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

Output Cost of A Lost Campaign

So what did I miss while in the bush? Before I went in many newly boat-loving people were waiting for a final win for the NZ Emirates team so they could claim the Americas Cup as their own – and when I came out people were still waiting but media were running articles discussing how much of a stimulus there would be to our economy when the next regatta would be held in Auckland. Actually, now that reality has set in it is a question of how much output has been lost these past 2-3 weeks by people showing up late to work each morning. The GDP hit probably shouldn't be that great and it has been swamped already by the real driver for our economy which is the effort put in by thousands in the dairy sector near every day of the year rather than a handful of state-subsidised boat racers. Yes – we Kiwis get bitter when we lose on the world stage! Go the All Blacks.

We've learnt this past fortnight that the NZ economy grew by a slightly faster than expected 0.2% during the June quarter with a good contribution from activities related to preparations for the rebuilding of Christchurch. Growth was 2.7% in the full year. We learnt that the current account deficit is running at a below average 4,3% of GDP, and that the annualised net migration gain for the most recent three month period has now lifted to 25,000 from 23,000 a month earlier and 19,000 three months ago. We have seen the Federal Reserve in the United States not start their money printing tapering exercise.

We also saw on Tuesday the announcement from Fonterra of yet more revenue for dairy farmers this year with the payout lifted to $8.30. The 50 cent increase from the previous estimate adds another $900mn into the economy and the total dairy income change from last season from Fonterra is about $5bn or near 2.3% of GDP.

All five of these things are positive for the NZD so unsurprisingly the currency is currently near US 82.5 cents from 81 cents a fortnight ago though it traded above 84 cents for a while before a decent bout of profit-taking set in.

Has the outlook for our economy changed at all? Not really. We are still anticipating a big stimulus to activity from the rebuilding of Christchurch, feed-through of a big jump in dairy incomes, hefty investment in the dairying sector, catch-up house construction in Auckland, and infrastructure work. We still anticipate monetary policy being tightened sometime early next year, and risks for the NZD still lie on the going up side as opposed to going down.

We still anticipate worsening labour shortages and still see house prices rising.

IF I WERE A BORROWER WHAT WOULD I DO?

The track for interest rates is upward as growth in our economy accelerates and monetary policy eventually gets tightened, and as the Federal Reserve and other central banks pull back from emergency monetary policy settings put in place during and after the worst global financial crisis since the Great Depression. It is not possible to predict monetary policy changes offshore with reasonable accuracy (the past week has shown this in the US with the Fed. not starting tapering as near everyone expected), and that means borrowers should not be thinking in terms of developing an interest cost minimizing strategy which hinges upon a set of rate forecasts coming true.

Instead borrowers need to think about their vulnerability to interest rate rises and consider taking some of that risk away by shifting some floating rate debt onto fixed rates. Were I borrowing currently I'd look for a simple risk-managing spread of one-third floating, one-third short-term fixed out to two years, and one-third in the three to five year area.

For the record, wholesale interest rates are slightly lower than they were a couple of weeks ago but not by any amount worth getting excited about. The small declines reflect the Federal Reserve last week not announcing the start of their pullback from printing US$85bn a month as the markets had been expecting. More money sloshing around than anticipated means more money available to buy fixed interest securities and that means some downward pressure on US bond yields which have relevance to where bank funding costs sit.

Next week, should US economic data turn really good again and speculation soar anew regarding tapering starting then interest rates will rise. If the data come in poor then the opposite will happen.

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%	3.00	2.93	2.89	2.61	5.8
3 year swap	3.93%	4.02	3.87	3.55	2.85	6.1
5 year swap	4.45%	4.57	4.39	3.96	3.14	6.3
7 year swap	4.76%	4.89	4.71	4.30	3.44	

