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

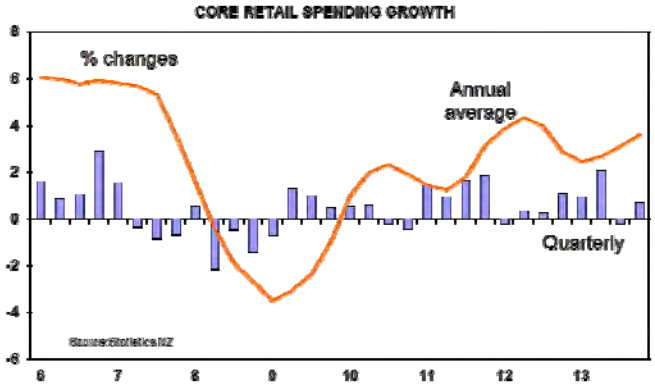
2014's Themes

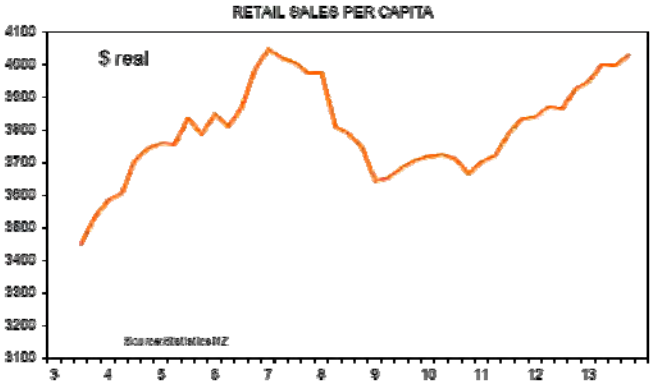
- Interest rates will rise
- The NZD will remain highish
- The labour market will tighten, pushing employment costs up.
- House prices will rise with gains spreading out of ChCh and Auckland.
- Construction will boom
- World growth will improve with unprecedented uncertainty regarding monetary policies.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

Consumers Not Throwing Money Around

This week we learnt that during the December quarter of last year total retail spending after adjusting for price changes and seasonal effects rose by 1.2%. This was less than the 1.6% rise analysts had expected to be announced but is still a good number – sort of.

One problem is that it followed a tiny 0.2% rise during the September quarter so partly a simple bounce effect was in play. Second, the average quarterly rate of growth in retail spending since the June quarter of 2009 has been 0.8% so 1.2% is above average but not hugely so and especially not by enough to allow one to say that consumers have finally decided to open their wallets big time.





Third, core retail spending excluding petrol and cars rose by only 0.7% in the quarter after falling 0.2% in the September quarter. Growth in the core measure has averaged 0.7% a quarter since 2009 therefore the latest result is just average.

Fourth, spending on durable goods rose by only 1.1% which was the slowest pace of growth in six quarters and down from 2.2% in the September quarter and 4% in the June quarter. This 1.1% rise was below average quarterly growth in spending on durables since 2009 of 2%.

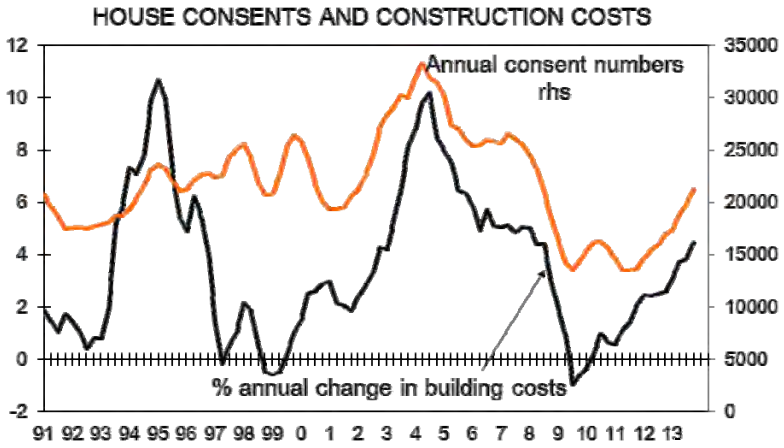
These results help explain why I pay little attention to Paymark electronic transaction data when it gets released on an increasingly frequent basis leading into then following Christmas. The numbers always attract a lot of media attention as we look at each outcome and ask ourselves whether we should be happy

