BNZ Weekly Overview

19 January 2012

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.

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 please click here.
http://feedback.bnz.co.nz/forms/Fx-I8ploskSGWgjN_7WOAw
To change your address or unsubscribe please click the link at the bottom of your email.

Year Of The Dragon

Welcome to the first Weekly Overview for 2012 – sent from Hong Kong. Why am I here? Because the chances are at least 99.9% of people reading this are not – and that is New Zealand's blind spot. Since the Free Trade Agreement between ourselves and China came into force in October 2008 our trade with China (including Hong Kong Special Administrative Region) has grown in total by about 120%. (Or 151% for the mainland only. China mainland's total imports from all countries have grown 43%.) That means China now accounts for 14% of our export receipts from 7% three years ago and around 2% back in 1990. At the current pace of change China will surpass Australia to become our main export destination in maybe 2017. That same year China may surpass the United States as the largest economy on the planet on a purchasing power parity basis as it continues on its way to regaining the position it had in the early-1800s of accounting for between 25% and 33% of world GDP. China bottomed out at less than 2% of world GDP in the 1970s and is sitting just over 13% currently.

On the face of it one might think that this huge surge in the money we are making from China's growth is great and as long as we keep doing what we have been doing everything will be okay. But that way of thinking is the very problem. Over 96% of the things we export to China are primary products and growth in those receipts has been about 126%. But growth in receipts of non-primary exports has been only 9%. We are exporting low value-added products to a country who's consumers are experiencing rapidly rising incomes and demanding increasingly sophisticated goods and services akin to those Western households consume. All we have achieved so far is to shift some of our dependency on low value-added primary sector exports from one set of countries to another.

Now one might think that riding a commodity boom can be a fine thing for one's growth. Yet in the year to September our economy recorded growth of only 0.1% if one takes away additions to inventories. The unemployment rate has been stuck near 6.5% for two years, wages growth is minimal, and there are record outflows of people seeking their fortunes in Australia. Don't underestimate what the outflows are telling us. Between 1975 and 1982 rising discontent with an increasingly regulated economy saw a net 156,000 people leave our shores. There is a message in the sound of feet walking away from our long white cloud. Something is not right here.

To get productivity growth and income growth up in New Zealand will take a lot more than simply adopting a cargo-cult mentality and assuming the swelling of China's middle class from 300 million people to 800 million in perhaps the next 15 years will see us right. It won't. One key reason is because by and large our primary sector is extremely hard to scale up. In contrast Australia's mineral exports sector can be grown many times. The outcome of our growing commodity incomes will be soaring land prices – with or without any change in bank lending criteria, with or without land sales offshore. These years may represent the last one's for young people to have a reasonable expectation of farm ownership.

That is why since early-December last year I have been studying the economic relationship between New Zealand and China with an eye to gauging the extent to which we are grabbing the opportunity provided by the FTA and running with it.

There are certainly examples of companies doing well over there either through exports or establishing an on the ground presence. And NZ Trade and Enterprise have a strong focus on developing business in areas such as supplying quality food and beverages to the hotel, restaurant, and institution sector, biotechnology, niche manufacturing, and agritechnology. But the popular debate surrounding the sale of the Crafar farms shows how astoundingly far away Kiwis are from understanding the economic and geopolitical implications of China's rise back to accounting for more than a quarter of the world's economy.

Avoiding being tenants in our own land is an extremely valid goal which if not satisfied would take NZ completely away from the sort of place people were seeking when they started flocking here in the nineteenth century. But the debate about the sale sidesteps the fact that over the past five years the Overseas Investment Office has approved proposals for the sale of 1.1 million hectares of land of which 117 hectares was approved for China buyers and 939 for buyers from Hong Kong.

The question we need to ask ourselves is this. How do we best make money out of the land sales we are already making? To whom would sales lead to greatest opportunities for extra sales of high value added products, extra processing in New Zealand, hefty extra capital for additional expansion? Or is it simply that we should instead be thinking in terms of not selling but leasing the land to foreigners – with again the same question asked. Which group of buyers is likely to provide the newest markets offering the best growth opportunities. Which country is most demanding the food quality and safety (and systems of) which we have?

Or taken from yet another angle. China accounts for 14% of our export receipts but maybe only 2% or our near $94bn foreign direct investment (no official data exist for the Chinese mainland so one is making best guesses). China has a policy of raising offshore direct investment. How do we best make money from the funds which would like to come down our way? How do we best also utilise the new funding capability being provided through the likes of the Memorandum of Understanding link signed last year between PwC and the China Development Bank – with their expressed interest in infrastructure and Christchurch reconstruction.

So my question comes down to a simple one. How do we best make money out of China's rise? That will be the focus of my research this year as compared with last year's which was on the impediments to New Zealand economic growth. If you feel you have expertise and insight to offer me on the NZ-China relationship feel free to email your details. Tony.alexander@bnz.co.nz

Is Our Economy Getting Better or Worse?

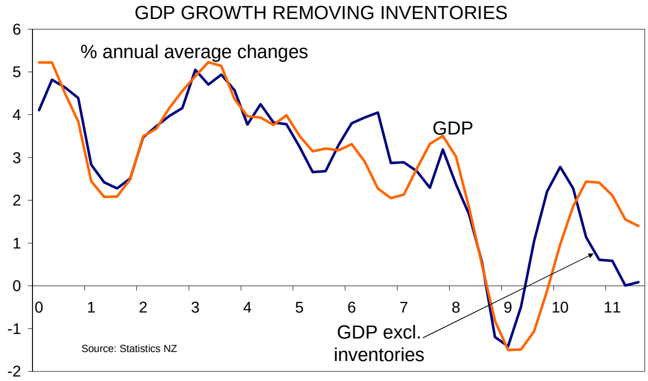
In this section we look only at what the data are actually telling us and pay no attention to forecasts or intentions measures.

My view through the second half of 2011 was very strongly that the NZ economy was a lot weaker than people were thinking and the bulk of the data showing. That is a theme I am likely to continue running for the first part of this year and the data released just ahead of Christmas give easy justification for mild though not outright pessimism.

On December 22 the September quarter National Accounts were released and they showed that the NZ economy grew by 0.8%. That outcome was what we had predicted and was 0.2% above the Reserve Bank's forecast. It sounds good, but the reality is that underlying growth in the economy was minimal if present at all.

First, the previously reported growth in the December 2010 quarter of 0.6% was revised down to 0.3% and the March quarter 2011 growth rate of 0.9% was revised down to 0.7%. So the economy was weaker at the turn of the year than previously thought and that means growth for the entire year to September 2011 was a truly mediocre 1.3%, the same as a year ago.

