BNZ Weekly Overview

18 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.

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The Weekly Overview is written by Tony Alexander. The views expressed are my own and do not purport to represent the views of the BNZ. To receive the Weekly Overview each Thursday night please click here.
http://feedback.bnz.co.nz/forms/Fx-I8ploskSGWgjN_7WOAw
To change your address or unsubscribe please click the link at the bottom of your email.

Nothing Much Learnt This Week

This week we have not learnt anything new of substance with regard to the state of or prospects for the NZ economy. We remain optimistic about growth next year on the basis of rebuilding Christchurch, farmers spending more of their high incomes, an acceptable world growth environment, a rapidly tightening NZ labour market with some fairly severe structural staff shortages appearing, catch-up house building in Auckland, underlying long term growth in some sectors such as filming and IT, and eventually catch-up spending by householders and businesses as confidence about the sustainability of the growth improves.

But there will be restraint on growth from tightening fiscal policy, bouts of huge worries about the European debt crisis and the US economy, net annual migration flows turning negative for a short time, a high and rising NZ dollar hurting some exporters, and outright recession in some sectors such as wine and tourism.

The Reserve Bank are highly likely to start raising interest rates in December and we recommend borrowers model a 2.5% rise in their short term funding costs between then and the middle of 2013 to see how they would be left. We reckon most will find some value in fixing up to 50% of their debt near a three year interest rates.

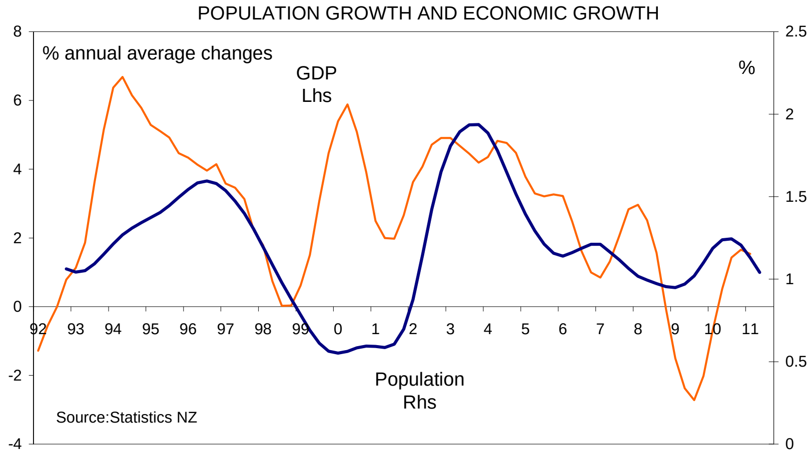
Exporters should keep an eye out for occasional bursts of NZD weakness as we have just seen in order to get extra hedging on board because the fundamentals suggest ongoing and extra strength in the Kiwi dollar over the next couple of years. Support will come principally from a better economic performance here than in many other economies, tightening monetary policy while interest rates in other countries are held low, firm commodity prices, investor diversification away from the major currencies, increased foreign direct investment from Asia, and the structural decline in the greenback.

Retailers would be best advised to keep inventories low until they have seen the whites of the eyes of extra customers coming through their doors for three months. That strategy of deliberately missing the first stages of a cyclical recovery in consumer spending seems safer than building inventories now in anticipation of a spending surge which yet again may not arrive.

Businesses generally should continue to focus on improving their balance sheets, but given that most will have been doing this for four years now the time is well and truly in hand when a strong eye should be kept out for acquisition opportunities. Speaking of which, with four years of shrinking staff training and people becoming disconnected form the workforce employers should keep an eye out for good staff and build workforce numbers ahead of expected strong output growth.

Population Growth Slow

Statistics NZ this week released data showing that during the June quarter the estimated usually resident population for New Zealand was for the first time ever just above 4.4 million people. This represented growth from a year earlier of 0.9% which is the slowest since September quarter 2001 when the migration surge from the middle of that year had yet to really kick in. The graph below shows four quarter on four quarter changes in GDP and population with the latter shown as the blue line. Population growth change tends to lag economic growth change suggesting that a lift in population growth is likely from early next year. This accords with our view of net migration flows getting worse in the next few months then improving over 2012 as the net outflow to Australia pulls back in light of divergent changes in our labour and housing markets.



