HUGOvision

Assessing the economic and political environment in New Zealand

October 1 2014 | **Confidential to HUGO members**

Forecasts at a glance

	INFLATION ann % change	GROWTH ann avg % change	$ v $US spot rate	$ v $A spot rate	WORLD GROWTH annual avg % change	TRADING PARTNERS annual avg % change
December 2015	2.1%	3.4%	73.0c	89.0c	3.2%	4.2%
December 2016	2.9%	1.8%	67.0c	87.0c	3.3%	4.3%
December 2017	2.2%	1.1%	65.0c	89.2c	3.1%	4.1%

Text finalised October 1

National's ministerial lineup next week. Bennett to rise

The main cabinet news so far is that Paula Bennett is headed for a portfolio in the "finance" area.

What Bennett could be given that would give her more seniority is unclear. The two senior posts in that area are finance (Bill English) and Steven Joyce (economic development). But John Key did say it might not be straightaway.

Is Bennett up to a top post? She is not the sharpest tool in the shed but neither is she the bluntest. She is highly thought of in the party and occasionally joins the inner five strategy group (Key, English, Joyce, Gerry Brownlee and Murray McCully). She has eclipsed Amy Adams, who had real promise but is too inflexible. Hekia Parata's troubles with media presentation, the unions and staff make her less saleable than Bennett. Nikki Kaye needs to self-promote less but could make it to a high-ish ranking by the end of the term.

If Bennett is going into a "finance" portfolio, that takes her out of health, where hospital finances and staffing are going to require intensive care over the next year. Key said health and education were big portfolios requiring attention. Jonathan Coleman has been talked of for health but is he up to it? How does Key placate the iwi leaders if Parata is moved?

Peter Dunne is a minister again, with 0.22% of the party vote. His portfolios are internal affairs, associate health and associate conservation. Concessions are limited: an "enhanced role for pharmacists in patient medicines management and primary care", which is likely to expand scope for the "self-medication" industry (which Tony Ryall was backing); improving freshwater quality (on which the government is taking some steps); more opportunities for recreational fishers, "as acknowledged in National's recently announced recreational fishing reserves policy"; and re-affirming public private partnerships for major roads. There is no mention of income tax splitting for couples and a flexible superannuation qualifying age.

David Seymour will be parliamentary undersecretary to the ministers of education (ACT wants to push "partnership" schools) and regulatory reform. National blocked ACT's bid in 2009 for a tightly constraining Regulatory Responsibility Bill but English has signalled he backs action along the lines of the Productivity Commission's July report. ACT wants radical Resource Management Act surgery but National will not go beyond its current bill (if that far).

There had been no announcement at press time of what role **Te Ururoa Flavell** will play. Top of his list will be the bedding in of Whanau Ora. That alone requires Flavell, a Labour-ish man, to stick with Key, in memory of Tariana Turia.

Child poverty

John Key has given high priority to attending to "child poverty". Bill English told public service chief executives straight after the election the government would apply the "investment" approach.

That involves assessing the return on investing to get children a good start. That return comes in them getting educated, being work-ready, earning an income and bringing up their kids well instead of failing at school, going off the rails as teenagers, going on a benefit and maybe ending up in very costly accommodation in prison. How extensively English will intervene is unclear.

It looks like Robertson-Ardern for Labour. But much to do

Labour's caucus has made it clear to David Cunliffe that he is not its choice. Reappointing David Shearer's chief whip, Chris Hipkins, whom Cunliffe dumped from that role, was a strong signal.

Grant Robertson has been very vocal. He has slimmed down since he lost last time and has sharpened his delivery. He said on radio Labour has to be "part of the communities we live in", which is in effect a searing criticism of the state of a party which is now essentially a coalition of the left-left and minorities' representatives.

He is likely to win the leadership election Cunliffe has triggered by resigning. He has the caucus, which is 40% of the vote. One key will be where the Engineering, Printing and Manufacturing Union goes. Unions account for 20% of the vote, each union's proportion of that vote depending its membership. There is likely to have been a shift in the party membership vote, which is worth 40%.

Jacinda Ardern, 33, is his choice of deputy. Robertson is 43 this month. They represent generational change.

The party council has commissioned a review, due to report on December 7. But the Robertson camp believes a far more searching review will be needed, going back to first principles and applying them to 2010s realities. While some of the policies in 2011 and 2014 were forward-focused there was also a fair bit of reaching back to 1950s-70s "mixed-economy" themes.

To be "part of the communities we live in" Labour will have to drastically widen its catchment – including to mortgage belts where National is dominant and where voters don't identify with minorities or with the least well off.

No rush on NZ's 2030 climate change target

The NZ election campaign meant there was negligible local media focus on the Sept 21 global day of action on climate change, which was a big deal in much of the rest of the world. Unremarked also was the fact NZ did not table targets for greenhouse gas emission cuts through to 2030 at a UN summit two days later.

The day of action was marked also by China publishing figures showing it is now the largest contributor to GHG emissions in the world, overtaking the US and Europe combined.

NZ has published a target for 2020 emissions cuts to 5% below 1990 levels by 2020, an offer derided by environmentalist critics as miserly and which can be expected to rise going into the 2015 global climate change summit in Paris late next year. Whether an increase, probably to a 10% cut below 1990 levels, is achievable by 2020 is another matter, given GHG emissions are now some 25% above 1990. Clearly, much rests on carbon sequestration in plantation forests, where replanting stopped once foresters lost assumed advantages from the ETS.

The climate summit was as notable for statements of intent by corporations as by governments. Fortune.com noted 1,000 companies were joining 73 countries and 11 regions to argue for a carbon price – either through a tax or through a cap and trade system.

