BNZ Weekly Overview

26 May 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.

Factors Add Up To A Rising NZD

This week I've been meeting people in both Ireland and London and the picture one receives is of two economies still struggling – one with a weak housing market, high unemployment, high government debt, fiscal restraint slowing growth, depressed consumer sentiment, banks unwilling to lend and many businesses unwilling to borrow - and the other place is Irish. The big differences lie in Ireland's unemployment rate being twice the UK's at about 15%, the extent of pullback in housing construction and remaining housing over-supply being phenomenally greater in Ireland than in the UK, and the fiscal impact of bank bailouts being much greater in the Emerald Isles.

You can read more about the Irish economy and some observations from walking around Dublin at this link. http://tonyalexander.co.nz/occasional-papers/

This week in New Zealand we have not learnt anything really new with regard to how the economy has been functioning, where it is likely to go and at what speed, and how quickly the inflation risk will rise and therefore interest rates go up – except with regard to inflation expectations. A quarterly survey undertaken by the Reserve Bank has found a lift in expectations for where inflation will be in two years time to 3% from 2.6% in the previous quarter. One might discount this result to some extent because headline inflation is at 4.5% courtesy substantially of the boost to GST. But that argument would apply almost equally for the 4% inflation rate in place at the time of the previous survey.

The piece of data is not a major indicator but it does serve as a reminder that every uplift in the rate of economic growth not driven by a productivity surge brings a rise in inflation and a rise in interest rates. For the moment the markets remain relatively sanguine about that risk, as evidenced by medium to long term borrowing costs not trending upward in recent times. But at some point market attention will turn to upside inflation risks and the thing to watch then will be the extent to which the many borrowers sitting on a floating rate at the moment act quickly to lock in a fixed rate.

Apart from that the situation in New Zealand remains one of weak growth for the past year as householders and farmers have concentrated on repaying debt and the economy and our sentiment has been hit by a wide range of shocks from weather events to tectonic ones to a high currency and finance company issues. But looking ahead for the next two years as we see some rather large stimulatory factors coming into play.

The obvious one is rebuilding of Christchurch. Another big factor will be the inevitable feed-through of higher farm incomes into farm capital spending and consumption. Then there is the strengthening labour market which when it delivers faster wages growth and higher job security will spur a period of catch-up retail spending. That in turn will spur a period of catch-up business capital spending including inventory rebuilding. These positive factors will easily offset restraint on growth from tightening fiscal policy and the eventual tightening of monetary policy, rising cost of living (including rents), and rising materials and energy prices – not to mention rates and insurance.

But along the way there is likely to be some high volatility and restraint in our willingness to spend and invest occasioned by fluctuations in commodity prices and what could easily be very negative or very positive news from offshore. Candidates for up and/or down shocks include the still developing European sovereign debt crisis, the still flat US housing market, the oil market, and rising inflationary pressures in China which may or may not be successfully combated without the People's Bank of China having to force growth to a very low level – if they can.

Oh – and the story for the next two years remains one of not just eventually rising NZ interest rates but of a strong currency. That is the feedback I have received from visits with various specialists in London who are looking at the feed-through of eventually higher farmer spending, the impact of the monetary policy tightening cycle when it kicks off, cross flows out of the Aussie dollar into the NZD, and strong commodity prices. Plus yesterday's news regarding Chinese possibly investing some $6bn in NZ is clearly currency positive and has already helped push the NZD above US 81 cents this morning.

I shall get time in the coming week to write some comments regarding what I have learnt in the UK over the past five days and will post them on my website whilst in Hong Kong.

This week the following material has been added to www.tonyalexander.co.nz

NZ Labour Market - May http://tonyalexander.co.nz/nz-labour-market/

This week we have added our monthly overview of the state of New Zealand's labour market. Things are tightening up and businesses need to increase their preparations for staff shortages and rising wage and non-wage labour costs.

On The Road 2 http://tonyalexander.co.nz/occasional-papers/

This is the second paper reporting on what I am finding in terms of things economic and touristic while overseas for a few weeks. This one looks at the Irish economy and gives my impressions of Dublin. Worth a visit of course, but get to the countryside to get a real feel for the place.

Businesses Find Success Cutting Costs http://tonyalexander.co.nz/occasional-papers/

In this paper you will find the results of the special question we added to our monthly BNZ Confidence Survey run earlier this month. Businesses have found that they have assisted themselves through the recent tough period by cutting costs and boosting productivity, but also by focussing more precisely on customer needs, investing in IT, better targeting their marketing etc.

Other Website Material

- **Situation and Outlook for the NZ Economy** – eight pages of snippets and outlooks for specific variables and sectors. Updated early each month. http://tonyalexander.co.nz/nz-outlook/
- **Weekly syndicated newspaper column** http://tonyalexander.co.nz/newspaper-column/
- **State of the NZ Labour Market** Updated mid-month. http://tonyalexander.co.nz/nz-labour-market/

- **BNZ-REINZ Market Survey** Released second week of each month. http://tonyalexander.co.nz/bnz-reinz-survey/
- **Real Estate Overview** Updated mid-late each month. http://tonyalexander.co.nz/bnz-reinz-survey/
- **Archived Weekly Overviews** www.bnz.co.nz/tonyalexander

Is Our Economy Getting Better or Worse?

