

# BNZ Weekly Overview

ISSN 2253-3672

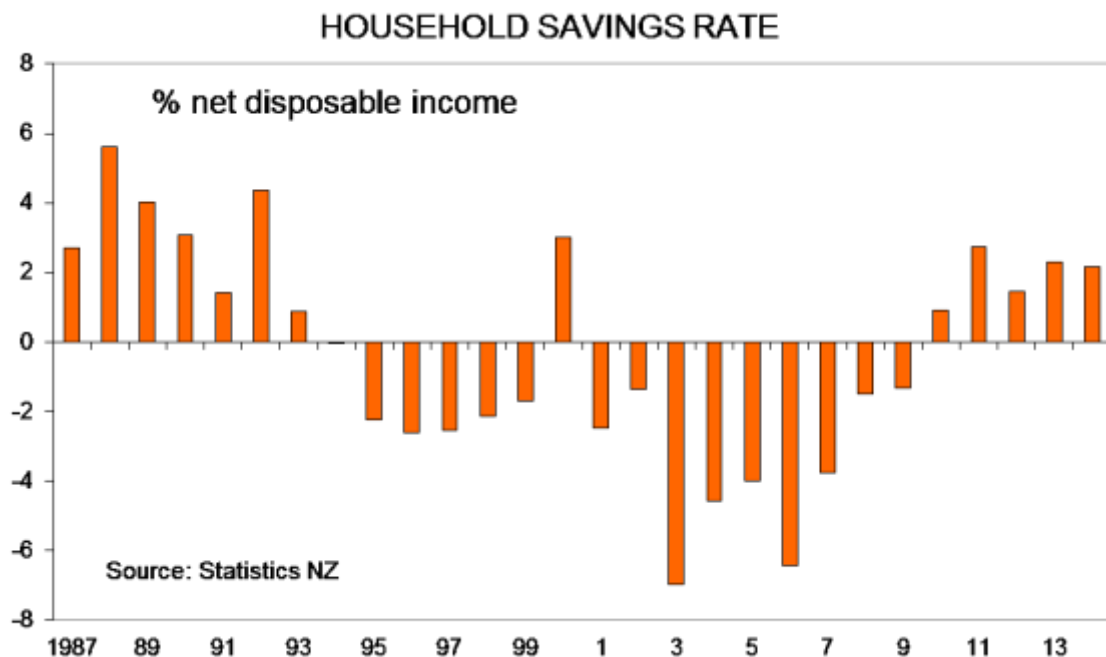
## Mission Statement

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

## Saving More

Many things have changed since the GFC of 2008-09 and one day I may attempt a listing of the ones which come to mind – such things as debt aversion, heightened sensitivity to interest rates, price sensitivity but not increased aversion to investing in residential property. This week we received information confirming that Kiwi household savings behaviour has changed.

The following graph shows the household savings rate improving firmly from 2007 as we eased off from a big spending splurge, and moving into positive territory from the year ending March 2010. The rate has now been positive for five years though there is no increase underway. The latest rate is 2.1%, the worst rate was -7% in 2003. What will be interesting to see is if this positive rate will be sustained once people start feeling more confident about their employment and perhaps start spending some of the paper wealth gained from rising house prices in our two biggest cities. Did you know that since the start of 2009 average house sale prices in Auckland and Christchurch have gained 46% and 41% respectively.



