HUGO*vision*

Assessing the economic and political environment in New Zealand

May 1 2014 | Confidential to HUGO members

Forecasts at a glance

	INFLATION	GROWTH	$ v $US	$ v $A	WORLD GROWTH	TRADING PARTNERS
December 2014	1.8%	4.0%	78.0c	92.9c	2.9%	4.0%
December 2015	2.8%	3.4%	71.9c	89.9c	3.2%	4.1%
December 2016	3.0%	1.8%	67.7c	88.8c	3.2%	4.2%

Text finalised April 30
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The Jones setback for Labour — but National still not there

Shane Jones's sudden departure from Labour damages it in two main ways: it adds to impressions of disunity and lack of direction; and it reduces Labour's potential reach to conservative wage worker blokes, who don't go for political correctness.

Senior Labour MPs knew he was thinking of going but expected him to stick around till the election and are grumpy that he didn't. They are also miffed that he was seduced by Murray McCully. John Key said on radio Jones was joining the National government.

Senior Labour MPs are less bothered about the conservative wage worker blokes issue. They say it is a long time since they voted Labour en bloc. But the fact is that Labour's economic policy pitch is aimed at those people and Labour would like more of them on its side. The likes of Clayton Cosgrove and Damien O'Connor don't have the rhetorical reach of Jones.

How much damage Jones's going will do to Labour's public support cannot be assessed yet. The best guess is that it will fade after an initial poll negative (no polls have been published since mid-April). One plus is that Jones was outspokenly contemptuous of the Greens and Labour needs to look as if it can be a comfortable senior partner of the Greens if there is not to be a repeat of 2011 when voters concluded there was not an alternative government available.

Meanwhile, National stays in the clouds

National continues to poll strongly. The Hugo four-poll rolling average for mid-March to early April had National at 47.4%, its 2011 election score. In a first-past-the-post election, that would be a landslide.

Labour slid to 30.4%, its lowest rolling average since April 2012. The Greens were on 11.2%, making a Labour+Greens score of 41.6%. That gave National a 5.8% lead though that looks to be topping out.

New Zealand First was averaging 5.6% and Winston Peters has been blustering about beating the Greens into third place as a basis for stronger hints he won't accept Greens in the cabinet.

The Conservatives' average was 1.7%, the Maori party's 1.3% (just enough to add a list seat to an electorate seat if it gets only one) and Mana and Internet combined were 1.5%. For that combination to leverage off Hone Harawira's seat, they have to be a single registered party which looks unlikely and, if it does come to pass, might jeopardise Harawira's hold on his seat, a prospect improved by the return of Kelvin Davis to Parliament in Jones's place.

But National is still not home

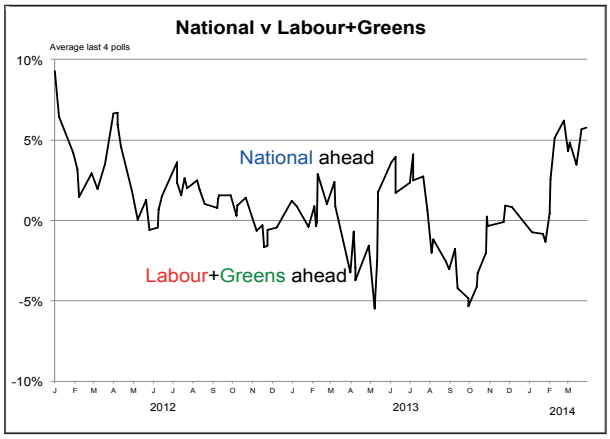
The table below inserts roughly the mid-March/early April figures into the Hugo hypothetical result.

It assumes ACT and United Future will hold their electorate seats. But each will earn a party vote quota which means two party vote quotas will not be available to other parties and one of the parties which will lose a quota in that event is almost certain to be National because the two big parties almost always have the 119th and 120th quotas.

National on this scenario falls just short and would have to cajole a reluctant Maori or New Zealand First to get a majority.

That changes if the Conservatives win seats. National would then get there on 47%. But the Conservatives are highly unlikely to get 5%, which Colin Craig insists is his objective. Craig has also said he does not want to be gifted an electorate seat by National – that would potentially limit his party vote.

Key said jokingly at his press conference on April 22 that he could wait as late as 24 hours before the election to do a deal. That is not as flippant as it sounds. While any such deal would need to occur before voting papers were finalised, it appears National will wait as late as possible and make a poll-based decision on whether to gift Craig a seat, most likely by having Murray McCully step aside from his



An updated hypothetical

National	47.0%	58 seats
ACT/United	1.2%	2 seats
Conservatives	2.5%	0 seats
TOTAL NATIONAL SIDE		60 seats
Maori party	1.2%	2 seats
NZ First	5.3%	7 seats
Labour	31.0%	38 seats
Greens	10.0%	12 seats
LABOUR+GREENS		50 seats
[Mana	0.7%	1 seat]

East Coast Bays electorate. Key would rather not deal with Craig, but if he judges he has to, he will.

Bill's Budget – "don't put it all at risk"

The political thrust of Bill English's May 15 Budget, his sixth in the John Key-led government, will be: "we've come through the storm, don't put it all at risk."

The rhetoric will try to balance the fact that for many NZers, the economy probably won't feel much stronger than it does right now. Rising interest rates and falling export dairy prices are likely to weaken the "rock star economy" story.

To try and counter that, English will focus on Treasury forecasts showing a $7,500 increase in average annual full time earnings between now and 2018, taking the annual average to $62,200. Taken from a 2010 starting point, that amounts to a $10,500 p.a. increase in gross average annual income.

For people who earn far less than this, the message may fall flat, but for middle income earners, English will stress wage rises in eight years of "around 20 percent, compared to inflation of just over 12 per cent over the same period."

