BNZ Weekly Overview

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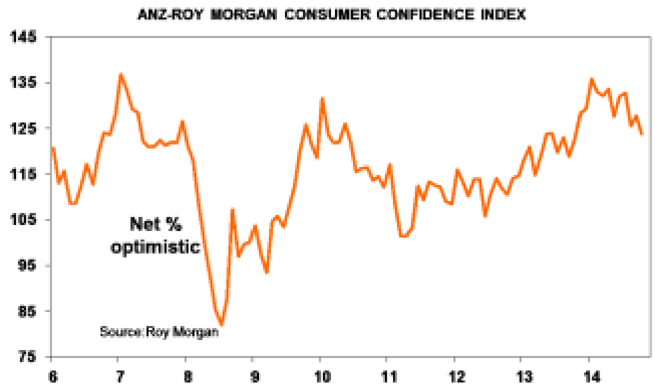
Mission Statement

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

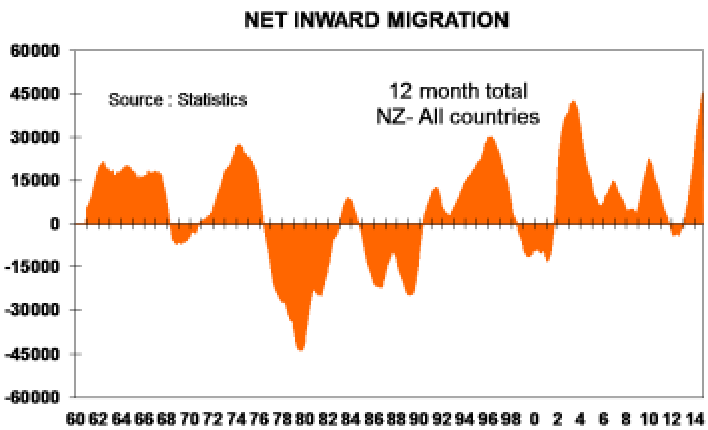
Prices

One measure by which we try to get a feel for whether retailers may do alright in the near future is consumer confidence. The main short-term measure followed is the monthly ANZ Roy Morgan index which for the past ten years has produced an average reading of 118. This month the outcome was an above average 123.7. Thus one would be on safe grounds saying that consumer spending is likely to be providing retailers with the opportunity to secure some higher sales.



However this latest reading is down from 127.7 in September and the lowest reading since October last year. Therefore, if there is such a thing as the average retailer, on this basis they should not in fact be lifting their sales expectations above what they achieved last year plus maybe an extra 4% to allow for overall nominal economic growth – the pace of which is probably slowing at the moment as near $6bn of dairy income comes out of the economy. Note the downward trend in confidence since early this year.

Most retailers have reported continued challenging times over the past year in spite of a 3.7% employment surge and fall in the unemployment rate from a peak of 7.2% to 5.6%, plus the strongest net nominal migration inflows on record for New Zealand. This week in fact we saw the release of data telling us that in the year to September our population gained a net 45,414 people from permanent and long-term migration flows. The average yearly gain over the past twenty years has been 12,000.



Why the continuing post-GFC trials and tribulations for retailers? Undoubtedly because of the same thing happening overseas – families are exercising restraint in their spending in the face of a desire to get debt levels down, absence of any acceleration in wages growth, and general air of risk aversion, uncertainty and caution post-GFC.

There is no way of predicting when this consumer attitude will change and in fact if anything the worsening situation offshore should be making consumers even more cautious. Then again there are some positive things happening. Firstly there is a round of small decreases in fixed lending interest rates happening as the worsening global growth outlook produces falling medium to long-term funding costs for NZ banks.

Second, petrol prices are falling as a result of rising production mainly from the United States, falling world demand including a scaling back of anticipated demand from China for many things, and unwillingness of large OPEC producers to cut output. Lower petrol prices will leave a bit more money in our pockets for spending so perhaps there will be a slight rise in expenditure on discretionary items.

