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.

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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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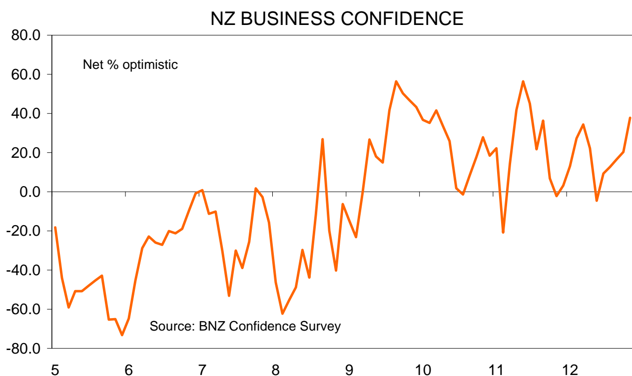
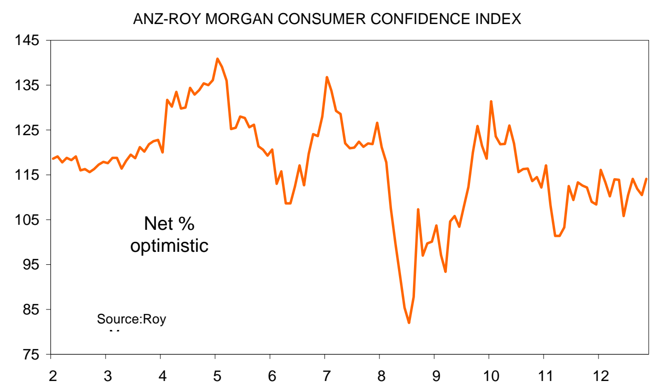
Underlying Same Old Thing

It would be nice to be able to say that as a result of the global financial crisis, the tightening up of credit availability, the growth in Asia's middle classes, and the shock of collapsing house prices in some other countries that we have been shaken to the core here in New Zealand and some things are going to change for the better. But we have not been and they aren't.

To start with, although the NZ unemployment rate may be at its highest level since 1999 of 7.3%, we don't feel as though the economy is munted. Our monthly business confidence survey sits at a net 38% positive which is the highest reading since July last year and well above the average since 2005 of -6%. The ANZ Roy Morgan poll of consumers has a reading of 114 where 100 is neutral.





We are not a shocked nation, therefore maybe it is not surprising to find that as we noted last week, the household savings rate has now moved back into negative territory (-0.1%) after touching a positive 0.2% in the year to March 2011.

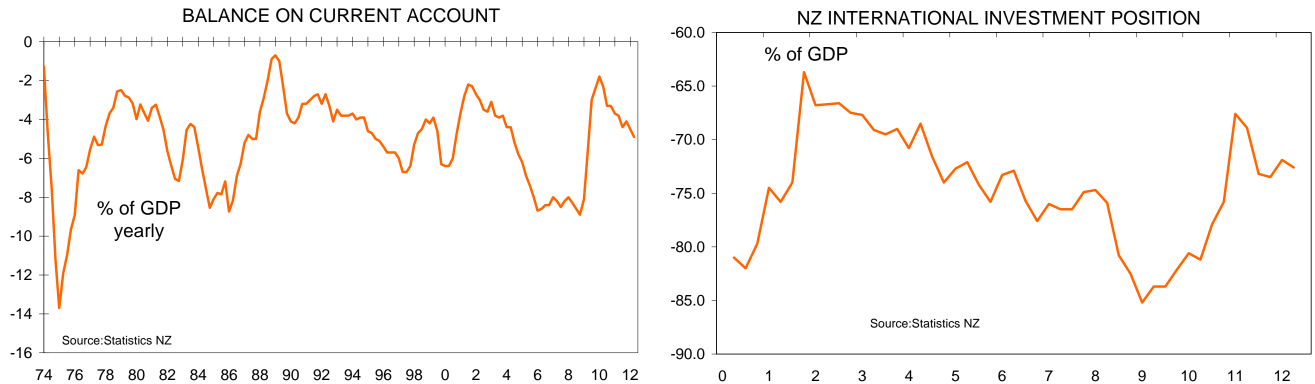
It is also maybe not surprising that household credit growth is accelerating. The annualised rate of growth in the September quarter was 3.3% compared with 2.9% in the June quarter and 1.6% in the March quarter. This is the fastest pace of debt increase since the middle of 2008.

