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.

Helping New Zealanders Be Good With Money

This is one of our aims at the BNZ and something strongly emphasised and repeated through discussions within the bank and outside it. The aim exists because there is research which shows that many people are not always good with their money. They borrow too much, they spend too much, they spend on the wrong things, they save too little. In particular, they fail to appreciate that achieving key life goals involves sacrifice. You want to achieve top marks at school and university, you sacrifice some of your social life, sports and immediate income. You want to be top in sports, you sacrifice some of your other learning and time doing other things. You want a mortgage, you cut back on non-interest payment spending.

One part of maturing as an individual is realising that whenever you take on a new thing like a partner, a car, a child, or a global trip some other thing or things need to be dropped. You have to make choices, otherwise you never grow up.

If you want to buy a house you must sacrifice spending on a great number of other things and you must not aim to buy your dream home in one step. Buy something you can improve using your own labour in your own time. Home ownership is expensive in terms of the deposit size, the purchase price, the stress, then the running costs, especially for young people with little furniture and starting a family. Pursuing home ownership will bankrupt some people. It ends in disappointment for many others as the repair bills come in. Relationship breakups will impose forced sales on some, and some relationships will fail because of the financial stress and the inability to spend on things which non-home owning friends may continue to enjoy.

People need to think very carefully before signing up to a large mortgage which will fluctuate in cost, with future changes almost guaranteed to be upward, by perhaps 2% for floating interest rates over the next two years. Budget for a 3% rise just in case. Home ownership is also dangerous because it reduces your ability to shift location should you need or want to. So think carefully before you try and lock yourself into a particular city and suburb for many years. Get it wrong and you can suffer financially from shifting house and be simple bread and butter for real estate agents.

Such commitment to a place does not make sense for most young people who face a massive range of opportunities here and overseas. Be very, very certain before you look your partner in the eye and say here, in this place, this is where I make my stand, and you are the one I make it with.

The key message of last week's Overview was that it is harder for young people these days to buy a house than it was for the Baby Boomers. This is not because of greed by older people, as one politician recently claimed, but a long list of factors we have repeatedly emphasised in this publication since 2009.

The list includes planning and building regulations, foreign buying, double income households, New Zealand no longer being a big farm, the concept of Brain Drain going out the window, the technological revolution causing people to want to live and work nearer to other people, a structural decline in interest rates, loss aversion by retirees, widespread forecasts of strong tenant demand, and so on.
http://tonyalexander.co.nz/wp-content/uploads/2017/03/WO-March-2-2017.pdf

These things are not going to radically change. It will remain hard for young people to purchase a property and that has been the key message here encapsulated in predictions of rising house prices since 2009. Anyone who acted on those price rise predictions rather than holding off for a price collapse will currently be sitting reasonably comfortably equity-wise.

If purchasing a house is your goal then there is no shortage of things which those who already have purchased sacrificed as they built up their savings, worked at reducing the principal to improve their position, and adjusted when their interest rates and/or expenses went up. Things people have cut out have included...

- Cafe visits
- Going to restaurants and bars
- Smoking
- The latest telephones, games consoles, cars
- International travel
- Weekend and evening leisure time because they took an extra part-time job.
- Hired help like dog washers, landscape designers, etc.
- Subscription tv, gaming, music
- Privacy – by taking in flatmates, student boarders, or renting out space on Airbnb.

If you want to buy a house these days now that prices compared with incomes have structurally jumped to levels they will never much decline from, then you will need to make sacrifices. If you can't then think carefully. You could keep renting and accept the uncertainty that brings in terms of rent levels and tenancy length. Either way, putting and keeping a roof over your head has become structurally harder in this country.

Following on from this discussion last week we introduced a new element which is worth going over again this week in case you missed it.

The world has changed. Following deregulation of the financial markets and institutions over 1984/85 the main problem for anyone wanting to get a loan shifted from rationing of a limited credit supply to price. It is now shifting back again. Banks face far greater demand from people wanting to go into debt with our assistance than we can satisfy through raising funds domestically.

