

Where to now for interest rates?

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In the space of a few weeks, conventional wisdom has shifted from expecting the OCR to rise again in the first half of next year to the possibility that there will be no rate hike before 2016. How and whether inflation emerges depends greatly on the path for the kiwi dollar.

TPP window opens in early 2015

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Sudden signs of progress on the TPP negotiations should be taken seriously. There is a window early next year. A big win for the Republicans in next week's mid-term Congressional elections may see "fast track" negotiating authority approved.

BIM City

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A flood of Briefings to Incoming Ministers will start to be released over the next fortnight and can be expected to reflect the desire for a more cohesive "whole of government" approach.

Labour law: Parliament and courts part ways

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The govt passed its package of labour market reforms in an early demonstration of its renewed mandate, but the Appeal Court ruling on pay equity drives in a different direction.

Dairy bounceback - how realistic is that hope?

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Fonterra continues to anticipate a bounceback in demand for dairy commodities when China re-enters the market, expected later this year. However, falling feed prices and higher production around the globe could offset any improvement in demand.

Silver Fern Farms targeting \$100m equity raise

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Silver Fern Farms is seeking advice on avenues for equity-raising, with a rough target of \$100m in mind. That could come from farmer shareholders in the cooperative, a selldown of elements of the business or external sources.

Goodbye to QE

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The formal end of the US Federal Reserve's quantitative easing programme is accompanied by global market volatility and concerns about another securitised loans bubble.

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	1.9%	3.4%	73.0c	89.0c	3.2%	4.2%
December 2016	2.5%	1.8%	68.0c	85.0c	3.3%	4.3%
December 2017	2.0%	1.1%	66.7c	89.8c	3.1%	4.1%

Seeking an elusive “whole of government” approach

Next week we should start to see the swag of briefings to incoming ministers which departments and other agencies produce before the election for the new or re-elected ministers. This year they are accompanied by a briefing to the whole government by the whole public service.

At the same time agencies (departments, ministries and Crown entities) have been writing “narratives” and other documents amounting to strategies (though ministers have banned that word) – for example, the Ministry of Transport has done some deep rethinking of future demand and potential policy responses. These strategies/narratives follow criticism in “performance improvement framework” reviews that the requirement to budget four years ahead and in a 10-year context was not backed by strategic analysis.

In addition there are some sectoral, cluster or “system” briefings, notably in the resources, economic and education areas. There has been some inter-agency consultation on the “narratives”.

CEO summits

The whole-of-government briefing follows summits of chief executives in March and Sept which produced the “Brackenridge declaration” (named after the modest Martinborough resort where they met). This included: “Mobilise our people and resources to ensure those leading complex system-wide issues are successful”.

The concept is that each ceo should be a ceo of the whole public service as well as ceo of his/her agency. This echoes the assumption before the 1988 management reforms that a public servant was a member of the whole public service, not just one particular agency.

As Deputy State Services Commissioner Al Morrison put it back in April, the idea is to “get the public services to think and operate across the whole government system” and to “retain the strengths of individual agency accountability within a system that encompasses collective responsibility”.

This is not simple, not least because, in addition to individual ceo patch protection (driven by the ceo’s legal accountability for how an agency runs), there is ministerial patch protection. Bill English thinks the latter is now more of a block than the former.

Hugo has seen some of the narratives but only on the basis of confidentiality until they are formally released. One usually sceptical senior minister was most impressed with the whole-of-government briefing. But a senior public servant warned Hugo

not to get too excited. That advice accords with the narratives Hugo has seen, which are unlikely to shake the foundations or ministers’ self-assurance, though they do contain some forward thinking.

More important is that the narratives and whole-of-government briefing have been done at all. A widespread criticism since the forelock-tugging Helen Clark era is that officials too often second-guess what the minister wants, or might want. Of course, in the final analysis public servants must do what the minister lawfully orders but officials would serve the public interest better if they first did top-quality analysis and argued best-case solutions. Some do but they are said to be a minority.

One aid to public servants offering top-quality advice is the appointment of departmental chief science advisers to some major departments to improve the rigour of evidence used by policy analysts. How well that will work has yet to be proven but the appointments so far have been high-quality.

Maori party looks for hope

The Maori party holds its annual general meeting on the evening of Oct 31 and the morning of Saturday Nov 1. It is unlikely to chart a confident way forward.

In 2005 the party won four electorate seats and in 2008 five. It lost one when Hone Harawira went his own way. In 2011 it lost another to Labour. It came third behind Labour and Mana in the Ikaroa-Rawhiti by-election last year, which forced Pita Sharples’ resignation as co-leader, in favour of Te Ururoa Flavell. It lost two more of its electorate seats to Labour in Sept and has two seats only because it crawled just over the party vote line to coattail Marama Fox - though it did beat Internet-Mana in both the party and electorate vote in the Maori seats.

The party is to elect a co-leader to replace retiring Tariana Turia. That is likely to be Fox.

The future is somewhere between murky and bleak. The best hope, albeit a long shot, is that it recovers much of Mana’s vote in 2017 and coattails one or two MPs.

The logic of backing National again is to get whanau ora embedded – and get it operating effectively. That is Turia’s signal achievement, though whether it will make a genuine difference has yet to be seen.

The arrangement with National this time is looser than in 2008-11, amounting only to voting for the budget and confidence motions and procedural motions. But that last put it in the invidious position of voting to truncate debate on the Employment Relations Amendment Bill which it had “utterly opposed”, to quote Fox.

Employers: a win in Parliament but a loss in the Appeal Court

National's windfall from the Internet-Mana debacle which boosted the wasted vote and gave it 61 seats with ACT's David Seymour has secured a significant increase in employment law flexibility.

The Employment Relations Amendment Bill, top legislative priority for the govt in the new term, allows flexible tea, meal and rest breaks, allows the Employment Relations Authority (ERA) to curtail protracted collective contract negotiations and allows employers to opt out of multi-employer contract negotiations, allows the extension of variable work arrangements, relaxes carry-over employment obligations when contracts change, requires advance notice of strikes and lockouts and allows deduction of wages for partial strikes. It also sets time limits on the ERA for releasing determinations.