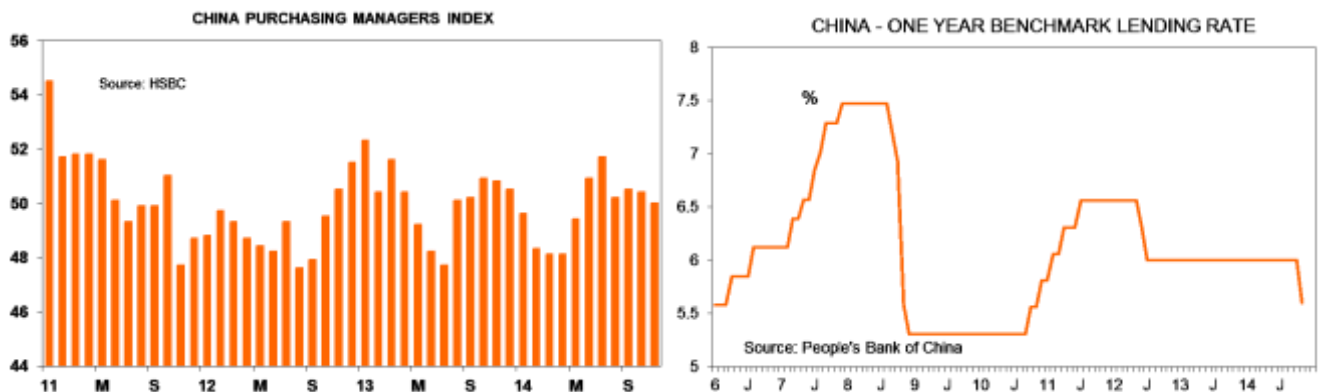
Keep an eye on Auckland in the coming year. The pace of price rises looks like it might accelerate not just because of the migration boom, new outlook for low interest rates, and the worsening shortage, but a new flood of Chinese buying is likely as the Australian's are on the cusp of radically tightening rules and enforcement of rules around foreign residential property purchasing.

## Monetary Policy Easing Offshore

In another example of how central banks are having to adjust their settings in response to growth surprising on the weak side, last Friday the People's Bank of China cut its two key interest rates for the first time in two years. The main rate, the One Year Benchmark Lending Rate, has been cut from 6% to 5.6% while the One Year Benchmark Deposit Rate has been cut from 3% to 2.75%.

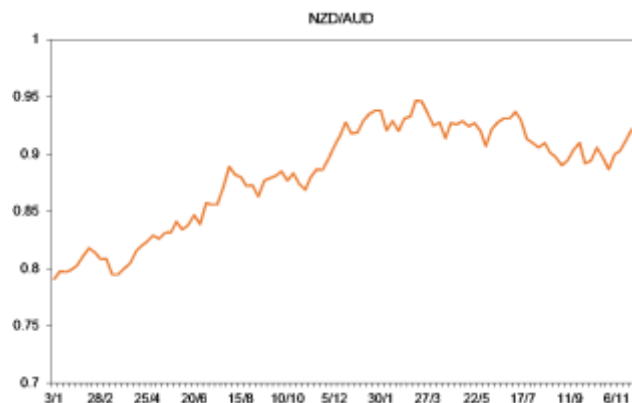
The move followed news from HSBC of a further fall in their largely small company-focused Purchasing Managers Index to a neutral reading of 50 in November (preliminary) from 50.4 in October. The result means no manufacturing sector growth and reinforces the chances of GDP growth this year in China coming in below the official target of 7.5% with the latest pace being 7.3% in the September quarter – not that one should consider the numbers to be accurate in a country where greater emphasis is given to preserving social harmony than delivering statistical accuracy.

That emphasis perhaps explains why in Brisbane last week the Chinese President acted politely while the US President slammed his hosts for not doing enough in his opinion to preserve the Great Barrier Reef. In just one week the status of China in the Pacific has been handily elevated while the US President has rubbed people the wrong way. Thankfully no-one offshore considers we have anything here of global significance for them to weigh in on or we could find ourselves indignant and challenged as well like the Australians. Except cows. Imagine how wealthy we could be if we could get Chinese consumers hooked on sugar-enhanced chocolate milk!



Back to Australia where I am at the moment attending a conference, concerns about short-term growth have deepened following a fall in iron ore prices below US70 a tonne. That level makes many producers uneconomic and the chances are that further resource development projects will soon be canned, and that means a continuing incentive for Kiwis and Aussies to shift here, and reduced incentive for us to hop across there. The enhanced NZ population growth will tend to boost Auckland real estate in particular and provide extra labour which will help suppress wages growth and therefore keep NZ consumers looking for bargains when they want to spend. Retailers will have to remain price-focused even as their customer bases grow because of the extra population growth.

