BNZ Weekly Overview

24 May 2012

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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 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.
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Thoughts For The Long Term

Most commentaries you will read in the next few days will be about the Budget and they will say largely the same thing – with a bit more moaning if the commentators have a predominantly left-wing or right-wing bias. So apart from noting the highlights further on lets do something completely different.

As a rule, since starting the Weekly Overview in 2000 I have not take material produced for one output and cut and pasted it here. What that means is that the column I have been writing for regional newspapers since 1998 does not get reprinted here. The NZ Property Investor monthly column does not get reprinted in the Housing Market section further down and so on. But I reckon my effort in the past two weeks in the newspapers may be insightful to a wider audience in these uncertain times so have decided to place it here. Plus not much time was available for anything new given the need to finish the Growing With China monthly.

Lets say you have made it through the past four years of recession, global crises, muted recovery, deteriorating European situation and US wobbles and have a business which is doing okay but not thriving. What are the sort of messages you might want to impart to your staff to get them in a better frame of mind to tackle what lies ahead and to think less about technical procedures and more about leadership and action?

The starting point has to be to outline to them the way the world we live in now is different from the past and we are not on the cusp of returning to the strong period from 1998 – 2007 (for different sectors at different times). In this week's column I shall run through the sort of things I think you and your staff need to consider from a strategic business positioning point of view. Next week I shall attempt to outline some actions to consider for handling these structural shifts.

1. Western economies will remain burdened by high government/banking/corporate and household debt for many more years and there will be periodic financial crises bringing hits to buyer confidence, volatility in interest rates, exchange rates, credit availability from banks, sharemarkets, and input costs including energy.

2. Government funding for new initiatives will be constrained by the fiscal burden of an aging population. Tax rises and removal of business tax deductions and programmes are highly likely.

3. Growth will average less than the 2.3% achieved in the past ten and 20 years on average not just because of volatility, but because labour force growth is slowing to 11% between 2011 and 2025 from 29% in the 15 years before then. Slower population growth means slower natural growth in consumer spending.

4. Once growth reaches 2.5% the labour market is likely to substantially tighten up bringing extra wage and non-wage pressure especially as many Kiwis shift to Australia for better pay. The gap between Australian and NZ remuneration will widen and NZ will never “catch-up” with Australia. Employers will need to develop programmes for recruiting staff offshore and training them up in New Zealand.

5. China will eventually become our biggest trading partner ahead of Australia, and other markets such as Indonesia and India will become more important while the US and Europe become less relevant in relative terms.

6. Rising construction standards and costs and shortages of builders will price home ownership out of reach of many younger people and create an accommodation crisis for low income earners. Business location relative to where staff live will become more important.

7. In service sectors growing giants like Google, Facebook etc. will either directly establish a presence or facilitate other nimble firms connected with people online to reshape entire sectors.

8. Reputation and brand will become more important as people seek insight into product quality through social media. Companies with easy to communicate propositions will fare better than those with products and processes people find hard to explain to others.

9. Funding business growth will become harder as the banking sector becomes more heavily regulated and cautious, consistently funding from offshore remains problematic, the return of finance companies en mass is prevented by better regulation, and NZ’s capital market remains small and dysfunctional. More internal funding will be required which will slow business expansion. Access to funding will become a strategic advantage for those companies which have it.

10. The NZD will be (already is) structurally higher against the US, British and European currencies thus curtailing returns from those regions for exporters while providing opportunities for cheaper imports. But against the Australian dollar the NZ dollar will be and is structurally lower. This and relative labour costs will bring a growing shift of businesses from Australia to NZ, eventually tightening the labour market more.

11. The ongoing problems in other Western countries will bring increasing foreign demand to live in New Zealand. NZ will eventually be presented with an opportunity for more selective migration policies.

12. An increasingly old customer base will shrink some markets and grow others. In-home care, remote diagnosis and monitoring, home maintenance will grow.

Next week – what one can do in response to these trends.
……………………………………….
Last week I wrote about the sort of things an employer might be wanting his staff to be aware of as regards the likely business operating environment over the next few years. For this week I promised to give some ideas on what on might do in response to the 12 listed factors. So here are some thoughts. There are plenty of others.

Western economies burdened by debt etc. One’s focus for trade and investment relationships needs to be directed more to our (fortunately) back yard of Asia, the Pacific, and Australia.

