BNZ Weekly Overview

27 November 2008

Mission Statement

To help Kiwi businesspeople and householders make informed financial decisions by discussing the economy and its implications in a language they can understand.

In this week's issue….

The Weekly Overview is written by Tony Alexander. The views expressed are my own and do not purport to represent the views of the BNZ. To receive the WO and Offshore Overview each Thursday night email me at tony.alexander@bnz.co.nz with 'Subscribe" in the Subject line. You do not have to be a BNZ customer to receive the WO.

A Quiet Week with Mainly Negative News

It's been a relatively quiet week with regard to economic data and news in New Zealand. We have seen the release of data showing the annual net migration flow still running just above 4,000 though on a monthly basis there is no net gain under way at the moment. It's likely to be next year that we eventually see some improvement in net migration flows as expat Kiwis come back home because of extreme weakness in foreign economies and the attractiveness to New Zealanders of going overseas diminishes quite substantially.

The big negative locally was Fonterra's announcement of a reduction in this year's forecast milksolid's payout to $6 per kilogram from $7.66 last year and an initial forecast of $6.60 season. The reduction will inject caution into the regions though the falling NZD and continuing world population, income, and protein demand growth suggests the medium to long term outlook remains strong for the dairy sector.

In the financial markets expectations are extremely high that next Thursday morning the Reserve Bank will cut the official cash rate by at least 1% with a few punters picking the cut could be 1.5%. At their last review the RB noted they are still keeping eye on domestic inflation but the situation internationally has deteriorated quite substantially over the past few weeks as seen in sharemarket weakness and further selling of risky assets such as the Kiwi dollar. Our currency traded below 52.0 US cents during the week but has ended close to 55.2 cents this afternoon.

Of interest however is the Kiwi dollar's decline to below 84.0 cents against the Australian currency and this will please many manufacturers. It should also please those in the tourism industry. Like other forecasters we think visitor numbers are likely to fall about 10% over the coming year as people offshore shut their wallets in the face of the worst global downturn since the Great Depression. However the Kiwi dollar's decline against the Australian currency and the fact the Australians themselves will not be travelling all that much because of weakness in the economy and their currency's collapse against other currencies improves the relative attractiveness of New Zealand.

Internationally attention has been on a fiscal stimulus package announced in the United Kingdom that will blow out the government's budget deficit, comments by President-elect Obama indicating a substantial fiscal stimulus package for America in the near future, the American government's bailout of Citigroup, the Fed.'s new US$800bn package, and more bad economic data.

During the week we received a few questions via email. One was from a person who has been saving their money in recent years and is now ready to purchase some household durable goods. They wanted to know whether they should buy now or hold off for better bargains further down the track. Arguing in favour of holding off is the high probability Christmas sales will disappoint retailers and there will be extra-large discounting after New Year. In addition as the global economy worsens gloom here could easily intensify. Plus house construction is falling rapidly so the need for new household goods is moving into a well below average period. In addition the unemployment rate is likely to rise to near 6% next year. Plus retailers are still going to receive goods in coming months which were ordered before the sea-change in world growth expectations from the middle of September.

But cash availability for consumers is improving as a result of rapidly falling petrol prices and some especially large cuts in fixed interest rates which will affect more and more people each month as old rates come up for renewal. Plus there are tax cuts planned for April (what are the chances the Government increases the size of personal tax cuts as a fiscal stimulus measure?) And the lower mortgage rates go the cheaper the cost of financing purchases of consumer goods using debt.

These factors collectively appear to argue in favour of holding off buying large household items. But it is very unlikely retailers are ignorant of these things. They will know that in uncertain times it is best to get stock levels down as far and as fast as possible. So on that basis there seems little reason for holding off making a decent bundle of purchases. But if one is fronting up with cash be sure to ask for a discount. Personally speaking one finds offers of zero interest credit on large purchases of zero interest to a cash buyer.

Another emailer noted they have funds in USDs and wonder when would be the best time to change them into NZDs. We made two key points. The first was that with nominal interest rates in NZ having capacity to fall further than rates offshore the interest rate advantage for the NZD is going to diminish. In addition as declining world growth, falling commodity prices, and reducing availability of trade finance hit world trade we will suffer due to our high dependence upon foreign trade.