Greens climate change spokesman and former diplomat Kennedy Graham called on Foreign Minister Murray McCully to table a target in New York, where McCully was lobbying for a UN Security Council seat, supported by former and wanna-be Labour leader David Shearer.

However, NZ will not offer a 2030 target until some time next year, says Climate Change Minister Tim Groser's office.

Election shields NZ from Iraq defence discussion

The election focus also drew media focus away from any question of NZ defence force involvement in the war developing in the Middle East. Either that, or the absence of an RNZAF strike capability rules NZ out of any discussions at this stage since the US-led strategy to date is led by air strikes.

However, training for local ground forces is in the mix, if not full-scale fighting troop commitments, the so-called "boots on the ground".

NZ sat out of the second Gulf War in Iraq, which was US-led, while contributing to the UN-led mission in Afghanistan.

Pressure from Aust could be strong this time. Australians are confronting an uncomfortable reality that they have a jihadist problem of considerable size. NZ is so far relatively unaffected, with few reports of NZ citizens either joining or seeking to join Islamic State to fight in Syria or the new "caliphate" area, which includes parts of Iraq.

The backdrop of escalating action on IS is likely to have reminded NZ voters that intelligence agencies are capable of spying for good reasons.

Multi-national tax practices face curbs

International tax reform normally takes years, but close observers of the OECD process to hamper cross-border tax regime arbitraging by multi-national companies say it is cracking along, with the issue firmly on G20 finance ministers' lips when they met in Sydney over NZ's election weekend.

In a bit over a year, the OECD's Base Erosion and Profit Shifting project has produced a series of initiatives that could shift the balance of information quickly in tax authorities' favour.

In particular, "country by country" reporting will be required by multi-national companies to tax administrations on their worldwide allocation of profits.

The OECD describes the problem as "unintended double non-taxation" caused by BEPS, as typified by the use of convertible notes by numerous large Aust corporates caught in the IRD's court challenges to hybrid securities that channeled tax liabilities back to the Aust tax system.

"Actions will be taken to neutralise hybrid mismatches and arbitrage, reinforce domestic legislation to protect the tax base of countries against shifting of profits to tax havens (through strengthening the so called "CFC" rules – Controlled Foreign Companies) and limit interest deductibility," the OECD says in a newly published BEPS work plan.

The Action Plan is focused on practical problems. On hybrid mismatches, it will pursue a new model tax and treaty provision, while elsewhere seeking to realign "tax relevant substance" to prevent tax treaty abuses; align transfer pricing with value creation, especially in the pricing of intangibles; and improve transfer pricing documentation and a template for country-by-country reporting.

Significant also is research into a multi-lateral instrument that would extend bilateral tax treaties and to counter "harmful tax practices", potentially requiring greater disclosure of govt subsidies and assistance through the tax system.

A BEPS Action Plan is scheduled for presentation G20 govts for final approval in 2015.

Meanwhile, yet another Aust firm has quietly disclosed a deal with the IRD over its use of mandatory convertible notes. Vitaco Healthcare, owned by Hirepool investor Next Capital, an Aust private equity firm, has foregone some $30m of tax losses, according to its latest filings with the Companies Office. Hirepool disclosed a similar settlement in the prospectus published before it pulled out of an NZX IPO earlier this year.

RMA reform – full steam ahead?

It would be tempting to assume National will now push through its fundamental reforms to the RMA, using its newly minted mandate. However, Environmental Defence Society head Gary Taylor believes John Key will honour his pre-election pledge to environmental peak bodies to seek a "less confrontational" approach to the issues.

The bill has yet to be introduced to Parliament and EDS and others are arguing the proposed collapsing of sections 6 and 7 into a single clause with more weight for economic as well as environmental considerations is unnecessary. Instead, they argue the RMA already allows such direction to occur through National Policy Statements and National Environmental Frameworks.

The attraction of that approach, they suggest, is that it would prevent the inevitable legal challenges that a revamped Section 6 would create. Much hinges on where the environment portfolio goes. If to Nick Smith, then the likelihood of compromise is stronger. If not, then there's a greater likelihood of full steam ahead on the legislation that stalled in the last Parliament, most of which deals with improving procedures and timeframes and has multi-party support.

Refinery strike threat raises essential industry question

The transport fuels industry is musing aloud about whether the govt should revisit the strike notice rules relating to essential infrastructure. That's after securing at short notice a 50m litre shipment of jet fuel that was almost immediately not required after a strike notice at the refinery was lifted.

Two trade unions gave a fortnight's notice of a two day strike on Oct 7 and 8, requiring a shutdown that would have taken the refinery out of action for around 11 days, if not more, while it was ramped down and brought back into production.

The unexpected escalation of industrial action prompted the scramble for a shipment of jet fuel, which was sourced from Korea and was on the water just ahead of the withdrawal of the strike notice. Disposing of the approximately US$60m cargo swiftly – it would overload NZ's limited storage facilities with the refinery in operation – will come at a cost.

However, ministers are not keen to intervene, having been kept in the loop about the looming stoush for some months and believing it was well in hand. Especially unattractive would be any push to include a longer notice period in the **Employment Relations Amendment Bill**, which looks ready to pass before Christmas. Adding a clause on essential infrastructure strike notice timings would only enlarge the bill as a target and holds no political appeal.

Freshwater in focus for infrastructure plan

One of the upsides of a re-elected National govt is continuity in complex, multi-year public policy formulation. One impending beneficiary is national infrastructure planning, where there's growing concern about how well NZ is placed to fund some $11b of capex requirements on freshwater infrastructure that looms in the next two decades.

The Treasury's national infrastructure unit has been operating since 2009, working through a strategic process that will develop a NZ National Infrastructure Plan next year.

