BNZ Weekly Overview

8 October 2009

Mission Statement

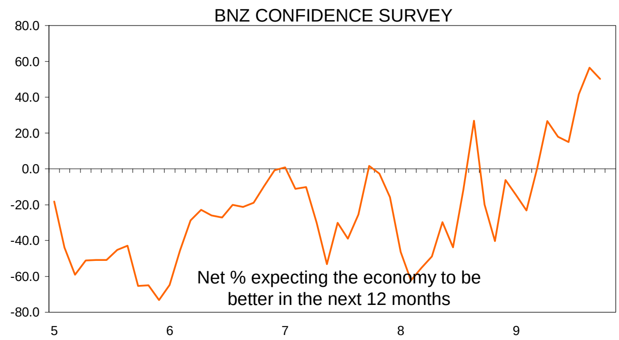
To help Kiwi businesspeople and householders make informed financial decisions by discussing the economy and its implications in a language they can understand.

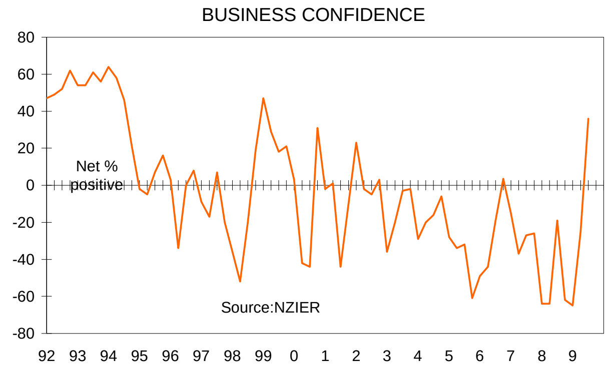
In this week's issue….

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

Businesses Very Confident

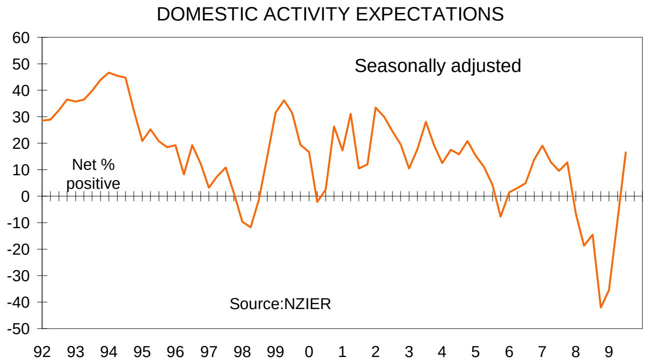
The past week has seen the release of at least four business surveys showing strong confidence that the economy will improve over the coming year. Our own monthly survey showed a net 50% of respondents expect improvement, which is only a small decline from the record net 56% positive in the September survey. There were some notably strong comments with regard to construction and the automotive sector, along with firmer employment comments. But residential real estate responses were less exuberant though still on the positive side.

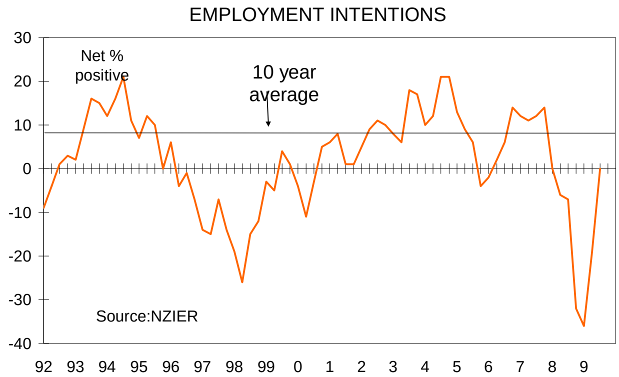




The most comprehensive survey to appear was the NZIER's Quarterly Survey of Business Opinion. This survey has been running for about four decades and has some very useful indicators. The headline one is that a net 36% of respondents from the business sector (excluding farming) see better economic times ahead. This is a hefty turnaround from a net 25% pessimistic during the June quarter and 65% during the March quarter. The result is the strongest early 1999 and is accompanied by plenty of other good numbers.

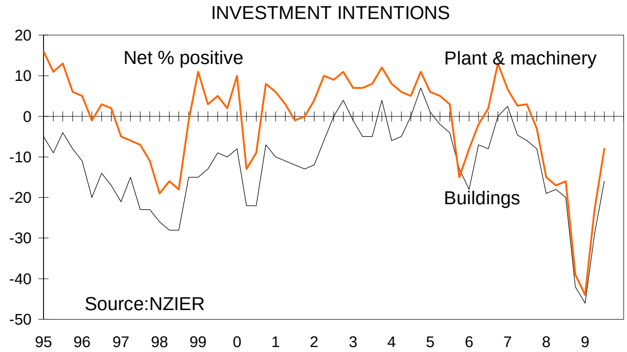
For instance a net seasonally adjusted net 17% of respondents expect their own levels of domestic trading activity to improve over the coming quarter from 9% expecting deterioration last quarter. This result is the strongest since 2007 and perhaps sheds some light on why headline sentiment numbers need to be treated with caution.





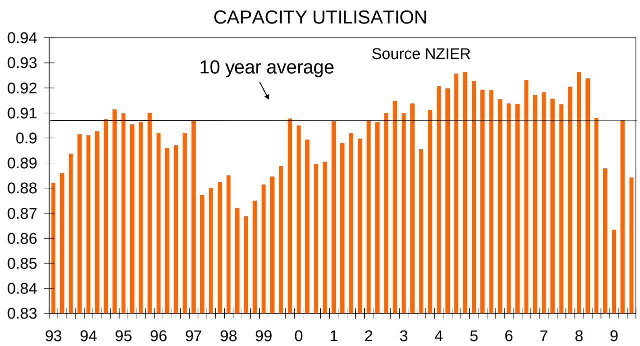
When asked how people see the overall economy doing we think there is a strong upward bias to current numbers from a feeling that there is no way things can go back to where they were earlier this year. But when asked how busy they think their own business will be there is optimism but we think more realistic caution. In fact this shows up quite well when we look at the all-important responses to questions about what companies plan doing.

