BNZ Weekly Overview

8 December 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.

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.
http://feedback.bnz.co.nz/forms/Fx-I8ploskSGWgjN_7WOAw
To change your address or unsubscribe please click the link at the bottom of your email.

Make Or Break Now For The Euro

This week the most important event will start tonight in Europe where the heads of government will be meeting to try and finally put an end to investor worries about the ability of European governments to service and repay their debt. The Germans and French have proposed that Europe move from a customs and monetary policy union to a fiscal union whereby significant oversight of domestic government spending and taxation is undertaken by a centralised body with penalties for governments which fail to meet fiscal rules. These rules may include running a deficit less than 3% of GDP and keeping debt below 60% of GDP – which are exactly the rules put in place when the Euro was created and which practically all countries ignored within a short period of time.

While agreement by government heads over the next two days could, under an accelerated programme, lead to changes to EU treaties within 18 months under an optimistic scenario which could include some referendums, on the face of it the proposals can do nothing to help the current situation as fiscal accounts are already munted and penalties would be of no use. However, it is believed that two positives could come from a strong agreement.

The first is that investors may become convinced that the days of fiscal profligacy in some recalcitrant Euro-zone members have permanently ended and probity is now here to stay. This week many investors appear to have adopted such a view especially in light of new stringent austerity packages introduced in Italy and Greece with the result that yields on Italian government bonds in particular have fallen sharply.

Second, it is believed that if the European Central Bank sees strong fiscal union with enforceable rules coming not far down the track they will be willing to step in if needed and act as lender of last resort to the governments just as they and other central banks rightfully act as lender of last resort to national banking systems.

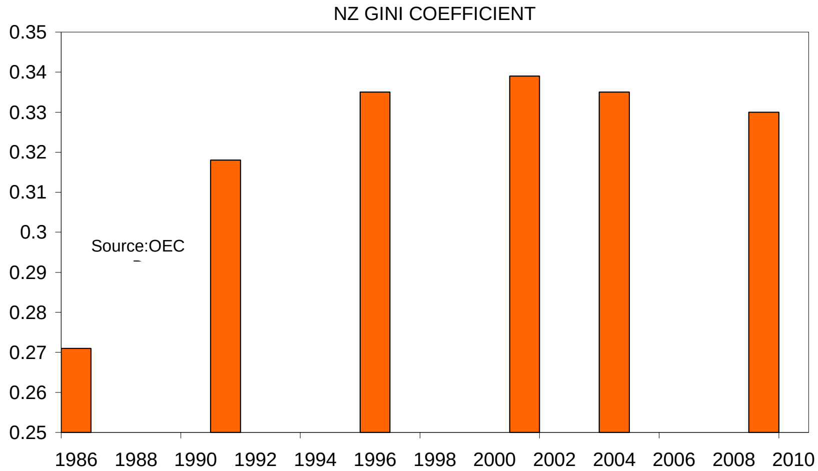
If agreement is not reached in the next two to three days – then we could enter the Euro break-up scenario because without strong agreement all attention will revert to the other things happening this week. These include the placing by Standard and Poors of 15 of the 17 Euro-zone members on negative credit watch, and their warning that if they do cut ratings then the rating for the European Financial Stability facility – underpinned by national guarantees – may be cut two notches. In addition there are still no solid plans for the IMF to provide new large bailout funding.

So again we await the outcome of yet another important European leaders' meeting.

This week the Housing section of the Overview is chock a block with material so in the interests of keeping publication size down we'll cut this front-piece here, apart from noting that while the RBA cut their cash rate 0.25% this week the RBNZ left their's unchanged at 2.5% and have finally adopted a more realistic – downbeat – view of what our economy has been doing recently and where the risks say we could go in the first part of next year at least.

NZ Income Inequality Falling

Just for your guide, this week the OECD released a report looking at growing income inequalities in some parts of the world and presented a lovely biased graph for the media to report showing that income inequality has increased practically everywhere – since 1985, some quarter of a century ago. What one had to dig around to find however was the dataset by country for the surveyed time periods from 1975 and doing that we find the following. For New Zealand the first reading was taken in 1986. The Gini coefficient which is a measure of income inequality was 0.271 back then compared with 0.33 in 2009 with the OECD average going from 0.291 in 1985 to 0.315 in 2008.



But, the NZ coefficient has fallen from 0.335 in 1996, 0.339 in 2001, and 0.335 in 2004. In other words, income inequality in NZ has reduced since the reforms kicked into full economic effectiveness in the mid-1990s. So although NZ has above average income inequality, our trend is toward reduced inequality whereas the OECD trend is toward increasing inequality.

Data here
http://www.oecd.org/dataoecd/39/45/49170007.xls
http://www.oecd.org/document/51/0,3746,en_2649_33933_49147827_1_1_1_1,00.html#DATA

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

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

We discuss the results of our last BNZ Confidence Survey for 2011.

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

Results from said survey.

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

Results also from our monthly survey of real estate agents.

Other Website Material

- **Weekly syndicated newspaper column** http://tonyalexander.co.nz/newspaper-column/
- **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?

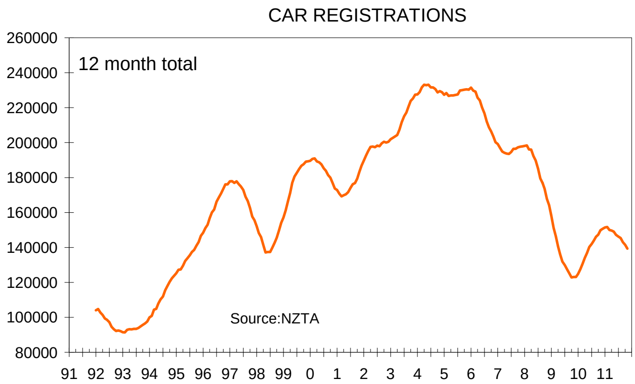
In this section we look only at what the data are actually telling us and pay no attention to forecasts or intentions measures.

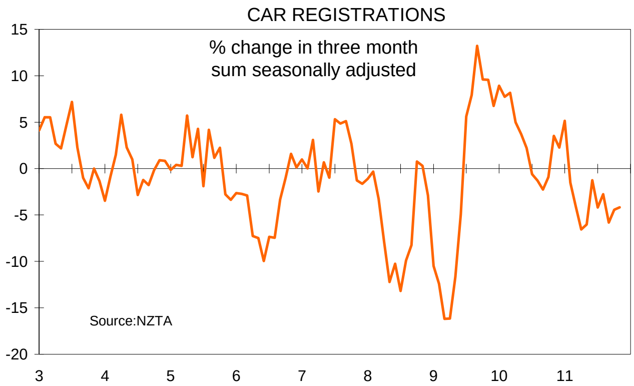
I am reasonably convinced that businesses are investing more in machinery but it could just be because they like the high NZ dollar against the Pound, Euro and greenback and are importing now what they were planning to import next year. For consumers I feel weakness and restraint in spending is still the underlying theme and that recent firm spending data have been artificially boosted by a Rugby World Cup effect. Exports are doing okay and the way dairy prices are holding up is extremely good. House construction I believe is on the cusp of rising and will be a growing stimulus to broader economic growth – though mainly in the second half of 2012 if the insurance for Christchurch housing loosens up. Commercial construction is weak but there are sounds of improving occupancy and rents in industrial locations so maybe some growth lies ahead there next year. Manufacturing is now going solidly backwards again which is what I have been expecting to see happen as the long term trend is strongly negative. Tourism has held up better than expected – but again there is the RWC effect to consider.

Basically I remain to be impressed by our economic growth though am hopeful for 2012 – unless Europe collapses. Note that the RB have at last picked up on the weakness out there by cutting there forecast for year to March 2012 growth from 2.8% three months ago to 2%.

Are householders opening their wallets more?

