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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Things To Worry About

If you were to ask me what are the things happening in New Zealand about which I worry I would have a long list which would include but not be limited to the following things.

Housing Crisis
Standards for building our houses are so high we are shutting out a large swathe of our society at the low end of the socio-economic spectrum from establishing a stable home environment. In addition we existing home owners like it that our councils do not open up large tracts of new land, do not permit large scale infill housing, and soak developers with lots of levies rather than pushing our rates up even higher. As house prices rise in the next few years but construction fails to keep up the well identified link between poor home environment and poor education outcomes will produce an increasing split in society. What we need are easily implement able ideas on how to address this crisis before it gets fully going, including cheaper house construction.

Overvalued NZ Dollar
The high NZ dollar is one factor contributing to the failure of our exporting sector to grow as a proportion of GDP by much in the past four decades. Options for getting the NZD down however are very limited. Cutting interest rates is pointless as that will just encourage a new consumer borrowing boom and worsen the housing affordability problem as investors seeking yield flood into property. A system of tax levies on all offshore investors in NZ debt could be tried.

Poor Household Savings
The sheer unwillingness of us Kiwis to forsake consumption and save not only means that interest rates are higher than they would otherwise be, it also means our capital markets are less deep and that there are fewer of us embracing a culture of backing budding entrepreneurs and established companies as we seek to actively grow our wealth over a long period of time. That lack of a long term wealth focus is probably an underlying cause of our determination not to save. But changing it would require weakening our welfare state, and the state provision of health, education, and retirement funding. In countries where such provisions are low savings rates tend to be high. But are we willing to see the decimation of these cherished Kiwi cultural elements in the interests of fostering greater NZ ownership of our assets and entrepreneurship? Probably not. Note that interest rate incentives don't work, and compulsory superannuation while always sought by fund managers who earn fees managing assets could merely see us paying off our mortgages at a slower pace while running more debt generally heading into retirement.

There is a lot more one could write here but time is short today so that's it for now.

INTEREST RATES

The Federal Reserve has said that it intends keeping its interest rates at "exceptionally low levels" until mid-2015. That will tend to have a suppressing effect on our interest rates as well if through no other link than the NZ dollar which will sit at higher levels on average than if the Fed had said things are great and we're going to raise rates soon. Unsurprisingly this week NZ wholesale interest rates have barely moved.

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	2.64%	2.67	2.69	2.76	3.02	5.8
3 year swap	2.94%	2.93	2.92	3.01	3.46	6.1
5 year swap	3.27%	3.24	3.28	3.36	3.91	6.3

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.**

Some Auckland Analysis

Auckland's housing market is booming according to the TVNZ news on Sunday night. News items like this will raise even further the awareness of the housing shortage in Auckland which I warned in late-2008 would limit the extent of house price falls. Now that interest rates look set to stay low for longer than anyone was sanely expecting more and more investors are going to be joining up the large dots and moving into property investment. This investment surge will focus naturally first of all on lower priced houses in Auckland, then more and more on relatively expensive ones in favoured suburbs with people wiling to gear themselves into places over $1 million in expectation that 1 – 3 years down the track they will be able to flick it on for a tidy profit.

Investors will also become more active in other parts of the country as will developers more generally looking to meet the rising demand from the investors, the first home buyers, and people just generally looking to change their circumstances.

The monthly survey which I conduct with REINZ looks at things largely from a nationwide perspective but one can also break the responses down by region to analyse the main eight questions regarding whether there are more first home buyers etc. These results for Auckland compared with the country as a whole are as follows.

	# of Responses	. # of people through Open Homes	% of Written Sales Unconditional	Auction Clearance rate	Requests for Appraisals	Investors buying	First home buyers	Prices	Buyers more motivated?
Auckland	142	39.4	43.0	44.0	20.4	35.9	47.9	73.2	54.2
All	429	36.6	35.0	31.6	24.7	24.7	38.7	40.8	18.4

Each number shows the net proportion of responding agents reporting affirmative to each question. Therefore a net 39.4% of agents in Auckland report that they are seeing more people through Open Homes than a month ago which is in line with the NZ-wide result. But a higher than average proportion are seeing auction clearance rates rising, a lot more see first home buyers and investors in the market, and many more see prices as rising rather than falling in Auckland and feel that buyers are much more motivated than sellers.

Compare those results with those for Wellington.

