BNZ Weekly Overview

11 August 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
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This Is Worse/This Is Not Worse

The week has been a tumultuous one and there is little point wasting space and your time here by iterating the percentage losses then gains on various sharemarkets, sharp currency changes etc. as such things have been all over the news for days. So lets take such knowledge as given and instead do what we macroeconomists try to be good at – seeing the bigger picture overlaying the volatility.

First, what are the causes of the current surge in risk aversion? Principally there are three. First there is the ongoing European debt crisis causing traditional buyers of European government bonds to be increasingly wary of the quantities they already hold and the extra volumes they are being asked to buy as governments are going to take some time to get their deficits out of the way. Various numbers have been bandied around regarding debt issuance with a recent large focus on the huge refinancing requirements of Italy and Spain in particular. Nervous investors have been increasingly demanding that recalcitrant governments do more to rein in their deficits <u>and</u> to enact reforms aimed at improving their economies' competitiveness.

These rising concerns a week ago coalesced around Italy, causing surging yields for that country but also for Spain. Surging worries generated general nervousness once again about how European bank capital bases would fare in the event of some structured default leading to heighted growth worries and so on. These developments on their own bat prompted the Italian Prime Minister over the weekend to promise an acceleration in the movement of his country's budget deficit to surplus and a package of economic reforms. In addition, in order to try and calm bond markets the European Central Bank bought some Italian and Spanish bonds. These are welcome developments and Spanish and Italian ten year bond yields subsequently fell 1%. But the pullback from a new abyss in Europe was somewhat swamped by the two other factors causing this bout of market weakness.

The second factor is the story of a US economy which has not yet found its legs. Time was bought for the private sector to get its accounts in order and start spending, investing and hiring again through stimulatory monetary and fiscal policies from 2008. But over three years along from those time buying exercises starting even well cashed-up corporates are unwilling to hire and invest because they are not confident that consumers will spend, and consumers are unwilling to spend because they are not confident that their house prices have stopped falling, that they will have a job a year down the track, or that they have yet saved enough for their retirement/education/health/income interruption needs.

This lack of growth has been seen in spades over the past two months with a lengthening string of weak monthly job reports, plummeting consumer confidence, a newly weakening manufacturing sector, and new weakness also in the housing market. Investors have been revising downward their forecasts for US and therefore world growth and one imagines increasingly questioning how the US sharemarket can gain some 22% between the end of 2009 and mid-July in the absence of a sustainable growth environment.

Hence pulling back from shares and selling of other risky assets plus commodities on expectations of a newly worsening growth environment.

Then there is the third factor which has acted essentially as a trigger or wake up call for those still assuming that things will be okay. The US credit rating cut on Friday night by Standard and Poors is a major event in an historical context for the United States as it is explicit recognition that the country is losing/has lost its standing in the world economy community and is on a long term relative decline already seen in things such as the US dollar trending broadly downward since 2002.

Investors have not only reacted to the credit rating they have woken up to the worsened economic outlook and decided to take some risk off the table.

One might also cite a fourth factor of worries about inflation in China and the extent to which the authorities there will need to slow growth to get price rises under control. But while that factor is present and we have included it in our list of things to monitor in the WO since the start of the year it is not really a thing moving the markets currently. In addition last night there were worries about the impact on French bank capital bases of their holdings of Greek government debt, rumours of a French credit rating downgrade, worries about the increased cost of insuring German government debt, and concern that the Congressional committee looking at US$1.25tn in spending cuts will yield little as staunch party partisans are being appointed to it.

So what does it all mean and where do we go from here? The first point to make in that context is to repeat a key point we have been making here for at least two years. If you think you know what is going to happen n the near future with regard to economic growth, interest rates, exchange rates, sharemarkets etc then you are deluded. This is the most uncertain forecasting environment we have ever seen and whatever set of forecasts you see for a thing one day will not be the same set three or six months down the track – or in the context of the current markets, just one week.

We have pointed out that one would be foolish to base any hedging strategy on an expectation that a particular set of forecasts will prove correct and we stick to that. There are so many long running massively uncertain factors in play you cannot reasonably have anything resembling certainty in your plans. This remains an environment for getting debt down, building robust cash flows, avoiding those with bad debt records, running low inventories while at the same time keeping an eye out for good acquisition/leasing/hiring opportunities thrown up by those getting weeded out.

It also pays to remember however that there are some specific factors which give better outlooks than we may have from a macroeconomic/average perspective. Rebuilding of Christchurch springs to mind.

Our central expectation remains that the world economy will slowly improve but that because of the need for governments to rein in their deficits and the desire of households to get debt down the growth for the next few years will be mild. There will be further bouts of volatility along the way as we are seeing now.

Short-Term Prospects

If the current volatility continues can we expect to see a repeat of the events of late-2008 following the collapse of Lehman's? That is what the title for this week's front piece is about. One can say that this time things will be worse for the following reasons.

This time around central banks have very little scope to ease monetary policy to provide a cushion for the private sector. Over a year ago we wrote here extensively in terms of central banks wanting to raise their interest rates as soon as they could in order to build a buffer which they could use the next time the markets went into tailspin. In New Zealand the Reserve Bank managed to get 0.5% of insurance by taking the cash rate from 2.5% to 3%. But they had to give that back in March because of concern about the impact of the February 22 earthquake and because of evidence that the economy was not performing anywhere near as well as they had expected when they raised rates.

In Australia the central bank has gained 1.75% worth of insurance in taking their cash rate from 3% to 4.75% with the job made very easy due to the booming mining and infrastructure sectors. In Europe the central bank clawed back 0.5% with their cash rate now at 1.5%. The Bank of England made no gains with their cash rate still at 0.5%, in Japan their rate remains essentially where it has been for one and a half decades now near 0%, and the US also remains at 0% - 0.25%.

This time around central banks in the major economies have almost no ability to insulate their economies against weakness by cutting interest rates. What about printing money? That has proved to be a useless exercise in the United States. The extra liquidity provided has not been lent out by banks because they are wary of taking on new risk, and few borrowers wanted the funds anyway because they are trying to cut their debt levels – not boost them. The money simply ended up producing speculative rises in asset markets (shares, commodities), a weaker greenback, and higher bank deposits with the Federal Reserve.

Governments no longer have the option of large fiscal stimulus programmes. The pressure instead is on them to raise taxes and cut spending in order to stop their ongoing massive issuance of bonds.

So with practically no monetary or fiscal dry powder left, this time if the current turbulence leads to collapsing demand around the world it could continue downward toward a Depression-like scenario involving collapses in our commodity prices as our currency goes back below US 50 cents, plummeting interest rates, massive share price falls, rising unemployment – all the bad stuff really.

Thankfully, while one can run through the arguments above and conclude that this time around the situation is worse, there is also a key difference with the late-2008 scenario which means this time around things are less worrying. That crisis was about liquidity with markets fearing that banks could not get their hands on enough of it to remain in business. That is, that they would not be able to encourage investors to give them new funds or to roll over maturing funds. It manifested itself for us NZ banks as a period of about six weeks when we could raise almost no fresh money in our offshore markets. That is a huge problem for us in NZ right up there with foot and mouth because of all the money lent to you by us banks over 40% has had to be sourced offshore.

We Kiwis do not save enough money to afford the lifestyle we (borrow to) give ourselves. We take the savings of the Chinese, oil producing countries, Japanese etc. and use the money to buy cars, houses, farms, TVs and so on. Had the market turmoil back in 2008 continued we would have joined in a global Depression scenario through inability to refinance debt and us banks having to call in your loans to pay back the 40%+ demanded by our offshore saviours. This is the vulnerability referred to by Standard and Poors last week specifically with reference to New Zealand.

But the MOST IMPORTANT thing about this crisis is that it is a simple reassessment of growth prospects and ongoing European debt attack rather than a desertion by investors of banks all over the planet. Interbank money market conditions remain acceptable, we can continue to raise new funds and replace maturing debt, there are ready lines of credit in place with central banks which can be drawn on if things do tighten up, and the corporate sector around the world is relatively cash rich. And remember what we wrote above regarding the Federal Reserve printing money (buying US government bonds) and the quantitative easing exercises resulting in ample funds being available to banks without them wanting to use them.

