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.

The Demand Curve

Students studying Economics 101 anywhere in the world usually have two major challenges. The first is being able to keep their essays down to the required word limit. That is one reason why when someone sends me a document to open (I don't) or refers me to something they have read on the internet for comment I ask them to summarise the argument in about 200 words. That weeds out 99% of people seeking validation for their pet theory as they don't have the ability to condense material into a readable form.

The other problem displayed by students and by those in the public without the economics basics is confusing a more along the demand curve with a move of it. The demand curve is a practical but usually theoretical representation of the almost universal fact that when the price of a thing goes down we demand more of it. When the price goes up we demand less of it.

At the moment we are seeing an increasing frequency of media articles about people shifting out of Auckland. We are being invited to interpret this movement of people (no numbers ever given) as a sign that the Auckland housing market has peaked and may soon fall because of population loss. But all that is happening is that as average house prices have gone up some people are no longer demanding houses in Auckland. They are shifting elsewhere, staying flatting, cramming more of themselves into one house, staying with parents longer.

The underlying level of demand for Auckland houses at particular house price levels is not actually changing ceteris paribus – which is what you should write at the end of every essay. It means other things remaining unchanged and covers the fact that as you are busy analysing what may be happening in an economy in response to a particular thing your little model is also being hit by 100 other things which you don't know about, and if you did you couldn't measure them, and if you could you couldn't figure out what their impact would be because you cannot separate out their effects, and even if you could all that analysis was out of date as soon as you did it. Welcome to the world of economics!

Back to Auckland, at the same time as people are leaving or cramming in, the demand curve is also shifting to the right meaning that at any given average house price more people are demanding houses. This is because Auckland's population is growing by about 3% per annum currently. House supply (which sat at 473,000 occupied and 33,000 unoccupied dwellings in the 2013 census) is not rising by 3% or 15,200. As discussed last week building that number of houses requires the issuing of almost 19,000 consents rather than the current running annual total of just over 9,500 consents which will produce about 7,700 extra dwellings.

For the moment I still find the exercise of developing a view on where Auckland house prices are going to go relatively easy. Demand is growing near 15,000 a year, supply is rising near 7,700. Prices rise. The rest of the debate regarding Chinese buyers here or not, little interest rate changes and so on is just fluffery. Things will get a bit difficult when and if supply is rising over 10,000 per annum (consents above 12,000) and population growth has slowed to 2% which it will one day when the migration cycle turns. Don't know when that will happen.

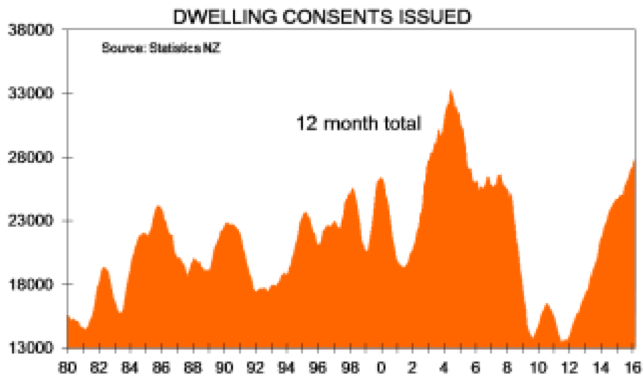
Housing

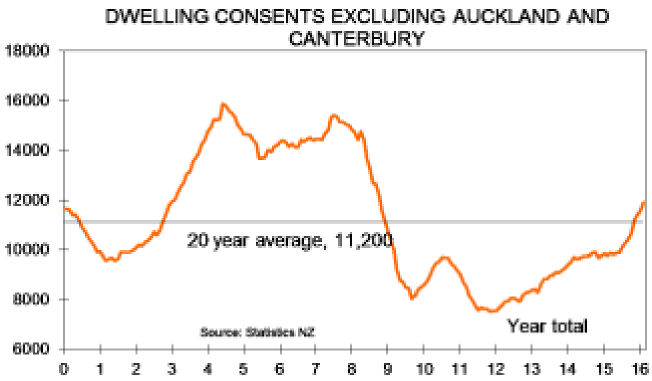
In Sydney and Australia analysts are starting to notice something which has been a phenomena in Hong Kong for many years. There appears to be a rising proportion of the housing stock sitting empty. In the case of Hong Kong, discussed in terms of buildings having few lights on in the evening, it is attributed to mainland buyers leaving flats empty rather than renting them out for a very low yield and this problem has been well known for many years.