Tax rises likely due to fiscal constraints – avoid making decisions on the basis of tax considerations which could easily change in 5 – 10 years time.

Slower population, labour force and economic growth – one’s business model needs to be less geared toward handling a growing customer base and more toward innovation, productivity, and stemming customer losses/turnover.

Labour market to permanently tighten up – companies will need to consider offshore recruitment programmes, ease of integrating foreign staff, retaining older people, encouraging and retaining women. The

BNZ for instance on Wednesday night in Auckland launched along with the Financial Services Institute of Australasia (FINSIA) a new industry body, Women in Financial Services Forum. This is aimed at facilitating a programme of events, policy work and other initiatives geared toward increasing female representation within senior positions in the financial services industry.

China to be come our biggest trading partner one day = familiarity with the Chinese economy, business scene, and news will need to be slowly raised.

Home affordability will worsen, low income accommodation shortages will grow – location vis-à-vis employee domiciles will need to be considered, relocation to cheaper housing towns may be optimal.

Technology firms expanding into non-traditional service sectors – concentrate innovation on products and procedures hard to easily computerise and distribute at low cost through networks.

Social media will guide brand recognition and reputation – make sure your online presence is strong in your targeted markets and especially the people/groups who influence those who decide whether to use your services or not. The two groups might not be the same.

Tight funding following the GFC and finance company collapses – greater recourse to building retained earnings will be needed, more single financier rather than main and mezzanine financing may be needed.

NZ dollar structurally lower against the Aussie dollar – look at opportunities for undercutting Aussie competitors in foreign markets, buying out and relocating Aussie businesses to NZ.

Eventual higher foreign demand for living in NZ – may open opportunities for foreign-themed retirement villages, lifestyle to become more and more a selling point vis-à-vis income.

Aging population – think about which products will be demanded more, which less etc.

These are the 12 points made, but there are some other over-riding considerations. One is that NZ's economy will forever be based around the primary sector. It cannot be moved. Practically all technology and manufacturing businesses can. In fact with foreign companies circling the globe actively looking for ideas and products to slot into large enterprises offshore our economic model will remain one of primary sector dominance and technology companies being sold offshore once they attract foreign attention.

That is, it will only be through the NZ-domiciled determination of people like Peter Jackson that we will retain successful service businesses in NZ and have them build to large size as has happened with Wellington's audio-visual industry.

This also means the processing of primary products into higher value-added consumer and ingredient goods is becoming more and more important.

If seeing me speak interests you then here are a couple of interviews done recently.
http://www.youtube.com/watch?v=PwvgxImwVuU
http://www.tv9.co.nz/?p=569

The Budget

A return to surplus is projected for 2014/15 (of only $197mn) but that probably won't be achieved as there are downside risks to the growth forecasts used by Treasury when generating their revenue and expenditure projections. Those forecasts are 2.6% in the year to March 2013 and 3.4% the following year then 3.1% and 2.9% with a 1% boost in each year from Christchurch rebuilding. But given the continuing general goodwill toward NZ from offshore a delay of one year eventually to be announced is not a major issue.

The budget deficit is forecast at 4.1% of GDP this year ending from 9.2% last year with 3.6% in the coming year of 2012/13. Net debt as a % of GDP is seen peaking at 28.7% of GDP in mid-2014. It is currently 25%. Core government expenses are projected to fall from 33.5% of GDP this year to 30.2% by 2015/16.
The excise tax on tobacco will be increased by 10% above the rate of inflation for each of the next four years.

Is Our Economy Getting Better or Worse?

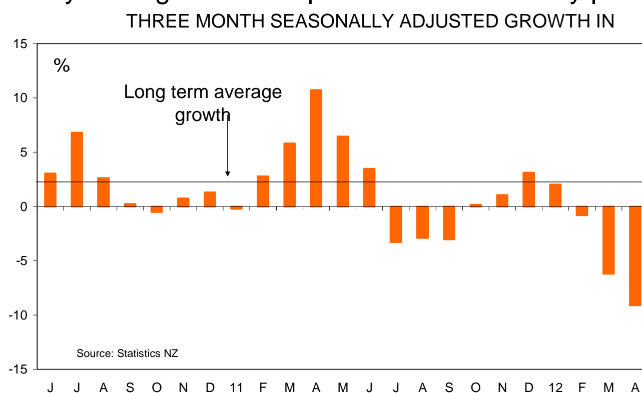
In this section we look only at what the data are actually telling us and pay no attention to forecasts or intentions measures.

