BNZ 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.

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 sign up at www.tonyalexander.co.nz
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2014 Themes

This week let's take a run-through of my eight central themes for this year to see how they are going.

Interest rates will rise
The cash rate has been increased 0.75% so far, we expect another 0.25% move in July, then a pause, then moves again in October and December. But some fixed borrowing costs have fallen rather than risen, courtesy of reduced long term borrowing costs in the United States.

The NZD will stay highish
Ask any exporter. Full accuracy there so far.

The labour market will tighten, pushing employment costs up.
We only have March quarter data but it showed jobs growth of 0.9% but the unemployment rate holding steady at 6% from the December quarter. In addition the NZIER's Quarterly Survey of Business Opinion for the March quarter had a net 30% of respondents saying they were having difficulty finding skilled labour and a net 10% unskilled labour. These results were unchanged from the December quarter Therefore as yet we do not have statistical proof of the labour market actually tightening up this year. We also as yet have zero statistical evidence of any acceleration in wages growth. So for our third theme for 2014 things have yet to start happening though we remain of the opinion that with the employment rate now at 65.1% from 63.7% a year ago things will get tight and a long overdue wages response will appear.

House prices will rise with gains spreading out of Auckland and Christchurch
House prices are still rising with the average sales price in the three months to May ahead by 3.7% from the three months to February and 8% from a year earlier. But are gains spreading? Speaking to an audience in Wanganui yesterday I did not get the impression that in their region things are improving. In fact their comments mainly centred around falling population and whether the Reserve Bank could give them a different monetary policy from the rest of the country, or whether government could look at a regional development strategy. My gut, taking into account the LVRs, and looking at a graph we include in the Housing section this week, tells me that such a spreading of the price effect is not really happening yet.

Construction will boom
Definitely.

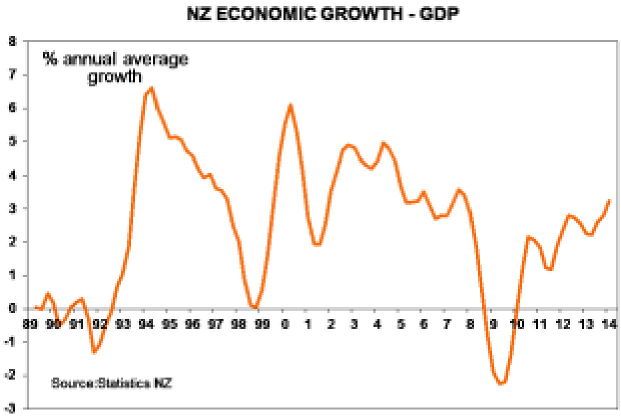
World growth will improve with unprecedented uncertainty regarding monetary policies
World growth is improving but the extent of the expected improvement for this year has been revised down by the likes of the World Bank and IMF. But policy uncertainty remains highly elevated.

Business capital spending will grow
Business investment declined by 1.5% during the March quarter after rising just 0.6% in the December quarter and 0.4% in the September quarter. One cannot yet run an argument that business investment is picking up based on these data from the National Accounts released this morning.

Household Spending Growth Will Accelerate
This is hard to figure out. Although real seasonally adjusted core retail spending rose by 0.8% during the March quarter this was less than 1% during the December quarter. But that 1% rise was partly a simple bounce up following a 0.2% fall in the September quarter. Perhaps we can conclude yes if we note that durables spending using the retailing measure rose by 2.3% in the March quarter after rising 1.3% during the December quarter. But then spending using debit and credit cards rose at an annualised pace of 4.5% in the three months to May compared with growth of 7.3% in the three months to February. And this morning we learned that private consumption was flat in the March quarter after rising 1.2% in the December quarter. Frankly one cannot really run a strong argument that consumers are buying into the upturn with a spending splurge. It is not happening.

The strike rate so far with fairly much only March quarter data in hand is 50%.

