BNZ Weekly Overview

4 October 2012

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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-I8ploskSGWgjN_7WOAw
To change your address or unsubscribe please click the link at the bottom of your email.

Monthly BNZ Confidence Survey

This is yet again the first Thursday in the month so if you have not already done so using the link in the email please feel free to click on the url here and let us know whether you reckon (or reckons not) that the NZ economy will be better in a year's time. If you have a minute also let us know how things are in your particular sector at the moment remembering to specify what that sector is.

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

I am also running a completely separate survey this week for those who have read beyond the paragraph above. Should I keep the Weekly Overview as a weekly, or switch to a fortnightly or a monthly? Hit reply and let me know. Personally I am getting the feeling that because there is so much uncertainty around, because interest rates won't be changing for ages, and because the world will be battling debt levels for many years, the usefulness of a weekly update is not as high as when the WO started about 12 years ago. Your thoughts? Tony.alexander@bnz.co.nz

Speaking of an absence of change, nothing has happened domestically or internationally over the past week to alter the broad thrust of our economy which you should be factoring into your business decisions over the coming 1-3 years. So stop reading at this point if you wish.

In Europe the fundamental deep structural issue of an unworkable Euro and countries struggling under debt or trying to stem rising debt continues. Europe will be a low growing region for our exporters for a long time – though remembering that outside of our main commodities the opportunities for niche sales of services in particular remain strong and for that reason SME exporters should not just blindly write Europe and the UK off. This is one of the most developed parts of the world with deep capital bases, strong business connectiveness, an international focus borne of centuries of foreign investment, and a highly educated workforce.

In China growth appears to be slowing from 7.6% toward 7% with high vulnerability to weakness in Europe and exports generally, plus growing social strains meaning the incoming leaders in early-November will face some huge policy challenges. Riding the coat-tails of a cheap labour country attracting the world's manufacturers and investing in an infrastructure base have made the past three decades comfortable ones for the Chinese economy. Now the harder graft starts and we should anticipate bumps of unpredictable timing, magnitude and duration along the way.

In the United States growth is expected to improve in the coming year from the 1.3% annualised pace over the June quarter. But the fiscal cliff of January 1 approaches when a policy tightening equalling 4% of GDP will start if nothing is done to prevent it. Something will be done but as the deadline approaches (after the Presidential election is out of the way) we could see world financial markets and business confidence slammed.

The worrying situation overseas means extra investor support for the NZ dollar with further currency support coming from our export commodity prices rising 4% over the past two months assisted by drought in many other parts of the world. There is and will be a lot of talk about how to get the NZ dollar down – and all such talk will be a waste of oxygen as nothing can be done of reasonable manner. In particular interest rates won't be cut by the RBNZ because the NZ housing market is already rising firmly in Auckland in particular and the rebuild of Christchurch plus Auckland construction catch-up mean capacity constraints will appear over 2013 in the construction sector.

Retailing prospects look acceptable with assistance from low borrowing costs, cheap imports, acceptable farmer incomes, and net migration flows turning to positive over the next few months as some of the attraction of Australia wanes. Speaking of which, Australia's economy is likely to continue growing near 3% with some of the heat coming out of mining but housing and retailing receiving a bit of support from the RBA cutting interest rates again this week. The Aussie cash rate is now 3.25% and well down from the peak last year of 4.75%.

In the NZ labour market conditions look set to remain on the worse than average side for the bulk of job seekers for the next few months before the construction upturn next year becomes soaking up a lot of people and tightness generally appears for many employers.

Overall we are still looking at an economy supported by construction and commodity exporting with a high currency and sustained low interest rates but vulnerability should the world economy go back into recession because of either nothing being done to prevent the US fiscal cliff, or Europe finally imploding.

I'm still on the road with family while working and here are a few very quick observations.

I gave a talk about the state of the New Zealand economy to the London meeting of UK Beachhead advisors – an initiative organised by NZ Trade and Enterprise aimed at using the expertise of a couple of Kiwis and 17 non-Kiwi selected individuals in the UK and Europe to assist NZ companies looking to grow their European export base. My outlook was much along the lines of what I have presented here this week and in recent weeks but we had some good discussion around issues such as this.

