BNZ Weekly Overview

28 July 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 please click here.
https://www.surveymonkey.com/s.aspx?sm=jiHaOCK3jut6CKU2l5unNg_3d_3d
To change your existing email address click here. http://feedback.bnz.co.nz/forms/vmQjJ7a8CEu8IgjOFnIUag

No Monetary Policy Change

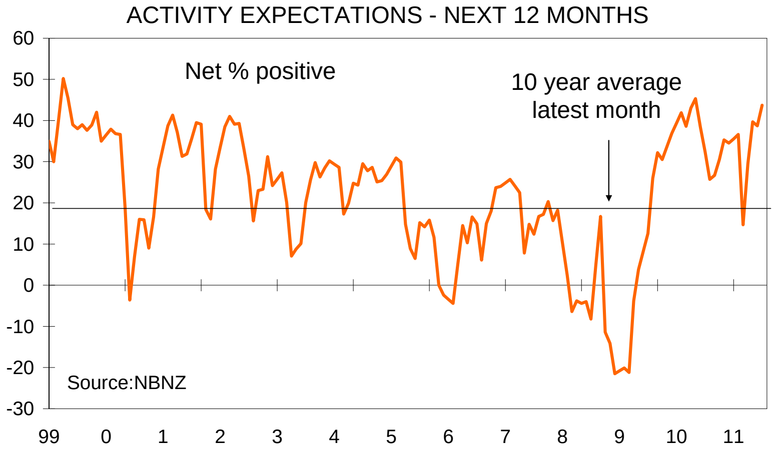
This week's Overview is smaller than normal as I have been (and still am) on the road giving talks in Blenheim, Nelson and Greymouth and substantial time has been spent driving. So lets get into it. The Reserve Bank this morning met fairly much everyone's expectations by leaving the official cash rate unchanged at 2.5% while noting that the justification for the 0.5% cut back in March post-earthquake had all but disappeared but they are staying their hand just for the moment to see how things pan out offshore and because the NZD is so high.

The markets have now moved to factoring in a 0.5% cash rate rise from September and that is our view also now. We then expect no rise in October then another in December so the cash rate ends the year at 3.25%. We then see another rise as likely in March and the rate ending 2012 at 5%.

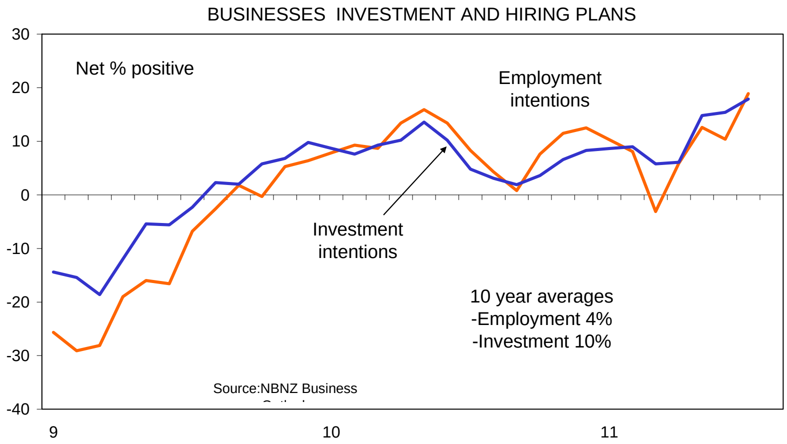
On the back of stronger market expectations of monetary policy tightening swap rates have risen further this week and we have seen more business borrowers in particular locking in some of their core debt in the 2-3 year area. Over the past week while a few mortgage holders have switched from floating to fixed the volumes have as we expected been exceptionally light given the jump one has to make of 1.4% in cost for example to fix three years.

The higher interest rate expectations have boosted the NZ dollar further – though the big factor in play which pushed it to US 87.7 cents yesterday and has it near 87 cents this afternoon was worries about the debt situation in the United States. Some investors are quitting the US currency and placing tiny amounts of their money in the likes of the NZ and Aussie dollars. Speaking of the latter, it has jumped up firmly this week because inflation in the June quarter in Australia was higher than expected so now the markets have pulled back on expecting an easing of monetary policy across the ditch and that is why the AUD has risen, we have eased against the AUD, and why we have had a bit of extra upward pressure on our wholesale interest rates.

