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.

Further Mortgage Rate Rises A Ways Out

This week's main point of interest for those of us involved in tracking the economy and conveying the likely implications of its tos and fros was this morning's review of the official cash rate by the Reserve Bank. Recently data releases have been on the marginally weaker than expected side. For instance on Monday we learnt that manufacturing output unexpectedly fell 0.7% in the June quarter and even excluding the meat and dairy processing sectors grew by only 0.1%. Consumer confidence is at a ten month low, business confidence 20 month, export receipts have fallen 8% seasonally adjusted in the past six months, and dwelling sales are running 12% down from a year earlier.

But more importantly dairy prices have fallen 45% from their massive February peak and the entrails used for reading overseas economies have yet again taken a step backward. Most notably Europe is looking worse, worries have deepened a bit about Japan with consumption yet to recover following the sales tax increase in April, the heightened potential of a breakup of the United Kingdom (not the Euro-zone, how ironic!) is depressing UK confidence, the Middle East is in flames, and the likelihood of China hitting a 7.5% GDP growth rate this year has lessened. Even US jobs growth data released on Friday night were weaker than expected.

So it was fairly much universally expected that our central bank would leave the cash rate unchanged at the 3.5% it took it to between March and July and that the comments would be relatively neutral, especially with the general election so close. Unchanged is how the cash rate was in fact left and consistent would be a good description for the words used by the RB this morning.

So where to from here? The opinion of most of us is that the process of the Reserve Bank taking the cash rate from stimulatory to neutral territory is most definitely not over, but when they restart the movement is a guessing game. Our newest view is that the next rate rise will come in March and that over the following year the cash rate will rise 1.25% in total to finish at 4.75%. After that don't even think about asking us when rates will start going down again. No economic model exists which can tell us that. We will simply have to see how the economy develops and what inflationary pressures are doing.

For the moment those inflationary pressures are not particularly strong outside of the Christchurch construction sector. The actual inflation rate is just 1.6% with tiny rises of 0.3% in the June and March quarters and a 0.1% rise in the December quarter. The monthly ANZ Business Outlook survey shows that just a net 23% of businesses plan raising their selling prices. This measure is below the long-term average of a net 27% and down from 33% in February.

Businesses probably do not feel that they have decent pricing power as yet. That is, the ability to raise their prices, say "meh" if customers complain, and sell fairly much the same volume of goods and services because customers don't have much choice. The attitudes I keep coming across in my travels around the country (New Plymouth and Wairarapa this week) coalesce around businesspeople saying they cannot feel much of a stimulus from the booms in Christchurch and Auckland and worry about rising interest rates, LVR rules, the sustained high NZD, disruption from the approaching election, and falling dairy prices.

This lack of perceived pricing power gels with evidence that the LVR rules and 1% floating mortgage rate rises have caused a decent slowing in the housing market, that employees remain more focussed still on job retention than wages growth, and that householders remain firmly focussed on getting a bargain or something extra for their money – such as the wonderful Little Shop toys offered by the New World supermarkets.

The Reserve Bank sees all of these things as well as they undertake their own extensive research on the ground to see what is happening and never rely solely on out of date statistical best guesses as to what has happened with economic activity and inflationary pressures. But they will also see that conditions continue however to move in the direction of higher interest rates eventually, one day, being required.

Most days one can read in the newspapers about worsening labour shortages and businesses increasingly looking to source staff from overseas because they can already see the bottom of the barrel of skills and motivation in the NZ unemployed pool. Something which left-leaning politicians fail to grasp is that just because there are people out of work does not mean that they are there because employers don't want to hire them. They do, they just hesitate because of experiences with poorly motivated people who end up costing the company more than they produce. Many are not worth the hassle of trying to train up and that is why even with a 5.6% unemployment rate businesses are eager to hire people from overseas.

The answer to getting the unemployed into work (beyond the base "frictional" unemployment level created by jobs being in location A but people needing to move from where their last job was in location B) is keeping down the cost of giving someone "a go" just in case they turn out to be a good'un (the 90 day probation period), case management of unemployed people to improve skills and motivation, and a strong labour "market" in the sense of widespread awareness of jobs on offer. The trick would be uncovering the inside jobs, the ones which tend not to be advertised.

Personally I don't think current minimum wage levels or welfare benefit rates any longer have much to do with making a difference these days, in the same way as cutting the company tax rate probably wouldn't shift the country's growth rate in any measurable sense. Reducing employee bargaining power is not the answer as already there are plenty of examples of predominantly "foreign" employers ripping off predominantly foreign employees, often outright abuse of visa holders.

Briefly offshore, last Thursday night the European Central Bank admitted yet again that the response of themselves, the Euro-zone member governments and other Euro-zone institutions has been inadequate to the GFC and underlying structural problems by again easing monetary policy. The aim is to keep borrowing costs down and to try and improve credit flows in an area where growth is being partly stymied by SMEs failing to attract credit from banks which remain wary of low capital levels. The ECB has cut its -0.1% overnight deposit rate to -0.2% and cut its refinancing rate from 0.15% to 0.05%.

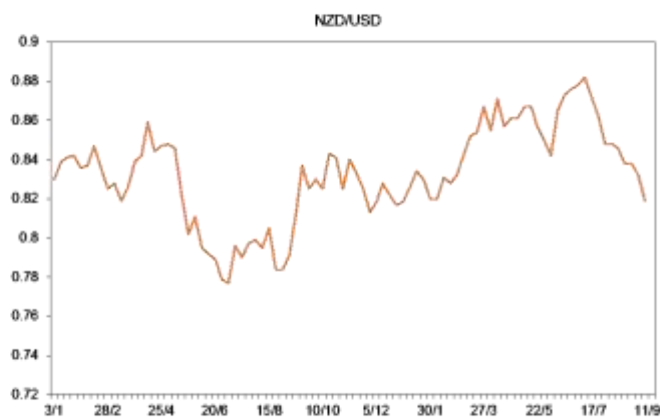
The changes are very minor but their impact will be assisted by a programme of purchases of various assets such as bonds. However as we have noted many times before, easing monetary policy only buys economies time to naturally recover and for policy-makers to enact what are invariably short-term painful changes aimed at boosting productivity and therefore income growth. But no new programme of measures has been announced by national governments and in fact France for one continues to press for more time to get its deficit under control rather than tackling it now – with that time period of "now" stretching over many years, now.

