BNZ Weekly Overview

4 August 2016

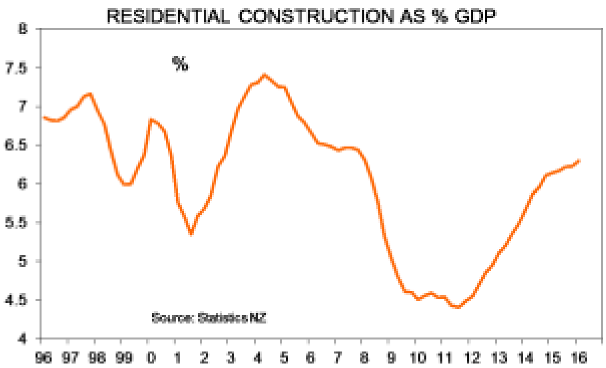
ISSN 2463-4328

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.

Booming Construction

Over the past 20 years on average construction of dwellings has accounted for 6% of GDP. There was a peak of 7.4% of GDP in 2004 and a low of 4.4% in 2011 – the worst in post-deregulation times.



In the year to March the percentage was 6.3% and a rise above 7.4% is likely over the next couple of years as all stops are pulled out to build houses to meet Auckland's rapidly growing population, and markets respond to the price surges occurring in the regions.

This week we learnt that in the June quarter the number of consents issued for construction of new houses around the country was ahead in seasonally adjusted terms by 10% from the March quarter and 18% from a year ago.

These two numbers indicate to us that until the June quarter consent numbers had actually been flattening out for about nine months so we need to ask ourselves what was causing that earlier flattening and whether this rebound can be sustained.

Up until the June quarter the main contributor to slowing consent growth was Canterbury where in the year to March consents fell 13% while they rose 22% in Auckland and 21% everywhere else.

In Canterbury December quarter consents were down 24% from a year earlier, March quarter 15%, but June quarter they were ahead 14%. This does not seem likely to continue given the declining need for extra houses in Christchurch post-earthquake. Therefore we don't read the strong June 10% June quarter seasonally adjusted jump in consent numbers all around the country as signalling a new boom. The trend in construction is upward, but not at a 40% p.a. pace.

For the record, in the June quarter Auckland consents were only 4% ahead of a year before and the annual total has all but stalled since February. Resource capacity issues?

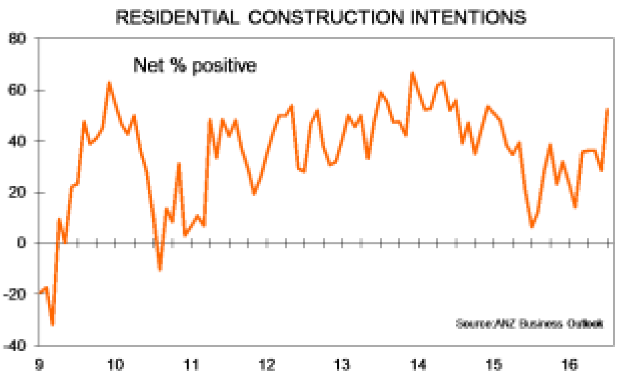
In contrast outside Auckland and Canterbury consents in the quarter were 32% ahead of a year before with the annual total now up near 900 since February to 12,794 whereas Auckland's annual total gain over the same time was only just over 100 to 9,651. As previously noted here, the jump in house construction outside of Auckland will sap the pace of growth in house building in Auckland. Builders will experience much lower living expenses outside the city than working in it with not too great a difference in gross income.

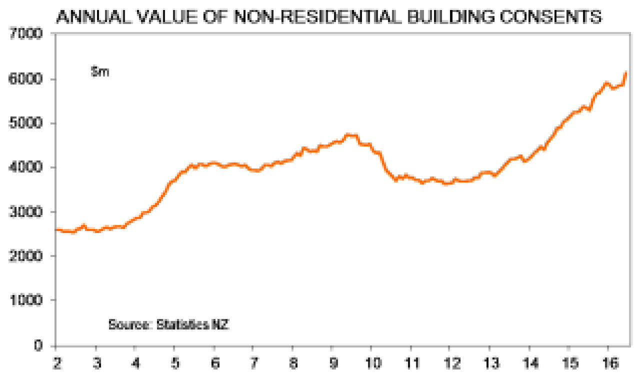
And as noted last week, with Auckland's proposed Unitary Plan changes aiming for 422,000 extra houses in the next 25 years this means 2.5 times average annual construction levels of the past 25 years. Canterbury achieved 1.5 times post-earthquake.

