Weekly Overview

ISSN 2253-3672

28 November 2013

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

Last Confidence Survey For 2013

This week we are running our regularly BNZ Confidence Survey so if you have not already responded using the link in the email sent out a couple of days ago please feel free to click here and let us know how you are seeing things out there. Results will be released on Monday.

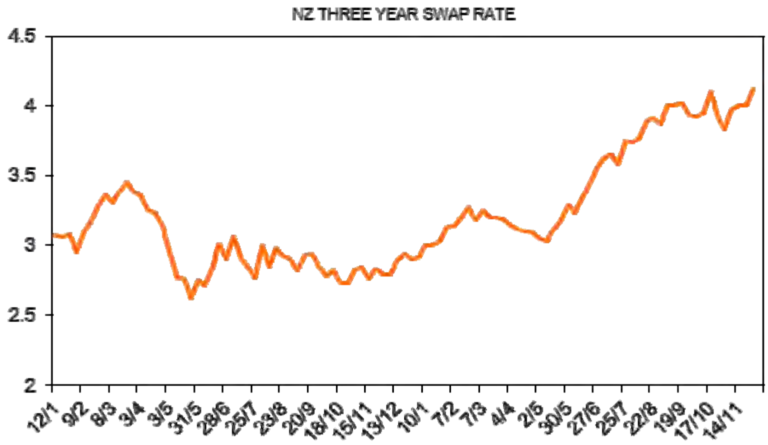
http://feedback.bnz.co.nz/surveys/Fi8Go-yFGEu0bwjPu5Waww

Would you like an insight into why growth in retail spending has been fairly weak these past few years but why we think things are improving? Take a look at the graph below. Using data from the NZ Income Survey which captures average weekly incomes for all people aged 15 and over as at June each year it shows total inflation-adjusted incomes rising 3.1% this past year. This followed growth of 2.6% in the year to June 2012, a 2.4% fall before that and 1.3% rise before that.

Growth in real incomes across all people aged 15 and over is at its best pace since 2007 and that, coupled with high levels of consumer confidence, a clearly improving labour market, and rising house prices in some areas means retailers can feel reasonably justified in expecting better sales next year than this year.

IF I WERE A BORROWER WHAT WOULD I DO?

Wholesale interest rates have moved up this week in response to a general lift in expectations of the Reserve Bank tightening monetary policy next year. The three year swap rate is now near 4.1% which is the highest rate since February 2012 and 1% higher than levels six months ago in May. Margins between swap rates and bank fixed housing rates are however a lot less than back then, so although strong competition for business is keeping those lending rates down, one suspects we can't be far off from a round of rate increases going through the market.



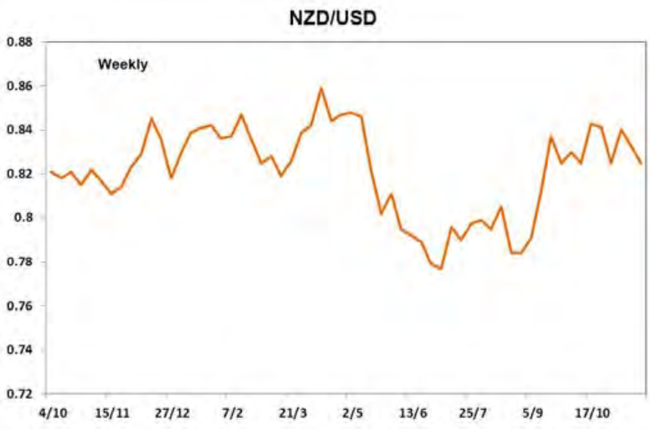
Given the considerable uncertainty regarding how quickly interest rates will rise over the next three years, it I were a borrower I would be inclined to have a mix of floating, short-term (out to two years), and medium term (3-4 years) rates simply to spread my risk.

