HUGOvision

Assessing the economic and political environment in New Zealand

August 14 2015 | Confidential to HUGO members

What is the PBOC up to? Page 5

This week's move by the People's Bank of China to change the way it calculates the 'daily fix' for the Chinese yuan was a shock to global financial markets, but cannot be construed as the start of a currency war. China has too much to lose by precipitating such a fight right now, although a weaker yuan is helpful to a fast-slowing Chinese economy.

Political challenges as economic sentiment turns sharply Page 2

There is no now doubt that NZ is in for a tougher time economically for at least the next year, or longer if dairy prices take longer to start recovering. However, there is no credible likelihood at this stage of recession. The govt and Opposition parties walk a tightrope between Pollyanna-ish optimism that the rest of the economy will remain robust and promoting self-fulfilling gloom.

NZ becoming isolated on TPP Page 2

Behind the scenes, intense negotiations continue to try find a way through the impasse on key trade access issues that are stalling conclusion of the TPP. However, early talk after the Maui ministerial of a fresh meeting later this month has faded. NZ risks being scapegoated if the talks fail for taking a principled stand on dairy market access.

Goff preparing for Auckland mayoral bid Page 3

Former Labour Party leader Phil Goff has not yet made a final decision to run for the Auckland mayoralty, but he is not discouraging the speculation. National has deputised two junior ministers, Paul Goldsmith and Nikki Kaye, to produce a coherent centre-right council. They would probably accept Goff as mayor.

RMA reform, such as it is Page 3

Environment Minister Nick Smith has laid out plans to develop four new National Policy Statements and two new National Environmental Standards as the govt accepts it won't be able to make fundamental changes to the RMA. A reform bill covering reforms that have gained cross-party support may be six to eight weeks away.

How not to establish a model farm Page 3

The 900 pages of documents released on the Saudi Arabian model farm deal and associated payments show an absolute determination by Foreign Minister Murray McCully to compensate angry Saudi business interests over the loss of the live sheep trade, while determinedly calling it anything but compensation. The saga harms NZ's reputation for honest dealing.

Buyers in the wings for Solid Energy? Page 6

At least one opportunistic counter-cyclical buyer has been checking out the failing state-owned coal miner's assets in recent months. There may be others. The 30 month voluntary administration announced this week buys time for what is effectively an orderly fire sale.

Text finalised August 14

Contact: hugo@thehugogroup.com. No responsibility is accepted for acts or omissions by clients as a result of items herein.

© The Hugo Group 2015

POLITICS AND POLICY

A spike in economic challenges – political implications

The sharp turn in both economic indicators and sentiment began in earnest last month, with the first of two very weak GlobalDairyTrade auctions. Since then, the scale of emerging economic challenges has been mounting thick and fast.

The huge cut to Fonterra's 2015/16 payout forecast to $3.85 per kg/MS – softened somewhat by 50c per kg/MS advances for shared-up farmers, characterised as interest-free loans for eventual repayment – is obviously a major source of headwinds on the domestic front.

However, the emergence of an aggressive depreciation strategy by the People's Bank of China this week poses fresh questions about the pace of the sluggish economic recovery in the US and, in turn, whether the Federal Reserve's timetable for raising interest rates has just been set back until December or even into 2016.

However, the underlying trend for both a weaker NZ dollar and further interest rate cuts by the RBNZ remain intact, as does the expectation that while the NZ economic growth may fall sharply over the next year, consistent with forecasters' downside scenarios, there is no serious prospect at this stage of a recession. Weak growth outside the dairy sector, assisted by tourism, ongoing strength in some commodity prices – most notably beef and wool – and improved returns for exporting manufacturers, looks assured. This week's BNZ/BusinessNZ Performance of Manufacturing Index shows the 34th consecutive month of expansion, despite some weakening in the extent of optimism in the last four months. While the Christchurch rebuild is levelling out, Auckland construction activity looks solid and there is no sign yet of strong inward migration, which is underpinning robust domestic demand, falling dramatically.

