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.
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My Offshore Worries Persist

I have a determined objective when travelling overseas. It is to leave as much of NZ behind as possible, focus on the underlying nature of developments in foreign economies, and give as accurate a description as possible of those problems in simple language to the largely Kiwi readership of this publication and the people who attend my 100+ functions each year back home. In that regard I consider myself to have been able to provide good insight these past two years into the way in which the bursting of the 2000s credit bubble is going to cause problems of varying degrees in different countries for a long and 100% unpredictable period of time. That is, I have presented a decidedly downbeat assessment of the global economy – or Western economies in particular.

Do I feel from this trip that things have changed for the better and we can start to breathe a huge sigh of relief regarding offshore prospects? Sorry to those of you who have not been overseas for a while to see and feel the shite-storm over here and who want nothing other than writings about happiness, Goldilocks, and fluffy bunny tails, but I do not feel that way.

- In Europe the tipping point at which the need to maintain social cohesion outweighs seemingly sensible and necessary economic policies is the closest it has been since this crisis started. The IMF has effectively apologised for promoting fiscal attacks in the past four years and said governments should ease up on their deficit reduction targets – presumably with bigger deficits to be financed by – ta daa
- In the US, Japan, UK, Switzerland, and Europe central banks are printing money as if they've decided the Zimbabwean economic model offers some answers.
- In the United States a sensible fiscal attack involving other than the looming fiscal Armageddon has yet to commence.
- Around the world public debt ratios to GDP continue to grow.
- There is increasing media discussion of alternative economic models and whether Governments should play a greater role in economies (public servants telling you what to do – like that worked so well for us in the 1970s.)
- In The UK there is rising support for leaving the European Union. That is unlikely but breaking some of the links is likely.

Now into the mix we add something new and very concerning – soaring global food prices, social tension, and international divisiveness resulting from weather-induced crop failures.

Yet this latter factor goes a long way toward explaining why my view on prospects for our growth is relatively sanguine. We are not going to boom given that people are sensibly concentrating in keeping debt ratios down, there is restraint on some price-based companies from the high NZ dollar (which will remain high), we look fundamentally good to investors as they compare economies, and falling food production overseas means higher demand for our commodities and the systems we use to produce them.

Our challenges are

- to facilitate adjustment of some sectors to a permanently high exchange rate which they cannot live with in their current form,
- getting off our butts to take advantage of the demand for our agricultural expertise,
- upgrading infrastructure to facilitate increased ease of remote business operation from New Zealand,
- improving connections between NZ businesses and those overseas who want to use what we have – and that means better effort on our part to recognise the IP we have in our businesses and leverage it,
- addressing a growing housing crisis in Auckland at the low end of the socio-economic spectrum,
- building up public financial reserves to assist during the next crisis (they come every decade),

I'll write more next week.

Some Final Offshore Observations

I spent less than 24 hours in Dublin associated with delivering a presentation on the state of New Zealand's economy to some 30 KEA members there. As I have found on previous trips outside New Zealand there was an unusually high frequency of questions not about New Zealand but about China. These revolved as usual around the growing vulnerability of NZ to any weakening in China's economy, China's immediate growth outlook, and long term prospects. With regard to NZ people were interested in the housing market, timing and magnitude of the Christchurch rebuild, and how Kiwis perceive the situation in Europe.

I explained that mainly we are chuffed because we got through the GFC well, have only 6.8% unemployment, can all sod off to Australia if things get really bad, are happy about China wanting all our food, and we feel no need for radical changes to be made to the NZ economy given these and some other factors.

I stayed at the Radisson Blu Hotel in Golden Lane which is a really nice facility but unfortunately had zero time for seeing anything other than its front entrance and the houses along the road to and from the airport as it did not seem right to take an extra day to look around while my family were back waiting for me in London. I'll look to get back to Ireland next year and will have time for some visits with other economists there as I have done in the past to get a feel for how things are going.

I accompanied my family back to Paris so they could fly back home and while we wore away some time between reaching Le Gare Du Paris Nord and taking the smelly, smoke-infested graffiti-covered RER to CDG Airport we walked for a bit in the rain and I showed the kids how backward France is with hardly any shops open. We undertook the cultural experience of eating at one of the restaurants near the railway station.

