BNZ Weekly Overview

2 June 2011

Mission Statement

To help Kiwi businesspeople and householders make informed financial decisions by discussing the economy and its implications in a language they can understand.

In this week's issue….

The Weekly Overview is written by Tony Alexander. The views expressed are my own and do not purport to represent the views of the BNZ. To receive the Weekly Overview each Thursday night email me at tony.alexander@bnz.co.nz with 'Subscribe" in the Subject line.

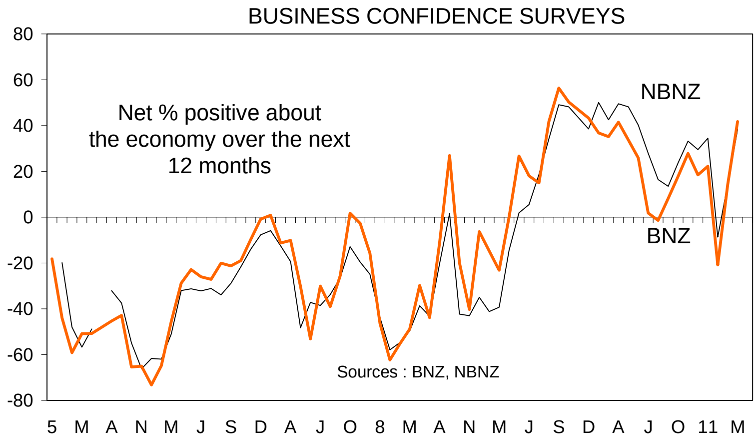
Monthly Survey Time

This week we are running our monthly BNZ Confidence Survey, so if you have not already responded using the link in the email sent to those on our distribution list please feel free to click here and let us know if you feel the economy will be better or worse in a year's time. Also if time permits tell us what industry you are in and how conditions are currently. And, just as we did last month we have added an extra one-off question, this one being "If there was one thing you would like the government to do right now, what would it be?" The results will be released early next week. Many thanks to past respondents.

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

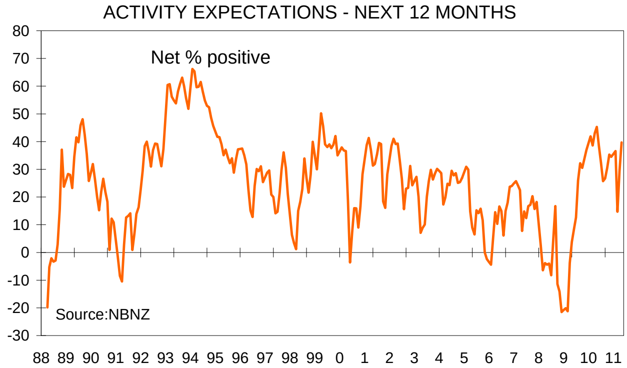
The week has been a relatively important one with regard to information about the New Zealand economy, the upshot of which is good economic growth prospects, increasing legitimacy of worries about inflation further out, therefore upside interest rate and exchange rate risks. It goes like this. First we have data in hand showing that courtesy mainly of the dairy, meat and forestry sectors exports in seasonally adjusted terms rose by 8.1% in April and were ahead 7.3% in the three months to April when compared with the three months to January. This latter rate of growth is well above the average of just 1.2%.

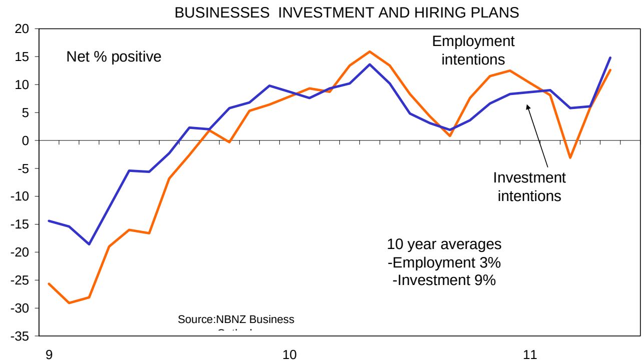
Second the monthly NBNZ Business Outlook survey replicated our own survey result from three weeks ago and showed a sharp rise in business confidence early in May. The graph here shows why the markets should not have been surprised as they were by the result on Tuesday. Silly rabbits.



A net 38% of businesses expect the economy to improve in a year’s time (our result was 42%). More importantly, because it is better correlated with actual economic growth, the activity expectations net percent positive jumped to 40% from 30% in April which is the strongest reading since May last year – which then hopefully makes you realise why forecasting and getting extremely optimistic on the basis of confidence surveys is not a good idea. They gave zero warning last year of the stalling in economic growth – even as it was happening in last year’s June quarter. In fact, were it not for soaring confidence back then the Reserve Bank might not have raised its cash rate 0.5%. So be careful when using sentiment surveys.

Still, for the record there are some other good numbers in the survey which gel with stuff we expect to happen. For instance the net percent of businesses planning to hire more people over the next three months jumped to 13% from just 6% in April. Plus investment intentions rose to a net 15% positive from 6%. Both measures are well above average.

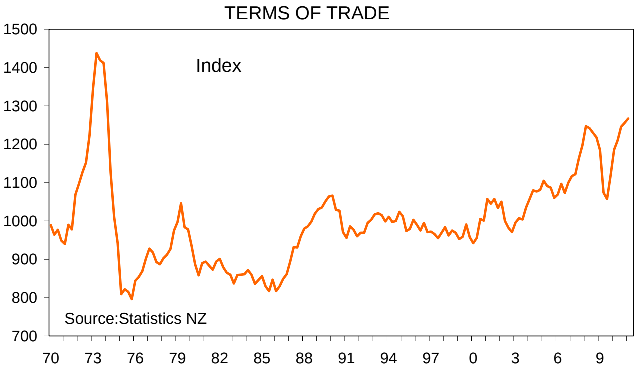


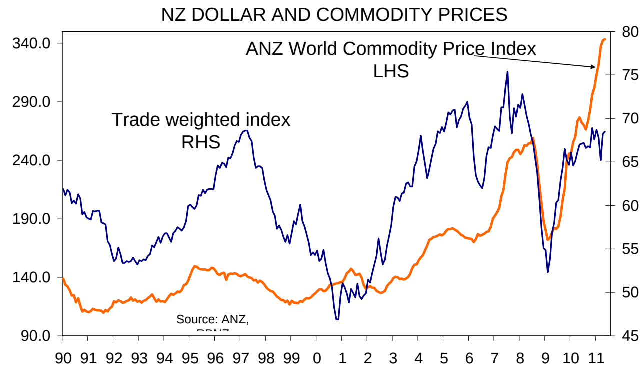


The employment result leaves us very happy with our quite positive view on the labour market with regard to strong jobs growth over the next two years, a plummeting unemployment rate, accelerating wages growth, increasing non-wage costs, a need for businesses to boost staff skills and invest in labour-efficient technology, and of course extra inflation and exchange rate pressures. The improving labour market will also assist our expectation of a return of widespread house price inflation.

