BNZ Weekly Overview

18 February 2010

Mission Statement

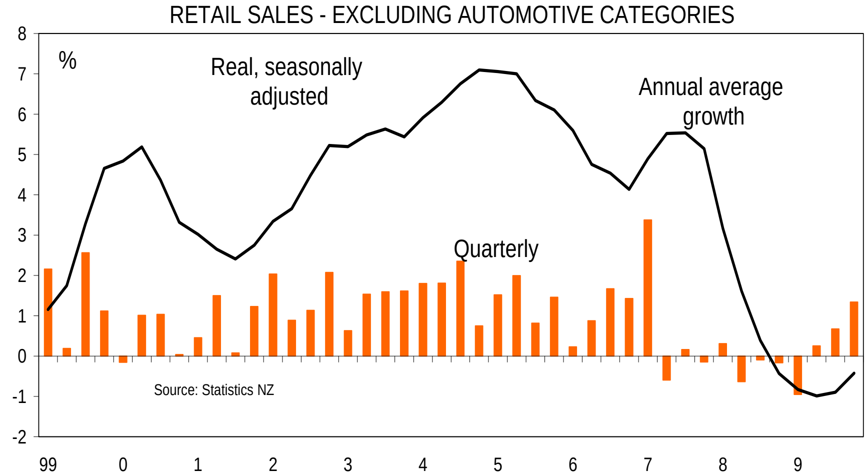
To help Kiwi businesspeople and householders make informed financial decisions by discussing the economy and its implications in a language they can understand.

In this week's issue….

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.

Retailing Not Yet Strong

Last week we learnt that during the December quarter retail spending rose by a relatively good 1% after adjusting for seasonal and inflation influences. More importantly the core measure which excludes the volatile automotive components rose by 1.3% after improving 0.7% in the December quarter and 0.3% in the June quarter. This all sounds very good – but we need to remember that for a period during the second half of last year there was a large sigh of relief sweeping through the economy with regard to a Depression scenario being avoided. This generated an upward bias to many statistics – including sentiment and housing measures – and would have produced some "catch-up" retail spending encouraged by continued hefty retailer discounting.



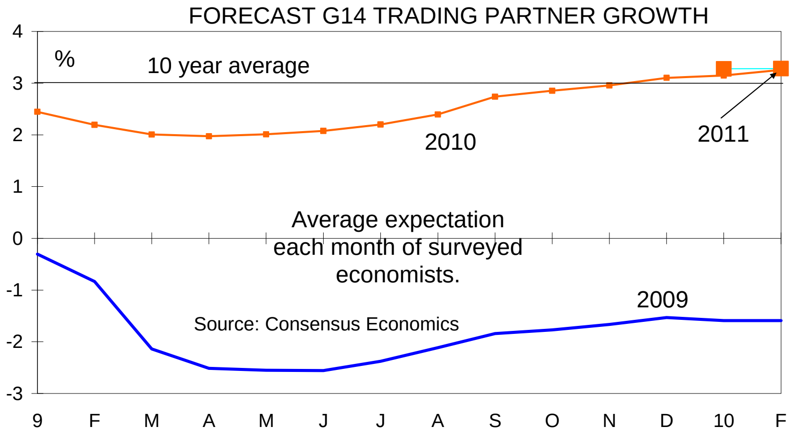
You may recall that as happens every year there was the usual media focus on some electronic retail transaction data just before and after Christmas. And as happens every year there was excitement about the data showing good spending growth. And as we have noted many times in the past the data need to be all but ignored because they do not adequately track what the official retail spending release from Statistics NZ tells us.

This time around the hype was yet again misplaced because in seasonally adjusted terms in December retail spending plummeted 1.8% from November. The spending strength during the quarter happened in October and November. Christmas was weak.

There is growth occurring with regard to household spending, but there is clearly high caution which does not come through in the confidence surveys. At some stage it is likely that high confidence levels will boost retailing with assistance from improving house construction (perhaps more patchy there than we earlier thought though), above average population growth, and improving jobs growth later in 2010. But for now one can't help but think the revelation of a jump in the unemployment rate to 7.3% will tend to cap spending enthusiasm.

