

## 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.

<b>Cyprus</b>	<b>1</b>	<b>Offshore</b>	<b>7</b>
<b>Interest Rates</b>	<b>6</b>	<b>Foreign Exchange</b>	<b>8</b>
<b>Housing Market Update</b>	<b>6</b>	<b>Discussion</b>	<b>9</b>

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/IFdYSs5FGEq4kAjP95uzTA>

## This is What Happened in Cyprus

I have spent much of this week in the Cyprus capital Nicosia initially enjoying a second Easter for the year and reading newspapers saved for me over the past month by New Zealand's Honorary Consul Tony Christodoulou, then two days of interviewing a range of people regarding what has just happened in Cyprus. These people range from the former Minister of Finance who negotiated the bailout deal with the Troika, to officials from the central bank, chamber of commerce, investment promotions agency and others.

I have written a paper outlining my findings and it is published here. <http://tonyalexander.co.nz/wp-content/uploads/2013/05/The-Cyprus-Haircut-May-2013.pdf>

It runs to nine pages and will be a bit dry for some readers. But it shows what can happen when you have poor governance of a banking sector – at the bank level and especially at the central bank. This is a crisis which Cyprus did not need to have but which they brought upon themselves by failing to adequately monitor and control bank activities. If there is one party ultimately responsible for what happened here given well known characteristics of financial systems, economies, financial markets, and bankers, it is the Central Bank of Cyprus.

The pain of Cypriots would be present but substantially less if the parties responsible for bailing out Greece in 2011 had recognised the huge impact this would have on Cyprus (a 25% of GDP hit from Greece's haircut). And their pain again would be present but substantially less if the European Union and Eurozone were groupings of countries and citizens with a shared concept of solidarity no matter what – like America or Australia.

But that is not the Europe I have seen during my past three years of visits and the treatment of small Cyprus is just one manifestation of a worsening deterioration in the concept of a European community. There will be more. No amount of either money printing, fiscal austerity easing, or Soviet-like campaigns and posters showing people holding hands advancing forward together is likely to change that. Europe is fracturing. I'm looking forward to being back home. Hopefully so too are my poor abandoned wife and five children looking forward to me being in the country for a while as well!.

## Some Cyprus Observations – Found My Best Coffee Ever

For those who prefer to read about what I saw here are some observations from the very brief and non-geographically diversified time I spent in Cyprus. Not a single beach was touched, or even seen until flying out on Thursday morning, in the production of this paper.

## BNZ WEEKLY OVERVIEW

In contrast to the airplane boarding in Auckland three weeks ago when everyone completely ignored the announcement regarding the order of boarding and rushed the gate at once, the boarding for my Cyprus Airways flight to Larnaca Airport on Saturday afternoon was the most orderly I have ever seen. I swear that the only person entering the queue earlier than they were supposed to was me.

Maybe the orderliness was because of the nature of the passengers. About four young families, lots of older British people, and some older Cypriot looking or at least sounding people. One imagines these latter people are the ones with some offshore assets and reasonable income flows which allow them to escape the depression running through Cyprus – and Greece also. Greece is experiencing a Depression.

During the 1930s GDP in the United States shrank by 32%. It has so far fallen almost 25% in Greece and it is that shrinkage or at least the events related to it which revealed the unsustainable foundation of Cyprus's economy and forced the recent catastrophic developments which I describe in my separate paper.

The taxi from Larnaca Airport to Nicosia costs just under €60 for the 44 kilometre trip along a lovely motorway which for such a small country is not ever likely to need to have extra lanes added. The taxi driver on the way back to the airport pointed out a church just over the Green Line within the Turkish occupied part of Cyprus, noting how they used it as a toilet. I was in fact handed some material by one of the people I visited showing what has happened to the many religious and historical sites in the occupied territory.

I arrived in Nicosia on Saturday night and was immediately picked up by the NZ Honorary Consul in Cyprus Tony Christodoulou and taken to his home to see in Easter Sunday and the consumption of a special type of celebratory soup. On TV one watches something to do with the Holy Light which was brought across from Jerusalem by the Russians on a big airplane. Same religion you see. Easter is huge in Cyprus – much bigger than Christmas though without all the present-giving. There are Easter decorations and some basic chocolate eggs to give to children. But the decorations largely take the form of some mangy cut-out or three dimensional chicken and egg displays on roundabouts at major intersections. There are some bunnies in evidence but not many. I saw no religious displays as such. In fact for something so serious there was little decoration of anything.