Concerns about growth in Australia are now so great that expectations have soared of an easing in monetary policy (their cash rate is 2.5% and this explains why the Kiwi dollar is now trading above 92 Aussie cents headed back perhaps to 94 cents, and goes to reinforce the consistent message we have been delivering here that New Zealand looks fantastic compared with most other economies against which our currency commonly trades.



We also saw more comments from the European Central Bank President this week indicating high willingness to undertake further money printing (bond buying) in order to try and stave off deflation and perhaps boost growth in the Euro-zone. But in the absence of widespread structural economic reforms downside risks remain for European growth this coming decade, especially given the massively entrenched reluctance to embrace reforms, the political structures which make such reforms near impossible, high labour costs now relative to the United States, and now high relative energy costs as well. The latter arises courtesy of the US shale boom producing cheap gas in particular, while Europe's drive for clean energy has cost a lot of money and produced expensive energy in the short to medium term.

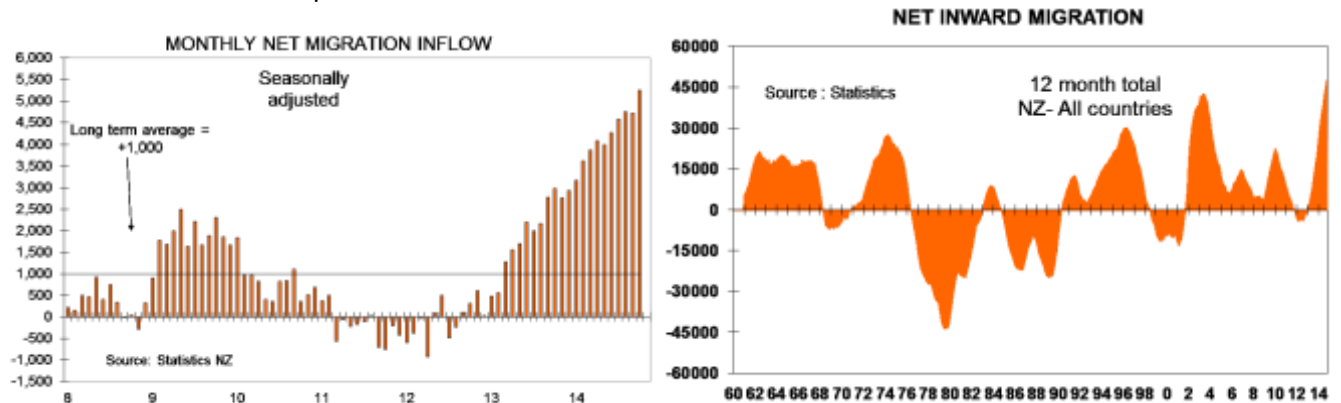
The slow movement of fresh investment into the US could become a flood in the coming few years with outright departure of corporates from Europe. This just reinforces the need for New Zealand to place greatest emphasis at all levels on linkages with the US, Australia, and Asia while cutting back on efforts put into Europe as more bits of it slip under the control of Russia.

The relevance for ourselves is ongoing strength of the NZ dollar against the Euro which looks more and more structurally weakened, plus pressure for interest rates to remain low which will further encourage our central bank to look at quantitative monetary policy tools (aimed at property investors). Money printing will tend to keep cash flowing into assets globally, hence rising property prices and well supported sharemarkets.

