

BNZ Weekly Overview

3 June 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.

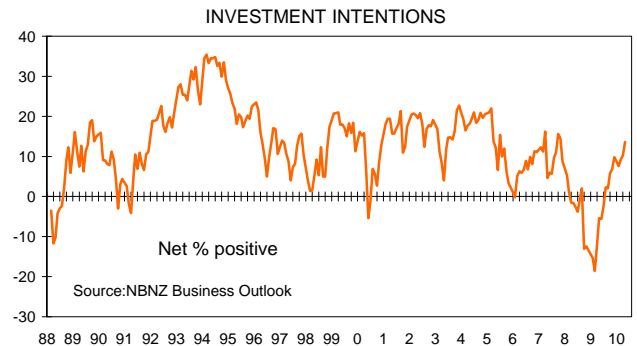
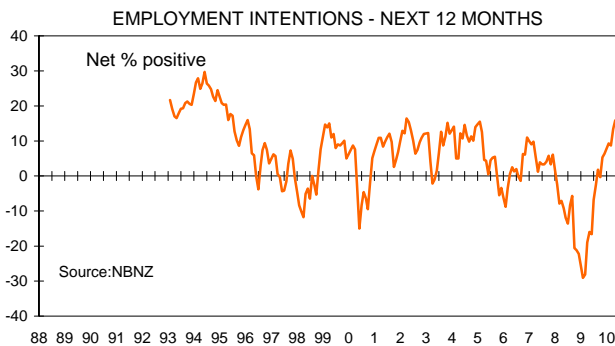
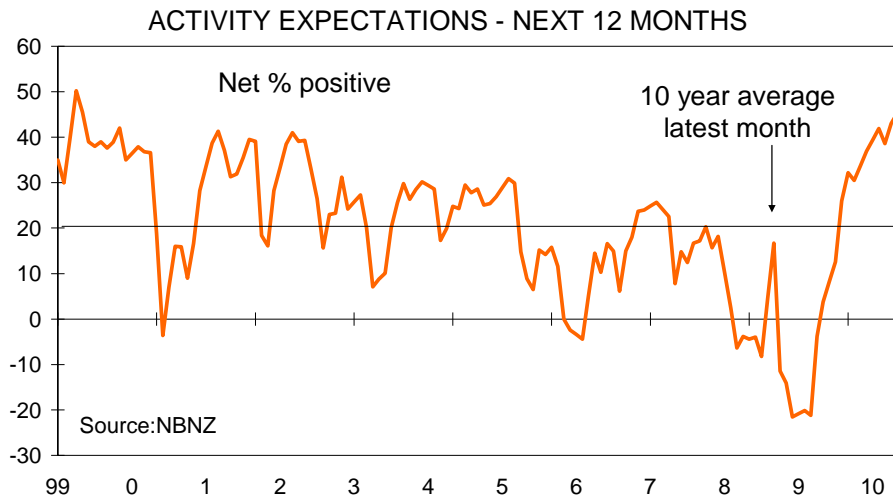
Strong Business Sentiment

Normally we would run our monthly survey in this first Thursday of the month. But as I am still offshore – this time in Hong Kong – we shall save that until next week when at which point we will be able fortuitously to get reaction to the official cash rate going up if our forecast of a rise is correct. Of course that may not happen if war breaks out on the Korean Peninsula, if the recent Middle East events boil over into a new local war, if the Euro collapses along with sharemarkets, or if the RBNZ simply feels it has time on its hands and can wait.

We don't believe they do because it is really only by assuming one or other of these truly nasty things happens that one can justify holding off in the face of the recent string of good data releases. Fonterra have indicated a record dairy payout is possible this season. Residential dwelling consents recovered reasonably well in April. Good data keep coming out of the United States. Export commodity prices on average keep rising. The Budget was slightly stimulatory and the housing tax changes less bad than many feared. We also learnt this week that businesses are feeling very happy and plan acting on their happiness by hiring people (believable) and investing (we'll see). To whit....

The long running NBNZ Business Outlook survey showed that early in May a net 45% of business respondents expected their levels of activity to improve over the coming year. This result was up from 43% in April and in fact the highest such measure since 1999. The outcome is consistent with growth in the economy of around 4% which is better than our current forecast of around 3.5% growth in the coming year and implies some upside risk which one can offset against the downside risks stemming from the events in Europe, whatever happens around Korea, and Chinese growth risks related to over-heating controls.

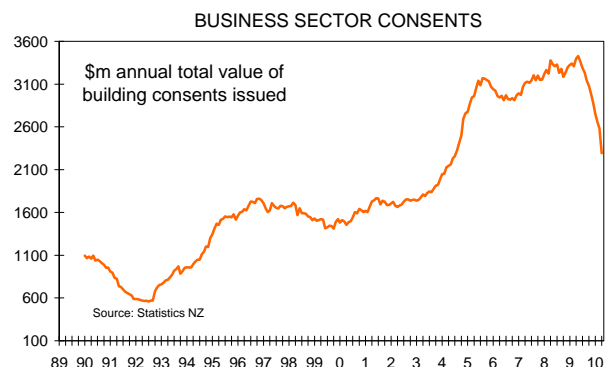
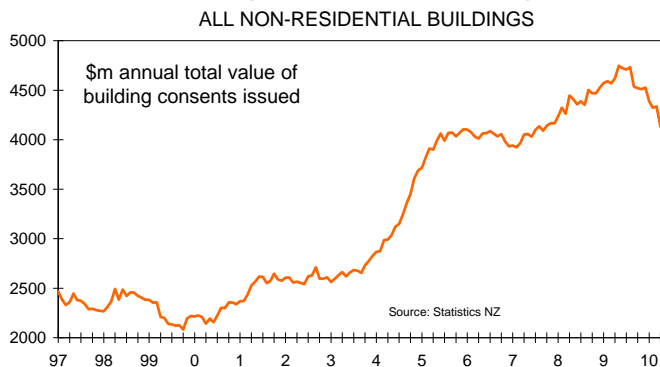
The positive import of the business sentiment result is neatly reinforced by the all-important intentions measures. A net 16% of respondents expect to hire more people over the coming year. This was up from 13% in April and the strongest result since early 2002. As such it gels well with the strong labour force survey released for the March quarter and our own long-running warning that the labour market risks tightening up faster than people have generally been thinking. This sort of thing is good for our expectations of stronger house construction and eventually retail spending – though developments there of course depend substantially on what is happening with debt tolerance. That is a true wild card for our economy and others.



