

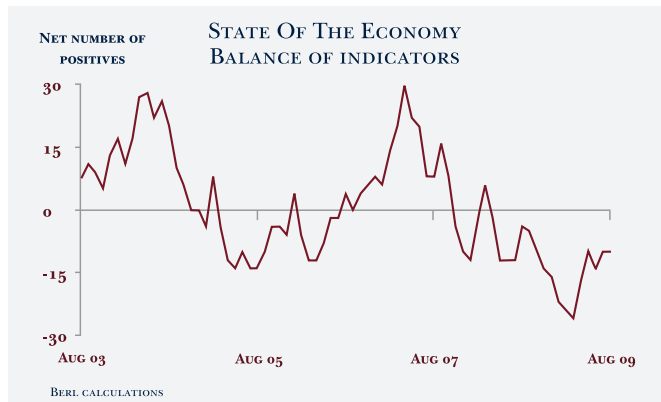


BERL Monthly Monitor

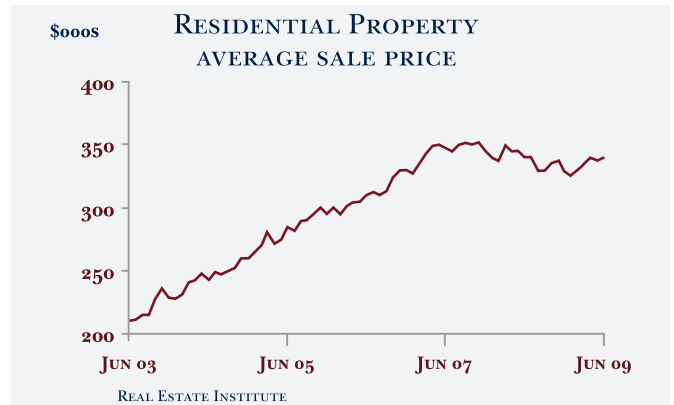
August 2009

Anyone seen Groundhog Day?

The groundswell of commentary suggesting that the worst of the recession is past is gathering pace. One can only agree that the worst is behind us. With global sharemarkets rebounding by about 30% since their March lows; and France, Germany and Japan recording positive GDP growth in the June quarter; the horror scenarios depicted late last year are no longer prevalent. And the BERL SONZE basket of indicators has also recovered somewhat from the depths reached earlier this year. With the basket now recording 20 positive indicators against 20 negatives, the net balance of minus 10 is a welcome improvement on the net figure of minus 24 recorded in March.



But, suggestions that “normal transmission is about to resume” give us an eerie feeling of déjà vu. In particular, the much desired export-led recovery is but a speck on the horizon, while signs of a housing market recovery indicate the necessary re-balancing of economic activity has not occurred. With the national median house price according to Real Estate Institute numbers now the same as it was a year ago (i.e. \$340,000), there is little indication that the necessary shift in property asset values relative to productive assets has taken place. Quotable Value data also indicates little significant change in sale prices. Already there are banks suggesting mortgage lending criteria can be eased, with loans above 80% of value being offered in some cases. Pretending little has changed and reverting to our old habits suggests we have learnt few lessons from the past year.



Quotes of the month

In the above context, we present several quotations.

Hon Bill English, Minister of Finance, 12 August 2009:

“In the long run the economy needs to shift away from spending and borrowing on housing to more exporting. The signs at the moment are that it’s not making the shift that we would want to see, so we need to look at whether there’s any policy mix that might make the right shift.”

Official Cash Rate Announcement, Reserve Bank of New Zealand, 30 July 2009:

“The level of the dollar in particular, is not helping the sustainability of future growth, and brings with it additional economic risks.”

“The forecast recovery is based on a further easing in financial conditions. If this easing does not occur, the forecast recovery could be put at risk. In these circumstances we would reassess policy settings.”



Dominion-Post, 12 August 2009:

“TS Securities senior strategist Annette Beacher said the Reserve Bank must be watching the ‘recent strangling of financial conditions with despair, certainly questioning widespread views of the recession ending this quarter’.”

“But she said lowering the official cash rate would be ‘counter-productive’ because the Reserve Bank would not want to stoke demand for housing.”

“Westpac said cutting interest rates from an already low 2.5 per cent would fuel growth and potentially lead to a ‘higher, not lower, currency’.”

Quotable Value New Zealand release, 10 August 2009:

“Property values have increased for the third month in a row according to the QV national residential property indices for July released today. Values are now 5.0 per cent below the same time last year, an improvement on the -7.1 per cent reported last month.”

