Weekly Overview

30 May 2013

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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

Survey Time

This is the last Thursday of the month so if you have not already done so in the email used for sending out the Weekly Overview please feel free to click on the link below and complete our survey. The survey has been expanded to start eliciting information on the likes of credit demand and attitudes towards China and house prices rising. The results will be released early next week.
http://feedback.bnz.co.nz/surveys/Fi8Go-yFGEu0bwjPu5Waww

Last week at the BNZ-sponsored GoGlobal conference in Auckland a number of people enquired about a paper which I wrote looking at New Zealand's business culture. I have written about the subject in a number of places and now have contributions from experts in the matter in the monthly Brain Gain NZ publication. http://tonyalexander.co.nz/topics/brain-gain-nz/

Perhaps the paper which the speaker was referring to however was the one from May 2011 summarising research which I was looking at back then into impediments to NZ growth. See page 3 of this document. http://tonyalexander.co.nz/wp-content/uploads/2011/05/Our-Deficiencies-Summarised.pdf

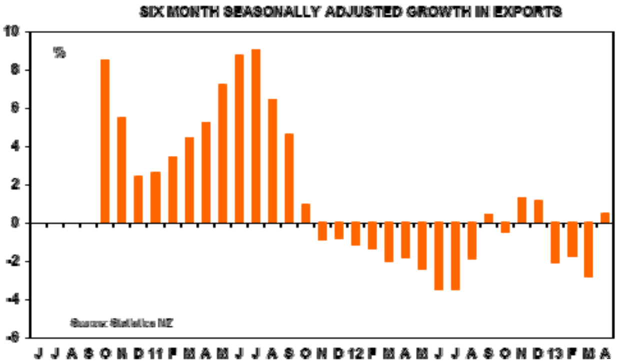
Just for your guide, one of the things which I have written about as having capacity to broaden New Zealand's economy and mitigate some of the risk associated with our growing dependence upon the primary sector and China is the EPIC centre in Christchurch. This article provides a good insight into why EPIC is important for its potential role in creating a critical mass of IT start-up companies. Boosting such companies would seem a better way to build economic capabilities than Wellington's current rush of excitement as Australian call centres set up operations there. Not much value-added potential exists there.
http://www.inc.com/philip-rosedale/start-up-magic-of-san-francisco.html

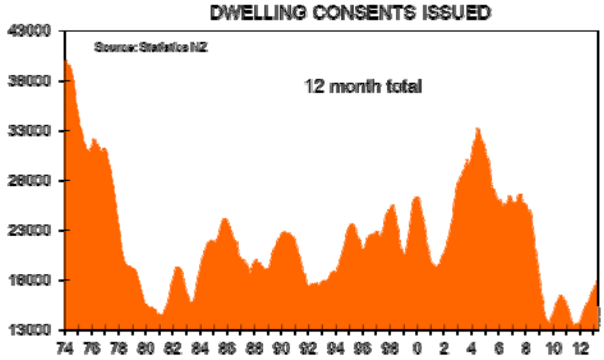
I've written enough in the rest of the WO this week so that is all for this lead section.

The Week's Economic Data

Debalancing

The monthly export data were released this week but they haven't greatly informed our understanding about what is happening in the NZ economy. Export receipts in seasonally adjusted terms fell 8.6% in April to give growth in the past six months of just 0.5%. Receipts have fallen 0.9% in the past year and have basically been trending downward since late-2011. There is no rebalancing of positive import happening in the NZ economy. Speaking of which, imports have fallen 0.5% in the past year.





And speaking of an absence of rebalancing, we received data this morning showing increasing strength in the construction sector – which is not really a new story but next year these numbers could get quite big and the inflationary pressures will eventually force the hand of the Reserve Bank and give the traditional cyclical upward boost in the NZD which we have seen many times before.

Seasonally adjusted dwelling consent issuance jumped 18.5% in April but it is best to smooth these volatile numbers over three months and doing that we get s.a. growth of a firm 8% from 2.1% three months earlier. The trend in consent issuance is upward and the annual total now stands at 17,922 from 14,932 a year ago and a four decade low of 13,269 just under two years ago. The ten year average is 22,000 so activity is still below trend.

