

BNZ Weekly Overview

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 email me at tony.alexander@bnz.co.nz with 'Subscribe' in the Subject line.

Asset Price Inflation

Commodity prices are soaring, our currency is probably on its way to a post float high above US 82 cents, sharemarkets are strong yet interest rates are low. Are we living in some new nirvana in which current weak data in many economies is essentially meaningless and ignored because future prospects are so bright? One might run such an argument (with current data strong) for the likes of China and Germany – though even in these countries, as in Australia, household spending remains relatively weak.

But while there are good grounds for hope regarding how the world economy will go in the next few years, there is also clearly a strong element of speculation behind current asset price moves and just as these things are currently rising in a hurry they will eventually fall also. And just as history shows asset prices overshoot by a completely unpredictable amount on the upside they also overshoot on the downside.

In late-2007 and early 2008 we saw many asset prices (houses, Kiwi dollar, equities) go excessively and unrealistically high as a result of a global credit boom. That is, lots of money was loosely floating around and finding its way into asset markets as opposed to new products, production processes etc – the stuff we really like to see. So what is happening at the moment? Is it that credit conditions are once again excessively loose? In the most commonly known way the answer is clearly no.

Banks have cut back on their lending (mainly offshore but also here in NZ to a much lesser extent), and perhaps more importantly in some instances people do not want to borrow money. They are concentrating their efforts on repaying debt. Yet some asset prices are rising strongly. What gives?

What gives is that because banks in the United States in particular don't want to lend and because people in the private sector do not want to borrow the Federal Reserve has decided to add to the US\$1.7tn it has already injected into the US money supply with another US\$600bn to be added by the middle of next year. Last week we explained the printing money element of this operation in our FX section so anyone interested in the matter should have a look there as we will not repeat the discussion here.

Where is the money going? It is not expected that the funds will go toward productive business uses or be used by consumers to boost their spending on goods, services and housing. If those expectations were present one might conclude that some asset markets would still be rising as they are now. But if such expectations were there the quantitative easing would almost certainly not in fact be needed.

What's happening is that because the extra cash is not expected to be utilised in a normal manner by a much larger economy it is going into financial assets. More money but not more production means more inflation. Normally as students of economics we analyse this in terms of inflation appearing in the normal sense – the consumers price index. But for that to happen the transmission mechanism for the extra money hitting the economy is consumers borrowing it and spending it. In this context however we are instead talking about investors being left with the money they were going to use to buy government bonds (see the FX section last week) now taking their investment money and buying other assets.

Hence our currency goes up at the same time as our commodity prices rise so the net impact on most primary sector exporters here is minor. But if you are an exporter not producing a commodity the extra quantitative easing is an outright negative factor. This includes tourism operators, manufactures etc.

The interesting question however is this. What happens when the US economy is strong enough that the Fed. starts taking the money back out again? Basically the opposite of what is happening now in perhaps a violent manner as investors look to quit clearly over-priced assets as rapidly as possible. Asset markets tend to go up the escalator and down the lift shaft as it were.

What this means is that at some stage the NZD is going to drop quite sharply yet at the same time commodity prices will be falling probably along with sharemarkets. At some stage exporters will want to pull back sharply on their hedging while importers put more in place. When will this happen? When US interest rates start rising and the Fed. implements quantitative tightening (QT). When will this happen? That is impossible to say. How high will commodity prices and the currency go before we reach this turning point? That also is impossible to say.

All one can safely say is that major uncertainty continues in world financial markets and those with currency and other asset price exposures would be wise to allow for high volatility over the next few years. In a year's time the NZD could just as easily be at 85 cents as 70 depending upon your interpretation of where the world is heading.

An Ageing Population

This week I have been attending a conference in Sydney looking at the challenges thrown up by Australia's ageing population. There are some differences with the situation here along the lines of

- disconnectedness from social networks of certain ethnic groups,
- a debate about big Australia vs. small Australia,
- the Federal/State government relationship, and
- special population remoteness issues.

But the issues beyond those look largely the same. Here are some comments gleaned from the conference in no particular order of importance and with little any of the business opportunity-oriented stuff one even struggles to find on the internet. That is, it is hard to find a decent summary of how businesses can reorient themselves to take advantage of the ageing population as opposed to simply adjusting to accommodate it. Further research will be needed in this area.

As is usual with these things one always starts with some facts intended to scare people a bit and make them aware that things are going to change.

- The ageing of the population results from the bubble of the Baby Boomers moving through the population, the reduction in fertility rates from the early 1960s (end of the BB period), and increased life longevity.
- The world gains over 1mn people aged 65+ per month.
- In 1970 in NSW there were 7.5 working age people for each retired person. That ratio is currently 5.5 and set to fall to 2.7 come mid-century.

- Between now and 2036 the NSW population under 18 years of age is projected to grow 19%, 18-64 years 21%, and 65+ years 111%. This will make about 22% of the population over 64 years old. In Japan at the moment the ratio is just over that already.
- In 1970 in NSW there were 59,000 people over 85 years of age or 0.5% of the population. This is now near 400,000 and 1.6% and is projected to reach 600,000 and 2.4% by 2020 then 2.1mn or 6% come 2050.
- Average life expectancy at birth has risen 25 years over the past century. That has come about largely because of factors which have stopped young to middle aged people dying. Going forward progress will be largely around older people dying at greater ages.
- There is a growing detachment between chronological age and societal age – as in middle age is shifting to 65 from 45!
- Two-thirds of the projected government spending increase associated with an ageing population will be health related.
- Currently in NSW there are 400,000 (1.7% of the population) over 85. That will rise to 1.6mn or 5.6% come 2047.
- The number of people with dementia (the big health cost category) in 2009 was 240,000. This is projected to rise to 591,000 in 2030 and 1.3mn in 2050.
- All Australian government costs associated with an aged population currently account for about 9.6% of GDP. This is projected to rise toward 14.4% by 2050.
- Some 40% of aged care providers (old folks homes) in NSW are running at a loss and many close every year. It is difficult to attract staff to these assisted living enterprises as the pay is far less than for those who work in acute care. A problem with this is that old people have to travel further and further to find accommodation and often because they cannot extra pressure goes on public hospitals to house them. Much more home based care is going to be needed and that will require not just centralised government funded programmes but a rejuvenation of the volunteer community.
- Those aged 65+ account for about 36% of acute hospital admissions in NSW and 48% of bed days. A health system oriented toward an aged population is actually already in place.
- There is a high rate of hospital admission for reactions to prescribed drugs – usually resulting from not following the instructions it seems.
- Not all old folk live in retirement complexes. Most stay in their homes the whole time up until death. In NSW 93.5% of those over 64 years of age live in their own homes. Only 6.5% are in care accommodation with these rates at 1% for those aged 65-74, 7% 75-84, and 31% 85+ years.