The hike in investment intentions is very welcome because New Zealand has tended to struggle a bit with regard to getting businesses investing enough and the appalling drop in productivity growth over the past few years shows we desperately need greater investment – in something.

Another piece of good news was a bit out of date but still useful. The terms of trade rose by 0.9% during the March quarter and 6.8% from a year ago to now sit at the highest level since the March quarter of 1974.





This is a fairly important development in the context of New Zealand’s trials and tribulations since the 1960s. The challenge will be converting this simple cargo-cult like delivery of mana from Heaven into a more resilient economy and export base rather than either seeing it blown on inflated land prices and eventually conspicuous consumption by farmers, (2001-08) or a repeat of the 1940s – 1980s taxing and regulating of the farming sector in order to redistribute the wealth to other sectors and in the process make the economy more rigid. Guess into which camp an accelerated emissions tax for farmers falls into? Not to mention higher personal tax rates and increased welfare.

My idea? Assist farmers to set up their own venture capital scheme which would invest in a diversified range of primary sector related activities aimed at boosting value added and NOT buying land or replicating the good research work already being done in the sector. Financing developments resulting from that research however would seem a useful track to go down. In addition an allocation of some funds toward general good areas of opportunity such as the nexus between food/pharmaceuticals and health products (much demanded in Asian markets), and IT projects generally with the aim for the latter being keeping some companies in NZ for just a few years longer before they are sucked offshore by big bucks. That is, try to achieve what tourism operators aim for – keeping customers in town for one more night. I'd also avoid devoting the capital to ventures aimed at lowering farming sector production costs. That is where New Zealanders traditionally focus – being the lowest cost commodity producer – and we need to move away from that. Just some ideas. Maybe no-one listens.

We also learnt this week that average export commodity prices in fact rose by another 0.3% in May to sit 24% ahead of a year ago. In NZD terms prices fell 0.8% in the month to lie 11.6% up from last year and 43% up from two years ago.

But it is not all good news. The rise in the Kiwi dollar above 50 pence and to a post-float high against the greenback above 82 cents will be hurting exporters receiving those currencies who are not also receiving high commodity prices. In addition imports of capital equipment have been falling quite a bit recently. Plus there is zero evidence of a lift in home loan approvals.

Still, overall the week has been a good one for NZ Inc. and leaves us happy with the bulk of our forecasts – except maybe the one about expecting the Kiwi to take a decent dip back down against the AUD before legging it up. Such is currency forecasting. A mugs game unless you are completely enmeshed in the markets and get to see the primary flows.

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

On The Road 3 **http://tonyalexander.co.nz/occasional-papers/**

This paper discusses what I have seen and learnt whilst in London with regard to ex-pat perceptions of NZ, the European debt crisis, and London itself. Mention is also made of a brief encounter with royalty. In a few days comments about Hong Kong will appear as On The Road 4.

NZ Real Estate Overview **http://tonyalexander.co.nz/bnz-reinz-survey/**

We have added our monthly overview of the NZ real estate market, concluding that a cyclical recovery is underway.

Other Website Material

- **Situation and Outlook for the NZ Economy** – eight pages of snippets and outlooks for specific variables and sectors. Updated early each month. http://tonyalexander.co.nz/nz-outlook/
- **Weekly syndicated newspaper column** http://tonyalexander.co.nz/newspaper-column/
- **State of the NZ Labour Market** Updated mid-month. http://tonyalexander.co.nz/nz-labour-market/
- **BNZ-REINZ Market Survey** Released second week of each month. http://tonyalexander.co.nz/bnz-reinz-survey/
- **Real Estate Overview** Updated mid-late each month. http://tonyalexander.co.nz/bnz-reinz-survey/
- **Archived Weekly Overviews** www.bnz.co.nz/tonyalexander

Is Our Economy Getting Better or Worse?

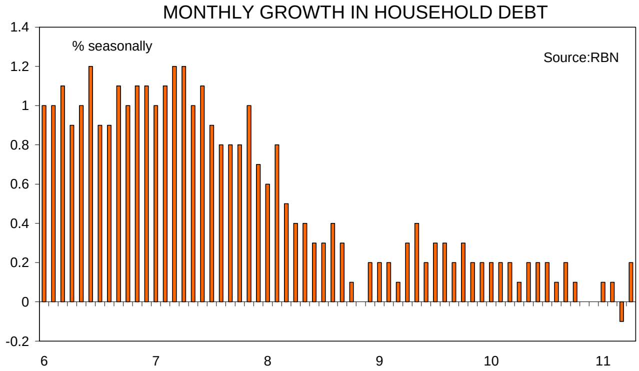
In this section we look only at what the data are actually telling us and pay no attention to forecasts or intentions measures.

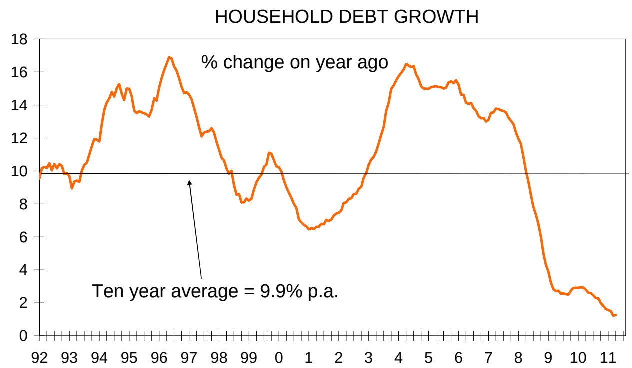
This week we have learnt that tourist numbers bounced up in April. But this followed a disastrous March and the underlying trend is down. We have also learnt that imports of capital equipment continue to pull back and that means weakness in business capital spending. However export growth has soared and that suggests a strong positive net exports contribution to growth over the first half of this year and especially the June quarter. The days of near 0.2% quarterly growth rates are behind us – for now. They always return.

Are householders opening their wallets more?

If we take lending to the household sector as a gauge then the answer is that things were a tad firmer in April but the change is not really statistically significant. That is, the indebtedness of the household sector rose by a seasonally adjusted 0.2% in April but this followed a 0.1% fall in March and average change on a monthly basis over the past year of 0.11%. So, given the likely downward bias to March numbers caused by the earthquake the April result taken with the March outcome says that there is still no improvement in debt growth underway.

But one has to be careful about using debt growth numbers as a proxy for spending changes because although when it comes to the real estate market there is a very strong correction, with regard to retailing the relationship is not so great.