Some credit rationing has already occurred via the LVRs. Some has manifested itself through new property developers struggling to find a financier. Next will likely be large corporates having to source funds in their own name from offshore and maybe via bonds. Without increased deposits or access to funding further rationing of credit is on the way, with the next housing cycle almost certain to see it in the form of Reserve Bank-imposed debt to income ratios, as sought by the RB and recommended this week by the IMF.

http://www.imf.org/en/News/Articles/2017/03/06/ms030617-New-Zealand-Concluding-Statement-of-the-2017-Article-IV-Mission

While preference is likely to be given from here on out to home buyers, businesses need financing too, especially SMEs. Hence the market opening up for foreign banks (Chinese almost certainly) to enter NZ to service the larger companies over the next few years.

Therefore the relationship between you and your bank is changing. It is shifting from the bank offering deals and discounts to get your business, toward them raising interest rates, reducing discounts, even introducing fees as a means of rationing demand, and picking and choosing between the many mortgage applicants. Preference will be given to those who show an ability to build savings over an extended period of time through (by definition) sacrificing expenditure.
http://www.nzherald.co.nz/personal-finance/news/article.cfm?c_id=12&objectid=11810637

Baby boomers will understand this need to build savings over many years before seeking a mortgage. But the younger generation used to businesses chasing them continually for their dollar will take some time to cotton on to the implications and figure out how to get to the head of the queue.

Some have already figured it out – the bank of Mum and Dad. But there are bad social stability implications from this development with home ownership decreasingly available for those without generous relatives. What will happen to counter this trend?

We will eventually see some changes in legislation favouring the tenant and penalising the high flexibility which landlords enjoy. Changes in this area will likely move quite slowly.

We will also eventually see the development of proposals for government financing of home purchase by those without family means, well beyond the small grants and savings withdrawals currently available from Kiwisaver. Given the way in which concerns are growing about regional depopulation and the high cost of buying a house in Auckland, these financing proposals will likely focus on regional housing markets. But they won't amount to much and history shows that in the absence of a township jobs surge it is unrealistic to expect any substantial movement of people out of the main cities to small localities.

But keep an eye on the area covered by the Waikato District Council (WDC). It uniquely straddles the gap between Auckland and Hamilton. Since 2007 population growth per annum has averaged 1.8% in the Waikato District versus 1.2% for all NZ, 1.6% for the Auckland Region and 1.3% for the entire Waikato Region.

Locations like Huntly, Pokeno (growing phenomenally), Ngaruawahia, Te Kauwhata, and Tuakau will become increasingly vibrant satellite towns and some of them first ports of call for free independent travellers exiting Auckland not wanting to drive immediately through to Rotorua. Tourism currently accounts for a well below average portion of the WDC GDP but scope for growth through people setting up tourism ventures looks very high. Living in any of the towns and working in Hamilton is a no brainer, commuting to Auckland is not yet a pleasant experience.

I spent a day and night in Hamilton last week giving three talks at Lake Karapiro, Wintec, and the stadium. Sentiment of people seems to be pretty good down there. It will be great when the expressway network between Auckland and Hamilton is completed in 2020. Next week I'll be spending time in Ngaruawahia and am looking forward to that. I also spent time in Rotorua today and the place looks really busy.

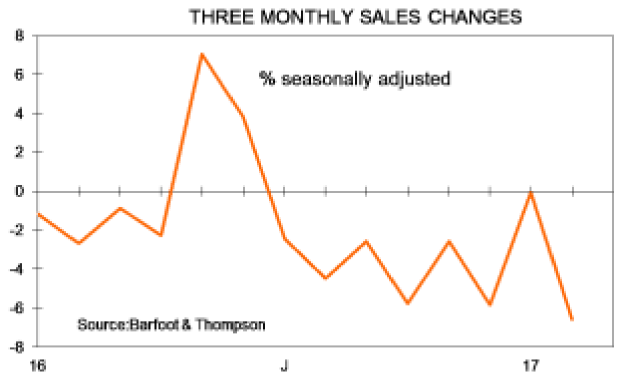
I also drove this week to Whangarei for a talk with dairy farmers and while the road is a lot better since I last drove the route perhaps over ten years ago, there are some hilly bits which made me think I was back driving south from Westport or Fox Glacier – still the most beautiful part of NZ in my opinion. A part of me still longs every now and then for the bach in Barrytown I didn't buy in the early-'90s.