Note that all or most of those changes will likely be temporary. Labour and the Greens have vowed to reverse them and NZ First and the Maori party have strongly opposed them.

The aged-care pay equity case

The courts have moved in the reverse direction. The Appeal Court has upheld an Employment Court ruling that pay equity claims can be based on equal pay for equal work in comparable occupations if a wages in a female-dominated occupation are lower than in a comparable male-dominated one.

Importantly, the Appeal Court said its decision was finely balanced. That means Terranova Homes, the aged-care company against whom a worker and the Service and Food Workers Union brought the claim, is likely to go to the Supreme Court, with the backing of the Aged Care Association which argues the sector can't afford higher (than the current minimal) wages without higher government subsidies which the government is unwilling to pay.

The Supreme Court's recent record, however, has been on the "liberal" or "creative" side so there is every possibility it will uphold the Appeal Court.

But even if it does, that does not end the matter. The Appeal Court said the best way forward would be for the Employment Court to set out principles for the appropriate comparisons and only then hear and decide the claim. There is some guidance from European courts but the Employment Court is not likely to find stating the principles straightforward and then finding appropriate comparators may also be problematic.

Then, lurking in the background is the living wage", also backed by Labour and the Greens.

Trade agreements

The long-sought **FTA with South Korea** is very close after a particularly difficult negotiation, which appears to have landed an almost signable version in the last 10 days. The meat industry regards this as its most important short term goal, as FTA's with Aust and the US were starting to threaten the kiwi beef trade to Korea.

On the TPP front, advocates for the deal are talking up last weekend's talks in Sydney, but perhaps as much because of the potential for next week's **US Congressional mid-term elections** to deliver a Republican majority, which might just approve "fast-track", or Trade Promotion Authority as the Congressional mandate for the US President to conclude a multi-lateral trade deal is now termed in more politically correct terms.

That's what's propelling talk of a TPP final agreement in Q1 2015. The flipside is that the longer the talks drag on, the more they are likely to become mired in the lead-up to the 2016 US presidential election.

That makes 2015 a year for global leadership (*see International Economy*).

Trade Minister **Tim Groser** is very cagey about discussing the IP elements of the TPP, which remain under intense negotiation. He clearly has some idea of what's going on, but won't discuss issues such as the duration of patents and copyright.

Where Japan and the US are concerned on agricultural export liberalisation, he believes Japanese PM Shinzo Abe must deliver at some stage on his "third arrow" of economic reform, including trade liberalisation, if he is to get the Japanese economy growing again.

India FTA still dead as a dodo

Meanwhile, Groser sees no progress on the India-NZ FTA proposal. While **Indian PM Narendra Modi** strides the world stage to promote a billion person alternative to China, he has made very little progress on a review the country's highly protectionist trade policy.

Fabled in his home province of Gujarat for attracting foreign direct investment, Modi has feted India's absurdly low-cost mission to Mars as an example of the potential of "Made in India".

He is attempting to rebrand FDI on a federal scale, saying FDI should mean "first develop India" and putting federal govt resource behind a "Made in India" campaign.

The flag

By appointing Deputy PM Bill English in charge of the flag referendum, John Key is freeing himself to have a view.

The flag may not change, but he is open to it as a monarchist, and that is a clever positioning.

“Tricky” Key

Anyone hoping election night was the end of “Dirty Politics” is likely to be disappointed.

The issues raised in Nicky Hager’s book will be pursued mercilessly in Parliament by opposition parties and by the Press Gallery, which is unfazed by the fact this is a so-called “beltway” issue but concerned by the blow to reputations from the implied undue closeness between some media outlets, individual journalists and the PM’s Office.

Having toughed it out during the “election and made some sacrificial offerings to clean house, such as the refusal to allow Judith Collins to use the “Honorable” title while the Chisholm inquiry is under way, John Key appears determined to defend his contact with blogger Cameron Slater.

However, the explanation that such contact was not in his capacity as PM is a figleaf that embarrasses him every time the issue is raised in Parliament. The Speaker’s ruling that he must answer some such questions where they can be shown to relate to that role is an important line in the sand.

While the public may tire of it, the issue appears likely to maintain an acid drip on the PM’s and, by extension, the gov’t’s integrity that will not quietly die. Key enjoyed mocking David Cunliffe as “tricky” before the election, but risks being tarred with that epithet himself.

Smith returns to TAG reports for RMA reform guidance

Environment Minister Nick Smith looks likely to turn back to the Technical Advisory Group reports he commissioned on RMA reform. Believing they still represent solid thinking on the issues, even if the gov’t doesn’t proceed with reforms to Sections 6 & 7, as signalled.

That’s how he expects to be able to turn around new policy and Cabinet decisions in time to introduce amending legislation next Feb.

That suggests he hasn’t given up on amendments that would soften the RMA’s commitment to environmental ‘bottom lines’, in favour of the “overall broad judgement” approach taken by the courts since the Act passed in 1991.

The TAG’s conclusions were controversial on this subject: asserting on one hand that “broad overall judgement” had undermined the sustainable management purpose of the RMA, while recommending that it be entrenched as part of its proposed reform.

On a longer horizon, Smith is contemplating the need for a return to bespoke urban planning legislation. NZ is one of the few countries no longer to have legislation akin to the old Town and Country Planning Act, which the RMA replaced.

Danger signs in social policy innovation

Signs are growing that the gov’t will run into heavy political weather with its pursuit of more-market initiatives in social policy.

Bill English’s social housing policy continues to provoke a torrent of negative commentary. If the case for limited competitive provision of social housing can’t be made, that has the potential to cut across the social policy procurement research the Productivity Commission is undertaking.

The thrust of its project is based on similar premises to the social housing initiatives, with focus on UK policy that has seen devolution of health and education funding to something akin to ‘voucher’ systems, where funding follows individuals rather than institutions.

Funds for bio-research

Four new primary sector research partnerships will be funded over 7 years to a total of \$15m.

The funds are being allocated from the Ministry of Business, Innovation and Employment’s Biological Industries Research Fund.

