Weekly Overview

8 August 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

Shocks Will Never Cease – "It's The Putting Right That Counts"

News of the week for NZ this past seven days has clearly been Fonterra's belated announcement of a dirty pipe in a processing factory in May last year leading to botulism bacteria entering some of their whey protein-based products subsequently on-sold to other food companies. The initial reaction in financial markets was severe with the NZD falling 1.2 cents upon opening first thing Monday morning. But come Tuesday much of the decline had been erased with news that while products have been recalled by food companies in many countries, China has banned very few dairy products from entering their country as skim and whole milk powders – which form the bulk of dairy exports – are unaffected. Average prices also fell just 2.4% at Tuesday night's Global Dairy Trade auction.

The damage is clearly to the NZ "clean and green" brand and this is a vulnerability which will never go away. The challenge is to ensure extraordinarily high processing standards are in place, that testing regimes are not just robust but quick, and that communication and remedial actions taken in the (inevitable) event of product problems occurring is swift and comprehensive. In that regard there can be little doubt that Fonterra will change their procedures following this event and one presumes all other food companies will undertake a fresh analysis of their own monitoring and reporting systems as quickly as possible. They had better because the media, social media, and our competitors (watch the supposed rise of Australia as "Asia's food bowl") will be ready to jump from here on out at any sign of a problem with any of our exported food products.

For your guide, here is a link to a summary of the Chinese social media reaction to the issue compiled by Syengage. http://syengage.com/what-chinese-netizens-are-saying-about-the-fonterra-botulism-crisis/

The reaction is interestingly not overwhelmingly negative with comments regarding action being taken before evidence of any babies getting sick and this probably not happening for Chinese infant formula brands. But a description by one main Chinese daily as the affair being a "festering sore" is a bit rich considering the way the Chinese have destroyed their air, soil and water quality, imprisoned dissenters and bulldozed villages in the hopes of rising up the global economic ladder. Then again, when you claim as a country to be "clean and green" you invite everyone to hold you to a high a standard and continually meeting it will be very difficult and an open invitation for an attack on one's possible hypocrisy – the thing which media on our behalf hunt out mercilessly.

On the local data front we received the June quarter Household Labour Force Survey yesterday. It showed slightly greater than expected employment growth during the June quarter of 0.4% or 8,000 people. Job numbers have grown 0.7% or 16,000 from a year ago but by a strong 2.1% or 46,000 in the first six months of the year. So the data are looking fairly strong and this will eventually have some positive implications for the retailing sector plus more positive import for the housing sectors in Auckland and Christchurch with other parts of the country also to benefit.

We say eventually because our BNZ-Nine Rewards Consumer Trends Survey released yesterday shows that although a firm net 29% of people are confident about the economy in a year's time there has been a downward trend over the past four months in the net percent of people who plan to spend above average in the coming month. You can find the results here.
http://tonyalexander.co.nz/wp-content/uploads/2013/08/BNZ-Nine-Rewards-August-2013.pdf

Note that the survey also asks whether people are finding it easy or hard to get extra work and the result there is a net 25% still finding it difficult.

In Australia the two big news items for the week were the calling of a Federal election for September 7 plus the widely anticipated 0.25% cut in the official cash rate by the RBA on Tuesday. The rate now sits equal to the NZ OCR at 2.5% and one cannot rule out another rate cut given the downgrading of Australia's growth forecasts which is underway. Late last week the Federal Treasury increased their forecast for the budget deficit this year by $12bn to $30bn – a fairly sharp weakening in the space of the ten weeks since the annual Budget was read in May.