Look at this another way. As at the 2013 census there were 509,000 dwellings in Auckland. In 2001 there were about 420,000. The plan is another 422,000 in the next 25 years – in other words doing in 25 years what it took 161 years to do following the designation of Auckland as the country's capital by the first Governor William Hobson in 1840.

That target looks highly unachievable unless we invite a few of the tens of thousands now unemployed migrant construction workers in Middle Eastern countries to help out – for more than the US$324 a month they earn in the likes of Saudi Arabia. That is not going to happen. Expect more efforts next year from the Reserve Bank to ration mortgage lending to those with the biggest deposits and the highest incomes.

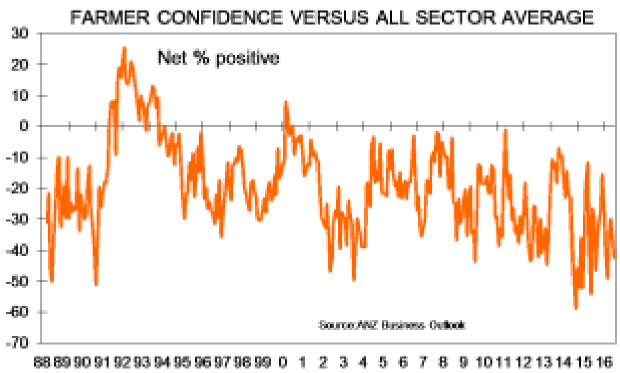
Nevertheless, house building is going to get stronger and this is reflected in the most recent ANZ Business Outlook Survey where a net 52.2% of respondents said they expect to see higher levels of residential construction in the coming year. This was near double June's net 28.6% positive, and above the ten year average of 25%.





And it is not just the residential part of the construction sector experiencing very strong growth. Commercial construction is also growing strongly. In June consents worth $739mn were issued and for the year to June the total was $6.1bn. This was a 15% rise from last year and well up from $4.1bn two years ago.

One of the factors we place on the debit side of our prospective growth ledger alongside deep global growth risks and slowing house building in Christchurch is weakness in the dairying sector. Dairy farmers have certainly been cutting back on their spending over the past year and farmers generally are far more pessimistic compared with other sectors in the economy than usual. That is, almost all of the time farmers are the most pessimistic businesspeople we have in New Zealand – and now they are more so.



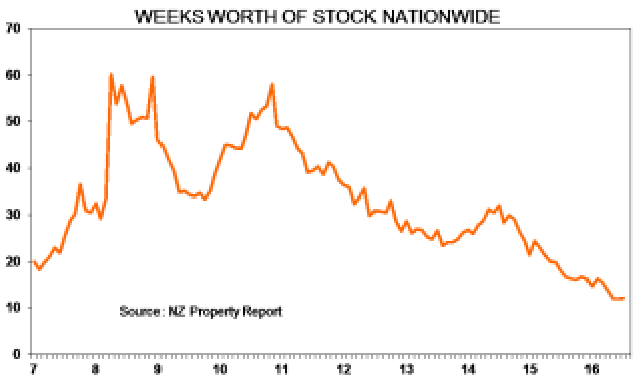
But what we learnt from Fieldays six weeks ago is that dairy farmers are busy knuckling under and changing the way they farm and few were grumbling about their situation. Farmers will be pleased that Fonterra were able to keep their initial forecast for this season's payout at $4.25 and actually lift their projected value-added contribution by 10 cents. And Tuesday night's 6.6% gain in average prices at the Global Dairy Trade auction is the first positive piece of pricing news since June.

