Weekly Overview

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Mission Statement

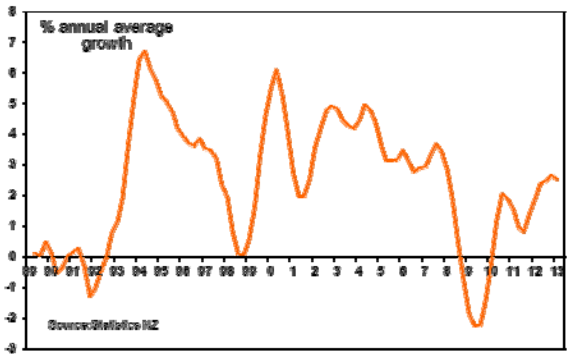
To help Kiwi businesspeople and householders make informed financial decisions by discussing the economy and its implications in a language they can understand.

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

Growth At 2.5%

This morning we learnt that our economy achieved a growth rate during the March quarter of a slower than expected 0.3% with the boost from Christchurch reconstruction offset by a fall in agricultural production courtesy of the drought. But the drought impact is fading while construction will lift further therefore the quarterly growth rate is going to be a lot higher soon. For the year to March NZ's GDP growth rate was 2.5% compared with 2.7% during calendar 2012 and 1.9% in the year to March 2012.

NZ ECONOMIC GROWTH - GDP



I partly prepared this week's Overview using a Microsoft 8 Pro Surface lent to me for a few weeks. I'd have used it sooner but as soon as daughter 1 saw it three weeks ago she grabbed it and ran to her room and I've only been able to get it back by purchasing a new one for her own use as she loves it so much. Obviously when one is lent a product it is beholden upon one to make some comments and the company lending the product of course takes the risk that not all the feedback will be positive. Luckily in this case things come out very much on the positive side though there are some things which I would change.

I very much like the ability to avoid using the mouse when in Word and doing editing just with fingers on the screen. With Excel however I find the mouse to be vital and that is one of the many reasons I found the iPad unsuitable for work purposes. Cutting and pasting graphs from Excel into Word is something I do a lot of and that was easy. However the upright angle of the screen itself is not optimal for me and I'd like it to lean back a bit further but that is not possible. I tried using the new Wedge mouse but found it too different from the normal mouse shape. Some others love it however.

I like the way in Windows 8 that a file when downloaded from email or the internet does not first of all fully open. You have to enable editing before you can change it thus giving some extra virus protection. As happened with my iPad, we lost the screen pen.

Overall, I tried my hardest last year but found the iPad cannot be used for work purposes if one's work involves more than sharing with people interesting stuff you have come across on the internet. But the Microsoft product would be a good tablet/PC for analytical work and document production. It can run Word and Excel which most of us use, there is a mouse which makes using Excel in particular easy, it has a file structure which is a terrible weakness of the iPad, and has a great touch screen.

The Week's Economic Data

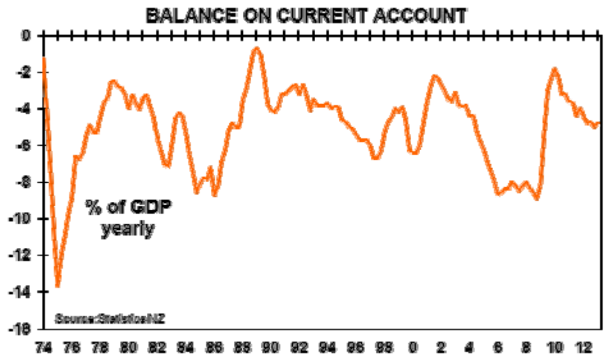
Consumer Confidence Rising

The Westpac McDermott Miller Consumer Confidence Index rose to a three year high of 116.6 in the June quarter from 110.8 in the March quarter and 99.9 a year ago. This jump accords with our more regular monthly BNZ-Nine Rewards Consumer Trends Survey which shows above average intentions on the part of consumers of spending on things in the next three months.

External Deficit Improves - Temporarily

The current account was in deficit by $663mn in the March quarter and almost exactly $10bn for the year to March from $8.9bn a year ago. The deterioration has come about due largely to balance on goods and services falling to a surplus of $576mn from $1.9bn a year ago. So where does the deficit come from if we actually make money on what we export versus what we import? Paying for all those past deficits through net dividend and interest outflows. The international income balance was a deficit in the year to March of $10.2bn from $10.4bn a year ago.