In other news for the week, the NBNZ Business Outlook survey results were released for July and they were well and truly on the strong side. A net 44% of businesses said they expect their activity levels to rise over the coming year compared with a net 39% in June and a ten year average of just 19%. The result bespeaks of high optimism about the future and it is unsurprising then that a net 19% said they plan hiring more people. This was up from 10% in June, well above the average of 4%, and the highest result in 16 years - since March 1995.

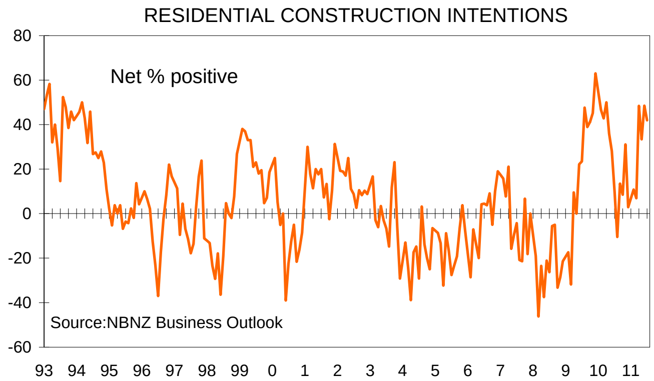


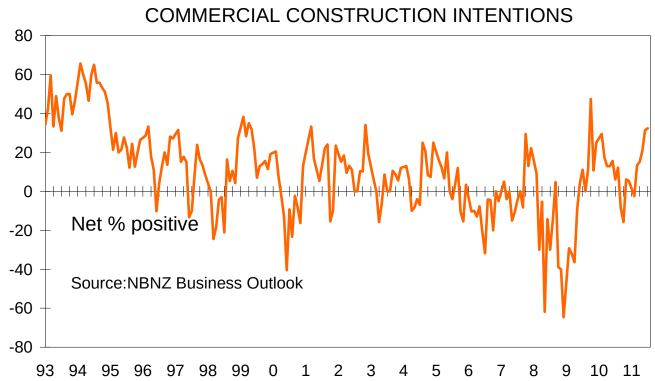
This employment result supports our relatively strong view that New Zealand's labour market is going to tighten up very rapidly this cycle and businesses should be thinking about where their future staff will come from, how they make themselves a preferred employer, how to reward people, training regimes, and sourcing people offshore.



Strong confidence has also been reflected in a high net 18% of businesses planning to raise their investment in plant and equipment. This result was up from 15% in June, the average of 10%, and was the best result in six years. What this means is that we can reasonably expect firm growth in business capital spending over the coming year which we shall try to track through measures such as monthly capital goods imports and registrations of vehicles.

Residential construction expectations remained well above average at 42% in July though this was down from 49% in June perhaps as the latest shake in Christchurch made a few people question the timing of the expected surge in residential construction. Commercial construction expectations however rose to a 22 month high of a net 32% positive from 31% in June and an average reading of -1%. This therefore supports a report released recently by one of the main commercial valuation companies expressing a view that the commercial property sector is starting to come back up again. We shall look for evidence of that in our monthly BNZ Confidence Survey.





Basically the NBNZ survey results support one having a strong outlook for growth.

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

Real Estate Overview http://tonyalexander.co.nz/topics/regular-publications/real-estate-overview/

Our monthly examination of the state of and prospects for New Zealand's residential real estate market concludes there is a cyclical recovery underway as evidenced in rising sales, prices, auction clearance rates, and interest from first home buyers. But no boom is in prospect in light of high debt and elevated prices, easing net immigration, and rising interest rates.

Weekly Newspaper Column http://tonyalexander.co.nz/newspaper-column/

This week we discuss interest rates.

Other Website Material

- **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 Residential 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 only have import and export data to look at.

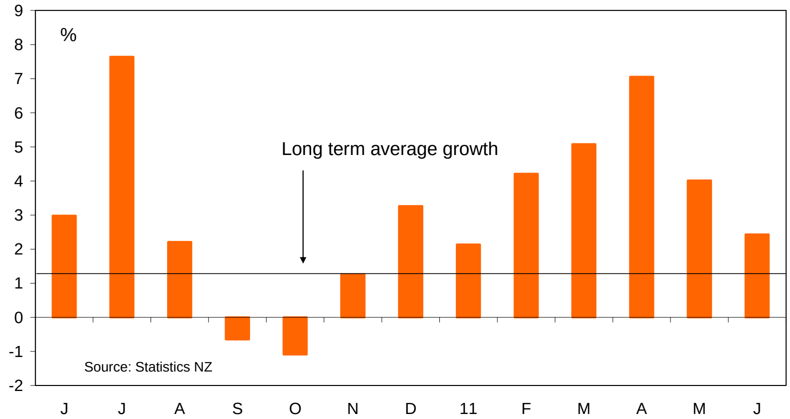
Are householders opening their wallets more?

