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.

No Baby Boomer Voted For This

It is harder for the current generation of first home buyers to make their house purchase than for earlier generations. This is because the helpful effect of interest rates falling to their lowest levels since the 1960s has been swamped by the rise in prices. Prices have jumped in response to the structural decline in the cost of taking out a mortgage, higher standards required for new buildings and materials, construction of bigger houses than in the past with higher specifications, expensive red tape imposed by local authorities, reduced availability of sections, falling average occupancy rates, proportionately more double income households, exhortations to people to save for retirement and logical resulting purchases of houses as investments, and internationalisation of the NZ housing market.

Many people when discussing the difficulties young people face couch their comments in terms of young people somehow being ripped off by older generations. They speak of some fantasised intergenerational war. The key point they miss however is this. No Baby Boomer lobbied the government or Reserve Bank for interest rates to fall back to 1960s levels just as they are retiring.

Older people have been building up savings for the past three or so decades anticipating moving their funds into boring conservative portfolios as they retire. They have been warned of the need to prepare for reduced entitlement to superannuation. They have planned to earn a good and steady income from term deposits, bonds, and blue chip stocks. But now as these people retire in droves they are finding that courtesy of the after-effects of the GFC, globalisation, and technology changes, sustained low inflation and debt aversion are locking interest rates in at low levels. They are facing returns half to one-third of what they were planning for.

This is not what the Baby Boomers wanted. Ask them and they will tell you they are struggling to find yield and would love the Reserve Bank to raise interest rates instead of cutting them again most probably next month.

Therefore, to the extent that surging house prices reflect extremely low interest rates this is not something sought by retirees. They have also not sought soaring house prices. One of the biggest fixed costs facing retirees is local authority rates. They “know” that if their house price goes up they will pay higher rates and this will be a cash drain. In truth if all house prices are rising about the same degree then there is no rates impact, but older folk don’t believe that.

No-one hitting 65 has voted for 3.5% term deposit rates and higher rates bills. In this structural shift of residential property ownership they are blameless, as are the young people. Its simply the way things have turned out.

But what about one of our key points regarding more and more older people chasing yield by purchasing more property than they ever intended to? This is a logical response to low interest rates and is not something Baby Boomers have been planning to do approaching retirement. If they were then they would have bought more houses earlier when they were physically more able to manage them themselves and able to glean capital gain over a longer period of time.

Young buyers may not be aware of one of the more frequent questions asked of us economists in the past three decades. Namely, what will happen to house prices when all the Baby Boomers retire and sell their houses to live in small units? I attempted one answer to this during a Saturday in Westport back in about 1995 waiting to fly back to Wellington that evening having come off the Heaphy Track a couple of days earlier (and spending one night in beautiful Karamea).

In the Saturday edition of the Press I looked at all the asking prices for houses on the market and compared the average with the average price of newer units/ownership flats etc. on offer. The flats cost more. The argument that older people would free up cash and cause collapsing prices in a wave of house selling could not hold water.

The relevance of this now is that completely contrary to the argument housing doom-mongers have been running for three decades now the aging population is actually boosting housing demand, not cutting it (in terms of bedroom counts). Older people are buying houses for yield, and to help finance a retirement likely to last considerably longer than previously thought due to health, medical and lifestyle advances.

Housing

For your guide, this week Statistics New Zealand released updated projections for growth in the NZ population out to 2068. They have not yet updated regional and local authority area projections but will eventually do so perhaps next year.

What we see is that our population has been and is expected to grow faster than was thought only one year ago.

In their previous projections the population was forecast to hit 4.95mn seven years from now in 2023. Now they see it 209,100 bigger at 5.126mn. More people means more spending and more retailing developments. More roading pressures, more need for all government services. But note this all you people who still think superannuation is going to disappear. The population boost is not being driven by more retirees but by more people who will be young enough to be working, paying PAYE, GST etc. and therefore helping to finance pensions and elderly health care costs.

Look for next year's Budget to not only contain lots of extra spending across health, education, welfare, housing, infrastructure and benefits, but also adjustments by Treasury in their forecasts of the fiscal burden of the aging population.

Here are the latest population growth projections set alongside last year's projections with the change shown in the third column.

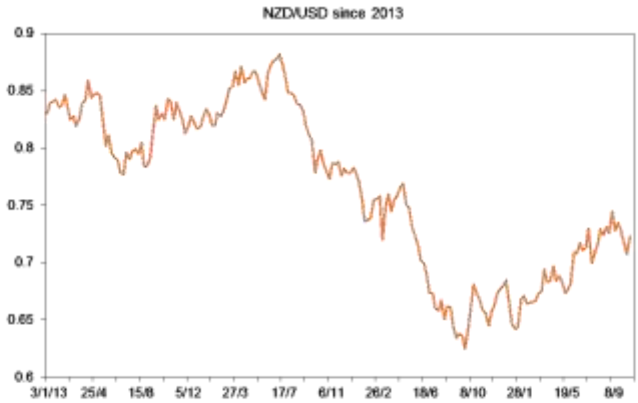
	2014 Base	**2016 Base**	**Boost**
2018	4738400	4864600	126,200
2023	4948800	5157900	209,100
2028	5152900	5389700	236,800
2033	5338300	5595000	256,700
2038	5499100	5769800	270,700
2043	5639000	5923100	284,100
2048	5761100	6060500	299,400
2053	5868700	6184600	315,900
2058	5969500	6299600	330,100
2063	6070500	6409400	338,900
2068	6174600	6515800	341,200

Note that one change in the numbers is a rise in the net migration assumption used in the median scenario shown here to 15,000 per annum from 12,000 per annum. Not so long ago this assumption was 10,000 per annum.