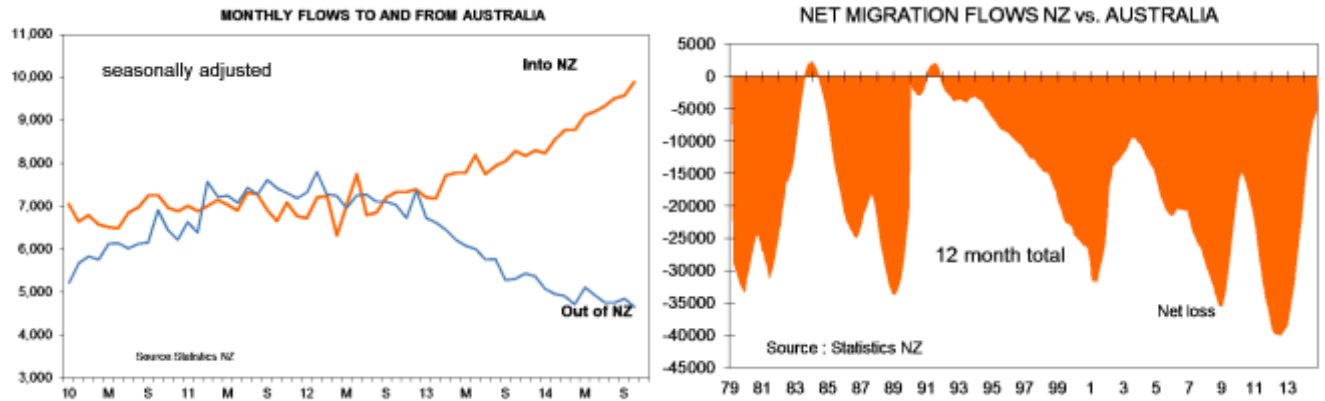
One day the printing will need to be unwound and unless that unwinding perhaps many years down the track occurs at the same time as surprisingly strong yet not too inflationary growth, there could be some wild market weakness.

### Booming NZ Net Immigration

Speaking of population growth just above, we learnt this week that in seasonally adjusted terms there was a huge net migration inflow into New Zealand in October of 5,250. This was up from 4,730 in September and means that for the entire year to October the net migration gain for the country was 47,684. This compares with a net gain of 17,490 a year ago, a loss of 2,319 two years ago, and an average gain for the past two decades of near 12,000 per annum.



This huge boost to our population of over 1% obviously adds to the pace of overall economic growth.



### Migration, Regions, Innovation, Asia, London

There are a few undercurrents out there which planners should keep an eye on. One is rising wealth inequality in New Zealand and overseas which may eventually elicit some fairly interventionary housing and growth-sapping income redistribution policies from a future left-wing government. Another appears to be rising employer exploitation of staff manifesting itself significantly in migrant treatment of other migrants, franchise owner treatment of near minimum-wage staff (petrol station owners making staff pay for drive-offs and supermarkets making staff pay for shoplifting losses), and employers taking staff desire for job security post-GFC for granted by offering minimal if any wage and salary rises.

Another is deepening noting and in some locations (the regions), worries about static or declining populations outside our main centres. I have noted previously that people need to stop thinking about New Zealand as being a homogeneous population with a few more people in some places than other – thinking that Auckland is simply a big Wanganui – and instead recognise that there are stark structural differences between the two big cities (and Wellington in a special but less dynamic extent) and other locations not offering some specific economic differences – such as New Plymouth’s energy and engineering, or Queenstown’s tourism and wealthy lifestyle opportunities.

The Economist magazine summed the situation up well this week when discussing the strong growth in London compared with most other UK cities.

“One explanation is that agglomeration effects—the economies of scale when businesses cluster—are getting more important as the economy shifts towards high-tech and finance. Information-sharing and networking, which benefit such industries, work best over a small area. City centres that managed to reach a certain density of these businesses will now continue to attract more of them; those that did not will thin out, falling prey to a range of powerful economic and social forces.”

<http://www.economist.com/news/britain/21633907-britains-largest-cities-are-centralising-smaller-ones-are-doing-opposite-empty-centre>

Auckland is New Zealand’s big agglomeration, our London, while Christchurch is the South Island and therefore secondary London with huge opportunities in future years as the CBD fills in again and the visual image of the city becomes quite entrancing from a business, living, and visiting point of view.

This is something quite different from the telecommuting which people thought many would embrace and cause population shifts away from the big cities. Ideas people want and need to be around other ideas people, and that is why Kiwis should not start thinking that we are going to become a high tech enclave in the South Pacific with thousands of people shifting here but working remotely for or with companies back in San Francisco or elsewhere. Such examples are interesting but will not be widespread. We are too far in the global wop wops and remuneration levels are too low.

