BNZ Weekly Overview

28 June 2012

ISSN 2253-3672

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.

Just Like 1992

I was reading the European edition of the Wall Street Journal this week and came across the following two paragraphs from an article about China. “Chinese savers increasingly are turning funds away from traditional deposits toward higher return wealth-management products, a trend that is posing new risks for the country’s banking system.

Analysts and regulators worry that the proliferation of wealth management products could put financial strains on China’s lenders. These products are a mix of short-term investments that package bonds, money-market funds and other securities. Banks market them as low- risk alternative to deposits with the added advantage of offering a higher return.”

This is relevant to the situation in New Zealand – not now, but maybe in three years time, with the higher yielding products people switch to being other than the bond/money market fund type instruments relevant in China.

At Fieldays in Hamilton two weeks ago four different people had conversations with me regarding the low returns they are earning on bank term deposits and how they are realising that as they approach retirement or are already in retirement they have not saved enough. The conversations arise I think because hopes these people had of interest rates rising were dashed four weeks ago when worries about Greece caused bank funding costs to drop, bank fixed housing rates to drop, bank deposit rates to go down, and forecasts to emerge of interest rates sitting at low levels for many years.

These people find themselves in exactly the same position as the previous generation approaching or in retirement in the early 1990s. Back then inflation fell from an average of 11% to 2% in 1992 and bank term deposit rates naturally fell sharply as monetary policy was substantially eased. Reserve Bank records show that at the end of 1990 the average six month term deposit rate was 12%. In the middle of 1992 it was 6%.

What did people do? They chased yield. Where did they find it? Finance companies and residential property investment vehicles. We all know what happened. With funding easy to find the finance companies and investment vehicles went on lending/buying/construction sprees into poor quality over-priced assets and investors lost billions from roughly 2006.

Will this happen again?

On the face of it one would think not. One would think that people have learnt their lessons and that this time the bulk of people will pay proper attention to the extra risk they are taking on in order to secure higher returns. And I think one will be right in that sort of thinking for this year, next year, and maybe even 2014. but sometime in that latter year or 2015 the fog of time will cloud memories and assessment and we will once again see people chasing yield in ignorance of risk.

And as each year goes by we will also see a new group of people entering that search pattern – those hitting 65 years of age and cashing in their Kiwisaver accounts. We will see investment offerors tailoring their advertising specifically to these people – and not all products on offer will be of low risk.

So from a macroeconomic and socioeconomic point of view this "problem" of low returns to investors is not yet a matter of moment. But it will eventually be and it behoves each of us with more nouse and knowledge of the risk-reward trade-off to make sure the people we know and love who are already in this position do not go goo-goo-eyed over some advertisement with an old rugby player/TV personality, or good old boy Buffet-look-alike and start throwing away their money like undies at a Tom Jones concert.

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.

Export receipts are falling is about all we have learnt this week – but that is nothing new.

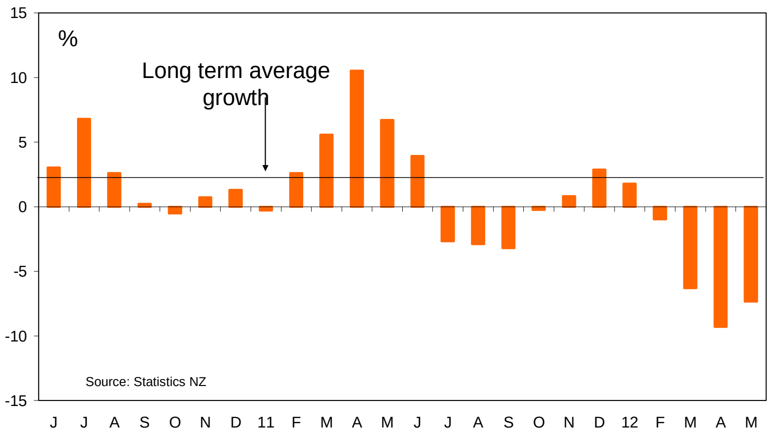
Are householders opening their wallets more?