Growth in exports of services from New Zealand does not receive as much attention as it should given the strong opportunities which exist to leverage the design and creative talent available in the likes of Wellington in particular. There is high scope for more foreign companies to locate portions of their research capabilities in New Zealand. While manufacturing is likely to remain challenged, there is good potential for licensing NZ manufacturing techniques etc. offshore thus bringing in export revenue.

I also attended a wine tasting by Yealand Wines who have 1,000 hectares in grapes south of Blenheim and attended a presentation by the Finance Minister Bill English. That was on Tuesday. On Wednesday I gave a presentation on the state of the NZ economy and the housing market at a function organised by Bayleys Real Estate, also held like the other functions at NZ House. Practically everyone who attended was a Kiwi ex-pat – reflecting the fact that advertising for the event used outlets more likely to be accessed by ex-pats than UK natives.

The attendees were as always keenly interested in the NZD/GBP exchange rate and whether the RBNZ would print money to lower it, the extent of the housing shortage, and the difficulty NZ will have attracting people to rebuild Christchurch given the much better pay ex-pats can receive by going to Australia. There was however the usual recognition that one returns to NZ for lifestyle and not income reasons with the schooling system being a big attraction. Only those at the upper end of the wealth spectrum able to afford to put their children into one of the top schools in London appear happy with education. The rest fret though many speak in terms of not judging all UK education by London's standards.

On the recreational side myself and my family visited Euro Disney in Paris paying the equivalent of over NZ$600 to spend a day in the two parks and while I can see why locals with their discounted annual passes would enjoy it, as a one-off visit it was over-priced and not worth it. There were so, so many people there and the kids had to queue for up to an hour to go on a roller coaster ride of which there are many. Cigarette smoke was everywhere. At least there was no dog crap on the ground.

The park is very big which for us was the initial problem as we kept thinking in terms of Dreamworld size as on the Gold Coast. But Euro Disney is much bigger. I loved the Swiss Family Robinson tree house having thoroughly enjoyed the story when I was a kid. The Frontierland area is good for small kids and a place to get away from the crowds. But the other Lands are packed and I fail to see the attraction myself.

There are souvenir stands all over the place, all essentially selling the same thing. The same goes for the cafes which all stock the same food. Both food and souvenirs again are over-priced.

Would I go again? No. I took the family there not because it is what one does when one visits Paris. One does not. Frankly it's naff. But I grew up watching Disney movies on Sunday nights back in the days of one channel (in black and white) and going to Disneyland was a fantasy restricted to those who won the Golden Kiwi or some special competition. Yes, at one point the emotion did bring almost a tear to the eye. But once beyond the magical castle the next few hours were just a crush of people – and this is the off-season! So in the end I'm glad we went, but having been there, seen that, I did not feel inclined to buy the T-shirt. And myself and my family have a whole new appreciation for Dreamworld in Australia. Go Aussies.

I had the littlest kids looking out the window for fish when I told them that the Eurostar train from Paris to London goes underwater. We only just made our departure time because the processing of people at Gare du Nord is terribly so. The British immigration people in particular are very finicky but thorough.

In London we are staying in an apartment near Canary Wharf and I like staying in the location because of the absence of tourists, the underground shopping mall, better value for money than a central London hotel, and ease of access everywhere using the Jubilee Line of the Underground. The location of the apartment just south of Marsh Wall is being filled up with multi-storey apartment buildings and the atmosphere is somewhat sterile. But if you are visiting London you're not going to be spending much time at your domicile anyway.

We visited the Natural History Museum which is just wonderful with its superb dinosaur exhibition, huge collection of rocks and crystals, great stuffed animals, and probably a lot of stuff which we missed.

We also visited the Science Museum which contains a great space exhibit including the actual capsule which the Apollo 10 crew came back in. There is a new large technology area which doesn't contain much in the way of exhibits but the kids seemed interested in some interactive screen things. Going to the museums at this time of year is a good idea because there aren't as many people as when the bulk of the tourists are about. I'm hoping to once again visit the Victoria and Albert Museum which I love but suspect the kids will get bored. So on a weekday I'll take them to the British Museum instead to look at the Egyptian exhibit which is wonderful. Apparently I am meant to find where Legoland is as well so they can go there!