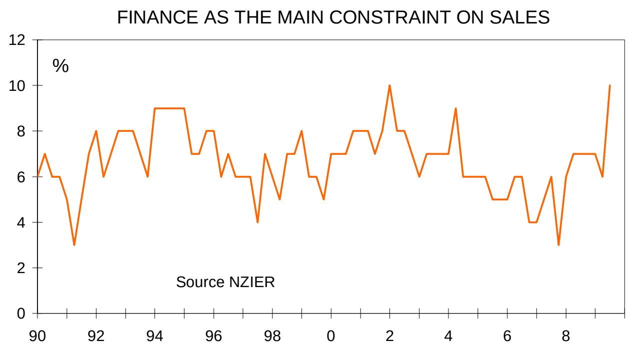
A net 0% intend hiring people. This is the best result since March quarter 2008 – only. It is also still below the September quarter average of +7%. Therefore one can use this number to say it seems reasonable to expect businesses have about reached the point where they are not planning to lay people off by and large. But they are not yet optimistic enough to start wading in and hiring people to any great extent.



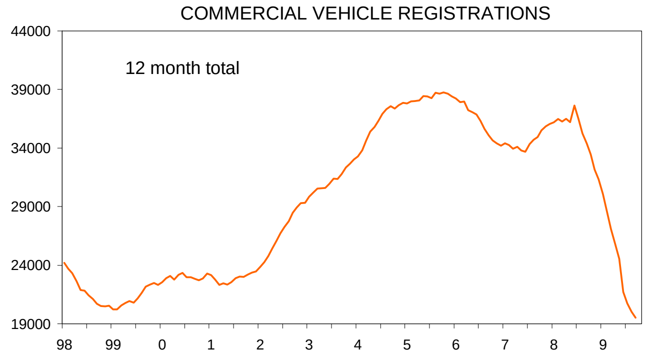
The same applies for investment in plant and machinery. A net 8% plan cutting it which is better than 23% planning cuts in the June quarter and 44% in the March quarter. It is the best result since the December quarter of 2007 but below the net 0% average. So, given what appears to be a persistent negative bias in this indicator the -8% reading is not that bad, but it is still below average though moving in the right direction.

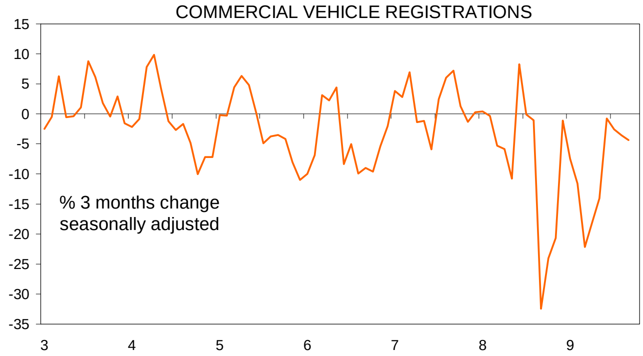
The pressure to invest actually appears to have eased a tad with the recently quite volatile capacity utilisation measure falling back to 88.4% from 90.7% in the June quarter. This is below the ten year average reading of 90.9%. Plus, only 5% of businesses say they are constrained by a shortage of capacity. A seven year high gross 10% say it is a shortage of credit restraining them from boosting output – which actually seems a mild result given the worldwide credit problem.



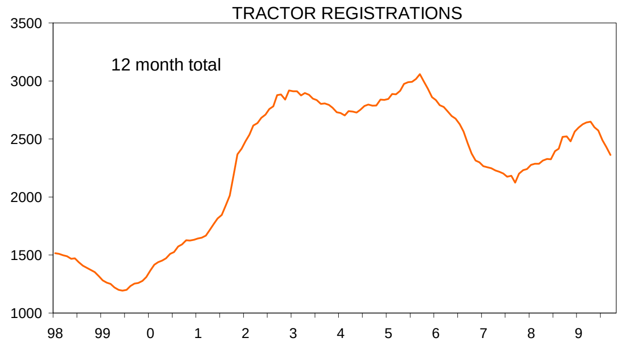


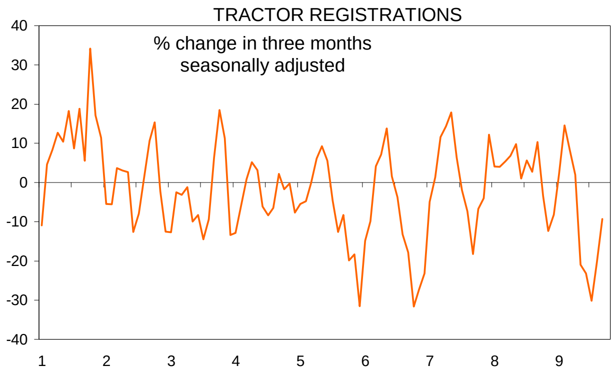
The results overall are consistent with an improving economy – but not a boom, and we can see this restraint in business spending when we look at the monthly motor vehicle registration numbers released this week. In September only 1,609 commercial vehicles were registered around the country. This was a 24% fall from a year ago, but more importantly for the quarter regos were down seasonally adjusted roughly 4% from the June quarter. There is no upturn yet in this most up to date indicator of business investment.





The same applies down on the farm (a sector not covered by the QSBO). Tractor registrations totalled 264 in September which was a big jump from 180 in August. But numbers always jump from August to September (apart from 1991) and the gain still leaves tractor regos 20% down from a year earlier. In the September quarter regos were down roughly 9% from the June quarter. One can look really hard and see some evidence of the decline in tractor spending starting to ease. But no improvement is apparent or likely for quite some time we suspect.



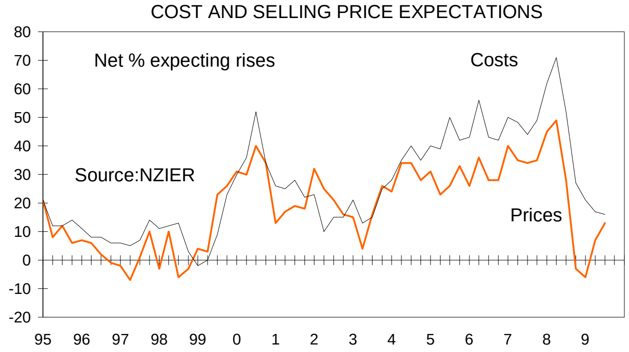


In fact, considering how far the annual number of commercial vehicle and car registrations fell from their peaks one could easily say substantial weakness still lies ahead for tractor sellers even though this week's dairy auction produced another rise in whole milk powder prices so they are 60% off their lows.

