HUGO*vision*

Assessing the economic and political environment in New Zealand

April 1 2014 | Confidential to HUGO members

Forecasts at a glance

	INFLATION	GROWTH	$ v $US	$ v $A	WORLD GROWTH	TRADING PARTNERS
December 2014	2.4%	4.0%	78.0c	92.9c	3.0%	4.1%
December 2015	3.1%	3.4%	71.9c	89.9c	3.3%	4.2%
December 2016	3.0%	1.8%	67.7c	88.8c	3.4%	4.3%

Text finalised March 31

Is there an electoral point to the Dotcom party?

Kim Dotcom's Internet party launched March 27. Mana party went cool on a joint ticket until Dotcom ruled out working with National at his launch and even then Hone Harawira remained cautious and Sue Bradford said she would leave Mana if it linked. A claim that an existing electorate MP was thinking of joining was unsubstantiated as this went to press.

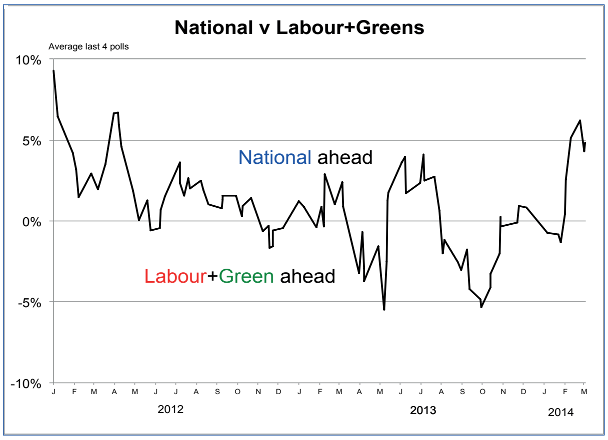
If Dotcom runs alone, doesn't get an electorate seat and doesn't get 5%, the main effect will be to siphon votes off the Labour-Greens side into the wasted vote and thereby improve National's prospect for a third term. If somehow it were to add party votes to a Mana win in Te Tai Tokerau through combining in a single ticket (as the two Christian parties did in 1996), that would make it harder for National to win and could bring in additional MPs.

Don't absolutely rule out such a deal. But it is unlikely. The two parties have very different priorities. Mana is a Maori nationalist party with an old-left social agenda stitched on. Dotcom can best be described as anarchic libertarian.

Its initial platform talks only of cheaper internet, limits on government surveillance, reform of copyright to make material more quickly and widely available, better channels for citizen feedback to the government, encouragement of green technologies, more innovation and high-tech jobs, opposition to the TPP, setting up a digital currency (like Bitcoin) and taking all classrooms digital.

Dotcom reckons it can reel in young people connected in cyberspace but disconnected from traditional politics. But there is also a disconnect between browsing a website, downloading an app and joining for a 99-cent fee and trudging out to vote. It did get 0.4% in TV3's poll. But Kim Dotcom has lost some gloss lately. The comparable Pirates party in Germany quickly faded after a first flush.

But there are still nearly six months to go.



Parata, Collins and how to not to handle errors of judgment

There used to be a rule in politics when the media were moderate and simple: keep quiet about something messy and hope it never surfaces and if it surfaces minimise it and hope it goes away. The rule is different now: fess up and front up (an f-word precedes those two). David Cunliffe stuck initially to the old rule over his leadership contest funding trust. Judith Collins did it over her dinner in China and Hekia Parata over misused kohanga reo public money.

We got it wrong, too, when we suggested in the March 15 HUGO*vision* the Collins misstep was not a big deal. Instead of cauterising the small political wound caused by her initial – wrong – arrogant dismissal of Grant Robertson, she left it to fester as Robertson dug out more and then more. Result: an angry Prime Minister and a step down the ladder some thought she was climbing to be John Key's successor.

Collins embarrassed the government. That is not good at any time and particularly not good in an election year. It is unlikely by itself to have tipped any votes across the line because the substantive issue is relatively minor and more a beltway issue than a voter-land one, though in voter-land it is an issue of Cabinet unity and management.

Parata's transgression was substantial: a defence of the non-examination of Te Kohanga Reo National Trust's subsidiary company, Te Pataka Ohanga, by Ernst & Young on the grounds that it was a "private" supplier. That was plain wrong, as the ministry in effect said later. Public money is public money wherever it turns up. Parata – and the government – looked sneaky and devious, and providing cover for undeserving beneficiaries of taxpayer funds.

As a portfolio minister Parata, with Peter Hughes' consummate public service skill behind her, is shifting education policy in a modernising direction. But her repeated public relations missteps suggest she needs wraparound help from the Prime Minister's office similar to Heather Simpson's not-so-tender ministrations in the Helen Clark days.

Key can't publicly discipline Collins and Parata. That would elevate misdemeanours into politically indictable offences. Key's need is closer management of wayward ministers to avoid similar incidents piling up as the election approaches and amounting to the sort of repetition that starts to register in voters' consciousness.

Meantime, Labour, still low in the latest polls, got some badly needed respite and David Cunliffe got out an "active government" forestry policy.

Labour's emerging economic policy

Labour is finally moving to put some flesh on the bones of its economic vision, although David Cunliffe's March 14 "economic upgrade" speech spent more time establishing his credentials as a change agent with relevant business experience than specific policy platforms.

That was forthcoming a few days later with the "wood-first" policy, which would see accelerated depreciation for sawmillers and a mandate to procure wooden construction options for low-rise government buildings.

The Cunliffe speech used anecdote about his time as a management consultant seeking productivity improvements at a pulp and paper mill by engaging workers on the shop floor and coming up with millions of dollars in savings.

With respect to current economic settings, Cunliffe diagnoses the problem as "a combination of poorly-structured investment in infrastructure, macro settings geared towards the interests of a small number of speculators, a hands-off approach to innovation, and a deficit of government-industry partnerships", especially in the regions.

The "wood-first" policy is an example of the partnership approach, while a capital gains tax is intended to deal with speculative investors. Making KiwiSaver universal would assist deeper domestic capital markets, along with resuming payments to the NZ Super Fund.

