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/lFdYSs5FGEq4kAjP95uzTA

Money printing – the revised 2000s boom and bust cycle

Often when we see the prices of things we own rising we feel quite chuffed about having made a canny purchase earlier on and think maybe we should have bought more of the thing and perhaps the time is not too late to do so. Therefore rising markets can generate their own upward momentum. In addition as we feel wealthier and more clever we start to shout ourselves some things from our rising paper wealth so retailing picks up along with travel etc.

These are the sort of developments which central banks overseas want to see as one outcome of their money printing operations. They wanted first and foremost the extra money pumped in to go toward improving bank liquidity with the hope that banks would lend more money and people would be willing to borrow more. But so far that process is not working as well as the central banks were hoping with the IMF this week noting how credit is not flowing around the world as they would like to see – especially in Europe.

But now that prices of assets such as shares and houses are rising central banks will feel that they are achieving some success and now will be waiting to see if the rising paper wealth is leading to higher spending. The evidence so far is mixed and that is partly why this week risky assets around the world including the NZ dollar generally fell in price.

In the United States the effects of the money printing are being partly offset by tightening fiscal policy. The same is happening in Europe and both the IMF and American officials have been lobbying European leaders to ease up on their fiscal austerity. That seems unlikely given the depth of Europe's fiscal malaise combined with their often overly restricted economies and a banking sector struggling to find the bottom of its credit cycle let alone start rising again on the other side.

Data for consumer confidence and retail spending printed weaker than expected in the United States this week, last night a weak car sales report appeared in Germany, and China's growth numbers for the March quarter proved less stellar than expected with GDP up "only" by 7.7%. Plus last night some company earnings reports were weaker than expected in the US.

All combined these developments have injected new caution into the minds of investors – as has happened many times since the pulling away from the Great Depression scenario in the first half of 2009. That caution for now manifests itself as weaker asset prices. But that caution also means central banks will feel they still have some way to go before the weight of money pushing up asset prices leads to increased willingness to spend and maybe borrow, and for the normal wheels of economic activity to turn at speed and allow more natural rather than forced healing of damaged government and financial sector accounts around the planet.

That means then that money printing is going to continue in earnest for potentially a lot longer than was being thought just a week ago. That in turn means more and more money seeking out better than near zero yields around the planet and that means more upward pressure on the Kiwi dollar lies just around the corner.

That in turn means that just as interest rates are not going up overseas so too will they not be going up in New Zealand. That means low borrowing costs here well into 2014 and probably 2015. That means continuing upward momentum in our housing market with the initially shortage-driven rises in Auckland and Christchurch spreading to the rest of the country. That means more rising wealth, higher retail spending, more construction, a new blow-out in the current account deficit, and coupled with funds going to IPOs, money less readily available to NZ banks and therefore likely increases once again in our dependency upon foreign funding.

That in turn means that the next time things hit the fan overseas we will once again see the NZ dollar fall away quite sharply. Will this happen? History tells us it most definitely will. But history also tells us that we have zero way of knowing when it will happen and what the trigger will be. It may not happen for five years. The chances are that by the time this adjustment occurs (and it will probably only generate temporary NZD weakness) the NZD will be a lot higher, and the declines in share prices could once again be relatively severe.

Why? Because their rises for now are illusory – based not upon improving expectations for good self-sustaining productivity-driven world economic growth, but simple money supply expansion looking for a place to roost. That is, we have in play a different version of the credit boom of the 2000s. It is different in that this time it is being explicitly created by central banks rather than the private sector through the development of exciting derivative products, widespread lending asset securitisation, and lowering of bank lending standards.

Just as the credit boom back then ended in tears, so too is this liquidity boom at high risk of ending badly also.

What then does one do? Here are just a small number of suggestions from a workshop list I have been building up in recent weeks.