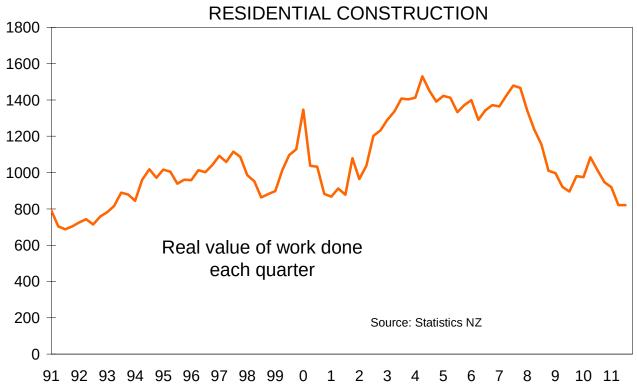
Not with regard to cars. In November the number of cars registered around New Zealand was down 7.9% from a year earlier at 12,606 and over the three months ending in November registrations were roughly down 5% seasonally adjusted from the three months to August. There is no catch-up period of car buying yet underway and the trend in spending is in fact firmly downward. If consumers were really feeling happy and opening their wallets these numbers would be rising.

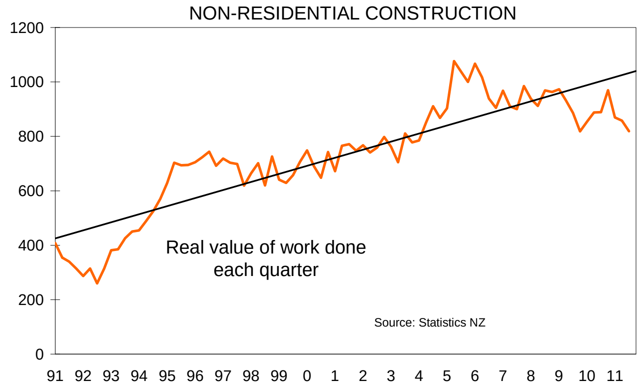




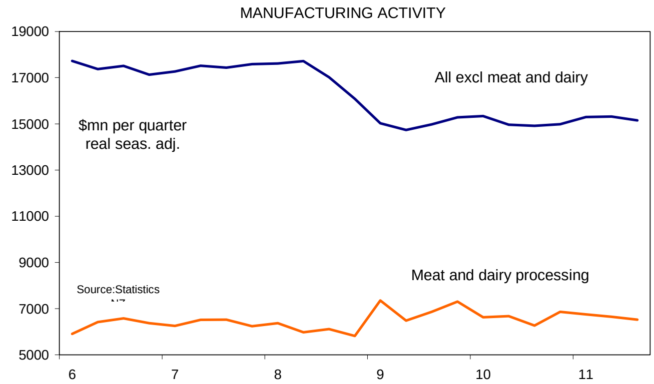
Is business output rising?

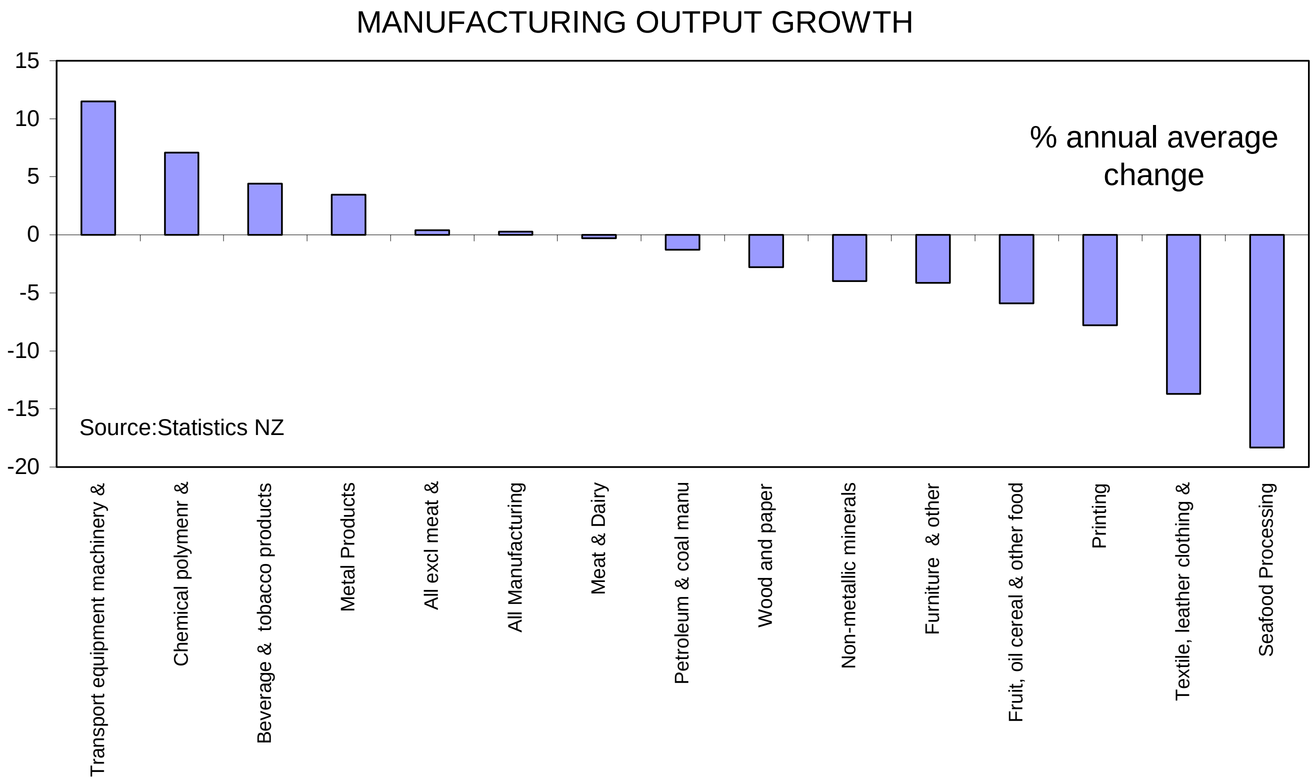
This week we received the quarterly Building Work Put In Place numbers. They show that there was zero growth in the output of residential buildings during the September quarter in real seasonally adjusted terms, and that output of non-residential buildings fell by 4.5%. Total construction activity shrank by 2.3% to be 13.9% less than a year earlier with residential down 19.1% and non-residential 7.9%. These are weak numbers though not entirely unexpected given the weakness we have seen this year in the issuing of consents for building work.





In the manufacturing sector a weak trend has reasserted itself over the September quarter with total activity falling 1.4% which matches a 1.4% fall in the June quarter and means growth for the entire past year of just 0.3%. For core manufacturing which excludes meat and dairy processing (30% of the total), activity fell 1.1% after growing only 0.2% in the June quarter. This leaves growth in core manufacturing at just 0.4% for the past year.





Are businesses hiring more people?

Nothing new this week beyond the comments in our BNZ Confidence Survey from people in the recruitment sector. This month those comments were much more negative than we have seen for quite a long time. To whit….

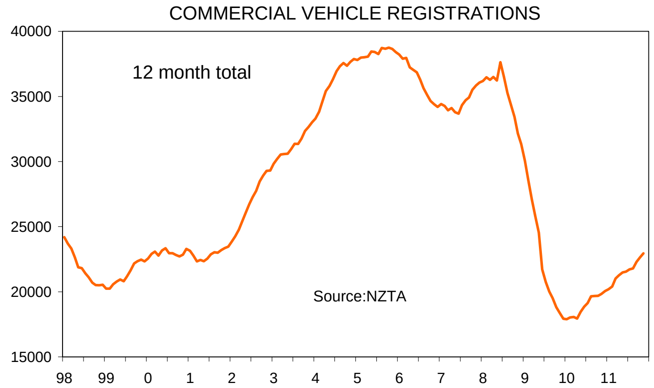
- Recruitment - Has become quite slow heading into the end of the year. Believe that things will pick up if the manufacturing sector shows some growth in 2012, in speaking to CFO & COO in both public & private sectors that they see some growth in their companies towards the end of 3rd quarter based on a reasonable finish to the year.
- Recruitment....average...no great momentum unfortunately but pockets of the business are doing well (large recruitment firm covering all sectors) Accounting and Finance quietest really.
- IT recruitment - we have experienced a real slow down over the past few months, with a lot of projects put on hold. Demand for highly technical people has remained high, but less technical roles such as project management have been quiet. Some of this can be put down to the election and waiting to determine direction (at least in the government sector). RWC was also an obstacle. Compared to this time last year, things are quite a lot slower moving.
- Recruitment - less quality candidates coming to the market

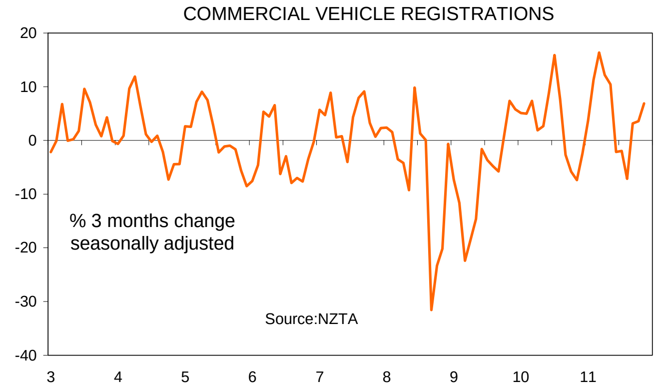
Are businesses boosting their capital spending?

