

## 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.

## Brexit

Guess I should write about Brexit - even though there is little one could expect an economist down in the most far flung part of the former British Empire to have anything to offer – except an outside perspective.

It was to get that outside perspective on New Zealand and our business culture and economy that drove me to start travelling to the UK and Europe near once a year just after the GFC. I have found time outside New Zealand to be extremely useful in terms of being able to better understand the failure of Kiwi businesses to become successful on the world stage – with a few exceptions.

I have also found it useful in my analysis of Auckland's housing market to be reminded about the economic impact of population growth rate changes when set alongside shortages of a product – in this case houses. Simple economics of supply and demand.

And I have also found seeking this outside perspective to be useful because while doing it I was also able to get some perspective on the European Union, the Eurozone, and why they are not succeeding. My comments regarding economic and political prospects for the EU have been very negative these past few years and as noted here have encouraged me to write that the UK referendum would probably result in a decision to leave.

What I observed in Europe was politicians, bureaucrats, senior businesspeople and the wealthy adhering blindly to the business model which says you have to keep moving or die, bigger means better, and if you are not part of the in group you will suffer. I saw Stalinist-like propaganda regarding the Euro and how it would bring disparate people's together, literally skipping hand and hand into a bright sunny day.

I saw those who questioned the speed of EU expansion, the spread of EU legislation into

national legal systems, and unfettered migrant flows painted as racist Neanderthals. It is no wonder so many young people voted Remain. They have grown up surrounded by messages and imagery that big Europe is best.

For some maybe it is and it is doubtful that the other 27 non-UK members have much interest in falling back to their previous warring nation-state world. However fault lines are developing between the core countries and others with the risk of new referendums should the core members and Germany in particular try to deliberately inflict pain on the UK for walking away.

But the UK has always been different, separate from the Continent. The country is certainly multinational and it is ridiculous to consider anything other than that London will remain one of the world's pre-eminent global cities. But my visits to the UK showed me a growing divide between those riding the surging London bandwagon and those outside feeling left behind.

The UK has experienced huge turmoil these past four decades and not everyone made redundant from the collapse of the mining industry, the shifting of low-to-medium skilled manufacturing offshore, and the more recent influx of cheap labour from countries which entered the EU in 2004, has been able to easily adjust. There are losers from globalisation.

Many people have felt disenfranchised and those who sought a voice found themselves ridiculed as supporters of Eurosceptic UKIP or outright racist Nazis potentially members of the National Front. The campaigns regarding expanding Europe being best have been so intense that reasonable opinions of reasonable people feeling cast aside have been derided. And that derision continues this week with Leave voters portrayed as old, racist, unintelligent destroyers. That bigotry is as appalling to watch as the true racists and their taunting of migrants.

For many people the June 23 referendum has provided essentially their ONLY chance to make (in their opinion) a true change in the direction of the UK away from their perceived loss of national identity, and the perceived loss of jobs to migrant hordes. It has been their only opportunity to extract a price from those more enlightened for the pain they have felt in being left behind in a changing world.

These concerns of identity and migration flows have been around for quite a few years and there is no chance Brexit will bring jobs back to old industrial Britain. But had the referendum been held in 2006 the Remain camp likely would have won quite easily. This is because the global financial crisis has changed everything. It showed the fallibility of all experts in the economic and business sphere. None of us picked it, even though plenty of people were warning about unsustainable excesses.

The GFC has also led to changes in the way people and businesses behave in response to things like movements in interest rates, prices, job security etc. which our models can no longer capture, based as they are largely on data covering the period from the 1980s up to 2007.

Why listen to warnings of experts regarding the economic impact of leaving Europe when these experts failed to pick the GFC, kept their jobs nonetheless, and have made appallingly inaccurate forecasts since then.

Economies have struggled to grow since 2007 yet housing has become extremely expensive in many locations as interest rates have been pushed to astoundingly low levels to try and encourage banks to lend and people and businesses to borrow – to take on even more debt, more and more. As the Bank for International Settlements warned yet again late last week, there is an "urgent" need to tackle reliance on a "debt-fuelled growth model" around the world. It can't go on.

