

# BNZ Weekly Overview

14 August 2008

## 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 long term big picture is positive for NZ – pity about the short term. Page 3**
- **Housing Market Pulls back from the brink – but no upturn by a long stretch. Page 7**

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 WO and Offshore Overview each Thursday night email me at [tony.alexander@bnz.co.nz](mailto:tony.alexander@bnz.co.nz) with 'Subscribe' in the Subject line. You do not have to be a BNZ customer to receive the WO. To get off the list email 'Unsubscribe'.

**Look For The Big Picture**  
**Economic Developments**

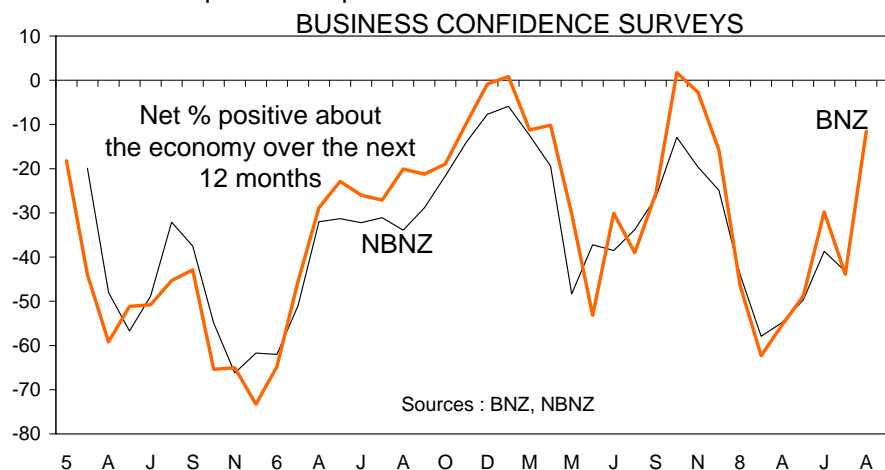
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## Confidence at a Nine Month High

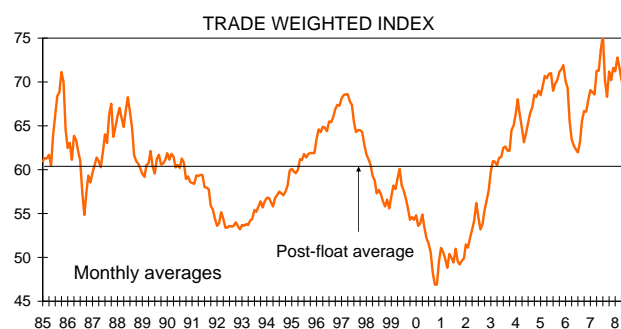
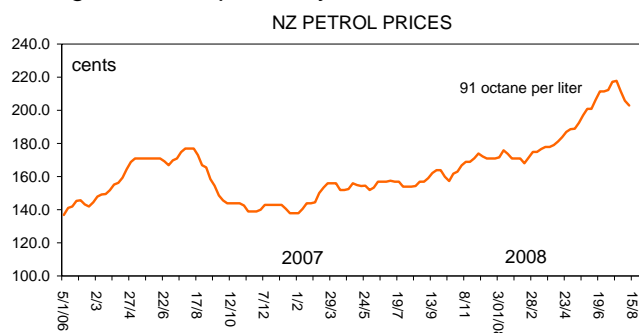
Last week we noted that mainly positive things of relevance to the New Zealand economy had happened. The exchange rate was falling, commodity prices rising, petrol prices falling, job numbers jumped up, and the Reserve Bank Governor was emphasising scope for the cuts in interest rates. Perhaps these developments help explain why in our monthly survey of Weekly Overview readers released on Saturday morning confidence has improved to its strongest level since November last year. Only a net 12% of respondents now expect the economy will get worse over the coming year compared with a net 44% in July and 62% back in the dark depths of despair in March.



