# Weekly Overview

ISSN 2253-3672

22 May 2014

## 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.

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## 2014 Themes

- Interest rates will rise
- The NZD will remain highish
- The labour market will tighten, pushing employment costs up
- House prices will rise with gains spreading out of ChCh and Auckland
- Construction will boom
- World growth will improve with unprecedented uncertainty regarding monetary policies
- Business capital spending will grow
- Household spending growth will accelerate

## The Christchurch Rebuild

I made my third visit to Christchurch for the year this week plus hopped across for functions in Greymouth and Westport. On the Coast the focus is understandably on fairly muted short-term prospects for the coal mining sector plus cleaning up after the storm of a few weeks ago. Coal price optimism is not high but there is a lot of work for builders following last month's storm, and the tourism sector appears to be offering increasing opportunities with more Chinese slowly making their way to the Coast. Linking the Coast and it's attractions increasingly with Queenstown and the strong growth in Chinese visitor numbers which they are expecting there looks like a good strategy.

In Christchurch I found a further decrease in optimism regarding the speed of the rebuild, deeper expressions of concern about the quality of construction and repair work which is being undertaken, rumours of a large player pulling out of the market entirely by the end of the year, and some people saying their work has dried up over the past fortnight.

What I take from this is not that the rebuild is badly faltering. After all, this week agreement was secured for construction of a large car parking building in the CBD which will clearly facilitate willingness of developers to advance other projects. In addition everything appears to be going ahead for the Christchurch Adventure Park on the Port Hills involving 120km of biking tracks and a bike lift rising 1,427 vertical feet, among other things.

Instead it seems as though there is disappointment that people are having to adjust their expectations for something which naturally is a huge job with which we have only fragmentary experience. The Australians are used to handling large scale destruction of an urban location associated with bush fires. In the United States they have experience with reconstruction following tornadoes and hurricanes. We do not.

In addition the swirling talk of things faltering appears to have encouraged a general despondency regarding the rebuild and led many businesses to abandon thoughts of returning to the old CBD and instead to sign up for six to eight year leases on the periphery, which of course discourages developers from building in the city, and so the spiral goes on.

Clearly on the ground however a high level of activity continues and the rebuild, while a suck-it-and-see exercise, is ongoing and will continue to be a stimulus to activity in the wider NZ economy for a great number of years. More years than previously thought.

I also visited Ashburton for a talk and down there irrigation of the plains continues apace with further developments planned further north. A problem they have there is one which is probably affecting some other secondary centres and small towns around the country. A lot of commercial space has been taken out of action by the need to meet earthquake strengthening requirements. But the cost of building is so high that developers will struggle to find tenants who can afford new premises.

This problem is probably more apparent in Ashburton than elsewhere because of the strong growth in the wider economy and the proximity to Christchurch's earthquakes respectively bringing higher demand for premises while taking more older stock out of action than elsewhere. Other centres might want to look at Ashburton to see how things go there in the next few years as input into how they might handle the commercial accommodation situation down the track in their own small CBDS.

Over the past four weeks in the email used for distributing the Weekly Overview to the near 29,000 addresses on the database, accrued since 2000, we have invited recipients to resubscribe. Almost 10,000 people have done so. Therefore for your guide, if you have an emailing list and like to trumpet it's size, just remember that while you may get a better feel for product usefulness by looking at the email opening percentage and then the document opening or click-through rate, asking for resubscription is probably the ultimate guide to whether anyone really gives a hoot about what you are writing. In that regard I am quite pleased with the resubscription rate of just over 34%.

If you missed the four weeks of opportunity to easily resubscribe with one click please don't email me asking to be re-added as I won't do it given the likely volume of such emails which will come through. Instead go to www.tonyalexander.co.nz and rejoin there.

## IF I WERE A BORROWER WHAT WOULD I DO?

I would still not feel inclined to panic about the speed of monetary policy tightening and the level to which floating rates might go. Therefore I would not feel inclined to shift all of my debt to as long a term fixed rate as possible. I would still look to spread my risk with a portion floating, some fixed near 18 months and some near four years, while keeping an eye out for anyone offering an unusually low long term fixed rate.

However, anything like a four year rate close to 6.5% would be something of a gimmee for a high proportion of my loan if I had one given that floating rates are currently largely near 6.25% and will almost certainly be above or at 6.5% come the third week of June. In fact near or just above 6.5% for four years I would ignore my comments above and fix 80% of my debt.

