BNZ Weekly Overview

13 October 2016

ISSN 2463-4328

Mission Statement

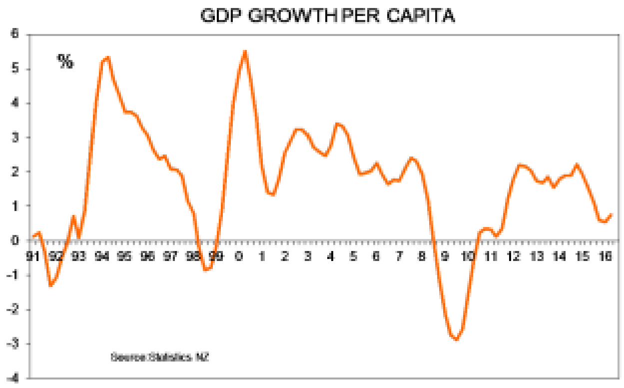
To help Kiwi businesspeople and householders make informed financial decisions by discussing the economy and its implications in a language they can understand.

Per Capita GDP Growth Not As Bad As It Looks

Lets have a quick recap on the overall picture for our remote economy. The official growth rate is 2.8% measured as GDP in the year to June 2016 compared with GDP in the year to June 2015. This is less than the measure which people have started to use of 3.6% which is the June quarter only compared with the June quarter last year.

This latter number makes us sound fantastic compared with almost every other economy but it is not the calculation historically used in this country so lets be consistent and say growth is 2.8%. That is almost spot on the average growth rate for the past two decades of 2.7%. Meh.

A key driver of growth has been a surge in population courtesy of a migration boom. Population in the year to June 2016 averaged 2% more than the year to June 2015. So per capita GDP growth was 0.8%. The 20 year average pace of population growth has been 1.1% so average per capita GDP growth has been 2.7 less 1.1 or 1.6% per annum. At 0.8% we are running at half that.



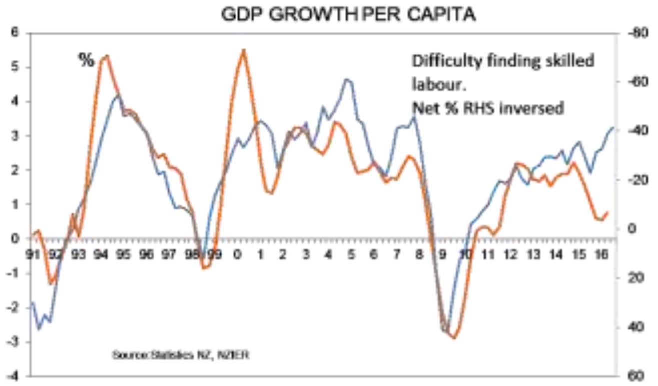
But before we pour cold water on glorious talk about how strong our economy is as the usual naysayers have been doing, it pays to recognise that one reason why GDP growth was not more than 2.8% this past year is because of a shortage of labour preventing goods and services from being pumped out.

In the June quarter job numbers were ahead perhaps 3% - 3.5% from a year earlier – we have to guess because classification changes mean the published annual jobs change of 4.5% is too high. But even with this jobs growth businesses are struggling to find labour.

The NZIER's Quarterly Survey of Business Opinion released last week showed that in the non-farming sector a net 41% of businesses said they were having difficulty finding skilled labour. This was up from 39% in the June quarter, 23% a year earlier, and more than double the ten year average difficulty net percentage of just 19%.

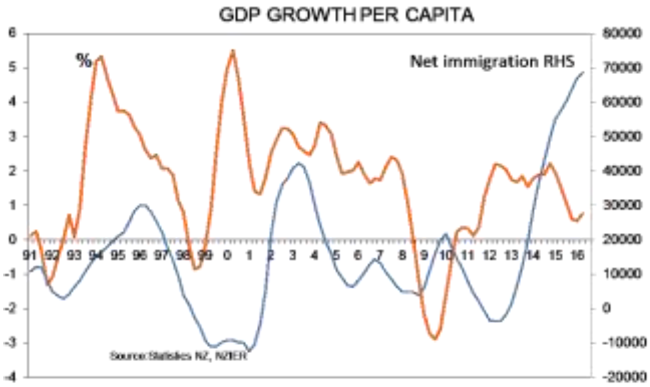
A net 14% of businesses said they are struggling to source unskilled labour. This is up from 13% in the June quarter, 3% a year earlier, and the average of 5% saying it is easy to find unskilled labour.

But this is where we enter the Twilight Zone. In the past when firms have had major difficulty sourcing labour GDP per capita growth has remained firm – 1994-96, 2000-07. A disconnect has opened up between these two measures, as shown in the graph below.



Why is GDP growth so weak while labour demand is very strong this time around?