The four initiatives are:

- a Pastoral Genomics Ltd ‘Commercialising Forage Biotechnologies’ Partnership, involving DairyNZ, Beef+Lamb NZ, Grasslands Innovation, NZ Agriseeds, DEEResearch, AgResearch, and Dairy Australia;
- a Pipfruit NZ ‘Apple Futures II’ Partnership, which aims to secure market access for apples to high-value Asian markets by developing new knowledge of pest and pathogen infestation and infection processes;
- a vineyard longevity and profitability partnership involving NZ Winegrowers;
- a Meat Industry Research and Innovation Partnership, to increase quality and shelf-life of chilled meat exports.

Industry funding matches gov’t funds one-for-one. 

How low could the Fonterra payout go?

Fonterra ceo Theo Spierings exuded confidence in a television interview on Oct 25 that the “very fair” global average price for whole milk powder (WMP) is around US\$3,500 per metric tonne and that China will re-enter the market by year’s end to repair the plunge to US\$2,503 per MT at the last GlobalDairyTrade auction, mid-Sept.

Morgan Stanley is not so sure. In a report on Oct 28 from its Hong Kong office, it warns that while China’s stockpiles of WMP, built up last year when prices reached record levels after the 2013 NZ drought, will run down in coming months, milk production in other parts of the world is about to expand markedly.

That’s partly because animal feeds in non-pastoral dairy markets, primarily the US and Europe, have been falling fast, with a three to six month lag generally noted between price falls and a ramp up in dairy production.

“Total WMP export volume is due to increase by 10% for 2014 versus a decline of 2% recorded in 2013.

Morgan Stanley takes issue with Spierings and argues the payout price for the current season could be as low as \$4.20 to \$4.50 per kilogram of milk solids.

Last year’s payout was a record at \$8.65 per kg / ms, with Fonterra retaining some capital rather than pay out in full.

Morgan Stanley sees “room for the NZD to adjust lower” if its scenario of a big negative swing in the global dairy trade plays out.

Interesting, given John Key’s recent nomination of 65 US cents as the “Goldilocks, just right” level for the kiwi, Morgan Stanley suggests if dairy prices stay where they are now, that’s exactly where they would expect the kiwi to head.

Prices at the most recent GDT auction would indicate a farm gate milk price of \$3.90 per kg / ms if sustained over the entire season.

Orion heads IPO flurry

Orion Health Group’s much-anticipated share sale will raise up to \$150m in new capital, with shares priced \$4.30 and \$5.70 apiece, leaving pre-IPO shareholders with as much as 86% of the health management software company. The indicative price range implies a valuation for the company of up to \$915m, although its ranking in the NZX 50 Index will be marked down with less than 30 million shares to be ‘freely traded’. Chief executive and founder Ian McCrae will be the largest single investors with

a dominant stake of about 50%. Orion offered no earnings forecasts in its prospectus, an unusual move given the weight institutions put on such estimates. Chairman Andrew Ferrier said the potential for large, ‘binary’ transactions, meant there was a prospect forecasts would be inaccurate

Martin Jetpack made good on its 2010 threat to stage its initial public offering in the Australian market if there wasn’t enough local interest, with an A\$25m target ahead of a planned ASX listing. The company has made two placements in recent months, raising almost \$11m. The IPO would sell up to 50m of new shares at 50 Australian cents apiece, valuing the company at as much as A\$112.6m. Existing shareholders including No 8 Ventures, owned by family interests of Jenny Morel and husband and former central bank governor Alan Bollard, and founder Glenn Martin will be diluted down to 78% if all the shares are taken up. Potential customers include the US Department of Homeland Security and the company also has plans for an unmanned, or drone version of its jetpack.

NZME, the NZ media operations of Australia’s APN News & Media, plans to list on the NZX by the end of the year and has tapped veteran businessman John Anderson as chairman designate. While yet to release a prospectus, previous capital raising documents have indicated spinning off the local business could raise A\$308.6m from selling shares and taking on debt, while Sydney-based parent APN would retain 40% of a business that owns The New Zealand Herald, The Radio Network and GrabOne.

Fund managers are also anticipating offers from **Oceania Living**, the retirement village operator owned by funds associated with Macquarie Group, and **Hercules**, which would pool 19 retirement villages and aged-care facilities into an NZX-listed company. **Jade Software** is also mulling the scope to spin out its **Master Terminal** port management software business following the success of intelligence software developer Wynyard Group’s IPO last year. Chief executive David Lindsay says Jade’s balance sheet is strong enough to fund Master Terminal’s strong growth aspiration although it faces some capital choices.

Silver Fern Farms sniffing for \$100m

Silver Fern Farms plans to hire an investment bank to review its capital structure after returning to profit following two years of losses. The review comes as

New TWI

The Reserve Bank’s outdated five currency trade-weighted index is to be brought up to date by creating a new basket of 17 currencies.

Perhaps most importantly, the TWI will now include the renminbi, reflecting the fact China is the country’s largest trade partner.

The new TWI will run from Dec 11 and include a range of Asian currencies.

DOMESTIC ECONOMY

Keith Cooper steps down after eight years as chief executive and the promotion of chief strategy officer Dean Hamilton as interim ceo. The nation's biggest meat processor, Silver Fern Farms is also reorganising its operations into three business units covering beef, sheepmeat and venison.

Its stronger balance sheet will give it more scope to participate in industry rationalisation, chairman Rob Hewett says.

He's talking a \$100m capital-raising, mainly to pursue an "aspirational target" to leave the company debt-free, but for the bank funding lines required to fund the seasonal kill.

That would leave Silver Fern well-cashed to force rationalisation in a fractured sector through merger and acquisition or to pursue its own growth opportunities.

At this stage, the company hasn't said which.

This can be high risk stuff for a farmer-owned cooperative to pursue.

Silver Fern tried four years ago to raise \$80m from farmer shareholders and got \$20m. Now it's looking for \$100m but also talking sale of discrete parts of the business.

By dividing its business on a meat type rather than capital equipment basis, it says will make it more responsive to opportunities in the industry.

Silver Fern repaid \$100m of debt last year and is reporting a \$45m turnaround to \$5 – 7m ebitda in the current financial year.

