HUGOvision

Assessing the economic and political environment in New Zealand

August 1 2014	Confidential to HUGO members

Game on

Parliament rose on Thursday this week before heading into campaigning for the Sept 20 election. On a "poll of polls" basis, National maintains a strong lead over the Labour/Greens combination, although conventional wisdom suggests that gap will close.

Chch contemplates innovative funding options

New analysis for Christchurch City Council has roughly doubled the city's potential funding shortfall to meet its share of the quake rebuild. One option will be to invite strategic NZ investors to take up to 25% of the city's asset holding company.

Growth robust, dairy notwithstanding

Fonterra's deep cut to the forecast payout for the 2014/15 season helped push the kiwi dollar a lower after last week's RBNZ jaw-boning exercise. The $6 per kg/Ms forecast will likely be revised as the season progresses and confidence outside the agriculture sector remains robust.

US economy roars back in 2nd quarter

Annualised economic growth for the US clocked in at 4% in the second quarter of this year, a very large bounce back from the weather-affected recessionary first quarter. Debate is heating up at the Fed about whether to start raising interest rates earlier in 2015 than previously anticipated.

Chorus gets a little clear air

Its Court of Appeal action against the Commerce Commission's UBA pricing seemed to get off to a shaky start, but the future for Chorus is looking a little brighter after an extended period of bad news. UBS is even rating the stock a "buy".

Lessons from Europe on food exports

New research for MBIE's food export programme shows the size of the challenge to raise primary produce exports into Asia and focuses on European exporters' disproportionate success in selling high margin, shelf and fridge-ready products into Asian markets.

Why Colin Craig dipped out

John Key eventually decided he didn't need Colin Craig enough to gift him an electorate seat, but his decision on East Coast Bays entrenches Winston Peters's likely influence on the election outcome.

Forecasts at a glance

	INFLATION ann % change	GROWTH ann avg % change	$ v $US spot rate	$ v $A spot rate	WORLD GROWTH annual avg % change	TRADING PARTNERS annual avg % change
December 2015	2.6%	3.5%	73.0c	90.1c	3.2%	4.1%
December 2016	3.1%	1.8%	67.0c	86.7c	3.2%	4.2%
December 2017	2.7%	1.2%	63.1c	87.2c	3.1%	4.0%

Text finalised July 31

POLITICS AND POLICY

The Peters factor: why John Key no longer needs Colin Craig

Back in May it was already looking too late for John Key to gift Colin Craig a safe National seat as he is doing one more time for ACT (David Seymour in Epsom) and United Future (Peter Dunne in Ohariu). If there were still lingering thoughts mid-July, they were squelched by Winston Peters not ruling out standing against Craig in East Coast Bays if National didn't – and probably beating Craig if he did.

In fact, New Zealand First had a candidate for East Coast Bays but held back the announcement.

The focus now turns to whether Peters will go with Key if he has the balance of power after September 20.

Key has reaffirmed that National will encourage electorate votes for Seymour and Dunne and will not stand candidates against Maori party candidates in the Maori seats. They might be all he needs after September – very likely if New Zealand First doesn't clear 5%. The Maori party, for all its Labour-like policies and its recognition that being close to National has cost it dearly, is clear that it wants to be in the government and if it doesn't go with National and Peters can and does, it can't count on being in a government. Peters has ruled out working with it.

Peters no longer feels so intensely about the slagging Key gave him in 2008 – at least not to the point where it cannot be got around. And he has been emphasising the need for "stability" which the other side is much less likely to be able convincingly to promise, even if it gets competitive.

So the logic, if National is nearly there and needs Peters, is that Peters would stay on the cross-benches but back it on budget and confidence votes, probably with a portfolio for himself. He would want concessions and that could prove difficult, given that on most economic and social issues he is closer to Labour than National and even in some cases out past Labour in favour of intervention.

But Peters learnt from 1996, with National, that too detailed an agreement is difficult to operate. And he learnt from 2005, with Labour, that he can extract some concessions without bringing the house down. Moreover, Key has shown, notably in his accommodation of the Maori party over six years, that he can be flexible up to a point.

So a deal can be done. And at this point in the lead-up to the election, that is the most likely outcome – though underline "at this point".

Will New Zealand First get 5%? So far, probably, yes. But might Peters recall that after both 1996 and 2005 New Zealand First fell below 5% at the next election? The answer may lie in the expectation of a growing number of New Zealand First activists that this coming term will be Peters' last. Key could promote him out of politics to a higher calling by 2017. Which would take out New Zealand First in that election.

National's list regeneration

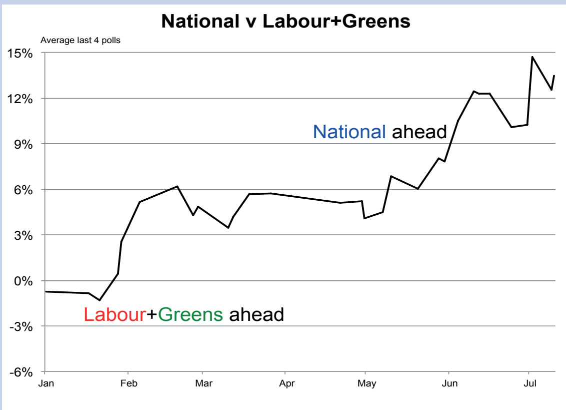
National's list looks set to add five under-45s, including three generation Ys, to the National caucus's present four. That would put it ahead of Labour in generational change and, given Key's track record of frequent reshuffles, that might become visible to voters by election time 2017. That in itself could be a factor in whether National could get a fourth term, if it gets a third term on September 20.

Regardless of whether it is in government or opposition, Labour has a job to do to clean out some of the older and longer-serving MPs next year or at least well before the 2017 election. If it loses, it is highly likely to have an under-45 generation X leader and generation Y deputy – Grant Robertson and Jacinda Ardern – which would be a visible generational change. But more change might be needed.

Where National is not competitive is in gender balance. Key has work to do, too.

