Weekly Overview

6 March 2014

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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.

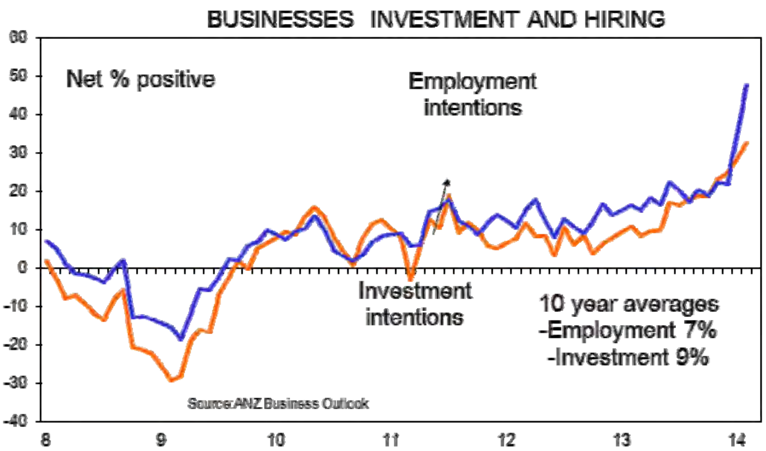
To receive the Weekly Overview each Thursday night please click here.
http://feedback.bnz.co.nz/forms/lFdYSs5FGEq4kAjP95uzTA

2014 Themes

- Interest rates will rise
- The NZD will remain highish
- The labour market will tighten, pushing employment costs up.
- House prices will rise with gains spreading out of ChCh and Auckland.
- Construction will boom
- World growth will improve with unprecedented uncertainty regarding monetary policies.
- Business capital spending will grow
- Household spending growth will accelerate.

Powering Ahead

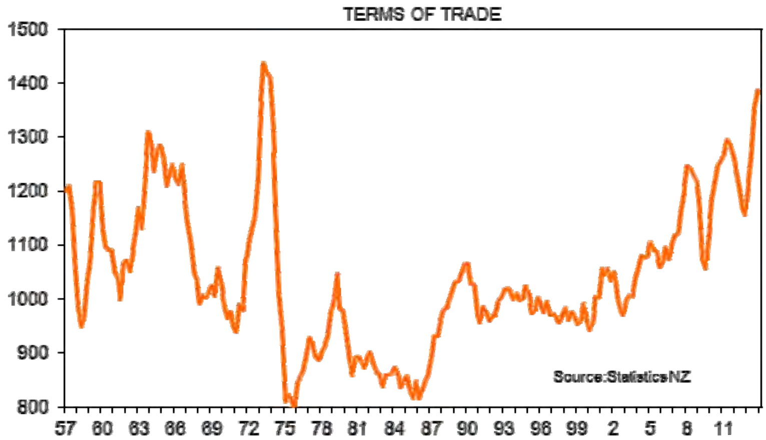
Business confidence continues to go up – which is fairly much what I discovered from a decent amount of travelling around the country last week and the week before. Businesspeople are thinking about putting investment plans into action and discussing options more freely with their bankers and backers. The ANZ Business Outlook survey this week showed their sentiment measure jumping to a net 71% optimistic in February from 64% in December and 39% a year ago. The net percent of businesses planning to boost spending on machinery and equipment rose to 48% in February from 22% in December and 16% a year ago. The ten year average reading is a net 9% positive so the latest reading is huge.



The net percent of businesses expecting to boost their payrolls soared to 32% from 25% in December where the ten year average is 7%. The net percent expecting their profits to go up rose to a 20 year high of 45% from 40% in December, 14% a year ago, and an average of just 1%.

All these readings are strongly supportive of growth taking off in New Zealand and the question we ask then is how long can the economy sustain strong demand growth before resource shortages and enhanced pricing power cause inflation to threaten 3%? The survey shows that the net percent of business planning to raise their selling prices continued a firm track upward in February with a reading of 33% from 31% in December and 18% a year ago. The average is 21%. That means that soon we will all be getting slugged with more than just price rises being foisted on us by companies in oligopolistic industries (supermarkets, building materials, electricity retailers and councils). New Zealand is an expensive country to live in, even compared with Australia, and that is another reason for employers not to think that the sudden drop in the net loss of Kiwis across the ditch will be a permanent thing.

