Weekly Overview

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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/lFdYSs5FGEq4kAjP95uzTA

Retail Spending Growth Improves

Getting an up to date feel for what is happening with consumer spending in New Zealand is hard – if not statistically speaking all but impossible. There is no monthly retail sales release from Statistics NZ, the quarterly data are out of date, and the monthly proxy from the Electronic Card Transactions release is explicitly noted by Statistics NZ as not suitable as a retail trade measure. So we all, including the Reserve Bank, are always guessing as to the current degree of strength in household spending – the factor which has a bigger impact on our growth than anything else except shocks.

We try to get a feel by looking at confidence indicators. But there is an uncertain and variable relationship and lag between confidence changes and spending levels with evidence that since the GFC the relationship between sentiment and actual spending has changed for the worse. Nevertheless what we know from the most up to date sentiment gauges is that people are expressing confidence in the economic environment they see or expect to see around them in the coming year.

Our BNZ-Nine Rewards Consumer Trends Survey released last week shows that a net 29% of the 553 respondents expect the economy to be in good shape in a year's time. Also a net 6% of people say they intend spending more than usual in the coming month. But this 6% is down from 19% three months earlier so retailers should not be rubbing their hands in anticipatory glee.

The Roy Morgan-ANZ sentiment measure stood at 119.8 last month where 100 is neutral. That sounds good but it is down from 124 in June and also therefore suggesting retailers should not get overly optimistic.

These measures perhaps should be listened to because it is not likely that the good robust growth rate in retail spending revealed for the June quarter yesterday will continue. Core retail spending after adjusting for inflation and seasonal factors grew by a faster than expected 2.3% after rising 1% in the March quarter and 1.1% in the December quarter. Spending on durable goods roughly classified grew by a strong 4.2% and for the entire year to June core spending rose by 2.7% following growth of 4.7% a year ago.

That latter comparison perhaps explains some of the strength in the June quarter. There was probably an element of catch-up spending involved. The Electronic Card Transactions release for July appeared this week also and it showed seasonally adjusted core spending down by 0.7% in a correction from 0.6% growth in June and 0.4% in May. The annualised pace of growth over the past three months was 4.2% compared with 3.6% three months ago and 6.4% three months before that.

The data and the sentiment measures tell us that there is probably not a big acceleration underway in the pace of growth of retail spending in New Zealand but June quarter was strong. The summary we gave of responses from retailers in our monthly BNZ Confidence Survey released last week was "Still evident that consumers are seen as keeping wallets reasonably tightly closed." Therefore don't be surprised if retailers continue to express concern about their operating environment, continue to feel obliged to discount goods, and some will close down.

But before one gets too dismissive of the strong June quarter result, prospects further out for retail spending look quite good given the construction boom now getting started, a sharp jump in dairy incomes this season, a migration boom also getting underway, and employment growth set to pick up. Low interest rates and rising housing wealth are also like to spur good spending growth in the coming three years.

Do We Really Need More Household Debt?

During the week a unionist made the suggestion that our central bank should promise not to raise interest rates until unemployment falls below a certain level. This is broadly the desperate approach being taken by both the Bank of England and Federal Reserve as they try to – in the words of new BOE Governor Mr Carney - get their economies to “escape velocity”. Their GDP growth rates remain low as people, businesses, banks and governments struggle to get debt levels down.

Why would such an approach be unwarranted in New Zealand? First, the explicit aim of the extraordinarily loose monetary policies being run in the UK and US is to get banks lending more, people borrowing more and boosting their debt levels, and hopefully people spending more. The last thing we need in New Zealand is a further rise in already dangerous levels of household and farming sector debt. The Reserve Bank is in fact so concerned about the exposure of NZ banks to household debt that they will soon introduce quantitative restrictions on high loan to value ratio lending.

Second, the explicit aim of the BOE and Fed. is to boost asset prices. That means they want house prices rising. We already have that in spades in New Zealand to the point where young and low income buyers are being squeezed out of the market and concerns about social implications are rising. The last thing we need is special policies to be put in place to accelerate house price rises.

Third, neither the UK or US faces a large obvious economic stimulus in the future. We do – the biggest reconstruction job our country has ever seen plus revenue into and investment in the dairy sector.

Fourth, neither the UK or US is experiencing the shortages of labour which are already appearing in NZ with above average difficulties being reported by employers in sourcing skilled labour and average difficulties in sourcing unskilled labour – and this with the unemployment rate of 6.4% well above the 4.6% ten year average.

Fifth, the US and UK have reached the end of usefulness in their traditional monetary policy instrument – the overnight cash rate – with rates set at 0.25% and 0.5% respectively. Any additional cuts would be all but meaningless in stimulating their economies so they are forced to resort to trying to massage the willingness of people to borrow not via current interest rates but interest rates in the future with promises of keeping them low. Those promises they couch partly in terms of unemployment rate goals which are heavily subject to inflation remaining quiescent. Here in NZ in contrast the RB has a cash rate of 2.5% and therefore plenty of scope still to stimulate the economy if they felt the dire need to (they definitely do not). Their need to resort to promises regarding the future rather than actions set in the present is simply not there.