So this time around we are not in a situation of having the global credit markets seize up and in that regard the late-2008 event was far more serious than this one.

At the end of it all we take this current episode of the heeby geebies as a sign that the global economic outlook is not as comfortable as many people were pricing in and that substantial struggles remain – but that a growth path will continue.

So what does it all mean for us here. Point number one is this. To repeat. Whatever we forecast today with regard to economic growth, employment, interest rates and the exchange rate (an assumption actually), will not be the same as what we will forecast in three or six months time – or next week. This is the most uncertain forecasting environment we have ever seen. If you rely upon such forecasts to develop your business strategy you are foolish. This is an environment in which you concentrate on the extreme basics of your business – your brand, your net cash flow and its stability, debt, a strong capital base, strong management of debtors with extension of credit kept in very tight control, good staff management with an eye toward skilled/motivated people, and development of interest rate and exchange rate risk management policies based entirely around your capacity to handle extreme rises and falls rather than forecasts.

Our view remains that we will see the following here in NZ.

- Reasonable economic growth next year and through 2013 on the basis of rebuilding of Christchurch, farmers spending more of their strong incomes, exports of manufactures assisted by continued good growth in Australia, eventually catch-up spending by you and I along with businesses rebuilding inventories a tad, and eventually some firm growth in business capital spending. This latter rise will be driven by the labour market tightening up potentially spectacularly and businesses needing to boost productivity.
- The Reserve Bank will raise interest rates – probably from December - and borrowers should run cash flow projections assuming that their floating rate funding costs are 2.5% higher come the middle of 2013. Then run a scenario where they rise 3.5% just in case things turn out to be more inflationary than our central scenario.
- The NZ dollar is likely to rise against the Aussie dollar and we are likely to regain ground against the other currencies eventually heading back toward US 90 cents, 55 - 60 pence, and over 60 euro.

Procrastination Will Rule

But in the short term one highly probable outcome of all the turmoil is that we choose to put off buying, hiring, investing unless for something absolutely needed or for an obvious growth area like Christchurch rebuilding. For the moment we will put things off because we don't really know how bad the markets will get overseas and what the impact will be on world growth, currencies, and commodity prices. Then we will put things off because the Rugby World Cup is close and as Kiwis we are supposed to be enthralled at the prospect of six straight weeks of wall to wall rugby, indecipherable referee rulings and games won by last minute penalties rather than skill-derived tries.

Then we will put things off because we are supposed to be watching the rugby and buying over-priced merchandise to fill the coffers of those selling our culture back to us.

Then we will put off spending once the games are out of the way because of the general election on November 26 with extra weakness if the trend of the past four yearly events continues and we do not "succeed" in the rugby tournament.

Then we will put things off because Christmas will be approaching and we will be looking forward to a well deserved Summer break.

So maybe come February next year we will return to our workplaces and businesses ready to spend, hire and invest. Maybe, six months from now. Its enough to make you want to start the holiday bit straight away. Personally speaking, after a month on the road overseas from May-June then travels around the country in all weeks bar one since then, a holiday sounds like a good idea. Go the Warriors.

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

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

This week we completely reverse our fixed versus floating suggestion based on the turbulence offshore. Who'd have thunk it?

Monthly BNZ-REINZ Survey http://tonyalexander.co.nz/surveys/bnz-reinz-survey/more-and-more-first-home-buyers/

Our latest survey has found still more first home buyers appearing, fewer investors buying, listings in worsening supply, and prices edging up – except in Wellington.

Other Website Material

- **Weekly syndicated newspaper column** http://tonyalexander.co.nz/newspaper-column/
- **State of the NZ Labour Market** Updated mid-month. http://tonyalexander.co.nz/nz-labour-market/
- **BNZ-REINZ Residential Market Survey** Released second week of each month. http://tonyalexander.co.nz/bnz-reinz-survey/
- **Real Estate Overview** Updated mid-late each month. http://tonyalexander.co.nz/bnz-reinz-survey/
- **Archived Weekly Overviews** www.bnz.co.nz/tonyalexander

Is Our Economy Getting Better or Worse?

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

This week the only piece of solid NZ data we have received is for spending using debit and credit cards. The data are strong but we don't think they show the weakness which really exists in retailing so do not conclude that, as the data suggest, spending is the strongest since early 2007 when a boom was occurring. That is ridiculous.

Are householders opening their wallets more?

This week we learnt that core spending using debit and credit cards grew by a seasonally adjusted 0.5% in July after rising 2.1% in June. The rise means that over the past three months this spending measure has grown at an annualised pace of 11.8% which is the strongest since early 2007. The trouble is this is not the sort of growth retailers are reporting around the country and you have to ask yourself, do I believe a series which Statistics NZ explicitly warns should not be used as a proxy for the monthly retail trade series which they decided to cancel, or do I believe my own eyes from two months travelling around the country, the massive advertising by retailers in newspapers, and the comments by retailers in our monthly survey. I personally choose the latter and feel that retailing in New Zealand is not enjoying the boom times these numbers imply, that more retailers will find themselves having to close down, and that hefty discounting will continue – especially for ridiculously over-priced branded clothing items.

Is business output rising?

Nothing new.

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

Nothing new. But lost of comments earlier this week from businesspeople in Christchurch noting that their difficulties in finding staff are growing and growing.

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/

Nothing new, and never anything up to date. Best guesses rule in this category.

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?

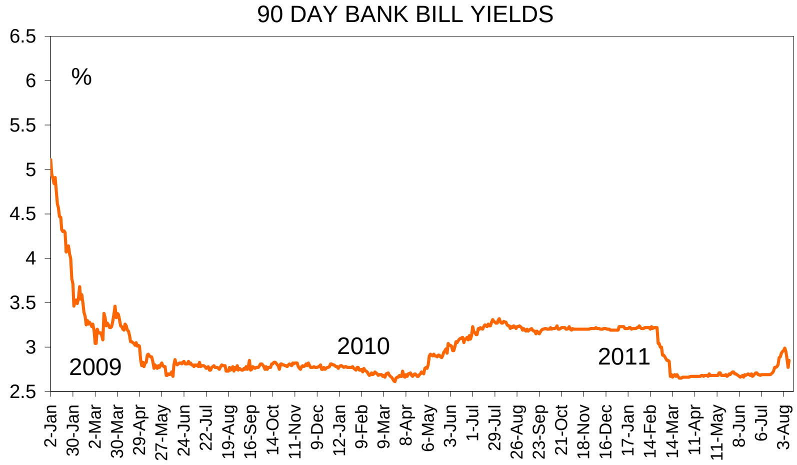
Well that was that. For a brief period the combination of higher than expected inflation and firmish data led to a shifting in monetary policy tightening expectations to September from December, 30 point jumps in wholesale fixed borrowing costs, and the arrival therefore of a time for borrowers planning to fix this cycle to do so. But now things have more than completely reversed with world market turbulence quite clearly set to worsen global growth prospects and our willingness to spend, invest and hire in the short term. That means monetary policy tightening has been pushed back out again.

Other Inflation Influencers

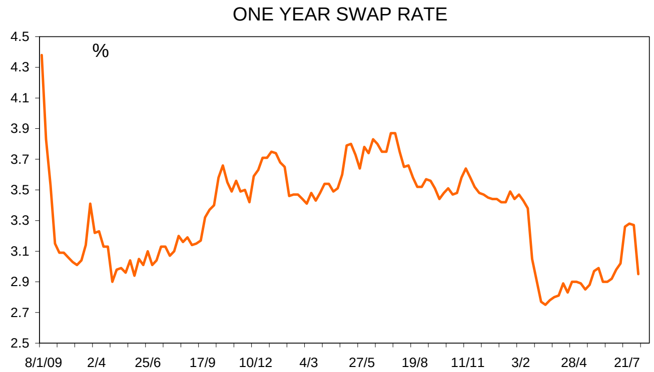
The fall back in the Kiwi dollar reverses one of the factors which would have given the RB pause for thought when tightening. But petrol prices have eased off and we saw no evidence of new inflationary pressures coming through in our monthly BNZ Confidence Survey.