The many surveys in hand easily suggest it is reasonable to expect growth in our economy near average over the next 1-2 years. But the surveys, other data sources, uncertainty about the track of growth overseas, and the unbalanced nature of our recovery suggest anticipating firm growth at any point ahead of the next (inevitable) downturn could be optimistic. We worry about what the recovering domestic economy set against a soaring currency will mean for eventually the current account deficit, the credit rating agencies, and the future stability of the exchange rate and interest rates. We may have avoided a depression scenario, but the path ahead is still going to be quite rocky at times.

INTEREST RATES

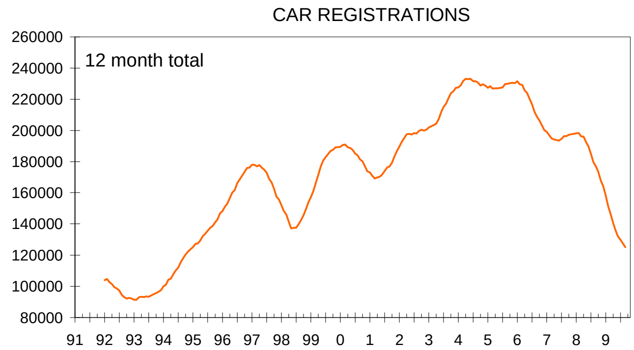
The QSBO noted above shows that there is little for the Reserve Bank to worry about with regard to inflation in the short term – as if they would given the strong rise in the exchange rate since March. The QSBO showed that only a net 13% of survey respondents expect to raise their selling prices over the coming quarter. This result is up from 7% in the June quarter but well below a net 28% a year earlier when worries about the feed-through of the declining currency would have been at the forefront of price-makers' minds.

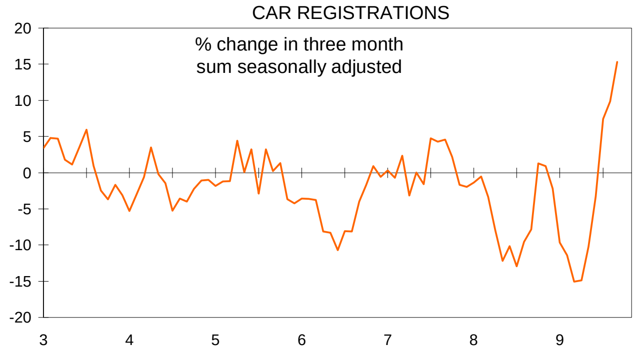


The fall in the capacity utilisation rate is also a positive with regard to inflation in the near future.

But the week has also brought further news showing there is some improvement in household spending underway and this ultimately is a key driver of the economy's growth rate, capacity use, and inflation. The number of cars registered around the country in September was down 17% from a year earlier at 11,512. In fact for the year to September there was a fall of 29% and at 125,238 regos numbers for the year were well down from the peak of over 230,000 early in 2006.

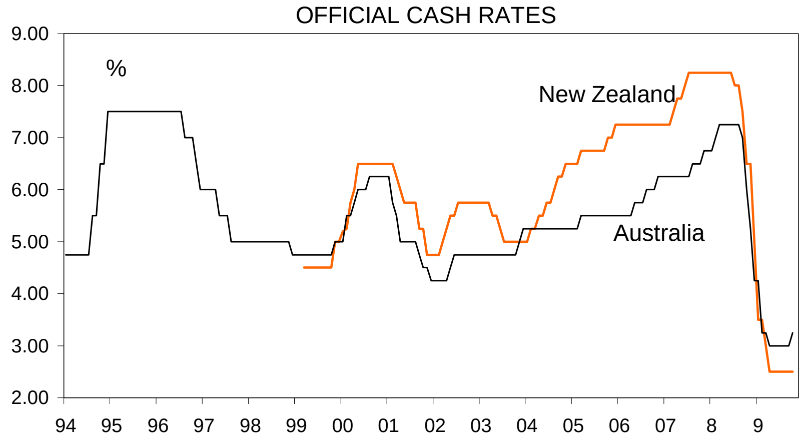
But in seasonally adjusted terms over the September quarter rego numbers were ahead 19% from the June quarter. Clearly there will be an element of recovery from a low base in this result. But it gels with the comments regarding the automotive sector recorded in our monthly survey – recovering from a low base therefore not something to worry about from an inflation and monetary policy point of view.



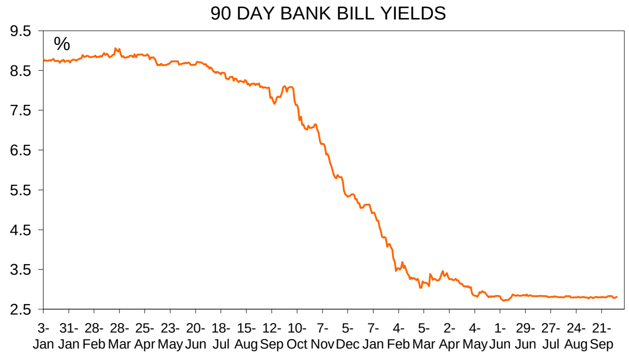


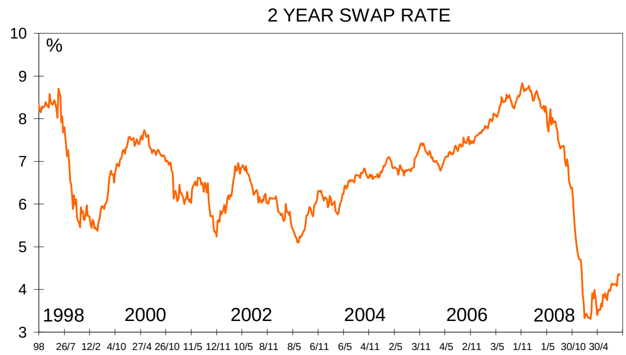
Speaking of which, this week wholesale interest rates have increased in NZ and the reason has been a slightly earlier than expected tightening of monetary policy in Australia. The RBA has raised its cash rate from 3% to 3.25% whereas most in the markets thought they would wait another month. The tightening should not be seen in terms of trying to restrain growth but in terms of taking away a clearly unsustainably low level of floating interest rates which were appropriate when the world faced deep recession but now risk stoking inflation further out.