Changes to the foreign direct investment regime would require technology transfer and export market access gains. A widened mandate for the RBNZ would bring down the high kiwi dollar, while R&D tax credits would assist innovation.

Regional development strategies might include rail links to Northport or dredging the Opotiki Harbour to encourage aquaculture.

National predictably panned the pro-wood policy, but it's likely to resonate in regional economies and with voters who struggle with the fact that NZ appears unable to move on from raw log exports, apart from rare exceptions such as Taupo-based Tenon, which has yet to make profits after a decade of dedicated investment in product development and market penetration into the US. The proof for Tenon will come in the next couple of years, as the US housing market recovers.

The pro-wood policy also includes special lending for forestry planting and joint ventures with iwi.

Twitter followers also heard last week that Labour's polling company, UMR, has been testing out policy combinations, including one that would introduce a carbon tax on the heaviest emitters in exchange for creating a tax-free threshold on the first $10,000 of income.

Winston gives a subtle pro-mining push

NZ First gained endorsement from Local Govt NZ and has positioned itself neatly to support National or Labour in favouring the economic role of extractive industries by announcing a policy to share 25% of mining royalties with regions where minerals are extracted.

Winston Peters singled out the West Coast as a region that would benefit from the policy and would apply to any minerals produced.

The policy chimes with Labour's push to announce policies that resonate with regional economies.

Russel Norman eyes Deputy PM role

The Green Party's Russel Norman is quietly asserting himself as the more dominant of the party's two co-leaders, marking out for himself a bid to become deputy PM in a coalition government with Labour, and continuing to overshadow the less politically saleable Metiria Turei.

Norman says he expects the Greens' election day vote to hold up at around the 11% achieved in 2011, although it's been as high as 14% in recent polls and showed a stronger surge than Labour in the March 21 TV3-Roy Morgan poll, which had National and Labour-Greens level-pegging at 45.5%.

That poll gave the Opposition parties considerable heart, given the earlier Herald Digi-poll, which gave National 51% support. The knock to National appears to have come from its own gaffes: the Judith Collins/Oravida saga and Hekia Parata's mishandling of both the kohanga reo issue and commentary that inflamed teacher unions on school performance measurement.

Norman also gave important signals in a TV3 The Nation interview on the Greens' willingness to accept that a Labour-led administration would be likely to approve deep-sea drilling and fracking, and would be likely to sign a Trans-Pacific Partnership treaty.

"We're standing up strongly to protect the environment and to avoid out of control climate change and also to make the move to the smart green economy, which is low carbon, right," said Norman. "Now Labour's taking a different path, right? So somehow in the post-election negotiations, we're going to have to find a compromise that we can live with."

If the Greens were to top 15%, Norman signalled the party would bargain considerably harder. For example, it would seek resistance to the highly contentious Investor State Dispute Settlement provisions in the TPP agreement, where opposition is strongly focused.

EU FTA breakthrough: still a long hill to climb

Among the many material gains made for the NZ trade agenda on the PM's swing through China and Europe, the European Union's willingness to consider an FTA with NZ stands out as significant.

In the past, Brussels officialdom made it clear there was no candle in an FTA with NZ – too small, too open an economy already to yield significant gains, no impetus to move.

What's changed? In part, it's the recognition in Europe that it needs to engage more in the Asia-Pacific region or risk its relevance in this part of the world. Hence also the decision to appoint an EU ambassador in Wellington, although that move has been expected for some time.

What surprised John Key's delegation in The Hague was the sudden change of tone on the potential for an FTA. It may be that the EU has finally recognised there's something amiss for NZ to be one of just six countries that aren't trading into Europe either on a most favoured nation basis or are negotiating FTA's with the Europeans. The others are Australia, China, Hong Kong, Russia and Taiwan.

Two-way trade between the EU and New Zealand is around $16 billion annually, with some key exports facing tariffs not borne by competitors. For example, kiwifruit carries an 8.8% tariff not levied on product from Chile. NZ exports of high value manufactures, services and software would also benefit from improved regulatory coherence, to ease their entry into the complex environment thrown up by the 28-member union. Discussions won't start until 2015, and the going won't be easy.

European Parliament elections in May are expected to deliver a more protectionist EU, while it remains to be seen how the five yearly reappointment process at the end of this year will affect the composition of the EU's super-bureaucracy, the European Commission.

China relationship "never been stronger", says Key

Memories fade fast, but John Key's mid-March visit to Beijing demonstrated again the uncommonly close relationship that has developed between NZ and China, not least the fact Key felt able to speak publicly about a personal rapport with Chinese president Xi Xinping, which has seen the pair meet one-on-one three times in the last year. That puts holiday golf with Barack Obama in the shade.

Among several notable announcements, including the hairy-chested goal of $30 billion in two-way trade by 2020, Key has said the Chinese and NZ governments will seek to "modernise" the six year-old China-NZ FTA.

No details have been forthcoming, but the move looks consistent with NZ's desire to position itself as the creator of high quality FTA templates, which would feed into TPP, EU-NZ, and potentially RCEP negotiations (being China's alternative to the TPP grouping), while improving the potential for China to hitch its wagon to the TPP, should the protracted talks produce a positive result for the 12 countries currently involved.

Note also the decision to build a new embassy in Beijing, the appointment of seven new MFAT officers in China, including a public affairs manager, and nine new MPI officials to facilitate trade at a practical level, along with Key's signal there will be funding boosts for other China-facing agencies in the Budget.

The new two-way trade target has provoked some justified hand-wringing in NZ about the potential for NZ to become overly dependent on China as a trading partner. Exports to the Middle Kingdom are now around 4% of GDP, similar to the exposure of the largest sources of China's imports: the US, Japan and Saudi Arabia. It remains to be seen whether NZ will be insulated from any shocks to the Chinese economy by the relative balance in our export profile in favour of soft commodities, for which demand may be less elastic than hard commodities associated with modernising infrastructure.