No new direct data this week, but we do have May consumption import numbers in hand. They show that imports of consumer goods in May were 4% ahead of a year earlier though flat if looked at over the three months to May versus a year ago. These are weak numbers.

Is business output rising?

In seasonally adjusted terms NZ's export receipts fell by 1.3% in May after declining 1.1% in April. This means that in the three months to May exports fell by 7.3% from the three months to February while in unadjusted terms three month exports were down 10.3% from a year earlier. The combination of falling commodity prices and weaker growth in offshore markets is hitting export receipts at a time when household consumption is proving to be very weak – ahead just 0.1% during the March quarter for instance.

THREE MONTH SEASONALLY ADJUSTED GROWTH IN

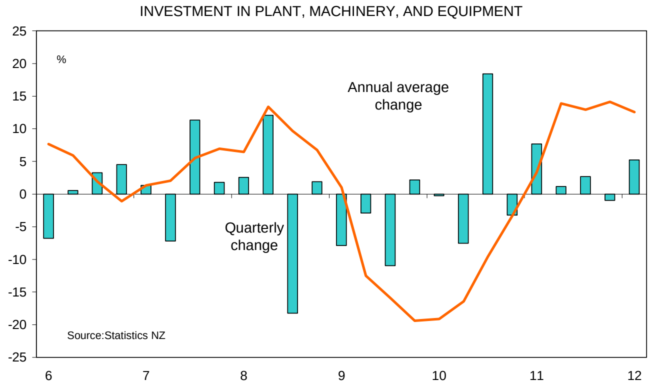


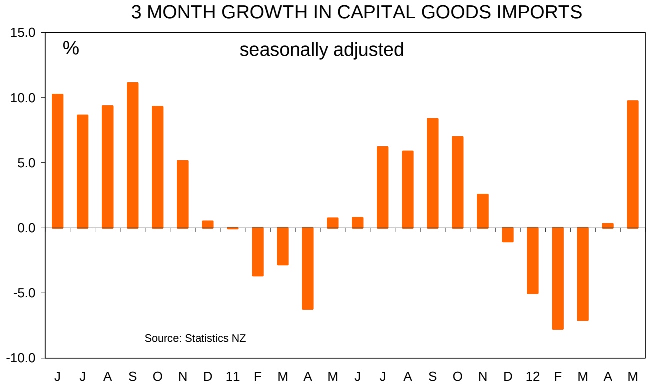
Are businesses hiring more people?

Nothing new.

Are businesses boosting their capital spending?
For equipment yes. 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/

Last week's national accounts showed that during the March quarter expenditure on plant, machinery and equipment grew by 5.2% to deliver growth for the full year of a healthy 12.6%. The question is however how much of the lift is due to equipment being used in the deconstruction of Christchurch or purchased in readiness for reconstruction.



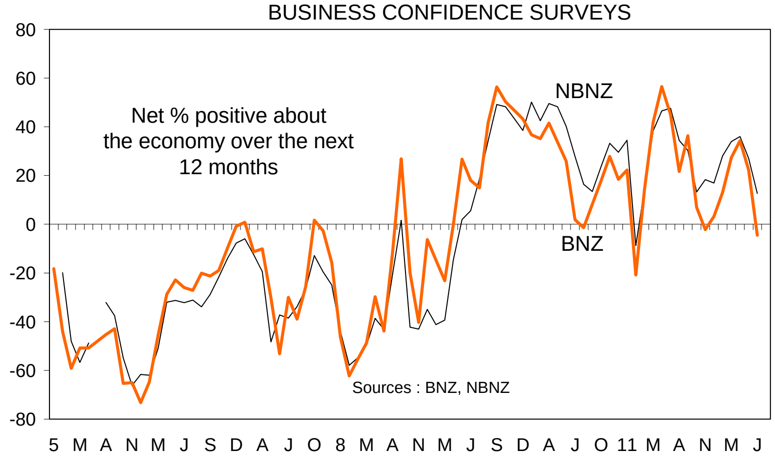


We can pose the same question when we look at this week's merchandise trade data which show that in the three months to May capital equipment imports rose 9.7% seasonally adjusted. Just Christchurch or something more?

