BNZ Weekly Overview

21 January 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.

A Year Better Than 2009

Welcome back to another year of trying to pick where the economy is most likely to go and probable directions for things like interest rates, house prices, and the labour market – along with some outright guessing about what the Kiwi dollar is likely to do. In that regard – for those pressed for time – the simple outlook is the economy getting better with growth approaching 3% by year's end, the labour market at risk of tightening up more quickly than many are thinking, house prices rising another 5% - 10% at best with stock shortages increasing (subject to the tax review) but no element of a boom, borrowing costs rising with the RB raising the cash rate from mid-year at the latest, and the NZD drifting up toward US 80 cents with commodity price and interest rates support.

What we know about the economy as it headed into the end of 2009 is that while things were definitely getting better and sentiment levels remained strong, nothing was jumping out to suggest rapid growth as such, and some things were pulling back after completing a bit of a catch-up period of growth. For instance, house prices rose on average 2.8% during the December quarter to lie 6% ahead of a year ago. But in December they retreated slightly by 0.9% and rose only 0.2% in November. Price action has settled down. Sales in the quarter were a strong 31% ahead of a year earlier. But they were off seasonally adjusted about 10% from the September quarter.

Consumers however revealed increasing willingness to spend. Nominal seasonally adjusted retail spending rose 0.6% in October then 0.8% in November and at an annualised rate of 5.4% in the three months to November. This was good compared with 1.1% at the start of the year, and the strongest such rate of growth since June quarter 2007 when spending was about to hit a wall after the RBNZ took the cash rate to 8.25%.

Business investment intentions measured in the NZIER's Quarterly Survey of Business Opinion were a net 2% negative in the December quarter which was a sharp improvement from -44% in the March quarter. But the average reading is net 0% so things are slightly below average and not racing away – but heading in the right direction. The same goes for employment with a net 1% of businesses expecting to hire people compared with a net 36% in the March quarter planning to sack them. But the average reading is +5% so again things are below average but heading in the right direction – with some interesting signs elsewhere in the QSBO showing capacity availability pulling back reasonably quickly.

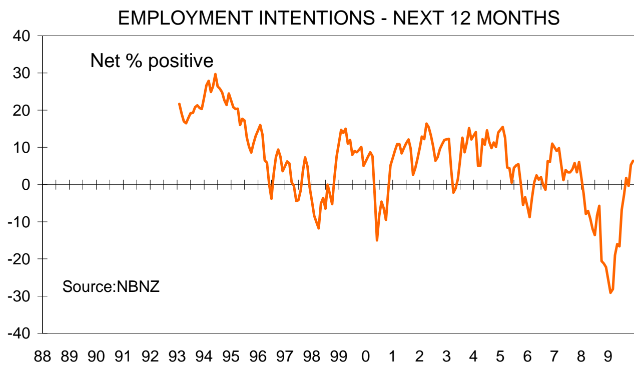
For want of anything else important springing to mind, we'll start our more in depth commentary with a look at the labour market.

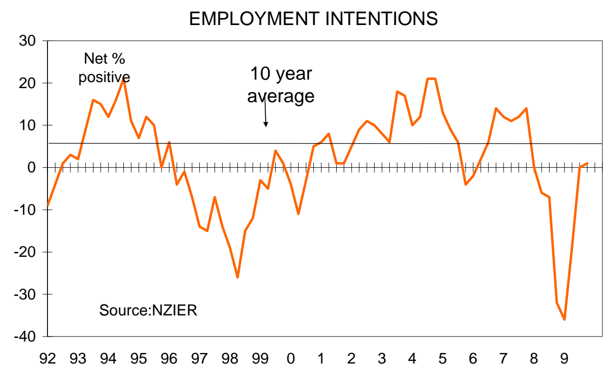
Labour Market Prospects

A key determinant of whether the strength in the housing market will continue and whether retail spending will continue to pick up reasonably well as we suspect it might is what happens in the labour market. The actual numbers in this regard are always well out of date. For instance the most recent data refer to the September quarter which is a period on average five months back from where we are now. Back then the economy was coming out of recession in a very muted fashion but because the labour market tends to lag what is happening overall in the economy the numbers showed the unemployment rate rising to 6.5% in the quarter from 6% in the June quarter with some 16,000 jobs lost.

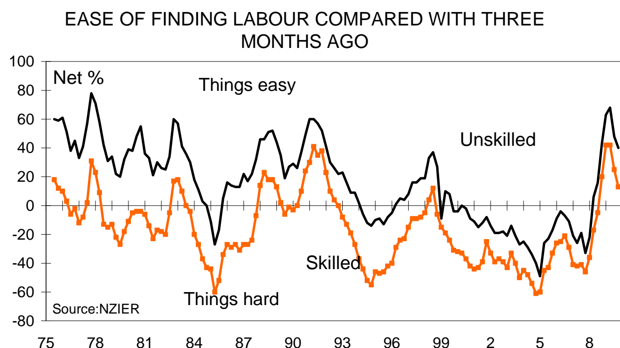
But the anecdotes we have been picking up since early in the December quarter have been that the labour market is turning – though the numbers won't show this for many months given the cyclical and the publication lags. However we can at least look at business surveys to validate the anecdotes from the likes of TradeMe jobs and recruitment firm surveys.

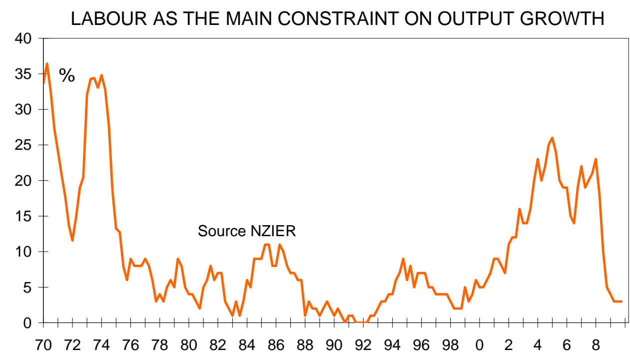
The NBNZ Business Outlook survey for the early-December period released late last year showed a net 6% of business plan taking on more people in the coming year. This was the strongest result since March 2007 and above the ten year December month average of 4% net positive hiring intentions. As such the result suggests jobs growth.





Tuesday two weeks ago the NZIER's Quarterly Survey of Business Opinion revealed that in the (non-farm) business sector a net 1% of businesses anticipate hiring more people over the coming three months. This is below the net 5% positive average reading for the December quarter and thus bespeaks of a still muted – though improving – labour market in the near future. Support for the improving labour market scenario also derives from the net 13% of businesses saying they find skilled labour easy to find. This measure of employment ease was well down from 25% in the September quarter and 42% in the March and June quarters and suggests a tightening up of skilled person availability – as we have been warning.