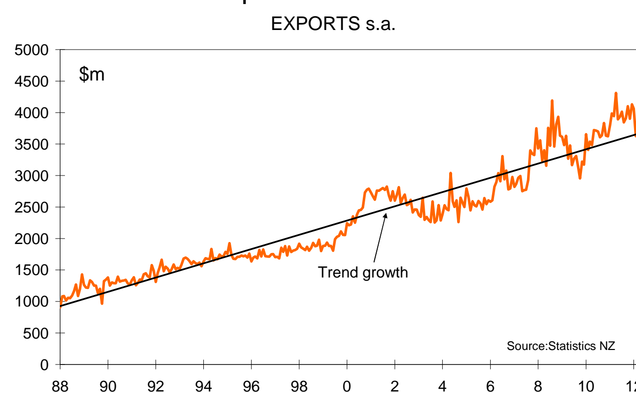
Are householders opening their wallets more?

Nothing new.

Is business output rising?

Seasonally adjusted export receipts fell by 0.6% in April after rising 1.9% in March which means that over the past quarter export receipts have declined 9%. This is a bad sign for overall growth in the economy though clearly the big driver is a pullback in commodity prices rather than a collapse of volumes.





Are businesses hiring more people?

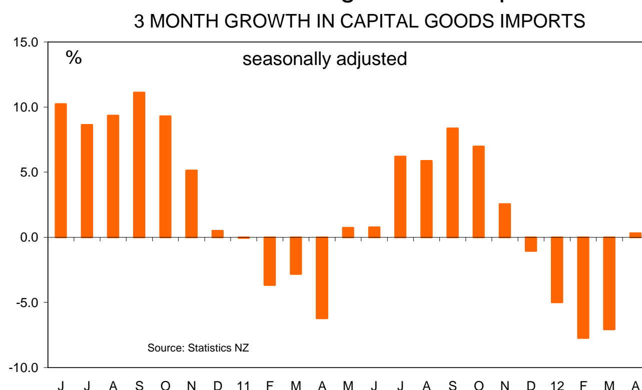
Nothing new. I feel jobs growth is slow overall but know that in ChCh demand is strong – though not for everyone. Many builders are finding it impossible to plan their workforce for the stop start nature of the work they have had coming in.

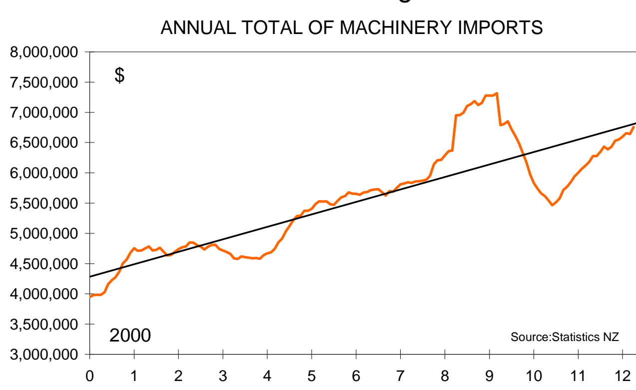
Are businesses boosting their capital spending?

For equipment no. Buildings = mixed.

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

The value of imports of capital equipment jumped in seasonally adjusted terms by 11.5% after rising 2.3% in March. This means that imports in the three months to April were ahead 8.3% seasonally adjusted from the three months to January and also from a year earlier. This is quite a positive development following the 5% fall of three months earlier and gives one hope that more business investment is occurring.





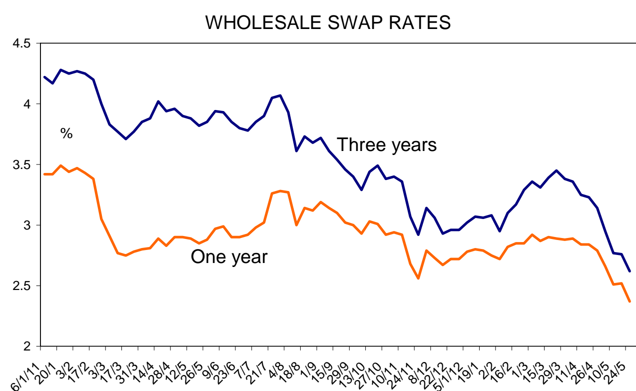
What Do The Leading Indicators Say?