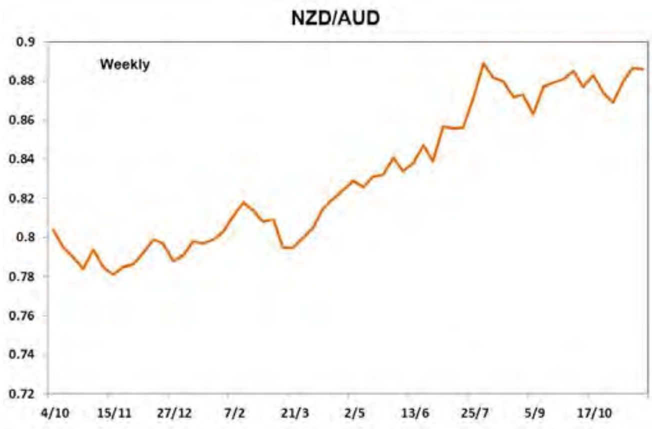
FINANCIAL MARKETS DATA	This week	Week ago	4 wks ago	3 months ago	Yr ago	10 yr average
Official Cash Rate	2.50%	2.50	2.50	2.50	2.50	4.9
90-day bank bill	2.69%	2.69	2.68	2.67	2.76	5.2
1 year swap	3.22%	3.14	3.02	2.93	2.69	5.3
3 year swap	4.11%	4.00	3.83	3.87	2.79	5.5
5 year swap	4.58%	4.52	4.32	4.39	3.11	5.7
7 year swap	4.91%	4.85	4.63	4.71	3.43	

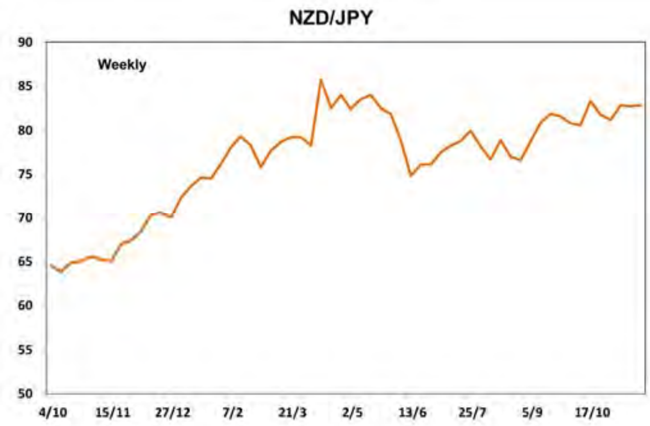
NZD Little Changed

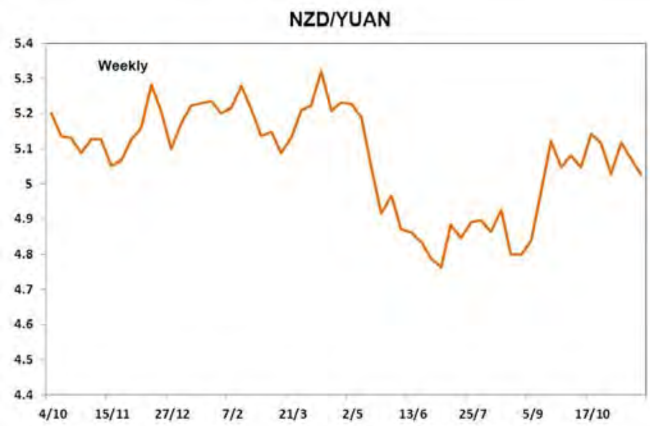
The NZD has generally been suppressed this week against the major currencies on the back of a falling AUD pushed lower by frequent talk from the RBA regarding the desirability of a lower AUD. Against the AUD the NZD has almost risen to 90 cents. The markets are oscillating from expecting RBA intervention to not expecting it so we should expect volatility in the NZD/AUD exchange rate to continue.

Exchange Rates	This Week	Week ago	4 wks ago	3 Mths ago	Yr ago	10 yr Average
NZD/USD	0.813	0.825	0.828	0.779	0.82	0.72
NZD/AUD	0.896	0.886	0.864	0.867	0.784	0.84
NZD/JPY	83	82.8	80.6	75.6	67.4	71.4
NZD/GBP	0.5	0.512	0.512	0.502	0.512	0.42
NZD/EUR	0.599	0.614	0.599	0.582	0.634	0.54
NZDCNY	4.95	5.03	5.04	4.77	5.11	5.14
USD/JPY	102.09	100.36	97.34	97.05	82.20	99
GBP/USD	1.63	1.61	1.62	1.55	1.60	1.72
EUR/USD	1.36	1.34	1.38	1.34	1.29	1.33
AUD/USD	0.91	0.93	0.96	0.90	1.05	0.87
USD/RMB	6.0929	6.0932	6.0836	6.1213	6.2268	7.17









