

# 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.

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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-l8ploskSGWgjN\\_7WOAw](http://feedback.bnz.co.nz/forms/Fx-l8ploskSGWgjN_7WOAw)

To change your address or unsubscribe please click the link at the bottom of your email.

## Survey Time

This is the first Thursday of the month so if you have not already done so from the email used for sending out the Weekly Overview please click on the link here to let us know whether you feel the economy will be in better shape or worse shape in a year's time.

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

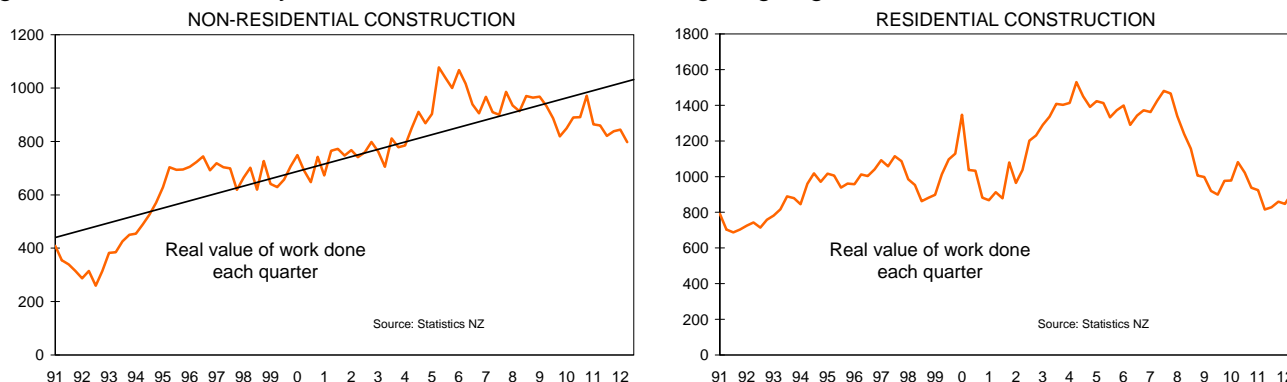
I don't have much to write in the front section of the Weekly Overview this week due to time being taken up with talks in Christchurch, an all-day symposium on China in Wellington, plus travelling and running the kids to and from school. Actually that isn't something I do very often but my partner had her own conference to run in Wellington - hence this afternoon I learnt about Harold the giraffe who lives in the back of a truck and goes around the schools teaching kids about healthy eating choices.

Speaking of giraffes, I was in Sydney for a conference last week and did not see any but did get a better feel for the way in which Australia's retailing sector is struggling under pressure from the high exchange rate encouraging people to shop on-line, weakness in sectors like manufacturing, tourism and construction, and of course household deleveraging.

This deleveraging process involving improving one's ratios of debt to equity, income, cash flows etc. appears to be continuing apace around the world and keeping growth subdued. As I've pointed out for the past three or so years, we have zero way of knowing when this deleveraging will end. This is akin to having zero way of knowing when a bubble in an asset class will end. You might do some analysis and conclude that a thing is over-valued and people are speculating on other people being a greater fool down the track and buying the thing they have just paid too much for. But such analysis never gives insight into when the collective penny drops and the market collapses. Just ask Alan Greenspan. His "she'll be right" attitude to the US housing market is one of the reasons the US economy is still struggling to find its legs.

For the record, we did get some data on the NZ economy this week - but nothing which really tells us anything different from what we already knew - hence no exchange rate or interest rate changes worth mentioning.

We learnt that during the June quarter the volume of construction work undertaken all around New Zealand rose in seasonally adjusted terms by only 0.7% after falling 0.4% in the March quarter. Activity was 1.7% ahead of a year ago and for the entire past year residential work fell 7% while non-residential work fell 8%. So things are turning around though with a surge in residential work in the June quarter of 7.1% only just offsetting a 5.6% fall in non-residential construction. It will be really interesting to see where these two series go over the next three years as the Christchurch rebuild gets going.