I tried to get the family up to the Penthouse function venue at NZ House in Haymarket but they have a rule that kids under 14 years of age are not allowed up there because the gap between the vertical railings is too great. And that is in fact the case. A small child could easily slip through so the rule is a fair one.

INTEREST RATES

Just because the RBA cut interest rates 0.25% this Tuesday does not mean the RBNZ will. Prospects for growth in Australia have shifted notably to the downside in recent months but that is not the case in New Zealand where our interest rates are already lower than Australia's.

This week we saw swap rates decline in response to the Aussie rate cut Overall there is downward pressure on NZ wholesale interest rates from the deteriorating global growth outlook and the high NZ dollar. But there is upward pressure from special inflationary factors such as rising insurance premiums and the construction boom timing getting closer.

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%	2.66	2.68	2.77	2.70	5.7
1 year swap	2.62%	2.61	2.61	2.76	3.02	5.8
3 year swap	2.78%	2.85	2.82	3.01	3.46	6.1
5 year swap	3.04%	3.14	3.13	3.36	3.91	6.3

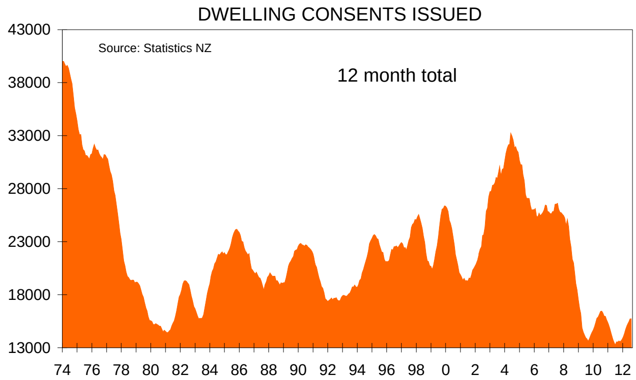
HOUSING MARKET UPDATE

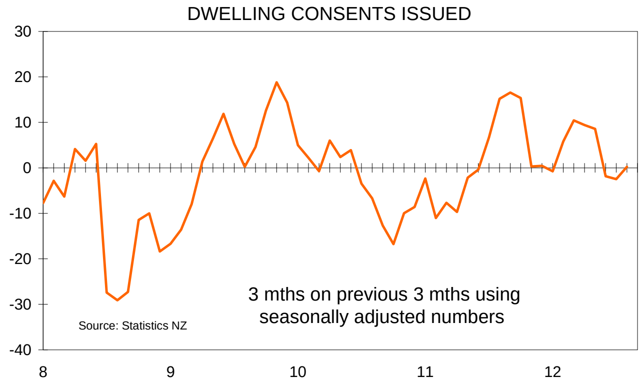
- **To view the most recent results of our monthly BNZ-REINZ Residential Market Survey click here.** http://tonyalexander.co.nz/bnz-reinz-survey/
- **I also write a monthly column on the residential property market in NZ Property Investor magazine available at your bookshop or newsagent.**

Supply Slowly Rising

In August the number of consents issued for the construction of new dwellings improved for the third month in a row in seasonally adjusted terms. But at 1.9% the rise was fairly small and over the past three months consents have risen only 0.2% after rising 8.5% in the three months to May. Compared with a year ago consents in the three months to August were up 15% but if we exclude the 5% rise for Auckland and 73% rise for Canterbury the gain for the rest of the country is just 2.7%. Therefore although the residential construction sector is picking up the gain so far is relatively light.

We don't expect this hesitant upturn to remain so weak however. With insurance now becoming more available in Christchurch and with the Reserve Bank indicating that interest rates will remain low for a long time while banks meanwhile are easing up on lending criteria, the scene is set for much stronger house building growth. For your guide, in the year to August consent numbers totalled 15,726 which is a good gain from the four decade low of 13,269 in the year to July last year.



