BNZ Weekly Overview

29 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.

Short Version This Week

This week I am in Tokyo to give a presentation at the annual Japan-New Zealand Business Council conference and what with all the travelling involved plus Monday lost to Labour Day that doesn't leave much time to put this week's Weekly Overview together. So it is a really short one. Plus anything we feel you really need to know about where the NZ economy is going and the pressures moving interest rates, exchange rates, the housing and labour markets etc. around has been written in recent weeks.

For the record and the benefit of the 22,000 WO readers not in Tokyo this morning, the key points I made at the conference talk on Thursday were as follows.

New Zealand has just emerged from its deepest recession since the 1970s but it wasn't all to do with the global crisis. We went into recession in the March quarter of 2008 because of our own domestic factors. These included collapsing finance companies, drought, floating mortgage rates at 10.5% and the NZD soaring to eventually reach US 82 cents. We also had pressure from soaring food and oil prices.

But just as we were expecting NZ to come out of recession late in 2008 the Lehmans collapse hit us with a bang and we suffered from further falls in dairy and other commodity prices, a shock to confidence which had just been recovering, a shocking outlook for tourism, and reduced credit availability. The Lehman's collapse saw our economy shrink another 1.8% so total shrinkage ended up just below 3%.

This shrinkage however was less than the OECD average decline of 5% and the likes of Japan's 9% fall. That is because we had some insulating factors in play. These included a well run banking system without the huge bad debts predominant in the US, UK and Europe (we had that problem in the 1980s). Our housing market was not oversupplied with properties, monetary policy easing of 6% saw floating mortgage rates eventually fall almost 5%, the NZD dropped like a stone to US 50 cents and 45 Yen, we had over $3.0bn worth of tax cuts in October 2008 and April 2009, and being highly migratory the economic collapse overseas prompted a shift in net flows back into New Zealand.

Now we can easily see signs of economic recovery. The economy grew 0.1% during the June quarter – which is obviously paltry and would not exist were it not for the fiscal stimulus. But more importantly we have seen house prices recover 8%, house construction consents rise 12% in the past three months with real estate turnover up 40%, and core retail spending firmed 1.2% in July. Both business and consumer confidence levels have soared with investment intentions almost back to average, and there have also been plenty of anecdotes about employers looking for people again.

Looking ahead we expect growth in our economy of an acceptable 2.5% - 3.5% over both 2010 and 2011. There will be support from things like infrastructure spending to catch up on years of neglect in the electricity sector in particular, preparations for the Rugby World Cup, trading partner growth going back to the 3% long term average bringing commodity price rises beyond the average 20% seen in the past seven months. There will be catch-up spending on cars and couches which have worn out, businesses rebuilding inventories, and companies putting back into action investment plans shelved during 2008. There will also be a strong catch-up on house construction.

But there will also be some strong sources of restraint. The NZD has soared like a rocket early in its cycle so this will not be a traditional export-led upturn – though manufacturers will benefit greatly from the strong Aussie economy and the below average NZD/AUD exchange rate. Farm sector debt is high and with land prices looking like they have fallen 30% farmers have balance sheets to get back into shape at a time when for many (dairy in particular) cash flows are well munted. (One did not use that Kiwi term today.)

While lots of Aussies flocking to NZ have kept the tourism figures up, it is hard to imagine anything other than further falls in visitor numbers over the coming year due not just to the high NZD but also the tremendous loss of wealth by householders in source countries.

Then there is the structural decline in credit availability. Businesses know about it but it isn't yet leading to widespread angst because their focus currently is on getting debt levels down due to the shock just experienced. But next year as demands for funding start rising, businesses are going to more keenly feel the permanent decline in credit as we banks are forced by

- overseas investors,
- the credit rating agencies,
- the regulatory authorities and
- our own desire to avoid a repeat of the post-Lehmans collapse credit drought,

to move toward lending growth more in line with domestic savings growth though not quite that low.

