BNZ Weekly Overview

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Mission Statement

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

The Weekly Overview is written by Tony Alexander. The views expressed are my own and do not purport to represent the views of the BNZ. To receive the Weekly Overview each Thursday night please click here.
http://feedback.bnz.co.nz/forms/Fx-I8ploskSGWgjN_7WOAw
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Monthly Survey

If you have not already done so using the link in the email, please feel free to click on the link below, let us know whether you feel the economy will be better or worse in a year's time, and pen a sentence on how things are in your industry currently – remembering to specify what that industry is. The results will be released early next week.

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

Global Slowdown Underway

Just in case you are pressed for time here is something to mess with your head. New Zealand is embarking upon a multi-year housing upturn driven by a worsening housing shortage (as pointed out here since 2004) meeting reduced investor expectations for returns on other assets and young buyers catching up on delayed buying at exactly the same time as export prices are falling, the current account deficit is already 4% of GDP, the Eurozone may be on the cusp of imploding, and much weaker than expected data have just been released for China, India, and even the United States. A new global slowdown of hopefully mild intensity is underway and as a recent BBC TV piece pointed out, those students in the United States who entered varsity in 2008 are now graduating into a labour market which does not want them. .

But not everything is as bad as one might casually think. First, the housing upturn is not being accompanied by a retail spending boom and it is extremely unlikely that retailing will improve much in the next few years. There will be more retail chain closures. Two, some export sectors such as tourism have held up remarkably well and with the NZD structurally lower against the AUD than in the past good opportunities exist for capturing some of their businesses and of course exporting our stuff there. China's urbanisation and increase in household incomes also presents us with a great structural lift in demand for our primary products in their various unprocessed and processed compositions.

Plus this week we learnt of 1.3% growth in Australia's economy last quarter and there was a 13.5% rise in dairy prices.

But in Europe, while overnight some government debt sales went acceptably well, this week the European Economics Commissioner warned of Eurozone "disintegration" and the ECB President said the Eurozone as currently structured is not "sustainable".

The Australian Treasury Secretary also said that the European crisis is “spiralling out of control” and his department has been working on contingency plans for a new crisis since before Christmas, the Reserve Bank of Australia has now cut interest rates 0.75% in two months because of deepening growth worries, and a teleconference between G7 central bankers and ministers yielded not even a communiqué on Tuesday night.

In the European corporate sector companies are undertaking scenario planning around the possible exit of Greece from the Euro then complete break-up of the Eurozone, as explained for instance by the head of AXA during the week in La Tribune, 1 June. He noted that while they had stopped buying assets in Greece a few years ago, then ceased buying assets in Spain and Italy just a few months ago.

The chances are increasing by the week that the Eurozone will fracture in some way. Last week I put the probability at 1%. Lets lift that to 5% this week. One of the key problems is that taxpayers in well managed northern countries are unwilling to bail out any longer their recalcitrant southern neighbours, and those neighbours are unwilling to continue with existing austerity measures in order to secure extra funds. They call for their pain to be shared through joint Euro bonds but are unwilling to give away control over fiscal policy to a central Eurozone authority.

Meanwhile any citizens with an understanding of investment risk are moving funds out of banks in Spain, Greece and Italy, perhaps recognising that the already large bank bad debts can only get worse as recessions drive property prices lower and banks accrue losses from government bonds bought with 1% three year ECB funding. The ECB has effectively funded bad governments with local banks as intermediaries and in the process merely shifted debt from one place to another.

This whole process is unsustainable and does not look like ending cleanly as the sums involved have become so large nothing short of outright money drops may end the problem – in which case the Euro will be so debased as to make it a leper currency no-one will want. Hence it is trending downward against the USD.

Oh, and one more thing. The Euro problem is entirely of the making of Eurozone members and no outside forces. It was France and Germany who first violated government deficit and debt rules, it was the northern members who encouraged dodgy southerners to join the party and capture German-level interest rates, and it was those southerners who binged on debt, failed to work at raising productivity to be competitive in an ever changing world, voted for governments devoted to income redistribution, and borrowed money to build houses in a massive self-generated pyramid scheme.

A Visit To Fiji

This week I delivered a presentation in Fiji at a large company’s conference – as one does. But as I have always said to those who say how lucky I am to give talks in Queenstown and have a holiday at the same time, that is not the way these things go. There is a world of difference between travelling to an exotic location with family and leaving the cares of the world behind, and going somewhere to make a presentation and undertake the analysis and written output production required of a normal days work in the office – which is what all such work travel involves.

So there was no snorkelling, riding Seadoos or whatever they are called, para-gliding and so on. Instead there was just the normal travelling and accumulation of more travel experiences that anyone on the road for over two decades like myself will recognise, and lessons brought back for those who might go to the same place later on for more enjoyable reasons. So here are some things to keep in mind if you are planning a family trip to lovely if somewhat littered Fiji in the near future.

First, Fiji is a third world country. The people are poor, the roads are bad, and one of the first things the announcer did when we were all seated ready to fly there on Air Pacific last Thursday afternoon was to ask people to donate money for the children.

If you choose to fly Air Pacific then it might be a good idea to pack your own meal because the lunch box provided with its small bag of corn chips, mini pottle of pasta, and small flat bread thing would not satisfy many people. This is an issue because you may not be getting your dinner in Fiji when you thought you would.

When the airplane arrived at Nadi Airport and we were taxiing we were redirected from one air bridge to an alternative because the first one did not work. That was okay and yielded no interruption. But the second one did not work either. So we were manoeuvred to a third which thankfully did function.

After passing quite quickly this time through immigration and customs (much better than my Heathrow experience) I thought that after boarding the bus we would be quickly on our way. Not so. We sat there for fifty minutes waiting for everyone to clear the airport (fair enough) including those who's bags were misplaced.

Then we drove for an hour over roads reminiscent of Christchurch on February 23 last year passing lots of people walking along the shoulders or standing waiting for buses in pitch black darkness disturbed only by the occasional roadside fire or dim fluorescent light outside someone's house.