An increasingly volatile regional economic outlook challenges the govt to go beyond soothing rhetoric about the new-found resilience in the NZ economy and plodding through its 'refresh' of the vast list of initiatives covered by the Business Growth Agenda. On its side is the fact that voters still trust National far more on the economy than they do Labour and that Labour is still working out its new economic policy positioning.

Labour also knows it is double-edged sword to attack too strongly in times of economic weakness. While it has been deeply critical of a lack of economic diversification leading to over-reliance on dairy, it is actively restraining the tone of its attacks on the economy for fear of being accused of talking the economy down and exacerbating current conditions.

TPP – NZ becoming isolated

New Zealand has been isolated in the Trans Pacific Partnership in its opposition to what Fonterra director Malcom Bailey has called a woeful offer on dairy access from Japan, Canada and the United States.

It appears that Australia has decided to prioritise its attempts to gain better access for sugar rather than access for dairy, which Aust regards as a "relatively minor" export sector. Thus NZ is on its own and the pressure on the negotiating team is intense.

At this stage it is coming in public from Japan and Canada and more subtly from the US.

Tim Groser has said that the big four – Mexico, Japan, Canada and the US – have and made it clear they will blame NZ if the talks eventually break down. But he has no choice. The success or otherwise of the TPP for NZ will be judged on what it does for dairy. Despite Groser's optimism that a deal can still be done, it would be wise to prepare for the possibility that the TPP could yet fall over.

Hopes that a follow-up negotiating round would be possible in Singapore later this month appear to be fading, with talk now turning to the November APEC summit. That is dangerously close to a drift into Christmas and a stalemate created by US political focus next year on the presidential election.

The Economist Intelligence Unit's chief economist Simon Baptist has pronounced the TPP "dead" in commentary last week saying the clash with the US and Canadian political timetables made a conclusion in 2016 "remote".

"The TPP was probably doomed when the US joined, and certainly when Japan did," he wrote. "It then became more of a political project than an economic one. Big trade agreements had hitherto focused on physical goods, while the TPP had an aim of forging rules of trade beyond this in intellectual property, investment and services."

Meanwhile, Groser is off to Malaysia for, amidst other things, another round of talks on the Regional Comprehensive Economic Partnership – the China led trade proposal for East Asia.

But that would be a second best because the only real gain to NZ out of it would be Japan and India. RCEP is much less advanced than TPP, India remains highly protectionist, especially towards its vast domestic dairy sector, and as the TPP has shown, Japan is not going to give way easily on dairy access either.

His Worship, Phil Goff?

Phil Goff may sound like Hamlet if he is asked about whether he will stand for the Auckland Mayoralty but that is beginning to fool fewer and fewer people. He's up for it and quite happy to talk in detail about his ideas.

Ironically he's saying the same thing as the centre right cabal of Paul Goldsmith and Nikki Kaye, who are tasked with ensuring a coherent, centre-right Auckland Council emerges next year.

What both sides are saying is that the Auckland Council firstly needs organising and sorting out.

Currently it is a Council of independents who as was seen over both the unitary plan and the rates setting process were chopping and changing their votes on whims.

Goff would insist on a disciplined block within the Council though whether that would be under the Labour brand might be questionable.

He is hardly the Labour party's favourite son these days.

Saudi Arabian nightmare

The 900 pages of documents that have been dumped on the Saudi Arabia sheep deal show a complex saga of confusion – unintended and at times orchestrated – all designed to deal with a simple issue.

The relationship with Saudi Arabia would not have gone off the rails if first the Clark govt and then the Key govt had not decided to let activism by animal welfare lobbyists trump international relations.

There is no real evidence in the documents that anybody in either govt raised questions about the greater relationship with Saudi as they bowed to the activists' demands to stop the live sheep trade.

Couple this with the paranoia that had set into the Ministry of Foreign Affairs as its Minister began its restructuring in the early years of the Key govt and it would have taken a brave official to warn the govt of the downside to its populist actions.

Thus when the wheels eventually fell off, McCully turned away from the Ministry towards his own political networks – organised by Michelle Boag – to try and solve the problem.