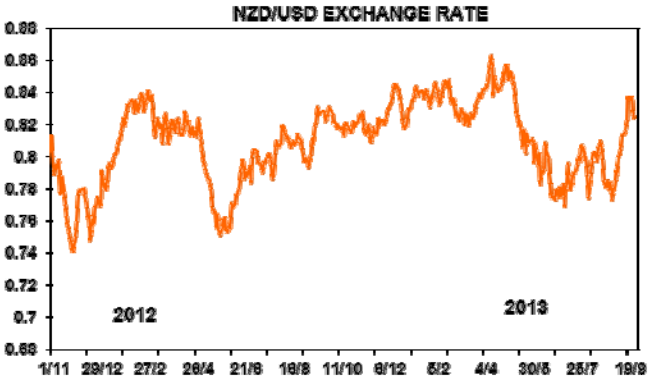
NZD Higher

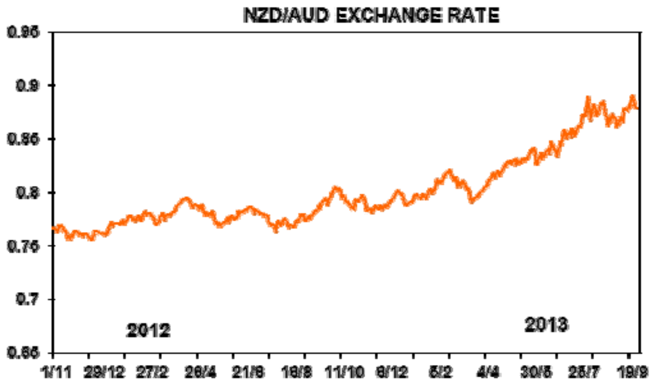
Two weeks ago before I went off tramping the Kiwi dollar was buying 81.3 US cents and now it is higher at around 82.5. We've also jumped up on the crosses. Why the appreciation?

Exchange Rates	This Week	Week ago	4 wks ago	3 Mths ago	Yr ago	10 yr average
NZD/USD	0.825	0.837	0.781	0.773	0.824	0.67
NZD/AUD	0.881	0.879	0.863	0.834	0.794	0.85
NZD/JPY	81.6	81.9	76.9	75.6	64	69.6
NZD/GBP	0.513	0.518	0.501	0.501	0.509	0.388
NZD/EUR	0.61	0.618	0.583	0.59	0.64	0.52
NZDCNY	5.05	5.12	4.78	4.75	5.20	4.99
USD/JPY	98.91	97.85	98.46	97.80	77.67	105.7
GBP/USD	1.61	1.62	1.56	1.54	1.62	1.72
EUR/USD	1.35	1.35	1.34	1.31	1.29	1.28
AUD/USD	0.94	0.95	0.90	0.93	1.04	0.788
USD/RMB	6.1195	6.1202	6.122	6.1449	6.307	7.56

- June quarter GDP growth at 0.2% was stronger than market expectations of a 0.2% fall.
- The current account deficit for the year to June came in lower than expected at 4.3% of GDP rather than 4.8%. (Not a biggie though).

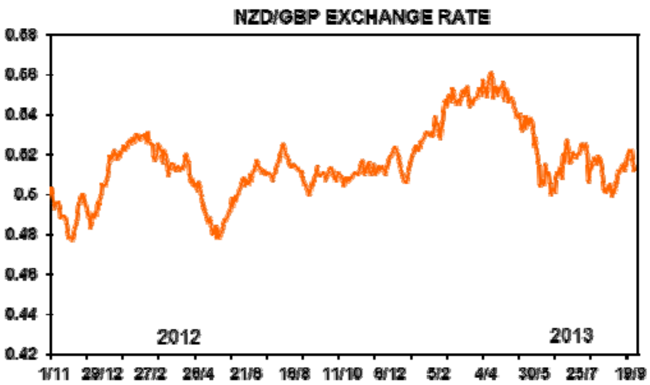
- Most significantly, the Federal Reserve did not indicate an imminent commencement of the tapering exercise which people were expecting last week. The continued printing of money means extra USD weakness and strength in peripheral currencies like the NZD.

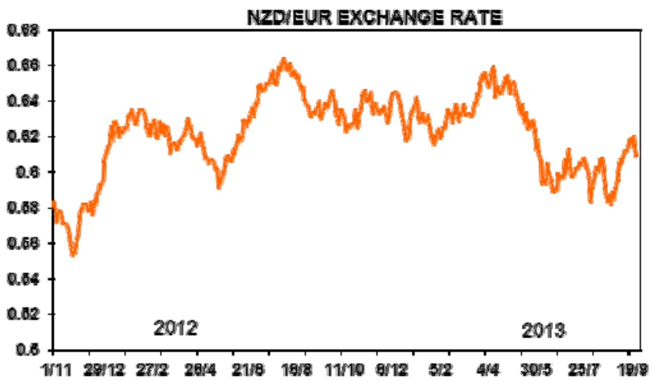




Offshore what we have seen recently is this.