Irrigation policy hits a snag

TrustPower's withdrawal as a prospective investor in the Ruataniwha Water Storage Scheme suggests that funding for irrigation projects requiring storage to be built, rather than using existing lakes or run of river, will be commercially challenging, even with government assistance.

Controlled by Infratil, an infrastructure investor known for its desire for bank-like certainty over return on investment, TrustPower had been suggesting a $50m to $60m commitment to the $270m scheme, and had signed MoU's with the Hawkes Bay Regional Investment Company and Ngai Tahu Holdings late last year.

While short term commercial viability appeared sound, TrustPower couldn't get comfortable with risk-sharing on the long term uptake profile for the scheme. What that suggests is that as the scheme became more and more concrete, potential users began focusing on the cost/benefit of participation and may have found it wanting.

A contributing factor may be the relative lack of experience with large-scale irrigation in Hawke's Bay. Land use changes the scheme might drive are less clear than, say, in Canterbury, where experience with irrigation schemes and their dynamic effects is more mature.

Ngai Tahu Holdings is now reported to be "very nervous" about its involvement in the scheme.

TrustPower's general manager for operations, Chris O'Hara, suggests if the Ruataniwha scheme is commercially knife-edge, then similar "greenfields" (for which read, requiring construction of storage) projects are also likely to struggle. Of schemes currently under consideration, Ruataniwha appeared to be the most bankable.

The most analogous proposal in the North Island currently is the Wairarapa Water Use Project, which proposes to irrigate up to 50,000 hectares. It's at a much earlier stage than the Hawke's Bay project, and is still determining storage options.

In the South Island, the largest proposed project requiring storage construction is the Hurunui Water Project, which would irrigate up to 58,500 hectares after construction of four storage dams.

O'Hara says the economics of schemes involving existing natural storage, such as the proposed Central Plains Water scheme, drawing on Lake Coleridge and combining hydro-electric generation, remains comparatively favourable.

The Ruataniwha scheme would rely on a capital subsidy from the $400m Crown Irrigation Investment Company. However, CIIR won't join schemes as a principal sponsor or majority funder as this would imply that "scheme economics are weak".

Fonterra's conundrum

Counter-intuitive as it may seem, given the booming contribution of dairy exports to NZ's terms of trade and current economic recovery, Fonterra would have made a loss on operations in the first six months of the current financial year, had it not intervened to reduce the Farm Gate Milk Price.

Holding back 70 cents per kg of milk solids reduced Fonterra payments to farmers by $519 million, allowing it to report a $217m net profit, a drop of 53% on the same period a year earlier, despite a 21% increase in total revenues to $11.3b.

The only reason farmer shareholders haven't complained is presumably because they still received a record Farm Gate Milk Price of $8.65 per kg/ms.

Fonterra Shareholders Fund unitholders, however, are not as happy, having had annual dividends cut from 32 cents per unit to a projected 10 cents.

Deutsche Bank analysis rated FSF units a "sell" after the March 26 result, targeting a unit price over the next 12 months of $5.64, compared with $6.01 on March 28 and $6.22 on March 25. That's a far cry from unit prices that nudged above $8 last May.

In essence, Fonterra is the victim of its own success in China. Whereas the conventional wisdom of the last 25 years has been to move up the value chain by producing non-commodity products for end consumers, the reality has proven the opposite. The price of whole milk powder is by far the most profitable use for milk as Chinese demand, in particular, outstrips global supply. Fonterra was simply unable to process as much WMP as it could have sold, because it doesn't have enough plant to do so.

Instead, it was forced to pay high milk prices for products like cheese, whose margins either contracted or were wiped out during the latest period.

The response is to ramp up an extra $400m to $500m in new capex on milk drying facilities to try and make the best possible margins on all the milk that Fonterra shareholder-farmers are producing.e Fonterra was unable in NZ to make best use of a milk production season that lasted longer and produced more milk than anticipated last year.

The results expose the inherent contradictions in a business that sometimes acts as an extension of farmers' balance sheets and sometimes as a separate balance sheet trying to make a profit to cover its own cost of capital. As a result of that, its story and strategy change according to circumstances.

That leads to non-farmer investor scepticism driving analysis such as Deutsche's, which bluntly suggests Fonterra's reporting lacks transparency, and that the intervention in the FGMP, while justified, is an unwelcome precedent.

It suggests Fonterra needs to adopt a reporting framework that "can be used to measure performance against some of the key areas of investment being made, thereby supporting increased confidence in implementation as it occurs."

It points out also that the FGMP intervention delivered windfall gains to competing dairy producers in NZ, by reducing the price they had to pay Fonterra for supply under the Raw Milk Regulations and the price they had to pay their own farmer-suppliers. Depending on their mix of "wet" and "dry" shares, there have also been uneven impacts on co-op farmers, and share milkers.

Electricity sector politics heating up

The heat is coming on the electricity sector as the election approaches, with new research suggesting the Electricity Authority's customer switching campaigns haven't been as effective as previously claimed and increasing focus on the fact disconnections for non-payment have returned to levels prevalent in 2007, when a Mercury customer died after a disconnection.

It seems the large retailers are complying well with self-regulation to act with great care in the case of medically dependent electricity customers. But disconnection rates have been rising among the major retailers. Meanwhile some new entrants – especially those offering highly competitive tariffs and operating as de facto suppliers of last resort for less creditworthy customers – have begun to show relatively high disconnection rates.

The degree of political concern is measurable by the fact Energy Minister Simon Bridges is seeking explanations for the growing number of disconnections, and the Electricity Authority is proactively seeking explanations for recent tariff increases.

Part of the answer may yet lie in MRP chief executive Doug Heffernan's call to separate the energy and supply elements of customer bills, so the sources of increase are more explicit.

Irrespective of the rights and wrongs of the issues, the fact remains that ongoing focus on tariff increases and disconnection rates play well to Opposition parties seeking to harness the politics of inequality, especially given the electricity sector's failure to win the argument about increasing competitiveness.

Reports suggesting the EA's "What's My Number?" campaign has cost almost as much as it has saved customers who've switched supplier is a blow to that effort. If average wholesale electricity prices continue to track low, the opportunity for a retailer to break out with tariff cuts, as opposed to more complex and hidden savings through discounts and switching offers, grows.

