BNZ Weekly Overview

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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.

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
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Outlook Okayish

We're looking okay here in New Zealand with a strong growth spurt to come from the rebuilding of Christchurch, catch-up house construction in Auckland, rising house prices and increasing investor demand for property, farmers spending some more with assistance from prices pushed up by bad weather overseas, infrastructure spending, and probably a soon to turn migration cycle. But if there is one thing which the past few decades and the last four years in particular have taught us it is that sentiment matters – a lot.

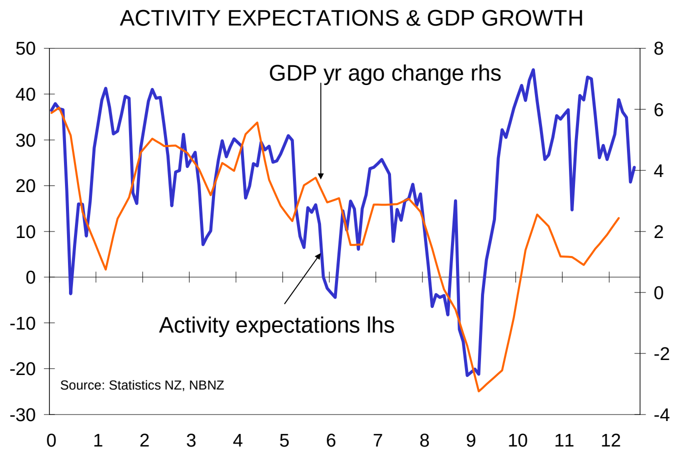
At the moment that sentiment offshore is heading down. The most recent partial indicators released for China and Europe (Germany even) have been weaker than expected, news is coming out of China regarding excessive inventories, and the situation is heating up in the Middle East. The combination of weak global growth yet rising fuel prices cannot be ruled out – especially as it is happening already.

What this means is that although we have some easily defined growth-driving factors in New Zealand it is not guaranteed that these factors will spur the same type of broad-based upturn as we have seen in the past due to businesses generally investing and hiring and consumers spending on the back of seeing things moving in the right direction – and anticipating that things will continue to do that.

I have written before about a disconnection since 2009 between how we feel and what we say we will do, and what we actually end up doing. The graph at the top of the following page shows this. The blue line shows business expectations of whether the economy will be better or worse in a year's time. The orange line is the annual average rate of change in GDP.

The thing to note is that by and large the two variables moved in the same territory between 2000 and early 2009. but since then while sentiment is back to oscillating where it used to the rate of growth in the economy has stayed low. Those people who have based their forecasts or plans upon sentiment measures since 2009 have tended to over-estimate growth in the economy and been left with excess staff, inventories, product lines and a lengthening string of downward revisions to predictions for interest rates, GDP and employment growth etc.

The old economic models no longer work as they used to – or at least the values of key coefficients in predictive or explanatory equations have changed. We can put the reluctance to act in spite of high confidence down to efforts to reduce debt and frequent bursts of worrying developments offshore revolving mainly around the deepening debt crisis in Europe.



So the question then becomes one of whether we can pick when willingness to act on positive sentiment will revert to the old norm. The answer is that we have no hope of picking that timing. That is because one needs to form a view on when the deleveraging process finishes and we have no models in hand which give us good insight into that. One also needs to take a view on when the debt situation in Europe will be felt to be under control. But not even the most senior people in Europe know that and those who have expressed confidence over the past three years about bailout measures solving the problem have been proved wrong over and over again.

