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.

The Weekly Overview is written by Tony Alexander. 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 click here.
http://feedback.bnz.co.nz/forms/lFdYSs5FGEq4kAjP95uzTA

Last Weekly Overview For 2013

This will be the last Weekly Overview for this year and at this stage I anticipate resuming production on January 23. Merry Christmas to everyone and here's hoping that a lot of people will find gainful employment, good wage rises, and higher profits during 2014. That is in fact what we are forecasting for the year and here is a run-through of reasons why we are optimistic and what at this stage we think you need to consider when planning for such an environment.

The big no-brainer is the rebuilding of Christchurch which when combined with the lift in house building in Auckland, rising infrastructure spending, investment in dairy conversions, irrigation, and processing, plus earthquake strengthening and water-tightening will bring a boom for the construction sector, engineering and the great number of industries associated with them. This will boost employment for a lot of people and place strains on materials prices and contractors' rates.

There is likely to be some catch-up inventory building and business capacity-building of a general nature plus catch-up spending by consumers after some years of restraint. Some anticipation of tax cuts may set in also as the government's accounts continue to surprise on the good side.

But because we start this surge in growth toward and probably above 4% with few spare resources the rise in inflationary pressures will eventually cause the tightening part of the monetary policy cycle to kick in. You should anticipate rising interest rates through 2014 and 2015 but not have high expectations that we will closely pick the pace of rate rises or the peak. The world is experiencing the biggest period of monetary policy experimentation in its history and we cannot know at what speed policy will be tightened in the United States, Australia and the UK and potentially further loosened in the EU and Japan. You should concentrate on adopting an interest rate risk management strategy which protects you against rate shocks rather than trying to minimise your borrowing costs by adhering to a particular view of what rates will do.

With the country's terms of trade at their highest levels since 1973 it seems unreasonable to expect that the NZ dollar is going to start the downward leg of its cycle. In fact with NZ monetary policy set to tighten the chances are we oscillate generally upward – though again the unpredictable monetary policy developments offshore mean one would be foolish to place too much reliance upon any set of forecasts of where the NZD will be in a year's time. Personally I feel that at rates above 90 Aussie cents it is a good time to ship long-term money into Aussie dollars. The same for rates above 85 US cents and especially 90 should we reach that. The same goes for levels of the NZD above 53 pence. I have no view on the NZD against the Japanese Yen but see upside potential against the Euro given the deeply entrenched problems affecting that part of the world for many years to come.

Regarding house prices in New Zealand the chances are that they will rise in response to accelerating population growth running up against resource constraints limiting the supply response. Investors and first-home buyers will look to purchase outside of Christchurch and Auckland and an aging population will start to sell in Auckland to retire with spare dosh elsewhere. It will take a few months for first-home buyers to re-engage with the market following the LVR rule imposition and the clearest impact of the rule is a drop-off in sales which in November were down 6.6% from a year earlier. Prices however continue to rise with an average gain of 1.2% nationwide in November with Auckland up 3% in the month and Canterbury 3.3%.

Wages growth will accelerate and that will be an extremely positive thing not so much in terms of higher incomes for people but in terms of inefficient businesses closing down and labour resources being reallocated to higher-paying more productive activities.

What could go wrong? Lots offshore. Japan's growth rate has slowed after an initial surge above 4%. If economic reforms are not strongly enacted the Bank of Japan's attempts to beat deflation by printing money (how desperate do you have to be?) may fail and the Japanese economy slip back to minimal growth with a shrinking population, collapsing public finances, and expensive infrastructure bringing high maintenance costs. Then again the economy may surge ahead driven by a popular desire to be strong against China.

China's growth rate will probably slow a bit further, and as the proportion of our export revenue coming from China rises we will become, like Australia, more and more influenced by what happens not just in China's economy but its society and politics. We will become more and more vulnerable to what seems an inevitable eventual clash between China and Japan in the East China Sea, and perhaps clash by China with other parties in the South China Sea. China claims the lot essentially, other countries including the United States have other ideas.

The US fiscal situation is not good but decisions overnight mean another Federal shut-down is unlikely and the President has some ability to unilaterally raise the debt ceiling now. The UK is going to spend 2014 grappling with how to keep growth going without the housing market entering a new bubble. Australia is grappling with a costly production base causing companies in the resources and manufacturing sectors to invest elsewhere. There is very high uncertainty regarding which way the Aussie dollar will go next year. But with the construction sector picking up quite strongly it is likely that retailing will eventually, probably much belatedly, follow, and as long as China's growth holds up, an acceleration in Aussie growth over the second half of the year is possible, bringing tightening monetary policy from the RBA and then perhaps fresh appreciation of the AUD.

Have a good break and try not to get too sunburnt.

IF I WERE A BORROWER WHAT WOULD I DO?

Seek a mixture of floating and fixed rates. Most people are floating or fixing only out to 18 months and it will be interesting to see what happens when the Reserve Bank starts tightening. By the time they do fixed borrowing costs risk being a lot higher than they are now, especially if the tapering exercise involving reduced money printing has commenced in the United States. High uncertainty prevails for interest rates over 2014.

FINANCIAL MARKETS DATA

	This week	Week ago	4 wks ago	3 months ago	Yr ago	10 yr average
Official Cash Rate	2.50%	2.50	2.50	2.50	2.50	4.9
90-day bank bill	2.72%	2.69	2.68	2.67	2.76	5.2
1 year swap	3.26%	3.22	3.09	3.01	2.58	5.3
3 year swap	4.15%	4.11	3.97	4.00	2.79	5.5
5 year swap	4.64%	4.58	4.47	4.58	3.09	5.7
7 year swap	4.97%	4.91	4.79	4.90	3.41	

Exchange Rates	**This Week**	**Week ago**	**4 wks ago**	**3 Mths ago**	**Yr ago**	**10 yr Average**
NZD/USD	0.828	0.819	0.825	0.813	0.84	0.72
NZD/AUD	0.917	0.907	0.881	0.877	0.797	0.84
NZD/JPY	84.9	83.6	81.8	80.9	69.2	71.4
NZD/GBP	0.506	0.5	0.516	0.513	0.521	0.42
NZD/EUR	0.6	0.602	0.615	0.61	0.645	0.54
NZDCNY	5.03	4.99	5.03	4.97	5.25	5.14
USD/JPY	102.54	102.08	99.15	99.51	82.38	99
GBP/USD	1.64	1.64	1.60	1.58	1.61	1.72
EUR/USD	1.38	1.36	1.34	1.33	1.30	1.33
AUD/USD	0.90	0.90	0.94	0.93	1.05	0.87
USD/RMB	6.0719	6.0909	6.0914	6.119	6.2451	7.17

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