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.

Budget, Christchurch	**1**	**Offshore**	**6**
Interest Rates	**3**	**Foreign Exchange**	**8**
Housing Market Update	**4**	**Discussion**	**9**

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

Budget delivered, Christchurch Visited

The Finance Minister Bill English this afternoon delivered his fifth Budget and for the first time was able to present a reasonably positive outlook with growth in the economy accelerating as the Christchurch rebuild gets underway, investment grows in the agricultural sector, commodity prices perform well, and building in Auckland also moves upward. I'm not going to write-up the Budget here as there is already a lot out there containing the details. Suffice to say, the outlook is improving, a few goodies have been handed out, but this is not an election year so largesse has been restricted with an emphasis on starting to combat the worsening housing crisis which one has warned about for the past five years.

This week I have spent a couple of days down in Christchurch speaking to a range of groups regarding what I saw in Europe, how our economy will likely fare in the next few years, implications for things such as interest rates, the exchange rate, housing market etc., and what businesses should consider when developing their strategic plans.

Christchurch itself is really starting to hum as the reconstruction effort gets going. The $40bn rebuild job will stretch over a number of years and affect many companies all around New Zealand. With annual NZ GDP around $206bn the rebuild equates to some 20% of GDP with upside potential. Part of that upside comes from people telling me this week that they let the insurance rebuild of parts of their house happen then they took the opportunity to redo the bathroom, kitchen, update the carpets etc. on top of that which is interesting.

I spent much of Thursday at the Enterprise Precinct and Innovation Centre (EPIC) which is looking to expand from 4,000 square meters to up to 40,000 on a nearby location and is working on securing key tenants and then investors to back the project. Call me if you are interested. The way in which the centre will be linking into Silicon Valley and other innovation centres in other parts of the world is fascinating and the development has the potential to provide some exciting opportunities not just for Kiwis but returning expats as well – who of course are also Kiwis, just somewhat more rounded ones than the stay-at-home variety.

The Week's Economic Data

Retail Growth Slows After an Early Summer Binge

During the March quarter retail spending volumes in New Zealand grew by 0.5%, although if we cut out the volatile automotive categories including fuel then growth was 0.6%. That latter core growth rate followed a rise of 1.2% during the December quarter. So does this tell us that growth is falling away and the earlier summer binge was a one-off?

The late onset of cold weather this autumn means that clothing sales were weak, falling 2.4% in the quarter. Without clothing sales actually rose 0.8%. But this was still 0.6% weaker than the adjusted December quarter growth of 1.4%. Where has the slowdown occurred then?

Almost all categories saw less growth in the latest quarter than the previous quarter. So the case is strong that people have pulled their heads in after an earlier binge. Nevertheless, sales of durable goods (roughly classified) rose 1.4% which is a good result one would not expect to see were people newly a lot more cautious in their outlook. But again, this is a slowdown with durable sales having risen by 2.9% in the December quarter and 2.7$ in the September quarter.

So the valid conclusion one draws from these numbers is that the rate of growth in retail spending has pulled back after an early summer binge. This conclusion is also supported by the monthly Electronic Card Transactions data.

Core spending using debit and credit cards during April rose in seasonally adjusted terms by 1% after falling 0.8% in March. But in the past three months spending has grown at an annualised pace of 3.2% which is down from 6.5% in the three months to January. So there has been some easing in the pace of retail spending growth after a summer spurt.

This sort of result is more in line with the anecdotes we have been receiving from retailers regarding how they are seeing things. As a reminder here are the retailer comments from our BNZ Confidence Survey released on April 30.

