Weekly Overview

23 May 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

Who you gonna hire?

Last week I spent a couple of days in Christchurch seeing how economic activity there is definitely picking up. The city will be a key driver of economic growth for the country over the next few years with Treasury's latest estimate being that the rebuild will cost $40bn. But the true level of expenditure will probably be more than that. I came across an unusually high number of people who volunteered the information that as soon as their repairs recently were completed they had their old carpet ripped up and replaced. Others say they plan taking the insurance money and adding more of their own to improve their house beyond what it was before with better fittings, bathroom etc.

This week I spent one day in Auckland giving three talks and from chatting with people a number of things became obvious. First the housing market is on everyone's lips with intense interest in where prices are likely to go, extreme discontent with the idea of multi-storey infill housing anywhere near where one lives, and questions about whether the aging population will see house prices falling as old folks sell up.

I pointed out that people have been throwing that house price collapse scenario into the ring for two decades now and I've responded by noting an absence of evidence from offshore that population aging is associated with people selling off investment properties or even necessarily downsizing to smaller houses. People want to keep a spare bedroom or two for the grandchildren to visit, a home cinema, gym, or even home office. In fact what I have found repeatedly is that five bedroom houses do tend to get sold but not so much four or three bedroom ones.

In fact we need to question the idea of an aging population meaning a massive reduction in the labour force. If the new 40 is the old 30, the new 60 is the old 50, then presumably the new 70 is the old 60 at least and people are going to try to keep working as long as they can. After all, the airwaves for two decades have been filled with stories of elderly living in poverty and needing to save, yet in the absence of such obvious saving and many having lost money after chasing yield in poorly run finance companies, the need and probably desire to work will remain strong.

This is an important point because once Christchurch really gets cracking, once Auckland house building also gets off the floor, and when overall growth is approaching 4% in the economy, the unemployment rate risks falling quite sharply (maybe back eventually to the 3.5% of 2007). Employers will need to start sourcing employees from less traditional sources. That is a key reason why I started publishing Brain Gain NZ earlier this year and why I have populated it with articles from experts noting the poor HR management of NZ businesses, the cultural challenges, and the need to adjust one's mindset in order to effectively utilise repats and migrants which businesses will need. http://tonyalexander.co.nz/topics/brain-gain-nz/

For employers who realise this need the movement to hiring repats and migrants is likely to be a tough three stage process. First they will struggle to believe that the people they want cannot be found locally. They will moan about a need for the government to tighten up on welfare benefits, rabbit on about education, then churn through a number of recruitment agencies trying to find one who can tap into the local body of unemployed really eager skilled people they are convinced are sitting out there just waiting to be called up. They are not.

Stage two then will be the employer reluctantly realising they do need to look at recruitment from offshore. But here is where they will make their biggest mistake potentially – thinking they can treat repats and migrants as they have treated their own Kiwi born and bred staff for the past few years or decades. Those folk who have remained in NZ know how the system works, how positive feedback is a rarity and often the only feedback you receive is when you stuff up, how you can't propose or promote ideas too far from the pack, and how you have to make sure you never look like you are "getting up yourself".

Migrants and repats however bring an often very different set of skills, way of thinking, and mode of operation which my survey of three months ago suggests NZ-bound employers will struggle to effectively utilise. The LinkedIn discussion group I participated in late last year tells me that what will happen is that the repats and migrants will either leave the country again, perhaps going to Australia, or they will look to start up their own business, or they will simply keep an active eye open for a better employment opportunity elsewhere – probably at a company run by a repat or a migrant where understanding and utilisation of their offering will be better. http://tonyalexander.co.nz/wp-content/uploads/2012/11/Expathiring.pdf

Stage three for the employer will then hopefully become the realisation that the reason they are struggling to retain staff and why their sometimes expensive repat and migrant hires do not stick around is not because of some deficiency on the part of their staff, but of themselves. That acceptance of employment management deficiency is very important because like accepting one has a drinking problem it can lead down the road to redemption and growth. In this instance that means seeking out information on how one's Kiwi-rooted business and employment culture is deficient and how to go about correcting it. That is what my articles posted under the "What we Lack" tab on my website start addressing and what I get people to write about in Brain Gain NZ. Good luck with your journey. http://tonyalexander.co.nz/topics/what-we-lack/

But that then takes me right back to the previous page where I started writing about employing older people. For some employers they will be the answer. That is, for some employers it will be easier to make workplace adjustments to accommodate the probably very Kiwi-rooted older people well used to our culture of under-statement and keeping your head down, than to make changes which allow effective utilisation of repats and migrants. Make your choice.