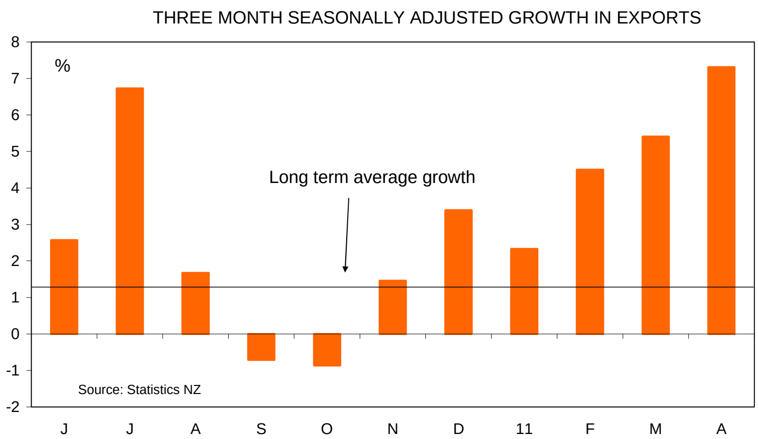




For the record, household debt in April was 1.2% ahead of a year ago and the $472mn growth in household debt over the three months to April was $555mn weaker than debt growth over the same period a year ago.

Is business output rising?

On the export front the answer is yes in aggregate, though not for all operators. In seasonally adjusted terms the value of export receipts jumped by 8.1% in April and by 7.3% in the three months to April compared with the three months to January.



Two-thirds of this 7.3% quarterly rise was due to higher dairy exports, meat accounted for another 13% of the rise, and forestry another 10%.

	3 month s.a. % change	**Proportion of all export change**
Milk powder, butter, and cheese	21.4	67.7
Electrical machinery and equipment	15.3	4.6
Crude oil	10.6	5.9
Logs, wood, and wood articles	9.8	9.6
Aluminium and aluminium articles	8.5	3.1
Meat and edible offal	8.1	13.3
Total merchandise exports	**7.3**	**100.0**
Mechanical machinery and equipment	4.9	2.5
Fish, crustaceans, and molluscs	2.2	0.9
Wine	2.1	0.7
Fruit	-11.2	-5.3

Although price changes help account for some of the export receipt growth this is not universally the case. In fact over the past three months although seasonally adjusted dairy export volume growth accounts for just over half dairy receipt growth, log volume growth of 22.6% easily swamped what was clearly a pullback in prices. The dairy output growth has little employment implication as the rise was simply a combination of some selling of inventories perhaps, but certainly some good grass growing conditions. The forestry growth however does mean more people working longer.

	Volumes three month % changes
Logs and wood	22.6
Milk powder, butter, and cheese	13.3
Fruit	3.9
Wine	2.9
Aluminium and aluminium articles	2.1
Meat and edible offal	-4.0
Fish, crustaceans, and molluscs	-6.8
Crude oil	-9.0

*various measures, tonnes, cubic metres, litres

Are businesses hiring more people?

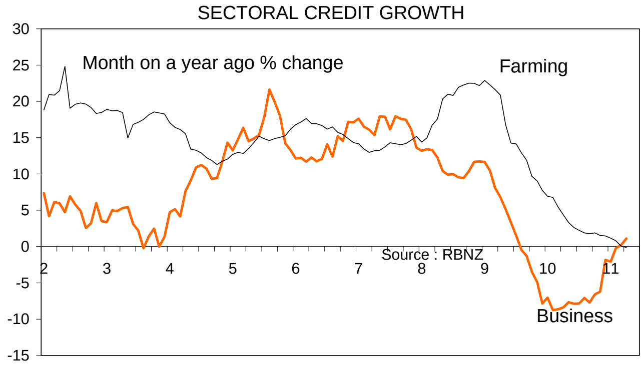
To view our latest monthly NZ Labour Market report click here. http://tonyalexander.co.nz/nz-labour-market/

We have no fresh factual data on jobs growth in hand.

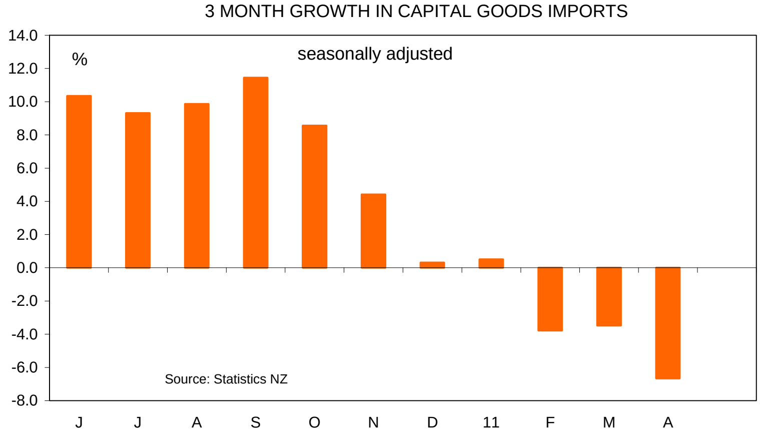
Are businesses boosting their capital spending?

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

If business debt growth were a reasonable gauge of business capital spending growth (and it most definitely is not) then one might say yes. This is because whereas in the three months to April this year business debt rose $33mn, over the same period last year it fell $2,330. But last year's result was clearly driven by businesses engaging in major balance sheet restructuring and because debt growth now is almost non-existent rather than negative we feel one cannot say there is something interesting happening with business investment. In fact the opposite is occurring.



In the three months to April in seasonally adjusted terms the value of imports of capital equipment were down 6.7% from the three months to January. This gives better insight than the fact that import values were 14% ahead of a year ago. This latter number simply reflects a stepping up of imports a few months ago whereas more recently they have eased off. So it is not possible for one yet to provide data suggesting business capital spending in New Zealand is in fact picking up on a national accounts quarterly basis.



INTEREST RATES

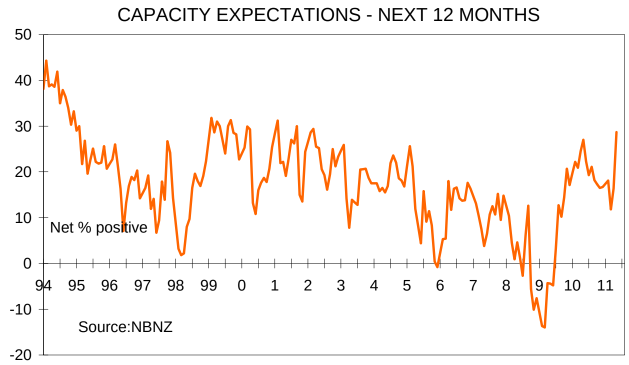
Growth vs. Economic Slack

In a nutshell this is what drives inflation along with institutional arrangements, imported inflation, and exchange rate changes. If you want to forecast monetary policy you need to monitor these things. So we will, adding stuff here when we learn it. The current common view is rate tightening from December. Have we learnt anything this week which alters this outlook?

