

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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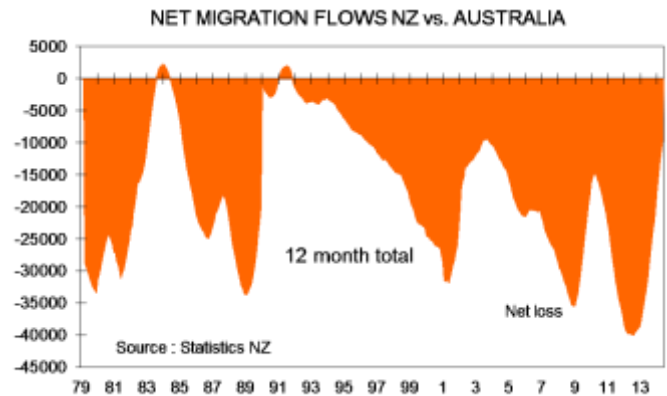
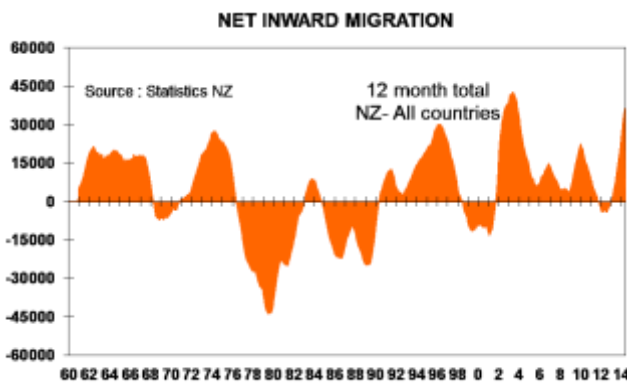
2014 Themes

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

I will be on leave for a couple of weeks starting next Thursday therefore the next Weekly Overview will appear on July 24.

New Zealand's migration boom is continuing courtesy largely of you and I not going to Australia and some of our cuzzies coming back. In the year to May there was a net gain to our population from migration flows of 36,397 people. This was up from 6,242 a year ago, -3,653 two years ago, and above the ten year average of 9,779.

The turnaround of near 30,000 from a year ago reflects a sharp reduction in the net flow to Australia from 32,862 a year ago to just 9,733 this year. The way things are going this net flow will turn in our favour before the year is out. The overall flow is currently running at an annualised pace of almost 48,000 which means over a 1% boost to the NZ population. We repeat that it is a no-brainer what this means for the speed of growth in economic activity given the extra demand for retailing goods and services along with accommodation. House prices will face additional upward pressure, as will rents and the pace of construction.



However while the accelerating population growth will deliver some more people to build houses this effect will be swamped by the extra housing demand. That means even more upward pressure on building material prices, architects' fees and so on. That means it remains reasonable to expect that monetary policy will continue to be taken away from overly loose settings. That means continuing strong support for the NZ dollar.

However that strong currency has its own deflationary effects and because of the recent strength in the NZ dollar we reckon now that after raising the cash rate again in July the Reserve Bank will then skip raising it in the September and October reviews and restart in December. Previously we thought they would skip only July and recommence tightening in October. Our pick for the OCR peak still remains 5% come early-2016.

Some Labour Party Policies

The Labour Party this week released their "Fiscal Plan" (a well presented document with some good costing analysis) which includes another tax they will put in place in the event that they are able to put together a coalition government with a wide variety of smaller parties after this year's general election on September 20. They will impose an extra tax on the 2% of taxpayers earning above \$150,000 and already contributing 22% to total income tax receipts. Last time around their envy tax proposal was 39% now it is 36% yet as equally unnecessary given that the budget balance is moving comfortably back into surplus anyway.

Labour also plan raising the age before people can collect superannuation from 65 to 67 (makes sense). They would introduce a capital gains tax on investment properties (would not affect housing affordability as all investors I have spoken to say it would not affect their decisions, which is somewhat surprising given the lowering of long-term expected returns to investing in property.) The CGT will be set at 15% and will apply to gains after implementation day and not just assets purchased from that date, and will capture things like farms as well as non-family homes. They would also strengthen ring-fencing legislation aimed at preventing landlords from offsetting housing income losses against other income sources.

Labour would also take make Kiwisaver membership compulsory, raise contribution rates, and tighten rules around contribution holidays.

