Mission Statement

To help Kiwi businesspeople and householders make informed financial decisions by discussing the economy and its implications in a language they can understand.

In this week's issue….

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

Monthly Survey Time

This is the first Thursday of the month so we are once again running our monthly confidence survey. If you have not already done so using the link in the email used for sending out the WO then if time permits cut and paste the link below into your browser and let us know whether you think the economy will get better or worse over the coming year. More importantly, if possible pen a sentence describing how things are in your industry currently – remembering to note what the industry is. Responses focussed on current conditions will be included in the results to be released early next week.

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

This week we have seen a range of data released of relevance to the NZ economy, and in no particular order of importance we have learnt the following.

- The Auckland housing market is steady at low levels of activity with no evidence of either rushed vendors or buyers.
- Business sentiment has fallen but remains at above average levels while investment and employment intentions are almost exactly equal to their averages.
- Farmers are showing a mild inclination toward borrowing more money but there is no evidence of credit demand rising in the household or urban business sectors.
- Registrations for all vehicle types have ceased growing during the September quarter.
- NZ export commodity prices have risen back to near record levels on world markets.

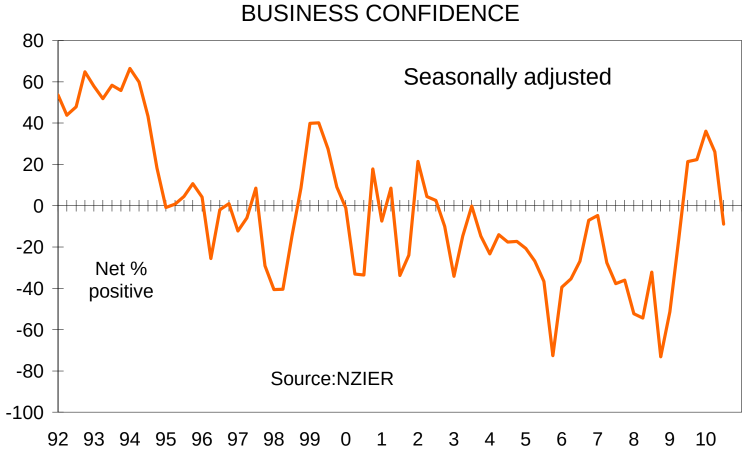
But before we all get too depressed, here are some of the things we expect will drive growth toward the 3.5% area over 2011.

- The below average NZD/AUD exchange rate which will be good in particular for Aussie visitor inflows and the manufacturing sector. About 45% of visitors currently come from Australia and about half manufactured exports go across the ditch.
- Strong growth in the Australian economy boosting demand for NZ goods and services generally.
- The Rugby World Cup. More visitors, positive buzz etc. until….

- The simple passage of time taking more household and business borrowers to a point where they are comfortable with their debt levels and willing to contemplate some gearing up. Currently the unchanging focus is on reducing debt.
- Rebuilding in Christchurch following the earthquake.
- Businesses boosting expenditure on plant, machinery & equipment after an extended period of weak spending running into falling employee productivity and rising capacity utilisation.
- The ending of the traditional lagged downturn in non-residential construction.
- Hastened investment in the dairying sector caused by firm global dairy prices and anticipation of continued good demand from rising world population and incomes.

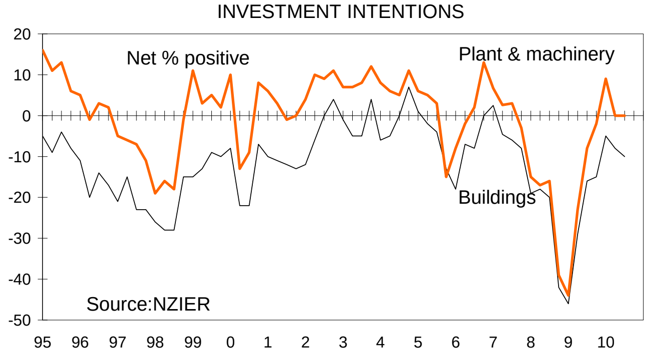
Business Confidence Falters

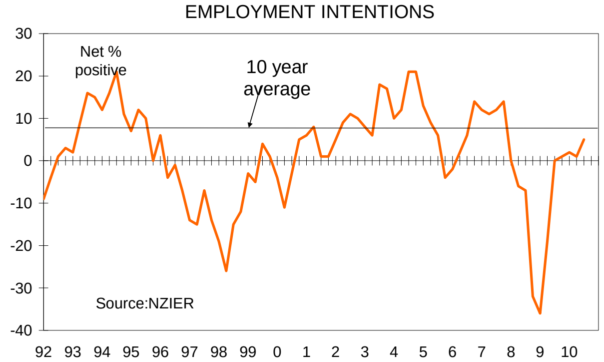
One of the more important collections of data released regularly in New Zealand is the Quarterly Survey of Business Opinion compiled by the NZIER. The results tend to date quickly but they give us a snapshot of where things were on average a couple of weeks ago. And where things were seems not to have been a very happy place. In seasonally adjusted terms business confidence about the economy over the coming three months fell to a net 9% pessimistic from 26% optimistic in the June quarter.



This is the lowest result since -16% in the June quarter of last year when the economy was just exiting from recession. It is however above the ten year average reading for this measure and nowhere near the net 73% pessimistic in the December quarter of 2008. The important thing therefore is that it is a pullback – but a pullback from levels which were probably "too" high to start with anyway given the troubles which are still affecting the economy.

With regard to what businesses are planning to do we find a mixed bag of results. For example a net 0% say they will boost spending on plant and machinery. But this result was unchanged from the June quarter and equal to the ten year average. A net 10% say they plan cutting spending on buildings compared with a net 8% in the June quarter. The average for this measure however is -8% so again we have a result about average and not at all suggestive of the economy dipping back into recession.

