Weekly Overview

27 March 2013

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Mission Statement

To help Kiwi businesspeople and householders make informed financial decisions by discussing the economy and its implications in a language they can understand.

The Weekly Overview is written by Tony Alexander. The views expressed are my own and do not purport to represent the views of the BNZ. To receive the Weekly Overview each Thursday night please click here.
http://feedback.bnz.co.nz/forms/Fx-I8ploskSGWgjN_7WOAw

Monthly Survey Time – Earlier Than Before

To ameliorate publication congestion around the middle of each month I'm shifting the timing of the BNZ Confidence Survey to the last Thursday each month from the first. That means the next survey is being run now. So if you have a minute please click on the link and let me know whether you feel the economy will be in better or worse shape in a year's time, how things are in your industry, and one more special question.

http://feedback.bnz.co.nz/surveys/Fi8Go-yFGEu0bwjPu5Waww

With regard to data received on the state of the NZ economy this week we have the good news from Fonterra of an upward revision to their forecast payout this season, and the bad news that the drought is continuing and risking hitting next season's production. We have learnt that courtesy of some shifting of stocks it seems seasonally adjusted exports improved by 16% in February after falling 15% in January. Growth for the past three months has been 3.3% which is a mediocre improvement following a 6.5% fall in the three months to November.

For the year to February NZ's merchandise export receipts have fallen by 4% and with the drought continuing, NZD high and likely to go higher, and world growth holding up but not really accelerating in aggregate, a further fall is likely in the coming year. The same is likely in tourism where spending by visitors in New Zealand fell by 6% during calendar 2012 with spending by visitors from the UK down 21%, the United States 7% and South Korea 22%. But spending by Japanese visitors rose 31% and Chinese 42%.

We also learnt from the Department of Labour that jobs advertised online (Seek and Trademe websites) fell in seasonally adjusted terms by 3% in February. But this followed a large jump of 12.7% in January making a change for the past three months of +0.2%. That is fairly small but there appears to be a tendency for these numbers to improve and feedback from my travels to Christchurch last week and Auckland this week suggests employers are becoming more and more aware of their need to recruit before supplies completely dry up.

INTEREST RATES

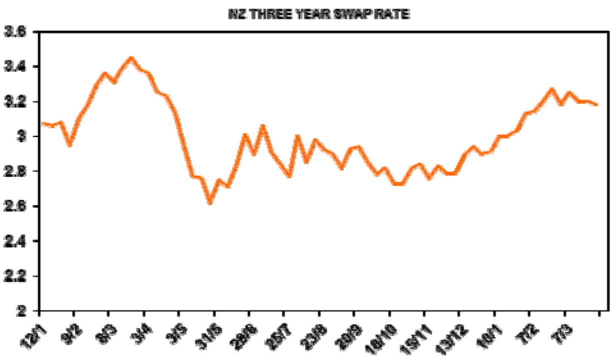
No major data this week, nothing startling offshore beyond the debacle in Cyprus, rates therefore steady.

A quick glance at the rates table below will show that compared with a week ago nothing much has changed with regard to NZ wholesale interest rates. That is because we have not received any fresh unexpected data, any unexpected comments from the Reserve Bank, or anything particularly startling with regard to probable interest rate movements offshore.

That view regarding offshore remains one of interest rates staying at low levels for a completely unknown period of time – basically until central banks feel that their economies have enough momentum away from the GFC and its aftermath that they can turn the afterburners off. Given the events in Cyprus we are if anything more distant from the point of rates rising in Europe than we were two weeks ago. In Japan a new central bank Governor is in place and the markets eagerly await his stimulatory measures. In the US the Fed. goes to pains sometimes to emphasise a complete lack of intention of tightening monetary policy anytime soon.

In Australian however there are few left in the financial markets now who expect that the RBA will cut rates again. That has added a touch of light upward pressure to some fixed borrowing costs here but nothing major.

The chances are that in a year's time we will still have 90-day bank bill yields about where they are now, while longer term rates will be higher based on the expectation that world growth will look better and we will be much closer to central banks starting to remove their extraordinary stimulus measures. However …. given the near zero probability that those measures will be removed in an optimal manner one should not believe that predictability of interest rate changes in a year's time will be any better than it is now.



