BNZ Weekly Overview

3 November 2011

Mission Statement

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

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

Monthly Survey Time

This is the first Thursday of the month so if you have not already done so using the link contained in the email used for sending out the Weekly Overview please click on it here and let us know if you think the NZ economy will be better or worse in a year's time. More importantly, if you can let us know how things are in your industry at the moment noting what it is. The results will be released next Monday at the latest.

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

Just when you thought it was safe to go back into the water – "Greece 2 : The Referendum". Having been offered yet another bailout last week which the markets embraced with soaring share prices and a return to risky currencies pushing the NZD back toward US 82 cents, this week things have turned around again after the Greek Prime Minister out of the blue said he would call a referendum on the latest package. At a date unknown Greek voters will be asked whether they want to accept the extra austerity and economic restructuring measures needed to be done in order to get extra bailout money. If they say no the package will not go ahead and essentially Greece will collapse. Before then a confidence vote is expected in the Greek Parliament and if the PM loses there could be a general election in a couple of months.

If the eventual referendum results in a No vote Greece will probably unilaterally renege on it's over €300bn of government debt but as much of this debt is held by Greek pension funds and banks people will lose their retirement wealth and the Greek banking system will collapse. One imagines that already many Greeks have in recent days taken their funds out of Greek banks for deposit in German banks. With no ability to lend the drying up of credit will cause renewed collapse of economic activity in Greece.

One might be prepared to write this off to experience – that experience being European countries making the wrong decision in allowing Greece to enter the Euro-zone. But what matters in financial markets as in our personal lives is what we think will happen next. The question all will be asking is whether other countries facing severe austerity may not also deep inside admire the audacity of the Greeks to burn themselves at a stake of their own making and consider themselves also defaulting. That can only lead to greater concern about the highly indebted country which really matters in the whole European sovereign debt debate – Italy.

In fact already we have seen the ten year Italian government bond yield soar 0.4% this week to 6.3% and the gap over the German bond reach a record Euro ear level of over 4.5%. This jump in Italian yields has happened even with the European Central Bank once again stepping into the market to buy Italian bonds. Their actions are essentially no longer effective. But the rot does not stop there. The gap between French and German bond yields has also risen to a Euro ear record and there is more and more talk of the French President not being able to get new fiscal tightening measures past his generally protest-ready populace and that the French credit rating risks being cut next year.

And then it gets worse. The OECD have this week cut their forecast for Euro-zone growth over 2012 to just 0.3% from a 2% prediction made back in May. Plus the Euro-zone Purchasing Managers Index fell away to a lower than expected 47.1 in October from 48.5 in September signalling that manufacturing is in recession and therefore the zone itself may already have started again to shrink. The Chinese PMI also surprised on the downside this week as did the US measure.

The relevance of this frankly outright debacle in Europe and slowing world growth to ourselves is as follows. First, concerns about Europe's banks will increase again and that can lead to nothing other than a further tightening of funding in the European markets. We NZ banks have to get about 40% of funding for our lending in NZ from foreigners because we Kiwis prefer using their money to saving up our own, and as markets again tighten one should anticipate further reductions in credit availability with a widening of the spreads between the official cash rate, swap rates, and retail lending rates.

Europe is China's biggest trading partner so the new shock will once again raise some concerns about Chinese growth, bringing the risk that just as the OECD have already cut their Chinese forecast for 2012 to 8.8% from 9.2%, further cuts in expectations may be made.

A now rapidly turning world growth outlook will work toward reducing commodity prices and one should be cautious regarding the so far muted falls in Fonterra's fortnightly auction prices.

As we read increasingly depressing news regarding the potential splitting of the Euro and talk of a repeat of the post-Lehmans collapse environment, we will as householders, farmers and urban businesspeople find greater incentive to put our spending and hiring plans on hold – thus further delaying the time when growth in our economy lifts from the below average 1.5% recorded in the year to June toward 3%.

The Kiwi dollar will, as we have repeatedly written, be pushed all over the place by sudden switches in global risk tolerance. Both importers and exporters have been and will be presented with good and bad hedging levels over the next X months/years.

Oh, and does the election outcome in NZ matter a damn in all of this? Not at all as far as the world or our immediate economic operating environment goes. So far in London only one person at my seminars has in fact asked about the election. Attention has tended to focus on the NZ housing market, labour market, access to capital, and of course the NZD/GBP exchange rate.

If you are interested in the broad thrust of the message I was giving regarding our wonderfully remote economy you can go to the Occasional Papers section of www.tonyalexander.co.nz to see the handout I referred my attendees to.

