BNZ Weekly Overview

28 May 2009

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 Weekly Overview each Thursday night email me at tony.alexander@bnz.co.nz with 'Subscribe" in the Subject line.

Budget Day

By the time anyone gets to read this week's edition of the WO there will be literally thousands of pages of information about the 2009 Budget already on the internet. So there seems little point in doing anything other than running through some of the high level stuff and noting the main implications. To whit

This is the first Budget in a long time which has not contained a list of handouts to all and sundry. In that regard it will be of little interest to most people and that is probably a good thing because quite frankly, the more people look toward the government to use someone's else money to solve their perceived problems and the economy's difficulties the further removed we truly are from the solution. One of these solutions of course would be Kiwis saving money for their health, education and retirement needs and at least running a positive savings rate rather than one of the worst rates of dissaving in the OECD.

But such moaning aside, this year's Budget is largely an accounting exercise aimed at avoiding a credit rating downgrade. It has achieved that and more with Standard and Poors taking the government's rating off negative watch. h the government projecting the ratio of net debt to GDP will rise to reach about 36% in 2016/17 then start very slowly declining. This improvement compared with projections of steady deterioration in the absence of new measures has been achieved by reining in some of the massive spending growth put in place by the previous three governments.

The tax cuts planned for 2010 and 2011 have essentially been cancelled. New spending announcements have been very small. Contributions to the NZ Superannuation Fund have been suspended for ten years to avoid pressuring debt markets even further.

The fiscal projections contained in the Budget look reasonable, though the fact no fiscal surplus is projected for about ten years is a source of concern and something which will require further addressing – probably through further cutting of wasteful programmes. Having said that, the economic projections look a tad too weak beyond this March year so scope exists for some extra improvement further out – or announcement of a tax cut ahead of the 2011 election!

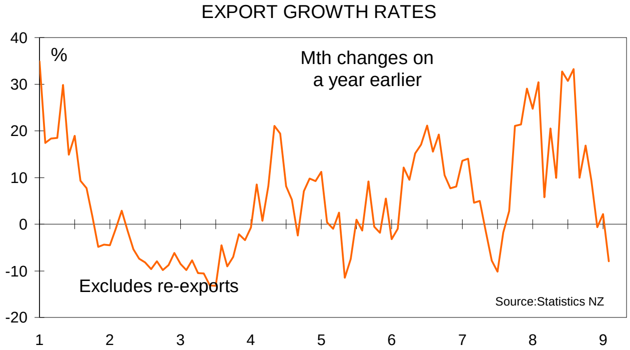
The Budget is not significant enough in either a restraining or boosting direction to have any noticeable impact on interest rates or the exchange rate.

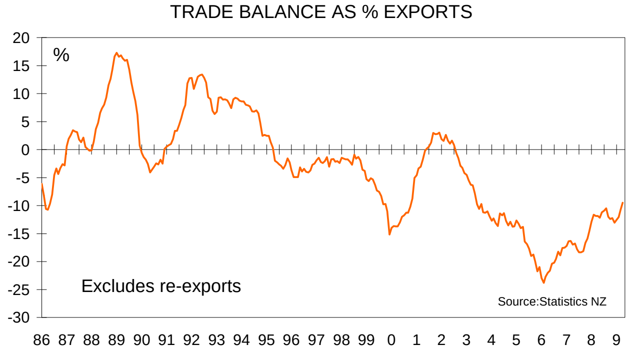
NZ ECONOMIC DEVELOPMENTS

Tuesday 26

Trade Balance Very Slowly Improving

The merchandise trade account recorded a surplus during April of $275m. This was a sharp improvement from a deficit of $292m a year ago. But that is because an oil rig worth $447m entered NZ in April 2008. If we take that out then the balance a year ago was actually a surplus of $154m so the improvement is not as stark as it seems. Imports were in fact down 8% from a year ago while exports were down 4.6%. In the past three months imports were running 6.1% down from a year ago and exports were ahead 1.8%. So weakness in the NZ economy hitting imports is exceeding weakness in exports. This is producing an improving trade balance. A year ago the annual deficit was $4.2b excluding the oil rig. Now it is exactly the same. So there remains a long way to go for this account to get back into surplus though we do expect improvement over the next couple of years even though exports are likely to decline.