Staunch adherents of the Greek Orthodox Church will forgo consuming any animal-based foods for 50 days until Easter Sunday when they gorge themselves on piles of meat and there is always interest in how many people get taken to hospital that night.

I spent Easter Sunday in the village of Palaichori which lies south of Nicosia in the Troodos mountains. The village is the source of some 90% of the Cypriots who have migrated to New Zealand (apparently we are quite popular with young doctors from all over the island). There are at least three and possibly four churches in the village and they took turns ringing their bells from about 11.30am. After that it was a free go for anyone wanting to pull the chain outside one church at least and the children there had great fun doing that.

Great quantities of food were eaten at the lovely lunch which included a traditional type of bread known as "flaounes", and smashing games are played with died eggs – usually red.

The village lies in a tight valley well off the main road with concrete, block, stone and rock houses built very close to each other with often lovely verandas sheltered by grape vines. There is a wonderful village square filled with cafes and TVs for people to watch sports, again with good shelter, this time from umbrellas and trees. It was like squares you see when you travel through the main parts of Europe might try to look like but miserably fail. One dreads to think what the planners may this time make Christchurch's Cathedral Square look like. There is no chance based on my decades observing the way they have ripped the place up and bastardising it that it will ever look like what I saw in Palaichori. I loved it there and will never forget it. <http://www.archontikorousias.com/attractions.php#5>

You can tell that there has been a building boom in Cyprus which has not ended well. I think the best word for describing Nicosia is "dishevelled". There were fenced off and unfenced off empty buildings, some which had been occupied and some which have never had a tenant. I saw four storey apartment buildings with

only one occupied apartment. There are empty house and commercial property-sized sections all over the place, broken down footpaths with not just weeds in many but trees planted smack bang in the middle of some. I thought I was in Christchurch at one point. Pedestrian crossings and signals are a rarity. Traffic lights are obscured by dust on the green, amber and red lights which no-one seems to brush off. Given the way things are so spread out you need a car – the L.A. model maybe.

I saw graffiti everywhere and apparently it is a relatively new phenomena. I saw unemployed people gathered outside a building to register for the dole. I spent time in a business which on the day of my departure was due to lay off 10% of its staff and put others on reduced hours.

The houses are certainly nice and look well-constructed, and the population by and large look like they live predominantly in standalone dwellings rather than apartments. There are just too many of them placed higgledy-piggledy all over the countryside. Urban planning does not seem to be an occupation over here.

The roads are well constructed but they have a military look to them with hard curbs sporting black and white strips. But then again, all I saw was Nicosia and Palaichori. I did not see a single beach or even the sea itself during my time on the ground. And of course it is for the sea that I imagine almost all tourists visit Cyprus – except the very old British lady who was staying where I stayed at the Hilton Park Hotel in Nicosia who would appear each morning, give detailed instructions on what she was having that morning, have herself escorted by the arm to her table, then sit back and I imagine wonder when her husband may come back from elephant shooting in Africa old chap.

On the morning I left the sky was very cloudy. But the cloud was dust from the Sahara and apparently this is a common phenomenon which might account for the many dirty cars I saw and my sore eyes the night before. Don't rub sore eyes! Speaking of cars, I was involved in more close calls with cars running red lights and not looking properly at roundabouts in my five days in Nicosia than for the rest of my life to date. I think the same goes for lane changing without indicating and travelling happy as Larry along the little judder bars at the side of the motorway to remind you to wake up.

There seem to be a lot of cats in Cyprus, and every one I saw was scrawny. Maybe it's this year's "look".

