BNZ Weekly Overview

9 August 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.

An NZ Summary

I give a number of talks around the country during most weeks between February and November when not on holiday tramping or researching overseas. At the moment these are the main messages which I think people need to take on board.

New Zealand had a six quarter recession over 2008-09 where the economy shrank by 3.8%. We are now 1.6% bigger than before the recession and that is a good result when compared with other economies such as the UK which have yet to regain their lost ground and are in fact in recession.

Our recovery has however been a very slow one with the unemployment rate still only just down from its 6.9% peak at 6.8% and job numbers up only 0.6% in the past year. Retail spending per capita is 5% below its 2007 peak. Last year dwelling consents were at a four decade low.

The slow recovery has occurred because

- the NZD has risen early this cycle,
- there has been major uncertainty regarding developments in Europe and the United States,
- the Canterbury earthquakes have disrupted activity and sentiment,
- credit availability has structurally declined,
- there was a widespread belief that house prices would fall sharply, and
- most groups in society have been concentrating on reducing debt.

This deleveraging process is likely to continue for a number of years to varying degrees in Western countries and there is no way of knowing when it will end. While it continues growth will be subdued in Europe, the US, and to a lesser extent New Zealand.

Our growth going forward will be supported by rising exports to China, above average farm incomes, the rebuilding of Christchurch, catch-up house construction in Auckland, infrastructure spending, good growth in our biggest trading partner Australia, and a generalised housing upturn caused by awareness of a shortage of property.

There will however be restraint on growth from tightening fiscal policy, the continuing risk of major weakness in Europe, rising insurance premiums, the structural rise in the NZD against the Euro, Pound and greenback, and the risk of further weakening in some commodity prices.

The risks are great enough that even though inflation is forecast to lift from the current 1%, NZ monetary policy might not be tightened until 2014. Before then fixed interest rates will rise if world growth prospects improve.

The labour market is likely to tighten up quite a bit next year once the construction sector is stronger and businesses will need to think about their offshore recruitment strategy and boosting productivity while allowing for lifting wage rises.

Shocks are likely to continue and businesses should focus less on preparing for good growth and more on handling unpredictable changes in costs and receipts to be caused by potential developments in China, the Middle East, Europe and the United States.

Overall, whereas the NZ economy achieved growth which averaged 3.5% a year from 1992 to 2007, over the next 16 years growth is likely to average closer to 2%. Factors contributing to this structural slowing include

- the fact that average house prices are already seven times average annual earnings compared with 3.8 times in the early 1990s,
- absence of a repeat of the massive decline in inflation and interest rates which happened between 1989 and 1992,
- absence of a productivity payoff as happened following the Rogernomics reforms,
- already high household debt near 145% of income compared with 60% in 1991,
- reduced trading partner growth,
- reduced global credit growth, and
- a slowdown in NZ working age population growth to 11% in the next 15 years from 29% in the past 15.

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?

In July there were 12,649 cars registered around New Zealand. This 11% rise from a year earlier makes for a small 1.4% rise for the entire past year and small 3% seasonally adjusted rise in the three months to July. So there is growth underway in this measure but it is not all that strong. That probably explains why comments in our monthly survey from those in the automotive sector remained on average (though not completely) downbeat this month. To whit.

- Vehicles: The only way to sell is to give, can't go on for ever
- Automotive - people are servicing their cars still rather than purchasing.
- Automotive - New Car Wholesale: New car market has grown 20%+ this year which is great. Playing catch up from previous years in some respects, with commercial good because of ChCh.
- Automotive. Steady but nervous.
- Pretty good. franchised motor vehicle dealer.
- Unbelievable - things aren't getting better in the used car sector, moments of light, but month on month, no improvement at all. Maybe even a slight downward trend.
- Used cars: Average at moment, considering world economy, but if you compared to 5 years ago very poor.

Are businesses boosting their capital spending or hiring?