One can broadly break down the issues surrounding an ageing population into seven areas.

Fiscal Costs

In the absence of change government spending on older persons will be about 4% of GDP bigger than at the moment come 2050. Combined with a shrinking labour force, in the absence of policy change government net debt will blow out from around 17% of GDP at the moment (NZ) to over 100% come the middle of the century. This will result from the operating balance deteriorating largely from the early 2020s to each 16% of GDP come mid-century.

That sounds scary. But it means we have four decades to slowly work on the challenge implementing measures which will shrink the deficit by about 12% of GDP over that period of time. That means about a 0.3% adjustment each year which to put this into context compares with countries in Europe currently cutting their deficits from about 10% of GDP to 3% over a four year period.

Panic about the fiscal situation is therefore not warranted and scary projections about how much government debt will blow out in the absence of that are simply that – scary projections which will not come to fruition. Frankly such straight-line exercises taint the debate by portraying population ageing as a problem requiring harsh medicine as opposed to a simple demographic change – of which there have been others in the past such as women entering the workforce and the Baby Boom period itself from 1945-64.

Health Care Services

There will not be enough money available to provide older people in the future with the same health arrangements as currently exist. That does not mean old people left dying in their homes. It means over time a movement toward more disease prevention programmes (obesity/diabetes), telehealth, in home care aimed at restoring mobility etc. The greatest challenges look like being the provisions of residential care and acute care for the 85+ group. Business opportunities will arise for providing in home care in particular – not just health but clipping toenails, hairdressing, cleaning etc.

Housing

With older folk living longer and proportionately more of them the average home occupancy rate will decline over the next few decades. This will put pressure on the available housing stock. In fact one estimate for Australia is that from 8.9mn households at the moment an extra 7mn will be required by 2050. This means that over time in New Zealand the required annual level of house construction will rise from the 23,000 estimate we use at the moment – which itself will naturally be rising as the population gets bigger. Given that currently NZ consent issuance is running at just over 16,000 it is fairly easy to see why we don't believe house prices are in for a big correction downward.

The key challenge however will be elderly people who do not own their own home facing rising rents they will not be able to afford. Responding to this challenge will involve things such as the freeing up of space in the state housing stock as announced two weeks ago in New Zealand, more pressure on council housing, plus more pressure on hospital beds and queues for places in rest homes.

Ageing people are likely to seek out communities offering good facilities (see below) creating extra upward pressure on property prices in such locations.

Community Facilities and Infrastructure

With a greater proportion of the community old councils will need to look at changes which make elderly living a better experience. That will mean things such as wider footpaths to handle mobility scooters, longer green light times for pedestrian crossings, more seats in public areas, improved wheelchair access, and of course more public transport.

Labour Force Changes

Challenges here include how to keep elderly people in the workforce longer (flexibility of work hours etc.), in the NZ context a shrinking labour force from the early 2020s, where to find the people to provide care in the home, how to handle the loss of many skilled people.

Larger businesses and the government sector tend to have older employees than other employers. Generally employers show an unwillingness to train older workers even though they identify hiring them as one way to combat employee shortages. There is also a tendency to promote early retirement when times are tough. Old workers get the bad end of the stick in other words. Older workers are less likely than young people to take sick days, but when they do they tend to for longer periods.

Ageism

Our societies are youth-oriented and as fiscal pressures slowly emerge there is a clear risk that elderly people are blamed for cutbacks in spending in non health and pension areas. Policies actively aimed at combating ageism will need to be introduced including the general portrayal of aging as something like people entering a third phase of their lives etc.

Changes in Household Consumption Patterns

Unfortunately this was a barely mentioned side issue at the conference and in fact it is hard to find material examining ways in which businesses can outright profit from the ageing of society. But areas of growth will include the following

- Reverse mortgages as old people tend to be asset rich and cash poor and this will especially be the case in New Zealand given our traditionally low household savings rate and the loss of wealth recently due to the collapse of finance companies.
- Anti-ageing products and services. Not just pharmaceuticals but therapies.

- Travel
- Housing for older people, retirement villages
- Taxis as only 64% of those over 75 years of age have access to a car.
- In-home care services.

We'll have a look at this last area in more depth in the future.

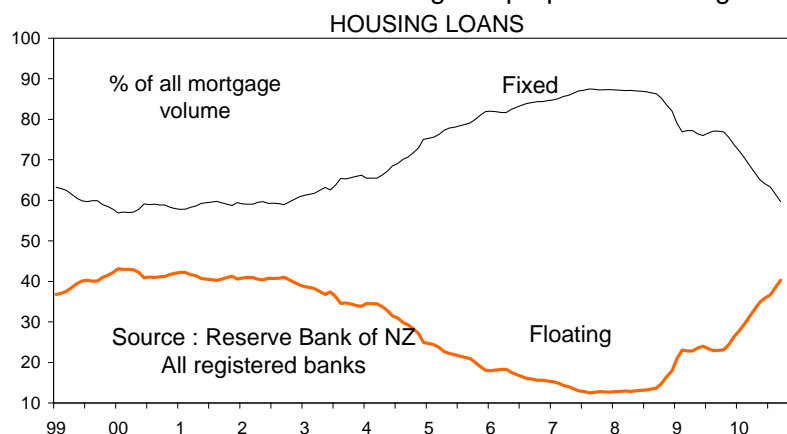
INTEREST RATES

Expectations that the Reserve Bank will restart its tightening cycle in March next year firmed up last week following the release of stronger than expected jobs data. This has not affected the 90-day bank bill yield relevant to movements in floating mortgage rates which will remain anchored near 3.2% until we get close to March. But swap rates which are more forward looking have reacted and unless we either see some new awful development overseas or some unusually weak data here it seems fair to say that we have probably seen the end of the decline in these fixed borrowing costs brought on by generally weaker than expected NZ data received over the past few months.

However, as we have noted for a couple of years now the level of uncertainty regarding economic growth and inflationary pressures is huge and one would be extremely unwise to put in place a borrowing strategy highly dependent upon anyone's forecasts of interest rates proving correct. Some of our forecasts from about 18 months ago have panned out very well (timing of the cash rate starting to rise) but others have had to be altered (continuation of the tightening cycle, peak in the cash rate, movements in swap rates.)

