

# BNZ Weekly Overview

## 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....

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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](mailto:tony.alexander@bnz.co.nz) with 'Subscribe' in the Subject line.

## Improvement Lies Ahead. Really

Many years ago at school I a friend gave me a copy of the Pohutukawa Book of Birthdays. It was a diary one could use for recording people's birthdays with each day having a special message. I memorised mine and it came in very handy many times during dark periods in the following years. 'Life, believe, is not a dream as dark as sages say, oft a little morning rain foretells a pleasant day.'

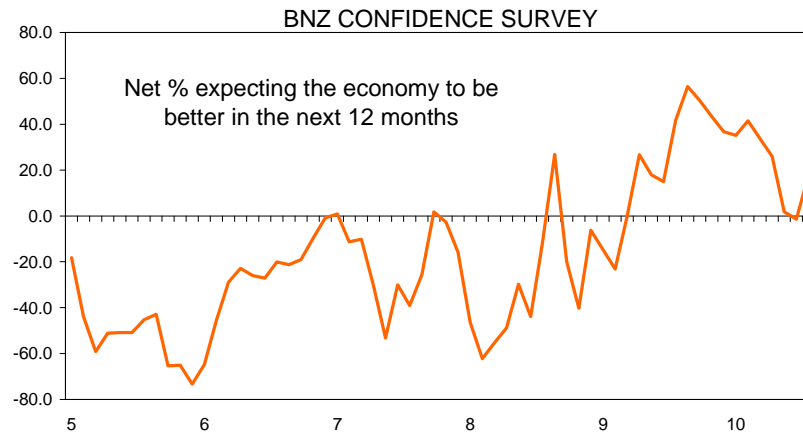
In other words, things may be tough now, but there are better times ahead. This sort of sentiment of course occurs in many different ways – work hard and save money for a good retirement, the surgery will be worth it when they see your new face/bits, 82 virgins await you when you are martyred, no pain no gain, you'll get a great view from the top, this is for your own good, the place will be even better after the rebuilding, and so on.

In the current context the message is this. The economy may be only two shades away from still being munted going by recent statistics, but prospects for growth over 2011 look good and it would pay to make sure you are ready for those stronger times. Feel better? Surprisingly given recent events, it seems that plenty of people do in fact feel better. Our latest BNZ Confidence Survey released to all Weekly Overview recipients on Monday night showed a firm lift in sentiment compared with two months ago when we last did the survey.

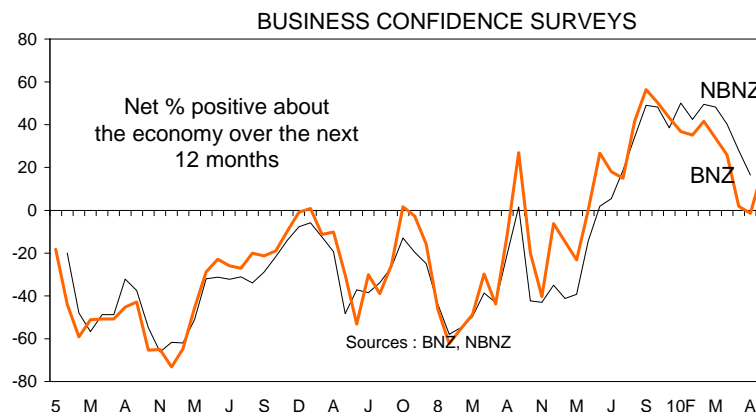
A net 18% of respondents feel the economy will get better over the coming year. That is up from a net 1% expecting a deterioration two months ago and the first improvement in the survey reading since April. So improvement is expected – a pleasant day in other words. But at the moment it is raining according to the comments people made regarding how things are in their sector or business right now.

Apart from generally positive sentiment in the likes of dairying, horticulture, residential rentals, log sales to China and manufacturing for export, the assessment given to current conditions was an overwhelming yuk. Consider this comment from an accountant for instance. "Chartered Accounting - still rocky. Clients slow to pay. Some people struggling - others doing really well. Hoping to see an improvement next year." Advertising. "Very slow gradual grind upwards. Nothing to get too excited about over the medium term. Lots of clients adopting a DIY approach where they can." Residential construction. "Still tight, competition is fierce with a lot of cost cutting and margin erosion.

“Provincial legal. Business has been quiet for a long time, no sign of change. we are just bouncing along the bottom.” “Commercial real estate - low enquiry levels, buyers have disappeared, low response to marketing campaigns, only buyers wanting something for nothing.” “Real estate...very flat and trending down in more markets than up. Sun does bring small buyer interest lift but of minor significance yet. Sellers sticking to their property and price...those who don't have to don't sell.”



Our survey usually receives a bit of media attention but is not market moving in the sense of altering immediate market expectations for interest rates, the exchange rate and so on. But there is a good established correlation with the longer running NBNZ survey which produces good insight into what businesses are planning with regard to hiring and capital spending. In that regard we expect their survey late this month will show some improvement, but probably not produce any great surge in business spending plans which were around average levels in their September survey.