That means the NZD is highly likely to fall further from current levels. But the second point we made was that in the current environment it is impossible to take a reasonable stab at the timing of the NZD's cyclical low against the USD and what that low will be. It is looking increasingly likely we trade well down in the 40-50 cent range. But when is anyone's guess.

NZ ECONOMIC DEVELOPMENTS

Maybe the biggest piece of news out of New Zealand over the past week has been Fonterra's reduction in its forecast milksolid payouts for this season from $6.60 a kilogram down to $6.0. The payout last season was $7.60 in the hand and $7.90 all up. There is an excess supply of dairy products on the market, buyers are attempting to get down existing inventories, underlying demand is shrinking with weak economic activity, and all of the earlier panic driven buying associated with forecasts of commodity prices continuing to rise massively in the near future is no longer happening. We have also seen a big increase in the supply of American product on the market.

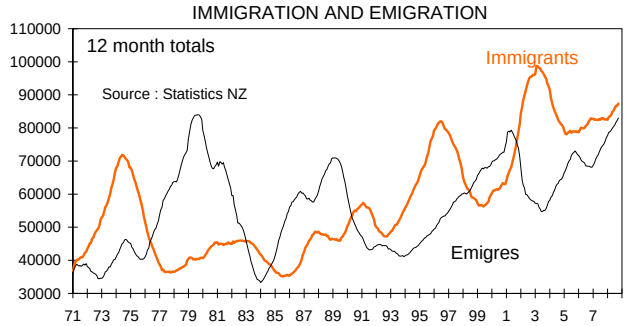
Given that it is likely to take quite a period of time to get rid of the excess supply of dairy products in the market place the payout for the season could be revised even further downward. Then there is a risk that in the following season the payout is similar or even lower. Having said that it is quite clear that volatility in prices of everything is amazingly high at the moment and predictability of commodity prices in particular is relatively low at the best of times.

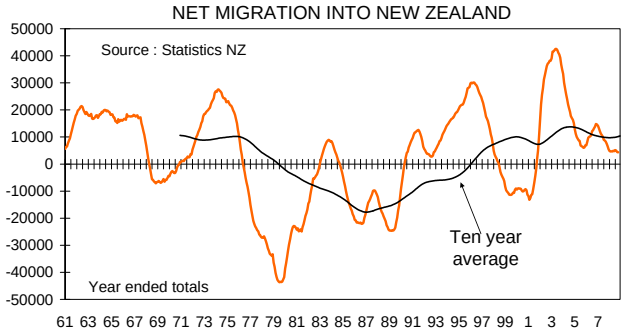
The key relevance of Fonterra's announcement is that dairy farmers will cut back quite sharply on their normal expenditure and there are likely to be some difficulties for those who have recently converted their farms to dairying in anticipation of prices remaining near last season's level.

Friday 21

Migration Gain Running at Half the Average

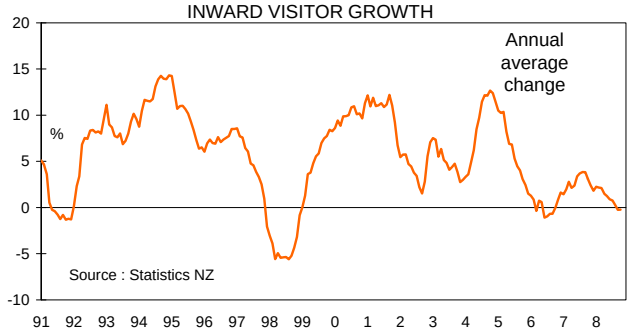
There was a net gain to New Zealand's population from permanent and long-term migration flows in October of 1,487 people. This was a reduction of only 74 from year earlier meaning the annual net migration gain is essentially unchanged in October from September at just over 4,300 people. A year ago the net gain was 7,520 people and over the past 10 years the average net gain has been 10,000 people per annum. So net migration flows are running below average but are still in positive territory.

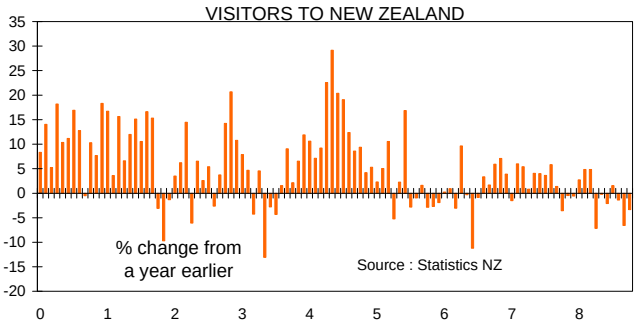




This is one way in which a key dynamic in the housing market is different this cycle of weakness in the economy than in the past. For instance when the economy was last in recession over 1998 there was a net migration outflow of 6265 people.