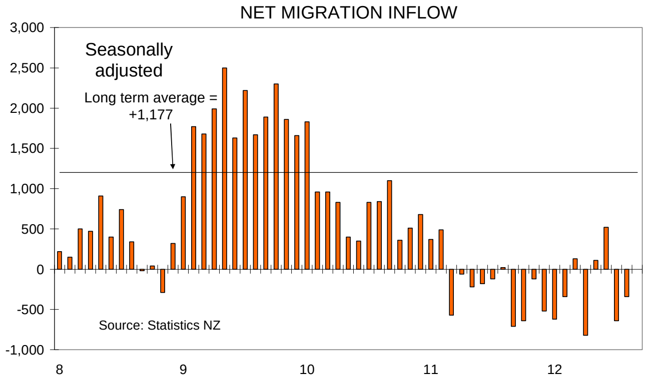


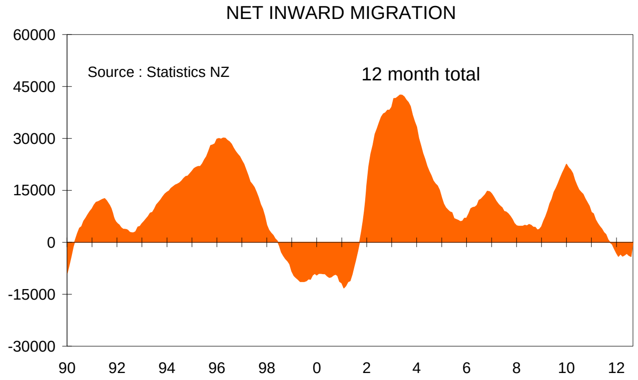
The key point of relevance here is that construction still remains well below required levels and this implies continuing upward pressure on house prices assisted as noted by low interest rates.

Prices Rising In Spite of Migration Losses

With regard to migration the situation is yet to change toward a net positive annual gain to the country's population but we suspect that will be the case by early next year.

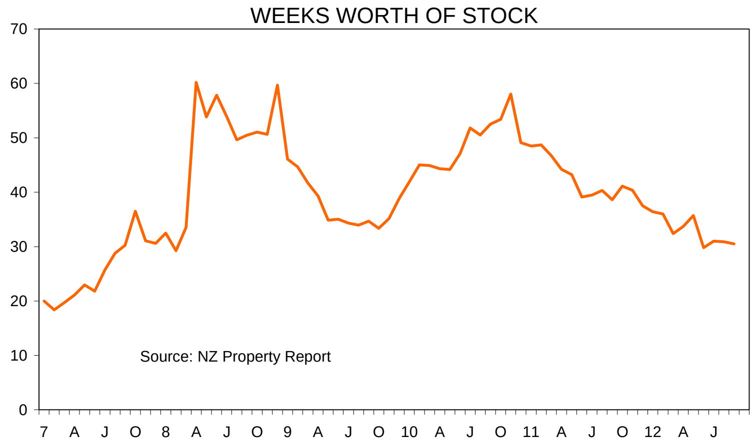
In seasonally adjusted terms the net flow in August was a loss of 340 people compared with a loss of 640 in July. For the past three months the annualised net flow was a loss of 1,840 people compared with a loss for the entire year to August of 4,118. So the data still show an ongoing population loss. But with economic conditions weak and deteriorating in Europe and the attraction of Australia dimming somewhat the relative attractiveness of NZ is likely to grow. Then one has to think in terms of this. If Auckland house prices have already risen about 11% from a year ago while the country is suffering net migration outflows, what will happen when those flows turn positive?