There is no trend rise or fall occurring in registrations of cars at the moment with regos ahead only 0.8% in August from a year ago and unchanged in the three months to August from the three months to May in rough seasonally adjusted terms. Maybe the key thing here is that no fresh weakness necessarily is appearing in response to the deteriorating situation overseas.

With regard to commercial vehicle registrations and tractors however the situation is more encouraging – from a productivity growth point of view. In the three months to August commercial vehicle regos were ahead 9% seasonally adjusted from the three months to May (with August up 36% on a year ago. And tractor registrations have risen 43% from a year earlier and 7% seasonally adjusted. So this is good.

## INTEREST RATES

Did you know that the level of year ahead inflation expectations revealed in the NBNZ Business Outlook of a couple of weeks ago was at the lowest level since 1999 at 2.34%? Also, only a net 16% of businesses say they intend raising their selling prices in the near future. This is the sort of thing the Reserve Bank looks at when it considers what to do with the official cash rate and the data firmly indicate that next week when the RB undertake their regular review there will be no rate change.

In fact the cash rate has been at 2.5% since March last year when it was cut 0.5% following the February 22 earthquake and a string of data showing the economy to be less strong than anticipated. Going forward we could easily see the rate sit at 2.5% for another 17 months. But in saying that one has to acknowledge that these remain very uncertain times and I have seen interest rate forecasts change more in the past four years than ever before.

These forecast changes and the massive uncertainty arise because we simply do not know what is going to happen with some of the major factors in play. For instance in Europe the debt situation could easily get a lot better or a lot worse. For the moment there is an expectation that the European Central Bank will buy bonds issued by the dodgy governments and maybe even set a cap for how high it will let interest rates go for some of them – which would be an exceedingly stupid idea because it would invite in to play the worlds most speculative players and those simply with a fundamental view that they are wrong and that the rate ceiling would eventually be abandoned.

Uncertainty surrounds how the coming fiscal cliff in the United States will be handled. That cliff is a 4% of GDP fiscal tightening programmed in for January next year. Uncertainty also surrounds the extent of the slowdown in China, how much of a cut-back there will be in Australia's growth because of falling commodity prices, and here in New Zealand how long it will take for the Christchurch rebuild to get going.

The upshot is that with high uncertainty and a lot of downside risks it would not be a particularly wise time to start raising interest rates. But with some firm factors set to boost NZ growth it is also not a situation where the RB is likely to cut interest rates.

This week nothing happened worth writing home about.

| 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       | 2.66%     | 2.66     | 2.68      | 2.77         | 2.70   | 5.7           |
| 1 year swap            | 2.67%     | 2.67     | 2.66      | 2.48         | 3.12   | 5.8           |
| 3 year swap            | 2.90%     | 2.90     | 3.85      | 2.71         | 3.68   | 6.1           |
| 5 year swap            | 3.22%     | 3.22     | 3.27      | 3.09         | 4.22   | 6.3           |

### If I Were a Borrower What Would I Do?

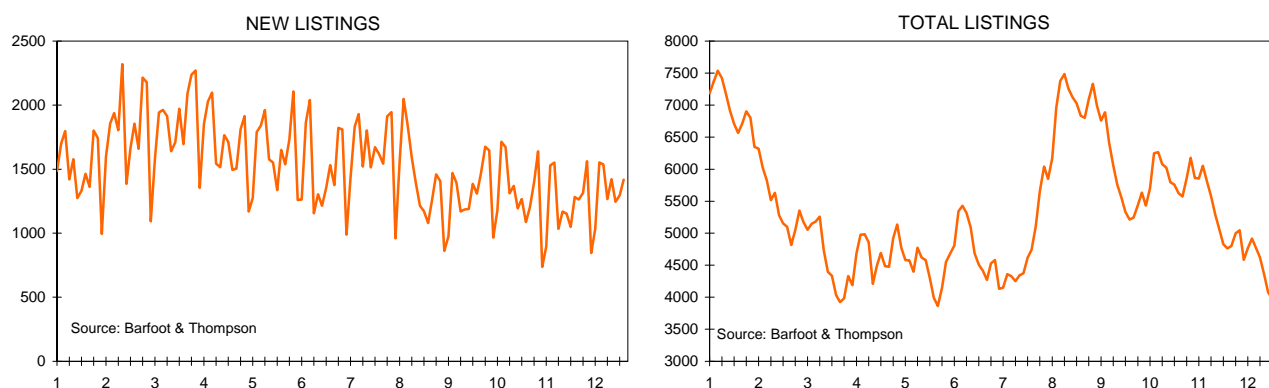
I'd be happy to stay floating but would keep an eye open for a discounted fixed rate in the three year are.

