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 – A Quick Summary

- Interest rates will rise

The next rise is likely in three weeks and this past week long term interest rates have crept higher as more borrowers in NZ have been locking in fixed interest rates and data in the United States have been stronger than expected.

- The NZD will remain highish

This week the NZD has eased slightly in response to falls in dairy prices. But with monetary policy tightening and growth accelerating while doubts remain about the underlying strength of recoveries overseas, support for the NZD still looks likely to remain strong.

- The labour market will tighten, pushing employment costs up.

There is as yet zero statistical evidence of wages growth accelerating but the traditional lag between jobs growth accelerating and wages growth rising means higher wages will be getting set right now.

- House prices will rise with gains spreading out of ChCh and Auckland.

The pace of gains appears to have slowed slightly but with employment picking up, the shortage in Auckland still worsening, and population growth accelerating, unless there is a huge negative reaction by investors to rising borrowing costs (unlikely) further price gains remain highly probable.

- Construction will boom

The number of consents for new dwellings to be built has risen by 25% this past year and the value of non-residential consents is ahead by 13%.

- World growth will improve with unprecedented uncertainty regarding monetary policies.

Growth forecasts continue to get revised up for most countries except China, and uncertainty regarding monetary policies can be seen in market swings in response to more hawkish than expected then more dovish than expected comments from the Federal Reserve Chairman.

- Business capital spending will grow

This is clear now not so much in the imports data but in non-residential building consents and investment in plant, machinery and equipment measured in the national accounts.

- Household spending growth will accelerate

There is no shortage of reports such as yesterday's regarding rapidly rising car registrations.

Key offshore debates

United States – Growth is improving and the labour market responding. But lots of people have left the labour force and as tapering morphs into rising interest rates next year will growth remain strong enough to seriously rebuild a society badly shaken by the sub-prime crisis?
China – The data show growth slowing down at the same time as worries grow regarding bank bad debts and corporate bond failures, excess capacity, housing bubbles, and lack of an obvious switch in growth drivers from exports and investment to consumption. The chances of stimulatory moves to keep growth above 7% this year look very high. China faces challenges, but a crunch is almost certainly not at hand and reforms are continuing.
Australia – vulnerable to slowing growth in China and regional tensions and hit by a budget deficit blowout, chooks coming home to roost in an inefficient manufacturing sector, and winding down of a huge resource sector investment boom. But household spending is lifting along with house prices and building. Further monetary policy easing looks decreasingly likely meaning the AUD may be better supported than exporters would like.
United Kingdom – Growth is picking up in manufacturing, construction, and retailing and businesses are showing willingness to invest. The BOE’s next move will likely be a tightening but not this year.
Japan – Prime Minister Abe’s Three Arrows policy involves easier fiscal policy, easier monetary policy, and deregulation. The first two are proceeding, the last not. This implies that the recent lift in growth could be short-lived, especially if households react badly to the consumption tax rise from 5% to 8%. Japan’s trajectory does not look all that good given huge debt, an aging and shrinking population, and mildly resurfacing nationalism.
Eurozone – Voters are shifting to the right as societies bend under the weight of inefficient economies weighed down by high public sector debt, employment, intransigence, and deficits, and now strains with old for Russia are alive again. Growth is improving but prospects do not look bright.

In the **United States** the Federal Reserve Chairman Janet Yellen appeared to pull back from comments made two weeks ago which led the markets to factor in rate rises from the June quarter of next year. Perhaps not wanting to risk sparking a repeat of the 1% hike in long term rates which happened just under a year ago after the previous Chairman waxed lyrical about pulling back on money printing she noted that to many Americans the economy still feels like it is in recession. She also noted that some of the data look that way as well. Yet while her comments were downbeat they have contributed to a rise in share prices on expectations that monetary policy stays easy for a long time and in response to a better than expected employment measure released on Wednesday. The actual March employment report will come out on Friday night NZ time and as usual it has capacity to surprise and to set the tone for financial markets in the short term.