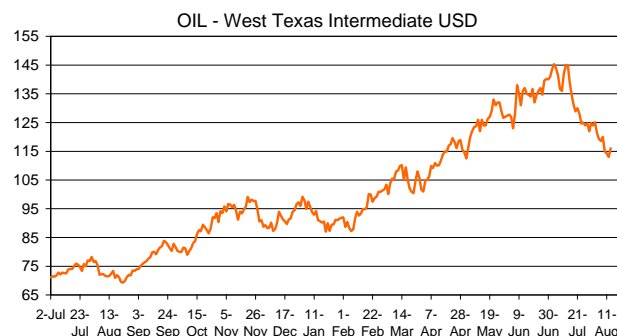
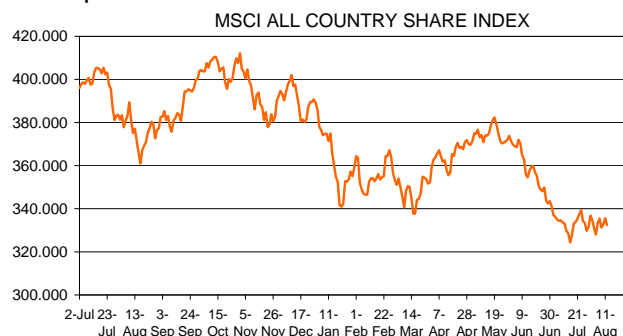
Do these results mean the economy is at a turning point and things on the ground are likely to be improving in the very near future? Not at all.

We interpret the results as meaning people can see positive developments under way which will eventually lead to better operating conditions. We should expect that when the NBNZ Business Outlook survey for August is released on the 28th of this month there are likely to be some firm improvements in the various indicators which could generate some excitement in the media and financial markets. But an improvement in sentiment measures from truly ugly levels still leaves us a long way off from saying things are firm at the moment.

For instance, even though petrol prices have fallen back recently they are still 30% ahead of a year earlier. And even though the trade weighted index has pulled back to just below 65 this is still almost 10% above the average over the past 23 years.



The tourism sector is going to face challenges going forward as a result of rising international airfares, travellers concerns about CO2 emissions, and major weakness in some of our main source countries. The global credit crisis is still showing no signs of improvement and sharemarkets are as wobbly as ever. Concerns about growth have risen quite sharply over the past few weeks in the United Kingdom, Europe, and Japan.



It also pays to note that because only one third of New Zealand mortgages mature in the coming year, 88% of mortgage interest rates are fixed, and on average those maturing in the coming year roll off at about 8.2%, it won't be until sometime in the first half of next year that on average those with maturing rates roll onto something less. That means that for the remainder of this year it leased the debt servicing burden for the New Zealand household will increase rather than decline as the Reserve Bank cuts the official cash rate.

And we still think there are many months to go with regard to retailers discounting stock to reduce inventories and in the process cutting back orders to domestic manufacturers of the products they sell. Small layoffs by many firms across the economy are likely to grow as the labour market tends to lag the economic cycle and companies are looking to get cash flows under control. And we still see evidence of businesses delaying some of their much-needed capital expenditure again to attack cash flow problems and because of some uncertainty about where things will go on the near future.

In other words there is still a lot of water to go under the bridge but at least there is light at the end of the tunnel with normal cyclical factors that will eventually produce stronger growth starting to operate.

## Look for the Big Picture

Economics is a great subject. While the media focus on the inevitable positive and negative shocks to inflation, exchange rates, oil prices, sharemarkets and so on, the focus of us economists is elsewhere. We get interviewed about the shocks but what we try to steer conversations around to is the things happening underneath.

That is, our job is to stand back from the day to day fray and remind people in dealing rooms, corporate decision makers, owners of SMEs, householders and our bosses what the big picture is showing. The big picture for New Zealand is overwhelmingly positive and those who for one reason or another focus on the current negatives are missing the point.

When our economy turned upward from the end of the last recession in 1998 growth was led by the rural sector. This growth eventually spread to the cities and produced a boom in household spending on retail goods and services, travel, and of course houses. Growth in household spending is of course great and ultimately what the economy exists for as it were. But often such growth becomes unsustainable. Spending either greatly exceeds income and a debt crisis arises, and/or overall economic growth outstrips growth in resources and productivity so inflation becomes a problem – for which the solution is higher interest rates.

Or maybe imports massively outpace exports and an exchange rate “adjustment” hits confidence and debt servicing costs.

Either way booms in household spending always come to an end and we economists try our best to pick when and how badly – sometimes with success, sometimes without. When the household spending correction comes people’s focus is always on the woe in the housing market, retail stores closing and sitting empty, unemployment rising, sharemarkets weakening, and migration numbers perhaps deteriorating as people have hissy fits and leave the country. That crunch this cycle started in the June quarter of last year as the Reserve Bank was taking the official cash rate from 7.25% to 8.25%. Since then rising prices for food and petrol, drought and the global credit crisis have shifted our economy’s position from a soft landing to first of all a hard landing and now probably a recession. It never rains but it pours.

But too often people extrapolate the short term weakness in household spending into a long term nightmare. They make bad decisions. House prices – if they fall – fall too far. Businesses lay off “too many” people, cut inventories too much, and delay capital expenditure longer than they should. This leaves business operators poorly placed to take advantage of the upturn when it inevitably comes along – which it always does. But more importantly, in their focus on domestic woe people invariably miss the vital importance of the retail and housing downturn to the export sector and therefore the economy overall – the big picture as it were.

