

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.

First Survey For 2011

This is the first Thursday of the month so we are yet again running our regular survey of WO readers. If you have not already done so in the email used for sending the WO out please click on the link below and let us know whether you feel the economy will get better or worse over the coming year. More importantly pen a sentence if you can on how things are in your industry right now letting us know what that industry is. Specify the region if you like.

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

Don't forget that the BNZ is bringing management guru Tom Peters to New Zealand for a one day workshop later this month on February 23 in Auckland and you can register your interest at

www.bnz.co.nz/tompeters

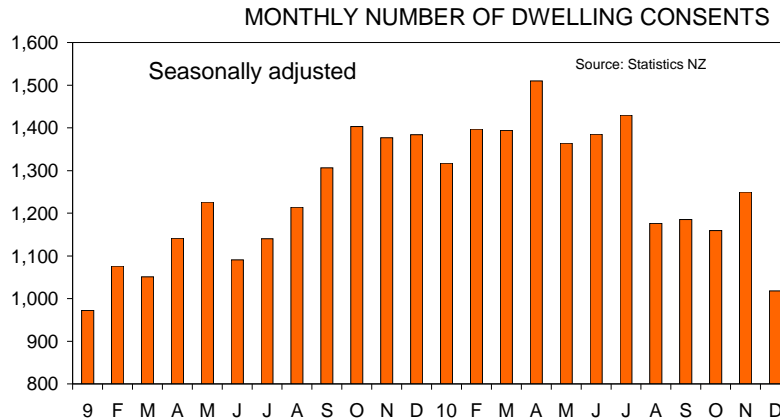
Is Our Economy Getting Better or Worse?

In this simple summary section we look only at what the data are actually telling us and pay no attention to forecasts or intentions measures. Other sections have more detail on retailing and housing.

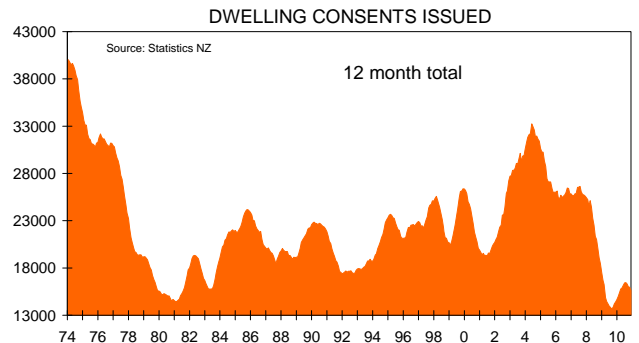
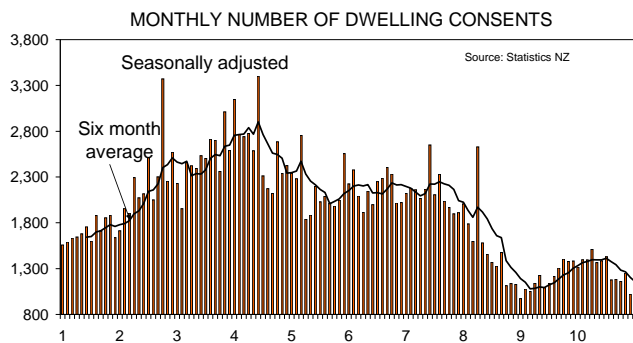
This week we have learnt that residential construction is sinking deeper into recession with December consent issuance the lowest since 1965. We have also seen the first recorded fall in the level of housing debt. Export growth has just about stalled and import growth exceeded export growth in the December quarter so this will act as a drag on GDP. And this morning we learnt that the ever-volatile (and therefore to be taken with a grain of salt) Household Labour Force Survey showed the unemployment rate rising to 6.8% from 6.4% and job numbers falling by 11,000 or 0.5% during the December quarter. But businesses appear increasingly willing to commit to new buildings and are importing more capital equipment which one hopes might work toward raising productivity. Plus job advertising on-line looks firm. Overall the data give little basis for claiming an acceleration in the pace of economic growth is underway and one now cannot rule out that the possibility that we have slipped back into a technical recession. Dang.

Are householders opening their wallets more?

Not when it comes to building houses. The sector is in recession and going deeper. By that we mean that after officially shrinking by 5.4% in the September quarter following three quarters of rises it seems certain that residential construction also fell over the December quarter because dwelling consents have been tracking downward since the middle of the year and most consents get acted on within 6-9 months. In the month of December the number of dwelling consents issued fell in seasonally adjusted terms by 18.6%. This big change was mainly because in December only a more normal 85 apartment consents were issued whereas in November this number was 226 boosted by retirement homes.

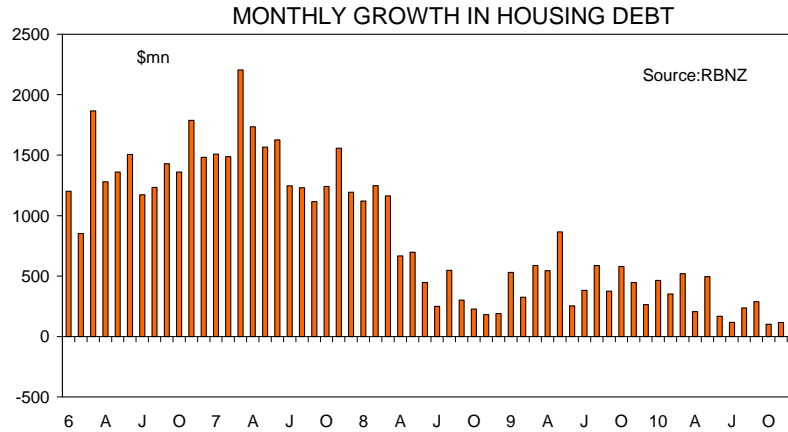


In the three months to December consent numbers fell 9.6% seasonally adjusted after falling 11% in the September quarter. If we exclude apartments and look at just houses the fall was 11.2% for the quarter and 15.5% for the September quarter. This is fairly shocking stuff and means that in calendar year 2010 only 15,602 consents in total were issued. Over 2009 only 14,425 were issued and over 2008 18,456. One estimate is that we need at least 26,000 consents to be issued each year (allowing for 20% that don't get acted on, are for replacements, or for holiday homes) so it is no surprise that we are seeing more and more commentary regarding a worsening shortage of accommodation in the country. We discuss this in some depth in the housing section further on in the WO. What it all means with regard to this section is that more and more builders will be finding things tough and thinking about hopping across the ditch. One imagines also on the basis of these numbers that retailers and manufacturers involved in housing materials, furnishings and appliances will also be struggling.



To the extent household spending is financed by debt there is no growth happening because seasonally adjusted household debt was unchanged in December for the second month in a row. Compared with a year ago household debt was up by only 1.6% whereas on average over the past ten years household debt has grown by 10% per annum. The household debt numbers are broken down by the Reserve Bank into housing and other. Under the other classification – hire purchase, credit cards – debt grew for the fourth month in a row gaining \$76mn in December to be 0.6% down from a year ago. So there is some debt funding of retail spending occurring. But...

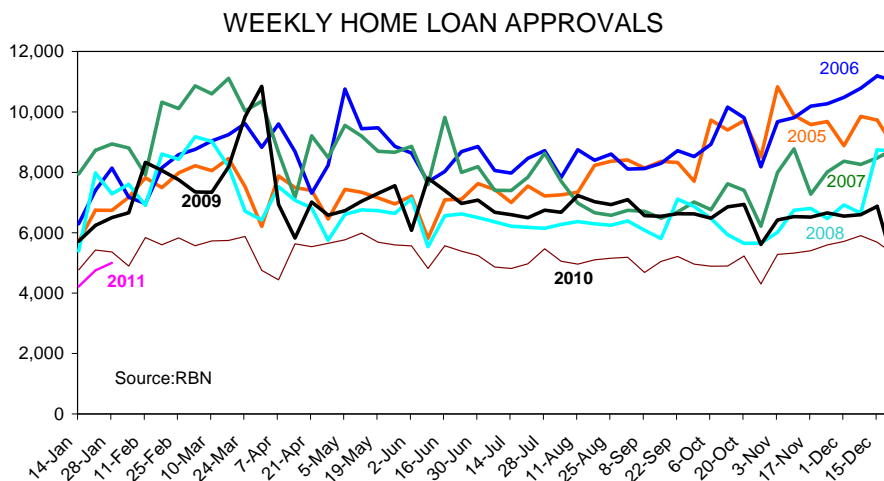
For the first time since these particular records started in 1999 the level of housing debt actually fell. It decreased by \$50mn in December after rising \$115mn in November and \$263mn in December a year ago. In December 2007 growth was a whopping \$1.2bn!



This number gels with the December number of dwelling consents being the lowest for any December since 1965.

There is nothing appearing with regard to indicators of household spending telling us anything other than that people remain very very focussed on getting their debt levels down. This is fantastic for the country's big vulnerability to any new global financial shock (large net external liabilities at 85% of GDP and banks having to fund 40% of lending offshore). But it means retailers and those supplying or servicing the retail sector should continue to keep their revenue forecasts well in check and inventories low.

Every now and then we will look at this weekly indicator to see if it happens to be telling us something interesting. But we won't look at it every week. The Reserve Bank run an experimental data series showing new housing approvals. The data show that in the week ending January 28 there were 4,996 mortgages approved by registered banks. This number was down by 7% from a year earlier and the weakest total for this week since the survey began in late-2003. This following graph is messy but at this stage it is the best we can come up with to simply try and get a visual feel for whether there is evidence of more people coming out of the woodwork to buy houses.

