INTEREST RATES

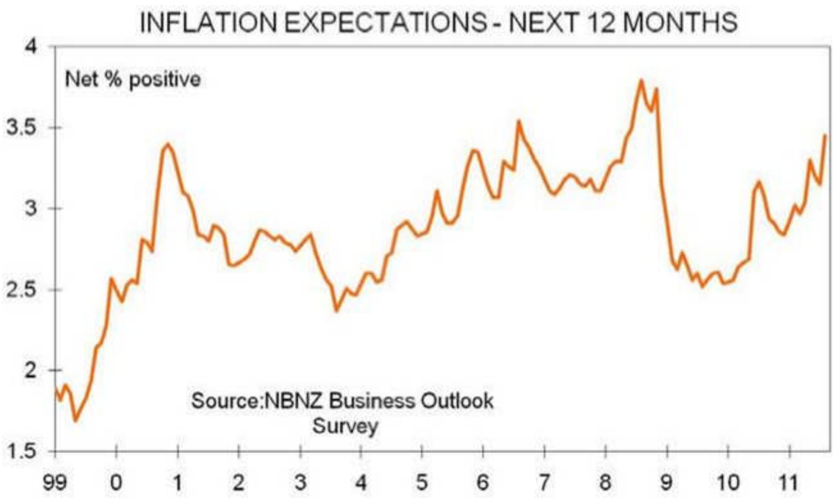
Growth vs. Economic Slack

In a nutshell this is what drives inflation along with institutional arrangements, imported inflation, and exchange rate changes. If you want to forecast monetary policy you need to monitor these things. So we will, adding stuff here when we learn it. The current common view is rate tightening from December. Have we learnt anything this week which alters this outlook?

Do not look for certainty with regard to projections of growth versus capacity availability in the coming couple of years and do not look for unchangeability of interest rate forecasts. They will change many times – as they already have done. At the moment we are trying to figure out how to trade off highly divergent growth factors such as a worsening world economy and some strong domestic leading indicators which may not actually be as growth suggestive in the new global order as past relationships would suggest. The week has produced a general easing in leading indicators of NZ growth so if anything some of the interest rates pressure has come off. However....

Other Inflation Influencers

The NBNZ Business Outlook survey for August showed a sharp jump in business inflation expectations to 3.45% a year out from 3.15% in July. This is the highest result since November 2008 when a rapidly falling exchange rate was pushing up cost expectations. But that is not the case this time around. Note that soaring inflation expectations over 1999 - 2000 were also associated with a collapsing NZD which reached below US 40 cents late in 2000.



This result would terrify the Reserve Bank were it not for the fact that the net percent of businesses planning to raise their selling prices fell to 21% in August from 29% in July. The average reading recently for this measure has been 29% and the ten year average is 25% so the latest result is quite good. Suffice to say that there is much to confuse the RB and being a cautious bunch we feel the results back up our expectation of no rate rise in September but one in December. Remember though that each week if not day brings new information so there is a very high probability that our forecasts and market expectations will change in the coming weeks, months, and definitely years

Rate Movements This Week

Driven partly by US debt markets backing away from the edge and a lift in domestic hedging wholesale interest rates have increased slightly over the past week. The three year swap rate has risen to near 3.72% from 3.68% - which is not that big a move . Swap rates are still low by the standards of recent months as they reflect a pushing out of the forecast timing of monetary policy tightening in NZ and reduced expectations for how rapidly rates will rise overseas also in light of new growth and debt worries and the US Fed. promise not to raise rates for at least two years.

