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.

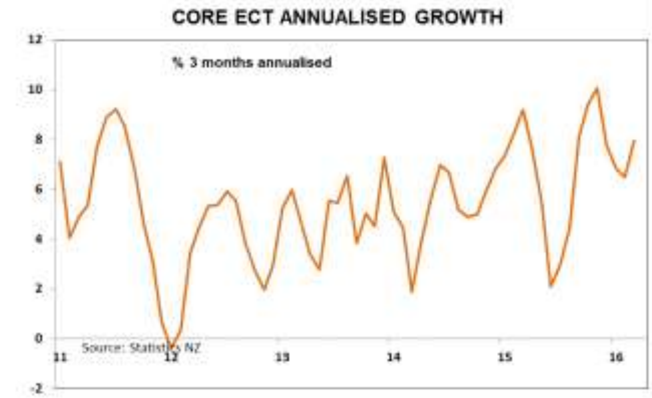
A Data Recap

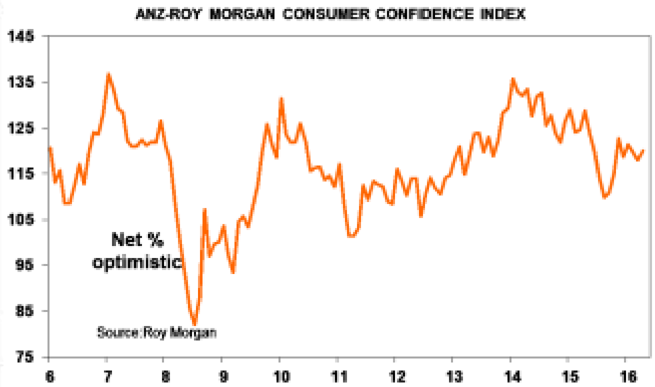
Much as forecasting has become a dogs breakfast post-GFC and most interest rate predictions are little better than coin tosses, we can still examine the data to get an understanding of where our economy is at now, and look at the factors driving it up and down in the future. So lets have a decent run-through of the data, the principal aim of which is to get my brain back up to speed after a couple of weeks on the GC.

The best place to start is with indicators of consumer spending because household consumption accounts for around 70% of all spending in modern mixed economies. The monthly Electronic Card Transactions data show that seasonally adjusted core retail spending in nominal terms grew by 2% in the March quarter after growing 1.9% in the December quarter and 2% also in the September quarter.

This equates to an annualised pace of growth of about 7.9% compared with a ten year average of 5.7%. So spending growth is well above average and chugging along at a firm unchanging pace. This means strong activity in the retailing and therefore wholesaling sectors and the industries which service them such as transport, importing, inward shipping.

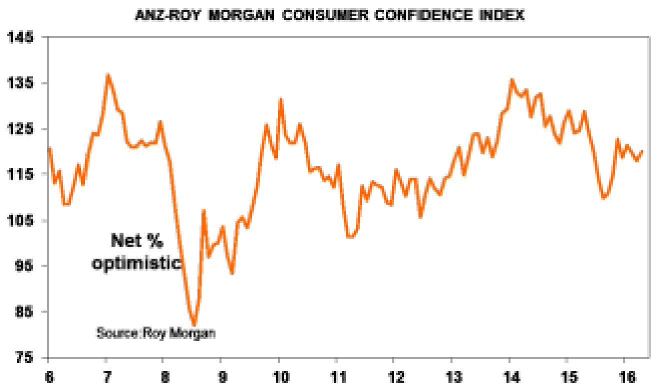
Will this strength continue? Retailers, those closest to the action, think so. A net 32% in the latest ANZ Business Outlook Survey expect their activity levels to be strong in the coming three months. This is above the average reading for this measure of 25% and the best reading since May last year. Consumers are also indicating that they might be out still spending up large in the near future with the Roy Morgan confidence measure sitting at 120 last month from 118 in March where the average reading is 117.

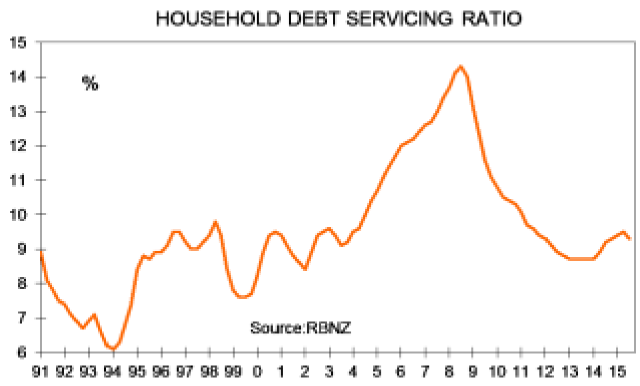




Why are consumers splurging and why is their confidence high? House prices are rising firmly and more people like prices rising than sitting flat or falling so this warm feeling of growing paper wealth is likely to be a contributing factor. History tells us however that people usually over-estimate the importance of this effect so lets keep looking for other reasons.