As for the highly probable increase in GST to 15% from October 1, there will almost certainly be some extra spending ahead of the change and an easing afterward. But given that the change is relatively small one suspects general discounting behaviour may have more influence than the rate change itself. Plus, who knows what we will have learnt come August about the path of global growth recovery and our own unsteady track upward and away from the effects of the global financial crisis.

Thankfully, for your guide, the consensus view is that there is a global recovery underway which is quite strong in China, the rest of non-Japan Asia, Australia, and even some hints of better than expected growth in the United States. The UK and Europe still look worrying however, especially with the new surge in sovereign risk which has depressed the Euro against the greenback and is likely to curb consumer and business enthusiasm for spending – especially in the deficit countries where outright aggressive fiscal policy tightenings are having to be imposed to avoid defaults.



A Well Known Recovery Danger

We economists look at the economy overall and generally allow people to draw their own conclusions about how the outlook we paint is likely to affect their business and what they should do about it. Often though people take too literally comments such as "economic recovery" and "accelerating growth" to mean everything will be sweet and the chances of business failure will decline. Actually that is not necessarly so.

When an economy hits recession it is often firms with big structural debt they can no longer service or refinance who go under. When the recovery comes and more customers appear a whole new set of pressures emerges, most particularly with regard to cash flow. Working capital can get put under severe pressure as businesses need to rebuild inventories and debtors ledgers get bigger - that is, sales are made but normal payment terms mean more need for cash on hand to pay suppliers.

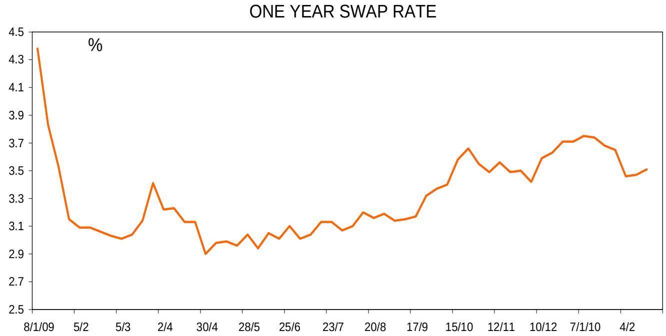
This year, as the economy recovers and firms find their cash flow needs rising, we may see more failures. Be prepared for this pressure by working out how you need to manage your cash flow to handle higher sales and inventories, staff costs etc. You may need a tad more term debt or capital to provide the liquidity you need. You might even need to restrain how fast you "let" your sales recover in an environment where credit is not as easy to get as it was before the global crisis. Here are some links to an article discussing this recovery danger.

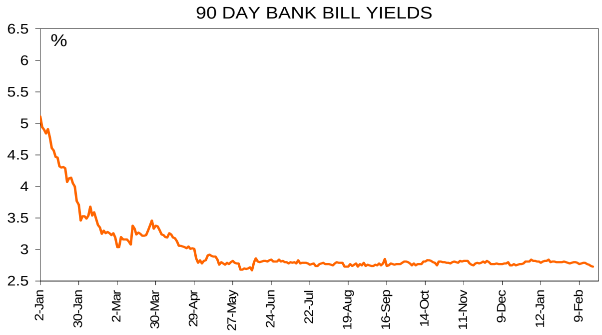
http://www.creditman.biz/uk/members/news-view.asp?newsviewid=11203&id=1&mylocation=News
http://www.adelaidenow.com.au/business/business-owner/risk-of-failure-rises-in-recovery/story-e6fredeu-1225786198216

INTEREST RATES

Swap rates today are largely where they were a week ago in the absence of any major developments offshore or domestically. However, with a few more analysts easing back from expectations that the Reserve Bank will tighten monetary policy in March or April we have seen the yield on 90-day bank bills ease very slightly.