Inventory Low

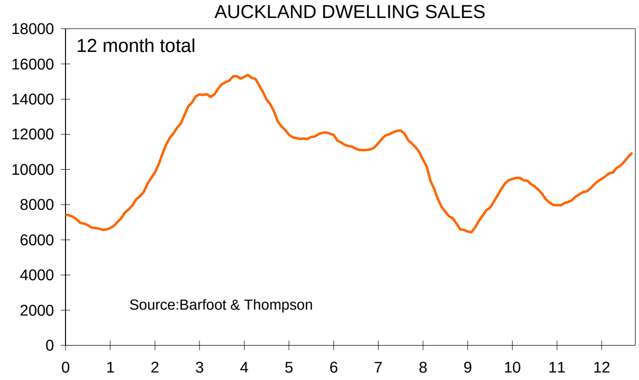
We got some updated information on the size of the residential real estate inventory this week from the NZ Property Report. It shows that over the three months to August the ratio of sales to stock stood at 30.5 weeks which was down from 30.9 weeks in the three months to July and the lowest reading since September 2007 apart from the period ending June when the reading was 29.8 weeks. This number simply tells us what we already know in terms of stock availability becoming poor. It should be noted that in Auckland the weeks worth of stock was well below the average of 32 at just 17.4 weeks.

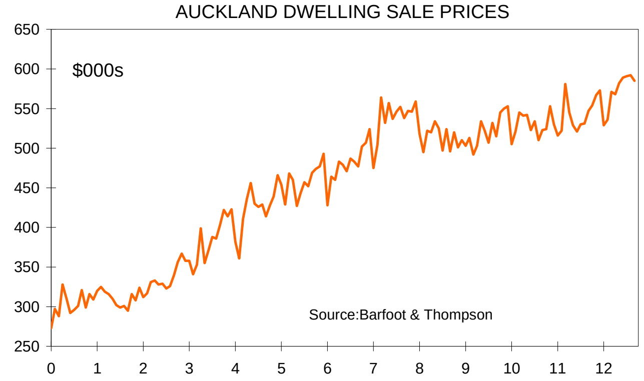


Auckland Data

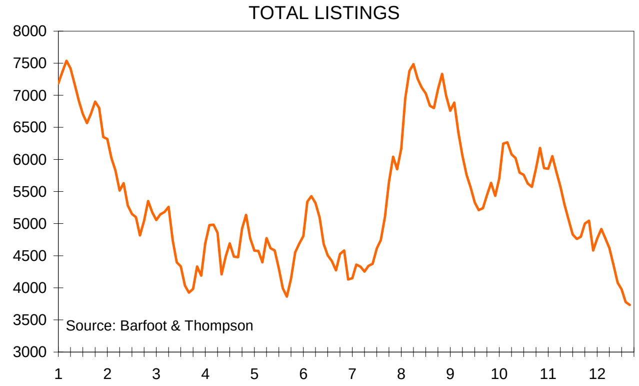
We also got information on stock availability from the monthly Barfoot and Thompson data which apply to Auckland. During the month they sold 969 dwellings which was a 31% rise from a year ago but near 5%

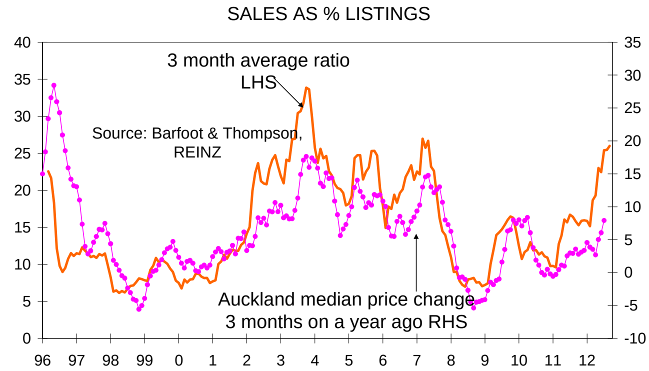
seasonally adjusted fall from August. In the past three months sales have risen about 2% s.a. so there is a mild upward trend in sales in place. The median dwelling sales price eased to $585,000 in the month from $592,000 in August but was ahead 1.7% in the past three months. Prices are rising at about a 7% annualised clip.





During the month B&T received 1,266 new listings which was largely unchanged from a year ago though ahead 10% in the September quarter from a year earlier. So a few more properties have appeared recently. But end of month total listings stood at 3,733 which was a 22% decline from September 2011 and means the ratio of sales to listings over the past three months has averaged 26% which is the highest level since May 2007.





