BNZ Weekly Overview

3 March 2011

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.

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 Time

This week we are running our second BNZ Confidence Survey for 2011. If you have not already done so from the link in the email used for sending the Weekly Overview out on Thursday night please feel free to click on the URL below and let us know whether you feel the economy will get better or worse over the coming year. Also, if you have the time, tell us what industry you are in (and where if you want) and pen a sentence on what conditions are currently like. The results will be released early next week.

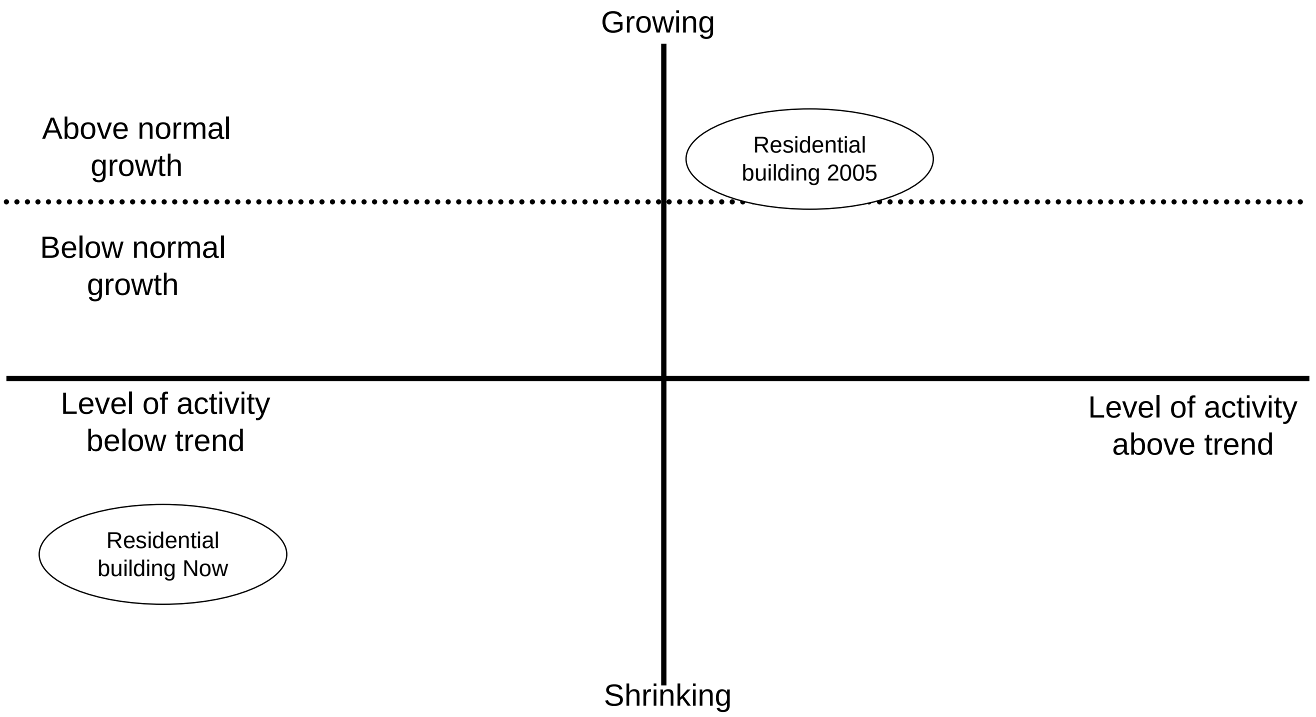
http://survey.usuite.com/survey/7f801dd05f3742619b046cc119c15106.sur

This week we are going to introduce something new in terms of trying to understand where the economy is at currently, as opposed to thoughts about where it will be later this year when the ecstasy surrounding rugby games will apparently make us open our wallets. If you think back to 2005 the economy had been growing firmly for a while and many sectors were bigger – showing higher levels of activity – than normal long term trends would suggest. For instance, in the March quarter of 2005 the annual number of consents issued for the construction of new dwellings was 30,255. The average number of consents issued per annum for the previous ten years had been 24,500. Therefore we would say that the house building sector was displaying above trend levels of activity.

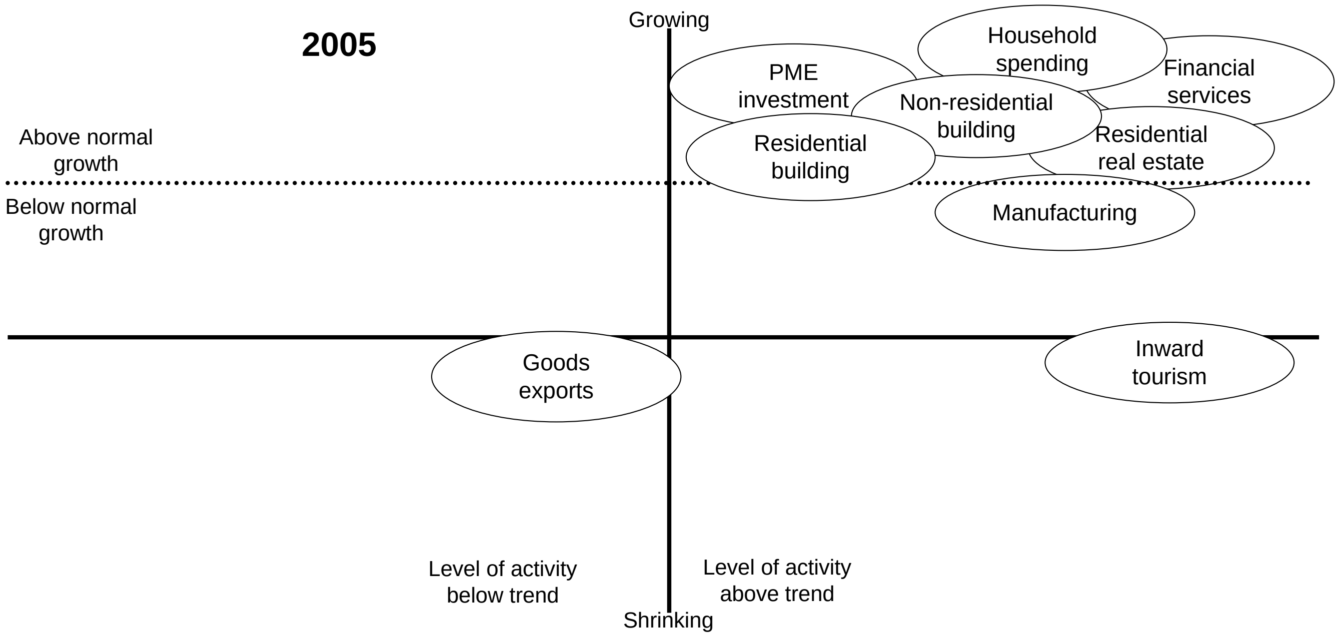
If you imagine a horizontal line with a zero in the middle then we could place house building on the right hand part of this line where one would record above trend activity. If instead the number of consents had been just, say 15,600 as is the case now, then we would place a marker for house building well on the left of the line to visually show below trend activity.

Now think in terms of whether the rate of growth in activity is negative or positive. In the March quarter of 2005 dwelling consent numbers were 20% greater than during the December quarter. Therefore not only was the level of activity above trend but the rate of growth was positive. One could plot positive rate of growth as an above zero point along a vertical line. We would therefore place dwelling construction in the upper right hand side of this two dimensional graph.