Also of positive tone was the net 14% of businesses saying they expect to lift their investment in plant, machinery and equipment. Our contacts show this lift in capital spending has yet to kick off but it will come eventually, perhaps when firms start running up against labour market barriers over 2011.

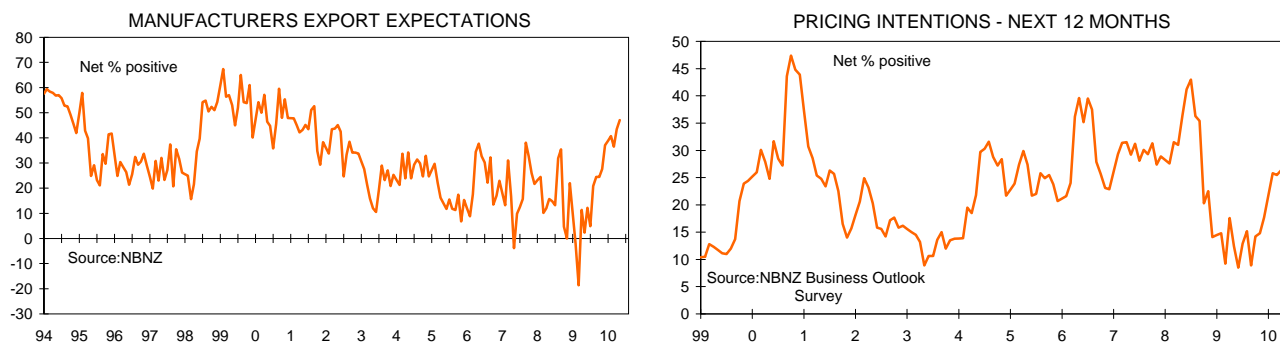
But while PME investment is set to rise soon the prospects for non-residential construction remain less stellar with a net 13% of businesses only saying they plan higher construction. This is however above the -6% ten year average for May which is kind of interesting as our feedback from the sector suggests a much weaker net percentage response would be more realistic. Worth keeping an eye on for sure but we will be very surprised if non-residential construction outside of infrastructure shows any decent strength until late-2011.

In fact, the recently released building consent numbers show that in April the value of non-residential consents issued was down 38% from a year ago. For the three months to April the decline was 20% on a year ago. But if we strip out as best we can the categories largely related to government we get "business" consents down a huge 63% from a year ago.



One point worth noting is that the NBNZ survey was undertaken before the May 14 Budget which was less bad than expected for housing, came before the breaking of the drought, and before Fonterra hinted at an \$8 payout next year. It was also done before the recent fall in the NZD against the greenback.

In line with the good noises we have been making for some time about the manufacturing sector a net 47% of manufacturers expect their exports to rise. This was up from 43% in April and the best result since 2001. The average reading for this measure is 24% and the result reflects the below average level of the NZD against the AUD (we believe) along with the fast growth in Australia's economy which takes about half of our manufactured exports.



All up the survey results show it remains very reasonable to expect our economy will record at least 3% growth over the coming year, that jobs growth will be firm with the unemployment rate falling further (though it always wobbles around given that it is a residual calculation), that business investment will pick up along with house construction, and that manufacturing centres will possibly outperform. In the rural sector the activity measure for farmers of a net 22% positive was only just above the 19% average versus the overall 45% reading for all sectors being above the 18% average. But once the Fonterra, exchange rate and weather results get accounted for we see scope for a better rural performance in the coming 18 months than we had been thinking.

There are of course monetary policy implications from the survey – most notably that the results give the green light to the RB to start taking away the unnecessary 2.5% cash rate from next Thursday morning. The net percent of firms planning to raise prices lifted to 28% from 26% in April, inflation expectations edged up to 2.69% from 2.67%, and capacity expectations rose to an eight year high of a net 27% from 25% in April.

