

BNZ Weekly Overview

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Mission Statement

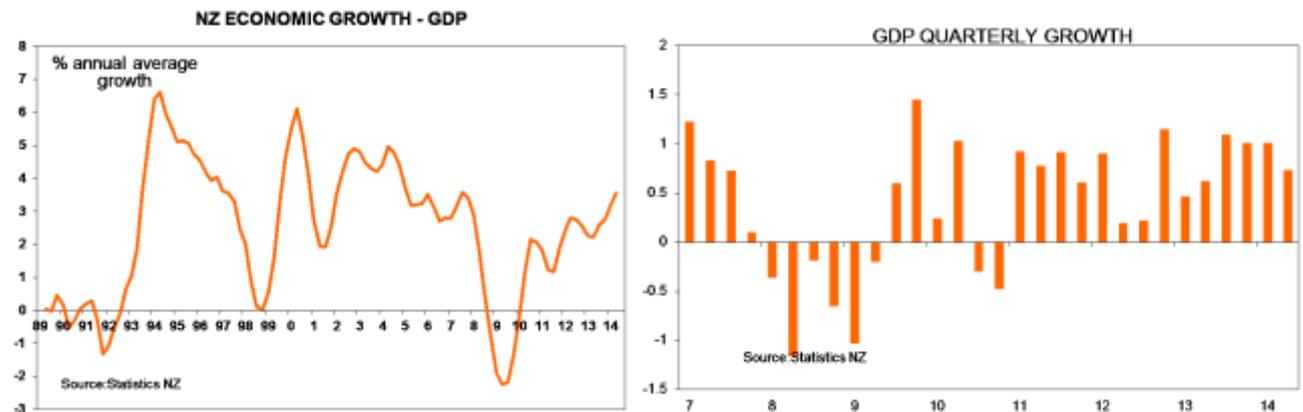
To help Kiwi businesspeople and householders make informed financial decisions by discussing the economy and its implications in a language they can understand.

Strongest Pace of Economic Growth in Nine Years

Statistics New Zealand released data this morning showing us that after growing by 1% in the December and March quarters our economy grew by a still above average 0.7% during the June quarter. This means that the official growth rate, calculated as four quarters versus the same four quarters a year earlier, rose to 3.6% from 3.2% last quarter and 2.2% a year earlier. This is the strongest annual rate of growth in the NZ economy since early 2005 so it is unsurprising that this nine year high in our growth has produced earlier revealed 3.7% growth in job numbers this past year and a fall in the unemployment rate from 7.2% to 5.6%.

Driving the 3.6% growth this past year was a near 12% rise in construction, 6% growth in agriculture, over 4% growth in retail trade and financial services, and over 5% growth in health and social care. Over the past two and a half decades the average pace of growth in the NZ economy has been 2.5% therefore 3.6% growth is well above average. Construction usually grows just 3% so 12% growth is an absolute boom. Agriculture normally grows less than 2% so 6% is also a boom – now ended.

The 0.7% quarterly growth rate was almost right on market expectations of 0.6% growth therefore the outcome had little meaningful measurable impact in the financial markets.



Continuing with comments on the still constrained retailing sector, accentuating the ongoing focus by households on better budgeting may be not just the ability to buy goods cheaper on-line, but a new reluctance to pay retail prices in NZ knowing what the item costs offshore. That is, we balk, delay making a purchase here when first confronted with the price of a book we can get for half the NZ price on Amazon, even though we may not buy that book remotely.

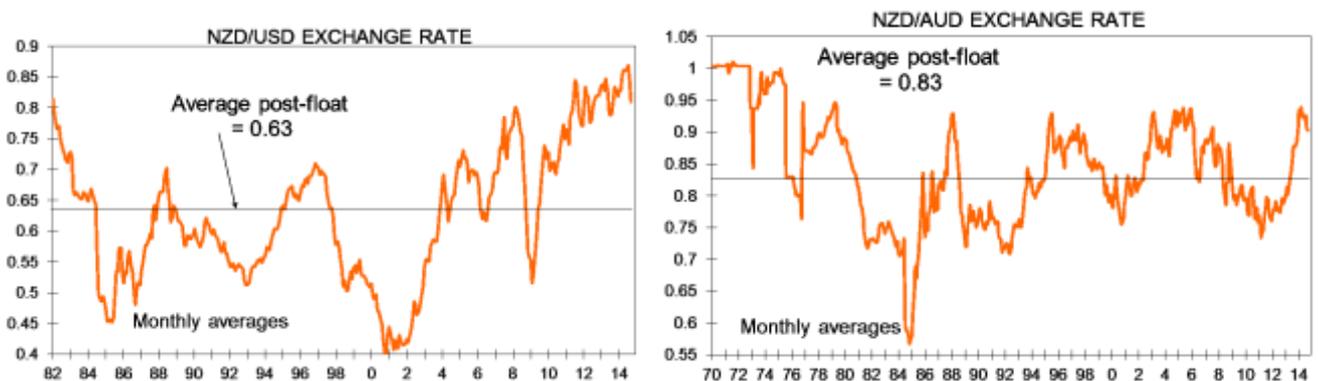
But it pays to think carefully before buying on-line if you think there is a chance your offshore purchase may need to be returned. I bought a new tramping pack recently from Bivouac in Newmarket which I could have got cheaper on-line. Once I put it on at home and stuffed it the way I stuff my old pack it felt completely wrong around the shoulders and could not be adjusted as I liked. So I took it back to the Bivouac store in Wellington (a city I still avoid shopping in when possible because of the parking difficulties and cost), and got my money back no questions asked. It would have been a long drawn-out process trying to achieve the same thing with the offshore seller.