Over the coming year we suspect that with economic conditions extremely weak overseas there will be an increasing number of people moving to New Zealand, most notably expatriate Kiwis, while far fewer New Zealanders will move overseas seeking higher incomes. It is conceivable that in a year's time the net migration gain could be around 15,000 people. There is no evidence of this happening yet however with the seasonally adjusted net migration gain for October coming in at only 10 people compared with a small loss of 10 the previous month.





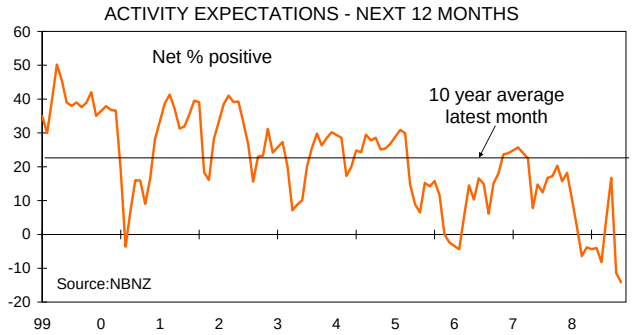
The number of people visiting New Zealand in October was down by 3.3% from a year earlier. For the year to October there was a decrease in visitor numbers of 0.2% and we expect this will move to around -10% in the coming year due to the global recession slashing the willingness of people to travel.

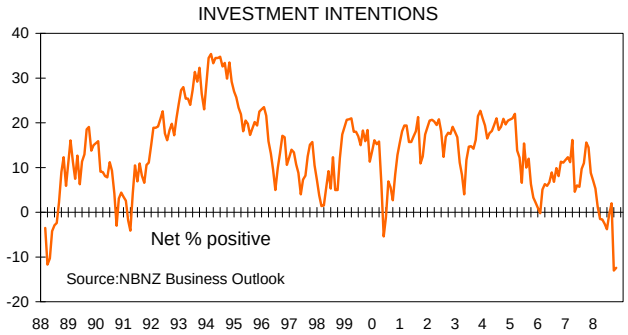
Thursday 27

Business Sentiment Remains Depressed

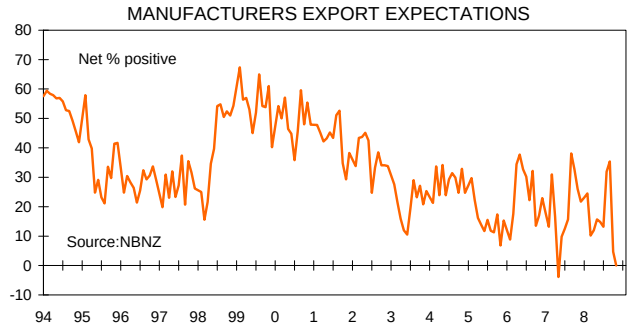
Business sentiment measured in the NBNZ's monthly survey held steady at a net 43% pessimistic in November from October. Activity expectations however weakened slightly to a net 14% pessimistic from 11% in the previous month and there were generally mixed results for other indicators showing all up that there has not been much change in business attitudes over the past month. Employment intentions have held steady at a net 21% pessimistic which is a shockingly weak result and well below the average reading of a net positive 2% in the past 10 years.

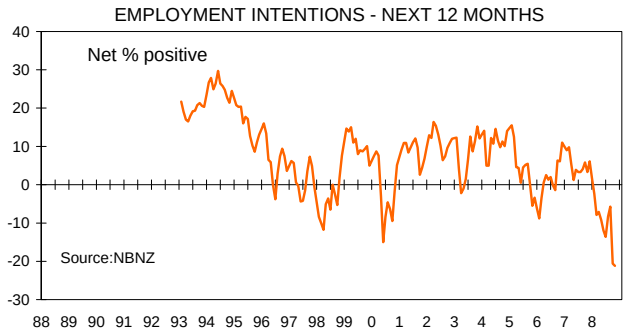
Investment intentions were -12% from -13%, commercial construction expectations -40% from -39%, residential construction expectations -29% from the 33%, and manufacturers export expectations of 0% from positive 5%.