In particular borrowers should note this point. If we can have a period as we have passed through recently where data surprise on the weak side and wholesale interest rates rally, we can also have a period when data will be surprisingly strong and rates will jump quite sharply. Perhaps awareness of this explains why a few more of the larger borrowers are showing an inclination toward locking in some long term funding costs. As they do so these long term rates of course rise. The big question however over and above what they do and what the data do is what will average mortgage holders do?

The proportion of mortgages sitting at a floating rate hit 40.3% at the end of September from 23% a year ago and a low of just 12.7% in December 2007. This is the highest proportion floating in eight years.



Late in March last year we saw a sharp rise in swap rates caused substantially by people who had been floating waiting for fixed rate lows securing those low rates in droves. These were rates such as 6.49% for a five year fixed rate (7.8% now) and 6.79% seven years (now 8.3%). These five and seven year rates come the end of April were 7.5% and 8.19% respectively and they peaked in October last year at 8.75% and 8.99%.

Could we see a similar sharp jump by mortgage borrowers into fixed rates from floating this time around? Probably not. Our discussions with home owners show most seem to be quite happy sitting floating paying

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6.09% and are prepared to ride the cycle with few feeling that the economy will get so strong and inflationary pressures so immense that these rates will jump massively. They are probably right. If our current forecasts prove correct these folk should budget for the 6.09% rate reaching close to 8.25% come early 2012. Of course this forecast is 100% guaranteed to change between now and then and that uncertainty is a key reason there are still a good number of people who do want to fix.

If I had a desire to fix and had been happy floating in recent months I would now be thinking seriously about moving into a two or three year rate given that the chances of these rates falling further (after small cuts we announced yesterday) are minor. But the chances of these rates rising in the near future are increasing.

Key Forecasts

- Tightening through to mid-2012 with the next rate rise in March.

FINANCIAL MARKETS DATA						
	This week	Week ago	4 wks ago	3 months ago	Yr ago	10 yr average
Official Cash Rate	3.00%	3.00	3.00	3.00	2.50	5.9
90-day bank bill	3.20%	3.21	3.20	3.28	2.82	6.2
1 year swap	3.64%	3.58	3.51	3.66	3.56	6.3
5 year swap	4.70%	4.64	4.41	4.56	5.77	6.6
180-day term depo	4.10%*	4.10	4.80	4.90	3.15	6.0
Five year term depo	6.50%	6.50	6.75	6.75	6.00	6.5

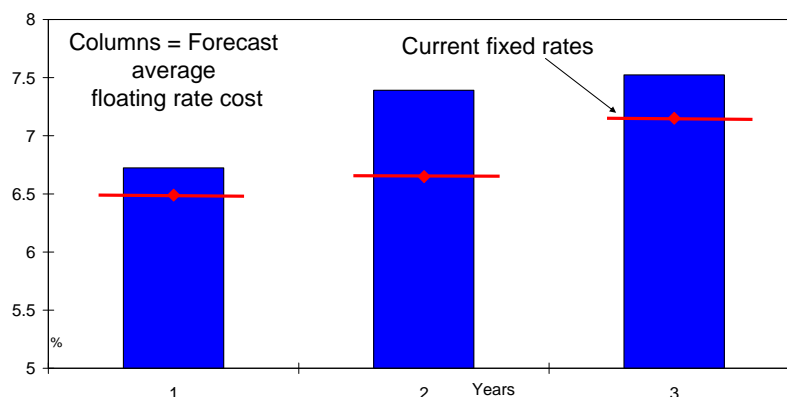
* 150 days = 5.1%

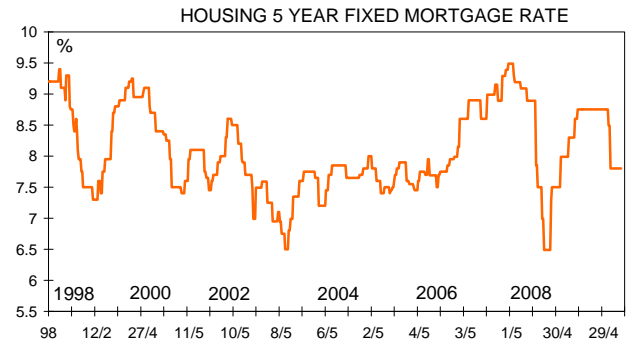
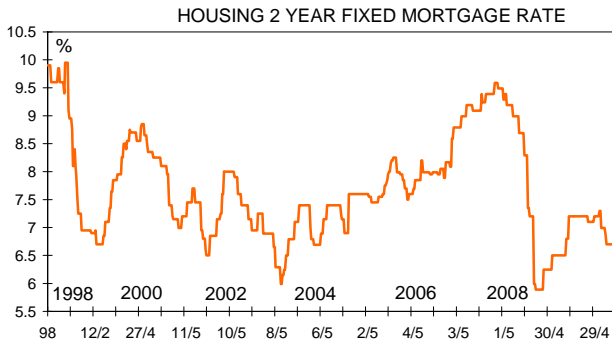
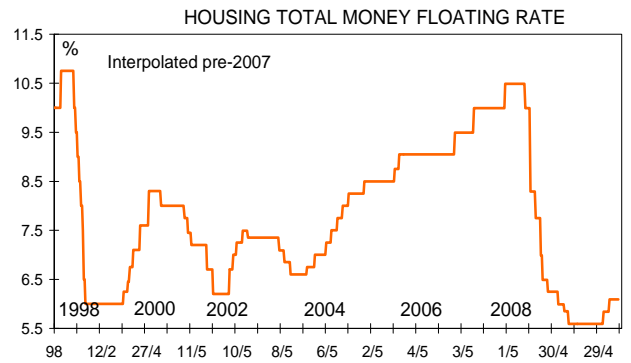
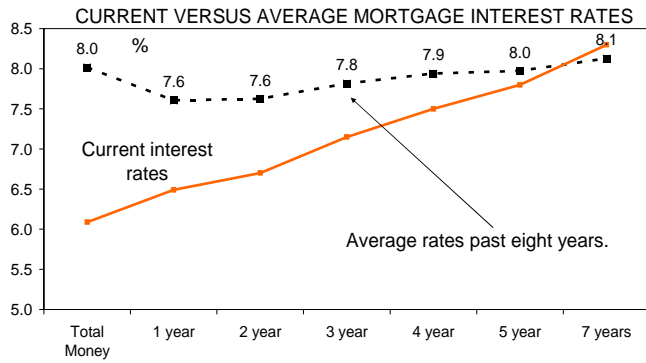
If I Were a Borrower What Would I Do?