Interest rates are at record lows and we Kiwis like to borrow the money of those foreigners we criticise for driving badly on our roads and buying our houses. We need those houses to get our debt fix!. The ratio of interest payments to household income is about average for the past couple of decades.





The key factor however behind strong confidence is strong jobs growth. Employment has risen 2.0% in the past year or by 47,000 people. Growth was 1.2% in the March quarter and 1% in the December quarter so underlying annualised growth is running above 4.5% which is very strong. Full-time employment has risen 2.4% the past year while part-time employment has gained a lesser 0.6%. That is very positive.

The ANZ's monthly survey released last Friday shows that a net 13% of employers plan hiring more people. This is above the average reading of a net 8%. Thus it seems reasonable to expect that firm jobs growth will continue in the near future.

Wages growth has yet to properly accelerate so we could not cite that as a key factor behind household spending strength. The measure I track described as an experimental series by Statistics NZ whereby they attempt to track wage rate changes for an unchanging range of positions grew in the year to December by 2.9%. A year earlier the rise was 2.5% and a year before that 2.8%. Only a minor lift in the pace of wages growth is underway.

However real wages are growing firmly because inflation is running at just 0.4% so people are likely on average to feel that they are experiencing rising purchasing power – on average.

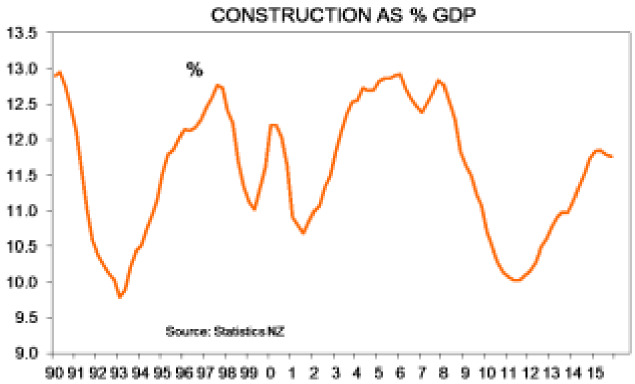
We need clearly to consider the role in rising household spending being played by record net migration inflows amounting to 68,000 people in the year ending March and in total 164,000 extra people since September 2012. This 3.6% population boost in just over three years clearly adds to retail spending growth.

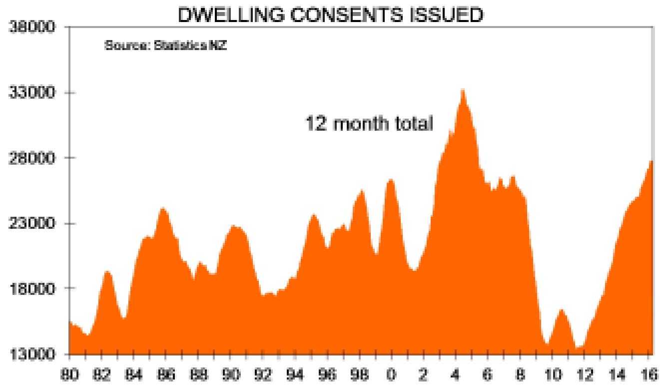
The high net inflows are likely to peak soon, but even as they ease off the numbers are likely to remain highly stimulatory for the next three years.

All up we can attribute high household spending growth to the combination of strong jobs growth, low interest rates, record net migration inflows, and also strong inward tourism when talking about the hospitality sector.

Construction and Investment

While household spending usually accounts for 70% or so of spending in the economy construction on average accounts for another 12%. This includes house building, commercial construction, and civil engineering. During calendar 2015 construction was almost right on its long term average contribution, but this was well up from just 10% in 2007 which was the lowest reading in almost two decades, courtesy of the GFC.





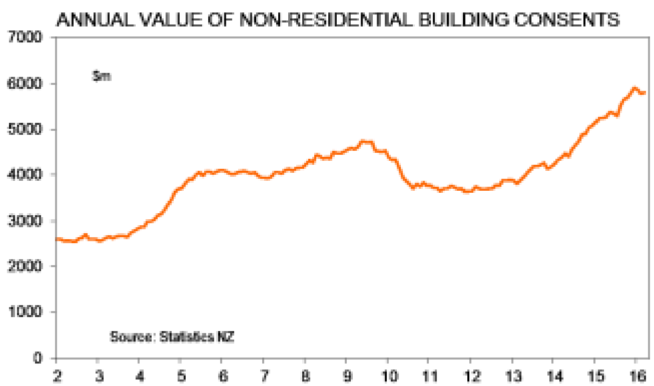
The most recent indicators show construction is still growing, though widespread anecdotes tell us that the staff with necessary skills are not there to allow the sector to grow as rapidly as customers want in the next few years. In the year to March the number of consents issued for the construction of dwellings rose by 12% led by Auckland with a rise of 22%. Stripping out that rise and a 14% fall in Canterbury leaves a 21% rise for the rest of New Zealand.

