BNZ Weekly Overview

2 February 2012

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.

First Survey of 2012

This is the first Thursday of February and we are running our first Confidence Survey for 2012. This is your opportunity to let us know how things are going in your particular industry. So if you have a few seconds please click on the link below and tick whether you think the economy will be better or worse in a year's time. Then pen a sentence if possible specifying what your industry is and how you are seeing things right now. The results will be released Tuesday.

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

This week we have seen the NZD rise above US83 cents on the back of some better than expected reports on manufacturing in major economies. We have also seen long term wholesale borrowing costs edge down slightly, confirmation that debt growth in New Zealand remains very weak, a decline in employment in October, weakness in building consents, yet good growth in exports. Plus…

New Reserve Bank Governor

This week two term RB Governor Dr Alan Bollard announced that he will not seek a third term and will finish as Governor come late-September. Various names have been thrown around as potential candidates for the job but it would be surprising in light of the international search for a head of Treasury if the government did not also extent its search outside New Zealand to tap potential expertise elsewhere. So speculating on a replacement and how they may approach the job is all just shooting the breeze at this stage. More important is the generalised discussion coming from largely left-wing economic commentators in New Zealand regarding a widened role for monetary policy – with one even proposing government departments, those fantastic untapped sources of business management expertise, should take a greater role in managing what you and I do on a daily basis.

Lets cut to the quik. There is no chance that the government will all of a sudden use the opportunity created by a change in RB Governor to switch its economic policy from a largely hands-off approach to reinstating public servants into the business management process (a la 1970s) than is already the case. But is it possible that the Policy Targets Agreement will be altered so the new Governor targets not just low inflation but low unemployment, strong economic growth, and current account balance. No.

Some central banks overseas do have such instructions but their primary focus remains on keeping inflation down and ensuring stability of their financial systems. The aims of low unemployment etc. are generally approached in terms of stating that achieving and maintaining low inflation is the best contribution which they can make to achieving these other goals.

Here in New Zealand we have just experienced a period of monetary policy run by a dovish Governor who has overseen an average inflation rate during the period of time when one could reasonably attribute inflation outcomes to his actions of about 2.9%. That is only just within the 1-3% target so when it comes to the primary RB Governor role of keeping inflation low one would give Dr Bollard maybe 7/10. If the PTA were altered one could reasonably expect New Zealand's average inflation rate to settle above 3%. That would enhance even further the incentive to invest in capital gains tax free property as opposed to business enterprises and it is extremely unlikely that either National or Labour Governments would favour such explicit encouragement to borrow and buy.

There has been some talk that maybe the determination of cash rate changes could shift from sole decision-making (responsibility actually) by the Governor to having a committee make the decision. It sounds like six of one and half a dozen of the other but with movement to a committee process likely to logically lead to calls for meeting minutes to be released. Offshore the release of minutes and voting outcomes can act as an additional tool giving information to the financial markets. But here in New Zealand there has long been a policy of openness from the Reserve Bank seen in the explicit discussion of factors influencing decisions and inflation expectations every six weeks, the release of detailed economic forecasts every three months, and release also of interest rate projections showing where the RB expects monetary policy to go over the next 2 – 3 years.

In contrast it is not long ago that the Reserve Bank of Australia decided to make a press release accompanying each monthly cash rate review, and the Federal Reserve in the United States has only just started projecting its monetary policy forward by 3 - 4 years.

The need for additional noise/information flow into the NZ financial markets from release of committee notes seems low given the good information flow which already exists. But shifting to an explicit committee decision-making process is possible. But that is something which would be up to the incoming Governor rather than the Minister of Finance or Parliament to decide.

Overall, there is zero reason at this stage for anticipating that a change in Governor will alter the implementation of monetary or broader economic policy in New Zealand. But if one sees hints of watering down or widening of the PTA then investors will want to take a look at weighing more heavily than they already may be toward tax effective capital gains tax free assets giving protection against higher average inflation. Plus householders will want to think about how they will get compensation for higher average cost of living increases (another name for inflation).

NZ Food Prices

This week I took a call from a journalist wanting to know why NZ food prices were so high compared with incomes according to a survey she had come across. Clearly the angle she wanted to be able to take was that someone somewhere in the system was ripping off hard working hard pressed Kiwi householders and someone should do something about it. Unfortunately she didn't get what she wanted from me because what I pointed out was that she was looking at the wrong variable in the food versus income number. Instead she needed to look at incomes and ask why they are so low.

Apart from differences created by government taxes and things like freight charges, wage and non-wage costs, food prices are going to be determined by their international market prices (by and large). So if global meat prices rise then meat prices will also rise in NZ otherwise NZ farmers will be subsidising NZ consumers – and we know how much farmers dislike subsidies, except when there are floods, or droughts, or pests, or emissions taxes.

Why are NZ incomes so low is the question we should be asking and then if we ask we have to be willing to consider measures which will raise our incomes relative to those overseas rather than concentrating on the low relative affordability of food and seeking to redistribute the income already being earned to ease burdens on low income earners. How low are NZ incomes by world standards? You can get massively caught up in varying income definitions here ranging from just wage income, individual income, to household income etc. So lets just keep it simple and use the catch-all broad measure of GDP per capita at http://en.wikipedia.org/wiki/List_of_countries_by_GDP_(PPP)_per_capita

Using the first column in the table from the IMF we see NZ per capita GDP is 32nd at $27,966 international dollars (maybe they mean SDRS?) which is 68% of Australia's $40,836, 58% of the US $48,147, 71% of Ireland's $39,507, 78% of the UK's $35,974, and 101% of Greece's 27,624.

We are a country wealthy in natural resources and beauty offering a relaxed lifestyle. But we are low on the relative income ladder and because we sell food offshore, because global food prices are determined by those offshore markets, and because therefore our local food prices are determined by prices offshore it is to be expected that the ratio of food costs to income in NZ would be high compared with many other countries. Therefore while examining monopoly positions and distribution system efficiencies is very important, the only big change in the relative cost of food will come about if we raise NZ incomes – or ban food exports! That latter move would not be a particularly intelligent thing to do.

