BNZ Weekly Overview

28 August 2014

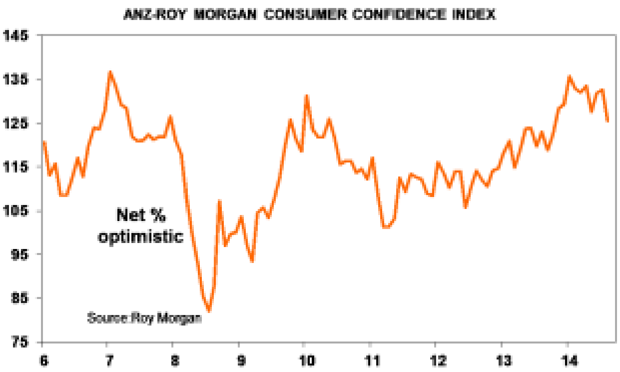
ISSN 2253-3672

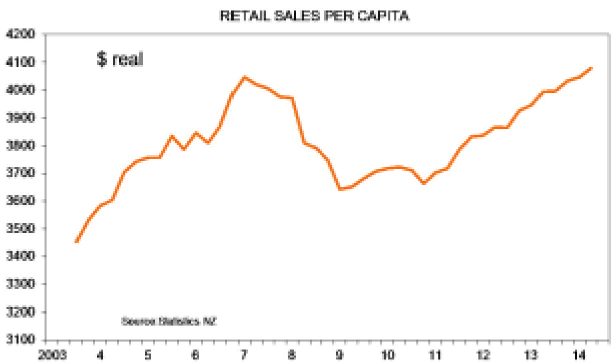
Mission Statement

To help Kiwi businesspeople and householders make informed financial decisions by discussing the economy and its implications in a language they can understand.

Miscellaneous

Just to rub salt into the wounds a bit of still struggling retailers around the country, have a look at the two graphs here. The first one shows two things of interest. Firstly that consumer confidence is tracking in the same territory as during 2007 and is higher than 2006 when retail spending was booming. Second, that confidence has just eased recently, by seven points according to this measure released last Thursday. Thus although sentiment has been very positive it has just eased back and even at the recently high levels many retailers have been struggling, restructuring, shifting locations, holding ever larger sales, and closing down.



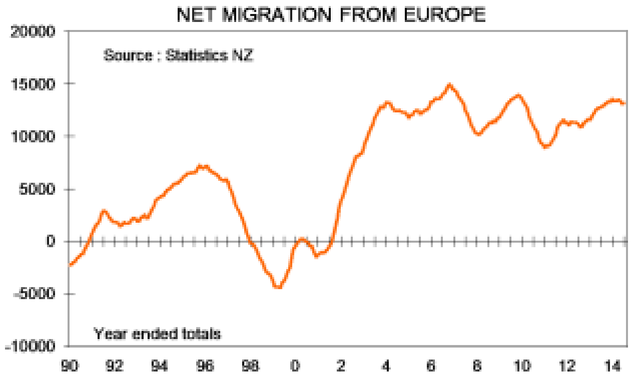


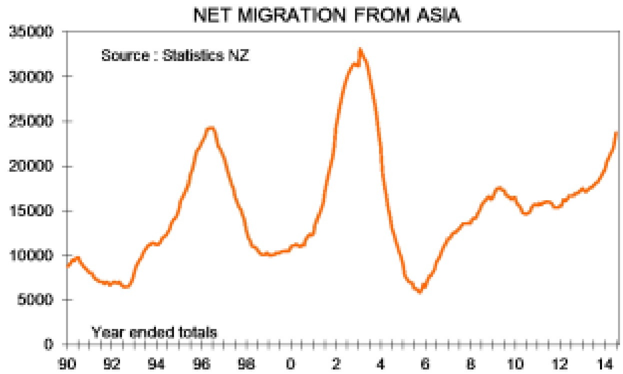
The second graph just reinforces the woe by showing how retail spending per capita is right back where it was in the peak of 2007 – yet still the woe for many retailers. As noted here for the past two weeks, this woe arises because householders remain very cautious in their spending and are only opening their wallets to any decent degree when they get a discount. Given the likes of publicity over the weekend to NZ consumers paying much more for basic things than consumers overseas and rising awareness that NZ is a high cost country to live in, retailers should not be counting on householders moving away from a discount mentality this cycle.

