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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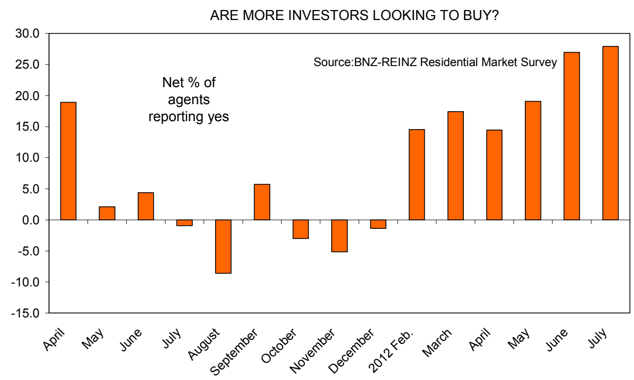
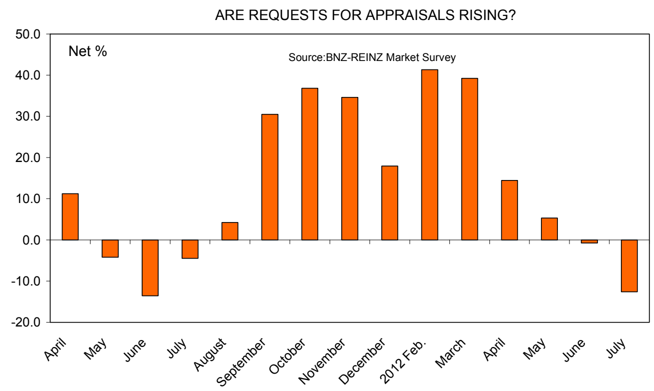
Short and Sweet

This week I am in Sydney having attended an economics conference so time has been tight and this intro section is therefore short. Suffice to say I heard nothing at all to give me confidence that the situation in Europe is about to turn for the better and in fact most of the speakers used various ways of saying that things are going to get worse and the situation will be around for many years.

For ourselves that brings the implications of a volatile but probably still well supported NZ dollar (the other currencies look like rubbish), continued low interest rates because credit demand globally will remain low, and the risk of further declines in commodity prices. Yet this week our monthly BNZ Confidence Survey recorded a small improvement in sentiment about where the economy will be in a year's time to a net 9% optimistic from 5% pessimistic four weeks ago. This reading is however toward the bottom end of the range in sentiment over the past three years and not suggestive of any particular strength in investment, employment growth, or economic growth.

But our monthly BNZ-REINZ Residential Market Survey also showed further rises in measures of buyer interest, a decline in the numbers of people thinking about selling, and clear perceptions among responding real estate agents of prices rising and that buyers are much more motivated than sellers. So the housing market in NZ continues to rise and as construction gets going in Christchurch and Auckland (less so elsewhere) this will be a clear source of growth stimulus going forward.



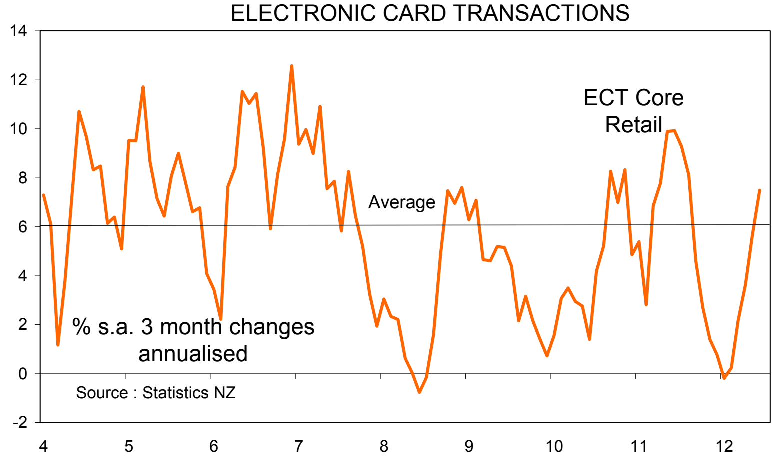


Is Our Economy Getting Better or Worse?