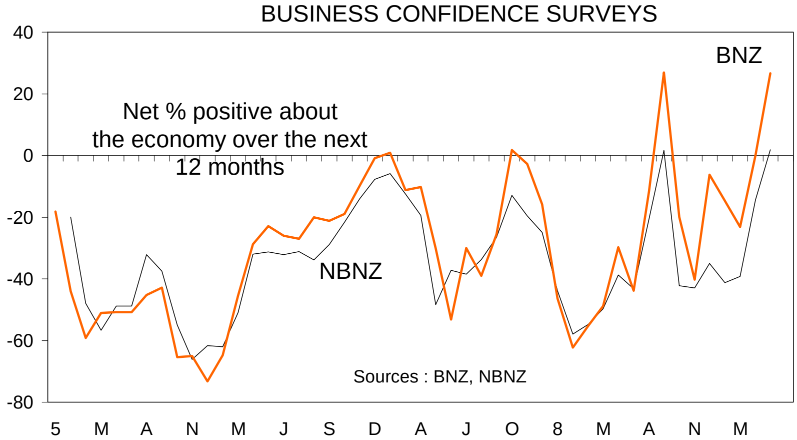




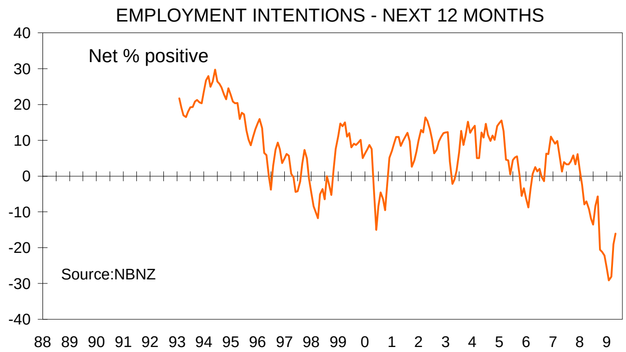
Wednesday 27

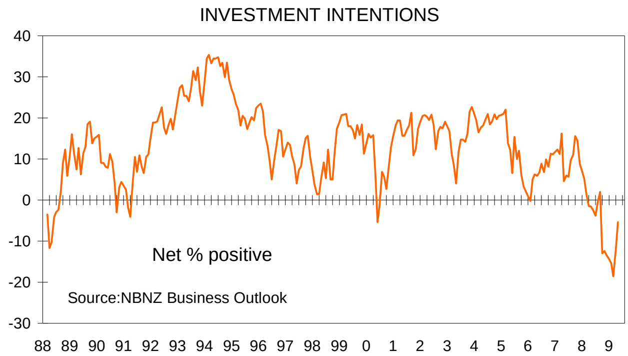
Business Confidence Confirmed Rising

Two and a half weeks ago we reported that business confidence had jumped strongly early this month. This was confirmed in the monthly NBNZ Business Outlook survey released this week which showed a rise in their confidence measure to a net 2% optimistic about the economy over the coming year from 15% pessimistic in April and 39% in March.



The NBNZ survey is more detailed than ours and it's value is in drilling down to see what businesses intend doing rather than what they are thinking. In that regard the outlook for the economy remains poor. A net 16% plan cutting job numbers over the coming year. This is clearly a poor result even though it is up from a net 19% in April and 28% in March. The ten year average reading for this measure is +2%.





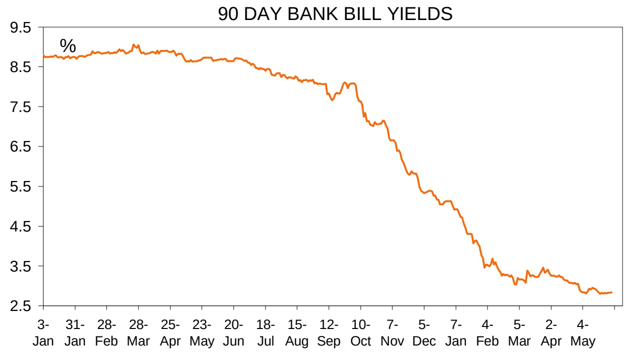
A net 5% plan cutting their capital expenditure. This is an improvement from 12% in April and 19% in March but well below the average reading of +10%. A net 2% of manufacturers expect their exports to rise which is worse than April's 11% result and well below the 25% average reading.

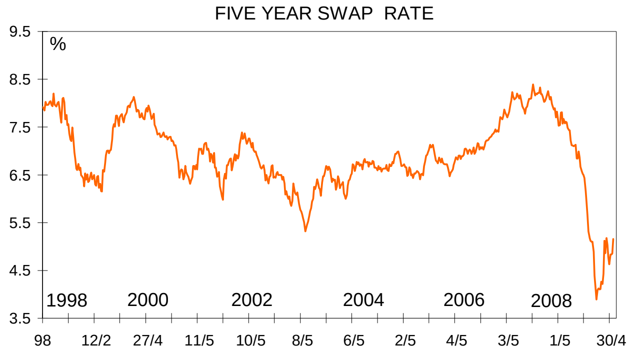
These indicators of continued spending restraint are reflected in business expectations of their own levels of activity over the next 12 months remaining very poor. Only a net 4% of respondents expect their activity to rise. This is up from 4% expecting contraction in April and 21% in March. But it is well below the 17% average reading.