Other factors tipping the Leave side over the line likely include

- the inability of the EU to protect its borders against inflows of economic migrants alongside true refugees,
- new rioting on the streets of Greece and France with the former still reluctant to modernise and repay debt and the latter

also unwilling to embrace global labour and business market norms,

- worries about an influx of Turks one day should Turkey ever be admitted to the EU,
- failure of the British PM to secure meaningful changes in the UK's relationship with the EU earlier this year,

On that last point, had EU leaders paid proper attention to the concerns outlined by David Cameron early this year when he was negotiating for special treatment, and given him more that he was seeking, perhaps they could have prevented the Leave campaign from winning. They gambled on their intransigence and lost.

I expected a victory for the Leave camp and can understand why they won. The fact that so many people are now campaigning for the result to be over-turned (a futile waste of time) shows how quickly democracy is willingly cast aside when some people don't get what they want. It shows how those who have done well from integration and had a good GFC cannot empathise with those left behind. It shows the mistake of young people who believe that if something goes viral on social media it is actually important rather than so much hot air blown from one self-promoting twit to another.

And it shows the power of having enough conviction in your beliefs to get your padded butt off the couch and cast a vote to do something about it. Action matters, not digital words which are nothing more than lettered selfies.

When you get more people voting for a thing in the UK than for any other single thing in UK history the result cannot be dismissed as not representing the wishes of the people. And what about the argument that the votes of older people should be stripped out because they will die soon and not live with the consequences of their vote?

Oh how easily some people discard their ideas of inclusiveness and respect for all when it selfishly suits them. There is no evidence older people made their choice based only on self-interest. Most material on the subject which I have read over the years suggests that the older people get the more they think about their legacy and leaving behind something they feel is better for their descendants even if that something is not what their descendants want.

If votes were to be discounted by age then the argument is made for denying health care to very sick people. They will be dead soon so why waste money which younger people could use? Before you know it we would have our vote rankings serialised and stamped on our arms.

### What Happens Next?

The UK and EU will be busy full-time for the next two or three years arranging the breakup. There will be little time to entertain development of trade agreements with other countries let alone tiny little us down at the arse end of the planet selfishly worried about getting our wine and sheep bits into the UK and Europe and missing the big picture that this is the most momentous global geopolitical event so far this century. We would be best not to bother UK bureaucrats and politicians that much for the next 1 – 2 years or risk being told to bugar off. Yappy ankle biters risk getting kicked over the fence.

Because so many things have been thrown up into the air if not out of the cot we will see reduced levels of business and confidence feed into reductions in economic growth rates from what they would have been. This means interest rates lower for longer. That means more support for rising house prices throughout New Zealand. That means earlier introduction of toughened credit controls from the Reserve Bank.

The source of any economic weakness is overseas, not here. That means a higher NZ dollar on average than would otherwise be the case once the immediate period of risk aversion ends. Regarding the AUD, probably we weaken once their election is out of the way. Against the Pound I would buy some now and take the bird in the hand rather than getting greedy hoping for 55 pence. Personally I think the NZD will finish the year against the greenback higher than it is now.

At the margin maybe migration flows to NZ get a boost. But we risk over-estimating this effect. In New Zealand we are not allowed to get up ourselves about anything, but we do nonetheless get up ourselves when we think we are so much better than people and countries enwrapped in their many problems overseas. We will not see a big rush of people down here escaping UK woe. Why on earth would someone who wanted to remain in the EU spit the dummy and go bush by shifting down here? It doesn't make sense. A few of us however may hold back from going to

London for a while amidst talk of staff dislocations over there.

How will sharemarkets move in the near future? Same as before, up and down in an unpredictable manner. Speaking of which, it is silly for anyone to be worried about the impact on their Kiwisaver account. Is there any reasonable basis for believing that the lump sum will be smaller than had the Remain camp won when you retire in 40 years time? No. 30 years? No. 10 years? No. Two years? Maybe, but if you are 63 why were you planning anyway to cash up as soon as you turn 65? Most people will be better off leaving their money in their diversified Kiwisaver fund and drawing from it over time than cashing up on their b'day and putting it all on term deposit to earn 3.3%.

### Learnings?

Votes of older people really matter. As people age they tend to become more conservative and they vote in greater proportion than young people for whom the future is a distant thing not too much to be worried about. Older folk in NZ are not going to vote for a party promising measures which will cause their house prices to go down. That removes one source of their power (inheritance favouritism), and reduces options for retirement home housing and wealth use. Nothing new there really.

