Weekly Overview Cutout

11 October 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.

This commentary is written by Tony Alexander. The views expressed are my own and do not purport to represent the views of the BNZ. There is no emailing list for this particular publication which is part of the Weekly Overview.

The Europe Situation

Europe

Things are still getting worse in Europe and that means there is no reason yet for being optimistic about world growth but plenty of cause for being concerned about dairy prices next year should this year's drought not be repeated.

In Greece the Prime Minister is warning that the country might end up like Germany – except the bad Germany which came from reparations pressure on the Weimar Republic and not the modern efficient version. In Portugal the PM says that more time is needed to enact reforms (which is what the Greeks want), while in Spain the PM remains committed to not asking for an official bailout while the ECB President sits ready with a set of rules to be imposed and list of bonds to buy should Spain relent, bow its head and ask for help.

Greece's economy shrank by 7.1% last year and is likely to decline by a further 6.5% this year. This shrinkage of course undermines the already extremely inefficient tax base in Greece (buy anything in the country and the shopkeeper asks for cash – GST seems to be the answer there), and means achieving the official goal of a government debt to GDP ratio of 120% in 2020 looks practically impossible. There has been more rioting in the streets this week, partly associated with a quick visit by the German Prime Minister, with protestors demanding that the Germans and other people who save money keep lending them their cash without asking that it be paid back while parading in Nazi uniform denouncing the Fourth Reich. As I've said and many others have also noted previously, Greece is not fit to be in the Euro-zone and it is questionable whether it should even be in the European Union. Cyprus falls into the same camp with the seemingly anti-EU PM now begging for money from the EU and IMF now that the Russians have cut his debt lifeline.

In fact there is increasing concern in the wealthier EU countries including the UK that the inefficient, corrupt tax dodgers in southern European countries view the EU essentially as a welfare mechanism for redistributing money from those who earn it to those who can't be bothered paying their own way.

The best thing for all would be if these countries were allowed to leave the Euro – or simply kicked out. Unfortunately that would lead to immediate potentially depression-causing large losses for many northern investors rather than the slow conversion of their private sector debts to taxpayer funded write-offs being undertaken via the various bailout schemes and now the increased buying of bonds by the European Central Bank. Debt in the EU is being mutualised by default and it is the northern savers who will in one way or the other pay for the ultimately societal inadequacies of their southern members.

In the UK it looks like the government will need to maintain a tight fiscal policy stance with spending cutbacks until 2018 given lower than expected growth and higher than forecasts deficits – which is fairly much the sort of comment one must make for a lot of other countries in the EU as well. Growth is less than hoped for, deficits bigger, and with investors wary of increasing their exposure to more and more government debt we get central banks having to step into their place by printing money and that money starting to create speculative booms in various asset markets.

What this means, and one of the key themes I am trying to get across in my commentary, is that we are not just talking about weakness in European economies with tight fiscal policy for a long time leading to rising social tensions which could have very unpredictable outcomes. We are also talking about money printing by the BOE, ECB, and US Federal Reserve causing money to seek places to sit where returns will be better than the lowly yields offered by government bonds.

Hence we get a new examination of the merits of gold, commentary in UK newspapers regarding the need for personal investors to shake off some of their risk aversion and buy equities, and the buying of commodity futures and risky currencies like the NZ and Australian dollars. History shows it is impossible to forecast the path of asset bubbles be they in housing, shares, currencies, tulip bulbs or whatever. What that means is not that you avoid such markets. It means you go into them with your eyes wide open to the possibility that before you engage your exit strategy (you do always buy an asset with one in mind don't you?) you may be caught out by unpredictable events triggering a sell-off, or simple a bout of the heeby geebies running through the collective market consciousness.

For myself I am explicitly sitting out asset markets knowing that I am not maximising my return. That is because I do not need to asymptotically keep seeking extra risk to get an extra 1%, I do not understand fully the factors driving some markets upward, I cannot forecast how those markets will move, and vulnerability of the world economy to new shock like we have seen every decade in recent times is extremely high.

United States

Did you know that the deleveraging process in the United States has so far reduced the household debt to income ratio from 134% in 2007 to 113% in the middle of this year? New Zealand's ratio has only fallen from near 154% to 143%. With our debt growth now at 2.1% this ratio will soon be rising again. As we've said so many times before (though not recently) in New Zealand we do not feel the pain which people are experiencing overseas. We went through the wringer in the 1980s and emerged with vast changes in fiscal management, economic efficiency, and banking practices. These changes meant we entered and exited the GFC in good shape – except when it comes to a record of productivity growth, diversification of exports and growth in exports as a proportion of GDP, and household balance sheets.

This latter problem is not a binding constraint as long as investors are willing to keep lending to banks to fund the excessive spending of Kiwis who cannot really afford the standard of living which we borrow to give ourselves. One day the rug will be pulled out from under us but it is impossible to know when.

There was some good news in the United States this week in the form of the September jobs report which showed employment up by a largely expected 114,000 in the month but the unemployment rate falling to a much lower than expected 7.8% from 8.1%. the trouble with this result however is that it suggests even more people are becoming so despondent about finding a job that they are leaving the workforce. So although the result was interpreted positively in the financial markets and in the media for President Obama, it leaves the Federal Reserve Chairman Ben Bernanke still in a position where he will continue his plan to buy up to US$40bn of mortgage backed securities each month in order to attack unemployment (while he can get away with it as inflation is low – he'd have a problem with his apparent shift in the target of monetary policy were inflation to rise to 3%).

There have been a few hints given by senior Republican people recently that should President Obama be re-elected in four weeks time that the Republicans will pull back from their position that there should be no tax increases for people earning over US$250,000 per annum. If that is the case then the chances of fiscal Armageddon involving a 4% fiscal contraction from the start of 2013 have declined and that is a positive thing.

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. Not that you'll find too much new there at the moment as I cannot find any time to update it while over here with family and doing work.

My monthly column written for the NZ China Trade Association can be found here.
http://www.nzcta.co.nz/chinanow-commentary/1531/china-slowing-but-nz-export-growth-continues-apace/

This article cut out of the BNZ Weekly Overview is written by Tony Alexander, Chief Economist at the Bank of New Zealand and is one of a range of releases including the following.

- Weekly Overview sent directly each Thursday night to 27,000 people http://tonyalexander.co.nz/topics/regular-publications/bnz-weekly-overview/
- 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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