In a presentation to the recent Water NZ conference, labelled throughout as "not govt policy", a senior analyst from the unit, Richard Ward, outlined at a high level the plan and its overall vision that "by 2030, NZ's infrastructure is resilient, coordinated, and contributes economic growth and increased quality of life". Better use of existing kit and better allocation of investment funding are two key outcomes sought, with some $16b of infrastructure projects currently on the govt's books, ranging through roading, rail, public transport, irrigation and ultra-fast broadband.

Work under way now is leading up to a public symposium next March, ahead of the planned publication of a detailed action plan, timed for August 2015, with freshwater policy to the fore as the costs associated with its provision rise in response to demand, environmental standards and the challenge of funding freshwater infrastructure in areas with ageing populations. In 84% of local authority areas, all population growth between 2011 and 2031 is projected to be 65+ years. All areas expect a decline in the proportion under 64 year-olds.

Jawboning's easier when the Fed's on your side?

Put together a former currency trader and a Washington insider who might once have run the World Bank and what do you get? Prime Minister John Key and RBNZ governor Graeme Wheeler.

The two of them have achieved quite a pas de deux in the past week, jawboning down the kiwi dollar, which has now fallen more than 11 US cents from its near post-float high of 88.35 US cents in early July, when Wheeler first used the "unjustified" and "unsustainable" language he's pulled now three times.

Key's intervention on Monday, at a press conference on "coalition" negotiations with Act, was intriguing. He nominated a "Goldilocks" level – not too high, not too low – of perhaps 65 US cents for the kiwi, another 12 US cents lower than current levels.

Give NZ that and there would be an export take-off and almost no doubt the RBNZ would find some inflation at last. Key has 2017 in mind and current forecasts of a slowdown, partly fuelled by lower returns from agricultural commodities. TWI assumptions are far higher than his nominated, no doubt cheeky, level. Wheeler is saying he's willing to wear a much lower dollar and some inflation because that's what NZ should be producing now and the only reason it's not is the over-valued dollar. It would help him get to the "new normal" OCR level, which has already slid from 5% in a couple of years to 4.5%.

However, timing is everything, and the wily Wheeler has played into a surge for the greenback, which created something of a bet for the central bank, which punted a conservative and carefully timed $521m on intervention activity in August.

Local banks may even have been dealt in, having complained they have missed the action in some previous interventions.

Fonterra's growth strategy

Fonterra sees the price of whole milk powder returning to its long-run average by March next year, climbing to US$3,500 a metric tonne by then from US$2,692 a tonne at the last GlobalDairyTrade auction. It is making the assumption that prices recover some 30 percent in cutting its forecast milk payout for the 2014/2015 year. For that to happen, China will have stopped running down inventory levels, production will have eased in the Northern Hemisphere and Russia will have lifted a ban on imports. Fonterra had a boom year for sales in the 12 months ended July 31, with revenue rising almost 20% to $22.3b. But sales were less profitable in the face of "constrained margins" in its food service, consumer businesses and non-milk powder products and earnings tumbled 76%. Chief executive Theo Spierings is embarked on a bold strategy, committing about $1.2b to build more drier capacity in NZ and selling assets into a joint venture with Beingmate to market infant formula in China. The plans will weaken Fonterra's balance sheet and have already taken one notch off its credit rating to 'A' with Standard & Poor's. The driers are urgently needed to produce more milk powder as existing plant ran at full capacity last season and excess milk had to be sent into the less profitable cheese stream. A recovery in milk powder is far from certain, given the volatility in world markets and there's a chance it will again revise the milk payout forecast at its annual meeting in November. Meantime, Fonterra has unveiled a community-building exercise for its farmers. Its new Farm Source hubs will include its rebranded RD1 farm supply stores with a loyalty programme, discounted fuel, software and drop-in centres, and support services including, potentially a fund that would make outside investors money available to farmers.

Weldon's difficult job

Mark Weldon is back at work five days a week in Auckland at Mediaworks, where he's charged not only with understanding a media business – and he was never a big fan of the media – and formulating an exit strategy.

While the investors who bailed out Mediaworks do not have seats on the board, they reportedly join board meetings by teleconference, creating an unorthodox governance environment.

A bit like APN News & Media, which rebranded its NZ assets NZME a couple of weeks ago, Mediaworks' most profitable assets are its commercial radio holdings, rather than its free-to-air TV assets, whose future is arguably as complicated as NZME's print assets, which include the NZ Herald.

Mediaworks' radio assets include Radio Live, while NZME's The Radio Network, includes the powerful NewstalkZB property. They are arguably the only parts of the business that make commercial sense at present. Speculation persists that a tie-up betweenMediaworks and Fairfax NZ could be explored.

Feltex case a lesson for all involved

A who's who of senior NZ corporate governance figures have emerged, a decade older and wiser, unscathed, bar substantial legal costs, from the efforts of "mum and dad" shareholders to pin them for deficient disclosure in the prospectus for the disastrous 2004 IPO of the Feltex carpet company.

At its heart, the High Court case turned on whether the directors had discharged their due diligence and other duties to shareholders adequately, given the company was in liquidation just two years after its NZX listing.

Star witnesses including Cameron Partners principal Rob Cameron argued on directors' behalf and exposed in barely reported proceedings that shareholders' evidence suggested over-reliance on broker advice.

That was consistent with Justice Robert Dobson's finding shareholders had failed to demonstrate materially misleading statements or omissions in the prospectus.

Appeals are anticipated and Dobson J has tried to deal with numerous ancillary matters in anticipation of various possible challenges.

