BNZ Weekly Overview

9 June 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.

Third Time Lucky?

This week I am in Shanghai examining the way expanding uptake of China Union Pay card acceptance by NZ retailers will allow NZ's economy to capture more of the economic benefits from China's continuing strong growth. Because of the many appointments involved a shortened version of the Weekly Overview has been produced.

These are the early days of our rush to embrace the growth expected to wash over us all soon from rebuilding Christchurch and watching farmers spend their commodity boom largess. There is very little chance that the upswing will run in smooth manner and we should expect over the coming 12 months that signs of the expected boom will wax and wane, bringing ups and downs also in our interest rate expectations, the exchange rate, probably sentiment readings, and maybe even that only marginally relevant of NZ economic gauges, the sharemarket.

At this stage one struggles to find any evidence beyond the few noted in our BNZ Confidence Survey released this week that farmers are in fact increasing their spending. The anecdotes are diverse and generally cautious, and although a few people are looking at electronic card spending measures for insight into whether the regions are coming up the data cannot be relied upon.

With regard to Christchurch we remain still well away from the reconstruction phase. The CBD rebuild in fact may as well be stripped out from this economic cycle given the length of time it will take to get some damaged buildings out of the way, and what one suspects will be a major period of (legitimate) debate about what the part of Christchurch surrounding the cathedral will look like for the rest of this century. It may not even be the CBD as such which for now has largely relocated to the west.

If we step back from the two big coming growth drivers and look at the most up to date partial indicators of growth for the economy we see hope but not outright solidity. Yes sentiment is strong – just as it was last year before the economy stopped growing and almost went back into recession. Sentiment measures are useful but one would be unwise to base forecasts largely upon them. Real activity measures matter and that is what the Reserve Bank have stated quite clearly they will be looking at to gauge what to do with monetary policy, and why we have our special analysis section below.

So what do the latest measures show? In construction it is all bad news with the seasonally adjusted number of consents issued for new dwellings falling by 10.5% over the three months to April and non-residential consent values down from a year earlier.

In retailing we have only the Electronic Card Transaction data to use and we don't believe the numbers. The data show spending rising at the fastest pace since mid-2007 in the three months to April and while there would have been some post-earthquake restocking of things this pace of growth is not the reality retailers are seeing in their stores.

Hence the very explicit warning from Statistics NZ not to use the ECT measure as a proxy for retailing, and the seeming ridiculous decision therefore for them to drop the monthly retailing survey. We are left completely in the dark with regard to up to date short term measures of the largest component of economic activity in our economy – private consumption.

For merchandise exports the data are very very strong, but that is not the issue. The question is when will the farmers switch from the excellent practice of paying down debt and hopefully building cash reserves against the next (inevitable) commodity price crash, toward spending. We hope for some insight from this next week from the National Farm Fieldays in Hamilton though suspect the flow-through will not come until next year – which would be excellent from a financial strength point of view.

With regard to business investment we have no data in hand showing improvement outside some strength in commercial vehicle registrations. Imports of capital equipment have been falling and non-residential construction consents are weak.

And stimulus from government spending which would drive higher growth? Hardly. There is a necessary multi-year period of spending restraint and deficit reduction underway.

What our analysis shows us is that for the moment the economy's growth remains mild though it is almost certainly growing given the export sector strength and some benefit of the doubt to the strong card transaction numbers. But the guts of this week's opening article is this. The commentary you will generally be reading is not around the still mild data releases but the positive portents for the future. The hopes and dreams as it were. Now hopefully these hopes and dreams will be realised this time around and our forecasts are certainly for strong growth over 2012 and 2013 bringing fairly obvious housing market, labour market, inflation, interest rate and exchange rate implications.

But we have been here before. First in early-September 2008 when NZ confidence surged just before Lehmans collapsed and the global financial crisis got cranking. Second the period from late-2009 into mid-2010 when there were recoveries evident in housing and retailing, just before the debt attack really got going and we were hit by a series of shocks. The question then is this. Will it be third time lucky for a sustained NZ recovery? If you are very optimistic and dismissive of risks we would invite you to have a read of the commentary coming out of the United States at the moment in response to a terrible string of weak data on GDP, housing, manufacturing and employment.

The upshot of these words then is a warning. We lay our money down on growth being good next year and over 2013 with a good chance the wheels of that growth have started to turn right now. But a wise person would keep their debt levels down, their new hiring contracts flexible, their inventories in check, and their eyes glued to what the real economic data as opposed to the numerical sentiment surveys are saying – exactly as the Reserve Bank are doing.

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

On The Road 4 http://tonyalexander.co.nz/occasional-papers/

Comments about Hong Kong and China

BNZ Confidence Survey http://tonyalexander.co.nz/bnz-confidence-survey/

Survey results.