Meanwhile, in crowd-funding land

Equity crowd funding platform Snowball Effect is underway with its third offer, "green" coking charcoal business CarbonScape, which wants to raise as much as \$1.5m to commercialise its product for the steel manufacturing market. It follows boutique brewer Renaissance's \$700,000 capital raising and the Lee Tamahori film 'The Patriarch', which raised \$453,800.

Low interest rates to stay?

Whether the Reserve Bank ever lifts interest rates again in the current cycle is a live question after governor Graeme Wheeler removed his tightening bias at the OCR update on Thursday.

That immediately saw the kiwi sold off strongly, with the path for the exchange rate almost certainly the key determinant now for the inflation track.

BNZ economists believe there will still be inflation in the current cycle that requires tightening, but have lowered their peak OCR rate from 4.5% to 4.25% and raised the prospect of no rate hikes before 2016.

The central bank would be looking for very clear evidence of inflation pushing past the 2% mid-range target before acting, which could see the moment for tightening coinciding with the slowdown in economic momentum forecast for 2017.

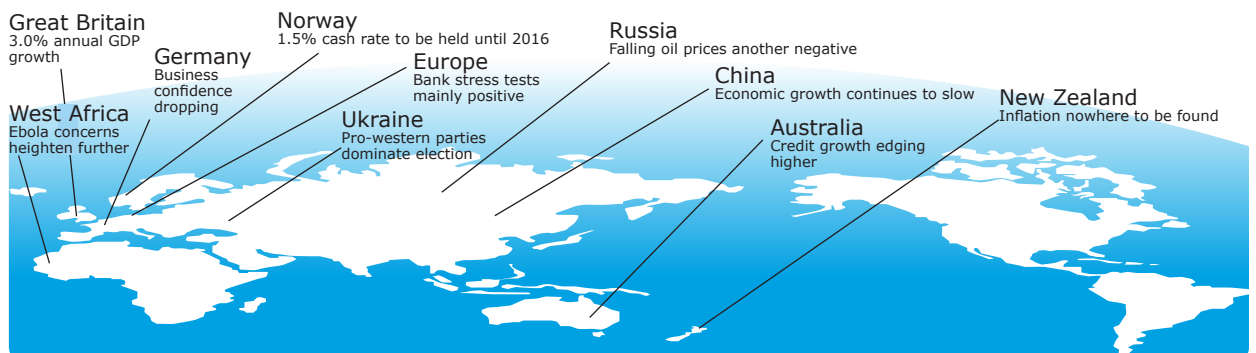
There is speculation the RBNZ has raised its view about the NZ economy's sustainable rate of non-inflationary growth, but is still puzzling over why old inflationary relationships appear so broken. Part of the equation is almost certainly the 25% fall in oil prices since mid-year (*see International Economy*). While RBNZ figures show there was no active intervention in forex markets in Sept, the conditions are ripe for another downward shove.

Jobs figures next milestone

NZ's macroeconomic vital signs continue to be unusually robust. As well as above-trend growth and low inflation, asset prices remain buoyant, investment is strong, the current account deficit remains narrower than usual, and fiscal surplus appears to be in the bag this year.

The next milestone statistic is the Nov 5 release of employment and wage data, with a further nudge down in unemployment expected. The Nov 12 Financial Stability Report from the RBNZ is also tipped to include macro-prudential setting tweaks. ■

The world at a glance



Potential global boost from low oil prices

Global benchmark oil prices have fallen by around 25% since mid-year, with signs that a combination of over-supply from the Middle East and sluggish economic growth in major economies will mean a sustained period of lower energy prices.

UBS modelling suggests a prolonged US\$15 a barrel drop in crude prices could be worth around 0.25% for global GDP, with the benefits skewed to countries that are highly dependent on oil imports, including much of Asia.

China, India, Singapore, Thailand and the Philippines should all relatively well from such a shift, while the ECB may find lower European fuel prices a further reason to crank up its own version of quantitative easing, now under way just as the US Federal Reserve ends its multi-trillion dollar bond-buying programme.

Countries worst affected will be those with high current account deficits and a strong dependence on oil exports, such as Russia, Venezuela, Colombia and Malaysia. The US would be relatively unaffected, as previous relationships between lower energy prices and higher consumer spending have become weaker following the US shale oil boom.

Republicans on a roll

The Republican Party expects to entrench its grip on the US Congress in mid-term elections next week.

The Democrats will be concentrating on trying to maintain its slender Senate majority, where the Republicans need to win six seats to gain a majority.

In Congress, predictions range from between four and 13 new seats for the GOP, the upper end of which would be looking at its largest congressional majority since 1928.

At 10 extra Republican congressional seats, the Democrats might expect not to control the Congress again before 2020 – two presidential elections from now.

Accompanied by a Senate majority through to 2016, the Republicans would seek to use control of both Congress and Senate as an opportunity to demonstrate their ability to govern – a questionmark as the party has struggled with its Tea Party's populist wing.

In that vein and as noted on TPP progress, there is some prospect of a Republican-led effort to allow Trade Promotion Authority for President Obama, raising some prospect of the stalled negotiations being completed in the relative political calm of 2015.

QE3's over - what now?

With the US Federal Reserve ending its pump-priming quantitative easing policy, focus is turning to whether the tidal wave of cash generated by three bouts of QE has created a new bubble of over-leveraged risk assets.

