BNZ Weekly Overview

11 June 2009

Mission Statement

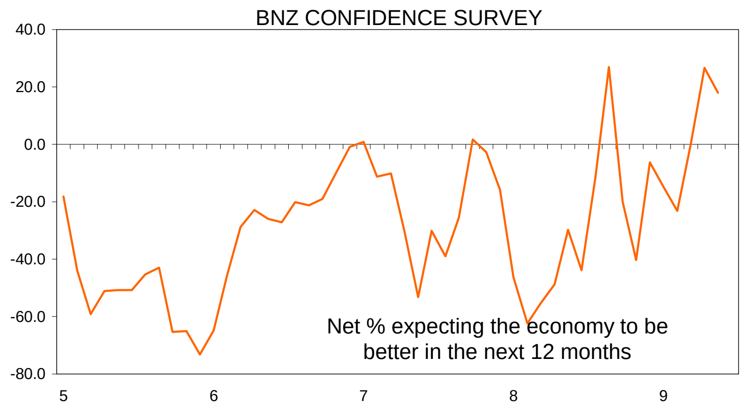
To help Kiwi businesspeople and householders make informed financial decisions by discussing the economy and its implications in a language they can understand.

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.

Housing and Interest Rates Tracking As Expected

First, many thanks to those people who responded in our monthly survey. The key result was a net 18% expecting the economy to improve over the coming year. This is down from 27% in the May survey but a well above average result consistent with our "sigh of relief" argument.



Second, nothing has happened over the past week to dissuade us from the two key views we have been expressing – that house prices have either stopped falling or are about as close to their lows as is meaningful for the average buyer, and that fixed interest rates will keep rising.

The REINZ's monthly figures released this morning back up those released by Barfoot and Thompson last week. They show house prices stabilising with the median dwelling sale price at $338,000 in May from $340,000 in April and $325,000 in January. Sales were 44% ahead of a year earlier but down in seasonally adjusted terms over the month. This is consistent with agents reporting a shortage of stock around the country.

Also this morning, the Reserve Bank left their cash rate unchanged at 2.5% which has caused swap rates to jump up to their highest levels since November in some cases. The RB also noted "…a potential rebound in household spending and residential investment as a result of the rise in net immigration and the pick-up in the housing market."

Third, I've been at National Farm Fieldays all today and yesterday speaking with lots and lots of people so time available to wax lyrical here is limited this week so I'll just finish this opening section with two comments.

1. Numbers appear to be slightly down at Fieldays, anecdotal feedback is of farmers cutting spending quite a bit from April then especially over May, with plans to hold off on as much normal expenditure as possible over the coming year in response to Fonterra's downbeat payout forecast and the high exchange rate. Some traditional exhibitors decided not to have a presence this year. So apart perhaps from sheep areas – where returns are good – rural NZ is going to be constrained over the coming year.

2. One of the views we have expressed in talks since early this year has been that those people wanting to buy a new plasma TV or other electronic appliance would perhaps be best served by holding off. Ahead of Christmas and in the March quarter it looks like a lot of people took advantage of hefty retailer discounting and zero interest financing deals to buy themselves nice new stuff. But now as unemployment rises many of these people will be forced to sell their new toys – perhaps on Trademe.

That means those who have retained their jobs are probably going to be able to pick up some very new goods at a cheaper price than going through a retailer – though without the same sort of product guarantee schemes.

Perhaps one indication that this is happening is the prices for PSPs. According to son number one some five months ago the common sale price was about $200. Now it is $150.

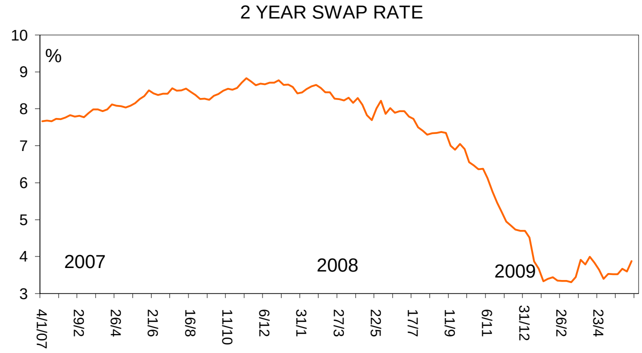
Finally, speaking of plasma TVs. There is a 103 inch Panasonic one on display at Fieldays – a snip at $70,000!