NXT gets the go-ahead

The FMA approved the framework for the NZX's new high-growth "momentum" market, the NXT, this week. That should be a positive development, but executives with an interest in public markets should keep a weather eye on the current listings surge and the creation of new kinds of equity opportunities. There has often been a mismatch between the political rhetoric of tougher enforcement that surrounded the Financial Markets Conduct Act and the fact the new regime is, in many respects, more permissive than the Securities Act, which it replaces. Lesser standards of disclosure are accompanied by stringent requirements to declare added risk, but will unsophisticated investors really understand the distinction?

The crowd-funding platform Snowball Effect has presided over a $700k capital-raising for Renaissance, a Blenheim craft brewery that kept retained profits on its balance sheet to make the investment "more attractive" rather than pay existing shareholders dividends and more latterly has hosted a $500k capital-raising for a new Lee Tamahori movie, backed by NZ Film Commission and other govt subsidy money, offering 20% annual returns for "preferred" crowd-fund shareholders. Returns don't assume profit, but are predicated on the film making sufficient sales to cover its costs.

Such hybrid investment types risk disappointment, albeit on small average outlays per investor.

NXT's launch depends on one or two companies being willing to take to the new market. The NZX hopes that will happen before Christmas, although recently appetite in equities has veered more towards proven earnings than the "growth stories" of so-called momentum stocks. NXT is particularly suited to high growth, unprofitable companies seeking capital for the scale to be profitable, often beyond NZ's shores. Some, but not all, are likely to succeed.

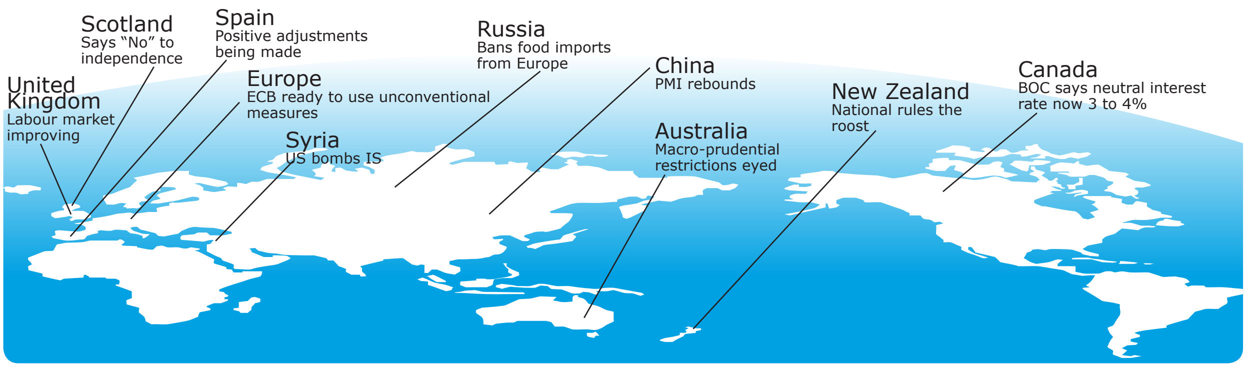
Unless NZ's culture regarding corporate failure changes, equity raisers should anticipate the need for repair work with investors if and when some high profile momentum stocks fail to deliver.

Business confidence weakens

This week's ANZ Bank Business Outlook survey show a significant step down in September, although that may have been affected by pre-election jitters.

Whereas a net 24.4% were optimistc about the year ahead when surveyed in August, that proportion dropped to a net 13.4% in the September survey.

The world at a glance



Outlook weak, G20 finance ministers agree

The evidence from the G20 finance ministers meeting in Sydney is that the world economy remains fragile and not recovering as quickly as forecast, with growing concern quantitative easing may be producing diminishing returns just as the ECB and BoJ are starting to print more money.

Evidence from China suggests a much weaker outlook there than is so far officially disclosed. Andrew Hunt, a consultant global economist in NZ last month for Tyndall Investments, thinks 4-5% is more likely from China this year, although Beijing will print close to forecast, of 7.5%.

The OECD is forecasting "prolonged stagnation" in the Eurozone "if further steps are not taken to boost demand" and supports ECB QE.

Under the continuing influence of monetary stimulation, Japan is projected to grow by 0.9% in 2014 and 1.1% in 2015.

The euro area is projected to grow at a 0.8% in 2014 and 1.1% in 2015, with widely differing growth prospects among the major euro economies, with France and Italy particularly weak.

Aust competition law review

NZ policymakers will be watching closely to see how Canberra responds to the Harper Review of competition law.

At its simplest, the review recommends a change to how the central test of anti-competitive behaviour is formulated. While it says the threshold test of "substantial degree of market power" is well understood, the test for "taking advantage of market power" has been harder to interpret. It recommends targeting anti-competitive conduct "that has the purpose, effect or likely effect of substantially lessening competition".

The review also calls for the creation of a new body to advocate for competition policy reform and oversee its implementation. A National Competition Council could perform this role. The existing competition watchdog, the ACCC, would remain in place, although a new access and pricing regulator should be created, and external governance should be added for the ACCC to broaden perspectives.

Numerous recommendations intended to streamline and lower the costs of processes including mergers and acquisitions are also included in the draft review, which contains a total of 52 recommendations.

RBA ponders macro-prudential tools

Concerns about an "unbalanced" housing market are causing the Reserve Bank of Australia to consider using macro-prudential tools to cool a pick-up in residential investment.

The problem is not owner-occupiers but property investors, meaning the RBA is less likely to follow the RBNZ's lead in using LVR's, but will instead focus on more stringent stress tests for borrowers and potentially increasing capital buffer requirements among trading banks.

