BNZ Weekly Overview

17 February 2011

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.

Taking Advantage of Australia

Research from the latest New Zealander of the Year Dr Paul Callaghan of Victoria University shows that the return to the New Zealand economy from niche manufacturing activities is far greater than the return earned in most other sectors yet the sector struggles over the years because of difficulties accessing capital when needed in a timely manner, currency volatility and level, and undoubtedly other less obvious factors. A big question we should all be asking ourselves at the moment is how has the game changed for locating such activity in New Zealand now that it seems highly likely that the Kiwi dollar has undergone a structural shift downward against the Australian dollar of maybe ten cents.

One would be unwise to make that claim too boldly because the road of currency forecasts is completely blocked with forecasting crashes of the past. But comments from the Australian Federal Treasury's head of macro-economics last week indicate a firm belief across the ditch that their commodity boom will persist for another couple of decades and that the resulting higher Aussie dollar will pose a challenge for non-resource sectors. That is, if you are not shipping the likes of iron ore, coal, gold or uranium out of Australia you now face a structurally higher exchange rate which may be making you think about where your operations need to be shifted to in order to retain profitability.

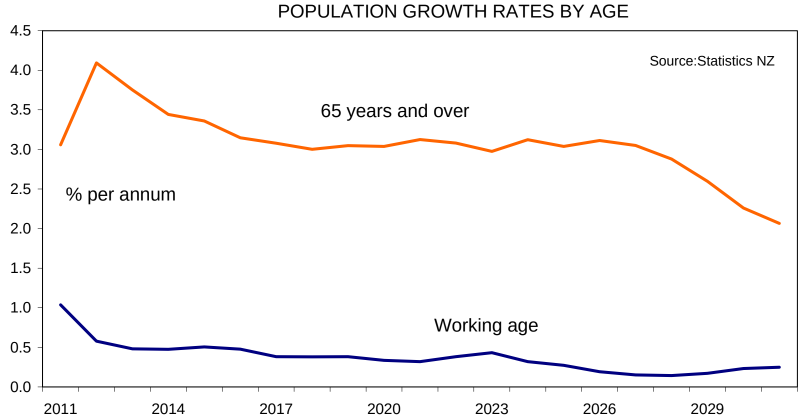
New Zealand pops up as one such potential location even though our currency is also high against the likes of the British pound, US dollar and euro. We rate as the number three best economy in the world for doing business (IFC and World Bank 2011) http://www.doingbusiness.org/reports/doing-business/doing-business-2011 and Forbes magazine 2008 http://www.forbes.com/2010/09/07/best-countries-for-business-business-washington-best-countries-10_land.html plus fifth in the Legatum 2008 Prosperity Index http://www.prosperity.com/default.aspx

Which is all well and good. But we have been losing some ground in the two big surveys people interested in this sort of international comparative stuff like- the Global Competitiveness Report (World Economic Forum
http://www.google.co.nz/url?q=http://www3.weforum.org/docs/WEF_GlobalCompetitivenessReport_2010-11.pdf&sa=U&ei=tq1MTfaBO4GosQOvzqnrCg&ved=0CA8QFjAA&usg=AFQjCNHbnAH_E8EEv44Pu_71MLAWWDau_w
and the IMD version http://www.imd.org/news/IMD-World-Competitiveness-Yearbook-2010-Rankings.cfm

Plus we face a workforce increasingly shooting off across the ditch for the bright lights (down the mines or on the building sites) across the Tasman. Over 6,500 people showed up at the Oz Jobs Expo run in Auckland over the weekend where employers were seeking people in 297 separate job categories and by the sounds of it quite a few people got signed up on the day. Expect to see more events such as that one over the next couple of years given the way the planets have lined up in favour of a soaring net outflow to Australia.

But if as an employer thinking about where your future workforce in New Zealand is going to come from this potential loss of people to Australia is nothing compared with what the demographics right this year are starting to hit you with. The Baby Boomers have started to retire in earnest and the impact on the population will be profound. Over the next ten years Statistics New Zealand predict – under their recommended range of assumptions, that the total population will grow by 8.9% or on average 0.9% per annum. That does not sound frightening. But…

The working age population between 15 and 64 is forecast to grow only 4.4% or only 0.4% per annum on average. The population aged 65 and over is predicted to grow in total by 38.5% or 3.3% on average per annum.



Between now and 2031 total population growth of 16.3% is predicted with working age growth of just 7.1% and old folk growth of 82.9%.

These are profound demographic shifts which businesses need to take into account in terms of potential customer base and location shifts and hiring plans. If in some manner your hiring policies do not take into account the limited growth in the normal working age population over the next decade you could find yourself struggling to maintain staff numbers and quality once we get beyond this current period of high unemployment.

More forward thinking companies will already be preparing for this shift by investing in labour-saving (productivity enhancing) technology, and figuring out how to best position themselves as preferred employers for the many retiring people who won’t want to simply fade from sight and sit on a patio somewhere.

Is Our Economy Getting Better or Worse?

In this simple summary section we look <u>only</u> at what the data are actually telling us and pay <u>no</u> attention to forecasts or intentions measures.

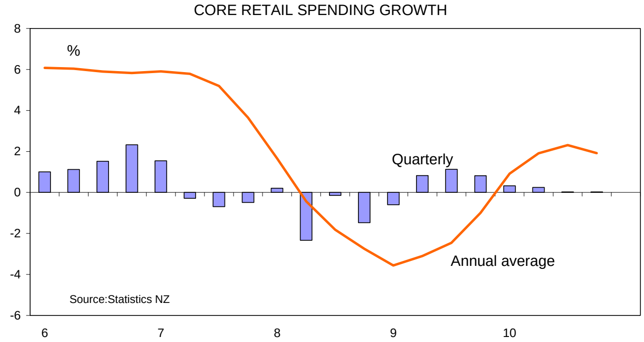
This week we have received dated data confirming what we already knew, namely that retail spending was weak during the December quarter. We have also learnt that a tentative upturn in dwelling sales over November and December got largely wiped out in January. But we have further confirmation that rising farm incomes is leading to rising farmer spending with farm sales up a seasonally adjusted 30% or so in the past three months. This is important because increased rural spending is the traditional NZ route to faster economic growth overall.

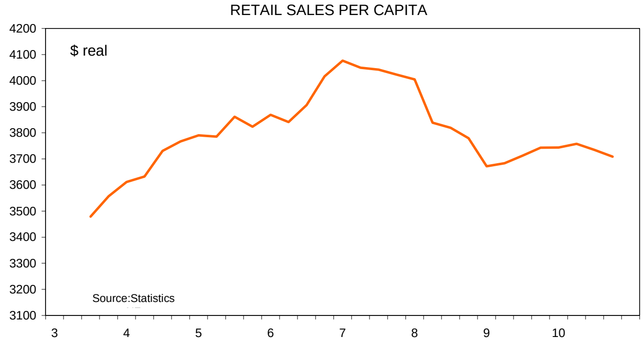
<u>Are householders opening their wallets more?</u>

Not when it comes to buying used houses (the new market being such a small proportion). In January dwelling sales were at a record monthly low, the median dwelling sale price was down 2.6% from a year ago (and also from December to put the volatility into perspective), and the days to sell blew out to 51 from 43 a year ago. The wallets closed up in January with regard to residential real estate thus calling into question positive interpretations some have taken of household willingness to spend from last week's card transaction retailing data. There is no evidence that householders overall are trending toward loosening their purse strings.

We already have January Electronic Card Transaction data in hand and from now on they will be the only monthly retailing-like measure available as Statistics NZ have suspended their monthly survey of retailers and retained just the quarterly one. That means the numbers we are going to comment on here are out of date and therefore we run through this exercise simply for the heck of it.

Over the December quarter the seasonally adjusted volume of retail spending fell by 0.4% after falling the same amount in the September quarter. Sales were only 0.2% ahead of a year ago and given that the population has grown 1.1% in the past year that means spending per capita was down by 0.9%. In fact retail spending per capita is some 9% below the somewhat ridiculous lofty levels of early 2007 when people kept spending in spite of floating mortgage rates breaching 10%.