Issues of sovereignty and national identity matter. But that is what the March flag referendum already told our political leaders so again nothing new there.

Regional income and employment disparities matter. This has already been acknowledged by the government, but perhaps we can expect to see a tad more effort put into regional economic development. Note however that we Kiwis are highly mobile internationally and domestically so do not have the same occurrence of depressed old industrial locations as in the UK.

Shocks are always just around the corner. NZ voters will again be disinclined to support any profligate party promising larger deficits which would raise the risk of austerity policies having to be imposed which extend periods of weakness should a big shock come along and remaining government debt buffers get quickly used up.

People are prepared to endure economic pain in the interests of achieving a larger goal. But this is also something already known in New Zealand. We knew going nuclear free in the 1980s would hurt our economic relationship with the United States. But we did it nonetheless. Russia knew invading the Crimea and taking part of Ukraine would bring economic sanctions. But President Putin did it in nationalistic interests. Nothing new here.

Globalisation and free trade threatened? No. British people have always favoured free trade and as noted in a Wall Street Journal article this week, Eurosceptic still tend to be free traders, not protectionists. Nonetheless, the referendum result highlights the importance to NZ of getting locked into widespread and strong free trade zones like TPP and RCEP.

But one thing Leave voters were rebelling against was intrusion of trade pact rules into wider legislative areas and this is one of the key concerns which TPP opponents have about that agreement. Freedom to set NZ legislation in NZ's interest could be challenged and defeated by foreign corporates and governments in the courts.

Immigration may be good eventually for an economy overall, great for those wanting a ready pool of cheapish labour, and vital for NZ to help counter areas of weakness in our business culture. But some people lose jobs to immigrants and their voices have been ignored, their concerns dismissed. Expect to see the government make some move to rein in high net migration inflows by tightening gross foreigner immigration. Point requirements are likely to be raised along with rejigging to even more favour migration to the regions (that won't have much impact). Any change however is likely to be small with our labour market tight and Statistics NZ yesterday revising down their estimate of the NZ unemployment rate from 5.7% to 5.2%.

### Housing

Simple. More upside in prices as migration flows get a slight boost at the margin and interest rates go lower and stay low for longer as a result of the UK referendum result.

However, further monetary policy easing offshore reduces even further the size of buffers to help fight the next major global shock. Vulnerability of our economy to such a shock is growing and

property investors should keep that in mind. Just because there are strong fundamental reasons for high house prices in Auckland and increasingly the likes of Hamilton, Tauranga and Wellington does not mean that markets don't have corrections. We struggle to generate a scenario of a substantial correction involving prices falling by any meaningful percentages in these locations. But a time will come when ability to sell quickly disappears and vendors have to pull back from unrealistic price expectations.

On top of that there will be many developers caught out eventually by cost increases forcing them to raise selling prices to buyers who have signed up. But a time will come when a flat market means those buyers choose to get their deposits back rather than pay the new higher price and the developer will go bankrupt.

Watch for this also in the regions for a different reason – not so much construction costs rising but bad forecasting of population growth in the first instance, and ongoing willingness of big city investors to keep buying regional assets as soon as they get a sniff of things cooling down.

And just to finesse our long running warning regarding over-estimating regional population growth. Yes it is true that many Aucklanders are and will be selling their high priced houses and downsizing to something smaller and cheaper whilst freeing up capital. But there is growing evidence that they are shifting not to the regions, but to suburban located apartment developments.

When might this flattening phase come along? My best guess is 2018 through a combination of lower net migration inflows, ending of the period of falling interest rates with forecasts of rate rises returning, the risk of an eventual over-tightening of credit supply as the Reserve Bank experiments with new tools, and a global economic shock associated with lack of economic reforms as the limits of futile easy monetary policy are reached.

At some point you want to give thought to taking some of your risk off the table.