By collapsing interest rates globally, investors have been forced to seek greater yield and therefore

Trading partner growth

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

Trading partners	Weights %	GDP Growth (ann avg %)					CPI Inflation (ann avg %)				
		2013	2014	2015	2016	2017	2013	2014	2015	2016	2017
China	27.6	7.7	7.3	7.1	7.1	7.3	2.6	2.3	2.7	3.1	2.7
Australia	21.3	2.3	3.0	2.9	3.2	2.9	2.4	2.7	2.5	2.8	2.6
United States	10.1	2.2	2.2	3.1	3.0	2.6	1.5	1.8	1.8	2.2	1.8
Japan	6.9	1.5	1.1	1.2	1.1	1.2	0.4	2.8	1.8	1.8	1.7
Eurozone	7.2	-0.4	0.8	1.2	1.6	0.8	1.3	0.5	1.0	0.9	0.9
United Kingdom	3.7	1.7	3.1	2.6	2.2	2.4	2.6	1.7	1.9	2.4	2.2
South Korea	4.0	3.0	3.5	3.7	3.7	3.5	1.3	1.5	2.2	2.6	1.9
Indonesia	2.3	5.8	5.2	5.6	5.8	5.6	6.4	6.1	6.0	5.1	5.9
Hong Kong	1.7	2.9	2.3	3.0	3.6	3.0	4.3	3.9	3.5	3.3	3.8
Taiwan	2.4	2.1	3.6	3.6	3.6	3.2	0.8	1.4	1.8	1.7	1.4
Singapore	2.6	3.9	3.2	3.7	4.1	3.7	2.4	1.5	2.1	2.3	2.1
Malaysia	2.3	4.7	5.7	5.2	5.3	5.2	2.1	3.2	3.9	3.1	3.1
Philippines	2.0	7.2	6.3	6.3	6.0	6.5	3.0	4.3	3.9	4.1	3.8
Thailand	1.9	2.9	1.3	4.3	4.5	3.3	2.2	2.2	2.5	3.0	2.5
India	1.5	4.7	5.6	6.3	6.4	5.8	9.5	7.7	6.8	6.8	7.7
Viet Nam	1.3	5.4	5.6	5.8	6.0	5.7	6.6	5.1	6.2	7.0	6.2
Canada	1.3	2.0	2.3	2.5	2.5	2.3	1.0	2.0	1.9	2.0	1.7
NZ Trading Partners	100.0	3.9	4.1	4.2	4.3	4.1	2.3	2.4	2.5	2.8	2.5
Forecasts for New Zealand											
Consensus		2.8	3.4	2.9	2.6	2.9	1.1	1.5	2.0	2.4	1.8
BNZ Forecasts		2.8	3.8	3.4	1.8	1.1	1.1	1.3	1.5	2.4	2.4
The World		2.6	2.7	3.2	3.3	3.1	2.8	3.2	3.1	3.4	3.1

greater risk. As a result, there has been wholesale packaging of sub-prime lending into asset-backed securities of the sort that helped hasten the events that provoked the GFC in 2008.

This flood of junk bond issuance is also evidence that while QE appears to have helped reflate the US economy, its impact on the real economy has been limited, compared to early expectations.

The Fed's comments from this week's FOMC are also indicating a more hawkish stance than had been widely expected. Where previously it was emphasising significant slack in the labour market, that wording has changed to a suggestion that under-use of labour is "gradually diminishing". The line on economic activity expanding at a 'moderate pace' was retained, but the Fed now sees "solid job gains and a lower unemployment rate."

China – a mixed bag

China's latest economic data has been a mixed bag. While key indicators have been weakening, they haven't been as poor as China-watchers had expected.

Growth running at an annualised rate of 7% in Q3 will likely be enough to prevent any further stimulus from the People's Bank of China.

Growth for calendar 2014 is forecast to be 7.3%, easing to 7% next year. Soft industrial production data over the third quarter did not translate to any marked slowdown in secondary industries although the contribution of service industries continues to rise as a proportion of total activity.

While there's still some speculation about PBoC stimulus, commentary from the central bank suggests policy makers are not keen. Interventions to date have been narrowly based, in areas such as agriculture and social housing – as authorities guard against a credit expansion to over-leveraged residential and heavy industry assets.

The two major industrial surveys were stable in Sept, with the National Bureau of Statistics PMI unchanged at 51.1 and the HSBC Markit PMI stable at 50.2. Output of electricity was stronger in Sept after a weak Aug all round, as was vehicle production. Construction products were weaker, with cement output falling 2.2% and steel output unchanged.

Eurozone blues

The brinkmanship between the ECB and Germany boils down largely to German irritation with the claims of France and Italy, two of the largest and most sclerotic Eurozone economies, to be treated as

special cases.

Where the PIGS had to shape up, France and Italy are seen as foot-dragging on structural fiscal and economic reforms that would dispose Germany more kindly to propping up the Euro project, notwithstanding its own slowdown.

Business confidence in Germany has fallen six months in a row and the outlook for 2015 is pessimistic. The German chamber of commerce, DHK, is forecasting growth in 2015 of just 0.8%, down from its already modest forecast of 1.3%.

However, there are signs that France will get with the programme, under scrutiny from Brussels over whether its fiscal projections are breaking the Eurozone bloc's fiscal rules.

France had been standing by its promise to reduce its budget deficit to 3% of GDP by next year, the highest it can be under the EU rules. Now it says weak growth projections mean it will more likely report a budget deficit of 4.3% of GDP.

Horse-trading between Paris and Brussels suggests France may be able to reach a compromise position, focused on progress towards reducing its structural deficit target of 0.8% of GDP. Brussels is indicating 0.5% might be acceptable, but not Paris's 0.2% offer. In Italy, which has also received formal warning from Brussels that its plans risk fiscal rule violations, has been more accommodating than Paris.

Australia – a few chinks of light

The stage is set over coming months for the NZ/Aust exchange rate to moderate, with the less inflationary outlook in NZ helping to take the edge off the pain felt by exporters across the Ditch. Meridian Energy's ceo Mark Binns also noted this week that a lower kiwi and improving aluminium prices are improving the outlook for aluminium, making him guardedly optimistic that RioTinto will be inclined to keep running the Tiwai Point smelter for a while longer. Its ability to trigger closure begins from July 1 next year.

The Aust federal gov't's review of the Renewable Energy Target, however, is not looking like good news for Meridian or Trustpower, both of which have substantial wind assets and development options in Aust, but whose profitability is underpinned by the scheme, which is intended to reduce Aust's reliance on coal for electricity production.

