

# 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.

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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.

## Labour Market Weak

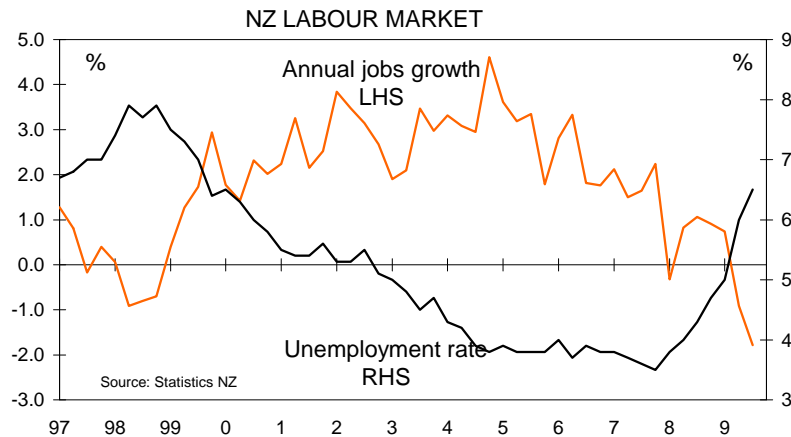
The main piece of news telling us something about the near current state of one part of the NZ economy came this week in the form of the quarterly Household Labour Force Survey. This gives the most up to date snapshot of the labour market with respect to jobs growth, the unemployment rate and so on – but it does not tell us where the economy is at currently.

Changes in the labour market tend to lag behind changes in the economy. So what we see now reflects what the economy was doing a few months or quarters ago. The reason it can take a while for economic changes to affect the labour market is that when spending in the economy weakens businesses don't lay spare people off straight away. They wait to see if the pullback looks like being sustained. It costs a lot to find new staff and train them up and the most recent intense experience of NZ employers has been of low unemployment and major difficulties finding staff. So the bulk of 2008 was characterised by businesses hoarding people waiting for the late-2008 upturn.

As we all know that upturn did not come along and the Lehmans collapse led to loss of confidence and businesses shed not only the staff they were hoarding but others as well. And so to this morning's numbers. The unemployment rate in the September quarter rose to 6.5% from 6% in the June quarter and a low of 3.5% late in 2007. This is the highest unemployment rate since 2000 when the economy was emerging from the Asian Crisis. Back then the rate peaked at 7.9% in 1998 and we think things are tracking this time around toward a peak close to 7.5%.

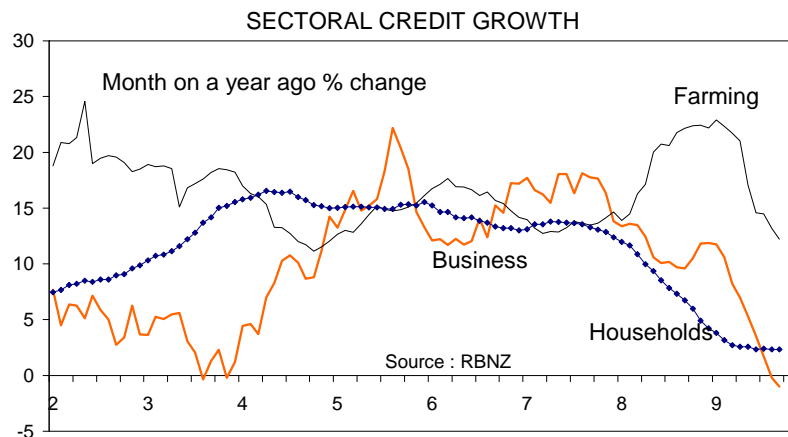
During the latest quarter job numbers fell by a slightly greater than expected 0.7% and were down 1.8% from a year ago. And while for the quarter the number of hours worked also fell 0.7%, for the entire year to September hours worked fell 1.7% while job numbers fell 0.3%. This has happened because businesses have been trying their best to cut back employee hours rather than laying people off. Profits now have been sacrificed in the interests of reducing costs of finding and training new people down the track.

Much as we describe the labour market as a lagging measure of the economy, it does nonetheless provide important information on the availability of capacity to handle growth now underway – mild as it is. The still rising unemployment rate suggests more restraint on wages growth than generally thought previously and that means slightly less chance of the RBNZ raising the cash rate as early as the March period the markets edged out to after the dovish RB comments last week associated with their rate review.



### Farm Debt Continuing To Escalate

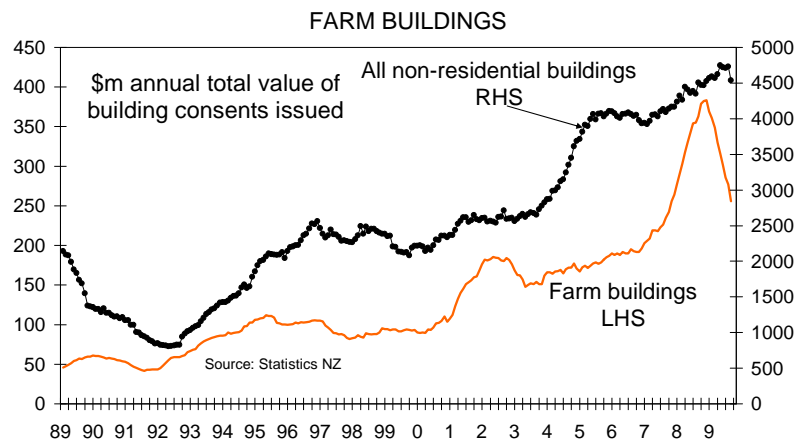
Debt in the agricultural sector continues to grow strongly at a time when the immediate outlook for farming is not so good because of the high NZ dollar, farm balance sheets are under pressure because of land price falls approaching 30% as best we can figure, and ever rising input costs. In September farm debt was 12.2% ahead of a year ago. This growth rate is a slowdown from 13.2% in August, and 21.7% six months ago. But urban business debt growth is now -1% from 8.2% six months ago. Household debt growth is also very low at 2.3% from 2.7% six months ago and average growth over the past 10 years of 10.8% per annum.



Yet farmers remain the most pessimistic group in the economy according to the monthly NBNZ Business Outlook survey. It is certainly true that there are some farmers who are having no great difficulties at the moment probably because they did not jump in boots and all loading up on debt when the dairy payout was \$7.90 and assumed by many to stay high. But one struggles to explain this continuing strong debt growth phenomena – especially when the Reserve Bank has expressed concern about farm debt levels on bank books. Also farm sales continue to run about 60% down from a year ago.

Either the reality of the new reduced credit environment has not yet hit home to farmers and they are quite willingly paying the higher liquidity premiums being charged by banks in order to buy on-farm equipment – or there is a lot of cash flow financing going on. Or, the numbers are being completely thrown out of whack because they capture not just farmers but farm servicing companies and as the headlines show many of those companies are struggling and perhaps it is their cash flow needs driving the numbers.

Lending to farmers certainly doesn't appear to be going toward new buildings. In September the value of consents issued for the construction of new farm buildings was just \$10m. This was a 68% fall from a year ago. The September quarter total was down 55% from last year and in the year to September the decline was 29%. In other words the fall is accelerating.