Basically the data tell us that while neither sales or prices are rocketing ahead there is no supply rush underway and buyers are facing the smallest level of choice since early 2007.

If I Were A Borrower What Would I Do?

I have nothing new to write here. I personally would opt for the two year fixed rate at 5.4% though would give some serious thought to an 18 month rate of 5.25% also.

MAJOR OFFSHORE ISSUES

Europe

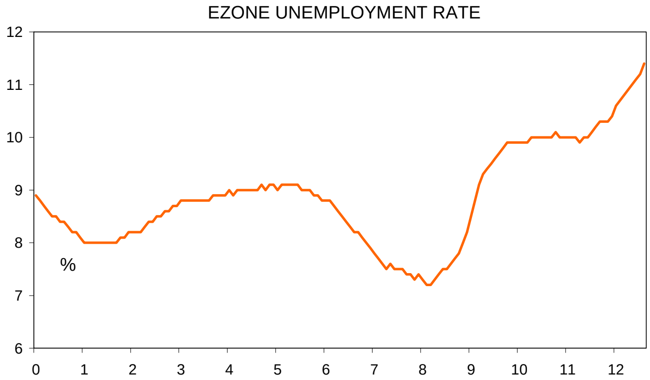
I would like to be able to write here that compared with my previous visits to Europe in the past two years there is this time around a greater air of optimism regarding the government debt crises being solved. However that is not the case – unless you really heavily on the statement by the ECB President that he will do “whatever it takes” to hold the Euro together. Given that means a continuation of the thing at the very heart of Europe’s problems one cannot be optimistic. Plus simply printing more and more money to ensure liquidity of recalcitrant governments is only going to aggravate speculative pressures which will be appearing in places we can’t even imagine in conjunction with the wave of money going into the US economy then out again offshore from Fed. printing looking for a better return than near 0% in a bank.

These remain exceedingly dangerous times and weak growth remains in prospect in the UK and Europe for some time. With regard to the UK, data remain unwaveringly poor, everyone keeps revising down their growth forecasts, worries about Europe and its impact on the UK remain high, and I see nothing to dissuade me from my view that the NZD/GBP exchange rate is headed toward a range of 55 – 60 eventually.

In France the Socialist Government has passed a budget which is aimed at getting the deficit down to 3% next year from 4.5% this year with balance targeted by 2017. However the economic forecasts used to generate deficit projections appear too optimistic with no sign yet that the current period of economic deterioration is ending. The budget also contains almost no spending cuts – just some freezing of spending. Instead it relies heavily upon further increasing France’s already high tax burden with a new 75% tax introduced for those earning over €1mn a year. This latter move has already prompted much talk of senior executives shifting to other countries which is probably something more and more companies generally will think of doing as France’s (high) competitiveness with other countries declines.

One of the reasons many European countries run large deficits and are struggling to rein them in is that spending on pensions is huge. Whereas in New Zealand superannuation costs about 5% of GDP, in Spain the percentage is 9%, France 15%, Italy 13%. With populations aging politically weak governments unwilling to risk losing votes from elderly people unwilling to give up their benefits is one of the factors set to consign Europe to the slow lane in world growth for the next few decades. Hence another reason why the NZD’s rise against the Euro and the pound is a structural and not just cyclical thing. Whereas the chickens came home to roost for our economy in the 1980s, it has taken more than another two decades for the same to happen in Europe. But given their political systems and popular desire for sucking on the State’s teat their period of adjustment will stretch over a much longer period than our 1984 – 92.

And while spending on pensions is draining European government budgets so too is spending on the largely young unemployed.