The general election will be out of the way very soon and according to the polls we will see the return of a National-dominated government with some sort of coalition or simple confidence and supply agreement with minor players. The evidence in opinion surveys and some economic data is that the economy has slowed down heading into this election. That will reflect first of all the usual uncertainty ahead of an election which could produce policy changes relevant to people's incomes and the potential profitability of businesses and their ventures. But also we have seen the terrible sight of foreigners cynically timing their interventions in our society at the behest of a foreign convicted fraudster bent on revenge and spraying money around to buy anyone willing to sell their soul and credibility for a few pieces of silver. We've also seen a radical left-winger timing book sales for the money-making marketing opportunity offered by the election.

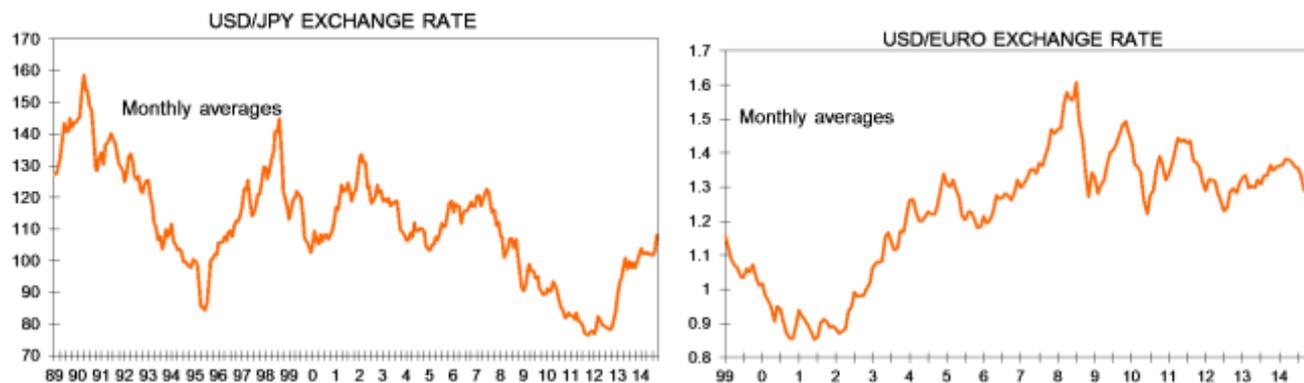
Thankfully the whole foreigners bullying Kiwis show will be over soon and businesses will be able to get back to focussing on things of true importance. These include the decreasing probability of interest rates going to anything considered serious levels this cycle as inflationary pressures remain relatively low. Shoppers are only buying above average when they can get a bargain so businesses do not have pricing power. Employees remain more focussed on job retention than wage rises so wage-driven cost pressure on consumer prices is yet to kick up this cycle. Conditions remain weak offshore so imported inflation remains low. Commodity prices are pulling back and that is exerting a disinflationary influence.

Nonetheless, while interest rates here may not rise again until March and rises after that may not much exceed 1.25% if that, this should be enough to ensure continuing good support for the NZD. Offshore economies continue to struggle, making us look good in comparison. For instance, the OECD have recognised the troubles around the planet this week with cuts to their growth forecasts. The Eurozone is picked to grow just 0.8% this year then an unremarkable 1.1% next year. In their last forecasts in May these predictions were 1.2% and 1.7% respectively. For the United States they forecast 2.1% then 3.1% growth from forecasts earlier of 2.6% and 3.5%. UK growth of 3.1% and 2.8% is picked from 3.2% and 2.7%. For Japan the numbers are 0.9% and 1.1% from 1.2% and 1.3%.

This evening the Kiwi dollar is sitting at a one year low against the USD near 81 cents from 83 cents a fortnight ago and 88 cents back in July. Why the decline? Our commodity prices have fallen, the election has created some uncertainty, some economic indicators for NZ have pulled back, and the USD itself has firmed quite a bit.