The Week's Economic Data

So welcome home, see we've built no place for you nowwwwwww

On Tuesday we learnt that the annual net migration inflow into New Zealand jumped up to a two year high of 4,776 in April from a net outflow of 4,006 a year ago. This sharp change derives from numbers coming into New Zealand rising 4.1% in the year to April and numbers leaving declining by 6.1%. In fact if we look at just the past three months we see arrivals ahead an even greater 7.3% from a year ago and departures down by 13.6%.

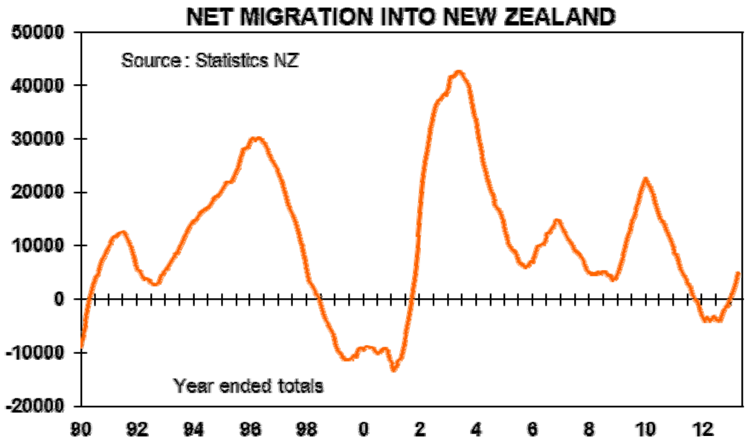
Of the total annual migration flow change of 8,782 people in the past year, 5,705 is accounted for by a change in the net loss to Australia from a record 39,778 to "only" 34,073. Now give thought for a moment to the news items which you have seen in recent weeks regarding talk of the ending of the Aussie mining development boom, problems in retailing, manufacturing and housing, and now forecast Federal government budget deficits for a number of years. Think also of the way New Zealand has comfortably handled the GFC and earthquake impact on government finances with a surplus within reach, the strong demand for our primary products from China, and forecasts of our GDP growth rate approaching 4% on the back of the biggest building project this country has ever seen – worth 20% of GDP.

These migration numbers are going to get even higher. In fact if we annualise the last three monthly seasonally adjusted net inflows of 760 then 1,290 then 1,570 we get an annual gain of 14,480. That is now above the average annual gain for the past decade of 11,373.

A key point which I have been making in recent months in my presentations has been that the strong rises which we have seen in house prices since 2009 in Auckland then more recently Christchurch have occurred during a time when net migrant inflows have been weak – averaging just 5,600 from January 2010 to December last year, with a net loss a year ago. Now imagine what will happen I have opined, once the migration cycle turns as it always does, and we go to average.

There will now be extra upward pressure on house prices as not only demand for housing from the population boost occurs, but investors look to buy properties before the migrants do. We have seen this in previous cycles.

How high might the migration numbers go? Over two decades of trying to forecast migration flows tells me that we cannot know when or at what level net annual inflows will peak. But for your guide as to what is possible take a look at the following graph which shows the net annual migration gain starting from 1990. I see peaks of 30,000, 42,000, and 23,000.



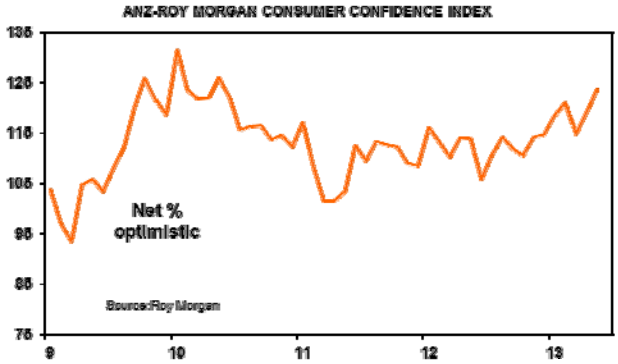
What do the data imply? Extra upward pressure on house prices, Extra strength in the pace of activity growth. Extra people around also for employers to hire – though remember folks, these are migrants and repats so be wary of treating them as badly as you do your current staff who are used to the poppy-bashing Kiwi way.

