand or supply? Given that the supply effort only involves figuring out who owns empty land around the place one would have to say their efforts will boost demand via the planned shared equity scheme. Related to that, will talk about forcing developers to build more cheap housing lead to fewer or more dwellings being constructed? Fewer.

Does the lift in world inflation mean more or less upward pressure on NZ dwelling construction costs? More.

Does accelerating growth in wages for carpenters etc. mean more expensive or cheaper new dwellings? More expensive ones.

Will accelerating wages growth boost or retard the ability of people to buy houses? It boosts it.

Does the extra tightening of the labour market give people more or less job security and debt tolerance? More.

Will the coming tax cuts boost or retard people's willingness and ability to spend? They will boost it.

In the current environment where we are experiencing an overdue cyclical easing in the housing market it is easy to focus on the two big negatives of high interest rates and declining net migration inflows. But there are many factors underneath which are supportive of the housing market and house prices.

But over short time periods economic fundamentals can get swamped by market plays – as we often see in the oil market for instance. And that is what will probably cause the NZ housing market to get worse and look quite bad over Winter. These market plays are

A) Investors rationalising their under-capitalised portfolios.
B) Potential owner-occupiers sitting back and letting the merde hit the fan realising they do not have to be in a hurry to buy.

Our best pick is that come Spring the buyers will come out of the woodwork and the investors will have done most of their portfolio rationalisation. If I were a property punter (definitely not) I'd be sniffing around now looking for failing developers, and I'd be looking to buy before the first home buyers get tax cut cash in their hands.

## Exchange Rates & Foreign Economies

See the Offshore Overview

## Data Sources

| | |
|---|---|
| Interest rates & exchange rates RBNZ at | http://www.rbnz.govt.nz/statistics/ |
| House mortgage data – RBNZ | http://www.rbnz.govt.nz/statistics/monfin/rbssr/rbssrpartE/data.html |
| House price information - REINZ | http://www.reinz.org.nz/reinz/public/market-information/market-information_home.cfm |
| NZ economic data, most from Statistics NZ | http://www.stats.govt.nz |
| Government accounts, NZ Treasury at | http://www.treasury.govt.nz/financialstatements/ |
| Parliament, select committees, publications etc. | http://www.parliament.nz/en-nz |

Want more detailed background information on the NZ economy? Start in these places.
http://www.treasury.govt.nz/economy/overview
http://www.oecd.org/country/0,3377,en_33873108_33873658_1_1_1_1_1,00.html
http://www.rbnz.govt.nz/monpol/statements/

# BNZ WEEKLY OVERVIEW

## ECONOMIC DATA

| All % | | Latest qtr only | Previous qtr only | Latest year | Year ago | 2 Yrs ago |
|---|---|---|---|---|---|---|
| Inflation | RBNZ target is 1% - 3% on average | 1.2% | 0.5 | 3.2 | 2.7 | 3.2 |
| GDP growth | Average past 10 years = 3.0% | 0.5 | 0.8 | 2.7 | 1.6 | 3.1 |
| Unemployment rate | Average past 10 years = 5.3% | 3.4 | 3.5 | ..... | 3.8 | 3.6 |
| Jobs growth | Average past 10 years = 1.9% | 1.1 | -0.3 | 2.5 | 1.4 | 1.6 |
| Current a/c deficit | Average past 10 years = 5.5% of GDP | 8.3 | 8.2 | ..... | 9.2 | 8.5 |
| Terms of Trade | | 3.7 | 0.4 | 8.4 | -1.3 | 0.9 |
| Wages Growth | Stats NZ experimental series | 1.6 | 1.2 | 4.9 | 4.9 | 5.1 |
| Retail Sales ex-auto | Average past 9 years = 3.8%. | 0.0 | 0.1 | 5.2 | 4.1 | 6.1 |
| House Prices | Long term average rise 5% p.a. | 0.3 | 2.8 | 11.4 | 10.1 | 14.0 |
| Net migration gain | Av. gain past 10 years = 10,400 | +5,494 | 8,319yr | ..... | 14,630 | 6,960 |
| Tourism – an. av grth | 10 year average growth = 5.0%. Stats NZ | -0.6 | 1.3 | 1.8 | 1.6 | 1.5 |
| | | Latest year rate | Prev mth year rate | 6 mths ago | Year ago | 2 yrs ago |
| Consumer conf. | 10 year average = 2%. Colmar survey | -16 | -10 | -8 | -3 | -35 |
| Business activity exps | 10 year average = 26%. NBNZ | 18.2 | 15.7 | 14.8 | 24.0 | -2.4 |
| Household debt | 10 year average growth = 11.3%. RBNZ | 12.3 | 12.8 | 13.7 | 12.9 | 15.5 |
| Dwelling sales | 10 year average growth = 3.5%. REINZ | -32.1 | -21.6 | -11.3 | 19.4 | -17.6 |
| Floating Mort. Rate | 10 year average = 8.1% | 10.69 | 10.55 | 10.30 | 9.55 | 9.55 |
| 3 yr fixed hsg rate | 10 year average = 7.9% | 9.30 | 9.19 | 9.00 | 8.15 | 8.15 |