Treasury will forecast annual GDP growth of between 2 percent and 4 percent a year out to 2018 and a continued fall in unemployment over that period. Note also that the Reserve Bank last week raised its forecast for growth in the year to March 2014 to 3.5%, from 3.3% at the monetary policy statement seven weeks ago.

"This year is likely to see a political debate between a determined government and complacent opposition parties who already believe today's good times are permanent," English said in his traditional pre-Budget speech in Wellington.

The govt will seek to reposition rising interest rates as necessary to sustain economic recovery for as long as possible, and lower under National than Labour.

"A lower interest rate cycle will mean less pressure on households with debt, more investment in productive businesses and less pressure on the exchange rate for our exporters.

English will be assisted in the political theatrics of the Budget by the fact his Australian counterpart, **Joe Hockey, will deliver his first Budget in Canberra two days earlier** *(see International Economy)*. To the extent that NZ's relatively stronger economic performance has attracted attention on both sides of the Tasman, the sight of an Australian Treasurer hacking into welfare spending, seeking to raise the pension age and generally belt-tightening will provide a stark contrast to the moderate, mildly generous and positive outlook for NZ over the next couple of years.

Parker spells out Labour's monetary policy

Financial markets were watching David Parker's monetary policy announcement this week with only one thing in mind: would Labour abandon inflation targeting as the prime focus of the Reserve Bank Act? The answer was no, so subsequent reactions ranged from benign to mildly supportive.

The idea of using a Variable Savings Rate, linked to compulsory membership by all earners in KiwiSaver schemes, is an intellectually elegant addition to the debate on tools that central banks might employ instead of interest rates to manage monetary conditions.

It would also be occurring de facto anyway at some point in the life of a Labour-led govt, since KiwiSaver would be made compulsory and the contribution rate raised from 6% at present to 9%. The rate at which that increase was implemented would effectively allow early use of a VSR. Hence Parker's view that introducing a VSR alongside compulsory KiwiSaver would be a "perfect" match.

There are some objections to the scheme. Borrowers, for example, can generally avoid OCR increase impacts by fixing their mortgage interest rates or by pushing out the term of their borrowing to accommodate a higher interest rate. There would be no escape for wage and salary earners from a VSR change.

There would be inevitable logistical implications for HR departments and fund managers having to change their payroll and portfolio settings to handle VSR changes. If it changed a lot, it could be quite a headache.

The desire to leave a decision on a VSR in the govt's hands is a curious one, as it potentially unpicks central bank independence, since the RBNZ could only recommend a VSR change. However, Labour is not settled on this approach. It may yet change.

The other important shift in Labour's policy is to make the Price Targets Agreement take into account the external balance of payments. It would be tasked with "maintaining stability in the general level of prices in a manner which best assists in achieving a positive external balance over the economic cycle".

Like much of Parker's contribution to economic policy debate, these thoughtful proposals arguably suffer most from being complex to explain and therefore to sell politically. They may also serve to remind low income voters of the intention to raid

their weekly cashflows by requiring higher savings rates. That may not matter – polling for the Financial Services Council suggests almost half of NZers would welcome being forced to save.

The other unknowable in the VSR proposal is whether it would really have any impact on the over-valued NZ dollar. Intuitively, it looks as if it should, but there's more influencing NZ's exchange rate than local policy settings.

Labour's manufacturing policy

David Cunliffe has added accelerated depreciation to the list of policies intended to boost NZ manufacturing, which the party has quietly stopped claiming is in "crisis", as it did when it presided over last year's inquiry into the state of the sector.

The policy would double depreciation rates on a selected range of inputs for "advanced manufacturing" activity, which it defines as "high technology" and "medium-high technology", as identified in MBIE's 2013 High Technology Manufacturing Sector Report. Labour's determination to demonstrate fiscal responsibility implies the policy would have relatively limited impact, costing $30m in its first year, rising to $70m annually, with a view to expansion to all manufacturing only as fiscal circumstances allow.

The other new element to the policy is an intention to target up to $200m more govt procurement opportunities to NZ suppliers in future. BusinessNZ welcomed the supportive stance, but damned much of the initiative with faint praise, saying it would prefer an across the board corporate tax rate cut to targeted industry assistance. It supported the increased local procurement aim.

Labour ramps up anti-foreign investment sentiment

As Labour contemplates a leeching of voters to both NZ First and the Greens as its grip on the election year agenda continues to weaken, the party has moved to a more pointedly anti-foreign investment stance.

While Labour isn't talking negatively yet about migrant arrivals, its immediately negative reaction to the billion dollar investment by a well-established Japanese investor in NZ over last weekend is just one of several strongly worded reactions to foreign investment.

David Parker repeatedly cited a "ban" on foreigners "without a connection to NZ" buying property here in his spot on The Nation, for which he underwent extensive media training. Expect National to start accentuating this shift in presentations to business audiences, if not a wider public. National's line is that Labour knows this degree of antipathy to FDI is unsustainable, given the country's dependence on imported capital and the lack of evidence for property sales to foreign investors who have no NZ connection affecting property prices.

The "Shane Jones Effect" buoys energy stocks

One of the more bitter ironies of Labour defector Shane Jones's decision to quit Parliament five months out from a general election is the impact of his actions on listed electricity sector stocks.

Across the sector, the presumption that a Labour-Greens government has become much less likely has seen an upward re-rating of share prices that were uniformly depressed last year once the shape of the Labour-Greens NZ Power policy was announced.

Meridian, for example, was trading at a post-listing high of $1.20 at the end of last week, immediately after the Jones resignation, Mighty River Power had regained somewhat to $2.30, its highest point since September last year, but still well below its $2.50 May listing price.

Genesis held at $1.82 a share, a cent below its high point of $1.83 immediately after listing on April 17. Contact, which has been enjoying some analyst approval lately, has been on a tear since early April and finished last week at $5.73, a far cry from the $4.70 12 month low point touched last November. It's a year since Contact last looked this strong, trading at $5.83 in early April 2013.