Either GDP growth is occurring in sectors where productivity growth and therefore income growth is low, or the people on offer and gaining employment simply do not have what businesses want.



Or, this confusion will be gone within a year because of an inventory effect. That is, there has been a fairly large rundown in inventories this past year and this has dragged down the headline pace of change in GDP – the 2.8% result. If we strip out the inventories effect then annual average growth was 3.7% and not 2.8%. Per capita GDP growth then becomes 1.7% which is on the long-term average.

Inventory rundowns and build-ups don't tend to be sustained. Therefore as this rundown effect exits the GDP data in the coming year be prepared for some fairly high rates of GDP growth and erosion of the argument that per capita GDP growth is exceptionally weak. For your guide here is the GDP per capita growth graph using a GDP series with the inventory effect removed. Note the disappearance of the downward dip over 2015-16 shown in the earlier graphs.

Housing

Regarding Auckland we have five new things. Legal challenges have been lodged to the Unitary Plan and that will delay the potential creation of a greater number of sections by a year apparently. Second the Finance Minister has indicated plans to boost house construction on state house land to supply a net extra 30,000+ houses over the next ten years.

Neither piece of news changes the outlook. There is a shortage of builders and building materials therefore delaying extra Unitary Plan-driven construction makes no difference as this simply means other houses will be built. And if extra state houses are built this means fewer private sector houses.

Third, a couple of weeks ago the NZ Treasury Secretary Gabriel Makhlof commented that Treasury may need to change their assumption that net migration will average 12,000 per annum. This is in line with comments we've been making here for the past couple of months regarding demographers lifting their net migration and Auckland population growth assumptions. That means more housing pressure.

Fourth, according to experts contacted regarding debate following cancellation of an apartment construction project in West Auckland this week, 35 such projects have been abandoned over the past year. This means that they were marketed but construction did not start in the stated timeframe. This is usually because costs have risen so much the developers can no longer make a profit, or they cannot get finance.

This development adds a few extra buyers at the margin because people who thought they had secured an apartment now have to go back into the market.

Fifth, as we have been warning would happen pre-election, the Immigration Minister on Tuesday announced changes in the number of points migrants must earn before they can come in on residency permits. It is expected that this will lead to 2,500 fewer people coming in over each of the next two years for which the rules are planned to be applied.

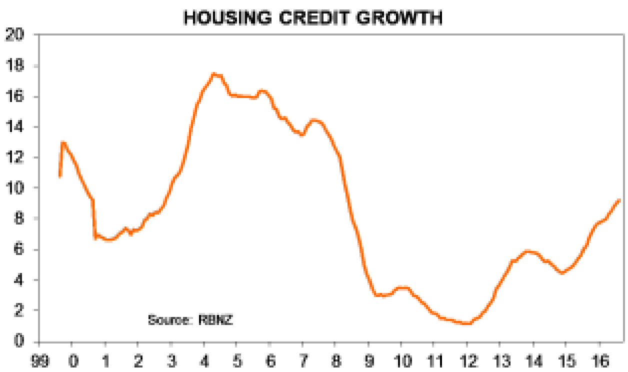
At the margin this move will mean fewer buyers in Auckland and to a lesser extent elsewhere. However given that migration in the past year totalled 125,000 the 2,500 change or implied 2% flow reduction won't be much noticed.

I'll only seriously start changing view on the Auckland housing market and its continuing potential for further price rises if something comes along to radically boost supplies of materials, cut material prices, boost builder numbers, and rein in credit supply much more than has already happened.

Given that there is deepening concern about the quality of houses being built already it is hard to imagine any concerted effort to rapidly boost new entrants into the construction sector. In particular it is very unlikely migration rules will be relaxed to let extra builders into the country.

As noted last week, indicators we are receiving of residential real estate market sales, inventories, days to sell etc. and prices are in line with what we expected following implementation of tougher lending rules late in July. If the experiences of late-2013 and 2015 are anything to go by we will see buyers jumping back in come December – February. If they don't then that will be interesting. If they do come back in, as we expect they will, then more lending rules will appear next year until the buyers don't reappear after a tightening. Simple maths really. The question is one of how tight will the lending controls need to be to slow down the pace of price rises and debt growth. We don't know.

Speaking of debt growth, housing debt was 9.2% greater in August than a year earlier. This is the fastest annual pace of growth since May 2008 when growth was on the way down from a peak of 17.5% mid-2004. Growth was 14% in early-2007.