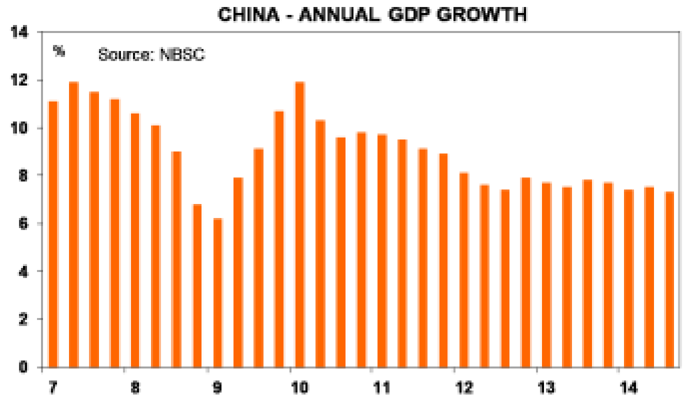
But nothing is suggesting at this stage that retailers of large items should be anticipating higher sales – although with house building ahead almost 80% on three years ago sales of home furnishings and such-like will remain strong and grow further. Falling petrol prices will tend to underpin sales of cars which are quite strong at the moment as people catch-up on spending delayed from earlier years, and perhaps the surge in construction activity leads a lot of contractors to upgrade their fleet.

Lots of people getting construction work sounds also like the sort of thing which would boost sales of recreational fishing boats. Sales of holiday homes however will probably remain in check this "cycle" however as although rising incomes for SME owners does traditionally boost such sales, debt aversion this time around and falling dairy incomes will likely keep such splurging in check.

Speaking of things remaining in check – inflation. There isn't much of it. Data released this morning show that in the September quarter the Consumers Price Index rose by just 0.3%. This followed a 0.3% rise during the June quarter and means that the annual rate of inflation has fallen from 1.6% to 1.0%. So why then might the Reserve Bank have raised interest rates by 1% from March to July this year if inflation is so quiescent and if in fact offshore the deepening worry is about deflation?

Firstly we think that the worries of the Reserve Bank regarding inflation threatening the 3% upper limit will be easing. But more importantly, the cash rate of 2.5% set for most of the period from 2009 until early this year was there as an emergency measure. The emergency passed a long time ago so it makes sense to raise rates and provide a buffer in case they need to be cut again should something newly bad strike the world economy and ourselves. Candidates include of course Ebola and the extent of the slowing in China's economy, not to mention the Middle East conflict spreading, war in Ukraine, and the risk that the Eurozone slips into deflation and outright panic about following Japan's deflation example sets in.

This week we learnt that China's pace of GDP growth from a year earlier slowed to 7.3% in the September quarter. This is the weakest rate of growth since 2009 and means that for the first time since 1999 the official GDP growth target – this year's is 7.5% - may not be achieved.



Additionally, monetary policy changes tend to affect inflation with a lag of around 18 months. So current inflation reflects cash rate settings from early last year, not the rises undertaken this year.

Our expectation has been changed again and we now don't see the next monetary policy tightening likely to come before September next year.

A Thought

With Europe slipping into prolonged stagnation, the gloss coming off Australia after 23 great years, and increasingly wealthy Asians looking for a better environment to raise their children, do demographers need to lift their assumption for the average net migration gain for New Zealand from the 5,000 which I believe is commonly used? Faster likely population growth will not just lift a little bit the underlying economic growth rate for New Zealand, it will also tend to give a stronger and better age-balanced taxpayer base to help finance the fiscal burden of an aging population.

Now consider two other long term assumptions. One is about the health of increasingly elderly people. Old people are getting healthier compared with people of the same age in previous decades. Assumptions about the demand for core health services might need to be cut back a bit. Second, people are choosing to stay in the workforce for longer. Not everyone wants to stroll the golf course or flop in front of the multitude of sports-focussed TV channels as soon as they hit 65. Assumptions about income and tax payments by an aging population may also need to be improved.

Consider for instance the release this week of a report commissioned by the National Advisory Council on the Employment of Women. The proportion of women aged over 65 actively employed has risen from 2% two decades ago to 15% now. Another 20 years from now that rate could be 30%. The proportion of the overall workforce expected to be over 65 is predicted to rise from just 5% now to 12% in 20 years. The report notes the vibrancy of the Kapiti Coast economy where 25% of women there are already aged over 65, a proportion expected nationwide come 2056. (Just in case you are confused, one number refers to the labour force proportion, the other the population.)