If my intention all along has been to sit floating simply waiting for the low point in fixed rates then I would be inclined to fix now. But I would only do that if I had a reasonable belief that fixed rates are about to rise. My analysis of the margins suggests we are close to a round of rate rises. So I find myself prepared to sacrifice the nice low 6.09% and lock in two years at 6.65% with an expectation that I will average an interest rate cost over the next two years near 0.75% lower than if I float.

I do not find the three year rate attractive as taking it will save me only 0.4% compared with floating for the entire three years. More than that, if our forecasts prove correct (cue giggle) two years at a 6.65% fixed rate then one year floating will yield a total three year average cost of 7.1% compared with the current three year fixed rate of 7.15%. It looks better to fix two years then float than fix three years.

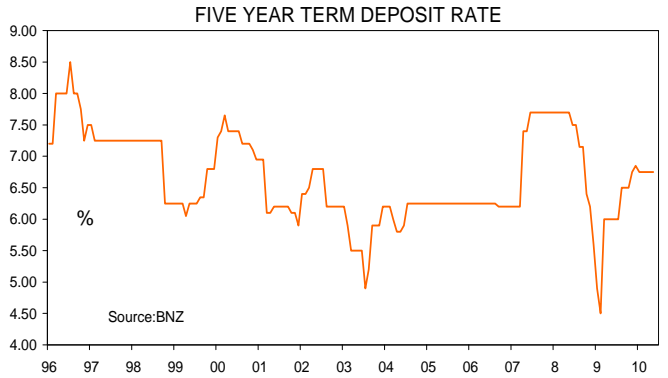
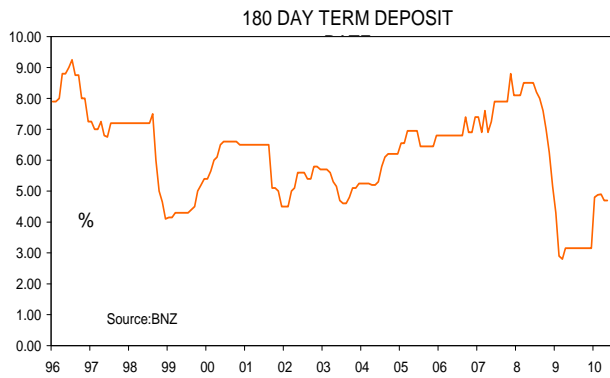
So I would fix two years.





If I Were a Term Deposit Investor What Would I Do?

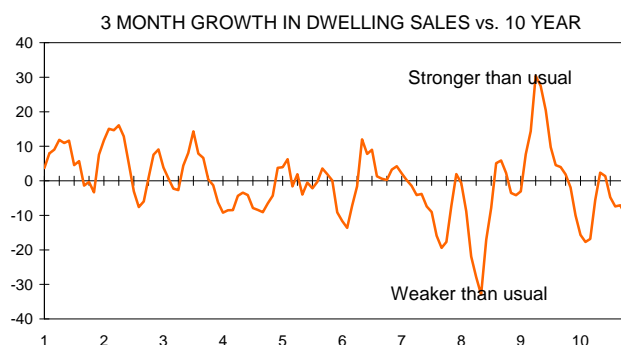
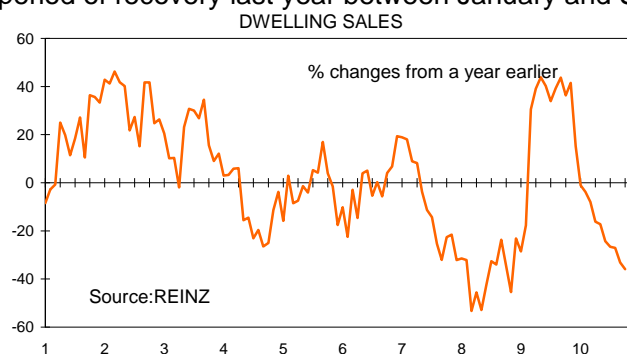
Take a range of shorter dated terms with a view to moving into longer terms in the second half of next year when those long rates are higher than they are now.



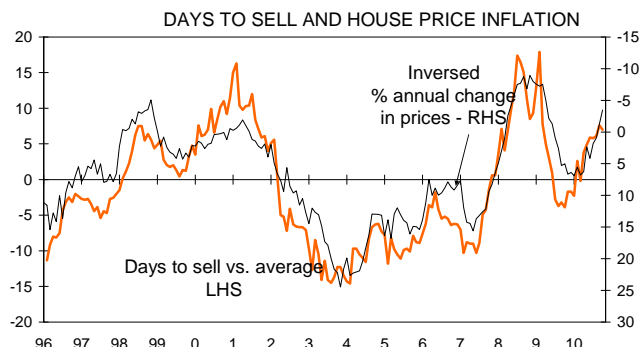
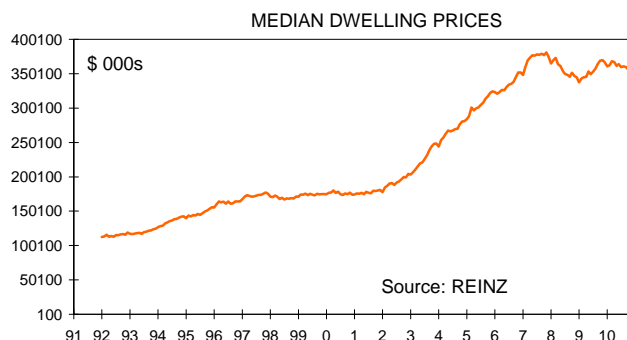
HOUSING MARKET UPDATE

Market Flat as A Pancake

The REINZ released their monthly data this week and there was nothing surprising. There were 3,903 dwellings sold in October which was a 36% fall from a year ago, though October 2009 was 36% ahead of October 2008 which was 35% down from October 2007. Lots of volatility in other words. In rough seasonally adjusted terms sales have fallen near 10% over the past three months so activity has worsened following a period of recovery last year between January and September.