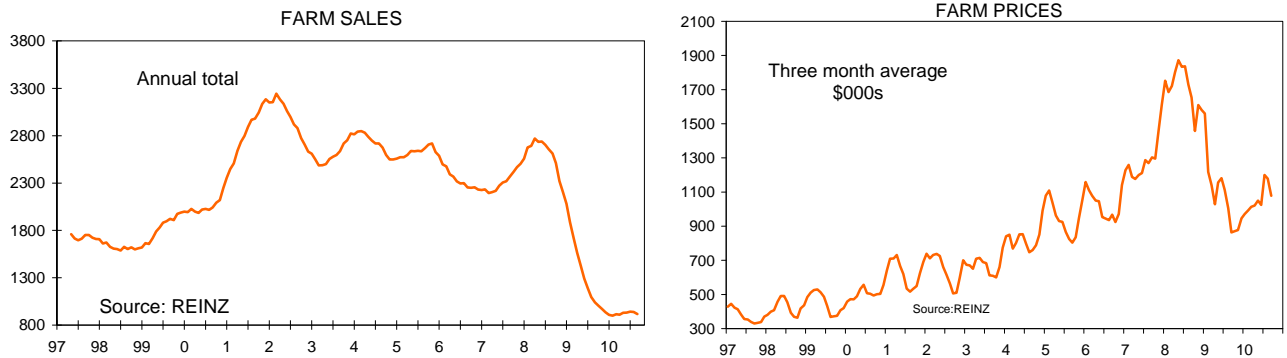


And just to finish with here are some reasons why one should believe that the current rain may foretell a pleasant day.

- Low NZD/AUD cross rate boosting tourism and manufactured exports to Australia.
- Strong Australian economy which already takes around 24% of all merchandise exports.
- Strong commodity prices with the ANZ Commodity price Index in NZ price terms up 29% from a year ago and almost back at May's record level.
- Rugby World Cup next year bringing more tourists.
- Rebuilding of Christchurch after the earthquake.
- Simple passage of time taking more people to the point where they are willing to gear up a tad.
- Low interest rates for longer keeping good cash flows for many borrowers.
- Passage of time and current near average capacity utilisation rate eventually forcing businesses to boost capital spending.
- Before then a process of labour/capital substitution helping employment growth.
- Fiscal loosening as the cost of income tax cuts exceeds extra GST gathered.

**Farm Real Estate Weakening Anew**

Commodity prices may be high but when it comes to rural real estate things are still quite depressed. In September there were only 53 farms sold around the country which was a 29% fall from a year earlier which was itself 42% down from September 2008. In the September quarter farm sales were down 8% from a year ago, off 14% seasonally adjusted from the June quarter, and 57% below average September quarter turnover. In other words, hardly any activity for rural real estate agents.



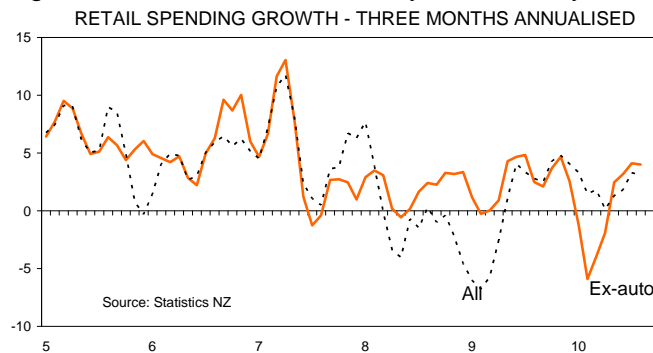
As for prices it is tremendously difficult to say anything definitive given the low turnover, changes in the mix, location, and size of farms sold from month to month, quarter to quarter, and even year to year. But for what it is worth, in the year to September the average farm sale price was down 15% from a year ago which was down 30% from the year before that. The price measure is broadly back where it was early in 2007. But we think one needs to be careful concluding that prices are down over 40% as recently Landcorp announced falls in their farm values of 10% - 15% so we are firmly of the view that the sales prices are over-stating actual land price changes. After all, only those who absolutely have to sell are selling. And if you extrapolate that sentiment to the same thing seeming to be happening in residential real estate it becomes very interesting to note that residential property prices, in contrast to rural prices, are essentially holding steady.

Again we read that as a sign that house prices have done their downward correcting and things are actually firmer than lots of people are probably thinking. The numbers won't show this for a long time however.

**Retail Spending Also Weak**

Sorry to depress you even further, but since retailing hit a brick wall in the middle of 2007 after the Reserve bank took the cash rate to 8.25% things have been very weak – except for a mildly firm patch late last year when our sighs of relief regarding avoiding a depression encouraged us all to buy a few extra things.

In the month of August core retail sales in seasonally adjusted terms excluding the ever volatile automotive sectors (cars, petrol) fell by 0.6% after falling 0.1% in July. The annualised rate of growth in this measure is only 4%. We anticipate stronger spending next year as people get more comfortable with their debt levels and the labour market is stronger. Christmas however is likely to be merely “acceptable”.



## INTEREST RATES

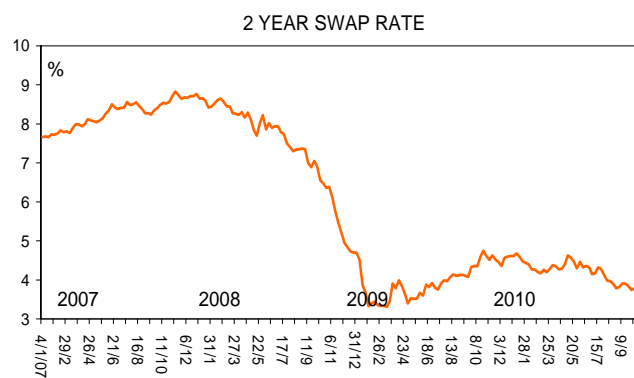
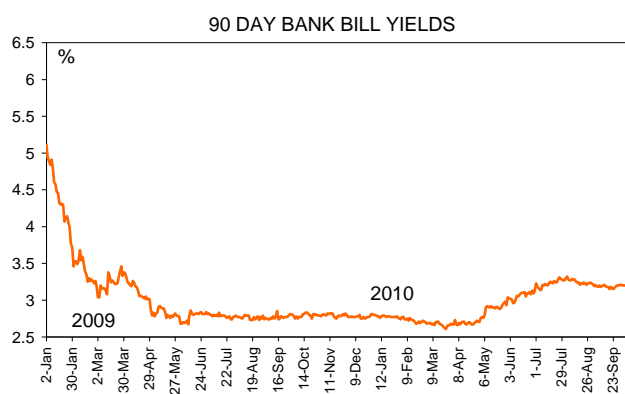
Nothing interesting happened this week. Data releases were few and far between and pressures on swap rates from developments offshore were quite limited. As a result 90-day bank bill yields remain near 3.2% and swap rates are about where they were last week. Our expectation for the moment is that the Reserve Bank will not be moving the cash rate from its current 3% level until March next year, and that the peak for the rate will be 5%.