This week wholesale borrowing costs have edged down slightly, largely in response to a decline in US long-term interest rates caused by reduced optimism about the pace of growth in the US economy. Less growth means less chance of the Federal Reserve raising interest rates next year. In that regard it is quite noteworthy that the benchmark US ten year government bond yield has fallen near half a percent since the start of the year to sit now close to 2.5%.

| | OCR | 90 day bb | 1 year swap | 2 year | 3 year | 4 year | 5 year | 7 year |
|---|---|---|---|---|---|---|---|---|
| This week | 3.00 | 3.42 | 3.73 | 3.99 | 4.18 | 4.31 | 4.42 | 4.63 |
| Last week | 3.00 | 3.42 | 3.75 | 4.06 | 4.27 | 4.41 | 4.52 | 4.68 |
| 4 weeks ago | 2.75 | 3.33 | 3.7 | 4.08 | 4.33 | 4.5 | 4.63 | 4.82 |
| 3 months ago | 2.50 | 3.13 | 3.52 | 3.88 | 4.17 | 4.38 | 4.56 | 4.85 |
| 1 year ago | 2.50 | 2.66 | 2.75 | 2.99 | 3.18 | 3.34 | 3.51 | 3.77 |

### NZD Loses Some Ground

The NZD has dropped against all currencies bar the AUD over the past week. Downward pressure has come from a further 1.8% decline in average prices at the fortnightly Global Dairy Trade auction, but mainly riding on the coat-tails of an Aussie dollar which has fallen near 1.5 cents.

The AUD has fallen this week in response to eventually unsubstantiated rumours that Standard and Poors might cut the country's credit rating, plus a fall in iron ore prices on the back of poor news about China's economy and evidence of extra supply coming out of Australia.

The NZD's small decline against the GBP was accentuated by a slight boost to the latter coming from increased expectations that the Bank of England might raise interest rates before the end of next year.

Will this decline in the NZD continue? Almost certainly not. As we have long pointed out the inflationary pressures in our economy will grow as growth settles in at above average levels for two or three years. In addition the migration surge we have long warned about is exceeding even our expectations and that is a great thing for the economy overall (how on earth can the whingers complain that people flooding out is better than this?). But extra pressure on housing when supply is already short and new construction will struggle to grow due to resource shortages and consent processing impediments means extra upward pressure on prices. That means more inflation risks. That means higher interest rates than would otherwise be the case. That means lots of ongoing support for the NZD through this year, 2015, and into 2016 as well.

| | NZD vs. USD | AUD | JPY | GBP | EUR |
|---|---|---|---|---|---|
| This week | 0.857 | 0.927 | 86.9 | 0.507 | 0.626 |
| Last week | 0.867 | 0.924 | 88.2 | 0.517 | 0.632 |
| 4 weeks ago | 0.861 | 0.927 | 88.3 | 0.513 | 0.623 |
| 3 months ago | 0.832 | 0.931 | 85.2 | 0.499 | 0.608 |
| 1 year ago | 0.802 | 0.832 | 82.5 | 0.533 | 0.624 |

For more detailed FX analysis including the 'BNZ Markets Outlook", "BNZ Strategist" "BNZ Commodities Wrap" and lots more go here. https://research.bnz.co.nz/Research/NewZealand/Pages/NZpublications.aspx

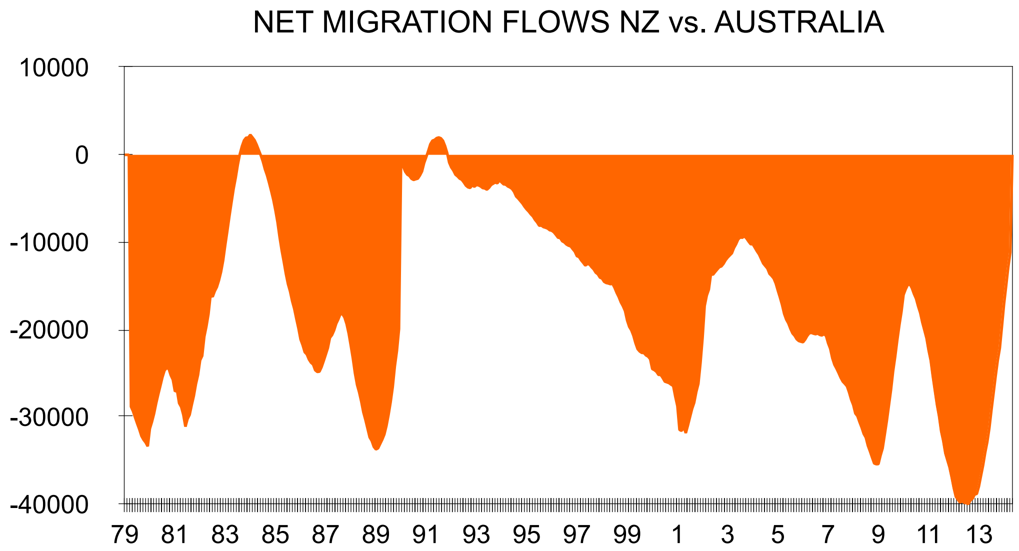
# Housing Market Update

### LVR Rules to Disappear? To Repeat....Don't Get Too Optimistic

Fairly soon we shall all be playing a new game of "How high does it go?" with the object in question not being interest rates or exchange rates but net immigration. In last week's Budget Treasury picked 38,000. Personally I think we will now get above 40,000 by the end of this year and have high net inflows for 2 - 3 years. In fact if we annualise the most recent three months of flows in seasonally adjusted terms then the rate of annual flow recently has been 46,000. That is a surge even greater than the net inflow of 42,500 recorded in the year to the middle of 2003.