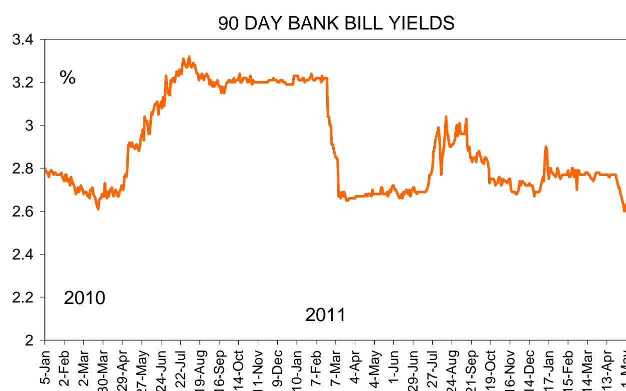
In this section we look only at the factors which can at times give insight into where the economy is headed. Generally we will only cover newly released information.

Also nothing new.

INTEREST RATES

With worries about the world rising and the likes of the UK FTSE share index falling 3% from a week ago and the ASX200 2% wholesale interest rates have declined further. Borrowers have entered into new territory with credit costs at extremely low levels and great opportunities now exist for companies to lock in low fixed interest rates for core debts over the next few years. The markets have moved to pricing in 0.5% worth of interest rate cuts in New Zealand but we remain to be convinced that this will in fact happen. The Treasury has a sanguine view of the economy over the coming year with growth of 2.6% forecast and one suspects that the Reserve Bank will also be maintaining an upward growth path on the back of the Christchurch rebuild and clear upturn in the Auckland housing market.





What this means is that fixed borrowing costs are at risk from a swift removal of market expectations of NZ rate cuts should we be hit by a string of positive data releases in the next few weeks. But barring not only that but a surprising turning of events in Europe, the interest rates environment in New Zealand looks fairly benign for the next year and a half though with clear upside interest rates risk further out.

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	2.50	5.4
90-day bank bill	2.56%	2.63	2.76	2.76	2.68	5.7
1 year swap	2.37%	2.52	2.79	2.85	2.88	5.8
3 year swap	2.62%	2.76	3.14	3.29	3.85	6.1
5 year swap	3.06%	3.17	3.56	3.76	4.49	6.3

If I Were a Borrower What Would I Do?

The woes in Europe have caused a collapse in hopes for global growth, inflation, and therefore interest rates (except for bonds of the bad nations) and this has led to a fresh round of cuts in NZ fixed home lending rates. What do I do now? Why ask me? If I had a mortgage in the past three months I would already have locked myself in for three years at 6.15% so clearly I cannot pick short term lending rate movements. It might pay to keep that in mind down the track.

Regardless, maintaining the illusion of prescience, were I a fresh faced borrower right this minute – I personally would again go for the three year rate. The cost now is 5.75%. That is a four decade low and brings home affordability into reach for a lot more people (which will just go to support my long-running positive view on the housing market which I see the media are now running with full tilt). I definitely claim housing insight – less so on the interest rates front. Not that any soul on the planet can claim interest rate forecast accuracy at the moment. So many faces, so few eggs.

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/
- **I also write a monthly column on the residential property market in NZ Property Investor magazine available at your bookshop or newsagent.**

Nothing New – Not Quite

We have not received any meaningful data giving insight into the state of or prospects for the housing market this week. But that does not matter because in my opinion this is the week in which the last recalcitrants hanging out for prices to fall probably threw in the towel. They have been battered by the solid evidence of prices rising seen in monthly REINZ, Barfoot and Thompson and QVNZ data. The media have been running more and more articles discussing the shortage of housing and rising rents with the appearance now of some discussions regarding the socioeconomic impacts of poor housing affordability for those on lower incomes. Watch for that discussion to grow and if you can think of a solution please let everyone know.