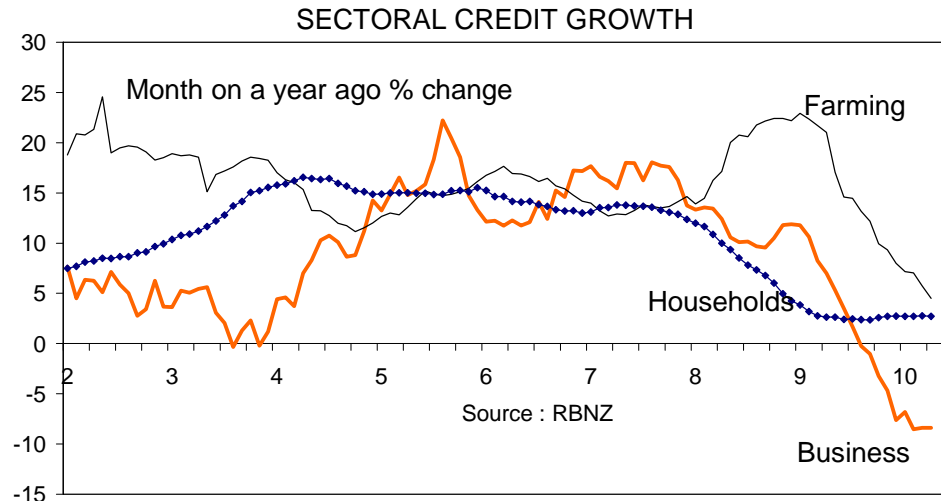
Debt Growth Still Subdued Or Negative

We noted above the continuing uncertainty with regard to how much savings – or in the NZ household case dissavings – behaviour has changed. There has been a strong focus by businesses and households on getting debt levels down and the longer this continues the more robust the economy will be for sure, which is a very good thing, but the more delayed will be the recovery in retail spending and business capital spending in particular.

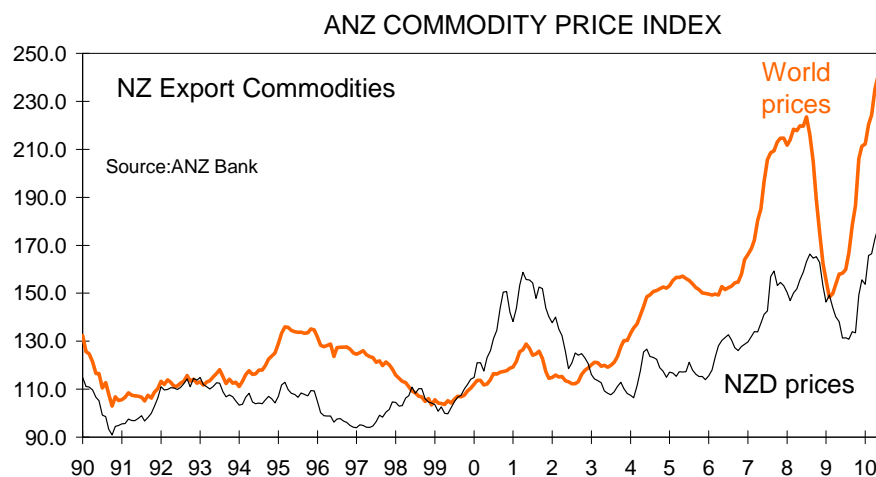
Reserve Bank data released last week show that in April the volume of business debt was down 8.4% from a year ago and that in the three months to April business debt fell \$2.5bn whereas a year ago over the same period it declined \$1.3bn, two years ago it rose \$2.0bn, and three years ago it rose \$2.3bn. There is as yet no sign that businesses are pulling back from getting debt levels down. The same goes for households.

In seasonally adjusted terms household debt grew just 0.2% in April from 0.2% growth in March and 0.1% in February. Annual growth was 2.7% and that is where it has been stuck for a year now – again with no sign of any change.

Down on the farm debt in April was 4.5% ahead of a year earlier and at \$47.1bn at the end of the month the total was largely where it was near the start of September last year.



We expect that at some stage credit demand will pick up. We just don't know when. Strangely enough given the existing high debt levels,, when it does the growth may come from the rural sector as export commodity prices continue to rise strongly – up on average by 2.5% in May to lie 53% ahead of a year ago. In NZD terms the gain was 2.9% in the month and 29% for the year.

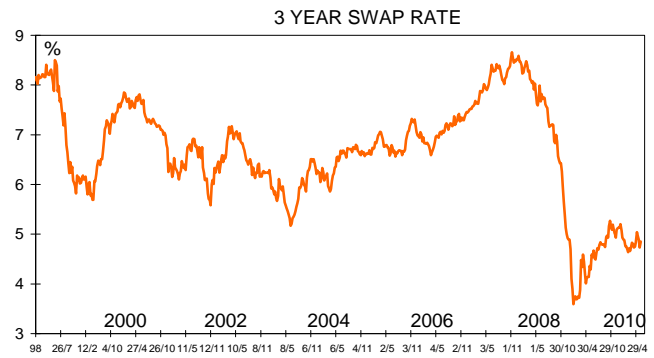
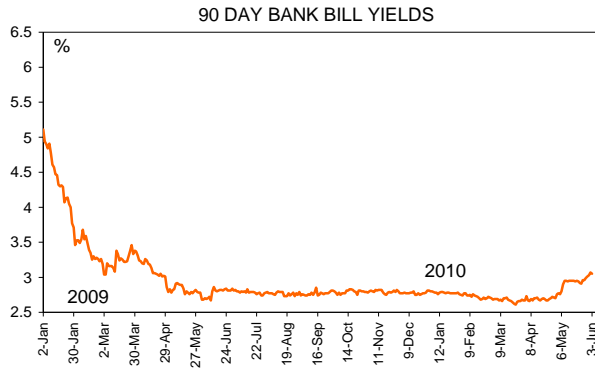


INTEREST RATES

Wholesale interest rates have moved back up this week with the rapid approach of the June 10 official cash rate review where a rise is increasingly expected in the markets due to some of the recent data coming in quite strong. In addition, with sharemarkets rallying overnight some of the Europe-related concerns have eased back a tad – as they have done temporarily many times in the past couple of months. Yields on 90-day bank bills are near 3.05% from 2.99% last week and the three year swap rate is near 4.85% from 4.73%.