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

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

What else but the debacle offshore?

Outlook for the NZ Economy http://tonyalexander.co.nz/topics/occasional-papers/

Paper referred to as a handout for talks in London.

Other Website Material

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

Is Our Economy Getting Better or Worse?

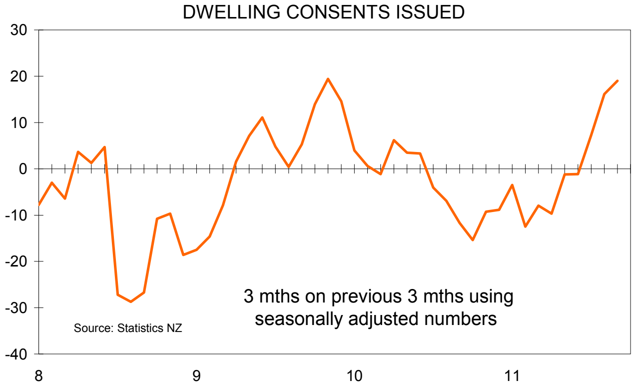
In this section we look only at what the data are actually telling us and pay no attention to forecasts or intentions measures.

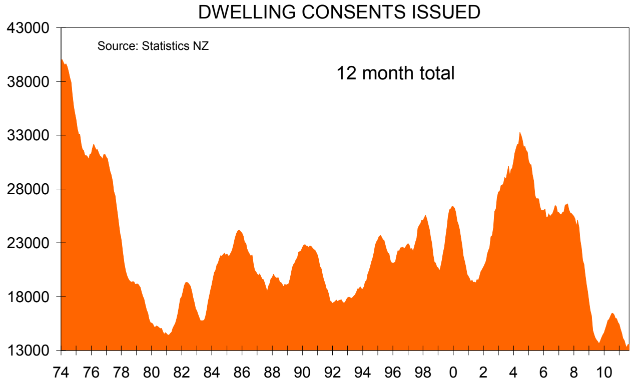
This week we have received data relevant to the construction sector and the labour market. Both were not strong and back up our view of an economy which like so many offshore has entered a weak patch.

Are householders opening their wallets more?

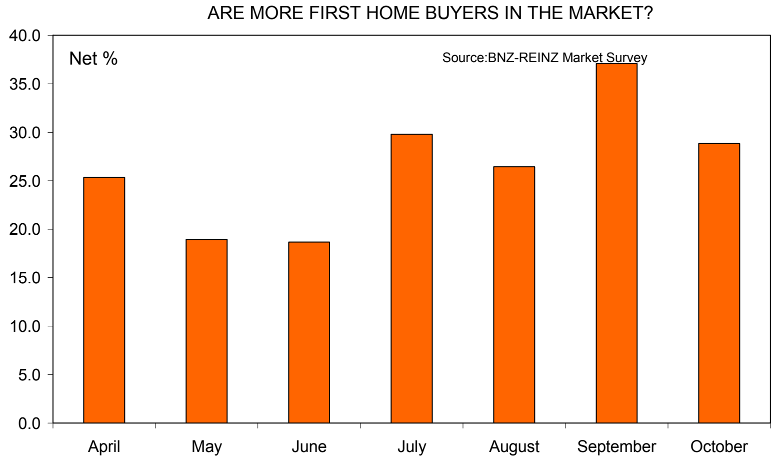
We have a view – like everyone else – that the rebuilding of Christchurch and to a lesser extent a period of catch-up construction in Auckland will see a strong rise in the residential construction sector. But construction costs are high, people are paying off debt, faith in housing wealth rising is low, finding finance for commercial developments is hard, and insurance is of course still thin on the ground in Christchurch. So the popular view has become that house building will not soar in earnest until the second half of 2012 and we concur.

So do we have data in hand supporting or contesting this view? This week we have learnt that in seasonally adjusted terms the number of consents issued for the construction of new dwellings fell by 17% in September after rising 16.7% in August. This still leaves a 19% gain for the September quarter but when we exclude apartments (for which numbers are very volatile) the gain over the three months slips to 9.7%.





The trend here is upward but the rate of gain is probably not going to be sustained given that confidence levels have recently fallen. Also note that the annual number of consents is still only just above a four decade low at 13,533 compared with an average of 23,297 over the past decade per annum. The shortage of dwellings therefore continues to grow, average occupancy per dwelling is clearly rising, and one suspects people are getting a bit sick of cramming in with their relatives and flatmates they probably got disgusted with a long time ago. At some stage a shift of this disgruntled population into the housing market will occur and we think that is what we are picking up in our monthly BNZ-REINZ Residential Market Survey.