Second, the 1.3% growth in the past year is almost entirely due to a build up of inventories. In the graph here we strip inventories out of the GDP data then calculate annual growth. The lines generally move together but what they show now is disturbing – yet in line with the very downbeat interpretation we have been giving here of what our economy is actually doing.

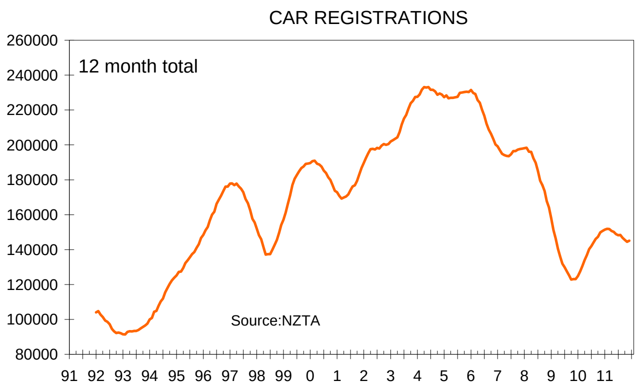


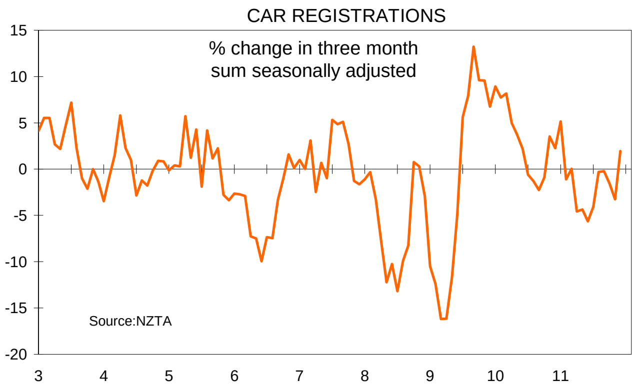
In the year to September ex-inventories GDP growth was 0.1%, down from 1.1% a year earlier. Production in the past year has not been sold. It is sitting in warehouses – to give a simple interpretation of what we are trying to say. The important point to note is the lagged relationship between the rate of change in the ex-inventories GDP measure and the headline number everyone sees. That relationship is implying that come mid-2012 the economy's growth rate will be close to zero.

Other things we have learnt include a fall in dwelling consents in November, and ending of what had been a three month rolling upward trend, plus consumer spending growth ceasing. Residential real estate numbers are however improving.

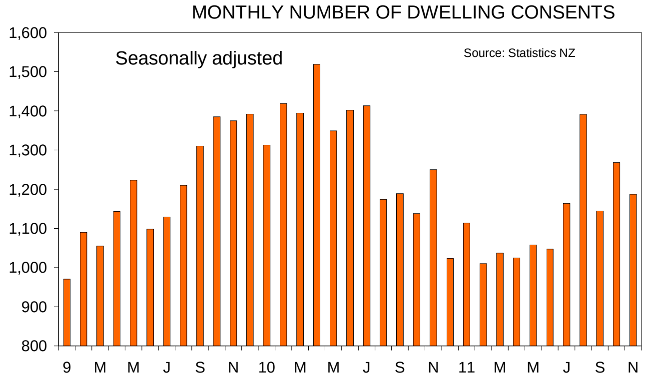
Are householders opening their wallets more?
No.

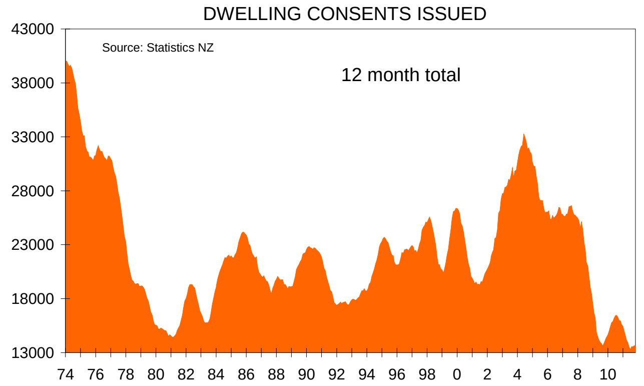
In December there were 12,830 cars registered around the country which was 4.2% more than a year earlier and means that during the December quarter regos were roughly 2% ahead of the September quarter in seasonally adjusted terms. So that means there is a small upward trend in place though the pace of improvement is mild.



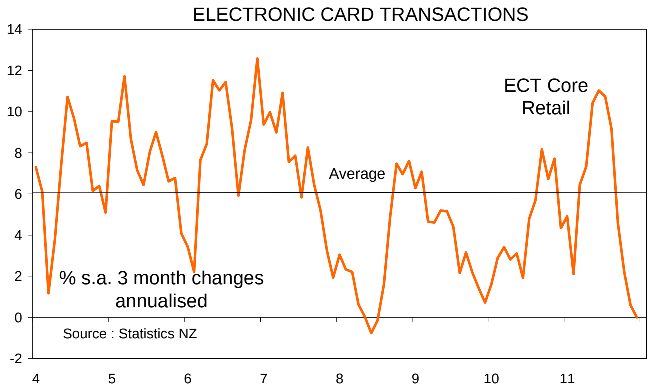


The upward trend in housing however has eased off. In November there was a seasonally adjusted fall in dwelling consent numbers of 6.4% taking the three month rolling average rate of change to -0.1% from 15.4% in the three months to August. Recovery in house construction is proving to be very much a stop-start affair but we think the drift is still upward and perhaps the first graph below shows this best of all.



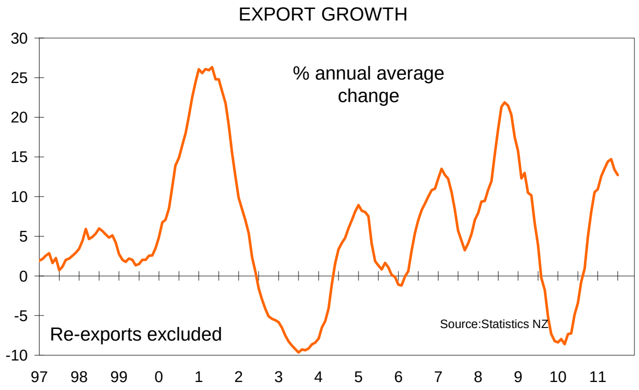


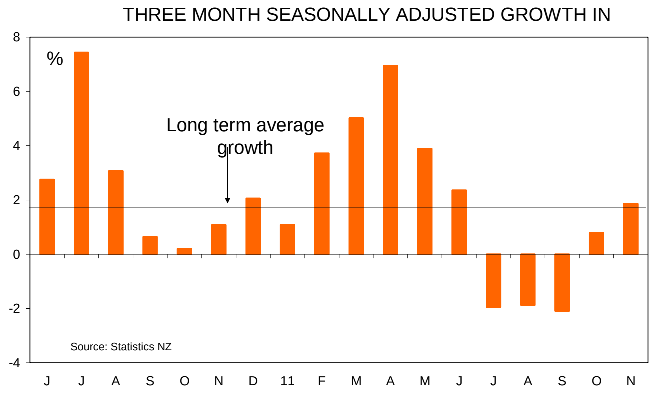
And finally, spending using electronic cards in seasonally adjusted terms fell 0.1% in December after falling 1.3% in November. That means spending achieved an annualised growth rate in the December quarter of exactly 0% following annualised growth of 4.6% for the September quarter. If there is a Rugby World Cup effect in there it is certainly wimpy.