After an hour we arrived at the resort which this trip was the Intercontinental. At that point the expectation was that one would drop bags and attend the dinner. But having been on the road since 8.30am that morning driving to Wellington Airport, waiting, flying to Auckland, waiting, flying to Nadi, waiting, getting on the bus, waiting, then driving to the resort ten and a half hours had passed. So I flagged dinner and worked instead after a good lie down.

That is I flagged dinner after finding my unit – and if you have travelled to an unfamiliar Fijian resort arriving at night-time you will know that this is not an easy thing to do. Resorts by their very nature are spread out. So one does not simply walk along a corridor to locate one's room. You need a guide.

But the problem is that you arrive en masse, disgorge from the bus, massage your backside after an hour of bumpy roads, hastily register and are given your room key, then a hand politely points in the general direction of where you should go to find your room. Being increasingly challenged when reading things close up I mistook a telephone extension for my room number so went well astray to start with before latching onto a group who had secured a guide and eventually finding my unit.

The units at the Intercontinental have the best outside seating areas of any I have ever seen on this planet. The pools are okay (I didn't swim), but the beach is dangerous and one suspects that the complex targets other than largely families for its clientele – of which there were not many at this time of year – apart from some loud Aussies getting drunk and married.

And the service standards – nine out of ten, except for the face flannel which disappeared the first morning and was never replaced, failure to refill the mini-bar on the last full day (chips and lollies are my hotel room weakness and often dinner), and absence of the dinner menu page in the Room Service booklet. But the breakfast cappuccino was surprisingly good, the nibbles at conference break times also very good, the staff of course amazingly friendly (though they don't say bula to each other as often as they do to us guests), the seating around the pools plentiful, the resort architecture very nice, and the activities schedule seemed good for those who took advantage of it.

All up probably a good place for a holiday – but just another hotel room for gnarly road warriors like myself.

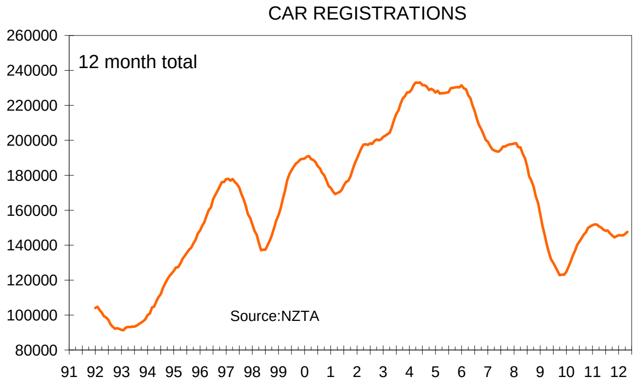
Is Our Economy Getting Better or Worse?

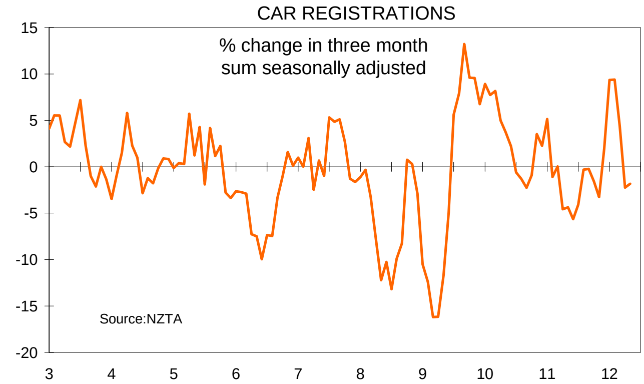
In this section we look only at what the data are actually telling us and pay no attention to forecasts or intentions measures.

The data we analyse here either refer to a housing sector undertaking a recovery which will carry it forward a good number of years, or other sectors which have yet to feel the effects of the deepening crisis and plummeting growth prospects offshore. So we need to be careful about the conclusions we reach here regarding overall strength in our economy until we see data which captures the new worries regarding Europe.

Are householders opening their wallets more?

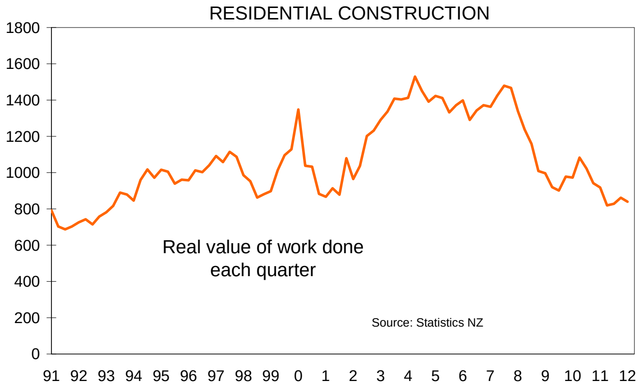
In May there were 12,735 cars registered around New Zealand. This was a rise of 10.3% from a year ago and in the three months to May regos were ahead 5.6% from a year ago but down 2% seasonally adjusted from the three months to February. This means that car registration growth has essentially petered out and is suggestive of a pullback in consumer spending though we treat the data with care given distortions which can be caused by imported car rule changes.

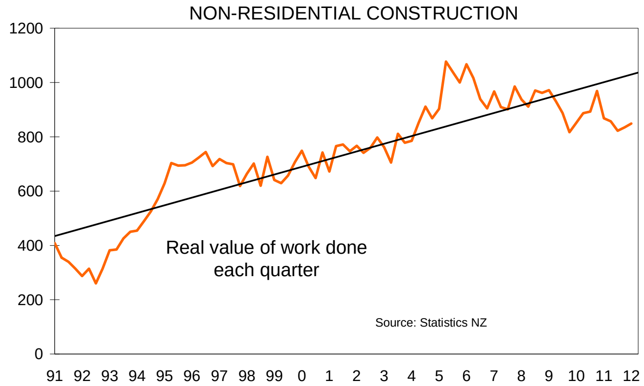




Is business output rising?