What you have to take into account here is that these restaurants serve mainly foreigners and French prepared to lose their dignity briefly as they mingle with the unsophisticates from other countries. The service is appalling beyond words. I decided that eating in McDonalds would not get across to my family what I wanted them to see because McDonalds anywhere in the world gives good service. So I thought about how crass things could really get and took them to a Western-themed restaurant with statues of cowboys and paper American Indian hats . They gave us a menu in English but still messed up the order by replacing chips with rice for a chicken wing dish (why do the Yanks call them buffalo wings when they look more like the appendages of sparrows?)

In French I asked for extra chips and rice later on but they never arrived. I asked for l'addition en Francais (the bill) but it also never arrived after ten minutes so we simply stood at le caisse to pay the bill and looked on as three of the staff had some sort of an argument with another set of customers.

But you have to love the French. And finally, courtesy substantially of the eating experience before heading out to the airport, my wife understands that I taught myself some French four years ago not so I could run off with some perfume-laden belle and live in a tiny apartment in the 16th arrondisement, but merely for the intellectual stimulus.

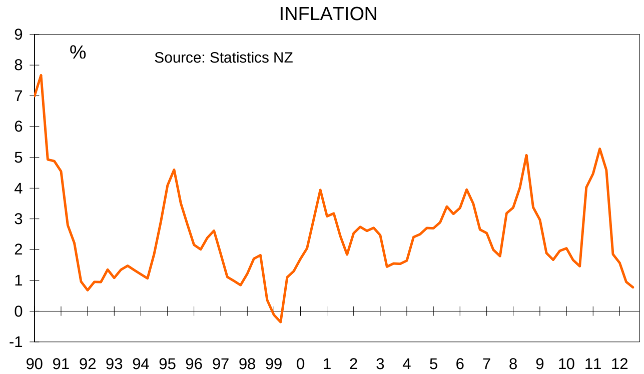
Speaking of intellectual stimulus – does one think there is any possible from an urban mass transit system? You sit or stand in a train surrounded by other people and think to yourself – we're all just one wrong look away from going postal. Or maybe we've all already done that and all that is missing to make us zombies is the make-up. In Paris the Metro systems functions well – though the platforms could do with considerably less urine and fewer beggars, while the trains might be nice if the graffiti were removed.

And do those people travelling on high speed trains think they are sophisticated and above the masses with their ridiculous LV luggage? I'm sitting typing this at the tiny café with three tables opposite Porte A for the Eurostar at Gare Du Nord, watching a group of three people sitting beside me with about ten bags most of which have the brown cross-stich look of LV or Prada – not knowing as they sit their feeling chuffed that there is a cockroach crawling under their table and sometimes up their chair legs. I think if anyone ever gave me an LV bag and I actually used it, I'd carry a sign around apologising for looking like a knob. When every man and his dog has a thing – it is no longer a status symbol. I guess the Italian-sounding people next to me haven't seen too many Chinese LV pelotons on their travels.

I asked the lady serving coffee at the tiny café to put two shots in rather than just one. She said "non". I hope the cockroach climbs up her leg.

INTEREST RATES

New Zealand's inflation rate came in much lower than expected in the September quarter with a rise of 0.3% rather than the commonly expected 1%. Annual inflation is not just 0.8% which is the lowest since early-1999. The low result comes about due to a rising exchange rate keeping the index measuring traded goods unchanged during the quarter while non-tradables inflation was 0.5% for the second quarter in a row – or 2.3% compared with a year earlier. The tradables annual change was -1.2% - hence we see the big role which the exchange rate and internationally traded commodity prices (dairy) have had in the past year.



The Reserve Bank gives emphasis to the non-traded component when assessing underlying inflation and the 2.3% change means the chances of an easing in monetary policy at next week's cash rate review are not high.

Nevertheless, wholesale interest rates have rallied following the surprising result (keeping in mind that it is extremely rare to have a CPI outcome more than 0.2% away from expectations). The three year swap rate now sits near 2.73% from 2.82% last week and 2.94% a month ago.