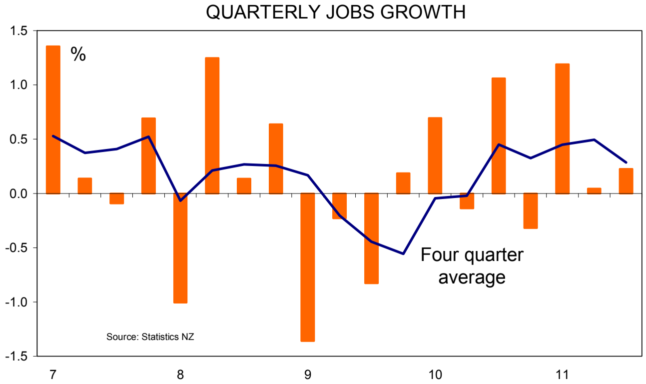
Is business output rising?

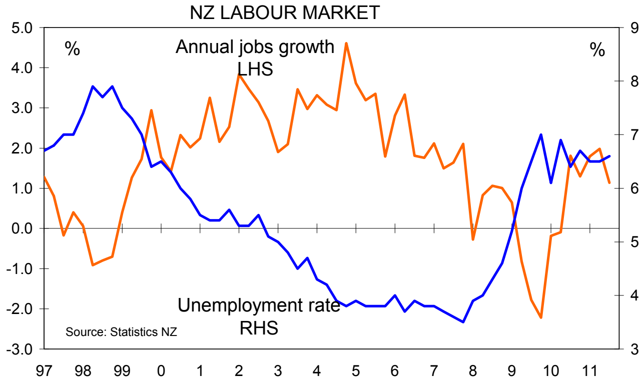
Nothing new.

Are businesses hiring more people?

This morning the quarterly Household labour Force Survey was released and the key point to note about it before one even looks at the numbers is that it has developed a tendency over the years to show some inexplicably big movements from quarter to quarter which make us wary of relying too much upon it to gauge the health of New Zealand's labour market. We like to take into consideration the newly developed National Employment Indicator – though that too has just shown itself to be highly volatile on a monthly basis. We pay no attention to registered unemployed numbers as they are simply administrative. Employment intentions can be forward looking – but again we are quite wary of those because of our view that a disconnect has opened up between business intention measures and what they have traditionally led to as actions.

So, taking this bucket load of caveats into account what do the latest HLFS numbers tell us? Nothing of clear nature that is for sure. We already have the NEI showing that the number of filled jobs in seasonally adjusted terms rose by 0.6% in the three months to August. The HLFS tells us that growth was in fact just 0.2% for the three months to September which was less than the 0.4% rise people had been expecting.





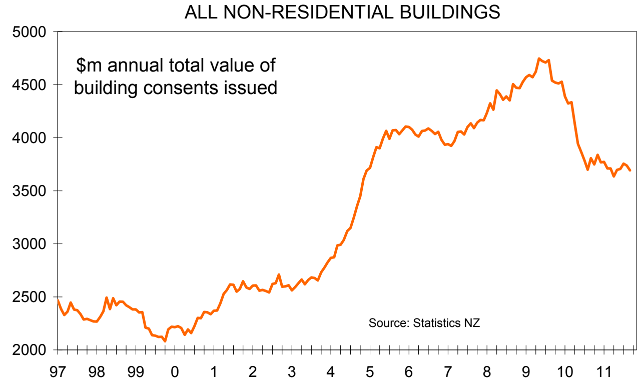
But the number of hours worked jumped by 1.0% after rising 1.5% in the June quarter. One might get excited about this indicating that the economy actually powered ahead quite strongly during the September quarter. But it only grew 0.1% in the June quarter when hours worked jumped 1.5% so a 1% rise in hours worked for the September implies – what exactly one wonders?

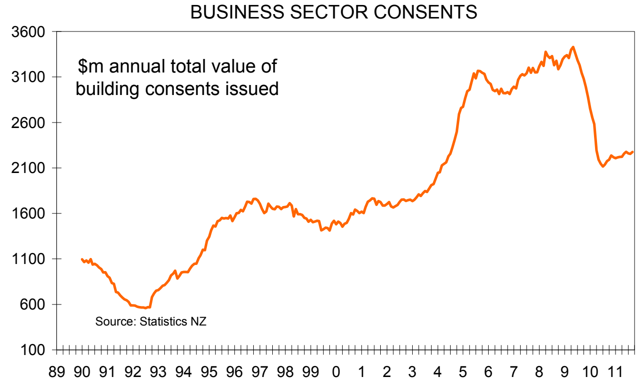
Compared with a year ago employment in NZ has grown by 1.1% which is not too bad a result but not enough to get unemployment going down which rose to 6.6% in the September quarter from 6.5% in the June quarter.