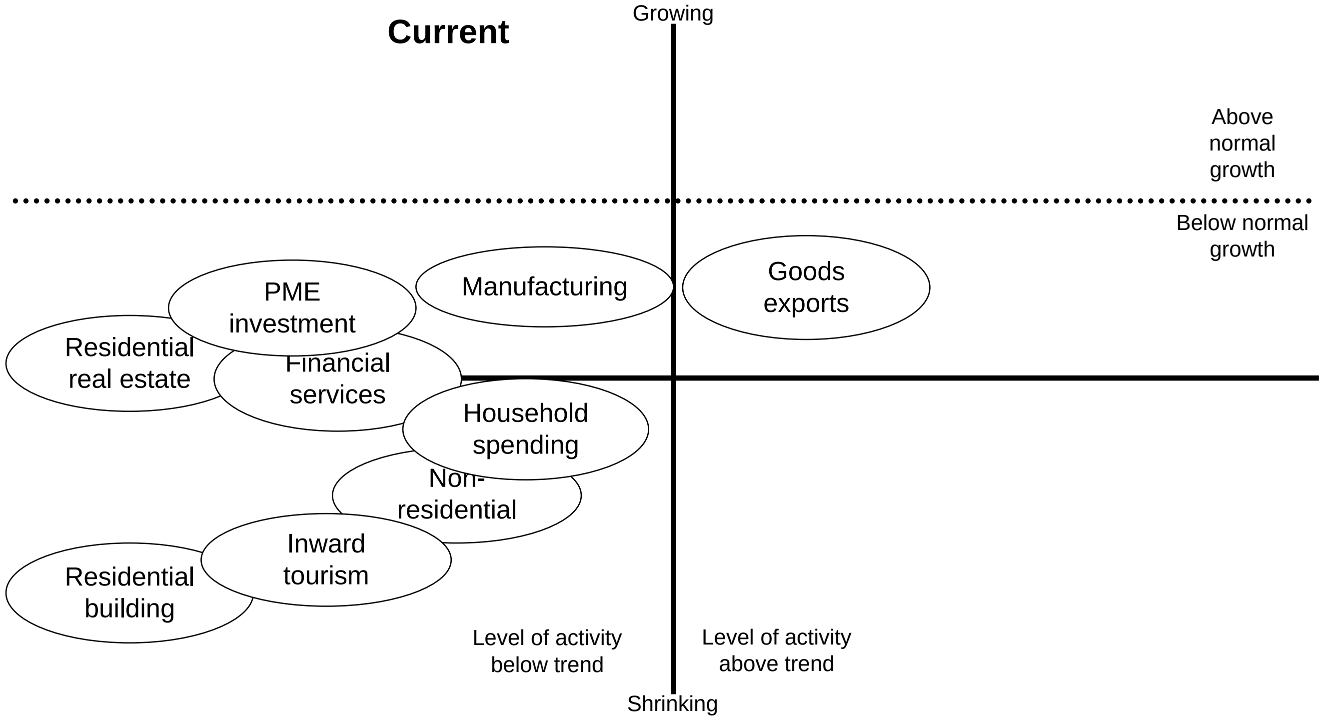
On the following page we show what such a graph would look like.



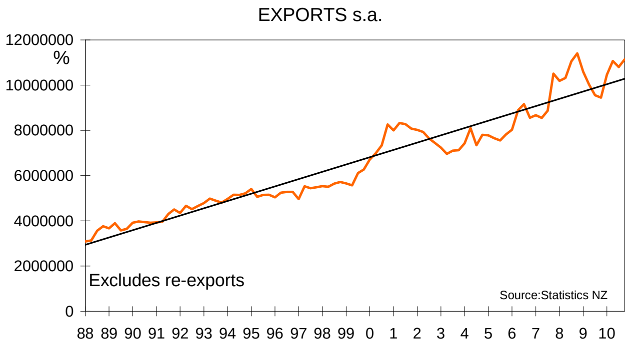
The horizontal dotted line is put in just to show that if your sector is above it the rate of growth is not only positive but above normal. The picture following shows what things looked like in 2005 for those sectors for which we can get reasonably up to date data.

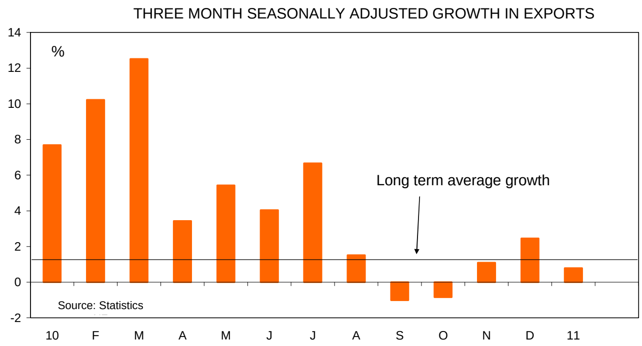


The economy was operating in most sectors at above "normal" levels of activity based on long term trend estimates, and most sectors were not only still getting bigger but doing so at a faster than normal pace. The economy in other words was firing big time on many cylinders – but not all of them. Merchandise exports and tourism were both weak with the former showing no growth. So, what do we look like now?

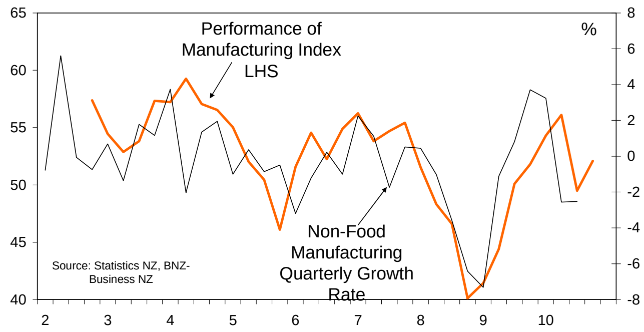


This is what our front section analysis in which we concentrate only on real world measures allows us to show. Merchandise exports are growing at a below average pace and activity is above where the linear long term trend says it "should" be. The position of the Goods Exports oval therefore represents these following two graphs.



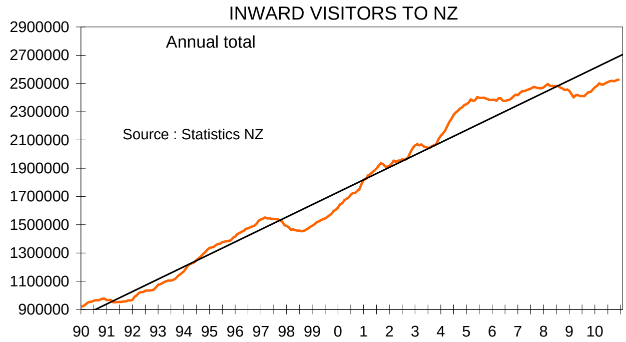


The manufacturing sector appears to be growing but from a smaller than "normal" base. Medium term correlation of the PMI result with actual manufacturing growth is reasonable but quarter to quarter correlation is not good therefore one cannot rule out that the sector is in fact shrinking – especially as the value of elaborately transformed manufactures exports over the December quarter was down roughly seasonally adjusted from the September quarter



Retail spending volumes fell 0.4% in the September and December quarters and one month of growth in the January Electronic Card Transactions series does not convince us yet that spending is now rising. Hence the positioning of the Household Spending oval. PME stands for plant, machinery and equipment and earlier growth has petered away so activity could shrinking anew from a below average base. But we are uncertain so leave the growth rate as positive for now based on the 6.3% gain recorded over the September quarter in the national accounts. Residential real estate activity is very low and only mild if any turnover growth is occurring.

Inward tourism is only just growing with trend growth of 0.4% in the past three months versus average three month growth for the past decade of 0.8%. But spending for the year was down 10% according to the International Visitor Survey and about 12% down in the December quarter from a year ago. Therefore this sector is shrinking (in recession) and is placed as such in the bottom left hand corner. Private sector lending growth is only just above zero so is placed near the horizontal line..



We will not include this graphic each week but will put it in now and again to update where we are at. What we are expecting to see over time is that the circles will move upward and very slowly toward the right. But there is little reason for believing this movement will be swift.

- The short term outlook for growth has been badly dented by the interruption to economic activity associated with the new earthquake in Christchurch.
- The shocking sight of people losing all their possessions is highly likely to dent consumer sentiment throughout the country and further promote attitudes of saving rather than spending.
- Oil prices have risen strongly recently and higher petrol prices will reduce money available for spending elsewhere.
- If an earthquake levy is introduced consumer spending will be further reduced.
- The tourism sector was already facing extended recession this year following last year's fall in receipts. The depth of that recession will now be increased as some potential visitors, seeing the devastation, stay away.
- Outward migration is likely to be boosted by the earthquake while inward migration will be affected to some uncertain degree.

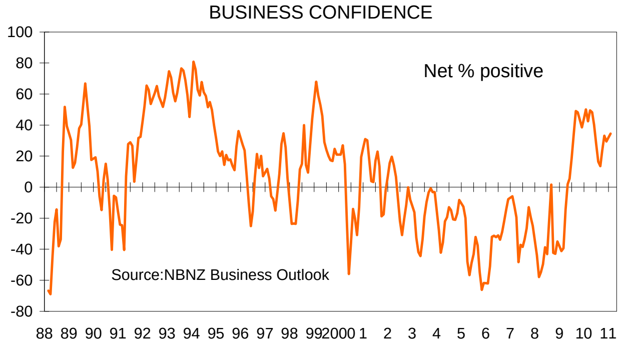
Note though that with interest rates falling and the currency lower non-Christchurch exports will benefit along with non-Christchurch borrowers.

