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.
http://feedback.bnz.co.nz/forms/Fx-I8ploskSGWgjN_7WOAw

Drought-driven recession is a low probability – but one that rises every day the rains fail to return to normal

I did a number of interviews whilst in Singapore – two of them live for radio and one for TV3, plus one on the day I left last Sunday with regard to the Finance Minister noting that the cost of the drought could be twice the government's earlier estimate. The reporter seemed to be playing two angles – one that the change suggested an error earlier on by the government, and the other that the change meant there was an urgent need for the government to do more to mitigate the effects.

On the earlier error side the argument is empty. The thing about a drought is you don't know you're in it until well after it starts. The first few weeks simply represent a period of lovely warm weather within seasonal norms. The other thing about a drought is you never know its ended until it has. And you can't calculate a final cost until you know that end date. Therefore all early estimates of the impact are naturally subject to change.

On the second issue of the government doing something about it – there is little they can do and farmers know it. Governments can't bring the rain, and farmers know that every now and then big challenges will be thrown their way. That is why being a farmer isn't a job. It's the accepting of a challenge and managing as best one can when the hard times strike. They always strike eventually.

One of the difficulties for farmers when it comes to drought however is that usually people in the city think the good weather is a boon and fail to understand farmers' pain. However this time around the dry conditions have struck Wellington at least with a vengeance so there can be no doubt that not only do Wellingtonians understand the urgency of the situation, but that the politicians do as well.

Does the drought have potential to offset the stimulus to growth from cyclically strengthening consumer spending, a rising housing market as young people catch up on buying, and a construction boom to throw the economy back into recession? The answer is yes if the drought runs for long enough. But with forecasters predicting that in April weather will be closer to normal, at this stage a recession is a low probability scenario.

But clearly the economy has taken and will take more of a hit and that helps explain why the current multi-decade lows for interest rates will continue into 2014. That therefore helps explain why house prices will continue to rise, household debt growth pick up, and the current account get into even worse shape.

Speaking of which. In calendar 2012 the current account deficit deteriorated to 5% of GDP from 4.7% in the year to September and 4% during 2011. With exports being hit by a high exchange rate while surging domestic growth naturally lifts imports, it is conceivable that the deficit goes back to the 8%+ of GDP level last seen in the period from 2006 – 2008. We all know that means our currency is fundamentally over-valued. However history tells us that this delivers no insight into when the NZD will strongly decline. In fact the chances are it will not for a number of years given the money printing offshore and continuing financial woes.

As a result of the deficits which we have accumulated over the past four decades, the level of New Zealand's (largely private sector) net external liabilities now stands at $150bn, which is the equivalent of 72% of GDP.

Why I gave $10 to a stranger on Marina Bay promenade in Singapore.

So there I was, sitting on a bench in the shade near a solar powered cooling fan along the Marina Bay Promenade. People walking by, some running, some on in-line skates, but not that many of them. It's hot. Then an Indian gentleman walks past, says hello, and out comes the line which tells you exactly what is coming next. "Sir, I have to tell you, you have a very lucky face.".

So immediately I know that he wants money from me but I couldn't figure out how he was going to sell me his shirt-making services with no shop anywhere in sight. He starts speaking rapidly about how my fortune looks good, then drags out a pad and pen and starts writing some simple things down. Apparently I am going to live to be 97 years old. What a gip. My plan was to stick around for the royal congratulations.

In 21 days I should be very wary of something involving swimming, driving, or signing my name. And so it went on. But the bit which made me willing to hand over some money even though I knew it was all an act was this. He scribbled some things on a tiny piece of paper, handed the paper to me to hold, then started reading my life lines. He then handed me the pen and paper and asked me to write down my favourite colour – green. Then to write any number – seven. Then to write my age – 50 - although technically that day last Sunday I was 49 years and 364 days old. (Mum, being one half Irish was pee'd off I was not born on St Patrick's Day. But it was nice and warm in there!).