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

Are householders opening their wallets more?

The monthly data from Statistics NZ's Electronic Card Transactions series continue to show very strong growth in spending by you and I. The core spending measure increased by a high 0.9% for the second month in a row thus taking June quarter growth to an annualised pace of 7.5%. We have previously noted a tendency for this measure to over-predict retail spending, which is something one should not get pedantic about because SNZ explicitly warn people like me not to use it as a proxy for retail spending changes. But it is the best up to date proxy available so one does of course.



The data suggest good spending growth but this is not supported by the comments from those involved in the retailing sector received in our monthly survey (at least not the majority of them). To whit…

- Retail sales and service electronics Manawatu. We have hung on and hung on but I think any upswing now is too late for us. We need people to spend money. Again what goes around comes around.
- Food processing. There is no growth in grocery. Innovative new products are hard to launch. Export is the way forward.
- Retail Flooring Bay of Plenty. Getting more than our share, not without a lot of effort though !! Call To Action promotions are working very well ! New housing will be the reason for an upswing.
- Hardware wholesale. June was a quite month and behind last year - market remains subdued.
- Importing wholesale distribution. Erratic consumer demand, high end product is steady, low end weak. Retail overall sluggish.
- I don't know quite why but we are up 10% on last year working on keeping it that way . Florist Auckland
- General/Academic bookseller - Not too awful - people still like books, students always leave it to the last minute and expect their book to be there.
- Wet fish, and takeaways.. getting harder and harder. Unable to increase prices to cover ongoing and regular increases in overheads
- Retail - clothing - things are dire. People aren't shopping, just looking. Worst month ever, overheads are fixed and pruned back but if sales don't improve in coming weeks, closure seems likely.
- Flat & hard through winter. Bike wholesale.

Still, up is up so growth is happening.

Is business output rising?

Nothing new.

Are businesses hiring more people?

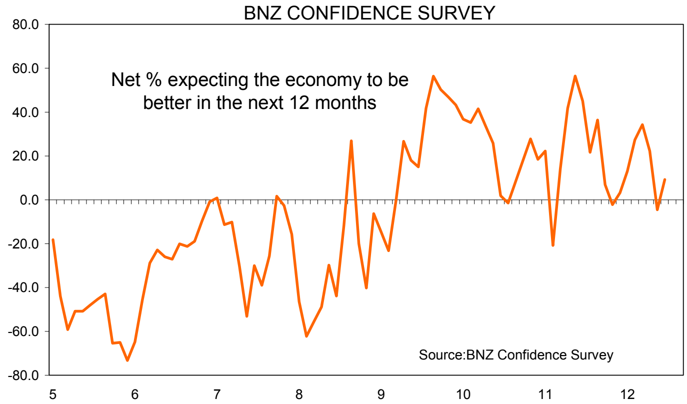
Nothing new.

<u>Are businesses boosting their capital spending?</u>
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/

What Do The Leading Indicators Say?

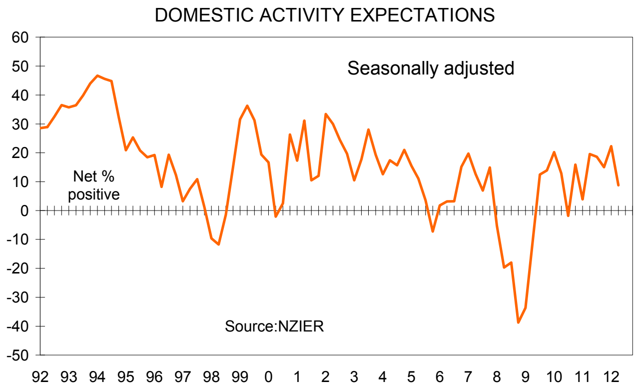
In this section we look only at the factors which can at times give insight into where the economy is headed. Generally we will only cover newly released information.