The decline in farm building consents is far more than for the non-residential construction sector overall, as shown in the graph just above. Only in the most recent month's data have we seen a decent decline in this aggregate measure – a fall of 43% in non-residential consent values from a year ago. In the year to September all non-residential consents were ahead 0.8% from a year earlier but this number owes a lot to consents issued for the likes of some new stadia and airport upgrades. Factory consents have fallen 13% in the past year and 31% in the September quarter on a year ago (worsening rate of decline), hotels and motels 41% down and 7% for the quarter (easing decline), shops, restaurants etc. off 8% for the year and 26% for the quarter (worsening more rapidly), and warehouses down 32% for the year and 45% for the quarter (also getting worse more rapidly.)

One actually struggles to find much evidence at all that the high levels of business confidence and activity expectations, and the return of the NBNZ investment intentions measure to near average, are in fact encouraging businesses to invest. Business focus appears strongly on what households should be doing – debt reduction. In the September quarter urban business debt in NZ fell \$1b. A year ago over the same period of time it grew \$2.5b, two years ago \$2.6b, and three years ago \$2.4b.

### A Few Days in Tokyo

Last Thursday I was in Tokyo to give a talk at the annual Japan New Zealand Business Council conference which alternates between NZ and Japan. The message was as noted last week – we were in recession when the Lehmans event hit but we are now out of it assisted by loose fiscal and monetary policies and it is reasonable to expect 2.5% - 3.5% growth ahead. But the road will be very rocky and optimists should only act on their sentiment if they have rock solid balance sheets and cash flows.

One of the organisers of the JNZBC conference noted that where we stayed, the Four Seasons Hotel in Chinzan-So, was where he got married. So what you might think. Well, on the same day 38 other couples got married in the same place. Marriage is a very big thing over here with hotels devoting a lot of their resources to making their marriage processing go as smoothly as possible. One group does not get to enter a ceremony room for instance until the previous group has completely cleared out by another door.

The Four Seasons complex has a seven storey building upon each of which a wedding reception was occurring on Saturday night, and some bigger parties were in a larger three storey building at the side. Outside the hotel there were over 30 taxis lined up at 5.00pm presumably waiting to take guests back to their homes. It costs about NZ\$1,000 per guest at a wedding plus \$1,000 for the bouquet and about \$3,000 for the cake. Love hurts.

With big cities it is probably a bit hard to tell when economic times are tough though in London one imagines there are considerably fewer people around the City and Canary Wharf. In Tokyo the frequency of homeless people looks the same as two years ago and having caught a train at 8.00am one morning just for the experience one can say they are still packing them in. But a couple of things stuck out.

One was the shopping complexes at Odaiba. There were closed up shops this time which were occupied two years ago. Thankfully the little place with the giant beetles is still there and well worth a visit (it is at Decks) if you are travelling to Tokyo with children. Second, passing by the Tokyo Exhibition Centre on the monorail there were thousands of graduates milling around and lined up apparently going through a big job application process. Every single one of them had on a black jacket, black trousers or skirt, black shoes, and a white shirt.

Awareness of H1N1 flu is high with the government kicking off a vaccination programme recently and far more people wearing face masks than last year or two years ago. One good thing cafes do is supply a moistened towelette in a plastic wrap for wiping one's hands before eating. There also seemed to be more cleaners standing at the tops of escalators holding a cloth to the handrail to stem the transfer of bugs.

I didn't go to the rugby match on Saturday night but did attend a function in the giant rugby ball on Friday night at which the Prime Minister spoke a few words and mingled. The pictures of the ball which we have seen in NZ newspapers give no idea about how truly huge the thing is on the inside. There are some amazing images projected onto the white inside surface which put Imax-type screens to shame. The whole experience is quite moving especially when the likes of Tana Umaga's image looms overhead, adjusts the ball, then kicks it/us all the way to the base of Tokyo Tower. Assuming the ball is back in New Zealand for the 2011 Rugby World Cup it is a definite must see – though one hopes the installation cost will be substantially less than the \$400,000 a day it is costing in Tokyo.

The walls of the ball are inflated, and just in case anyone is worried about a puncture causing the roof to collapse on everyone's heads, there are 3-4 backup systems manned 24/7. Plus apparently, Japan is the only country in the world with an organisation specifically devoted to construction and operating standards of inflatable things. One understands it was their pressure which saw maximum numbers in the ball while in Tokyo capped at 160 rather than the more usual 220. Back home we will probably try for 500 just for the heck of it.

The train system is fantastic and one can proudly say that after making a complete hash of using the system in 2007 and last year on the Future Business Counterparts Programme, this time around I've mastered in to a T. The downside is that jumping on the system from Akihabara to Shinjuku, Ginza, Odaiba, Edogawabashi, Ryogush etc., one loses all concept of the true size of Tokyo where about 12 million people live in the central area. And here is a thought. After jumping around all day, sometimes walking 400 meters between train lines – in the same station underground – it is good to get back to the hotel and have a soak in the bath if there is one. But you had better be short or really want to examine the rough skin on your knees because the baths are not long.

Apparently when the wind gets a bit strong the police boats go out and warn people to get off the harbour. Why? Is it because they seriously think the yachties are so bad they will tip out? Not really. But there is a risk one or two might and Japan's culture is overwhelmingly one of risk avoidance – something operators in the NZ tourism sector are only too aware of.

But what is the risk the police boaties are avoiding here? It is actually not the risk of getting wet but the risk of losing face. Are the police acting to save their own face in case they are blamed for not warning a yachtie? No. They are acting to save the face of the boat captains amongst their guests and those they know in case they do capsizes.

### Shore Leave in Hong Kong

I've never been to Hong Kong before so it seemed like a good idea after speaking in Tokyo to take a week's annual leave and travel to Hong Kong to see what is there. In a nutshell, lots and lots of very tall buildings in a relatively small area on Hong Kong Island. There are also lots and lots of tall buildings across Victoria Harbour in Kowloon and beyond that an increasing number of tall buildings in various parts of the new territories.

Although I took the week in Hong Kong off as leave, being a complete nerd from years back I couldn't just treat the whole thing as a holiday so arranged a number of meetings. These included with the Economist Intelligence Unit, NZ Trade and Enterprise and a talk for the NZ Chamber of Commerce in Hong Kong, some Kiwi milk powder exporters dealing also in the international sulphur and steel markets, some investment advisory people, someone from the Australian Chamber of Commerce and some individual readers of the Weekly Overview including a doctor and a student studying journalism. In no particular order of importance or significance here is a smattering of some of the things learnt from chatting with these people and wandering the city at length on foot, the MTR and the skinny trams.

Whereas in Japan people are almost outrageously polite, in Hong Kong there is not impoliteness as such, but a lot of indifference. When registering at the hotel the pen would not work but the receptionist did nothing about it and I had to use my own. In Japan the non-functioning item would have been noticed, its lack of performance apologised for, and a replacement offered with more apologies offered.