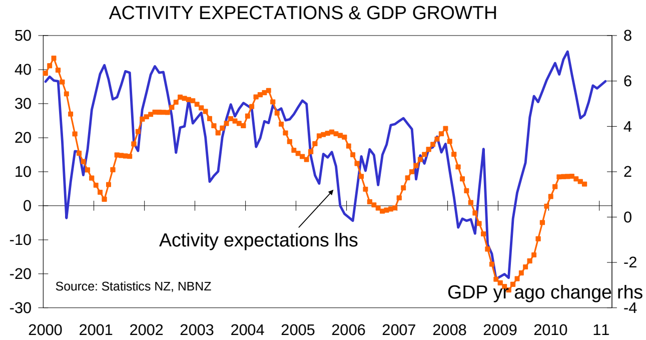
At this stage it is hard to imagine that we will soon see a return of 2005 conditions when domestic-focussed sectors were larger than trend and mainly growing at above average rates. Only if the Reserve Bank anticipates that happening are we likely to see aggressive tightening of monetary policy. Note however that this graphic and the trend estimates upon which it is based cannot take into account trends and shocks which alter growth in resource availability – like the aging of the population reducing labour force growth and the earthquake destroying capital stock. In simple terms these developments mean the economy's ability to handle strong growth without inflation may be less than people generally think. Hence one cannot rule out the official cash rate rising around 2% over 2012 as we currently predict with perhaps a rapid clawing back of the rate cut of 0.25% or 0.5% we now expect for next week.

Business Sentiment and Intentions Good

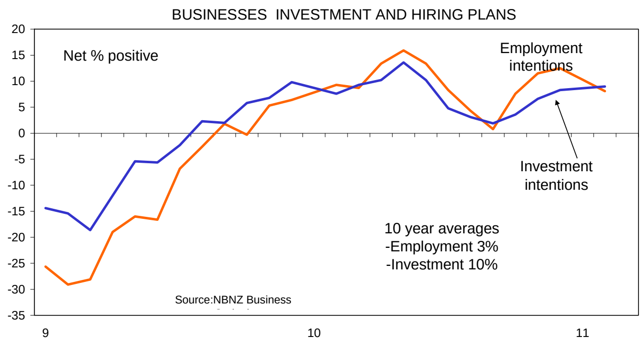
We're going to soon set up a format like the section below for analysing leading indicators of activity in an easy to understand manner. But until that happens we'll continue to use this front section to look at data collections of leading import. For instance, this week the NBNZ Business Outlook survey came out and as has proved many times to be the case the result shows what we already learnt almost four weeks ago in our first BNZ Confidence Survey for the year. Namely that sentiment is steady.

A net 35% of respondents in the NBNZ survey expect the economy to improve over the coming year. This was up marginally from a net 30% positive in early December. This reading is well above average though because there is usually little change between December and February (there is no January survey) the result in seasonally adjusted terms is in reality a small improvement. The activity expectations measure came in at 37% from 35% and an average of 20%. This measure is partially though not particularly well correlated with economic growth but is suggestive of some firming in activity this year.





That is positive on the face of it and such a conclusion is supported by investment intentions improving very slightly to a net 9% positive from 8% in December with a reading of 10% being the long term average. Employment intentions however eased to a net 8% positive from 13% in December though given that the average reading for this measure is 4% the result suggests good jobs growth.



But one suspects that the earthquake will have dented all of these readings therefore we caution against blindly extrapolating the results into a golden 2011-12 period. After all, high investment and employment intentions in the middle of 2010 in the graph above did not signal at all the weakness in economic activity at that time or for the rest of the year. The confidence and activity measures did however pick something up with regard to the weak September quarter at least.

Is Our Economy Getting Better or Worse?

In this simple summary section we look only at what the data are actually telling us and pay no attention to forecasts or intentions measures.

We are probably back in recession and we feel our analysis in this section has given a better steer toward what is going on than obscuring the signals data are sending us by focussing too quickly on sentiment surveys as we were doing over 2010. This week we have learnt that the labour market appears to be cooling a tad with job advertising online showing slower and slower growth. Also imports of capital equipment have eased off recently so business capital spending growth may not be as strong as the earlier numbers were showing. Perhaps businesses were simply buying offshore to take advantage of the high NZ dollar rather than embarking on an extended period of productivity-enhancing capital spending. But export growth is proving to be acceptable while real estate appears flat rather than falling.

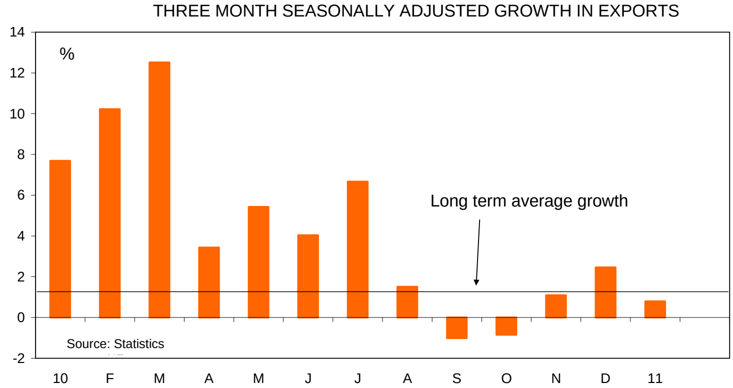
Are householders opening their wallets more?

Measures of household spending are going to be messed around tremendously over February and March as a result of the earthquake so we are going to refrain from trying to say anything too forceful here when the data do eventually appear. The February Electronic Card Transactions data were due to be released next week (always to be taken with a grain of salt) but damage to the Statistics NZ building in Christchurch means that release has been delayed indefinitely.

As discussed in the Housing section below the Barfoot and Thompson Auckland real estate data show a market treading water.

Is business output rising?

The export numbers for January were quite good. Receipts for January were only 4% ahead of a year earlier, but the seasonally adjusted value of exports for the month was ahead 5.9% following a 1.6% rise in December and the trend estimate grew 0.9% in January and 1% in December. This trend number however was a rise of only 0.2% last month. The November trend estimate was originally a fall of 0.1%. Now it is a rise of 0.7%. The trend numbers therefore are not useful for our purposes of gauging the most recent pace of growth in our exports so we will ignore them.

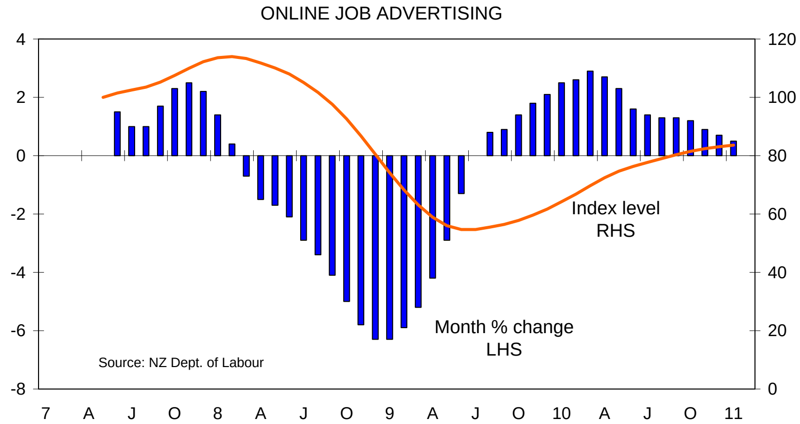


The seasonally adjusted growth rate for the past three months was 0.8% which is slower than average three month growth for the past ten years of 1.2%. Therefore we are prepared to say that although export receipts are growing they are doing so at a below average pace. But they are growing and that is the important thing.

The same cannot be said for our (now probably) second largest export sector - tourism. Data just released by the Ministry of Economic Development show that spending by foreign visitors in NZ was down near 12% from a year ago in the December quarter.

Are businesses hiring more people?

Last week the Department of Labour released their January OnLine Jobs report and it showed a small 0.5% gain in the trend number of jobs advertised in January. This was down from 0.7% growth in December, 0.9% growth in November, and 1.2% growth in October. The rate of growth in job advertising is clearly slowing and this might make one quite depressed about short term growth in the economy were it not for the fact that the labour market lags changes in economic activity. Therefore this slowdown reflects the slowing in activity earlier in the year.

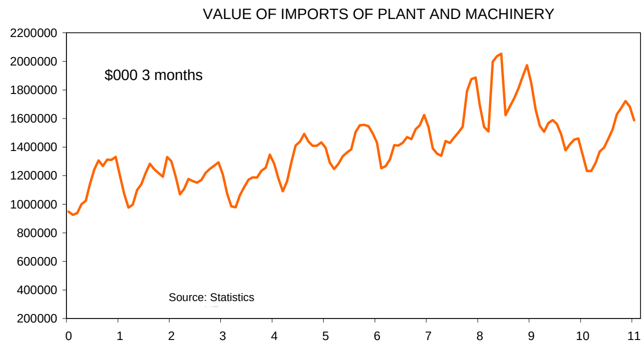


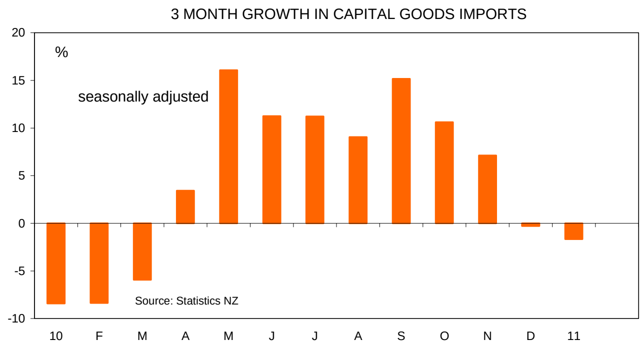
The trouble with this series however is that the trend gets re-estimated every month and because the series has only been running since 2007 there can be some very large changes in the estimated short term rate of growth in job ads. For instance a month ago the estimate for all job ad growth in November was 2.3%. Now it is 1.1%. The December estimate was 2.1%, now it is only 0.8%.