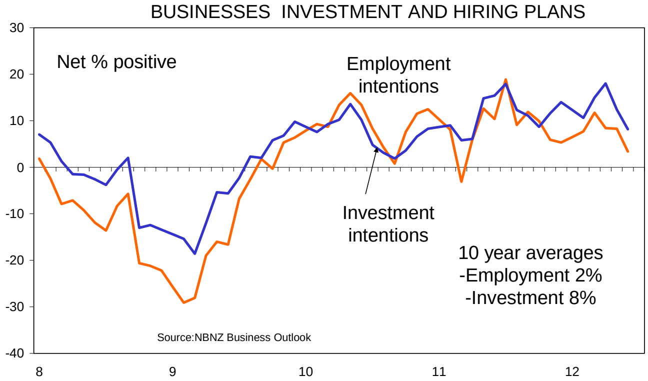
What Do The Leading Indicators Say?

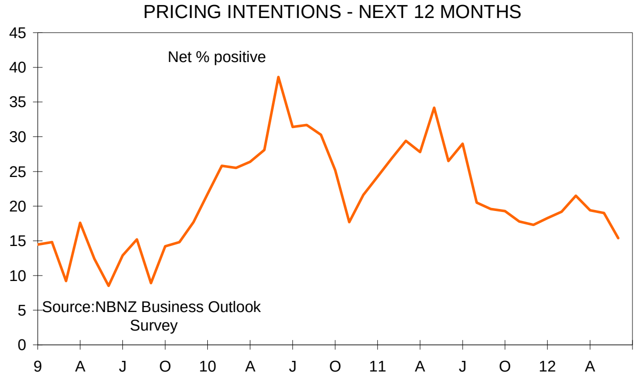
In this section we look only at the factors which can at times give insight into where the economy is headed. Generally we will only cover newly released information.

It was no surprise that today we learnt of a fall in the monthly NBNZ Business Outlook confidence reading to just a net 13% positive in early-June from 27% in May and 36% in April. As previously noted (many times, tee hee) the NBNZ survey headline measure merely shows what we have already learnt from our own monthly survey which fell away sharply in June as shown in the graph below.



The good value of the NBNZ survey however is in the intentions measures and here it is unsurprising that things have weakened off quite considerably. Only a net 3% of respondents plan hiring extra people compared with 8% in May and April. This reading is only just above the ten year average of 2%. Similarly the investment intentions measure has fallen away to 8% from 12% in May and an average of just under 8%.





Profit expectations have fallen to only a net 5% positive from 15% in May and in another sign that the need for higher interest rates in New Zealand is non-existent, the net percent of respondents planning to raise their selling prices fell to 15.4% from 19% in May. No surprises in the survey, and for the record, the often examined by more than often misinterpreted activity expectations measure fell to a reasonable though not inspiring net 21% positive from 35% in May and a recent peak of 39% in March.

INTEREST RATES

Wholesale interest rates have edged marginally lower this week in response to some reassessment of the true strength of the NZ economy implied by last week's surprising 1.1% March quarter GDP rise. Mainly though things were merely settling down as the world awaits the outcome of the latest European leaders summit starting tonight. The summit may extend into the weekend and while it may produce some progress on issues of European-wide banking supervision it is extremely unlikely that measures will be adopted which address the current concerns of investors regarding the ability of some European countries to finance themselves.

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	2.68%	2.68	2.73	2.76	2.68	5.7
1 year swap	2.73%	2.76	2.50	2.88	2.92	5.8
3 year swap	2.90%	3.01	2.75	3.38	3.78	6.1
5 year swap	3.23%	3.36	3.16	3.88	4.40	6.3

If I Were a Borrower What Would I Do?