Will the RBA move bring a response from our own central bank? Not in the short term. The RBNZ have made it clear they intend keeping floating rate borrowing costs as low as possible for as long as possible – though we see little chance they will be able to keep the 2.5% official cash rate in place until the "…latter part of 2010." as they have repeatedly stated. We expect a move July next year at the latest – but the quicker the Australians move the sooner a rate rise here is likely. As the graph on the next page shows there is an obvious correlation between them and us.



With few market participants expecting our own RB to follow the RBA wholesale interest rates have changed by very little. The one year swap rate has edged up to 3.4% from 3.37%, the three year rate down to 4.93% from 4.97%, while 90-day bank bill yields have stuck as ever very close to 2.8%.





Key Forecasts

- No more monetary policy easing this cycle.
- Medium to long term housing rates have seen their multi-year lows – stop-start rises now lie ahead. Speed unclear.

FINANCIAL MARKETS DATA	This week	Week ago	4 wks ago	3 months ago	Yr ago	10 yr average
Official Cash Rate	2.50%	2.50	2.50	2.50	8.00	6.2
90-day bank bill	2.78%	2.83	2.80	2.83	7.63	6.5
10 year govt. bond	5.53%	5.59	5.65	5.62	5.65	6.2
1 year swap	3.40%	3.37	3.15	3.04	6.75	6.7
5 year swap	5.48%	5.57	5.40	5.31	6.67	7.0

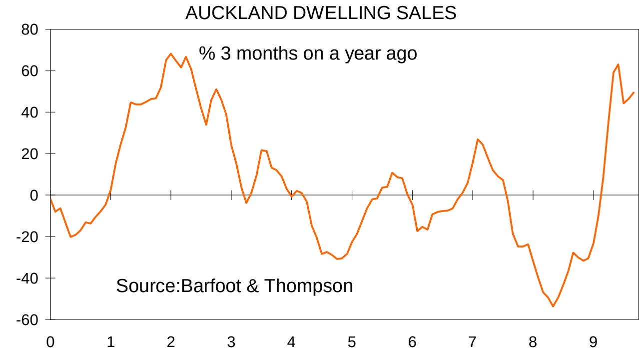
If I Were a Borrower What Would I Do?

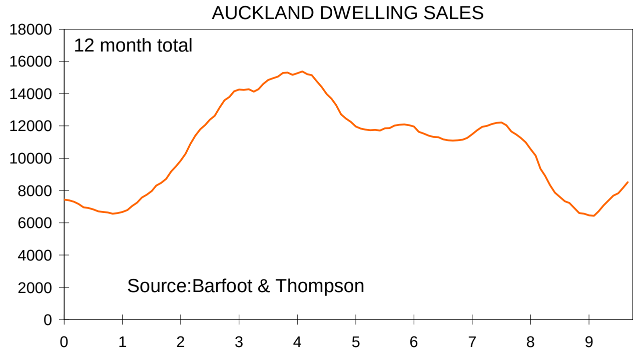
Nothing new to write here. Fixed rates will continue to creep higher, floating rates will start rising about 3% from mid-next year at the latest. I'd now probably float and go for the ride given both the leap higher to fixed rates and the fact fixed rates from four years on are now above their five year averages.

HOUSING MARKET UPDATE

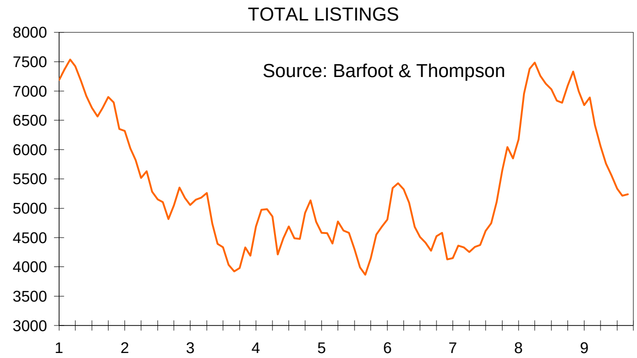
Mild Strength in September In Auckland

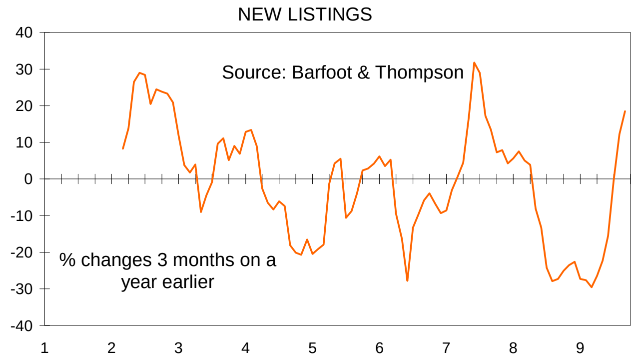
Barfoot and Thompson released September numbers for their long-running data series this week and they show that in the month in Auckland they sold 917 dwellings. This was a strong 64% rise from a year earlier and in rough seasonally adjusted terms was a rise of 6% which followed an 8% rise in August. So one can say activity levels are rising.

