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

Developments the country needs. If meat, wool and dairy were enough we'd be rich by now.

In a week and a half's time I shall once again be in Europe to attend some conferences, meet various people who will let me bother them, visit Cyprus to witness the horror of a banking system collapse on the ground, and undertake some presentations to largely Kiwi expat audiences in London – though not Kea this time around as they have taken sponsorship from another bank. Contact me if you are over there reading this and would like to meet up.

When I make such presentations there is always intense interest in the exchange rate between the British Pound and the NZ dollar. And there have been lots of groans for three years now when I tell them that the rate is going to move into a range of 55 – 60 pence – which is exactly where it is now and headed higher.

After that there is interest in the housing market where again I'll tell them about my comments for five years of a housing shortage getting worse, then how prices are rising (Auckland now up 31% from early-2009) and at that point this time around I imagine some may start crying. The prices will continue to rise.

But after that their point of interest becomes the state of the labour market in New Zealand and the difficulties which they expect to have slotting back in if and when they return.
http://tonyalexander.co.nz/wp-content/uploads/2012/11/Expathiring.pdf

While Kea's approach is to arrange connectivity between expats and offer points of contact to NZ companies thinking of expanding overseas, my approach is primarily though not exclusively in two alternative areas.

1. Educating NZ businesses about the need to change the way most treat migrants and expats or risk closure through lack of staff once the labour market is a lot tighter.
2. Better linking expats wanting to return with businesses that will most effectively utilise their skills.

(I am also interested in the area of assisting Kiwi companies looking outward and have a new contact for those wanting to get an ICT company into France.)

The challenge is identifying such businesses and when pressed to do so I tell expats that they need to scout around the country's developing innovation centres. The Wynyard Quarter Innovation Precinct will open presumably in a few months' time.
http://businessaucklandnz.com/sectors/wynyard-quarter-innovation-precinct

The Christchurch precinct – EPIC, or Enterprise Precinct and Innovation centre – is already up and running with 19 tenants employing 250 people and a waiting list of 100 more businesses. http://www.epicinnovation.co.nz/

What distinguishes the EPIC companies from others is their strong desire to advance beyond the traditional NZ “Man Alone” way of doing business to something more collaborative involving a stimulating environment of exchanging ideas, validating potential developments with others with experience, and effectively networking like no other place in the country. It is also interesting to note that 70% of people in the building are developing IP for export markets, including the newly created official government effort to boost business-science links – Callaghan Innovation.

The sheer stimulatory nature of EPIC is why when I visit Christchurch now I always locate myself there between functions rather than where I think I am supposed to be (sorry boss) amongst the BNZers at Russley or Riccarton.

What I will point out to the expats offshore is that EPIC is set to expand from 4,000 square metres to up to 40,000 thus providing an environment for up to ten times the number of collaborating businesses already there. The importance of getting this expansion undertaken as quickly as possible cannot be under-estimated.

New Zealand showed the world how regulating one’s economy as we did from 1938 to 1984 leads to economic failure and loss of people. We then showed the world how given a certain parliamentary system (which Europe, Japan, the US etc. do not have) you can radically alter your economic game board and allow strong productivity and income growth to occur.

But unfortunately we have since perhaps the late-1990s offered the world a third lesson. Just because you have a good deregulated environment, and just because you rank as world leaders in economic freedom, ease of starting up a business, low corruption etc. does not mean your economy will power ahead. As horses we have been led to water but we have not drunk. Why?

My answer is that it is most definitely not because of the regulatory environment, or because state assets should be privatised, or because we don’t have a capital gains tax on housing and farmland, or compulsory superannuation. It is because of some particular aspects of our business culture along with a few other things outlined in my summary paper on these matters back in May 2011 posted here.
http://tonyalexander.co.nz/wp-content/uploads/2011/05/Our-Deficiencies-Summarised.pdf

Changing a culture is of course something which most people would immediately say is the last thing you would ever want to do. But when it comes to how we operate and grow our businesses we have no choice because if relying on meat, wool, and milk production was the answer, we’d already be top world earners. And one of the best routes for achieving change is by accelerating the growth and development of those companies which do challenge the cultural norms, one of which is business isolationism. And that is the space in which EPIC operates and why getting the second stage of its development up and running is so important.