We see a strong chance (though not 100%) that the RB raise the official cash rate 0.25% next week to 2.75% and signal further rises in response to growth in the economy actually looking a tad stronger than they assumed. But they will note the troubles in Europe and how they are worth keeping a very close eye on, and the restraining effect on credit conditions of the recent mild tightening up again of funding for banks offshore.

BNZ WEEKLY OVERVIEW



Key Forecasts

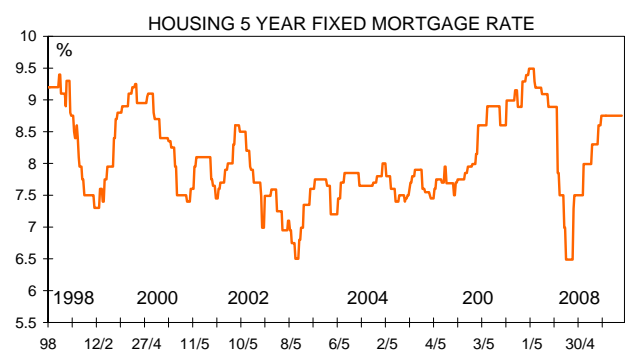
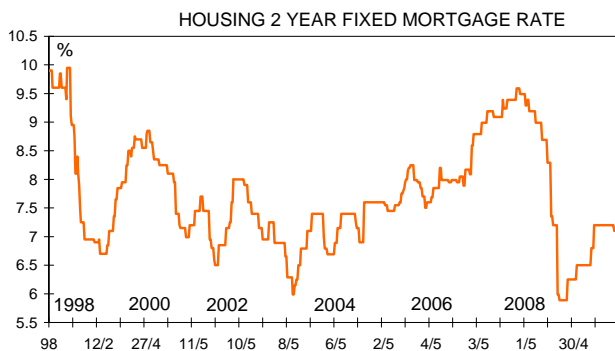
- Tightening mid-2010.
- Medium to long term housing rates to rise again in a few months.

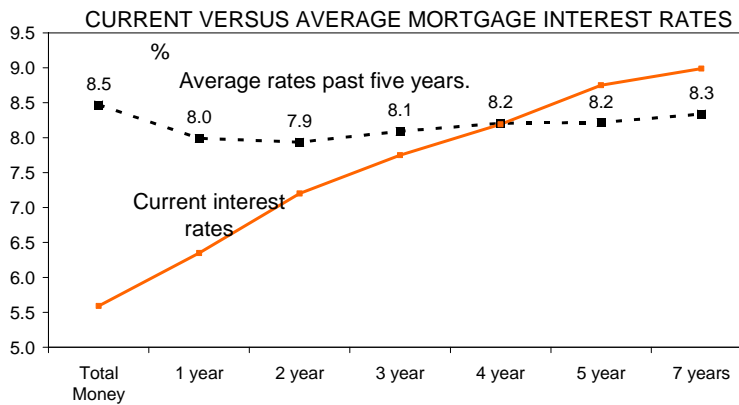
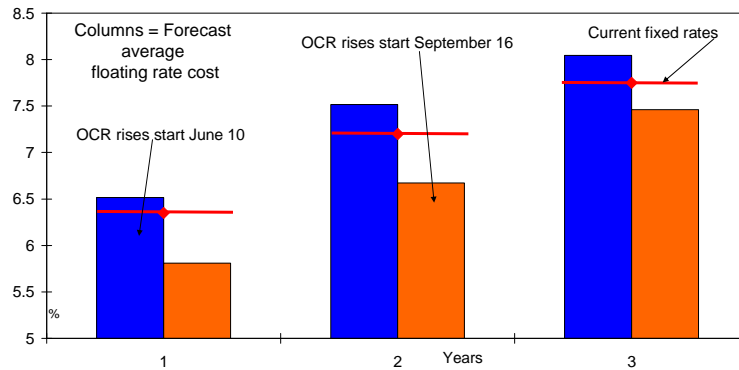
FINANCIAL MARKETS DATA

	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	2.50	6.2
90-day bank bill	3.05%	2.95	2.76	2.69	2.69	6.5
1 year swap	3.78%	3.64	3.79	3.41	2.94	6.7
5 year swap	5.31%	5.25	5.44	5.17	5.12	7.0
180-day term depo	4.80%	4.80	4.70	4.88	3.15	6.0
Five year term depo	6.75%	6.75	6.75	6.75	6.00	6.5

If I Were a Borrower What Would I Do?

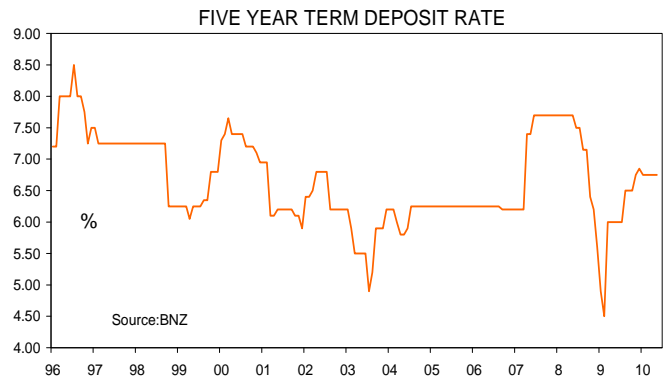
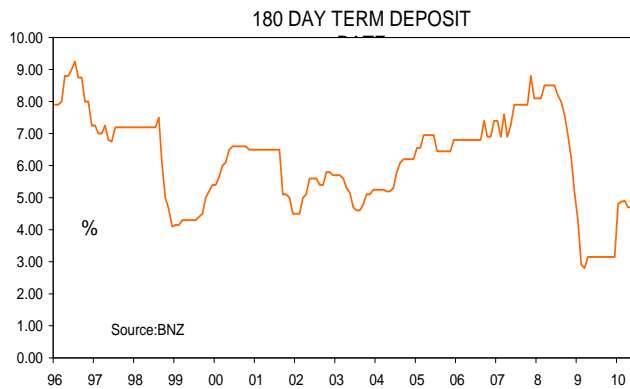
Still toss a coin between floating the next three, two or one years of fixing. I like certainty however so if pressed would probably fix two years knowing nothing I can do will stop me being hit at some stage by high floating and later slightly higher fixed rates.