Just for your guide, of the 8,782 turnaround in migration flows in the past year, 5,244 is due to a change in net Kiwi flows with the number of Kiwis returning to New Zealand in the year to April at 24,367 from 22,407 a year ago, and the number leaving at 58,614 from 61,988 a year ago.

Interest Rates

Minor rises this week

This week we learnt that consumer confidence measured in the regular survey undertaken by Roy Morgan improved to a reading of 123.7 from 119.2 in April. This is the highest reading since 2010 and what we take from it is that the chances of higher than expected retail spending and household debt growth are rising. The result does not necessarily mean that these potentially inflationary things happen – look at what happened after the 2009 confidence surge – but the data will pique the interest of the Reserve Bank, as will the recent weakening of the NZD against the USD which they will be watching closely.



This week wholesale fixed rates have crept higher on the back of US rates rising in response to speculation of the Federal Reserve ending its huge money printing operation soon – or at least tapering it off before the end of the year.

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%	2.75	2.78	2.84	2.37	5.8
3 year swap	3.18%	3.12	3.09	3.27	2.62	6.1
5 year swap	3.51%	3.45	3.39	3.64	3.06	6.3
7 year swap	3.77%	3.73	3.67	3.93	3.45	

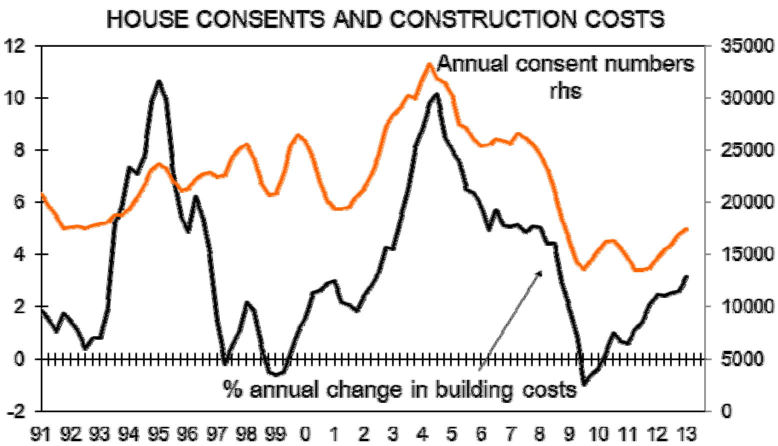
Housing Market Update

Construction costs rising

There are a great number of reasons why house prices are high in New Zealand, why they have risen so much recently, and why they will keep rising for perhaps another three years. One of those reasons is that building costs are high courtesy of such things as inefficiencies in the building materials sector, lack of bulk construction of similar houses, costs of importing materials from overseas, high and rising construction standards and so on.

This week we learnt that although the annual pace of consumer price inflation in New Zealand is only 0.9%, the costs of residential construction measured in the Capital Goods Price Index release from Statistics NZ have risen 3.1%. It is not always like this. Compared with five years ago while the CPI has risen 12.5% house building costs have only risen 7.9%.

What these numbers tell us is that with house construction picking up construction costs are quickly responding. The worrying thing is that the 3.1% rise in costs has occurred during a period when house construction has only risen to a still well below average level of around 17,000 in the year to March. The graph below tells us that as consent issuance rises toward 30,000 house construction cost inflation will head toward 10%. Building a house is only going to get more expensive.



If I Were A Borrower What Would I Do?

Same as ever – stay floating with some nice low discounted short-term fixed rates but try to get half my debt locked in for three to five year terms for purposes purely of risk management – the risk being managed being that the world looks great and interest rates soar around the planet.