Eurozone

There was some mild downward pressure on the Euro this week following comments from some ECB board members along the lines of scope existing for further cuts in interest rates if conditions should warrant it. But this weakness was offset by a rise in a business sentiment gauge in Germany to an 18 month high. That may be – but this will only exacerbate the rising discord in Europe regarding how well Germany is doing and how its growth is based upon surging exports while domestic consumers who could greatly boost sales of other countries continue to exercise restraint in their spending.

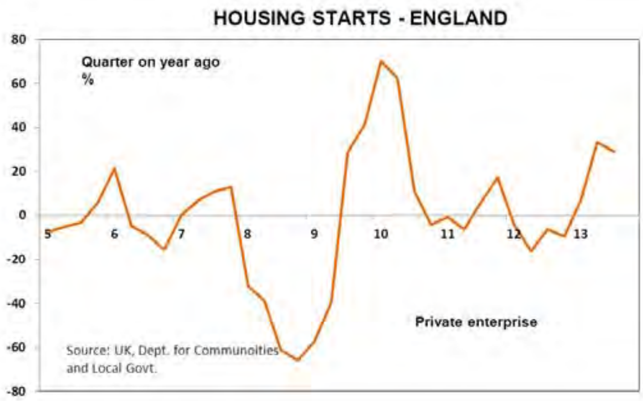
United Kingdom

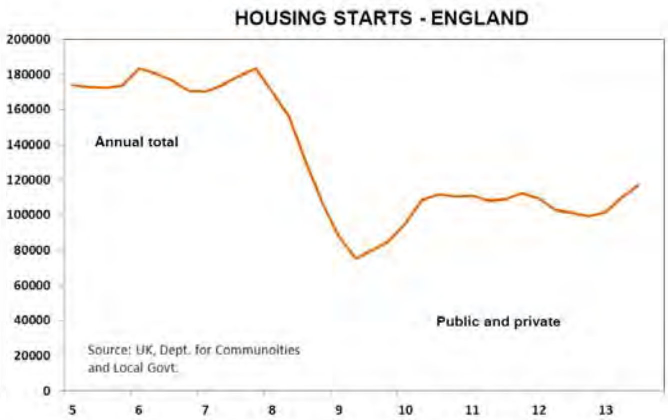
The release of BOE Monetary Policy Committee meeting minutes a week ago shows that the markets have probably got ahead of themselves in expecting monetary policy tightening as early as the end of next year.

The minutes show that the committee is not of the view that a fall in the unemployment rate to 7% necessarily means that rate rises will commence. The BOE therefore, like the Federal Reserve and other central banks is wanting to avoid sending signals or allowing the markets to build up expectations of cash rate rises in order that important long-term borrowing costs remain low for an extended period of time. How long? As long as inflation remains in check central banks probably won't raise rates until business investment is growing with a good head of steam.

That is certainly something one can reasonably expect to happen at some stage as the corporate sectors in major economies generally have large cash surpluses. But investing requires confidence and that degree of confidence and willingness to act on it is not yet there. No model tells us when it will return. Hence the uncertainty regarding the sustainability of economic upturns underway in the United States and the UK, and therefore uncertainty regarding when interest rates start rising.

There was some good news released on Friday in the form of private enterprise housing starts in England for the September quarter coming in 29% ahead of a year earlier. The "Help to Buy" house subsidy scheme and "Funding for Lending" bank financing scheme are driving a surge in housing turnover, prices, and now building. Builders started work on 28,500 homes in the quarter which is the highest quarterly total since late-2007.