Treasury now pick GDP growth of 2.5% this year from 2.75% at Budget time and see the unemployment rate rising next year to 6.25% from the current 5.5% rather than the earlier forecast of 5.75%. In fact today data were released showing that Australia's unemployment rate has held steady at 5.7% in July but with 10,200 jobs lost during the month. This is a poor result as growth of 6,000 jobs had been commonly forecast. The chances of additional rate cuts have lifted following these numbers plus data on Monday showing the weakest retail trade numbers since 1961. There is now general acceptance that as happens in New Zealand (1989 and 2008) the Labour Party in Australia has overseen an unsustainable rise in spending, left the (probable) incoming party with a deficit blowout, and introduced business unfriendly taxes and legislation which have left Australia extremely poorly placed to handle the ending of the resources boom built around the surge of growth and infrastructure spending in China up until recently.

As Australians almost certainly vote out the ALP and seemingly reluctantly vote in a Liberal-National coalition the chances are that consumer and business sentiment levels will remain low as the unemployment rate soon heads above 6% - at the same time as the rate in NZ is heading downward from 6.4%. This divergent labour market dynamic will drive a decreased net loss of Kiwis across the ditch and be one factor adding upward pressure to the NZ housing market while also however alleviating to probably only a slight degree the strains which are showing in labour availability.

Labour shortages in fact was a key theme to appear in our latest BNZ Confidence Survey. The overall sentiment reading rose to a record 59% late last month from 56% in June and 57% in May but many respondees noted that they are already finding it hard to source the labour they want. Recruitment agencies in particular noted rising difficulties in finding candidates for positions. http://tonyalexander.co.nz/wp-content/uploads/2013/08/BNZ-Survey-Results-August-5-2013.pdf

Eventually the deepening shortages will drive generalised wages growth to which the Reserve Bank will respond with higher interest rates (pre-emptively) though for the moment the wage gains appear to be confined mainly to construction contractors rates – hence high ute sales around the country. Lots of lovely Ford Rangers around the place.

In the United States Friday night saw the release of a weaker than expected jobs report with employment rising 162,000 in July rather than the anticipated 185,000, and increases for the previous two months being revised down by 26,000. The result is yet another reminder (like the weak consumer confidence data we referenced last week) that growth in the US economy is not necessarily as self-sustaining as everyone would like. That means the chances of the Federal Reserve beginning their tapering exercise this year have eased a tad, the USD has fallen, and bond yields have pulled back a bit. In the next few days we remain in exactly the same boat as for the past four years – wondering whether US growth is getting solid or not and reacting as data come out negative or positive. The picture remains cloudy, uncertain, therefore exchange rate and interest rate predictability remain low.

In the United Kingdom things are looking a tad less dire than previously due partly to strength in the housing market. That strength is being driven by low interest rates which the Bank of England has indicated it intends keeping low for a long time, a government subsidy scheme for first home buyers, and in London at least strong buying of new developments by foreigners – largely from Asia. The strength is manifesting itself not just in sales but in prices rising on average near 5% in the past year, and an index for the construction sector rising to its highest level since mid-2010. Also, on Monday night there was much excitement and talk of the UK leaving the EU behind in the economic cycle as an index measuring services sector activity rose to a six year high and retail spending grew the most in two years – hence some strength in the British Pound.

In Japan the Cabinet Office has raised its growth forecast for this year to 2.8% from 2.5% but expectations for next year are being scaled back on expectations that the first stage of a two year move in the consumption tax from 5% to 10% will have a strongly depressing impact on economic growth. The tax increase is badly needed given the still spiralling ratio of Japanese government debt to GDP (around 240%) and the over two decade inability of Japan's leaders to manifest much self-control over their spending plans. While there are hopes that the recent victory for the returned PM Mr Abe will allow some strong deregulatory policies to be pushed through both houses of Parliament there remains a high chance that he fails and a debt bust happens in the world's third largest economy. The effects globally would be dire and were explicitly warned of by the Australian Treasury in the new economic assessment released last week where they downgraded Australia's growth prospects. The IMF have also warned about the risks of a debt implosion in Japan if investors believe the Bank of Japan is simply monetising the government's debt mountain. Could this be the thing which causes the next global financial crisis? The IMF worry that it is.