Our expectation remains that the movement of the cash rate away from the 2.5% level it was taken to in case the world economy collapsed will start in June and push the rate to something close to 6% by early 2012. But just as we have seen the Reserve Bank of Australia pause in their tightening cycle after three rate rises it is certain our own central bank will careful assess the impact of its rate rises and feel little compunction also in pausing if the need arises.





Key Forecasts

- Tightening by mid-2010.
- Medium to long term housing rates to keep on rising.

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	5.00	6.2
90-day bank bill	2.79%	2.80	2.81	2.82	3.54	6.5
1 year swap	3.47%	3.46	3.74	3.56	3.09	6.7
5 year swap	5.28%	5.39	5.51	5.77	4.09	7.0

If I Were a Borrower What Would I Do?

Our central view regarding what to do has not changed for a long time and probably won't until just before the Reserve Bank starts raising the cash rate in June. For the majority of borrowers the time to fix medium to long term came and went last year and now one may as well float. There are many people still choosing to fix, but usually only for one year or 18 month periods and frankly it is the toss of a coin whether one will do better fixing or floating for those periods.

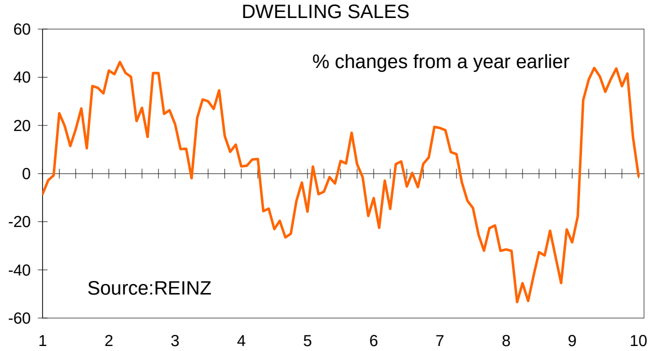
We favour floating for now then having a look at fixing for 12 or 18 months just before the RB raises the cash rate. That way one gets a still low floating mortgage rate between now and perhaps May and saves compared with say fixing one year at 6.25%. We are counting on being able to get a short term fixed rate in May at about current levels – though they could disappear quickly if a string of positive data releases causes the 1-2 year swap rates to jump up then.

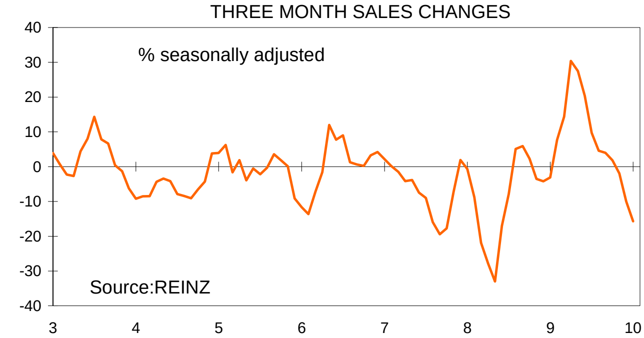
Following this strategy frankly isn't going to yield much of a saving so realistically we default back again to just floating and going for the ride. Nothing at this stage suggests to us that come 2012 or 2013 floating rates will move to unusually high levels. Something unexpectedly good will need to happen with regard to NZ economic growth to get that outcome – or something very bad with regard perhaps to global inflation surging if loose monetary policies offshore are not tightened quickly enough.