- In the UK economic data have been coming in better than expected with an increasing frequency of stories regarding booming house construction and rising wages for the likes of bricklayers.
- In Europe data have been acceptable and few now talk in terms of the Euro falling apart. But debt problems remain in peripheral economies and some more writing off of Greek debt is likely. Germany's economy looks good but outside that the likes of France remain bedevilled by high youth unemployment and especially rigid labour markets.
- In the United States we are still not seeing a string of unwaveringly good economic data. Because of that the Federal Reserve have not yet announced any plans to cut back on their $85bn a month money printing operation.
- In China economic data have attracted some sighs of relief as they have not continued to show slowing growth. But worries about debt remain strong and a rebalancing of growth away from exports and fixed asset investment to consumption is not happening.
- In Australia it is hoped that the lower AUD will soon improve exports and that rising house prices will eventually lead to rising house construction. A new Federal government is in place and this may help stem a steady stream of project cancellations announced in the past year and a half by mining companies. Uncertainty is high but generally forecasters are expecting growth above 2.5% in the coming year.





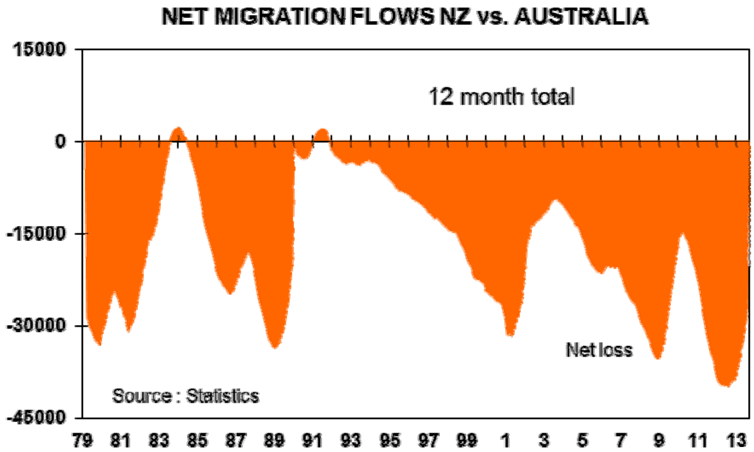
Uncertainty regarding the world economy still remains reasonably high, but things appear to be generally moving in the right direction. In this sort of environment, while high volatility is guaranteed, investors are more likely than not to think about placing some extra funds in risky assets such as peripheral currencies like the NZ dollar. The drift for our currency therefore is likely to remain upward and the interesting thing to see will be what happens when the Reserve Bank starts tightening monetary policy sometime early next year. History shows us that rising NZ interest rates cause the NZD to go up.

Housing Market Update

Accelerating Population Growth

The migration numbers keep climbing and the implications for the housing market are very obvious. In seasonally adjusted terms in August there was a net gain to the NZD population from migration flows of 2,100 people. This was up from 1,960 in July and if we annualise the past three months we get a gain of 25,000. That is the annual total in other words that we appear headed for compared with the actual total net gain in the year to August of 12,848 compared with a loss of 4,118 a year ago.

This is a fairly rapid turnaround in people flows and it stems largely from a collapse in the number of people going to Australia and more Kiwis coming back from there. In the year to August the gross loss of Kiwis across the ditch was 44,919, a decline of 8,985 from the loss of 53,904 a year ago. The gross flow to NZ from Australia has risen to 17,667, a gain of 3,719 from 13,948 a year ago. The total net flow change is 12,704 which accounts for 75% of the overall flow change.



As previously noted, history shows that this trans-Tasman flow can change a lot and we could easily see the net loss fall to 15,000 from the 27,252 net loss across the ditch recorded for the year to August.

Low Deposits

Regarding the impact of the new low deposit lending rules introduced by the Reserve Bank, none of us yet is in a position to be able to say how great the effect will be and it may take quite a few months to stick some numbers around it – which probably we will never really be able to do. Clearly the changes mean a reduction in demand, but the question is to what extent this reduction will be mitigated by borrowers sourcing funds from other sources (don't know), shifting their house price target range down (no idea), looking in cities outside Auckland, and buying a house still but not gearing to the max to take celebratory holidays and purchase completely new house furnishings as young debt-tolerant people seem wont to do.

My view is that the impact will be very little and mainly noticeable in terms of the biased impact upon young buyers rather than the market overall. There is a lot of pent-up demand from first-home buyers and investors who sat on their hands waiting for prices to collapse from 2008 – 2011 (building up bigger and bigger deposits by the way), awareness of a housing shortage in Auckland and Christchurch is high, the shortage will be impossible to adequately address this cycle given the recent multi-decade construction lull and coming shortage of builders, and net migration inflows are booming.