What to make of it all? Jobs growth in NZ is just enough to keep the unemployment rate steady near the 6.5% it has been at for two and a half years now.

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/

You' would have to be of a very optimistic bent to look at the data on non-residential building consents and conclude that an upward trend is in place. And if you factored in cost increases then concluding volume growth is occurring would look plain wrong. In September the value of such consents was down 12% from a year ago at $320mn which followed a 6.4% fall in August. For the quarter values were down 1.5% from a year ago and for the entire year a 3% fall was recorded.





For the six month period which we tend to look mainly at for this aggregate we find a decline of 1% from a year ago though there was a 5% rise for business consents. At a stretch one may conclude the latter is evidence of some growth in commercial construction but we think it is too early in the cycle to yet say that so and interpret these data as flat. Note that farm building consents for the six months were 20% ahead of a year earlier so maybe that is a sign of some spending coming out of the rural sector. But the numbers are quite small.

What Do The Leading Indicators Say?

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

This week we learnt that average NZ export prices fell 3.5% in world price terms during October to sit 7.3% down from their peak in May. Considering the downward revisions to growth forecasts offshore this is not too worrying a move, especially as prices on average are still almost 50% above their average level for the past decade. Of greater import was last week's downward revision by Fonterra for their forecast payout this year. This change will tend to reinforce caution on the part of farmers, as too will the developing La Nina weather pattern which can produce some damaging weather events.

INTEREST RATES

With the Reserve Bank of Australia cutting interest rates 0.25% this week and a good chance they cut again by year's end the chances have clearly reduced that NZ monetary policy will be tightened in the next year. Our latest official view is that NZ's cash rate goes up in June next year. But I would run my hedging on the basis of no rise happening until 2013.

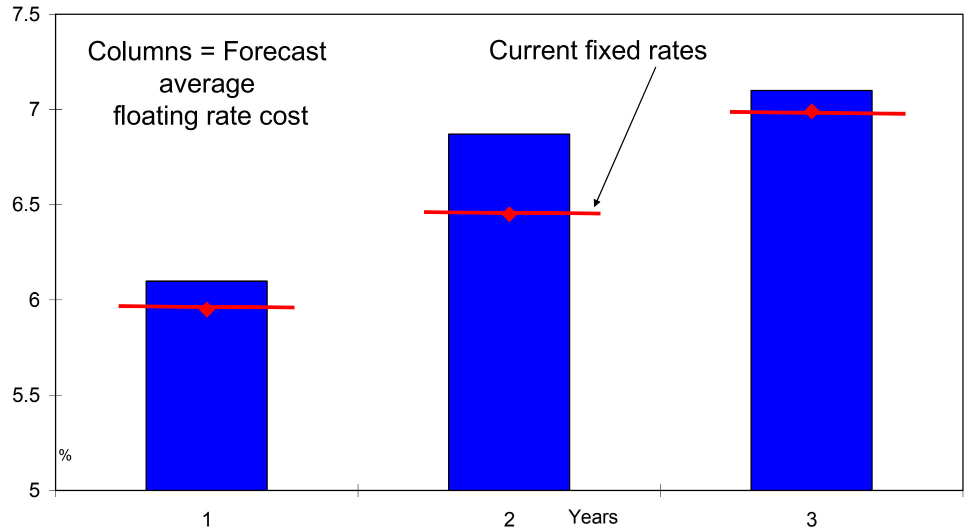
Responding to a deteriorating global outlook and talk of European monetary policy easing, printing extra money in the United States, plus the RBA easing, unsurprisingly NZ wholesale interest rates have retained the falls they underwent last week.

