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.

To receive the Weekly Overview each Thursday night please click here.
http://feedback.bnz.co.nz/forms/lFdYSs5FGEq4kAjP95uzTA

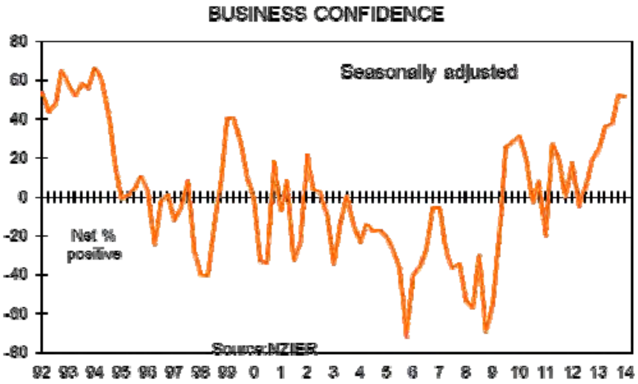
2014 Themes

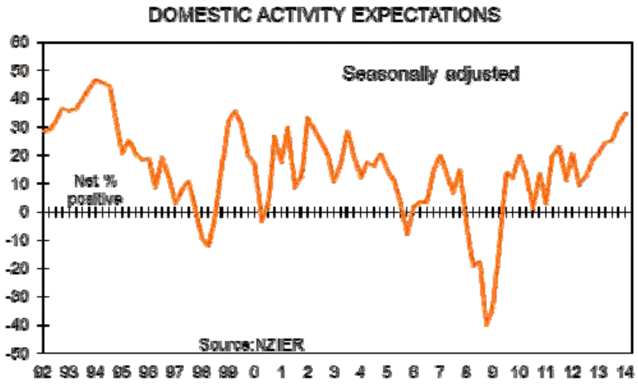
- Interest rates will rise
- The NZD will remain highish
- The labour market will tighten, pushing employment costs up
- House prices will rise with gains spreading out of ChCh and Auckland
- Construction will boom
- World growth will improve with unprecedented uncertainty regarding monetary policies
- Business capital spending will grow
- Household spending growth will accelerate

Confidence Very High

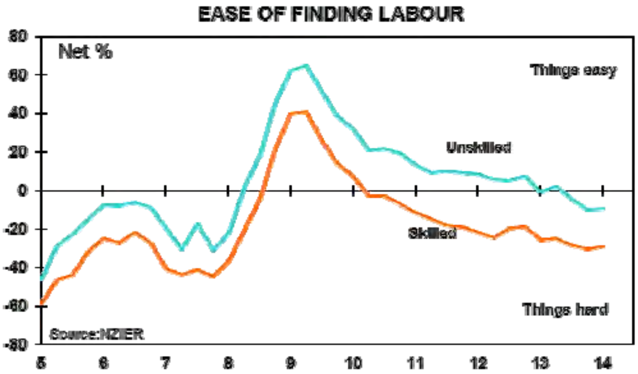
We have a couple of business confidence surveys to report on this week. The first is our own monthly survey sent out on Monday morning which showed a continuing very high level of business confidence. A net 64% of our 480 respondents are optimistic about where the economy will be in a year's time. This is consistent with results since November.

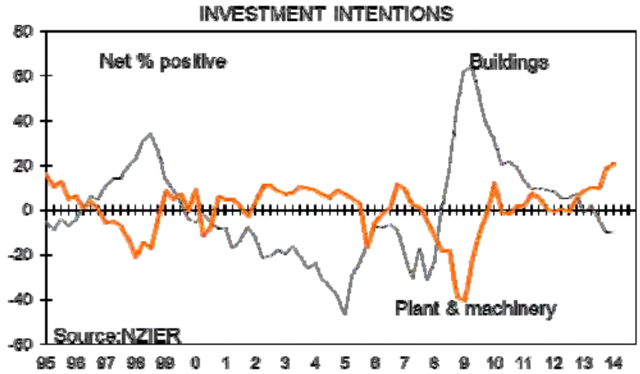
The other is the NZIER's long-running Quarterly Survey of Business Opinion which provides some great detail on business intentions, inflation pressures, and sectoral performances. Their headline outcome was a net 52% of non-farming sector respondents feeling confident about the economy over the next six months. That is statistically the same as the December quarter result but well up from a net 23% a year earlier and the ten year average of a net -14%. Businesses see bright times ahead.