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

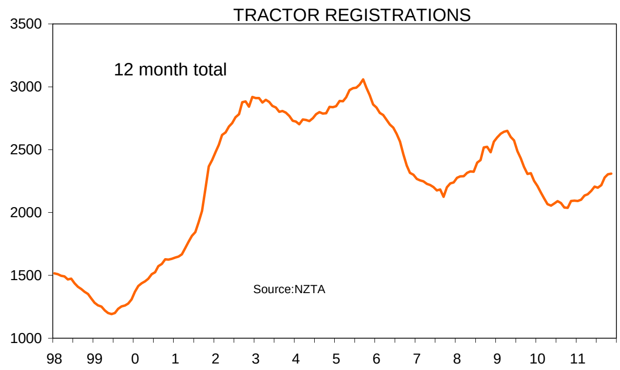
We think they are on the basis of rising imports of capital equipment and trend growth in registrations of commercial vehicles and tractors.

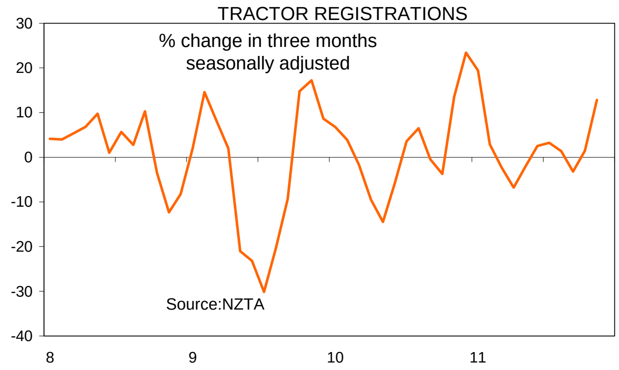
In November there were 1,916 commercial vehicles registered around New Zealand. This was a 19% rise from a year ago and near 5% seasonally adjusted gain in the three months to November from the three months to August. There is an upward trend in this measure consistent with rising business capital expenditure.





There is some mild strength also in tractor registrations which makes us feel reasonably confident in saying that the trend in this particular area of farm spending is still upward. There were 276 tractors registered in November which was a 2% rise from a year ago and produces a near 10% seasonally adjusted gain for the past three months. So things are rising, but activity is still at a relatively low level by the standards of the past few years.





What Do The Leading Indicators Say?

In this section we look only at the factors which can at times give insight into where the economy is headed. Generally we will only cover newly released information.

Business confidence is steady according to our latest BNZ Confidence Survey sent out to all Weekly Overview email recipients earlier this week.

INTEREST RATES

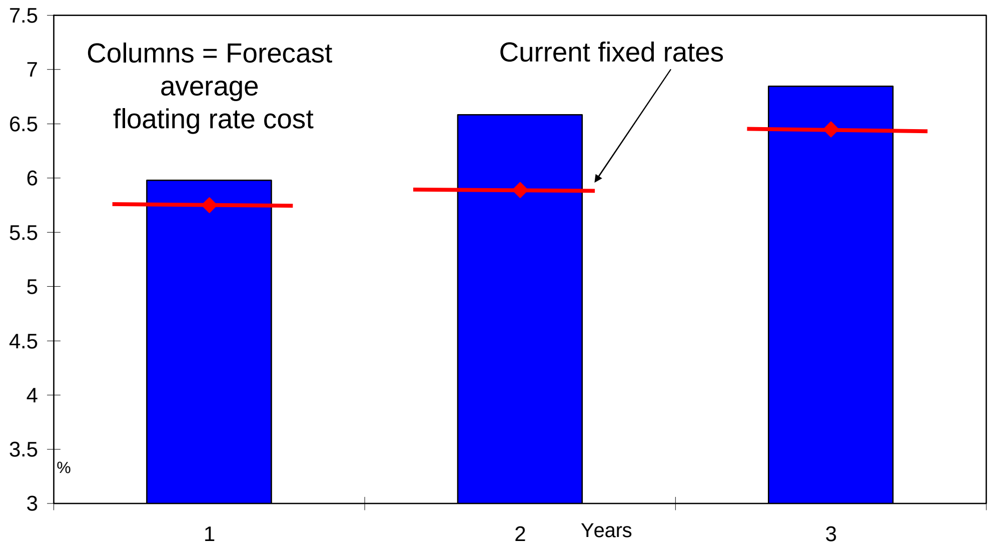
Wholesale interest rates have crept slightly lower this week mainly in response to underlying worries about world growth. The Reserve Bank met expectations this morning by leaving the official cash rate unchanged at 2.5% and while noting the downside risks to growth from events in Europe, and the economy recently being weaker than they had expected, they were at pains to emphasise the low probability that the cash rate will be cut. This seems a reasonable position given that the rate is already so low and there are some large stimulatory factors to come into play next year. But clearly, if Europe implodes they will move if necessary.

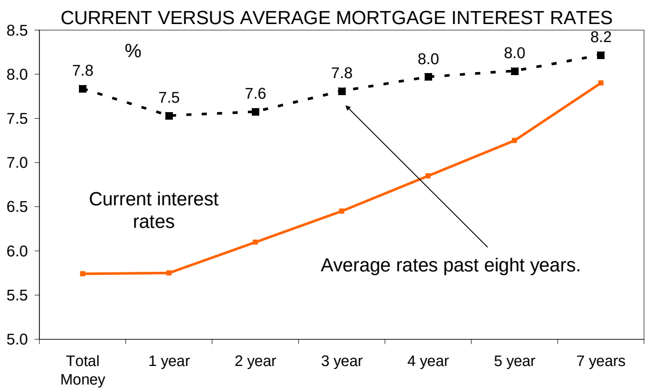
FINANCIAL MARKETS DATA

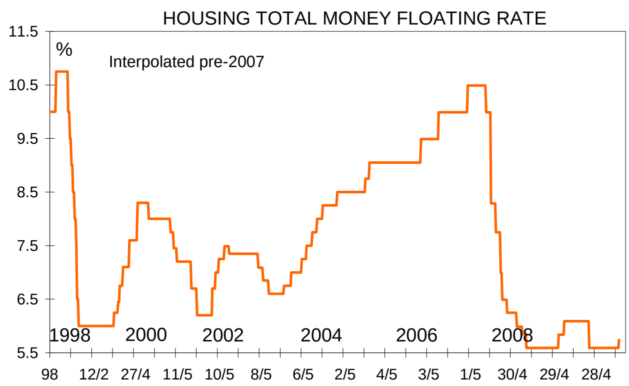
	This week	Week ago	4 wks ago	3 months ago	Yr ago	10 yr average
Official Cash Rate	2.50%	2.50	2.50	2.50	3.00	5.9
90-day bank bill	2.72%	2.68	2.76	2.95	3.21	6.2
1 year swap	2.79%	2.56	2.94	3.19	3.48	6.0
3 year swap	3.14%	2.92	3.40	3.72	4.28	6.2
5 year swap	3.63%	3.44	3.94	4.24	4.82	6.4
180-day term depo	4.00%	4.00	4.50	3.60	4.90	6.0
Five year term depo	5.85%	6.00	6.00	6.00	6.75	6.5

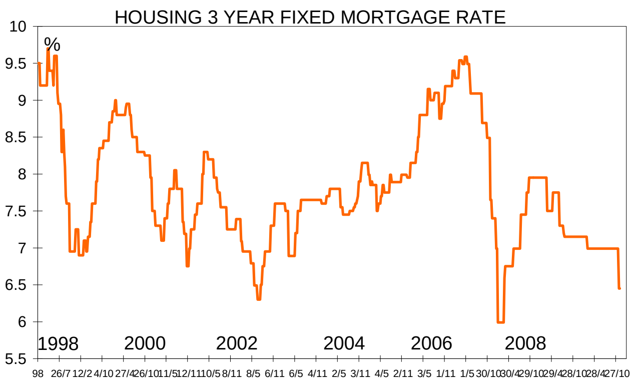
If I Were a Borrower What Would I Do?