Having said all of that, you could hardly say that our central bank is succeeding with its monetary policy actions when the annual inflation rate is below their 1% - 3% target range at just 0.7% and has been less than 1% for five quarters. Still, the four year average which the previous excessively dovish Governor let rise to 3.2% in 2008 and 2011 is looking more acceptable now at 2.2%.

Spilt Milk

When news first broke of Fonterra’s dirty pipe debacle there were plenty of people who felt that the impact on our economy would be devastating as the Chinese would shun us. Media paid attention to some Chinese who apparently cancelled their trips to New Zealand because they no longer believed us to be clean and green. That seems silly. The Chinese social media platforms were awash with Chinese sticking the boot in and here in NZ a lot of people took the opportunity to land a few callous blows on an organisation which plays a massively vital role in our economy – perhaps too big a role given the concentration of our economic risk in one corporate/cooperative structure.

But the currency impact of the news faded quickly, the social media commentary eased off, and now we are going to have many months of investigations into what went wrong with Fonterra people obliged to publically show shame about what happened. If you are one of those people then spend some time seeing how the Japanese do it. They seem to be experts.

Why has the impact faded? It pays to remember a key thing regarding Chinese demand for our dairy products. They want them - badly. China is facing increasing problems feeding its own people, has a farming system not much changed from three centuries ago in vast need of modernisation, and the CCP want to ensure people can feed themselves, their aging parents and their children with good food. They need our products and our technology to try and replicate production on their own (polluted) soil.

So while some scalding of New Zealand is understandable and warranted, ultimately the Chinese authorities cannot let the outrage develop into a generalised abandonment of Kiwi products. In the same manner when disputes arise between China and Japan the CCP usually lets people get upset and riot for three days then starts shutting down blogs, changes the tone of media commentary, and tells students to go back to their classes. China’s reaction to things not liked is all about bluster, show of force, indignation, and admonition – all aimed explicitly at avoiding actual conflict or in this case cessation of product flows.

IF I WERE A BORROWER WHAT WOULD I DO?

First I would note that picking the speed with which fixed interest rates will rise is all but impossible. That is not just because of the usual uncertainty about the speed of economic growth, development of inflationary pressures, and anticipation of monetary policy changes in New Zealand and offshore. It is because of uncertainty over the success of the Bank of England and Federal Reserve in convincing people that they won’t raise interest rates for a long time. Central bankers offshore are worried that investors will short-circuit nascent economic recoveries by pushing medium to long term interest rates up too soon as they anticipate rises in official overnight interest rates. To try and stop such early fixed rate rises the central bankers are promising to keep rates low for long times, sometimes couching their comments in terms of not moving until labour markets have decisively changed. (The US 30 year mortgage rate has risen 1% recently to near 4.5% simply in anticipation of a rate rise the Fed is at pains to emphasise may not come for years.)

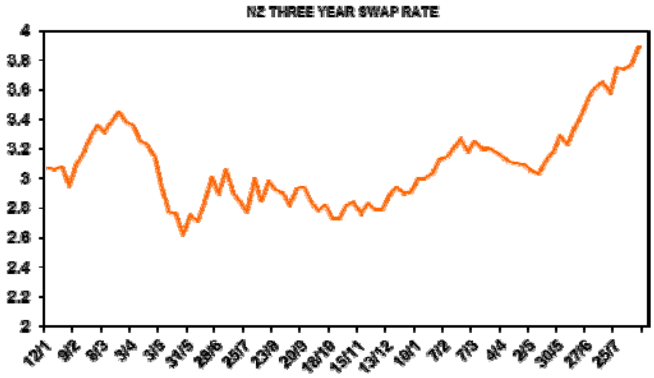
The trouble here is the target they have picked of official unemployment rates. The labour market lags and does not lead the economic cycle and therefore investors are concerned that by the time unemployment rates fall away inflationary pressures will already be strong and central banks will either have to very rapidly raise rates to curb pressures or they will break their promises and raise rates before unemployment rates reach their targets.

It is impossible to predict how market expectations of these things will alter over time and in particular how markets will react when central bankers make their steady rate promises. Two weeks ago in the UK rates actually rose after the new Governor made his promise not to tighten until the unemployment rate was below 7%.

Thus what I seek to do with these comments is to reinforce what I’ve been writing here for a long time now. You cannot think in terms of interest cost minimisation in this environment but must instead think strongly in terms of interest rate risk management. Managing the risk that rates suddenly rise and you are caught out with 100% of your debt on a floating interest rate. Seek out a spread of rates so you can absorb whatever shocks come along – and shocks always come along. Ask Fonterra. Seddon. Christchurch. Westport. Invercargill (avoided, but only for a few more years).

