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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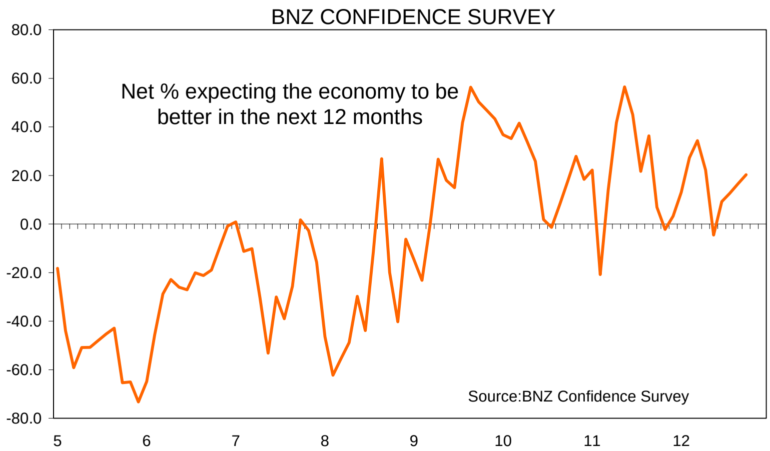
Business Confidence Up Slightly

Our now eight year long monthly Confidence Survey this week revealed a lift in sentiment about where the economy will be in a year's time for the fourth month in a row. A net 20% of respondents feel confident about the economy compared with 17% a month ago and a net 5% who were feeling pessimistic back in June. A quick glance at the graph shows that this four month upward movement is not unusual and cannot be interpreted as reason for lifting one's growth forecasts by any appreciable degree in the near future. But the direction of change is important in that it signals to us that in spite of the high NZ dollar bringing pain for those manufacturers who's business models rely substantially on price rather than innovation and what they teach you at Harvard Business School, the NZ economy is not in bad shape.

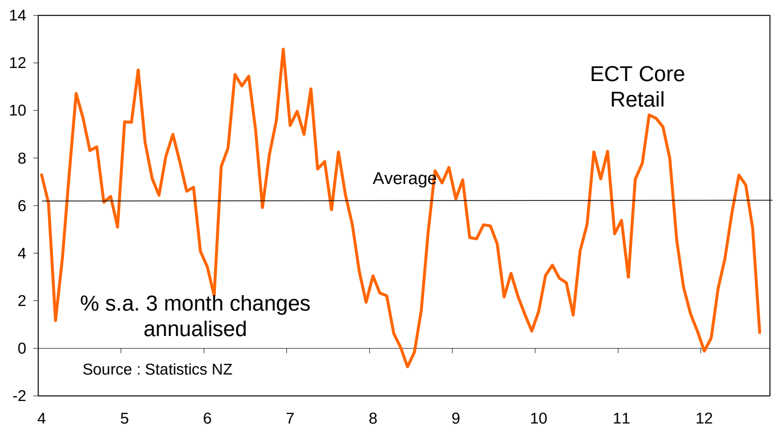


My other survey from last week regarding whether to change the frequency of the Weekly Overview led to a gross 54% favouring retaining output weekly, 39% fortnightly, and just 7% monthly. Many people noted it would be perfectly acceptable to write that there is nothing much happening and produce just a slim edition if warranted. Therefore what I shall do is keep the weekly format but have no hesitation to state in the introduction that content is near zero either because nothing much happened, none of the underlying trends have altered, or I have been too busy with my other publications and/or travelling for talks around the country – and now and then offshore. There was however extremely positive feedback regarding writings and observations about economic, recreational, and social conditions when offshore so I shall include more such things this issue as I am still in London.

But first some things on the economic side.

Apart from our survey showing rising business confidence, we also learnt from the REINZ that dwellings are selling at a faster than average pace but price gains are still occurring at a measured pace. It will be interesting to see if that latter dynamic continues next year when more retiring people look to earn yields higher than those offered in bank term deposits and start flocking to the residential property investment companies which appear to be springing up again.

The monthly Electronic Card Transactions data from Statistics NZ showed that core retail spending fell by a rather large 0.9% in September. However this monthly measure is quite volatile and it is best to smooth over three month periods. Doing that we see that core retail spending in nominal seasonally adjusted terms has grown only 0.2% in the September quarter from 1.8% in the June quarter and 0.6% in the March quarter.



So some unusually firm retail spending growth has now ended and this latest weak result while probably over-emphasising the restraint which is out there is more in accord with the feedback we have been getting from those in the retailing sector.