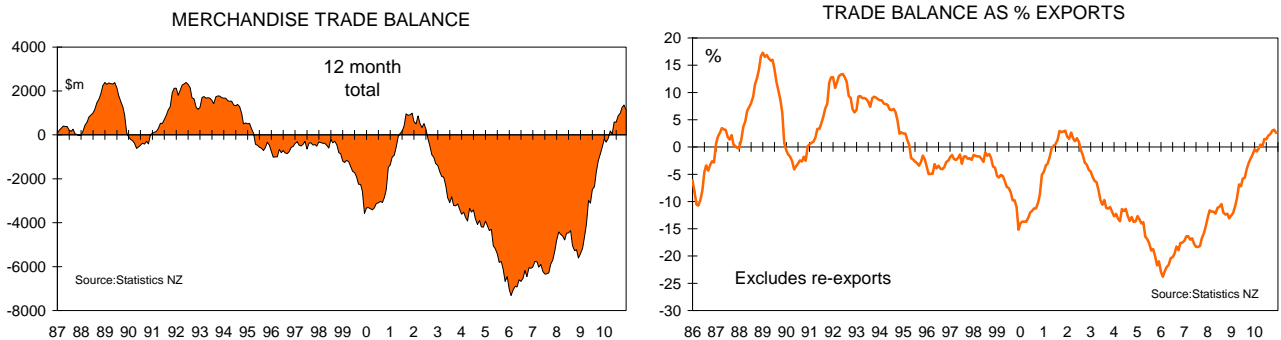


You need to look at the very left hand side and find the little pink line. That line refers to this year. The x-axis shows weeks across a calendar year. The 2011 line is below the other lines for past years showing how comfortably weaker than previous years recent loan approvals have been. Things tend to move up at this time of year and we might have got excited if the first numbers for 2011 had shown a sharp rise. They haven't therefore one cannot make any claim that mortgage activity is showing a pick up. The real estate

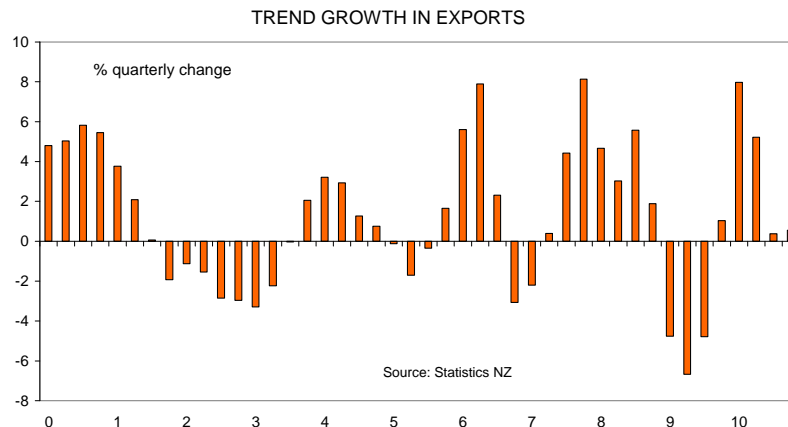
market is therefore starting the year on a quiet note as confirmed by Barfoot and Thompson data for Auckland real estate discussed in the Housing section.

Is business output rising?

This week we received the monthly export numbers and they show trend growth over the December quarter of 0.6% in export receipts from 0.4% over the September quarter. That is positive but very slow and one suspects that this slowing may not be picked up by most people because attention will instead be on other much more positive numbers which one has to remember largely reflect a surge in exports over a three quarter period ending in the middle of this year. For instance, the annual trade surplus of \$1.1bn is only just down from \$1.4bn the previous month which was the best since 1994 when read as a proportion of total exports.



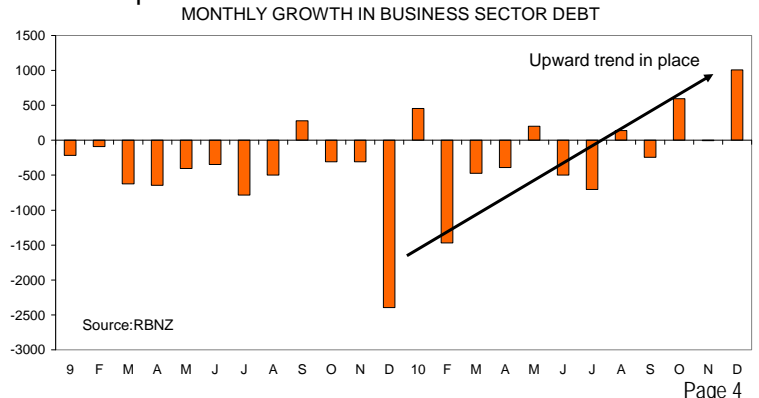
This next graph shows the near stalling in export growth.



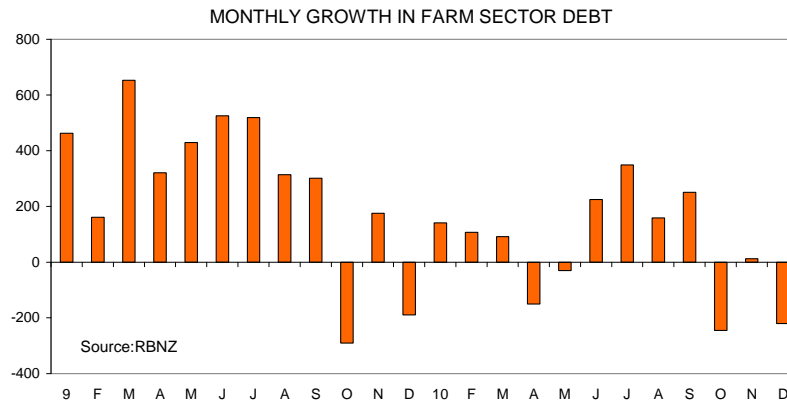
The export sector is barely growing.

This week we also received the monthly credit growth numbers and what they show is that in December business debt grew by \$1bn. In December last year debt fell \$2.4bn and two Decembers ago it was flat. Businesses appear to be borrowing more and this backs up our conclusion of rising investment seen in improving imports of capital equipment and some improvement in the value of consents issued for commercial buildings.

This is all very interesting because this borrowing and investment is occurring at the same time as consumers have completely stuck their heads in their shells. This suggests therefore investment for raising productivity as opposed to investment to boost capacity. If so this would be fantastic for the economy's productivity growth – but we shall have to wait and see.



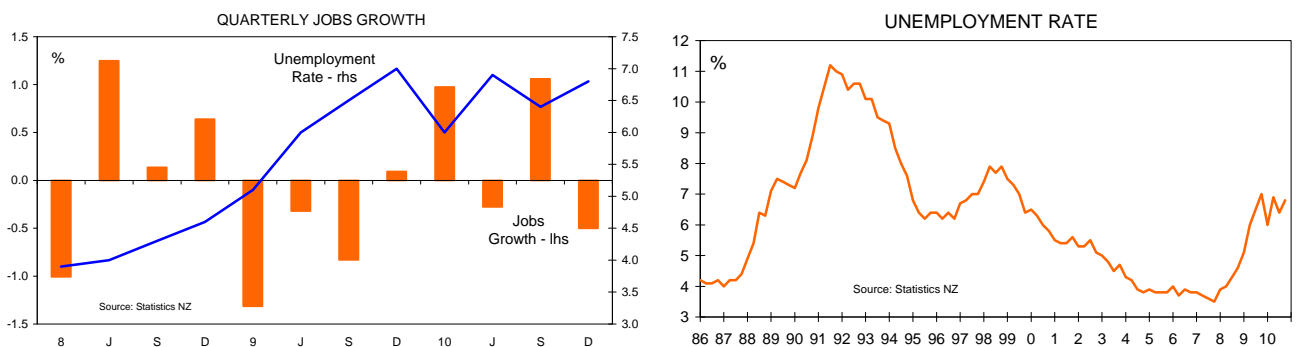
With regard to growth in farming sector debt there is none. Farm debt fell \$220mn in December and making the same graph for farming as above for the urban business sector we see no upward trend in growth. We read this as backing up our view that although farm produce prices are generally high farmers are, like householders, concentrating on getting their debt levels down. That means limited feed-through into the regions of rising farming incomes and thus no basis for thinking other than that the regional housing market will remain fairly suppressed for quite some time given the over-supply of properties following the strong growth up to 1997.



To the extent that lending growth is a measure of growth in the financial services industry, the fact that total private sector credit was largely flat in November and December suggests that this sector is not growing. But there is more to financial services than just lending so one can't really extrapolate this conclusion far.

Are businesses hiring more people?

