BNZ Weekly Overview

23 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.

In this week's issue….

The Weekly Overview is written by Tony Alexander. The views expressed are my own and do not purport to represent the views of the BNZ. To receive the Weekly Overview each Thursday night email me at tony.alexander@bnz.co.nz with 'Subscribe" in the Subject line.

Slow Improvement Underway

We have learnt very little that is new or surprising about the New Zealand economy this week. The annual net migration gain has been reported as continuing to rise at a steady pace and by year end an annual gain between 20,000 and 25,000 looks likely. Foreign visitor numbers continue to decline with 5% fewer in June than a year ago – though this result is better than we thought would happen as the likes of a near 70% fall in visitors from Japan is being offset by Aussies coming here for a quick holiday perhaps including skiing.

Overseas the story remains as it has been since the second week of March when interest rates, sharemarkets, and the NZD began shooting up. Green shoots continue to appear showing that the rate of deterioration in the big economies is slowing, but at the same time deep structural problems remain. That means it is not wise to extract positive growth indicators which are likely to start appearing soon (in fact they already have in US housing) into expectations of strong growth.

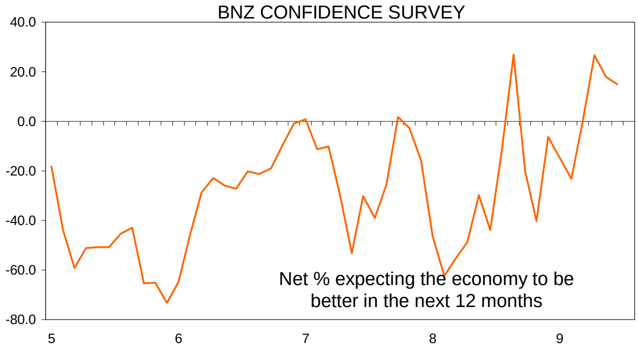
The global economy faces a still very tough road over the next two years as banks will continue to restrict their lending, governments struggle with how to rein in huge deficits, and we all wonder to what extent increases in household savings rates currently underway will be permanent. The more householders choose to build their savings the slower the upturn will be but the better will be long term growth and stability prospects.

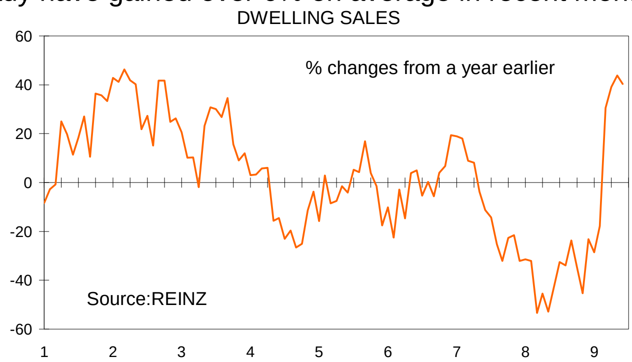
Another worry is that the massive monetary injections and low interest rates engineered by central banks will generate a surge in inflation a couple of years from now. However this is not a prevalent view though is one which we expect will contribute to slow rises in wholesale borrowing costs over the next two years. Arguing against the high inflation scenario is the fact that the transmission mechanism for the money injections in the likes of the US to drive inflation is sharply increased bank lending with low regard for risk. However, what is happening in the US is that the funds banks have received one way or the other from the basic money supply expansion have been reinvested bank with the Federal Reserve.

A year ago US banks had US$2bn on deposit with the Federal Reserve. Now that amount stands just under US$900bn. Banks feel a lot safer placing their funds there than lending it to a house buyer in a market where the security offered by the house may continue to diminish in value. And in the business sector worries remain about profitability and therefore potential lending losses.

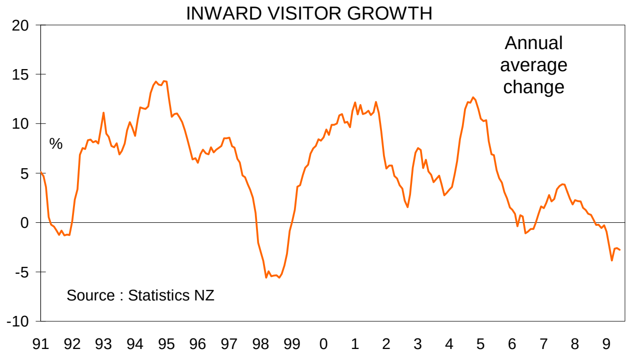
It is likely that as economic conditions improve in the US and other major economies central banks will begin efforts to take excess cash out of the system. In simple terms, one indicator in the US of increased willingness to lend is likely to be those bank balances at the Fed. shrinking.

