

# BNZ Weekly Overview

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## Mission Statement

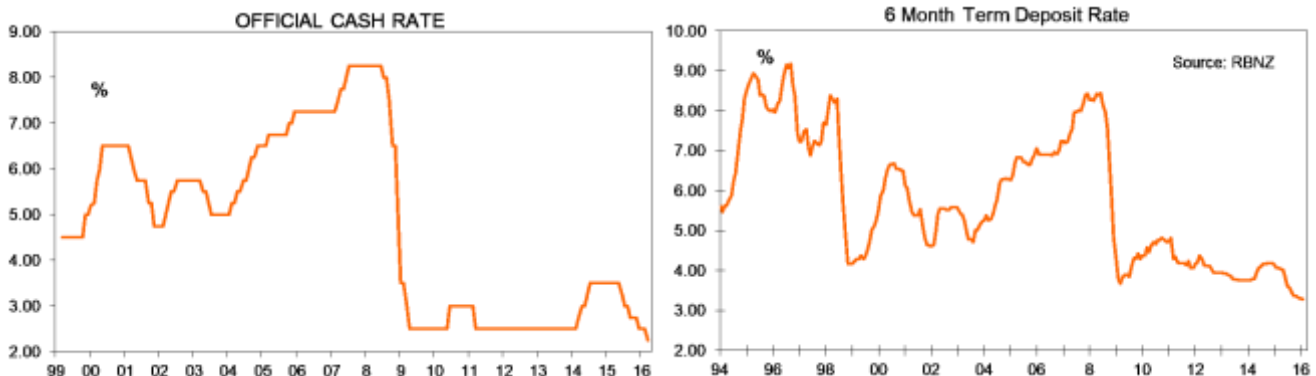
To help Kiwi businesspeople and householders make informed financial decisions by discussing the economy and its implications in a language they can understand.

## Monetary Policy Eased Again

The global story currently is one of deepening worries about prospective growth rates, high volatility in financial asset and commodity prices, and central banks easing monetary policies to try and boost growth and stoke some inflation. The fact that central banks are still doing this almost eight years after the global financial crisis hit its strides in late-2008 means that such easings to date have not done the job.

Therefore moving to a -0.1% rate in Japan and -0.3% rate in Europe probably won't achieve the results desired in a world where people and businesses are far more cautious about raising debt levels than in the past, and inflation is settling structurally lower for a variety of reasons ranging from technology developments to reluctance of employees to seek high wage rises. In the United States the Federal Reserve is still signalling that they will raise rates further, but the markets have changed from expecting four rate rises there this year when the first rise occurred in December to assigning about a 60% chance to only one more coming maybe toward the end of the year.

Here in New Zealand our central bank has responded to the deepening worries about world growth, rise in bank funding costs offshore, rise in the NZ dollar, falls in local inflation expectations, and decline in dairy incomes by cutting the official cash rate this morning from 2.5% to 2.25%. They have signalled a further cut as likely and that probably will come in June though April cannot be ruled out.



We had thought they would wait for a bit more data before acting and the markets had only given about a 30% chance to a rate cut coming today so the surprise has seen the NZD drop back from around 68 cents to lie exactly where it was last Thursday near 66.5 cents. We discuss the currency and interest rates in more detail in following sections.

One thing to keep an eye on in coming months will be the response of investors to their worsening outlook for returns on simple bank deposits. As investors factor in lower returns on low risk assets they will increasingly chase returns on other assets. This is why we have foreign parties seeking properties in New Zealand and it is likely that affected investors here will initially look for corporate bonds then join the crowd and look for higher property exposure. Falling interest rate expectations will boost housing demand and push prices higher all around New Zealand.

### Housing

Nothing this week beyond a restatement of our key thoughts.