He then waffled a bit longer before getting me to open the tiny piece of paper I had been holding – onto which he had written Green, 7, 50. I figure that trick was worth ten dollars when he opened his wallet book and had me place my hand on the piece of paper there with a S$50 note on one side and a photo of a family on the other. He wanted more money but I said no. He tried another pitch asking me to make a wish for something so I wrote 'Happy wife" (Seriously guys – if you can pull that one off the world is your oyster.)

He then asked me to write the name of a flower. At this point enough time had passed for the initial awe to pass and I figured I'd challenge him. So I wrote Daisy. He asked for another. I wrote Rhododendron. Then he asked for another and being Kiwi I figured I'd better save him further embarrassment so I wrote Rose. He waffled a bit then got me to cross out two flower names and I played the game by crossing out the first two. He then had me open up a second piece of paper onto which he had written something else. It of course said Rose.

By then although he was asking for more money I'd had enough and moved along. At least I got to see a psychological magic trick as opposed to Paris where lazy unimaginative people either ask you straight out for money, or they try the gold ring on the ground thing.

Singapore's financial sector is large and looks set to boom as Europeans escape their home bases and Chinese escape the clutches of the CCP.

I recall reading a few months ago an article about how China was shutting out Singapore in favour of Hong Kong and Shanghai as financial centres. Maybe there are some issues relating to the timing of ability to trade in RMB denominated products. But the key point is that as a financial centre Singapore is soaring on the back of wealthy people from China, India, and Indonesia looking for a safe place to put their funds where authorities in their home countries cannot access them. In fact Singapore is acquiring a reputation as offering greater financial secrecy than Switzerland.

On that subject more and more Europeans also are turning to Singapore as a place for management of their funds given the tightening up of financial disclosure regulations throughout Europe. Basically Europe is becoming a less friendly place to have one's money as the politics of envy, fiscal restraint, and banking backlash wash through the regulatory frameworks. Plus the 10% haircut that had been proposed to most bank deposits in Cyprus is possibly the biggest incentive the authorities could have given Europeans to get their money out of banks in that part of the world since World War 2.

Prospects for Singapore's funds management sector look exceptionally bright and that is something many Kiwis may want to pay attention to given the number who over the years have left our shores and done very well in funds management and financial assets trading. Expats tired of London but not yet ready to stick crayons up their nose to fit back into New Zealand - see my Brain Gain NZ for March
http://66.147.244.100/~braingai/wp-content/uploads/2013/03/Brain-Gain-Mch-2013.pdf

should give thought to rounding out their time abroad with a stint in Singapore. The Asian knowledge is going to prove invaluable once NZ businesses wake up to their need to upgrade Asian connectivity.

In Singapore there are lots of open spaces and parks with wonderful tropical trees and plants. But there are very few benches provided for sitting on. There are many locations with water nearby and that is one attractive feature of Lavender where I stayed. The hotel is not only right on top of the MRT with good eating places underneath, it is also just across the road from the Kallang Riverside Park, and a 15 – 20 minute walk from the new enclosed stadium which is in the process of being built. An area with a number of mosques and quaint Arab shops is perhaps a 20 minute walk away in the other direction.

Unlike Hong Kong I never found the streets to be crowded, the buildings in Singapore are reasonably well spaced out, and courtesy of a major campaign in the 1960s to build social housing the quality of the buildings looks good. In comparison Hong Kong still has a lot of old stock which needs to be pulled down.

There is a rule that apartment buildings in Singapore cannot have more than set percentages of different races of people – the aim being to ensure ethnic enclaves do not develop and that a strong mix is found largely everywhere of Malay, Chinese, Indian-derived people. The British probably should have tried something similar as their brand of multi-culturalism has produced virtual countries within a country. Is New Zealand multi-cultural? Try and find a bookshop with any sizeable sections in a language other than English and you'll get your answer. Or ask employers without overseas work experience what they expect of repats and migrants. I released the results of a survey specifically on that this week.
http://66.147.244.100/~braingai/wp-content/uploads/2013/03/Employer-Survey-March-2013.pdf

Unlike Hong Kong there is an absence of air pollution in Singapore, and the waterways appear to be clean though discoloured. The water does eventually end up lovely and clear, and in people's houses because much of what you see forms the city's reservoirs. Singapore has high water purification skills. And unlike Hong Kong Singapore has a future as a separate country. Hong Kong will over time simply be absorbed back into China and like so many other locations in China simply contain some interesting reminders of significant events in the civilisation's five millennia stretch.