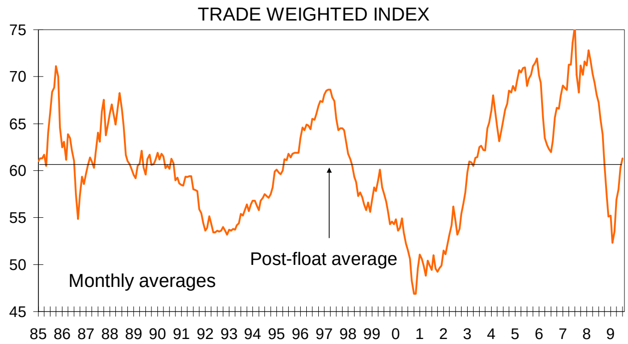
Back here in New Zealand we can see signs of things getting better – as we have noted in recent weeks. House sales, dwelling consent numbers and prices have all come off their lows. Annualised growth in retail spending has improved, household debt growth has lifted, and business and consumer sentiment measures have improved. The economy over the coming year or two is going to be positively supported by low interest rates freeing up business and household cash flow – especially for those who fund floating - increased government infrastructure spending, preparations for the Rugby World Cup, above average population growth, increasing dwelling construction following the slump recently to 1981 building levels, and improvements in some commodity prices which already have gained over 6% on average in recent months.





But there are a number of factors which will suppress the speed of New Zealand's recovery over the coming 12-18 months. They include inability of some consumers to spend from wealth because it has gone, only slow global recovery, the global shift to tighter bank lending criteria, the lagging downturn in tourism and the commercial leasing market, awareness perhaps that fiscal policy has to be tightened soon, the early-cycle rise in the NZ dollar now above average on a trade-weighted basis, and the weakness in international dairy prices and therefore the dairy payout.





It pays to remember that tourism and dairying are New Zealand's top two export earners and neither sector looks flash at the moment and in fact both are likely to get worse before getting better.

This week an emailer made this observation regarding the impact of the dairy slump.

"I don't know whether you monitor these figures or not but thought I would pass them on as I think they are interesting. They were brought to my attention by a farmer commenting on the advertised dairy farm job vacancies in the Waikato Times. Normally at this time of the year there is a page or more of these adverts in the Waikato Times on Wednesday or Saturday. I have just the Sat numbers but they are quite telling especially as this is for the whole of the Waikato.

Saturday 11th July - 11 dairy farm vacancies. Saturday 18th July - 5 dairy vacancies.
There were no other agri sector vacancies."

This comment highlights the fact that the labour market remains weak and this is going to continue through into next year. What it implies for the unemployment rate however is in all honesty anyone's guess. That is because the weak state of the labour market is likely to discourage a lot of people from actively seeking work. That means they will drop out of the labour force, the still unusually high participation rate will decline, and therefore the extent of the rise in the unemployment rate will be suppressed.

Decreasing employment is a key reason why retailers should remain cautious in their growth expectations – especially those in dairy regions where falls in spending will occur. While it is true that our couches and cars are wearing out it does not seem likely that we will see an upturn in the retailing durables cycle until some point perhaps toward the middle of next year when there is likely to be assistance from increasing dwelling construction. That will benefit hardware, furniture and appliances not to mention work toward reversing the labour market deterioration.

Discretionary spending is more likely to benefit once consumers do decide prospects look secure enough to start spending a bit more. Picking where spending on electrical goods such as televisions will go is difficult. The discounts on products over the past year have been quite large and are continuing. One suspects there will be some strong competition for retailers of such goods over the coming year from good recently purchased appliances being placed on Trademe by previously overly optimistic and now indebted folk losing their jobs.

NZ ECONOMIC DEVELOPMENTS

Covered elsewhere in the WO.

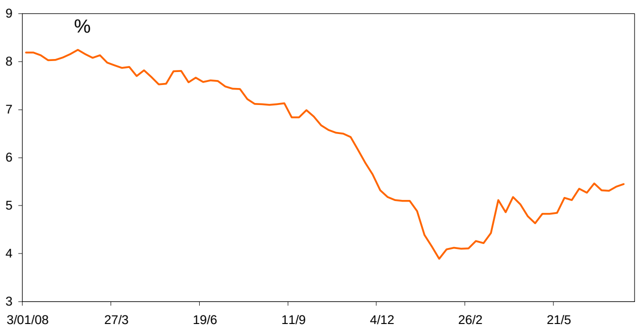
INTEREST RATES

Wholesale interest rates have crept higher this week due to a lowering of global risk aversion associated with strong rises in sharemarkets. The fall in risk aversion has been caused by more positive economic data, some better than expected quarterly profit reports in the United States, and signs of progress in managing the crisis affecting US banks. The rise in borrowing costs comes about because

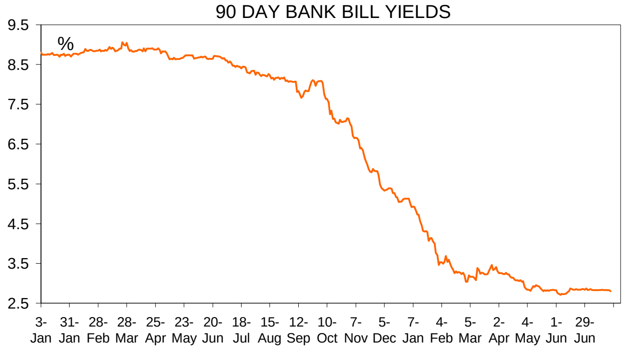
-investors look to sell fixed interest assets and buy growth ones such as shares and commodities when they anticipate better economic times,
-borrowers and investors increase their expectations of monetary policies being tightened, and
-expectations rise of higher business and consumer credit demand.