The average dwelling sales price fell 1% in the month to lie 3.5% down from a year ago and 6.5% below the late-2007 peak. On average in October it took 41 days to sell a dwelling which was 10 days longer than a year ago and 7 days longer than average for the month. This was actually an improvement from September being 7.6 days longer than average though still shows a market with properties sitting on the market for long periods of time.



Basically buyers feel in no hurry and sellers are not selling unless they have to. This state of affairs is likely to continue through into the second half of 2011 by which time we expect to see more clearing of the backlog of sales and downward pressure on prices from rising mortgage rates more than offset by an improving labour market (already underway) and awareness of housing shortages.

Are You Seeing Something We Are Not?

If so, email us at tony.alexander@bnz.co.nz with Housing Comment in the Subject line and let us know.

Key Forecasts

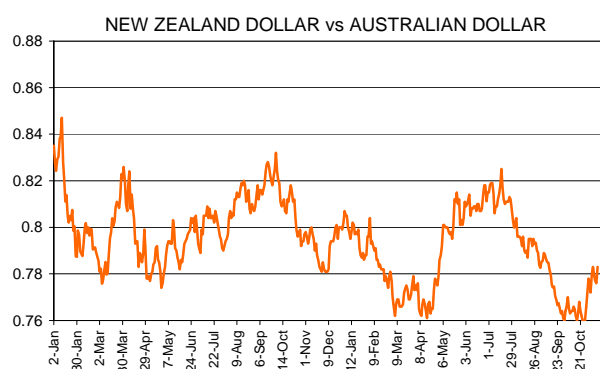
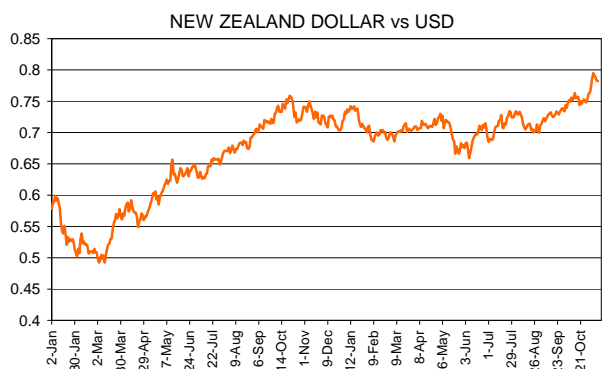
- Dwelling consent numbers to improve further out.
- House prices edging higher from second half of 2011.

Exchange Rates & Foreign Economies

Exchange Rates	This Week	Week Ago	4 wks ago	3 mths ago	Yr ago	Consensus Frcsts yr ago*	10 yr average
NZD/USD	0.785	0.785	0.756	0.724	0.741	0.610	0.592
NZD/AUD	0.783	0.780	0.764	0.792	0.798	0.770	0.856
NZD/JPY	64.60	63.30	62.00	61.80	66.5	61.366	66.8
NZD/GBP	0.486	0.486	0.474	0.456	0.443	0.380	0.345
NZD/EUR	0.570	0.557	0.540	0.549	0.495	0.445	0.51
USD/JPY	82.29	80.63	82.01	85.36	89.744	100.600	113.9
USD/GBP	1.615	1.615	1.595	1.588	1.673	1.607	1.709
USD/EUR	1.377	1.409	1.400	1.319	1.497	1.372	1.156
AUD/USD	1.003	1.006	0.990	0.914	0.929	0.792	0.69

Kiwi Steady

This evening the Kiwi dollar was trading against the greenback near 78.5 cents which is exactly where it was last week and still about four cents up from two weeks ago. We are also largely unchanged against the AUD. The gain back then came about largely on the back of the stronger than expected labour market report for the September quarter raising the chances of the Reserve Bank lifting interest rates in March, partly riding the coat-tails of an Aussie dollar lifted by an unexpected rate rise over there, profit-taking following the Kiwi dollar's decline against the AUD in recent months, and generalised buying of growth, risky, and commodity based assets around the planet following the Federal Reserve's decision to undertake another US\$600bn worth of quantitative easing.

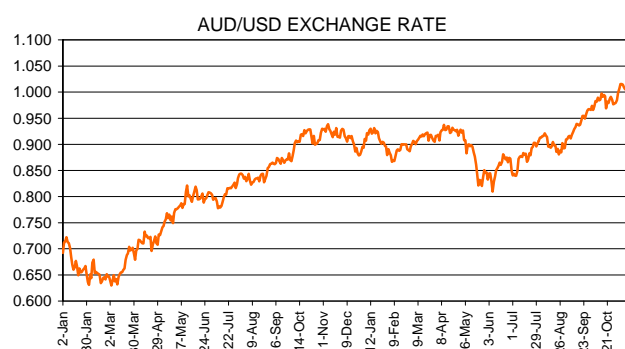
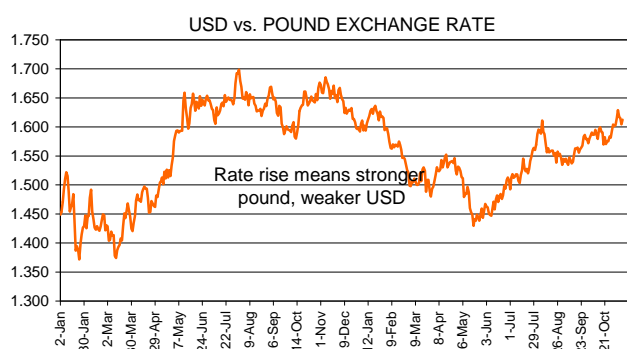
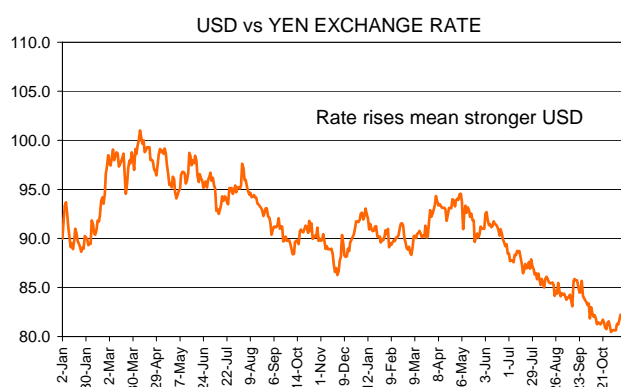
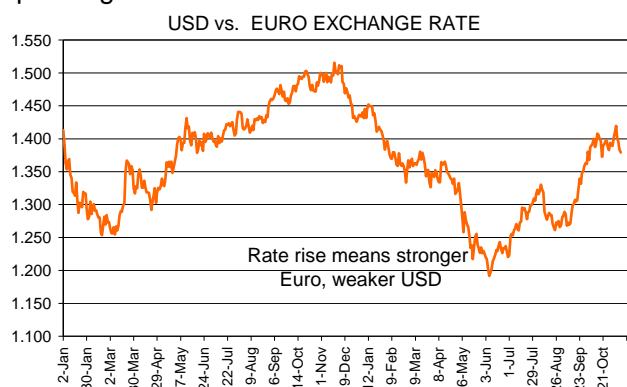