## ECONOMIC FORECASTS

| **Forecasts at Jan 24 2008** | **March Years** | | | | | **December Years** | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | 2006 | 2007 | 2008 | 2009 | 2010 | 2005 | 2006 | 2007 | 2008 | 2009 |
| ***GDP - annual average % change*** | | | | | | | | | | |
| Private Consumption | 4.6 | 2.6 | 3.3 | 0.5 | 1.7 | 4.9 | 2.4 | 4.1 | 0.7 | 1.2 |
| Government Consumption | 5 | 4.4 | 3.7 | 3.6 | 4.2 | 4.1 | 4.7 | 3.9 | 3.4 | 4.2 |
| Investment | 5.2 | -2.3 | 4.1 | 1.5 | 2.7 | 3.9 | -1.6 | 4.2 | 1.7 | 1.9 |
| GNE | 4.1 | 1 | 4.7 | 1 | 2.4 | 4.2 | 1 | 4.9 | 1.4 | 1.8 |
| Exports | -0.1 | 3.1 | 2.1 | 3.7 | 3.8 | -0.4 | 1.7 | 2.9 | 3.5 | 3.7 |
| Imports | 4.1 | -1.7 | 8.3 | 3.4 | 3.1 | 5.4 | -2.8 | 8.1 | 4 | 3 |
| GDP | 2.7 | 1.6 | 2.9 | 1.1 | 2.5 | 2.8 | 1.6 | 3 | 1.4 | 2 |
| Inflation – Consumers Price Index | 3.3 | 2.5 | 3.4 | 3.1 | 2.9 | 3.2 | 2.6 | 3.2 | 3 | 3 |
| Employment | 2.6 | 1.7 | 0.8 | 0.7 | 1.8 | 1.6 | 1.4 | 1.8 | 0.7 | 1.4 |
| Unemployment Rate % | 3.9 | 3.7 | 3.8 | 4.4 | 4.4 | 3.6 | 3.7 | 3.7 | 4.3 | 4.4 |
| Wages | 4.6 | 5.5 | 4.8 | 4.2 | 3.3 | 5.1 | 5.5 | 4.3 | 4.6 | 3.5 |
| **EXCHANGE RATE ASSUMPTIONS** | | | | | | | | | | |
| NZD/USD | 0.64 | 0.7 | 0.76 | 0.67 | 0.61 | 0.7 | 0.69 | 0.77 | 0.69 | 0.62 |
| USD/JPY | 117 | 117 | 107 | 112 | 119 | 119 | 117 | 112 | 110 | 118 |
| EUR/USD | 1.2 | 1.32 | 1.47 | 1.38 | 1.31 | 1.19 | 1.32 | 1.46 | 1.4 | 1.32 |
| NZD/AUD | 0.87 | 0.88 | 0.87 | 0.82 | 0.79 | 0.94 | 0.88 | 0.88 | 0.83 | 0.79 |
| NZD/GBP | 0.36 | 0.36 | 0.39 | 0.37 | 0.34 | 0.4 | 0.35 | 0.38 | 0.37 | 0.35 |
| NZD/EUR | 0.53 | 0.53 | 0.52 | 0.49 | 0.47 | 0.59 | 0.52 | 0.53 | 0.49 | 0.47 |
| NZD/YEN | 74.6 | 81.9 | 81.3 | 75 | 72.6 | 82.7 | 81 | 86.3 | 75.9 | 73.2 |
| TWI | 65.6 | 68.6 | 70.4 | 64.6 | 61 | 71.9 | 68 | 71.6 | 65.8 | 61.7 |
| Official Cash Rate | 7.25 | 7.47 | 8.25 | 7.75 | 6.75 | 6.99 | 7.44 | 8.19 | 8 | 7 |
| 90 Day Bank Bill Rate | 7.55 | 7.78 | 8.73 | 7.95 | 6.98 | 7.49 | 7.64 | 8.77 | 8.2 | 7.23 |
| 10 year Govt. Bond | 5.71 | 5.91 | 6.3 | 6.1 | 6.3 | 5.89 | 5.77 | 6.38 | 6.1 | 6.25 |
| 2 Year Swap | 6.99 | 7.76 | 8.29 | 7.23 | 6.65 | 7.24 | 7.48 | 8.58 | 7.46 | 6.7 |

**All actual data excluding interest & exchange rates sourced from Statistics NZ.**

**The BNZ Weekly Overview is prepared by Tony Alexander, Chief Economist at the Bank of New Zealand. Ph 04 474-6744.**