One would be very unwise however to place much money on these forecasts not changing because the key thing we have long highlighted about this period of economic recovery is the huge uncertainty regarding both developments here and those overseas. The chances are the cash rate will actually peak higher than 5% but this far out from whenever the peak will be it is impossible to give reasonable insight into what the key forces would be behind such extra upward pressure – especially when one factors in the risk that the NZ dollar performs far better (on average) than many may currently be thinking and this will produce some offset to inflationary pressures.

With regard to the next few months for swap rates, the chances are they will remain low given clear signs from offshore that further quantitative easing may be undertaken – mainly in the United States but perhaps also in the UK. That means printing money explicitly in an effort to keep long term rates low. Sound familiar? Between 2004 and 2007 long rates were kept low – not by central bank actions but by a wave of cash coming out of Asia. One suspects the problem however for our central bank of long rates undercutting rising short rates will not be all that great this cycle given the extremely muted level of domestic credit demand and the impact of global risk premium changes which have driven a wedge between wholesale rates you see here and in the newspapers, what we banks actually pay to raise funds for those terms offshore, and what it costs you.

We noted this effect last week with regard to fixed housing rates and current swap rates. The three year swap rate for instance is just over 4% and the three year fixed housing rate is 7.15%. But in early March last year when the three year swap rate was 3.7% the housing rate was 5.99%. The apparent margin increase is actually mostly a reflection of our increased funding costs.

Another example would be with regard to deposit rates. With the 90-day bank bill at 3.2% one would normally have term deposit rates close to that level. But currently, with us banks competing so hard for domestic funding, those term deposit rates are much higher with ourselves for instance offering 5.15% for 150 day deposits. Times have changed.



### Key Forecasts

- Tightening through to mid-2012 with the next rate rise in March.

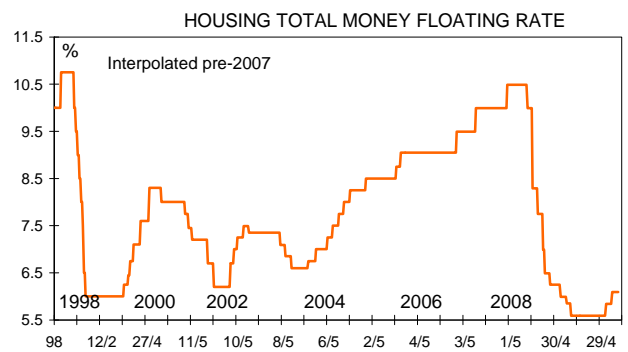
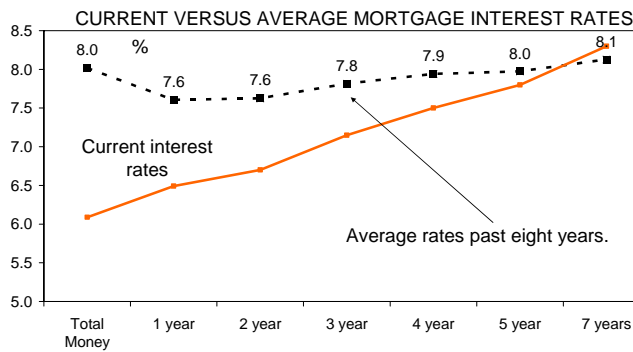
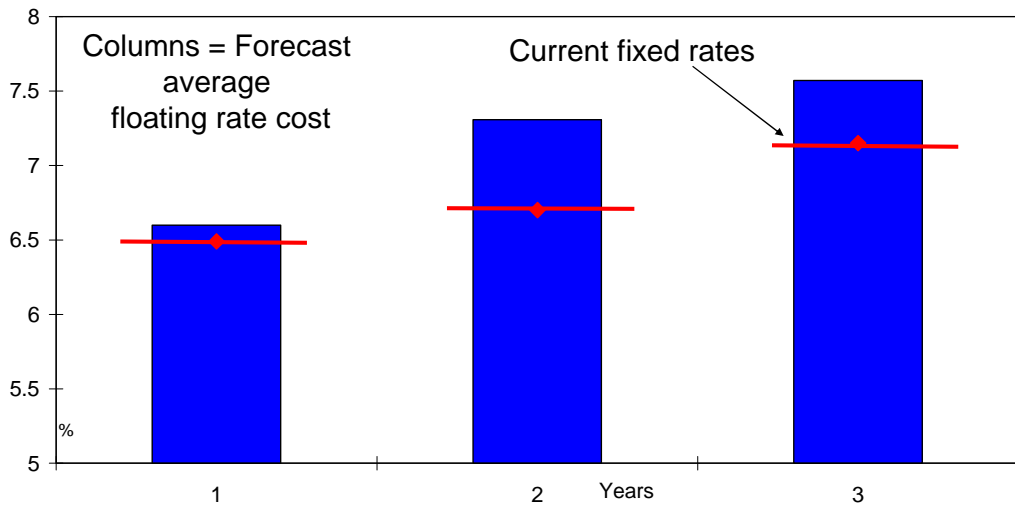
**FINANCIAL MARKETS DATA**

