BNZ Weekly Overview

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Mission Statement

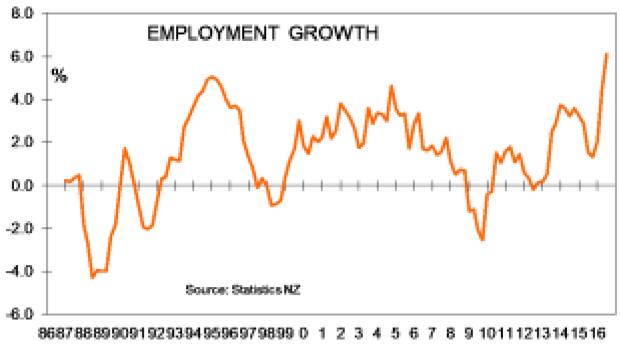
To help Kiwi businesspeople and householders make informed financial decisions by discussing the economy and its implications in a language they can understand.

Positive News Continues To Flow

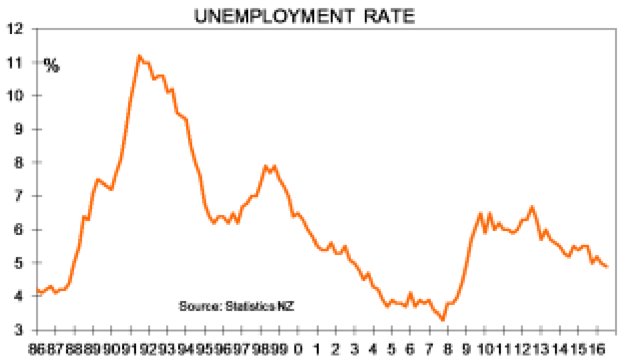
We have long been writing about the way the NZ economy has performed much better than many others post-GFC either emphasising the positive effects of the 1980s-90s reforms or the list of “insulating factors” in play.

This week we have seen developments suggesting not just that our economy has remained strong in the second half of this year but that strong growth is very likely to continue. Lets start with the jobs data released on Wednesday.

The number of people in work during the September quarter rose by 1.4% or by about 5% from a year ago if we allow for some better counting of jobs by Statistics NZ from the June quarter. The labour market is booming.



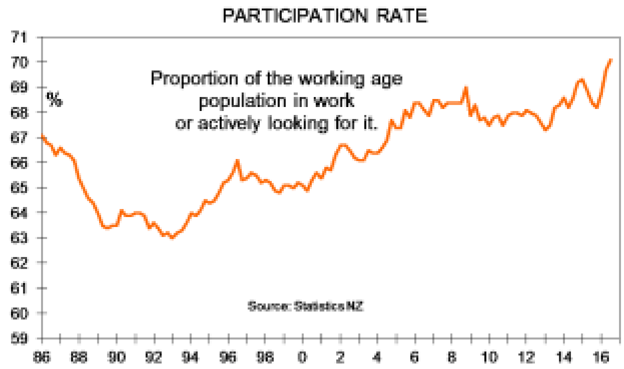
The unemployment rate has fallen to 4.9% from 5.5% a year ago and a peak of 6.5% early in 2010 and this is the lowest rate since the end of 2008.



All good, but we have to remember that the labour market data do have a history of sometimes going all over the place and there appears to be an element of that this quarter in the form of a massive 7.5% rise in part-time employment from a year earlier. This is unusual and while it means the true rate of jobs growth is probably less than our 5% estimate for the year let alone the published all jobs growth rate of 6.1%, the labour market is nonetheless very strong.

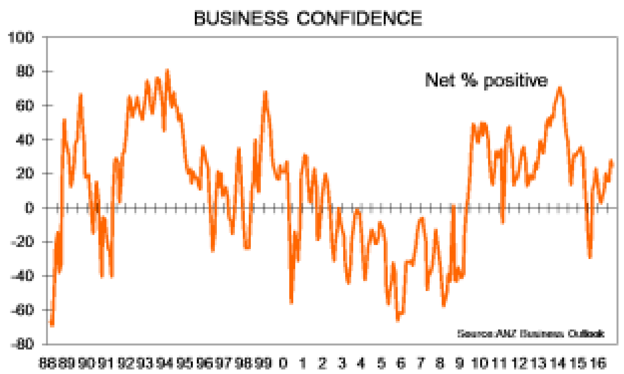
This strong performance is one reason why NZ’s net migration numbers have been strong and increasingly why they will remain firm for the coming year. That plus the simple fact that many more people are getting jobs means housing sector activity will remain firm with prices continuing to rise, while retailing also will retain considerable strength. Economics 101.

As an aside, you might think that maybe we are not that special given that the unemployment rate in Australia is 5.6% and the US rate is 5%. But the proportion of the NZ working age population in work or actively looking for work is at a record 70.1%. In Australia this rate is 64.5% and in the US so many people have given up any hope of finding a job that the rate is a terrible 62.4%.



The economy in New Zealand is providing people with job opportunities and people believe it. That is less the case in Australia and barely the case in the US – hence perhaps the support for the US version of the Philippines President in Mr Trump.

