



JULY 2011

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SKILLED MIGRANT CATEGORY POOL SELECTION

There were two draws from the Skilled Migrant Category (**SMC**) pool in June. The pass mark for the draw that took place on 1 June was 120 points and the pass mark for the draw that took place on 15 June, was 135 points for all Expressions of Interest included in the SMC pool that did not hold a full time offer of skilled employment. Applicants however, in both draws, were also required to claim a minimum of 15 points for holding work experience in an area of absolute skill shortage.

RELEASE OF INVESTOR POLICY CHANGES

Immigration New Zealand (**INZ**) has finally released the detail of the investor migration policy changes taking effect on 25 July 2011.

Our May newsletter already covered the main changes, although the full policy has been released to allow greater scrutiny of the changes.

For the purposes of this newsletter there are two important matters for consideration:

1 Residential Property Development as an Acceptable Investment

The definition has been released regarding whether or not residential property development can be deemed as an acceptable investment.

The definition is as follows:

- a The residential property must be in the form of new developments on either new or existing sites; and
- b The residential property(ies) cannot include renovation or extension to existing developments; and
- c The new developments must have been approved and gained any required consents by relevant regulatory authorities (including local authorities); and
- d The purpose of the residential property investments must be to make a commercial return on the open market; and
- e Neither the family, relatives, nor any one associated with you, may reside in the development; and
- f The costs associated with obtaining any regulatory approval (including any resource or building consents) are not part of your acceptable investments.

At first flush the policy seems sensible, until you delve a little deeper.

In the press release provided by INZ (refer below), a question has been proposed as to what approval or consents will be required before the investment can be considered acceptable. Advice is provided in that document that a person would require a "Code Compliance Certificate" and a "Building Consent" as a minimum requirement (subject to the other criteria) before the residential property development could be considered acceptable for the purpose of investment. Unfortunately, whoever designed this policy failed to understand that obtaining a Code Compliance Certificate is the final certificate issued upon completion of the development. Therefore, in a normal subdivision type situation, INZ are suggesting that the property and the investment in to that property will only be accepted once the individual parcels of that development have been completed. This is nonsensical! We understand this issue has already been raised at the highest level, and no doubt we will see some necessary changes there.

RELEASE OF INVESTOR POLICY CHANGES

2 Transitional Policy

As predicted, INZ has put in to place some transitional policies. For applicants who have applications currently processing under the investor categories, or have merely been approved in principle (and have not already invested their funds in to acceptable investments) INZ will be contacting all applicants to provide them an option to withdraw their prior application (at no cost) to allow a secondary approval under the new policy to allow investments to be made as per the additional acceptable investment criteria.

In addition to this, even if applicants hold resident visas under the investment policies, and have therefore already made acceptable investments, they will also be permitted to take advantage of the new acceptable criteria. Applicants will be contacted and a process of varying the conditions of resident visas will need to be undertaken.

Providing a transitional policy was sensible, and allows free transfer of funds already invested in New Zealand, benefiting New Zealand, to be channelled in to alternative investments now seen as acceptable and strategically advantageous.

Full advice in relation to the policy release can be found by following the below link:

<http://www.immigration.govt.nz/migrant/general/generalinformation/qanda/investormigrationchanges>

THOUSANDS OF JOBS CREATED IN CANTERBURY

In an article in the Press that featured on 29 June 2011, a commentary was provided by Canterbury Employment and Skills Board (CESB) and various stakeholders in the industry that thousands of jobs are soon to be created due to the Canterbury earthquake recovery.

The demand is likely to be for a full range of employment positions, but competition would be most intense at the specialist end, being managers, insurers, engineers and architects. Although in addition to this, trade, hospitality sectors, and also professional service providers will also be in demand.

