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RODNEY'S RAVINGS

Treasury's pessimistic forecasts for residential building are nonsense

EXECUTIVE SUMMARY

If we assume that the world is about to end will it? Most likely not so just because the Treasury is assuming away the unfolding strong upturn in housing market activity it doesn't mean it won't happen. In Treasury's words "it is unlikely that the housing market will stage a significant recovery any time soon" which is more than a bit perplexing when the number of dwelling sales reported by REINZ in March were up 30.5% on March 2008 and the number in April were up a staggering 39.1% on April 2008. Calling the Treasury statement dumb is a compliment!

In the Budget released yesterday the Treasury forecast a 22.7% fall in residential building activity in the year ended March 2010. Unless another major negative shock is about to hit the economy this prediction is bizarre given that the number of REINZ dwelling sales are the most useful leading indicator for residential building consents and point to a sharp upturn starting now. On a seasonally adjusted basis the number of consents for new dwellings has already increased 6.4% between January and March. The recovery has already started and the leading indicators that have worked faithfully for many cycles point to it continuing over the rest of this year. There is also the fact that the number of section sales reported by REINZ in April were up 13.6% on April 2008, which confirms that residential building consents will continue to rise.

And if that is not enough the Treasury is forecasting that consumer spending growth will remain negative until the 2012/13 March year, which might make some sense if the RBNZ wasn't dousing the economy with super-low interest rates that will encourage spending over saving! The Treasury's dire forecasts for growth in consumer spending seem to be motivated by wishful thinking (i.e. a desire to see people and the country save more and spend less that doesn't stack up with how people actually behave when doused with super-low interest rates). Economic recoveries start in the housing market and filter through to retail spending with a moderate lag, so by assuming away the upturn in housing market activity that is already underway the Treasury is cutting the legs out from under the recovery in consumer spending growth. But just as the world won't end by assuming it will the Treasury can assume reality away all it wants but it won't stop the economic upturn from occurring this year. In a future Raving I will debunk the idea that the rising unemployment rate will halt a recovery in consumer spending.



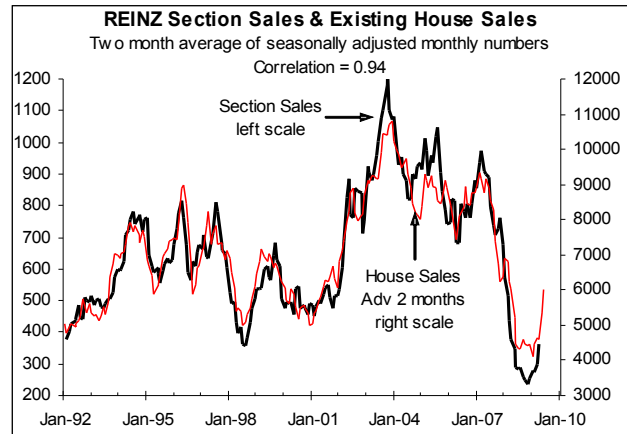
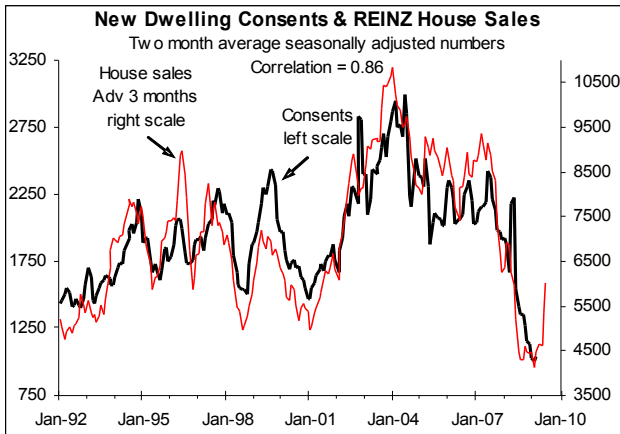
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Do Treasury's forecasters live on this planet?!