National still far ahead

National is near-paranoid about the complacency factor: supporters who don't vote because they think John Key has got it won. So it has been working the phones and social media and putting up billboards far more intensively than in 2011 when its election result fell 7% below its pre-campaign poll average. The chart shows why there might be complacency: a lead over Labour+Greens in the 12%-15% range (though maybe having peaked). That is despite a far more intensive and better targeted effort from Labour than in 2011 and unprecedented on-the-ground campaigning by Greens in their strong seats.



Chorus's regulation escape bid – a little help from Vodafone

Telecom, CallPlus and others are doing their best to stymie Chorus's attempt to break free of some of the Commerce Commission's restrictions on its pricing for copper wire-based broadband services.

CallPlus labeled the so-called BOOST services proposed by Chorus a "cynical attempt" to get around regulation, and Telecom took the proposed changes to the Commerce Commission, alleging breaches of Chorus's service obligations.

Telecom is perhaps reasoning that the longer Chorus is prevented from launching any new services – the BOOST products were originally scheduled for September launch - the more time that will give Telecom (to be known as Spark from next week) to plan its own variants. Unlike others in the sector, Telecom can't unbundle its services until after December.

However, not everyone is up in arms with Chorus's proposals, especially since it dropped its intention to axe its VDSL2 fast broadband-over-copper product following pushback from the industry.

Partial support for Chorus is apparent from Vodafone. "As a point of principle, Vodafone supports a regulatory framework that incentivises Chorus to invest in new commercial services that are distinct from regulated services," its submission to the Commerce Commission investigation says. "Chorus's Boost HD and Boost VDSL services represent this kind of opportunity."

While the commission must consider whether the new products could be covered by existing regulation, "the commission should only take this step if there is a clear requirement for intervention."

Meanwhile, Chorus's proceedings against the Commission's Unbundled Bitstream Access and Unbundled Copper Local Loop pricing decisions have commenced in the Court of Appeal.

In further moves to ease its UFB funding difficulties, Chorus announced on July 25 it was suspending dividends until at least June 2015 or until the commission rules finally on UBA pricing, whichever is the later.

It also announced changes to its banking covenants and early access to $178 million of Crown Fibre Holdings funding, offering the company some financial latitude, if required. However, the terms don't look attractive and Chorus is unlikely to trigger its new rights unless it's forced to.

Reflecting the halving of its share price since 2012 and a more stable outlook, UBS this week rerated Chorus a "buy".

Labour's plan for labour reform

Labour has sharpened its pitch for low waged voters by promising to increase the minimum wage by $2 an hour to $15 an hour in its first 100 days in office, with an increase to $16.25 an hour shortly afterwards, "early in 2015". Youth rates would be abolished, as would the 90 day trial period rule, parental leave would be extended to 26 weeks, and wage bargaining legislation would be reformed, subject to the findings of a Commission of Inquiry.

A Labour-led administration would aim for a minimum wage set at two-thirds of the average wage within its second term in office.

The Living Wage would be extended to "core public sector workers", which excludes the nursing and teaching professions. Trade union access rights to workplaces would be restored and rules governing facilitation processes would be strengthened to require outcomes within "a reasonable period of time … rather than waiting for agreement between the parties."

The policy gained predictable kudos from trade unions and raspberries from employer groups.

The Novopay deal

Coverage of the Novopay takeover by the government has been extensive. However, one aspect not noted is the fact that Talent2 has agreed to any form of compensation or cost-sharing at all.

Our soundings with close observers of the relationship between the Crown and Talent2 suggest the Australian payroll provider stuck to its guns until only very recently in its insistence that it was meeting the letter of its contract with the Ministry of Education.

Comcom drops WACC percentile for regulated monopolies

The Commerce Commission has responded to the High Court merits review instigated by Vector and other regulated monopolies into the appropriate weighted average cost of capital to apply when setting prices.

Justice Denis Clifford's mammoth decision suggested setting WACC at the 75th percentile allowed regulated monopolies to earn excessive profits and proposed dropping to the 50th percentile. The commission has come down in the middle of the range, proposing WACC at the 67th percentile for gas and electricity network owners.

That equates to a 25 basis point drop to 6.57% for electricity networks and 28 basis points for gas networks.

The changes are worth just $30 million a year or so and further challenges are possible, although the Major Electricity Users Group welcomed the decision as "a pretty good win". Vector expressed concern about its impact on willingness to invest in its network.

The commission continues to investigate the appropriate regime for airports.

Radio Communications Act 1989 Review

The key areas of the radio spectrum management regime to be considered in a review of the current legislation by Communications Minister Amy Adams are: interference management; competition regulation during spectrum allocations; technical definition of management rights and licences; regional division of management rights; and regulation of new technologies such as cognitive radio and white space devices. MBIE has issued a discussion document for submissions by October 1.

Waste disposal levy review

The govt is to tender for a waste survey to improve data collected on waste sent to landfill and subject to the $10 a tonne waste disposal levy, which has been in place since 2009 and has been given its first triennial review. A national waste data framework is also to be developed, led by the Waste Management Institute of NZ and involving councils, recyclers, disposal facility operators and industry.

Unfair contract terms consultation under way

The Commerce Commission is consulting on draft guidelines ahead of changes applying from March 17 next year to the Fair Trading Act, relating to unfair contract terms. Particularly in focus are contract terms offered on a "take it or leave it" basis for goods that are for personal use.

Utilities, financial institutions, membership organisations like gyms, and retirement homes are among the scope of businesses likely to be affected and will apply to renewed contracts from the implementation date.

A term may be deemed unfair if it would cause a significant imbalance in the parties' contractual rights and obligations; is not reasonably necessary; and would cause some detriment if applied, enforced or relied on. Submissions on the guidelines are due by Sept 30.

"Equity release" mooted for Chch funding gap

Christchurch City Council is preparing to mount an argument to allow the sale of up to 25% of its commercial assets holding arm, CCC Holdings Ltd, following fresh advice from merchant bankers Cameron Partners that the city faces a larger funding gap than previously estimated.

The Camerons report, released this morning, builds on earlier work by Korda Mentha, which had identified a $440 million shortfall in the city's ability to pay its share of quake reconstruction and concludes the shortfall could be around $783 million to $883 million, on a worse case basis.