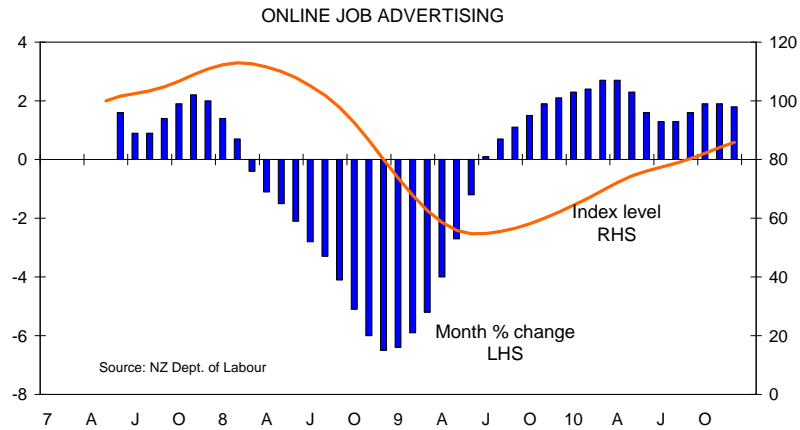
Not during the December quarter. The data released this morning show that employment in seasonally adjusted terms fell 11,000 or 0.5% during the December quarter. Things are not actually quite as bad as that because part-time work fell 2.8% (after rising 2.4% the previous quarter showing this series is all over the place), while full-time work rose 0.3%. Hours worked in fact gained a small 0.2% during the quarter. But the result was unequivocally weak and means the unemployment rate is back up at 6.8% from 6.4% in the September quarter.



Things are better than they were a year earlier with job numbers ahead 1.3% but the pace of jobs growth is slow averaging just 0.3% a quarter over 2010 which is a stark contrast to the situation in Australia where employment has boomed and the unemployment rate is near 5%. Hence the accelerating flow of people across the ditch.

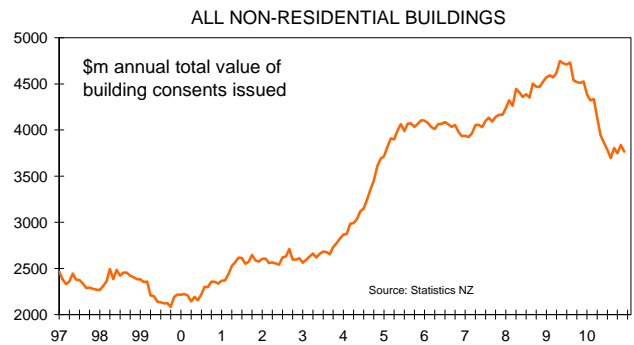
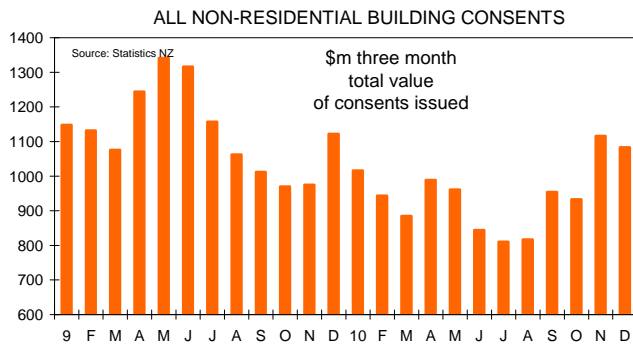
However....

The Department of Labour released their monthly Jobs Online indexes this week and what they show is an improving trend in advertisements being placed for jobs as shown in the graph below. The line shows the trend in terms of a level measured as an index on the right hand side. The bars show by how much the trend changed in percentage terms from the previous month measured on the left hand side. Growth is occurring at what seems to be a reasonable pace.

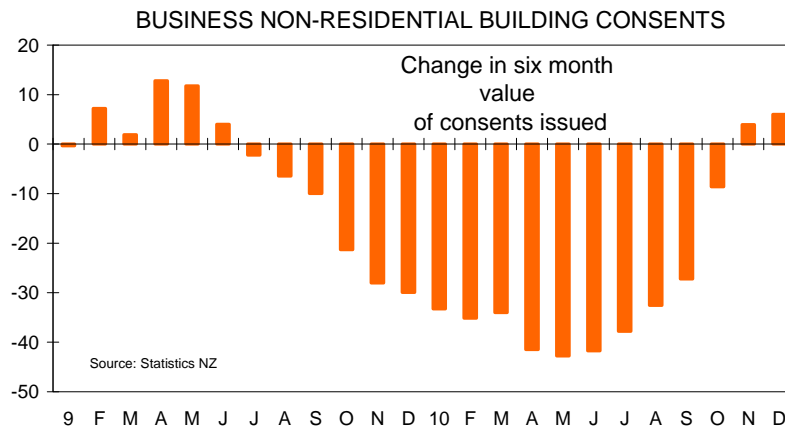


Are businesses boosting their capital spending?

We learnt this week that in December the value of consents issued for the construction of non-residential buildings came in at \$332mn which was a decrease from the unusually high November total of \$479mn and down 18% from a year earlier. But these monthly numbers go all over the place so you don't want to examine just one or two months. In fact we recommend for this series that you look at six month totals. Doing that we find consent issuance over the second half of last year was down 4.5% from a year earlier but that the rate of decrease had shrunk from 27.7% six months earlier and 8.4% 12 months earlier.

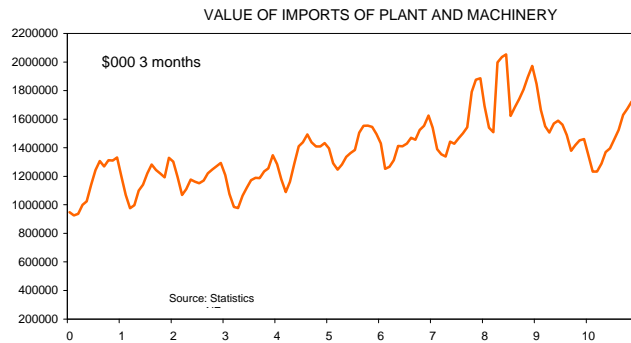


If we do our best to take government buildings out of the mix we get growth in business consents of 6% in the past six months compared with a year ago which was up from 42% shrinkage six months earlier. There is evidence that businesses are spending more on buildings and this conclusion is enhanced by the value of consents for factories running 62% ahead of a year ago in the second half of last year. Storage buildings were ahead 24% and even shops and restaurants were ahead 54% (go figure).



There is evidence that business investment in this area is picking up. This is good.

The most up to date indicator which we have been citing as evidence that business capital spending appears to be picking up is imports of plant and machinery. The trade data released on Monday show that in December the value of these imports was 20% ahead of a year earlier and as the graph here shows the trend in this measure is decidedly upward. This is a very positive development which gels with the mild underlying improvement we think we can see in commercial construction, plus improving tractor registrations.



INTEREST RATES

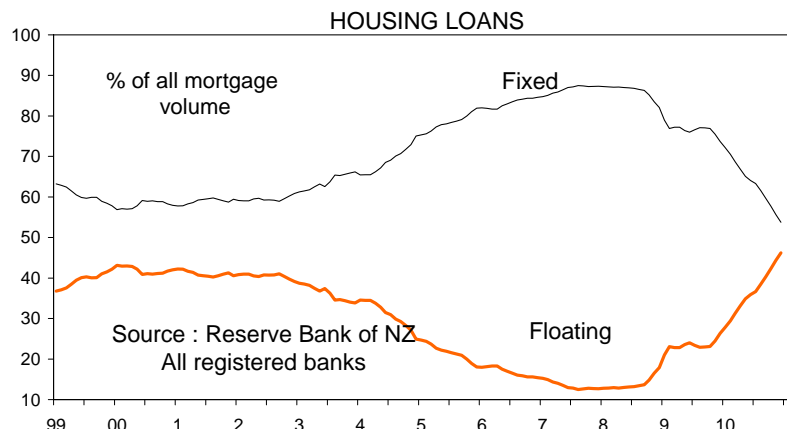
Growth vs. Economic Slack

In a nutshell this is what drives inflation along with institutional arrangements, imported inflation, and exchange rate changes. If you want to forecast monetary policy you need to monitor these things. So we will, adding stuff here when we learn it. The current common view is rate tightening from June-September. Have we learnt anything this week which alters this outlook?

This week we learnt that output in the residential construction sector is going to keep falling away with consent numbers declining at a rapid clip. This will clearly restrain inflation coming from the construction sector. We've seen also confirmation of export receipt growth being near zero while imports rose more than exports over the December quarter so that means in aggregate economic shrinkage. We've seen lending for housing falling for the first time on record though a sizeable jump in lending to the business sector. And we've seen the unemployment rate rising to 6.8% in the December quarter and not holding at 6.4% as forecast by the Reserve Bank in early December.

What we have then is a combination of easing demand and rising slack in the economy. These developments argue strongly against an interest rate rise in the next few months. We now do not expect the next rate rise to come until September. As we have warned many times in the past – and especially in recent weeks – major uncertainty continues regarding our economy and economies offshore so one must be very careful about blindly adopting an interest rate strategy based rigidly upon a particular set of interest rate forecasts coming true. In this sort of environment these forecasts have already and will continue to change a lot.

Further supporting the argument for the next monetary policy tightening being a long way away is the increasing power of monetary policy changes coming about as people roll off fixed rates into floating rates. The latest data show that at the end of December 46.2% of mortgage volume was floating which is the highest proportion since sometime before mid-1998 when the records start. A change in the official cash rate now will affect many people straight away meaning that the RB can take its time assessing the inflation risks whereas in the past they had to move quickly knowing it would take a long time for the bulk of borrowers to feel any cash flow change.



Other Inflation Influencers

One needs to keep an eye on the fact that although we have spare capacity in the economy to handle growth without inflation there will still be price rises because of soaring international prices for a wide range of things. That is one reason we are not yet ruling out any monetary policy tightening this year. The other reason is our expectation of the pace of economic growth picking up quite well this year and the labour market tightening up late in the year as we lose a lot of people to Australia.