The Asian middle class may be growing, but if we take China as an example, there is little evidence that we are doing more than just shipping more generally higher-priced primary products there.

Exports of primary products to China including Hong Kong accounted for near 92% of all our exports there in the year to September from 88.5% four years earlier and 88% ten years ago.

New Zealand's current account deficit sits at 4.9% of GDP from 3.8% a year ago and data out this week show we should brace ourselves for this measure deteriorating further. In the three months to October the value of New Zealand's merchandise exports was down by 6.3% from a year ago while imports were down 0.7%. With the domestic economy set to be boosted by a boom in construction while exports get constrained by weak growth in some destination countries, a sustained high NZ dollar, and little evidence we are grasping the opportunities provided by Asia's climb, the current account deficit looks like it will go back to levels above 8% of GDP last seen in early-2009.

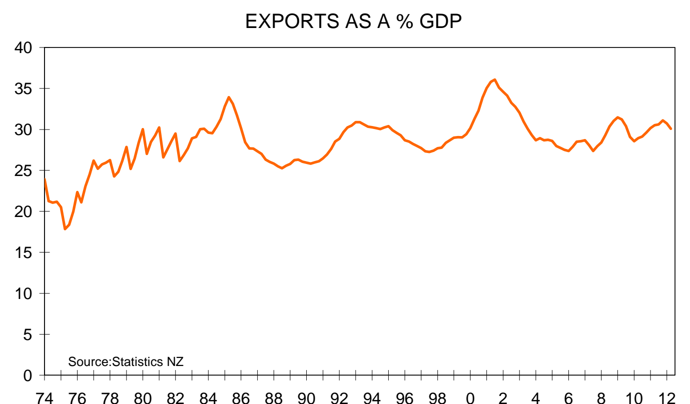
That means we should expect to see the country's net international investment position deteriorate anew.



This then raises the question of how long overseas investors upon whom we are dependent for financing our excess spending will remain willing to extent their loans. The answer is that there is absolutely zero way of knowing when this will happen. Anyone expecting since the float of the NZD 27 years ago that the currency would depreciate and stay low to reflect our persistent current account deficit has been proved wrong. There is no way of knowing whether our period of living beyond our means will extend for another 27 years or for just 27 days.

However the fundamentals for the moment do not suggest that a structural adjustment downward in our currency is imminent. This is because we are viewed almost as a safe haven and Australia is on the cusp of officially being declared as so by the IMF given strong and rising purchases of AUDs by central banks and sovereign investment funds. The centre of world economic activity is shifting closer to us. We have an export base which rising middle classes in Asia will be clamouring to buy. (The challenge there is to see more than that demand simply manifest itself as higher farmland prices.) We have a history of having radically changed our economy when the global financing strings were on the verge of being cut in the 1980s. Government debt is amongst the lowest in the world. We have no history of government debt default. The debt we are building is in fact in the private rather than public sector by and large. Plus our interest rates are slightly higher than those available overseas.

Unless one believes that there is about to be a massive change in one of what I consider to be four factors which help explain our newly worsening position, then there is no reason for believing that our long term lack of export growth will change and no reason for believing that the government's goal of raising the ratio of exports to GDP to 40% by 2025 will be met. Time permitting I may start to flesh out those impediments to growth next week.



INTEREST RATES

Wholesale interest rates have moved by little over the past week and there is frankly nothing of substance worth discussing here beyond noting that NZ monetary policy will likely next be altered in 2014 with a tightening – though should we see more data such s the recent bad numbers for exports, employment, and consumer spending then a rate cut cannot be ruled out.