when a number is high or sad that this is all Christmas has turned into. In addition the numbers help explain why Statistics NZ explicitly state that we should not consider their monthly Electronic Card Transactions data to be a measure of retail spending growth. The correlation is not as accurate on even a quarterly basis as one would like. Note that some years back SNZ dropped their monthly retail trade survey as it tended to go all over the place and was statistically speaking almost worthless on a regional basis for measuring short-term rates of growth. Even the quarterly numbers should be treated with caution below the national level.

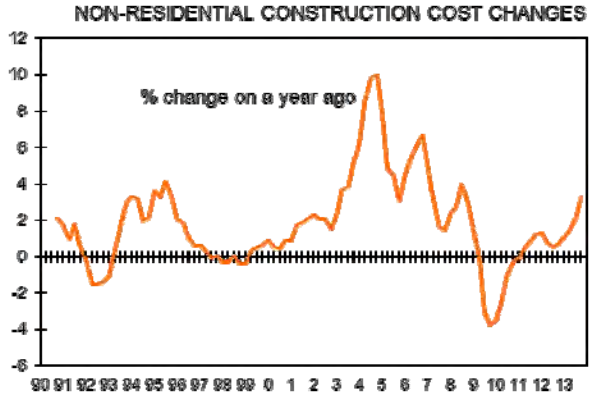
Overall there is an upward trend in retail spending in New Zealand which is what our second graph above shows. But you cannot at all as yet run a strong argument that spending growth is accelerating. Do we expect it to? Yes, based on the rapidly strengthening labour market, seven year high consumer confidence, and accelerating population growth.

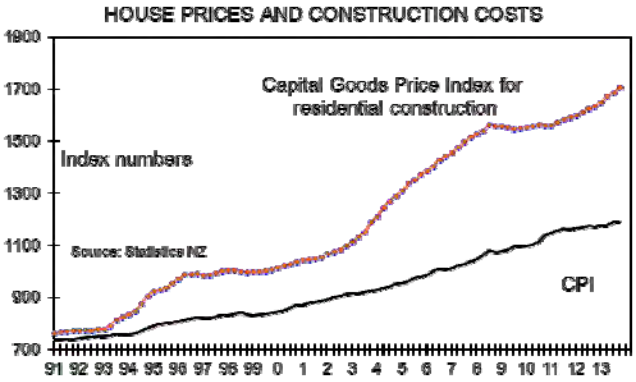
Building Costs Escalating

The Capital Goods Price Index was released this morning and it tells us that average residential construction costs rose by 1.1% in the December quarter to sit 4.5% higher than a year earlier. As a basis for comparison the Consumers Price Index rose just 1.6% last year, transport equipment prices fell 1.2%, and plant, machinery and equipment prices fell 1.7%. Thus the price escalation which is happening in the residential construction sector is well at odds with what is happening elsewhere. Non-residential construction costs rose by 3.2% last year with a strong jump of 1.4% in the December quarter.



House construction costs are going up and this will be another factor underpinning the prices of existing property. Will you contemplate getting a house built rather than bidding for the simplicity of an existing one when you know costs stand a high chance of coming in a lot higher than you may currently be budgeting for? More than that, will you build when once again quality issues are coming to the fore as the bottom of the tradies barrel once again starts to get scraped and anyone who thinks they can wield a hammer gets into the building business?





Not Ireland

Apparently a fund manager offshore has said New Zealand looks like Ireland did just before it crashed. What a load of rubbish. Here in NZ there is no massive over-building of residential property underway. In fact there are acknowledged shortages of houses in our two biggest cities. There is no credit boom underway with lending to households in 2013 up by only 5.7% from the end of 2012. Our terms of trade are at a four decade high not on the back of a global inflationary surge as happened four decades ago, but because there has been a structural surge in demand for our dairy products plus wood.