Not moving to the expanded premises as quickly as possible will see some existing tenants having to move out simply because there is a time limit on the existing location and they need certainty of the up to 40,000 square metre development as they grow. Not upgrading EPIC size would also risk seeing Christchurch’s economic rejuvenation stall once the peak of the wider reconstruction effort has passed. After all, while Christchurch has a large rural hinterland and will benefit from irrigation of the Canterbury Plains, it will miss out on the population boost this cycle caused by aging Aucklanders cashing up to retire with some spare cash somewhere else. Not many are likely to opt for Christchurch this time around.

Christchurch’s economy will also be challenged once the artificial construction stimulus passes by shrinkage of the manufacturing sector due to the high exchange rate.

In a few years' time Christchurch is going to offer a style of inner city living in New Zealand perhaps second only to Wellington. But unless care is taken to ensure the redeveloped CBD contains a sharply expanded innovation centre well linked with the Christchurch Polytechnic Institute of Technology, the Christchurch economy may not provide the high earning types of free-thinking jobs vibrant people will be seeking as part of their city-living experience. And planners need to keep in mind – Wellington is not sitting still in this area and plans are afoot for something potentially quite spectacular there.

Sentiment strong and labour market tightening up

The latest Quarterly Survey of Business Opinion from NZIER has recorded a good seasonally adjusted rise in non-farm business sentiment to a net 32% optimistic from 19% in the December quarter and an average since mid-2009 of just 13%. Responding to their good sentiment a net 3% of businesses plan boosting investment in buildings versus a -6% average and -3% December quarter reading. A net 8% plan boosting spending on plant and machinery from a 2% average and 5% in the December quarter. These are positive results which feed well into a picture of growth in the economy improving.

A net 5% of businesses plan boosting employment from 3% last quarter and an average since mid-2009 of 3%. A net 4% actually boosted hiring in the March quarter from a net 3% shedding staff in the December quarter and average reading of -7% since mid-2009. Thus the data tell us that the labour market is strengthening.

With regard to whether the survey contains anything hinting at rising inflationary pressures we find little to get worried about. Only a net 13% expect to raise their selling prices versus an average 21%. However such pressures will come. The capacity utilisation rate in the building and manufacturing sectors has risen to 91.5% from 90.5% in the December quarter and an average of 90%. Plus a net 25% of businesses now say they are having difficulties finding skilled labour from 20% in the December quarter and an average since mid-2009 of 10%. Even a net 0% of businesses now find it easy to get unskilled labour whereas since mid-2009 a net 17% on average said they could easily find the unskilled people they needed.

Thus we see that the labour market is tightening up and eventually this will lead to wages pressure against which the Reserve Bank will lean – but not for quite some time.

One reason the RB will hold off tightening is the high and rising exchange rate noted below. Another is that retail spending growth while firming is not taking a straight line upward which would lead the RB to conclude that people are spending the capital gains occurring on their houses.

The seasonally adjusted change in spending using debit and credit cards fell by 0.8% in March (core measure) after rising 0.7% in February and 0.2% in January. One can put some of the weakness down to the late warm summer hitting sales of winter clothing and perhaps some issues surrounding the timing of Easter. But the annualised rate of core spending growth over the past three months of 4.8% is probably a more realistic number showing how things are than the 7.5% annualised growth rate for the three months ending in February. After all, the anecdotes we are getting from retailers from our monthly BNZ confidence Survey still fall largely on the negative side.

INTEREST RATES

Declines Prompted by Japan's Huge Money Printing Exercise and Weak US Data

Bond yields have fallen around the world over the past week driven lower by weak jobs data in the United States and Bank of Japan extraordinary policy easing. In the United States the March jobs report was much weaker than expected with employment ahead only 88,000 rather than the near 200,000 expected and February's rise of 268,000. The unemployment rate actually managed a decline to 7.6% from 7.7% but that was because people left the workforce. The participation rate is now the lowest since 1979 showing just how despondent people are about finding a job. Had the rate sat at the long term average of 65% the current unemployment rate would be 10%.