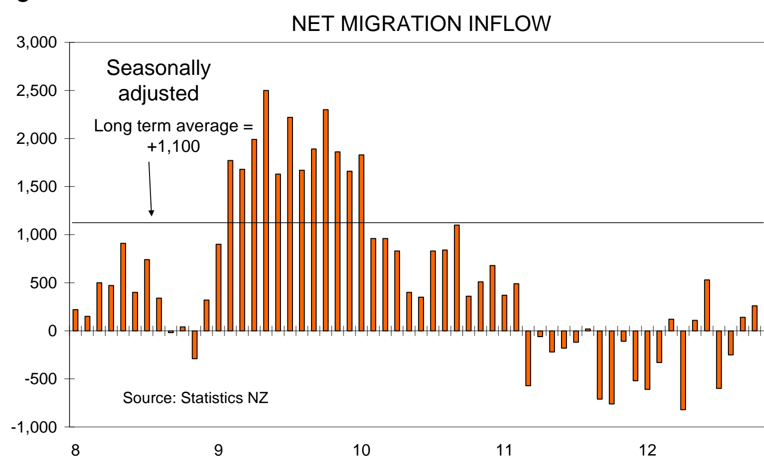
FINANCIAL MARKETS DATA

	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	2.66	2.67	2.76	5.7
1 year swap	2.69%	2.60	2.63	2.67	2.56	5.8
3 year swap	2.79%	2.83	2.82	2.90	2.92	6.1
5 year swap	3.11%	3.12	3.11	3.22	3.44	6.3

HOUSING MARKET UPDATE

This week the most important thing to point out with regard to New Zealand's housing market is that it has been rising during a period when net migration outflows have been negative. In the year to October there was a net population loss from migrant flows of 2,319 people. A year ago the loss was 103. The market has lifted while the migration numbers have worsened. But now the migration numbers are getting better. In the year to August the net migration loss was 4,118 therefore the situation is turning.

In seasonally adjusted terms the three month annualised flow has improved to a gain of 3,120 from a loss of 7,200 in the three months to July. This is quite a quick turnaround and one needs to treat short-term migration movements with caution. But the trend is there and a number of factors which we have previously identified are contributing to it.



First, the net flow with Australia is turning from a massive net loss of Kiwis each year to simply a large loss. The net annual loss stands at 39,330 which is down from a peak of 39,956 two months ago. The net gain from the United Kingdom has risen to 5,689 from 5,369 two months ago. Plus the net gain from China including Hong Kong has risen to 5,599 from 5,574 two months ago and 4,899 a year ago.

Note the changes in these flows and how the China +Hong Kong rise is undoubtedly a long term rise whereas, the Aussie flow is simply a cycle turning, and the UK flow is more of a few years of people deciding to quit a tough environment to raise their kids in a better place. Each flow is unique but they are all now contributing to a migration upturn at the same time and it would pay to watch therefore what happens with the total net migration numbers over the past year.

If I Were A Borrower What Would I Do?

I do not feel that I have anything particularly insightful to offer in answer to this question at the moment. It looks like floating rates are going to remain low into 2014 and then when they start rising there is no reason for believing at this stage that the rises will be large – or small – or huge – or last only a short time – or last a long time – or last just two years. In other words if we can't even strongly support an argument as to when monetary policy starts tightening we have no show of picking the nature of the tightening cycle. That is why I personally feel there is some value in getting a portion of one's interest rate risk locked down by fixing in the three to five year area. This will give some certainty in very uncertain times.

However I would only lock in if I could get a 3 – 5 year rate between 5.5% and 6.0%. So I'd be sitting waiting for a lender to offer a deep discount on current rates and while waiting would sit floating and have some of my debt locked in at the nice low one year rate of 5.25%. Actually, maybe the optimal strategy is fix everything for one year then break it and reset a goodly portion at 3 – 5 years should a discounted rate appear.