For the record, given that the markets were largely already pricing in the next cash rate rise coming in September and because forecasts for this morning’s employment numbers had been carved back in recent days there has not been much change in wholesale interest rates compared with a week ago.

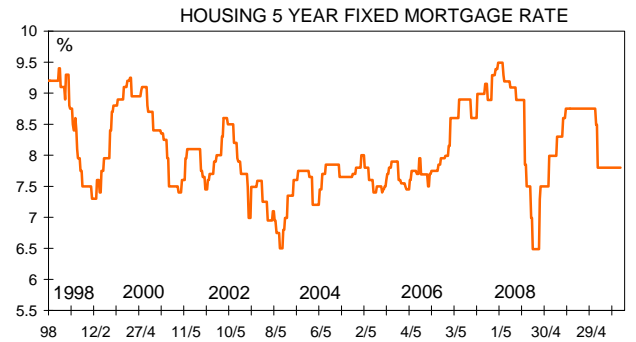
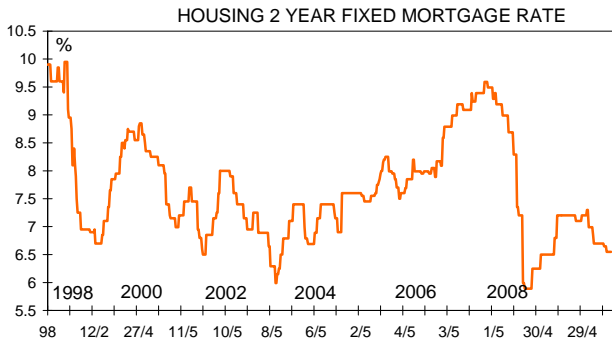
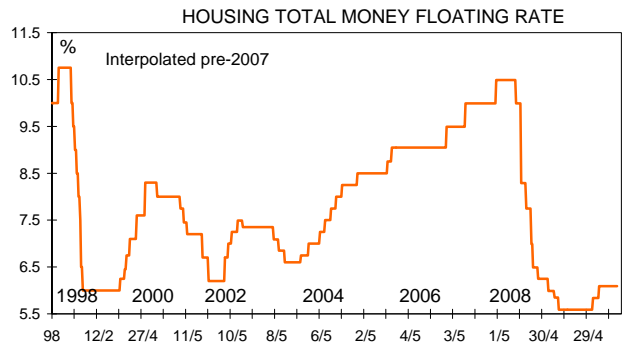
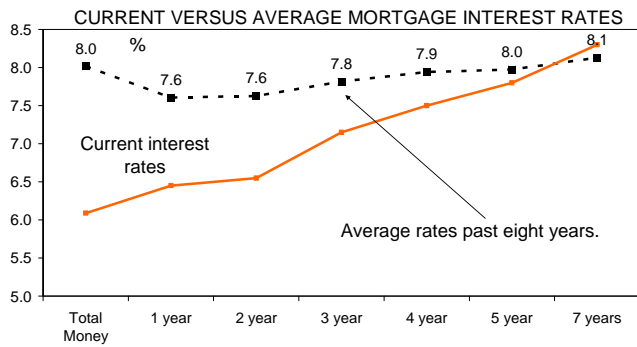
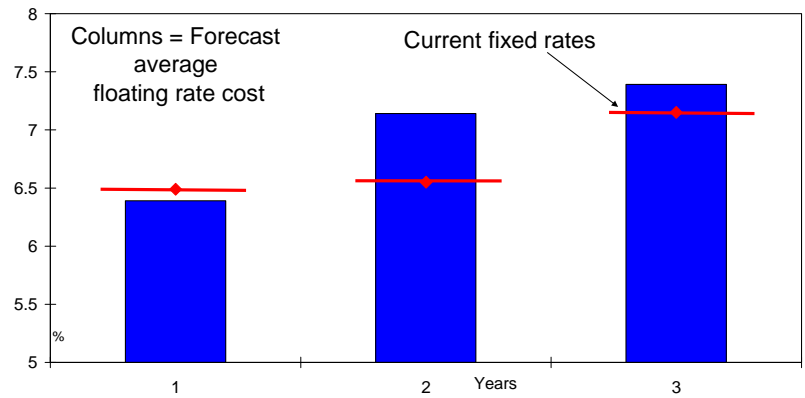
FINANCIAL MARKETS DATA						
	This week	Week ago	4 wks ago	3 months ago	Yr ago	10 yr average
Official Cash Rate	3.00%	3.00	3.00	3.00	2.50	5.9
90-day bank bill	3.20%	3.20	3.19	3.20	2.77	6.2
1 year swap	3.40%	3.44	3.42	3.48	3.46	6.3
5 year swap	4.70%	4.73	4.78	4.39	5.39	6.6
180-day term depo	4.10%*	4.10	4.80	4.90	3.15	6.0
Five year term depo	6.50%	6.50	6.75	6.75	6.00	6.5

* 160 days = 5.2%

If I Were a Borrower What Would I Do?

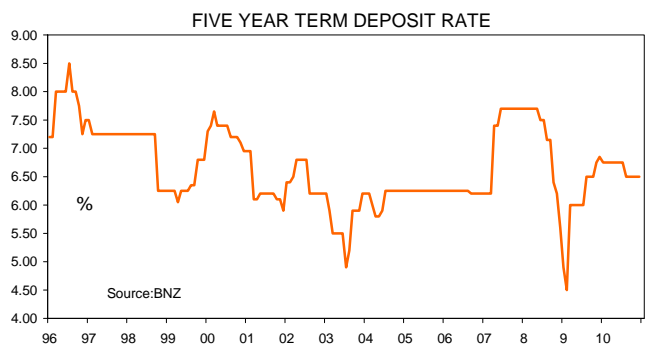
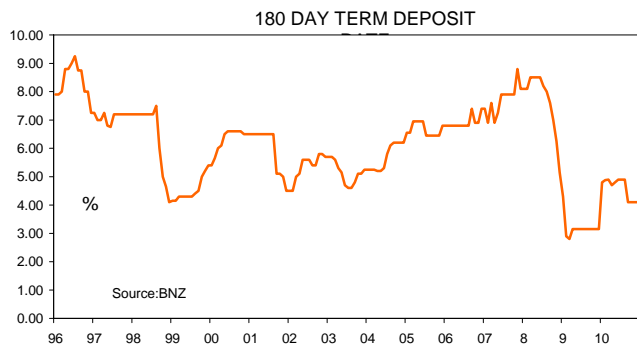
The economic data we have received since the start of the year show convincingly that the rate of growth in the New Zealand economy is not picking up. There are certainly many factors which argue for much stronger growth this year than last but they have yet to kick in and the longer it takes for that to happen the more spare capacity builds up. That means reduced inflationary pressure and that means the Reserve Bank can wait longer before they feel the inflation threat is great enough to warrant raising interest rates.

In the absence of anything suggesting fixed rates will be rising in the near future I feel that staying on a floating rate for a great number of months remains the optimal thing to do. What this means is that even though the graph below shows we think a borrower would be better off fixing two or three years than floating over those periods of time there is little point sacrificing a low floating rate for a higher fixed rate at this point in time. Note how the one year fixed rate is now above where we think the floating rate will average in the coming year.



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

Take a spread of term rates. Nothing interesting to say here sorry.



HOUSING MARKET UPDATE

Turnover is weak, construction falling, and prices essentially flat on average.

Report From the Building and Housing Department

This week the Building and Housing Department released the first issue of their NZ Housing Report. The aim of the report is to pull together all available information on the state of the NZ housing market in order to promote debate and raise awareness of particular issues. Those particular issues include one we have long been highlighting, namely that construction of dwellings is not great enough to meet rising demand. BHD forecast on the assumption of average net annual inward migration of 10,000 that 21,190 extra households on average will be formed each year between 2011 and 2031.

However, that does not mean one only needs construction of 21,190 dwellings per annum or even issuance of just 21,190 dwelling consents. Each year there are houses demolished to make way for new ones, and consents issued but not acted on, building of holiday homes etc. to the point where around 20% of consents do not in fact become available to meet underlying housing demand. One actually needs therefore consent issuance of around 26,500 per annum. BHD contracted Infometrics to forecast consent issuance over the next few decades and on the basis of their forecasts predict that there will be a shortfall of 14,772 dwellings over the next five years in total then more than 10,000 over the following ten years.

In other words dwelling construction is not expected to keep up with dwelling demand and one does not need an economics degree to figure out what that means for prices. But the situation may in fact be somewhat worse than they are predicting for a variety of reasons. The first is that while Statistics NZ use 10,000 net immigrants as the middle assumed number in their population projections history recently has been telling a different story. On average in the ten years ending 2010 the net migration gain has been 15,000 per annum. In the ten years before that it was 9,000 and before that a loss of 11,000 so on the face of it a 10,000 average versus the average of 4,700 over the past three decades seems generous. But the trend is for rising numbers coming to New Zealand so we think there is over the long term some upside risk to the 10,000 net immigration assumption – over the long term. Not this coming year.

Second, as we have noted many times and BHD do as well, the collapse of finance companies has removed the ready supplier of finance for property developers. One comment they make in the report is "...the collapse of the traditional highly-g geared entrepreneurial development model, funded through finance companies, may have introduced a constraint on recovery that is specific to the industry. It is not yet clear how the sector will adjust to the need for new development and funding structures."

