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.

Good Shape

This week we have seen the release of bits and pieces of data, all showing our economy to be chugging along reasonably well in spite of the troubles overseas. Dwelling consents rose in seasonally adjusted terms by 6.6% in April. The terms of trade rose 4.4% during the March quarter. Business employment intentions in the ANZ Business Outlook Survey rose to a net 18% positive in May from 13% in April and a ten year average of 9%. Investment intentions rose to 15% from 11% with a 12% average.

Our own quarterly survey showed boom conditions in construction, engineering and tourism, and strong conditions in most other sectors apart from dairying where farmers are knuckling under making changes. The deep pessimism of three months ago is no longer evident. Average prices even improved 3.4% at last night's dairy auction.

Next week the Reserve Bank will review its 2.25% cash rate and while the sort of data we are receiving would have caused a rate rise pre-GFC, the pressure is on the RB to lower rates further because of low inflation. Next week no change is the most probable outcome however.

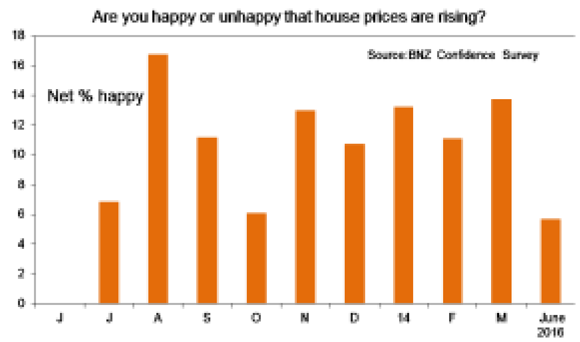
Housing

QVNZ released their monthly data this week showing how prices have been tracking over the past three months – with observations in their dataset weighted toward the start rather than end of that period. That is why personally I prefer the monthly REINZ data to get a good gauge as to how prices are moving. Their numbers better reflect the latest developments and that is why I'm not going to discuss the QVNZ numbers here., But if you are interested then there is plenty of information online. Try here. https://www.qv.co.nz/resources/news/article?blogId=228

Happy or Unhappy At House Prices Rising?

In our latest quarterly BNZ Confidence Survey we asked the largely business audience who read the Weekly Overview to respond as to whether they were Happy, Unhappy, or Indifferent to house prices rising rapidly. Of the 564 people who replied 218 were Happy, 186 Unhappy, and 160 Indifferent.

That means that a net 6% of respondents are pleased at the way house prices are rising. The last time we asked this question, back in March 2014, a net 14% of respondents were happy. In fact during the period from June 2013 until March 2014 a small majority were Happy about house prices rising every month except the first survey which produced a dead even outcome.



There are no price forecasts derivable from this survey result beyond the implication that there are plenty of people who like house prices rising and may take actions to either keep them rising or to prevent them from falling. The impression given by the media that there is near universal hand-wringing regarding high and fast rising house prices is not accurate. The majority are not having their views reflected in popular discussion.

Here is a reminder regarding how to interpret what you read and hear regarding housing markets. There are three categories of comment.

First, most of what you encounter will be moaning about the speed with which house prices are rising and how some groups are being negatively impacted. You will hear little about those doing well from the rises beyond tall poppy bashing along the lines of such people being speculators and rich. In New Zealand it is not socially acceptable to be rich so calling someone that is an insult here.

In the same vein, when house prices were falling over 2008-09 the stories you heard were about people suffering because of those declining prices – not those benefitting because they had held off gearing themselves to the hilt and were subsequently getting bargains. Just as some older dairy farmers are doing now.

Attention is always on the most negative aspects of whatever is happening in fairly much anything we discuss amongst ourselves. Its human nature.

Second, and this is an extrapolation of the first set of housing comments, we get discussion about what "should" happen and how things "should" be. Such discussions are great for helping to formulate policy. But they won't give you much useful insight into where house prices are going to go or what is moving them. In particular, just because someone is angry about house prices rising does not mean they have or even had any insight to offer into actual price movements these past six years. In fact the emotional approach of one long in the public eye NZ economist has led him to incorrectly forecast house price movements for four decades now.

I deal in the third area of discussion. That which "is" and that which I believe "will be". No bemoaning the winners and losers. No whinging about how the world should be fairies and fluffy pink unicorns.

This type of analysis and commentary can be a bit difficult for some people to understand. So if you live in the world of "should" stop reading now and go back to the talkback radio.

What "is" in this country's housing markets is that

1. strong population growth is exceeding housing supply,
2. interest rates are at record lows so borrowing costs are minor and returns on the simplest of non-housing investments extremely low, is means even land-banking is cheap,
3. people are living longer so preparing a wealth base,
4. older people are splitting up and needing two houses,
5. the population is aging thus also naturally requiring more houses as bedrooms sit empty – perhaps ready to accept tourists using Airbnb,
6. council rules make building a new house expensive,
7. central government keeps raising building standards and costs,
8. we Kiwis like expensive bespoke houses rather than little boxes on a hillside which we look down our noses at (our snobbery goes both up and down in the same people),
9. an oligopolistic industry structure keeps building material costs high,
10. we Kiwis seem to suck at building houses which pass inspections and don't leak,
11. most of us live in NZ for the nice leafy yard lifestyle rather than making big bucks (overseas) so we actively prevent housing intensification,
12. people are "catching up" on buying they did not do from 2008 until recently as they sat listening to people in the world of "should" expecting prices to fall 40%,
13. there is a shortage of skilled tradespeople needed to build extra houses,
14. investors have flooded out of Auckland seeking better yields and smaller mortgages as they do every cycle,
15. few people seriously believe the government and central bank have the tools to flatten house prices let alone cause them to correct downward to more "affordable" levels,
16. people are being driven by FOMO (fear of missing out) to buy as quickly as they can,
17. some are driven by housing investment seeming to have become the social norm with pictures of happy investors looking just like you and I,
18. Auckland is changing from looking like many Invercargills in one place to being a globally connected world city.