- Borrowers need to be wary as they start to think funding in cheaper foreign currencies will be a great help to their businesses. Unhedged borrowing may look good while the NZD is rising. But one day when it inevitably corrects downward by 30 or so cents your company may go bankrupt.
- Borrowers also need to be wary thinking that these low interest rates are the new norm. They are not. The chances are that before the correction comes our central bank will be fighting inflation and history tells us when they raise rates they almost always go higher than people budget for. Parents, remind your children as they gear themselves up that floating mortgage rates were 10.9% in 2007 and 11.3% in 1998. They won't go that high this cycle – but scare them nonetheless.
- Exporters, the NZD is going to go higher and stay high for a potentially long period of time before a big correction occurs. You need to give thought to natural hedging through increased importation of inputs, compensate for the currency hit by building your internationalisation skills, and in spite of what I wrote just above, give thought to foreign currency funding. But pay special attention to matching the funding currency with your receivables currency exposure, and be deadly certain that you're not going to lose your receivables market, have to export and receive in another currency, and therefore be left with an unhedged foreign debt position.
- And just one final little point regarding companies thinking about exporting to China. It is not easy. If you have refrained from getting into the Australian market because it is difficult you have little hope of functioning profitably in China. If you cannot develop a good market research, marketing and distribution plan for the existing Chinese community in Auckland, what hope do you have in China? For insight into how different China is and why business cultural differences in particular exist, my next Growing With China monthly to be released in a couple of weeks' time will contain the best article I have ever seen discussing that very issue – from Sharon Lucock, PhD student at Lincoln University.

Interest Rates

Weak data offshore and low NZ inflation justify RB caution about moving ahead of the pack

The main theme in the financial markets this week has been weak economic data coming out of the United States and China and nothing of major importance here in New Zealand. That includes the March quarter Consumers Price Index released yesterday which showed average consumer prices rose by 0.4% in the three months to lie 0.9% ahead of a year earlier. This is a result below the lower end of the 1% - 3% range targeted by the Reserve Bank and does not therefore signal any particular need on their part to change their current plan for monetary policy changes in the coming couple of years.

But could they cut interest rates to offset the clear impact of the rising NZD on suppressing inflation? No. rate cuts stimulate domestic economic activity and that is already rising firmly in the construction sector.

- The number of consents issued for the construction of new dwellings was 22% higher in the three months to March than a year earlier.
- The value of consents issued for the construction of non-residential buildings in the business sector was ahead 8.4% in the six months to February from a year earlier.
- Dwelling sales in the March quarter were 12% ahead of a year ago with prices up 8%.
- Car registrations in the March quarter were ahead 9% from a year ago, commercial vehicle regos 44%, though tractors were down 6%.
- Annualised core retail spending growth was 4.8% in the March quarter according to debit and credit card data.

The Reserve Bank will see no need to boost domestic activity by cutting the official cash rate and in fact would like to raise it to curb the speed of growth in the housing market. Though even then their economics training will tell them that because there is a shortage of property caused by some years of weak construction a lot of what is happening is simply the market attempting to clear itself by the price adjusting to a new equilibrium.

The upshot is that these low interest rates are going to be with us for a potentially long time. But there is no-one with a good record of picking interest rates in the past three or so years and no-one should feel that rate predictability has improved at all. That means one’s interest rate risk management decisions need to be based not upon anyone’s view of where interest rates are going to go but simple spreading of risk from uncertain interest rates over time by seeking a mixture of fixed rate terms.

This week, for the record, wholesale interest rates fell marginally. The swap rates sit almost exactly where they were three months ago and are down slightly from a year ago even though the growth outlook is better.

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	2.66%	2.67	2.66	2.67	2.76	5.7
1 year swap	2.75%	2.78	2.80	2.76	2.84	5.8
3 year swap	3.07%	3.11	3.20	3.00	3.23	6.1
5 year swap	3.35%	3.41	3.56	3.32	3.68	6.3
7 year swap	3.65%	3.69	3.88	3.64	4.06	

Housing Market Update

Warnings we have heard before – to no effect then and none this cycle either

Last Thursday during a speech in Wellington the Finance Minister Bill English warned that the current rate of increase in house prices would push interest rates and the NZD higher, that the housing bubble is likely to burst, and that when this "…inevitably, eventually…" happens households would be hit.

