BNZ Weekly Overview

7 April 2017

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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.

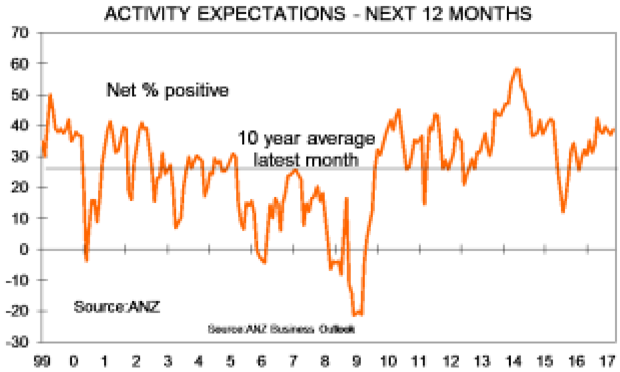
Some Recent Data

There will be no Weekly Overview next week because of Easter. The next Overview will appear on April 20.

Last Friday we learnt from the ANZ's monthly business survey that like consumers businesses have become a tad less confident about the economy recently. Only a net 11% of businesses early in March felt that the economy would improve over the coming year. This is the lowest reading since May last year and down from a net 28% in September.

The first thing to note then is that this measure can easily move around. Second, at 11% the latest result is only just below the ten year average of 12% so one could not look at the number and say things are really on the slide. In fact by some measures just the opposite conclusion is possible.

We economists tend to pay less attention to the headline confidence number than to the expectations firms have of their own activity levels – something about which they have genuine insight as opposed to views on the overall and somewhat nebulous "economy".



In March a net 39% of businesses said they see their activity levels rising. This compared with a net 42% in September so the decline from the peak period last year was far less than for overall sentiment. In addition the average March reading is a net 27% positive so the result bespeaks of firms expecting to be busier than usual.

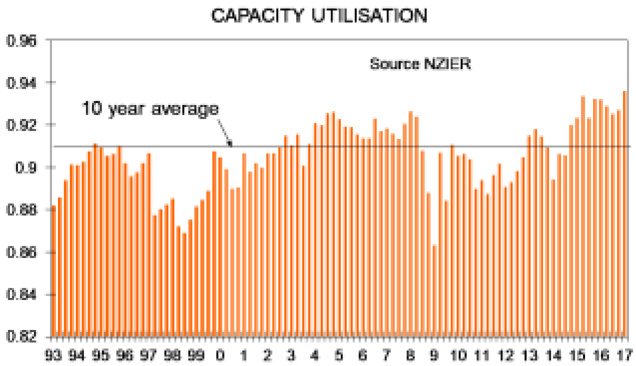
That helps explain why a net 23% expect to hire more people whereas average employment expectations are 8%. Plus a net 21% expect to boost capital spending versus an average of 12%.

These two measures of intentions are what really matter and the fact they remain positive suggests it is reasonable to expect that firm levels of economic activity growth will be recorded over the coming year. The labour market is likely to remain tight, and there will be plenty of business for firms involved in providing investment goods (machinery) and services (software systems etc.)

We reach the same conclusions from looking at the NZIER's Quarterly Survey of Business Opinion which was released on Tuesday. It showed a net 17% confidence about the economy going forward and a net 25% expecting their domestic activity levels to increase. The average reading for this latter important measure is 12%.

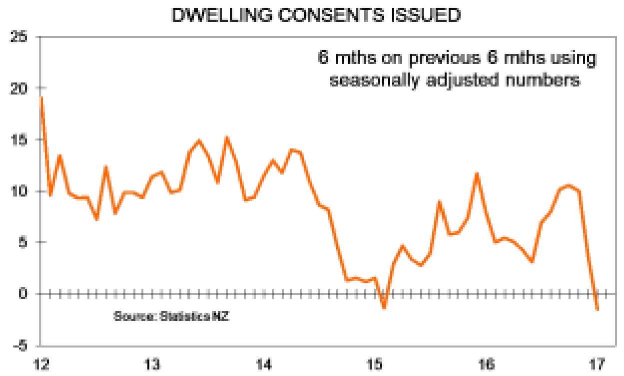
A net 8% of businesses plan boosting staff numbers which is above the 2% average but down from 27% six months ago. So some caution has kicked in there. A net 18% plan raising capital spending which is above the 3% average and largely unchanged from 17% six months ago.