Note however what the second graph just above shows. Only a gross 3% of businesses say a shortage of labour is the main reason they cannot expand. Two years ago this reading was 21%. So it is not as if suddenly the unemployment rate will plummet and wages growth soar. But the tide in the labour market is in the process of turning and one would expect that good firms would have prepared for this turnaround already by rejigging their workforces to "let go" the not so good people and hire the good ones laid off elsewhere.

Note that there are two key areas of uncertainty with regard to how quickly the labour market tightens up and employers are once again scrambling for people while paying through the nose for low quality. The first uncertainty comes from the extent to which employers have effectively hoarded people through the recession by cutting hours rather than numbers. As things pick up the need for fresh people will be less than in the past when it appears people were laid off more than has happened this cycle where the focus has been on cutting hours.

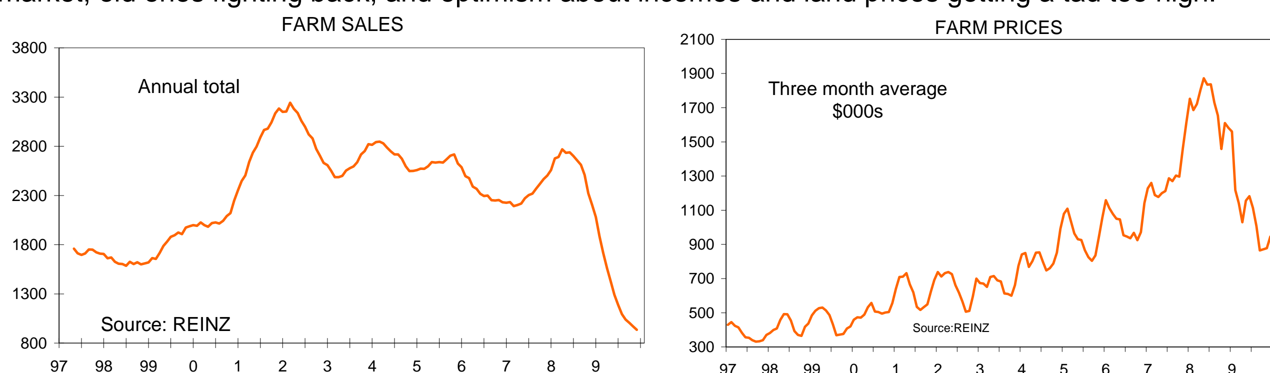
Second, the net migration inflow is well above average at the moment and this boosts labour availability. But the gain in net flows has come about entirely because fewer people have been leaving rather than more arriving. That suggests potential for a quick jump in gross outflows if the offshore attraction becomes strong enough. There is nothing to suggest a lift in flows of people to the UK, Europe and the US this year. But Australia is a different kettle of fish. The Aussie economy has avoided recession and the labour market is improving strongly. Demand for people in construction in particular looks strong as house construction rises in response to a worsening housing shortage. This will take skilled tradespeople away from NZ in increasing numbers as this year progresses. And the same drag of our folk will occur from the newly booming mining ad infrastructure sectors.

The Aussie connection is likely to produce some less generous than hoped for labour market situations for those planning building a house late this year and through 2011 in particular – and for those planning big infrastructure projects for the same time period.

We think there is potential for the labour market to surprise on the firm side and this will underpin house construction and house price rises, while also driving higher retail spending. But there will be no boom.

Farm Prices Fall Almost 40%

Here is a fairly stark number. During calendar 2009 there were 935 farms sold in New Zealand. This small total was a drop of 58% from 2,204 over 2008 and a 63% drop from 2,503 over 2007. In fact usually each year about 2,000 farms change hands so the total for 2009 is unusually low. The collapse reflects the combined impact of the plunge in dairy prices occurring at the same time as availability of finance to farmers underwent a stark reduction after many years of high availability caused by new competitors entering the market, old ones fighting back, and optimism about incomes and land prices getting a tad too high.

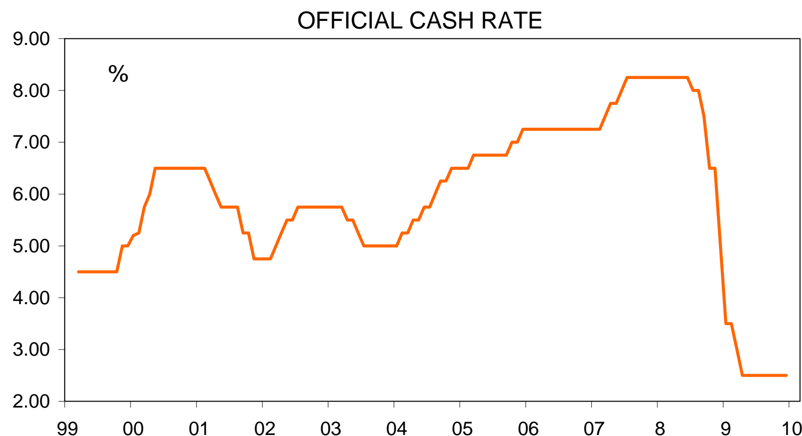


Unsurprisingly, with farm sales plummeting and finance less readily available, farm prices have fallen sharply. It is hard to get a decent measure, but over 2009 as a whole the average farm sale price according to the REINZ numbers was down 39% from 2008 so farm balance sheets in many cases will be severely stretched – hence the RBNZ's professed concern about farm debt and their advice to banks to prepare for more losses.

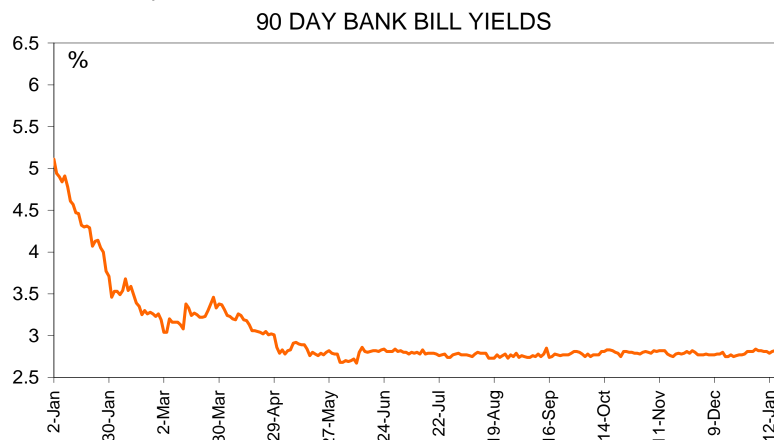
Farm debt levels have become somewhat excessive in recent years and as the period of adjustment continues it will be reflected in low levels of farm sales, land prices stable perhaps at best in the next couple of years, and "consolidation" occasioned by some operators having to leave the sector.

