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.

Nothing Much Really

I've been on the road this past week in Waikato and Taranaki – both dairying regions. In both farmers have put their chequebooks away as hopes of a reasonable bounce upward in the dairy payout have gone out the window following recent weakness in fortnightly auction results. Discussions have increased about some exiting the industry, off-farm assets are being sold to support family members in trouble, off-farm assets are also being sold to have cash ready to purchase land falling in price, and debt exposures are being restructured.

As in the Waikato where the roading network is improving greatly and connectivity with Auckland soaring, in New Plymouth big improvements to the road north of the city are almost complete. My message to people at this morning's in function in New Plymouth was the same as that I give to all non-Auckland audiences. Rather than moaning about people shifting to Auckland and the media paying attention to what is happening there, work on how you can boost your regions linkages with what is happening in our biggest city. And recognise the simple fact that Auckland's share of the NZ population has risen from 21% in 1961 to 34% in 2013, and on current projections will reach 40% by 2043, especially with what looks like a structural lift in average net immigration flows to NZ and Auckland capturing 60% of the net flow.

And that's it for the lead article this week given time spent on the road.

Housing

In the three months to January dwelling sales were ahead from a year earlier by 46% in Northland, 32% in Waikato/Bay of Plenty, 32% in Hawkes Bay, 19% Manawatu/Wanganui, 21% Taranaki, 12% Wellington, 5% Nelson, 7% Canterbury, 24% Central Otago Lakes, 11% Otago and 18% Southland. Have sales jumped up sharply in most non-Auckland regions because the economies of these regions have suddenly soared?

Clearly not. Consider Taranaki which is being hit by downturns in dairying and energy, or Wellington where central government bureaucracy is a key element and no massive expansion phase has just been entered into. And so on.

Regional housing markets have soared not because of changes in economies or their prospects but because investors have come out of Auckland looking for yield and lower prices and local investors seeing markets rising have jumped on the bandwagon after choosing to sit on their hands doing very little for a number of years moaning about the focus on Auckland and secretly wishing for Auckland's Chinese buyers to come their way.

So when will the regional surges end? To pick that there is no point forecasting changes in regional growth outlooks. Instead you need to pick when the Auckland investors will back away – because it looks like it is from those big city folk that the regional folk take their guide for what is a good thing to do – investor cultural cringe as it were.

Unfortunately we have no strong feeling for when this satiation of the Auckland appetite for country property will end. Best guess, next year. One trigger might be the reappearance of Chinese buyers in Auckland. There are actually still many Chinese buyers but they tend to be migrants and it has been out to me by someone enmeshed in the Chinese residential investment community that the phase of simply scrambling to buy anything on offer has ended and there is a higher degree of professionalism evident now with regard to what to buy and how to manage it.

Having said that he agreed that eventually the uninformed Mums and Dads seeking any property asset outside of China will return but no-one knows when. Perhaps next year when people are more comfortable with the new tighter rein on capital outflows and the need for such restraint by the Beijing government to protect FX reserves will have diminished.

For this year at least the story is likely to remain one of Auckland having a rest and the rest of the country outside over-supplied Christchurch seeing listings shortages and potentially rapidly rising prices. One thing to watch for will be the still spreading realisation that interest rates will be staying at low levels for many, many years and the boost this will give to property on average in investor portfolios. And watch for any easing in monetary policy which the RB might undertake though we still feel they do not want to cut rates further and will only do so if things get a lot worse offshore. Simply cutting rates in a futile attempt to get inflation to settle near 2% is unlikely.

I wonder when the first set of statistics will be released showing the nationality of foreign people buying houses in New Zealand from November last year.

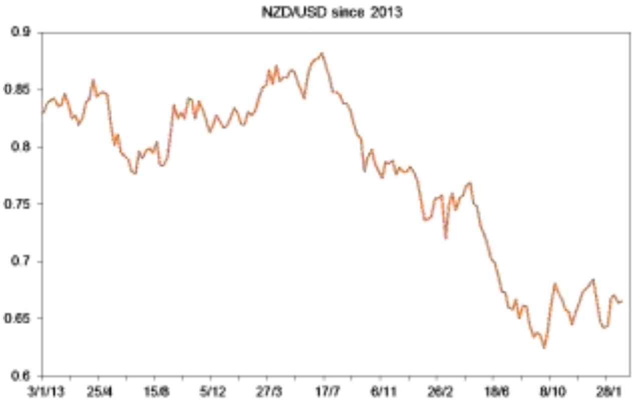
NZ Dollar

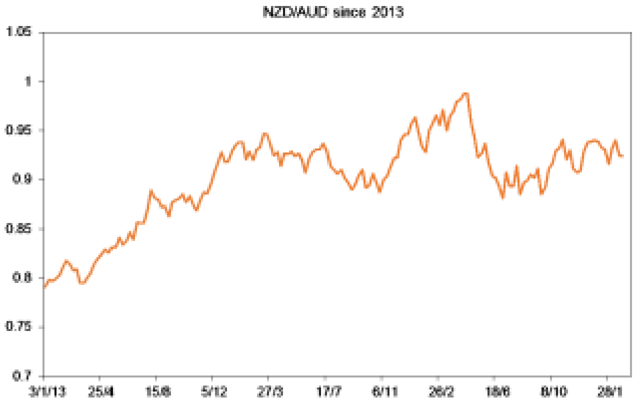
Offshore things continue to move in the direction of investors selling risky assets and currencies of countries not doing economically well – which is interesting because on that regard New Zealand is very much like Japan, except the opposite way around. The Yen faces downward pressure because the economy is flat with downside risk, yet upward pressure because the Yen is traditionally considered a safe currency and one investors buy when the world worries them. The upward pressure is winning even with the Bank of Japan continuing to print money and implementing a negative interest rate – thus telling everyone explicitly that the Japanese economy is munted and acts of desperation are necessary.

