BNZ Weekly Overview

15 October 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.

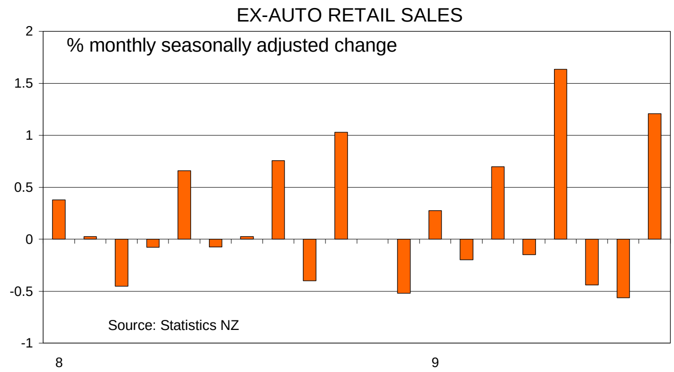
In this week's issue….

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.

Wallets Being Opened

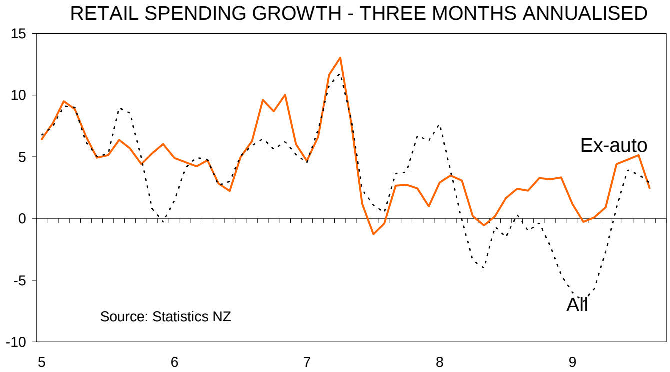
During the week there were probably a couple of meaningful pieces of economic data released which told us something about where the economy is right now. One was yesterday's collection of housing data from the REINZ which we discuss in our Housing section. The other was Tuesday's retail trade numbers for August. They provided the first truly solid piece of evidence that consumes are starting to spend again.

During the month seasonally adjusted spending excluding the volatile automotives sector (petrol, car sales) grew by a strong 1.2%. This followed falls during each of the previous two months and had another decline been recorded we could have started to think about throwing all confidence readings out the window.



But the sharp jump in sentiment is clearly starting to feed through into a willingness to open up wallets. And the important point to note is that this growth has occurred in spite of a still generally weak labour market. In fact it pays to note that house sales, housing turnover, and house prices have all risen in spite of rising unemployment. This illustrates why we economists can speak about things getting better even as more people lose their jobs. The labour market changes after the economy changes. That means the labour market changes after spending levels change. The economy drives the labour market and not the other way around.

But there is a key second point to note here and it is one we have made many times before. One would be very unwise to judge the state of New Zealand's retailing sector and the underlying trend in consumer spending by just looking at one month's results. These numbers can be highly volatile – to the point in fact where regional numbers are practically worthless even on a quarterly basis. So just because sales grew 1.2% in August does not mean one should start talking about annualised retail spending growth above 12%. That is clearly not going to happen. The latest three months annualised growth rate is a still lowly 2.5%.



While there are some strong factors supporting higher retail spending there are also some firm sources of restraint. On the positive side we have above average net migration inflows which are continuing to grow, cash flow being freed up each month as borrowers move from fixed rates near 7.5% to floating mortgage rates below 6%, and the simple need for people to replace worn out things.

But on the negative side we have a tourism sector which has not seen the worst of its downturn yet (the rising NZD and absence of handouts to Aussies in the coming year will see to that). Also in the dairy sector debt reduction is the strong focus for most operators and the people who advise them.

Perhaps also Kiwi householders are going to voluntarily exercise more restraint in their spending and borrowing now that they have received a huge financial shock which has sent the unemployment rate soaring and retirement portfolios and house prices collapsing. Opps, no we haven't in New Zealand. That is what has happened in some economies overseas – but not here. Our average house prices are now only around 4% down from their late-2007 peaks. Our unemployment rate has only risen from 3.5% to 6%. We have hardly any savings so collapsing sharemarkets affect few of us. And we saw far worse economic conditions after the 1987 crash.

It is very doubtful that the shock to NZ households from the global financial crisis has been big enough to cause a large sustained change in savings behaviour. At the moment household debt demand is low. But it is an article of faith that we will all save more. We will believe it when we see it five years down the track looking back.

Speaking of shocks – the rural real estate market remains quite munted. In September there were only 75 farms sold around the country compared with 130 in September 2008 and 177 in September 2007. sales in the past three months were down 59% from a year ago and in seasonally adjusted terms fell about 8% from the June quarter.

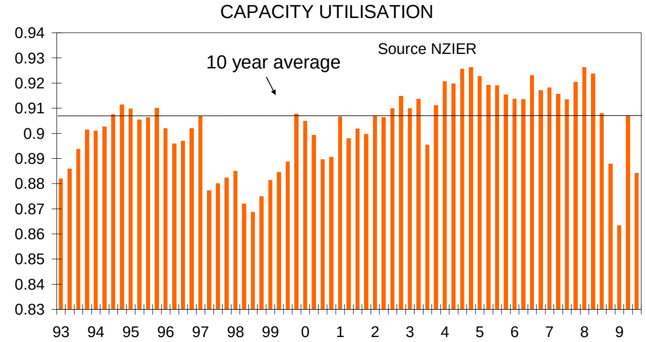
With regard to prices we find ourselves struggling to know what is really happening because the monthly REINZ numbers get thrown around by changes in the size of farms sold, their location, their type and so on. But for what it is worth, over the 12 months to September the average farm sale price was down 30% from a year ago.