While Ms Yellen's comments applied some downward pressure to interest rates globally there was also pressure from the March inflation number for the **Eurozone** coming in at only 0.5% which was well below expectations of 0.2%. In Spain there is deflation of 0.2%. The result is well away from the ECB's target of 2% and strongly opens the door for further easing of monetary policy. The difficulty however in all of this is that governments throughout Europe will continue to believe that monetary policy changes will be able to take up a lot of the strain of economic adjustments which their economies vitally need. But easy monetary policy can only buy time for underlying changes to be made and if they are not then Europe truly risks slipping into the type of deflationary state which afflicted Japan for almost two decades and which could easily return there given a lack of deep reforms.

Actually, easy monetary policy only "works" in buying time if it extends beyond the ECB to the actions of commercial banks. However with hefty bad debts and a need to raise expensive capital, European banks are choosing to manage their poor balance sheet positions by shrinking them - restricting lending. Without a European version of the US TARP scheme of 2008 which stood ready to recapitalise US banks early in the crisis, hopes of credit flowing again to where it is needed in Europe (messy, time-consuming SMES in particular) will continue to be dashed.

Reflecting the discontent people feel with Europe's situation voters in France delivered 7% support in regional elections for the National Front right wing party. Acknowledging the result and his own popularity ratings which are the lowest for any French President post-WW2 the French President Mr Hollande has appointed a new, more reform minded, anti-immigration Prime Minister. Good luck, he'll need it as French people show no indication of realising that deep, rapid, and painful changes are needed if their economy and society are not to both slip further down their respective ladders. Mr Hollande appears to have acknowledged that reform resistance by immediately following up that PM appointment with the granting of jobs in the new cabinet to a largely left-wing group of senior politicians who will clearly mute the policies which the new PM will put forward.

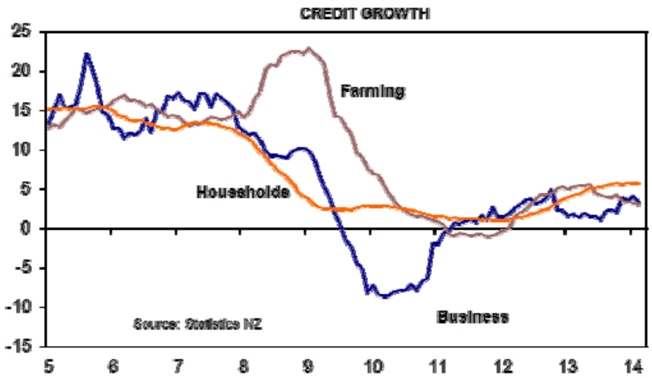
Making economic changes in France will be difficult with the budget deficit coming in at 4.3% of GDP last year and the gross government debt to GDP ratio now at 93% from 86% three years ago. The NZ ratio is below 30%. France's economy will more and more over time resemble Paris - a place with some wonderful inherited edifices from past glory but covered on the ground where people actually live, work and go on strike with dog crap.

In the **United Kingdom** economic activity is picking up as measured by a range of measures and the housing market continues to power ahead with one measure showing London house prices up 18% from a year ago and gains spreading out in fits and starts to the rest of the country. This is like the NZ situation where gains in Auckland, while less than in London, will affect markets in the rest of the country.

In **Japan** the consumption tax has just gone up from 5% to 8% and the focus now is on the extent to which consumer spending declines following a lift to beat the tax rise. Retailers are certainly very pessimistic about immediate prospects with a survey showing a sharp decline in sentiment with that decline being a lot more than for the same survey the last time a rise was undertaken in the tax back in 1997.

IF I WERE A BORROWER WHAT WOULD I DO?

Perhaps note that although the Reserve Bank has imposed credit controls on home buyers there is no obvious slowing in the pace of debt growth – thus backing up slightly our contention that the controls have mainly pushed first home buyers out of the housing market and provided more space for other groups such as investors. Household debt grew 0.4% seasonally adjusted in February which was the same pace of growth as the previous two months and at 5.4% annualised this growth is barely changed from actual annual growth of 5.7% in February. Thus, to the extent that the RB wants credit growth to slow it is having little impact – hence upside interest rate risks.

