BNZ Weekly Overview

3 May 2012

ISSN 2253-3672

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.

In Madrid

This is the first Thursday of the month so we are once again running our very useful Confidence Survey. If you have not already done so using the link included in the email used for sending the WO out please feel free to click on the url below and let us know whether you believe the economy will be better or worse in a year's time. Also if you like, pen a sentence describing how things are in your industry at the moment remembering to specify what that industry is.

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

This week I have been in Birmingham speaking at a tradespersons jobs expo aimed at attracting people down to NZ and Australia and am currently in Madrid having spent the day at meetings organised in the interests of NZ Inc with the same to happen tomorrow in Paris before returning back home. The week has brought no positive developments with regard to the state of play here in Europe and for ourselves this has meant some increase in the NZD for now against most other currencies largely because we do not suffer the same problems as them. I discuss the situation in Europe again in the Major Offshore Issues section further on.

In that section I also discuss Australia where the RBA has this week cut its cash rate 0.5% amidst fears about the domestic economy, developments offshore, and to offset banks having to pass on into lending rates increases in funding costs over and above base levels influenced by monetary policy.

Locally we have seen the release of data showing the following in New Zealand.

- Accelerating growth in lending to the household, business and rural sectors.
- A downward trend in exports amounting to a seasonally adjusted 6% fall during the March quarter.
- A possible flattening of recent declines in the value of imports of capital equipment.
- Some underlying upward movement in the value of consents issued for the construction of non-residential buildings.
- A clear upward trend in issuance of consents for dwellings now ahead 32% from a year ago over the March quarter and 11% ahead seasonally adjusted from the December quarter.
- Good business sentiment in April with above average investment and employment intentions.
- 0.4% jobs growth in the March quarter – only a 1.6% annualised growth rate.

These indicators are positive and supportive of our view that the rate of growth in NZ economic activity will lift as the year goes by, especially with the boost to come from reconstruction in Christchurch over the next three years. It is estimated that the reconstruction will create some 26,000 jobs over that period of time with a cost of some $30bn spread over a longer time period.

But one would be unwise to ignore the implications of falling export receipts, the recent declines in international dairy prices, the new surge in concerns about the situation in Europe, and the clear concerns of the Reserve Bank of Australia about the Aussie economy.

The world therefore remains worrying and it would pay NZ SMEs to keep a strong focus on robust cash flows and low debt levels, run scenarios on how to handle revenue shocks, and continue to give preference to flexibility in the likes of hiring and leasing contracts. After over three years of extremely slow growth following the end of the worst depths of the global financial crisis in early-2009 we cannot yet say that business operating conditions have become “safe” – here or anywhere else.

Travelling

I flew from London to Madrid from Gatwick Airport and it was much nicer than Heathrow. There was lots of seating in the departures area, good shops, good cafes, and it is easy to get there from Victoria Station on the Gatwick Express for about £19 in 30 minutes. Madrid was cold with snow on mountains sitting off to the side. . Tuesday when I arrived the place was fairly dead with people taking the May 1 holiday. Wednesday was not much better – though for about half an hour whilst walking around the centre of the city I thought I’d be a spectator to a Sleeping Dogs moment. Springbok Tour replay? Try riot.

There were policia everywhere, big trucks designed for containing miscreants, humvees, mounted police, police on scooters, motorbikes and in cars, and various military personnel. But it turned out to all be preparations for some official parade of which I am still unclear of the details. The police trucks weren’t in fact even for carting away rioters. They were floats for lots of lovely white horses. Suffice to say all remained calm, no-one had their head smashed in – probably because the attention of austerity protesters was on Barcelona where there is to be a meeting of the European Central Bank on Thursday.

Coffee in Madrid is not good – but the architecture is lovely, as it is in most European cities not bombed out seven decades ago.

Is Our Economy Getting Better or Worse?

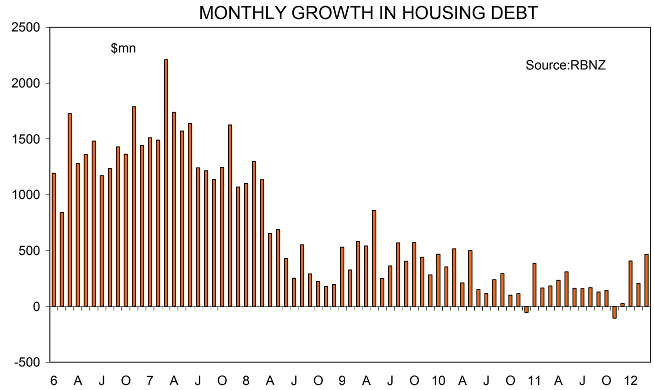
In this section we look only at what the data are actually telling us and pay no attention to forecasts or intentions measures.

We see better signs of underlying improvement.

Are householders opening their wallets more?

If debt growth is a proxy for household spending then there is growth. The monthly seasonally adjusted rate of growth in household debt lifted to 0.2% in March from 0.1% in the preceding three months. Housing debt rose $465mn which was $281mn more than a year earlier whereas February was ahead just $41mn and January $21mn. So some real growth is occurring and this correlates with growth in turnover in the residential real estate market which was an annual 29% in the March quarter.

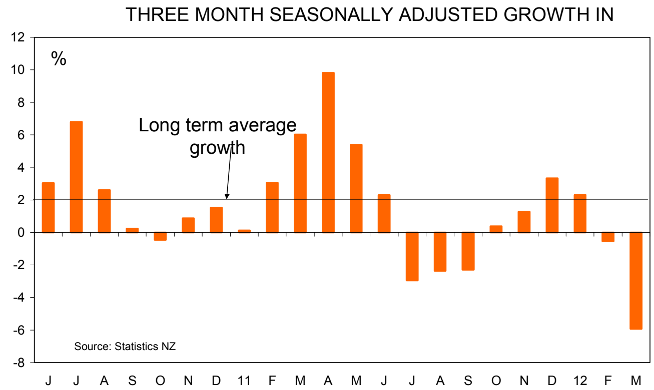
But is there growth outside of housing? Actually there has been some with non-housing lending to the household sector falling only $37mn in March this year whereas it fell $141mn in March 2011, $79mn in March 2010, and $120mn in March 2009.