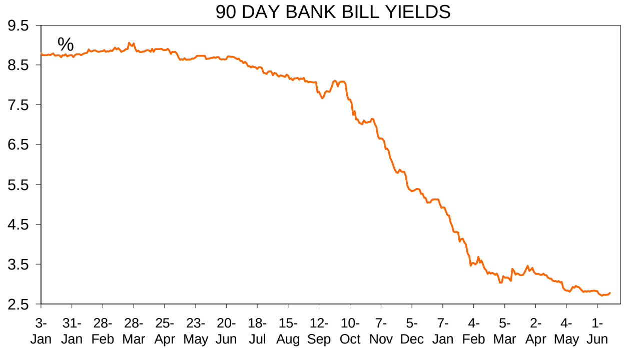
NZ ECONOMIC DEVELOPMENTS

This week I have been at Mystery Creek Fieldays in Hamilton all today and yesterday so time available for writing the WO has been limited. That means this section is scrapped. Suffice to say data appeared showing the country's terms of trade falling about 3% during the March quarter, but spending using cards was surprisingly strong in May and construction volumes seasonally adjusted only fell 0.7% in the March quarter.

INTEREST RATES

We have been expressing a strong view here in recent months that medium to long term fixed borrowing costs will be rising well ahead of any tightening action by the Reserve Bank in response to a range of factors. We have expected upward pressure as a result of borrowers who had been sitting floating deciding to fix (this is what happened in spades late in March), improving economic data offshore leading investors to shift funds into growth and risky assets and away from fixed interest investments, and expectations of tighter monetary policies causing reduced willingness to accept record low long term investment rates.





All of these factors have been in action and over the past week they have strengthened with the result that NZ swap rates have jumped up yet again. The implications for bank lending rates have been obvious since our “FIX NOW” comment of March 19’s Weekly Overview.

This morning the Reserve Bank left their official cash rate unchanged at 2.5% and noted that things are not looking as bad as they were though they still see some downside risks and might cut the cash rate further. They also said they don’t intend raising it before late 2010. Our view is that further cuts are not likely and as to when they start the tightening cycle – well that depends on too many uncertain factors to say anything other than the second half of 2010 probably.

Because the markets had factored in a chance they would cut 0.25% today and because some market participants have had their hopes of a renewed fall in swap rates dashed we have seen those swap rates rise to their highest levels in a long time. The two year swap rate has climbed to 3.88% from 3.6% last week. This is only just below the 3.99% level of early April and it is likely we will be above that level soon.

The five year swap rate has risen to 5.35% from 5.12% last week and this is the highest rate since late-November last year. The seven year rate has risen to 5.76% from 5.57% last week which is the highest also since November.

Rates are likely to creep higher from these levels over coming months though at a slower pace than that seen since March, with the yield curve becoming even steeper. The yield on 90-day bank bills has ended near 2.78% from 2.71% last week and is likely to remain low through to mid-2010.

Note that it is not just NZ fixed interest rates which are rising. In the United States rates have risen quite substantially recently with the ten year government bond yield this week rising above 4% for the first time since October last year. Last week the rate was 3.55% and a month ago 3.2%. The big move this week came about following comments from Fed. officials interpreted as meaning the Fed. may be close to ending its quantitative easing – printing money. In fact the markets have started to price in the Fed. raising its cash rate to 0.5% come December from the current target range of 0% - 0.25%.

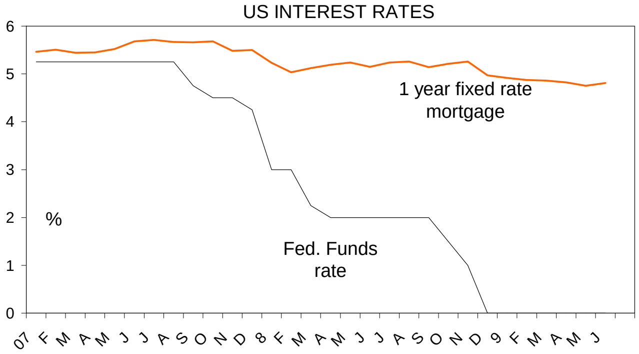
Key Forecasts

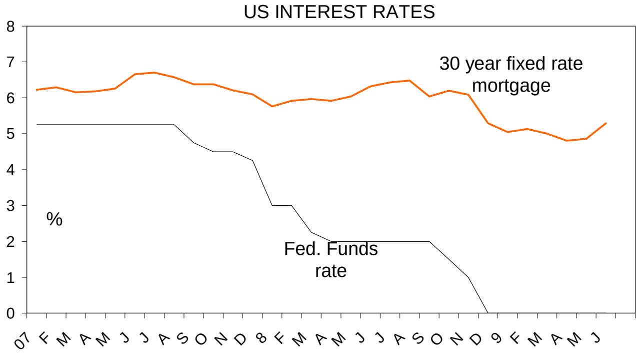
- No more monetary policy easing with the this cycle.
- Medium to long term housing rates have seen their multi-year lows – stop-start rises now lie ahead. Speed unclear.

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	2.50	3.50	8.25	6.2
90-day bank bill	2.78%	2.71	2.91	3.13	8.68	6.5
10 year govt. bond	6.00%	5.86	5.65	4.48	6.47	6.2
1 year swap	3.05%	2.94	2.99	3.04	8.39	6.7
5 year swap	5.35%	5.12	4.83	4.22	7.67	7.0

If I Were a Borrower What Would I Do?