FINANCIAL MARKETS DATA	This week	Week ago	4 wks ago	3 months ago	Yr ago	10 yr average
Official Cash Rate	2.50%	2.50	2.50	2.50	2.50	5.4
90-day bank bill	2.67%	2.68	2.66	2.67	2.76	5.7
1 year swap	2.79%	2.80	2.81	2.69	2.89	5.8
3 year swap	3.18%	3.20	3.18	2.94	3.45	6.1
5 year swap	3.53%	3.56	3.52	3.24	3.96	6.3
7 year swap	3.83%	3.88	3.76	3.56	4.35	

HOUSING MARKET UPDATE

This is how we are reminded of our low incomes

People often ask how our low income relative to countries overseas manifests itself. We usually answer along the lines of inability to afford a proper public transport system in Auckland, poor roads throughout New Zealand, insufficient money in the health system (including for keeping our NZ-trained health professionals), loss of many young people offshore, and lack of good broadband. There are many other ways but perhaps one of the modern in-your-face ways is this. We are outbid for properties in Auckland by people offshore with deeper pockets.

That is perhaps the uncomfortable message of the concern about foreign buying – from Asia in particular given that it is in Asia that relative incomes are changing rapidly to our own rather than the UK or USA. The optimal answer is that we raise our incomes. But failing that the optimal response could be a rational public debate about foreign purchasing rules.

On the housing issue overall, this Tuesday I spent four hours at a symposium on housing affordability held at the Massey University Albany Campus. Given the special nature of the event and importance of the issue I prepared a handout and this is it here. You can find it also at http://tonyalexander.co.nz/wp-content/uploads/2013/03/Massey-March-2013.pdf

Late in 2008 when New Zealand's recession was extended another three quarters by the global financial crisis, some people were predicting that NZ house prices would fall by 30% - 40%. The basis for their forecasts appeared to be that prices were falling sharply overseas and because NZ house prices were high by global and historic standards they would also similarly collapse in New Zealand.

I gave an opinion at the time that house prices would decline by between 10% and 15%.
http://www.stuff.co.nz/business/773623
http://www.nzherald.co.nz/property/news/article.cfm?c_id=8&objectid=10555198
http://www.nzherald.co.nz/property/news/article.cfm?c_id=8&objectid=10553773

This prediction was based upon a number of factors.

- NZ did not enter the 2008 recession with a housing over-supply but with an under-supply caused by not so much the absence of bank lending as occurred overseas, but a lack of people to build the houses. New Zealand's unemployment rate hit 3.5% in 2007 and builders became in short supply.
- That under-supply got rapidly worse from early-2008 and dwelling consent numbers fell below the 23,000 long term annual average in July 2008 and have been below that ever since, hitting a four decade low of 13,269 in mid-2011.
- Because we started with interest rates at very high levels (10.5% floating mortgage rates) the Reserve Bank was able to cut rates a very long way and come late-2009 floating mortgage rates were below 6%. That means borrowers faced a massive decline in debt servicing costs so not many had to sell their houses.
- New Zealand's unemployment rate never breached 7% apart from one errant quarter last year.

During 2011 I delivered the view that at some stage awareness of the shortage would grow and there would be a wave of buyers entering the market. To help identify the timing of that wave I initiated a monthly nationwide survey of licensed real estate agents with the REINZ in April of that year. In December 2011 a net 1% of agents said there were fewer investors in the market than the month before and a net 29% said there were more first home buyers.

But in the first survey for 2012 in February those measures had jumped to a net 15% and 49% respectively. That is when awareness of the shortage kicked in. Both measures have remained very strong with the latest readings being 37% and 39%. Since then average Auckland house prices have risen by 11% and they are 31% up from their late-2008 lows.

The two key fundamentals driving the market now are four years' worth of first-home buyers catching up on purchasing they did not do earlier for reasons of

- concern house prices would fall
- thoughts that banks no longer lent money to buy houses
- fears of unemployment.