INTEREST RATES

The exciting stuff with regard to big changes in wholesale interest rates happened last year and this year could be quite boring in contrast. Last year rates initially plummeted as the markets were gripped by worries about another Depression and deflation and central banks slashed rates to multi-decade lows. But early in March green shoots started appearing around the world showing the Depression scenario was off the table. Acknowledging that, investors and canny borrowers recognised this meant credit demand would once again eventually rise, inflation risks would shift to the upside, and central banks would need to start taking away very low cash rates. In addition worries rose regarding the ease with which governments could fund huge budget deficits.

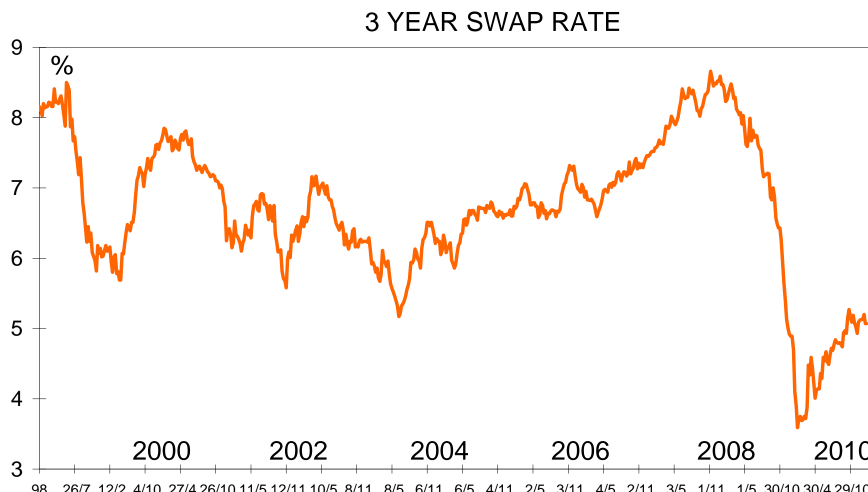


As a result medium to long term wholesale borrowing costs soared and some central banks started taking away their low rates – most notably Australia.



Where things sit now is that at the short end of the yield curve still nothing much interesting is happening in NZ. The RBNZ cut their cash rate from 5% at the start of 2009 to 2.5% right at the end of April and yields on 90-day bank bills declined over the same period from near 5.1% to 2.8%. And they are still at 2.8%. They are likely to stay near this rate until about the middle of the year when we expect the RB to start raising the cash rate from 2.5% with the rate likely to reach about 6% sometime early in 2012. This means floating rate borrowers should long have been budgeting for their floating rate costs rising about 3% or so from mid-2010 to the end of 2011.

Further out along the curve the three year swap rate started 2009 near 4.9%, hit just 3.6% in February then was at 4.5% by the end of March. It is now just under 5% and likely to creep higher in slow fashion along with all other swap rates as the year progresses. Upward pressure will come from the improving global economic environment, tightening NZ monetary policy and increased credit demand.



Over the past few weeks economic data have come out largely on the side of the economy continuing to recover with potential for accelerating growth this year but hints that capacity availability may not continue at current generous levels for as long as previously thought. But the outlook for inflation remains benign with yesterday's consumer price index for the December showing the 0.2% decline expected by the RBNZ – which was better than the 0.0% to +0.2% result anticipated in the markets. NZ inflation sits at just 2% from 3.4% a year ago and 3.2% two years ago.

Next Thursday morning the RB will review the official cash rate and we expect it will be left at 2.5%. It is not very likely that we will see a change in the language of the statement accompanying the decision from that which was used back at the last review on December 10. Back then – acting on the rising inflation risks further out (still muted though so no need to panic) – the RB said "…conditions may support beginning to remove monetary stimulus around the middle of 2010".

This was a stronger statement than in October where they noted "…we expect to keep the OCR at the current level until the second half of 2010."

That was a stronger statement than in September when they noted "…we continue to expect to keep the OCR at or below the current level through until the latter part of 2010".

In other words the RB have been steadily pulling back from a very dovish monetary policy view to something closer to where the markets are at. However – the markets are of the opinion that a tightening could come as early as March but our expectation remains that the first tightening will come mid-year.

Key Forecasts

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

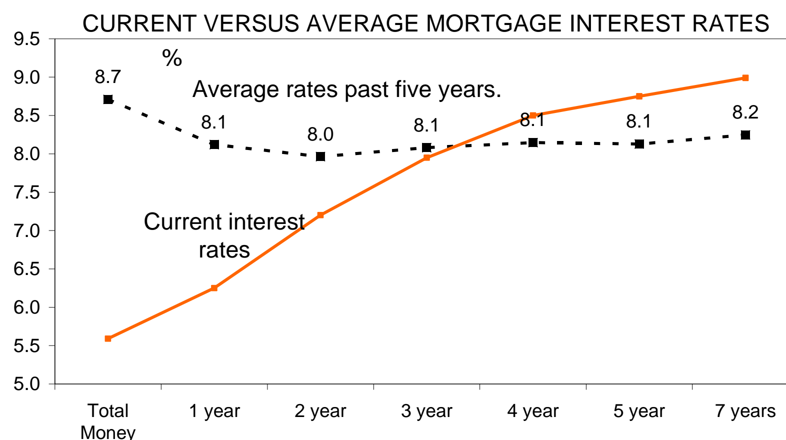
FINANCIAL MARKETS DATA

	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	2.81%	2.82	2.76	2.79	4.29	6.5
10 year govt. bond	5.85%	6.02	6.00	5.72	4.36	6.2
1 year swap	3.68%	3.74	3.71	3.66	3.53	6.7
5 year swap	5.41%	5.51	5.61	5.73	4.15	7.0

If I Were a Borrower What Would I Do?

Floating mortgage rates still sit at four decade lows whereas fixed interest rates for periods of three years and beyond are at average or above average levels. The time to fix everything for one of the long periods disappeared many months ago and for the majority of borrowers the optimal strategy now is probably just to sit floating and budget for that floating rate rising about 3% between the middle of this year and the end of 2011. That means floating rates will get back to their average levels sometime late in 2011 and borrowers will remain in an historically generous interest rate environment for up to another two years.