Here is something important worth noting. It is not just in New Zealand that mortgage interest rates have been rising. The graph below shows two important things. The first is that over the period of time between August 2007 and December 2008 when the Federal Reserve in the United States cuts its funds rate from 5.25% to 0% the one year US fixed mortgage interest rate only declined from 5.7% to 5% with a more recent low near 4.8% in late-April. The 30 year rate over the same period went from 6.6% down to 5.3% with a recent decline to 4.8% in April.





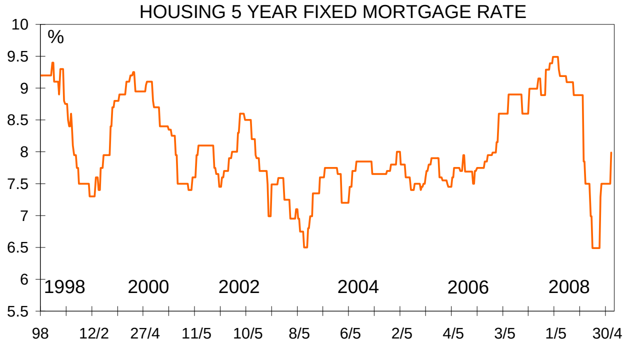
The important point is that a hefty easing of monetary policy produced only minor mortgage rate declines because of the huge risk to banks of lending to the housing sector and because they raise cash not from the Fed. at the funds rate but in the private market. Contrast that with NZ where over the period of time our cash rate fell 5.25% (July 2008 – March 2009) floating mortgage rates fell about 4.5% and the three year fixed rate over 3%.

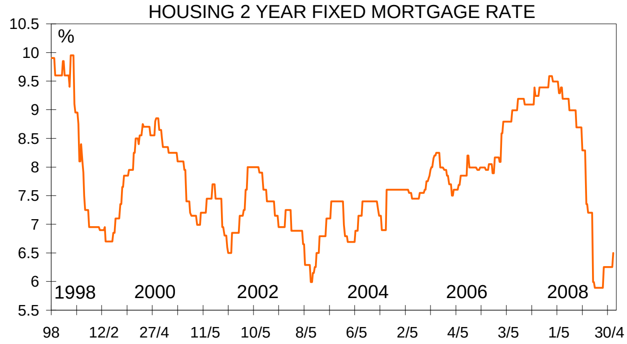
The second important point to note is that the US mortgage rates have risen sharply recently as the markets have started to price in monetary policy tightening before the end of the year as hopes for growth strengthen and the Fed.'s expected withdrawal of unusual stimulatory measures commences. The US one year mortgage rate has risen from 4.7% to 4.8% and the 30 year rate from 4.9% to 5.3%.
http://www.freddiemac.com/pmms/

So NZ is not weird in having mortgage rates rising.

If I were borrowing at the moment my personal preference would remain for the security of the three year rate at 6.99% even though this rate is now just 1.1% below its average over the past five years and not 2.1% below as it was back in March when we strongly advocated fixing as long as one could tolerate.

However, we Kiwis tend to go for what we consider cheapest at the moment rather than give good thought to where things are going in the future. That is why so many people made the avoidable mistake last year of fixing five years at 9.19% when we were suggesting one year fixing. In the June 19 2008 WO we wrote "Borrowers should already have cut back to fixing only short terms and home buyers in particular should be fixing just six months or one year. There may be strong competition in the two year fixed rate area but personally I'd go just one year max."



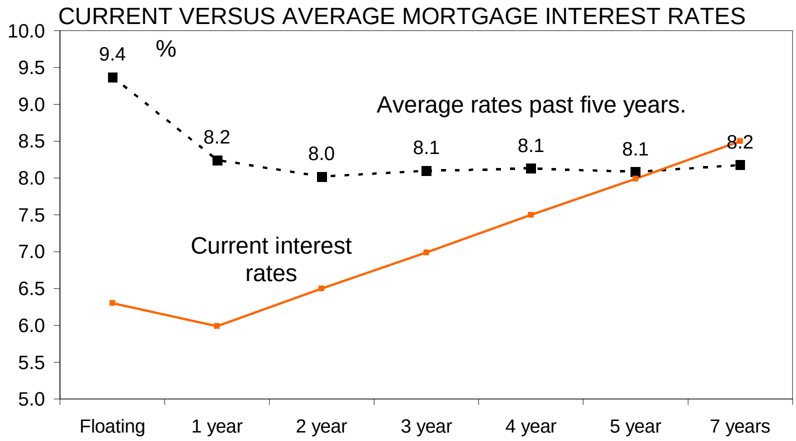


People fixed long term at the top of the interest rates cycle for the same reasons that other people did so in the middle of 1998 – in order to save cash flow compared with floating. Back in 1998 people fixed five years at 9.3% to avoid floating at 11.25% even though we wrote not to touch fixed rates with a bargepole. This time people fixed five years last year at 9.49% to avoid floating at 10.95%.