For instance from our latest Confidence Survey we have these comments relevant to retailing.

- Pharmacy - only average in retail. Some hopeful days but still some shockers.
- Retail giftware. Margins very tight. Customers wanting product within very limited $ value. We are regionally based but also sell on line which has been our saving grace. Hopefully longer days and better weather will see more potential customers out and about
- Retail Flooring - Tauranga. Business is fairly brisk - lots of enquiry, a good ratio of confirmations.

Some Offshore Observations

I forgot to mention last week that in Paris the beggars don't just confine themselves to the streets. They also roam the train platforms and the trains themselves. Some simply ask for money while you are sitting in your seat, others walk past handing out a small note to each person detailing their circumstances. They then return a few minutes later gathering up the notes and clearly hoping that having read their story someone will feel inclined to donate some money.

On the trains there are also frequently musicians who will play their instruments then after three or so stops will go around shaking their tin for money.

In the UK the television system shows starkly how appallingly behind the times we are with our stone age internet. There are a number of TV programme companies like our Sky offering their services including the ability to access any programme on demand which they have shown in the previous seven days, and being able to search online and have made available for instant viewing any programme containing the key word which you enter – such as Kung Fu according to the advertisement which I saw. It looks like the programmes are sent on demand and not stored on one's black box and for that one needs good internet which we do not have. The building we are staying in at Millharbour beside Canary Wharf is in the process of upgrading to 1GB – vastly superior to the 10MB we are aiming for with the National Broadband rollout.

Seriously – how can we hope to attract people wishing to live a modern life in a more relaxed environment while they ply their services over telecommunications networks if the best they can hope for is 10MB – if there are few other people are on the network at the same time? Like insulation in our houses we are a country which does not offer the modernity which skilled highly mobile people overseas are demanding. It is almost like we require that they step back in time if wishing to settle in NZ.

I prefer staying in apartments to staying in hotels because you get much better bang for your buck. But attention to detail can be lacking and things can seem a bit strange. For instance in the apartment we are in one of the cushion covers was held in place not by stitches or even staples – but large pins! The curtains are draw cord-driven blinds in four vertical sections which keep hardly any light out so if you are not used to sleeping with a streetlight beaming through your window you'll need nightshades. My wife woke up at 5.00am and seeing the light shining through got changed into her running gear, had a cup of tea and was about to set out when she chanced to pull aside a blind and saw that it was still pitch black outside. So she went back to bed – without waking me thank goodness.

There is heating at certain times of year but no cooling – in other words no air conditioning. In fact the extraction fans in the two bathrooms and the kitchen do not even work. The doors have an automatic closing spring loaded which means they slam when closing and to keep them open to allow air to circulate you need to wedge a shoe in the opening.

The apartment has windows which open by leaning back at the top – which is fine for windows, but the doors opening to the balconies do it as well. So when one of the children turned the large latch and the top of the large glass door started falling towards him we thought he was about to be crushed to death. But it stopped of course and after much head scratching we realised that by pushing the door back in and turning the handle the other way it became a door. Culture shock. Its funny in hindsight, embarrassing at the time.

On Sunday night we had a good dinner at one of the oldest pubs in London – the Crooked Billet at Wimbledon. The area used to be frequented by highwaymen and one was hanged nearby. The pub like so many others is warm, welcoming, relaxed, with children and dogs allowed to roam freely and good food on the menu for those wanting to eat. In summer people take their drinks and food across the small road to a grassy paddock and eat and drink there.

We went to visit Greenwich Village which is just a few stops down the Docklands Light Rail line (no, I don't think Wellington or Christchurch should waste money on a light rail system) and it is worth a visit. There is the wonderful Maritime Museum to wander through, the Observatory, nice parks, the village itself, and a great market with interesting stalls and ethnic food able to be perused and consumed respectively in a far less bustling atmosphere than you will find at Covent Gardens. We went there as well on a Saturday and it is a madhouse though well worth spending time at for the various forms of entertainment. Don't use the Underground there as it can only be entered using a couple of large lifts and you can only get out using either the same lifts or waking up untold stairs.

At Greenwich we also visited the restored (yet again) Cutty Sark tea and wool clipper which is quite good. The kids are fascinated by the squirrels which seem to be in most parks and keep asking about whether we can take one home. I explain about what the possums have done to our forests, plus the devastation of the bunnies, the deer, pigs, and so on.

