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.

Low Interest Rates For A Long Time

This morning the Reserve Bank released their latest Monetary Policy Statement and reviewed the 2.25% level of the official cash rate. As was near universally expected the rate was left at the 2.25% it was taken to in March and exactly the same words were used to describe the RB's view that further easing might be needed.

"Monetary policy will continue to be accommodative. Further policy easing may be required to ensure that future average inflation settles near the middle of the target range. We will continue to watch closely the emerging flow of economic data"

http://www.rbnz.govt.nz/monetary-policy/monetary-policy-statement/mps-june-2016

Does inflation seem headed for such mid-ground? Not really. The current inflation rate is 0.4%, the exchange rate is about 4% above the long-term average, the World Bank last night cut its global growth forecast to 2.4% from 2.9% for 2016, and recent growth measures have been weak in the US, Japan, China, Europe and the UK. Wages growth still shows no signs of accelerating, Offsetting this oil prices have moved back above US50 a barrel overnight, measures of capacity utilisation have lifted slightly, and inflation expectations seem to have stopped falling.

But with foreign inflation measures still generally declining the clear risk is that the Reserve Bank will find that further interest rate stimulus needs to be applied to the NZ economy. This is especially so as they have assumed both that the world economy improves and our currency declines. The chances are that the official cash rate will be cut again in August to 2.0%.

For your guide, in their Monetary Policy Statement the Reserve Bank see the 90-day bank bill yield, currently just over 2.3%, still sitting at 2.1% come the middle of 2019. In other words they anticipate no need for higher NZ interest rates for at least the next three years.

Housing

Nothing new to add this week having written quite a bit on this subject recently. Insufficient construction, low interest rates for decades, strong population growth, ever rising construction standards and costs etc. all add up to high and still higher prices. Watch for a new credit supply control soon from the Reserve Bank as with the one hand they stimulate the housing market through record low interest rates and with the other try to impose restraint while waiting for supply to catch-up over the next decade or so. Note that in this morning's MPS the RB wrote "**House price inflation is likely to persist in the near term.**"

NZ Dollar

Commensurate with our long held view that there is a big list of factors strongly supporting the Kiwi dollar we have this past week seen the NZD trade above US 71 cents. The main cause of the three cent jump from a week ago was the worse than expected employment growth number for the United States. Jobs grew just 38,000 in May rather than the 160,000 which had been commonly estimated. The implication of this outcome is that the next tightening of US monetary has – surprise surprise – been pushed back out yet again.

Our warning since last year has been that assumptions of a steady upward path for US interest rates need to be restrained in light of complete rate rise reversals in numerous countries since 2010. These include New Zealand, Australia, Sweden, the Eurozone and so on. The way things are going there may be no further US rate rise this year and if there is then it could be reversed next year.

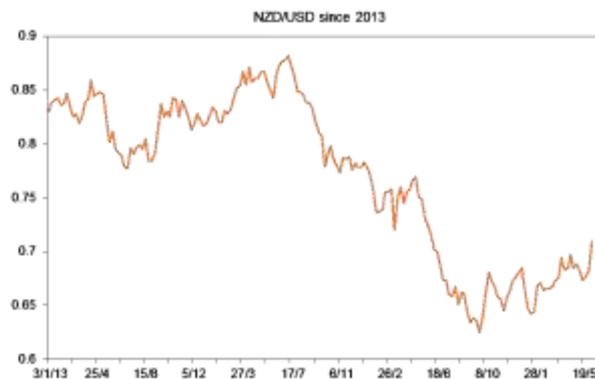
The weak US jobs growth might not be quite so concerning if US firms were strongly investing and therefore presumably raising labour productivity. But investment indicators have been weak recently. This means the global development post-GFC of weak productivity growth (NZ included) shows no signs of changing in the US.

The poor jobs report also calls into question the sustainability of recent strength in US consumer spending.

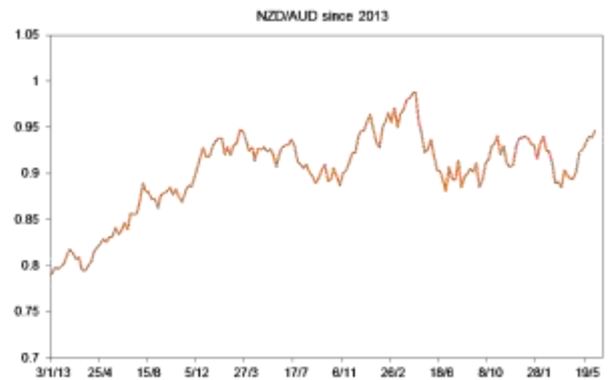
Nevertheless, the monthly job results can jump all over the place so this latest outcome, nearly the weakest in six years, does not lead to a conclusion that US growth is slowing rapidly. Not yet anyway. But for ourselves the outcome is that with a reduced chance of further US monetary policy tightening our currency seems set to go higher rather than lower as many others have been forecasting on the basis of a blind extrapolation of the expected NZ-US interest rate differential.

