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.

Keep Calm and Carry On

I wonder how many people are still sitting out there, holding off from buying a house, hiring staff, or undertaking capital expenditure because they expect the economy to fall into a hole in the ground because of

- the collapse in the dairy payout,
- the US Presidential election campaign,
- Brexit
- high house prices in Auckland
- money printing in many countries
- terrorism
- peak oil
- unrest in the Middle East,

and so on.

As humans we are hard wired to pay more attention to things which may turn out bad than things which may turn out good. The media know that and feed us stories which attract our attention and get coverage for the advertisers who pay them. Capitalism hand in hand with generally left-wing reporters exploiting human weakness.

As K says in the first Men in Black movie "There's always an Arquillian battle cruiser, or a Corillian death ray, or an intergalactic plague that is about to wipe out all life on this miserable planet..."

There is always something sitting out there which can cause significant economic disruption so you are always presented with an excuse for sitting on your hands and doing nothing. Plenty of people have done that since the global financial crisis and while that was the logical thing to do in 2008 and for much of 2009, ignorance of the fundamentals driving our economy and housing market in particular has seen many people choose to sit out a period of good growth and capital appreciation.

If you have avoided buying shares then you have missed a 120% rise in the NZX50 over the past five years. If you have despaired of New Zealand's prospects and switched your assets into foreign currencies from late-2009 then you'll have lost about 14% on a trade weighted index basis. If you have held off buying a house waiting for one of those silly forecasts of 40% price falls to come true then you are massively out of money and perhaps out in the wops when you finally make your purchase.

Were these gains and the good performance of the NZ economy predictable? No. None of us predicted the extent of money printing. None of us predicted how low interest rates would go and that they would still be falling now. Hardly anyone picked this strength in the NZ dollar. I'll claim not picking a house price collapse and advising people to buy rather than sit on their hands in the housing market since mid-2009. But I can make no claim to remotely coming close to predicting the extent to which prices have risen.

The point is this. Predictability of many things had collapsed post-GFC. But that is no reason for blindly assuming the worst, growing potatoes and building a bunker. When you don't know what is going to happen its a 50:50 call as to whether good stuff or bad stuff will come along. So why assume only the bad? Because, as noted, we are hard-wired to do exactly that. Plus, because we feel losses three to four times more intensively than gains psychologically-speaking, we give strong preference to lose avoidance rather than making gains.

Consider people running to catch a bus. Are they running so they can be on the bus? Usually not. They are running to avoid the situation of just missing the bus and feeling stupid because of the loss they have suffered. If you have no idea when a bus on a regular schedule arrives at all, there is no reason for any particular speed of walking.

So as you listen to the news people telling us about the woe surrounding us and how we should feel bad about it whilst anticipating even more woe down the track remember this. Buying into dystopic scenarios guarantees failure. Having at least some hope that the worst will not happen gives you a chance to thrive. Nothing ventured, nothing gained. "After all, tomorrow is another day."

Housing

This week Quotable Value NZ released data showing that the average Auckland sales price has averaged just above $1 million for the past three months.

Someone wondered if the $1 million average would become a psychological barrier. What a silly comment. There is no single house which you could say is the representative commodity in the Auckland housing market and which is repriced daily or more frequently as happens with say gold, oil, or the NZ dollar. A psychological barrier or resistance point in technical analysis terms is only relevant when talking about a single completely homogeneous product which is traded by a very large number of people and that is not the case in the housing market.

There will not be a single auction where the bidders hold back because the price has got to $990,000 and they don't think a rise above $1 million can be justified. Houses are already trading above that level and have been doing so for many years in the cases of high specification properties.

The average price measure is an artificial construction, it is not the market price for a uniform product like gold.

So you can kick any thought of the one million dollar mark representing a barrier to the current market's movements firmly into touch – along with yet again the same analysis-poor comments from those who have been predicting falling prices and smugly warning buyers they have been paying too much for years now.

Just in case you have forgotten what we have been writing here for the past eight years, here are the fundamentals for the Auckland housing market.