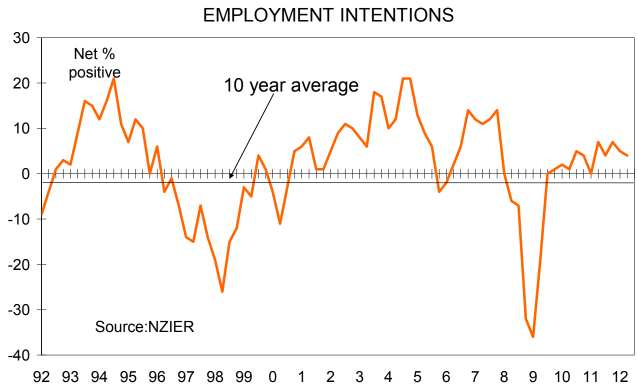
Nothing much too positive I am afraid. While our monthly BNZ Confidence Survey improved to a net 9% optimistic about the economy in a year's time from a net 5% pessimistic a month ago, the level of sentiment is at the low end of its range still for the past three years. In addition, to the extent the rise in confidence reflects feelings that Europe's worries are off the boil, the resurgence in Spanish bond yields this week suggests that were we to run the survey again this week the result would be somewhat less positive.



The NZIER released their long-running Quarterly Survey of Business Opinion also this week and frankly one struggles to find much in it justifying hopes of strong growth in the near future for our little economy.

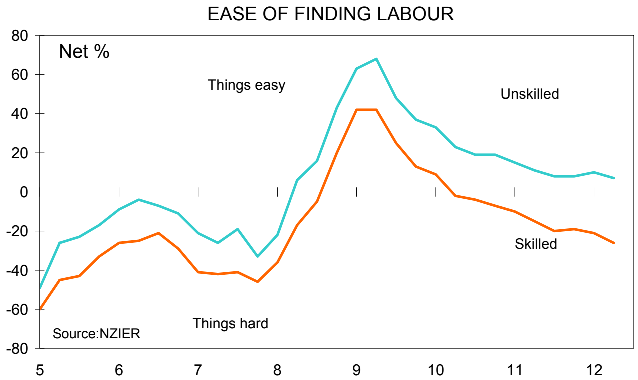
- The headline confidence number fell from 13% to -4% which in seasonally adjusted terms is actually worse with a fall from +21% to -1%.
- Business employment intentions fell to -4% from +1% in the March quarter which is below the 3% ten year average.
- Expectations for staff overtime fell to -14% from -4%.
- Business expectations for their domestic levels of activity fell to only a net 8% positive from 17% last quarter – the weakest outcome since early 2011.





But just reinforcing the fact that interest rate risks facing borrowers are low, the net percent of businesses expecting their costs to go up fell from 32% to 24% and the net percent planning to raise their selling prices declined from 23% to 10% which is the lowest reading since June quarter 2009.

One would have to say that on the basis of those results monetary policy won't be tightening for a long time – except there are actually other results which suggest things are not quite so rosy on the inflation front. First, in spite of the unemployment rate being at 6.7% and fewer businesses planning to hire people, more businesses are having difficulty getting staff. A net 26% say it is hard to get skilled staff which is up from 21% in the previous quarter and the highest such result since the start of 2008. Now that is interesting!



In addition, the capacity utilisation rate for builders rose to its highest reading since mid-2010 and for non-exporters all up rose to a seven quarter high. None of these readings are particularly high as yet but the movements are interesting.

All up the NZIER survey says to us that low growth at best remains in the offing.

INTEREST RATES

Nothing much to say really. There is upward pressure on rates one day because Europe looks better, then downward pressure the next as Europe looks worse. Rates this week are lower than they were last week because – ta daa – worries about Europe have increased again. Next week if European worries deepen rates will fall further. If European worries ease, NZ interest rates will rise.