Over the coming year our forecasts imply the Total Money floating mortgage rate will average about 6.2%. The one year fixed lending rate is currently 6.25%. Because we are now closer to the period when we expect rates to rise I would now toss a coin between floating and fixing one year whereas ahead of Christmas the numbers stacked up in favour of sitting floating. Of course if one believes the one year fixed rate won't rise for many months then one stays floating at 5.59% as long as possible then jumps into the fixed rate. But note how over the past month and a half while the likes of the three year swap rate relevant to three year fixed mortgage rates has fallen 0.15% or so, the one year cost of money to us has risen about 0.1%.



The yield curve is going to be flattening out as the year goes by and that means the short fixed rates will rise earlier than if your view is based on when the RB tightens in about June.

Over the next two years our forecasts for the official cash rate imply sitting on the floating mortgage rate will give an all up cost of about 7.2%. The two year fixed lending rate is exactly that. Once again I might toss a coin between the two.

Over the next three years – well frankly forecasting for the floating rate average gets into pure guesswork territory. But if our forecasts prove correct (lol as they say) the floating rate will average about 8%. The three year fixed rate is currently 7.95%.

This is actually quite cool! For all three terms the fixed rate equals the forecast floating rate cost. So, if I were a borrower contemplating a mortgage I won't be paying off for many years what would I do? Personally I would float and use the cash flow benefit to get the principal down on my mortgage as much as possible before the floating rate kicks up. I am near 100% certain nothing will push me to fix three years or beyond over the next 2-3 years and fixing two years is also very unlikely given the rate jump from floating that would involve. BUT, I would keep a close eye on where the markets are going and see a strong probability that I could fix one year or even 18 months sometime in the first half of the year if we are close to the floating rate starting to rise and if I could lock in a fixed rate at current levels.

HOUSING MARKET UPDATE

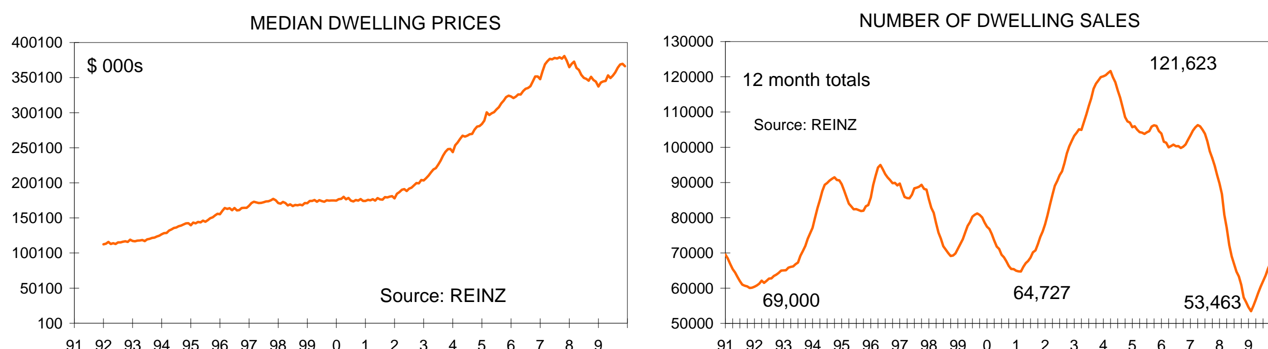
Prospects For 2010

2009 was a story of the market initially falling away as the world was gripped by worries about a new Depression, evidence of plunging house prices in some other countries, and therefore NZ house buyers naturally backing away from making a purchase unless they really had to. Then in March we started to see stories suggesting the Depression scenario was in the rubbish bin and investors acting on that growing belief by buying assets such as shares and risky currencies. The improvement in sentiment brought a few buyers back into the NZ housing market attracted by fixed interest rates hitting record lows in March and floating rates hitting four decade lows shortly after that and staying there.

Then we started to see (one guesses) increased awareness of the fundamentals we had been pointing out from 2008 as reason for house prices only falling 10% -15% and providing reason for one to want to make a desired "canny" purchase before the middle of 2009. Namely

-we did not enter the global crisis with an over-supply of newly constructed houses,
-when the excrement hits the fan overseas our net migration inflows improve and population growth is always good for house prices,
-NZ house construction was plummeting away to eventually hit the lowest annual number of new dwelling consents in four decades, and
-our interest rates hit record and multi-decade lows as noted above and that is something we debt-hungry Kiwis quite like.

So house prices at their worst were "only" down 11% from late-2007 highs, and they have now recovered on average just under 9%. According to the monthly REINZ measure which is now quite accurate and by far the best up to date price gauge, prices on average are now just under 4% below their November 2007 peak.



While prices have almost recovered all their lost ground turnover remains mild. In calendar 2009 there were 69,629 dwellings sold which was a 24% rise from 2008 but 22% below the average annual total for the past decade of 89,645.

So that was 2009 in a broad stroke. Late in the year we could see signs that the initial surge in catch-up type buying was fading and a more normal pattern of activity perhaps was getting established. For instance, during the June quarter rough seasonally adjusted dwelling sales rose by a strong 20% over the March quarter. The September quarter gain was just 4%. The December quarter change was a pullback of 10%. Things eased off.

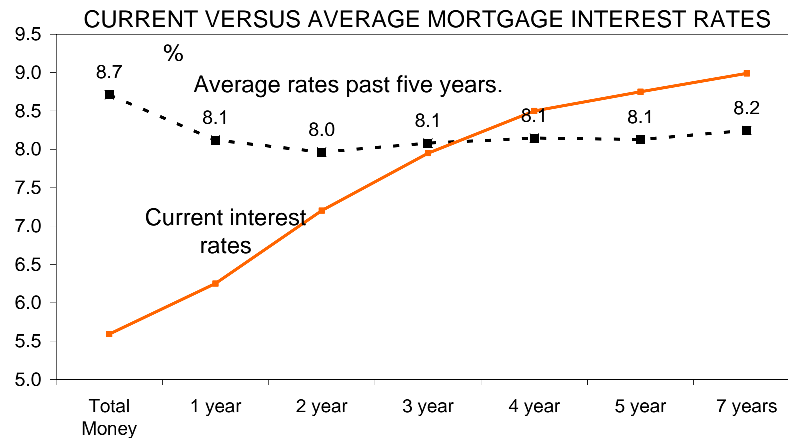
The average dwelling sale price however rose 2.2% over the June quarter, 2.5% over the September quarter, and 2.8% over the December quarter – though with a 0.9% dip in the month of December following a minor 0.2% rise in November.

