BNZ Weekly Overview

ISSN 2253-3672

23 August 2012

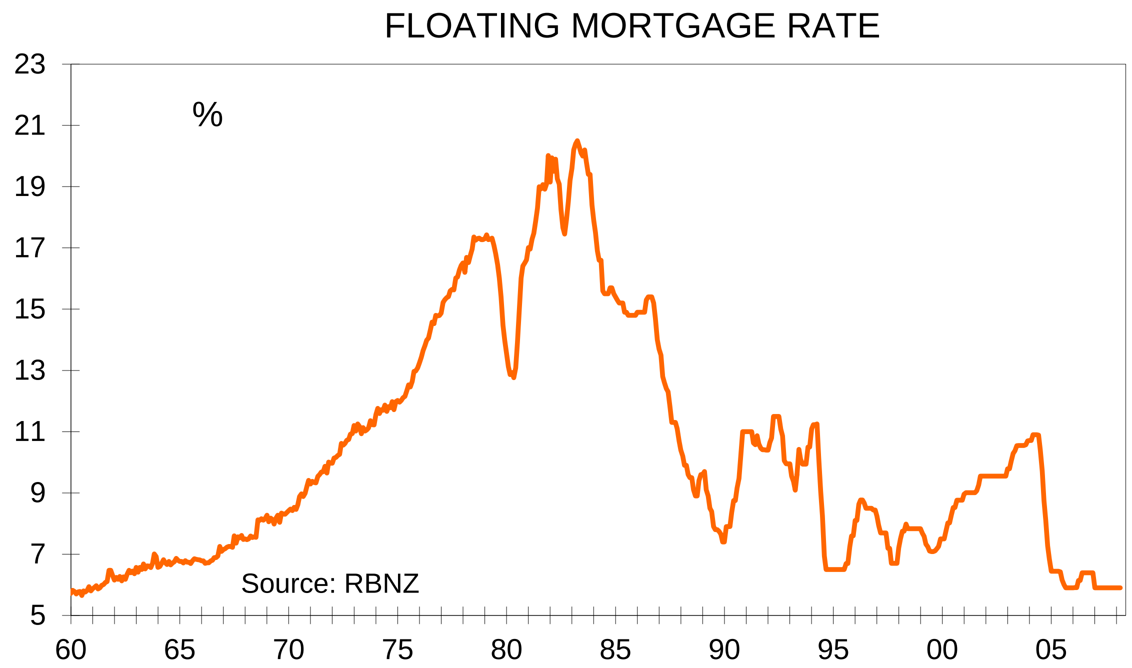
Mission Statement

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.

No Time This Week

Fresh news regarding the NZ economy and major offshore issues has been thin on the ground this week, and because I have been busy with the Growing For China publication have nothing to offer in this week's front section. So that's that. Here's a graph instead.



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 beyond the number of Kiwis going offshore for tourism rising a seasonally adjusted 0.4% in July after rising 0.7% in June.

Are businesses boosting their capital spending or hiring?

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

Nothing new in this area this week.

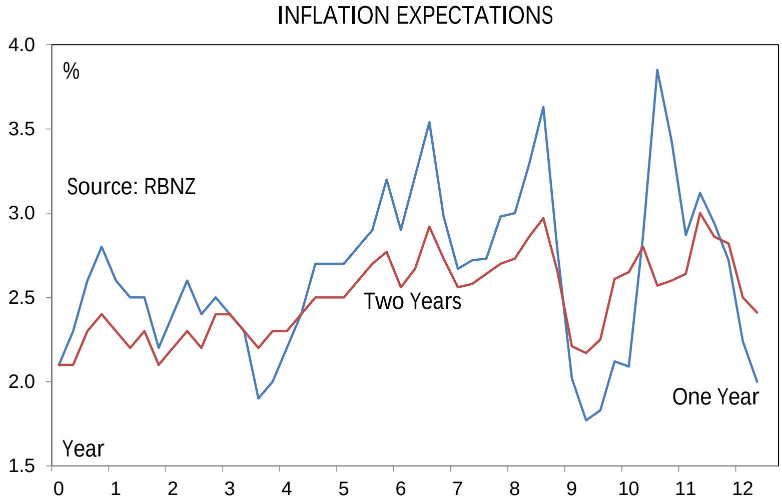
What Do The Leading Indicators Say?

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.

Nada

INTEREST RATES

Inflationary pressures in New Zealand remain very muted and this week's release of the RB's Survey of Expectations shows few worries about the next couple of years. The average business sector expectation for where inflation will be in a year's time fell to 2% from 2.2% in the March quarter survey and 3.1% a year ago. This is the lowest result since September 2009 which had a reading of 1.8% which was the lowest since 1.7% in 1999.



