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.

Budget 2017

Clearly the focus of most people writing today about the NZ economy is going to be on the Budget. The details are readily available to anyone who wants them online but we can summarise this afternoon's news as follows, with a preamble.

It is an election year, so the natural bias is toward boosting spending and cutting taxes or levies.

Because of good fiscal management structures put in place a generation ago the NZ Crown has run a surplus now for three years in a row and with our economy doing very well these surpluses are projected to grow and grow. Therefore it has been appropriate to start using the growing surpluses for more than just cutting Crown debt and boosting ability to handle the next major disaster. There is no pressure on the government to seek new sources of revenue as is the case across the Tasman where fiscal management has been poor and ability to cut spending constrained by the balance of votes in the Federal Senate.

There has been rapid growth in the NZ population recently courtesy of very high net immigration, and it looks like strong growth is set to continue though at a slowing pace. It is appropriate to address the strains being placed on the country's infrastructure and public services by boosting spending across most areas.

There is no need however for a stimulatory package per se given that the economy is already growing strongly, jobs growth has been stellar, and the economy is increasingly limited to growing now at a pace which resources such as the transport network, environment, and labour supply allow.

With these factors in mind Treasury project that the operating surplus excluding special factors will rise from an estimated 0.6% of GDP in the year ending this June 30 to 1% next year, 1.4% the year after, 2.0% in the year 2019/20, and 2.2% come June 2021. This is a very positive fiscal track which will be the envy of the oh so many poorly managed government accounts overseas.

At issue however is the economic growth track underpinning projected growth in revenue and containment of some expenditure. GDP growth is picked by Treasury at 3.5% in the coming June year, then 3.8%, 2.9% and 2.4%. We think there will be more restraint on growth from capacity limitations than allowed for by Treasury. That suggests more inflation than they have pencilled in of 1.6%, 2.1%, 2.2% then 2.1%. That in turn suggests their forecast of the Reserve Bank only slowly tightening monetary policy and taking the current 2% 90-day bank bill yield to 2.7% in June 2019 and 3.9% in June 2021 may be too slow. The end-point seems reasonable.

Net Crown debt is projected to fall from 23.2% of GDP to 19.3% with a target of below 15% mid-2020s.

The Budget includes a wide range of new spending, capital investment, and taxation changes driven by the factors mentioned earlier, and collectively the proposals will produce a fiscal impulse of 0.4% of GDP in the coming year, 0.5% after that, then negative stimuli from 2019/20.

There is a strong lift in infrastructure spending of 40% in the next four years compared with the previous four. The $14,000 income tax threshold for the 17.5% rate has been lifted to $22,000, and the $48,000 threshold for the 30% rate to $52,000. Those changes highlight the way in which the giveaways are focussed at the lower end of the income earning spectrum. There are also boosts to the Accommodation Supplement, Working for Families and Accommodation Supplement.

Treasury forecast that average NZ house prices, having risen 14% over 2015/16 and 5.1% over 2016/17, will rise over the next four years by 7.8%, 3.9%, 3.1%, and 2.2%. Looks good from an investor's point of view contemplating a still low interest rates outlook. Not so good for young home buyers, especially with only a small lift in average wages growth predicted.

As mentioned, for further details you won't have to look far on the web.

On top of the slight stimulus to the pace of NZ growth to come from the Budget (including facilitating growth through improving infrastructure eventually), we also have a new boost running through the economy of a $4bn rise in dairy sector receipts. International prices have recovered well in recent months and on Wednesday Fonterra confirmed a $6.15 payout for the season just ending and projected $6.50 for the season coming. Last season the payout was only $3.90 and before that $4.40. Before that it was $8.40.

Increased revenue for dairy farmers is likely to be devoted first to getting debt levels down however after a couple of scary years, so the extent of the regional economic stimulus will initially be quite limited.

Regarding our second biggest export earner, tourism, the news remains good there. In seasonally adjusted terms visitor numbers firmed by 3.5% in April after rising 1.9% in March, delivering 1.4% growth over the past three months versus the three months to January.

We also learnt late last week of a small recovery in consumer confidence in May according to the ANZ Roy Morgan measure. It now sits at 123.9 from 121.7 in April and a ten year average of 117. This result is suggestive of continued good growth in retail spending after a strong gain in core spending of 1.2% in the March quarter and 5.2% in the year to March – real seasonally adjusted.

A couple of weeks back we also saw the release of some very strong numbers for non-residential consent issuance. In March these consents totalled a record $837mn and for the year to March grew by 11.2%. The number of residential consents rose a seasonally adjusted 5.2% in the March quarter.

And a bit before that we learnt that NZ employment grew 1.2% over the March quarter to be over 4.5% ahead for the year.

The positives keep flowing – which is a key reason why we expect the net migration numbers to remain good for quite a while longer. The issue is this. When will the pressures on resources cause a surge in inflation, how high will interest rates have to rise to contain these pressures, and will the peak in interest rates lead to a recession by initially pushing the export sector under with a soaring NZD and then hitting the domestic sector?

As long as the decline in inflation we have observed in recent years is structural then the threat from high interest rates is minimal – and that is what we believe. However, should inflation surprise upward then history suggests that has greater capacity to bring a sustained shock to the economy than some disturbance in world growth perhaps associated with China's military expansion through its neighbouring seas.

If I Were A Borrower What Would I Do?

The Budget has not made me more worried about inflation. I would still be happy to have a mixture of a floating rate and either a two or three year fixed rate.

Briefly, does the Budget imply a different NZD outlook? No. Any impact seen today will be lost in the wash almost immediately.

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/