All up, for me Singapore wins hands down when it comes to being a good place to live while working as an expat servicing the Asian region. But choice of location will very much be a function of what your target markets are. If China then you will find Hong Kong the better location. If the ASEAN nations then it would be Singapore. Of course I say that without having yet visited any other members of ASEAN – which clearly is something I shall need to do over the next couple of years, perhaps starting with something after a trip to Japan I have coming up in early-November.

What was the best bit for me? The Jurong Bird Park. I deliberately held off visiting it a second time to have something solid to look forward to down the track.

A reporter called me up and when I said I was in Singapore he asked 'Which city?"

INTEREST RATES

Drought pushes out even further the timing of rate rises in New Zealand, so staying floating looks good, though keep an eye out for discounted long-term fixed rates.

I recall writing in this section many months ago that for this year I'd probably not have much to say with regard to interest rates because a rate rise would be well down the track and there would be lots of uncertain factors staying the hand of our central bank. The very last thing which they will want to do is repeat the 2010-11 experience where they raised the cash rate from 2.5% to 3% then had to cut it back down again because the data were bad from late-2010. The February 22 earthquake gave them a handy reason for reversing the earlier two tightenings.

Looking ahead now they see an economy who's growth outlook is deteriorating due to the effects of the drought so far and the extra effects to come the longer it lasts. They see an exchange rate which is already high and know that once they start raising rates it will go even higher.

Yet they also know that with so many skilled people having left the country over the past five years, low training having been undertaken by businesses, and suppressed pressure building up for wage rises from people who've been asked to share their company's pain the past five years, inflationary pressures from the labour market will eventually be a problem. Plus the housing market is rising firmly and building costs are going to head in only one direction – same as electricity prices, and Sky charges, and insurance premiums, and local authority rates, plus food due to the drought effect.

The RB will be extremely reluctant to risk relying much on unconventional monetary policy changes (in the NZ context) because if they over-estimate the impact of maximum loan to value ratios for instance they'll have to later on play catch-up with the official cash rate and send the NZD through the roof.

What it all adds up to even before we start trying to factor in the many uncertainties overseas, is that they will not be touching the cash rate for quite time. That applies even taking into account this morning's far stronger than expected GDP number showing our economy grew by 1.5% during the December quarter and not the 0.8% commonly expected. The NZ economy managed 2.5% growth last year after growing by 1.4% during 2011 and 1.8% during 2010. Our economy is now 8% bigger than in the depths of the recession in 2009 and almost 4% up from the late-2007 peak.

With regard to rate movements this week – nothing happened to suggest a break up or down in rates from trading ranges in place for many months now.

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	2.80%	2.78	2.84	2.69	2.89	5.8
3 year swap	3.20%	3.20	3.27	2.94	3.45	6.1
5 year swap	3.56%	3.53	3.64	3.24	3.96	6.3
7 year swap	3.88%	3.84	3.93	3.56	4.35	

HOUSING MARKET UPDATE

Offshore buying of NZ property is only going to grow and a national debate on rules regarding foreign purchases would seem useful.

I have received a good number of emails from people who have either read my survey of real estate agents or saw it reported in the newspaper. Almost all expressed incredulity at the low proportion of sales reported as going to Chinese people. One person advised looking at property registers to see all the Asian names owning houses in certain streets. One suspects they are unaware that New Zealand has an Asian population of near half a million people and that some people with Asian names have had their families here for generations.

