Weekly Overview

25 April 2013

ISSN 2253-3672

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

Monthly survey time and what I learnt in Brussels.

This is the last Thursday of the month so if you have not already done so using the link in the email please click here to complete our monthly business confidence survey.
http://feedback.bnz.co.nz/surveys/Fi8Go-yFGEu0bwjPu5Waww

I've spent the past week first travelling to Brussels via Heathrow then attending conferences in Brussels and Bruges. Why Europe again? Partly because since May 2010 when problems in Greece appeared it has become clear that it is not just the GFC and its after-effects which beset Europe, but existential issues as well which the GFC has brought to light. Should the Euro and even the EU break apart (UK leave?) to some degree the impact on the world economy, our exports etc. could be devastating, especially if it were to occur at the same time as a slowdown in China – something which is guaranteed to deliver our economy shocks for ever and a day from here on out. C'est la vie from whoever we sell our stuff to.

The first conference I attended was the Brussels Think Tank Dialogue which addressed the question "Federalism or Fragmentation – Europe's F-word".

The main things which I took away from the first conference are this. (Stop reading at this point if all you want to hear is that everything is going to be alright.)

With there being ten think tanks located in Brussels gathered together to put the conference on it suggests that there is a lot of energy wasted in the EU on simply bringing the various countries together, solving their disparate problems, and stopping them from moving apart. Both Australia and the United States have well-functioning federal systems. Europe does not and it is many decades off having such a system. With this extra burden of trying to corral the cats in one place it is virtually guaranteed that productivity growth will be less than in more established countries and emerging economies.

Divisions within the EU are growing – between north and south, young and old, the centre and the periphery, and debtors versus creditors. These divisions are manifesting themselves as citizens blaming those in other countries for their problems, rioting, voting for non-mainstream parties, difficulties in forming stable governments, falling support for expansion of the EU, falling support within the EU for the EU concept itself etc. There was laughter when the UK was grouped with Turkey as being on the periphery of the periphery of the EU – showing that within the room the strong view is that being in the EU is right at all costs and if you don't want to be there then you are to be laughed at. This is somewhat patronising and a worrying sign when you display your cohesiveness through derision of those not "in" your group. .

People worry that Germany is getting too strong. People worry when the German economy looks like it might get weak! People worry that Germany is becoming less and less dependent upon the rest of Europe. People think a lot about Germany in other words – then dis it by noting it accounts for less than 1% of world population so can hardly be considered to provide a suitable model for everyone. The same people who say this however would not one suspects claim that the planet should instead pay 20% more attention to the country accounting for 20% of the world's population – China. The 1% comment is another example of the way in which the different EU members put each other down.

More and more the concept of the EU is seen as really meaning the Eurozone, and that barring the six founding countries the concept of the EU as more than an economic union but also a union of shared values seems not to be shared by the new and especially newer entrants. There is acceptance that the EU was probably expanded too rapidly, especially in the context of countries having fought for their independence and self-determination now being asked and instructed to sacrifice national sovereignty in the interests of EU cohesiveness. This less than optimal quick expansion of the EU occurred partly as a response to the Soviet Union falling apart in 1990 and a desire to quickly get democracy established in the fractured states, and on the part of those states to move forever and a day away from any potential Russian resurrection.

There is general acceptance that the Euro was rushed, and acknowledgement that it is not the Maastricht Treaty which has failed or the Growth and Stability Pact, but adherence to the treaties - with Germany and France ignoring the rules before others also broke them.

Debt funding is not flowing to SMEs and because they are the source of innovation and new industries that leaves Europe especially exposed to loss of existing industries to other parts of the world. While generally one thinks of "other parts" as only Asia that is changing and one needs also to throw in the United States. That is because of falling energy prices in the US causing fresh investment in energy-intensive industries to occur in the US rather than in Europe. Such investment will eventually drag in the industries which support the energy-intensive ones. Now throw in robotics and 3D printing. Interesting. I'd bet 99% of Kiwis are not aware of this trend and if they do have some global economic awareness it will instead be focussed on firms shifting manufacturing to China. That however is becoming an old story.