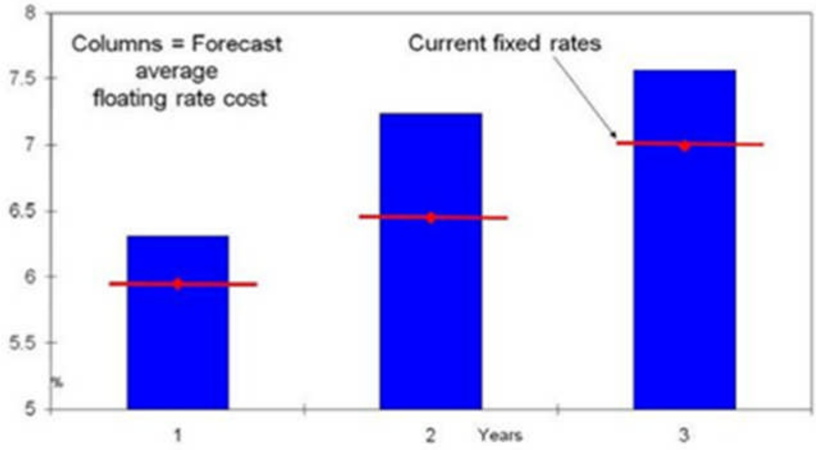
FINANCIAL MARKETS DATA

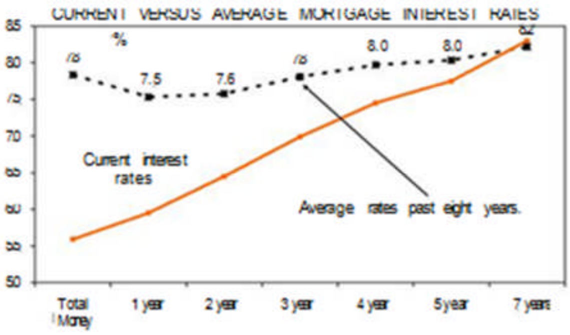
	This week	Week ago	4 wks ago	3 months ago	Yr ago	10 yr average
Official Cash Rate	2.50%	2.50	2.50	2.50	3.00	5.9
90-day bank bill	2.95%	2.95	2.93	2.72	3.22	6.2
1 year swap	3.19%	3.12	3.27	2.97	3.52	6.0
3 year swap	3.72%	3.68	3.93	3.94	4.00	6.2
5 year swap	4.24%	4.22	4.44	4.53	4.30	6.4
180-day term depo	4.30%	4.30	4.50	3.60	4.90	6.0
Five year term depo	6.00%	6.00	6.00	6.00	6.75	6.5

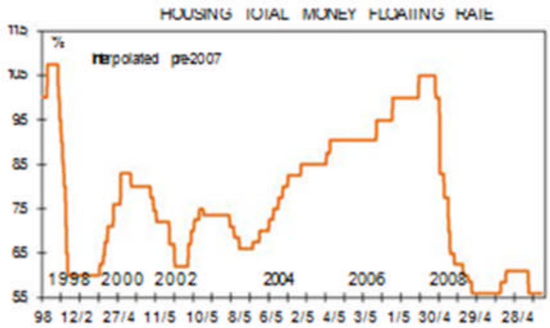
If I Were a Borrower What Would I Do?

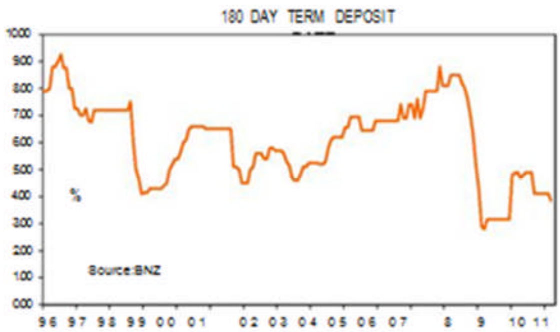
Nothing new I am afraid. I would still sit floating for now but plan to move to a fixed rate at some stage in order to get protection against forecast increases in floating rates from December into 2013 as the Reserve Bank acts against rising inflationary pressures by taking the official cash rate up maybe 2.5%. Such a move would in total take average floating mortgage rates from levels currently between 5.5% and 6% to between 8% and 8.5%. The graph below uses the blue columns to show where we feel the BNZ Total Money floating rate will average over the coming one, two and three year periods. The short red horizontal lines show current fixed rates for those terms.

Our current one year fixed rate for instance is 5.95% and the floating rate 5.59%. Come December when we forecast a cash rate rise we see the floating rate at 5.84% then moving to 6.09% come perhaps late-January. That 6.09% rate will be above the current 5.95% one year fixed rate.







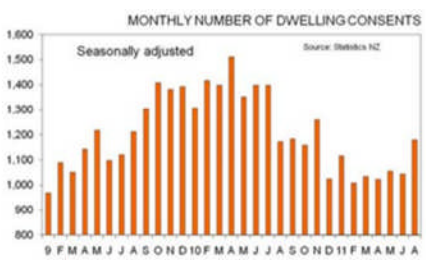


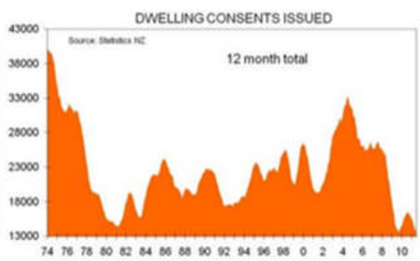
HOUSING MARKET UPDATE

To view the most recent results of our monthly BNZ-REINZ Market Survey and read our monthly Real Estate Overview click here. http://tonyalexander.co.nz/bnz-reinz-survey/

Construction Starts To Rise

This week we learnt that the supply of new houses may be about to start recovering from a four decade low. In July there was a seasonally adjusted rise in dwelling consents of 13% which is the strongest one month gain since early 2008. Although the rise was mainly driven by a jump in apartment consents to 168 from 60, house consents also rose by a reasonable 6.3%. But as this followed a 4.3% fall in June we find ourselves not willing to interpret either the total or housing-only number as signaling that a big supply boost has officially started even though the very strong lagged relationship between dwelling sales and consents tells us that construction will soon rise firmly.





This week we also received the monthly data on real estate listings at www.realestate.co.nz. At the end of the month 10,120 properties were listed compared with 8,966 in July. So listings have risen quite a bit. The rise in listings of 12.9% is more than usual therefore one can run an argument that more vendors are appearing. We shall gain better insight into this from the real estate comments in this week's BNZ Confidence Survey plus next week's BNZ-REINZ Residential Market Survey.

Averaged over the past three months the stock of listings to July (no August sales data to use as yet) was equivalent to 36.7 weeks of sales. This was the lowest total since December 2009 and generally tells us that although listings are perhaps rising, the starting point versus sales is not that high

The data suggest rising listings. Now we await August sales data.