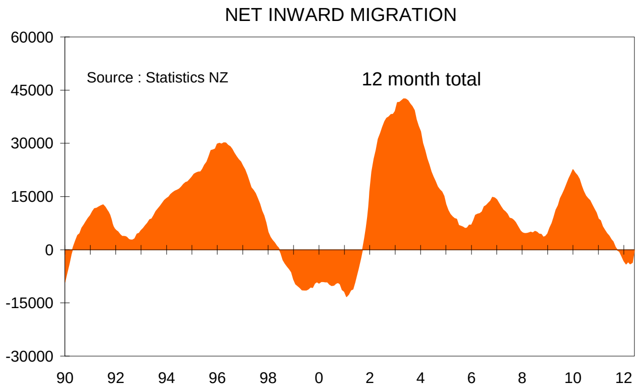
I personally like the three year fixed rate at 5.75% though for most people sitting floating will be optimal given the repayment flexibility it delivers.

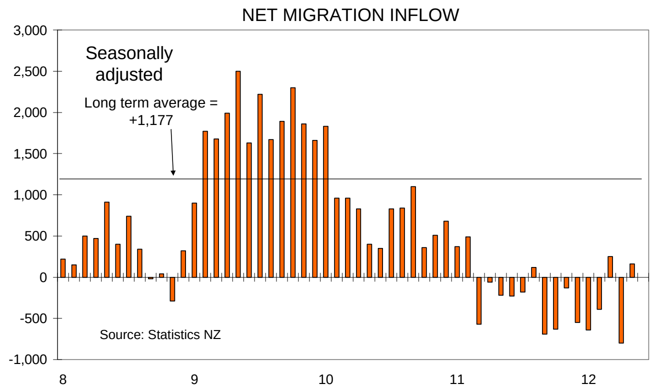
HOUSING MARKET UPDATE

- **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.**

Migration

A journalist asked me this week about the impact of migration on the housing market. I noted that at the moment migration is a drag on the normal state of affairs because the net flow in the year to May was a loss of 3,653 and because the average flow over the past ten years has been a gain of 15,000 p.a. However the other factors in play are so large as to make the migration flows not all that relevant – but what about when they turn?



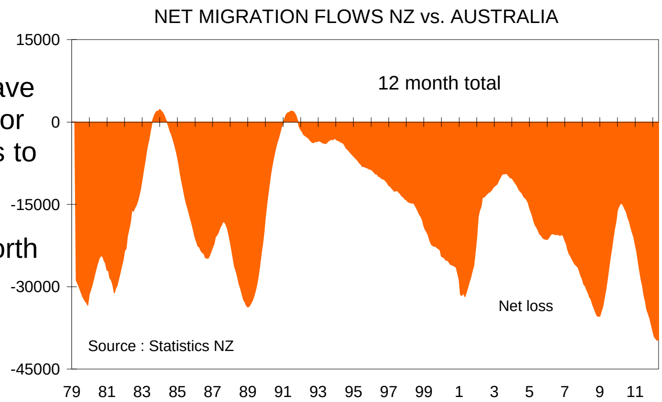


That is, what will happen when the migration cycle switches back to a reasonable positive? Then clearly we will have another source of upward pressure on NZ house prices on top of pressure from rising construction standards and costs, builder shortages, investor and first home buyer demand, and the stimulus from low interest rates.

So is the migration cycle turning? The annual loss recently was 4,068 in February so maybe the peak has been reached. Is there a sharp turnaround underway? In seasonally adjusted terms the net flow over the three months to May was a loss of 390 people compared with 1,580 in the three months to February and 1,450 in the three months to November.

The data suggest that things are turning. But I have been watching the migration numbers for a great number of years and have seen periods in the past when things appeared to be changing direction only to flip back again. Predictability of migration flows I have found to be low. So caution is required. But it needs to be noted that the data are suggesting that the migration cycle is now heading back into positive territory soon.

Speaking of cycles, I have previously mentioned that there is a large migration cycle between New Zealand and Australia and that recently we have simply been going through the big negative part for ourselves. In the year to May the net population loss to Australia was 39,622. That was down from the peak of 39,778 in April. One month's worth of improvement does not a trend make. But this is worth watching.



MAJOR OFFSHORE ISSUES

Here is some reading to back up the outright pessimism I am expressing here regarding world growth prospects over the next few years. In a report prepared ahead of last week's G20 meeting in Mexico the IMF noted the following.