As a result, the two year swap rate this week has risen to its highest level since April 8 at 3.99% while the five year rate has climbed to 5.45% from 5.4% last week. The moves are not large and we were close to these levels back at the end of June. Therefore they are probably not yet large enough to spark a new round of increases in fixed lending rates – though we expect slow increases as the year advances.

FIVE YEAR SWAP RATE



90 DAY BANK BILL YIELDS



Key Forecasts

- No more monetary policy easing 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	2.80%	2.83	2.84	3.08	8.43	6.5
10 year govt. bond	5.79%	5.70	6.04	5.10	6.19	6.2
1 year swap	3.13%	3.13	3.10	3.13	7.99	6.7
5 year swap	5.45%	5.40	5.46	4.78	7.43	7.0

If I Were a Borrower What Would I Do?

The bulk of people borrowing at the moment are going short – basically that means fixing two years or less. Those opting for floating are overwhelmingly getting the 5.99% Total Money rate rather than the old standard variable at 6.49%. At 5.99% one is getting a rate around 2.5% below the average over the past five years and this presents borrowers with a wonderful opportunity to work away at getting their principal down – or simply to save the house if cash flow is a major problem at the moment.

Personally speaking, while I would find the 5.99% floating rate quite attractive I would still be prepared to pay a premium for some certainty in this still very uncertain environment. So I would still fix three years. One suspects the well capitalised long running investors whom we believe are taking properties off the hands of the inexperienced ones now are likely to show a greater preference for a longer fixed rate given that their focus is on long term yield rather than holding to flick for a quick capital gain.

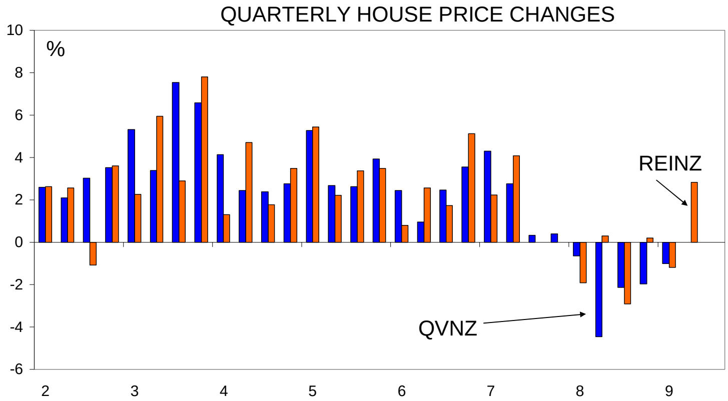
HOUSING MARKET UPDATE

Are House Prices Rising?

The definitive guide to changes in house prices in New Zealand is put out by Quotable Value New Zealand each quarter. The numbers appear with over a three month lag so are of no use in gauging the current state of the housing market. But they tell us where things have been not too long ago and are the only series one should use for long run analysis.

In the March quarter average house prices around the country fell by 1%. This decline was the smallest in four quarters and compared with a drop of 2% in the December quarter, 2.1% in the September quarter, and 4.5% a year ago. The rate of average house price decline in New Zealand has slowed quite sharply – and this slowing in the March quarter occurred before the housing market recorded its solid jump up in sales – or at least the March quarter number only captures the first surge which happened in March.

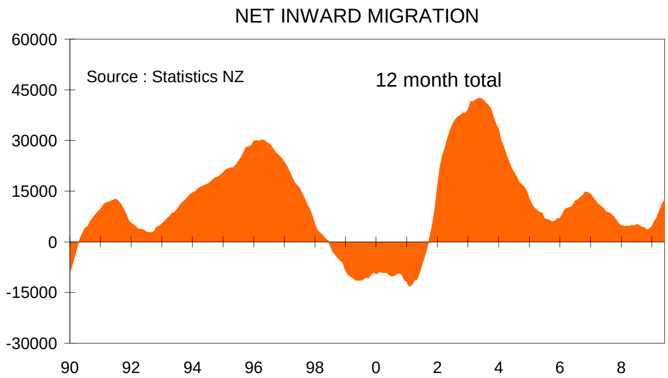
Over the March quarter the REINZ median house price sales number fell 1.2% so it produced a result practically the same as the QVNZ 1% decline. But the December quarter REINZ change was +0.2% versus -2% for QVNZ. That means there are times when the two measures can diverge quite a bit. But the graph below shows these occasions are relatively rare and with no tendency for one measure to exceed the other in terms of quarterly movement.