### NZ Dollar

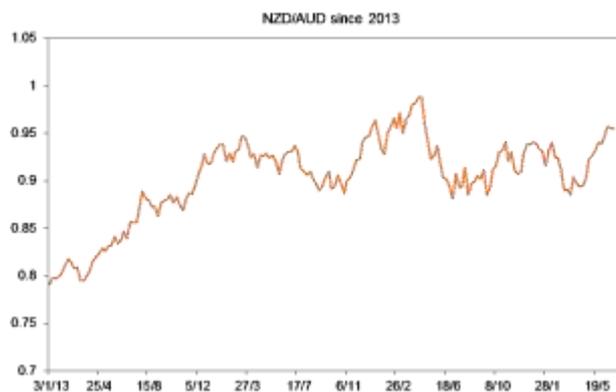
The Kiwi dollar this afternoon was trading near US71.2 cents compared with 71.7 a week ago. This small change of just half a cent is less than the average weekly change for the past year of

## BNZ WEEKLY OVERVIEW

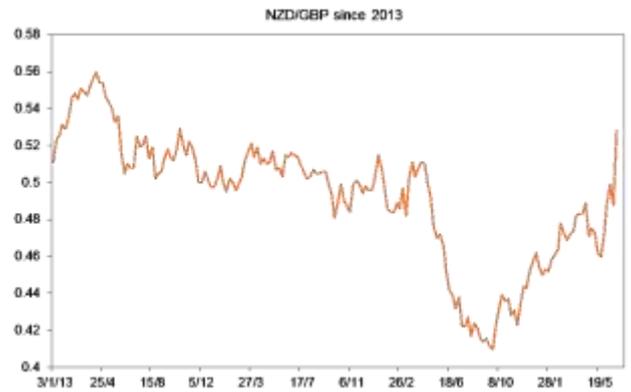
0.9 cents so one could be forgiven for thinking that nothing happened. But in reality the Kiwi dollar fell for a while just below 70 cents amidst the global market correction when the UK referendum produced a Leave result whereas most positioning had been for a Remain victory.



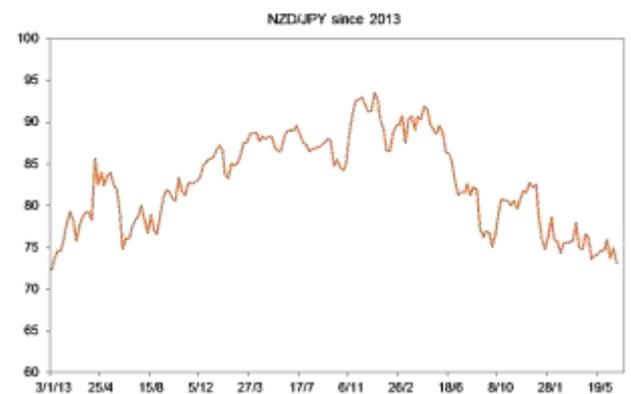
The NZD weakness happened at the same time as sharemarkets plunged. But things have improved over the past couple of days and the Dow Jones Industrial Index is now just 200 points below its pre-Brexit level, the UK's Footsie Index is back at pre-vote levels, though Germany's main index is still off 5% for the week.



With some worries easing the NZD easily recovered whilst through it all we have held strong against the AUD and have ended unchanged from last Thursday near 95.5 cents. But of course the NZD is well up against the British Pound at near 53 pence from 49 – the highest rate since May 2013.



With expectations of further US monetary policy tightening this year now chucked out the window there is little to stand in the way of the NZD rising to US75 cents, especially as the Reserve Bank will only reluctantly ease NZ monetary policy further in light of strong labour market data and a surging housing market.



### If I Were A Borrower What Would I Do?

Readers may recall the warning written here last year regarding expectations of steadily rising US interest rates. Our warning was that people should note the lessons of NZ, Australia, the ECB and Sweden when thinking about US rate prospects and the clear risk that the US would raise rates by little then quickly cut them as we had done already. The US markets have now priced out any prospect of rate rises this year to follow the one-off 0.25% increase of December 2015. For a few days there was talk of the Fed. stripping away that rate rise. But such an expectation seems premature at this stage.

Nonetheless, interest rates globally are falling anew. The UK ten year government bond yield has fallen below 1% for the first time ever. The US ten year yield has fallen close to 1.45% from

## BNZ WEEKLY OVERVIEW

1.68% last week. The NZ ten year bond yield has hit a record low of 2.32%.

Were I borrowing currently I would still target the 2 – 3 year area.

### **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/>

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