The most recent signals from Canberra are negative. ■

Economic indicators

Weaker **log and dairy prices** drove merchandise trade to a wider-than-expected deficit in Sept of \$1.4b, or a deficit of \$919m once lumpy one-time imports such as aircraft from the US were excluded, the highest for that month since 2008. Logs and wood products dropped 31% from a year earlier and dairy fell 12%, led by a 28% decline for whole milk powder. China remained the largest market although exports fell 30% from a year earlier while imports rose, resulting in a **return to a trade deficit with China** compared to a surplus in Sept 2013. Exports to Aust fell 4.9%. More recent pricing of both logs and dairy products suggest improvement in the value of exports, especially given the NZD has fallen about 10% from its July highs above US 88 cents. Agrifax data shows the average wharf gate price for NZ A-grade logs rose 9.9% to \$95.7 a tonne in Oct, while its Agrifax Log Price Indicator, which measures all grades, rose 4%. Prices of dairy products rose 1.4% from a five-year low in the latest GlobalDairyTrade auction, as whole milk powder, the biggest product by volume, gained 3.1% to US\$2,503 a tonne.

Consumer confidence fell to a 12-month low in Oct, although at a reading of 123.4, the ANZ-Roy Morgan consumer confidence index remains above its long-run average of 118.8 and combined with business confidence, which rose from a two-year low following the election, suggests economic growth won't falter in 2015. A net 17% see good times for NZ's economy in the next 12 months and 19% see good times over the next five years – both measures down from Sept's survey.

The net 45,400 migrants that arrived in the year ended Sept 30, was a record for NZ and exceeded the Treasury's estimate. The outflow of kiwis heading across the Tasman continued to abate, with a net loss of 6,000 people to Australia in Sept, down from 25,300 a year earlier. The inflow to NZ was helped by students from India, with total arrivals from the sub-continent soaring 60% to 10,287, edging out China as the third-largest source of migrants behind Australia and the UK.

The Reserve Bank is downplaying the stimulus effect from migration, given it includes returning kiwis and younger people coming on temporary working visas.

Corporate news:

Accident Compensation Corp's annual surplus fell 57% to \$2.14b, exceeding its forecast by \$290m and giving it scope to reduce levies. The decline reflects a 12% increase in claims paid to \$2.96b, while levy income was broadly unchanged at \$4.73b and investment income fell 23% to \$1.56b. The state-

owned accident insurer's investment portfolio returned 6.33%, beating its benchmark while being the lowest since 2009.

Downer EDI sees earnings accretion in its first year of owning **Tenix Holdings Australia**, which designs, builds and operates networks for utilities. Downer is acquiring Tenix for A\$300m, funded through existing bank facilities effective the end of Oct. Tenix had pretax earnings of A\$29.4m on sales of A\$791m in 2014. As well as networks it has design and build capability in mining, petrochemicals and manufacturing, providing potential synergies with Downer's existing infrastructure, mining and rail building operations.

Feltex Carpets' shareholders led by Eric Houghton have appealed a High Court decision that found the directors were not liable for alleged disclosure failings in a 2004 prospectus. Houghton's case to the Court of Appeal is that Justice Robert Dobson erred in his interpretation of the Securities Act and the Fair Trading Act, the definition of a promoter and losses suffered by shareholders.

Building costs are set to rise at the fastest pace since the mid-2000s construction boom, led by demand in Auckland and the continued rebuild of Christchurch, according to NZIER analysis for property consultancy Rider Levett Bucknall. Non-residential construction cost inflation will average 4.3% a year over the next three years, accelerating from a 3.3% rate in the year through June.

Innovation

Xero found a ready appetite in the US for its shares last year when it raised \$180m to sustain its cash burn while chasing sales. The cloud-based accounting firm is eyeing a return to the American market, potentially with a share sale prior to a Nasdaq listing. A sale reportedly may target A\$500m to A\$1b, potentially bolstering its equity capital by a third. Xero, whose market capitalisation is currently about \$2.1b, is chasing a share of the estimated 29m small to medium sized US business owners expected to migrate to the cloud for services such as accounting.

Agriculture

Seeka Kiwifruit Industries has heralded its recovery from the Psa-V vine disease, saying it expects profit of \$2.6m to \$3m for calendar 2014, as much as 11% up on last year. The country's biggest kiwifruit grower is planning to expand its coolstore and packhouse capacity in anticipation of rising fruit volumes, notably of Psa-V resistant variety G3 fruit.

ECONOMY AT A GLANCE

New Zealand economy

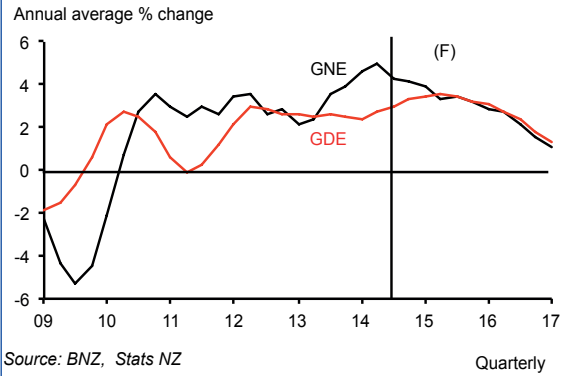
(% change on previous year)
Calendar year except where indicated)

	2013A	2014F	2015F	2016F	2017F
GDP components					
Consumption	2.8	2.9	2.7	1.4	0.9
Investment	9.7	8.2	6.6	2.3	0.7
Stocks (contribution to growth)	-0.1	0.6	-0.5	-0.1	0.0
GNE	4.0	4.2	3.2	1.5	0.8
Exports	1.3	3.2	2.9	4.0	3.8
Imports	6.3	6.0	3.0	2.9	2.7
Activity					
Real GDP (production)	2.8	3.8	3.4	1.8	1.1
Output Gap	0.4	1.3	1.7	0.3	-0.3
Labour productivity growth	0.6	0.1	0.2	0.1	0.2
Employment growth (annual % change)	3.0	3.1	2.7	1.3	0.8
Unemployment rate (S.A. % as at Dec Q)	6.0	5.4	5.4	5.9	6.2
Inflation (% increase from Dec Q previous year)					
Consumer prices	1.6	1.0	1.9	2.5	2.0
Average hourly earnings	3.2	3.3	3.9	3.2	2.7
Terms of trade	20.2	-9.7	3.2	3.6	1.1
Financial sector					
Operating balance (OBEGAL)					
(as % of GDP – June Year)	-2.1	-1.1	0.1	0.3	0.7
Net debt (as % of GDP – June)	26.2	25.9	26.8	26.7	25.8
90 day bank bill (%) (1)	2.7	3.7	4.5	4.8	4.4
5 yr NZGS yield (%) (1)	4.2	3.9	4.7	4.6	4.2
10 yr NZGS yield (%) (1)	4.8	4.3	5.2	5.1	4.6
External sector					
\$NZ/\$US(1)	0.823	0.784	0.730	0.680	0.667
\$NZ/\$A(1)	0.915	0.891	0.890	0.850	0.898
\$NZ/Y(1)	85.1	84.7	85.4	81.6	76.8
TWI(1)	77.5	76.3	74.4	70.0	68.3
Trade balance \$(m)	1207	984	-2404	281	2520
Current account \$(m)	-7350	-8716	-12624	-10353	-8435
(as % of GDP)	-3.3	-3.7	-5.2	-4.1	-3.2