I went looking for a t-shirt saying "I went to Cyprus and all I got was this lousy haircut". I guess had I found one, it would have been in Russian. Speaking of languages. People in Europe speak so many. Oh they are so sophisticated. I met a gentleman in Paris who spoke seven languages and was learning another. He made me a great kebab each night for dinner. Also in Paris I met a lady who spoke four languages which she sometimes found overwhelming. But it thankfully did not impede her ability to take my key when I left the hotel each morning and give it back to me in the evening. And in Bruges I met a lovely young woman who switched easily from one language to another as she handed each of us our correct change after making our basket of purchases. Oh yes, Europeans are so clever and well off for speaking so many languages. Read carefully at this point. Stop learning foreign languages and forcing your kids to do so. Learn maths, mechanics, engineering, technology – something which will actually count for something more than low paying service sector employment when they go job-hunting.

The cellphone system seems very poor with strength of reception varying substantially from one place to another place close by and one's phone having to switch to a different carrier. I was simply not able to send a text while at the airport. It smells like a sector in bad need of deregulation. There are some people in NZ who could help them with that. And with curbing the ridiculous power of the unions, the seemingly cosy relationships between senior businesspeople, bankers, politicians and maybe the church (no insight to offer there sorry).

Cyprus will bounce back from this crisis, but as with other European countries I have seen no sign that there will be a radical shake-up of the governance systems in many areas. Absence of ability of Europe to tap the world's investors as they have done for decades, and with the United States rising anew and strong and Asia providing huge business opportunities, mean Europe is going to slide in world rankings over the next few decades. We will rise against them back up the OECD ladder. Cool.

For Cyprus, its future as an international business centre looks good. But as an international financial centre it is goneburger.

And the coffee? In Cyprus this is very very easy. If you order a cappuccino you'll get something not offensive but not good either. Simply drink the Cypriot coffee either with no sugar, medium sugar, or full sugar. I took it medium and it was fantastic in its tiny cup with sludge at the bottom. Best non-milky coffee I've ever tasted. I'm jonesing for it already on the plane flying out.

### UK Economic Situation

I said that I would write up the material presented at the Oxford Economics conference in London last Thursday morning so here it is, starting first with their assessment of the rest of the world.

The BRIC economies are slowing not because monetary policy is tight (though China tightened a bit), and not because fiscal policy has been tightened( apart from Brazil), and not because currencies have risen strongly, though the Yuan has appreciated. The slowdowns appear to some degree structural with demographics of an aging and therefore lower spending population at work in China, along with reduced investment. It is also however worth noting that the real exchange rate has risen quite a bit.

They are quite pessimistic for Russia regarding the effects of corruption, absence of a rule of law, falling oil prices, shrinking population. Brazil is seen to be badly in need of reform as is India about which they are very worried.

In the United States, although fiscal policy will act as a drag on growth in the next few years there are quite a few positives. Housing is recovering, lending is rising, corporations are sitting on large surpluses, productivity growth has picked up, and the US dollar has fallen since 2001. Demographics are favouring growth also along with energy developments.

For Japan there are positives of sharply easier monetary policy with money printing near US\$80bn a month, a much lower exchange rate, and a coming stimulatory fiscal policy. Some key indicators are rising such as manufacturing sector gauges. But the risk for Japan is if growth soars inflation will lift, interest rates will rise, and with debt already above 220% of GDP government finances would collapse in the event of a 2 – 3% interest rate rise.

They are quite bearish on the European Union. No deleveraging has occurred yet, just a flattening in debt growth. Housing is still falling. Banks are not lending. Some corporates have good surpluses but they are indicating that they intend investing elsewhere. Productivity has barely improved the past 10 – 12 years. They expect a widening income gap between northern and southern Europe and that the Euro does not look solid. Bank lending rates in the south are about 2% above those in the north and money is not flowing to SMEs. The productivity gap between the south and the north has widened some 30% since 1999.

Will the Euro split? No. Resistance to that is massive. But staying together risks a political backlash.

Will the current slowing in the pace of fiscal austerity work? (France and Spain targets pushed out two years). That depends upon the views of the financial markets.

Germany is being challenged by a rise in Japan's competitiveness and slowing growth in China.

In the United Kingdom....

Recovery is weak with GDP still 3% lower than before 2008. In fact current GDP is about 15% below trend of the past four decades. Why this 15% gap?

1. Permanent damage from the GFC in the form of low innovation levels recently, low R&D.
2. Resource under-utilisation due to weak demand. This weak demand coming from tighter fiscal policy the past two years, tight credit conditions, and weak Eurozone demand.