Offshore

A general summary of the situation

The week started firmly in the United States in the form of the consumer confidence index from the University of Michigan rising to its highest reading since mid-2007 at 83.7 in May from 76.4 in April. The rise suggests that in spite of the sequester affecting public sector employment and incomes people are increasingly hopeful of the future and are therefore more likely to increase their spending. Businesses seeing the report will become more likely to rise their hiring and investment.

Japan also started the week well with the release of data showing the economy grew by 0.9% during the March quarter following 0.3% growth during the December quarter, with consumer spending accounting for around half of the quarterly improvement. This is good, but then after near two decades of a moribund economy facing deflation, structural rigidities, banks unwilling to lend, and politicians failing to agree on much at all, there was bound to be some sort of positive catch-up spending response to PM Abe's monetary policy easing.

The question for Japan is two-fold from here. Can the surge in growth be well-founded enough that when the 16th fiscal policy package in the past two decades and doubling of money supply within two years cease the economy will keep growing? And will the economy be opened up to the capitalistic forces of creative destructionalism – the so called third arrow in Mr Abe's policy thrust? The signs so far are not good with an apparent backing away from moves to deregulate the labour market. One also suspects that the Japanese have no intention of opening their agricultural sector up to competition during the TPP negotiations. The average Japanese farmer is aged 66, has 1.9 hectares, and subsidies to the sector equal the value of its output.

Therefore there is a good chance that just as over the next two years European countries will probably waste the deregulatory window provided by the easing in fiscal austerity, so too will Japan fail to make effective use of its money printing sugar rush. Speaking of Europe, the Eurozone shrank 0.2% during the March quarter after shrinking 0.6% in the December quarter. Some analysts consider this reduced speed of decline to be a positive – which it is – but the fact remains that the zone is still shrinking and with weakness spreading out of the debtor countries to Germany and in particular notoriously rigid and often un-capitalistic France, worries are deep regarding the area's immediate prospects.

In China the main story is one of underlying concerns about indebtedness, the increasing role played in recent years by SOEs, and simple adjustment to a huge economy not likely to return to double digit growth rates. However China has to be the most exciting place to consider analysis and observation as the authorities move to boost societal inclusiveness through development of an affordable healthcare system, welfare, residency in major cities for migrants, and well-priced housing for the millions who shift from the countryside into the cities each year. The opportunities for businesses with high assertiveness, good capital, lots of battle scars and a long-term focus are immense – especially if one has some way of protecting one's IP!

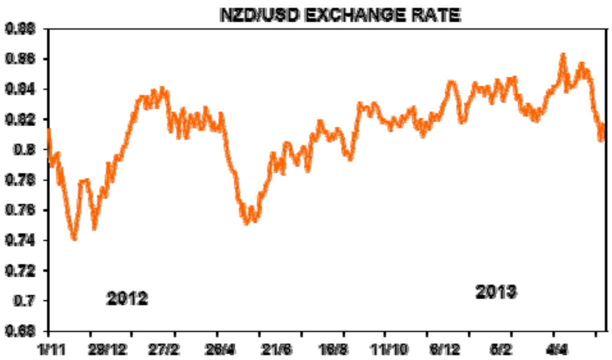
In the United Kingdom there were some weak numbers released last night in the form of retail sales for April which fell away by 1.3%. A 0.1% increase had been expected. Sales were just 0.5% ahead of a year ago. Still, there is some underlying optimism regarding growth improving in the UK even though the Conservative government is determined to maintain its fiscal austerity programme aimed at improving the government's accounts. After growing 0.3% during the March quarter the soon to leave bank of England Governor Mervyn King reckons growth will improve to 0.5% this quarter.