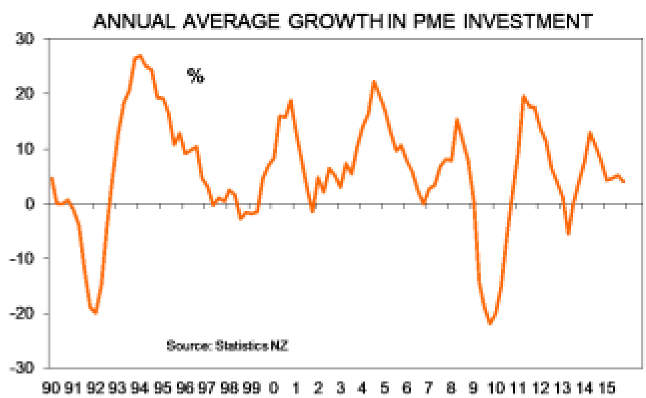
The house building sector is growing strongly supported by firm population growth, catch-up building following the lean post-GFC years, low interest rates, and investor demand. At this stage it is not possible to give a reliable indication as to when the construction peak will occur, and that applies to the commercial sector as well.

The value of non-residential construction consents rose by 11% in the year to March and at $5.8bn was well up from $3.9bn three years ago. With tourism booming there will be a substantial offset to weakness in dairy sector construction (gross overinvestment in cows anyway). As for the other area of construction, civil engineering/infrastructure substantial expenditure is underway and planned in Auckland in particular and local authorities as ever have a lot of work to catch up on.

The ANZ's monthly survey shows that over the three months to April on average a net 29% of builders said they expect higher levels of residential construction in the next three months. This is just above the average of a net 26% so bespeaks of strong activity but not a boom, probably because falling construction in Canterbury is offsetting to some degree the growth in the rest of the country.

A net 26% of builders expect higher levels of commercial construction which is well above the average of a net 16% and indicative of a slight resource shift in the construction sector from residential toward non-residential.





It adds up to construction having capacity to expand a lot more from current levels, but in fact lacking the resource capacity to do so and that will have cost and quality implications.

Alongside the long-term nature of construction activity benefits is business investment in plant, machinery and equipment. As repeatedly noted over the years, in New Zealand we lack good up to date indicators of what is happening with business investment so we end up relying upon confidence surveys. The national accounts data show that investment in PME rose by 4% during calendar 2015 after rising 7% in 2014 and 4% in 2013. The trend is upward but the path on a quarterly basis is so erratic that even if we had up to date short-term measures we would probably ignore them.

In the ANZ survey a net 12% of businesses on average recently have been saying they plan higher PME spending which equals the average reading. So there is business investment growth in this area which is good, but it is not a special driver of economic growth currently – which just goes to reinforce the point we economists and many businesspeople outside lobby groups have long made. Interest rates (currently at record lows) are not the key determinant of business investment.

Exports

The other big area of expenditure in the economy is exports which usually make up about 29% of GDP. Exports grew 6.9% in 2015 after rising 3% over 2014 and 1% in 2013. These numbers come from the national accounts, include services as well as goods, and are adjusted for price changes. Thus they are more accurate as a measure of the country’s export growth than the more frequently cited merchandise trade and current account numbers. However the merchandise trade numbers are monthly and more up to date so we use them to get a reasonable feel for how things are currently tracking.

These latter pieces of data show that in the March quarter the value of goods exports was down by 1% from a year earlier after falling 0.2% for the entire year. In seasonally adjusted terms export receipts were down 1.3% from the December quarter but this measure is highly volatile. The underlying situation for goods exports is one of mild weakness, that coming largely from the dairy sector, with a big offset from most other exports which are doing quite well.

On the services export front we switch to getting a feel for tourism receipts using the International Visitor survey which tells us that spending by foreign visitors to NZ rose 30% in 2015 after rising 14% in 2014 and 4% in 2013. The sector is growing strongly and producing many anecdotes of accommodation shortages which will drive construction growth and employment in the sector.

Growth is being driven mainly but not exclusively by increased Chinese visitor numbers and at the current pace China will surpass Australia to become our largest source of tourism receipts during 2017.