Regarding the GDP data released this morning, they showed that our economy grew by 1% during the March quarter to deliver 3.2% growth for the full year using the production measure, led by construction up 12.1%. The expenditure based measure rose by 1.3% in the quarter to give 2.5% growth for the year led by private consumption rising 3.4%, residential building 16.8%, but a 7.9% rise in imports swamping a 0.3% rise in exports. The data fairly much contain numbers which support views of both pessimists and optimists depending upon the time period you choose. The two graphs here however give strong weight to a positive interpretation.



Microsoft Surface 2 Wins

Well that was interesting. For the past two months I have been working on only my iPad having put the PC to the side completely. It is certainly possible to use the Numbers and Pages Apps on the iPad to analyse data and prepare a document – just in the same way as it is possible to get to work each morning crawling along the berm rather than using the car, bus, cycle or train.

Using Pages is not too bad except for the most important parts – typing at speed when the creative juices get flowing, and easily pasting graphs from the spreadsheet programme. The machine simply can’t keep up a lot of the time and you have to sit waiting and watching the screen enter the words you typed a few seconds ago before advancing. Putting in apostrophes and dashes is a nightmare, and sometimes the Caps Lock stays on for a few words then goes off. Cutting and pasting text is also difficult because once you start scrolling down below the bottom of the visible page you never quite know where you’ll end up.

But it is not difficulties with Pages which made me last week buy a Microsoft Surface 2 Tablet ready installed with glorious Word and Excel, it was the horror of Numbers. Trying to manage data in Numbers is like finger painting only with less certain results. Grabbing cells beyond what you see on the screen is either impossible for going horizontally, or a guessing game for where you will end up going vertically. Taking data from one spreadsheet to put into another is appallingly difficult. You can have only one spreadsheet open at a time.

What I found the difficulties with Numbers doing was creating a thickening fog between me and the work I wanted to do. The thought of wading with difficulty through sets of data meant I found myself backing away from doing the analysis in the first place. It was a bit like getting an electric shock each time you touched something. After a while you don't want to go anywhere near it.

But as the astute amongst you will have noticed, the format of the Weekly Overview has shifted back to what it was last year, the graphs are making a comeback, and there will once again be more commentary backed up with data and sometimes graphs on foreign economies. Having said that the focus will remain overwhelmingly on the NZ economy.

Correction

Last week I wrote "Labour, the Maori and United Parties prevented a government bill passing recently which would have reformed parts of the Resource Management Act and made it easier for new houses to be built." Actually, according to Phil Twyford, Labour spokesman for housing, that is not true. Labour offered to allow passage of RMA changes which would have improved housing affordability but the government turned them down.

Interest Rates

Wholesale interest rates have risen slightly this week in spite of worries about war in Iraq and rising oil prices sapping the strength of the world economy and therefore reducing underlying inflationary pressures. One source of upward pressure was a higher than expected 0.4% inflation rate for May in the United States taking their annual rate up to 2.1%. No-one seriously believes that the Federal Reserve is about to raise interest rates, but risks are starting to shift toward a tightening being signalled before the end of the year, though when actual movement may occur is still hugely uncertain.

In fact last night while cutting their money printing operation again by $10bn to $35bn a month the Federal Reserve Open Committee said that economic activity has rebounded in recent months, but they cut their growth forecasts for the year and Ms Yellen said that interest rates will remain low after the bond buying programme ends "for a considerable time". So no hints of rate rises and US long term interest rates declined slightly following the announcements.

FINANCIAL MARKETS DATA

	This week	Week ago	4 wks ago	3 months ago	Yr ago
Official Cash Rate	3.25	3.25	3.00	2.50	2.50
90-day bank bill	3.61	3.50	3.42	3.10	2.66
1 year swap	3.98	3.80	3.73	3.64	2.88
2 year swap	4.28	4.06	3.99	4.06	3.19
3 year swap	4.46	4.28	4.18	4.37	3.43
4 year swap	4.58	4.43	4.31	4.53	3.63
5 year swap	4.68	4.53	4.42	4.66	3.79
7 year swap	4.84	4.73	4.63	4.86	4.06
10 year swap	5.00	4.93	4.81	5.07	4.33