New Zealand’s export sector has been getting crunched since the trade weighted index moved to above average levels early in 2003 and reached 25% above average in the middle of 2007. It is still about 9% above average but will probably hit the average post-float reading of 60 from near 65 currently before the middle of 2009.

The falling exchange rate and improving availability of resources is shifting our economy’s cycle back in favour of the export sector and this will inevitably pull the domestic economy back up – probably over 2010. But this common cyclical tendency is not the only big picture we are trying to get people to focus on. The really big one is the sharp improvement in New Zealand’s long term growth prospects these past two years as a result of soaring incomes in emerging economies lifting demand for bulk food then later processed food and beverages.

We sit very well positioned to take advantage of offshore economic growth even though we should expect some uncertain movements in food prices depending upon whether the world backs away from the food-sourced biofuel boom or continues growing crops for cars rather than people. The current recession is merely a bump on an increasingly friendly road and for many businesses the current environment could represent a great opportunity to position themselves for good long term growth in the next 10 or 20 years.

Employees are becoming more readily available and slower growth is producing time if not necessarily ready cash flow to train people up. That training should embrace not just task-focussed skills but general literacy along with management skills and processes.

The less frenzied current economy is also providing scope for business rationalisation to get ready for future growth. This may mean mergers with or takeovers of businesses who have left it too late to get their cash flows under control. It may mean relocating to new premises at more acceptable lease terms or even a more competitively priced new building as residential construction fades away.

It may mean putting in place new plant, machinery and equipment or ICT system at a time when interruptions to processes from integrating the new things will be less disruptive than if one's business were running at full speed.

It may mean being able to take the time to truly figure out which product lines make the most money, which are just profitable, and which are deadweight created by years of wasteful expansion during the boom. Time may be available now to create a better pricing strategy built around pricing to what the market will bear so pricing up when strong demand conditions eventually return. It may mean taking the time now to figure out how one can benefit from the expected growth in the primary sector, the regions, rural towns and secondary centres, and the food and beverage industry.

And ultimately it may mean this. If you accept that it is not just the export sectors' five year prospects which are improving each month as the NZD falls, but the overall economy's outlook due to trends offshore then a behavioural response is implied. Be quiet, let the media focus on the negatives, let the politicians try to convince us the economy will be munted unless we vote for them, and let your business counterparts run around like headless chooks. Then hire their people, buy their machinery, secure their premises, extract bargains from pessimistic suppliers desperate just to cover marginal costs, and say in surveys read by the Reserve Bank that you also think the economy is munted. (Doing that increases downside potential for interest rates and the exchange rate.)

Above all think about the current seemingly depressed economy this way. Its providing a healthy move away from debt-driven growth and freeing up resources for where we really want growth to come from – exports. If possible enjoy the recession. It's the first one for ten years and the next stress-relieving one might not come along for another decade.

### **Awash With Cash? Hardly**

One of the respondents in our monthly survey of Weekly Overview readers made the following comment. "What are the banks going to do with the inflow of funds from investors who have pulled out of other investments? Will there be a return to loose lending policies? After an initial tightening of lending criteria banks are already easing off in order to get the business levels flowing. The merry-go-round continues."

Hardly. Lending standards are tightening - though not tremendously so. But that is not really the issue. Total lending by New Zealand banks adds up to almost \$300 billion. We need to get almost one third of our funding from offshore so our foreign funding requirement approaches \$100 billion. Total lending by finance companies in New Zealand adds up to about \$18 billion.

Only half the finance companies are mainly dependent upon investments from the public and the rest have private funding sources. That leaves \$9 billion which could shift to other investments. But not all of these publicly funded finance companies are in strife and those that are of course have money that is not shifting across to us banks. So there may only be \$4 billion or so available to shift across to us banks with a few hundred million more from mortgage trusts.