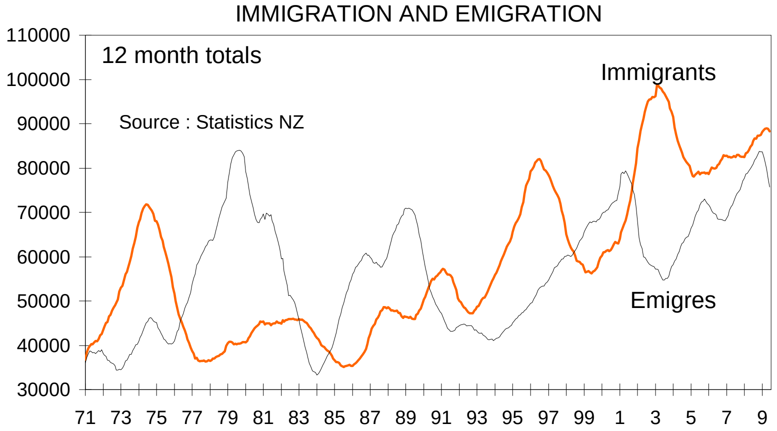
On that basis, if you had to lay money down you would say the 2.8% rise in the REINZ measure during the June quarter is probably associated with a rise in the QVNZ measure. In other words, yes Victoria, house prices do appear to have risen again.

Population Growth Increases Again

The monthly numbers from Statistics New Zealand show that in June there was a net addition to our population from permanent and long term migration flows of 730 people. A year ago the net flow was a loss of 583 therefore the annual net gain has now climbed to 12,500 from 11,202 in May. It was 4,735 a year ago and 3,569 at its low point in November.



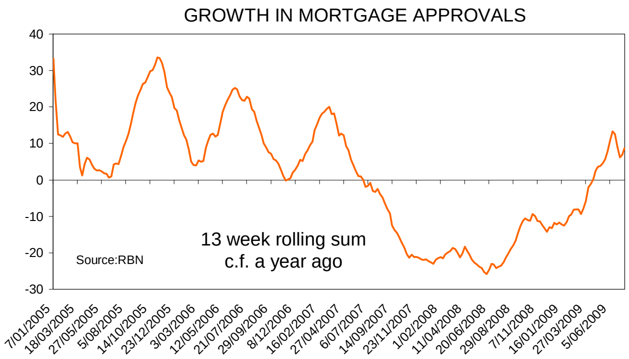
The gain in flows is coming about at this stage not because people are flooding to our shores but because fewer people are leaving. In June the number of immigrants was down 9.7% from a year ago and down 3.4% in the June quarter compared with last year. The number of emigrants was down 27.8% from a year ago in June and down 26.6% in the June quarter from a year earlier.

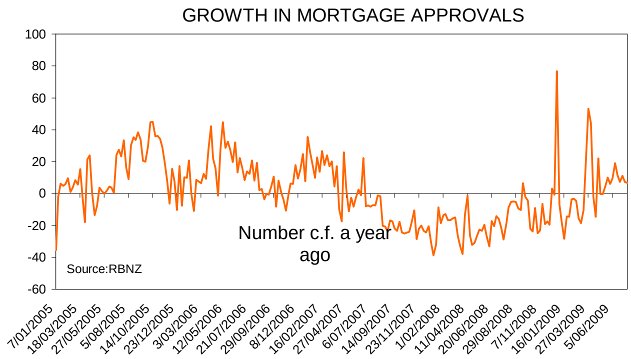


Looking at the seasonally adjusted numbers it seems that annualised flows are running at between 20,000 and 25,000 and that seems a reasonable expectation for what we will end up with in calendar 2009. This will be double the annual average gain over the past decade of just over 11,000 people and therefore will place increased pressure on the available housing stock at a time when additions to that stock are increasing at their slowest pace since 1981. And as we have been pointing out for many many months now, that basic relationship gives simple insight into house price pressures, what will happen (and now has happened) with sales, and what looks like it is just starting to happen with construction – moving upward again.

Mortgage Approvals Not Racing Away

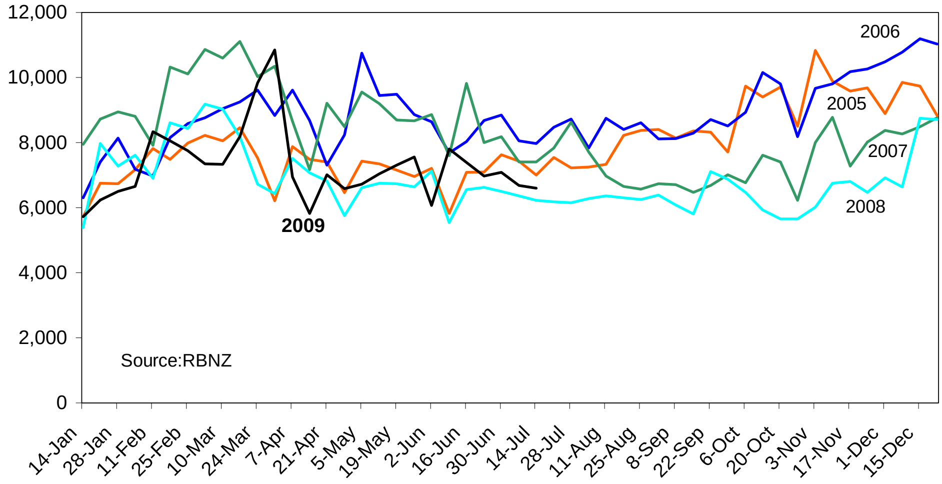
As a good reminder that the housing market has bottomed but has not commenced a decent upward leg of the cycle we have the weekly home loan approvals data put together by the Reserve Bank. The number of approvals in the week ending July 19 was ahead 6.7% from a year ago and over the past 13 weeks approvals have been running 8.7% ahead of a year earlier.