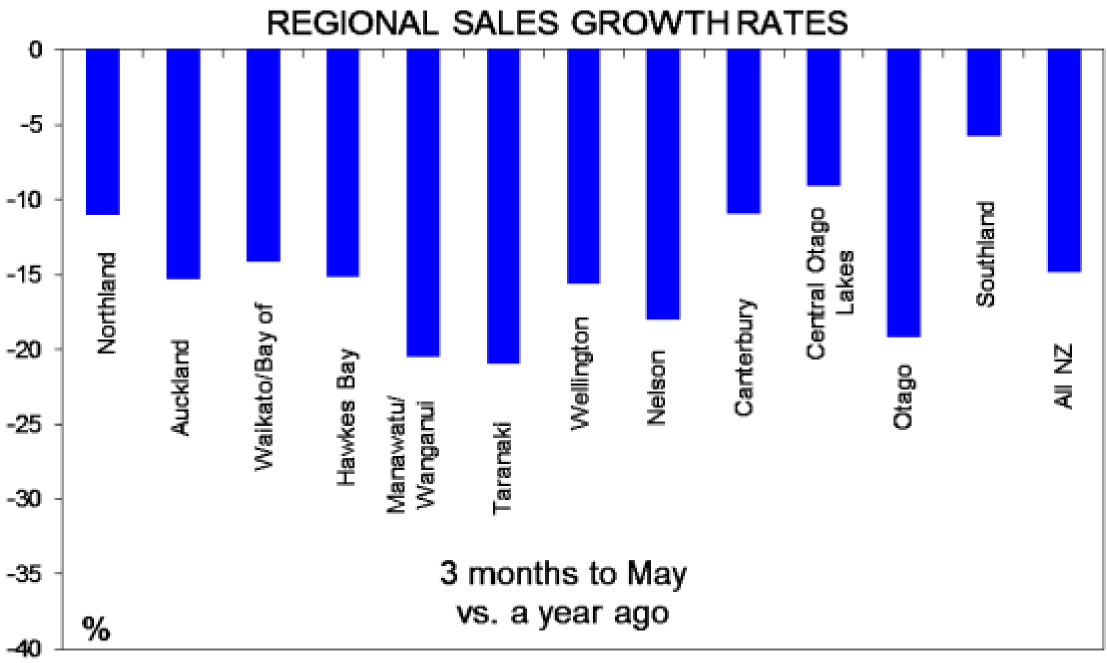
If I Were A Borrower What Would I Do?

I would fix three or four years and not be tardy about doing it because bank borrowing costs have just edged up.