In addition investors are buying because

- there was no wave of selling following the removal of the ability to claim depreciation
- there was no wave of selling following the removal of the ability to use LAQCs to offset losses against other income
- there was no collapse in prices
- returns from investing in banks are low.

The situation now is that in spite of the Commerce Select Committee undertaking an investigation into housing affordability in 2008, and the Productivity Commission last year repeating the exercise, five years of action have been wasted and the situation is even worse.

Within the BNZ and in my talks for the past six or so years one of my key points of focus has been the coming crisis of not just housing affordability, but in the case largely of Auckland, housing availability as well. Worsening housing situations will bring deteriorating family environments with the concomitant health and education problems such environments bring.

The question now is whether there is a chance that things will get better in the near future. I believe not for a variety of reasons. In the case of Auckland I presented 19 of these reasons in my Weekly Overview of November 1 last year.
http://tonyalexander.co.nz/wp-content/uploads/2013/02/WONovember-1.pdf

The reasons amount to

- An existing shortage.
- The shortage getting worse with annual consents only at 4,722 when 7,000 is the long term average and the Auckland Council estimates 13,000 per annum are needed. I can find no record of consents having ever reached that level.
- Rising construction costs associated with rising building standards.
- Strong demand from investors assisted by low financing costs and loss of a belief that house prices will collapse.
- An aging population.
- Rising net migration inflows now at 1,195 from -4,068 a year ago.
- Lack of builders as a result of low training the past five years, loss of tradespeople to Australia, and demand from other areas including Christchurch, irrigation projects, roading projects etc.

The situation is going to get worse.

One factor attracting special attention recently has been the role being played by foreign buyers – though the only anecdotes regarding such buyers concern Chinese people. In order to get a feel for the size of the offshore buying issue I added some special questions to my monthly BNZ-REINZ Residential Market Survey last month.
http://tonyalexander.co.nz/wp-content/uploads/2013/03/BNZ-REINZ-Survey-March-2013.pdf

In Auckland 23% of house sales are to first home buyers (all NZ 24%), 22% to investors (19% nationwide), and 11% to people offshore (9%). I asked where the foreign buyers were coming from. This first table presents the Auckland-only results. It shows that 19% of Auckland offshore sales are to people from China (15% nationwide), 15% to people in Australia (14%), and 18% to people in the UK (18%).

Auckland Only	China	Australia	UK
% of the sales offshore	19	15	18
% who will shift to NZ	42	47	74
% NOT planning to shift to NZ	22	18	6
If assume ½ Don't Knows=Won't Shift			
% sales to offshore investors	**0.8**	**0.6**	**0.3**

Agents indicated that 42% of buyers in China plan shifting to NZ, 47% of those in Australia, and 74% of those in the UK. If we count half the Don't Knows as planning to shift to NZ and apply the resulting proportions to sales offshore we get the final bottom line.

It shows that 0.8% of Auckland house sales go to people in China not planning to move to New Zealand. 0.6% go to people in Australia not planning to move, and 0.3% to people in the UK. The following table presents these figures along with those for all other regions and NZ as a whole. Note the final column showing the proportion of each region's sales to people staying offshore.

	% of sales to pure offshore investors									
	Australia	**China**	**Europe**	**India**	**Other Asia**	**South Africa**	**UK**	**USA**	**Other**	**All**
Northland	0.2	0.5	0.3	0.2	0.5	0.3	0.4	0.3	0.3	**3.0**
Auckland	0.6	0.8	0.5	0.4	0.7	0.3	0.3	0.4	0.5	**4.6**
Waikato	0.3	0.6	0.3	0.5	0.5	0.4	0.2	0.3	0.4	**3.6**
Bay of Plenty	0.3	0.5	0.4	0.3	0.4	0.2	0.1	0.3	0.2	**2.7**
Hawkes Bay/Gisborne	0.4	0.5	0.4	0.4	0.3	0.2	0.2	0.3	0.3	**2.9**
Taranaki	sample too small									
Manawatu/Wanganui	0.6	0.8	0.4	0.5	0.5	0.6	0.8	0.4	0.4	**5.1**
Wellington	0.3	0.3	0.2	0.2	0.2	0.2	0.3	0.1	0.2	**2.1**
Nelson/Marl. W. Coast	0.2	0.8	0.6	0.5	0.6	0.4	0.1	0.4	0.4	**4.0**
Canterbury	0.3	0.4	0.3	0.3	0.6	0.3	0.2	0.4	0.4	**3.3**
Otago	0.6	1.0	0.8	0.8	0.8	0.9	0.5	0.5	0.5	**6.4**
Southland	not included by accident									
All	**0.5**	**0.7**	**0.4**	**0.4**	**0.6**	**0.3**	**0.3**	**0.4**	**0.4**	**4.0**