NZ – China Publication

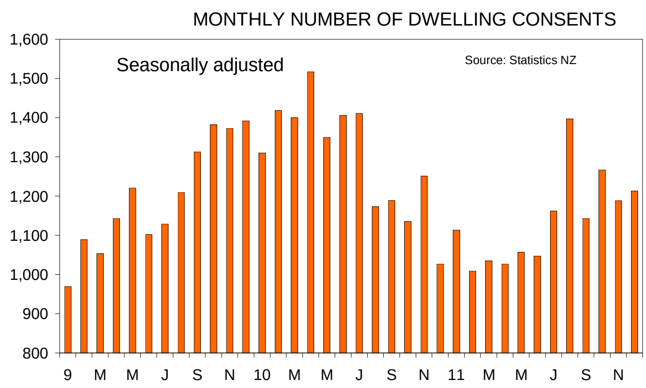
In just over two weeks time I shall commence distribution of a new monthly publication looking at the economic relationship between NZ and China. If you would like to be on the emailing list to receive it please email me specifying your name, your company (or "individual"), and if relevant your connection with China. The latter is important because the aim of the publication is to describe the relationship with a view to informing Kiwi businesses about how to go about investigating whether a trade or investment link with China may be good for them. Knowledge gained by those already engaged with China is therefore invaluable so please let me know if you would be willing to be a point of contact for myself. Tony.alexander@bnz.co.nz

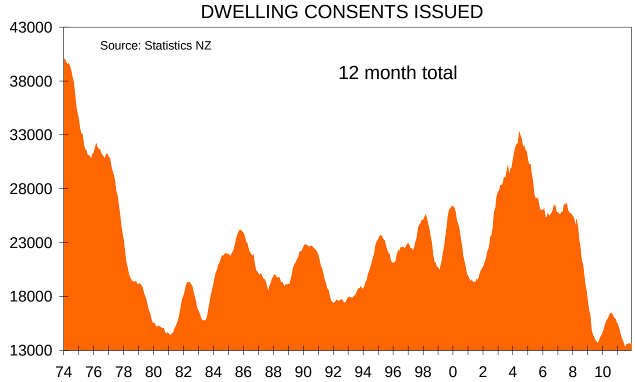
Is Our Economy Getting Better or Worse?

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

Bits are, bits aren't. On the good side export growth is strong with assistance from good grass growth over Spring and Summer boosting dairy production. Jobs growth however has slowed further and there is no sign that things are considered good enough by either householders or businesses to warrant building up debt levels.

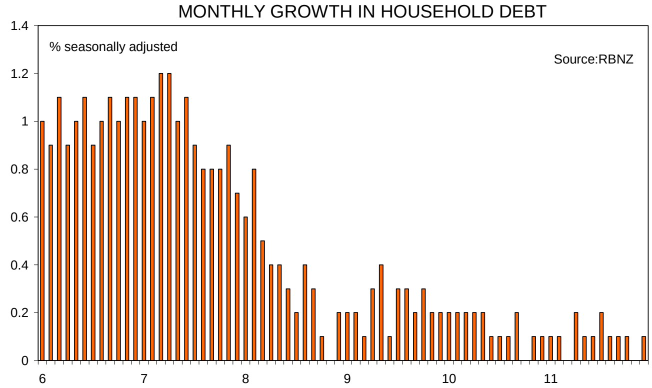
Are householders opening their wallets more?
No.
There is an upward trend in place in the number of consents being issued for construction of new dwellings. This is most easily seen in the first graph below showing the consent total for each month. But things have to some extent stalled recently with the small 2.1% rise in consent numbers in December seasonally adjusted being dwarfed by the 6.2% fall in November and taking the December quarter rate of change to a fall of 0.9% following a rise of 18.2% over the September quarter which followed a 0.9% June quarter fall. The underlying story then is really one of a September quarter surge in consents not continuing.

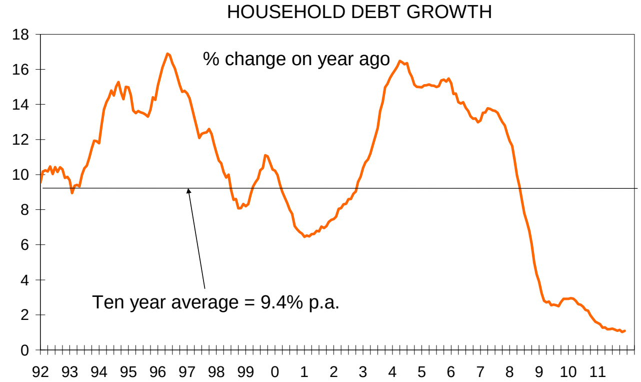




Annual consent numbers now stand at 13,695 which is still close to a four decade low and implies continuing deterioration in property availability.

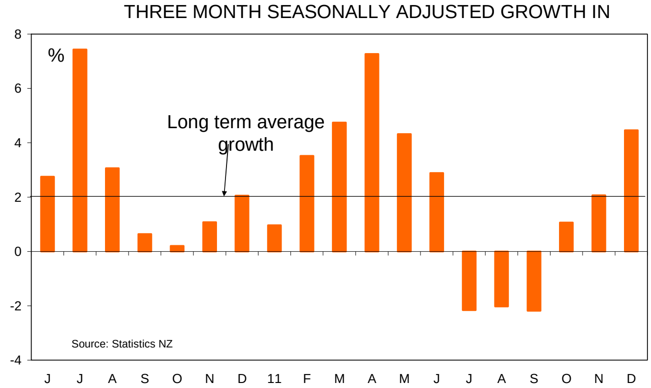
The Reserve Bank's data release yesterday showed that in seasonally adjusted terms lending to households grew only 0.1% seasonally adjusted in December. This sort of almost zero monthly growth has been underway since the middle of 2010 and means that at the end of 2011 household debt was only 1.1% up from the end of 2011. Housing debt was ahead 1.2% but non-housing lending to consumers down by 0.3%.

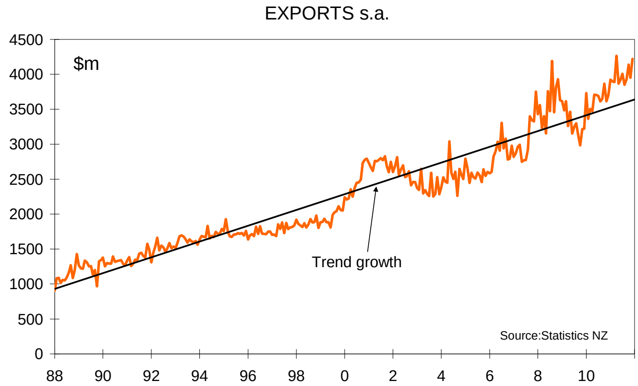




Is business output rising?

There was strong growth in exports in December with a seasonally adjusted 6.8% rise in receipts delivering 4.5% growth for the quarter. This followed a 2.2% fall in the September quarter and 2.9% rise in the June quarter so is a strong result which takes growth for the entire 2011 year to 9.7% which exactly matches growth over 2010.





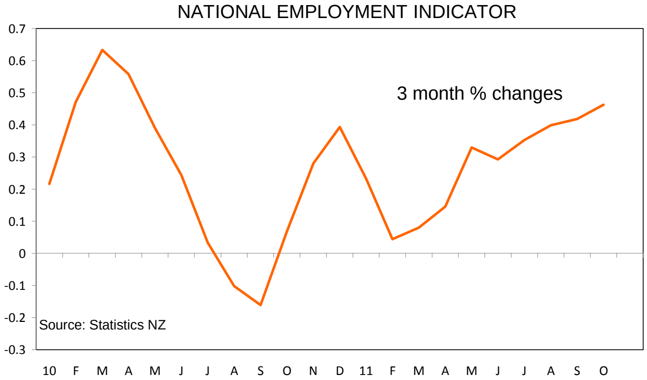
The major export categories which enjoyed the best growth over the quarter were crude oil up 32% to $550m or $2.2bn for the year, dairy products +14% to $3.6bn for the quarter and $11.9bn for the year, plus wool up 21% to $229mn for the quarter and $795mn for the year and electrical machinery and equipment 17.7% to $321mn for the quarter and $1.1bn for the year.