Among major costs looming are up to $360 million in additional infrastructure costs, $55 million in council contributions to the city's anchor projects and up to $220 million less recovery from insurers than anticipated.

The funding shortfall risks the council breaching its debt ratios in 2019, when obligations relating to the rebuild are expected to peak. That could trigger a one notch downgrade of the council's A+ credit rating from Standard & Poors, and could breach requirements of the Local Govt Finance Act, the revised version of which passed through final readings in Parliament this week.

CCCHL's principal holdings are 89.3% of electricity network Orion, 75 percent of Chch International Airport, and 79.3% of NZX-listed Port of Lyttelton. The Cameron report suggests selling down shareholdings in each of these entities would be less efficient for the city than to offer a non-controlling stake – perhaps up to 25% – of CCCHL, to what it hopes would be a consortium of strategic local investors.

Infratil, the NZ Super Fund and ACC might all be candidates in a process that would both release capital and bring new shareholders and commercial discipline in a way mayor Lianne Dalziel will argue could assist in the city's long term transformation and create a blueprint for other cities' need to make better use of both their capital base and strategically significant assets. No MOM-style public float is contemplated.

"A key consideration in asset optimisation is whether CCC needs to partially or completely own certain assets in order to meet strategic objectives," the report says. "There is considerable scope to impact CCC's funding position through partial sale (where CCC retains control) if it considers that its strategic objectives can still be met through partnership and other arrangements," says Camerons.

Dalziel will be cautious about pushing this option in public as a foregone conclusion because of the statutory requirement for consultation on such a plan. However, it is by far the council's best option for relieving pressure for potentially very large rates increases, as well as its attraction as a means to mobilise private capital strategically in the city's long term interest.

New Zealand dollar

The Reserve Bank has succeeded in taking some of the steam out of the NZ dollar, with the implied threat of intervention in Governor Graeme Wheeler's characterisation of the currency's strength as 'unjustified.' That's one of four criteria the bank applies when determining whether to use its reserves to attempt to drive the dollar lower. On a trade-weighted basis the kiwi is now sitting around 79.70, the average level the Reserve Bank has projected for the third quarter. Wheeler also met market expectations by signalling a pause in the tightening cycle, with the official cash rate at 3.5%, although the benchmark rate still needs to return to what's deemed a 'neutral' level of about 4.5% during the cycle. The use of the word 'unjustified' may prove to be just jawboning as the level of the kiwi will be very much driven by the direction of the US dollar and the timing for the Federal Reserve's to lift its key rate from near zero. The US Dollar Index has strengthened above 81, a level not seen since early February.

Online news rivals to take different paths?

NZ Herald publisher APN's intention to introduce a subscriber paywall for readers who want to read more than just a few articles is well-known. Less clear is whether its rival Fairfax Media, which publishes the Stuff.co.nz website, will go the same way. There are strong indications that Fairfax's recently appointed NZ group executive editor Sinead Boucher has decided not to follow suit and will pursue something more like the UK Daily Mail's approach, which has seen the Mail's site surviving profitably on advertising revenue alone, unlike most news websites.

Journalists at both houses also report a growing use of paid editorial content inserted into news offerings without acknowledgment, most often in non-controversial areas such as travel writing, but the practice may be spreading. While this may be good news for advertisers seeking apparently high credibility placements, the practice risks undermining reader trust in traditional news sources.

Flurry of infrastructure project action

Ministers were steamed to learn that the EPA board of inquiry had rejected the long-running project to ease inner city Wellington traffic congestion by building a controversial $90 million flyover by the Basin Reserve. However, the plan appears to be dead in the water politically, with high profile supporters urging a search for alternatives.

The BOI concluded the historic nature of the area and the "spatial void" created by the avenues leading up to the Basin and the structure itself were more valuable in the long run than taking 15,000 cars a day out of the existing roundabout.

However, the equally controversial $730 million "holiday highway" toll road between Puhoi and Wellsford has been approved, despite the BOI for that application noting the massive earthworks required will permanently change the local environment and may have long term impacts on coastal waterways because of the way stormwater will drain from the new road.

Transmission Gully, Wellington's long-stalled new route north via the Kapiti Coast and NZ's first roading project structured as public-private partnership, also took a major step forward with the finalising of contracts for the $1 billion project, to be led by Leighton Contractors.

Wellington International Airport also unveiled its latest plans for a runway extension, proposing now to push the landing facility south into Cook Strait after discovering deep silt would have added prohibitive cost to its earlier plan to infill part of Evans Bay, in Wellington harbour.

Government Ministers continued to show very limited enthusiasm for a plan that assumes government involvement to make the business case stack up, but which is integral to a wider set of projects to revive Wellington's economic fortunes. One of these, a new public transport "spine", has taken a knock for now, thanks to the rejection of the Basin Reserve flyover.

Food exports – Europeans eating our lunch in Asia

MBIE has released three thought-provoking reports by research firm Coriolis as part of its Food and Beverage Information Project. While they show the expected strong performance in dairy products and a range of other relatively unprocessed agricultural products, they also demonstrate the size of the challenge if NZ is to raise its exports to the govt's target of 40% of GDP.

"NZ has had a good run over the past decade, with a number of stars aligning for its food and beverage exports," says the "What Does Asia Want for Dinner?" report. However, "maintaining that performance will be difficult going forward without some new thinking."

Achieving 40% of GDP exports means 7% p.a. growth in exports, well above the actual growth rate being achieved, between now and 2025."

Among key insights in the reports:

- European producers have a lot to teach us about exporting high margin processed foods into Asia. Europe is disproportionately represented in this area, where NZ could focus to improve earnings without relying on increasing sheer output. "Relative to peers, NZ's export mix is currently overweight to raw material ingredients. European peers suggest transforming these into shelf-ready processed foods and beverages";
- Sparkling wine is under-explored in a market dominated by European producers. "Wine, as NZ's newest platform, is under-developed," the report says. Sparkling wine could be an opportunity for a "restart" strategy;
- Perhaps surprisingly, the report suggests a major opportunity in brandy production. NZ could invest in developing a "Marlborough sauvignon blanc of brandy" to meet growing Asian demand, which again is dominated by European producers;
- Areas of significant potential growth emerged from a rigorous screening process, including: avocados, nuts, innovative foods, and chocolate;
- Petfood emerges as a potentially much larger export industry, with potential to leverage NZ's reputation for safe food transferrable to petfood, which commands strong supermarket margins.