Some 4% of all house sales in NZ are to people not planning to shift here. In Auckland that proportion is 4.6%. Results for the other regions should be treated with caution given the smaller sample sizes.

Many emailers have questioned the results, but I offer the following four reasons to justify their accuracy.

First, if there was an agent desire to downplay the role of foreign buyers I would have expected the number of responses to have risen from 572 in February – not fallen to 355.

Second, I would also have expected the net percent reporting more interest from investors to have done more than move from a net 35% positive in February to 37% this month.

Third, given that the sensitivity is with regard to Chinese bias I would have expected a big drop in the numbers reporting buying from people in China. But compared with last month's survey where we asked for agent opinion about sales offshore versus actual personal sales, the change across reported buyers from China, Australia, and the UK was basically the same. From page 5 of the report.

	Perceived % of offshore sales to buyers February survey	**Actual sales March survey**	**Perception error**
China	24%	15%	9 percentage points
Australia	21	14	7
United Kingdom	27	18	9

Fourth, the url below will take you to a pdf copy of the annual report issued by the National Association of Realtors in the United States called "Profile of International Home Buying Activity 2012" It covers the year to March 2012. The NAR survey found that 8.9% of US house sales by value were to people offshore or only recently migrated to the United States, measured by dollar value. Some 4.4% of sales were to foreigners not planning to shift to the United States. That is very close to the 4% derived from my survey – though the results need to be treated with caution as the US survey may or may not capture expats.

In that regard it could understate purchases and the true figure may be more than 4.4%. Equally however their survey is of values and the average value of a house sold to a foreigner is $400,000 versus $212,000 to domestic buyers. It is however unlikely that foreigners buy houses on average worth over $1m (the average Auckland sales price is near $550,000) but nevertheless, on the face of it NZ house sales to people not intending to move to NZ may still be very close to the US result allowing for probably high NZ expatriate buying.
http://www.realtor.org/sites/default/files/2012-profile-international-home-buying-activity-2012-06.pdf

However, much as the data suggest that the impact of foreign buyers so far is low, that impact is highly likely to grow over time as Asian incomes rise. On that basis a debate about rules relating to offshore purchasing of NZ houses would be useful.

Migration Flows Adding to Housing Demand

One of the factors which can have a large influence on New Zealand's housing market – in Auckland in particular, is changes in net migration flows. In that regard the long warning I have been giving here is that house prices have been rising in an environment when those flows have been weak or negative. But now they are positive and set to get more so.

In the year to February the net migration gain was 1,195 people. One month earlier the net annual flow was a gain of 12 and a year earlier the flow was a loss of 4,068. In seasonally adjusted terms the annualised gain has been close to 2,500 in the past three months so the numbers do not suggest that net inflows are skyrocketing as they did in the early 1990s and 2000s. But nevertheless the trend is there and it is supportive of house demand while doing little for housing supply unless many of the people coming in are builders.

If I Were A Borrower What Would I Do?

I'd have half my mortgage floating and fix the other half for a term of 3 – 5 years but only if I was offered a nice low rate comparable to floating. I would also run a scenario for budgeting purposes of interest rates in two years' time being 2% above current levels, then 3% above in three years' time. People borrowing money currently should in no way assume that interest rates will always be at these levels. Rates currently are the lowest they have been since the 1960s and that is not because we are in a new permanent low rate paradigm but because central banks offshore want to push their economies away from recessionary states and don't plan letting up until a lot of growth momentum has developed.