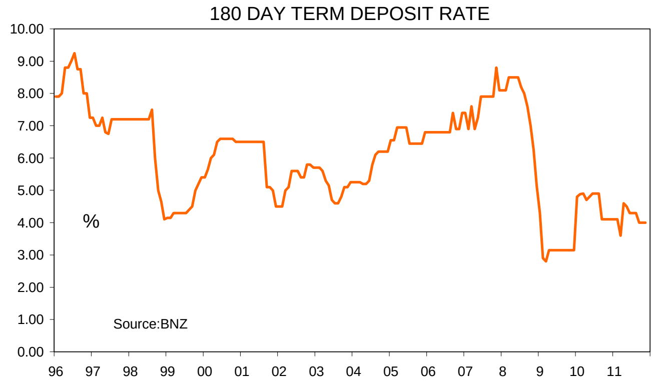
I float. Personally I worry that the situation in Europe will stay bad, that the global growth outlook will deteriorate, that expectations of reduced inflation will push wholesale interest rates lower, and that in deep extremis our central bank will cut its cash rate. If Europe muddles through our official view is that the OCR rises in the second half of 2012. But the risk is that it sits still until 2013. The fact that the Reserve Bank of Australia cut their cash rate 0.25% for the second month in a row this week explicitly citing Europe increases my willingness to remain floating.


Columns = Forecast average floating rate cost
Current fixed rates
%
Years
7.5 7 6.5 6 5.5 5 4.5 4 3.5 3
1 2 3


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

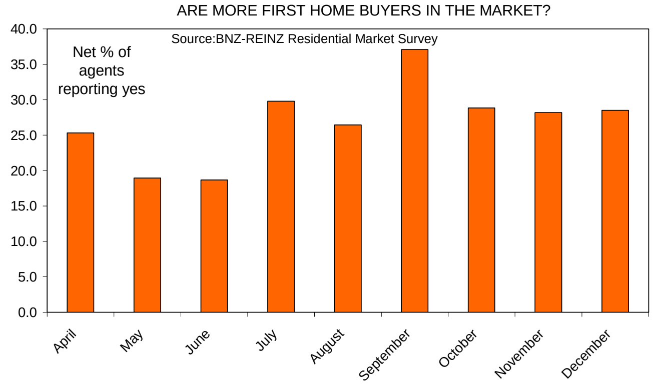

180 DAY TERM DEPOSIT RATE
%
Source:BNZ
10.00 9.00 8.00 7.00 6.00 5.00 4.00 3.00 2.00 1.00 0.00
96 97 98 99 00 01 02 03 04 05 06 07 8 9 10 11

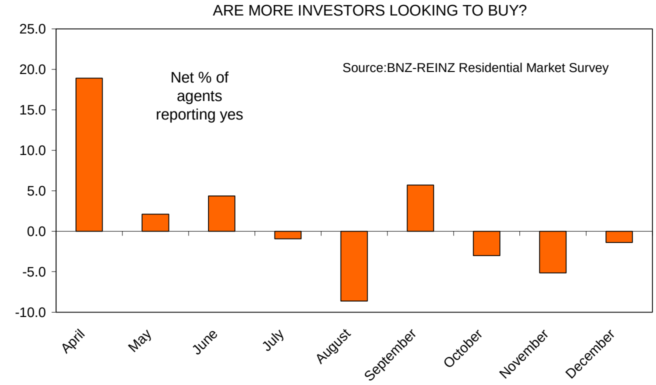
HOUSING MARKET UPDATE

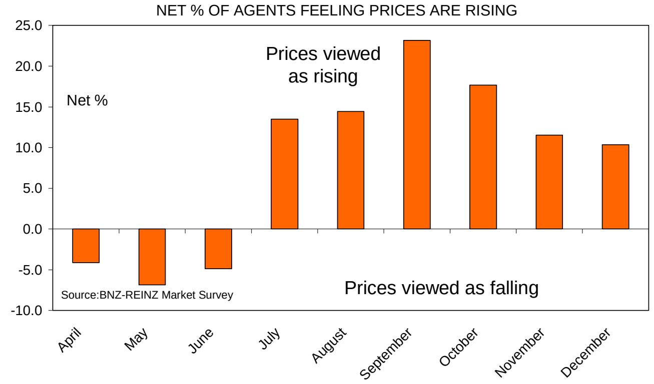
To view the most recent results of our monthly BNZ-REINZ Residential Market Survey click here. http://tonyalexander.co.nz/bnz-reinz-survey/

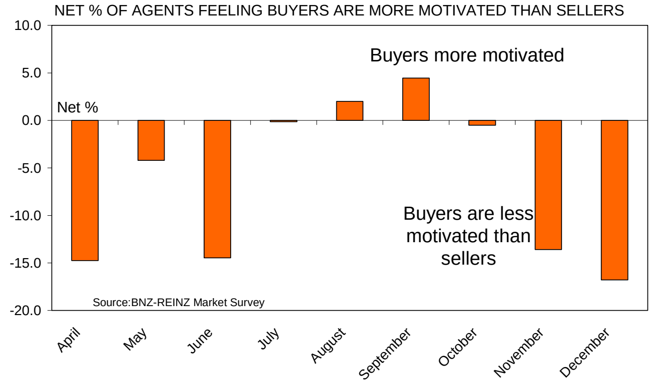
BNZ-REINZ Residential Market Survey

Yesterday we released the results of our latest survey of the country's 10,000+ licensed real estate agents. If you did not get it a copy can be found at the link just above. The results show continuing growing interest from first home buyers, investors doing nothing, sellers being highly motivated but unwilling to cut their prices, with the result that a net 10% of agents perceive prices as rising.









BNZ Confidence Survey Comments

For those who may have missed them, here are the comments submitted by people relevant to residential real estate in our monthly survey sent out last Thursday night. Everyone on the Weekly Overview emailing list will have received the full release on Tuesday morning.

Real Estate – Residential

- Real estate Dunedin, except for university steadily climbing, the rest is the same, rents don't move at all.
- Real Estate Invercargill: maybe slightly busier last couple of weeks, sales volumes steady, prices still flat.
- Rural real-estate Sales are sporadic with wide fluctuations in buyer confidence and seller expectation.
- Real Estate - North Shore Auckland. The wheels fell of a little bit during the world cup closely followed by the election and now Xmas is on us so I am thinking the drastic shortage of listings is probably going to be with us until late January. Plenty of buyers out there but minimal choice, is putting pressure on prices currently.
- Steady, Real Estate
- Real Estate - Central Auckland - residential - still a 'good' market. Still a relative shortage of good properties which in turn is still driving the prices up.