This week there has been extensive discussion and discord regarding the Fed.'s move with criticism of the implicit devaluation of the greenback from countries which themselves have traditionally cheated the system to gain currency advantage, plus Germany which is concerned about potential for higher inflation. Much of the discussion was in the context of positioning ahead of a G20 leaders meeting today and tomorrow in South Korea which is unlikely to result in any change in global foreign currency rules and relationships. But in a sign of just how weird things are getting with regard to worries about a currency war the World Bank President this week proposed a return to the gold standard while the US proposed then appeared to back away from explicit limits of the size of individual countries' current account deficits and surpluses – a proposal which the Chinese described as involving too much authoritative control. Ironic.

The issue of currency levels and current account imbalances is going to be around for quite some time but it is unlikely that much attention if any will be paid to our situation given that the NZ current account deficit at the moment is only 3% of GDP.

With regard to the greenback, it has strengthened this week against the Yen and Euro after the October non-farm payrolls report came in stronger than expected. Job numbers rose 159,000 in the month which was more than double market expectations. Quite pleasing was the firm growth in private sector job numbers and a small fall in the unemployment rate. In addition the dollar rose against the Euro on a fresh – but seemingly

periodic – bout of concern about the debt situation in Europe. These two items brought a round of profit-taking following near a month and a half in which the USD has been losing ground against the Euro after the indication from the Federal Reserve Chairman that he was considering additional quantitative easing. Speaking of which.



The Aussie dollar has managed to spend almost the entire week above parity with the USD though it weakened a tad today after the monthly Australian jobs report showed the unemployment rate rising from 5.1% to 5.5%. That jump came about solely because more people have chosen to enter the workforce taking the participation rate to a record high. Job numbers actually rose a very healthy and more than expected 29,000 in the month.

At what point does one cash out of the NZ dollar and buy greenbacks or Pounds? The question is not posed in terms of buying Euro or Yen because we are nowhere near as strong against those two currencies as against the first two. Against the Aussie dollar we are well below the (old) average but it is unclear what the new average will be given the large structural shift in Australia's terms of trade yet less solid shift in our own.

We pose the question because there are clearly speculative elements in play driving commodity prices, commodity currencies, and risky assets upward as investors seek to take funds out of a debasing US currency and some other economies attempt to keep their currencies down against the greenback by doing their own printing. The world is becoming awash with money again – though not money flowing into banks as was the case earlier this decade. This time the flow is into non-banking assets and such flows are almost certainly as equally unsustainable as those earlier ones.

At some point a correction will occur in these over-priced assets but history unfortunately shows us that it is IMPOSSIBLE to pick when the adjustment will occur. But are there things one can look out for? Yes, and in this instance they are almost certainly strong US data on business investment, housing and personal consumption which will permit the Federal Reserve to start raising interest rates and at the same time start taking extra cash out of the system by selling its hoard of government securities into private hands. Maybe these developments happen next year, maybe 2012.

But if one cannot pick the timing for a correction in over-stretched assets like the NZD can one at least take a punt on the level at which it would seem wise to sell out? Good luck with that because a number of years ago when the Dow Jones Industrials Index was at 6,400 the then Federal Reserve Chairman Alan

Greenspan described the sharemarket as displaying “irrational exuberance”. It kept rising of course to over 11,000. Picking levels is dangerous.

Nevertheless, personally speaking I would find an exchange rate of US 85 cents to buy one Kiwi dollar worth acting on. Maybe 53 pence also. Good luck.

Australia

As noted near the start of this week’s WO I have been in Sydney this week attending a conference on the aging population. Apparently the weather has not been good here recently so people were glad for the absence of rain for a few days this week. Of course one thing Australia could handily have more of is rain in order to reduce reliance upon the likes of desalination plants which already supply water to about 1.5mn homes in Sydney. There was a report just out suggesting E. coli bacteria may have been in the water of one of them but apparently some measuring errors were involved so it is safe to drink the stuff. But one suspects that next time a plant is built it would be a good idea to place the intake pipe more than 2.5km away from a sewage outlet. Plus, although the research showed the current took the sewage away from the intake pipe, about 20% of the time the current switches around the other way. Doh!

I stayed in the CBD the whole time and it is good to feel the buzz of a functioning financial centre as opposed to the dress-down public servant atmosphere in Wellington and the mish mash of retail, offices, apartments, university, and English language schools which makes up Auckland. Dunedin is filled with students, Hamilton with Mums out shopping and beneficiaries hanging around the office in the main street and square while Christchurch is so unfocussed that once again there is talk of redeveloping the square – this time toward putting in more greenery to replace the horrible non-NZ platz-like format installed some years ago. Napier is off-putting because there is a road through the main pedestrian way, New Plymouth has its beautiful waterfront obscured by a closed in shopping mall. Nelson is nice, so is Invercargill – except for the temperature. Westport is quaint and one of my favourite spots, Hokitika usually quite busy when I visit, Timaru acceptable as long as people are not blocking the road with protests, Kaikoura is obviously touristy but the setting with sea and snowy mountains has to be one of the best in the world. Ashburton is dominated by the roads right through the middle. Blenheim is nice and compact, Paraparaumu, Waikanae, Otaki, and Levin mainly just slow one down on the long drive north (though Levin and Otaki at least look vibrant). Foxton is off to the side so usually not seen but worth a rest break, in Wanganui one must change jacket at the border. Taupo one can now bypass completely using the new road but that would not be a good idea because it is pleasant there. Rotorua CBD is better than it used to be but if one goes there for the shops one is missing completely the attraction of the place. Whangarei is strangely shaped and roads cut the CBD off from the water.

Back to Sydney. A new shopping precinct is in the process of opening up in Pitt Street centred around a new Westfield Mall. The street has been turned into a wide pedestrian mall for a long block and the shops seem quite classy. Everywhere there are cafes and places for the office crowd to eat, but in the evening there is little worth being in the CBD for and for eating one needs to head to the likes of Darling Harbour or other parts of the periphery.