DEMAND EXCEEDS SUPPLY AT CURRENT PRICES.

Too simple. More comprehensively...

-Population growth is strong.
-Interest rates are low and falling.
-A large cohort of people are approaching retirement and seeking assets to help fund the retirement which officials for three decades have been brainwashing them into believing will be miserably wretched affairs of shredded blankets and collapsing health unless they save and build a large investment portfolio.
-There is an existing shortage which keeps growing.
-Supply is being constrained by literally dozens of factors. A few include shortages of builders, electricians, plasterers, surveyors, inspectors, plumbers, concrete slabs, sections, infrastructure and so on.
-Finance to allow developments is being reined in by banks having to meet tougher lending standards post-GFC.
-Building standards and therefore costs keep rising.

The natural pressure is for prices to keep rising. Given that the Reserve Bank continues to express concern about banks being exposed to a shock which might cause prices to fall (insert the foot and mouth scenario here because nothing else bar Mt Rangitoto going up or China invading is going to do it), there will be more lending restrictions introduced. They can next year quickly raise the 40% investor deposit requirement to 50%, then 75% if deemed necessary. But at some stage, again probably early next year, they will introduce a strong regime of controlling credit supply by restricting how much banks can lend to multiples of household incomes. 3.5 times as in Ireland, or 4.5 times as in the UK, or something probably higher to start with.

Remember, this environment of influencing bank lending risk by controlling how much they can lend (credit supply) is a reversal of the approach from the mid-1980s of controlling such risk by influencing credit demand by changing borrowers' interest rates.

And also remember this. The Reserve Bank has no goal regarding housing affordability, homelessness, or buying by the young. They don't even in fact explicitly aim to rein in the pace of price rises. Their aim is simply to make sure that if prices fall sharply for whatever reason the banking system will remain fully functioning. The way things are going, in 2018 we will probably reach a point where there are so many credit supply controls in place bank mortgage portfolios will be exceedingly robust. But supply constraints will not have changed and demand will simply have been delayed and not killed forever in most instances by the RB's actions. Therefore prices will continue to rise and the Reserve Bank will be quite happy. Note however our view that a plateauing seems likely before mid-2018 on the basis of a lot of price fatigue, higher supply levels, lower net immigration, and the RB measures. But sustained falls? Again, that would take foot and mouth.

NZ Dollar

US economic data following the interest rate rise last December have continued to be less strong than expected and yet again market expectations for the timing of another rate rise have been pushed out. This time the culprits have been weak numbers on employment growth and the services sector.

A rise this year is fairly unlikely and this pattern of disappointment in growth has already been seen elsewhere following rate rises post-GFC.

Locations include New Zealand, Australia, Sweden and the ECB where rate rises on the basis of good growth have been more than completely reversed in every case. We noted late last year that the risk is following the US rate rise expectations eventually turn to expecting that increase to be unwound. We are not there yet and the Federal Reserve will be extremely reluctant to do that.

With rate rise expectations pulling back again the USD has weakened and the NZD now trades near US 74.5 cents from 72.6 cents last week on its way to the 75 cents we have postulated. Once we get there look for forecasts of 80 cents being regained on top of the growing talk about the NZD exceeding parity against the Aussie dollar.

Why so much confidence in a rising NZD? It not only goes hand in hand with a strongly performing economy growing at above a 3% pace, but because dairy prices continue to surprise on the upside. The latest Global Dairy Trade auction produced another 7.8% rise in average prices which now sit 30% above their lows of mid-July and down 57% from the April 2013 peak.

Prices have been boosted by supply falling in NZ and elsewhere and we suspect a bit of a scramble from buyers because this turnaround in prices has been far greater than anyone was expecting. It pays to remember that no-one has displayed an ability to accurately forecast dairy prices a season ahead so it would be unwise to blindly extrapolate the recent price gains into further gains this year. We will simply have to take price movements as they come and hope the trend away from so many cows polluting our water continues.

If I Were A Borrower What Would I Do?

Nothing new.

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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