At least the still bad indicators are now moving in the right direction and we expect that over the next few months further improvements will be recorded. But gains are going to depend significantly upon whether the world economy's prospects seriously start to improve.

INTEREST RATES

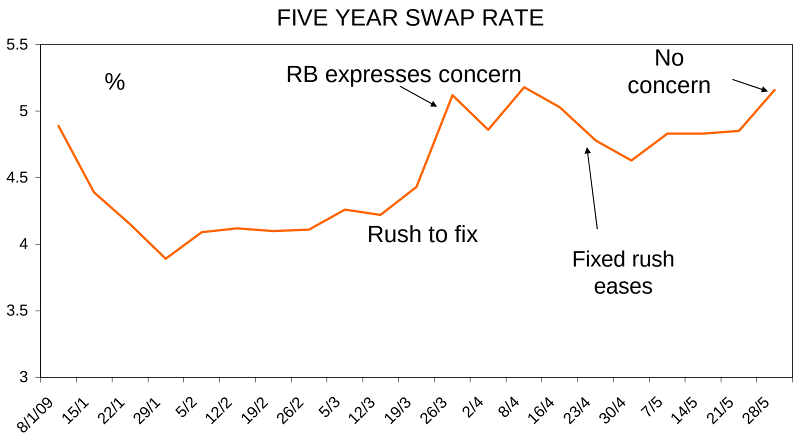
Wholesale interest rates have increased over the past week for terms beyond 90 days, driven up by some positive business sentiment data and rises in yields offshore offsetting Fonterra's downbeat payout projection. While the yield on 90-day bank bills has ended unchanged just over 2.8% (we borrow these funds offshore with about a 2% extra cost), the two year swap rate has ended near 3.67% from 3.52% last week. The five year swap rate has ended near 5.16% from 4.85% last week.





An important point to note here is the following. On April 1 the Reserve Bank issued a statement saying **"Reserve Bank Governor Alan Bollard today expressed concern over the recent strength of long-term wholesale interest rates."**

They were concerned about the likes of the three year swap rate jumping in late-March from 3.75% to 4.5%, the five year rate from 4.2% to 5.1%, and the seven year rate from 4.6% to 5.4%. The three year rate is now 4.4%, the five year rate above that earlier high level at 5.16%, and the seven year rate also higher at 5.6%.



Will we see a similar statement issued this time around? Almost certainly not because interest rates have also risen overseas and the green shoots offshore and within New Zealand have become more prevalent. Again – we need to remind people that none of these green shoots should give cause for optimism regarding the strength of economic activity anywhere over the next 12 months. But they do increasingly confirm both the avoidance of the Great Depression scenario and the validity of expecting a cessation of shrinking global growth probably before the end of the year. Those two things explain why yield curves around the world are steepening and why borrowers planning to fix should have down so over two months ago or do so now.

The RB next review their official cash rate on June 11. We see a reasonable chance they cut the rate from the current 2.5% level. However, in light of the fact their last cut caused practically no change in lending rates the action may be quite pointless. Hence our continued firm support for interest rate management policies geared toward gaining protection against funding costs drifting upward at a pace it is impossible to pick at the moment.

Key Forecasts

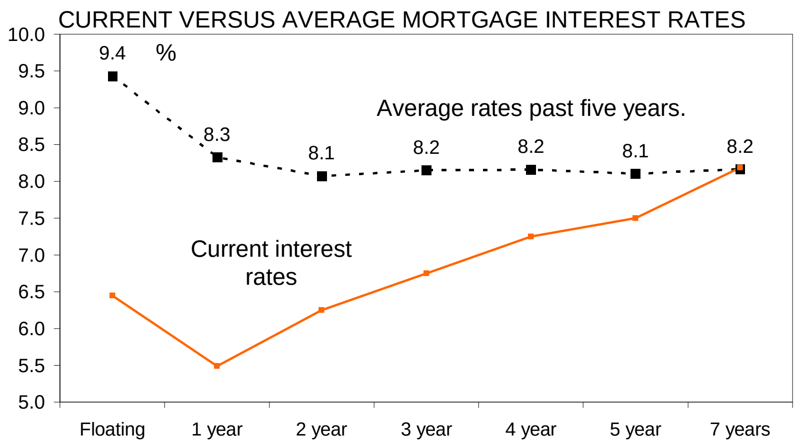
- Monetary policy easing with the official cash rate possibly at 2.0% come mid 2009.
- Medium to long term housing rates have seen their multi-year lows – stop-start rises now lie ahead. Speed unclear.