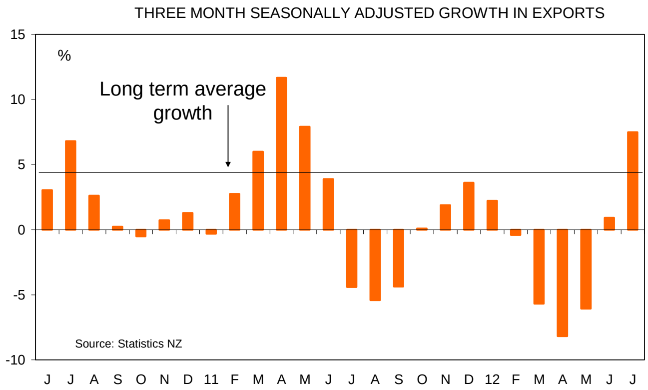
One also needs to take a view on how and when the looming fiscal cliff will be removed in the United States. By that we refer to the 4% of GDP automatic tightening of fiscal policy set to start on January 1 if nothing is agreed between the Republicans and Democrats before then to phase the contractionary measures in over a longer period of time.

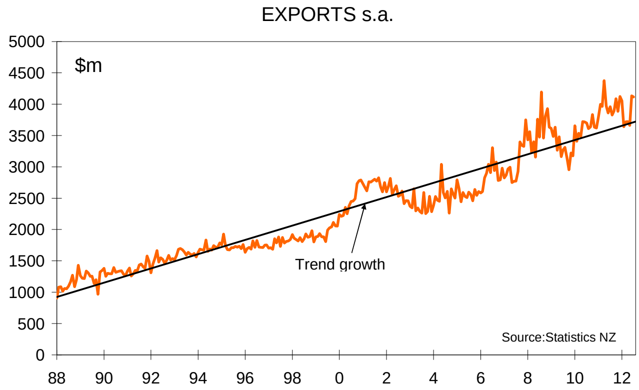
One also needs to take a view on when things will settle down in the Middle East and the threat of sharply higher oil prices goes away. No-one has known that since 1973.

The upshot of that then is that we are going to be experiencing our growth-positive factors in an environment where major uncertainty continues offshore for potentially a high number of years. This uncertainty will tend to keep interest rates low in NZ even as the Christchurch rebuild in particular gets cranking. But as the Reserve Bank warns about inflationary pressures there will be new upward pressure on the NZ dollar – remembering the rule of thumb here that when the RB tightens monetary policy the NZ dollar goes up. That process has not even started yet – therefore to many people holding a long NZD position for the next few years will look like an attractive proposition. Personally I like it. Exporters will need to get used to this situation of a continuing (though volatile as ever) high NZ dollar.

With regard to what we have learnt that is new and worthy of commenting on regarding the NZ economy over the past week we have the following.

In seasonally adjusted terms in July exports fell 0.4% after soaring 13% in June. So on a month to month basis exports go up and down wildly and it is not a good idea to look at just one month – for essentially any variable in our little country. But even averaging over three months still leaves us with some big movements. In the three months to July exports rose 7.5% after falling 8.2% in the three months to April. So lets try averaging over six months. Doing that we see that values have fallen 3.7% after fall 1.1% in the six months ending in January.

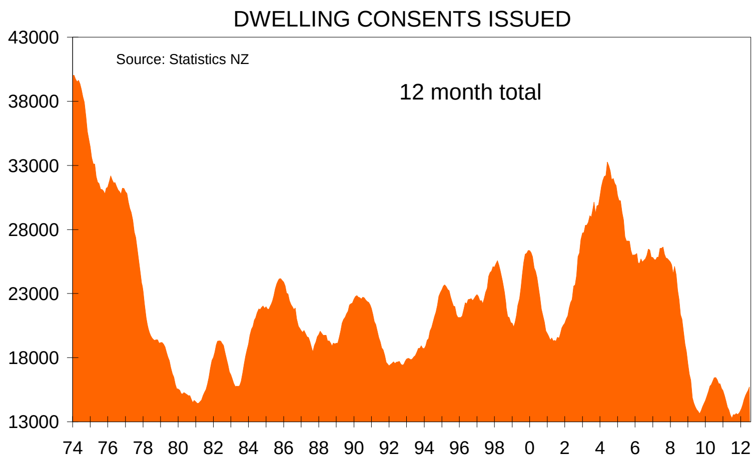




Therefore we feel happy saying that the trend in NZ goods export receipts is flat to down, especially as in this six month period the volume of dairy exports was 12% ahead of a year ago but dairy output would not have jumped by that amount. So recently some of the weakness in exports has been disguised by a stocks rundown.

