BNZ Weekly Overview

2 July 2009

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.

Monthly Survey

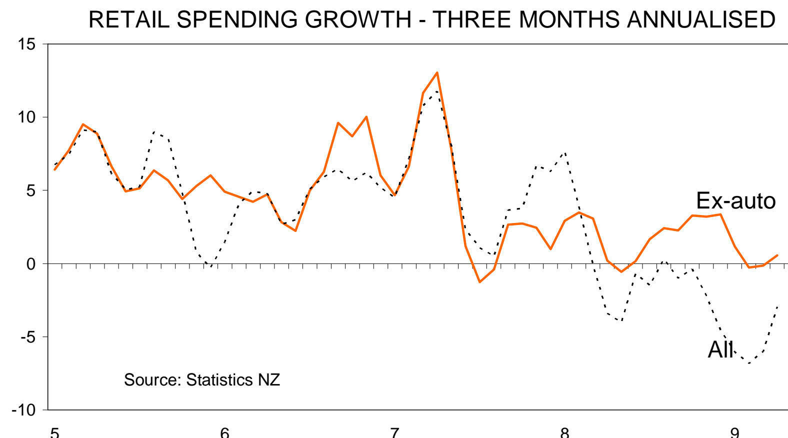
This is the first Thursday of the month so we are once again running our monthly survey. If you have not already done so from the email then please click on the URL below and tick whether you believe the economy will get better or worse over the coming year. Then, if you feel like it, pen a sentence or two letting us know how things are at the moment in your industry specifying what that industry is. The results will be released early next week.

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

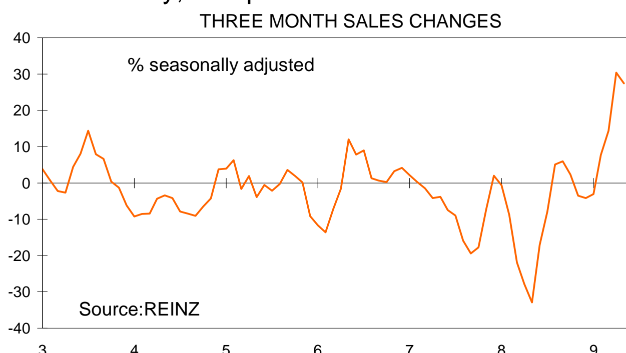
A Quick Look At Retailing

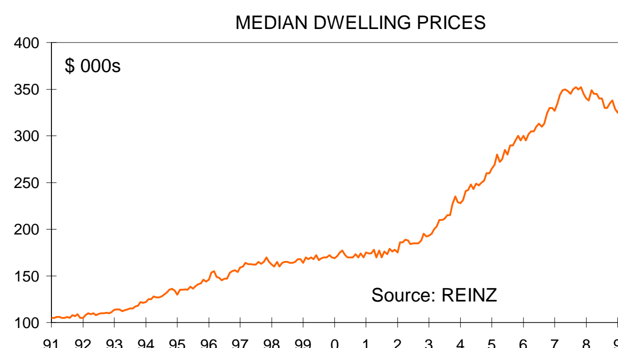
Because we haven't done this for a while, lets take a run-through of the things which will influence the strength of household spending over the coming year, starting with an assessment of how that spending has been going recently. About 60% of household spending is accounted for by expenditure on retail items and the data there show such spending hit a wall in the June quarter of 2007 as householders were struck by rising mortgage rates. Since then no upturn in spending as such has appeared and we take as our gauge for this the three month annualised rate of spending excluding fuel and motor vehicles.

In the three months to April nominal seasonally adjusted spending was ahead only 0.5% at an annual rate. Given that this rate of growth averaged 6.3% in the five years ending mid-2007 the result shows consumers continuing to keep their wallets closed.



This spending restraint is occurring even though the other big area of household spending – housing – is showing some signs of life. Real estate turnover in the three months to May was 37% ahead of a year earlier, the average number of days taken to sell a dwelling in May was only 3 days above average versus 18 in February, and prices have at worst been stable since January.





One might expect an improving housing market to be associated with improving retail spending. However the real estate gains are to a large extent a simple matter of the market clearing after many months of buyers and sellers not being willing to agree on a price in the middle of their expectations. Having said that we expect the worsening shortage of dwellings will eventually produce a price response and therefore a positive wealth effect probably before the end of the year.

But at the same time as this factor appears to marginally help underpin retail spending there will be other worries. Most notably rising unemployment will dent the ability of the average household to spend. In addition the dairy sector is undergoing a downward correction brought on by a combination of excessive debt and now downwardly correcting land prices, last year's fall in the payout, plus this year's further projected decline with risks coming from the NZD's unusual strength at this point in the cycle against the greenback.

But on the other hand as each month goes by more and more people will have their old fixed rate roll off at an average rate close to 8% and they will float near 6% or refix also near 6% or maybe up to 7%. This freed up cash flow will tend to underpin some spending. There will also be support from accelerating population growth as net migration becomes increasingly large. The net gain – courtesy largely of fewer people leaving so far – has improved from 3,500 in the year to November 2008 to just over 11,000 in May. A total near 20,000 seems quite likely late this year.

There will also be some spending support from increasing residential construction. This is not happening yet to any great degree, but there is a well established relationship between an upturn in dwelling sales and an upturn in dwelling construction. So the 37% rise in dwelling sales in the three months to May from a year earlier suggests improving residential construction soon. In fact, seasonally adjusted dwelling consent numbers have actually risen 11.5% over the past three months – though if we take apartments out there was still a decline of 1%.

Taking all these various factors into account along with restraint on wages growth from rising unemployment, weak tourism, and perhaps an increased willingness of Kiwis to save rather than spend (yeah right!) we think the retailing sector has passed the worst in terms of sales. But there is no big upturn in the offing. No big surge in consumer spending on durables like cars and furniture is imminent. And this means not only are the good discounts likely to continue, but “rationalisation” in the retailing sector is likely to continue. This means further store closures and increasing issues for retail property owners.

NZ ECONOMIC DEVELOPMENTS

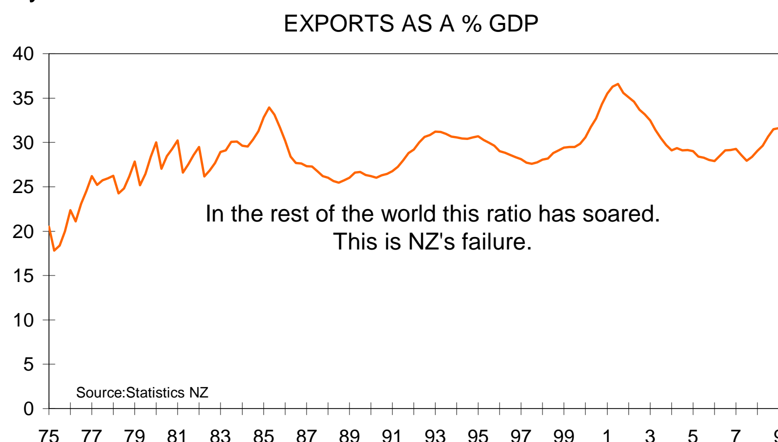
Thursday 25

Our Dependence On Foreign Money Keeps Growing

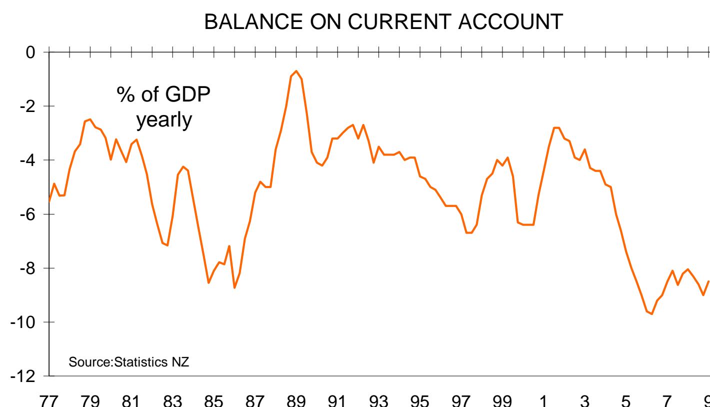
We Kiwis spend more overseas than we earn from exports and this is a problem which eventually is going to generate a shock to the economy through a sharply lower exchange rate, higher interest rates, and eventual strong shift of resources from the domestically focussed sectors to exports. But some economists have been forecasting such a shock ever since the NZ dollar was floated in March 1985 and it has yet to happen. It is impossible to know when this currency adjustment will occur because it will be driven by something causing a sharp change in offshore investor sentiment.

Since the currency float foreign investors have generally been pleased with what they see here in terms first of massive economic deregulation during the 1980s, then a strong fiscal position up until recently along with things like improving trade links with other countries and low inflation.

That has meant they have been quite willing to supply the funds we need to pay for our lovely imports by either lending it to us, buying our assets, or leaving in NZ the profits they make on their operations here. In other words – each year they give us more rope which one day will hang us. But not now – and not if there are solid signs of a strong shift in NZ resource allocation towards the export sector. Is such a resource shift underway? Unfortunately there is no evidence of such.