- Vending=Grim.
- I work in retail and notice people having less disposable income.
- Fuel retail. Very buoyant. Shop sales increasing particularly coffee, muffins, sandwiches & good old fashioned pies.
- Online retail. Very quiet since new year. Low value items moving much more than larger value items were last year. Sell a lot to the rural areas so drought may have affected this.
- Pharmaceutical Wholesaling. No fat left in the system but costs still increase while pricing is tightly controlled and getting screwed down even more by Pharmac. Pharmacies that are well managed and run efficiently are getting by but the there is no joy for the inefficient operators.
- Horticulture (Ornamental) Still very static, development in Auckland is definitely going ahead but plants are the last thing to be purchased and installed in a project. Recent house price increases may improve domestic projects as owners see the benefit in investing in improvement projects.
- Retail horticulture is noticing a downturn ahead of seasonal affects which means we are all in for a tough winter this year. We are an early predictor of economic conditions and it looks dismal for the next few months.
- Pharmacy tightening up more and more, period of uncertainty with regards to dhb contract.
- As a wholesale distributor to retailers, we continue to see them with plenty of confidence but lacking in actual sales. Now the consequences of poor cash flow are beginning to bite as we like many other suppliers see our payment terms being dragged-out by another 30-60 days. Seems banks are not overly sensitive to retailers' needs. The wholesaler has become the retailers second bank of choice!

What about that which lies ahead? If confidence about the economy is a guide to what people are going to do with their money then the omens are good. The Roy Morgan company's monthly survey of consumer sentiment is running at slightly above average levels as is our own BNZ Confidence Survey. The labour market is improving with jobs growth at around 0.4% a quarter. But in a way that number sums things up. Jobs growth is running at about 1.6% annualised which is good but not especially strong. For instance from 2000 to 2005 jobs growth averaged 2.6% p.a.

In addition wages growth is low. But then so are financing costs. Yet if people were really responding to low interest rates the annual pace of growth in personal (non-housing) lending would be a lot more than just 1.3%.

What about rising house prices? Surely as people feel wealthier they will spend more? Maybe. But one would have to be quite sceptical about the strength of such an effect these days given the desire of people to keep debt growth under control. Finally, can we add anything to the picture yet from our new BNZ-Nine Rewards Consumer Trends Survey? Not really. We have only one month's observations in hand so cannot talk about trends or outcomes compared with average. But for your guide, here are the key results from the survey results which we released on May 6.

- A net 19% of the 529 respondents say they plan spending more than usual over the coming month.
- 18% are thinking about buying a car in the next three months.
- 40% are thinking about buying furniture or appliances in the next three months.
- 68% are planning an overseas holiday in the coming year.
- 76% are thinking about buying more clothing and accessories in the next three months.
- But reflecting the low debt growth data above, only 12% of people are thinking about borrowing more money in the next six months.

So personally I am left expecting retail activity to show acceptable but not stellar growth this year.

Interest Rates

Mild upward pressure from rising US rates

We have seen some mild upward movements in wholesale interest rates further out along the yield curve this past week driven largely by slightly higher yields in the United States rather than any shift of NZ monetary policy expectations. The US ten year government bond yield has climbed this week to 1.93% (peak was 1.97%) from 1.8% a week ago on the back of swirling rumours regarding the Federal Reserve cutting its money printing exercise in the not too distant future.

As previously noted this is one factor which will be generating volatility in interest rates for quite some time and it will be very interesting to see how the ceasing of money printing affects asset markets generally. One would expect weakness in equities and commodity prices, rises in interest rates, and some firming of the US dollar.

But there is no way this is going to be a straight line movement to zero printing and then money withdrawal. It will be a stop-start affair with the Fed. judging things carefully as they go, and it is not at all certain that easing of printing will even start this year. That is because the run of economic data could easily switch from generally good to generally poor and that has happened repeatedly over the past three years.

In fact just last night we saw the release of weaker than expected data in the United States on New York area manufacturing, industrial production, and producer prices. So Kiwi borrowers are probably not yet being faced with a situation where fixed rate borrowing costs are about to jump up sharply, and I have no intention of taking a punt and saying that one should fix as much as possible in the near future because uncertainty regarding the path forward remains extreme.