We also learnt from the merchandise trade release that the value of capital goods imports in the three months to July was ahead 8.1% in seasonally adjusted terms from the three months to April which itself recorded a rise of 0.3%. The trend here is upward and that is a good thing which correlates with accelerating growth in lending to the business sector and is probably partly driven by preparations for the Christchurch rebuild.

Data released today show that dwelling activity is picking up with total consent numbers in the year to July ahead 18.5% from a year earlier, ahead 13.7% in the three months to July from a year ago but still down 2.6% in seasonally adjusted terms in the past three months. That latest number will soon reverse because July s.a. was up 2% following a 5.9% gain in June. Note that compared with a year ago in the three months Auckland consents were up 22% and Canterbury 86%.



Maybe other stuff happened. But I've been in Sydney for most of the week attending a conference on Australia's trade relationship with China and buying up a new stack of books on China which you'll never find in New Zealand. The best book shops in Sydney CBD are Abby's Dymocks, and Kinokuniya.

INTEREST RATES

Worries about growth offshore will keep interest rates down in New Zealand – until those worries ease. We cannot predict when that will happen therefore one cannot predict when fixed interest rates will take a decent jump up. Good luck. As for floating interest rates – they won't be going anywhere for a long, long time in an environment where central bankers overseas are trying to dream up new growth supporting policies and our own central bank will be getting more and more wary of what the NZD is going to do once they start raising the OCR.

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	2.67%	2.70	2.73	2.50	3.12	5.8
3 year swap	2.90%	2.98	3.00	2.75	3.68	6.1
5 year swap	3.22%	3.28	3.28	3.15	4.22	6.3

If I Were a Borrower What Would I Do?

Floating is fine but I'd keep an eye out for a good three year fixed rate. The world is a very uncertain place and a key thing people need to start noting now is this. You are beginning to think that the likes of a floating mortgage rate below 6% is normal in New Zealand. No it is not. You are paying the lowest rates since the 1960s. At some stage (and as I have long highlighted we have no idea when) these rates will bump up. So think about a mixture of fixed and floating and be wary of complacency and risking your home ownership should the world suddenly become a happy colourful place with bouncing bunnies and interest rates rise 3%.

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.**

Cyclical Upturn The Story For The Next three Years

There's nothing new is there? A shortage exists, people are aware of it, young buyers are scrambling to get on the ladder (in Auckland), investors have pricked up their ears and opened their wallets, banks have sensed the rise in demand and are eager to lend, construction is rising but we're going to run out of builders, costs are rising and will rise further, people don't want vast swathes of new land opened up for housing, and all of this when net migration flows have been negative. Imagine what will happen when we get back to net gains over 10,000 per annum.

Oh, and with regard to Auckland in particular there is a lot of construction being financed by Chinese money (they are taking care of business which traditional financiers in New Zealand are to a great extent refraining from still). China including Hong Kong has now become our largest single source of net migration inflow ahead of the UK then India. A recent survey in China shows that of the estimated 500,000 people with financial assets over the equivalent of US$1.5mn 27% have already established houses overseas and another 47% are considering it.

Not only that, I am coming across an increasing number of articles noting rising demand for land for agricultural purposes as well as traditional bolt-holes from one's domestic woes.

MAJOR OFFSHORE ISSUES

Europe

Time passes and meetings approach in Europe and while the waiting goes on the media focus on hints from some important people of a willingness to help Greece then comments from others that the uneconomic liars should be cut adrift. There is a meeting of the ECB Governing Council on September 6 where a proposal to print money will be on the table – more politely described as ECB buying bonds of dodgy governments on the secondary market. Those holding such debt will be salivating at the prospect of unloading their worrisome assets to European taxpayers.