Third, we are not going to see the same proportion of aging people leave their homes to live in retirement villages or hospice-like facilities in the future as we have seen in the past. There simply won't be enough beds. The past freeing up of houses of old folks will be less over the next four decades than in the past four and the study's authors note this factor has not been allowed for. Then again, they have not been able to take into account how much longer young people may remain at home before renting or buying a dwelling because of high housing costs.

Fourth, land availability for new dwellings is an issue in many parts of the country. Fifth, availability of skilled people to build houses in the future will be constrained by low training since 2008's recession and loss of people to Australia.

And finally, consent issuance is already undershooting the number used in the predictions. In 2010 only 15,602 consents were issued. The forecast used in the report for calendar 2010 was 17,294. That is an extra 1,700 or so in arrears. And that goes on top of the 10,266 construction shortfall BHD estimate occurred over the period from 2006-09 and the further 16,581 over the 2009-11 period. The predicted 2011-16 shortfall of 14,772 goes on top of that and one gets a picture of a growing gap between what the population needs for housing and the quantity of houses which is and will be available.

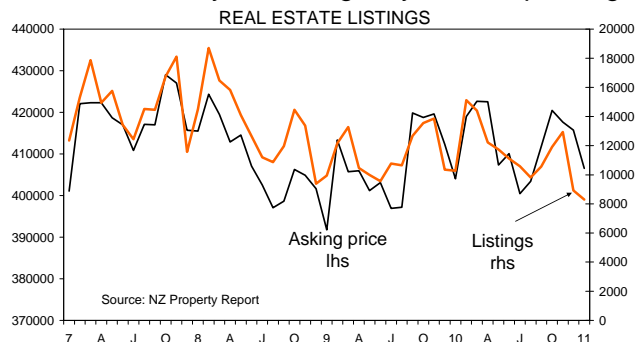
The implications are relatively clear in the medium to long term though definitely still clouded for the moment by the drive of people to save and general caution keeping the residential real estate market flat. When rising demand meets inadequately rising supply prices rise – with extra upward pressure from rising construction costs and decreasing land availability, especially in Auckland.

If you have an interest in urban development, the housing market, rental market, socioeconomic trends etc. the report looks like quite a good one for gathering useful background information.

<http://www.dbh.govt.nz/UserFiles/File/Publications/Sector/pdf/2009-2010-nz-housing-report.pdf>

Listings About Where They Were Last Year

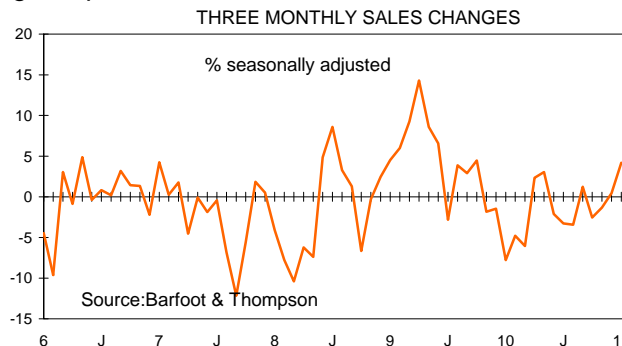
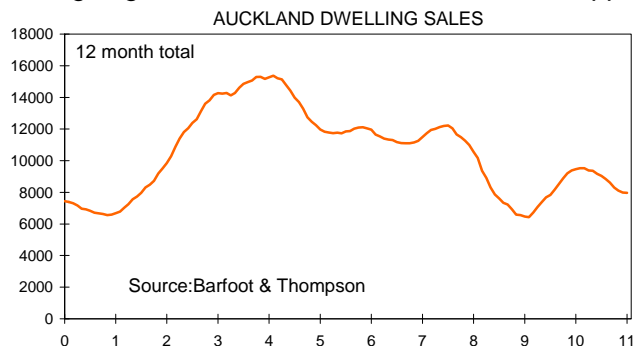
The NZ property report released this week shows that at the end of January there were some 53,297 properties listed for sale on the REINZ website. This was little changed from 52,817 a year ago but when measured in terms of sales was a rise to 47.9 weeks worth of stock from 37.4 weeks in January last year. In other words, sales are weak but there is no evidence of great financial pressure forcing people to put their properties on the market. This is the sort of thing one would expect to see with interest rates being kept at low levels. Few forced sellers but also few buyers feeling they need to pull finger and snap something up.



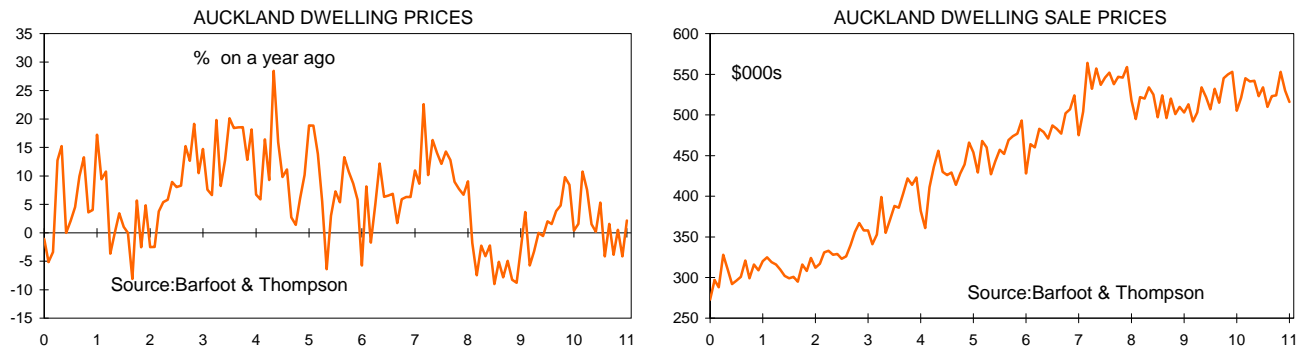
The median listing price eased to \$407,000 in January from \$416,000 in December but was up from \$404,000 a year earlier. Nothing major there it seems. The graph above shows that there is no clear tendency for changes in listings to lead changes in prices.

Auckland Real Estate Market Flat

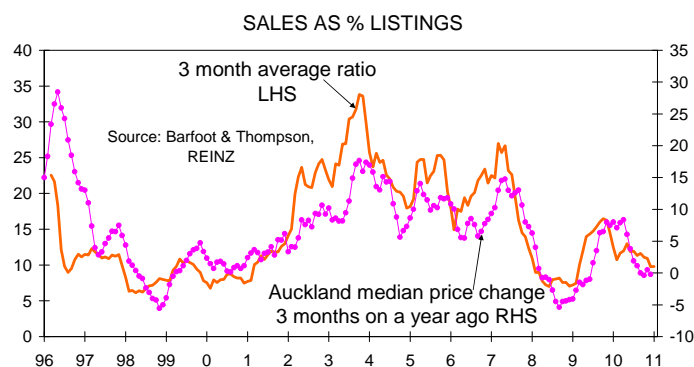
Barfoot and Thompson released their Auckland-centric sales data this morning and revealed that the housing market there remains very flat. They sold 563 dwellings in January which was a 3% fall from a year earlier and small 6% seasonally adjusted decline from December. Over the past three months seasonally adjusted sales were ahead 4% which in the scheme of things allowing for volatility is best interpreted as sales going nowhere which is what has been happening for quite some time.



The average sale price fell to \$516,000 from \$530,000 in December but was ahead 2% from a year ago and 2% in the past three months from the previous three month period. We choose to read that as showing prices are largely flat.



They had 5,854 dwellings listed on their books at the end of the month which was a 2.6% rise from a year earlier. But new listings totalled only 896 which was a 24% fall from a year ago. Therefore, consistent with the NZ Property report discussed above, these data show vendors not bothering to put their properties on the market. They feel no panic and buyers feel in no hurry. Hence the low turnover and steadyish prices.



This week we received this comment from a landlord in Wellington.

"I have been a residential property investor in Wellington for 19 years.. There's been talk of a rental glut in Wellington. However, last week I rented out a one-bedroom property on The Terrace (central Wellington), having raised the rent by 4%. I placed it on TradeMe and had about 20 calls within less than 48 hours - easy. Those enquiring included a large number of people from overseas (from all parts of the world) - coming to work in Wellington on The Hobbit or in other jobs, or coming to study. I've asked almost everyone who has come to view my property. They say that it's tough out there for renters with good properties snapped up immediately. However, dark and cold properties remain vacant for longer and some places, especially the new ones, are not very attractive as they're little more than shoeboxes and have tiny bedrooms.

After that property I rented out another one this week, a 2-bedroom property also on The Terrace. I raised the rent by 3% and advertised the property on TradeMe. This time I held an 'open home' and had four groups wanting to rent from me. Some of them are desperate - they've just arrived in Wellington or their previous leases have expired and in the meantime they're living in hostels or on friends' floors. So, no obvious rental glut in central Wellington for mid-grade properties aimed at the young professional market.

On the other hand, I currently have a 2-bedroom unit in Upper Hutt which has been vacant for just over two months.. There's nothing wrong with it - it has been freshly painted and has a heat pump. I own quite a few units in Upper Hutt and this is by far the longest I've had a property vacant - they're usually snapped up immediately. DBH data which I've read in the New Zealand Property Investor magazine indicates that the number of properties let in November 2010 was about a third of the number in November 2009. It appears that potential tenants feel unsecure or can't get together the money for the bond."