And when being seated for breakfast one was not generally directed toward a specific table. Instead the manageress of the restaurant waved her arm in the general direction of the tables then waved it in the direction of the food.

But again, it would be wrong to say there was impoliteness. In fact people seem to be very happy, offering a nice thank you if a door is held open, or sharing something funny with a total stranger such as a cat sleeping in a shop window amongst the jewellery items on display. Actually that was the only cat I saw. There were some dogs being taken for walks – but mainly big ones. In contrast to Japan which seems to have a predominance of miniature dogs there seem to be very few small dogs in Hong Kong. Where have they gone?

Property has again become very expensive in Hong Kong and although no-one is expecting another period of price correction such as the 70% falls at the time of the Asian Crisis, worries about a correction seem to be discouraging buyers from purchasing at the moment. The market is amazingly jittery.

The train system, or MTR, is very efficient and the best way to use it is to buy an Octopus pass the first time you go to a station then just swipe it over the reader when passing through the turnstiles. The trains have no doors between the carriages and it is fascinating to travel inside the belly of a long silver snake as it wends its way speedily through the tunnels, with parts 50 meters in front curving one way and the back part near 150 meters in the other direction going the other way.

My hotel was in the Wan Chai part of Hong Kong which is an interesting area. There are modern buildings with some very upmarket shopping areas (Times Square) alongside the traditional outside food markets with their fruit and veges, basic household goods, and lots of different types of animals sliced into lots of different pieces – plus live fish and crustaceans. The smell is interesting.

In the parks there are special areas with mechanical devices which old people can use to keep their muscles and joints functioning. Most however seem not to bother with such devices and instead practice Tai Chi, do lots of walking swinging their arms and clapping, and my personal favourite – sitting on benches swinging their legs back and forth like children do when their feet can't reach the ground.

There is a very strong focus on public hygiene in Hong Kong – which is a very good idea considering 7 million people live in a very small area. Lots of lessons appear to have been learnt from the SARS outbreak of 2003 and there are warning notices regarding washing hands, wearing face masks and so on. People are warned not to feed any birds in the parks with hefty fines if they do so (bird flu worries) and advice to wash one's hands if one comes into contact with a bird or its droppings. Fewer people were wearing face masks however than in Tokyo.

The public toilets all appear to have attendants who keep them very clean and many places have notices indicating how frequently they are cleaned – hourly, four hourly and so on. Often at the top or bottom of an escalator there will be a cleaner holding a cloth to the handrail to clean it as it passes by. In the parks there are some very very old people sweeping away leaves and twigs and watering trees the correct way – at the

drip line through the arranged paving stones. But they often use not a hose but a plastic litter scope to distribute the water one scoop at a time.

The footpaths are quite challenging to walk along – unless you really love going slow. There are no clear rules about which side to walk on and people will stop dead when it suits them to look in a window or talk with their companion. But again – there is no impoliteness and one imagines that after a while one would adjust one's walking speed to the generally sedate pace – or at least the pace is sedate above ground. Underground coming out of the stations after exiting a train the speed can be quite frenetic.

In the Central area one finds the main commercial buildings and most are linked with above ground walkways. There are shops with fronts along the street but the vast majority of the shops are inside the buildings – a bit like the most interesting part of a geode stone is on the inside. In fact there can be a thriving beehive of shopping activity in a building but you would have no idea looking from the outside. One really has to get onto the walkways and wander about to discover such places – usually with their really expensive stores spread over many stories.

Speaking of expensive. For the equivalent of \$8 in NZDs one can have a coffee and pie at Starbucks or any other small café catering to the European clientele. Or one can spend the same amount for a full meal including soft drink, tea and two courses at one of the small restaurants catering mainly for the Chinese and other Asian nationalities.

Speaking of nationalities, an English cricket team was just across in Hong Kong taking part in a tournament and that meant lots of short-haired pasty poms walking around on the early Sunday evening when I arrived in the Wan Chai area. The lack of hair did not seem to discourage lots of interest in these gentleman from females who would call out to them inviting them in for a drink and conversation. The hot weather probably explained the lack of much clothing on the ladies but not why they chose to sit on stools outside the bars with their air conditioning rather than inside.

They seemed to be after husbands because women who looked like their mothers were standing outside with them encouraging them to get a gentleman's attention. The tactic seems to work because the next morning none of them were there – so presumably they either found a suitable British husband – or an American one because later in the evening lots of US sailors were out and about off the USS George Washington aircraft carrier.

There are about 160,000 Filipino woman working as maids in Hong Kong. They earn about NZ\$700 a month most of which they send back to their families in the Philippines as they are earning more than four times what they could back there. They live in the apartment of their employer, usually in a tiny room often without a window somewhere between the kitchen and beside the laundry. Sunday is their day off and they leave the apartment and congregate in public places all over the city. Apparently, one of the reasons you will find almost no seats in the elevated walkway areas of Central is to stop the maids from passing their Sundays in those locations.

Most gather outside in a park somewhere, perhaps attending an informal shopping mall they set up each Sunday where they exchange items of clothing and such-like.

In Hong Kong there are no government subsidies for those who seek health care in the private sector, but one can turn up and be treated for free at a public hospital – though one might have to wait a while for a consultation and an operation if needed. General practitioners tend to work very long hours, often not finishing until 8.30pm, and according to one I had a pleasant coffee with (thanks Wing) most patients are seeking treatment for anxiety or stress. It is not just that the pace of life is reasonably hectic, but perhaps more that people work such very long hours.

There are obviously some big cultural differences between New Zealand and other parts of the world. With regard to Hong Kong and Japan tolerance of non-mainstream sexuality seems very low with gays and lesbians strangely considered to be suffering from a mental illness. There was a gay and lesbian parade/celebration underway on Sunday evening at Southorn Park in Wan Chai but not many people were

there. The group applied to use a bus to travel from one part of the city to another but were ignored. Invitations to senior politicians to attend were also ignored. There is almost an American military-like don't ask don't tell policy informally in place.

There is also a cultural difference with regard to housing. We Kiwis value our houses as places where we live – where we are who we are and do what we do with our friends and family. That does not seem to be so much the case in many places I have visited overseas. The apartment is where people sleep and sometimes eat a bit. Where they live/be/are is the public space and maybe their work space. They live in tiny apartments and enjoy all that their city has to offer. Which raises an interesting point.

If one lives in an apartment and suffers the loss of a lot of creative freedom, vastly reduced living space, plus noise risk in exchange for enjoyment of the city, why live in an apartment in New Zealand? Overseas cities have night life. When we Kiwis hear that expression we immediately think in terms of clubs and bars – like Auckland here and there. But that is not what overseas night life is about. At night time the shops are open, people are walking with their families, they are relaxing in public places. If that is the sort of thing you like then NZ does not make the grade by any measure. We are still only a small step removed from the way we were in the 1960s.