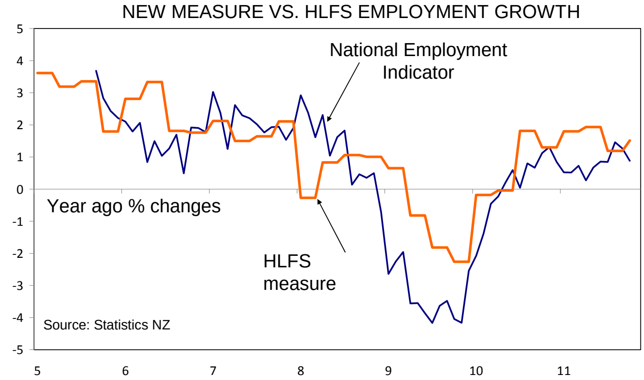
NZ export growth is going well. But businesses are showing little inclination to raise debt to finance further growth. In December business debt was only 1.8% up from a year earlier and in the December quarter net lending growth was only $225mn more than last year at $1.7bn. Hardly a great vote of confidence in the economy. Farm debt fell 0.5% over 2011.

Are businesses hiring more people?

Not really.

In fact the rather out of date National Employment Indicator for October released this week showed a seasonally adjusted decline in job numbers of 0.2%. This followed a 0.1% fall in September and means job numbers, while ahead 0.5% for the three months to October, were up just 0.9% from a year earlier.



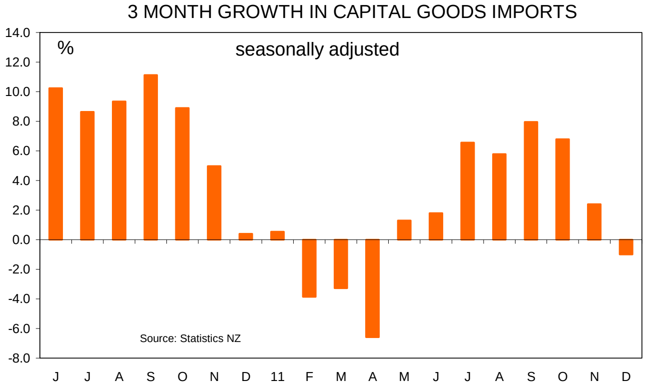


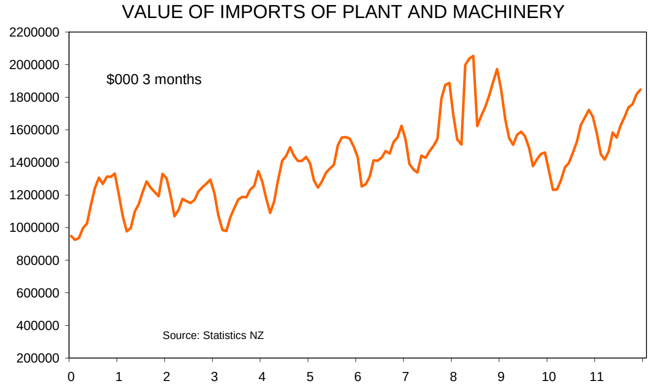
Are businesses boosting their capital spending?

For equipment yes. Buildings = mixed.

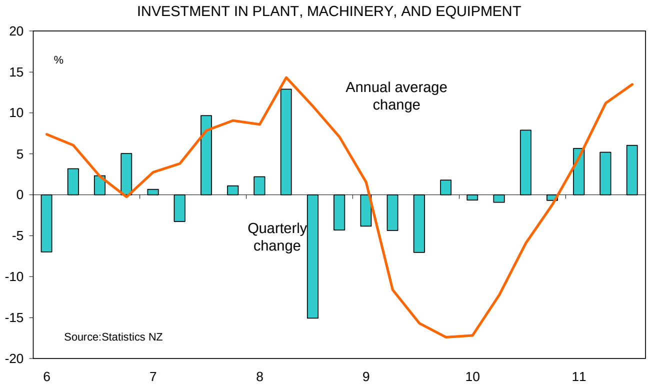
To see how businesses are feeling right now one can read our monthly BNZ Confidence Survey here. http://tonyalexander.co.nz/bnz-confidence-survey/

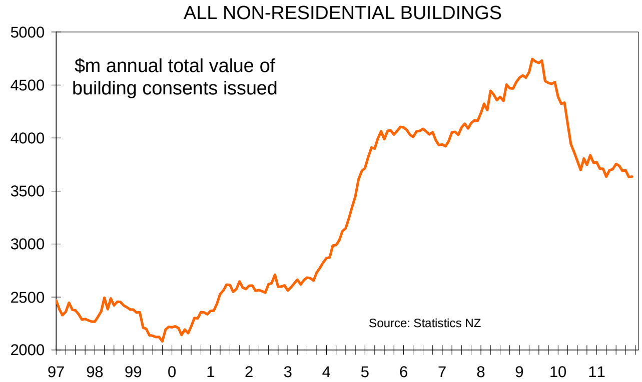
We noted for much of last year that one of the generally inadequate measures we use to gauge business investment, imports, was performing strongly. We also noted a thought that maybe this was because businesses were taking advantage of the high NZ dollar to get equipment into the country they might normally have held off buying.





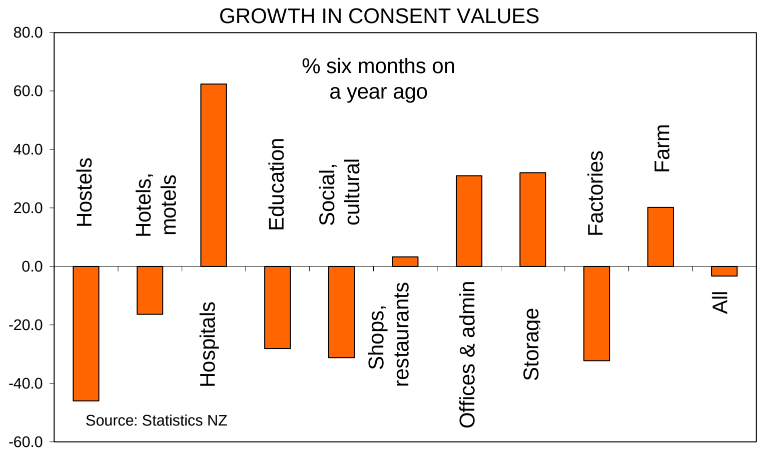
In seasonally adjusted terms the three month rate of growth in the value of imports of plant and machinery peaked at 8% in September, eased to 2.4% in November, then dropped to -1% in December courtesy of a fall of 6% in the month of December. These data are very volatile so we don't think one can conclude at this stage that investment growth has stalled or declined. But the trend will be worth watching as so far in this economic recovery the growth in plant, machinery and equipment investment measured in the national accounts has actually been quite strong.