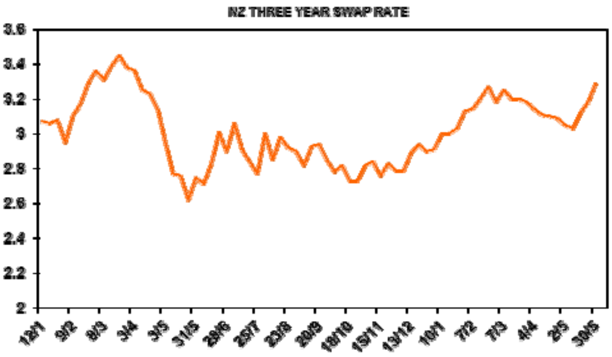
Interest Rates

Swap rates a lot higher this week

The Reserve Bank will be increasingly thinking about when to raise interest rates in light of the rising housing market or more especially rising construction costs which will boost inflation, and accelerating economic growth assisted by the likes of Fonterra's news this week. But they will be wary of the effects of the strong NZ dollar and cutbacks in predictions for growth in our biggest trading partner Australia whereas in many other countries monetary policy will probably be eased even further in coming months. Growth forecasts are also being cut for our second biggest China.

The chances are that the official cash rate will not be raised until well into next year but that just as the RB has undertaken fruitless experiments with currency intervention aimed at getting the NZD down they will undoubtedly run some suck-it-and-see exercises with their new mechanisms for promoting financial system stability. That is, we will probably see some more moves with regard to risk weighting for high loan to value ratio mortgages. But given that such moves will affect only a small subset of borrowers (mainly young ones), and people will find ways around the imposts they will in the end stick with cash rate changes as the primary monetary policy tool.

This week wholesale fixed interest rates have risen quite a bit with the two key driving forces being improving US growth driving US bond yields higher plus good economic news in NZ. The three year swap rate has jumped to a 13 month high near 3.29% from 3.18% last week and just over 3% four weeks ago. If the positive NZ data run continues and US data also comes in firm and pushes US bond yields higher, then borrowing costs in NZ will rise higher also.

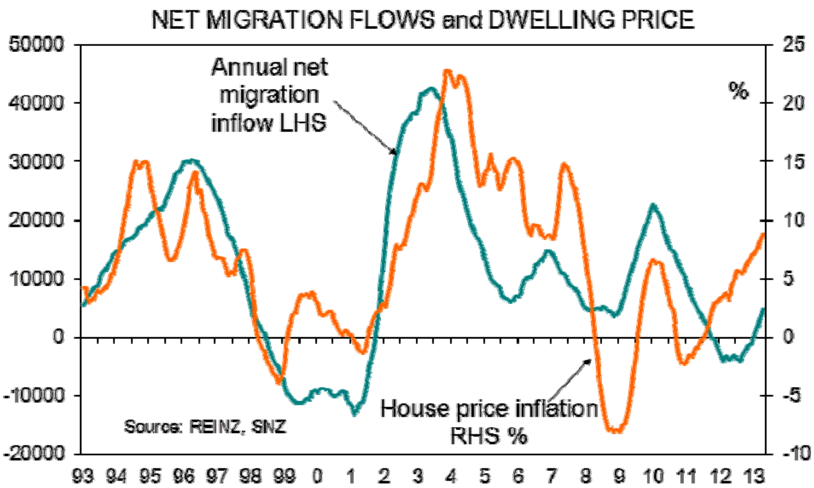


FINANCIAL MARKETS DATA	This week	Week ago	4 wks ago	3 months ago	Yr ago	10 yr average
Official Cash Rate	2.50%	2.50	2.50	2.50	2.50	5.4
90-day bank bill	2.66%	2.66	2.66	2.67	2.76	5.7
1 year swap	2.80%	2.75	2.75	2.81	2.50	5.8
3 year swap	3.29%	3.18	3.05	3.18	2.75	6.1
5 year swap	3.64%	3.51	3.33	3.52	3.16	6.3
7 year swap	3.92%	3.77	3.59	3.76	3.54	