This is not to say that Europe is the only driver of our rates. The state of the US economy is relevant also, and in that regard there was additional downward pressure on NZ rates from yet another weak jobs report. And on top of that, although the relationship is still small (but growing), China's monthly data releases have been on the weak side.

It all adds up to a situation of minimal predictability of interest rate movements because one cannot predict the main rate mover currently – European investor sentiment shifts. There is little prospect of NZ monetary policy tightening for a very very very long time given the downward drift the world seems to have got itself into.

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	2.70%	2.68	2.73	2.76	2.68	5.7
1 year swap	2.67%	2.78	2.58	2.84	3.02	5.8
3 year swap	2.91%	3.06	2.83	3.25	3.90	6.1
5 year swap	3.21%	3.39	3.18	3.69	4.49	6.3

If I Were a Borrower What Would I Do?

I would fix three years because I am cautious and would like something to be certain in these increasingly uncertain times. However I also think floating is just fine given that the chances of the Reserve Bank tightening monetary policy in the next two years are not particularly large. I am concerned about where things are going with regard to growth in Europe and the United States, less optimistic to a small degree about China (where the big risk is more social unrest hitting growth than “normal” economic factors some year down the track), and only mildly assuaged by the continuing growth of Australia’s economy. NZ commodity prices have fallen about 20% from their peak and further declines look likely, local sentiment levels are poor, household finances are under pressure from poor wages growth yet rising costs (insurance), and the NZ dollar nonetheless is strong and likely broadly to remain so.

This latter currency factor is important. A high NZD (mainly because most other currencies look bad) keeps imported goods prices down, encourages spending on those goods and foreign travel, and suppresses export receipts. The firm NZD acts to stay the hand of our central bank. In addition, the NZIER’s QSBO released this week showed some big falls in business cost and pricing expectations (discussed above).

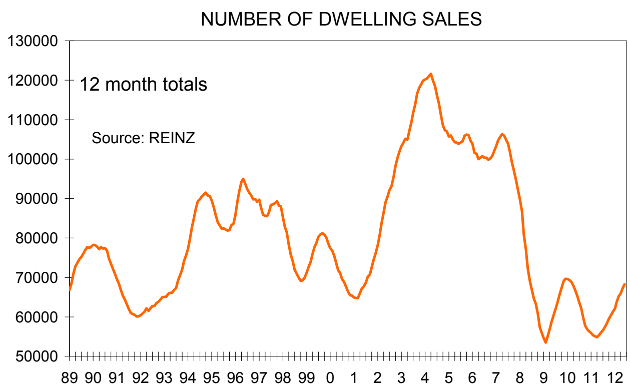
So if you choose to stay floating I think you will enjoy low rates for quite a long time. But remember that you get no rate certainty, and if your strategy is to float then one day fix you run the risk of things suddenly brightening offshore and those fixed rates bumping up before you can lock one in. And for the record, the experience of the past three years proves that none of us can pick when fixed rates will undergo their structural shift higher.

