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.

No Game Changers

The Finance Minister released the government's annual Budget this week which for the uninitiated is basically an accounting exercise in which spending is offset against revenue streams to produce projected deficits or surpluses, along with lots of information on debt levels and financing, the outlook and plans for the next ten years, and assessment of risks facing the government accounts along with an updated outlook for the economy from Treasury. The Budget also contains details of new policies, though it has been the practice for perhaps a couple of decades now to announce almost all new spending measures in the weeks leading up to the late-May event. Surprises tend to be few and far between, though last year's boost to benefit levels was an unexpected development.

As a macroeconomist my interest is not in the minutia, important as hundreds of things are to particular groups, but the overall package and whether it suggests a different outlook for the pace of growth in employment, GDP etc., inflation, interest rates, housing, and the robustness of the government's accounts.

In that regard, while the likes of the already announced tax changes for SMEs and money for hi-tech start-ups are wonderful and at the margin will make running a small business easier in New Zealand, they don't justify lifting growth expectations unless you are silly enough to deal in growth numbers two out from the decimal point. The same goes for extra funding for apprenticeships, health research, tourism, and so on. All good stuff but no game-changers.

Nonetheless, the Innovation New Zealand package of an extra $761mn in operational spending over the next four years is positive, as is the Public Infrastructure Package totalling $697mn. The Health package is the biggest of the four packages getting an extra $2.2bn over four years, with the final package being the Social Investment Package which gets $641mn. Capital spending for the Public Infrastructure Package adds another $1.4bn.

The measures announced with give a small positive fiscal impulse to the economy this year then small negatives after that, but with none of the numbers being large enough to alter the positive outlook which we and Treasury have for the economy. They see GDP growth in the coming years of 2.9% for the year to June 2017 then after that 3.2%, 2.8%, and 2.5%. They see no tightening of monetary policy until the 2018/19 year and the unemployment rate trending down to 4.6% come 2020.

Fiscal surpluses as percentages of GDP are projected at 0.3% for 2015/16, then 0.3%, 0.9%, 1.7%, and 2.2%.

Housing

It is popular amongst those who fail to understand the factors pushing Auckland house prices higher and/or have for years incorrectly predicted big declines, to blame speculators for the surge in prices. However grouping all investors into the speculators' camp gives an incorrect guide to the true make-up of the many people purchasing properties to rent out.

The results of a survey by Mortgage Choice in Australia were released this week showing that whereas two years ago 20% of people buying investment properties were first home buyers now the proportion is one-third. These "rentvestors" have become a key driving force behind parts of the Australian housing market and we suspect that the same is happening in New Zealand going by anecdotal reports.

It seems reasonable to assume that these rentvestors are not in it for a quick capital gain but a medium-term hold in order to build up a bigger deposit from anticipated price rises and principal repayment and enhance flexibility in their work location early in their career – as in not being tied down to one place through home ownership which can reduce effective functioning of the labour market.

Another group of we suspect long-term holders is older people who have built up cash assets which they are looking to invest in order to earn more than simply leaving the money in the bank. These investors have above average deposits so are not much affected by deposit size rules and they are not speculating in order to earn a lump sum which will then go back into a bank to earn very little. They want something which will yield income over a long period with reasonable chance of capital gain. Maybe some will buy an investment property with their offspring.

Then there are the people acting on warnings about the need to build wealth for retirement by doing exactly that in the form of housing assets. These are also quite likely long-term investors. Plus there are the people who are pursuing housing investment as a business.

It would be great to have data in hand telling us the roles being played by these four groups of investors along with foreign buyers and true buy and flick speculators targeted by the two year bright line test which clearly is having no sustained measurable impact. Without such data the chances that policy can be developed and effectively implemented so that goals around targets like home ownership, social housing provision, and financial system stability can be met are very small – speculative in fact. We need data, not kneejerk analysis and potentially faulty policies.

The Solution

People are always talking about finding a solution to the Auckland housing crisis – usually without specifying which particular crisis they are talking about. Sometimes affordability, sometimes commuting distance, sometimes social housing and emergency housing, sometimes prices, sometimes rents. Is there a solution? If I walk up to someone attending one of my talks and stab my pen through their hand, what is the solution? Its the same for Auckland. The situation is already at hand with “damage” registered and nothing will radically change things unless truly stringent policies are introduced such as removing all zoning rules. All of them.

And a message was provided this week for all those people in other parts of the country who say the government needs to force people to live elsewhere in New Zealand to use their infrastructure and to ease the burden in Auckland. Sorry, according to reports today not even the homeless offered up to $5,000 want to live in your towns. And those Ducklander investors flooding into the regions seeking yield and smaller mortgages should also take note of this development. Your assumptions about regional population growth are probably too optimistic – just as they were last cycle, the cycle before that, the one before that and so on.

Auckland is where over one-third of New Zealand’s population want to live. And just like farmers who with open eyes accept the challenges thrown up by their land, weather, animals, markets, pests and diseases, these Aucklanders knowingly accept the challenge of managing dense traffic, high house prices, and high numbers of people per household.

For your guide, the Budget contained an extra $100mn to free up Crown land for development, extra assistance for social housing, and a warning to councils. In his Budget Speech the Finance Minister referenced something called the National Policy Statement on Urban Development which is “upcoming”

“This will direct councils to allow more housing development where necessary and to measure the impact of their decisions on house prices.”

NZ Dollar

The NZD has risen close to 93 Aussie cents because the AUD has fallen about 8% against the US dollar after the release of weaker than expected inflation numbers a few weeks ago. Expectations are high that Australia's 1.75% cash rate will be cut again as the RBA tries to stimulate growth and create extra inflation. The falling AUD has however dragged the NZD lower against the greenback so we now sit near 68 cents compared with near 70 cents five weeks ago. There has also been some movement down in the NZD/USD exchange rate caused by rising expectations that US monetary policy will be tightened again soon, perhaps in July.

Against the Euro the NZD sits near 60.0 centimes which is little changed from one, four and eight weeks ago. The risk is that the NZD rises against a Euro depressed by continuing money printing by the ECB and a deteriorating outlook for the French economy if not society as people strike and paralyse the country over the President's now heavily watered down policy to open up the labour market and provide a route for millions of disaffected youth to find and grow in gainful employment. France's economic system is one designed to protect those already in work which means change as a response to alterations in consumer demand and competition from offshore is slow to come. Slow growth has become locked in and this means that right at the heart of the EU gaps are opening up between core members just as they have opened up with the less developed economies near the Mediterranean Sea. Each year France looks less and less like Germany and the UK and more and more like Venezuela but without the hyperinflation.

Against the Yen the NZD also risks rising from current levels as the economy has barely grown in two years, and government debt is huge and growing as the population ages and shrinks. The Prime Minister this week at the G7 meeting is begging leaders of other G7 countries to show support for yet another wasteful fiscal stimulus package (number 17 since 1990 we believe). Money is being printed with no end-date to the printing programme specified, and further lowering interest rates into negative territory cannot be ruled out.

Basically our comments about the NZ dollar's prospects are the same as they have been since 2009. Most of the rest of the world has major economic problems while our economy is not just doing okay but very strongly underpinned by construction, tourism, migration and even manufacturing, our economy is flexible thus able to respond to the shocks which always come along, and the government accounts are in good order.

If I Were A Borrower What Would I Do?

Fix 2 – 3 years with maybe 25% floating.

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/

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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