BNZ-REINZ Market Survey http://tonyalexander.co.nz/bnz-reinz-survey/

By Friday morning the June report will be loaded. It will show improving numbers attending Open Homes and more Written Sales going Unconditional, but other indicators still generally mild and with no clear sign of generalised price pressure. The report will contain comments about around 10 individual locations for which sufficient responses were received.

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?

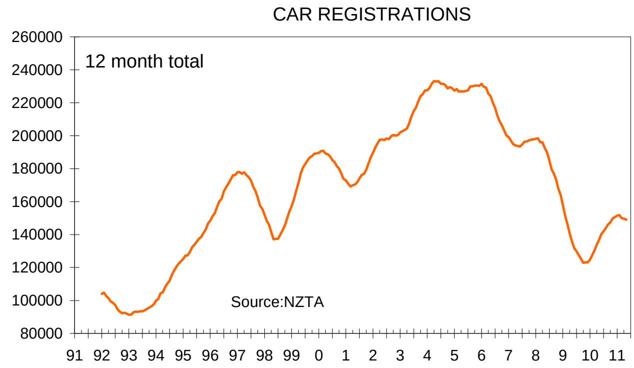
In this section we look only at what the data are actually telling us and pay no attention to forecasts or intentions measures.

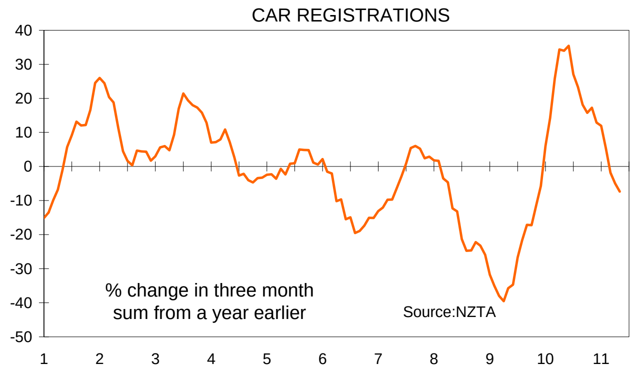
This week we have learned of further weakness in the house building and non-residential construction sectors (both actual construction and consent values for future building), weak car registrations, but continuing strength for investment in commercial vehicles.

Are householders opening their wallets more?

Definitely not when it comes to spending on getting a new dwelling built. In April seasonally adjusted dwelling consents totalled only 1,008 which was a 1.7% fall from March and a 10.5% decline in the three months to April when compared with the three months to January. The house building sector is still in recession in New Zealand and still going deeper. Of course things will look different next year when the Christchurch rebuilding gets going – if home owners can get their money out of EQC. But for now, this sector is actively detracting from growth and because there are many sectors which feed into house building the multiplier effect is quite strong – and also negative.

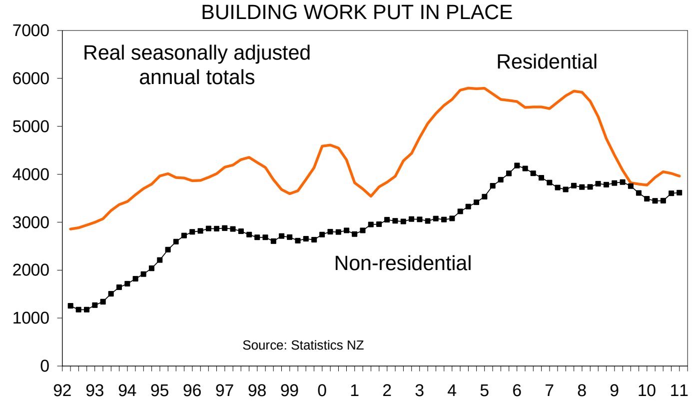
The number of cars registered in May was also down by 3.7% from a year earlier, off 7.4% in the three months to may from a year ago, and down around 5% seasonally adjusted compared with the three months to February. So if car registrations are primarily driven by consumer spending then the data say things are still weak. Note though that business lease purchases affect the data and there may be a downward bias at the moment due to trade interruption from Japan following the earthquake.





Is business output rising?

Not in the construction sector where this week we learned that during the March quarter the seasonally adjusted volume of residential construction fell by 2% to be 7.8% weaker than a year ago, and non-residential construction fell 10.5% to be 1.9% firmer than a year ago.

