

BNZ Weekly Overview

15 April 2010

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.

The Place Looks The Same

After ten days on the Gold Coast with the kids (sun, theme parks, animals, beach, lots of books) it doesn't look like anything has changed with regard to where the NZ economy interest rates, exchange rate, house prices and the labour market are likely to go over the next couple of years. The data releases show sentiment levels remain high but that both businesses and consumers are still quite reluctant to spend. There is some catch-up spending underway in areas like cars and commercial vehicles, but retail spending is astoundingly weak.

The Reserve Bank still looks to be on track to start taking away the stimulatory monetary policy setting of a 2.5% cash rate come June though there is a risk they wait a tad if data releases come in weaker than expected before then. And it is important to remember that the RB will not have a target level for the cash rate in mind which they plan getting to in a rigid manner. Both here and overseas interest rates will be raised taking into account how the economy reacts along the way. If necessary rate rises will be slowed or hastened depending upon how we react.

At this stage one would have to say that if recent data are anything to go by we will not react well. Businesses are aggressively paying down debt while households are barely growing their debt levels at all. Given that rising interest rates are intended to retard borrowing and spending one imagines that at some stage either late this year or next year the RB will feel it is a good idea to pause in their tightening cycle to see how the economy is getting along.

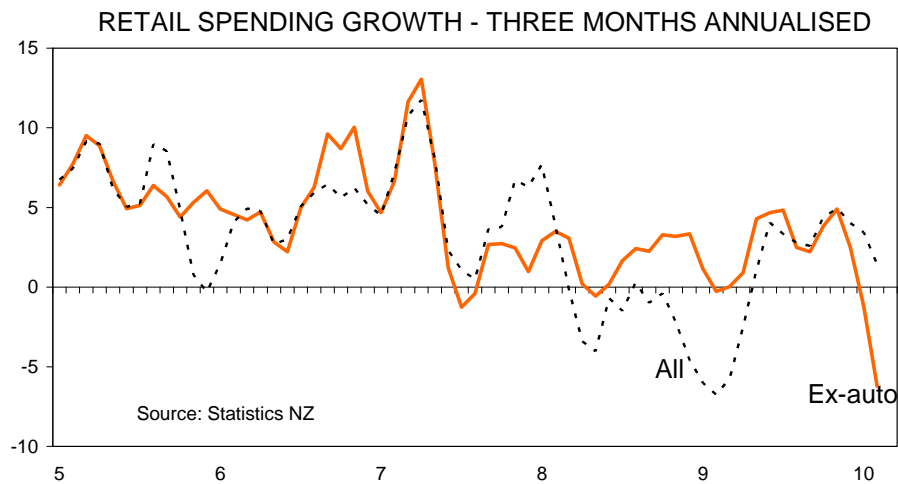
That uncertainty means people need to be wary of interest rate predictions for the next couple of years and especially wary of fancy borrowing strategies dependent upon rates being at certain levels at certain times. For the moment, given the uncertainty, we think most borrowers will remain well served by floating the bulk of their debt and budgeting for that floating rate cost rising 3% between the middle of this year and the end of 2011. After that is frankly anyone's guess given uncertainty about the world economy.

Speaking of which, overseas data releases have been generally on the better than expected side recently and various international bodies have been upgrading their growth forecasts. For us this is a good thing because it implies extra support for commodity prices – which data show are still creeping upward on average – plus good prospects for tourism. The downside is that petrol prices are highly likely to continue rising with extra upward pressure from the GST lift likely to happen on October 1.

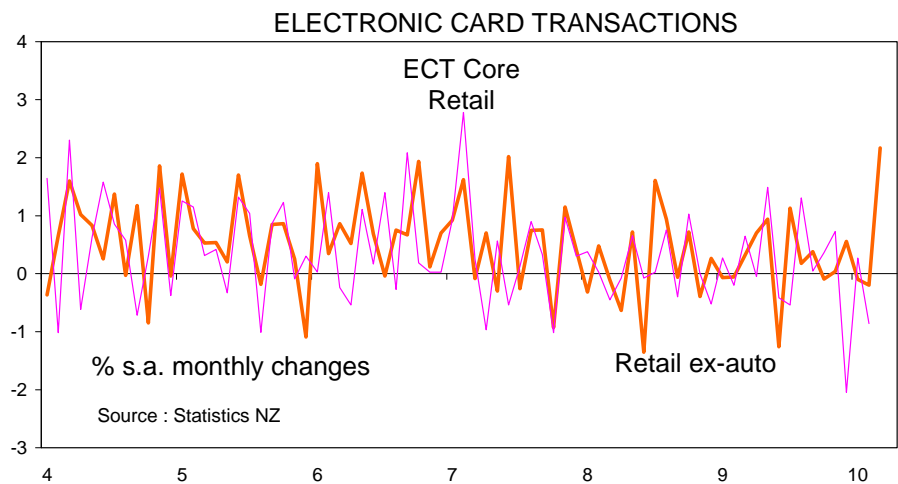
That GST change is likely to be announced in the May 20 Budget and if the recent announcements by the government with regard to things like considering unemployment insurance, private construction of schools and prisons, benefit eligibility tightening, investigating opening up the mining sector are anything to go by we could actually see a Budget one will conclude will go some way to boosting the economy's potential growth rate. That has not really been something one could say for well over a decade now – hence the appalling productivity performance in our economy in recent years.