Prices rise.

Key Forecasts

Dec. year		**2011**	**2012**	**2013**	**2014**	**2015**
GDP	annual average chg	1.4	2.7%	2.5 – 3.0	3.0 – 3.5	2.0 – 3.0
CPI	on year ago	1.8	0.9	0.5 – 1.5	1.5 – 2.0	2.5 – 3.0
Official Cash rate	end year	2.5	2.5	2.5	3.5 – 4.25	3.5 – 4.5
Employment	on year ago	1.6	-1.3	2.5 – 3.5	2.0 – 2.5	1.0 – 2.0
Unemployment Rate	end year	6.3	6.8	5.5 – 6.5	5.0 – 6.0	5.0 – 6.0

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It's A Hard Life…

When predictions of massive rain prove wrong and you have one of your best tramping days ever. That is what happened last Friday when I walked 38 km from the James Mackay hut on the Heaphy Track to the Kohaihai shelter. The previous day the weather got worse and worse on the walk from Perry Saddle to JM but really set in once I was comfortably ensconced in the hut watching groups of gear-heavy mountain-bikers haul their way into the hut and stand there very impolitely dripping over everything discussing for ages whether to continue on or stay the night.

For the past three years between May and September DOC have allowed MTBs on the Heaphy on an experimental basis and will in coming months review the experience based partly upon feedback from those using the track over that time – which includes myself this year and also in late-July last year. Having walked the Heaphy Track at least five times now I feel in a good position to offer some comments, so to anyone from DOC reading this please pass on to those doing the assessment.

First, while although along the track there are some locations with reasonable mud and lots of tyre tracks in them, I do not attribute the track condition to the bikes as the mud was there before and used to show boot prints instead. I noticed no obvious MTB damage to the track.

Second, last year I met only about five bikers so formed no assessment but this year met maybe 20 and can say they were all polite on the track. When approaching from behind one can usually hear them as they change gears and talk to each other thus allowing lots of time to get out of the way which is no problem as a micro-rest is always useful. When approaching (including from the front) the lead person would often shout out the number in the group in total – which is useful.

Third, their presence is good for the West Coast and Golden Bay economies as they use the track during the walking off-season of winter. The locals in Karamea are very happy with their presence.

Fourth, while their track etiquette is in my opinion good, their hut etiquette is poor. By and large the bikers are not trampers and they do not know hut rules. They are over-whelmingly male, young, and with more money than sense when it comes to their bikes and their gear of which they seem to wear untold. That means that when they bowl into a hut dripping wet they put water everywhere and take ages doing it as they remove their various layers. A tramper by contrast simply sheds the boots and parka and that is that largely apart from changing wet (not dripping) inner gear for dry clothing. Most huts will not have the number of drying racks needed to handle the volume of clothing the bikers shed. Message to DOC – in the new huts you need pegs to hang really wet gear in the entry airlocks. Also include some hut etiquette suggestions when the bikers book their trip.

Overall I support continuing the May to September season as few trampers have their walking experience disrupted by the bikers in that period, the hut upgrades might not happen without the bikers, and the track is being upgraded which will allow more walkers over time. One would definitely not want to extend the biking season out of May to September.

As for things other than MTBs on the track this year, if you are going to walk the Heaphy then allow for three or four nights (I did it in two but that's just me and I'd not recommend it for others), and save your casual wombling time partly for the Gouland Downs but mainly the section between Lewis Hut and Heaphy Hut which is my favourite. It is flat, there are Nikau palms everywhere, beautiful huge trees teeming with epiphytes, great limestone outcrops, lots of birds, the river to the side, more warmth than at higher elevations, and many sheltered places where one can spend hours contemplating the universe and one's navel if that is your thing. It's not mine.

I always stay a night at The Last Resort in Karamea when I emerge from the bush. The coffee is great (they have three baristas available), and one can spend a lovely few hours as I did on the Saturday sitting by the fire chatting with the locals and visitors (from Costa Rica this time). If doing more than tramping or MTBing is your thing then there are some fantastic caves to explore near Karamea (Oparara). I also got to spend some time in Westport and the coffee there was also excellent. Try the Denniston Dog café and restaurant. When travelling to the Heaphy Track start I usually use the excellent services of TrekExpress. www.trekexpress.co.nz