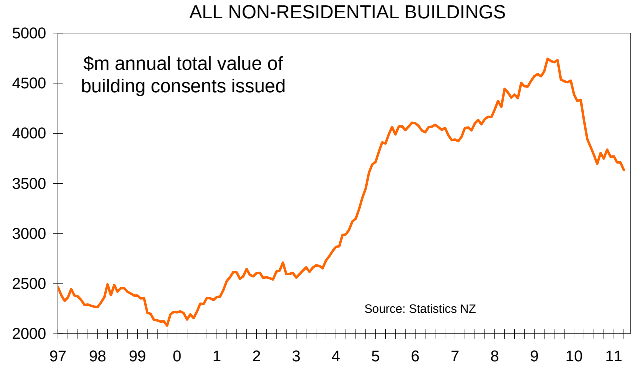


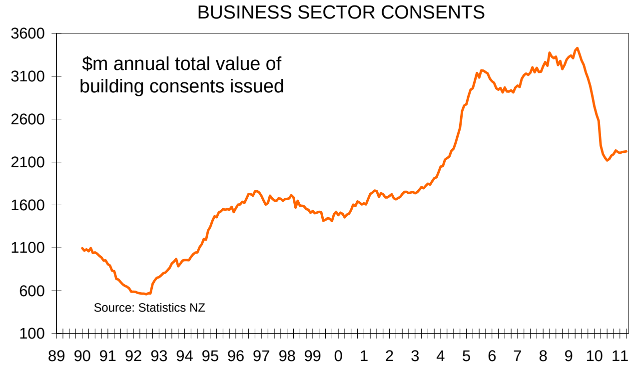
Are businesses hiring more people?
To view our latest monthly NZ Labour Market report click here. http://tonyalexander.co.nz/nz-labour-market/

Also we have nothing new although in our BNZ Confidence Survey at www.tonyalexander.co.nz you will find positive comments from those in the recruiting sector.

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/

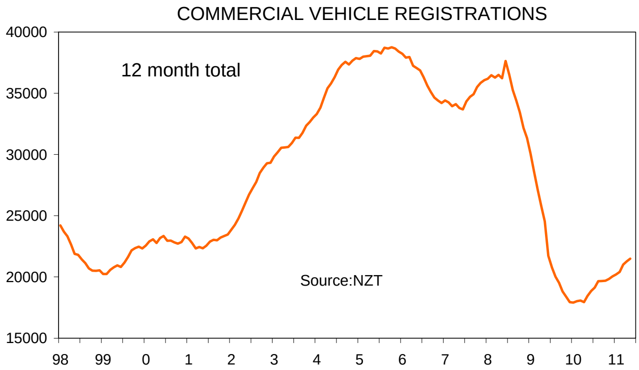
Not with regard to commercial construction. In April the value of consents issued for the construction of non-residential buildings was just $252mn. This was a 23% fall from April of 2010 and well below the average April sum for the past five years of $368mn. In fact over the six months to April consent values were down 6% from a year earlier and off 12% for the entire year. However, there is a very small glimmer of light in the form of business only consents rising 3% in the past six months from a year ago with factories ahead 44%, farm buildings 15%, and hotels etc. 24%.

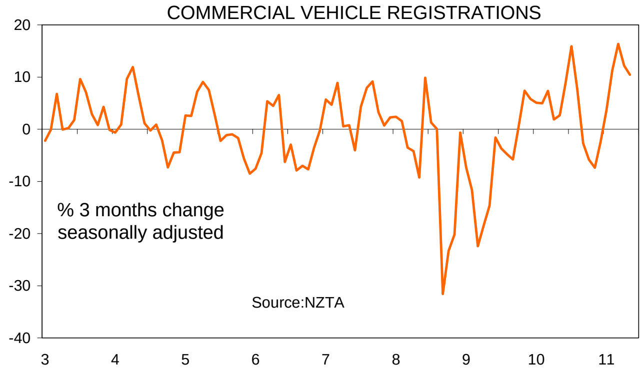




So maybe there is a small amount of private sector activity picking up but given the inherent volatility in these numbers we would not call it an upward trend as yet.

The number of commercial vehicles registered in May was ahead 10.9% from a year ago, up 21.4% in the three months to May from a year earlier, and roughly ahead 10% seasonally adjusted from the three months to February. So there is growth in business spending in this area.





As for our favourite indicator, tractor registrations, the numbers are good when compared with a year ago but in recent months in seasonally adjusted terms there has been slight weakness which suggests farmers are still largely keeping their hands in their pockets.

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?

The Reserve Bank are looking for real economic data upon which to base their monetary policy decisions. What they have seen recently is that a dodgy quarterly employment report was unusually strong, a phenomenally dodgy card spending report was also strong, but reliable data on residential and non-residential building consents have been weak along with imports of capital equipment. Exports are strong but there is no solid evidence farmers are doing much more than repaying debt.

Capacity measures however are on the tight side, and forward indicators for growth such as sentiment surveys are identifiable things like Christchurch rebuilding are positive. What it adds up to is that in “normal” circumstances the RB might already be tightening monetary policy. But these are not ordinary times. Offshore news has become newly worrying and false dawns occurred in the NZ economic cycle in 2008 and 2010. Therefore the RB will wait before acting and short term borrowing costs look like staying low until quite late in the year.