## HOUSING MARKET UPDATE

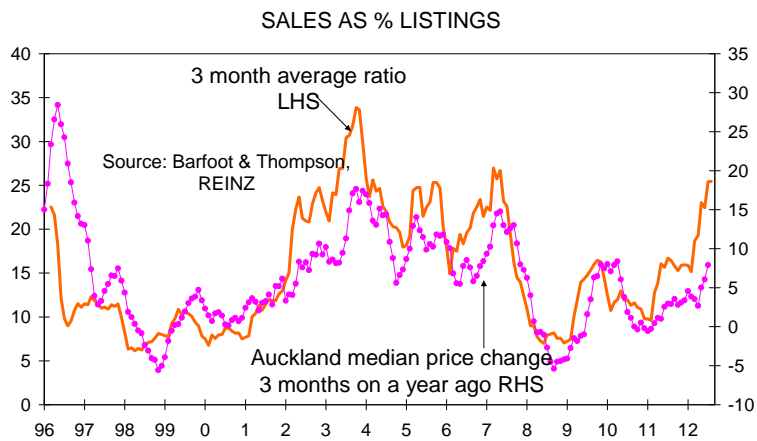
- To view the most recent results of our monthly BNZ-REINZ Residential Market Survey click here. <http://tonyalexander.co.nz/bnz-reinz-survey/>
- I also write a monthly column on the residential property market in NZ Property Investor magazine available at your bookshop or newsagent.

### Auckland Rising

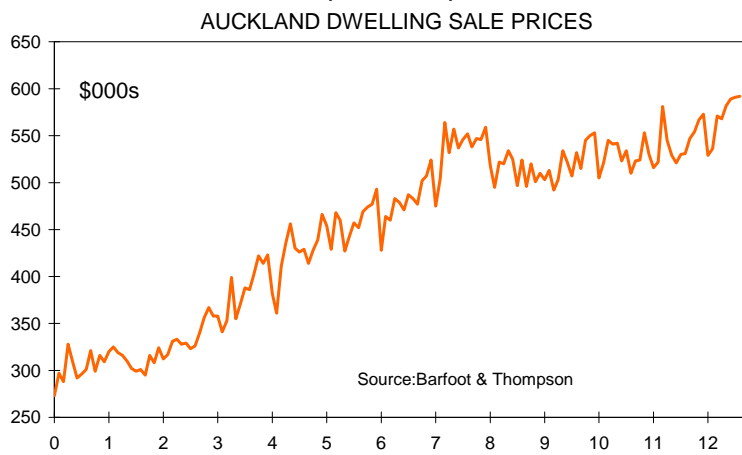
Barfoot and Thompson sold 1,016 dwellings in Auckland in August which was a very strong 34% rise from a year earlier and seasonally adjusted gain for the month near 7%. The rise was accompanied by a 10.5% lift in the number of new listings from a year earlier which attracted some media headlines because this total of 1,417 was the highest total for August in five years. But there is no listings surge underway when one does the simple calculation comparing listings with sales.



Over the past three months the sales to listings ratio was 25.5% compared with 23% three months ago and 16.4% a year earlier. This is the highest sales to listings ratio since May 2007 and in fact the fourth highest such ratio since 2005. As I have long highlighted here, there is a very good correlation between movement in this ratio and changes in the annual rate of change in Auckland dwelling sales prices.