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

This week we have learnt that tourist numbers bounced up in April. But this followed a disastrous March and the underlying trend is down.

Are householders opening their wallets more?

Nothing new this week sorry. The latest Electronic Card Transactions data suggest strong retail spending growth. But the numbers disagree with the anecdotes in our monthly BNZ Confidence Survey so we remain cautious. In the housing market seasonally adjusted turnover is improving, led by Auckland, but there is yet no trend improvement in the issuance of consents for new dwellings to be built. We also continue to see weakness in car registrations though the data there may be distorted downward by the Japanese earthquake.

Is business output rising?

A few more tourists came our way in April – but you'd be wanting to treat these numbers with a grain of salt for the moment because of the impact of the earthquake. In April the number of people coming to NZ for a look around was ahead 5.2% from a year ago. That sounds good and could mean either that April was strong this year, or that it was very weak last year. Rule number one when you look at these month on month a year ago numbers is to realise they tell you as much about the month a year earlier as of the month this year.

For a better feel for whether that increase is actually good one needs to look at data adjusted for seasonal patterns. Doing that we see that in April the s.a. number of short-term visitors was up 8.2%. Again that sounds good. But this number either says April was very strong or March was very weak. In fact in March s.a. visitor numbers fell 8% from February, and in February they fell 4% from March.

So you'd need to be wearing some really silly rose-tinted glasses to look at the April tourism numbers and conclude its all okay with the NZ tourism sector. No, its not okay.

Over the three months to April visitor numbers were down 5.6% from the three months to January seasonally adjusted. Sorry if the language here looks a bit more liberal than usual. Its Sunday morning and I'm currently sitting in the large waiting area of Terminal 2 at Dublin Airport ahead of a flight to London. I've learnt to ask always for a double shot coffee overseas and the stuff is kicking in. But I've two hours to go before boarding, so why so early out here? Partly it is to avoid any security hassles of unknown magnitude which may be associated with preparations for President Obama's visit tomorrow (Monday 23). There are Garda (Irish police) literally everywhere on the road into the airport and in the city. They are all however acting completely differently from what one sees similar people doing in the United States. They are smiling like Cheshire cats thinking not only of the over-time they are pulling for Obama's visit but the hours they've already scored for the Queen's visit earlier in the week. Not that they are taking the visit lightly. A few days ago some high profile Irish radical Islamist convert said on TV that if he had the chance he would assassinate the US President. Apparently he's locked out of the sunshine somewhere for a while now.

Plus today there is a state funeral for a former important Irish leader and extra streets on top of those already closed off for the US President's visit will be closed off. And to top it all off there is yet another volcano blowing its head in Iceland and while the ash forecast is that European air space will be fine for 24 hours it is best just to be in the right place at the right time ready to move at a moment's notice. Plus, evening's may be one thing in Dublin, but Sunday morning is like Wellington used to be of a weekend morning three decades ago. Closed. You'll only find a coffee at 7.30am at either McDonalds or one of the upmarket hotels. I chose the latter.

Anyway, back to the tourism. I have seen one advertisement over here on a sports channel related to the Rugby World Cup. But it was not for tickets to it, simply asking people to buy stuff from a licensed seller of memorabilia. You know, like making sure you buy an authentic pink plastic tiki and not an imitation one. The ad was on the TV just after the Warriors secured their fifth win in a row. Beware imitation plastic.

Are businesses hiring more people?
To view our latest monthly NZ Labour Market report click here. http://tonyalexander.co.nz/nz-labour-market/

Nothing new.

Are businesses boosting their capital spending?
To see how businesses are feeling right now one can read our monthly BNZ Confidence Survey here. http://tonyalexander.co.nz/bnz-confidence-survey/

And again nothing new. Recent data on imports of capital equipment have been weakening, and although we are experiencing growth in the number of businesses signing up to loan deals they are reluctant to draw the funds down. One suspects that in the business sector although confidence about where the economy will be in a year's time is high, businesses won't commit to higher investment until they see the whites of the eyes of customers coming through their doors for a few months in a row. That sounds like a wise choice given the false start we saw to the economic recovery over 2009-10 and the many uncertainties which still sit out there for the moment.

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 December. Have we learnt anything this week which alters this outlook?

We have not received any useful new information on the state of resource availability in the economy over the past month or of resource uptake – except maybe the migration numbers. For the second month in a row there was a seasonally adjusted fall in net migration-induced population change. But the decline was only 100 which followed a 510 fall in March and we think the data were biased downward by a post-earthquake quit New Zealand effect. Still, annual net migration gains are now running below average and likely to stay that way for the coming year at least and that means some extra rapid tightening up of the labour market which implies extra wages and non-wage labour cost pressure over 2012 – 13.