In the Treasury's April 2009 Monthly Economic Indicators report released on 1 May it was stated that, "March building consents fell, pointing to ongoing weakness in residential building", this followed the observation that "The REINZ reported that [March] sales volumes were up 6.5% and that the median price rose 1.5% compared to February. ... We think that it is too early to say that the housing market has turned the corner." (Source: <http://www.treasury.govt.nz/economy/mei/archive/pdfs/mei-apr09.pdf>).

The number of dwelling sales reported by REINZ in March was up 30.5% on March 2008, which in our book suggests the market is off to a flier rather than meaning "it is too early to say that the housing market has turned the corner". If the Treasury's forecasters did their homework or subscribed to our reports on the topic which was offered to them some time ago they would know that rising REINZ dwelling sales is the single best near-term leading indicator of what will happen to residential building consents (see the left chart below). Subsequent to Treasury's April report the REINZ reported the April data with the number of sales up 39% on April 2008, which to us confirms that the sharp upturn in housing is underway, with the prospect that it will filter to residential building consents with around the normal three month lag shown in the left chart. The number of REINZ section sales in April was up 13.6% in April 2008 which gave substance to our expectation the consents for new dwellings would soon be following the lead of REINZ dwelling sales, with the right chart showing REINZ dwelling sales as a leading indicator for REINZ section sales and section sales starting to follow the lead of dwelling sales.



In reading the myriad of comments on yesterday's Budget I came across an article that reported the following:

"The Treasury's economic outlook for the year, released in today's budget, forecasts a shrinkage in residential investment of 25% for the year to March [2009] and a further 23% contraction the following 12 months. "There have been signs of a slight recovery in house sales over April, but ... it is unlikely that the housing market will stage a significant recovery any time soon, with the risks tilted towards further declines in house prices as 2009 progresses." The Treasury outlook forecast house prices to fall 8% for the year to March 2010 and a further 4% the following year. This follows a 9% contraction in the 12 months to March this year." (Source: <http://www.sharechat.co.nz/article/536e5757/new-zealand-s-property-market-is-forecast-to-slump-further.html>)

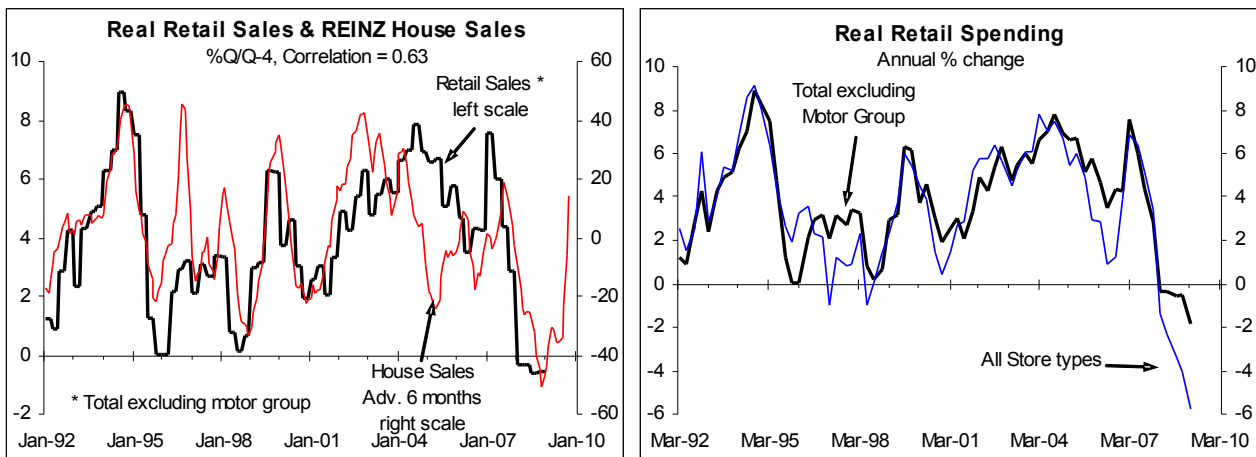
If the number of dwelling sales reported by REINZ in April being up 39% on a year ago and the number of section sales being up 13.6% isn't black-and-white confirmation that a sharp upturn is underway in the housing market then what is?! What are these guys thinking?! Are they under instructions from the government to paint as bad a picture as possible for some twisted political reason?