In the context of the electricity price controls proposed by Labour and the Greens, it should be noted that speakers on the European electricity market noted the dangers of price control in terms of black outs as investors would stay away from the sector and the creation of new generation. To quote one "Let me be clear. This kills investment". (But I like to balance any comments critical of political parties with something positive so let's add here that Labour are far more advanced than National in recognising and being prepared to do something large about the worsening housing crisis – though there is little chance of construction cost savings reaching 30% given the oligopolistic nature of our building materials sector. Sounds like the electricity sector. Or supermarkets. Not banks though!)

In a well-functioning democracy such as New Zealand's (my comment) people vote not just for politicians who will look after their personal interests but who will also work toward the interests of the entire society. In Europe the sense of crisis is not strong enough for people to drop nationalistic thinking and strongly support an over-arching European solution. In fact just the opposite appears to be happening with voters becoming more divisive. The word "solidarity" – the concept of willing joint sharing of pain and adjustment - is rarely used.

Greece will probably need support for decades but things are heading in the right direction even though the asset sales programme is failing, efforts to get people to pay their taxes struggling, and resistance to cutbacks in cosy subsidised public service jobs as strong as ever. (Just like Portugal where the courts won't let the public servants be laid off!) There was criticism at the conference of those portraying people from particular EU countries as being inherently inferior and somehow lazy. Instead it was noted that politicians set the rules, institutions and incentive structures which people then respond to. It is up to leaders to alter those rules and structures if behaviours are to be altered.

Even with a 12% unemployment rate Europe is short some 4 million skilled engineers and technicians. Young people are less and less interested in jobs in the industrial sector and focus is believed to need to move more toward training and education. There is a view that a lot of the hollowing out of European industry was foreseeable but no plan was put in place two decades ago to deal with it. Sounds like NZ's absence of any plan to assist those thrown out of work by the 1980s reforms.

One of the best presentations was by the New Zealand Ambassador to the EU Vangelis Vitalis speaking about the outside perception of Europe and in particular its seeming lack of engagement in the Asian Pacific region as its internal problems make it de facto not a global power. He noted how Europe appears to be less interested in a multilateral approach to global trade and is embracing bilateralism – but then who isn't?

There were a small number of Asian people present and one who showed the still very poor understanding China has of how to engage internationally. He felt that Asia was superior to Europe's cohesion model as ASEAN accepted the Muslim nation of Indonesia whereas Turkey was not in the EU. It was pointed out to him that Turkey and the EU have been negotiating since 2005, that there are 80,000 pages of regulations to go through, and that the EU fully intends that Turkey becomes a member. Plus ASEAN is simply an economic zone and not the increasingly integrated political venture which the EU is. The Chinese person also said that the 2009 comment by President Obama that the US could learn from China in the context of high speed trains showed his support for their authoritarian regime. The response was a comment about lack of media freedom in China limiting anyone's ability to know what is really going on there. Plus a comment was made later on that authoritarian regimes are good at projects but lack the ability democracy has to learn from mistakes and make changes.

What of relevance to New Zealand did I take from the conference?

The EU is busy fighting internal problems and navel-gazing. Their willingness and ability to engage as a strong international voice is compromised. They are more focussed on a free trade pact with the United States than furthering multilateral trade deals it seems. While maintaining links with Europe, NZ must for now shift its global diplomatic efforts more toward helping to shape what is happening in Asia with our own voice and membership of regional bodies rather than riding along with compromised Europeans.

Europe's economic growth will be soft for many years and ease of NZ export revenue growth there will be impeded. The biggest manifestation of this may be tourism flows. There is little to suggest that FDI flows will be any different from what would otherwise be the case as European companies look for more exciting markets than their own. Additionally, as previously noted, NZ can only ever exploit niche markets and the EU is a wealthy, modern, technologically advanced part of the world with sophisticated consumers highly interested in the quality and safe food products we produce and probably better able to absorb, utilise and not steal technology we develop for mutual advantage than the current bright light – China.

Shocks to world financial markets from Europe remain likely. This means volatility in asset prices such as for equities and exchange rates. At times bank funding ability and cost may also be impacted.

The Fourth Bruges European Business Conference – Europe as a Location for Industry and Innovation

This second conference I attended was presented by the College of Europe and Deloittes and looked at how Europe can become a more attractive location for manufacturers and boost competitiveness. Europe's industrial sector is facing strong challenges and the lack of cohesion I saw discussed means the goal of returning industrial production to 20% of EU GDP is unlikely to be achieved. Challenges include the following.

