

## 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.

## Sustained Low Interest Rates In Our Time

The main piece of news on the short-term economic front this week was the review of the official cash rate this morning by the Reserve Bank. Before discussing what they did, maybe one can ask the question whether it really matters if the cash rate falls another 0.25% or not. Borrowing costs facing most people in New Zealand are now the lowest they have ever seen. If you need rates lower than they were last week to stay in business or take out a mortgage then you are not in a sustainable/debt raiseable position.

Reacting to the low interest rates household debt growth is averaging 0.7% a month seasonally adjusted or near 8.5% annualised. That 8.5% easily exceeds income growth. Household spending is growing at a well above average pace as proxied roughly by the annualised rate of growth in the value of debit and credit card transactions. That growth rate is 9% compared with average growth for this measure of 5.6%. The housing market is also very firm in most parts of New Zealand.

Thus you can't run the argument that the household sector is depressed and needs lower interest rates. What about the business sector? Borrowing costs are irrelevant to the performance of the retailers falling over this past year – they are simply being out-competed by better operators and shoppers more able to make price comparisons than ever before. The construction sector and the huge number of service industries it drives is booming so no rate cut stimulus is needed there.

A net 15% of businesses in the latest ANZ Business Outlook survey say they intend boosting spending on capital goods which is above the average reading of 11%. A net 14% say they plan hiring more people which is above the average of 7%.

As mentioned previously, outside of dairying and sheepmeat most other exporters are doing well. These include the pipfruit industry, Kiwifruit, beef, education, wine, and tourism which is rising very strongly.

On the basis of the state of the NZ economy you cannot make a case for lower interest rates. But from the Reserve Bank's point of view, as long as they "seek to avoid unnecessary instability in output, interest rates, and the exchange rate" the pace of growth in the economy is only relevant to the extent that it influences the rate of inflation. And that is where things have come unstuck for our central bank since the GFC.

Inflation in New Zealand is only 0.4% - not the 1.6% rate the RB forecast it would be over a year ago. Inflation is not reaching levels we would have seen with our economy growing near 2.5% if this were the pre-GFC environment. But it isn't and for a wide range of reasons inflation here and overseas is staying very low. Worryingly low still in the case of the Eurozone and Japan where money printing continues unabated in an attempt to boost growth and price pressures.

Based on our inflation rate of just 0.4% the case is very strong for cutting the cash rate to 2.5%. But what if inflation is still low in a year's time while the economy grows 2.5%? Does the RB then cut to 1.5%? That seems ridiculous because of the extra stimulus which would be given to house price rises and household debt. Controlling that debt growth is why our central bank and others are introducing non-interest rate means of influencing household debt growth. These measures so far include the loan to value ratios and the 30% deposit requirement for buying an investment property in Auckland. There will be more, probably eventually the debt to income restrictions in place in the United Kingdom and Ireland, plus extension of the 30% deposit requirement outside of Auckland.

Changes in the official cash rate are no longer available to the Reserve Bank to use as the primary means of promoting stability in the financial system. They are increasingly reverting to direct credit controls. Changes in the OCR are also minimally effective in boosting inflation. As noted, this is a problem overseas as well and we are not unique. The way that well above average retail spending growth is not producing rapidly rising retail prices illustrates the impact of changed buyer attitudes post-GFC and the impact of technology allowing easy price comparisons.

As repeatedly noted this past year we should expect to see more rationalisation in the retailing sector as sellers adjust to the changed environment of consumer choice and buyer power.

As it turns out the Reserve Bank met the expectations of most forecasters this morning by cutting the cash rate 0.25%. The rate is now back to where it was taken during the full throes of the GFC in 2009, and where it was taken back to in 2011 when the 0.5% rise to 3% of 2010 proved premature in hindsight. It is very unlikely that they will cut the rate again. In fact the RB said they expect to get inflation back to the middle of the 1-3% target range with no further change in interest rates. That compares with six weeks ago when the RB said "...some further reduction in the OCR seems likely."