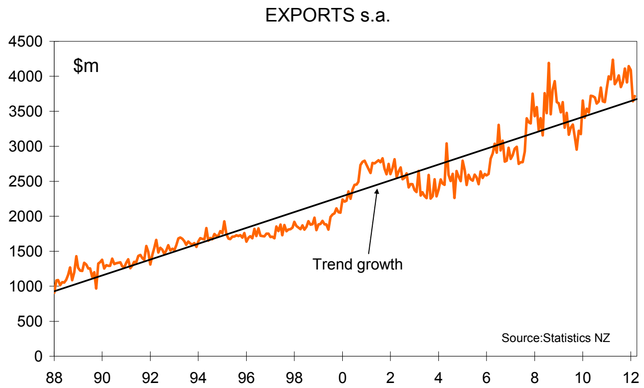


Is business output rising?

Not for exports

In recent months we have been noting weakness in export growth in this section and data for March continue the theme. Seasonally adjusted export receipts rose only 2% after falling 11% in February and that means a 6% fall for the entire March quarter following a 3% rise in the December quarter and 2% fall in the September quarter.

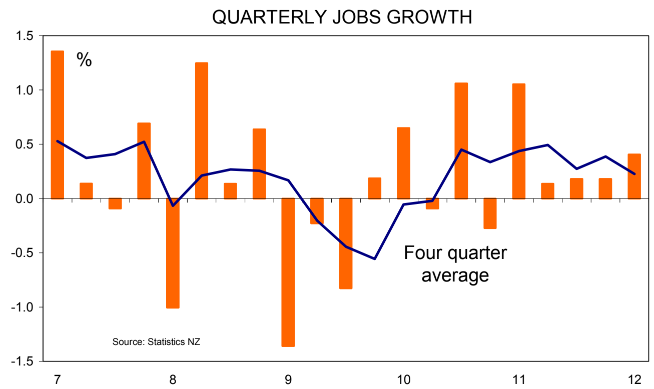


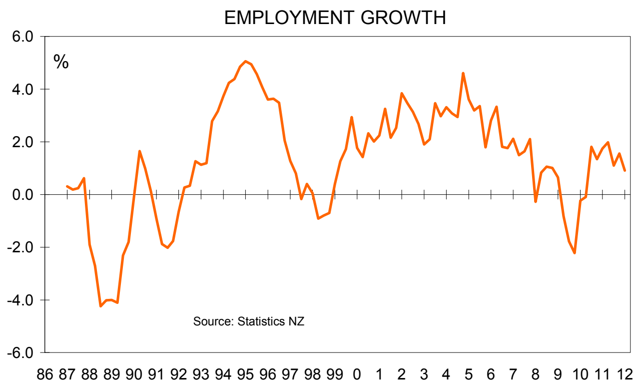


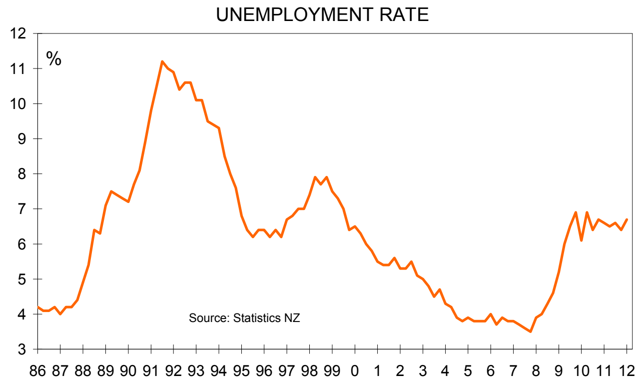
During the quarter the big decliners were crude oil -20%, fruit -26%, and dairy -6.4%.

Are businesses hiring more people?

This morning's Household Labour Force Survey revealed that during the March quarter an extra 9,000 jobs net appeared meaning that since the recession ended some 76,000 jobs have been created which is very good compared with other countries. The unemployment rate actually rose to 6.7% from 6.4% but this reflects a rise in the participation rate to its second highest level ever at 68.8%. That means more people stuck up their hands and went actively looking for a job in the quarter than got a job.





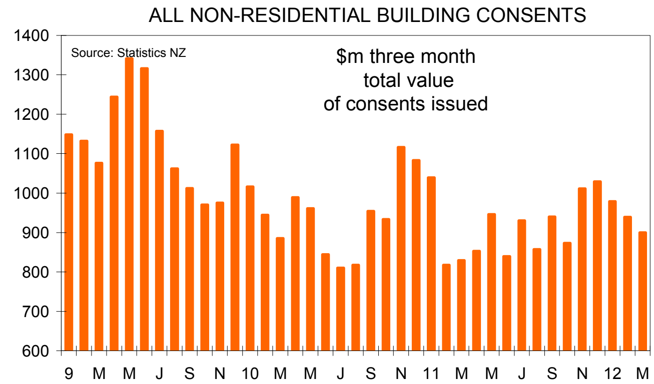


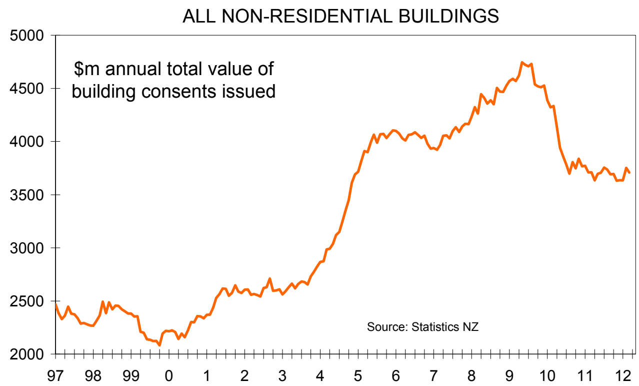
However the employment rate which measures the proportion of the working age population in employment rose to 64.2% from 63.9%. There is jobs growth in NZ which at 1.6% annualised is acceptable in the context of a still very wobbly world. But with the economy having growth only 1.4% during calendar 2011 this implies essentially no productivity improvement occurring in the country which when combined with average wages growth near 3.5% provides quite a crimp on business profitability.

Are businesses boosting their capital spending?
For equipment no. Buildings = mixed.