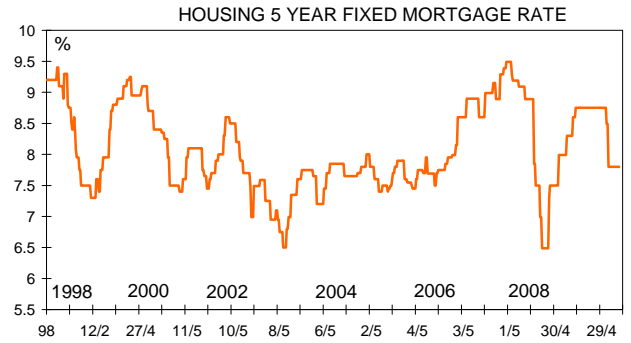
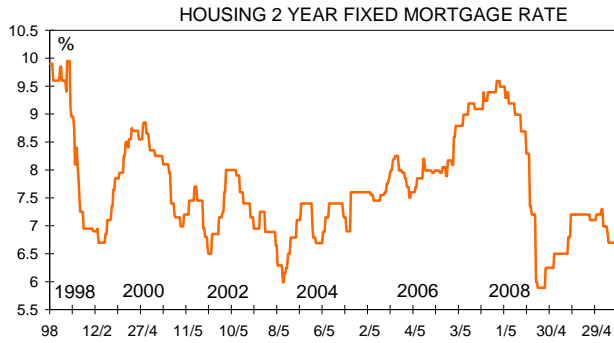
	<b>This week</b>	<b>Week ago</b>	<b>4 wks ago</b>	<b>3 months ago</b>	<b>Yr ago</b>	<b>10 yr average</b>
Official Cash Rate	3.00%	3.00	3.00	2.75	2.50	5.9
90-day bank bill	3.22%	3.20	3.21	3.20	2.83	6.2
1 year swap	3.51%	3.48	3.56	3.87	3.58	6.3
5 year swap	4.41%	4.39	4.53	4.96	5.66	6.6
180-day term depo	4.10%*	4.10	4.80	4.90	3.15	6.0
Five year term depo	6.50%	6.50	6.75	6.75	6.00	6.5

\* 150 days = 5.1%

**If I Were a Borrower What Would I Do?**

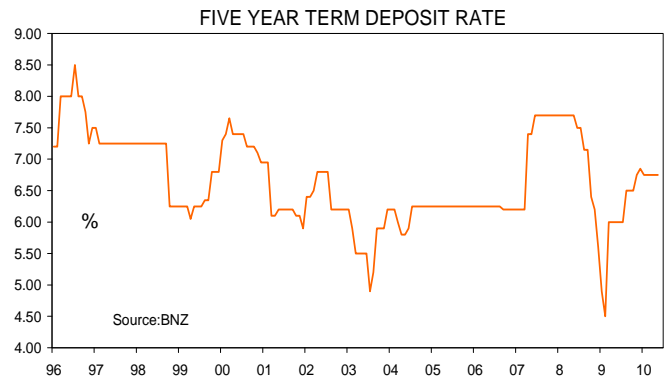
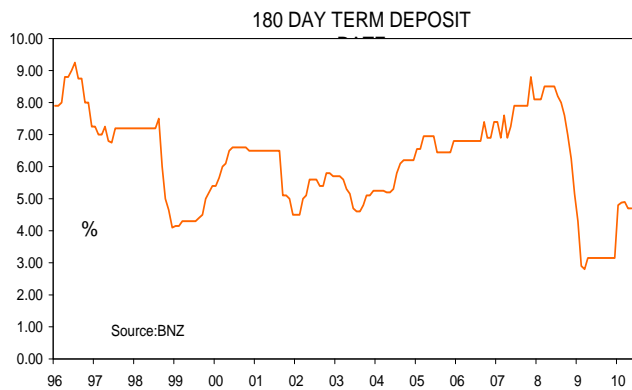
Nothing new to say this week. I would be floating because although our projections say fixing now will give a lower 1, 2, and 3 year cost than floating, current fixed rates are less than floating rates and they don't look likely to rise in the near future.





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

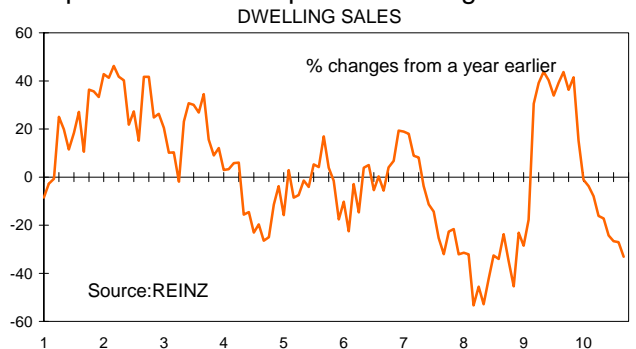
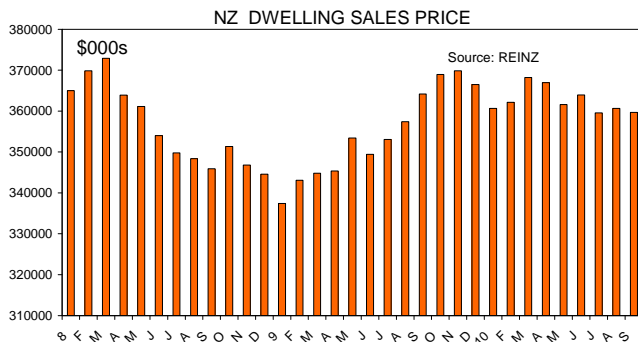
Given the reduced chance of long rates rising much more in the near future I would take a spread of terms.