Is business output rising?

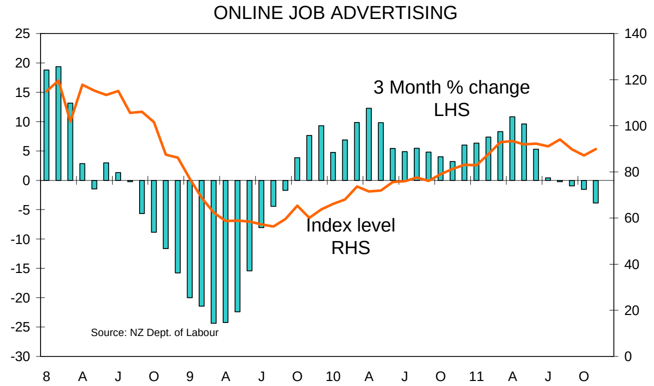
Seasonally adjusted export receipts shrank by 4.6% in November but were up 1.9% in the three months ending in that month compared with the three months to August. The trend in export receipts is upward still but a period of strong growth has ended and one of the big questions for this year will be the extent to which the high NZD and weakness in some export destinations impacts upon receipts.

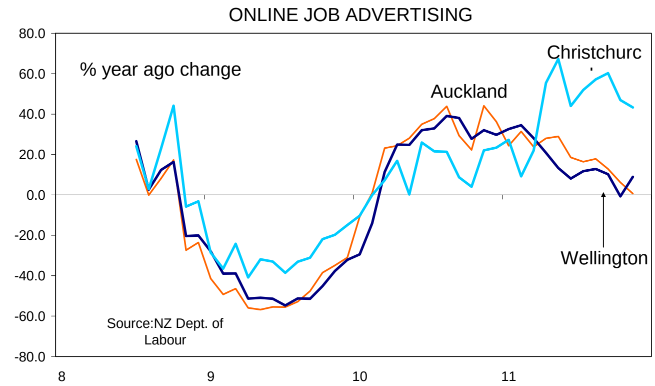




Are businesses hiring more people?

The most reliable up to date comprehensive reading on this comes from the Department of Labour's monthly Jobs Online report. Their November issue showed a seasonally adjusted rise in skilled job ads of 2.8%. But the monthly data are volatile and when we smooth over the three months to November we find a decrease of 3.9%. This is suggestive therefore of a fairly weak labour market for the moment with a hint given in the December Trademe jobs release that the situation deteriorated a tad further going into Christmas.

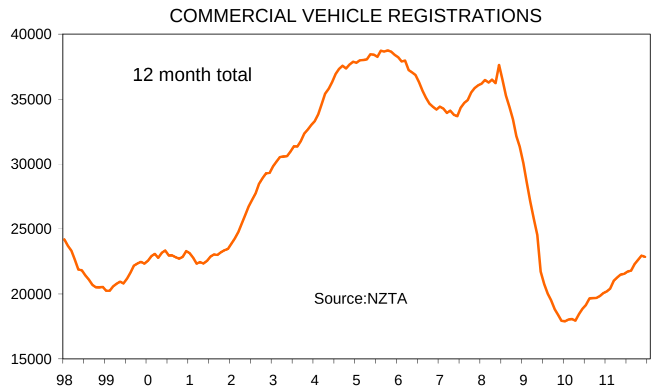


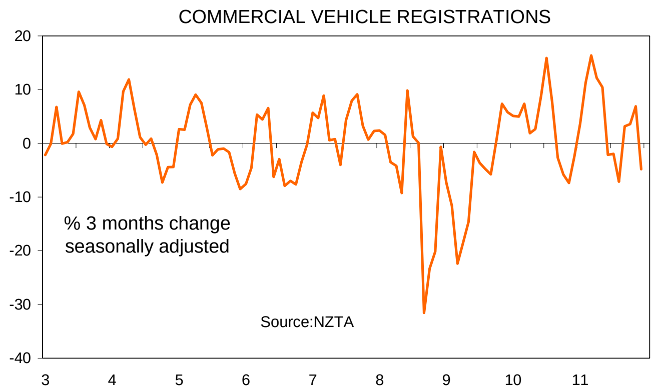


Are businesses boosting their capital spending?

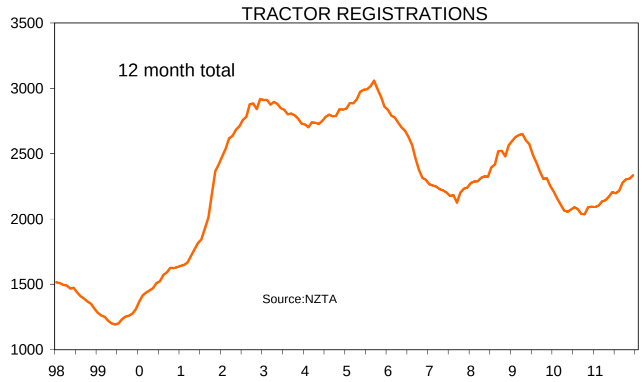
To see how businesses are feeling right now one can read our monthly BNZ Confidence Survey here. http://tonyalexander.co.nz/bnz-confidence-survey/

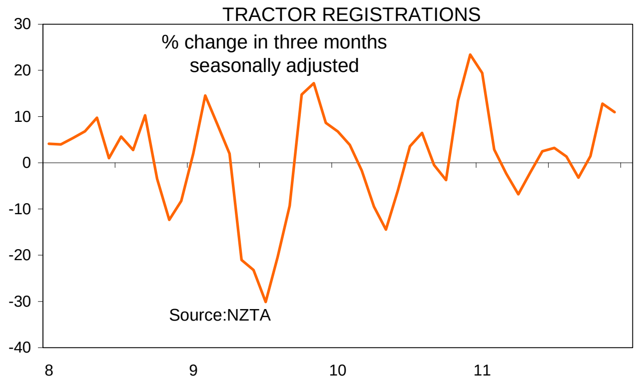
In December there were 1,463 commercial vehicles registered around New Zealand which was a 5.7% decline from December 2010. In rough seasonally adjusted terms regos were down 5% in the December quarter from the September quarter suggesting that a slight pause may be underway in the generally improving trend for this particular measure of business investment.