Housing Market Update

Now the migration effect starts

An emailer during the week asked me to reproduce the graph I published last cycle showing the correlation between net migration flows and house price inflation. Here it is. I think it helps show why none of us picked the sharp rise in house prices from 2011. It occurred when migration flows were worsening. Now those flows are rising and we could be headed for a large net inflow near previous peaks. That will now drive house prices higher whereas it has not been a factor up until now.



For your guide, now that debate about migration soaring and the insular side of Kiwis is starting to be revealed again, here are the numbers showing who the migrants are. Of the gross inflow of 87,217 people in the year to April 28% were Kiwis. After that if we strip these Kiwis out of the country flows we get the pure foreigner numbers shown in all the other rows in the table below. The third column shows growth in each category from the year to April 2012.

	Year to April 2013	% of the Year's gross inflows	Number change	Annual Growth %
Kiwis	24,367	28%	1,870	8.3%
Foreigners	**62,850**	**72%**	**1,540**	**2.5%**
-United Kingdom	8,771	10.1%	-119	-1.3%
-China (incl Hong Kong)	7,762	8.9%	238	3.2%
-India	6,069	7.0%	-102	-1.7%
-Australia	5,616	6.4%	632	12.7%
-United States	2,547	2.9%	21	0.8%
-Germany	2,507	2.9%	55	2.2%
-France	1,628	1.9%	229	16.4%
-Japan	1,652	1.9%	-59	-3.4%
-Ireland	1,530	1.8%	-140	-8.4%
-South Africa	1,094	1.3%	-54	-4.7%
All	87,217	100	3,410	4.1%

What I want to highlight is this. The gross inflow of migrants to New Zealand has risen by 3,410 or 4.1% in the past year. Pure Kiwis account for 1,870 or 55% of that change, Chinese account for 7% of that change – hence the idea that there is a soaring Chinese inflow driving the Auckland housing market is not accurate.

No Debt Binge

Also not a factor in house prices rising so far is a debt binge. I have done an interview for some TV people which will play in a couple of Sundays time I believe. The interviewer kept pressing the point about banks being responsible for the soaring house prices. Sorry but that is not the case - yet. We will get updated data tomorrow, but what the data to March show is that debt in the household sector grew by just 4.3% in the past year after rising 1.4% in the year to March 2012 and 1.2% in the year to March 2011.

To repeat my key point – house price rises to date have been driven principally by an imbalance at current prices between supply and demand. Prices are rising to correct that imbalance. They have further to go in order to do so. But from here on it is highly likely that debt growth will accelerate and head back to 10% per annum now that we are moving into a period when other than basic repricing of a constrained housing stock is driving prices upward.

With regard to the ability of NZ house supply to rise to meet demand it is worth noting a forecast out of Australia this week that the country will be short of 45,000 builders in three years time.

I also chatted with a journalist from the South China Morning Post who asked why New Zealanders seem intent on blaming the Chinese for rapidly rising house prices. I said that people do not understand the basic economics of a shortage of supply at current prices causing prices to adjust so cast around for some simple explanation. Because the Asian population in New Zealand and Auckland in particular is growing they have decided the Asians – and Chinese in particular - must be the problem. It's our version of the growing backlash against immigrants in many European countries, but rather than blaming them for not earning and spending enough money and embracing the local culture we are upset the Chinese are doing all three in Godzone including our cultural drive to own property and buy houses in prime school zones. Damned if you do, damned if you don't.

My Fifth Housing Cycle – Been There, Done That

This is the fifth housing cycle I have lived through with my brain thinking about more than what TV to watch or tree to climb when getting home from Marshlands Primary School in Christchurch. What that means is that I've built up some familiarity with the phraseology of the housing cycle and some of the arguments people raise as they fail to come to grips with why the market is rising and scramble for factors which they think will cause it to go back down again – thus removing their problem which is that something is happening that they do not understand.