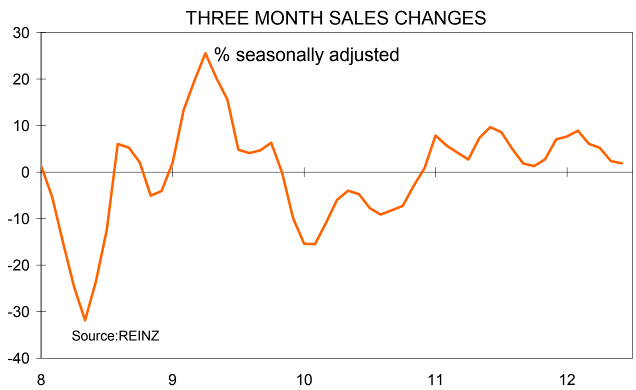
HOUSING MARKET UPDATE

- **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.**

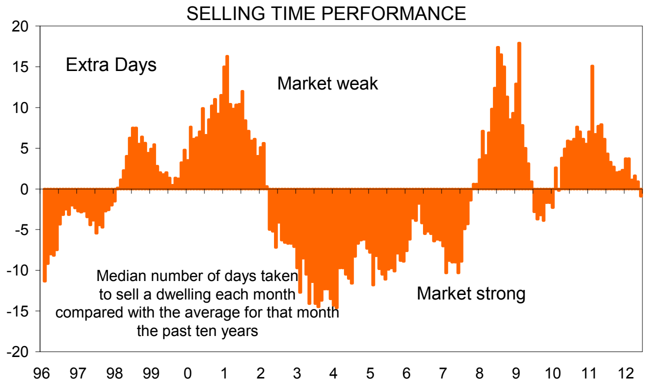
Upward

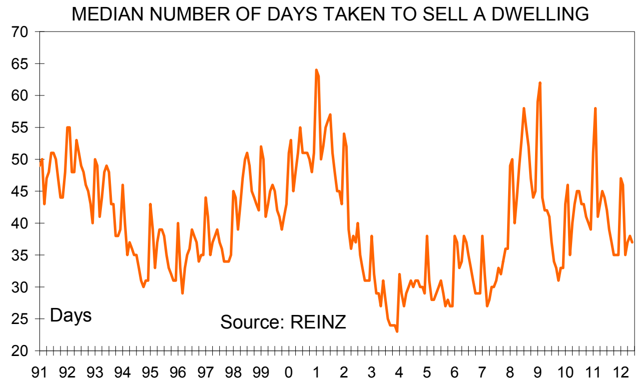
REINZ nationwide data released this week show that in June there were 17.3% more dwellings sold around the country than a year earlier. For the June quarter sales were 18.8% ahead of a year ago and for the entire year were 21.8% up from the year to June 2011 at 68,243. This is the highest annual number of sales since March 2010 but well down from levels over 120,000 early in 2004. In seasonally adjusted terms sales rose just 0.1% in June to be up 1.9% in the June quarter. That is not a particularly fast pace of growth and that could be because of listings becoming harder and harder to find. If so then we would expect to see properties selling more quickly. We do.



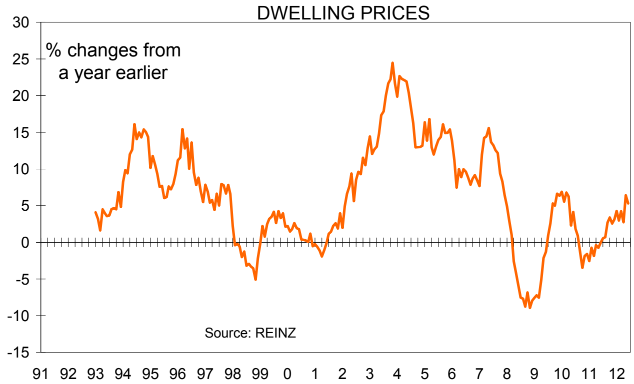


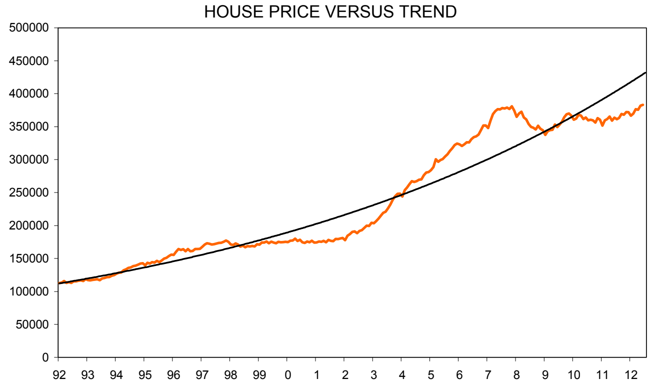
On average in June it took 37 days to sell a dwelling. This was 0.9 days less than the average for June and as such is the first time turnover has been quicker than average also since early 2010.





With sales rising and listings tight it is unsurprising that prices are rising – with a 0.3% rise recorded for June and 2.5% gain for the June quarter. The median dwelling sales price adjusted for quality changes was 5.3% ahead of a year earlier.