The world is filled with unusual forecasts and one of the strangest ones in years made its appearance this week in New Zealand with a person predicting that NZ inflation will be 10% in a small number of years. The forecast, if one can call it that, is well wide of likely reality for a number of reasons. The first is that inflation outcomes are influenced by inflation expectations and the current two year ahead expectation for inflation is 3% which although the highest level since 1991 is only up from 2.8% one year ago, 2.2% two years ago, 2.9% three years ago, and 2.6% four years ago. Average inflation over the past four years has been 2.8% and the peak of 5.1% in 2008 only came about because of temporarily soaring food and petrol prices. The ex-petrol and food rate of inflation at the moment is just 1.5% excluding the GST increase.

Second, a common mistake non-economists make is to fail to consider simple game theory which says you have to consider what players will do in response to the situation changing. In this case, what will the biggest player do when they see an inflation threat? They in this case are the Reserve Bank and they will tighten monetary policy to keep inflation contained. To assume they would sit idly by displays a lack of understanding of the functioning of monetary policy. It is simply a matter of them finding out each cycle how high they need to take their cash rate in order to control cost of living increases. Last cycle it was 8.25%, the one before that 6.5%, and before that about 9% (though there was not an official cash rate as such). And if fighting inflation means sending the economy into recession they – and other central banks – have done it and will do it again if necessary – not that we think they will need to this time around. But then we have said that before and been wrong!

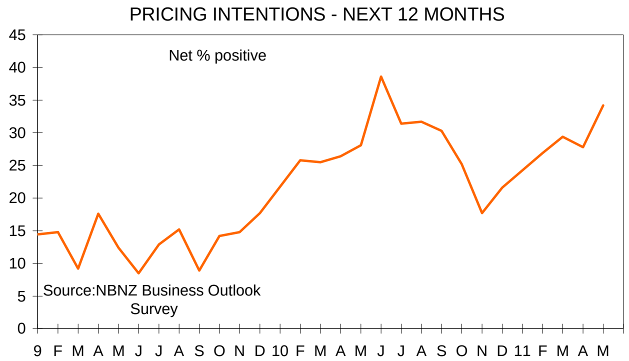
This week the extent of demand for resources in the economy took a step up with the news that exports in seasonally adjusted terms rose by 8.1% in the month of April to register a 7.3% rise in the three months to April compared to the three months to January. Given that average three monthly growth for the past decade has been 1.2% this is a stellar result which can only work to boost growth in the economy – not only directly as represented in the national income statistics, but indirectly as those earning the higher income start spending it. In addition the sharp lift in employment intentions in the NBNZ Business Outlook survey bespeaks of the accelerating wages pressure we have long warned about and which businesses had better make sure they are budgeting for from next year. If you don't budget, or especially don't pay, be prepared to lose staff.



There was also some worrying news in the form of the capacity expectations measure rising to 29% from 16% in April. As the graph shows this is a particularly high level which although still well off levels of 1994 is a sharp jump which will have caught the Reserve Bank's eye.

Other Inflation Influencers

Perhaps the big worry for the Reserve Bank this week came in the form of the one year ahead inflation expectations measure in the NBNZ survey jumping to 3.3% from 3.04% in April. There was no obvious reason why such a jump would occur, though one might cite the then rising fuel prices. Businesses are showing themselves to be increasingly concerned about inflation and a net 34.2% now plan raising their selling prices in the next three months compared with 28% a month ago.



Rate Movements This Week

With such worrying fundamentals for inflation as discussed above one might be forgiven for engaging in a bit of head scratching over news that the yield on 90-day bank bills has only crept up a tad to 2.72% from 2.7% last week. The two year swap rate has also only moved to 3.5% from 3.41%. The reason for such small rises is partly that inflation worries offshore have pulled back slightly recently, but mainly that the Kiwi dollar has risen very sharply to get above 50 British pence and hit a post-float high against the greenback.

The higher currency will help contain inflationary pressures by curbing export receipt growth, causing falls in some import prices, reducing the feed-through of higher international commodity prices into domestic prices, and encouraging businesses and consumers to purchase imports rather than domestically produced including services such as tourism.

FINANCIAL MARKETS DATA

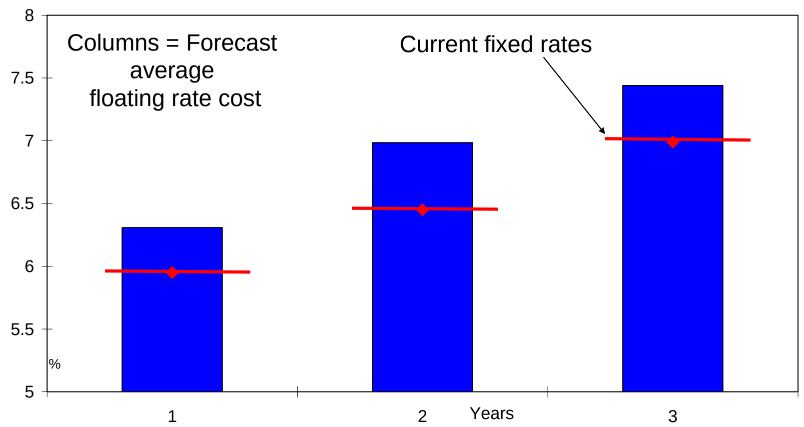
	This week	Week ago	4 wks ago	3 months ago	Yr ago	10 yr average
Official Cash Rate	2.50%	2.50	2.50	3.00	2.50	5.9
90-day bank bill	2.70%	2.68	2.70	2.91	3.02	6.2
1 year swap	2.97%	2.88	2.90	2.91	3.78	6.3
5 year swap	4.53%	4.49	4.54	4.45	5.31	6.6
180-day term depo	4.40%	4.50	4.60	4.10	4.80	6.0
Five year term depo	6.00%	6.00	6.00	6.50	6.75	6.5

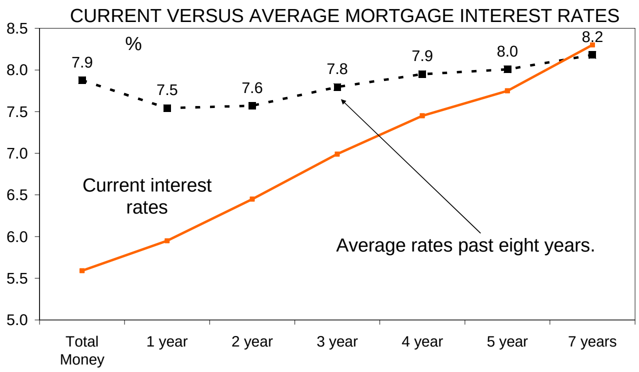
If I Were a Borrower What Would I Do?