With the NZIER's survey us economists mainly look at gauges of capacity use and inflationary pressures. The main capacity measure hit 93.6% in the March quarter which is the highest level ever and up from 92.7% a quarter ago. Firms are under intense pressure to boost investment.



A net 29% said they expect their costs to rise which is right on average, and a net 29% also said they plan raising their selling prices – which is above the 20% average. This suggests some increase in inflationary pressures but not enough to start warning about big upside risks to interest rates.

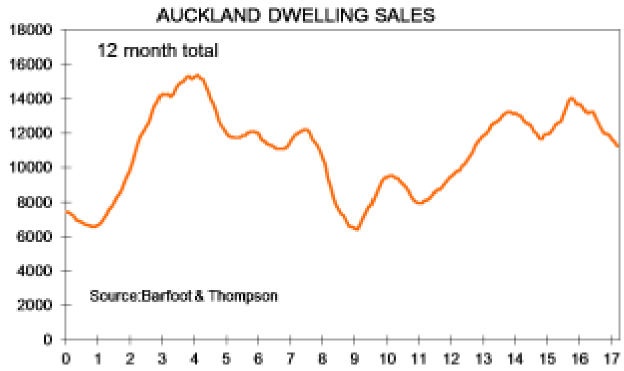
This week we also learnt that the number of consents issued for the construction of new dwellings rose by a seasonally adjusted 14% in February after rising 2.1% in January but falling in total by 16% over November and December. At best things are flat, though in the three months to February consent numbers fell 7.5% after falling 5% three months earlier. So more realistically there is still a downward trend in place. This is not what one would expect to see happening if sufficient resources were available to fuel the strong level of housing demand which sits out there.



The fundamental situation – in Auckland at least – of a shortage of housing which is getting worse remains. Population growth exceeds dwelling supply growth. But with prices having risen about 95% since 2007 it seems reasonable to say that a new equilibrium has been reached where the shortage calculated using backward-looking measures will persist. But in technical economic terms there may not be a shortage if we are at a new equilibrium. If we are not at that equilibrium yet then prices will rise further which has been our central message in this publication for many years now. Eco 101 stuff.

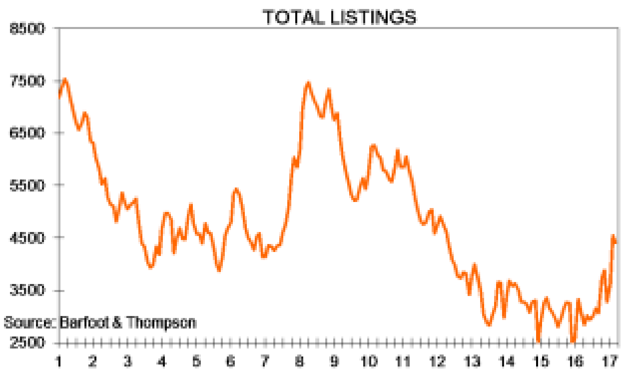
Sorry if that sounds complicated but it all comes down to prices adjusting to reflect demand exceeding supply, and shortage calculations being completely dependent upon what your basis of comparison is – a year in the past, a particular ratio of people to houses, a level of homelessness? Shortage is a physically defined thing. Affordability is something completely different.

Regarding Auckland, yesterday we received monthly data from Barfoot and Thompson real estate company. They show that in March sales of 1,110 dwellings represented a 17% fall from a year earlier. Seasonally adjusted over the past three months sales have fallen by 1.4% after falling 6% three months earlier. So there is a downward trend in sales activity but it is flattening out.



The average sales price for the three months to March was up 1.2% from the December quarter which was up 3.6% from the September quarter. But we prefer to use the REINZ's House Price Index series to measure price movements as they cover the entire city and adjust for changes in the types of dwellings being sold to maintain a consistent basis of comparison. Their measure in the three months to February (so not as timely as the Barfoots data) was down 1.2% after rising 2% in the three months to November. Auckland prices have flattened out.