One suspects many borrowers will now simply float or fix one year. This is nowhere near as bad a decision however as fixing long term last year. We see a reasonable though not over-whelming chance the short term rates will still remain relatively low until late next year while the longer term rates continue to creep higher.

There are plenty of people who will choose to fix just one year or float in order to get their repayments to qualify within bank debt servicing limits. Plus some may still have an apocalyptic view of the world and expect rates to fall back down again. We don’t.

Most people will therefore now choose to float or fix one year. I’d fix three years.



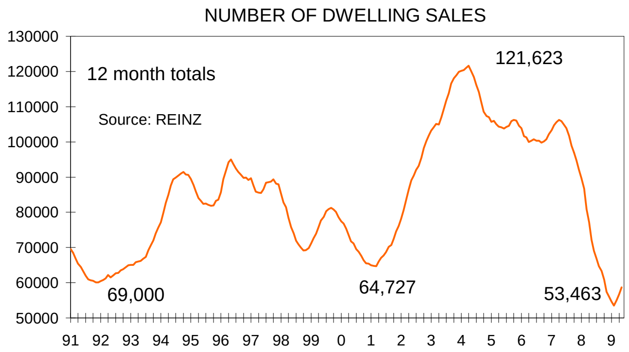
Note however that this section always deals with the home mortgage fixing choice. But for business and farming borrowers the situation is different. Whereas there is only about a 1% difference between floating or fixing three years for home owners these other borrowers face a gap of 2-3%. This means many are finding it optimal from a cash flow management point of view to simply float. Doing so is likely to yield a low cost of funds until late-2010. Then those floating interest rates will be rising and the risk is they rise firmly over 2011 in particular.

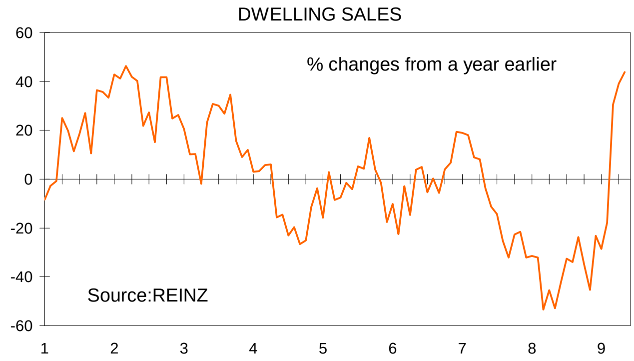
So we would suggest that if you have decided to fund your business floating then allow for that interest rate rising 3% by late-2011. Use the time between now and then either to get your principal down, or find cost savings elsewhere to handle that extra burden.

HOUSING MARKET UPDATE

Housing Data Confirm Market Stabilising

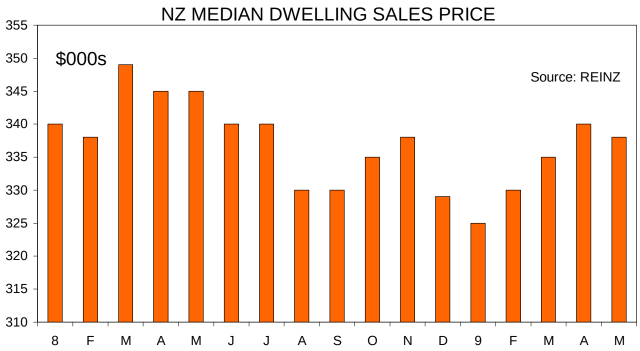
The REINZ today reported that in May there were 6,291 dwellings sold around New Zealand. This was a strong 44% rise from a year ago but in rough seasonally adjusted terms was a decrease from April of over 5% which followed firm rises over the previous three months. What this tells us is that activity levels are well off their lows but one could not yet safely conclude that an upward trend in turnover of any firm magnitude is underway.

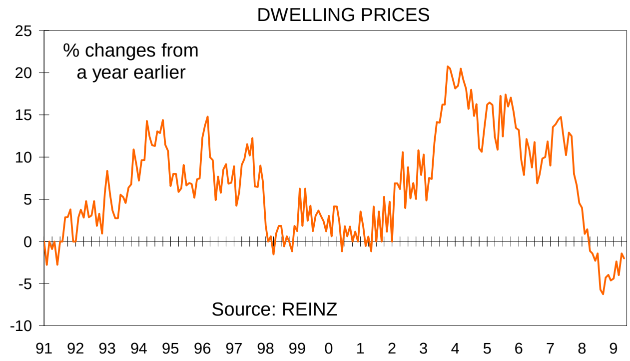




Such an upturn will certainly come but for the remainder of this year the extent will be limited by a shortage of stock partly caused by vendors not being willing to accept low prices if they do not desperately have to.