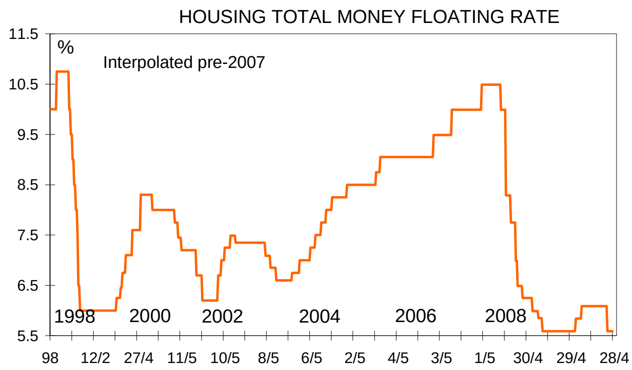
The blue columns in the graph below show what we expect floating mortgage rates will average over the next one, two, and three year time periods. Time has marched on and we are almost in the middle of the year. That means we only have perhaps six months left of floating rates at these four decade lows – then the cyclical rises will start. We have modelled here an assumption that the peak in the cash rate will be 5.5% in mid-2013 and that floating mortgage rates peak at 8.6%.

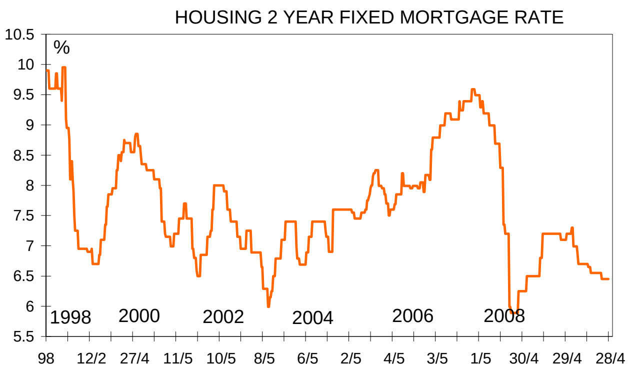
The little red lines show current fixed rates for the relevant periods. In all cases, if our forecasts/assumptions prove correct (but they will with 100% certainty change) then it pays to fix rather than blindly float through the next three years. The issue then becomes when does one forsake the lovely low floating rate of 5.59% and go fixed? The jump to fixing is a difficult one because just to fix one year involves boosting one's rate immediately to 5.95%, fixing two years costs 6.45%, and three years 6.99%.

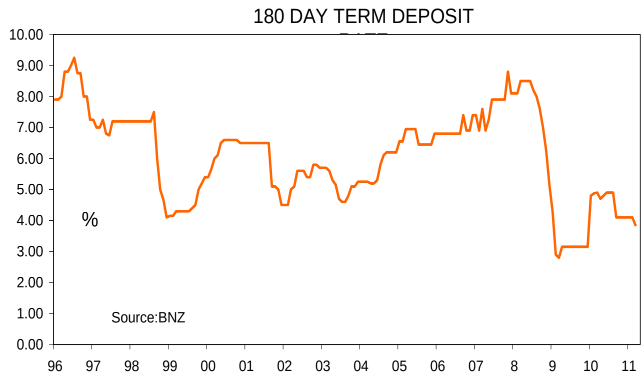
If I were a borrower my inclination would be to still sit floating, working principal down, aiming to fix before the end of the year. Actually to be more accurate. If I were a borrower I would be aiming to fix before I told you about my intentions because in March 2009 my comment 'Fix now" contributed to a sharp jump in fixed interest rates as thousands of people tried straight away to go from floating to fixed and the wholesale markets reacted with a sharp jump in swap rates. Luckily I am not in reality a borrower so there is no issue. But be aware that not everyone is planning to go through the next three years floating. So if and when we see a rush to fixed rates don't be surprised if instead of banks waiting a day before they raise fixed rates, as happened in March 2009, they do it the very hour the movement starts – if not before word goes out.











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

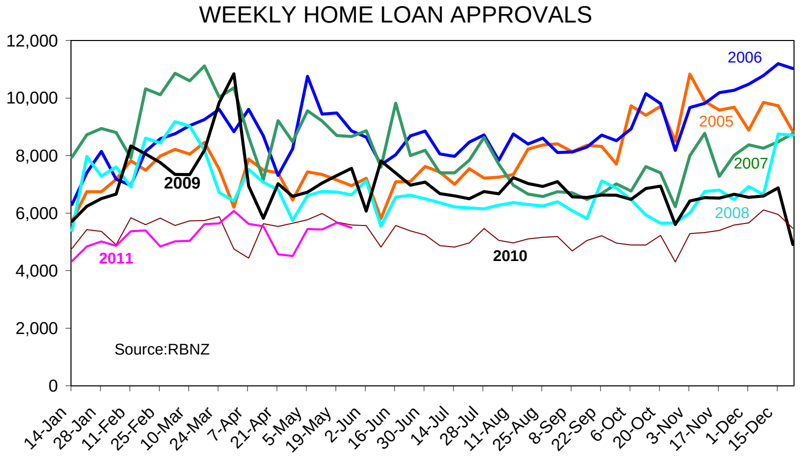
I still cling to the dream of riding the yield curve up over the next two to three years and at some stage being presented with an opportunity to lock into a nice long term rate at better levels than those around currently. The economic data we have been receiving recently suggest my expectation of rising short term rates over 2012 – 2013 and from perhaps even late this year is quite reasonable. Getting a nice three to five year term deposit rate however depends upon a lot of factors so as happens with many people I could end up simply riding the short end up then down. But we shall see. For the moment I am happy to look for good rates in the 90 – 180 day range. The big challenge will be that when short rates peak so too will the NZD probably be in peaking territory and my optimal move may hoping out of the NZ dollar. A frightening thought.

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/

Lending Growth Muted

For your guide, there has been a lift recently in the number of home loan approvals. However as the graph here shows, this lift revealed in the pink line below the others usually happens at this time of year. Therefore one cannot look at these experimental data put together by the Reserve Bank and conclude that there is great strength in the recovery of the housing market which we can identify in other data.



If you go to our United States section below you'll find some fairly worrying data on the state of the US housing market. Be careful not to blindly extrapolate the US situation to our own market as a few silly people did three years back resulting in their predictions of house prices here falling 40%. We did not enter either our recession or the global financial crisis with excess construction of houses (sections yes). We have a shortage of around 41,000 houses. Our labour market is stronger than in the United States, our terms of trade are at near a four decade high, and we are strongly locked into the continuing firm growth in China which now takes over 12% of our merchandise exports. Australia takes 23%, the United States 9%, Japan 8%, the UK 3% and EU all up 11%.