HOUSING MARKET UPDATE

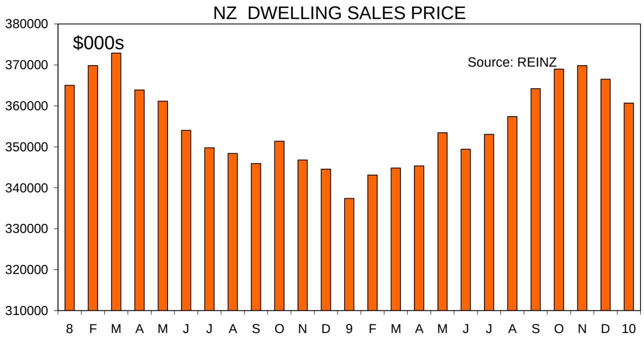
Investors Reassess Their Commitment

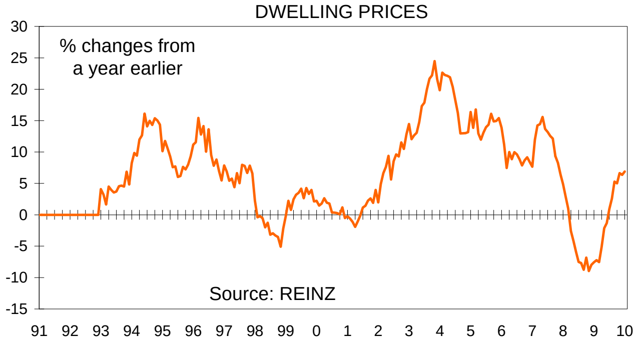
The January real estate data from REINZ seem to show that uncertainty about the coming tax changes affecting residential property investment has stymied activity in the sector. In January there were only 3,666 dwellings sold around the country. This was not only 1.1% lower than January last year when Depression fears swept through all markets, but the lowest total for any month since the data started in 1988.





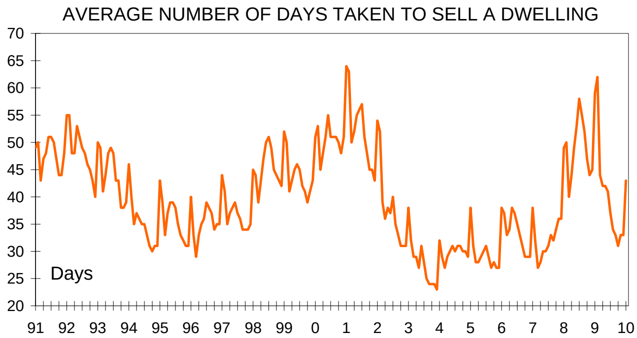
In rough seasonally adjusted terms the change from December was a fall of about 20%. The market hit a wall and this was reflected in a reduction in the average (quality adjusted) house price for the second month in a row. The price index fell 1.6% after declining 0.9% in December but still sits 6.9% ahead of a year ago.

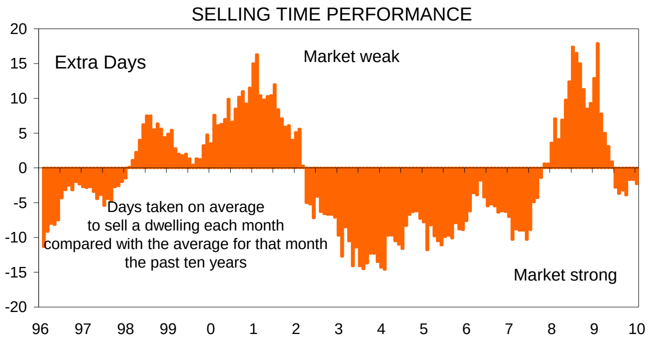




Is this a large hit to the housing market which leaves one questioning the very idea of a continued cyclical recovery? No. Certainly for the next few months activity and price action are both likely to be subdued as investors run through their numbers and decide whether they can afford to buy or hold or need to sell if they cannot claim building depreciation. Most will probably give more thought to running their investment as a business and pricing appropriately than ever before and this is likely to lead to increased upward pressure on rents assisted by the slowly worsening shortage as construction remains at extremely low levels.

In fact construction is likely to back off in the near future as the same factors which tend to boost and lower real estate turnover also tend to boost and lower issuance of consents for new dwellings to be built.