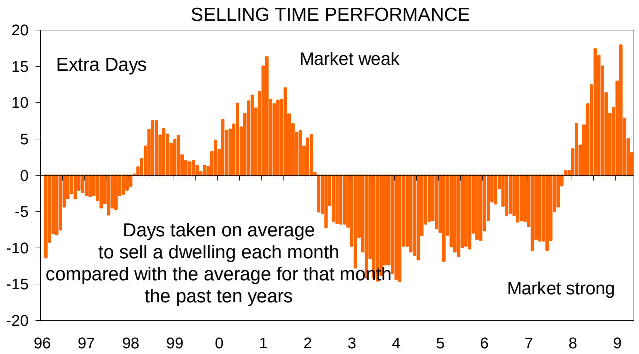
The second indicator from the REINZ release is the median dwelling sales price. This was essentially unchanged in May from April at $338,000 from $340,000. This price measure was at $325,000 in January so the result strongly suggests prices have stopped falling – though of course there will always be variations between areas.

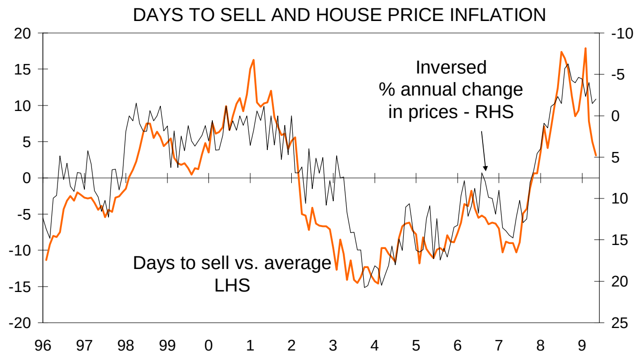




Our view is that although there will be upward pressure on prices from the shortage of housing on average around New Zealand, the multi-decade low in construction, and accelerating population growth, there will be some restraint from rising unemployment, low wages growth, and rising fixed interest rates. The upshot is likely to be only a slow drift upward in prices from current levels.

Finally, on average in May it took 42 days to sell a dwelling. This was the same as in April but seven days faster than a year ago. In fact compared with how long it has taken to sell a house in May on average over the past decade the latest result is only 3.1 days above that average. April was over by 5 days, March 7.8, and February 17.9. In other words, there is not really any evidence to suggest properties are now taking an unusually long time to sell. The trend of reducing average selling times is well in place and given the continuing strong anecdotal evidence of listings shortages this indicator is likely to go beyond average soon.





Overall, we can see a steadily accumulating pile of data to support our long held view that the extent of the average house price decline in New Zealand would be quite limited and nothing remotely approaching the silly forecasts of 30% to 40% declines pushed by individuals seemingly unaware of basic factors which move New Zealand's housing market.

Australia Improving

Here is a very brief commentary written by our NAB economists regarding the monthly home lending numbers released across the ditch this week. Their data are broken down by owner-occupier and investment loans and one suspects would apply here as well.

"The number of housing loans rose 0.9% in April, trivially different from the median forecast of +1.5% and following a 4.8% monthly increase in March. The value of loans rose by 3.6%, as Owner Occupied Housing loans rose by 1.9% while Investment loans rose by 8.9% in value. The latter was the real eye opener of the release, the increase following a solid 5.7% rise in March. These are the strongest two months in a row for lending for investment purposes since May and June 2007 (shortly after the strong 2007 results, the RBA started tightening rates ending at 7.25% in March 2008). Investors are now flocking back to the market, attracted by low interest rates, better rental yields and the boost to market confidence from the First Home Buyer scheme enhancements. First home buyers represented 28% of all loans written in the month, a fresh record high and a clear sign that policy is having a substantial effect in 'turning on' the construction sector. Lending for Construction rose by a further 1.3% after a massive 13.7% jump in March."

There are two implications here for NZ's housing market. The first is that given a broad tendency for our markets to move together it supports the case of those arguing in favour of investor demand having recently picked up here. But secondly, with signs of residential construction turning around in Australia it implies our own construction levels will soon start to improve – but that currently unemployed builders could find work over there. This will tend to constrain our construction upturn while limiting further short term downward pressure on construction costs. But these effects will take some time to come through and don't really have implications for prices here at the moment.

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, rising slightly over 2010.