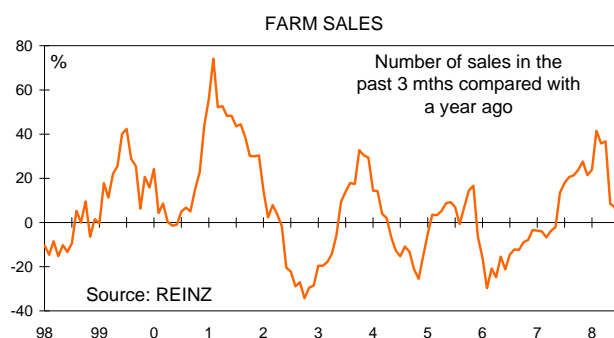
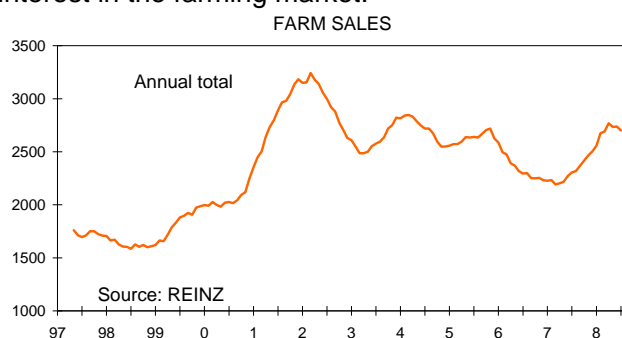
The new flow of funds into banks is a mere drop in our ocean of funding requirement from offshore. So we are not awash in cash and even if we were that would manifest itself as reductions in interest rates rather than some wholesale easing of lending standards during a period when the world economy is experiencing its worst financial crisis since the Great Depression.

# NZ ECONOMIC DEVELOPMENTS

Wednesday 13

## Farm Sales Ease Slightly

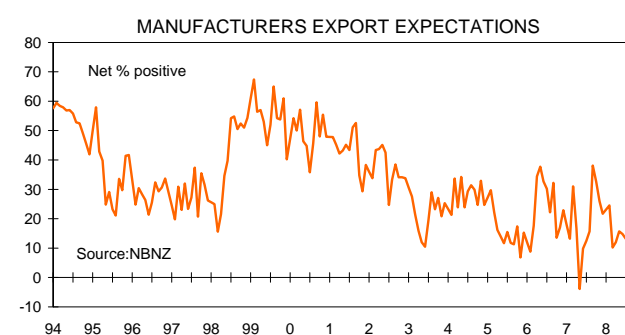
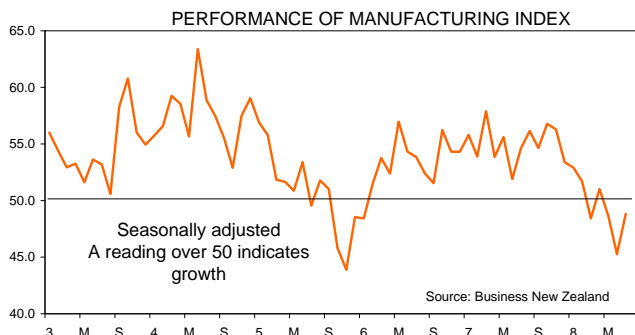
In July there were 154 farms sold around New Zealand. This represented a decline of 19% from a year earlier and over the three months to July the number of farms sold was down from a year ago by 10%. There was even some weakness in seasonally adjusted terms with a decline of some 14% in turnover for the last three months. The three-month total was also 6% below average for this period of time over the past six years. So there is evidence of some easing off in what has been a truly rampant rural estate market. But this is not a trend we expect to continue. The Kiwi dollar is falling and this is likely to attract extra investor interest in the farming market.



Thursday 14

## Manufacturing Index Improves Slightly

Consistent with other measures showing things are pulling back from the brink although remaining at still worrying levels was the BNZ Business New Zealand Performance of Manufacturing Index which rose to a seasonally adjusted level of 48.8 in July from 45.3 in June. This is still below the neutral level of 50 and as such suggests some continuing shrinkage of New Zealand's manufacturing sector.



The fact that the outlook for manufacturing still remains worrying can be seen in the export expectations measure from the NBNZ Business Outlook monthly survey released a couple of weeks ago. Only a net 13.2% of manufacturers expect their exports to improve over the coming 12 months which is well below the long-term average reading of a net 28% positive.

### Feedback & Queries

If there are any issues in the Weekly Overview you wish to comment on or you have a query about the economy, send me an email at [tony.alexander@bnz.co.nz](mailto:tony.alexander@bnz.co.nz) Useful issues will be discussed in the WO.