It seems that once Treasury's forecasters form a view they never let the facts get in the way even if the facts suggest they are living in cloud cuckoo land! But to make sure the media had reported Treasury's forecasts correctly I visited the Treasury website - <http://www.treasury.govt.nz/>. And yes, the Treasury were estimating that residential building activity fell 25.2% in 2008/09 and predicted it to fall 22.7% in 2009/10 before eventually recovering by a modest 7.1% in 2010/11. But then the Treasury delivered a positive surprise by forecasting that the volume of residential building activity will increase 18.7% in 2011/12 and 20.6% in 2012/13. (Source: <http://www.treasury.govt.nz/budget/forecasts/befu2009/004.htm>)



Don't even get me started on the Treasury's prediction that the volume of consumer spending will fall 1.3% in the 2009/10 March year, 1.5% in 2010/11, 0.1% in 2011/12 and won't show positive growth until 2012/13. These forecasts can best be described as philosophically-driven nonsense of the sort the latest RBNZ forecasts also indulged in with respect to consumer spending growth prospects. What is motivating these forecasts is a view that consumers have way too much debt and the external deficit is way too high so let's assume consumer spending growth will be negative for years because this assumption will ensure that household debt ratios improve and import growth will be weak so the external deficit rebounds. This would be great if the policy settings by the government and the RBNZ were consistent with these outcomes (e.g. if interest rates were higher to encourage saving over consumption). But when the RBNZ is dousing the economy with super-low interest rates that are starting to underwrite a strong upturn in housing market activity then there is no way consumer spending growth is going to remain negative until 2012/13.

The left chart below shows annual growth in the number of REINZ dwelling sales as a leading indicator of annual growth in the volume of retail sales excluding the motor group. The strong upturn that is already underway in existing house sales will drive up incomes for real estate firms, lawyers and valuers. The subsequent strong upturn in section sales and residential building will fuel a recovery in incomes and employment in a myriad of industries that service the housing market. And that is why the left chart shows that upturns in existing dwelling sales are followed by upturns in retail spending around six months later. So just as residential building activity will start recovering much earlier than Treasury is forecasting growth in consumer spending will start recovering much, much earlier than 2012/13.



If forecasts contain some really dumb stuff like predicting that residential building activity will fall 22.7% in the year to March 2010 then it undermines the usefulness of the whole caboodle. By assuming away the prospects of a strong upturn in the housing market, which is already plain to see for anyone with eyes half open, the Treasury's forecasters are cutting the legs out from under the prospect of a recovery in consumer spending growth. If we are right in predicting that the housing recovery is already underway and will gather pace this year then we can confidently predict that consumer spending growth and overall economic growth will deliver a positive surprise in the second half of 2009 compared to the bizarrely negative predictions by the likes of the Treasury.

If anyone wants serious analysis of prospects for the housing market they should have a look at our **Housing Prospects** reports (see <http://www.sra.co.nz/housing.html> for info) and the **Building Barometer** reports (see <http://www.sra.co.nz/building.html>), and if they want serious analysis of prospects for consumer spending growth, economic growth and interest rates that isn't biased by wishful thinking they should have a look at our **Interesting Times** reports (see <http://www.sra.co.nz/interesting.html>). And while we are plugging our pay-to-view reports, anyone serious about understanding what drives the exchange rate and for quality analysis of prospects especially for the NZD/USD should see our **Forex Prospects** reports (<http://www.sra.co.nz/currencyservices.html>), while for critiques of the RBNZ's six-weekly OCR decisions and analysis of prospects for the OCR then the **Monetary Policy Briefing** reports are just the thing (see <http://www.sra.co.nz/monetary.html>). We are in the business of helping clients with strategic risk management (e.g. forewarning them of the likes of recessions, rising or falling exchange rates and economic/industry recoveries before they happen not after they are evident in the rear-view mirror.

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