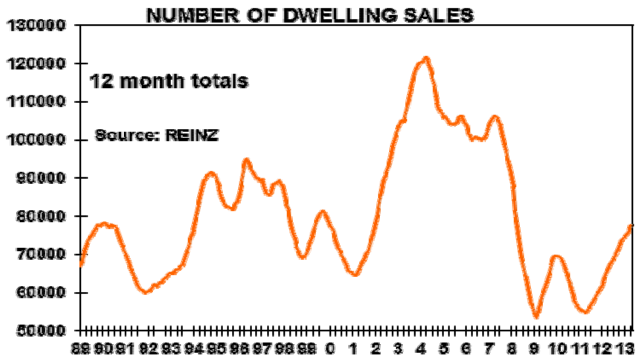
Taking a spread of floating and fixed rates appears optimal and we have noticed recently an increasing number of NZ businesses fixing some of their debt near the five year term simply because the rates are so low.

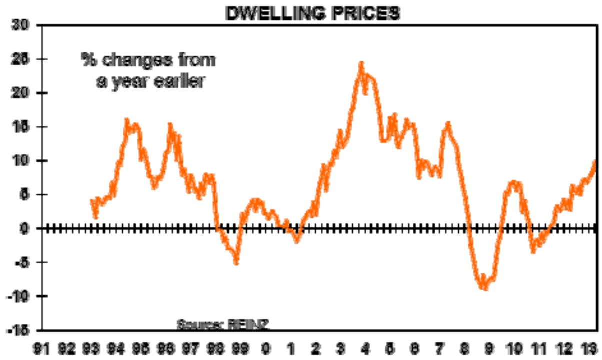
FINANCIAL MARKETS DATA	This week	Week ago	4 wks ago	3 months ago	Yr ago	10 yr average
Official Cash Rate	2.50%	2.50	2.50	2.50	2.50	5.4
90-day bank bill	2.66%	2.66	2.66	2.67	2.76	5.7
1 year swap	2.75%	2.72	2.71	2.86	2.52	5.8
3 year swap	3.12%	3.03	3.10	3.20	2.76	6.1
5 year swap	3.45%	3.32	3.40	3.52	3.17	6.3
7 year swap	3.73%	3.57	3.68	3.83	3.56	

Housing Market Update

Same old – housing market rising

The REINZ reported this week that in April there were 7,104 dwellings sold around New Zealand. This was a decrease from 8,128 in March but March is almost always the strongest month of the year so we read nothing into that monthly change. In fact in rough seasonally adjusted terms sales actually firmed in April by close to 4%.





Over the past year dwelling sales in New Zealand have risen by almost 18% to reach 77,550 from 65,927 a year ago and a low of 54,829 in April 2011.

The median dwelling selling price adjusted for quality changes rose by 0.8% in the month to lie 8.8% up from a year ago, 8.3% above the late-2007 peak, and 22% ahead of the early-2009 low. The following table shows these various changes for all NZ and the three main centres.

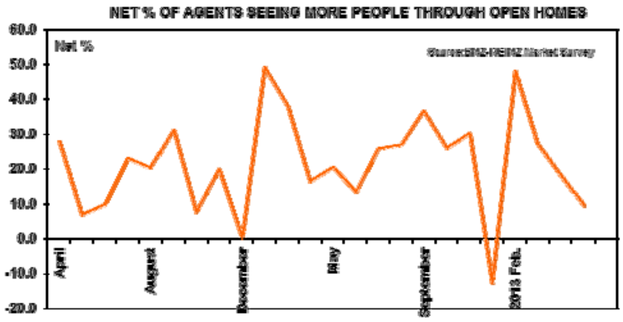
	Month %	Year ago %	Nov. 2007 peak	2008-9 low
Auckland	-0.8	14.1	20.8	36.0
Wellington	4.4	8.8	3.9	13.9
Christchurch	1.9	12.7	12.7	29.0
NZ	0.8	8.8	8.2	22

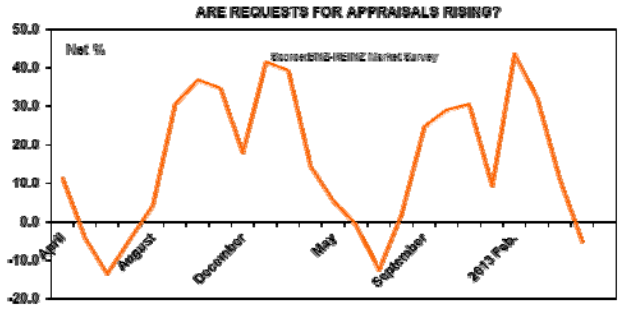
Neither the sales data or price numbers for April tell us anything particularly enthralling or different. But there is perhaps something interesting in the days to sell indicator. On average in April it took 34 days to sell a dwelling. This was just 1.9 days faster than average whereas March was 3.1 days faster than average, February 4%, and January 2.6%. How do I interpret this result?