The world economy is "vulnerable". "The latest news firmly suggests that momentum is weakening again." Risks include a sharp slowdown in China and the European crisis. In some emerging countries like China it notes "rapid credit expansion may have pushed output growth above sustainable rates." With regard to huge government debts in Japan and the United States it notes that their "repeated failure" to present credible debt management plans could "eventually unnerve investors."

So not very robust all up.

Europe

- Spain managed to sell the €2bn worth of five year government bonds it was offering at last Thursday's auction, but the yield was over 6%. That is not a sustainable level. Ten year yields have recently been above 7%.
- A report estimated that Spanish banks will need €62bn to handle their bad debts and processes are in train now to get the emergency funds flowing.
- Neither the Greek PM or Finance Minister will make it to tonight's European leaders meeting to discuss the Greek crisis because they are both sick – detached retina and collapsing respectively. In fact the Finance Minister resigned on Monday night citing his ill health. His family had told him not to take the job in the first place.
- Cyprus has now become the fifth Eurozone member to request a bailout, asking for money to help its banking sector.
- The new Greek governing coalition of three parties intends asking the rest of Europe for a two year postponement of most of the conditions it previously agreed to in exchange for bailout money. That is they want to not raise taxes, enforce tax collections, reduce the bloated public sector, sell assets etc. Yet who could possibly believe promises of action in two years from a country with a proven track record of lying and now led by the very party which governed during the boom years, built up the public service and welfare entitlements, and lied to its European partners about the true size of the budget deficit and government debt level?
- Meanwhile, in France the new Finance Minister said he rejects the idea of austerity and intends ploughing ahead with the President's promises to hire another 60,000 public servants, lower the retirement age for some, increase minimum wages, increase industry subsidies, and raise taxes to a 75% marginal rate for those earning over €1mn. The aim this year is a budget deficit equal to 4.5% of GDP then balance by 2017.
- Moodys cut ratings on 28 Spanish banks.
- The European Court of Justice this week ruled that if you get sick while taking annual leave you are entitled to paid time off equal to the amount of time one did not feel well. In New Zealand we just call it ACC and get on with building our decks.
- Bunga bunga expert Silvio Berlusconi said that he does not consider it blasphemy for Italy to think of leaving the Euro and pursuing competitive currency devaluation.

With years to work on the structure the Europeans could not come up with a Eurozone which could function properly and did not even think about writing in a method for how a country could exit the union. What chance then that a hastily put together package for a European-wide banking system will function properly? Not much. A major short-term problem cannot be addressed with a long term structure which for its effectiveness relies upon long term adherence to rules.

One of the proposals for supposedly "solving" the Euro crisis is Eurobonds. These are bonds issued by a pan-Eurozone authority backed by al Eurozone members. The key benefit is that they would allow heavily indebted countries having trouble getting their own bonds away at good interest rates to investors to reduce their borrowing costs. That is part of what caused this problem in the first place! Greece etc. have had the benefit of being able to issue bonds at interest rates artificially lowered because of Germany's membership of the Eurozone. Had Germany not been a member the interest rates would have been higher. But perhaps more simply, realisation that the suggested solutions to high debt problems largely involve borrowing more money show why this is not going to end well at all in Europe. A lost decade could be the optimistic view.

In a nutshell, should anything come out of this week's meeting of European leaders it would be very surprising given that the Germans will not supply extra funding without having a say in what countries do with it, and the French will not give away any sovereignty. Plus, even if some market-soothing agreement is reached it is extremely unlikely that European countries will take measures needed to put them fundamentally on a sound footing ahead of the next bout of investor nerves.