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%	2.67	2.68	2.77	2.70	5.7
1 year swap	2.51%	2.60	2.64	2.76	3.02	5.8
3 year swap	2.73%	2.82	2.94	3.01	3.46	6.1
5 year swap	3.03%	3.11	3.27	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.**

No Time

In case you missed it here is the link to my monthly BNZ-REINZ Residential Market Survey released on Saturday.
http://tonyalexander.co.nz/wp-content/uploads/2012/10/Survey-October-13.pdf

If I Were A Borrower What Would I Do?

At some point one will seriously want to ditch a floating rate and lock into a long term fixed rate as insurance against all interest rates rising strongly. The past three years tells us that in the new world environment where so many economic relationships have changed and forecasting of things such as an end to deleveraging are impossible, picking when to optimally jump to the other end of the yield curve is also impossible. It will be pure luck if you jump from floating to fixed at just the right time.

There will inevitably come a time in this cycle when fixed interest rates are rising while floating rates are sitting still and forecast to remain low for quite some time (high exchange rate effect for instance), and the apparent worth of ditching a floating rate for a fixed rate 1% higher will be attractive to practically no-one. But when that time comes making such a jump as early as possible could be a wise thing to do because fixed rates could rise quite a distance when investors worldwide buy into a growth scenario and begin worrying about inflation from the credit boom central banks are trying to recreate.

We are not near that point yet. But it will come. And for that reason you should cot confine your interest rate hedging decision to just a choice between floating and fixing 1 – 3 years. The competition between banks for your business is heating up and manifesting itself as an easing of lending standards (something which is being officially pushed in the UK to try and get lending rising), and more and more special rate discounting.

If I were a borrower at the moment I would be sitting there watching those discounts and seeing if a bank's marketing people may decide that it would be a good strategic move to offer a really low five or seven year rate in order to secure a batch of new customers for as long a period of time as possible.

MAJOR OFFSHORE ISSUES

Europe

Here are some good statistics on Greece which I came across in an article this week. The Greek unemployment rate is about 25%. Public sector employment grew five times between 1970 and 2007 while private sector employment rose only 27%. Wages in the public sector are on average 1.5 times those in the private sector. Since 2009 the number of Greek public servants has fallen 12%. The number of people employed in the private sector has dropped 55%. The Greek government has failed to keep promises to creditors regarding shrinking the size of the public sector, and had shrinkage been 24% rather than 12% as noted the government's accounts would now be in surplus.

As noted previously, the Greeks are not only unfit to be in the Euro, they seem unfit also to be in the European Commission.

But in more up to date news, the flow of information has generally been on the positive side this week. Moodys for instance did not follow Standard and Poors by cutting Spain's credit rating a couple of notches. Greece looks like meeting troika spending cut demands. UK unemployment has unexpectedly fallen. So the glass is half full for the moment – hence strength in high beta assets like the NZD and share prices.

United States

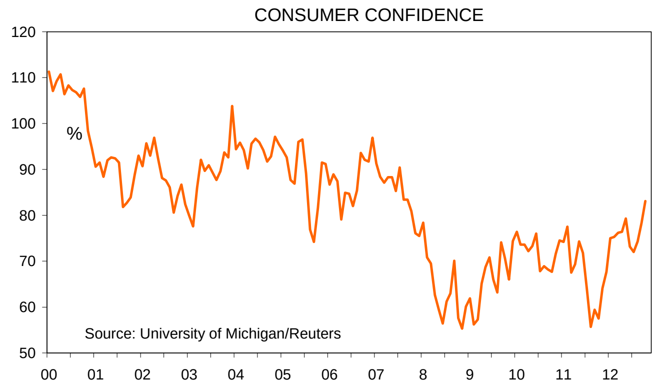
My feelings about the dangers of the Federal Reserve printing money in the hope that replicating the flood of liquidity which produced so many problems during the early 2000s will solve those problems were well summed up by the Bank of Japan Governor. Speaking after the annual IMF meetings in Tokyo he said "We have to accept that the growth rate may be lower. " until excess debt is worked off. "Unless we come to terms with this fact, recovery could be endangered by the adoption of inopportune and inappropriate policies, driven by discontent among the general public, that could erode efficiency and destabilise the global economy." (Financial Times, Page 1, Monday)

His comments came at the same time as some hefty criticism from officials in emerging countries regarding destabilising capital flows being created by the theoretically infinite money printing promise made by the US Federal Reserve. Such capital flows inward then quickly outward lay behind the Asian Crisis of 1997/98 and the determination following that crisis of the affected and nearby countries (China) to build FX reserves as part protection against such destabilising flows happening again one day. But against unlimited printing of money only unlimited reserves could prevent potentially large exchange rate changes and liquidity availability for domestic banks and hence the growing concern.