It pays to note that with oil prices recovering recently the general tone toward commodities has improved and this traditionally adds some support to the NZD. But in the absence of any strong sign of reduced milk production in the EU it would be unwise to simply assume rising oil prices mean a solidly rising track as yet for NZ dairy prices.

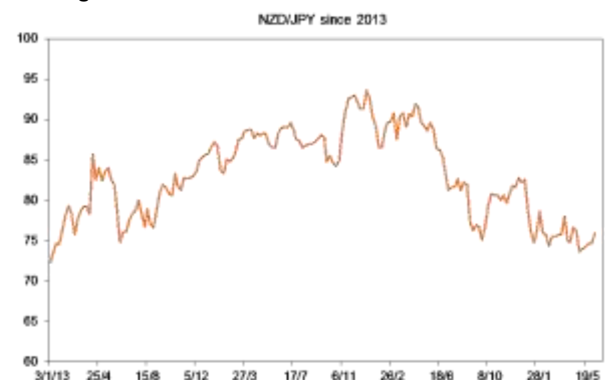
The second major factor pushing the NZD higher this week was this morning's Monetary Policy Statement and official cash rate review by the Reserve Bank. There was no cut in the cash rate, and although this was largely expected it appears some punts were nonetheless taken that a cut would come and covering of those positions has pushed the NZD to a one year high against the greenback near 71 cents.



Against the Aussie dollar this week the NZD has changed little with the AUD also rising against a weaker USD and lifted by the RBA decision on Tuesday not to cut their cash rate again – for the time being.

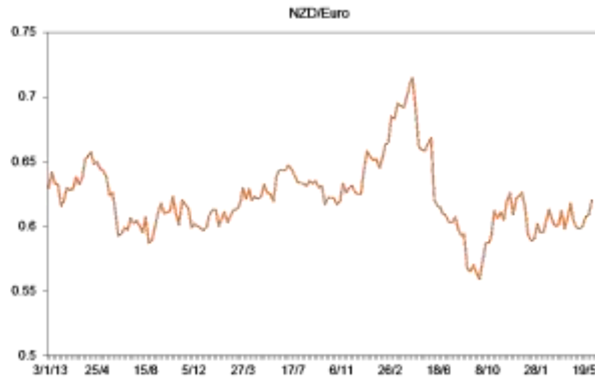


In Japan the Prime Minister has officially delayed indefinitely the planned consumption tax rise for next year in an effort to remove the risk of recession reappearing. But with the Three Arrows policy having failed because of the simple demographics of a shrinking old population plus absence of very strong structural reforms (the third arrow), it is hard to imagine the Yen being strong.

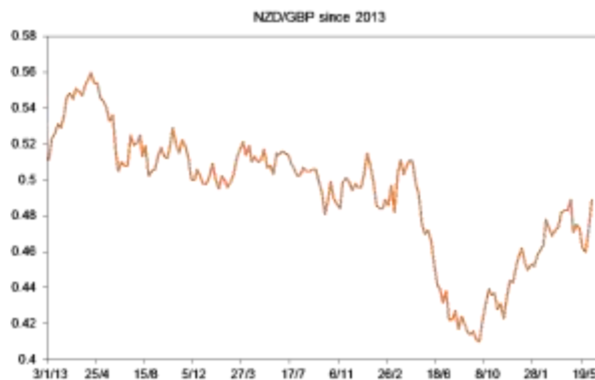


However there is a big caveat to this view. If the Americans are stupid enough to vote Donald Trump as their President in November (President Obama's lasting legacy?) then the lift in global geopolitical and economic uncertainty will boost flight-to-safety buying of the Yen.

The Euro however faces a test in two weeks with the UK referendum on whether to remain within the failed cooperative structure which used to be called the Common Market then morphed into the European Union/track to political union. Same for the Pound. Event risk is huge so be wary of having FX transactions planned involving those two currencies in the next four weeks. Longer term the Euro looks like suffering from ongoing structural economic, political and social woes. No wonder our net migration numbers are so high.



And against the British Pound the NZD has risen back to almost 49 pence.



Taking all of these factors plus many more into account we get the point we have been making for a number of years now. New Zealand looks like a bright shining fiscal, economic, social and political light during ongoing days of so much darkness in the rest of the world. This will strongly support the Kiwi dollar. As previously mentioned, exporters should look for occasional bouts of weakness in the NZD to boost hedging.

If I Were A Borrower What Would I Do?

Were I borrowing currently I would have about 20% or so floating and fix the rest for two or three years. I would fix five years if I thought inflation might be a problem two or three years from now – but I don't.

If I Were An Investor ...I'd see a BNZ Private Banker

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/

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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