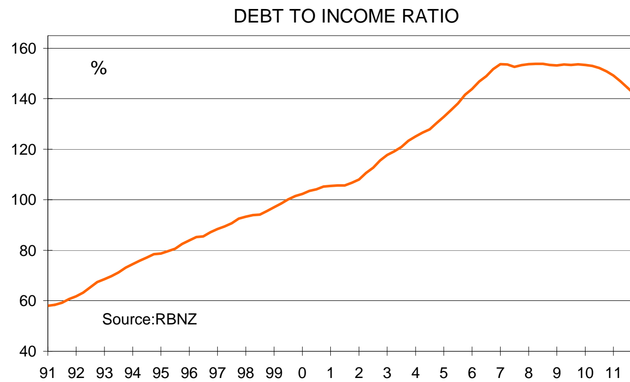
In addition we have evidence from our monthly survey with the REINZ of a flood of young buyers entering the market with investors following along like seagulls behind a fishing boat. And now we have an entirely new thread entering the picture which I did not anticipate. Unusually low interest rates.

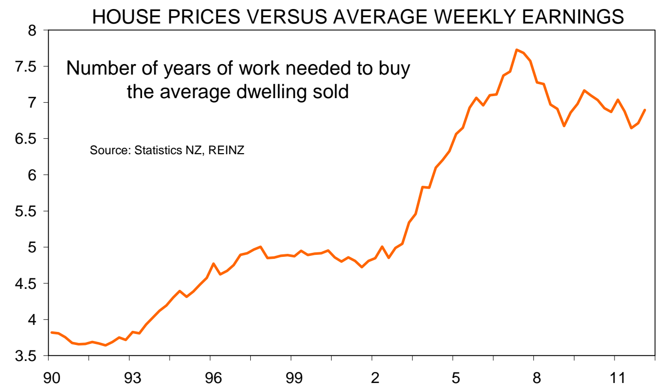
By unusually low interest rates I mean the fresh found of cuts we have just seen in home lending fixed rates in response to the worsening outlook for world growth associated with the deteriorating European debt situation. That deterioration means not just weaker world growth (US and China will be impacted), but clearly reduced inflationary pressures. That means higher prospects for interest rate cuts in affected countries and a scaling back of expectations that monetary policy will be tightened.

In the NZ context I have long highlighted the risk that we would not see any raising of New Zealand's official cash rate until next year sometime and now that appears virtually certain – or maybe 2014. The markets have started factoring in cuts however adding up to 0.5% and because of that the cost to us banks of borrowing to lend fixed has gone down and so what manifested itself initially as a willingness to discount rates to bargaining borrowers has now moved onto generalised rate cuts for all.

Investors are now doing the simple maths. Do they stay in term deposits avoiding equities because of the high probability of another mini-crash there, and avoiding housing because they fear price falls? No, times have changed. The chances of a sharemarket decline have soared. But house prices are now rising and people are comparing the cost of borrowing with the possible capital gain and lumping onto that the scope for good rents growth afforded by what they now accept to be a shortage of property in some parts of the country.

Investors are now actively choosing property because the prospective returns stick out as very positive in a world of volatile and low returns in so many other assets (key Facebook shares here maybe). But we all have memories of what the Reserve Bank did from 2004 – 2007 in taking the official cash rate from 4.5% to 8.25% as they tried to stem a soaring housing market and generalised inflationary pressures. The risk of a repeat of such rate rises is minimal in the near future given the obvious low inflation outlook created by poor global growth prospects. Plus house prices versus income start the cycle much higher than last time as does the ratio of household debt to income.





Nevertheless, why lob stones at a sleeping dog by skiting of how one is buying property and locking in potential for good capital gains? Instead we are being politically correct and saying in interviews and surveys that we are buying or we believe others are buying because of good long term yield made possible by scope for raising rents. The comment is correct but not complete. The buying is happening because of the psychological "GO" trigger afforded by the removal of expectations that prices will fall and the arrival of a growing expectation that prices will rise. The price rises expectations are not at the front of our decision-making process. But they linger in the background and whisper quietly to us as we walk into the investor forest "It's okay. Go that way. You'll be alright."

And so it begins. Enjoy the ride. Can you guess the next step?