So, sorry to all those people who think apartment living in NZ is a sophisticated type of thing which will catch on and boom – you have only one hope, oil prices at \$250 a barrel so people have no choice other than to ditch the car and live in the city. Those who really seek the city living lifestyle will go overseas. BUT – and this is the point which means it is not silly to live in an apartment in NZ. You can get a lot of apartment for your money in New Zealand leaving lots left over to finance jaunts offshore. For the same amount of money in Hong Kong or Tokyo you get a shoebox. It's a trade-off in exactly the same way staying in NZ is for most of us a trade-off in one way or another.

In Tokyo there were lots of people smoking everywhere. In Hong Kong people also smoke but not very often in public. In fact walking the footpath there was probably less smoke than along Lambton Quay during a Wellington lunch hour. (That problem could be easing soon if it is true that National are easing out the near 7,000 "excess" core public servants taken on by Labour.)

About 20 years ago one would have heard very little Mandarin spoken in the streets, but now it is common. Mandarin is the language of mainland China as compared with Cantonese. So make sure you learn the "right" one when you think about learning Chinese for business purposes! But good luck with Mandarin. It has nine tones while Cantonese has only four.

In many quarters there is wariness regarding the short to medium term outlook for the world economy but not overwhelming concern about China's performance in the near future. China is seen as remaining firmly on a multi-year growth track with hefty infrastructure work to undertake, continuing strong investment in machinery, and increasing evidence of household consumption gaining strength. But factories are still well below full strength and exports remain weak.

The Chinese authorities have many issues to grapple with including reversing the environmental damage done by the past three decades of unfettered growth, ensuring the growth benefits spread from the eastern cities into the western hinterland, and becoming a far more important international player without scaring the beejebers out of Asian neighbours like Japan and the Americans.

China is not seen as having an internationalist brand of communism like the Soviets did, but the race to lock up resource supplies for future decades is scaring people outside of China. Communism is probably no longer an accurate word to use for China anyway. Free enterprise is definitely well accepted.

In Hong Kong, fears of major bad changes after the British handover in 1997 have not proved justified. The rule of law and property rights prevails – though with two or three examples of legal decisions being overridden from Beijing business operators do keep a wary eye out for any trend – though with general agreement that there does not seem to be such a movement thankfully.

As always there is wariness regarding the question about growing milk production in China as well as Mongolia. No-one knows to what extent milk production will grow, and no-one really knows to what extent supply growth might be completely swamped by demand growth from extra eating, and extra eating of protein in particular.

A relatively strong view was expressed that when getting involved in something more than just exporting one's goods to China, it pays to deal on the ground with those who know the ways of Chinese businesspeople, their communications systems, their business ethics, their legal framework and so on. Blindly assuming respect for product quality and customer satisfaction will be the same in China as in New Zealand is a near guaranteed recipe for disaster. Dealing with long established experts on the ground is the most advisable method for pursuing business in China and for that working alongside NZ Trade and Enterprise is almost certainly the best place to start.

There is no obvious movement of business from Hong Kong to Shanghai. But there is a tendency for businesses to expand their operations into Shanghai.

Just as has largely been the case in New Zealand, the global recession has not been obvious on the ground in Hong Kong. Some higher end restaurants have been less busy, along with some of the high fashion shops as well (of which there are lots and lots here!)

Is New Zealand the only place in the world with decent coffee? The Australian stuff is mediocre, the Parisian coffee was boring early this year, Tokyo coffee is weak with too much milk, and Hong Kong coffee is similar – though in bigger cups. There is a Fuel outlet in the IFC mall in Central however which did a good job.

One of the WO readers I met is a Kiwi studying journalism at the local university here. She is staying in a dormitory on campus (two students to a small room) but there is always the risk that at the annual performance review one might not be allowed to stay. Whether one is allowed to stay or not depends a lot upon how involved one is with the numerous team activities and games the students seem to greatly enjoy playing. The game playing is apparently more reminiscent of what we Kiwis might have done when we were at school. But it appears to serve the function of hastening the social development of the students because in order to get into university they have had to study during most of their non-official school time. Getting into a good university is the big aim and once that is achieved the students tend to relax.

In Hong Kong there are lots and lots of jewellery shops. If you want to make a purchase but are wary of the quality of what you will buy and whether you will pay a fair price then it is a good idea to get advice from someone on the ground – like a trustworthy Kiwi local. Many thanks Allan and Julia. I am hopeful my wee purchase will be well received.

One could write pages more but that is probably enough – and I'll only write more next week if some really interesting things are discovered during the remainder of my visit in the next two days.

## INTEREST RATES

As an economist working in New Zealand and occasionally speaking with economists or investment advisors overseas one quickly learns that there is a bit of a gap in understanding with regard to NZ monetary policy. Speaking with some people in Hong Kong this week it is clear that there is still an inability offshore to understand that when the RBNZ needs to raise interest rates to stem NZ inflation they often need to push them to levels considered depression-creating offshore. So forecasts by the likes of ourselves and others in NZ that the official cash rate will rise from 2.5% currently to something approaching 6% in 2012 tend to be greeted with disbelief.

One can certainly understand the attitude offshore because their frame of reference is their home market. But in New Zealand we Kiwis are different, special. History shows that we are prepared to pay interest rates other people would not touch with a bargepole. It was not until the RB took the cash rate to 8.25% in 2007 and floating mortgage rates went to 10.5% that we backed off buying each others houses and lots of consumer goods. And back in 1998 it was floating mortgage rates at almost 11.5% that were needed to restrain us.

Given the high level of household debt and perhaps some lessons learned from the recent crisis, when next the RB need to get rates cyclically high maybe the cash rate peak won't be 8.25%. In fact there is very little chance that it will and here is why.

The relationship between the cash rate set by the RB and the cost to us banks of borrowing money has structurally altered. We used to almost always have retail deposit rates below the cash rate or at least bank bill yields. Now the opposite is true. The cash rate is 2.5%, 90-day bank bill yields 2.8%, and term deposit rates are around 4.5% for the popular 150 or so day period.

NZ banks are striving to boost domestic funding of domestic lending and that means higher rates being offered to savers. This has implications for finance companies which from the early 1990s were able to easily secure funds from generally older savers because those savers wanted improved returns. Now with the lesson of lending to finance companies learnt to the cost of many of those poor people, and banks offering higher rates over the cycle, the pool of funds for a second tier group of financiers in NZ is going to be much smaller. But that is a side issue which pops up as restricted finance for property developments including subdivisions.