The two year ahead average inflation expectation which the RB pays more attention to because they can influence outcomes two years down the track more easily than one year out fell to 2.4% from 2.5% last quarter. This also was the lowest since 2009.

But realistically I'm just filling up space here for want of anything else to write. The economic data in NZ have recently been strong enough to preclude any cutting of the official cash rate unless Europe goes under, but the worries about Europe, the US, and China mean they may well not raise the cash rate until 2014. This week swap rates have edged slightly lower but there is no clear upward or downward trend underway.

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	2.66%	2.66	2.68	2.77	2.70	5.7
1 year swap	2.70%	2.70	2.56	2.37	3.12	5.8
3 year swap	2.98%	2.98	2.77	2.62	3.68	6.1
5 year swap	3.28%	3.32	3.05	3.05	4.22	6.3

If I Were a Borrower What Would I Do?

Some of the fixed interest rates went up this week. The three year rate has risen to 5.9% from 5.75% and the four year rate from 5.89% to 6.2%. The two year rate however has been cut to 5.4% from 5.55% which is a good saving over the floating rate at 5.74% for the Total Money product or 5.99% standard. Are the changes enough to alter what I would do currently if I were a borrower?

My level of uncertainty regarding where interest rates will go over the next few years is as high as ever, therefore if you lock into a three year rate you may or may not make big savings should the RB start raising the cash rate in 2014. I feel that the difference between the three year rate at 6.2% and the floating rate at 5.74% is a bit too big to expect many people will fix three years now and I would be happy to sit floating.

But I would keep an eye on how the situation develops internationally and if things were to suddenly look a lot better in Europe then because that would push bank fixed borrowing costs and therefore fixed lending rates up potentially quite quickly, I would probably jump into the three year fixed rate at that point.

But what about the good low 5.4% two year fixed rate? It will suit those who's plan is simply to stay floating I would suggest. But I personally would not take it because I like fixing but don't feel that a two year rate will do me much good further down the track when rates (one day) start rising again. So I still would stay floating though recognise that for those who might quit their mortgage in the next two years it would appear to be the optimal path. I do not look at tricky scenarios involving fixing, breaking, then refixing or floating. The permutations are simply too multitudinal.

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

Awareness of the housing shortage is strong so more buyers are entering the market. Investors are growing more confident of gaining rent rises and capital gains so are also seeking property. Supply of new houses will grow soon but the Christchurch rebuild and loss of tradespeople to Australia etc. means the supply rise will be limited. Thus unless the world economy collapses or interest rates shoot skyward quite sharply average house prices are likely to trend upward over the next 3-5 years especially as building standards will continue to be raised. This will create a housing crisis for those on low incomes and while there will be lots of talk about freeing up land little will actually be done.

MAJOR OFFSHORE ISSUES

Europe

Did you know that only one of the Eurozone economies – Germany – has output back at the level it was at before the global financial crisis? Here in NZ output is 1.8% higher. What this means is that with data last week showing the Eurozone shrinking 0.2% in the June quarter after registering no growth in the March quarter, effectively a fresh recession is in place before the full effects of the previous one have been erased. This is a very unusual thing to happen and is going to make the social implications of Europe's weak economic performance far worse than had there simply been a recession in 2008, growth recovering all lost plus 5%, then another recession.

For your guide the US economy reached its pre-recession level of GDP at the end of 2011.

The Europeans are back from their holidays now and meetings are once again scheduled to discuss debt woes. That means that we have once again entered into a period when there will be shifts in sentiment and market asset prices in response to 100% unpredictable shifts in sentiment regarding where things are heading. Hang on.

United States

No truly ground changing data releases have occurred this week and the only interesting thing was the release of minutes from the most recent Fed. board meeting showing a strong willingness to ease further should things get worse.

China

China's influence on the world economy and our own has soared and will grow further. If you have a question you would like to ask regarding China or a point of view you feel it would be useful for me to take on board in my studies then please email me at tony.alexander@bnz.co.nz

The media have started to run stories recently regarding the growing threat to China's garment and component assembly industry from some amazing robot developments in the West. The trend is well worth watching because if it accelerates then growth in China's economy which has been based upon growth in the export manufacturing sector could be cut off at its knees. There would seem logically to be no impediment to vast robotic manufacturing plants opening in the West given that no local jobs will be lost, and new ones will be created tending the robots, possibly making them in the West etc. Here are some links.

http://www.weekinchina.com/2012/07/an-american-revolution/?fs=&c=1
http://www.nytimes.com/2012/08/19/business/new-wave-of-adept-robots-is-changing-global-industry.html?_r=1&pagewanted=all
http://www.huffingtonpost.com/x-prize-foundation/the-end-of-chinese-manufa_b_1695573.html
http://www.reuters.com/article/2012/07/24/us-usa-manufacturing-onshoring-idUSBRE86N0XB20120724

How relevant is this to China? Specifically, won't they just install the machines themselves? To some extent yes, but with 38% of China's exports being refashioned imports, the Western company owners who account for 55% of China's manufactured exports and 90% of high level consumer electronics exports will be able to save component shipping costs by simply manufacturing at home.