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

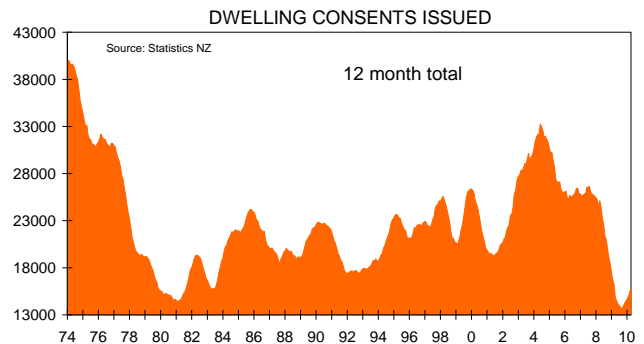
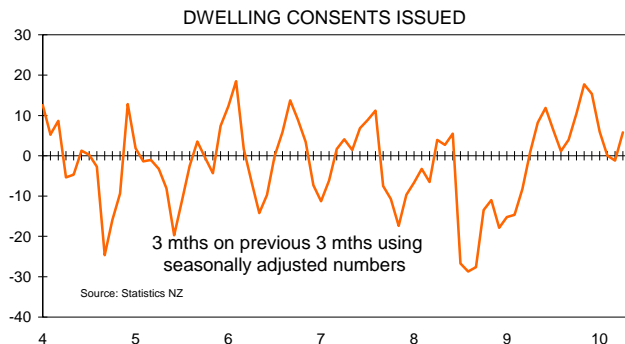
I'll be investing short and riding those rates up hoping to be able to spot the peak in the long rates even though the rises in those long rates will be much less of course than for the short rates. One factor to take into account however is the rising need for banks to both raise funds domestically and raise longer term funds. I expect their efforts will deliver me some reasonably good term deposit rates further down the track, on top of the fact that such changes currently account for rates being near 2% higher than one would expect with the official cash rate at 2.5%.



HOUSING MARKET UPDATE

Construction Recovering

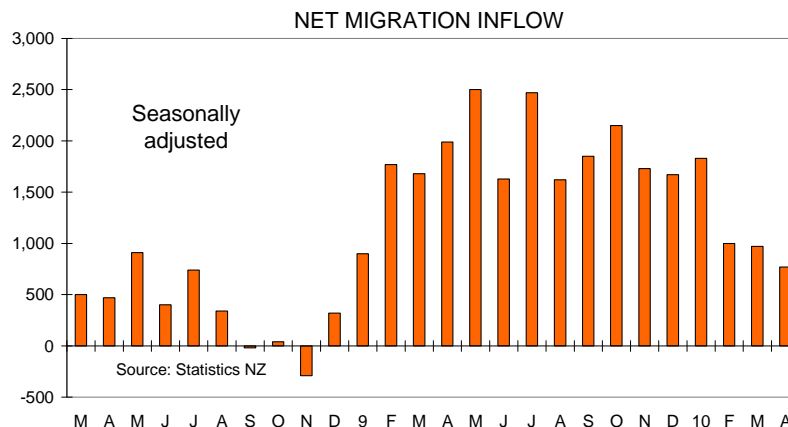
In April there was a seasonally adjusted rise in the number of residential building consents issued around the country of 8.5%. This followed a flat result in March and 6.1% gain in February meaning that over the past three months consents have risen 5.8% over the previous three months. Therefore, as our anecdotal feedback has been revealing, there is an upturn in residential construction in place and this is going to have a good multiplier effect through the economy as people get hired to build the houses, make and distribute the materials, plus make and distribute furnishings.



But at just below 16,000 the annual number of consents remains below the 23,000 estimated as needed to meet long term average population growth and we remain of the view that it will be some time before construction gets back to average levels due to constraints of finance, eventually tradespeople, and fewer investors willing to build. Diversion of activity toward fixing leaky homes will also be an issue, though the sharp decline in non-residential construction will probably easily offset that factor.