The weak data mean that the Federal Reserve is not close to easing off in its money printing exercise and that weight of money argument is a factor which limited the decline in the US sharemarket following the jobs news and saw bond yields fall.

But yields have also been pressed lower by the larger than expected money printing programme announced last week by the Bank of Japan. There are expectations that investors will seek better yielding assets outside of Japan and hence falls in bond yields around the planet – including our own.

Domestically we have seen NZ wholesale interest rates edge down during the week as detailed in the table below. Given the continuing easy policy stances offshore, the effects of the drought on the immediate speed of growth in the NZ economy, March's weak debit and credit card data, and the extra upward pressure on the NZD due to events overseas, there is little prospect of NZ monetary policy tightening for a year or so.

This means borrowers can look forward to a continuing low interest rate environment which as history tells us is both a negative and a positive. For conservative investors it is a negative which as each month goes by will see more and more people look for higher yielding assets than bank term deposits. This is what happened in 1992 when inflation and interest rates plunged and old folk started throwing their money at finance companies. This time around that option is not so easy (yet) but the search is underway and some will be taking their money into residential and commercial property investment.

As I have noted here a number of times in recent years, it is up to those of us with a bit above average nous to say to our elderly friends and relatives that if they chase yield then they are taking on higher risk and should things go wrong their ability to recover is going to be very low. They should sit down, take a breath and simply admit that one of the ways in which NZ is hit by the ongoing effects of the global financial crisis is that conservative investors in little old New Zealand and in fact all around the planet, get penalised through low returns. Accept it and go back to watching ducks and TVs.

But what about borrowers? Isn't this ongoing low rate environment great for them? Not as great as you might think. Young people freshly leveraging themselves into a dwelling are going to start thinking that these low rates are the norm. They will take on too much debt, fail to maximise principal repayments in the early years of their loans, and get badly caught out when our central bank eventually has to respond to inflationary pressures over 2015 – 17.

The Reserve Bank knows that this cycle it has time on its side – it can sit back waiting to see how things go knowing that because hardly anyone is borrowing at 3 – 5 year fixed rates the impact of a cash rate change will be very quick. That quickness will come not just through most borrowers sitting floating and being hit straight away by official cash rate rises, but young people being surprised that rates can go up and getting eventually terrified by people like myself warning of how high floating rates have gone in the past.

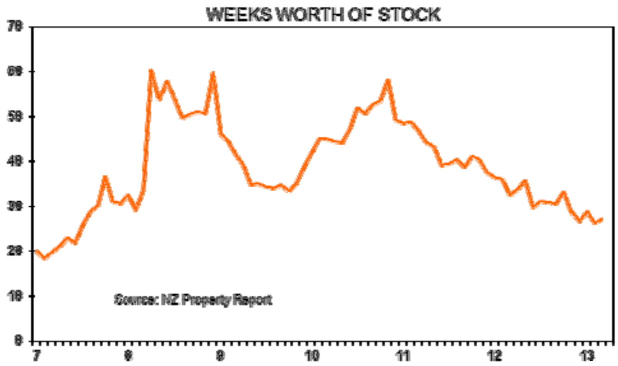
FINANCIAL MARKETS DATA

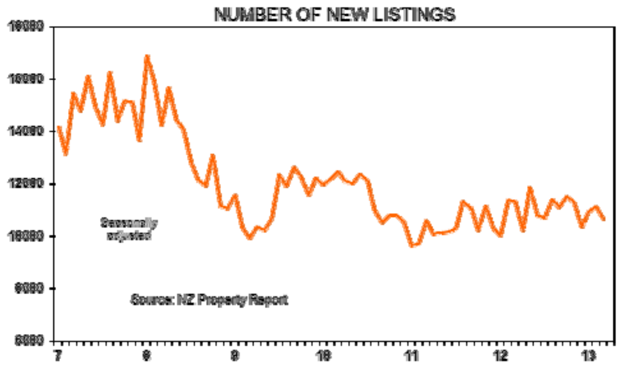
	This week	Week ago	4 wks ago	3 months ago	Yr ago	10 yr average
Official Cash Rate	2.50%	2.50	2.50	2.50	2.50	5.4
90-day bank bill	2.67%	2.67	2.66	2.67	2.76	5.7
1 year swap	2.78%	2.77	2.78	2.71	2.89	5.8
3 year swap	3.11%	3.14	3.20	3.00	3.45	6.1
5 year swap	3.41%	3.48	3.57	3.28	3.96	6.3
7 year swap	3.69%	3.77	3.89	3.60	4.35	

HOUSING MARKET UPDATE

The housing market continues to tighten up.