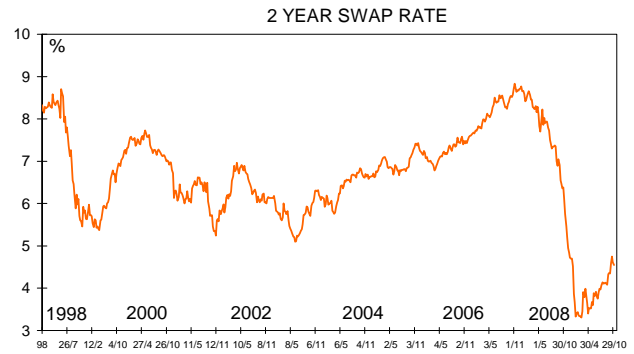
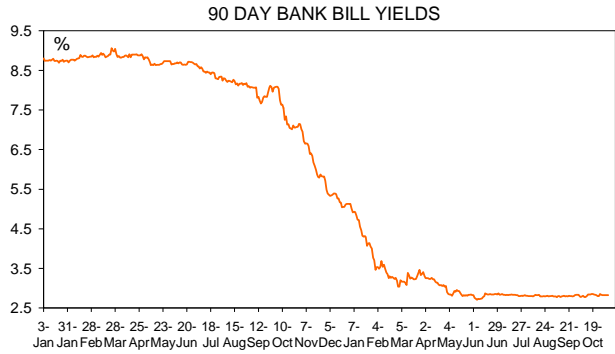
The other reason bank funding costs now sit higher than in the past versus the official cash rate is the cost of borrowing money offshore. We used to pay about a 0.2% premium to foreign savers to get their money to lend to us debt-hungry Kiwis. Now we pay 1.5% - 2.0%.

So monetary policy is actually tighter at the moment than implied by the level of the cash rate, or even the good old monetary conditions index the RB used to follow many years ago which incorporates the trade weighted index and bill yields. But there is also something else to consider. Credit criteria are tighter than they used to be. This means that at any given level of the cash rate the availability of funds from banks to NZ borrowers is reduced – courtesy of the biggest global financial crisis since the 1930s. At least NZ banks are still lending which is not something that appears to be happening much yet in the UK or US.

What this means is that perhaps today's 2.5% cash rate is really more equivalent to 4% or some level like that. And perhaps the neutral cash rate which we have tended to believe is about 6% is in fact lower by some unknown amount also. So perhaps come early 2012 the cash rate will not quite be pushed to 6% by the RB. Or more likely, when the RB next need to tighten the screws the rate will only need to go to 7% and not 8.25%. But that time period seems well down the track from now and we don't really think it is reasonable this far out to start picking when the interest rate cycle will peak this time around. And remember, no-one picked a 2007-08 peak when the last tightening cycle started in early 2005.

# BNZ WEEKLY OVERVIEW

This week there has been less excitement in the interest rate market following the previous week's rally after the RB came out less hawkish than expected in the commentary attached to their rate review. But there was some mild downward pressure on rates today as the drop in employment during the September quarter was more than expected, and the RB Governor made comments emphasising that NZ is not going to grow as fast as Australia in the near future. Yields on 90-day bank bills remain as ever anchored near 2.8%. The two year swap rate is near 4.5% from 4.6% last Thursday and 4.75% two weeks ago while the five year rate is near 5.7% from 5.74% last week and the same two weeks ago.



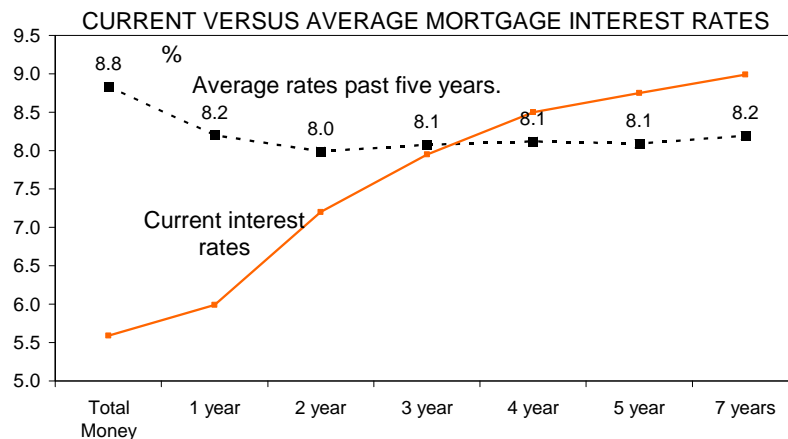
## Key Forecasts

- Tightening by mid-2010.
- Medium to long term housing rates to keep on rising.

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	6.50	6.2
90-day bank bill	2.82%	2.82	2.78	2.80	6.71	6.5
10 year govt. bond	5.67%	5.78	5.49	5.79	5.98	6.2
1 year swap	3.49%	3.55	3.40	3.10	6.03	6.7
5 year swap	5.72%	5.74	5.48	5.42	6.43	7.0

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

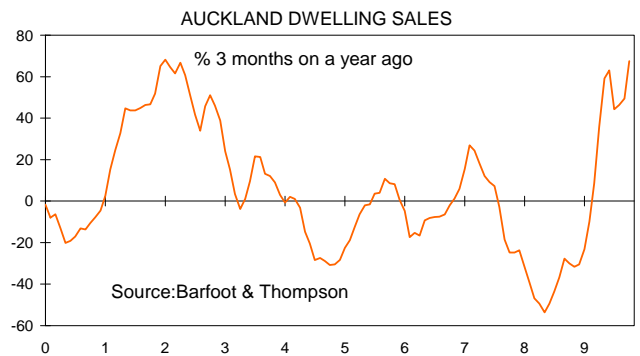
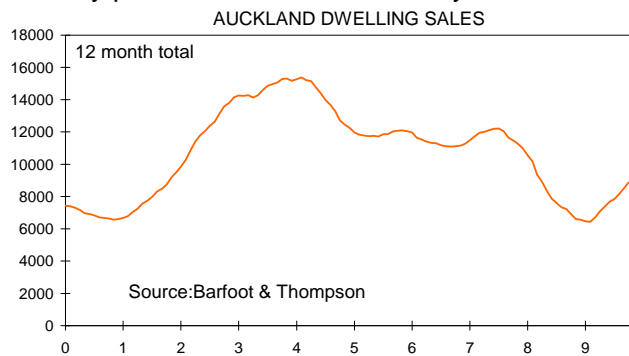
The time for getting a good medium to long term fixed rate this cycle came and went earlier in the year. If I were borrowing at the moment I would simply float and go wherever the ride takes me.



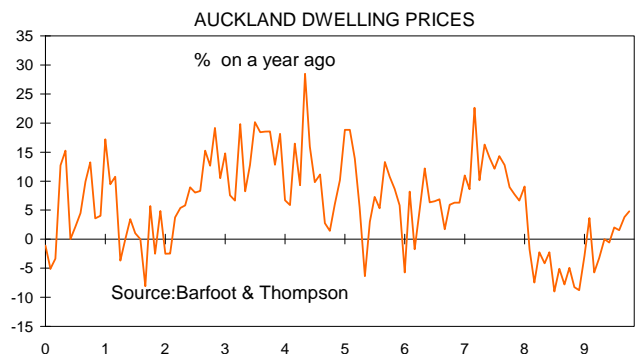
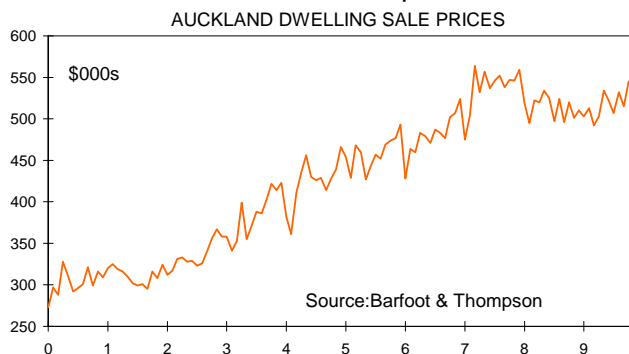
# HOUSING MARKET UPDATE