One obvious reason for the increasingly booming economic conditions is soaring export prices which on average rose by 13.8% last year. With import prices falling 5% this means our merchandise terms of trade leapt 20% to sit at the highest level since December quarter 1973. If the index rises just another 3.5% it will be at its highest level since 1861! This is quite astounding. Our graphical data series only goes back to 1957.



Key offshore debates

United States – Growth lifting to 2.8% from 1.9% in 2013 but could interest rates jump as tapering proceeds?
China – Impact of non-performing loans following the 2009+ credit boom, ability to switch from export and fixed asset investment as growth-driving forces toward consumption, impact of loosening controls on outward capital flows.
Australia – ability of strengthening retailing and housing to offset the resource sector investment decline plus vulnerability to China shocks.
United Kingdom – Construction is picking up along with manufacturing, but worries exist regarding the 2017 referendum on EU membership, and the risk of premature policy tightening by the BOE.
Japan – Tension with China is growing as Japan breaks away from its post WW2 accepted pacifist shackles to confront its traditional regional competitor. Conflict appears probable with potentially severe economic consequences.
Eurozone – growth is picking up but will it be strong enough over the cycle to seriously dent entrenched unemployment, especially of youth? If not will the resulting social deterioration foster more radicalism?

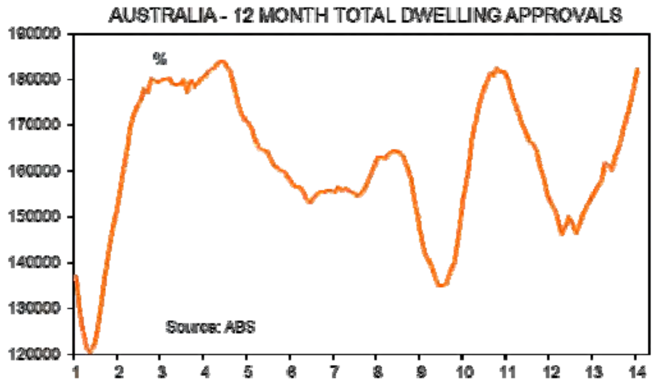
In the **United States** on Thursday night the new Federal Reserve Chairman Janet Yellen made a comment regarding uncertainty as to how much of the recent data weakness was due to bad weather and how much to soft underlying activity. That comment implying there may be new fundamental weakness has added to market caution regarding the true strength in US growth and contributed to falls in the greenback, US shares, and bond yields this week.

The monthly durable goods data which is looked to as a gauge of business investment was reasonably good. But December quarter annualised growth was revised down to just 2.4% from the initial estimate of 3.2%.

The **Australian** Bureau of Statistics runs a survey each month asking people in the business sector what their plans are for investment in the coming year. The survey for this quarter released last Thursday was very weak with investment spending planned to be cut by more than 20%. The decline is the biggest in 20 years and includes a 20% planned cut in manufacturing sector investment and 25% in mining. This reduction in fixed asset investment is one of the key factors causing Australia's growth rate to slow, the unemployment rate to rise, and encouraging the RBA to cut interest rates to just 2.5%. Australia is pulling back from a period when mining investment accounted for 8% of GDP to the long-run average of 2%. Manufacturing is suffering from the previously high AUD plus years of increasing rigidity and soaring costs of employing staff.

The car assembly industry will be gone come 2017 due to rising costs and the unwillingness (finally) of Federal government to keep subsidising businesses so they can keep paying ridiculous wages and conditions to heavily unionised staff. Qantas has just announced 5,000 staff will be laid off as competition from other airline operators increases with assistance from some big capital injections which Qantas has not had access to because of restrictions on foreign ownership – which the Federal government is now seeking to overturn.