Such strength is definitely not occurring however with regard to non-residential construction. The value of consents issued for such building totalled $338mn in December which was a 1.8% rise from a year earlier. In the six months to December the value of non-residential building consents was down 3.3% from a year earlier though if we do our best to exclude government activity we find a small positive growth rate of 1.5%. Allowing for cost increases that means essentially no volume increase underway in commercial building.

However when broken down by building type there was 20% growth in farm consents in the second half of 2011 compared with a year earlier, and just over 30% growth for offices and storage buildings. The big areas of weakness have been factories, -32%, hotels and motels -16%, with shops and restaurants ahead just 3%.



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.

Nothing new this week.

INTEREST RATES

How the world has changed. I was trying to find where the weekly newspaper column I write gets posted on the internet and in searching came across references to comments I was making in the first half of 2010 regarding interest rates rising 3% by the end of 2012. Actually it looks like floating rates will be unchanged from back then and fixed rates much lower. What changed? Many things. The big one is Europe. The concerns of investors regarding the willingness and ability of highly indebted governments to get their deficits and debts under control rose sharply over the second half of 2010, settled down, then rose again. This has led to sharply reduced forecasts for economic growth in Europe and therefore weaker growth elsewhere.

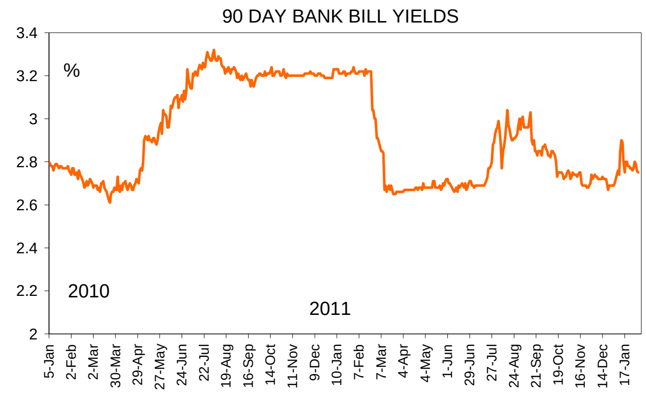
At the same time the United States recovery proved a lot weaker than expected – and then one makes exactly the same comment for most other economies. Underlying concerns about debt levels have remained and businesses, governments, and householders have remained strongly focussed on getting debt down. That means more saving and less spending. That means reduced credit demand and reduced inflationary pressures. That means lower interest rates.

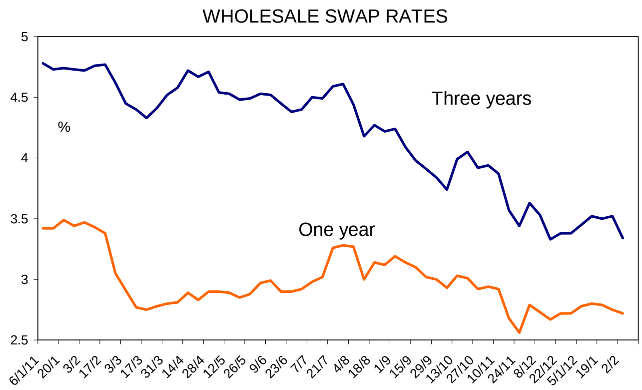
Thank goodness one of the key points we have been making for the past three years is that no-one should be developing an interest rate risk management strategy on the basis of a particular set of interest rate forecasts proving accurate. None of us has a model which adequately guides us as to what happens when the world comes close to a repeat of the 1930s Great Depression. So we have learnt that optimistic assumptions about the immediacy of economic recovery proved misplaced. So can one have greater confidence now in interest rate forecasts proving correct? Not at all.

We remain uncertain as to what is going to happen and when. There is no solid evidence that householders around the world feel they yet have debt at desired levels. We are no closer to being able to pick when the US housing market will engage in a sustained recovery.

In other words, yes it is possible that floating interest rates will fall from current levels and therefore one does not want to fix anything. And yes it is possible that the opposite will happen, fixed interest rates will rise sharply, and one should in fact fix the lot. Currently I feel it is reasonable to stay floating in anticipating floating rates will remain low well into 2013. But that view may not be a reasonable one even a month from now. So it pays to stay alert just in case things turn around one way or the other. Given that the bulk of debt is now sitting on a floating rate basis that staying alert comment applies to watching for signs of extra growth here and overseas which will cause fixed borrowing costs to jump up. That seems a very unlikely situation in the near future – just as forecasting no change in floating rates between early 2010 and the end of 2012 seemed just under two years ago. Good luck.

This week, simply for the record, 90-day bank bills did………nothing. However swap rates have rallied mainly in response to some weakish data in the US and continued market digesting of the Federal Reserve's forecast last week that its cash rate will stay near 0% for another three years.