## Auckland Housing Firm

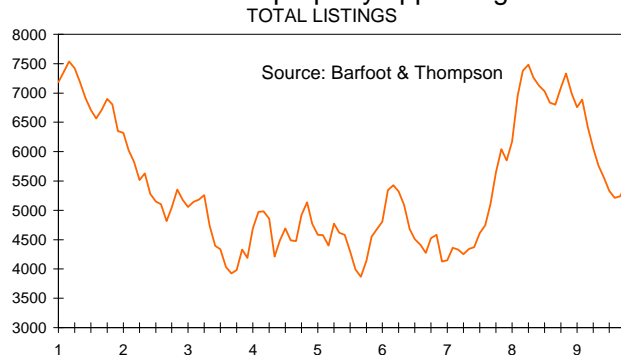
Barfoot and Thompson's Auckland activity data show that their dwelling sales in September were a strong 73% ahead of a year earlier at 871. But one has to keep in mind that for the next few months a lot of these month on year ago comparisons are going to go through the roof because of the massive negative impact of the Lehman Brothers collapse a year ago on economic activity. A better gauge of what is happening with real estate activity at the moment is to look at monthly seasonally adjusted rates of change. Doing that we see by our rough estimate that although sales in September eased 2%, over the September quarter they were up 4% from the June quarter. So activity levels are improving but not at a rapid pace. That rapid recovery period occurred earlier this year.

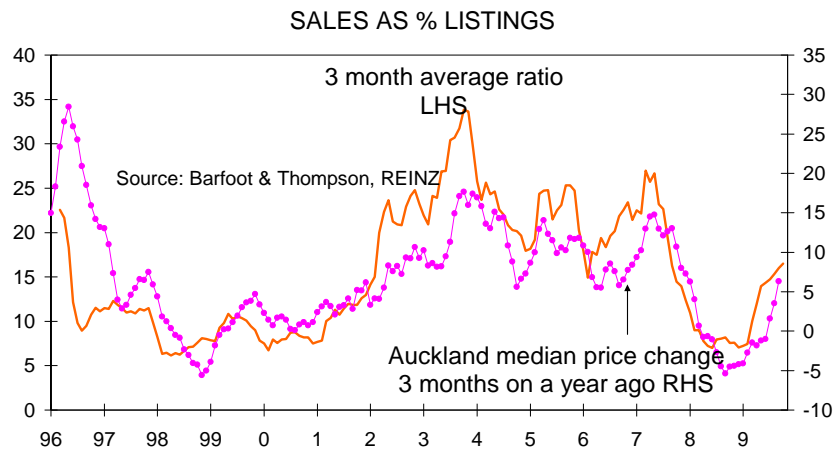


High volatility in the average sales price measure was seen again this month with a sharp jump to \$545,000 from \$515,000 in August and \$532,000 in July. The trend however is upward – as confirmed by the nationwide monthly measures from REINZ. In the September quarter the Barfoot and Thompson measure was ahead 1.9% from the June quarter.



The number of new property listings received in September was ahead 15% from a year ago but there is no clear evidence of a rush of vendors hitting the market. In fact the total number of listings on the books stood at 5,439 at the end of September which was a 23% decline from a year earlier. The ratio of sales to listings for the month was 16% and if there was a flood of property appearing this ratio would be a lot lower.





The important thing we have learnt regarding the housing market this week is that the absence of a Spring surge in listings has been confirmed. This means the potential for downward pressure on prices from a flood of properties – basically the only hope left for those people recently still forecasting a price collapse – has gone.

The implications for house prices of what is happening in the housing market are as clear now as they have been for a year and a half. Specifically

1. The Reserve Bank have said they are determined to keep floating interest rates low until the second half of 2010. That means ongoing strong support for the housing market as borrowers are attracted by currently low financing costs.
2. There is no massive surge in house construction underway though a recovery is occurring. Construction remains near the lowest levels in four decades at a time when housing is already in shortening supply.
3. The net migration numbers continue to increase and are now in above average territory.
4. The ability of housing supply to recover strongly is going to be constrained first by a lack of finance for subdivisions, then by builders going across to Australia to take advantage of a strong building recovery there to handle a massive housing shortage.

House prices are likely to keep rising but one should not be thinking in terms of a boom. In fact it pays to keep an ear open to the comments from the likes of the Finance Minister regarding the potential for some reform in the ability of property investors to offset losses against other income. No capital gains tax is coming, but given that it is looking more likely some other change will occur, property buyers should make sure they are purchasing for positive cash flow and not doing what so many did in the past and plan ongoing cash losses in the hope of long term strong capital gain.

And to finish with here is a test of your understanding of economics. If the returns to investors are reduced through some tax-type changes will more or fewer houses be built? What will the impact of that change eventually be on prices? So does a long term yield-focussed investor buy or sell houses if prices fall for a while? = fewer, upward, buy the dip.

### 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 late-2010.
- Real estate sales continuing to increase but the rise limited by listings shortages.
- House prices edging higher.

## Exchange Rates & Foreign Economies

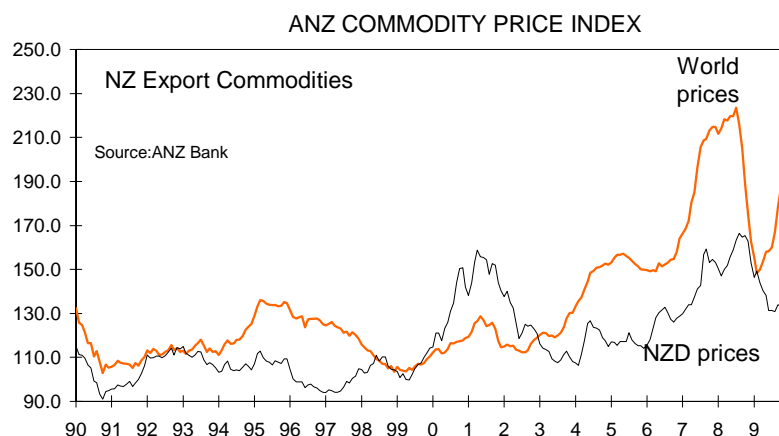
Exchange Rates	This Week	Week ago	4 wks ago	3 mths ago	Yr ago	Consensus Frcsts yr ago	10 yr average
NZD/USD	0.719	0.725	0.716	0.670	0.605	0.603	0.592
NZD/AUD	0.792	0.804	0.825	0.794	0.871	0.831	0.856
NZD/JPY	64.800	65.800	64.300	63.800	60.6	64.340	66.8
NZD/GBP	0.434	0.441	0.449	0.396	0.378	0.357	0.345
NZD/EUR	0.484	0.492	0.492	0.465	0.466	0.453	0.51
USD/JPY	90.125	90.759	89.804	95.224	100.165	106.700	113.9
USD/GBP	1.657	1.644	1.595	1.692	1.601	1.688	1.709
USD/EUR	1.486	1.474	1.455	1.441	1.298	1.331	1.156
AUD/USD	0.908	0.902	0.868	0.844	0.695	0.726	0.69

### Some Divergent Pressures This Week For The NZD

Back on October 26 the NZD was near US 76 cents, 69 Yen, 46 pence, 50.5 centimes (Euro), and 81.5 Aussie cents. But then last week the RB made more dovish than expected comments in their six weekly rate review so markets pulled back from their expectations of rate hikes starting in January. In addition a bout of heebie jeebies went through the world's financial markets with regards to the speed of global recovery and the US in particular, so risk tolerance fell and investors sold risky assets like shares and the NZD.