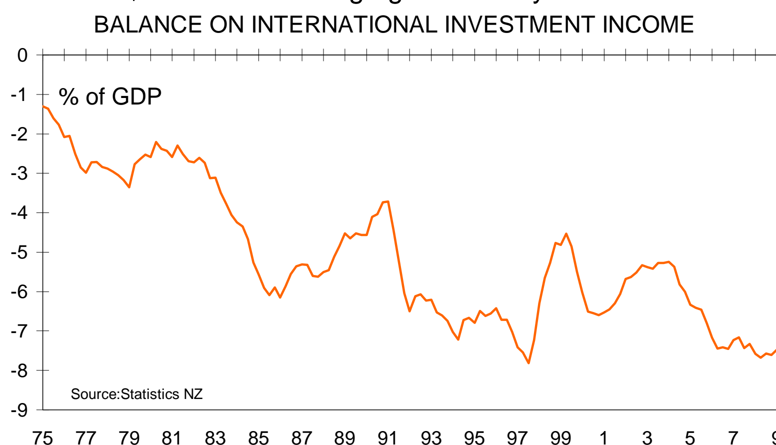


The quarterly balance of payments release from Statistics NZ showed that in the year to March our current account deficit stood at $15.2b. This was an improvement from $16.1b in the calendar 2008 year but worse than $14.2bn a year ago. The more common way to measure the relevance of the current account deficit is to look at it as a proportion of gross domestic product. This proportion is now 8.5% from 9% in December and 8% a year ago.



There is an improvement underway and one can best see this by looking at the quarterly seasonally adjusted current account deficit which was $2.7bn for the March quarter from $3.7bn in the December quarter and $4bn for the September quarter.

But at 8.5% of GDP the deficit remains huge by OECD standards and is well above our average deficit since 1985 equal to 5.2% of GDP. The large deficit of course means a large financing requirement and the cost of this financing through borrowing someone else's money and selling our stuff to foreigners is a continuing deterioration in what is called the International Investment Position. This stood at -$177b at the end of the March quarter from -$154b a year ago. This means that if we wanted to square our account with the rest of the world we would need to win $177b in some huge global lottery.



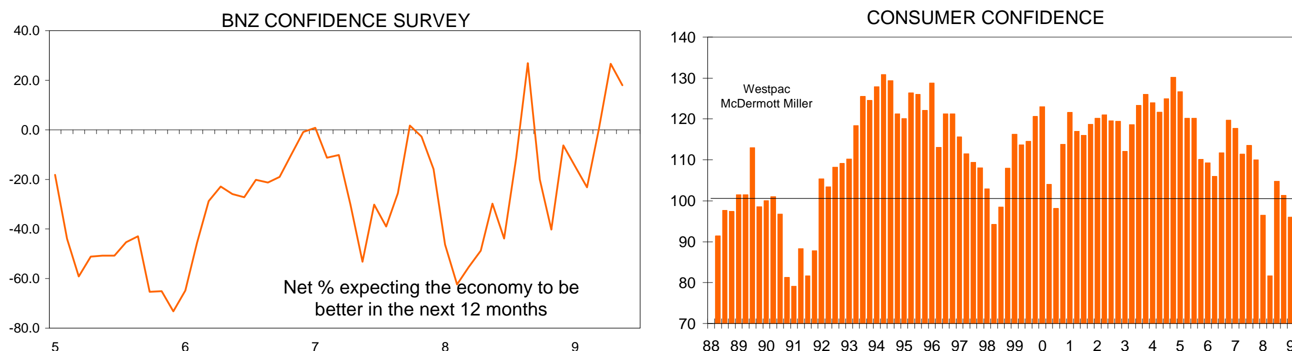
The bad net indebted position (a private sector thing as the government's accounts in NZ have been good for many years) is made up as follows. We have $125b of investments offshore, foreigners have $301b worth of investments here. Foreigners have lent us about $89b and bought $80b of debt securities, hold about $10b of equities, while the rest is largely direct ownership of NZ businesses.

The servicing of this huge net negative position is what now causes our continuing large current account deficit. Of the $15.2b current account deficit in the year to March $13.4b directly reflects the net difference between what we earn on our investments offshore and what foreigners earn from their loans to us and their assets here. The actual goods and services balance showing the extent to which imports match exports was a deficit of just $2.6b. But it is the accumulation of such smallish deficits over decades which has generated the current net indebted position (which is equal to about 98% of GDP).

The current account numbers rarely affect NZ interest rates or the exchange rate. But one day investors offshore will become concerned about something here and demand a higher risk premium for continuing to fund our unsustainable way of life. When that happens – and it is 100% impossible to forecast when – the NZD will plunge and finally export profitability will soar. This might happen sometime before 2050, or maybe 2100.

Consumer Confidence Improves Further

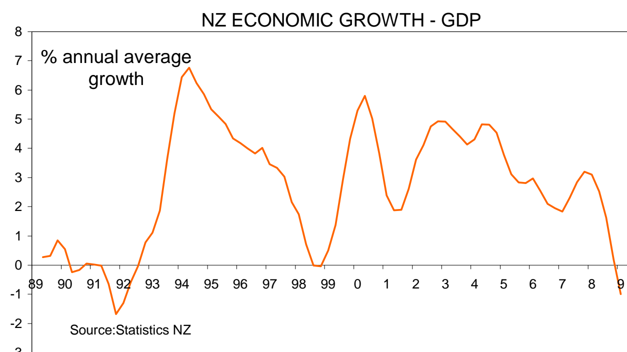
About two months ago we reported the results of our monthly BNZ Confidence Survey which showed a surge in sentiment about the economy over the coming year to a net 27% positive from 0% in April and -23% in March. We interpreted the jump in sentiment to an equal record level as indicating a huge sigh of relief that the Great Depression scenario had been avoided. The same interpretation appears warranted for the Westpac McDermott Miller Consumer Confidence survey which jumped to a reading of 106 in the June quarter from 96 in the March quarter and 82 a year ago. A reading of 100 is considered neutral and the average reading for the past decade has been 114.



The result implies some support appearing for household spending though because we think there is a sigh of relief factor at work we remain weary of the extent to which retail spending may improve over the coming 12 months.

NZ Economy Shrinks Another 1%

The NZ economy shrank for the fifth quarter in a row early this year falling 1% in the March quarter following shrinkage of 1% in the December quarter. The economy is now 2.7% smaller than a year ago and the official growth rate – which is calculated as the four quarters ending March 2009 on the four quarters ending March 2008 – has decreased to -1% from 3.1% a year ago and average growth for the past decade of 3.3% per annum.



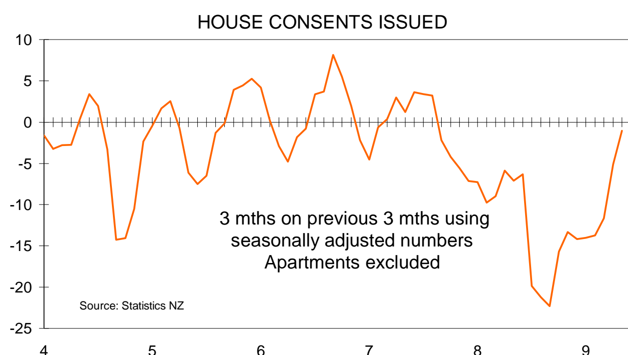
Household spending was very weak during the quarter recording a large 1.3% fall which is the greatest three monthly decline since June quarter 1991. Private consumption has decreased 0.7% over the past year. Residential building fell by only 0.3% in the quarter but has declined 23% for the past year while non-residential construction weakened 4.9% in the quarter to be up 1% for the year. Reflecting the sharp pullback in business capital expenditure, spending on transport equipment fell 37% in the quarter!

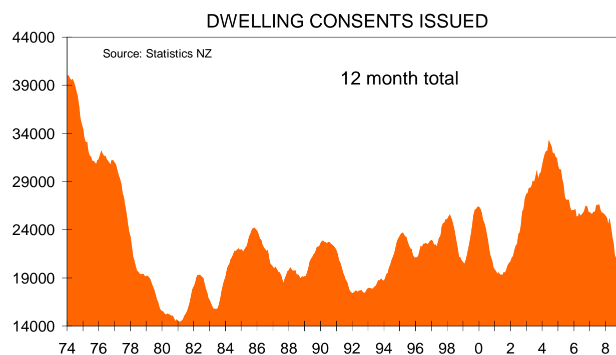
Monday 29

House Construction Stabilising

In May there were 1,238 residential building consents issued around New Zealand. This was a 25.1% decline from a year ago which is the smallest such rate of decline in eight months. In seasonally adjusted terms numbers improved 3.5% in May following an 11.9% rise in April. However the improvement over the past two months is mainly because of more apartment consents and when these are stripped out we find

housing-only consents retreated 3.2% in May after gaining 4.5% in April. There is as yet no clear upward trend in housing consents being issued, but the decline has ended. Growth is likely to commence soon however given the strong correlation between consent issuance and dwelling sales which have soared since March.





