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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Drought

First of all many thanks to those readers who responded in our monthly Confidence Survey this week. The result of a net 41% feeling optimistic about the economy in the coming year tells us two things. First, things look good with respect to growth in job numbers and business investment, better conditions beckon for raising funds either through an IPO or off-market venture, and conditions will likely generate eventually higher interest rates and a sustained high exchange rate.

And what is the second thing which the survey result tells us? That if you have been around long enough following the New Zealand economy like I have you'll know these confidence levels won't last because there is a full blown drought underway which only hits city psyches with a lag – as we learned very strongly back in 1997/98, and again in 2008 when drought was one of five factors back then which pushed us into recession.

As someone who lives on ten acres north of Wellington with two big water tanks supplied by a large roof area, complacency about rain has already cost me one $220 10,000 litre delivery of water and the way things are going I may be up for another $220 soon after I get back from Singapore on Monday.

Drought always hits our economy and it will be one of the factors which offsets the stimulus already started in the construction sector and the reasonably strong lift in retail spending which is underway. Will the drought effects be severe enough to push the economy back into recession? We don't think so – but then we don't know how long the drought will last and the extent to which it hits not so much late-season agricultural production, but production potential for the coming season or two.

Thanks also to the 355 real estate agents who responded to our BNZ-REINZ Residential Market Survey this week. The results for the first time ever in this country give us some good insight into really basic things like the proportion of house sales that are to first home buyers (24%), investors (19%), and buyers located offshore (9%). They tell us that of those offshore buyers, across the country 18% come from the UK (Auckland 18%), 15% from China (Auckland 19%), and 14% from Australia (Auckland 15%). So only 2.1% of house sales in Auckland are to buyers located in China – and given that at least 39% of those buyers plan shifting to New Zealand, at most 1.2% of Auckland's sales are to buyers in China intending to stay away. So much for all those anecdotes about the Chinese buying everything in sight. Full results are posted here http://tonyalexander.co.nz/wp-content/uploads/2013/03/BNZ-REINZ-Survey-March-2013.pdf

In Singapore

So here I am in Singapore, sitting at a newly opened "Chaitime" tea outlet in the AXA Building just across the road from the Monetary Authority of Singapore where I shall be meeting a couple of their economists in less than half an hour. The temperature outside is over 30, humidity is through the roof, I'm wearing my suit and favourite blue tie, and can't wait to get back to the hotel located above Lavender MRT Station to get changed before heading out later to an evening at Block 71 – a start-up facility some angel investors are going to show me through.

I'm looking forward to going because frankly, when I look at the economy of New Zealand and where things are going, (more cows – more, more) I struggle to find too much exciting to say as reason for dragging expats back outside of suggesting they start forming links with the many incubators getting set up and the developing innovation centre sector (EPIC, Wynyard hub, Lightning Accelerator). And no, I don't for a second believe selling state energy assets will do anything to boost the economy's productivity growth.

The MAS meeting went well and here are a few of my learnings.

MAS controls the exchange rate with a six monthly review and management within a currently rising band. That means they have no control over interest rates (you can't do both) and those rates are currently very low courtesy of low interest rates in other developed economies and money printing elsewhere.

Research released in 2010 by the Economic Strategies Committee found that too much of Singapore's growth had come about simply from growth in the labour force as foreigners were brought in mainly for construction work. Productivity and investment growth were too low. So restrictions have been increasingly placed on foreign workers over the past year in an effort to force out inefficient businesses and encourage greater investment to boost productivity. The Productivity Innovation Credit has been created to give firms an incentive to raise productivity.

Singapore has always aggressively sought foreign investment and continues to do so today with an emphasis on new industries they seek to promote – space/aeronautics and clean energies. (Compare that to NZ where we think anyone bringing money in is taking something away from us.)

Block 71

My visit to Block 71 went well. Block 71 is an entire large multi-storey building which has been made available on National University of Singapore grounds for start-up businesses. I visited a special facility there called The Joyful Frog Digital Incubator which runs an accelerator programme over 100 days for selected start-ups with the aim of securing investors at the end. The pre-selection for the programme appears to be key and the head Wong Meng Weng looks for the match first of all between the idea and the team, then between them and JFDI. I may have the spelling wrong but I believe a NZ-associated company Tradegecko successfully went through the accelerator programme.