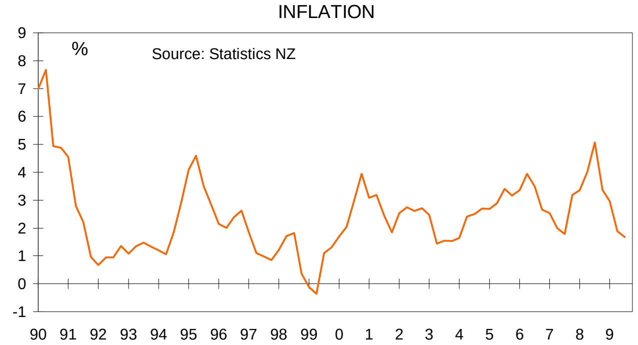
INTEREST RATES

The Reserve Bank have little chance of being able to keep the official cash rate low until "…the latter part of 2010…" as they have repeatedly stated in recent months. The motivation for making the statement is laudable – a desire to give businesses as long a possible period of low floating rate funding costs so they can hopefully get through a period when their revenues are constrained and they are being told to get debt levels down.

But last week the Reserve Bank of Australia raised their cash rate and it is highly likely our own RB will need to move earlier than they think – but not necessarily as early as the January rise financial markets here have priced in.

While some of the economic data releases in NZ recently have been quite strong, there is clearly going to be substantial restraint on inflation from the rising NZD. In addition the latest survey results from the NZIER showed that there has been some more freeing up of capacity in the manufacturing and construction sectors.





This situation will eventually change. But for now we don't think conditions are on the road toward getting worrying enough that the RB will need to move near the turn of the year. But there is a risk they move sooner than the mid-2010 point we are currently forecasting. The reasons are fairly obvious. Retail spending rose 1.2% in August and this shows consumers are opening their wallets. House prices rose 1.9% in September and are 8% off their lows, so this will tend to encourage extra house construction and willingness to spend. And this morning we learnt that inflation in the year to September was 1.7% and not either the 1.3% expected in the markets ahead of the release or the 1.4% rate forecast by the Reserve Bank.

Consumer prices increased on average 1.3% in the quarter with unexpected upward pressure from reversing of some discounted airfares, higher used car prices, and some large increases in state sector charges.

This week the yield on 90-day bank bills has sat mostly near 2.84% compared with 2.8% most of the time in recent months. Swap rates have however moved up quite substantially on the back of the inflation number and the way it has followed other stronger than expected numbers. The three year swap rate is now 5.16% from 4.93% last week and 4.74% a month ago. This is the highest rate since November last year. The one year rate has jumped to 3.58% from 3.4% last week and 3.17% four weeks ago as the markets price in a higher probability of the RB moving well ahead of their late-2010 forecast.

Where will rates go from here? The risk now is the very same as it has been since March. Upward – but not at the same speed we saw back then.

Key Forecasts

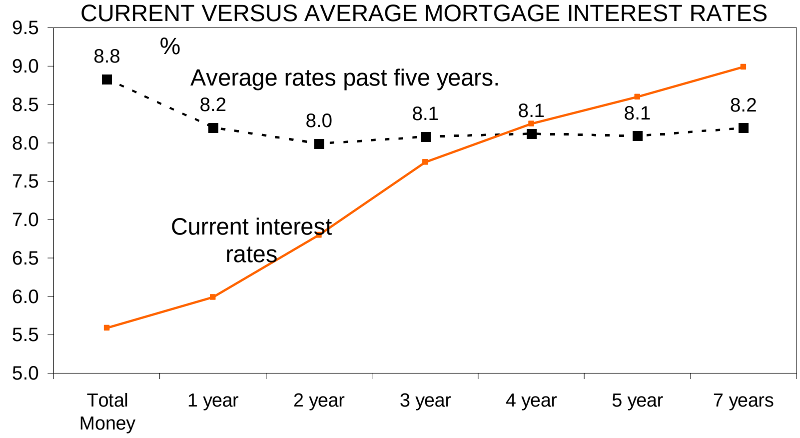
- Tightening by mid-2010 at the ultimate latest.
- Medium to long term housing rates to keep on rising.

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	2.50	7.50	6.2
90-day bank bill	2.78%	2.78	2.81	2.84	7.34	6.5
10 year govt. bond	5.53%	5.53	5.52	5.63	6.14	6.2
1 year swap	3.58%	3.40	3.17	3.13	6.53	6.7
5 year swap	5.66%	5.48	5.41	5.40	6.58	7.0

If I Were a Borrower What Would I Do?

Quite clearly there is likely to be another round of fixed housing rate increases in the near future as a result of the recent rises in wholesale funding costs. Since late-March we have been pointing out in terms too strong for some people that if you have been floating only because you are waiting to fix then there is no incentive to wait. So back on March 19 we wrote "Fix Now". Many thanks to those people who have emailed thanking us for that commentary back then.