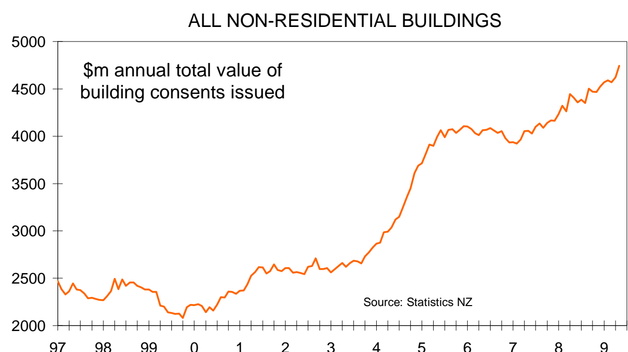
This implies that those builders who have been able to keep their cash flows under control and can still do so for the remainder of the year are likely to benefit quite strongly from an upturn in house building. This upturn will not only be driven by below average interest rates, but also the existing shortage of accommodation plus the recent decline in the number of consents issued to the lowest annual number since 1981 – though as a proportion of population the decline now is far more substantial.

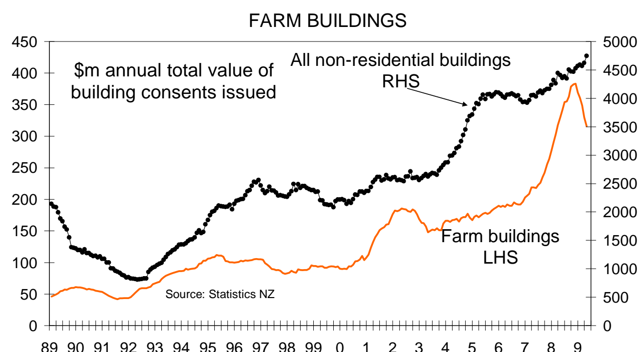
Will house construction boom over the next three years with assistance from the acceleration in population growth caused by a migration boom? Probably not because of tighter lending criteria and the fact that as things improve here they will probably improve more so in Australia where the housing shortage is even worse. This will tend to encourage (eventually) NZ tradespeople to shift to Australia.

The upshot then is that upward pressure on existing house prices is implied by this existing shortage, escalating demand, but potentially initially limited construction supply response.

Non-Residential Building Holding Up Very Well

The value of consents issued for the construction of non-residential buildings was 35% higher in May than a year earlier at $479m. This strong gain means that over the past three months consent values were 13% up from a year ago and ahead 12.8% in the six months compared with a year ago. Non-residential construction is being supported by construction of stadiums, airport upgrades and some hotels. But there is weakness in areas of the economy experiencing pain, such as farming where consents were down 34% in the six months to May compared with a year earlier, factories 8%, and warehouses 42%.



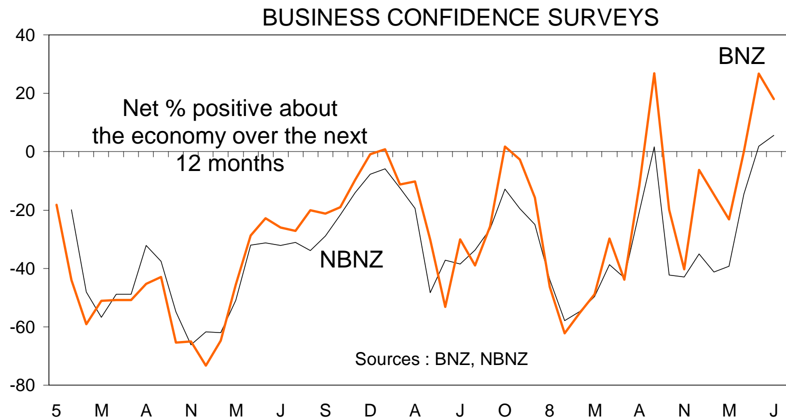


Tuesday 30

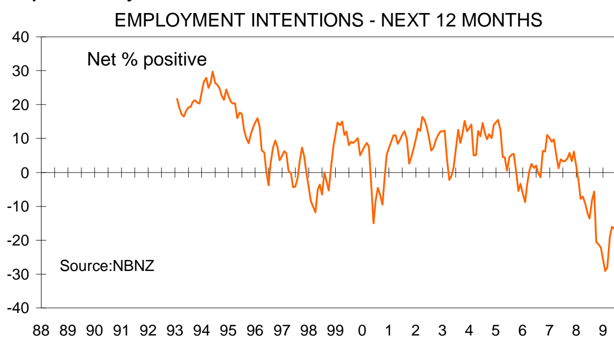
Business Sentiment Shooting Green

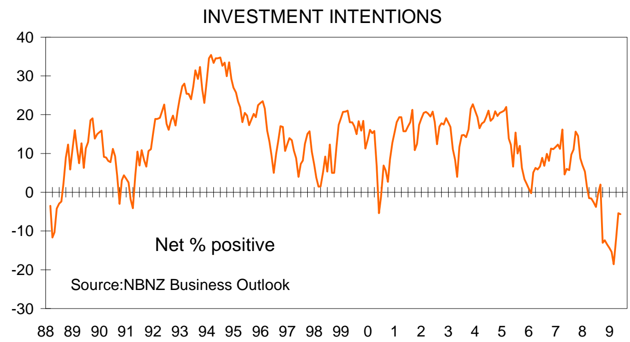
Four weeks ago our monthly survey showed business sentiment holding at a firm level and today the NBNZ Business Outlook survey which essentially replicates our results with a 3-4 week lag has confirmed the improvement in sentiment already seen. Business confidence about the economy over the next 12 months

has risen in early June to a net 6% optimistic from 2% in May and a recent low of -41% in February. This improvement is also evident in firms' own activity expectations which have improved to a net 8% positive from 4% in May and -21% in March.

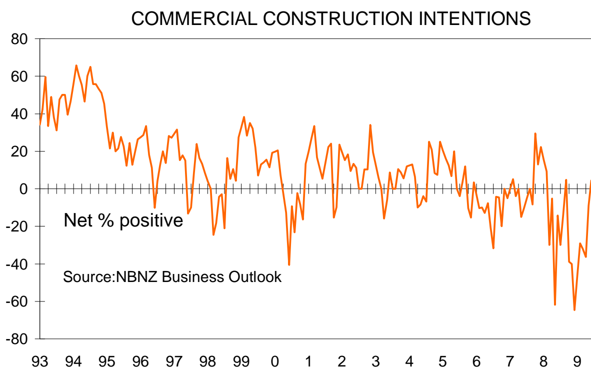


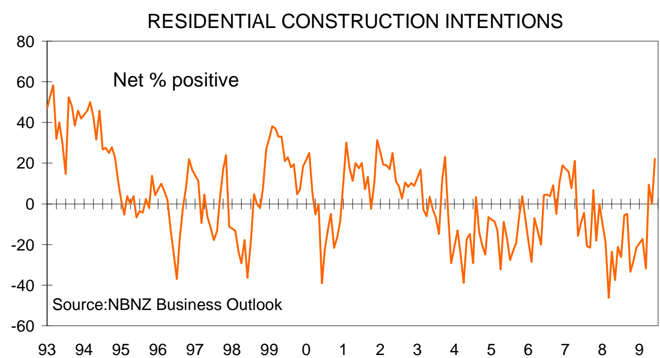
This latter result is still below the ten year average of +17% but the trend is clear. Businesses can clearly see light at the end of the tunnel although for now they are wary of doing much about it. In fact a still high net 17% intend laying off staff from 16% in May and 29% in February. A net 6% plan cutting capital spending from 5% in May and 19% in March. The average readings for these two indicators are 1% and 8% respectively.





But there are interestingly positive results as well. Following on from the comments just above regarding non-residential construction consents, a net 4% of firms plan higher commercial building. This is up from 9% planning cutbacks in May and 65% in December, and right back where the result was in early-September before the Lehman's bank collapse. The average reading for this measure is -4% so we can identify one part of the economy which is going to be making a positive contribution to growth over the coming year or so.





Another part is residential construction. A net 22% of builders expect higher residential construction over the coming year from 0% in May and 32% expecting reductions in early March before the green shoots started appearing.

We have long noted the shortage of dwellings in NZ and how accelerating population growth plus low financing costs would combine with low construction to produce a limit on the extent of average price declines here. We have also noted our expectation that this shortage would eventually produce rising house building – and this now seems to be the widespread expectation as well. This is very good for a lot of retailers as well as suppliers of building materials. But this cyclical (structural?) upturn in house construction is starting from a low level.

A major implication is one we have emphasised for quite some time now. Eventually the oversupply of builders will disappear again so now is a good time to get some house work done if cash flows allow.

Overall the survey results are consistent with the NZ economy exiting recession over the second half of this year but not recording strong growth.

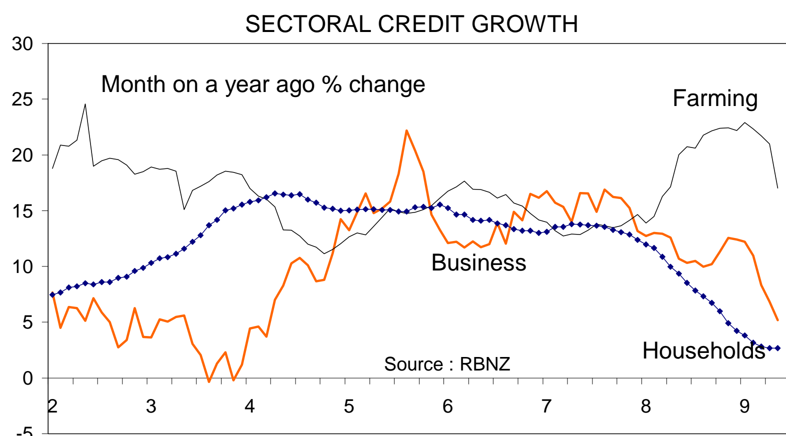
Householders Gain Enough Confidence To Borrow More

In seasonally adjusted terms lending to the household sector grew at its strongest pace in ten months in May with a gain of 0.4%. This followed gains averaging 0.2% over each of the previous five months and indicates that the rise in consumer confidence seen in some monthly and quarterly measures is translating through into a willingness to take on more debt. This is quite reassuring from an economic growth point of view but leaves as confused as ever the likely track of household savings following the global credit crisis.