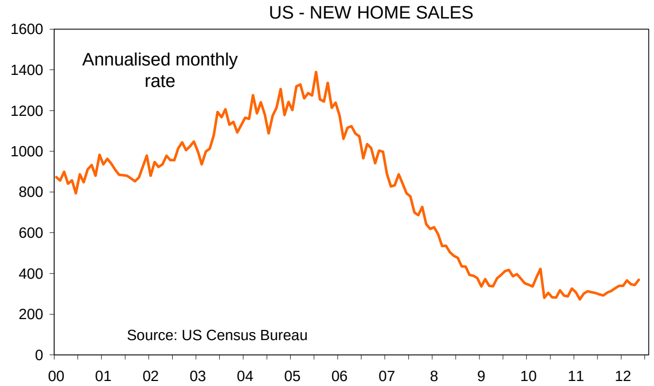
Australia

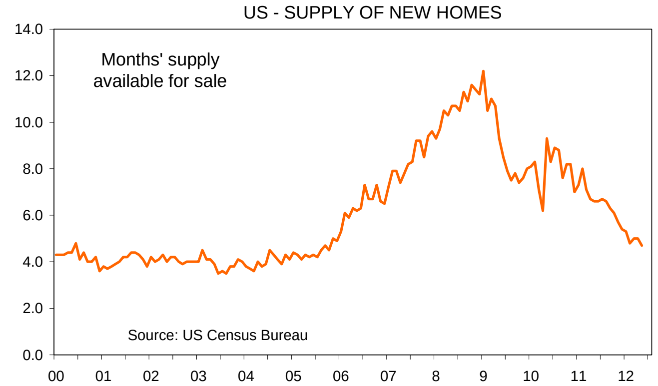
Australia's continue to boom in infrastructure and mining but recessionary conditions persist in tourism (Lara Bingle notwithstanding), retailing, housing, and manufacturing. More commentators are now openly opining about the worthiness of continuing to subsidise unprofitable manufacturers on the Eastern seaboard given the high probability that the strength in the Aussie dollar is a structural upward shift, and the clear disincentive to modernise and boost productivity which subsidies bring. This is good for us as it means more Aussie companies are going to be looking at shifting their operations across here. Welcome cobber.

United States

The US economy has been growing recently at a pace just below 2% and there are no clear signs suggesting that growth is going to consolidate much above that rate in the near future. The monthly economic data releases show growth but little new strength as such, and in retailing and employment deteriorating trends are apparent. Thus as usual Friday week's employment number is very important and the clear risk is that the deteriorating situation in Europe will see the same level of only mild growth displayed as over the previous three months.

The number of new homes sold in the United States in May rose to the highest seasonally adjusted number since early 2010 with a 7.6% gain from April and 19.8% rise from a year earlier. There is now just 4.7 months' worth of stock sitting unsold compared with 5 in April, 6.6 months a year ago, and a peak of 12.2 months early in 2009.



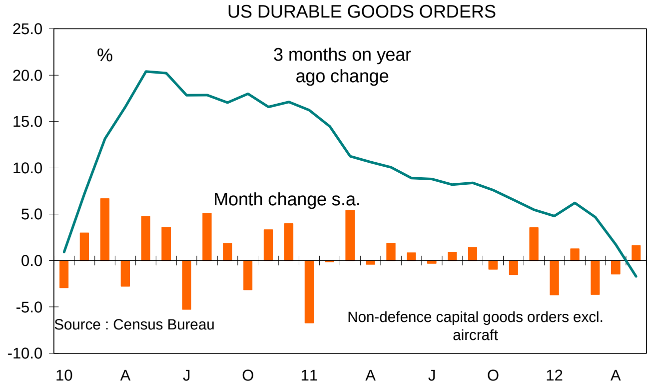


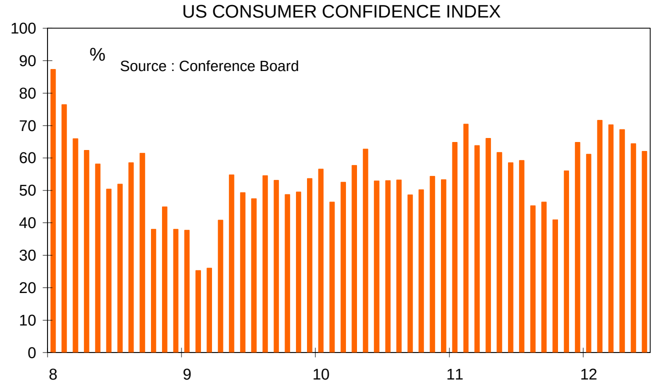
The median sale price for new dwellings was $234,500 in May which was a 5.6% rise from a year earlier and just 3.7% below the average price over the two year period 2006-07. So these are good numbers.