Are You Seeing Something We Are Not?

If so, email us at tony.alexander@bnz.co.nz with Housing Comment in the Subject line and let us know.

Key Forecasts

- Dwelling consent numbers to improve further out. House prices edging higher from second half of 2011. Auckland leading the country, the regions lagging. More buyers entering the real estate market.

MAJOR OFFSHORE ISSUES

European Debt

I have written something on this subject in my On The Road 3 document at http://tonyalexander.co.nz/occasional-papers/

Suffice to say, the month of June is a big one for Greece with a deadline of the 27th for the IMF to be satisfied that they will be able to raise some money in its own name on the markets over the coming year and that it is meeting criteria set down for extending credit. If they are not satisfied then the expected €12bn tranche of funding will not be forthcoming and then it will be a matter of whether the euro zone countries are willing and able to add the extra cash. The next few weeks will prove very interesting and will almost certainly generate volatility in financial markets.

Chinese Inflation

We have no new information but keep an eye on the webpage http://tonyalexander.co.nz/occasional-papers/ as I shall within a few days post On The Road 4 which looks at Hong Kong and China

US Growth Momentum

The central theme with regard to the US economy has not changed much over the past year or so. It is that there is a recovery underway but it is tentative with the household sector in particular hesitant to buy retail goods or houses because of employment fears and worries that house prices have further to fall. There is growth in the manufacturing sector and improvements are being recorded in business capital spending. But without firm growth in private consumption it is difficult to imagine the US rate of growth consolidating near 3% in the near future. Data this week seem to prove all these points.

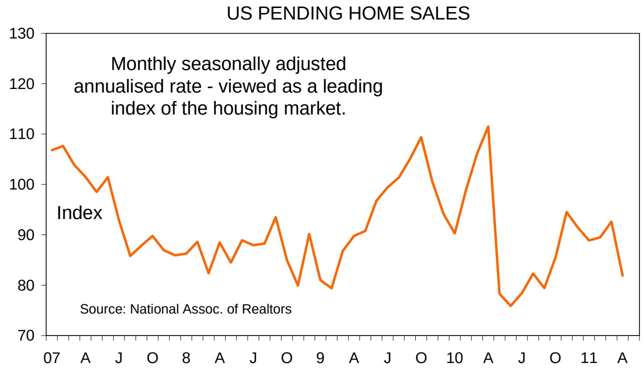
Firstly last week the markets were disappointed by the March quarter rate of growth in GDP not being revised up from the early estimate of 1.8% annualised. The reason for the absence of a revision to 2.2% was a downward revision in fact to private consumption growth.

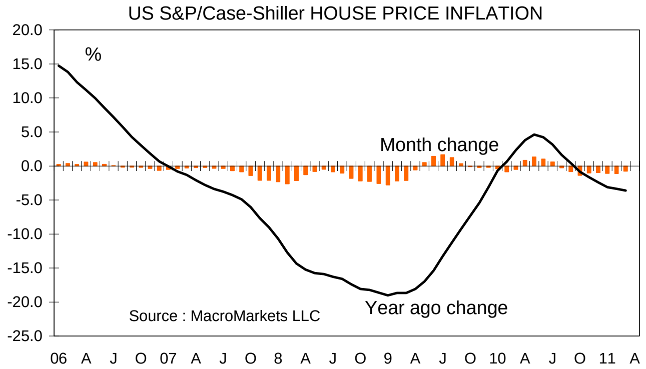
Perhaps there is some underlying concern in the minds of householders regarding the worsening US Federal deficit and debt situation. There has been no credible plan discussed let alone agreed upon, let alone implemented, aimed at getting the deficit down and the rising ratio of government debt to GDP stabilised. In contrast in Europe major efforts are underway to get debt under control. For now the US is getting away with this bad behavior partly because of a view that it is not reasonable to expect that much will happen ahead of the November 2012 Presidential elections – though approaching elections have been no impediment to fiscal restraint being imposed in European (and NZ) economies.

Mainly though the financial markets remain willing to finance the US deficit because they still have faith in the greenback in light of concerns about the alternatives – the yen and euro by and large. But the risk – if not virtually guaranteed outcome – is that at some stage just as investors have withdrawn their support in order to force peripheral European economies to get their accounts in order, so too will a day come when the markets pull back on willingness to buy US bonds.

That day does not appear close, but the longer it takes to arrive the higher will be the debt level and the more difficult the job of reining it in. In other words, the US economy is running on borrowed time and it is by no means guaranteed that the day of reckoning will be generously delayed until after the recovery from the 2007-09 crisis has become a period of solid self-sustaining growth. What to watch for? News of the People's Bank of China directing more of its reserves to other assets. Other central banks opting to hold renmimbi in their FX reserves.

As regards data this week we have seen the release of much weaker than expected data on the housing market. Pending home sales decreased by a large 11.6% in April rather than the 1% which had been expected. This early indicator of the state of the US real estate market is now running 27% down from a year earlier and is signalling continuing weakness in the US housing market.

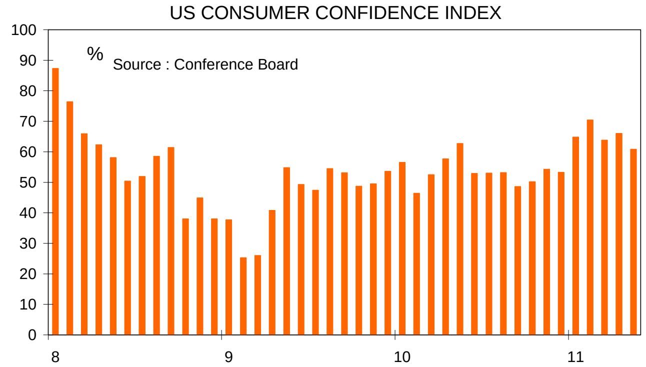


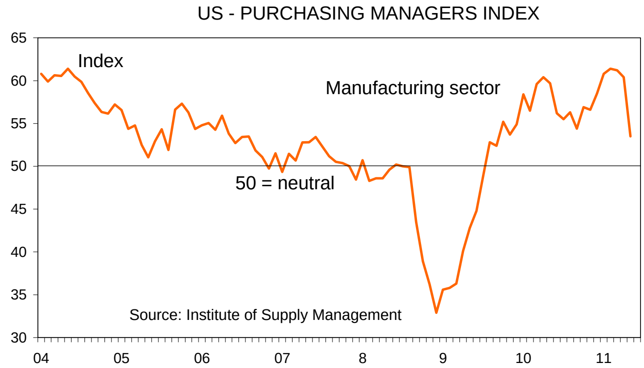


In addition, the Case-Shiller national house price index fell another 0.8% in March to lie 3.6% down from a year ago. Average house prices have now given up all the ground recovered between mid-2009 and mid-2010 and now are below the April 2009 low-point to once again be 33% below their July 2006 peak. Average prices are back to where they were in April 2003.