In Europe recently some better than expected data on the manufacturing sector have been released and the unemployment rate has held steady for two months at a record 12.1%. Spain is even forecast to come out of recession soon and there are improving signs of life apparently in Greece. Frankly both these developments however sound more like a concussed player on the field managing to wriggle a little finger rather than throwing off the neck brace, climbing off the stretcher and re-joining the playing team. The IMF expect Spain's unemployment rate to stay above 25% until 2018.

IF I WERE A BORROWER WHAT WOULD I DO?

I would continue to keep an eye out for discounted fixed rates for terms of three years and beyond in order to get some protection against the uncertain rate rise cycle which is to come along. That uncertainty was heightened this week with the markets having to factor in how much if any of a hit the economy and inflationary pressures will take from Fonterra's news about tainted milk products (not much if anything measurable at all one suspects). This just reinforces one of our key messages which is that interest rate predictability is still very low and one should not construct an interest rate risk management strategy based upon one set of interest rate forecasts proving correct.

This week bank fixed borrowing costs are about where they were last week.

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	2.67%	2.67	2.66	2.67	2.76	5.7
1 year swap	2.97%	2.95	2.91	2.72	2.66	5.8
3 year swap	3.77%	3.74	3.65	3.03	2.85	6.1
5 year swap	4.23%	4.21	4.13	3.32	3.27	6.3
7 year swap	4.50%	4.48	4.44	3.57	3.57	

NZD Holds Up In The End

The NZ dollar dropped US 1.2 cents first thing Monday morning following the weekend announcement by Fonterra that it had distributed some poisonous milk product ingredients. Given the economy's high dependence upon dairy exports, the clear sensitivity of the Chinese to quality matters as evidenced by their immediate recall of all NZ-produced infant formulas, and the time which it has taken for this error to come to light there will be negative consequences from the pipe-cleaning failure. How big however is impossible to say and this will be an early severe test of the improved communication between NZ primary sector authorities and the Chinese following the miscommunication a couple of months ago which left NZ meat sitting on China's wharves.

But the NZD has ended this afternoon largely where it was a week ago against the USD near 79.5 cents with support from the crisis being quickly "contained" and dairy prices falling only 2.4% at Tuesday night's Global Dairy Trade auction. One wonders if seeing the easy way in which the NZD handled this news a few more investors and currency traders are perhaps revising upward rather than downward their expectations for the NZD's movements in the coming year.

This may especially be the case in light of the Reserve Bank of Australia this Tuesday afternoon cutting its official cash rate to a record low of 2.5% as the Aussie economy struggles to find its legs as the mining boom fades away. The statement from the RBA Governor accompanying the cut was slightly less dovish than expected so the AUD actually gained half a US cent following the cut. But the RBA said that the AUD remains "at a high level" and that further depreciation would be welcomed in order to help fostering a rebalancing of growth in the economy.

Nonetheless, while the NZD is basically where it was a week ago against the USD and AUD we have shed some ground on the other crosses as the USD weakened following the weaker than expected US jobs report released on Friday night. The report is by no means a game-changer but instead is merely a reminder that the US economy may be growing but it is nowhere yet near finding its natural economic stride.

Exchange Rates	This Week	Week ago	4 wks ago	3 Mths ago	Yr ago	10 yr average
NZD/USD	0.795	0.799	0.769	0.845	0.815	0.67
NZD/AUD	0.882	0.889	0.85	0.83	0.772	0.85
NZD/JPY	76.7	78.2	77.8	83.7	64.1	69.6
NZD/GBP	0.513	0.525	0.516	0.546	0.522	0.388
NZD/EUR	0.595	0.6	0.6	0.647	0.658	0.52
NZDCNY	4.87	4.90	4.72	5.19	5.19	4.99
USD/JPY	96.48	97.87	101.17	99.05	78.65	105.7
GBP/USD	1.55	1.52	1.49	1.55	1.56	1.72
EUR/USD	1.34	1.33	1.28	1.31	1.24	1.28
AUD/USD	0.90	0.90	0.90	1.02	1.06	0.788
USD/RMB	6.1195	6.1289	6.1328	6.14	6.3677	7.56