But while the underlying rate of growth in Australia is slowing there are strong indications that the cuts in interest rates and decline in the AUD are producing payoffs. The number of approvals for new dwellings to be built rose by a firm 6.8% in January to be 34.6% ahead of a year ago. There is a firm lift in house building underway which NZ builders seeking staff should keep an eye on as it means there may not be the flood of tradespeople back to NZ which they are hoping for.



Business investment is showing some very welcome signs of growth in the **United Kingdom**. Revisions to data show that business investment rose by 2.4% during the December quarter to lie 8.5% ahead of a year earlier. Such spending on capital however is still 20% below its previous peak.

IF I WERE A BORROWER WHAT WOULD I DO?

Nothing new to report here. This coming Thursday morning however the Reserve Bank will review their official cash rate and the strong expectation of us all is that they will start to take away the extraordinarily low rate of 2.5% put in place to combat the global financial crisis and its lingering after-effects. We expect a rise in the cash rate of 0.25% and that come the end of 2015 the rate will be 4.5%.

But it pays to remember two vitally important things as you contemplate whether to switch to a fixed rate and when to do it. First, every policy tightening period is a suck-it-and-see exercise. You never know for certain how borrowers, savers, businesses, and the exchange rate will react to rising interest rates. Last time the RB started raising rates just over a decade ago the common view was that the cash rate would rise from 5% to 6.25%. I picked 7.25%. The actual peak was 8.25%.

The second important point to note about this rate tightening period is this. As we have been pointing out since 2009, no-one has an economic model which tells us how economies move after almost falling into a new Great Depression. The old economic models have proved completely inadequate at forecasting how growth would proceed over the past four years and there is no reason for believing that predictability of things is now better than it was four years ago. In other words, this rate tightening period is the most uncertain you will have ever seen.

As we have been saying for the past 3 – 4 years now, you should not be developing an interest rate risk management strategy on the basis of any particular set of interest rate forecasts. They will almost certainly be wrong and all have been since 2007 fairly much. You need instead to consider your risk tolerance, your ability to cut debt and costs should rates rise tremendously, and your intellectual ability to understand what is happening in the macroeconomic environment in which you operate.

Seek a spread of floating and fixed interest rates, watch your debt levels, and sit back and watch as a whole new cohort of borrowers unfamiliar with the role of the Reserve Bank and what it is capable of stamp their feet and wail in indignation and incomprehension once rate rises really get cranking.

Personally speaking, were I a borrower I would shift much though not all of my home mortgage to a three year fixed rate of 6.35%. Shorter rates are cheaper but give little protection. I would like to fix longer but 7.2% for a five year rate is too big a jump currently.

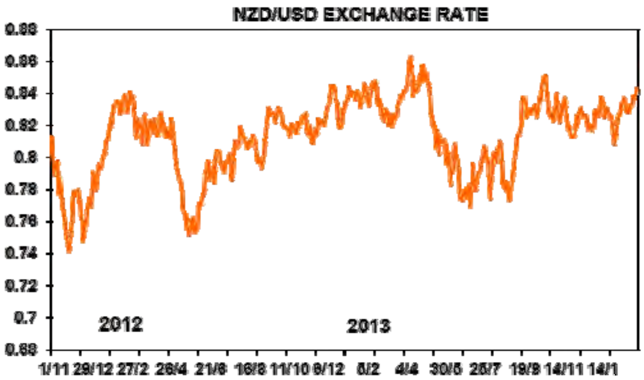
FINANCIAL MARKETS DATA	This week	Week ago	4 wks ago	3 months ago	Yr ago	10 yr average
Official Cash Rate	2.50%	2.50	2.50	2.50	2.50	4.9
90-day bank bill	3.03%	2.98	2.89	2.70	2.70	5.2
1 year swap	3.55%	3.52	3.52	3.22	2.81	5.3
3 year swap	4.17%	4.17	4.21	4.11	3.18	5.5
5 year swap	4.54%	4.56	4.61	4.58	3.52	5.7
7 year swap	4.81%	4.85	4.88	4.91	3.76	5.8