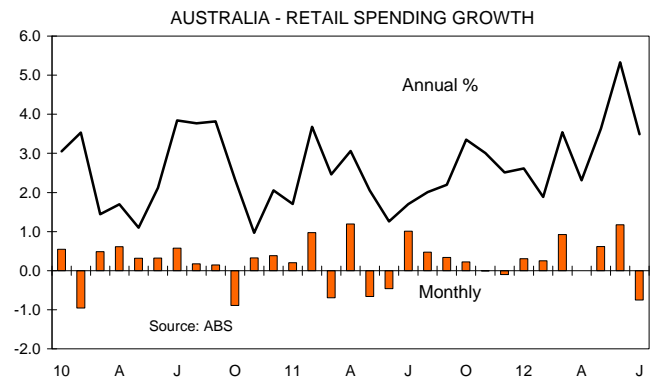
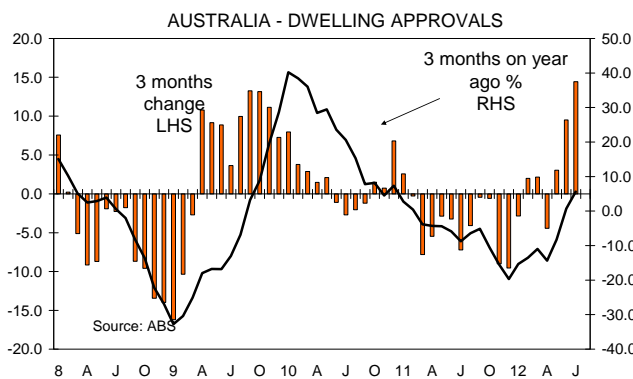
A clear gap has opened up between the ratio and prices. Therefore the chances are that in the next few months prices will rise quite strongly following an 11.5% gain in the past year. The Barfoot and Thompson price measure at \$592,000 now sits 5% above its pre-2008 peak.



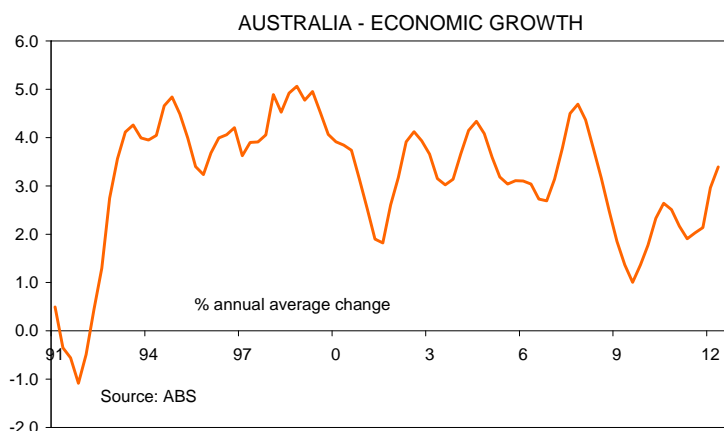
## MAJOR OFFSHORE ISSUES

### Australia

Across the Tasman there are deepening worries about economic growth sourced from the continuing weakness in manufacturing, retailing, tourism, and housing, the ongoing sharp decline in iron ore and coal prices, postponements recently announced for major minerals projects, and some weaker than expected data. Into the latter camp we have building approvals for instance which showed a surprisingly large 18% fall in July. However two months earlier this number soared 27% so the trend is still in fact upward.



Retail spending fell by a large 0.8% in July. But again this followed a good 1.2% rise in June and means that the trend in spending still appears upward though not at all strongly so. And although the June quarter growth in GDP announced yesterday was 0.1% less than expected, the result was still a good 0.6% which followed a 1.4% rise in the March quarter. This means that over the past year Australia's economy has grown by a healthy 3.4% and has now been showing positive annual growth for 21 years.



### Europe

The tone of sentiment has improved a tad in Europe this week even though the economic data remain bad. This is because behind closed doors the ECB President is reported to have said that he thinks the ECB can buy bonds of maturity up to three years without violating any treaties. We will find out if this might happen tonight following the ECB's monthly meeting. But substantial attention remains on the coming decision of the German Constitutional Court regarding whether it is legal for Germany to sign up to the proposed European Stability Mechanism planned as a permanent bailout fund. That decision comes on September 12.