Exchange Rates & Foreign Economies

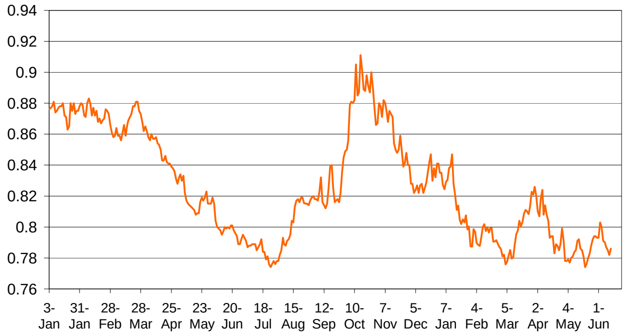
EXCHANGE RATES	This week	Week ago	4 wks ago	3 months ago	Yr ago	Consensus* Frcst Yr Ago	10 yr average
NZD/USD	0.636	0.633	0.603	0.504	0.752	0.693	.592
NZD/AUD	0.786	0.791	0.785	0.78	0.795	0.793	.856
NZD/JPY	62.3	60.7	59.5	49.8	80.8	73.3	66.8
NZD/GBP	0.388	0.388	0.396	0.367	0.385	0.371	.345
NZD/EUR	0.453	0.447	0.442	0.398	0.486	0.48	.51
USD/JPY	98.0	95.9	98.7	98.7	107.4	105.8	113.9
USD/GBP	1.64	1.63	1.522	1.37	1.95	1.867	1.709
USD/EUR	1.404	1.416	1.364	1.268	1.547	1.443	1.156
AUD/USD	0.81	0.80	0.77	0.646	0.946	0.874	0.69

NZD Rises After Reserve Bank Decision

A week ago the NZD was buying US 63.3 cents and this evening it was at practically the same level having traded below 62 cents mid-week as the US dollar underwent a surge. This morning, before the Reserve Bank announced their decision to leave the cash rate unchanged and painted a less pessimistic economic outlook, the NZD was trading near 62.5 cents.

NEW ZEALAND DOLLAR vs USD

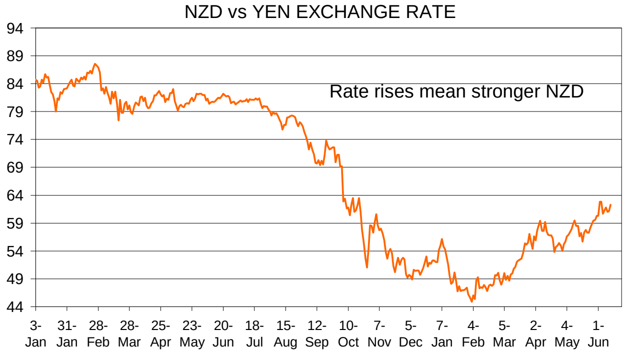
NEW ZEALAND DOLLAR vs AUSTRALIAN DOLLAR



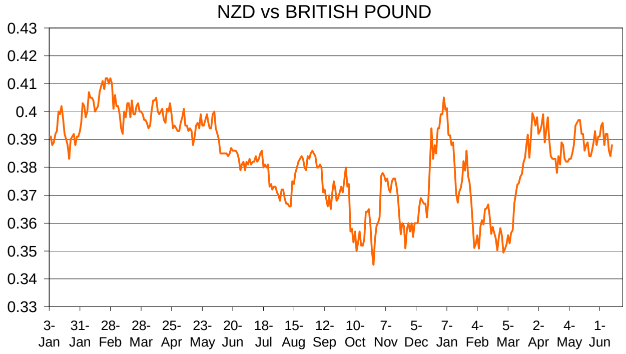
At these levels we think the NZD is still somewhat over-cooked. But it is impossible to pick what combination of factors may cause a decent pullback let alone the timing of any such move. In particular, with increasing signs that Japanese investors are feeling less wary about buying NZD denominated higher yielding assets, it may take an increasingly large negative factor to shift the NZD downward to any large extent and for any long length of time.

Against the Aussie dollar we have ended the week near 78.6 cents from 79.1 cents last week with no clear trend evident in this important cross rate for about four months now. Against the Japanese Yen we have ended near 62.3 from 60.7 and a clear upward drift in the NZD is underway.