This is where the serious issues arise. If MFAT were not warning the Minister they were at least keeping detailed notes of his meetings on the issue.

And their notes show how determined Mr McCully was to avoid any suggestion that the payment to Hamood Al Khalaf was "compensation".

The reason for that – and presumably what the Auditor General is focussing on – is a Cabinet meeting in Feb 2013 where McCully advised that he was going to make the payments to Al Khalaf.

Usually he would sought approval from Cabinet to appropriate money to make the payments.

But what he appears to have done is to define the reason for the payments in such a way that they fitted into an already approved appropriation.

Hence there was no need for any formal Cabinet decision. That not only reduced the paper trail, but also would have seen off the opposing views of at least some Ministers, including David Carter, who saw no grounds for the deal.

A lot this is the kind of stuff that fascinates only Wellington. Like the detail in 'Dirty Politics', the Saudi deal appears not to have ignited a reaction in the political polls, so the govt assumes it can ride this out.

However, it is highly questionable whether the circumstances in both cases are consistent with the actions of the govt of a country consistently rated one of the most transparent and least corrupt in the world.

RMA reform

Environment Minister Nick Smith has laid out the govt's agenda for the development of four new National Policy Statements and a range of associated National Environmental Standards in lieu of parliamentary support for fundamental reform of the Resource Management Act. A speech to the Environmental Defence Society's annual conference was notable for the absence of any reference to changes to Sections 6 and 7 of the Act, while promising reforms to management of natural hazards, introducing standardised templates, eliminating resource consents for minor activities and steamlining local govt plan-making processes. Four NPSs are to be advanced in the following areas: urban development; aquaculture; bio-diversity, and natural hazards. NESs on telecommunications facilities and plantation forestry are being developed. Consultations will begin next year on standards for air quality and contaminated soils. Smith is proposing a collaborative process akin to that used to develop freshwater policy for the bio-diversity NPS, which is similar in the tensions it will expose, particularly between agricultural land users and the environmental lobby.

Hugo website log on

We have upgraded our website this year with a member-only section, which includes back issues of Hugovision, a full compendium of legislation before the House, our forward speaker programme, and copies of the presentations given at our breakfast meetings. And, we will soon be adding the Hugo Handbook, containing long-range policy and economic forecasts and a Who's Who of the government.

Please let us know if you have not yet received an email with your user name and a temporary password:

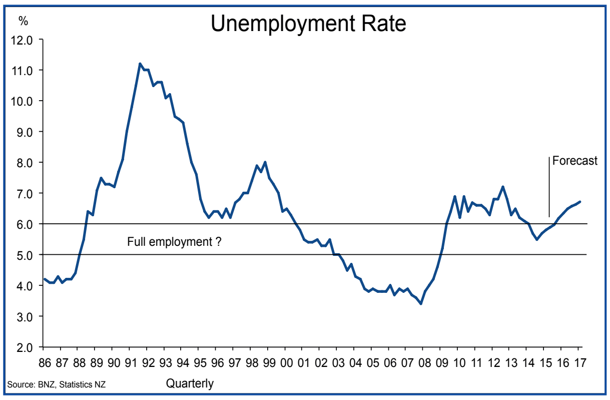
hugo@thehugogroup.com

DOMESTIC ECONOMY

Auckland house price pause?

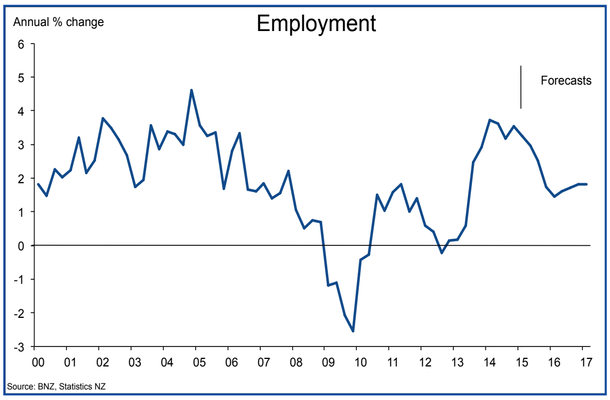
Mixed data on Auckland's property market may be a signal prices are starting to top out. REINZ statistics this week showed that while the median Auckland house price rose 20% in the year to July, the median price fell 2.6% between June and July, despite very high sales volumes both in Auckland (up 41%) and nationally (up 38%). The national median average rose 3.3 percent in July to $465,000 for an annual increase of 12%, although that falls to 6% when Auckland is excluded.