But overall, the report suggests no magic bullets and a need for focus on investment in higher margin processed products.

Robust outlook, dairy notwithstanding

The recent falls in business confidence indices are not only relative to very high recent readings, but they also exhibit a tendency for expectations for own activity to remain robust, even if confidence about the circumstances of others is less so.

Headline business confidence in the most recent ANZ Business Confidence Index dropped to a net positive 39.7 from 42.8 a month earlier and a peak of 70.8. Seasonally adjusted, this was the lowest reading since May 2013. Even at these levels, confidence remains well above average. Business own-activity expectations remain strong. The cut to Fonterra payout forecasts will pull confidence down again in the next reading, albeit farmers were already among the least optimistic already.

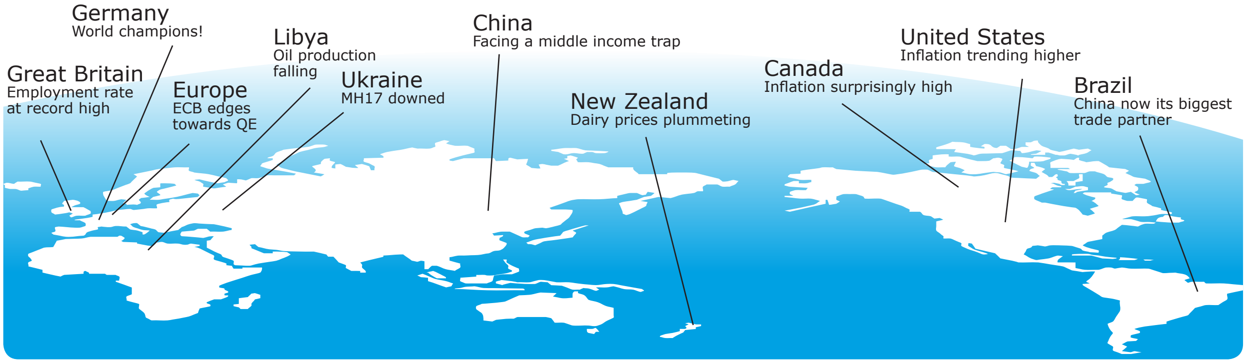
Such strength suggests economic growth significantly above not only the RBNZ's expectations, but also well above the 2.8% level the central bank regards as sustainable without inflation. Relative to average, construction remains the most optimistic sector but manufacturing and services also reported readings well above average.

Residential construction indicators remain strong enough to suggest expansion may be curtailed by supply constraints, supported by price and labour market indicators that suggest current high levels of net migration may be insufficient to meet new job growth.

In this environment, the strong exchange rate is not emerging as a major constraint.

Manufacturing confidence and export expectations remain strong. Outside agriculture, profit expectations are also consistent with a period of robust growth ahead.

The world at a glance



Indonesia: Jokowi win bedding in

Encouraging signs are emerging from Indonesia that powerful opponents of incoming president Joko Widodo will line up with him in a new Parliament, denying the losing candidate, former special forces general Prabowo Subianto, oxygen for a threatened bid to overturn the July 9 election result.

Leaders of the Golkar party, the dominant party in Indonesian politics since the Suharto dictatorship, have indicated they would rather be part of a new government than support a challenge to Widodo's 53% majority vote.

"We must change direction, meaning we are not going to be in opposition in the parliament and will support the government," Golkar deputy chairman Agung Laksono was quoted as saying in the Wall Street Journal, July 25. Crucial to the ebbing of support may be Subianto's running mate, Hatta Rajasa's National Awakening Party choosing not to back his desire to contest the vote outcome.

Strong US economy surprises

The US economy has bounced back in the second quarter of the year, showing annualised growth of 4 percent, against a 3 percent expectation among economists and sparking renewed tension on the board of the US Federal Reserve about the pace of monetary policy tightening.

Stronger consumer spending and inventory-building by companies drove the stronger showing after an unexpectedly weak first quarter, which felt the impact of savage winter weather, although the size of the contraction was revised to 2.1 percent from an earlier print of 2.9 percent.

That result was followed, as expected, by the removal of a further US$10 billion of monthly bond-buying to further reduce the massive monetary stimulus that's helped kick the US economy back into life. Unemployment is around 6 percent, its closest to the technical measure of full employment for the first time since before the GFC, but the Fed is noting plenty of spare capacity in the labour market, partly reflecting low participation rates.

So, while bond purchasing is now set at US$25 billion a month, with the expectation it will be withdrawn completely from October, there are signs of disagreement among the Fed's top brass about whether and when to start raising interest rates, especially now that it says fears of persistently low inflation have abated.

The chair of the Philadelphia Fed, Charles Plosser, is reported to have held out against the view that rates should stay lower for longer, saying that stance doesn't reflect recent progress towards sustained economic recovery.

Supachai questions wisdom of regionalism

Former WTO secretary-general and head of UNCTAD, Panichpakdi Supachai, voiced concerns about the rise of regional trade blocs in his recent swing through NZ after the B20 meeting in Sydney.

That includes scepticism about the Trans-Pacific Partnership.