They would try to get the Reserve Bank to use changes in Kiwisaver contributions as a tool to influence economic activity and inflation alongside official cash rate changes. Good on them for thinking outside the square, but such a policy would reduce Kiwisaver returns through boosting top of the price cycle share purchases and reducing purchases when prices are low. There is also zero information on how much one would need to change contributions to replicate the effect of a 0.25% cash rate change.

Labour have also proposed changing migration rules (presumably giving the Reserve Bank power to do this) as a means of aiding monetary policy. Such a policy would have a low probability of success given that near three quarters of gross migration flows are Kiwis coming in and out and sudden eligibility changes would be needed for people who may have spent a long time jumping through hoops to try and shift to New Zealand. Family reunification opportunities could be decimated.

They also propose building 10,000 state houses a year which they would sell to occupants. That is a good idea given the housing crisis in some parts of the country, but the policy would probably fail as buying land in the cities would be very expensive, folk already there would use the full force afforded them by the RMA to stall the process, and the builders won't be available.

They would regulate the electricity sector and run the risk that price controls would lead to reduced construction of new generation, thus producing brown outs and maybe blackouts. Big unknowns there but worth investigating given the huge increases in power charges these past few years.

They would ban foreigners from buying existing houses. That is a good idea given the wave of Chinese money heading our way, but implementation may prove difficult as the system appears to have failed in Australia where it is being rorted and ignored by the likes of real estate agents marketing properties only to Chinese buyers with details accessible only from a mainland internet connection.

You can find a full listing of all Labour's announced policies here. www.labour.org.nz/policy

Interest Rates

Wholesale interest rates have edged down slightly this week but still sit above levels of a couple of weeks ago in response to a rise in US rates by and large. In the absence of any local data showing the NZ economy's growth path falling away or accelerating our view remains that the official cash rate will rise again in July and finish up at 5%, but perhaps early in 2016 rather than late in 2015. We expect the Reserve Bank to pause after the July rate rise and not move again until December as they assess the impact of rate rises so far. Working that out could be difficult with regard to the housing market because of the impact of LVR regulations effective since October last year. The RB will have to try and strip out their effect in order to work out the effect of interest rates rising 1%. That will be difficult.

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	3.61	3.42	3.13	2.66
1 year swap	3.97	3.98	3.69	3.66	2.89
2 year swap	4.21	4.28	3.98	4.06	3.26
3 year swap	4.38	4.46	4.16	4.37	3.55
4 year swap	4.50	4.58	4.32	4.55	3.79
5 year swap	4.59	4.68	4.40	4.70	3.96
7 year swap	4.74	4.84	4.62	4.90	4.30
10 year swap	4.90	5.00	4.81	5.10	4.62

If I Were A Borrower What Would I Do?

Some fixed borrowing costs have increased in the past fortnight so I would not be tardy about locking a portion of my mortgage up at a three or four year fixed rate.

Housing Market Update

Many people and journalists in particular like to point out

- how many houses you could buy in XXX in exchange for just one house in Auckland,
- how infrastructure resources in regions are being wasted as people flock to Auckland,
- how extra consideration should be given to encouraging people to live outside of Auckland.

The last time I looked there were plenty of attractive people walking past the shops on Lambton Quay, but we have no interest in seeing their pictures in the newspapers or following their stories. We track what film stars and pop singers are up to instead. We follow those latter people not because we necessarily like them but because other people follow them. They are popular. We feel more included in society if we know something about them, perhaps making us more socially accepted around the water cooler. (The whole basis of sites such as Reddit.)

We buy houses in Auckland and have greater expectations for capital gains there than in other parts of the country because other people buy houses there and also expect better capital gains. They buy because of our expectations and so it goes. Auckland is popular, we have a set of expectations for our purchases there, and unless something happens to make Auckland unpopular or shatters those capital gain expectations, then prices will continue to rise, with those gains accentuated by the still worsening shortage and plethora of stories noting the shortage and difficulties boosting supply.

But are the regions starting to look more attractive to us individuals yet? Not really. On my travels around the country locals are more often than not telling me stories of how their businesses are not doing as well as the stories they hear regarding the economy's overall strong pace of growth. Therefore psychologically-speaking, there is as yet no obvious reason why people not fixated on their own analysis of the economic fundamentals (the herd) will turn their attention away from Auckland. They are not reading stories of regional strength so don't believe other people will be biasing their focus and investments away from Auckland.