But while NZ retailers may feel depressed and we struggle to offer solace as interest rates rise and have zero insight to offer on when the old relationship between a particular confidence level and spending will restore itself (2050?), spare a thought for Europe. Inflation is at a four and a half year low of only 0.4% and with the economy having recorded no growth during the June quarter and forecasts being cut (yet again) for coming quarters, worries have deepened anew that the zone may be repeating Japan’s scenario. This is one where consumers are reluctant to spend, banks are reluctant to lend, politicians are reluctant to make changes aimed at boosting efficiency and international competitiveness, average prices fall thus discouraging spending before one needs a thing and boosting debt burdens, and government accounts go from bad to worse as failed fiscal stimulus is followed by failed fiscal stimulus.

In Japan after one and a half decades at least of this outright desperation reigns in the form of yet another fiscal stimulus, doubling of money supply in the hope someone will spend the money sloshing around, and some attempts at reform which are fairly minor on a global standard. Facing electoral reaction to failing policies Plan B is being rolled out bit by bit – hold popular support and society together through nationalism. Mr Putin is already well down that track in Russia spurred partly by popular discontent over the way Russia's opening up after the collapse of the USSR led mainly to wealth and power gathering in the hands of connected people – the oligarchs.

Western Europe is slowly going down that populist route not so much via leadership in that direction from the top but by people gravitating to the right-wing fruitcakes who define the "enemy" for them and offer solutions for getting rid of them. Anti-immigration, anti-Semitism, religious fanaticism (UK mainly with its unintegrated communities), and a threat to ourselves from a possible rise in protectionism. These developments can do little other than reinforce the caution of European businesses regarding hiring people and committing to large investments, and encourage migration flows down to our part of the world. That flow has yet to really kick off, especially compared with the net flow from Asia which is rising strongly.





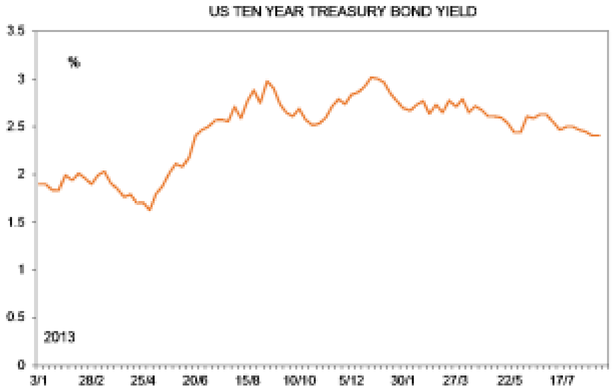
Economic woe and unwillingness to reform will keep politicians lobbying the European Central Bank for relief through even lower interest rates and money printing. But what they fail to recognise or admit is that easy monetary policy is not a tool for economic growth. It is simply a means for giving economies time to naturally find their feet again (which Europe is not doing) and for policy-makers to address the factors which are holding their productivity growth back – which is also not happening to the necessary degree. And to make matters worse the ECB President this week voiced mild support for the demands from France and Italy that yet again fiscal policy be used to try and stimulate growth – just as Japan has been unsuccessfully doing for a couple of decades now.

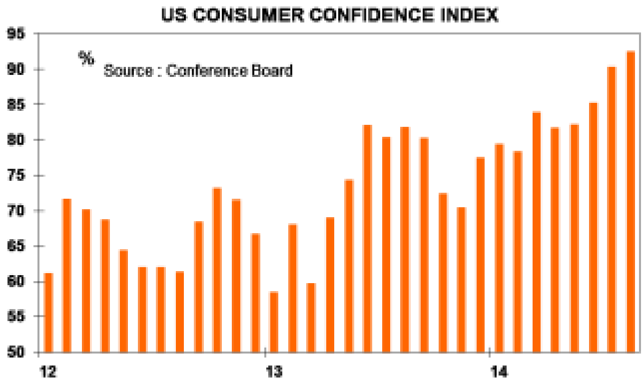
Speaking of France, only five months after a government reshuffle the President has asked for another one to be undertaken following strong anti-Germany comments from the Economy Minister. This deepening in uncertainty regarding policy direction in France might retard business confidence and therefore hiring and capital spending levels. However the change involves dumping a deep leftie for a reformist intent on boosting productivity so maybe things are actually turning for the better – subject to how many hundreds of strikes will occur in response to possible changes.