“QV Valuation Manager Glenda Whitehead said ‘sales activity remains at solid levels, particularly given the time of year. There are also signs that more vendors are putting their properties on the market. This is perhaps in response to reports of shortages of listings, signs that values have stopped declining, and increased buyer optimism and activity’.”

Business New Zealand, Performance of Manufacturing Index release, 13 August 2009:

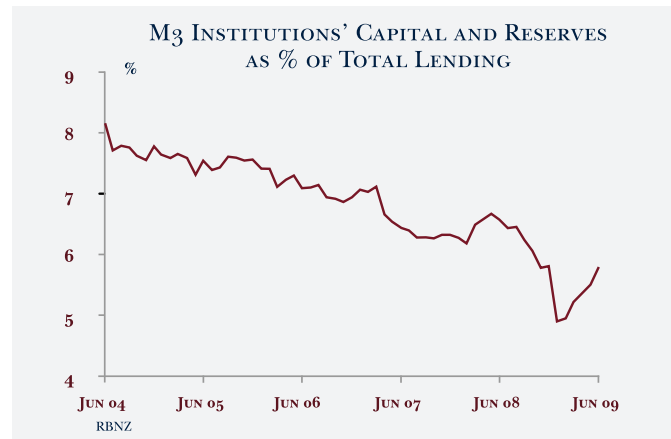
“While the result is very encouraging and almost identical to manufacturing developments offshore, the next significant development for sustained expansion needs to come from improvements in numbers employed in the sector, which is still some way off a recovery. Also, although comments from respondents highlight increased offshore orders, the continued upwards swing of the New Zealand dollar against the USA dollar will cause growing concern amongst some manufacturers if current trends continue.”

“BNZ Capital Head of Research Stephen Toplis said ... an improvement in demand will be highly beneficial but competitiveness will face headwinds to the extent that the NZD finds further support. That said, a strong global economy and a strong NZD are preferable to weakness in both.”

www.tvnz.co.nz, 13 August 2009:

“New Zealand’s banks face a negative outlook, says ratings agency Moody’s, as the global financial crisis weakens the quality of banks’ assets.”

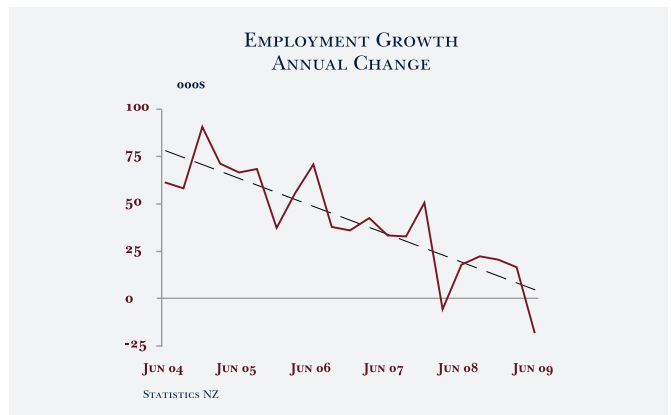
“Moody’s says rising unemployment and soft commodity prices would result in lower export returns which could put pressure on mortgages and delinquency rates.”



BERL comment

So, what are we waiting for? It would seem to us that the above comments are pretty damning evidence that current NZ monetary policy tools have been impotent in taming housing price inflation and, furthermore, are not sufficient to instigate the necessary re-balancing of economic activity. So, why do we continue to cling to a policy framework that is so inappropriate for the needs of the New Zealand economy?

Employment growth eases consistent with trend

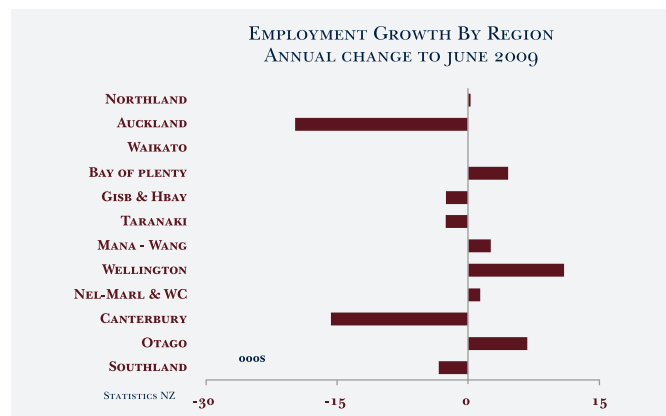


Growth in employment as measured by the HLFS has continued its slide, fairly much consistent with the trend since 2004 (give or take the blips we get quite regularly from this survey). The approximate trend is that there was a close-to zero increase for the 12 months ending June 2009, and if the trend continues, we can expect job losses of about 16,000 a year. The actual survey measure was for a net loss 18,000 employed in June 2009 compared with June 2008, so it is possible that as in earlier blips we may have a small rebound in the September quarter.