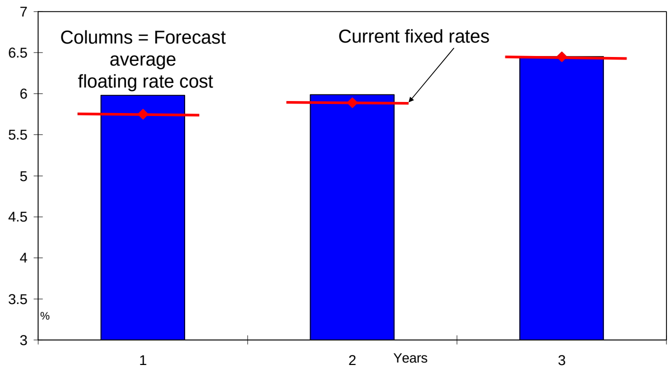


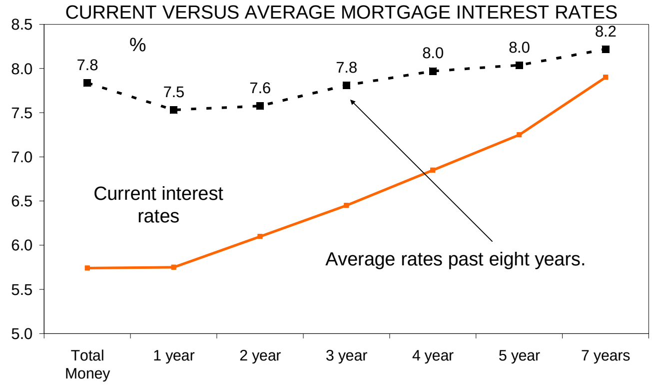


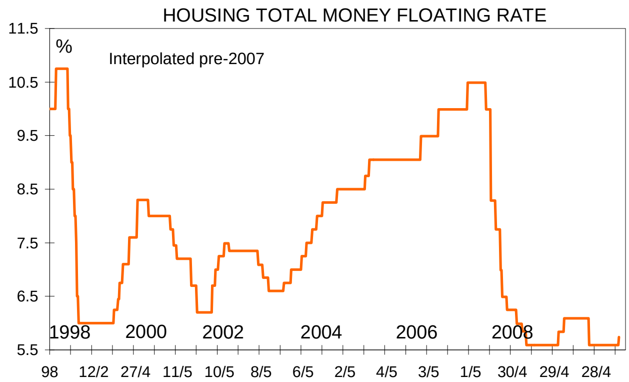
FINANCIAL MARKETS DATA	This week	Week ago	4 wks ago	3 months ago	Yr ago	10 yr average
Official Cash Rate	2.50%	2.50	2.50	2.50	3.00	5.4
90-day bank bill	2.75%	2.76	2.70	2.75	3.21	5.7
1 year swap	2.72%	2.72	2.78	2.94	3.47	5.8
3 year swap	2.95%	3.08	3.02	3.40	4.27	6.1
5 year swap	3.34%	3.52	3.45	3.94	4.72	6.3
180-day term depo	4.00%	4.00	4.50	3.60	4.90	5.7
Five year term depo	5.85%	5.85	6.00	6.00	6.75	6.4

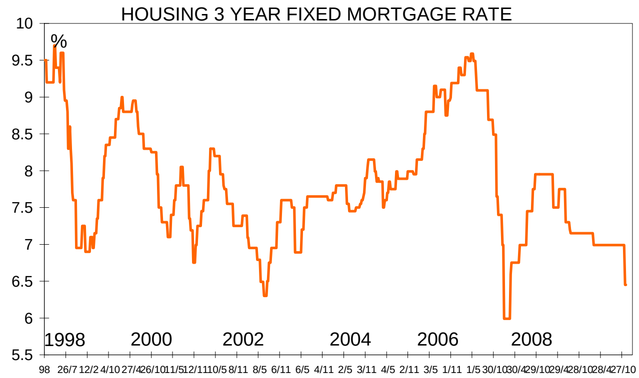
If I Were a Borrower What Would I Do?

There is no indication of rising global inflation, no indication of accelerating economic growth in New Zealand, and no downward trend in the NZD which could boost inflation and warrant early monetary tightening. I have little expectation that fixed lending rates will be rising in the near future and see a very high probability that floating mortgage rates will be unchanged all year. So I chose to stay floating while acknowledging however that there are some interesting dynamics in the fixed rate market at the moment. A few good deals are starting to appear and currently at minimal cost above floating here and there one can lock in a mid-term fixed rate. So I would float but keep an eye open for fixed rate bargains.









HOUSING MARKET UPDATE

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

Housing Slowly Rising

The NZ Herald newspaper on Wednesday and Thursday morning this week fairly well summed up the situation in the Auckland housing market with their lead articles on aggressive bidding amongst renters to secure property and housing shortages. The key fundamental I have been pushing here for some time – extending back to the second half of 2004 in fact – has been that construction in New Zealand is not keeping up with population growth. The consents data released during the week show that annual consent numbers remain near a four decade low and an earlier surge in consent growth over the September quarter has all but petered out.

Net migration outflows which will approach 5,000 – 10,000 this year will not appreciably alter the market dynamics given the extent of the shortage, and in fact the simple passage of time bringing more young people into their household formation phase will see the situation get worse. There will inevitably be more upward pressure on rents and more debate about affordable housing. But all the debate over the past few years has led to few solid measures to address the situation, and in fact tightening rules around insulation, presumably earthquake strength, etc. mean the situation is if anything getting worse.

While many contend that opening up more land for residential development is the answer that will not happen in New Zealand for at least two reasons. First, most of us are here rather than in a more developed and better performing economy elsewhere because we like the current living arrangements which offer us quick access to the rural recreational environment. We don't want to have to travel greater and greater times through suburbs before reaching our particular non-urban patch of paradise.

Second, with a very small population spread over a country the size of Japan our infrastructure costs per person are high by world standards. Throw in the fact that GDP per capita in New Zealand is only 58% of the US, 68% of Australia, 82% of Japan and 78% of the UK, and we cannot afford the mass transit systems – train, wide motorways – needed to allow efficient sprawl of people.
http://en.wikipedia.org/wiki/List_of_countries_by_GDP_(PPP)_per_capita

For Auckland this means just one thing. It goes vertical, or as the Mayor calls it - the compact city concept. Makes sense. It also means developers with an eye to the future will want to secure land not too distant from the city centre, not too far from an existing transport node, and perhaps in an area which the council may have indicated will be favoured early on for compacting. For renters it means no end in sight to bidding against each other, rising rents, and eventually the return of more investors to the Auckland housing market. After that happens the search for yield and presence of accrued capital gains to borrow against will see these investors taking a look at other centres.

Our monthly BNZ-REINZ Residential Market Survey will give us early insight into the extent to which the investor market is starting to move.

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

The good news coming out of Europe is that bidding at bond auctions of the heavily indebted countries has generally been good with yields on ten year government bonds for Italy below 6% and those issued by Spain below 5%. But yields for Portuguese debt are still very high, Spain's unemployment rate has reached almost 23%, banks are cutting back lending (in Europe, Asia, Eastern Europe etc.) to meet hardening capital adequacy requirements, and German bond yields keep falling to record lows as investors seek a safe asset due presumably to sometimes not expressed fears that things will still fall over. In addition the Euro-zone manufacturing sector remains in recession with the Purchasing Managers Index still below 50 in January at 48.8. This was however up from 46.9 in December and 46.4 in November so perhaps things are not completely bad.

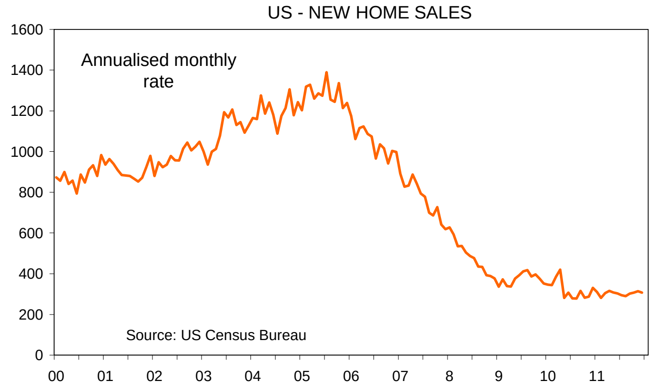
With regard to Greece there is still no agreement with private debt holders to write off at least 50% of their debt, though news overnight was that agreement may be close. But at the EU summit this week agreement was reached among leaders to implement (for 25 of the 27 countries) a long term fiscal agreement which will make the Euro a more sustainable currency. However the agreement does nothing to change the current concern among investors and in fact if pursued vigorously adherence to the new fiscal pact would require additional fiscal tightening in the short term therefore extra economic weakness, therefore worse budget deficits, therefore…and so on in the downward spiral which many prominent economists feel is already in place.