To me it is saying that there is no frenzy as such in the market. There is rising activity and rising prices but properties are not going out the doors as soon as they come in. Buyers are in strong presence but not purchasing anything they can get their hands out.

Perhaps we can flesh this idea out a bit by looking at the results of our monthly BNZ-REINZ Residential Market Survey released on Monday. It shows that of the 549 licensed real estate agents who responded (many thanks) a net 49% see prices rising, a net 21% feel it is a sellers' market (average is 5%). But only a net 10% in May said that they see more people going through Open Homes compared with an average result of a net 22% and results of 27% for March and 18% for April.

It looks like some buyers may have backed off a tad. But then too do have vendors with a net 5% of agents saying that they are seeing fewer potential sellers coming forward looking to get their properties appraised.





My interpretation therefore of these two sets of numbers is that most of all they show the listings shortage continuing – in fact getting worse – with prices continuing to rise, but no blind feeding frenzy from buyers which would allow one to talk about the market being in a bubble. It is not, and as a reminder, there is no acceleration in household debt growth underway. Household debt is growing by a near unchanging 0.4% a month and was up just 4.3% in the past year.

Housing Construction Costs

The government has announced an enquiry into why house construction costs in New Zealand are about 30% higher than in Australia. The absence of economies of scale will be one key factor behind the difference about which one can do little and it looks like hopes are not high for moves which could radically cut costs. This explains the high doubts regarding the ability of a Labour government to produce 10,000 houses a year with cost savings of 30% - though the policy is a good one in the context of a housing shortage around the country.

Evidence is starting to appear of the high prices in Auckland encouraging people to shift elsewhere.
http://www.rotoruadailypost.co.nz/news/city-slickers-looking-bay-way/1862986/

If I Were A Borrower What Would I Do?

There has been no sea change recently in the factors affecting where interest rates are likely to go, although the speculation regarding the ending of US money printing is worth keeping an eye on. For the moment we prefer to take a wait and see attitude which simply leaves me with the same comment that I have been making for a long time. I would have half of my mortgage at a floating interest rate including some very short fixed period simply because that is where rate discounting is the greatest. But the other half I would look to fix in the period from three to five years when someone was offering a discounted rate.

Offshore

US economy improving, Europe six quarters of recession, Australia 2.75%, Japan experiment roars ahead.

I've not much to write here this week even though there are always things of interest happening in the countries of interest to us. In Australia the story is one of the economy not performing as well as expected with weakness induced in some sectors by the high AUD. The Aussie currency has actually eased this past week or so to trade back below parity against a newly strong greenback, but with some selling also following the RBA's 0.25% cut in its cash rate to 2.75% last week. That cut is likely to assist an upturn of mild nature in the housing market which is underway. But it means little to manufacturers who will be hoping for a lot more AUD weakness than is likely to appear.

In the United States the general economic signs are moving for the better to the point where speculation is growing about the Federal Reserve easing off on money printing later this year. But the chances are we will see many bouts of such speculation for a long period of time with a lot of water still to go under the bridge with regard to fiscal policy, damage to the country's human capital stock from high long-term unemployment, and weakness in some key trading partners.

In Europe the best one can hope for is the absence of declining output in the coming year – but some people seem overly excited about what might be achieved from easing off in the pace of fiscal austerity. Unless the 2 – 3 years grace being bought by slowing the pace of policy tightening is used to speed up structural economic reforms then Europe will within two years be facing rising global interest rates driven by US growth and asset movement out of bonds, but higher levels of public sector debt. That will make for potentially scary forecasts of blow-outs in debt servicing costs. Data out last night show the Eurozone shrank for the sixth quarter in a row early this year.