**HOUSING MARKET UPDATE**

**Monthly Data Show Still Very Quiet Real Estate Market**

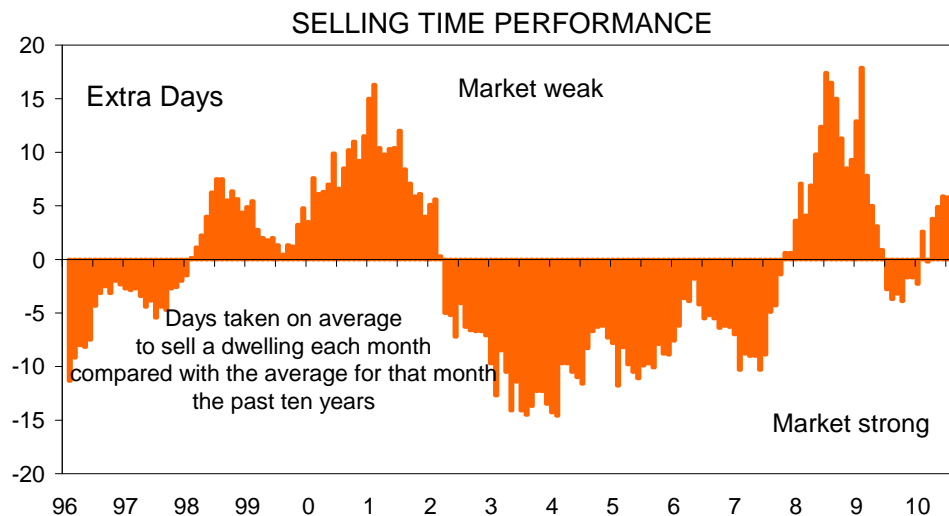
REINZ released their monthly nationwide data this week and they contained nothing surprising. The median dwelling sales price index edged down 0.3% after rising 0.3% in August showing that prices are largely flat though down 1.2% from a year ago and still 5.6% off the peak reached late in 2007. The number of dwellings sold was down 33% from a year ago at 4,323. This was the lowest September total in over a decade and shows what other numbers and anecdotes show. Buyers are taking their time and only pressed vendors are selling – in which case the near stability of the price measure is quite interesting.



In Canterbury sales were less than half those of a year earlier due to the earthquake.

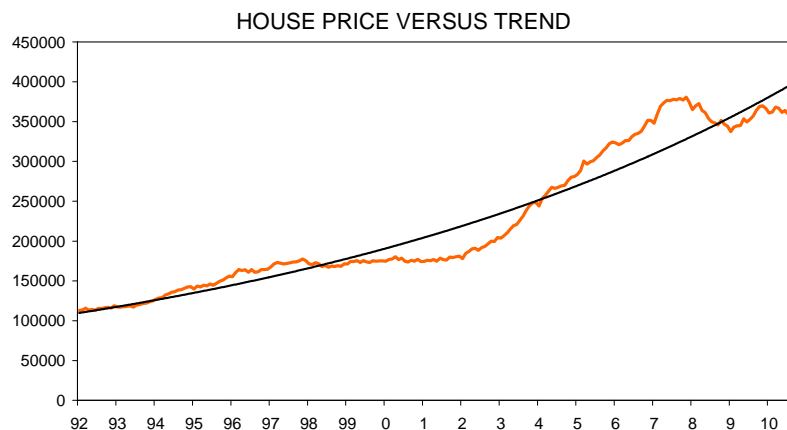
The average number of days taken to sell a dwelling was steady from August at 43. But this was 7.6 days longer than average compared with 5.9 days longer than average in August and 0.5 days faster than

average back in February. This is a clear sign that turnover is weak – again with both buyers and sellers unhurried.



All up nothing interesting frankly apart from the Canterbury result. Our view remains that the housing market will be flat until mid-2011 then it will rise as awareness rises strongly regarding inadequate construction, rising construction costs, shortages of builders. Before then we expect attention to focus on diminishing availability of rental property plus rising rents.

Just for a laugh. Here is one of the graphs some folk were using when things were a lot stronger. On the basis of the graph they forecast big price declines. Are they now forecasting big rises? Of course not. These sort of valuation measures are worthless when it comes to predicting where things will go. They simply give three numbers at any point in time – an arithmetic calculation of a trend/fair/average value, actual value, and the difference. Nothing more. The same goes for such graphs in sharemarkets, currency markets, commodities etc.



**Are You Seeing Something We Are Not?**

If so, email us at [tony.alexander@bnz.co.nz](mailto:tony.alexander@bnz.co.nz) with Housing Comment in the Subject line and let us know.

