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.

An FX Comment

Exporters and the Reserve Bank will probably be feeling a bit upset at the bounce up in the Kiwi dollar over the past couple of weeks. Before going into specifics the rise is consistent with the theme we have been running for a number of years here now. Compared with the alternatives New Zealand reveals itself to be in excellent economic shape. We are not beset with the rigid economies, ineffectual political structures, bloated public services, high and rising public debts, stifled banking sector, and imminent desperate money-printing of Europe. We do not have the huge public debt, massive deficits, destroyed property-based wealth, deflation history, and economic and political rigidities of Japan – which has just gone back into recession. We do not have 23 years of no-recession fat and inefficiencies to burn off as Australia has, nor the retreat of their mining sector from a huge investment period, nor their deficit or ham-strung parliament.

We do not have an economy driven overwhelmingly by just one city as the UK has, where they are also exposed heavily to the woes of Europe and possibly on the cusp of leaving the European Union or disturbing their links in a way which is already undermining sentiment.

We have a budget almost in balance, low government debt, a heavily deregulated economy, re-election of a pro-business government for another three years, a manufacturing sector undergoing an interesting resurgence, and an export product mix which puts us in a good position to be able to benefit strongly from growth in China's household incomes.

Thus it is understandable that although our currency has fallen in response to a big drop in dairy prices, jawboning from the central bank, and sharply altered outlook for interest rates, there is not a straight-line decline underway.

When will the NZD resume it's adjustment downward? That is impossible to say. Try thinking about it this way. Have dairy prices bottomed out? The common view is that they have – surely this time. The future then suggests upside pressure on the NZD from this source, perhaps early next year. Are private capital inflows into New Zealand from China likely to rise or fall? They will rise over time as rules restricting such investment out of China are eased and other countries restrict Chinese access to their residential property markets while we keep ours open.

If you can pick when economic prospects look much better in Europe, Japan, the UK, and Australia then you could take a reasonable stab at when the NZD might drop another eight cents. But no-one can do that.

Therefore all one is left with is this single thing. The United States economy is looking good and the Federal Reserve is likely to start raising interest rates late next year. That will tend to place some downward pressure on the NZD, and the Euro, and the AUD, and so on. In other words, late next year we might decline against a strengthening greenback, but we will probably remain strong against everything else, unless those other economies mentioned just above suddenly look a lot better. Or we get foot and mouth disease, or Ebola goes global.

For your guide, speaking in Brisbane the Finance Minister Mr English felt that in the "...mid to high 70s..." the Kiwi dollar is sustainable.

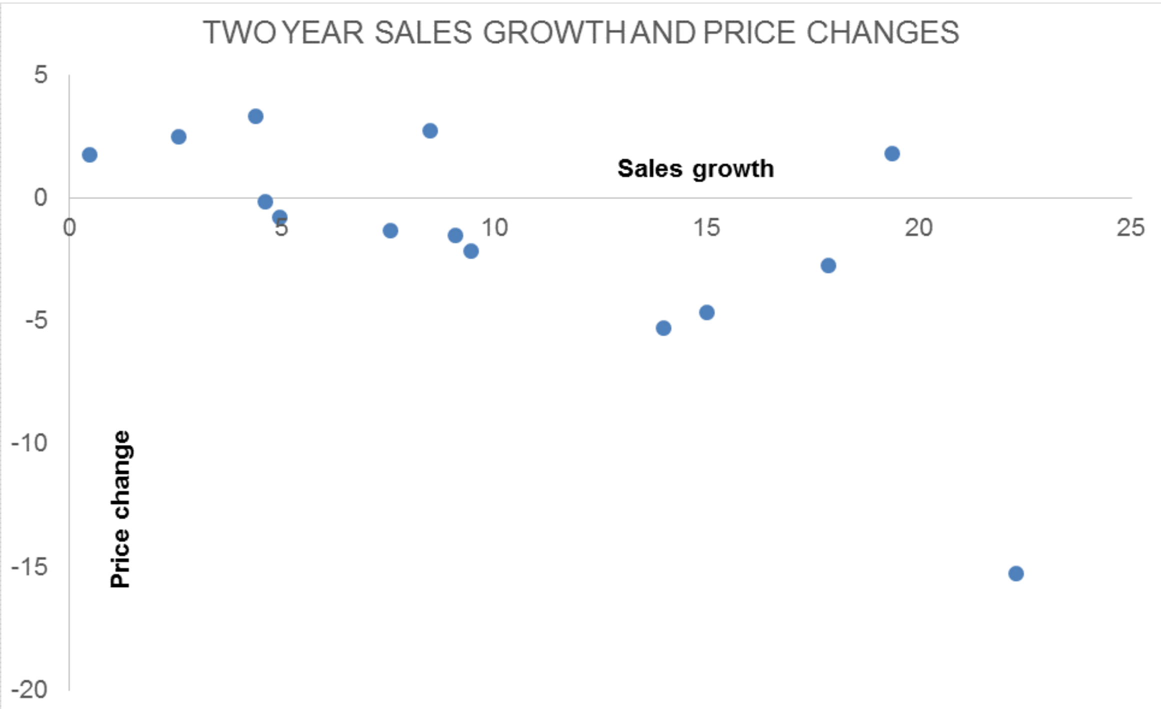
	This Week	Week Ago	4 Weeks Ago	3 Months Ago	Year Ago
NZD/USD	0.786	0.787	0.786	0.838	0.825
NZD/AUD	0.912	0.903	0.897	0.902	0.886
NZD/JPY	92.6	91	84.2	86.9	82.8
NZD/GBP	0.501	0.499	0.49	0.505	0.512
NZD/EUR	0.626	0.633	0.622	0.631	0.614
NZD/CNY	4.81	4.82	4.81	5.15	5.03
USD/JPY	117.81	115.63	107.12	103.70	100.36
GBP/USD	1.57	1.58	1.60	1.66	1.61
USD/EUR	1.26	1.24	1.26	1.33	1.34
AUD/USD	0.86	0.87	0.88	0.93	0.93
USD/CNY	6.1212	6.1263	6.12	6.1408	6.0932

