BNZ Weekly Overview

6 November 2008

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 WO and Offshore Overview each Thursday night email me at tony.alexander@bnz.co.nz with 'Subscribe" in the Subject line. You do not have to be a BNZ customer to receive the WO.

Survey Time

This week we are once again running our monthly survey. If you have not already done so in the email used for sending out the Weekly Overview please click on the URL below and let us know whether you think the economy will get better or worse over the coming year. More importantly if you have a couple of minutes let us know how things are looking in your particular industry at the moment specifying what the industry is and the region you are located in if relevant. The results will be released early next week.

http://survey.usuite.com/survey/7f801dd05f3742619b046cc119c15106.sur

This week we have learnt that wages growth was relatively strong during the September quarter and employment actually increased 0.1% rather than falling around 0.5% as most forecasters had been expecting. However the September quarter numbers don't really matter when one considers that the global credit crisis only really blossomed from the second half of September and prospects for world growth have been slashed since then. This doesn't mean that September quarter numbers should be completely disregarded because they still give the starting point from which the global recession will be affecting us. But there's not much point in deeply analysing some of the numbers given the shock which will be coming through.

Which then takes us to another problem. Monthly data for October around the world look absolutely appalling and it would be unsurprising if we did not see some very bad numbers for New Zealand eventually as well. Consumer sentiment for instance in the United States has fallen to a 41 year low. But given our distance from the major problems overseas it's unlikely that the collapse in sentiment because of the credit crisis would explain the over 30% fall in commercial vehicle registrations here in October compared with a year earlier. Businesses in New Zealand are pulling back on their capital expenditure in an environment where growth expectations are declining and funding costs are not falling as much as the Reserve Bank is cutting the official cash rate.

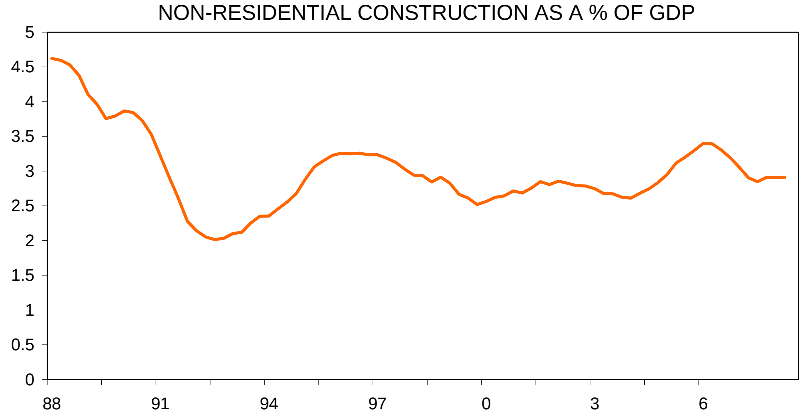
Speaking of which, having cut the cash rate 1% two weeks ago we expect at least another 0.5% cut on December 4 with the risk the reduction is greater than that. A decent cut is highly probable following on from the 0.75% cut in Australia this week and another 0.5% cut over there coming just two days before our own central bank's next review.

Whither Commercial Property?

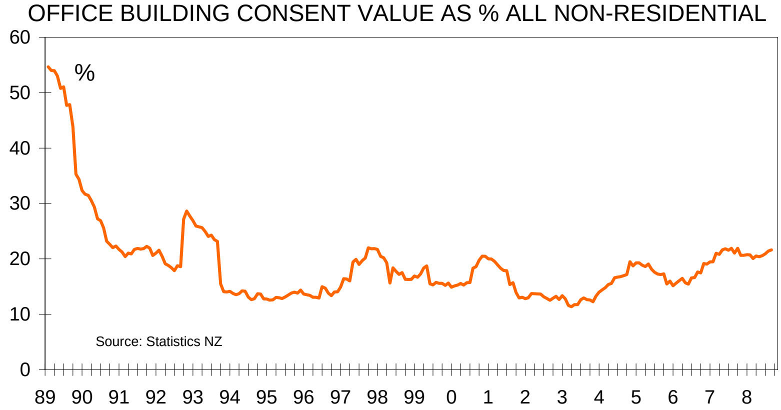
Will the recent large fall in our sharemarket be associated with the commercial property market also plummeting away – as happened in conjunction with the 1987 sharemarket crash? We don't have readily available data on vacancy rates which one should optimally use to answer this question. But here is a way of getting to the answer in simple fashion.

The sharp fall in NZ commercial property prices in the early 1990s was driven by a massive increase in supply over the late -1980s occurring at a time when the economy experienced six years of zero growth. This weak period resulted from the sharemarket collapse of late -1987 along with the Reserve Bank's efforts to fight inflation and the government's efforts from 1991 to rein in spending, along with global recession from 1991. This time around only the global recession element is in play. But more importantly, we do not enter this extended weak period following a massive construction boom.

The first graph below shows expenditure on non - residential construction as a proportion of GDP. The data only start in 1988 so miss the true peak. But they still show non-residential spending above 4.5% of GDP in 1988 compared with a peak of 3.4% early in 2006 and just 2.9% in the year to June. The non-residential building boom has been quite limited this cycle.



Second, the main problems during the early-1990s commercial property bust involved office buildings. In the year to February 1989 (earliest data) the value of office consents made up 55% of total non-residential consents. In the year to September 2008 this was just 22%.