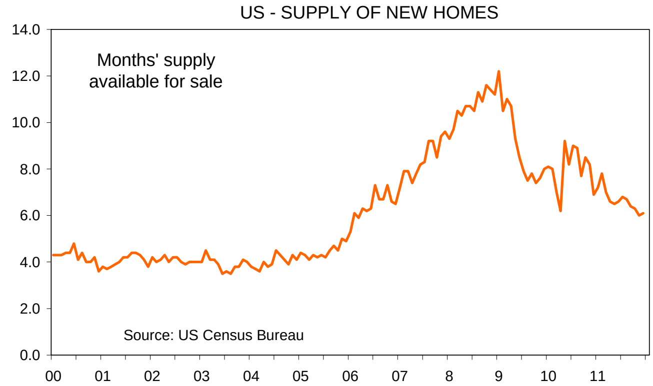
For the record, agreement was reached (but not yet signed up to) for limiting structural budget deficits (what is left after adjusting for where one's country is in the economy cycle) to 0.5% of GDP. But in the event of downturns countries can strip out form the deficit special stimulus measures so there is still flexibility to respond to normal recessions and deep downturns.

United States Growth

The US economy has produced generally stronger than expected growth in the past few months and this helps explain strength in the sharemarket. But deep worries remain about things such as the fiscal restraint needed to prevent a new debt blowout and fresh credit rating cut. Presumably once the Presidential election is out of the way some greater attention will be paid to Federal debt near 100% of GDP and continuing large deficits. For now though we can see things are not all that bright as one might think by looking at the housing market.

The situation is better than in recent times to the extent that the supply of new homes sitting unsold on the market has declined to 6.1 months in December from 6.9 months a year earlier.

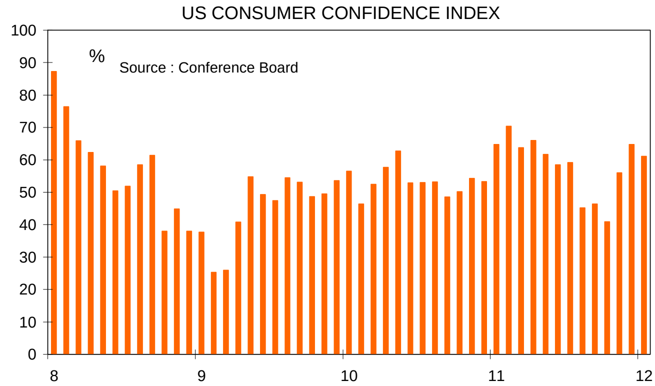


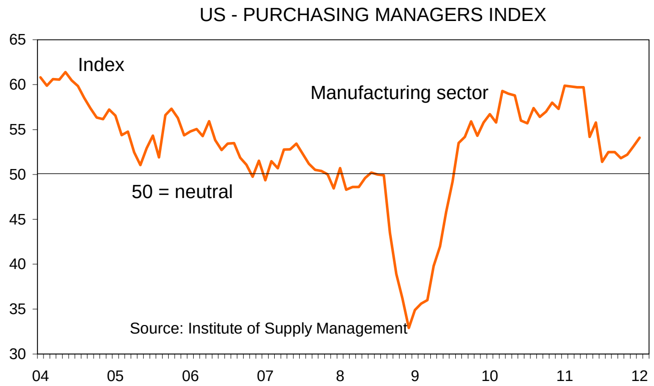


But in December sales fell 2.2% seasonally adjusted and were 7.3% weaker than a year earlier. These numbers feed into the generalised comments at the moment regarding the US housing market still not being on a firm footing from which it can rise and assist consumer willingness to spend.

During the December quarter the US economy grew at an annualised pace of 2.8% compared with 1.8% during the September quarter. On the face of it the result looks acceptable. But then it is still below the 3% pace generally considered as needing to be sustained to cause significant drops in the unemployment rate. Plus a lot of the quarter's growth simply went into the production of inventories and adjusting for the stocks build-up growth was only an annualised. For the full 2011 year growth was just 1.7% compared with 3% for all of 2010.

And following the caution injected by the GDP result was the revelation Tuesday night of a much weaker than expected reading for consumer confidence. The Conference Board index fell to 61.1 in January from 64.8 in December – a result well away from expectations of 68 and below the most pessimistic pick. The low sentiment just reinforces the fact that the US economy has yet to establish a solid foundation for growth extending over a number of years. Hence falls in bond yields which fed through to lower swap rates in NZ this week.

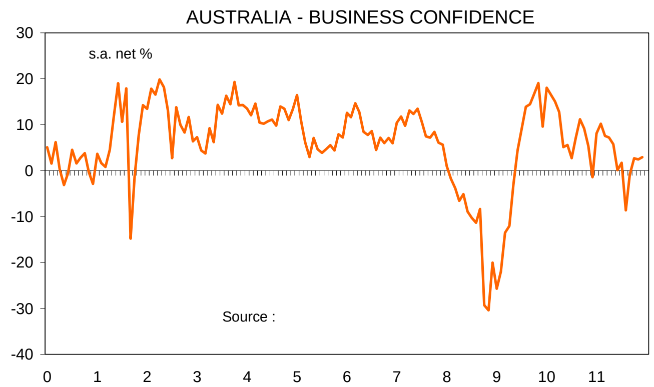


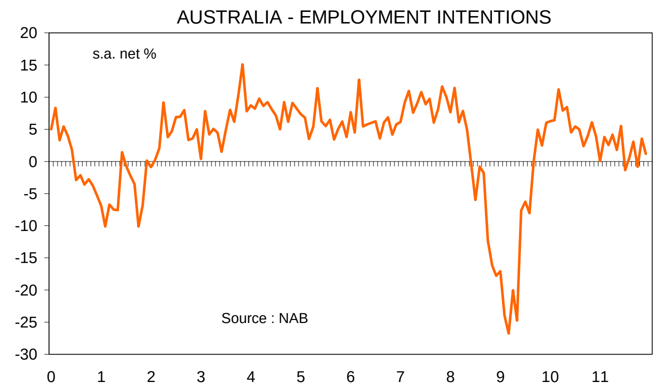


But in the manufacturing sector there is an improving trend in place with the monthly ISM index improving (slightly less than expected) to 54.1 in January from 53.1 in December and 52.2 in November.