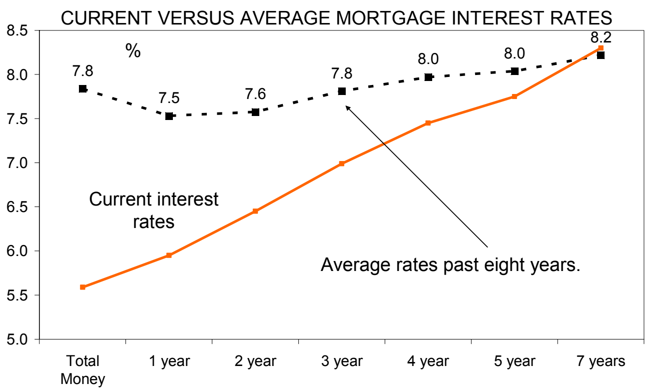
FINANCIAL MARKETS DATA

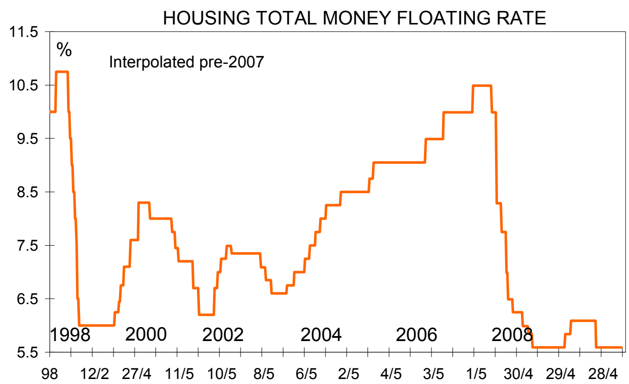
	This week	Week ago	4 wks ago	3 months ago	Yr ago	10 yr average
Official Cash Rate	2.50%	2.50	2.50	2.50	3.00	5.9
90-day bank bill	2.72%	2.75	2.86	2.96	3.19	6.2
1 year swap	2.94%	2.92	2.93	3.27	3.58	6.0
3 year swap	3.40%	3.38	3.29	3.93	4.27	6.2
5 year swap	3.94%	3.92	3.74	4.44	4.64	6.4
180-day term depo	4.00%	4.00	4.50	3.60	4.90	6.0
Five year term depo	6.00%	6.00	6.00	6.00	6.75	6.5

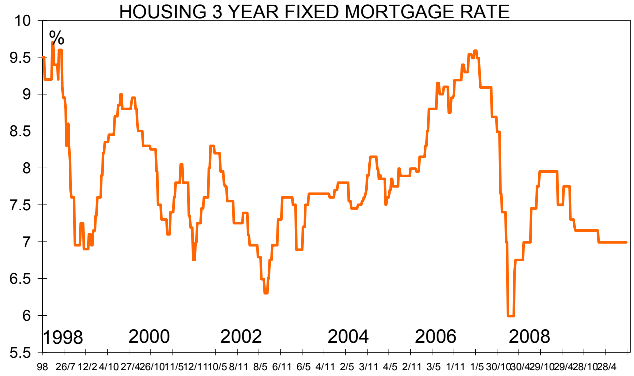
If I Were a Borrower What Would I Do?

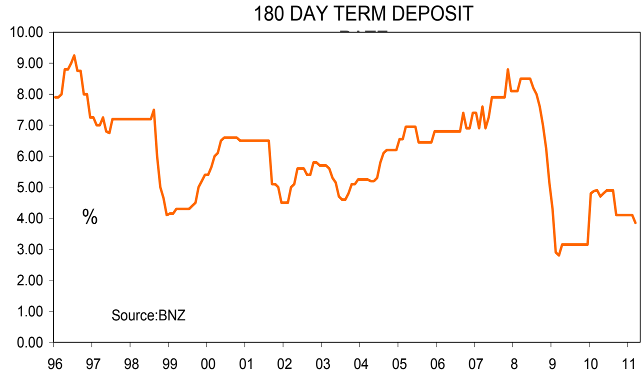
I still do what The Floaters sang back in the 1970s – unless as previously stated I can get a three year or thereabouts rate near 6.25% or a two year or thereabouts rate near 6%. One should be prepared to pay a premium for certainty about something in this very uncertain world and the cost for such certainty currently is not that much. Note though that we retain our view that the risk is NZ growth remains mediocre going forward and the Reserve Bank may not tighten for a long long time. So I also see floating as a very good ongoing strategy.











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 Startling

We discuss the latest building consents data in the section above looking at whether we are growing yet and conclude that growth is occurring but the shortage of property is worsening. Our view remains that the housing market will improve as more buyers appear, that prices will edge up led by rents, that there will eventually be a surge in construction but by then the shortage will exceed 60,000, that there won't be enough builders to meet construction demand, that builders rates will rise, that frustrated buyers will be forced to rent longer or buy an existing house, and so prices keep rising. ECO 101 analysis which has stood us in good stead with regard to commenting on the housing market since the second half of 2004. (The first half view then was not too flash.)

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

See the leader for this week's WO.