But they follow other housing indicators which have been mediocre so one cannot yet conclusively say that the US housing market is improving – though that is generally where we think things are heading.

But while the housing sector may be getting a tad better, it is hard to see much momentum developing while consumer confidence is falling. The monthly Conference Board sentiment gauge fell to a five month low in June of 62 compared with 64.4 in May. This level is well ahead of 41 in October last year when worries were high regarding a double dip recession. But the absolute confidence level remains low and not suggestive of sustained improvement in generalised household spending and investment.

Another seemingly good number last night was for durable goods orders which improved 1.1% in May which was stronger growth than expected. However orders fell in both April and March and in the three months to May orders were ahead just 4.3% from a year ago which is the slowest pace of growth since January 2010. thus the underlying growth is not that flash. In fact if we take out the defence sector and transport items then while orders rose by a healthy 1.6% in May they were 1.7% down from a year ago for the three month period and down 4.5% compared with the three months to February – weak in other words.





China

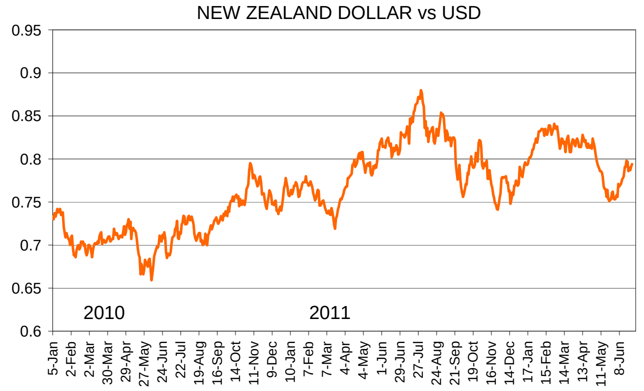
Chinese economic developments are now covered in our new publication “Growing With China”, the June issue of which was released today, June 21. If you wish to receive this monthly then please email me specifying your name, company name, and connection with China. Tony.alexander@bnz.co.nz

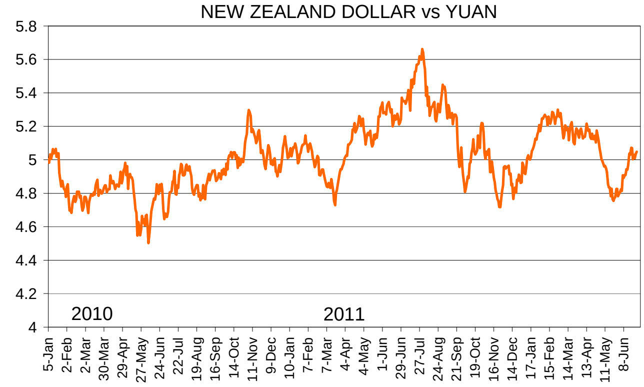
Exchange Rates

Exchange Rates	This Week	Week ago	4 wks ago	3 Mths ago	Yr ago	10 yr average
NZD/USD	0.794	0.797	0.753	0.822	0.806	0.67
NZD/AUD	0.785	0.784	0.772	0.784	0.771	0.85
NZD/JPY	63.100	63.400	59.900	68.300	65.1	69.6
NZD/GBP	0.510	0.508	0.481	0.515	0.504	0.388
NZD/EUR	0.636	0.628	0.600	0.616	0.564	0.52
NZDCNY	5.049	5.070	4.777	5.177	5.222	4.99
USD/JPY	79.471	79.548	79.548	83.090	80.769	105.7
USD/GBP	1.557	1.569	1.565	1.596	1.599	1.72
USD/EUR	1.248	1.269	1.255	1.334	1.429	1.28
AUD/USD	1.01	1.02	0.98	1.05	1.05	0.788
USD/RMB	6.3585	6.3609	6.3433	6.2986	6.4794	7.56