Where things sit now the incentive to jump out of floating into fixed is not that great. One can float at 5.59% or fix two years at 6.8%. Taking into account as many uncertainties as one can think one may as well toss a coin between the two alternatives. With the three year rate at 7.75% there is little incentive at all to take it beyond the good rate certainty it gives.



In a nutshell the equation now – and especially after the coming round of rate rises is completed – is quite simple. If you haven't fixed already you have missed the boat this cycle. You are going to float and take whatever that rate does over at least the next two years. Beyond the end of 2011 is frankly anyone's guess here and overseas at this stage, but unless the world falls into a new dark hole there seems little reason for expecting a new downward leg of the monetary policy cycle to commence then.

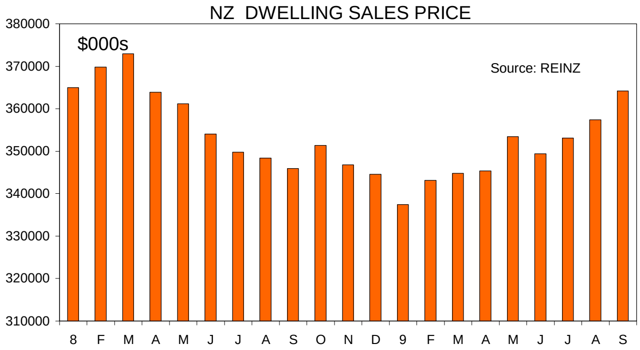
But one has been around long enough to see monetary policy forecasts two years out prove horribly wrong. So basing one's interest rate management strategy on a forecast of where rates will be in a couple of years is quite a dangerous thing to do.

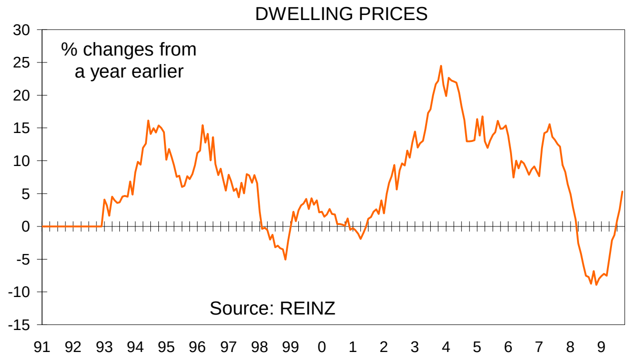
If I were borrowing at the moment I would float and work to get the principal down as rapidly as possible before the floating rate rises from 5.59% now toward 8.5% come late-2011 and whatever beyond that. Keep in mind that over the floating mortgage rate cycle the peak tends to be around 10.5%. Good luck.

HOUSING MARKET UPDATE

House Prices Now Up 8%

REINZ reported this week that their average house sale price measure gained another 1.9% in September after rising 1.2% in August and 1% in July. Average house prices have now recovered 8% exactly since January and are only 4.5% down from their peak in late-2007.





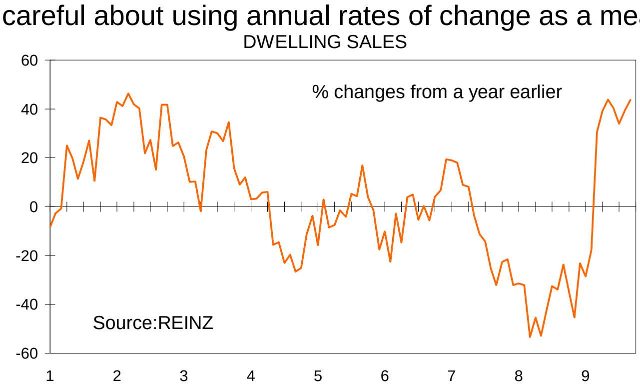
The fundamentals driving house prices higher are as clear now as they have been since last year when we predicted declines would not exceed 10% - 15%. There is a shortage of housing in NZ – as investigated by the Commerce Select Committee over 2008-08. Construction of new houses is at its worst level in four decades. Financing costs are at four decade lows. And net migration inflows have moved to above average levels with further gains likely.

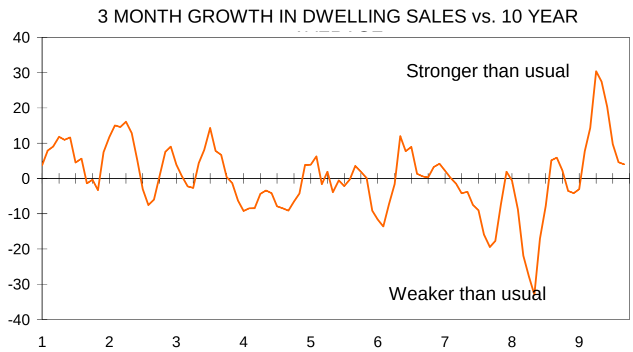
Prices will continue to be underpinned by these factors along with a few others.

- Spring has not brought the flood of properties onto the market that many feared.
- The ability of new house construction to rise strongly will be constrained by lack of finance for subdivisions.
- There is no sign that councils are freeing up more land or cutting various compliance costs.
- From some point next year we expect tradespeople to be flocking back across the ditch to take part in a housing construction upturn over there driven by an existing bad shortage of housing now being aggravated by strong population growth (0.5mn people last year).