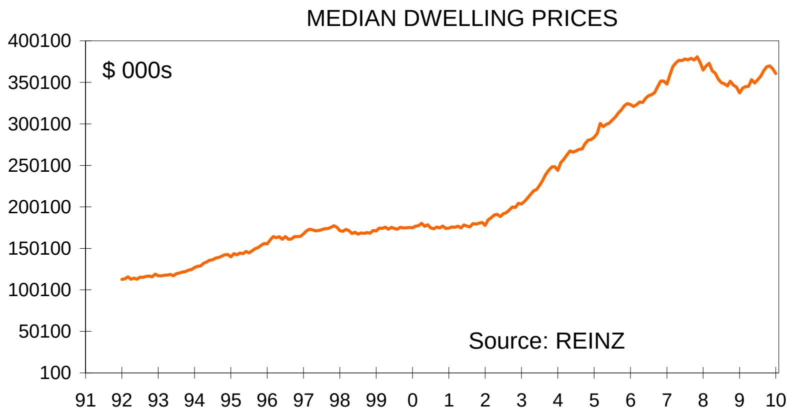




Of interest in the January data is the average number of days taken to sell a dwelling rising to 43 from 33 in December. This sounds a lot and was reported as such. But the days to sell measure always rises between

December and January and at 43 days the time taken was 16 days better than a year earlier whereas December was 12 days better and November 11 days.

In fact, compared with the average number of days taken to sell a dwelling in the relevant month the January outcome was 2.3 days faster which is the best result since October. This is hardly a compelling statistic which calls into question other numbers showing the market pulling back. But it does suggest things are not as bad as the main turnover number suggests.



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

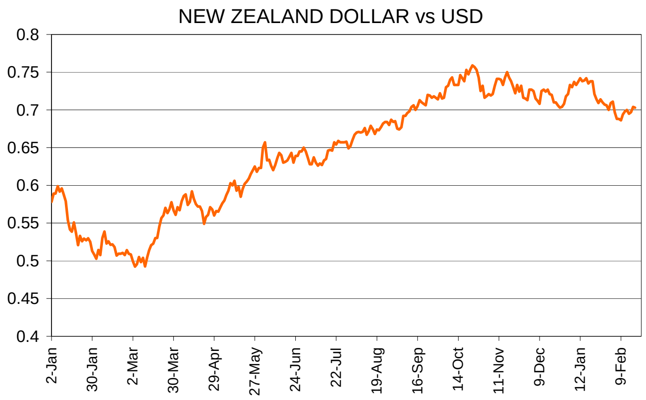
- Dwelling consent numbers to recover now with potentially good activity from mid-2010.
- Real estate sales continuing to increase but the rise limited by listings shortages.
- House prices edging higher subject to tax changes bringing short term downward pressure.

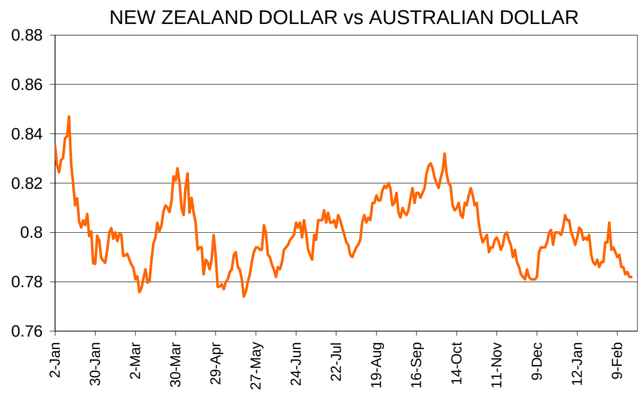
Exchange Rates & Foreign Economies

Exchange Rates	This Week	Week Ago	4 wks ago	3 mths ago	Yr ago	Consensus Frcsts yr ago*	10 yr average
NZD/USD	0.703	0.698	0.735	0.743	0.5069	0.573	0.592
NZD/AUD	0.782	0.786	0.798	0.800	0.7993	0.848	0.856
NZD/JPY	64.00	62.70	66.70	66.30	46.79	59.0	66.8
NZD/GBP	0.448	0.446	0.453	0.443	0.3561	0.358	0.345
NZD/EUR	0.516	0.506	0.512	0.500	0.4031	0.448	0.51
USD/JPY	91.03	89.82	90.74	89.23	92.306	103.0	113.9
USD/GBP	1.569	1.565	1.623	1.677	1.423	1.601	1.709
USD/EUR	1.362	1.379	1.436	1.486	1.258	1.278	1.156
AUD/USD	0.899	0.888	0.921	0.929	0.634	0.676	0.69

