Weekly Overview

5 December 2013

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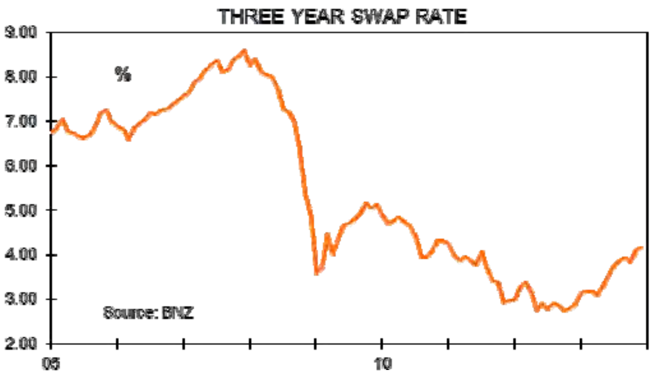
Mission Statement

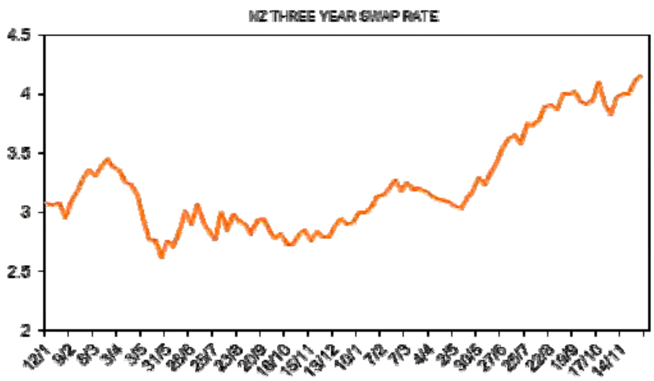
To help Kiwi businesspeople and householders make informed financial decisions by discussing the economy and its implications in a language they can understand.

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

IF I WERE A BORROWER WHAT WOULD I DO?

With signs of improving growth in New Zealand plus hopes of growth establishing a more solid base in the manufacturing and housing sectors in the United States wholesale interest rates are tracking upward with an extra jump this week. The three year swap rate is now near 4.15% which is the highest level since February 2011.





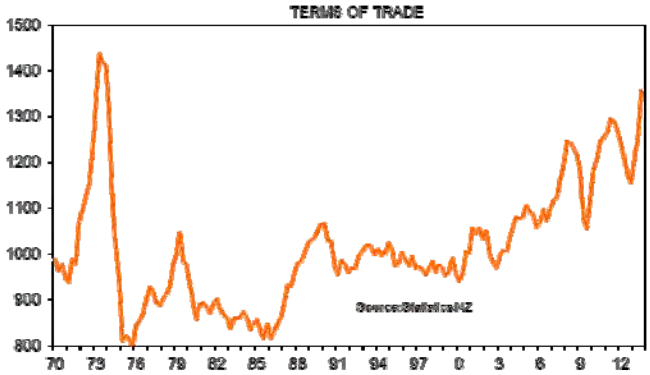
I continue to believe that rates will rise at a fairly unpredictable pace over the next three years so would look to get a mixture of floating and fixed rates in place. Watch for a round of fixed rate increases in the next few weeks given the increase in funding costs underway.