FINANCIAL MARKETS DATA	This week	Week ago	4 wks ago	3 months ago	Yr ago	10 yr average
Official Cash Rate	2.50%	2.50	3.00	3.50	8.25	6.2
90-day bank bill	2.84%	2.81	3.04	3.19	8.73	6.5
10 year govt. bond	5.83%	5.51	5.26	4.51	6.49	6.2
1 year swap	3.04%	2.96	2.90	3.03	8.58	6.7
5 year swap	5.16%	4.85	4.63	4.11	7.81	7.0

If I Were a Borrower What Would I Do?

Wholesale borrowing costs have increased over the past week. The chances have increased that fixed lending rates will rise from current levels in the next few weeks. Therefore my position remains unchanged. If I were looking to float simply because I liked the flexibility I would not. I would fix one year at 5.49% and save 1% right away. The RB's 0.5% cut in the official cash rate three weeks ago produced no cut in floating mortgage rates. Therefore the remaining 0.5% cut we think might come will have little if any impact. There seems zero chance the floating rate hits 5.49%. This one seems to be a no brainer.

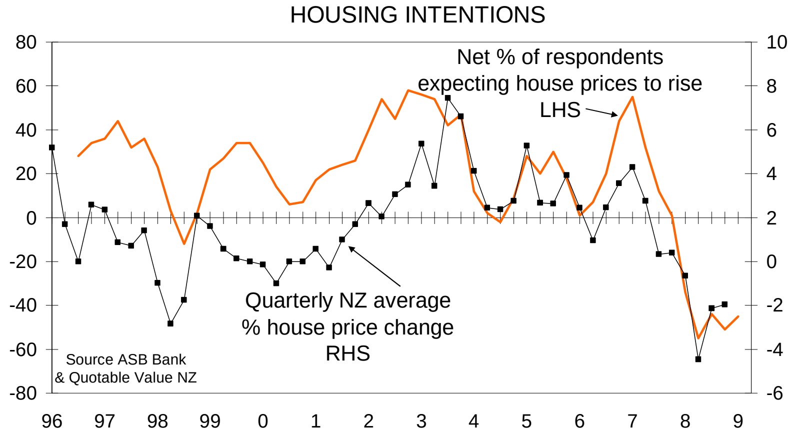
If however I was only floating in order to fix I can see no reason for waiting. I would fix now, probably for three years at 6.75%. Of course those who follow this section will already have fixed either at seven years for 6.79% back on March 20, five years at 6.49%, or three years at 5.99%. Those rates are currently 8.19%, 7.5%, and 6.75% respectively. I would fix now.



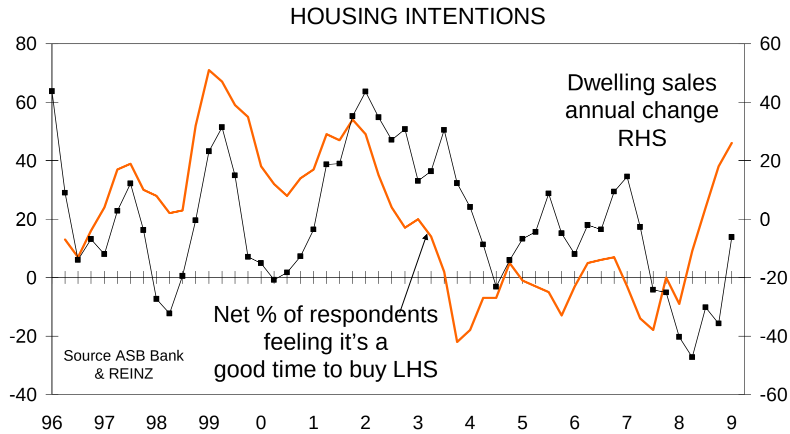
HOUSING MARKET UPDATE

Nothing Much New This Week

We have learnt nothing startlingly new about the New Zealand housing market over the past week. The quarterly ASB Housing Report reveals that a net 45% of respondents expect house prices to fall over the coming year. This is better than a net 51% in the December quarter expecting declines but still reveals that people have a strongly dour view on house prices. The graph shows that these price expectations tend to reflect what is happening and not what will happen.



However a net 46% feel it is a good time to buy a house up from 38% in the December quarter and 9% feeling it was a bad time a year ago.



This indicator – shown as the orange line in the graph above – tends to give a leading indication of changes in house sales. It therefore suggests continued strength in sales in the near future.