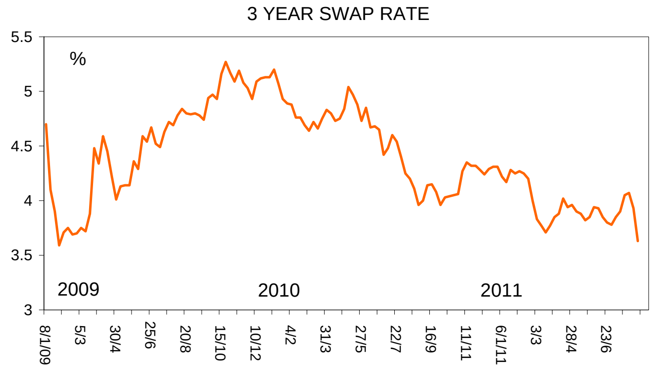
Rate Movements This Week

With the markets almost – though not quite – pricing out a September official cash rate hike in NZ the yield on 90 day bank bills has pulled back to near 2.85% from near 3% last week. This is above the 2.7% level however which prevailed between March and mid-July following the 0.5% rate cut of March 10.



The one year swap rate which sets the base for the cost at which we banks borrow to lend fixed has fallen back to where it was five weeks ago near 3.00% from almost 3.3% last week. The three year rate has fallen back to levels not seen since January 2009 near 3.6% from near 4.1% two weeks ago and 3.85% five weeks ago. The five year rate has fallen to 4.2% from 4.44% last week and 4.6% a fortnight ago and this is the lowest level since February 2009.





The world has changed – again. The Federal Reserve in the United States have said that they intend keeping interest rates low for the next two years and if that eventuates it will tend to suppress the extent to which our fixed borrowing costs rise this cycle because the further out along the yield curve one goes the less and less relevant our central bank's official cash rate. This severely eats into the very idea of hopping off floating into fixed rates to a large degree this cycle though does not remove the case entirely because from a simple risk management point of view spreading one's risk is a darn good idea in this massively uncertain environment.

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	2.85%	2.99	2.69	2.68	3.28	6.2
1 year swap	3.00%	3.27	3.02	2.89	3.66	6.0
3 year swap	3.61%	3.93	3.90	3.88	4.20	6.2
5 year swap	4.18%	4.44	4.49	4.53	4.56	6.4
180-day term depo	4.30%	4.30	4.50	3.60	4.90	6.0
Five year term depo	6.00%	6.00	6.00	6.00	6.75	6.5

If I Were a Borrower What Would I Do?

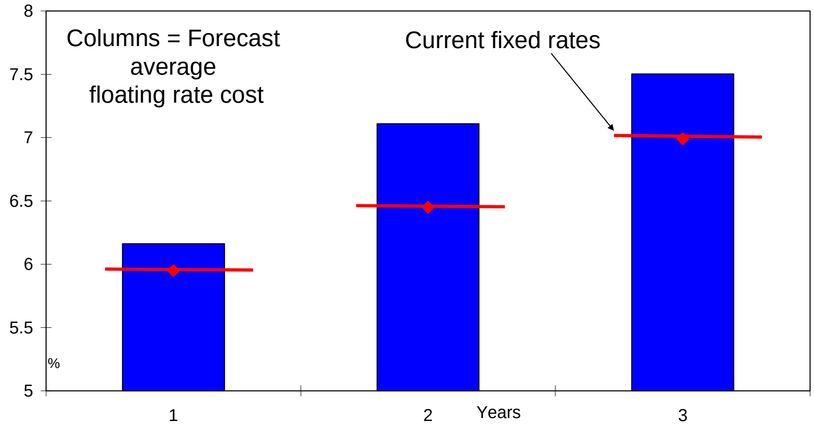
The bulk of the immediate pressure for rises in fixed housing interest rates has evaporated as a result of the turmoil freshly gripping world markets leading to tumbling expectations for world growth and inflation and sharp falls in wholesale borrowing costs. And so for the third time since March 2009 my period of saying I would shift from a floating rate to a fixed rate has ended after only 2-3 weeks! Thank goodness I said I'd fix 50% and not the whole lot, and thank goodness that hardly anyone actually made the jump from floating to fixed because the cost of moving is/was simply too much. C'est la vie.

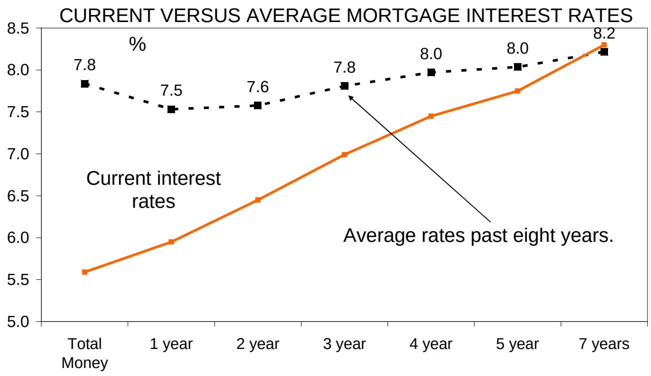
As we have stated many times, these are the most uncertain times we have ever seen and the extent to which the markets in New Zealand have switched from factoring in a tightening by the Reserve Bank any day to taking the bulk of rate rises off the table is staggering. All we can do is repeat that no-one should base any of their hedging decisions on an expectation that anyone's interest rate forecasts will remain unchanged over a period of a few months, or that they will prove correct. Each night it seems we learn something new regarding the global growth backdrop.

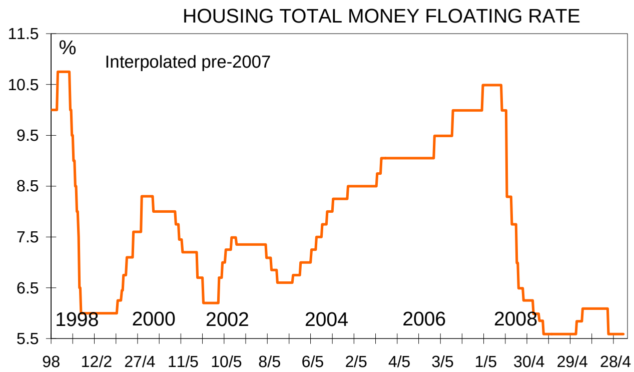
That sort of ongoing uncertainty actually argues in favour of having some of one's debt at a fixed rate simply as a risk management tool. But pressure to make a jump from floating to fixing has come right off and so I find myself right back to where I was in the July 14 Weekly Overview. Namely, and essentially summing up the view since early this year, "I'll be keeping an eye out for any decent fixed rate specials and as stated some months back would be willing to fix right now if I could get a two year rate for 6% or three rate for 6.25%. If I were a business borrower I would slowly be moving perhaps 20% - 40% of my core debt to a fixed rate near a three year term before the end of the year. I'd probably do this taking advantage of the occasional rallies we see in wholesale interest rate markets."

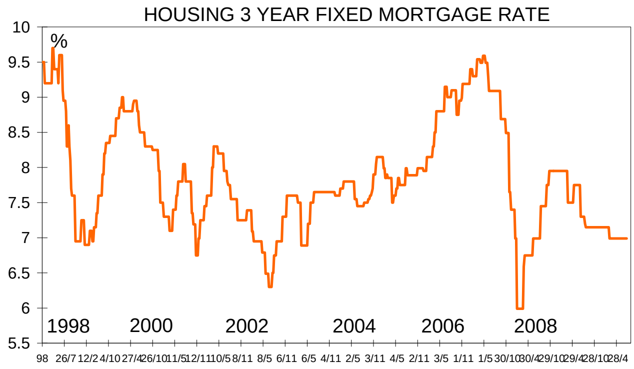
What are the chances of a bank offering me a 6% two year or 6.25% three year rate? Not very high. But if they did I would be dragged away from floating. What a nightmare.