- Low costs of production in China and other Asian countries
- China undermining European competitiveness by stealing trade secrets.
- Cheapening US energy drawing energy intensive industries away from Europe.

- A weak domestic EU market encouraging industrial producers to focus their attention, design, and location plans on fast growing markets in the emerging economies.
- EU regulations on business activity
- Shortages of skills with young people not wanting to become engineers
- EU regulations preventing successful commercialisation of new developments.
- Rising competition from other locations improving their infrastructure, supply chains, skill levels.
- The long term focus of Europe is not on industrial development but issues such as regional assistance, infrastructure building in new entrant countries, environmental protection.
- Politicians over-react to public perceptions of risk leading to sometimes massively disturbing and quick policy changes – such as nuclear power following the Japanese power plant collapse.

As with the conference in Brussels there was puffing of European chests in terms of foreign direct investment inflows being second only to Asia (27% global FDI in 2011, estimated 21% in 2012), the highly developed social and economic infrastructure, skilled workforce, good infrastructure and education system. One speaker even noted that in recent years while the US percentage share of total world GDP had fallen 6% and Japan 3%, Europe had held its portion. He neglected to point out that this was because of EU membership expansion. The comment was a silly one to make.

It is worth noting that in contrast to the situation in New Zealand not a single person at the Bruges or Brussels conference mentioned the exchange rate or planning regulations as contributory factors to the weakness of the industrial sector. Factors mentioned as problems included the definition of SMEs used for purposes of granting R&D advantages, accounting costs associated with rules on "conflict" materials, loss of agricultural research and development due to GMO rules. One speaker noted "In Europe it has never been easier to get R&D funding, but it has never been harder to bring a product to the market." No-one mentioned the labour market being too regulated – quite an omission given the role played by restrictive practices in undermining competitiveness of many of the currently indebted and struggling economies. Perhaps this reflects the semi-socialism at the heart of European politics.

There was much noting of the disengagement which the young generation appear to have with Europe – their lack of clear commitment to bringing countries closer together. Some noted that the EU is still very young at only some 60 years with half of the EU members in fact younger than the EU itself. But to me it stands out that there was in neither conference a presentation of the European project as a collective embracing of a core set of values. This stands in contrast to the United States of America which coalesces around a Constitution and Bill of Rights expressing Americans' key values and principles. Or the Chinese solidarity around rebuilding a long-lasting civilisation and regaining international respect (losing ground there currently). Europe comes across more as an attempt to drag as many potential enemies into as tight a grouping as possible in order to reduce the chance of future conflict with a possible payoff being better economic and social outcomes. In this context it was noted by one speaker that in the commercial world over half of company mergers fail. Bringing together so far 27 countries in a merger with more entrants expected is therefore a monumental task which wastes a lot of resources.

One speaker noted that only one EU member has achieved the target of companies being able to be set up within three days. In some countries it takes months. I did not have the heart to point out that in NZ it takes 30 minutes and yet our industrial sector is not roaring ahead.

Research presented by the Deloittes speaker noted that out of all factors identified in their Global Manufacturing Competitiveness Report the most important one cited by the 500 surveyed CEOs was <u>access to talent-driven innovation</u>. After that the next most important determinant of where manufacturing companies place their investment was trade and taxation policies, then the cost of materials, energy and labour, then infrastructure.

The identified key determinants of talent-driven innovation in the Deloittes study were the following.

1. Quality and availability of researchers, scientists, and engineers.
2. Quality and availability of skilled labour generally.
3. Quality of primary and secondary schools.

4. Quality of universities and the extent of their linkages with the business sector.
5. Migration policies.

What of relevance to New Zealand did I take from this conference?

We are fortunate not to have to waste resources of trying to create a well-functioning federation of extremely disparate economies and societies. We do not seek to equalise outcomes across our regions through differentiated subsidies and development grants. We do not have to waste time developing regulations which get buy-in from so many different groups with the result appearing to be excessive prescriptiveness of such regulations across many thousands of pages for often very small areas. We also are not burdened with a multi-level system of government.