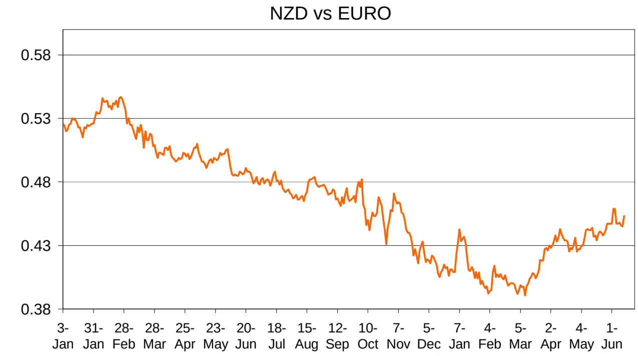
NZD vs YEN EXCHANGE RATE

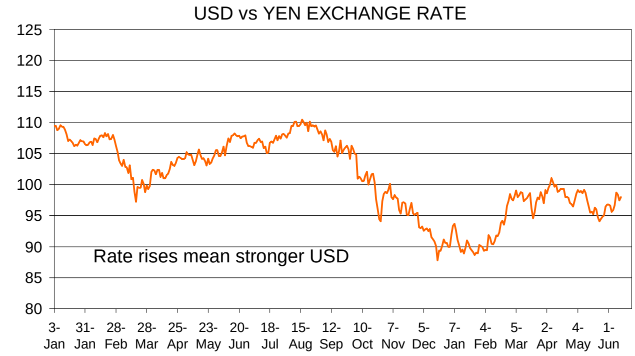


NZD vs BRITISH POUND

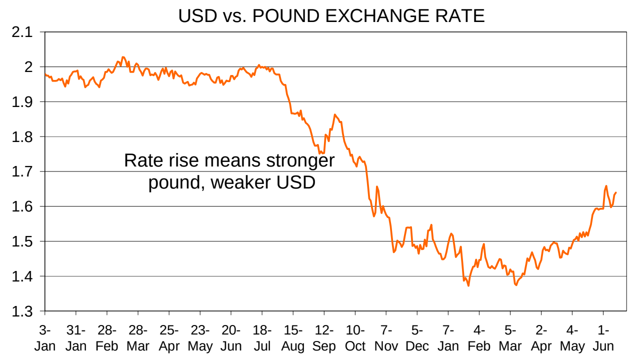


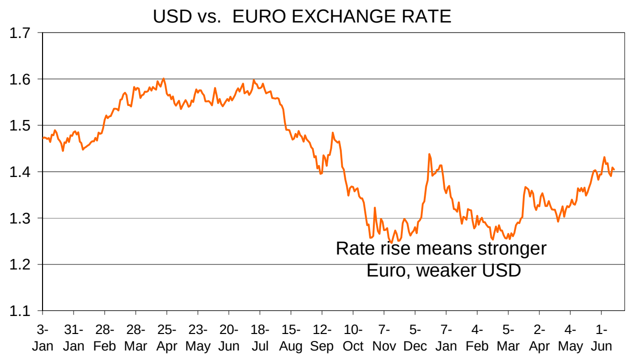
Against the British pound the NZD has been sticking close to 38.5 since April and no trend is evident. Against the Euro the NZD has ended near 45.3 from 44.7 last week with a similar upward trend underway as is occurring against the Yen.





Over the week the US dollar has continued its broad upward trend against the pound to end near $1.64 from $1.63 last week and $1.52 a month ago. Against the Yen no clear movement one way or the other has been evident since early March and the dollar has ended near 98 Yen from 95.9 last week and 98.7 a month ago. Against the Euro the USD has generally been weakening since late-April but has ended today little changed from last week near $1.404.

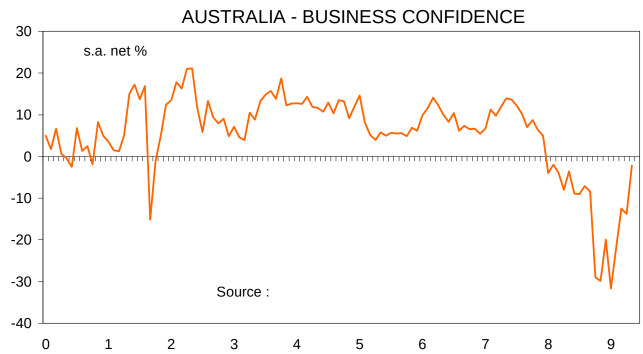


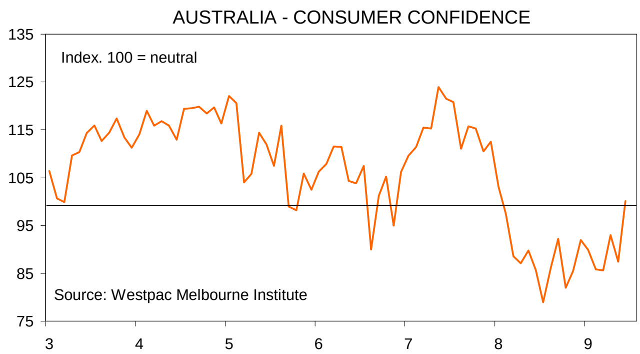


The main green shoot during the week was the monthly non-farm payrolls report in the US which showed job numbers falling "only" 345,000 in May rather than the 520,000 decline that had been expected. The unemployment rate has however jumped to a 26 year high of 9.4% - though even this is partly a green shoot because it implies more people deciding times are getting less horrible enough they may as well look for a job.

In Australia the economic releases over the past week have fallen decidedly on the positive side.