Some of the phrases seen in past cycles started appearing three or so months ago. "I've got to get a foot on the ladder" is one of them. Another is "I cannot afford to sell in Auckland or I'll never get back in again."

Now we have reached the stage where the evening property seminars are appearing offering you easy access into the property investment market. What will come after that is a surge in the Auckland inner city apartment market because it is easy to market such properties and people are comfortable with their low maintenance characteristics (as long as they don't leak), and nice tidy lines. Late last cycle when developers got desperate as supply lifted you could pick up an apartment with a $1,000 deposit. That is something the Reserve Bank's mortgage powers cannot affect. If developers get finance themselves then LVR rules are irrelevant.

How can the developers get finance so you don't have to go to the bank? Partly they will get bank funding, but that will only be one source of funds as we banks have been wary of large exposures to property developers ever since we funded as many as we could find in the mid-1980s. The developers will need funds from second tier lenders and investors. That is where the finance companies came in last time and where the new tier of mezzanine financiers will again soon start appearing in whatever form appears to work for them this cycle. Given the continuing low level of interest rates and aging population there will once again be plenty of elderly people looking for deposit rates slightly better than they can get in a bank and they will again form a large part of the investor money which will once again go to develop apartments. But as I have noted, these are still early days in the housing cycle.

We have also reached the stage where people say, as they did strongly last cycle, that house prices will fall because price gains are not being matched by rent gains, therefore there is no shortage. That theory proved wrong last time and will do this time as well because the key determinant of rent levels in New Zealand is not the yield but what people can afford to pay. Most people investing in property in New Zealand are doing it for the capital gain, not because they wish to develop a product (accommodation), price it, brand it, market it, and sell it to customers. People simply want someone to occupy the property, cover most of their running expenses, and not smash up the walls or set up a P lab.

One other stage we have reached is people looking at selling in Auckland to live elsewhere in NZ with cash freed up, and young people considering buying out of Auckland also.

For your guide in case you missed it at the top of the email used for sending the WO out, this week and last week I have posted longer than usual video commentary on my Youtube channel regarding the housing market. Last week's video got almost 1,000 hits compared with far smaller numbers for the normal videos – hence why I write a lot about housing. It is what many, many people are primarily interested in.

If I Were A Borrower What Would I Do?

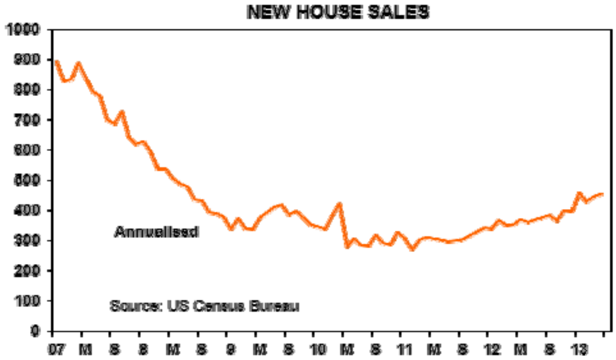
Maybe I would be taking a wee look at the way fixed interest rates are creeping up in the United States and think that if my plan is to fix for a three year period or longer it is possible that rates are as low as they are going to go – especially as banks are competing for business with discounted short-term fixed rates (out to 18 months) and contributions towards grocery costs rather than discounting the longer term fixed rates.