Mainly people gave the same anecdotes about Chinese buying at auctions. But again they gave no indication that they had ability to detect whether that person already lived here, intended living here, or was buying with no intention of occupying the house. Mainly however, I don't think many of the people emailing me had knowledge of areas outside prime school zones and traditional destinations for migrants such as the North Shore.

In that regard some greater granularity in another survey would be useful. But I don't plan repeating it every month – maybe every three months is all that is necessary.

Those interested in the foreign buying topic may be interested in this.
http://www.realtor.org/sites/default/files/2012-profile-international-home-buying-activity-2012-06.pdf

This url will take you to a pdf copy of the annual report issued by the National Association of Realtors in the United States called "Profile of International Home Buying Activity 2012" It covers the year to March 2012. The NAR survey found that 8.9% of US house sales were to people offshore or only recently migrated to the United States, measured by dollar value. Some 4.4% of sales were to foreigners not planning to shift to the United States.

My survey with the REINZ found that 9% of NZ dwelling sales are to people offshore, and some 42% plan coming back. Adding in half the 44% who responded 'Don't Know" we get 64% of people offshore buying NZ houses planning to move here – or 36% planning to stay away. Then if we take 36% of 9% we end up with about 3.2% of NZ dwelling sales being to people offshore not planning to shift to New Zealand. This is lower than the US figure of 4.4%. But the US data is by value whereas the responses from NZ real estate agents are likely to have been on the basis of property numbers. Given that the average purchase by a foreigner in the United States is for $400,000 compared with $212,000 for US-based buyers, it looks like our proportion of sales to people staying offshore is in the vicinity of the US proportion.

If we look at where the NAR survey shows that foreign buyers are coming from we get this – remembering that our survey found that 18% of sales offshore were to people in the UK (foreigners and expats), 15% to people in China, and 14% to people in Australia. In the United States 24% come from Canada, 11% from

China, and 8% from Mexico. Therefore courtesy substantially of buying by their northern neighbours, the proportion of property sales to Chinese in the United States is lower than in New Zealand. But the key point to note is that our 15% is not vastly different from their 11% of sales to Chinese.

Note that there are just over 1 million realtors in the United States so the NAR survey response of 1,745 is a response rate of about 0.17%. Our response of 355 out of just over 10,000 is a response rate of about 3.5%.

If I Were A Borrower What Would I Do?

Stay floating but look to fix half of my debt at a rate of three years or beyond if someone offers a very discounted rate. Same comment as for the past few months. Plus, for your guide, I struggle as yet to see a serious chance of fixed rates suddenly shooting up though this is likely to happen at some stage. A heavy influence will be US monetary policy including money printing operations.

OFFSHORE

In Europe the news is all about the 0.5% of the Euro-Zone GDP accounted for by Cyprus rocking financial markets with fears of bank runs and capital flight from heavily indebted countries because of the proposed but now ditched levy on Cyprus bank deposits. In Italy there is no government in place. In Spain there is a political scandal. In Greece there is continuing failure to implement reforms agreed as part of previous bailouts.

Basically, much as there was excitement about some strong import data for Germany last week along with good German employment data, the story for Europe remains one of the debt crisis rumbling on for many years. This means a weak macro-environment facing NZ businesses (but it pays to remember it is the niches which matter there and everywhere else).

In the United States continue to come out in reasonable shape, though the Fed. Have just cut their growth forecasts slightly. Their money printing operations show no sign of being curtailed this year.

Exchange Rates

Exchange Rates	This Week	Week ago	4 wks ago	3 Mths ago	Yr ago	10 yr average
NZD/USD	0.826	0.819	0.836	0.84	0.817	0.67
NZD/AUD	0.795	0.795	0.814	0.795	0.779	0.85
NZD/JPY	79.2	78.7	78.3	75	68.4	69.6
NZD/GBP	0.547	0.549	0.548	0.527	0.515	0.388
NZD/EUR	0.638	0.632	0.628	0.629	0.618	0.52
NZDCNY	5.13	5.09	5.21	5.22	5.16	4.99
USD/JPY	95.88	96.09	93.66	89.29	83.72	105.7
GBP/USD	1.51	1.49	1.53	1.59	1.59	1.72
EUR/USD	1.29	1.30	1.33	1.34	1.32	1.28
AUD/USD	1.04	1.03	1.03	1.06	1.05	0.788
USD/RMB	6.2118	6.2142	6.2379	6.2181	6.3189	7.56

Strong GDP data offset drought worries and new European turbulence to push the NZD slightly up this week – but it remains within recent trading ranges.