A net 29% of businesses say that they are finding it hard to get skilled labour. This is unchanged from three months earlier and more than the average net 20% saying they have difficulties. A net 9% say finding unskilled labour is hard versus a net 1% on average saying it is easy. So the labour market is tighter than average but not yet tremendously so.





In fact whereas on average for the past decade a gross 13% of respondents have said that labour is the main constraint on their ability to grow, currently just 9% say that – though this is up from 6% a year ago.

A net 11% say they plan hiring more people versus 4% on average. A net 21% plan more investment in plant and machinery versus 0% on average, and a net 10% plan reduced spending on buildings versus -8% on average. Apart from that construction reading (completely at odds with the net 61% confidence of builders) the numbers point toward strong growth in the economy.

Key offshore debates

United States – Growth is improving and the labour market responding. But lots of people have left the labour force and as tapering morphs into rising interest rates next year will growth remain strong enough to seriously rebuild a society badly shaken by the sub-prime crisis?
China – The data show growth slowing down at the same time as worries grow regarding bank bad debts and corporate bond failures, excess capacity, housing bubbles, and lack of an obvious switch in growth drivers from exports and investment to consumption. The chances of stimulatory moves to keep growth above 7% this year look very high. China faces challenges, but a crunch is almost certainly not at hand and reforms are continuing.
Australia – vulnerable to slowing growth in China and regional tensions and hit by a budget deficit blowout, chooks coming home to roost in an inefficient manufacturing sector, and winding down of a huge resource sector investment boom. But household spending is lifting along with house prices and building. Further monetary policy easing looks decreasingly likely meaning the AUD may be better supported than exporters would like.
United Kingdom – Growth is picking up in manufacturing, construction, and retailing and businesses are showing willingness to invest. The BOE's next move will likely be a tightening but not this year.
Japan – Prime Minister Abe's Three Arrows policy involves easier fiscal policy, easier monetary policy, and deregulation. The first two are proceeding, the last not. This implies that the recent lift in growth could be

short-lived, especially if households react badly to the consumption tax rise from 5% to 8%. Japan's trajectory does not look all that good given huge debt, an aging and shrinking population, and mildly resurfacing nationalism.
Eurozone – Voters are shifting to the right as societies bend under the weight of inefficient economies weighed down by high public sector debt, employment, intransigence, and deficits, and now strains with old for Russia are alive again. Growth is improving but prospects do not look bright.

Things are looking acceptable in most other parts of the world though uncertainty still surrounds the extent of China's slowdown and the strength of the reaction to it through stimulatory policies. The IMF this week cut the probability they assign to a global recession this year from 6% to 0.1%, upgraded their forecast UK growth rate to 2.9% from the earlier 1.9%, predicted 2.8% growth in the US economy, and forecast total world growth of 3.6% rising to 3.9% next year from near 3% the previous two years.

This sort of outlook is positive for the NZ economy in that it will underpin global willingness to invest in less central economies such as our own, will tend to support our inward tourist flows, and will deliver some support also to our export commodity prices. The firmish world growth will also tend to mitigate some of the strength in the NZ dollar naturally arising from our strong economy which is being lifted by factors which have near nothing to do with conditions in our trading partners.

In London where I am currently the economic climate is exceptionally positive. House prices are rising strongly along with employment, confidence levels are high, and people volunteer their opinion that things are good. Compared with my previous visits there is far more focus on London as an international city and an entity in its own right slightly separate from the rest of the UK. I have noticed little inclination by Kiwis here to scarper back to NZ to milk the cows in one form or another, though have had an interesting number of discussions with those who are of older age looking to settle back in NZ and wondering whether they should sell their property in London. No is the answer unless one really needs the rising stack of cash to finance a purchase and lifestyle back in NZ.