Lifestyle in the regions is all well and good and many embrace it to the full. But our big cities will attract the country’s ideas people by and large, and regions should not start getting so enamoured with their lifestyle

advantages that they think they can attract ideas migrants to any great degree. Another focus will be needed to get your share of migrants – keeping in mind that this current burst of high net immigration will not last. Our flows go through cycles and eventually the numbers will flatten, turn down, then go negative again. By the time you develop a policy to attract migrants there is a risk the cycle has peaked and your spending is wasted.

Don't look to a government change in migration policy either as your population and business saviour. Such a development is very unlikely. Who could possibly implement a migration policy favouring the locating of migrants in regions with reduced job and income advancement possibilities (relative to our Londons) when it is exactly those things which the migrants are coming here for. Assuming that people will be so glad to be in our remote paradise that they will willingly go to where they are told is naive and again probably reflects a belief in many people's heads that the only difference between Auckland and Christchurch and the regional towns is population size.

Where we want people to go is where their connectivity and keenness has the highest probability of good long-term payoff, especially in the area of innovation – which is what the conference I am attending in Sydney this week is all about. (More below)

Regions should focus first on retaining the business and people they already have, facilitating the growth and development of those same businesses and the sectors which they are in, then think about attracting new businesses. Don't try to create whole new industries or use council money to "invest" in something like a new sock factory.

Back to "The Fifth Asia-Pacific Innovation Conference". It is only just starting ten minutes after writing this little section so I will report and bits worth mentioning next week. The one bit worth getting it quickly here however is this from the short programme introduction by Professor Thomas Clarke of the Centre for Corporate Governance, University of Technology, Sydney"

"...There is an international focus upon the Asia-Pacific as an engine of economic growth and innovation. From a neo- perspective (ed. note, growth driven by innovation) we are increasingly engaged in shortening and intensifying cycles of innovation. The successful IPO of Alibaba this year demonstrates innovation in the Asia Pacific is moving beyond manufacturing into the knowledge economy..."

Point one which I wish to make is to note this Asia Pacific dynamic at a time when Europe, even in the words of the Pope for goodness sakes is seen as "...being somewhat elderly and haggard, feeling less and less a protagonist...", is relevant when we think of the international linkages which are of most value to us, and the migrants as well.

Point two is that the research I noted a couple of years ago with regard to New Zealand's business culture was that as Kiwis we are good at inventing things but suck big time when it comes to converting the ideas into profitable business products. The innovation process is the step beyond simple ideas and invention.

The third point is that if this interests you then go to the NZ Herald edition today, page B14, where Peter Lee, adjunct Professor at the University of Auckland, has published a very good article about choosing the appropriate tools for managing innovation. The idea that there are varying yet standardised ways for undertaking such innovation is interesting and probably not something which over 95% of idea generators in the NZ business sector would have any idea about.

- Tools for innovation
- Asia links (this century's location for stellar economic, intellectual, social, urban, innovation etc. growth.)
- Agglomeration of business activities and people in Auckland and Christchurch

These are three things key to growing incomes in New Zealand. Note however that in no way do they directly imply any degradation of the role of our primary sector and therefore the importance of regional towns as primary-servicing locations and conduits between the potentially best domestic users of ideas and innovation in New Zealand, and those who can undertake the innovation then take it to the world.

### FX Reality

Early this week I received this email from a Kiwi in London.

“As pleased as I am to read about New Zealand’s rude economic good health, we would still like to idly speculate on the GBP NZD fx position some three years out. If you were to scratch your head and put your finger in the air, where do you see the rate moving to by the close of 2017? Are we dreaming to expect Sterling to get back up to circa 2.5 levels anytime this decade?”

We appreciate that trying to predict fx accurately is like trying to predict the patterns in the cloud cover two weeks out.”

My reply was this.

“Based on our growth forecasts and taking into account the post-GFC breakdown in economic models on top of the usual zero predictability of exchange rates three months out let alone three years, I currently expect the NZD/GBP rate then to lie within a range of 0.4 - 0.6. You seek 0.4 or 2.5 your way around and I would suggest that should an event in the next three years produce such a rate I would transact the kitchen sink. After all, in early-2009 the rate was near 0.35 or 2.85. Good luck.”