Nothing new.

Is business output rising?

Export growth continues though no longer at a blistering pace. In seasonally adjusted terms the value of merchandise exports from New Zealand recovered 1.2% in June after easing 8.1% in May and rising 8.3% in April. In other words, the monthly numbers can go all over the place so one must smooth over at least a three month period. Doing this we see that in the June quarter the value of exports improved by 2.4% after gaining 5.1% in the March quarter and 3.3% in the December quarter. The underlying growth in exports is very strong though there are hints that the rate of growth is slowing perhaps as we get past a period when surprisingly good growing conditions boosted pastoral exports and unlikely to be repeated price hikes fed into total receipts.

THREE MONTH SEASONALLY ADJUSTED GROWTH IN EXPORTS



Over the June quarter there was strong growth in the exports of both mechanical and electrical machinery and equipment reflecting growth in the manufacturing sector and suggesting that the firm 2.5% growth recorded during the March quarter in non-dairy and meat manufactures output may have continued in the June quarter. The effect of the low level of the NZ dollar against the Australian currency could be more powerful than we were thinking. Then again, maybe that March quarter output growth sat on the docks and has gone out only recently because the export changes for these two categories in the March quarter were both negative.

	3 month s.a. % change	**3 months earlier change**	**Proportion of all export change**
Milk powder, butter, and cheese	2.3	12.9	24.0
Meat and edible offal	8.3	6.0	40.1
Logs, wood, and wood articles	-2.1	7.9	-6.2
Crude oil	1.1	32.7	2.1
Mechanical machinery and equipment	10.7	-3.5	15.5
Fruit	5.7	-3.5	7.1
Fish, crustaceans, and molluscs	7.0	2.2	8.3
Aluminium and aluminium articles	2.9	-3.3	3.1
Wine	8.7	-8.9	7.9
Electrical machinery and equipment	14.0	-4.6	12.3
Total merchandise exports	**2.4**	**5.1**	**100.0**

The slowdown in export value growth during the June quarter when compared with the March quarter is largely due to reduced growth in exports of crude oil dairy products.

Are businesses hiring more people?

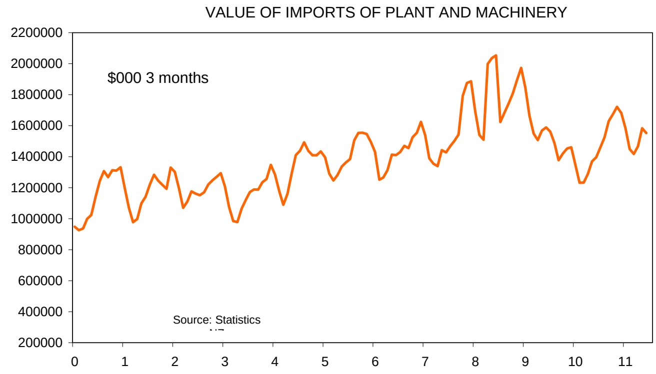
To view our latest monthly NZ Labour Market report click here. http://tonyalexander.co.nz/nz-labour-market/

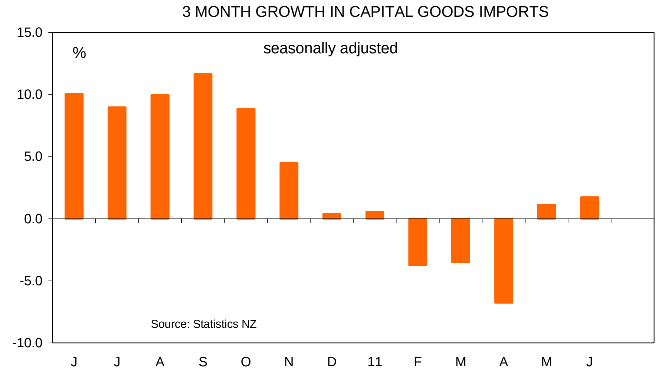
Nothing new – the Household Labour Force Survey will appear on August 4.