Retailing Spending Very Weak

As is the case in many other countries retail spending growth remains weak in New Zealand as consumers – having been shocked by the credit crisis – concentrate on getting debt back under control in an environment of some labour market uncertainty. In February retail spending excluding the volatile automotive components fell by 0.9% in seasonally adjusted terms. This followed a rise of only 0.3% in January and fall of 2% in December. That means in the three months to February core retail spending fell at an annualised rate of 6.2%. That is extremely weak and in fact the sharpest decline in this particular measure since our records started in 1996.



We think March was a better month for retailers because the value of core electronic transactions rose in seasonally adjusted terms by 2.2%. But this series also rose 0.6% in December when the actual retail spending change was a fall of 2%. And the 0.2% fall recorded for February was less than the actual decline mentioned above of 0.9%. Therefore one would have to be very cautious in interpreting this rather erratic measure as seriously showing strength in retail spending. Frankly it is probably best ignored.

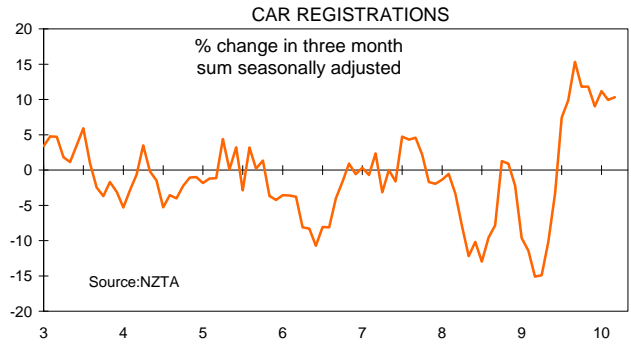
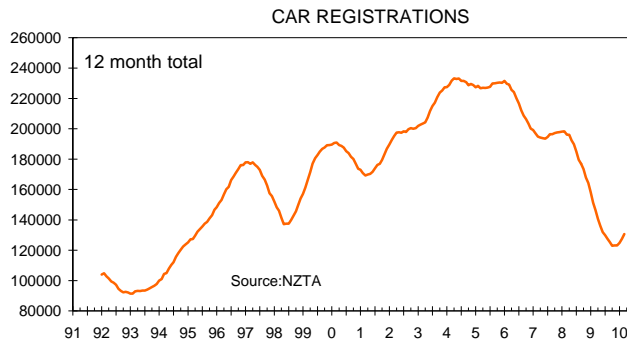


Eventually we expect retail spending to improve with people catching up on durables spending – which has been weak since mid-2007 – and buying furnishings for new houses. Plus as the labour market improves generalised spending will lift. But that is probably the key ingredient missing here. It is not until there is solid evidence that the labour market is improving that one is likely to see strong spending growth. And even then

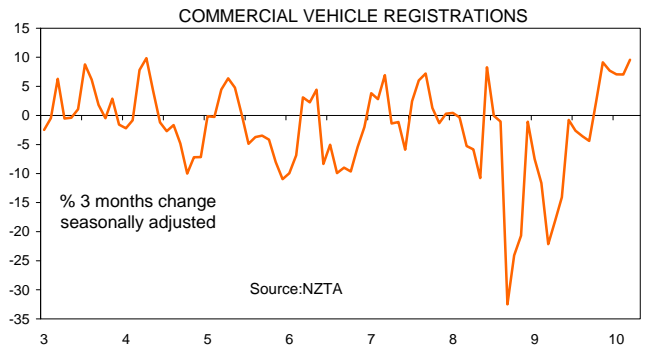
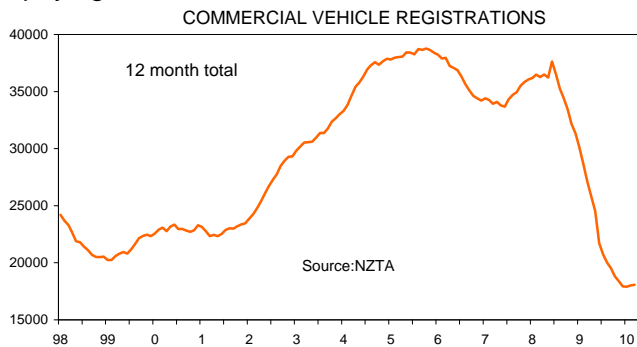
one must be cautious because although the Australian labour market is strong consumers there also remain quite reluctant to spend.

Some Vehicle Spending Increase Evident

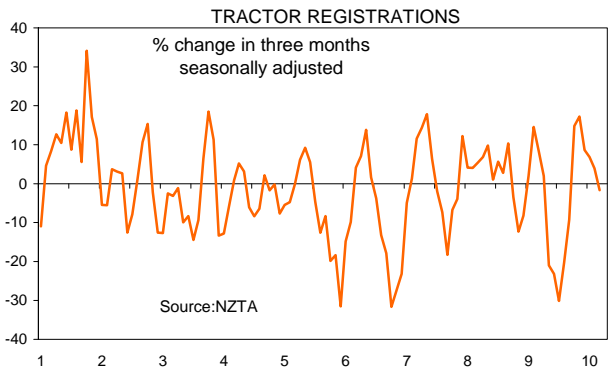
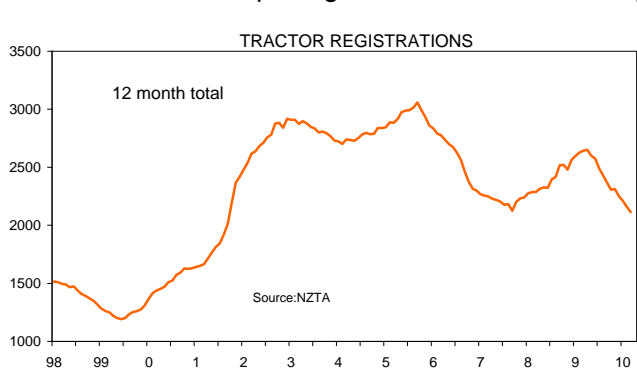
Although general retail spending remains quite weak the car market is showing some signs of life. In March there were 13,192 cars registered around the country which was a 32% rise from a year ago and 10% seasonally adjusted gain for the March quarter. Consumers are likely to be catching up on a bit of spending and it is also likely that some businesses which lengthened their vehicle lease terms are now into a period when they are getting new vehicles in place.