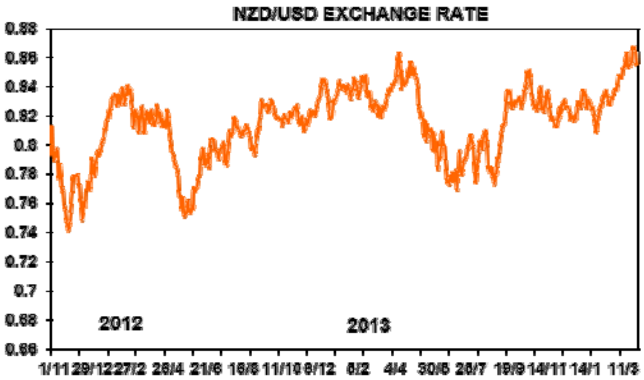


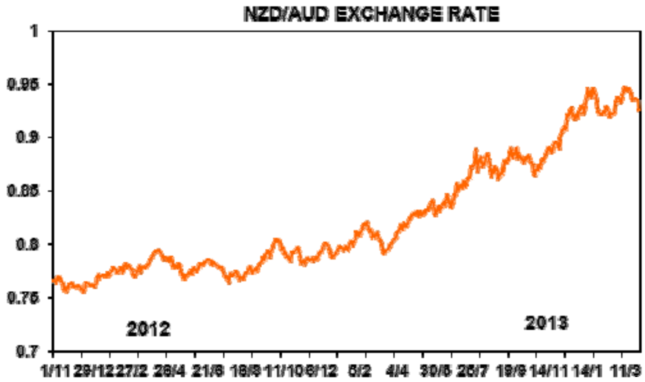
This week wholesale interest rates have moved higher with increased borrowing for fixed terms and the simple passage of time bringing us closer to the next expected official cash rate increase on April 24. There was also some slight upward pressure from a rise in US bond yields caused by better than expected economic data.

FINANCIAL MARKETS DATA	This week	Week ago	4 wks ago	3 months ago	Yr ago	10 yr average
Official Cash Rate	2.75%	2.75	2.50	2.50	2.50	4.9
90-day bank bill	3.19%	3.13	3.03	2.90	2.67	5.2
1 year swap	3.72%	3.66	3.55	3.52	2.79	5.3
3 year swap	4.44%	4.37	4.17	4.28	3.18	5.5
5 year swap	4.74%	4.70	4.54	4.79	3.53	5.7
7 year swap	4.96%	4.90	4.81	5.09	3.83	5.8

