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.

If Not Up Then Down, Then Up, Then Down...

You may have noticed recently in the media that we economists have been talking in terms of the peak of this cycle's pace of growth having been reached. No problem there. The next step however is problematic – picking the extent of the slowdown. The temptation one picks up very early in this forecasting game is to think that if something is no longer going up it will soon go down so one paints worrying scenarios, and if something is no longer going down one switches to talking about it going up with again much speculation about the strength of the up bit.

This is something which most obviously happens with regard to monetary policy. If we believe the official cash rate has reached the end of a falling phase then we switch to talking about when rises will come. If it appears to have stopped rising we switch to falling talk. This behaviour is driven by a couple of things. One is the tendency for economies and therefore financial variables to move in cycles driven by things such as stocking and destocking, catching up on delayed hiring, durables purchasing, house building and so on, and delaying such things when worries grow about future income levels.

The other factor is the need for financial markets economists to deliver a story to their closest customers – the corporate dealers leasing with large clients in the corporate and funds management world. Having a story means one has an excuse for a visit. To avoid getting into trouble let me stay that there is equally strong demand from the large clients for a story upon which they can develop a strategy for the likes of hedging currency risk, minimising interest rate costs, profiting from bond yield movements, pleasing their boards and so on.

But whatever the driving forces the outcome is talk of slowing growth once a growth peak appears to have been reached and that is what is happening in NZ currently. We can look through the data coming out over the past month or so and see a growing list of things which have pulled back from peaks. Here are a few.

- Business confidence measured in the monthly ANZ Business Outlook survey has declined to a net 24% optimistic in July from a peak 71% in February.
- Consumer confidence measured in the ANZ Roy Morgan survey has declined to a reading of 125.5 from 135.8 in January.
- The annual pace of growth in dwelling sales using as our measure three month totals compared with a year earlier, peaked at 29% in early-2012, was 14% in September last year, but now sits at -11.6% in the period ending in July.
- The seasonally adjusted rate of growth in employment peaked at 1.2% in September last year then slowed in the next three quarters ending in June to 1.1%, 0.9%, then 0.4%.
- The three month pace of change in seasonally adjusted exports has fallen to -8.2% in the three months to July from -0.5% three months before, 6.5% three months before that, and 8.9% three months before that in the period ending in October 2013.
- Average dairy prices at the fortnightly Global Dairy Trade auction have declined 45% from their peak earlier this year to hit a two year low and Fonterra may further cut their $6 forecast payout this year ($8.40 last season).

So should you enter into a state of despair? Should you start digging holes and burying nuts for the cold winter to come as some appear to be suggesting with their warnings of a hard landing coming up? I think not and this is why.

Firstly, we can counter worries of an apocalyptic slowing with a simple reminder of our list of eight key factors driving growth in the near future.

Rebuilding Christchurch	Catch-up house construction in Auckland
Dairy sector investment	Earthquake strengthening of thousands of commercial buildings
Infrastructure spending	Leaky building remediation
Better world growth	A migration boom

1. Canterbury dwelling consents have reached twice their annual average level and speaking from personal experience, finding a builder for a fresh project is a nightmare. The construction sector there will be active for many years with the eventual passing of the house building boom and the contractor woes which that will bring being offset by stronger commercial building in the CBD.
2. Auckland's housing woes will take more than a generation to "solve", house consents have yet to even reach long-term average levels which produced the shortage in the first place, awareness of the shortage keeps on growing, and growing also is determination to do something about it even though physical constraints mean affordability will only get worse.
3. Dairy sector incomes are plummeting this season, as they have on a regular six yearly cycle. But the strong long-term focus remains based on growth in demand from China with the occasional piece of very positive news such as that last week involving Fonterra moving solidly into infant formula production in conjunction with a large Chinese partner.
4. There may be some 25,000 commercial buildings which need strengthening over the next 15 years to meet earthquake standards.
5. The government is determined to boost the quantity and quality of infrastructure around the country.
6. In Auckland buildings continue to leak and need fixing.
7. Better world growth was expected for this year but now those forecasts have been shifted to next year. I would consider this the least certain development in this list.
8. Migration is set to add over a net 50,000 people to our population this year and while the numbers are likely to ease off after that it is likely that above average injections will occur also in 2016 and 2017.

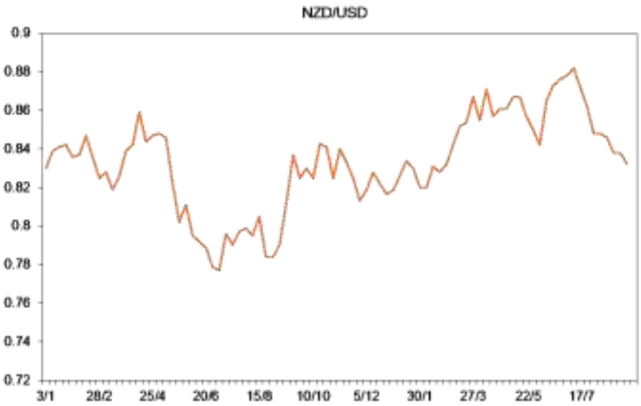
Now lets look at things from a different angle. There are certainly many pieces of data suggesting that the pace of activity growth is slowing. There are also many numbers telling us that growth will remain strong. Here are some.