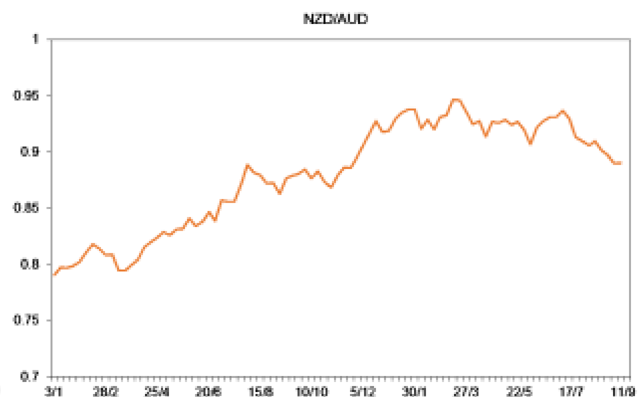
Given the lack of acceptance by European voters that painful change is needed, the lack of intestinal fortitude on the part of European leaders when it comes to matters such as economic reform and countering military aggression on their borders (five gears on their tanks, four of them reverse as the old joke goes), appeasement of disaffected groups and Russia looks likely to continue. The NZ dollar therefore remains highly likely to gain stay firm against the Euro this coming year while losing ground bit by little bit against the greenback which is likely to eventually be lifted by tighter US monetary policy – perhaps from the first half of 2015.

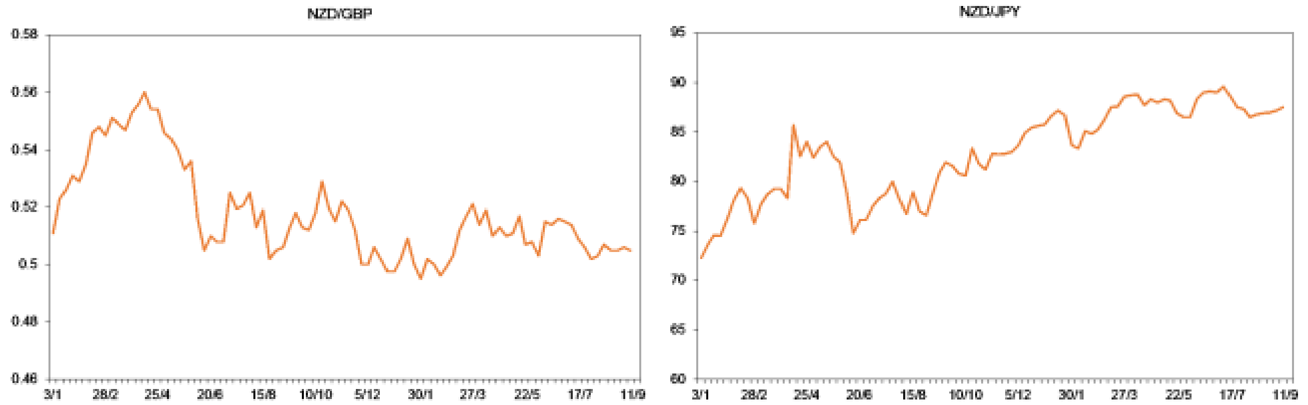
Against the British pound this week the NZD briefly too a jump above 51 pence as the pound was hit down two cents against the USD by increased worries that Scottish voters will opt to exit the United Kingdom. There could be substantial economic disruption of magnitude, focus and duration no-one really knows. That uncertainty more than anything has caused some capital flight away from the pound – seemingly into the greenback as all the other major alternatives have problems which we have noted here for a number of years now.

In this ongoing environment we repeat that the NZ dollar sticks out as being relatively untroubled and hence our ongoing strength on average – something which is likely to continue until the world economy falls over and we are hit by plummeting commodity prices, falling global risk tolerance, and reduced prospects for NZ growth. But as noted above, depreciation against the greenback is likely and this evening the NZD/USD rate is just below 82 cents as the Reserve Bank's comments this morning were slightly more dovish than expected, and speculation is growing about tightening US monetary policy.

	This Week	Week Ago	4 Weeks Ago	3 Months Ago	Year Ago
NZD/USD	0.819	0.832	0.846	0.865	0.813
NZD/AUD	0.891	0.89	0.91	0.922	0.877
NZD/JPY	87.5	87.2	86.8	88.3	80.9
NZD/GBP	0.505	0.506	0.507	0.515	0.513
NZD/EUR	0.634	0.633	0.633	0.639	0.61
NZD/CNY	5.02	5.11	5.21	5.38	4.97
USD/JPY	106.84	104.81	102.60	102.08	99.51
GBP/USD	1.62	1.64	1.67	1.68	1.58
USD/EUR	1.29	1.31	1.34	1.35	1.33
AUD/USD	0.92	0.93	0.93	0.94	0.93
USD/CNY	6.1298	6.1414	6.1634	6.2191	6.119







If I Were A Borrower What Would I Do?

Look for a discounted three year fixed rate for a large part of my mortgage but keep some floating. Nothing much new here beyond a heightened risk of rising long-term fixed interest rates due to increased expectations of tighter monetary policy in the United States.

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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