The volume of residential construction completed during the March quarter fell 2.4% after rising 4% in the December quarter – thus showing that so far the recovery in house building is very muted following a fall in activity to its lowest level in 18 years. Activity was 8.5% lower than in the March quarter of 2011. With regard to non-residential work activity improved 1.7% after rising 1.6% in the December quarter. Non-residential building is recovering from an eight year low at a very slow pace as well.





Are businesses hiring more people?

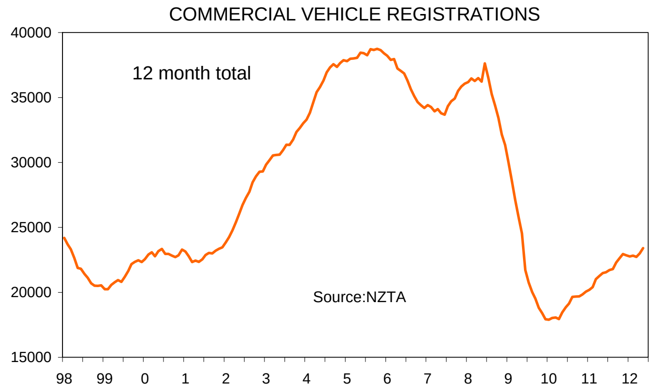
Nothing new and unfortunately the monthly National Employment Indicator compiled on an experimental basis by Statistics NZ has been canned due to issues achieving consistent returns to IRD of employer payrolls.

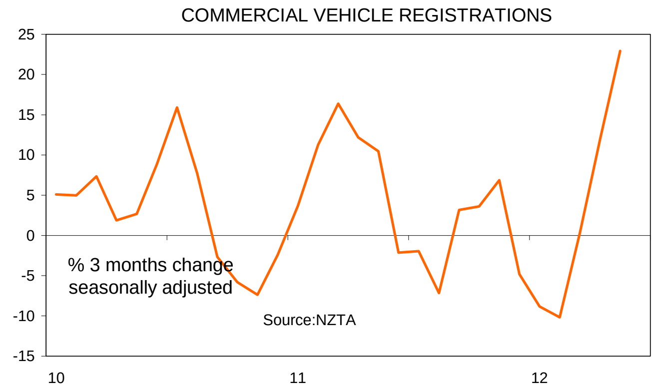
Are businesses boosting their capital spending?

For equipment no. Buildings = mixed.

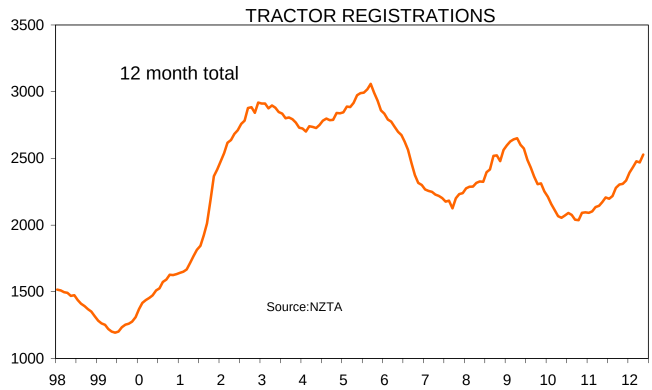
To see how businesses are feeling right now one can read our monthly BNZ Confidence Survey here. http://tonyalexander.co.nz/bnz-confidence-survey/

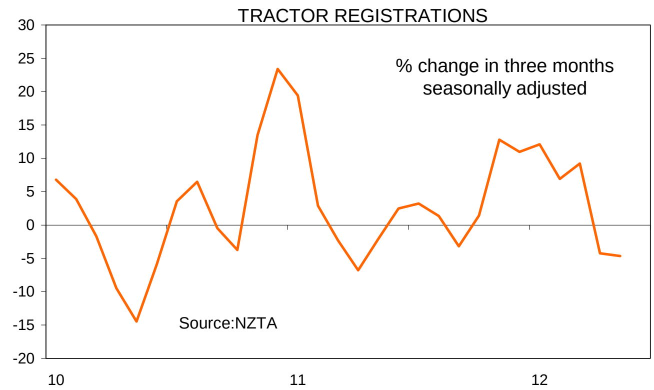
In May there were 2,614 commercial vehicles registered around New Zealand which was a strong 18.6% rise from a year earlier. Registrations in the three months to May were ahead 9.4% from a year ago and in seasonally adjusted terms were up by a strong 23% from the three months to May. This is a very good sign that some business investment is occurring and helps underpin our positive (though cautious) outlook for growth in the coming year or two.





At first glance farmers would appear to be spending up large again with tractor registrations in May ahead 35% from a year ago at 230. Plus, for the three months to May tractor regos were ahead 19.2% from a year ago. But regos were down 4% seasonally adjusted from the three months to February meaning that growth has stalled for now.





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.

INTEREST RATES

Soaring worries about the world slipping back into another recession produced fresh falls in wholesale borrowing costs this week. The three year swap rate for a while fell to near 2.6% from 2.75% last week, and a month ago, and 3.45% almost three months ago. The levels at which rates are at now are simply astounding. Never during even one's most insane moments during the past quarter of a century working as an economist in New Zealand have I imagined the likes of the five year swap rate sitting below 3%.

Having said that, yesterday wholesale rates bumped up a tad as Australia's economic growth rate for the March quarter came in more than twice expectations at 1.3% and this afternoon data showed employment ahead almost 40,000 in May. That is a strong result and Australia's continuing growth will be a key factor helping to underpin growth in our economy as export receipts elsewhere get hit by Europe's woes.

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	2.61%	2.61	2.73	2.76	2.68	5.7
1 year swap	2.48%	2.50	2.51	2.87	2.88	5.8
3 year swap	2.71%	2.75	2.77	3.31	3.85	6.1
5 year swap	3.09%	3.16	3.21	3.74	4.49	6.3

If I Were a Borrower What Would I Do?

