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.

A Summary

This is the first Thursday for the month so if you have not already done so in the email used for sending the WO out please feel free to click on the link below and let us know if you think our economy in a year's time will be in better or worse shape.

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

This is what you need to know regarding how our economy is tracking at the moment.

Growth in the United States has slowed to 1.5% and unemployment is stuck above 8% with householders unwilling to spend and likely to remain focussed on debt repayment for X more years. The sharemarket rallies on expectations of stimulatory measures but these measures have already failed and the barrel is about empty for future ones. Throw in a looming fiscal disaster and it appears unreasonable to expect firm US growth in the future and the NZD is probably heading toward US 85 cents as worries about the US economy stalling grow.

In Europe debt is huge, the investors want their money back, the Euro has failed in its primary task of bringing Eurozone economies together, the politicians are out of ideas, and thankfully the Germans are holding the ECB back from printing money to make life easier for the incompetent countries which got themselves into their current position. Recession is likely for an extended period with a high probability of a new global financial shock.

In Australia growth is firm due to mining, engineering and infrastructure but other sectors are weak. There are growing worries about slowing Chinese growth and forecasts of the boom ending in two years. The country is split between strong and weak parts and migrants should give thought to where they are going.

Here in NZ we have downward pressure on growth from a worsening world economy, tightening fiscal policy, net negative migration flows, unwillingness to borrow, rising insurance costs, and a high exchange rate coupled with falling commodity prices. But we have support from the reconstruction of Christchurch and catch-up house building in Auckland, feelings of improving wealth in Auckland now that prices are rising, plus the Kiwi dollar is weak against the Aussie dollar and exports of goods and services to China continue to grow. Developing issues include a housing crisis, fiscal pressures further out, and huge vulnerability of the country's finances should another disaster occur.

The very rough outlook overseas means tightening monetary policy in New Zealand is a long way off and one cannot rule out the OCR being cut should things deteriorate substantially offshore. Our currency is likely to stay very strong against all bar the AUD and JPY while the labour market risks tightening up quite a bit next year as construction surges. The retailing sector is likely to be forced to continue to restructure due to a structural shift down in consumer willingness to spend.

Days In The Bush

So I walked the Heaphy Track again during three and a half days last week with stays at the huts Brown, Gouland Downs, James Mackay, and Heaphy. There was not a drop of rain and I encountered only three other trampers plus ten mountain bikers. The track has been opened to bikers from May – September for three years on an experimental basis and the consensus seems to be that it is working out okay – after all, only people like myself who detest crowds in the bush tend to be on it in winter anyway.

It has been seven years since I last heard (or acted on) the call of the wild and it was great to be in the bush again – even if it was only on a track more resembling a footpath (suitable for bikes remember) than good old Tararuas-like mud and tree roots. The Heaphy does not challenge your quads or knees but it can cause pain in the lower parts of your legs because of the often unchanging thud thud rhythm. It can bring blisters on your feet when normally you might not get them.

The bridge across the Lewis River has been washed out so if you are contemplating entering the area before Christmas when a new bridge stretching across the Heaphy upstream of the Lewis will probably have been constructed you need to be aware that if it rains the Lewis will rise quickly and you will not be able to cross. You then either sit it out or turn around and go back. You can wait in the Lewis hut if you are approaching from the Collinwood end of the track.

The river was low when I crossed so there was no issue, and if it had been up then I would have followed the rule I always emphasise to people regarding rivers – there is never one you need to cross. You can always wait it out and should be prepared to do so with extra food and some shelter in case a hut is not nearby or you are in a situation such as along the Karamea River north of the Wangapeka where it is quite easy to get caught between the side streams well away from the huts.

Three huts are being replaced on the track to cater for the huge numbers which use it during peak season (absolute peak is January so avoid it like the plague), with the Perry Saddle hut completed, work started on the Heaphy, and the Mackay hut to follow. The Perry Saddle hut is better than many people's houses – even with solar-charged and motion-activated small lights in the ceiling. There is gas on for most of the huts except Gouland Downs and rangers are there all year round now – which means that I got caught not paying hut fees this time whereas in the past no-one was ever there to check. It was a fair cop so I'll pay up when the bill arrives in the mail. $32 a night. Apparently some people still get aggro when caught – especially foreigners.