The graph below probably shows things best of all if you study it. The solid black line for 2009 is running above the teal 2008 line but not aggressively so. Note that it is normal at this time of year for approvals to back off as Winter suppresses the housing market.

WEEKLY HOME LOAN APPROVALS



Key Forecasts

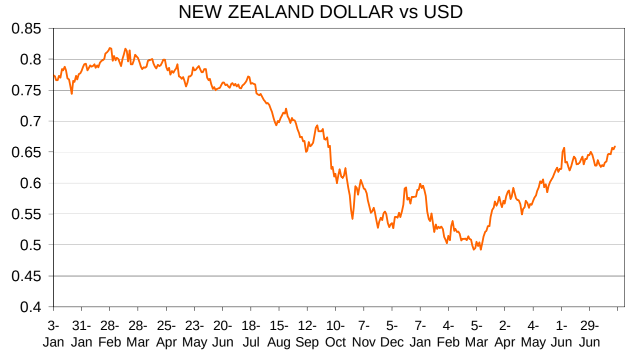
- Dwelling consent numbers to recover now with potentially good activity from late-2010..
- Real estate sales continuing to increase but the rise limited by listings shortages.
- House prices edging higher.

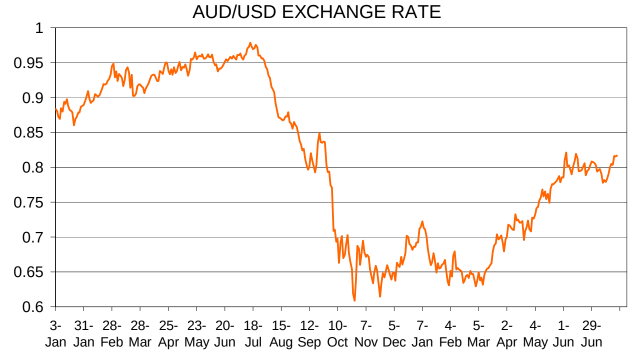
Exchange Rates & Foreign Economies

EXCHANGE RATES	This week	Week ago	4 wks ago	3 months ago	Yr ago	Consensus* Frcst Yr Ago	10 yr average
NZD/USD	0.659	0.646	0.63	0.558	0.759	0.693	.592
NZD/AUD	0.807	0.808	0.799	0.788	0.781	0.793	.856
NZD/JPY	61.6	60.9	60.4	54.7	81.4	73.3	66.8
NZD/GBP	0.40	0.394	0.385	0.384	0.381	0.371	.345
NZD/EUR	0.463	0.46	0.456	0.428	0.481	0.48	.51
USD/JPY	93.4	94.3	95.9	98.0	107.2	105.8	113.9
USD/GBP	1.648	1.639	1.636	1.45	1.99	1.867	1.709
USD/EUR	1.42	1.40	1.38	1.30	1.58	1.443	1.156
AUD/USD	0.817	0.799	0.788	0.708	0.972	0.874	0.69

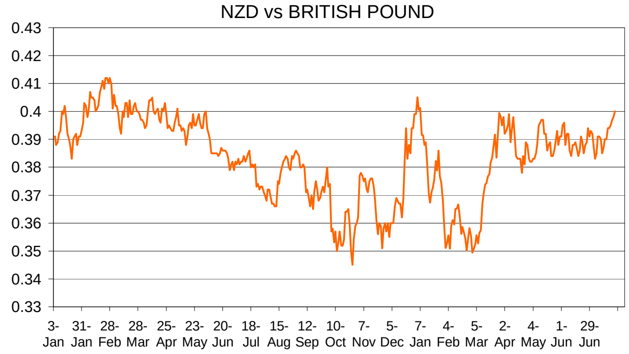
NZD Near Nine Month High

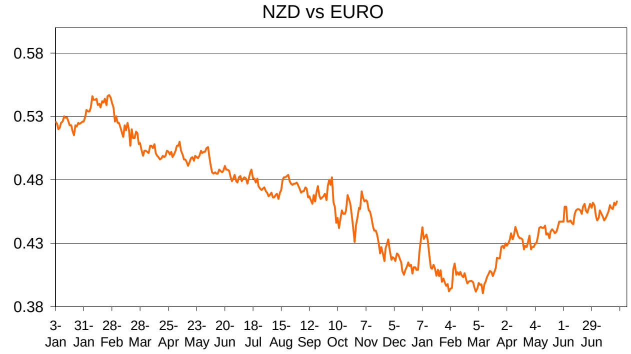
With the world bouncing back from a bout of the heebie jeebies we have seen money going into shares, away from fixed interest securities, and into risky currencies. That means the NZ dollar has risen over the week to end this afternoon near US 65.9 cents from 64.6 cents a week ago and 62.6 cents two weeks ago. As we noted last week, if the NZD was going to stage a decent pullback from high levels against the greenback then it probably would have done so by now, and the fall to trade briefly below 62 cents a couple of weeks ago may have been as good as it gets for quite some time for exporters receiving in USDs.



