BNZ Weekly Overview

15 September 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.

Handout For A Recent Talk

I gave a presentation this week to some potential home buyers at a function in Takapuna this week and promised them that I would reprint in the Weekly Overview the 15 points I raised regarding the Auckland housing market. So here they go, in no particular order. And for the record, here is a link to my 2012 article on 19 reasons why Auckland house prices would keep rising. Most still seem valid. Enjoy if you have already bought. Despair if you have not. And if you have put off buying because of one of the many incorrect forecasts that house prices were about to fall – whoops a daisy.
http://tonyalexander.co.nz/wp-content/uploads/2013/02/WONovember-1.pdf

Here also is the link to my recent Weekly Overview containing official Statistics New Zealand population projections for each local authority area around NZ – relevant if you mistakenly think Auckland's population growth will be replicated in very cheap housing locations. There is a reason those prices are low. It is the flipside to the key reason why Auckland prices are high. There will not be a flight of people out of Auckland to the regions.
http://tonyalexander.co.nz/wp-content/uploads/2016/08/WO-August-18-2016.pdf

Underbuilding

- Not enough houses have been built in Auckland since the mid-2000s.
- Auckland went into the GFC with a shortage.
- That shortage got worse as construction in 2012 fell to the lowest levels since the 1960s.
- The Unitary Plan panel recently estimated the shortage at 40,000 dwellings and it continues to grow because of Auckland's strong population growth

Population Growth and Migration

- Between 2006 and 2015 Auckland's population grew by 14.3% while the rest of NZ grew just 7.6%.
- In 1961 Auckland accounted for 21% of NZ's population. In the 2013 census that was 34%.
- Come 2043 Auckland's population is likely to grow by about one million and account for 60% of all NZ growth. Auckland then will account for about 41% of NZ's population.
- Auckland receives about 60% of the net migration flow.
- In the year to July the net NZ gain was 69,000 meaning a 42,000 net boost to Auckland. With average household occupancy of three in Auckland that means 14,000 extra houses needed to be built. But consents only totalled 9,600 in the past year and with only 80% - 90% adding to the housing stock that means maybe supply was boosted 8,000. Only just over half the number needed.
- Add in natural population growth and the shortage continues to worsen.
- There are one million Kiwis offshore increasingly favourably comparing NZ with other countries, and 4.7 million people here who are feeling they same way and may not leave.

Auckland Agglomeration

- In a technology-driven world company and country economic growth comes from rapid development, introduction and recalibrating of new technologies.
- This works best when many talented, educated, free thinking people from diverse backgrounds interact closely – like a neural network.
- The technology age may allow people to telecommute but they choose to be physically close because that fosters extra growth and opportunities.

- Auckland is NZ's agglomeration and there is increasing depth across a range of sectors which is encouraging young people to stay and develop here, and others to come back.

Buyer Backlog

- In 2007 many people held off buying a house because of high interest rates.
- Over 2008-09 they held off because of the NZ recession, then the GFC, then stories of banks not lending anymore.
- Over 2010 – 2011 people held off because of continuing stories about house prices falling.
- Come late-2011 people started to pull back on price decline expectations and entered the market.
- But since then other buyers have put off buying because of new LVR rules.
- The upshot is that there is a huge and still growing backlog of unsatisfied buyers.

Interest Rates Have Structurally Declined

- Almost everyone buys a house using borrowed money.
- The cost of borrowing has fallen and the realisation has been strongly sinking in since early-2015 that interest rates will remain low for a very long time.
- The housing stock is being repriced to reflect permanently reduced borrowing costs.
- Yields are falling on all assets as a result of the structural fall in interest rates – including shares, commercial property, and rental property.

Baby Boomers Need Yielding Assets

- For three decades people have been told to save for retirement or risk living in poverty.
- But plans of the BBs to retire and live off a conservative yet well-yielding portfolio have evaporated with low interest rates.
- BBs are seeking assets and buying investment properties.
- They are also seeking assets they can hold and live off of for three decades in retirement rather than just 15 years given advances in health and medicines.

Shift To The Regions?