Just to reinforce the idiocy of anyone thinking that economics can give you reliable forecasts of things post-GFC – no-one picked an over 30% collapse in oil prices at the same time as ISIS spreads through Syria and Iraq and Libya collapses. No-one picked an over 40% decline in Fonterra’s payout this season. The sharp fall in Aussie’s iron ore prices to five year lows has caught all companies out, many of which risk now going bankrupt. No-one picked the coming 60,000 NZ net migration inflow.

In this new world you must not develop a strategic plan highly dependent upon someone’s forecasts proving correct. You need to emphasise flexibility in your hiring and remuneration practices, stocking levels, property leasing and so on. As an investor be wary of companies without such flexibility and perhaps with boards made up of staid individuals wedded to “The Plan”.

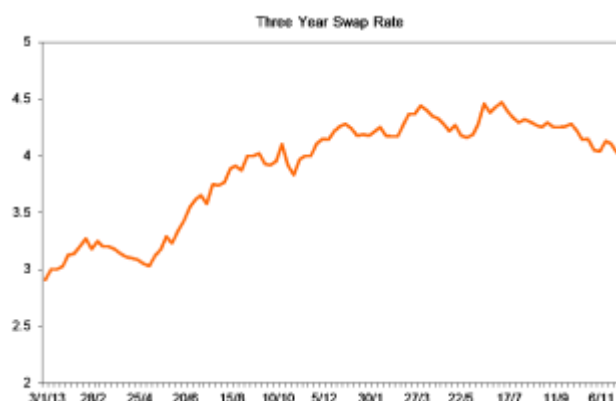
	<b>This Week</b>	<b>Week Ago</b>	<b>4 Weeks Ago</b>	<b>3 Months Ago</b>	<b>Year Ago</b>
NZD/USD	0.788	0.786	0.78	0.838	0.813
NZD/AUD	0.922	0.912	0.887	0.897	0.896
NZD/JPY	92.8	92.6	84.9	87	83
NZD/GBP	0.499	0.501	0.487	0.505	0.5
NZD/EUR	0.63	0.626	0.617	0.635	0.599
NZD/CNY	4.84	4.81	4.77	5.15	4.95
USD/JPY	117.77	117.81	108.85	103.82	102.09
GBP/USD	1.58	1.57	1.60	1.66	1.63
USD/EUR	1.25	1.26	1.26	1.32	1.36
AUD/USD	0.85	0.86	0.88	0.93	0.91
USD/CNY	6.1385	6.1212	6.113	6.1434	6.0929

### If I Were A Borrower What Would I Do?

Competition between banks is strong. I would bargain and look for a sub-6% rate in the three to five year area. Such rates are out there. Note that wholesale borrowing costs for banks have fallen again this week.

## BNZ WEEKLY OVERVIEW

	This week	Week ago	4 wks ago	3 mths ago	Year ago
Official Cash Rate	3.50	3.50	3.50	3.50	2.50
90-day bank bill	3.70	3.68	3.70	3.73	2.71
1 year swap	3.78	3.80	3.76	3.90	3.22
2 year swap	3.93	3.98	3.91	4.06	3.72
3 year swap	4.03	4.11	4.05	4.25	4.11
4 year swap	4.11	4.19	4.14	4.34	4.35
5 year swap	4.18	4.27	4.22	4.42	4.58
7 year swap	4.30	4.54	4.34	4.54	4.91
10 year swap	4.43	4.53	4.46	4.64	5.19



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](http://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](mailto:Tony.alexander@bnz.co.nz)

This publication has been provided for general information only. Although every effort has been made to ensure this publication is accurate the contents should not be relied upon or used as a basis for entering into any products described in this publication. To the extent that any information or recommendations in this publication constitute financial advice, they do not take into account any person's particular financial situation or goals. Bank of New Zealand strongly recommends readers seek independent legal/financial advice prior to acting in relation to any of the matters discussed in this publication. Neither Bank of New Zealand nor any person involved in this publication accepts any liability for any loss or damage whatsoever may directly or indirectly result from any advice, opinion, information, representation or omission, whether negligent or otherwise, contained in this publication.