BNZ Weekly Overview

1 November 2012

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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.
http://feedback.bnz.co.nz/forms/Fx-I8ploskSGWgjN_7WOAw
To change your address or unsubscribe please click the link at the bottom of your email.

Survey Time

This is the first Thursday of the month, so if you have not already done so using the link supplied in the email, please click on the url here and let us know whether you feel that the NZ economy will get better or worse in the coming year. Also let us know how things are in your industry currently – remembering to specify what that industry is.

http://survey.usuite.com/survey/7f801dd05f3742619b046cc119c15106.sur

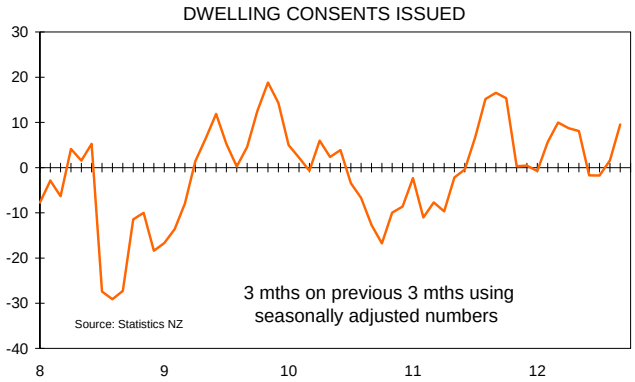
Last week I wrote the WO using my new iPad as part of an experiment to see if it were possible to shift all my computer work away from my small PC. The spelling mistakes reflect unfamiliarity with the "Pages" software but the reason I have reverted back to the PC is that the "Numbers" software for spreadsheet management is near unusable. Moving data, adding it etc is like a stop-start finger painting exercise and ability to form graphs is primitive beyond belief. So I'm retaining the iPad for its newspaper reading and quick access abilities (plus Angry Birds and other games) but have had to go back to the Lenovo box for data analysis and document preparation. Somewhere down the track when a mouse can be added to the iPad, a spreadsheet management app reaches this century, and one can flick instantly between programmes then maybe it will be useable. For now it is unusable for analysts.

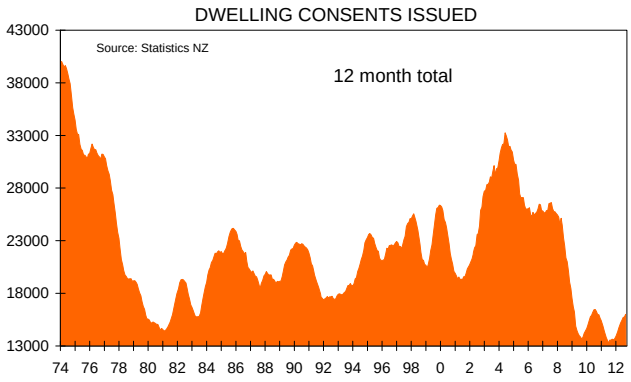
House Building Rising

On the economy front this week we have learnt that there is a definite upward trend in residential construction in New Zealand led by Christchurch and Auckland. For the country as a whole the number of dwelling consents issued in September was ahead a seasonally adjusted 7.8% from August making four monthly rises in a row. For the September quarter consents were ahead 9.5% from the June quarter and 14% from a year ago. The annual consent total now stands at 16,000 from 13,533 a year ago.

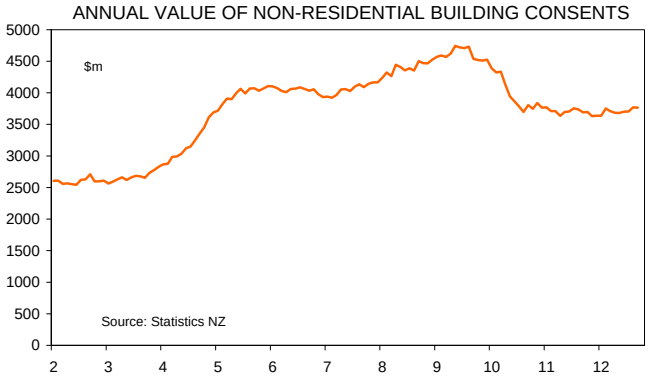
In Canterbury consent numbers for the quarter were ahead 66% on a year ago, Auckland 12%, and the rest of the country was down 5%.