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 July there were 2,384 commercial vehicles registered around New Zealand which was a near 25% rise from a year earlier13.3% gain for the entire year, and near 17% rise seasonally adjusted for the three months to July. So there is some good growth underway in this proxy-type measure of business investment which is a very good thing and supportive of reasonable growth in the NZ economy.

In addition to this good result, farmers registered 33% more tractors in July than a year ago taking the gain for the full year to 17.7% and delivering a near 10% seasonally adjusted rise over the past three months. This measure has returned to showing some strength. However it is clear from comments in our monthly survey that conditions are quite variable in the farming community with returns down for most but hopes for higher prices due to the US drought offset by a continuing high NZ dollar.

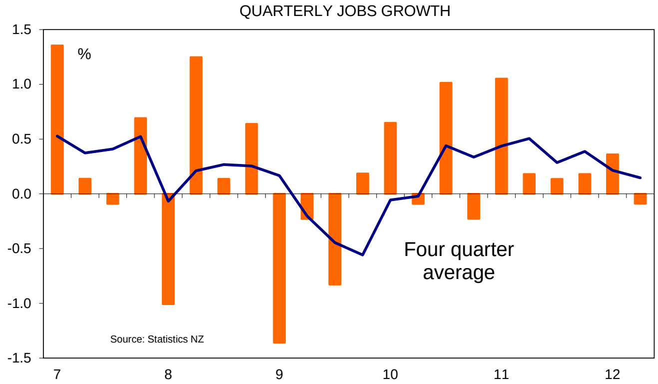
- Dairy - short term looking tight, beyond 6 months looking strong again.
- Farm commodity and net farm incomes have fallen significantly over the past 6 months with no immediate improvement likely except perhaps for dairy.
- Sheep and beef farming. Signals are for a large reduction in lamb and wool prices for the coming season. Beef looking sound, drought in the states may help pricing next year. Not a lot of fat in the system at these levels.
- Dairy farming/forestry services. Dairy farmers wary of spending unless a return is probable. Forestry sector is constant as owners wish to log prior to any price falls from Asia. ETS is a concern with little benefit from registration, forestry continues to subsidise other sectors. Costs are a concern in both areas.
- Agriculture - Grain & Seeds. Possible lift in prices due to weather factors overseas may assist this sector in the short term, however long term looks much like being similar to current status. The NZ$ could drop a bit!
- Sheep & Beef farming Way worse, just sold wool from pre lamb shearing and $2 kg less from last season and they talking $20 drop in lamb this season.
- Very average in dairy with uncertainty.

Hiring

The Household Labour Force Survey was released this morning and in all regards it was weak – thus placing downward pressure yet again on expectations for when NZ monetary policy will tighten, confirming that businesses are failing to back their positivism by hiring, and taking a little bit of heat out of the NZD.

During the June quarter seasonally adjusted job numbers in New Zealand fell by 2,000 making for a small 0.6% or 13,000 rise from a year earlier. This is the slowest pace of growth since the 0.1% fall in the year to June 2010 and shows the labour market upturn has stalled.

The unemployment rate has risen to 6.8% from 6.7% in the March quarter and is essentially equal to the peak of 6.9% seen in the June quarter of 2010. The employment rate – which measures the proportion of the working age population actually in a job – fell to 63.8% from 64.1%.



Basically with this sort of labour market weakness it is unreasonable to expect that retail spending will be good in the near future and the recent reporting of strong growth in spending using debit and credit cards is highly likely to revert back soon to showing only slow gains. With regard to housing the data will act to suppress the extent of the rise in activity and prices – but still the fundamental of buyer catch-up and under-supply will underpin the market.

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 this week.

INTEREST RATES

Wholesale borrowing costs climbed in NZ early this week on the back of hopes that the ECB might come to the rescue of Spain etc. by effectively printing money. But rates fell away again this morning after the NZ employment data came in much weaker than anticipated. The weak data imply little scope for monetary policy tightening on the basis of worries about consumer spending surges or wage inflation in the near future and I retain my view that change from the RBNZ may not come on the upside until 2014.

