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.

Auckland's House Price Outlook

Auckland's unitary plan has been given the go ahead with a multitude of legal challenges being dismissed this week all in one go. That means full steam ahead for the target of building 400,000 extra houses over 23 years. That works out at an average of 17,391 a year. Allowing for consents not acted on that means around 19,000 consents needing to be issued each year.

But issuance was just under 10,000 in calendar 2016, some five years after the realisation really started to kick in that Auckland did after all have a shortage of houses. That 10,000 total represented a rise of only 7% from 2015 which was up 23% from 2014 which was up 21% from 2013 which was up 37% from 2012 which was up 21% from 2011. Growth has slowed to its weakest pace in five years at exactly the same time as all stops are being pulled out to facilitate growth.

What are the chances of the 400,000 target being met by 2040? Really, really low. In an environment where demographers are lifting their estimates of the average pace of Auckland's population growth courtesy of higher average expected net migration inflows, the pricing implications seem as obvious now as they have been all this decade.

In fact consider this – Auckland's rate of population growth outpaces the rest of the country even when net migration inflows are weak- witness 2012.

June	Net	Population Growth		
Years	**migration**	**AKLD**	**RoNZ**	**Differen..**
2012	-3000	1.2%	0.3%	0.9%
2013	8000	1.1%	0.6%	0.5%
2014	38,000	2.3%	1.2%	1.1%
2015	58,000	2.8%	1.4%	1.4%
2016	69,000	2.8%	1.7%	1.1%

This is probably because Auckland has the youngest population of all NZ regions therefore the greatest propensity to make babies . That therefore means the greatest desire by people to get their own family home.

In the following table we show the median age for each region estimated by Statistics NZ in June 2016. But we also show the estimate for 2014. We have done this because not only does Auckland have the youngest population, it has become younger by 0.5 years over a two year period.

	2016	2014	Diff
Northland	42.6	41.9	0.7
Auckland	34.1	34.6	**-0.5**
Waikato	37.2	37.2	0
Bay of Plenty	40.8	40.5	0.3
Gisborne	36.3	36.1	0.2
Hawke's Bay	40.8	40.5	0.3
Taranaki	39.8	39.7	0.1
Manawatu-Wang.	39.2	38.9	0.3
Wellington	37.2	37.2	0
Tasman	45.6	44.6	1
Nelson	43	42.4	0.6
Marlborough	45.8	45.1	0.7
West Coast	44	43.1	0.9
Canterbury	38.6	39.3	**-0.7**
Otago	38.5	38.7	**-0.2**
Southland	39.4	39.3	0.1
All NZ	37.1	37.5	**-0.4**

The Canterbury median age reduction probably reflects builders arriving. Otago might reflect something happening in Queenstown.

The pace of average house price rise this year for Auckland will probably be toward the lower end of a 5% - 10% range with restraint against the obvious fundamentals from the recent increase in fixed rate borrowing costs, the effects of the 40% investor deposit requirement, and a general tightening of bank lending criteria.

In Australia banks are voluntarily restraining the pace of growth in their lending to investors. Having worked in Australian-owned banks for 31 of the past 32 years I can say that the level of understanding of Australians about the way in which monetary and housing conditions differ in New Zealand from Australia is not particularly high. (The Aussies never ever came to grips with the way monetary policy in NZ some years back was run by targeting a monetary conditions index before the official cash rate appeared in March 1999.) Therefore it seems reasonable to expect that leaders over there will look to impose their tighter lending restraints here as well.

Measures aimed at restraining investor demand do not turn investors into sellers (as interest rate rises can do) and can merely have the impact of forcing investors to save up longer for their purchase than would otherwise be the case. After all, LVR tightening does not boost returns on alternative investments like term deposits or corporate bonds. Some of the investor demand gets spread over time. This acts to support the market when occasional causes of weakness come along like higher interest rates or economic decline.

Not that weak economic conditions look likely in New Zealand for a great number of years. There is hefty support for growth from construction, migration, tourism, above average business and consumer confidence, well above average business intentions of hiring people and investing, growth in various service industries, growth in many primary sub-sectors like goat farming, manuka honey (taking a step back for the moment though), wine, pipfruit, Kiwifruit, and the recovery in dairy prices.

An Irish Chat

I gave a talk this week at an excellent breakfast function organised by the Irish Business Network of NZ which focussed on Brexit. The other speakers representing the UK and Ireland gave great insights into the positions of their governments and goals they wished to achieve, while I concentrated mainly on the reduced relevance of the UK to NZ now than when it joined the EEC in 1973, and our very different economic state.