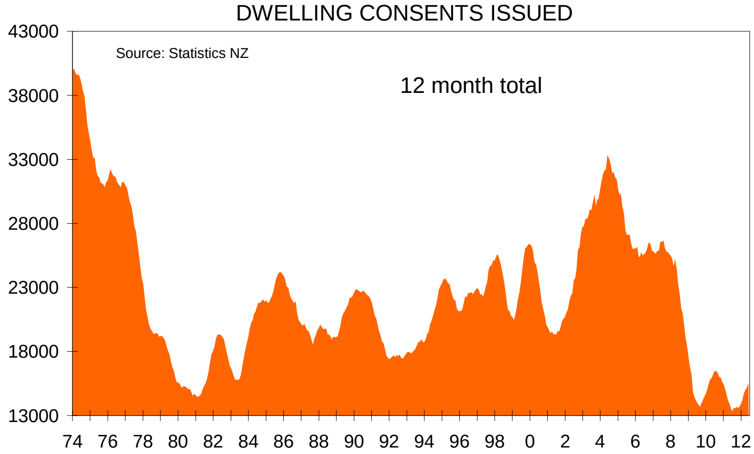
For me part of the tramping experience is the bit before and the bit after. The bit before is getting all the gear and food ready, studying the route, planning the transport, and stripping everything down so I end up with a light pack. The bit after is spending a night wherever I end up which in the case of the Heaphy is lovely frost-free Karamea where I always stay at the Last Resort. To get there from the track end you just call the local taxi (thanks again David), then for getting from Karamea to Westport there is a shuttle in the morning. I caught that which meant I spent a great day in Westport looking through the shops with a lot more enjoyment than I've ever had battling my way through foreign students along Queen Street or perambulating through Newmarket.

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 number of consents issued for the construction of new dwellings rose by a seasonally adjusted 5.6% in June to give a fall of 2.1% for the June quarter after a rise of 10.3% in the March quarter. Growth in house building is proving to be a stop-start affair but we d expect improvement clearly resulting from the rebuilding of Christchurch and catch-up construction in Auckland.



Speaking of which, in the June quarter the number of consents issued for the construction of new dwellings around all the country was 27% ahead of a year ago. For Auckland the rise was 26% and Canterbury 56%. Outside of these two regions growth was only 16%.

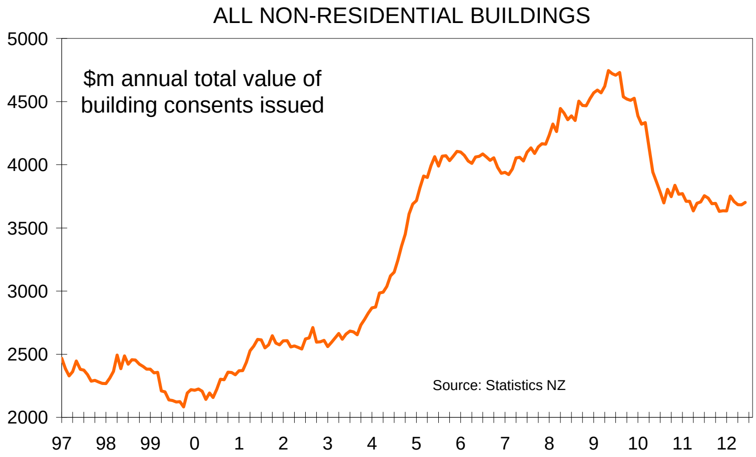
For the record, we can see further evidence of the household sector getting better with the seasonally adjusted rate of growth in household debt rising to 0.3% in June from 0.2% in May. This is the highest monthly growth rate since October 2009 and means annual growth has lifted now to 1.8% from 1% six months ago. This is very low however compared with growth which averaged 10% p.a. for the decade leading into 2007 – and hopefully we never see such growth rates again given the existing high debt levels of NZ households and the vulnerability such growth would create for the household sector.