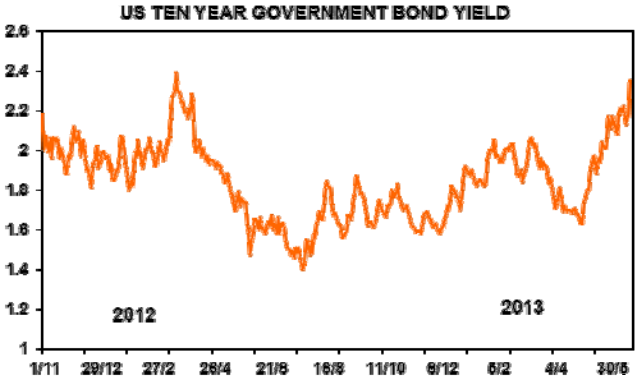
The total deficit now equals 4.8% of GDP which is actually a decline from 5% in the calendar 2012 year but a rise from 4.4% of GDP a year ago. At these levels the deficit is not much different from nominal GDP growth so the country's net international investment position now stands at 69.3% of GDP from 70.6% a year ago. This bad number was worse at 85% of GDP four years ago and the improvement has been driven by reinsurance payments following the February 2011 earthquake and 2009-09 recession slashing imports and the size of the annual current account deficit.

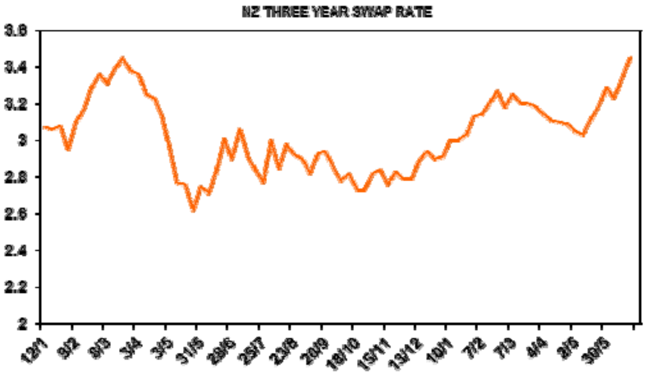


Interest Rates

Fixed Rates Rising

Wholesale interest rates have taken a fairly large step up this week on the back of a sell-off in US bond markets. That sell-off has taken the US ten year government bond yield up to 2.35% from 2.22% a week ago. This is the highest level since a brief spike in March last year and before that August 2011.



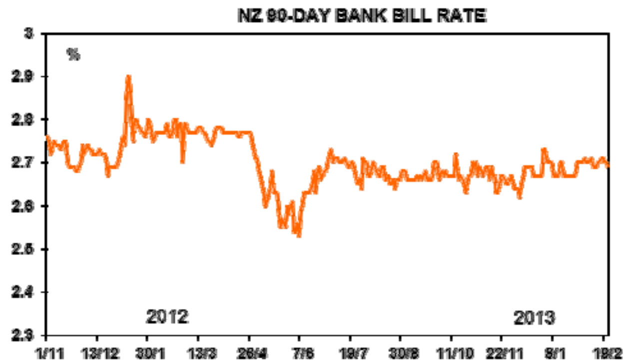


The sell-off was caused by the Federal Reserve Chairman last night stating that if the economy pans out as expected they will start reducing the quantity of their bond purchases (money printing) later this year and cease altogether by the middle of 2014. That statement was more definitive than the markets were expecting hence the interest rate increases which have flown through here.

What this means for our interest rates is that unless the US economy tanks we will see further rises with the short end of the yield curve moving later this year as we approach the time when our central bank will start to tighten monetary policy – at some stage in 2014 depending upon how our data go.

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	2.88%	2.79	2.75	2.80	2.58	5.8
3 year swap	3.43%	3.34	3.18	3.20	2.83	6.1
5 year swap	3.79%	3.71	3.51	3.56	3.18	6.3
7 year swap	4.06%	3.99	3.77	3.88	3.52	



Housing Market Update

A Dot-Point Summary

I have written more about the housing market in the past few weeks and months than ever before so let's try for some sort of summary of the situation.