These numbers are important as they show that the key factor which we expect to underpin NZ growth in the coming few years even if the rest of the world suddenly became munted again is in play. A key issue however is that we have no good idea as to when construction will peak, how quickly activity will rise, when exactly resource pressures arise and what the specific choke points will be (labourers, carpenters, council inspectors, project managers, engineers, materials producers, electricians, tilers, geo-technical assessors etc.)

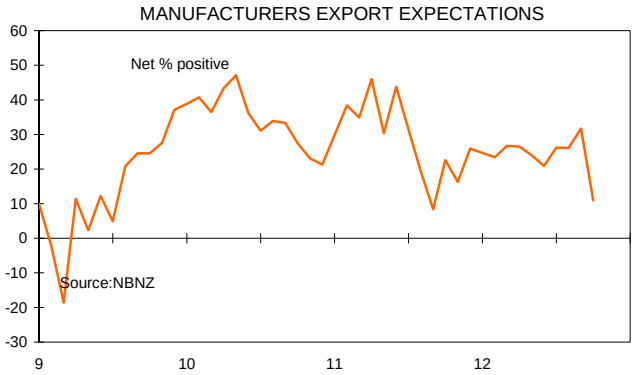




But while residential activity is boiling upward, non-residential activity remains flat. The value of non-residential consents issued in September was down 2% from a year earlier and for the past six months was ahead only 3.2% from a year ago. However if we do our best to strip out the public sector then we get growth in the past six months of 15% from a year ago so maybe this bespeaks of some underlying business sector investment growth.



The latest NBNZ Business Outlook survey shows that a net 19% of businesses in the construction sector expect to boost payrolls soon. In contrast, and perhaps reflecting the high level of the NZD, a net 12% of farmers expect that they will be laying people off. So we have a worrying split emerging between a domestic economy driven by the construction sector soaring, and an export sector not doing all that well. In October a net 11% of manufacturers said that they expect their exports to go down. This is well down from a net 33% expecting higher exports in September and the worst result since September last year and before that the middle of 2009.

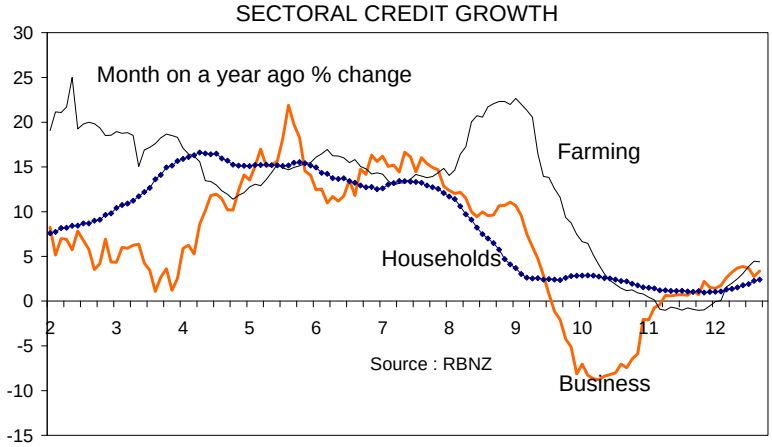


In fact last week we learnt that in September the value of exports in the September quarter was just 0.8% ahead of a year ago while imports were ahead by 1.6%. The balance for the year now stands at a deficit of $870m from a surplus of $694mn a year ago. This deficit is likely to get worse with one contributor being increased imports of plant and machinery to help with the Christchurch rebuild along with the necessities for increased government infrastructure pending and expansion of the dairying sector. Investment intentions sit at a slightly above average 12% positive. Will the deteriorating trade deficit bring the NZD down? No.