Are businesses boosting their capital spending?

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

The value of consents issued for the construction of non-public buildings (as far as one can estimate) came in 4% higher in June than a year ago making growth a reasonably good 13% in the first six months of the year compared with a year earlier. So there is evidence of some business investment occurring in this area and the numbers will presumably before the end of the year receive a good boost from the start of the CBD reconstruction phase in Christchurch – though maybe next year would be a better call for that timing.

With regard to all non-residential construction consents the value was 8% ahead of a year earlier in June and just 4% for the first six months of the year. So as yet there is no reason for construction companies generally to be anticipating strong non-residential activity over the remainder of this year.

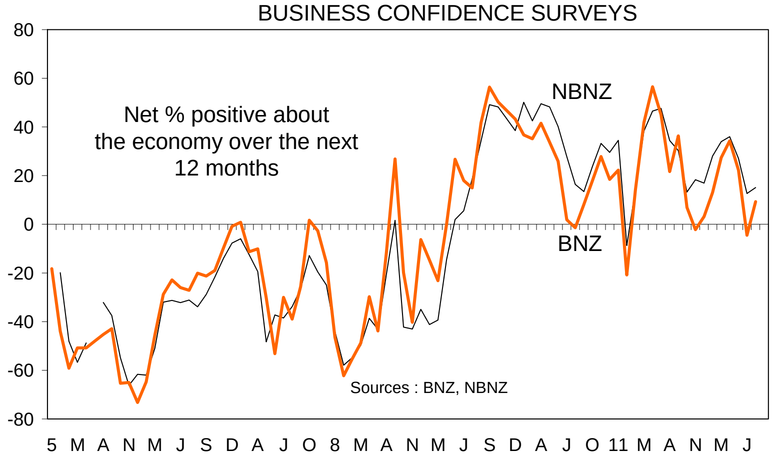


To the extent that it is an indicator of business capital spending growth – and it only is at the margin I feel – the acceleration in the annual rate of growth in business credit to 3.9% in June from 3.8% in May and 1.5% six months ago suggests growth is underway. This doesn't actually add anything to what we already know.

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.

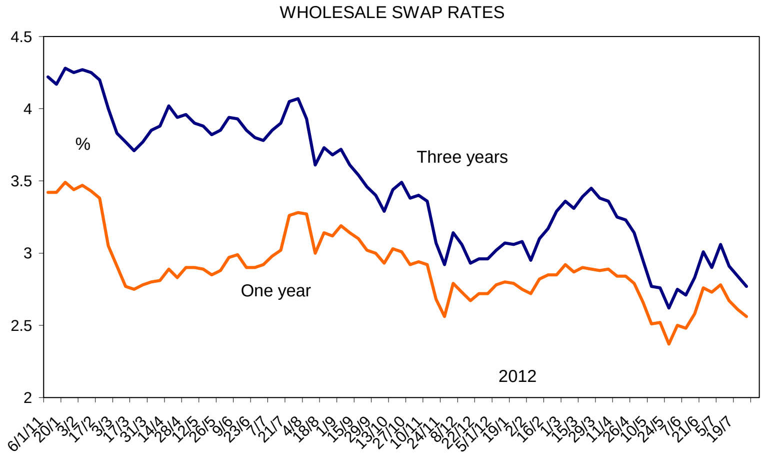
The NBNZ Business Outlook from their survey of 3-4 weeks ago came out this week and like our own of 3-4 weeks ago showed a small rise in confidence about the economy. Their measure rose to a net 15% positive from 13% in June. Of greater interest was a rise in employment intentions to a net positive 11% from just 3% in June while investment intentions rose to 13% from 8%.



The results back up our expectation of continuing growth in the NZ economy even as some parts of the rest of the world get worse and worse. We are so lucky to be here in this bush paradise.