With regard to commercial vehicles there is some sign of life. In March 1,789 were registered around NZ which was a 2.7% rise from a year ago and 33% fall for the entire year. But in seasonally adjusted terms regos rose 10% from the December quarter and this followed an 8% rise for that quarter. This is possibly the only piece of data suggesting businesses are investing more because import values continue to fall for plant, machinery and equipment, consents issued for new buildings are falling strongly, and businesses are repaying debt.



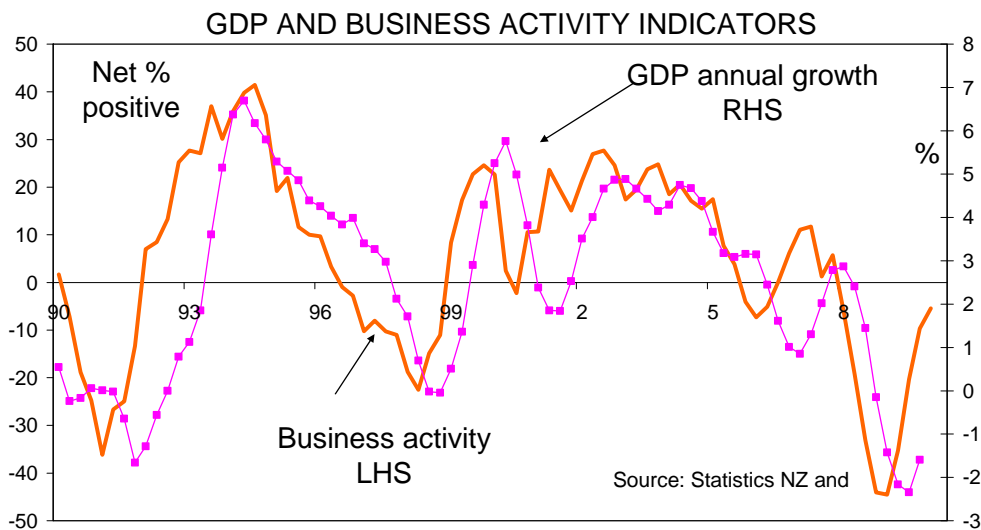
For a short time there one was able to say there was a spark of life in the tractor market – but alas no flame has caught. In March there were only 144 tractors registered around the country. This was a 24% fall from a year ago and 20% fall for the entire year. In rough seasonally adjusted terms regos for the March quarter were down 2% from the December quarter after rising 9% in the December quarter compared with the September quarter. But as the second graph shows the short term change measure is all over the place so it would have been surprising if the small December quarter lift had continued.



NZIER's Quarterly Survey Results

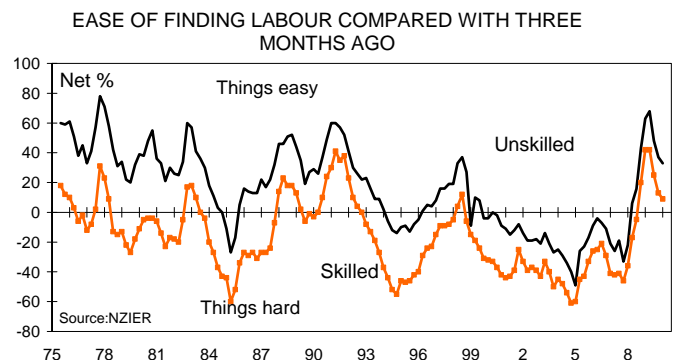
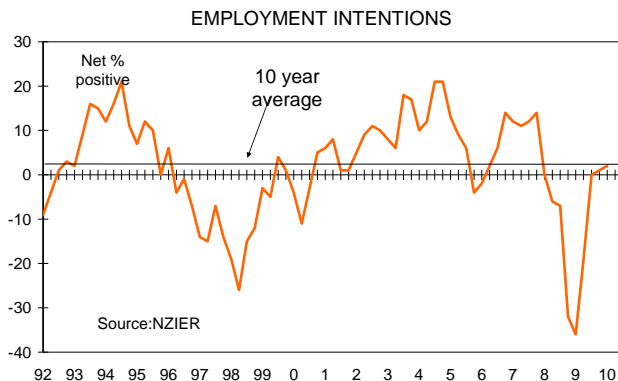
The most useful set of data released in the past fortnight came in the form of the NZIER's Quarterly Survey of Business Opinion. This showed that a net 36% of business respondents (excluding farming) in seasonally adjusted terms expect the economy to get better over the next six months. This is well up from a net 20% positive in the December quarter survey and is the strongest result in almost 11 years.

But this number is not what one should really focus on. A better gauge is to look at business expectations of their domestic activity levels. This was a net 15% positive in the March quarter from 11% in the December quarter. But the reading was 23% in the September quarter which was the strongest result since early 2005. This pattern of up then easing quite nicely we think shows the way in which a huge sigh of relief swept across sentiment last year but now attitudes are a tad more realistic when it comes to how busy firms think they will really be.



