# 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.





## Boosting New Zealand's Economic Performance

Over the past two years I have been giving increasing thought to New Zealand's long term prospects. This is the point I have reached.

There is no appetite in New Zealand for big policy changes and we will not vote in parties proposing big changes.

This is because we do not feel overall that anything radical needs to be done. We are chuffed that the reforms in banking, government finances, and the economy being forced through overseas were undertaken here a long time ago. We feel that the rest of the world is catching up with us. We do not need to catch up with them. In addition we have an export product mix other countries would dearly love - namely high quality safe food products produced with good water supply. We see foreigners trying to buy our farms. We see some rich well known people moving here and also see hefty gross migrant inflows almost offsetting the loss of people to Australia and expect that with some of the gloss coming off Australia the net loss across the Tasman will soon ease.

We are highly inventive people who love to tinker but excluding a good number of outstanding individuals generally do not have the drive, the managerial skills, the capital, or the connections to turn our designs and products into NZ based multi-billion or just multi-million dollar enterprises. We tend to either put our developments in the drawer and fail to recognize their value and patent them. Or we develop them but either sell out early or fail and/or pull back from foreign shores because of our cultural characteristics.

I examined and wrote about these characteristics over the Summer of 2010/11 and my summarized findings can be found under the "What We Lack" tab at www.tonyalexander.co.nz Look for the last two papers in the series.

My view has become that if we were going to pull ourselves up by our boot straps and develop a whole new large range of dynamic export-focused enterprises then we would have done it by now. After all, in 1992 New Zealand became one of the most deregulated and open economies in the world. We certainly have started many businesses and invented many things, but we haven't take them aggressively to the world. We shy away, stay in the shadows and enjoy the wonderful life we have in NZ.

If we are going to....
- Go back up the OECD ladder.
- Stop ourselves from falling anew down the ladder.
- Stop telling all our kids they have to go offshore and stay away as long as possible to build wealth before coming back to raise a family when their kids get to high school level.
- Come close to achieving the official NZTE target of taking the ratio of exports to GDP to 40%.
- Earn enough in taxes to meet the superannuation and health requirements of our aging population.
- Earn enough to address a deepening housing crisis for those on low incomes.
- Build world class infrastructure.

....then we have to recognize that doing what we have always done and relying solely upon ourselves in New Zealand taking us to where we want to go is not going to be enough.

This is the point I have reached in my thinking. So what does one propose to change the situation? First one has t recognise that some f the simplistic and generally self- serving solitons proposed by some will not work. The main one in that category is undertaking some as yet unthought of action which will structurally lower the NZD. Even if a weapon existed to do it such a decline would not change any of the cultural characteristics which keep us from professionally expanding offshore as we could.

Another oft-proposed solution is lowering interest rates. But as I have pointed out for the past two decades research does not show that the level of interest rates is a major determinant of business investment. In addition with interest rates already at their lowest levels in four decades one can no longer seriously propose a lowering of borrowing costs as a solution - especially as such a move would merely inflame an already rising housing market.

We showed the world in the 1970s that government intervention will not work and I recall we voted out a government in 2008 which was trying to tell us what to do with regard to buying lightbulbs and installing shower heads.

The current government's strategy recognises that their are no silver bullets and it focuses on removing obstacles to growth. The asset sales however are a tangential exercise of title relevance to our problems.

If I were to pick one area which I feel we could gain some mileage while recognising our deficiencies and working sensibly to overcome them it would be improving the connectivity between business developers in New Zealand wanting to grow and two main groups of others. The first group would be the many deeply knowledgable and well connected people who migrant our way. They have a lot of connections and now ledge which we could use. The second group is the many Kiwis offshore wo I have found very willing to contribute in some way toward the betterment of New Zealand it who like foreigners tend to find we don't reach out enough or in a consistent manner.

There are some good projects in the latter area including the NZTE Beachheads scheme and activities undertaken by KEA. I would welcome ideas on what other methods we might use. Email me for this particular project at tonyalexander5@icloud.com

## HAMBURG

On Thursday night I stayed at the Baseler Hof hotel in Hamburg which is centrally located near a big urban lake. I took a stroll in the evening before getting stuck into some computer work to guard against data loss from some system changes and can see why people would love to live here and presumably in many other European cities. The evenings are fantastic. Hundreds and presumably thousands of people were sitting in outside restaurants and cafes enjoying food and drink and the long dusk one gets at latitudes such as this and in Invercargill - where presumably the same outdoor dining exists!

I felt a very definite difference between the evening dining here and the image which springs to my mind when I think of such a thing in New Zealand. Back home my image is more one of an alcohol focus and younger people, less relaxed, more loud bravado, windier. Here it is all very pleasant and I know from being here before in January 2009 that even in the depths of winter the inside restaurant atmosphere is superb.