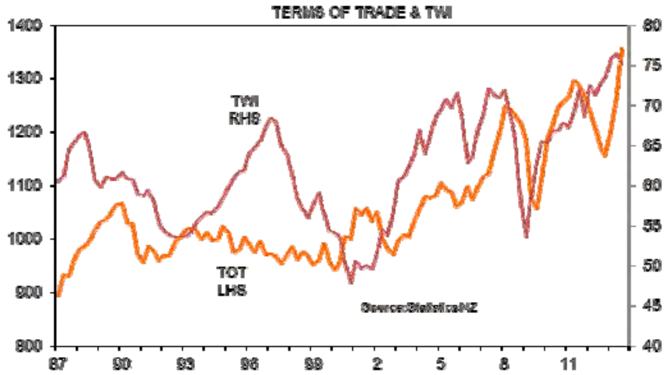
FINANCIAL MARKETS DATA

	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	

NZD Well Supported

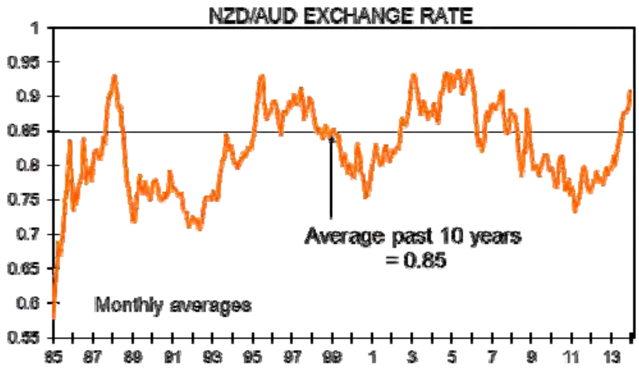
Here is a key reason for not expecting a substantial downward correction of sustained nature in the Kiwi dollar in the next wee while. New Zealand's terms of trade jumped by 7.5% during the September quarter to be 15.9% ahead of a year earlier and at their highest level since the end of 1973.

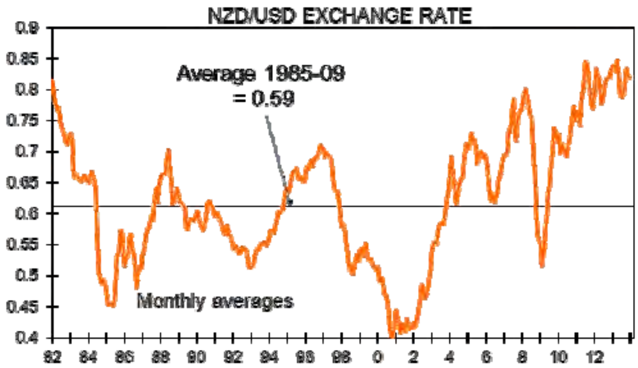




The second graph above starts in 1987 and shows a broad correlation between the level of the terms of trade and the trade weighted index. But the relationship is far from exact as seen for example in the dip in the terms of trade over 2012 which was not correlated with any change in the TWI.

Nevertheless a correlation is there and this week dairy prices rose by 3.9% at the fortnightly auction. This helps explain the NZD's rise against the AUD during the week to its highest level since mid-2007. We have long noted upside risk for the NZD/AUD cross rate and there is probably still a bit further to go following the release of weaker than expected Aussie growth numbers yesterday.





Regarding the other exchange rates, the NZD has stayed well within its recent trading range against the USD – though toward the lower end. We are oscillating above and below 50 pence with the British Pound benefitting from some good economic data and hopes for growth compared with a still struggling Europe. Against the Yen we are holding up as additional monetary stimulus is speculated upon over there.

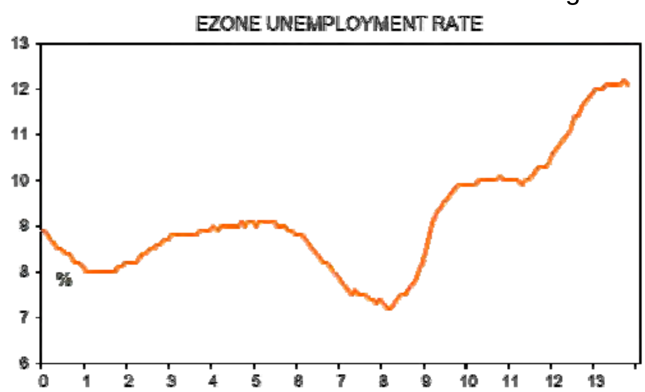
Exchange Rates	This Week	Week ago	4 wks ago	3 Mths ago	Yr ago	10 yr Average
NZD/USD	0.819	0.813	0.828	0.791	0.824	0.72
NZD/AUD	0.907	0.896	0.871	0.863	0.787	0.84
NZD/JPY	83.6	83	81.6	78.8	67.4	71.4
NZD/GBP	0.5	0.5	0.518	0.506	0.512	0.42
NZD/EUR	0.602	0.599	0.612	0.599	0.629	0.54
NZDCNY	4.99	4.95	5.05	4.84	5.13	5.14
USD/JPY	102.08	102.09	98.55	99.62	81.80	99
GBP/USD	1.64	1.63	1.60	1.56	1.61	1.72
EUR/USD	1.36	1.36	1.35	1.32	1.31	1.33
AUD/USD	0.90	0.91	0.95	0.92	1.05	0.87
USD/RMB	6.0909	6.0929	6.098	6.119	6.2256	7.17