Which is fairly much what they said in this morning’s cash rate review. They have noted that things are turning out better than they though three months ago just after the Christchurch earthquake and that as the data appear to allow them to better gauge the extent of the strong growth they are forecasting they will make appropriate monetary policy decisions. They have pencilled in a rise in the official cash rate from the current 2.5% to 4.75% come 2013 starting in December by the looks of it – though it is clear they also do not completely rule out moving in September.

The statement was slightly more hawkish than anticipated so there has been some mild upward pressure on wholesale interest rates which wiped out some declines earlier in the week occasioned by weak data offshore.

Our analysis suggests that borrowers still have time on their side – but for how long is the question. There is a clear risk that at some stage world growth shocks will move to the upside at the same time as inflation risks start becoming more solid in NZ and we could see a decent jump in long term borrowing costs.

Other Inflation Influencers

Rate Movements This Week

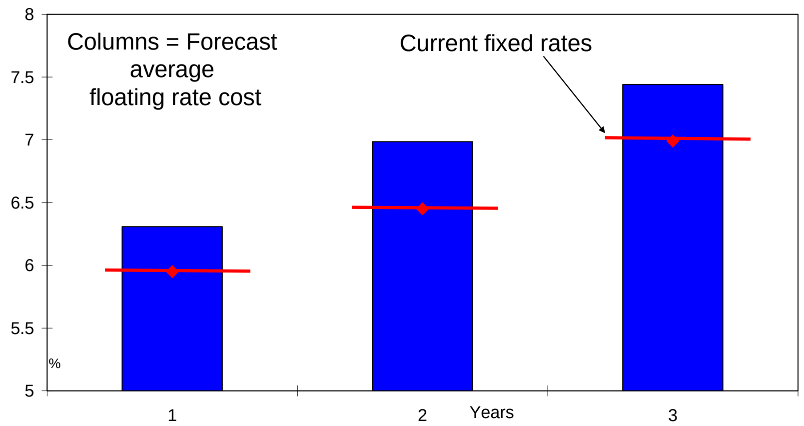
As noted, slightly upward. No time to write more.

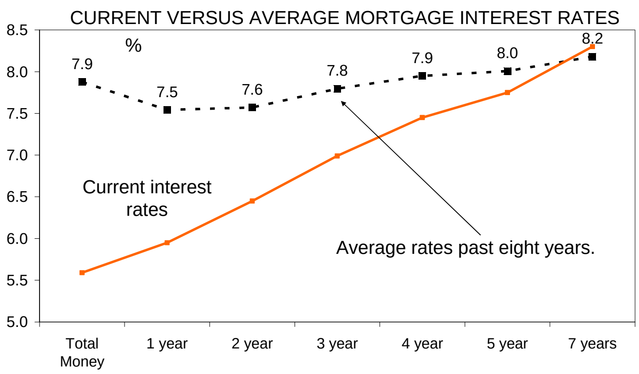
FINANCIAL MARKETS DATA	This week	Week ago	4 wks ago	3 months ago	Yr ago	10 yr average
Official Cash Rate	2.50%	2.50	2.50	3.00	2.50	5.9
90-day bank bill	2.65%	2.68	2.70	2.91	3.02	6.2
1 year swap	2.99%	2.97	2.89	2.91	3.78	6.3
5 year swap	4.52%	4.53	4.53	4.45	5.31	6.6
180-day term depo	4.40%	4.50	4.60	4.10	4.80	6.0
Five year term depo	6.00%	6.00	6.00	6.50	6.75	6.5

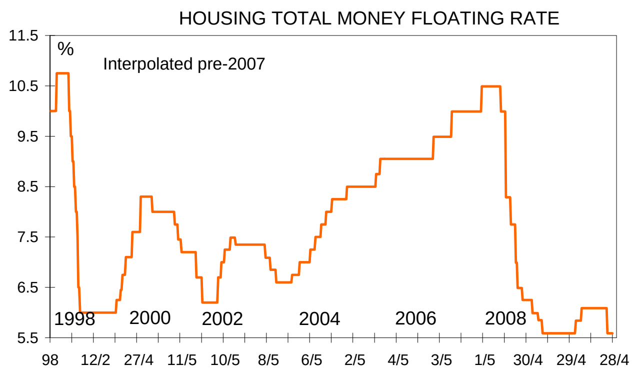
If I Were a Borrower What Would I Do?