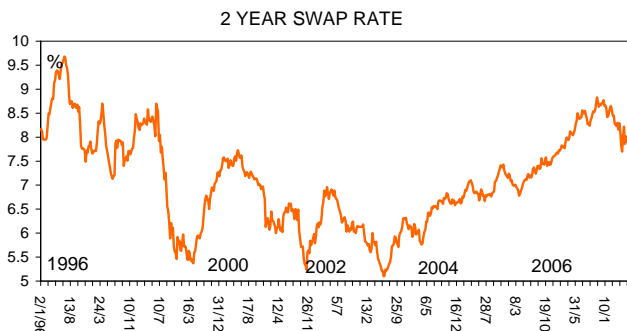
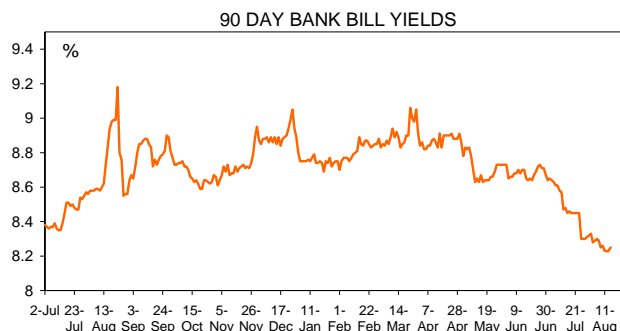
# INTEREST RATES

In the absence of any major data releases there has been practically no movement in wholesale interest rates over the past week and even the fall of the Kiwi dollar which for a while became quite rapid yesterday has not had much impact. If there was going to be some impact it would have been the market pulling back on expectations that the Reserve Bank would cut interest rates at each six weekly review over the next few months. The Reserve Bank have explicitly noted that they intend cutting interest rates unless there is "excessive" depreciation in the Kiwi dollar. At the moment the trade weighted index is close to 65 compared with 67.5 a month ago, the same two months ago, and 68 three months ago.

The decline in the Kiwi dollar has so far been relatively mild and has only looked exciting for a while because the cyclical weakness has combined over the past few weeks with a rebound in the greenback. Looking forward our expectation remains that the Reserve Bank will be cutting interest rates by 0.25% at each of the official cash rate reviews in the next year leading to a cyclical low for the rate somewhere between 5.5% and 6.5% toward the end of 2009.

That is, we see the cash rate being taken back to somewhere very close to the probable neutral level. At this stage we don't believe the Reserve Bank is likely to be aggressively cutting the cash rate this cycle to actively stimulate the economy and generate more inflation. Our economy still remains fundamentally short of resources and the easing we can see at the moment is merely cyclical - not structural.

The yield on 90 day bank bills has ended unchanged from a week ago near 8.25%, while the benchmark two year swap rate has ended near 7.34% from 7.3%.



## Key Forecasts

- Monetary policy easing with the official cash rate near 6% come late 2009.
- The two year fixed housing rate falling below 8.50% at a stretch late 2008, hitting the five year average of 7.8% in mid-2009 optimistically, but going lower will require weaker data on the NZ economy and decent easing of global credit tensions – possible late in 2009. Falling to the 6.5% low of 1999, 2001 and 2003 is very unlikely this cycle.

FINANCIAL MARKETS DATA						
	This week	Week ago	4 wks ago	3 months ago	Yr ago	10 yr average
Official Cash Rate	8.00%	8.00	8.25	8.25	8.25	6.2
90-day bank bill	8.25%	8.25	8.48	8.67	8.73	6.4
10 year govt. bond	6.15%	6.12	6.07	6.36	6.39	6.5
1 year swap	7.69%	7.67	8.01	8.20	8.68	6.6
5 year swap	7.11%	7.12	7.44	7.54	8.08	7.0

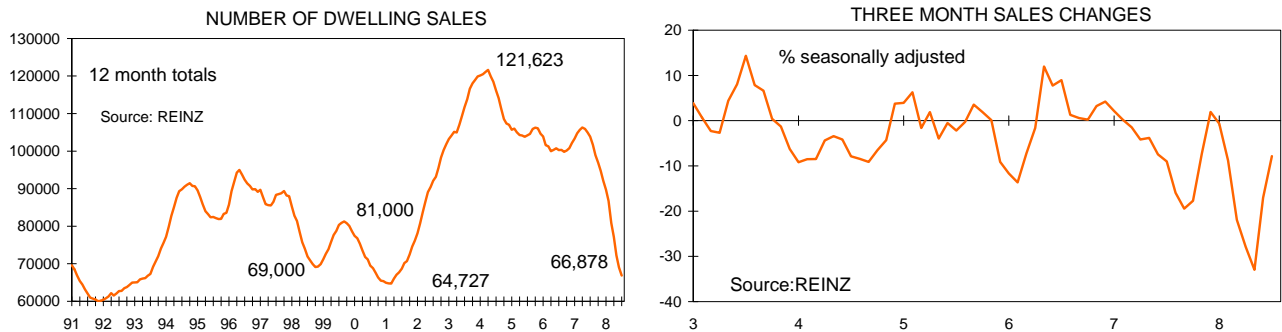
## If I Were a Borrower What Would I Do?