The monthly NZ property report tells us that at the end of March nationwide there were 41,775 properties listed for sales. This represents some 27 weeks' worth of sales based on activity to the end of February compared with a measure of 32.4 weeks a year ago and 46.7 weeks two years ago. This report only starts in 2007 so it would be a bit much to talk in terms of records being broken, but the data nonetheless show a housing market continuing to tighten up.





More tightening in fact lies around the corner going by the Barfoot and Thompson sales data for Auckland which I commented on last week, and the fact that only 12,732 new listings nationwide were received during March. This was a decline of 4% from a year earlier.

I continue to receive anecdotes regarding Chinese buying at property auctions in Auckland – nothing from the rest of the country. Personally while I believe the anecdotes do not fully reflect the true situation I am a strong supporter of restrictions on foreign purchases (all nationalities) of NZ residential property and warn that whatever the level of buying from China is now it could easily be four times that within a decade given developments in the world's most populous country. It would seem better to address the issue now before the anecdotes coalesce into a nationalistic backlash and outright blaming of Chinese buyers for the housing crisis and inability of young people to purchases houses in Auckland.

In that regard and for your guide, tomorrow morning I shall release the results of the latest BNZ-REINZ Residential Market Survey which will provide insight into the proportion of properties sold by agents on behalf of offshore vendors. That will allow a better estimate of the net change in property ownership to offshore buyers rather than the gross data our survey gave us last month.

Here is an anecdote received this week.

"I wanted to pass back some anecdotal evidence of Chinese buying of residential property in Auckland. Yesterday I called in to view an auction in Milford (next suburb up from Takapuna – in case you don't know the area). The location has good school zoning but is quite cold in winter. It would be similar to less attractive parts of Karori in Wellington.

The property was a 40+ year old bungalow which the current owners had owned for the last 19 years and were downsizing. It badly needed modernising and re-decorating. It has a QV of NZD620k and we thought it would sell for around $780k max.

Some 120 interested parties attended the auction including at least 5 groups of prospective Chinese buyers – say 50 such people in total. The auction started with a hiss and a roar and quickly blew through the owner's reserve. It ended up with three Chinese groups bidding against each other with a final buy price of $1023k – a staggering 65% over the QV. This is not an isolated case. I spoke with two of the buyers neither of whom were NZ residents. Both said they will be back to buy 'more' houses – how many I don't know."

It would seem better to address this issue of rising concern about foreign buying now before China becomes New Zealand's biggest export destination in 2 – 3 years' time and policy changes will have to strongly take into account how our top customer feels about the things we do and say – such as talking about which side one would support in a reactivated Korean War. .

If I Were A Borrower What Would I Do?

Nothing new here. I would remain floating for half my debt but for the other half would keep looking around for a 3 – 5 year fixed rate at close to the current floating rate simply in order to get some risk management in place. Uncertainty about where interest rates will go and at what speed in the next few years should not be under-estimated. For those people feeling that there is some wonderful nice assured growth ball rolling around the world and that all is rosy should sit back and realise that a lot of what is happening is on the basis of Social Credit-like money printing being undertaken by central banks. The latest burst is coming out of the Bank of Japan and this is pushing the NZD up while placing downward pressure on interest rates around the world and boosting asset prices.

These developments are unsustainable but history shows us that we have zero way of predicting when the asset price escalation phase will end. History does however tell us that the ending is often not pretty.

The global surge in money printing makes this investing environment a dangerous one and people should explicitly take that into account when considering how much they borrow, how quickly they attack their principal, and the level of floating interest rate exposure they should be running. These are not normal times – we just don't know how abnormal.