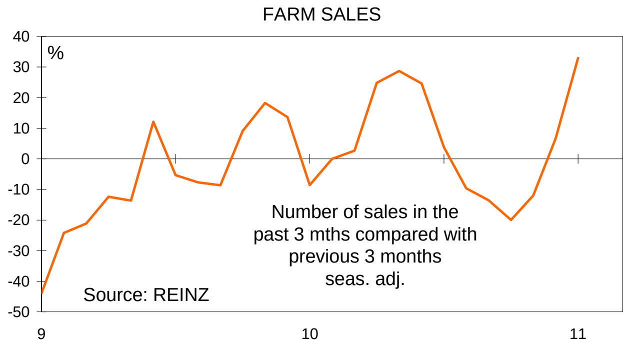


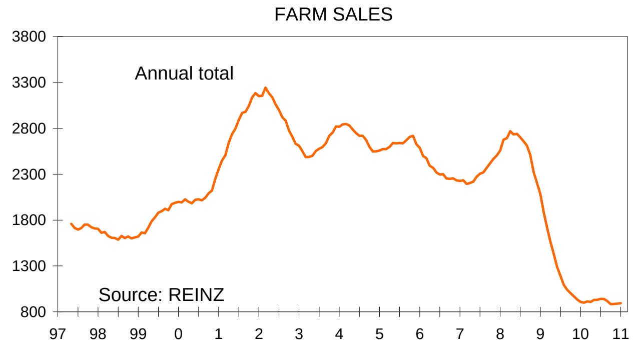
Not only was the headline number of a 0.4% fall weak but sales of durable goods people generally buy more of when they feel happy about their futures fell 4% in the quarter. And in the month of December retail spending in nominal seasonally adjusted terms weakened by 1.1%. But we already know the card transaction numbers fell 1.6% in December then bounced back 2.4% in January. See how silly this exercise is?

Interestingly the stocks to sales ratio (seasonally adjusted stocks to 3 months sales only) rose in the quarter to 41.1% from 40.4% at the end of the September quarter and 38.9% a year earlier indicating retailers entered this year with stocks perhaps a tad high for comfort. Perhaps they misjudged both the pre-GST buying strength as well as Christmas season spending.

Is business output rising?

The output as such of rural real estate agents is showing a lot more strength with the number of farms sold in January up 13% from a year ago and ahead a rough 32% in seasonally adjusted terms in the three months to January compared with the three months to October. The level of activity is still low with turnover in that three months period only half of average for the past six years. But the ultra important thing is that this growth indicator lines up with rising tractor registrations and the positive tone of comments submitted in our monthly BNZ Confidence Survey.

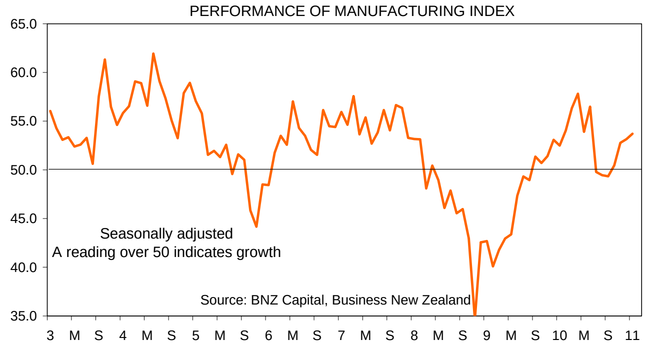




That is, there are signs that rising (yet erratic) farm incomes are leading to higher spending by farmers. This is very positive because this sort of thing eventually feeds through to the wider economy with a lag of 12-18 months and that leaves us hopeful that the spurt to growth we expect later this year from the Rugby World Cup and earthquake rebuilding will not fade away to be replaced by nothing over 2012. The pace at which things are going suggests anyway that post-quake rebuilding is going to be slow in starting and might take a long time.

This week we have also learnt that the Purchasing Managers Index in the BNZ-Business NZ survey firmed a tad more to a reading of 53.7 seasonally adjusted in January from 53.2 in December. This is not actually a reading of manufacturing sector output but it is the closest one can get to an up to date measure for industrial production in New Zealand so we include here for want of anything better. There is a reasonable correlation with what quarterly non-primary manufacturing output actually does.

The latest measure suggests reasonable growth is occurring in manufacturing though we suspect there will be an extreme range of experiences depending upon whether one is exporting to Australia or anywhere else, or dependent somehow upon domestic consumer spending.



Are businesses hiring more people?

We have no fresh information on the labour market this week. I attended and spoke at a seminar this week addressing issues of worsening labour shortages in New Zealand and the rising need to source migrants to fill labour force gaps. All that indicates is that there is awareness of the issue and an underlying firm tone to employer willingness to hire but gives us nothing solid to slot in here in terms of actual evidence that hiring is rising.

Are businesses boosting their capital spending?

Nothing new this week. Recent indicators have however been decidedly on the positive side thus giving us rising business capital spending to add to other positives seen in the data of rising farmer spending and improving manufacturing activity.

INTEREST RATES

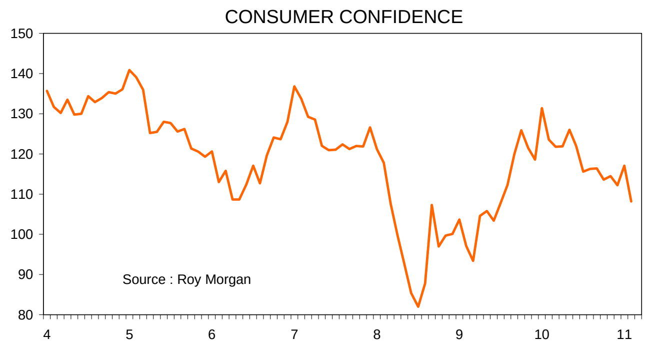
Growth vs. Economic Slack

In a nutshell this is what drives inflation along with institutional arrangements, imported inflation, and exchange rate changes. If you want to forecast monetary policy you need to monitor these things. So we will, adding stuff here when we learn it. The current common view is rate tightening from September. Have we learnt anything this week which alters this outlook?

We've learnt nothing new this week to greater change the odds that the next increase in the official cash rate will come in September. We have had further confirmation of improving rural spending from a low base but new weakness in the residential real estate sector. Recently we have learnt that the starting point for the labour market in terms of handling growth is more generous than previously believed with the unemployment rate rising to 6.8% from 6.4%, and the outlook for residential construction has deteriorated anew with further weakness in dwelling consents. We have also been getting feedback that the reconstruction of Christchurch and Kaiapoi residential properties following the earthquake has yet to kick off. We've also seen what appears to be a further deterioration in willingness of households to borrow though there is an upward trend in business debt growth underway.

A few weeks ago the NZIER's survey also showed us that the capacity utilisation rate in the manufacturing and construction sectors has fallen to 2% below average from an earlier 0.5% below average.

Plus this afternoon we have seen consumer confidence measured in the monthly ANZ-Roy Morgan survey falling to 108.2 from 117.1 in January. The result probably reflects rising cost of living pressures and perhaps talk of a double-dip recession and implies the risks are that current weakness in household spending will continue.



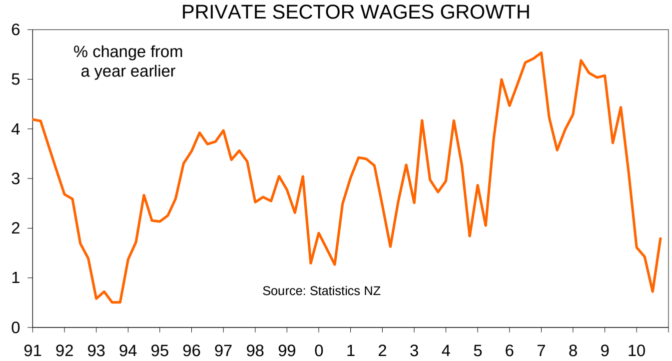
But we have also seen increasing signs of business investment which while stimulating growth also tends to boost productivity and therefore the ability to handle growth before inflation creeps up.

Basically the recent data imply a reduced need for monetary policy to be used to slow economic growth in the economy in order to reduce pressure on the resource base. That is why we have recently shifted our forecast for monetary policy tightening out to September from June and if the recent trend of data continues for another month or so then that date will be further shifted out. The Reserve Bank next review the official cash rate on March 10.