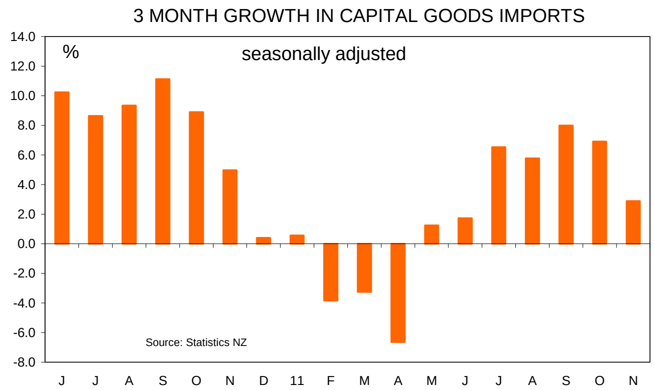


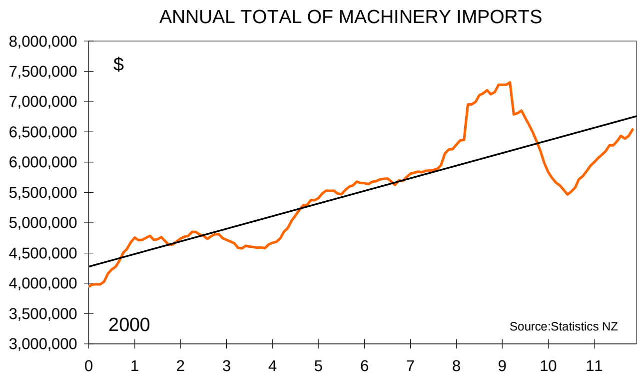
There were 220 tractors registered around NZ in December which was a 12.2% rise from December 2010. For the entire December quarter regos were 7.7% ahead of a year earlier and 11% up roughly seasonally adjusted from the September quarter. There is an upward trend in this measure of rural investment.





The value of capital goods imports has grown by 2.9% over the past three months after rising 5.8% three months earlier and 1.2% in the three month period before that. So there is an upward trend in place in this particular gauge of business capital expenditure. But the question we need to ask is the extent to which the good growth in capital goods imports last year was driven simply by a high NZD encouraging businesses to bring forward in time purchases planned for 2012.



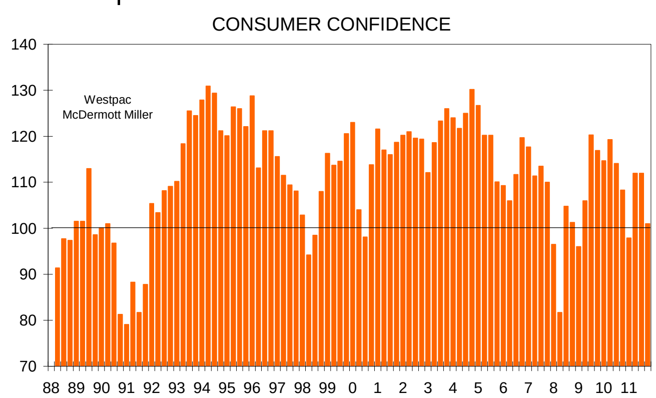


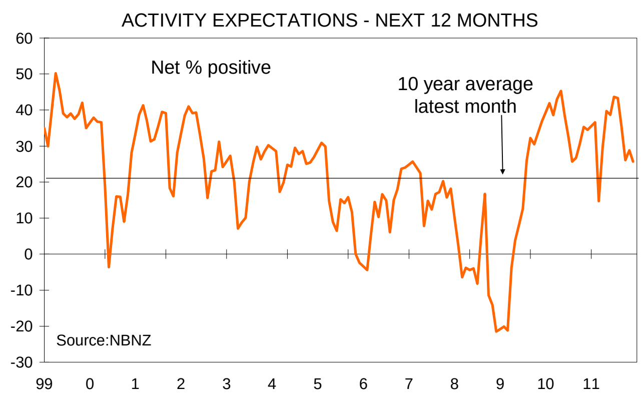
What Do The Leading Indicators Say?

In this section we look only at the factors which can at times give insight into where the economy is headed. Generally we will only cover newly released information.

Indicators Worsening

Consumer confidence measured in the quarterly Westpac McDermott survey fell away to what appears to be a neutral level of 101 but is in fact well below the average for the past ten years of 114. In that regard the result is suggestive of weakness in consumer spending which is the view we have had for some time as long as one makes an effort to try and adjust actual spending data for the artificial boost provided by the Rugby World Cup.

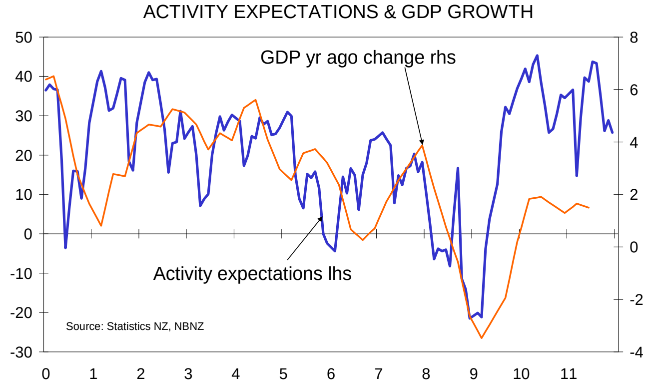


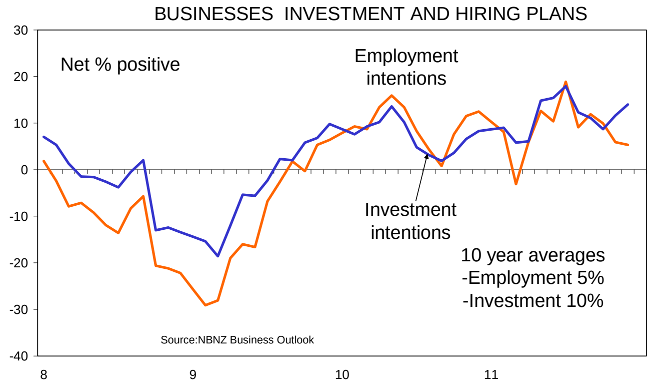


Business Sentiment Declines

Business confidence measured in the NBNZ Business Outlook eased to a net 17% optimistic in early December from 18% in November and a ten year average of -7%. This looks like a strong result, but it pays to remember that the long term average has been depressed by the intensity of the 2008-09 global crisis and the presence of a Labour government until 2008 which we have in the past noted is correlated with a structural shift lower in this business sentiment gauge.