The importance of access to talent-driven innovation is why the likes of EPIC in Christchurch and its hopefully rapid expansion are important, especially in the context of linking with the local polytechnic. This is also why the Callaghan Initiative is very important – though I have found few people as yet who believe the scientists can be turned toward thinking about the business applications of their developments in cooperation with profit-focussed businesspeople, as opposed to science for science's sake. Good luck Mary.

In Bruges – lace, waffles and tourist galore

I am typing this while sitting in the breakfast room of the Martins Brugge Hotel right behind the bell tower in the middle of Bruges, surrounded by a few dozen Japanese people enjoying their food before spending the day doing whatever one does here. For some it will involve climbing the 300+ steps to the top of the tower though I have not heard of anyone actually jumping off as happened in the movie.

If you want to get a mental picture of what Bruges looks like think of the little town which Ned Flanders took Rod and Tod to in the episode about his moustache. The shops are cute and the houses lovely to look at and you're away laughing if your shopping interests encapsulate chocolate and lace, and your nutrition interests centre around waffles and beer. The coffee is appalling beyond belief-squared, which is typical for a tourism-focussed location.

The thing that people do here is walk all around the main square. During the day and early evening there are people everywhere and the atmosphere is quite festive. There are many large upright bikes being ridden by the locals plus tourists who have hired them. The police are on bikes, but there are also cars and lorries winding their way sometimes too rapidly through the very narrow streets.

The roads are largely cobblestone and it is funny watching the tourists drag their wheelie bags to destruction in noisy manner. Because of these cobblestones the bikes often have quite fat types – somewhat like large upright versions of NZ mountain bikes – of which I saw not a single one. You wouldn't want to wear shoes with small heels here.

Visitors can go for a ride around the town in lovely horse-drawn open carriages though they do look a bit naf passing by people strolling leisurely along the same routes. People also queue to go on the boats which ply the canals and that seems quite popular.

For some reason there seem to be lots of school groups with kids who all look the same! Maybe it's an age thing but teenager rebellion through radical appearance looks like it went out the window years ago. But having said that, some of the older people definitely do look different – like those walking along Rodeo Drive in the first Beverly Hills Cop movie. Europeans sure do dress funny.

I bought no souvenirs, having little use for lace, funny teapots, little models of houses, or chocolates shaped as animals or breasts.

Interest Rates

Reserve Bank makes no change, none likely until well into 2014

You have to feel sorry for central bankers sometimes. They know that their every word will be examined in detail, they limit the words which reach public ears, and they put an extreme amount of effort into draughting press releases they have to make such as this week's OCR review. So imagine how they felt about market reaction to this comment.

"The New Zealand dollar remains overvalued and is higher than projected in March. Further appreciation has occurred partly in response to the announcement of a substantial quantitative easing programme in Japan. The high New Zealand dollar continues to be a significant headwind for the tradables sector, restricting export earnings and encouraging demand for imports."

You would think that this expression of concern about the negative impact on exports of the high NZD might push the NZD down a tad. Instead it went up by almost half a cent. Why? Because analysts felt it was not as strong an expression of concern as could have been the case.

This is like telling your partner you love her and being cuffed around the ear for not saying it as tenderly as you used to.

Such is the nature of what we sometimes call an "open mouth operation" as opposed to an open market operation. Central banks know they can influence markets through words and so the markets are always looking for this subtle tool to be used ahead of any actual shifting of the a cash rate itself. But meaning gets lost in translation.

Aside from the higher NZD that there was little reaction to the RB's decision to leave the cash rate at 2.5% apart from a minor rise in interest rates because of the absence of expressions of concern about a weak labour market.

Our view remains that the next change in monetary policy will be upward – even though the odds have increased recently of another rate cut in Europe and even Australia. Those developments will have their main impact in the FX market and on medium to long term fixed interest rates which will remain low for a longer period of time.

All up then – nothing much new this week though I have become slightly less optimistic about world growth prospects and hence more convinced that the OCR rise does not come until late-2014 or even 2015 – and that even though the housing market will keep rising.

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%	2.66	2.66	2.67	2.76	5.7
1 year swap	2.78%	2.75	2.79	2.76	2.84	5.8
3 year swap	3.09%	3.07	3.18	3.00	3.23	6.1
5 year swap	3.39%	3.35	3.53	3.32	3.68	6.3
7 year swap	3.67%	3.65	3.83	3.64	4.06	

Housing Market Update

The smoggier it gets in China, the higher Auckland house prices will go

Concerns about air pollution in China are soaring and people are talking more and more about migrating or at least getting their children out of the country. There are three implications for NZ from this suddenly developing trend which adds to developments stemming from rising incomes and increasing ability to get overseas.

