BNZ Weekly Overview

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Mission Statement

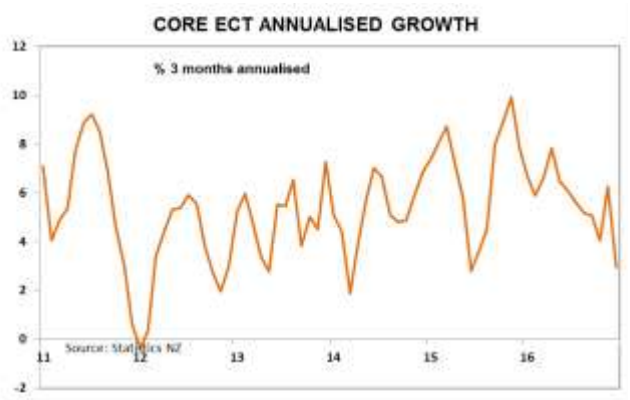
To help Kiwi businesspeople and householders make informed financial decisions by discussing the economy and its implications in a language they can understand.

Retail Spending Strong – Sort Of

Fresh economic data have been fairly thin on the ground this week. We learnt that core retail spending using debit and credit cards rose 1.4% in April to deliver an annualised pace of growth in the most recent three months of 5.4%. This is slightly below the average of 5.6% but not by much. Basically people are out there spending money. But there are two indications that things are not as rosy as one might think when extrapolating the implications of the employment and migration booms.

First, the average annual net migration gain since 2004 has been 21,000 and it is over that period of time we calculate the average 5.6% rate of growth in debit and credit card spending. The most recent net migration gain of 72,000 represents an extra 1.1% boost to population growth – yet this is not showing up in this specific measure of household spending growth.

Second, the annualised pace of growth in spending on durable goods was only 0.2% in the three months to April. This is not what we would expect to see given the factors mentioned above.



There is some caution being shown by spenders and that means retailers need to be cautious in their revenue growth expectations as well. Of course when it comes to profit expectations it is hard to be all that optimistic.

Retailers are having major difficulties maintaining margins in an environment where all of us shoppers can easily find alternatives to many of the goods we are used to buying. The cost of searching for an alternative price for a good or service is virtually zero and that means that even if the increase in price a retailer undertakes is matched by other retailers, the first one may not get the sale because we will have been exposed through our search to alternative suppliers we may not have considered before.

Thus the availability of smartphone technology lowering search costs not only can prevent price rises from occurring, it can also reduce customer loyalty. Maybe this is why so many retailers are trying to get our email addresses, sign us up to loyalty cards, and bombard us with emails.

The fact that the Electronic Card Transaction data are actually weaker than the headline numbers and historical comparisons would suggest perhaps is one reason why the Reserve Bank surprised the markets this morning in their Monetary Policy Statement.

Analysts had been expecting the Reserve Bank to acknowledge the strong labour market, weaker currency, rise in commodity export prices, and lift in inflation and inflation expectations by changing their bias from neutral to tightening. They did not and instead they left their forecast timing for the first rise in the official cash rate from the current 1.75% in the second half of 2019.

We think they will find the need to move earlier than that but for now they appear to have attached a continuing high weight to the risk of weakness stemming from the potential for shocks overseas and continuing global excess capacity.

They also have noted that the recent jump in inflation to 2.2% was due in large part to hikes in petrol and food prices which are expected to reverse. Perhaps then some more importance needs to be attached to the core inflation measure we noted a few weeks ago of the CPI excluding food and energy which has risen just 1.6% in the past year. This is less than other core measures which rose near 2%.

For now the Reserve Bank's maintenance of a neutral policy stance (meaning they see the same chances of the OCR having to go down as up) takes off some of the underlying upward pressure on bank lending rates. But it is not the cost of money which is the problem for many borrowers out there but the availability of finance.