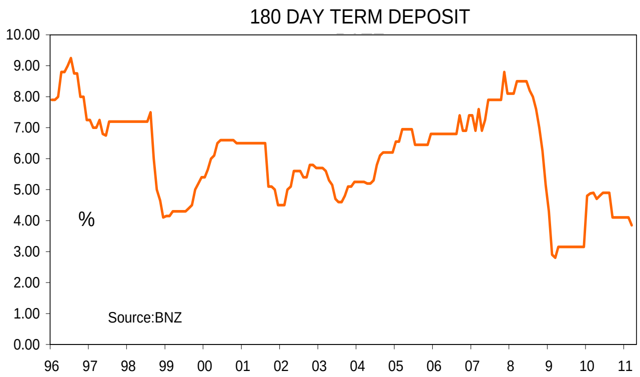
Note that our forecasts (this week's version) still imply one will gain a lesser cost by fixing at current rates than floating over the relevant fixed period. This is what the graph here shows with the little red lines showing current fixed rates sitting below the tops of the blue columns which show average floating rate costs over the entire period covered.











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

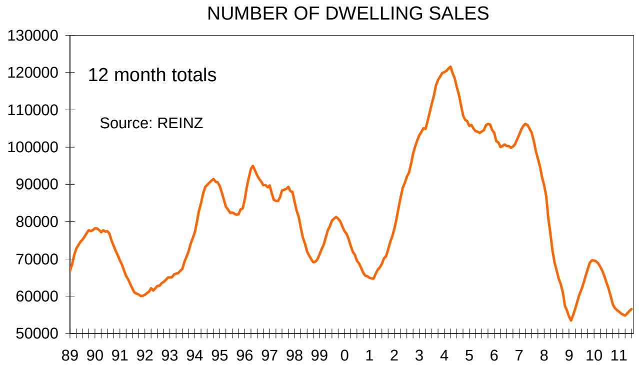
Guess I won't be riding rising short term rates up for a while. But I sleep very easy at night having cashed out of the sharemarket a year and a half ago. I am happy to still invest for terms out to 180 days.

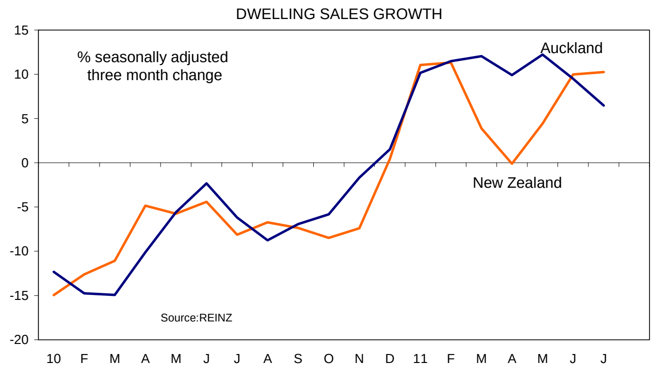
HOUSING MARKET UPDATE

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/

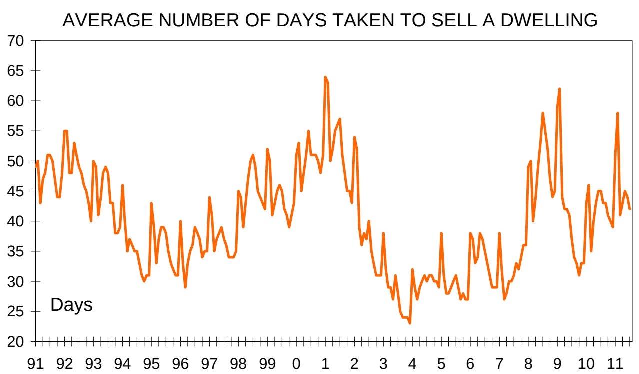
Market Improving Slowly. No Rush

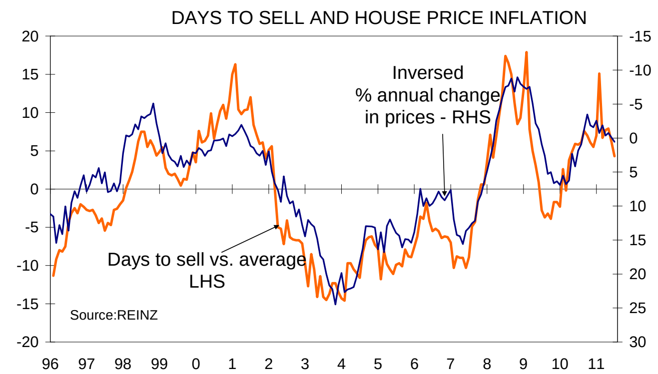
The REINZ monthly data released this morning show that in July there were 4,928 dwellings sold around New Zealand. This was a 12% gain from a year ago in line with annual increases recorded in May and June and bringing sales growth in the three months to July to 10% ahead of the three months to April in seasonally adjusted terms. Turnover is rising.



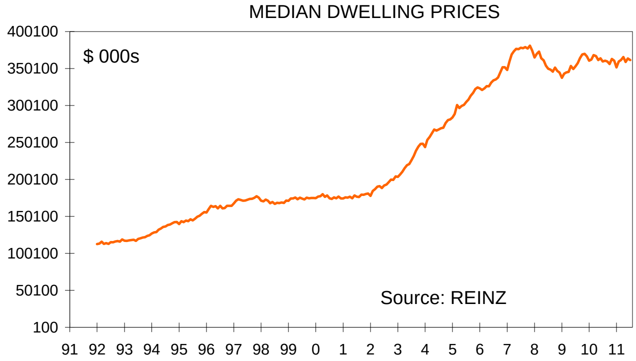


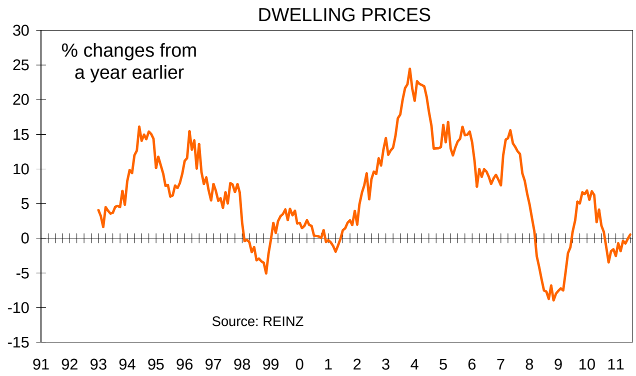
Turnover is also accelerating. In July on average it took 42 days to sell a dwelling which was 4.3 days slower than average compared with 6.1 days slower in June and 7.9 days in May. The latest result is the best since April last year and is consistent with a story of turnover rising. As the graph here shows it is also consistent with prices rising but as yet not too much is happening.





The stratified price index for July was down by 0.6% after rising 1.3% in June and was down 0.2% in the three months ending in July. Prices are flat – though we expect increases. In fact, while the NZ-wide price measure is ahead just 0.5% from a year ago and 7% from the January 2009 low, Auckland prices on average area ahead 3.5% from a year ago and 11% from early 2009, Wellington 0.8% on a year ago and 1% from 2009, Christchurch 0.2% on a year ago and 1.1% from early 2009.





This week we have conducted and released the results from our fifth survey of the country's 10,000+ licensed real estate agents. You can find the survey results here.
http://tonyalexander.co.nz/bnz-reinz-survey/
They show more and more first home buyers entering the market, investors moving away, listings in increasingly short supply, and prices rising – though not everywhere by any means.

This week we also ran our monthly BNZ Confidence Survey and each time we get 1-2 pages of comments submitted by those in the residential real estate and property management business. In case you are hard up for something to read here are the submitted comments.