Also this week we have confirmation that business sentiment remains firm with the latest ANZ Business Outlook survey showing a net 25% of businesses feeling confident for the coming 12 months. This was down an inconsequential 3% from September but well above the average reading of 16%. As such the result is suggestive of businesses planning to invest and hire people and other data show us that.



The net percent of businesses planning to hire extra people was 21% in October compared with 26% in September and an average of just 8%. The net percent planning more capital spending came in at 19% from 20% a month before and an average of 10%.

Third, on Tuesday night the Global Dairy Trade auction produced a massive 11.4% rise in the price indicator which now sits 59% above its low earlier this year, 33% higher than a year ago, and just 36% down from the peak four or so years back.

As a result of this development, which has been driven by poor weather conditions drastically cutting NZ production this season (near a 7% output fall is expected by Fonterra), we expect the payout to sit near $6 this season and next. The payout last season was $3.90 and the season before $4.40. Three seasons back it was $8.40 with dividend payments of 10 – 40 cents each year.

Fourth on the positive side, interest rates are likely to be cut again by the RB in spite of all these positive developments because inflation remains too low for their comfort. The ANZ's monthly survey shows one year ahead inflation expectations stuck below 1.5%, and the Labour Cost Index wages measure I follow fell to an annual rise of 2.6% in the September quarter from 2.8% in the June quarter and 2.7% a year ago.

Housing

Just a reminder regarding measures showing residential real estate weaker on an annual basis. In the three months leading into October 2015 sales activity was boosted upward, days to sell downward, and prices up as a result of people bringing their buying and selling forward to beat October 1 LVR changes. The changes revolved around Auckland investors needing a 30% deposit plus all buyers needing to supply an IRD number.

This year the bias for this three month period is in exactly the opposite direction. As soon as the Reserve Bank announced the 40% investor deposit requirement nationwide in the middle of July they made clear to banks and everyone that the rules should be applied straightaway rather than only after October 1. So they were and that has of course hit market activity.

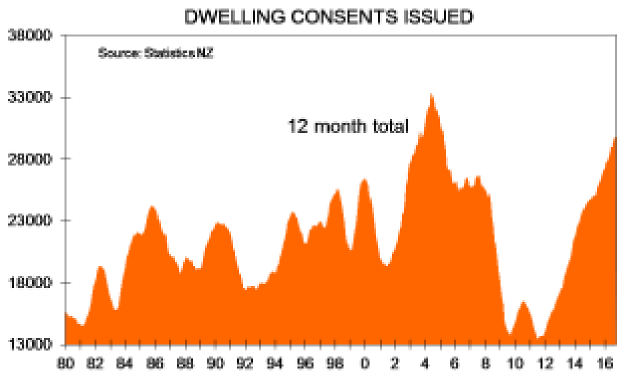
This results in annual rates of change for the months of August and September in particular which give a misleadingly weak picture of the state of the market. This does not mean things have not cooled down somewhat, just that the cooling is not as great as the numbers suggest. And that leads us to state for the third time now that this period immediately following implementation of new credit supply control measures presents an opportunity for young buyers to pick and choose to a greater degree and have fewer competitors at auctions than in more normal times. It might be a good idea to take advantage of this lull in the storm before two things happen.

First the market is likely to reignite sometime in the next two or three months. Second, the Reserve Bank will respond. Given that there appears to be some pushback from the Minister of Finance against the introduction of debt to income limits ahead of the election it is very highly probable that LVR rules will be tightened again next year.

Watch for the 20% requirement going to 25% and the 40% minimum investor deposit to 50%.

Dwelling Supply Rising - Slowly

For the record, on Monday we learnt that the number of consents issued for the construction of new dwellings around the country rose by a small seasonally adjusted 0.2% in September after falling 1.5% in August and 8.7% in July. Does this mean construction is trending down? No.



In June consents rose 20.4% so we need to smooth over three month periods and doing so we see numbers improved 2% in the September quarter. For the year as a whole consents totalled 29,755 and were 13.6% ahead of the year to September 2015 while sitting 31% ahead of the 20 year average.

So activity levels are quite strong and the highest in fact since early-2005. The pace of growth is a bit erratic but it remains upward.

In Auckland consent numbers in the quarter were ahead 11% on a year ago, Canterbury down 11%, and the rest of NZ up 24% with Wellington ahead 53% - a catch-up burst of activity.

The Structural Shift in Migration Flows

In Tuesday's Dominion Post there was a wonderful article written by a bloke coming back to New Zealand after many years away. He extolled the virtues of Wellington and discussed one of the key points which we have been making about returning to NZ no longer being a case of going bush as it used to be.

http://www.stuff.co.nz/business/opinion-analysis/85903155/Nick-Quin-We-choose-NZ-for-a-lot-more-reasons-that-just-the-scenery

There is a greater depth to many sectors in the economy now and greater diversity of things one can do. The level of expertise is such that participants in technology areas in particular are no longer sacrificing potential employment offshore in future years by staying in NZ longer before going for an OE, or coming back.