Credit availability is getting worse and more tightening is set to come. Banks operating in New Zealand need to further reduce dependence upon financing by foreigners. Ahead of the GFC 40% - 45% of all the money we were lending to Kiwis had to come from people overseas. This is because we Kiwis are very poor savers and love spending.

That ratio has now fallen to a less worrying 29% but even that level is still too high. Just two days ago the IMF noted that New Zealand's continuing high dependence upon lending by foreigners is a key vulnerability for the economy.

The trouble is that the ratio has started going back up again. This is because there is strong demand for credit from an expanding business sector. But to lend domestically we need to fund domestically. However Kiwis are showing themselves to be very reluctant to save more even when special term deposit rates are offered.

What this means is that there has been and will continue to be upward pressure on lending rates regardless of what the OCR does and it is worth noting that bank interest rate margins have still shrunk recently. Maybe this de facto tightening of monetary policy on top of the tightening coming from the LVRs also helps explain the Reserve Bank's relaxed attitude toward the potential for high capacity utilisation and declining availability of labour causing inflation to accelerate.

Speaking of high capacity utilisation. I am well into my peak speaking season now which will run for maybe four months. Last week the talks were in Auckland, this week Auckland, Blenheim and Nelson (tomorrow) and Christchurch on Wednesday. Next week Queenstown and Auckland then Wellington the week after.

In Christchurch businesses appear to be very busy by and large and while house building is slowing down commercial construction still seems to be lifting. The BNZ building is up and running on Cashel Street and slowly other businesses are moving back to the CBD. But there is still a long way to go before things will be properly functioning again and a key part of the new city looks like being a shift of the centre away from Cathedral Square with its broken church which looks like sitting there for decades, toward the farmers market planned for the retail space which had been occupied by containers.

A tourism operator noted to me that young people still seem to be bypassing the city. That got me to thinking about the importance of getting the night scene back up and running, concentrated once again near the Avon River near Cashel Street. That then got me to thinking that Christchurch has yet to properly participate in the surge in the tourism industry over the past three years. Eventually it will and when that happens the image of Christchurch as a work in progress is likely to be quite different from now.

That then got me to thinking about the way in which Auckland has become and is set to become more and more congested. My theory is that in 3 – 5 years time there will be an interesting movement of people out of Auckland to or back to Christchurch – into a rejuvenated city properly up and running. This won't make much impact on Auckland but it will amplify the Christchurch recovery.

That then got me to thinking about Wellington. Our capital is in very good mood currently, partly because of rapidly rising house prices making most occupants feel clever, and the development of the road network north of the city. Pity about the failure to improve the link between the CBD and the airport. Development of the Kapiti Coast Airport will be a good long-term development.

The interesting thing about Wellington is this. Things are panning out as I expected a year or so ago when I wrote that Wellington was due for a catch-up surge in house prices assisted by young people realising working there could still place them well on the corporate career ladder of their choosing – like Auckland. But this period of a catch-up surge in prices is somewhat clouding the true relevance of what we learnt on November 14 from the Kaikoura earthquake. We have not only been reminded that the location is seismically unstable, businesses have had to think more deeply about their continuity plans. They are having to think that even if the building they are in is a good safe one, ready for when the proper Wellington earthquake strikes one day or we get another Kaikoura event, that they will close down for some time still because the city will be out of action.

This shift in the minds of many in the desirability of operating in Wellington has not received much attention. That is partly because of the clouding effect on sentiment and commentary of the house price surge, but also because of human politeness. It is simply rude to speak about longer term negative implications of disasters. We avoid the topic.

Example? My quick mention two or so years ago about the cost of getting a cab from Christchurch airport into the CBD which brought a clip around the ear warnings that you can't say something negative about post-earthquake Christchurch. That attitude means that not enough people are likely to be seriously enough thinking about what is going to happen in Wellington over the next few years.