So these low rates will not be here forever and borrowers should give serious thought as to whether they can really afford to service the high debt they may currently be stretching to service already with interest rates at these multi-decade lows.

Borrowers also should maybe run numbers comparing their housing costs in the cities versus city-incomes, with the ratio if they bought and lived in a smaller centre.

OFFSHORE

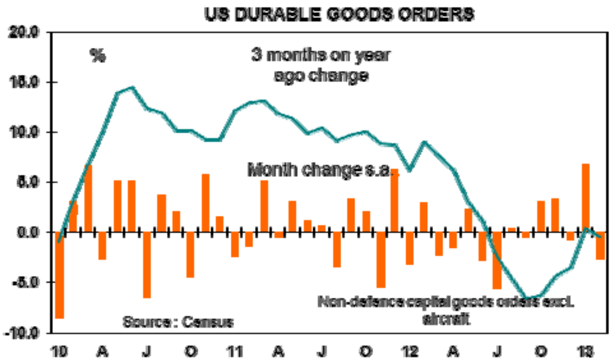
The main piece of news about growth and financial markets offshore this week surrounded the €10bn bailout of Cyprus by the ECB and European Commission. Because Cyprus only accounts for some 0.2% of Euro-Zone GDP, because German voters and those in some other well managed northern European countries are tired of bailing out the economic failures down south, because a lot of the deposits in Cypriot banks are from Russians, and because Cyprus previously has preferred Russian to European assistance money and failed to reform there was never any intention to show them quarter.

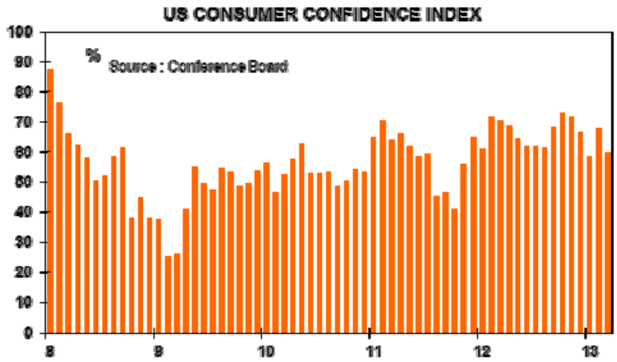
So the EU initially tried to force a tax on all Cyprus depositors. In doing so they reopened completely the worries Europeans already have about deposits in their own banks and thus risked precipitating Europe-wide bank runs and a Euro-collapsing outflow of funds to other parts of the planet including down here in NZ.

Sticking it to Cyprus just because they could has backfired and following the Cypriot parliament’s rejection of the first depositor levy proposal a new scheme has been enacted whereby all unsecured depositors in Cyprus’s second biggest bank are going to lose a lot of their money in order that Cyprus can come up with the over €5bn demanded by the bailout parties as offset for Cyprus receiving funds. The trigger for Cyprus caving in and agreeing to big losses for many depositors (but not the small ones) was the announcement from the European Central Bank that unless they reached agreement there would be no more emergency liquidity funding come Tuesday morning – and thus Cypriot banks would have collapsed.

The upshot of this terribly mismanaged episode is a reopening of worries about European banks and top level European political and economic management skills, new sustained downward pressure on the Euro, and extra support for the likes of the NZ dollar.

In the United States we received data last night giving a further sign that businesses are buying into the upturn scenario through raising capital spending. Orders placed for core durable goods fell in February by less than expected after rising strongly in January.