Aucklanders since just before the middle of last year have been buying assets in the regions. The locals have seen this and joined in. Construction in the regions is rising now that supply is drying up and people are buying into stories of Auckland being so expensive that there will be a flood of people leaving the city to live in the wonderfulness of our smaller urban locations. They won't in bulk numbers though a few people will and the local media will write about them. There will be over-investment in new subdivisions and dwellings in some areas because of over-optimistic population growth forecasts and eventually, a few years from now, this will cause problems for some late cycle investors. For now the ball is rolling.

Many investors are still adjusting to a world of permanently low interest rates and they have yet to enter housing markets. Their yet to arrive buying will help underpin all locations these coming couple of years.

The Chinese buyers will eventually come back into Auckland as they find ways to get capital off the mainland.

Migration net inflows will stay strong and remain concentrated in Auckland, worsening the housing shortage, pushing prices higher.

House building will be a strong source of economic stimulus for the economy in all but Christchurch over the next two or three years. Construction costs will rise, difficulties sourcing tradespeople will grow.

### NZ Dollar

If the Kiwi dollar was going to fall strongly on the back of lower dairy prices then it would have done so by now. It is already fully factored into expectations that dairy producers will have three bad seasons in a row and that this will dent New Zealand's export earnings. However, to the extent that the balance on goods and services exports and imports matters to exchange rate movements and it doesn't really over less than the very long-term, there is massive offset to dairying weakness.

This offset is coming from the likes of tourism where visitor numbers have soared over 11% in the past year and their spending has risen three times more than that. This is fostering an investment surge in tourism assets and employment growth in the sector. The export education sector is also growing strongly with a surge in Indian student inflows. Conditions and growth are reported to be good in sectors like honey, wine, pipfruit, forestry and beef to a lesser extent.

These good news stories will attract interest from offshore in investing in NZ assets and there are reports of large institutional fund managers from overseas trying to buy just about any commercial property someone is willing to sell in our major centres in order to get higher yields than they can find offshore. There are reports also of some increase in recent weeks in the number of Chinese entering the residential real estate market in Auckland.

New Zealand offers higher interest rates than on offer in other developed parts of the world, even after this morning's 0.25% rate cut, our economy is nicely deregulated with high rankings on many economic scorecards like low corruption and ease of starting a business and accessing credit. The government's accounts are in good order with the latest two months' accounts coming in better than expected and leaving open the possibility of a surplus for the second year in a row.

There is also good support for the overall pace of economic growth not just from non-dairy exports but construction, strong consumer spending growth, infrastructure spending, and of course the ongoing and yet to peak migration boom.

With so many positive things happening it is not surprising that the Kiwi dollar retains a lot of strength at a time of rising pessimism around the world regarding geopolitical stability and the pace of global growth.

Nevertheless, this morning's rate cut by the RBNZ was a move taken earlier than the markets and ourselves expected so the NZD has eased off and wiped out gains made earlier in the week assisted by all of the just mentioned factors. This afternoon we sat against the USD unchanged from a week ago and in fact four weeks ago also just below 67 cents.

We have ended unchanged from last Thursday and a month ago also against the Japanese yen but well down against the Australian dollar near 89 cents from 91 cents last week and 94 cents a month ago. This five cent decline over the month largely reflects a strong AUD. The AUD has risen mainly because of some better than expected data on the likes of GDP growth during the December quarter along with inflows of foreign capital seeking exposure to the agribusiness sector, booming tourism, the very recent jump in some minerals prices, new economic stimulus policies in China, and an overall view that the economy is adjusting well to the mining slump.

Where to for the NZD from here? We retain the view we have long been expressing. There is scope for the NZD to decline on the back of world growth worries and a fall back below US65 cents is possible. But if and when such a fall comes along exporters should give serious thought to boosting their hedging and importers should think about delaying account payments because the chances are that the NZD will go back up again relatively quickly. Which is what it has had a bout of doing already. We were trading at US 64 cents less than two months ago. Against the AUD at 89 cents feels like a good time personally speaking to be moving some funds out of AUD back into NZD if that is something one has been thinking about doing for some time. This is the lowest we have been against the Aussie dollar since August last year.