It is not a biggie, but Bulgaria – the poorest EU member – has shelved plans to join the Euro citing the risks associated with bailing out other members in particular.

### United States

In his speech at the Jackson Hole gathering of central bankers last Friday night the Federal Reserve Chairman Ben Bernanke expressed deep concern about continuing high unemployment and while not announcing any planned policy actions used language indicating that this month a further bout of bond buying is likely to be announced. So the US story for the moment is all about waiting for that news. But while waiting we learnt this week that the ISM manufacturing index came in weaker than expected with a reading of 49.6 from 49.8 in July. This means a worsening manufacturing sector recession.

Ironically however the weak data increase the chances that the Fed. will ease again and hence negative reaction in the financial markets to the data was muted.

### China

you have a question you would like to ask regarding China or a point of view you feel it would be useful for me to take on board in my studies then please email me at [tony.alexander@bnz.co.nz](mailto:tony.alexander@bnz.co.nz)

OR

You can find my China page on Facebook at <http://www.facebook.com/TonyAlexanderNZ> I have set up this page specifically for discussing the NZ-China relationship and as a tool for disseminating information and furthering my own still inadequate knowledge. If you go there this week you will find comments regarding the following.

- A very weak manufacturing index for August showing China's economy slowing more than expected and bringing labour market issues which more than anything will be any day driving the authorities to do more

loosening of economic policies. But their job will be made more difficult by evidence of house prices rising again – the Soufun Index now having risen for three months in a row to gain 0.6%. This raises deepening issues of housing affordability.

- A discussion on wine.

Also, an emailer asked this question during the week.

“From what I have heard a significant portion of China’s GDP growth has been driven by rapid development of their internal infrastructure. I understand a lot of this is under utilised and wasteful i.e. roads and bridges to nowhere and cities without residents. If so, what is their real GDP and what impact is this having on their debt situation?”

My reply is here. <http://tonyalexander.co.nz/wp-content/uploads/2012/09/Comment-Sept6.pdf>

I also prepared two papers as handouts following a talk at the China Symposium 2012 held in Parliament’s Legislative Chambers yesterday. I looked at whether we have taken advantage of the FTA yet. The papers are here.

<http://tonyalexander.co.nz/wp-content/uploads/2012/09/September-5.pdf>

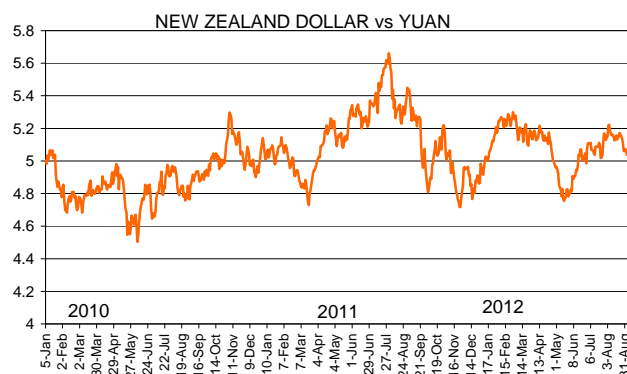
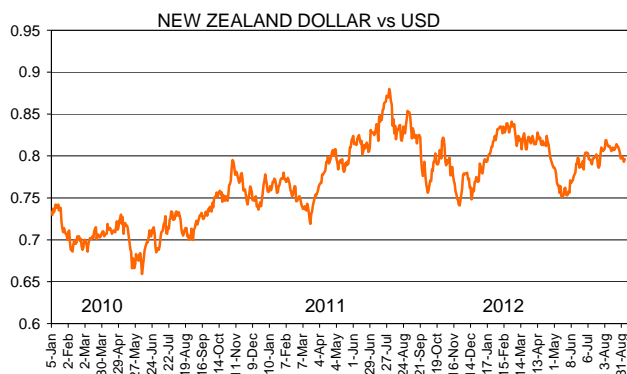
<http://tonyalexander.co.nz/wp-content/uploads/2012/09/Sept-5-KIWI-EXPERIENCES-IN-CHINA.pdf>