Looking ahead, growth will be restrained by a near 1% of GDP fiscal tightening each of the next five years, and weakness in European countries. The Bank of England's 'Funding for Lending' programme is having some positive impact in the housing market. The business services sector is quite firm. Public servant numbers have been cut 500,000 the past three years but more cuts are to come. Consumer confidence levels are still very depressed. But weak recovery of only 1% to 2% is seen in the near future. Interest rates are unlikely to be raised until 2016.

London is in quite a different position from the rest of the UK with a strengthening housing market, good services sector growth, wealthy foreigners coming in etc.

### The Week's Economic Data

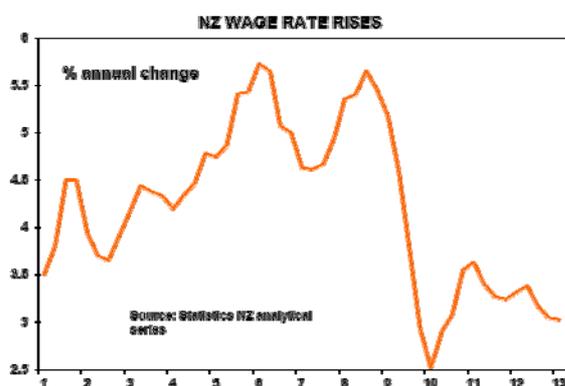
#### Vehicle Spending Rising

In April there were 13,325 cars registered around New Zealand which was a firm 18% rise from a year earlier. Growth appears strong. There were 2,630 commercial vehicles registered which was a huge 45% gain from a year earlier and 39% rise for the three months from a year ago. Thus this makes one think strongly that business investment is rising which is a very positive thing. Tractor regos for the month were ahead 33% on a year ago though up just 2% spread over the three months to April versus last year. So some caution is there in farming but the April result suggests maybe a pause in spending associated with the drought has passed.

#### Labour Market Improving

One needs to take the Household labour Force Survey with a truck of salt on a quarterly basis, but the latest numbers do look closer to what we think is reality. Back data have been extensively revised and without time to download the numbers I choose not to include any graphs here which would look weird. During the March quarter employment jumped by 1.7%, though it is best to smooth that with the December quarter decline of 0.9% to say underlying jobs growth is about 0.4% a quarter or 1.6% a year. That sounds about right.

The unemployment rate fell to 6.2% from 6.8% in the December quarter – and that also feels about right. Things are getting better, but there is no sign of wages pressure as yet. That will take some time and the imperfect gauge we use there comes from an alternative data release this week, the Quarterly Employment Survey. The special series created by Statistics NZ which tries to follow the same occupations rose just 0.6% during the March quarter to lie 3% ahead of a year ago which was the same annual rise as in the December quarter.



## Interest Rates

### Hawkish RBNZ Means Higher Interest Rates – One Day

In a statement accompanying the release of their annual Financial Stability Report this morning the Reserve Bank said that from September 1 they will increase the capital risk weighting which large (but not small) lenders must apply to high loan to value ratio housing loans. The effect will be to slightly raise the premium high LVR borrowers pay and decrease the willingness of large banks to lend at high LVRs. Does this move mean that the RB are less likely to raise interest rates? No because they went to pains to stress that they have concerns about the housing market and the impact which a large correction would have on the economy should such a thing happen.

The RB's problem however is that rising house prices are being driven by solid fundamental demand – which they note – meeting an over-arching lack of supply. This is not something they can do anything about. Therefore although the capital risk weighting change is a move in the right direction its impact is unlikely to be noticeable. Those borrowers seeking high LVRs will go to small lenders, take out second mortgages, buy cheaper properties, or find alternative sources of finance for their deposit.

So does the statement then mean that a rise in the cash rate is imminent? Not at all. The RB Governor Mr Wheeler also noted that the RB intervened in the FX markets last month to lower the NZD (clearly with no sustained impact). Thus they have a goal of lowering the currency – which is impossible to achieve with rising interest rates.

As noted, the RB face exactly the same problem they have had a number of times before and there is nothing they can do of reasonable means to lower the currency and raise interest rates at the same time.