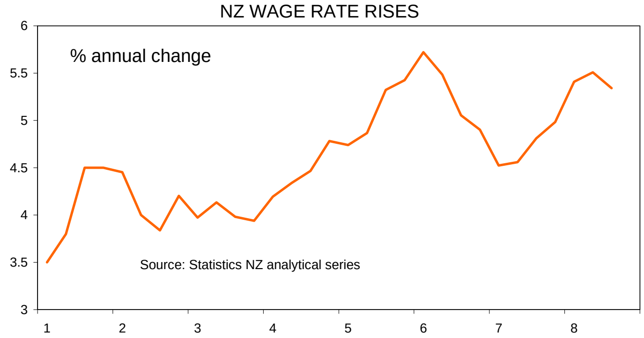
On the face of it, potential for a large correction in our commercial property sector appears limited. But feedback from the sector shows reducing demand from both investors and tenants and this correction is likely to continue through 2009. This will produce some increase in yields as prices ease, but then rents are likely to face downward pressure as well. Of high interest will be what happens in Wellington if a change in government produces a winding back in the number of "policy advisors" crammed into the harbour city over the past nine years.

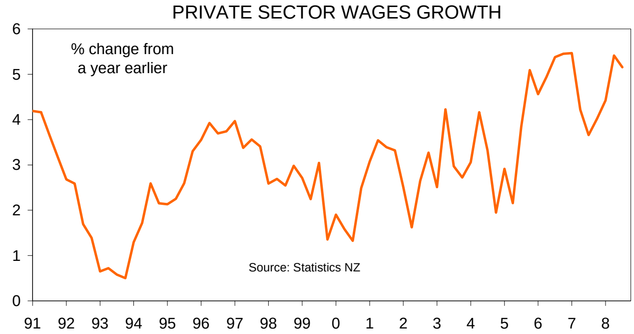
NZ ECONOMIC DEVELOPMENTS

Monday 3

Wages Growth Strong

For what is worth – because clearly the data have been superseded by events - wages growth was quite strong during the September quarter and the year to September. Private sector ordinary time wage rates measured in the Labour Cost Index rose by 1.1% in the September quarter after rising 0.8% during the June quarter. The increase from a year ago was a record high of 3.7% compared with 3.3% one year ago and 2.9% two years ago. An alternative measure published by Statistics New Zealand which attempts more closely to track changes in wage rates for the same jobs recorded a rise for all sectors of 1.5% in the September quarter from 1.1% in the June quarter and 1.7% a year ago. The annual increase in this measure was 5.3% from 5.5% in the June quarter and 4.8% a year ago.

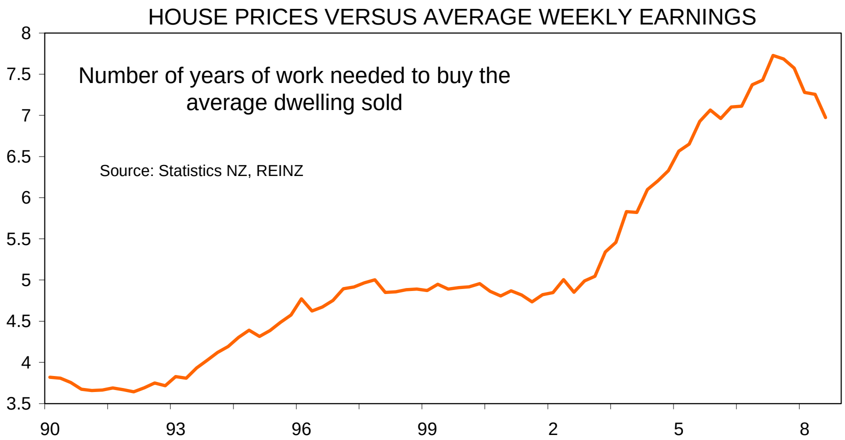




One can also try to get a feel for changes in wages growth by looking at the Quarterly Employment Survey. Private sector ordinary time earnings rose 1.1% in the September quarter after rising 2% in the June quarter and 1.3% in the September quarter of 2007. The annual rate of change was 5.2% from 5.4% in the June quarter and 3.7% year ago. The rate of increase is high but there are hints of a slowing in wages growth.

With the unemployment rate over the coming year likely to head towards 6% it seems fair to conclude wages growth is going to slow down and this will be one of the factors constraining household spending through 2009. Having said that however there are some positive things underway and what we can do is take some of the data from the Quarterly Employment Survey to get a feeling for how affordable houses are becoming.

Average weekly earnings for all individuals (not families and only those earning wages or salaries please note) across all industries rose to $919 in the September quarter from $910 in the June quarter and $873 a year earlier. The median dwelling sale price calculated using REINZ numbers was $333,000 in the September quarter. Comparing this price with average earnings one can calculate it would take 6.97 years to fully purchase the average priced dwelling. In the June quarter it would have taken 7.25 years. A year ago it would have taken 7.7 years. The latest result is the lowest since the March quarter of 2006 though as the graph below shows houses are still far less affordable than in previous years.