Nevertheless, the average reading for this gauge in the past ten March quarters has been just +7% therefore the latest result is strongly suggestive of good economic growth – and certainly suggestive enough to leave us forecasting 3% GDP growth this year and 3.5% over 2011. The graph above shows the correlation between annual average GDP growth and the answer by firms to the question regarding actual activity levels.

But confidence and activity expectations are not the be all and end all. What we really look at are the measures showing what firms plan doing about their outlook. In that regard we find a net 2% expect to hire more people which is equal to the long term average. That means we think it is reasonable to speak in terms of the NZ labour market improving soon and that the anecdotes about employers more actively looking for people are probably a reasonable indicator of what is truly happening at the moment in the labour market.



Only a net 9% of businesses now say they are finding it easy to get skilled labour. That was a net 13% in the December quarter and 42% a year ago. The long term average is however -28% so one definitely cannot

say the labour market is tight. Similarly a net 33% say it is easy to find unskilled labour versus an average 8% saying it is hard. So unskilled labour is still easy to find.

Businesses are however saying they plan investing. A net 9% say they plan boosting spending on plant and machinery. This is well up from a net 2% planning cutbacks in the December quarter, a net 44% planning cutbacks a year ago, and long term average 2% planning cutbacks. However, as we have noted many times in recent weeks, firm investment intentions are not translating into actual expenditure with businesses still concentrating hard on repaying debt and improving cash flows. Our theory is that firms may seek to handle initial growth in output through higher labour input so the labour market has capacity to turn around quite firmly if not late this year quite possibly from the first half of 2010.



The Reserve Bank will have noted that a net 27% of respondents expect to raise their selling prices over the next 12 months which is about equal to the 25% average. But the result is not frightening in the context of a still loose labour market and below average capacity utilisation rate (shown just above).

The survey overall leaves us content with our expectation of an improving economy with few inflationary pressures in the near future but easily enough strength to allow the RB to start taking away the extra low cash rate in the near future.

So So Small

One of the great things about going overseas – even if it is only to the Gold Coast – is that one gets to put NZ into perspective. We don't matter diddly-squat folks outside of maybe the milk powder industry. I couldn't find NZ mentioned anywhere in The Australian newspaper (excellent) or the Sydney Morning Herald (okay) except a small paragraph on us winning the WTO case for getting our apples into Australia. In fact it would be fair to say that were it not for the Warriors in the NRL and Phoenix in the A-League people there might forget we exist at all.

The Gold Coast is a good place for a family holiday and one doesn't even need a rental car. We just took the train from Brisbane Airport to Robina then the local bus from there. One can catch local buses to the theme parks, Currumbin Sanctuary etc. as well so no need for taxis or the special park shuttle services which are much more expensive. The shopping at Pacific Fair is good but one really needs to spend time at Robina which is excellent. The Surfers Paradise shopping area is a bit crass frankly and perhaps only worth a serious visit on a wet day to go to the haunted house place, Ripleys, the laser mirror/infinity place, and the games parlour area. It did not rain when we were there so we did not bother.

INTEREST RATES

Nothing much of interest at all has happened in the past fortnight with regard to prospects for NZ interest rates. Swap rates and bill yields are basically where they were before Easter and we remain of the opinion that the RB will start removing the stimulatory 2.5% official cash rate at their June 10 meeting. The risk is they wait a tad longer than that though it all depends upon whether we get any great surprises in the data in the near future. None of the releases we have had time to discuss earlier on in this week's WO were astoundingly weak or strong so the markets remain priced for a tightening in two months with the chance of a delay.

Key Forecasts

- Tightening mid-2010.
- Medium to long term housing rates to rise again in a few months.