The broad implications of our outlook are the RB responding to the improving outlook by taking away the unsustainably low cash rate starting in the middle of next year. Fixed rates will rise further though the longer ones have probably done the bulk of their rises for this cycle. The NZD is likely to rise above US 80 cents while there is plenty of scope for gains against the Yen.

There will be good growth in revenue for operators in the housing sector including builders, manufacturers and distributors of building materials, plus retailers of durable consumer goods. House prices are likely to keep rising as lack of finance for subdivisions limits the construction bounce and builders start flocking back across the Tasman next year to take part in a building boom Australia sorely needs to house its rapidly growing population.

The government will do some tinkering eventually with the tax system, but negative comments about the impact of increasing GST mean wholesale reforms are extremely unlikely. The current account deficit will get better then blow out again with the extent of the eventual blowout to be heavily influenced by the extent to which the lack of credit falls more or less on exporters than domestic focussed companies. It is very unlikely households will permanently change their savings habits as the financial shock here has not been great enough – and many of those who did save for years lost it to some atrociously managed finance companies.

But although the current environment is still very uncertain, long term prospects for NZ look very similar to what they were four years ago. We are a high quality producer of primary goods which the rapidly expanding Asian middle classes in particular are going to want more and more of. We offer a strong tourism product with plenty of investment opportunities, plus there are some core sectors set for additional expansion such as the audio-visual sector involving not just filming but games production.

INTEREST RATES

As expected this morning the RB left the cash rate at 2.5%. But their comments were less dovish than anticipated with a change in their comment regarding leaving the cash rate low until "…the latter part of 2010" only moving to "..the second half of 2010." That caught out a market which had got ahead of itself in pricing rate rises by January. We stick with our view that the first rate rise comes in the middle of the year but will obviously in these very uncertain times keep that under review.

The impact of the RB comments was around 0.2% falls in swap rates – but apologies for not having up to date rates given one could not leave the conference today to source the most up to date data. The drift from here is likely to be upward for rates. But as we noted quite some time ago, the exciting moves in interest rates this year came and went many months ago.

Key Forecasts

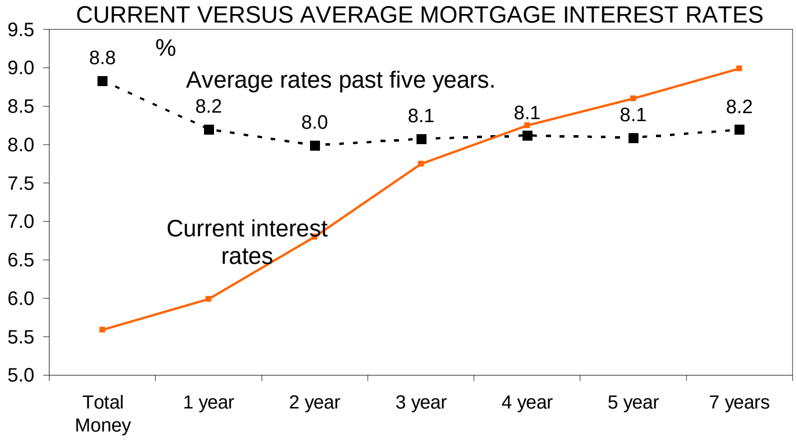
- Tightening by mid-2010.
- Medium to long term housing rates to keep on rising.

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	6.50	6.2
90-day bank bill	2.82%	2.82	2.83	2.81	7.07	6.5
10 year govt. bond	5.76%	5.76	5.57	5.74	5.94	6.2
1 year swap	3.50%*	3.66	3.37	3.07	6.39	6.7
5 year swap	5.55%*	5.73	5.57	5.39	6.50	7.0

*Best estimate

If I Were a Borrower What Would I Do?

Nothing new to say. No time to write. Best read last week and the week before. If you have not fixed by now (and especially if you missed doing it back on March 20) then you may as well float and enjoy the ride. 2012 will be your next big test.



HOUSING MARKET UPDATE

Nothing

Enough written in the past few weeks. Things tracking as we warned mid-last year when writing buyers wanting to make a canny purchase should look to do so before the middle of this year.