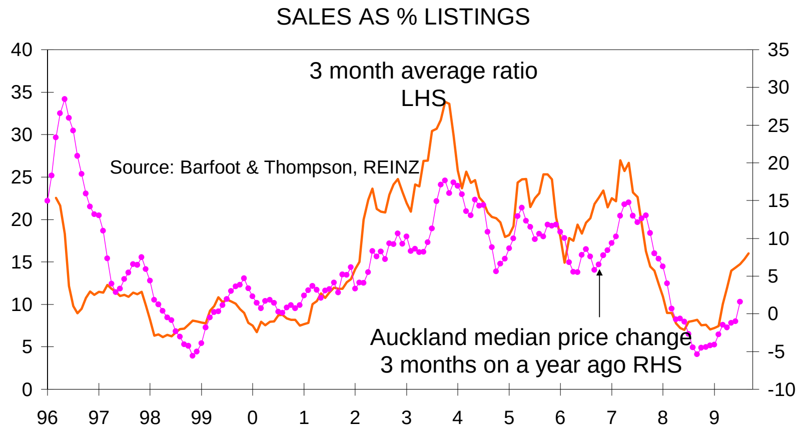




But can we see evidence of a Spring flood of properties coming onto the market? Not really. The number of new listings received during the month was 1,466. This was a 16% gain from a year ago that was less than the annual gain of 21% in August and 18% in July. In addition, if we take the number of sales in the month away from the number of listings we get an "excess" as it were (a bit dubious) of 549 properties. In August this number was 479 and in July 607. A year ago this number was 704 and two years ago 868.

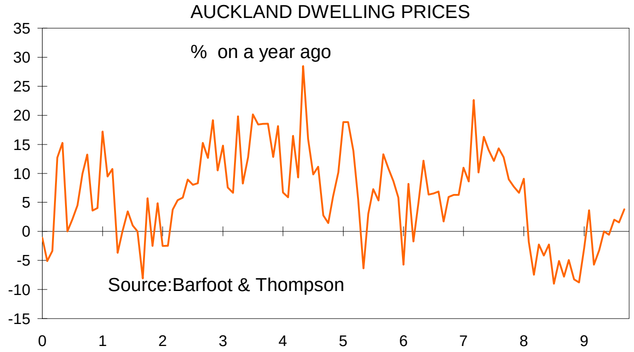






It is hard to read much into this measure, but we would have expected it to be a lot higher if the market was being flooded.

With regard to prices one has to be very careful with monthly numbers. For instance the average sale price was $507,000 in July but a much higher $532,000 in August. Now it is $515,000. The average for the September quarter was 0.3% less than for the June quarter so one could not use these numbers to say prices are rising in Auckland.



Overall the data suggest a firming market with regard to turnover, no Spring flood, but no real price action in recent months.

Some more good comments on the inability of house construction to soar in the near future.

We have been involved in large scale residential property development for nearly two decades and are involved in several projects at the moment. We totally agree with you on the demand/supply disequilibrium which is building. Like you we don't see this changing in the near future, the real issue holding back house building is funding. As an example, we have a pre sold subdivision of 200 sections positioned in Auckland's highest growth area (which is in the $150k, $200k per lot region) the builders want to settle but can't because they are unable to obtain funding from the banks and there are no finance companies left in this area, even xx and yy finance have left property finance behind.

The banks are very reticent to fund undercapitalised house builders (probably for good reason) and purchasers don't want to buy off the plans (again probably for good reason) this is a structural issue in the market and won't change quickly. Because of these facts we don't see a boom in house building occurring for some time, the Reserve Bank can relax on this issue.

Are You Seeing Something We Are Not?

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

Key Forecasts

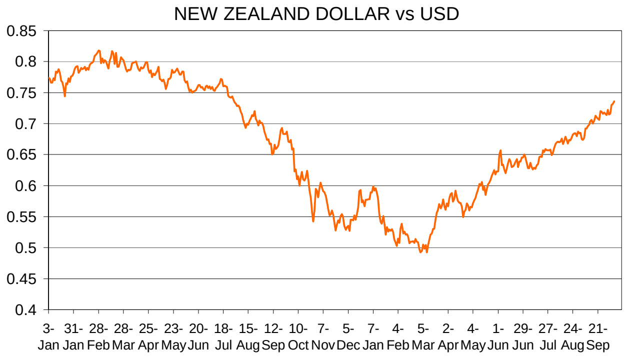
- Dwelling consent numbers to recover now with potentially good activity from late-2010..
- Real estate sales continuing to increase but the rise limited by listings shortages.
- House prices edging higher.

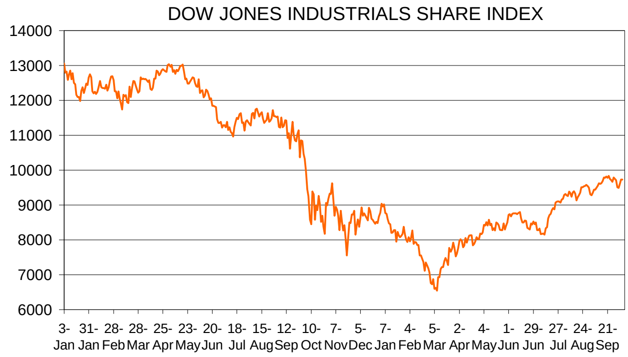
Exchange Rates & Foreign Economies

Exchange Rates	This Week	Week ago	4 wks ago	3 mths ago	Yr ago	Consensus Frcsts yr ago	10 yr average
NZD/USD	0.740	0.722	0.692	0.630	0.626	0.77	0.592
NZD/AUD	0.820	0.818	0.808	0.797	0.881	112	0.856
NZD/JPY	65.400	64.800	64.400	59.900	63.400	1.46	66.8
NZD/GBP	0.462	0.451	0.423	0.391	0.358	0.88	0.345
NZD/EUR	0.500	0.494	0.483	0.453	0.459	0.38	0.51
USD/JPY	88.378	89.751	93.064	95.079	101.278	0.53	113.9
USD/GBP	1.602	1.601	1.636	1.611	1.749	86.3	1.709
USD/EUR	1.480	1.462	1.433	1.391	1.364	71.6	1.156
AUD/USD	0.902	0.883	0.856	0.790	0.711	8.25	0.69