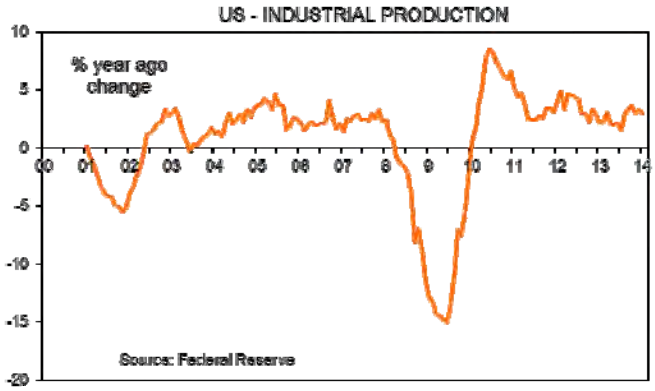
Note that making a comparison between one's country and Ireland pre-crash has become the latest bogeyman story for those unable to grasp the fundamentals driving some housing markets. The same comparison with Ireland was being made last year in Australia. The key is to see whether rising prices are radically boosting supply. Here, they are not. In Ireland supply boomed, as it did in Portugal, Spain, and the United States.

Note also that back in 2007 the assets of Ireland's banks amounted to eight times GDP. Our ratio is about 1.5.

Key offshore debates

United States – Growth lifting to 2.8% from 1.9% in 2013 but could interest rates jump as tapering proceeds?
China – Impact of non-performing loans following the 2009+ credit boom, ability to switch from export and fixed asset investment as growth-driving forces toward consumption, impact of loosening controls on outward capital flows.
Australia – ability of strengthening retailing and housing to offset the resource sector investment decline plus vulnerability to China shocks.
United Kingdom – Construction is picking up along with manufacturing, but worries exist regarding the 2017 referendum on EU membership, and the risk of premature policy tightening by the BOE.
Japan – Tension with China is growing as Japan breaks away from its post WW2 accepted pacifist shackles to confront its traditional regional competitor. Conflict appears probable with potentially severe economic consequences.
Eurozone – growth is picking up but will it be strong enough over the cycle to seriously dent entrenched unemployment, especially of youth? If not will the resulting social deterioration foster more radicalism?

There is a little chill running through the ranks of **United States** analysts at the moment caused by many of the recent monthly indicators coming in below expectations. Examples include retail sales which fell 0.4% in January after declining by 0.1% in December. Sales were 2.6% ahead of a year ago. Industrial production also fell by 0.3% in January though activity was still 2.9% ahead of a year earlier following growth of 2.1% one year before that and 3.9% two years ago. Steadyish and without the acceleration which many had been hoping for.



The number of housing starts fell by a relatively large 16% in January to be 2% lower than a year earlier. This is the first annual decline since August 2011 but the outcome will have been downwardly distorted by the very bad weather last month.

In **China** credit growth during January was a lot more than expected at 1,320 billion Yuan compared with 483bn in December and 1,070 bn a year earlier. This number follows last week's stronger than expected export and import growth outcomes for January and means that for now, yet again, immediate worries about the pace of economic growth in China have eased off.

Bad news this week for those hoping Abenomics is going to set **Japan** on a new growth path. Japan's GDP rose by just 0.3% during the December quarter last year which was less than the 0.7% rise commonly expected by analysts. The weak result increases the chances of more determined money printing operations from the central bank which will tend to weaken the Yen. In fact on Tuesday the BOJ announced a doubling of the amount of cheap bank financing it was making available and extended loan terms from 1 – 3 years to 4 years.

The weak data also increases the chances of heightened tensions with China as one suspects Prime Minister Abe's Plan B for retaining LDP power should his economic thrust fail is to let loose simmering nationalist sentiment and resentment at the way Japan is expected by some countries to apologise more deeply for its actions during and especially before WW2.