First there is a big opportunity for NZ tourism to shift the average length of visit of Chinese holiday-makers from 6 days to twice that by focussing on our wonderful air quality. The longer people are in NZ the greater the time they can breathe without coughing or stunting the growth of their children.

Second, the attraction of sending one's child overseas to study will be soaring and that could boost Chinese student numbers in NZ anew. Already Chinese students bring in over $1bn to our economy and account for near 27% of the total numbers from offshore studying here.

Third, if student numbers rise that will mean more Chinese parents looking to buy houses for their kid to occupy. In addition more will be looking to migrate here and that will again add to housing market pressure.

These developments therefore just add to the case for NZ to develop a policy regarding foreign buying of NZ residential property. At the moment there are no rules for city purchases.

Speaking of migration – this week we learnt that the upward trend in the net migration inflow is continuing. In March the seasonally adjusted net gain was 1,220 people which is the highest since late-2009 and well up from 720 in February and 420 in January. The annualised gain for the March quarter was 9,440 which gives us a guide to where the actual 12 month gain is headed. For now that annual gain sits at 2,542 in the year to March from a loss of 3,383 a year ago. Onward and upward it seems driven by fewer people leaving rather than a flood of people back to our shores. In the March quarter permanent departures were down 11.6% from a year ago while arrivals were ahead only 3.1%.

If I Were A Borrower What Would I Do?

No change – here is last week's comment repeated.

"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

New caution sweeps the globe

The theme running through the world's financial markets at the moment is one of growth showing signs of faltering in the United States, China and Germany, rising pressure for an easing off in the pace of fiscal tightening in Europe, and increasing probability of more easing of monetary policies. Basically things are getting worse once again.

In the United Kingdom there is growing debate about whether the fiscal austerity path being staunchly followed by the Chancellor of the Exchequer Mr George Osborne can be sustained in the face of newly faltering growth in Europe, downward revisions to UK growth forecasts, criticism of the policy by the IMF, a one notch credit rating cut to AA+ from Fitch, and new weakening in the UK labour market. Into this environment steps a new Governor for the Bank of England Mark Carney who has already warned that monetary policy alone is not capable of delivering the sustained economic growth people are seeking.

Quite right. All central banks can do by cutting interest rates and expanding money supply is buy time for the private sector (banks, businesses, and households) to get their accounts back in order and resume more normal spending patterns when they feel it is safe to do so. And that is where a major problem is developing. The longer the money printing goes on the more desperate central banks look, the more over-valued asset markets will become, and the more vulnerable everyone gets to a correction in asset prices.

This is why the sharp decline in gold prices two weeks ago needs to receive special attention. Gold prices fell 13% over two days – their biggest such decline in three decades, on rumours that the Federal Reserve might reduce its quantitative injections and news that Cyprus was going to have to sell its near €400mn worth of gold reserves. The latter is a relatively small affair but the reaction to the former suggest there may be elements of a pyramid scheme in play in the gold market. Another name for this is the "greater fool theory" whereby one buys a thing knowing its price cannot be justified on any other basis than that someone else may buy it on the basis that someone else may buy it and so on.

In Germany there was a weaker than expected figure released this week in the form of the monthly PMI which came in at a recessionary level of 47.9 rather than the expected 49 for April. This result contributed to the overall Eurozone PMI staying at a bad looking 46.5 in the month where a reading of 50 means no growth.

In Italy economic prospects look dim following eight quarters of GDP shrinkage as citizens voted more for a comedian-led party than any other in general elections earlier this year and a government has yet to be formed. Failure to reach agreement on a new President has seen the previous one reappointed at age 87 for another seven years even though he did not want the job. He will have the power to call fresh general elections. With policy developments at a standstill the economy cannot help but stumble unless the external trading environment turns strongly for the better – but that is not happening.

In Spain a budget deficit equal to 7% of GDP was achieved last year but it is expected that Spain will win agreement to slow down the pace of further deficit reduction as the economy remains in deep recession with unemployment above 26%.