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 put some perspective around our situation in New Zealand.

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.

We have not received any fresh information on the state of the NZ economy this week.

Are householders opening their wallets more?

Nothing new.

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/

Empty.

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/

Ditto.

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?

Nothing new this week.

Other Inflation Influencers

The quarterly data on business input costs and the costs of capital items like houses and transport equipment were released this week. But they do not tell us much more than that there remains some inflation bubbling away down low and the risk for monetary policy is on the tightening side.

Rate Movements This Week

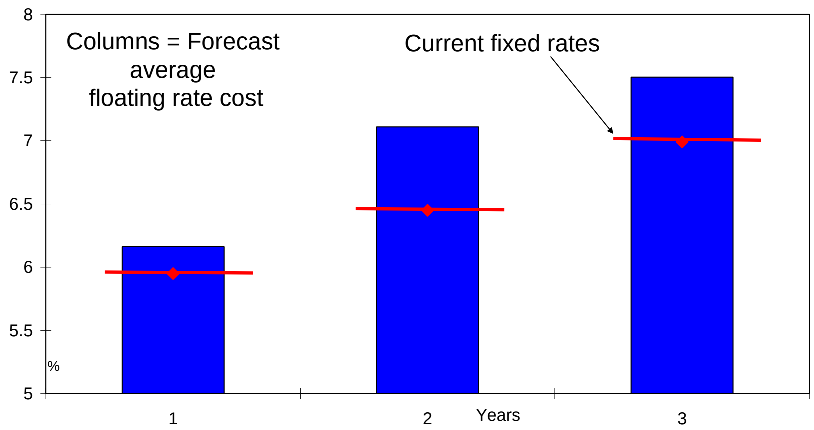
With gross concern about the world in general easing this week wholesale interest rates have climbed across the curve with the yield on 90-day bank bills once again reflecting expectations of a monetary policy tightening before the end of the year. Swap rates climbed also though mainly for short terms. Long rates have a fresh cap on them courtesy of the Federal Reserve in the US indicating they intend keeping their cash rate at its current low level for at least the next two years.

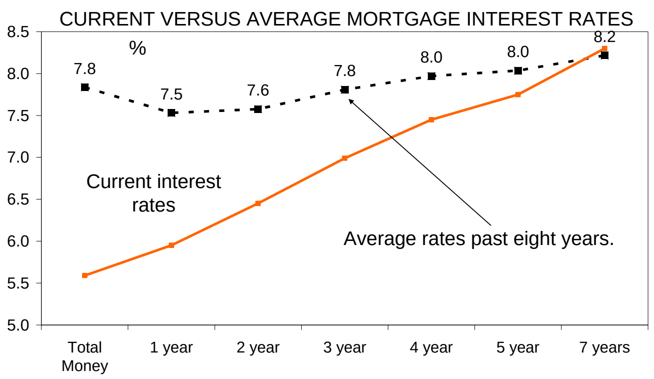
FINANCIAL MARKETS DATA	This week	Week ago	4 wks ago	3 months ago	Yr ago	10 yr average
Official Cash Rate	2.50%	2.50	2.50	2.50	3.00	5.9
90-day bank bill	2.95%	2.85	2.69	2.68	3.21	6.2
1 year swap	3.14%	3.00	3.26	2.85	3.58	6.0
3 year swap	3.73%	3.61	4.05	3.82	4.11	6.2
5 year swap	4.27%	4.18	4.59	4.48	4.44	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