Other Inflation Influencers

Global commodity prices continue to rise and this week we saw a further 3%+ rise in prices at Fonterra's fortnightly auction. These rises will slowly feed through to NZ dairy grocery prices but the Reserve Bank will tend to look through these rises as it were to see if the higher cost of living leads to higher wages growth. That is a bit of a problem in New Zealand given that the wages data are not necessarily truly telling us what is happening with wages. There does appear to be a lift in wages growth underway however going by the Quarterly Employment Survey released a couple of weeks ago.

This survey shows that ordinary time average hourly earnings in the private sector rose 0.6% during the December quarter last year whereas they fell 0.4% in the same quarter in 2009. Annual wages growth using this measure (which can get distorted by changes in the proportion of the labour force in particular industries) has now accelerated to 1.8% from 0.7% in the September quarter. But the rate was 3.1% a year earlier so realistically all one can reasonably say is that a period of falling wages growth may have ended. But wages growth is muted and unless productivity is falling away is not inflationary.



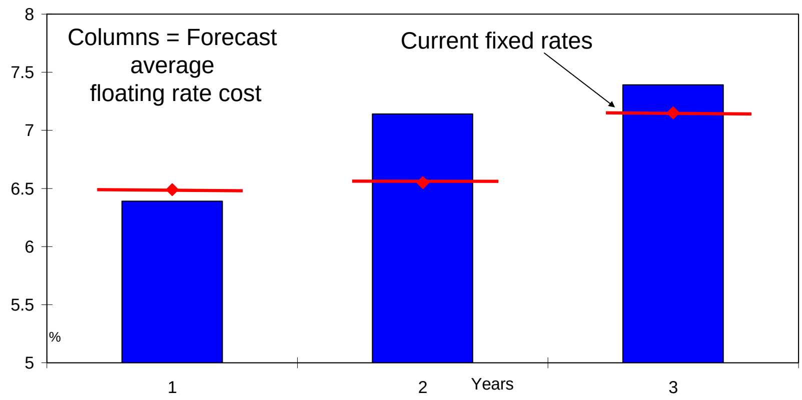
This week, in the absence of any startling news, we have seen small declines in short term wholesale interest rates caused largely by the weak December quarter retailing report.

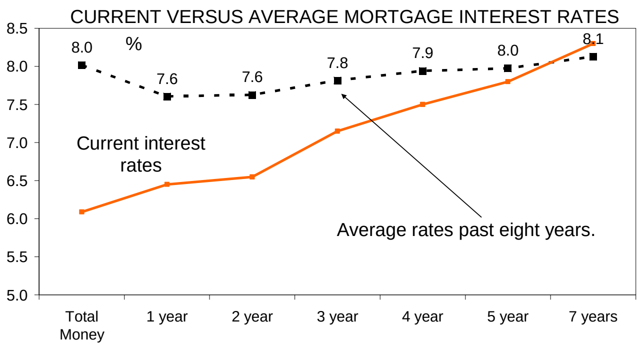
FINANCIAL MARKETS DATA	This week	Week ago	4 wks ago	3 months ago	Yr ago	10 yr average
Official Cash Rate	3.00%	3.00	3.00	3.00	2.50	5.9
90-day bank bill	3.22%	3.22	3.21	3.20	2.70	6.2
1 year swap	3.39%	3.43	3.49	3.58	3.47	6.3
5 year swap	4.75%	4.76	4.74	4.76	5.28	6.6
180-day term depo	4.10%*	4.10	4.80	4.90	3.15	6.0
Five year term depo	6.50%	6.50	6.75	6.75	6.00	6.5
* 160 days = 5.2%						

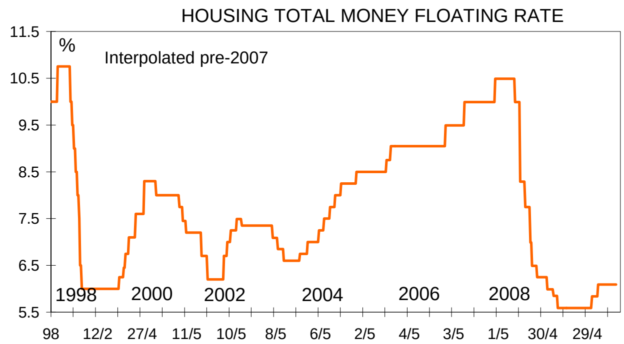
If I Were a Borrower What Would I Do?

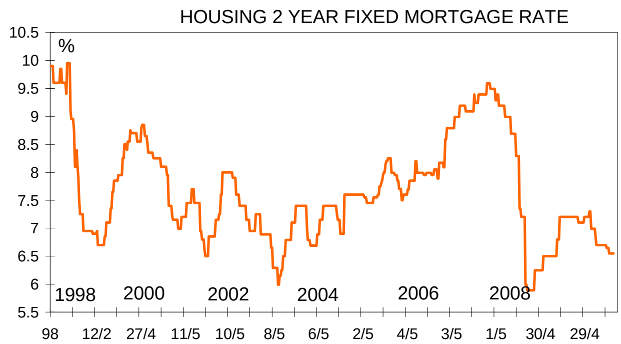
There are no signs of rising inflationary pressures in the economy and we feel the Reserve Bank will be quite relaxed about the inflation outlook for the next couple of years. They will be keeping a close eye on rising inflation rates overseas but with reasonable spare capacity in the NZ economy and a strong currency limiting imported inflation (dairy products aside) we don't expect monetary policy to be tightened again until September at the earliest.

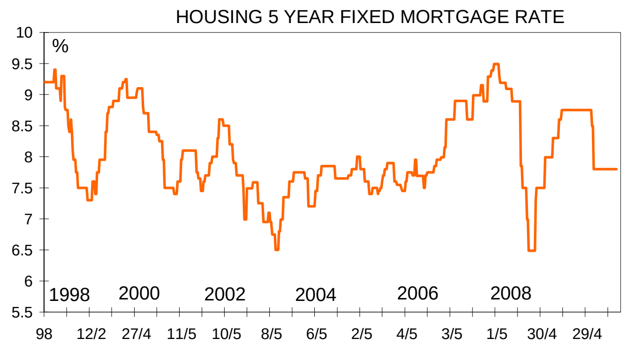
That means floating interest rates are expected to stay low until them and in the absence of anything suggesting to me that fixed rates will be jumping up in the near future I personally would feel happy to stay on a floating mortgage rate.





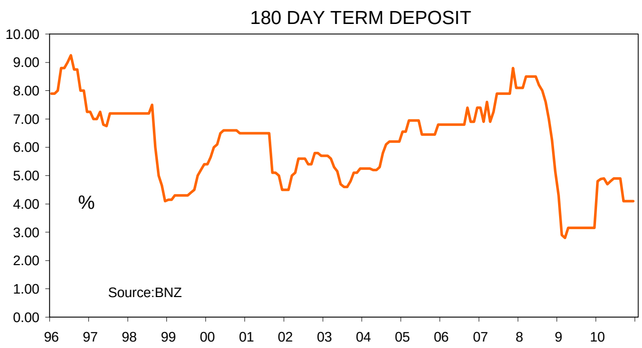


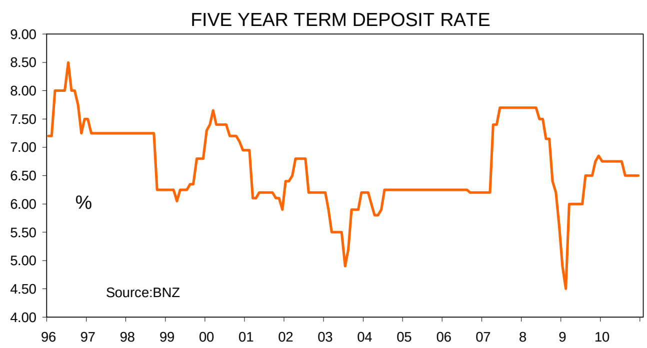




If I Were a Term Deposit Investor What Would I Do?

Take a spread of term rates and still be wary of long rates just in case world inflation nudges to the topside.