MAJOR OFFSHORE ISSUES

Europe

Nothing of positive nature has emerged regarding the European debt crisis this past week. In particular the Group of Eight leaders meeting in the United States produced lots of hand wringing and words about the need for coordinated actions to resolve the crisis – but not a single action. Very French. The debate has certainly shifted ground with the focus now largely on how to promote growth and how to convince Germany to back the issuance of euro bonds backed by all 17 member countries. But at heart all that means is that for recalcitrant countries such as Greece, having put off bringing themselves into the modern world paying their way by earlier using low Euro interest rates and lying about their fiscal numbers, now they want to put changes off for a few more years by drawing other countries more deeply into being part of their debt binge. The greater the access Greece has to other people's money in the short term the less the reform they will undertake and the greater will be the adjustment further down the track with more of the burden on taxpayers.

This putting off change to another day is also the cost of any short term stimulus package which might appear in the next few weeks – just as literally hundreds of fiscal boosts provided by European governments in recent decades have been used to cover up weakness.

Reading the latest offering by Trainspotting author Irvine Welsh helps one understand the addiction Greece has to other people's money, how lies are told and promises made in order to extend use of the substance for as long as possible, and how so many other lives are damaged by this addictive behavior. Going cold turkey is what Greece needs and cauterizing the wound they are growing by kicking them out of the Euro seems inevitable. How to handle the contagion effect however is the difficult bit and probably where most thought is being directed behind the scenes in Europe at the moment.

As an aside, perhaps many people now better understand why the Chinese have made strong promises of supporting Europe but not committed much if any new lending. They undoubtedly recognise the black hole which Europe's finances have become and are logically unwilling to face the blogosphere backlash at home once losses arrived.

Australia

Sorry yet again – no time this week. The Aussies have a problem of a declining growth outlook occasioned by falling export commodity prices and deepening concerns about Europe at a time of weaker than expected data in China. There is a good chance that the RBA will cut interest rates again.

United States

Just to show how volatile and uncertain things are, last week we reported a good rise in consumer confidence measured in the monthly University of Michigan survey. This week we report instead a fall in consumer sentiment to a four month low in an alternative and now more up to date Bloomberg weekly survey which fell to a reading of -43.6 from -40.4 previously. We don't have a data series for this survey yet but apparently such low sentiment is associated with recession.

Yet we also saw the release of some stronger than expected monthly housing numbers and that means it remains acceptable still to buy into the gradual US economic growth scenario – though the next monthly employment number is assuming quite large significance.

China

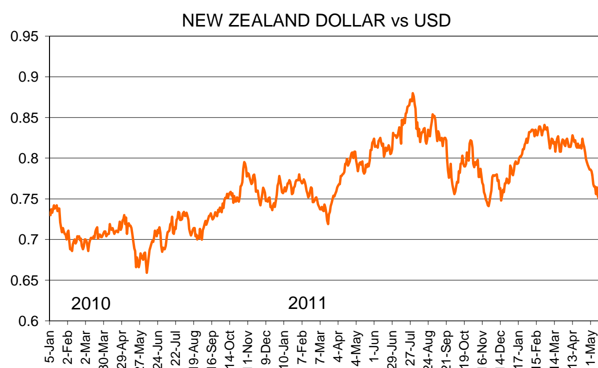
Chinese economic developments are now covered in our new publication "Growing With China", the last issue of which appeared on May 22. If you wish to receive this monthly then please email me specifying your name, company name, and connection with China. Tony.alexander@bnz.co.nz