Other Inflation Influencers

As noted above we saw an inflation expectations measure rise this week – to a 20 year high. That reminds us all that the inflation risk is present in the economy and eventually a monetary policy response will be required. But it pays to remember that the Kiwi dollar is strong and this rise is doing part of the Reserve Bank's job for it. Keep an eye on the Auckland housing market in coming months. That has potential to generate increasing inflation discussion as the imbalance at current prices between demand and supply eventually produces rising prices on average.

Rate Movements This Week

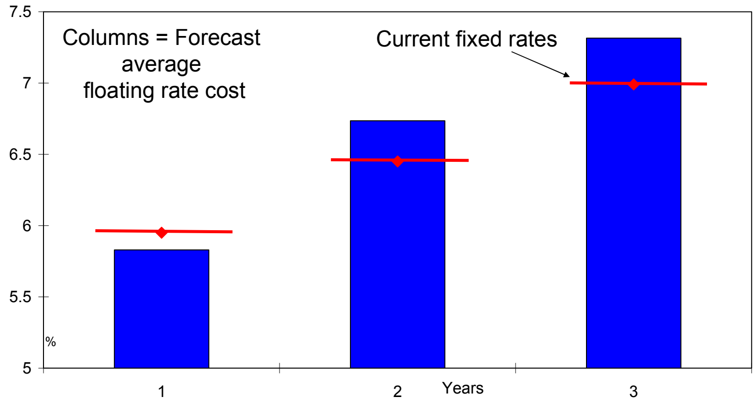
Nothing of import frankly as all and sundry see monetary policy as largely on hold for almost all of this year and no big rate movements have happened overseas as inflation risks get played off against low debt demand. But watch for inflation risks shifting to the upside as the year advances and interest rates creeping up as the markets factor in more tightening than they are currently allowing for.

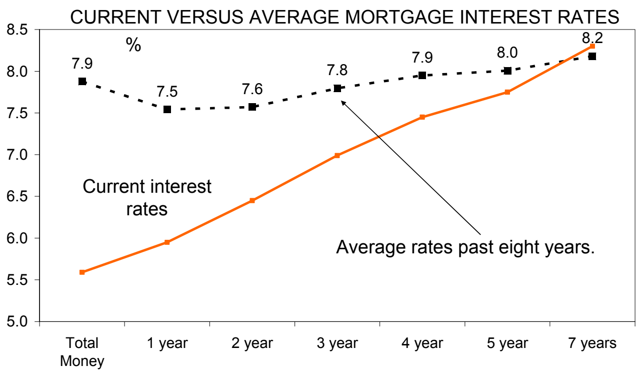
FINANCIAL MARKETS DATA	This week	Week ago	4 wks ago	3 months ago	Yr ago	10 yr average
Official Cash Rate	2.50%	2.50	2.50	3.00	2.50	5.9
90-day bank bill	2.68%	2.68	2.68	3.00	2.94	6.2
1 year swap	2.88%	2.85	2.90	3.05	3.64	6.3
5 year swap	4.49%	4.48	4.71	4.62	5.25	6.6
180-day term depo	4.50%	4.50	4.60	4.10	4.80	6.0
Five year term depo	6.00%	6.00	6.00	6.50	6.75	6.5

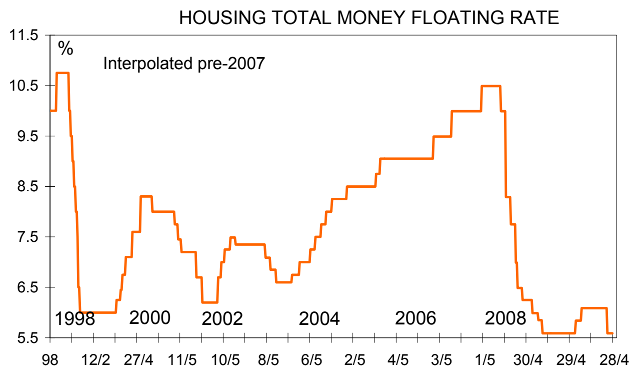
If I Were a Borrower What Would I Do?

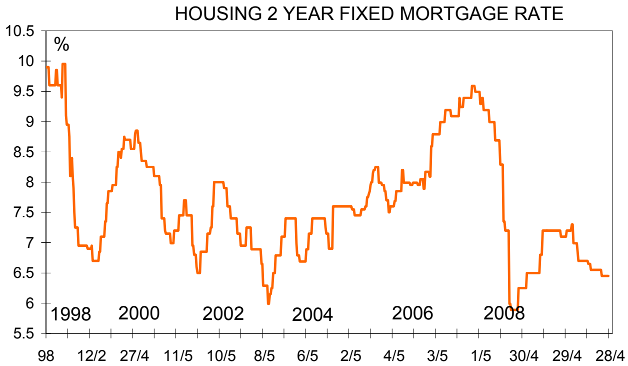
For the moment inflationary pressures in the NZ economy remain weak and long term borrowing costs are being held down by worries offshore causing investors to still favour (low yielding) fixed interest investments. At some stage this situation will change and as a borrower I would want to switch some of my housing debt from floating to fixed. But we are not at that point yet so I would be happy to stay floating – though keeping an eye open in case I could get a nice low rate in the two or three year period. For instance I would fix two years at the moment if I could get a rate of 6%, or fix three years at 6.25%.