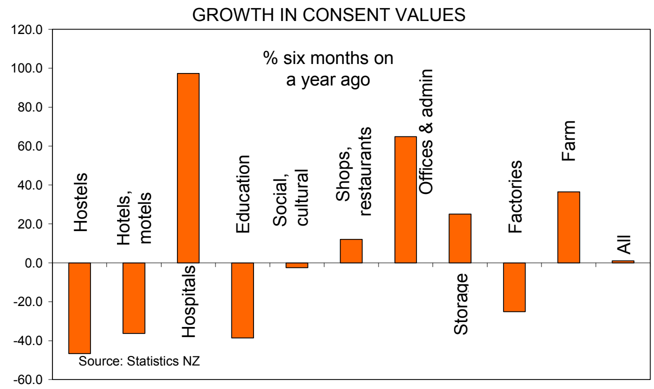
To see how businesses are feeling right now one can read our monthly BNZ Confidence Survey here. http://tonyalexander.co.nz/bnz-confidence-survey/

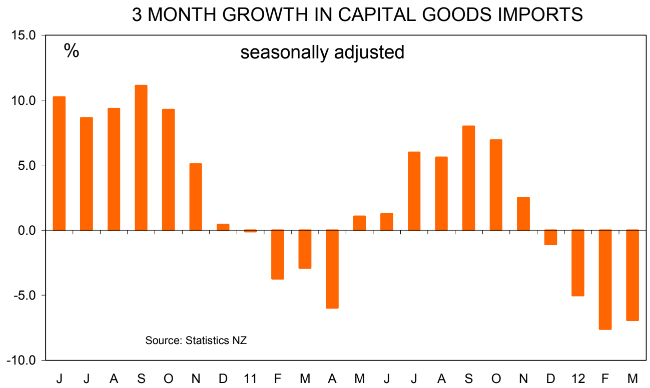
The value of consents issued for the construction of non-residential dwellings fell 13% from a year earlier in March to $299mn. However in the March quarter values were 9% ahead of a year earlier though unchanged for the year as a whole. One can see some hints of growth here, especially if we try our best to exclude the public sector and focus on actual businesses. Doing this yields growth in construction consent values for the past year of 7% and growth for the quarter of 14% from a year ago.





Looking at six months on a year ago the total business growth was 8%, farm buildings 36%, factories fell 25%, warehouses rose 25%, offices rose 65%, shops rose 12%, and hotels and motels fell 36%.



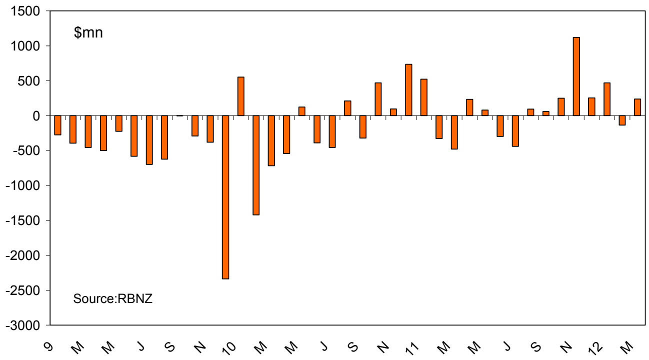


So there is some investment growth in this area. But when it comes to equipment the story is different. The value of imports of plant and equipment in seasonally adjusted terms was down 7% in the March quarter. However with small rises recorded in the months of February and March the data could be telling us that a pullback in imports after a surge earlier in the year as businesses took advantage of the strong NZD may have ended. So we don't believe a downward trend is in place as such – just absence of a positive one of any meaningful nature at this stage.

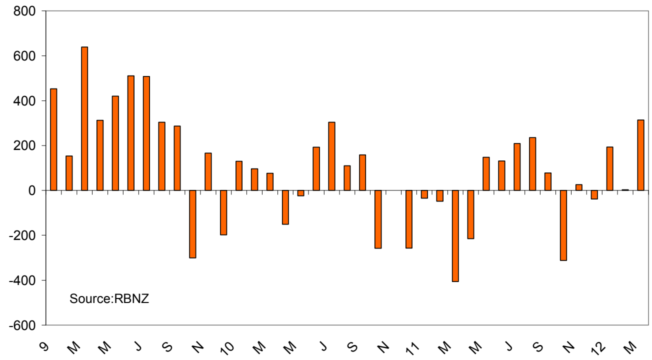
Debt Growth

There is not really much of a correlation in the short term between business investment and business credit growth because if the investment is financed through means other than debt the credit data don't capture it. But for the record, the annual rate of growth in lending to the business sector was 2.6% in March which was the highest since June 2009. Growth for the quarter of $572mn compares with a fall of $287mn a year ago. Debt stands at $76.8bn which is just 8% down from the peak in December 2008.

MONTHLY GROWTH IN BUSINESS SECTOR DEBT

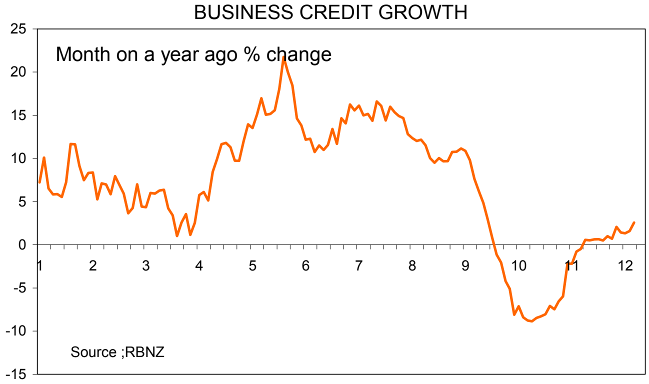


MONTHLY GROWTH IN FARM SECTOR DEBT

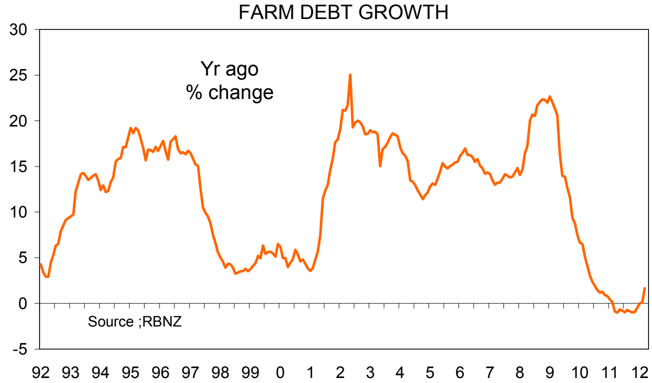


Farm debt stands at $47.6bn which is up 1.7% from a year ago and exceeded only marginally by a couple of months in 2010.