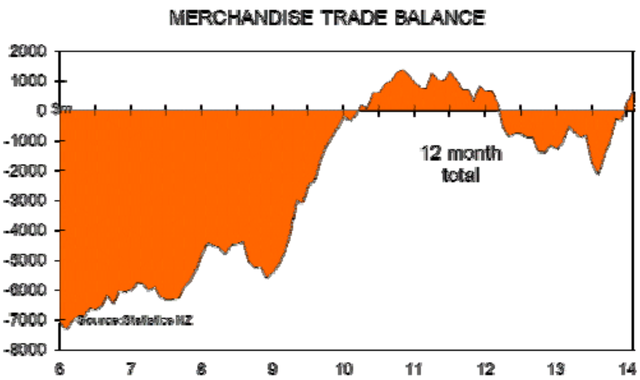
NZD Eases

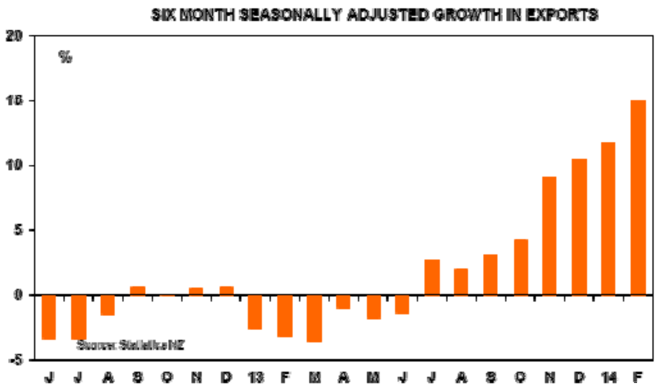
The Kiwi dollar has moved slightly lower this week in response partly to the 8.9% fall in average prices at the fortnightly Global Dairy Trade auction, but also some simple profit-taking following a period of high strength.





One factor not placing downward pressure on the NZ dollar is the trade account. In February the country ran a trade surplus of $818mn compared with $493mn a year ago and the annual outcome was a surplus of $649mn compared with a deficit of $1,066 a year before. The turnaround results from a 7.6% rise in exports outpacing a 3.7% rise in imports with dairy and forestry exports ahead 26% each. Exports to China have soared 53% the past year but fallen 7% to Australia 5% to USA, and 9% to Japan. To the UK they have risen 6% and the rest of Europe 8%.





New Zealand's current account deficit – which adds in flows in services and international income – was just 3.4% of GDP during calendar 2013 from 4.1% in 2012 and 2.9% in 2011.

Looking ahead, with commodity prices easing there will be some downward pressure on the NZD. But with NZ interest rates trending up while movements offshore remain unlikely for a long period of time it is likely that overall the NZD will remain very well supported and exporters with receipts in the near future might want to take advantage of any periods of weakness to undertake hedging.

Exchange Rates	This Week	Week ago	4 wks ago	3 Mths ago	Yr ago	10 yr Average
NZD/USD	0.855	0.867	0.837	0.8185	0.842	0.726
NZD/AUD	0.925	0.936	0.937	0.9188	0.805	0.839
NZD/JPY	88.7	88.6	84.8	85.79	78.6	72
NZD/GBP	0.514	0.521	0.502	0.4976	0.557	0.423
NZD/EUR	0.621	0.63	0.609	0.5989	0.656	0.545
NZDCNY	5.31	5.39	5.14	4.95	5.22	5.1
USD/JPY	103.74	102.19	101.31	104.81	93.35	99.3
GBP/USD	1.66	1.66	1.67	1.64	1.51	1.72
EUR/USD	1.38	1.38	1.37	1.37	1.28	1.33
AUD/USD	0.92	0.93	0.89	0.89	1.05	0.87
USD/RMB	6.2055	6.2139	6.1457	6.050703	6.1996	7.15

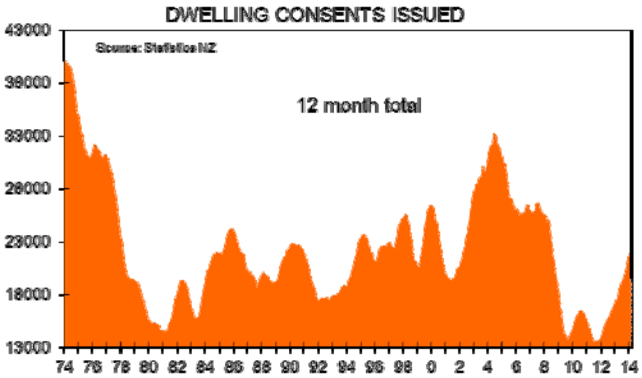
For more detailed FX analysis including the ‘BNZ Markets Outlook”, “BNZ Strategist” “BNZ Commodities Wrap” and lots more go here. https://research.bnz.co.nz/Research/NewZealand/Pages/NZpublications.aspx