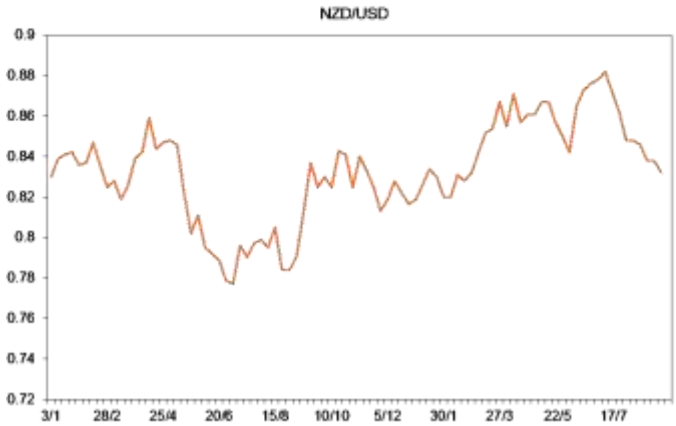
- Business confidence may have fallen from 71 to 24 but it remains well above the long-term average of just 4.
- Employment intentions are a net 18% positive versus an average 5% and are not far off the peak of a net 32% in February.
- Business investment intentions are a net 17% positive which is well above the average reading of 9%.
- Residential construction expectations sit at a net 39% positive versus average of 20% and blip-like peak of 67% in December.
- Commercial construction expectations are a net 35% positive versus an average 8%. This measure is hugely volatile and was 59% in May.
- Consumer confidence at a reading of 125.6 sits above the long-term average of 118.
- The quarterly pace of growth in core retail sales lifted from 0.9% in December to 1% in March and 1.2% in the June quarter.
- The pace of growth in the value of non-residential consents issued in six month periods compared with a year earlier lifted to 19% in July from 2% six months before and 17% six months before that.

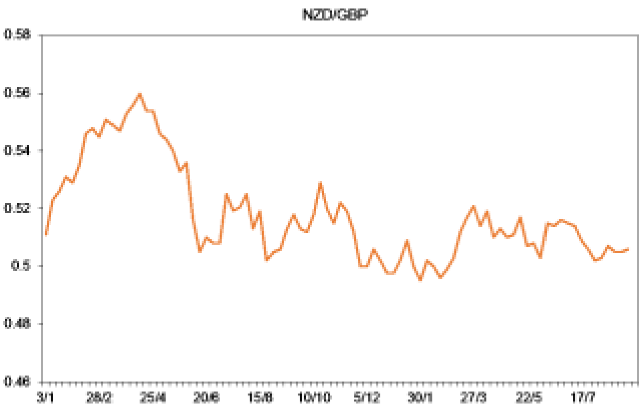
Thus, even though the pace of growth may be slowing now the outlook remains positive and it pays to remember that employment lags the GDP growth cycle so strong jobs growth remains in prospect for a while. Plus it is worth noting that there is a good chance that this period ahead of our three-yearly general election may be producing more of a negative hit to sentiment than has been the case in the past. Sitting as one does each weekday morning in the Groundup Cafe at Pauatahanui working for a couple of hours one overhears the many conversations people are having saying how disgusted they are with the radicals and journalists this election. Their sentiment is very negative and conversations always start and/or finish with the wish that the whole damn thing was over and done with so we can all get back to focussing on other things.

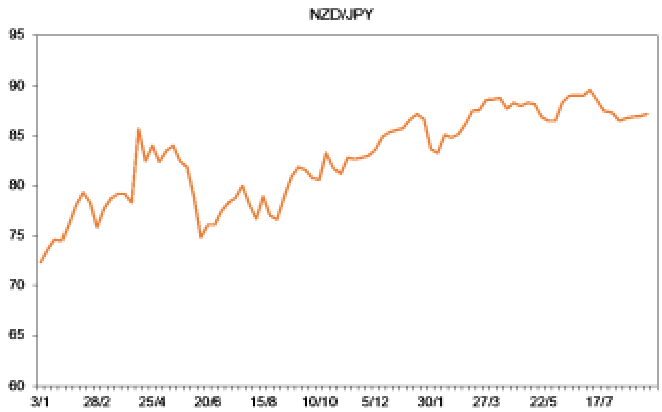
For your guide the Kiwi dollar has edged lower this week following the unexpected 6% fall in average dairy prices at the latest Global Dairy Trade auction, plus a rise in risk aversion associated with the worsening situation in Ukraine as proof emerges of Russia invading its neighbour like Hitler did, and data on the Chinese economy came in on the weak side. Forecasters are currently again easing back on their forecasts for growth in China this year and at the same time also getting a bit less optimistic about Japan following some weak investment data – and about Europe as well on the back of weak manufacturing measures. In contrast US numbers have been good this week and speculation is growing of an actual tightening of monetary policy via higher interest rates.