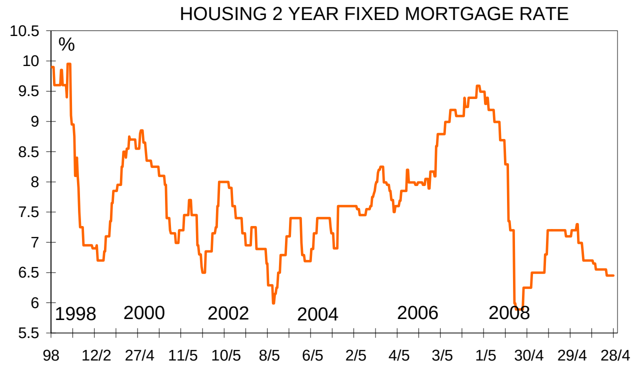
I would increasingly be thinking about how floating interest rates will be rising from late this year and keeping an eye on fixed rates. The trick is to stay on a floating rate as long as possible before jumping to a more expensive fixed rate which will give some protection against the upside risk we see facing floating interest rates over 2012-13. The risk however is that one leaves the jump too late and when you try to move so does everyone else and the weight of demand for fixed rate borrowing will cause a sharp spike in those fixed rates.

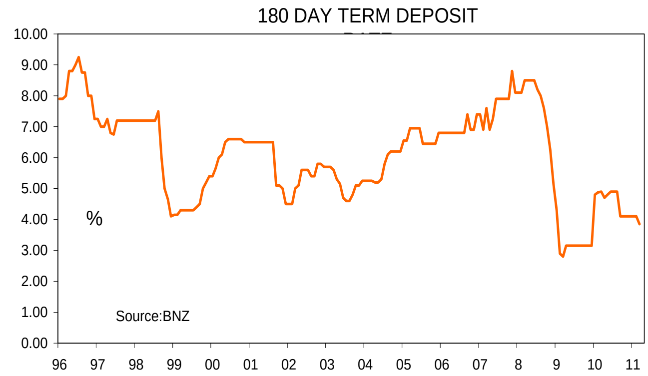
Personally I find myself still inclined to sit floating, but anticipate switching to fixed before year's end.











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

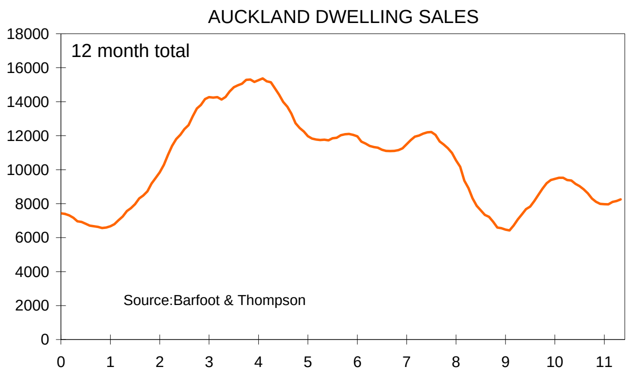
Look around the 180 day area.