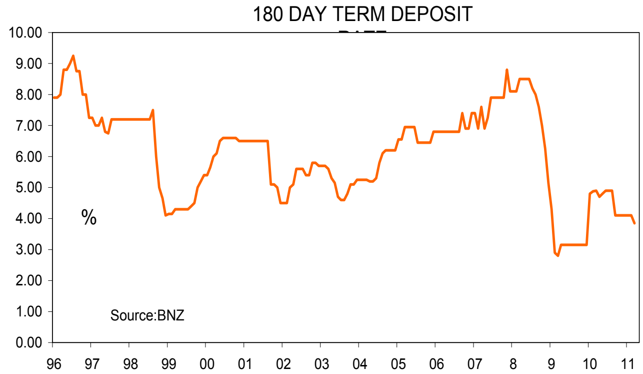
In London this week a Kiwi ex-pat wondered if they should break their 6.6% fixed rate which ends early in 2013 to go floating or lock in something else. I said I would simply stick with it and not try to be too clever about my interest rate risk management in an environment where it is guaranteed that our interest rate view will change from where it is currently.











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

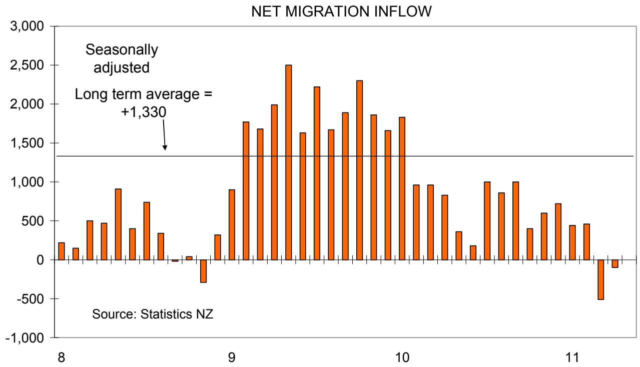
Look at the 180 day area planning to ride these short rates up over 2012 – 13 before locking into a longer term sometime in that period. Nice in theory.

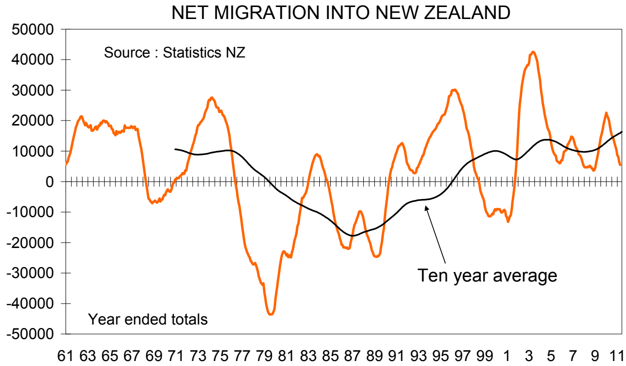
HOUSING MARKET UPDATE

To view the most recent results of our monthly BNZ-REINZ Market Survey and read our monthly Real Estate Overview click here. http://tonyalexander.co.nz/bnz-reinz-survey/

Migration A Negative Factor

Migration flows matter for the housing market and this week we learnt that following a large seasonally adjusted net outflow of people in March of 510 there was a lesser net loss of 100 in April. What this tells us is that following the understandable knee jerk response to the earthquake late in February the numbers are probably on the path to settling back down again with small net gains likely to be recorded over coming months – but with the annual net gain falling further from 5,500 achieved in the year to April.





On average over the past decade there has been a net migration gain for the NZ population of about 15,000 people. Therefore we are in the midst of a below average population growth period and this will tend to take some of the heat out of the housing market. But one should note that the migration assumption upon which we have built our estimate of a 40,000 housing shortage is 10,000 per annum which implies a need for some 25,000 dwelling consents at least to be issued each year – and we are running near 14,500. So the fundamental shortage of housing continues to grow and that has obvious implications for rents and prices.

At the functions I have spoken at in London this week there were quite a few Kiwis either with a housing asset in New Zealand or thinking about buying one as an investment or because they are going to return soon. Their trouble however is the near three decade low for the British pound against the NZ dollar and the high chance the pound weakens even further. The lump sum they had planned brining back to NZ is now not so great and this may help explain why over the past year the number of people migrating to NZ from the United Kingdom has fallen by 14% from 16,497 to 14,173. Numbers coming from China have lifted 10% from 5,992 to 6,600, and from India by 11% from 6,597 to 7,316. Numbers coming from Australia are largely unchanged at 15,575 from 15,642 a year ago.