Things have calmed down. But are they truly going in reverse as one might initially think from prices easing 0.9% and turnover falling 10% s.a. for the quarter? To get a feel for such things we like to look at how quickly properties are turning over. On average in December it took 33 days to sell a dwelling. That was 12

days faster than a year earlier and compared with the average December for the past decade it was 1.7 days faster than average. In November the days to sell measure was also 1.7 days better than average but in October the improvement was 3.9% and September 3.2%.

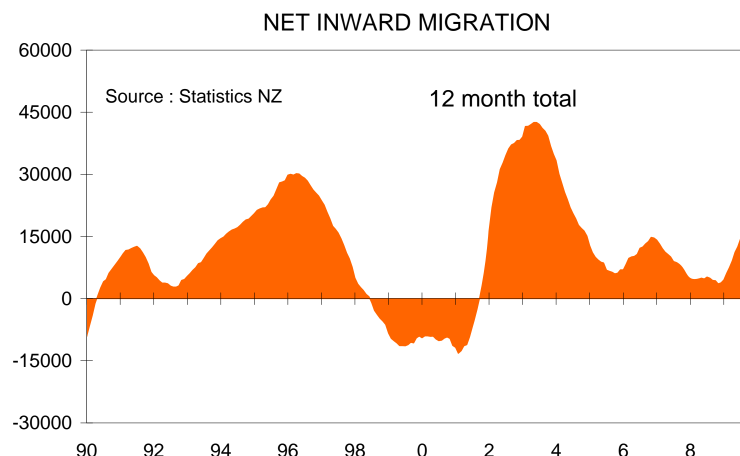
The days to sell measure also suggests some heat has come out of the market – and that begs two questions. Why and where to now?

We think the three main indicators have eased off because of a combination of some clearing of cashed up bargain hunters from the market, awareness that the labour market is still fundamentally weak, and rises in fixed housing rates to average or above average levels for terms of three years and beyond.



Where to now?

1. Net migration inflows remain above average. The average net gain for the past decade has been an inflow of just over 12,000 people. In the year to November the gain was 20,021 and looking at the monthly seasonally adjusted numbers this total may peak around 23,000 or so. This suggests good housing demand. But people should be aware that NZ migration flows can move sharply and the next big move is more likely now to be down than up. When? That is hard to say as the period of improved net annual flows has been relatively short. But given that the improvement in the net inflow from a low point of just 3,569 in the year to November 2008 came entirely on the back of more people staying rather than more people shifting here, one has to allow for the possibility of a whip back in the net inflow at rapid speed somewhere down the track. That night happen in 2011.



2. There is only one way interest rates are going to go and that is upward. We expect fixed rates to creep higher, though at a far slower pace this year than last year. Floating rates are likely to start their rises near the middle of the year and borrowers should allow for their floating rate rising around 3% between the middle of 2010 and early in 2012. Clearly these developments will help take some strength out of the housing market.

3. Dwelling construction is starting to pick up reasonably firmly and this is going to be one of the factors propelling total growth in the economy toward 3% by the end of the year. The number of dwelling consents issued in the three months to November was ahead a strong 20% from the three months to August. But – and this is a bit but – the annual number of consents stood at only 14,199 which was a decline of 26% from a year earlier and 42% below the ten year average of 24,575. It was also only just up from the four decade low of 13,616 in the year to September.

It will take some time for annual consent issuance to reach the average level and the longer that takes to happen the longer the period in which new housing supply is below what is demanded from a population experiencing above average growth. In fact, we have major difficulty trying to figure out exactly where consent issuance will end up and when because of two special factors. The first is a high chance many tradespeople will shoot off across the ditch this year and next to earn more money and take part in Australia's residential construction upturn which is being driven by a housing shortage far worse than ours.

Second, the destruction of the old finance company model has removed a traditional source of finance for residential subdivisions. That is not a matter of moment with regard to the number of sections coming forward as there is an oversupply of them around the country which will persist for some time. But when it comes to bulk construction on those existing subdivisions growth will be constrained because of the finance company problems.

We expect the worsening housing shortage, below average floating rate funding costs through until perhaps late-2011, and the improving economy (including the labour market) to contribute to growth in real estate sales over 2010 and prices rising on average between 5% and 10% at best.

But, what is one to make of the suggestions regarding removing the taxpayer subsidies to residential property investors. Clearly they have to go and it is just a matter of whether it will be by tax calculated at an assumed rate of return, removal or slashing of building depreciation allowances, or ring-fencing of investment tax losses. We don't know what will happen, we don't know when, and one can only guess what the response will be from existing investors and new ones. In simple economic terms if the return to owning property is reduced demand will decline therefore some buyers will not enter the market and some with investments will look to sell. During the transition process when existing owners sell in particular there will be downward pressure on house prices.

There will also be upward pressure on rents which could be quite strong. If this upward pressure is widespread as landlords seek to boost cash returns renters will have no choice other than to pay. This will reduce the extent of selling and the downward movement in prices.

It seems safe to say that potential for average house price rises this year will be severely reduced if major tax changes are made. But – then it gets interesting. After the initial shake-up we will be left with fewer willing investors. That means fewer properties will be specially built for investment purposes. That means the upward movement in construction currently underway will be curtailed – especially as some people thinking about building (and all the hassles therein) pull their orders in preference for buying an existing house. But as growth in new housing supply eases off the fundamental imbalance between population and housing stock will worsen. Prices will go back up.

A major change in the tax regime facing residential property investors will in the short term place downward pressure on prices. Then the reduced supply growth will push prices back up again. Many cash flow poor investors will be weeded out, rents will rise along the way. Timings? No idea at this stage.

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

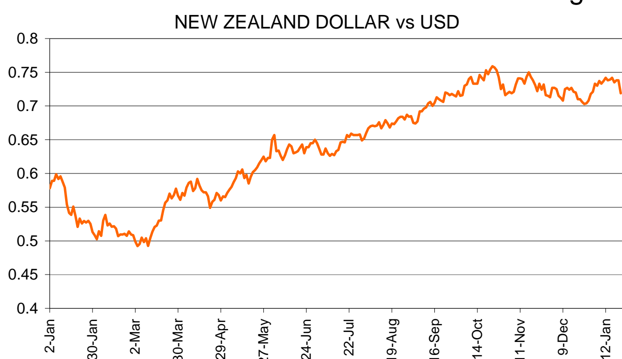
- Dwelling consent numbers to recover now with potentially good activity from mid-2010.
- Real estate sales continuing to increase but the rise limited by listings shortages.
- House prices edging higher subject to tax changes bringing short term downward pressure.