He is correct about rising house prices eventually pushing interest rates up – nothing special there – and the NZD rising further also – again nothing outside the economic norm. He is also correct in warning of household financial instability should there be a bursting of a housing bubble – again nothing out of the ordinary. The question however is whether this is really a bubble which we are seeing and whether it will in fact burst.

His words are in line with those delivered repeatedly by previous Finance Ministers and central bank governors during the past three house price cycles. Their warnings had no impact then and the Minister's words will have no impact now either – but it is good that he has said them as people should be informed about risks. But is there a bubble? I would say not in that we are not talking about a large flock of sheep flooding into a particular paddock with capability at some unknown time to abandon it and flock to another.

Rising house prices predominantly in Auckland and Christchurch are being driven by

- A shortage of supply
- Awareness of that shortage catching up on a lot of people
- Inability to address that shortage in the next five years because of construction constraints

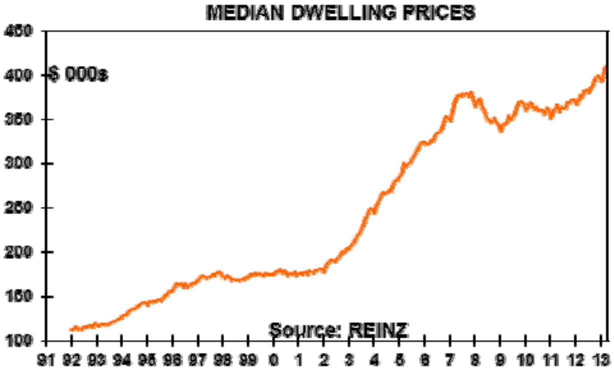
This is not the same as, say, tulips, where supply eventually boomed and people one day looked in the mirror and said "seriously, flower bulbs as an investment?" Housing supply cannot boom in New Zealand and although lending criteria have been loosened so one-third of loans are for deposits less than 20% of home value, the rate of growth in lending to the household sector continues to grow only slowly at 0.4% a month seasonally adjusted.

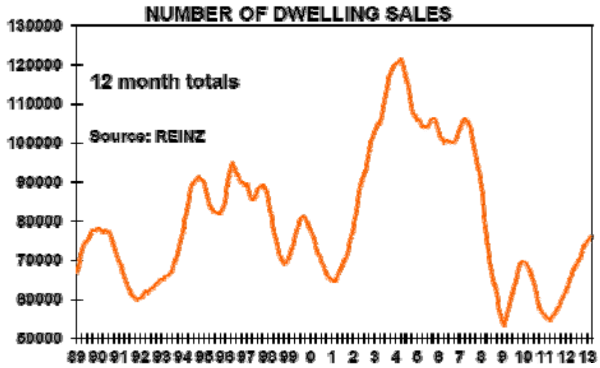
The upshot is that prices are going to keep rising, the NZD will rise, interest rates will eventually go up but the RB will hold off raising them for as a long as it can because of the export-crushing impact of the NZD. The housing availability and affordability crisis will get worse, social problems for those at the lower end of the socio-economic spectrum will worsen, central and local government will be forced to construct affordable accommodation and developers eventually forced to do the same for specified projects. There will be debate about a capital gains tax but it won't be imposed unless there is a change in government and even if it was the price impact would be minimal if present at all. There will be increasing discussion and anecdotes regarding foreign buyers driving the market and discussion about rules on foreign purchases, but they are just one of the many elements generating high prices and pushing them up further.

And just to finish off – the worsening housing crisis would not be so bad were it not for people buying into the ridiculous forecasts five years ago that house prices would fall 40%. Believing those forecasts led to a pullback in long-term efforts to address NZ housing affordability, a reduction in construction, and first home buyers putting off their buying. Effectively those bad forecasts have cost the country five years of addressing this deepening social issue.