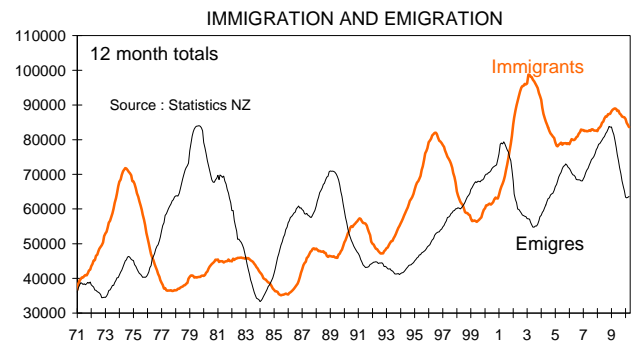
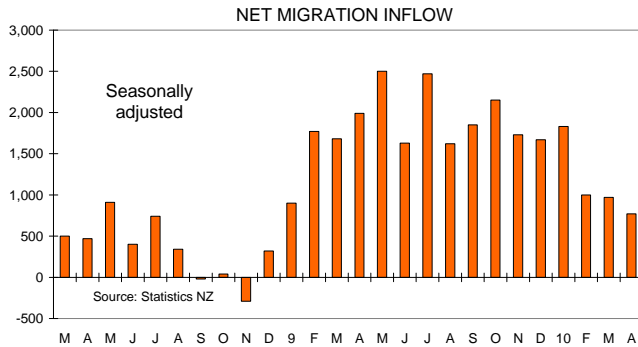
So things are tracking still as we have been expecting and that means that while for the next few months there may be some real estate market disturbance associated with mild reactions to the Budget (really mild going by the absence of much angst reported in the media), come 2001 average houses prices are likely to be creeping back up.

And we do mean creeping. There will be offsets to the supply effect from rising interest rates plus the net migration inflow falling below average possibly before the end of this year. Speaking of migration, data released about a fortnight ago (too busy at the time to report on it) showed that in April there was a seasonally adjusted net long term migration gain for NZ of 770 people. This was down from 970 in March, a peak of 2,150 last October, and the lowest result since December 2008.



The annual net migration gain now stands at 19,954 from 20,973 in March, a peak of 22,588 in January, and ten year average of 13,600 which in annualised terms we are now running below near 10,000. The turnaround is seen in the number of people leaving over the past three months rising 1.4% whereas six

months ago the change was -31% on a year ago. The number arriving was down 10.7% versus 7.5% six months ago.

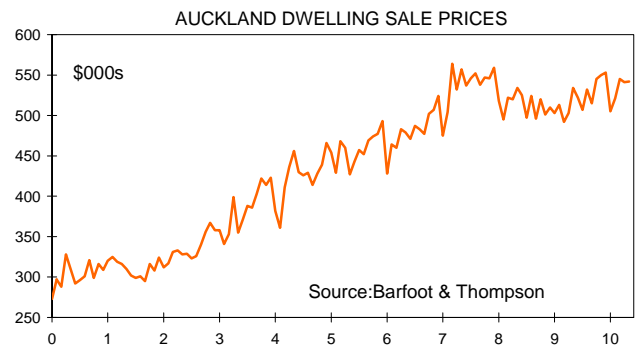
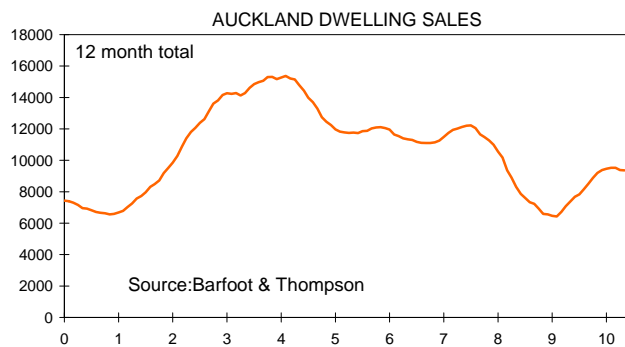


What is changing then is the thing we have spoken about in the past. People who put off leaving because of all the bad stuff swirling around the planet are now putting their old plans back in place and shooting through. It is hard to know where this will end and anyone in the field knows that forecasting migration flows is extremely difficult though there is a cyclical element involved. In that regard the growth in NZ we see coming ahead and the strong labour market coming will help stem the reduction. But for most of us Australia is the first port of call and things are strong there with wages in NZDs now even more attractive than before because of the below average NZD/AUD exchange rate. It adds up to downside risks for net migration inflows which will bear watching for the pressure that will be taken off house prices.

Again this just reinforces the fact than our outlook for house prices is one of mild recovery, not a period of strong rises as we have seen in the past. The exciting housing market stuff happened last year.

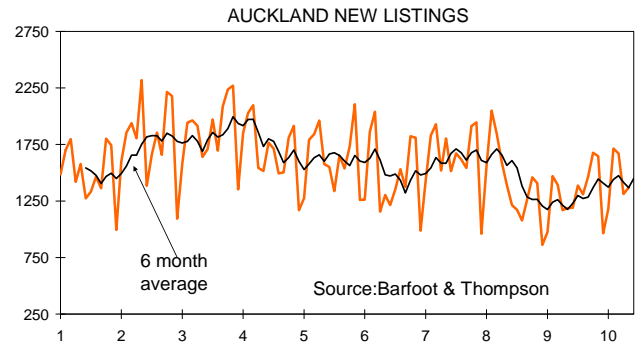
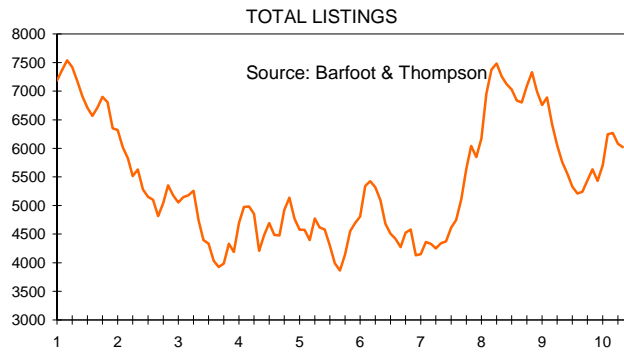
Barfoot & Thompson Data

With regard to real estate activity this week we received the monthly Auckland data from Barfoot and Thompson. They show that the average dwelling sale price for the month was essentially unchanged from April at \$542,000. There were 792 dwellings sold which was a 2.7% fall from a year ago whereas the April total was down 17% on a year earlier. In rough seasonally adjusted terms sales recorded the fourth small monthly increase in a row close to 4%. Like other statistics these ones show things holding relatively steady and because the data neatly straddle the before and after Budget period we will have to wait for June’s data to get some decent insight into the Budget’s impact – beyond our own intuition which says the impact will be minimal.