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/

As ever we struggle to find up to date gauges of business capital spending and this week we received one of the relatively indirect measures in the form of capital goods imports. In seasonally adjusted terms the value of imports of capital goods eased 0.7% in June after rising 5.5% and was up 1.7% in the June quarter compared with the March quarter. The gain from a year ago was 10% or about 13.5% adjusting for the rise in the trade weighted index. So there is some growth in imports of equipment underway but not all that much.





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?

Discussed in the lead article – no time to write more.

Other Inflation Influencers

Currency through the roof = less need for higher interest rates as growth accelerates.

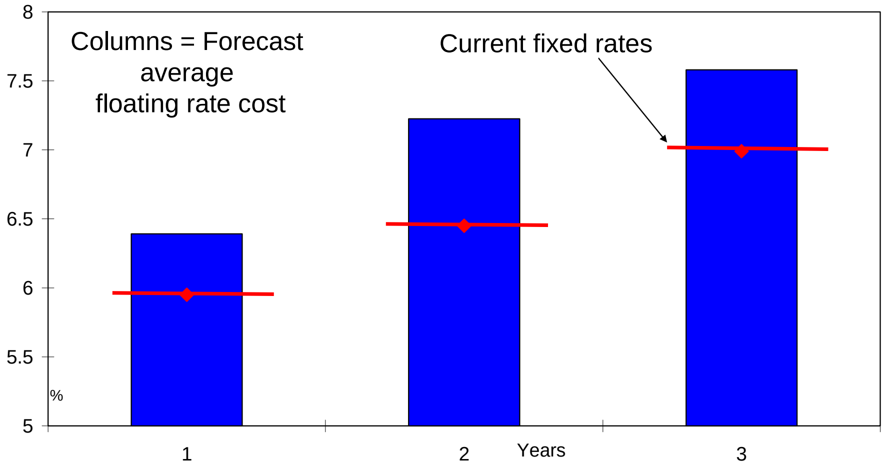
Rate Movements This Week

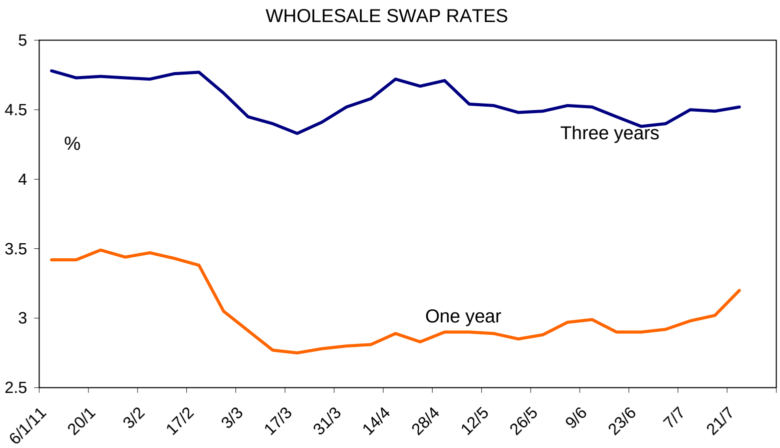
Upward, see the table.

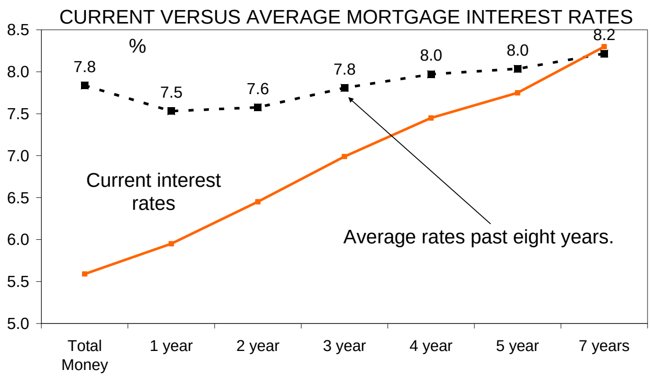
FINANCIAL MARKETS DATA	This week	Week ago	4 wks ago	3 months ago	Yr ago	10 yr average
Official Cash Rate	2.50%	2.50	2.50	2.50	2.75	5.9
90-day bank bill	2.85%	2.70	2.68	2.67	3.14	6.2
1 year swap	3.39%	3.26	2.92	2.90	3.75	6.0
3 year swap	4.14%	4.09	3.78	3.96	4.40	6.2
5 year swap	4.62%	4.59	4.40	4.71	4.76	6.4
180-day term depo	4.30%	4.30	4.50	3.60	4.90	6.0
Five year term depo	6.00%	6.00	6.00	6.00	6.75	6.5