Exactly how much the NZ Power policy knocked off the potential sale price for the 49% of Mighty River Power, Meridian Energy and Genesis Energy is difficult to calculate with certainty. However, it is indisputable that they depressed the sum the taxpayer could expect to gain from these sales. Jones's departure, which must be read as a senior insider's view that Labour cannot hope to form a govt this year, has crystallised the fact that the asset sales occurred during a period when political fear depressed their value.

Labour and the Greens were on the moral high ground in arguing their policy had to be known before the partial sales occurred, even though the political intent of those announcements was to try to scupper the process.

One of the unintended effects of Jones's departure is to underscore the extent to which that stance also cost the taxpayer in lower listing prices and investor sweeteners.

Wolak advocates tougher retail electricity regulation

Stanford University-based energy markets adviser Professor Frank Wolak has weighed back in on NZ's electricity market arrangements, simultaneously supporting current pro-market settings for wholesale electricity while advocating far more stringent regulation of retail price-setting.

Wolak's contribution, in a commentary for the NZ Herald, attracted very little attention at the time, but argues "there is not a lot to like about residential electricity prices in NZ".

While promoting further reforms to "identify and fix flaws in the existing market", Wolak is at pains to be clear he thinks such reforms would be far more than a tweak here and there, and would abandon the 'light-handed' regulation model.

"This always seemed to me a contradiction in terms," wrote Wolak. "Effective regulation as practiced in North America and Europe is anything but light-handed", requiring information from sector participants that they'd rather not share, and actively seeking to "protect electricity consumers from economic harm".

Through the first decade of the 2000's, the greatest market harm was judged both by the industry and politicians to be insecurity of electricity supply, as evidenced by the panic induced during three dry years during that period. However, with current generation over-supply and tariff increases continuing in a relatively uniform fashion across the sector, the industry may find itself vulnerable to further reform in the next term of Parliament, including under a National-led govt.

One of the less spoken expectations of market reforms to the electricity sector was that it would reduce the political risk that accompanied state ownership of all major facets of the sector. However, retail pricing behaviour – especially for residential consumers – has remained a political hot potato. The urge to empower the Electricity Authority further may be difficult to resist.

Retirement savings – the case for tax reform

Peter Neilson's Financial Services Council is trying again to get political traction for its proposals to improve the compound savings rates available from KiwiSaver schemes by moving away from current tax treatment.

The FSC has dropped one of the two options it first proposed last year. It no longer suggests abolishing the $1000 scheme entry sweetener payment, but is pushing for abolition of the $521 a year Member Tax Credit (MTC), worth $630m a year, to pay for a lower tax rate on KiwiSaver fund earnings.

The recent statements sparked no political party responses and Treasury secretary Gabriel Makhlouf has indicated the lead govt agency in the area is not giving the issue particular thought.

Retirement Commissioner Diane Maxwell welcomes the debate, saying the "tax conversation needs to be kept alive", but worries Neilson's message runs counter to her mantra that savings work when best when savers take a "little and long" approach to retirement provisioning.

Because it's easily understood and a material sum for low income earners, she fears losing the MTC could discourage those already least able to save by making tax changes that are complex to understand and likely to be portrayed as favouring the wealthy.

Neilson's pitch is simple: a 20 year-old joining KiwiSaver today and saving for 40 years needs to put aside $27 a day to achieve what he calls "a comfortable retirement income" – figures that provoked some dispute at a recent forum where he relaunched the FSC's thinking.

Assuming he's right, he argues that daily commitment would drop to $16 a day under the FSC's proposals because of the improved compound returns achievable by dropping the percentage tax rate on KiwiSaver fund earnings from 28, 17.5 and 10.5, to 15, 8 and 4.3 respectively.

Mono-lingual Kiwis need Mandarin and Spanish: Treasury's Makhlouf

The two most valuable languages NZ youngsters could learn today are Mandarin and Spanish. That's the personal view of the secretary to the Treasury, Gabriel Makhlouf, who is currently reading the influential new Thomas Piketty book on inequality (see International Economy) in the author's native French.

A UK/European import, Makhlouf looks at NZ's global position on the map and sees a simple equation: Asia on the left, the Americas on the right.

With Mandarin the lingua franca for both China and chunks of the business community of South East Asia, and Spanish the language of Latin America and much of the population of the US West Coast, Makhlouf suggests initiatives to push both languages into the NZ educational curriculum are overdue.

"I hope in 20 years' time we won't be sitting here discussing this sort of thing because we will have done something about it," he says.

DOMESTIC ECONOMY

New records for confidence and inward migration

Business and consumer confidence indicators continue to reflect very strongly positive sentiment. NZIER's quarterly survey of business opinion for the March quarter showed the strongest sentiment in 11 years. The ANZ-Roy Morgan consumer confidence indicator for current conditions came in at 134 in April, although there was a slight easing in expectations of further improvement. The future conditions index in April registered 135.8, compared to 136.2 in March.

Net long term inward migration at 31,900 was its strongest in a decade, continuing to reflect a far smaller outflow of NZers, especially to Australia, as well as inward flows led by Chinese, India and British migrants at a net 6,200, 6,100 and 5,800 respectively in the year to March 31.

A Grant Thornton international business sentiment survey underscores the divergence in sentiment between NZ and Australia, with a net 88 percent of New Zealand businesses being optimistic about the country's economy over the next 12 months, compared with only 36 percent in 'the Lucky Country'.The latest Ray Morgan poll for Australian Consumer confidence in April showed a slump of 4.4% to an index reading of 111.1, reflecting anticipation of a tough Budget.

The Grant Thornton survey found New Zealand current ranks fifth equal for business confidence among the 45 countries it surveyed.

Trade

The total annual **value of exports** topped $50b for the first time in the year to March, and exceeded $5b in one month for the first time at the same time. For the year to March, the balance of merchandise trade surplus came in at $805m, against expectations of $920m. While the March monthly export figures showed continued strength in sales of dairy products to China, trade surpluses may be peaking. Fonterra's April 16 **GlobalDairyTrade auction** saw a further 2.6% slide to a 14 month low and lower total volumes contracted, confirming the softening trend of recent months.