China

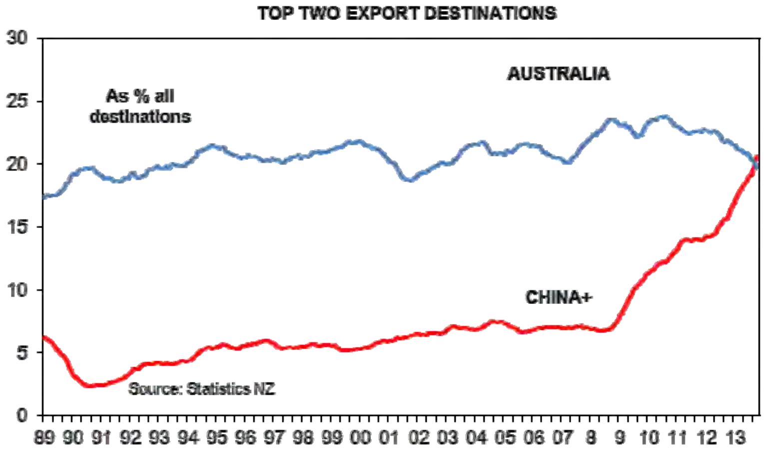
China this week upped the stakes in its territorial dispute with Japan over unoccupied islands south-west of Japan known as the Senkaku/Diaoyu Islands, by declaring effective ownership of airspace above the islands as part of a wider, newly-created East China Sea Air defence identification zone.

Japan and China are not on friendly terms and it is possible that at some stage there will be another military confrontation between the two powerful nations driven by China's desire to assert what it sees as it's maritime claims and attempt to regain its international mana following "one hundred years of humiliation", and Japan's desire not to be swamped by its traditional competitor for dominance in the area. We will be caught up in the conflict probably not in any military sense beyond traditional provision of intelligence services to the United States who via a treaty will be obliged to assist Japan if asked – something which they have reiterated in the past few days. But with 44% of our merchandise exports going to Asia excluding Australia we would take quite a hit from disruption to shipping channels. In addition 21% of our visitors come from Asia and one imagines willingness to travel would be impeded by a military conflict so that would be another route by which our economy would be hit – along with reduced levels of consumer and business confidence plus reduced growth in Australia which has far greater links with Asia than we do.

Exporters should keep in mind the steadily deteriorating relations between Japan and China as they contemplate their ventures into Asia.

One of the factors contributing to a slowing in the trend rate of growth of China's economy is rising wages and other costs encouraging manufacturers to locate new facilities elsewhere in the world and to shift some existing facilities elsewhere, sometimes back to their home country. A study by the UK government's Manufacturing Advisory Service of 500 SMEs has found that 15% are reshoring (or onshoring) production, up from 4% last year. 26% of companies cited cost, 20% quality, and 18% lead times.

The NZ merchandise trade data were released this week and they show that in October we exported $1.1bn worth of goods to China+ (China plus Hong Kong SAR), which was a rise of 117.3% from a year ago whereas exports to all other countries were up just 6.3%. Exports to China+ have grown by 33.1% in the past 12 month period versus a 5% fall in exports to all other countries. China+ is now officially our largest export destination taking 20.7% of all goods by value compared with 15.7% a year ago and just 7% five years ago. China+ has just passed Australia which now supplies 19.7% of our receipts from 21.9% a year ago and 23.6% five years ago. Can you guess which foreign country now has the greatest influence over NZ policy settings and perhaps why the government has chosen not to impose restrictions on foreign purchases of NZ houses?