- Young people won't because they want the opportunities which Auckland offers.
- Businesses won't because Auckland has both the labour force and the domestic client base and technology drivers they want.
- Older people won't because they want to be near excellent health facilities, their offspring, their friends etc. Also, those cashing up appear increasingly to be opting for newly built apartments located outside the CBD.

Resource Shortages and Building Costs

- Construction of dwellings in Auckland will be hampered by a long list of resource shortages.

-Skilled builders
-Building materials
-Roading capacity
-Land
-Finance

- Plus construction costs keep rising in response to these shortages along with rising building standards to address issues such as insulation, earthquake strength, leaking buildings etc.

NZ Economic Prospects Look Good

- Our economy is deregulated meaning it is highly responsive to shocks and demand shifts. Witness the absence of collapse following the dairy payout shock.
- Government debt is low and accounts are back in surplus.
- The banking system underwent reform over two decades ago following excesses of the 1980s.
- Tourism is strong and growing as is demand for NZ food and nutraceuticals from Asian markets.

All Attempts To Slow The Market Have Failed

- Removal of depreciation allowances

- Removal of ability to use LAQCs
- LVRs introduced in October 2013
- LVR of 30% for Auckland investors in October 2015
- Two year brightline test October 2015
- IRD number requirement from October 2015

The effect of these rules has been to push young buyers out of the market and to push investors toward lower-priced properties. Over time people save higher deposits and/or find alternative sources of finance.

A $1 million average is Meaningless

- Unlike gold, a currency, a barrel of oil, there is no homogeneous Auckland house. Whereas all gold at a point in time trades at essentially the same price, houses are unique and tens of thousands have traded above $1 million for many years,
- The idea therefore that the artificial construct of an average hitting $1 million will cause buyers to pause is ridiculous.

Chinese Buying

- We really don't know the proportion of sales going to offshore Chinese and we never will because people often buy on behalf of Chinese people back in China.
- Millions of people in China want to buy offshore assets partly to get their funds off the mainland.
- Currently there is a legal limit of US$50,000 per adult per annum of funds which can be taken out of China. The ability to get around this rule has been constrained for the past two years by a massive anti-corruption drive. Eventually that drive will fade.
- Also, eventually the rule will be relaxed.
- In coming years there will continue to be strong demand for NZ, predominantly Auckland property, by Chinese buyers.

Impact of The 40% Investor Deposit Rule

- Likely to be temporary as weakness only lasted 3 – 4 months following the October 2013 and 2015 rule tightenings.
- Chinese buyers remain present at auctions, watching what is happening. (The issue I did not address when discussing this phenomena in the Weekly Overview of a few weeks back was what the Asian people are watching as they attend generally quiet auctions. The answer – each other.)

More Rules Are Likely

- The Reserve Bank largely has two main jobs. Controlling inflation and maintaining financial sector stability.
- Prior to the GFC both risks would worsen together as a result of sustained strong economic growth. Inflation would rise as cost pressures grew and banks would undertake riskier lending, often because of higher and higher demand for such from borrowers.
- Both risks would be attacked by raising the official cash rate and causing bank lending rates to go up.
- Since the GFC however and with the NZ economy growing well for eight years inflation not only remains low it is too low for comfort. To try and generate more inflation under the theory that lower borrowing costs will boost growth the RB is cutting the cash rate.
- But sustained strong growth has strongly lifted demand for interest-only and low deposit financing and such borrowing is being encouraged by the RB's interest rate cuts.
- In order to help maintain financial sector stability and low vulnerability to a shock the Reserve Bank is shifting to a regime of controlling bank risks by controlling credit supply – rather than credit demand through manipulating its price.
- Credit controls have been introduced and if high credit demand continues (to be caused partly by cutting interest rates to stimulate such demand) then LVR rules are likely to be tightened further.
- Additionally, because the Reserve Bank acknowledges that LVR rules merely spread demand out over time rather than permanently lowering it, they are working on a regime limiting bank mortgage lending to a multiple of household income.
- In Ireland banks cannot lend more the 3.5 times household income and in the UK 4.5 times.

- Next year a debt/income regime of credit control/rationing is likely to be introduced.
- This of course provides an incentive for people to buy sooner rather than later.