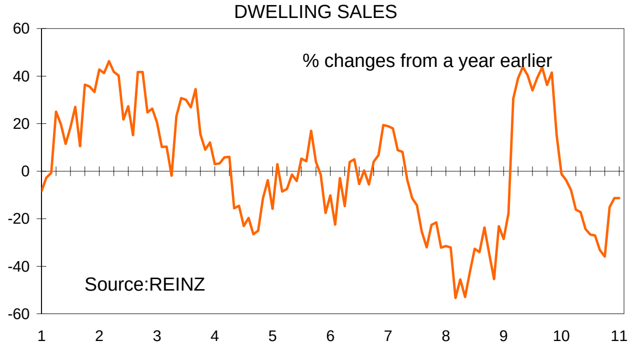
HOUSING MARKET UPDATE

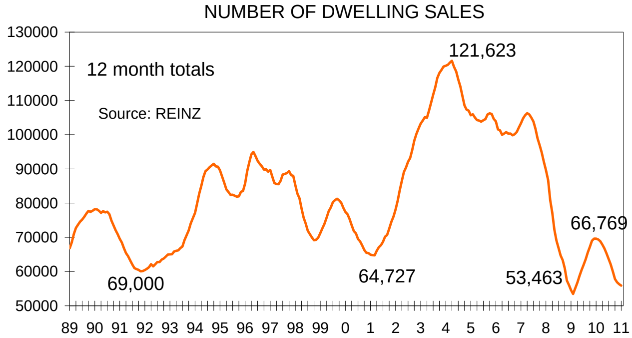
Turnover is weak, construction falling, and prices essentially flat on average.

Real Estate Market Goes Backwards Anew

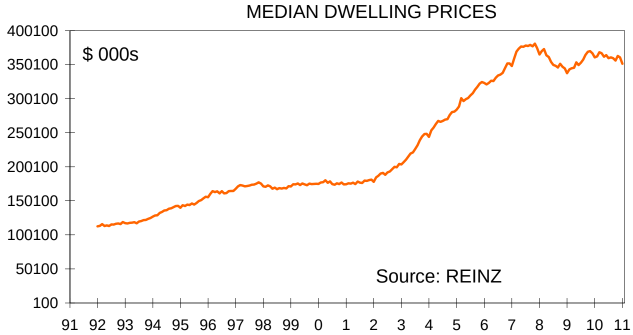
Just when one could look at the real estate numbers and discern a small improving pattern over November and December the January numbers have come along and re-established a weakening trend. There were only 3,252 dwellings sold in the month which is the lowest total for any month since records started in January 1988. In rough seasonally adjusted terms sales were down 17% after improving 4% in December and gaining 22% in November.

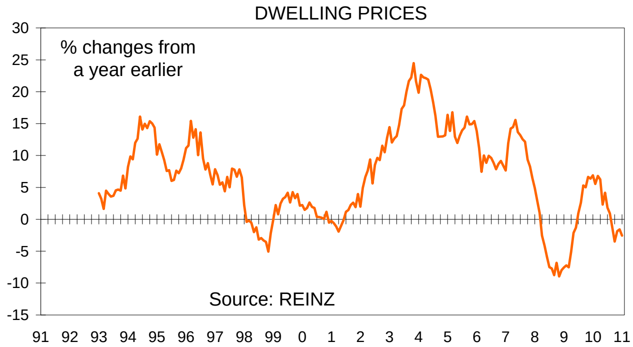
The real estate industry is in recession and like house building going deeper it seems.





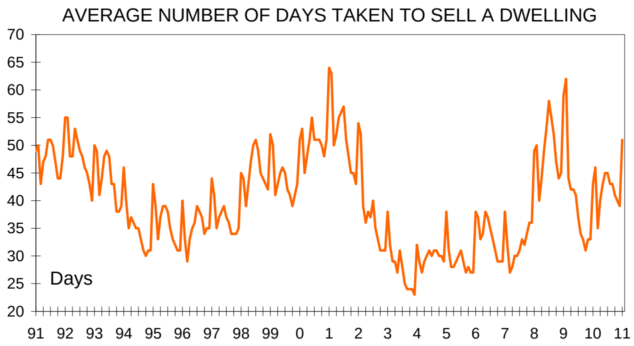
The median dwelling sale price eased 2.6% in the month to be 2.6% down from a year earlier showing straight away that one needs to be careful about extrapolating short term price movements. On a monthly basis prices can go all over the place, but when we look at the past three months we see that prices were down 0.1% from the three months to October. We still maintain that overall prices are largely flat. But there is little reason for believing they are going to firm soon given the clear reluctance by buyers to hop into the market, with that reluctance matched by the fact most vendors are not pressed enough by debt servicing costs to feel they need to take whatever they can get.

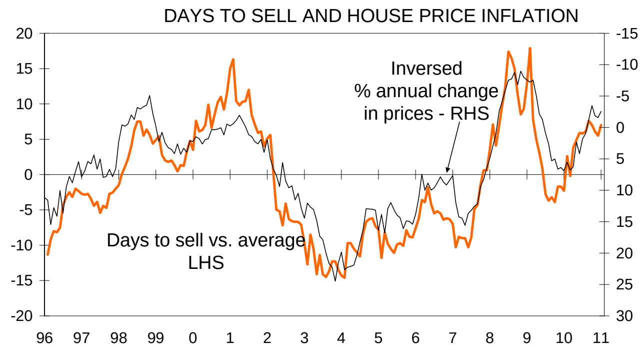




It's a Mexican standoff and things are likely to remain this way until the second half of the year when more awareness of lack of construction is likely to make buyers more willing to enter the market – at which point they'll probably be swamped a few times by waves of sellers. It will be fascinating to watch.

On average in January it took 51 days to sell a house which was eight days longer than a year earlier and seven days more than average for January. That takes the days versus average measure back where it was three months ago before improving to 6.1 days in November and 5.5 days in December.





The housing market remains weak, prices flat to falling, and things will stay this way for a while.

Headline of the week

That prize goes to the NZ Herald this morning with their front page heading “Rent crisis hits new high”. We’ve said it many times and we’re going to keep saying it. New Zealand did not go into the Global Financial Crisis with excess construction of dwellings. That is why at their worst prices fell only 11% and not the ridiculous 40% some people were predicting. Prices have since then recovered a tad, eased back, and sit now down around 8% down from their absolute peak in November 2007, or 5.7% below the average for that year.

In the real estate market there is an over-supply of properties for sale at current prices but price adjustment downward is being contained by vendor cash flows receiving assistance from low interest rates.

The country needs around 25,000 dwelling consents to be issued each year to meet population growth. We are running at 15,602 in calendar 2010 and falling and the fundamental shortage is close to 28,000 at the moment and rising rapidly. Our long held view has been that slowly this shortage will manifest itself as rising rents then rising awareness of the shortage. That will then translate into even less willingness of vendors to sell, more willingness to price rents up to make property yields better, greater interest from buyers as they read the shortage stories, then rising average house prices. At some stage housing construction will pick up but there has been a structural dent in the ability of that to happen and to reach needed construction levels by the closure of finance companies and the loss of tradespeople to Australia.

We are at the rising rents stage which as we noted last week is being accompanied by larger more yield-focussed professional residential property investors picking the eyes out of properties on offer at the lower end of the market.

We noted last year that it is going to be fascinating watching these developments unfold in the housing market this year – including debate again about housing affordability and pressure on those on low incomes – and we stand by that view.

Space for building in Victoria

I just came across another reason why tradespeople will be drawn across the ditch to build houses. In June last year the Victoria Parliament extended the city boundaries by 43,600 hectares – room for 134,000 houses – taking available land supply from ten years to 30 years. (Suffice to say the chances of such a thing happening in Auckland seem quite remote, hence price support up there.) Developers are hopping in and scouring earth into buildable sites which presumably will be built on.

One emailer noted this week…

“Hi Tony, how can we be short of houses – I don’t see anyone living under park benches?”
I replied…
Our lifestyle choice and demographic tendency is to live in houses with an average of 2.7 people per dwelling. We are cramming in together above that currently not so much I think because people cannot find

a place to live in but because we are looking to boost our housing deposits, worried about job loss etc. What that means is that house prices are where they are now with that demand out of the system. Imagine what will happen when the labour market improves and people look to resume their long term plans with a place of their own. That is when the shortage will show up. It does not now.

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 improve further out. House prices edging higher from second half of 2011.

MAJOR OFFSHORE ISSUES

There are many important things happening offshore not easily covered in the one country commentaries we have traditionally included when time permitted in the FX section below. So this new section will concentrate solely on developments in the areas occupying the minds of the markets, policy makers and politicians around the world. In some weeks certain sections will be empty because nothing new will have occurred.