Similarly north of Wellington as the Northern Corridor transport network develops the option of living on the Kapiti Coast and in the Horowhenua becomes more and more attractive. The huge lift in commuter traffic near 6.30am on a Monday morning as I drive to Wellington Airport to fly to Auckland each week attests to strong growth having already occurred since commuting into Wellington at the same time from 23 years ago.

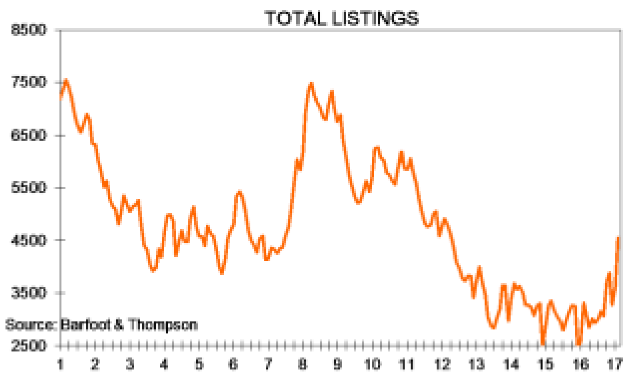
None of these eventual changes in the coming decade will alter the fundamental house price dynamics. Young home purchasers are worse off than the Baby Boomers were and that won't change because of all the factors discussed at length last week. Sacrifices of greater and greater magnitude will need to be made to purchase a property. If you can't make those sacrifices think carefully about getting a mortgage.

Auckland Has Cooled

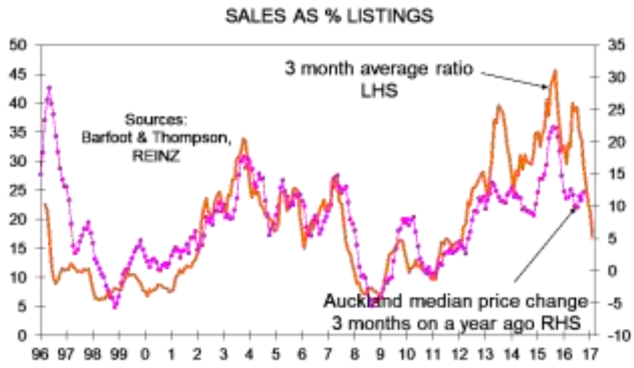
Barfoot and Thompson released their monthly data on residential real estate sales in Auckland this week and what they show is a market which has peaked out. We said we would be waiting for February to come in before making a final analysis of the impact of the 40% minimum investor deposit requirement imposed since the third week of July last year.



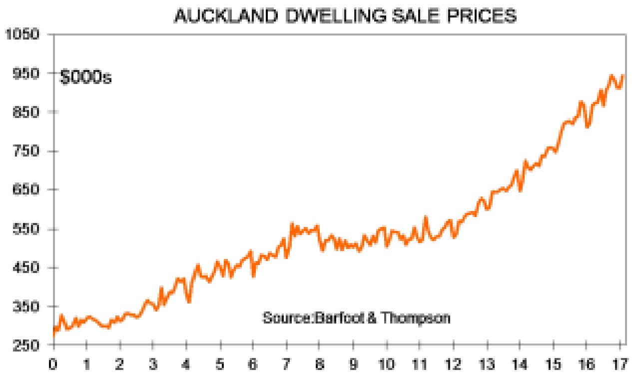
The data show that sales in the three months to February were down by 20% from a year ago and about 7% seasonally adjusted from the three months to November. The number of new listings received in February was up by 11% from a year ago after rising 24% in December. At the end of the month the total stock of listings was 37% ahead of a year before.



The ratio of sales to listings now sits at only 17% on average for the past three months which is the lowest ratio since early-2012.