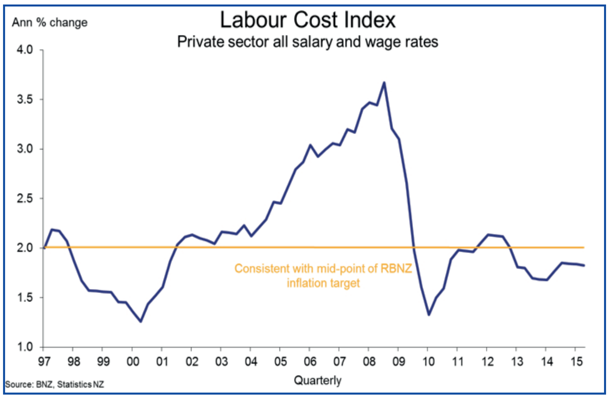
Similar results were observable from both QV and leading Auckland real estate agency Barfoot & Thompson. QV figures showed values in the Auckland region surged 18.8% in the 12 months through July to a median of $855,672, the fastest pace since 2004, while Barfoot's monthly sales figures suggest house price growth may have stalled, even as turnover remains high, with properties deemed 'fully priced'. Barfoot's data shows the average Auckland sales price in July of $827,359 was little changed from $826,474 in June and $822,148 in May. The firm sold 1,388 homes in July, up by almost a fifth from June and marking the most sales for the month since 1999. "This month's results confirm that prices are no longer racing ahead," said managing director Peter Thompson. The QV figures show NZ residential property values rose at the fastest pace in eight years in July, driven by Auckland, and are now about 27% above the previous market peak in late 2007. National property values accelerated 10.1% in the 12 months through July to $527,760.



Job seekers increase

NZ's jobless rate rose to 5.9% in the second quarter from 5.8% three months earlier as migration swelled the working population faster than new jobs were created. Employment grew 0.3% in the quarter, lagging behind the 0.7% expansion of the working age population for the first time since the Sept 2012 quarter. The participation rate fell 0.2 of a percentage point to 69.3%. Separately, the labour cost index showed private sector ordinary time wage rates rose 0.5% in the quarter, up from 0.3% in the first quarter but unlikely to be sufficient to concern the Reserve Bank. Annual private sector labour costs rose 1.8%, faster than the 1.2% increase for public sector wages. Manufacturing was the biggest contributor to jobs growth in the year, rising to 266,300 people employed from 241,700 in June 2014, and outpacing expansion in the construction sector, where 221,400 people were employed, up from 198,700. That's the first time construction hasn't driven annual jobs growth since Dec 2013.





Rate cuts vs inflation

A weaker economic outlook for at least the next 12 months is assured, with one of the key questions being how the RBNZ will manage tension between a weaker, and therefore more inflationary, NZ dollar and the expectation that interest rate cuts will continue. A range of new growth forecasts is emerging and we are picking a 2 percent annual growth low point, underpinned by a low interest rates, a depreciated NZ dollar, still-strong migration inflows and momentum in domestic demand.

On the relationship between the NZD and the Chinese yuan, we expect the NZD to increasingly mimic the CNY, but to depreciate against it over the next six months.

What China's depreciation means

There was a lot more heat than light in much of the early reporting of this week's move by the People's Bank of China to edge the country closer towards a 'free float' of the yuan. The immediate depreciation of 1.9% was barely digested when the central bank's new method for setting the 'daily fix' for the yuan produced a second day of depreciation, taking the total fall to a little over 3%.