Beyond speculation on whether or not the ECB will buy bonds there are thoughts that Spain may ask for a broader rescue package beyond the €100bn bank bailout facility which has already been made available. The Greeks meanwhile are on a European begging tour hoping that they can convince their Eurozone partners that after lying about their deficit and debt levels, receiving two bailouts already, and failing to keep their promises for the past two years regarding what they would do for the bailout money, that they should be given an extra two years to keep those promises. This sounds like exactly the situation to which one applies the saying regarding not throwing good money after bad. Greece are not fit to be in the Euro (and the Euro as such is a failure) but getting them out if it happens could be amazingly messy.

September 12 however is shaping up as potentially the biggest day of the month with Germany's Constitutional Court scheduled to deliver its ruling on whether Germany can contribute to the proposed new European Stability Facility – the new bailout fund. If they say no then we can expect some fairly severe market ructions.

Then if all this were not worrying enough, there was a good point raised in Monday's International Herald Tribune (the global version of the New York Times) regarding the collective European concept of a united Europe weakening not just because of the debt problems, economic inefficiencies down south, and slipping of the area back into recession, but the loss of mana and power on the global scene. The United States is turning its attention toward Asia, China is rising in the world and scaring the bejeebers out of some because they have never before been a senior player in global politics and have no clearly formulated set of values beyond everyone leaving everyone else alone with regard to internal matters, and Brazil is becoming an important player.

I am building up a set of books for summer reading around the theme of civilizations including Fukuyama's 1992 effort " The End of History and The Last Man". History most definitely has not ended and the challenge for us in New Zealand will be to realise that as the situation develops of a moribund Europe, rising China, Chinese tension with East and South Asian nations and growing American engagement in Asia, we will be drawn into issues in ways we probably cannot conceive of currently. Rather than sitting comfortably in our South Pacific paradise and cutting diplomatic representation overseas we need instead to be building offshore resources not only to make sure our voices are heard offshore but to be sure we are completely aware of what is happening out there, can formulate well thought out positions on how to respond, and can maybe even influence a bit the way the planet evolves over a century which could turn out to be more globally interesting (though less war-like one hopes) than the previous one.

United States

No king hits one way or the other. I could run through bits of data which were good, and bits which were bad but they won't clarify anything. Instead the important thing to note is this. On Friday night the world's central bankers meet for a good ole time in Jackson's Hole (heck, why not Jacksons on the West Coast?) and the US Federal Reserve Chairman Mr Bernanke will give a speech in which he is expected to indicate whether or not the Fed. will initiate some more money printing in a third effort to try and get the economy growing at a faster pace by throwing taxpayers' money at it. It hasn't worked two times already. Thoughts that it might work a third time seem mainly driven by traders hoping for a new burst of asset buying from investors who find the Fed. will have already bought the bonds they were planning to purchase.

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

Note: Although I am studying and now writing a lot about what is happening in China and our relationship with that country, this does not mean that the rest of that grouping we Westerners call Asia is unimportant. In the year to July, of New Zealand's $47bn of goods exports 41% went to Asia and if you add in Australia that rises to 63%. We should add in Australia because 30% of their goods exports alone go to China. What happens in Asia matters to us both via the direct trade and investment routes and via Australia with its more intense linkages. But China is the thing changing as it were as it rebuilds self-respect about its great civilisation and questions naturally are asked about how China's rise will affect us. No-one asks that about Indonesia, Vietnam, Malaysia, Burma, Thailand and so on.