- Pick up in residential sales. Increases in value of inner city dwellings and dwellings presented well.
- Real estate....A gradual improvement throughout the year but our biggest issue at the moment is a shortage of homes coming to the market. Property Management continues to be buoyant.
- Residential Real Estate - Hawkes Bay. More action from buyers than we have seen in a long time.
- Real Estate Auckland Eastern Suburbs: Buyers & Sellers becoming ever more nervous about global financial risk. Uncertainty ensures declining activity and price. Only properties completely fit for purpose are attracting buyers in the lower & mid price ranges. Up to $1.5 million still getting reasonable competition for those properties, so long as vendors are prepared to meet the market. Top end properties are really struggling to find buyers at what vendors think are reasonable prices.
- Residential apartment sales steady
- Real Estate North Shore Auckland. -- Huge amount of sales recently. One house in Milford had 41 groups through, I wrote 7 offers up - sold first weekend cash unconditional. We have lots of new listings as well.
- Real Estate - Central North Island. We are still seeing a lot more activity with sales numbers nearly double that of last year for the same two months, September and October. Plenty of good listings coming on as well.
- Real Estate Napier, Very slow at the moment. Listings are down and buyers are very hesitant. Average sales for the year are indicating that this will be the slowest year since the recession began.
- Real Estate. Ponsonby and Grey Lynn have been moving up in activity very slowly and more people are listing once they see that the house prices have lifted above the 2007 peak.
- Real Estate in Hawkes Bay. Increase in residential sales through November with good new listings coming in also.
- Central Auckland Real Estate. More listings more choice for buyers results are dictated by quality and price, overpriced property not selling.
- Real estate sales shortage of listings - less for buyers to choose - pressure firming prices
- Properties are selling in waves. Two weeks good then two weeks quiet.
- Residential real estate Tauranga/Mt Maunganui, reasonable level of sales last 2 weeks with a few sales over the 1M at last!
- Residential Real Estate Napier. A steady month for sales but would like it to pick up markedly yesterday! Enquiry slow.
- Real estate Palmerston North: this will probably be a quiet Nov judging by our sales when compared to other Novembers... A hangover from the RWC and elections as a distraction???
- Real Estate. It's been a tough year but there is definitely more confidence out there amongst the buyers. Vendors are becoming more aware of the true market conditions (helped no doubt by the new lower rating values) and us agents are getting better at communicating facts (just the facts, ma'am) to our vendors. Am looking forward to better times.
- Green shoots are appearing in the Dunedin property market after a long drought. Contractors are busy, the stadium is a success bringing in the punters and there is a general lift in optimism in this sector. Property developers seem to be positioning themselves for the predictable cyclical uplift with a number of new quality builds around the city to satisfy the steady and solid demand caused by growth in the university infrastructure.
- Real estate, South Auckland. Investors looking for cheap deals. Some genuine home buyers but quality listings scarce and buyers wary of future economic situation. Next few years will be tough.
- Real Estate I have had quite a lot of interest from people looking for investment properties mostly between $300K and $1 million. The less savey investors have no idea what sort of return they want however those that are a bit more experienced are looking for net return in excess of 6%
- Real Estate - Hastings & Havelock North Residential. Much improved activity levels in November, but we all have serious "catch-up" required to compensate for what has been without doubt the toughest year yet (since the Financial Crisis began). Buyers are still very much in control and Vendors are having to meet the market if they wish to sell.
- Real Estate Tauranga influx of listings buyers still cautious sellers over optimistic on values good sign of new homes starting to be built.
- Real Estate - Static
- Real estate activity and volumes have improved during November...Some prices achieved in Auckland are the best ever but provincial areas are still struggling and vendors price expectations are not being

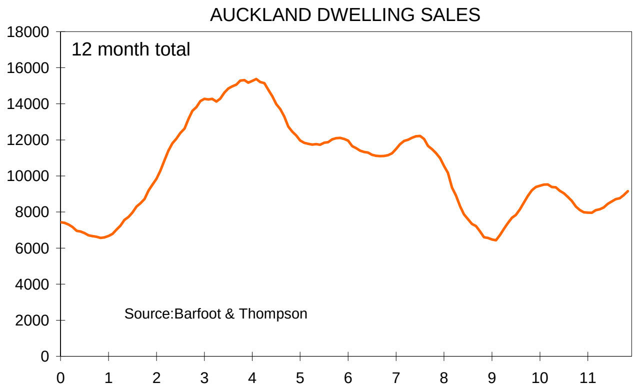
met. There is a vast difference between central Auckland and the Hibiscus Coast, for example. Christchurch is doing well with Red Zone homeowners making decisions so they can be settled before Christmas. But the rest of the country is very ho hum.
- Real Estate Sales person Wellington. Appears to be slowing early before xmas. Good properties still going very well with multiple offers, others with issues, no sun, walk up/downs are being heavily discounted
- Residential Real Estate Wellington. Better, with world cup and elections gone.. Buyers more willing to act, more good stock. prices still weak though. fear of redundancies
- Real Estate Invercargill. Dealing with a lot of 1st home buyers who want it all excepting any work yet are (this time round compared with 2006-7) also very price conscious
- Real Estate, Eastern Beaches. Ending the year pretty much where it started; short on listings anything good under $650k usually attracts good, quick and multiple offers. Less than good languishes. Next year possibly a little easier but probably not much.
- Residential Property. Sales volumes running up 15% Yr on Yr, more activity from First Home Buyers and a little more movement in top end of market. Cautiously optimistic for next 1/4.
- Nth Shore Real Estate. Vendors who had their homes appraised up to 4/5 mths ago are now coming to the market and with a good number of purchasers looking sales are now strong

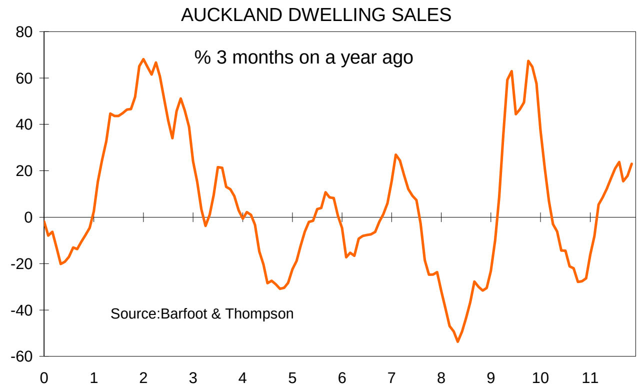
Property Management
- Residential property management Christchurch. Rents are increasing as shortages loom. Quality of tenants has increased as homeowners seek rentals as their houses are repaired
- Property Manager North Shore of Auckland, things have picked up this month with strong enquiry after 2 months of subdued enquiry. Rents are holding up with new pressure I believe we will get strong growth after Christmas. A few owners are testing the market as sales for under $550k are strong. Student applications for next year are up on last year so all looking good. looking good , low vacancy rates , low interest rates at the moment . Residential rental]
- Property Management Warkworth: Inquiry down Properties available down The phone is ringing again so we may pick up before Christmas, after that it will be flat until at least mid January
- Property Management - Wellington. Market remains flat, rents not moving much. Not many rentals available, and not many tenants looking. Despite that our business is growing steadily. Bring on the summer!
- No change- property investment
- Plenty of rentals available in palm Nth
- Property Investment- Flat lining
- I lease out houses to tenants. A few more houses are now available to rent, now that the RWC is over. Demand is strong however.
- Residential property rentals are solid, and rents tending upwards.

Barfoots Monthly Data

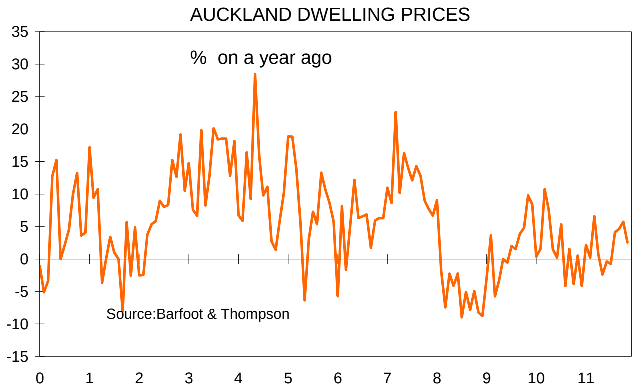
Sales and prices rising, listings falling.

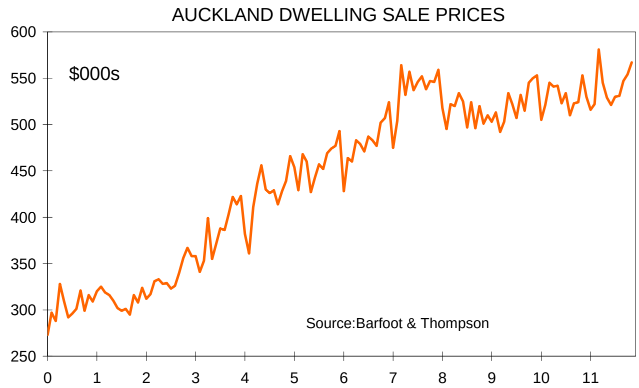
Lets start with the monthly data on Auckland real estate activity from Barfoot and Thompson. They reported 894 dwelling sales in November which was a seasonally adjusted rise from October near 10% and 34% rise from a year earlier. This is a strong result but looking through the monthly volatility merely suggests sales trending up at about a 2% seasonally adjusted three month rate. Activity is rising.