As the dust settled – and the PBOC called a press conference to further explain its actions after intervening late on the second day to stabilise the yuan – it became clear that rather than starting a currency war, Beijing monetary authorities were in fact allowing market forces to play a greater role in setting the value of the Chinese currency.

Choosing to do so now serves two important and mutually reinforcing purposes. Firstly, it has served as an acknowledgement that the Chinese economy is in fact considerably weaker than official growth statistics suggest. This is hardly a novel concept, but it's been up to external observers to guess at the extent of underlying Chinese weakness rather than for Beijing to admit it. By allowing a market-driven depreciation to occur at this time, China gets a small but useful export competitiveness boost by lowering the value of a currency that is estimated to have been around 10% over-valued.

Secondly, the move dove-tails with China's long term strategic goal of establishing the CNY as a global reserve currency. One key to that ambition is its inclusion alongside the USD, euro, GBP and JPY as a Special Drawing Rights currency at the IMF. A vote on admitting the CNY to that status is due within weeks, with inclusion in SDRs possible as early as September next year. China's focus on achieving this goal is the reason it would not seek to precipitate a currency war right now. Its greatest barrier to being accepted as an SDR currency is the entrenched fear, especially in the US, that Beijing manipulates its currency and is therefore not worthy of SDR status. Of course, the way recent events have played out could yet have an impact on the SDR vote, but it is inconceivable that China would be seeking to destabilise its passage to greater integration into the global economy.

However, the timing may have been influenced by evidence of substantial repayments of foreign debt by Chinese borrowers in recent months (see chart to right), giving authorities more room to move on a depreciation.

NAB suggests the weaker CNY "may provide incentives for further capital flight in the short term" as carry traders who have been buying CNY for its appreciating trend in recent months depart.

The move may also place further downward pressure on prices for USD-denominated commodities, which are already under pressure because of weak Chinese industrial activity.

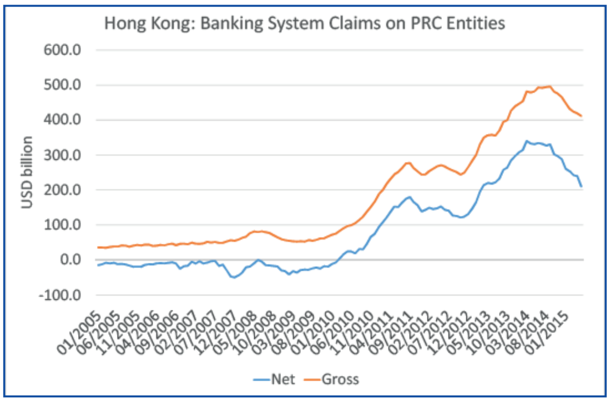
Headline industrial production growth slowed to 6% yoy in July, from 6.8% in June, with some greater nuance about the nature of the Chinese slowdown available in the of the contributing elements to that result. Electricity output was down 2% yoy, cement was down 4.7%, crude steel down 4.6% and motor vehicle production fell heavily yoy in July, by 11%.

Two key PMIs also fell to either a neutral or newly negative setting. Real estate and manufacturing investment remain particularly weak.

NAB anticipates further cuts to official benchmark interest rates and required reserve ratios from the PBOC this year.

Implications for the Fed?

Even if Beijing didn't mean to start a currency war, could the prospect of a considerably weaker CNY against an already appreciating USD have any implications for the Federal Reserve's plans to raise benchmark US interest rates?



At this stage, the answer appears to be a tentative no. Noteworthy is the Aug 12 speech by the president of the NY Federal Reserve, William Dudley.

He described the Chinese moves as having "huge implications for the world economy" but that it was too early to judge their impact and appeared to suggest the Fed remains on track for an interest hike no later than December.

"Hopefully in the near future, we will actually begin to raise rates," he said in answers to questions, although he did not directly address the issue in his formal speech.