This is because although our economy only grew by 2% in the past year that is quite a good result when set against many others. Our commodity export prices have also risen recently, our interest rates are likely to stay above those in major economies for many years, the government debt level is low, and overall during a time of major worries overseas we look not too bad.

The new RB Governor also made it clear early this week that although he would like the NZD to be lower, he has no intention of undertaking unorthodox, radical measures to get it down. Stupid Social Credit-derived ideas like printing money thankfully get short shrift from the new Governor.

Speaking of credit, lending growth is accelerating in New Zealand. In seasonally adjusted terms household debt rose by 0.3% in September following a 0.4% rise in August and the annual pace of growth has risen to a two year high of 2.4% from 2.3% in August and 1% a year ago. The pace of growth in lending to the farming sector has held steady at 4.4% up from -0.9% a year ago while urban business sector debt growth has lifted to 3.4% from 2.8% in August and 1.1% a year ago. It doesn't look like any special stimulus is needed in order to get debt growth picking up in our lovely country where people like so much to borrow the money of others.



On the Road in NZ

As fate would have it as soon as I got back into the country I was off again for talks in Auckland, Queenstown and Dunedin. Frankly this travelling away from home has probably got out of hand. I was up in Auckland on Sunday and walking along Queen Street without the crowds of office workers and foreign language students was good – but less Saturday night vomit on the footpath would have been a bonus.

In Queenstown people are feeling fairly dour generally because an over-supply of apartments persists and the Winter was not a good one. The snow was poor and there has been a change in the way people, especially Australians, book to visit. It seems that too many in the past have been burnt by booking well in advance and arriving to an absence of snow. So now they wait until the last minute and only come if the snow is there.

At this time of the year Queenstown is quiet as it is the off-season between the skiing crowd and the summer outdoors crowd. I did not hear many foreign accents in the streets – which were pleasant to walk along with lots of interesting and high-priced shops to go into. Queenstown these days offers a far greater range of places to eat (and I guess drink at night-time) than seemed to be the case just five years ago. I imagine that for the next few years the property market will remain quiet as it will take some time for the apartment over-

supply to be used up, take some time for people with fingers burnt by some spectacular large-project failures to come back in again, and the persistent high NZD is going to keep the rich foreigners in North America away for quite a few years. I suggested to the woman in the Sunglasses Hut shop to give thought to the type of sunglasses which Chinese and Asians more broadly would like to wear.

That I guess is one of the things I am going to be saying forever now. If you are in business you should continually ask yourself how you will position your activities over time to cater for the steady multi-decade rise in the number of Asians coming to New Zealand, Asians looking to buy a holiday home here, perhaps wanting to move here, maybe wanting to get a part of a business operation here. There is no need for immediate radical change – just slow change at the edge in one's strategic plans.

INTEREST RATES

It is possible to create a scenario in which NZ interest rates jump quickly by maybe 1% but without the outlook for the economy or even the exchange rate changing to any great degree. One element behind a sharp rate rise would be accelerated construction in Christchurch and Auckland leading to a sharp rise in construction costs causing the RBNZ to become fearful of higher inflation becoming locked in. Another factor could be fears about the huge US deficit and rising government debt causing investors to back away from US government bonds thus causing their yields to jump. Perversely one driver of such a US rates rise could be good economic growth which raises expectations that the Federal Reserve will cease its money printing/bond buying activities. The Fed. currently buys about 70% of the government bonds issued to finance the deficit and refinance maturing debt. That is not at all a sustainable situation but it is impossible to know when we might see some market reaction to the deep debt problem.

Nothing interesting happened with regard to NZ interest rates this week. Nothing interesting will happen next week either….

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	2.63%	2.51	2.62	2.73	2.94	5.8
3 year swap	2.82%	2.73	2.78	3.00	3.40	6.1
5 year swap	3.11%	3.03	3.04	3.28	3.94	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 Affordability Report Boring

The Government put the final nail in the coffin for those anticipating some grand official moves to improve housing affordability in New Zealand and avoid a housing crisis in Auckland, with a weak set of proposals announced on Monday. Responding to the unproductive work undertaken last year by the Productivity Commission (unproductive in that it repeated what was already reported on four years ago) the Finance Minister announced the following.