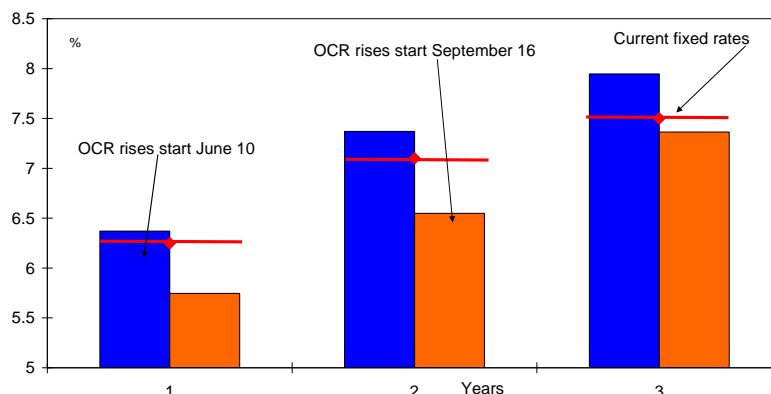
FINANCIAL MARKETS DATA

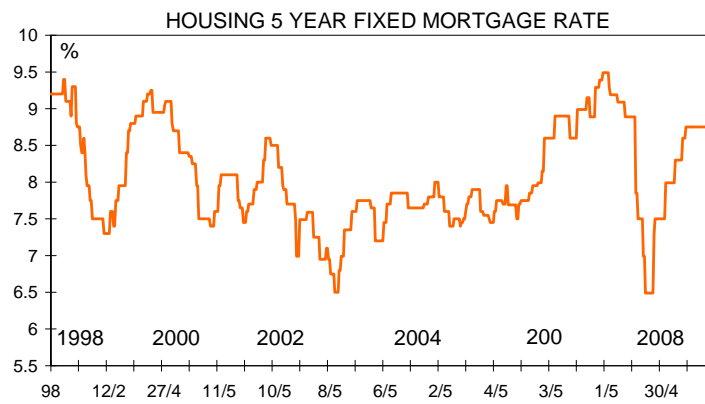
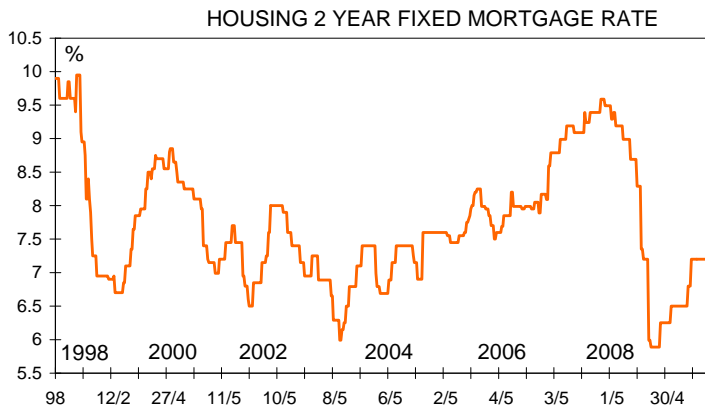
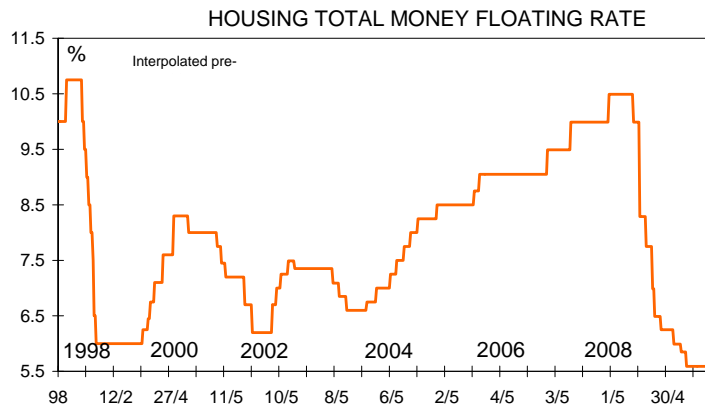
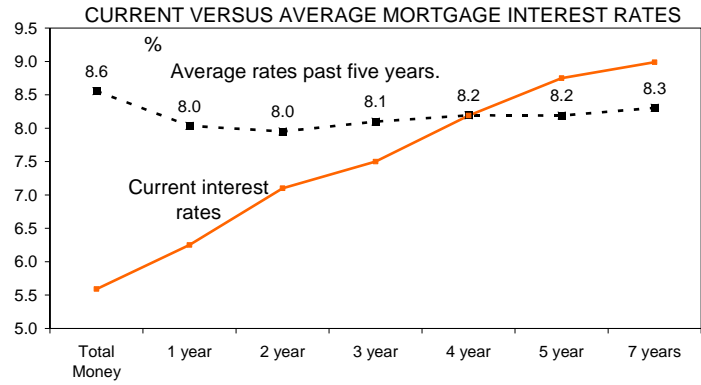
	This week	Week ago	4 wks ago	3 months ago	Yr ago	10 yr average
Official Cash Rate	2.50%	2.50	2.50	2.50	3.00	6.2
90-day bank bill	2.72%	2.70	2.73	2.82	3.18	6.5
1 year swap	3.49%	3.54	3.43	3.74	3.13	6.7
5 year swap	5.30%	5.35	5.21	5.51	5.03	7.0

If I Were a Borrower What Would I Do?

Swap rates today look very similar to what they were a fortnight ago so for the moment there is little reason for expecting anything fresh with regard to changes in bank lending rates. Some of the longer term fixed rates have been cut in recent weeks – but this is of little importance because few people are borrowing for fixed periods beyond two years.

If I were borrowing at the moment I would still be floating and paying down debt as much as possible. I would be thinking about opportunistically hopping into, at the longest, a two year rate some time in the next two or three months just ahead of the RBNZ tightening monetary policy. But I wouldn't contemplate grabbing a nice low fixed rate for terms three years and beyond until this interest rate cycle has peaked then bottomed out again some year down the track from now. It is impossible to know when that year will come.





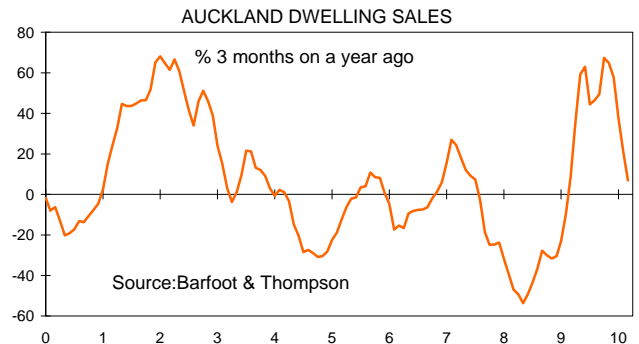
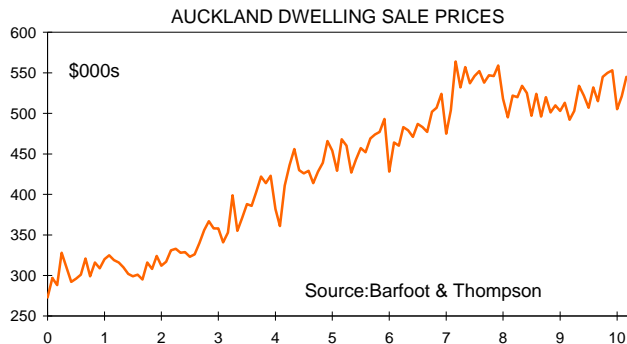
If I Were a Term Deposit Investor What Would I Do?

No time to write anything here this week sorry. Maybe next week.