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	2.72%	2.75	2.78	2.76	2.84	5.8
3 year swap	3.03%	3.05	3.11	3.00	3.23	6.1
5 year swap	3.32%	3.33	3.41	3.32	3.68	6.3
7 year swap	3.57%	3.59	3.69	3.64	4.06	

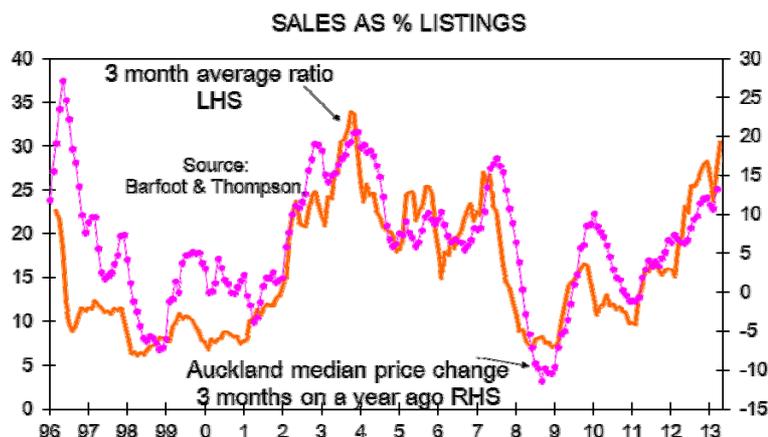
## Housing Market Update

### Same old – lots of buyers catching up, vendors relaxed, migration inflows rising, interest rates low for ages.

Just quickly for the record, the monthly Barfoot and Thompson data for Auckland show they sold 1,062 dwellings in April which was a 42% rise from a year ago but only a small monthly gain seasonally adjusted. Basically April last year was very weak. Sales have risen 3% seasonally adjusted the past three months so activity is rising but not soaring. One reason for this is that listings are in short supply rather than that buyers are not there (that is, the sellers are not there).

Listings totalled 3,467 at the end of April which was a fall of 25% from a year earlier. New listings for the month of 1,532 were 21% more than April 2012 so the market is not completely bereft of people wanting to sell. There just aren't enough of them. The median dwelling sales price was static in April but up 2.2% in the

past three months and 13% on a year ago. Prices are rising but not at an accelerating pace. However my favourite graph derived from B&T data tells me the pace will accelerate again soon.



For your guide, in case you missed it Monday night, we have a new monthly confidence survey which has some information relevant to the housing market. Our BNZ-Nine Rewards Consumer Trends Survey asks about thoughts of spending on travel etc., and also regarding properties. We have only one month's results in so can say nothing about trends or whether things are strong or weak.

But for the record,

- 8% of the 530 respondents are thinking about buying an investment property in the next 3 months.
- A net 54% of people feel house prices will rise in the coming year.
- Those expecting prices to rise on average expect a gain of 4.3%.
- Of those (33) who expect prices to fall, the average expectation is 3.8%.

Probably Monday I shall release the results of this month's BNZ-REINZ Residential Market Survey.

Finally, the rise in risk weighted capital requirements imposed by the Reserve bank on bank home lending appears to have lifted interest rates for mortgages above 80% of house value by about 0.15%. That is fairly small but acts as an extra hurdle for young people though not investors who are focussing on capital gains which they have missed so far and which they assume will continue in the near future. Plus the rise makes no difference to offshore buyers. So the Reserve Bank has instituted a change which will assist the movement of property ownership in New Zealand toward investors and foreign buyers.

### If I Were A Borrower What Would I Do?

Float, put some into extra low short-term fixed rates, try and get half long-term but only at rates close to floating, simply to help manage risk in very uncertain times.

## Offshore

**Enough written elsewhere – but very briefly...**

A sigh of relief rally went through the financial markets last Friday when the United States monthly employment numbers turned out better than expected. The 165,000 rise for April was not far from expectations, but of importance the previously reported 88,000 rise for March was revised up to 138,000 and the February result was also lifted. The numbers are not strong enough to take away worries engendered by a recent swathe of other weaker than expected releases. But they do tend to take the more extreme worries about a dipping economy off the table.