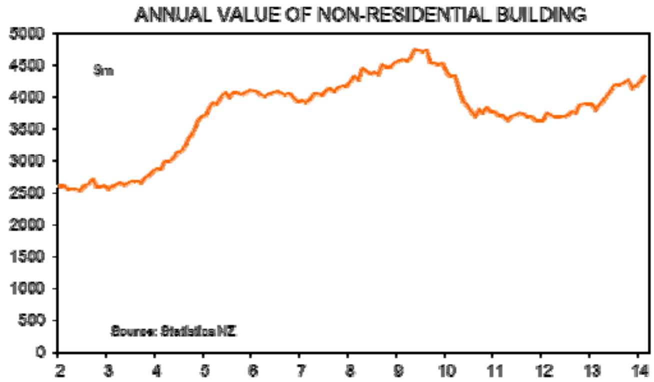
Housing Market Update

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

Supply Creeping Higher

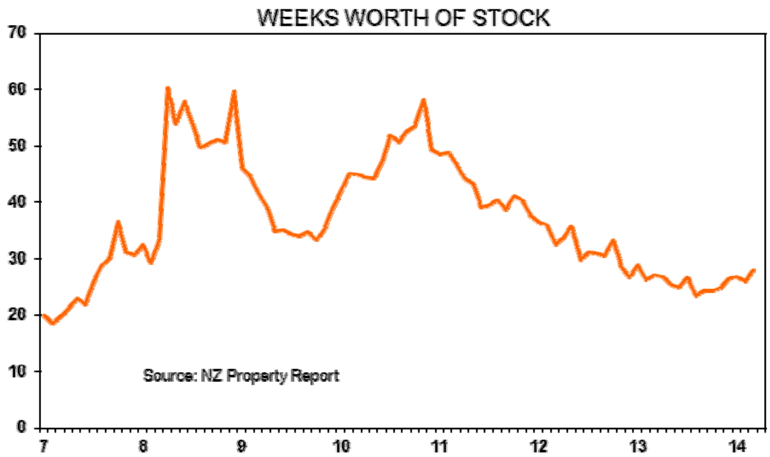
New dwelling supply is on an upward trend but that trend does experience some ups and downs – with the latter occurring recently. In seasonally adjusted terms the number of consents issued for the construction of new dwellings fell by 1.7% in February after falling 8.6% in January. But for the year to February numbers were up by 25% and at 21,854 were just above the ten year average of 21,100. Consents for Auckland were ahead 29% for the year and Canterbury 44% while the rest of the country rose 13%.





Note that it is not just residential construction which is growing. The value (not number) of consents issued for the construction of non-residential buildings was ahead 26% in February from a year earlier and 13% for the entire year. Office and administration building consents were ahead 26%, storage buildings 34%, and farm buildings 9%. Consents values for factories were however down by 3%.

But while new house supply is rising, listings on the real estate market appear to be falling. The NZ Property Report shows new listings on www.realestate.co.nz received in March were down 2% from a year ago and have fallen 3% seasonally adjusted in the past three months. The stock of listings at the end of the month was down 5% on a year ago though equal to some 27.9 weeks of sales from 26.3 weeks three months ago and 27 weeks a year ago.



None of these changes are particularly large and therefore they don't really lead to anything all that interesting being able to be said about market pressures. But the trend is clear in the above graph and it shows some slow easing in the overall degree of market tightness.

One other development relevant to the housing market this week was a possible hint from the Reserve Bank Deputy Governor that the RB might cut back on its minimum deposit credit controls which are freezing first home buyers out of the market. Delivering a speech last Friday the Deputy Governor Grant Spencer noted "They (LVR restrictions) will be removed once housing market pressures have moderated and when we are confident there will not be a resurgence in house price inflation," said Spencer. "But how should the exit be coordinated with the expected OCR tightening cycle?"

"The factors to consider include: The degree of moderation achieved in rates of house price inflation and credit expansion; Factors that might affect the potential for a resurgence in house price inflation following the removal of the LVRs, such as the dampening effect of increased housing supply and mortgage rates, and the stimulatory effect of higher net immigration flows; Any distortions or inefficiencies that become apparent as a result of the policy," said Spencer."

In other words, maybe some groundwork is being laid here, but there is a very long way to go it seems before relief will be afforded to young buyers.

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