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	2.66%	2.73	2.67	2.51	3.00	5.8
3 year swap	2.85%	3.00	2.91	2.77	3.61	6.1
5 year swap	3.27%	3.28	3.21	3.21	4.18	6.3

If I Were a Borrower What Would I Do?

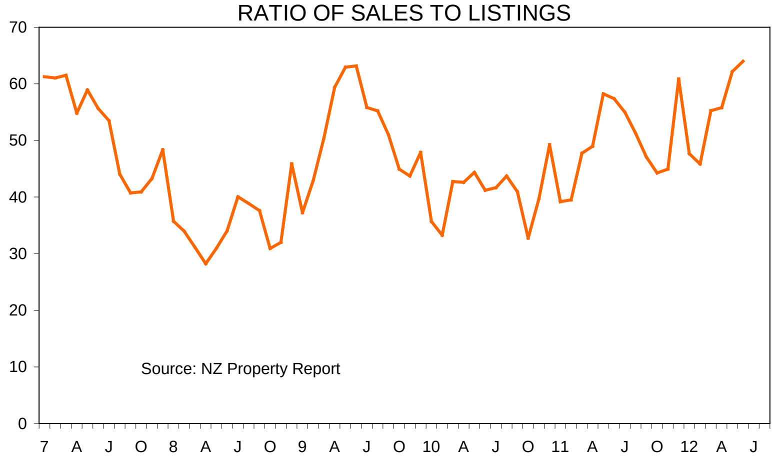
Nothing new. I would fix three years but floating is fine as well given that the Reserve Bank will be leaving the cash rate at low levels for a very very long period of time.

HOUSING MARKET UPDATE

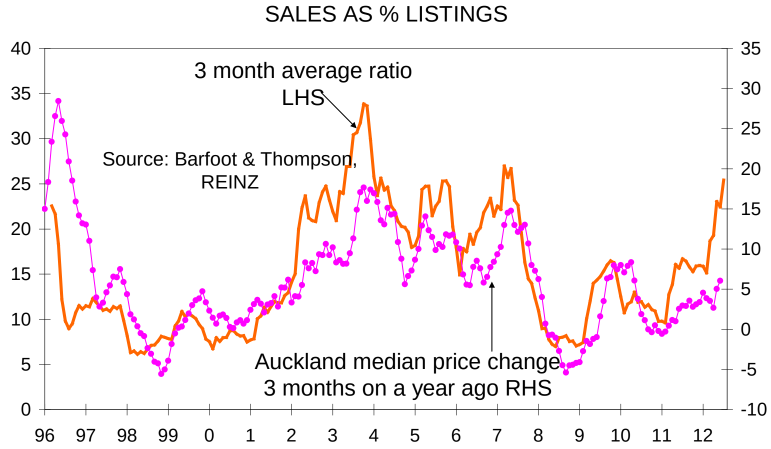
- **To view the most recent results of our monthly BNZ-REINZ Residential Market Survey click here.** http://tonyalexander.co.nz/bnz-reinz-survey/
- **I also write a monthly column on the residential property market in NZ Property Investor magazine available at your bookshop or newsagent.**

Listings Short

Data from the Property Report of www.realestate.co.nz shows that the supply of property for sale is tightening up with the ratio of sales (June latest data from REINZ) to listings in June rising as shown in the graph below. In July listings were just 5% ahead of a year earlier.