Therefore we treat these results with caution and it is necessary also to remind ourselves that these are just the advertisements placed for jobs and not actual jobs growth numbers.

Are businesses boosting their capital spending?

In January the value of imports of plant and machinery was 17% ahead of a year earlier at $451m. That sounds good. In the three months to January growth in such imports was a strong 18% up from a year ago or about 23% after adjusting for exchange rate shifts. That also sounds good. But over the past three months the seasonally adjusted value of these capital goods imports has fallen 2%. So although the level of capital goods imports is good in the context of things being weak a year ago an earlier surge in growth appears to be easing off and that has to make one a tad cautious about claiming that business capital spending is going up.





INTEREST RATES

Growth vs. Economic Slack

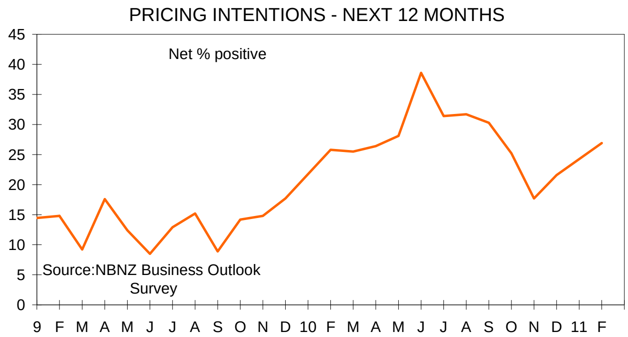
In a nutshell this is what drives inflation along with institutional arrangements, imported inflation, and exchange rate changes. If you want to forecast monetary policy you need to monitor these things. So we will, adding stuff here when we learn it. The current common view is rate tightening from September.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

The earthquake has hit both demand and supply in the economy. That is, all of us are likely to become more cautious in our spending and encouraged to build more precautionary savings by the earthquake. That means weaker economic growth and that will be the key factor likely to encourage the Reserve Bank to cut its cash rate next week. But at the same time the capital stock of the country (Christchurch) from which output is produced has been reduced and this means the economy's ability to handle x% of growth before inflation becomes worrisome has been reduced.

For the moment the combination of weak economic data before the earthquake and the need to shore up confidence will likely encourage easier monetary policy. But inflation risks for 2012 have been heightened so borrowers may want to keep that in mind from late this year when rising global inflation perhaps hits our shores more forcefully.

Other Inflation Influencers

The year ahead inflation expectations measure in the NBNZ Business Outlook survey rose to 3.02% in early February from 2.84% in December. This is a small increase possibly attributable to the headline inflation number coming out in January and showing inflation at 4% in calendar 2010 from 1.5% in the September quarter before GST went up to 15%. The net percent of businesses planning to raise their selling prices also increased – to 26.9% from 21.6% in November.



These movements will have attracted the attention of the Reserve Bank but are unlikely to have them scared given that both measures were higher in the middle of last year and the ability of businesses to pass on price increases is probably near nil for most currently going by the newly heavy discounting being undertaken by retailers.

Rate Movements This Week

Wholesale interest rates have fallen even further this week as the markets price in a rising probability of the Reserve Bank easing monetary policy next week. It is possible that they will but the difficulty for them is that what Christchurch needs is initially basic living facilities then rebuilding of infrastructure, buildings, and houses. Taking 0.5% off borrowing costs will do essentially nothing to accelerate the pace at which those needs are satisfied. In this instance fiscal policy in the form of the assistance package announced this week is far more useful.

In addition, outside of Christchurch the need for lower borrowing costs is not great. Though the need for the cash rate to be at 3% as opposed to 2.5% is also not that great given what we have been observing in the most recent economic data. It then comes down to the Reserve Bank deciding whether or not a cut would help Christchurch much, whether the rest of the country needs it, and when it thinks there will be a need for interest rates to be raised.

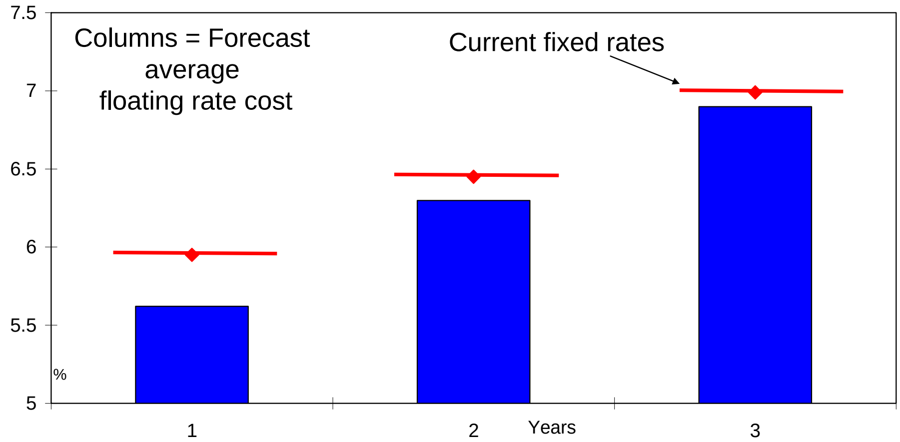
The case is not strongly made we think for a rate cut. But they probably will cut next week and then the pace of rate rises may need to be hastened over 2012. That perhaps is the trade-off they will focus on in their commentary.

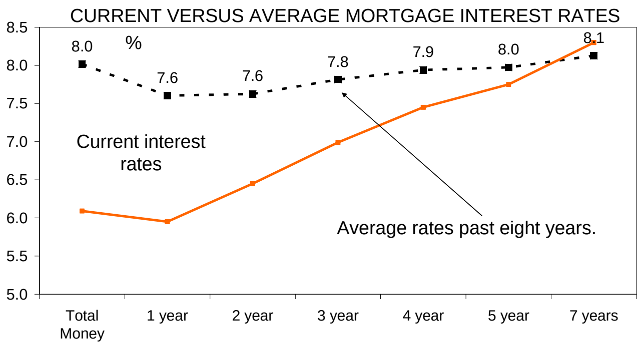
FINANCIAL MARKETS DATA

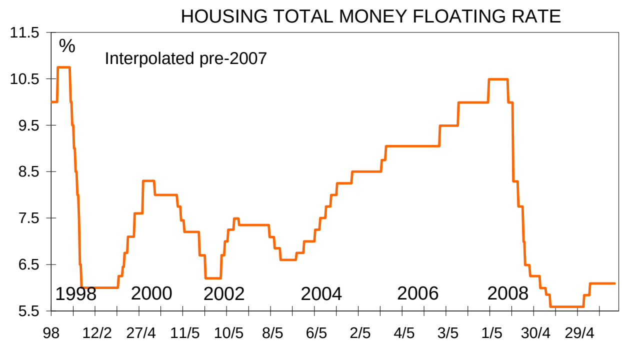
	This week	Week ago	4 wks ago	3 months ago	Yr ago	10 yr average
Official Cash Rate	3.00%	3.00	3.00	3.00	2.50	5.9
90-day bank bill	2.89%	3.22	3.21	3.20	2.70	6.2
1 year swap	2.91%	3.05	3.47	3.48	3.41	6.3
5 year swap	4.45%	4.62	4.72	4.82	5.17	6.6
180-day term depo	3.85%*	4.10	4.10	4.10	4.90	6.0
Five year term depo	6.00%	6.50	6.50	6.50	6.75	6.5
* 160 days = 5.2%						

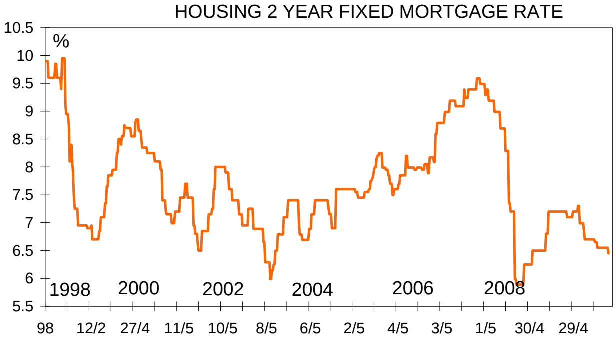
If I Were a Borrower What Would I Do?