HOUSING MARKET UPDATE

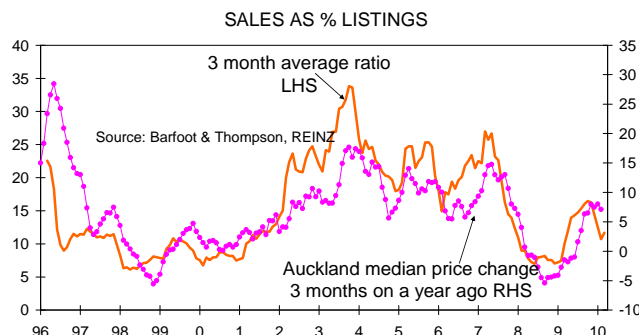
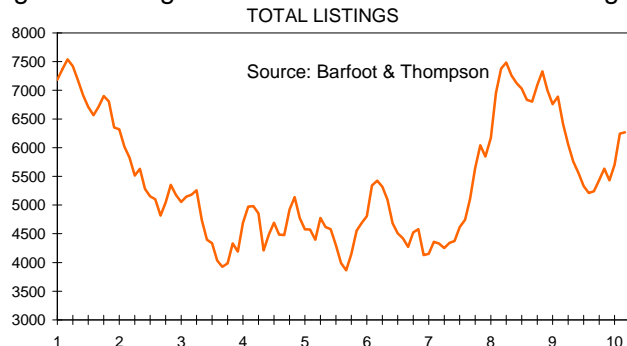
Auckland Somewhat Static

There was nothing too earth-shattering in the monthly Barfoot and Thompson data for Auckland residential real estate in March – except the fact that there is little evidence the easing back of investors because of tax uncertainty is causing prices to fall. The average sale price in the month in fact increased to \$545,000 from \$512,000 in February and over the March quarter it was ahead 4.2% from a year ago. The average was down 4.7% from the December quarter but this is not important because prices almost always ease off over this period of time as few expensive houses sell in January.



Turnover was 927 in the month which was a small seasonally adjusted rise near 4% which followed a 3% gain in March. The 26% fall in January has not yet been recovered but the importance of the March result is that it shows things have somewhat stabilised.

At the end of the month there were 6,267 properties listed which was a 2.3% fall from a year ago giving a ratio of sales to listings for the March quarter of 11.7% which was up from 10% a year ago and 9% two years ago. No listings flood in other words even allowing for the unusually weak level of sales in January.



The data do not show a market going in any particular direction and we suspect the desire to wait to see what the Budget brings will tend to keep things subdued but steadyish for a while longer yet. After that we expect possibly a few investors to opt out and after that wash-up is complete it is likely prices will start climbing again at a potentially firm pace come 2011 due to rising construction costs, higher GST, and the imbalance between supply and demand we have highlighted for about two years now.

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

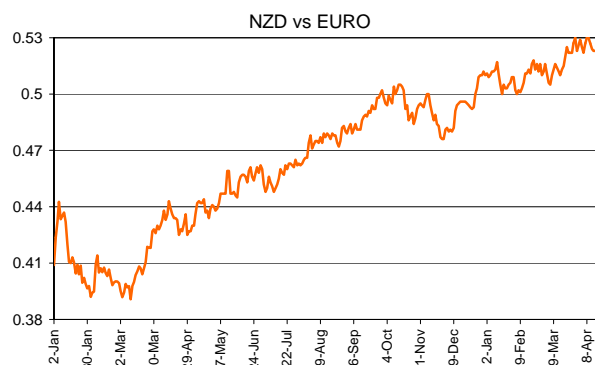
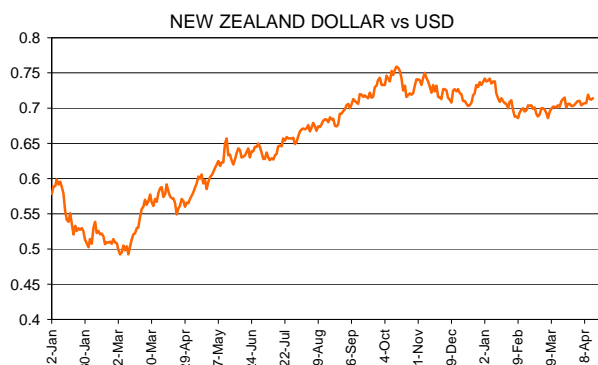
- Dwelling consent numbers to recover now with potentially good activity from late-2010.
- House prices edging higher after tax change effects wend their way through.
- Sales recovering later this year.