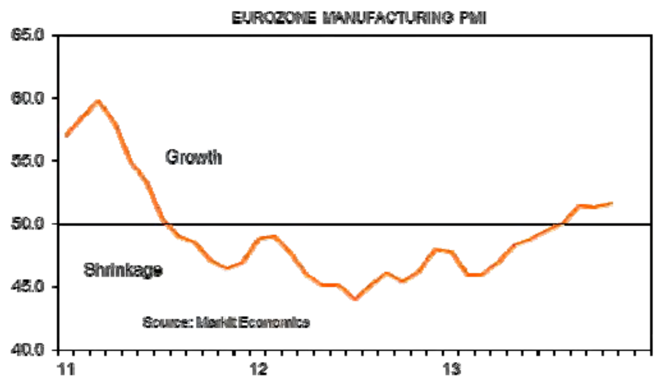
Eurozone

One of the growing worries in Europe is of deflation. This is the dangerous situation whereby consumer prices on average decline thus signalling to consumers that they should cut back on spending and wait for prices to decline before making their purchase. In addition people tend to become wary of borrowing money as the cost of repaying it goes up relative to expected future receipts. Businesses also tend to cut investment as they are uncertain how much the final price of their product will decline.

Data released on Friday night showed that consumer prices in the Eurozone fell by 0.1% for the second month in a row in November, taking the annual inflation rate to 0.9% from 0.7% in October. The European Central Bank's inflation target is 2% and that target has now been under-shot for ten months in a row. This helps explain why the ECB recently cut its overnight cash rate another 0.25% to just 0.25%. But this reliance upon stimulative monetary policy to try and dig Europe out of its hole is doomed to fail in terms of stimulating growth if people are unwilling to borrow and banks unwilling to lend while governments retain their interventionist bias and refuse to undertake deregulatory productivity-boosting reforms.

In a piece of positive news however the Eurozone unemployment rate fell to 12.1% s.a. in October from 12.2% in September. The rate a year earlier was 11.7%. The Purchasing Managers Index also improved slightly to 51.6 from 51.5 in October which is a hardly awe-inspiring level but at least indicates some growth in a sector which is increasingly burdened by rigid and expensive labour rules and bureaucratic interventions. Meanwhile the US manufacturing sector discussed below is on a roll.





United Kingdom

The Bank of England moved to curb some of the excess in the housing market this week not by raising interest rates or imposing lending controls but by removing a couple of changes made some time ago to stimulate bank lending for home purchases. They have removed a waiver on bank capital requirements for lending to households and ceased the Funding for Lending Scheme for households, restricting it to funding of bank lending to businesses. The move comes at the same time as one of the measures of house price changes shows just a 0.2% rise in London prices last month. So the debate in the UK with regard to London in particular has shifted to perhaps house price rises generally slowing down and construction rising less rapidly than previously predicted.