Predictions Wrong

- So far, every prediction of Auckland's housing market collapsing post-GFC has been wrong.
- All predictions of collapse before the GFC were also wrong and using three month averages prices only fell 10% over 2008 (recovered by the end of 2011), and 7% in 1998 during the Asian Crisis (recovered by the start of 2002).
- After a shock it takes three years for Auckland prices to regain their previous peak.

Housing

Debate is growing about the pressure being placed on infrastructure, community resources, and the housing market of immigration. The impression being given is that we are being flooded with foreigners. While that is certainly the case for Queen Street which is filled largely with Indian and Chinese students contributing to an export sector worth over $3bn, it is less so for the population over all.

In the year to July 2012 we suffered a net migration loss of 4,000 people. The gain is now 69,000. The net surge is 73,000. Is it a surge of immigrants causing this? Not really.

In the year to July 2012 the number of foreigners granted Residence and Work visas was 37,000. In the year to July this year the total was 55,000. The increase was 18,000. Thus foreigners account for 18,000 of the 73,000 turnaround in migration flows, or almost exactly 25%. The rest is people coming in to study, a few more long term visitors, and Kiwis and Aussies.

The number of NZ citizens who left in the year to July 2012 was 62,000. In the year to July 2016 this was only 34,000. The decline of 28,000 accounts for 38% of the total net migration turnaround. The number of Kiwis coming back has risen from 22,000 to 31,000.

The net Kiwi flow therefore is a shift from -40,000 to only -3,000. In fact the net loss of only 3,069 is the smallest since April 1984, 32 years ago.

We Kiwis staying and coming back account for 37,000 of the 73,000 four year net migration turnaround, or 51% of it. We are the main cause of the boom in net inward migration.

The net Aussie flow is from +466 to +3,352 or a shift of about 3,000 accounting for another 4% of the net 73,000 four year change.

We don't have data on gross outflows of people who came as Students, Other, and Visitors. But the gross inflows of these groups collectively rose from 21,000 to 34,000 or a rise of 13,000, largely students. This accounts for about 18% of the net migration turnaround.

In summary then...
Causes of the 73,000 migration turnaround

Foreigners	18,000	25%
Kiwis	37,000	51%
Aussies	3,000	4%
Students etc.	13,000	18%
Misc.	2,000	2%

The gross inflows for each of these groups in the years to July 2016 and 2012 were as follows.

	2016	**2012**	
Foreigners	55,000	37,000	
Kiwis	31,000	22,000	
Aussies	6,000	3,000	
Students etc.	27,000	16,000	
Misc.	7,000	5,000	
Misc. classifications		2,000	1,000

The net migration gain in the year to July was 69,000. The 20 year average gain has been 15,000. To get back to that you need to stop and/or make leave 54,000 people. Essentially all foreigners would have to be prevented from migrating here to work, join family etc.

That is unlikely. But the issue here is this. Migration policy has been set in New Zealand with the general expectation as encapsulated in the net flow assumptions by Treasury and Medium scenario projections published by Statistics New Zealand, of a net gain near 12,000 per annum. But New Zealand is no longer the place it was in comparison with the rest of the world. Our economy is stable, well founded, flexible, and free of the many, many problems afflicting economies elsewhere.

Because of this we will on average going forward lose fewer Kiwi citizens to the bright lights elsewhere than has been the case. And more will come back. So what we need is a calculation of how that net flow has changed or where it is expected to settle, and then an adjustment to migration targets to offset that.

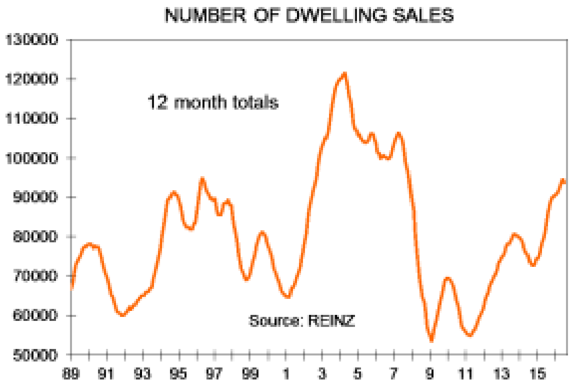
Consider for instance that for the starting point from which data are available in 1979 up to the end of 2008 the average net loss of Kiwis overseas was 21,000 per annum. The past year's loss was just 3,000. If we assume the new net loss going forward is 10,000 the case is made for cutting immigration about 11,000 per annum. If you think the case is made for no average net Kiwi loss going forward the case is made for cutting the immigrant inflow by 21,000 per annum.