In this context it is interesting to consider how Germany has moved on from its atrocities whereas the adventurism of Japan starting over a century ago still lingers as a festering sore in many parts of Asia. Germany is fully integrated with other European economies in the European Union. Japan stands alone. Germany has accepted millions of immigrants. Japan has not. Germany has worked to alter itself so that military adventurism does not return. Japan accepted a foreign-imposed constitution and system of government as part of the punishment accepted as validly inflicted on a vanquished nation and has abided by the rules.

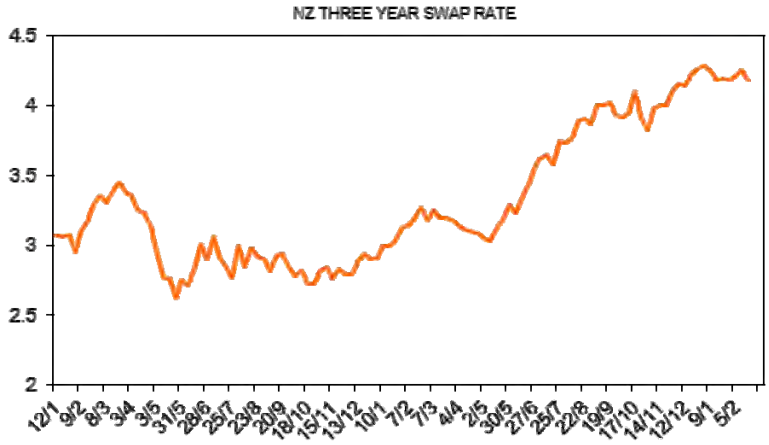
Speaking of war. One of the worries of Japan and Western navies is that the Chinese have developed ship-launched missiles capable of evading defences and taking out foreign aircraft carriers. But this week we learnt that the Australians have developed and successfully tested a ship defence system against sea-skimming supersonic missiles superior to systems currently in use by the Americans. Should such a system be deployed on US (and Japanese) warships China may feel it's maritime ascent is being blatantly challenged. See the Weekend Australian, page 2.

The **Eurozone** economy grew by a slightly faster than expected 0.3% during the December quarter of last year to give full year growth of -0.4%. The result has reduced at the margin the lingering worries about deflation, or at least the risk that worries about deflation would prompt much slower spending growth than if people believed consumer prices would keep rising. The outcome however is still fairly poor and has not changed expectations in general that the Eurozone will grow by 1% or just above it this year. This pace of growth will almost certainly not be enough to cause worries about deflation and sovereign debt to easily disappear and will leave deep concerns that jobs growth will be both muted and insufficient to make much if any dent in the growing pool of long-term unemployed. The Eurozone economy for your guide is still 3% smaller than before the GFC. Our economy is over 5% larger, 6.5% for the US, 15% for Australia.

These worries may manifest themselves in a swing to the right during elections for the European Parliament this May and that may prompt governments to take more right-wing stances on issues concerning Europeans such as immigration, rights to work and so on. For the immediate moment however huge focus is on the deteriorating situation in the Ukraine with analysts openly wondering if this could be the start of war between Western-supported factions there and the Russian-supported government.

IF I WERE A BORROWER WHAT WOULD I DO?

Fixed wholesale borrowing costs have been in a bit of a holding pattern in recent weeks in the absence of any inflation or monetary policy expectation shocks either here or in Australia or the United States. Our expectation is that the RBNZ will start its policy tightening cycle on March 13 with a 0.25% rise in the official cash rate and that by the end of this year the rate will be 3.75% and the end of next year 4.5%. Risks however lie to the upside in terms of speed and height largely next year given the strong momentum which we see developing in the economy.



Therefore, were I a borrower at the moment I'd be looking to lock a decent chunk of my mortgage in at the three year term for 6.35%. I would like to fix five years but at 7.2% I find it too expensive.