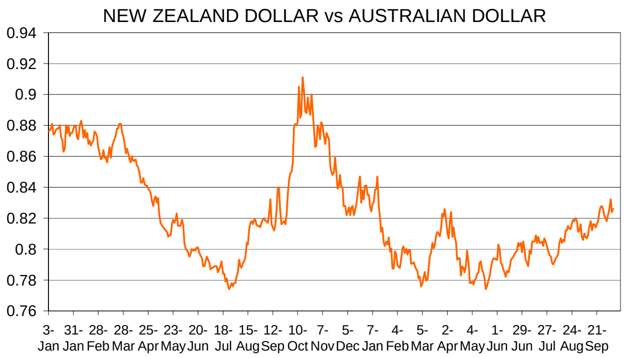
NZD Above US73 cents Now

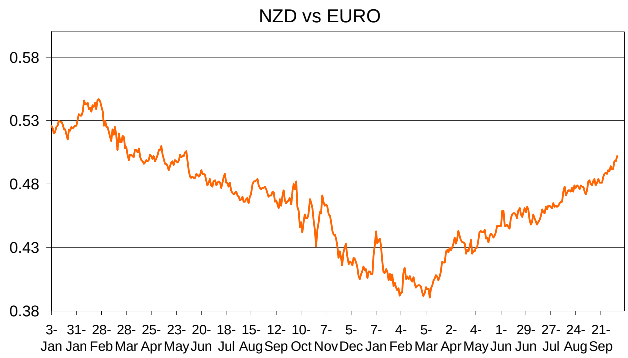
This afternoon the Kiwi dollar was trading against the USD close to 74 cents compared with 72.2 cents a week ago, just below 70 cents one month ago, 63 cents three months ago, and 49 cents back in March. Between March and June as the world pulled aggressively back from the possibility of a Depression scenario we saw rapidly soaring sharemarkets, escalating long term interest rates, and jumping risky currencies such as the NZD. Between March and June the NZD rose from 49 cents to 65 cents, the Down Jones Index jumped from 6,500 to 8,800, and the NZ five year swap rate went from 4.1% to 5.5%.





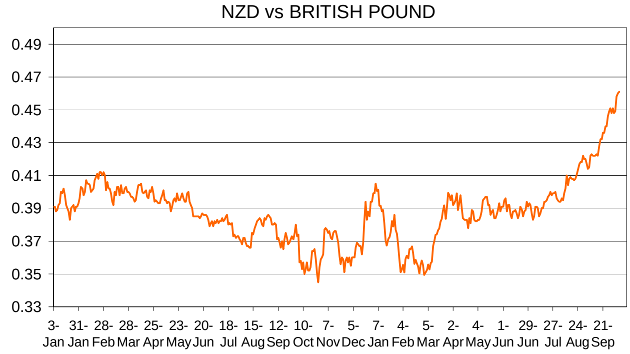
Since then the long term interest rates have settled down, the US sharemarket measure has gained another 1,000 points while the NZD has put on almost nine cents. These more recent rises can be put down less to the ending of Depression fears and more to actual expectations of positive things such as improving company profits assisted by solid data showing a recovering US housing market, and in the case of the NZD commodity prices rising on average 20% in the past seven months.

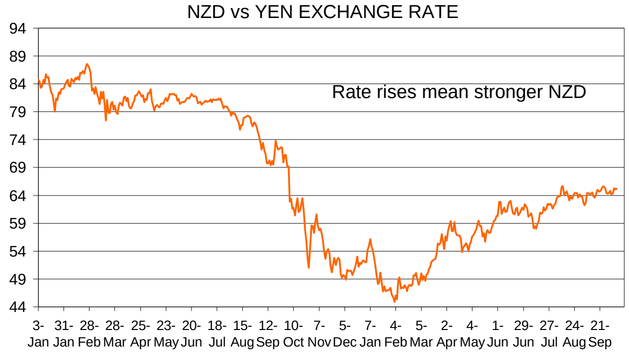




With movements of such magnitude there is always the chance of a decent pullback. But for the NZD there have been only two such periods in the past seven months involving falls of about four cents in April and again in June. As the graph shows both pullbacks occurred after unusually sharp currency appreciations and because that is not necessarily what is happening now it does not seem reasonable for exporters to expect a similar pullback in the near future – unless we saw to 78 cents in the next week and a bit.

Over the past week we can put the rise in the NZD down to a small amount of greenback weakness against the Yen and Euro, the Aussie dollar jumping above 89 cents following the early 0.25% rise in their cash rate, and more positive data on NZ business sentiment and dairy export prices. At Fonterra's auction two nights ago average whole milk powder prices rose another 6% after gaining near 25% in each of the previous two monthly auctions. Dairy is New Zealand's second biggest export earner, and price rises have already allowed Fonterra to boost this year's payout projection from $4.55 to $5.10.





Where will the rise in the NZD end this cycle? If you have been around the past couple of decades when the NZD has been floating you will know that it is a waste of time trying a serious answer to this question. It has proved impossible over the years to pick

- the cyclical high point for the NZD,
- when that cyclical high point will occur,
- when retracement from the high point will start in earnest,
- how fast the retracement will be,
- when the NZD will reach its cyclical low point,
- where the low point will be
- when the recovery from that low point will start
- how fast the recovery will be.

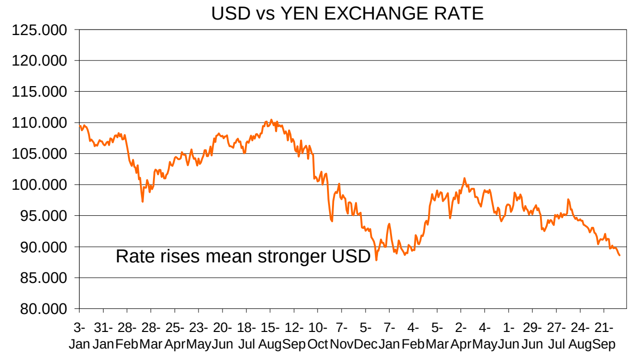
So for goodness sakes – all of you exporters and importers who continue to base your hedging "strategies" on predictions of what the NZD is going to do have to get realistic and stop it. We can't reasonably predict the NZD's cyclical movements and neither can you. Hedging needs to be primarily based upon your cash flow and balance sheet ability to handle currency shocks. The starting point could be seeking natural hedging by trying to match revenue and expenses – though the extent to which the vast majority of exporters can pursue this is very limited before we even talk about mismatching similar expenses in time.