In this context, MBIE's cancellation of the Quarterly Survey of Domestic Electricity Prices is unhelpful. While the EA consultations on the series have demonstrated the MBIE figures don't fully account for the range of discounts being offered in the market today, the move to have the industry produce a new series is too easily painted as turning the poacher gamekeeper.

IRD clarifies tax residence status

The tax department has issued a new interpretation to assist with determining tax residence following a **Taxation Review Authority** decision last year that threatened to make ownership of NZ residential property automatically a qualifying factor. That had raised **concerns for expatriate employees** of NZ firms on long furloughs offshore. Tax practitioners are welcoming confirmation that long term investment properties and holiday homes would not normally constitute a permanent place of abode. But the devil's in the detail.

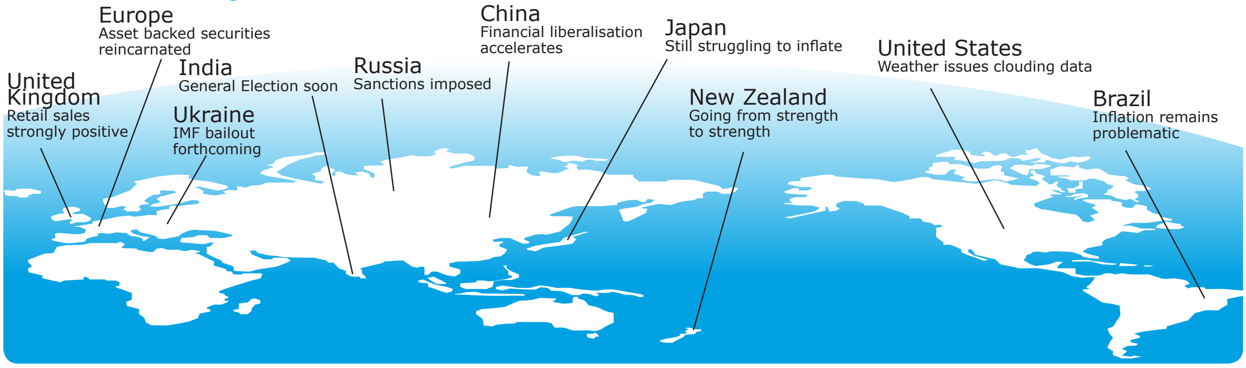
New financial reporting obligations go live this month

Simplified financial reporting obligations come into effect from April 1. They are of greatest benefit to businesses with annual turnover of between $2m and $30m, as they will no longer be required to produce complex financial statements under the Financial Reporting Act and for tax purposes.

The External Reporting Board (XRB) in association with Inland Revenue and the New Zealand Institute of Chartered Accountants is running seminars to explain the combined effect of the changes under the Financial Reporting Act and the Tax Administration Act.

From April 1, SME's will only be required to prepare simplified statements, complying with regulated minimum standards.

The world at a glance



DOMESTIC ECONOMY

RBNZ talks up LVR's; exporters coping with high kiwi?

If we assume the Reserve Bank intends to increase the cash rate by 25 basis point increments over the next couple of years, then its loan-to-value ratio restrictions for home lending have saved us two such increases, says the bank's deputy governor Grant Spencer.

Speaking in Hong Kong, Spencer sought to outline how the bank both balances and coordinates monetary policy and macro-prudential policy – the former focused on stable prices and the latter on a stable financial system, but with each able to influence the other.

Restricting LVR lending, for example, was judged to be slowing house price inflation and had already had an observable impact on the volume of residential property changing hands.

At the same time, LVR's were judged to have been worth somewhere between 25 and 50 basis points of increase in the Official Cash Rate before the first such upward push at the mid-March monetary policy statement.

That, in turn, had probably taken some of the pressure off the over-valued New Zealand dollar, Spencer argued. However, in question time after his speech, Spencer also suggested that kiwi exporters had learnt to cope with the dollar at around current levels, a comment that foreign exchange market analysts interpreted as meaning the RBNZ had few qualms about the currency implications of pushing interest rates higher. The kiwi spiked to a two and a half year high immediately after Spencer's comments. Meanwhile, the RBNZ has all but confirmed that the Chinese yuan will enter the calculation of the most commonly used trade-weighted index measure when it review TWI composition at the end of the year.

Productivity shows sharp jump

Latest productivity statistics suggest an improvement is finally occurring in one of NZ's most persistently sluggish economic indicators. If the trend persists, it may suggest a more sustainable underpinning to the cyclical and earthquake repairs-driven economic recovery currently occurring.

In the year to March 2013, Statistics NZ says productivity improved by 2.1%, compared with an average 1.6% average rate recorded for the 17 years the measure has been taken.

The improvement came from a 1.2% improvement in multifactor productivity, which averaged just 0.2% growth in the previous five years, and 0.9% in capital per worker. ANZ chief economist Cameron Bagrie is talking the result up as evidence that the post-GFC recession was a wake-up call to NZ business managers.

The uptick is also consistent with evidence of a surge in capital goods investment, which has seen businesses importing efficiency-enhancing machinery and taking advantage of the strong NZ dollar.

However, NZ's latest figures only take the country to a par with the recent Australian annual average for productivity.