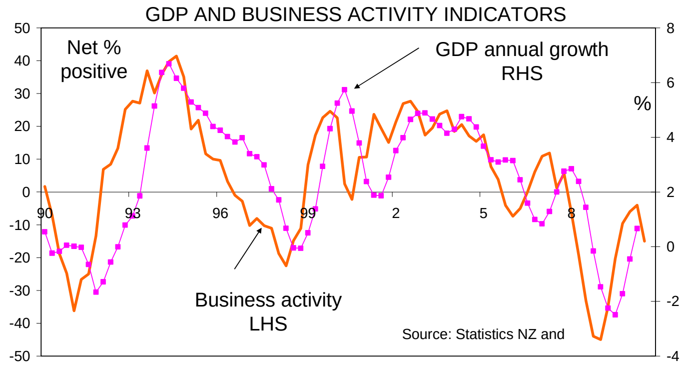




Interestingly there were some results in line with our view that the labour market is in better shape than the last Household Labour Force Survey would have one believe. A net 5% of respondents said they plan hiring people. This was actually up from 1% in the June quarter though just below the 7% average. A net 19% of employers said they find it easy to get unskilled labour, but this was down from 23% in the June quarter and the lowest result (greatest level of difficulty) since the September quarter of 2008. A net 4% say they are finding it hard to get skilled people. This is a measure we think could change quite a bit in the coming year to reveal some major skilled labour deficiencies. During the June quarter this reading was -2% and the result is the strongest also since the September quarter of last year.

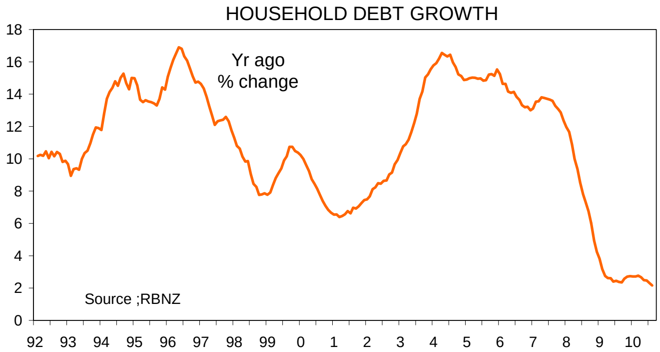
The capacity utilisation rate remained relatively firm at 90.4% from 90.8% in the previous quarter (not a % really but what the heck). The average reading for this measure is 90.8% so it shows there is not a lot of unused machinery sloshing around the country. This is one reason why we believe there exists good scope for much stronger business capital spending – once willingness to borrow picks up (see below).

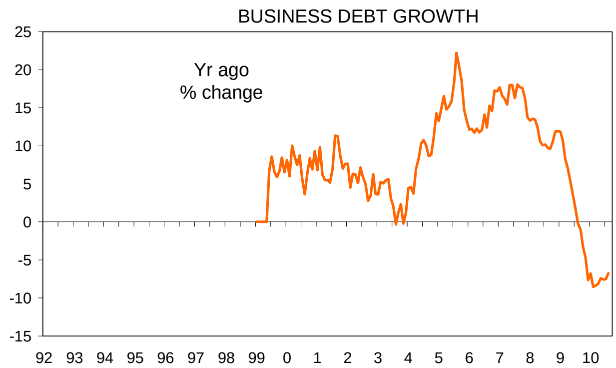
Overall, although the survey was weaker than we were expecting we feel it still shows an economy headed for growth above 3% with few immediate inflation worries for the Reserve Bank. Having said that, plus 3% growth does look like a slightly brave call when one considers the graph below showing a reasonable correlation between the annual average rate of change in GDP and the business activity expectations measure contained in the QSBO. This measure fell to a seasonally adjusted net -15% in the September quarter from -4% in the June quarter.



Credit Growth Remains Weak

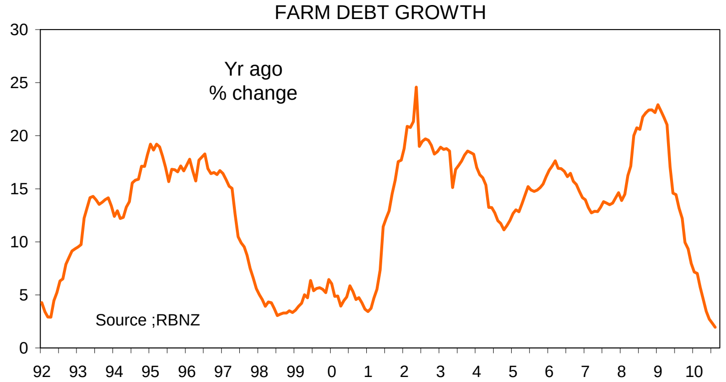
In August the level of household debt in New Zealand rose by only 0.1% in seasonally adjusted terms from July. This miniscule increase continues a series of small rises near 0.2% in place since the end of 2008 and allows one to say that not only is there practically no growth in household net borrowing (up 2.2% from a year ago) there is no improvement in that low growth underway. Householders appear to remain as focussed as ever on getting debt levels down and as we have pointed out before there is simply no way of knowing when this process will come to an end. That means one needs to be very careful about putting any timeframe around when retail spending or the housing market will pick up. It could be next month, it could be December 2013. We assume next year. Frankly your assumption may be just as valid as ours if it is for a different time period.





In the urban business sector the level of debt at the end of August was down 6.8% from a year earlier. This was the lowest annual rate of shrinkage since November last year so are there signs that businesses are borrowing more? The level of debt in August was $72,311 whereas two months earlier it was $72,856. Debt is still falling. In fact in the three months to August business debt fell $952mn whereas it grew $2.6bn over the same period in 2008 and $2.9bn over the same period in 2007. Businesses still do not want to borrow money and again one cannot know for certain when this period of debt reduction will end. When it does there will be a potentially strong lift in capital spending which at the moment is still on the weak side.

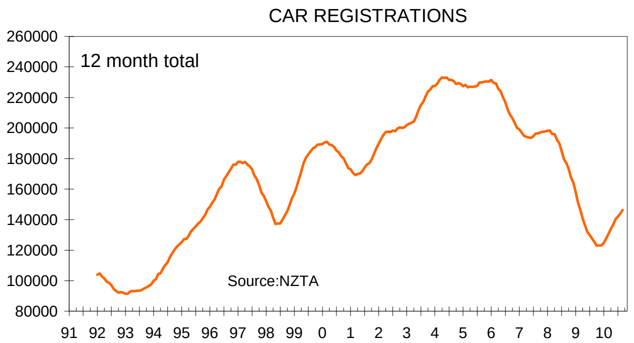
In the farming sector debt at the end of August was ahead 2% from a year ago and at a record level. So farmers are still borrowing whereas urban businesses are gearing down their balance sheets. Interesting. In the three months to August however farm debt grew only $730mn compared with $2.6bn two years earlier and $1.6bn three years ago. Growth is weak but still occurring.