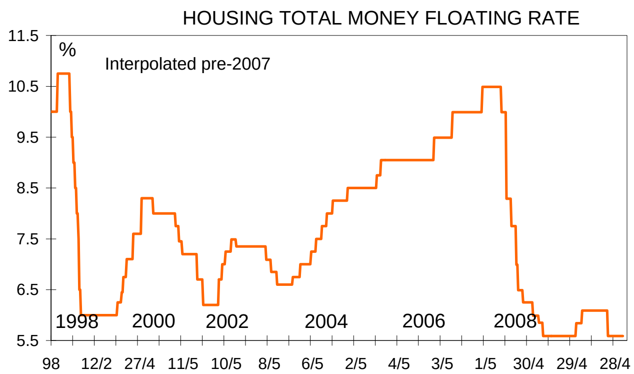
If I Were a Borrower What Would I Do?

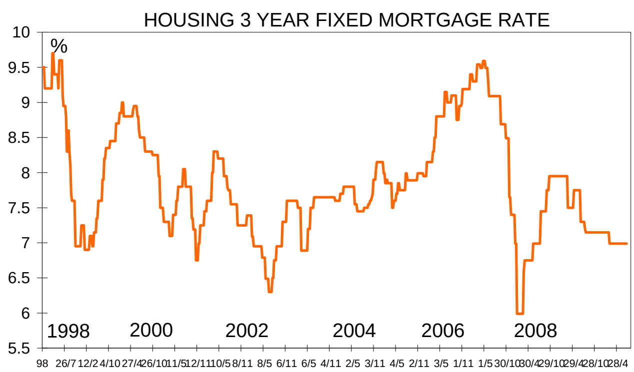
Fix 50% of my mortgage for three years at 6.99% before the rate rises. Note that the swap rate used as a base for calculating the margin banks earn from three year fixed rate lending has risen by 0.36% over the past four weeks so the risk is lending rates rise soon – though I have no inside knowledge of such. Most people will not fix however as the jump from floating is too much to contemplate, regardless of what our graph below shows.

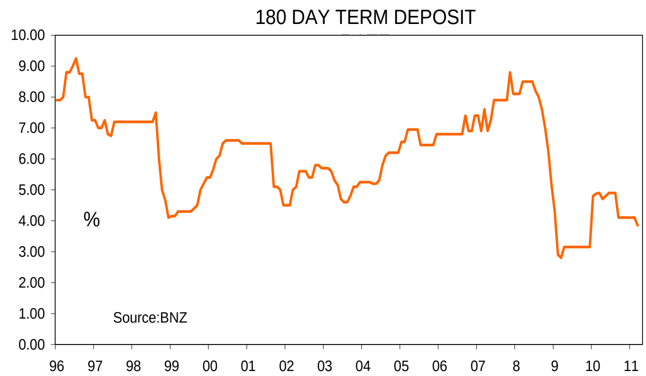

Columns = Forecast
average
floating rate cost
Current fixed rates
%
8
7.5
7
6.5
6
5.5
5
1
2
Years
3


WHOLESALE SWAP RATES
%
Three years
One year
5
4.5
4
3.5
3
2.5
6/1/11
20/1
3/2
17/2
3/3
17/3
31/3
14/4
28/4
12/5
26/5
9/6
23/6
7/7
21/7


CURRENT VERSUS AVERAGE MORTGAGE INTEREST RATES
%
7.8
7.5
7.6
7.8
8.0
8.0
8.2
Current interest
rates
Average rates past eight years.
8.5
8.0
7.5
7.0
6.5
6.0
5.5
5.0
Total
Money
1 year
2 year
3 year
4 year
5 year
7 years


HOUSING TOTAL MONEY FLOATING RATE
%
Interpolated pre-2007
11.5
10.5
9.5
8.5
7.5
6.5
5.5
1998
2000
2002
2004
2006
2008
98
12/2
27/4
11/5
10/5
8/5
6/5
2/5
4/5
3/5
1/5
30/4
29/4
28/4