Some businesses are going to shift or expand up the coast. (Some will shift to Christchurch.) The Wellington region's economic centre is going to very slowly drift northward – not as far as Auckland given the congestion problems there, but somewhere up the Kapiti Coast. Astute investors know that and they have been buying land for some years. Levin knows it and the council and people there have long been planning for the effects of the better link with the Capital.

Similarly, as mentioned here previously, towns between Auckland and Hamilton and investors looking for long-term gain are in no doubt what the implications for growth are of the surging growth in Auckland's population and the still improving motorway/expressway link with Hamilton.

Infrastructure development is a key driver of not just where economic growth will occur, but the very sustainability of growth. If capacity is not expanded growth becomes compromised – and that is the key problem for Auckland. Central government explicitly views Auckland as a key driver of New Zealand's economy over the long-term. But unless funding for development is radically boosted then the city is going to start falling down the list of the world's best places to live. Is such a boost imminent? No, and the best example of the reluctance of central government to act was the indication that funding will be provided for a light rail system from the CBD to the airport – but only after another one million people get crammed in.

As discussed in the series of articles I wrote five or so years ago looking at impediments to growth in the New Zealand economy – our lack of long-term thinking holds us back. Unless thinking about Auckland's worsening congestion changes and willingness of central government to act improves, then the lives of Aucklanders in five, ten, and 20 years from now will be worse than they currently are on average.

NZD

As a currency which tends to get bought when investors feel relaxed about the world and sold when the heeby geebies appear, recent developments have been supportive of our currency. The failure of Marine Le Pen to get even close to winning the French Presidential election has completed a run of voter movements back from the nationalistic brink on the European continent. The prospects of a world moving toward protectionism and broad anti-foreigner sentiment to the degree feared has gone down.

In addition last Friday night's US employment report was a strong one with the unemployment rate falling to a ten year low of 4.4% and job growth above 200,000 in April.

On the other hand, the discovery of myrtle disease in Northland has some dire implications for the currently booming manuka honey sector which has lifted total honey exports from New Zealand above $300mn and caused prices even for clover honey in our shops to shoot skyward. Back to Marmite I guess.

Growth of tourism receipts in the near future will be constrained by a lack of sector capacity. Growth in dairy receipts will be restricted from here on by strengthening environmental controls.

Plus of course we have this morning's decision by the Reserve Bank not to adopt a tightening bias for monetary policy. Thus currently the Kiwi dollar is one cent lower than it was on Wednesday near US68.5 cents which is down just slightly from 68.7 cents a week ago.

Compared with a week back the NZD has declined slightly against a Euro supported by the French Presidential election outcome. We are also slightly down against the British pound near 52.8 pence from 53.4 and 55.5 four weeks back with the Pound benefitting from expectations that the expected strong win for the Conservatives against the largely Marxist UK Labour Party will give a stronger mandate for hard positions to be taken in the Brexit negotiations. We of course await Russian interference in the UK election and wonder if they will try the same down here should they remember we exist.

If I Were A Borrower What Would I Do?

This week has reminded us that there are uncertain things hitting our economy and financial asset prices all the time. Myrtle Rust disease. President Trump sacking the FBI Director. The RBNZ not adopting a tightening bias. Australians making life even harder for Kiwis across the ditch. The Auckland Council trying to levy 100% of a rates burden on a group less than 10% responsible for incurrence of the Council expenditure (and seeming not to realise many hotel units are owned by investors who lease them to the hotel at fixed rates for fixed terms and not the hotel itself.)

So lets repeat the warning we have been delivering for seven years now. In an environment of low predictability, where old relationships between key economic variables have changed in ways we can't yet measure or explain, forecasting has become very, very difficult. One would be very foolish to adopt an interest rate risk management strategy which is highly dependent upon a particular set of interest rate forecasts coming true.

It is best to seek to spread risk by taking a range of fixed interest rates and getting debt levels down as quickly as possible just in case interest rates surprise on the upside.

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. **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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