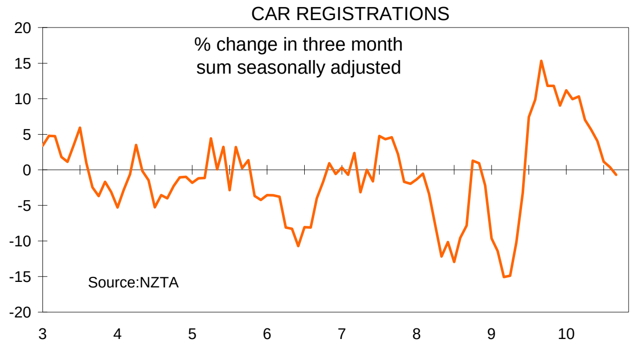


Overall the numbers continue to show high unwillingness to borrow. One day this will change. One day.

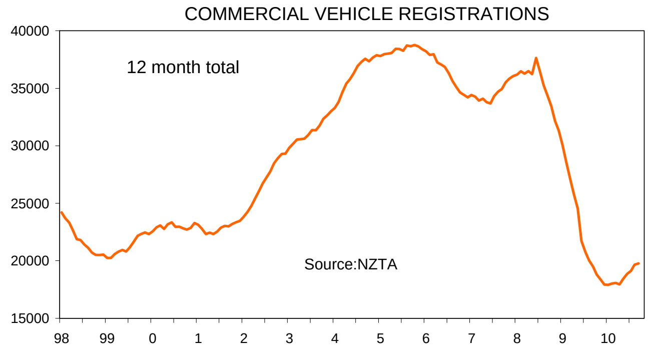
Vehicle Registration Activity Flattens Out

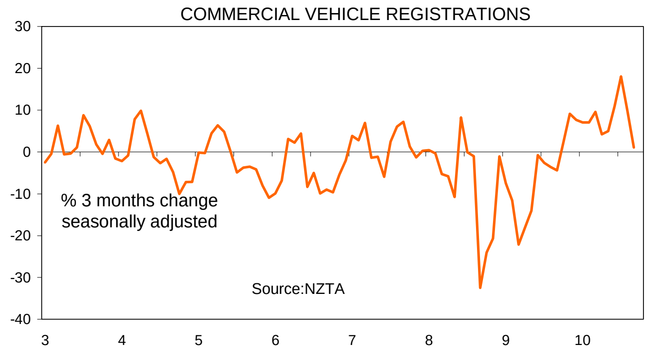
In September there were 13,728 cars registered around the country. This was a 19% rise from a year ago and during the September quarter regos were ahead 18% from a year ago but flat in seasonally adjusted terms compared with the June quarter. There has been a recovery in car registrations but that recovery is not continuing for the moment. Only when consumers come out of their shells and become willing to borrow more money are we likely to see more than fleet repurchase patterns for the business sector driving anything interesting with regard to car sales.



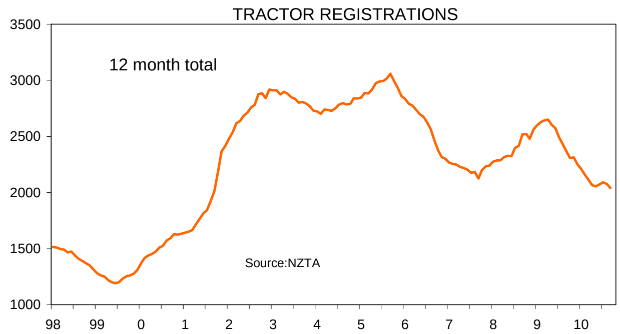


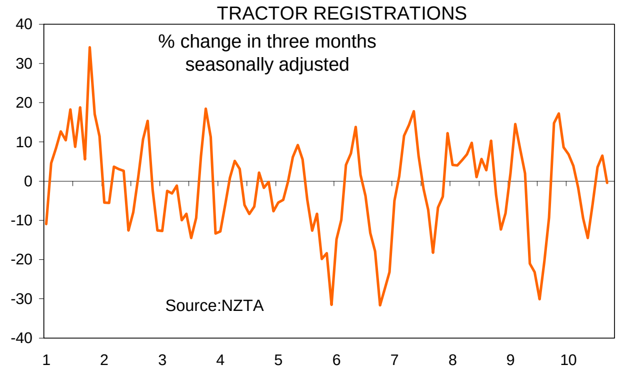
There were 1,728 commercial vehicles registered in New Zealand in September. This represented a 7% rise from a year ago and for the September quarter regos were ahead 21% from a year earlier but flat in seasonally adjusted terms compared with the June quarter. As with cars there has been a recovery in this particular indicator of business investment but the growth has now ceased.





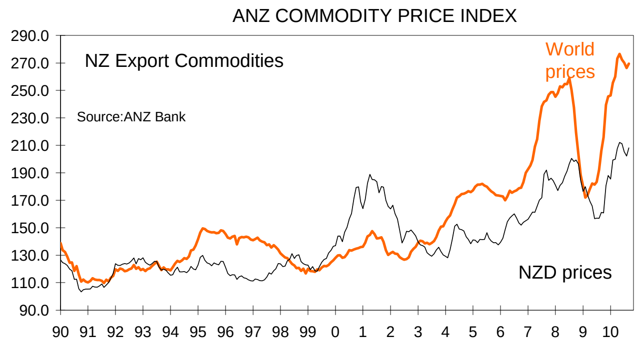
In September there were 228 tractors registered around the country which was a fall from a year ago of 13%. For the September quarter the change was a fall of 5% from a year ago and yet again seasonally adjusted regos were flat compared with the June quarter. Activity growth in the vehicle sector all up has stalled.