If you are conservative like me then you'll probably find fixing for three years at 5.75% to be optimal. If you are more focussed on minimising short-term cash outflows then you fix 18 months for 5.1%. If you think the world outlook is terrible then you stay floating because our central bank is unlikely to lift interest rates until 2014. I do believe the outlook is terrible but I value rate certainty – hence I fix three years.

During the week I received the following email.

"… based on your bulletin in March he decided to fix for 3 years at 6.15%. Unfortunately the rates have dropped and he has a large Early Repayment Cost. I asked what he would like me to do and he said two things, one a lower rate with no cost to him. I told him in detail why we were unable to do that. He also asked that I pass on his comments to you so that other people who have fixed based on your advice will not be in the position he is in now.

I explained to .. that your bulletin is not giving advice and your views are your own. However the rates at the time are (sic) some of the lowest we have had for years and the deal he has now is a good one. I explained that he would not have taken up the rate if it did not fulfil his requirements and that is security of payments for the next 3 years, a low affordable rate. .. accepted my explanation."

The person concerned appears to have opted for the 6.15% three year rate on the basis of a belief that rates would not go lower. I certainly did not expect them to but my personal support for the 6.15% rate was not based upon either

- no expectation of further rate falls,
- anticipation of imminent fixed rate rises, or
- anticipation of floating rate rises.

Instead I was merely attracted by the low cost of achieving certainty of my mortgage costs for the next three years – namely only a 0.41% premium to pay over floating compared with a 1.4% premium back in November. To whit, from the February 17 Weekly Overview

"The gap between floating and fixing for three years has declined to only 0.41% from 1.4% three months ago and is now the lowest since March 2009. Personally I would take the three year rate because I like certainty and the 0.41% cost is very small. Most people however seem to be very comfortable sitting floating so if they change will probably only jump to the two year rate. The chances are however that with little discussion in the media regarding interest rate rises and picking low points, very few people will in fact shift away from floating. This will likely happen even though it is a complete gimmee because the chances of either the two year rate or floating rates falling again this year are low (though not zero given Europe uncertainty) and our official view is that the Reserve Bank will start tightening monetary policy before the end of the year."

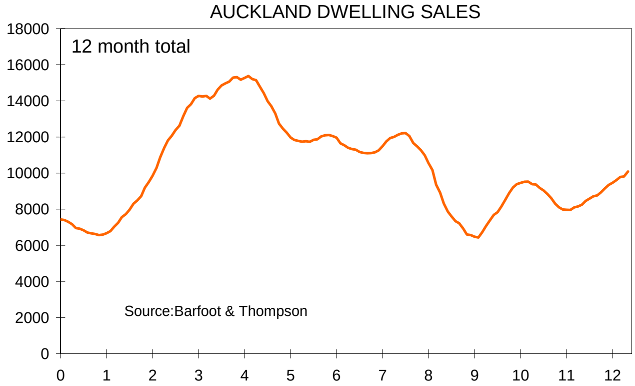
So yep, I am going to hang my hat on that non-zero chance of rate falls based on European uncertainty for the rest of this year!

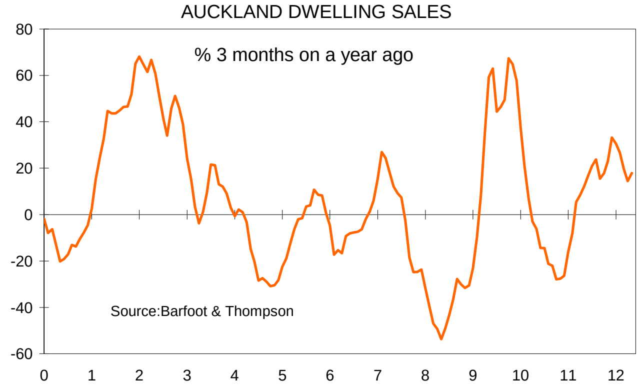
HOUSING MARKET UPDATE

- **To view the most recent results of our monthly BNZ-REINZ Residential Market Survey click here.** http://tonyalexander.co.nz/bnz-reinz-survey/
- **I also write a monthly column on the residential property market in NZ Property Investor magazine available at your bookshop or newsagent.**

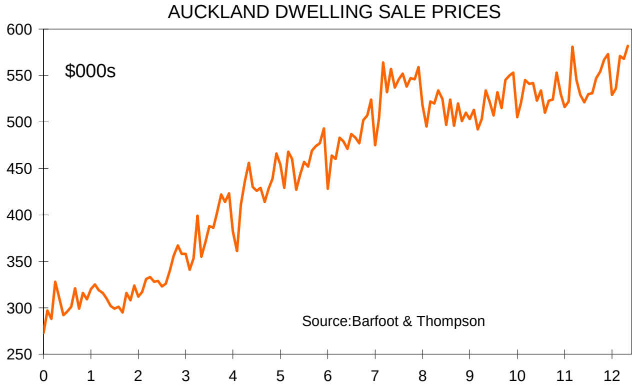
Auckland Powering Ahead

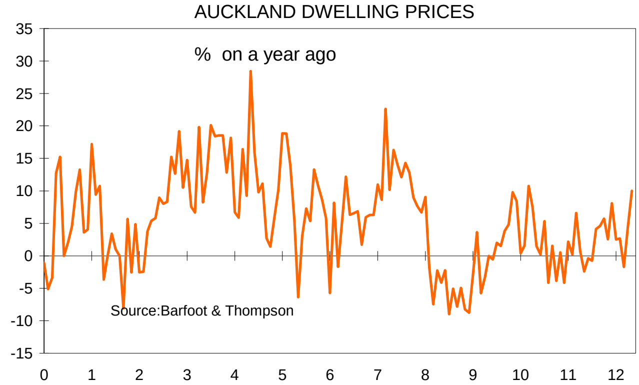
Barfoot and Thompson reported this week that they sold 1,165 dwellings in Auckland during May. This was a 31% rise from a year earlier and near 30% seasonally adjusted rise from April's Easter-affected sales. In the past three months sales have risen around 7% seasonally adjusted so there is a firm upward trend in place.