CORPORATE ROUND-UP

Solid Energy – fire sale looms

Sale to an opportunistic counter-cyclical investor may yet emerge as an option. At least one unidentified Australian resource investor has been acquainting itself with Solid Energy's assets. Now that the board has elected to place the company in voluntary administration for orderly selldown, it's likely there will be time to run a competitive process, albeit the assets are unlikely to cover the company's outstanding debts at current values for coal.

At least one bank, thought to be Bank of Tokyo, appears to be resisting the administration process, which effectively freezes repayments on outstanding debt until after the asset sale process is completed. BoT resisted the 2013 capital restructuring, in which lenders were forced to swap $75m of debt for redeemable preference shares.

The Solid Energy board is in an invidious position. Several of the current board were pulled into service in part because of their long connections with Mark Ford, the turnaround CEO appointed after Don Elder's departure, who died last year. Pip Dunphy resigned as chair in February when it became clear she could not support Finance Minister Bill English's belief that the company was salvageable. The acting chair now is Auckland-based professional director Andy Coupe, who is also deputy chair of the Takeovers Panel.

Closure or large-scale curtailment of Solid Energy's West Coast mine at Stockton could have serious implications for KiwiRail's trans-alpine route, which relies on coal transport to Lyttelton for viability.

Strong start to earnings season

There haven't been many disappointments for analysts so far in earnings season, although SkyCity's Australian results caused some analysts to downgrade ratings, even as an improved win rate from high-rollers and strong growth in Auckland lifted full-year profit by 31%. ASB Bank reported a 9% increase in full-year cash earnings to $846 million on rising interest income after lifting its home loan, business and rural lending books. Vital Healthcare Property Trust recorded a 4.6% annual profit gain after generating increased rents from its growing Australian assets. Diligent Corp, the governance software developer, lifted first-half profit 11% on stronger US sales and industrial landlord Property for Industry more than doubled its first-half profit on a valuation uplift for its portfolio. Retirement village operator Summerset Group also more than doubled first half profit after opening four new villages and rural services company PGG Wrightson beat its own guidance with an 18.4% gain in annual profit, led by an improved performance for seed and grain. Forsyth Barr analysts forecast a relatively modest 3.2% lift in per-share earnings, in aggregate, for the 48 listed companies they follow, on sales growth of 1.1%.

Spending for growth

Xero, the cloud-based accounting software developer, burned through cash at a faster pace in the June quarter as it ramped up spending on an expanding workforce and more than doubled expenditure on marketing and advertising. The Wellington-based company's operating cash outflow more than doubled to $17m from the same quarter a year earlier, and widened from the $12.2m outflow reported in the March period. Customer receipts jumped 72% to $40.5m from a year earlier.

Weighting toward equities

The NZ Superannuation Fund will maintain its strong weighting to equities following a five-year review of its passive reference portfolio, which forms the basis for most of the fund's investments. The manager, Guardians of NZ Superannuation, expects the reference portfolio, introduced in 2009, to return an annual 7.7% over 20-year periods, 2.7% above the risk-free Treasury bill interest rate. The five-year review found the portfolio's current mix of 80% equities and 20% fixed income remains appropriate, given the fund's long-term investment horizon. The fund, established in 2001 to help pre-fund universal super benefits, is not projected to start paying out money until 2031/32. Guardians chair Gavin Walker said setting the reference portfolio was the most important decision the board makes, given it provides both economic return and a benchmark for active investment.

Who will chair Contact Energy?

With the departure of Origin Energy from the Contact Energy share register, the composition of the company's board will be an early priority. The question many Contact-watchers will ask is whether founder chairman Phil Pryke will seek to convert his current interim chairmanship into a permanent position. Pryke himself will be weighing that too. Involved since Contact's initial corporatisation in 1995, Aust-based Pryke retains a great affection for a company that analysts at the time thought had been given runt assets and would struggle to succeed. However, Pryke's uncompromising attitude to shareholders who took him on over a perceived lack of independence from majority shareholders over the years have made him an inevitably polarising figure in NZ corporate governance. Neither of the two other independents, Sue Sheldon and Whaimutu Dewes, are seen as candidates for the chairmanship.