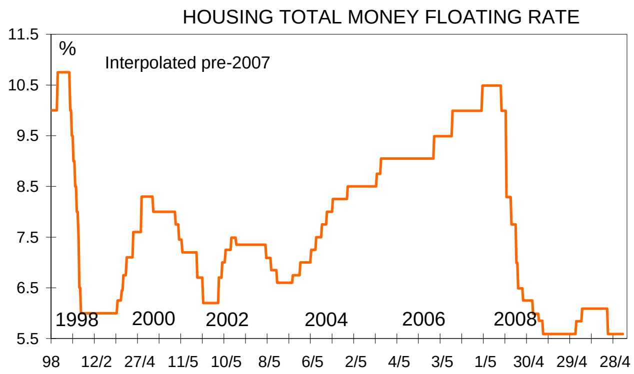
If I Were a Borrower What Would I Do?

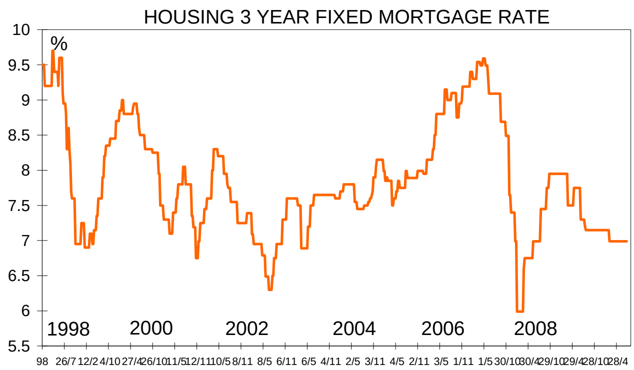
If my plan were to float all the way through this cycle then I might keep an eye out for any attractive 12 or 18 month fixed rate at levels close to current floating rates as we expect floating rates to be rising from December. If my plan were to fix I feel that once again time is on my side so I would sit floating but anticipate fixing before the end of the year. Clearly picking when to pick this move is proving problematic so don't feel like you have made a mistake if over the past month you have moved from floating to fixed. You have rate certainty which many others will be seeking in coming months and which many will eventually regret not securing once the monetary policy cycle is truly chugging along.

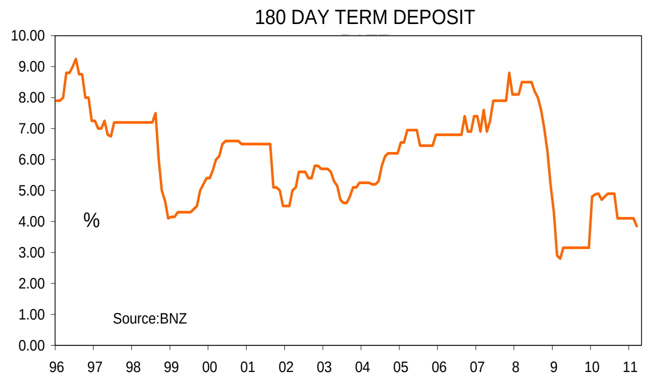
If I were a business borrower I would be doing what we have suggested many times over the past few months. That is to take advantage of the periods of rallies in wholesale borrowing costs to move 20% - 40% of my debt onto a fixed rate basis near the three year term. This is/has been one of those periods.











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

Nothing new. I stay short.

HOUSING MARKET UPDATE

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

Nothing

No new information on the state of the housing market has appeared this week – so that's that.

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

Things have calmed down once more in the European markets as seen by the yields on ten year Spanish and Italian government bonds moving back below 5% having been over 6% during the heights of the recent crisis and just before the ECB indicated they would purchase the bonds. But little new has been learnt with regard to where things are going from here and the much-heralded emergency meeting between President Sarkozy and Chancellor Merkel produced nothing of true substance. They expressed their opposition to euro bonds (central funding of individual country deficits on an ongoing basis), opposed also any further expansion of the bailout fund, but supported some sort of golden rule regarding countries balancing their budgets.