Housing Market Update

Auckland Powering Ahead As Ever

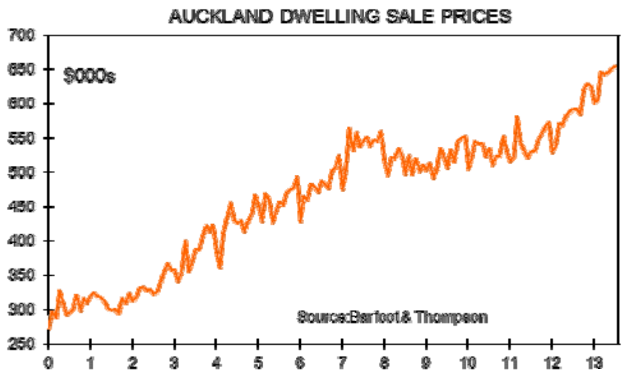
This week Barfoot and Thompson reported that in Auckland in July they sold 1,133 dwellings which was a 13.5% rise from July of 2012. In rough seasonally adjusted terms sales recovered near 10% after falling just over that in June but the three month change is a minor fall suggesting that sales growth has plateaued. What our monthly BNZ Confidence Survey tells us is that sales growth is flattening not because buyers are backing off but because real estate agents cannot source stock.

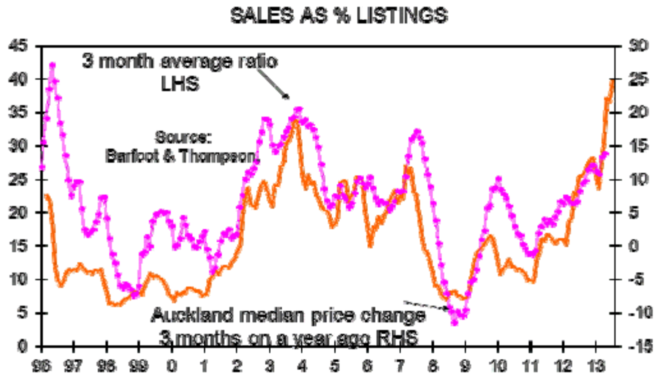
People have indicated that they won't sell until they have already bought, and that they are holding onto first homes as investments when they move up the ladder to the second (better) home. You will find over two pages of comments from real estate agents in our monthly survey which is available here. http://tonyalexander.co.nz/wp-content/uploads/2013/08/BNZ-Survey-Results-August-5-2013.pdf

You'll also find an answer to the question "Are you thinking about buying an investment property in the next three months/" in our BNZ-Nine Rewards Consumer Trends Survey at http://tonyalexander.co.nz/wp-content/uploads/2013/08/BNZ-Nine-Rewards-August-2013.pdf

Only a gross 6.9% of our 551 respondents in the survey are thinking this way. This result is up from July's 5.9%, June's 5%, but below the first survey's result of 7.6% in June. Make of it what you will. The regional breakdown for August is Auckland 8%, Bay of Plenty 4%, Canterbury 5% (low), Hawkes Bay 18%, Otago 11%, Waikato 4%, and Wellington 6%.

The Barfoot and Thompson data show that during July they received 1,637 new listings which was actually a strong 26% rise from a year earlier. So it would be wrong to say that vendors have backed off to a huge degree. However the level of stock at the end of the month of 2,837 listings was down by 29% from a year before. The ratio of sales to listings for the past three months on average was a record 39.7% from 30.5% three months ago and 25.4% a year ago.





With regards to prices the direction remains upward with a 10.7% gain between July 2012 and this year with the average sales price at $654,000 from $650,000 in June and $591,000 a year ago.

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

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