The other main services export is education. The data for this sector tend not to be up to date and no official spending gauge is available. But based upon a recently updated survey the sector brings in over $3bn (tourism near $10bn) with growth in student visa numbers for long-term study in the year to March of 9% following 52% growth a year earlier – largely on the back of higher Indian student numbers. A couple of years ago student visa rules were changed to allow part-time employment.

Prospects for growth in services exports look good. The main threat would be a major global downturn or especially significant weakness in the Chinese economy. However while the IMF have recently cut their global growth forecasts they sit only just below average and improvement is forecast for next year. In China extra stimulatory measures are being introduced delaying a period of major adjustment in some sectors to perhaps two or three years from now.

Government

Another sometimes substantial driver of short-term changes in growth pressures for the NZ economy is the government sector. We can measure this using what is called the fiscal impulse and will get an update on this measure when Treasury release the 2016/17 Budget on May 26. But with good monthly tax versus spending outcomes recently, a small surplus last year and the chance of one this year, low debt and a long-term focus on reducing debt further, the chances of much change in fiscal settings is quite low.

Add everything up and one struggles to forecast anything other than good growth in the NZ economy in the coming year or two with recent growth continuing at a good pace.

Could the growth be interrupted by inflation getting out of hand and the Reserve Bank having to tighten monetary policy a lot? No. Inflation is low at 0.4% and a small easing bias remains following 1.25% worth of cuts to the official cash rate over the past year or so. Inflation indicators for the coming year remain well contained and the bigger challenge for the RB is not lowering inflation but raising it with low interest rates sustained for many years and containing the firm rise in house prices in most parts of the country.

In that regard will the rapidly rising probability of new credit controls cause a sharp reduction in house prices, consumer sentiment, and house construction? No. The chances the RB makes are likely to be minor – partly because they are still experimental and fundamentals still say a real price adjustment in the Auckland housing stock is warranted.

Housing

Personally I have just one question regarding the housing market. When will the Reserve Bank act? While I find the timing of Auckland's resurgence to be earlier than expected, it is not surprising that it has done so given the worsening shortage as supply growth fails abysmally to keep up with population growth. The ongoing strength in the regions is also not surprising as this has happened in previous cycles and was well overdue for getting going this time around. It is surprising it has taken so long – but that just means there are more catch-up price gains to be registered around the country, especially as sustained low interest rates are factored into calculations of affordability and yield.

The housing market is on a roll again and with the pace of housing debt growth hitting its highest rate since early-2008 at 8% the Reserve Bank will be getting increasingly concerned about risks to the financial sector stemming from the risk (a low one) that some weird shock causes a decent 20% plus pullback in house prices.

For the record, this week Barfoot and Thompson data showed that sales are slowly improving though in April were 12% down from a year earlier, with some of that decline likely due to a shortage of listings. Stock at month's end was down by 10% from April 2015 and the number of new listings received during the month was 5% lower than a year ago. The average sales price edged up slightly from March to $873,000 which was 8.6% ahead of a year earlier. In the past three months prices have risen 0.2% after rising 2.4% in the three months to January and 0.9% in the three months to October. So price action is mildly positive. We await REINZ data for better, all of market, insight.

NZ Dollar

The big NZD rate change for this past week or so has been against the Aussie dollar. The NZD is trading near 92.0 cents compared with 90 cents last week, and 89 cents three weeks ago. The rise has come about partly because of a fall in the AUD following lower than expected inflation numbers last week (-0.2% for the March quarter, 1.3% for the year), and Tuesday's 0.25% cut in the Australian cash rate to a record low of 1.75%.

The weakening of the AUD actually dragged the NZD down a bit as well so whereas for a while we were trading near US 70.5 cents this past week the currency is now closer to 69 cents. The NZDs strength mainly reflects ongoing positive economic data culminating in the strong 1.2% March quarter growth in employment reported yesterday.

We've said it here before and will say it again. The NZD is fundamentally very well supported because our economy is in far better shape than many others, both in terms of structure (deregulated etc.), current growth (approaching 3%+ on construction, migration, non-dairy exports), and long-term growth based on exporting food and food technology to growing numbers of middle income Asian families. And again let us note that for exporters their incentive is to take advantage of the occasional bouts of weakness in the NZD (as we saw recently with the fall below AU$89 cents) to get extra hedging on board.

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?

Nothing much new as yet to say here. I would have a bit floating and the rest probably fixed two years at 2.39%. Investors should try to fix longer and perhaps spread their risk a bit more, perhaps getting some debt fixed for a four year term.

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
To change your address or unsubscribe please click the link at the bottom of your email. Tony.alexander@bnz.co.nz