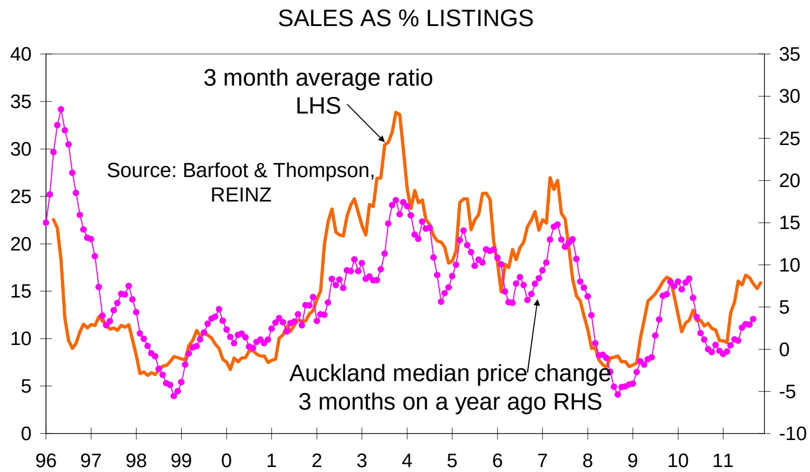


The median dwelling sale price lifted to $567,000 from $554,000 in October to lie 2.5% ahead of a year ago. Prices have gained about 5.4% in the past three months on average so we feel it is fair to say that on average Auckland house prices are rising. But one would be a tad unwise to extrapolate the near 5% three monthly rise to an annualised rise of 20%. Things are nowhere near that strong!.





During November Barfoot and Thompson received 1,562 new listings which was 4.7% fewer than a year earlier. The total number of listings at the end of the month stood at 5,046 which was 18.3% down from a year ago. And so we get our favourite graph of the correlation between movements in the sales to listings ratio and annual house price changes. The graph implies that with the sales to listings ratio rising prices will also be rising toward an annual growth rate near 8% from the current 4.3% in the past three months on average.



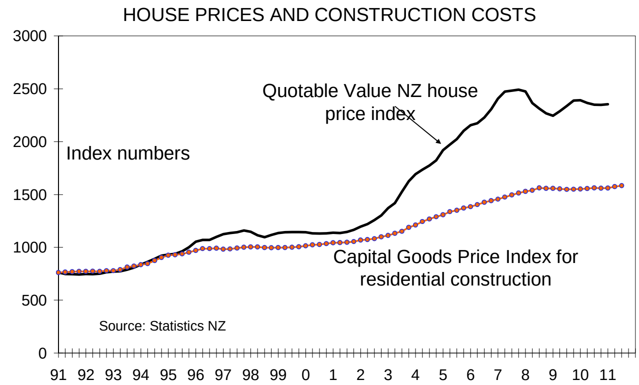
Basically the data show a rising Auckland residential real estate market. No doubt.

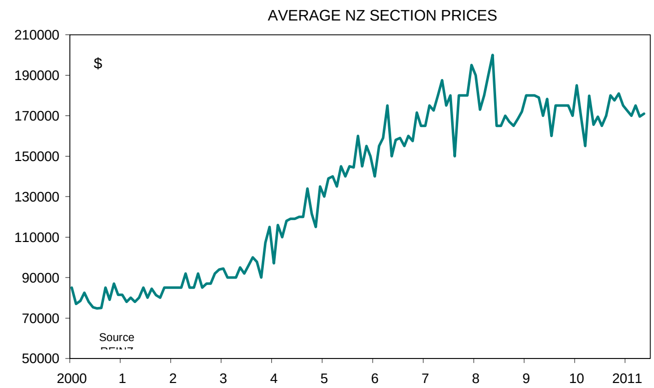
House Prices 25% Over-Valued?

The Economist magazine this week released their annual assessment of housing markets around the world and concluded that "Based on the average of the two measures, home prices are overvalued by about 25% or more in Australia, Belgium, Canada, France, New Zealand, Britain, the Netherlands, Spain and Sweden…"
http://www.economist.com/node/21540231

The implication one is invited to draw is that NZ house prices may fall 25% in the near future. And so we offer again – as we have been offering in various guises since the second half of 2004, our reasons for why NZ house prices will not significantly correct downward in the near future – in no particular order of importance.

1. The cost of building a house has risen along with average house prices over the past decade, councils have not opened up vast tracts of new land for housing and they keep adding extra costs for consents, inspections, developer contributions etc. Construction standards keep getting raised (post-leaky homes, insulation etc.), and materials prices generally keep rising. The first graph below shows the construction cost index for houses rising – though not as much as the total house price index. That is why one needs the second graph to understand things. It shows the sharp jump in average NZ section prices. Put the two together and the cost of building a house including a section has clearly soared along with house prices since the early 2000s.



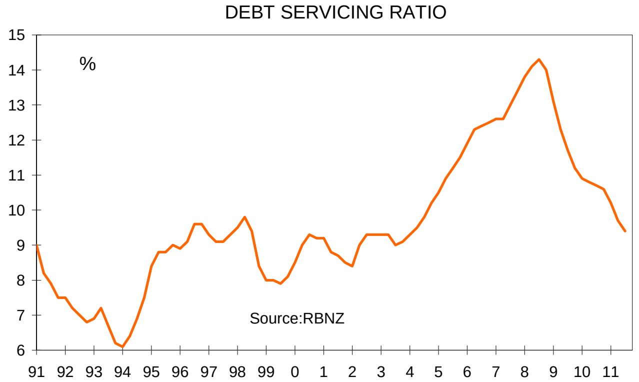


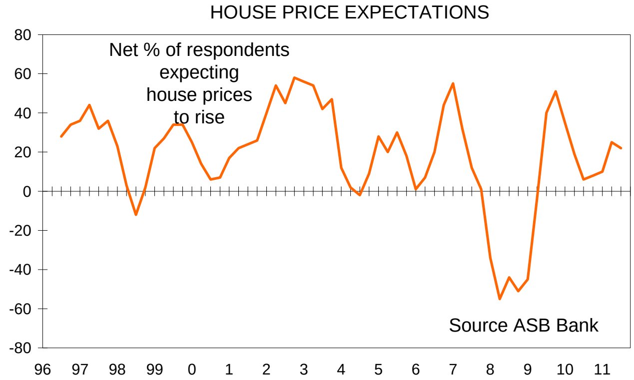
2. We have just had the worst global financial downturn since the 1930s and average NZ house prices only fell 11% at their worst. If that crisis could not produce a severe price correction then one struggles to imagine what will.

3. NZ vendors do not feel under pressure to discount prices to get a sale because the labour market remains in acceptable shape with the overall unemployment rate at 6.6% and not 8.6% as in the United States, 21.5% in Spain, or near 15% in Ireland.

4. In New Zealand we did not enter the downturn with a construction boom. We need maybe 24,000 consents to be issued per annum to meet average population growth and have averaged 23,200 in the past ten years, and 24,000 from 2005 – 2008. In addition there is a growing housing shortage with consents amounting to just 13,600 in the past year.

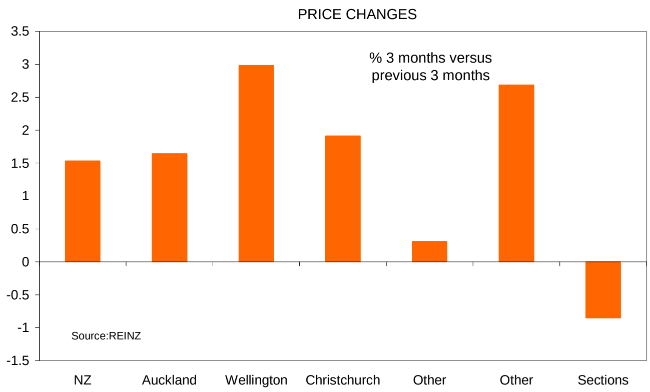
5. The sharp fall in interest rates from internationally high levels in 2008 has strongly cushioned mortgage holders. The average floating mortgage rate was 10.2% over 2007 then 6.4% over 2009 and now 6% in the past year. The household debt servicing ratio has fallen to 9.4% of disposable income from 14% in 2008.