D1 had her birthday on the Saturday and said she wanted to have clothes bought for her at Primark on Oxford Street. I knew what to expect and despite warning her that it would be better to go on a day other than the late afternoon of a Saturday she insisted. So we went. As we entered the store I gathered everyone for a briefing on what to do if they got lost and as we walked in the security guard backed up my warning with his own regarding it being a madhouse in there and did we really want to take the kids in? With his support I managed to encourage everyone back out again but D1 still insisted so she re-entered with my wife and our small boy (B2, B1 is back home) while the rest of us strolled north of Oxford Street to the calmer environs there. I later learnt that D1 was unable to try on any garments because the queues for the fitting rooms were simply too long and they ended up spending most of their time standing in line simply waiting to pay and get out.

If you are going to go to Primark and mix there with the Eastern Europeans and Londoners looking for cheap stuff, do it during the day on a weekday and remember to leave your dignity at the door. Speaking of dignity, apparently a few of the customers frustrated at their inability to get into the changing rooms simply try outfits on in the aisles. Free entertainment.

We also managed a visit to the biggest shopping mall in Europe which is located just along the DLR line from Canary Wharf at Stratford. It is just beside the Olympic Stadium and apparently was a madhouse when the games were on. We were there on a Wednesday afternoon and it was quite pleasant. The bottom floor contains the sort of stuff you find in most NZ malls with a food court as we understand the concept. For decent food the second floor contains a good range of restaurants along with many better presented shops which you'll also find many of on the first floor and in the "street" outside. One level has a champagne bar but seriously – that seems a bit naff in a mall. I think to myself would that sort of thing slot into Shirley where I grew up in Christchurch and I'd say most definitely not – though I could name a few relatives who'd give it a go and think they were well up the ladder.

There are two or three stores there which are quite dark on the inside and I think one was called Holister California but it was hard to tell because there was no name out the front. Another might have been Gilly Hicks of Sydney and their thing is to have lightly clad male and female models hanging around out front.

As with just about every shop in London we went into there are security guards in the stores. English people must be very dishonest I guess, or maybe it is all the foreigners who visit there.

INTEREST RATES

Nothing new worth reporting on. Or to put it another way. I could waffle on for ages about the upward pressure from one thing and the downward pressure from another, but in the end it is nothing of consequence. High uncertainty accompanying an expected burst in NZ economic activity with inflation at 1% and a currency sky high and likely to rise further as investor move from rising money supplies in other countries means our central bank will be neither raising nor lowering the official cash rate for a long time. Get used to it and read something else.

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	2.67%	2.70	2.68	2.77	2.70	5.7
1 year swap	2.60%	2.62	2.67	2.76	3.02	5.8
3 year swap	2.82%	2.78	2.93	3.01	3.46	6.1
5 year swap	3.11%	3.04	3.24	3.36	3.91	6.3

HOUSING MARKET UPDATE

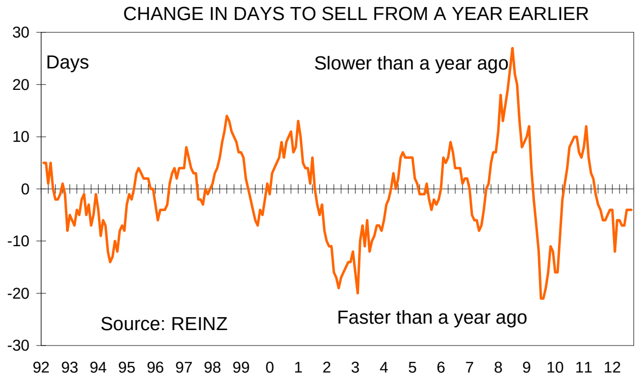
- **To view the most recent results of our monthly BNZ-REINZ Residential Market Survey click here.** http://tonyalexander.co.nz/bnz-reinz-survey/
- **I also write a monthly column on the residential property market in NZ Property Investor magazine available at your bookshop or newsagent.**

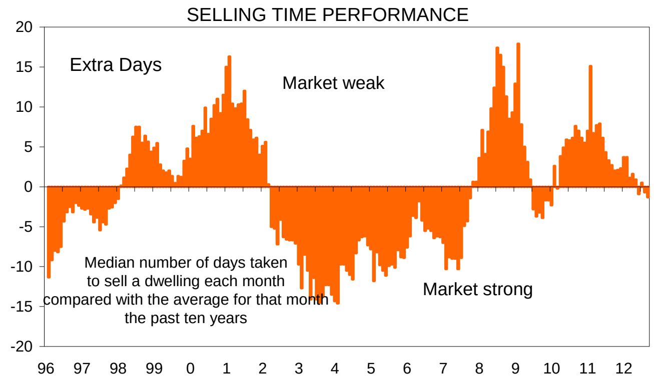
Housing Market Rising

The REINZ released their monthly data for residential real estate transactions around New Zealand and they show a market constrained by a lack of listings with prices creeping higher at a so far sober pace. In September there were 5,653 dwellings sold around the country which was an 8% gain from a year earlier. This was the slowest annual pace of growth since April 2011 but does not signal that activity is falling away because it appears to be a lack of supply crimping turnover rather than a lack of demand.