Of course before you can do that without having it appear that any adjustment is some sort of racism in play you need to have a debate about what sort of population growth Nzers are happy to accommodate on average given the pressure upon resources and house prices etc. And if 1996 is anything to go by then that is what the leader of the NZ First Winston Peters is likely to be seeking (again) when he almost certainly enters into negotiation with the two major parties immediately after next year's general election.

Immigration has become a hot topic in New Zealand just as it has also in other countries. We should expect discussion to grow here and each of us do our best to make sure that discussion is based upon first the facts then second the desire regarding acceptable population growth. After that one needs to throw an overlay of some more explicit research into the economic impact of immigrants – research which we understand is underway.

Hopefully, when the adjustment to migration rules comes it will be amidst a calm debate.

The REINZ this week reported that in August all around New Zealand there were 7,527 dwellings sold. This was a 3% fall from a year ago which followed a 10% fall in July, but the data a year ago were boosted by people buying/selling to get in ahead of October's rule changes on investor deposits in Auckland etc.

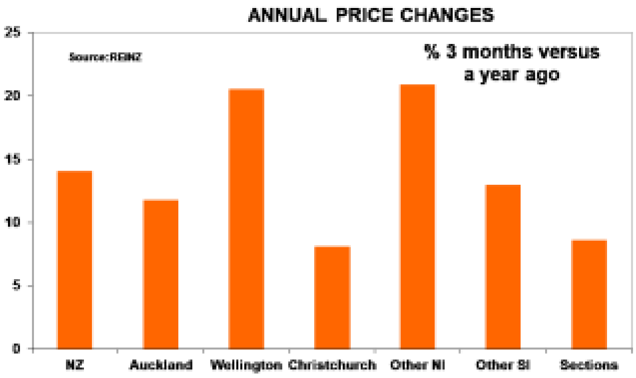


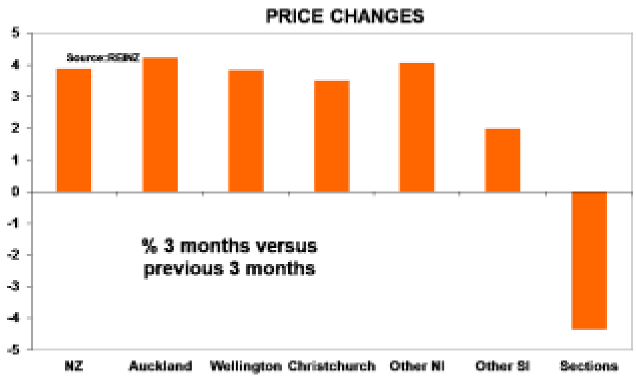
The average number of days taken to sell a dwelling in August was 30 which was 7.2 days faster than average compared with 8.5 days faster than average in July and 7.8 in June.

The data suggest a mild slowing in activity but nothing too severe – especially considering that banks started applying the new 40% minimum deposit requirement for investors nationwide from late-July.

The median dwelling sales price adjusted for changes in the mix of dwellings sold eased 1.1% in the month but it pays to look at three monthly movements as monthly numbers in NZ can go all over the place. Doing so we see that in the three months to August the average price measure was ahead 3.9% from the three months to May and ahead 14% from a year ago.

Auckland prices have risen 4.2% the past three months after rising 8.2% in the three months to May. So price increases have slowed and the monthly change was a fall of 2.3%. In Wellington prices rose 3.8% the past three months to lie 20.5% ahead of a year ago. Christchurch 3.5% and 8.1%.