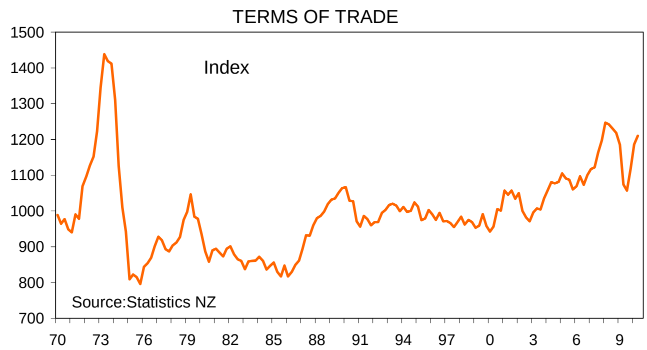




Commodity Prices Firm

And finally, commodity prices. The world generally wants what we have to sell and the ANZ Commodity price Index in world price terms rose 1.2% in September to sit 31% up from a year ago and only 2.6% below the record level reached earlier this year. In NZ dollar terms the index rose 2.9% in September to lie 29% ahead of a year ago and 1.9% off the record high reached in May. Strong gains in commodity prices have gone a long way to offset higher prices for fuel and various materials over the past year producing a near 13% rise in the terms of trade in the June quarter compared with a year earlier.

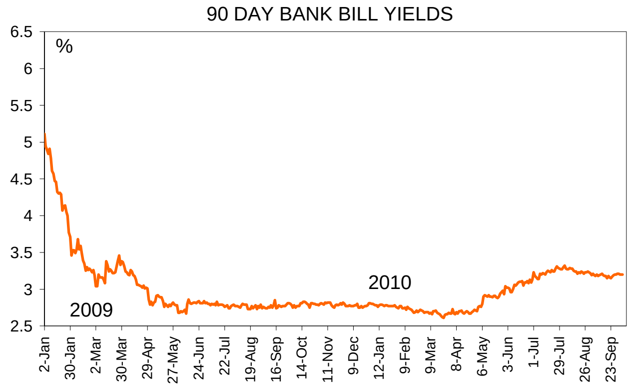


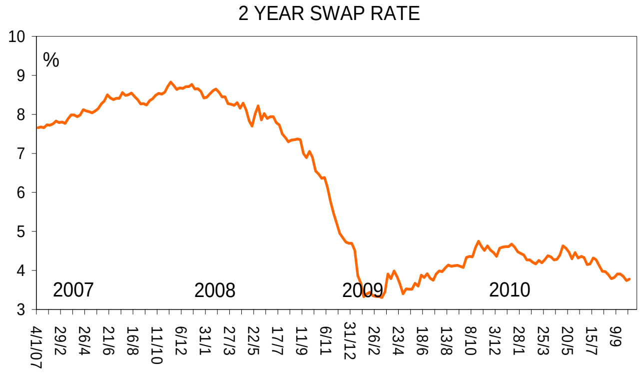


Our expectation is that with world growth easing off we are unlikely to see export commodity prices continuing to rise, but falls are likely to be quite limited if they come along. The exchange rate as ever remains a key uncertain element for farmers – along with the weather, market conditions, competition from other producers, animal health etc.

INTEREST RATES

Apart from the Australian Reserve Bank surprising most market participants by not raising their cash rate this Tuesday there has been little news of big enough import to move wholesale interest rates this week. Bill yields remain at 3.2%. Swap rates are also essentially where they were last week. Our expectation is that bill yields will remain where they are until we approach March next year when – for the moment – we expect the next official cash rate rise will occur. Swap rates are expected to creep high but there is high uncertainty around the impact of any quantitative easing in the United States which could generate offsetting downward pressure on rates. Then again, if one begins to worry about inflation further out because so much money is being printed then one would expect at some stage interest rates will rise very sharply. But given that there is no sign of accelerating credit growth as yet the inflation risk globally appears extremely minor. And one suspects that as soon as inflation does star rising we will see quick withdrawal of the quantitative stimuli.





Key Forecasts

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

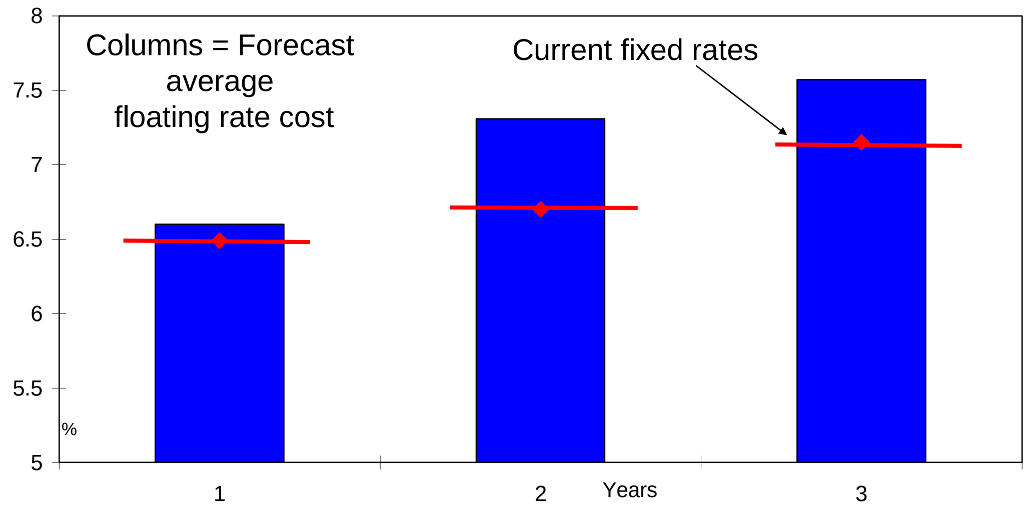
FINANCIAL MARKETS DATA	This week	Week ago	4 wks ago	3 months ago	Yr ago	10 yr average
Official Cash Rate	3.00%	3.00	3.00	2.75	2.50	5.9
90-day bank bill	3.20%	3.21	3.19	3.14	2.78	6.2
1 year swap	3.48%	3.44	3.57	3.75	3.40	6.3
5 year swap	4.39%	4.34	4.54	4.90	5.58	6.6
180-day term depo	4.10%*	4.10	4.80	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%						

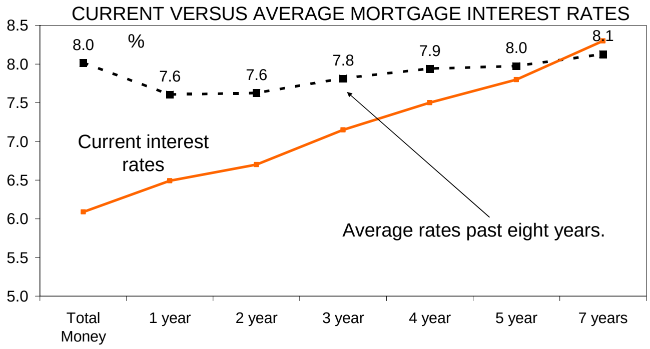
If I Were a Borrower What Would I Do?