I wrote here a few weeks ago about how people tut tut in a politically correct manner regarding the high prices of houses in New Zealand and how difficult it is for young people to get one, but in reality few people want extra houses near them or bold measures which will reduce their household wealth by forcing down the price of their main asset. This week on page 1 of The Dominion newspaper appeared an article regarding 7,000 extra houses potentially being built in Wellington in the next few years as the result of a housing accord being signed giving the council and government power to fast-track new house consents.

But commentary in the article concentrated on worries that infrastructure would not be up to handling the extra people. Regarding Johnsonville one person wrote "If people want to live cheek by jowl, they'll want to live somewhere like Mt Cook, somewhere close to the CBD. People in Johnsonville still want quality of life, they still want a backyard." And "It's a noble idea, but the reality is you can't just create infrastructure..."

And accompanying the article was a note regarding the accord in Auckland aimed at building 39,000 over three years (in place for a year or two now with consents there still below average). "Auckland scheme fails to impress" read the headline, and "...but observers say it is yet to yield any concrete results."

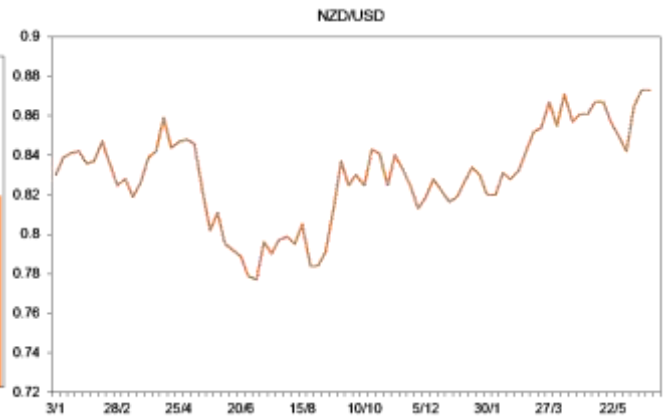
Still, a Newtown spokesman in Wellington did support more housing saying more people made the streets safer – thus highlighting that maybe in that area, well known as a destination for refugees and other new migrants, there may be a crime problem. There is certainly a driving one with the main road inadequate for handling existing traffic flows let alone even more people moving about.

FX and Offshore

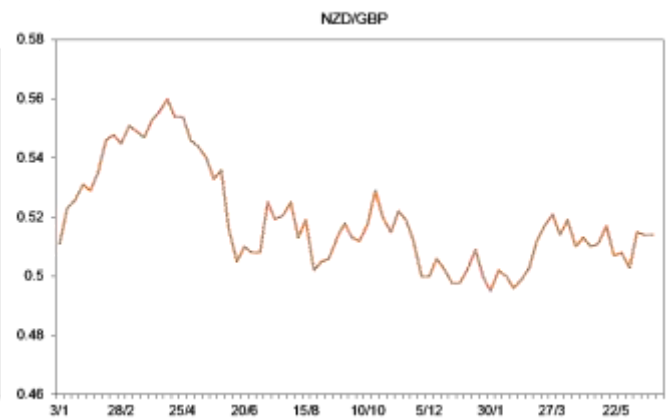
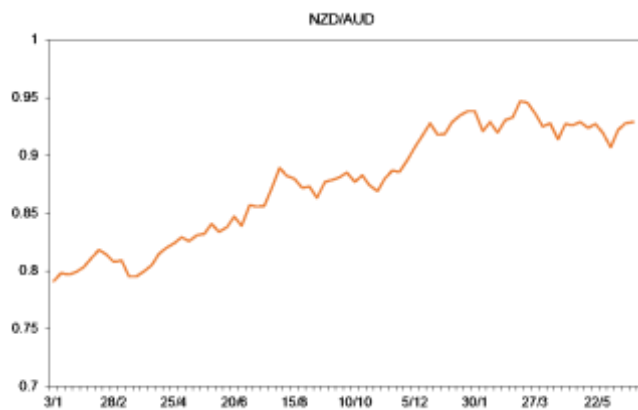
	This Week	Week Ago	4 Weeks Ago	3 Months Ago	Year Ago
NZD/USD	0.876	0.873	0.85	0.867	0.779
NZD/AUD	0.931	0.928	0.92	0.936	0.839
NZD/JPY	89.1	89	86.5	88.6	76.1
NZD/GBP	0.516	0.514	0.508	0.521	0.508
NZD/EUR	0.643	0.643	0.625	0.63	0.599
NZD/CNY	5.46	5.44	5.30	5.39	4.79
USD/JPY	101.71	101.95	101.76	102.19	97.69
GBP/USD	1.70	1.70	1.67	1.66	1.53
USD/EUR	1.36	1.36	1.36	1.38	1.30
AUD/USD	0.94	0.94	0.92	0.93	0.93
USD/CNY	6.2346	6.2311	6.24	6.2139	6.1476