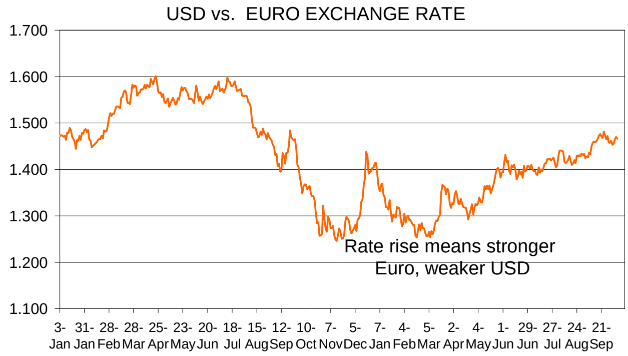
Next one can consider hedging by focussing on a range of export markets. This is also a very big ask not only because of the third world export base we have which is focussed on primary products, but because we are price and market takers for most of what we export.

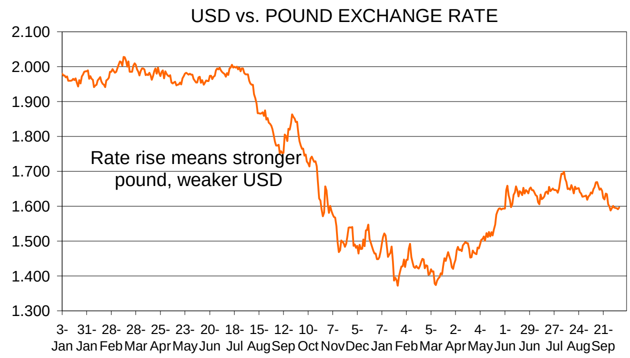
One can consider funding in foreign currencies. But as anyone who has done this over the past couple of decades can tell you – this can be a hair raising experience which can cost you your company if you get it wrong.

There are plenty of financial instruments available to assist hedging and while the starting point is invariably foreign exchange contracts, look also at option products and the way these can be arranged to minimise up front costs.

And to finish off this week's commentary – as if normal levels of uncertainty were not enough, not only do we have post-deep recession movements in play, we also have renewed debate/speculation about the role of the greenback in central bank FX reserves and as the international medium of exchange. The more this debate occurs the greater the downward pressure on the greenback – as occurred this week – therefore the extra the upward movement in the NZD against the USD. Predicting how this debate will wax and wane is impossible.



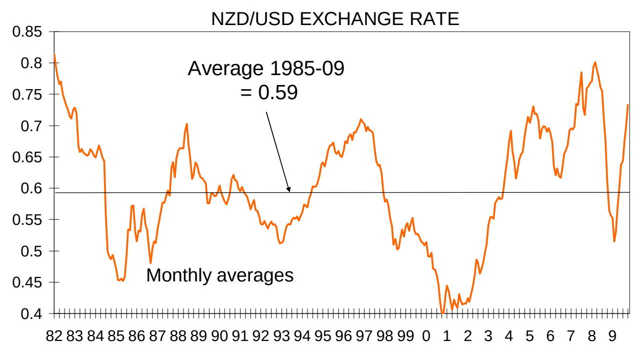


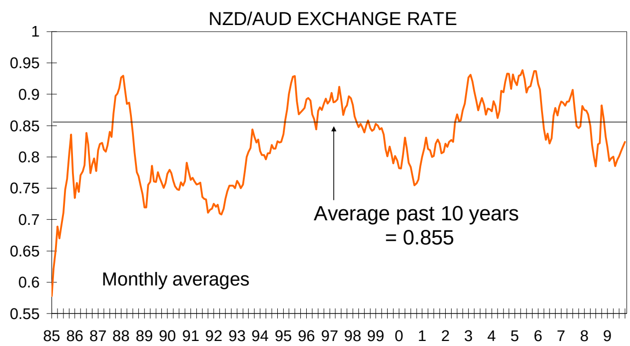


If I Were An FX Receiver What Would I Do?

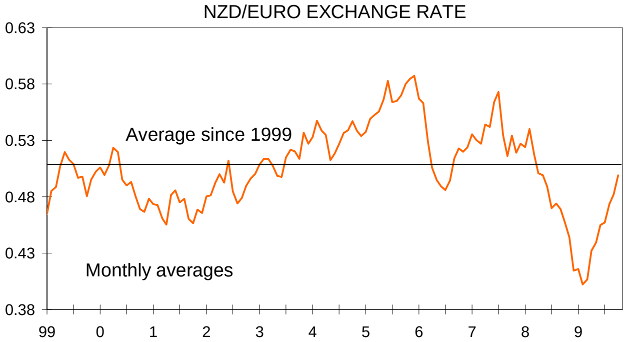
It is too late to jump in boots and all to hedge as clearly at these high levels we are getting into some uncharted territory and it becomes difficult to speak in terms of what it is reasonable to expect currencies to do from here on out. Specifically, since the NZD was floated in March 1985 we have never been this high against the British pound. And against the greenback at near 73.5 cents we have only treaded this level or higher between mid-2007 and mid-2008. This increasingly is an environment in which options start to become more useful.

Simply based upon where the NZD has gone in the past one would be pulling back on hedging against the British pound, still building it against the Yen, putting in place some more against the Euro, maybe just getting cover at most to 18 months against the greenback, and running normal hedging levels against the AUD where the cross rate is only at its average level currently.