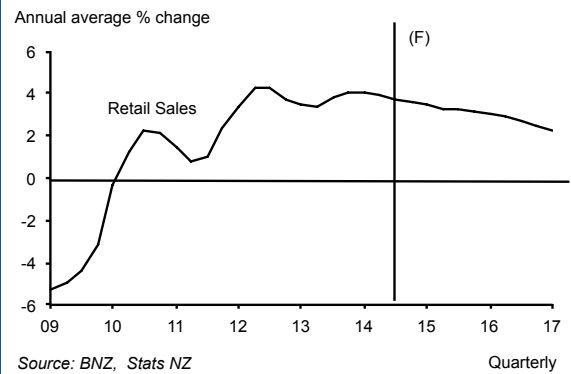
(1) Average for month of December

(2) Using current prices

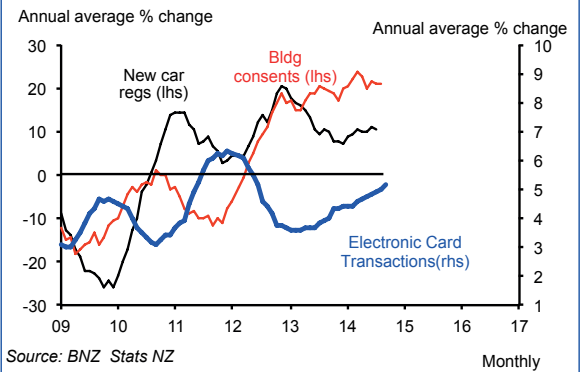
Economic growth



Retail sales



Partial indicators

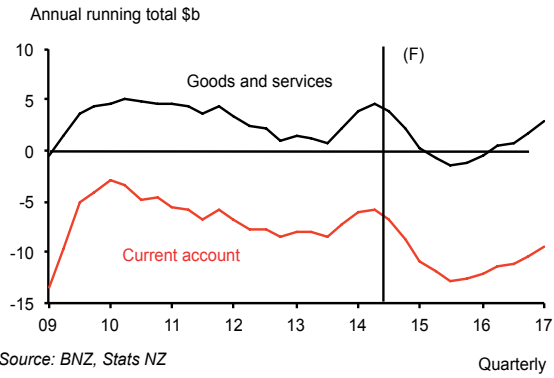


The labour market

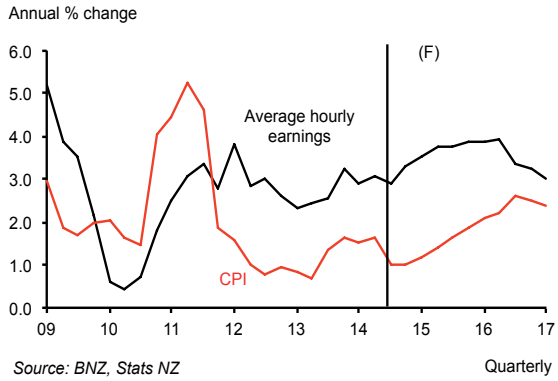


ECONOMY AT A GLANCE

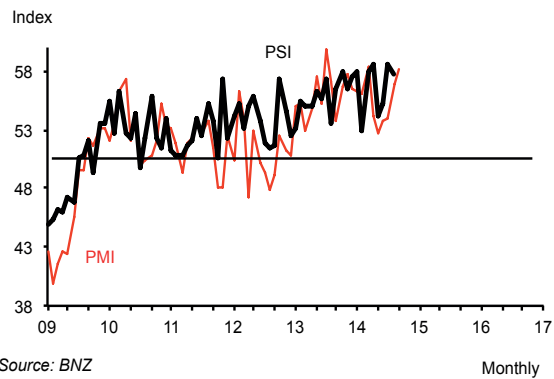
Balance of payments



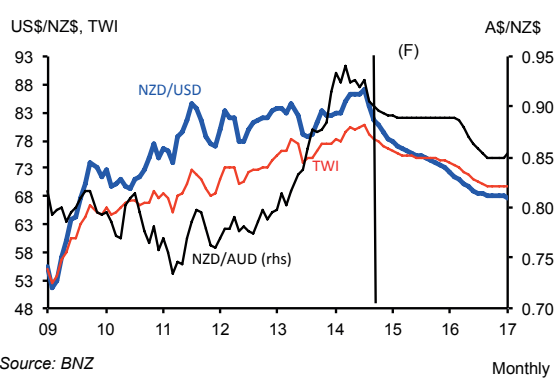
Inflation



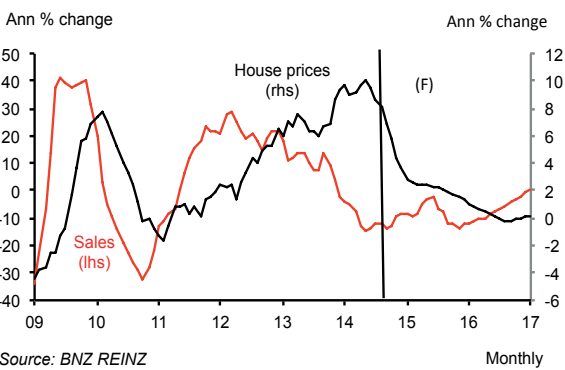
PSI and PMI



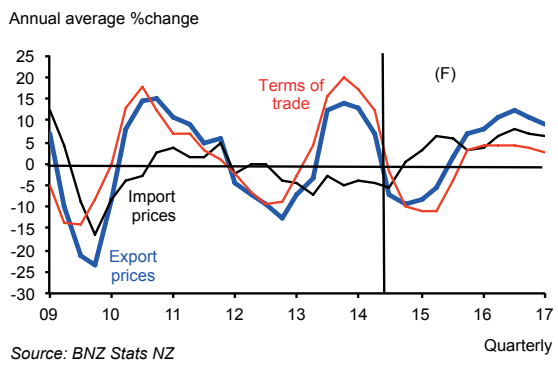
Exchange rates



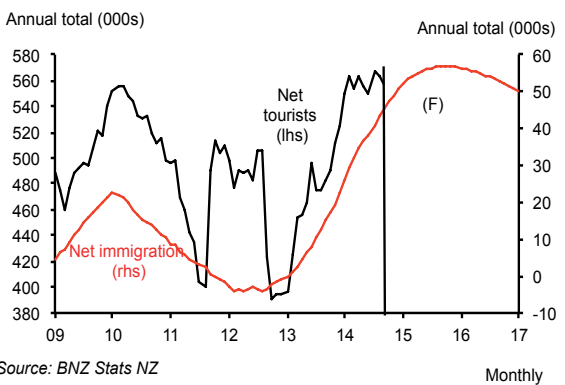
Housing market (three month average)



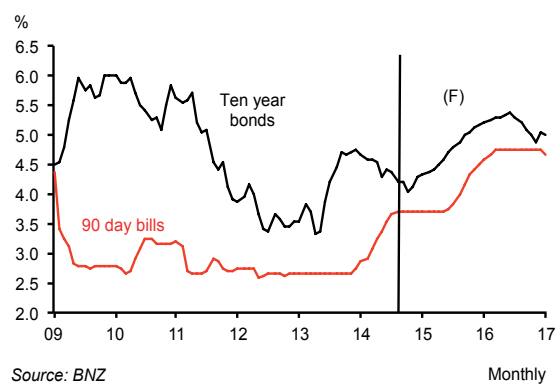
Terms of trade



Net migration flows



Interest rates



ECONOMIC ROUND-UP

Continued from p9

M&A activity

Nuplex Industries, the specialty chemicals maker, has agreed to sell its Nuplex Masterbatch plastic additives business and Nuplex Specialities distribution business units to a company backed by **Champ Private Equity** for A\$127.5m. The sale will make Nuplex a pure play global resins business and has been welcomed by shareholders. Funds will be used to repay debt and possibly for a capital return. Sam Bastounas, chief operating officer of the specialties unit has been named ceo of Axieo, which will own the assets. Nuplex, in turn, named Holcim Australia's Clive Cuthell as chief financial officer, replacing Ian Davis, who retires after five years with the company.

Cavalier Wool Holdings and New Zealand Wool Services International (WSI) will merge their two wool scouring operations, with the new business to be 45% owned by WSI and 55% by Cavalier Corp, Direct Capital and Accident Compensation Corp.

Media + Entertainment

Sky Network Television plans to push back against rival content providers including Coliseum, Spark, Netflix, Quickflix and Ezyflix by offering a \$20/month video on-demand service, Neon, in Dec. Chief executive John Fellet said uptake of the new service would depend how hard Vodafone pushed bundled services to customers and Sky was currently finalizing two other content deals.

Regulation

As anticipated, the Commerce Commission has confirmed it will cut the **WACC allowable for gas and electricity networks** to the 67th percentile from the current setting, at the 75th percentile. The commission believes this will save consumers \$45m a year, with electricity networks subject to the change next April and gas networks from 2017. Vector, which led the protracted merits review that sought to overturn the commission's approach, said the new regime will reduce incentives to invest in security of supply, and has warned this could lead to greater likelihood of unplanned outages.