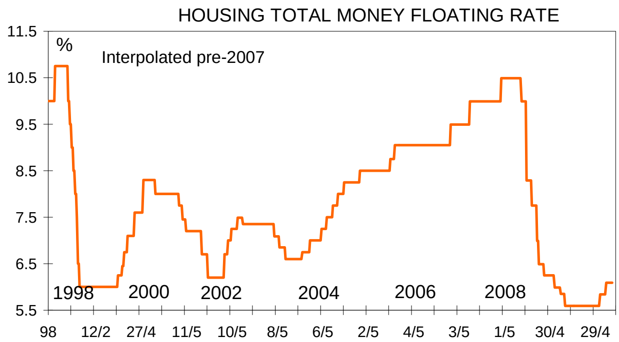
I think the comment here is going to remain the same here for quite some time. I would simply sit floating – unless someone came along and offered me a really attractive fixed rate. How attractive would that fixed rate have to be to get me to move now? Fairly attractive because in an environment where the Americans look set to keep long rates down by printing more money soon there is little risk to sitting floating now. Our analysis suggests that over the next two years the floating rate will average 7.3%. The current two year fixed rate is 6.7% so were it not for the fact we think neither fixed or floating rates will go anywhere for a while I would say fix. But we see little scope for change soon – and even a risk that fixed rates decline given the fall in wholesale funding costs recently.

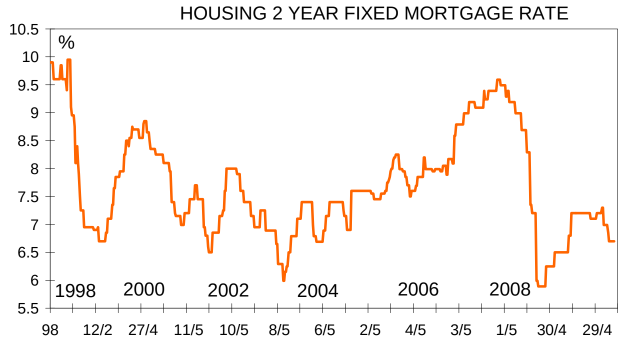
I would forsake the current 6.09% Total Money floating rate and jump into a two year fixed rate if someone offered me 6.35%. And to fix three years? That rate is currently 7.15% and we forecast an average floating rate for the coming three years of 7.6%. I would sacrifice my nice low 6.09% floating rate and opt into three years fixed if offered a rate of 6.5%. For your guide I have no insight into whether anyone is going to offer such rates soon and frankly don't expect such large cuts from current rates given rising bank funding costs outside of what you see via the swap rates we discuss here. The underlying relationship between swap rates and actual funding costs continues to change – for the worse.

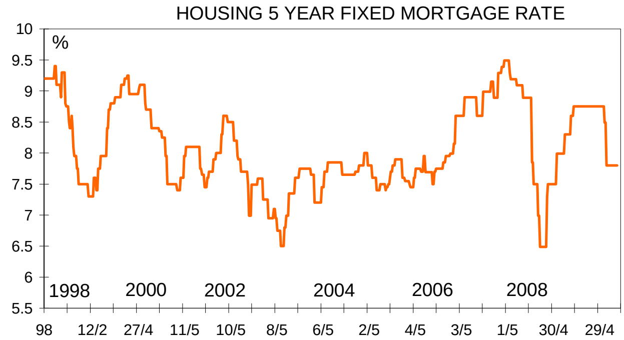
Meaning? Back in mid-March 2009 before swap rates and fixed lending rates jumped very sharply we had the likes of the five year swap rate at 4.22% compared with near 4.35% currently. Back then the five year housing fixed rate was 6.49%. it is currently 7.8%. The global money world has structurally changed and we banks face far higher costs of funding than in the past but those costs do not appear in the simple swap rates.





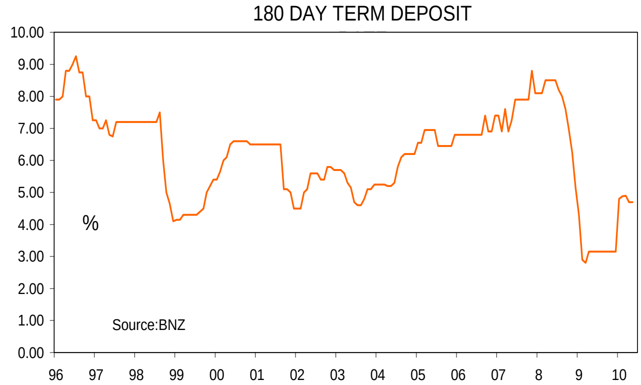


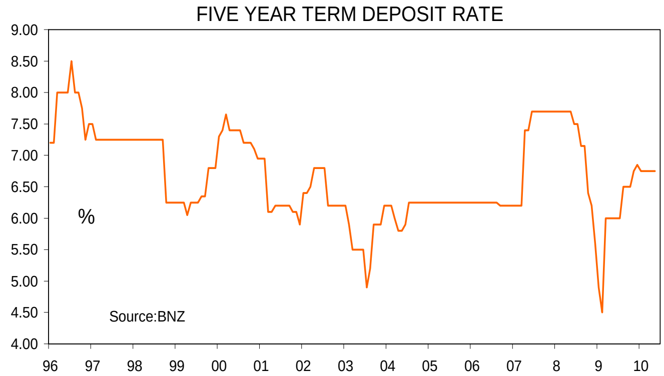




If I Were a Term Deposit Investor What Would I Do?

Look for specials in the 150 day area and place a tad more long term for extra yield.