The waterfront area of Circular Quay toward the Opera House is busy but enjoyable and there often seem to be helicopters buzzing around. At least the Botanic Gardens are nearby so it is exceptionally easy to escape the dark canyons of the CBD for green spaces.

For all the small shops selling newspapers I failed to find any selling even a few days old newspapers from Europe or the UK. Maybe I should have looked in more. I find that one of the pleasures of being overseas spending time in a city – as opposed to the countryside – is whiling the few spare hours away reading foreign newspapers. But it doesn’t seem to take too long to get through the Sydney Morning Herald, AFR and Australian.

Another thing I like about visiting our nearest foreign country is that everyone understands colloquialisms such as “no worries”, “she’ll be right” and “cheers”. But that means the place is hardly foreign in a people sense. In fact although in the CBD one hears occasional conversations in Mandarin, Italian and Greek, the

place definitely lacks the cosmopolitan feel of cities in other countries – not least because there is a near uniformity in the colour of people on the streets. That I think is one of the differences between New Zealand and Australia which probably doesn't get much talked about and which Australians often show their ignorance of when they assume the relationship between European descendants and indigenous people is the same in New Zealand as in Australia. Figuring out where to start from the multitude of differences between our relationship and theirs when correcting them is the hardest part.

The monorail looks old and frankly just messes up the streets. Hyde Park is wonderful though a bit noisy as it is surrounded by busy roads. There seems to be a reasonable amount of construction going on. There are tourists around, but given the size of the place they are less noticeable than was the case in Villefranche sur Mer two months ago where a new cruise ship (or two) berths every day over summer.

I might be going out on a limb with this comment but here goes. It doesn't look like one receives a particularly good exchange rate if one chooses the rate offered by a retailer's Eftpos terminal at the time of the transaction. In fact one rate offered to me seemed to be about three cents away from the market mid-point. Probably shouldn't have done so much shopping.

Greece

Just for your guide. After returning from Europe in May this year one of the comments we made was that economists and politicians there were not so much concerned about the broader European economy as they were about the possibility of extreme fiscal tightening producing a tectonic shift in voter preferences away from centrist parties toward the extreme left and right. We noted that one expert advised us to keep an eye on Greek local elections late this year to see if this would happen. Those elections have been held and it looks like people have made their protest against austerity measures by not voting rather than opting for the extremities. That is positive.

Yet at the same time as one can have a sigh of relief about the voting pattern (which was largely in support of the ruling Socialist Party) it is also clear that worries are once again on the rise regarding the economic stability of Ireland, Greece, Portugal and Spain. In fact concerns about Ireland have rocketed over the past week led by deteriorating data on home loan servicing rates (more defaults) and worries that a flood of defaults has yet to hit. (The bank bailout cost has reached an estimated US\$50,000 for every household in Ireland.) The resulting losses for banks risk wiping out what little capital they have left and as this places extra pressure on the government's finances there are growing worries about the Irish Government defaulting on their debt.

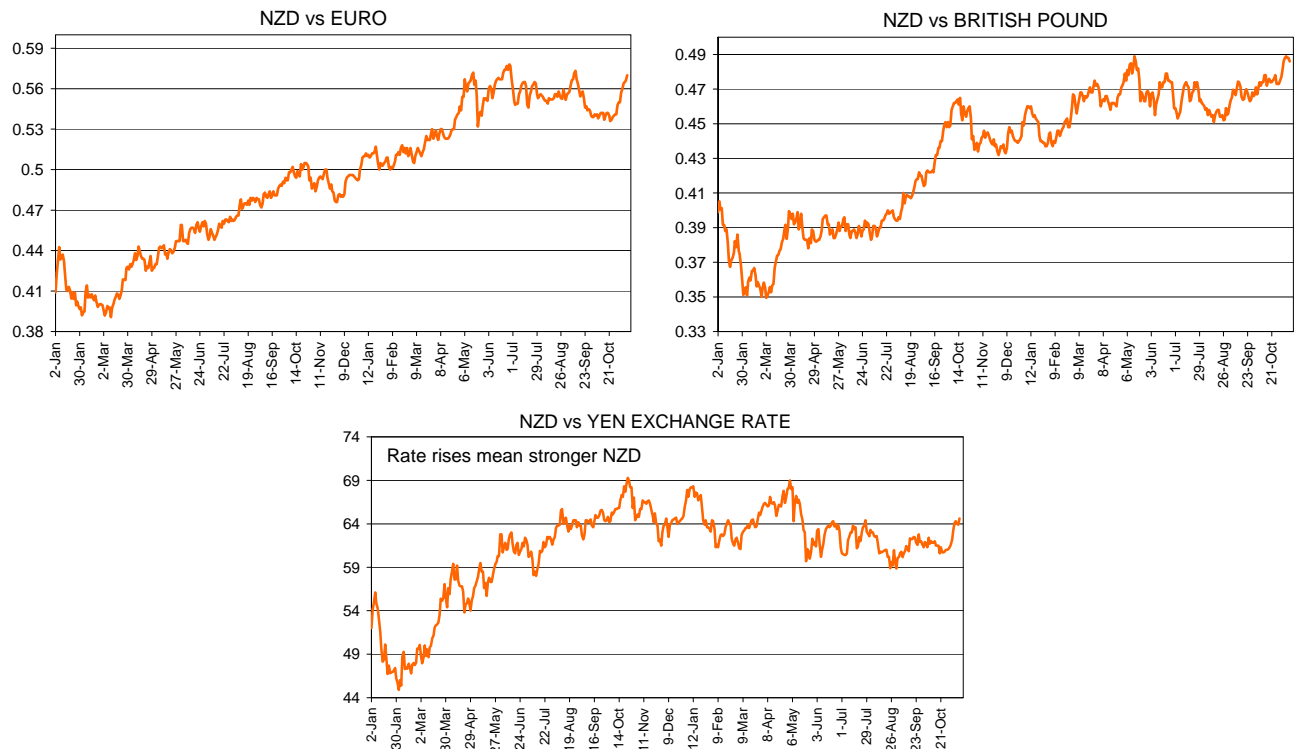
The cost to the government of borrowing funds measured as a spread over German bond yields has risen to a record level and the European Central Bank has resumed buying government bonds (like the Federal reserve is doing) after taking a three week break from doing so.