Electricity retailers also face new **intervention from the Electricity Authority**, which is proceeding with

a regime to limit the use of so-called "save" calls by retailers seeking to prevent a customer switch by offering retention inducements. The measure is favoured by small retail market entrants, whose customer acquisition budgets are stretched when "big five" generator-retailers can easily induce valuable customers not to finish a switch. The major retailers are not happy. Retailers will have to opt in to the scheme to be protected. "Winback" calls, made after a switch is complete, will still be allowed.

Meanwhile, Local Govt Minister Paula Bennett is conducting a hardy perennial exercise in populist red-tape cutting with a **Rules Reduction Task Force**. She's seeking public input on "what bugs them when it comes to loony rules and regulations", with an emphasis on property and local govt rules. Michael Barnett, head of the Auckland Chamber of Commerce, is the only private sector appointee so far. It has no announced timetable as yet.

Banking sector

Bank of New Zealand reported an increase in both business and household lending in the year to Sept. 30, generating a 3.1% rise in net interest income to \$1.51 billion. It noted "steady growth" in business lending and "a solid pick-up" in home lending. The local unit of National Australia Bank was able to limit to 2 basis points a contraction in its net interest margin to 2.24 percent by sourcing cheaper funding. The interest margin squeeze reflected a trend toward fixed-rate mortgages in the wake of the Reserve Bank's interest rate hikes and competition in the home-lending market. Impairments declined for bad and doubtful debts to \$87m from \$99m. Gross loans rose to \$63b from \$60.6b, while customer deposits climbed to \$42.6b from \$38.5b. ANZ New Zealand, which is facing industrial action from workers over its plan to introduce new, flexible contracts, was also due to report.

Construction

Fletcher Building ceo Mark Adamson is shaking up his senior team, with Building Products division ceo Tim Richards and infrastructure products division ceo Mark Malpass both departing. A global search is on for two new, larger business divisions - light and heavy building products. The company is particularly concerned to lift Aust performance. ■