**Key Forecasts**

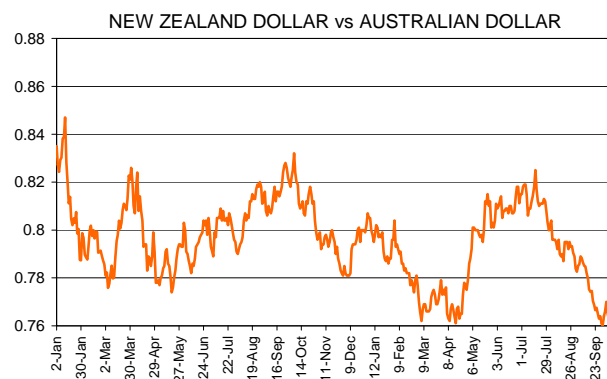
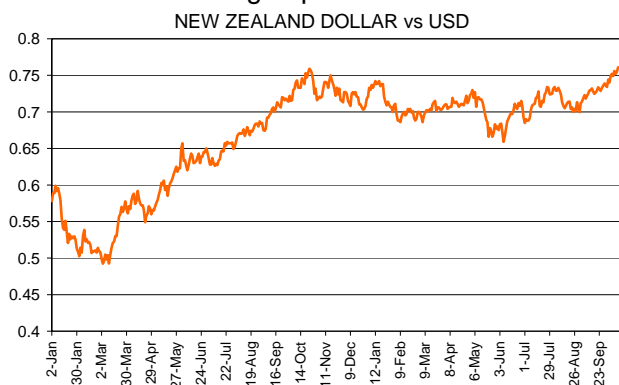
- Dwelling consent numbers to recover now with potentially good activity from mid-2011. (Changed from late-2010 August 26).
- House prices edging higher from second half of 2011. (Changed from post-Budget August 26)

## 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	0.763	0.752	0.730	0.719	0.733	0.610	0.592
NZD/AUD	0.765	0.765	0.782	0.814	0.81	0.770	0.856
NZD/JPY	62.00	62.40	61.06	63.80	65.8	61.366	66.8
NZD/GBP	0.478	0.474	0.474	0.474	0.461	0.380	0.345
NZD/EUR	0.542	0.541	0.567	0.565	0.494	0.445	0.51
USD/JPY	81.26	82.97	83.67	88.74	89.76	100.600	113.9
USD/GBP	1.596	1.586	1.540	1.517	1.590	1.607	1.709
USD/EUR	1.408	1.390	1.287	1.273	1.484	1.372	1.156
AUD/USD	0.997	0.983	0.933	0.883	0.905	0.792	0.69

### NZD Above 76 cents

The Kiwi dollar has risen back above US 76 cents for the first time since October last year driven by some weakness in the greenback over the week, association with the strong Aussie dollar headed for USD parity, and perhaps some risk reassessment. That risk reassessment factor runs like this. Compared with the major currencies the NZD is higher yielding but more volatile with risks surrounding our economic base. But with growing worries about currency intervention affecting the Yen, Chinese Yuan etc. there is a new element of uncertainty in the FX markets – for those currencies. Not the NZD. That means the relative riskiness of the NZD is diminished. That means that in the absence of any changes in other fundamentals such as interest rate differentials we go up.

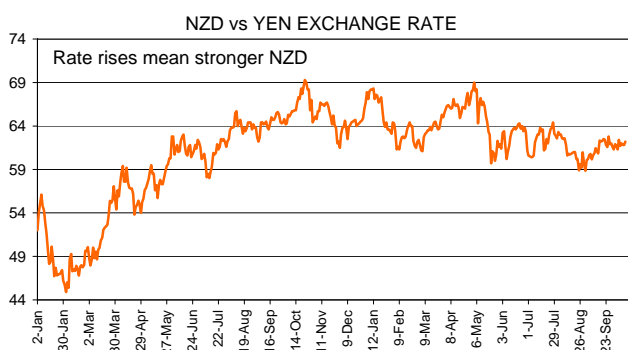
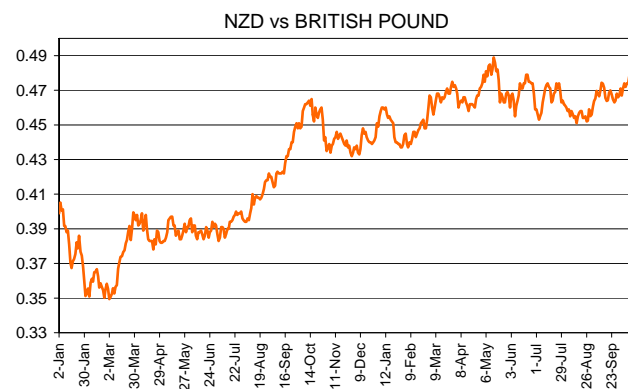
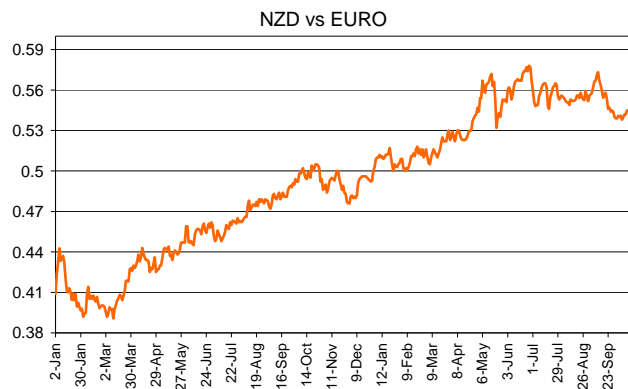


Of course there is a change in those fundamentals. The US federal Reserve is highly likely to undertake some new quantitative easing – printing money – in a month's time. More dollars means a reduced dollar value measured in terms of other currencies. But in addition the governments of those other economies want their currencies to fall against the greenback therefore the chances of them raising their interest rates in the near future have taken a step back. That means in terms of interest rate differential prospects things have shifted more in favour of the NZD these past three weeks.

