BNZ 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.

Cold, So Cold

Well it's really great to be back in New Zealand and back at work. Enjoying 9 degree highs after the 20+ degrees of the Gold Coast and sitting in the sun is such a relief – and the rain is great too!

But seriously, it is four weeks since the last Weekly Overview and to all those people who in the past week or so have been emailing me to say they seem to have fallen off the emailing list – well you haven't had a reply from me because if you were that serious about reading this thing you'd have seen the bit in bold right at the start of the June 26 issue saying how I'd be on leave and the next issue would be today. Durrrrr.

But enough of that. What has been happening in our lovely sodden and milk resplendent economy over this past month and do these developments warrant alterations in the views I wish to express regarding our exchange rate, interest rates, housing market, labour market and so on.

Lets start with a run-through of the more relevant pieces of economic data which I can remember from a couple of weeks causally reading the newspapers on the balcony. The degree of strength in the housing market has eased off and the Reserve Bank are likely to be quite pleased with developments following the introduction of credit controls on October 1.

The number of dwelling sales in June was down by 6.1% from a year earlier making eight months in a row of annual declines. June quarter sales were down 14.1% from a year ago. The average number of days taken to sell a dwelling in June was 39 which was equal to the average for the past ten years whereas sales were happening faster than average for the previous 21 months. Thus we can safely talk in terms of turnover backing off.

Regarding prices we see that the quality-adjusted measure in June was 6.2% ahead of a year earlier (Auckland 6.5%, Christchurch 5.5%, Wellington -3.3%), in the June quarter prices were ahead 2.2% from the March quarter, but they are off by 1.3% from a peak in March.

At this stage it is too early to conclude that mortgage rate rises account for the easing in activity and prices and instead one can more comfortably put it down to the effects of the loan to value ratio limits of October stripping a class of buyers out of the market. Their success will likely be attracting a lot of attention offshore where central banks are grappling with the issue of how to control surging housing markets without raising interest rates and stifling broader economic upturns which they have been trying to foster since 2009.

In the labour market the newspapers have been carrying more and more stories regarding shortages of labour but as yet still zero indication that wages growth is accelerating. Based on similar developments in the United States it looks like post-GFC the relationship between speed of upturn in the labour market and the wages response has lengthened. Eventually however we will get a response (one is starting to show up in the United States now) and this is backed up by the NZIER's Quarterly Survey of Business Opinion released a couple of weeks ago.

It showed that late in the June quarter a net 32% of non-farm business respondents were having difficulty finding skilled labour and a net 11% were finding unskilled labour hard to find. These results showed greater difficulties than the net 29% and 9% respectively for the March quarter and were above the ten year averages of 19% difficulty and 5% easiness.

A net 15% of firms plan hiring more people from 9% in the March quarter and an average of 3%. But still just a gross 12% of firms say that labour is the main constraint on their ability to grow which although up from 9% in the March quarter is still just average.

So although the housing market is pausing for now, the labour market is powering ahead as before and my recommendations to employers remain to start addressing staff concerns about remuneration before they shoot up the road for an extra 10% or simply pull back their efforts, max out the sick days, and spend more time web-surfing cat videos than doing whatever it is they are supposed to be doing online.

Retail spending growth looks about the same, as best as one can gauge by looking at the not entirely accurate sales proxy from the Electronic Card Transactions data. Core retail sales using debit and credit cards were down in seasonally adjusted terms by 0.4% in June but ahead at an annualised pace of 5% in the June quarter from 2.9% in the March quarter and 10% in the December quarter. This measure is highly volatile but still rising. So retailers cannot claim that no-one is raising their spending, but I think they can continue to claim that the market remains tough and with interest rates going up there is probably not a high chance that they will experience a boom this cycle, especially in dairying areas.

After all, householders remain reluctant to take on more debt – and good on them. Debt can be very useful but it can also be dangerous in times of income weakness and we recommend that people maintain the debt pay down approach they are likely to have adopted from 2008. Lending to households was ahead just 5.2% from a year ago in May. The rate of growth the year before was 5.1%, 2012 1.5%, 2011 1.2%, 2010 2.5%, 2009 2.5%, 2008 9.1%, 2007 13.4%.

This data list shows three things. A massive slowing from 2009 (which clearly started in calendar 2008), a pick-up in growth from near 2% to above 5% from late-2012, but a plateauing at that lowish rate with in fact some easing in recent months. This slow pace of household debt growth is also evident offshore where businesses, governments, and householders remain debt-wary.

From a debt growth point of view there is little for the Reserve Bank to be worried about. Their concerns more centre around the extent to which house prices have risen – yet without a debt surge. That is why one cannot talk in terms of a bubble for our housing market. House price rises simply reflect demand running into the inadequate supply one has been writing about here since late-2008.

On the business investment front we have as usual no information upon which we can make any strong statements. But for the record, investment in other than residential buildings was ahead by 8.3% in the year to March. That is good but hardly awe-inspiring. Businesses continue to treat the upturn in our pace of economic growth with caution. And why not? After all, there have been cuts in growth projections for major economies offshore (the IMF last night cut the US growth forecast they made only a month ago to 1.7% for this year from 2.0%), in the US business investment is struggling to rise, Australia has slowed and has many problems to grapple with (and further interest rate cuts are unlikely after yesterday's higher than expected 3% inflation), Europe looks as munted as ever with politics of complacency and appeasement still dominant in the spheres of economics and international relations. China's growth rate looks like coming in at the lowest annual calendar year pace since 1990 this year, and Japan's March quarter surge in growth of 6.7% annualised may just be a pre-consumption tax rise flash in the pan.