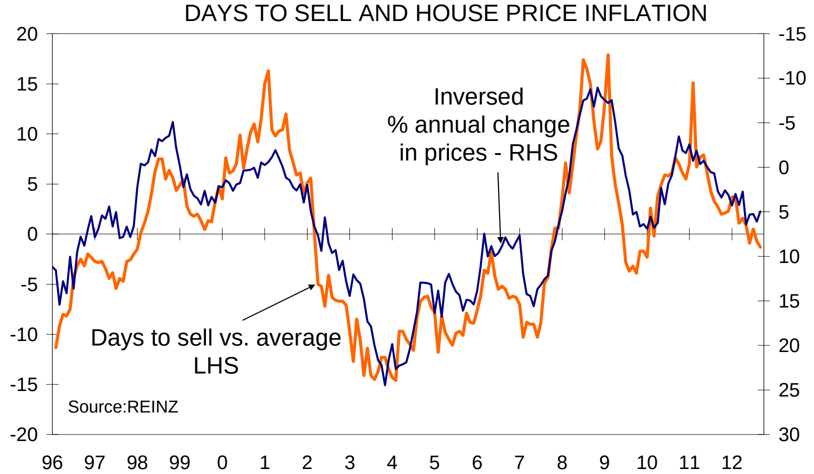
In seasonally adjusted terms sales grew by 3.7% in the month and 2.3% in the September quarter.

We can see this by looking at the Days to Sell measure. It fell to 33 days in September from 35 days in August. But more important, this 33 day total was 1.3 days faster than average for September over the past decade whereas August was 0.7 days faster than average. The latest outcome is the strongest since January 2010 and although well off rates of 2007 still signals a market where properties are turning over faster and faster than average.

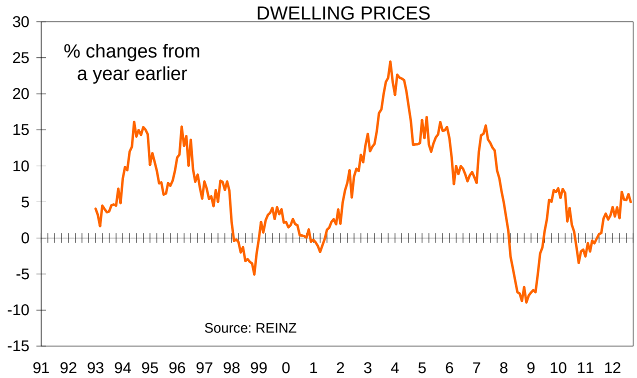


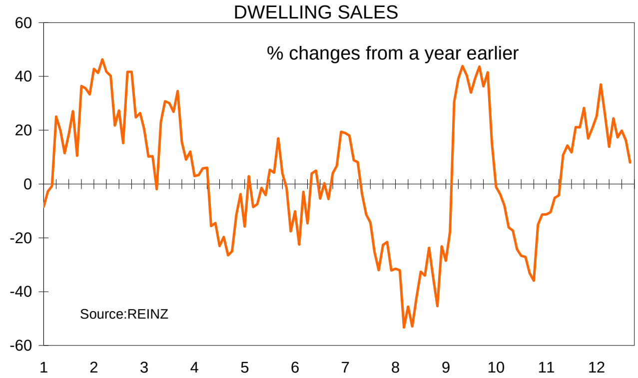


With regard to prices – keep in mind that monthly measures are meaningless. You need to smooth things over at least three months to get a reasonable feel for where things are trending and at what pace. So, while noting that prices rose on average 0.6% in September with Auckland back by 0.6% we see that in the September quarter average NZ dwelling sale prices rose by 1.1% after rising 2.5% in the June quarter. There is not an accelerating rate of rise in house prices underway but they are going up.