- Real Estate.... shortage of good stock and realistic vendors. Good open homes with specific houses in specific locations highly sought after.
- Real Estate Tauranga. Bargain Hunters out and about. Under $300,000 reasonable demand. Higher price slow. Mortgagee Sales people like "ants looking for sugar!
- Real Estate - no listings anywhere unless sellers are motivated or literally don't have a choice. Could be an opportunity if people realized that there is no competition. But, buyers seem very picky and hesitant. Not the best year in the industry.
- Real Estate - Central Auckland. Market still quite tight although there seems to be a slight increase in listings from last month. Good prices being paid due to lack of stock but buyers frustrated at lack of choice. Will be interesting to see how prices react when the Spring brings an increased number of listings. I doubt we will see a backslide in prices in this market.
- Real Estate...no listings...realistic vendors and purchasers want to do the business
- Real Estate Auckland (North Shore) Plenty of buyers out there, sales have been good but stock levels now near critical, very few appraisals either.
- Real Estate specialising in the Lakeside and holiday homes market Very dependent. Currently very slow with the only activity being in the lower value properties
- Real estate - things are still slow but are turning shortage of listings meaning it is more like a sellers market than a buyers market. Not all buyers have realised this yet and are still trying low offers or are waiting and missing out on properties. More multiple offers are being submitted on Auckland homes.
- Real Estate: Steady at a reduced pace, listings starting to come in, a few buyers about but cautious re price, tend to be on low side.
- Real Estate: Shortage of listings and listings that are well priced. The market is very slow, and in some cases it is taking weeks and even months to get deals together. Vendors are still coming to terms with the drop in value of their properties and some are unfortunately "following the market down". What is selling is at the lower end of the market. But there is a real shortage of top end "quality" listings.
- Real Estate, Onehunga, high buyer demand and low supply pushing prices for quality homes up, and keeping DOM down. The tough bit isn't selling property, it is getting property to sell.
- Property/Healthcare - Property sales improving entry into villages. Resales significantly stronger than the same time last year. Contracts written during the month also stronger than last year.
- Real estate Lack of listings Prices still steady in south Auckland
- Residential real estate Hamilton: still excellent buyer activity that seems to be getting more motivated to buy as looming spectre of interest rate rises starts to put pressure on. Listings still bard to come by at present as vendors seem to still be fixated on wanting to wait until spring. May miss the best opportunity

to sell right now. Due to limited stock coming on prices holding and still fierce competition for new properties to the market. Prior to auction sales and competitive offers still very common.

- Real estate. Palmerston north.... A very quiet month after 2 good months, approx 1/2 the sales volume. Listings slow and not getting any easier to find.
- Residential Real Estate - multiple offers and higher than expected price for quality homes in all price brackets
- Real Estate - Well priced property is selling well. New properties are slow to come on the market.
- Real Estate is going off for the first time in 3 years on the North Shore, multi offers houses selling within days of being listed. Bring it on.
- Residential Real Estate Christchurch .Activity levels improving across the board, but getting commitment from purchasers is still difficult .Many potential sellers are waiting to take advantage of the sellers market which they anticipate will lead to higher prices as the red zone purchasers flood the market .Their optimism may be misplaced as many red zoners are entering the rental market and waiting to see what happens in Christchurch over the next six to twelve months .Our phones for rental accommodation are running white hot Still a real shortage of listings in the city fringe area, strong demand of buyers.
- Real estate - the market is busier now than summer, more deals, better quality buyers, more getting over the line once under offer.
- Auckland Real Estate - Pt Chevalier, Westmere, Grey Lynn. Very strong prices being obtained due to the most serious shortage of stock we have seen in 15 years, nothing new being built and huge volume of seriously motivated buyers. Would estimate that anyone who purchased 12 months ago in these areas would have seen on average around a $100,000 gain since then. Not likely to see the usual spring surge of listings as nobody seems to want to list for sale before the RWC is over and then we will also have the usual pre election slow down. So looks like prices will strengthen further over the next few months and probably low listing levels until next year.
- Real estate. Things are ticking over but quiet really. I believe it will remain quiet this year due to the elections and world cup.
- Real estate: Better than last year. A bit slow, its winter but certainly some positive signs.
- Residential Real Estate Napier. Listings are slow we need more listings!!! Buyers are out and about keen to spend their money
- Residential Real Estate Howick/Pakuranga - Very short of saleable properties, which you would think would create more demand and push prices up - but it's not. Buyers very picky and refusing to pay what's asked, so quite a lot of property actually sitting on the market going nowhere. Motivated sellers prepared to meet the market are selling.
- Real Estate, Eastern Beaches. Achieving very solid prices, especially in sub $600k range and in short order. Buyers are plentiful but an absolute scarcity of homes listed for sale; shortest supply position I have ever seen.
- Starting to look better - real estate
- Real Estate Eastern Suburbs, 23 sales in July, only 17 listings, big shortage of property for sale.
- Real estate. Much the same which is spluttering along
- Property Manager North Shore Auckland very busy at the moment. Listing have dropped 15% in last 2 weeks. Rents have flattened off but still 5-10% higher than same time last year. It feels like the spring surge has started a month early. I can see large shortage of accommodation becoming apparent by Christmas.
- Property Management Wgtn - If there's light at the end of the tunnel, it’s very dim. The market remains obstinately quiet, with activity levels verging on flat lining.
- Plenty of houses to rent in Palmerston North. People selling rentals because of legislation change
- Rental houses steady, no problem finding tenants, first impact of rate and insurance increases starting to be felt and rent increases will follow.
- Residential property investment in Wellington. Tenants are keen to stay put, and want to have certainty of 1-year leases. For this time of year, that is a bit unusual, and might suggest that they recognise a shortage of quality flats/houses is developing.
- Very good! - residential property investment in Auckland (fringe city. Strong demand, firming rents

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

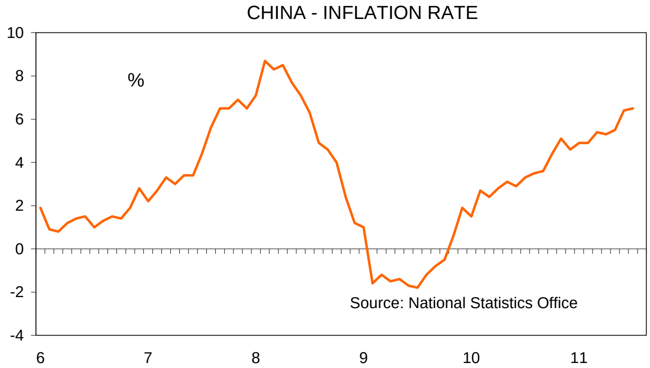
Concerns have grown so great regarding the impact on European growth of the deteriorating debt situation that the European Central Bank last Thursday night bought some bonds to try and stem the rise in yields for some countries, and offered extra short term financing to financial institutions – essentially a liquidity boost aimed at offsetting some investor withdrawal from the banking market. It pays to remember that the ultimate danger of the debt crisis is that banks will fall over because of their holdings of the bonds of highly indebted governments and that we could see a repeat of the aftermath of the September 2008 Lehman's bank collapse. Only this time governments would not have the ability to ease fiscal policy to offset private sector spending restraint, and central banks would have little scope for cutting interest rates.

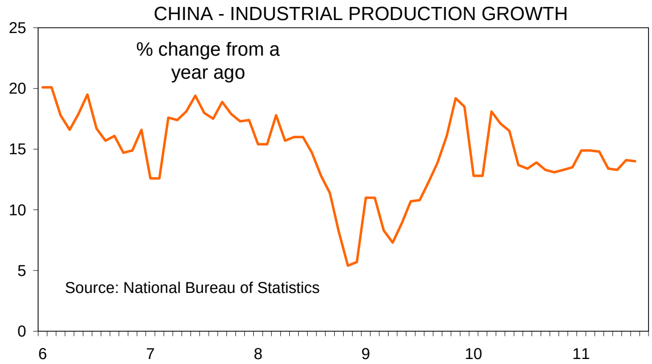
Speaking of such, the ECB left their cash rate unchanged at 1.5% last Thursday following a 0.25% lift in July, and signaled their growing disquiet by removal of the term "strong vigilance" from their commentary. The chances of further rate rises by the ECB in the near future appear reasonably slim.

Over the weekend the Italian Prime Minister announced that in response to growing investor concerns about Italian finances leading to soaring bond yields he would initiate a new fiscal austerity programme aimed at returning the state to surplus a year earlier than previously planned.

Chinese Inflation

This week I was going to put comments on the website regarding the Australia-China conference I attended in Melbourne last week but there has been too much happening - so maybe next week. This week we learnt that inflation in China continues to track at higher than desired levels. Inflation hit a 37 month high of 6.5% in July from 6.4% in June with food prices up sharply by 14.8% from a year ago and prices generally elevated by the huge monetary stimuli applied to the Chinese economy during 2009 and 2010 as their contribution toward insulating the world economy against the post-Lehman's events.