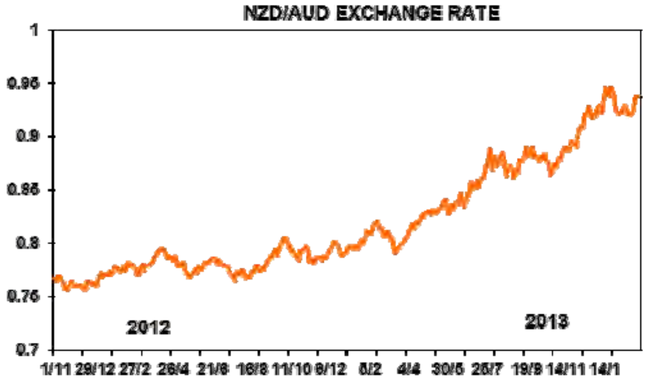
NZD Up

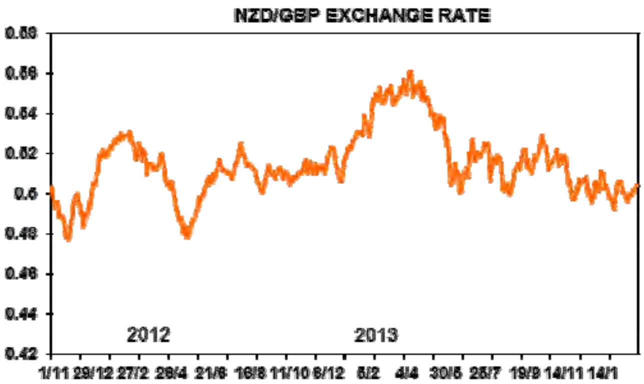
One might have thought that the uncertainty surrounding Russia's invasion of Ukraine would generate huge weakness in global financial markets. But barring a one day sell-off such has not been the case so the NZD has not fallen sharply during the week on the back of a large scale movement away from volatile assets. In fact we end the week up against the USD over 84 cents from 83.2 cents even though dairy prices fell 4% at the fortnightly auction.

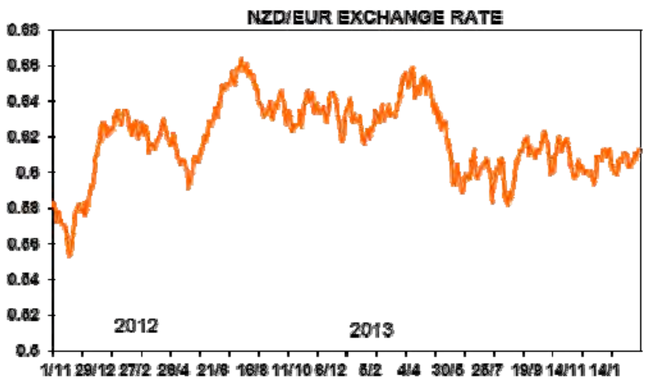
NZ looks to be in very good shape compared with other economies where uncertainty persists about the true underlying strength of the recovery in the United States, Japan, Europe, and to a lesser extent the UK. Confusion also exists regarding the immediate pace of growth in China's economy with some data coming in weaker than expected (not exports though), but the PBOC facilitating some unusual weakness in the Yuan for reasons unclear.

For that reason risks for the NZD continue to lie on the upside – though there is event risk surrounding the RB's review of the NZ official cash rate come next Thursday morning. If the RB fails to meet expectations and raise the cash rate the NZD will likely decline a cent or so. If they tighten but fail to make any particularly strong comment warning about the effects of a higher NZD then the NZD will climb.









Exchange Rates	This Week	Week ago	4 wks ago	3 Mths ago	Yr ago	10 yr Average
NZD/USD	0.842	0.832	0.821	0.821	0.83	0.726
NZD/AUD	0.933	0.931	0.922	0.906	0.811	0.839
NZD/JPY	86.2	85.2	83.2	83.5	77.5	72
NZD/GBP	0.503	0.499	0.504	0.503	0.549	0.423
NZD/EUR	0.613	0.608	0.607	0.601	0.637	0.545
NZDCNY	5.16	5.10	4.98	5.00	5.16	5.1
USD/JPY	102.38	102.40	101.34	101.71	93.37	99.3
GBP/USD	1.67	1.67	1.63	1.63	1.51	1.72
EUR/USD	1.37	1.37	1.35	1.37	1.30	1.33
AUD/USD	0.90	0.89	0.89	0.91	1.02	0.87
USD/RMB	6.1286	6.1244	6.0602	6.0917	6.2211	7.15