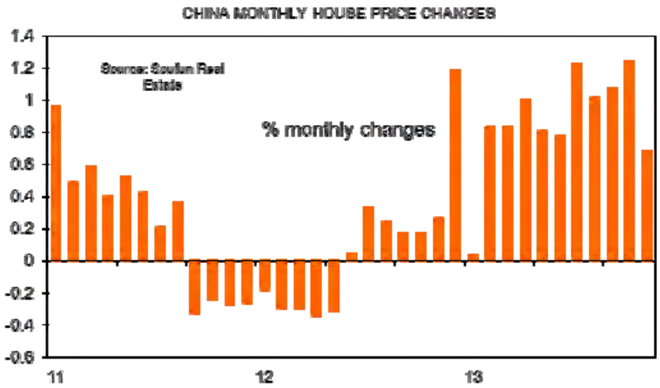
China

There are trillions of dollars in China wanting not to be in China. An estimated $1.5tn will leave the country this year as corrupt officials take their ill-gotten gains away from the reach of the CCP. But more importantly from a long-term perspective is the ability which individuals and companies have to get legitimate funds out of the country into desired investments offshore. That ability for normal people is quite limited with a rule that only $50,000 can be converted into foreign currency each year.

However this week it was announced that anyone operating an account in this year's newly-created Shanghai Free Trade Zone would face no capital controls – plus that foreign bodies can issue bonds there to raise cash for their operations. The outcome will eventually be more funds leaving China and boosting asset markets and currencies of desired destinations such as the United States, UK, Europe, Australia and probably ourselves as well.

There is no time-table on how much will leave China, especially as people must first of all figure how to get their funds into one of the free zone accounts. But this is a step in the right direction for China's integration in the global financial system.

Whereas the Purchasing Managers Index measuring activity in the manufacturing sector in the United States unexpectedly climbed to a good level of 57.3 in November, the official index for China held steady at the minimally-growing level of 51.4. This was a better than expected outcome but not one which suggests accelerating growth in China's economy in the near future.



House prices continue to track upward in China with the Soufun index covering 100 cities rising by 0.7% in November to sit 11% ahead of a year earlier.

United States

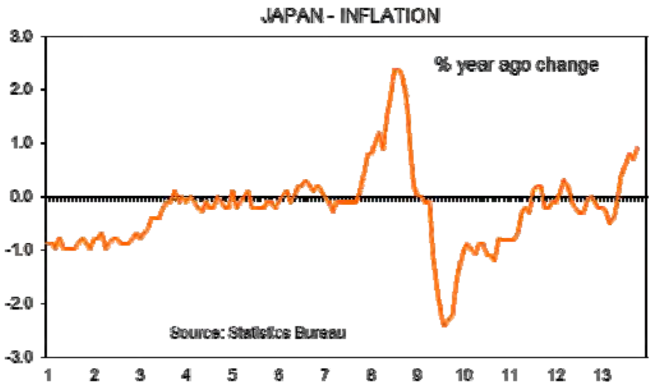
The US manufacturing sector is looking healthier as measured by the much-watched Purchasing Managers Index which rose to 57.3 in November from 56.4 in October. A fall to 55.1 had been expected. This is the best reading since eraly-2011 when the US economy was experiencing its second of (hopefully only) three false starts since the 2008-09 recession.

There was good news also in the data for sales of new houses released last night. Sales were ahead 25.4% s.a. in October and 21.6% up from a year earlier. The number of months' worth of supply at the end of the month stood at just 4.9 from 6.4 months in September and 5.3 months in August.

But the data have had little impact with general squaring up of positions in the various asset markets (including equities) ahead of the important non-farm payrolls report due out on Friday night. The outcome will have a big influence on expectations for when Fed. tapering may start and could easily cause some big asset price changes. The markets are expecting a rise in job numbers of around 180,000.

Japan

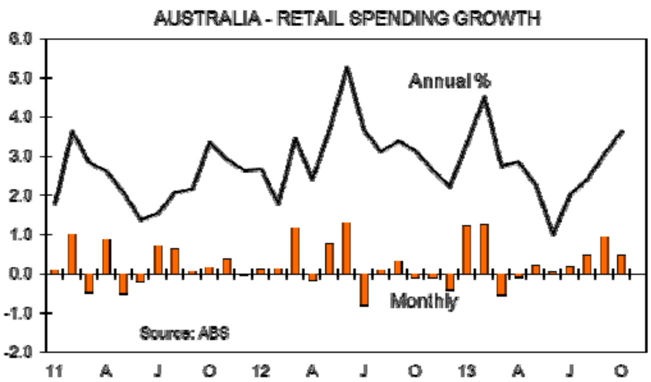
The annual rate of inflation as measured by the Bank of Japan's target measure of the CPI less fresh food rose to 0.9% in October from 0.7% in September and 0.0% a year earlier. Inflation has averaged -0.2% p.a. in Japan since 2001 and the BOJ is printing money with the aim of taking inflation to 2% within two years as part of the "Abenomics" policies which also involve a fiscal stimulus and deregulation such as the removal of rice subsidies in coming years noted here last week.