Key Forecasts

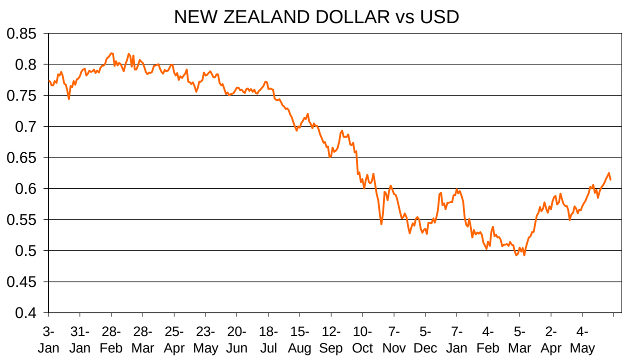
- Dwelling consent numbers to slowly recover from the middle of this year.
- Real estate sales have bottomed for this cycle. Activity is likely to fluctuate and begin a drift upward before year end with potentially firm activity over 2010.
- House prices stabilising now possibly, then rising slightly over 2010.

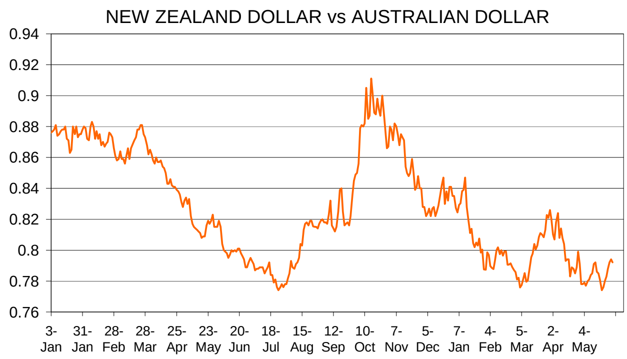
Exchange Rates & Foreign Economies

EXCHANGE RATES	This week	Week ago	4 wks ago	3 months ago	Yr ago	Consensus* Frcst Yr Ago	10 yr average
NZD/USD	0.618	0.605	0.568	0.508	0.789	0.729	.592
NZD/AUD	0.794	0.78	0.799	0.786	0.823	0.849	.856
NZD/JPY	59.6	57.3	55.0	50.0	82.2	75.8	66.8
NZD/GBP	0.388	0.384	0.388	0.355	0.399	0.385	.345
NZD/EUR	0.447	0.44	0.436	0.399	0.503	0.504	.51
USD/JPY	96.4	94.7	96.8	98.5	104.0	104	113.9
USD/GBP	1.593	1.576	1.464	1.43	1.977	1.892	1.709
USD/EUR	1.383	1.355	1.303	1.273	1.569	1.445	1.156
AUD/USD	0.778	0.776	0.71	0.647	0.959	0.859	0.69

NZD Still Holding Up Versus USD

Once again the NZD has held strong this week against a greenback weighed down by worries about the ballooning fiscal deficit, talk about Asian central banks diversifying away from USDs, and worries about a credit downgrading. Early in the week the NZD climbed to a seven month high against the greenback above 62.5 cents but it has ended near 61.8 from 60.5 last week with selling following Fonterra's projection of a \$4.55 milk solids payout over 2009/10 from \$5.20 this season and \$7.90 last year.



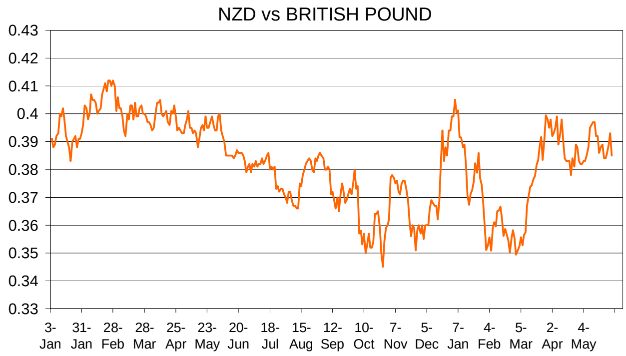


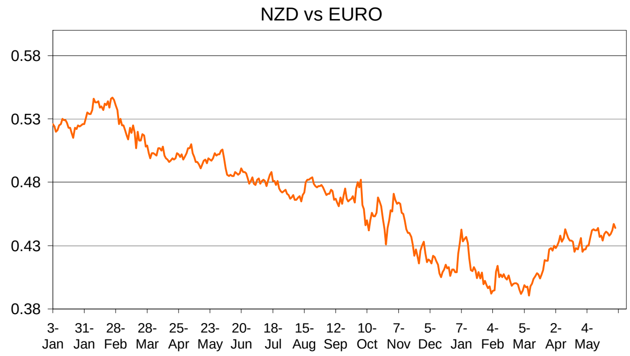
One factor weighing down the NZD slightly was the announcement by the United States of a return to dairy export subsidies. The move reduces the upside potential for NZ dairy export prices as world growth eventually improves and could place fresh downward pressure on prices in the short-term. This just goes to reinforce the fact that although NZ traditionally has an export led upturn the extent of that cyclical upturn this time around is likely to be quite muted.