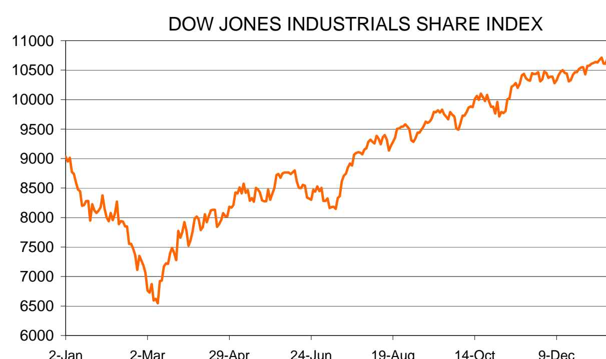
Exchange Rates & Foreign Economies

Exchange Rates	This Week	Week Ago	4 wks ago	3 mths ago	Yr ago	Consensus Frcsts yr ago*	10 yr average
NZD/USD	0.721	0.739	0.710	0.747	0.5207	0.573	0.592
NZD/AUD	0.791	0.801	0.795	0.811	0.802	0.848	0.856
NZD/JPY	65.800	67.600	64.200	67.700	46.72	59.0	66.8
NZD/GBP	0.443	0.454	0.440	0.456	0.3755	0.358	0.345
NZD/EUR	0.511	0.510	0.495	0.500	0.4044	0.448	0.51
USD/JPY	91.26	91.47	90.42	90.63	89.73	103.0	113.9
USD/GBP	1.628	1.628	1.614	1.638	1.387	1.601	1.709
USD/EUR	1.411	1.449	1.434	1.494	1.288	1.278	1.156
AUD/USD	0.912	0.923	0.893	0.921	0.649	0.676	0.69

NZD Where It Was Five Weeks Ago

Up until this morning one could have said that the NZD has passed through a decent period of pullback from the US 76 level seen back in October and was now on the way back up again after falling to just above 70 cents right before Christmas. Yesterday the NZD was almost at 74 cents. But today it is near 72 cents having fallen away solidly on the back of a rise in risk aversion associated with a big bout of profit-taking on Wall Street after the Dow Jones Index hit its highest level since October 2008.



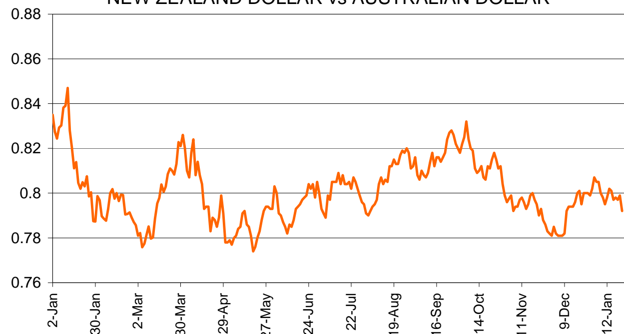


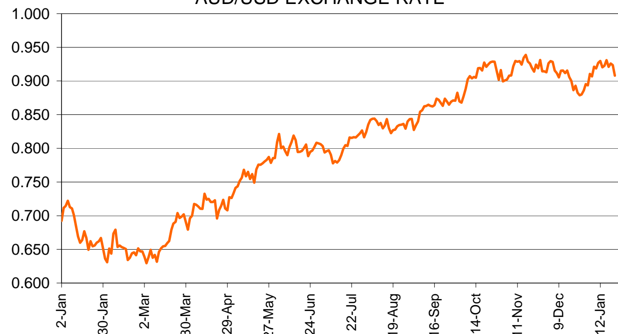
The NZD remains as tied as ever to volatile movements in global investor risk tolerance and there is no reason for believing anything other than that this year as sharemarkets rise the NZD will tend to rise and when they fall the NZD will fall as well.

But there was more in play overnight than just weak sharemarkets. Yesterday the December quarter inflation result for NZ came in below market expectations at -0.2% for the quarter versus an anticipated 0% to +0.2% result. The outcome has taken some of the hawkishness out of the interest rates market with regard to the timing of the RBNZ's first tightening of monetary policy. That means interest rate support for a currency well known as a high yielder is now considered likely to be less in the first half of the year than thought previously. So the NZD edged down.

Underlying everything however we still have an expectation of NZ interest rates rising this year and almost certainly earlier and faster than will occur in the United States. That argues for the NZD drifting up during the year, as does the usual factor of rising on the coat-tails of the Aussie dollar which is likely to gain even more interest rate support early in February as the RBA raise their cash rate again.

The Australian economy continues to show good growth and the labour market in particular looks extremely healthy. The RBA raised their cash rate from the low of 3% it was taken to in April to 3.75% at the end of last year. A rise of 0.25% is expected in a fortnight and after that perhaps the RB will pause for a while to see how the rises impact on the economy.





For ourselves the relevance is upward pressure on the NZD against the greenback, but restraint on the NZD's traditional cyclical rise against the AUD – especially as there is widespread talk of the AUD this time managing to reach parity against the greenback. This evening against the AUD the NZD is near 79.2 cents from 79.5 cents just before Christmas.

With regard to the major currencies it is difficult to know where to start. Data for the US remain as mixed as ever and a decent upturn remains an article of faith sorely tested at times by banks continuing to reveal problems, a government which needs to cut spending and raise taxes to get the deficit under control, lack of widespread confidence that the housing recovery is more than just a dead cat bounce, worries about commercial property and consumer credit, and little confidence monetary policy will be retightened at some theoretical "optimal" pace. So why buy dollars? Because the alternatives also look like *&%#@.

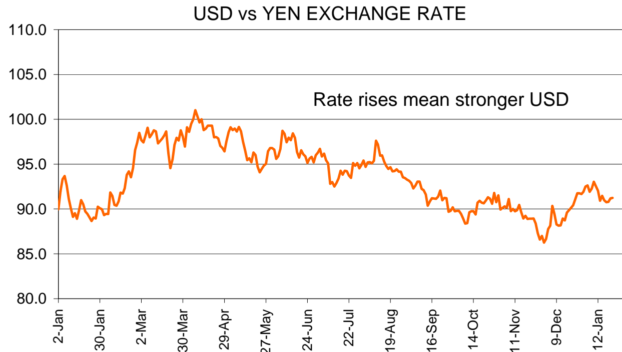
The Japanese economy faces escalating problems as the population ages and shrinks and the manufacturing base is increasingly nibbled at by other up and coming Asian economies. Government debt is huge and the national airline has just failed after years of bailouts. The trade balance's strong continuing surpluses suggests the Yen will rise, but with deflation back it would be helpful for Japan if their currency fell, inflation rose, and people received an extra incentive to open the chequebooks they still refuse to use in the face of many finance worries – 20 years after their boom ended in 1989!
http://www.bloomberg.com/apps/news?pid=20601068&sid=abKKqvQlde.0