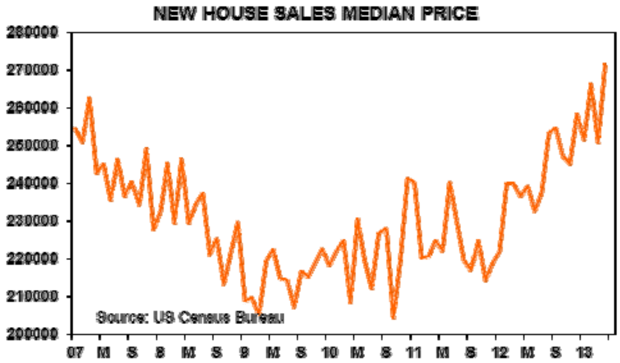
But it costs a bit of money to shift further out along the yield curve, so if I were borrowing now (keeping in mind that I actually paid my mortgage off back in about 1998) I'd largely compensate for the absence of really low long-term fixed rates relative to short rates by having half my debt floating (ready to fix long should a discounted rate appear), and get the other half into a discounted 12 – 18 month rate. I'd then not travel anywhere for three years, not buy untold new whitewear, not replace the car, limit my initial breeding, and basically get my principal down as quickly as possible. The pay-off comes strongly in terms of reduced exposure to interest rate rises once the Reserve Bank starts putting the boot in (and they will), and lower life-time interest costs.

Offshore

US Faster, China Slower, Australians Start Navel Gazing

In the United States some more signs of improving life in the housing market have appeared over the past week. One was sales of new homes which in April were ahead 29% from a year earlier with the median sales price up 14.9% from April 2012. That is quite a jump and one of the reasons why people are thinking the Fed. will be feeling there is a new bubble risk in the housing market and perhaps it is time to start taking some of the heat out by pulling back on money printing – hence the stronger USD and higher US bond yields.





After their holiday on Monday the Americans received news on Tuesday of a rise in consumer confidence to a five year high as measured in the monthly Conference Board survey. The index hit a much higher than expected 76.2 in May from 69 in April. Data from case-Shiller also showed that on average during the March quarter US house prices were 10.2% higher than a year earlier with prices in March ahead 10.9% from March 2012. These pieces of positive news helped the US sharemarket rise during the week and added strength to the US dollar.

The main US theme then is one of accelerating growth but vulnerability still to labour market shocks with deepening concerns about a housing bubble.

In Australia the whole mood is one of woe is us. "We've p*%#$ed the mining boom against the wall and don't know what to do without it." Informed commentators are writing articles about appalling fiscal mismanagement involving continually soaring spending and overly optimistic assumptions about revenue, poor productivity growth previously covered by the boom but now revealed as a major structural weakness, and chooks coming home to roost for a protected car assembly sector which should have been put out of its subsidised misery years ago. And this is with an unemployment rate of 5.5% up from 5% a year ago. Our rate is 6.2% from 6.7% last year. Imagine how much they'll be beating themselves up when our rate goes below theirs within a year. Imagine what that will do for migration flows and then NZ house prices.

There was a little piece of positive news for the Eurozone at the start of this week in the form of the composite PMI rising – but only to a confirmed-in-recession 47.7 from 46.9 in April. France was at 44.3, Germany 49.9. Hence the deep worries in some quarters about weakness in the periphery of the Eurozone spreading to the centre and in the process perhaps highlighting the difference between a forward-looking always-reforming Germany, and a France stuck in a belief it can thrive on past glories without substantial change.

Realisation of the need for change appears to be growing but this is definitely one of those believe it when you see it situations. Europeans and the French in particular are notoriously resistant to freeing up their economies and maintain a strong belief that just a little bit more fiscal stimulus will see everything sweet like it used to be. That belief means there is excessive optimism over the likely impact of France, Spain, Poland, Portugal, Slovenia and the Netherlands being given an extra two years to achieve the goal of fiscal deficits below 3% of GDP. What will happen is that in two years time their public debt levels will be even higher and with global interest rates rising on the back of stronger US growth and the Fed. BOE and ECB as well probably taking liquidity back out of money systems, debt servicing costs will blow out. Credit rating agencies will likely cut country ratings, investors will back away, and a new phase of fiscal austerity will start with speculation once more of default by the most heavily indebted Eurozone members.

As British PM David Cameron said a few months ago, he does not believe we have yet reached the half-way point for the European debt crisis. Even Keynes would be turning in his grave at the mess they have made of fiscal policy.