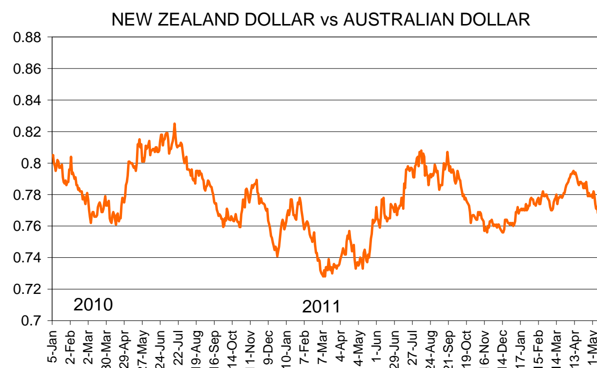
Exchange Rates

Exchange Rates	This Week	Week ago	4 wks ago	3 Mths ago	Yr ago	10 yr average
NZD/USD	0.751	0.765	0.813	0.833	0.79	0.67
NZD/AUD	0.770	0.771	0.788	0.779	0.752	0.85
NZD/JPY	59.700	61.500	66.000	66.700	64.8	69.6
NZD/GBP	0.479	0.480	0.504	0.530	0.49	0.388
NZD/EUR	0.597	0.601	0.618	0.624	0.563	0.52
NZDCNY	4.755	4.834	5.124	5.248	5.131	4.99
USD/JPY	79.494	80.392	81.181	80.072	82.025	105.7
USD/GBP	1.568	1.594	1.613	1.572	1.612	1.72
USD/EUR	1.258	1.273	1.316	1.335	1.403	1.28
AUD/USD	0.98	0.99	1.03	1.07	1.05	0.788
USD/RMB	6.3318	6.3191	6.303	6.2997	6.4948	7.56

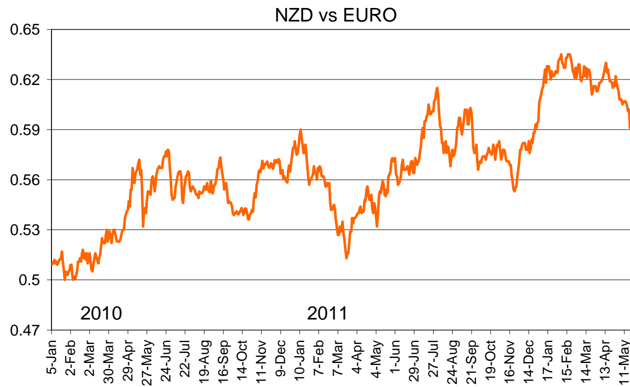
Kiwi Keeps Falling As World Outlook Gets Worse

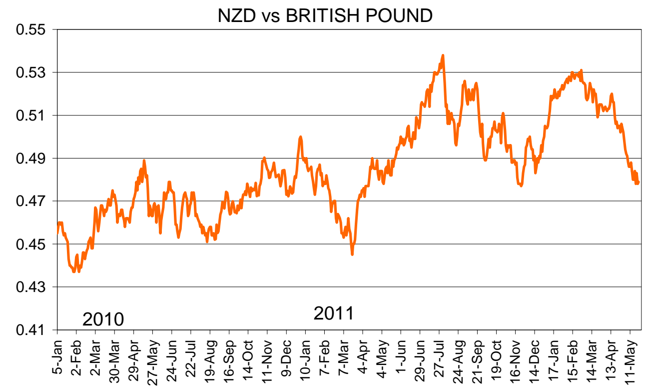
With deepening worries about Europe investors have continued to sell risky assets – and so the NZD has fallen to just over US 75 cents from 76.5 cents a week ago. This is the lowest level for the NZD/USD exchange rate this year and if things continue to drag on in Europe then the NZD will almost certainly go lower. And that means weakness also on the cross rates.



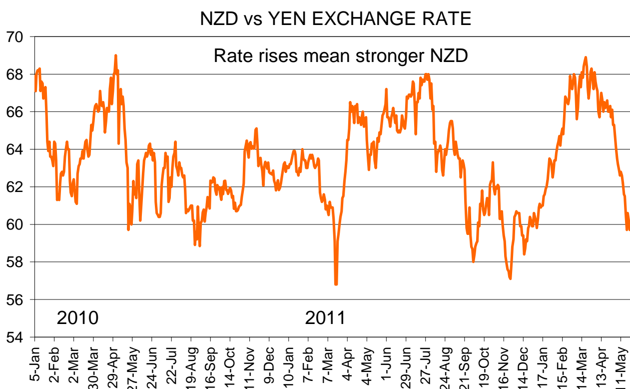


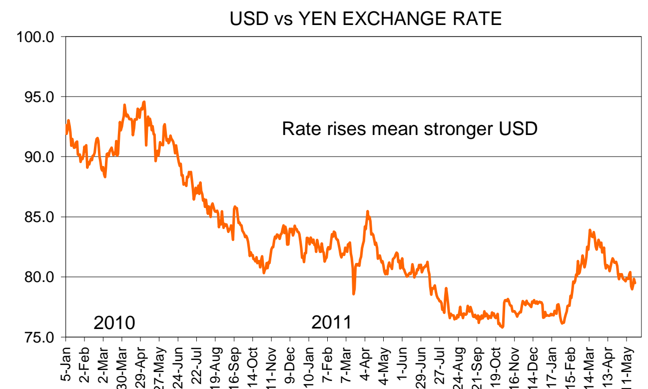
We have fallen against the Aussie dollar to near 77 cents from just over that last week. In fact this week an emailer asked "I had expected that when Australia dropped its OCR earlier this month the Kiwi would benefit against the Aussie Dollar because the attractiveness of the AUS$ would diminish to investors, however the opposite has happened! Why?" Well, since the RBA cut the OCR on April 30 the NZD/AUD exchange rate has fallen from 78.7 cents to 77.1 cents. The decline arises over the same time period during which the NZD has fallen from US82 cents to 75 and that in itself tells us something – the big change in the NZD was directly against the world's major currency and whatever happened against the AUD was a subsidiary thing.