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. Auckland leading the country, the regions lagging. More buyers entering the real estate market.

MAJOR OFFSHORE ISSUES

European Debt

Worries remain high about Greece and during the week Fitch Credit Ratings cut their assessment for Greece by three notches and Standard and Poors placed Italy on negative credit watch. Fitch also placed Belgium on negative watch and the Spanish government fared poorly in local elections over the weekend.

These actions have heightened worries about the debt crisis affecting peripheral European economies. Much as the European central bank repeatedly rules out any chance of a debt restructuring the strong consensus view in the marketplace is that a restructuring is inevitable and it is only a matter of time before it happens. Perhaps it is partly because of this seeming inevitability that the Greek authorities are not moving as rapidly on reform of their economy as the bodies who have bailed them out would like.

Another factor causing a rise in market concern during the week was a threat by the ECB to cut off the flow of emergency credit to Greek banks.

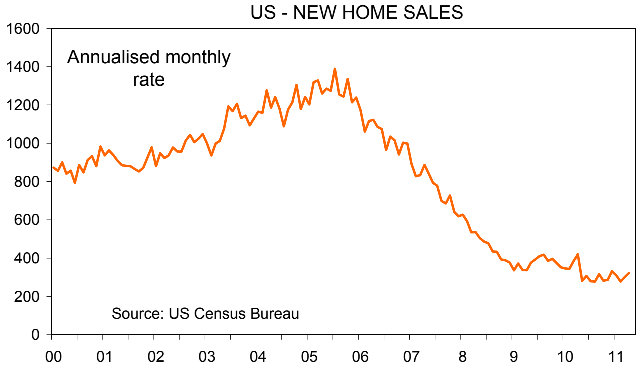
I shall be writing some comments regarding the European debt situation in the coming week to be placed on my website. Finishing this issue of the Weekly Overview off at 1.30am your time in NZ is not leaving enough time to collect and jot down those thoughts at the moment.

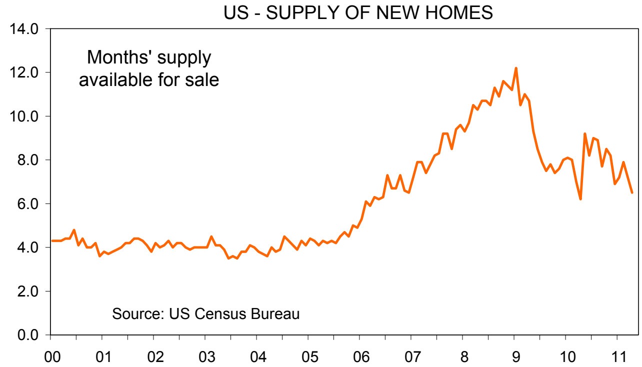
Chinese Inflation

No economic data releases have appeared this week to challenge the view that growth is strong, inflationary, and not slowing rapidly enough to avoid further tightening of monetary policy.

US Growth Momentum

We had the release of another set of figures this week showing that the US housing market is perhaps showing signs of recovery in one sense – though when it comes to prices derived in other series the news still remains poor. New home sales rose in April by a seasonally adjusted 7.3% after rising 8.3% in March. But as the first graph below shows the level of activity is still extremely low and not at all trending up. Plus the month’s worth of unsold homes remains highish though with a downward trend evident.





Australian Growth

No time to write anything here. Maybe next week.

Exchange Rates

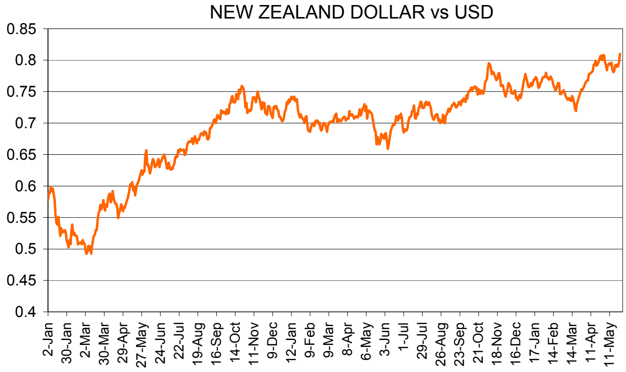
Exchange Rates	This Week	Week Ago	4 wks ago	3 mths ago	Yr ago	Consensus Frcsts yr ago*	10 yr average
NZD/USD	0.810	0.792	0.801	0.748	0.666	0.689	0.629
NZD/AUD	0.764	0.742	0.746	0.743	0.812	0.773	0.855
NZD/JPY	65.800	64.600	65.300	61.200	60	67.7	68.4
NZD/GBP	0.495	0.489	0.485	0.464	0.463	0.448	0.368
NZD/EUR	0.571	0.554	0.548	0.542	0.54	0.52	0.511
NZDCNY	5.259	5.150	5.224	4.923	4.549		4.83
USD/JPY	81.235	81.566	81.523	81.818	90.090	98.3	109.9
USD/GBP	1.636	1.620	1.652	1.612	1.438	1.54	1.705
USD/EUR	1.419	1.430	1.462	1.380	1.233	1.33	1.229
AUD/USD	1.06	1.07	1.07	1.01	0.82	0.891	0.737