OFFSHORE

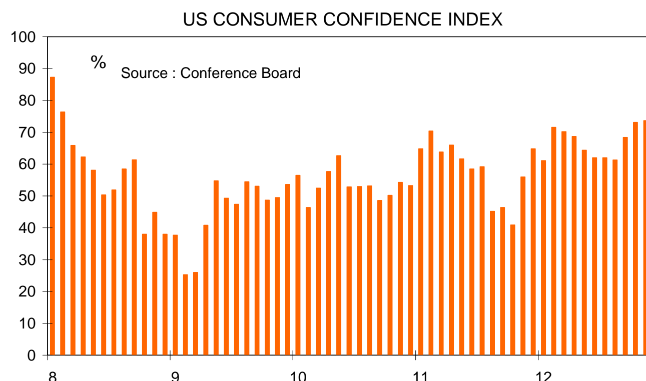
While expectations for growth in China have improved over the past six weeks and hopes of US growth seem acceptable on the basis of some good monthly numbers, deep worries persist about world growth due to the ongoing European debt crisis and uncertainty about the US fiscal problem. The OECD this week assumed that a solution will be found to avoid a large tightening of US fiscal policy from January 1 yet still cut their forecasts for OECD area growth over 2013 to only 1.4% from the 2.2% prediction they made six months ago.

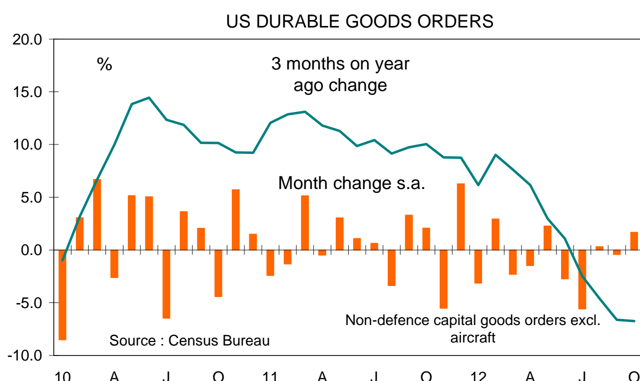
The OECD are forecasting growth in the US economy next year of 2% improving to 2.8% over 2014. For Japan they expect 0.7% then 0.8%. For the Euro-Zone they expect shrinkage during 2013 of 0.1% then growth of 1.3% over 2014.

In Europe negotiations have been continuing over how to advance the next bout of funding to Greece with few participants involved in the process willing to concede that Greece will never be in a position to service let alone repay its debt and a huge write-off is necessary. Today it looks like agreement has been reached but this will not prevent the debt burden in the short term rising above the current 170% of GDP, and the target of 124% come 2020 is still uncomfortably high. Eventually a lot of Greece's debt will need to be written off. In Italy consumer confidence fell to its lowest level since 1996 with the economy into its fourth recession in the past 11 years.

In the United States there was some excitement for a while regarding reports of retail sales during the Thanksgiving period being 13% ahead of a year earlier. But retailers remain cautious about buying into an upwardly trending household spending story given the repeated disappointments of the past three years with many worried that shoppers have merely brought forward spending which they would otherwise be doing in December.

However, consumer confidence as measured in the monthly Conference Board index has risen to a four year high with a reading of 73.7 in November from 73.1 in October.





There was also a positive sign on the business investment front during the week with the value of orders placed for durable goods in the non-defence sector (and excluding aircraft) rising 1.7% after falling 0.4% in September. But this measure was still 6.7% lower than a year earlier in the three months to October and as yet one cannot run an argument that the improvements we are seeing in the United States in the labour, housing, and to a lesser extent the retailing market are yet proving good enough to encourage businesses to much boost their capital spending.

Businesses are naturally concerned about the fiscal deficit negotiations (or lack of them) and forecasts that if an agreement is not reached the US economy will go back into recession at the start of 2013. With that uncertainty hanging around plus confirmation that the biggest trading partner for the US – the EU – is back in recession, caution is understandable.