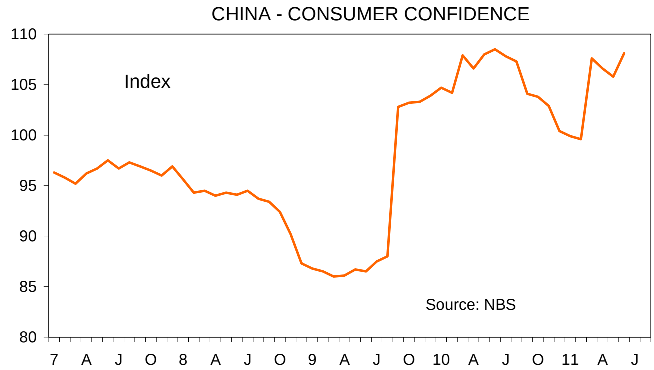


The Chinese authorities have moved to try and suppress inflation through tighter bank lending controls, reserve ratios, and interest rates. But there is little evidence of growth slowing down in a major way and in fact whatever slowdown is happening does not yet appear to be great enough to keep inflation away from levels causing rising social unrest. Those on low incomes tend to have high proportions of their household spending devoted to food and the sharp rises in prices for basic items such as pork – ahead 57% from a year ago – hit householders hard as their wage bargaining ability tends to be poor.

With regard to the rate of growth in the Chinese economy we have seen a range of data released in recent weeks showing things as still being robust. The annual rate of growth in industrial production slowed to 14% in July from 15.1% in June. But as the second graph just above shows however this growth rate is strong and the change over the month inconsequential.

The annual rate of growth in fixed assets remained high in July at 25.4% from 25.6% in June with the only real change in this series in the past five years behind the temporary surge over 2009 as special projects were undertaken to help combat the effects of the global downturn.

Consumer confidence remains at high levels. But there is some evidence of slowing if we look at the official monthly Purchasing Managers Index in the manufacturing sector put together by CFLP. It fell to a 28 month low of 50.9 in June from 52 in May.



Yet if this is all there is showing slowing after so many rises in interest rates etc. it seems fairly easy to conclude that more tightening action will probably need to be taken – though maybe not in the next few weeks as the People's Bank of China waits to see where markets settle around the world and what the impact of the turbulence is on exports.

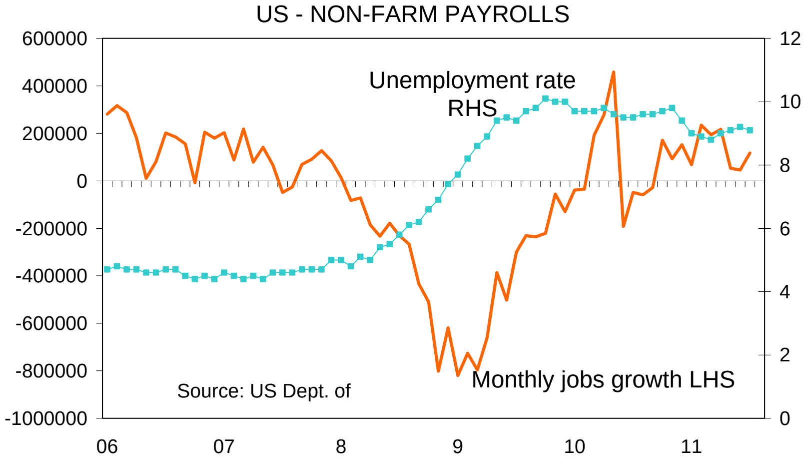
US Growth Momentum

In the US this week the focus has been on highly volatile asset markets with investors shifting funds to reflect their worries about the US economy and the credit rating cut by Standard and Poors. Share prices have weakened, bond prices have risen, and one imagines that in the short term at least growth prospects are now dimmer as people factor in higher uncertainty and generally reduced wealth – yet again. The Federal Reserve made a strong contribution toward steadying things with their regular meeting on Tuesday producing a widely expected decision to leave the cash rate unchanged in a target range of 0% - 0.25%, and a relatively unusual statement of their commitment to keep rates exceptionally low "at least through mid-2013". That is, 0% rates for another two years which is probably what we were getting at last week when we spoke in terms of US monetary policy eventually tightening, but we were unsure during which decade.

But their two year commitment in itself is worrying because it is effectively a statement on their part that they think the economy will be stuffed for at least another two years, that jobs growth will not be great enough to boost wages, that consumer spending growth will not be great enough to allow businesses to recoup margins through price rises, and that the housing market will remain weak thus preventing price rises there and a construction surge which would lift building costs.

So can they do anything about it? Although expectations have died down a tad, there is continuing underlying speculation that the Fed. may still engage in a further round of quantitative easing. This involves the Fed. buying US government bonds and those investors who would otherwise have bought the bonds seeking investments elsewhere thus boosting asset markets, while banks find more liquidity around so presumably boost lending. The trouble is that while the first thing happened in response to the first two rounds of money printing, banks remained reluctant to lend and people did not much want to borrow anyway. So all the QE1 and 2 exercises did was push sharemarkets and commodity prices to high levels with no apparent sustained impact on underlying economic activity. At best, if it occurs, QE3 may only achieve a temporary burst in asset prices. Once that fades not much is left except to read up on how Japan has done since 1990 with similarly impotent monetary policy.

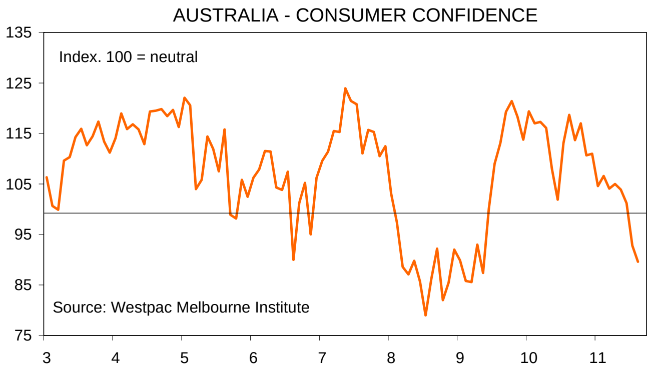
For the record there were some data releases in the US in the past week but the only really important one was the monthly jobs report. The number of people employed in the non-farm sector grew by 117,000 in July. This was better than the average expectation of an 85,000 rise and the results for June and May were revised up slightly. But jobs growth remains at about one-third that necessary to make a dent in the unemployment rate, and now on top of state governments cutting back their spending and laying off people the Federal government may also soon be cutting back in order to bring spending under control.

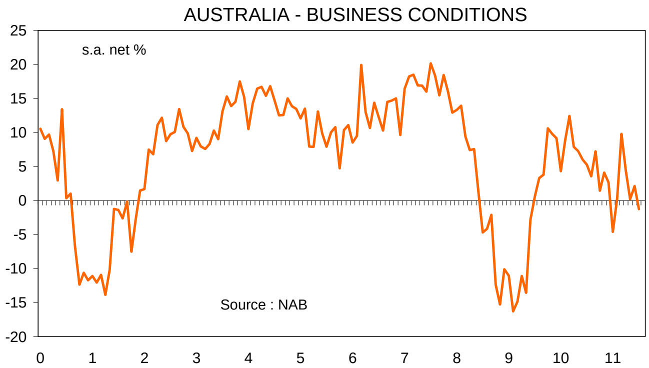


When the 2008 recession started (it ended in mid-2009) the US unemployment rate was 5%. Now it is over 9%. So if the US economy is headed back into recession the labour market consequences do not bear thinking about.