Trading partner growth

(2013 actual; 2014-15 Consensus Forecasts; 2016-17 figures Hugo estimates)

Trading partners		GDP Growth (ann avg %)					CPI Inflation (ann avg %)				
	Weights %	**2013**	**2014**	**2015**	**2016**	**2017**	**2013**	**2014**	**2015**	**2016**	**2017**
China	25.2	7.7	7.3	7.1	7.1	7.3	2.6	2.5	2.9	3.1	2.8
Australia	23.1	2.4	3.1	3.0	3.2	2.9	2.4	2.7	2.6	2.8	2.6
United States	10.3	1.9	2.2	3.1	3.0	2.6	1.5	1.8	1.9	2.2	1.9
Japan	7.2	1.5	1.5	1.2	1.1	1.3	0.4	2.6	1.8	1.8	1.7
Eurozone	7.2	-0.4	1.1	1.5	1.6	1.0	1.3	0.7	1.2	1.1	1.1
United Kingdom	3.5	1.7	3.0	2.6	2.2	2.4	2.6	1.8	2.1	2.4	2.2
South Korea	4.1	3.0	3.6	3.7	3.7	3.5	1.3	1.8	2.5	2.6	2.1
Indonesia	2.2	5.8	5.3	5.7	5.8	5.7	6.4	6.2	5.7	5.1	5.9
Hong Kong	2.0	2.9	3.3	3.5	3.6	3.3	4.3	3.9	3.6	3.3	3.8
Taiwan	2.2	2.1	3.2	3.6	3.6	3.1	0.8	1.2	1.8	1.7	1.4
Singapore	2.6	3.9	3.8	4.0	4.1	4.0	2.4	2.2	2.7	2.3	2.4
Malaysia	2.3	4.7	5.3	5.1	5.3	5.1	2.1	3.3	3.6	3.1	3.0
Philippines	1.9	7.2	6.4	6.3	6.0	6.5	2.9	4.2	3.9	4.1	3.8
Thailand	1.8	2.9	1.3	4.1	4.5	3.2	2.2	2.4	2.8	3.0	2.6
India	1.7	4.7	5.4	6.2	6.4	5.7	9.5	7.8	7.0	6.8	7.8
Vietnam	1.2	5.4	5.6	5.9	6.0	5.7	6.6	5.6	6.8	7.0	6.5
Canada	1.3	2.0	2.2	2.5	2.5	2.3	1.0	1.8	2.0	2.0	1.7
NZ Trading Partners	100.0	3.8	4.0	4.1	4.2	4.0	2.3	2.5	2.7	2.8	2.6
Forecasts for New Zealand											
Consensus		2.7	3.6	3.0	2.6	3.0	1.1	1.8	2.2	2.4	1.9
BNZ Forecasts		2.7	4.1	3.4	1.8	1.1	1.1	1.7	2.4	3.0	3.0
The World		2.5	2.8	3.2	3.2	3.1	2.7	3.1	3.1	3.2	3.0

He favours development of TPP's main rival, the Regional Comprehensive Economic Partnership (RCEP), which includes the rising powerhouses of China, India and Japan but doesn't at this stage involve the US.

"TPP … could drive the world back into the old days before the WTO was conceived, a world trading system predominated by major trading nations, which was something I thought we tried to adjust with the more democratic participation of membership of the WTO," said Supachai, who was here as an adviser to the Asia New Zealand Foundation. New Zealand belongs to both TPP and RCEP, which was initiated in 2012.

Australia – rebalancing nicely

The economic news from Australia is improving a bit as evidence mounts that the mining downturn is being replaced by increasing consumer confidence and home construction, particularly on the eastern seaboard. HSBC suggests there's even a risk of a real estate bubble developing in Sydney, although not elsewhere, despite expecting an annual average rise in house prices this year of 10%. The bank notes Aussie borrowers are generally not too heavily leveraged, with only 13% of all lending going out at LVR's of more than 90% of valuation and household debt skewed strongly to upper incomes.

The potential for the RBA to raise rates as early as the first half of 2015 is starting to be discussed.

China – IMF expects slower growth

The IMF says China's economic growth rate is likely to fall to between 6.5% and 7% p.a., down from a projected 7.4% this year, unless it steps up the pace of reform.

Its latest review of the Chinese economy, issued July 30, assumes Beijing will continue to favour domestic consumption over export growth to underpin growth and suggests a slower pace of growth is appropriate to its need to address economic vulnerabilities and "secure a safer development path".

China's over-reliance on investment and credit to drive growth since the GFC is "running out of steam" and leading to inefficient capital allocation, which in turn is creating stress points, including very strong growth in local govt and corporate debt.

The report coincides with further evidence of President Xi Xinping's determination to act at the highest levels to stamp out corruption. Earlier this week, he moved against the 72 year-old former head of domestic security, Zhou Yongkang, who also at one time controlled state oil monopoly rights. Previously regarded as "untouchable", Zhou is the most senior official ever to be investigated for corruption.

However, while this fits part of the IMF's prescription for more transparent and efficient economic management, the international body is recommending priority across a broad swathe of the Chinese economy, including the financial sector, state-owned enterprises, monetary policy and exchange rate management, and removing implicit guarantees created by central and local govt ownership of strategic and commercial assets.

Assuming the IMF and the Chinese Politburo are on something like the same page, a subdued global outlook for hard commodities appears reasonable, barring the emergence of stronger growth in other BRIC economies, such as India or Indonesia.

"While spillovers to the global economy would reduce growth slightly in the short run, the benefits of a stronger and less vulnerable China dominate in the long run," the IMF says.

Data theft epidemic keeps growing - encryption low

Commercial holders of private citizens' data continue to under-invest in basic encryption technologies that would at least prevent stolen data being useful to cyber-criminals.

That's the over-riding finding of the latest report on global data theft from US-based SafeNet Inc, publisher of the quarterly Breach Level Index.

SafeNet says in the first half of 2014, more than 375 million customer records were stolen or lost as a result of 559 breaches worldwide. The retail industry accounted for 83% of those breaches, yet fewer than 1% of the data covered by these breaches was protected by strong encryption or authentication protocols.

The pace of data theft is such that in each of the last four quarters, there has been one major data breach in which more than 100 million records were exposed. SafeNet calculates that in the second quarter, data theft reached a pace equivalent to 1,355 records stolen every second.

Identity theft was the leading cause of breaches with 58% of all incidents and 88% of records stolen. However, encryption was used in only 10 of the 237 reported data breach incidents in the June quarter, of which only two could be classified as secure breaches in which encryption restricted the access of stolen data.

Earnings season outlook

The main annual earnings season is under way, with 48 NZX-listed companies reporting, dominated by companies reporting full year earnings at the top of the economic cycle.