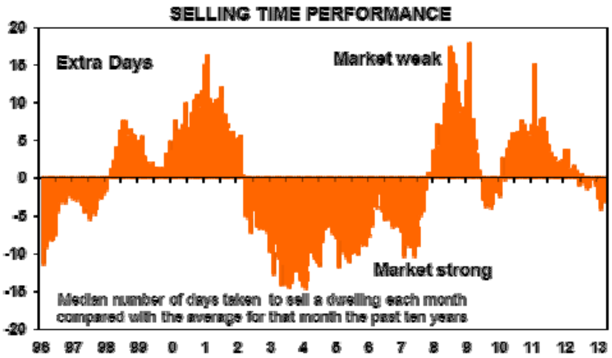
REINZ data show a housing market rising strongly, but over-whelmingly in Auckland and Canterbury – so far.

The monthly data from REINZ show that in March around New Zealand there were 8,128 dwellings sold around New Zealand. In seasonally adjusted terms this was a strong 3.6% rise from February and a gain of 11% from March 2012. But this is not a boom level of activity because the March turnover was still 26% below that of March 2007 and down similar percentages from the four Marchs before that also.





The result is strong but not what one would expect to see were there a bubble. The same goes for the average number of days taken to sell a property. This came in at 31 in March which was 3.1 days faster than average where sales in February occurred 4 days faster than average. From 2003-08 days to sell were usually 8 – 12 days faster than the then averages.



With regard to prices however things are rising strongly though the annual gain of 8.6% sits below the average 14.2% annual rise from 2003 to 2007 and 24% peak in November 2003 when net migration was a massive 37,000 positive. The latest annual flow is just over 1,000.

Coupling these data with household debt growth near 0.4% a month we would not describe the housing market as being in a bubble. But it is strong and set to get stronger as more investors get attracted by the record of tax free capital gain (just like farmers), net migration inflows pick up, interest rates stay low, buyers come in from overseas, and construction is seen to be unable to catch-up with demand.

For your guide, here is a little table I put together for the next Brain Gain NZ issue coming out in the weekend. It shows the net proportion of real estate agents responding in the BNZ-REINZ Residential market Survey who say that they are noticing more investors in the market. The first column shows Auckland – strong for all the period covered. The second shows Wellington – all over the place. The third shows Canterbury. Note the sharp jump in perceived investor presence from the start of this year. That jump coincides with the Christchurch construction sector activity being perceived as moving from messy deconstruction to construction with a concomitant rise in demand for worker accommodation.

	Auckland	Wellington	Canterbury
August	33	10	20
September	36	24	20
October	29	41	6
November	43	24	17
December	29	9	11
February 2013	40	48	49
March	38	24	46
April	32	13	45

If I Were A Borrower What Would I Do?

Inflation is low and expected to stay that way for quite some time. The NZD is strong and likely to rise further. The world looks wobbly still with the IMF this week shaving 0.2% off their forecasts for global growth – from 3.5% to 3.3%. In this environment the RBNZ are highly unlikely to raise the official cash rate. So I stay floating but I also keep an intense eye out for anyone who will offer me a 3 – 5 year fixed rate close to what I pay floating. I'd probably also put some of the half of the debt I would keep in floating into one of the heavily discounted 6 – 18 months rates where the competitive battle is being fought at the moment it seems.

Offshore

The IMF this week released their regular update on how they see the world economy and scaled back their forecast for global growth during 2013 to 3.3% from the earlier 3.5%. The change came about largely because they cut their expectations for European growth from -0.1% to -0.3% and UK growth from 1% to 0.7%. US growth is picked at 2.2% from 2.4% in January. Growth during 2012 was 3.2%. During 2014 the IMF anticipate global growth of 4%.