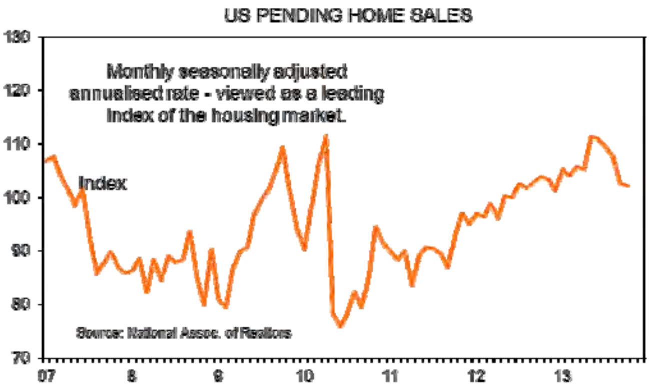


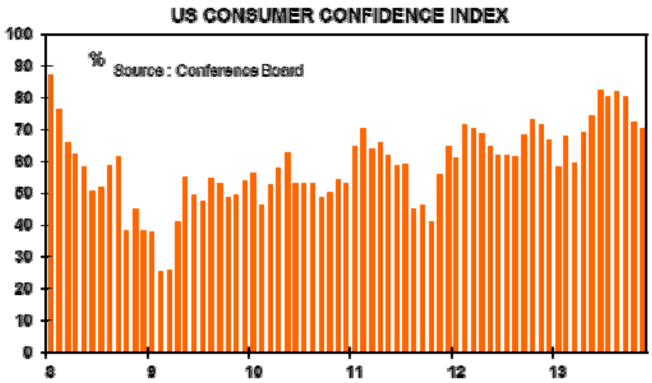
NZ meat exports to China+ in the past year have risen by 118%, dairy exports have risen 48%, and wood 59%.

United States

The US economy is improving but the economic data keep coming in on the good side then the disappointing side, then good again. That means high confusion reigns regarding how strong next year will be, when the Federal Reserve will start cutting back on money printing, where interest rates will go and so on. This week provided a collection of data which were, frankly, all over the place. To whit…

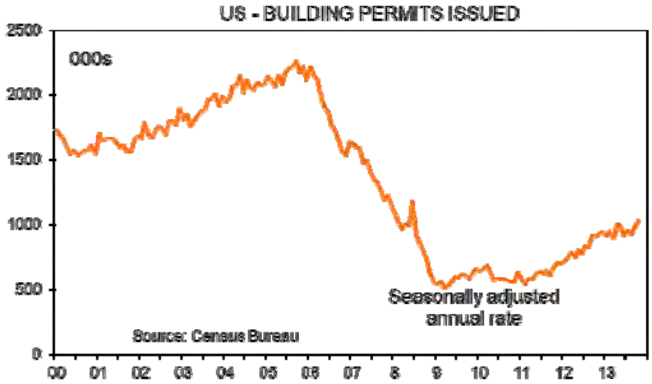
The number of contracts signed for the purchase of existing homes unexpectedly fell by 0.6% in October following a 4.6% fall in September. Sales were 1.6% lower than a year earlier and this is an interesting development.

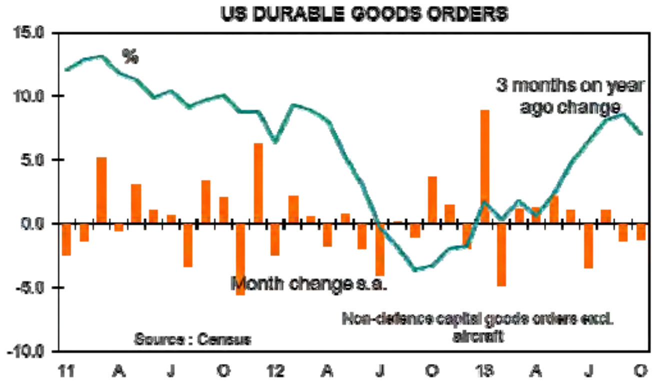




This indicator of the housing market is following others showing that perhaps in response to a 1% rise in mortgage interest rates the rise in the US housing market which commenced in 2010 is petering out. If so this decreases the chances that the Federal Reserve will begin their money printing tapering exercise soon – or means they will try to find some innovative way to push long-term interest rates down even as they ease up on the printing.

Adding to the cautionary signal delivered by house sales statistics was the monthly Conference Board consumer sentiment measure which fell to a lower than expected 70.4 in November from 72.4 in October and a recent peak of 82.1 in June. Reduced confidence implies reduced growth in household spending. But the University of Michigan measure jumped in the month to 75.1 from 73.2 last month. But at least house construction is continuing to rise with the number of permits issued in October up 6.2% s.a. from September and 13.9% ahead of a year ago. The trend in construction is upward at a fairly steady pace we can see from the graph.





Then last night we learnt that orders placed for durable goods fell by 2% in October, or by 1.2% excluding the defence sector and aircraft. Were businesses confident about the future then orders for long-lasting goods would be rising.