In the ten years ending in 1986 the average net migration flow was a loss of 17,000, the ten years ending 1996 a gain of 3,000, ten years ending 2006 a gain of 11,000 and the ten years ending August 2016 a gain of 20,000. A fairly clear trend is there.

NZ Dollar

The NZD has recovered two cents against the USD this week assisted by the September quarter inflation number coming in slightly higher than expected at 0.2% rather than 0.0% - for both the quarter and year in fact. The chances remain high that the official cash rate will be cut to 1.75% in the second week of November. But a further cut after that is looking less and less likely, especially in light of the string of positive measures for economic activity in New Zealand.

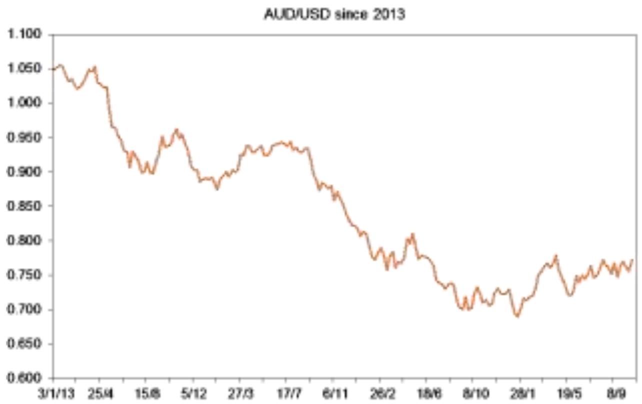


The NZD also got a slight lift from dairy prices recovering 1.4% at the Global Dairy Trade auction. Prices on that platform have firmed by

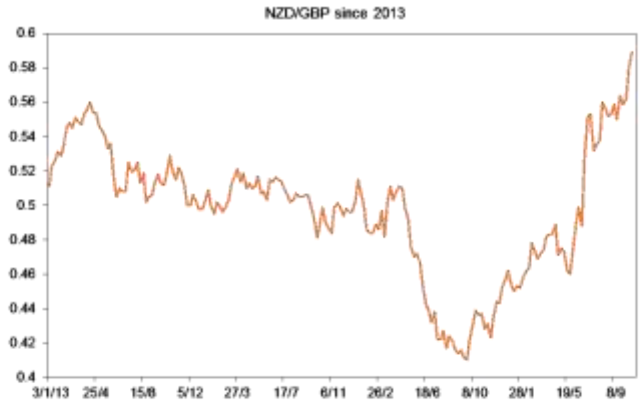
43% since March, assisted by recent heavy rain in NZ cutting production. But it may pay to be wary of forecasts that prices will continue to hike higher. The world has just harvested the most grain ever this northern hemisphere season. Prices are low and that improves the profitability of raising cattle for beef, and feeding cows to boost milk production, especially in the United States.

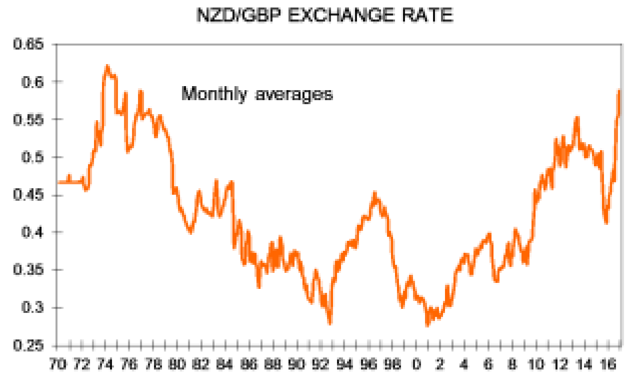
There is also increasing discussion in the US in particular regarding rising incomes and food demand in Asia and how this provides good reason to boost food output and movements up the food value added chain in the US.

Nonetheless, with prices rising firmly recently for minerals like iron ore and coal the NZD has probably seen its peak against the Aussie dollar, but a rising AUD will tend to drag us up some way as well. The AUD is drifting higher against the USD in response to these rising minerals prices though investors are cautious in light of very strong statements from the RBA seeking a lower Aussie dollar.



Against the British Pound the NZD has risen to its highest level since 1976 just below 59 pence courtesy of weakness in the Pound associated with Brexit – something which will be tossing the Pound around in an unpredictable manner for the next two or three years.





Were it not for US monetary policy most probably tightening the NZD could easily quickly go a lot higher. But if the expected Fed. tightening in December is accompanied by comments suggesting a further tightening is well down the track then we could easily be back at 75 cents by the end of the year.

If I Were A Borrower What Would I Do?

Nothing new. Float one-third, fix one-third two years and one-third three years unless someone were to offer me a very juicy five year rate. Chances of fixed rates falling from current levels look very low but jumping out to five years from the shorter terms is quite expensive.

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
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