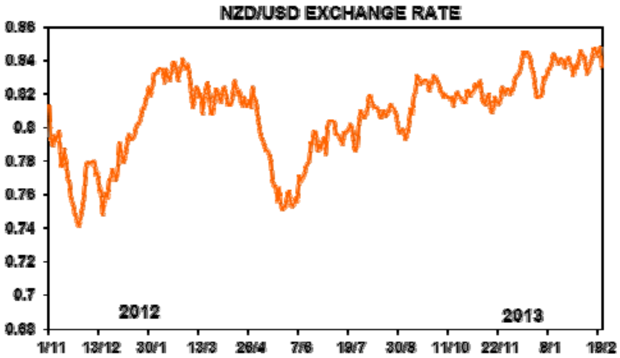
The big event in the FX market this past week has been the Euro getting slammed lower in response to plans for Cyprus bank depositors to pay up to 10% of their deposits toward the bailout of the banks they have their funds in as part of the overall bailout package for Cyprus. Few of the rescuers are inclined to show much mercy toward Cyprus which in the past has played the Russian-influence card by accepting a contribution from the Russians a few years ago, failing to reform, asking for more, and having the Russians realise what the Western European countries knew – that Cyprus needs a wake-up call with regard to economic management. In that regard it is being dragged kicking and screaming into the world of economic reality just as other badly managed countries are such as Spain, Italy, Greece and Portugal (plus NZ back in the 1980s).

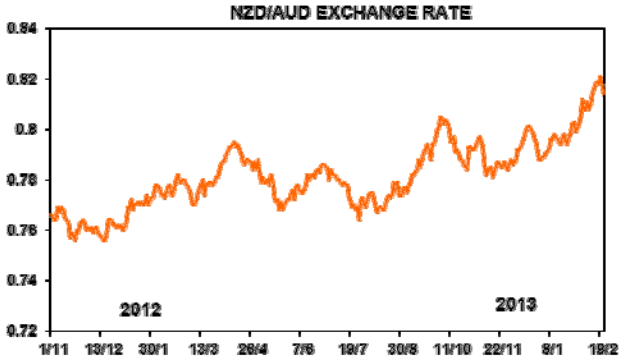
Thus we have in a mini-version a repeat of the crises which have occurred in these other southern European economies and a reminder that the European crisis still has a long way to go. That reminder has been enough to send the Euro lower. But the big slapper of course was the precedent set of taking funds from depositors. Almost half of deposits in Cypriot banks are from Russia. Logically other people in the indebted countries are asking if they might also be forced to pay toward their bailouts. Hence there are huge fears now of a run on other banks in Europe.

From a risk premium point of view this sort of development would usually push the NZD lower. But as I have highlighted for quite some time now – we are viewed as a safe haven at times as well. In fact, even in their comments about NZ of Tuesday morning the IMF offered nothing scary when compared with what is happening in Europe.

Helped by this morning's stronger than expected GDP data the NZD has risen about 0.3 cents today to finish about one cent higher against the greenback than a week ago – but still within the recent trading range. The NZD has also understandably crept higher against the Euro, and also risen against the Japanese yen with the markets expecting the new Bank of Japan Governor to undertake some new easing measures shortly.

With regard to the NZD/AUD cross rate we have seen the NZD fall away back below 80 cents recently. This has been driven to a large extent by the dovish monetary policy comments from our central bank compared with stellar jobs growth data (up 78,000) for Australia last month, and the markets easing off on their expectations of further Aussie cash rate cuts.





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

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