With wage costs rising sharply in China Boston Consulting Group estimate that by the end of the decade some 2 – 3 million jobs will shift back to the United States – based on its survey of large companies one-third of which said they are planning to bring production back home.

Earlier today I released the August issue of Growing With China. You can find it at http://tonyalexander.co.nz/topics/china/ Here are the contents.

Attached please find the latest edition of Growing With China. If you have any feedback to offer on the contents or just wish a general discussion regarding developments in China please feel free to email me at tony.alexander@bnz.co.nz

This month's issue contains the following.

Can anyone reasonably expect China to bailout Europe? No, we explain why. Plus we note how although the value of NZ goods exports to China (incl. Hong Kong) has risen 134% since October 2008 and a 141% rise in primary exports explains the bulk of the gain, non-primary exports have grown 33% while such exports to the rest of the world have risen only 3%. Therefore more than just a commodities boom has taken China to accounting for 15% of our export goods receipts from 7% four years ago. Page 1.

NZTE Trade Commissioner in Hong Kong Kevin Parish looks at the market for natural products in China and the need for vigilance when signing up a partner, the need to be able to scale up quickly should one's products find favour with Chinese consumers, and the need for regular trips to keep good contact. Page 3

With regard to the state of China's economy the data have been disappointing with export growth slipping to only 1%, and weaker than expected growth in retail spending and industrial production. But low inflation at 1.8% provides good scope for additional easing of monetary policy – though with an eye toward a newly rising housing market and potential strong rises in food prices. Pages 4 – 6

Susan Kilsby, Dairy Analyst at Agrifax, gives insight into the nature of China's dairy industry and how hefty investment is occurring in China's milk supply chain while very strong demand remains for imported infant formula. Page 7

Understanding how Chinese customers differ in their preferences from those in the West is important to avoid wasting a lot of time, money and brand reputation. Page 8

The popular Western view is that with $3.2tn in FX reserves China is on its way to buying the world. We put this misplaced notion in context on page 9.

On August 3 I was on-line for an hour answering questions regarding China for the NZ Herald LiveChat session. The full text of the session is included on pages 10 – 13.

Later this year China will undergo only its fourth leadership change since the Communists defeated the Nationalists in China's most recent civil war in 1949. Joseph Judd of The New Zealand Initiative gives his thoughts on the transition on page 14.

Simon Young of Sy-engage follows up his column last month on the importance of social media in China. Page 15.

Finally, from pages 16 – 21 we look at the latest data on the economic relationship between New Zealand and China, look at how the exchange rate has changed (not by much) and include a few insightful comments sent in by emailers over the past month.

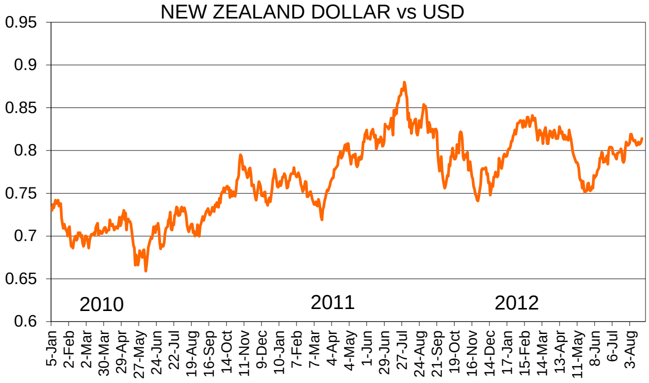
If anyone has a thought on where I could usefully post my now weekly comments on China apart from on my own website (which I really use only as an on-line filing cabinet) then please let me know.