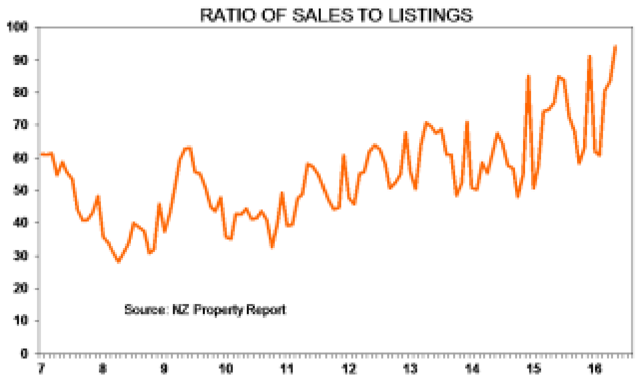
While nothing suggests that dairy prices will stage anything more than a mild recovery over the coming year, with NZ production falling and hopefully some supply reactions offshore to low prices, there is light at the end of the tunnel.

Something for farmers generally to keep an eye on however is the booming construction sector and the way it will soak up the pool of young people choosing to work outdoors for the next decade. Availability of farm workers has been poor for some time and it will only get worse.

Housing

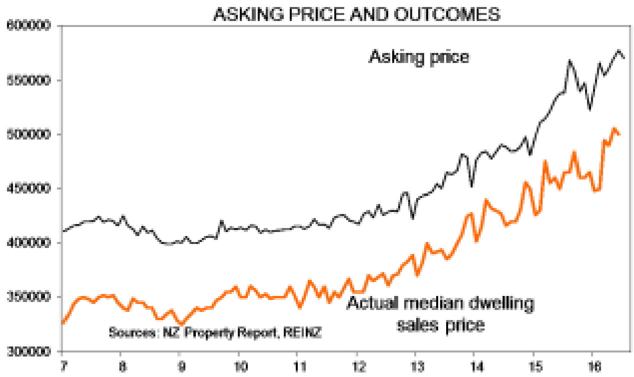
This week website realestate.co.nz released their monthly NZ Property Report which shows that nationwide the availability of properties for sale remains tight. Calculated as the number of weeks worth of property sales on the market in July stock sat at 12.1 weeks. This was little changed from 11.9 weeks in June and May and well down from 18.2 weeks one year ago, 32.1 weeks two years ago, and 26.7 weeks three years ago.





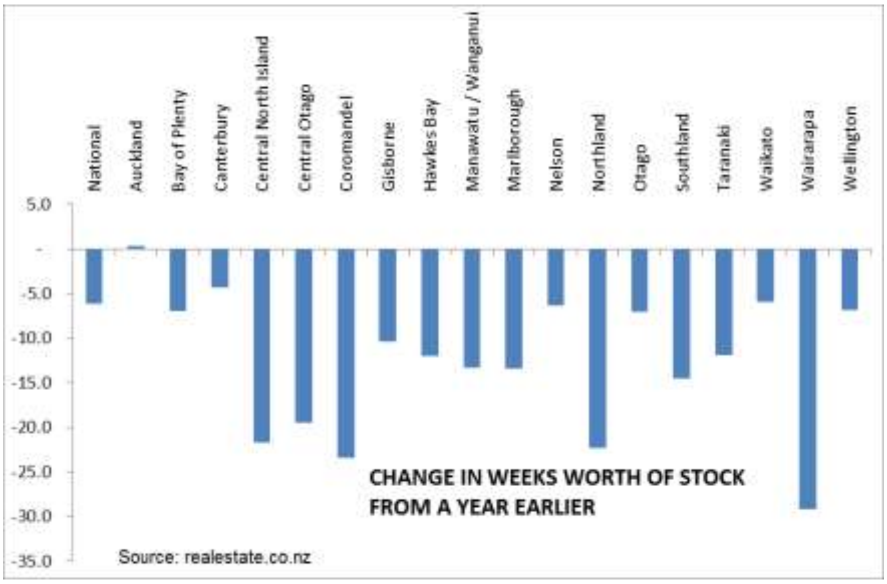
We can also get a feel for tightness by looking at the ratio of sales to listings. The trend here remains firmly upward as shown in the following graph.

The average asking price (note, not actual selling price) edged down slightly in July to $570,000 from $578,000 in June but this move is meaningless and you get better insight looking at the graph below showing the continuing upward trend in prices. We have included the actual average sales price nationwide also as the lower orange line using REINZ data.



Listings are in short supply. Sales are strong. Thus prices will rise further.

What about regional results? I've chosen to answer this question with a single graph showing by how much the number of weeks worth of sales available in each region has changed from a year ago. The more the bar falls below the line the greater the tightening up of stock availability. Note how things have tightened sharply in many locations.