European Debt

Southern Euro-zone governments have soaring debts and/or deficits due to taking on their private sector's debts, or simply their own fiscal incompetence. Concerned by these developments and the lack of suitable EU-wide institutions for handling crises investors are demanding higher and higher interest rates before investing in more debt, causing debt servicing budget blowouts for the recalcitrant borrowers. To try and keep investor confidence some governments are radically slashing spending, raising taxes and restructuring but still borrowing costs climb and the citizenry grow increasingly restless. The logical route is they restructure their debt but that can't happen yet because the bulk of such debt is held by French and German banks and the capital losses could send them bankrupt thus crushing their own economies. What happens then? Lots more investor worries, more official bailout packages as already done for Ireland and Greece, more fiscal austerity and rioting, then when bank capital bases are secure enough debt restructuring will almost certainly come for Ireland, Greece, Portugal and maybe Italy and Spain.

What's new?

This week worries have surfaced regarding a large bank in Germany which was bailed out by the European Commission during the depths of the crisis and now may not be able to meet the terms of its rescue agreement by either restructuring or finding a buyer. This seems like a bit of a storm in a tea cup given that only one already munted bank is involved and no-one is talking about a contagion effect.

Apart from that we have seen a small fall of no significance in industrial production in Germany, and learnt that the euro zone economy grew by just 0.3% during the December quarter of last year. That means for the year as a whole growth was 1.7% which is slightly better than what we probably ended up with in New Zealand of 1.4% assuming the December quarter shows no change.

Chinese Inflation

In China high inflation tends to spur non-one party thoughts from the populace à la Tiananmen Square 1989 therefore the leaders will do all they can to get food price rises in particular down. So is inflation easing, what measures will be added to get inflation down? The big global worry is that these measures could produce a sharp slowing in growth which slams sharemarkets, Chinese raw material demand and therefore commodity prices relevant especially for Australia and via them to us, plus our own large dairy and forest product exports to China.

What's new?

The annual inflation rate rose to 4.9% in January from 4.6% in December with food prices more than 10% higher than a year earlier. The 4.9% outcome was lower than expectations of a 5.4% rise but the rate is widely expected to climb higher in coming months with food prices being the main culprit – especially with growing worries about grain prices due to drought conditions in north-west China.

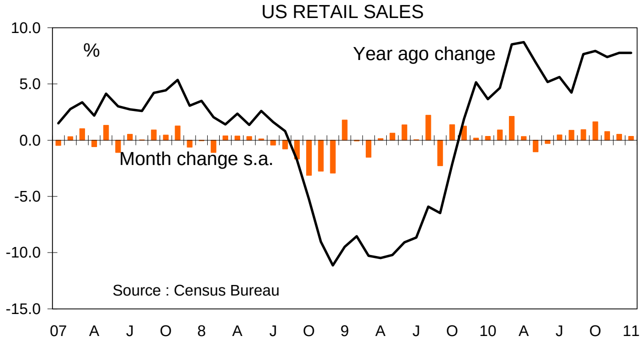
US Growth Momentum

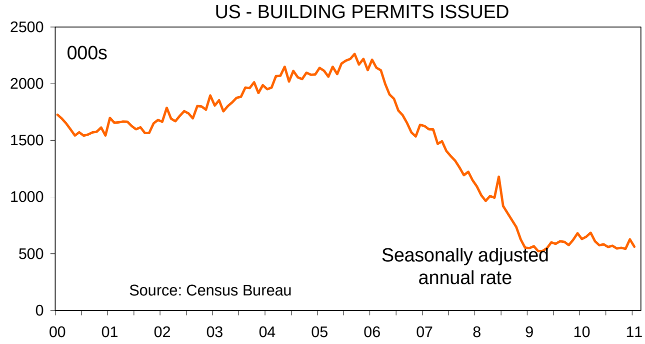
The US economy has grown 2.2% over the past year but the upturn is not yet "self-sustaining" or reducing unemployment stuck above 9% at 14mn - worse than Germany, Japan, Britain and Russia. Manufacturing is firm but retailing, housing and business investment remain weak while few moves have yet been started to rein in an unsustainable Federal Budget deficit above 11% of GDP and concerns are growing about state and local budgets. What we're looking for are signs that the economy is firing on more cylinders than just those caused by a low USD, restocking, and fiscal stimuli. I.E. consumption, housing, and business capital spending.

What's new?

The confidence of consumers in the United States continues to improve even though jobs growth has been mediocre and house prices show no sign of rising. The monthly University of Michigan index rose to 75.1 in February from 74.4 in January. This measure had firmed quite a bit since the reading of 67.7 in October and this is one factor encouraging the markets to give a stronger benefit of the doubt to the US economic recovery gaining its legs. Other factors include strength in the manufacturing sector along with signs of firming business investment and a slight increase in lending to consumers recently.

But as we have noted many times before, strong confidence does not in the very short term necessarily lead to higher household spending and in January retail spending improved by only 0.3% thus continuing a recent run of low increases. Consumers appear still reasonably firmly focused on repaying debt having seen their wealth in the form of housing collapse.

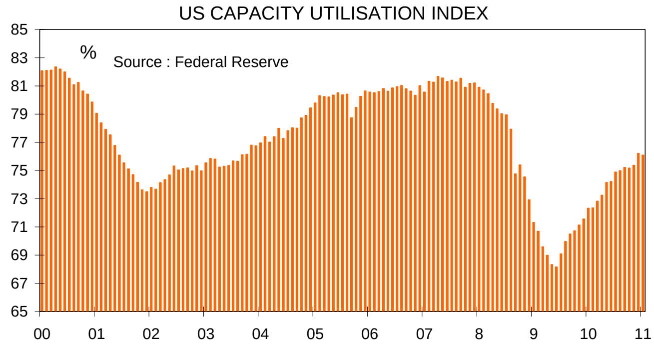


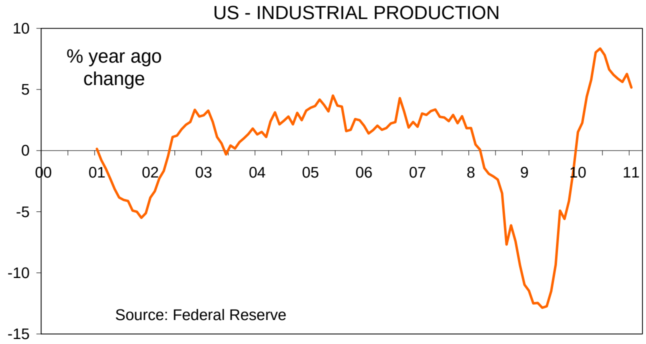


For ourselves from a currency point of view the big question is whether this strength leads to tightening monetary policy. It will eventually but going by recent comments from the Federal Reserve Chairman not until next year. Given that the thing we think most likely to trigger a decent downward correction in the Kiwi dollar is rising short term interest rates in the United States we remain of the view that the NZD will be firm all this year (though as volatile as ever) against the greenback.

With regard to the much-watched US housing market the news this week was that when it comes to construction there is still no reason for expecting a decent lift. The number of permits issued for construction of new dwellings eased back 10.4% seasonally adjusted in January to lie 10.7% down from a year earlier.

On a more positive note and fairly much in line with what others have already done, the Federal Reserve revealed in their Board minutes released last night that they have lifted their forecast for growth in the US economy this year to between 3.4% and 3.9% from 3.0% - 3.6%. But the level of industrial production stepped back 0.1% in January though was still ahead some 5.2% from a year ago mainly reflecting growth in the manufacturing sector – one of the things currently growing well in the US economy. The second graph below we include to show that there is still plenty of spare capacity in the US economy so the need for monetary policy tightening to combat traditional resource pressure-driven cost increases is not particularly strong.





Global Currency Conflict

Asian economies have driven growth for many years by keeping their currencies low against the greenback (thus hurting the purchasing power of their consumers). But their model of growth relying on excess spending by US households is shattered yet they either don't realize it or can't face the adjustment pain. Natural pressures on the greenback are now downward (budget and current account deficits, debt risk, relative interest rates and share of world economic activity and growth) but to stop their currencies appreciating versus the USD Asian economies are keeping their interest rates low and printing more money thus running rising inflation risks. Recent and planned extra US bond buying is adding to rising economic/political/trade tensions. We are watching for either Asian currency capitulation (most closely watched are the Chinese), further capital inflow restrictions, deployment of trade weapons, etc. The big risk is a global currency/trade war.

