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.

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

No New Trends

This is a short week without too much in the way of new information on the state of the NZ economy, so I've not written much for this week's Overview. Note the link however in the email you will have received this week where we are updating our emailing list. Be sure to click on the link provided at least once in the next four weeks to ensure you will receive the Weekly Overview from the end of May.

This week we have seen the Reserve Bank raise the official cash rate 0.25% again as expected so we savers can expect our term deposit rates to soon go higher while you borrowers will face higher costs as the RB attempts to slow the pace of growth in order to stop inflation settling too far away from 2%. The job of the RB will be made slightly easier by the strong NZD which has risen slightly this past week though has failed to move outside of recent trading ranges.

But the RB's job will be made slightly harder by booming net immigration courtesy of Kiwis having the good sense to ease off on their shifting to Australia for a while as the Aussie economy undergoes a period of slight, though not aggressive, weakness. In a few weeks time the Federal Treasurer will release a Budget which is expected to slash spending in a whole range of areas including industry assistance, while cutting back on welfarism which naturally built up during the term in power of the ALP. His comments about the Australian economy are likely to be slightly cautionary given that conditions in China, which takes about 35% of Australia's exports, are turning slowly for the worse with regards to exports, manufacturing, and residential construction.

Just for your guide in case anyone notices, I am experimenting once again with preparing the Overview completely on an iPad. The quirks are numerous but so far so good. Fewer graphs will be one outcome. Less weight in my bag will be the main benefit. If anyone knows how to make the two tables below flow with the text please let me know.

Plus one more thing. How hard is it to get a new house built in Christchurch at the moment? I would welcome some insight from a personal point of view.
tony.alexander@bnz.co.nz

IF I WERE A BORROWER WHAT WOULD I DO?

The Reserve Bank fully met expectations this morning by following it's March 13 increase in the official cash rate with another 0.25% rise. The rate now sits at 3% on its way to perhaps 3.75% come the end of this year and something near 5% come the end of 2015. However there is considerable uncertainty surrounding the end-point of this rate rise period and how quickly we will get there given lack of data providing us insight into how newly sensitive people are to interest rates following the global financial crisis. So this is a suck it and see exercise and people should not be at all surprised if we see some big shifts in market expectations for what our interest rates will do over the next couple of years.

That uncertainty tells us clearly that there is value in establishing a mix of fixed and floating rate debt exposure. If you have some debt at floating rates and we all prove hugely sensitive to rates going up then they will not go far and you will benefit from that portion of your debt at least. If you have some debt at fixed rates of at least three years duration then should we do what we have done in the past and largely ignore the Reserve Bank for the first couple of years of rate rises then you will have some insulation against the heights which floating rates will go to.

	OCR	90 day bb	1 year swap	2 year	3 year	4 year	5 year	7 year
This week	3.00	3.33	3.7	4.08	4.33	4.5	4.63	4.82
Last week	2.75	3.28	3.74	4.08	4.35	4.52	4.65	4.86
4 weeks ago	2.75	3.13	3.66	4.06	4.37	4.55	4.7	4.9
3 months ago	2.50	2.94	3.52	3.9	4.19	4.42	4.62	4.93
1 year ago	2.50	2.66	2.78	2.94	3.09	3.24	3.39	3.67

Therefore if I were a borrower at the moment I would seek to place over 60% of my debt at a three year fixed rate.

NZD Still Well Supported

The NZD has moved slightly higher against all the rates we monitor here this week, partly in response to the tightening of monetary policy announced this morning though the move was near universally anticipated. The RB did make mention of the NZD being at an unsustainably high level and that there is a drag on the economy from the restraint which the high NZD is placing on the export sector. However their comments are nothing new, and they cannot realistically back them up with either an interest rate cut or currency intervention, so they mean nothing.

	NZD vs. USD	AUD	JPY	GBP	EUR
This week	0.861	0.927	88.3	0.513	0.623
Last week	0.857	0.914	87.7	0.51	0.62
4 weeks ago	0.867	0.936	88.6	0.521	0.63
3 months ago	0.824	0.946	84.4	0.499	0.602
1 year ago	0.852	0.826	84.4	0.556	0.653

Part of the NZD's gain against the Aussie dollar this week reflects the March quarter inflation number across the ditch being slightly lower than expected. This has caused an easing off in what were building expectations of a rate rise in Australia within the next 12 months.

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

No Bubble - Net Migration Booming

We have no new data to comment on this week but it is worth repeating what so many others have said in response to the bloke saying that the NZ economy is in a bubble and set to collapse. This is the same sort of rubbish some were saying back in 2008 when they were predicting that NZ house prices would fall by 40%. The problem here is that some people are quite lazy in their analysis and simply look at a situation in one country, try to find just one point of similarity in another, then jump immediately to the same conclusion as for the first country.

Those who predicted a collapse in NZ house prices back then were left with egg on their faces when prices on average in fact only fell by 11% at their absolute worst, before recovering quickly to now sit on average 17% above their late-2007 peak.

The situation is different here in NZ now as it was then because we have a shortage of dwellings, bank lending is done to a far higher standard than was the case offshore, our rate of population growth is slightly above average, our construction costs keep rising all the time due to oligopolistic pricing practices and ever-rising building standards, and the pace of growth in lending to the household sector remains low at under 6%.

I have found from working back in NZ as an economist since 1987 that analysts offshore tend to have a surprisingly low understanding of things in NZ such as how our monetary policy functions, factors driving the housing market, the importance of the primary sector to our economy and vulnerability to weather, and relative steadiness of government policies and lack of popular appetite for radical changes.

So will the NZ housing market collapse? As stated last week this scenario is only likely in the event of a foot and mouth outbreak. The Reserve Bank and Treasury prepared a paper in 2002 looking at the impact of a limited FMD outbreak and estimated a cumulative 8% fall in GDP over a two year period with substantial cushioning from assuming a North Island-only outbreak, just 6 week interruption to dairy exports, and the official cash rate being quickly cut by about 5%. And that is where worries develop because with our interest rates already very low the ability of our central bank these days to insulate our economy against a large shock is far more limited than before the GFC.

http://www.rbnz.govt.nz/research_and_publications/research_programme/additional_research/0130346.html

Still, as long as we don't face that scenario the chances of a substantial fall in NZ house prices in the next few years given the underlying shortage in particular is very, very low.

For the moment we are also receiving increasing support for real estate market prices and activity from booming net migration inflows which now stand at 31,914 compared with just 2,542 a year ago and a ten year average of 10,000. In fact annualising the past three monthly seasonally adjusted results we see that the pace of annual gains is running even higher than this near 42,000.