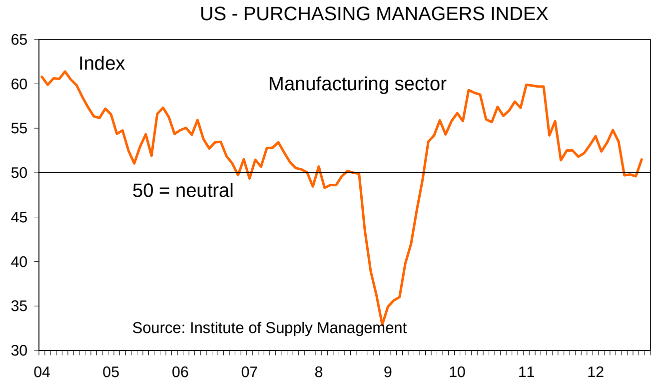
Europe’s unemployment rate in August stayed at a record of 11.4%. This is fairly bad news and helps explain why more and more of the commentary I am reading in the media over here in London and discussion among the people I speak with is about Europe’s social fabric and how it is pulling itself apart. As noted previously, gauging that is chiefly what I try to do when coming here each six months as anyone can download the basic data from the internet and talk about the economy.

In Spain government debt continues to grow with a big surge lying just ahead when it accepts liability for repayment to the IMF of up to €60bn estimated to be needed by Spanish banks for recapitalisation. This figure is less than the €100bn number which had been feared, however all is not as it seems. A €60bn injection would only keep core capital ratios near 6%, and the scenario used for calculating that amount did not allow for losses which might occur on government and regional government debt held by Spanish banks. The scenario also assumed a 37% fall in house prices but one estimate is that prices have already declined 40%. Only 3% capital flight from Spain is assumed. The total for July alone was 5% of Spanish bank funding and August's loss was 1.1%.

United States

Data released in the past week have been as mixed as usual. Orders for durable goods in seasonally adjusted terms weakened by a large 13% in August. However this result was distorted by a big one-off fall in aircraft orders and when transport and defence items are removed the change was actually a rise of 1.1% - but this followed several months of falls.
The annualised rate of growth in the economy during the June quarter was revised down to just 1.3% from 1.7%.

But the ISM manufacturing reading rose back into positive territory at a better than expected 51.5 in September from 49.6 in August.



China

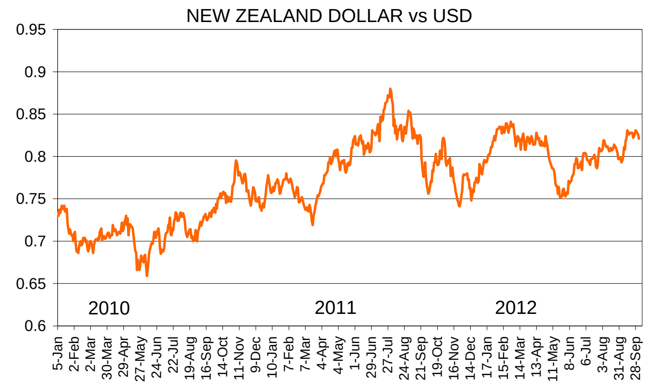
You can find my China page on Facebook at http://www.facebook.com/TonyAlexanderNZ I have set up this page specifically for discussing the NZ-China relationship and as a tool for disseminating information and furthering my own still inadequate knowledge.