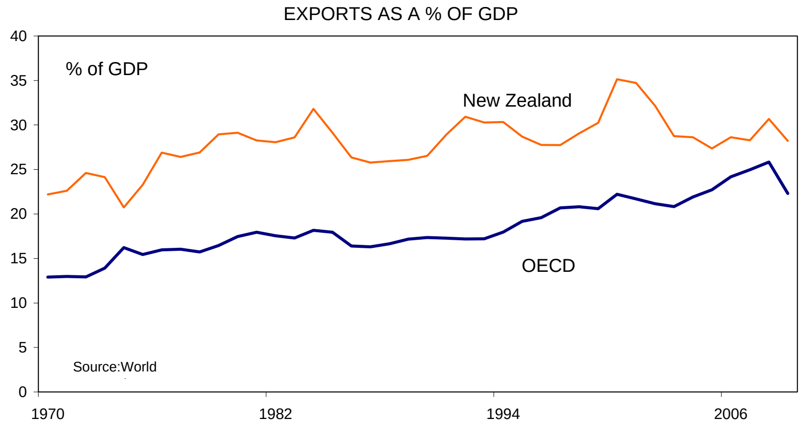
What's new?

Part of the global currency conflict story is how to slowly move toward a greater role for emerging economy currencies at a pace that won't create volatility they cannot or are not willing to tolerate, while avoiding potential radical movements in the greenback. This week the IMF Chief proposed including the Chinese yuan in the basket of currencies determining the market price of SDRs – special drawing rights. SDRs are basically an artificial currency created in 1969 and used as a means of wealth transfer between rich and poor countries within the accounts of the IMF. Its just a kite in the breeze at this stage and not something which if implemented would be likely to radically change the FX landscape – especially as 99% of people don't know what an SDR is.

Tomorrow the first large G20 meeting of the year will be held among finance officials and a key topic on the table will be how to allow countries to cleanly implement capital controls when viewed necessary to curtail what are seen as destabilising capital flows. The problems are fairly obvious straight away in that one person's definition of destabilising is unlikely to match another's, perhaps it will be hard to take a control away once it is put in place, can controls be varied to match the intensity of the flow, does it matter where the flows are coming from and can one in fact even gauge the true size of them, can other things be done before controls are put in place (monetary policy, exchange rate policy) and so on.

In other words, there will be big discussions but approaching agreement on a framework is a long shot. For us in New Zealand it seems fairly unlikely that our authorities would seriously consider dirtying the (almost) virginal float of the NZ dollar with uncertain capital controls even though there is widespread agreement that the high level of the Kiwi dollar on average acts as an impediment to growth in our export sector.

It's a big problem for us this lack of export growth. Over the past four decades while a grouping we have created of other small OECD economies has practically doubled its ratio of exports to GDP we have barely budged. Is this simply because some two-thirds of our exports come from the primary sector and increasing the volume of output is very difficult compared with simply doubling the number of factories if the world really loves the stuff we put together here? Possibly. Maybe there is also a case of the old Argentinean disease (one of them) here I recall learning back at university in the early 1980s.



In contrast with countries like New Zealand, Canada and Australia Argentina did not grow and prosper to the same degree as we did. One factor cited is that the owners of the profitable agricultural exports from

Argentina lived very comfortably on their earnings and felt no need to take their capital and invest it in other fields such as manufacturing.

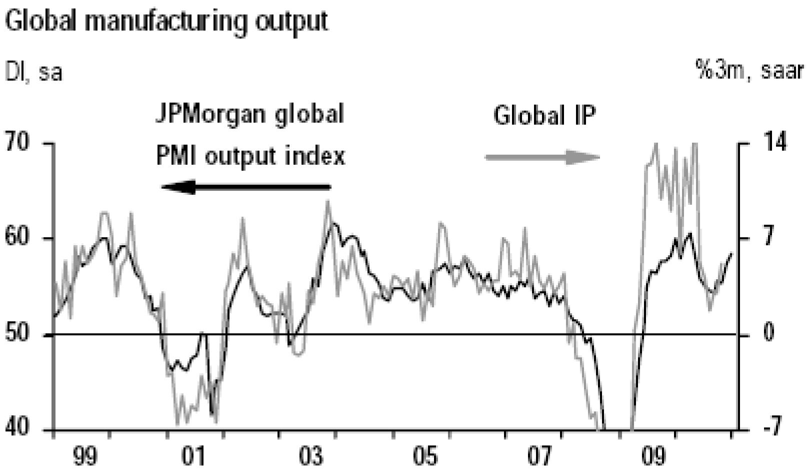
Here in New Zealand however nowadays do we tend to see capital flowing out of the farming sector into other industries? Or do the farmers simply plough it all back into their current volume-limited activities pushing down further and further the return they get on their capital? The method? Buy each other's land thus pushing the price well away from levels commensurate with the returns.

Who knows. Its just a theory, one of many we will be having a look at this year in some separate research we'll be presenting soon through a different vehicle to the Weekly Overview which is already too big for most readers one suspects. But its fun to write.

Commodity Prices

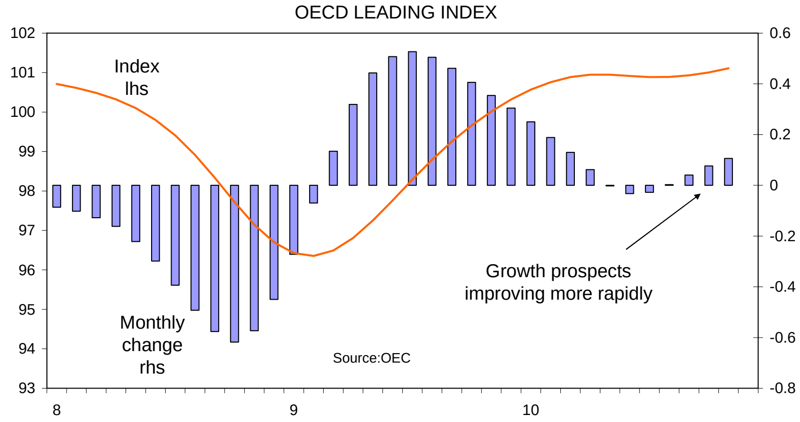
Prices of commodities are soaring on the back of currently firm Asian growth, expected rising structural demand related to infrastructure and rising incomes, and surging speculative investor buying driven by US money printing, inflation fears, ultra-low interest rates, and wariness of alternative investments. Bubbles are undoubtedly developing but history shows we have zero chance of picking when they peak and where.

Obviously the outlook for world growth is a key influence on where commodity prices go and in that regard there is little reason for believing prices will be easing much in the near future. Food prices have been pushed skyward by shock weather events, but mineral and energy prices respond more to demand projections and two weeks ago we noted the IMF's upward revision to its 2011 world growth forecast from 4.25% to 4.5%. A lot of attention was also paid two weeks ago to the monthly global Purchasing Managers Index for the manufacturing sector put together by JP Morgan. The index has risen strongly and as the graph here shows there is a good correlation between this sentiment reading of manufacturers and what happens with global industrial output – and therefore demand for raw materials.

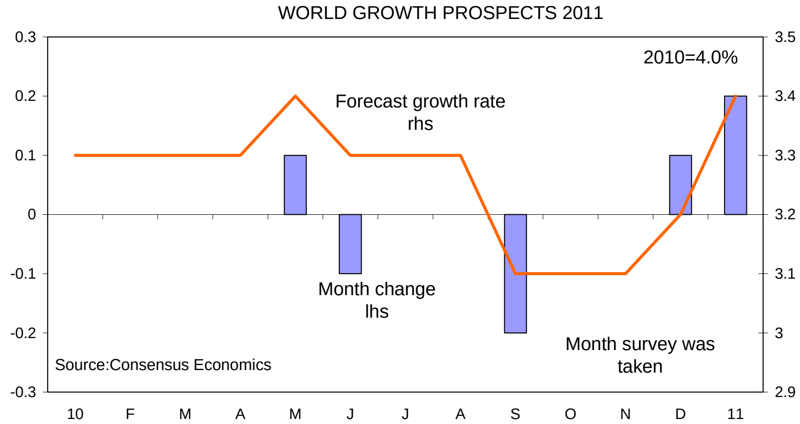


http://www.ism.ws/files/ISMReport/JPMorgan/JPMorganMfg020111.pdf

We have also seen a fresh turn upward in the monthly leading index calculated by the OECD.