I would still fix one year.

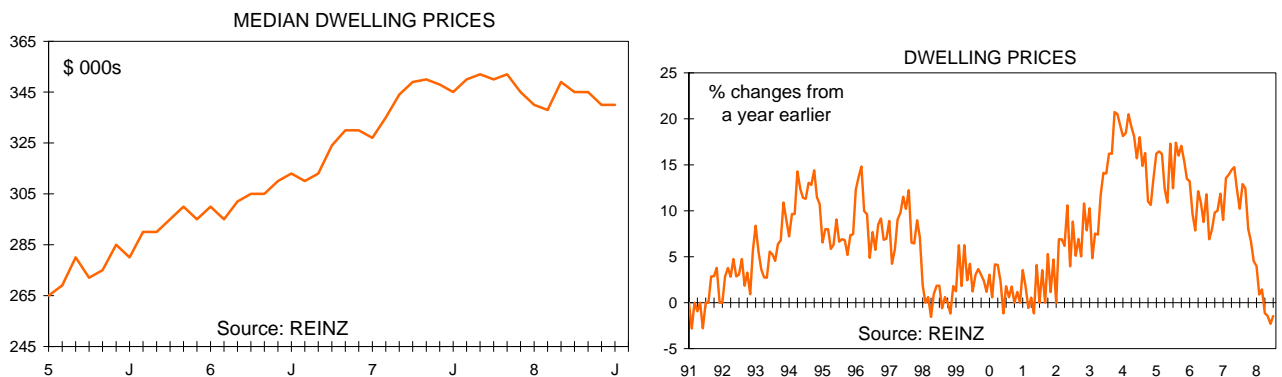
# HOUSING MARKET UPDATE

## Dwelling Sales Confirmed As Firming In July

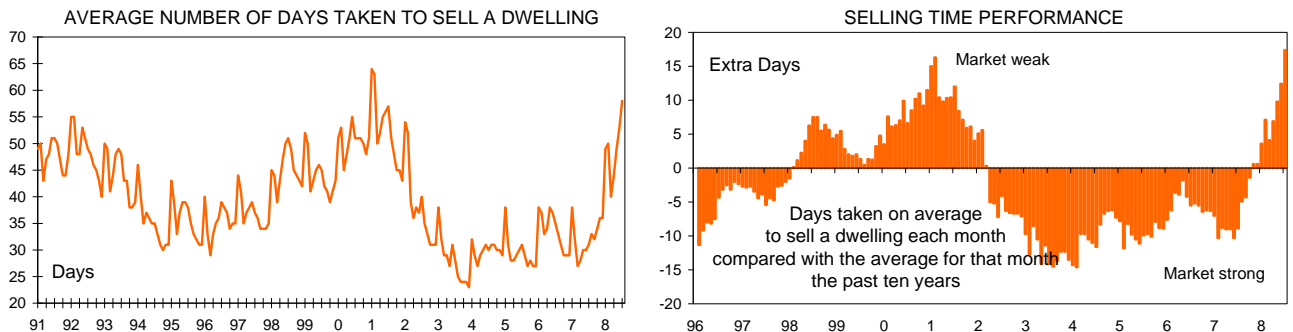
The REINZ reported this week that there were 4,489 dwellings sold around New Zealand in July. This was a decrease or 33% from a year earlier which sounds fairly shocking. But it's actually the weakest annual rate of decline since February and in seasonally adjusted terms sales in the month improved by roughly 5% after rising 9% in June. The direction of change is the same as that we commented on last week in the Auckland data supplied by Barfoot and Thompson. Sales activity appears to have been at its most depressed levels over the months of March, April, and May but since then there has been some greater matching up of the dreams of buyers and the hopes of sellers and hence an improvement in turnover.



And it's interesting to see that still there is no evidence prices are pulling back to any significant degree. The median dwelling sale price for the entire country in July was \$340,000. This was exactly the same as the median price in June and down by only 1.4% from a year earlier.