For migrants looking to travel to New Zealand, opportunities in Christchurch from 2012 should seriously be investigated. Often the biggest challenge to migrate to a country is receiving an offer of employment (coming from a foreign jurisdiction), and it appears, that soon, Christchurch and greater Canterbury will provide a number of options for migrants to easily obtain skilled offers of employment due to the significant demand in the skill required to rebuild the region.

From a regional point of view therefore, in relation to the labour requirements, 2012 and onward will be an interesting time, principally to determine whether or not the huge numbers of skilled employees required for the rebuild can be sourced within the region, and domestically within New Zealand. Quite likely, significant numbers of international migrants will be required to supplement the gap between the country's ability to up skill existing labour and attracting skilled New Zealanders from other parts of New Zealand in to the region.

For further information or assistance with emigration please contact **Mark Williams** of **Lane Neave Lawyers** on **+64 3 379 3720** or email liveinnewzealand@laneneave.co.nz



The rebuild of Christchurch has commenced finally, albeit slowly. The recent decisions around the classification of land in and around Christchurch has brought some closure for residents in particular.

We recently met with a number of the five key Alliance partners involved with the rebuild. They have commenced recruitment as the packages of work start to be determined and released by CERA. The key areas of one of our key clients has been narrowed down to the following disciplines: Landscaping generally, Roads, Driveways and Paths, Underground and Piping and Construction.

Our Commercial / IT division presented at the Canterbury Software Cluster meeting last week. There are desperate shortages in software development generally throughout Canterbury. Key skill sets required are predominantly in .NET and ASP.NET development

ENTERPRISE RECRUITMENT (Con't)

especially, along with Java for application development. There are numerous vacancies for Testers also, as the software and IT sectors start to heat up. The western suburbs of Christchurch are where the majority of the IT companies are based.

This area has been largely unaffected by our recent seismic activity and as such there remains opportunities for numerous IT related positions.

We remain interested in hearing from any overseas based candidates who are looking to relocate to New Zealand and Christchurch in particular.

For further information on employment opportunities, please call **Steve Baker** of Enterprise Recruitment on **+64 3 353 0680** or email him at **steve.baker@enterprise.co.nz**



The latest Harcourts National Sellers and Purchasers Survey results have uncovered a significant shortage in the number of homes available. The survey measures the tenure of sellers and buyers and other trends around New Zealand homeowner and buyer activity such as volume of sales, and listings coming on the market plus their marketing results.

Harcourts CEO Hayden Duncan says these results coupled with recession tightening funding options for developers and the impact of damaged homes in Christchurch, eliminating over 5,100 homes in national circulation from the market have all played a crucial role resulting in a very real housing shortage nearly at crisis point. "We are dealing with factors such as residential building consent numbers down 45% beneath where they need to be to meet the population growth rate and as the BNZ Weekly Survey reported, with our labour market improving, the record migration outflow may reverse placing more pressure on housing numbers, decreasing affordability."

"There's no way all the developers in New Zealand combined with those thinking of selling can provide the level of housing now needed and that is a real concern. On top of these factors we are also seeing changes to tenure. If people choose to hold onto their houses for longer, first home buyers will be battling with a shortage of choice, driving competition up and increasing prices. We must then take into consideration the situation if more Christchurch homes are classified as exempt from being rebuilt."

The BNZ Weekly survey has noted an unadjusted consent issuance of 1,073 dwellings this last month rather than the near 2,100 needed. This creates serious implications for rent prices and immediate accommodation problems. Harcourts specialist division Mortgage Express has also seen an increase in mortgage applications showing confidence remains in housing investment. "We all know the lending criterion currently offered by banks is the best its been in nearly seven or eight years and Mortgage Express have seen a 15% increase in mortgage applications."

Of those who have bought new homes there has been a 21.48% increase in the intention to reside in the home for a length of 10-20 years between the two quarters, but only a 13% increase in those intending to stay in their homes for five to seven years. Buyers increased the amount they spent over the past two quarters by 12%.

The results of the National Harcourts Sellers and Purchasers Survey are conducted at the end of each financial quarter.