Trading partner growth

(2012 actual; 2013-14 Consensus Forecasts; 2015-16 figures Hugo estimates)

Trading partners		GDP Growth (ann avg %)					CPI Inflation (ann avg %)				
	Weights %	2012	2013	2014	2015	2016	2012	2013	2014	2015	2016
China	25.2	7.7	7.7	7.4	7.3	7.2	2.6	2.6	2.9	3.2	3.1
Australia	23.1	3.7	2.4	2.8	2.9	3.3	1.8	2.4	2.8	2.6	2.7
United States	10.3	2.8	1.9	2.8	3.1	3.0	2.1	1.5	1.7	2.0	2.3
Japan	7.2	1.9	1.6	1.4	1.3	1.1	0.0	0.4	2.6	1.7	1.4
Eurozone	7.2	-0.6	-0.4	1.1	1.4	1.5	2.5	1.4	0.9	1.3	1.5
United Kingdom	3.5	0.1	1.8	2.7	2.5	2.2	2.8	2.6	2.0	2.2	2.5
South Korea	4.1	2.0	2.8	3.5	3.7	3.9	2.2	1.3	2.1	2.6	3.0
Indonesia	2.2	6.2	5.8	5.4	5.8	5.9	4.3	7.0	6.2	5.3	5.3
Hong Kong	2.0	1.5	2.9	3.5	3.6	3.9	4.1	4.3	3.9	3.6	3.4
Taiwan	2.2	1.3	2.1	3.3	3.7	4.0	1.9	0.8	1.3	1.8	1.9
Singapore	2.6	1.3	4.1	3.8	4.0	4.3	4.6	2.4	2.7	2.8	2.7
Malaysia	2.3	5.6	4.7	5.1	5.0	5.5	1.7	2.1	3.2	3.5	3.1
Philippines	1.9	6.8	7.2	6.5	6.2	5.7	3.2	2.9	4.2	3.9	4.3
Thailand	1.8	6.5	2.9	2.8	4.4	4.8	3.0	2.0	2.4	2.8	3.2
India	1.7	5.0	4.7	5.4	6.8	7.1	10.3	9.7	8.0	7.0	6.3
Viet Nam	1.2	5.2	5.4	5.6	5.9	6.0	9.1	6.6	6.9	7.2	7.0
Canada	1.3	1.7	2.0	2.2	2.5	2.5	1.5	1.0	1.5	1.9	2.0
NZ Trading Partners	100.0	4.0	3.8	4.1	4.2	4.3	2.5	2.4	2.7	2.8	2.8
Forecasts for New Zealand											
Consensus		2.7	2.7	3.5	2.9	2.5	1.1	1.1	1.9	2.3	2.3
BNZ Forecasts		2.6	2.7	4.0	3.4	1.8	1.1	1.1	1.9	2.7	3.0
The World		2.7	2.5	3.0	3.3	3.4	3.0	2.8	3.0	3.1	3.1

Online gains aplenty for most sectors

Best practice users of online services and the internet in NZ can be up to 73% more productive than average performers in their sector, a study by Sapere, funded by Internet NZ and Google, has found.

Across the economy as a whole, but excluding the ICT sector, better internet users are on average 6% to 11% more productive than their sector peers, the report suggests.

It found the retail sector lagging others, with just 3% of those covered in the survey making more than 25% of their sales online and that retailers were slightly behind the pack for their businesses having a website, at 75% versus more than 80% for all sectors.

The survey, using a combination of Statistics NZ Business Operations Survey data and interviews with 76 firms, found that only one-in-10 "economically significant firms" is making more than 10% of its total sales online or has more than 10% of sales outside NZ.

96% of such firms have online access, 90% use the internet for finance, and 77% use the web for ordering and making government payments. But just 45% have the ability to receive online orders. Only 69% have a website and only 12% are capable of taking online payments.

Regularly cited barriers to internet use were lack of skills, fragmented service provision and difficulty getting good quality advice. The results chime with the Productivity Commission's recent investigation into service industry productivity, which suggested NZ firms may face less competition than peers in larger economies, and are adopting online opportunities more slowly as a result.

Economic indicators still strong; dairy coming off the top?

NZ's economic indicators continue to be very strong, ranging across GDP, balance of payments, export performance, confidence indices, net inward migration, and further evidence that a capital investment cycle is under way.

A note of caution is warranted on signs that dairy prices are coming off their recent highs. The April 2 globalDairyTrade auction will be an important pointer on that trend.

That said, growth in timber, fibre and meat exports has also been impressive and the outlook for coming months is for continued strong trade balance outcomes.

Beyond that is less clear. The EU and US are ramping up dairy production in response to current prices, and there are signs of a new El Nino pattern developing, which could affect NZ agricultural output.

China: making life harder for investors

Two significant developments have occurred in the last month to put investors on their mettle when it comes to exposure to China.

Firstly, the People's Bank of China has begun to allow the yuan to depreciate within what appears to be a narrow 1% to 2% band around its daily reference rate.

And secondly, authorities have allowed a corporate bond default to occur, in what is read as a signal to investment markets that implicit government guarantees cannot be assumed.

Note that while there are concerns about the concentration of NZ's trade to China, at around 22% of total exports, it has been worse in the past with other trading partners. Between 1900 and 1960 , the UK took between 50% and 80% of total NZ exports.

Australia: Adjusting to the mining downturn

Reserve Bank of Australia governor Glenn Stevens believes the Australian economy is showing greater resilience to the mining downturn than local commentators have given it credit for.

Households are in sufficiently good shape to be an engine of consumption growth and to have the RBA warning it's looking out for signs of housing bubbles developing in the ongoing low interest rate environment.

Exports outside minerals and the tourism sector are picking up some of the slack created by the slowdown in mining. Queensland and Western Australia remain the strongest-growing states.

Competition policy review gets started

The Abbott administration has appointed its competition policy review panel and given terms of reference for what it's calling a "root and branch" examination. Chaired by one of Australia's best known economists, Professor Ian Harper, the review "will examine not only the current laws but the broader competition framework" and is due to report within 12 months.

US: tapering continues

Severe winter storms have clouded the picture for the US economy recovery. The Federal Reserve continues to withdraw monetary stimulus at the expected rate, but Federal Reserve chair Janet Yellen has moved to dampen expectations of a more aggressive monetary policy tightening in 2015.

NZ business and economic round-up

Asset sales

The government's **asset sales** programme will raise a gross $4.7b after the sale of 49% of **Genesis Energy**, within the reduced range adopted after the withdrawal of Solid Energy from the sale process and mixed results from the part-sales of MightyRiverPower and Meridian Energy. While 49% of MRP sold at what came to be seen as a relatively full price of $2.50 a share, its subsequent share price performance, along with threats to the future of the Tiwai Point aluminium smelter and the Labour-Greens electricity policy, gave Meridian a relatively weak start. The whole process, from the Supreme Court ruling last year allowing sales to proceed ahead of Treaty of Waitangi settlements on fresh water claims, has taken 13 months. Five research reports commissioned for the NZX concluded the offer price is attractive, with a range between $1.60 and $1.97. Craigs Investment Partners was the only firm to put a value on Genesis lower than the IPO price, valuing the shares at $1.52 if a Labour-Greens government were elected and implemented power price cuts through the NZ Power policy.