Chinese Inflation

China's economy is slowing down as a result of the tightening of monetary policy over the past year and a half but last week worries about the speed of decline ebbed in response to a monthly manufacturing measure coming in better than expected. The trouble is the particular measure is not the official one and that one appeared this week – turning out worse than expected. It showed a fall in the manufacturing index to 50.4 in October from 51.2 in September bringing it to the lowest level since February 2009. A rise in the reading to 51.8 had been expected.

The graph above shows that the index is still well away from where it was late in 2008 and by sitting above 50 indicates that the Chinese manufacturing sector is still growing. But the trend from late-2010 is abundantly clear and the latest result is important in signaling that one cannot yet run a case that the downward trend has ended.

It is interesting to note that many China analysts have interpreted the result positively because it means additional easing of monetary and perhaps fiscal policy in the near future. Already this process has started with last week bringing announcements of some increases in income thresholds before paying VAT and business taxes. But a key factor driving the decline in China's growth is weakness in foreign markets and the new export orders index in the monthly PMI fell to 48.6 from 50.9 in September. Europe is China's biggest market and the probable move of the EU into recession can only slow China's export sector and produce employment worries.

But slowing growth will contribute to falling inflation and analysts expect that the monthly inflation number next week will show the cost of living annual change slowing to something near 5.3%.

US Growth Momentum

No time to write here this week beyond noting third quarter growth lifted to a better than expected annualised 2.5% from 1.3% in the second quarter and talk of recession has fairly much disappeared. But worries remain especially as fiscal deficit reduction talks look like again going down to the wire with the potential for a reap of what happened in early August.

Australian Growth

Responding to recent signs of weakness in the Australian economy and a better than expected inflation outcome for the September quarter the RBA this week cut its cash rate 0.25% to 4.5%. The relevance to NZ businesses is that Australia has capacity to deliver some good insulation against the weakness coming out of other parts of the world and as our biggest trading partner this will tend to help insulate our economy also. But it pays to remember that when interest rates are being cut it is generally in the context of growth weakening, not improving.

Exchange Rates

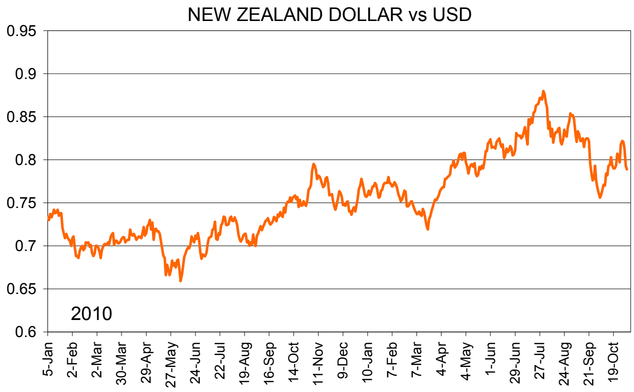
Exchange Rates	This Week	Week Ago	4 wks ago	Mths Ago	Yr ago	Consensus Frcsts yr ago*	10 yr average
NZD/USD	0.789	0.818	0.761	0.866	0.7706	0.689	0.629
NZD/AUD	0.764	0.766	0.787	0.803	0.7718	0.773	0.855
NZD/JPY	61.600	62.100	58.700	66.700	62.17	67.7	68.4
NZD/GBP	0.493	0.509	0.489	0.531	0.4807	0.448	0.368
NZD/EUR	0.572	0.578	0.570	0.610	0.5494	0.52	0.511
NZDCNY	5.006	5.194	4.855	5.572	5.156		4.83
USD/JPY	78.074	75.917	77.135	77.021	80.677	98.3	109.9
USD/GBP	1.600	1.607	1.556	1.631	1.603	1.54	1.705
USD/EUR	1.379	1.415	1.335	1.420	1.403	1.33	1.229
AUD/USD	1.03	1.07	0.97	1.08	1.00	0.891	0.737

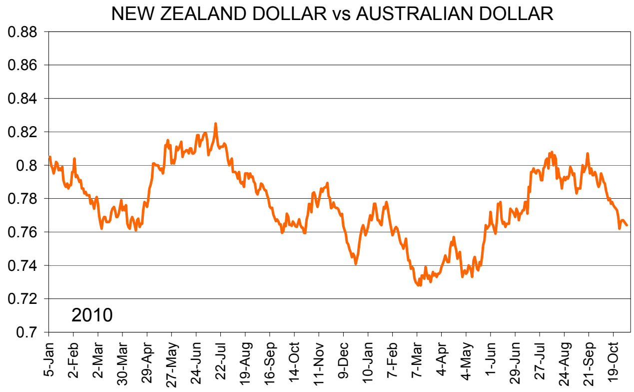
*Sourced from Consensus Economics. http://www.consensuseconomics.com/