What is one of the identified key issues with start-ups? The people involved are usually very enthusiastic about their product development. But they don't always realise that a lot of what they need to do involves selling. In fact for a start-up in the technology field it is the most important thing as you need to first sell your idea to backers, then fully develop the product with funds to undertake appropriate market research, focus groups, technical assessments etc. it is not as easy as simply inventing a thing.

Business Class – Not Really

I am flying Singapore Airlines in Business Class (this isn't a bank expense, I'm self-funding this trip) but next time think I'll just stick with Economy. Their Business Class is essentially the Air New Zealand Pacific Economy class – but at twice or so the price. The seat does not convert into a flat bed and instead just extends to a downward sloping angle. You don't have your own cocoon-like space as with Air New Zealand and there is no instruction booklet for the video system which you have to figure out for yourself.

I'm staying at the V Lavender Hotel which is very handy as it sits practically on top of the Lavender Station for the MRT rail system. But the wireless system has many dead spots. At the breakfast restaurant there are no newspapers to read. The coffee is almost acceptable. But it's quite cool to arrive at the outside restaurant for breakfast just after 6.30am when it is still dark but lightening rapidly. The air is warm but not hot, the breeze winding around the building is nice, the birds in the trees sound great, and you get a view of some of the city's skyline from the large balcony. My room unfortunately just looks right across to other rooms on the other side.

In contrast with Hong Kong where people drive on the left but stand to the right on escalators, in Singapore you also drive on the left but stand to the left as well on escalators.

There is a far less frenetic pace to the place than Hong Kong and things are much tidier. That is not to say that there is no litter because if you look you can find some. But there is none of Hong Kong's air pollution derived from mainland China factories – just a tropical haze at times.

Singapore Backgrounder

So what is the story of Singapore? First, it is an independent country – a city state, an island state, of some 273 square miles with a population currently of 5.3 million. In 1818 as Britain developed its interests in India, trade between India and China was growing, and greater physical presence was needed as a counter to Dutch expansion in the East Indies. So Sir Stamford Raffles was sent off to find a place to establish a base. He did so in 1819 on the island of Singapore which offered a great port and place to refit and resupply vessels travelling along the spice route.

Singapore became a Crown colony with a Governor in 1867, it was occupied by the Japanese in the second World War, and in 1959 it became a self-governing state within the British Empire as citizens saw little benefit or honour in retaining the original strong British linkages following its abandonment by the British to the Japanese in the war. Apparently the British were facing south all geared up for a naval attack but the Japanese just strolled over from Malaysia to the north.

Mired with high unemployment but increasing calls for independence, Singapore unilaterally declared independence from Britain in 1963, spent two years as part of the Federation of Malaysia, but broke away and officially gained sovereignty on 9 August 1965.

With Britain leaving its bases in 1968 unemployment soared, but with Cambridge-educated Prime Minister Lee Kuan Yew it did what China did from 1978 and adopted a low tax while regime opening itself to foreign investment in labour-intensive export-oriented industries. Singapore rode the wave of strong global growth until the late-1970s when it switched focus from low skilled manufacturing to technology-intensive high value added industries. The move was timely and Singapore enjoyed newly booming manufacturing of computer disk drives.

In contrast to China which adopted a relatively extreme laissez – faire attitude toward social services, public housing etc. from the late-1970s, Singapore's government created the Central Provident Fund of compulsory contributions from employers and employees and therefore was able to deliver a strong social welfare system including financial security in retirement.

At the same time Singapore boomed (along with Hong Kong) as a financial services centre

Singapore's economy grew by about 8% per annum on average between 1960 – 99 but managed just 1.3% during 2012 from 5.2% in 2011, 14.7% in 2010, 1.3% shrinkage over 2009, 1.1% growth in 2008, and 7.7% in 2007 and 7.9% in 2006. The average growth rate therefore remains high at around 5% per annum, but the most recent growth rate and projections of growth near 2.5% this year are raising concerns – which are partly manifesting themselves as a worsening attitude toward foreign workers.

Anti-Foreigner Sentiment

Just a few weeks ago there was the extremely rare event of a public protest in Singapore – against foreign workers – following forecasts of the population reaching 6.9 million in 2030 from 5.3 million currently. Yet these protests run directly counter to the desires of the business sector for continued availability of foreign labour and a firmly growing population underpinning spending growth.