Flying into and out of the city was a far better experience than traveling to and fro by high speed train back in 2009. By air one gets to see the beautiful trees which seem to be everywhere. It was quite startling. One can see the layout of the port which is the second biggest in Europe and expanding, and one can see also something weird. Whereas in New Zealand and other countries I have been to the farm paddocks are laid out generally in squares or bulky rectangles, close to Hamburg there are vast strips of land where the paddocks are extremely long and thin. It is like the original surveyors could not be bothered walking everywhere so they just strolled along one line and set a new marker every 50 meters then matched that up one kilometer out.

There was one unsettling thing about flying. On the airport runways and fields between the concrete there are many big black birds - looking at you, angry!

The hotel Internet setup was a gyp. I had to not only re-enter the login and password details every time one of my machines (3 devices) went to sleep, but also after maybe five to ten minutes of being on-line and active. Eventually I used up the 750mb limit and that was that. I have a device into which I can slip a foreign sim card to access cellular service but haven't needed it up to now because places I have stayed have generally been good - except Marlin Apartments near Canary Wharf in London where my work Thinkpad cannot connect at all. The new iPad however worked perfectly.

I travelled in three taxis while in Hamburg and in each of them the radio was on which was great. I got tired a long time ago of having to ask NZ drivers to turn the radio on. Anything is better than silence. The weather in Hamburg was unseasonably warm at 21 degrees which is probably not what the shop owners wanted as the clothing stores were filled with the best range of fine looking winter clothing that I have ever seen anywhere. It was fantastic. It would be great to be there as the Northern hemisphere winter was ending and ours was about to start.

Overall, I liked Hamburg. The streets were clean, the people looked healthy and happy, the city was easy to stroll around, the brochures I looked at suggest there are many things which a visitor can do, the shops looked good, and the evening dining is something I and I am sure hundreds of thousands of other Kiwis wish we could replicate in as relaxed a manner back in NZ.

I finished this six-monthly trip to London with two days in Paris. This time I was put up at a cheap hotel near Le Place de Clichy which I've never been to before. So in the evening when I walked to the top of my road and turned left I saw lots of restaurants and it all looked pleasant if nowhere near as nice as some other parts of the city. Then I turned around and started heading east and came across the Moulin Rouge and all around it some shops and entertainment complexes of a sort which caused some parents I saw to walk along holding a magazine on the side of their child's face to obscure the wares on offer.

I came across some very friendly Parisian ladies inviting me inside their shops to see what was in there and it was so nice to feel so wanted!

If you want to read about what happened when I tried catching the flight from Heathrow back to NZ then click here. One encountered Troy Flavel the rugby great.

http://tonyalexander.co.nz/regular-publications/stuck-in-london/

# INTEREST RATES

The Reserve Bank this morning met almost everyone's expectations by leaving the official cash rate unchanged at 2.5%. This low level has come not because our economy is all that depressed - though a 6.8% unemployment rate is above average - but rather because economic conditions offshore are not just weak but generally worrisome. By holding off from cutting the cash rate now the RB is leaving itself with ammunition to use in case things get very bad overseas. This is ammunition which most other central banks do not have which is why they have resorted to trying to recreate the voluminously loose credit conditions of the 2000s with immensely loose monetary conditions. Notice the different terminology?

During the 2000s people and businesses were willingly borrowing a lot of money which banks were willingly lending and the world's central banks adopted a "she'll be right" attitude toward the whole thing. This time around although the central banks have once again shown themselves wiling to oversee a sharp monetary expansion, the banks don't want to lend and people and businesses essentially don't want to borrow. That means there is not an abundance of credit - just narrowly defined money measures such as M1.

The tone of comments used by the new RB Governor in his first cash rate review was on the slightly more hawkish than expected side so there was some mild upward pressure on wholesale interest though they remain largely in their ranges of recent months.

**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 | 2.63% | 2.70 | 2.66 | 2.77 | 2.70 | 5.7 |
| 1 year swap | 2.54% | 2.60 | 2.67 | 2.76 | 3.02 | 5.8 |
| 3 year swap | 2.77% | 2.82 | 2.93 | 3.01 | 3.46 | 6.1 |
| 5 year swap | 3.09% | 3.11 | 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 Crisis

There was a good article on Auckland's housing crisis in the Sunday Star Times this week which you should go and read if you still disagree with the opinion I have been writing here for four years regarding a shortage. I am pleased that there is increasing attention being paid to the issue and that in the space of just a few months the terminology being used to describe the shortage has shifted to include the word "crisis".