When will the rate go up? Don't bother asking. There is not a single forecaster any of us can point to and say they have got their predictions on interest rates generally right since 2007. We have all proven that as yet in the post-GFC environment we have not regained the ability to predict sustained interest rate changes. The chances are that low interest rates will be around for a large number of years.

### Housing

Here is a reminder of some of the key things going on in the wider NZ housing market.

- There is a supply shortage at current prices in Auckland and not enough builders available to allow that shortage to be eradicated for perhaps a generation. Prices will rise further.
- Currently in Auckland we are in the part of the cycle where investors look at other centres for yield and smaller mortgages. This expected effect is being amplified by the 30% deposit requirement in Auckland, and Auckland being depressed a tad by Chinese buyers being less able to get funds out of China for the moment as the authorities undertake an anti-corruption drive and stem plummeting FX reserves.
- The stack of frustrated young buyers in Auckland is as large as ever and for the next few months they will face fewer competitors at auctions and a greater range of properties on offer. But they won't get any bargains.
- In the regions the first wave of Auckland buyers has probably already snapped up the low to mid-priced places sitting unsold or on/off the market for the past three years.
- As regional markets get hotter more locals will join in the buying, sections will be increasingly snapped up, and house construction will rise in the regions. This will reduce further the quantity of builders able to boost construction in Auckland.
- Eventually when the economy next has a recession (no idea when) some regional investors will suffer most through unsold sections, empty spec. properties, and absence of the ongoing population growth which Auckland will enjoy.
- The Reserve Bank will continue to experiment with quantitative controls in the housing market. If Auckland booms anew they will take the 30% deposit requirement to 50%. If the regions get really ballistic they will get a 30% rule. Work will begin on introducing debt to income rules.
- The crisis in housing for lower socioeconomic groups in Auckland will become much worse than it is now.

## NZ Dollar

The Kiwi dollar received almost a one cent boost following this morning's cut in the official cash rate partly because not all market participants had expected a cut, and partly because the RB set a very high bar for any further cut to be undertaken. The NZD has ended this afternoon one cent higher than a week ago near US 67.3 cents. The USD has fallen over the week against a Euro and Pound boosted by the recent easing of monetary policy by the ECB being less than expected. Additionally the Yen has improved slightly as September quarter growth was revised from negative to a small positive. Thus with the NZD rising we have ended unchanged against the Pound and Yen near 44.3 pence and 81.5 Yen respectively, but have fallen against the strong Euro to near 61 centime from 62.5. Against the Aussie dollar the NZD has gained over two cents to near 93 cents with the AUD weakened slightly by the ongoing falls in energy prices and a decline in consumer confidence.

You will find current spot rates here.

<http://www.nzforex.co.nz/forex-tools/spot-exchange-rates>

## If I Were A Borrower What Would I Do?

I saw a quote from an economist during the week that in NZ currently the ratio of mortgage interest costs to income is near record levels. Wrong. At the end of the June quarter according to RBNZ data the ratio of household debt to income was 154.9% which is quite high but down from 155.4% a year earlier. This is shown in the first graph below. The ratio of interest payments to income was 9.3% which was up from 8.9% a year ago. However as the second graph shows this is well below levels in many years in the past and this helps explain why house prices are so high. We borrow as much money as we can to get the best house we can. If interest rates are low we borrow more. Thus the structural decline in interest rates over the past quarter of a century accounts for a large part of the structural rise in house prices and explains why you should pay no attention to measures showing house prices overvalued when those measures are based upon the past era of higher interest rates – which is basically every year between financial deregulation in the mid-1980s and 2007. And remember – every single prediction of house prices falling because of poor affordability or high prices relative to incomes has been wrong these past three decades.