In Auckland prices rose by 2.7% in the quarter from 3.9% in the June quarter to lie 8.4% ahead of a year earlier. In Christchurch prices rose 3.3% in the September quarter after gaining 1.6% in the June quarter (accelerating?) and were 2.3% ahead of an unusually high reading for September last year.





All up I see nothing in the data to dissuade me from my long standing view that house prices in NZ will be pushed higher by a simple shortage of supply which is getting worse.

If I Were A Borrower What Would I Do?

If we were to see another Lehmans-type event then funding for banks would again be a problem. But central banks have flooded and continue to flood the world with cash as they attempt to reignite the borrowing and spending of the 2000s in a manner they want to direct this time rather than having the private banking sector doing it as back then. That is, they are pursuing a “hair of the dog that bit you” solution to the global crisis.

The trouble is people generally don’t want to borrow and banks in many countries don’t want to lend. The IMF for instance are forecasting that outstanding loans by European banks will decline by 7% by the end of 2013. In New Zealand banks are finding funding not to be a big issue offshore and because people domestically are saving more the domestic funding situation is better as well. As a result and because profitability in the banking sector is strong there is a growing willingness to loosen the lending strings and get more sales. This is slowly manifesting itself as a mild easing of lending terms along with the occasional selling of home mortgage discounted products (temporary low interest rates).

The very low interest rates being offered as specials for short fixed terms are aimed at winning business while not initiating a 2004-like permanent cutting of fixed lending margins. That cutting back then annoyed the Reserve Bank because it happened as the RB was trying to slow lending growth by pushing the official cash rate up. That is not happening now so they are unlikely to be too concerned about easing lending criteria. (But they may not have that attitude in a year’s time when house price inflation is stronger and the attitude will likely have changed to one of how to slow the housing rise while not crimping the overall economy and taking the NZD to parity against the devaluing greenback.)

But just as back then when early-cycle determination by banks to not permanently cut margins eventually went out the window, the question becomes one of whether this time around the “specials” will become so frequent they become permanent.

I do not know if that will happen or not. I stay away from pricing decisions within my bank so my analysis and commentary here can be as unbiased as possible. All I know is that with the outlook for world growth getting worse, central banks just itching to throw even more liquidity at banks, and investors looking for assets they can believe in, bank funding is not a huge problem and interest rates are going to stay low.

If I were a borrower, given the behaviour I now see the banks displaying, I would look to fix at one of the discounted rates when offered. As previously stated, if I was offered a three year rate at or below say 5.5% I would take it. The current three year rate at 5.9% is too high for me to touch.

MAJOR OFFSHORE ISSUES

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.

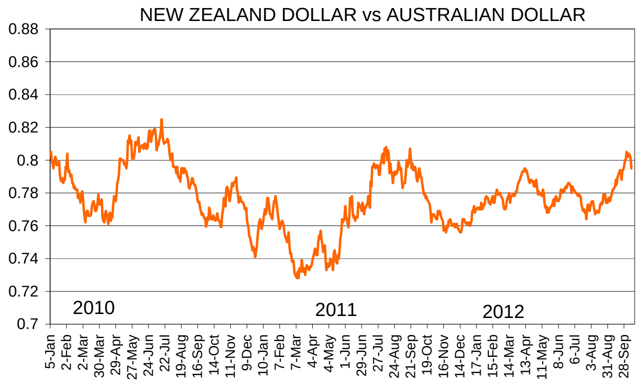
My monthly column written for the NZ China Trade Association can be found here.
http://www.nzcta.co.nz/chinanow-commentary/1531/china-slowing-but-nz-export-growth-continues-apace/

Exchange Rates

Exchange Rates	This Week	Week ago	4 wks ago	3 Mths ago	Yr ago	10 yr average
NZD/USD	0.818	0.821	0.808	0.795	0.784	0.67
NZD/AUD	0.795	0.804	0.782	0.779	0.785	0.85
NZD/JPY	63.800	64.500	63.300	63.000	60.1	69.6
NZD/GBP	0.510	0.510	0.505	0.512	0.5	0.388
NZD/EUR	0.635	0.634	0.633	0.646	0.574	0.52
NZDCNY	5.136	5.203	5.122	5.063	4.977	4.99
USD/JPY	77.995	78.563	78.342	79.245	76.658	105.7
USD/GBP	1.604	1.610	1.600	1.553	1.568	1.72
USD/EUR	1.288	1.295	1.276	1.231	1.366	1.28
AUD/USD	1.03	1.02	1.03	1.02	1.00	0.788
USD/CNY	6.2783	6.3375	6.3388	6.368	6.348	7.56