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

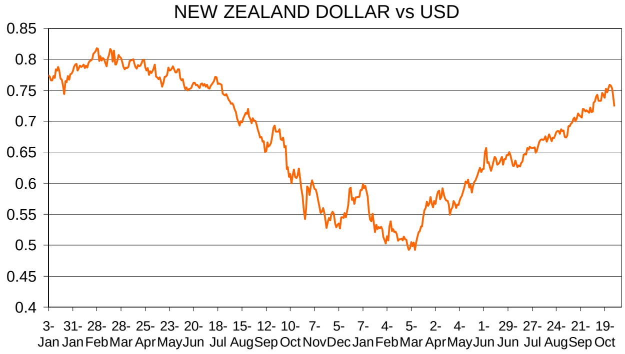
- Dwelling consent numbers to recover now with potentially good activity from late-2010.
- Real estate sales continuing to increase but the rise limited by listings shortages.
- House prices edging higher.

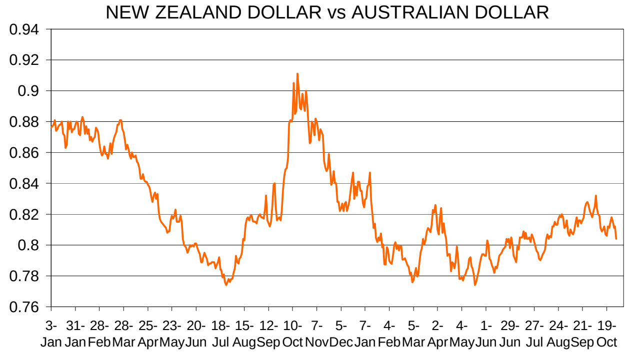
Exchange Rates & Foreign Economies

Exchange Rates	This Week	Week ago	4 wks ago	3 mths ago	Yr ago	Consensus Frcsts yr ago	10 yr average
NZD/USD	0.725	0.754	0.716	0.658	0.56	0.603	0.592
NZD/AUD	0.804	0.815	0.822	0.796	0.878	0.831	0.856
NZD/JPY	65.800	68.600	64.300	62.200	54.5	64.340	66.8
NZD/GBP	0.441	0.454	0.451	0.400	0.354	0.357	0.345
NZD/EUR	0.492	0.502	0.491	0.465	0.444	0.453	0.51
USD/JPY	90.759	90.981	89.804	94.529	97.321	106.700	113.9
USD/GBP	1.644	1.661	1.588	1.645	1.582	1.688	1.709
USD/EUR	1.474	1.502	1.458	1.415	1.261	1.331	1.156
AUD/USD	0.902	0.925	0.871	0.827	0.638	0.726	0.69

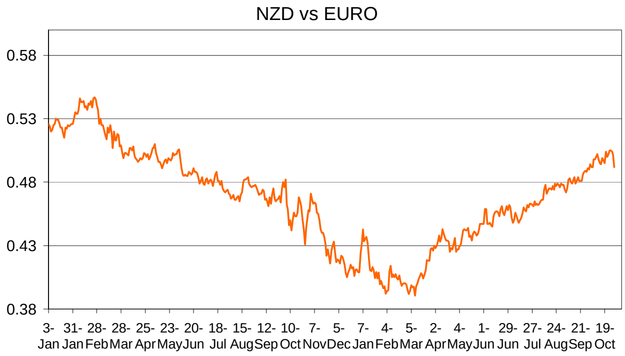
NZD eases Below US73 cents

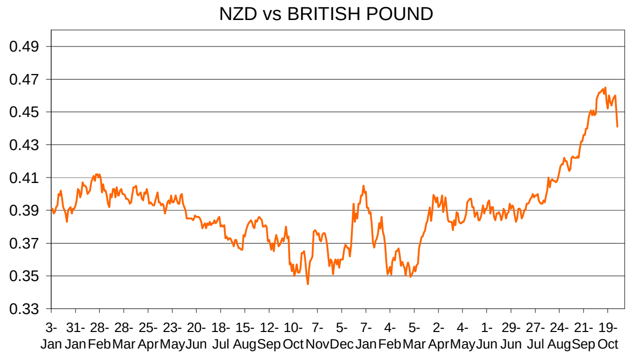
Exporters received some good news today with the NZD going back to the painful level it was at just over three weeks ago at a close near 72.5 cents from 75.4 cents last week. There were three main factors behind the NZD's decline.