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.

MAJOR OFFSHORE ISSUES

There are many important things happening offshore not easily covered in the one country commentaries we have traditionally included when time permitted in the FX section below. So this new section will concentrate solely on developments in the areas occupying the minds of the markets, policy makers and politicians around the world. In some weeks certain sections will be empty because nothing new will have occurred.

European Debt

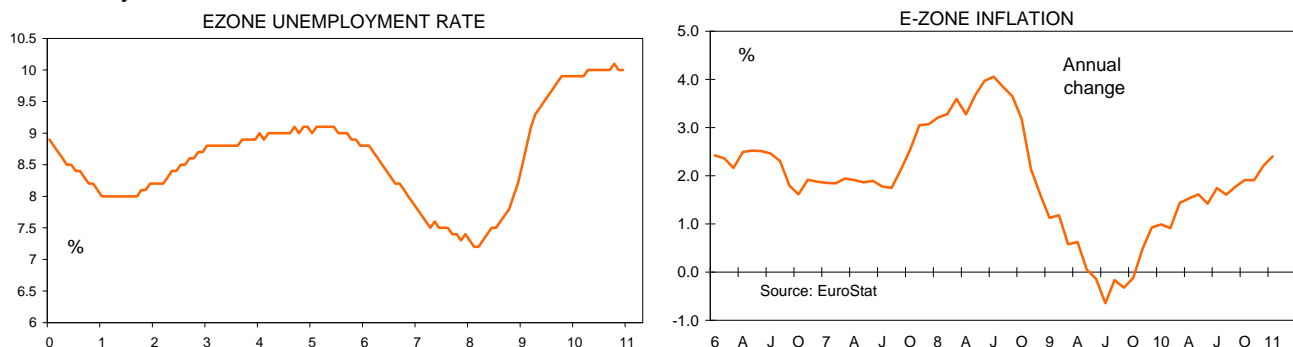
Southern Euro-zone governments have soaring debts and/or deficits due to taking on their private sector's debts, or simply their own fiscal incompetence. Concerned by these developments and the lack of suitable EU-wide institutions for handling crises investors are demanding higher and higher interest rates before investing in more debt, causing debt servicing budget blowouts for the recalcitrant borrowers. To try and keep investor confidence some governments are radically slashing spending, raising taxes and restructuring but still borrowing costs climb and the citizenry grow increasingly restless. The logical route is they restructure their debt but that can't happen yet because the bulk of such debt is held by French and German banks and the capital losses could send them bankrupt thus crushing their own economies. What happens then? Lots more investor worries, more official bailout packages as already done for Ireland and Greece, more fiscal austerity and rioting, then when bank capital bases are secure enough debt restructuring will almost certainly come for Ireland, Greece, Portugal and maybe Italy and Spain.

What's new?

More and more there is a feeling that the debt crisis has passed its worst point and attention is now turning toward the expressed inflation worries of the European Central Bank and the markets are increasingly pricing in rate rises late this year. In fact sentiment is so positive the ECB announced that last week they suspended emergency purchases of euro government debt.

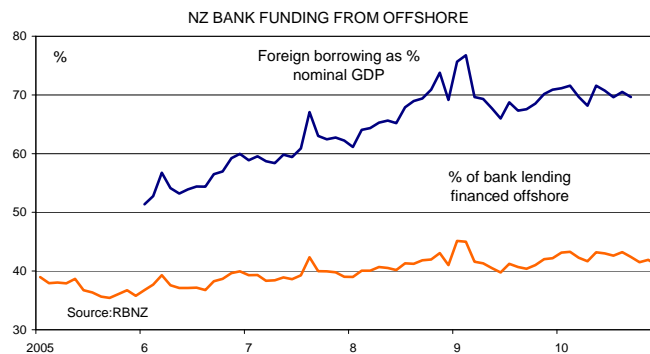
Barring a new surge in investor concern about the crisis the next major event for Europe comes in March when decisions are expected to be taken regarding increasing the effective size of the European Financial Stability Facility to make more of the €440bn available for lending, extending the term of loan repayments, increasing flexibility in use of the fund and reducing loan interest rates.

The unemployment rate in the euro-zone held steady in December at 10% which equates to almost 16 million people out of work and looking for a job. The German unemployment rate is now at its lowest rate since 1992 at 7.4%, Spain 19.1% (down from 20.6% in September), Italy 8.4% unchanging, Greece 10.2% down from 12.9% in October, Portugal 10.2% down from 11.1% in November. UK unemployment was 7.7% and steady in recent months.



Euro-zone inflation now sits at 2.4% from 2.2% in December according to the early flash estimate compiled by Eurostat. That will worry the ECB and further supports the case for rate rises. In fact full data show that the German inflation rate has hit its highest level since October 2008 at 2% with import prices rising at their fastest pace in 29 years in December.

Standard and Poors yesterday cut their credit rating for Ireland one notch from A to A-. They expressed concern about Ireland's previously booming banking sector and estimate external indebtedness of the banks stands at about 170% of GDP. Here in NZ where we banks fund about 40% of our lending offshore the ratio of this foreign financing to GDP is about 69%.



Chinese Inflation

In China high inflation tends to spur non-one party thoughts from the populace à la Tiananmen Square 1989 therefore the leaders will do all they can to get food price rises in particular down. So is inflation easing, what measures will be added to get inflation down? The big global worry is that these measures could produce a sharp slowing in growth which slams sharemarkets, Chinese raw material demand and therefore commodity prices relevant especially for Australia and via them to us, plus our own large dairy and forest product exports to China.

What's new?

Just to illustrate why we have this section in here regarding Chinese inflation, a poll just conducted by Bloomberg of 1,000 of its customers found 45% expect a Chinese crisis within five years. There are high concerns regarding food price inflation and potential for social unrest, but mainly concerns centre around property market bubbles producing excess construction along with over-investment in infrastructure and business assets.

<http://www.bloomberg.com/news/2011-01-26/china-will-face-crisis-within-5-years-45-of-investors-in-global-poll-say.html>

The trouble with this view however is that it has been around for quite some time and probably fails to take into account the massive transition China's population is undergoing from agrarian to urban living and the fact that population location shifts will not always occur at the same speed as construction. This is not to say that there will not be crises down the track because there almost certainly will be. But in some regards bumps along the way are to be expected when one has nearly 20% of the world's population undergoing such a massive shift in incomes, consumption, and lifestyle generally. The trick for those like ourselves who would be hit by any crisis is to factor such a hit into our risk management.

This week's move to try and control real estate bubbles came in the form of the central authorities allowing some cities to impose property taxes. Details are scarce and only two cities are concerned at the moment but it looks like maybe annual taxes of 0.4% to 1.2% of property value may be imposed.

Every four months the People's Bank of China release a monetary policy report and the one issued on Sunday expressed concern about strong capital inflows driven by quantitative easing in other economies. It noted inflation expectations and price pressures are strong and that it will use a range of instruments, particularly interest rates, to control aggregate demand and manage inflation expectations. Nothing new there really, just them noting they have a problem they will be spending the year battling.

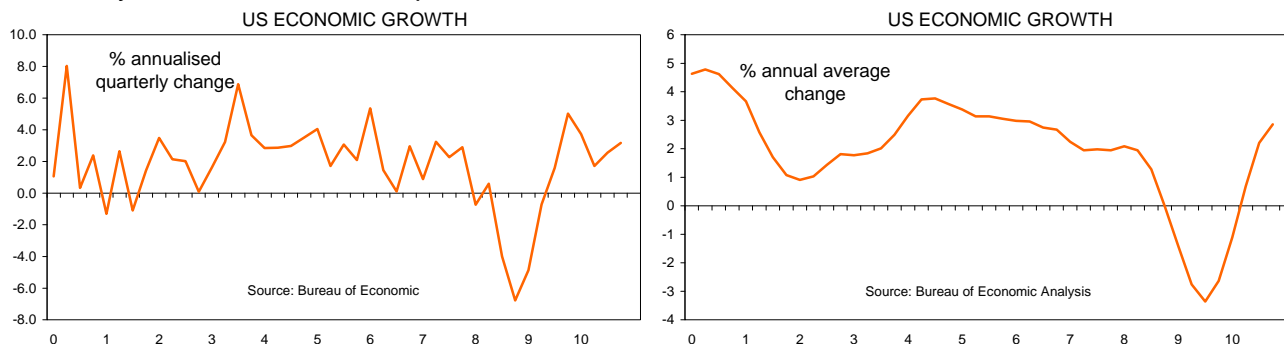
Following the recent news that minimum wages in Beijing have been lifted 21% this week Shanghai announced a 10% rise and Guangdong 18-26%.

US Growth Momentum

The US economy has grown 2.2% over the past year but the upturn is not yet "self-sustaining" or reducing unemployment stuck above 9% at 14mn - worse than Germany, Japan, Britain and Russia. Manufacturing is firm but retailing, housing and business investment remain weak while few moves have yet been started to rein in an unsustainable Federal Budget deficit above 11% of GDP and concerns are growing about state and local budgets. What we're looking for are signs that the economy is firing on more cylinders than just those caused by a low USD, restocking, and fiscal stimuli. I.E. consumption, housing, and business capital spending.

What's new?