If we were to extrapolate price movements over the past six months we would conclude NZ house prices are rising at an annualised rate of over 11%. But there is clearly an element of recovery which has driven prices up to some extent recently and we do not expect this pace of house price gains to continue. But it does remain as likely now as it has been for many months that prices will continue to creep higher over the next couple of years

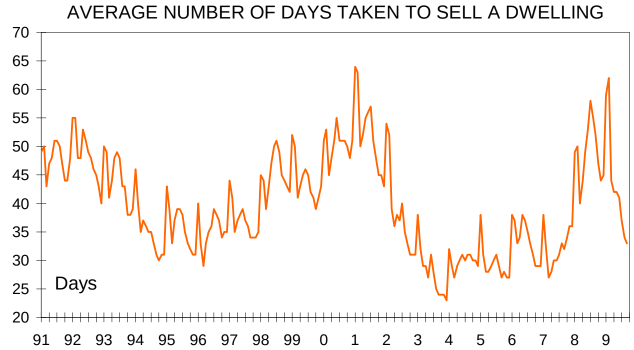
With regard to real estate activity we learnt this week that there were 6,464 dwellings sold in September. This was a strong 44% rise from a year earlier when things were deteriorating rapidly. So one should be careful about using annual rates of change as a measure of activity.

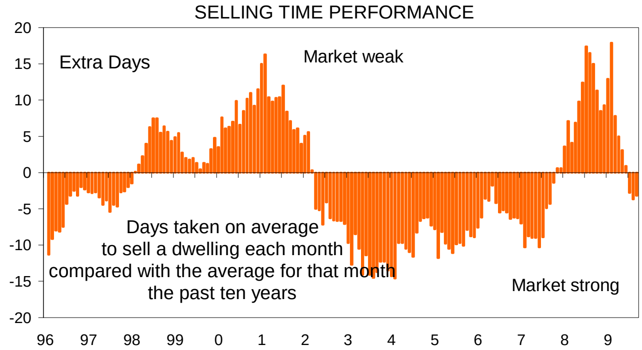




But in seasonally adjusted terms house sales recovered about 10% in September after weakening 5% in August. Sales have improved about 4% in the past three months. So the trend in turnover remains upward even though the anecdotes continue to describe a shortage of listings.

On average in September it took 33 days to sell a dwelling. This was 19 days quicker than a year ago and 3.2 days faster than the September average. In August this days to sell number was a greater 3.7 days faster than average. So we are not seeing a straight-line rapid reduction in the length of time properties are sitting on the market. But they are selling faster than average.





Overall the housing market remains very well supported by the factors noted above along with, we suspect, a bit more scrambling to buy now being undertaken by those potential purchasers who have held off because they paid too much attention to the silly forecasts of house prices falling 30% to 40%. Good luck because the stock shortage is likely to get worse given our view on the supply response limitations this cycle.

One housing email we received this week went as follows.

We have a couple of investment properties and I keep in close contact with about 5 real estate brokers in Auckland, all of whom are top 3 with the firms they represent.

1. Top end housing circa $3m+ is dead.
2. In the $1m to $1.5m bracket within 20 minutes drive of Auckland central there has been a noticeable upturn of people who have not lost jobs and think they are safe buying houses. This price bracket is very much bid over with multiple buyers at most sales.
3. Most sellers in the above price bracket are trading down to reduce debt, cant get loan rollover, investment property and not enough cash to develop/hold on, or they have lost job and any new job does not pay as well so can not hold on anymore.
4. There is a lot of property in the above category coming on the market in the next couple of weeks looking for sale before Xmas.
5. Speaking with a few builders they are seeing a big uptick in enquiries with most now seeing 3-6 months of forward business.

I am not suggesting it is all about to go mad, but a lot of the slack has been taken out/redeployed.

This is (as stated) in the area 15-20 minutes of CPD Auckland.

Are You Seeing Something We Are Not?

If so, email us at tony.alexander@bnz.co.nz with Housing Comment in the Subject line and let us know.

Key Forecasts

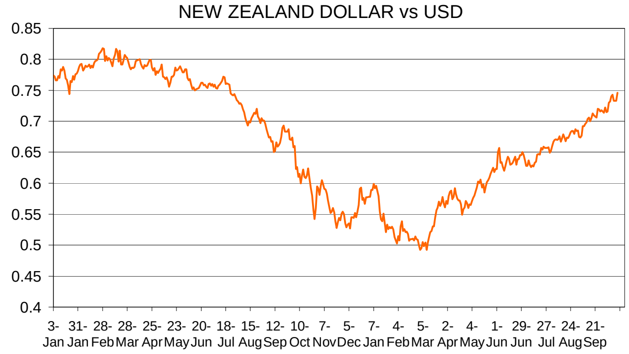
- Dwelling consent numbers to recover now with potentially good activity from late-2010..
- Real estate sales continuing to increase but the rise limited by listings shortages.
- House prices edging higher.