The industries where the number employed has reduced by significant numbers are retail trade where 21,000 fewer people say they are employed. This is a major blip, as last quarter was flat, and just two quarters ago there was an increase by 13,000 people. Employment in manufacturing, agriculture and forestry, and communications continue to decline, by about 5,000 to 10,000 in each industry. There is also some loss emerging from cultural and recreational services (e.g. libraries) and other personal services. Other industries, including wholesale trade, business services, social services, and government continue to add workers.

Summarising, there is not a blanket weakening of employment across the economy. There is even some indication that construction, hospitality and transport industries may have "bottomed out". Also, that much-overlooked potential driver of growth, mining increased employment by probably about 30%. But given that it is even now only 6,700 people, it can hardly yet be counted as a 'green shoot'.

The regional dimension of the employment numbers indicates the previously Auckland-centred job losses picture has now spread to Canterbury. These declines in job numbers suggest the fortunes of the manufacturing industry remain bleak.

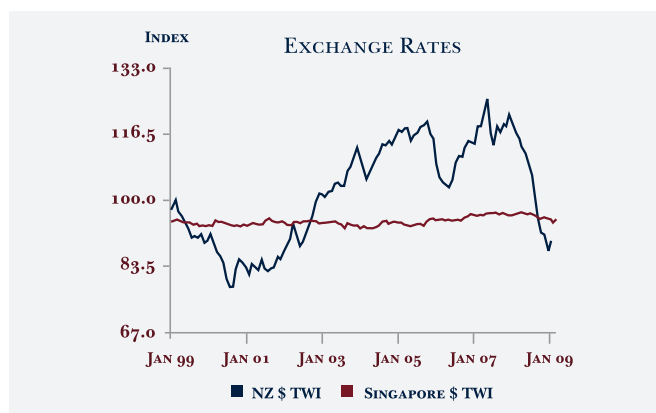


The unemployed number is recorded as 133,500, which is up 46,000 on last June. It is sitting at 5.8% of the labour force and we do not see it blowing out into double-digits the way the pundits have been suggesting.

The number *Not in the Labour Force* has not blown out either. In fact it has increased by just 14,000 since last June. This is signalling that people are staying in the labour force and trying for work, rather than losing hope, pulling out of the labour force, and becoming dependent. It will be important that increasing numbers of these people are given the opportunity of going into training to acquire greater skills. This is the secret to reinforcing a recovery and, indeed, turning one into a strong recovery.

Monetary conditions remain awry

Over the past month the NZ\$ has been very volatile. It has strengthened from 59.9 to 62.5 on the TWI. Economic fundamentals do not explain such a rise, leaving us with market sentiment as the causal factor. Sentiment, a fickle influence at the best of times, is particularly pernicious given that it could, at any time, turn negative in the event of a credit rating downgrade or similar.



Of course, the Reserve Bank could, as a matter of urgency, take control of the situation by adopting and announcing a managed exchange rate policy, à la that of Singapore. This would remove the danger to our tradable goods industries of further sentiment-led appreciation of the NZ\$. It would also provide protection to our financial system against any chaotic withdrawal of funding by overseas investors if, and when, sentiment was to then turn seriously negative.

Failing action of this kind, we are heading for a repeat performance of conditions experienced over the past quarter century. Indeed, the situation may be worse because of the weaker world economy and the weaker condition of our own economy - notably, a shrinking export sector along with a hugely excessive foreign debt-to-GDP ratio.

As of now, there is no sign that the bank credit situation is improving. Latest Reserve Bank statistics show virtually zero expansion of lending over the past six months and the base interest rate to business is tending to rise. Furthermore, banks' reserve ratios remain low (compared to a Basel I benchmark of 8%), with significant improvement not yet in sight.