The woe, angst and teeth gnashing across the ditch following the Federal Budget is visceral with common focus on many families losing $6,000 worth of charity from other families. Like the French who are incapable of thinking any other way, too many Australians, including in the business sector, have grown so used to sucking on the taxpayer teat that they cannot contemplate life without someone else paying for their spending.

The climate of despair can do nothing other than accelerate the flow of Kiwis back to our fair though shaky and lower income shores and discourage even more from going into Australia's maelstrom. After all, personal experience and discussions with many people show me that the Kiwis who shoot off across the ditch are generally not looking to bludge off the Aussie taxpayer (can't now anyway) or trade drugs. Like migrants who shift to New Zealand they are looking for a better way of life, higher incomes, greater freedom from whatever variety of cultural, neighbourhood, national, historical restrictions which may be surrounding them, and better opportunities for their children. The howls of outrage breaking out across the ditch at the moment from bludging Aussies wanting to retain their subsidies can do nothing other than discourage those forward-thinking Kiwis from moving - for now at least. Eventually many will still go as there is a notable cycle in the Trans-Tasman flow, though picking when the turn will come is difficult. Best guess = a couple of years from now.




In the past six months the average net migration loss across the ditch has declined by just over 2,000 from the same month a year earlier. With the annual loss at just over 11,000 in the year to April this suggests that come October the net flow may well have moved into positive territory. If so, and I think it will, this will be the first net positive annual inflow across the ditch since 1991, shown in the graph just above.

For your guide, the annual net migration flow across all countries has improved by just over 29,000 from 12 months ago. This turnaround from a net gain near 5,000 to a net gain near 34,000 revealed yesterday can be attributed to the following shifts.

| | |
|---|---|
| Australia | 22,931 |
| Asia | 4,078 |
| Europe | 1,002 |
| Africa and Middle East | 843 |
| Americas | 335 |

From about 18 months ago we warned that the upward pressure on house prices coming from shortages in Auckland and Christchurch in particular would be increased by a turnaround in net migration flows and that price gains to date had happened in an environment of below average and at times negative annual net migration flows. As we wrote for instance in the Weekly Overview of October 4 2012....

**"With regard to migration the situation is yet to change toward a net positive annual gain to the country’s population but we suspect that will be the case by early next year.**

**In seasonally adjusted terms the net flow in August was a loss of 340 people compared with a loss of 640 in July. For the past three months the annualised net flow was a loss of 1,840 people compared with a loss for the entire year to August of 4,118. So the data still show an ongoing population loss. But with economic conditions weak and deteriorating in Europe and the attraction of Australia dimming somewhat the relative attractiveness of NZ is likely to grow. Then one has to think in terms of this. If Auckland house prices have already risen about 11% from a year ago while the country is suffering net migration outflows, what will happen when those flows turn positive?"**

Yep. Told you so. Housing shortage, construction still below average, rising building costs, accelerating population growth, LVR rule effect already captured, offset against rising interest rates. House prices keep rising - same message we've been running since min-2009.

Also, there is a physical shortage of houses in Auckland and Christchurch. If you reduce the expected returns to investors by putting in place a capital gains tax, will that boost or reduce the likely upcoming supply of houses aimed at addressing the shortages? Reduce of course. In this way, as written here many years ago, the horse has bolted with regard to addressing housing shortages and the resulting high prices by soaking investors. Their reduced construction will make things worse.

However....... if your economy is capacity constrained, to the extent investors do not build houses owner occupiers will instead be able to build them. Thus a capital gains tax would have probably no impact on construction and supply in the current climate.

I have written the contradictory paragraphs above to illustrate that the conclusions you reach regarding a particular policy depend hugely upon the nature of the environment in which they will be implemented. Our economy is going to become increasingly capacity constrained, therefore a capital gains tax would have a positive impact on the level of home ownership and would ease some of the upward pressure on prices. If however you think a tax will appear in the next few years then your incentive is to buy your investment properties now rather than after the tax comes in, running on the assumption than existing holdings will be grandfathered as tax free and only new purchases will attract the CGT.

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