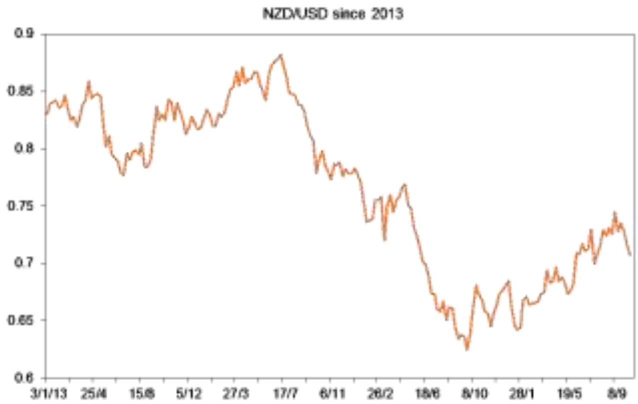


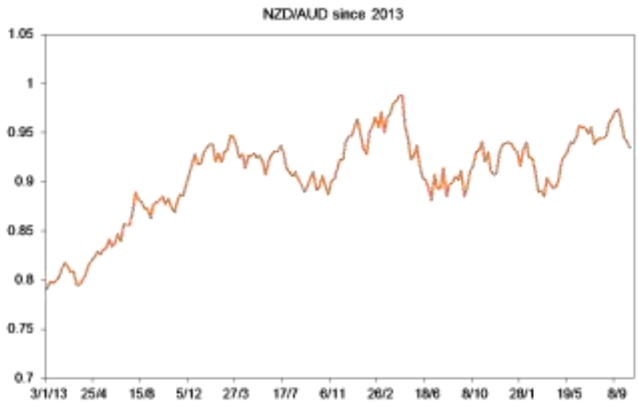
A couple more things. During the week someone purporting to be an expert on housing matters claimed that New Zealand has never seen so many apartments being built. Wrong. The number of consents issued for apartments to be built in the year to August was 2,409. In the year to June 2003 it was 4,997. In the five years leading into December 2007 the total was 17,847. In the past five years the total was 8,049. No comparison in other words.

However, if we include townhouses the latest total is 6,355 from 9,068 in the year to October 2004. Still less though.

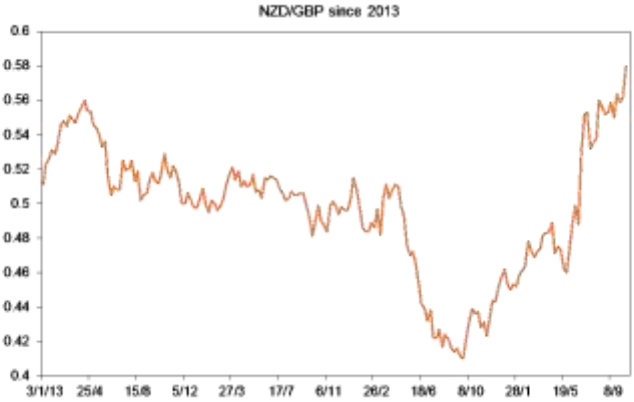
NZ Dollar

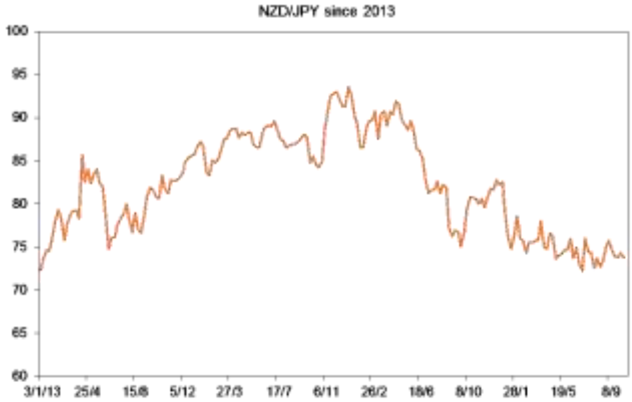
The Kiwi dollar is trading three cents lower than three weeks ago against the USD near 70.5 cents. Why the decline? Mainly an increase in expectations that US monetary policy will be tightened a few weeks after the Presidential election which occurs on November 8. The NZD's decline against the Aussie dollar to just below 94 cents from close to 97 cents three weeks back however means more is in play than just US rate expectations.

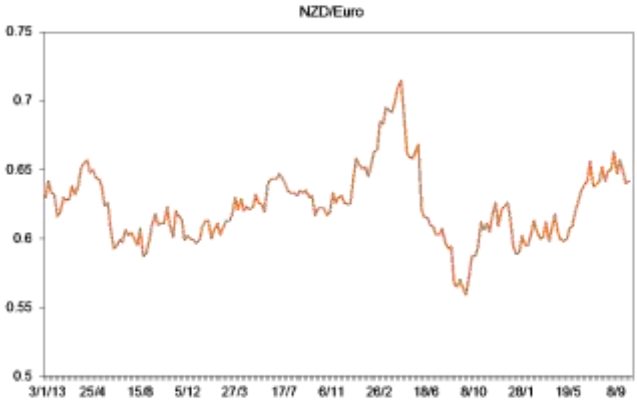




Partly the NZD's weakness reflects strengthened expectations of easier NZ monetary policy plus the small 3.1% decline in dairy prices at last week's auction. Plus the Aussie dollar has been supported by improvements in minerals prices recently and a change in tone of the discussions surrounding mining stocks across the ditch – from negative to positive.