OFFSHORE

In the United States the week's worth of data got off to a fairly lacklustre start with employment rising only 88,000 in March rather than the near 2000,000 which forecasters had been expecting. This mediocre rise following a strong gain of 268,000 in February is the weakest monthly rise since June, but consistent with many other indicators showing that the US economy is growing, but the pace of growth is not necessarily secure or accelerating. That is why the Federal Reserve is going to keep its US$85bn monthly money printing operation in place and why asset markets generally around the world are going to continue to oscillate upward.

There is an increasing weight of money moving into assets such as shares and in some countries houses, and in normal economic times we would look at these rising things and the absence of credit booms as telling us good things are happening underneath the numbers in the relevant economies. But to take that view this time would be a risky bet. Were the money printing to stop it is not at all certain that asset markets would hold their values.

What this means is that if you are forecasting asset markets in the major economies you will be in a difficult position when it comes to factoring in economic data releases. Bad data mean the money printing continues and asset markets remain supported. Just look at the rise in Japan's sharemarket since the option of aggressive money printing was put on the table as a means of reversing 15 years of deflation and boosting growth. The Nikkei share index has risen 53% from five months ago. So bad numbers tend not to cause markets to fall and will make weight of money buyers more bullish.

But what to do then about good economic data? Good numbers surely mean stronger economic bases for generating consumption-supporting jobs growth and valuation-supporting higher dividends. But strong data also bring closer in time the very uncertain period of monetary stimulus cessation and then withdrawal.

Exchange Rates

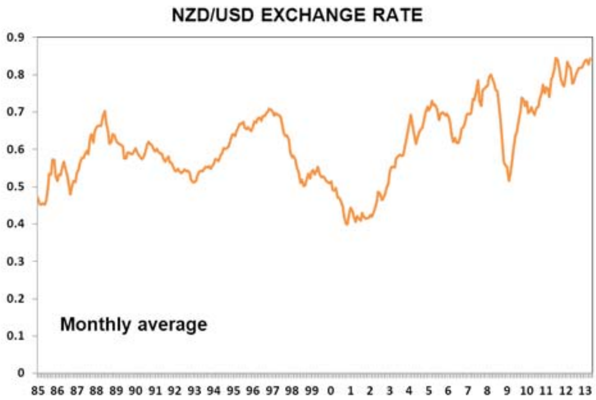
Exchange Rates	This Week	Week ago	4 wks ago	3 Mths ago	Yr ago	10 yr average
NZD/USD	0.859	0.842	0.82	0.844	0.814	0.67
NZD/AUD	0.815	0.805	0.803	0.797	0.794	0.85
NZD/JPY	85.7	78.3	78.9	74.4	65.7	69.6
NZD/GBP	0.56	0.556	0.55	0.523	0.513	0.388
NZD/EUR	0.657	0.655	0.632	0.637	0.622	0.52
NZDCNY	5.32	5.22	5.10	5.25	5.14	4.99
USD/JPY	99.77	92.99	96.22	88.15	80.71	105.7
GBP/USD	1.53	1.51	1.49	1.61	1.59	1.72
EUR/USD	1.31	1.29	1.30	1.32	1.31	1.28
AUD/USD	1.05	1.05	1.02	1.06	1.03	0.788
USD/RMB	6.1939	6.2014	6.2163	6.2158	6.3107	7.56

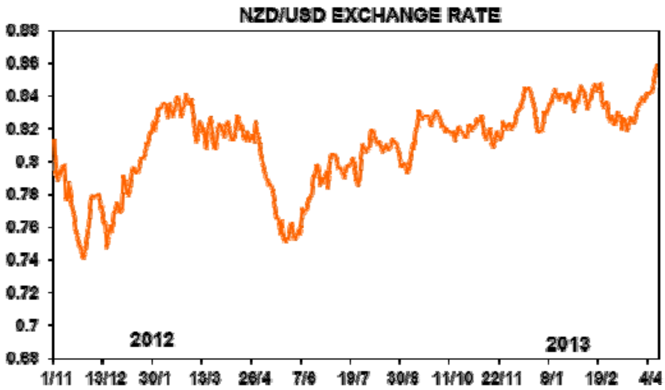
To repeat – the NZD trend is upward because of foreign money printing, good export prices, and NZ looking better than many other economies. Higher levels loom, and they may last many, many years.