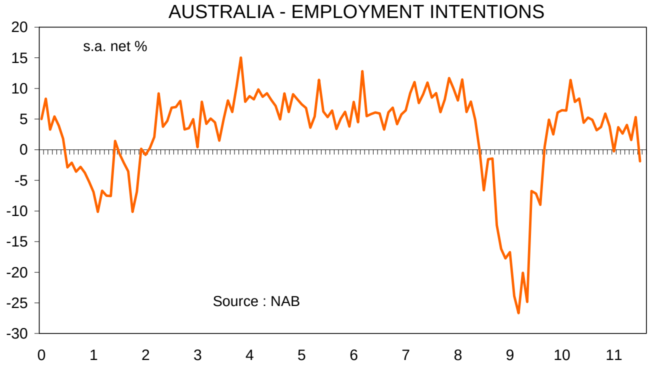
Australian Growth

Australian economic data have been posting on the weaker than expected side for a few weeks now and this week was no exception. Perhaps the biggie was the monthly measure of consumer sentiment from Westpac/Melbourne Institute. It fell to a reading of just 89.6 early this month from 92.8 in July where 100 is neutral. The reading was the lowest since May 2009 and hardly bodes anything positive for either the housing sector or consumer spending though does reinforce the case already made strong this week by market turbulence for the RBA to hold off raising interest rates further for quite some time. The markets are in fact pricing in 1.3% worth of cuts to the 4.75% cash rate over the coming year but we feel that pricing is way too pessimistic and cuts are not all that probable.





Another piece of weak news however was the monthly NAB business survey which recorded a fall in the current business conditions index to -1.3 from 2.1 in June. As shown in the graph above this level is weaker than normal but nowhere near the lows of late-2008. The employment index however retreated to -1.9 from 5.3 and this feeds into the developing picture of a slowing labour market which we expect in the context of an improving NZ jobs market will see a reversal of the rising net loss of Kiwis to Australia perhaps six months or so from now.



In fact the monthly job numbers were released today across the ditch and they showed that in July job numbers were unchanged and the unemployment rate climbed to 5.1% from 4.9% in June. The Aussie labour market growth has stalled.

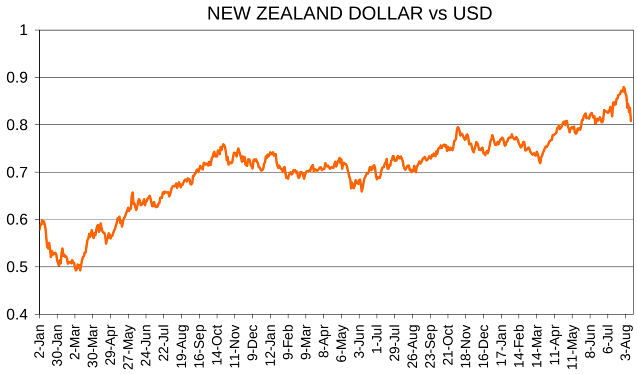
Exchange Rates

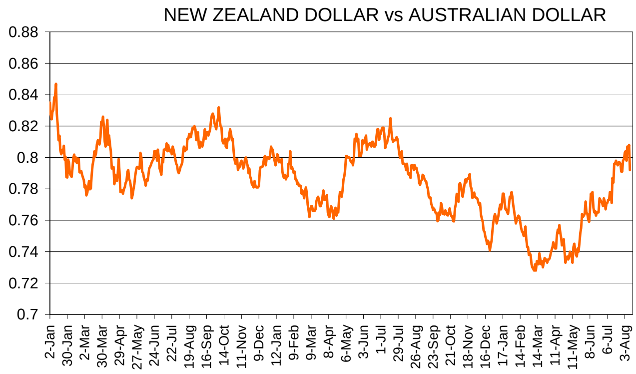
Exchange Rates	This Week	Week Ago	4 wks ago	mths ago	Yr ago	Consensus Frcsts yr ago*	10 yr average
NZD/USD	0.820	0.861	0.838	0.795	0.724	0.689	0.629
NZD/AUD	0.800	0.804	0.778	0.733	0.792	0.773	0.855
NZD/JPY	62.800	67.500	67.500	64.300	61.8	67.7	68.4
NZD/GBP	0.506	0.525	0.522	0.486	0.456	0.448	0.368
NZD/EUR	0.576	0.601	0.587	0.552	0.549	0.52	0.511
NZDCNY	5.263	5.540	5.418	5.162	4.903		4.83
USD/JPY	76.585	78.397	80.549	80.881	85.359	98.3	109.9
USD/GBP	1.621	1.640	1.605	1.636	1.588	1.54	1.705
USD/EUR	1.424	1.433	1.428	1.440	1.319	1.33	1.229
AUD/USD	1.03	1.07	1.08	1.08	0.91	0.891	0.737

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

Nine Cent Range For The NZD In Ten Days

What a week. After trading at a post-float high of 88.3 US cents last week, this week the Kiwi dollar briefly traded as low as 79.7 cents during the worst of the crisis of confidence gripping the world's financial markets. Some of the weakness started toward the middle of last week when the NZD pulled back from 88 cents and was at 86.1 at the time we started sending out last week's WO. But as soon as the electronic distribution of the WO started the Kiwi got hit as the Bank of Japan started intervening in the FX market selling yen. As a result we saw a surge in the greenback flowing through to a quick drop in the Kiwi dollar from above US86 cents to near 84.5. Then later in the night the tanking US sharemarket and general movement by investors away from risky assets saw some extra selling of the NZD which fell away to near 83.5 cents while losing some ground also against the pound, euro, and even against the yen.

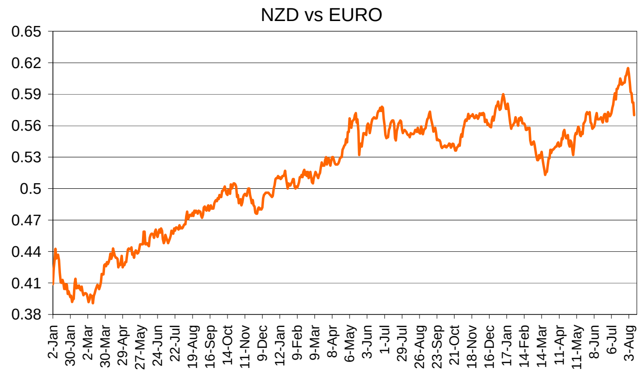


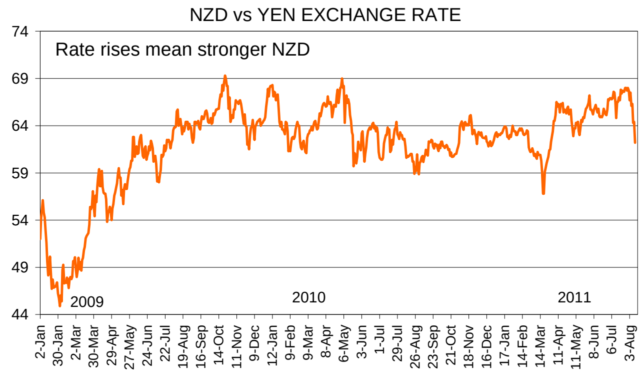


The fall to 79.7 cents happened on Tuesday night. We recovered back over 83 cents as sharemarkets recovered but have eased off again today to just over 82 cents following the fresh selloff in equity markets overnight.

So where to from here? Toss a coin. There are probably only two intelligent things which have been worth reading in this section of the WO for a number of weeks now. The first has been a comment suggesting that exporters look for a highly likely pullback in the NZD of 3-4 cents in order to get some extra hedging on board because we see forces in play as far more likely to cause the NZD to rise over the coming year than fall. We are still of that view.

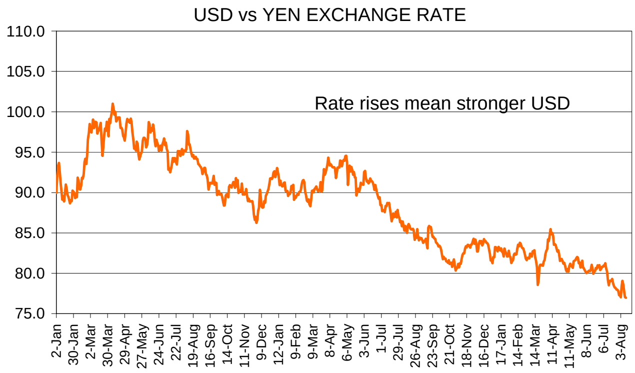
Our second good comment was the one we printed on the front page of the WO last week, namely…" Personally speaking if I had an overseas trip planned in the coming six months I would be inclined to take the bird in the hand now and buy FX not worrying about the small amount of interest I will sacrifice or the non-zero probability that the NZD will in fact go higher."