What does this mean? Government fiscal numbers look better long-term so the chances of political parties promoting changes aimed at radically cutting superannuation payments, raising the age of superannuation eligibility, and finding new sources of tax revenue are reduced. Does this mean then that people should pull back on their long-term savings plans? Not at all.

The longer we live and the healthier we are the more things we will want to do such as travelling, elective surgery and procedures, helping fund education etc. of grandkids. Additionally, businesses are developing more and more products geared specifically toward people aged over 65 as Baby Boomers retire in droves and one will need extra income to be able to consume such age-specific products and services down the track. Examples include cars with seats which can detect when the driver has a heart attack.

The argument for building one's long-term savings shifts slightly from needing to react to stories about reduced pensions and slaughtered health access, toward setting oneself up for a more enjoyable participatory life after the mid-60s with greater choices facilitated by assets yielding income alongside national superannuation and part-time employment.

Note that these changes also help explain continuing investor demand for housing. It will provide a long-term stream of income and eventual capital gain and the longer one's target for holding the asset the less relevant the warnings about property being over-valued. Plus, this desire for long-term income means that if there ever is a bout of selling in the housing market caused by people aging and wanting to get capital from their housing asset, it is many decades away from now and completely irrelevant to purchase decisions for many years – if such a thing happens at all. And let's not forget that the outlook for interest rates staying low for longer also supports additional property market investment on the basis of low borrowing costs plus search for yield. History shows that as average NZ interest rates have declined we gear ourselves into initially bigger and "better" located houses, then simply have to borrow more to pay the higher prices caused by lower financing costs. Lower interest rates do not generally free up money for non-housing spending over the long-term.

And speaking about more active retirement than in the past. The image we have been fed these past two decades is of people reaching retirement, running out of money, living in poverty, losing whatever wealth they had built up in finance company collapses, and being very unhappy. In fact surveys show the older the age group the happier people report themselves to be, and that the bulk of wealth is held by older people – not the young people trying to impress each other with the latest cell phone or silly selfie. Older people are building up the future purchasing power for a range of products and services geared toward older people which have not been either invented or developed yet.

Businesses should watch that they have not developed a blind spot for this growing market simply because of the aged image they have been fed by savings promoters since the late-1980s, and the popular media and product focus on young people. Your best long-term profit may come from better servicing older people rather than young ones with minimal brand loyalty – apart from Apple products which looks like more of blind faith religion than anything else these days when one considers the high quality of the alternatives. Plus you may do better hiring those older people as well rather than taking on young people with the school-indoctrinated knowledge of their rights but empty echo chambers of awareness of their responsibilities.

A final quick thought. Does the low inflation news today mean the RB will soon remove the LVR rules? No. In fact low inflation decreases the chances of the rules being eased. You see the rules are aimed specifically at housing – not general inflation. The official cash rate is aimed at overall inflation, not specifically housing. Low inflation means low interest rates which will tend to underpin house price rises thus making the RB even more concerned about over-valued house prices and exposure of banks to lost capital should something one day cause prices to fall. Thus the low inflation/low interest rate situation means LVR rules become a relatively more important tool in suppressing that housing risk. Sorry young folk.

If I Were A Borrower What Would I Do?

Be in no hurry, but have just a little debt floating while looking for a good two to three year fixed rate.

A weird number of people have contacted me recently regarding financing the purchase of a property in one country with money raised in another. This is a very dangerous practice which I would not recommend even for those with an income stream in their borrowed currency because a sharp currency move could see debt exceed property value.

Speaking of currency moves, the NZD fell over a cent this morning to sit now near 78.6 from 79.8 a week ago. The decline came about following the 0.3% quarterly inflation number being well below market expectations of a 0.5% rise and Reserve Bank forecast of 0.7%. It is quite unusual in New Zealand for the CPI to differ much from expectations so there was genuine shock value in the outcome which has produced some small falls in fixed borrowing costs today along with a weaker currency as the markets factor in no monetary policy change for another year. Good news for consumers, exporters, and borrowers.

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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