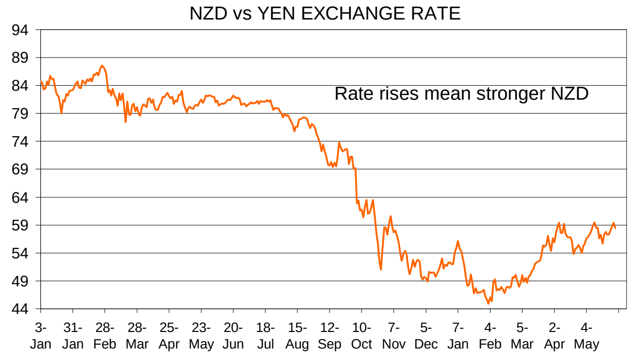
Restraining factors will be the structural decrease in availability of credit to an exceptionally debt-hungry farming sector which the Reserve Bank feels has stretched the limits of tolerable indebtedness. Another is the likely muted and delayed world economic recovery which will limit the initial strength of cyclical commodity prices gains. In addition there is the strength in the NZD which above 60 cents is well above where it might "normally" be at the low point in its cycle as world growth recovers.

Our currency has to some degree recovered well in advance of any improvement in world economic activity. Having said that one must be mindful that the recovery is mainly against a much greenback and the NZD remains low against the currency of our largest trading partner which is Australia. The NZD/AUD cross rate has ended this afternoon near 79.4 cents from 78 cents last week.

Against the British pound the NZD has ended almost unchanged at 38.8 pence, also practically unchanged against the Euro at 44.7 centimes, but up against the Japanese Yen near 59.6 from 57.3.





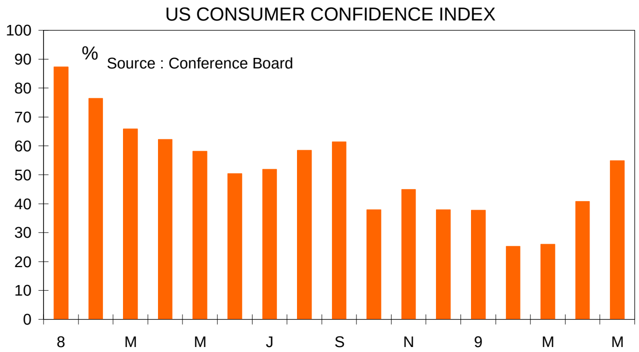


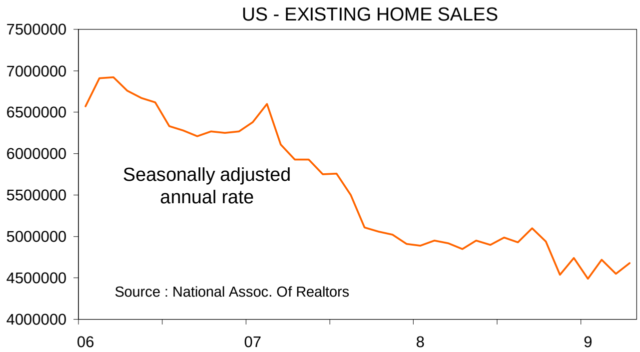
The greenback has ended the week stronger against the Yen near 96.4 from 94.7, but weaker against the pound and Euro at $1.593 and $1.383 respectively from $1.576 and $1.375. Economic data releases during the week have been highly mixed and for the moment there appears strong unwillingness in the markets to shift funds to any further large degree until a better feel is gained for not just when US and global growth may resume but how firm it could be. Uncertainty about numerous things remains very high.

For instance, during the week US ten year government bond yields rose to their highest levels in six months amidst worries about the ability of the US government to finance its huge budget deficit. Oil prices have also risen strongly in the absence of any indication from OPEC that they plan boosting production to keep prices low and assist recovery. Uncertainty is obviously extreme regarding the situation on the Korean Peninsula, and Swine Flu continues to slowly spread beneath the radar around the world.

With regard to some of the data releases offshore we have the following.

- The US Conference Board consumer confidence index rose to a far higher than expected reading of 54.9 in May from 40.8 in April. In the overall scheme of things this is still a weak result. But it is nonetheless the best level of sentiment since September 2008 before the collapse of Lehman Brothers investment bank.





- Existing home sales in the US rose a greater than expected 2.9% in April to lie just 3.5% down from a year earlier. But as the second graph above shows, there is no upward trend in place for this measure yet so high caution remains about the housing market.

But there were plenty of weak data releases offshore as well.