For further information and advice about the general property market in New Zealand please contact **Tim Harris** of Harcourts on **+64 3 379 6596** or email him at **tim@timharris.co.nz**



A MATTER OF EXCHANGE

A view has been gaining ground in policy circles that low savings have been responsible both for New Zealand's high interest rates and its high exchange rate. The implication is that an increase in saving would provide relief for the export sector and allow lower interest rates. As seductive as this view is for monetary policy, we think it is largely wishful thinking.

A MATTER OF EXCHANGE

Concerns have been mounting around New Zealand's low national saving rate. The worry has been that low savings have made the economy more vulnerable to a funding shock (we'd probably agree) and that low savings are the culprit for New Zealand's low growth (we're sceptical).¹

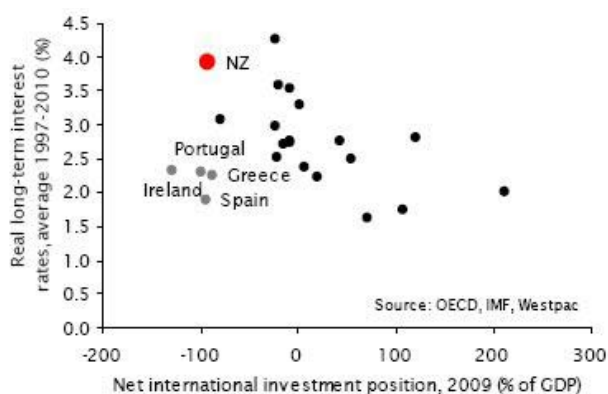
More recently, it's been argued (both in the recent report by the Savings Working Group, and by the RBNZ) that low savings have contributed to New Zealand's high exchange rate – that raising New Zealand's national saving rate could result in a lower exchange rate as well as lower interest rates, and so take pressure off the beleaguered export sector. In this bulletin we take a closer look at that claim: we think it's based on a number of questionable assumptions, which could lead to both savings policy and monetary policy decisions being made for the wrong reasons.

GLOBAL VS LOCAL

At the heart of the disagreement are two very different explanations for why New Zealand's interest rates have, over time, been so much higher than in most other OECD countries – each of which has very different implications for the exchange rate. The standard economics view – which we share – is that the only way in which interest rates in different countries can diverge over the long haul is through different perceptions of risk or different rates of inflation. For countries with the same riskiness and the same inflation trends, interest rates should converge to the same global level – otherwise speculators could make riskless profits forever by selling assets in the low-yielding country and buying them in the high-yielding country. (Global interest rates are themselves determined by global saving and investment patterns – essentially by factors such as global growth prospects and global risk appetite.)

For New Zealand the standout risk is credit risk – we aren't that different from other countries (notably Australia) in terms of our inflation rates or the volatility of our exchange rate. What we do have is an unusually high national debt. While our government debt is relatively low by international standards, the net foreign liabilities of New Zealand as a whole, at over 80% of GDP, put us within reach of some euro area basket cases. This would tend to push our interest rates higher than for countries with lower debt (by making us a riskier investment proposition). The chart below, which plots average inflation-adjusted interest rates against net foreign debt for a range of countries, suggests that this broadly holds true (the aforementioned euro area countries are a notable exception, highlighting the extent to which their riskiness was mispriced before the Global Financial Crisis).

Average inflation-adjusted interest rates and net foreign debt



We'll call this explanation of New Zealand's high interest rates the 'risk premium' view. Over short periods, of course, interest rates in different countries diverge all the time, for reasons other than risk. For example, monetary policy tightening in one country might drive up interest rates. When this happens the exchange rate tends to appreciate as well, as investors chase yields. This is called the carry trade. Economic theory says that there is a limit to this carry trade – investors will pile into higher yielding currencies only up to the point where the exchange rate has become sufficiently 'overvalued' for its expected depreciation to off-set the prospective interest rate gains.