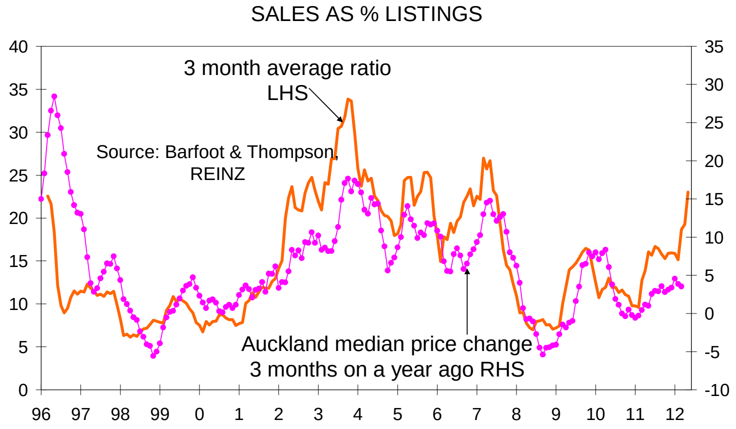
The median dwelling sales price firmed in the month to $582,000 from $568,000 in April which represented a 10% rise from a year earlier. This is quite a strong lift though smoothing over three months we see that the price is just 4% up from the same time last year. The trend is fairly clear however.





At the end of May Barfoot and Thompson had total listings of 4,356 dwellings. This was 18% fewer than a year earlier even though new listings received in the month were ahead 22% in number from May 2011. What this tells us is that an increase in listings is being easily swallowed up by sales. The ratio of sales to listings has in fact risen to a five year high of 23% in the past three months from just 16% a year earlier.

Properties are being snapped up. Look at what the graph below tells us will happen with prices as a result of the strong jump in the ratio of sales to listings.



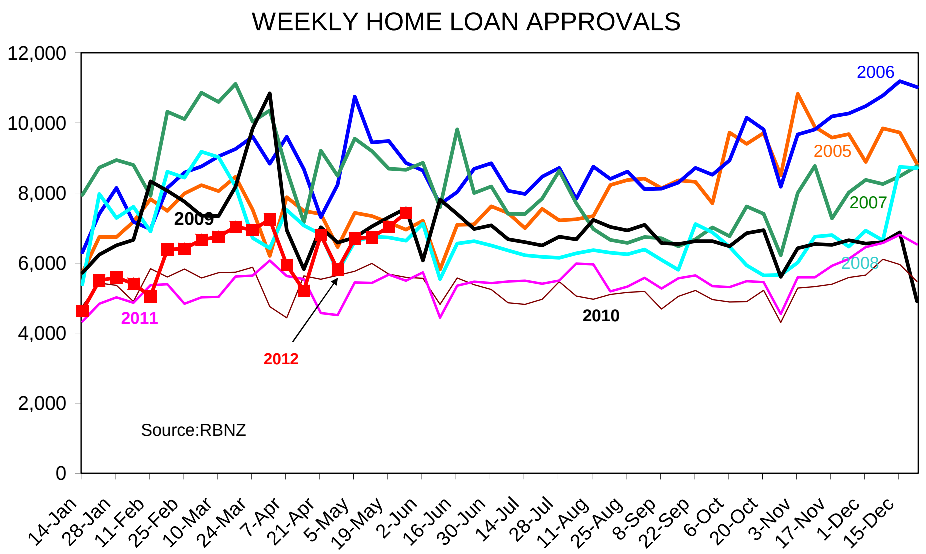
Welcome To The Twilight Zone

We Kiwis have a history of ignoring the Reserve Bank when it raises interest rates to try and stem a surging housing market. There is little prospect of interest rate rising in the next year and a half given the new Europe-induced global downturn now underway. But does anyone else have the feeling that the Reserve Bank must be a tad concerned at the recent sharp declines in fixed housing interest rates at a time when buyers are coming out of the woodwork (the young buyers and investors I have long written about), when banks are easing their lending criteria, and when some are using terminology in their near full page newspaper advertisements like "…we're not just lending money. We're giving it away." *

This is not the type of behaviour one would expect to see had the lessons of the 2008 crisis truly been learnt. Is there anything the Reserve Bank can do to slow the housing upturn without aggravating the clear negative hit the economy is about to take from events offshore?

First we need to get a better feel for whether the opening of the lending floodgates is actually leading to accelerated household debt growth. Then we need to see if there is solid evidence of the lending causing what could turn out to be unsustainable house price rise.

On the first point we can look at the weekly home loan approval data gathered up and reported by the RB, then the less up to date household debt data. What we have here is our messy graph showing weekly home loan approvals for each year starting in 2005 running from January on the left to December on the right.



The line we are interested in is the red one with red boxes along it. What we see is that after soaring ahead of Easter, then pulling back a tad, home loan numbers have reached weekly levels higher than in 2010, 2009, 2008, and 2005. Lending growth has lifted strongly.

Next we look at the monthly credit aggregates reported by the RB. Whereas the data above run to the week ending May 25, the lending data only go to the end of April. Seasonally adjusted household debt rose by 0.2% in April after rising 0.2% in March and February and 0.1% in January. There is no substantial surge in lending growth apparent.

Second, with regard to house prices, is there evidence yet of rapid rises? No – but keep an eye open. The stratified price index calculated by REINZ using methodology developed by the Reserve Bank for adjusting for changes in the mix of houses sold, has risen only 0.9% in the three months to April to sit 2.7% ahead of a year ago. Price rises are so far limited. But the monthly Barfoot and Thompson data discussed below shows accelerating price gains.