HOUSING 3 YEAR FIXED MORTGAGE RATE
%
10
9.5
9
8.5
8
7.5
7
6.5
6
5.5
1998
2000
2002
2004
2006
2008


180 DAY TERM DEPOSIT
%
Source:BNZ
10.00
9.00
8.00
7.00
6.00
5.00
4.00
3.00
2.00
1.00
0.00
96
97
98
99
00
01
02
03
04
05
06
07
8
9
10
11

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

Keeping sitting on my chuff waiting for the Reserve Bank to raise the cash rate so my short term returns will improve. Then at some stage down the track I shall look at locking in a long term rate on the assumption that monetary policy tightening will cause the entire yield curve to rise.

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/

Nothing

Nothing new this week beyond our monthly NZ Real Estate Overview which you can find at **http://tonyalexander.co.nz/topics/regular-publications/real-estate-overview/**

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.

MAJOR OFFSHORE ISSUES

European Debt

On Friday a new bailout package for Greece was announced involving extension of an extra €109bn in emergency loans from the European Financial Stability Facility with an extra €37bn coming from the private sector. In addition, new loan terms will be lengthened from the current 7.5 years to between 15 and 30 years and the interest rate on new loans will be 3.5% rather than the current 5.5%. Interest rates have also been cut on loans to Ireland and Portugal from 5.5% to 3.5%. Plus, the EFSF can now purchase bonds of debtor countries on the open market and can inject capital into banks needing it.

However Moodys announced that they were unimpressed by the new bailout package and cut Greece's debt rating another three notches to one rung above junk status at Ca while Standard and Poors said the proposed restructuring amounts to a default – and now we wait to see therefore if credit default swaps therefore get acted on and whoever issued them faces financial pressure.

In a nutshell the end game has not yet been reached in Europe and these financial woes look like they will continue for a lot longer.

Chinese Inflation

No time.

US Growth Momentum

No time – but suffice to say that during the week data were released on orders placed for durable goods, consumer sentiment, and new home sales. All the numbers disappointed so the chances of the Fed. tightening even next year seem all but zero and the risk is if the debt negotiations do not lead to the US$14.3tn ceiling being lifted the US economy will go into recession. That will drag the rest of the world down and push commodity prices and confidence lower, thus forestalling our recovery. Such are the beautiful times we live in. Good luck out there.

Australian Growth

In a speech the RBA Governor noted that he expects currently weak household spending will rebound at some point and that some of the current gloom could be overdone and will ease off. Here's hoping he is right. One issue however may be that the chances of the RBA cutting interest rates as the markets have been pricing in have just been dealt a blow with the June quarter CPI coming in higher than expectations at a 0.9% increase. Annual inflation is now 3.6%. Interestingly the result was only 0.1% more than expectations but it caused the Aussie dollar to jump by one cent as monetary policy easing expectations got slammed.

No time for more.

Exchange Rates

Exchange Rates	This Week	Week Ago	4 wks ago	mths ago	Yr ago	Consensus Frcsts yr ago*	10 yr average
NZD/USD	0.871	0.856	0.806	0.807	0.733	0.689	0.629
NZD/AUD	0.788	0.796	0.771	0.739	0.812	0.773	0.855
NZD/JPY	67.700	67.400	65.100	66.000	64.4	67.7	68.4
NZD/GBP	0.533	0.530	0.504	0.483	0.47	0.448	0.368
NZD/EUR	0.606	0.602	0.564	0.543	0.564	0.52	0.511
NZDCNY	5.611	5.529	5.222	5.255	4.968		4.83
USD/JPY	77.727	78.738	80.769	81.784	87.858	98.3	109.9
USD/GBP	1.634	1.615	1.599	1.671	1.560	1.54	1.705
USD/EUR	1.437	1.422	1.429	1.486	1.300	1.33	1.229
AUD/USD	1.11	1.08	1.05	1.09	0.90	0.891	0.737