Given that the deepest worries about the Euro-zone centre around the second and third largest economies of France and Italy, and with the Ukraine dispute now hitting sentiment in the biggest, Germany, another recession in the Euro-zone is becoming possible. NZ exporters to Europe best watch their assumptions about demand and currency levels. About 3% of Germany's export revenue comes from Russia and exporters expect the total to fall near 25% this year.

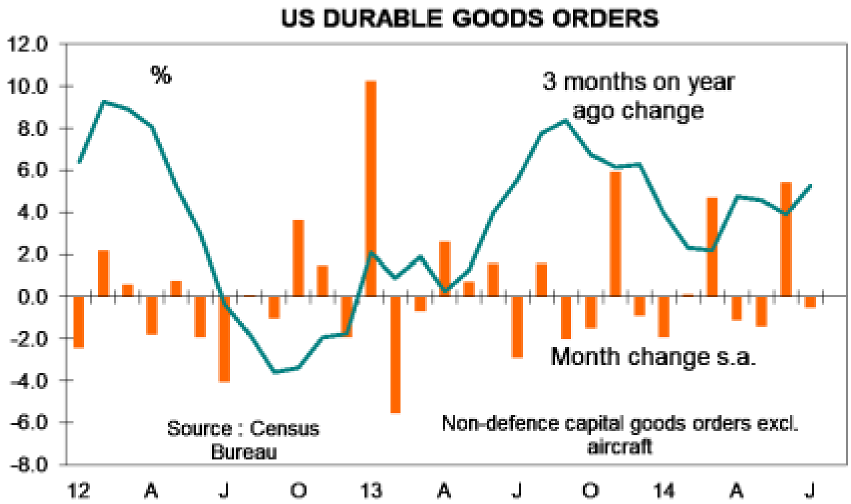
The upshot for us is migration flows as mentioned, especially with the Eurozone unemployment rate stuck at 11.5% which is more than double our 5.6%. In addition we should expect structural ongoing weakness in the Euro against which we are likely to remain firm even as we lose ground against the Pound, USD, and AUD over the next couple of years.

Regarding the USD, all eyes this week have been on the annual gathering of central bank leaders at Jackson Hole in the United States. The speech from Federal Reserve Chair Janet Yellen was mildly more hawkish than expected and this has added some strength to the USD. However, were the markets truly convinced that monetary policy is about to get tightened soon one suspects the ten year US treasury bond yield would be a lot higher than it is. At the start of this year the rate was 3% and it is now near 2.4%. Before talk of tighter policy arose in May last year the yield was 1.7% but it jumped to almost 3% this time last year after the previous Chairman's warning of policy tightening.