The survey is consistent with a very weak outlook for the New Zealand economy over the coming year.

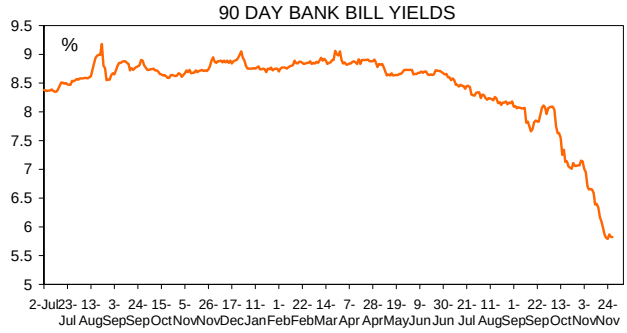


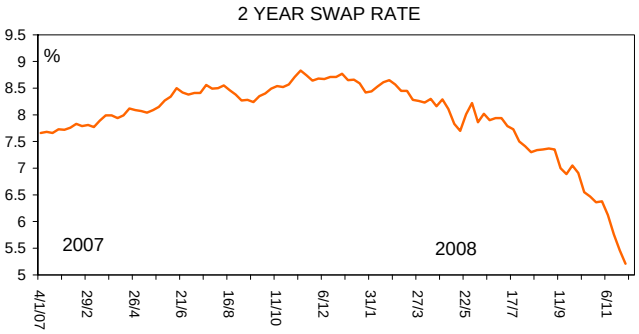


INTEREST RATES

Next Thursday morning the RB will review their 6.5% official cash rate and a cut to 5.5% is expected. They may cut further but their incentive to take drastic action is somewhat less than for central banks in the Northern Hemisphere facing major economic crunches. In addition this week we have seen some very hefty reductions in bank mortgage interest rates showing that OCR cuts so far and the 1% cut anticipated for next week have had a strong impact. Having said that the risk is the cut does amount to more than 1%.

The market has largely factored in an expectation that the official cash rate will reach 4% in the middle of next year and that explains why we have seen such a strong decline in wholesale interest rates in recent weeks. The two-year swap rate has ended this afternoon near 5.2% from 5.46% last week and 6.4% a month ago. The 90 day bank bill rate has ended near unchanged from a week ago just above 5.8% but well down from 7.1% a month ago.





Key Forecasts

- Monetary policy easing with the official cash rate near 4.5% come mid 2009.
- The two year fixed housing rate reaching 7.0% in mid-2009 or earlier, with minor downside possible after that assuming easing of the credit crisis. Falling to the 6.5% low of 1999, 2001 and 2003 is now more possible this cycle than previously thought for the past few months because of the worsened global outlook.