Therefore, while it might seem weird that housing is rising strongly while the world outlook crumbles, there is as yet no widespread sign of inflationary pressures building, and the lift in lending growth still leaves debt rising at an historically slow pace.

* Note that it is not just on the lending side that the advertising has changed to more explicit targeting of basic human instincts. On the deposit side one bank has been using the technique favoured by Mao Zedong and finance companies of creating outsider discontent, implying in this case that if you don't give your money to them then you are being ripped off by the banks. Their line runs "Don't be held back by greedy banks." The Mao reference is toward his ability to mobilise resentment against outside groups in order to garner support – much as one or two of our more high profile tub-thumping politicians have done repeatedly over the years. Disgraceful. The last time I looked those accusing banks of being greedy were either in court or living in luxury with other people's now long gone money.

I include this comment because it is relevant to what could happen over the next 20 years – a repeat of the finance company rip-offs. Each year more and more Baby Boomers will retire and realise they have not saved enough to be able to do what they hoped they could do had interest rates remained at the old high levels associated with a near two decade global debt binge. They will believe they have no choice other than to chase higher yields and will lend their money to new borrowers offering slightly more than bank interest rates and using the techniques I have written about here a few years ago.

These techniques include using high profile people who can build trust in order that depositors switch their brains off, and stimulating the fear emotion by making them believe that by not investing with them they are **missing out** on an extra 1% - 2%. This stimulus is 3 – 4 times more powerful than the attraction of **gaining** an extra 1% - 2%. The third element is presenting pictures of happy retired couples playing with grand children on a lovely beach (who wouldn't want that?). Be wary. Its your money they're after – not so much now, but in a few years time.

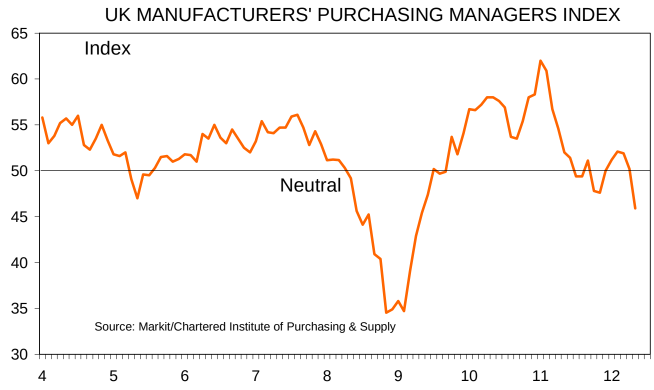
MAJOR OFFSHORE ISSUES

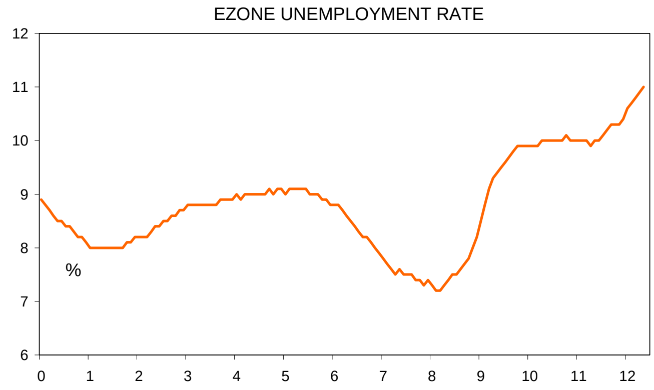
Europe

Europe's spiral downward toward potential major disruption of the Euro has accelerated over the past week in the face of bad economic data, major expressions of concern from the most senior people, and now clear signs of Europe's woes affecting the rest of the world..

- The EU Economics Commissioner Olli Rehn has warned of "disintegration" of the Eurozone if actions are not taken.
- The President of the European Central Bank has warned that the Eurozone as currently set up is not "sustainable".

- The monthly gauge of UK manufacturing sector strength – the Purchasing Managers Index – fell to a three year low of 45.9 in May from 50.2 in April. A decline to only 49.8 had been anticipated and some have described the fall as a “collapse”.
- The Eurozone unemployment rate has risen to a record high of 11% in May from 10.9% in April and 10% a year ago.
- The Eurozone PMI has fallen to 45.1 in May from 45.9 in April.





- Spanish industrial production has fallen by the most in two years and German production also came in unusually weak with a 2.2% fall in April following a 2.2% rise in March.

On the positive side the ECB President said that supplying unlimited quantities of money to banks for three month periods will be continued into next year but the three year loan scheme will not be reintroduced. He indicated also that although no change in the 1% cash rate was made this month there were discussions at the monthly meeting about cutting it. But with regard to the deepening domestic funding crisis for Spanish banks he said there is no “silver bullet.”.

The key problem for the Eurozone is that moves which are needed to make the Eurozone functional can only be undertaken over a long time period – fiscal union, European-wide banks, citizen buy-in to further integration and sacrificing of national identities.

One of the points I have been making during presentations over the past few weeks has been that the financial markets are losing faith in Europe and individual countries like Greece because they do not believe the strong measures needed to win confidence can or will be taken. This contrasts with the United States which has shown its mettle in the past, but more especially the United Kingdom which reformed itself under Margaret Thatcher.

Some other poor individual appears to have drawn the same analogy. In Greece this week a 61 year old father of two hanged himself in an Athens park and wrote regarding his despair about Greece and his descendants “At least they will know a foreign language as Greek will be abolished by then unless there is a politician with balls, like Thatcher, to fix both us and the state.”

Unfortunately the ascendant politicians in Greece are Nazis and radical left wingers threatening to bring down Europe in its entirety unless they are given more of other people’s money so they don’t have to change their tax dodging over-spending non-economic reforming ways.

This European crisis looks like spiraling into something exceedingly ugly perhaps in depth but more especially in lack of certainty. It is that lack of reasonable certainty about what will happen next which will act as a brake on business investment and hiring decisions around the globe and the willingness of consumers to spend – except here in New Zealand where we will keep buying houses because they offer more secure yields than other investments and because there is a shortage – as pointed out here since late-2004.