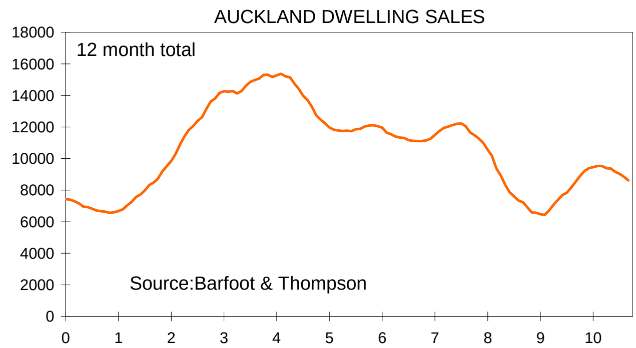


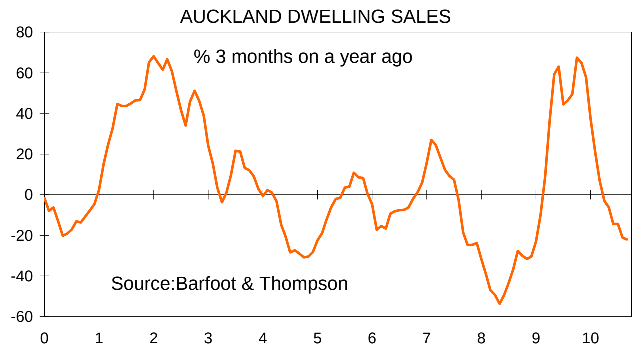


HOUSING MARKET UPDATE

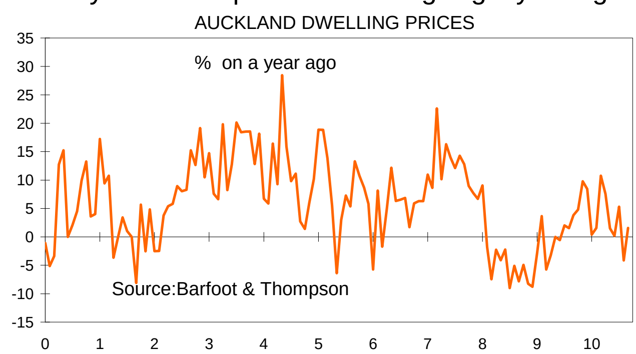
Chugging Along In A Flat Manner

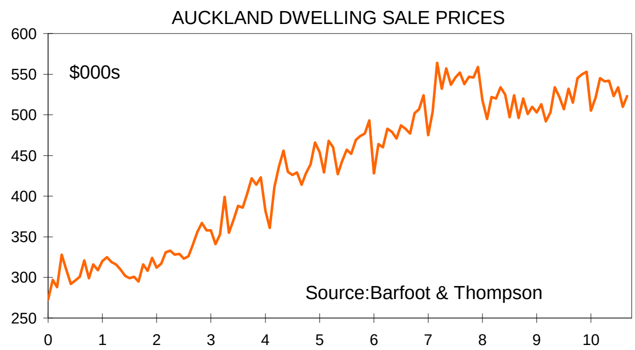
This week we received the monthly data on activity by Barfoot and Thompson who account for about one-third of the Auckland residential real estate market. In September they sold 689 dwellings which was a fall of 25% from a year earlier but a 23% rise from September 2008. In rough seasonally adjusted terms sales were ahead about 1% after rising 3% in August so there is a very small improvement in activity underway. But it is small and from a low base.



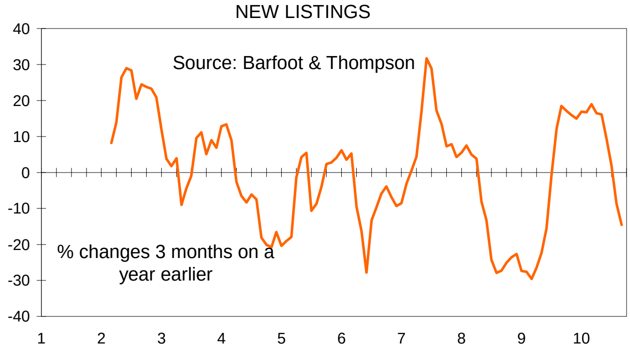


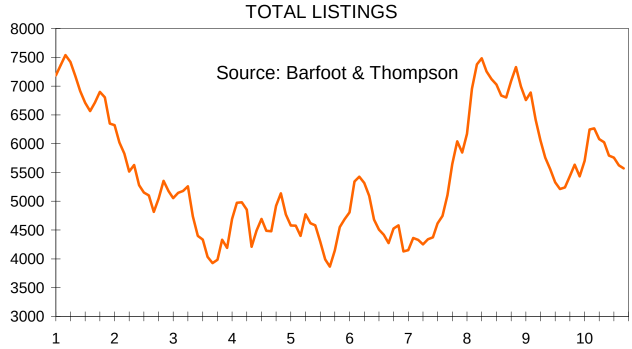
The median dwelling sale price improved to $523,000 in the month from $510,000 in August but it is best to smooth this reading and doing so we see that over the September quarter this particular price measure was down by 2.4%. So prices are falling slightly though with low turnover.





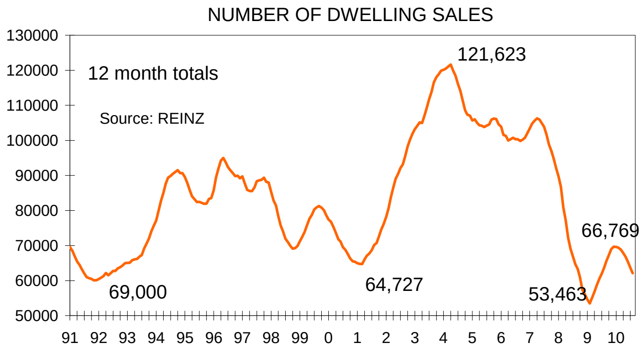
At the end of the month there were 5,572 properties listed which was a 6% rise from a year earlier – which was itself however down 23% from September 2008. Listings are not rising all that much. In fact the number of new listings received in the month was just 1,203 compared with 1,466 in September last year and 1,263 in September 2008. So there is still no flood of properties coming onto the market. Vendors clearly do not on average feel pressured to sell and with interest rates set to stay at current low levels for another six months or so that pressure is unlikely to intensify. If anything we expect it could lessen for some owners as the labour market improves. But one suspects there are thousands of vendors who would sell if the market were stronger.