INTERNATIONAL ECONOMY

US monetary policy: clarity on unclarity emerging

International financial markets appear to be getting the measure of the new US Federal Reserve chair, Janet Yellen, after a nervous few weeks spent trying to decode her less prescriptive approach to signalling the future path of US interest rates.

The trouble started in March, when Yellen appeared to suggest ultra-low US rates might start to rise in the second half of 2015, comments which led to clarifications that she had not intended that interpretation.

The incident still had traders watching her every word, and the expectation of mid-2015 rate rises remains built into futures market pricing for now.

Calm should return following the outcome of the Fed's April 29/30 meeting, at which its bond-buying quantitative easing programme was cut back a further US$10 billion to US$45 billion in monthly issuings, met market expectations.

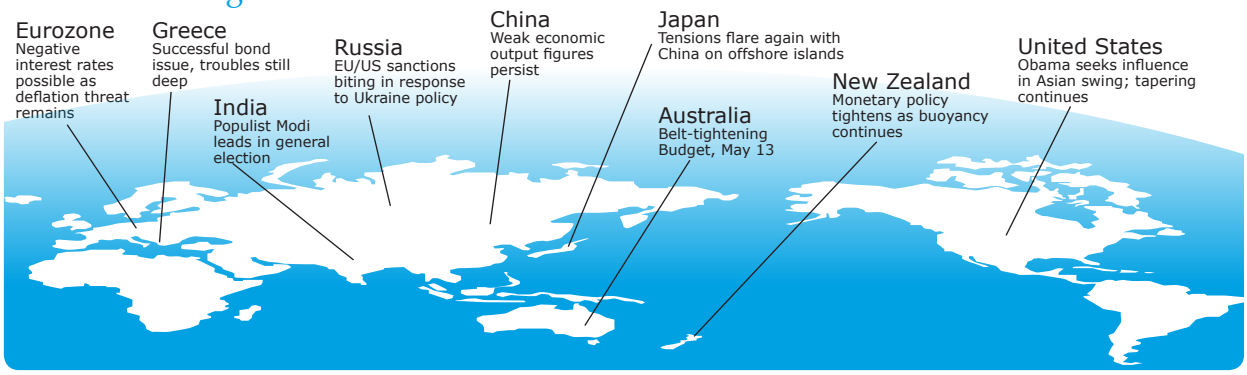
Yellen had already made it clear in a major speech in New York that she was deliberately taking a more flexible approach than her predecessor, Ben Bernanke, when it came to signalling which monetary policy levers might be pulled and when.

That's because the US economic recovery, while apparently intact, is confounding economic entrail-readers with lower inflation, slower growth and productivity improvements, less buoyant than expected housing activity, and lower unemployment than expected.

Accordingly, said Yellen: "While monetary policy discussions naturally begin with a baseline outlook, the path of the economy is uncertain and **effective policy must respond to significant unexpected twists and turns the economy may take**."

In the same way as the **RBNZ's Graeme Wheeler** has recently begun to do, the Fed actively targets an inflation rate of 2% p.a. and is as concerned to

The world at a glance



see inflation falling below that level as it is to see it pushing above it. Currently, US inflation is thought to be tracking at about 1.5% p.a. in calendar 2014.

The China enigma: massive promise and massive challenges

Will China, now New Zealand's No 1 market for exports and tourist growth, stay on track? There is a very wide range of views.

Western media talk of a hard versus a soft landing. This is not the Chinese perspective. The issue for the government is to manage expectations down, in the next year or so to around 7% but eventually, some argue, nearer to 5% than 7%, without frightening off productive investment or stirring popular resentment as imbalances are addressed.

That transition will require skilled management. The leadership has set up a raft of semi-official think tanks to tease through that and other issues. The think tanks are frank in their analysis, though how influential they are is not yet clear.

The imbalances elicit widely varying forecasts ranging from the "Pamplona" (as in "running with the") bulls to Arctic bears. These include:

- a huge credit expansion at provincial and local level through trusts which in effect launder loans official banks are barred from making; at one end optimists say this is manageable because the government has huge reserves; at the other pessimists say credit bubbles of this dimension always cause an economic contraction at some point and China is not an exception (and can't just reimport its foreign reserves);
- overinvestment in infrastructure and housing (and shopping malls) which bulls say will be fully used in due course and are overstated and bears say are unproductive and a serious drag on the economy;
- a need to lift state-owned enterprises' performance which bulls think is manageable and bears doubt;
- serious problems, bluntly stated by the think tanks, in soil, water and air pollution and in energy and resource availability; bulls say the technocrats will sort it before public concern becomes acute; bears point to the rising "middle class" emigration;
- very large and rising inequalities, compounded by egregious corruption and rent-taking by party bigwigs, which bulls say the new leadership is responsive to and addressing and bears say will at some point trigger political convulsions and in any case can't be controlled from the centre.

An inexpert outside view: the balance seems to be on the side of optimism for the next five years or so – but with caution that there could be sudden pain for a time, potentially with flow-on damage to social and political stability. The Communist party will also need to be reconstructed at some point.