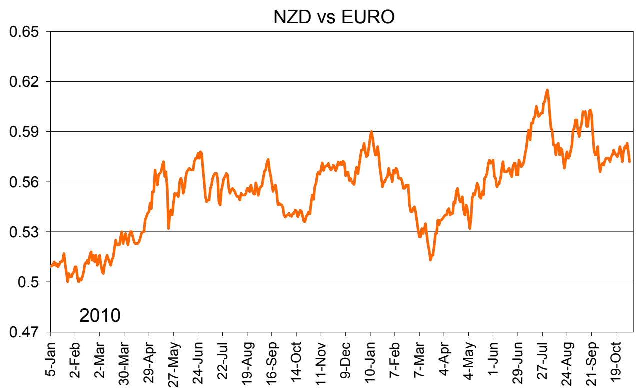
Risk Aversion Dissipates – Opps, Off That

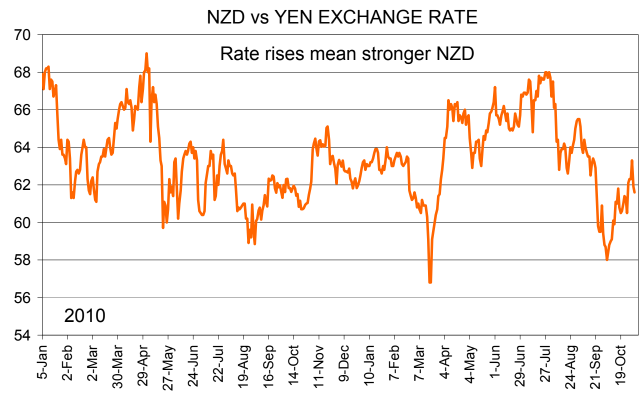
The first main piece of news in global FX markets this week was the unilateral intervention by Japan to push its currency lower against the greenback. The significance is not the intervention itself which had been anticipated, but the fact that no other central banks joined in with the Bank of Japan. Coming immediately ahead of this weekend's G20 meeting it suggests hopes of policy coordination aimed at boosting world growth need to be kept in check.

Also we saw the Euro weakening during the early part of the week as the hangover set in after last week's rather ridiculous euphoria over the European bailout agreements. Then on Monday night the Greek PM said he will put the latest package to his voters in a referendum and that has gone down like a bucket of cold sick with other EU leaders who were not expecting such a potential road block. The passage of the bailout now depends upon domestic Greek politics and experts say the referendum on the latest set of fiscal restraints in Greece needed to get extra funds will probably result in a no vote. What happens then is unclear as the funds will not be advanced unless Greece restructures its economy. Plus no date has yet been set for the referendum. Plus before then there is a confidence vote in Parliament which could result in a general election being called. Aye carumba! As we have long said, there is zero reason for believing that we will see anything other than continuing high volatility in exchange rates – and now we have a serious possibility that Greece will exit the Euro and the drachma reappear some 70% - 80% lower than where it went in 11 or so years ago.