Former Origin appointee Bruce Beeren can be expected to leave the board too. Pryke will inevitably preside over a search process for new directors, presumably with an eye to a future-proof chairman.

Meanwhile, Contact's share register is now comparatively wide open following the selldown of Origin's 53.1% shareholding. Investors were stunned – and institutions and brokers irked not to be able to get more allocation – at the discounted $4.65 a share exit price that Origin accepted. The extent of the money left on the table will require a A$270m impairment charge to be recognised in Origin's accounts when it reports later this month. While the company's investment grade credit rating has been under pressure because of the cost and reduced trading prospects of its ALNG project in Queensland, observers note that even at current low global gas prices, the new plant will be on-stream next year and will transform Origin's cashflows. While some will ask whether the Aussie got out in a panic when it might have held on, it seems Origin decided there was nowhere to go with Contact and became willing to quit at a discount after failing over several months to find a buyer for its majority stake.

Auckland port expansion

Under cover of the Fonterra payout cut, Ports of Auckland made a little-noticed announcement it plans to expand its container-handling capacity by moving to containers stacked four high, rather than three high. That will require some capex in new container straddle-hoists and will see greater automation on the wharves, assuming the proposal goes ahead. Feasibility studies and consultations with the port workforce are under way, but no decision will be made until early next year. Stacked four high, the containers will be up to 15.5 metres high, compared with around 12 metres at present. Opponents of the abandoned wharf extensions at the port have yet to react, although they are crying foul at their exclusion from a consultation process on the port's future. Former NZ Initiative executive director Rick Boven is heading the study, which was ordered by Auckland Council after the wharf extension plans were withdrawn and is due for completion next June. Meanwhile, a draft recovery plan for the damaged Lyttelton Port and its surrounding area is out for public consultation.

Maori economy

Ngai Tahu Property ceo Tony Sewell, who built the value of the tribe's property portfolio from $2m in 1994 to $553m today, is leaving the company to explore other business opportunities. A replacement ceo is now being sought to start at the beginning of 2016 at which point Sewell will assume the role of director of major projects until the end of next year, to ensure a smooth handover. Tainui Group Holdings (TGH), the investment arm of the Waikato tribe, plans to sell as much as 50% of its The Base shopping centre in Te Rapa, northwest Hamilton, using the funds to repay debt and for other investments. The underlying 30ha site, which was taken prior to World War II for use as the Te Rapa Air Force Base and returned to the tribe in 1995, is to remain in Tainui ownership. In 2009, TGH said it had invested $100m developing The Base and had committed a further $100m to develop the shopping mall. It has reportedly been valued at $250m. The property was run as a joint venture with Warehouse Group from 2002 until 2007, when TGH bought out the retailer's stake in the joint venture company for $37.4m.

Confidence falters

NZ businesses became the most pessimistic in six years in July, based on the ANZ Business Outlook. The agricultural sector was the gloomiest but sentiment among construction companies was also negative. A net 15% of firms were pessimistic about the general economy in the year ahead, up from 2.3% in June. The proportion expecting their own business to grow in that time dwindled to 19% from 23.6% in the previous month. Farming sentiment was 45.4% negative and the sector recording negative readings for profits, employment and investment intentions. Pessimism in the construction industry reached 28.6%. The services sector and retailers both turned pessimistic in July, at -4.8% and -19% respectively. Some 15.5% of manufacturers were pessimistic. Brighter points were the net 8.9% overall that saw real profits improving, up from 6.9% in June. Investment intentions were little changed at 10.8% seeing an increase, while export intentions rose to 19% from 14%. Inflation expectations for year ahead edged up to 1.7% from 1.68%.

Manufacturing still expanding

The manufacturing sector showed expansion for the 34th consecutive month in the BNZ-BusinessNZ Performance of Manufacturing Index for July, although it slipped 1.6 points from June to a reading of 53.5. The only sub-index to improve in July was finished stocks, rising to 51.7 from 51.1 in June. Production slowed to a rate of 55.9 from 56.1, employment declined to 50.8 from 53.8, new orders slowed to 54.4 from 58 and deliveries dropped to 53.5 from 55. The results suggest an inventory build-up. While the employment reading is barely positive, the sector has contributed a strong 24,000 new jobs in the last year.