BUSINESS CREDIT GROWTH



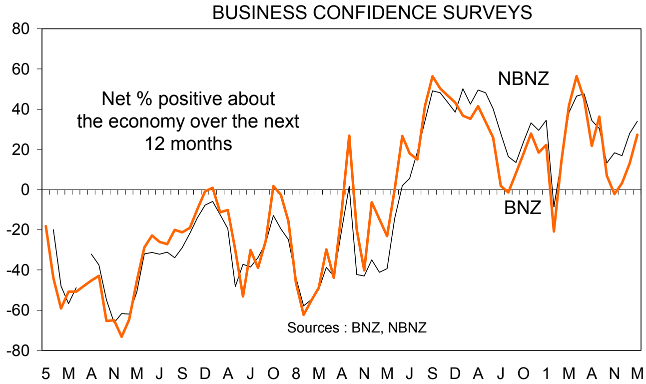
FARM DEBT GROWTH



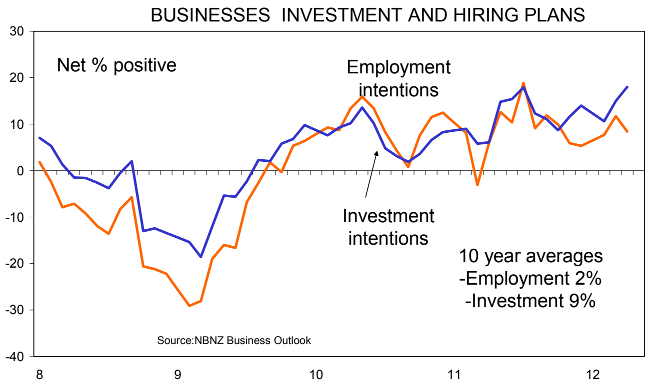
What Do The Leading Indicators Say?

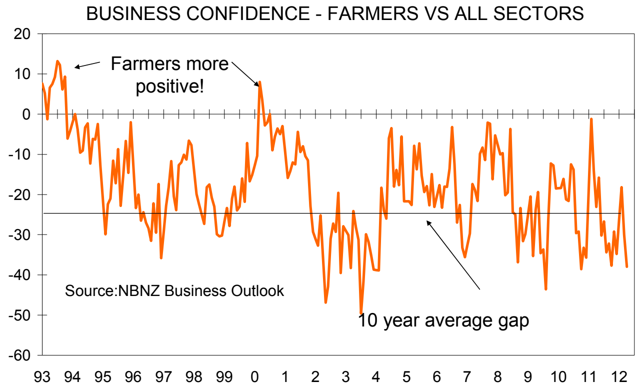
In this section we look only at the factors which can at times give insight into where the economy is headed. Generally we will only cover newly released information.

This week the NBNZ Business Outlook survey appeared and as it is wont to do it showed what we already reported three weeks ago in the results of our BNZ Confidence Survey – namely that sentiment about the economy in a year's time improved. In our survey it went from a net 27% positive to 34%. In the NBNZ survey it went from 34% to 36%. So no surprises there and clearly no market reactions either.

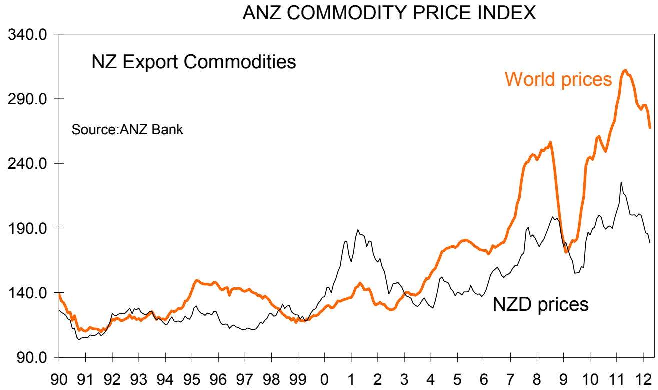


The net percent of businesses planning to hire people fell to 8% from 12% in March just highlighting the still weak state of NZ's labour market seen recently in the slowing rate of growth in jobs creation evident in the National Employment Indicator. Investment intentions however improved to a net 18% positive from 15% which is a good sign.



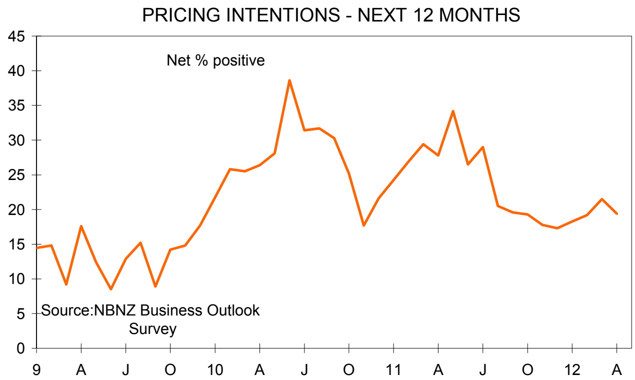


For your interest, here again is our graph showing the way in which farmers are almost always the most pessimistic part of the business sector – even when incomes are at record highs as they have been until recently for some. Speaking of which, those incomes are now falling courtesy of commodity prices pulling back. There was another small fall in Fonterra's auction prices this week and average NZ commodity prices in world price terms are now just 30% above their ten year average and 14% down from their peaks of about a year ago.

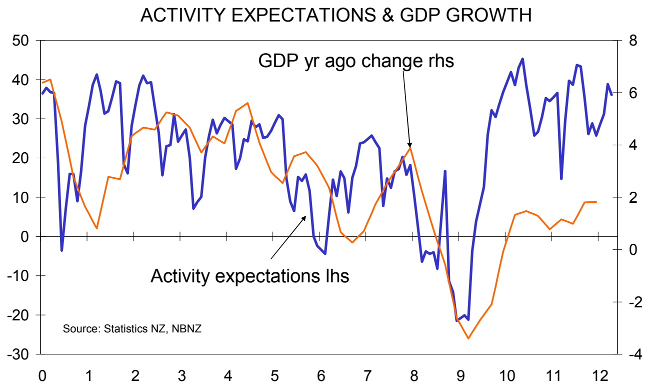


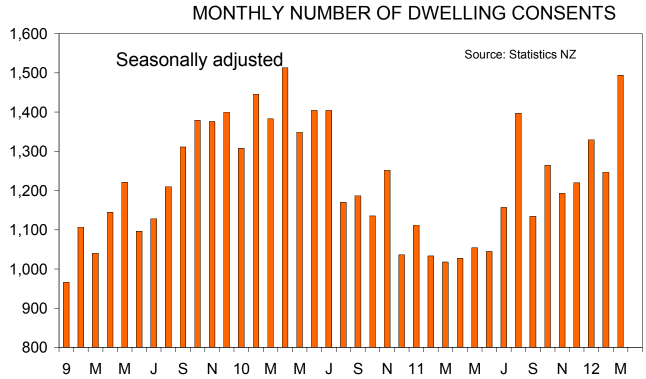
Easing export prices will tend to make farmers cautious and in doing so will push out the period when they start spending more of their incomes on general consumer goods and services, and understandably cut the magnitude of that expected boost to NZ-wide growth as well.