In the first two rounds of QE the Fed. printed just over $2tn and QE3 so far has added about $1tn. But since QE3 started in September last year only $80bn of the printed money has ended up in circulation. Bank reserves with the Fed in contrast have risen by about $800bn. In fact those reserves now total near $2.5tn compared with about $4bn before the money printing started in earnest. Note trillion, billion.

Japan

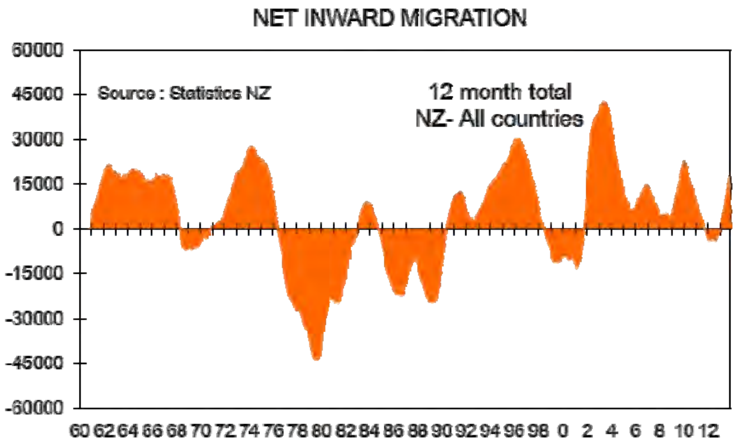
The Yen weakened slightly this week assisted by a comment from the Bank of Japan Governor that the Yen was not weak. Of greater importance was the government announcement that come 2019 the current subsidy system for Japan's 1.2 million rice farms run on average by 70 year old pensioners with 70% tending less than one hectare would end. Payments will half in 2014 then end completely five years later. This is an important development because the traditional strength of the rural constituency has produced an agricultural system unable to compete against imports for which tariffs are applied at rates such as 778% for rice, 328% for sugar, and 38.5% for beef. The reform will help smooth the path for Japan to officially sign-up to the Trans-Pacific Partnership trade agreement currently under negotiation.

Housing Market Update

Demand For Housing Rising

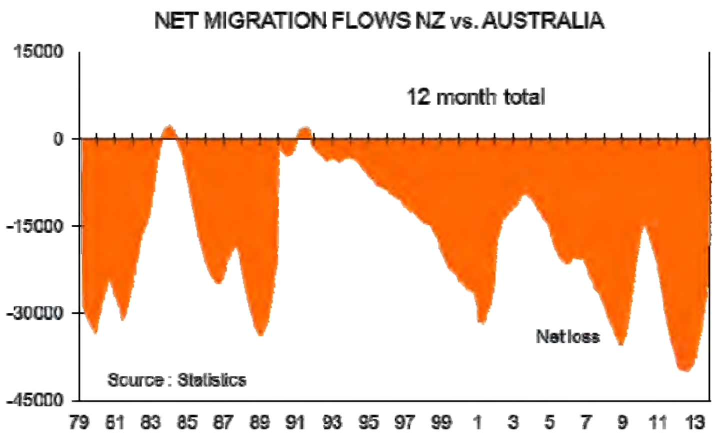
Population growth obviously has a big influence on the housing market and courtesy of rapidly changing migration flows NZ population growth is accelerating. In the month of October, seasonally adjusted, there was a net migration gain to our country of 3,000. This was the highest such monthly gain since just over ten years ago. The annual net migration gain now stands at 17,490 compared with a loss of 2,319 people a year ago.

The turnaround of almost 20,000 people largely reflects a near 16,000 change in the net loss to Australia to 23,513 from 39,330 a year ago. The net gain from China has barely budged at 5,929 from 5,599 a year ago, and the net UK flow is also up only marginally at 5,927 from 5,689. In fact no country other than Australia stands out as having made a big contribution to the annual migration flow change in the past year.



The change with Australia reflects 11,665 fewer people heading there and a rise of 4,152 in the number coming here.

Will this big change keep going? Yes. Our unemployment rate is falling while Australia's is rising. If one annualises the last three months of seasonally adjusted migration gains then the current annual speed of gain is near 32,000 across all source and destination countries. It seems reasonable to assume that the net gain will go to near that level within a few months.



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 – 3.0	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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