New Zealand on the other hand is not considered a “safe” country as such because of our size and commodity export base so the NZD tends to go down when the world gets nervous. But economically we are in a very solid position notwithstanding the economically small but exporting big dairy sector having a bad run. This then tends to push the NZD upward with assistance from what we think is the reluctance of the RBNZ to cut interest rates again at a time when chances are steadily rising that more rate cuts will occur offshore.

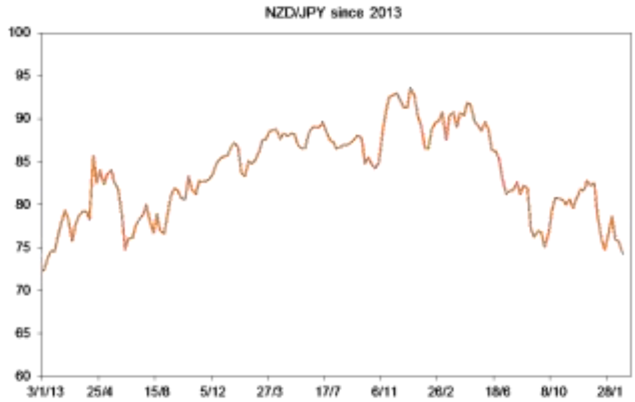
In Europe economic data are edging lower, most notably with regard to German business confidence. The ECB is likely to push out even further the currently planned end date for money printing of March next year and take the central bank’s deposit rate of -0.3% even more negative. In the UK the economy is getting a push ahead from the pound falling in response to uncertainty about the EU membership referendum set for June 23. But the Bank of England has found itself talking about negative interest rates in the sense of the Governor saying “it is not yet our judgement that (the bank rate) could go negative.”

In the US consumer confidence has jumped weakened off quite a bit and given that the key driver of the US economy is consumer spending this increases the chances of no further rate rise from the Fed for a very long period of time and perhaps even a reluctant reversal of December’s 0.25% increase. For good measure a reading of services sector activity last night fell to its lowest reading since 2013 and new home sales have recently fallen more than expected.





This past week the NZ dollar has ended unchanged against the USD and AUD. But we have lost a little bity of ground against the rising Yen while rising to an 11 month high against the British pound near 48 pence as the GBP has fallen in response to the increased probably of Brexit associated with the London Mayor coming out in support of quitting the increasingly dysfunctional, bureaucratic, socialistic, undemocratic, floundering EU.



You will find current spot rates here. http://www.xe.com/currency/nzd-new-zealand-dollar

If I Were A Borrower What Would I Do?

The main thing happening in financial markets which is relevant to where interest rates go in the near future is not our Reserve Bank's monetary policy. Instead it is the investor concern about banks in Europe and general global bank exposure to the energy sector which is causing such investors to become far less willing than they were to fund banks. What this means is that it has become more difficult to borrow, say, $500mn for a five year fixed rate offshore. The cost of such borrowing has logically shot up.

Ahead of the GFC the extra cost to Australasian banks of raising such funding offshore rather than at home was about 0.2% or 20 basis points. This spread blew out to 300 points late in 2008 and since then drifted down to around 100 points. But in recent weeks the spread has risen to 125 points and more recently as much as 195 points.

Because we NZ banks still fund just under 30% of everything we lend to you from people offshore the cost of lending in New Zealand is going up even without any tightening of monetary policy or jump in the swap rates which pre-GFC used to always give an accurate guide to funding costs. Now they don't.

As a result of rising funding costs one bank last weekend actually lifted their floating lending rates 0.25% but then pulled them back down again by Tuesday, perhaps because for this first stab at lifting rates "out of cycle" no other lender was prepared to join them. But the signal was sent. The pressure is upward. This increases the chances that the RB will cut interest rates. But if they don't then you may well find both variable and fixed retail interest rates rising in the very near future. One signal may be a round of hikes first of all in term deposit rates.

Thus, given this risk I continue to find myself prepared to fix three years at 4.49% if I were a borrower at the moment.

If I Were An Investor
The text at this link explains why I do not include a section discussing what I would do if I were an investor.
http://tonyalexander.co.nz/regular-publications/bnz-weekly-overview/if-i-were-an-investor/

For Noting

There are just over 40,000 people employed in New Zealand on farms working with cows or processing the milk. That adds up to 1.7% of all jobs in the country. Dairying however makes up 22% of our total exports of goods and services and that is why the sector attracts so much attention – along with the $38bn worth of debt which accounts for 64% of all lending to the farming sector. Lending to all urban businesses adds up to $89bn, and to households (including to finance rental property ownership $223bn.

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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