And the world growth forecast contained in the monthly Consensus Economics survey of economists around the world moved up by 0.2% in January to reach 3.4%. When the February results come out any day we are likely to see a further jump in this particular measure.



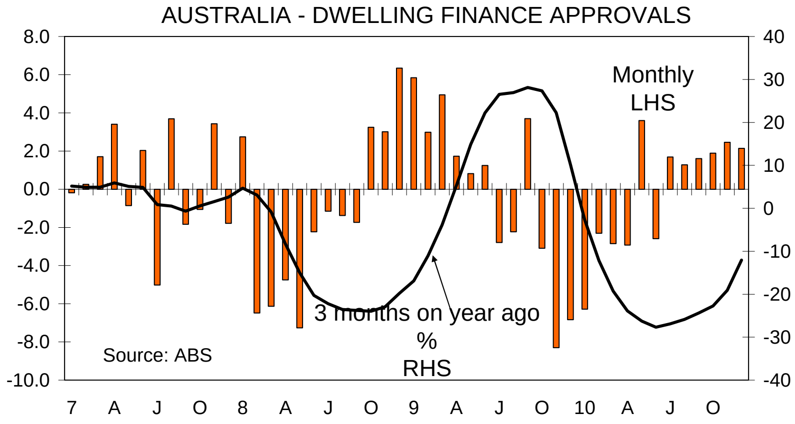
This week OPEC revised upward their forecasts for growth in global oil demand to 1.62% from the earlier 1.23%. They cited cold weather as a factor but also “sturdier industrial activity within the US and China, ignited by stimulus plans and government incentives, boosted demand.”

Australian Growth

Australia delivers 24% of our merchandise export receipts, 45% of our tourists, owns almost all our banking sector and 51% of FDI, contains over 600,000 Kiwis and acts as a back-up labour market for most of us. What happens there matters to us so we shall monitor their growth here. The Aussie economy is growing strongly on a mining and infrastructure boom bringing us competitiveness advantages in tourism and manufacturing as the AUD soars but will drain our skilled labour base. There is an opportunity to entice manufacturers here. Jobs growth is averaging over 30,000 a month and at what point does this do four things – spur currently weak retail spending, spur appallingly low house construction, drive wage inflation, and spur higher non-mining business investment to boost productivity. The first three feed-throughs will accelerate monetary policy tightening and lower the NZD/AUD exchange rate further. If job growth accelerates migration outflows from NZ to Australia will soar even more than seems certain over 2011-12.

What’s new?

There were some positive numbers received on the state of the housing market in Australian this week in the form of the monthly housing finance numbers improving. There was a seasonally adjusted rise of 2.1% in the number of home loans approved in December making six months in a row of increases. Compared with a year ago approvals were still down by 12% in the December quarter but the trend is looking more solidly upward now. Excluding simply refinancing existing loans approvals were ahead 4.9% in the December quarter from the September quarter which was the strongest rate of increase since the middle of 2009.



Other indicators on the Australian housing market are still decidedly muted but with a large housing shortage but a strong jobs market it is likely construction will be recovering soon – over and above the boost to come from rebuilding after the Queensland floods. And with a home mortgage war having just broken out between the big Australian banks the chances of firming construction have lifted.

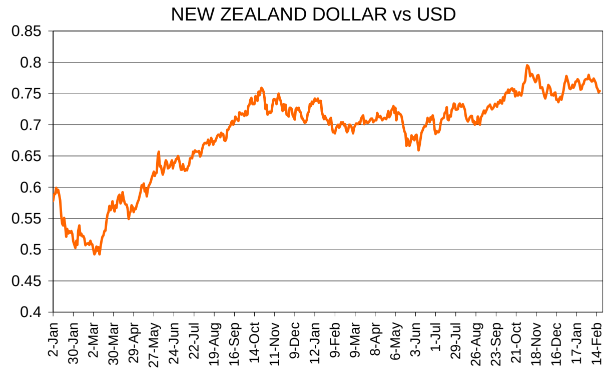
Exchange Rates

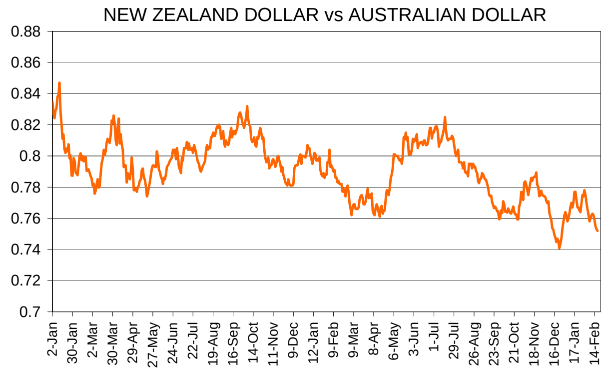
Exchange Rates	This Week	Week Ago	4 wks ago	3 mths ago	Yr ago	Consensus Frcsts yr ago*	10 yr average
NZD/USD	0.754	0.771	0.769	0.768	0.704	0.690	0.629
NZD/AUD	0.752	0.763	0.777	0.786	0.782	0.772	0.855
NZD/JPY	63.100	63.500	63.900	64.030	63.6	66.999	68.4
NZD/GBP	0.469	0.479	0.485	0.484	0.447	0.426	0.368
NZD/EUR	0.556	0.562	0.576	0.570	0.511	0.495	0.511
NZDCNY	4.967	5.080	5.073	5.099	4.810		4.83
USD/JPY	83.687	82.361	83.095	83.351	90.341	97.100	109.9
USD/GBP	1.608	1.610	1.586	1.589	1.575	1.620	1.705
USD/EUR	1.356	1.372	1.335	1.349	1.378	1.394	1.229
AUD/USD	1.00	1.01	0.99	0.98	0.90	0.894	0.737

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

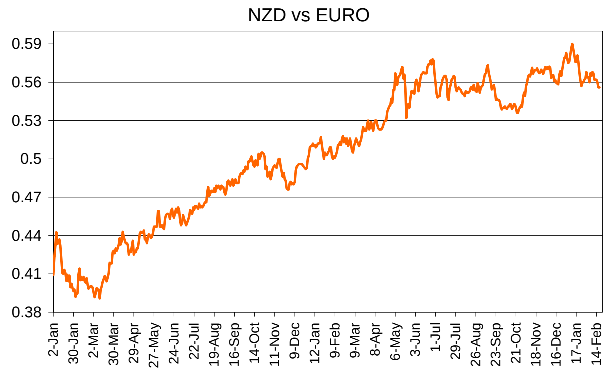
Kiwi Goes Back Down

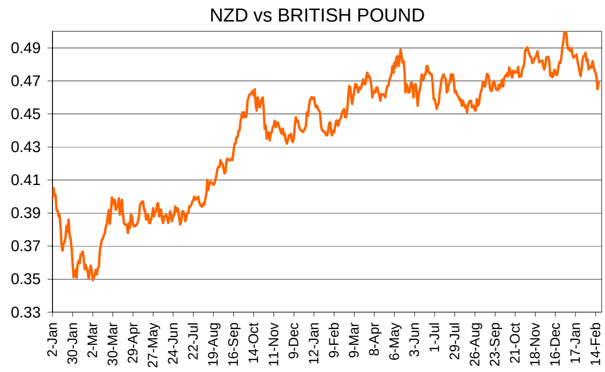
The Kiwi dollar has shed almost two cents against the greenback this week pushed lower principally by weakness in our currency rather than strength in the greenback. One factor pushing the NZD down was the weak retailing report which showed spending falling another 0.4% during the December quarter. This and other indicators show that householders remain tightly focussed on repaying debt rather than spending and with some two-thirds of spending in the economy coming from the household sector this is suggestive of muted growth in the economy if it continues. Or at least it suggests a low starting point for the good growth we expect will come and that means spare capacity which helps to suppress inflation as growth accelerates and hopefully continues.