- Ask councils to make more land available within and outside their cities.
- Set a maximum six month limit on council processing of residential building consents and consider rezoning all land as residential. (No chance of that latter move.)
- Look at how to fund infrastructure.
- Hold an inquiry into construction sector productivity.

And that is it. The Finance Minister in fact admitted that any impact on housing affordability will be minimal and will take many years to accrue. From here then its all up to the market. To whit…

Why Auckland House Prices Will Keep Rising

Regular readers of the Weekly Overview will know that I have had a vastly less negative view on the NZ housing market than most other commentators over the past few years with one of my key points being that shortage of supply would limit price declines over 2008-09. Now here is a list of 19 reasons why prices in Auckland in particular are going to keep rising. Enjoy, or despair, depending upon whether you own or wish to own Auckland property. And ask yourself – where does the greater number of votes lie? With those wanting to get their foot on the ladder, or with those who already own property? Hence no big legislative changes. As the Americans say, turkeys don't vote for an early Thanksgiving.

1. Auckland did not enter the 2008 recession then late-2008 into 2009 global financial crisis with an over-supply of property. Shortages of personnel constrained house construction from 2004 through 2008.
2. The shortage has become worse in the past four years and last year annual consent numbers were at a four decade low.
3. The government is explicitly aiming to grow Auckland's population as a means of achieving "agglomeration" benefits for economic growth which accrue from high interaction amongst economic players.
4. Despite the biggest global financial crisis since the 1930s NZ house prices only fell 11% at their worst and now sit on average above 2007 levels.
5. Removing the ability to use LAQCs to offset housing investment losses against other income has produced no flood of properties onto the market.
6. Removing the ability for property investors to deduct depreciation expense has not produced any flood of property onto the market.
7. Over the past four years young people have put off their normal household formation (leaving home, buying their own house) because of worries about mortgage availability, falling house prices, employment, and ability to raise a deposit. Now those four years worth of people are entering the market and looking to "catch-up" on their purchase.
8. Construction standards in New Zealand are always rising (watertightness, earthquake strength, energy efficiency) and this boosts construction costs.

9. A big fall in apprentice numbers in the past five years coupled with the loss of skilled people to Australia and older tradespeople leaving the sector rather than get licensed means labour-related construction costs will rise and labour will not be available to build houses even were more land available.
10. Banks are not going to step back into the property development sector left bereft of funds from the closure of finance companies.
11. Poor growth prospects in the next few years for Western economies mean their and our interest rates will remain at low levels for many years. This means low borrowing costs for home buyers.
12. Low returns on bank deposits mean older savers in particular will be seeking extra yield through investment in residential property either directly or through a yet to appear wave of property investment vehicles. (Be in no doubt. They will come.)
13. The migration cycle appears to be on the cusp of turning and if the housing market has performed so well with net outflows over 3,000 in the past year the implications of positive gains are clear.
14. The nature of net inward migration is changing toward greater numbers of people coming from Asia and with Asia's middle class booming in size potential inflows of wealthier people are large.
15. The NZ unemployment rate of 6.8% is likely to fall quite quickly over 2013 as the construction sector booms on the back of the rebuilding of Christchurch.
16. The aging population will produce a decrease in the average house occupancy rate and therefore a need for more houses for any given population size. People will retain their old homes with many bedrooms to allow visits by grandchildren, gyms, home offices, home cinemas etc.
17. The government has announced its efforts to improve housing affordability (lower prices) and they are minor and unlikely to have a noticeable impact if any for many years.
18. Any credibility people may have assigned to those who have been predicting big price declines simply because prices have risen a long way and now fallen sharply in some other countries has gone out the window. Few people will now listen to their price decline views.
19. Members of the Opposition believe monetary fairies can make the exchange rate settle permanently lower by forcing interest rate cuts and printing money while letting inflation therefore go up. Given the non-zero possibility that such economically ignorant policies get introduced it is worth getting inflation protection by investing more in property – not less.