This week we also received the monthly data on Auckland sales by real estate firm Barfoot and Thompson who account for near 40% of activity. They were surprisingly weak with sales in July down 26% from a year earlier and off 11% seasonally adjusted from June. The decline may reflect a generalised pullback in purchasing by investors following the July 19 announcement by the RB of tighter LVR rules and their immediate implementation by major lenders.

In fact in the last (fourth) week of July sales were an unusually large 124 weaker than the same last week of July in 2015, the third week's sales were down 67 from a year before while the second week's sales were down 113 which also is unusually large.

It will be interesting to see whether this weakness continues in August. Note that we do not have a basis of comparison for the shock effect of new lending restrictions because the October 2015 introduction of the 30% investor deposit requirement in Auckland was announced in May that year. The original October 2013 rules were announced in August that year.

But even if there was some temporary shock effect at work in July that would not necessary account for the fall in average sales price to just 4.8% ahead of a year ago at $867,000 in July from $908,000 in June. The median sales price, which is little disturbed by changes in the mix of properties sold, was however unchanged from June and ahead 11% from a year earlier. It would be premature to conclude as yet that prices have stopped rising and we await August's results with high interest.

Note that there has been a tendency for sales in Auckland to weaken for four months following LVR rule tightening then for a rebound to occur. So we may have to wait until November data are released in December to see if the tighter LVR rules have a sustained or just temporary effect.

NZ Dollar

Every time a bout of weakness hits the NZD something comes along to cause it to jump back up again by two or three cents. This week, after falling slightly below US70 cents the NZD rose above 72.3 cents (though now is near 71.6) after the greenback fell away in response to weak GDP growth of only an annualised 1.2% during the June quarter following weak 0.8% growth in the March quarter. Plus the 6.6% dairy price rise helped on Tuesday night.

Analysts had expected US growth of 2.6% so the outcome is very weak, plus the March quarter growth rate was a revision down from 1.1%. The December quarter rate was also revised down to 0.9% from 1.4% - all annualised numbers when GDP is discussed for the US economy. The chances of a rate rise this year from the Federal Reserve have slipped yet again.

US consumers are spending but businesses are holding back from investments. This just goes to remind us that it is not the cost of capital/interest rates and sharemarket strength which determines business capital spending levels. Businesses need to have confidence in the upcoming economic and regulatory environments and they have neither. So they continue sitting on piles of cash, helping to keep share prices high because of these high cash assets and share buybacks.

The Presidential election campaigns are probably depressing sentiment. If the US gets Hilary Clinton there will be more rules on wages, finance, benefits, healthcare etc. and higher business taxes. If, God forbid, Mr Trump wins they get fewer migrant workers and tariffs on imported inputs. Neither outcome appears to be a recipe for a higher US dollar.

We'll also be dusting off our copies of the 1982 Commission for the Future report on Nuclear Disaster. Take a look. The pdf is a photocopy and hard to read but it is fascinating. I still have an original copy.
http://www.mcguinnessinstitute.org/Site/Projects/NSDS_national_strategy/Past_Future_Thinkers/nuclear_disaster.aspx

Similarly in Japan the drive from three years ago to boost growth and inflation through easy fiscal and monetary policies alongside structural reforms has failed. The Bank of Japan on Friday effectively signalled that there is nothing more monetary policy can do now that the central bank owns one-third of government bonds on issue (printing money through buying such bonds), and the overnight cash rate is -0.1%. This does not sound like a recipe for a stronger Yen outside the effect of funds quitting other parts of the world seeking a safe haven offering lower costs than Swiss francs. The Swiss National Bank overnight interest rate is -0.75%.

Across the ditch growth is okay near 2.5% but the RBA on Tuesday cut it's cash rate again by 0.25% to a record low of 1.5%. Analysts feel one more rate cut may come.

China's growth is slowing, social dislocation is rising, and debt problems are growing – hence increasing militarism and proven false territory claims in the South China Sea. A distraction from the struggling economy may be needed by the CCP to retain legitimacy.

China's light has started to dim internationally and exporters might do better diverting their attention to South East Asia and Japan rather than exposing themselves to the growing geopolitical risk associated with trade with China.