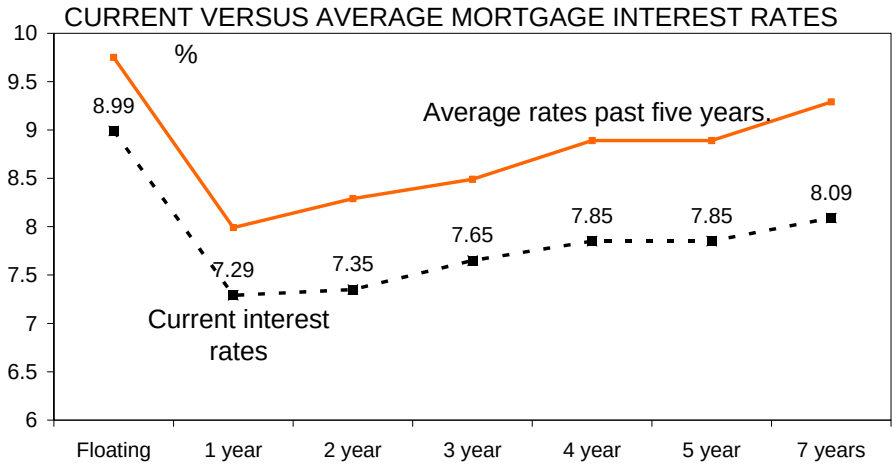
FINANCIAL MARKETS DATA

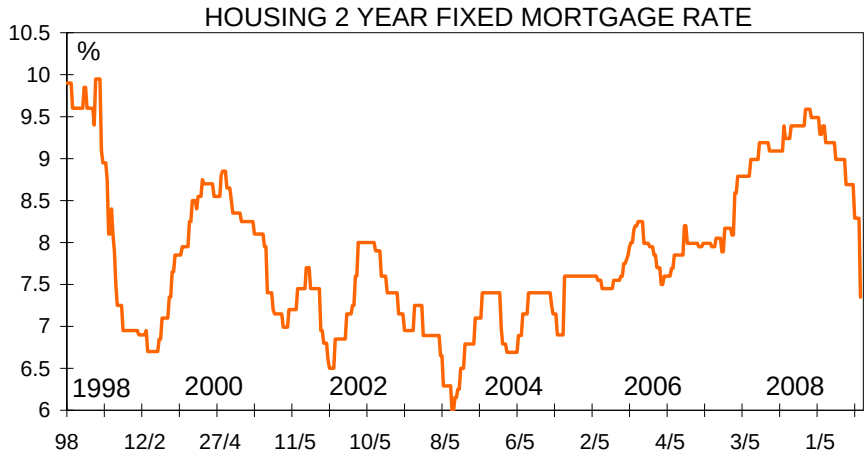
	This week	Week ago	4 wks ago	3 months ago	Yr ago	10 yr average
Official Cash Rate	6.50%	6.50	7.50	8.00	8.25	6.2
90-day bank bill	5.82%	5.97	7.06	8.18	8.79	6.5
10 year govt. bond	5.28%	5.69	5.92	6.01	6.19	6.2
1 year swap	5.10%	5.53	6.39	7.73	8.87	6.7
5 year swap	5.65%	6.03	6.50	7.11	8.20	7.0

If I Were a Borrower What Would I Do?

Given that one can now fix six months at only 6.99% while the floating rate is still much higher than that, if I were borrowing at the moment I would now fix six months in anticipation of being able to lock in at a much lower long term rate toward the middle of 2009. Though perhaps then it may be optimal to float a bit if it appears the bottom for rates has not been reached. If it looks like the bottom will be reached before then the cost of breaking a six month fixed rate would be minimal. The six month rate only applies for loans with at least 20% deposit. But if I had a smaller deposit than 20% I would probably still fix 6 months – though the rate would be up to 7.39% if I needed to borrow 95%.

The first graph below shows that all fixed rates are now well below their five year averages. The second graph puts the new two year rate of 7.35% in historical perspective.





HOUSING MARKET UPDATE

No fresh data have appeared this week. Last week we noted our caution regarding the initial stimulus to the housing market which one might expect from fixed lending rates going below 8% - or now below 7% in the case of our six month rate. Rising unemployment is the bug in the ointment basically. The tightening of lending standards now underway with some banks requiring 20% deposits will clearly reduce demand and reinforces our expectation that prices will decline another 5% or so from current levels before stabilising.

Key Forecasts

- Dwelling consent numbers to fall from 24,500 in the year to March 2008 to below 18,000 in the year to March 2009 (annual low point near 16,000 now likely) with a slight recovery to March 2010 then above average activity after that as attention turns to a shortage of dwellings late in 2009.
- Real estate sales falling from 77,130 in the year to April 2008 to between 55,000 and 65,000 come the end of this year then recovering back over 65,000 in calendar 2009 with further growth over 2010.
- House prices down 5%-10% by the end of 2008, flat over 2009, rising slightly over 2010.

Exchange Rates & Foreign Economies

See the Offshore Overview.

Blanket apology for any strange words or phrases resulting from not doing enough proof-reading after using the Dragon Naturally Speaking voice recognition software.