Trading partner growth

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

Trading partners		GDP Growth (ann avg %)					CPI Inflation (ann avg %)				
	Weights %	2013	2014	2015	2016	2017	2013	2014	2015	2016	2017
China	27.6	7.7	7.4	7.1	7.1	7.3	2.6	2.4	2.8	3.1	2.7
Australia	21.3	2.3	3.0	2.9	3.2	2.9	2.4	2.7	2.6	2.8	2.6
United States	10.1	2.2	2.1	3.1	3.0	2.6	1.5	1.9	2.0	2.2	1.9
Japan	6.9	1.5	1.2	1.3	1.1	1.3	0.4	2.8	1.8	1.8	1.7
Eurozone	7.2	-0.4	0.9	1.4	1.6	0.9	1.3	0.6	1.1	1.0	1.0
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	3.6	3.7	3.7	3.5	1.3	1.7	2.3	2.6	2.0
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	2.4	3.0	3.6	3.0	4.3	3.8	3.5	3.3	3.7
Taiwan	2.4	2.1	3.5	3.6	3.6	3.2	0.8	1.4	1.8	1.7	1.4
Singapore	2.6	3.9	3.3	3.8	4.1	3.8	2.4	1.6	2.2	2.3	2.1
Malaysia	2.3	4.7	5.6	5.1	5.3	5.2	2.1	3.2	3.6	3.1	3.0
Philippines	2.0	7.2	6.3	6.3	6.0	6.5	2.9	4.4	3.9	4.1	3.8
Thailand	1.9	2.9	1.2	4.4	4.5	3.3	2.2	2.3	2.6	3.0	2.5
India	1.5	4.7	5.5	6.2	6.4	5.7	9.5	8.1	7.1	6.8	7.9
Vietnam	1.3	5.4	5.5	5.8	6.0	5.7	6.6	5.5	6.5	7.0	6.4
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	2.5	2.6	2.8	2.6
Forecasts for New Zealand											
Consensus		2.9	3.5	3.0	2.6	3.0	1.1	1.5	2.1	2.4	1.8
BNZ Forecasts		2.9	3.7	3.3	1.8	1.1	1.1	1.4	2.0	2.8	2.8
The World		2.6	2.7	3.2	3.3	3.1	2.8	3.2	3.2	3.4	3.1

INTERNATIONAL ECONOMY

End of QE3 in sight in US

Next month will likely see the full unwinding of the US Federal Reserve's so-called QE3 policy, which began in September 2012 with a US$40b per month bond-buying programme that rose to US$85b a month in December that year.

Since June last year, that programme has been tapering, to the point where there's only US$15b a month in the programme, which has been dropping at the rate of US$10b a month.

The policy is either credited with assisting the US economy back to life after the GFC or with creating a boom time for corporate bond issuers that has taken focus off investment in the real economy.

However, the Fed's latest Open Market Committee report still sees "considerable time" elapsing between the end of QE purchases and starting to raise benchmark interest rates.

Rate hikes are widely expected not to occur before June 2015, although there's been a trend among FOMC members shifting their expectations from 2016 to next year.

The median FOMC voting member forecast for the Fed funds rate at the end of 2015 rose from 1.13% in June to 1.375%, while the 2016 median forecast rose from 2.5% to 2.875%.

The first read on 2017 Fed fund forecasts was estimated at 3.75%, which is well above the market's pricing of around 2.95%. That's consistent with research suggesting the Fed and the US public are out of step on the interest rate track, with the Fed seeing a steeper rate track.

In its economic projections the Fed lowered the 2014 GDP growth forecast mid-point by one tenth to 2.1% and the 2015 forecast by three tenths to 2.8%. The unemployment rate forecast for 2014 was inched down to a range of 5.9% to 6%.

European imbalances persist

Weak GDP data for the second quarter in the Eurozone shows recovery has yet to take hold and that such growth as there is remains uneven.

While previous basket-cases Spain and Ireland look a little healthier, France, Italy and Germany all maintain weak outlooks, while Germany shows little appetite for stimulating activity across the zone.

That means it continues to run large balance of payments surpluses while perpetuating low growth in peripheral states, where social and economic cohesion remain under threat.

The likelihood of protracted tension between Russia and Ukraine isn't helping either.

Countries outside the Eurozone are expected to fare better, with growth forecasts for the UK running at around 3% this year and next. That compares with growth forecasts closer to 1% in the Eurozone in both years.

Large-scale wind and solar challenge gas in US

Large-scale wind farms and solar electricity generation installations are beginning to be as price-competitive as US gas-fired power stations, notwithstanding the country's gas glut.

While rooftop solar installations are still miles out of the money, recent research by investment house Lazard suggests solar at scale can produce electricity for around $US72 per Megawatt hour.

That compares with gas-fired baseload generation in the mid US$70's per MWh and blows away peaker plant at around US$200 per MWh.

That's attractive in parts of the US where high summer temperatures produce peak consumption for air-conditioning.

Wind in the US is also competitive at around US$37 per MWh in high quality wind settings.

Rooftop solar continues to produce electricity at higher costs, around US$180 per MWh.

Seabed mining

Chatham Rock Phosphate has begun its hearing before a decision-making committee of the Environmental Protection Authority to mine phosphate nodules from the seabed on the Chatham Rise. Its marine consent is the only live application for seabed mining, with the only hope for TransTasman Resources' ironsands project now in an appeal to the High Court now set for March 2015. Chatham Rock's managing director Chris Castle dusted off decades-old geological survey data to support his proposal to secure locally sourced fertiliser, attracting a partner with the expertise to hoover up the thin layer of seabed that contains the nodules and enough capital via the NZX to push the project forward. He now has to convince an EPA decision-making committee, chaired by former diplomat Neil Walter, that the environmental impact will be limited, there will be minimal effect on fishing grounds and that the project doesn't tread on Maori sensitivities. Ngai Tahu, the Environmental Defence Society and the fishing industry are among groups appearing at the hearing to oppose the consent. The EPA's preliminary staff report in August said there were too many uncertainties. But the Crown itself is neutral – the project would fit with the govt's growth agenda provided fisheries can be safeguarded.