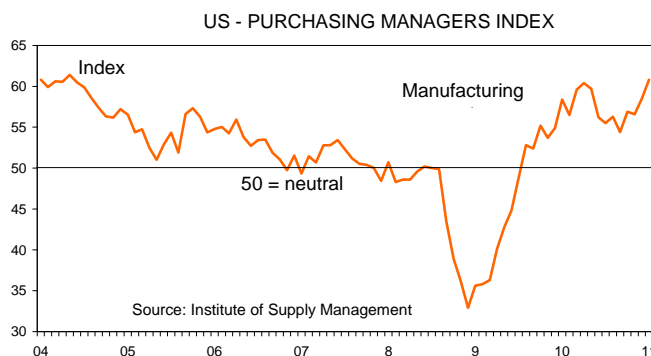
There was no positive surprise of surging growth contained in the December quarter GDP numbers which were released on Friday night. Rather than growing at an annualised pace of 3.5% as expected growth was actually estimated at 3.2% from a 2.6% pace during the September quarter. The growth means that output is now above the peak reached in the June quarter of 2008 which is quite a contrast with New Zealand where our activity is still 1.8% below the peak reached at the end of 2007.



One piece of positive news however was that private consumption rose at a healthy annualised rate of 4.4% which was the fastest pace in almost five years. However most of the improvement in GDP growth from the September quarter was due to a weakening in imports after a mid-year restocking surge and a strengthening of exports.

The big nice economic surprise for the week in the US however was the January manufacturing Purchasing Managers Index which rose to a near seven year high of 60.8 in January from 58.5 in December. In the words of the Chair of the Institute of Supply Management which compiles the index "The past relationship between the PMI and the overall economy indicates that the PMI for January (60.8 percent) corresponds to a 6.4 percent increase in real gross domestic product (GDP) on an annual basis."

<http://www.ism.ws/ISMReport/MfgROB.cfm>



The fact that the manufacturing sector is growing well is not new and does not change the worries which persist regarding the US housing and labour markets. But it is obviously good news suggesting one can reasonably expect that eventually these two markets will improve – eventually. Few forecasters however expect a fall in the US unemployment rate below 9% before the end of the year.

Global Currency Conflict

Asian economies have driven growth for many years by keeping their currencies low against the greenback (thus hurting the purchasing power of their consumers). But their model of growth relying on excess spending by US households is shattered yet they either don't realize it or can't face the adjustment pain. Natural pressures on the greenback are now downward (budget and current account deficits, debt risk, relative interest rates and share of world economic activity and growth) but to stop their currencies appreciating versus the USD Asian economies are keeping their interest rates low and printing more money thus running rising inflation risks. Recent and planned extra US bond buying is adding to rising economic/political/trade tensions. We are watching for either Asian currency capitulation (most closely watched are the Chinese), further capital inflow restrictions, deployment of trade weapons, etc. The big risk is a global currency/trade war.

What's new?

We mentioned here last week the way in which higher inflation in China than the United States could take care of the current under-valuation of the Chinese yuan within three years according to one analyst. This week we have seen reports of Western multinational buyers of Chinese goods cutting back their orders because of price increases in the order of 20% - 50% for the likes of leather shoes and polo shirts.

Commodity Prices

Prices of commodities are soaring on the back of currently firm Asian growth, expected rising structural demand related to infrastructure and rising incomes, and surging speculative investor buying driven by US money printing, inflation fears, ultra-low interest rates, and wariness of alternative investments. Bubbles are undoubtedly developing but history shows we have zero chance of picking when they peak and where.

We have seen soaring copper and contract coking coal prices this week so nothing new in terms of price worries around the world easing off. With commodity prices rising strongly concerns grow not just about who riots where in the developing world but how high inflation rates will get in the emerging and developed worlds. For the latter things are probably not too problematic because the developed economies by and large have spare capacity and pricing ability of those directly hit by cost increases will not be strong. The price rises therefore become largely a drag on growth as wealth is transferred to commodity producers. But for emerging economies like China, Brazil and India where inflation rates are already worrying the price rises risk greater cementing in of sustained high inflation while severely denting the real purchasing power of those people not immediately enjoying the fruits of strong economic growth.

As noted last week one problem with the way countries respond to soaring food prices is that their actions can make things worse. Algeria is attempting to hoard as much grain as it can by aggressively buying product offered on the global markets while other countries are banning exports or controlling prices paid to farmers. This latter practice reduces the incentive to farmers to plant out more land thus taking away an important market mechanism for correcting inadequate production.

For your guide the Food and Agricultural Organisation released an updated set of guidelines this week for countries to follow in handling their food crisis.

<http://www.fao.org/news/story/en/item/49954/icode/>

Australian Growth

Australia delivers 24% of our merchandise export receipts, 45% of our tourists, owns almost all our banking sector and 51% of FDI, contains over 600,000 Kiwis and acts as a back-up labour market for most of us. What happens there matters to us so we shall monitor their growth here. The Aussie economy is growing strongly on a mining and infrastructure boom bringing us competitiveness advantages in tourism and manufacturing as the AUD soars but will drain our skilled labour base. There is an opportunity to entice manufacturers here. Jobs growth is averaging over 30,000 a month and at what point does this do four things – spur currently weak retail spending, spur appallingly low house construction, drive wage inflation, and spur higher non-mining business investment to boost productivity. The first three feed-throughs will accelerate monetary policy tightening and lower the NZD/AUD exchange rate further. If job growth accelerates migration outflows from NZ to Australia will soar even more than seems certain over 2011-12.

What's new?

Access Economics in Australia for decades have compiled a list of infrastructure, mining, and other large construction projects being planned in Australia. They release the information quarterly and with the biggest mining boom in over a century underway some of the numbers they have been releasing in recent years have been mind boggling. This week in their latest report they note that the total value of resource projects either being built at the moment or on the drawing board increased by AU\$32bn over the quarter to a massive AU\$362bn. Just under one-third are actually being built or about to turn a sod.

In comparison non-resource projects fell AU\$25bn over the quarter and this is one figure illustrating what many are calling the two-speed nature of the Australian economy. General business investment is weak. That is not the case in New Zealand where we believe growth in business capital spending is occurring in spite of the weakness in retailing and housing plus flat growth in exports of goods and tourism.

Exchange Rates

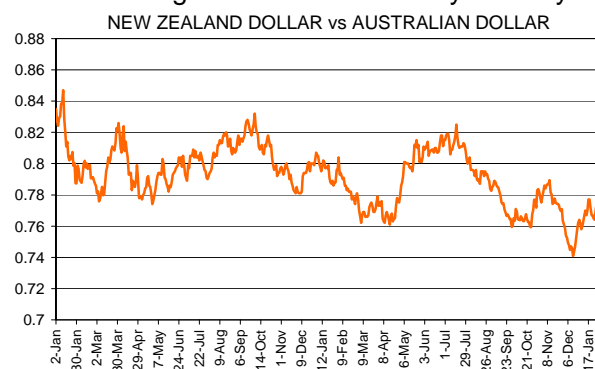
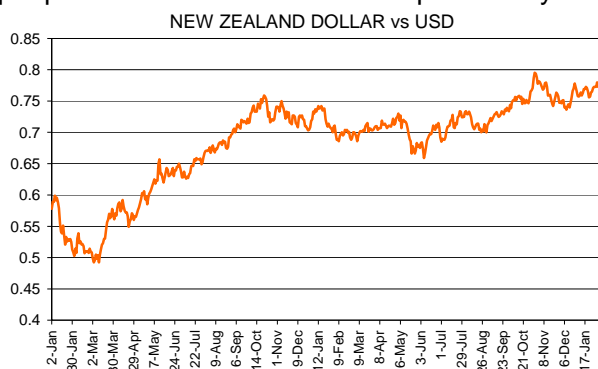
Exchange Rates	This Week	Week Ago	4 wks ago	3 mths ago	Yr ago	Consensus Frcsts yr ago*	10 yr average	
NZD/USD	0.773	0.771	0.778	0.771	0.711	0.690	0.629	
NZD/AUD	0.766	0.775	0.762	0.772	0.804	0.772	0.855	
NZD/JPY	63.000	63.300	63.200	62.170	64.3	66.999	68.4	
NZD/GBP	0.477	0.485	0.500	0.481	0.445	0.426	0.368	
NZD/EUR	0.560	0.562	0.583	0.549	0.509	0.495	0.511	
NZDCNY	5.098	5.075	5.140	5.156	4.854		4.83	
USD/JPY	81.501	82.101	81.234	80.677	90.436	97.100	109.9	
USD/GBP	1.621	1.590	1.556	1.603	1.598	1.620	1.705	
USD/EUR	1.380	1.372	1.334	1.403	1.397	1.394	1.229	
AUD/USD	1.01	0.99	1.02	1.00	0.88	0.894	0.737	

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

In the interests of saving space this section is being kept deliberately short. For more detailed commentaries from BNZ and the NAB group on foreign currencies click on the following link.

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

The Kiwi dollar broke above US 78 cents for a while this week while not experiencing radical changes against other currencies as the greenback was pushed lower because of easing worries about the European debt crisis, increasing feelings that the global economic recovery is gathering pace, and therefore increased tolerance of risk by investors. We are classified as a risky currency (the most remote small OECD economy, bad productivity trend, large net external liabilities, 56% export dependence upon primary exports) so when people feel less scared about the planet they become more willing to throw some money our way.