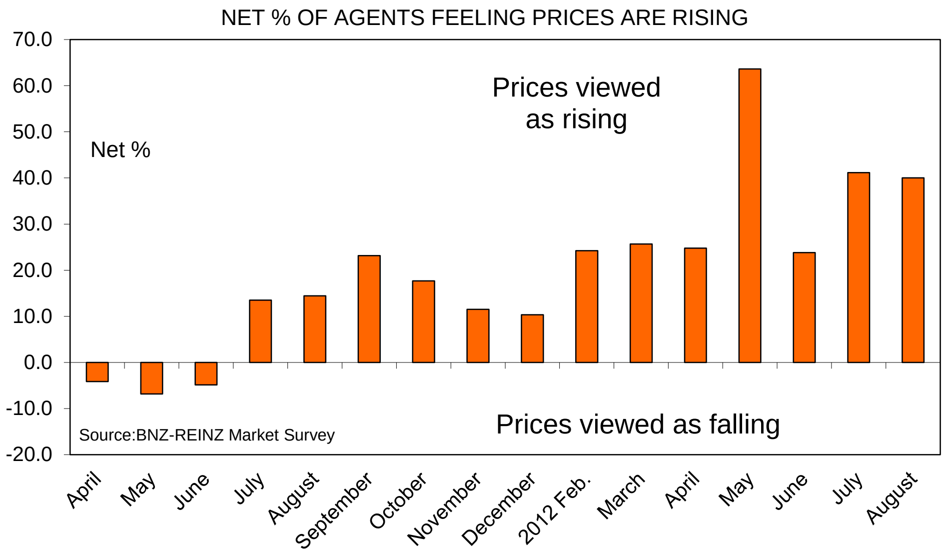


In July in Auckland Barfoot and Thompson sold 28% more properties than a year earlier and in the past three months sales in seasonally adjusted terms have gained about 5%. However the stock of listings at the end of the month was down almost 18% from a year earlier and the ratio of sales to listings is trending upward just as indicated in the Property Report data above. The price implications are clearly shown in the following graph which utilises the REINZ monthly sales price data which run just to June at this stage.



One of my theories is that the housing market is going to receive some additional support over the next few years from a turnaround in the migration numbers. The year to June flow was a loss of 3,191 people. That was down from 4,006 two months earlier and the chances are that before the end of the year the net flow will be positive. Contributing to the turnaround will be the usual cycle with Australia peaking and ebbing toward a smaller net loss, people coming in for the Christchurch rebuild (mainly 2013), and generally people shifting to NZ from Europe and the UK because they want to avoid many years of economic woe over there. Here is a link to an article discussing that last factor.
http://money.msn.co.nz/businessnews/other/8512863/survey-kiwi-expats-returning-home

This week I conducted then last night released the results of the monthly BNZ-REINZ Residential Market Survey. All results show a housing market with rising prices, more buyers appearing, few new vendors on the horison – basically a sellers market. This is not however the case for all of the country and having altered the agent location choices form local authority areas to regional council areas I have been able to report regional results for all bar Taranaki and Southland where few agents bothered responding. To read the report if you have not already done so just click here.
http://tonyalexander.co.nz/bnz-reinz-survey/



MAJOR OFFSHORE ISSUES

Nothing shockingly new – hopes of easing by the ECB and Fed. But underlying fundamentals offshore as bad as ever with downside risks associated with central banks disappointing investors.

Europe

Representatives of the three creditor bodies responsible for bailing out Greece gave positive interim reports on Greece's progress in meeting the terms of its second bailout – thus raising hopes that further funds will be advanced in coming months as financing needs arise.
The Spanish Prime Minister indicated that it is conceivable that pain will request a bailout.
The Italian PM warned of a breakup of Europe unless greater efforts were taken to lower borrowing costs.
Data out of Germany and the UK were very weak.

United States

For the first time since May 2001 there was a triple digit rise in employment on a monthly basis in the United States. In July non-farm payrolls rose by 163,000 which was above expectations of a 100,000 rise. The result is still weak and not enough to prevent the unemployment rate rising (to 8.3% from 8.2%) let alone do anything to start eating into the growing army of people who have left the workforce altogether for lack of hope of finding a job. But the result is positive and so sharemarkets rallied and the NZD got an extra boost upward.

Here is a reminder of how fiscal stimulus has failed in the United States. President Obama's $860bn plan was supposed to have produced a 6% unemployment rate by now – not the 8.3% rate reported last Friday night. An interesting piece of research reported in Tuesday's edition of the Wall Street Journal notes that those countries which enacted the greatest fiscal stimuli as proportions of GDP between 2007 and 2009 had the worst subsequent shrinkage in GDP. The least shrinkage was Australia which saw GDP growth slow 3.5% with just a 3.3% of GDP spending boost followed by NZ with 6% growth change and just 3.4% government spending boost. The US stimulus amounted to 7.3% of GDP and the growth change 8.4%.