Last year the government increased levies on foreign workers hired by businesses and with wage costs rising firmly there is deepening concern about weakening foreign investment in the Singaporean economy – especially as rapidly developing infrastructure in other Asian economies and rising education standards opens up vast workforces in other locations for companies to consider accessing.

Inflation was 4.6% last year, Singapore is rated as the sixth most expensive city in the world to live in, and the Gini coefficient measuring income disparity widened to 0.45 last year including transfers and taxes, compared with an OECD average near 0.32. A reading of zero means complete income equality and 1 means one person has everything.

There is rising debate about congestion on public transport during peak periods and proposals are being tossed around to address it including staggered business hours, more buses etc. If the staggered hours are introduced Singapore could provide a useful testing bed for other cities to monitor.

Singapore's economy is very closely tied into global economic growth along with regional growth. In that regard the improving fortunes in the United States are positive as is the common expectation of firm growth continuing in China. High growth in the likes of Indonesia also is forecast to boost activity, especially from tourism. The top personal income tax rate is 20%. But before you get excited about that, consider the cost of owning a car.

So You Want To Own A Car In Singapore

First you need to purchase a ten year Certificate of Entitlement to own a car. That may amount to $90,000 and after ten years it is worth nothing. Used cars seem to cost maybe 2 – 3 times what we pay in NZ. With regard to new cars the differences are even greater.

In New Zealand a new Toyota 1.3 litre Yaris auto will cost you about $25,000. In Singapore you will pay the equivalent of over NZ$150,000. A Kia Soul 1.6 litre in NZ costs about $30,000 – in Singapore $111,000! And that is not all. Then there are various registration fees and peak hour tolls to consider.

The aim of all of these charges is essentially to force people to use public transport – which brings me to the train system. Whoever designed Singapore's train system must have been a fan of 'The A Team" because rather than calling it the MTR like Hong Kong does, they called it the MRT. There is a worsening over-crowding problem on the trains – but the solution would seem clear. Double the number of trains on each line.

The frequency with which trains pass stations is less than half and perhaps only a third that of Hong Kong. Singapore is the only country I have been in where after all those disembarking from a train had got off I was not able to get on because the doors closed – even though I was just one person back in the queue to get on at the side of the open door.

The trains are however very cheap to ride, well air conditioned, and generally not noisy.

The Botanic Gardens are lovely and easy to stroll through plus they contain some 1.5 metre monitor lizards which I may go back to look for this weekend. Unlike the gardens I visited near Shinjuku in Tokyo about three years ago they are free and one does not have to go through a turnstile to gain entry.

On Sunday I took a trip to the Jurong Bird Park which is fantastic. It is apparently Asia's biggest bird park and for me the highlight was the large flock of Pink Flamingos, followed by the astounding range of Macaws, then the birds of prey including vultures and an American Bald Eagle (not bald at all – just white feathers on the head from the age of five). At Currumbin Zoo on the Gold Coast the bird show is very good – especially as one is so close to the birds. Having to cater for – at best guess - twenty times the number of people per sitting – one is further away at the Jurong bird show but the one I saw was still fairly good. The highlight there was a wonderful display of talking by a special parrot. It counted to 10 in English and Chinese, and sang three songs across three languages.

Getting to the bird park is easy. Just take the MRT to Pioneer Station or Boon Lay on the East West line and take a bus from there. Or you can do what I did and walk the couple of kilometres instead and get to see some dormitory accommodation for the thousands of largely Indian or Bangladeshi construction workers. At Boon Lay there is a great normal person's shopping mall – as opposed to the malls along Orchard Road each of which largely contains the same up market shops catering to the same high spending visitors.

The Coffee

And what about my standard test of all places I go – the coffee? Singapore rates better than London in that I was not offended by any of the coffees I had. But they still lacked bite so I'd give the place six out of ten with one point deducted because the prices were stupidly high for what one got. One place along Orchard Road charged $6.50 for an over-frothed cappuccino.

Unlike London, Paris, Hong Kong and fairly much every other city I have been to overseas, in Singapore it is very hard to find an outlet selling newspapers. Maybe newspaper reading was long ago considered passé here and everyone reads off their computer – or they don't read papers much at all. I found one place selling the Financial Times – sometimes. But even the wonderful Kinokuniya store sold only a very basic range of newspapers. Apparently I need to seek out the Seven-Eleven stores as they have newspapers.