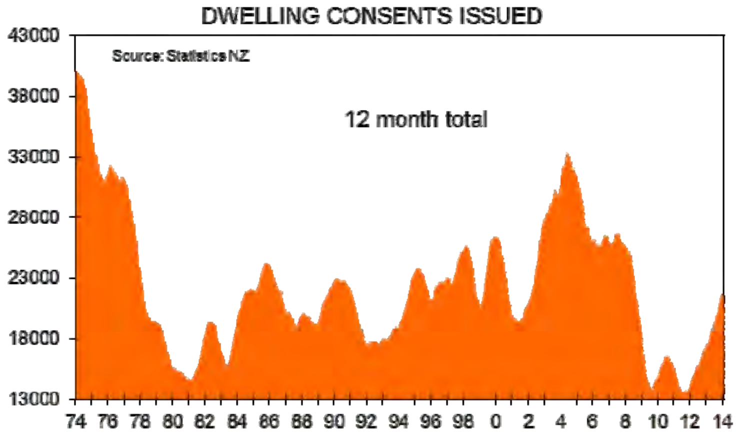
For more detailed FX analysis including the ‘BNZ Markets Outlook”, “BNZ Strategist” “BNZ Commodities Wrap” and lots more go here. https://research.bnz.co.nz/Research/NewZealand/Pages/NZpublications.aspx

Housing Market Update

Additional analysis and commentary are available fortnightly in the NZ Property Press and monthly in the NZ Property Investor magazine.

Construction Rising

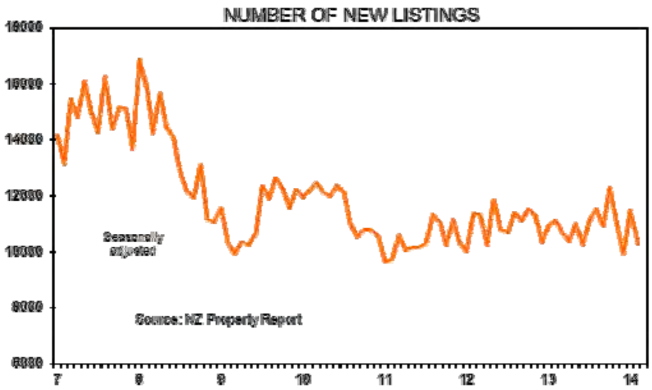
In January there were 1,640 consents issued for the construction of new houses around New Zealand. This means that in the past year numbers have risen by a strong 26% to sit just above the ten year average of about 21,000, with Auckland ahead 33% and Canterbury 46% while the remainder of NZ has advanced just 12%. That makes sense given that the housing shortages exist in Auckland and Christchurch – and will continue to do so for a great number of years given labour shortages and ever-rising costs.

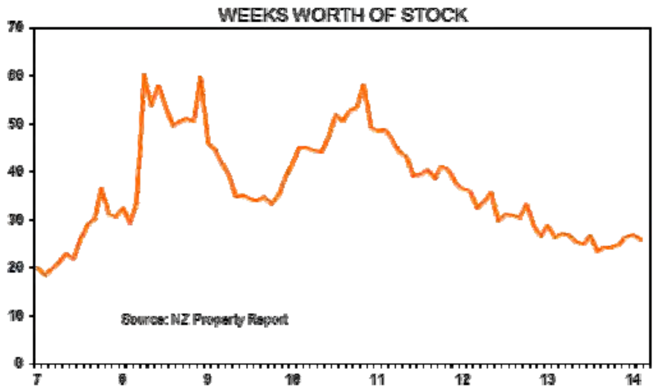


Although consent numbers fell in seasonally adjusted terms by 8.3% in the month this series can be volatile and if we extract the hugely changeable apartments category the monthly change was a fall of just 1.1% following a 10% rise in December. The trends are upward.