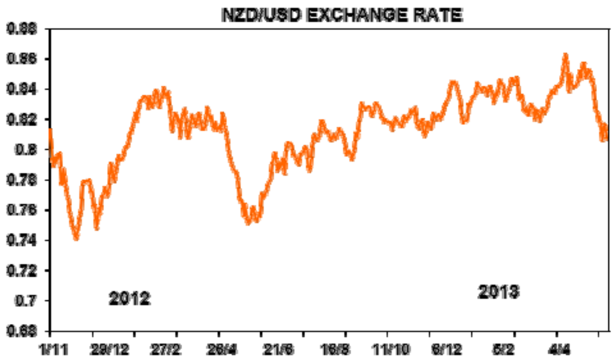
Exchange Rates

Exchange Rates	This Week	Week ago	4 wks ago	3 Mths ago	Yr ago	10 yr average
NZD/USD	0.802	0.846	0.838	0.847	0.768	0.67
NZD/AUD	0.832	0.826	0.814	0.819	0.774	0.85
NZD/JPY	82.5	83.5	81.4	78.8	61.6	69.6
NZD/GBP	0.533	0.544	0.548	0.547	0.48	0.388
NZD/EUR	0.624	0.643	0.642	0.635	0.604	0.52
NZDCNY	4.92	5.19	5.18	5.28	4.85	4.99
USD/JPY	102.87	98.70	97.14	93.03	80.21	105.7
GBP/USD	1.50	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	0.96	1.02	1.03	1.03	0.99	0.788
USD/RMB	6.1312	6.1346	6.1869	6.2326	6.32	7.56

Surging USD presses The NZD Downward – For Now

The Kiwi dollar has fallen to a nine month low against the greenback near 80.2 cents in response to a generalised firming of the USD driven by market speculation of a "tapering" of the Federal Reserve's asset buying programme soon. Last night in formal testimony the Fed. Chairman gave no hint of an end to the programme, opining instead about the damage from high unemployment. But in a Q&A session later he noted that tapering would commence if the data kept moving in the right direction (toward a 6.5% unemployment rate presumably) and the Fed. believed that such good movement would continue.

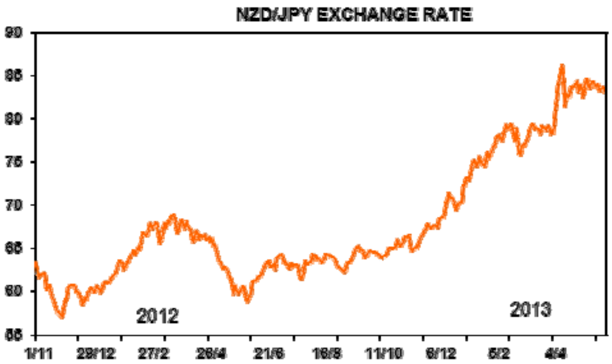


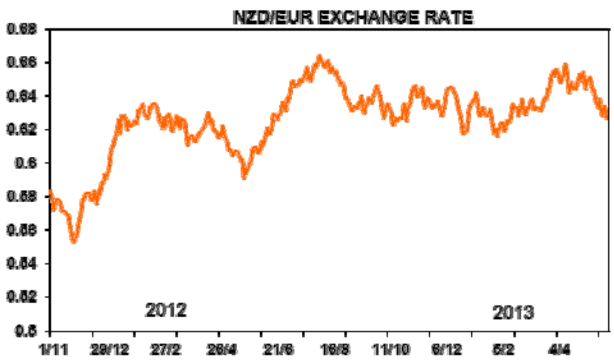


Those latter comments caused a sell-off in the bond market and sharemarket, but strength in the greenback. Hence the NZD's fall but also our sustained strength against the other currencies we track above. Thus this shows how much the NZD's decline against the USD is really all about a unilateral movement in the greenback rather than anything much specific happening for ourselves.

Having said that, because the NZD and AUD are high beta currencies (risky assets let's call them) we have both eased a tad against the Pound, Yen and Euro from last week's levels.

Perhaps concerned about a profit-sapping rise in imported energy and materials costs the Japanese Economy Minister this week suggested that perhaps the fall in the Japanese Yen had gone far enough and negative effects could occur.





For the Aussie dollar the talk is all about whether the recent fall back below parity against the USD is a temporary change or the start of a decline toward some figure with an eight in front of it. Actually most talk is not so much about the direction of movement as the speed at which the AUD gets there. The generally negative views toward the AUD reflect discontent at the fiscal mismanagement of the Federal Labour government – in the words of many they have squandered the opportunity provided by the biggest resources boom in generations, spending money they do not have and – as Labour governments on both sides of the Tasman are wont to do – leaving a steaming fiscal pile for the conservatives to deal with. It happened in NZ at the change from Labour to National governments in 1990 and again in 2008.
Frankly – there are now some rather large forces in play for all of the currencies of interest to us. Volatility looks like being strong in the next few months and both importers and exporters are likely to be presented with some good hedging opportunities. And what about the overall average trend for the NZD? There is downward pressure from new strength in the greenback, and weakness in the AUD upon who's coat-tails we usually ride. But that is it. There is upward pressure from

-NZ interest rates being raised almost certainly before rates overseas.
-NZ growth accelerating toward 4% while many other economies remain mired in debt.
-NZ commodity prices being well under-pinned by growth in China.
-NZ fiscal numbers being the envy of the world, and maybe even of Australians now.