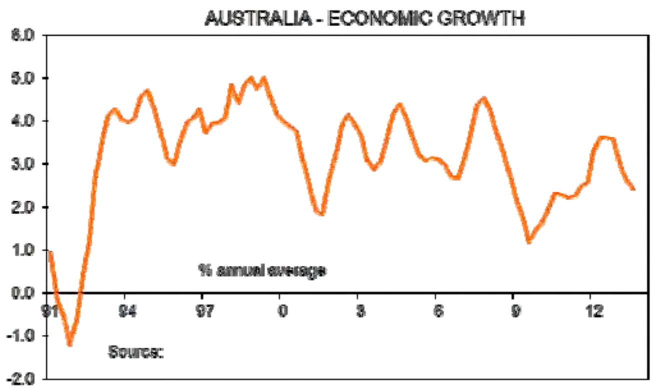


Australia

The RBA met expectations this Tuesday by leaving their cash rate unchanged at the 2.5% they cut it to back in August. They noted that the AUD remains "uncomfortably high" but few in the financial markets expect a rate cut to get the AUD down even though the RBA is concerned about its impact on some sectors. This is because there is increasing evidence of household consumption and investment picking up. House prices on average in November rose by 8% from a year earlier according to RP Data-Rismark, the strongest annual rate of change since late-2010.

We also learnt on Tuesday that retail spending across Australia rose by a stronger than expected 0.5% in October and September's rise was revised upward to 0.9% from the previously reported 0.8%.





But yesterday the September quarter national accounts were released and they showed the Aussie economy grew by 0.6% in the quarter and by 2.4% for the entire year whereas growth rates of 0.7% and 2.6% had been expected.

Housing Market Update

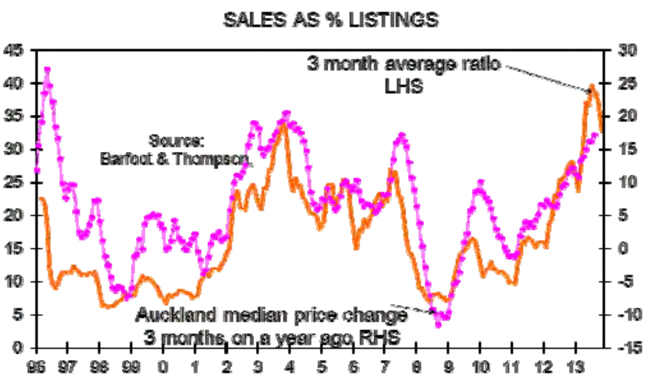
Hints of Listings Easing

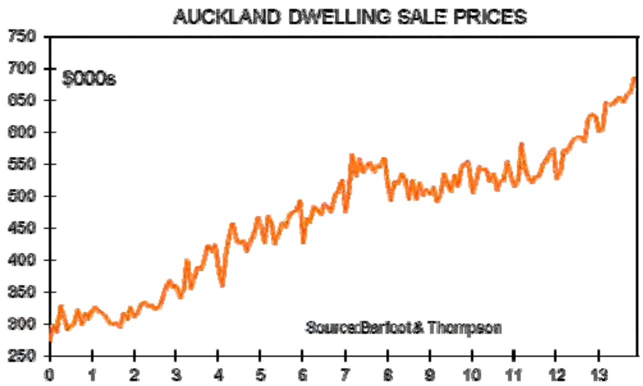
The NZ Property Report this week showed us that at the end of November there were 40,046 properties listed for sale and that this number was down by 9% from a year earlier. Stock was the equivalent of 24.8 week's worth of sales over the three month period ending in October – meaning that one cannot use this particular indicator to say anything about LVR impact as it covers three months and being reliant on REINZ data which are not yet available for November only captures one month of the post-LVR rule introduction, namely October.