	# of Responses	. # of people through Open Homes	% of Written Sales Unconditional	Auction Clearance rate	Requests for Appraisals	Investors buying	First home buyers	Prices	Buyers more motivated?
Auckland	142	39.4	43.0	44.0	20.4	35.9	47.9	73.2	54.2
Wellington	38	28.9	28.9	39.1	28.9	23.7	42.1	31.6	10.5
All	429	36.6	35.0	31.6	24.7	24.7	38.7	40.8	18.4

In the monthly survey release I do not break the results of the other four questions down by region but have undertaken that exercise as a one-off this month for Auckland.

What are the main factors holding buyers back?

If buyers are holding back or frustrated in their buying efforts then in Auckland it is far more likely to be because they cannot find what they want than in the whole of the country. Auckland has an intense listings shortage.

	NZ-wide %	Auckland %
They feel prices will decline	13.8	14.4
Worries about securing finance	17.9	13.0
Not confident they can sell their house	16.1	8.9
Poor quality of listings	52.2	63.7

What are the main reasons people are buying?

When it comes to the reasons people are buying, agents in Auckland report results which are not hugely different from the NZ-wide outcomes apart from maybe more people arriving from overseas, fewer coming into Auckland from elsewhere in NZ, a few more people fearful of missing out, and more people buying for reasons of schooling.

	NZ-Wide %	Auckland %
Fear of missing out/Feel time is right for prices	10.2	13.7
Trading up	10.6	10.2
Trading down	10.9	10.2
Shifting into town	12.2	7.2
Arriving from overseas	4.4	6.6
Relationship breakdown	8.7	6.1
Commuting costs	1.3	1.4
Schooling	6.8	10.5
Want closer proximity to shops	1.3	1.2
Want closer proximity to relatives	2.1	2.7
Want closer proximity to health care services	1.4	0.8
Investing	0.3	0.0
First home	14.9	13.7
Earthquake	0.3	0.0
Good interest rates	14.4	15.6

What are the main reasons Written Sales fail to go unconditional?

There is a greater tendency in Auckland for sales to be completed because buyers have been put off by a negative Builders report than in the rest of the country.

	NZ-wide %	Auckland %
Finance	31.2	28.6
LIM report	6.1	4.4
Builders report	57.8	65.9
Earthquake/insurance	3.9	0.0
Can't sell own house	1.0	1.1

What are the main factors motivating vendors to sell?

With regard to why people are selling, in Auckland fewer people cite leaving town than the rest of the country, a few more cite schooling, and a few more cite retirement. But the results are not much different from the averages for the country as a whole.

	NZ-wide %	Auckland %
They think prices are going to fall	1.7	2.8
Need the money	13.4	11.3
Trading up	11.8	13.2
Trading down	15.4	16.9
Leaving town	13.3	10.1
Leaving the country	6.6	7.4
Relationship breakdown	13.6	12.9
Commuting costs	0.8	1.4
Schooling	2.8	4.6
Want closer proximity to shops	1.1	0.2
Want closer proximity to relatives	1.6	1.2
Want closer proximity to health care services	1.3	1.1
Earthquake	0.1	0.0
Bank request, job loss	0.0	0.0
Retirement	10.2	12.2
Estate sales	6.1	4.6

If I Were A Borrower What Would I Do?

These are extremely uncertain times we live in so I do not fall into the camp of those who believe it is “safe” to have all of one’s mortgage sitting at a floating rate simply because the chances are that rates will not rise until 2014. Basing one’s interest rate risk management strategy on forecasts of interest rates is not as dangerous as basing one’s FX hedging strategy on exchange rate forecasts – which is plain silly – but it is inadvisable. That is because predictions of interest rates have changed more in the past four years than I have ever seen before. Borrowers should not take heart from the fact that the changes in forecasts have been downward. Between 2004 through 2007 those changes were upward.

At the moment I am presented with the option of floating at 5.74%, fixing one year at 5.25%, fixing two years at 5.4%, three years at 5.9%, or four years at 6.2%. Do I think it highly probable that the Reserve Bank will cut interest rates more than 0.5% very soon and that therefore the floating rate drops to near 5.25%? Not by any stretch of the imagination. Therefore my starting point is that I fix one year at 5.25%. In a year’s time what are the chances that fixed rates will have jumped up therefore I should now fix at least two years to avoid paying a lot a year from now?

Frankly the chances do not look high that rates will soar, but uncertainty is high and what if things start trending toward the better in Europe and the US in spite of the bumps which will still come along the way? In that case fixed rates might jump a bit. Therefore, is paying an extra 0.15% too great a cost for getting greater certainty than fixing one year and making another decision in 12 months? No it isn't. So I would therefore fix two years at 5.4% as the rate is nice and cheap.