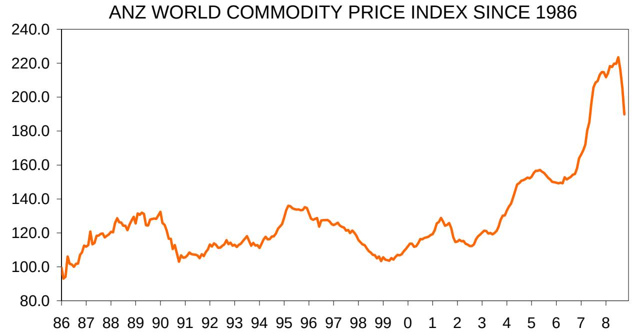


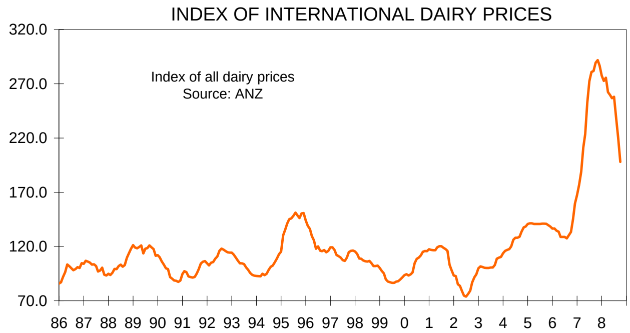
Note that over the time between 2003 and the June quarter of this year when this measure rose from around five years to seven years, residential construction costs rose 38%. (The measure of residential construction costs for the September quarter won't be released for another couple of weeks.) Over the same period of time the consumers price index rose by just 16% and average weekly earnings rose by 22%. This means about one quarter of the increase in the number of years taken to buy a dwelling over the past five years - or approximately half a year - can be attributed to higher construction costs.

Tuesday 4

Commodity Price Falls Offset by Plummeting Kiwi Dollar

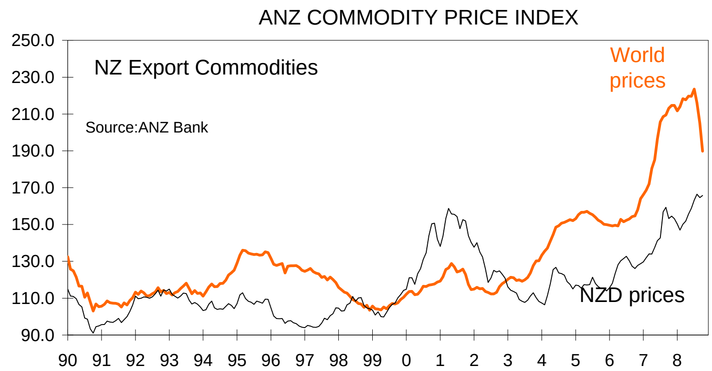
With the world economy heading into a recession of uncertain depth and longevity it is unsurprising that the prices being received for New Zealand's export commodities are falling away relatively sharply. The ANZ Commodity Price Index measured in world price terms fell 7.4% in October and has now declined by 10.9% from a year ago and 15.1% from its level in July. Many commodity prices fell during October with beef down almost 20%, dairy products 10%, wool almost 13%, and sawn timber prices down 5.8%. The important dairy price index is now down 32% from a year earlier and it seems reasonable to expect some further declines in the near future on the basis of a deteriorating outlook for the world economy generally.





The interesting thing will be how much of an impact this fall in international prices has on the willingness of farmers to undertake normal household spending and especially to invest further in the dairy industry. Hundreds of millions if not billions of dollars have been invested in recent years in dairy conversions with many more conversions planned. However, as is happening in all other parts of the world credit availability to finance expansion has reduced, funding costs are relatively high in comparison with the state of the economy and inflation outlook because of the international credit crisis, and of high importance for actual and potential dairy farmers costs have increased substantially.

The fall in the New Zealand dollar is thankfully providing some good insulation to farmers against the fall in international commodity prices. The ANZ Commodity Price Index in Kiwi dollar terms actually rose 0.7% in October to sit 8.8% ahead of a year earlier.