Australian Growth

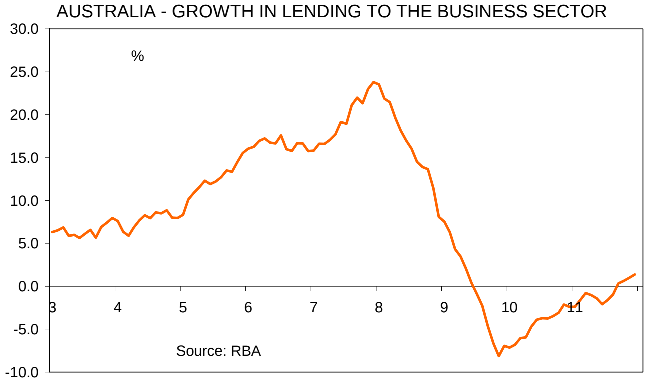
The monthly NAB Business Survey was released this week and it showed that things have been relatively steady with regard to business sentiment in recent months. However employment intentions, forward orders, and capacity utilisation are running at below trend levels suggesting that there are some downside risks to growth. As a result of these numbers the NAB economists have cut their forecast for growth in Australia this year to 3.75% from 4.5% but still expect growth near 3.5% over 2013. They expect the RBA will cut interest rates two times this year with the first cut expected next week, and another penciled in for August.

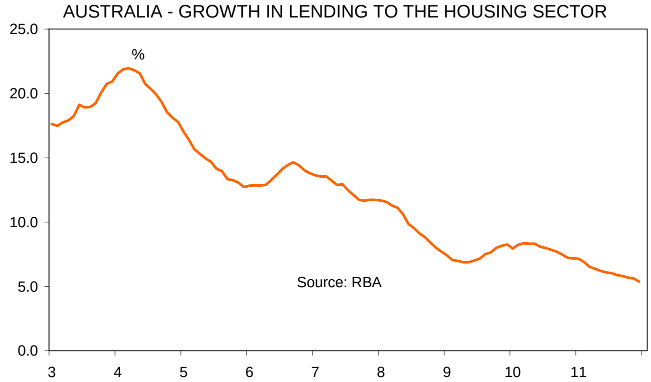




For New Zealand the numbers are suggestive of some reasonable demand for our goods and services, especially in the context of a relatively low NZD/AUD exchange rate. But there are risks surrounding the impact on Australia of any unexpected extra slowing in Asian growth and developments in bank funding costs and availability in Europe.

At least across the ditch there are some signs of businesses coming out of their shells with regard to borrowing. Business debt in December was ahead 1.4% from a year earlier compared with a 2.4% annual fall a year ago. But growth remains very low and suggestive of many businesses still concentrating hard on cutting debt levels. In the household sector debt growth is 5.4% but slowing down.





China

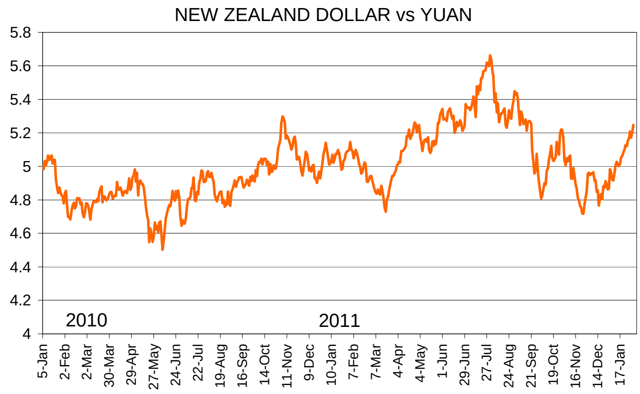
As noted on page 3, we will shortly release a new monthly publication focusing on the economic relationship between NZ and China. If you wish to receive it email me at tony.alexander@bnz.co.nz specifying your name, company, and existing linkage with China if relevant. Many thanks to those who have already offered their knowledge.

Exchange Rates

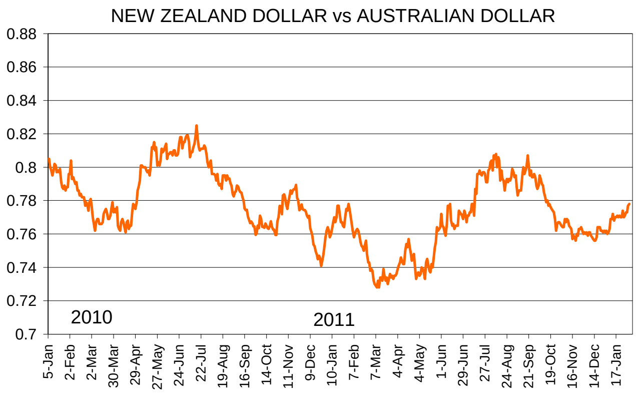
Exchange Rates	This Week	Week ago	4 wks ago	3 Mths ago	Yr ago	10 yr average
NZD/USD	0.832	0.817	0.791	0.793	0.78	0.67
NZD/AUD	0.778	0.770	0.762	0.765	0.77	0.85
NZD/JPY	63.400	63.500	60.600	61.900	63.4	69.6
NZD/GBP	0.525	0.522	0.505	0.496	0.483	0.388
NZD/EUR	0.632	0.623	0.606	0.578	0.564	0.52
NZDCNY	5.247	5.152	4.983	5.040	5.145	4.99
USD/JPY	76.202	77.723	76.612	78.058	81.282	105.7
USD/GBP	1.585	1.565	1.566	1.599	1.615	1.72
USD/EUR	1.316	1.311	1.305	1.372	1.383	1.28
AUD/USD	1.07	1.06	1.04	1.04	1.01	0.788
USD/RMB	6.306	6.3055	6.3	6.3561	6.5962	7.56

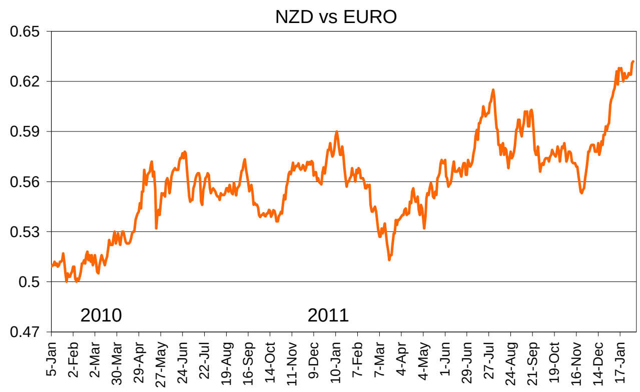
Kiwi Rising

Our view on the Kiwi dollar this year is that it goes upward against fairly much everything though with limited gains against the Aussie dollar This week we have seen the NZD rise 1.5 cents to touch a five month high against the greenback and appreciate slightly against most other currencies except the Yen in response to some hopes that the Greek debt talks may soon yield a good outcome, and some better than expected manufacturing data releases in major economies. As investors have become less risk averse they have shifted toward less liquid more volatile currencies such as the NZD - which simply means of course that when we get the next inevitable bout of concern about the world economy the NZD will take a sudden dip down. Exporters and those many people wanting to repatriate funds to New Zealand will need to keep an eye out for those dips to shift funds into NZDs this year given our view of general NZD appreciation.