The problems afflicting economies in Europe are many-fold and vary in intensity and relevance from one country to another. They can be summed up however as follows.

- Regulated economies unable to efficiently shift resources including labour and capital from failing firms and industries to newly growing high productivity businesses and sectors.
- Decades-long entrenchment of the idea that budget deficits can stimulate growth – the result being excessive debt levels and citizenry unable to understand how reversing old fiscal policy stances can this time eventually drive growth!

- Banks, businesses, and households burdened by debt and unwilling to spend, hire, and invest as they try to reduce their exposure to another weakening of growth while hoping others are raising debt and spending so they can help them in their personal circumstances.

Attacking all three areas of the banking system, Government finances, and economic structures at once is very difficult and was only able to be achieved in New Zealand over an eight year period because of the combination of

- the first past the post electoral system,
- the threat of huge population loss to Australia,
- a generally homogeneous society accepting TINA (there is no alternative), and
- initial covering up of the necessary economic damage from removing industry subsidies and sectoral protection by a credit boom – which proved unsustainable as it fed collapses in property and share prices.

Frankly the situation was well summed up by the German Bundesbank President Jens Weidmann recently when we warned that the crisis could drag on for a decade. Taking NZ's eight years as a starting point and allowing for the disunity in Europe between countries and within countries, the strictures imposed by the Euro, and the starting points for the problems and I'd suggest one reads the decade comment as having a starting point of now and not five years ago in 2008.

In Japan it's all hands to the bunsen burners as planners undertake one of the world's biggest ever experiments in economic management. It involves printing lots of money in the hope that banks will lend it, and that people will borrow and spend it. The polite presentation of the policy however is attempting to achieve inflation of 2% within two years. Good luck.

As many have been increasingly wondering in recent weeks, including the IMF head Christine Lagard, why is it that so much monetary policy stimulus so far has failed to life national and global growth? Simple. People don't want the extra debt. And because there is no model in existence which tells us when that debt-intolerance behaviour will change it is both impossible to predict when world growth becomes sustainably good and whether further money printing in Japan and elsewhere will have any positive impact.

So I am left with presenting here comments which I have been delivering to my audiences for four years now.

'No-one on the planet has an economic model which says when you come this close to repeating the Great Depression (hold two fingers close together at this point), this is what usually happens on the way out. We have no idea and are building up just one data point which tells us it takes a lot longer than you think."

And

'We have no idea when people will decide that their debt levels are good. It could be next month, it could be in ten years."

In this sort of environment where rising asset prices are not correlated with improving conditions there are profits to be made riding those asset prices upward. And losses to be made when reality one day kicks back in.