INTEREST RATES

The Reserve Bank left the OCR unchanged at 2.5% last Thursday morning which was no surprise. The hopes of actions to spur Eurozone growth however led to rises in wholesale interest rates here in NZ as detailed in the table below. The trend in all these rates for now however seems flat and there is no way of knowing when rates will cyclically rise – or slump even further if a new global recession starts. It would seem to be a wise idea to minimise worries about completely unpredictable interest rates by perhaps minimising how much one borrows in these continuing massively uncertain times.



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	2.65%	2.65	2.68	2.77	2.70	5.7
1 year swap	2.73%	2.56	2.78	2.66	3.27	5.8
3 year swap	3.00%	2.77	3.06	2.95	3.93	6.1
5 year swap	3.28%	3.05	3.39	3.41	4.44	6.3

If I Were a Borrower What Would I Do?

Nothing new. I would fix three years but floating is fine as well.

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.**

No Fresh Data

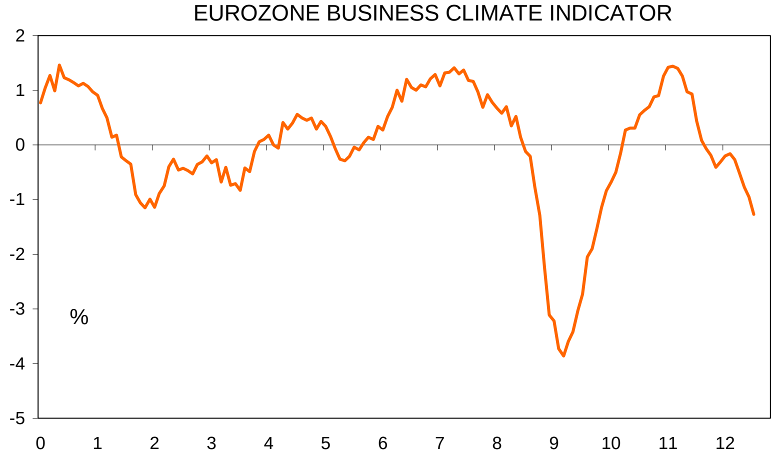
MAJOR OFFSHORE ISSUES

Europe

All bad.

- The week started badly with news on Wednesday night our time that the UK economy shrank by a horrendous 0.7% during the June quarter. An Olympian effort. Contributing to the decline were the day lost to the Jubilee celebration plus lots of rain. The decline followed 0.3% shrinkage during the March quarter and only a 0.2% fall had been expected for the June quarter.
- Hopes that the decline might quickly be reversed have been dashed with the July PMI coming in at a much lower than expected 45.4 from 48.4 in June thus showing a deepening recession in the UK manufacturing sector.
- Spain's unemployment rate has hit 24.6% with the youth rate at 53%.

- The Eurozone unemployment rate has moved up to a record 11.2% with almost 18 million people now officially classified as unemployed.
- The ECB President promised to do “whatever it takes to preserve the Euro”. No-one is sure what that means but the fact that he felt obliged to make the statement indicates that he – with far greater knowledge of the situation than perhaps anyone else – fears the Euro’s days are numbered. They probably are. But for now his comments generated optimism which led to rises in sharemarkets and falls in yields on Spanish and Italian government debt.
- Germany said it sees no reason for giving the European Stability Mechanism a banking license which would allow it to gear up by borrowing funds from the ECB and then purchasing the debt of governments investors don’t want. The Germans clearly have had enough of mutualisation of the debt problems that the southern European countries have brought upon themselves.
- Spain recorded a budget deficit equal to 4% of GDP for the first six months of the year – meaning its full year target of 6% looks like being blown out of the water.
- The Business Climate Indicator for the Eurozone fell to a far lower than expected reading of -1.27 in July from -0.95 in June. The decline if blindly extrapolated would suggest a fall in GDP during the July quarter of -1%. Yuk.



United States

The main US theme at the moment is one of growth slowing, unemployment stuck above 8%, and market speculation that the wonderful Fed. may ride to the rescue by - well there is the problem. Their actions so far have failed to cement in sustained good growth and one feels that the confidence investors have in the US central bank is misplaced. Hence I remain worried about the ability of the US sharemarket to hold up.