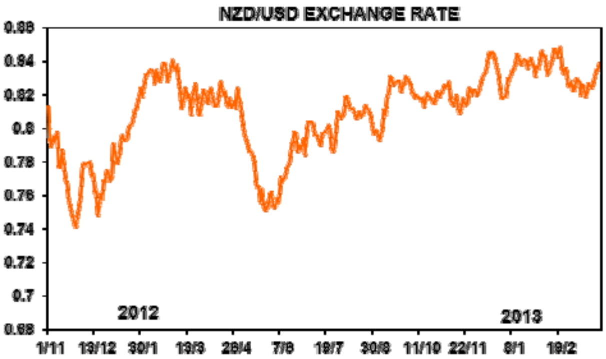
Data from Case-Schiller also show average US home prices now over 8% higher than a year earlier. This is very important because it will give greater confidence to potential buyers to enter the housing market while encouraging builders to gear up ready for higher construction. Higher prices also boost perceived wealth (an explicit target of the Federal Reserve’s easing policy) and therefore some boost to household consumption may follow. But just to remind everyone that in no way can one yet conclude that the US economy is fully out of the woods consumer confidence in the US measured in the Conference Board’s monthly survey declined by more than expected in March to a reading of 59.7 from 68 in February.

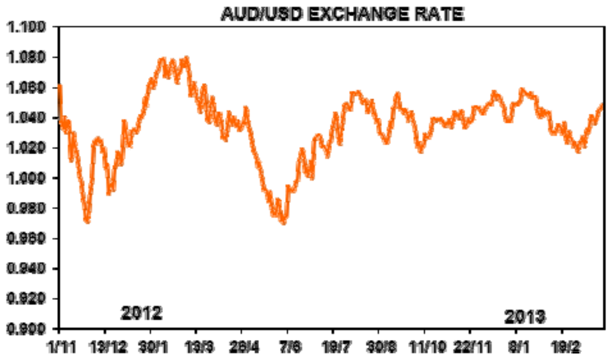
Exchange Rates

Exchange Rates	This Week	Week ago	4 wks ago	3 Mths ago	Yr ago	10 yr average
NZD/USD	0.839	0.826	0.826	0.818	0.823	0.67
NZD/AUD	0.8	0.795	0.806	0.788	0.781	0.85
NZD/JPY	79.2	79.2	75.9	70	68.1	69.6
NZD/GBP	0.553	0.547	0.546	0.507	0.515	0.388
NZD/EUR	0.652	0.638	0.632	0.618	0.616	0.52
NZDCNY	5.21	5.13	5.15	5.10	5.19	4.99
USD/JPY	94.40	95.88	91.89	85.57	82.75	105.7
GBP/USD	1.52	1.51	1.51	1.61	1.60	1.72
EUR/USD	1.29	1.29	1.31	1.32	1.34	1.28
AUD/USD	1.05	1.04	1.02	1.04	1.05	0.788
USD/RMB	6.2118	6.2118	6.2296	6.2354	6.3036	7.56

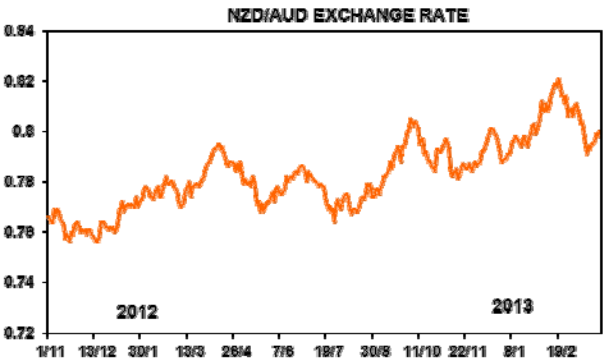
Kiwi dollar rises to near US 84 cents and upward trend for the year toward 90 cents remains a high probability

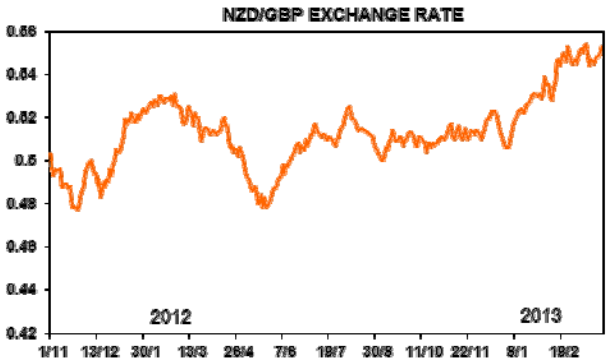
As noted above the Euro has weakened this week in response to worries about capital flight following the appalling handling of the request from Cyprus for help from the troika of the IMF, European Commission and European Central bank. With investors now feeling (despite vociferous denials) that contributions from bank depositors may be required for any future bank bailouts the risk is that people and institutions move some of their savings out of the Eurozone banks. That implies some greater flow of funds into currencies like the NZD and Aussie dollar and just as we have risen by a cent against the US dollar this week so too has the AUD.