In the case of Australia's largest cities the theorised rising proportion of foreign investors owning dwellings is one reason given, but mainly the discussion is couched in terms of investors generally not bothering to get tenants and risk property damage etc. when the rental yield may be only 1.5%. People are simply leaving the places empty and waiting for capital gain. With borrowing costs facing investors so much lower now than previously the cash flow cost of not renting an investment property out is less than in the days of high interest rates.

Out of this then one gets the theory that as the proportion of a housing stock owned by investors rises there will be a tendency for the proportion of the stock left unoccupied to rise and therefore for any given population more houses are needed. The housing shortage is worsened in other words.

Statistics NZ this week reported some fairly strong numbers for dwelling consent issuance around the country in February. Seasonally adjusted issuance was ahead from January by a healthy 11% and 3.9% in the three months to February compared with the three months to November. Compared with a year ago consents were ahead 17% in the three month period with growth in Auckland of a strong 37%, a fall in Canterbury of 20%, and a rise in the rest of the country of 30%. Auckland annual consents now sit at 9,534 which is a 24.4% rise from a year earlier and 29% above the 23 year average of 7,400.





NZ Dollar

The NZD has risen to its highest level against the greenback since June this week, sitting this afternoon just over 69 cents from 67.5 cents last week. The rise mainly reflects weakness in the USD following dovish monetary policy comments from the Federal Reserve Chairperson, but also some short-covering of the NZD by investors who have been waiting for the NZD to fall perhaps in response to weak dairy prices. But weak dairy prices are already factored in so if the NZD is going to fall further it is going to have to be either because the economy is surprisingly weakening away – unlikely – or the Reserve Bank cuts interest rates more than the further 0.25% expected in April or June.

That is possible but they will be reluctant to deliver extra strength to the housing market as investors find themselves "forced" to seek property assets because returns on bank term deposits will be so low.

The NZD is fundamentally well supported by the relatively healthy state of the NZ economy and absence of the many factors which are worrying people in major economies offshore – migration crisis, Brexit, deflation, corruption, the United States Presidential race, and so on. As written previously, exporters might be well advised to take advantage of the occasional bouts of weakness in the NZD to lock extra hedging in place.

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?

Wholesale interest rates haven't really changed in the past week and neither has the outlook for the NZ economy and inflation. So I would remain happy to look at a two or three year fixed rate for the larger part of my mortgage while keeping at least 20% floating to allow for cost-free early repayments.

If I Were An Investor ...I'd see a BNZ Private Banker
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

Business confidence measured in the ANZ Business Outlook survey has declined further this past month to a net 3% expecting the economy to be better in a year's time from a net 7% in February, 23% in December, and long term average of a net 10% optimistic. A net 46% of farmers are pessimistic though they are almost always the most pessimistic group in the economy and almost always more pessimistic rather than optimistic.

That does not mean weakness in the farming sector should be ignored because the ongoing downturn in dairying will have a widespread negative effect on the economy. But there are plenty of non-dairy parts of the economy doing well including in the primary sector, with construction the broad standout currently. Even including the dairy sector pessimism a net 29% of surveyed businesses expect their own levels of activity to improve in the coming year which is a rise from 26% in February and a reading slightly above the long term 25% average.

A net 16% of businesses plan raising staff numbers – up from 12% in February and well above the 6% average. A net 11% of all businesses also expect to boost their investment. This is down from 14% in February and equal to the long term average – meaning dairy investment weakness is being offset by strength elsewhere.

The numbers don't tell us anything greatly new about the economy and it remains reasonable to expect growth above 2.5% in the coming year. And it also remains reasonable to expect another cut in interest rates in April or June with only a net 18% of businesses saying they plan to raise their selling prices which is below the average of 25% and unchanged from February.

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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