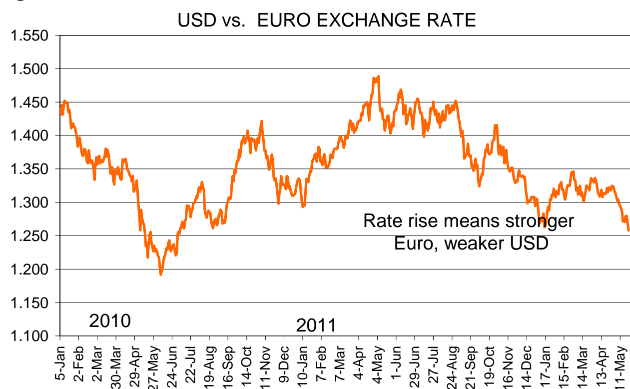


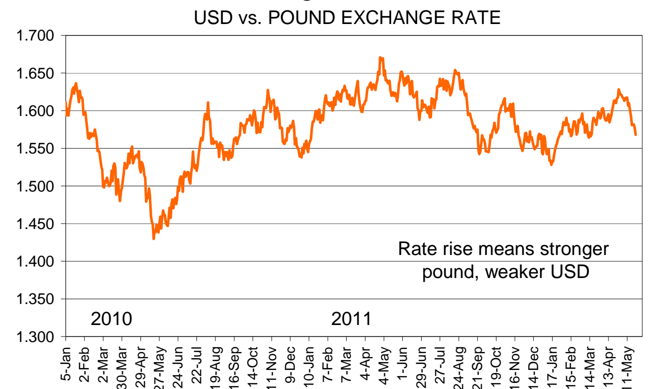
The NZD has fallen sharply because of a surge in worries about the world economy causing investors to sell risky assets like shares and far flung currencies. Our currency is more far flung than Australia's – hence we have fallen further.





As regards the major currencies this week, the AUD has retreated to US 97.5 cents from 99.2, the Japanese Yen has strengthened against the greenback to 79.5 from 80.4 last week, and the USD has strengthened against the British Pound to $1.568 to buy one Pound from $1.594. The Euro has fallen to a 20 month low against the USD near $1.258 from $1.273 last week and $1.316 four weeks ago.





Exchange Rate Assumptions

This table contains the latest NAB currency forecasts. In red I indicate where I believe the risk lies for these rates. You are welcome to toss your own coin and generate an equally valid table.

	2011	2012	Risk	2013	Risk
Year end					
NZD/USD	0.77	0.83	Higher	0.75	Higher
NZD/AUD	0.76	0.85		0.82	
NZD/YEN	60.0	71		60	Higher
NZD/GBP	0.50	0.52	Higher	0.49	Higher
NZD/EUR	0.60	0.61	Higher	0.54	Higher
USD/JPY	78	85	Lower	80	Lower
GBP/USD	1.54	1.58	Lower	1.56	Lower
EUR/USD	1.30	1.35	Lower	1.38	Lower
AUD/USD	1.01	1.00	Higher	0.95	Higher

Key Forecasts

Dec. year		**2010**	**2011**	**2012**	**2013**
GDP	annual average chg	1.2	1.4	1.5 – 2.2	2.5 – 3.5
CPI	on year ago	4.0	1.8	2.0 – 2.6	2.5 – 2.9
Official Cash rate	end year	3.0	2.5	2.50 – 2.75	3.25 – 4.25
Employment	on year ago	1.3	1.6	1.0 – 1.6	1.5 – 1.9
Unemployment Rate	end year	6.8	6.3	5.5 – 6.0	4.8 – 5.5

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