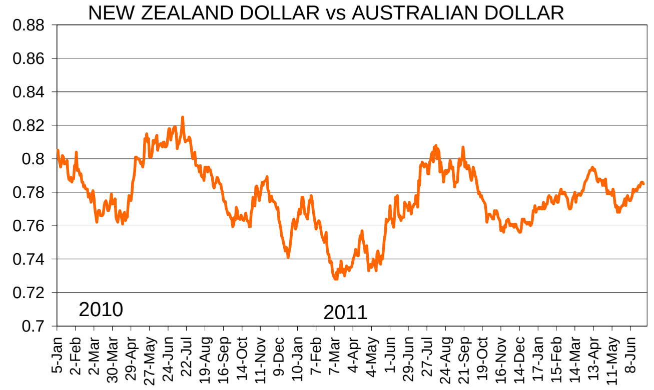
Exchange Rates On Hold

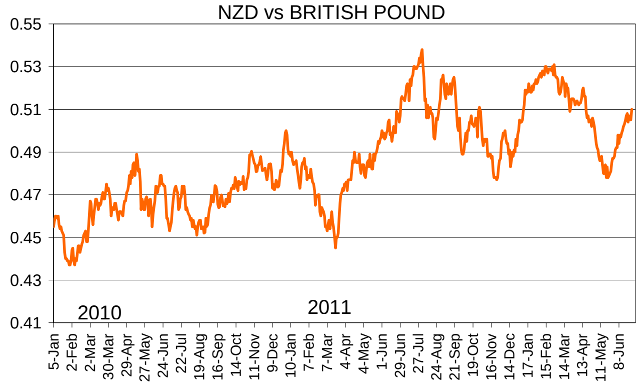
If you look at the FX table above you'll see that there has been very little change in exchange rates from levels of a week ago – apart from some renewed weakness in the Euro and the NZ dollar rising back to 51 British pence. I hope all you tens of thousands of people with money in pounds waiting for the return of 28 pence to bring it back to NZ managed to get some shifted at the 47 pence rate of just over a month ago.





Where exchange rates go in the coming week will depend almost entirely on what comes out of the European summit. We don't know what will happen at the summit so can give no guide as to what the coming week will bring and whether as an exporter one should once again ease up on hedging, or buy more in case everyone makes nice and demand for risky assets leaps.





Key Forecasts					
Dec. year		**2010**	**2011**	**2012**	**2013**
GDP	annual average chg	1.8	1.3	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	3.00 – 3.75
Employment	on year ago	1.3	1.6	1.0 – 1.7	1.5 – 1.9
Unemployment Rate	end year	6.8	6.4	6.0 – 6.5	5.0 – 5.6

The Weekly Overview is written by Tony Alexander, Chief Economist at the Bank of New Zealand. The publication is sent to 26,000 subscribers each week and is one of a stable of regular releases which include the

- monthly Growing With China publication, http://tonyalexander.co.nz/topics/china/
- monthly BNZ Confidence Survey, http://tonyalexander.co.nz/topics/surveys/bnz-confidence-survey/ and the
- monthly BNZ-REINZ Residential Market Survey. http://tonyalexander.co.nz/topics/surveys/bnz-reinz-survey/ This latter survey provides information from a survey of over 10,000 licensed real estate agents on the current state of the residential property market in New Zealand.
- He has also written a weekly newspaper column since 1998, http://www.stuff.co.nz/business/opinion
- writes a column for the Farming Show posted at http://www.farmingshow.com/opinion/
- produces a monthly column for the NZ Property Investor magazine, http://www.propertyinvestor.co.nz/ and
- writes a monthly column for the NZ China Trade Association. http://www.nzcta.co.nz/

Most of these publications plus research into impediments to NZ's economic growth are available on his website. www.tonyalexander.co.nz

Tony Alexander has been Chief Economist at the BNZ since 1994 and apart from publications and advising management spends considerable time on the road around New Zealand making presentations and speaking with the media. He travels to the UK and Europe twice a year to assess economic conditions and present at numerous functions, has five children, and his partner Dr Sarah Farquhar runs the early childhood education network www.childforum.com

Tony.alexander@bnz.co.nz Ph 00644 474-6744