Discussing their worries the IMF called for a pullback in fiscal austerity policies citing the spreading of woe in the peripheral European economies into the core countries. This spreading they feel will limit the willingness and ability of those core countries like Germany to further assist the deeply indebted and structurally restricted countries in the event they require further assistance.

In contrast to cuts in most other countries' growth forecasts the IMF lifted their prediction for Japan's growth to 1.6% from 1.1%.

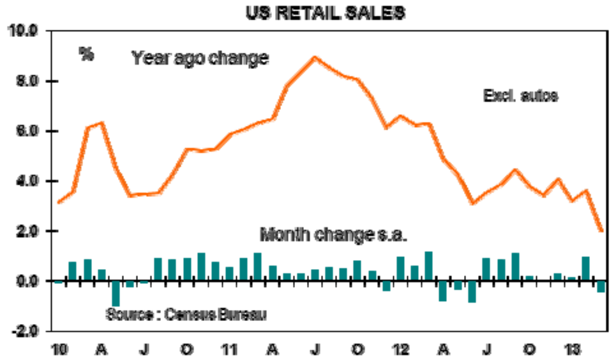
In the United Kingdom the economy is back in recession again courtesy of the country's exposure to the moribund Eurozone and its economic, budgetary, and banking problems, and courtesy of a stringent fiscal austerity plan aimed at reining in British debt. The Bank of England took its cash rate down to 0.5% in March 2009 during the depths of the GFC from 5.5% early in 2008, but has not been able to raise it since then because of the economic woe.

However perversely given the state of the UK economy inflation there is a problem. Inflation was 2.7% in March and is commonly expected to average about that this year while growth may come in at only 0.7%. The BOE would probably either cut the base rate or more probably reactivate its bond buying (money printing) programme were it not for the high inflation. That they cannot suggests poor growth continuing and that will help feed into continuing NZD appreciation against the Pound.

In Australia the unemployment rate moved up to 5.6% in March from 5.4% in February with job numbers falling 36,100 in March in a correction from the massively above expectations. Although there are improving signs of life in the housing market worries about cancellation of more large mining sector projects are growing and the chances are increasing – especially in light of weak China data – that the RBA will cut interest rates again 1 – 2 times in coming months. That will send the NZD higher against the AUD.

In China the March quarter GDP numbers came in slightly weaker than expected with growth from a year earlier of 7.7% which was a slowdown from 7.9% quarter on year ago growth in the December quarter. Some of the monthly numbers were also on the weaker than expected side such as industrial production being ahead 8.9% in March from 9.9% growth in February, and investment in fixed assets being up 20.9% from 21.2%.

In the United States the data releases over the past week have fallen largely on the weaker than expected side, starting with Friday night's University of Michigan Consumer Sentiment gauge. This fell to 72.3 in April from 78.6 in March – the lowest reading in nine months.



Retail sales also came in weak in March with a fall of 0.4% following a 1% rise in February. Sales for the quarter were ahead 1% seasonally adjusted from the December quarter compared with 1.5% growth during the December quarter itself and 1.3% during the September quarter. The graph above shows the same weakness in the core retailing measure which excludes automobiles.

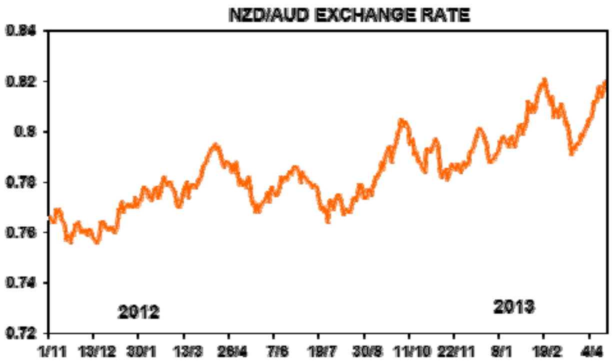
Overall the weak has been one of a pullback in expectations for world growth – hence falls in wholesale interest rates and equity markets.