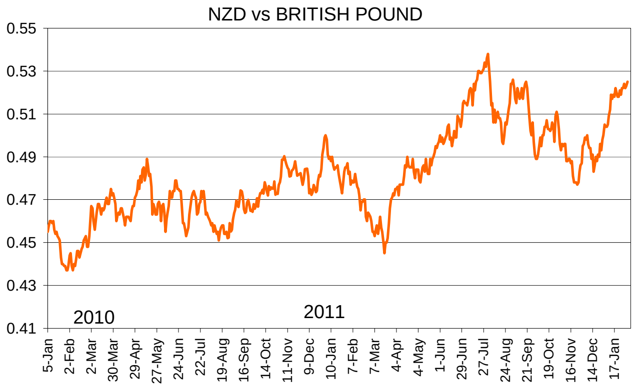


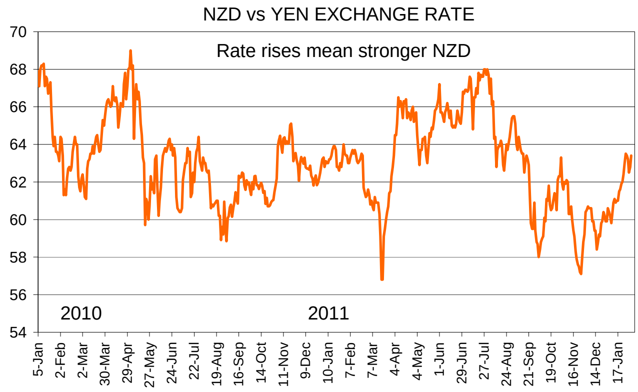
Not that the trend will necessarily be a strong one. There is little scope for raising interest rates in New Zealand this year given fragility in some sectors and further pushing out of the Christchurch rebuild.





One thing people are keeping an eye on is any sign of truth to a rumour that the Russians may be about to start slotting some of their FX reserves into Aussie dollars. This movement, which could be replicated to a small extent by other central banks is being driven principally by one factor with encouragement from a second. The first is the clear indication that both the Euro and USD currencies are not what they were. The relative size and role of the US economy on the world scene is diminishing (though massive), printing of dollars to bolster the US economy is undermining its fundamental underpinning, while the Euro might not exist in its current form by the end of the year (though the chances are it will). The second factor is rising expectations that both US and Euro interest rates will be at very low levels for long periods of time. The Federal Reserve last week indicated they plan keeping their cash rate low until the end of 2014. That means very low returns to anyone holding USDs and hence a desire to consider other higher yielding currencies.





The AUD offers not just a good yield in today's terms but represents a country with a booming minerals sector expected to continue growing and developing for many years on the back of Asia's rise and especially China's growth. China is relatively poor in energy and key resources such as iron ore and good quality coal.

These strong underlying trends mean that on sell-offs of the Aussie dollar long term buyers are likely to step in limiting the periodic declines and generating a slow upward trend. This implies some further long term decline in the NZ dollar against the AUD (five year view - thus making working in Australia even more attractive for Kiwis), and increasing incentive for Australian businesses to consider locating in New Zealand. As we have noted before this structural change in the NZD/AUD exchange rate generates structural implications for business locations and is something the government should give explicit thought to targeting.

Not that this is likely to happen to any major degree given the sensitivities around weakness in Australia's manufacturing sector and the traditional low key approach by NZ governments to economic growth strategy. Note that to a certain extent a long term rising AUD will also boost the NZD against the Euro, Pound and USD (not the Yen) as we ride its coat-tails higher.

Exchange Rate Assumptions

This table contains the latest NAB currency forecasts. In red I indicate where I believe the risk lies for these rates. You are welcome to toss your own coin and generate an equally valid table.

	2011	2012	Risk	2013	Risk
Year end					
NZD/USD	0.77	0.82	Higher	0.77	Higher
NZD/AUD	0.76	0.82		0.81	
NZD/YEN	60.0	66		63	Higher
NZD/GBP	0.50	0.53	Higher	0.50	Higher
NZD/EUR	0.60	0.64	Higher	0.57	Higher
USD/JPY	78	81	Lower	82	Lower
GBP/USD	1.54	1.56	Lower	1.53	Lower
EUR/USD	1.30	1.29	Lower	1.36	Lower
AUD/USD	1.01	1.00	Higher	0.95	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	-0.3%	0.4	1.8	4.0	2.0
GDP growth	Average past 10 years = 2.6%	0.8	0.1	+1.3	1.0	-2.7
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	4.3	3.7	......	3.5	3.0
Terms of Trade		-0.6	2.4	3.4	17.9	-14.1
Wages Growth	Stats NZ analytical series	1.0	0.8	3.4	3.4	3.7
Retail Sales ex-auto	Average past 9 years = 3.9%.	2.4	1.1	2.1	2.3	-2.5
House Prices	REINZ Stratified Index	1.7	0.5	3.0	0.7	-0.4
Net migration gain	Av. gain past 10 years = 13,900	-558	2,257yr	......	11,519	20,021
Tourism – an. av grth	10 year average growth = 3.2%. Stats NZ	2.4	-0.6	2.4	3.4	-0.6
		Latest year rate	Prev mth year rate	6 mths ago	Year ago	2 yrs ago
Business confidence	BNZ survey	3	-2	57	18	43
Consumer confidence	ANZ-Roy Morgan 100=neutral	116	108	109	117	131
Household debt	10 year average growth = 10.3%. RBNZ	1.0	1.1	1.2	1.8	2.9
Dwelling sales	10 year average growth = 2.5%. REINZ	20.9	16.9	14.3	-11.3	15.2
Floating Mort. Rate	(TotalMoney) 10 year average = 7.9%*	5.74	5.74	5.59	6.09	5.59
3 yr fixed hsg rate	10 year average = 7.8%	6.45	6.45	6.99	7.15	7.95

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

The BNZ Weekly Overview is prepared by Tony Alexander, Chief Economist at the Bank of New Zealand. Ph 04 474-6744 tony.alexander@bnz.co.nz www.tonyalexander.co.nz

Key Forecasts

Dec. year		2010	2011	2012	2013
GDP	annual average chg	1.4	1.5 – 2.0	1.5 – 2.2	2.5 – 3.5
CPI	on year ago	4.0	1.8	2.0 – 2.6	2.5 – 2.9
Official Cash rate	end year	3.0	2.5	2.25 – 2.75	3.25 – 4.25
Employment	on year ago	1.3	1.5 – 2.0	1.0 – 1.6	1.5 – 1.9
Unemployment Rate	end year	6.8	6.0 - 6.5	5.5 – 6.0	4.8 – 5.5

*extrapolated back in time as TotalMoney started in 2007

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