The alternative account of New Zealand's high interest rate history – which has been set out most fully in a recent Treasury Working Paper 2 - builds on the carry trade idea. This explanation – which we will call the 'excess demand' view - essentially says that a very long-lived aggregate demand boom specific to New Zealand has kept both interest rates and the exchange rate high. The story goes like this: for a host of reasons New Zealand has suffered from a chronically low level of saving relative to investment, and – as a corollary - persistently strong domestic demand. This has forced the Reserve Bank to keep interest rates above those seen in countries with higher saving rates. A side effect has been the large current account deficit, and our high level of foreign debt. What has allowed these high interest rates, and large current account deficits, to persist over time is a chronically overvalued exchange rate. Essentially, investors have been expecting the currency to come crashing down for 20 years. It won't happen overnight, but it will happen!

² Labuschagne, N and P Vowles (2010), 'Why are Real Interest Rates in New Zealand so High? Evidence and Drivers', Treasury Working Paper 10/09.

FAIR OR FOUL

Both these theories explain the coincidence of high debt and high interest rates in New Zealand, but their predictions for the exchange rate couldn't be more different. The 'risk premium' view suggests that as countries become more indebted, they should see rising interest rate premia and, if anything, a sagging exchange rate (because they need to export more and import less to pay their rising overseas debt burden). The 'excess demand' explanation, by contrast, implies that relatively high interest rates should have coincided with an 'overvalued' exchange rate.

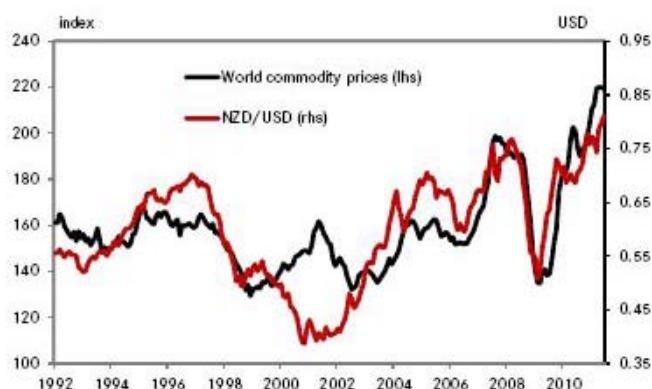
The Treasury authors argue that the New Zealand dollar has been significantly above sustainable levels, and that this counts in favour of their story. We're not so sure. In other work the Treasury have pointed to research by the IMF and others concluding that the dollar is still well above its long run value.³ But we would argue that what you consider fair value depends crucially on your expectations for the terms of trade, or the price of a country's exports relative to its imports – higher terms of trade provide an income boost that allows a country to service its debts at a higher exchange rate. For New Zealand, rising global commodity prices have seen the terms of trade reaching record highs, and our view is that they are likely to stay high for a long time to come. In that kind of world, we would also expect the exchange rate to stay above historical averages.

A MATTER OF EXCHANGE

The IMF use a variety of approaches to assess our exchange rate, but only one of those models controls for the terms of trade – and we're not surprised to see that model concluding that the exchange rate is less than 5% overvalued, well within the margin of error around zero.⁴

Leaving aside what 'sustainable' is, we think the IMF's conclusions are based on some debatable assumptions for New Zealand's debt outlook. The approach of the IMF's other two models is to ask what exchange rate would be needed to get our current account and net foreign debt back to sustainable levels – but that's relative to the IMF's baseline forecasts.

Commodity prices and the exchange rate (inflation-adjusted)



Those forecasts are for the investment income deficit (i.e. the interest paid on overseas debt and the profits earned by foreign-owned firms) to blow out to 8% of GDP by 2016! Back-of-the envelope calculations suggest that this would require interest rates, or profits, or New Zealanders' appetite for debt, to be higher over the next few years than at the peak of the last housing boom.