The unemployment rate fell to its lowest level since 2008 at 7.5%. This compares with 12.1% and rising steadily in the EuroZone. However there are many people outside the labour force and worries are strong regarding long-term damage to potential growth and some sections of society from long-term unemployment.

In Australia the RBA cut interest rates another 0.25% to 2.75% which somewhat caught the markets by surprise. The cut however reflects ongoing weakness in some sectors and another one could follow if economic activity does not improve in the likes of retailing, housing, and manufacturing exports.

## Exchange Rates

Exchange Rates	This Week	Week ago	4 wks ago	3 Mths ago	Yr ago	10 yr average
NZD/USD	0.846	0.848	0.846	0.832	0.789	0.67
NZD/AUD	0.826	0.829	0.812	0.808	0.779	0.85
NZD/JPY	83.5	82.4	84	77.7	62.9	69.6
NZD/GBP	0.544	0.546	0.554	0.529	0.488	0.388
NZD/EUR	0.643	0.644	0.65	0.621	0.605	0.52
NZDCNY	5.19	5.23	5.25	5.19	4.98	4.99
USD/JPY	98.70	97.17	99.29	93.39	79.72	105.7
GBP/USD	1.56	1.55	1.53	1.57	1.62	1.72
EUR/USD	1.32	1.32	1.30	1.34	1.30	1.28
AUD/USD	1.02	1.02	1.04	1.03	1.01	0.788
USD/RMB	6.1346	6.1658	6.2038	6.233	6.3091	7.56

### Intervention smintervention. Meh

The NZD fell away by over a cent on Wednesday when the Reserve Bank Governor said that the RB had intervened selling NZDs in April “We’ve also indicated that we would not expect, given the strength of the flows, that intervention would materially change the level of the exchange, but we could take potentially the tops off rallies,” he said. “In terms of activity, there has been some intervention.”

Thus the Governor realistically does not expect he can change where the NZD is going but can take away extreme moves. That just means they may try to stop the occasional 1 -2 cent rise in a short period, and the same rise will occur over a longer period of time.

The news was a mild jolt to the markets and the fall in the NZD was driven to a large extent by traders cutting long positions which may have been in need of trimming anyway. Given the concerns expressed by the RB about the housing market the chances of interest rates going up in the coming year are greater than they are of rates going down. So this easing in the NZD is likely to be temporary and provide an opportunity (we have seen many such opportunities before) for exporters to boost their hedging slightly.

In fact the opportunity lasted only a day because much stronger than expected employment growth revealed in the March quarter Household Labour Force Survey sent the NZD back up again toward US 85 cents.

If the RB intervenes again will the impact be more long-lasting? No. The first point to note is that their intervention last month clearly had little impact on the NZD at the time. Second, they do not have the firepower to make much difference. Third, given expressed concerns about the housing market it is unlikely that the official cash rate will be cut in order to support any intervention. So that was that – just as in 2007 the RB intervened selling around \$2.4bn when the NZD was near 76 cents. It went up nonetheless to 82 cents early in 2008.

The upshot of the NZ factors this week has been that our currency ends the week near where it was last week against all currencies.

One source of weakness in the Euro for a while during the week was comments by the ECB President that "We will be looking at all the data that arrives from the euro-area in the coming weeks and if necessary, we are ready to act again." Meaning they may cut the 0.5% cash rate again if necessary to try and spur growth.

The Aussie dollar weakened initially in response to weaker than expected data on retail sales. Spending fell 0.4% in March. Then it fell a tad further against the USD on Tuesday after the RBA cuts its cash rate another 0.25% to a record low of 2.75%. The rate cut was the first since December and brings total reductions in the past two years to 2%. The cut was driven by signs of ongoing weakness in manufacturing exports, housing and retailing and was only 50% factored into the market. The RBA has a well-established history of surprising the financial markets with its rate moves.

## Discussion

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

### Re: people not selling their homes in Auckland whilst away

"That's so true, as a Kiwi working and living in a semi-permanent status in Aust. We have our own home in Parnell as well as a home here in Brisbane. I am itching to put our NZ home up for sale but the thought of having to go back and buying the same house for twice the price has put me off completely."

### Key Forecasts – I'll update these one day. No hurry.

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/>
- 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](http://www.tonyalexander.co.nz)

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