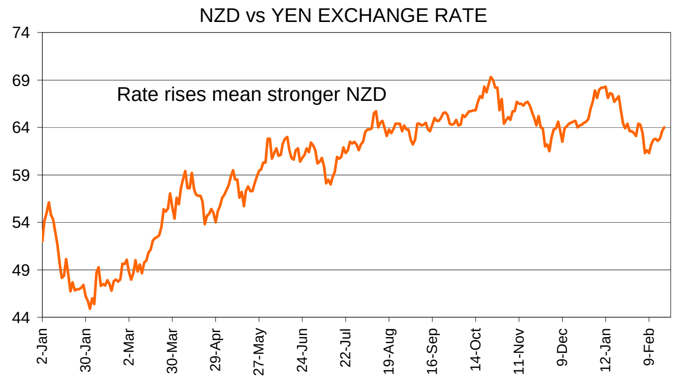
Kiwi Dollar Steady

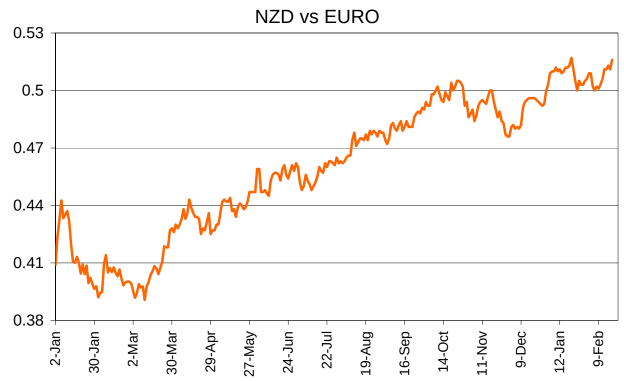
The Kiwi dollar last week was buying US 69.8 cents and this week it is slightly firmer just over 70 cents. The week has been relatively quiet with no major NZ economic data releases and no large changes offshore in risk tolerance. There has however been a slight easing in worries about the Greece debt situation and that helps explain the recoveries in global sharemarkets and marginal firming of risky currencies such as the NZ dollar.





The NZD has made stronger gains against the Yen and Euro rising to 64 Yen from 62.7 last week and 52.6 centimes from 50.6 last week. These gains reflect the NZD rising against the greenback at a time when the USD was boosted slightly by some better than expected economic data.





In fact against the Euro the greenback is at its strongest level since May last year near $1.36 from $1.38 last week and $1.51 to buy one Euro back in early December. These gains have been driven largely by worries about the fiscal situation in many European countries and a more general backing away from the view that the recent global crisis somehow spells the start of the end of the greenback as the global medium of exchange and store of value.

In fact just the opposite outcome may ensue. There are questions about whether the Euro will even exist in the near future given the widely divergent performances of individual economies and the apparent desire of some to have their economies assisted in the short term through a lower currency bringing higher export receipts. Over the coming year or two the extra weakness which will be forced upon the Greek economy to get the government's deficit down from over 12% of GDP to 3% could easily produce wider calls for more flexibility.

The Yen is the currency of an economy facing stronger and stronger headwinds after two decades of failing to bounce back from the crisis of 1989-90. The population is now shrinking and aging rapidly. The manufacturing base is being seriously challenged by other Asian economies – and worries about those countries moving up the sophistication ladder help explain the significance of the problems besetting Toyota.