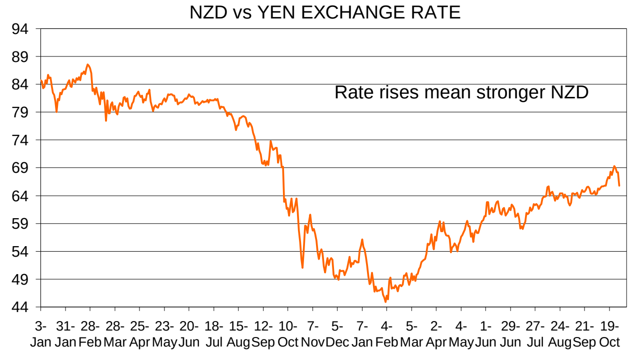


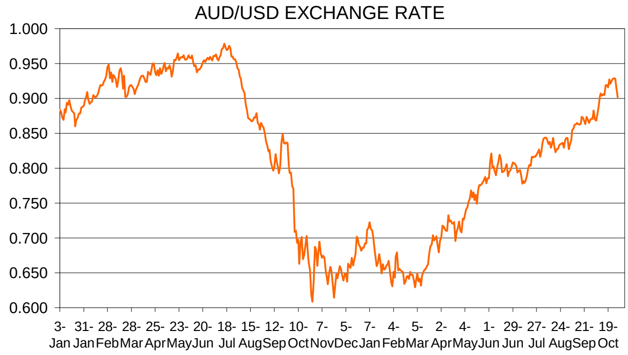
- The Reserve Bank's more dovish than expected monetary policy comments this morning.
- A decent fall in the AUD to 90 cents from 92.5 against the greenback on the back of falling commodity prices and reduced expectations of a 0.5% Aussie cash rate rise next week.
- A rise in global risk aversion associated with weakening sharemarkets and weaker than expected data in the US on consumer confidence and house sales in particular.





It would be optimistic for exporters to think of this pullback as the start of a downward trend – unless the outlook for world growth suddenly turns decidedly sour again which we do not expect. The NZD is a risky currency which means when global investors feel worried about things around them they sell the NZD heavily and buy whatever is considered the safe-haven currency at that time. Sometimes it is the USD, but currently it is the Japanese yen and Euro. When they feel safe they buy our currency – and that explains the bulk of our rise against the greenback since March. Largely we have shot up but also the greenback has weakened.



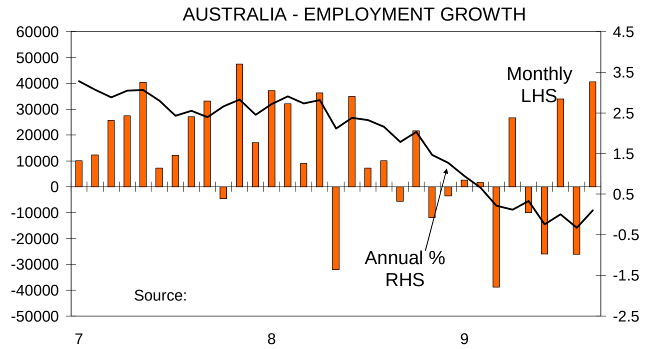


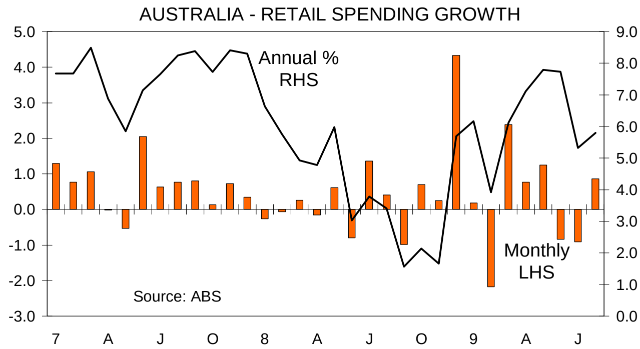
Over the past week global risk tolerance has crept down. It is likely risk tolerance will improve again in the near future so exporters may want to take advantage of the situation to get extra hedging on board.