Australia

Hockey's first Budget seeks path to surpluses

Australians are being primed for their most austere federal Budget in many years, with Treasurer Joe Hockey warning that "we all have to contribute", referring to the intention to cut back not only social

Trading partner growth

2012-13 actual; 2014-15 Consensus Forecasts; 2016 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	7.3	7.2	7.1	2.7	2.6	2.6	3.0	3.1
Australia	23.1	3.7	2.4	2.8	2.9	3.2	1.8	2.4	2.8	2.6	2.8
United States	10.3	2.8	1.9	2.7	3.0	3.0	2.1	1.5	1.7	1.9	2.2
Japan	7.2	1.4	1.5	1.3	1.3	1.1	0.0	0.4	2.6	1.7	1.8
Eurozone	7.2	-0.6	-0.4	1.2	1.5	1.6	2.5	1.3	0.9	1.3	1.5
United Kingdom	3.5	0.3	1.7	2.8	2.4	2.2	2.8	2.6	1.9	2.1	2.4
South Korea	4.1	2.3	3.0	3.5	3.7	3.7	2.2	1.3	1.9	2.6	2.6
Indonesia	2.2	6.3	5.8	5.4	5.8	5.8	4.0	6.4	6.3	5.5	5.1
Hong Kong	2.0	1.5	2.9	3.4	3.5	3.6	4.1	4.3	3.9	3.6	3.3
Taiwan	2.2	1.5	2.1	3.3	3.6	3.6	1.9	0.8	1.2	1.7	1.7
Singapore	2.6	1.9	4.1	3.8	4.0	4.1	4.6	2.4	2.5	2.7	2.3
Malaysia	2.3	5.6	4.7	5.1	5.0	5.3	1.7	2.1	3.3	3.6	3.1
Philippines	1.9	6.8	7.2	6.4	6.3	6.0	3.2	2.9	4.1	3.8	4.1
Thailand	1.8	6.5	2.9	2.5	4.2	4.5	3.0	2.2	2.4	2.8	3.0
India	1.7	5.0	4.7	5.4	6.0	6.4	10.3	9.6	7.7	7.1	6.8
Viet Nam	1.2	5.2	5.4	5.7	5.9	6.0	9.1	6.6	6.0	6.9	7.0
Canada	1.3	1.7	2.0	2.2	2.5	2.5	1.5	1.0	1.6	2.0	2.0
NZ Trading Partners	**100.0**	**4.1**	**3.8**	**4.0**	**4.1**	**4.2**	**2.5**	**2.3**	**2.6**	**2.7**	**2.8**
Forecasts for New Zealand											
Consensus		2.6	2.7	3.5	3.0	2.6	1.1	1.1	1.9	2.3	2.4
BNZ Forecasts		2.6	2.7	4.0	3.4	1.8	1.1	1.1	1.6	2.5	3.0
The World		**2.7**	**2.5**	**2.9**	**3.2**	**3.2**	**3.0**	**2.7**	**3.0**	**3.1**	**3.2**

welfare entitlements, but also to scythe deeply into the A$10b annual budget for industry assistance. Car industry closures and Canberra's uncompromising stance on Qantas's commercial difficulties have already set the tone for the latter.

Yet for all the rhetoric, the case for fiscal austerity is not strong and nor perhaps are there all that many notches on the belt. At issue is a projected Budget deficit by 2024 to be tightened at 1.5% of GDP. That is tiny against an economy by then forecast to be worth A$2.6 trillion annually, and all Hockey is targeting is a surplus by then of 1% of GDP.

Hockey is creating theatre around these forecasts, which are being produced by the Commission of Audit for official publication on May 1, but are the subject of leaks. They look similar to the NZ Treasury's 30 fiscal forecasts, which routinely forecast much worse than likely outcomes for this country, but are understood as extrapolations from the present, which are unlikely to occur in practice.

The bottom line? The Australian economy is in much better shape than Australians, in particular, give it credit for.

Hockey's Budget looks likely to make pre-emptive strikes on areas of eligibility entitlement such as pharmaceuticals, disability insurance, and generous treatment of superannuation savings *(see Domestic Economy, Retirement Savings)*.

While there will be no move in this Budget to raise the pension entitlement age from 67 to 70, Hockey is also openly discussing that need.

The Budget themes draw on Hockey's identification in February of the need for a new "age of responsibility" in Australia.

Australian defence spending: another world

Underlining one of the fault-line political differences between NZ and Australia is the fact that, at the same time as talking up the need to cut welfare entitlements and industry support, Canberra has committed to a **A$12.4b investment in 58 F-35 Lockheed Martin stealth fighters** for the RAAF. Announced just before ANZAC Day, the decision reiterates both Australia's commitment to and sense of itself as being a regional defence power of substance and bulwark to US presence in the region. The purchase is described by *Reuters* as "raising (Australia's) air combat power to among the world's most advanced" and is a major vote of confidence in the Pentagon's most expensive current arms development project, which is several years behind schedule and over budget. The RAAF already had 14 such jets on order. The first will be in service for the RAAF in 2020.

Aussie benchmark rate to stay at 2.5% after weak CPI

Australian **inflation** came in lower than expected, at 0.6% in the March quarter, for an annual rate of 2.9%. Market expectations were for a 0.8% and 3.2% increase respectively. The outcome sparked weaker Australian bond prices and a sustained fall in the value of the Australian dollar against the US dollar, amid expectations the RBA will sit for longer on the current benchmark interest rate at 2.5%, where it's been since last August, having fallen from a high point in recent years of 4.75% between Nov 2010 and Sept 2011.

Piketty lights up the inequality debate

A new book on an old subject is having global impact on both economic and political debate. "Capital in the 21st Century", by French economist Thomas Piketty, is exciting interest across the political spectrum with its fundamental reassessment of the role of capital accumulation in the creation of social inequality. From the Occupy movement to the IMF, Piketty's findings are sparking new thinking on one of the most pressing economic and social policy issues facing developed countries, in particular.

In very simple terms, Piketty challenges the analysis of inequality trends based on income levels, arguing that the capacity for individuals with accumulated capital to outstrip the material circumstances of those with few capital resources is becoming a force for social and political upheaval because of the way wealth has recently concentrated in the hands of a very wealthy but tiny global minority.

His central thesis is that the period 1945 – 1973, during which income levels both rose and converged in developed economies such as the US, may have been an historical anomaly rather than, as is widely assumed, an indication of economies at work in a "normal" way.