Not that US geopolitical risks are improving with strong electoral support for the abhorrent Donald Trump and both candidates opposing TPP. Brexit, embedded EU dysfunction, and voters flocking to the political extremities show us that geopolitical risks are rising also in the UK and Europe.

Militarism is also rising in Japan perhaps in response to China's pushing of maritime claims.

Negative risks well outweigh positive ones in a world still struggling to achieve sustained economic growth following the worst financial shock since the 1930s Great Depression.

Our economy in contrast has substantial support from a construction boom set to last many years, rampant tourism growth, very high net immigration, strong institutions and deregulated markets, stable politics and policies, rule of contract and law, and cheap financing costs. The Kiwi dollar is going to be strong for many years. But when the next global hit comes we will be deeply affected as well.

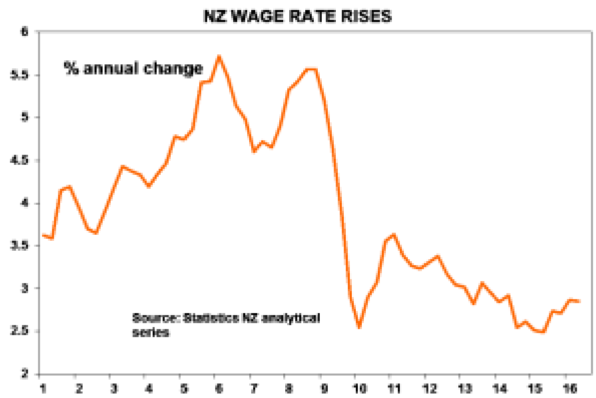
If I Were A Borrower What Would I Do?

Interest rates look set to go lower with the Reserve Bank highly likely to cut the 2.25% official cash rate to 2.0% next Thursday morning. Factors contributing to their decision will be still falling inflation rates offshore with downward revisions to global growth predictions recently by the likes of the IMF. The annual NZ inflation rate also came in lower than the RB were forecasting for the year to June at 0.4% and it looks like the September quarter result could easily undershoot their expectations.

We have also seen a fall in the net percent of businesses planning to raise their selling prices in the monthly ANZ Business Outlook Survey to 17.4% in July from 19.6% in June. The ten year average reading for this measure is a net 26% expecting to boost prices.

The NZ dollar has also been tracking much higher than the RB had assumed in their forecasts. And of course just two weeks ago the RB noted some of these things in their special interim update on the economic outlook and wrote **"At this stage it seems likely that further policy easing will be required to ensure that future average inflation settles near the middle of the target range."**

Plus yesterday we learnt that still, in spite of strong demand for labour, there is no sign that the pace of wages growth is rising. Our preferred measure from the Labour Cost Index series where an attempt is made to measure wage changes for an unchanging group of jobs held steady at an annual rise of 2.8% in the year to June from the same in the March quarter, 2.5% a year ago, and 2.9% two years ago.



This lack of accelerating wages growth is a phenomena seen also overseas and increasingly a problem in terms not just of promoting badly needed inflation, but addressing deepening equity issues and encouraging shifting of valuable labour resources to high productivity positions. Along with cutting the number of cows in New Zealand and wasteful investment in more milk powder production, one of the best things which could happen to assist our economy would be a doubling if not tripling of the pace of wages growth. Another positive development would be fewer unsuitable young people wasting their time at varsity building debt. They would do better going straight into a trade.

In other words, the Reserve Bank is going to keep cutting interest rates to try and stimulate higher inflation by trying to stimulate faster economic growth, faster growth in wages, and faster growth in borrowing by businesses and households so they can snap up resources and push up their prices. And at the same time the RB will continue trying to slow down the pace of growth in borrowing by all sectors to control financial risk.

Floating rate borrowers look like getting lower rates soon though perhaps not all the likely 0.25% OCR cut. In Australia this week the cash rate was cut to 1.5% from 1.75% but floating rates fell by only half of that reduction.

As for fixed rates, these are always harder to pick because of the greater influence of changes in borrowing costs offshore and because banks in New Zealand tend to compete for business using fixed rates rather than floating rates so discounting comes and goes.

Chances are however that these rates will fall slightly and were I borrowing at the moment I would be prepared to hold off fixing until a tad after the rate review just to see what happens.

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