Here is a link to my November 1 2012 Weekly Overview listing 19 reasons why Auckland house prices will keep rising (page 5)
http://tonyalexander.co.nz/wp-content/uploads/2013/02/WONovember-1.pdf

and the April 2014 update.
http://tonyalexander.co.nz/wp-content/uploads/2014/05/WO-1-May-2014-.pdf

Does the government's National Policy Statement on Urban Development make any difference? No. Consider their desire to speed up land availability against each of the factors listed above. For most it is not relevant. Prices keep rising.

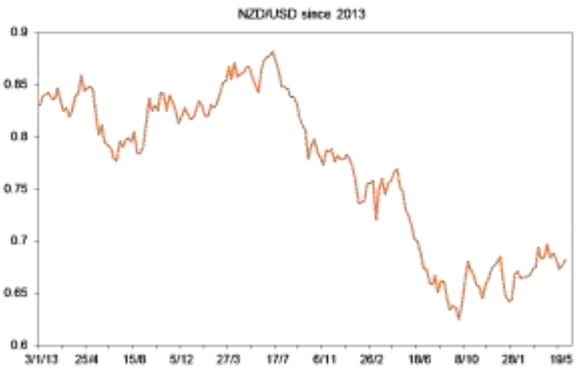
So what is likely to happen? Prices keep rising but two to three years from now some regions will have seen excess construction compared with population growth (or shrinkage) and some developers and investors will suffer losses. Auckland will plateau through the combined effects of prices simply being really, really high, mildly easing migration, higher annual supply growth, and possibly slightly higher interest rates from 2019.

Before then the Reserve Bank will try to put the hammer down. In the past this would have been done by taking mortgage rates to 11%, causing major pain for exporters and an eventual recession. They cannot do that now so instead we will see more controls aimed not at restricting credit demand but at curtailing its supply – the pre-1980s approach. When? Don't know. Before year-end. What form? Probably lifting the investor deposit requirement in Auckland and instituting one elsewhere, plus maybe debt to income rules for new lending.

Would I still be a buyer? Yes, with anticipation of this reply changing to No come some point in 2018. Nelson, Hamilton, Tauranga, Wellington, Auckland fine. Elsewhere, question your population growth assumptions.

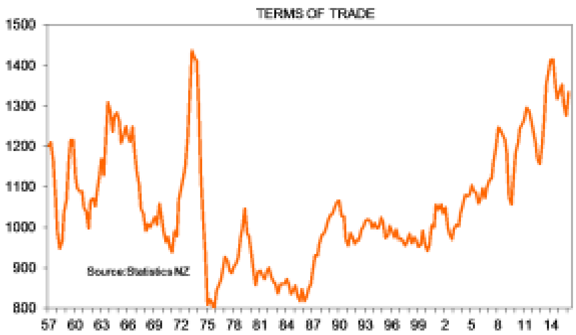
NZ Dollar

The Kiwi dollar has risen marginally against the USD over the past week to sit this afternoon near 68.2 cents from 67.7 cents last week.



Support for the NZD has come from a range of things.

- Average prices at last night's Global Dairy Trade auction rose by 3.4% and now sit 11% above the March low but 5% lower than at the end of 2015.
- The British Pound was sold lower because of a couple of polls showing small majorities in favour of leaving the EU.
- The Euro was sold lower for the same reason.
- We rode on the coat-tails of a stronger Aussie dollar boosted by good GDP numbers yesterday (growth 3.1%).
- The terms of trade rose by a healthy 4.4% during the March quarter and are just 6% down from the June 2014 peak in spite of a 56% fall in dairy prices from three years ago.
- The OECD last night predicted NZ growth to be above the OECD average both this year and next.



As mentioned many times already, the NZ economy is in good shape at a time when the list of problems and uncertainties afflicting other countries is huge. As the OECD noted last night, the world is in a low growth trap. The UK may leave the EU with rising probability. The EU is weighed down by bad structural economic policies and a dysfunctional finance market among other things including terrorist threats. Americans may just be stupid enough to elect the most ridiculous

US President on record. China's growth is slowing (the data are fictional), structural problems are worsening, and debt levels are soaring. Japan has failed to convincingly beat deflation and ignite growth. The Middle East is falling apart.

Hence the strong NZD and high net migration inflows.

If I Were A Borrower What Would I Do?

We think that while the Reserve Bank will probably leave the official cash rate unchanged at 2.25% at the review next Thursday, another cut is likely before the end of the year. That is good for borrowers who float or like short-term fixed rates. But in the United States the probability has risen slightly this past week that the funds rate will be raised again in the next couple of months. That means some upward pressure on mid to long-term financing costs – if it happens.

Were I borrowing currently I would have about 20% or so floating and fix the rest for two or three years. I would fix five years if I thought inflation might be a problem two or three years from now – but I don't.

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