Specifically, back then we were still receiving over 30% of our goods export receipts from the UK whereas now the proportion is only just over 3%.

Back then the NZ economy was rigid and as the UK entered the EEC it was made more rigid and inefficient with subsidies for farmers and more protection for manufacturers – especially as over 1973/74 the first oil price crisis struck and our economy took a big terms of trade hit. Shortly after that the huge residential construction boom which had seen over 40,000 dwelling consents issued in 1973 began to go into reverse resulting in huge job losses and business closures – which then contributed to a growth-sapping net migration loss of 156,000 people between 1975 and 1982.

Come 1984 with the economy weak, government finances bad, talk of an IMF bailout swirling and people tired of increasing constraints on their activities a snap election brought a Labour government to power. The economy was radically reformed over 1984-87, then again for a while from 1990-92 when a National government was elected specifically to finish the job following David Lange's "cup of tea".

I mention this because one of the questions asked by the audience was what the optimal policy changes would be for a country looking to reform its economy. Presumably this was with an eye toward the many structural problems which beset European economies and the EU overall.

My reply was not to address policy, but instead note that in order to undertake reform you need the populace accepting that big changes are needed. In New Zealand that acceptance was there – though it definitely was not universal.

At the time there was an acronym in New Zealand TINA – there is no alternative.

You also need a system of government which allows speedy change to occur. We had a first past the post electoral system which meant once you won power the opposition could be ignored because the concept of crossing the floor to vote with the opposition was highly controversial (still is really in NZ). The caucus would vote the way Cabinet determined, and Cabinet could be controlled by a handful of determined individuals, as long as they had the confidence and support of the Prime Minister.

Few countries have anything approaching such a system now and undertaking reforms can be a very slow drawn out process involving a multitude of policy trade-offs.

It also helps if your economy is doing well so that the inevitable short to medium-term pain which reform inevitably brings can be partly hidden. That was the case in New Zealand because reform involved an early freeing up of the financial sector and a credit boom occurred which produced a massive surge in the construction sector, surging share prices and paper wealth for a while, and great optimism about reform actually being a winner right away! Privatise everything and make us all sharemarket winners!

We have all learnt that credit booms can be very dangerous and it is very unlikely that a government these days (outside of China) would create one to temporarily offset the effects of reforms given the eventual downside of a collapse in over-valued asset prices which is what happened from October 1987 with a property collapse soon after making our downturn so much worse than those elsewhere.

But there is also something unique to New Zealand which assisted the reform process. When we Kiwis don't like what is happening around us, for whatever reason, we can virtually all get on a place and go bludge off our cuzzies across the ditch for a few weeks, months or years. And so we did with a net migration outflow between 1986 and 1989 of 89,000 people.

This safety valve still exists today but few if any other countries have it – except for members of the European Union which of course is one reason why the majority of voters in the UK's June 23 referendum opted for Brexit. They don't want that safety valve existing for others at their perceived expense.

So my answer to the question regarding policy changes focussed not at all on what a government might choose to do, but on the unique circumstances of New Zealand back then and the way in which such conditions do not exist anywhere else currently – except maybe Ireland four or so years ago. And that is the answer I and others used to give to visiting delegations of Japanese politicians, public servants, and businesspeople back in the early-1990s when they would visit New Zealand to see what we had done and how. They would quickly reach the conclusion that replicating NZ reforms was an impossibility in Japan – hence two lost decades so far for that country and counting.

If I Were A Borrower What Would I Do?

I wouldn't panic thinking that the Reserve Bank is going to be jacking interest rates up soon. They probably won't raise rates until toward the middle of next year and come the end of 2019 they will probably have taken the official cash rate from its current 1.75% to 3.5% with 2.5% likely at the end of 2018.

That means come two and a half years from now your floating mortgage rates are likely to have risen from around 5.8% to 7.5%. Make sure you run your budget for that rate or plan how you will cut your cloth to handle it when we get closer to that time. Maximising principal repayments is a good idea. Later on cut coffee outings (get a machine and buy discounted capsules online), rationalise your tv subscriptions to embrace modern, cheap, technologies, cease travelling offshore for a while and see more of New Zealand before all the motel signs are in Chinese, (only 8% so far of Chinese people have passports), and stop buying new electronics.

Fixed interest rates are likely to rise before floating rates go up and as we have seen they have in fact jumped already. Our two year fixed home mortgage rate now sits at 4.79% from 4.29% in November. Fixed rates have been pushed higher because medium to long term borrowing costs around the world have been pushed up by tightening monetary policy in the United States and an anticipation of extra tightening because of stimulatory fiscal measures expected to be introduced by the Trump administration (lower taxes, higher Federal spending).

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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