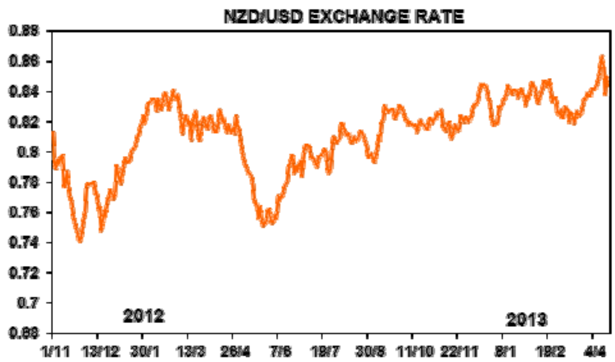
Exchange Rates

Exchange Rates	This Week	Week ago	4 wks ago	3 Mths ago	Yr ago	10 yr average
NZD/USD	0.844	0.859	0.827	0.841	0.822	0.844
NZD/AUD	0.82	0.815	0.794	0.798	0.79	0.82
NZD/JPY	82.5	85.7	78.8	75.6	66.5	82.5
NZD/GBP	0.554	0.56	0.547	0.526	0.516	0.554
NZD/EUR	0.648	0.657	0.633	0.629	0.626	0.648
NZDCNY	5.21	5.32	5.14	5.23	5.18	5.21
USD/JPY	97.75	99.77	95.28	89.89	80.90	97.75
GBP/USD	1.52	1.53	1.51	1.60	1.59	1.52
EUR/USD	1.30	1.31	1.31	1.34	1.31	1.30
AUD/USD	1.03	1.05	1.04	1.05	1.04	1.03
USD/RMB	6.1727	6.1939	6.217	6.2181	6.3031	6.1727

Global growth, terrorism worries and profit-taking send NZD back toward US 84 cents this week

The kiwi dollar this afternoon was buying just over US 84 cents compared with almost 86 cents a week ago. It was also down about three Japanese Yen and marginally off against the Euro and Pound while gaining against the Aussie dollar to sit near 82 cents.





Downward pressure on the NZD this week came largely in response to weaker than expected US economic data released on Friday night calling into question some of the optimism which has driven up commodity prices and risky assets such as equities and far flung currencies. There was also some safe-haven buying of the USD and selling of risky assets following the bombings in Boston and confirmation of ricin in a letter sent to a US senator. Selling of risky assets also followed weaker than expected profit announcements by some listed companies in the US last night which pushed share indices lower.

But unless one buys into a scenario of things falling back into a hole again it is very unlikely that the pullback in the NZD will amount to more than a brief chance for exporters to get on board a small amount of extra hedging – at still very high levels. While no tightening of NZ monetary policy is likely until probably late next year or 2015 the chances remain that our cash rate will rise in advance of rates offshore. In addition money printing continues overseas with cash flooding out of Japan looking for a home offering something better than a near 0% yield and so the carry trade appears to be mildly active again.

In New Zealand business and consumer sentiment measures are sitting at above average levels, the labour market is slowly picking up, there is evidence of accelerated growth in retail spending (though many retailers are still struggling), and the construction sector is picking up strongly. Dairy prices this week held the huge gains made in previous fortnightly Global dairy trade auctions achieved in response to the drought cutting milk output though the drought appears to have just about ended in many parts of the country.

All it all up and we see an environment in which unless there is a fresh global shock the NZD stays high and goes higher – and that includes against the Aussie dollar where the markets are still of the view that the RBA may cut interest rates another one or two times.

Discussion

In this section I shall include noteworthy comments made by emailers. Some weeks nothing will be here. No names will be printed.

Poor NZ Employer Utilisation of Expats

"Hi Tony, An interesting picture. I am however disappointed about the ongoing problems for Expats returning to NZ. Little has changed in the last 30/35 years. I experienced just what you describe but at least had a job to come back to! I have always had a management philosophy of having good people around me, in some cases with better qualifications. I have always been of the view that the team is then better equipped for the day to day let alone future challenges. A good manager leads a tem and inspires them not worrying about the level of knowledge where he or she can use the in house expertise. Why is middle management and in many cases senior management still not understanding some basic facts of life?"