This week there was mild downward pressure again on the NZD from more dovish RB comments this morning along with slightly worse than expected job numbers. But the impact of these numbers was offset to a great extent by a small improvement in global risk tolerance, along with some strong NZ commodity price numbers.

The ANZ Commodity Price Index in October rose another 4.6% meaning prices are now on average up 24% from where they were seven months ago led by dairying up 65%.



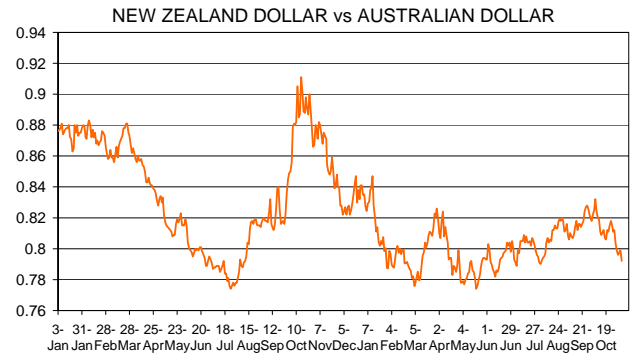
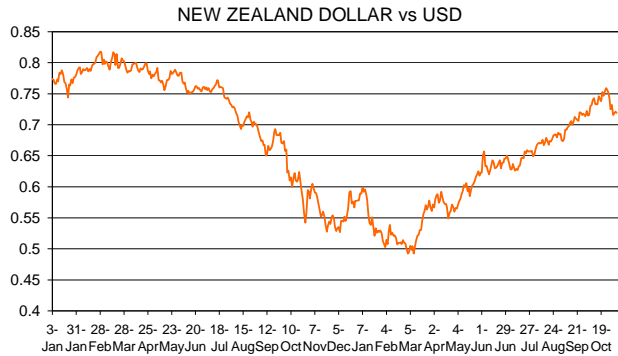
In fact, on Tuesday night Fonterra's monthly auction of wholemilk powder produced an average 14% gain in prices which followed a 6% gain last month and near 25% gains in each of the two months before that.

The NZD is a commodity currency and not just a risky one, so rising commodity prices are supportive. We also frequently get lumped in with the AUD in the minds of offshore investors and with the Aussie economy looking good and their interest rates rising we are going along for a bit of a ride. We also offer attractive interest rates to savers overseas who are tired of near 0% returns in many parts of the world.

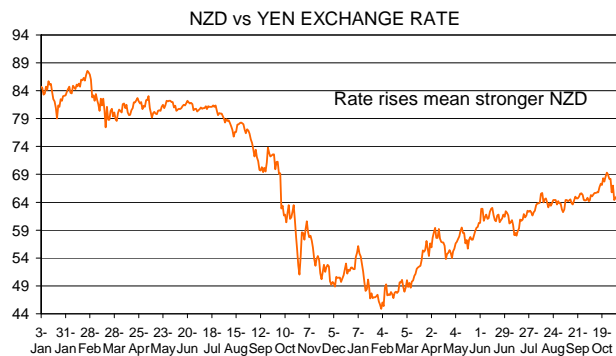
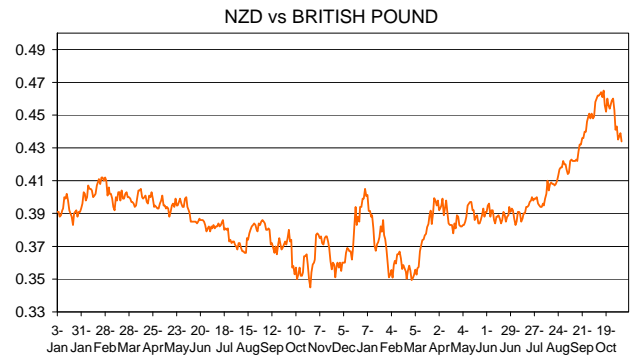
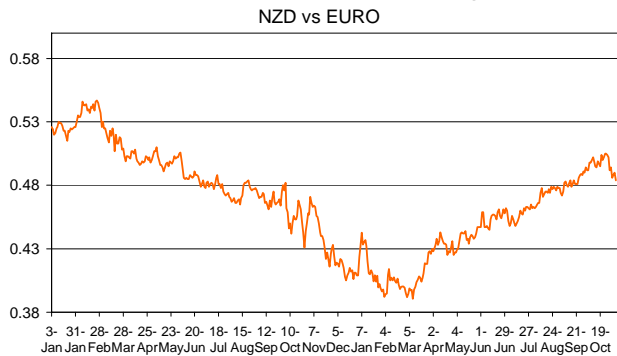
## BNZ WEEKLY OVERVIEW

So while we are certain to see high volatility continuing along the way, the drift for the NZD against the major currencies is still likely to be upward in coming months – assisted probably by some general weakening in the greenback. Next year will be quite interesting as the NZ and probably US monetary policy tightening cycles kick off.

As at the time of writing this near midnight NZ time but 7.00pm in the evening in Hong Kong the NZD was trading just under US 72 cents which as the graph here shows takes us back to about where we were exactly one month ago. Against the AUD however the NZD has reached a three and a half month low near 79 cents from over 80 cents last week.



The NZD has also crept down to a six week low against the Euro near 48.4, a six week low against the pound near 43.4, and a four week low against the yen near 65.



### If I Were An FX Receiver What Would I Do?

I would run the sort of FX hedging policy which one large firm we encountered at the rugby ball function this week does. They hedge expected receipts three years ahead without fail, and just ease off a tad when the currency is above average and add some more when it is below average. That is it. They do not do what a lot of exporters still unfortunately seem to do which is hedge on the basis of cash flow pain. This process is one in which hedging is kicked into touch if cash flows are good – probably because the currency is low. But when the currency is high cash flows are bad and exporters tear their hair out worried that they could not survive if the currency were to rise another five cents. So they hedge everything at 80 cents.