Oh, and just to make matters worse, the EU Trade Commissioner appears intent on pressing ahead with punitive tariffs on the €21bn worth of Chinese solar panel imports into the EU and to investigate dumping of telecommunications equipment. This in spite of 18 of the 27 EU members voting against the panel tariffs and the Chinese trade representative explicitly warning about retaliatory measures and a full blown trade war. That doesn't sound too positive for growth.

The IMF took it easy on the United Kingdom in their annual report last week suggesting only that there should be some extra spending on infrastructure rather than rallying against continuing fiscal austerity as some had thought might be the case. They did however warn that the UK is "…still a long way from a strong and sustainable recovery."

In Japan the big piece of excitement for the week was the 7.3% fall in the Nikkei share index on Thursday. This was the 11th biggest one day fall in the measure on record and after all the bits and pieces of analysis simply comes down to being caused by profit-taking after many months of rises which had seen the index almost double from where it was last year. That sharp increase had been driven by generally rising markets assisted by stronger US equities, but then anticipation and confirmation of a massive money printing exercise by the new government and a fiscal stimulus package.

The Japanese market rise has basically been on the back of hopes that the stimulus packages will work plus expectations of higher profits for exporting companies following the near 25% decline in the Japanese Yen – with the often large offshore earnings by Japanese companies from foreign investments converting into more Yen than before. Did you know that like NZ and Japan both get 18% of their export receipts from China?

Data so far are looking good in Japan but these are very early days and a problem starting to develop is that rather than money printing pushing interest rates down they are instead rising in anticipation of higher inflation – the official target being 2% inflation within three years assisted by money supply doubling in the next two years. This could pose a huge problem as come the end of this year public debt in japan is expected to exceed 45% of GDP with the government raising less than half of its annual spending in taxes

In China the week started quite poorly with the early estimate of the HSBC Purchasing Manager's Index for May falling from 50.4 in April to a lower than expected 49.6. This decline has led to forecasts that June quarter GDP growth may come in lower than the March quarter's 7.7% and expectations are building that the authorities will soon introduce a new fiscal stimulus package because indicators of domestic activity within the index were unusually weak.

Within a year or two China will be New Zealand's biggest export destination (it is not yet) and could remain in that position forever. What that means is that more and more over time our fortunes will depend upon what is happening in China, that we will see more Chinese people investing and living in New Zealand, that we will receive more Chinese tourists – and that the other side of the equation will grow as well. We will travel more frequently to China, we will invest in China, some of us will live in China, more of us will marry Chinese people.

The current projection from Statistics NZ is that from 3% of our population in 1994 Asian people generally (including those actually born in New Zealand) will make up 16% of our population come 2024. We will get an update on the current proportion when census results are releases presumably late this year.

The growing relationship between New Zealand and China will mean we will all need to learn a bit more about each other. My monthly publication 'Growing With China" produced since February last year is aimed at better informing kiwis about what is happening in China and what to think about when operating there. To further my informational effort I will endeavour to write something here each week about China – not just what the data are showing but also something interesting which can help people to very slowly build some base familiarity with China and allow people to start to form their own judgements when headline-seeking politicians pandering to frightened people start lambasting a particular group for apparently being the source of all our society's evils. Adolf was his name I think.

As a snippet of information consider this. In China many high-priced restaurants are going out of business because of the new President's sharp crackdown on lavish meals and gift-giving as part of his attack on corruption. Such corruption typically rates as one of the top three concerns of Chinese people in various surveys (along with things such as inequalities, pollution, access to healthcare, land seizures).

Former Fonterra Chairman Sir Henry Van der Heyden was attempting to highlight this corruption problem when he made a comment that Kiwis should not trust anyone in China. He apologised afterwards noting that he did not intend to say that and I feel I know exactly what he was trying to do – emphasise to people that although there are many business opportunities in China you need to go in with your eyes wide open. Our typical Kiwi business culture of high trust and reliance on contracts is not the way things are done in China's low trust society and when I speak about China to people I often note that for many it is not a market they should be entering at all if they do not already have some offshore experience. More than that however, you have to be confident if you enter China that you will not sacrifice your business ethics in order to get deals done. If you do have to make such concessions then do not operate there. It is not worth sacrificing your morals just for a few bucks.