But the chances of things turning for the better globally within two years are a lot higher than within one year, therefore the chances of fixed rates being appreciably higher than they are now within 24 months are strong. So I could face paying a lot more for my next interest rate in two years than the 5.4% I would lock in today. So does that mean I would be better off paying an extra 0.5% and fixing three years at 5.9%? In my opinion the answer to that question is no. That premium cost is too high. If the extra cost were only 0.25% then I would take it.

Therefore at the moment, if I were a borrower I would fix two years at 5.4% for most of my mortgage, but maybe leave some floating because of the enhanced ability that gives me to make early repayments if I should be in a position to do so.

MAJOR OFFSHORE ISSUES

Europe

The important development in Europe this past week (following last week's ECB bond buying announcement and German okay for the bailout fund) was the re-election of the Prime Minister in the Netherlands with extremist parties advocating less Europe suffering losses. This is an important development not just because it keeps in place an ally of France and Germany in their efforts to hold the euro together, but because it suggests there might also be some pulling back from the political brinks in other European countries.

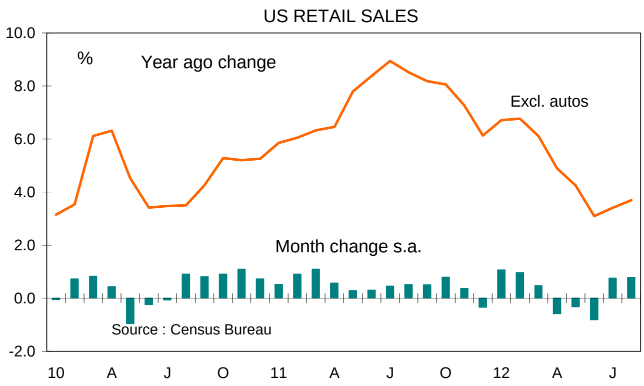
Having said that however the Netherlands is not suffering massive fiscal restraint and economic shrinkage as some other countries are so one should not blindly extrapolate the result to the rest of Europe. In fact in Greece unrest is growing and the troika of the IMF, ECB, and European Commission has told Greece that some €4bn of the proposed spending cuts in its €11bn package are unlikely to be delivered so new cuts must be found. Support for the far right Golden Dawn Party in Greece is growing anew and the far left appears also to be winning favour with the populace amidst an increasing incidence of strikes with a general strike planned for September 26.

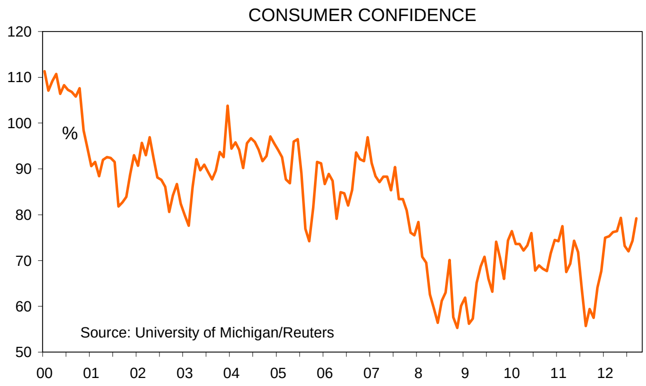
For the moment the glass half full scenario dominates. Experience of the past three years tell us that this situation will not last.

United States

The Federal Reserve last Thursday night eased US monetary policy again with the announcement of its intention to buy US$40bn worth of mortgage backed securities each month and a promise to leave its interest rates at current very low levels until mid-2015. That latter promise was previously set at late-2014 and therefore places some extra downward pressure on short-term interest rates wit the aim of stimulating growth. But worries about inflation further out are now starting to creep in and that is why in spite of the announcement the likes of the 30 year Treasury bond yield rose to 1.8% from 1.67%.

Retail sales excluding the volatile automobiles component rose by a firm 0.8% for the second month in a row in August. This result marks quite a turnaround from the three falls in a row recorded over April – June and gives hope that in spite of a weak labour market willingness to spend in the US may be picking up. In fact the monthly University of Michigan consumer sentiment reading rose more than expected in September to 79.2 from 74.3 in August.





China

You can find my China page on Facebook at http://www.facebook.com/TonyAlexanderNZ I have set up this page specifically for discussing the NZ-China relationship and as a tool for disseminating information and furthering my own still inadequate knowledge.

Here is a link to my monthly article written for the NZ China Trade Association.
http://www.nzcta.co.nz/chinanow-general/1527/chinese-government-designates-special-emerging-industries-for-growth/

This morning I published the September issue of **Growing With China** available at
http://tonyalexander.co.nz/wp-content/uploads/2012/09/GWC-September-2012.pdf

Some specific sections of the GWC split off into their own pdfs are as follows.