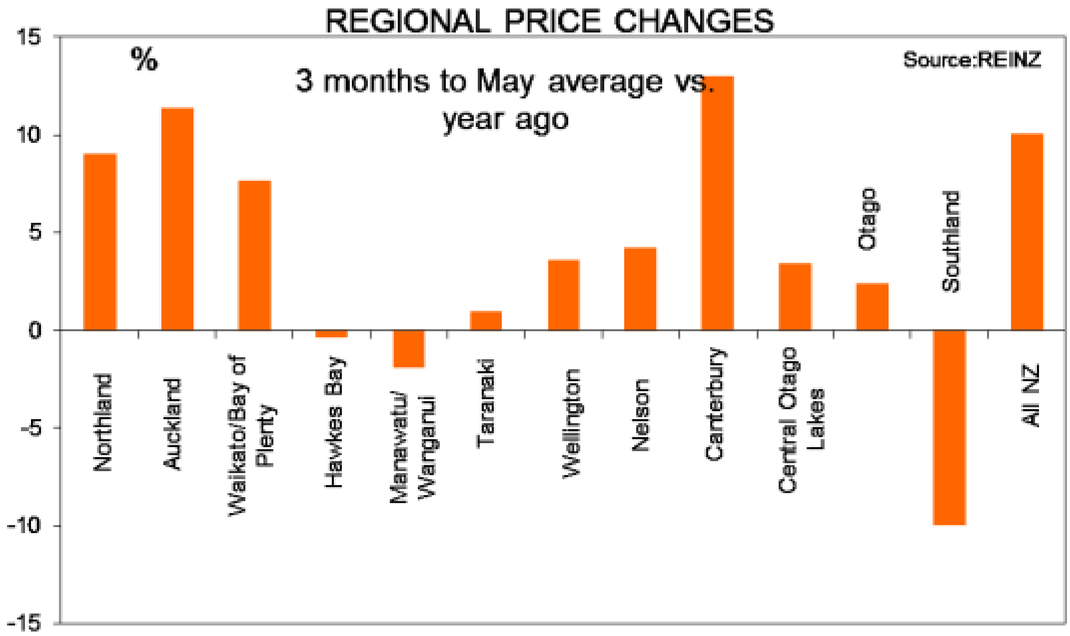
Housing Market Update

The REINZ this week reported that during May there were 6,572 dwellings sold around New Zealand. This was a decline of 14.8% from a year ago and means that in the three months to May sales were down by the same 14.8% from a year ago. Thus activity levels have fallen away and this has been apparent since the LVR restrictions took first home buyers out of the market from October last year.

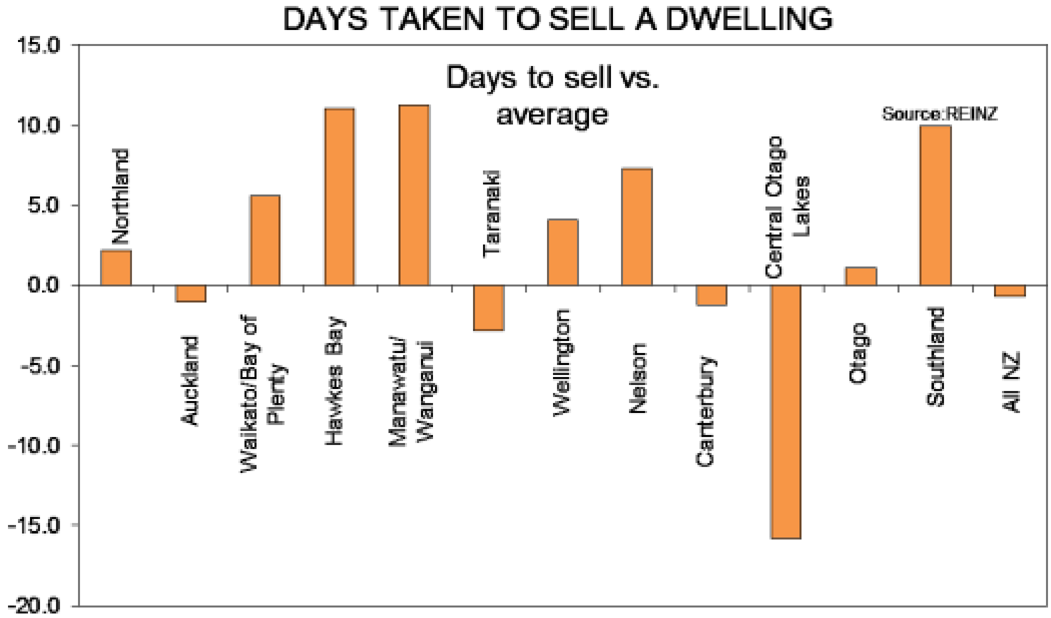
Falls in all regions from a year ago are within ballpark of each other so one could not really say that the regions have been hit more than Auckland or Canterbury.



The housing type adjusted price index for all NZ was 1.2% lower in May than April and up just 6.5% from a year earlier. This is the slowest annual pace of house price inflation since September 2012 and meant that in the three months to May prices were ahead 10% from a year ago using the raw price measures. Doing so allows us to produce the following graph showing annual changes for the regions reported by REINZ. Regional variations are far greater than for sales growth.



The REINZ data also tell us that on average in May it took 38 days to sell a dwelling which was 0.7 days better than average. By region the latest days to sell versus average are as in the following graph. Below the line means faster than the ten year average while above it means slower.