### For Noting

Last week my eldest daughter Lilia won the 2015 Hutt Valley Youth Award in Entrepreneurship and one of the things she is doing is selling 3D printing pens from her website [www.youcreate.co.nz](http://www.youcreate.co.nz)

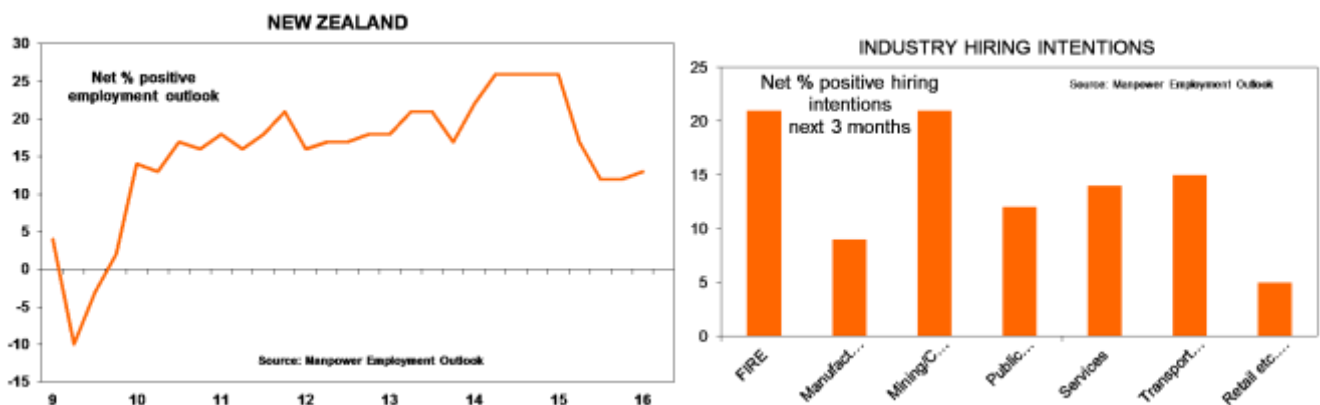
The pens melt a length of plastic filament, like a hot glue gun, and you can form shapes either in 3D or lying down ready for erection with other pieces. Unlike 3D printers you do the creating yourself rather than downloading software for a design and waiting a few hours while a machine does all the work and prints out a 5 cm model of a dolphin.

In the spirit of Christmas I figured I'd do her a favour by advertising her product here as encouragement to a budding entrepreneur and because plenty of people have asked me for favours for their teenage kids over the years, usually revolving around answering questions for an assignment or on how to become an economist (Don't. Keep the supply down.) Great for a Christmas present. You buy!!

And again in the spirit of Christmas and for the next issue of the Weekly Overview only, the final one for 2015, if you also have one of your offspring unleashing their entrepreneurial talents via a website please send the details through to me and depending upon how many come through (if any) I will run a short blurb with website address. The Weekly Overview gets sent to 12,000 addresses each week and around 3,000 people click through to the pdf. Many people however download a copy then forward it to others in their company so end-readership is somewhat higher than that.

### Employment Outlook Static

We received one of the lesser leading indicators of labour market strength yesterday in the form of the Manpower Employment Survey. Their latest survey of some 650 employers has found that a net 13% plan hiring more people in the next three months. This was down from a net 26% a year ago but little changed from levels since the March survey. Thus, consistent with other indicators, it captures the sharp pullback in optimism and spending plans which happened in the first half of this year, but unlike the ANZ Business Outlook Survey is not recording a bounce back following that sharp decline.



In fact the latest result would have been a further deterioration had it not been for a surge in Christchurch employment intentions to a net 18% from 7%. That probably relates to commercial construction but we treat that location's results with some caution given the uncertain nature of so many things down there.

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](http://www.tonyalexander.co.nz) To change your address or unsubscribe please click the link at the bottom of your email. [Tony.alexander@bnz.co.nz](mailto:Tony.alexander@bnz.co.nz)

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