Exchange Rates & Foreign Economies

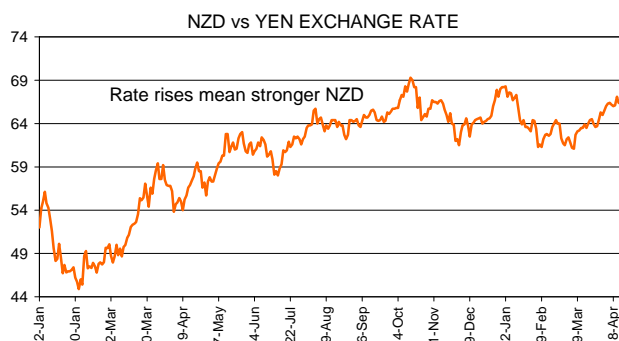
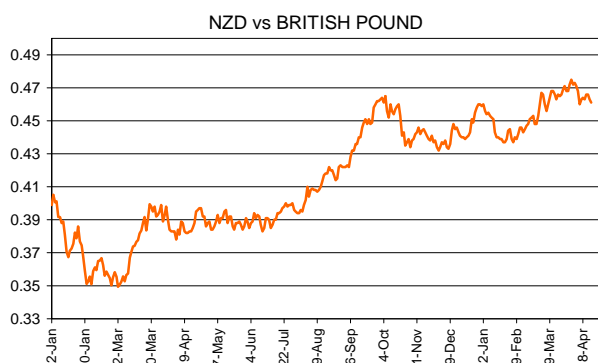
Exchange Rates	This Week	Week Ago	4 wks ago	3 mths ago	Yr ago	Consensus Frcsts yr ago*	10 yr average
NZD/USD	0.714	0.707	0.704	0.742	0.5414	0.535	0.592
NZD/AUD	0.764	0.763	0.766	0.797	0.8205	0.778	0.856
NZD/JPY	66.50	66.00	63.90	67.50	48.13	53.5	66.8
NZD/GBP	0.461	0.464	0.463	0.455	0.3705	0.357	0.345
NZD/EUR	0.523	0.530	0.510	0.512	0.4106	0.404	0.51
USD/JPY	93.13	93.35	90.76	90.97	88.90	100.0	113.9
USD/GBP	1.549	1.524	1.521	1.631	1.461	1.50	1.709
USD/EUR	1.365	1.334	1.380	1.449	1.319	1.324	1.156
AUD/USD	0.935	0.927	0.919	0.931	0.660	0.688	0.69

Doesn't Look Much Different From Before Easter

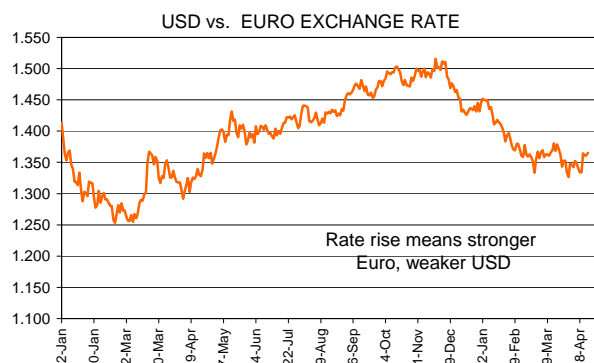
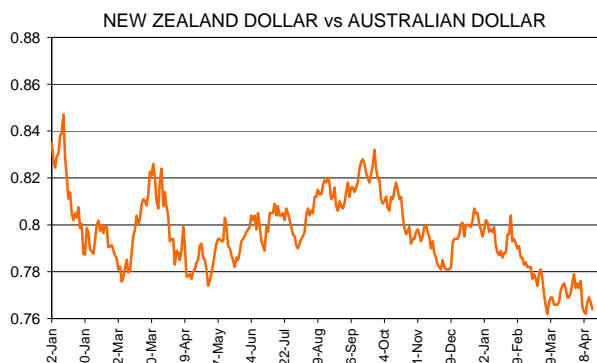
Two weeks ago the NZD was buying US 71 cents and now it is at fairly much the same level though with a tad more strength in recent days near 71.4 cents. But this gain mainly reflects some weakness in the greenback after a period of strength against the other major currencies and on the crosses we are slightly weaker.



Against the British pound we are near 46.1 pence from 47.3, against the Euro near 52.3 centimes from 52.6, and against the Aussie dollar near 76.4 cents from 77.3. Only against the Japanese Yen are we ahead a tad near 66.5 from 65.5 Yen.



The Kiwi dollar has been supported by the agreement between the IMF and Euro-zone economies to supply some sub-market rate funding to Greece if they fail to raise funds themselves on the open market. That does not yet mean they will avoid default because it is not guaranteed the funding will actually be supplied if worst comes to worst. But progress has been made so perhaps some of the jitters which have gripped markets a tad recently will back off – until the next major uncertain element comes along and there remain plenty of those.

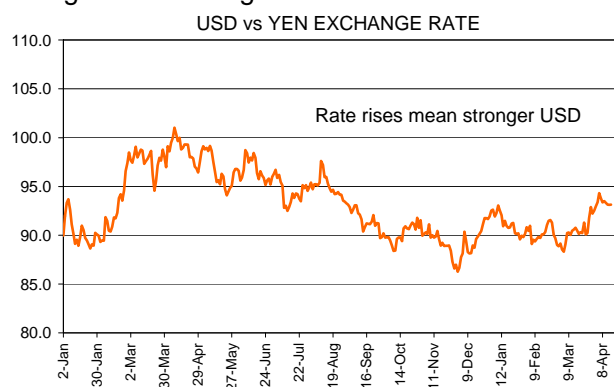
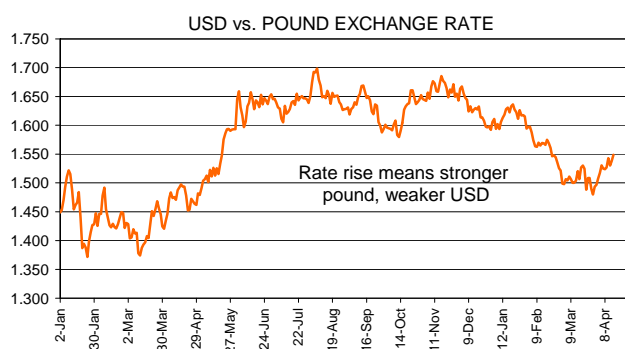


Greece is probably just the first cab off the rank with regard to the markets upping the return they need for investing in the debt of a party with such horrible finances. Others include Spain, Ireland, Portugal, the UK and the United States. Our Budget on May 20 is likely to show the government making hastened progress toward getting back into surplus and the contrast between our finances and those of so many other countries is likely to be one factor causing the Kiwi dollar to rise over the remainder of this year.