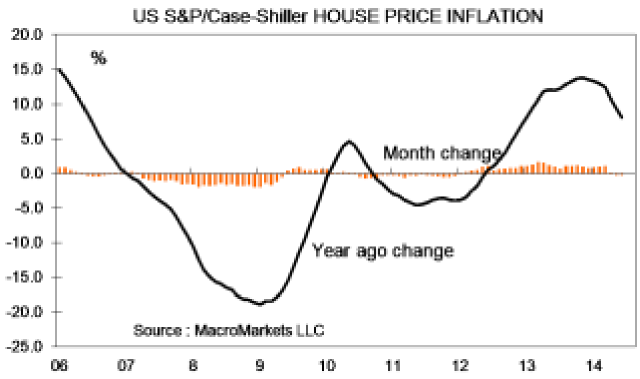


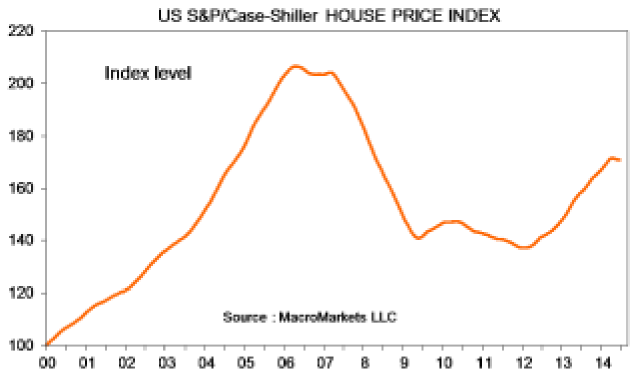


There remains considerable uncertainty regarding how fast the US economy is growing and how sustainable the growth is. Just this week for instance there was good news in the form of the Conference Board consumer confidence index rising higher than expected to 92.4 in August from 90.3 in July. In addition orders placed for durable goods soared 22.6% in July. However this was because of a big order for aircraft and excluding that the change was a fall of 0.5% in the month and growth of 5.3% from a year earlier for the three months to July. This is still quite positive as one element previously missing and about which doubts still persist in the US recovery is business investment. This now appears to be on a firmly growing trend which gives support to those arguing that employment prospects remain good, wages growth will eventually accelerate, and therefore interest rates will rise.



For your guide, here is an update on one of the housing market indicators which we track for the United States. The best measure of house price changes comes from Case-Shiller and the data for June released yesterday show average prices in the 20 biggest cities fell by 0.2% after declining by 0.3% in May. Prices are 8.1% ahead of a year earlier, down from 13.7% growth in November 2013. On average prices now sit 17.4% down from their April 2006 peak and 24.4% above their February 2012 low.



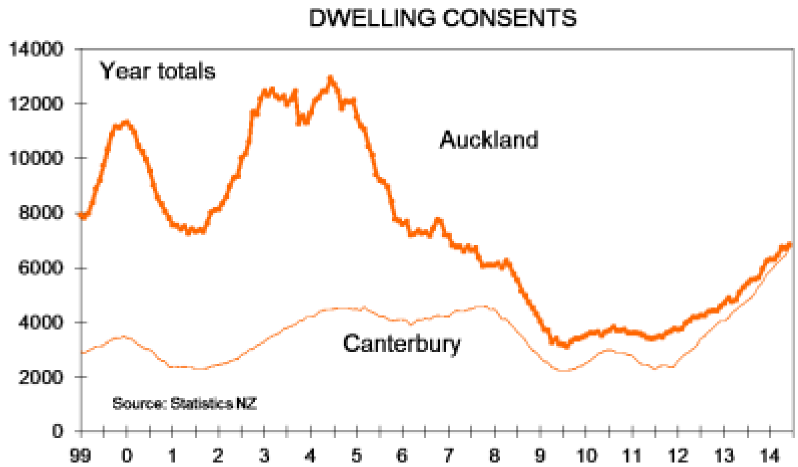


Back on NZ

The week produced a couple of pieces of information backing up our continuing expectation that house prices will continue to drift upward (or resume their upward drift) especially in Auckland and Christchurch. First we have the policy proposal from the governing National Party to boost the number of people who qualify for first home assistance and the amount which people can take out of Kiwisaver contributions, whilst lifting maximum house prices eligible for such assistance.

The changes boost demand therefore add to prices though there will be a possible boost to supply from a doubling of the grant for newly built houses. The problem here however is that the constraint on house construction in coming years is very much going to be the availability of builders rather than a dearth of buyers. And the true issue is the extent to which the policy encourages a shift away from building large houses on an expensive piece of land to small ones – also on an expensive piece of land. And that is where the problem lies. Unless regulations are changed to free up large swathes of land for residential rather than rural use, almost all the policies coming forward to address the housing affordability crisis we have written about for years will be mere words in the wind.

And here is a forecast for you. At some stage Aucklanders are going to ask themselves how it is that in Canterbury (Christchurch) consent numbers can go from average to twice average numbers in less than two years but after three years of going up still sit below average in Auckland. Christchurch shows us how much building of houses can rise and how quickly if all stops are pulled out and the land is available. Auckland is on an isthmus and there might never be a building boom as Christchurch is currently experiencing and will continue to do so probably until a bust near 2018.



Speaking of which, the NZ Initiative (the rebranded Business Roundtable) this week apparently produced a report warning about a severe deepening of the housing crisis because of a factor which we have had in our list of things pushing prices up for quite a few years – an aging population. They note that at 2.6 people per household the NZ occupancy rate is high by OECD standards but that it is likely to fall toward 2 over the next few decades as an aging population leads to elderly couples and singles occupying multi-bedroomed properties. Some reporters referenced the report but I have not been able to find it.