Yet despite the strength of the economic recovery, investment analysts are expecting no better than a mixed bag. Forsyth Barr are expecting a strong showing from the construction and transport sectors, but utilities, retail and telecommunications are expected to show declines. In the electricity sector, that reflects low demand growth, affected in part by a warm start to winter, and plentiful hydro storage in the South Island.

The biggest fortnight for earnings will start Monday, August 18. In the first of those two weeks, Contact, Freightways, Meridian, Fletcher Building, MRP, Trade Me, Auckland International Airport, Port of Tauranga, Telecom/Spark, Sky TV, Vector and Refining NZ will report. In the second week, Chorus, Metlifecare, Wynyard Group, NZOG, Air NZ, Ebos, and Genesis are due to report.

M&A activity

Dorchester Pacific continues to find appetite for its shares, as a form of currency in takeovers at least. Turners Auctions chairman and major shareholder Michael Dossor will accept Dorchester shares and convertible notes as payment for his 20.8% stake in the listed auction house. Dorchester already owns 19.85% of Turners, meaning it would need only acceptance for a further 10% for control, at which point it would oblige Turners to pay a fully-imputed special dividend of 15 cents, valuing the takeover at $3.15 a share. Dorchester sees a natural fit with Turners given that 70% of its finance lending is for motor vehicles and it also offers vehicle-related insurance. CEO Paul Byrnes says his company will raise up to $27.5 million selling shares and some $15 million of notes to fund the deal. Since avoiding failure in a complex debt-for-equity swap in 2010, which was supported by Auckland private equity group the Business Bakery, Dorchester has rebuilt its business. It added auto finance company Oxford Finance this year and debt collection company EC Credit Control in 2012, again using its share to part-fund the deal. The shares are trading at 24 cents, well up on the low of 2009 of 2.7 cents although well down from the pre-reconstruction highs of $2.67 in 2005.

Interests associated with the family of pioneering Christchurch businessman Robertson Stewart are teaming up with the Royston Hospital Trust Board and Australia's Evolution Healthcare to take Acurity Healthcare private. They have offered a healthy premium of $6.50 a share cash for the 29% of Acurity they don't already own. The private hospital investor formerly known as Wakefield Health must bring its Wakefield hospital in Wellington up to earthquake code, a cost it must bear in a sector where margins are being squeezed. The offer is being made by Evolution's Connor Healthcare unit, which on settlement would be 75% owned by the Stewart family and Royston's Austron Ltd and 25% by Evolution.

Telecommunications

Chorus wants to show it is doing everything in its power to trim costs, freeing up cash to meet its obligations to build the nation's ultrafast broadband network for the govt. It has confirmed it won't pay dividends until June 2015 and has negotiated some headroom under its lending covenants. Chorus still needs approval from Crown Fibre Holdings to pay a dividend before December 2019 under an agreement that would allow it to draw down $178 million from the govt funding entity ahead of schedule. Its longer-term plans are up in the air pending the Commerce Commission's final decision on its regulation of pricing on the copper network, which has been put back until next year – after the regulated price cuts are due to come into effect. Chorus is before the Court of Appeal this week, challenging a High Court ruling that upheld the way the regulator set a theoretical price for copper services. There are signs the investment community believe Chorus is making progress. Its shares have gained almost a fifth this year, twice the NZX 50 Index's gains, having shed 46% in the past two years. Still, as evidence that its wiggle room is restricted, internet service provider CallPlus has asked the regulator to investigate Chorus's offer of broadband services it claims are outside the current terms of regulation, a position rejected by both Orcon and Telecom.

Fast-food sector

Burger King's losses widened in 2013, suggesting margins are tight in the burger segment of the fast-food industry. Burger King competes directly with McDonald's Corp, the fledgling Carl's Jr franchise owned by Restaurant Brands and listed fastfood franchisor Burger Fuel Worldwide. Burger King has been owned by US-based private equity firm Blackstone Group since 2011, and current management are embarked on refreshing the stores and menu of a brand that traces its roots back to the early 1950s and was reportedly inspired by McDonald's. The NZ chain had a loss of $4.4 million in 2013, from a loss of $1.9 million a year earlier.

Continued p12

ECONOMY AT A GLANCE

New Zealand economy

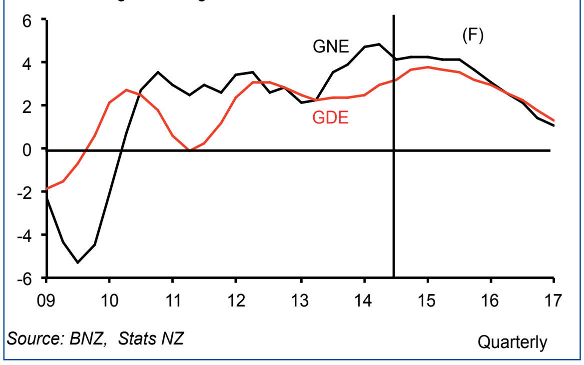
(% change on previous year
Calendar year except where indicated)