There is a popular theory that with so many people finding themselves heavily in debt at a time of rising unemployment there will be a new determination to cap debt in the future and instead build savings. But because by the same rational there will be millions of people determined not to save and run the risk of wealth decimation again as a result of falling sharemarkets, collapsing finance companies, fund manager mismanagement, or outright rip-offs from the likes of Mr Maldoff.

For now the NZ monthly lending data support the green shoots theory and our own prognostications on the housing market in particular being far better supported than the doom-sayers have been promoting.

The annual rate of growth in household debt held steady in May at 2.7% from 9.4% a year ago and average growth of 11.1% p.a. over the past decade.



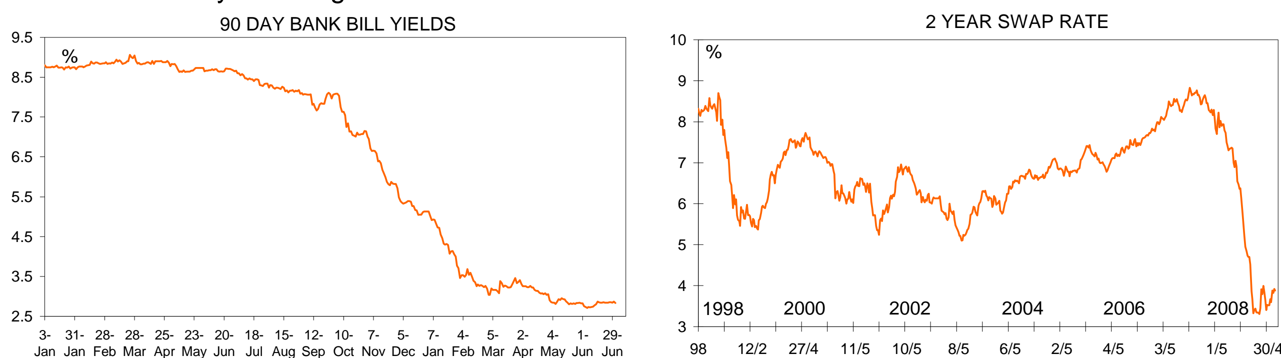
The annual rate of growth in lending to the business sector in contrast fell further in May to hit 5.2% from 6.8% in April, 10.7% a year ago, and an average of 9.6% over the past ten years. In the past three months business borrowing has fallen $1.8b whereas it grew $2.2b over the same period last year and $3.3b two years ago. In other words, the annual rate of change does not show it yet, but business indebtedness is falling sharply.

In the farming sector debt has grown by $1.4b over the past three months which is $1.4b less than growth a year ago and $0.5b more than growth two years ago. The annual rate of increase in farm debt now stands at 17% from 21% in April and 20% a year ago. One way or the other this continuing high rate of growth in farm debt is going to slow down.

INTEREST RATES

There is very little new worth writing about with regard to interest rate this week. Wholesale interest rates have eased back to where they were two weeks ago with assistance from a firm rally in the US rates market on diminished expectations that the Federal Reserve will raise its funds rate this year. The US ten year govt. bond yield has fallen to 3.53% from 3.68% a week ago and almost 4% three weeks ago.

In NZ the yield on 90-day bank bills is still near the 2.84% level of two weeks ago while the two year swap rate is also broadly unchanged close to 3.8% but down from 3.9% last week.



The really interesting stuff with regard to NZ wholesale interest rates this year has already happened. It occurred in two parts. The first part was the massive decline in interest rates early in the year as central banks around the world slashed interest rates, started printing money, and economic data led to increasingly dire expectations for the world economy.

At the start of the year the two year swap rate was at 4.6%. It fell to 3.2% during the second week of March. The 90-day bank bill yield was at 5.1% at the start of the year and reached 3% early in March.

The goal we gave ourselves late last year was to recognise when household mortgage rates would be at their low point for the year and call them as such. We managed that by one day with our "Fix Now" recommendation in the March 19 Weekly Overview. Since then the seven year fixed mortgage rate has risen from 6.79% to 8.5%. The three year rate has gone from 5.99% to 6.99%. The one year rate – more closely affected by monetary policy – has gone from 5.79% to 5.99%. The two year swap rate has gone from 3.2% to 3.8% and the five year swap rate from 4.2% to near 5.3%.

The story for the rest of the year is going to be this. Rates will tend to drift upward in response to slowly rising but at times highly challenged expectations of improving world and NZ growth, rising inflation risks 2-3 years out, big government borrowing demands, and expectations of central banks tightening monetary policy over 2010. What we will be doing is reporting on periods when rates rise a tad more than usual during a month and we will cite these factors – plus maybe someone will come up with a new term to represent the second stage of the "green shoots" developments.

Key Forecasts

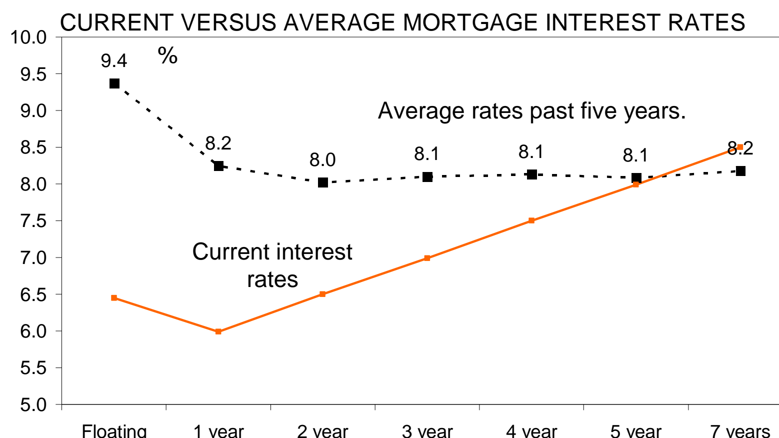
- No more monetary policy easing with the this cycle.
- Medium to long term housing rates have seen their multi-year lows – stop-start rises now lie ahead. Speed unclear.

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	3.00	8.25	6.2
90-day bank bill	2.84%	2.85	2.75	3.25	8.66	6.5
10 year govt. bond	5.90%	5.98	5.75	5.08	6.34	6.2
1 year swap	3.01%	3.10	2.94	3.23	8.32	6.7
5 year swap	5.32%	5.46	5.12	5.18	7.60	7.0

If I Were a Borrower What Would I Do?

Personally I would still fix three years at 6.99% because that rate is 1.1% below average and it gives me good cash flow certainty for an extended period in an environment where lots of other things are extremely uncertain. I don't expect mortgage rates to be dipping back down again so see no point in waiting around for a better fixed rate. I could simply float but the 1% rate saving if I take the Total Money package may disappear quickly should inflationary pressures prove strong 12-18 months from now around the world.



However, plenty of people do feel that it is safe to fix short or float – and a few people seem to be unaware of the economic factors at work and still expect rates to fall away again in the future. Good luck with that.

What Are Borrowers Doing At The Moment?

Last week was asked a sample of people within the bank what they were seeing customers doing with regard to their financing at the moment. Here are some responses which readers may find interesting. What we aimed to find out from the small survey was not so much what people are doing but why they are doing it.

I have noticed just over the last 2/3 weeks more appointments with people who have been made redundant and looking for some help/ideas with managing home loans and reducing payments. Anyone on a floating rate and struggling financially - the 5.99% fixed for 18 months has been a help (some going interest only) to get them through the next year. Most people seem optimistic that another job will come along in the future when things improve a bit. So that is one reason for choosing the 18 month fixed rate - lower the servicing cost to get them through a tight 12/18 months.

Loan splitting has also been "in vogue" (thought you might like the French term) with borrowers hedging their bets over short and medium term - some splitting the loan 3 ways and taking a bit over 5 years as well.

Just getting back to the redundancy thing - representatives from Work and Income are happy to come and talk to the banks regarding handling the redundancy issues for people and discuss what entitlements would be in different scenarios.

… doing a mixture of fixing everything for normally the 3yr rate or splitting 5ys, 3yrs & floating (or something similar). A recent example was a client who only just completed a house under construction project & therefore missed the opportunity to fix at the lower rates earlier this year. He had a total debt of $400k which he split $300k fixed 3yrs 6.99% & $100k on Total Money variable 5.99%, hoping to have some interest rate certainty over the next 3yrs whilst still taking some advantage of the lower variable rate.
Most people still feel the inclination to fix as that fear of skyrocketing interest rates is always at the forefront of their mind however the temptation of the lower variable rate is become increasingly popular.