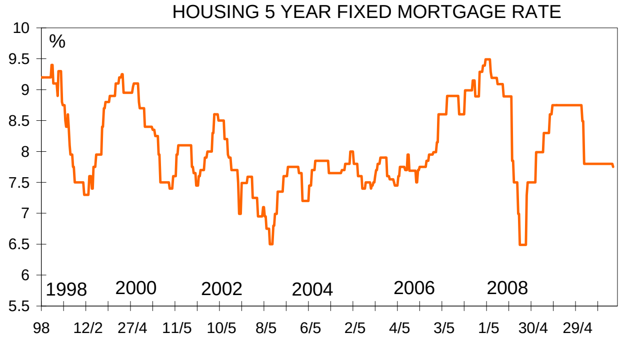
Stay floating. There is no benefit to fixing now apart from rate certainty, and given the rally in wholesale borrowing costs there is a good chance fixed rates will be cut again very soon following a round of cuts this week concentrated on the short terms. So if you are planning to fix then holding off seems like a good idea. I personally could see myself continuing to float for a long time – probably into next year. Note that the graph below assumes the Reserve Bank cuts the official cash rate 0.5% next week and floating mortgage rates drop by the same amount.





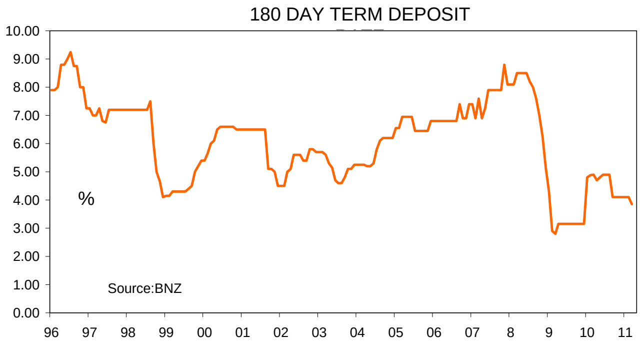


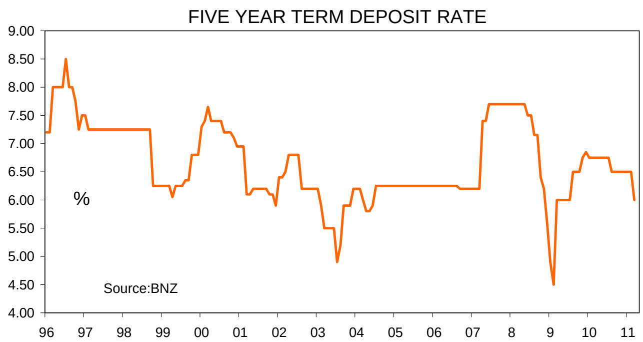




If I Were a Term Deposit Investor What Would I Do?

Look really quickly for a rate at one year which has not been cut in the past week because a round of reductions has gone through the marketplace in anticipation of the Reserve Bank cutting the official cash rate next week and in response to falls in wholesale interest rates.





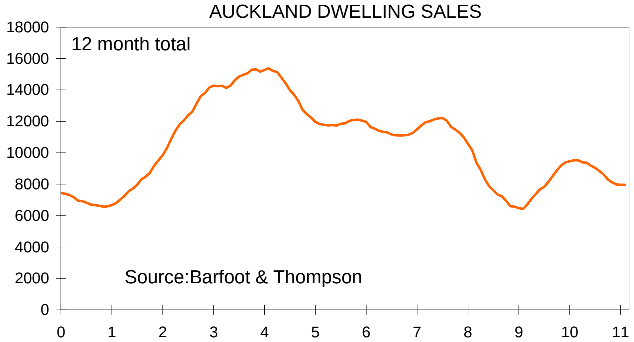
HOUSING MARKET UPDATE

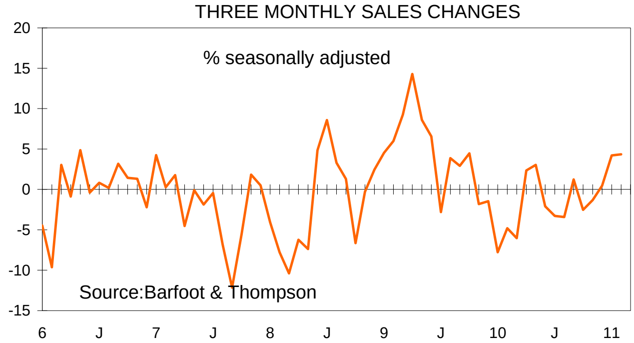
Turnover is weak, construction falling, and prices essentially flat on average.

Auckland Real Estate Flat

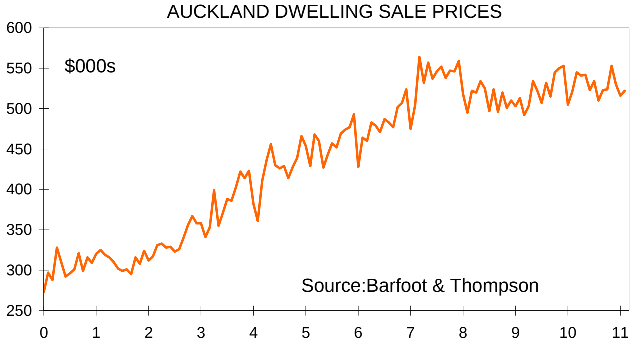
The Barfoot and Thompson real estate numbers for February in Auckland show a market holding up well in the face of many economic challenges with prices still essentially flat, sales seasonally adjusted also going nowhere, and listings still on the low side.

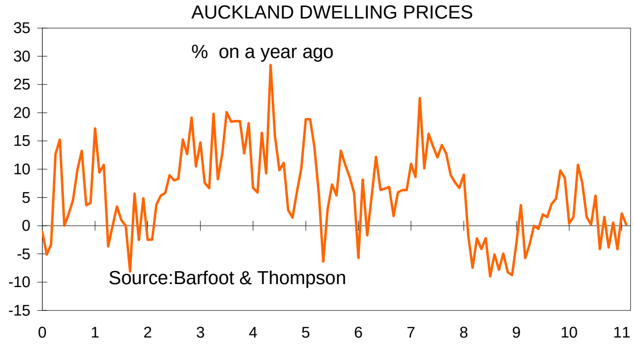
The number of dwellings sold in February came in at 619 which was a 1.1% fall from a year ago and in rough seasonally adjusted terms was a rise near 7% for the month though a fall of 2% for the three months to February. We interpret these numbers as showing activity is stable at a low level.





The average sale price improved to $522,000 from $516,000 in January to lie 0.2% ahead of a year ago. This price measure usually falls in January then bounces up in February so we read nothing into the monthly rise. Prices have on average fallen 2% in the past three months after rising 2% in the three months to November and we read that as showing prices are flat. Perhaps the only interesting thing which the more optimistic people might get excited about is that the usual monthly rise in the average sale price for February happened in spite of the proportion of sales for amounts over $1m falling to 12.2% from 15.3% last February and 15.2% in February 2009. That means maybe some price rises above normal for houses of less than $1m. But we would advise caution before jumping to any price rise conclusions.





There were just 1,529 new listings received in the month which was a 10.8% fall from the number newly listed in February 2010 though 4% higher than February 2009. There remains no evidence of a flood of properties hitting the market and with housing mortgage rates now falling again even more vendors are likely to find they can hold off from selling and continue to chip away at their principal in an environment where the anecdotes continue to bespeak of a rental market in Auckland tightening up reasonably quickly.

Not that the rental numbers from Barfoot and Thompson actually show anything like that. The average rent for newly tenanted properties was $402 a week in February which was just a 3.1% rise from a year ago. But the number of properties let was ahead 16% from a year ago at 817 so maybe there is some soaking up of space occurring and the rent response will come later. Clearly to the extent some people have shifted to

Auckland from Christchurch there will be some extra uptake of properties though it is unclear how long this effect will last.

The destruction of part of the housing stock in Christchurch not only immediate worsens the 28,000 or so shortage number we are working with but makes it even more difficult for rebuilding to occur down the track as tradespeople will be involved in rebuilding commercial property and of course the Christchurch houses. But does this mean the earthquake is a positive for house prices in other parts of the country? Not in the coming year because we suspect people will become even more cautious with their spending and especially their willingness to raise debt. That is the earthquake has probably boosted the willingness of people to build precautionary savings.

But the earthquake does imply extra upward pressure on rents around the country and this in itself is likely to strengthen the quiet rise in investor interest we are already seeing in some parts of the country.

Here are a couple of emailed comments we received during the week.

"I am a conveyancing lawyer and out firm has seen no sign of any marked improvement in the number of sales here in Palmerston North."