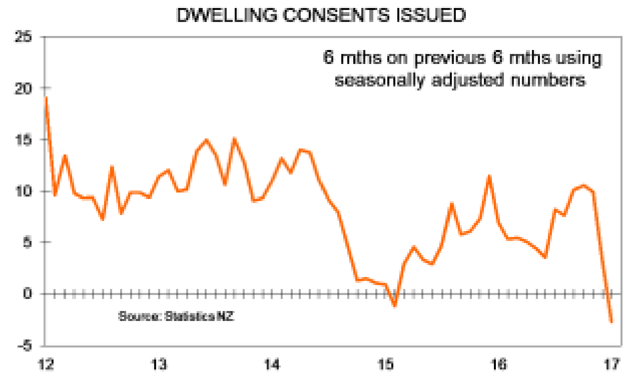
As for prices the average sales price in February was 15% ahead of a year ago. But in the three months to February the price averaged 1% down on the three months to November which was 4% ahead of the three months to August. Prices have flattened out.



So that was that. This cycle is over, and clearly so when sitting in on an auction this week whilst walking home. One bidder, passed in.

But do we see prices trending downward? No. The cycle has not been ended because of recession, sharply higher interest rates, a collapse in migration, or a surge in supply. The cycle has ended because demand has been locked up behind a high 40% dam and because taking that into account the equilibrium price has largely completed its upward adjustment – for now. The demand still sits there. People still want to buy. But they can't get the deposit together.

Speaking of supply, Statistics NZ is now of the opinion that the trend for issuance of dwelling consents (new houses, townhouses etc.) is downward. In the past three months seasonally adjusted consents were down 13% from three months earlier. The separate trend estimate calculated by SNZ peaked in August last year and has now declined 15%.



So what happens now? Prices could easily still creep up 5% this year and next because of the intensity of the population growth set against slowing growth in new supply with that latter growth slowed by shortages of materials, builders, and development finance.

But time is now on the side of buyers in Auckland. They have a bigger range of properties to choose from.

Will conditions change enough that the Reserve Bank will lower the 40% deposit requirement? The answer wanting to jump out here is no because the RB won't cut the LVR until they start cutting the official cash rate and that is many years off in our opinion – we have not even had the OCR tightening cycle yet.

But we have spent some time highlighting the way in which the Reserve Bank has had to introduce LVRs because OCR changes don't achieve their dual goals post-GFC of targeting inflation and bank lending risks. Is it possible that bank lending risks will be contained enough even with the economy's growth rate picking up and the OCR rising from next year that the RB could cut the 40% requirement?

This does not seem likely. As highlighted in last week's Overview credit demand is exceeding the ability of banks to meet it through funding domestically. The Reserve Bank is unlikely to stimulate demand further by cutting the LVR. Technically they could, but banks would still ration credit and because investors tend to offer greater loan security than first home buyers cutting the

40% requirement for investors would newly bias the market against first time purchasers. Only when the economy next tanks can we reasonably expect anything more than a token adjustment downwards to the 40% requirement. History tells us that we do not have the ability to predict when a substantial economic decline will come along. We also can't forecast exchange rates. Dairy companies can't forecast milk prices. Oil companies can't forecast oil prices – ditto for iron ore, coal etc. As for interest rates since the middle of 2008....

If I Were A Borrower What Would I Do?

Nothing new to offer here. I would look to lock in much of my mortgage for three years especially as uncertainty regarding the future path of retail interest rates has increased and will increase further.

What that means is that in the easy old days we economists could make a reasonable stab at where mortgage rates would go with reference to actual and predicted changes in the official cash rate and swap rates. Those equations no longer work and they go almost completely out the window when things shift from rationing of loans via price toward other measures like length of relationship with a lender. Savings history.

So let's repeat again the key message we have been delivering in this section of the Weekly Overview for seven years now. Do not make your decisions regarding interest rate risk management highly dependent upon a particular set of interest rate forecasts proving correct. You must explicitly recognise the new low predictability of interest rates by spreading your risk through a range of floating and fixed rate terms. The chances are quite low that looking backward you will find that the structure you set in place will have delivered the cheapest possible cost of funds. If minimising debt cost is your ultimate goal above all else and you are a person who cries over spilt milk, then don't borrow money in the first place.

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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