If I Were A Borrower What Would I Do?

Nothing much new to say here this week. The degree of competition between banks for home loans has clearly increased. Sales targets are not being met as consumers remain debt wary and as real estate sales languish due to a shortage of listings. You should be able to cut a good deal and easily trade one bank off against another. I have found that to be the case as a term depositor.

We learnt on Monday that core retail spending in New Zealand grew by a strong 1.4% after adjusting for inflation and seasonal factors during the September quarter after rising 1.2% in the June quarter. These are strong results which produce 3.8% growth for the year to September from 3.4% a year earlier and long-term average yearly growth of 2.5%.

For your guide, the graph below plots the extent to which sales by a storetype have grown from two years ago along the horizontal axis, and price changes from two years ago along the vertical axis. The blue dot furthest down to the right registers as 22% sales growth and 15% price decline- in this case for the Electrical goods storetype.



What the chart shows is that there is a firm correlation between price declines and sales. If you are a retailer and you are on average raising your prices – your dot lies above the horizontal zero line – then your sales growth has been mediocre unless you are selling hardware – the blue dot to the upper right area reading as 19% sales growth and near 2% price rise. Hardware captures building materials prices pushed up by the Christchurch reconstruction.

What do I conclude from this simple analysis? We consumers are price sensitive. Retailers will know this and feel they do not have much pricing power. That will tend to keep inflation low in spite of strong sales volume growth recently revealed and make retailers place extra pressure on their suppliers to cut their prices. Suppliers had best be ahead of the curve in cutting their own costs and seeking productivity gains.

	Two year sales growth	**Deflator 2 year change**
Electrical & electronic goods	22.3	-15.3
Hardware & garden supplies	19.4	1.8
Motor vehicles & parts	17.9	-2.8
Furniture, floor coverings etc.	15.0	-4.7
Department stores	14.0	-5.3
Liquor	9.5	-2.2
Non-store & commission retailing	9.1	-1.5
Food & beverage services	8.5	2.7
Recreational goods	7.6	-1.4
Pharmaceutical	5.0	-0.8
Specialised foods	4.6	-0.2
Accommodation	4.4	3.3
Fuel	2.6	2.5
Supermarkets & grocers	0.5	1.7
Clothing & footwear	-0.6	-1.9

	This week	**Week ago**	**4 wks ago**	**3 mths ago**	**Year ago**
Official Cash Rate	3.50	3.50	3.50	3.50	2.50
90-day bank bill	3.68	3.72	3.70	3.73	2.71
1 year swap	3.80	3.84	3.84	3.94	3.14
2 year swap	3.98	3.99	4.03	4.11	3.61
3 year swap	4.11	4.13	4.15	4.27	4.00
4 year swap	4.19	4.21	4.23	4.37	4.28
5 year swap	4.27	4.29	4.29	4.46	4.52
7 year swap	4.54	4.40	4.39	4.57	4.85
10 year swap	4.53	4.55	4.49	4.69	5.12

Were I borrowing at the moment I would look for either a five year rate just below 6% or three year at 5.85%.

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
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