Meanwhile, TTR has been instructed by Justice Denis Clifford to produce a more focused statement of claim for its appeal.

Honey products

Comvita's acquisition of **New Zealand Honey**, bringing its share of local honey production to about 45%, is starting to bear fruit, with full-year net profit guidance of between $9m and $10m, from $7.6m a year earlier. The profit growth is all in its second half, given the seasonal nature of honey and costs associated with the acquisition, which will result in a first-half loss. In July, Comvita lifted the cash component of its $12.3m purchase price to $10.3m from $7.3m to win over the owners, the New Zealand Honey Producers Cooperative and secure the Hollands Honey, 3 Bees and Sweet Meadow brands. It is in talks with iwi landowners in the North Island to further boost its honey supply.

Mainzeal liquidation

BDO, the liquidators for the **Mainzeal** group of companies, are now in receipt of $151.3m in claims from unsecured creditors of the group, which failed leaving a string of unfinished construction projects. Their administration has been slowed by the efforts of the construction group's principal, Richard Yan, who was successful in having the Court of Appeal exclude some businesses from the liquidation pending resolution of disputed debts. The liquidators must now complete their investigations into the group's affairs, pursuing the recovery of related party debts. Any payment to unsecured creditors is likely to depend on those recoveries.

Fund managers

Milford Asset Management is upbeat enough about the outlook to have established a Sydney office, at this stage to put it closer to investments across the Tasman rather than to begin marketing Aust products. Funds under management rose by 55% to $3.1 billion in 2014, of which about $700m is invested in Aust companies. The firm's retail funds issuing unit, Milford Funds, posted a 79% increase in fee revenue in the latest year, made up of fund inflows and performance fees. Milford Funds had a net profit of $10.5m, after paying a management services fee to its parent that more than doubled to $15.2m. Fisher Funds Management, another high-profile firm, reported fee income that more than tripled to $62.5m in the March year, for a five-fold increase in profit to $15.8m.

Energy company shares

Electricity company shares have risen since the National Party's convincing election victory on Sept 20 wiped out any regulatory fears for the power companies. **Meridian Energy, MightyRiverPower, Genesis Energy, Contact Energy, TrustPower** and **Infratil** all gained in a relief rally that the Greens and Labour polled poorly and won't be in a position to demand a centralised buying agency for electricity, as they had threatened. National was broadly expected to return to power, and the NZX Energy Index rose almost 7% in the 30 days prior to the vote but investors were surprised it garnered enough votes to govern alone.

Beef prices soar

Drought-hit cattle ranchers in the US are starting to rebuild their herds with the return of more favourable weather and improved pasture growth but the US Department of Agriculture doesn't expect American beef production to start increasing until 2017. Several years of drought and high feed costs conspired to whittle down the US beef herd, which is at its lowest level since 1973, boding well for NZ beef producers, who send about 43% of their meat to America, making it the biggest market. Agrifax data shows bull beef used for hamburger patties rose 59% to US$3.18 a pound in the past year, or a record $8.37

Continued p12

HUGOvision

October 1 2014

ECONOMY AT A GLANCE

New Zealand economy

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

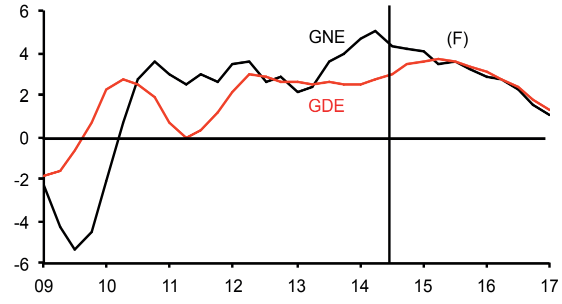
	2013A	2014F	2015F	2016F	2017F
GDP components					
Consumption	2.8	3.0	2.8	1.4	0.9
Investment	9.7	8.2	6.6	2.3	0.7
Stocks (contribution to growth)	-0.1	0.6	-0.5	-0.1	0.0
GNE	4.0	4.2	3.3	1.5	0.8
Exports	1.3	3.2	2.9	4.0	3.8
Imports	6.3	6.0	3.0	2.9	2.7
Activity					
Real GDP (production)	2.8	3.8	3.4	1.8	1.1
Output Gap	0.3	1.1	1.5	0.0	-0.7
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	1.4	2.1	2.9	2.2
Average hourly earnings	3.2	3.3	3.9	3.2	2.7
Terms of trade	20.2	-7.5	-0.7	3.6	1.5
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	3.8	4.8	5.0	4.4
5 yr NZGS yield (%) (1)	4.2	4.1	4.9	4.4	4.9
10 yr NZGS yield (%) (1)	4.8	4.5	5.3	4.8	5.4
External sector					
$NZ/$US(1)	0.823	0.800	0.730	0.670	0.650
$NZ/$A(1)	0.915	0.909	0.890	0.870	0.892
$NZ/Y(1)	85.1	86.4	85.4	84.4	79.5
TWI(1)	77.5	77.0	73.3	69.7	67.4
Trade balance $(m)	1207	1730	-1847	99	2231
Current account $(m)	-7350	-7904	-12041	-10485	-8698
(as % of GDP)	-3.3	-3.4	-5.0	-4.1	-3.3