Instead, he suggests "potentially terrifying" implications if current wealth distribution inequalities continue. "The egalitarian ideal has faded into oblivion and the New World may be on the verge of becoming the Old Europe of the 21st century's globalised economy."

To critics of market economics, the book is being used to claim that capitalism has "failed". Policymakers, however, are taking the analysis as a serious restatement of the scale of an emerging, urgent need to ensure that the wealth-producing benefits of capitalism are not threatened by entrenching deeply unequal wealth distribution. Some critics note that Piketty makes little of the emergence from extreme poverty of emerging economies' populations. Others suggest his proposed remedies – largely to tax

wealth and very high incomes heavily – are weak by comparison with his powerful new analysis, based on the World Top Incomes Database, which he helped to create.

What is unarguable is that "Capital in the 21st Century" is the book that everyone will be talking about in 2014 and probably beyond.

NZ Business and Domestic Economy Round-up

Tourism

Dunedin may have lost a five star hotel proposal but Auckland – a more credible candidate – has gained commitment to a $200m hotel development, involving super-wealthy Chinese investor Chan Laiwa.

Described as one of China's richest women, Chan chairs **Fuh Wah International Group**, which will reportedly build the **Wynyard Quarter** hotel in a joint venture with local council-controlled Auckland Waterfront.

Auckland mayor Len Brown says the "deal is a direct result of Waterfront Auckland's involvement on the Mayoral Trade Mission to China in 2012."

Earlier this year, Fuh Wah bought the Melbourne Park Hyatt Hotel, reportedly for A$135 million.

Meanwhile, NZX-listed **Millennium & Copthorne Group** is contemplating a capital return to shareholders, now that it has quit interests in parts of China where the company ran into serious difficulties created by the **criminal activity of a local manager**.

Resources

A Supreme Court decision cleared **King Salmon** to develop three of eight salmon farm sites in the Marlborough Sounds. A fourth site was knocked back in a landmark decision that will guide future decision-making on **outstanding natural landscapes and outstanding natural character** – both of which are defined terms in the Resource Management Act. Four sites had previously failed to gain consents at the application stage. The decision came roughly three years after King Salmon first sought resource consents under the then newly established "fast-track" board of inquiry process overseen by the **Environmental Protection Authority** for projects of national significance.

The Supreme Court's majority 4:1 decision to overturn the BOI granting a consent for a site at Port Gore is significant for creating precedent that entrenches the status of National Policy Statements (in this case, the NZ Coastal Policy Statement) in the context of the RMA. The win is a coup for the Environmental Defence Society, which stood aside from appeals on the other three sites.

Chatham Rock Phosphate has brought on board a new American private equity shareholder, identified only as Vista Grande LLC, the vehicle for a privacy-seeking high net worth individual, who underwrote part of CRP's most recent $2.1m capital raising. CRP expects May 5 public filings with the EPA for a marine resource consent to mine phosphate on the Chatham Rise, and is targeting late June for dual-listing on the AIM board of the London Stock Exchange. Key fisheries interests remain implacably opposed to the scheme, which is in a Benthic Protection Area created during the Clark govt to protect areas of relative insignificance to commercial fishers from the practice of "bottom-trawling". There are fears sediment plumes from such mining could compromise rare corals (Green Party) and fisheries breeding grounds (Deepwater Group).

TransTasman Resources's EPA board of inquiry hearings into proposals to mine ironsands in the EEZ off the southern Taranaki coast continue around the North Island among potentially affected communities. Opponents have homed in on the potential for plumes, created by depositing processed sands back on the ocean floor, could travel inside the 12 mile nautical limit, which is governed by the RMA rather than the EEZ. They argue this could require a second set of resource consents. They are also challenging the degree of certainty provided by environmental impact assessments of the proposed activity. Foreign investors in TTR reportedly took fright at reports that some 98.5% of submissions on its application were opponents, although the vast majority were pro forma submissions.

Energy

Genesis Energy listed at a 17% premium to its $1.55 issue price, to complete the govt's partial privatisation programme. Mighty River Power has appointed its GM, Operations, **Fraser Whineray**, to replace founder CEO Doug Heffernan on Sept 1.

Banking and finance

Bank of New Zealand has appointed the former head of its business banking arm, Anthony Healy, chief executive of the local operation after the promotion of current ceo Andrew Thorburn to the top spot at BNZ's owner, National Australia Bank.

The **Financial Markets Authority** has joined the **Commerce Commission** in probing the marketing of interest rate swap products to farmers in the mid-2000's. The commission has already indicated

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ECONOMY AT A GLANCE

New Zealand economy

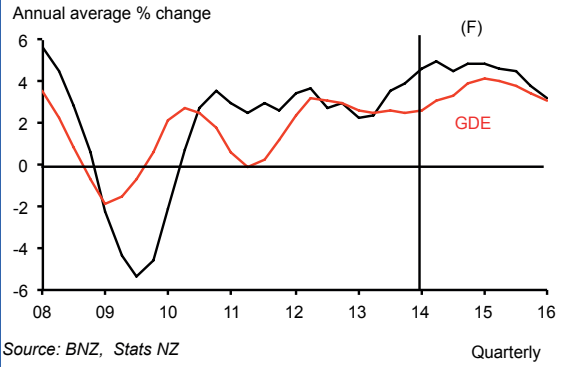
(% change on previous year
Calendar year except where indicated)

	2012A	2013A	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	0.3	1.4	1.8	0.4
Labour productivity growth	2.3	0.6	0.8	0.3	0.2
Employment growth (annual % change)	0.4	3.0	3.0	2.7	1.3
Unemployment rate (S.A. % as at Dec Q)	6.8	6.0	5.4	5.0	5.2
Inflation (% increase from Dec Q previous year)					
Consumer prices	0.9	1.6	1.8	2.8	3.0
Average hourly earnings	2.6	3.2	3.6	3.8	3.2
Terms of trade	-8.9	20.0	-6.9	-1.3	4.7
Financial sector					
Operating balance (OBEGAL)					
(as % of GDP – June Year)	-4.4	-2.0	-1.0	0.0	0.7
Net debt (as % of GDP – June)	24.3	26.2	26.3	26.5	25.8
90 day bank bill (%) (1)	2.7	2.7	4.5	5.3	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	1744	-1521	1465
Current account $(m)	-8590	-7546	-8209	-12382	-9701
(as % of GDP)	-4.1	-3.4	-3.4	-4.9	-3.7