	2013A	2014F	2015F	2016F	2017F
GDP components					
Consumption	2.9	2.8	2.9	1.4	0.9
Investment	9.7	9.4	6.7	2.1	1.1
Stocks (contribution to growth)	-0.1	0.4	-0.2	-0.1	0.0
GNE	3.9	4.3	3.6	1.5	0.9
Exports	0.7	4.6	3.3	4.1	3.8
Imports	6.2	5.7	4.3	2.9	2.7
Activity					
Real GDP (production)	2.9	4.1	3.5	1.8	1.2
Output Gap	0.3	1.4	1.8	0.3	-0.3
Labour productivity growth	0.7	0.4	0.3	0.3	0.7
Employment growth (annual % change)	3.0	3.4	2.7	1.0	0.6
Unemployment rate (S.A. % as at Dec Q)	6.0	5.6	5.2	5.4	5.9
Inflation (% increase from Dec Q previous year)					
Consumer prices	1.6	1.5	2.6	3.1	2.7
Average hourly earnings	3.2	3.3	3.8	3.2	2.7
Terms of trade	20.2	-8.5	-1.9	3.9	1.1
Financial sector					
Operating balance (OBEGAL)					
(as % of GDP – June Year)	-2.1	-1.1	0.2	0.5	0.9
Net debt (as % of GDP – June)	26.2	25.8	26.4	25.9	24.0
90 day bank bill (%) (1)	2.7	4.1	5.0	5.3	4.4
5 yr NZGS yield (%) (1)	4.2	4.4	5.3	5.1	4.2
10 yr NZGS yield (%) (1)	4.8	4.8	5.7	5.6	4.6
External sector					
$NZ/$US(1)	0.823	0.797	0.730	0.670	0.631
$NZ/$A(1)	0.915	0.934	0.901	0.867	0.872
$NZ/Y(1)	85.1	86.1	85.4	83.1	78.2
TWI(1)	77.5	77.5	74.1	70.2	67.0
Trade balance $(m)	1307	2439	-1404	591	2817
Current account $(m)	-7622	-8108	-12814	-10938	-8916
(as % of GDP)	-3.4	-3.4	-5.1	-4.2	-3.3