Basically the housing market is doing what the articles in the newspapers are now saying – going up.

MAJOR OFFSHORE ISSUES

Europe

So that was that. The poultice was applied, yields on debt issued by the recalcitrant governments fell – and now they are going back up again with Spanish ten year government bond yields once more close to 7%. Nevertheless, the ECB met expectations last Thursday night by cutting its cash rate 0.25% down to a record low of 0.75%. It is now below the level it was taken to when worries about a global Great Depression were at their peak in late-2008 and early 2009, and they have cut the rate 0.75% after managing to raise it 0.5% to 1.5% between April and July 2011. In other words, in terms of how much help they feel they need to give the European economy the requirement is now more dire than back then and the situation has worsened considerably since November last year when they started cutting the rate from 0.5%. In fact the optimism which drove the rate up 0.5% to 1.5% lasted only seven months last year.

The Bank of England also eased monetary policy on Thursday night but via an extra £50bn quantitative easing rather than via a change in the already very low 0.5% base rate.

During the week a Kiwi living in Spain sent in these insightful comments.

"I read the Anglo-Saxon news about how bad the banking and economic situation is in Spain and so on, but the recognition of this by normal Spanish people is next to zero. They know about it but, they have their life and nothing has changed for them, so they are happy in their little bubble and news is all about crooks and make believe money that they never had in the first place. So nobody is wringing their hands in anguish, and if you don't turn on the TV then you'd never know there was a problem.

They all know unemployment is 30% around here, and this has depressed prices so a coffee will set you back only 1 euro. The costs in Madrid or Barcelona are pretty high, (just damn tourist traps) but provincial prices are very low. Locally I buy beer for one euro at a bar, or Heineken ~50c each at supermarket. Generally supermarket shopping is 75% of NZ supermarket prices when converted to NZ$, so it is cheaper here.

So, if you have money and/or a job, Spain is a fantastic place to live because prices are depressed, it is cheap to live here and the weather is rather nice too. In fact I thoroughly recommend it. The NZL currency is strong against the pound, but still prices in the UK are painfully high.

Many young Spanish people live at home because there is no work and unemployment could end up stretching across generations and entire 'working' lives where the kids / gran-kids never leave home. So I would say the crunch at ground level has yet to come and it could get really bad. If nobody has any money to spend then prices will go down a lot more, they will have to. This will make Spain an even better tourist destination, but pity anyone who has to live here and has to figure out how to put food on the table.

So far the Spanish population don't see it coming, it might cause panic if they did. Some do I guess as there are regular protests. I can't see how work / jobs or money will materialize in this downward spiral and I don't think the true state of local government debt or banking bad debts have yet become apparent. So, eventually I think the proverbial will hit the fan, but at the moment the crisis is at the government level and not yet reaching the man on the street. Give it another 24 months of this and the situation could be dire. It may become too depressing to want to visit here by then.

Out of work Spanish people are applying for jobs all throughout Europe, they use up their remaining cash to fly to job interviews, but they never get the jobs because their English or the local language is not quite good enough. They are trapped."

Australia

No time to write anything.

United States

Prospects for growth in the United States are deteriorating – that is why in spite of the initial euphoria over the European summit meeting of a couple of weeks ago the yield on ten year government bonds is back pushing new record lows near 1.5% rather than rising to 1.7%.

Non-farm job numbers in the United States increased by only 80,000 in June which was an outcome less than the miserable 90,000 expected and stretches to four months the period during which jobs growth has been anaemic. It appears clear that the earlier lull in jobs creation was not merely the result of jobs growth being pulled into January and February due to sharp weather changes but instead reflects businesses newly exercising caution in an increasingly uncertain world.