Australia

As had been widely expected the Reserve Bank of Australia this week cut its cash rate by another 0.25% having surprised the markets with a 0.5% cut a month ago. The rate now sits at 3.5% compared with 4.75% in October last year. In their words "At today's meeting, the Board judged that, with modest domestic growth and a weaker and more uncertain international environment, the outlook for inflation afforded scope for a more accommodative stance of monetary policy."
And
"Europe's economic and financial prospects have again been clouded by weakening growth, heightened political uncertainty and concerns about fiscal sustainability and the strength of some banks."
But
"In Australia, available indicators suggest modest growth continued in the first part of 2012, with significant variation across sectors. Overall labour market conditions firmed a little, notwithstanding job shedding in some industries, and the rate of unemployment remains low. Nonetheless, both households and businesses continue to exhibit a degree of precautionary behavior, which may continue in the near term."

Speaking of which, the Australian economy grew by a very strong 1.3% during the March quarter which was twice the pace expected and a clear reflection of the mining and infrastructure boom underway in the country. Non-dwelling construction jumped 12.6% in the quarter and engineering construction was 53% ahead of a year earlier. But household spending was also ahead an unusually strong 1.6% in the quarter in spite of major pain in the retailing sector. Retail spending actually rose by more than four times expectations in the March quarter with a gain of 1.8%. Putting this alongside the clear pain being revealed by retailers suggests margin management may have become almost impossible.

The December quarter GDP rise was also revised upward and that means that Australia's economy is now 4.3% bigger than a year ago and not 3.3% as economists had been estimating.

This news, coming during a week when monetary policy was again eased has generated a strong pullback in expectations for when the RBA will next cut interest rates and that is one factor which applied upward pressure yesterday to the Aussie dollar, our own currency against the USD, and wholesale interest rates. In addition this afternoon we learnt that Aussie job numbers jumped 39,000 in May to be 1% ahead of a year ago. The unemployment rate rose marginally to 5.1% from 4.9%.

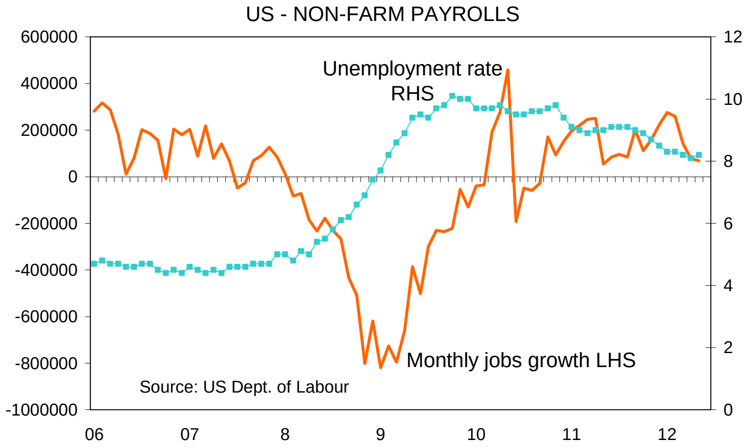
Note that whereas New Zealand has a household savings rate of +0.2%, Australia's is 9.3%. Australia had productivity growth from a year ago of 2%. We chug along barely positive – hence why it is so easy when asked about how NZ will close the income gap with Australia to reply that it will never happen. NZ is destined over the decades to become poorer and poorer compared with Australia – thus answering slowly over time the question someone put out there over a decade ago – What city will New Zealand more resemble in 50 years time, Sydney or Suva?

United States

One of the key issues in the United States is (obviously) how to get faster employment growth. The most recent monthly job numbers have showed jobs growth slowing down and one must admit that the chances of jobs growth accelerating in the near future given what is happening in the Europe and the way the greenback is appreciating are fairly low.

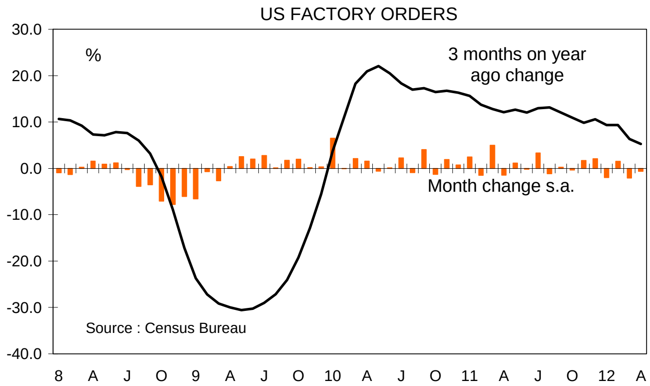
A key labour market problem is trying to figure out if the weak jobs growth is the result of weak demand for employees – in which case some additional fiscal or monetary policy stimulus might have a good impact – or a result of the unemployed not having what employers are looking for. If that is the case then artificial stimulus will not work and instead there must be either a scaling down of employer expectations or a lifting of applicant skills.

For the record, in May US non-farm job numbers rose by less than half of what was expected with a gain of only 69,000. Worse, increases previously reported for April and March were revised downward by a total of 49,000. The unemployment rate has risen to 8.2% from 8.1%.



Whereas many people were prepared to discount the weakening in jobs growth seen in the March and April results that is not the case this time around and the outcome has been near universally interpreted as bad. In fact the general discussion now is around how for the third year in a row nascent recovery in the US economy appears to be petering out. Last year when this happened talk quickly turned to a double-dip recession being possible and the Dow Jones Index – which shed 275 points on Friday night – fell from 12,800 at the start of May 2011 to near 10,700 in early August before worries eased and it rose to near 13,300 at the start of April this year.

Other data released in the US this week have also been poor. Factory orders fell 0.6% in April after declining 2.1% in March.