A net 26% of businesses expect their own levels of activity to rise in the coming year which was a fall from 29% in November but above the 20% average. On the face of it this would suggest good growth, but again, there is an upward bias from the artificially depressed average. Plus we think there has been a structural shift in the relationship between this measure and actual GDP growth and the result is only consistent in this new weaker world with perhaps 1.5% growth rather than the 4% which would be suggested if one used data only up until 2008.

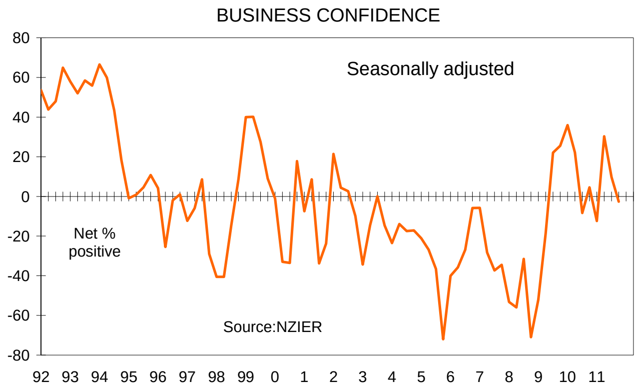


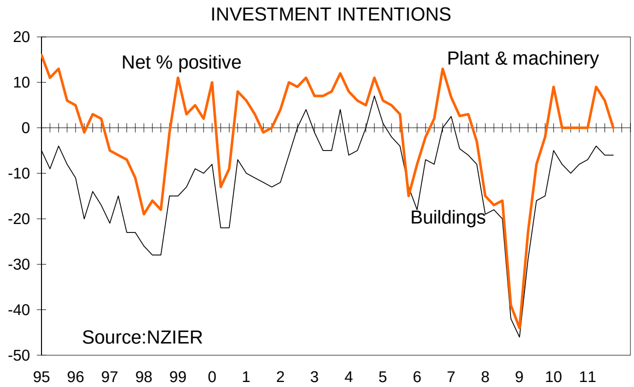


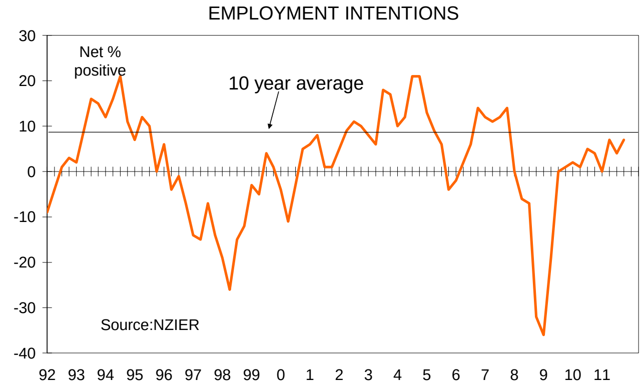
But the survey was generally a good one with employment intentions still positive at 5% though down from 6% in November and the weakest result barring post-earthquake since September 2010. Investment intentions were a good net 14% positive from 12% in November and a ten year average of 10%.

NZIER Survey Weakens

This week we also received the NZIER's Quarterly Survey of Business Opinion which showed a fall in confidence to a net 0% confident from 25% in the September quarter. Employment expectations however improved a tad to a net 7% positive from 4% while investment intentions in plant and machinery fell to 0% from 6%. The results are not suggestive at all of growth accelerating in the economy and in that regard leave us still wary of how strong the economy will be – especially as there is an upward bias as it were in the data because of the Christchurch rebuild.

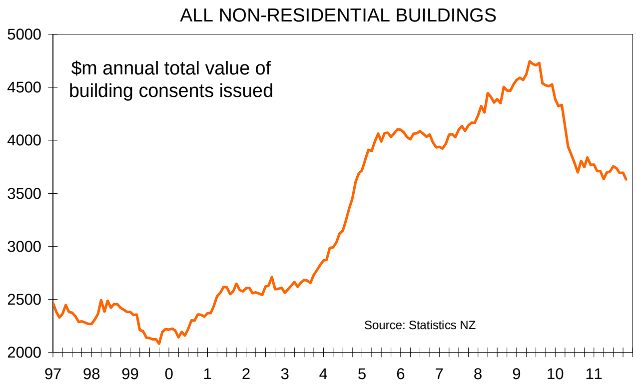


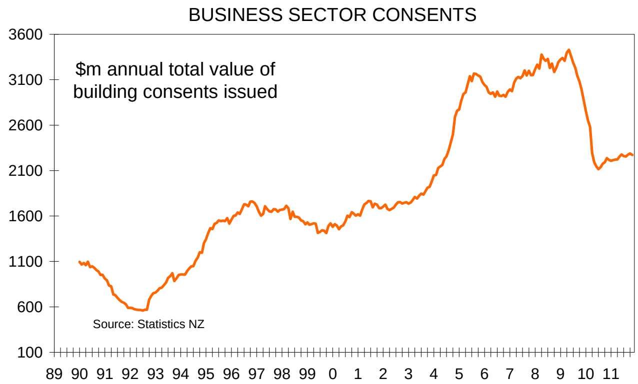




Building Outlook Flat To Down

With regard to commercial construction the best leading indicator available – the value of consents issued for non-residential buildings – fell 13.5% in November from a year earlier and in the six months ending November was down 3.4% from a year ago. Business sector consents were ahead 1.3% in the six month period from a year ago, but allowing for cost increases this implies falling volumes of construction, which is the interpretation we take overall from the data. They signal that as yet it is not reasonable to expect that non-residential construction is going to be picking up over the next 12 months.





INTEREST RATES

This morning we learnt that the annual rate of inflation fell to 1.8% from 4.6% courtesy of the CPI falling 0.3% rather than rising the commonly forecast 0.4% in the December quarter. Inflation in NZ is a dead Dodo and the need for tighter monetary policy is now even less than the minimal requirement we were writing about here for almost all of last year. The risk as we highlighted in December is that the official cash rate stays at 2.5% all this year.