Chinese buying of houses in Auckland

"My anecdotal research as a frustrated property developer who attends auctions weekly is that 95% of all developable property sells to Chinese. Yes, 95%! My guess on other residential property is far more approximate at around 50%. Interestingly I asked 2 different agency managers what their proportion of sales to Chinese were and one said "well over 50%" and the other said "around 60%". I confess that my research is primarily on the Eastern suburbs of Auckland and both agencies are in this area as well. It may be that percentages are lower in other parts of Auckland - or higher. The other fact I am unsure of is the status of Chinese purchasers but I think it fair to assume that at least half of them are not residents or NZ citizens."

"My friend in Albany in a large 5 bed home is now surrounded by owners who are absentee having bought and left their kids here while they go back to China (like HK a few years ago). Their whole street is experiencing major problems as a result – last weekend masses of police with protection guards had to come at 2am as 80-90 Asian and other teenagers were in the street and the debris the next day was terrible."

"I live in Victoria Avenue, Remuera, albeit in a modest flat with one bedroom, bathroom-laundry, kitchen, separate dining room and lounge, together with a North-Easterly outlook and view ("peek of Rangitoto") and sun-filled living rooms all day. I have a separate garage beneath but not internal access. The 'Independent Valuation' of my flat two years ago was $360,000. Two to three weeks ago a similar, indeed 'mirror image', flat immediately adjoining mine went up for auction. However, the particular flat has minimal outlook and is badly lacking light and sunshine inside, even on a sunny day. The vendors cunningly installed an interior wall separating the dining room from the lounge, thereby creating a "Two Bedroom Flat" Bidding was brisk between three Asian/Chinese buyers and the leading bidder paid $515,000, for essentially a one bedroom flat . This anecdotal example bears out your forecast of steadily rising Auckland residential property prices, especially in Remuera and those in Grammar Zone, not to mention the Asian ideal of 'best street'.

Rising House Prices

"When you name Auckland you may want to identify the difference between city prices and the now outlying areas that are not experiencing this housing boom. Go around Snells Beach and prices are still below 2007. We know because we have recently sold – took 6 months and we lost money having bought October 2006. Many bachs selling but they are low $400,000 level and often first time buyers rather than weekenders we are noticing. Anything over $500,000 much more difficult. Our next door neighbour (we are renting while building) has only had an offer for her 4 bed house (not bach) just above her purchase price in 2005. And she is over the $600,000 price area. Lots of people now live here – not just weekend bachs people because further south is too expensive. So perhaps it would be good to define Auckland region into two categories – City and north of Orewa and maybe there is an area South of Auckland too?"

Business Culture As An Impediment To NZ Growth
I reprint this first comment to show how our culture blinds us to the way the world has changed and that modern economies do not base themselves upon what one can grow or build in a timely manner on a piece of land.
"In a country where land use is the fundamental generator of wealth the act (RMA) will continue to apply a brake on development, innovation, productivity growth and the wealth and wages of NZers… I fully recognise the necessity for environmental protections but I would argue that the RMA is a collectivist piece of legislation that inhibits growth, innovation and productivity and is not that good at protecting the ecological environment. "

"We hear a lot about the impediment of "rules and regulations". I have owned a number of small businesses for many years including, butchery, law firm, consultancy firm (to the legal profession) and managed a software house. In all of that time I did not find the "rules and regulations" a burden. I have always had difficulty relating the cost of compliance calculated by accountants with what happens in my business. When I worked for county councils I prepared reports for subdivisions. There was one surveyor who would first discuss his client's proposal with me to get it to fit the rules. Most of his applications were successful. I think too many business people try to do things without first finding out what the rules are and then get frustrated because they cannot do what they want. A little bit of forethought and they may have succeeded."

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/
- 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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