This week for the newspaper column which I have been writing since 1998 I took a look at the American Pivot toward Asia and how it may be necessary given China's continuing narrative of victimhood, strengthening nationalism (as a replacement for Communism maybe), and concerns laid out one imagines quite strongly behind closed doors by other Asian countries inviting the Americans to re-engage in their backyards. You can find the discussion here. http://tonyalexander.co.nz/topics/regular-publications/newspaper-column/

This week we learnt that the unofficial HSBC Purchasing Managers Index for China (which captures more SMEs than the official CLSA index) fell to 47.8 in August from 49.3 in July. A reading below 50 means the sector has shrinking output and that would appear to be the case going by the anecdotal evidence and other indicators in the release showing soaring inventories. Factories have been keeping production up but with orders and sales low stocks are piling up not just for consumer goods and components but raw materials such as coal as well. Coal and iron ore prices have fallen sharply in recent months and continue to do so – hence problems for Solid Energy in New Zealand and cancellation of some mining and infrastructure projects in Australia.

If you are thinking about exporting to China or establishing a presence there then one of the first things you should do is register your trademark – perhaps as soon as you publicly utter a sentence containing your company name and the word China. In China ownership of patents and trademarks accrues to whoever registers first – the "first to file" principle - not who the inventor of a thing was or who or what the trademark might actually refer to. China leads the world in registered trademarks because of this system and because people look to game it by registering a trademark (like squatting on a website name) potentially years before anyone else even hears the name. So that means you should be careful when you read of people saying China is now leading the world in innovation because it issues so many patents. Many of those patents are not for Chinese inventions.

I mention this because of an article in this Tuesday's China Daily entitled "Trademark speculators bet on Olympic Games." Speculating that some promising Chinese athletes might win their events people registered their names years ago planning to sell them if and when they did win and became of sponsorship value to companies who would want to associate their products with the athletes. The example was given of Ye Shiwen, the 16 year old who swam her way to multiple medals. A company in Sichuan Province registered her name in August last year. A health products company registered the same month the name of Sun Yang who went on to win China's first Olympic gold medal in swimming.

This week I have spent some time in Sydney attending the Australian China Business Week conference and will write up what I learnt for my September Growing With China issue which will come out on the 20th.

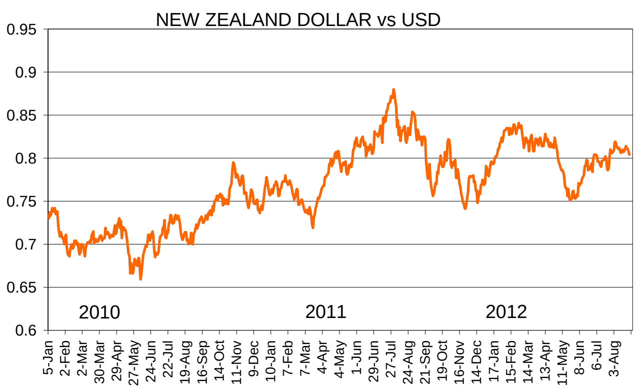
Exchange Rates

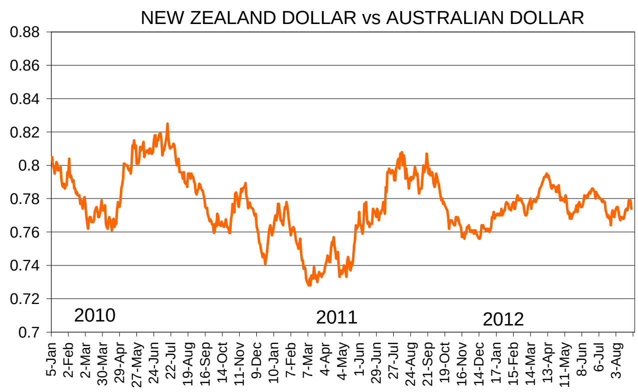
Exchange Rates	This Week	Week ago	4 wks ago	3 Mths ago	Yr ago	10 yr average
NZD/USD	0.804	0.814	0.810	0.761	0.838	0.67
NZD/AUD	0.774	0.774	0.773	0.772	0.792	0.85
NZD/JPY	63.100	64.000	63.500	60.500	64.4	69.6
NZD/GBP	0.508	0.513	0.514	0.485	0.512	0.388
NZD/EUR	0.640	0.650	0.658	0.607	0.578	0.52
NZDCNY	5.107	5.171	5.168	4.826	5.353	4.99
USD/JPY	78.483	78.624	78.395	79.501	76.850	105.7
USD/GBP	1.583	1.587	1.576	1.569	1.637	1.72
USD/EUR	1.256	1.252	1.231	1.254	1.450	1.28
AUD/USD	1.04	1.05	1.05	0.99	1.06	0.788
USD/RMB	6.3515	6.3529	6.3806	6.342	6.3875	7.56