The greenback has risen to almost a seven year high against the Japanese Yen near 109 from 106 last week. It has also risen to a 16 month high against the Euro near \$1.29 from \$1.31 two weeks ago. This strength in the USD in fact accounts for a lot of the apparent decline in the NZD when we consider that since the NZD was at US 88 cents in July and we fell seven cents we have declined just three Aussie cents, a couple of Yen, two pence, and two centime (Euros). Why the strength in the greenback?



Partly it reflects funds flowing into USDs because of worries about the Scottish independence vote hitting the Pound, and worries about the European and Japanese economies hitting their currencies. Mainly however it reflects a trend rise in expectations of tighter US monetary policy next year (though with vacillations between first half and second half timing).

Where to from here? Good support for the NZD is coming from our economy compared with most others, our tightening monetary policy trend, and perhaps commodity prices having bottomed out. But the USD appears on an upward track so in a year's time while we may not be hugely changed on the crosses, against the greenback we are likely to be closer to 75 cents than 85. Or not.

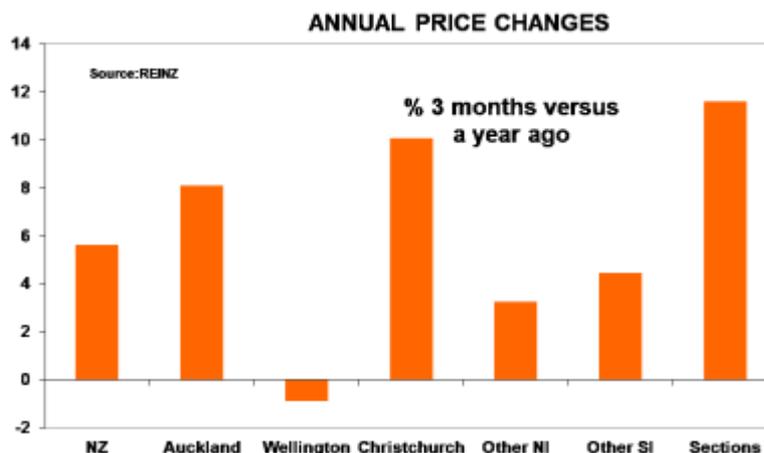
If I Were A Borrower What Would I Do?

Things have settled down again now so I would feel that I have some time on my side to make a decision. The risk however is that I might hold off locking some of my mortgage in at a fixed rate and get caught by a decisive shift in US monetary policy expectations which push those fixed rates upward. This week the opposite actually happened with a bout of feeling in the US that the Federal Reserve won't raise interest rates in the early part of 2015. Hence our swap rates are marginally lower than a week ago. Last week the view was they would, and next week the markets could go back to that view, then shift it again the week after that. This game of picking US monetary policy has been going for a few years now and will continue for quite some time.

The Federal Reserve and other central banks such as the Bank of England will be keeping an eye on how things respond in our economy to a genuine tightening of monetary policy and so far the evidence visible to them is that we are more interest rate sensitive than before the GFC. The 1% rise in interest rates when combined with the LVR credit controls have had a greater impact on housing market activity than most of us were expecting.

For instance, and recognising that there is almost certainly a pre-election effect in the numbers, during August dwelling sales around New Zealand were down by 16% from a year earlier. Sales in the ten months since the LVR rules came into play were 10% below levels of a year earlier. Sales since mortgage rates started rising from essentially the start of April were 14% down from a year earlier. Average dwelling sales prices nationwide have fallen by 1.2% in the three months to August after falling 1.2% in the three months before that ending in May, and rising 2.1% in the three months before that. Allowing for the inherent volatility one can say that for now price rises have ceased on average. However it may pay to note that average Auckland and Christchurch house price rises in the past three months have been 1.4% and 0.6% respectively from 3.8% and 3.6% respectively three months before that. The big change has been in Wellington with prices falling on average 4.8% in the past three months. That seems a bit unusual and will likely be reversed soon.

BNZ WEEKLY OVERVIEW



	This week	Week ago	4 wks ago	3 mths ago	Year ago
Official Cash Rate	3.50	3.50	3.50	3.25	2.50
90-day bank bill	3.74	3.73	3.73	3.45	2.68
1 year swap	3.90	3.93	3.93	3.80	3.02
2 year swap	4.10	4.15	4.14	4.06	3.57
3 year swap	4.25	4.29	4.30	4.28	4.00
4 year swap	4.37	4.39	4.41	4.43	4.31
5 year swap	4.46	4.47	4.50	4.53	4.55
7 year swap	4.59	4.59	4.61	4.73	4.88
10 year swap	4.72	4.67	4.74	4.93	5.15

The Weekly Overview is written by Tony Alexander, Chief Economist at the Bank of New Zealand. 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. To change your address or unsubscribe please click the link at the bottom of your email. Tony.alexander@bnz.co.nz

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