Out of these three sets of information we can broadly say that the weakest markets are Hawkes Bay, Manawatu-Wanganui, and Southland. Wellington also remains a tad soft. The strongest markets are Auckland and Canterbury, but not necessarily by all that much.

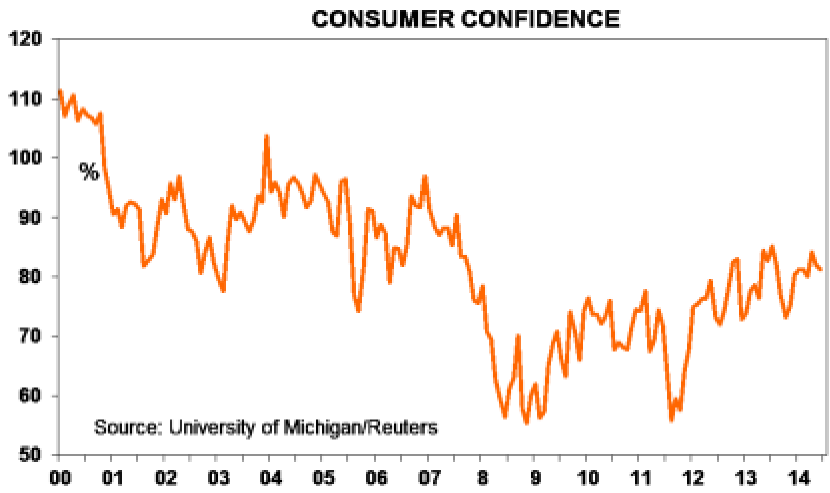
For your guide last month the largest mortgage lender in the UK, Lloyds, announced that they would voluntarily impose a debt to income limit of four times for houses over £500,000. The Royal Bank of Scotland has done the same. There are thoughts being expressed here in NZ of the Reserve Bank perhaps looking to use such a tool to help contain the housing market – even though there is little evidence that rising house prices are causing people to feel wealthy and rush out to spend their paper wealth. The RB's concern would be more about a potential bubble developing and the banking system being vulnerable in the event of some shock which pushed house prices much lower.

FX and Offshore

	This Week	Week Ago	4 Weeks Ago	3 Months Ago	Year Ago
NZD/USD	0.873	0.865	0.857	0.854	0.789
NZD/AUD	0.928	0.922	0.927	0.946	0.847
NZD/JPY	89	88.3	86.9	87.6	76.1
NZD/GBP	0.514	0.515	0.507	0.517	0.51
NZD/EUR	0.643	0.639	0.626	0.617	0.594
NZD/CNY	5.44	5.38	5.35	5.29	4.83
USD/JPY	101.95	102.08	101.40	102.58	96.45
GBP/USD	1.70	1.68	1.69	1.65	1.55
USD/EUR	1.36	1.35	1.37	1.38	1.33
AUD/USD	0.94	0.94	0.92	0.90	0.93
USD/CNY	6.2311	6.2191	6.238	6.1943	6.1273

NZ Dollar Stays Elevated

Both the NZD and AUD have held up well this past week in spite of an increase in global risk aversion stemming from events in the Middle East. Oil prices have risen in response to the new Islamist war in Iraq and this would tend usually to place downward pressure on our currency as we are a net energy importer. But worries about disruption to oil supplies and data showing US retail spending rising just 0.3% in May rather than the 0.6% expected have weakened the US dollar to some extent. Consumer sentiment in the US also dipped a tad last month. And on Monday night the IMF cut their forecast for growth in US GDP this year from 2.8% to just 2% and recommended that zero interest rates be kept in place for an extended period of time. The World Bank a week ago cut their forecast from 2.8% to 2.1%.



This weakening was accentuated by some strength in the Yen on the back of monthly orders for machinery placed by Japanese companies falling less than expected in April following the April 1 rise in the consumption tax from 5% to 8%.