Most of my customers are fixing short term. They believe that only short term rates are going to be low in the next few years. They are also hoping that the short rates will reduce rather than go up in the next 2 years.

Starting to find more residential borrowers are covering their bases by putting some of their loan short term and some around the 3 Year Fixed mark.

I am recommending 3 years fixed unless they are selling property and are likely to repay debt. Around half of my customers will take this onboard and fix for 3 years. The other half are fixing shorter. Usually 6 months, some 12 months and only a handful 18 months. The reason for this is either they are chasing the cheapest rate or believe that rates will come back further.

I have found some people are still refixing 6mths-1 year as they still have some belief in the market changing and are looking for the lower rate as money is tight. I have just started doing comparisons with customers on their repayments if they take the 3 year rate to encourage the longer term. Some are too scared to fix long term because they have been burnt with a high rate fixed over a long term.

With respect to housing, people are fixing short term i.e. 6 mths - 18 mths. The belief is rates will still be low this time next year.

…most of my clients are opting for the 18 month classic home loan rate of 5.99%pa, even after reading what you are saying, they think the longer term rates are too high and most feel that rates will come down because the Reserve Bank will make the banks reduce them

The simple answer is the clients I see are not much in the way of new borrowing. In the last 4 weeks I have drawn 7 loans at a grand total of $53k in new lending.
2 ($0k new) of these were restructures to go to a lower rate and/or combining loans to reduce future re-fix fees
-1 x 12 mths 5.49 as are paying heaps more than reqd and will have their $215k paid of in 3 years
- 1 x 12 mths 5.49 (+ .5 LEP margin) to reduce payments while wife on maternity leave
2 ($10k) are final drawdowns from a construction loan
- Total Money variable awaiting other loans to mature in Sept then amalgamate. Also over 80% (but before LEP).
1 ($18k) upgrade the car and amalgamate with existing variable rate loan (had previously broken a fixed rate)
- 18 months 5.99
2 ($25k) consolidate other debt (with help from parents security)
- both 3 years 6.99%

Business Customers

There have been lots of fixed rate enquiries from business clients recently, however once they see the difference between, for example, fixed 3-5yrs & say CCAF prime 90 days most stick with floating. For a lot of businesses their forecasts for 2009 were based on much higher rates therefore by taking advantage of the lower variable rates now they are able to be well ahead of plan.

Not a lot of farming debt rolling now. But that stuff that is tends to be 50% floating (well 30 - 90 day type arrangements) and 50% fixed 3 years. 1 & 2 years aren't long enough and 4 & 5 has become a little expensive. The combination of part floating part fixed 3 years produces a healthy rate for the client too.

This week I have gained commitment from a new to bank $20m refinance from …. The closely held business wishes to break the existing swap which has circa 16mths to run and re-fix for 5 years. The attraction is to lock-in today's rates and the thinking behind that is the rates will go up in the medium term due to inflationary pressures that will arrive when the NZ & Global economy begins its growth cycle. I was able to win this business largely because …. were not willing to go to 5 yrs.

For existing business borrowers, 2 main camps really - going with floating rates to improve cash flow or refixing and maintaining repayments at current (higher) level to reduce term.

I have a large utility company with c$XXm in borrowings. We have been on at them since November 2008 to put some hedging in place but they are still floating with no interest rate hedging in place. I have a number of other examples where borrowers cite the fact that they were burned by hedging at high rates in late 2007-early 2008 and then watched from the sidelines as floating rates dropped off a cliff. A number of companies now have the view that floating bill-rate (CCAF Prime) debt is the cheapest over time and they will ride the market.

Based on current rates a bit of a short-short-long approach seems to suit their appetite as follows:
On the commercial side we have had 1 yr rates in mid 6's (say 6.5%) and 2 yr rates of say 7.25%.
Option One: Take a 2 year fixed rate approach at 7.5% = 14.5% paid over 2 years.

Option 2: Take a 1 yr + 1 yr rate at 6.5% in the first year then the second year needs to be at 8.00% to break even on a average 2 year fixed rate 7.25%.
The question then posed to the client is whether rates will increase by 1.5% over the next 12 months when their loan matures.
Indications for the OCR announcements indicate that rates are unlikely to increase by this much in the next 12 months but beyond that who knows.

My clients (asset financing) are in the main (say 70%+) opting for the floating rate, given shorter payback periods, and many progressively down sizing/ageing their fleets (contracting/transport) by not maintaining their replacement programmes with as much vigour as maybe 24 months ago. Some have the decision taken out of their hands, because if there's less work to go round, then no point shiny new toys sitting in the yard chewing cash.

With the reduction in forecast for the dairy payout recently and the increase in interest rates for farming, it has been noted that more people are prepared to float their interest rate in the hope of keeping the borrowing cost as low as possible for the next 12 months. In the event that the payout rises next year, clients will be in a better position to pay slightly more for their interest cost and hence will look to fix in to gain more certainty in interest cost.

…a large number of my customers are acknowledging that current floating interest rates are attractive but are also taking steps to remove longer term uncertainty from their business objectives by entering into fixed rates or other hedging instruments for 3-5years. The customers are not looking to fix the full debt amount but between 25-50% of the total loan.

HOUSING MARKET UPDATE

Net Migration Soaring – But…

In the year to May the net migration gain was an above average 11,202 compared with 9,176 in April and just 3,569 six months ago in November. The turnaround is very strong and in fact the net flow in May of +727 was 2,026 better than May 2008 which is the strongest such annual change comparison since February 2003.

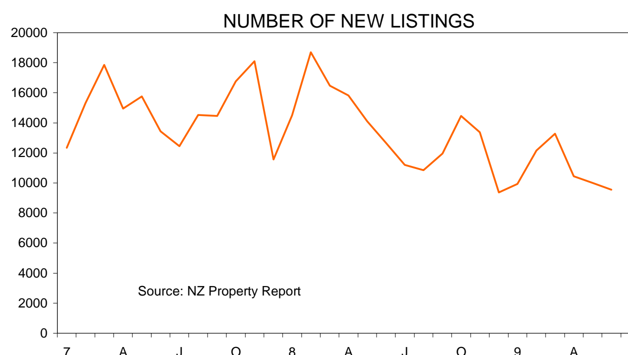
Now it goes without saying that the more people there are the greater the demand for housing therefore the stronger the pressure on rents and prices, especially in an environment such as we have at the moment with a fundamental shortage of affordable housing and extremely weak new construction. However before people get too optimistic in their price expectations it pays to remember that our commentaries for a long time now have been along the lines of the market flattening out in the first half of the year then prices not going anywhere for possibly quite some time.

That outlook for limited short term price action appears supported by the fact that the migration gains so far are being achieved by a collapse in the number of people leaving NZ rather than soaring numbers arriving here. In the three months to May the number of immigrants was only 1.5% ahead of a year earlier. But the number of emigrants was down by 22%.

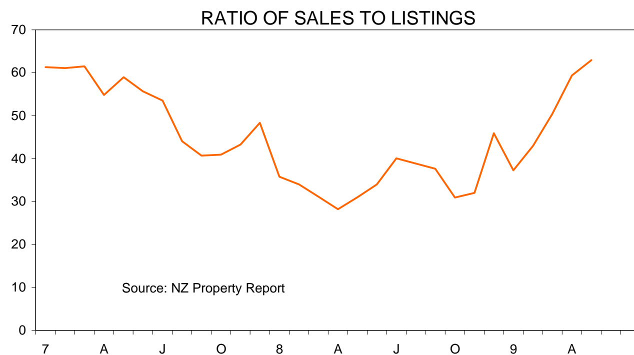
Presumably Kiwis leaving tend to be less cash rich than those arriving therefore the housing implications of the current net migration boom (note the addition of the word "net") are not as strong as the last time migration flows turned on a dime back in the middle of 2001. This is the case even though over the first six months of the turnaround back then net migration flows improved 8,823 from -13,214 to -4,391 and this time the six month turnaround is not dissimilar at 7,633.

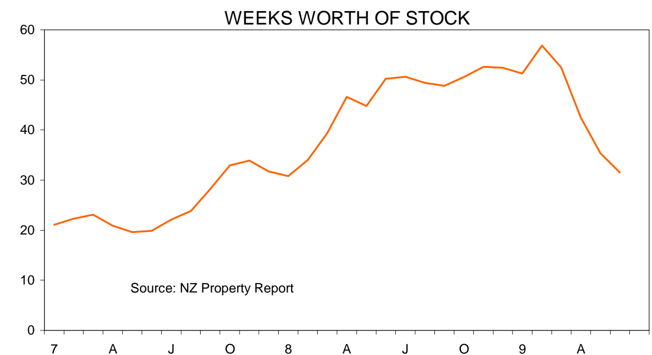
Housing Market Continues To Firm

The monthly NZ Property Report compiled by the website www.realestate.co.nz shows even more clearly why those people still predicting NZ house prices will collapse have forgotten their basic economics. The report shows that during June there were 9,561 properties newly listed for sale which is a strong 24.4% decline from a year ago and the second lowest number since the series started in January 2007.