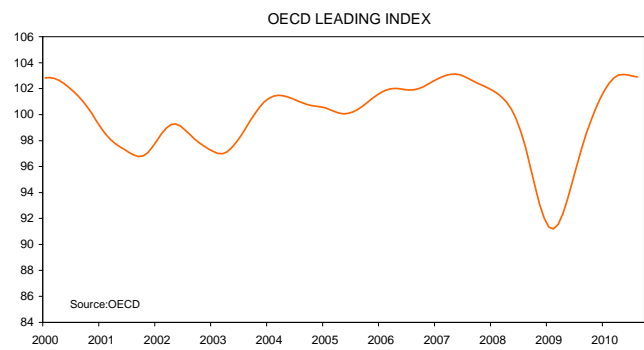
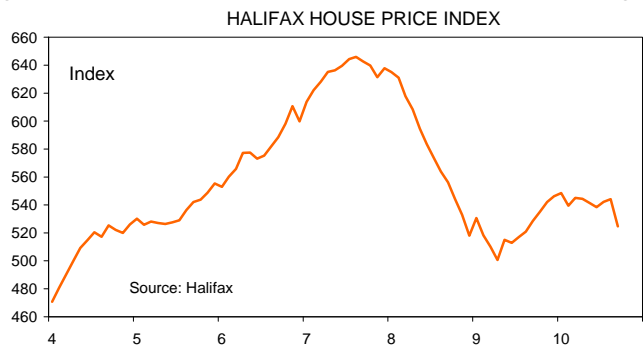
This is not a fully fledged currency war as yet by any means. But the signs are somewhat worrying. If one does develop, then a lot of our argument above may in fact go out the window because the resulting increased concern about world growth will likely dent commodity prices and risk tolerance thus sending the NZD back down again.

In other words? We have taken the one factor of competitive currency depreciations and generated a forecast that it places upward pressure on the NZD, but could eventually place strong downward pressure on it as well. Good luck with your hedging.





Like in New Zealand economic data received recently for many other economies has come in weaker than expected showing recoveries losing some of their steam. In the United Kingdom for instance a report from the British Chamber of Commerce has shown a sharp slowing in growth in the services sector. In the words of their Chief Economist “The results for the third quarter of this year show a marked slowdown in the pace of the recovery.” The Halifax monthly house price measure decreased 3.6% last month which was the greatest decline since 1983 when their records began.

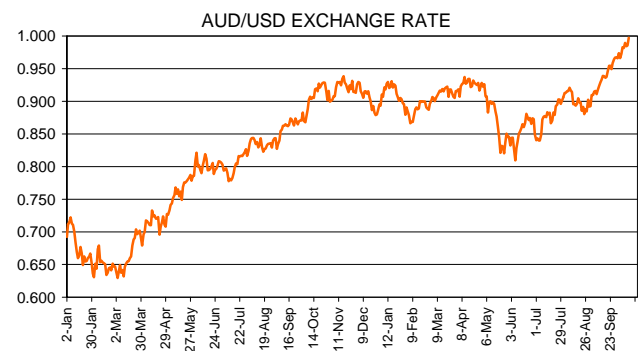
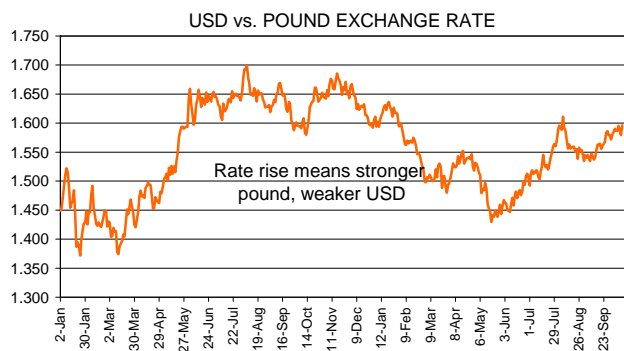
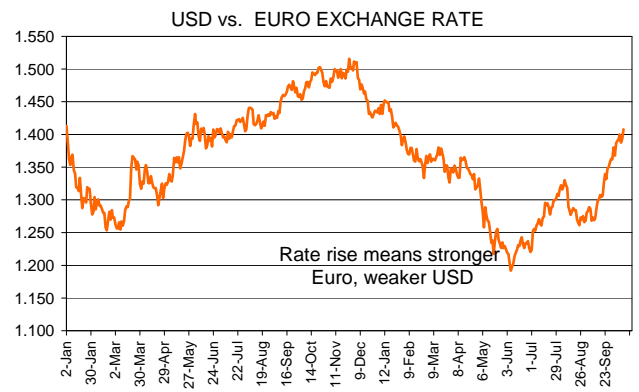
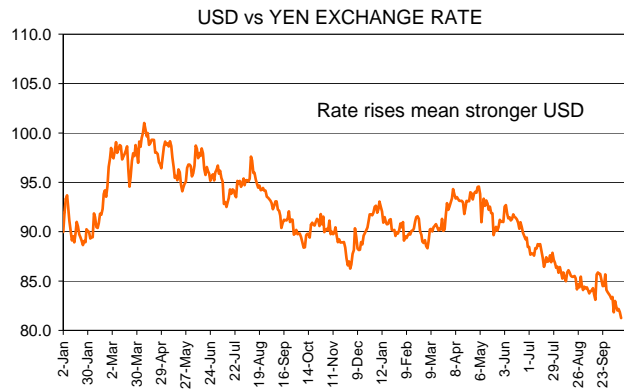


UK consumers remain beset by worries about employment, high debt, house valuations, and the government’s fiscal austerity measures – those already in place and the swathe expected to come October 20.