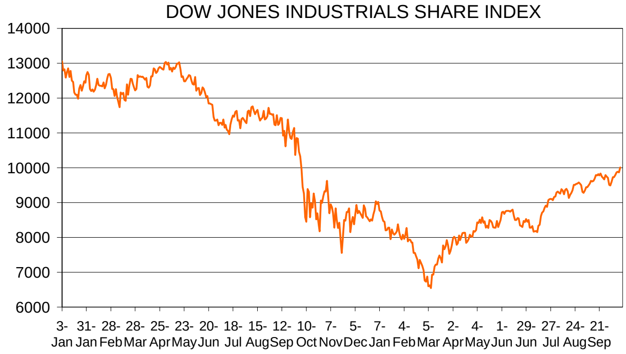
Exchange Rates & Foreign Economies

Exchange Rates	This Week	Week ago	4 wks ago	3 mths ago	Yr ago	Consensus Frcsts yr ago	10 yr average
NZD/USD	0.746	0.740	0.700	0.635	0.622	0.77	0.592
NZD/AUD	0.812	0.820	0.812	0.804	0.887	112	0.856
NZD/JPY	66.700	65.400	63.600	59.300	63.500	1.46	66.8
NZD/GBP	0.465	0.462	0.422	0.390	0.357	0.88	0.345
NZD/EUR	0.499	0.500	0.479	0.455	0.456	0.38	0.51
USD/JPY	89.410	88.378	90.857	93.386	102.090	0.53	113.9
USD/GBP	1.604	1.602	1.659	1.628	1.742	86.3	1.709
USD/EUR	1.495	1.480	1.461	1.396	1.364	71.6	1.156
AUD/USD	0.919	0.902	0.862	0.790	0.701	8.25	0.69

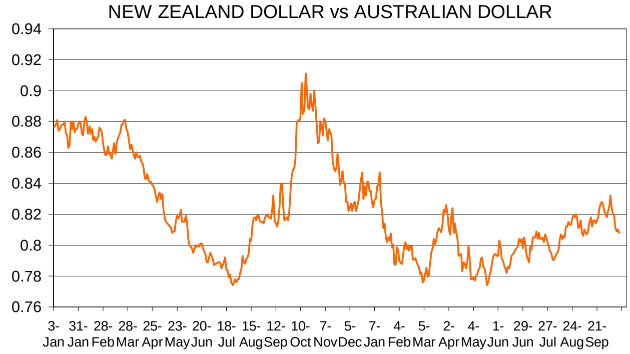
NZD Boosted Even Further

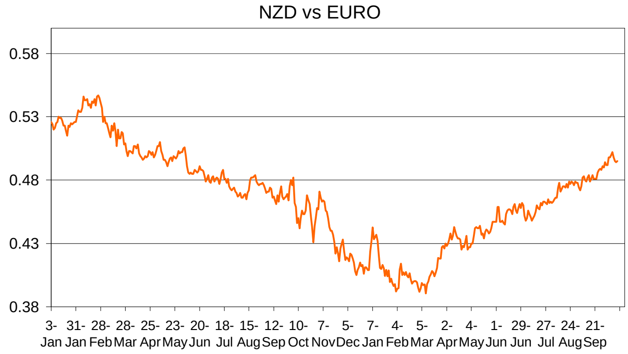
The Kiwi dollar has remained well supported over the past week with investors willing to embrace risky assets. That willingness has been enhanced this week internationally by some positive quarterly profit releases for US listed companies, and better than expected data out of the UK, China, and US (retail sales). The Dow Jones Index was last night pushed above the 10,000 mark to close at its highest level since October last year when it was in the process of collapsing from over 11,000 to below 9,000.





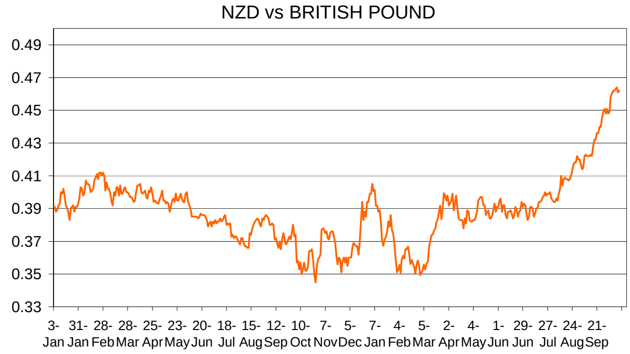
This morning the NZD was around US 73.8 cents. But this evening it is sitting near 74.6 cents with extra demand following the much higher than expected 1.3% CPI increase for the September quarter. The inflation number followed the better than expected data on August retail sales (+1.2%) and September housing activity (prices +1.9%). There were some natural concerns yesterday about the government's final accounts for 2008-09. The core operating deficit came in at a worse than expected $3.5bn or 2.2% of GDP and a string of deficits is expected for many years taking the ratio of net debt to GDP from 7% currently to near 30% in a few years time.

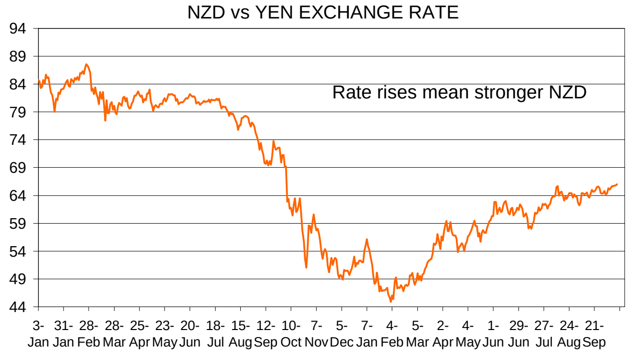




But confidence about an early-2010 tightening of monetary policy in NZ has risen and hence the extra NZD leap in an environment where investors are once again happy to chase yield.