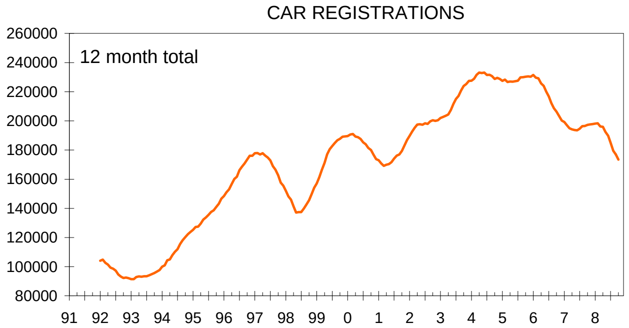


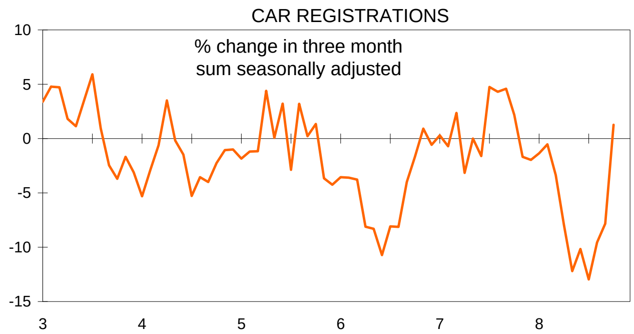
Government Accounts Show Mixed Results

Over the first three months of this fiscal year the government ran an operating deficit of $0.8 billion which was $1.7 billion worse than had been expected by Treasury. The change was entirely due to downward revaluations of financial asset prices in response to the global credit crisis. The underlying operating balance which excludes such factors came in $0.5 billion higher than forecast at $0.9 billion. Net Crown core debt excluding investments in the New Zealand superannuation fund now stands at only $2.6 billion. Gross debt stands at $32 billion or less than 18% of GDP. One can compare this with the near 70% ratio of gross debt to GDP in the United States and perhaps see clearly that substantial scope exists for the New Zealand government to use fiscal policy as a short term means of bolstering the New Zealand economy against the impact of a global recession over 2009 without aggressively scaring international investors or credit rating agencies.

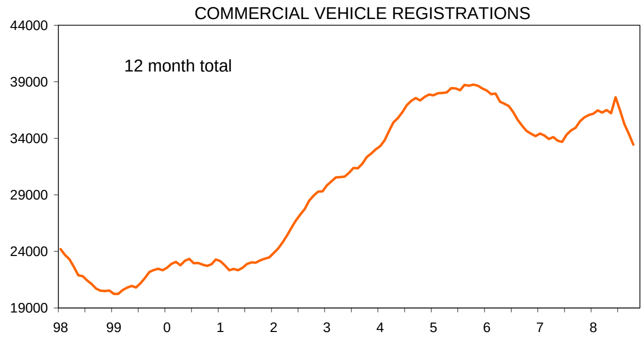
Commercial Vehicle Registrations Plummet

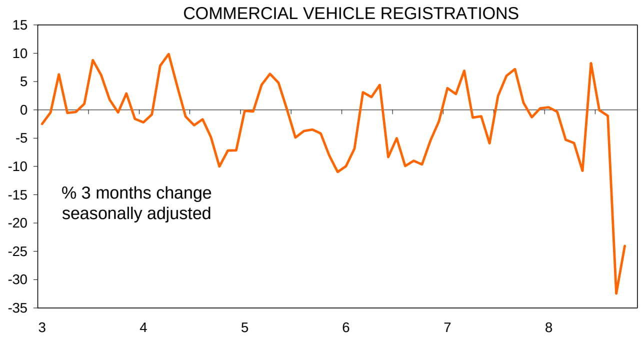
In October there were 14,091 cars registered around New Zealand. This was a 20% decline from a year earlier. In the three months to October the decline from a year ago was 22% but in seasonally adjusted terms there was a small increase from the three months to July of about 1%. In other words although overseas we are seeing plummeting numbers for motor vehicle sales in recent months in New Zealand the weakness manifested itself mainly earlier this year. The question however is whether we are about to see a second wave of spending restraint as our unemployment rate heads toward 6% over 2009 and the global recession deepens.



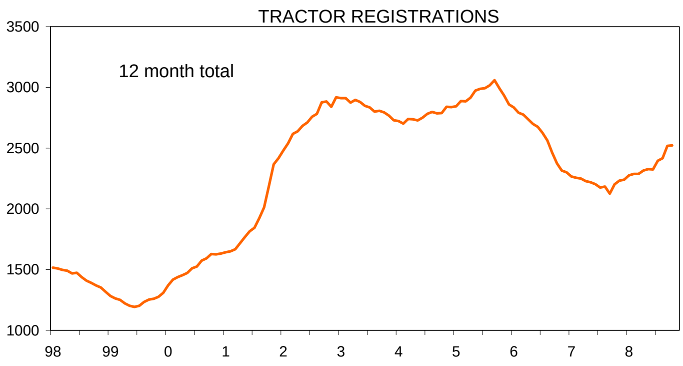


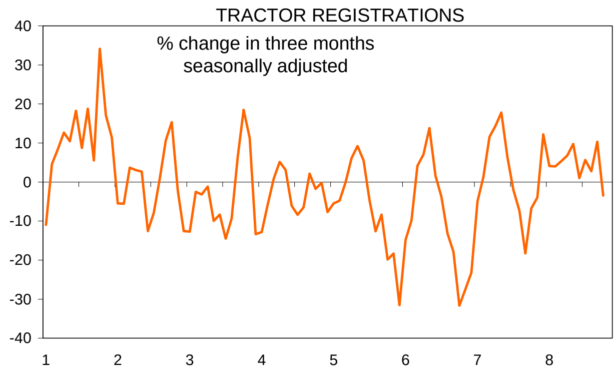
The number of commercial vehicles registered in October came in at 2,119. This was a relatively shocking 31% decline from a year earlier. In the three months to October in seasonally adjusted terms commercial vehicle registrations were down approximately 24% from the three months to July. Therefore whereas car registrations have weakened only slightly recently there is a new massive decline underway in commercial vehicle registrations as businesses adjust to a weaker economic outlook and cut back on their capital expenditure.





But whereas commercial vehicle registrations are plummeting tractor registrations are still holding up for now. In October there were 304 tractors registered around New Zealand which was a small 1.3% rise from a year earlier. In the three months to October tractor registrations were ahead 17% from a year ago, but in seasonally adjusted terms registrations were down by a small 3% compared with the three months to July. So there is evidence of some new restraint in farm expenditure on this important item but the restraint so far is relatively muted. It will be interesting to see in coming months how the divergent factors of high pessimism and a worsening global economy will be offset by optimism about better returns from 2010 in response to the weakening Kiwi dollar.