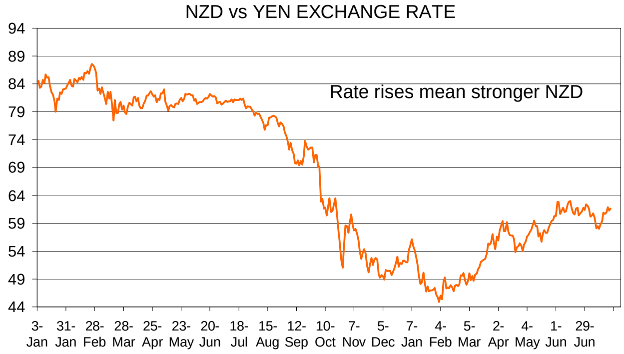


For those receiving in some other currencies the situation is not quite so bad. In particular, against the Aussie dollar the NZD is still low by historical standards near 80.7 cents from 80.8 last week. The AUD has also had a strong week on the back of investors seeking riskier assets and it has ended near US 81.7 cents from 80 cents last week. This is the highest rate since June and before then October. The NZD is also at its highest level against the greenback since October last year if one does not count a very quick blip above 66 cents a few weeks ago.



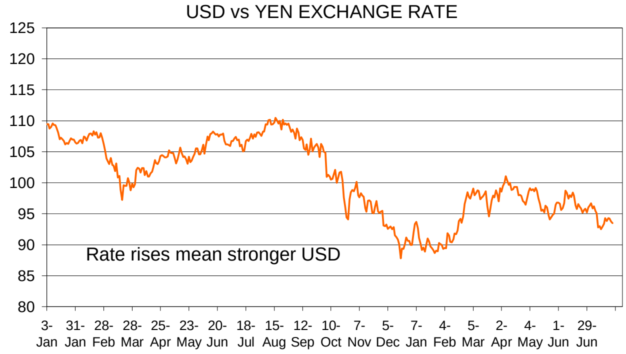


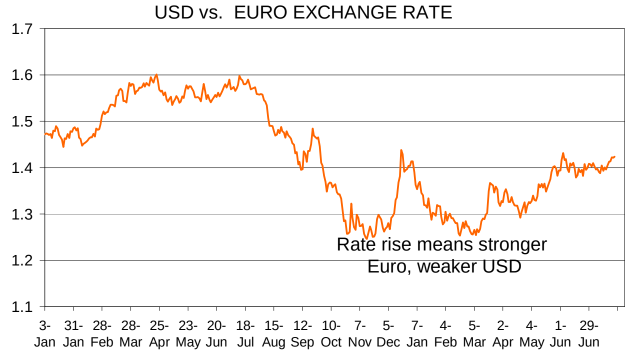
Against the British pound the NZD is now at a seven month high of 40 pence from 39.4 last week with the pound being kept quite weak by extreme worries about the British economy and its banks. Against the Euro we have moved to about an eight month high of 46.3 centimes from 46 last week while against the Japanese Yen we are near 61.6 from 60.9 last week with slightly higher levels seen during much of June.

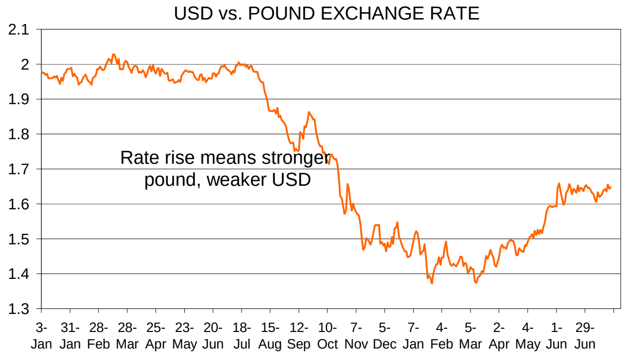


We think the bulk of the NZD's rise this year has now happened but the risk is we drift slowly higher from here. The next big move will probably not come until world commentary shifts from accepting the worst is over to thinking about strong global growth. That sort of talk seems unlikely before next year given the continuing appalling economic circumstances of some countries such as the UK and throughout Europe.

With regard to the greenback, the week has largely been one of weakness as investors have found themselves less scared and so less in need of holdings of the current safe-haven currency. Against the Japanese Yen the greenback has eased to near 93.5 from 94.3, against the Euro to $1.42 to buy one Euro from $1.40 last week, and $1.65 to buy one Pound from $1.64 last week.