The annualised rate of growth in the United States economy slowed to just 1.5% in the June quarter from 2% in the March quarter. This slowdown plus clear signs of weakness in more up to date monthly partial indicators has spurred increased talk of the need for the Federal Reserve to take further stimulatory measures. When expectations of such measures being applied rise the US sharemarket gains – failing to grasp the simple premise that the measures can only cushion the existing decline and never sustainably reverse it.

More than that the measures can only be minimal in nature and have clearly failed already to spur growth. The main talk centres around further selling of short dated securities to buy long dated ones to keep key long term interest rates down. The trouble with this is that by the end of the year the Federal Reserve will run out of short dated Treasury notes with which to pursue this “twist” strategy. Plus, the likes of 30 year mortgage rates at record 3.5% lows are clearly not stimulating spending already. Interestingly on Wednesday night the Fed. noted that the economy has weakened but made no announcement of fresh stimulus moves.

People do not want to borrow, banks do not want to lend. Only the passage of time and creation of far stronger household balance sheets will alter this – but no-one knows how long this will take. Hence NZ exporters should be cautious in their projections of demand from the US, should factor in a firm NZD against the currency of an economy not firing on many cylinders, while investors might want to ask themselves how sustainable the recent sharemarket rally can be when so many of the fundamentals in the US economy are bad – including fiscal policy for which outright disaster may loom.

The US manufacturing sector shrank for the second month in a row in July as measured by the ISM index which came in at 49.8 from 49.7 in June where a reading below 50 means shrinkage.

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	0.807	0.786	0.800	0.814	0.876	0.67
NZD/AUD	0.772	0.769	0.780	0.788	0.799	0.85
NZD/JPY	63.300	61.400	63.800	65.300	67.7	69.6
NZD/GBP	0.519	0.507	0.509	0.502	0.538	0.388
NZD/EUR	0.660	0.652	0.631	0.615	0.615	0.52
NZDCNY	5.140	5.021	5.078	5.114	5.640	4.99
USD/JPY	78.439	78.117	79.750	80.221	77.283	105.7
USD/GBP	1.555	1.550	1.572	1.622	1.628	1.72
USD/EUR	1.223	1.206	1.268	1.324	1.424	1.28
AUD/USD	1.05	1.02	1.03	1.03	1.10	0.788
USD/RMB	6.3698	6.3881	6.3481	6.2824	6.4382	7.56

Risk Aversion Changes

The Kiwi dollar went up this week because worries about Europe eased after the ECB President said he would do whatever is necessary to hold the Euro together. That’s fairly much it for currency influences this week. Next week, if worries return the NZD will go down because we are a peripheral asset which people tend to sell when worried about the world – except keep an eye out for what must surely be a growing pool of money looking to escape all the major currencies, each of which has factors making them look horrible.

Euro – probably going to break up. After all, when the person overseeing the only truly pan-Eurozone institution has to make a strong affirmation of support you know things are really really bad.
Dollar – there is a fiscal cliff approaching and growth is slowing.
Japan – the government is and has been ineffective at creating a climate to boost growth for decades, debt is huge, the population is aging and shrinking, and the manufacturing base is being nibbled away by other Asian countries.
British Pound – not as bad as the others frankly but caught by association with the Euro with an economy in deepening recession.

Now throw in the bad American drought which is expected to provide some support to New Zealand’s commodity export prices, (dairy prices up 3.5% last night at the fortnightly GDT auction), our housing upturn, the coming boom in construction, and the absence here of banking and government problems and you get ourselves looking fairly good for the next few years.

For myself what this adds up to is an expectation that the NZ dollar along with the Australian currency will be well supported over the next few years against the pound, Euro and dollar in particular, the Yen less so, while remaining as volatile as ever. If I were an exporter I would look for the occasional bouts of weakness to improve hedging against all the majors except maybe the Aussie dollar where I find myself without any particular view beyond that we have undergone a structural shift lower.

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, search www.stuff.co.nz
- 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, tramps, and his partner Dr Sarah Farquhar runs the early childhood education network www.childforum.com

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