Fundamentals however continue to support a strong NZ dollar. One of those fundamentals is strong economic growth which we expect to continue. When it comes to consumer spending the growth appears to be ongoing.

We learnt this week that core retail electronic card spending jumped 2.1% in September after falling 1.4% in August. The annualised pace of growth in the September quarter was 5.5% which was up from 5.2% in the June quarter. Good, but not booming as average growth has been 5.7% since 2004.

Another NZD supporting factor is a below average current account deficit sitting at just 2.9% of GDP compared with a 20 year average of 4.1%. Another is rising commodity prices. Oil prices have climbed recently, partly on the back of OPEC possibly restricting supply a bit. Coal prices are up, and the ANZ' Commodity Price Index in world price terms was 11% higher than a year earlier in August.

The only real thing holding the Kiwi dollar back is interest rate differentials. Easier monetary policy is anticipated here while a tightening will likely come in the United States and it is just a matter of when – December is the common pick. However given that these relative rate changes are largely already factored into the current NZD/USD exchange rate we may not see much extra short-term weakness as we approach the respective rate review dates.

If I Were A Borrower What Would I Do?

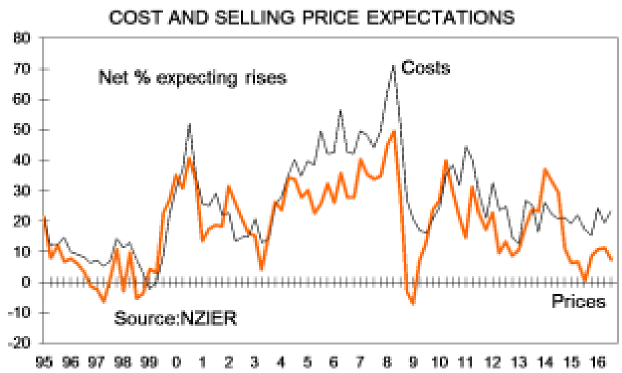
Next week the annual rate of inflation for the year to September will be released and it is likely to be about zero. This will lead to a lot of debate about whether low interest rates are working in boosting inflation – they are not – and whether the lack of price rises is permanent or temporary.

It will be temporary in that we expect the rate to pick up over the coming year. But the chances of inflation settling at the middle of the 1-3% target band in the near future seem slim, let along threatening the 3% limit. Thus we expect the 2% official cash rate to be cut to 1.75% come early

November with another cut also in February though that is less certain.

A problem for the Reserve Bank is that even with the economy achieving an underlying growth rate above 3.5%, strong jobs growth, and capacity pressures, leading inflation gauges remain very low.

The NZIER's Quarterly Survey of Business Opinion for instance showed that in the non-farming sector only a net 7% of businesses said they plan raising their selling prices. This is up from 1% a year ago but down from 11% in the March and June quarters and well below the average of 20%. Pricing intentions collapsed late in 2014 and have not recovered.

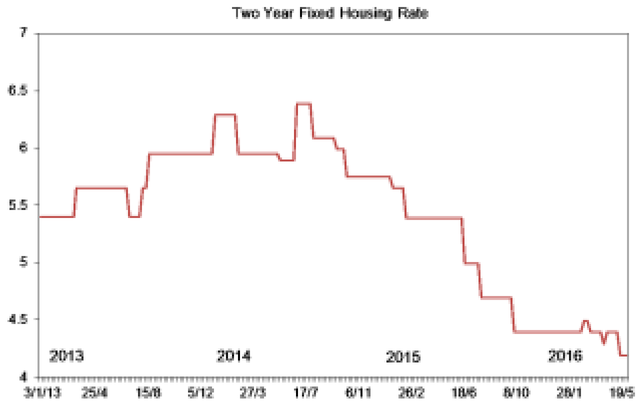


The ANZ's Business Outlook survey for September showed only a net 17% of businesses intending to raise their selling prices. This was consistent with other readings since February but down from 23% a year ago, 19% two years ago, and an average reading of 23%. This measure is therefore below average but not horribly so. The Reserve Bank might take some comfort from that were it not for the fact that business confidence in the survey was well above average at 28% in September versus the usual 16%, and employment intentions were a net 25% positive versus the average of 9%.

One year ahead inflation expectations are only 1.4% versus a 2.6% average and 1.7% a year ago and the clear risk is that this reading falls further when the CPI numbers come out next week.

Low inflation remains likely for many years both here and overseas. That means low interest rates for a long time as well. However with US monetary policy slowly tightening scope for fixed interest rats to decline further is fairly limited.

So were I borrowing at the moment I would split my mortgage three ways between floating and fixing at two and three year periods.



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