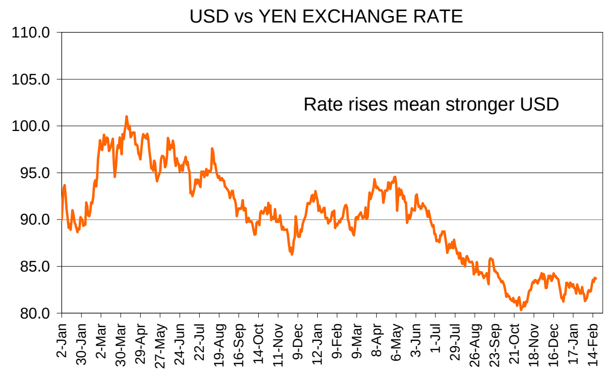


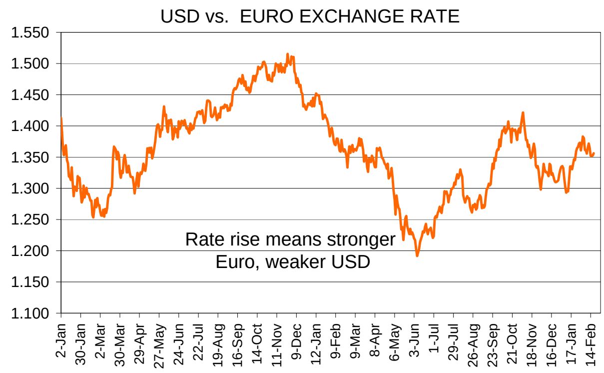
There was little impact on the NZD from another 3%+ rise in dairy prices at Fonterra's fortnightly auction even though as a commodity currency rising prices are clearly supportive of the NZD's level against other currencies on average.



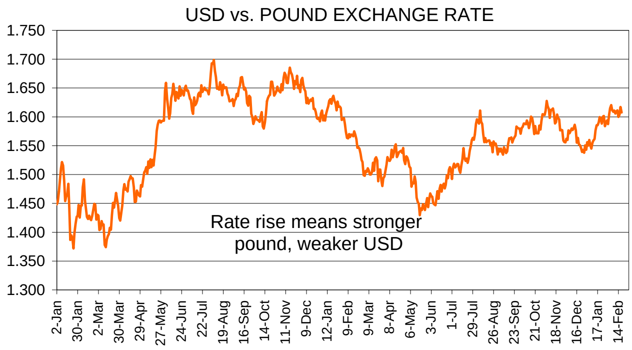


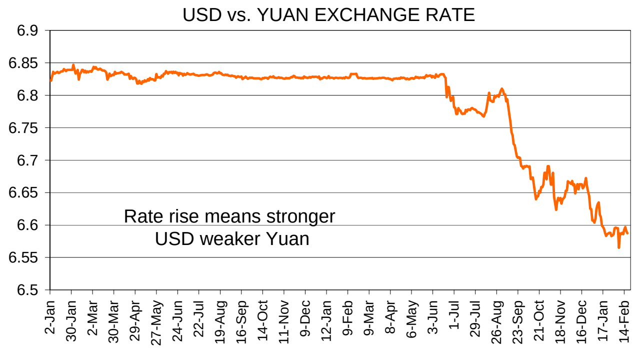
With regard to other currencies the British pound strengthened quite a bit in the middle of this week after inflation numbers for January came in much higher than expected. Inflation is now 4% and the markets have increased their pricing in of Bank of England monetary policy tightening this year. Yet at the same time as inflation in the UK has lifted and the Bank of England has predicted it will stay above the 2% level until 2013 data just released show the economy shrank by 0.5% in the December quarter after growth of 0.7% in the September quarter. Plus the Bank of England minutes released last night were less hawkish than expected so the pound is back largely where it was a week ago against the USD.





The euro suffered a near two cent drop against the greenback this week due to increased worries about Portugal and the ability of a German bank to stay in business.





Yet at the end of it all the exchange rates remain well within their recent trading ranges.

ECONOMIC DATA

All %		Latest qtr only	Previous qtr only	Latest year	Year ago	2 Yrs ago
Inflation	RBNZ target is 1% - 3% on average	2.3%	1.2	4.0	2.0	3.4
GDP growth	Average past 10 years = 2.6%	-0.2	0.1	+1.4	-2.5	1.5
Unemployment rate	Average past 10 years = 4.8%	6.8	6.6	......	7.0	4.6
Jobs growth	Average past 10 years = 1.9%	-0.5	1.1	1.3	-2.4	1.0
Current a/c deficit	Average past 10 years = 5.5% of GDP	3.1	3.0	......	3.2	8.6
Terms of Trade		3.0	2.0	17.9	-14.1	5.8
Wages Growth	Stats NZ analytical series	0.4	0.8	2.7	5.4	5.0
Retail Sales ex-auto	Average past 9 years = 3.9%.	0.9	0.9	1.9	-0.9	0.4
House Prices	REINZ Stratified Index	0.0	-1.2	-2.3	6.0	-7.9
Net migration gain	Av. gain past 10 years = 13,900	+10,451	13,914yr	......	22,253	3,814
Tourism – an. av grth	10 year average growth = 3.2%. Stats NZ	2.8	3.9	2.8	-0.0	-0.3
Consumer Conf.	Neutral = 100 Westpac McDermott Miller	108.3	114.1		116.9	101.3
		Latest year rate	Prev mth year rate	6 mths ago	Year ago	2 yrs ago
Business confidence	BNZ survey	22	18	-1.4	36.8	-14.7
Household debt	10 year average growth = 10.3%. RBNZ	1.6	1.8	2.6	2.9	4.3
Dwelling sales	10 year average growth = 2.5%. REINZ	-11.3	-15.2	-24.3	15.2	-23.1
Floating Mort. Rate	(TotalMoney) 10 year average = 7.9%*	6.09	5.84	5.59	5.85	10.49
3 yr fixed hsg rate	10 year average = 7.8%	7.15	7.30	7.95	7.45	9.09

ECONOMIC FORECASTS

Forecasts at Jan. 27 2011	**March Years**					**December Years**				
	2009	2010	2011	2012	2013	2008	2009	2010	2011	2012
GDP - annual average % change										
Private Consumption	-1.1	0.4	1.5	1.5	1.4	-0.3	-0.7	1.9	1.2	1.5
Government Consumption	4.2	0.2	1.9	1.4	0.9	5	0.6	2.1	1.1	1.2
Investment	-7.2	-9.5	4	5.4	6.8	-4.3	-10.1	1.1	4.4	7.5
GNE	-1.4	-3.6	3	3.5	2.5	0.3	-4.9	3	2.9	3.1
Exports	-3.5	4.6	1.8	5.3	2.2	-1.7	1.7	2.8	4.5	2.8
Imports	-4.4	-9.4	6.5	3.6	4.6	2.1	-14.6	7.5	2.9	5
GDP	-1.5	-0.5	1.3	4	1.7	-0.2	-1.7	1.4	3.2	2.3
Inflation – Consumers Price Index	3	2	4.3	2.7	2.6	3.4	2	4	2.6	2.6
Employment	0.7	-0.1	1.5	2.6	0.9	0.9	-2.4	1.3	2.9	0.7
Unemployment Rate %	5.1	6	6.3	5.4	5.6	4.6	7.1	6.8	5.4	5.6
Wages	5.1	1.6	3	3.8	4.6	5	3.1	1.9	3.4	4.6
Currently reasonable exchange rate ASSUMPTIONS										
NZD/USD	0.53	0.7	0.78	0.74	0.64	0.56	0.72	0.75	0.76	0.67
USD/JPY	98	91	85	89	85	91	90	83	88	86
EUR/USD	1.31	1.36	1.35	1.39	1.34	1.34	1.46	1.32	1.38	1.36
NZD/AUD	0.8	0.77	0.76	0.8	0.82	0.83	0.79	0.76	0.8	0.82
NZD/GBP	0.37	0.47	0.49	0.44	0.39	0.37	0.44	0.48	0.46	0.4
NZD/EUR	0.41	0.52	0.57	0.53	0.48	0.41	0.49	0.57	0.55	0.49
NZD/YEN	51.8	63.7	65.9	65.9	54.4	50.9	64.2	62.6	66.9	57.6
TWI	53.8	65.1	69.4	67.3	60.9	55.1	64.7	67.8	68.7	62.8
Official Cash Rate	3	2.5	3	4.75	4.75	5	2.5	3	4.25	5
90 Day Bank Bill Rate	3.24	2.67	3.2	5.12	4.95	5.23	2.78	3.17	4.62	5.2
10 year Govt. Bond	4.77	5.86	5.75	6.5	6.5	4.88	6.02	5.82	6.5	6.5

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

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

*extrapolated back in time as TotalMoney started in 2007