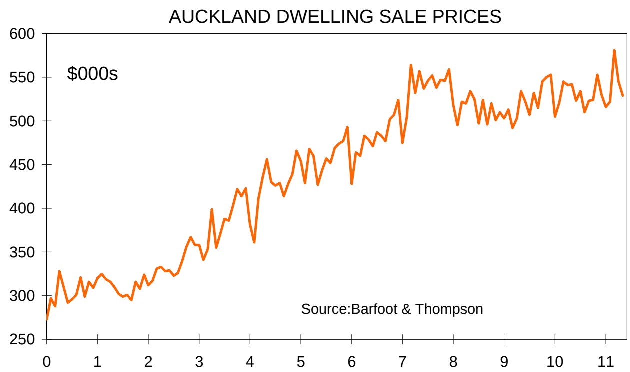
HOUSING MARKET UPDATE

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/

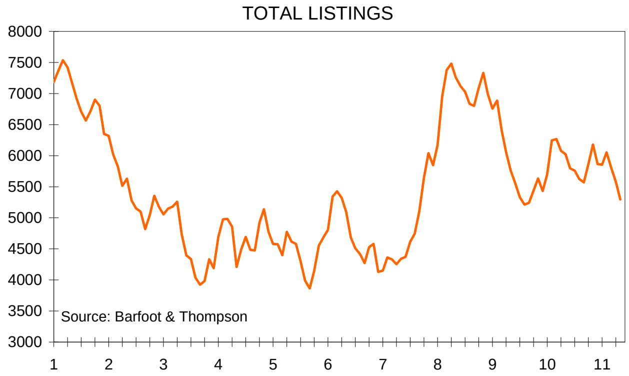
Auckland Listings Hard To Find

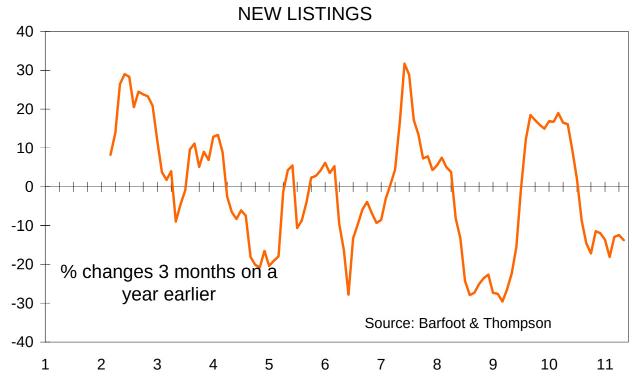
Barfoot and Thompson released their May data for Auckland this week and probably the only thing really worth highlighting is the worsening shortage of listings. Sales were up slightly seasonally adjusted for the month while prices eased but this appears mainly because of few sales in the $1mn plus category.

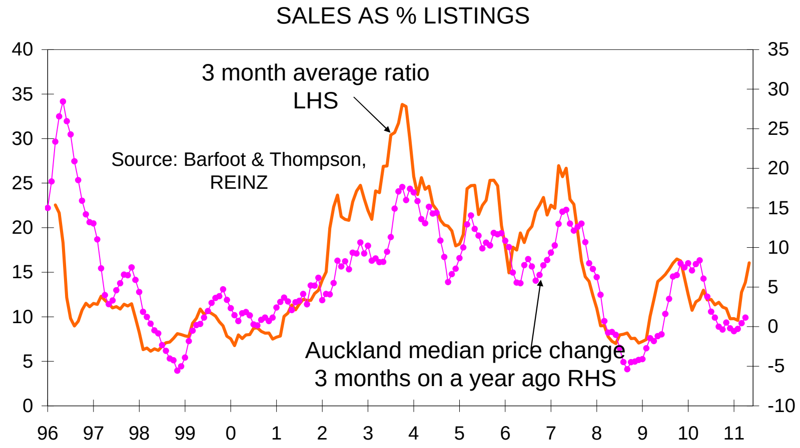




But at the end of the month they had just 5,294 homes on their books which was the lowest number in 20 months and down 12% from a year ago. The number of new listings was also down 15% from a year ago and the ratio of sales to total listings is creeping back up. As the main graph below shows this tends to be a precursor to rising prices.







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

No time this week. Greece still an issue but on the way to being resolved – again!

Chinese Inflation

I'll be writing something more detailed for the website over the coming week – hopefully involving something more insightful than how to survive dinner bonding/drinking games in Shanghai. The head!

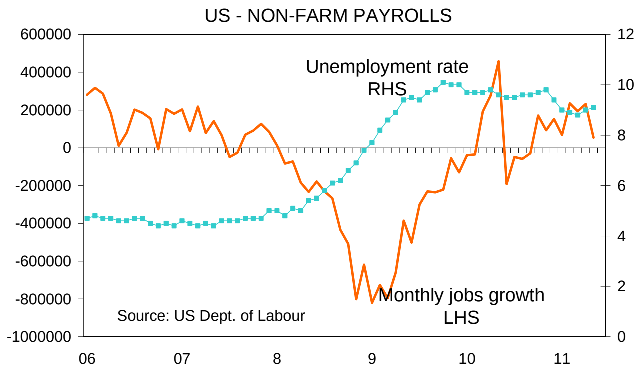
US Growth Momentum

We have been explicitly monitoring the US economy in this section because of the risk that the recovery fizzles out and there ensues downward pressure on commodity prices, long term interest rates, sharemarkets, and risky currencies like the NZ dollar. There is a version of that fizzling out in play now in response to recent worryingly weak data on US GDP, manufacturing, housing and employment. The bond market appear to have correctly picked this weakness with yields falling in recent weeks in spite of the QE2 money injection ending this month which ceteris parebus would cause yields to rise. The yields have fallen because of reducing economic growth expectations.

The US sharemarket however appears not to have been quite so prescient with gains of sizeable magnitude up until recently. That is probably because of the simple weight of money looking for a home and the low yields offered on interest rate investments.

The US dollar might have been weaker were it not for great worries about Japan and the European debt situation. As for commodity prices, they have shown signs of peaking out recently and a few semi-official warnings have been appearing regarding the clear risk of bubbles being in play.

So have we learnt anything new this week which seriously challenges or radically reinforces the case that the US economy is heading toward another dip? The dip scenario was reinforced big time by Friday night's non-farm payroll report which showed job numbers up only 54,000 in may whereas a rise on average of about 165,000 had been expected. The outcome is well below average monthly jobs growth in recent months of just over 180,000 and when questioned about the result the person in charge of the Labour Bureau said that although some people have cited tornadoes and the Japanese earthquake he could not identify such effects and instead the weakness appears to be widespread.