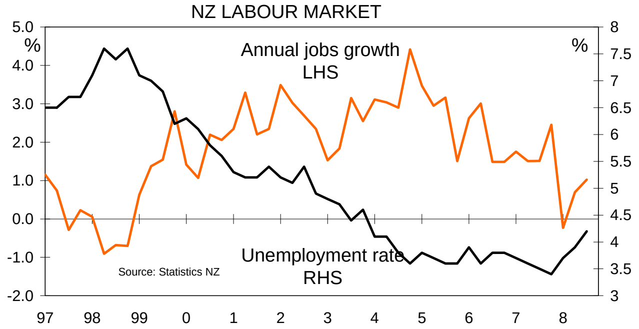


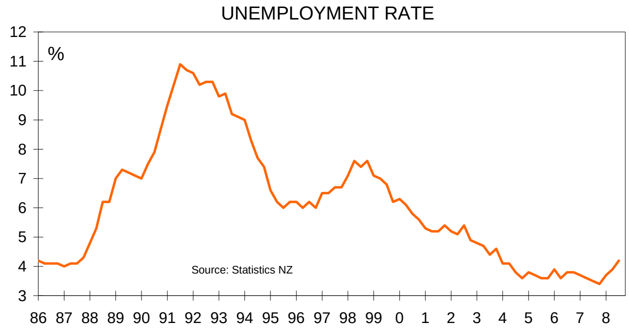


Thursday 6

Unemployment Rises - Lots More to Come

in spite of jobs growth of a better than expected 0.1% seasonally adjusted over the September quarter the unemployment rate rose to a three-year high of 4.2% from 3.9% in the June quarter and 3.5% a year earlier courtesy of more people entering the workforce. The total number of unemployed people in New Zealand now stands at 94,000 which is the highest level since the end of 2003 and up from 79,000 a year ago.





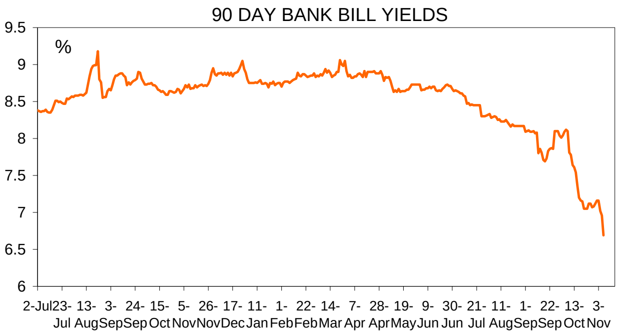
There are lots of little pieces of information released each quarter with the Household Labour Force Survey and normally we could have quite a bit of fun digging down to see if there is anything interesting. But there seems little point in doing that this time around for two reasons. One is that the survey recently has shown some exceptionally high volatility which means focusing on just quarterly numbers is probably not a good idea and one needs to smooth over a couple of quarters of least. For instance job numbers fell 1.3% in the March quarter there rose 1.3% in the June quarter. That doesn't really make sense given the economy moved into recession over the first half of this year.

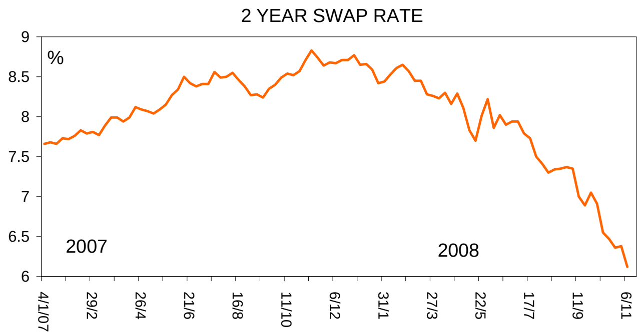
The main reason however is that it's obvious our labour market and labour markets in every other country will be weakening off potentially severely over the coming year in response to the global credit crisis and emerging global recession. Perhaps one point of interest however is that the labour market is not necessarily as weak as the Reserve Bank may have been thinking when discussing monetary policy recently. In fact the Reserve Bank explicitly noted on October 23 when it cut the cash rate 1% “However, we still have concerns that domestically generated inflation (particularly in labour costs, local body rates, electricity prices and construction costs) is remaining stubbornly high.”

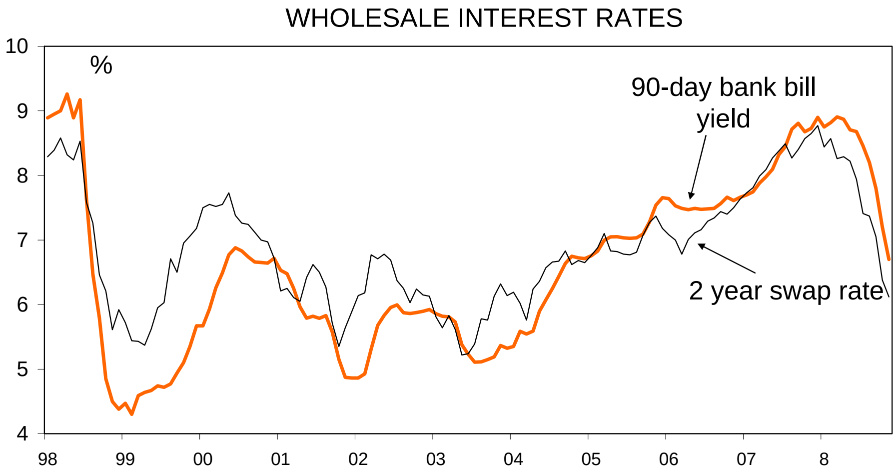
So if anything the better than expected employment result for the September quarter may cause some of the optimism regarding the Reserve Bank cutting the cash rate as much as 1% in early December to back off a bit.