(1) Average for month of December

(2) Using current prices

Economic growth

Annual average % change

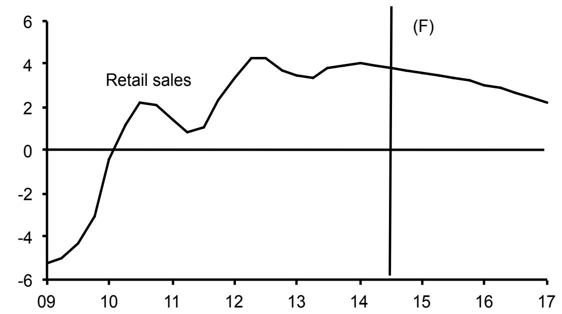


Source: BNZ, Stats NZ

Quarterly

Retail sales

Annual average % change



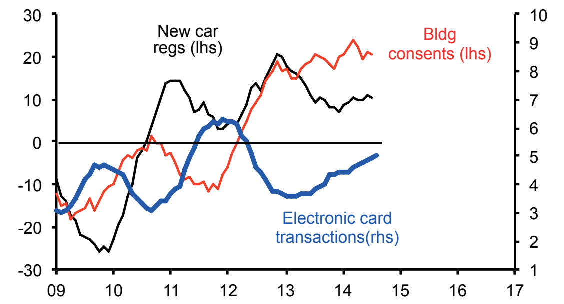
Source: BNZ, Stats NZ

Quarterly

Partial indicators

Annual average % change

Annual average % change

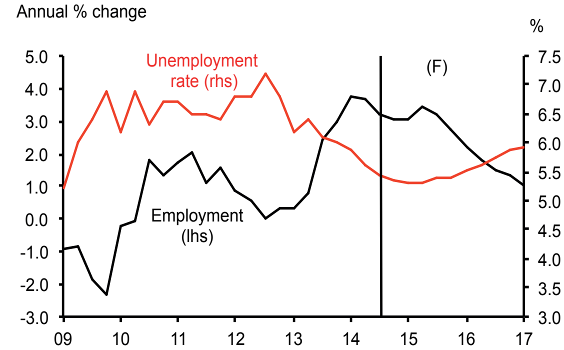


Source: BNZ Stats NZ

Monthly

The labour market

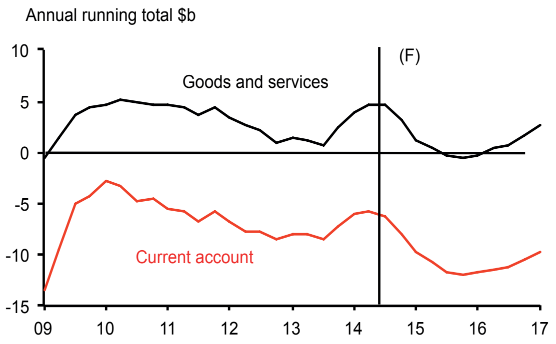
Annual % change



Source: BNZ Stats NZ

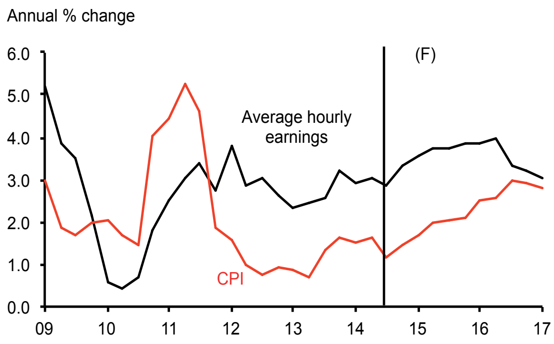
Quarterly

Balance of payments



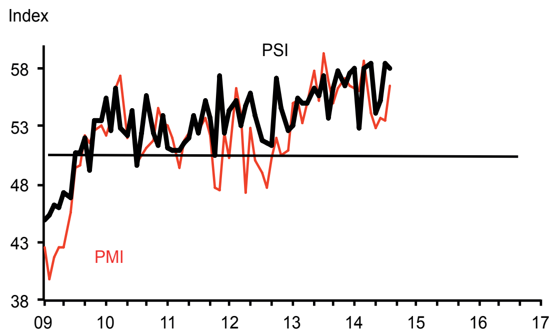
Source: BNZ, Stats NZ Quarterly

Inflation



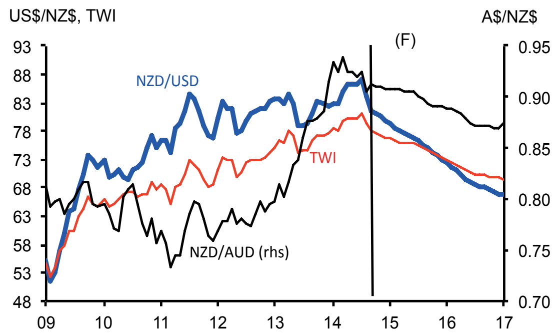
Source: BNZ, Stats NZ Quarterly

PSI and PMI



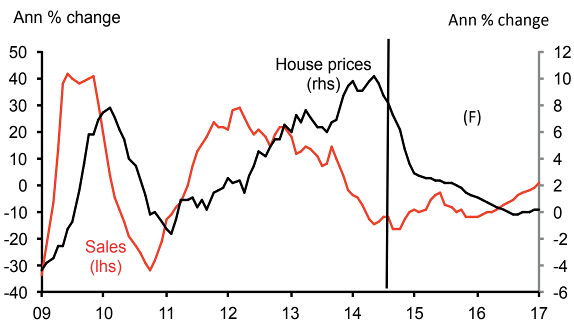
Source: BNZ Monthly

Exchange rates



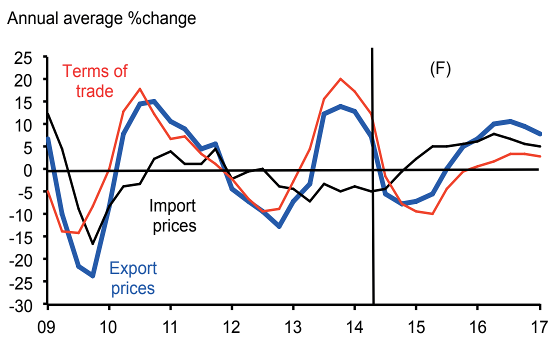
Source: BNZ Monthly

Housing market (three month average)