Capital Gains Tax Wouldn't Change Much

One day when we get a change in government there may be a CGT tax introduced which may apply to properties beyond the family home, may have a sliding scale depending upon how long a property is held, and may (should) extend to farmland.

Would a CGT
-improve housing affordability,
-boost household savings,
-reduce household borrowing,
-lower NZ interest rates,
-lower the NZD,
-provide increased capital for non-housing business ventures and therefore,
-boost NZ economic growth?

Not really and no-one has produced any research attempting to quantify any of these factors. We have no idea how many people have bought a house because it can offer a tax free return, nor how many might sell. So why do I believe there will be little benefit to our economy or change in housing market dynamics were a CGT to be introduced?

- Australia has a CGT and their house prices are very high plus their housing market moves in cycles like ours.
- NZ investor interest in housing has risen, not fallen, since the LAQC and depreciation rules were changed.

- Housing is largely debt financed so there is no large pool of money available to shift toward productive business ventures.
- To the extent a CGT dissuades people from building it will exacerbate the housing crisis and push prices up rather than down.
- Investors generally have good access to credit. If the anticipated life-time return from property investment is reduced by a CGT they may buy more rather than fewer properties in order to meet their wealth goal.
- Unless house prices fall sharply (very unlikely given the existing housing demand/supply imbalance at current prices) or construction plunges, there will be **no change in demand for credit** to finance home ownership. Even if investors were to sell owner occupiers would purchase (recall that there are many frustrated buyers out there) and debt would simply shift from one person to another. Therefore reliance on foreign financing would not change so neither interest rates nor the exchange rate would decline.

From an equity point of view there is justification for introducing a capital gains tax and that equity position means the tax must apply also to farmland. However this will not lead to any structural shift in New Zealand's economic prospects. In fact we must even question the assumption that the absence of a capital gains tax accounts for New Zealand's high house prices. The commonly cited statistic is that in the 1990s the NZ home ownership rate was 75% and now it is around 65%. But a lot of that change will simply reflect people placing the family home into a trust rather than houses changing to investor status.

The restraints on New Zealand's rate of income per capita growth lie outside the institutional and tax framework and the causes of high house prices lie well away from the tax treatment of capital gains.

If I Were A Borrower What Would I Do?

I'd sit floating keeping an eye out for a lender offering a heavily discounted five year fixed rate near perhaps 5.5% rather than the current 6.5%. This is because I like rate certainty and worry that at some stage investors will reassess their outlook for world/United States inflation and push bond yields up 1% or so.

MAJOR OFFSHORE ISSUES

Europe

The UK economy grew by a stronger than expected 1% during the September quarter after shrinking 0.4% during the June quarter and by 0.3% during the June quarter. This result however received at least a 0.2% boost from the Olympics and maybe a 0.3% boost from the one day special holiday for the Queen in the June quarter not being repeated. The underlying UK growth rate is something close to 0.2% a quarter with restraint on growth coming from tight fiscal policy and low confidence coupled with a debt repayment drive across many sectors.

In Spain retail spending in September was down by a whopping 10.9% from a year earlier after falling 2% in August. Ouch.

United States

The US economy managed to grow at a slightly faster than expected annualised pace of 2% in the September quarter which was an improvement from 1.3% during the June quarter and the same as the March quarter. The result was boosted by the tentative signs of a turnaround in the housing market including construction levels rising 14.4% annualised, and the biggest area of spending in any modern economy, consumer spending, rising 2%. Exports however decreased by 1.3% and there are worries that with America's trading partners struggling this will continue to be a drag on growth in the short to medium term.

Other data were released but I have done too much travelling this week to do further analysis.

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.