One could write screeds more but time tonight does not permit it. Sorry. The following piece was written earlier in the week.

Like the NZ dollar the Aussie dollar has soared in recent months. But while the AUD has enjoyed support from increasing risk tolerance as we have, they have also had four other very important strong factors in their favour. First, courtesy of some well-timed fiscal stimulus the Aussie economy did not even go into recession during the biggest global financial crisis since the 1930s. This would naturally make the average investor feel more confident about holding the Australian currency than the currencies of a lot of other countries.

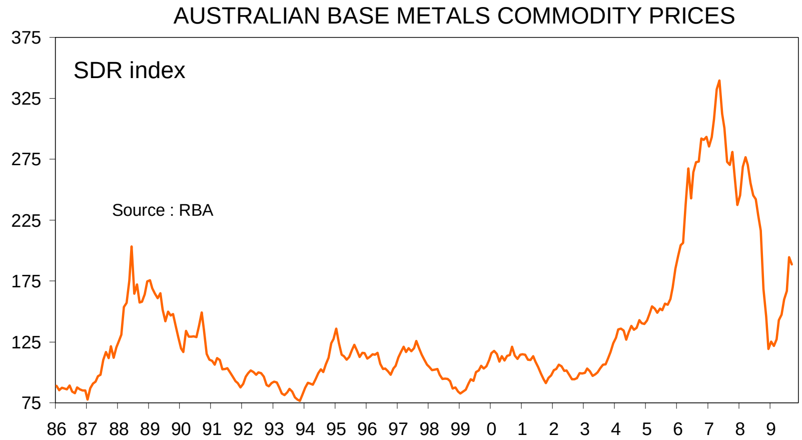
Second, some – but definitely not all – economic indicators have come in on the much better than expected side recently. Job numbers jumped an unexpected 40,615 in September and the unemployment rate fell to 5.7% from 5.8% in August. Job numbers are now 0.1% ahead of a year ago And why the “definitely not all” comment here? Because although total retail sales rose 0.9% in August, they fell that much in July and fell 0.8% in June.





Third, Aussie monetary policy is the first in the world to be tightened following the global crisis and another rate rise is expected next week.

Fourth, commodity prices – for base metals at least – have been recovering strongly recently. The RBA’s base metals index is now around 60% above its lows reached back in



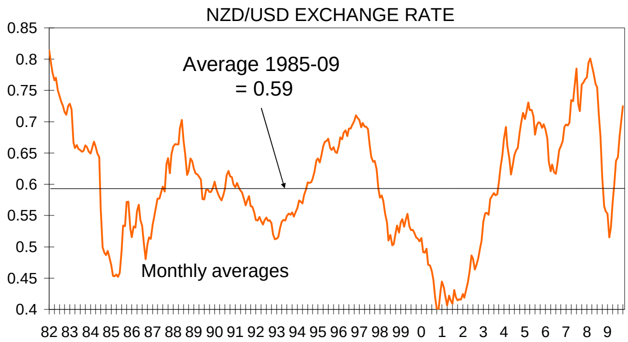
Whereas in NZ over the past six months household indebtedness has grown by only 0.2% on average a month, in Australia growth has been 0.6% on average.