On the cross rates the NZD has had a mixed performance over the week. We have shed over one cent against the Aussie dollar to just under 81 cents from 82 cents, and eased a tad against the Euro to near 49.5 centimes from 50. But against the Japanese Yen a 12 month high has been reached near 66 from 65.4 last week with support from investors increasingly leaving low yielding currencies to take a punt on higher yielding volatile currencies like the NZD.

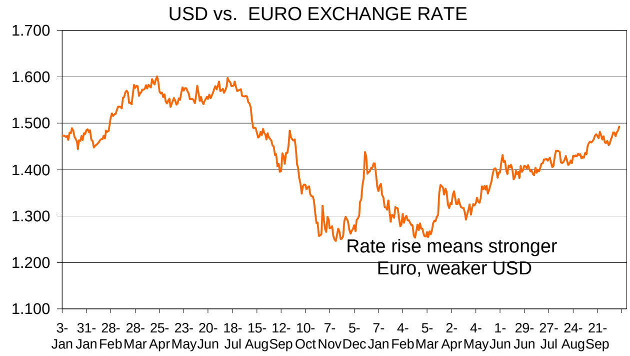


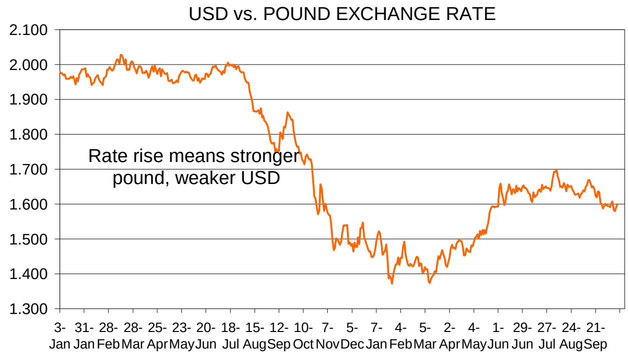


Against the British pound the NZD we are unchanged near 46.2 pence.

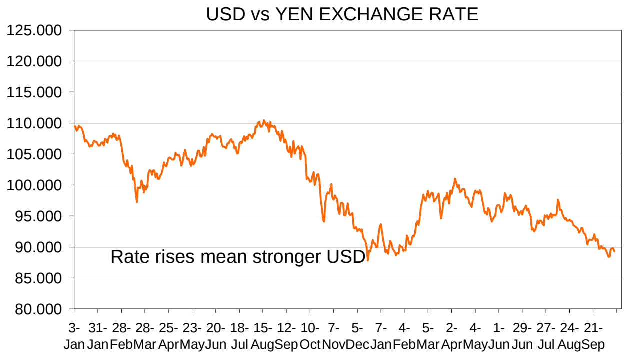
At current levels the NZD is looking somewhat over-stretched, especially as we think the markets are getting a bit ahead of themselves expecting the RB will raise the official cash rate as early as January 2010. But barring a collapse in confidence about the world economy it seems unlikely that any pullback in the NZD will be either large or sustained and further appreciation over coming months toward US 80 cents seems quite possible.

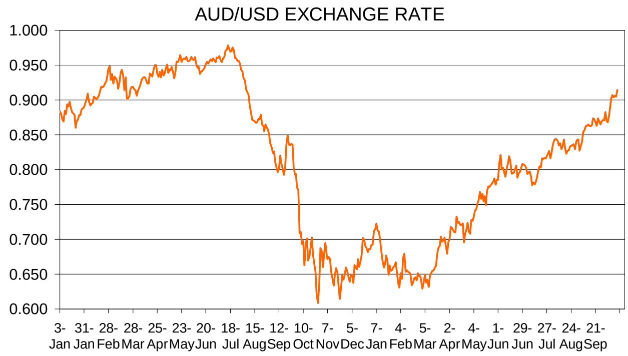
With regard to the USD, the theme remains one of worries about the budget and trade deficits, and willingness to fund at low US interest rates for investment in higher yielding currencies. In addition, the ongoing string of slightly better than expected data out of the United States is boosting willingness to move toward higher yielding riskier assets. The USD has ended the week slightly weaker against the Euro near $1.493 from $1.48. This is a 14 month high for the Euro against the greenback. Against the moribund British Pound the USD has ended unchanged from last week near $1.602 while against the Japanese yen the USD firmed a tad to 89.3 from 88.4 supported by greater selling of Yen to invest in higher yielding currencies than of the USD.





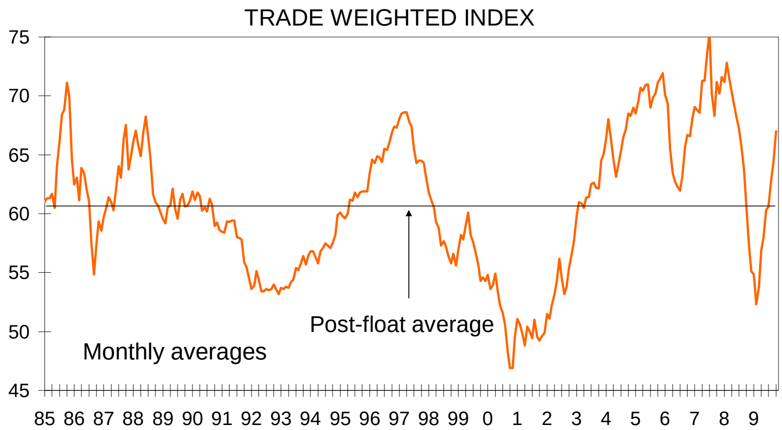
Meanwhile, underpinned by an economy that did not even have a recession in the past two years, stronger than expected data, and last week's monetary policy tightening, the Aussie dollar continued its climb against the greenback. It is now near a 14 month high of 91.9 cents from 90.2 cents last week.