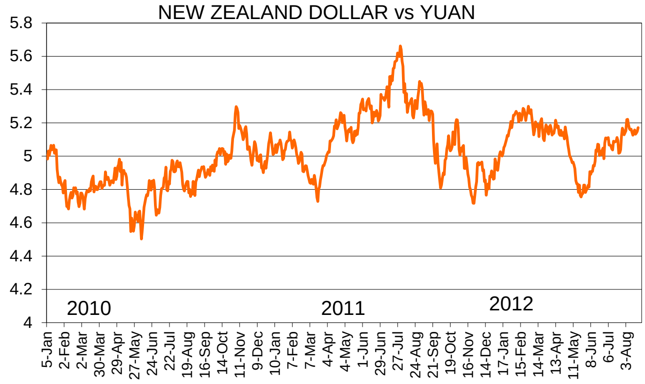
Exchange Rates

Exchange Rates	This Week	Week ago	4 wks ago	3 Mths ago	Yr ago	10 yr average
NZD/USD	0.814	0.807	0.799	0.754	0.824	0.67
NZD/AUD	0.774	0.768	0.770	0.768	0.791	0.85
NZD/JPY	64.000	63.600	62.700	60.200	63.3	69.6
NZD/GBP	0.513	0.514	0.510	0.478	0.5	0.388
NZD/EUR	0.650	0.657	0.657	0.594	0.574	0.52
NZDCNY	5.171	5.135	5.094	4.765	5.274	4.99
USD/JPY	78.624	78.810	78.473	79.841	76.820	105.7
USD/GBP	1.587	1.570	1.567	1.577	1.648	1.72
USD/EUR	1.252	1.228	1.216	1.269	1.436	1.28
AUD/USD	1.05	1.05	1.04	0.98	1.04	0.788
USD/RMB	6.3529	6.3633	6.3749	6.32	6.4009	7.56

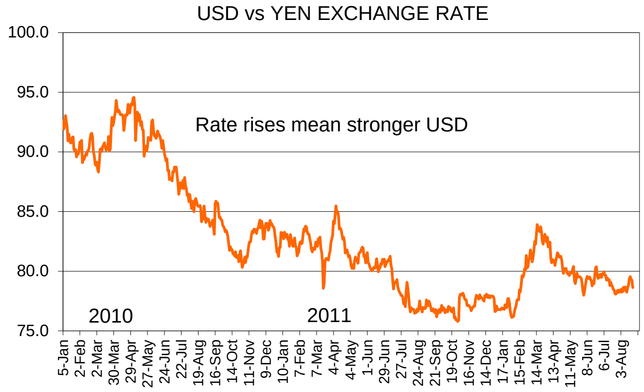
Rates Largely Static

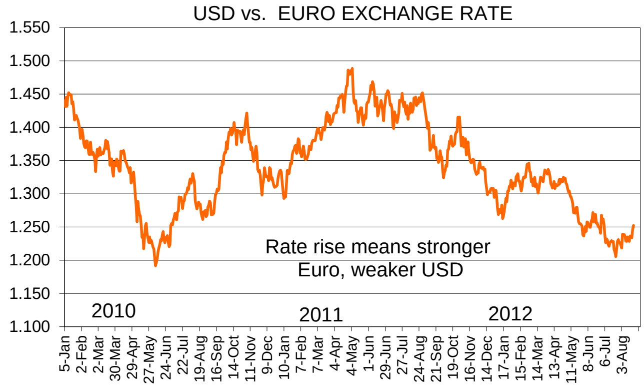
The Kiwi dollar has risen slightly against most currencies except the Euro and Pound this week but movements in exchange rates overall have been minimal in the absence of any fresh major developments. Specifically, in the United States the story remains one of mild growth held back from accelerating partly by worries about the Federal deficit and partly by fears Europe could sink. But there are underlying hopes that the Federal reserve might ease monetary policy further – though the chances of even lower interest rates having much stimulatory impact are fairly low.





In Europe people are returning from holidays and the debate about whether the Germans will sign up to even more bailing out of the economically inefficient Greeks is starting up again.





Locally no major data have appeared and from here there will be generalised upward pressure on the NZD because of newly improving commodity prices, but high vulnerability to shifts in sentiment regarding Europe in particular.

Key Forecasts

Dec. year		2011	2012	2013	2014
GDP	annual average chg	1.4	2.0-3.0%	2.0 – 2.5	1.0 – 2.0
CPI	on year ago	1.8	1.8	2.2 - 2.9	2.5 – 3.5
Official Cash rate	end year	2.5	2.5	2.5 – 3.5	3.5 – 4.5
Employment	on year ago	1.6	1.0 – 1.5	1.0 – 2.0	0.5 – 1.5
Unemployment Rate	end year	6.4	6.0 – 6.5	5.5 – 6.0	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, search www.stuff.co.nz
- 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, tramps, and his partner Dr Sarah Farquhar runs the early childhood education network www.childforum.com

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