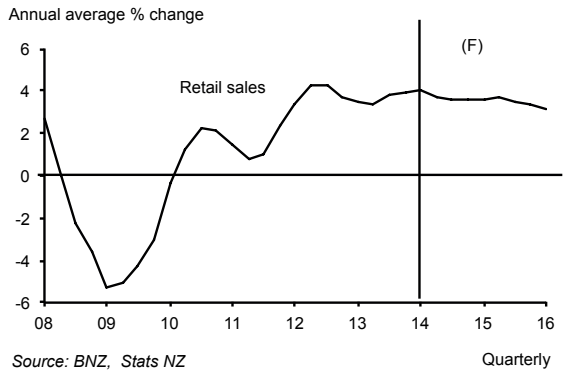
(1) Average for month of December

(2) Using current prices

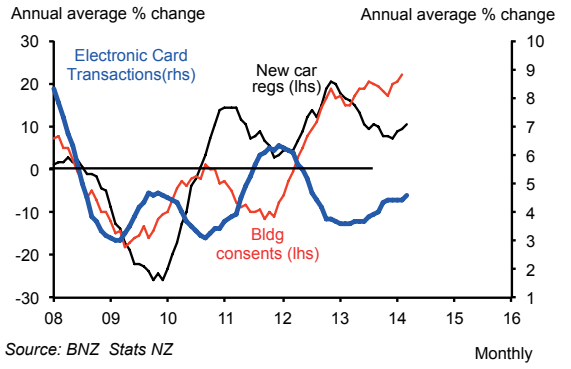
Economic growth



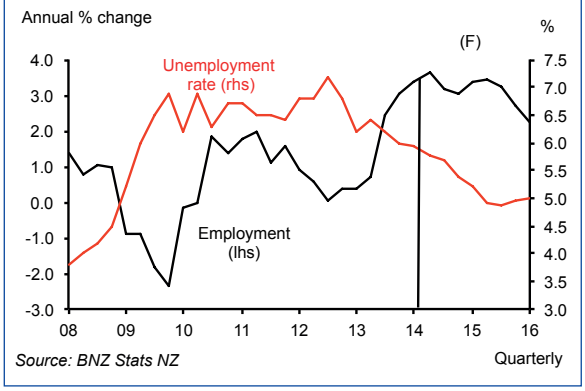
Retail sales



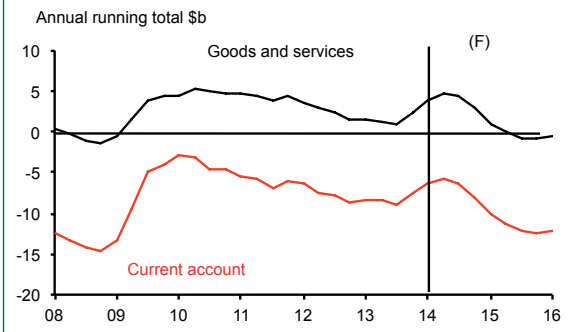
Partial indicators



The labour market

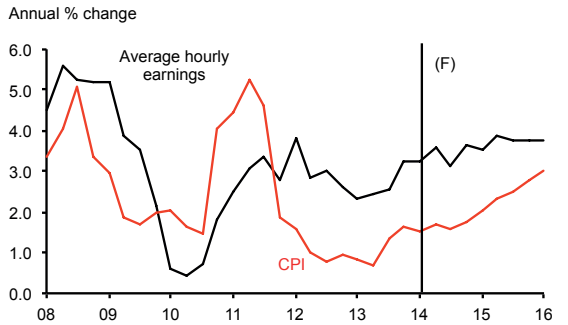


Balance of payments



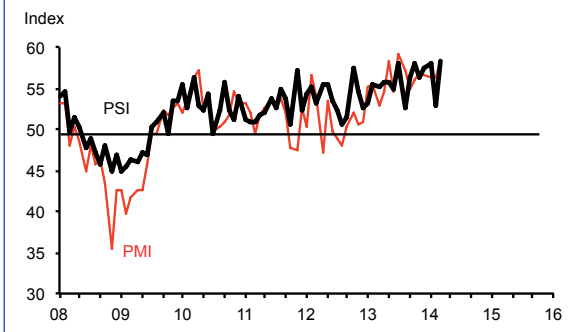
Source: BNZ, Stats NZ — Quarterly

Inflation



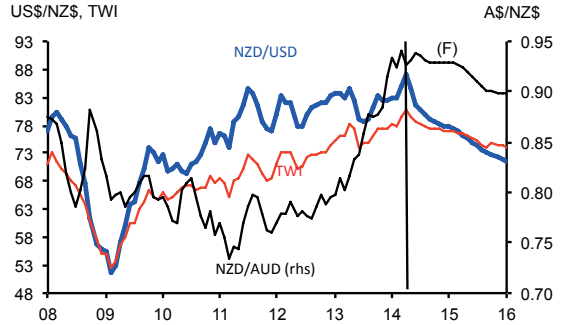
Source: BNZ, Stats NZ — Quarterly

PSI and PMI



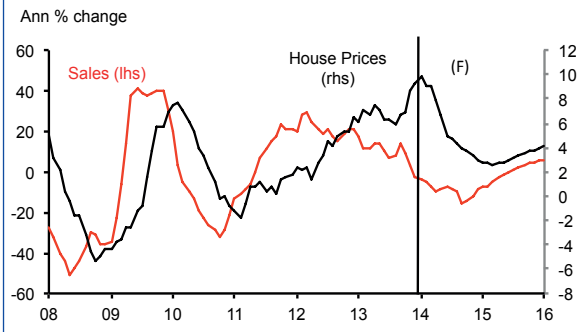
Source: BNZ — Monthly

Exchange rates



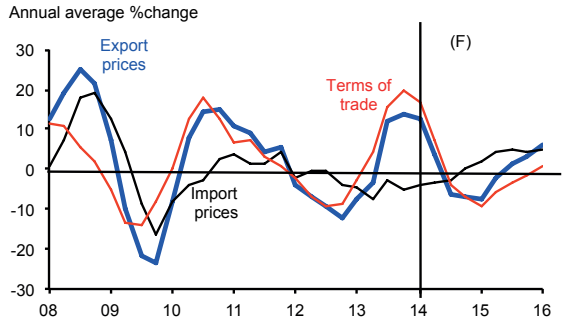
Source: BNZ — Monthly

Housing market (three month average)



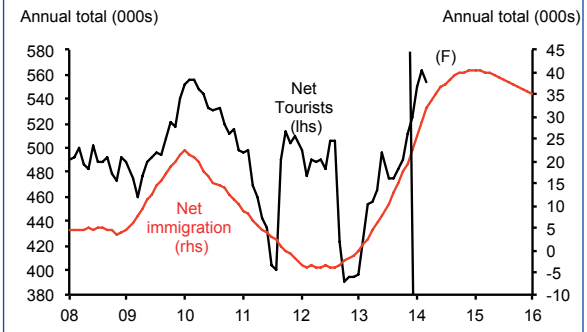
Source: BNZ REINZ — Monthly

Terms of trade



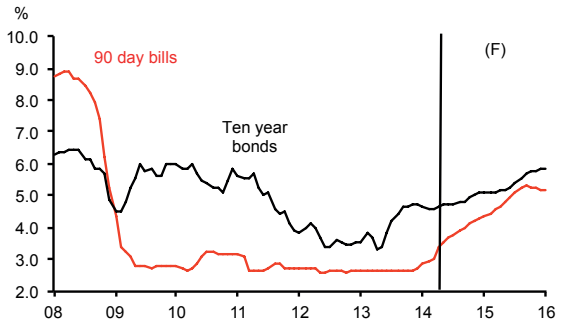
Source: BNZ Stats NZ — Quarterly

Net migration flows



Source: BNZ Stats NZ — Monthly

Interest rates



Source: BNZ — Monthly

ECONOMIC ROUND-UP

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it intends filing claims against ASB, ANZ, and Westpac under the Fair Trading Act, and has sought additional time to prepare its information since receiving information gained through more extensive powers of investigation.

Corporate plays

Shareholders representing 19% of the **Abano Healthcare** register have embarked on what appears a doomed project to try and oust sitting chair Trevor Janes, whom they accuse of misrepresenting his status as an independent director when recommending against a takeover bid they mounted last year. Leading the charge are Peter Hutson (14% shareholder, half-owner of the Bay International audiology business also half-owned by Abano) and James Reeves (5% shareholder). The Abano board tried calling Hutson's bluff with a $12.9m bid for his half of Bay International, a valuation well above that offered in a Korda Mentha valuation report prepared for Hutson and Reeves. The first of possibly two special shareholders' meetings is set for May 27. Institutional shareholders appear to be supporting the Abano board.

Technology

Christchurch software developer **Jade** will return $14.9m to investors, most of its proceeds from the selldown by IPO last year of its spin-off intelligence software business **Wynyard Group**. Chair Ruth Richardson said the board had not found a more compelling use for the funds.

Xero shares, which have been buffeted by a global change in sentiment towards tech stocks, saw a healthy 11% bounce in its share price accompanying announcement that its rate of cash burn has slowed in the first quarter of calendar 2014 and a strategic partnership with US tax return market leader H & R Block.