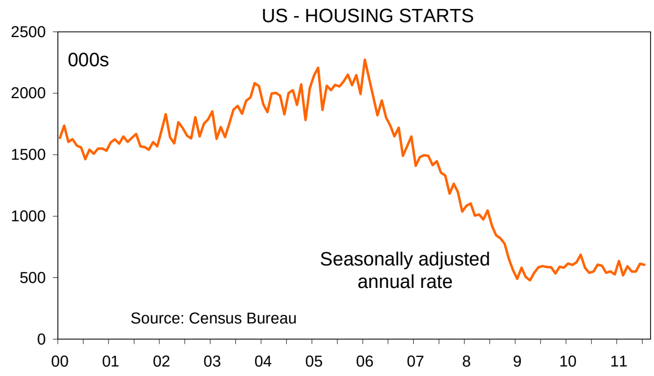
But there are growing concerns that the growth problems affecting highly indebted countries are spreading to the bigger European economies. In fact euro zone growth all up was only 0.2% in the June quarter following growth of 0.8% during the March quarter. Similarly weak results have recently been seen in other parts of the world with Japan's GDP falling 03% in the June quarter and US GDP ahead 0.3% following only 0.1% growth in the March quarter. The German economy grew only 0.1% after rising 1.3% in the March quarter.

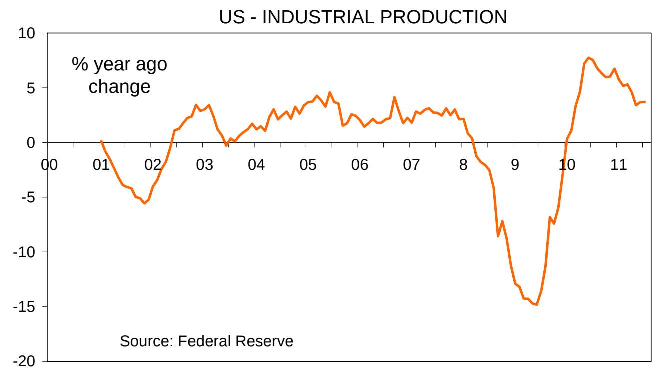
Chinese Inflation

Nothing much of import has been learnt about the Chinese economy this week. With a rising proportion of our merchandise export receipts now coming from China (12.3% of all and up 40% in the past year) what happens there is vitally important to our economy. In fact the importance is much more than these numbers imply as 22.5% of our exports go to Australia and the Aussie economy is massively tied into Chinese growth through minerals exports and mines development.

US Growth Momentum

There was yet another set of bad housing data released in the US this week in the form of the annualised pace of housing starts (construction) falling to 604,000 in July from 613,000 in June. As the graph shows, this particular measure continues to go nowhere. Low interest rates as a positive contributor to construction are being offset by a weak labour market, drive to reduce household debt, and continuing oversupply of houses with downward pressure on prices persisting.





However there was a piece of positive news in the form of industrial production rising for the third month in a row with a seasonally adjusted gain of 0.9% in July. Compared with a year ago output was ahead by 3.7% - a pace which is acceptable though not stellar.

Australian Growth

Last week the markets became exceedingly pessimistic about Australian growth prospects and priced in 1.3% worth of cuts to the RBA’s cash rate over the coming year. This week that pessimism has been steadily easing off and the extent of expected rate cuts has eased substantially. We retain our view that the next change in monetary policy in Australia is still more likely to be a tightening rather than a loosening.