The Reserve Bank will have been pleased by the continuing weak inflation threat posed by business expectations with the net percent of businesses planning to raise prices easing to 19% in April from 21% in March. The ten year average for this measure is 23%.



While a net 36% of businesses said they expect higher levels of activity, and while this has been associated with 4% growth in the past, we remind everyone that the relationship between sentiment measures and growth outcomes has broken down as a result of the aftermath of the global financial crisis. People prefer paying down debt and we see no reason for arguing against that policy as yet given the still wobbly state of the world economy.





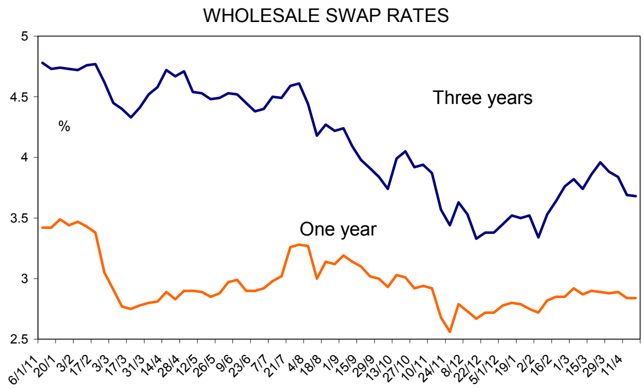
But while we read little exciting into the NBNZ survey results beyond support for growth in the NZ economy eventually improving, we do interpret positively the latest dwelling consents data. Seasonally adjusted consent numbers have risen 11% in the past three months or by 9% excluding apartments so a good upward trend is in place which will soon start showing through in better activity levels for those involved in house construction. This includes the producers and distributors (and importers) of building materials, home furnishings etc.

INTEREST RATES

In the face of yet another round of worries about the European debt situation and with the Reserve Bank of Australia cutting interest rates 0.5% this week rather than the 0.25% expected, NZ wholesale interest rates have fallen further this week. Barring a surprising surge in global growth and/or inflation there seems little reason for expecting that rates are going to be jumping up again in the near future – but then we did not expect them to jump down did we?

Which just brings us back to the comment we have been writing here for at least the past three years and which we will undoubtedly write again many times. You are a fool if you base your interest rate risk management decisions on any particular set of interest rate forecasts. We and everyone else have repeatedly proven that predictability of interest rates and lots of other things post-GFC is extremely low.

We are certain in the next four years to see interest rate forecasts made, turn out to be wrong, change, then be wrong again. For the moment our central forecast is that the RBNZ will raise its cash rate in December. The chances are extraordinarily high that forecast will be changed, and that whatever we change it to that will change as well. So good luck with your risk management and remember that in uncertain times there is value in the certainty which fixed interest rates offer.



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	2.50	5.4
90-day bank bill	2.68%	2.75	2.77	2.76	2.68	5.7
1 year swap	2.66%	2.79	2.89	2.72	2.91	5.8
3 year swap	2.95%	3.14	3.36	2.95	3.83	6.1
5 year swap	3.41%	3.56	3.84	3.34	4.45	6.3
180-day term depo	4.50%	4.50	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?

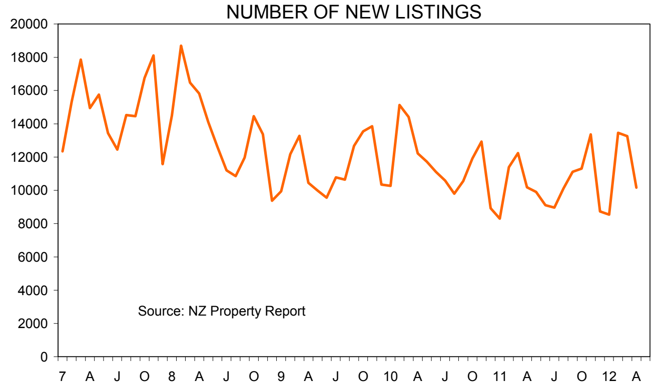
Unlike the three previous times since March 2009 when I have written here that I would stop floating and fix then been hit straight away with a fresh deterioration in Europe and fall in borrowing costs, this fourth time I do not feel inclined to outright switch back to saying don't fix. Certainly the chances of bank fixed interest rates going up in the near future have collapsed in the face of disappointing economic data. So while I personally like the three year fixed rate at 6.15% there is no need for haste to fix from those happily sitting on floating at 5.74%. But I would keep an eye on things and personally be happy to fix and not worry about whether I average a rate of 6.15% in the next three years or 6%.

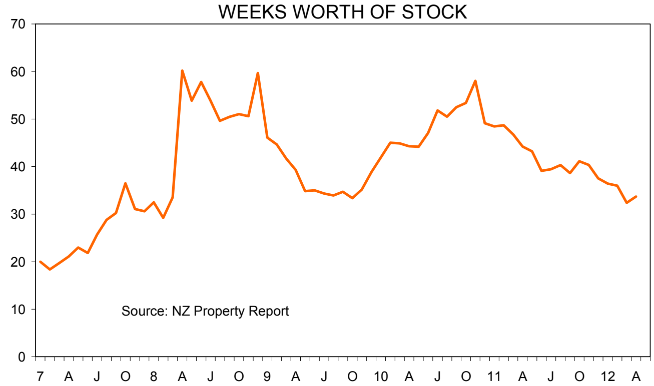
HOUSING MARKET UPDATE

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

No Listings Surge

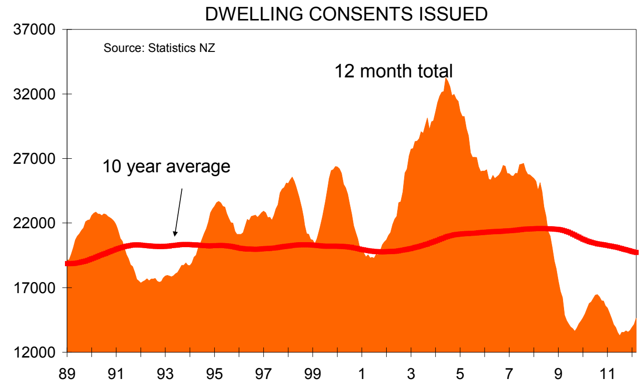
The NZ Property Report prepared by www.realestate.co.nz was released this week. It does not add a huge amount to what we know about the housing market but is useful nonetheless. It showed that over April the number of new listings amounted to 10,174 which was virtually unchanged from a year earlier and as the first graph below shows there is no clear trend in this indicator. The second graph shows the weeks worth of total inventory (46,948) calculated by comparing the April total with sales in the three months to March. The trend is clearly downward though things are nowhere near as tight as they were in early 2007 when the Report first appeared. The message to home buyers however is reasonably clear. There is no flood of listings appearing.