A better route to take is to look at the seasonally adjusted change in new listings. These were down by 10.6% in November after rising 12.6% in October and falling 5.3% in September. There is still an underlying growth trend in fresh listings but it is not strong and given the volatility between October's rise and November's fall I conclude nothing regarding vendor willingness to list following the LVR introduction. Note however that our BNZ-REINZ Residential Market Survey of 250 licensed agents in early-November found just a net 8.4% seeing more requests for appraisals from potential vendors. This was a result below the net 12.7% average so maybe the LVR rules have scared away a handful of potential sellers at the same time as lots of potential buyers have pulled away from the market.

The average asking price eased slightly in the month to $479,000 from $482,000 in October but this change is neither here nor there.

Barfoot and Thompson this week reported that in November they sold 1,118 dwellings in Auckland. This was a fall of 0.5% from a year earlier and the first such annual decline since February 2011. In rough seasonally adjusted terms sales fell over 10% in the month after rising near 10% in October. The latter total was probably boosted by some people buying early to quickly use pre-approvals while the former would have been depressed by this bringing-forward of sales. In that regard then we struggle to discern to any great degree the exact impact on turnover from the LVR rule introduction.



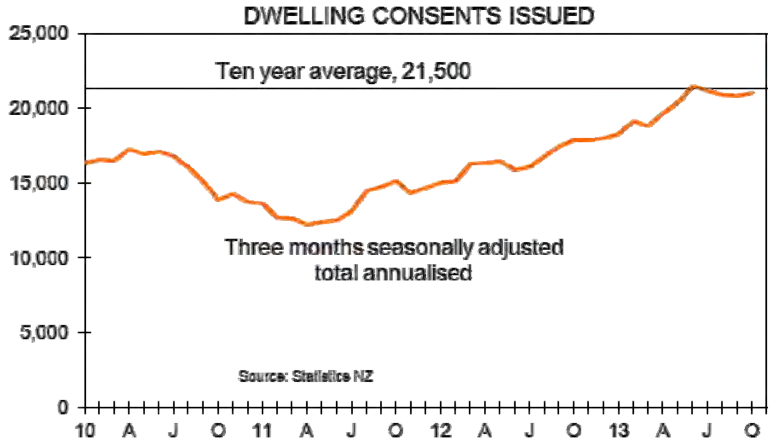


The median dwelling sales price jumped to a record $684,000 in November from $663,000 in October – a rise of 8.9% from a year earlier. The number of fresh property listings received during the month was down 5.9% from a year earlier at 1,665, after recording strong annual rises in each of the previous four months. So this backs up evidence from the NZ Property Report that just as buyers have edged back so too have some sellers.

The stock of listings was down 4.7% from a year ago at the end of November.

House Supply Not Booming

The number of new consents issued for the construction of dwellings in October fell in seasonally adjusted terms by 0.6% from September's total. This means that in the three months to October consent numbers have weakened by 0.7% after rising 7.4% in the three months to July. The fall then is not a large one and comes after good growth earlier. But it is concerning in the context of a shortage of houses in Auckland and Christchurch – sort of.



In the year to October the number of consents issued for dwellings in Christchurch was 5,323 which was a rise of 41% from a year earlier and up from 5,084 in the year to September and 4,881 in the year to August. So annual numbers have risen 517 from three months ago. Now consider Auckland. The annual total in October was only just above Christchurch's total at 5,638 from 5,595 in September and 5,564 in August. The increase from the annual total three months ago is just 199. This pace of increase is not at all what planners want to see as they talk of building 13,000 houses in each of the next (unspecified) three years.

Auckland's consent numbers remain below their 20 year average of just under 7,500. This fundamental ongoing shortage then is something people need to think about as they contemplate where Auckland house prices will go. For the moment first home buyers have backed away from the market, vendors are pulling back from selling via auctions, and even some Chinese buyers have backed off as it appears they are uncertain about what is happening in the market.