The level of confidence of NZ businesses has eased recently. The NZIER's QSBO recorded seasonally adjusted sentiment of a net 33% positive in the June quarter from 51% in the March quarter. The ANZ Business Outlook Survey has eased to a net 43% in June from a peak of 71% in February.

Nonetheless, the QSBO shows that a net 19% of businesses plan raising capital spending so we remain hopeful that this will continue to be a reasonable source of growth in the near future, along with rising house construction, mildly improving retail spending, and rising spending on infrastructure etc.

What about the most recent 8.9% fall in average prices at the Global Dairy Trade auction taking prices 35% down from their peaks? Clearly the income of dairy farmers is about to tale a big hit and Fonterra are highly likely to revise downward their initial forecast for this season's payout of $7.00 from $8.40 last season. The extent of the revisions will depend partly upon where the NZD goes. Is it falling as many have so far this year been incorrectly predicting? No.

On June 26 when I was last paid to give a hoot the NZD was buying US87.6 cents and now it is buying close to 86 cents. That is a slight change in the scheme of things though we are down from near 88.5 cents a couple of weeks ago as global risk aversion has naturally risen in light of developments in Gaza and Ukraine. The NZD has also eased almost two cents against the AUD from four weeks ago, about one Yen, below one pence, and is about the same against the Euro.

Nothing major there but the question is why has our currency held up in the face of falling export prices, falling business confidence, a stalling housing market, mediocre retail spending measures, and expectations (which proved valid this morning) of a less hawkish tone from the Reserve Bank?

Frankly one can mainly put it down to the same factors which might cause one's local sports team to win even though the top player has the flu, the coach has bad attitude, and supporters have written off the season – the other side sucks. In this case – why buy the Euro given the war on their doorsteps, slowing growth, and a moribund banking sector? Why buy the pound when the UK economy is so heavily exposed to the struggling economies across the channel and the Bank of England recently voted 9-0 to keep interest rates steady, noting a lack of inflationary pressures? Why buy the AUD when the list of problems which will constrain growth is quite strong and the newly-installed Senate is beleaguered by the actions of a rogue political party under the control of a fat rogue. (Could this be NZ after September 20!) Why buy the US dollar when businesses won't back the recovery by boosting investment, the President appears to be floundering, and the Federal Reserve continues to stress the absence of any solid plans to raise interest rates?

Actually, as previously stated, I would buy the USD at a rate near 90 cents, have bought the AUD above 94 cents, and anything above 52 pence looks like a gimmee while I'd buy Euro near 65 centimes. I don't believe the NZD is headed for a decent downward correction anytime soon even if the RBNZ likes to repeatedly, ineffectually, warn about such an event. But sometimes you just have to stand back from the day to day or week to week guff, look at the graphs stretching over a few years or decades and say – seriously, the NZD near 90 US cents when US monetary policy will probably tighten next year and our export prices are pulling back from a China surge? It looks like a sell though one cannot know when you will be well in the money. Exporters should be looking more and more at currency options.

My view remains that the NZD will stay "highish" this year through a lot of next year, but I would be a seller at certain levels.

The outlook for the NZ economy remains good on the back of rebuilding Christchurch, catch-up house construction in Auckland, lots of other construction related to infrastructure, earthquake strengthening, water-tightness remediation, investment (but not incomes) in the dairy sector, booming net immigration, an eventual wages response to the tightening labour market, but with restraint from rising interest rates and an ongoing uncertain global environment.

Looking just quickly at a couple more things. This morning the Reserve Bank met expectations by raising the cash rate 0.25% to 3.5% and signalled that rates are now on hold for an unspecified period of time while they see how the economy reacts to rises so far and what happens generally on the domestic and financial fronts here and overseas. That is a very logical thing to do and what you have been seeing recently and will continue to see if us forecasters moving to and fro our predictions for when the next rate rise will occur. Sometimes we will get a run of strong data and we will say the next rise will come in December or even earlier. Then the data will turn weak and we will push the timing out to January, or March, or June. Such is the nature of forecasting things like sports results and financial variables.

Also, this week we learnt that the migration surge continues apace and we look to be on the way to a record full year net inflow near 50,000 while the net flow to Australia will probably turn positive before the end of the year. In June the seasonally adjusted net flow was a gain of 4,270 from 4,020 in May and 2,190 a year ago. The annual net gain now stands at 38,338 from 36,397 in May, 7,907 a year ago, and a loss of 3,191 two years ago.

In the past year 22% fewer people have left NZ and 14% more have shifted here. The driver of the migration surge is however starting to shift from you and I not leaving (but oh God, 20 degrees in winter is tempting – maybe in retirement), toward more people coming in. In other words, this migration turnaround still has strong legs. For flows just with Australia the net loss now stands at just 8,345 from 31,246 a year ago and a record 39,956 in the year to April 2012.

Hopefully everyone has handled the bout of wet and cold weather sweeping the country. It does put one's weekend chainsaw work on hold, but thoughts of a crampon and ice axe trip to snow-covered Lake Angelus are growing. Maybe something easier would be warranted before tackling that again and the time of year is good given that tourist trampers staying up to all hours of the night in a cosy hut are few and far between in the bush and mountains in winter.

If I Were A Borrower What Would I Do?

US bond yields have fallen in response to global tensions and that has fed through to some slight falls in NZ swap rates assisted by the slightly more dovish comments from the RBNZ this morning. The trend however is upward so if I were borrowing at the moment I would look for whoever is offering a discounted rate in the three to five year terms (probably three years, good BNZ rate at 6.25%!) and lock up most of my mortgage there, to a maximum of maybe 80%.

The Weekly Overview is written by Tony Alexander, Chief Economist at the Bank of New Zealand. 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 sign up at www.tonyalexander.co.nz
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