There is no question that an exchange rate at current levels is painfully high for non-commodity exporters and import competing manufacturers. But that is not necessarily the sign of an 'imbalance' that policy needs to correct, or could easily correct even if it wanted to. It reflects that the world is willing to pay more for what we export, and that as a country, we are able to consume more for what we produce. That is the blessing and the curse of Lucky Countries, also known as Dutch Disease.

FOREVER OVERVALUED

Not only do we have doubts about how overvalued the exchange rate is right now, we find it very hard to believe that the exchange rate has been overvalued, on average, for decades at a stretch. Over that sort of time span markets adjust and 'long-run' drivers look increasingly relevant. It does seem to be true that, as the Treasury paper notes, the 'carry trade' can be profitable for extended periods before the exchange rate comes back to earth.⁵ But apart from investors continually expecting an exchange rate depreciation which never comes – which really does not seem plausible to us - there are only two obvious ways in which this could happen. One is that financial markets are 'irrationally exuberant', expecting an overvalued exchange rate to stay overvalued. This is reasonable over an economic cycle, but not over 20 years.

³ Mabin, G. (2010) 'New Zealand's Exchange Rate Cycles: Evidence and Drivers',
⁴ IMF, 2011 New Zealand Article IV Report.

⁵ See, for example, Burnside, C, M Eichenbaum, and S Rebelo (2008) 'Carry Trade: The Gains of Diversification' *Journal of the European Economic Association*, 6(2-3): 581 – 588.

FOREVER OVERVALUED (Con't)

The second way would require a whole series of surprise boosts to aggregate demand over that period – what's more, boosts to demand that are specific to New Zealand. One candidate source of these positive demand shocks that we have heard mention is net migration. But New Zealand's net immigration rate has, on average over the past 20 years, been less than that experienced in the US and Australia. Overall, it's this aspect of the 'excess demand' story that just doesn't pass the sniff test.

Is there any evidence, consistent with the 'risk premium' story, that higher debt levels would tend to coincide with a lower exchange rate over time? It's mixed – the IMF has done several cross-country studies looking at determinants of exchange rates, including a country's net foreign debt. Some find a small negative effect (higher net foreign debt is associated with a lower exchange rate), some don't. It seems that other factors such as relative productivity and the terms of trade matter more. **6**

HAVING YOUR CAKE AND EATING IT

The 'excess demand' account of New Zealand's high interest rates has some very seductive implications. If we could only find a way of getting New Zealanders to save more, we could have both lower interest rates and a lower exchange rate. We disagree. On our preferred 'risk premium' view, higher savings would also be rewarded with lower borrowing costs – but the exchange rate would, if anything, be higher because of a lower foreign debt servicing burden and reduced country credit risk.

But the implications of the two views of the financial world go beyond the exchange rate. As we have set out in our previous work on the post-financial crisis interest rate landscape **7**, they also potentially lead to very different predictions for future monetary policy. Under the 'excess demand' view, borrowing rates might in future be permanently lower (if New Zealand becomes a nation of savers), whereas under our 'risk premium' view, interest rates should eventually return to levels seen over the past couple of decades, and could even rise higher. In particular, what if the required compensation or risk – not just in New Zealand, but everywhere – has shifted higher since the bursting of the 2000s credit bubble?

On our view, this inevitably means that NZ lending and deposit rates will be higher, on average, than in the past decade. There will be nothing the RBNZ can do to persistently offset the reduced willingness of foreigners to lend to us, without causing higher inflation. Under the logic of the 'excess demand' view, provided that sufficiently high domestic savings could be engineered, the RBNZ could offset higher international funding costs with a lower OCR for decades (implying, presumably, an undervalued exchange rate over the next 10-20 years!)