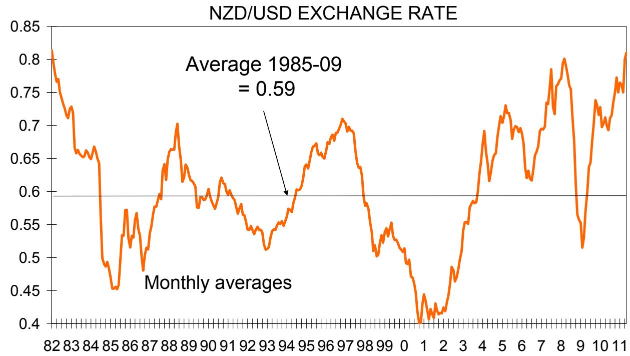
*Sourced from Consensus Economics. http://www.consensuseconomics.com/

Kiwi Dollar Soars On China News

The Kiwi dollar has risen to a three year high against the USD overnight of just above 81 cents on the back of
-the stronger than expected payout numbers delivered during the week by Fonterra,
-a rise in inflation expectations raising a few doubts in some minds about the sanguine pace of monetary policy tightening the markets have factored in,
-some easing off of concerns about the European debt situation and recovering equity markets, and
-the rumour that the large Chinese sovereign investment fund has plans to invest up to $6bn in NZ assets.

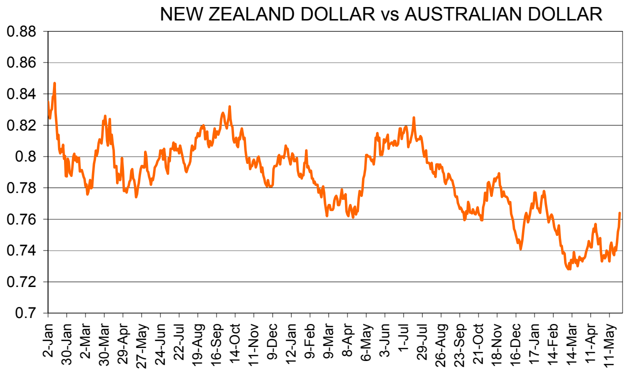
That last factor was the straw that broke the back as it were and as noted in the introductory section of the WO, what I have found in London is that attitudes are fairly positive toward the NZD and the pundits involved are simply thinking in terms of when is the optimal time in coming months to establish a long position they anticipate holding for quite some time.

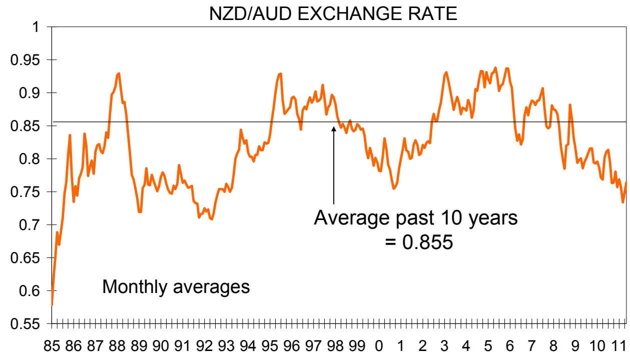




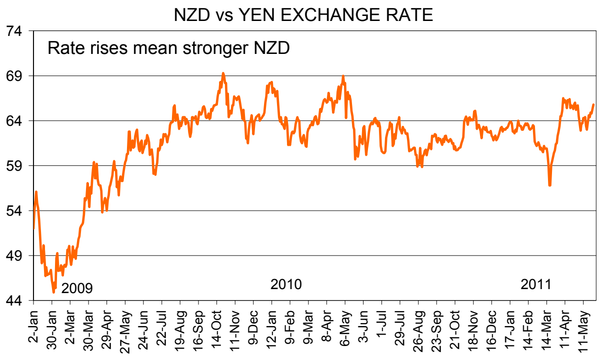
Our long expressed view has been that there are strong upside risks for the NZD associated with support from commodity prices, accelerating economic growth (one day), tightening monetary policy, and a downwardly trending greenback. Our view remains that a rise in the NZD to US 85 cents is highly likely, and for all you poor ex-pat Kiwis in London reading this let me repeat what I said last night at a function and also the night before at NZ House. The chances are that the NZD will not only consolidate soon above 50 pence but head toward 55 at a stretch – though not necessarily this year.