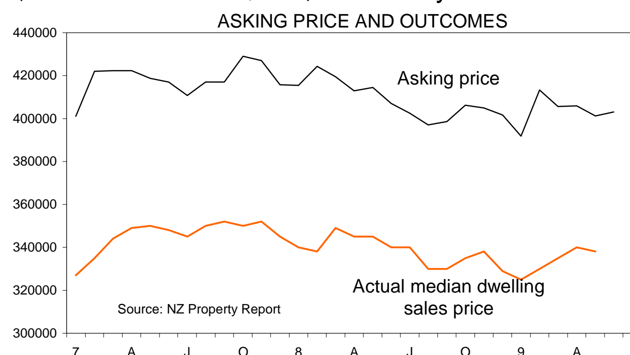
Calculated using data over the past three months to May and comparing listings with REINZ reported sales (June not available yet) the data show that the total stock of listings at the end of May was equal to 31.5 weeks of sales compared with 35.4 a month ago and 51.3 at the end of last year. This is the smallest such inventory measure since January 2008 and backs up the conclusion that the availability of residential real estate stock on the market is diminishing quite quickly.





For the moment we think the price implications of this trend are muted. But eventually, the listings shortage combined with below average interest rates, accelerating population growth and weak construction will produce a price response. Good luck picking when and by how much in your favourite area. Just be cautious about expecting any grand price movements. Average NZ prices are above average and there will be restraint from rising unemployment and still quite a few mortgagee sales as inexperienced and undercapitalised “investors” get burnt off. Also, seaside property still appears highly likely to fall in price for quite some time.

For the record, the truncated average price being asked in the Property report (top 10% and bottom 10% of prices removed) rose to $403,107 in June from $401,196 in May. But this was down from $405,936 in April.



Key Forecasts

- Dwelling consent numbers to slowly recover from the middle of this year.
- Real estate sales have bottomed for this cycle. Activity is likely to fluctuate and begin a drift upward before year end with potentially firm activity over 2010.
- House prices stabilising, rising slightly over 2010.

Exchange Rates & Foreign Economies

EXCHANGE RATES

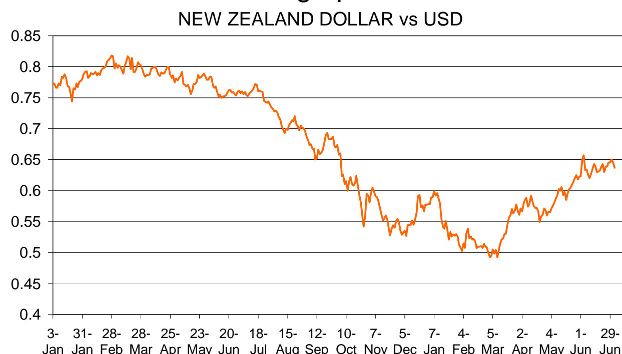
	This week	Week ago	4 wks ago	3 months ago	Yr ago	Consensus* Frcst Yr Ago	10 yr average
NZD/USD	0.637	0.639	0.65	0.567	0.757	0.693	.592
NZD/AUD	0.793	0.802	0.803	0.81	0.793	0.793	.856
NZD/JPY	61.6	61.1	62.8	55.9	80.3	73.3	66.8
NZD/GBP	0.387	0.389	0.395	0.392	0.379	0.371	.345
NZD/EUR	0.452	0.458	0.459	0.428	0.479	0.48	.51
USD/JPY	96.7	95.6	96.6	98.6	106.1	105.8	113.9
USD/GBP	1.646	1.643	1.645	1.45	1.997	1.867	1.709
USD/EUR	1.41	1.395	1.416	1.33	1.58	1.443	1.156
AUD/USD	0.803	0.796	0.809	0.70	0.955	0.874	0.69

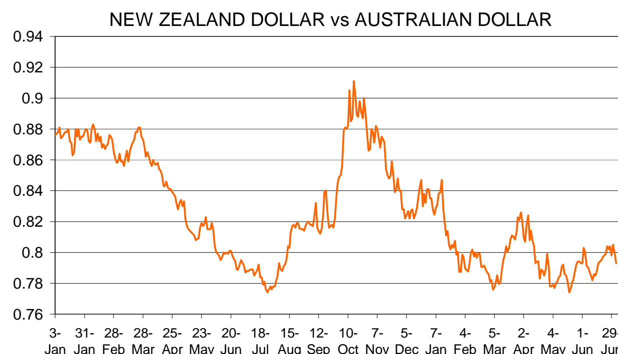
NZD Still Above US 63 cents

If the NZD was going to have a large pullback from levels above US 63 cents one suspects it would have done so by now. We have been warning about a pullback in this exchange rate from overcooked levels for three months now with no success. There remains medium interest offshore in buying riskier assets like the NZ and Aussie dollars in order to get improved yields. Only if we see a substantial reversal of still rising offshore expectations of improving world economic activity later this year will the NZD likely settle back below the US 60 cent level.

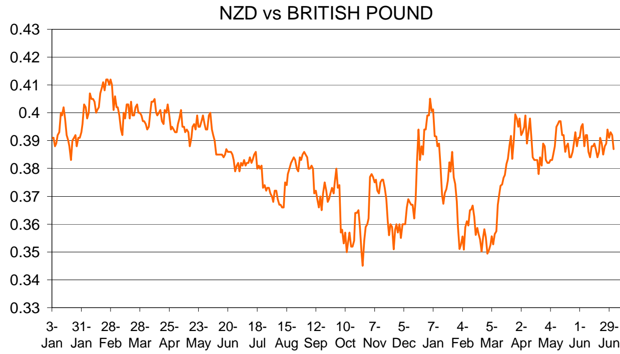
Having said that, over the next few weeks quite a few Uridashi and Euro-Kiwi bonds mature and there is a chance fresh issuance does not match maturities. So it may still be worth USD receivers holding off their hedging for a while longer.

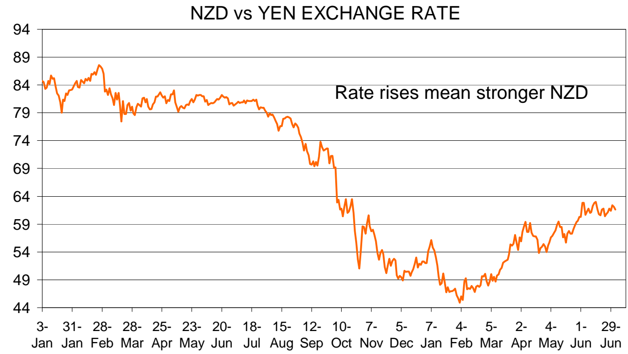
The NZD this evening is trading against the greenback near 63.7 cents from 63.9 last week. Against the AUD the NZD remains as directionless as ever and also as weak as ever from a long term point of view – as shown in the NZD/AUD graph from 1985 in the next FX section.

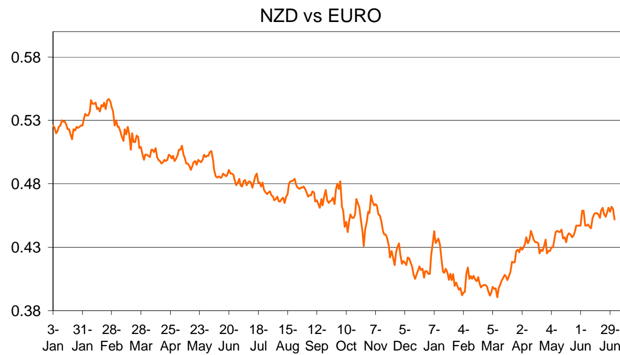




Against the British pound the NZD is where it was last week just under 39 pence, against the Japanese yen we are still just over 61, and against the Euro we are still close to 45.5 centimes.

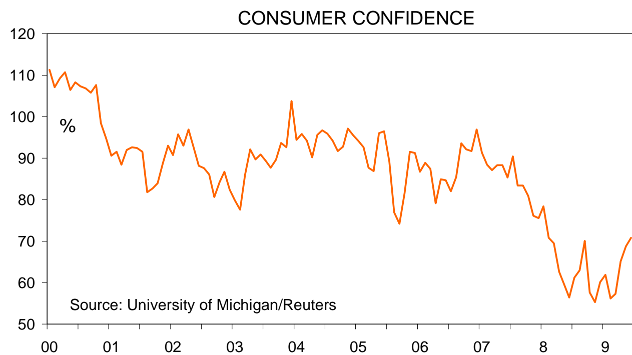


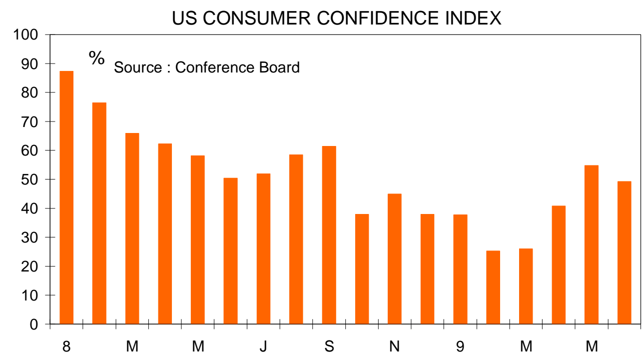




Looking offshore now, the greenback has changed little from where it was a week ago with downward pressure from reduced monetary policy tightening expectations offset by generally positive economic data releases.

