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/IFdYSs5FGEq4kAjP95uzTA

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

Labour Market Strengthening Well

Yesterday Statistics NZ released the Quarterly Labour Force Survey. It told us that in seasonally adjusted terms during the March quarter this year job numbers in New Zealand rose by a stronger than expected 0.9%. Numbers were ahead 3.7% or 83,000 from a year ago which is the strongest annual pace of jobs growth since late-2004. The unemployment rate held steady at 6% but this is because confidence about finding a job is so high that the participation rate has risen to a record 69.3%.

The employment rate has recovered now to a healthy 65.1% from 64.7% in the December quarter, 63.7% a year ago, and now sits above the average for the past ten years of 64.6%. The fact that jobs growth is strong bodes well for retail spending growth and demand for housing, tourism services etc in the coming year. But from an inflation point of view one still cannot say that there is evidence of accelerating wages growth. Partly this will be because it will take some time for staff to come out of their shells of fear they have been in since 2008. But also with the unemployment rate still held up by people entering the workforce again wages growth will naturally be contained. This situation won't last forever but for now employers are still not really feeling the heat.

This is evidenced in the Labour Cost Index analytical wages series which tries to track the same types of jobs over time. That wages index rose by just 0.5% during the March quarter compared with a 0.6% rise a year earlier. The annual pace of increase slowed to 2.8% from 3% in the December quarter and 3% also a year ago.

But eventually, as the labour market tightens up, businesses will find that they cannot source the staff they want and have to take on decreasingly skilled, decreasingly motivated, and increasingly dependency-issue afflicted people. Existing staff will leave for better paying jobs elsewhere, those who stay will seek higher pay or start cutting back if they feel their boss is not recognising the change in the labour market. It's hard for a firm to argue hardship when the economy is growing at near a 4% pace.

How should firms react to this coming tightening up? Firstly try to get ahead of staff feeling that continued wage restraint excuses are just taking the proverbial by upping remuneration. Look to limit the monetary increase in cost by doing the very un-Kiwi thing of giving positive feedback to staff outside the formalised assessment programmes. Examine your vulnerability to the loss of key people and the high costs of recruiting and training new people against simply paying a bit more and better managing the people you already have. Give thought to your skills in managing other than the idealised type of employee you have in your mind when you think about recruiting someone new. Think how you will learn the skills to manage and effectively use older people, young people, migrants, and returning Kiwis.

Challenge yourself to think about how vulnerable your operations are to some of your suppliers not being able to furnish you with the outputs they have contracted for. Your biggest vulnerability may lie there rather than in your own operations and if you find yourself unable to fill a contract it could be because of that reason.

Give thought to the true cost of trying to acquire more customers and produce more output. You may make more profit by cutting output, focussing on core clients, concentrating on good staff, and raising your selling prices.

IF I WERE A BORROWER WHAT WOULD I DO?

The chances that the Reserve Bank will raise the official cash rate in both June and July have diminished slightly this week. this comes in response to the unemployment rate staying above the 5.6% level assumed by the Reserve Bank, and with the RB Governor in the context of expressing concern about the high NZD, implying that restraining it's strength could mean slowing the pace of interest rate rises.

Inflationary pressures in NZ will slowly build as growth in demand and output outpaces growth in resource availability. The Reserve Bank is acting now to restrain the pace of cost and price increases a year and a half down the tack by raising interest rates. But as we have repeatedly pointed out, there is high uncertainty as to how interest rate rises will affect behaviour, economic growth, and inflation in the post-GFC world. But it seems reasonable to expect that the official cash rate, which has already been increased from 2.5% to 3.0% will be near 5% come the end of 2015.

Thus borrowers should think about allowing for their funding rate costs in a year and a half to be about 2% higher than they are now. Were I borrowing currently I would look to control the extent to which my interest rate costs will go up and to mitigate some of the risks by seeking a mixture of floating and fixed rates, trying to get to at least a three year fixed rate for over half of my debt.

	OCR	90 day bb	1 year swap	2 year	3 year	4 year	5 year	7 year
This week	3.00	3.35	3.7	3.99	4.22	4.37	4.49	4.68
Last week	3.00	3.37	3.68	4.03	4.28	4.44	4.55	4.74
4 weeks ago	2.75	3.13	3.72	4.14	4.4	4.57	4.7	4.89
3 months ago	2.50	2.94	3.52	3.91	4.21	4.42	4.61	4.88
1 year ago	2.50	2.66	2.72	2.87	3.03	3.18	3.32	3.57

NZD Goes Higher

The NZD has been boosted this past week by the better than expected US employment report encouraging investors and traders to buy risky assets such as shares and far flung currencies like our own. US employment rose by 288,000 whereas a rise of 218,000 had been expected. The March and February increases in employment were also revised slightly upward. Plus the unemployment rate fell to just 6.3% from 6.7%.