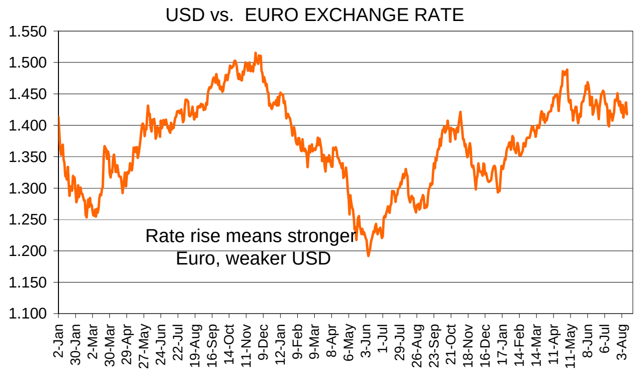




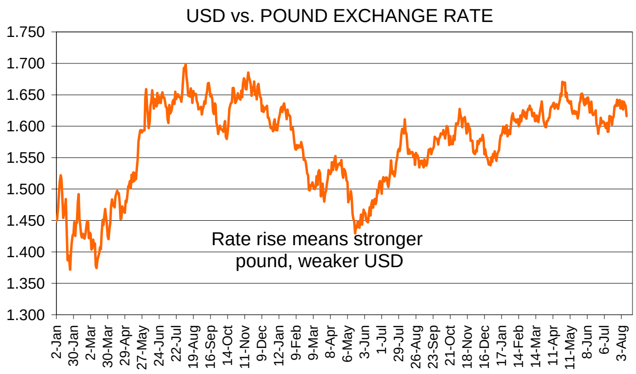
Over the coming week the NZD will go higher and lower and end up lower or higher. Don't know which. It depends upon whether the markets have settled down after undergoing a structural shift in asset placements to reflect the reduced credit rating of the United States, the worsened and worsening outlook for the US economy, and the still deteriorating debt situation in Europe. Oh, and there is the intervention by the Bank of Japan to try and factor in as regards to the levels at which they might do it again.

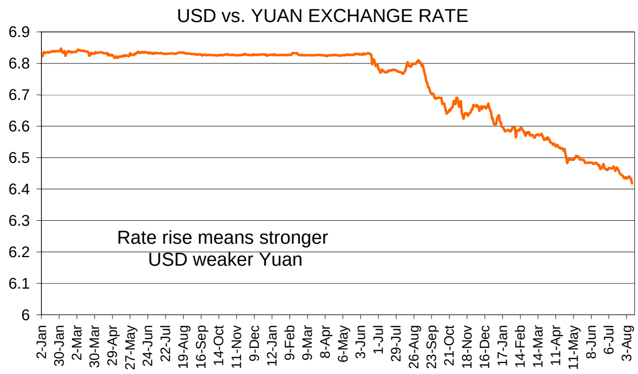
With regard to the major currencies the theme for the week has essentially been one of investors seeking safe havens in the Japanese Yen (hence the intervention), the Swiss franc (hence their monetary policy easing and flooding of their money system with liquidity), and the greenback. In fact investors have not been selling US government securities following the credit rating downgrade on Friday night by Standard and Poors, they have been buying them as a safe haven asset and as growth and inflation expectations have been slashed, and because the US Federal Reserve on Tuesday night said they plan keeping interest rates low for at least another two years.





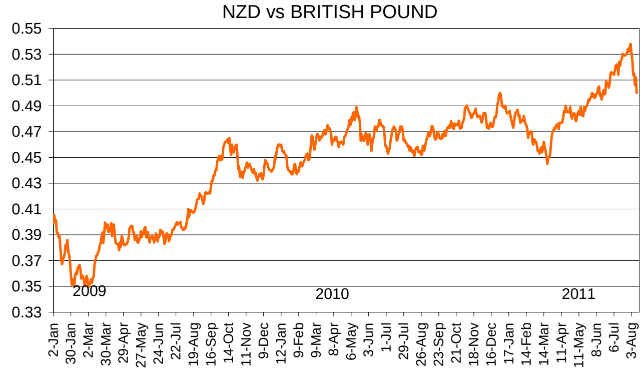
The euro has generally been sold because of the worries about Italy's ability to refinance its debt in the coming year and various rumours about the French government's credit rating and French banks. At the end of it all we have the USD trading at just above a record low against the yen (76.25) near 77 this afternoon from 78.4 last week. Against the pound the USD is near $1.616 from $1.64 though this is easily within the recent trading range. The same applies for the dollar's appreciation against the euro where it now sits near $1.418 from $1.433 last week.





United Kingdom

The rioting in UK streets has not had any noticeable impact in the markets – especially as the global rout fundamental has essentially swamped anything else in play. But rising risk aversion driving people toward the USD, Swiss franc and Japanese yen has seen generalised weakness in the pound against which the Kiwi dollar has fallen to near 50 pence from 52.5 last week as we are perceived as riskier than the GBP. But when it comes to economic fundamentals the situation is different with a far rosier outlook for our economy than for the UK's over the next couple of years. That means that once the current market turmoil settles down (and it always does) we expect to see the NZD rising again against the pound back to the 55 – 60 pence range. When? Don't know. Probably before the end of the year.



As for factors economic in the UK this week one should mention the quarterly inflation report from the Bank of England released last night which contained downward revisions to growth and inflation forecasts. That means expectations for interest rate rises have been pushed further out and that means diminished support for the pound over a time period when we fully expect NZ monetary policy to be tightening.

Exchange Rate Assumptions

Good luck.

	2010	2011	Risk	2012	Risk
Year end					
NZD/USD	0.73	0.80	Higher++	0.81	Higher+
NZD/AUD	0.74	0.78	Higher	0.86	
NZD/YEN	64.2	69		70.0	Higher
NZD/GBP	0.44	0.49	Higher+	0.50	Higher
NZD/EUR	0.51	0.55	Higher	0.58	Higher
USD/JPY	88	86	Lower	86	Lower
GBP/USD	1.66	1.63		1.62	Higher
EUR/USD	1.43	1.45	Higher	1.40	Higher
AUD/USD	0.99	1.03	Higher+	0.94	Higher++

ECONOMIC DATA

All %		Latest qtr only	Previous qtr only	Latest year	Year ago	2 Yrs ago
Inflation	RBNZ target is 1% - 3% on average	1.0%	0.8	5.3	1.7	1.9
GDP growth	Average past 10 years = 2.6%	0.8	0.5	+1.5	-0.7	-1.5
Unemployment rate	Average past 10 years = 4.8%	6.6	6.7	......	6.1	5.2
Jobs growth	Average past 10 years = 1.9%	1.4	-0/4	1.8	-0.1	0.6
Current a/c deficit	Average past 10 years = 5.5% of GDP	4.3	4.1	......	2.4	8.0
Terms of Trade		0.9	0.8	6.8	0.1	-5.0
Wages Growth	Stats NZ analytical series	0.6	1.0	3.6	2.5	5.2
Retail Sales ex-auto	Average past 9 years = 3.9%.	0.7	0.0	1.4	1.0	-3.6
House Prices	REINZ Stratified Index	1.5	-0.6	-0.4	4.2	-2.9
Net migration gain	Av. gain past 10 years = 13,900	+3,867	6,554yr	......	16,504	12,515
Tourism – an. av grth	10 year average growth = 3.2%. Stats NZ	-0.1	0.2	-0.1	3.8	-2.8
		Latest year rate	Prev mth year rate	6 mths ago	Year ago	2 yrs ago
Business confidence	BNZ survey	45	57	22	2	15
Consumer confidence	ANZ-Roy Morgan 100=neutral	109	113	117	116	108
Household debt	10 year average growth = 10.3%. RBNZ	1.2	1.2	1.8	2.6	2.7
Dwelling sales	10 year average growth = 2.5%. REINZ	14.3	10.8	-11.3	-24.3	40.3
Floating Mort. Rate	(TotalMoney) 10 year average = 7.9%*	5.59	6.09	6.09	5.59	6.49
3 yr fixed hsg rate	10 year average = 7.8%	6.99	7.15	7.15	7.95	5.99

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

*extrapolated back in time as TotalMoney started in 2007