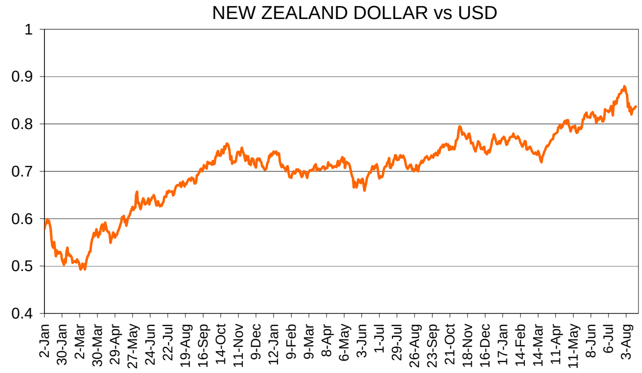
Exchange Rates

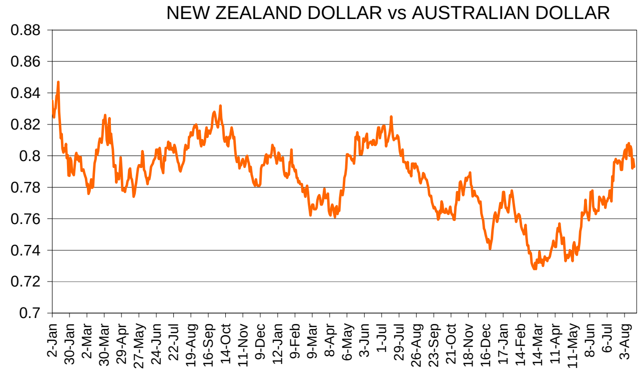
Exchange Rates	This Week	Week Ago	4 wks ago	mths ago	Yr ago	Consensus Frcsts yr ago*	10 yr average
NZD/USD	0.837	0.820	0.848	0.783	0.712	0.689	0.629
NZD/AUD	0.793	0.800	0.796	0.737	0.787	0.773	0.855
NZD/JPY	64.000	62.800	67.000	63.800	60.9	67.7	68.4
NZD/GBP	0.506	0.506	0.525	0.482	0.457	0.448	0.368
NZD/EUR	0.579	0.576	0.598	0.550	0.553	0.52	0.511
NZDCNY	5.346	5.263	5.481	5.093	4.836		4.83
USD/JPY	76.464	76.585	79.009	81.481	85.534	98.3	109.9
USD/GBP	1.654	1.621	1.615	1.624	1.558	1.54	1.705
USD/EUR	1.446	1.424	1.418	1.424	1.288	1.33	1.229
AUD/USD	1.06	1.03	1.07	1.06	0.90	0.891	0.737

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

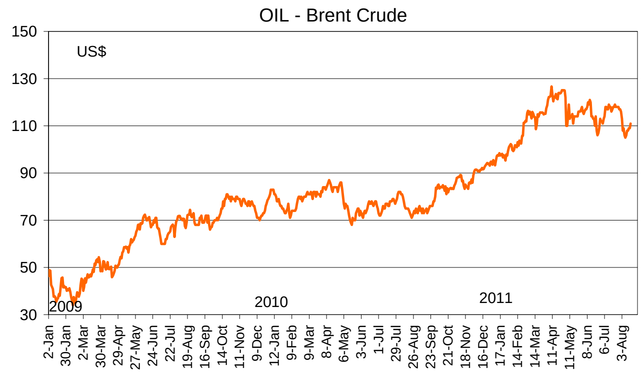
NZD Up A Tad

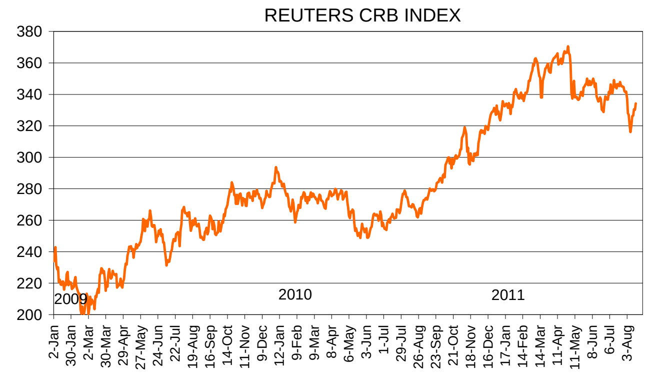
At just over US 83.5 cents the Kiwi dollar is up over a cent from this time last week but right back where it was two Fridays ago just before Standard and Poors cut their US credit rating. Things have settled down following that shock but the global backdrop for our economy still remains challenging and we are virtually guaranteed to see new periods of market turmoil in the next few months. In Europe the debt situation is frankly as worrying as ever but for the moment investors have decided to bask in the sun rather than adjust their portfolios during the Northern hemisphere summer. In the United States economic data remain weak and immediate growth prospects poor.