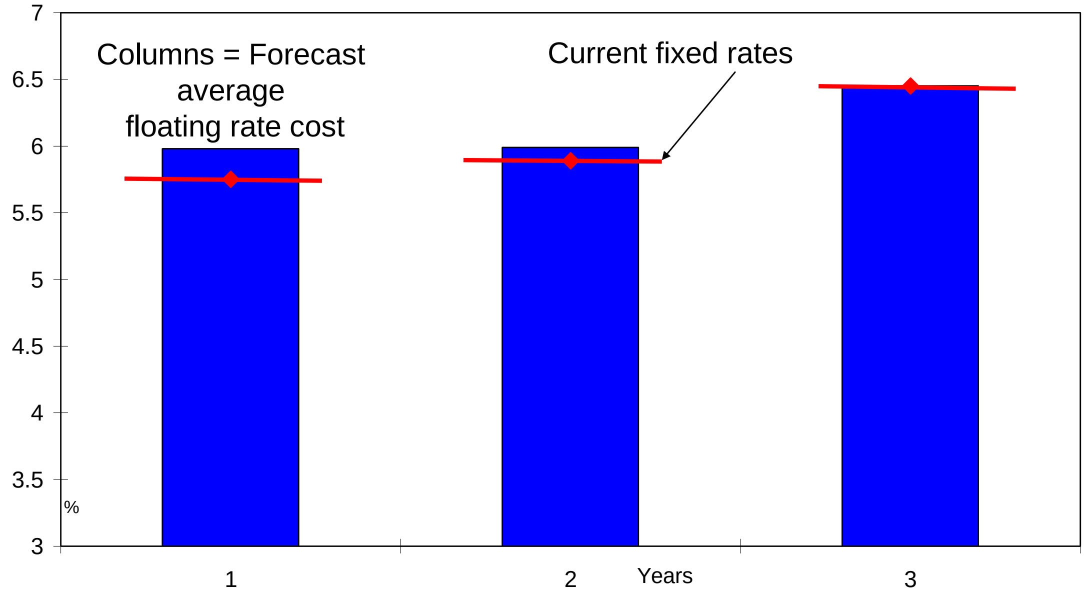
FINANCIAL MARKETS DATA

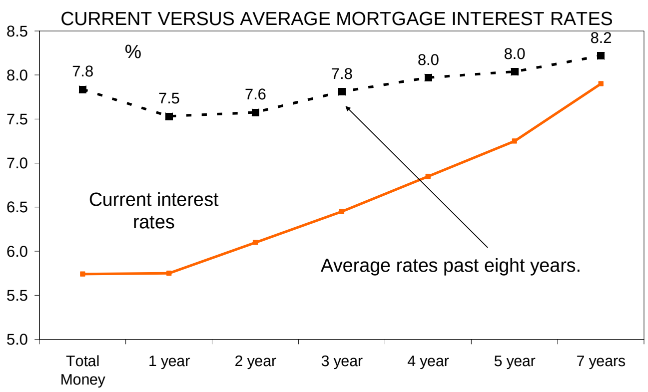
	This week	Week ago	4 wks ago	3 months ago	Yr ago	10 yr average
Official Cash Rate	2.50%	2.50	2.50	2.50	3.00	5.9
90-day bank bill	2.80%	2.90	2.72	2.75	3.21	6.2
1 year swap	2.79%	2.80	2.72	3.01	3.49	6.0
3 year swap	3.06%	3.07	2.96	3.49	4.28	6.2
5 year swap	3.50%	3.52	3.38	4.05	4.74	6.4
180-day term depo	4.00%	4.00	4.50	3.60	4.90	6.0
Five year term depo	5.85%	6.00	6.00	6.00	6.75	6.5

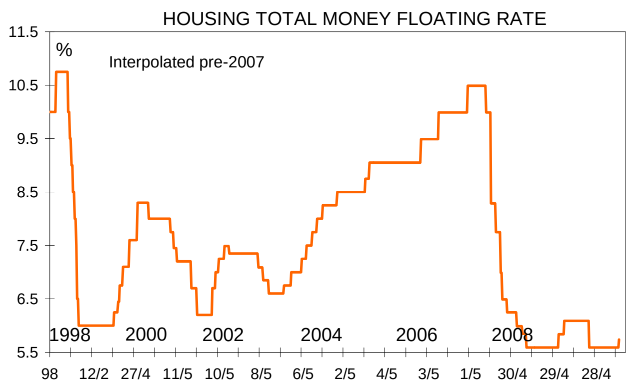
If I Were a Borrower What Would I Do?

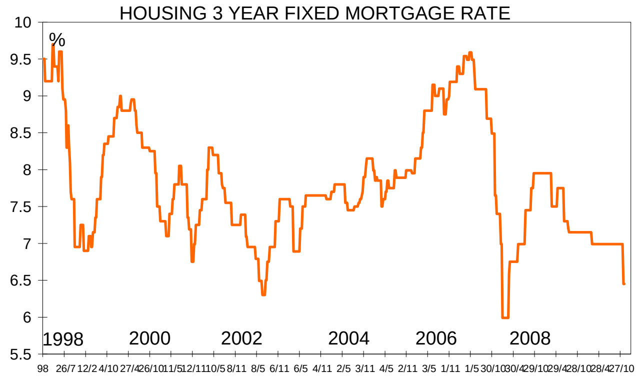
I spent most of last year saying I would float – apart from a brief period mid-year when optimism about Europe, the US and even our economy was high and swap rates were going up. Then things started to turn to custard anew overseas and NZ data became less than inspiring once one made adjustments for the effects of the Rugby World Cup. This year starts with a generally glass half-full interpretation of the debt crisis in Europe though deep lingering fears that the optimism could yet again prove misplaced. Data for the United States have come in better than expected, while in China data show a slowing economy providing scope for easier monetary policy which will take some strain out of the falling housing market.

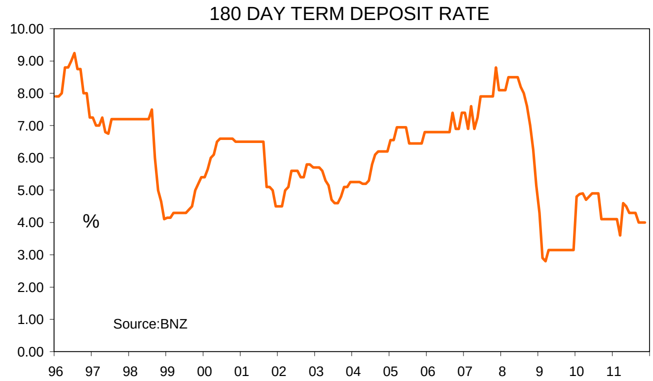
Locally NZ data are not suggesting the economy's growth rate is accelerating (discussed above) and there are plenty of risks still to the economic outlook. Therefore, until we get some greater clarity with regard to Europe, the United States, the timing of the Christchurch rebuild, and when farmers start spending more money, I find myself still extremely happy to sit floating. At this stage it seems very reasonable to assume that NZ monetary policy will not be tightened this year. But as we have warned for 2-3 years now, the forecasting environment is massively uncertain and one would be extremely foolish to base interest rate risk management decisions on one particular set of interest rate forecasts proving accurate.