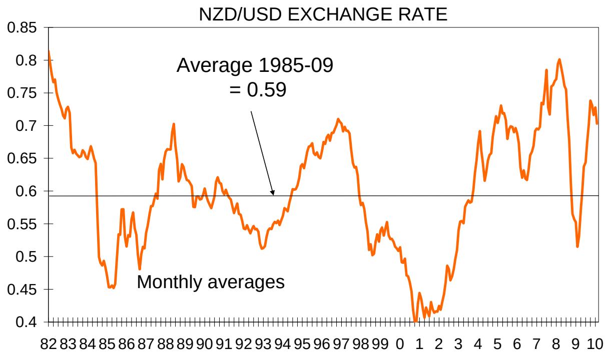
The Chinese Yuan is a controlled currency, and the British Pound comes from an economy with a shrinking financial services sector and rising number of major companies shifting their headquarters elsewhere to escape the more punitive tax regime.

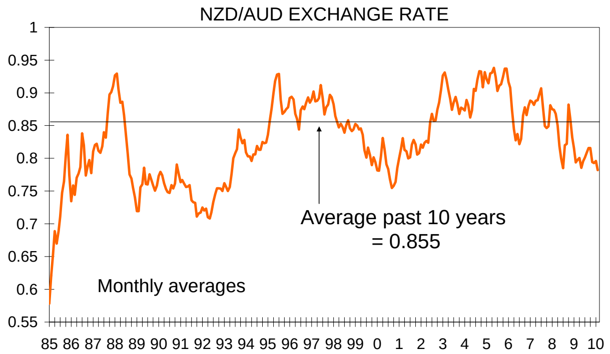
And that is where one can get a forecast for the NZD hitting 80 Yen. We firm on the back of rising risk tolerance against a greenback recovering because the other major currencies look undesirable.

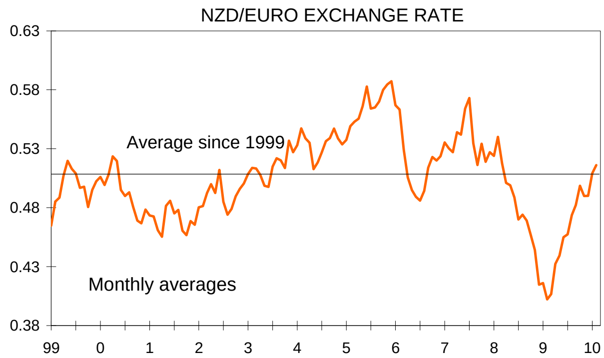
With regard to the cross rate of most importance to our manufacturing and tourism sectors the NZD has changed by little over the past week. We are just above AUD 78 cents which as the graph on the previous page shows is at the bottom end of the range we have been trading in over the past year. In fact this is fairly much our most competitive rate in almost a decade.

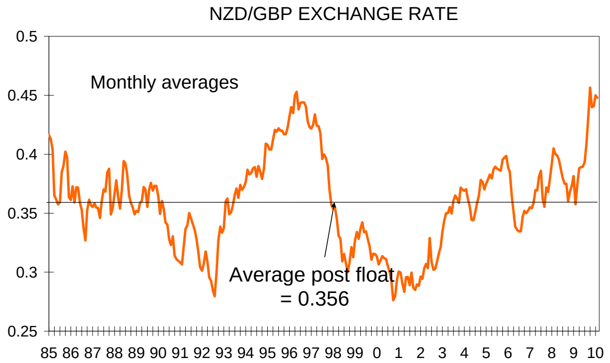
If I Were An FX Receiver What Would I Do?

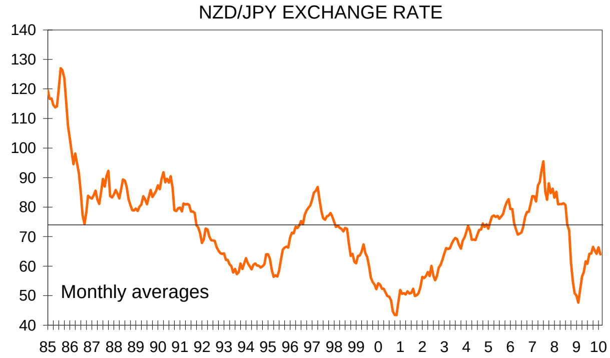
Nothing new to write. I'd be hedging.