- Auckland and Christchurch house prices have risen sharply but the rest of the country has yet to show much strength.
- The Christchurch gains have been driven largely by supply shortages following the earthquake and an expected inflow of people for the reconstruction jobs.
- Auckland gains have not been driven by either speculation or surging migration but instead the realisation that there is a supply shortage at current prices. That shortage started before the GFC and is getting worse as each month passes because construction was at a multi-decade low two years ago and at below 5,000 consents in the past year Auckland consent numbers are not even back at their 20 year average.
- Demand for housing will remain strong in Auckland as first home buyers and investors catch-up on buying they did not do from 2008 – 2012 because of worries about prices falling. Builders however will struggle to catch-up on supply they put off providing given resource constraints.
- House prices in NZ did not collapse from 2008 because interest rates fell a long way and because of the supply shortage in Auckland principally.
- Net migration inflows into NZ are now rising sharply courtesy to a great degree of a turning in the migration cycle with Australia that history suggests has a long way to go.
- With interest rates at their lowest levels since the 1960s housing demand will remain strong and the RB are reluctant to raise rates because they know the NZD will appreciate sharply.
- The RB is to tinker with rules on loan to value ratio costings but their focus is bank stability in the event of an economic shock and not housing affordability. People will find ways around their rules and the RB will eventually be forced to raise interest rates potentially a lot more than people are currently thinking.
- Borrowers should think seriously about getting half their debt at a fixed rate of three years or longer as part insulation against what history tells us can happen when we ignore the RB and keep buying houses.
- Only between 8% and 9% of NZ dwelling sales are to people located offshore and maybe half of those buyers intend shifting to NZ. About 4.5% of the vendors which real estate agents represent are located offshore. So there may be no net transfer of NZ properties to people offshore. But further research beyond my surveys of real estate agents is required to verify both sets of statistics.
- Here is a growing visceral perception that Chinese buyers are snapping up NZ houses, leaving them empty, pushing up prices, and making home ownership more difficult for Kiwis. The data do not support these claims but that may not matter. Perception does and if this is the level of discontent when actual purchasing may be quite low, the discontent will become extreme and ultimately threaten our trade and investment relationship with China when Chinese purchasing becomes much greater over the coming two decades.
- NZ stands out as having almost no restrictions on foreigners buying NZ houses. It would seem sensible at a minimum to adopt Australia's system of banning sales of existing houses to foreigners but allowing foreigners to purchase newly built houses.
- Because I believe foreigners are not the driving force behind prices rising strongly I do not believe such rules would have much impact on prices – especially as no-one is able to provide data showing the Asian buyers they see at auctions are foreigners rather than Kiwis. However by cutting out foreign demand and yet seeing prices still rising Kiwis would be forced to more actively examine and attempt some correction of the true factors causing high and rising house prices in New Zealand.
- The strong price gains in Auckland and Christchurch will spread to the rest of the country (to a lesser degree though) as has happened in past (Auckland-initiated) cycles.
- We are only at the start of this particular housing cycle and the only true way to address housing affordability in New Zealand is a massive boost to supply – of entry-level housing in particular.

- For your guide, in my BNZ Confidence Survey of a couple of weeks ago 29% of people said they were unhappy about house prices rising, 29% said they were happy, and 42% were indifferent. So 71% of people would disagree with the statement that they are unhappy about house prices rising.

Come One, Come All

It's your money they're after. Remember that if you feel that you have missed out on some simple house price gains and now want to catch up. The way in which the spruikers with their evening seminars will do this is to use the trick Winston Peters uses – create an enemy then put yourself forward as peoples' saviour from that enemy. In this case it means slagging off people they will portray as somehow denying innocent Kiwis knowledge of how to make money in the housing market.

Here is some text taken from a website offering such a service.
"If you're sick of the confusing information from the media and so-called property experts hiding their secrets about how they really make money from property, then this could be your best chance in 2013 to find the truth about how to make serious money from property."

There are certainly many people who have made good money from property and many who will do so. But like all investments you need to go in with your eyes wide open to the risks involved and hopefully some awareness of the ways in which you can lose money. In particular, remember to allow for interest rates rising from current levels which only exist because the world economy is still struggling to recover from the biggest financial downturn since the 1930s.

Also watch your assumptions on rental income, how much time you may need to give up to arrange for broken toilets to be repaired (you are investing in an accommodation business remember, not buying a corporate bond), and be very wary of rent guarantees. The cost of such guarantees will be factored into the price you pay. Watch for some projects in which you buy off the plan perhaps never getting off the ground, and for goodness sakes check out whether the land is leasehold and subject to a review which could see costs skyrocket as happened at a few sites in Auckland.