This week fixed borrowing costs facing banks have appreciably risen in response to higher US rates where the ten year bond yield has climbed to 2.71% from 2.59%, higher European rates on the back of some better than expected GDP data released last night, and our own strong retail spending data for the June quarter.

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%	2.67	2.66	2.67	2.76	5.7
1 year swap	3.01%	2.97	2.89	2.75	2.70	5.8
3 year swap	3.89%	3.77	3.58	3.12	2.98	6.1
5 year swap	4.35%	4.23	4.03	3.45	3.32	6.3
7 year swap	4.65%	4.50	4.32	3.73	3.66	



NZD Recovers

The Kiwi dollar has climbed against all but the AUD this week. The AUD is seen as a proxy for China's growth prospects and the release of better than expected Chinese economic data in recent days has seen the AUD rise one US cent from a week ago. Data include a firm 9.7% annual rate of growth in industrial production in July and exports in July being 5.1% ahead of a year earlier following a 3.1% fall in June. Imports were also ahead 10.9% signalling perhaps some better domestic growth following June's 0.7% annual decline.

But while such data are positive for the AUD, domestic developments across the ditch are largely negative. The Federal Treasury released an independent analysis of their forecasts released a couple of weeks ago which said there is a 70% chance that nominal GDP growth for the next three years is 1.75% p.a. rather than the predicted 3.5%. If that is the case then the budget deficit implications are dire for whoever wins the September 7 Federal election. The latest NAB business survey also shows business confidence at a four year low with NAB's Chief Economist noting that 'The downside risks are building."

The tone of economic data out of the United States this week has been positive so the USD has risen along with US bond yields and oil prices. Retail spending excluding motor vehicles rose by 0.5% in July to be 4% stronger than a year ago. This is about the annual growth rate we are running at also in New Zealand.

Interestingly the data released recently in the UK and Europe have also surprised slightly on the good side these past few days. So why has the NZD risen against currencies like the Pound and Euro which one would expect to get a boost from good data? Because we are viewed as a peripheral risky currency and if the world is this week looking like a slightly less terrifying place investors will naturally gravitate toward high beta assets such as shares and our currency.

What this means is that if the economic data flows offshore remain good the Kiwi dollar will go higher. And it will go higher still if our own data also come in strong and speculation builds of a tightening of monetary policy by the Reserve Bank.

Exchange Rates	This Week	Week ago	4 wks ago	3 Mths ago	Yr ago	10 yr average
NZD/USD	0.805	0.795	0.7792	0.819	0.806	0.67
NZD/AUD	0.88	0.882	0.8592	0.828	0.768	0.85
NZD/JPY	78.9	76.7	77.33	83.7	63.4	69.6
NZD/GBP	0.519	0.513	0.516	0.538	0.514	0.388
NZD/EUR	0.607	0.595	0.5967	0.633	0.654	0.52
NZDCNY	4.93	4.87	4.78	5.03	5.13	4.99
USD/JPY	98.01	96.48	99.24	102.20	78.66	105.7
GBP/USD	1.55	1.55	1.51	1.52	1.57	1.72
EUR/USD	1.33	1.34	1.31	1.29	1.23	1.28
AUD/USD	0.91	0.90	0.91	0.99	1.05	0.788
USD/RMB	6.1195	6.1195	6.137449	6.1429	6.36	7.56

Housing Market Update

Woe For Young Buyers

The Government has announced some minor (though helpful) changes to the Resource Management Act and altered criteria for the Welcome Homes and Kiwisaver home purchase schemes. Both sets of changes will improve the housing affordability situation in New Zealand but almost certainly not to any degree which will be noticeable in the marketplace. Prices will keep rising and the gains in Auckland and Christchurch slowly spread at uncertain speed to other parts of the country. That for instance is what I told an audience in Blenheim this morning – expect an influx of older, cashed up Jafas.

On Monday we sent out the results from our latest BNZ-REINZ Residential Market Survey. They show a record net 26% of agents feel that it is a seller's market and a near record net 48% expect house prices to keep rising. Only 8 of the 253 respondents this month feel that house prices are falling. We asked agents what they think young people will do to get around the Reserve Bank's efforts to prevent them buying a house with minimum deposit as most of us (and them) did years earlier.