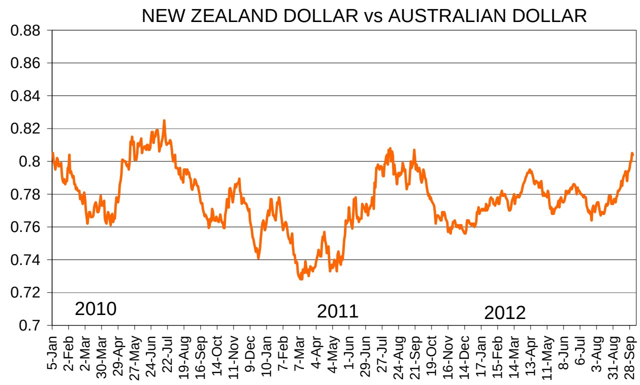
Exchange Rates

Exchange Rates	This Week	Week ago	4 wks ago	3 Mths ago	Yr ago	10 yr average
NZD/USD	0.821	0.827	0.797	0.804	0.756	0.67
NZD/AUD	0.804	0.794	0.777	0.782	0.789	0.85
NZD/JPY	64.500	64.200	62.400	64.100	58	69.6
NZD/GBP	0.510	0.510	0.502	0.512	0.489	0.388
NZD/EUR	0.634	0.641	0.633	0.637	0.571	0.52
NZDCNY	5.203	5.215	5.056	5.108	4.808	4.99
USD/JPY	78.563	77.630	78.294	79.726	76.720	105.7
USD/GBP	1.610	1.622	1.588	1.570	1.546	1.72
USD/EUR	1.295	1.290	1.259	1.262	1.324	1.28
AUD/USD	1.02	1.04	1.03	1.03	0.96	0.788
USD/CNY	6.3375	6.3059	6.3432	6.3536	6.36	7.56

Weaker AUD The Main Change

The Kiwi dollar has fallen slightly against the USD this week but risen to a 13 month high against the Aussie dollar.

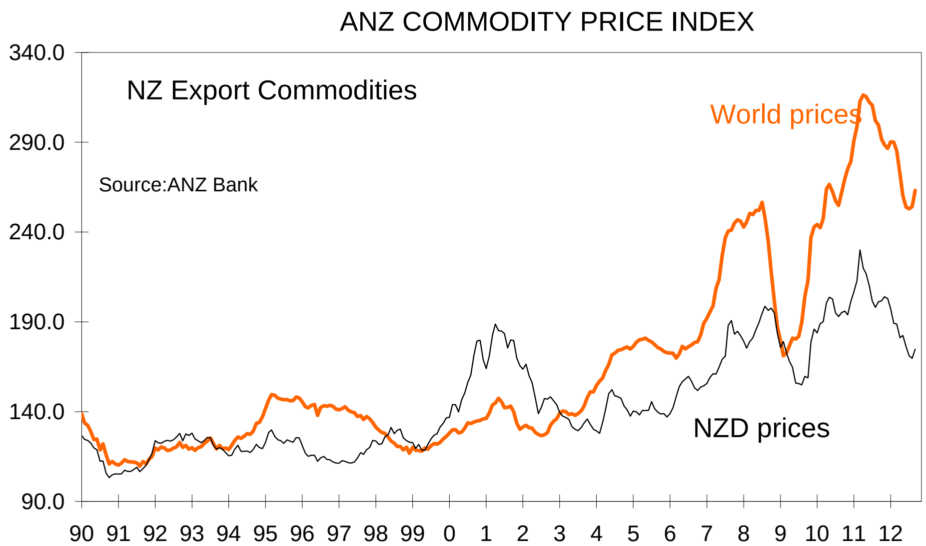




The cause of that latter movement was a weaker AUD following the surprise decision of the Reserve Bank of Australia to cut its cash rate another 0.25% to 3.25%. The RBA has now erased almost all of the 1.75% increase in interest rates it imposed between October 2009 and November 2010. In cutting the rate they cited the currency being higher than expected, worries about offshore growth, and softening of the labour market. All of these things are relevant to New Zealand. So does that mean our currency is about to be pushed lower by the RBNZ cutting our 2.5% cash rate?

Not really. First, the RBNZ unwound their 2010 rate rises a year and a half ago. Second, unlike Australia our export commodity prices are rising.

The ANZ Commodity Price Index in world price terms rose by a strong 3.5% in September led by 11% rises in prices for skimmed milk powder and aluminium – not that the second item means anything really for the primary sector. It is more relevant to the extent of cutbacks at the Tiwai smelter near bluff where one suspects a few more factors are in play than just the spot aluminium price.



Butter and whole milk powder rose by 8%, wool and apple prices 6%, cheese 5%, and venison 2%. So the gains are spread across many items and that is a good sign for growth but clearly places extra pressure on the manufacturing sector – the part of our export sector which continues not to be able to keep up with either the primary sector or tourism. Visitor numbers rose by 5.3% in the year to August in spite of the firm NZ dollar. There is clearly more to manufacturing sector inability to compete offshore and against imports than the exchange rate.

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 – 2.75	2.75 – 425
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
- 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
- Discussion of New Zealand's relationship with China can be found here. 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

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