CORPORATE ROUND-UP

Commodity prices fall

Dairy's weakness has cast a shadow over NZ's commodity exports in general. Prices fell at their fastest pace on record in July to the lowest level in almost six years, led by dairy. The ANZ Commodity Price Index for July fell 11.2% to the lowest level since Oct 2009 and is 27% below year earlier levels. Thirteen of the 17 main commodities declined. The drop in dairy prices was 23% to the lowest level in more than 11 years. Whole milk powder prices fell 35% and skim milk powder declined 11%. ANZ economist Con Williams cited global oversupply as "a significant headwind for dairy exporters." The downturn is broader based than that, with aluminium down 2.6% in July, and forestry prices down 2.2%. Beef prices recorded the only increase across the main commodity groups monitored by ANZ, helped by a strong US market. Beef's 5.4% increase offset a 2.7% decline in lamb, a 4.2% fall in wool and a 2.9% decrease in skins. The decline in prices had some offsets. Govt figures showed NZ wool exports jumped to their highest level in more than a decade in June, aided by a lower currency and strong demand from China, the nation's largest market. Wool exports rose 19% to $75m in June from the same month last year, the highest level for a June month since 1994. Exports to China, which accounts for two thirds of the total, jumped 34% to $50m.

Banking strength

Ratings agencies Moody's and Fitch say NZ's lenders are in a strong enough position to weather slowing economic growth over the next year-and-a-half, while slumping dairy prices aren't expected to pose as big a threat as they did in 2009. Both agencies have a stable outlook on the nation's banking system. Banks are expected to maintain strong asset quality and stable profitability in the face of a slowing economy. Moody's anticipates slower gross domestic product growth of 2.9% in 2015 and 2.5% in 2016 as lower dairy prices crimp export incomes, though building activity in Auckland and Christchurch, persistently strong inbound net migration, and lower interest rates will support the economy. It said weak dairy prices, imbalances in the property market and high household indebtedness were "key credit challenges." Fitch notes sound govt finances and the fact that the RBNZ has considerable further scope to ease monetary policy.

Campervan growth

Tourism Holdings, the campervan rental company, will remain listed and says it has the balance sheet strength to take on debt to fund acquisitions. The Auckland-based company hired First NZ Capital in April to help with a review of its capital structure. That month it lifted its profit guidance for a third time. While aiming to increase profit from existing businesses to at least $30m in 2019 the company will use its balance sheet flexibility "to focus on value accretive acquisitions, either globally or domestically."

Forestry industry

Rayonier plans to increase its holding in Matariki Forestry Group to 77% from 65% with a US$160m capital infusion that will be used to repay debt. Rayonier manages 2.7m acres of forests in the US and NZ. Matariki is NZ's third-largest forestry estate with more than 169,000ha of plantations. The company's Matariki partner, Guernsey-registered, London Stock Exchange-listed Phaunos Timber Fund will end up with a smaller holding as a result.

NZ and the AIIB

The Asian Infrastructure Investment Bank is China's first attempt at forming an international multi-lateral organisation and grew out of concerns in Beijing that the so-called Bretton Woods institutions – the IMF and the World Bank – were not willing to increase Chinese voting power commensurate with the growing size of its economy. China's decision to establish the bank was not welcomed in Washington.

But NZ was the first developed western nation to join it; a fact that officials claimed did not lead to any overt criticism from the US. Former Treasury Secretary John Whitehead played a crucial role in its development and told a select committee this week that NZ so far had had a "disproportionate" amount of influence in the early stages of the bank's development. Early insistence on high standards of governance and accountability encouraged the likes of the UK and France agreed to join. The US and Japan have not . NZ's involvement is being described as the "fifth first" for NZ as an early supporter of Chinese integration into the world economy. This is noted across Asia and has the potential to bring positive benefits beyond China, officials say.

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