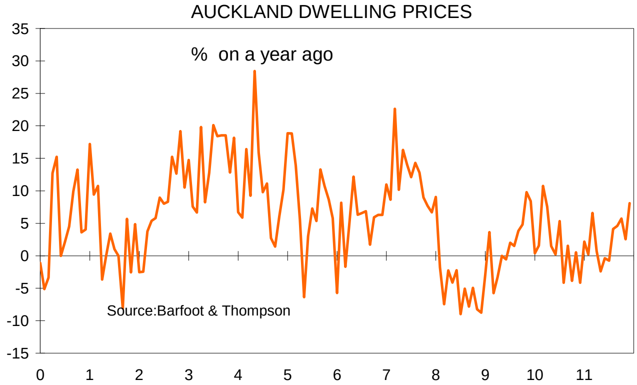
HOUSING MARKET UPDATE

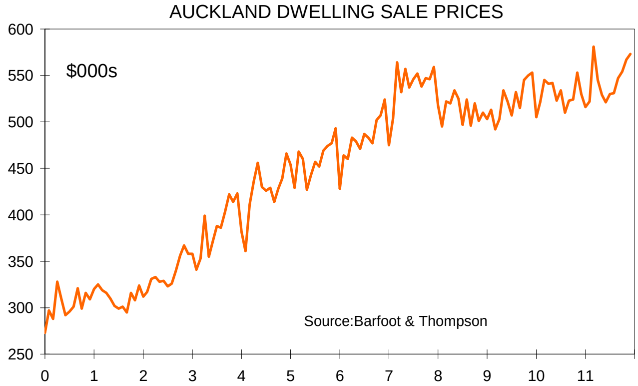
To view the most recent results of our monthly BNZ-REINZ Residential Market Survey click here. http://tonyalexander.co.nz/bnz-reinz-survey/

New Zealand's residential real estate market is slowing improving driven by a shortage of listings and lowest construction in 40 years encouraging buyers with foresight to get in before a stronger labour market brings a wave of buyers in. Investor activity is still weak.

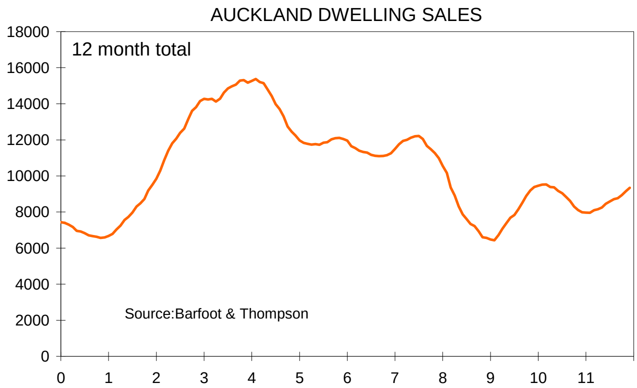
Auckland Market Rising

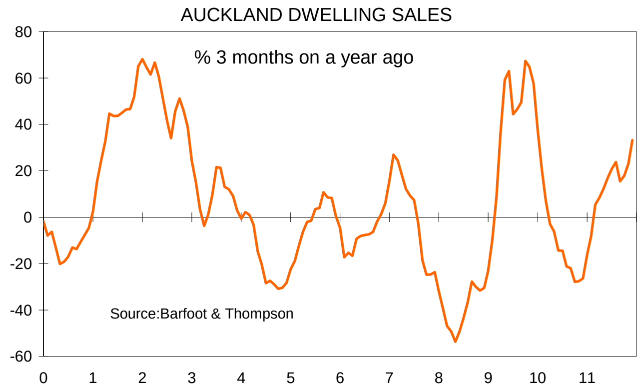
Barfoot and Thompson's data for Auckland activity in December were relatively firm with the median dwelling sales price creeping up for the sixth month in a row to lie 8.1% up from a year ago at $573,000. The number of dwellings sold in the month was ahead roughly 5% seasonally adjusted from November which was up near 10% from October and sales for the December quarter were 33% ahead of a year ago.



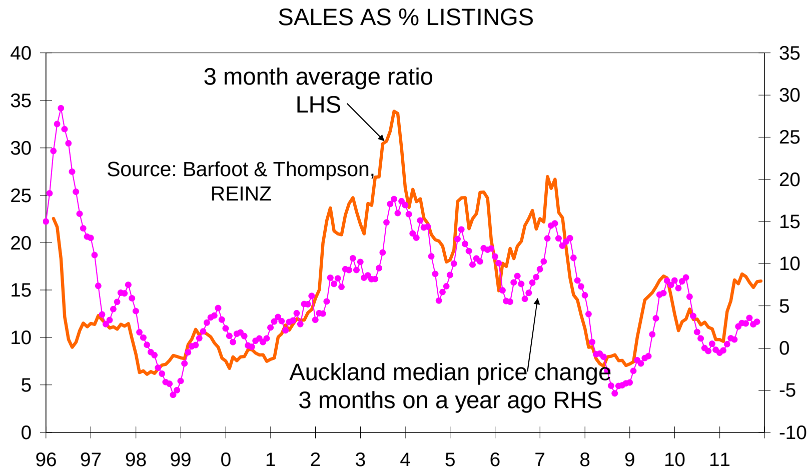


Yet while prices and sales activity improve, the listings shortage continues to get worse. Although in December Barfoot and Thompson received 15% more fresh listings than a year earlier, at the end of the month total listings on hand were down 22% from the end of 2010.





This graph suggests the annual rate of price gain in Auckland using the more widespread REINZ data is set to go higher.



Overall the data show a housing market moving upward with decreasing availability of stock. I shall review the nationwide REINZ data next week.

Are You Seeing Something We Are Not?

If so, email us at tony.alexander@bnz.co.nz with Housing Comment in the Subject line and let us know.

MAJOR OFFSHORE ISSUES

European Debt

No time – will write next week.

Chinese Inflation

No time – will write next week.

US Growth Momentum

No time – will write next week.

Australian Growth

No time – will write next week.

Exchange Rates

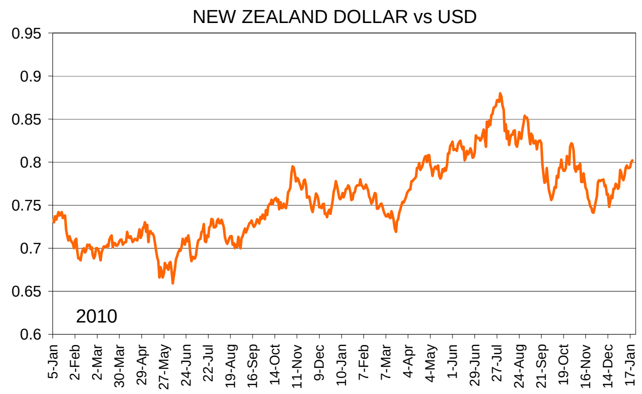
Exchange Rates	This Week	Week ago	4 wks ago	3 Mths ago	Yr ago	10 yr average
NZD/USD	0.802	0.796	0.761	0.790	0.771	0.629
NZD/AUD	0.770	0.772	0.764	0.776	0.772	0.855
NZD/JPY	61.600	61.100	59.200	60.500	63.7	68.4
NZD/GBP	0.520	0.519	0.490	0.503	0.482	0.368
NZD/EUR	0.624	0.626	0.584	0.576	0.576	0.511
NZDCNY	5.062	5.027	4.833	5.032	5.079	4.83
USD/JPY	76.808	76.759	77.792	76.582	82.620	109.9
USD/GBP	1.542	1.534	1.553	1.571	1.600	1.705
USD/EUR	1.285	1.272	1.303	1.372	1.339	1.229
AUD/USD	1.04	1.03	1.00	1.02	1.00	0.737
USD/RMB	6.3117	6.3153	6.351	6.37	6.5875	