"We have seen a definite increase in foot traffic with genuine enquiry for property in Tokoroa with this month been our best month in sales for 2 years. We have 350 rental properties with huge interest from people happy to live in Tokoroa and commute to work in Hamilton, Tauranga, Taupo etc. We only hope the enquiry and sales continue."

Are You Seeing Something We Are Not?

If so, email us at tony.alexander@bnz.co.nz with Housing Comment in the Subject line and let us know.

Key Forecasts

- Dwelling consent numbers to improve further out. House prices edging higher from second half of 2011.

MAJOR OFFSHORE ISSUES

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

European Debt

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

What's new?

Nothing much new has been learnt about the European debt situation over the past few weeks. Attention is however on the demands for interest rate and repayment term relief from Ireland and Greece. One imagines that any such agreement will come at a cost along the lines of extra fiscal rectitude etc. that Germany is looking for.

Still the important thing is that things remain calm and attention in Europe for the most part now is focused on rising inflation, (currently 2.4%) the many hawkish comments from ECB officials, and rising expectations that the ECB will tighten monetary policy well ahead of any move in the United States. Hence strength seen recently in the euro which is near a four month high against the greenback.

Chinese Inflation

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

What's new?

One thing likely to come out of the turmoil in the Middle East is a new determination by the authorities to cap potential for domestic unrest by further boosting wages and slowly concentrating more on promoting domestic growth rather than relying on export-driven forces. That is, the chances of more rapid appreciation of the yuan have probably increased because a stronger currency directly boosts household spending power by making imports cheaper. This will help in suppressing food price inflation to a limited extent.

Over the weekend the Chinese Premier Wen Jiabao noted a need for greater focus on income distribution, more attention on the environment, and the need to keep house prices reasonable.
http://imarketnews.com/node/26995

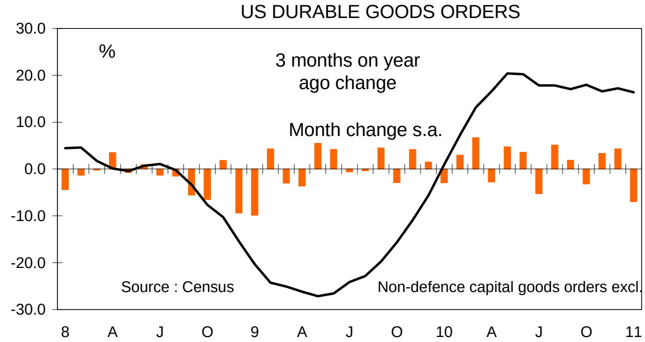
Manufacturing activity in China eased off in February with the monthly Purchasing Managers Index falling to 52.2 from 52.9 in January and 53.9 in December. The result is seasonally adjusted but because it falls in the New Year holiday period one must treat the result with extra caution as adjustment processes do not always capture the impact of holiday-induced activity changes.

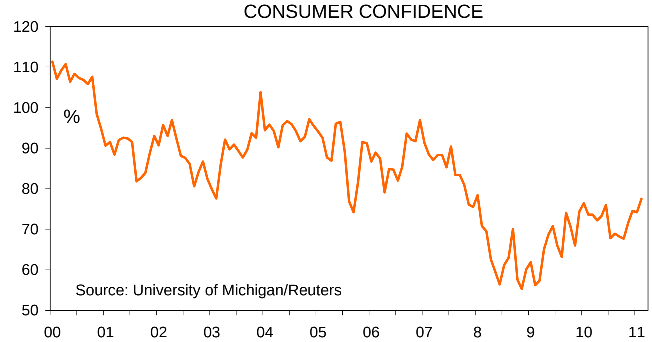
US Growth Momentum

The US economy has grown 2.9% over the past year but the upturn is not yet "self-sustaining" or reducing unemployment stuck above 9% at 14mn - worse than Germany, Japan, Britain and Russia. Manufacturing is firm but retailing, housing and business investment remain weak while few moves have yet been started to rein in an unsustainable Federal Budget deficit above 11% of GDP and concerns are growing about state and local budgets. What we're looking for are signs that the economy is firing on more cylinders than just those caused by a low USD, restocking, and fiscal stimuli. I.E. consumption, housing, and business capital spending.

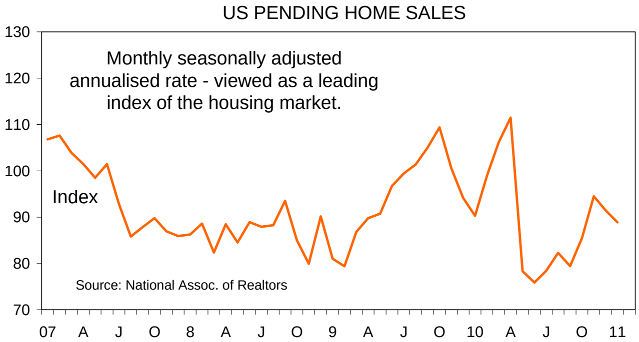
What's new?

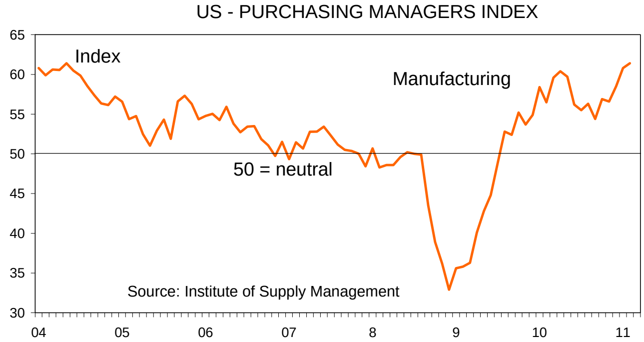
Generally mixed indicators continue to appear. This week one was for durable goods orders which rose 2.3% in January to lie 9% ahead of a year earlier. But excluding the military and aircraft there was actually a large 6.9% fall. Still, this core measure tends to be volatile and over the past three months it has increased 2.2%. This bespeaks of some underlying growth in business investment.





The week also brought another measure showing rising consumer confidence about where things are going, and therefore presumably eventually producing stronger retailing and housing markets. The final February reading for the University of Michigan consumer confidence index rose to 77.5 in February from 74.2 in January. This is the highest reading in three years. But the most forward-looking indicator of the housing market – pending home sales – eased 2.8% seasonally adjusted in January after falling 3.2% in December. There is an upward trend in this measure from the lows of mid-2010 but the two weak months just passed suggest this trend is mediocre.





The best piece of news however was a rise in the Purchasing Managers Index for the manufacturing sector to 61.4 in February from 60.8 in January. This is the strongest result in almost seven years and gives hope that jobs growth will soon become stronger in the United States.

Global Currency Conflict

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

What's new?

We haven't written much in this section recently, mainly because there has not been much news appearing with regard to competitive currency devaluations and capital controls in the past 2-3 weeks. And why is that? Probably because worries about rising food prices and inflation are becoming very strong in the emerging economies who were most concerned about their rising currencies and those currency appreciations can in fact help in suppressing inflation. So one problem can help fight another, and given the clear correlation between rising food prices and social unrest in the often less than democratic emerging economies a green light has perhaps been given to faster appreciation of emerging currencies.

Commodity Prices

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

Fonterra's fortnightly auction produced another strong rise in (short term contract) dairy prices this week and average prices have now risen some 30% since November. This sort of increase has been seen for many commodities with oil prices at their highest levels in over two years though still well below 2008 peaks.

Gold, silver and other precious metals prices have also soared over the week with the underlying demand coming from US money supply expansion added to by unrest in the Middle East spurring risk-aversion buying. That buying may also have been enhanced by the growing view that the US dollar is no longer the safe-haven asset that it was in the past.

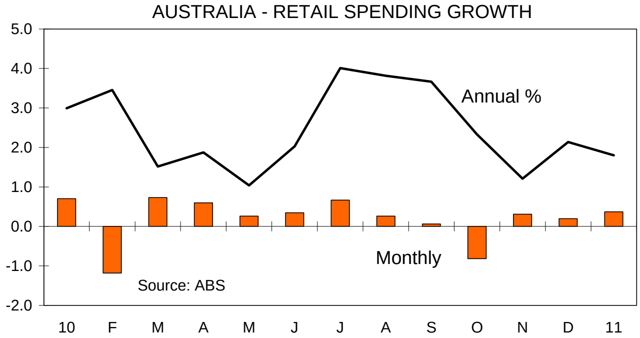
Governments are rapidly taking measures aimed at reducing the pain on household budgets but in doing so they are setting the scene for prices to remain elevated. Measures taken in the likes of Singapore, India, Hong Kong, Indonesia, Bolivia, Venezuela, etc. include cash handouts, price controls, export restrictions, subsidies, and so on. But by reducing the market signaling delivered by rising prices they are reducing the incentive to producers (farmers) to boost output while cutting the message to consumers that they should change their purchasing habits.