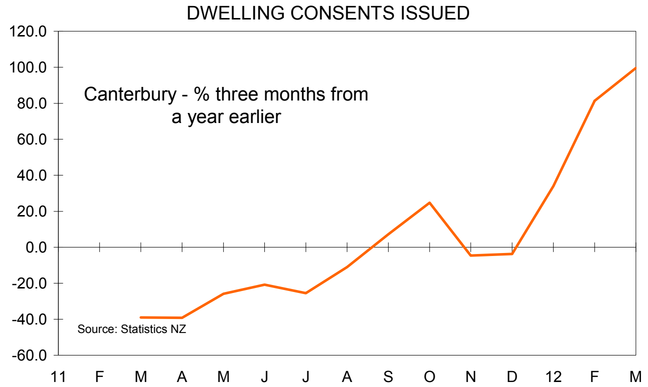




Construction Prospects Rising

In March in seasonally adjusted terms the number of consents issued for new dwellings rose by a strong 20% to deliver 11% growth during the March quarter after a flat result in the December quarter and 18% growth in the September quarter. The annual number of consents now stands at 14,629 which is a 0.1% rise from a year ago and the best result since February last year.



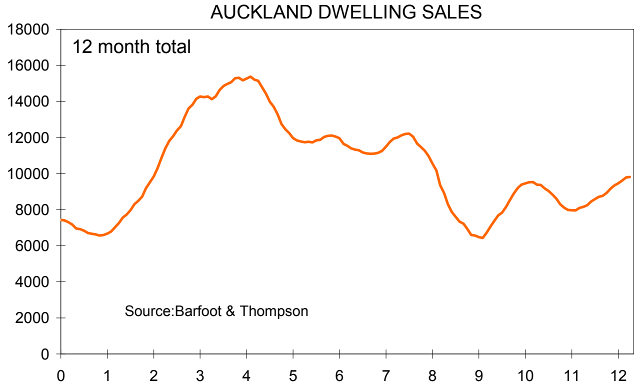


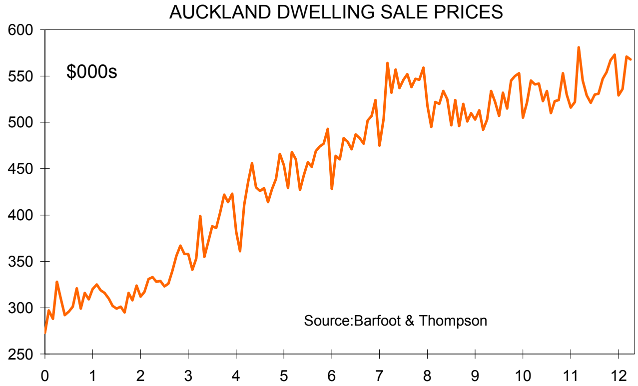
In the three months to March the change in consents from a year ago for the entire country was 32%. For Auckland the gain was 24%, for Canterbury 100%, and the all NZ excluding these two areas 17%. Canterbury is leading the way and there is clearly a heck of a lot more to come as we head back toward the ten year average number of consents which stands at 23,000.

Auckland Pulls Back

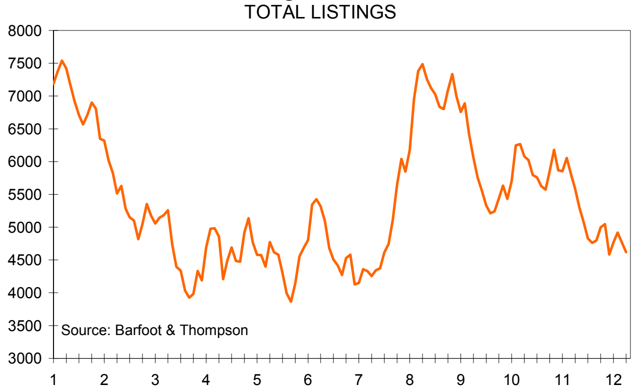
Monthly data from Barfoot and Thompson in Auckland show that their sales roughly 10% seasonally adjusted in April to 750 from 1,246 in March. Sales usually ease off from the annual peak in March but with

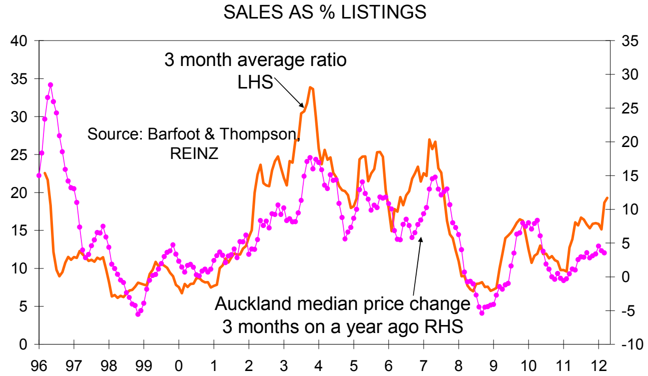
April's growth from a year ago only 3.7% it is the lowest annual rate of improvement since February last year. As such it suggests a market which may have just paused a tad. The average sales price eased marginally to $568,000 from $571,000 in March though this was a 4.2% gain from a year ago.





B&T received 1,266 new listings during the month which was a 23% rise from a year earlier – quite a strong increase. But total listings at the end of the month were down 17% from April 2011 at 4,621.





The data suggest an Auckland housing market taking a mild pause.

MAJOR OFFSHORE ISSUES

Very mixed. Good manufacturing data in China and the US this week, Europe deteriorating, US employment report Friday night to set the tone for next week.

Europe

A key problem in Europe and a reason why the long term growth prospects are bad is not just that the fiscal numbers are rotten and getting worse in some cases, but that politicians cannot break away from two streams of thinking. The first is thinking that if government spending is boosted in the short term the resulting growth will allow deficits to be addressed easily further down the track. That sort of thinking has dominated policy-making for at least four decades and the result has been increasingly rigid, slow growing, debt burdened economies. Eurosclerosis.

The other bad stream of thinking is that only higher government spending will deliver highly desired growth. Few politicians are proposing that other than Spain and Greece engage in hefty labour market deregulation, cut corporate taxes, reform social welfare and undertake other deregulatory policies which history shows produce the goods in the long run but can easily cost votes for weak governments in the short-term. Witness policy proposals in France and criticism of Germany for not taking the drugs its EU partners have burnt their brains out with – namely fiscal stimuli.