Sharemarket

The NZX50 Index of leading stocks topped 5,000 for the first time during the month. The exchange operator, **NZX**, announced it would launch a new trading platform for smaller companies, intended as an eventual replacement for the NZAX, which has not performed to expectations since launching in 2003. The new market will have fewer disclosure obligations and will target firms raising between $10m and $100m. Periodic rather than continuous disclosure will be required, and key metrics rather than prospective information will be the standard for financial disclosure.

Primary sector

Drought: The government is keeping an eye on the long dry spell affecting localised parts of Northland and the Waikato, none of which were assisted by the heavy rainfall that occurred elsewhere during the mid-month Cyclone Lusi event. At March 26, conditions did not meet the criteria for declaration of a medium scale adverse event.

Synlait Milk, like Fonterra, is accelerating its investment in new milk drying facilities to try and match demand from China for dried wholemilk powder. The company says it was caught out by both the strong kiwi dollar and delays to introduction of its own infant milk formula product to the Chinese market, caused by more stringent food safety regulation by Chinese authorities. As a result, it's dropped its full year net profit forecast to between $25m and $30m, $5m lower than the previously announced range, although still well ahead of prospectus forecast of $19.8m at the time of NZX listing last year. Capex to expand drier capacity will rise from $103.5m to $135m this year. The company, which is 39% owned by China's **Bright Dairy** & Food, is not yet paying a dividend. Dutch firm **Royal Friesland Campina**, where Fonterra ceo **Theo Spierings** once worked, has taken a 9.99% stake in Synlait.

Manufacturing

Hamilton-based **Pacific Aerospace** signed a $75m deal during John Key's China swing mid-month, to supply its flagship P-750 model to the Chinese market, through a relationship with one of the country's largest carmakers, **Beijing Automotive** (current owner of the Finnish **SAAB** brand). The craft is a 10-seater and production is expected to increase from 12 to as many as 200 annually during a ramp-up period of several years. At present, the company has capacity to build around 30 a year.

Energy

Genesis Energy shares are being offered to the market at $1.55 ahead of listing on April 17, implying a gross dividend yield in the 2015 financial year, based on prospectus forecasts, of 14.3%, ahead of the issue of loyalty bonus shares at a 1:15 ratio for shareholders who keep the shares for at least 12 months from listing date.

Minerals

Hearings for the first resource consent application under the EEZ regulations are under way, with expert evidence being heard over the next fortnight relating to the **TransTasman Resources** application for ironsands mining rights off the coast of Patea, at a distance of between 22km and 36km from land. The company claims the operation would be worth around $150m annually to the NZ economy, while environmental lobbies opposing the application say it should be delayed in the absence of crucial baseline scientific information. Questions on this point are likely to be canvassed in the current round of hearings.

Telecommunications

The **Commerce Commission** has confirmed it will rule by December this year on the final price Chorus can charge users for its copper line services. **Chorus**

Continued p12

ECONOMY AT A GLANCE

New Zealand economy

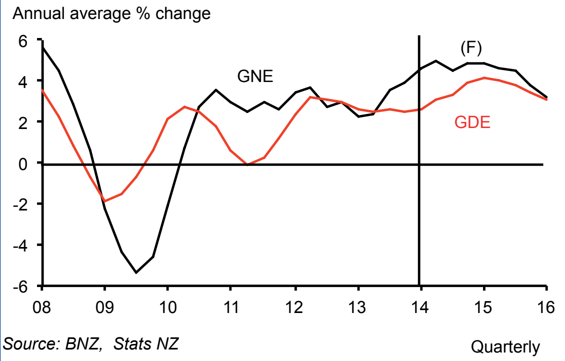
(% change on previous year
Calendar year except where indicated)

	2012A	2013F	2014F	2015F	2016F
GDP components					
Consumption	2.0	2.9	3.2	2.9	1.4
Investment	7.2	9.5	8.4	6.9	2.3
Stocks (contribution to growth)	0.2	0.0	0.1	0.0	-0.1
GNE	3.0	3.9	4.8	3.8	1.5
Exports	2.2	1.0	4.0	3.8	4.1
Imports	2.6	6.3	7.2	4.6	2.9
Activity					
Real GDP (production)	2.6	2.7	4.0	3.4	1.8
Output Gap	0.0	0.2	1.5	2.0	0.5
Labour productivity growth	2.3	0.6	0.8	0.5	0.0
Employment growth (annual % change)	0.4	3.0	2.9	2.6	1.4
Unemployment rate (S.A. % as at Dec Q)	6.8	6.0	5.4	4.9	4.9
Inflation (% increase from Dec Q previous year)					
Consumer prices	0.9	1.6	2.4	3.1	3.0
Average hourly earnings	2.6	3.2	3.6	3.8	3.2
Terms of trade	-8.9	20.0	-6.7	-1.7	5.2
Financial sector					
Operating balance (OBEGAL)					
(as % of GDP – June Year)	-4.4	-2.1	-0.9	0.0	0.3
Net debt (as % of GDP – June)	24.3	26.3	28.4	28.7	28.1
90 day bank bill (%) (1)	2.7	2.7	4.3	5.2	4.8
5 yr NZGS yield (%) (1)	2.9	4.2	4.8	5.4	5.1
10 yr NZGS yield (%) (1)	3.5	4.8	5.1	5.8	5.6
External sector					
$NZ/$US(1)	0.832	0.823	0.780	0.719	0.677
$NZ/$A(1)	0.794	0.915	0.929	0.899	0.888
$NZ/Y(1)	69.5	85.1	86.6	84.1	79.2
TWI(1)	74.3	77.5	77.1	74.3	70.7
Trade balance $(m)	149	1333	2167	-1901	1440
Current account $(m)	-8590	-7546	-7585	-12548	-9410
(as % of GDP)	-4.1	-3.4	-3.2	-5.0	-3.6