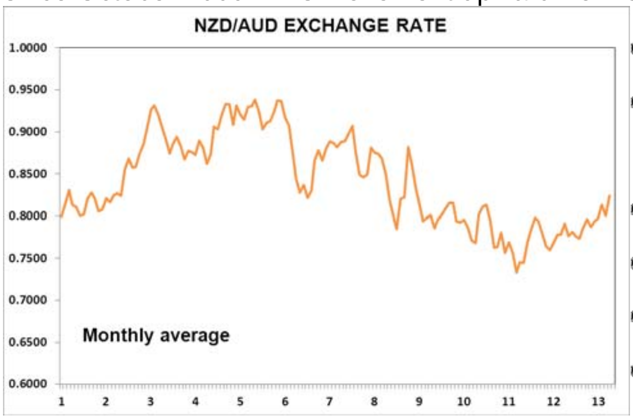
Exchange Rates

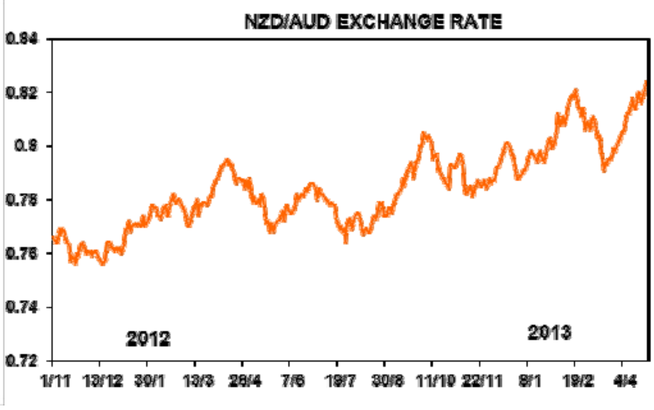
Exchange Rates	This Week	Week ago	4 wks ago	3 Mths ago	Yr ago	10 yr average
NZD/USD	0.847	0.844	0.835	0.838	0.813	0.67
NZD/AUD	0.824	0.82	0.799	0.802	0.787	0.85
NZD/JPY	84	82.5	78.9	75.7	66	69.6
NZD/GBP	0.554	0.554	0.548	0.531	0.505	0.388
NZD/EUR	0.65	0.648	0.643	0.626	0.615	0.52
NZDCNY	5.23	5.21	5.19	5.21	5.12	4.99
USD/JPY	99.17	97.75	94.49	90.33	81.18	105.7
GBP/USD	1.53	1.52	1.52	1.58	1.61	1.72
EUR/USD	1.30	1.30	1.30	1.34	1.32	1.28
AUD/USD	1.03	1.03	1.05	1.04	1.03	0.788
USD/RMB	6.1781	6.1727	6.212	6.2204	6.3037	7.56

NZD at three and a half year high against the Aussie dollar

Well spotted those who saw that last week's column in the table above showing ten year averages was exactly the same as the first column. Don't know how that happened.

Against the Australian currency the NZD has risen firmly in recent weeks and now sits at its highest level since October 2009. This movement upward from 80 cents a month ago is based upon a number of things.





First there are continuing expectations that in spite of signs of life in Australia's retailing and housing sectors the RBA will probably cut interest rates another one or two times. In contrast no rate cut is expected in new Zealand given the rising pace of growth in domestic economic activity.

Second, every few weeks another one of Australia's very large projects gets cancelled. That is not just feeding into some mild easing of medium term growth prospects but also expected to lead to reduced capital inflows into Australia as some 80% of the resource investment in recent years has been financed from offshore. Contrast that with NZ where accelerating growth will drag in more foreign funds.

Third, the fiscal track in NZ is surprising on the positive side with revenue inflows running ahead of expectations this year. In contrast in Australia the Treasurer Wayne Swan has had to make a very embarrassing climb-down from his position that fiscal surplus would be achieved in 2013/14 no matter what. Now he speaks in terms of a surplus not appearing for many years. Commentators are noting that a Federal Labour government in Australia has not produced a surplus since 1989, there is growing criticism of the never-ending spending promises being made, and this week Standard and Poors warned that they could cut Australia's rating in five years' time.

Fourth, Australia's currency is more strongly assessed as being tied to growth prospects in China than the NZD.

Fifth, as China grows the expectation is that NZ will benefit more than Australia from here on out because of strong food demand compared with past strong demand for coal and iron ore.

It all adds up to the NZD rising against the AUD with a level likely of 85 cents within a year.

Over the week our little currency has also gained marginally against the other major monies for a variety of reasons. Let's put the rise against the Euro down to a sharp lift in expectations that the ECB is about to cut its 0.75% cash rate. Let's put the rise against the Japanese Yen down to the continued factoring in of money printing happening over an extended period of time, plus the new tensions with China surrounding the Senkaku/Diaoyu islands dispute.

The Japanese PM threatened to use force if anyone on the eight Chinese ships which entered disputed waters climbed onto the islands, with China having sent the boats in after over 100 Japanese PMs visited the Yasukuni Shrine. This shrine in Japan honours 2.5 million war dead including 14 recognised war criminals. The Japanese PM did not attend but the Deputy PM did and the PM sent a tree.

Risks of financial and economic shocks coming out of Asia are growing.

Discussion

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

Auckland Housing

"Hi Tony Went to a meeting at the Auckland Town Hall about the Unitary Plan. What I found interesting was when I sidelined one of the Planners trying to find out the data on how they modelled the intensification increase in floor area to the amount of people they wish to absorb in each suburb, I was astounded to find no modelling had been carried out, the basis of the intensification was what the public would accept. The Planner conceded that the current level of intensification would not house anywhere near the 1000 people expected over the next 30 years. The Unitary Plan is not going to give relief to property shortages during this property cycle."

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://tonyalexander.co.nz/topics/brain-gain-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,

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