In fact the Census Bureau estimate that there are ten million houses vacant in the US, some 1.5mn more than normal. Some 2.3mn are foreclosures and 80,000 are newly repossessed each month. About one-third of all US house sales are “distressed” and as these properties tend to sell for 30% less than others there remains strong downward pressure on prices, as noted above. One estimate is that it will take five years to clear the housing backlog.

To top it all off consumer confidence measured in the monthly Conference Board poll unexpectedly fell in May to a reading of 60.8 from 66 in April.





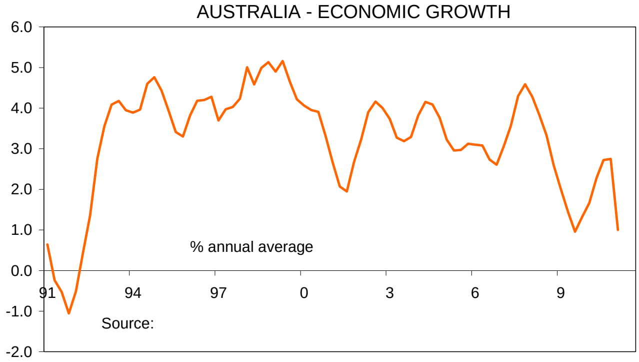
But that was news up to Tuesday. On Wednesday we learned of some much weaker than expected numbers which caused widespread weakness in US and therefore global sharemarkets, falls in long term interest rates, and weakness in risky currencies like the NZD. What we learnt was that the ADP measure of private sector jobs grew only 38,000 in May whereas a rise of 175,000 had been expected. The result means the markets now anticipate growth in the non-farm payrolls report due out on Friday night of much less than the originally expected 186,000.

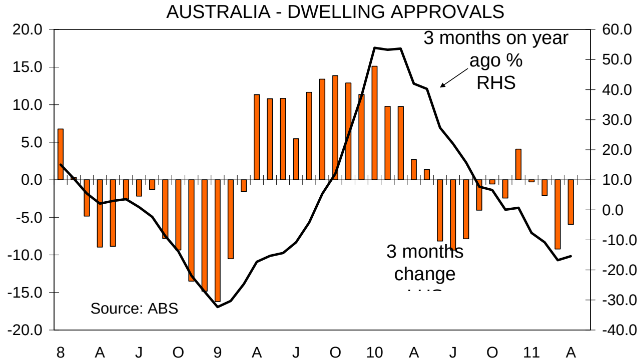
In addition the much-watched monthly PMI for manufacturing fell to 53.5 in May from 60.4 in April which was also a much weaker than expected result which has called into question the strength of the manufacturing sector.

All up the week has been one in which confidence in the US recovery has been dampened and hence the falls in share prices etc. noted above.

Australian Growth

The Australian economy shrank by 1.2% during the March quarter courtesy of the Queensland floods slashing coal exports. Without the floods growth may have been around 0.8%. Still, the much weaker than expected result has pushed out expectations for when the Reserve Bank of Australia will next tighten monetary policy from June to July – hence one reason for the NZD jumping against the AUD this week.





Also, dwelling approvals fell 1.2% in April and have now declined by 5.9% over the past three months. High interest rates are causing weak housing demand – making the existing shortage of housing even worse.

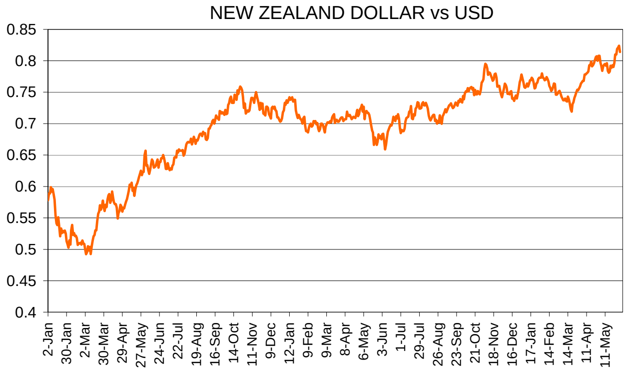
Exchange Rates

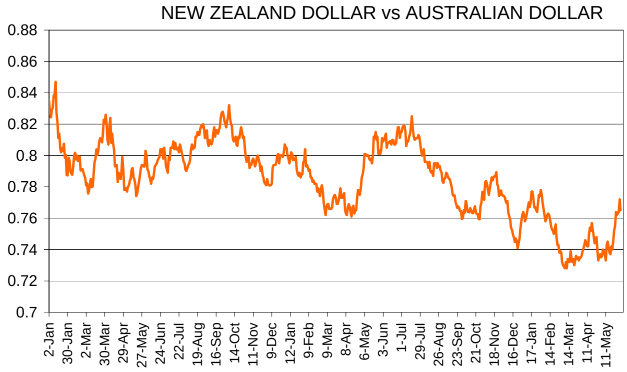
Exchange Rates	This Week	Week Ago	4 wks ago	mths ago	Yr ago	Consensus Frcsts yr ago*	10 yr average
NZD/USD	0.814	0.810	0.808	0.748	0.675	0.689	0.629
NZD/AUD	0.765	0.764	0.736	0.738	0.811	0.773	0.855
NZD/JPY	65.700	65.800	65.600	61.300	61.4	67.7	68.4
NZD/GBP	0.497	0.495	0.484	0.460	0.46	0.448	0.368
NZD/EUR	0.563	0.571	0.546	0.542	0.551	0.52	0.511
NZDCNY	5.278	5.259	5.238	4.914	4.609		4.83
USD/JPY	80.713	81.235	81.188	81.952	90.963	98.3	109.9
USD/GBP	1.638	1.636	1.669	1.626	1.467	1.54	1.705
USD/EUR	1.446	1.419	1.480	1.380	1.225	1.33	1.229
AUD/USD	1.06	1.06	1.10	1.01	0.83	0.891	0.737

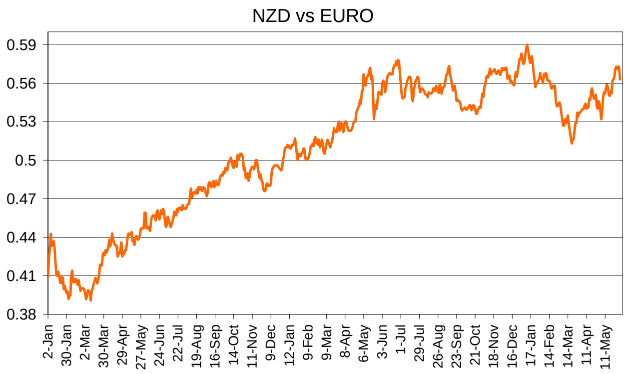
*Sourced from Consensus Economics. http://www.consensuseconomics.com/