(1) Average for month of December

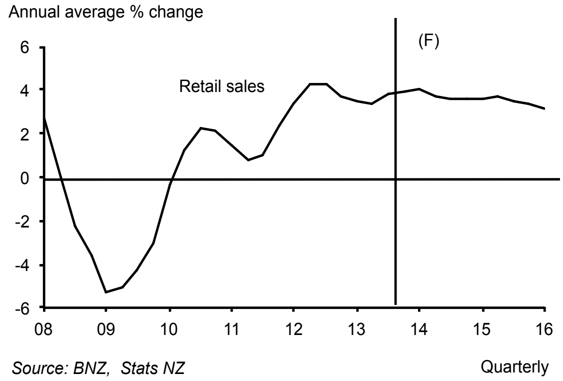
(2) Using current prices

Economic growth



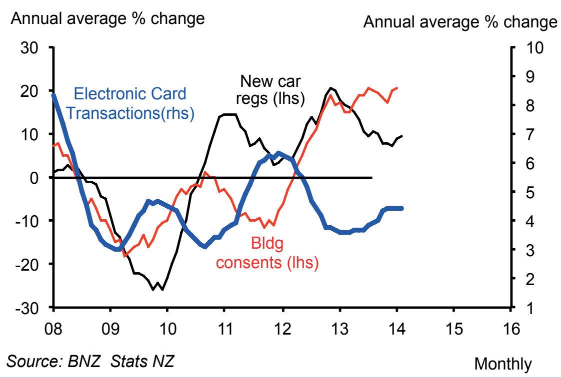
Source: BNZ, Stats NZ

Retail sales



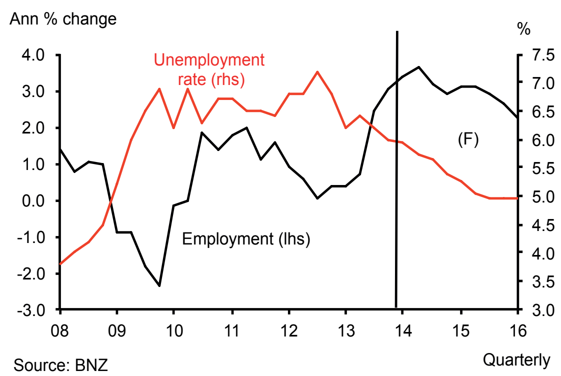
Source: BNZ, Stats NZ

Partial indicators



Source: BNZ Stats NZ

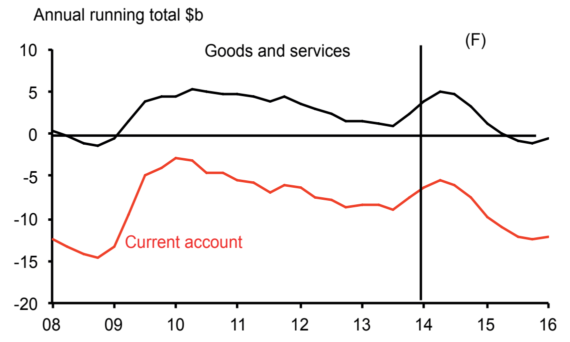
The labour market



Source: BNZ

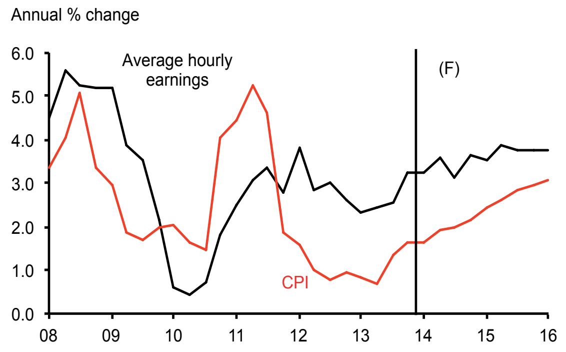
ECONOMY AT A GLANCE

Balance of payments



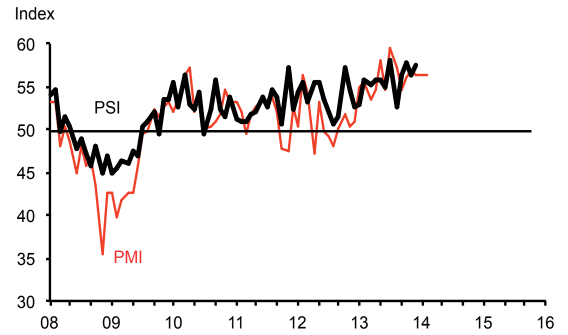
Source: BNZ, Stats NZ Quarterly

Inflation



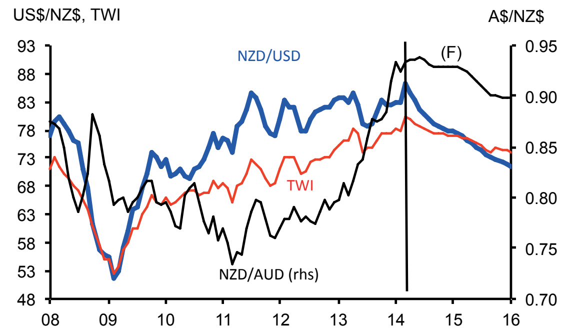
Source: BNZ, Stats NZ Quarterly

PSI and PMI



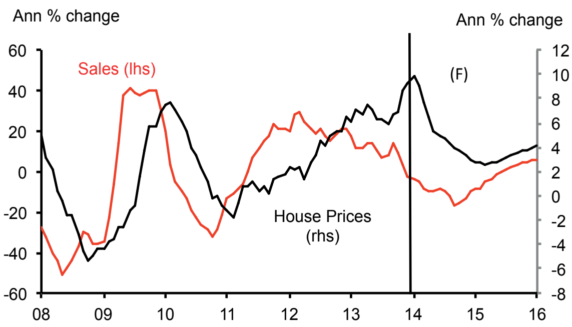
Source: BNZ Monthly

Exchange rates



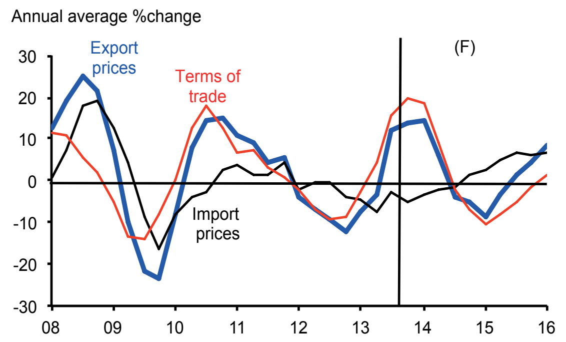
Source: BNZ Monthly

Housing market (three month average)



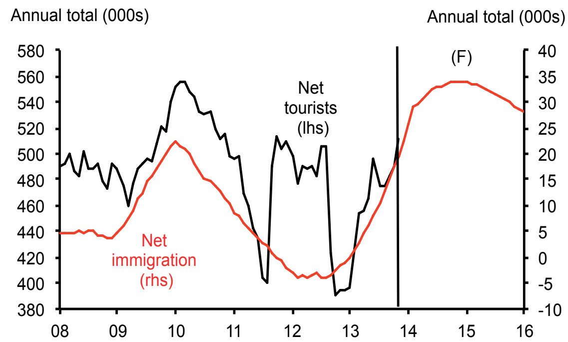
Source: BNZ REINZ Monthly

Terms of trade



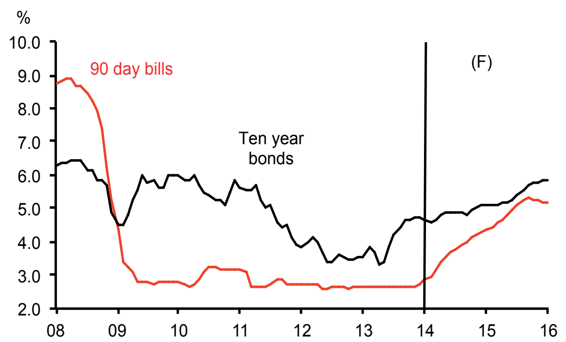
Source: BNZ Stats NZ Quarterly

Net migration flows



Source: BNZ Stats NZ Monthly

Interest rates



Source: BNZ Monthly

DOMESTIC ECONOMY

Continued from p9

shares rose on the news, reflecting earlier concerns that the process could take much longer.

Transport

Auckland International Airport has unveiled the master plan for the country's primary hub airport to expand through to 2030, including construction of a second runway by 2025, which it warns will likely need to be made longer within a 30 to 50 year timespan to deal with ever larger long haul jets. In the short term, the airport will concentrate on connecting the domestic and international terminals within the next five years. It is also preserving land for a rail link to the Auckland CBD, with provision for an underground station at the terminal. AIA is forecasting forecasting a trebling of passenger numbers from 14.5m last year to 40m in 2044, with annual flight numbers expected to rise from 150,000 to 260,000 in that time.

There is no sign yet of the E+Y report on the proposal to extend the runway at **Wellington airport** to take long haul passenger jets. A draft was completed some weeks ago and sent back for further work.

Tourism

The New Zealand Tourism Industry Association launched its Tourism 2025 framework, with a focus on growing sustainable air connectivity and targeting 6% annual growth for the tourism sector, to increase tourism revenue to $41 billion by 2025.

Jetstar has quit direct Auckland-Singapore flights, raising concerns about competition with code-sharing partners **Air NZ** and **Singapore International Airlines** now providing capacity. The Jetstar service had become a significant source of traffic from the Philippines, as well as Singapore.