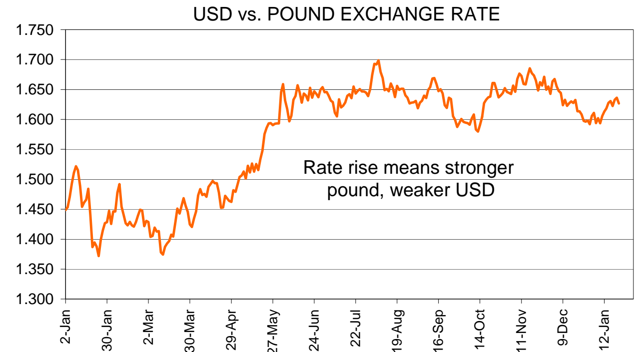
In Europe there is economic recovery underway – but the strongest debate for some time about whether the Euro-area is going to be able to hold together. In Greece the officials have been – it seems – outright lying to the European Commission with regard to the size of their budget deficit in recent years and there is so much anger about this that the authorities appear quite determined not to give Greece any special treatment to help them out of their worsening fiscal hole. Having said that however it is difficult to imagine their economy will be allowed to fail. But capacity of the EU to respond will be limited by big problems in other member countries as well such as Ireland, Spain and Italy.

It is unlikely Greece will drop out of the Euro. But the fact that the debate about continued membership of this country or that never seems to end somewhat undermines the case for dumping the USD as the global medium of exchange in international trade and global store of value for official FX reserves.

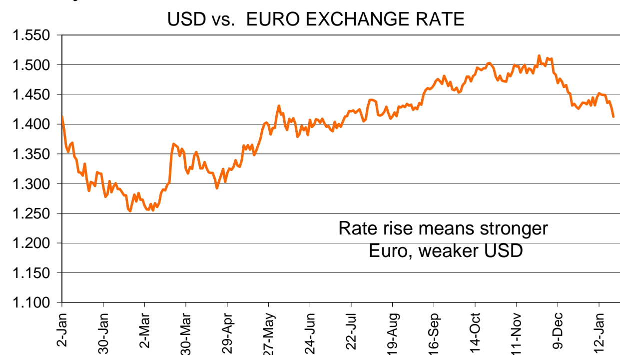
And the British pound? There have been some surprisingly good economic numbers recently – which unfortunately go no way toward changing the picture of continuing fiscal problems which will limit growth over the next few years, if not the next generation. In fact just two days ago the Bank of England Governor painted a very dour outlook for 2010 and 2011. Nevertheless the pound has just risen to a five month high against the Euro and managed to keep up with a firming USD.
http://www.bankofengland.co.uk/publications/speeches/2010/index.htm

The upshot of these things plus dozens of developments over the past five weeks which are relevant to currencies is that the greenback now sits against the Japanese Yen near 91.2 which is a reasonable gain from 88.1 when the last Weekly Overview came out on December 10. One can say that generally the USD has been recovering ground against the Yen since the start of December.



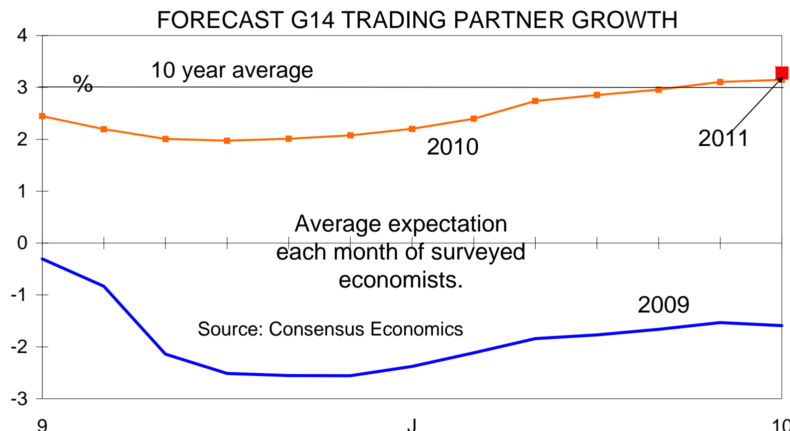


Against the British Pound the USD is now near $1.627 to buy one pound from $1.633 on December 10. No change in other words. Against the Euro the USD is near $1.413 from $1.477. The greenback has gained around 4.4%. That is not much but as the graph shows one can run an argument again that the greenback has been strengthening since early December.



This general strength in the USD helps explain why the NZD has not shot higher in spite of continuing good news with regard to commodity prices. On average NZ export commodity prices in world price terms rose by another 2.6% in December after gaining over 10% in November and rising in total 42% since February. The NZD is a commodity currency – along with a high yielding and risky currency - so if world growth continues to slowly improve it seems reasonable to expect commodity prices to broadly drift up and therefore the NZD to drift higher also as we pass through 2010. Speaking of the world growth outlook…

On average new Zealand's top 14 export destinations grow by about 3% each year. They are estimated to have shrunk 1.6% last year after growth of 2% during 2008. This year, 2010, growth of 3.1% is expected according to the monthly Consensus Economics survey of economists around the world. In addition, over 2011 growth of a slightly better 3.3% is forecast.



In Australia growth of 2.9% is picked this year (with upside risk we would suggest given recent continuing strong labour market results), and growth is picked to reach 3.2% over 2011. This good outlook is quite important for the short haul inward tourism market and the manufacturing sector.

In the United States growth of 2.9% is commonly forecast for this year with improvement of 3.1% picked for 2011. In Japan the forecasts are 1.3% and 1.5%, Germany 1.8% then 1.6%, China 9.7% then 9.1%. There is no overall forecast for the EU available for 2011 yet but the 2010 pick is 1.2%.

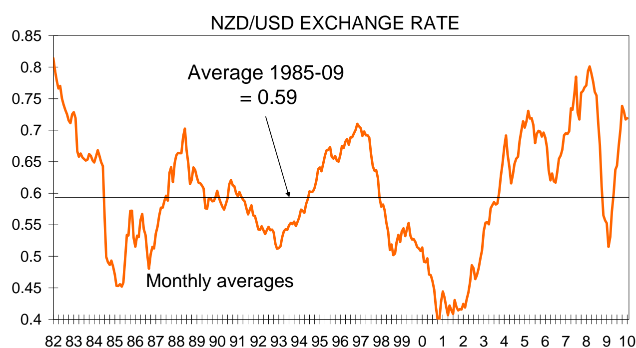
There are two important points to note about these forecasts. The first is that they show no expectation of the world heading back into recession again even though we are all aware of some still very troubling things.