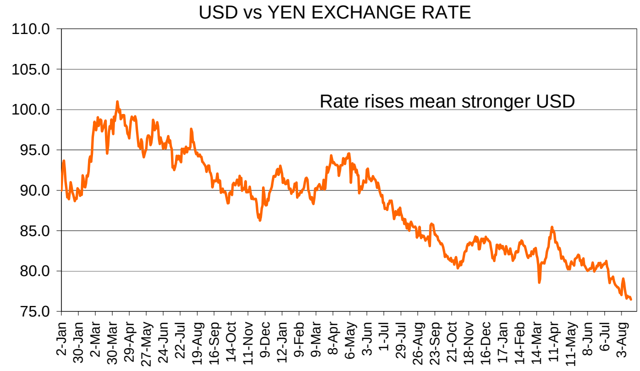
Out of all the turmoil what we appear to be left with is lower interest rates in the United States for longer as a result of not just the weak data but the Federal Reserve's promise not to tighten monetary policy for at least two years. That announcement has reinforced the relative interest rate attractiveness of our currency and the AUD now and for the next two years and it is highly likely that in the coming weeks we will see the NZD test its high from three weeks ago of US 88.3 cents while the Aussie dollar heads back toward US110 cents.

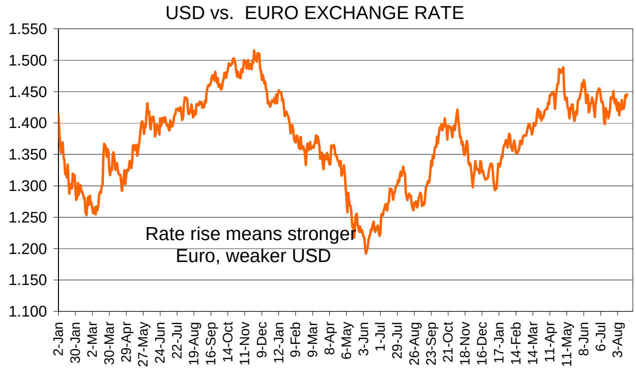


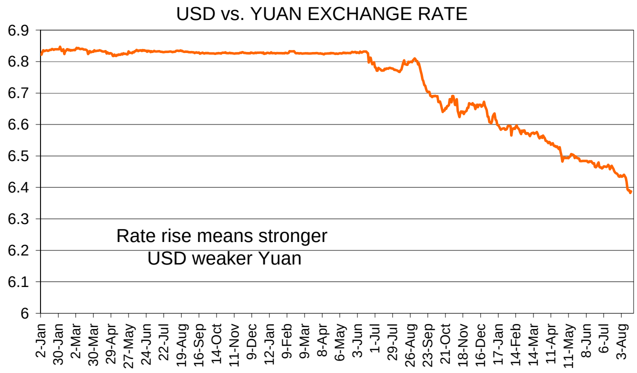


This is especially so as we are seeing stability in our global dairy prices, and commodity prices generally creeping back up. The Brent spot oil price has moved back up to US111 a barrel from $105 a week ago and a peak of $119 back on July 22. The CRB index of a broad mix of commodities has risen back to near 334 from a low of 316 a week and a half ago and a peak of 349 in mid-July.

The USD itself has settled lower following the furore though not as low as one might think would have happened given the reassessment of growth potential and credit rating cut as investors in uncertain times have actually bought US assets as a safe haven.