Japan's economy grew at an annualised pace of 6.7% during the March quarter (revised up just days ago from the initial estimate of 5.9%) and all eyes now are on the extent to which things go into reverse following the tax rise and then where activity growth will settle above the June quarter decline. But while not related to the tax change, the export data released last night were unusually weak with receipts down in May from a year earlier which is the first annual rate of decline in 15 months.

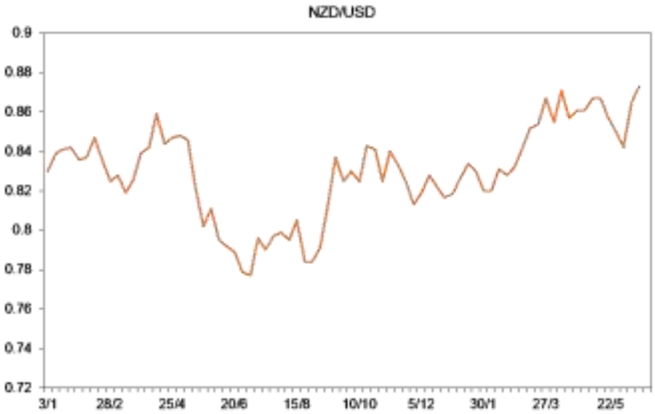
Back to rising oil prices. They throw a spanner into the works of optimism regarding recovery in the US economy and will tend to encourage the belief that the Federal Reserve will delay even longer before raising interest rates That is one reason why our currency has held up and is likely to continue to do so when one considers that some of the key factors driving our strong growth and eventually rising inflationary pressures and interest rates will be little affected by much higher oil prices.

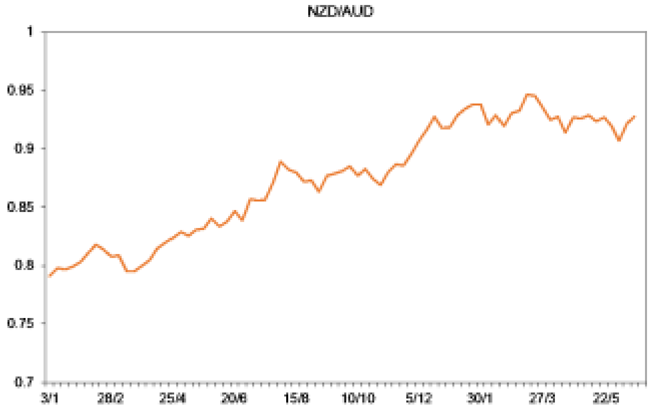
In fact here is the list of eight factors which I go through during my talks around the country. Form your own opinion regarding what the constraint is on the strength of each item and consider the impact of higher oil prices. I think you'll find that of the big items only the dairy expansion is at risk – but then any weakness could be contained given the long term investment focus on supplying China's rapidly growing dairy market.

- Rebuilding Christchurch
- Catching up on house construction in Auckland
- Dairy sector expansion.
- Infrastructure spending (motorway, tunnels, electricity etc.)
- Earthquake strengthening of over 20,000 commercial buildings.
- Water-tightness remediation work largely in Auckland.
- A migration boom (would probably get bigger).
- Slightly better world growth – clearly at risk now.

The British pound received a bit of support early in the week after the Bank of England Governor gave a hint that interest rates may need to be increased earlier than the mid-2015 timing generally expected in the financial markets.. There is not really anything new in what he said as the story for the GBP is one of good underpinning from strength in London spreading to other parts of the country, yet worries about Europe and sheer lack of knowledge about how the economy will react to rising interest rates in the post-GFC environment. This lack of knowledge of what their rate changes could do is causing central banks everywhere bar in New Zealand to sit on their hands just in case hints of rising interest rates cause their economies to stall. In that regard in coming months as we gather evidence of how rising interest rates here impact our economy those foreign central bankers will be very interested – assuming they know we exist.

The NZD has held up against the Aussie dollar over the week, partly in response to the AUD being slightly pressured a fall in iron ore prices to their lowest level in almost two years.





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