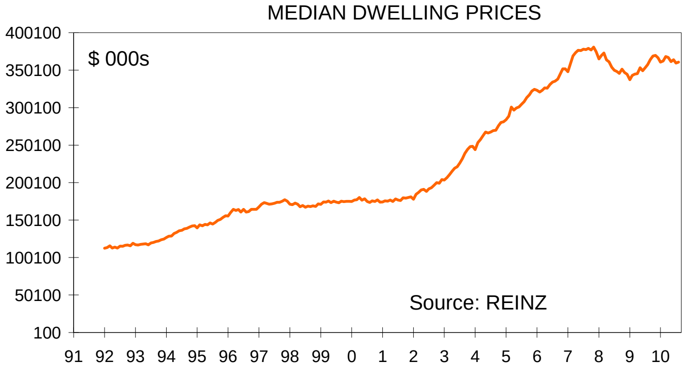


All up the data show a housing market in Auckland still in a firm low volume holding pattern. Nothing new.

Just for your guide, on average over the past ten years 90,000 dwellings have been sold each year. In the year to August the total was only 62,000 so that explains why in the residential real estate sector there is still a period of rationalisation underway.



Average nationwide house sale prices are where they were in the early part of 2007 and over the past year they have risen almost 1% after rising 3% the previous year and falling almost 8% in August 2008 compared with August 2007.



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 mid-2011. (Changed from late-2010 August 26).
- House prices edging higher from second half of 2011. (Changed from post-Budget August 26)

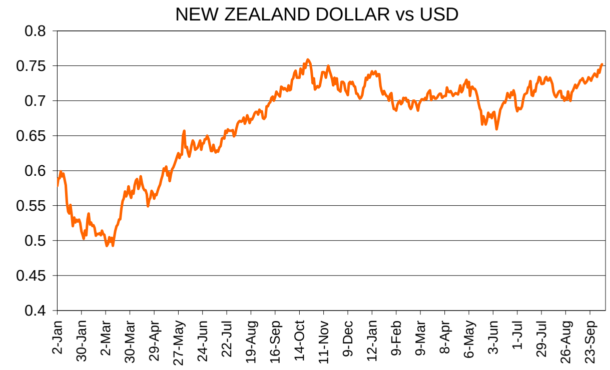
Exchange Rates & Foreign Economies

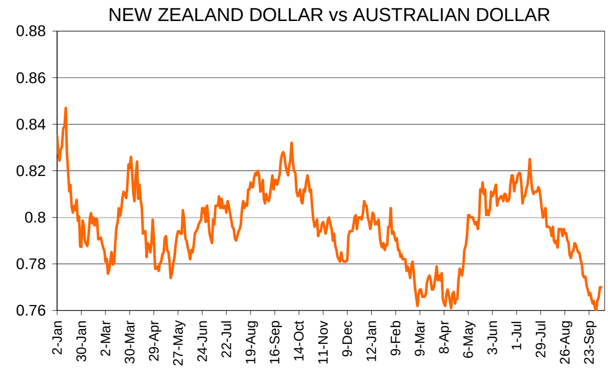
Exchange Rates	This Week	Week Ago	4 wks ago	3 mths ago	Yr ago	Consensus Frcsts yr ago*	10 yr average
NZD/USD	0.752	0.736	0.723	0.692	0.637	0.610	0.592
NZD/AUD	0.765	0.761	0.789	0.815	0.799	0.770	0.856
NZD/JPY	62.40	61.60	60.78	60.60	60.8	61.366	66.8
NZD/GBP	0.474	0.466	0.470	0.457	0.391	0.380	0.345
NZD/EUR	0.541	0.540	0.562	0.549	0.456	0.445	0.51
USD/JPY	82.97	83.69	84.09	87.57	95.4	100.600	113.9
USD/GBP	1.586	1.579	1.539	1.514	1.629	1.607	1.709
USD/EUR	1.390	1.363	1.286	1.260	1.397	1.372	1.156
AUD/USD	0.983	0.967	0.916	0.849	0.797	0.792	0.69

NZD Over US 75 cents

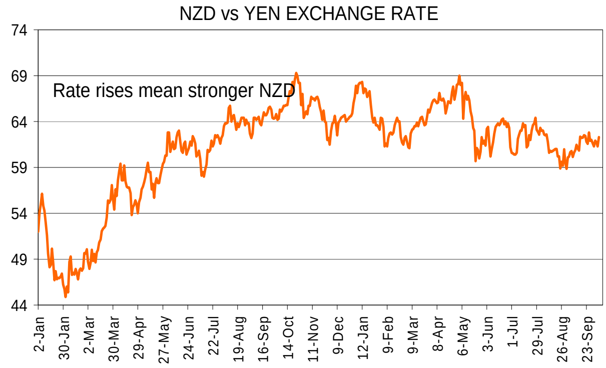
The Kiwi dollar this evening is trading near US 75.2 cents compared with 73.6 cents last week and 72.3 cents four weeks ago. Why the rise? The first reason is that the greenback has weakened slightly against the other major currencies as the markets have got worried about Fed. talk of additional quantitative easing. That means more dollars floating around and the increased supply means a reduced price when measured in terms of other currencies.

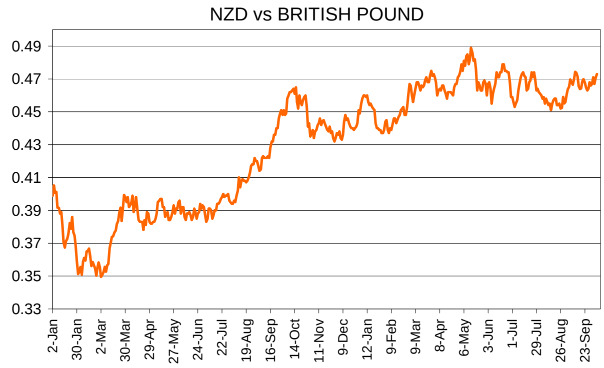
Second we have seen profit taking against the Aussie dollar (selling AUD and buying NZD) after the RBA this week surprised most analysts by leaving the cash rate unchanged at 4.5%. Our compatriots across the ditch still expect additional rate rises soon but it appears that for now the RBA is slightly less upbeat about global growth than previously, and perhaps a tad less concerned about inflation based upon one particular monthly measure which has been quite weak recently.