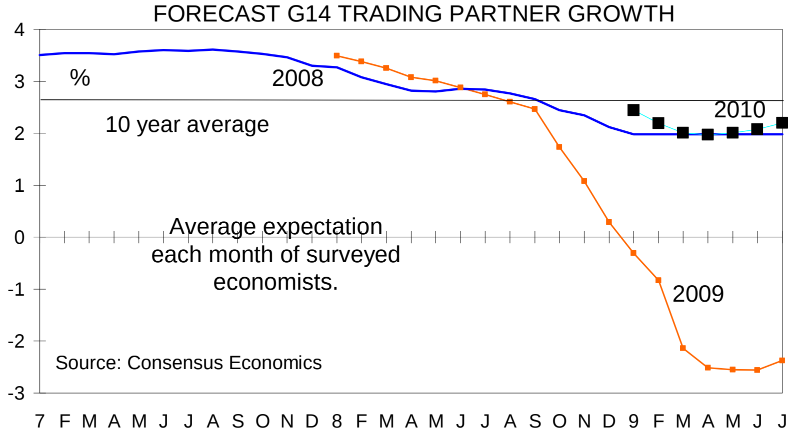




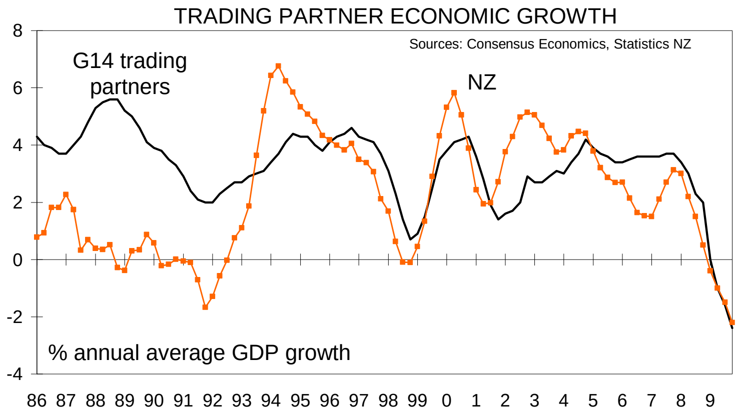


Trading Partner Growth Outlook Improving

For the first time in the seventeen months Consensus Economics have been asking economists around the world for their forecasts of 2009 growth, the average pick of relevance to New Zealand (our top 14 export destinations) has improved. The July survey showed that shrinkage this year of 2.4% is expected whereas a month ago the expectation was 2.6%. In January 2008 growth for 2009 was picked at a healthy 3.5% and a year ago the pick was 2.7%. The situation therefore is still appallingly bad but it is starting to get a little bit better.

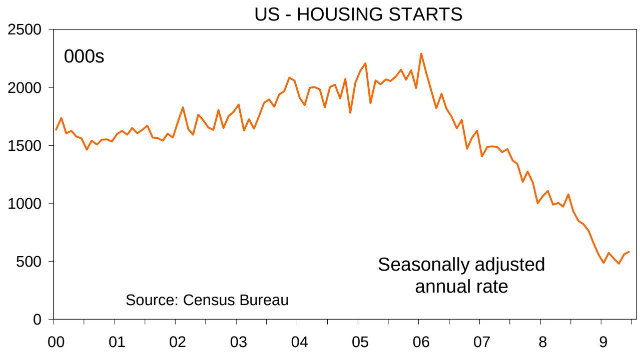


In fact, for the third month in a row the consensus pick for 2010 growth has improved. On average our top 14 export destinations are expected to grow 2.2% next year whereas a month ago this expectation was 2.1% and four months ago 2%. This growth will still be below the average of 3.1% achieved over the past decade and therefore provides no basis for great optimism on the part of NZ exporters. But at least things are moving in the right direction.



Next month we are likely to see the 2010 growth expectations around the world improve a little bit more in light of some of the positive data released in the past few days. For instance, importantly in the United States some positive housing numbers have appeared.

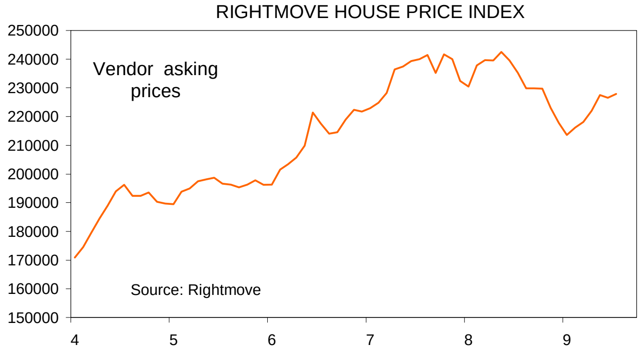
The annualised number of housing starts rose to a stronger than expected seasonally adjusted 582,000 in June. This was the strongest result since November last year though was still down 46% from a year ago when the Lehman's collapse had yet to happen. The data have been interpreted as meaning the housing construction sector has now passed its low point.