China

Chinese economic developments are now covered in our new publication "Growing With China", the August 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

Did you know…

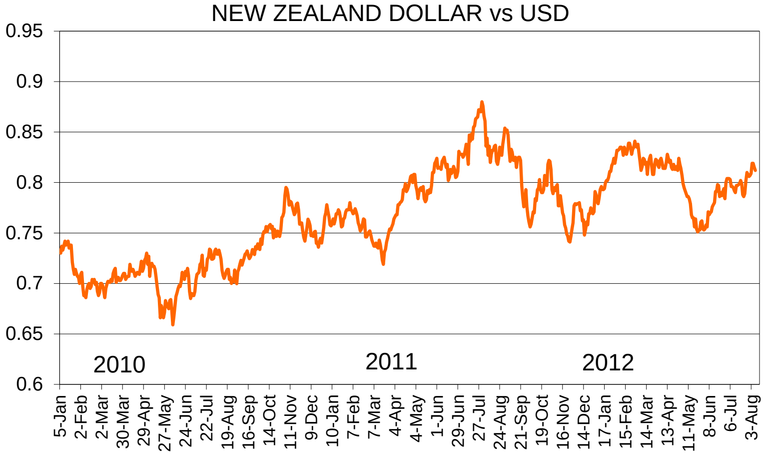
- With near 20% of the planet's population China has only 1.1% of global oil reserves, 1.5% gas, and 13% coal?
- The stock of foreign direct investment in China stands at around US$0.5tn, but China's FDI into rich countries only amounts to about $30b.
- GDP per capita stands at around $8,400 compared with a world average of $11,500, NZ at $28,000, EU at $32,000 and US at $48,000.
- China's ratio of government debt to GDP stands at 43% if one includes local governments or just 23% for central government. The NZ ratio is 38%, Eurozone 88%, US 100%, Japan 225%.
- China's working age population is 950 million. That of all high income countries combined is 720 million.
- China now has over 160 cities with populations of more than one million people (Europe has just 35, the United States nine) and 20 cities with over 5 million people.

Exchange Rates

Exchange Rates	This Week	Week ago	4 wks ago	3 Mths ago	Yr ago	10 yr average
NZD/USD	0.812	0.807	0.796	0.789	0.827	0.67
NZD/AUD	0.769	0.772	0.780	0.779	0.805	0.85
NZD/JPY	63.700	63.300	63.400	62.900	64.3	69.6
NZD/GBP	0.519	0.519	0.514	0.488	0.506	0.388
NZD/EUR	0.657	0.660	0.649	0.605	0.582	0.52
NZDCNY	5.166	5.140	5.067	4.978	5.322	4.99
USD/JPY	78.448	78.439	79.648	79.721	77.751	105.7
USD/GBP	1.565	1.555	1.549	1.617	1.634	1.72
USD/EUR	1.236	1.223	1.227	1.304	1.421	1.28
AUD/USD	1.06	1.05	1.02	1.01	1.03	0.788
USD/RMB	6.3624	6.3698	6.3658	6.3091	6.4358	7.56

Not Much Change

A quick glance at the table above shows that exchange rate have not moved by much over the past week apart from the Euro rising a tad against the greenback - in spite of the good US jobs report - because of hopes that the ECB will print money and buy bonds from private investors who want rid of them.



During the week this optimism about Europe and the jobs report pushed the NZD above US 82 cents. But we sit near 81 cents now with some downward pressure from this morning's very weak employment numbers for NZ in the June quarter.

Will we hit parity against the USD? One day yes. We have resources which the world needs. Can we predict when this will happen? No.

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
- 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

Tony.alexander@bnz.co.nz Ph 00644 474-6744