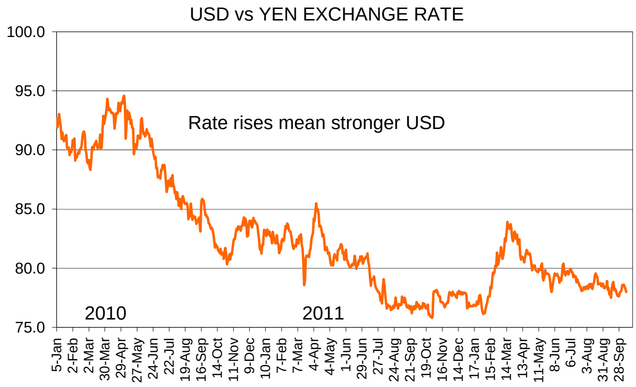
Nothing To Get Excited About

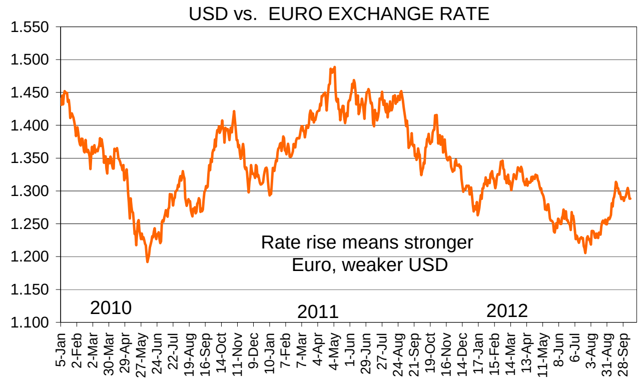
The Kiwi dollar has made no substantial moves against the currencies of interest to 99% of people reported in our table just above. The underlying story remains one of support from many sources including interest rates marginally higher than those available to economies overseas in which people are paying down debt – as opposed to our economy where debt growth is accelerating. That is because much as exporters feel it would be great if interest rates were cut, as borrowers we feel interest rates are already so low they are a gimmee – especially with house prices so consistently rising in many parts of the country now.

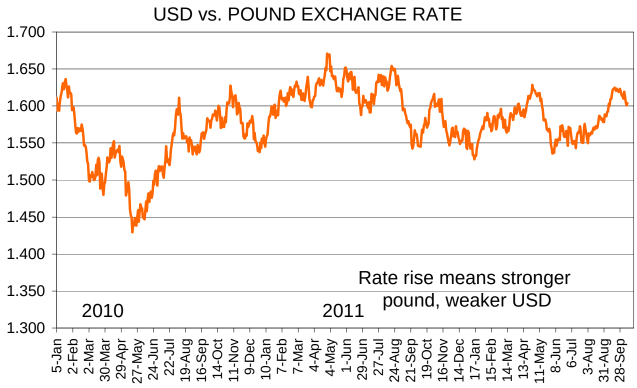


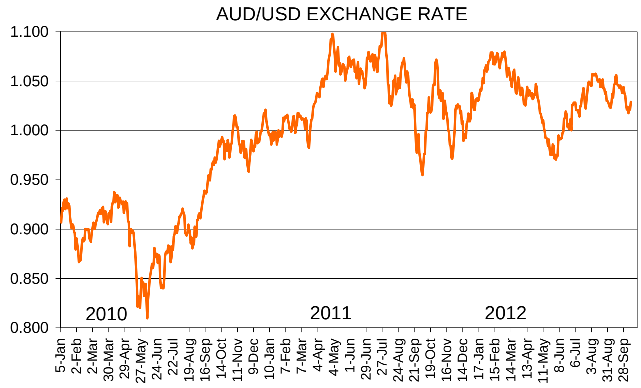
For the incoming Reserve Bank Governor – welcome to the same problem which faced Don Brash and Alan Bollard. How do you raise interest rates to stem a rising housing market (especially given the new belief post-Greenspan that bursting bubbles early is optimal) when your currency is strong and getting stronger. It can't be done unless one directly controls lending volumes from banks – in which case people will simply get funding from other sources. The growing Chinese community for instance is a rising source of funding for residential construction in Auckland and if bank lending gets restricted it would not seem too difficult to get informal networks set-up funded by the large volume of Chinese money looking for a home anywhere outside of China.

Offshore you can easily see from the lower lines in the table above that major exchange rates have not moved to any meaningful degree in the past week.









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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