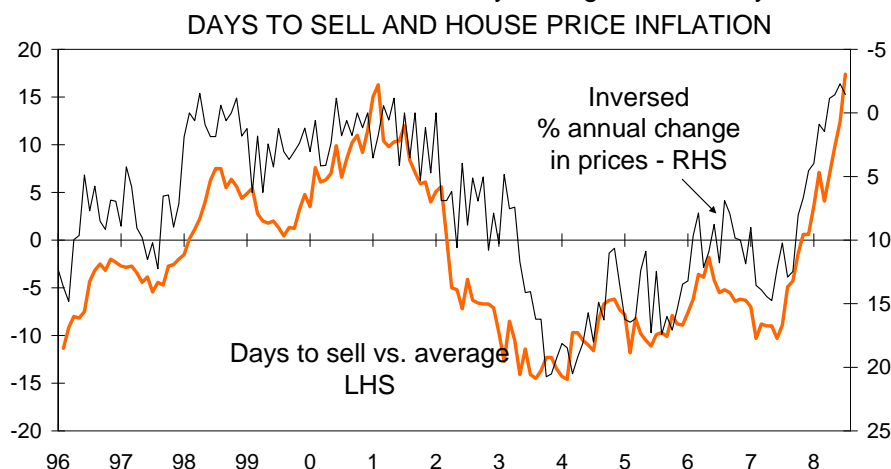


But before anyone gets excited and thinks that in this third paragraph we are about to write something positive about the real estate market it pays to look at the days to sell measure. Remembering that we believe this number is biased downward as people see their houses sit on the market for a while then switch to another agent and therefore the account goes back to zero we note the following.



On average in July it took 58 days to sell a dwelling. This is the longest time for any month since February 2001 and was up from 53 days in June. More significantly the measure was a huge 27 days ahead of a year

earlier meaning that it now takes almost twice as long to sell a property as it did a year ago. Compared with how long it has taken a property to sell on average in July over the past 10 years the latest result is 17.4 days worse than average. June was 12.4 days, May 9.8 days, and December only 0.6 days. This is an extremely weak result and means that we are not suddenly seeing a rush of buyers into the market.



For the moment we think the results for June and July indicate a pulling back from the scenarios some people are peddling involving prices falling 30%. Heck, even in the United States prices have “only” declined 19% over a two-year period and they experienced massive bad bank lending to people who should never have been given a sniff of mortgage money in the first place at low teaser interest rates of 2%. Nothing remotely approaching that has happened in New Zealand and we know many people got a very unpleasant surprise over the past three years when they went to their bank expecting to get 100% financing and found their income was not high enough to qualify.

Forecasts of massive price declines do not stack up considering two rounds of tax cuts look likely over the coming year, interest rates have started to fall and the Reserve Bank are clearly indicating they intend cutting further, and vendors are increasingly taking properties off the market. Our monthly survey of Weekly Overview readers also produced some interesting positive real estate comments although the overall tone was still firmly negative.

But it would be equally wrong to believe there is anything remotely smelling like an upturn just around the corner. There has been no jobs growth in New Zealand economy over the first half of the year and the risk is job numbers decline slightly over the second half and perhaps in the first half of 2009. This weak labour market along with many employees becoming less secure in their jobs and less confident of wage rises will tend to cap willingness to buy. In addition we believe that when the market does show strength we will see vendors placing properties back on the market again.

So the interpretation we invite people to take from these latest numbers is merely a pulling back from an ugly brink but not the end of the downward slope or even visual confirmation of the bottom in the near distance.

### Key Forecasts

- Dwelling consent numbers to fall from 24,500 in the year to March 2008 to below 18,000 in the year to March 2009 with a slight recovery to March 2010 then above average activity after that as attention turns to a shortage of dwellings late in 2009.
- Real estate sales falling from 77,130 in the year to April 2008 to between 55,000 and 65,000 come the end of this year then recovering back over 65,000 in calendar 2009 with further growth over 2010.
- House prices down 5%-10% by the end of 2008, flat over 2009, rising slightly over 2010, possibly earlier.

## Exchange Rates & Foreign Economies

See the Offshore Overview.

### Data Sources

Interest rates & exchange rates RBNZ at	<a href="http://www.rbnz.govt.nz/statistics/">http://www.rbnz.govt.nz/statistics/</a>
House mortgage data – RBNZ	<a href="http://www.rbnz.govt.nz/statistics/monfin/rbssr/rbssrpartE/data.html">http://www.rbnz.govt.nz/statistics/monfin/rbssr/rbssrpartE/data.html</a>
House price information - REINZ	<a href="http://www.reinz.org.nz/reinz/public/market-information/market-information_home.cfm">http://www.reinz.org.nz/reinz/public/market-information/market-information_home.cfm</a>
NZ economic data, most from Statistics NZ	<a href="http://www.stats.govt.nz">http://www.stats.govt.nz</a>
Government accounts, NZ Treasury at	<a href="http://www.treasury.govt.nz/financialstatements/">http://www.treasury.govt.nz/financialstatements/</a>
Parliament, select committees, publications etc.	<a href="http://www.parliament.nz/en-nz">http://www.parliament.nz/en-nz</a>