Late last month I attended the **Australia China Business Week** conference in Sydney where a variety of people spoke about operating in and with China. Here are the key points which I picked up.
http://tonyalexander.co.nz/wp-content/uploads/2012/09/AustChina-Bus-Week.pdf

Increasing evidence is building of a firm slowing in China's rate of **economic growth**, seen not just in the usual monthly indicators but also much anecdotal commentary.
http://tonyalexander.co.nz/wp-content/uploads/2012/09/Economy.pdf

Ian McInnes of Sino Investments Ltd writes of the importance of green technology and invites those interested in this area which is receiving increasing attention in already heavily polluted China to read the report for insights into how Kiwi companies might be able to play a profitable role.
http://tonyalexander.co.nz/wp-content/uploads/2012/09/Greentech.pdf

This month **Pat English, Trade Commissioner, Guangzhou**, writes abut the professionalism NZ firms need to take with them when they go to China.
http://tonyalexander.co.nz/wp-content/uploads/2012/09/Opening-Doors-To-China.pdf

The experience of **Pacific Helmets** in selling into China.
http://tonyalexander.co.nz/wp-content/uploads/2012/09/Selling-Helmets-to-China.pdf

Kererua Savage writes about his experiences from visiting China visit as part of his **Victoria University MBA**
http://tonyalexander.co.nz/wp-content/uploads/2012/09/Victoria-MBA.pdf

On August 24 I attended a **Wellington China Business Network** breakfast where there were two speakers - William Summerville from Whittakers Chocolates and Ian Douglas from the Village Goldsmith.
http://tonyalexander.co.nz/wp-content/uploads/2012/09/WgtChinaBusinessNetwork.pdf

Exchange Rates

Exchange Rates	This Week	Week ago	4 wks ago	3 Mths ago	Yr ago	10 yr average
NZD/USD	0.828	0.821	0.807	0.798	0.825	0.67
NZD/AUD	0.792	0.784	0.773	0.783	0.807	0.85
NZD/JPY	64.700	63.900	64.200	63.000	63.2	69.6
NZD/GBP	0.510	0.510	0.514	0.507	0.525	0.388
NZD/EUR	0.635	0.636	0.653	0.629	0.603	0.52
NZDCNY	5.225	5.195	5.132	5.072	5.269	4.99
USD/JPY	78.140	77.832	79.554	78.947	76.606	105.7
USD/GBP	1.624	1.610	1.570	1.574	1.571	1.72
USD/EUR	1.304	1.291	1.236	1.269	1.368	1.28
AUD/USD	1.05	1.05	1.04	1.02	1.02	0.788
USD/RMB	6.3108	6.3275	6.3596	6.3557	6.3864	7.56

Kiwi Boosted By Fed Money Printing

The Kiwi dollar is going to rise further against the greenback. Why can one be so confident in such a forecast? Because the US Federal Reserve has promised not just to keep interest rates at exceptionally low levels until the middle of 2015, but because they will print some $40bn of money each month by buying mortgage backed securities with the aim of keeping mortgage interest rates down.

The printing of money dynamic comes about because those who held the MBSs now find themselves with cash and they and others who were planning to buy their MBSs will be looking for somewhere to invest that money. That means funds going into assets like shares, commodities, and especially foreign currencies. The Fed. have essentially adopted a 1930s-like “beggar-thy-neighbour” exchange rate policy which while boosting the export competitiveness of US companies will cause problems in other countries. We are one of those countries.

As the greenback weakens we are one of the currencies against which it will be going down. This process will be encouraged by the strong commitment to producing growth enunciated by the Fed. bringing optimism that it is now safer to invest in risky, volatile, far flung assets such as peripheral currencies. But not only that, our NZ dollar is the currency of a country which produces primarily commodities for exports and those commodity prices will benefit from cash-burdened investors looking for somewhere to place their funds – hence there is more than just worries about drought causing our dairy export prices to rise 21% in the past couple of months.

Higher commodity prices mean higher commodity currencies.

Therefore, unless we see a dramatic falling over of the US or EU economies, or the appearance of strong growth which would lead to the Fed. reversing its money printing, we are highly likely to see the NZD going upward – though in the usual volatile fashion.

There is nothing we can do about this short of placing a special tax on foreign investors in New Zealand securities like government bonds, bank securities, term deposits etc. That is not highly likely. Intervening by the Reserve Bank selling the NZ dollar was proven not to work in 2007. Cutting interest rates would have little impact given that the NZD is being driven higher not on the basis of interest rate differentials but simple weight of cash (heck, isn’t that what the 2000s were about?) and commodity prices.