Innovation

Bio-fuels pioneer **Lanzatech** has raised a further US$60m in its D capital-raising round, adding Mitsui and Siemens to its register and giving Mitsui a board seat in exchange for its US$20m commitment. Eftpos software developer **Vend** raised US$20m in a private funding round that attracted funds from serial Silicon Valley tech investor **Peter Thiel**, who is also a shareholder in **Xero. Wynyard Group** raised $30m in private placements with local and foreign institutions. The intelligence software developer raised $65m in an IPO last year. **Kim Dotcom's Mega** service is to backdoor-list using shell company **TRS**, attracting commentator scepticism in the process.

Insurance

IAG has ACCC permission to buy Wesfarmers' Australian general insurance interests, including the **Lumley** brand, but continues to wait on word from the **Commerce Commission** on the NZ leg of the proposed acquisition.

People

Fonterra has appointed **Gordon Jon Thompson**, its general manager, external communications, further boosting its in-house capability after a decade in which comms were the preserve of externally contracted Baldwin Boyle Group. The former advisor to Labour leaders Helen Clark and Phil Goff (and brother of Radio NZ ceo Paul Thompson) has jumped around a lot since 2008, going first to pollsters UMR, and then to a corporate comms role at Sky City.

Dairy investor **Shanghai Pengxin** has picked up the services of the former Fonterra executive **Gary Romano**, who resigned after carrying the can for the cooperative's initial response to the whey protein concentrate contamination scare last August. Romano was head of NZ Milk Products, Fonterra's biggest production arm, and will become ceo of **NZ Milk Management.**

Graham Stuart is to step down as chief executive of **Sealord**, saying it's time for rejuvenated leadership. The company had its toughest year in 2013, with a $36.5m loss following the failure of an Argentinian fishing venture. Stuart will be leaving the company in better heart. It's performing ahead of plan at the 2014 half year mark.

The head of the **Treasury**'s transactions team responsible for the asset sales programme, response to the Solid Energy crisis and the South Canterbury Finance receivership, **John Crawford**, left the Treasury last Friday, coinciding with the conclusion of the Genesis Energy book-build. He is returning to the private sector after six years in the bureaucracy, the first two years spent in the DPMC, six months of that time in the Helen Clark-led administration.

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