INTEREST RATES

Courtesy of the Australians wholesale interest rates have rallied strongly in New Zealand over the past week. The yield on 90 day bank bills has declined to near 6.7% compared with just over 7% last week. This is the lowest level since September 2004. Just before the Reserve Bank started tightening monetary policy in January 2004 the 90 day bank bill yield was just above 5%. The two-year swap rate has fallen to near 6.1% from just over 6.3% last week. This is the lowest rate since April 2004.







Across the Tasman the Reserve Bank of Australia surprised the markets by cutting its official cash rate 0.75% to 5.25% rather than the 0.5% cut which had been expected. The RBA cited concerns about the global financial crisis, weakening domestic economic activity, and newly emerging evidence of weakness in emerging economies such as China which is a major trading partner for Australia. Because the Australian central bank now has a worse outlook for the Australian economy and is expected to cut interest rates more than previously thought one has to expect similar action in New Zealand given that over 20% of our export receipts are derived from Australia including 40% of our tourist numbers. The 0.75% interest rate cut across the ditch increases the chances that come December 4 when the official cash rate is next reviewed in New Zealand our central bank will also cut 0.75% rather than the 0.5% more commonly expected and which we still think is the most likely outcome.

However there is more to it than that. Ahead of our next rate review the Australian central bank will have had the chance to cut interest rates again at their monthly meeting. If they cut 0.5% as is now largely expected that means there will be 1.25% worth of reductions in the cash rate across the Tasman since our central bank cut by 1% to 6.5% on October 23.

The markets therefore have started to price in a high probability the RBNZ will cut about 1% and hence the extra rally in New Zealand wholesale interest rates. One key point to note is the increased steepening of the yield curve. The yield curve shows the different interest rates applied to different terms. The one-year swap rate for instance is now at approximately 6% whereas the five-year swap rate is just above 6.4%. That represents a 0.4% positive gap whereas a week ago the gap was about 0.1% with the one-year swap rate at

6.4% and the five-year swap rate at 6.5%. Four weeks ago the yield curve was inverse with the one-year swap rate at 6.75% and the five-year rate at 6.67%.

Key Forecasts

- Monetary policy easing with the official cash rate near 5.0% come mid 2009.
- The two year fixed housing rate reaching 7.5% in mid-2009 or earlier, with further downside after that assuming easing of the credit crisis. Falling to the 6.5% low of 1999, 2001 and 2003 is unlikely this cycle.

FINANCIAL MARKETS DATA

	This week	Week ago	4 wks ago	3 months ago	Yr ago	10 yr average
Official Cash Rate	6.50%	6.50	7.50	8.00	8.25	6.2
90-day bank bill	6.69%	7.10	8.12	8.29	8.72	6.5
10 year govt. bond	5.98%	5.92	5.64	6.09	6.57	6.2
1 year swap	6.05%	6.39	6.75	7.67	8.95	6.7
5 year swap	6.40%	6.50	6.67	7.12	8.39	7.0

If I Were a Borrower What Would I Do?

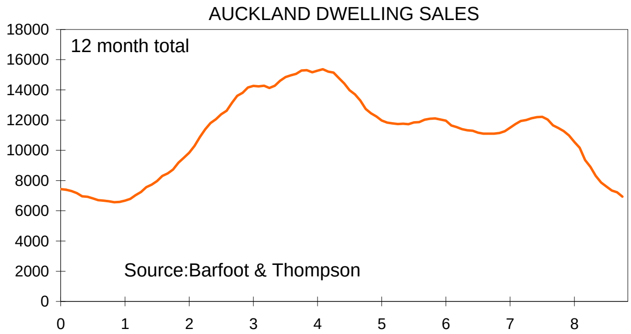
Under normal circumstances the discussion just above regarding falls in short-term swap rates would lead to one stating a high expectation that fixed housing rates would fall sharply in the near future. However we have to come back to the point we have been making for many months that the cost to banks of raising funds internationally has gone through the roof and a simple relationship between swap rates and fixed housing rates went out the window a long time ago. Competitive pressures suggest to us we are likely to see some fixed housing interest rate cuts in the future but in the short term one should not get optimistic about the magnitude.