The weak employment result, and accompanying rise in the unemployment rate to 9.1% from 9%, can only work toward making individuals even more wary of borrowing, spending and buying houses, and also make businesses wary of boosting capital spending given that so much of the US economy is driven by consumer spending.

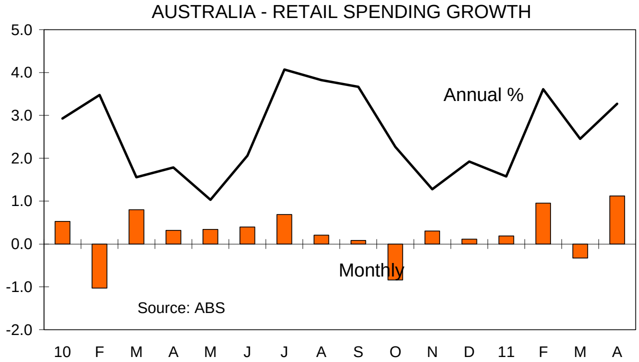
Australian Growth

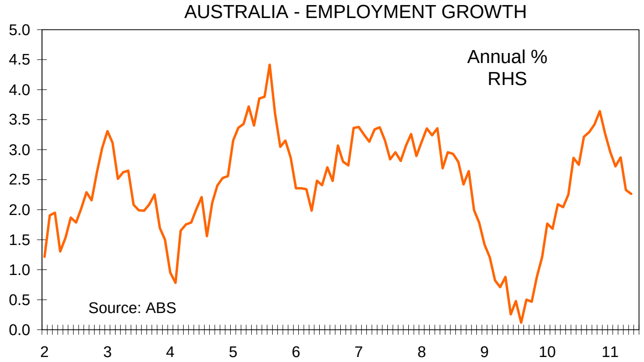
I've undercooked commentary on Australia in recent weeks so lets go into a bit more depth this time around. The key issues for Australia are the growing structural dependency upon China, the worsening structural shortage of houses in spite of already very high house prices when compared with incomes, and the major matter for the moment which is the Reserve Bank's attempts to suppress inflation stemming from the biggest resources boom in over a century.

What they are explicitly trying to by is suppress household consumption and the housing market in order to provide "space" for the infrastructure and mining sectors to grow. They achieve their goal by raising interest rates and have already taken their cash rate from 3% late in 2009 to 4.75% and although they left it unchanged this week the chances are they will raise it again next month.

The high interest rates being faced by households at a time when the cost of living is rising firmly appear to be successfully keeping retail spending growth in check, and the housing market is going nowhere with broadly flat prices and relatively weak construction. That latter development is already biting in many ways and is setting things up for some major social problems down the track as rising rents price the bottom end of the working households out of reasonable accommodation.

So the question then is whether we have learnt anything this week which implies the RBA have over-tightened, or that they may need to outright create a domestic recession by aggressively raising interest rates – and the exchange rate – further to control inflation. On the it sounds good but one should be wary of getting optimistic side we have news that retail spending in April rose by a firm seasonally adjusted 1.1%. This is more than double average monthly growth for the past ten years of 0.5%, but compared with a year ago sales were ahead only 3.3%. In three past three months growth was a firm annualised 5.2%, but this will have reflected post-Queensland flooding buying and in the three months to January growth was only an annualised -0.1%.





So there is not any compelling evidence that Australian households are spending up large so the RBA can probably continue to rest easy for now. In fact that is exactly what they did on Tuesday in leaving their cash rate unchanged at 4.75%. That no change decision received some extra justification this morning when the labour market numbers came in weaker than expected for the second month in a row with only minor jobs growth though the unemployment rate still sitting at 4.9%.