6. People do not feel house prices will fall. The most recent ASB Housing Intentions Survey reveals that a net 22% of respondents feel house prices will rise over the next 12 months.

7. Average house prices are in fact rising. The REINZ stratified house price index was 3.4% higher in October than a year ago and has risen 1.5% on average over the past three months. In Auckland their measure in October was 6.6% higher than a year ago. Plus, as noted above, the Barfoot and Thompson average sale price measure for Auckland has gained 5.4% over the past three months.



8. The economy entered recession in 2008 and since then many young people have delayed moving into their first home (the household formation process) because of concerns about employment, eligibility for a mortgage, a desire to get personal debt down, and a desire to build a bigger deposit. This cohort of people is going to enter the market as the labour market improves and we think we can see that happening in our BNZ-REINZ Residential Market Survey results. A net 29% of agents report that they are seeing more first home buyers entering the market. In contrast a net 1% say they see fewer investors.

9. Unlike the United States mortgage lending in NZ is full recourse so the incentive to walk away from one's house when prices edge down – thus boosting the downward cycle – is not present.

10. The removal of the ability to claim depreciation for buildings expected to last less than 50 years and removal of ability to use Loss Attributing Qualifying Companies to reduce tax bills means fewer developers will look to build new dwellings.

11. When the rebuilding of Christchurch and the period of catch-up construction in Auckland commence we will quickly run out of builders. They will either have gone across the Tasman, retired, not been bothered to remain in the trade and meet new licensing requirements from the start of 2012, or simply will not have entered the trade with apprenticeship numbers down 40% in the past four years.

In a nutshell, if we were going to see a large price correction it would have happened by now. Just because one's measures show prices over-valued does not mean they will decline. In fact it pays to note that if a thing is considered 25% over-valued it was first 5% over-valued yet prices rose, then 10% yet prices rose and so on. A thing may only be 25% over-valued because it is on the way to being 50% over-valued! Valuation measures have little reliable predictive power.

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

This week is all about waiting for the leaders' summit over the next two days which may decide on a new fiscal framework for Europe and could stem the current spiral toward break-up of the Euro. Meantime Standard and Poors have increased pressure for the issue to be resolved with warnings that they may cut credit ratings for 15 of the 17 Euro-zone members and if this happens they might lop two notches off the rating for the bailout fund.

Chinese Inflation

The rate of growth in China is continuing to decline after easing from an annual pace of 9.7% in the March quarter to 9.5% in the June quarter and 9.1% in the September quarter. Evidence for the slowing can be seen in a few (but definitely not all of) the various monthly indicators with the most significant one recently being the official PMI which has slipped below 50. Tomorrow (Friday) we will receive updates on some of the monthly indicators so we shall write more about China next week.

US Growth Momentum

No time to write anything here this week. The general theme = growth occurring but not necessarily accelerating, deep worries about Europe, Federal debt problem unresolved.

Australian Growth

The Australian economy's growth rate is forecast to lift from near 1.8% this year to between 3% and 4% next year on the back of a truly massive minerals/infrastructure/engineering boom involving a pipeline of projects totaling around AU$0.5tn. Yet while these sectors boom others are suffering from a combination of

-increasing industrial action as increasingly militant unions take advantage of favourable Labour Government legislation and the tight labour market to acquire and spread around more working benefits,

-interest rates high by current world standards due to the tightening of monetary policy from late-2009 to late-2010 as the Reserve Bank looks to create space for the boom to occur without creating soaring inflation,

- high AUD pushed up by the minerals boom and high interest rates,

-reduced credit availability as banks face tightening funding conditions in European markets,

-tightening fiscal policy,

Sectors particularly experiencing pain are manufacturing exports, tourism, house building, and retailing.

This week we learnt however that assisted by the mining boom in Western Australia and Queensland in particular the Australian economy grew 1% in the September quarter to register 2.5% growth for the full year. Nevertheless, before that data release the RBA cut their cash rate 0.25% for the second month in a row in response to deepening worries about Europe. The rate is now 4.25%. Plus today we learnt that employment fell 6,300 in November (up only 0.4% on a year ago, and the unemployment rate climbed back up to 5.3%.

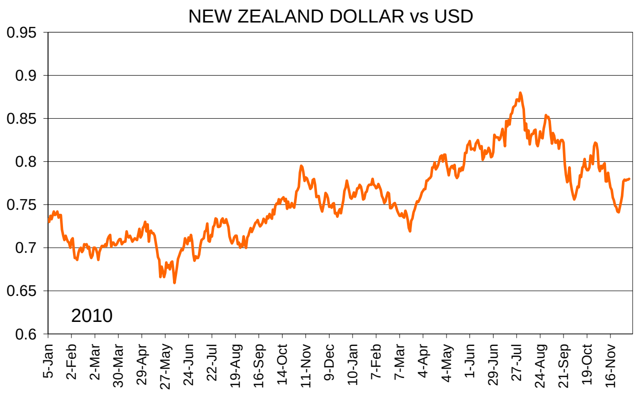
Exchange Rates

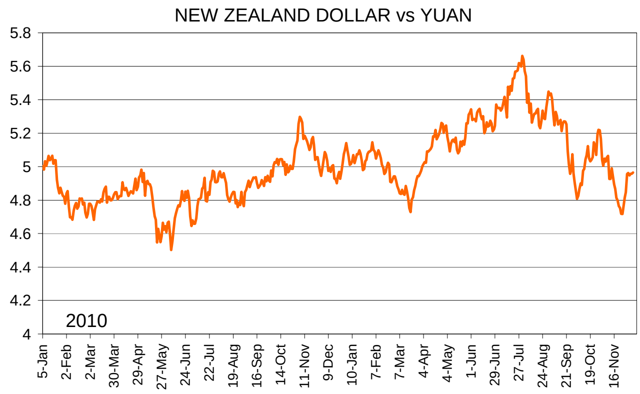
Exchange Rates	This Week	Week Ago	4 wks ago	Mths Ago	Yr ago	Consensus Frcsts yr ago*	10 yr average
NZD/USD	0.780	0.777	0.796	0.833	0.7575	0.689	0.629
NZD/AUD	0.761	0.761	0.767	0.786	0.7709	0.773	0.855
NZD/JPY	60.600	60.400	62.100	64.400	63.29	67.7	68.4
NZD/GBP	0.496	0.495	0.496	0.522	0.4809	0.448	0.368
NZD/EUR	0.582	0.578	0.578	0.592	0.5713	0.52	0.511
NZDCNY	4.965	4.957	5.055	5.327	5.036		4.83
USD/JPY	77.692	77.735	78.015	77.311	83.551	98.3	109.9
USD/GBP	1.573	1.570	1.605	1.596	1.575	1.54	1.705
USD/EUR	1.340	1.344	1.377	1.407	1.326	1.33	1.229
AUD/USD	1.02	1.02	1.04	1.06	0.98	0.891	0.737

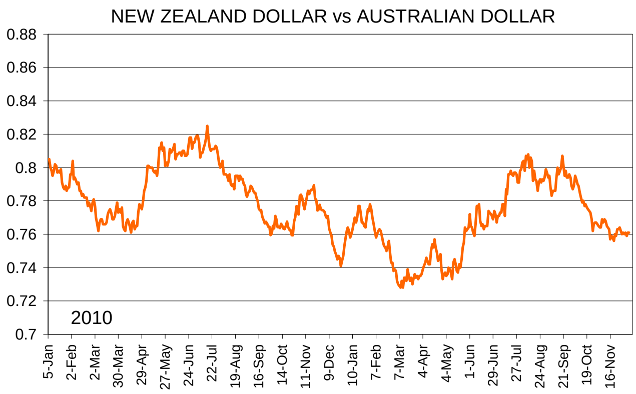
*Sourced from Consensus Economics. http://www.consensuseconomics.com/

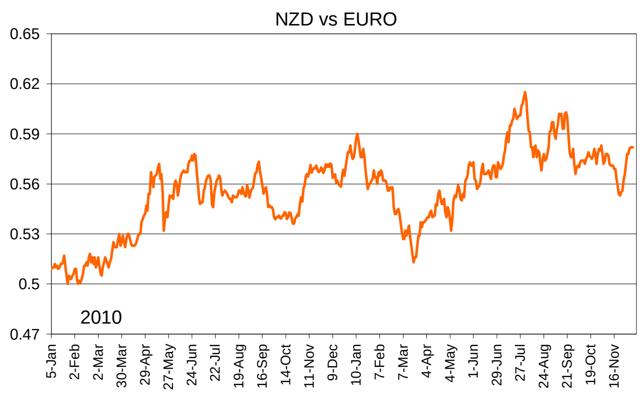
Markets Await Europe

The Kiwi dollar has crept up about one cent against the greenback over the past week but registered practically no change against the other currencies we track in the above table. That means nothing specific to ourselves was in play and the week was simply a story of the greenback edging lower. Why? Because of strong hopes that the two day European leaders' summit will result in proposals strong enough to assuage investor concerns about fiscal positions. That means that if the meetings are convincing then there is a good chance investors embrace risk and we will see the NZD move higher. If however agreement is not reached on what to do and how to do it then the return of risk will see the Kiwi dollar probably drop four cents. So again we await the outcome of yet another meeting.