Consumer confidence continues to slowly improve with the monthly University of Michigan consumer sentiment reading improving to end June at 70.8 which is up from 69 in the middle of the month and 68.7 in May. But the reading is still well below the 100 neutral level – which stands in contrast to the recent above 100 reading in a New Zealand survey and illustrates that it remains very unreasonable to expect the long-running engine of world growth – spending by US households – to be firing into life anytime soon. In fact during the week an alternative confidence measure compiled by the Conference Board fell to 49.3 in June from 54.8 in May.



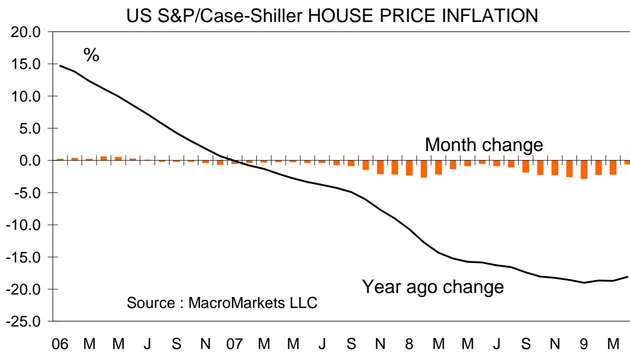


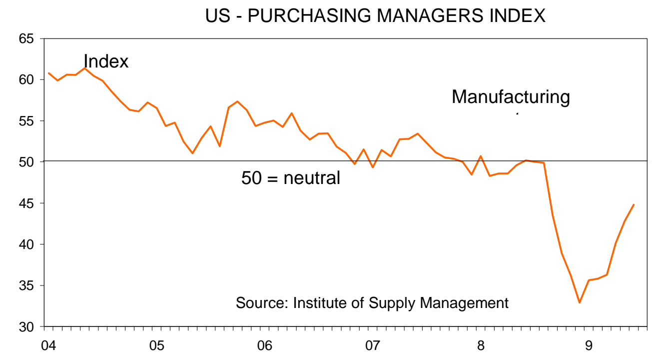
Actually, with regard to US household spending there is a general state of confusion at the moment. Those who are very pessimistic note that the household savings rate has just hit a 15 year high of 6.9% and this means a large structural decrease in the average propensity to consumer from income is underway. But others note that this jump in the savings rate in April was because of a large 1.4% rise in earnings attributable to the Obama stimulus package and spending still managed to rise 0.4%.

From an NZ exporter's point of view we would suggest not building too many optimistic projections of sales into the broad US household market for the next 12 months – though targeted marketing is always a different story.

For those with high interest in US consumer spending a highly relevant thing to watch will be tonight's monthly non-farm payrolls report (appearing one day early due to a US holiday tomorrow). If it surprises on the low side as May's did then sentiment regarding the US household and economy could take a step up. The markets are expecting a 0.2% rise in the unemployment rate to 9.6% and job losses of about 350,000 are expected from 345,000 in May.

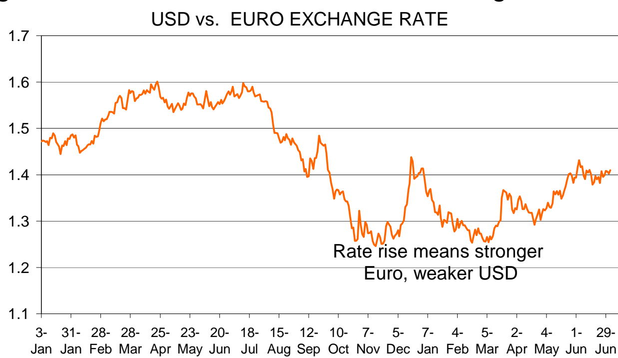
The much-watched Case-Schiller House Price Index fell another 0.6% in April meaning US average house prices have now declined by 32.7% since the middle of 2006. However the monthly decline was the smallest since June last year and much better than the 2.2% declines registered in March and February and the 2.8% fall in January. As such the data strongly suggest some stabilising of the US housing market and that has important implications for the increasingly popular theory that growth in the US and world economies will resume before the end of the year.

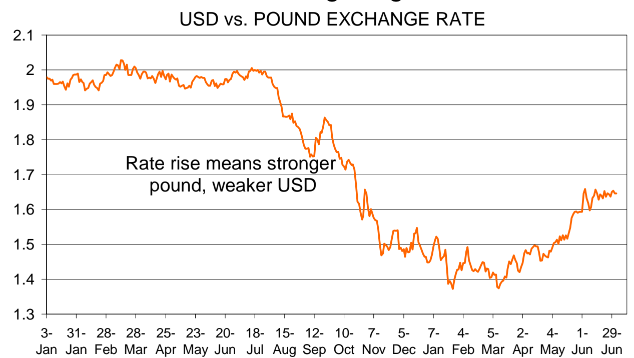


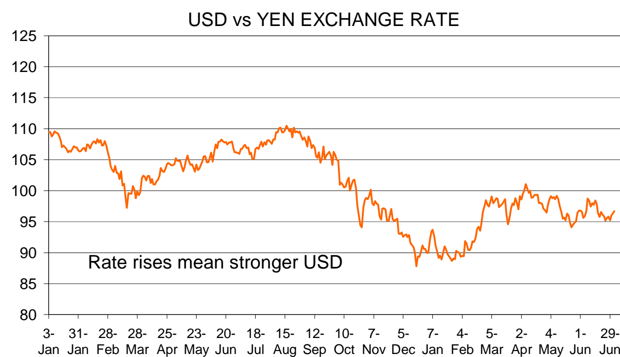


Conditions are also improving in the manufacturing sector – or more accurately they are deteriorating at a decreasing pace. The monthly ISM Purchasing Managers Index improved to a better than expected 44.8 in June from 42.8 in May where 50 is neutral.

The USD this evening is trading against the Euro near $1.41 from $1.40 last week. Against the pound it is near $1.645 from $1.643, and against the Japanese yen 96.7 from 95.6 – a small strengthening in the greenback which still leaves this exchange rate well within its four month trading range.





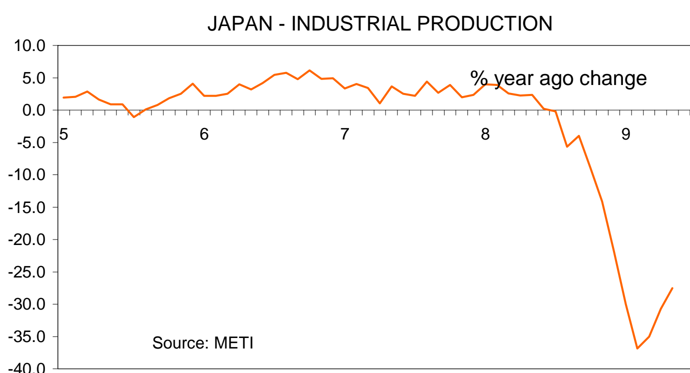


Looking at Japan now…………

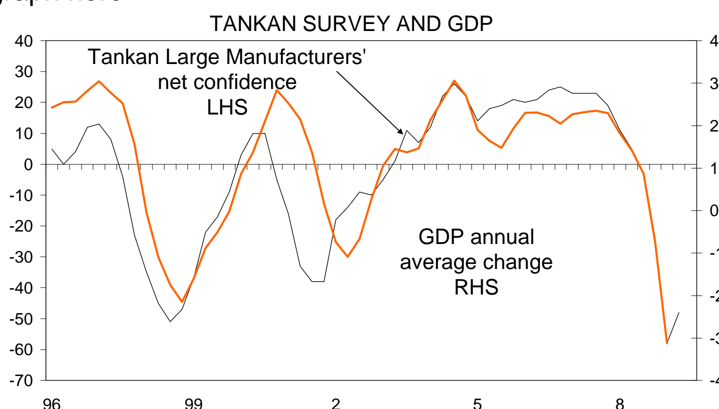
Japan's economy has been very severely hit by the global credit crisis even though Japanese banks have little exposure to the sub-prime markets and have not engaged in the terrible lending undertaken by banks in the US and UK. The economy's vulnerability is trade links with other economies. Following the collapse of Lehman Brothers investment bank in the US in September buyers in the US, Europe etc. sought to slash their inventories of manufactured goods and institute stock policies more suited to then worsening economic growth expectations. So orders for industrial goods were slashed leading to the likes of Japan's exports earlier this year running 50% down from a year earlier.

But now there are a few signs of life returning to the economy following shrinkage of near 4% in both the December 2008 and March 2009 quarters.

Industrial production in seasonally adjusted terms rose by 5.9% for the second month in a row in May. The gain still leaves production over the past three months around 28% down from a year ago but this is much better than the 37% annual decline in the three months to February. Still – the graph here tells a very sad story.



And as they say, a swallow does not a Summer make, and in the case of Japan short term growth prospects tend to be forecast strongly on the basis of the quarterly Tankan survey. This is an extremely detailed survey undertaken every three months by the Bank of Japan and GDP growth outcomes closely track the results. This is best seen in the graph here.