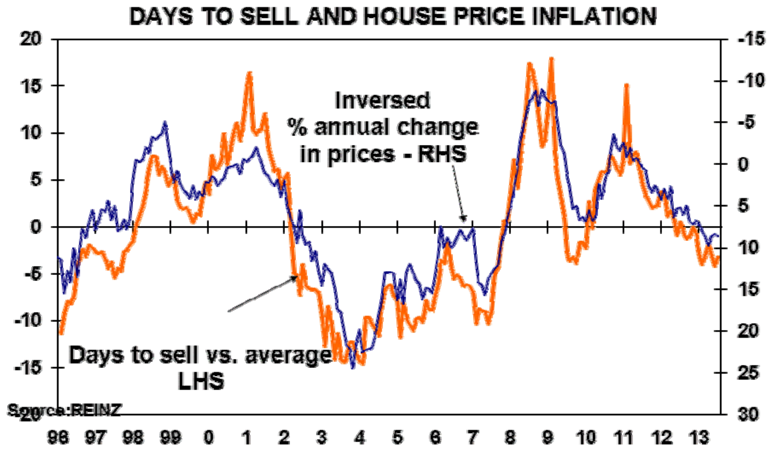
Basically agents expect family to assist and buyers to find extra commercial finance sources.

Use family/parents' money to make the deposit.	93
Borrow from other sources, solicitors, etc.	38
Get family/parents to guarantee the debt	35
Not buy anything/do nothing	10
Save more	9
No need to worry, banks will find ways around the rules	7
Parents to take an equity stake	6
Use Kiwisaver	5
Prices will get driven down	4
Buy in partnership with another young couple	3
Shift to a cheaper location	1
Ask vendors to leave money in	1
No impact will be felt from the rules	1

REINZ Data

The REINZ reported their monthly data for July this week and they show a market in good health. During the month there were 6,777 dwellings sold around the country which was a rise of 14.7% from a year ago and a strong seasonally adjusted gain for the month of about 10%. The stratified median dwelling sales price eased in the month to $413,000 from $415,000 in June but was ahead 8.6% from a year ago and for the three months to July was ahead almost 2% from the three months to April.

On average in the month it took 35 days to sell a dwelling which was 3.2 days faster than average whereas sales in June were 4.2 days faster than average. This is a strong but not outstanding result considering how rapidly properties were selling a few years ago.



Overall the data show a firm market trending upward by all measures.

RBNZ – A Problem for First Home Buyers

Soon the world will be a worse place for first home buyers in New Zealand as the Reserve Bank introduces loan to value rules for banks and does it's best to prevent people getting around those rules with threats of punishment to banks which assist alternative financing routes. In releasing their response this week to submissions received on the mooted restrictions the RB expressed no concern that their efforts to restrict such lending will badly affect young people wanting to stay here and make a life for themselves. The RB has said it will be concerned about "more prominent marketing" by banks of the likes of deposit guarantee schemes, and it outlined clauses it may force banks to include in mortgages preventing borrowers from taking out second mortgages.

This will make home affordability a lot worse for young people – not by raising prices but by curtailing the ability of many to get a home before prices this cycle rise another 10% - 30%. The Government has announced some attempts to soften this central bank blow to aspiring home owners with improvements in access to credit using Kiwisaver. But the effects will be minor and given that first home buyers probably won't have been in Kiwisaver all that long the amounts they will be able to draw down will not be great.

What is the answer? Many young people are going to look for Auckland inner city apartments so keep an eye on developers appearing there soon offering low deposit financing which they themselves will source perhaps from this cycle's version of finance companies or contributory mortgage schemes targeting the elderly. Young people will need to look well away from the suburbs they grew up in or the areas they have been renting and head to the west and south in Auckland or head elsewhere in New Zealand.

Email of the week prize goes to this person.

Yeah, it's skiting. Suck it up you three-decades-in-error housing dystopians.

"I owe you a beer, your comments in 2008 about houses not falling 30% and there being a likely future shortage helped support my decision to buy properties in Sandringham and Mt Eden at the time (which was a brave move considering the GFC was still in full swing), these have now sky rocketed and funded my 'personal kiwi saver' in 4 short years."

The emailed reply followed my response to the person's query the day before regarding rental availability. I wrote…

"All those who tried to understand the housing market and predict prices last two cycles on the basis of rents staying low ended up badly caught out. Rents reflect paying ability of renters with landlords simply wanting someone who won't set up a P lab and will keep the place tidy while they wait for capital gain. Rental supply looks good especially as people are investing so want to rent properties out."

Key Forecasts

Dec. year		2011	2012	2013	2014	2015
GDP	annual average chg	1.4	2.7%	2.5 – 3.0	3.0 – 3.5	2.0 – 3.0
CPI	on year ago	1.8	0.9	0.5 – 1.5	1.5 – 2.0	2.5 – 3.0
Official Cash rate	end year	2.5	2.5	2.5	3.5 – 4.25	3.5 – 4.5
Employment	on year ago	1.6	-1.3	2.5 – 3.5	2.0 – 2.5	1.0 – 2.0
Unemployment Rate	end year	6.3	6.8	5.5 – 6.5	5.0 – 6.0	5.0 – 6.0

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