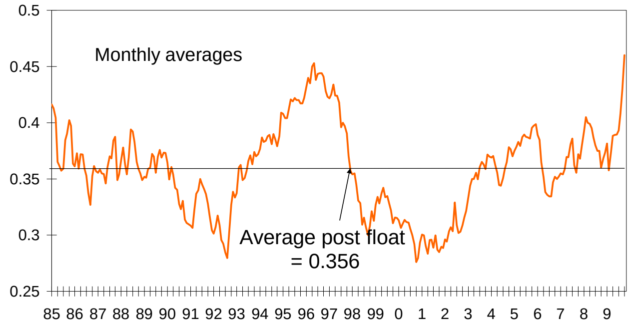




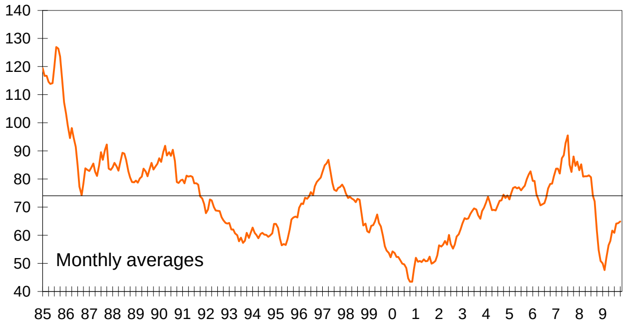
NZD/EURO EXCHANGE RATE



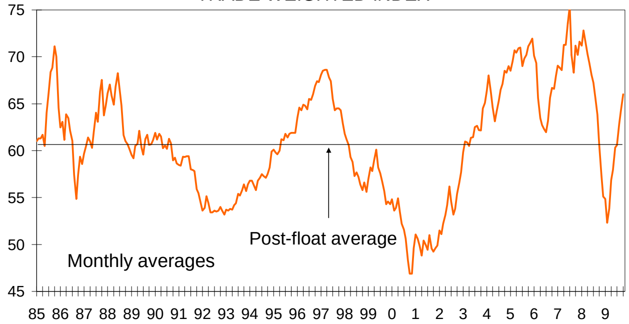
NZD/GBP EXCHANGE RATE



NZD/JPY EXCHANGE RATE



TRADE WEIGHTED INDEX



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

ECONOMIC DATA

All %		Latest qtr only	Previous qtr only	Latest year	Year ago	2 Yrs ago
Inflation	RBNZ target is 1% - 3% on average	0.6%	0.3	1.9	4.0	2.0
GDP growth	Average past 10 years = 3.0%	+0.1	-0.8	-1.8	2.5	2.3
Unemployment rate	Average past 10 years = 5.3%	6.0	5.0	......	4.0	3.7
Jobs growth	Average past 10 years = 1.9%	-0.5	-1.4	-0.9	0.8	1.5
Current a/c deficit	Average past 10 years = 5.5% of GDP	5.9	8.1	......	8.3	8.2
Terms of Trade		-8.9	-2.7	-13.1	10.7	2.3
Wages Growth	Stats NZ analytical series	0.6	0.8	4.6	5.6	4.6
Retail Sales ex-auto	Average past 9 years = 3.8%.	0.2	-1.0	-1.0	1.6	5.5
House Prices	REINZ Stratefied Index	1.6	1.8	0.7	-7.0	13.1
Net migration gain	Av. gain past 10 years = 11,700	+15,642	11,202yr	......	4,938	8,738
Tourism – an. av grth	10 year average growth = 5.0%. Stats NZ	-2.8	-2.6	-2.8	0.3	3.9
		Latest year rate	Prev mth year rate	6 mths ago	Year ago	2 yrs ago
Consumer conf.	10 year average = 2%. Colmar survey	57	38	-9	23	-8
Business activity exps	10 year average = 26%. NBNZ	32.0	26	-21	17	17
Household debt	10 year average growth = 11.3%. RBNZ	2.4	2.6	4.2	8.5	13.7
Dwelling sales	10 year average growth = 3.5%. REINZ	39.0	33.4	-17.7	-34.0	-25.3
Floating Mort. Rate	(Total Money) 10 year average = 7.6%*	5.59	5.85	6.49	10.49	9.99
3 yr fixed hsg rate	10 year average = 7.9%	7.75	7.45	6.59	8.69	8.75

ECONOMIC FORECASTS

Forecasts at Sept. 17 2009	March Years					December Years				
	2008	2009	2010	2011	2012	2007	2008	2009	2010	2011
GDP - annual average % change										
Private Consumption	3.3	-0.7	-0.5	1.8	2	4.1	0	-1.3	1.7	2
Government Consumption	4.3	3.4	3	2.8	1.9	3.9	3.9	2.9	2.9	2.2
Investment	4.3	-8.9	-16.4	6	8.9	5	-5.1	-17.8	1.1	9.7
GNE	4.2	-2	-3.9	3.3	3.4	4.5	0	-5.4	2.5	3.6
Exports	2.9	-3.4	-0.4	0.5	4.9	3.8	-1.6	-1.8	-0.4	4.7
Imports	9.6	-4.4	-14	2.3	5.9	8.6	2	-17.1	0.4	5.6
GDP	3.1	-1	-1	3	3.1	3.2	0.2	-1.9	2.3	3.3
Inflation – Consumers Price Index	3.4	3	2	0.7	1.8	3.2	3.4	2.1	0.7	1.5
Employment	-0.3	0.8	-1.6	2.6	3.2	2.3	1	-2.9	1.7	3.4
Unemployment Rate %	3.8	5	7.3	7.2	6.1	3.5	4.7	6.9	7.3	6.3
Wages	4.4	5.1	2.4	1.5	3.8	4	5.1	3.1	1.3	3.3
EXCHANGE RATE ASSUMPTIONS										
NZD/USD	0.8	0.53	0.73	0.75	0.71	0.77	0.56	0.72	0.75	0.72
USD/JPY	101	98	102	108	110	112	91	100	108	110
EUR/USD	1.55	1.31	1.5	1.46	1.36	1.46	1.34	1.49	1.47	1.4
NZD/AUD	0.87	0.8	0.82	0.84	0.85	0.88	0.83	0.82	0.84	0.84
NZD/GBP	0.4	0.37	0.42	0.43	0.41	0.38	0.37	0.42	0.43	0.42
NZD/EUR	0.52	0.41	0.49	0.51	0.52	0.53	0.41	0.48	0.51	0.51
NZD/YEN	81.1	51.8	74.5	81	77.9	86.3	50.9	72	81	79.1
TWI	71.6	53.8	67.3	70.3	68.8	71.6	55.1	66.3	70.1	69
Official Cash Rate	8.25	3	2.5	4.25	6.25	8.25	5	2.5	3.75	5.75
90 Day Bank Bill Rate	8.91	3.24	2.7	4.62	6.62	8.9	5.23	2.75	4.12	6.12
10 year Govt. Bond	6.36	4.77	5.75	6.4	7	6.4	4.88	5.7	6	6.8

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 Total Money started in 2007