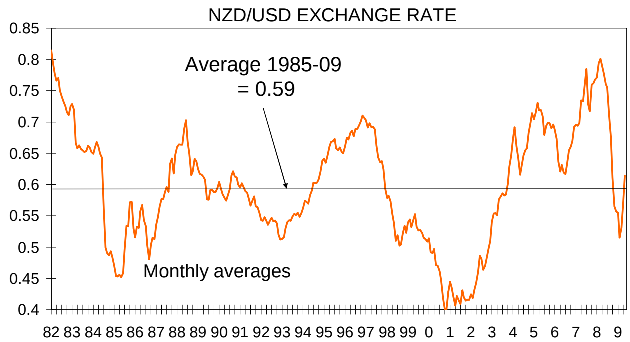
- Eurozone industrial orders fell 0.8% in March whereas a rise of 0.8% had been expected.
- The German financial regulator warned that levels of German debt could explode “like a grenade”
- Case Shiller reported that US house prices on average fell 2.2% in March after also declining 2.2% in February. Prices were down 18.7% from a year ago and have now fallen 32.2% since July 2006.

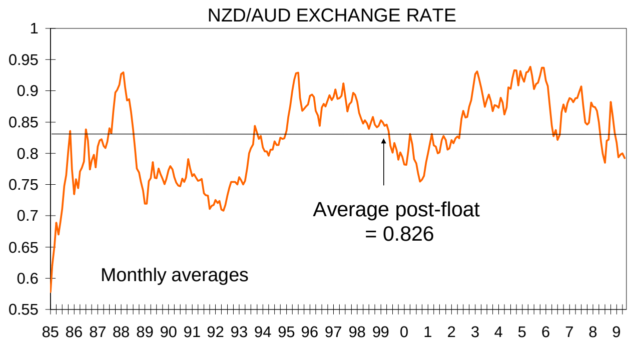
If I Were An FX Receiver What Would I Do?

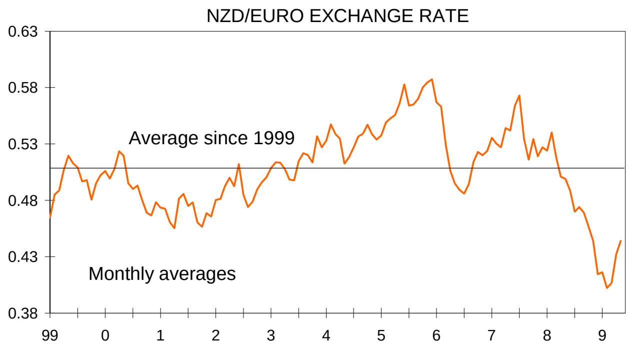
We can write about what to do as an exporter wanting to get hedging in place by simply listing the main currencies in order of those against which we think hedging is best done now. To whit….

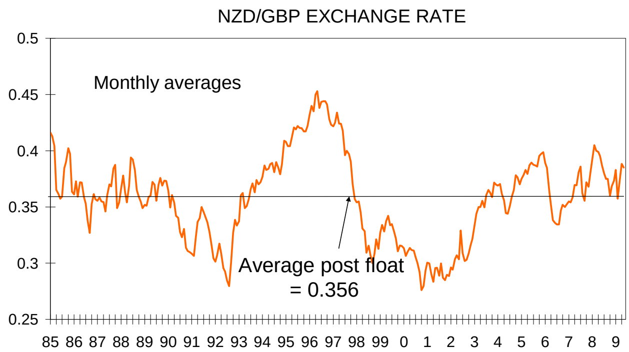
Australian dollar
Japanese Yen
Euro
US dollar
British pound

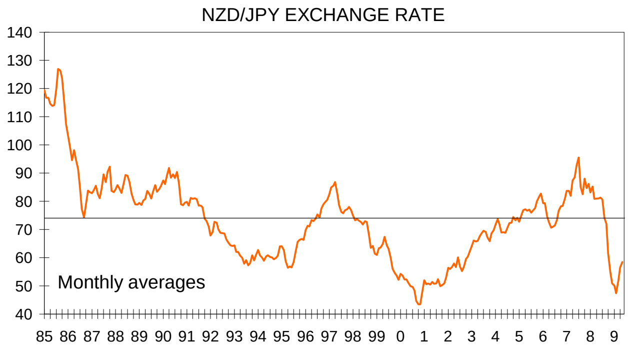
That is, if I were an exporter receiving in all these major currencies, given where the NZD is currently sitting compared with its long term average I would be most inclined to lock in my expected Aussie dollar receipts for the next three years now, and practically do the same for expected Yen receipts. I would hang about a bit for a 1-2 centime pullback in the Euro, maybe 3-5 cents if that in the USD, and be in no hurry at all to hedge against the pound. The graphs below say it all. Good luck.











For your guide, we are finding a high willingness by businesses to tidy up their interest rate and exchange rate risk in order to get on with running their businesses.