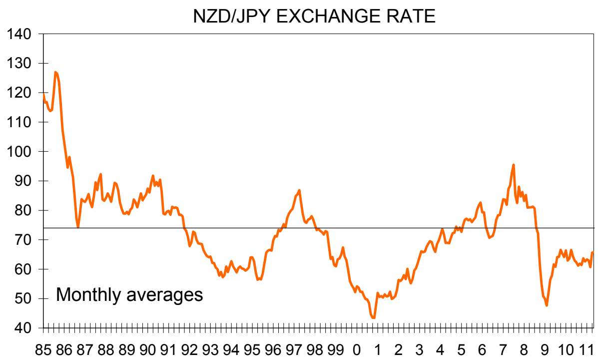
The flow of funds into the Kiwi dollar (which will strengthen once Japanese confidence returns and the carry trade kicks off) has also pushed us to a three month high against the Aussie dollar near 76.4 cents from 74.2 a week ago.

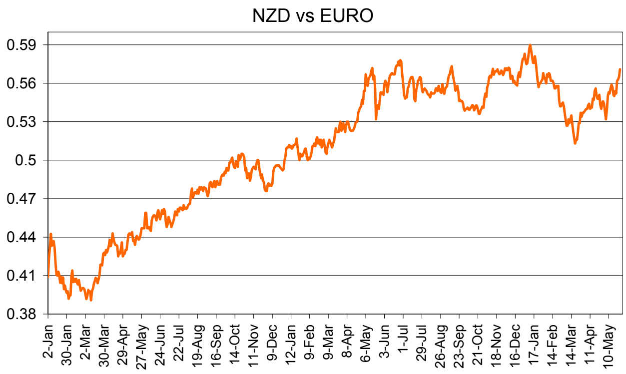


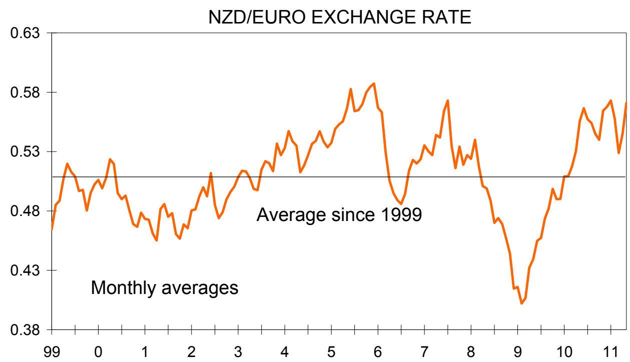


The NZD has also risen slightly against the Japanese yen to near 65.8 from 64.6, against the euro to 57.1 cents from 55.4, and against the British pound to near 49.5 from 48.9.





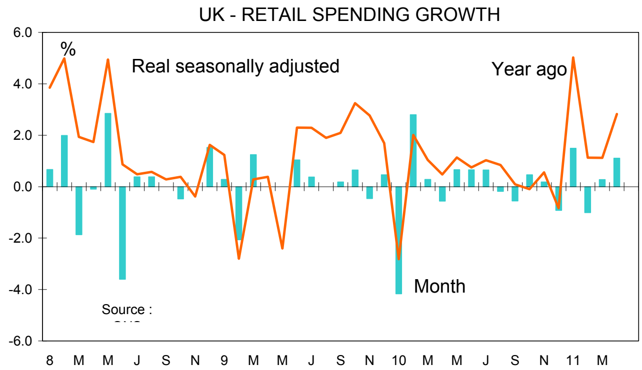




The other main theme running through the FX markets at the moment is selling of the euro in response to generalised worries about the sovereign debt crisis. Specifically there are increasing doubts about the commitment of the Socialist Greek government to taking the steps demanded by the IMF and their euro partners in exchange for the bailout they are delivering. There is increasing talk of some form of default, interest rates for peripheral country debt are rising again, and investors are generally quite nervous when they hear threats from the European Central Bank to withdraw from providing liquidity to Greek banks.

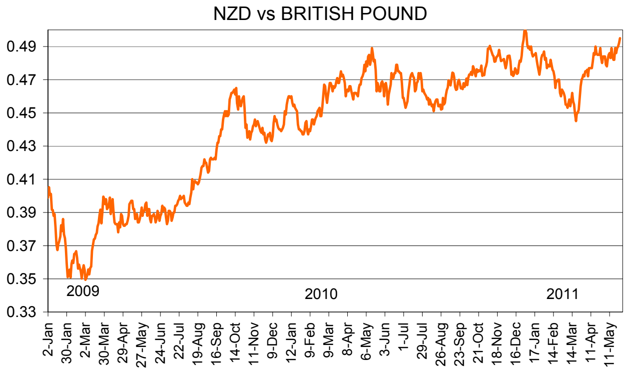
United Kingdom

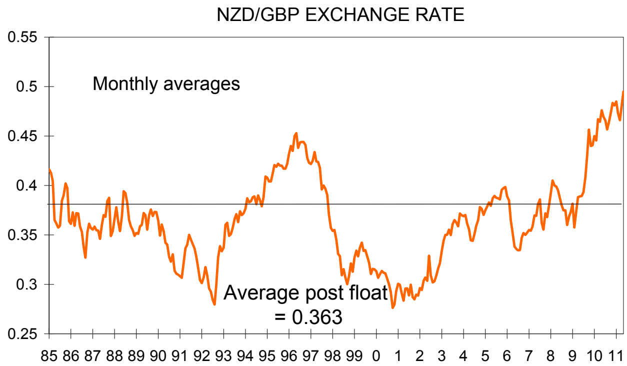
There was some support for the pound this week from retail spending numbers for April which came in stronger than expected, showing a 1.1% rise for the month and 2.8% gain from a year ago. But the timing of Easter may have distorted the data and the change from a year ago is still very low so concluding that consumer spending is on a firm upward track based on one month's result would be a bit too optimistic.