Construction Costs Rising

This is going to be a very strong theme in NZ for a number of years. Here is yet another example of how costs are rising even without the stimulus from Christchurch and Auckland building. This is another factor helping to explain why it costs so much to build a house in our lovely little country.

"The Dept of Labour (osh under old name) campaign for work place safety now requires all building projects to be scaffolded where in the past it was only 2 storey housing. We have gone from a 2 to 5 day forward booking to two to six weeks. An extreme shortage of qualified and willing labouring staff, stock and associated support services see this situation becoming a serious issue over the next year given the projected growth for new housing in Auckland and the ChCh rebuild gathering impetus.

You only have to look at the number of two storey dwellings built to the single storey to calculate the increase in demand for our services (60 to 70%) plus all other household maintenance carried out by tradesmen to get an idea of the increase in demand. Great for our industry but just another challenge in the increasing cost of building and the question of affordability for the first home buyer.

I have spent $Xk as an SME in the last three months (12 staff) increasing stock levels from 1.2 million and could continue to do so with appropriate funding. Having to now look offshore for staff from Philippines to assist with growth and demand."

If I Were A Borrower What Would I Do?

I'd try to move more of my debt to longer term fixed rates before they go up and to get some insulation against the rate rises to come in response to the biggest construction job our country has ever seen.

Offshore

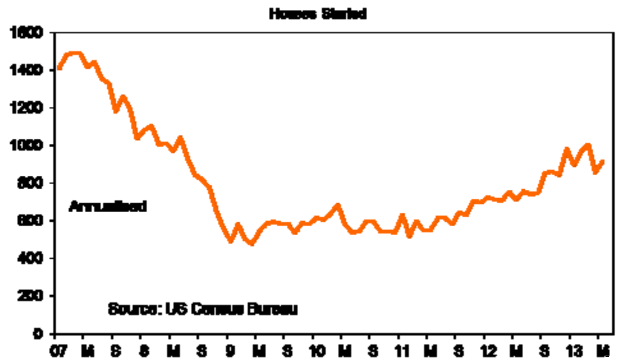
To Taper, Or Not To Taper…

I've not written much here this week partly because the past few weeks have contained a lot of material and partly because little of huge significance regarding foreign economies has happened this week – except in the **United States**. The Federal Reserve chairman has indicated that the economic outlook is a bit better than they were previously thinking and that if things pan out as they now expect they will start tapering their money printing operations later this year and cease altogether by the middle of next year.

The announcement has caused some sharp movements on financial markets since last night and will continue to do so as the markets now gauge each piece of data in terms of whether it is stronger or weaker than the Fed. might have expected and whether it therefore brings forward or pushes out in time the commencement of the tapering exercise. There will be continuing high volatility in financial markets this year and next.

In the US retail spending rose by a stronger than expected 0.6% in May though was ahead just 0.7% in the three months to May from three months earlier and 3.7% from a year earlier. So there is growth though no boom by any means. In fact consumer confidence has eased a tad this month as measured in the Reuters/University of Michigan survey to a reading of 82.7 from 84.5 in May.

The number of houses for which construction started in May was 28.6% ahead of a year ago which was a strong result and a 6.8% gain for the month.