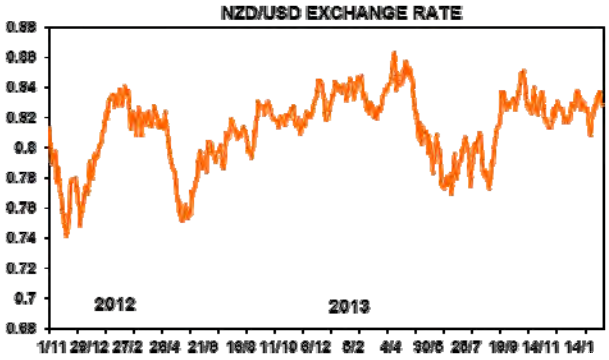
FINANCIAL MARKETS DATA

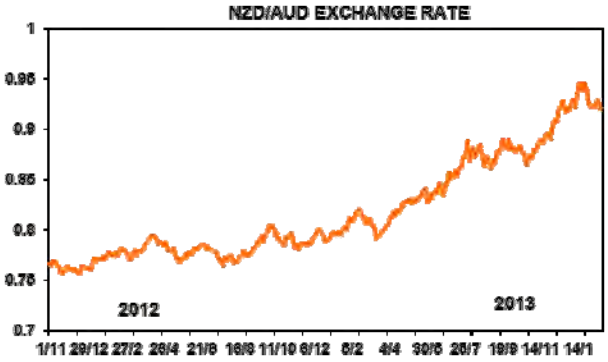
	This week	Week ago	4 wks ago	3 months ago	Yr ago	10 yr average
Official Cash Rate	2.50%	2.50	2.50	2.50	2.50	4.9
90-day bank bill	2.95%	2.95	2.89	2.70	2.70	5.2
1 year swap	3.53%	3.53	3.52	3.14	2.84	5.3
3 year swap	4.18%	4.25	4.19	4.00	3.27	5.5
5 year swap	4.59%	4.66	4.62	4.52	3.64	5.7
7 year swap	4.88%	4.95	4.93	4.85	3.93	5.8

NZD steady

There have been no big changes in the level of the NZ dollar against our usual currencies of comparison this past week. In fact around the world nothing much has happened barring some recovery in emerging market currencies on the back of an easing off in worries about their financial health and risk of huge capital outflows. But these worries about the likes of Argentina, South Africa and so on are likely to return as the US tapering exercise continues and this will become a source of downward pressure on the NZD generally as risk aversion rises and investors pull back generally from the more volatile currencies.

However our currency is going to continue to receive very strong support from the best terms of trade in four decades, accelerating economic growth, and our central bank raising interest rates 1 – 2 years before rates start going up in other developed economies.





Exchange Rates	This Week	Week ago	4 wks ago	3 Mths ago	Yr ago	10 yr Average
NZD/USD	0.828	0.831	0.825	0.835	0.848	0.726
NZD/AUD	0.92	0.929	0.939	0.886	0.818	0.839
NZD/JPY	84.8	85.1	85.8	83.6	79.2	72
NZD/GBP	0.496	0.5	0.502	0.518	0.55	0.423
NZD/EUR	0.603	0.611	0.609	0.617	0.633	0.545
NZDCNY	5.03	5.04	4.99	5.09	5.30	5.1
USD/JPY	102.42	102.41	104.00	100.12	93.40	99.3
GBP/USD	1.67	1.66	1.64	1.61	1.54	1.72
EUR/USD	1.37	1.36	1.35	1.35	1.34	1.33
AUD/USD	0.90	0.89	0.88	0.94	1.04	0.87
USD/RMB	6.0764	6.0627	6.0498	6.0933	6.2445	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