The OECD’s leading index of economic growth in its 33 members fell for the second month in a row in August. The measure was flat in May and June and the last time it rose was back in April.  
[http://www.oecd.org/document/40/0,3343,en\\_2649\\_34349\\_46166824\\_1\\_1\\_1\\_1,00.html](http://www.oecd.org/document/40/0,3343,en_2649_34349_46166824_1_1_1_1,00.html)

Last week the IMF cut their forecast for global growth next year to 4.2% from 4.8% expected this year. The monthly Consensus Economics survey we use shows economists globally on average expecting our top 14 trading partners to grow 3.1% over 2011 from almost 4% this year. Things are easing off globally but we see little chance of a double dip recession here or in our major trading partners.

# BNZ WEEKLY OVERVIEW



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	0.3%	0.4	1.8	1.9	4.0
GDP growth	Average past 10 years = 2.6%	+0.2	0.5	+0.7	-2.2	2.4
Unemployment rate	Average past 10 years = 4.7%	6.8	6.0	.....	5.9	4.0
Jobs growth	Average past 10 years = 2.0%	-0.3	1.0	0.0	-0.9	0.8
Current a/c deficit	Average past 10 years = 5.9% of GDP	3.0	2.4	.....	5.6	8.1
Terms of Trade		2.0	5.8	12.7	-13.5	10.7
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%.	1.3	0.7	1.3	-0.6	2.8
House Prices	REINZ Stratified Index	-1.1	0.7	2.3	0.7	-7.0
Net migration gain	Av. gain past 10 years = 13,900	+14,507	17,967yr	.....	15,642	4,938
Tourism – an. av grth	10 year average growth = 3.2%. Stats NZ	4.4	3.1	4.4	-2.8	0.3
		Latest year rate	Prev mth year rate	6 mths ago	Year ago	2 yrs ago
Consumer conf.	10 year average = 3%. Colmar survey	46	36	57	3	-34
Business activity exps	10 year average = 19%. NBNZ	27	26	39	32	17
Household debt	10 year average growth = 10.3%. RBNZ	2.3	2.5	2.7	2.4	7.8
Dwelling sales	10 year average growth = 2.5%. REINZ	-27.1	-26.7	-3.8	39.3	-34.0
Floating Mort. Rate	(TotalMoney) 10 year average = 7.9%*	6.09	5.84	5.59	5.85	10.49
3 yr fixed hsg rate	10 year average = 7.8%	7.15	7.30	7.95	7.45	9.09

## ECONOMIC FORECASTS

Forecasts at Sept. 23 2010	March Years					December Years				
	2009	2010	2011	2012	2013	2008	2009	2010	2011	2012
<b>GDP - annual average % change</b>										
Private Consumption	-1.2	0.6	2.2	2.2	1.3	-0.4	-0.6	2.3	2.2	1.5
Government Consumption	4.3	1.1	2.3	1.4	0.9	5	1.4	2.7	1.1	1.2
Investment	-7.1	-9.7	4.7	1.9	3.4	-3.5	-12	2.5	2.6	2.8
GNE	-1.5	-3.3	2.6	3.6	1.7	0.4	-5.1	2.7	3.3	2.1
Exports	-3	3.2	3.5	6.1	2.3	-1.1	0.4	3.8	5.8	3
Imports	-4.3	-9.5	6.3	4.6	2.7	2.3	-14.8	7	4.4	3.1
GDP	-1.5	-0.4	2.2	4	1.5	-0.2	-1.7	2	3.8	2
Inflation – Consumers Price Index	3	2	4.7	2.8	2.6	3.4	2	4.5	2.7	2.6
Employment	0.8	-0.1	1.7	2.3	0.9	0.9	-2.4	1.9	2.9	0.8
Unemployment Rate %	5.1	6	6.1	5.3	5.4	4.6	7.1	6.4	5.3	5.4
Wages	5.1	1.6	2.7	3.8	3.4	5	3.1	1.6	3.4	3.5
<b>EXCHANGE RATE ASSUMPTIONS</b>										
NZD/USD	0.53	0.7	0.75	0.71	0.67	0.56	0.72	0.73	0.72	0.68
USD/JPY	98	91	86	90	93	91	90	85	89	93
EUR/USD	1.31	1.36	1.33	1.37	1.36	1.34	1.46	1.31	1.36	1.4
NZD/AUD	0.8	0.77	0.78	0.81	0.84	0.83	0.79	0.78	0.8	0.83
NZD/GBP	0.37	0.47	0.48	0.44	0.41	0.37	0.44	0.47	0.45	0.41
NZD/EUR	0.41	0.52	0.56	0.52	0.49	0.41	0.49	0.56	0.53	0.49
NZD/YEN	51.8	63.7	64.5	63.9	62.3	50.9	64.2	62.1	64.1	63.2
TWI	53.8	65.1	68.4	65.8	64.1	55.1	64.7	67.1	66.4	63.9
Official Cash Rate	3	2.5	3.25	5	5	5	2.5	3	4.75	5
90 Day Bank Bill Rate	3.24	2.67	3.57	5.15	5.15	5.23	2.78	3.2	5.07	5.15
10 year Govt. Bond	4.77	5.86	5.75	6.75	6.75	4.88	6.02	5.5	6.5	6.75

All actual data excluding interest & exchange rates sourced from Statistics NZ.

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\*extrapolated back in time as TotalMoney started in 2007