Up until a few months ago I spoke in terms of the shortage providing an incentive to hold onto one's property and for investors to consider more exposure. But the bigger issue is the worsening problem for people at the low end of the socio-economic spectrum who will not just be "priced" out of the market like middle income couples not wanting to shift to city fringes, but will also find the physical unavailability of accommodation means they don't have a house at all. The thing to watch for here is an increasing frequency of stories about people living in caravans, sleep-outs, holiday parks, and two or three families in one house.

This is very serious stuff from a social stability point of view and all of us need to think how the situation can be resolved. Easing access to credit is not an answer because that will just boost demand. In fact whenever you see a proposed solution always ask yourself whether it will boost demand or supply. Only if it works on the latter will it be of much use. In that regard we need to seriously start giving thought to reducing building costs by cutting standards of construction for cheap housing. Rock solid well insulated houses are wonderful. But if for the same price you can build twice as many slightly less sturdy houses then go for it. For instance I have met someone looking at an innovative quick and low priced housing solution involving a central foundation which radically cuts costs.

What about giving people incentives to leave Auckland and live elsewhere? The problem there is how do you stop them moving back to be with their extended family and friends? After all, not many people at all have left Christchurch. The Press newspaper had a good article on that on Tuesday suggesting a net movement from Chistchurch to elsewhere in New Zealand since the earthquake of only about 7,000 taxpayers net. All my relatives bar the mother-in-law remain there.

## Target Higher Cost of Living Increases?

Here is yet another reason for expecting that house prices will rise. In spite of inflation averaging 2.7% over the past decade there is increasing debate about giving the Reserve Bank some other targets such as trying to influence the exchange rate. It does not matter what you think about the merits of this policy. All that is relevant here is that it means higher average inflation than would otherwise be the case. That means a greater incentive to invest in housing. Note however that the new Policy Targets Agreement actually toughens the inflation stance a tad so one would need to await a change in government for such a reduced emphasis on keeping cost of living changes (inflation) low. But housing is a long term investment and talk of a change is relevant to market dynamics in the near future.

Of course now what you need do is extrapolate what a PTA change would mean for other policies that a left leaning government could favour. To try and reduce the rise in house prices such a government might strongly favour a capital gains tax. Also because of higher cost of living changes they would look to strengthen the negotiating ability of employees - hence policies for stronger unions. Interest rates would initially dip with a PTA change then average higher than before. So you'd want to take advantage of the dip to fix your mortgage rate for ten years.

Also, because the change would boost investor house buying and push prices higher the plight of low income earners and young people seeking home ownership would worsen. Thus more of a housing crisis plus a greater incentive to move to Australia with a lower exchange rate should that eventuate, and the old interest rate difference opening up again.

Targeting a higher rate of growth in household cost of living - which is what the exporters don't tell you is what higher inflation really means - is not good policy.

## Migration a Housing Drag?

There was commentary on the migration data this week noting that the country experienced a net loss of over 3,000 people in the past year and that this would act as a restraint on the housing market. Actually what you need to understand is that the housing market has been strengthening in spite of the net migration loss. Now imagine what, will happen when those flows turn as I believe we are on the cusp of seeing with regard to Trans-Tasman flows?

Additionally, I am sticking with my theory that with people in Europe casting their eyes ahead to dour economic times for a number of years, and as time goes by getting used to the structural rise in the NZD, we will see more people from there heading our way.

## If I Were A Borrower What Would I Do?

I would keep an eye out for a good discounted long term fixed interest rate which one might see a bank offer now that wholesale borrowing costs have fallen a bit and lending growth is picking up. That latter point is important in that in a flattish type of market where the focus of people is strongly on repayment of debt there is little to be gained by advertising a lot. But when you get a rise in the number of people thinking about buying then there is a greater potential payoff to advertising and offering something special.

Failing the appearance of anything nicely out of the ordinary I would stick floating even though I do not believe that the Reserve Bank will be cutting the cash rate in the near future - especially given the coming construction boom and already rising house prices. The RBNZ will want to avoid the risk that they grossly underestimate the extent of inflationary pressures down the track and over-stimulate the housing market. The risk reward trade-off says it is better to leave the cash rate unchanged rather than cut it.

# MAJOR OFFSHORE ISSUES

## Europe

There are a number of meetings happening in the next month or two which will go a long way toward deciding whether the EU becomes a more cohesive force with good economic outcomes, or whether it fractures to various degrees. That sentence is actually a joke in that one could have written it at any time over the past four years and will probably be able to roll it out for the next few as well.

There is no point going to detail here regarding the aim of the meetings, the positions of the man protagonists, their degree of domestic support and so on. There is plenty of information available on such things online. What matters for us in New Zealand is how it affects us. In that regard the important points to note are this.