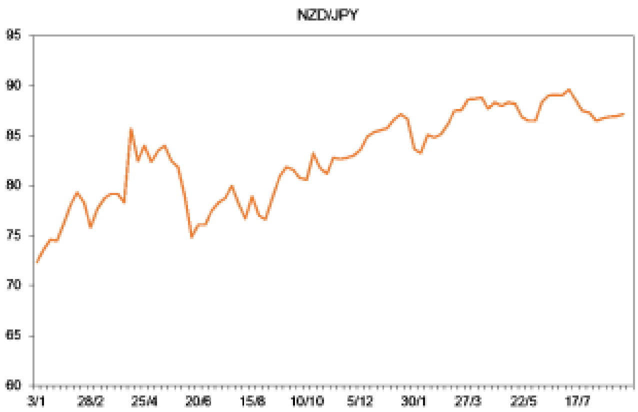
Against the greenback the NZD this afternoon is trading around 83 cents from just under 84 cents last week.

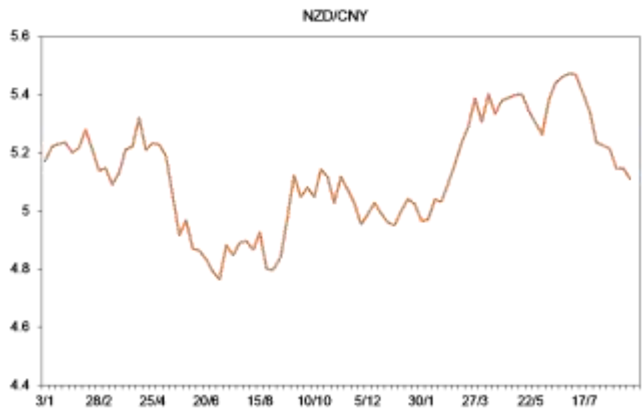








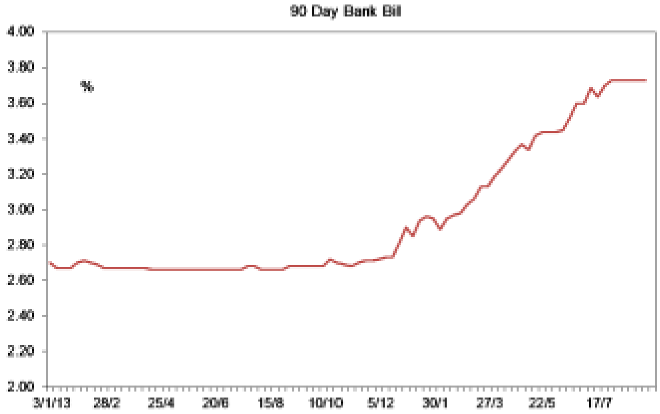


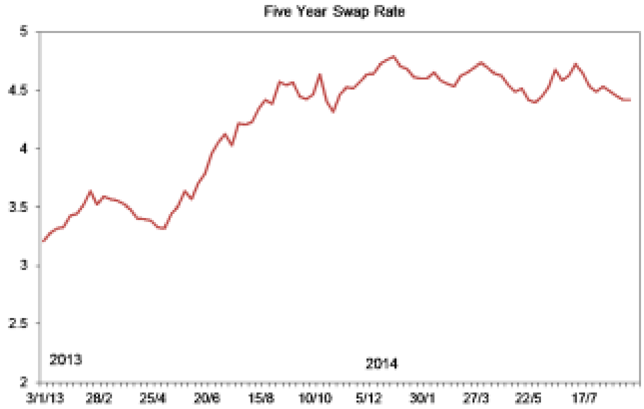


If I Were A Borrower What Would I Do?

Nothing too major has come along. The lower NZD adds to inflation risks, but slowing growth and falling confidence in the business sector suggest less risk of businesses feeling they have and can exercise pricing power to boost profits. Offshore investors continue to pile into bonds in spite of a reasonable growth outlook in the United States and expectations that the Federal Reserve will tighten monetary policy perhaps late next year. Uncertainty actually remains very high and with sharemarkets at high enough levels to make people increasingly debate whether prices have become divorced from company earnings, at the margin interest rate products are continuing to attract funds.

Thus for the moment the environment facing NZ borrowers remains relatively benign, especially as our central bank probably won't tighten monetary policy again for quite a number of months – March next year is our pick with the OCR topping outat 4.75% sometime in 2016. Subject to change of course.





I'd look to fix for three years.

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