Perhaps the Japanese Governor's comments are intended to reinforce the analysis presented by the IMF during the week where they calculate that the sustainable growth rates of major economies have dropped. The message from various sources is that there is a "new normal" out there which involves slower economic growth and if central bankers in particular do not grasp this change then huge disaster lies ahead.

While this potential disaster develops (and no-one knows how many years this may take) we will see flows into our high beta currency plus upward moves in commodity prices through direct purchases to build inventories, forward purchases to secure supplies, and purchases of financial derivatives to replicate in cyberspace a physical stock of grain, soy beans, milk powder etc.

The key changing theme in the United States at the moment is with regard to the housing market. With the Case Schiller house price index rising some 8% since early this year and the measured stock of unsold houses falling strongly since 2008, the view now is that the housing market may well have turned the corner. This view is growing at the same time as consumer confidence is improving with the University of Michigan Consumer Confidence Index rising in October to its highest level since September 2007 of 83.1 from 78.3 in September and 72 in July.



Theory tells us that when consumers are more confident they spend more though the very short term correlation between sentiment shifts and spending changes is not strong.

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.

Exchange Rates

Exchange Rates	This Week	Week ago	4 wks ago	3 Mths ago	Yr ago	10 yr average
NZD/USD	0.821	0.818	0.826	0.798	0.793	0.67
NZD/AUD	0.790	0.795	0.789	0.773	0.778	0.85
NZD/JPY	64.900	63.800	65.000	63.100	60.8	69.6
NZD/GBP	0.508	0.510	0.509	0.510	0.503	0.388
NZD/EUR	0.627	0.635	0.630	0.649	0.577	0.52
NZDCNY	5.131	5.136	5.224	5.087	5.051	4.99
USD/JPY	79.050	77.995	78.692	79.073	76.671	105.7
USD/GBP	1.616	1.604	1.623	1.565	1.577	1.72
USD/EUR	1.309	1.288	1.311	1.230	1.374	1.28
AUD/USD	1.04	1.03	1.05	1.03	1.02	0.788
USD/CNY	6.2503	6.2783	6.3245	6.3742	6.3698	7.56

NZD Firm In Spite Of Very Low Inflation

I'm sitting and I'm reading – on the 11.31am Eurostar from St Pancras in London to Gare du Nord in Paris ahead of waving ta ta to the wife plus 80% of the kids as they wing their way back to NZ on Korean Airlines. What I've been reading over the past few minutes are a couple of articles in the Sunday issue of The Observer. The first is about the events in Wellington in six weeks time celebrating the release of a new hobbit film and the way NZ's tourism sector is hoping that visiting geeks will boost economic growth. That sounds positive for the NZ dollar – but nowhere near as hugely positive as the second article I have been reading.

This one is about the combination of factors leading to decreasing stocks of grain this year with food prices rising and predictions of shortages and famine – plus predictions that prices of meat and dairy produce will soar. Factors cited include bad weather, investors buying land in less developed economies to grow fuel for cars rather than people, a growing world population, and growing demand for meat products by a swelling middle class in emerging economies. This latter is an issue because it takes a lot more feed and water to grow meat for consumption than the same number of calories from grain.

Rising prices for meat and dairy prices will my dear readers do what for the Kiwi dollar? A world awash in investors looking for yield and seeing forecasts of our structural rise in food prices will do what for foreign demand for our land and primary sector businesses?

Like I've said before. There is a lot more supporting our currency and driving it upward than the factor so many lobbyists in some sectors focus on – our cash rate. Cutting the cash rate would have little impact on our currency and simply provide a fantastic lower entry level into the NZD for investors.

This week the adoption of a glass half full attitude by investors in response to some good data has seen support for the NZD in spite of the downward move one would have expected from low inflation raising expectations that the RBNZ will be cutting interest rates again soon. I don't think they will. But if they do then any NZD weakness would present some good buying levels and any yield curve rally a good chance to lock in cheap long term fixed rates.

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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