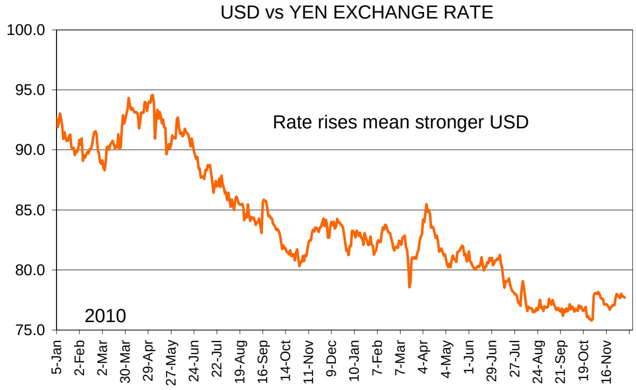


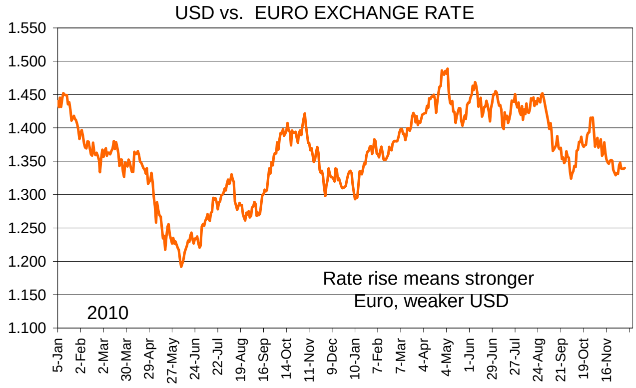






Under the scenario of things turning out okay we expect to see the NZD rising back above US80 cents toward 85 cents, especially when investors cast their tired eyes our way and realise that through all of the recent troubles our commodity prices have managed to hold up strongly and our central bank is still forecasting that its next interest rate change will be an increase.



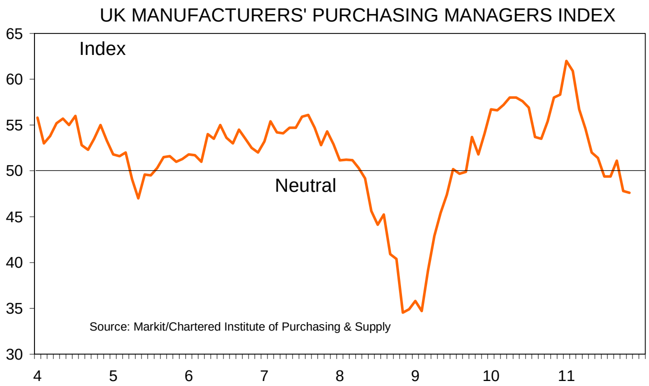


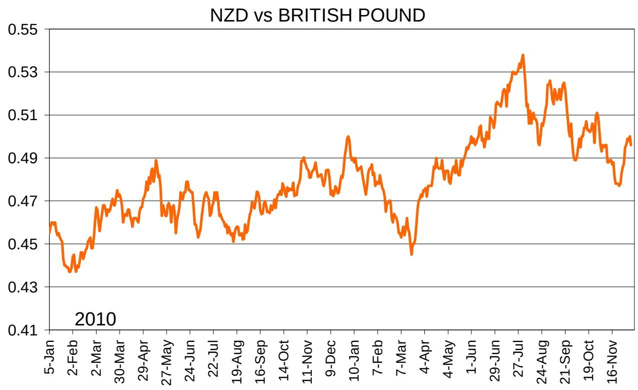
United Kingdom

It is difficult to get optimistic about what the coming year holds when one hears the following from the Bank of England Governor last Thursday night "An erosion of confidence, lower asset prices and tighter credit conditions are further damaging the prospects for economic activity and will affect the ability of companies, households and governments to repay their debts,"…"This spiral is characteristic of a systemic crisis." He in fact explicitly warned banks to bolster their defences against a systemic crisis.

The same day last week saw the biggest strike in a generation in the UK as hundreds of thousands of largely public sector employees marched against austerity measures being put in place to get down a budget deficit still sitting above 8% of GDP.

Here is just one of many possible graphs showing the slowdown of the economy into a probable recession in the first half of 2012. The PMI for the UK in November fell to 47.6 from 47.8 in October. A reading below 50 means the manufacturing sector is shrinking.





Exchange Rate Assumptions

Remember that exchange rates are impossible to forecast with reasonable accuracy. Treat the numbers below as assumptions for modelling purposes only.

	2010	2011	Risk	2012	Risk
Year end					
NZD/USD	0.73	0.70 - 0.8		0.84	Higher
NZD/AUD	0.74	0.73 – 0.79		0.85	
NZD/YEN	64.2	56 – 63		72.0	
NZD/GBP	0.44	0.45 – 0.50		0.52	
NZD/EUR	0.51	0.54 – 0.58		0.60	
USD/JPY	88	75 – 79		86	Lower
GBP/USD	1.66	1.52 – 1.62		1.62	Higher
EUR/USD	1.43	1.28 – 1.40		1.40	Higher
AUD/USD	0.99	0.95 – 1.05		0.99	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	0.4%	1.0	4.6	1.5	1.7
GDP growth	Average past 10 years = 2.6%	0.1	0.9	+1.5	0.5	-2.4
Unemployment rate	Average past 10 years = 4.8%	6.6	6.5	......	6.4	6.5
Jobs growth	Average past 10 years = 1.9%	0.2	0.0	1.1	1.8	-1.8
Current a/c deficit	Average past 10 years = 5.5% of GDP	3.7	3.6	......	2.5	5.6
Terms of Trade		-0.6	2.4	3.4	17.9	-14.1
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%.	2.4	1.1	2.1	2.3	-2.5
House Prices	REINZ Stratified Index	1.5	-0.2	2.3	-1.3	4.3
Net migration gain	Av. gain past 10 years = 13,900	-103	2,867yr	......	12,610	18,560
Tourism – an. av grth	10 year average growth = 3.2%. Stats NZ	2.5	-0.6	2.5	3.2	-1.0
		Latest year rate	Prev mth year rate	6 mths ago	Year ago	2 yrs ago
Business confidence	BNZ survey	3	-2	57	18	43
Consumer confidence	ANZ-Roy Morgan 100=neutral	109	112	103	115	122
Household debt	10 year average growth = 10.3%. RBNZ	1.2	1.2	1.5	2.4	2.6
Dwelling sales	10 year average growth = 2.5%. REINZ	28.3	21.1	-4.2	-35.9	36.3
Floating Mort. Rate	(TotalMoney) 10 year average = 7.9%*	5.74	5.59	5.59	6.09	5.59
3 yr fixed hsg rate	10 year average = 7.8%	6.45	6.99	6.99	7.15	7.95

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 tony.alexander@bnz.co.nz www.tonyalexander.co.nz

Key Forecasts

Dec. year		2010	2011	2012	2013
GDP	annual average chg	1.4	2.0 – 2.5	3.0 – 3.5	3.5 - 4.0
CPI	on year ago	4.0	2.5 – 3.0	2.5 – 3.0	2.5 – 3.0
Official Cash rate	end year	3.0	2.5	3.0 – 4.0	4.00 – 4.50
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