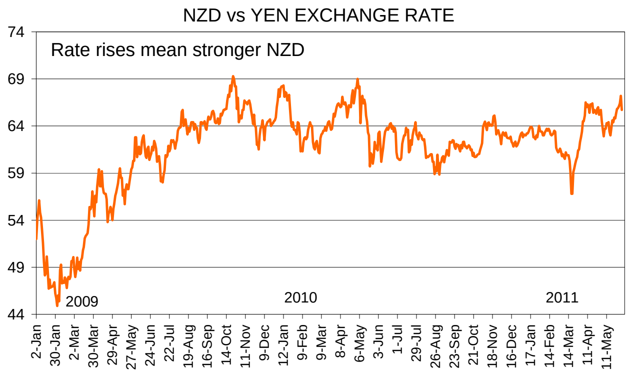
Kiwi Near 83 Cents For A While

The Kiwi dollar this week traded close to US 83 cents – a post-float high – against the greenback on the back of high commodity prices, last week's news about Chinese investment in New Zealand, and the good business sentiment report noted earlier on in the Weekly Overview. Last night however the currency took a step back as investors quit risky assets following weaker than expected US economic data and worries about the sustainability of the US upturn. The upshot though is that the NZD is still slightly stronger than a week ago against the USD, but little changed against other currencies.







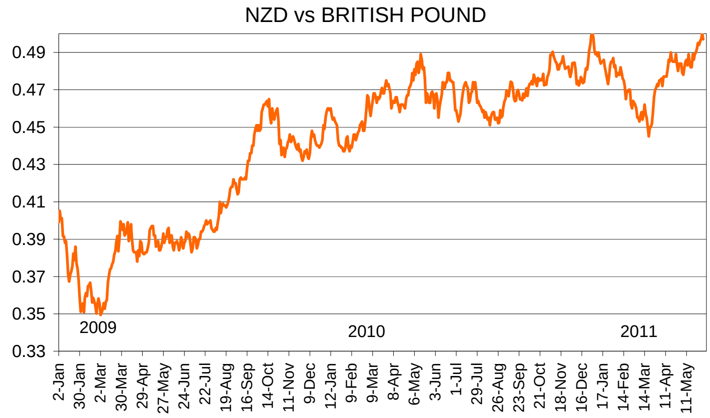


Last week I mentioned offshore investors expecting that the NZD would rise and looking to buy on dips. This was a bit confusing for some who felt that if they expect the currency would rise then surely they would buy it straightaway. Not necessarily and the reason is that all the time there are unpredictable movements up and down in freely floating exchange rates and if you buy today there is maybe a 30% chance in a rising market that the asset will be cheaper the next day. So what happens is that when a bout of positivism grips a market and the Kiwi dollar jumps as it has just done, those who reckon the underlying pressures will remain upward will want to let some early buyers take profit and look to purchase when the initial euphoria has passed.

Of course the risk in waiting is that the pullbacks are minimal – in which case one ends up biting the bullet and buying at a higher level – perhaps much higher – than one had hoped. This process in itself can push currencies to over-extended levels as these last frustrated buyers can provide a final short-term currency surge. Such is the psychology of markets and such is the stuff which technical analysts try to capture without using any psychological or sociological terms or understanding when they look solely at what the charts are telling them. In the short term you will probably do better using such technical analysis to pick currency movements (good luck) than economic analysis because the latter assumes rational behaviour while the former is based on raw emotions on the ground. Ask yourself, which type of behaviour determines the long run functioning of your household, and which the day to day stuff!

United Kingdom

I probably should have written something here this week but with time taken up travelling to Hong Kong, meeting people here etc. this section has got lost in the wash this week. Note however that during the week the NZD traded above 50 pence for a while – and will do so again.



Exchange Rate Assumptions

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

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

ECONOMIC DATA

All %		Latest qtr only	Previous qtr only	Latest year	Year ago	2 Yrs ago
Inflation	RBNZ target is 1% - 3% on average	0.8%	2.3	4.5	2.0	3.0
GDP growth	Average past 10 years = 2.6%	0.2	-0.2	+1.5	-2.1	-0.2
Unemployment rate	Average past 10 years = 4.8%	6.6	6.7	......	6.1	5.2
Jobs growth	Average past 10 years = 1.9%	1.4	-0/4	1.8	-0.1	0.6
Current a/c deficit	Average past 10 years = 5.5% of GDP	2.3	2.2	......	2.8	8.8
Terms of Trade		0.9	0.8	6.8	0.1	-5.0
Wages Growth	Stats NZ analytical series	0.6	1.0	3.6	2.5	5.2
Retail Sales ex-auto	Average past 9 years = 3.9%.	0.0	0.0	0.6	2.2	-3.7
House Prices	REINZ Stratified Index	-0.7	-0.5	-0.7	5.5	-7.2
Net migration gain	Av. gain past 10 years = 13,900	+5,508	8,689yr	......	19,954	9,176
Tourism – an. av grth	10 year average growth = 3.2%. Stats NZ	0.9	2.5	0.9	3.1	-2.7
		Latest year rate	Prev mth year rate	6 mths ago	Year ago	2 yrs ago
Business confidence	BNZ survey	42	14	28	34	27
Consumer confidence	ANZ-Roy Morgan 100=neutral	103	101	115	126	106
Household debt	10 year average growth = 10.3%. RBNZ	1.2	1.5	2.3	2.9	2.8
Dwelling sales	10 year average growth = 2.5%. REINZ	-4.2	-5.1	-35.9	-16.2	39.1
Floating Mort. Rate	(TotalMoney) 10 year average = 7.9%*	5.59	6.09	6.09	5.59	6.49
3 yr fixed hsg rate	10 year average = 7.8%	6.99	7.15	7.15	7.95	5.99

All actual data excluding interest & exchange rates sourced from Statistics NZ.
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	1.0 – 1.5	3.5 - 4.0	4.0 - 4.5
CPI	on year ago	4.0	3.0 – 3.5	2.5 – 3.0	2.5 – 3.0
Official Cash rate	end year	3.0	2.5 - 2.75	4.0 – 5.0	4.0 - 5.0
Employment	on year ago	1.3	2.0 – 2.5	2.0 – 2.5	2.0 - 2.5
Unemployment Rate	end year	6.8	6.0 - 6.5	5.0 - 5.5	<5.0

*extrapolated back in time as TotalMoney started in 2007