Listings Falling

The NZ Property Report which presents data from the website www.realestate.co.nz showed that at the end of February the number of properties listed for sale was 7.3% down from a year earlier and 17% below stock in February 2012. New listings received during the month were down 7.4% from a year earlier and 10% below those received in February 2012. Thus the data show listings availability deteriorating in February. The average asking price was ahead 8.9% from a year ago.

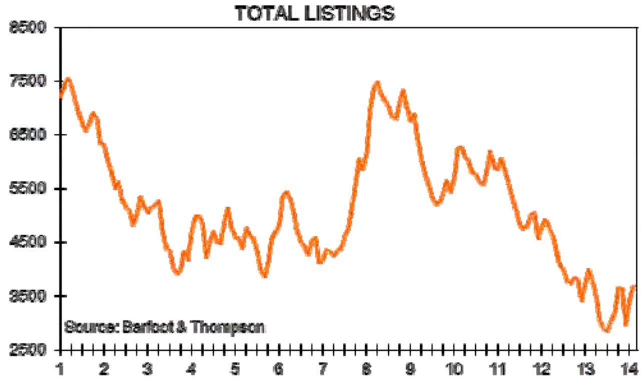




Auckland Slowing

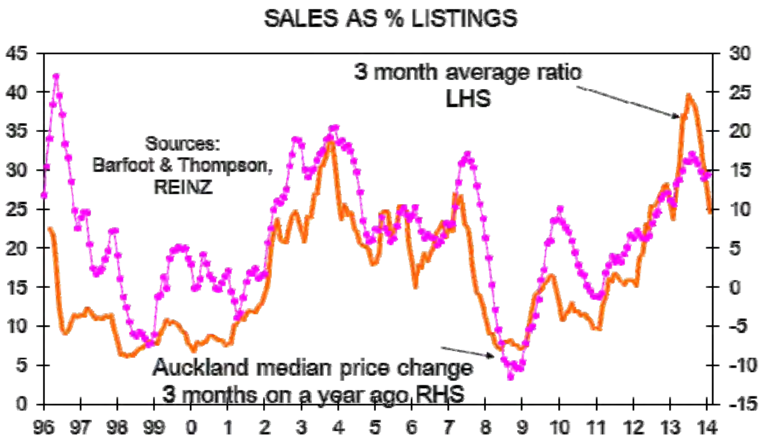
Monthly data from Barfoot and Thompson who account for around one-third of residential turnover in Auckland show that their sales in February were down 13.6% from a year ago and off about 15% in seasonally adjusted terms from January. February therefore was a quite weak month for turnover. New listings received during the month amounted to 1,664 which was 5% fewer than a year ago whereas the January new listings were almost 15% down from a year earlier.

But the listings annual comparisons can go all over the place and it is often hard to decipher exactly what is going on. If we look at the total stock at the end of the month we get a slightly more stable picture with listings at 3,674 sitting 7.9% down from a year ago.



I take as my interpretation that a downward trend in listings has stopped – best summed up as the second graph. What does this mean for prices? In February the average sales price was a strong 12.3% ahead of a year earlier at $678,000. This is the strongest annual pace of change since September. One might think that price rises are slowing by noting that in the three months to February average prices were just 1% ahead of the three months to November. Three months earlier the quarterly change was a stronger 2.7%. But last year these respective changes were -0.2% and +3.4%. Two years ago they were -1.8% and +5.4%. Three years ago -2% and +2.1%. The latest 1% change is quite firm by standards of the past three years.

But will price growth slow down? In all probability yes because that is what is implied by one of my favourite graphs which compares with sales to listings ratio with price changes.



I conclude that listings numbers have stabilised, turnover has fallen 10% - 15% since the LVR rules became effective at the start of October, and price growth is starting to slow down as one would expect. Will it stall? That is very unlikely given the continuing shortage and accelerating population growth. However we approach a period of rising interest rates which will have an impact – we just don't know how much and how quickly, and in particular we don't know in the context of a lot of the economy's upturn this cycle being driven by factors not really sensitive to interest rates – dairy boom, Christchurch rebuild, infrastructure, and Auckland catch-up house building.

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