Not that everyone is rolling in money here. There is a wide range of incomes here and all you have to do is stroll through either the Westfield Mall at Stratford or the less salubrious mall across the road to realise that if a virus wiped out the entire casts of Coronation Street and East Enders overnight within a week you could replace everyone with equally heavily accented opinionated people. Folk really do talk like that over there. You can close your eyes when on the DLR and imagine you're listening to the TV. I do that on the tube but in comparison with the DLR (Docklands Light Rail) people rarely talk on the Underground.

IF I WERE A BORROWER WHAT WOULD I DO?

There is no reason for believing other than that with the huge number of positive readings appearing on the economy that the Reserve Bank will continue to take away the low level of debt-encouraging interest rates put in place to fight a depression scenario in 2009. Our central bank is first cab off the rank in this process and if you read offshore commentaries you will note that more and more of the discussion in the United States and UK is about when the Federal Reserve and Bank of England will raise interest rates. Behind them is Australia where the discussion is more around no further cuts occurring. Then there is Europe where debate is raging about what sort of quantitative easing the ECB will undertake to fight the risk of an extended period of very low inflation. In Japan some additional stimulus is also possible but for now deflation has disappeared.

What this adds up to is this. First the whole world is undergoing continuing monetary policy experimentation with huge uncertainty over outcomes. That makes for low predictability of interest rates, exchange rates, and share prices. In this sort of environment is it any wonder that investors the world over are jumping into residential property – though this time without the construction surge to well above average levels which characterised the 2000s.

Second, we really do stick out like a sore thumb with our positive growth measures. As our monetary policy tightens with no changes offshore there is a risk that the carry trade will ignite whereby people borrow in low interest rate currencies and invest in higher rate ones. That means upside risks for the NZ dollar

Third, it is really really unclear how long-term borrowing costs are going to change in the next few years. While we should definitely expect our rates to rise as our monetary policy tightens there is considerable debate over whether US long rates will rise all that much given risks of sharemarket weakness. There is also considerable debate about a large sell-off in US bonds and sharply rising rates.

What all of this and many other things add up to is a reasonable expectation that our floating rate borrowing costs will rise 2% - 3% over the next couple of years regardless of what policy changes occur overseas. Long rates will also rise higher but you should not have an expectation that any forecast made now of where any of those rates will be in the next few years will be very accurate. We remain in an extremely uncertain environment – one in which I would want to take advantage of one or three fixed rate terms to spread over time the period during which my home financing costs will rise from depression-fighting levels back to more normal rates. Note that nothing you do will stop those rate adjustments hitting you beyond getting rid of the debt. You can either take all of the adjustment now by fixing your mortgage for seven years at 7.85%, or adjust more slowly by floating or taking shorter term fixed rates.

FINANCIAL MARKETS DATA

	This week	**Week ago**	**4 wks ago**	**3 months ago**	**Yr ago**	**10 yr average**
Official Cash Rate	2.75%	2.75	2.50	2.50	2.50	4.9
90-day bank bill	3.23%	3.19	3.06	2.90	2.67	5.2
1 year swap	3.72%	3.72	3.57	3.45	2.78	5.3
3 year swap	4.40%	4.44	4.28	4.24	3.11	5.5
5 year swap	4.70%	4.74	4.63	4.71	3.41	5.7
7 year swap	4.89%	4.96	4.89	5.02	3.69	5.8

This week we got some price pressure gauges from the NZIER's Quarterly Survey of Business Opinion. A net 20% of non-farm respondents said that their costs rose last quarter which is below the ten year average of a net 34%. A net 25% expect costs to rise from 21% last quarter and an average 34%. A net 16% whacked their selling prices up from 11% in the December quarter and an average 17% who normally do so.

None of these three measures gives cause for concern. The last one does however. A net 25% of business on average for the past ten years have said that they intended putting their selling prices up. In the December quarter a net 26% said this. This quarter a net 37% said they intend raising their selling prices.

This is the highest reading since mid-2008 when many companies were reacting to a fall in the NZD. This high level of pricing expectations is probably being driven by businesses finding that they are gaining more pricing power as more customers come through the door.