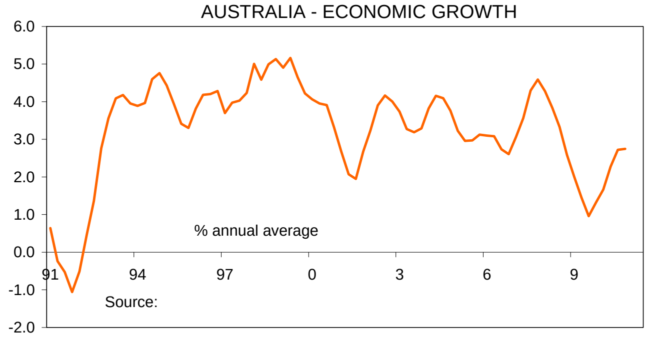
Australian Growth

Australia delivers 24% of our merchandise export receipts, 45% of our tourists, owns almost all our banking sector and 51% of FDI, contains over 500,000 Kiwis and acts as a back-up labour market for most of us. What happens there matters to us so we shall monitor their growth here. The Aussie economy is growing strongly on a mining and infrastructure boom bringing us competitiveness advantages in tourism and manufacturing as the AUD soars but will drain our skilled labour base. There is an opportunity to entice manufacturers here. Jobs growth is averaging over 30,000 a month and at what point does this do four things – spur currently weak retail spending, spur appallingly low house construction, drive wage inflation, and spur higher non-mining business investment to boost productivity. The first three feed-throughs will accelerate monetary policy tightening and lower the NZD/AUD exchange rate further. If job growth accelerates migration outflows from NZ to Australia will soar even more than seems certain over 2011-12.

What's new?

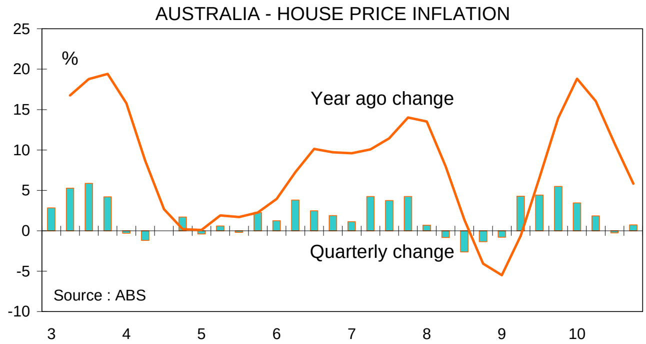
Retail spending growth is acceptable in Australia with a seasonally adjusted rise in total spending of 0.4% in January following a 0.2% rise in December and 0.3% rise in November. Spending is however only 1.8% ahead of a year ago so one would describe conditions in the Australian retailing sector as still challenging. A strong labour market would normally be driving better spending growth. But as in New Zealand people may be preferring to build up their savings levels.

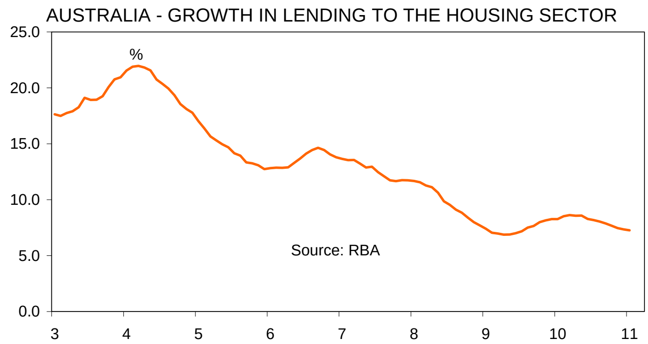




Data out yesterday show that the Australian economy grew by a healthy 0.7% during the December quarter but only after recording tiny growth of 0.1% during the September quarter. For the year as a whole growth was 2.7% from 1.3% over 2009 and 2.6% over 2008. The Australian economy has now been growing without recession since the second half of 1991 – 20 years in other words almost. Over that time they have grown 90%. Over the same period of time our economy has grown by 70%. Their GDP per capita has grown 50%. Ours has grown 35%. Their household savings rate is now 9.9%. Ours will be slightly in positive territory when the annual numbers for the year to March 2011 eventually come out.

Just for your guide, house price inflation has all but disappeared on average in Australia over the past year with the Australian Bureau of Statistics average measure across the eight big cities slowing to an annual rise of 5.8% in the December quarter from a year ago. But the December quarter change was a rise of 0.7% and the September quarter a fall of 0.2%. Price rises have largely been capped by the RBA's 1.75% cash rate increase between October 2009 and November last year.





The more up to date RP Data-Rismark monthly measure showed average prices down 1.6% over the month in January to lie about flat from a year ago with the Queensland floods clearly contributing to what was the biggest monthly nationwide house price decline in five years.

The Australian housing market remains cool in terms of both construction and turnover with lending seasonally adjusted up just 0.6% in January and monthly growth not exceeding that monthly pace since April last year. Annual housing lending growth sits at 7.3%. Lending growth to the business sector however is actually negative at -2.4%.reflecting caution on the past of businesses and tighter lending standards.

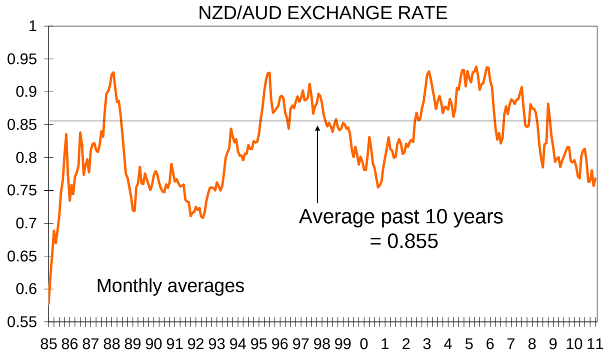
Exchange Rates

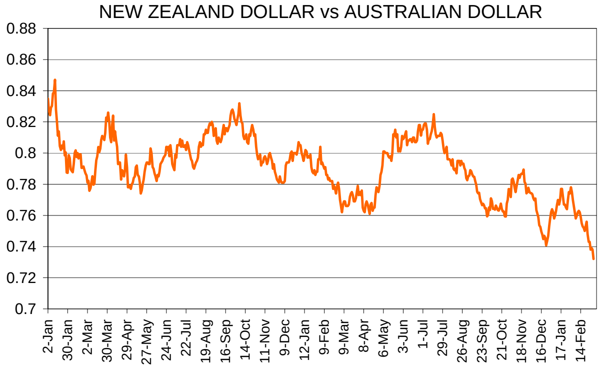
Exchange Rates	This Week	Week Ago	4 wks ago	3 mths ago	Yr ago	Consensus Frcsts yr ago*	10 yr average
NZD/USD	0.743	0.746	0.773	0.755	0.698	0.690	0.629
NZD/AUD	0.732	0.743	0.766	0.774	0.77	0.772	0.855
NZD/JPY	60.800	61.400	63.000	63.330	61.8	66.999	68.4
NZD/GBP	0.455	0.460	0.477	0.484	0.466	0.426	0.368
NZD/EUR	0.536	0.542	0.560	0.572	0.511	0.495	0.511
NZDCNY	4.883	4.906	5.098	5.036	4.765		4.83
USD/JPY	81.830	82.306	81.501	83.847	88.539	97.100	109.9
USD/GBP	1.633	1.622	1.621	1.560	1.498	1.620	1.705
USD/EUR	1.386	1.376	1.380	1.321	1.366	1.394	1.229
AUD/USD	1.02	1.00	1.01	0.98	0.91	0.894	0.737

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

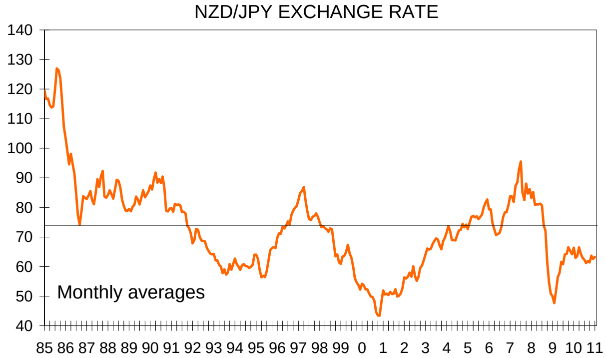
Kiwi Heads South

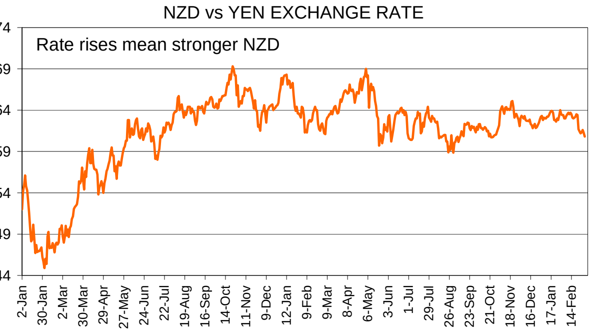
The direction of movement during the week for the Kiwi dollar has been decidedly downward, especially against the Aussie dollar where we now sit near a 19 year low just above 73 cents from just over 74 cents last week and 77 cents a year ago.