This adds up to a far lower probability now that the NZD makes it to US 90 cents, but a good chance that we regain recently lost ground against the Pound and Euro, rise further against the Aussie dollar, and experience volatility against the Yen driven by official Japanese policy toward their currency. Hang on. These are very weird times with outright economic experiments underway in all the major economies now.

Key Forecasts

Dec. year		**2011**	**2012**	**2013**	**2014**
GDP	annual average chg	1.4	2.5%	2.5 – 3.0	3.5 – 4.0
CPI	on year ago	1.8	0.9	0.5 – 1.5	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	n/a	2.0 – 3.0	2.0 – 2.5
Unemployment Rate	end year	6.3	6.8	5.0 – 6.0	5.0 – 5.5

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/
- monthly BNZ-REINZ Residential Market Survey. http://tonyalexander.co.nz/topics/surveys/bnz-reinz-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

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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It's a Hard Life

If I were to write a general even less economics focused column than what the Weekly Overview becomes some weeks this is what I'd call it. "It's a hard life." That's what I tell my children as I try to bring them up with a sense of humour - an ability to look at what they are doing, the people around them, the circumstances they find themselves in, and the stuff that other people do and see the funny side of it. I'm not sure it's worked for B1 and D1 but D2, D3, and B2 seem to be picking it up okay – which means they've developed a great ability to turn it back on me.

For years I've quoted Cheech and Chong at them without them even knowing with the comment "Who cut your hair man?" They've turned that around to saying, every time I come home from having my hair done – no not cut these days, "done" – "That's an ugly haircut". My Aussie mates in Sydney used to ask what I was going to do with the money I must have been given to cut my hair like that.

D3 in particular has massively turned back on me the comment regarding letting sensitive people know you are laughing "with" them rather than "at" them. Whenever I do something weird or make a mistake she'll emphasise that she is laughing AT me.

She's also just about mastered what I joke about when we go shopping at the supermarket. I'll say we're only going to buy what we "want", not what we "need". If we need it then we made a mistake not buying it earlier on and the punishment is we do not get it. In practice that means she has learnt to say she wants something and never ever gets to the whinging stage of saying "But we need it" as that automatically means we don't get it. Truth be told of course we only buy that which is necessary plus Coke, chips, coconut ice and marmite scrolls.

It's a hard life for many people in Christchurch obviously following the earthquake. Yet you want to know what interests me most about the comment I made in the media last week regarding the high cost of a taxi from the airport to my hotel? Not a single person in Christchurch moaned to me. My mother told me she thought people would be quite angry and listened to local talkback to see what would be said. There was nothing. The one piece of negative feedback came from outside Christchurch.

In fact what did I get from the wonderful people in Christchurch? Three offers of assistance with better priced taxi access to the city and free accommodation for a couple of nights for me and my family to better enjoy the wonders of the city. That is fantastic and supports in my mind a comment which I have been making to Aucklanders in particular over the past year. No, not everyone has left Christchurch. Those loosely attached to the city left a long time ago. Those left like my parents and brothers are committed to the city. Businesspeople in particular are clearly very determined to drive the city's economy forward (think EPIC, Tait Electronics which I visited last week, the NZ Manufacturers and Exporters Association), and prepared to take the front foot to promote their, my, home town.

Still. It is a hard life – stressful too - when you return from three weeks in Europe and straight-away have to get up early, and hit the road again to talk about what you've learnt and where things are headed in NZ. Very hard.

If you happened to find this little column at the bottom of the Weekly send me an email telling me whether to can it or keep it (it would be irregular) tony.alexander@bnz.co.nz I might place it on a non-work site.

Some things are best kept private

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