B&T had 6,023 listings on their books at the end of the month which was a small 4.6% rise from a year earlier. New listings received during the month were ahead 15.4% from a year ago with May 2009 being relatively weak. These numbers show no flood of property hitting the market.

BNZ WEEKLY OVERVIEW



All up, nothing major from the survey, just things on hold and holding up.

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

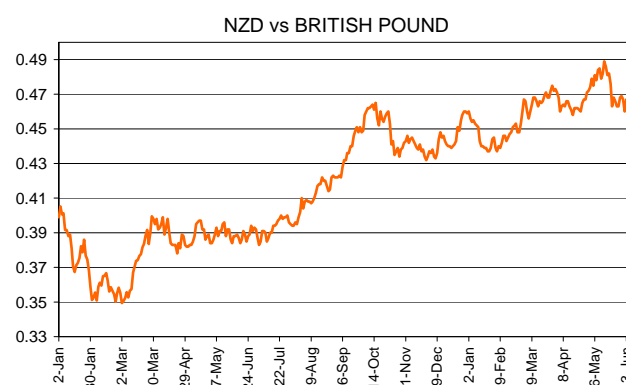
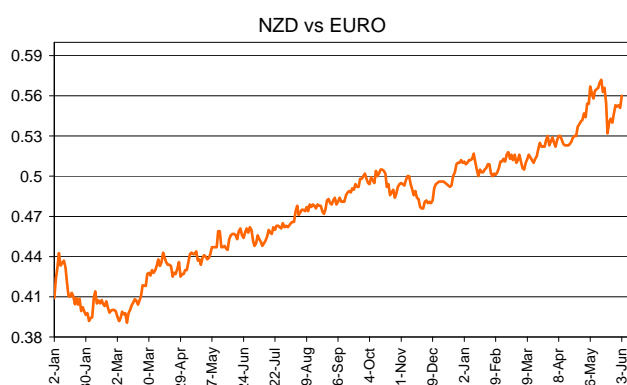
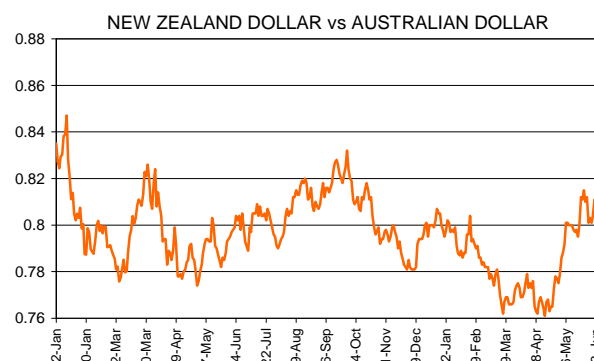
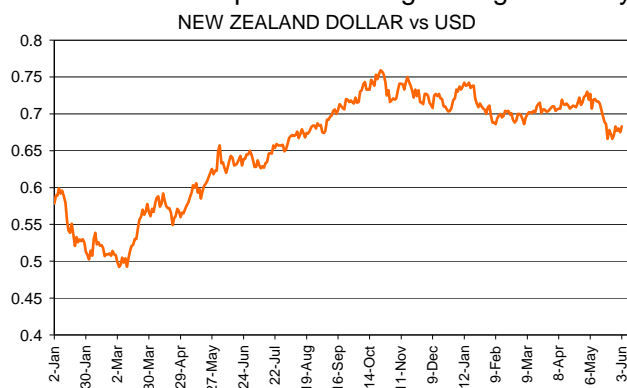
- Dwelling consent numbers to recover now with potentially good activity from late-2010.
- House prices edging higher after tax change effects wend their way through.

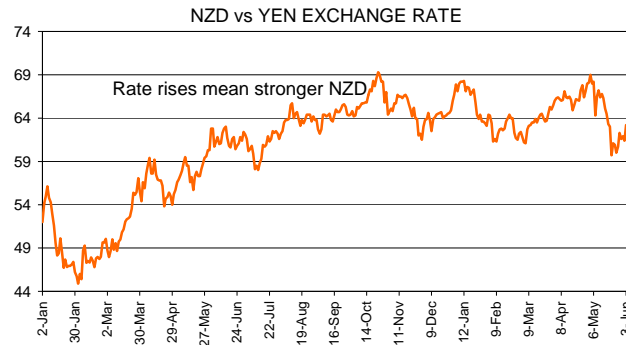
Exchange Rates & Foreign Economies

Exchange Rates	This Week	Week Ago	4 wks ago	3 mths ago	Yr ago	Consensus Frcsts yr ago*	10 yr average
NZD/USD	0.683	0.671	0.725	0.698	0.657	0.566	0.592
NZD/AUD	0.809	0.801	0.786	0.770	0.8	0.773	0.856
NZD/JPY	63.20	60.70	68.10	61.80	62.8	56.8	66.8
NZD/GBP	0.467	0.463	0.474	0.466	0.396	0.371	0.345
NZD/EUR	0.560	0.547	0.544	0.511	0.459	0.427	0.51
USD/JPY	92.53	90.46	93.93	88.53	95.58	100.5	113.9
USD/GBP	1.463	1.449	1.530	1.498	1.659	1.52	1.709
USD/EUR	1.220	1.227	1.333	1.366	1.431	1.327	1.156
AUD/USD	0.844	0.838	0.922	0.906	0.821	0.732	0.69

Kiwi Edges Lower

Its 11.00pm Hong Kong time which is 3.00am NZ time and that means no time is left for writing anything truly insightful in the FX section this week. Suffice to say the week started with Europe worries pushing the NZD lower, then good data came out of the US plus the business confidence data in NZ were good (plus commodity prices) so the NZD recovered. It has ended then against the greenback near 68.3 cents from 67.1, and against the AUD near 81 cents from 80 cents. Recoveries were also recorded on the other crosses and our expectation of tightening monetary policy implies a firmer NZD from here out.