Another factor is the extra upward pressure we see possible for commodity prices, plus the fact our central bank is likely to start raising its cash rate well in advance of the likes of the United States, UK, Europe – and of course Japan where deflation is back in full swing with consumer prices down over 1% from a year ago.

Apart from the still relatively “live” issue of Greece the other focus for markets is on the increasing chance that China will allow some revaluation of the Yuan before the end of the year. Timing is very uncertain and it is unlikely the magnitude will be great – especially as the Chinese can point to their trade account having just recorded the first deficit in six years due partly to extremely strong imports but also timing effects of the Chinese New Year.

But the Chinese President has made some encouraging signals and relations between China and the US appear to have improved slightly recently as evidenced by general discussion surrounding China supporting some increased sanctions against Iran and the Americans delaying the release of the Treasury currency report which identifies countries believed to be manipulating their exchange rates.



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	-0.2%	1.3	2.0	3.4	3.2
GDP growth	Average past 10 years = 3.0%	+0.8	0.3	-1.6	-0.1	2.8
Unemployment rate	Average past 10 years = 5.3%	7.3	6.5	4.7	3.5
Jobs growth	Average past 10 years = 1.9%	-0.1	-0.8	-2.4	0.9	2.1
Current a/c deficit	Average past 10 years = 5.5% of GDP	2.9	3.2	8.7	8.0
Terms of Trade		5.8	-1.6	-8.2	1.8	8.8
Wages Growth	Stats NZ analytical series	0.4	0.8	2.7	5.4	5.0
Retail Sales ex-auto	Average past 9 years = 3.8%	1.3	0.7	1.3	-0.6	2.8
House Prices	REINZ Stratified Index	2.8	2.5	6.0	-7.9	8.0
Net migration gain	Av. gain past 10 years = 11,700	+21,618	20,021yr	6,160	4,644
Tourism – an. av grth	10 year average growth = 5.0%. Stats NZ	2.4	-0.6	2.4	-2.4	2.2
		Latest year rate	Prev mth year rate	6 mths ago	Year ago	2 yrs ago
Consumer conf.	10 year average = 2%. Colmar survey	52	57	3	5	2
Business activity exps	10 year average = 26%. NBNZ	41	37	26	-20	2
Household debt	10 year average growth = 11.3%. RBNZ	2.7	2.7	2.4	4.2	12.4
Dwelling sales	10 year average growth = 3.5%. REINZ	-3.8	-1.1	39.3	-17.7	-32.1
Floating Mort. Rate	(Total Money) 10 year average = 7.6%*	5.59	5.59	5.99	6.25	9.99
3 yr fixed hsg rate	10 year average = 7.9%	7.50	7.95	7.75	6.75	9.49

ECONOMIC FORECASTS

Forecasts at Apr. 8 2010

March Years

December Years

	2008	2009	2010	2011	2012	2007	2008	2009	2010	2011
GDP - annual average % change										
Private Consumption	3.2	-1.1	0.6	3.1	2	3.9	-0.3	-0.6	3.1	2.1
Government Consumption	4.9	4.2	0.8	2.2	2	4.4	4.8	1.4	1.8	2.1
Investment	5.5	-7.2	-9.9	5.8	8.9	5.5	-3.6	-12.3	2.6	9.5
GNE	4.6	-1.6	-3.3	5.6	3.2	4.6	0.4	-5.1	5.1	3.5
Exports	3.1	-3.4	2.4	1.2	5	3.8	-1.4	0	1	4.8
Imports	10	-4.7	-9.9	7.4	4.7	8.9	1.9	-14.9	7.3	4.6
GDP	2.9	-1.4	-0.4	3.6	3.2	2.8	-0.2	-1.6	3	3.5
Inflation – Consumers Price Index	3.4	3	2.3	4.8	2.8	3.2	3.4	2	4.8	2.7
Employment	-0.2	0.8	-1.3	2.5	3.2	2.3	0.9	-2.4	1.6	3.4
Unemployment Rate %	3.8	5	7.2	6.9	6.1	3.5	4.7	7.3	7.1	6.3
Wages	4.3	5.1	2.7	1.8	3.6	4	5	3.1	1.8	3.2

EXCHANGE RATE

ASSUMPTIONS

NZD/USD	0.8	0.53	0.7	0.72	0.66	0.77	0.56	0.72	0.73	0.68
USD/JPY	101	98	91	104	108	112	91	90	100	106
EUR/USD	1.55	1.31	1.36	1.32	1.28	1.46	1.34	1.46	1.33	1.29
NZD/AUD	0.87	0.8	0.77	0.81	0.81	0.88	0.83	0.79	0.8	0.82
NZD/GBP	0.4	0.37	0.47	0.41	0.37	0.38	0.37	0.44	0.43	0.38
NZD/EUR	0.52	0.41	0.52	0.54	0.52	0.53	0.41	0.49	0.55	0.52
NZD/YEN	81.1	51.8	63.7	74.4	71.3	86.3	50.9	64.2	73	71.6
TWI	71.6	53.8	65.1	68.3	65	71.6	55.1	64.7	68.7	65.9
Official Cash Rate	8.25	3	2.32	4.25	6	8.25	5	2.5	3.75	5.75
90 Day Bank Bill Rate	8.91	3.24	2.67	4.57	6.15	8.9	5.23	2.78	4.07	6.07
10 year Govt. Bond	6.36	4.77	5.86	6.3	7	6.4	4.88	6.02	6.1	6.8

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

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*extrapolated back in time as Total Money started in 2007