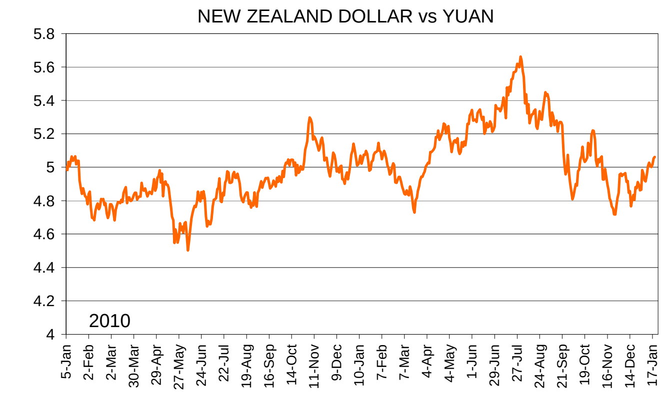
Kiwi Firm – Upside For The Year

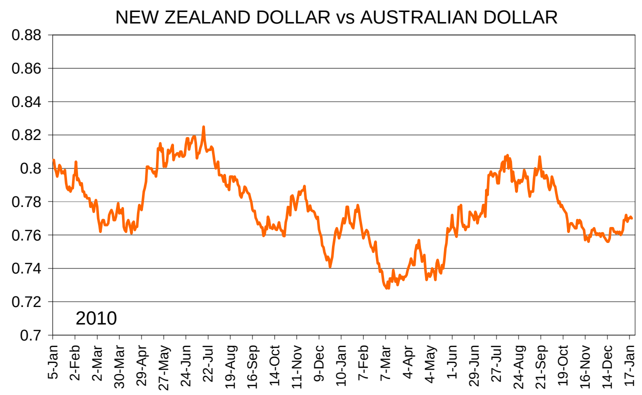
The Kiwi dollar has gained ground marginally against most currencies over the past five weeks with some extra strength this week on the back of good dairy prices and hopes of a Euro collapse being avoided. Generally positive US economic data have also helped. So what will the year most likely bring?

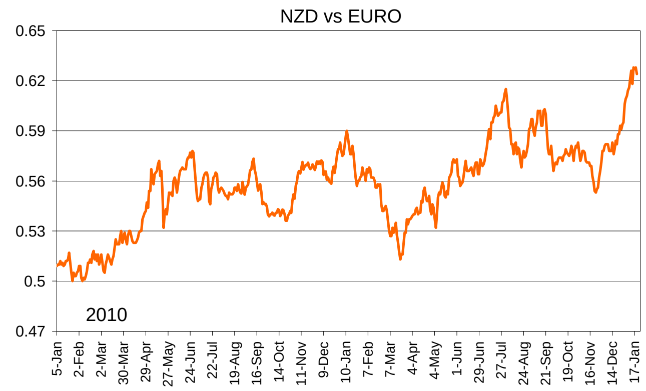
If the Euro collapses all bets on exchange rates are off – though the Kiwi would probably fall sharply. Failing that the risk is that the NZD appreciates against most currencies this year but gains will be limited by the continuing weakness of New Zealand's recovery from the 2008-09 recession.

I would write more but I want to get this off before checking out of my hotel in Guangzhou.









Exchange Rate Assumptions

I shall update the usual table here next week. If you base your exchange rate risk management decisions on forecasts however you are very very very silly might one suggest – especially given the continuing major global uncertainty.

ECONOMIC DATA – will update next week.

All %		Latest qtr only	Previous qtr only	Latest year	Year ago	2 Yrs ago
Inflation	RBNZ target is 1% - 3% on average	0.4%	1.0	4.6	1.5	1.7
GDP growth	Average past 10 years = 2.6%	0.1	0.9	+1.5	0.5	-2.4
Unemployment rate	Average past 10 years = 4.8%	6.6	6.5	......	6.4	6.5
Jobs growth	Average past 10 years = 1.9%	0.2	0.0	1.1	1.8	-1.8
Current a/c deficit	Average past 10 years = 5.5% of GDP	3.7	3.6	......	2.5	5.6
Terms of Trade		-0.6	2.4	3.4	17.9	-14.1
Wages Growth	Stats NZ analytical series	0.6	1.0	3.6	2.5	5.2
Retail Sales ex-auto	Average past 9 years = 3.9%.	2.4	1.1	2.1	2.3	-2.5
House Prices	REINZ Stratified Index	1.5	-0.2	2.3	-1.3	4.3
Net migration gain	Av. gain past 10 years = 13,900	-103	2,867yr	......	12,610	18,560
Tourism – an. av grth	10 year average growth = 3.2%. Stats NZ	2.5	-0.6	2.5	3.2	-1.0
		Latest year rate	Prev mth year rate	6 mths ago	Year ago	2 yrs ago
Business confidence	BNZ survey	3	-2	57	18	43
Consumer confidence	ANZ-Roy Morgan 100=neutral	109	112	103	115	122
Household debt	10 year average growth = 10.3%. RBNZ	1.2	1.2	1.5	2.4	2.6
Dwelling sales	10 year average growth = 2.5%. REINZ	28.3	21.1	-4.2	-35.9	36.3
Floating Mort. Rate	(TotalMoney) 10 year average = 7.9%*	5.74	5.59	5.59	6.09	5.59
3 yr fixed hsg rate	10 year average = 7.8%	6.45	6.99	6.99	7.15	7.95

All actual data excluding interest & exchange rates sourced from Statistics NZ.

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Key Forecasts

Dec. year		2010	2011	2012	2013
GDP	annual average chg	1.4	2.0 – 2.5	2.0 – 2.5	3.0 – 3.5
CPI	on year ago	4.0	2.5 – 3.0	2.0 – 2.5	2.5 – 3.0
Official Cash rate	end year	3.0	2.5	3.0 – 4.0	4.00 – 4.50
Employment	on year ago	1.3	2.0 – 2.5	2.0 – 2.5	2.0 - 2.5
Unemployment Rate	end year	6.8	6.0 - 6.5	5.0 - 5.5	<5.0

*extrapolated back in time as TotalMoney started in 2007