Attention has now turned to what the Federal Reserve will do to try and assist growth – which of course is a complete gip and illustrates yet again that so many people fail to grasp the true nature of the problem at hand. It is simply that after many years of binging on credit with the Fed. always jumping in to keep downturns and debt servicing problems short-lived, American citizens need to stand on their own two feet and finance their own way forward rather than rely on someone else's money.

This process of deleveraging back toward more tolerable debt levels clearly has further to run and if the Fed. had the ability to radically shorten the period of adjustment and weak growth then we would not now be talking about more money printing and efforts to lower interest rates further. As in Japan for two decades now the issue is not so much one of the cost of credit but the willingness to borrow and spend in the first place.

All the Fed. can do is keep interest rates low for as long as possible so that low debt servicing costs allow people to accelerate the pace at which they reduce debt principal. The Fed. actions will shorten the total period of adjustment undoubtedly by a few years, but cannot prevent the debt attack from occurring in the first place as their actions did during the 1990s and 2000s.

China

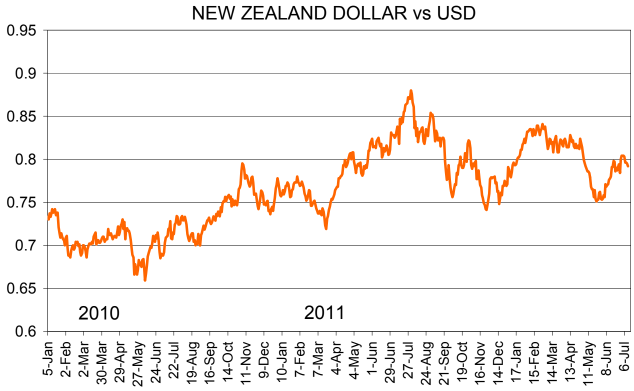
Chinese economic developments are now covered in our new publication "Growing With China", the July issue of which will be released in the 23rd. If you wish to receive this monthly then please email me at Tony.alexander@bnz.co.nz

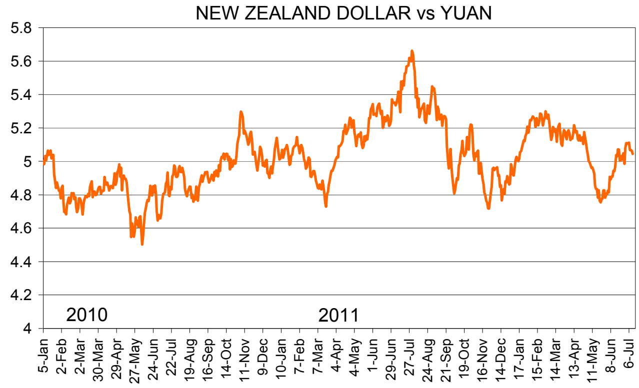
Exchange Rates

Exchange Rates	This Week	Week ago	4 wks ago	3 Mths ago	Yr ago	10 yr average
NZD/USD	0.792	0.804	0.771	0.820	0.829	0.67
NZD/AUD	0.778	0.782	0.778	0.795	0.778	0.85
NZD/JPY	62.900	64.200	61.200	66.400	66.5	69.6
NZD/GBP	0.511	0.515	0.497	0.515	0.521	0.388
NZD/EUR	0.647	0.641	0.617	0.625	0.591	0.52
NZDCNY	5.045	5.104	4.908	5.166	5.361	4.99
USD/JPY	79.419	79.851	79.377	80.976	80.217	105.7
USD/GBP	1.550	1.561	1.551	1.592	1.591	1.72
USD/EUR	1.224	1.254	1.250	1.312	1.403	1.28
AUD/USD	1.02	1.03	0.99	1.03	1.07	0.788
USD/RMB	6.3694	6.3486	6.366	6.3	6.4671	7.56