Hence tightening monetary policy and a Reserve Bank hoping that it has not left things too late.

NZD Back Up vs. USD

The Kiwi dollar has jumped back above US 87 cents this week mainly on the back of some weakness in the greenback associated with some increased flows of funds back to emerging economies, plus more dovish than expected minutes from the most recent Federal Open Market Committee meeting. That is, this week the markets have pulled back slightly on their expectations for how early in 2015 the Fed. may start raising US interest rates. Such movements will be the norm from here on out.

On the cross rates no major changes have been registered.

Exchange Rates	This Week	Week ago	4 wks ago	3 Mths ago	Yr ago	10 yr Average
NZD/USD	0.871	0.855	0.847	0.8255	0.852	0.726
NZD/AUD	0.928	0.925	0.933	0.9275	0.812	0.839
NZD/JPY	88.8	88.7	87.4	86.54	84.4	72
NZD/GBP	0.519	0.514	0.507	0.5009	0.556	0.423
NZD/EUR	0.629	0.621	0.61	0.6067	0.651	0.545
NZDCNY	5.40	5.31	5.19	5.00	5.28	5.1
USD/JPY	101.95	103.74	103.19	104.83	99.06	99.3
GBP/USD	1.68	1.66	1.67	1.65	1.53	1.72
EUR/USD	1.38	1.38	1.39	1.36	1.31	1.33
AUD/USD	0.94	0.92	0.91	0.89	1.05	0.87
USD/RMB	6.2	6.2055	6.1274	6.054634	6.2023	7.15

For more detailed FX analysis including the ‘BNZ Markets Outlook”, “BNZ Strategist” “BNZ Commodities Wrap” and lots more go here. https://research.bnz.co.nz/Research/NewZealand/Pages/NZpublications.aspx

Housing Market Update

Additional analysis and commentary are available fortnightly in the NZ Property Press and monthly in the NZ Property Investor magazine.

Nice, Empty, Houses

In London one-third to three-quarters of sales of newly built higher-priced dwellings look like they go to foreigners. Many if not most of these dwellings sit empty for much of their time – sometimes years – because the offshore buyers are investors simply looking for a piece of action in a real estate market which held up well during and immediately after the GFC, has powered ahead recently, and in which dwelling supply is constrained. Some want simply to get some of their funds out of their home countries.

In New Zealand and especially Auckland we would have nowhere near such a high proportion of sales to foreigners, but in Australia the data show 11% of new builds are sold offshore.

What matters for us is that the wave of investor preference for residential property over other assets seems not to be abating and with household incomes rising in China we can expect continued growth in offshore buying of NZ property. This will push prices up. I have for the past year advocated that we mitigate the effect of this unrestricted foreign buying of our houses and apartments on prices and societal cohesion by adopting Australia’s legislation. In Australia Kiwis and Aussies can buy what they want. All other people can only purchase a newly built house though residents can purchase after one year. Hence 6.5% of existing house sales in Australia go to people still classified as foreigners.

But there are concerns that the system is not working or not being enforced in Australia and that not only will prices continue to be pushed higher in main cities but that locals will find accommodation harder and harder to find simply because builders are very busy putting up complexes for foreigners (Chinese largely) which will never, or only rarely, be occupied.

Given these concerns, which have prompted a new government investigation into the matter, and given the London situation of building new houses for non-Brits, the clear risk is that simply adopting Australia’s legislation would not be enough to mute the worsening accommodation problem in Auckland.

That is, just because consent numbers are rising does not mean that effective, utilised, housing stock, is growing at the same pace. If houses are built or bought and sit empty then no-one bar the builders and previous owners moving out of the area win.

Heading into the election National have no policy of restricting foreign home purchases. Labour and NZ First (and I think the Greens) advocate adopting Australia's policy. But what I wish to point out in this week's commentary is that what Labour propose will still not be enough to prevent a deterioration in Auckland's housing situation given rising foreign incomes and desire to purchase here combined with the increased marketing of NZ properties to Chinese buyers in particular by NZ real estate agents.

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