The number of listings on stock at the end of March stood at 4,413 which was 43% ahead of a year ago.



New listings received in the month of 1,983 were 6% ahead of a year ago. There are plenty of properties for buyers to peruse before making a bid. This is important because while it clearly helps explain the stabilisation of prices on average it also means FOMO will be disappearing. Fewer and fewer people every day will feel they need to buy any old piece of rubbish now or else they will miss out on future gains. With these buyers leaving the market, a lot of them already pushed out by the 40% LVR requirement for investors, a decrease in easy access to cheap credit for investors generally, and Chinese having greater and greater difficulties getting funds out of China (they still can, its just harder), space is provided for the continuing wave of "catch-up" buyers to satisfy their wants. These are the people who put off buying last year, the year before, etc. all the way back to a decade ago because they incorrectly thought prices were going to fall. They got caught out and have been scrambling to make their long-planned purchase. Now they can do so as they get their deposit together and they will provide a good ongoing level of support for the market on top of normal people shifting house, the growing population, and investors still purchasing when they can with knowledge of Auckland's key fundamental. There is a shortage and it will get a lot worse as population growth exceeds and will continue to exceed dwelling supply growth for many years.

If I Were A Borrower What Would I Do?

While inflationary pressures are edging upward there is an offset from falling fuel prices, technology changes, alterations in labour market dynamics etc. which suggest our central bank will not feel the need to raise the official cash rate until the middle of next year. Come a year and a half later at the end of 2019 we see a good chance that their official cash rate will have gone from the current 1.75% to 3.5%.

But be aware that two times since the GFC the Reserve Bank have raised rates only to slash them again. And high uncertainty remains regarding economic prospects, inflation, and interest rates overseas, and inflation dynamics back here in New Zealand.

Because of these factors, were I borrowing at the moment I would not feel the need to pay the big extra interest cost to fix four or five years rather than say three years. I would look to have part of my loan floating and the rest fixed three years. Many others will be happy with two years – I have always tended to adopt a more conservative position regarding my interest rate risk management than other people.

Floating	5.90%
1 year fixed	4.59%
2 years	4.79%
3 years	5.09%
4 years	5.89%
5 years	6.09%
7 years	6.15%

NZ Dollar

A regular reader has requested that I write something about the NZ dollar – but I have nothing insightful to offer. There is no shortage of exchange rate commentaries from people spending a lot more time than myself looking at currencies, and I remain of the opinion that when it comes to currencies it is professional risk management which matters – not forecasting. Get advice.

Thinking of all my FX transactions over the years I never once took into account prospects for currency movements when choosing timing of my transactions. I did them when the underlying purpose required them.

But perhaps in terms of risk management I can offer something important. As I travel the country talking with people about the reduction in credit volumes which banks in New Zealand can now make available to customers, people are getting indignant thinking we are a public service they are entitled to and when puffing up about the cutbacks not being fair they often say they will look to borrow offshore. Then they get even huffier and say they will pay lower interest rates as well. Good luck.

The only way you can lock in a lower interest rate from borrowing offshore is if you don't hedge the currency risk. The cost of hedging by and large is the interest rate difference. If you go unhedged you leave yourself highly vulnerable to a fall in the Kiwi dollar.

But you will assuage yourself by looking at exchange rate forecasts and say the professionals don't expect a decline. But as they said in Monty Python's Flying Circus, "Nobody expects the Spanish Inquisition". It is a piece of cake to deliver a scenario in which the Kiwi dollar drops 10% or so. EG...

- President Trump attacks North Korea, the North Koreans lob missiles at South Korea and Japan, then China gets involved.
- President Trump decides to blockade Chinese access to the islands which the Chinese have created and turned into military bases (nice one Barack).
- The Wellington earthquake comes.
- Our central bank somehow engineers things to get the lower currency they (always it seems) want.

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/

Enjoy Easter.

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. **This edition has been solely moderated by Tony Alexander**. To receive the Weekly Overview each Thursday night please sign up at www.tonyalexander.co.nz
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