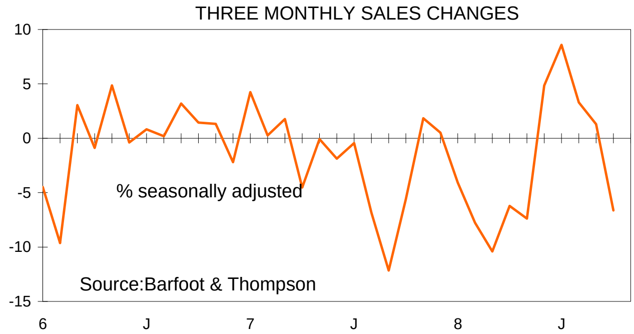
Only if the global credit crisis improves substantially in the future would we be likely to see a major rally in fixed interest costs in New Zealand. But it's more likely that the global credit crisis will only slowly ease over the coming year. What that means is even when monetary policy is no longer easing in New Zealand and swap rates have stopped falling we could still get some falls in fixed housing lending rates because of the reduction in the cost of the raw material we source from overseas.

Because of uncertainty about when the official cash rate reaches a low and when markets think it will start rising again, and the easing path of the global credit crisis, it is unusually difficult to take a punt on when fixed borrowing costs are likely to bottom out this cycle. One’s best guess is sometime in the second half of next year but don't be surprised if that timing changes or if one flip-flops between July and December as the probable low points

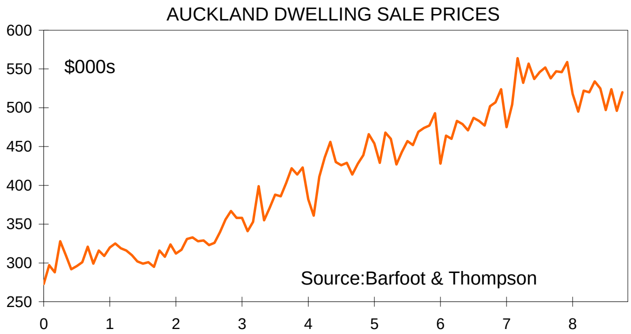
HOUSING MARKET UPDATE

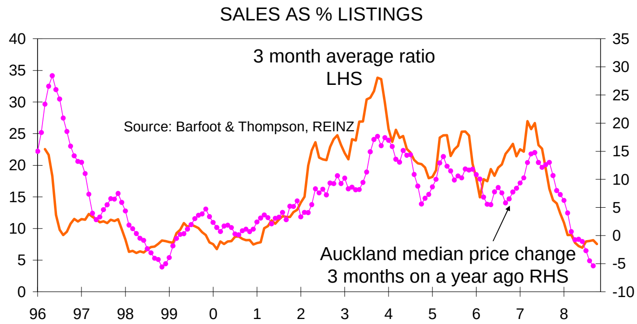
This week we received the monthly data from Barfoot and Thompson regarding activity in the Auckland real estate market during October and some of the numbers make for very bad reading. During the month they sold only 503 dwellings which was the lowest number for October since records started in 1995. Sales in the month were down 37% from a year earlier and in seasonally adjusted terms were down roughly 10% from September. In other words some fresh weakness has appeared after a small seasonally adjusted improvement in September of 7%.



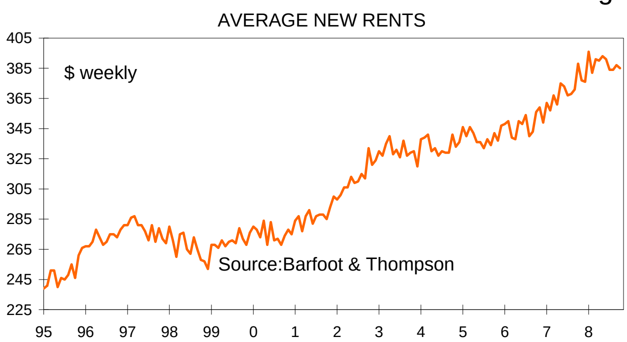


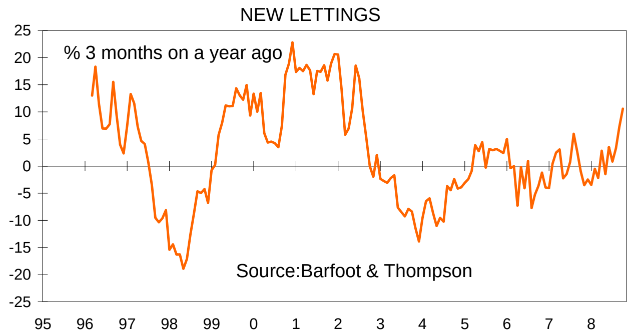
Interestingly the median dwelling sale price actually improved enough in the month to $520,000 from $496,000 in September and $524,000 in August. This was a 4.9% decrease from a year earlier but the result suggests there is no new fresh weakness in prices appearing - yet.





The total number of listings at the end of the month stood at 7,090 which was a 25.6% increase from a year earlier and the highest October number on record. The ratio of sales to listings has now fallen to a new low of 7.09% which is also the lowest October reading on record.





What the numbers show is that for the moment prices continue to hold up but there are plenty of people who want to sell their properties and they are tending to let them sit on the market. At the same time however they may well have made them available for rent and the rental market seems quite active. During October there were 691 properties let which was an increase from year earlier of 13.1% and the highest October number since 2002.

Key Forecasts

- Dwelling consent numbers to fall from 24,500 in the year to March 2008 to below 18,000 in the year to March 2009 (annual low point near 16,000 now likely) with a slight recovery to March 2010 then above average activity after that as attention turns to a shortage of dwellings late in 2009.
- Real estate sales falling from 77,130 in the year to April 2008 to between 55,000 and 65,000 come the end of this year then recovering back over 65,000 in calendar 2009 with further growth over 2010.
- House prices down 5%-10% by the end of 2008, flat over 2009, rising slightly over 2010.