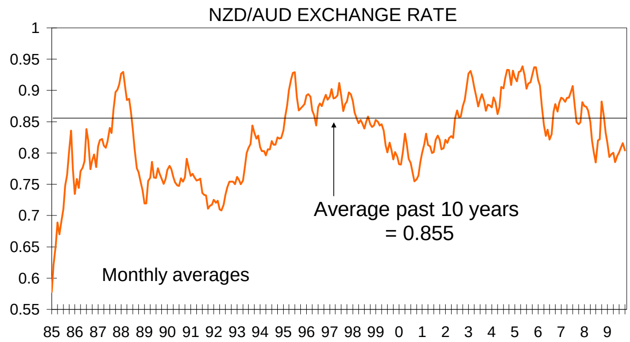
One similarity with New Zealand – and probably much of the rest of the planet – is declining debt in the business sector. In August Australian business debt was down 2.2% from a year earlier. The New Zealand decline was 0.3%. Businesses have been making great efforts to get debt levels down – mainly of course because they know credit is not now available as it was before the biggest credit crisis in modern times. One of our theories is that for the moment this is not necessarily being viewed as an impediment to growth in our economy or Australia's because the debt reduction as it were is mainly driven by businesses pulling back. But come 2010 when high confidence levels are likely to lead to greater credit demand to fund new machinery, factories etc. then the lack of credit will become a constraint on economic growth and commentary from the business sector is likely to be along the lines of expressing concern about how growth can be financed in a radically altered world where banks are lot falling over themselves to lend.

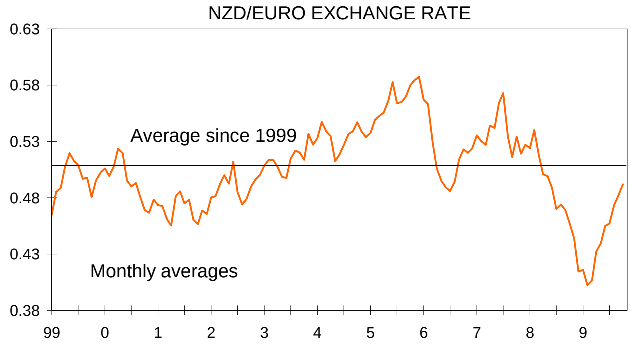
As noted above, over the week the AUD has shed two cents against the USD. But the decline is likely just temporary.

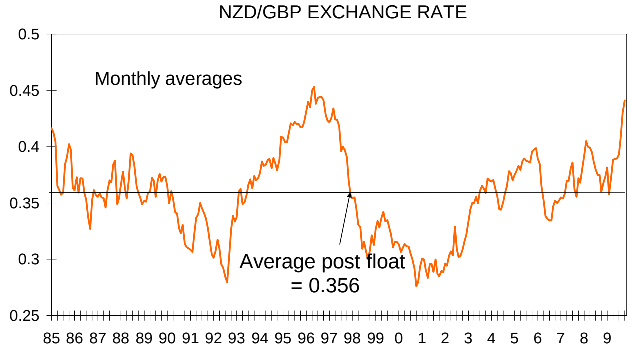
If I Were An FX Receiver What Would I Do?

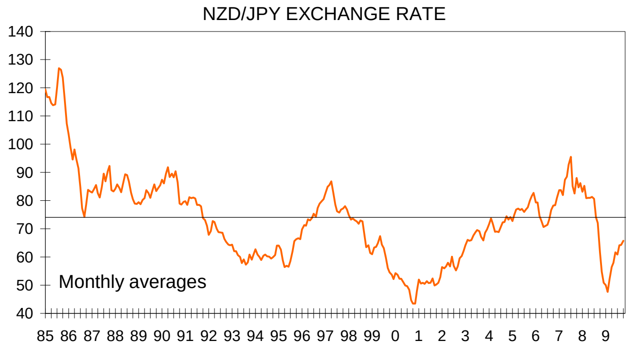
Take advantage of the dip to improve my short term hedging.











*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	+17,043	12,515yr	......	4,403	8,319
Tourism – an. av grth	10 year average growth = 5.0%. Stats NZ	-1.8	-2.8	-1.8	-0.3	3.8
		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	5.59	6.49	10.49	9.99
3 yr fixed hsg rate	10 year average = 7.9%	7.95	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.

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

*extrapolated back in time as Total Money started in 2007