Growing debt concerns have pushed the Euro down against the dollar over the past week just reminding us all yet again that when we speak in terms these days of the Euro, Pound, or greenback looking strong it is really just a matter of looking less rubbishy than the others.

As for the Yen there are fundamentals which say it should weaken – bad growth, huge government debt, aging population cashing up financial assets – but other clearly stronger factors arguing that it will rise and almost certainly keep doing so. These include the absence of the round of collapsing property asset prices and disappearance of bank capital bases now underway in many other countries (that was Japan a few years ago), continuing deflation, plus ongoing large current account surpluses. The Bank of Japan intervened in the middle of September to try and stop the Yen rising. Back then it was around 86 to the greenback and now it is around 82. Their intervention was as successful as our Reserve Bank's in 2007 when they sold Kiwi dollars mid-year around 76 cents and it ended up nine months later at 82 cents. The rule here is that intervention does not work by itself. One also has to do things such as sacrificing inflation objectives and promoting bubbles by printing money and forcing interest rates down. One has to destroy the village in order to save it (Vietnam war reference).

BNZ WEEKLY OVERVIEW

During the week the Japanese Prime Minister and Finance Minister effectively admitted they cannot keep the Yen down when they said Japanese companies should look to take advantage of the high Yen by buying overseas assets. Dairy farms?



For more detailed commentaries from BNZ and the NAB group on foreign currencies, commodities, etc click on the following link.

<https://research.bnz.co.nz/Research/Pages/default.aspx>

*Sourced from Consensus Economics. <http://www.consensuseconomics.com/>

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ECONOMIC DATA

All %		Latest qtr only	Previous qtr only	Latest year	Year ago	2 Yrs ago
Inflation	RBNZ target is 1% - 3% on average	1.1%	0.2	1.5	1.7	5.1
GDP growth	Average past 10 years = 2.6%	+0.2	0.5	+0.7	-2.2	2.4
Unemployment rate	Average past 10 years = 4.7%	6.4	6.9	6.5	4.3
Jobs growth	Average past 10 years = 2.0%	1.0	-0.2	1.8	-1.8	1.1
Current a/c deficit	Average past 10 years = 5.9% of GDP	3.0	2.4	5.6	8.1
Terms of Trade		2.0	5.8	12.7	-13.5	10.7
Wages Growth	Stats NZ analytical series	0.4	0.8	2.7	5.4	5.0
Retail Sales ex-auto	Average past 9 years = 3.9%.	1.3	0.7	1.3	-0.6	2.8
House Prices	REINZ Stratified Index	-1.1	0.1	0.5	2.9	-7.9
Net migration gain	Av. gain past 10 years = 13,900	+13,914	16,504yr	17,043	4,403
Tourism – an. av grth	10 year average growth = 3.2%. Stats NZ	3.9	3.8	3.9	-1.8	-0.3
		Latest year rate	Prev mth year rate	6 mths ago	Year ago	2 yrs ago
Consumer conf.	10 year average = 3%. Colmar survey	46	36	57	3	-34
Business activity exps	10 year average = 19%. NBNZ	31	27	43	31	-11
Household debt	10 year average growth = 10.3%. RBNZ	2.3	2.3	2.9	2.5	6.8
Dwelling sales	10 year average growth = 2.5%. REINZ	-33.1	-27.1	-8.0	43.7	-23.7
Floating Mort. Rate	(TotalMoney) 10 year average = 7.9%*	6.09	5.84	5.59	5.85	10.49
3 yr fixed hsg rate	10 year average = 7.8%	7.15	7.30	7.95	7.45	9.09

ECONOMIC FORECASTS

Forecasts at Oct. 7 2010

March Years

December Years

	2009	2010	2011	2012	2013	2008	2009	2010	2011	2012
GDP - annual average % change										
Private Consumption	-1.2	0.6	1.9	1.9	1.4	-0.4	-0.6	2.2	1.8	1.5
Government Consumption	4.3	1.1	2.3	1.4	0.9	5	1.4	2.7	1.1	1.2
Investment	-7.1	-9.7	4.8	5.3	4.1	-3.5	-12	2.5	4.9	5.1
GNE	-1.5	-3.3	2.6	3.9	1.9	0.4	-5.1	2.8	3.4	2.6
Exports	-3	3.2	2.6	5.9	2.3	-1.1	0.4	3.2	5.3	3
Imports	-4.3	-9.5	6.4	5.3	3.1	2.3	-14.8	7	4.9	3.7
GDP	-1.5	-0.4	2	4.1	1.6	-0.2	-1.7	2	3.6	2.3
Inflation – Consumers Price Index	3	2	4.8	2.8	2.6	3.4	2	4.6	2.7	2.6
Employment	0.8	-0.1	1.4	2.3	0.9	0.9	-2.4	1.7	2.8	0.8
Unemployment Rate %	5.1	6	6.2	5.4	5.5	4.6	7.1	6.5	5.4	5.5
Wages	5.1	1.6	2.7	3.8	3.4	5	3.1	1.6	3.4	3.5
Currently reasonable exchange rate ASSUMPTIONS										
NZD/USD	0.53	0.7	0.75	0.69	0.65	0.56	0.72	0.74	0.7	0.66
USD/JPY	98	91	86	90	94	91	90	85	89	93
EUR/USD	1.31	1.36	1.34	1.39	1.43	1.34	1.46	1.35	1.38	1.42
NZD/AUD	0.8	0.77	0.79	0.81	0.84	0.83	0.79	0.76	0.8	0.84
NZD/GBP	0.37	0.47	0.48	0.42	0.39	0.37	0.44	0.47	0.43	0.4
NZD/EUR	0.41	0.52	0.56	0.5	0.45	0.41	0.49	0.55	0.51	0.46
NZD/YEN	51.8	63.7	64.5	62.1	61.1	50.9	64.2	62.9	62.3	61.4
TWI	53.8	65.1	68.4	64.1	61.8	55.1	64.7	66.9	64.8	62.4
Official Cash Rate	3	2.5	3.25	5	5	5	2.5	3	4.75	5
90 Day Bank Bill Rate	3.24	2.67	3.57	5.15	5.15	5.23	2.78	3.2	5.07	5.15
10 year Govt. Bond	4.77	5.86	5.75	6.75	6.75	4.88	6.02	5.5	6.5	6.75

All actual data excluding interest & exchange rates sourced from Statistics NZ.

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*extrapolated back in time as TotalMoney started in 2007