Diligent Board Member Services cfo Carl Blandino is leaving the company after a year spent helping it fix embarrassing misfilings of three years' annual accounts, which had to be restated and saw Diligent knocked back by the NZX on requests for a waiver relating to the issue – a refusal that raised eyebrows among US investors. On-the-ground reports are that Diligent's latest sales performance is strong and a NASDAQ listing, and likely departure from the NZX mainboard, is on the cards.

Accounting

During a visit to NZ last month, the head of International Accounting Standards Board, Hans Hoogervorst, expressed concerns about the growing use of unconventional profit measures by listed companies when reporting earnings. While he appreciates IFRS reporting has created previously unseen distortions by pushing items such as changes in the value of financial instruments above the line, he maintains an old school preference for net profit after tax as the primary reported earnings figure.

"Ebitda I don't understand at all," he said in an interview. "Why don't you want to know about depreciation and interest, which tells you a lot about the leverage of the company?" He was especially skeptical about the use of bespoke "underlying earnings" measures.

"I think that the logic of the markets is that one number is always dominant and it should be the P&L," Hoogervorst said. "In the long run that number gives the least surprises because it includes everything. I recognise that P&L is a rough number."

Housing

The Reserve Bank calculates only 5.6% of lending is now at high (deposits under 20%) **loan-to-valuation ratios**, six months since the policy was imposed on banks, requiring no more than 10% of their home lending to be at high LVR's. It was running at above 25% last September. While banks will prefer to operate with a buffer, that outcome may indicate some greater availability of credit for low deposit first home buyers. The RBNZ has given no indication of when it may lift the restrictions. **REINZ** statistics for March showed a 10% drop in total house sales for March, compared with March 2013. The drop occurred in houses valued between $400,000 and $600,000, while sales grew in higher price brackets. The annual, seasonally adjusted stratified housing price index show a 9.2% increase.

Annual residential building permit issuances in the year to March rose 30% to 22,366, or 25% to 19,768 excluding apartments.

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