Overall, we feel that there is a reluctance on the part of some participants in recent policy discussions to accept the implications of a tighter global funding environment for New Zealanders' standard of living. There also seems to be a widespread desire to search for ways of tightening monetary policy without raising the exchange rate. We suspect a lot of this is wishful thinking. We agree that higher savings have the potential to drive New Zealand's real interest rate premium down. But that would not necessarily lead to a lower exchange rate – which reflects the best export environment that New Zealand has seen in decades. And it is higher interest rates – via a more realistic global pricing of risk – which may help achieve those higher saving rates in the first place.

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6 See Edison, H and F Vitek, 'Australia and New Zealand Exchange Rates: A Quantitative Assessment', IMF Working Paper 09/07, table 2, and Ricci, L, G Milesi-Ferretti, and J Lee, "Real Exchange Rates and Fundamentals: A Cross-Country Perspective", IMF Working Paper 08/13, p. 9.

7 'A matter of interest', Westpac Bulletin, 12 August 2010. Treasury Working Paper 10/10, p. 26.



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AVOID THE RISK OF HISTORY REPEATING ITSELF.

On 4th March 1985, the New Zealand Dollar was allowed to float freely against other currencies. Prior to this date, it had been pegged to a value calculated by a basket of currencies. From an opening exchange rate of around NZ\$2.50 to £1.00, the Kiwi Dollar fell in value and by the 3rd quarter of 1995 each pound was commanding NZ\$3.70 but the Sterling – NZ Dollar exchange rate is one of the most volatile in the financial markets and we have seen a drop to NZ\$2.17 and a bounce to NZ\$3.70 again.

Sadly for those moving to New Zealand, we are currently testing the lowest levels we have seen since the Kiwi Dollar was initially floated. I am sure you are bored of reading the reasons for the extraordinary fall we have seen in this exchange rate since 2008 but that was a continuation of a trend that started around the millennium. This trend may well have a lot more downward momentum which from both a technical and fundamental perspective could see us reach NZ\$1.60 to the Pound in the year ahead.

Because the NZ Dollar exchange rate was artificially managed prior to March 1985; we are into uncharted territory as far as technical analysts are concerned but in 1973, the Sterling – Kiwi Dollar rate did bottom out at NZ\$1.56. If any of us were asked a year ago, whether we would see those levels again, I am sure most would have laughed and said don't be daft, but here we are and there we may be heading.

This may be a doom laden report if you are planning to move your funds to New Zealand but better to know that this potential exists and protect against it than to wait for a bounce which doesn't happen and be forced though time pressure to convert your funds at an exchange rate that robs you of another 15% of your funds.

So, thinking on the positive side and planning to avoid loss, the three vital elements are protection, protection and protection. I know that is only one element really but I thought it was important enough to write it three times.

Protecting against a further drop in the value of the pound against the Kiwi Dollar is remarkably simple if you have access to the right tools through a broker you can trust. If you have a specific level at which the migration plans stop making financial sense, then you can guarantee yourself that exchange rate as a worst case scenario through automated market orders called "Stop loss" orders. They do exactly as they say on the tin, in that they stop you losing more money by triggering and guaranteeing the exchange rate you targeted no matter what happens to the exchange rate after your order has been triggered.

If you want to just guarantee yourself the current exchange rate, you can agree a rate today but set a settlement date for the exchange of funds up to two years ahead. This is particularly useful if the bulk of your funds are tied up in a property in a stagnant market, or shares which are too poorly priced to sell at this stage.

And people generally think of their currency conversion as a yes or no decision. Convert everything or wait. In many cases, it is worth converting portions of your funds in phases to ensure you receive a good average exchange rate but don't run full risk on all your funds in the interim.

Of course the other option is to do nothing; to wait and hope but after decades of trading currency, I would always urge caution and risk management as the key ingredients and press clients to avoid risk taking unless they have no other option. That is almost never necessary.

For a more thorough explanation of the current trends, please contact **David Johnson**; a Director of Halo Financial; specialist providers of foreign exchange for migration purposes on **+ 44 (0) 207 350 5474** or email him at **david.johnson@halofinancial.com**

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