First, it is extremely unlikely that the EU will fall apart and it is looking less and less likely that Greece or any other country will leave the Euro. That is extremely positive from an economic and financial markets stability point of view but is more the absence of a big negative than the appearance of a positive for our economy which might alter our growth prospects.

Second, economic data have recently turned out to be less bad than expected, though the numbers remain exceedingly poor and bring major worries about social stability. These less bad numbers mean that while there are day to day wobbles the general feeling among investors regarding Europe now is that it Is muddling through. This means some underlying support for risky assets like the NZD. But watch for big periods of doubt which will inevitably arise ow and then.

## United States

No time sorry.

## China

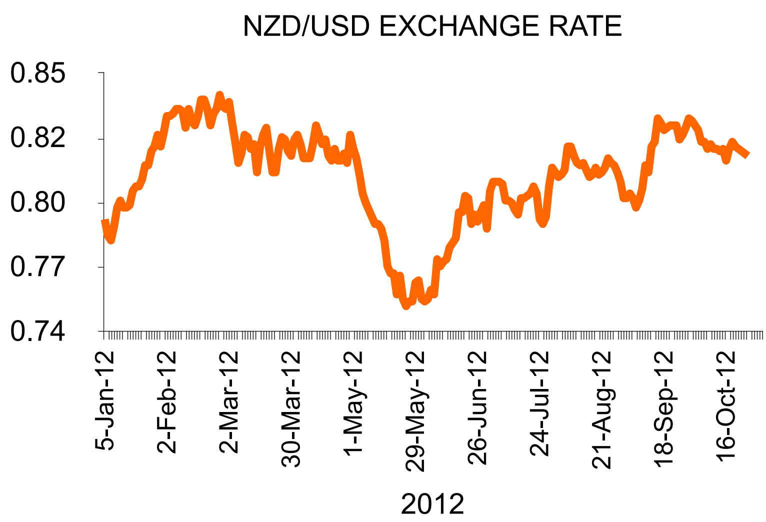
You can find my China page on Facebook at http://www.facebook.com/TonyAlexanderNZ I have set up this page specifically for discussing the NZ-China relationship and as a tool for disseminating information and furthering my own still inadequate knowledge.

# Exchange Rates

| | Now | Week ago | Mth ago | 3mthago | Year ago | 10 Year average |
|---|---|---|---|---|---|---|
| **NZD/USD** | 0.815 | 0.821 | 0.826 | 0.798 | 0.793 | 0.67 |
| **NZD/AUD** | 0.784 | 0.790 | 0.789 | 0.773 | 0.778 | 0.85 |
| **NZD/JPY** | 65.0 | 64.900 | 65.000 | 63.100 | 60.8 | 69.6 |
| **NZD/GBP** | 0.508 | 0.508 | 0.509 | 0.510 | 0.503 | 0.388 |
| **NZD/EUR** | 0.627 | 0.627 | 0.630 | 0.649 | 0.577 | 0.52 |
| **NZD/CNY** | 5.090 | 5.131 | 5.224 | 5.087 | 5.051 | 4.99 |
| **USD/JPY** | 79.8 | 79.050 | 78.692 | 79.073 | 76.671 | 105.7 |
| **USD/GBP** | 1.604 | 1.616 | 1.623 | 1.565 | 1.577 | 1.72 |
| **USD/EUR** | 1.300 | 1.309 | 1.311 | 1.230 | 1.374 | 1.28 |
| **AUD/USD** | 1.04 | 1.04 | 1.05 | 1.03 | 1.02 | 0.788 |
| **USD/CNY** | 6.2449 | 6.2503 | 6.3245 | 6.3742 | 6.3698 | 0.756 |

## NZD Firm

This week the NZD has retained a firm tone and that is for the simple reason that investors around the world for the moment feel that things are not heading n the wrong direction in Europe so they have become more willing to buy risky assets. That means shares and high beta currencies like the NZD and AUD. Factors contributing to the improvement in sentiment include the strongest signs in four years that the US housing market is improving - though from a low 2% of GDP base. China's third quarter GDP growth was slightly better than expected. In Europe slow progress is being made in the right direction on many fronts including banking union and Greek fiscal policy.




History tells us that this period of optimism will not last and given my view that there are some very strong factors which will keep the NZD up exporters will need to keep an eye out for such periods of the heeby jeebies to get some better cover rates. At this stage there is no reasonable reason for having an expectation that the NZD will fall away to any appreciable degree in the near future. Having said that, there is a clear candidate on the horizon for precipitating a confidence collapse and big currency decline - the looming US fiscal cliff.

It is unlikely that the new President and Congress will allow the automatic tax rises and spending cuts amounting to 4% of GDP to go through.  But approaching the end of this calendar year markets may easily sell-off risky assets in case the eventual fiscal agreement still involves a substantial fiscal contraction.

## 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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