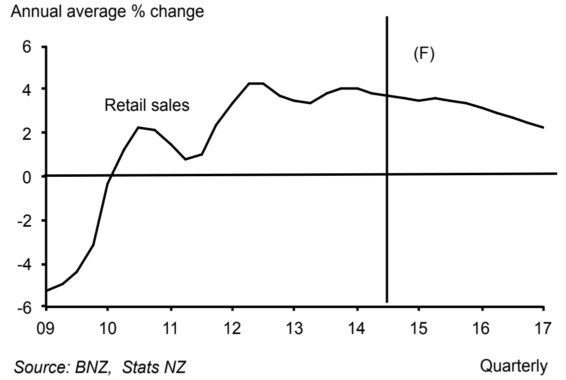
(1) Average for month of December

(2) Using current prices

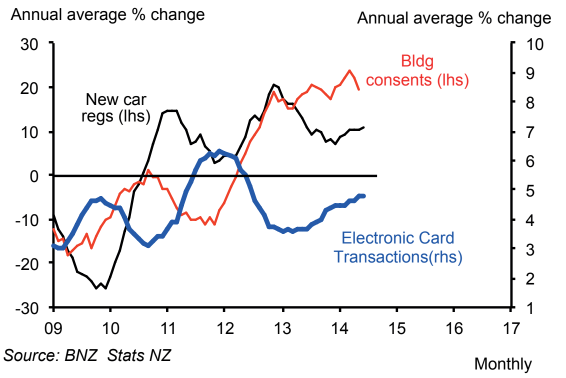
Economic growth



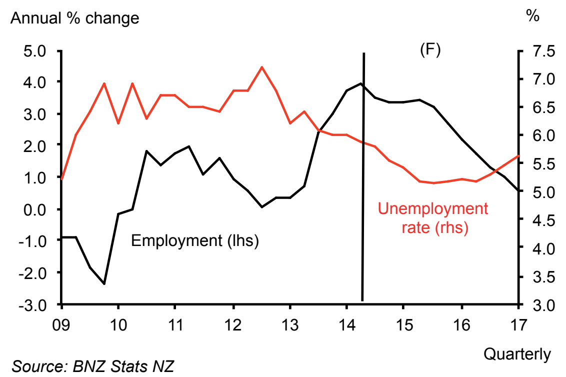
Retail sales



Partial indicators

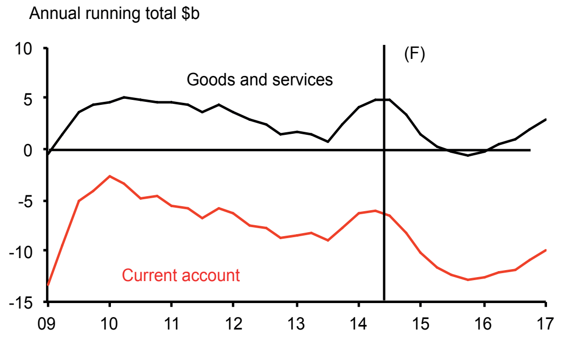


The labour market



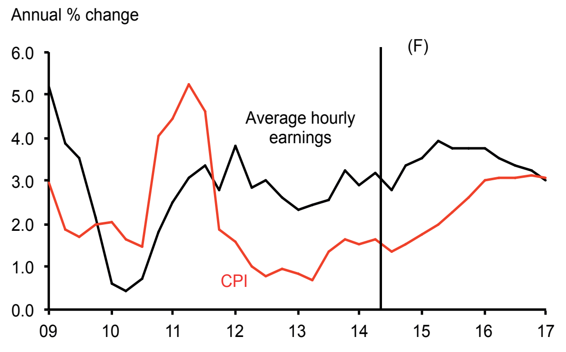
ECONOMY AT A GLANCE

Balance of payments



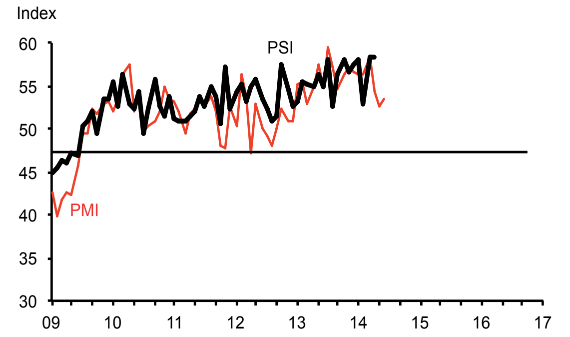
Source: BNZ, Stats NZ
Quarterly

Inflation



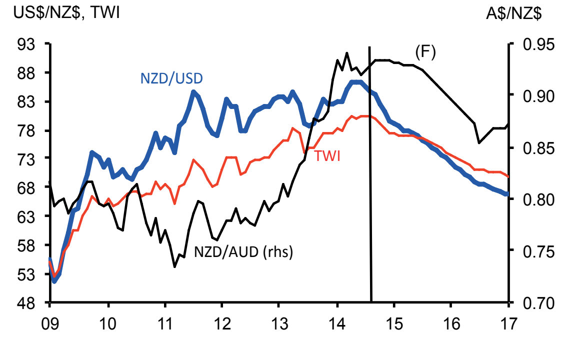
Source: BNZ, Stats NZ
Quarterly

PSI and PMI



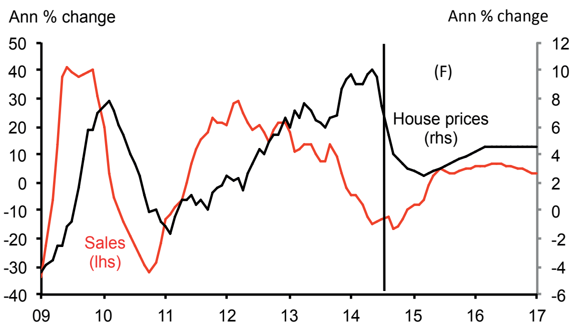
Source: BNZ
Monthly

Exchange rates



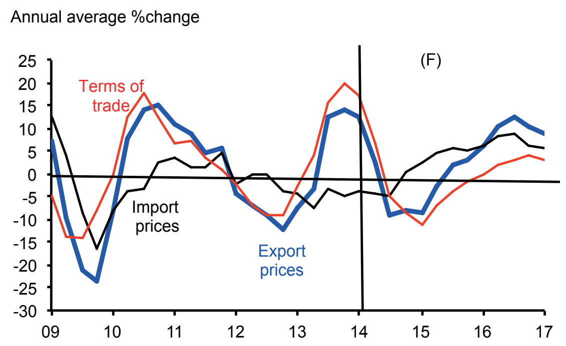
Source: BNZ
Monthly

Housing market (three month average)



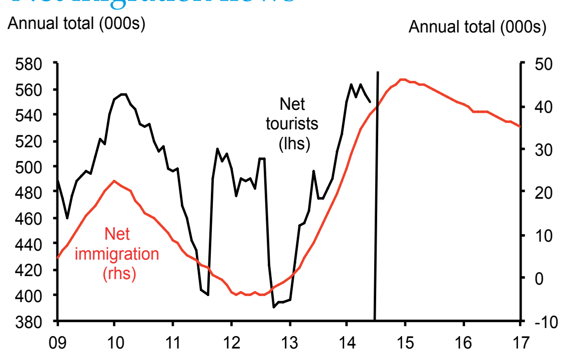
Source: BNZ REINZ
Monthly

Terms of trade



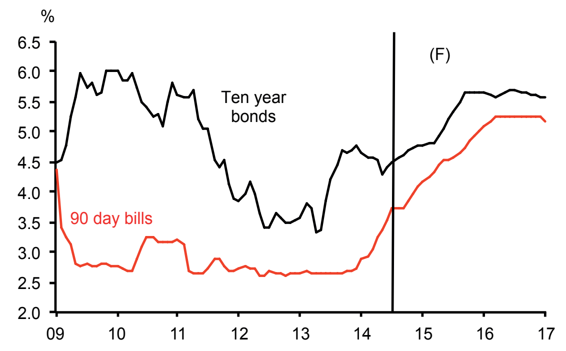
Source: BNZ Stats NZ
Quarterly

Net migration flows



Source: BNZ Stats NZ
Monthly

Interest rates



Source: BNZ
Monthly

ECONOMIC ROUND-UP

Continued from p9

While sales edged up 0.6% to $175.9 million, costs of raw materials, consumables, consultancy fees and property rose more. Larger rival McDonald's, which has added a revived Georgie Pie brand to its burger and café menu, posted profit of $30.7 million last year as sales rose 5.6 percent to $216.6 million.

Platinum permits

Platinum hasn't been for the faint-hearted in the past decade, shedding almost two thirds of its value in 2008, although its price of around US$1,484 an ounce this week is almost four times higher than in the 1990s and the metal is more precious than gold. Its applications range from jewellery to a catalyst in catalytic converters and electrodes. The award of five mineral exploration permits to Lynx Platinum, a unit of Canada's Coronado Resources, to hunt for platinum in the South Island is a first for NZ, where previous forays have only amounted to small scale alluvial production in Southland the late 19th and early 20th century. Three of the permits cover 355 square kilometres east of Murchison, and the other two cover 168 sq kms north of Invercargill. The locations are "highly prospective" for platinum, says MBIE. Coronado is new to minerals exploration in New Zealand, although its 49% owner Tag Oil of Canada, is a veteran of the oil and gas sector here.

Dairy market

Fonterra chief executive Theo Spierings says the global dairy market was in an unusual position this year where all producers were lifting supply at the same time, or "milk coming from everywhere". That's been the primary factor forcing milk prices at global auction down by more than 35% since February and prompting a cut in forecast payout to $6 per kg/MS - an announcement likely to take some of the wind out of the sails of the rural economy, even if it turns out subsequently to have been unduly pessimistic.

Typically climatic or other factors see output wane in some parts of the world and grow in others, he said. Fonterra's forecast of a Farm Gate milk price of $6/kgMS for 2015, down from an earlier projection of $7/kgMS would dock farmer's farm-gate income by some $3.8 billion. Milk price movements affect Fonterra as both an input and output cost which is why it is able to forecast a dividend payment of 20-25 cents for the coming year, from 10 cents. The forecasts are likely to be revised again as global supply-demand comes back into balance, with Spierings saying he "anticipates some recovery in global dairy prices but it is too early to predict how strong this recovery will be or when it will kick in."

Minerals

Would-be ironsands miner TransTasman Resources is facing a big line-up of parties opposing its appeal of the EPA decision-making committee decision to reject its application to mind offshore from Patea in the EEZ. But ceo Tim Crossley is playing down speculation the company may decide not to fight on. "We have a range of strategic options in front of us at the moment and I suggest we will need quite a few more weeks to work through them, but they are certainly more positive than negative," Crossley says. The Environmental Defence Society, activist group Kiwis Against Seabed Mining, seven fishing companies, and the Kupe joint venture parties have all joined the action.