Last week I travelled down south for talks in Christchurch, Queenstown and Dunedin. In Christchurch the taxi situation at the airport is better with the near $11 charge to taxis for using the location cut to half that for both drop-off and pick-up. So it is good that the airport company responded to the groundswell of concern about their charges. Now, with the way councils love to tax drivers for using car parks in cities etc. there are fears that people avoiding parking charges at the airport by parking along the road outside Russley Golf Course may somehow end up paying for it beyond having their utes broken into and tools stolen.

The best job I ever had by the way (much better than this long-lasting one) was assistant greenkeeper at Russley in about 1980 during varsity summer holidays.

There is more and more work happening in the Christchurch CBD. The roads are receiving a thrashing in terms of being dug up and one hopes that some extra tough ground preparation is being undertaken because there will be hundreds of thousands of heavy truck journeys over them in the next few years as construction ramps up – something which is increasingly happening.

Retailing in the city however is still a very patchy affair and it will be interesting to see how many people return from the suburbs when the new shops are created in Cashel Mall – remembering that people disappeared from the CBD to do their shopping in the suburb many years before the earthquakes, just as has happened in many other cities as well. (Legal high seekers may be early returnees if the council proposal to confine sales of such substances to the Christchurch CBD are acted on.) My suggestion to the council would be to introduce free parking rather than taxing people. Parking costs are one factor which ensure I visit Wellington CBD retailing only occasionally since the earthquake last year took two big parking buildings out of play and others immediately raised their prices. Higher prices weed out demand. I am weeded out so I now shop at Queensgate when the urge takes me.

In Queenstown it would be good if the development of shops at Frankton Flats was completed as quickly as possible because the commercial centre, while not crowded in a foot traffic sense, is difficult to get to now as the main road into Queenstown is getting quite congested. The CBD is great to spend time in however as a visitor and I always buy the kids (and me) some lollies at the Remarkable Sweet Shop – which now also has an outlet at the airport which following some recent changes is quite pleasant to be at. Christchurch Airport is also great, Auckland is getting better, and Wellington which was great, is now looking less ahead of the pack than a few years ago.

In Dunedin the airport waiting area is quite nice. The city looks about the same as ever though perhaps with a tad more activity south of the Octagon than I recall from previous visits. I spoke at a function room in the new stadium. It looks like a good venue to watch a game, though many people I spoke with bemoaned the lack of rock concerts and the ratepayer burden of paying for it.

Speaking of burdens on ratepayers from councillors convincing each other that they need a new expensive stadium else they will not get big rugby test matches or rock concerts, that keeping up with the Jones' mania has now spread to convention centres. If you don't have a big centre then you won't get conventions and the largess they bring. My advice? Watch the assumptions regarding frequency of use. Examples? Wellington's Sesquicentennial celebrations of 1990, flower shows, and the new Napier Museum. Google it. Love Napier. More sand needed though.
http://wellington.govt.nz/about-wellington/history/history-of-wellington/1972-2000
http://www.stuff.co.nz/dominion-post/news/local-papers/hawkes-bay-sun/9660436/Museums-wee-problem

The Ministry of Business, Innovation and Employment this week released a report showing a decline in the year to June in the number of people attending conferences around NZ to one million from 1.1 million the year before. The trend for big events however does appear to be upward.
http://www.med.govt.nz/sectors-industries/tourism/tourism-research-data/other-research-and-reports/convention-research/convention-activity-survey

If I Were A Borrower What Would I Do?

Take note of the recent decline in fixed interest rates and look for a discounted rate near the three year term.

	This week	Week ago	4 wks ago	3 mths ago	Year ago
Official Cash Rate	3.50	3.50	3.50	3.44	2.50
90-day bank bill	3.73	3.73	3.73	3.44	2.66
1 year swap	3.94	3.94	3.91	3.69	2.93
2 year swap	4.11	4.11	4.11	3.98	3.43
3 year swap	4.27	4.27	4.29	4.16	3.87
4 year swap	4.37	4.37	4.39	4.32	4.16
5 year swap	4.46	4.46	4.49	4.40	4.39
7 year swap	4.57	4.57	4.62	4.62	4.71
10 year swap	4.69	4.69	4.79	4.81	4.98

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
To change your address or unsubscribe please click the link at the bottom of your email. Tony.alexander@bnz.co.nz