For more detailed commentaries from BNZ and the NAB group on foreign currencies, commodities, etc click on the following link.

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

*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	0.4%	-0.2	2.0	3.0	3.4
GDP growth	Average past 10 years = 3.0%	+0.8	0.3	-1.6	-0.1	2.8
Unemployment rate	Average past 10 years = 5.3%	6.0	7.1	5.1	3.9
Jobs growth	Average past 10 years = 1.9%	1.0	0.0	-0.1	0.7	-0.3
Current a/c deficit	Average past 10 years = 5.5% of GDP	2.9	3.2	8.7	8.0
Terms of Trade		5.8	-1.6	-8.2	1.8	8.8
Wages Growth	Stats NZ analytical series	0.4	0.8	2.7	5.4	5.0
Retail Sales ex-auto	Average past 9 years = 3.8%	1.3	0.7	1.3	-0.6	2.8
House Prices	REINZ Stratified Index	-1.3	2.8	6.4	-7.4	2.9
Net migration gain	Av. gain past 10 years = 11,700	+20,973	21,253yr	7,482	4,675
Tourism – an. av grth	10 year average growth = 5.0%. Stats NZ	4.2	-0.0	4.2	-3.9	2.1
		Latest year rate	Prev mth year rate	6 mths ago	Year ago	2 yrs ago
Consumer conf.	10 year average = 2%. Colmar survey	46	36	57	3	-34
Business activity exps	10 year average = 26%. NBNZ	43	39	31	-4	-4
Household debt	10 year average growth = 11.3%. RBNZ	2.8	2.7	2.7	2.8	10.9
Dwelling sales	10 year average growth = 3.5%. REINZ	-3.8	-1.1	39.3	-17.7	-32.1
Floating Mort. Rate	(Total Money) 10 year average = 7.6%*	5.59	5.59	5.99	6.25	9.99
3 yr fixed hsg rate	10 year average = 7.9%	7.75	7.95	7.75	6.75	9.49

ECONOMIC FORECASTS

Forecasts at May 20 2010	March Years					December Years				
	2008	2009	2010	2011	2012	2007	2008	2009	2010	2011
GDP - annual average % change										
Private Consumption	3.2	-1.1	0.5	2.8	1.9	3.9	-0.3	-0.6	2.8	2
Government Consumption	4.9	4.2	0.8	2.2	2	4.4	4.8	1.4	1.8	2.1
Investment	5.5	-7.2	-9.9	5.8	8.9	5.5	-3.6	-12.3	2.6	9.5
GNE	4.6	-1.6	-3.3	5.4	3.2	4.6	0.4	-5.1	4.9	3.4
Exports	3.1	-3.4	2.5	1.6	5	3.8	-1.4	0	1.5	4.8
Imports	10	-4.7	-9.9	7.9	4.7	8.9	1.9	-14.9	7.9	4.6
GDP	2.9	-1.4	-0.3	3.6	3.2	2.8	-0.2	-1.6	3.1	3.5
Inflation – Consumers Price Index	3.4	3	2	4.6	2.8	3.2	3.4	2	4.3	2.7
Employment	-0.2	0.7	-0.1	2.6	2.8	2.3	1	-2.4	2.7	3.2
Unemployment Rate %	3.9	5.1	6	6.1	5.4	3.5	4.6	7.1	6.3	5.5
Wages	4.3	5.1	1.6	1.8	3.6	4	5	3.1	0.8	3.2
EXCHANGE RATE ASSUMPTIONS										
NZD/USD	0.8	0.53	0.7	0.72	0.66	0.77	0.56	0.72	0.73	0.68
USD/JPY	101	98	91	99	105	112	91	90	97	103
EUR/USD	1.55	1.31	1.36	1.21	1.25	1.46	1.34	1.46	1.21	1.24
NZD/AUD	0.87	0.8	0.77	0.83	0.84	0.88	0.83	0.79	0.82	0.83
NZD/GBP	0.4	0.37	0.47	0.46	0.4	0.38	0.37	0.44	0.49	0.42
NZD/EUR	0.52	0.41	0.52	0.6	0.53	0.53	0.41	0.49	0.6	0.54
NZD/YEN	81.1	51.8	63.7	71.3	69.3	86.3	50.9	64.2	70.8	69.5
TWI	71.6	53.8	65.1	70.7	66.1	71.6	55.1	64.7	71.3	67.2
Official Cash Rate	8.25	3	2.32	4.25	6	8.25	5	2.5	3.75	5.75
90 Day Bank Bill Rate	8.91	3.24	2.67	4.57	6.15	8.9	5.23	2.78	4.07	6.07
10 year Govt. Bond	6.36	4.77	5.86	6.3	7	6.4	4.88	6.02	6.1	6.8

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