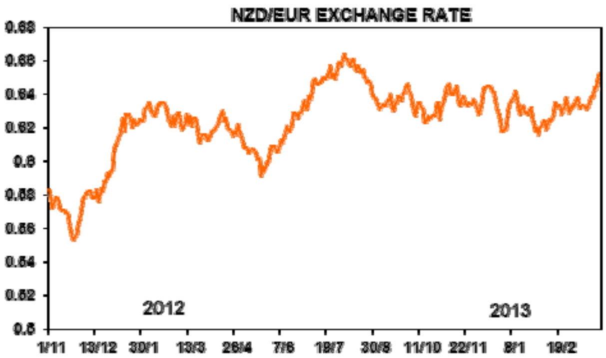


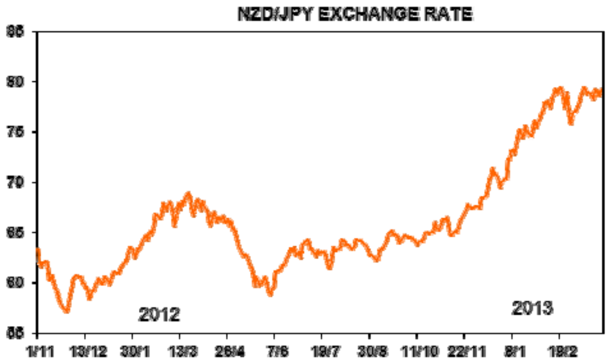
The AUD's rise has been assisted by a reduction in market expectations that the RBA will cut interest rates again.





With regard to the NZD itself there has been upward pressure this week from Fonterra's upward revision to its payout forecast to $6.12 per kilogram of milk solids from a range of $5.90 - $6.0. Plus, the merchandise trade account balance for February came in better than expected.





Key Forecasts

Dec. year		2011	2012	2013	2014
GDP	annual average chg	1.5	2.0-3.0%	2.5 – 3.0	3.0 – 3.5
CPI	on year ago	1.8	0.9	1.0 - 2.0	2.0 – 2.5
Official Cash rate	end year	2.5	2.5	2.5 – 2.75	2.75 – 4.25
Employment	on year ago	1.6	1.0	1.0 – 2.0	1.5 – 2.0
Unemployment Rate	end year	6.4	6.5 – 7.0	6.0 – 7.0	5.5 – 6.0

The Weekly Overview is written by Tony Alexander, Chief Economist at the Bank of New Zealand. The publication is sent to 27,500 subscribers each week and is one of a stable of regular releases which include the

- monthly Growing With China publication, http://tonyalexander.co.nz/topics/china/
- monthly Brain Gain NZ publication http://www.braingainnz.co.nz
- monthly BNZ Confidence Survey, http://tonyalexander.co.nz/topics/surveys/bnz-confidence-survey/
- monthly BNZ-REINZ Residential Market Survey. http://tonyalexander.co.nz/topics/surveys/bnz-reinz-survey/
- Monthly column for the NZ Property Investor magazine, http://www.propertyinvestor.co.nz/
- Monthly column for the NZ China Trade Association. http://www.nzcta.co.nz/
- Most of these publications plus research into impediments to NZ's economic growth are available on his website. www.tonyalexander.co.nz

Tony Alexander has been Chief Economist at the BNZ since 1994 and apart from publications and advising management spends considerable time on the road around New Zealand making presentations and speaking with the media. He travels to the UK and Europe twice a year to assess economic conditions and present at numerous functions, has five children, tramps, and his partner Dr Sarah Farquhar runs the early childhood education network www.childforum.com

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