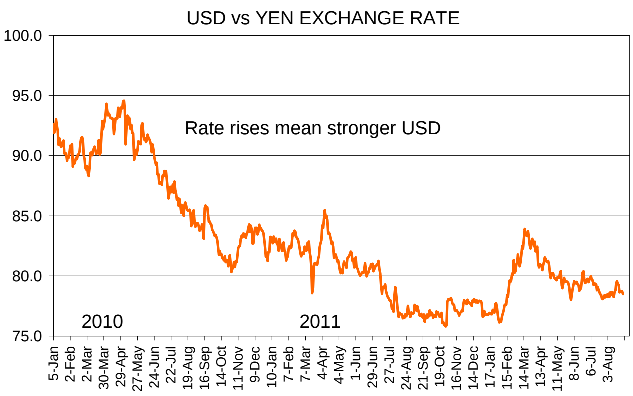
Time Passes Slowly

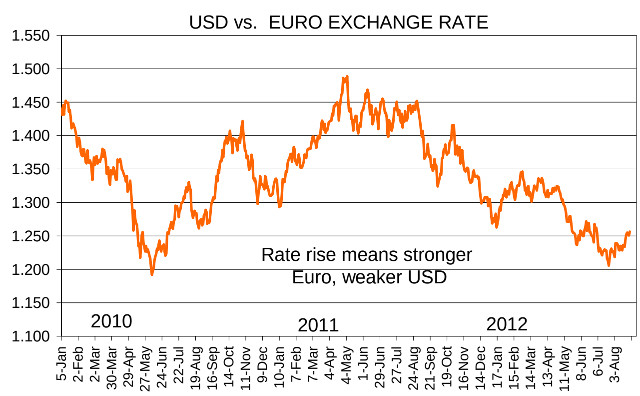
With people around the planet waiting to see what comes out of the mouth of Mr Bernanke on Friday night and various meetings in Europe over September there has been practically no movement in the major currencies over the past week. The NZD has crept a tad lower however with mild selling in response to worries about falling coal and iron ore prices taking the AUD lower and us riding its coat-tails, plus nothing spectacular on the data front here in NZ.

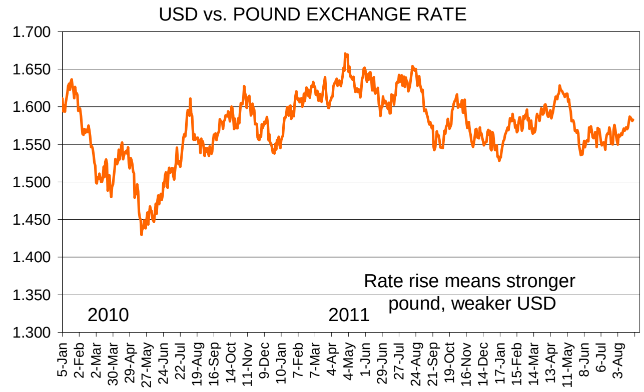
In the coming weeks there are many events offshore which could easily move the big currencies around so don't be surprised if in a month's time we are sitting at 77 or 85. Both rates seem possible at this stage.











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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