ECONOMIC DATA

All %		Latest qtr only	Previous qtr only	Latest year	Year ago	2 Yrs ago
Inflation	RBNZ target is 1% - 3% on average	1.5%	1.6	5.1	1.8	3.5
GDP growth	Average past 10 years = 3.0%	-0.2	-0.3	2.6	2.4	2.4
Unemployment rate	Average past 10 years = 5.3%	4.2	3.9	.....	3.5	3.8
Jobs growth	Average past 10 years = 1.9%	0.1	1.3	1.0	1.5	1.5
Current a/c deficit	Average past 10 years = 5.5% of GDP	7.8	7.9	.....	8.5	9.6
Terms of Trade		2.9	3.7	8.8	3.8	-1.9
Wages Growth	Stats NZ analytical series	1.5	1.1	5.3	4.8	5.1
Retail Sales ex-auto	Average past 9 years = 3.8%.	-0.2	-0.6	0.4	5.5	4.5
House Prices	Long term average rise 5% p.a.	-4.5	-0.7	-4.4	13.7	10.3
Net migration gain	Av. gain past 10 years = 10,400	+4,403	4,938yr	.....	8,319	13,210
Tourism – an. av grth	10 year average growth = 5.0%. Stats NZ	-0.2	0.8	-0.2	3.1	-0.0
		Latest year rate	Prev mth year rate	6 mths ago	Year ago	2 yrs ago
Consumer conf.	10 year average = 2%. Colmar survey	5	3	-33	2	-10
Business activity exps	10 year average = 26%. NBNZ	-14.1	-11.4	-4.4	15.7	23.7
Household debt	10 year average growth = 11.3%. RBNZ	6.7	7.3	10.9	13.3	13.3
Dwelling sales	10 year average growth = 3.5%. REINZ	-34.8	-23.7	-45.5	-22.6	4.0
Floating Mort. Rate	10 year average = 8.1%	8.99	9.75	10.95	10.55	8.55
3 yr fixed hsg rate	10 year average = 7.9%	7.65	8.49	9.49	9.19	7.99

ECONOMIC FORECASTS

Forecasts at Nov. 20 2008	**March Years**					**December Years**				
	2007	2008	2009	2010	2011	2006	2007	2008	2009	2010
GDP - annual average % change										
Private Consumption	2.9	3.3	-0.4	1.6	2.3	2.7	4.1	0	0.9	2.3
Government Consumption	4	4.1	3.6	3.2	3.3	4.7	3.6	4	3.2	3.2
Investment	-1.9	4.3	-4	-5.1	6.6	-1.5	4.7	-1.7	-7.4	5.1
GNE	1.1	4.5	-0.9	0	3.8	1.2	4.5	0.4	-1.1	3.4
Exports	3.1	2.3	0.5	0.2	2.2	1.7	3.3	0.9	-0.1	1.5
Imports	-1.6	9.7	2.9	-2.7	2.2	-2.6	8.7	5.4	-2.9	0.8
GDP	1.8	3.2	-0.4	1.3	3.9	2	3.2	0.4	0.3	3.8
Inflation – Consumers Price Index	2.5	3.4	3	2.4	2.3	2.6	3.2	3.8	1.7	1.9
Employment	1.8	-0.2	0.6	-0.5	2.1	1.4	2.5	-0.3	-1.1	2.1
Unemployment Rate %	3.7	3.7	4.9	6	6.1	3.8	3.4	4.6	5.8	6.1
Wages	5.5	4.4	4.8	3.2	2	5.5	4	4.9	3.5	2.3
EXCHANGE RATE ASSUMPTIONS										
NZD/USD	0.7	0.8	0.53	0.56	0.64	0.69	0.77	0.54	0.54	0.62
USD/JPY	117	101	93	98	110	117	112	94	95	107
EUR/USD	1.32	1.55	1.24	1.24	1.32	1.32	1.46	1.25	1.22	1.3
NZD/AUD	0.88	0.87	0.85	0.9	0.9	0.88	0.88	0.86	0.9	0.9
NZD/GBP	0.36	0.4	0.36	0.37	0.4	0.35	0.38	0.36	0.36	0.39
NZD/EUR	0.53	0.52	0.43	0.45	0.48	0.52	0.53	0.43	0.44	0.48
NZD/YEN	81.9	81.1	49.3	54.9	70.4	81	86.3	50.8	51.3	66.3
TWI	68.6	71.6	54.6	58.1	65.4	68	71.6	55.5	56.3	63.5
Official Cash Rate	7.47	8.25	4.75	5	6	7.50	8.25	5.5	4.75	5.75
90 Day Bank Bill Rate	7.78	8.83	5	5.2	6.2	7.64	8.77	5.55	5	5.95
10 year Govt. Bond	5.91	6.35	5.3	6.4	6.5	5.77	6.38	5.5	6.2	6.5

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.