Exchange Rates

Exchange Rates	This Week	Week ago	4 wks ago	3 Mths ago	Yr ago	10 yr average
NZD/USD	0.823	0.814	0.822	0.804	0.754	0.67
NZD/AUD	0.786	0.785	0.793	0.774	0.762	0.85
NZD/JPY	67.4	67	65.4	63.1	58.8	69.6
NZD/GBP	0.514	51	0.51	0.508	0.486	0.388
NZD/EUR	0.637	0.634	0.635	0.64	0.566	0.52
NZDCNY	5.13	5.07	5.14	5.11	4.81	4.99
USD/JPY	81.90	82.31	79.56	78.48	77.98	105.7
USD/GBP	1.60	0.02	1.61	1.58	1.55	1.72
USD/EUR	1.29	1.28	1.29	1.26	1.33	1.28
AUD/USD	1.05	1.04	1.04	1.04	0.99	0.788
USD/RMB	6.2273	6.2258	6.2489	6.3515	6.3852	7.56

Risks Perceived To Have Fallen – So The NZD Has Gone Up

The Kiwi dollar has risen this past week mainly due to investors seeking out riskier and higher yielding assets in response to slightly reduced worries about managing the fiscal deficit situation in the United States. Last Friday night these reduced worries led to a 173 point rally in the Dow Jones Industrials Index and the Kiwi dollar jumped by one cent against the greenback. We've also made ground against the Euro over the week assisted by worse than expected data on the state of the manufacturing sector in Europe and an increasing expectation that after shrinking 0.1% in the September quarter and 0.2% in the June quarter the Euro-zone economy may decline by up to 0.5% in the current December quarter.

The underlying theme for the Kiwi dollar is that it is well supported by improving commodity prices, woe in other parts of the world, desperate money printing by other central banks, low government debt, well run

banks with strong capital bases, no history of government default and plenty of history of biting the bullet and undertaking big reforms when needed, plus a coming construction boom. In a world likely to be grappling with debt levels for a great number of years investors are highly likely to find the NZD attractive, with part of that attraction being our association with the Aussie dollar which central banks are increasingly placing some of their reserves in. This placing led to some excitement last week with RBA balance sheet data implying that money printing had been undertaken in Australia. But that is not the case and the Aussie economy, while displaying problems associated with the high AUD and sectoral strains, is not going to be boosted by a money printing effort by the RBA – not with the unemployment rate only just over 5%.

Here in New Zealand there will be no money printing given that there will soon be inflationary (cost of living) pressures from the Christchurch rebuild and a lot of other construction work. In addition the RBNZ is highly unlikely to cut interest rates given these coming pressures even though the currency is high and the unemployment rate also at a very undesirable level.

Speaking of unemployment, keep an eye on the migration data. While in the short term higher migration can boost unemployment, over the longer term it can lead to extra economic activity and an improved average workforce quality. The net annual migration inflow has improved to a loss of just 2,319 people in the year to October from 3,280 in September and a peak loss of 4,118 in the year to August. The migration flow is turning – and history tells us all in spades what that means for the NZ housing market, and what that means for inflationary pressures, and what that means for NZ monetary policy, and what that means for the NZD.

In other words…

The NZ dollar is strong even before monetary policy in NZ has started tightening. When the tightening comes in 2014 the NZD will rise higher and there is nothing which the government or Reserve Bank can do about it no matter how much lobbying comes from exporter groups or pain occurs in the export sector generally. The trade balance and current account deficit will worsen, and while theory says that this will push the NZD lower, that theory has not worked in practice in the past 27 years and nothing at all is jumping out to say that it will suddenly begin to function in the next wee while. Sorry exporters but that is the reality of the situation and it is highly likely to get worse for you unfortunately.

Key Forecasts

Dec. year		**2011**	**2012**	**2013**	**2014**
GDP	annual average chg	1.3	2.0-3.0%	2.0 – 2.5	1.0 – 2.0
CPI	on year ago	1.8	1.3	2.2 - 2.9	2.5 – 3.5
Official Cash rate	end year	2.5	2.5	2.5 – 2.75	2.75 – 4.25
Employment	on year ago	1.6	0.0 – 0.5	1.0 – 2.0	0.5 – 1.5
Unemployment Rate	end year	6.4	6.5 – 7.0	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 also 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

Tony.alexander@bnz.co.nz Ph 00644 474-6744

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