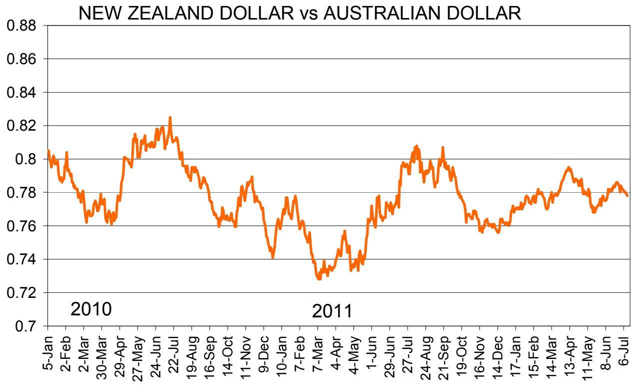
Kiwi Down

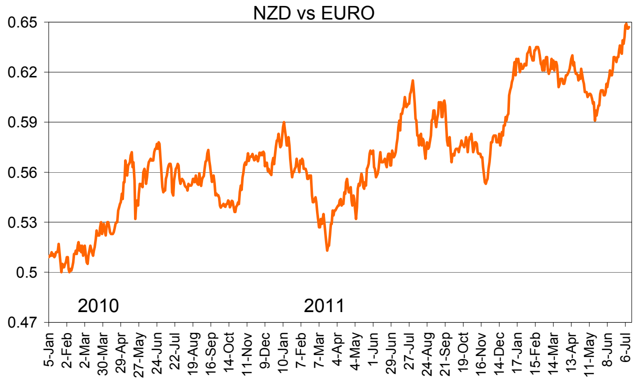
Worries about Europe have risen again in the past week so increased risk aversion has pushed the NZD down against the US dollar and Japanese Yen mainly. We have however risen against the Euro which investors are finding less and less attractive.

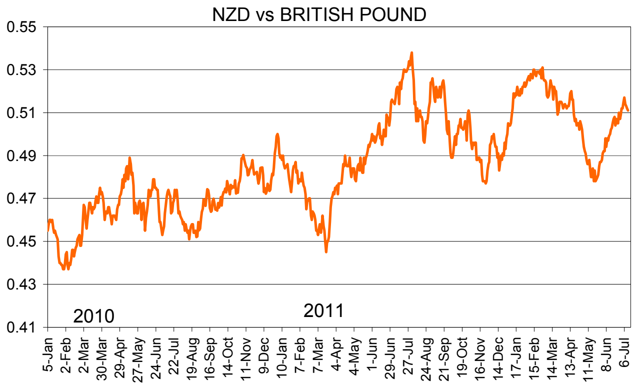


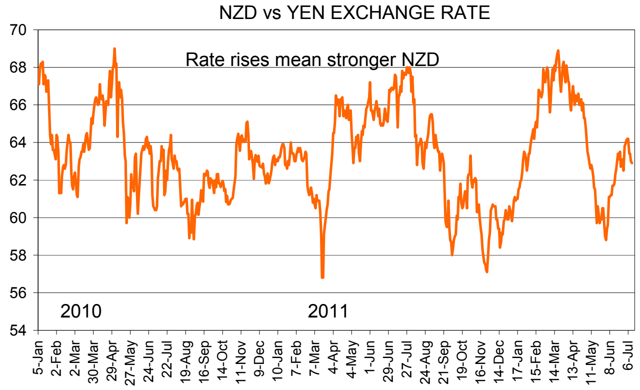


Currently in the United States there is a lot of attention on whether the Federal Reserve might print more money. If they do we can expect some slight decline in the greenback which could see us consolidate above US 80 cents again. But realistically, the big mover for the NZD will remain changes in sentiment regarding Europe and as e continue to note, if sentiment improves next week the NZD will go up, if sentiment worsens the NZD will go down. We cannot predict such sentiment shifts. Good luck.









Key Forecasts

Dec. year		2010	2011	2012	2013
GDP	annual average chg	1.8	1.4	2.0 – 2.7	2.5 – 3.5
CPI	on year ago	4.0	1.8	1.5 – 2.0	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	1.5 – 2.0	1.0 – 1.5
Unemployment Rate	end year	6.8	6.4	6.0 – 6.5	5.0 – 5.8

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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