The Week's Data

Further evidence of strength developing in the retailing sector appeared this week in the form of core spending using debit and credit cards rising 0.7% seasonally adjusted in February. This gives annualised growth of 7.9% in the past three months which is the strongest pace of growth since July 2011. There is solidity to the result as it were seen in annualised spending on durable items rising 9.5%.

Maybe other numbers came out but I've had no time to work on them given time spent meeting people over here and work needed on four other publications.

INTEREST RATES

This morning the Reserve Bank released their three monthly Monetary Policy Statement and results of their six-weekly review of the official cash rate. As had been universally expected the cash rate was left unchanged at the 2.5% level they took it to in March 2011. But a few people were surprised by the RB's dovish tones, the pushing of their forecast starting point for rate rises to March 2014, the absence of any mention of prudential controls, absence of any great expression of concern about either the exchange rate or house prices. So wholesale interest rates finish this week slightly lower than last week.

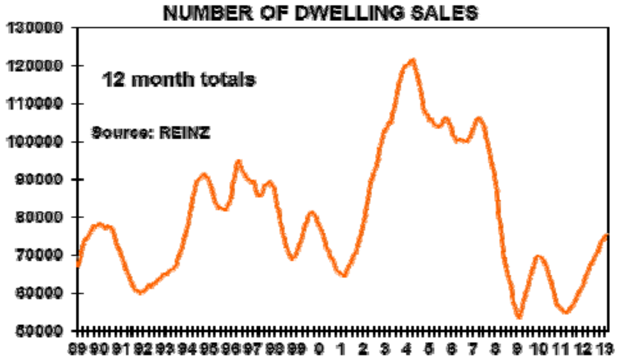
FINANCIAL MARKETS DATA

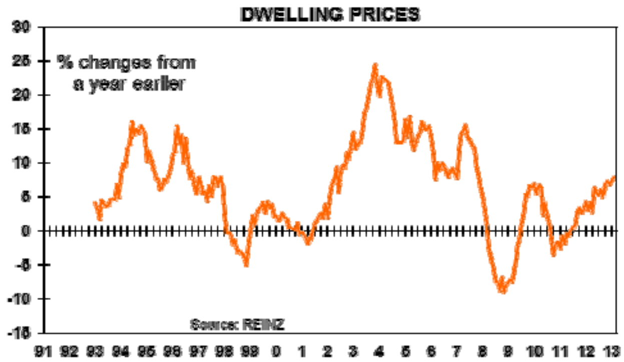
	This week	Week ago	4 wks ago	3 months ago	Yr ago	10 yr average
Official Cash Rate	2.50%	2.50	2.50	2.50	2.50	5.4
90-day bank bill	2.68%	2.68	2.66	2.67	2.76	5.7
1 year swap	2.78%	2.85	2.86	2.68	2.92	5.8
3 year swap	3.20%	3.24	3.20	2.89	3.36	6.1
5 year swap	3.53%	3.57	3.52	3.17	3.82	6.3
7 year swap	3.84%	3.86	3.83	3.47	4.19	

HOUSING MARKET UPDATE

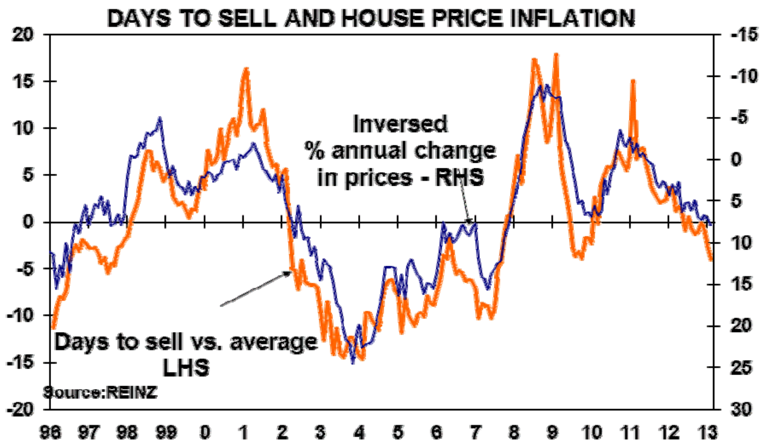
Prices Rising

This week the REINZ released their monthly housing data and they show the following. In February there were 6,632 dwellings sold around New Zealand which was a rise of 7.5% from a year earlier and rough seasonally adjusted change near zero. Sales growth appears to be plateauing. Prices however are rising with the measure adjusted for changes in the mix of dwellings sold from month to month rising 1.6% after falling 1% in January. The rise in the past three months has been 0.7% from a 2.8% rise three months ago so as with sales the pace of price gains has slowed slightly from late last year. But both trends remain upward. Prices in February were on average 7.9% ahead of a year ago.