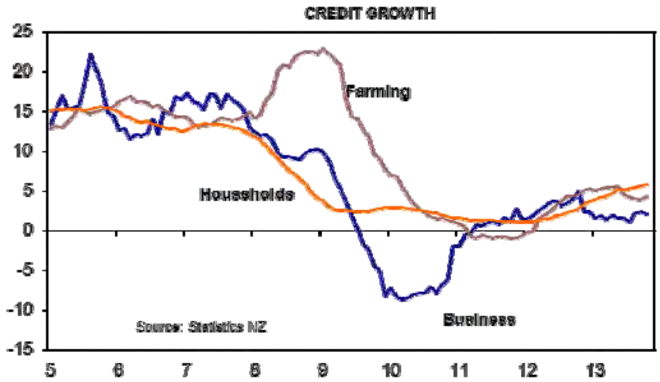
But the shortage persists, it is getting worse as construction fails to move to average levels, and population growth is accelerating courtesy of a rapid change in the net loss of people to Australia.

Thoughts of People In The Market

You can read about three pages of comments from people in the residential property sector in our BNZ Confidence Survey released on Monday morning. Go to page 14.
http://tonyalexander.co.nz/wp-content/uploads/2013/12/BNZ-Survey-Results-December-2013.pdf

Lending for Housing

In seasonally adjusted terms lending to the household sector in October grew by the same percentage as in September, 0.5%. In fact growth has been either 0.4% or 0.5% per month for a year now. It is too early however to conclude that the LVR rules have not slowed down lending growth as clearly in October a lot of people would have been using up pre-approvals. Lending for housing purposes rose by $936mn in October compared with a $644mn rise in October last year and $155mn two years ago. In addition we have the clear evidence from the experimental weekly home loan approvals series produced by the Reserve Bank showing approvals running 10% - 15% or so down from a year earlier.



PropertyIQ – First Home Buyers Estimate

For your guide, PropertyIQ this week released data showing the proportion of home sales going to first home buyers, using as their criteria that the person's name on the title has not appeared before and they have taken out a mortgage. They estimate that since the beginning of 2012 20% of dwelling sales have been to FHBS. Allowing for the slight under-reporting which their method will deliver it is very close to the results from our two surveys asking real estate agents earlier this year the proportion of their sales to FHBs. In March 23.6%, May 23.3%. But there is also an upward bias to their 20% caused by first-time purchases in New Zealand by migrants.

While data are provided on a disaggregated basis showing average FHB proportions since 2012 no other data have as yet been made available.

A Housing Paper

Here is a paper where I take a look at when different regions started to experience house price rises following the 2008 decline, how current prices compare with long-term averages in terms of an NZ-wide measure, and whether it is true that Auckland leads the housing cycle. Enjoy.
http://tonyalexander.co.nz/wp-content/uploads/2013/12/Housing-Cycles-December-2013.pdf

Key Forecasts

Dec. year		2011	2012	2013	2014	2015
GDP	annual average chg	1.4	2.7%	2.5 – 3.0	3.0 – 3.5	2.0 – 3.0
CPI	on year ago	1.8	0.9	0.5 – 1.5	1.5 – 2.0	2.5 – 3.0
Official Cash rate	end year	2.5	2.5	2.5	3.5 – 4.25	3.5 – 4.5
Employment	on year ago	1.6	-1.3	2.5 – 3.5	2.0 – 3.0	1.0 – 2.0
Unemployment Rate	end year	6.3	6.8	5.5 – 6.5	5.0 – 6.0	5.0 – 6.0

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Tony Alexander has been Chief Economist at the BNZ since 1994 and apart from publications and advising management spends considerable time on the road around New Zealand making presentations and speaking with the media. He travels to the UK and Europe twice a year to assess economic conditions and present at numerous functions, has five children, tramps, and his partner Dr Sarah Farquhar runs the early childhood education network www.childforum.com www.myece.org.nz