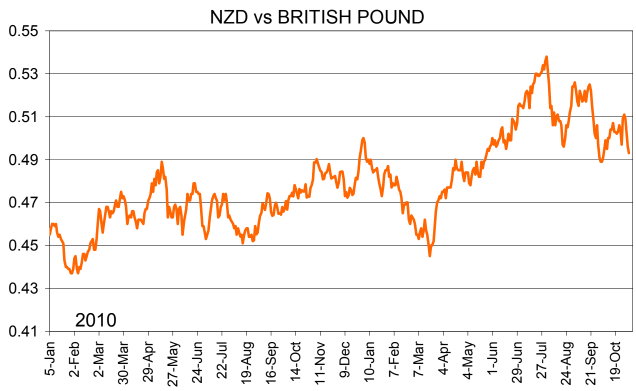


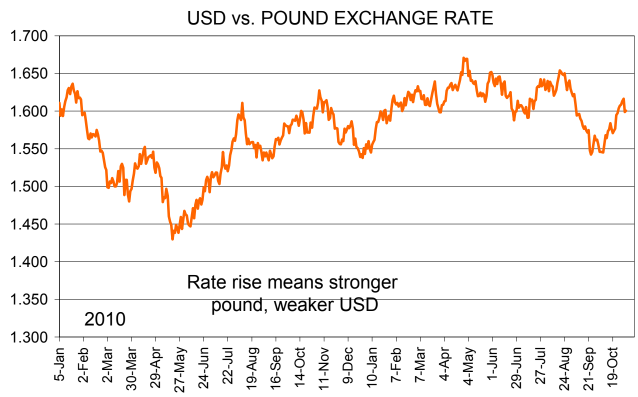
United Kingdom

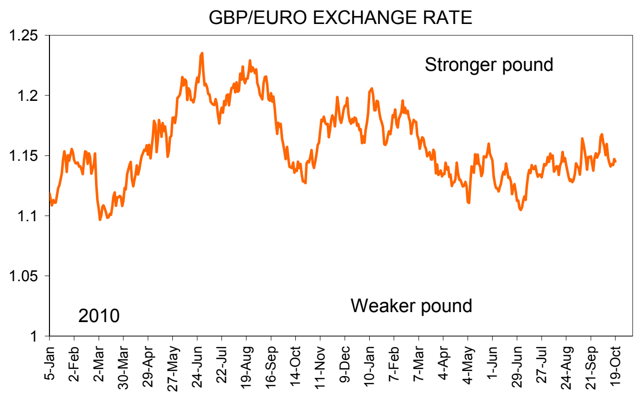
GDP growth lifted to 0.5% in the September quarter from 0.1% in the June quarter. But this change was partly due to the royal wedding mucking things up in that earlier quarter and the official recommendation is that we average the two quarters to get 0.3% in each. For the year growth has been just 0.5% meaning the UK economy has only just skated above recession – and could easily head back down given what is happening in Europe.

The UK economy is depressed under the weight of a rapid tightening of fiscal policy, weak housing and labour markets bringing unwillingness of consumers to buy, and Europe worries. With the Bank of England's cash rate already at 0.5% there is not much they can do to help things along beyond printing extra money on top of the £75bn recently announced.

So out of it all with risk aversion dropping then rising again taking the NZD up then down, and the pound gaining against a Euro slammed afresh by the debt crisis, the NZD has finished the week against sterling down slightly from where it was last Thursday but nowhere interesting in the context of the trading range over the past few weeks.







Exchange Rate Assumptions

	2010	2011	Risk	2012	Risk
Year end					
NZD/USD	0.73	0.87		0.84	Higher
NZD/AUD	0.74	0.81		0.85	
NZD/YEN	64.2	68		72.0	
NZD/GBP	0.44	0.53		0.52	
NZD/EUR	0.51	0.60		0.60	
USD/JPY	88	78	Lower	86	Lower
GBP/USD	1.66	1.64		1.62	Higher
EUR/USD	1.43	1.45	Higher	1.40	Higher
AUD/USD	0.99	1.07		0.99	Higher

ECONOMIC DATA

All %		Latest qtr only	Previous qtr only	Latest year	Year ago	2 Yrs ago
Inflation	RBNZ target is 1% - 3% on average	0.4%	1.0	4.6	1.5	1.7
GDP growth	Average past 10 years = 2.6%	0.1	0.9	+1.5	0.5	-2.4
Unemployment rate	Average past 10 years = 4.8%	6.6	6.5	......	6.4	6.5
Jobs growth	Average past 10 years = 1.9%	0.2	0.0	1.1	1.8	-1.8
Current a/c deficit	Average past 10 years = 5.5% of GDP	3.7	3.6	......	2.5	5.6
Terms of Trade		2.3	0.8	7.0	12.7	-13.5
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%.	1.0	1.0	1.3	1.9	-3.1
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	+773	3,867yr	......	13,914	17,043
Tourism – an. av grth	10 year average growth = 3.2%. Stats NZ	1.2	-0.1	1.2	3.9	-1.8
		Latest year rate	Prev mth year rate	6 mths ago	Year ago	2 yrs ago
Business confidence	BNZ survey	7	36	14	18	50
Consumer confidence	ANZ-Roy Morgan 100=neutral	113	113	101	116	120
Household debt	10 year average growth = 10.3%. RBNZ	1.2	1.2	1.5	2.4	2.6
Dwelling sales	10 year average growth = 2.5%. REINZ	21.1	21.1	-5.1	-33.1	43.7
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	3.0 – 3.5	3.5 - 4.0
CPI	on year ago	4.0	2.5 – 3.0	2.5 – 3.0	2.5 – 3.0
Official Cash rate	end year	3.0	2.5	3.0 – 4.0	4.00 – 4.50
Employment	on year ago	1.3	2.0 – 2.5	2.0 – 2.5	2.0 - 2.5
Unemployment Rate	end year	6.8	6.0 - 6.5	5.0 - 5.5	<5.0

*extrapolated back in time as TotalMoney started in 2007