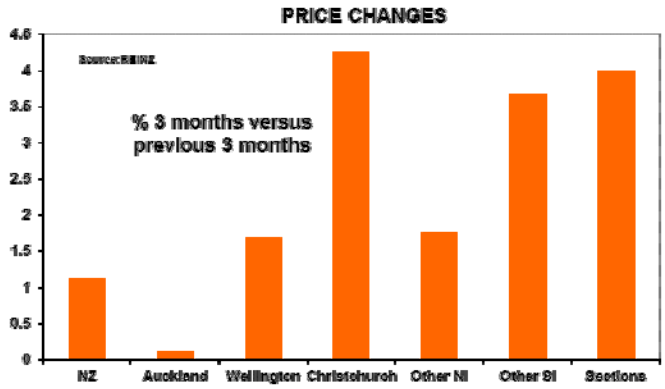
Housing Market Update

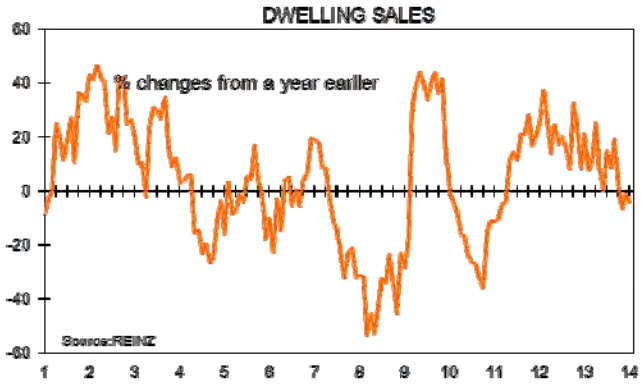
Additional analysis and commentary are available fortnightly in the NZ Property Press and monthly in the NZ Property Investor magazine.

Nothing Too Major in the Residential Real Estate Market

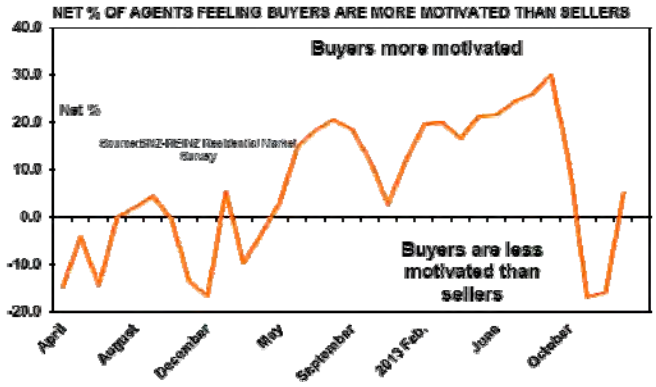
Last week the REINZ reported that in January there were 4,719 dwellings sold around New Zealand which was a decrease of just over 4% from a year earlier. In rough seasonally adjusted terms sales fell about 2% in the month and it looks like sales have retreated about 10% since the LVR rules came into force on October 1 last year. The greatest decline occurred in November but as yet we have not seen a rebound kick in.

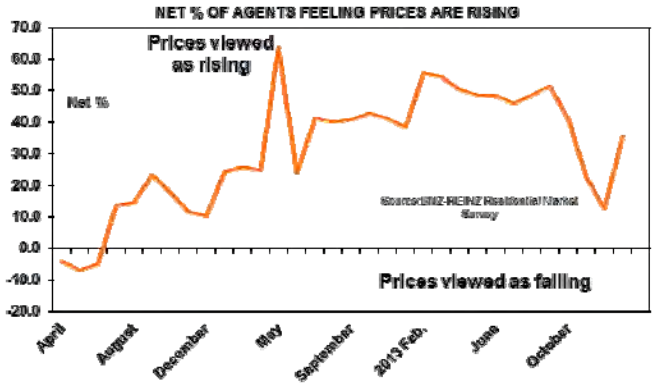
The stratified average sales price eased by 2.4% in January after falling 1% in December to sit 7.7% ahead of a year ago. These numbers can be quite volatile so we don't read too much into this movement.





Our BNZ-REINZ Residential Market Survey sent out on Monday morning gives us some indications that things are improving with buyers once again seen as more motivated to transact than sellers, and price expectations going back up again. http://tonyalexander.co.nz/wp-content/uploads/2014/02/BNZ-REINZ-Survey-February-2014.pdf





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