*Sourced from Consensus Economics. http://www.consensuseconomics.com/

ECONOMIC DATA

All %		Latest qtr only	Previous qtr only	Latest year	Year ago	2 Yrs ago
Inflation	RBNZ target is 1% - 3% on average	-0.5%	1.5	3.4	3.2	2.7
GDP growth	Average past 10 years = 3.0%	-0.9	-0.5	0.3	3.2	1.9
Unemployment rate	Average past 10 years = 5.3%	5.0	4.7	......	3.8	3.8
Jobs growth	Average past 10 years = 1.9%	-1.1	0.6	0.8	-0.2	2.1
Current a/c deficit	Average past 10 years = 5.5% of GDP	8.9	8.6	......	8.2	9.0
Terms of Trade		-0.9	-1.0	1.8	8.8	3.8
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%.	-1.2	-0.0	-0.8	3.2	4.9
House Prices	Long term average rise 5% p.a. QVNZ	-2.0	-2.1	-8.9	8.0	9.7
Net migration gain	Av. gain past 10 years = 10,400	+9,176	4,538yr	......	4,667	11,230
Tourism – an. av grth	10 year average growth = 5.0%. Stats NZ	-2.7	-0.9	-2.7	1.5	2.1
		Latest year rate	Prev mth year rate	6 mths ago	Year ago	2 yrs ago
Consumer conf.	10 year average = 2%. Colmar survey	3	-9	3	-34	-4
Business activity exps	10 year average = 26%. NBNZ	-3.8	-21.2	-11.4	-3.8	22.5
Household debt	10 year average growth = 11.3%. RBNZ	2.8	3.2	6.7	10.9	13.6
Dwelling sales	10 year average growth = 3.5%. REINZ	39.1	30.5	-34.8	-45.5	8.2
Floating Mort. Rate	10 year average = 8.1%	6.49	6.49	9.75	10.95	10.05
3 yr fixed hsg rate	10 year average = 7.9%	6.75	6.75	8.49	9.49	8.80

ECONOMIC FORECASTS

Forecasts at May 14 2009	**March Years**					**December Years**				
	2007	2008	2009	2010	2011	2006	2007	2008	2009	2010
GDP - annual average % change										
Private Consumption	2.8	3.2	-0.4	0.5	1.8	2.6	4	0.1	-0.1	1.8
Government Consumption	4	4.3	3.7	3.7	3.4	4.6	3.9	4	3.8	3.3
Investment	-0.6	4.3	-10.4	-16.2	5.9	-0.4	5	-5.7	-18.8	1.8
GNE	1.4	4.4	-2.1	-2.8	3.2	1.4	4.5	-0.3	-4	2.4
Exports	3.1	2.9	-3.7	-4.1	1.2	1.8	3.8	-1.8	-4.7	-0.6
Imports	-1.6	9.6	-2.5	-10.1	2.1	-2.6	8.6	2.5	-12	0.1
GDP	1.8	3.1	-0.9	-0.9	3	2	3.2	0.2	-1.7	2.3
Inflation – Consumers Price Index	2.5	3.4	3	1.9	1	2.6	3.2	3.4	2.3	1
Employment	2.1	-0.2	0.8	-3.2	2.9	1.7	2.3	0.9	-4	2.9
Unemployment Rate %	3.8	3.8	5	7.5	7.2	3.8	3.5	4.7	7	7.2
Wages	5.5	4.4	5.1	2.4	1.5	5.5	4	5.1	3.1	1.3
EXCHANGE RATE ASSUMPTIONS										
NZD/USD	0.7	0.8	0.53	0.6	0.66	0.69	0.77	0.56	0.58	0.65
USD/JPY	117	101	98	105	115	117	112	91	103	113
EUR/USD	1.32	1.55	1.31	1.34	1.38	1.32	1.46	1.34	1.33	1.37
NZD/AUD	0.88	0.87	0.8	0.78	0.81	0.88	0.88	0.83	0.77	0.81
NZD/GBP	0.36	0.4	0.37	0.38	0.39	0.35	0.38	0.37	0.37	0.39
NZD/EUR	0.53	0.52	0.41	0.45	0.48	0.52	0.53	0.41	0.44	0.47
NZD/YEN	81.9	81.1	51.8	63	75.9	81	86.3	50.9	59.5	73.1
TWI	68.6	71.6	53.8	59.1	65.1	68	71.6	55.1	57.2	64
Official Cash Rate	7.50	8.25	3.00	2.25	4.25	7.50	8.25	5.00	2	3.75
90 Day Bank Bill Rate	7.78	8.82	3.24	2.62	4.62	7.64	8.77	5.23	2.2	4.12
10 year Govt. Bond	5.91	6.35	4.77	5.6	6.4	5.77	6.38	4.88	5.55	6

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.