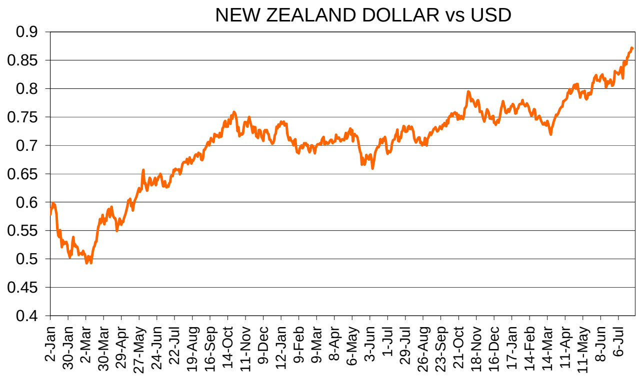
*Sourced from Consensus Economics. http://www.consensuseconomics.com/

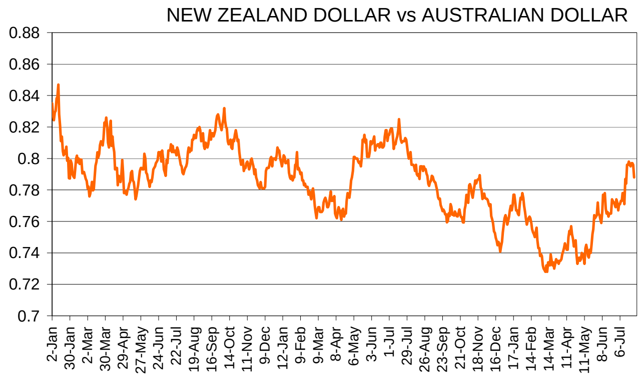
Kiwi Climbs

The week started with new weakness in the greenback pushing the NZD easily above US 86 cents. That weakness was driven by expressions of concern from ratings agency Standard and Poors regarding the deficit and debt positions of the US Federal Government. They warned that failure to raise the current US$14.3tn debt ceiling would wreak havoc on the world economy and repeated their statement that there is a 50% chance they will cut the US debt rating in the next three months.

The USD then suffered a bit more as investors bought the Euro following announcement of a new package to help prevent full blown default on Greek government debt. But as doubts emerged about the effectiveness of the plan and the increasing burden which will be placed upon other Euro member finances from the bailout and buying of Greek debt currently held by banks the Euro weakened and that led to some buying against of the greenback.

But then worries grew again about the continued inability of the Republicans and Democrats to agree on a deficit fighting package which they would support and therefore vote to let the debt ceiling go up. As this game of brinksmanship continues the greenback has suffered and that along with the strong business survey result here in NZ plus higher expectations of NZ monetary policy tightening have pushed the NZD to a new post-float high against the USD this week.



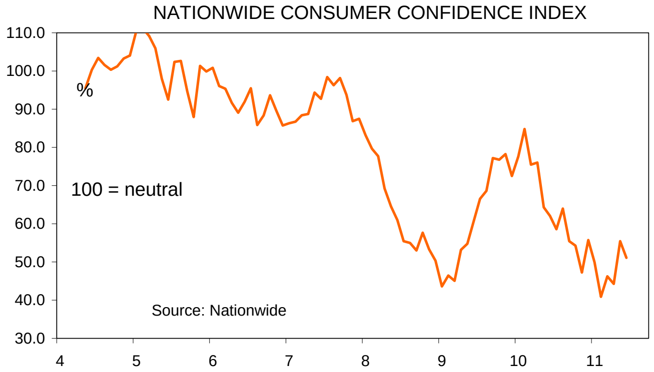


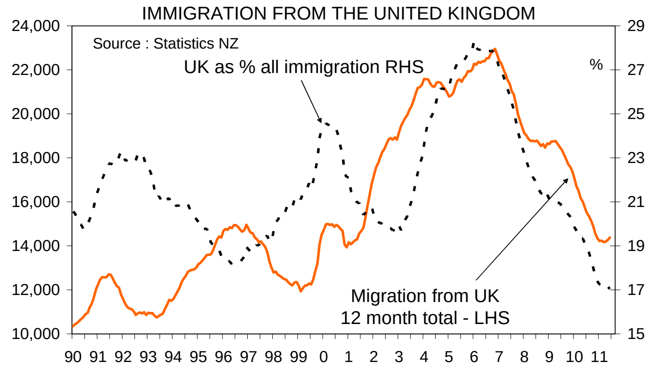
Basically the name of the game with regard to the major currencies still remains one of which looks like the least bucket of steaming crud. Sometimes the greenback reeks less badly than the Euro, Yen and Pound and at other times it humms to high heaven. Out of all this we appear to be seeing mild flight toward the likes of the Kiwi and Aussie dollars because we do not share the fundamental problems of many northern hemisphere economies and have good long term prospects on the back of demand for our commodity exports. Because of this demand we could easily see the NZD spike higher – and also spike down substantially as well if some of these newer investors in our Australasian currencies get nervous or situations radically change in Europe and/or the United States.