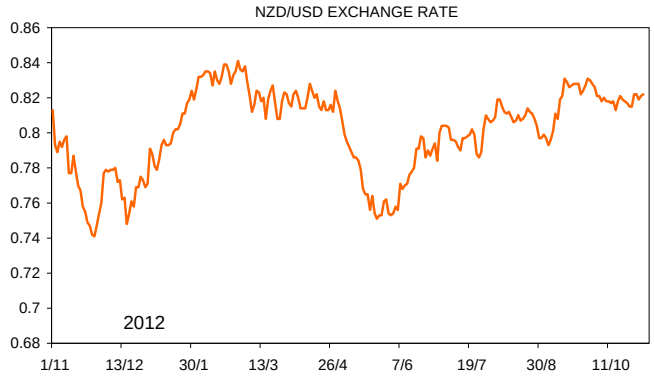
The main China-related development this week was the release of Australia's white paper entitled "Australia In The Asian Century" I have prepared a review on the paper for the next issue of Growing With China which will appear on November 26. If you want to be on the emailing list for that publication email me tony.alexander@bnz.co.nz

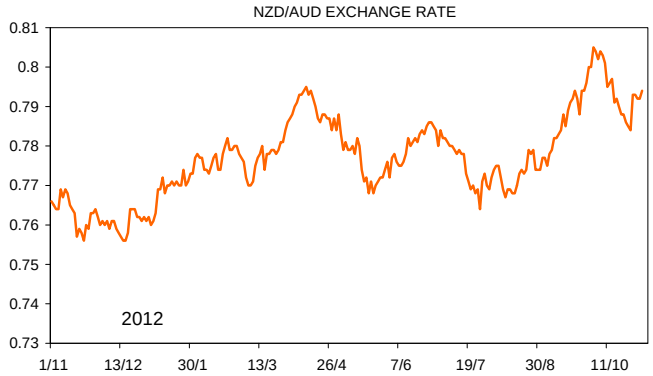
Exchange Rates

Exchange Rates	This Week	Week ago	4 wks ago	3 Mths ago	Yr ago	10 yr average
NZD/USD	0.822	0.815	0.83	0.806	0.813	0.67
NZD/AUD	0.794	0.784	0.8	0.769	0.766	0.85
NZD/JPY	65.6	65	64.7	63.2	63.3	69.6
NZD/GBP	0.51	0.508	0.513	0.516	0.503	0.388
NZD/EUR	0.634	0.627	0.646	0.657	0.583	0.52
NZDCNY	5.13	5.09	5.22	5.13	5.17	4.99
USD/JPY	79.81	79.75	77.95	78.41	77.86	105.7
USD/GBP	1.61	1.60	1.62	1.56	1.62	1.72
USD/EUR	1.30	1.30	1.28	1.23	1.39	1.28
AUD/USD	1.04	1.04	1.04	1.05	1.06	0.788
USD/RMB	6.2373	6.2449	6.2858	6.3628	6.355	7.56