It comes with no degree of satisfaction or happiness to say that NZ exporters are going to be severely pressured through the entirety of this economic cycle stretching many years by a high and still rising NZ dollar. The world's investors consider us and Australia as safe havens. We have an export mix the emerging nations want access to. We have low government debt. We have no history of debt default. We have some of the highest rated banks and banking system in the world. We are not printing money to stimulate household debt, spending, and house prices. We are going to raise interest rates before the major economies do. We have no restrictions on foreign residential property purchases. We have no FX capital controls. We have stable government and strong rule of law. To the rest of the world, we look like Godzone.

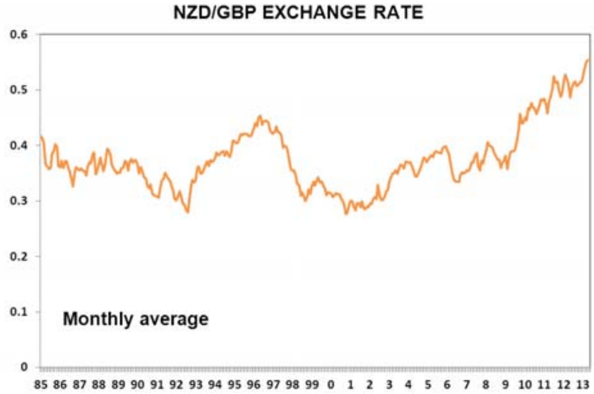
The NZD goes up. House prices go up. Interest rates stay low a long time. The labour market dries up. Relations with China soar. Shocks however come – and that is what exporters need to watch for.

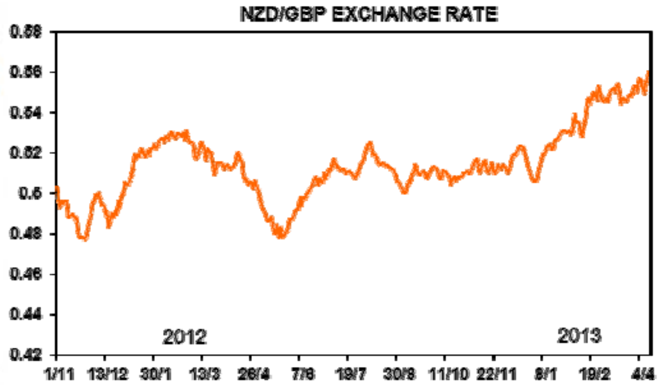
But putting these long running trends aside, why this week has the NZD jumped above 56 British Pence and nearly US 86 cents?





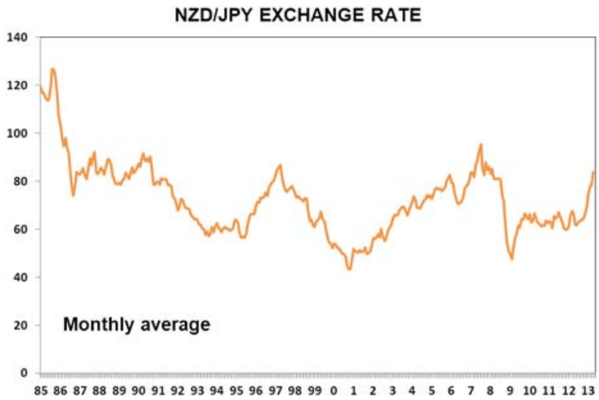
Last Thursday the Bank of Japan held their first meeting under the new Governor and exceeded market expectations as to the extent of their widely foreshadowed extra easing of monetary policy. With a target of getting inflation up to 2% in two years following 15 years of deflation and economic weakness the BOJ have announced that rather than using the overnight cash rate as their policy tool as is standard around the world (or it was) they will target a base money measure growth rate. Doing that means injecting an extra 7 trillion Yen into their money system each month.