In fact the rest of the news regarding the UK over the week was largely on the not so good side. Moodys announced that they are putting UK banks on negative credit watch, and the government's monthly accounts showed a deficit in April of £10bn rather than the £6bn expected. Basically, one struggles as yet to find reason for expecting strength in the pound in the near future, hence unless we see a commodity price collapse the chances are that the NZD will soon be consolidating above 50 pence – which was not at all the news which people wanted to hear at two evening talks I gave in London this week.

The level of interest in what is happening back in New Zealand was immense and there are a large number of people who have residential property assets back in NZ and/or are planning to move back within the next couple of years, either for "retirement" of a sorts after many years spent offshore, or accepting downsizing of their incomes as the price for brining their children up in a better school system.





Exchange Rate Assumptions

The following table contains year end assumptions for exchange rates in 2011 and 2012. It also contains a column beside each rate for each year indicating where the risk lies – that the outcome will be higher than shown or lower.

	2010	2011	Risk	2012	Risk
Year end					
NZD/USD	0.73	0.75	Higher++	0.79	
NZD/AUD	0.74	0.77	Lower	0.86	
NZD/YEN	64.2	66		67.9	Lower
NZD/GBP	0.44	0.45	Higher	0.46	Lower
NZD/EUR	0.51	0.51	Higher	0.57	Lower
USD/JPY	88	88.0	Lower	85.9	Lower
GBP/USD	1.66	1.67		1.72	Higher
EUR/USD	1.43	1.47		1.39	Higher
AUD/USD	0.99	0.97	Higher++	0.92	Higher+

ECONOMIC DATA

All %		Latest qtr only	Previous qtr only	Latest year	Year ago	2 Yrs ago
Inflation	RBNZ target is 1% - 3% on average	0.8%	2.3	4.5	2.0	3.0
GDP growth	Average past 10 years = 2.6%	0.2	-0.2	+1.5	-2.1	-0.2
Unemployment rate	Average past 10 years = 4.8%	6.6	6.7	......	6.1	5.2
Jobs growth	Average past 10 years = 1.9%	1.4	-0/4	1.8	-0.1	0.6
Current a/c deficit	Average past 10 years = 5.5% of GDP	2.3	2.2	......	2.8	8.8
Terms of Trade		0.6	3.0	12.2	-8.2	1.8
Wages Growth	Stats NZ analytical series	0.6	1.0	3.6	2.5	5.2
Retail Sales ex-auto	Average past 9 years = 3.9%.	0.0	0.0	0.6	2.2	-3.7
House Prices	REINZ Stratified Index	-0.7	-0.5	-0.7	5.5	-7.2
Net migration gain	Av. gain past 10 years = 13,900	+6,554	10,451yr	......	20,973	7,482
Tourism – an. av grth	10 year average growth = 3.2%. Stats NZ	0.2	2.8	0.2	4.2	-3.9
		Latest year rate	Prev mth year rate	6 mths ago	Year ago	2 yrs ago
Business confidence	BNZ survey	42	14	28	34	27
Consumer confidence	ANZ-Roy Morgan 100=neutral	101	101	114	122	105
Household debt	10 year average growth = 10.3%. RBNZ	1.2	1.5	2.3	2.9	2.8
Dwelling sales	10 year average growth = 2.5%. REINZ	-4.2	-5.1	-35.9	-16.2	39.1
Floating Mort. Rate	(TotalMoney) 10 year average = 7.9%*	5.59	6.09	6.09	5.59	6.49
3 yr fixed hsg rate	10 year average = 7.8%	6.99	7.15	7.15	7.95	5.99

All actual data excluding interest & exchange rates sourced from Statistics NZ.
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Key Forecasts – to be updated next week.

Dec. year		2010	2011	2012	2013
GDP	annual average chg	1.4	1.5 - 2.0	3.5 - 4.0	3.5 - 4.0
CPI	on year ago	4.0	3.0 – 3.5	2.5 – 3.0	2.5 – 3.0
Official Cash rate	end year	3.0	2.5 - 2.75	4.0 – 5.0	4.0 - 5.0
Employment	on year ago	1.3	1.5 - 2.0	2.0 – 2.5	2.0 - 2.5
Unemployment Rate	end year	6.8	6.0 - 6.5	5.0 - 5.5	<5.0

*extrapolated back in time as TotalMoney started in 2007