As for developments over the past week there has been nothing positive. Spain have had their credit rating cut two notches by Standard and Poors and put the country on negative credit watch indicating a 30% chance that the rate will be cut again. The Spanish Foreign Minister likened his country to a critically ill patient and Europe to the Titanic following news that the unemployment rate has risen to 24.4% with 50% unemployment for people aged less than 25 years.

- The UK Prime Minister has said he feels the European debt crisis has not yet reached its half-way point.
- Romania's government – which is not a part of the Euro-zone but is a member of the European Union – collapsed this week in a vote of no-confidence.
- Seven of the Euro-Zone economies are now in recession.
- Whereas four years ago fewer than 300 Portuguese migrated to Angola, the total in the past year was over 20,000.
- The Greek under-25 unemployment rate, like Spain's, is above 50%. NZ's is about 16%.
- The Euro-Zone unemployment rate is now at a 15 year high of 10.9%.
- In Spain compulsory redundancy payments have been cut from 42 days per year worked to 33. Imagine that here in NZ! No wonder businesses are reluctant to hire anyone they don't figure will shoot through voluntarily in hard times. The top Spanish personal income tax rate is being raised from 45% to 52%.
- Standard and Poors have just cut the credit ratings of 16 Spanish banks.
- The UK Purchasing Managers Index for manufacturing almost fell back into recession territory with a reading of 50.5 from 51.9 in March where a result of 51.5 had been anticipated.

The European debt crisis ball is well and truly rolling yet again and the growing big picture debate on easing fiscal austerity in favour of a growth package shows EU politicians after four years still do not understand the role of financial markets in influencing their economies. You can only run a deficit if someone is willing to finance it and a lot of the recent funding has come from EU banks taking near free cash from the ECB and buying their own governments' bonds. This process has now ended, bond auctions are becoming less well supported, banks are building up mark to market losses, and the ECB may be called upon once again to indirectly monetise the debts of recalcitrant EU governments.

The Germans must be apoplectic about the bastardisation of the ECB involved here and the long term threat of higher inflation from currency debasement. This still does not look like having a happy ending for everybody and debate about some countries ditching the Euro is again picking up. That is why Spaniards and Greeks in particular are pulling money out of their banks and putting it elsewhere – perhaps partly explaining the recent strength in the pound and absence of funding problems for German banks.

I am very happy to be working and invested well away from this mess.

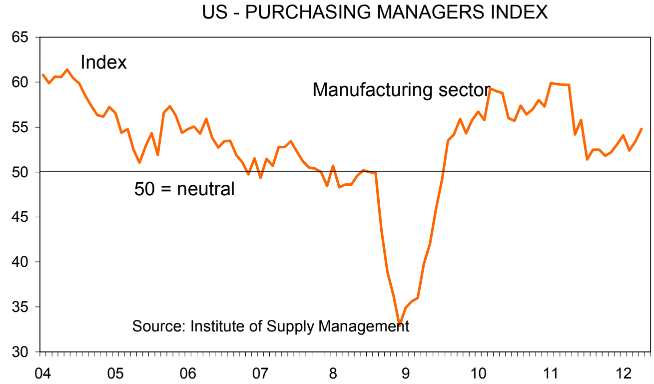
Australia

The RBA surprised the markets this week by cutting their cash rate 0.5% rather than the 0.25% commonly expected. Why the extra cut? They cited weakness in the domestic economy and some mild concern about events overseas. But we suspect they were allowing for banks not fully passing on the reductions in bank bill yields into their lending rates. For your guide, this week in the UK banks are raising many of their home lending rates 0.4% to reflect higher funding costs – even though the Bank of England's base rate has not been changed in a long time. Such is the new world we live in. As we have pointed out for four years now, the old relationships between official overnight interest rates and basic wholesale interest rates such as bank bill yields and swap rates have gone out the window.

I shall resume writing more about our biggest trading partner when I return to NZ and can find the time.

United States

The rate of growth in the US economy slowed to 2.2% annualised in the March quarter which was a slowdown from 3% in the December quarter and a pace of 2.7% expected by analysts. As such the result shows an economy muddling through but not yet showing signs of accelerating away in a fashion which would ease the pain for Europe, lift export growth from Asian countries, and newly push up the commodity prices important to us. Doubts persist about the pace of US growth, but the data do not provide justification for despondency. In fact the markets strongly seize on to the occasional good piece of news with this week's being the PMI for manufacturing which came in stronger than expected with a reading for April of 54.8 from 53.4 in March. A fall to 53 had been expected. The result is the strongest since June last year and as such gives hope that this important part of the US economy is moving ahead.



This Friday night the monthly non-farm payrolls report will be released and it always has capacity to surprise. The question is whether it will be weak enough (well below the expected gain of 170,000) to cause increased expectations that the Federal Reserve will engage in a third round of quantitative easing.

China

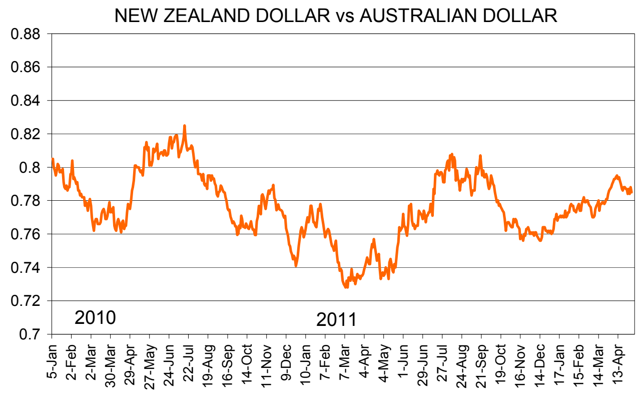
Chinese economic developments are now covered in our new publication "Growing With China", the last issue of which appeared on April 24. If you wish to receive this monthly then please email me specifying your name, company name, and connection with China. Tony.alexander@bnz.co.nz

Exchange Rates

Exchange Rates	This Week	Week ago	4 wks ago	3 Mths ago	Yr ago	10 yr average
NZD/USD	0.807	0.816	0.824	0.832	0.808	0.67
NZD/AUD	0.783	0.787	0.790	0.777	0.737	0.85
NZD/JPY	64.700	66.300	67.600	63.400	65.7	69.6
NZD/GBP	0.498	0.505	0.514	0.526	0.484	0.388
NZD/EUR	0.613	0.618	0.618	0.633	0.544	0.52
NZDCNY	5.070	5.143	5.186	5.245	5.246	4.99
USD/JPY	80.173	81.250	82.039	76.202	81.312	105.7
USD/GBP	1.620	1.616	1.603	1.582	1.669	1.72
USD/EUR	1.316	1.320	1.333	1.314	1.485	1.28
AUD/USD	1.03	1.04	1.04	1.07	1.10	0.788
USD/RMB	6.2824	6.303	6.2938	6.3041	6.4925	7.56

Kiwi Lower

The Kiwi dollar has shed ground this week against most currencies on the back of an increase in worries about Europe, mild downward movements in commodity prices, a higher than expected unemployment rate, and riding the coat-tails of the AUD marginally lower. The AUD fell about a cent on Tuesday following the shock 0.5% cut in interest rates but it still managed to end the week near US$1.03 from US$1.04 a week ago.