Regarding the pound one would be unwise to run large open positions currently given the uncertainty and likely fluctuations in views surrounding the June 23 referendum on whether the UK stays in the European Union. The pound has weakened recently in response to an increased probability being assigned to the country voting to leave. Anything is possible and don't be surprised if the pound suddenly regains strength should some polls show majority support for staying.

Predicting movements in the Japanese Yen has always been very difficult but has become more so recently. There is clear downward pressure from the move to negative interest rates, printing of money with no end date in prospect, and slow realisation that Abenomics is not boosting either the pace of economic growth or inflation. Yet there is upward pressure on the Yen as investors consider it a safe asset to buy when worries grow about the world economy, partly because of the current account surplus Japan runs.

The Euro is highly vulnerable to worries about economic disturbance associated with Brexit, faltering growth in many economies and new unrest in that hotbed of socialist reality denial France, and indications from the ECB that monetary policy could easily be eased yet again to try and boost growth and inflation.

Out of all of this the greenback ends up looking good, along with the AUD and NZD. Good luck picking trends in this uncertain world and be extremely careful about running open currency positions. The risk of event shock causing large changes in major currencies is very high.

You will find current spot rates here. <http://www.xe.com/currency/nzd-new-zealand-dollar>

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

As noted above the RBNZ have expressed concern about the further deterioration in the dairy sector and world economy, falls in inflation expectations and rise in the currency, and increase in bank offshore funding costs (credit spreads) so have cut the official cash rate to a record low of 2.25% from the 2.5% it was taken to back in early-December. They have also pencilled in another cut later this year according to their forecast track for the 90-day bank bill.

As a result of their cut we may or may not see a round of cuts in retail interest rates occur. The may not possibility exists because of the rise in the cost to NZ banks of raising funds offshore caused by investors becoming newly nervous about European banks and us banks down here getting caught in the backwash. It is hard to know how these factors will balance out. Therefore if I were borrowing at the moment I would feel

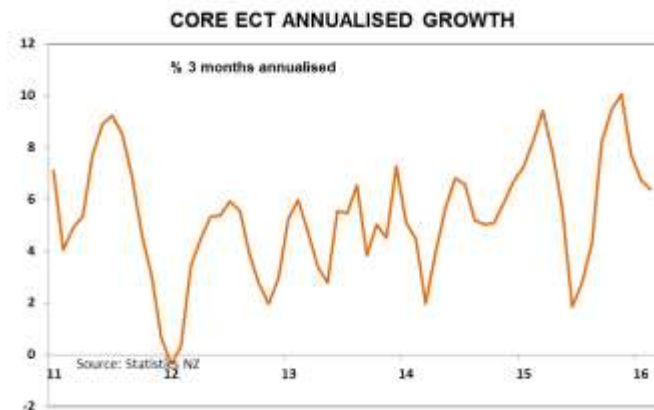
inclined to hold off for maybe a week before making a decision regarding what term to fix at. My desire would be to fix for three years at the current rate we offer of 4.64% but I would be prepared to punt on a cut within a week or two though this is not guaranteed.

### If I Were An Investor

The text at this link explains why I do not include a section discussing what I would do if I were an investor. <http://tonyalexander.co.nz/regular-publications/bnz-weekly-overview/if-i-were-an-investor/>

### For Noting

The earliest gauge we get of any changes in the pace of growth in consumer spending comes from the monthly Electronic Card Transaction data released by Statistics NZ. These data showed very strong spending growth exceeding 10% at an annualised pace up to late last year but since then things have slowed down and the latest annualised pace of growth is 6.4% in the three months to February for core retail spending. This is above the average growth rate of 5.7% achieved when inflation was running at higher levels than now therefore we can say there is actually a very good pace of growth still happening in consumer spending.



In fact for just the month of February spending rose 1.2% but the monthly data can be highly volatile which is why we average over three months before calculating an annual pace of increase.

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)

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