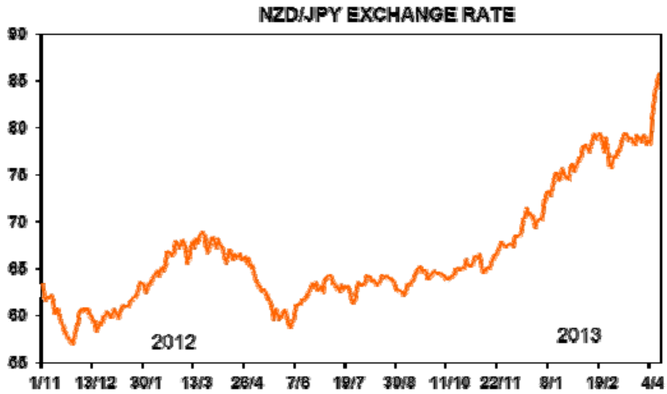




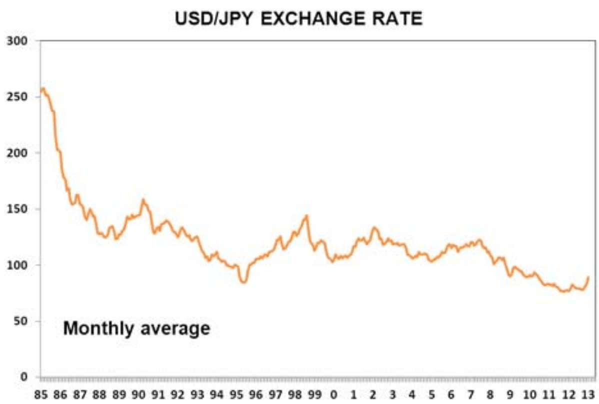
This extra supply of Yen means weakness in the currency which is what we have seen not just this week following the announcement, but from a few months ago as anticipation of the change built on the back of comments from the now Prime Minister Mr Abe.

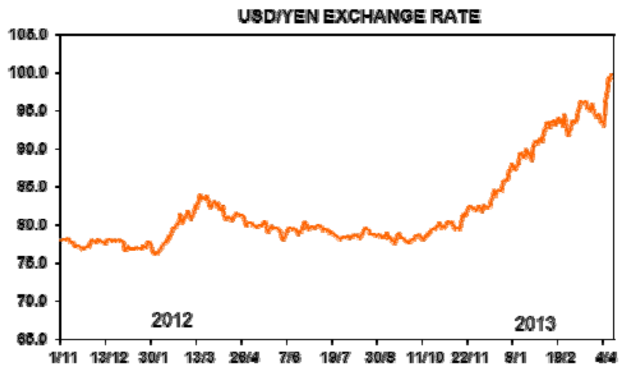
There is considerable uncertainty as to whether the policy change will in fact sustainably lift inflation and uncertainty about whether that higher inflation will in fact spur increased consumer buying. The risk is that all that gets achieved is higher levels of government debt, and because the monetary stimulus is being assisted by a fiscal stimulus, a greater risk of eventual internal financial collapse. That in itself is enough to have global investors down-weighting the proportion of their portfolio which they will hold in Yen. Add in ongoing woe for the Euro and you get support for the dollar currencies.





That dollar support and Yen weakness has seen the greenback rise to a four year high against the Yen at almost 100 from 80 six months ago – a 25% depreciation of the Yen. The Kiwi dollar has now risen to a five year high against the Japanese Yen and with increasing signs that Japanese investors are activating the old carry trade (fund in yen and invest elsewhere) further NZD/JPY appreciation is probable.





That means also extra NZD appreciation against other currencies because of the interest rates offered compared with other countries and the high chance that monetary policy gets tightened in NZ before it gets tightened anywhere else.

Is there any hope for exporters wanting to get hedging in place at better levels? As we have been noting since late-2009 when the NZD jumped quickly from under US 50 cents to 76 cents (then 88 cents in August 2011), the world financial environment is extremely wobbly and shocks will come. When they arrive the NZD will tend to fall and that is when exporters can look at boosting their hedging. For instance from 88 cents in mid-2011 the NZD subsequently fell to 77 cents two months later.

Scope for shocks going forward is massive. Take your pick.

- Korean War reactivated
- Iran-Israel war
- China-Japan islands dispute flare-up.
- H7N9 bird flu pandemic
- New European banking collapse (Slovenia)
- Earthquake
- Pakistan collapse

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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