Steady

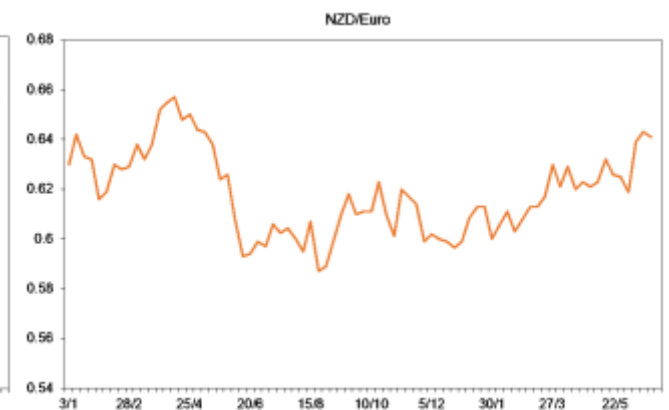
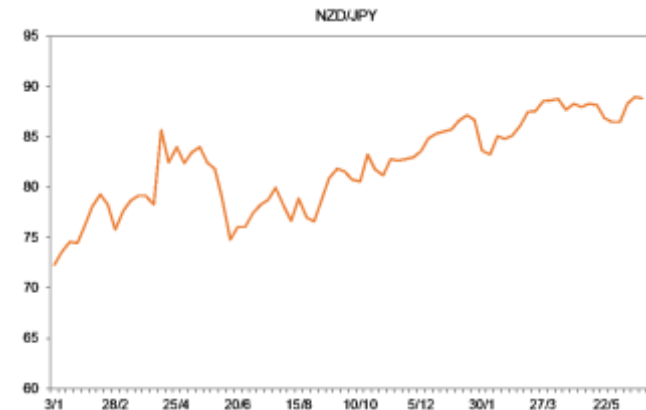
The NZD has remained firm this week (no surprises there), partly riding the coat-tails of a strong AUD lifted by a better than expected piece of data on the state of the manufacturing sector in China. The preliminary HSBC PMI for China rose to 50.9 in June from 49.4 in May. This was the first reading this year above 50 which means growth returning to the sector and some alleviation of worries that spreading woe in the housing sector is affecting wider economic activity.



Locally we have not had any data or news items worthy of moving the NZD around and in the absence of some shock it remains likely that come the end of the year the NZD will still be firm against most currencies. The biggest uncertainties revolve around developments offshore rather than New Zealand, especially with regard to monetary policies. In the UK the officials are making comments indicating that they are actively thinking about raising rates – and then they make clarifying comments suggesting the markets are reading too much into what they say. In Japan there is no chance of tighter monetary policy for a great number of years though it was pleasing this week to see cabinet approval of proposals from the Prime Minister aimed at freeing up the Japanese economy in some limited ways.



In the United States the easing back from money printing continues and when the monthly buying slips from the current \$35bn to zero before the end of the year there will be even more attention on what the officials say and how they say it. The general view is that US interest rates may start rising around the middle of the year. But that view was challenged this week by the revision to second quarter GDP announced overnight taking the first estimate of 1% annualised shrinkage to a much worse than expected 2.9% decline.



In Australia growth measures remain very mixed but a rate rise is possible before the end of next year. In Europe this week the Purchasing Manager indexes were unexpectedly weak for Germany and France,

calling into question yet again the strength and sustainability of the Eurozone recovery. Rate rises look to be a long long way off there. In fact the chances are rising that the European Central Bank will need to engage in outright quantitative easing – money printing one way or the other.

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