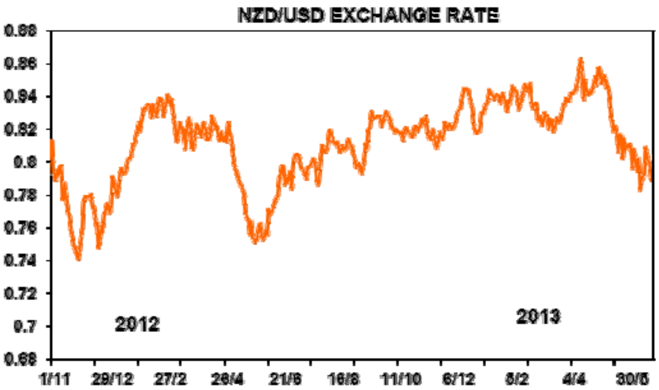


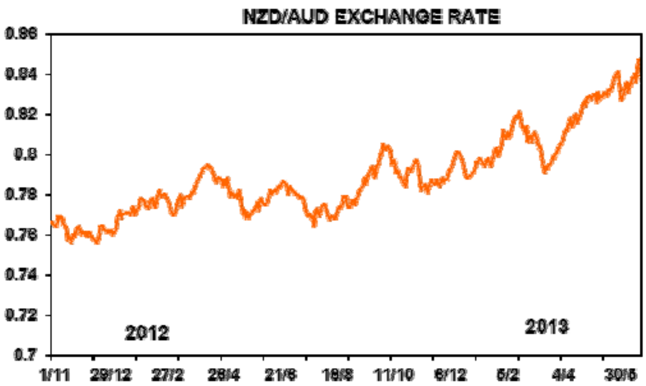
Exchange Rates

Exchange Rates	This Week	Week ago	4 wks ago	3 Mths ago	Yr ago	10 yr average
NZD/USD	0.789	0.792	0.806	0.824	0.798	0.67
NZD/AUD	0.847	0.838	0.829	0.795	0.783	0.85
NZD/JPY	76.1	74.8	83.2	78.2	63	69.6
NZD/GBP	0.51	0.505	0.532	0.545	0.507	0.388
NZD/EUR	0.594	0.593	0.628	0.639	0.629	0.52
NZDCNY	4.83	4.86	4.95	5.12	5.07	4.99
USD/JPY	96.45	94.44	103.23	94.90	78.95	105.7
GBP/USD	1.55	1.57	1.52	1.51	1.57	1.72
EUR/USD	1.33	1.34	1.28	1.29	1.27	1.28
AUD/USD	0.93	0.95	0.97	1.04	1.02	0.788
USD/RMB	6.1273	6.14	6.1412	6.2158	6.3557	7.56

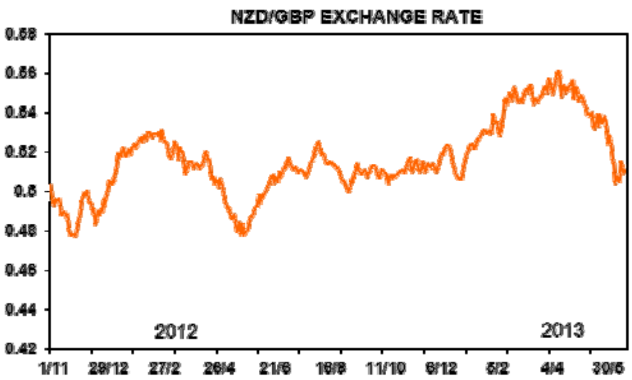
NZD Down A Tad Again

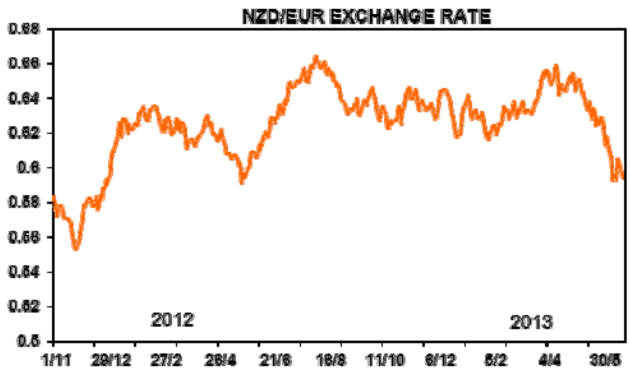
The Kiwi dollar initially rose early this week assisted by a good result at the Global Dairy Trade auction but got pushed lower again last night from 80.4 cents after the USD went up and peripheral risky currencies were sold following the Fed. announcement on bond purchases. Their money printing operations will ease off from later this year then probably cease mid-2014 and the reduced pace of US money supply growth (then shrinkage after mid-2014?) means a firmer USD and less money chasing financial assets. Hence a 206 point fall in the Dow Jones share index last night, over 1.5 cent fall in the NZD, and what will be newly growing worries about capital flows out of many parts of the world including Asia.





These are very uncertain times which we continue to live in and the NZD is going to be battered by chops and changes in the experimental economic policies being pursued around the world (Japan, US, EU in particular). But underneath it all the economic fundamentals are supportive of a strong NZD. Most notably our firm export commodity prices and accelerating growth rate which will be producing inflation and higher interest rates come 2014 – 16 in the context of strong resource shortages in many sectors.





All that this means is that we have probably not seen the peak for the NZD this cycle but struggle to form a view as to when the upward leg resumes.

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/
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- 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

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