The most interesting number in this month's release is the days to sell measure. This came in at 39 in February which was four days faster than average for the month whereas January sales happened just 2.6 days faster than average and December 0.8 days. This shows the listings shortage to a certain degree.



Overall the data show a strong market but not one which is running away with itself.

High Building Material Costs

One of the factors we cite as helping explain the high cost of houses in new Zealand is the high cost of building materials. Here are some comments from a person at the coalface.

"Some WO's ago there was a description of the residential construction industry being a cottage industry of one-man players. This cottage industry deals with an oligopoly of merchants who are supplied by a monopoly or at best a duopoly of manufacturers.

Like a lot of things, residential building is CHC and AKL and the rest.

In the rest of the country it is a version of say a town like Taupo, where every merchant chain, 5 of them are represented. The market there is somewhere between 6 – 18 new build consents per month against a 10 yr average of 30 per month, the pricing is being beaten down to the lowest point by low demand and over supply, yet all are hanging in there subsidised by their corporate owners or are marginally profitable if they are locally owned. In Australia that town would have one merchant.

The cost of materials in NZ is artificially high because the merchants' parent's take and hold manufacturers rebates and bulk purchasing advantages, using the merchant chains as a means of extending their monopoly through the distribution of their materials or manufactured goods, thus preventing the goods' true cost from hitting the market. From experience and exposure to the true costs, a house can be built for about $900 per m2. with average fit out specification.

Canada and Scandinavian countries have greater climatic extremes and build at far lower cost than we do per m2. Their homes are more sophisticated and warmer and cheaper to build and the same specification.

The real cost of building homes in NZ is not that we build high spec, or due to style and size, it's fundamentally the lack of purchasing power by a cottage industry that enables an oligopoly to hold a disproportionate share of the profit that is made compared to their role or stake in the value chain."

BNZ-REINZ Residential Market Survey

I released the results of this month's survey this morning. It turns out that only 9% of NZ house sales are to folk offshore. Some emailers have opined that real estate agents deliberately biased their results downward. I doubt that.
http://tonyalexander.co.nz/wp-content/uploads/2013/03/BNZ-REINZ-Survey-March-2013.pdf

First, if there was an agent desire to downplay the role of foreign buyers I would have expected the number of responses to have risen from 572 in February – not fallen to 355.

Second, I would also have expected the net percent reporting more interest from investors to have done more than move from a net 35% positive in February to 37% this month.

Third, given that the sensitivity is with regard to Chinese bias I would have expected a big drop in the numbers reporting buying from people in China. But compared with last month's survey where we asked for agent opinion about sales offshore versus actual personal sales, the change across reported buyers from China, Australia, and the UK was basically the same. From page 5 of the report.

	Perceived % of offshore sales to buyers February survey	**Actual sales March survey**	**Perception error**
China	24%	15%	9 percentage points
Australia	21	14	7
United Kingdom	27	18	9

If I Were A Borrower What Would I Do?

Nothing new – half fixed at a rate from three years onward but only if it was a special being offered by a lender, and the other half floating and in short-term fixed. There is little chance of the Reserve Bank raising rates in the near future.

OFFSHORE

Not much here this week. Not enough time.

In the United States the news remains largely positive. Job numbers in February increased by 236,000 whereas a gain of 160,000 had been commonly expected. Plus the unemployment rate fell away 0.2 points to 7.7% in the month. Nevertheless, the rate remains well above the 6.5% which the Federal Reserve has indicated they are waiting for before contemplating removing the current extraordinary level of monetary policy stimulus.

In fact the combination of signals that the stimulus will continue along with strengthening economic data accounts for the continuing rise in the US sharemarket which is having a positive effect on markets elsewhere.

In Europe there was some good data on imports into Germany but bad data on Italian GDP which fell 2.8% for all of 2012 and manufacturing in France down 4.5% on a year earlier.

In Australia the run of data shows a housing market picking up, but enough weakness elsewhere that there still remains a chance that the RBA will follow through on the 1.75% worth of rate cuts they have already implemented with another 0.25% reduction. The cash rate is currently at 3.0%.