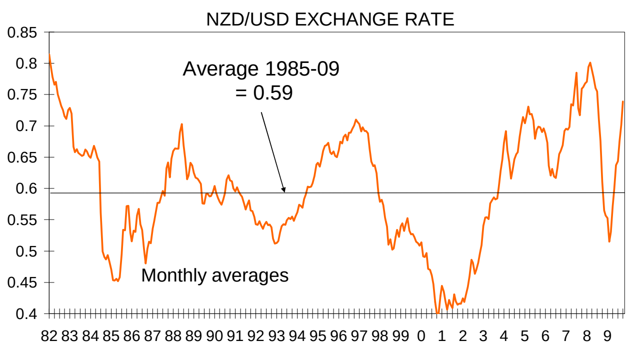
If I Were An FX Receiver What Would I Do?

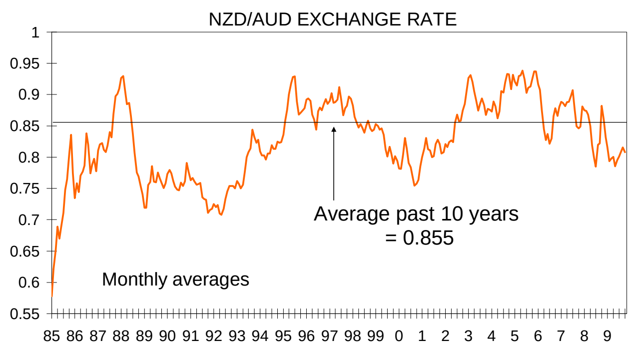
I'd have been well hedged since May. But barring that, I'd look at hedging against the USD, JPY and Euro, but ease off against the GBP and AUD. I'd look strongly at starting to incorporate options in my hedging against the USD.

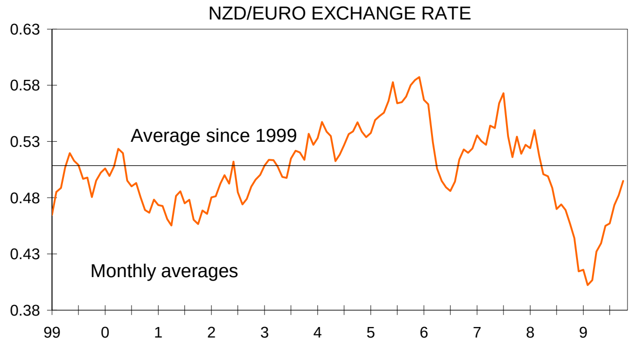


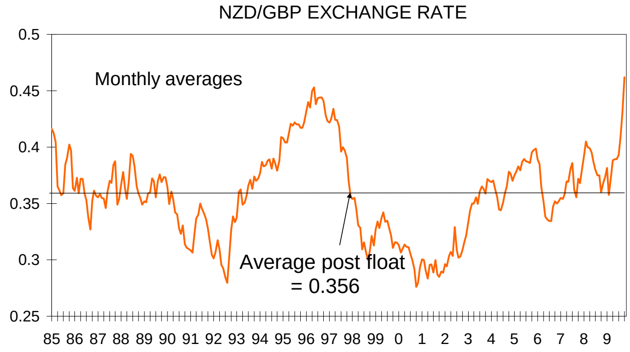
Here is something to put the current exchange rate strength into perspective. The NZ economy grew 0.1% during the June quarter allowing one to officially say that the recession has ended. The 1997/98 Asian Crisis-induced recession was over in the December quarter of 1998. Going four months after that to put us in the same period of time as we are now for this cycle the TWI was near 57 or about 6% below average. The TWI currently is over 10% above average. But it gets worse.

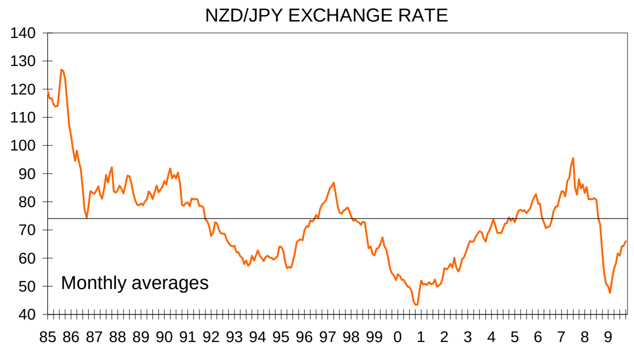
Back then the TWI kept falling to reach over 20% below average late in 2000. It did not rise above average until the start of 2003. The upturn in the NZ economy following the Asian Crisis was driven initially by a very strong period of growth in the export sector. That is not happening this time around.