Speaking of money, if you are travelling soon to Yunnan province don't budget for buying white t-shirts, face masks, or getting any photo-copying done. Recent demonstrations against a particularly carcinogenic chemicals plant proposed for the city of Kunming have led the authorities to require all sellers of these products to take the names and addresses of the buyers.

Marlborough Chamber of Commerce
"Regional New Zealand is now grasping the opportunities in China with the Marlborough Chamber of Commerce theming its first annual conference around doing business in China. The conference is being held August 15, 8.45am - 3.00pm at the Scenic Hotel in Blenheim. Michael Barnett & Tony Alexander are the keynote speakers. The conference will be focusing on understanding the driving force of China's economic growth phenomenon over the last 30 years and the future, and appreciating the uniqueness of the Chinese market, organisations, and social structure. See www.mcoc.org.nz <http://www.mcoc.org.nz > for more information and to pre-register."

Exchange Rates

Exchange Rates	This Week	Week ago	4 wks ago	3 Mths ago	Yr ago	10 yr average
NZD/USD	0.811	0.802	0.857	0.825	0.754	0.67
NZD/AUD	0.841	0.832	0.828	0.808	0.776	0.85
NZD/JPY	81.9	82.5	83.9	75.8	59.6	69.6
NZD/GBP	0.536	0.533	0.553	0.545	0.487	0.388
NZD/EUR	0.626	0.624	0.654	0.629	0.609	0.52
NZDCNY	4.97	4.92	5.28	5.14	4.78	4.99
USD/JPY	100.99	102.87	97.90	91.88	79.05	105.7
GBP/USD	1.51	1.50	1.55	1.51	1.55	1.72
EUR/USD	1.30	1.29	1.31	1.31	1.24	1.28
AUD/USD	0.96	0.96	1.04	1.02	0.97	0.788
USD/RMB	6.1239	6.1312	6.165	6.227	6.3425	7.56

NZD/AUD Goes Higher Still

Against the Australian dollar the NZD has risen yet again this week to sit at a four and a half year high. The gain to just under 85 cents from just over 83 cents last week reflects some Kiwi-specific positives and an Aussie-specific negative. The Aussie negative is the deepening degree of concern about slowing growth in the Australian economy. The Kiwi specifics include the announcement from Fonterra that this coming season's dairy payout is forecast to be $1.20 higher than the current season, near $7.00. That implies an extra $2bn or so injected into the economy and will be another factor on top of the many construction-related factors helping to accelerate NZ GDP growth this year.

This acceleration in growth story is also what is happening in the United States and helping to push the greenback higher – especially as traders bet on the Fed. easing off money printing in the next few months. Changes in market expectations for when the tapering off happens will be one source of volatility in the USD this year.

A source of volatility in the Yen will be fluctuating degrees of optimism regarding the outright economic experiment being conducted by Prime Minister Abe in Japan. So far the experiment amounts largely to a forced depreciation in the Japanese Yen achieved through promises to try and get private sector debt and spending up by doubling money supply in the next two years. This could end exceptionally badly and is one potential shock to the NZ economy in the next five years.

Relative fundamentals in a nutshell favour NZD appreciation so exporters may want to continuing to take advantage of this pullback in the NZD against all but the AUD to get some extra hedging on board.

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/
- monthly BNZ-Nine Rewards Consumer Trends Survey http://tonyalexander.co.nz/topics/surveys/bnz-nine-rewards-consumer-trends-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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It's a Hard Life

There were three people who voted to drop this column and 75 who voted to keep it. So I shall keep it and as the mood takes me will write something here. That will not be every week so to ensure no-one starts thinking it will be weekly lets end things here apart from noting that the temperature this week has made for a hard life. But I have found that if I take off my t-shirt, remove my shoes and socks, change to shirts rather than black jeans, and sit in the shade, life while visiting Port Douglas is not so hard after all.