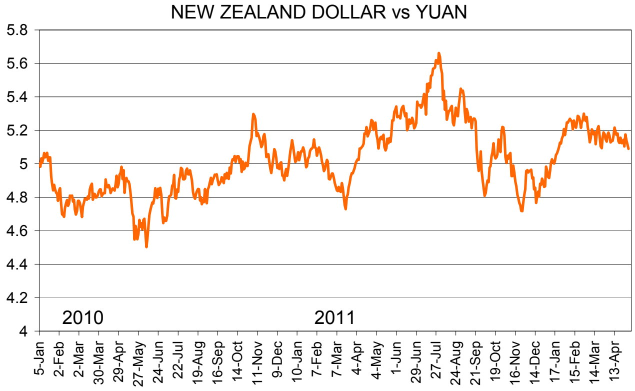


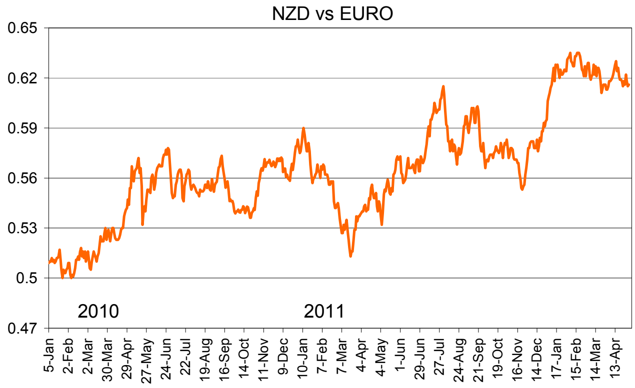
Against the British pound the NZD is just back below 50 pence. The Pound has recently hit a post-crisis high against the Euro as investors have been treating it a bit like the Swiss Franc – a safe haven. That may sound strange given that the UK is back in recession but there are a number of things to consider. First is that the Swiss Central Bank has set a ceiling on the Swiss Franc so expectations of appreciation have ended and investor hoping for some capital gain to compensate for the lack of interest rate return while they park their money have veered toward the Pound. Additionally, whereas the ECB and Fed. have not ruled out further quantitative easing the Bank of England by and large has.

Also, in the City of London and presumably other financial centres chatter is rising again regarding the Euro breaking up. This is still a low probability scenario, but with a potentially huge battle coming between Germany and their demands for continued fiscal austerity versus the indebted countries and their growing desire for growth packages (who on earth will pay for them?) discord between the Euro-Zone partners will become more pronounced.

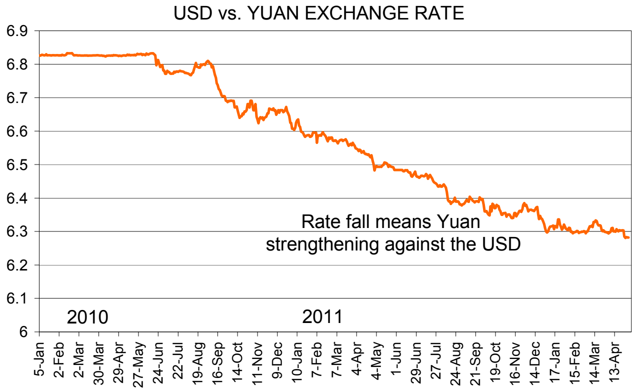
The Kiwi dollar has barely changed against the Euro from a week ago but we are down a cent against the greenback which has benefited from a far better than expected report this week on the manufacturing sector.

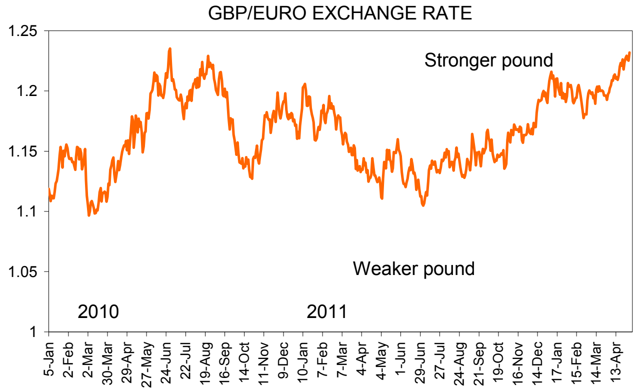
China also saw the release of a good monthly manufacturing report and the Yuan has risen to a fresh record against the greenback though the NZD is well within its recent trading range against the Chinese currency.





Looking ahead we see huge uncertainty continuing about most parts of the world which virtually guarantees that we will at some stage see some high volatility in the Kiwi dollar. For the moment the most obvious likely change to come along would appear to be appreciation against the Aussie dollar which has held up astoundingly well in the face of the RBA's rate cut and growing expectations of more to come. Note that the Bank of Japan during the week expressed some major concern about strength in the Yen and hinted at intervention.





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	0.83	Higher	0.75	Higher
NZD/AUD	0.76	0.85		0.82	
NZD/YEN	60.0	71		60	Higher
NZD/GBP	0.50	0.52	Higher	0.49	Higher
NZD/EUR	0.60	0.61	Higher	0.54	Higher
USD/JPY	78	85	Lower	80	Lower
GBP/USD	1.54	1.58	Lower	1.56	Lower
EUR/USD	1.30	1.35	Lower	1.38	Lower
AUD/USD	1.01	1.00	Higher	0.95	Higher

Key Forecasts

Dec. year		2010	2011	2012	2013
GDP	annual average chg	1.2	1.4	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	2.50 – 2.75	3.25 – 4.25

Employment	on year ago	1.3	1.6	1.0 – 1.6	1.5 – 1.9
Unemployment Rate	end year	6.8	6.3	5.5 – 6.0	4.8 – 5.5