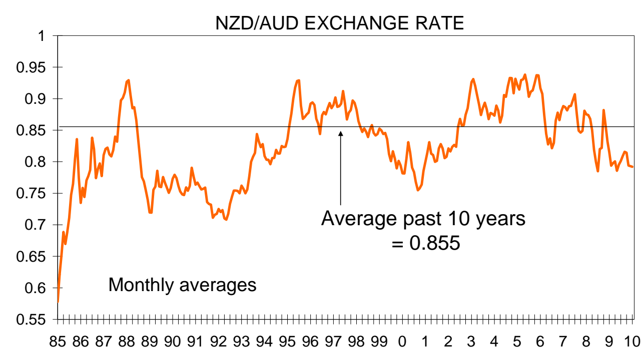
Second, they show the strength of the upturn is expected to be relatively mild and not a massive rebound from the most depressed global economic conditions in decades. There is widespread recognition of the destruction of wealth which has occurred, the reduced willingness of households to borrow in the most affected Western economies, and the reduced willingness of banks to lend in those same countries.

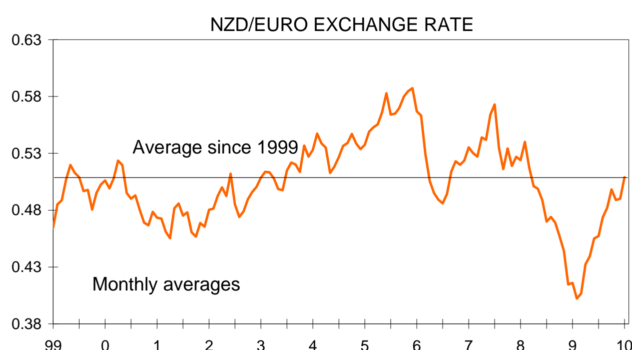
These things imply good support for our commodity prices over the next couple of years, good support continuing for the NZ dollar, and hopes for a recovery in tourism – but perhaps not until 2011 given the lags in the sector.

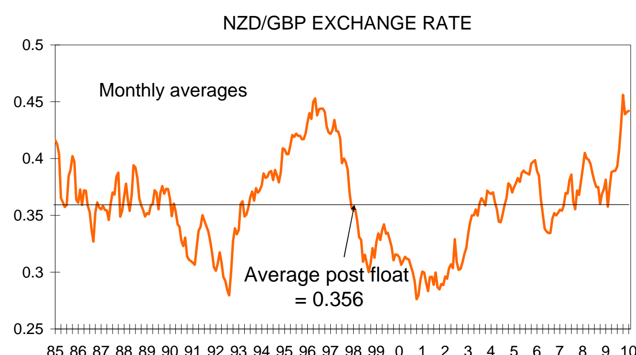
If I Were An FX Receiver What Would I Do?

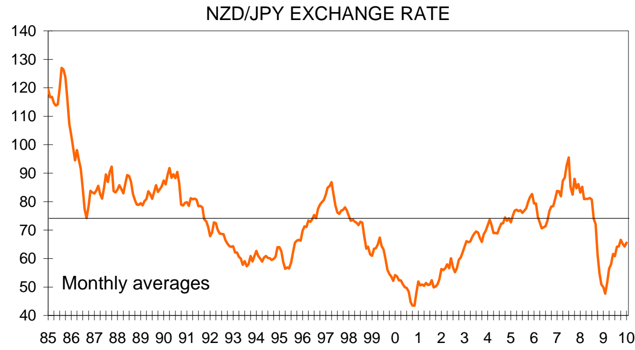
There is zero reason for believing the FX markets are going to “settle down” and allow exporters plenty of time to sit around thinking about what might be a good hedging strategy. The need to get a strategy sorted out and implemented is as strong now as fairly much any point in the NZD’s cycle. Our best pick is that over the year the NZD will drift upward with support from tightening monetary policy, firm and probably firming a bit more commodity prices, plus improving world growth raising risk tolerance. I would take advantage of dips in the NZD to get some extra hedging on board. The higher the NZD goes the more I would look at options which would allow me to profit should the NZD fall away sharply. But given that we are not in unusually high territory yet options would not be at the forefront of my mind.











*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%	+0.2	0.2	-2.2	1.5	2.1
Unemployment rate	Average past 10 years = 5.3%	6.5	6.0	......	4.3	3.6
Jobs growth	Average past 10 years = 1.9%	-0.7	-0.4	-1.8	1.1	1.6
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	0.6	0.8	4.6	5.6	4.6
Retail Sales ex-auto	Average past 9 years = 3.8%.	0.5	0.3	-0.9	0.4	5.5
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	+20,021	15,642yr	......	3,569	6,590
Tourism – an. av grth	10 year average growth = 5.0%. Stats NZ	-0.6	-2.8	-0.6	-0.6	2.4
		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	2.8	2.6	2.6	4.9	12.9
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 Dec. 10 2009	**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	-11.7	5.7	8.8	4.9	-5.2	-14	2	9.6
GNE	4.2	-2	-3.4	4.2	3.5	4.4	-0.1	-5	3.6	3.7
Exports	3.1	-3.3	1.3	0.6	5	3.9	-1.3	-0.5	0	4.8
Imports	10	-4.7	-12.4	3.8	5.9	8.9	2	-16.3	2.6	5.6
GDP	3.1	-1.1	-0.6	3.1	3.1	3.2	0	-1.5	2.5	3.4
Inflation – Consumers Price Index	3.4	3	2.6	1.2	2.6	3.2	3.4	2.5	1.7	2.1
Employment	-0.2	0.7	-1.5	2.6	3.2	2.4	0.9	-2.8	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	4.3	5.1	3.4	1.6	3.8	4	5	4.1	1.4	3.3
EXCHANGE RATE ASSUMPTIONS										
NZD/USD	0.8	0.53	0.77	0.77	0.7	0.77	0.56	0.75	0.78	0.72
USD/JPY	101	98	92	105	109	112	91	91	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	0.81	0.83	0.82	0.88	0.83	0.81	0.82	0.83
NZD/GBP	0.4	0.37	0.46	0.44	0.41	0.38	0.37	0.45	0.44	0.42
NZD/EUR	0.52	0.41	0.52	0.53	0.5	0.53	0.41	0.5	0.54	0.51
NZD/YEN	81.1	51.8	70.8	80.9	76.3	86.3	50.9	68.3	81.1	77.8
TWI	71.6	53.8	68.9	71.4	67.2	71.6	55.1	67.2	71.8	68.5
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	2.75	4.62	6.62	8.9	5.23	2.8	4.17	6.12
10 year Govt. Bond	6.36	4.77	5.8	6.3	7	6.4	4.88	5.75	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