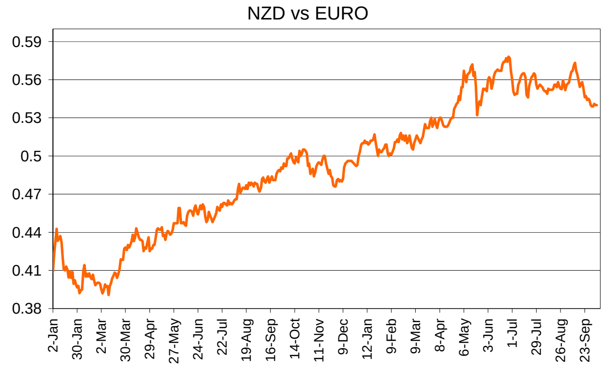


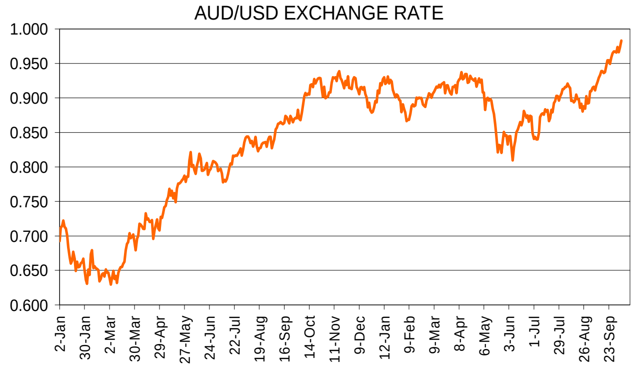


The NZD has risen against the AUD to near 76.6 cents from 76.1 cents last week. We have also gained slightly against the Yen and pound but stayed the same against the Euro. Nothing major there.





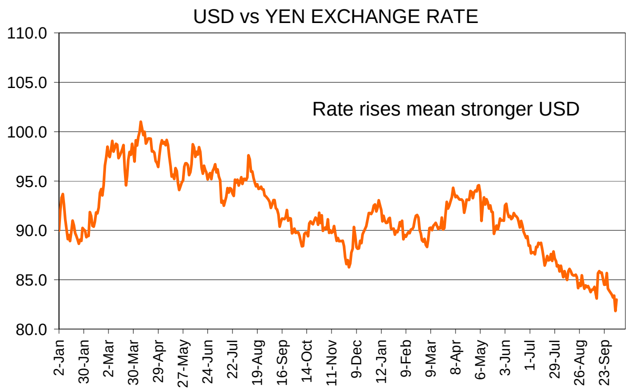


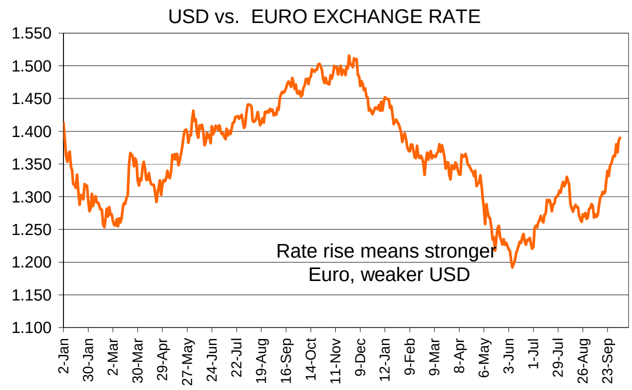


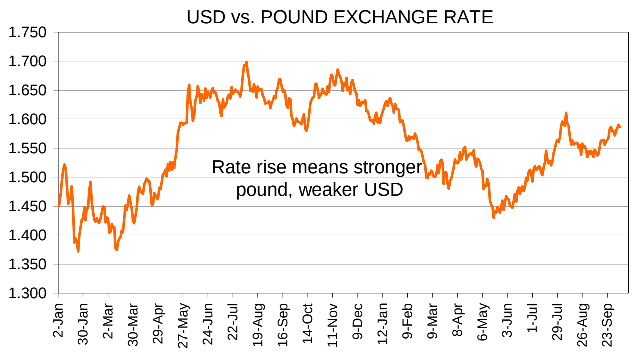
The Aussie dollar initially eased against the greenback after the RBA no change rate decision, but since then with assistance from record gold prices it climbed again to lie near 97.7 cents this morning from 96.7 cents last week. Then early this afternoon the monthly Aussie job numbers came out and whereas the market had been expecting a rise near 20,000 the actual gain was close to 50,000. This strong report has pushed the Aussie higher and this evening it is near 98.4 cents.

This is the highest exchange rate in 28 years and we could see parity parties very soon if commodity prices rise a tad further.

Meanwhile in Japan concerns about the strength of the Yen are once more rising now that the currency has regained all the ground it shed against the greenback after intervention by the Bank of Japan to sell the Yen a couple of weeks ago. To whit the Japanese Prime Minister said “I hope the BOJ will take further necessary steps aimed at overcoming deflation.” They did in the form of moving their cash rate even asymptotically closer to 0%. In other words – a fairly meaningless change which just highlights that like other Asian countries taking measures to try and stop their currencies’ rising against the greenback they are rather bereft of any decent policy ideas beyond relying on the US to keep buying their exports. Sad really to think that these countries are unwilling to do their bit to help the US out of the increasingly deep debt hole it is digging itself into. Asian currencies are clearly under-valued and the longer the intervention goes on the greater the eventual adjustment.







But it is not just the Asian countries showing they want currency devaluation to help their export bases. The Americans want and need the greenback lower, the Europeans are worried about the firm Euro, and the British would like an export boost from a weaker pound. Seriously – in a world like this where the big players are trying to race to the bottom it is surprising the NZD is not already at US 80 cents and above 50 pence given our closeness to Australia and strong commodity prices. Next year probably.

One final bit.

I don't mean any offence to the writer, but this email just has to be repeated.

"We had an announcement last week that NZ is sitting on $1 trillion of oil and gas reserves, conservatively speaking. There were comparisons made between NZ's and Norway's economies. For long term currency investors surely this must make the $NZ a good investment and push our currency even higher?"

Sounds good right? A few points need to be made however.

1. No-one has found all this stuff yet and the same sort of claims are repeatedly made for many parts of this planet.
2. We are also highly vulnerable to shocks – as we have pointed out many times – and these include the likes of foot and mouth disease and earthquakes.
3. NZ has an ongoing large current account deficit problem which shows no sign of self correcting. That is quite negative for the NZD long term.

Good luck all of you long term currency position takers. Many may still be waiting some 25 years after the float for the NZD to collapse to reflect our deficit problem.

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/

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
GDP - annual average % change										
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
EXCHANGE RATE ASSUMPTIONS										
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.

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