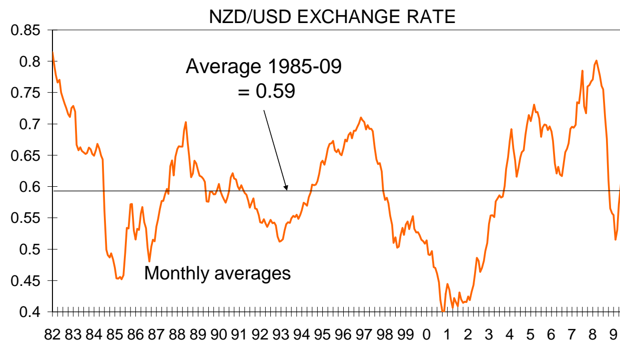
The June quarter results were released on Wednesday and they remained exceptionally bad. The manufacturing index remained terribly weak at -48 in the quarter. This was better than the March quarter -58 outcome but still indicative of a very bad economy which is not going to provide broad growing sales opportunities for NZ exporters for perhaps quite some time.
http://www.bloomberg.com/apps/news?pid=20601068&sid=aq56sXC16G8M

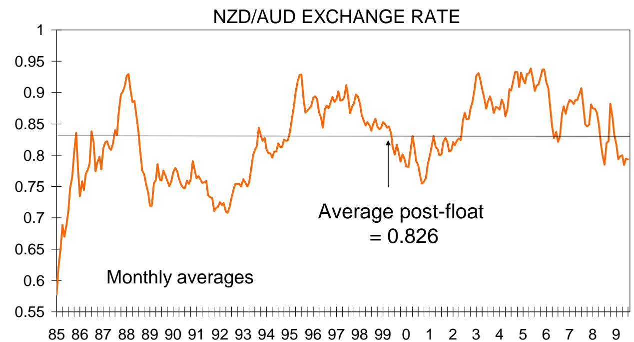
For the record, the UK economy is in even worse shape than previously though. Growth in the UK economy during the March quarter was revised to a fall of 2.4% rather than the initially reported 1.9%. This was a result much worse than expected and generated some new weakness in the already depressed British pound.

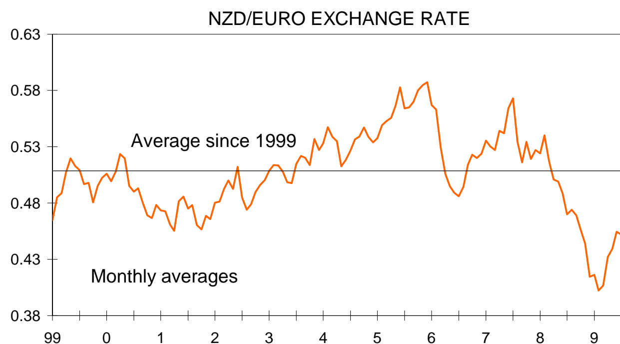
General sentiment regarding China currently is that courtesy of a massive fiscal stimulus package plus the return of some orders for manufactured goods after retailers slashed stocks overseas, the rate of growth for the June quarter will come in comfortably above the 6.1% recorded during the March quarter. That rate of growth was the slowest in over ten years but compared with major activity declines in other economies stacks up very well.

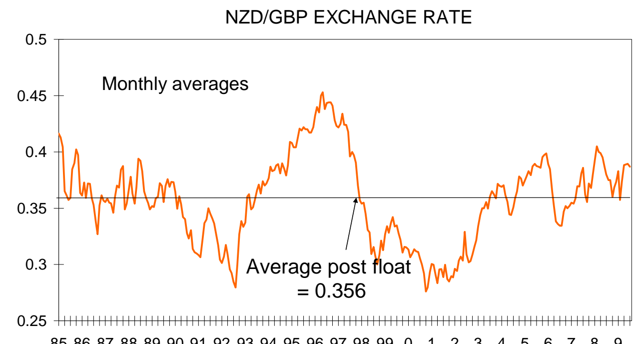
If I Were An FX Receiver What Would I Do?

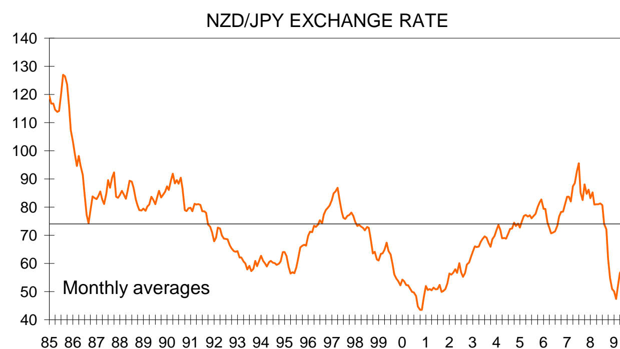
I'd be inclined to build hedging against the AUD, JPY and Euro given that the NZD is at well below average levels against these currencies. But I would tread lightly with hedging against the pound and greenback – and I would ignore pretty much everyone's forecast of where the NZD is going to go because no-one sits in a forecasting chair bereft of egg on their faces.











Apologies for the length of this week's WO – but it just feels so great to be healthy again.

*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	0.3%	-0.5	3.0	3.4	2.5
GDP growth	Average past 10 years = 3.0%	-1.0	-1.0	-1.0	3.1	1.8
Unemployment rate	Average past 10 years = 5.3%	5.0	4.7	......	3.8	3.8
Jobs growth	Average past 10 years = 1.9%	-1.1	0.6	0.8	-0.2	2.1
Current a/c deficit	Average past 10 years = 5.5% of GDP	8.5	9.0	......	8.0	8.5
Terms of Trade		-3.0	-1.0	-5.2	11.6	4.5
Wages Growth	Stats NZ analytical series	1.5	1.1	5.3	4.8	5.1
Retail Sales ex-auto	Average past 9 years = 3.8%.	-1.2	-0.0	-0.8	3.2	4.9
House Prices	Long term average rise 5% p.a. QVNZ	-2.0	-2.1	-8.9	8.0	9.7
Net migration gain	Av. gain past 10 years = 10,400	+11,202	6,160yr	......	4,938	10,680
Tourism – an. av grth	10 year average growth = 5.0%. Stats NZ	-2.6	-2.4	-2.6	1.3	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	3	-9	3	-34	-4
Business activity exps	10 year average = 26%. NBNZ	8.3	3.8	-21.5	-4.0	14.8
Household debt	10 year average growth = 11.3%. RBNZ	2.7	2.7	4.9	9.4	13.8
Dwelling sales	10 year average growth = 3.5%. REINZ	43.9	-39.1	-45.4	-52.9	-3.7
Floating Mort. Rate	10 year average = 8.1%	6.49	6.49	9.75	10.95	10.05
3 yr fixed hsg rate	10 year average = 7.9%	6.99	6.75	8.49	9.49	8.80

ECONOMIC FORECASTS

Forecasts at June 25 2009	**March Years**					**December Years**				
	2007	2008	2009	2010	2011	2006	2007	2008	2009	2010
GDP - annual average % change										
Private Consumption	2.8	3.2	-0.6	-0.2	1.8	2.6	4	0.1	-1	1.7
Government Consumption	4	4.3	3.7	3.3	2.8	4.6	3.9	4	3.4	2.9
Investment	-0.6	4.3	-10.2	-15.8	6.1	-0.4	5	-5.7	-18.1	1.7
GNE	1.4	4.4	-2.2	-3.1	3.2	1.4	4.5	-0.3	-4.5	2.4
Exports	3.1	2.9	-3.2	-3.4	1	1.8	3.8	-1.8	-3.3	-1
Imports	-1.6	9.6	-2.8	-10.9	2.2	-2.6	8.6	2.5	-13.1	0.2
GDP	1.8	3.1	-0.8	-1	2.9	2	3.2	0.2	-1.7	2.2
Inflation – Consumers Price Index	2.5	3.4	3	2.1	1	2.6	3.2	3.4	2.5	1
Employment	2.1	-0.2	0.8	-3.2	2.9	1.7	2.3	0.9	-4	2.9
Unemployment Rate %	3.8	3.8	5	7.5	7.2	3.8	3.5	4.7	7	7.2
Wages	5.5	4.4	5.1	2.4	1.5	5.5	4	5.1	3.1	1.3
EXCHANGE RATE ASSUMPTIONS										
NZD/USD	0.7	0.8	0.53	0.67	0.69	0.69	0.77	0.56	0.65	0.69
USD/JPY	117	101	98	102	108	117	112	91	100	107
EUR/USD	1.32	1.55	1.31	1.41	1.43	1.32	1.46	1.34	1.4	1.43
NZD/AUD	0.88	0.87	0.8	0.8	0.81	0.88	0.88	0.83	0.79	0.81
NZD/GBP	0.36	0.4	0.37	0.39	0.39	0.35	0.38	0.37	0.39	0.39
NZD/EUR	0.53	0.52	0.41	0.48	0.48	0.52	0.53	0.41	0.46	0.48
NZD/YEN	81.9	81.1	51.8	68.3	74.5	81	86.3	50.9	65	73.3
TWI	68.6	71.6	53.8	63.3	65.6	68	71.6	55.1	61.7	65.1
Official Cash Rate	7.50	8.25	3.00	2.5	4.25	7.50	8.25	5.00	2.5	3.75
90 Day Bank Bill Rate	7.78	8.82	3.24	2.7	4.62	7.64	8.77	5.23	2.7	4.12
10 year Govt. Bond	5.91	6.35	4.77	5.75	6.4	5.77	6.38	4.88	5.7	6

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.