But in spite of the data the US sharemarket gained 287 points last night on expectations that the Federal Reserve will engage in QE3 – a third round of printing money. Yet if such actions were effective this potential third burst of Federal Reserve bond buying would not be necessary. Faith in policies which have already failed suggests blindness to the true gravity of the situation.

China

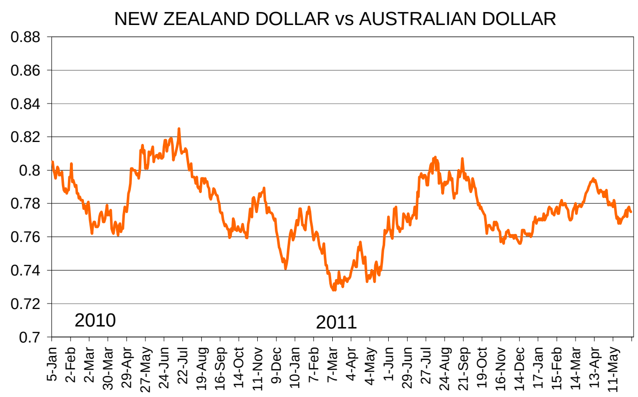
Chinese economic developments are now covered in our new publication “Growing With China”, the last issue of which appeared on May 22. If you wish to receive this monthly then please email me specifying your name, company name, and connection with China. Tony.alexander@bnz.co.nz

Exchange Rates

Exchange Rates	This Week	Week ago	4 wks ago	3 Mths ago	Yr ago	10 yr average
NZD/USD	0.771	0.754	0.795	0.812	0.813	0.67
NZD/AUD	0.775	0.776	0.781	0.770	0.759	0.85
NZD/JPY	61.100	59.600	63.500	65.600	65.2	69.6
NZD/GBP	0.498	0.487	0.492	0.517	0.497	0.388
NZD/EUR	0.613	0.609	0.608	0.619	0.558	0.52
NZDCNY	4.907	4.782	5.003	5.128	5.271	4.99
USD/JPY	79.248	79.045	79.874	80.788	80.197	105.7
USD/GBP	1.548	1.548	1.616	1.571	1.636	1.72
USD/EUR	1.258	1.238	1.308	1.312	1.457	1.28
AUD/USD	0.99	0.97	1.02	1.05	1.07	0.788
USD/CNY	6.3649	6.3425	6.2928	6.3153	6.484	7.56

Kiwi Rises 1.5 Cents

The Kiwi dollar has risen over one cent against the greenback this week in spite of deepening worries about what will happen after Greece's June 17 general election and with Spanish banks now all but shut out of all international markets with their depositor base steadily disappearing into other countries. The rise has been driven by much stronger than expected GDP and jobs data released in Australia yesterday and today, plus a surge in investor willingness to buy risky assets encouraged by rising expectations of a third round of money printing in the United States.



Is it likely that this rise will be sustained in coming weeks? Not really. Prospects for the Euro look fairly dire as the European Central Bank overnight has shown a bit more fortitude and adherence to its principles with the announcement that it does not plan compensating for the reluctance of governments to help themselves by repeating the over €1 trillion of loans made to European banks at 1% interest for three years undertaken early this year and late last year. This massive money printing exercise was aimed at giving banks ongoing liquidity support in exchange for an expectation that they will use some of the money to buy government bonds of the heavily indebted countries as happened earlier this year. They did but now they are recording losses on those investments, the underlying economic imbalances have become worse, and credibility of the ECB has been dented.

A full break-up is still a low probability scenario. But withdrawal of the Greeks looks highly likely and the irony is that if that occurs without economic collapse it will embolden the calls of others for their countries also to leave to Euro.

Europe as we know it is falling apart. So do you buy or sell NZDs? In the short term the risks for the NZD appear downward because of the escalation in global risk which the downward spiral of Europe entails. But further out the search for yield and exposure to Asia will see our currency go back up again. To decide on the timeframe for these potentially large moves you must form a view on if and when the Euro collapses, how quickly new currencies appear, the extent and longevity of the impact on the United States, Asia, and China in particular, and when the world economy turns back up again.

If you think you know when these things are going to happen you must stand in front of a mirror, tell yourself you are mad, and seek help.

Key Forecasts

Dec. year		**2010**	**2011**	**2012**	**2013**
GDP	annual average chg	1.2	1.1	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	3.00 – 3.75
Employment	on year ago	1.3	1.6	1.0 – 1.7	1.5 – 1.9
Unemployment Rate	end year	6.8	6.4	6.0 – 6.5	5.0 – 5.6

The Weekly Overview is written by Tony Alexander, Chief Economist at the Bank of New Zealand. The publication is sent to 26,000 subscribers each week and is one of a stable of regular releases which include the

- monthly Growing With China publication, http://tonyalexander.co.nz/topics/china/
- monthly BNZ Confidence Survey, http://tonyalexander.co.nz/topics/surveys/bnz-confidence-survey/ and the
- monthly BNZ-REINZ Residential Market Survey. http://tonyalexander.co.nz/topics/surveys/bnz-reinz-survey/ This latter survey provides information from a survey of over 10,000 licensed real estate agents on the current state of the residential property market in New Zealand.
- He has also written a weekly newspaper column since 1998, http://www.stuff.co.nz/business/opinion
- writes a column for the Farming Show posted at http://www.farmingshow.com/opinion/
- produces a monthly column for the NZ Property Investor magazine, http://www.propertyinvestor.co.nz/ and
- writes a monthly column for the NZ China Trade Association. http://www.nzcta.co.nz/

Most of these publications plus research into impediments to NZ's economic growth are available on his website. www.tonyalexander.co.nz

Tony Alexander has been Chief Economist at the BNZ since 1994 and apart from publications and advising management spends considerable time on the road around New Zealand making presentations and speaking with the media. He travels to the UK and Europe twice a year to assess economic conditions and present at numerous functions, has five children, and his partner Dr Sarah Farquhar runs the early childhood education network www.childforum.com

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