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

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%	+0.2	0.2	-2.2	1.5	2.1
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	5.9	8.1	......	8.3	8.2
Terms of Trade		-1.2	-9.4	-13.8	5.8	8.4
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	+21,253	17,043yr	......	3,814	5,494
Tourism – an. av grth	10 year average growth = 5.0%. Stats NZ	-0.0	-1.8	-0.0	-0.3	1.8
		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	37	34	26	-22	18
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	15.2	41.5	40.3	-23.1	-32.1
Floating Mort. Rate	(Total Money) 10 year average = 7.6%*	5.59	5.59	5.99	7.75	9.99
3 yr fixed hsg rate	10 year average = 7.9%	7.95	7.45	6.99	6.99	9.40

ECONOMIC FORECASTS

Forecasts at Jan 28 2010	March Years					December Years				
	2008	2009	2010	2011	2012	2007	2008	2009	2010	2011
GDP - annual average % change										
Private Consumption	3.2	-0.8	-0.2	1.8	2	4.1	-0.1	-1	1.6	2
Government Consumption	4.2	3.3	0.8	2.7	1.9	3.8	3.8	1.3	2.3	2.2
Investment	4.2	-8.8	-11.5	5	8.8	4.9	-5.2	-13.7	1.3	9.6
GNE	4.2	-2	-3.3	4	3.4	4.4	-0.1	-4.9	3.3	3.7
Exports	3.1	-3.3	-1.3	0	4.9	3.9	-1.3	-2.4	-1.3	4.7
Imports	10	-4.7	-13.9	3	5.9	8.9	2	-17.3	1.2	5.6
GDP	3.1	-1.1	-0.7	3	3.1	3.2	0	-1.6	2.3	3.3
Inflation – Consumers Price Index	3.4	3	2.5	1.1	2.6	3.2	3.4	2.6	1.4	2.1
Employment	-0.3	0.8	-1.6	2.6	3.2	2.3	1	-2.9	1.7	3.4
Unemployment Rate %	3.8	5	7.4	7.2	6.2	3.5	4.7	7	7.4	6.3
Wages	4.4	5.1	2.4	1.5	3.8	4	5.1	3.1	1.3	3.3
EXCHANGE RATE ASSUMPTIONS										
NZD/USD	0.8	0.53	0.76	0.73	0.65	0.77	0.56	0.75	0.75	0.67
USD/JPY	101	98	92	105	109	112	91	88	104	108
EUR/USD	1.55	1.31	1.48	1.44	1.4	1.46	1.34	1.49	1.45	1.41
NZD/AUD	0.87	0.8	0.82	0.83	0.8	0.88	0.83	0.81	0.83	0.82
NZD/GBP	0.4	0.37	0.46	0.42	0.38	0.38	0.37	0.47	0.43	0.39
NZD/EUR	0.52	0.41	0.51	0.51	0.46	0.53	0.41	0.5	0.52	0.48
NZD/YEN	81.1	51.8	69.5	76.7	70.9	86.3	50.9	66	78	72.4
TWI	71.6	53.8	67.9	68.3	62.8	71.6	55.1	66.9	69.6	64.4
Official Cash Rate	8.25	3	2.5	4.25	6.25	8.25	5	2.5	3.75	5.75
90 Day Bank Bill Rate	8.91	3.24	2.7	4.62	6.62	8.9	5.23	2.76	4.12	6.12
10 year Govt. Bond	6.36	4.77	5.75	6.3	7	6.4	4.88	5.5	6	6.8

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

The BNZ Weekly Overview is prepared by Tony Alexander, Chief Economist at the Bank of New Zealand. Ph 04 474-6744.

*extrapolated back in time as Total Money started in 2007