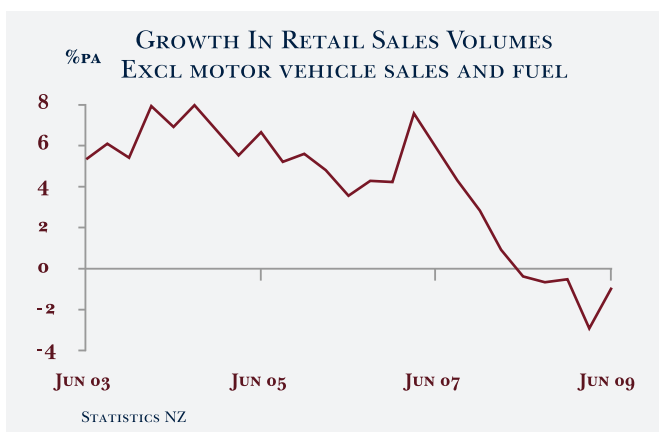
August 2009

A retail recovery may be in sight

The June 2009 quarter saw the first rise in quarterly sales values since the March 2008 quarter, climbing by 1.1%. Retail sales volumes also rose, by 0.4%. This is the first quarterly increase in sales volumes since September 2007. However, this rise comes after a record 2.7% fall in the March 2009 quarter. As such, this rebound may partly reflect an 'averaging out' of the statistics, rather than a change in spending behaviour.

Only Waikato saw an increase in retail sales values in the June 2009 quarter, compared to the same quarter in 2008. However, focusing on the most recent quarterly changes from March to June 2009, all regions, except Wellington and Canterbury, saw increases in seasonally adjusted retail sales. This almost reverses the picture we've seen over the past few quarters or so, where sales in Canterbury were growing but declining elsewhere. But as the monthly data still shows quite a lot of erratic movements - from negative to positive and back - we suggest caution in calling this a general recovery in retail sales.

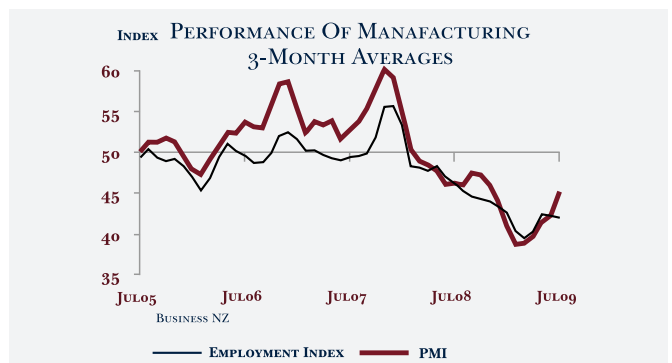
Seasonally adjusted sales in supermarkets (2.3%), takeaways (7.5%), and fresh produce retailing (5.0%) rose over the last quarter. Other big rises were in appliance (4.7%) and clothing and softgoods (3.2%) retailing. Motor vehicle retailing, often a bellwether for consumer sentiment, recorded a 3.0% increase.



Manufacturing back to square one (almost)

The surveys that we monitor indicate that manufacturing activity remains in contraction. The Bank of New Zealand - Business New Zealand Performance of Manufacturing Index (PMI) stood at 49.7 in July, up from the 46.2 recorded in June and 43.1 recorded in May. This result is an improvement, but indicates that manufacturing activity in New Zealand remains in contraction as a PMI reading below 50 indicates manufacturing activity is contracting.

Three of the five seasonally adjusted sub-indices measured recorded a contraction, with employment (44.0), finished stocks (42.6) and deliveries (47.6) recording values below 50. The only seasonally adjusted index to record a result poorer than the previous month was finished stock, down from 43.9 recorded in June. Deliveries improved 5.1 points on the previous month, while production improved 3.4 points. The employment index bounced back 3.9 points, but is below the seasonally adjusted figure seen in July 2008 of 46.0. And as indicated in the figure below, this index has been below 50 for some time.



The three-monthly average for the PMI improved slightly in July to sit at 45.3, up from the 42.3 recorded in June. All three quarterly average indicators have improved, with new orders showing the strongest result, up 5.3 points. Over the last three months, employment has averaged 42.0, a slight decrease from previous quarters and below the three-monthly average seen in July 2008 (46.3). However, the last time the three-monthly average for the employment index in July was above 50 was in July 2004 where it stood at 52.2.

While every effort is made to ensure that the information, opinions and forecasts included in this publication are accurate and reliable, BERL and all contributors do not accept responsibility for any errors or omissions, or for any loss or damage resulting from reliance on or the use of information, forecasts or opinions it contains