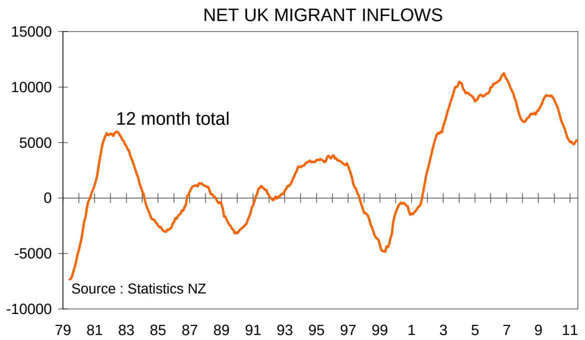
Basically we should all expect very high currency volatility to continue and not run large open currency positions. No time for more sorry.

United Kingdom

Faced with high unemployment, weak house prices, a debt crisis on their doorsteps, and public sector layoffs it is no surprise that UK consumers are feeling increasingly despondent. The monthly Nationwide consumer sentiment survey produced a fall in their measure to an index reading of 51 in June from 55 in May. This wiped out a large part of the recovery from a low of 40.9 in February and suggests that in the short term both retailing and housing will remain weak in the UK. Given these factors plus the NZD/GBP exchange rate sitting above 53 pence one imagines that we will see further weakness in the number of visitors coming to New Zealand from the UK as well as reduced gross and net migration flows.







The net migration gain to NZ form UK migrants was 5,208 people in the year to June from 7,095 a year ago and an average gain of 7,775 for the past ten years.

Still, you have to laugh, because on the same day this week when we got news of a fall in consumer sentiment we received stronger than expected data on retail spending. Spending rose by 0.7% in the UK in June whereas a gain of 0.6% had been expected. This just goes to reinforce the fact that although the financial markets trade in response to monthly numbers one really needs to smooth over about three months to see what is happening and acknowledge that for some things such as confidence measures the relationship with spending gauges is more in the medium term than the very short term.

Exchange Rate Assumptions

Good luck if you have to use these or other assumptions for planning or hedging purposes. History does not suggest one can have much faith in exchange rate forecasts.

	2010	2011	Risk	2012	Risk
Year end					
NZD/USD	0.73	0.80	Higher++	0.81	Higher+
NZD/AUD	0.74	0.78	Higher	0.86	
NZD/YEN	64.2	69		70.0	Higher
NZD/GBP	0.44	0.49	Higher+	0.50	Higher
NZD/EUR	0.51	0.55	Higher	0.58	Higher
USD/JPY	88	86	Lower	86	Lower
GBP/USD	1.66	1.63		1.62	Higher
EUR/USD	1.43	1.45	Higher	1.40	Higher
AUD/USD	0.99	1.03	Higher+	0.94	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	1.0%	0.8	5.3	1.7	1.9
GDP growth	Average past 10 years = 2.6%	0.8	0.5	+1.5	-0.7	-1.5
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	4.3	4.1	......	2.4	8.0
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%.	0.7	0.0	1.4	1.0	-3.6
House Prices	REINZ Stratified Index	1.5	-0.6	-0.4	4.2	-2.9
Net migration gain	Av. gain past 10 years = 13,900	+3,867	6,554yr	......	16,504	12,515
Tourism – an. av grth	10 year average growth = 3.2%. Stats NZ	-0.1	0.2	-0.1	3.8	-2.8
		Latest year rate	Prev mth year rate	6 mths ago	Year ago	2 yrs ago
Business confidence	BNZ survey	45	57	22	2	15
Consumer confidence	ANZ-Roy Morgan 100=neutral	109	113	117	116	108
Household debt	10 year average growth = 10.3%. RBNZ	1.2	1.2	1.8	2.6	2.7
Dwelling sales	10 year average growth = 2.5%. REINZ	14.3	10.8	-11.3	-24.3	40.3
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	2.0 – 2.5	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	3.0 – 3.5	4.5 – 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