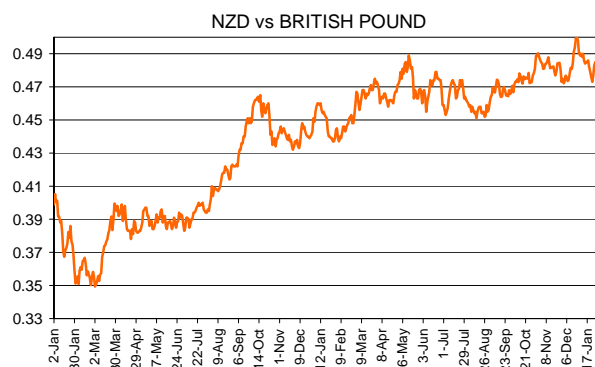
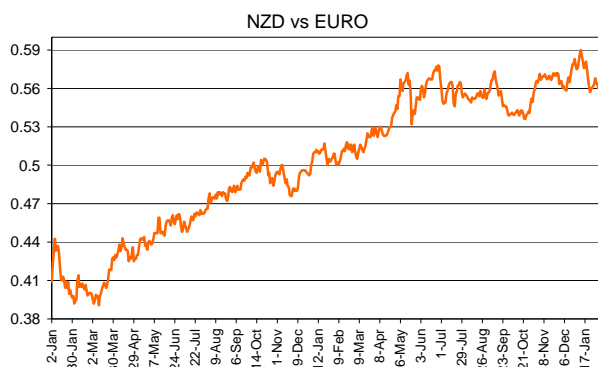


Note that the unending short term fluctuations in this risk factor have little relevance to longer term foreign direct investment decisions like those being made by the Germans who have just bought some farms, the Chinese who want to and so on.

Their decisions reflect long term expectations of returns and increasingly strategic advantage in asset exposure as expressed by the Blackrock fund manager Chief Executive. "Go long agriculture and water and go to the beach."

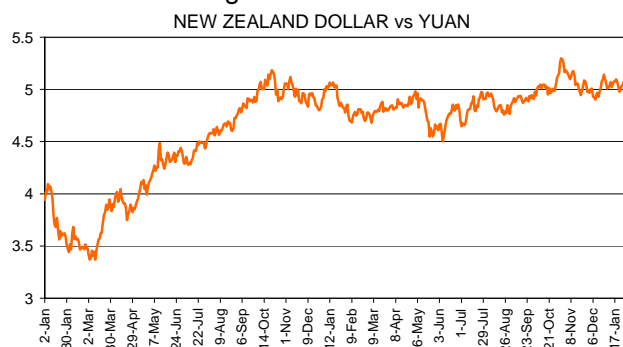
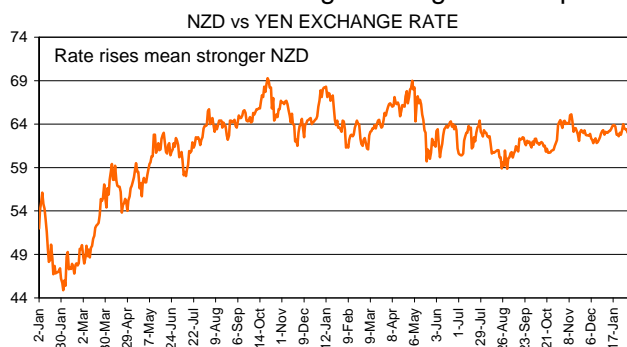
<http://www.theaustralian.com.au/business/invest-in-agricultureand-water-says-blackrock-chief/story-e6frg8zx-1225997694069>

We have agriculture and water so we should fully expect that foreign interest in purchasing our land assets will not only continue but increase. Some farmers will like to hear this because it will tend to support land prices. Others wanting to start or expand in the industry will be fearful because of that land price impact – though given that average land prices appear to have fallen some 30% over the past couple of years the current investment starting point is less horrible. Then again that means the entry price for foreign buyers is not so bad – or would not be so horrible if it were not for the exchange rate. The high NZD against the Euro did not deter the German investors.



Speaking of agriculture, the latest Fonterra auction produced another 7.2% rise in average prices. We are also a commodity currency and that means even more upward pressure on the NZD. But this morning the jobs report for NZ came in largely weaker than expected and this caused the NZD to lose half a cent to end this afternoon barely changed from last week just above US 77 cents. But we are down a cent against the AUD which is back above parity against the greenback because of strong commodity prices.

We have also shed some ground against the pound as inflation worries grow over there.



Our interpretation of the risks facing the NZD suggests it still remains reasonable to expect we break above US 80 cents this year but volatility is likely to remain very high because a simple glance in the business and international pages of a decent newspaper will show there are some major events in play offshore that could easily scare the financial markets many times this year and next. Pakistan, the Middle East, Korean Peninsula, food riots – at least no-one worries about nuclear winter these days as we did during the 1980s. Of course that would at least cancel out (completely) global warming.

But note this. At the same time as we are pushing out the timing for the next interest rate rise here expectations for interest rate rises in the UK and Europe are firming while if we see some strength appearing in the US labour market expectations for the US will also shift in. This suggests that if and when we do move above US 80 cents we may not stay there very long unless we see the mirror side of recent weak economic growth surprises.

For the record, the Yen weakened a tad after Standard and Poors cut the country's foreign debt credit rating by one notch from AA to AA-. New Zealand's rating is AA+.

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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	2.3%	1.2	4.0	2.0	3.4
GDP growth	Average past 10 years = 2.6%	-0.2	0.1	+1.4	-2.5	1.5
Unemployment rate	Average past 10 years = 4.8%	6.8	6.6	7.0	4.6
Jobs growth	Average past 10 years = 1.9%	-0.5	1.1	1.3	-2.4	1.0
Current a/c deficit	Average past 10 years = 5.5% of GDP	3.1	3.0	3.2	8.6
Terms of Trade		3.0	2.0	17.9	-14.1	5.8
Wages Growth	Stats NZ analytical series	0.4	0.8	2.7	5.4	5.0
Retail Sales ex-auto	Average past 9 years = 3.9%.	0.9	0.9	1.9	-0.9	0.4
House Prices	REINZ Stratified Index	0.0	-1.2	-2.3	6.0	-7.9
Net migration gain	Av. gain past 10 years = 13,900	+11,519	14,507yr	20,021	3,569
Tourism – an. av grth	10 year average growth = 3.2%. Stats NZ	3.4	4.4	3.4	-0.6	-0.6
Consumer Conf.	Neutral = 100 Westpac McDermott Miller	108.3	114.1		116.9	101.3
		Latest year rate	Prev mth year rate	6 mths ago	Year ago	2 yrs ago
Business confidence	BNZ survey	18	28	26	43	-6
Household debt	10 year average growth = 10.3%. RBNZ	1.6	1.8	2.6	2.9	4.3
Dwelling sales	10 year average growth = 2.5%. REINZ	-11.3	-15.2	-24.3	15.2	-23.1
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 Jan. 27 2011	March Years					December Years				
	2009	2010	2011	2012	2013	2008	2009	2010	2011	2012
GDP - annual average % change										
Private Consumption	-1.1	0.4	1.5	1.5	1.4	-0.3	-0.7	1.9	1.2	1.5
Government Consumption	4.2	0.2	1.9	1.4	0.9	5	0.6	2.1	1.1	1.2
Investment	-7.2	-9.5	4	5.4	6.8	-4.3	-10.1	1.1	4.4	7.5
GNE	-1.4	-3.6	3	3.5	2.5	0.3	-4.9	3	2.9	3.1
Exports	-3.5	4.6	1.8	5.3	2.2	-1.7	1.7	2.8	4.5	2.8
Imports	-4.4	-9.4	6.5	3.6	4.6	2.1	-14.6	7.5	2.9	5
GDP	-1.5	-0.5	1.3	4	1.7	-0.2	-1.7	1.4	3.2	2.3
Inflation – Consumers Price Index	3	2	4.3	2.7	2.6	3.4	2	4	2.6	2.6
Employment	0.7	-0.1	1.5	2.6	0.9	0.9	-2.4	1.3	2.9	0.7
Unemployment Rate %	5.1	6	6.3	5.4	5.6	4.6	7.1	6.8	5.4	5.6
Wages	5.1	1.6	3	3.8	4.6	5	3.1	1.9	3.4	4.6
Currently reasonable exchange rate ASSUMPTIONS										
NZD/USD	0.53	0.7	0.78	0.74	0.64	0.56	0.72	0.75	0.76	0.67
USD/JPY	98	91	85	89	85	91	90	83	88	86
EUR/USD	1.31	1.36	1.35	1.39	1.34	1.34	1.46	1.32	1.38	1.36
NZD/AUD	0.8	0.77	0.76	0.8	0.82	0.83	0.79	0.76	0.8	0.82
NZD/GBP	0.37	0.47	0.49	0.44	0.39	0.37	0.44	0.48	0.46	0.4
NZD/EUR	0.41	0.52	0.57	0.53	0.48	0.41	0.49	0.57	0.55	0.49
NZD/YEN	51.8	63.7	65.9	65.9	54.4	50.9	64.2	62.6	66.9	57.6
TWI	53.8	65.1	69.4	67.3	60.9	55.1	64.7	67.8	68.7	62.8
Official Cash Rate	3	2.5	3	4.75	4.75	5	2.5	3	4.25	5
90 Day Bank Bill Rate	3.24	2.67	3.2	5.12	4.95	5.23	2.78	3.17	4.62	5.2
10 year Govt. Bond	4.77	5.86	5.75	6.5	6.5	4.88	6.02	5.82	6.5	6.5

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 TotalMoney started in 2007