In addition there is increased talk about the thing which we have been warning about here for the past couple of years - the imminent reactivation of the carry trade once NZ monetary policy starts to get tightened. We are at that point now and for the coming year while our interest rates go higher and those offshore stay unchanged the risk we have tried to highlight is that the NZD may go higher or at least remain at highish levels. It is perhaps noteworthy this week that in spite of another 1.1% fall in average prices at the fortnightly Global Dairy Trade auction the NZF still rose about one cent on Tuesday night on the back largely of weakness in the greenback.

The currency however shed half a cent on Wednesday morning after the RB Governor indicated that he is getting increasingly frustrated at the way the NZD is holding up in spite of some easing in commodity prices. He warned that were this situation to continue he may intervene in the FX markets. The problem there is that such intervention had no lasting impact back in 2007 when intervention at 76 cents mid-year failed to stop the NZD heading to 82 cents come early-2008. But any intervention would cause some temporary NZD weakness and that worry may be enough to clear out some long positions currently.

This upward move in the NZD helps illustrate why forecasting exchange rates is fairly much a waste of one's valuable time. Knowing ahead of time that the US employment report would be good one might have bought greenbacks and sold the NZD on an expectation that people would boost their expectations of the US Federal Reserve tightening monetary policy including raising interest rates next year. Earlier than previously anticipated rate rises would mean in theory a stronger USD. But the opposite has happened as for the moment the markets assign greater weight to market participants assigning greater weight to market participants assigning greater weight to risk tolerance being the driver of rates for the moment rather than interest rate differentials.

Thus to successfully forecast exchange rates you need to devote your skills to forecasting changes in what the markets consider to be current rate drivers, or finding someone who seems embedded enough in the markets to be able to pick such changes. Hence why if you are intent on picking currencies you need to spend time chatting with your currency advisor.

That aside, from an economic fundamentals point of view I remain of the continuing opinion that in a world where people remain highly uncertain about growth in their economies, where our growth is headed to over 4%, where our monetary policy is on a tightening path and our labour market strengthening well, and where we have an export mix which in contrast to opinion in the 1960s through 2000s is now the envy of many, risks for the NZD clearly lie on the topside. Yes, at some stage we will correct back downward. But probably not until there is very high certainty regarding economic progress offshore and those economies have started to raise their interest rates. Until then you and I are going to enjoy falling prices for imported goods and cheaper travel overseas.

	NZD vs. USD	AUD	JPY	GBP	EUR
This week	0.867	0.929	88.3	0.511	0.623
Last week	0.861	0.926	88	0.51	0.621
4 weeks ago	0.86	0.928	88.7	0.518	0.626
3 months ago	0.828	0.924	84.8	0.505	0.608
1 year ago	0.845	0.83	83.7	0.546	0.647

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

Aussie Fiscal Tightening Will Boost NZ Housing Market

In a week's time the Australian Federal government will deliver what is expected to be a fairly severe tightening of fiscal policy as it attempts to return its accounts to surplus almost a decade from now. It looks like what has become an increasingly generous welfare system will be substantially rolled back. As well a good number of public servants are likely to face redundancy and this will add to a slowing in the pace of economic growth attributable to chooks coming home to roost in a high cost manufacturing sector overly reliant on government assistance, an ending of a period of huge investment in the resources sector, and lingering effects of a relatively high Aussie dollar.

The relevance for ourselves is that the sharp change in the Trans-tasman migration flow which started about a year and a half ago is likely to continue. That means a further rise in the overall net migration gain for the NZ population which will increase demand for housing. That will tend to place extra upward pressure on rents and prices though some relief will come from increased availability of builders.

When might the migration flow start easing off again. We have been in this situation a number of times before of trying to figure out when the migration cycle turns. Experience tells me that it is largely a guessing game but my personal best guess is that we will see the annual net gain start to taper off in 2016. Before then a net gain close to 40,000 is likely to be achieved.

Auckland Sales Lower, Listings Rising, But Price Trend Not Obviously Dented Yet

We learnt this week that Barfoot and Thompson sold 24% fewer dwellings in Auckland in April than they did a year earlier. The monthly change in rough seasonally adjusted terms was a 10% fall and for the three months ending in April the s.a. change was near a 7% decline. It seems fair to say that activity levels are still backing off in Auckland. With regard to prices we see that the median sales price in April of $706,000 was up by 10% from a year ago and 4% higher in the three months to April than the thre months to January. Therefore one cannot yet solidly conclude that the pace of house price inflation has slowed all that much.

The number of new listings received in April was 6% higher than a year earlier so there is mild evidence of a few more properties coming onto the market. The total number of listings at the end of April was 4% ahead of a year earlier and this was the first positive annual rate of change in this measure since January 2011.

Thus sales activity has eased off, a few more listings are appearing in Auckland, but as yet one struggles to measure a price response to this cooling in activity.