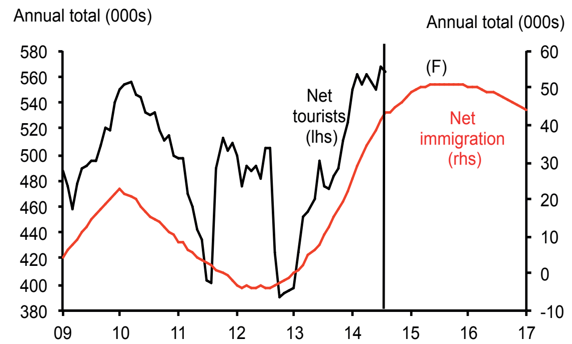
Source: BNZ REINZ Monthly

Terms of trade



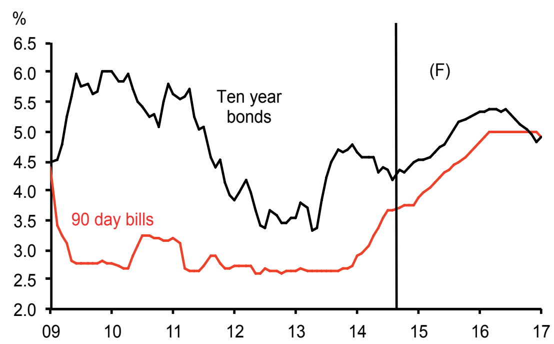
Source: BNZ Stats NZ Quarterly

Net migration flows



Source: BNZ Stats NZ Monthly

Interest rates



Source: BNZ Monthly

ECONOMIC ROUND-UP

Continued from p9

per kilogram in NZ dollars. Agrifax says the US may kill 700,000 to 800,000 fewer cows this year. NZ's total annual kill is about 900,000.

Retailer earnings

Listed retailers are broadly optimistic about the outlook after reporting 2014 results that highlight tough trading conditions in NZ and Aust. **Warehouse Group**, the biggest retailer on the NZX 50, reported an 18% drop in full-year profit as costs grew faster than sales and margins shrank. It expects a return to profit growth in 2015 after revamping its Red Shed and buying businesses. **Kathmandu's** annual profit fell 4.5% as sales of seasonal stock were hurt by a warm start to winter, a season that heralds one of its biggest annual sales. It sees growth in Australasian earnings this year although investment spending is likely to dent overall profit as it tries to lift sales in the UK and Europe. Children's clothing chain **Pumpkin Patch** posted a $10.2m annual loss on costs to reorganise its business and said it doesn't expect improvement until 2016, when analysts are picking a return to dividend payments.

Migration

NZ's annual net migration has exceeded official forecasts, with the country gaining a net 43,500 migrants in the year ended Aug 31, the biggest-ever inflow. A record 103,900 people arrived while departures fell 22% to 60,400. The flow across the Tasman has shrunk to a trickle, with a net 6,500 departures, a nine-year low. The Reserve Bank has been closely scrutinising the data because the expected 'flood' of new migrants hasn't yet showed up as major factor in heating the housing market. It concludes this largely reflects the make-up of recent arrivals, which include younger people arriving on temporary working visas, such as builders heading to Christchurch, and fewer kiwis leaving for Aust. The figures also show an uptick in student arrivals, particularly from India.

Manufacturing and services

Gauges of the manufacturing and services sectors suggest an economy still in good heart. The BNZ-Business NZ performance of manufacturing index (PMI) rose to 56.5 in August from 53 in July. That's encouraging after gross domestic product figures showed manufacturing shrank 0.3% in the second quarter for annual growth of 3.1%. GDP grew 0.7% in the second quarter, beating estimates of 0.6% and suggesting the economy hasn't slowed as much as feared from the first quarter's 1% pace. The performance of services index, or PSI, slipped 0.5 points to 57.9 in August, still a strong reading, and the employment sub-index was at a record 56. The services sector accounts for about two-third of the economy and the retailing component was weak, at 47.4, which signals contraction.

Aviation

China Eastern Airlines is the latest Chinese state-owned carrier to commence services to Auckland International Airport, with a seasonal direct connection to Shanghai from December to March. That will complement Air NZ's service, the only direct connection at present. China Southern is already well entrenched in its Auckland - Guangzhou route. Meanwhile, Air NZ and Singapore Airlines will begin a daily code-shared return service between Auckland and Singapore from Jan 6 next year.

At the other end of the North Island, Wellington International Airport has published a long-awaited study by EY of its runway extension plans. The report offers no cost-benefit analysis, although it claims substantial regional economic benefits for a project that would cost more than $300m and which 66% shareholder Infratil would look to central and local govt to help fund. Wellington City Council (33% owner) has identified a runway capable of taking modern long haul jets as a key element in plans to accelerate the city's growth, but Ministers are cold on the plan so far.

The EY report outlines scenarios which show that even after 45 years, the runway could be expected to support only 16 to 33 extra flights weekly, or two to five per day.

Construction

Building permit statistics for August showed a surge in apartment building. While new dwelling consents were flat on July, they remained 20.3% higher than the same month a year earlier.

Meanwhile, roading and infrastructure firm Fulton Hogan has signalled weaker Aust growth in the year head and that it will make final payments to Shell to complete its buyout by the end of the calendar year.

PO Box 25120, Featherston Street, Wellington 6146, New Zealand
PHONE 04 385 6249 EMAIL hugo@thehugogroup.com www.thehugogroup.com
THE HUGO GROUP