The big question, as is the case for other indicators showing the same pattern, is how firm the improvement will be. At this stage there appears little reason for believing the upturn in housing will be strong when one factors in the still large stockpiles of unsold houses, rising unemployment (at a decreasing rate it seems), shortage of bank credit, and reluctance of householders to borrow.

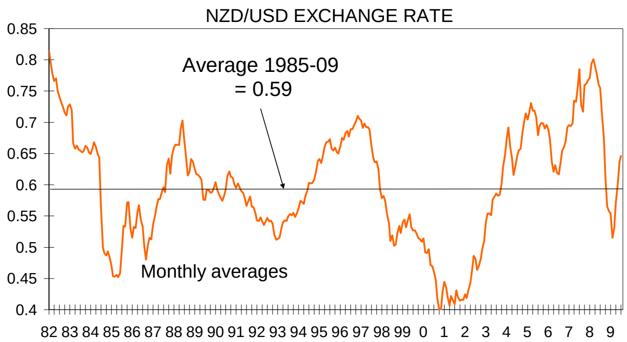
One house price measure we have not looked at before actually rose 0.9% in May. The Federal Housing Finance Agency measure of average prices of houses financed by Fannie Mae was down 5.6% from a year ago but ahead in the month whereas the reporting of a small decline had been expected.
http://www.bloomberg.com/apps/news?pid=20601068&sid=aJQTpVkEucpQ

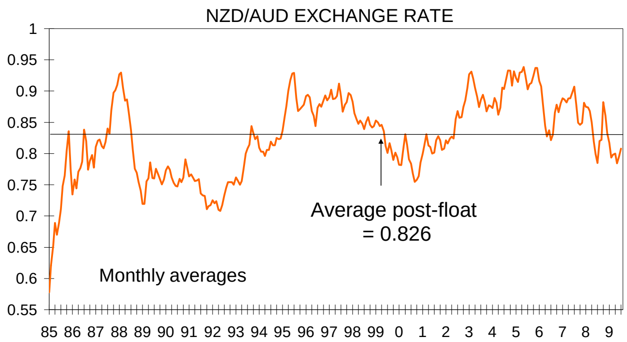
And, just as there are indications of the housing market improving in the US, there are also signs of things stabilising in the UK. Mortgage approvals appear to be slowly increasing with expectations growing that banks will ease their lending criteria within the next few months. In addition the monthly Rightmove asking house price average rose 0.6% in July after easing 0.4% in June and now sits at its highest level since October last year.

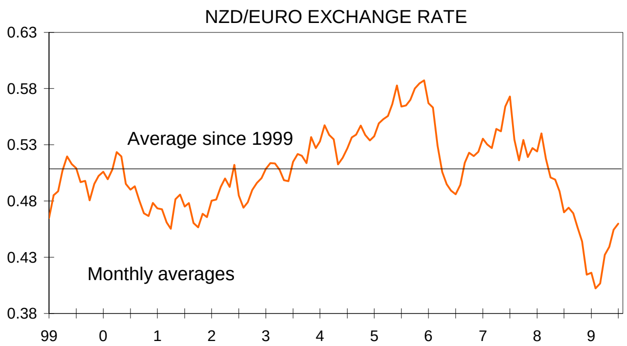


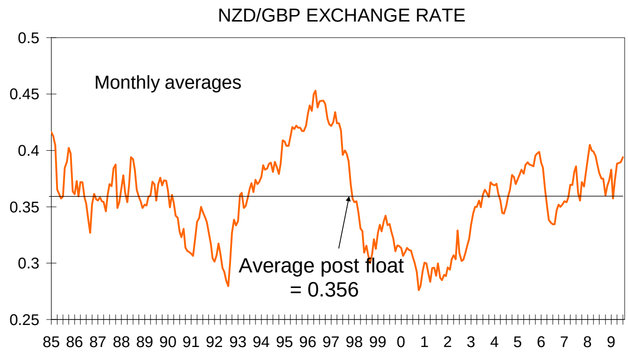
If I Were An FX Receiver What Would I Do?

I would remain inclined to build hedging against the AUD, JPY, and Euro, take advantage of pullbacks to boost USD hedging, and run average to below average hedging against the Pound.









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

ECONOMIC DATA

All %		Latest qtr only	Previous qtr only	Latest year	Year ago	2 Yrs ago
Inflation	RBNZ target is 1% - 3% on average	0.6%	0.3	1.9	4.0	2.0
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	+12,515	7,482yr	......	4,735	10,080
Tourism – an. av grth	10 year average growth = 5.0%. Stats NZ	-2.8	-3.9	-2.8	0.9	3.4
		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	(Total Money) 10 year average = 7.6%*	5.99	5.99	7.75	10.49	9.49
3 yr fixed hsg rate	10 year average = 7.9%	6.99	6.99	6.99	9.09	9.00

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.

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*extrapolated back in time as Total Money started in 2007