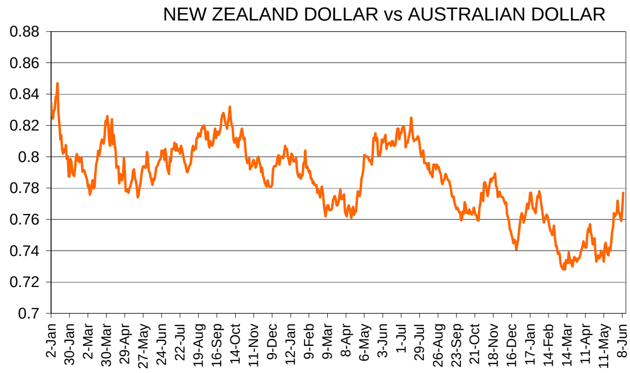
Exchange Rates

Exchange Rates	This Week	Week Ago	4 wks ago	mths ago	Yr ago	Consensus Frcsts yr ago*	10 yr average
NZD/USD	0.823	0.814	0.791	0.740	0.667	0.689	0.629
NZD/AUD	0.777	0.765	0.739	0.732	0.805	0.773	0.855
NZD/JPY	65.900	65.700	63.700	61.200	61	67.7	68.4
NZD/GBP	0.500	0.497	0.482	0.458	0.461	0.448	0.368
NZD/EUR	0.562	0.563	0.550	0.532	0.557	0.52	0.511
NZDCNY	5.336	5.278	5.136	4.861	4.555		4.83
USD/JPY	80.073	80.713	80.531	82.703	91.454	98.3	109.9
USD/GBP	1.646	1.638	1.641	1.616	1.447	1.54	1.705
USD/EUR	1.464	1.446	1.438	1.391	1.197	1.33	1.229
AUD/USD	1.06	1.06	1.07	1.01	0.83	0.891	0.737

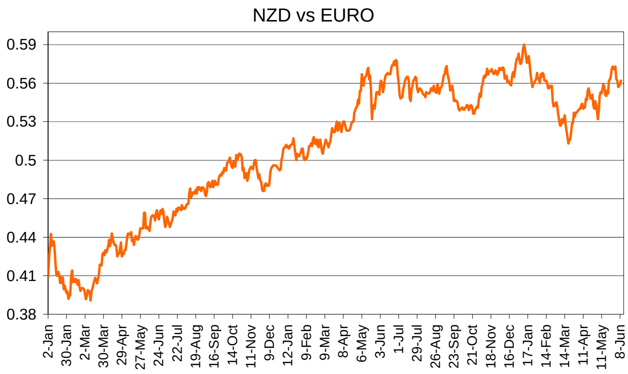
*Sourced from Consensus Economics. http://www.consensuseconomics.com/

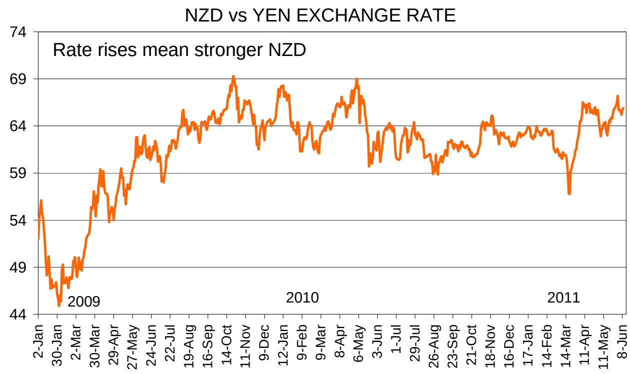
Kiwi Dollar Rising

The Kiwi dollar has finished the week almost one cent higher against a greenback weighed down by growth worries (weak jobs data on Friday night in particular), and up one cent also against the Aussie dollar courtesy of a less hawkish than expected monetary policy review by the RBA on Tuesday. The relatively optimistic growth commentary from the RBNZ this morning has added to the Kiwi dollar's strength and that helps explain the small gains against the pound and yen, though the euro has benefitted over the week from a glass half full interpretation of progress on the latest leg of the Greek debt problem.



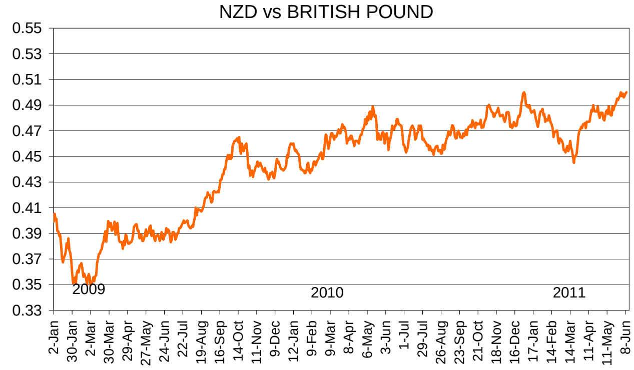
Given our expectation of hastening growth in the NZ economy and the fact that market pricing is still not completely for the first cash rate rise to occur in December, we see upside movement generally for our currency over the remainder of the year. There will be high volatility at times however due to the likes to fluctuating risk tolerance surrounding European debt in particular. But also one should keep an eye out for bouts of concern about the sustainability of high commodity prices.





United Kingdom

No time for anything to go in this section this week sorry.



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		0.9	0.8	6.8	0.1	-5.0
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	+5,508	8,689yr	......	19,954	9,176
Tourism – an. av grth	10 year average growth = 3.2%. Stats NZ	0.9	2.5	0.9	3.1	-2.7
		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	103	101	115	126	106
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

Dec. year		2010	2011	2012	2013
GDP	annual average chg	1.4	1.0 – 1.5	3.5 - 4.0	4.0 - 4.5
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	2.0 – 2.5	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