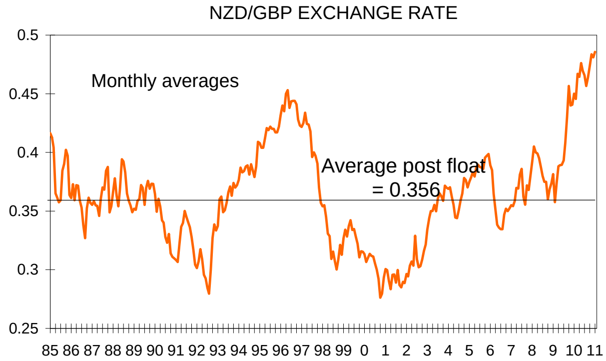


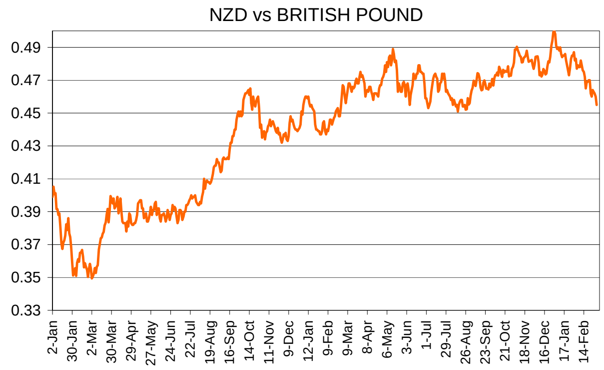
We have slipped slightly on the other crosses to six month lows against the yen and pound just above 60 yen and near 45.5 pence respectively. We have fallen to near a ten month low against the Euro near 53.6 centimes.

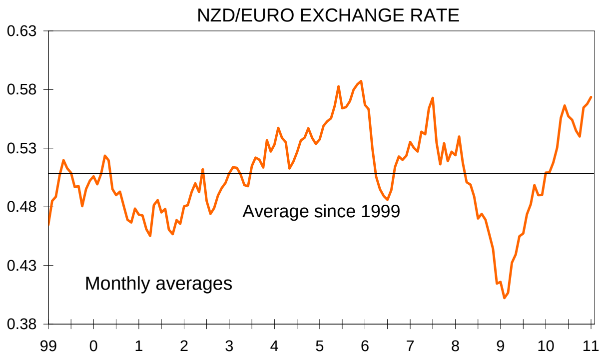


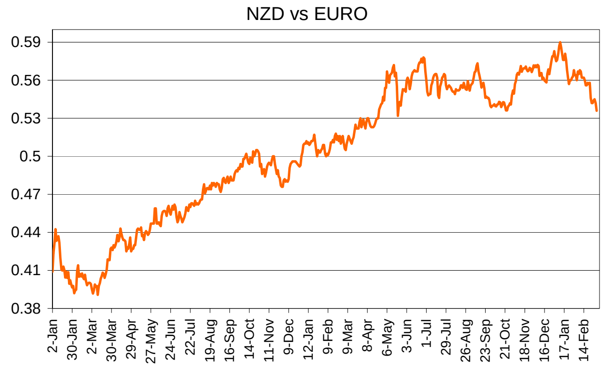


The Kiwi dollar's decline has been driven partly by a rise in risk aversion associated with trouble in the Middle East but mainly by worries about the economy following last week's earthquake and expectations that next week the Reserve Bank will cut the official cash rate either 0.25% or more probably 0.5%.





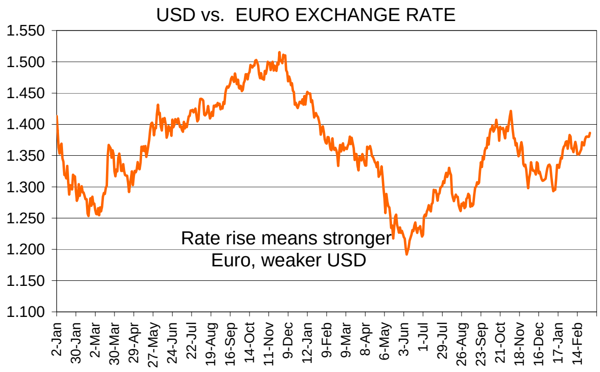


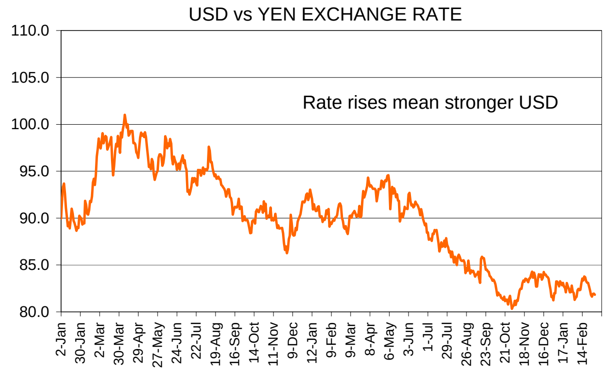


Yet there was some support for the NZD from a further rise in prices at Fonterra's fortnightly auction and this serves to remind us that fundamentally the case does not stack up for gross weakening in the NZD though it would be unsurprising if another couple of cents were shed in the next two weeks or so. In that regard it pays to keep an eye on monetary policy prospects overseas where things are heating up in favour of rate rises in the UK and Europe while rises in the US still seem long way off.

One noticeable development in FX markets in recent weeks has been that in spite of its traditional role as a safe-haven during times of global worry the US dollar has been losing ground against the euro. This may reflect the fact that underlying worries are growing about the size of the US Federal budget deficit and the limited chances that it will be substantially reined in in the next few years. There is also the underlying very slow movement toward other currencies assuming more of a role as reserve assets for central banks, individuals and corporates. There is however also the very strong view currently that interest rates in Europe will be rising well in advance of those in the United States and therefore currency support from relative yields will move more toward the euro this year and next.

This week for instance a producer prices report in the euro-zone came in higher than expected and further boosted rate rise expectations thus taking the euro to a four month high against the greenback.





ECONOMIC DATA

All %		Latest qtr only	Previous qtr only	Latest year	Year ago	2 Yrs ago
Inflation	RBNZ target is 1% - 3% on average	2.3%	1.2	4.0	2.0	3.4
GDP growth	Average past 10 years = 2.6%	-0.2	0.1	+1.4	-2.5	1.5
Unemployment rate	Average past 10 years = 4.8%	6.8	6.6	......	7.0	4.6
Jobs growth	Average past 10 years = 1.9%	-0.5	1.1	1.3	-2.4	1.0
Current a/c deficit	Average past 10 years = 5.5% of GDP	3.1	3.0	......	3.2	8.6
Terms of Trade		0.6	3.0	12.2	-8.2	1.8
Wages Growth	Stats NZ analytical series	0.4	0.8	2.7	5.4	5.0
Retail Sales ex-auto	Average past 9 years = 3.9%.	0.0	0.0	0.6	2.2	-3.7
House Prices	REINZ Stratified Index	-0.0	-1.1	-2.3	6.0	-7.9
Net migration gain	Av. gain past 10 years = 13,900	+10,451	13,914yr	......	22,253	3,814
Tourism – an. av grth	10 year average growth = 3.2%. Stats NZ	2.8	3.9	2.8	-0.0	-0.3
Consumer Conf.	Neutral = 100 Westpac McDermott Miller	108.3	114.1		116.9	101.3
		Latest year rate	Prev mth year rate	6 mths ago	Year ago	2 yrs ago
Business confidence	BNZ survey	22	18	-1.4	36.8	-14.7
Household debt	10 year average growth = 10.3%. RBNZ	1.5	1.6	2.5	2.9	3.9
Dwelling sales	10 year average growth = 2.5%. REINZ	-11.3	-11.3	-26.7	-1.1	-28.5
Floating Mort. Rate	(TotalMoney) 10 year average = 7.9%*	6.09	6.09	6.09	5.59	6.49
3 yr fixed hsg rate	10 year average = 7.8%	6.99	7.15	7.15	7.95	5.99

All actual data excluding interest & exchange rates sourced from Statistics NZ.
The BNZ Weekly Overview is prepared by Tony Alexander, Chief Economist at the Bank of New Zealand. Ph 04 474-6744.
*extrapolated back in time as TotalMoney started in 2007