- Business confidence measured in the NAB monthly survey improved to a reading of -2 in May from -14 in April. This is the strongest result since February 2008.
- Consumer confidence measured in the Westpac monthly index staged its second biggest monthly rise in the 35 history of the survey. The reading improved in June to 100.1 from 87.4 in May and is now just back on the long term average reading.

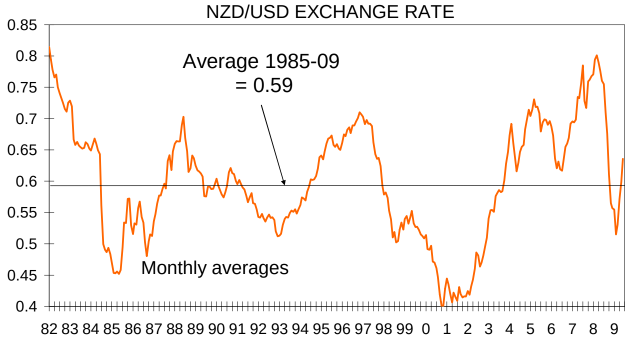


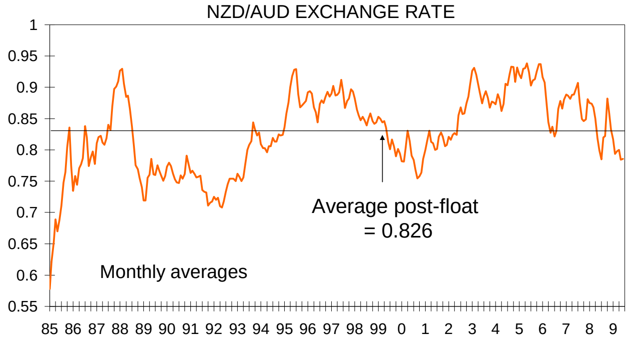


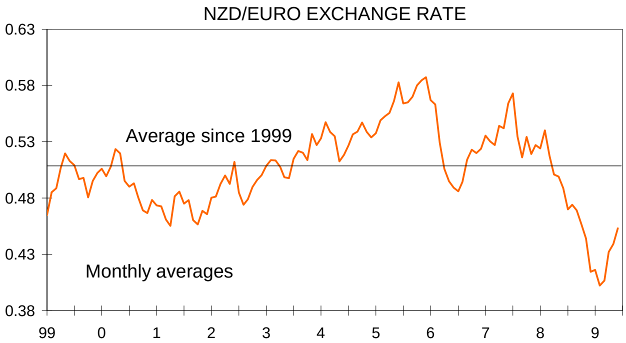
- Seasonally adjusted home loan numbers improved 0.9% in April after rising 4.8% in March.
- Job numbers were flat during April and not down to the extent implied by job advert numbers. It appears employers are choosing to hold onto staff.

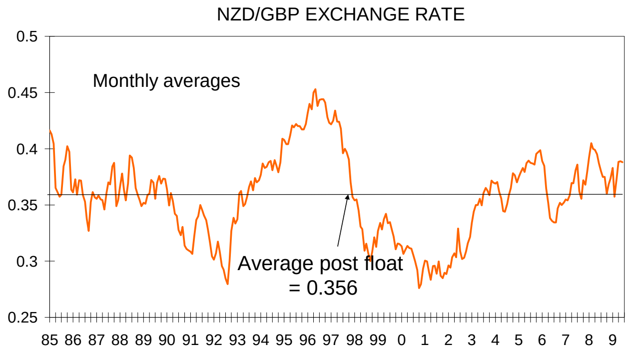
If I Were An FX Receiver What Would I Do?

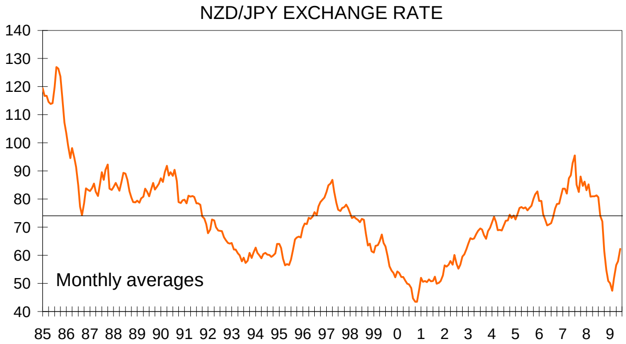
Same old – boost hedging versus Yen, Euro and Aussie dollar, do little versus the British pound, and wait for a pullback of a few cents against the greenback before putting more hedging in place.











*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		-3.0	-1.0	-5.2	11.6	4.5
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	-3.8	-14.1	-4.4	7.8
Household debt	10 year average growth = 11.3%. RBNZ	2.7	2.8	6.0	10.0	13.8
Dwelling sales	10 year average growth = 3.5%. REINZ	43.9	-39.1	-45.4	-52.9	-3.7
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%	6.99	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.