Plus, were NZ interest rats to be cut the movement of funds into housing investment would multiply and we would embark upon a completely unsustainable and ultimately destructive house price cycle. There will be enough upward pressure on house prices from the worsening shortage and catch-up buying after four years of many people believing forecasts that our house prices would collapse. Now it is easy to see how wrong those forecasts were.

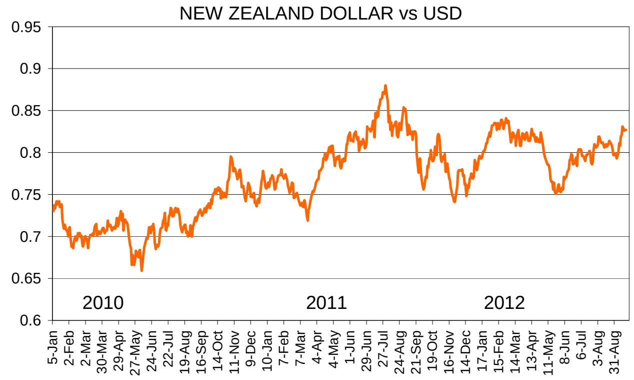
Where will this end? How high will the NZD go? That is impossible to say because it is not underlying economic fundamentals driving our currency but an asset binge. The past two decades show that it is not possible to accurately predict asset cycle peaks either in terms of timing or level. The best we can do is suggest that the NZD will be well underpinned with an upward bias until the Fed. signals that its era of extraordinary money printing has come to an end. No-one knows when that will be.

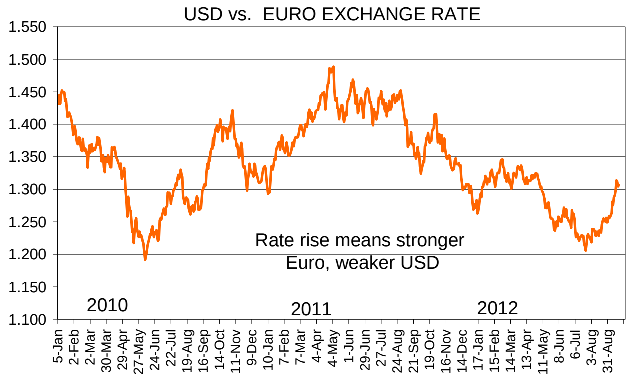
Speaking of which, The Australian newspaper of Wednesday this week ran a good article put together by a panel of high placed US economic administrators containing the following interesting pieces of data.

- The US Treasury has shifted so much of its debt to short-term securities in order to save servicing costs that each year when the deficit of just over $1tn is added in it must raise/renew $4tn.
- The Federal Reserve finances three quarters of the deficit through purchasing securities/printing money.
- Foreign governments purchase most of the rest of the debt.
- The Fed. now owns 1/6 of US government debt.
- Banks in the United States are so awash with cash they do not want to lend, as a result of this money printing they have on deposit with the Fed. near $1.5tn compared with $8bn in 2008 – yes those suffixes are trillion then billion.
- The decimation of wealth for many in the United States continues with inflation just over 1.5% and bank deposit rates lower than that thus delivering negative real returns (and minimal nominal returns) for US savers.

http://www.theaustralian.com.au/opinion/world-commentary/unhappy-facts-about-the-united-states/story-e6frg6ux-1226476777882

Looking back again at the NZD's movements this week. It started a week ago near US 82.1 cents and is now just below 83 cents. Upward pressure has come from the weakening of the greenback against which the Euro now sits near a four and a half month high.





The Kiwi dollar might at a stretch also have received some minor support from yesterday's balance of payments data which showed the current account deficit at 4.9% of GDP rather than the expected 5.4%. This level is about equal to the average over the past two decades but up from 3.8% a year ago and headed higher as construction activity will boost imports in the coming three years while the high NZD suppresses export growth. We have been here before and there is a long way to go yet because the RBNZ has not even started tightening monetary policy.

There was only a mild upward movement earlier today when the June quarter rate of growth in GDP turned out to be 0.6% rather than the 0.3% which had been expected in the markets.

As noted, I remain quite happy to leave my money sitting in NZDs earning a low risk return far superior to returns from bank deposits in other parts of the world.

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 – 2.75	2.75 – 425
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 27,000 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
- Discussion of New Zealand's relationship with China can be found here. www.facebook.com/TonyAlexanderNZ

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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