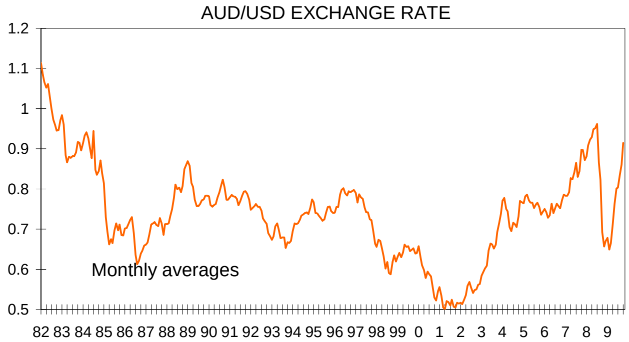












*Sourced from Consensus Economics. http://www.consensuseconomics.com/

ECONOMIC DATA

All %		Latest qtr only	Previous qtr only	Latest year	Year ago	2 Yrs ago
Inflation	RBNZ target is 1% - 3% on average	1.3%	0.6	1.7	5.1	1.8
GDP growth	Average past 10 years = 3.0%	+0.1	-0.8	-1.8	2.5	2.3
Unemployment rate	Average past 10 years = 5.3%	6.0	5.0	......	4.0	3.7
Jobs growth	Average past 10 years = 1.9%	-0.5	-1.4	-0.9	0.8	1.5
Current a/c deficit	Average past 10 years = 5.5% of GDP	5.9	8.1	......	8.3	8.2
Terms of Trade		-8.9	-2.7	-13.1	10.7	2.3
Wages Growth	Stats NZ analytical series	0.6	0.8	4.6	5.6	4.6
Retail Sales ex-auto	Average past 9 years = 3.8%.	0.2	-1.0	-1.0	1.6	5.5
House Prices	REINZ Stratified Index	1.6	1.8	0.7	-7.0	13.1
Net migration gain	Av. gain past 10 years = 11,700	+15,642	11,202yr	......	4,938	8,738
Tourism – an. av grth	10 year average growth = 5.0%. Stats NZ	-2.8	-2.6	-2.8	0.3	3.9
		Latest year rate	Prev mth year rate	6 mths ago	Year ago	2 yrs ago
Consumer conf.	10 year average = 2%. Colmar survey	57	38	-9	23	-8
Business activity exps	10 year average = 26%. NBNZ	32.0	26	-21	17	17
Household debt	10 year average growth = 11.3%. RBNZ	2.4	2.6	4.2	8.5	13.7
Dwelling sales	10 year average growth = 3.5%. REINZ	43.7	39.3	30.5	-23.7	-32.0
Floating Mort. Rate	(Total Money) 10 year average = 7.6%*	5.59	5.85	6.49	10.49	9.99
3 yr fixed hsg rate	10 year average = 7.9%	7.75	7.45	6.59	8.69	8.75

ECONOMIC FORECASTS

Forecasts at Sept. 17 2009	**March Years**					**December Years**				
(CPI updated 15/10)	2008	2009	2010	2011	2012	2007	2008	2009	2010	2011
GDP - annual average % change										
Private Consumption	3.3	-0.7	-0.5	1.8	2	4.1	0	-1.3	1.7	2
Government Consumption	4.3	3.4	3	2.8	1.9	3.9	3.9	2.9	2.9	2.2
Investment	4.3	-8.9	-16.4	6	8.9	5	-5.1	-17.8	1.1	9.7
GNE	4.2	-2	-3.9	3.3	3.4	4.5	0	-5.4	2.5	3.6
Exports	2.9	-3.4	-0.4	0.5	4.9	3.8	-1.6	-1.8	-0.4	4.7
Imports	9.6	-4.4	-14	2.3	5.9	8.6	2	-17.1	0.4	5.6
GDP	3.1	-1	-1	3	3.1	3.2	0.2	-1.9	2.3	3.3
Inflation – Consumers Price Index	3.4	3	2.5	1.1	2.6	3.2	3.4	2.6	1.4	2.1
Employment	-0.3	0.8	-1.6	2.6	3.2	2.3	1	-2.9	1.7	3.4
Unemployment Rate %	3.8	5	7.3	7.2	6.1	3.5	4.7	6.9	7.3	6.3
Wages	4.4	5.1	2.4	1.5	3.8	4	5.1	3.1	1.3	3.3
EXCHANGE RATE ASSUMPTIONS										
NZD/USD	0.8	0.53	0.73	0.75	0.71	0.77	0.56	0.72	0.75	0.72
USD/JPY	101	98	102	108	110	112	91	100	108	110
EUR/USD	1.55	1.31	1.5	1.46	1.36	1.46	1.34	1.49	1.47	1.4
NZD/AUD	0.87	0.8	0.82	0.84	0.85	0.88	0.83	0.82	0.84	0.84
NZD/GBP	0.4	0.37	0.42	0.43	0.41	0.38	0.37	0.42	0.43	0.42
NZD/EUR	0.52	0.41	0.49	0.51	0.52	0.53	0.41	0.48	0.51	0.51
NZD/YEN	81.1	51.8	74.5	81	77.9	86.3	50.9	72	81	79.1
TWI	71.6	53.8	67.3	70.3	68.8	71.6	55.1	66.3	70.1	69
Official Cash Rate	8.25	3	2.5	4.25	6.25	8.25	5	2.5	3.75	5.75
90 Day Bank Bill Rate	8.91	3.24	2.7	4.62	6.62	8.9	5.23	2.75	4.12	6.12
10 year Govt. Bond	6.36	4.77	5.75	6.4	7	6.4	4.88	5.7	6	6.8

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

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*extrapolated back in time as Total Money started in 2007