In China the data show an economy bobbing along just below an 8% growth pace with retail spending in April ahead 12.8% from a year ago, industrial production 9.3%, investment in fixed assets 20.6%, and exports 14.7%.

In Japan the economic honeymoon of glorious expectations from money printing continues. The sharemarket is rising, growth forecasts are being lifted, and hopes are high of a surge in exports following the sharp fall in the Yen. But other countries are already responding to Japan's use of the currency weapon with interest rate cuts in a swathe of countries over the past two weeks.

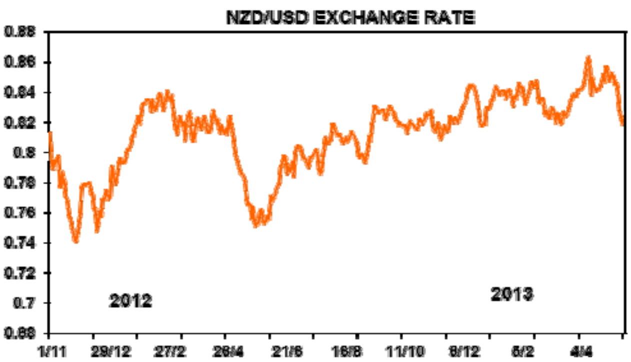
Exchange Rates

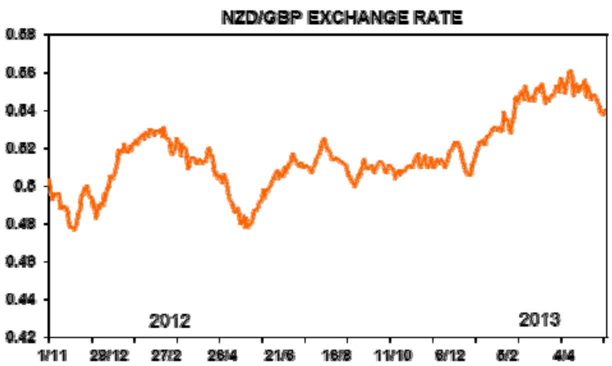
Exchange Rates	This Week	Week ago	4 wks ago	3 Mths ago	Yr ago	10 yr average
NZD/USD	0.822	0.846	0.838	0.847	0.768	0.67
NZD/AUD	0.831	0.826	0.814	0.819	0.774	0.85
NZD/JPY	84	83.5	81.4	78.8	61.6	69.6
NZD/GBP	0.54	0.544	0.548	0.547	0.48	0.388
NZD/EUR	0.638	0.643	0.642	0.635	0.604	0.52
NZDCNY	5.05	5.19	5.18	5.28	4.85	4.99
USD/JPY	102.19	98.70	97.14	93.03	80.21	105.7
GBP/USD	1.52	1.56	1.53	1.55	1.60	1.72
EUR/USD	1.29	1.32	1.31	1.33	1.27	1.28
AUD/USD	0.99	1.02	1.03	1.03	0.99	0.788
USD/RMB	6.1461	6.1346	6.1869	6.2326	6.32	7.56

Surging USD presses The NZD Downward – For Now

The Kiwi dollar has undergone a sizeable fall against the greenback over the past week (but not the Australian dollar) and exporters are being presented with some improving levels for boosting their hedging. This evening the NZD was trading near US 82.2 cents compared with 84.6 cents a week ago. The NZD has also declined by reasonable percentages against the British Pound and Euro. Why the fall?

- Confirmation by the Reserve Bank that it intervened in the FX markets selling NZDs last month. (described as using a peashooter by the Wall Street Journal)
- Better than expected economic data in the United States causing the USD to be bid up generally against a Yen being deliberately depreciated by the Bank of Japan and a Euro hit by ongoing European economic woe.
- An article in the Wall Street Journal opining that the Fed. may soon cut its money printing operations.





These factors have combined to cause a cleaning out of what apparently had grown to be some quite large long positions in the NZD. That process will eventually end and the NZD is then likely to climb back up again in its usual very volatile fashion.

Regarding the USD – the big news there was the last factor mentioned just above and the dollar's rise to back above 100 Japanese Yen for the first time since April 2009.

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 28,000 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/
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- 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

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