## Exchange Rates

| <b>Exchange Rates</b> | <b>This Week</b> | <b>Week ago</b> | <b>4 wks ago</b> | <b>3 Mths ago</b> | <b>Yr ago</b> | <b>10 yr average</b> |
|-----------------------|------------------|-----------------|------------------|-------------------|---------------|----------------------|
| NZD/USD               | 0.796            | 0.804           | 0.819            | 0.756             | 0.832         | 0.67                 |
| NZD/AUD               | 0.778            | 0.774           | 0.775            | 0.776             | 0.788         | 0.85                 |
| NZD/JPY               | 62.400           | 63.100          | 64.300           | 59.600            | 64            | 69.6                 |
| NZD/GBP               | 0.500            | 0.508           | 0.524            | 0.492             | 0.517         | 0.388                |
| NZD/EUR               | 0.632            | 0.640           | 0.661            | 0.608             | 0.59          | 0.52                 |
| NZDCNY                | 5.055            | 5.107           | 5.219            | 4.815             | 5.313         | 4.99                 |
| USD/JPY               | 78.392           | 78.483          | 78.510           | 78.836            | 76.923        | 105.7                |
| USD/GBP               | 1.592            | 1.583           | 1.563            | 1.537             | 1.609         | 1.72                 |
| USD/EUR               | 1.259            | 1.256           | 1.239            | 1.243             | 1.410         | 1.28                 |
| AUD/USD               | 1.02             | 1.04            | 1.06             | 0.97              | 1.06          | 0.788                |
| USD/RMB               | 6.3507           | 6.3515          | 6.3725           | 6.3684            | 6.3858        | 7.56                 |

### Nothing Major

There have been no major changes in exchange rates over the past week and even some excitement regarding the European debt situation managed to push the Euro up only slightly against the USD. However this is a big month for the European debt problem and it would not be surprising if we saw the Euro rise if something big comes along, or fall back because optimism about the ECB doing something is already high so the markets are basically set up for a fall. Given that the behind the doors aim of the Europeans is probably more muddle along without a crash than find a silver bullet (an impossibility) we could easily see the Euro’s volatility remain within a relatively tight range.



As for the NZD, if you look at the table you will see that we have edged down marginally against the USD during the week but up a completely insignificant amount against the AUD. There was downward pressure on the NZD in association with the AUD early this week from weaker than expected manufacturing data out of China and a lower than expected reading for the US services sector PMI. These factors offset the 6% rise in dairy prices in the fortnightly Global Dairy Trade auction, and the feel-good buy risky assets attitude stemming from hopes about Europe. The AUD itself lost two cents against the USD on the back of falling commodity prices and the June quarter GDP number coming in 0.1% weaker than expected.

Next week the RBNZ will review their cash rate and they are likely to leave it at 2.5% and indicate that no change is likely for a long time with an emphasis on building domestic growth pressures around construction but downside risks offshore with restraint from the continuing high NZD. There, that should save you from reading their many pages.

**Key Forecasts**

| Dec. year          |                    | 2011 | 2012      | 2013      | 2014      |
|--------------------|--------------------|------|-----------|-----------|-----------|
| GDP                | annual average chg | 1.4  | 2.0-3.0%  | 2.0 – 2.5 | 1.0 – 2.0 |
| CPI                | on year ago        | 1.8  | 1.8       | 2.2 - 2.9 | 2.5 – 3.5 |
| Official Cash rate | end year           | 2.5  | 2.5       | 2.5 – 3.5 | 3.5 – 4.5 |
| Employment         | on year ago        | 1.6  | 1.0 – 1.5 | 1.0 – 2.0 | 0.5 – 1.5 |
| Unemployment Rate  | end year           | 6.4  | 6.0 – 6.5 | 5.5 – 6.0 | 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 27,000 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](http://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](http://www.tonyalexander.co.nz)
- Discussion of New Zealand's relationship with China can be found here. <http://www.facebook.com/TonyAlexanderNZ>

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](http://www.childforum.com)



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