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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	1.6%	0.7	4.0	2.0	4.0
GDP growth	Average past 10 years = 3.0%	-0.3	0.8	2.9	1.6	2.7
Unemployment rate	Average past 10 years = 5.3%	3.9	3.7	.....	3.6	3.6
Jobs growth	Average past 10 years = 1.9%	1.3	-1.3	0.7	1.5	3.0
Current a/c deficit	Average past 10 years = 5.5% of GDP	7.8	7.9	.....	8.5	9.6
Terms of Trade		2.9	3.7	8.8	3.8	-1.9
Wages Growth	Stats NZ analytical series	1.2	1.3	5.5	4.5	5.5
Retail Sales ex-auto	Average past 9 years = 3.8%	0.2	0.1	3.1	4.9	5.6
House Prices	Long term average rise 5% p.a.	-0.7	0.4	2.8	11.7	12.2
Net migration gain	Av. gain past 10 years = 10,400	+4,735	4,675yr	.....	10,080	10,690
Tourism – an. av grth	10 year average growth = 5.0%. Stats NZ	1.3	2.2	1.3	2.4	0.6
		Latest year rate	Prev mth year rate	6 mths ago	Year ago	2 yrs ago
Consumer conf.	10 year average = 2%. Colmar survey	-28	-25	-10	-10	-22
Business activity exps	10 year average = 26%. NBNZ	-8.2	-4.0	10.3	12.4	14.9
Household debt	10 year average growth = 11.3%. RBNZ	8.4	9.3	12.3	13.7	14.1
Dwelling sales	10 year average growth = 3.5%. REINZ	-42.4	-52.9	-32.1	-1.3	5.0
Floating Mort. Rate	10 year average = 8.1%	10.95	10.95	10.55	10.30	9.55
3 yr fixed hsg rate	10 year average = 7.9%	9.09	9.49	9.19	9.15	7.75

## ECONOMIC FORECASTS

Forecasts at July 31 2008	March Years					December Years				
	2007	2008	2009	2010	2011	2006	2007	2008	2009	2010
<b>GDP - annual average % change</b>										
Private Consumption	2.8	3.3	-1.1	1.4	2.3	2.6	4.1	-0.6	0.6	2.3
Government Consumption	4.4	4.2	3.7	3.2	3.3	4.7	4.2	3.8	3.3	3.2
Investment	-1.9	4.2	-0.2	-0.4	7.6	-1.5	4.7	0.6	-2	6.7
GNE	1.2	4.5	-0.4	1.4	3.8	1.1	4.7	0.4	0.5	3.5
Exports	3.1	2.3	0.6	4.6	3.1	1.7	3.4	0.5	4	3.2
Imports	-1.7	9.7	1.8	0.5	3.6	-2.8	8.8	4.1	-0.1	2.7
GDP	1.6	3	0	2.6	3.7	1.6	3.1	0.4	1.7	3.8
Inflation – Consumers Price Index	2.5	3.4	4.1	2.4	2.2	2.6	3.2	4.4	2.7	2
Employment	1.8	-0.2	-0.3	0.4	1.8	1.4	2.5	-1.4	-0.1	1.8
Unemployment Rate %	3.7	3.6	4.7	5.2	5	3.8	3.4	4.5	5.1	5
Wages	5.5	4.4	4.3	3	2.4	5.5	4	4.5	3.4	2.4
<b>EXCHANGE RATE ASSUMPTIONS</b>										
NZD/USD	0.7	0.8	0.68	0.63	0.61	0.69	0.77	0.7	0.64	0.62
USD/JPY	117	101	108	116	120	117	112	107	114	120
EUR/USD	1.32	1.55	1.47	1.34	1.3	1.32	1.46	1.5	1.37	1.34
NZD/AUD	0.88	0.87	0.77	0.76	0.77	0.88	0.88	0.78	0.76	0.76
NZD/GBP	0.36	0.4	0.37	0.36	0.36	0.35	0.38	0.37	0.36	0.36
NZD/EUR	0.53	0.52	0.46	0.47	0.47	0.52	0.53	0.47	0.47	0.46
NZD/YEN	81.9	81.1	73.4	73.1	73.3	81	86.3	74.9	73	74.4
TWI	68.6	71.6	63.1	61.5	61.1	68	71.6	64.1	61.7	61.2
Official Cash Rate	7.47	8.15	6.75	5.5	6	7.44	8.19	7.25	5.5	6
90 Day Bank Bill Rate	7.78	8.83	6.81	5.73	6.23	7.64	8.77	7.46	5.73	6.23
10 year Govt. Bond	5.91	6.35	6.1	6.1	6.3	5.77	6.38	6.1	6.1	6.25

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.