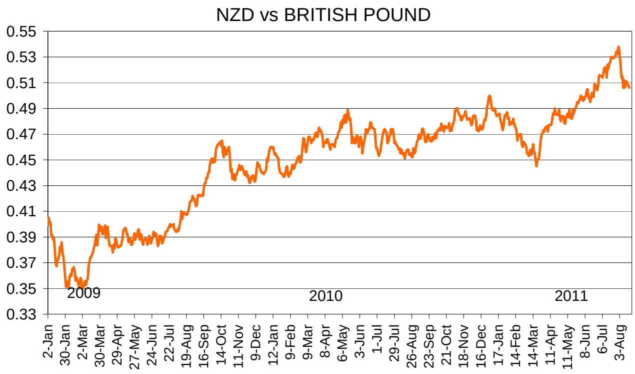


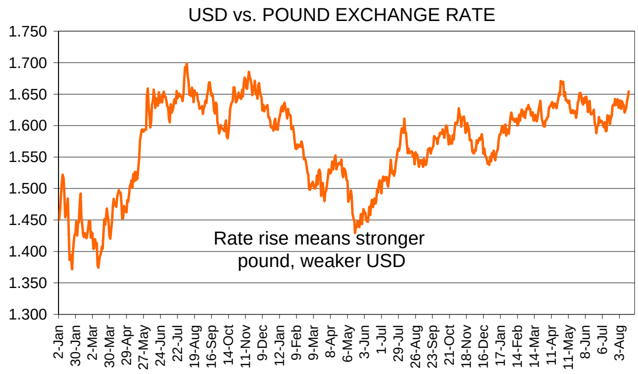
One notable currency change out of all of this has been an acceleration in the rate of appreciation of the Chinese Yuan against the greenback to sit now near 6.387 from 6.438 before the credit rating cut.

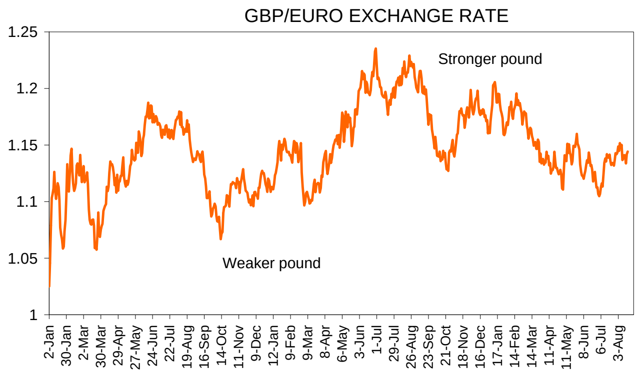
United Kingdom

Inflation came in at 4.4% in July which when taken in conjunction with weak economic data shows that the Bank of England has a problem with regard to where to set its cash rate. The rate has sat at 0.5% since March 2009 and the BOE would normally have raised the rate well before now given that inflation is above the target level of 2%. But an economy staggering under the weight of aggressively tightening fiscal policy, high unemployment, business, banking and household sectors deleveraging their balance sheets is in little condition to be able to handle higher interest rates without possibly dipping back into recession.

In fact last night the release of BOE board meeting minutes showed unanimous support for keeping the cash rate at 0.5% whereas in previous months 2 – 3 members had been voting to raise the rate.







What that means is that with the NZ economy in far better shape and interest rates set to rise probably before the end of the year, the NZD/GBP exchange rate is highly likely to head higher. Perversely, last night the GBP actually rose on the back of traders feeling the BOE stance will be more supportive of growth than they were thinking before. But then overnight we also learnt that the UK unemployment rate has climbed from 7.7% to 7.9% so the place is in bad shape.

Exchange Rate Assumptions

Read science fiction instead. Some of what Arthur C. Clarke wrote has come true.

	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%	6.5	6.5	......	6.9	6.0
Jobs growth	Average past 10 years = 1.9%	0.0	1.3	2.0	0.0	-0.8
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	-0.2	1.1	-0.1	2.8	-0.9
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	22	45	-21	-1	42
Consumer confidence	ANZ-Roy Morgan 100=neutral	113	109	108	116	112
Household debt	10 year average growth = 10.3%. RBNZ	1.2	1.2	1.6	2.6	2.6
Dwelling sales	10 year average growth = 2.5%. REINZ	11.7	14.3	-11.3	-26.7	34.0
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