Exchange Rates & Foreign Economies

See the Offshore Overview.

Blanket apology for any strange words or phrases resulting from not doing enough proof-reading after using the Dragon Naturally Speaking voice recognition software.

ECONOMIC DATA

All %		Latest qtr only	Previous qtr only	Latest year	Year ago	2 Yrs ago
Inflation	RBNZ target is 1% - 3% on average	1.5%	1.6	5.1	1.8	3.5
GDP growth	Average past 10 years = 3.0%	-0.2	-0.3	2.6	2.4	2.4
Unemployment rate	Average past 10 years = 5.3%	3.9	3.7	......	3.6	3.6
Jobs growth	Average past 10 years = 1.9%	1.3	-1.3	0.7	1.5	3.0
Current a/c deficit	Average past 10 years = 5.5% of GDP	7.8	7.9	......	8.5	9.6
Terms of Trade		2.9	3.7	8.8	3.8	-1.9
Wages Growth	Stats NZ analytical series	1.2	1.3	5.5	4.5	5.5
Retail Sales ex-auto	Average past 9 years = 3.8%.	0.2	0.1	3.1	4.9	5.6
House Prices	Long term average rise 5% p.a.	-4.5	-0.7	-4.4	13.7	10.3
Net migration gain	Av. gain past 10 years = 10,400	+4,403	4,938yr	......	8,319	13,210
Tourism – an. av grth	10 year average growth = 5.0%. Stats NZ	-0.3	0.9	-0.3	3.8	-0.7
		Latest year rate	Prev mth year rate	6 mths ago	Year ago	2 yrs ago
Consumer conf.	10 year average = 2%. Colmar survey	1	23	-34	2	-10
Business activity exps	10 year average = 26%. NBNZ	-11.4	16.7	-3.8	20.3	18.0
Household debt	10 year average growth = 11.3%. RBNZ	6.7	7.3	10.9	13.3	13.3
Dwelling sales	10 year average growth = 3.5%. REINZ	-23.7	-34.0	-53.3	-32.0	-5.6
Floating Mort. Rate	10 year average = 8.1%	9.75	10.95	10.69	10.55	9.55
3 yr fixed hsg rate	10 year average = 7.9%	8.49	9.09	9.54	8.75	7.89

ECONOMIC FORECASTS

Forecasts at Oct. 9 2008	March Years					December Years				
	2007	2008	2009	2010	2011	2006	2007	2008	2009	2010
GDP - annual average % change										
Private Consumption	2.9	3.3	-0.5	1.3	2.4	2.7	4.1	-0.1	0.7	2.3
Government Consumption	4	4.1	3.6	3.2	3.3	4.7	3.6	4	3.2	3.2
Investment	-1.9	4.3	-3.5	-2.2	7.7	-1.5	4.7	-1.5	-4.9	6.8
GNE	1.1	4.5	-0.9	0.9	3.8	1.2	4.5	0.3	-0.3	3.6
Exports	3.1	2.3	2.5	4	3.1	1.7	3.3	1.9	4.1	3.1
Imports	-1.6	9.7	3.4	-0.2	3.7	-2.6	8.7	5.6	-0.6	2.9
GDP	1.8	3.2	-0.1	2.2	3.6	2	3.2	0.5	1.3	3.6
Inflation – Consumers Price Index	2.5	3.4	4	2.4	2.1	2.6	3.2	4.3	2.7	1.7
Employment	1.8	-0.2	0.4	0.7	1.9	1.4	2.5	-0.6	0	1.9
Unemployment Rate %	3.7	3.7	4.7	5	4.8	3.8	3.4	4.5	5	4.8
Wages	5.5	4.4	5	3	2.4	5.5	4	5.3	3.4	2.4
EXCHANGE RATE ASSUMPTIONS										
NZD/USD	0.7	0.8	0.6	0.63	0.67	0.69	0.77	0.62	0.62	0.66
USD/JPY	117	101	104	112	117	117	112	101	110	116
EUR/USD	1.32	1.55	1.37	1.33	1.37	1.32	1.46	1.38	1.32	1.36
NZD/AUD	0.88	0.87	0.81	0.78	0.8	0.88	0.88	0.84	0.78	0.79
NZD/GBP	0.36	0.4	0.35	0.38	0.4	0.35	0.38	0.35	0.38	0.4
NZD/EUR	0.53	0.52	0.44	0.47	0.49	0.52	0.53	0.45	0.47	0.49
NZD/YEN	81.9	81.1	62.4	70.6	78.4	81	86.3	62.6	68.2	76.6
TWI	68.6	71.6	58.8	62.4	66.1	68	71.6	60.2	61.4	65.2
Official Cash Rate	7.47	8.15	6	5.5	6	7.44	8.19	6.5	5.5	6
90 Day Bank Bill Rate	7.78	8.83	6.45	5.75	6.25	7.64	8.77	7.08	5.75	6.25
10 year Govt. Bond	5.91	6.35	5.7	6.1	6.3	5.77	6.38	5.7	6	6.25

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

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