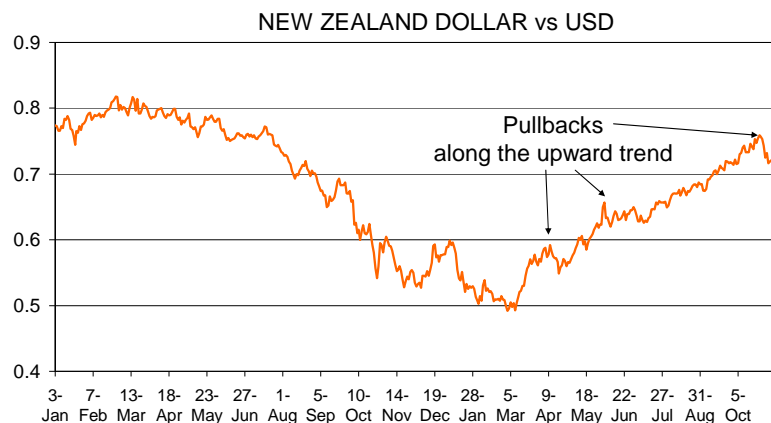
Maybe when they do that is some sort of capitulation point – the last gasp of the panicked buyers traders wait for as their signal to sell out. Who knows.

One interesting phenomenon of the past seven months has been a reluctance by many exporters to hedge because they were being told by their advisors that a ten cent decline in the Kiwi was just around the corner so they should hold off. That decline has not come of course and when it does we could be in 2011 or later.

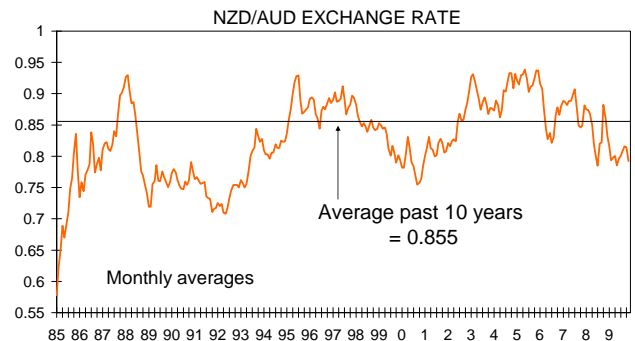
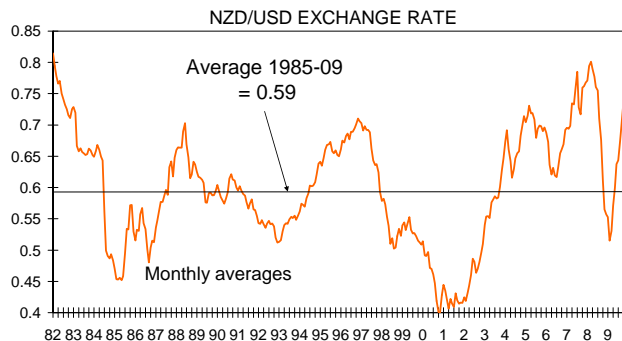
What the advisors missed was the key point we have been making in this section since about May – we won't claim March or April as starting points for this comment. The point we have been making is that it has only been reasonable to expect the NZD to plummet back down again if the thing which made it drop like a stone over 2008 reappeared and that thing was worries about a Depression-type economic scenario for the world economy. It has not been reasonable to expect that scenario since the green shoots started appearing in March.

Note that this is something totally different from the risk of a bumpy economic ride ahead or even a near W-shaped global recovery (which we do not expect.) The green shoots were only ever about the absence of a Depression and not the first shots of a global recovery. Those sorts of positive data releases have only been appearing for the past three months at most and it is legitimate to worry about the path ahead and therefore it is legitimate to expect the occasional 2-4 cent falls in the NZD and decent falls in sharemarkets as we have recently seen.

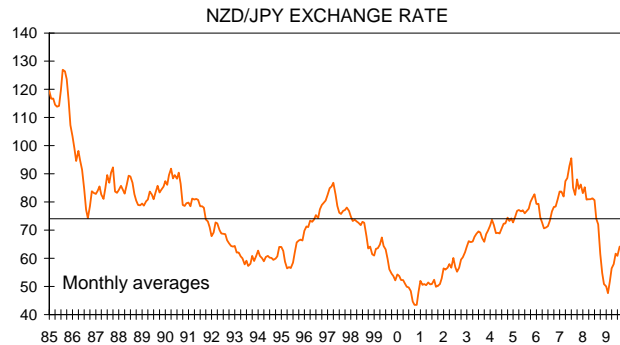
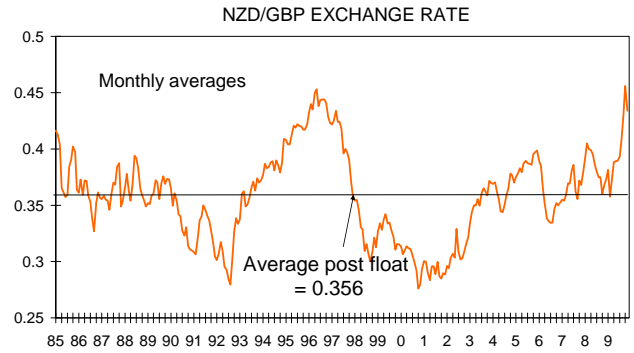
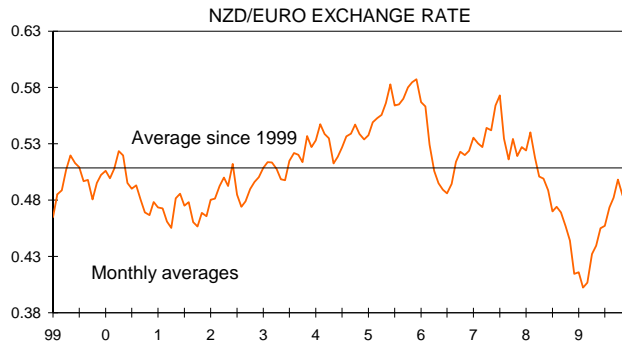
In fact lets just update some commentary we made 4-6 weeks ago regarding the extent of the periods of pullback in the NZD since March. We now have three such periods shown in the graph below. If you were slow you missed the opportunity each provided to get a bit more hedging on board.



Here are our usual graphs showing where the NZD currently sits in relation to long term trends.



# BNZ WEEKLY OVERVIEW



\*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	1.3%	0.6	1.7	5.1	1.8
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 Stratified Index	1.6	1.8	0.7	-7.0	13.1
Net migration gain	Av. gain past 10 years = 11,700	+17,043	12,515yr	.....	4,403	8,319
Tourism – an. av grth	10 year average growth = 5.0%. Stats NZ	-1.8	-2.8	-1.8	-0.3	3.8
		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	43.7	39.3	30.5	-23.7	-32.0
Floating Mort. Rate	(Total Money) 10 year average = 7.6%*	5.59	5.59	6.49	10.49	9.99
3 yr fixed hsg rate	10 year average = 7.9%	7.95	7.45	6.59	8.69	8.75

## ECONOMIC FORECASTS

Forecasts at Sept. 17 2009 (CPI updated 15/10)	March Years					December Years				
	2008	2009	2010	2011	2012	2007	2008	2009	2010	2011
<b>GDP - annual average % change</b>										
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	2.5	1.1	2.6	3.2	3.4	2.6	1.4	2.1
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
<b>EXCHANGE RATE ASSUMPTIONS</b>										
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