NZ is no longer just a big farm with farm servicing towns of varying sizes. Auckland is no longer just 40 Invercargill's bunched together. Wellington is no longer just a government town. There is a long list of businesses in the technology field which have grown strongly and new ones starting up all the time. This does not mean NZ is the global centre for such things, just that we represent one place in which someone wanting to work in technology can do it.

Think of it this way. No farm scientist is likely to have felt that spending time working at Massey, Lincoln, or one of our many research institutes has cost them promotion opportunities offshore or denied them knowledge of latest developments in their field of study. New Zealand has led farm science developments for decades and scientists have stayed in NZ to pursue their field of study or willingly come back after being offshore with no feeling that they are hoping off their sector's ladder of opportunities. Foreign scientists have actively sought to work with leaders in their field in NZ.

The same thing now applies in many other sectors in the technology, film production etc. fields. Hence one reason for the trending structural shift in our emigration and immigration flows – less of the former, more of the latter. That means firmer population growth than before and that means more need for houses and that means more pressure on a sector which does not have the ability to quickly respond to higher demand – or even slowly respond maybe given shortages now of finance for developers.

Welcome to a world of better bank risk management! Seems superior to the old model of financing everything which someone wants to plonk on the ground and producing a boom then bust cycle involving taxpayer bailouts of lenders and unemployment for many.

For the record. On the way up people always complain that banks are not lending enough money. On the way down people always complain that banks lent too much money.

NZ Dollar

I was asked a couple of weeks ago why changes in existing house prices are not included in the CPI. Here is a link to the Statistics NZ explanation. http://www.stats.govt.nz/tools_and_services/newsletters/price-index-news/Apr%20-14/purchase-of-housing-and-rentals-in-the-cpi.aspx

Clear now? Probably not really, but just think of the CPI as measuring the price of things when they are sold by a business to consumers, not between consumers.

The question was asked because of problems we have pointed out whereby the Reserve Bank is trying to boost inflation by cutting interest rates and causing things like soaring house prices. Were existing house prices captured then inflation would be higher. True. But there is a but.

House prices tend to rise faster than the consumer price index partly because of household incomes rising faster than inflation. So in the past inflation would have been higher than otherwise. So interest rates would have been higher. That would have hurt businesses. And the exchange rate would have been higher, thus hurting exporters and benefitting importers of overseas goods and services.

The key issue here is not poking and prodding the CPI to try and get a measure which suits the economy when different things are going on, but ensuring the Reserve Bank has adequate tools to achieve its goals without having to rely only on changes in the official cash rate.

This means that in earlier years I supported introduction of a special changeable levy on all fixed rate mortgages so that changes in the cash rate would hit all borrowers right away rather than only those on floating rates. This would have limited upward pressure on the NZD during the 2000s.

What it means currently is that the Reserve Bank is developing tools other than interest rate changes to influence bank lending risks into the property sector. But what it could mean beyond that is the RB simply giving up on cutting interest rates further because even though credit growth is very strong to the household sector, unemployment low, and capacity utilisation well above average, inflation and inflation gauges are not lifting as they want.

Nonetheless, a further cut in the official cash rate is likely next Thursday morning but after that no further cuts are likely. The cut, when it comes, may exert some downward pressure on the NZD. However the markets have almost completely factored in a rate reduction so attention will mainly be on the words accompanying the decrease and whether further cuts are hinted at.

This week the NZD has firmed to US 73 cents from 71.5 cents last week and I retain my view that the path from here is more upward than downward assisted by rising dairy prices, strong economic growth, and continuing uncertainty in other economies. The only bugbear is the likely widening interest rate differential between NZ and the US but most of that is already factored in.

If I Were A Borrower What Would I Do?

There is an increasing feeling in the United States that interest rates will be raised by the Federal Reserve in December. The solidifying of this view reflects data such as the Fed.'s preferred measure of inflation rising close to the 2% target at 1.7%, and slightly better than expected GDP growth during the September quarter. Growth was at an annualised pace of 2.9% from 1.4% during the June quarter.

However picking the pace at which rates will rise after a likely December 0.25% increase is impossible. All expectations for every country since 2009 of firmly rising interest rates have proved wrong. Either growth has proved weaker than expected or growth was good but inflation simply failed to appear. The United States remains vulnerable to this lack of inflation situation continuing yet at the same time the using up of spare capacity strongly suggests inflation and borrowing costs will rise further.

A wise person might want to explicitly recognise this uncertainty with an upward bias by extending the average period over which their interest rates are fixed. Personally if I were borrowing at the moment I would have one-third floating, one third two years fixed and one-third three years. The jump from three to four years still remains too large given the low probability that NZ monetary policy will be tightened for a number of years.

It would pay to note that the three year swap rate which underpins bank fixed lending for three years has risen in the past four weeks from 2.17% to 2.35% and the five year rate has gone from 2.31% to 2.54%. A round of fixed interest rate rises could be imminent.

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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