NZ Dollar

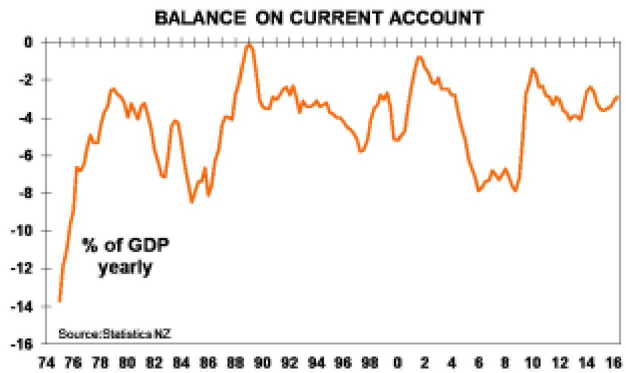
The Kiwi dollar has pulled back from sitting close to US 75 cents this week with most of the decline to just under 73 cents coming on Friday night. The decline was caused by a rise in the US dollar on increased expectations of tighter US monetary policy following some hawkish comments from one official.

But in addition the decision by the ECB not to boost their asset purchase programme and general expressions of concern from central bankers regarding the effects of sustained easy monetary policies have got the markets thinking maybe the halcyon days of the money flood are ending. No-one really knows, but the growing consensus that negative interest rates and money printing have failed to do anything in Japan and had minimal impact in Europe means central bankers may start setting the stage in the coming year for higher interest rates to stem asset price excesses even as inflation rates remain low. We shall have to wait and see how this pans out as the central bankers are still very, very wary of raising interest rates and throwing their economies into recession. In other words – lots of uncertainty continuing.

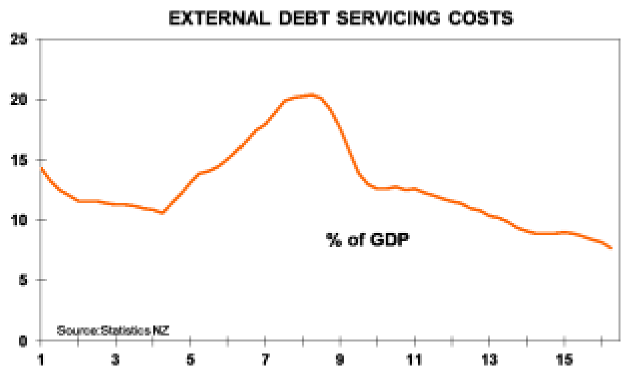
In fact this caution crystallised on Monday night when three more Fed officials made comments and these were interpreted as pushing out the date for another rate rise – so the USD then fell and the NZD once more climbed a tad.

The fundamentals remain extremely supportive of the Kiwi dollar with two big examples this week being the good current account deficit numbers and June quarter economic growth data.

The current account deficit has averaged 4.1% of GDP over the past two decades and was below average at 2.9% in the year to June from 3.6% a year earlier. This is in spite of the sharp decline in dairy export receipts over the past couple of years. In fact the value of exports of all goods and services (tourism included etc.) rose 4.4% in the year to June after falling 0.6% a year earlier. Overvalued NZD? Nope.



Helped by the decline in global interest rates the country's debt servicing ratio (debt servicing as a % exports) has fallen to just 7.7% from 8.9% a year ago and an average since 2001 of 12.9%. Another blow for the doom-mongers who for decades have been predicting debt-driven economic collapse in New Zealand as a result of opening up the economy quarter of a century ago. Try your luck in a regulated economy, maybe Greece.



With numbers like these it is no wonder the trade weighted index is above average.

This morning we learnt that during the June quarter the economy grew by a slightly less than expected 0.9% after growing 0.9% (revised up from 0.7%) during the March quarter. The annual growth rate has lifted to 2.8% from 2.5% and per capita GDP grew 0.5% after growing 0.3% in the March quarter. Basically the economy is growing at an underlying pace near 3.5% and per capita GDP nearer 1.6%.

If I Were A Borrower What Would I Do?

What I did about this time last year was take out a mortgage with one-third of the amount floating and the rest fixed two years. I would do the same again. That is not only because I can reduce the principal at a rapid pace, but because I still see little chance of any decent hike in borrowing costs over the next few years and short-term fixed rates are much lower than long-term ones.

Having said that, if I were in the same financial position as when taking out previous mortgages in 1987 and 1993 I would split my mortgage three ways. Floating, two year fixed, and three year fixed at BNZ rates of 5.64%, 4.29% and 4.49% respectively to better spread my risk.

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