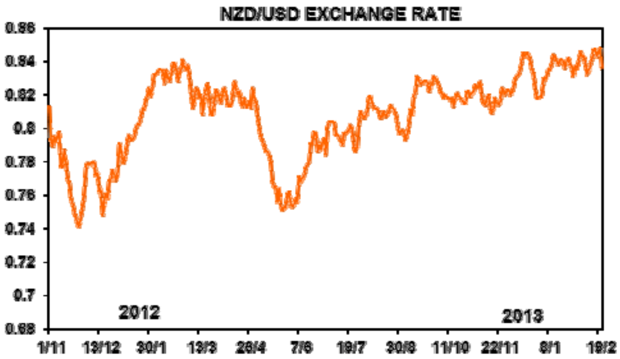
Exchange Rates

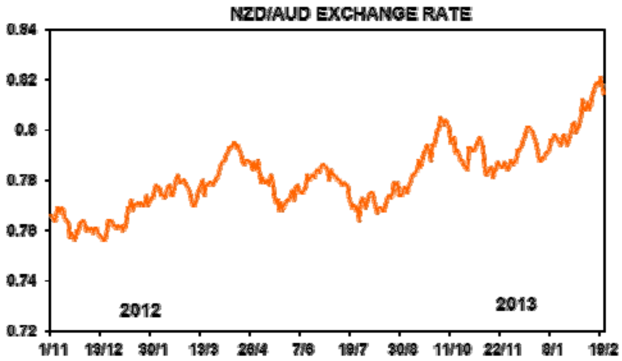
Exchange Rates	This Week	Week ago	4 wks ago	3 Mths ago	Yr ago	10 yr average
NZD/USD	0.819	0.828	0.847	0.842	0.82	0.67
NZD/AUD	0.795	0.809	0.818	0.796	0.78	0.85
NZD/JPY	78.7	77.7	79.3	75.2	68.1	69.6
NZD/GBP	0.549	0.551	0.546	0.524	0.522	0.388
NZD/EUR	0.632	0.638	0.63	0.63	0.627	0.52
NZDCNY	5.09	5.15	5.28	5.23	5.19	4.99
USD/JPY	96.09	93.84	93.62	89.31	83.05	105.7
GBP/USD	1.49	1.50	1.55	1.61	1.57	1.72
EUR/USD	1.30	1.30	1.34	1.34	1.31	1.28
AUD/USD	1.03	1.02	1.04	1.06	1.05	0.788
USD/RMB	6.2142	6.218	6.2325	6.217	6.3277	7.56

NZD – Down For Now

The NZD has fallen slightly this week in response to some strength in the USD associated with the string of good US economic data and run up in their sharemarket, plus this morning's more dovish than expected monetary policy comments from the Reserve Bank. These two factors are likely to keep some of the immediate heat out of the NZD so the path upward we expect it to follow will stretch out a bit more. More it is still an upward path which we are expecting and exporters may do well to boost hedging on dips like this which come along. The chances of a substantial dip are fairly remote given the extra boost to the NZ housing market the RB's absence of expressions of concern and low interest rate profile will give. Plus retailing data have been firm recently and the construction sector is rising strongly.

The big area of uncertainty is of course the drought and we can only play that by ear and slowly judge over time the extent of the negative impact.





Key Forecasts

Dec. year		2011	2012	2013	2014
GDP	annual average chg	1.5	2.0-3.0%	2.5 – 3.0	3.0 – 3.5
CPI	on year ago	1.8	0.9	1.0 - 2.0	2.0 – 2.5
Official Cash rate	end year	2.5	2.5	2.5 – 2.75	2.75 – 4.25
Employment	on year ago	1.6	1.0	1.0 – 2.0	1.5 – 2.0
Unemployment Rate	end year	6.4	6.5 – 7.0	6.0 – 7.0	5.5 – 6.0

The Weekly Overview is written by Tony Alexander, Chief Economist at the Bank of New Zealand. The publication is sent to 27,500 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 Brain Gain NZ publication http://www.braingainnz.co.nz
- monthly BNZ Confidence Survey, http://tonyalexander.co.nz/topics/surveys/bnz-confidence-survey/
- monthly BNZ-REINZ Residential Market Survey. http://tonyalexander.co.nz/topics/surveys/bnz-reinz-survey/
- Monthly column for the NZ Property Investor magazine, http://www.propertyinvestor.co.nz/
- 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

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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