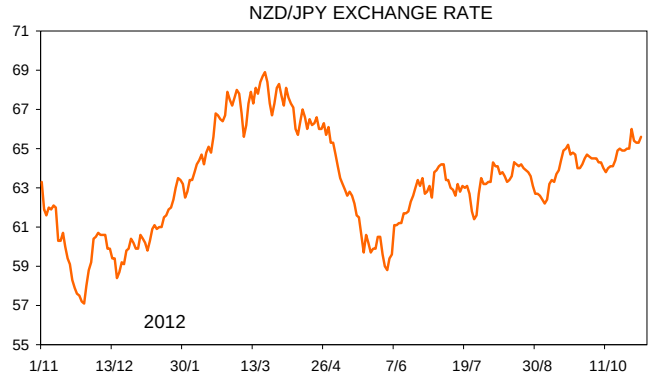
NZD Is Rising

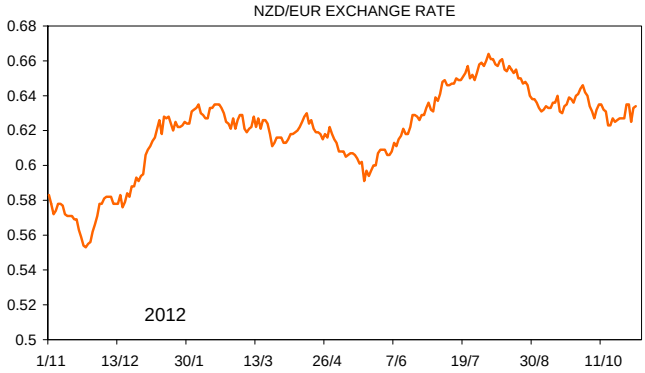
The Kiwi dollar is on a slow upward trend against the USD as seen in the first graph below. As yet the levels of January around 84 cents have not been reached but that seems like just a matter of time. In the United States the money printing continues at a pace of US$40bn a month, interest rates won't be going up for a great number of years, and there is a substantial tightening of fiscal policy to occur one way or the other. But here in New Zealand we stand on the cusp of an inflation-driving construction boom, enjoy generally well underpinned commodity prices, and have a housing market more generally rising at what could become an accelerating clip. Exporters may want to keep an eye out for occasional bouts of global growth worries to get some extra short term hedging locked in.



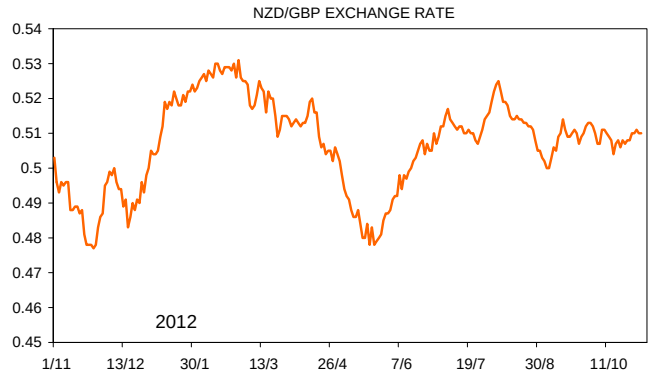


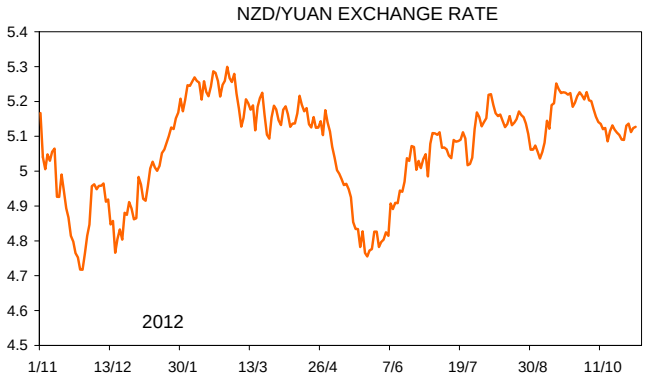
The Kiwi dollar has risen against the Japanese Yen from a few weeks ago in response to expectations of monetary policy easing by the Bank of Japan and underlying expectations that there may be official intervention to get the Yen down against other major currencies. The Yen is strong even though the Japanese economy remains as challenged as ever by deflation, weak household spending and a massive government debt burden because as a creditor nation during a time of major worries offshore Japanese investors are preferring to leave their funds at home rather than risk them in offshore investments.





The absence of any hint from the new RBNZ Governor last week that he would contemplate cutting interest rates should the NZD get even stronger should now put to bed those thoughts some lobbyists have been having recently of housing-stimulating rate cuts being undertaken in order to boost export competitiveness. Plus this week the RBA Deputy Governor took away hopes of Australian exporters that there might be intervention to get the AUD down from near $1.04. He said that the AUD is "not over-valued" and instead its level logically reflects the high level of Australia's export commodity prices.





He also noted the way in which money printing exercises overseas are pushing the AUD upward and Aussie interest rates downward.

It should be clear to everyone which direction I expect the NZD to oscillate in over the coming few years.

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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