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 Construction Failure

Here is an interesting little development. We all know that house building in Auckland has increased quite a bit in recent years and that a lot more building has to happen. The impression one gains is that Auckland is the centre of house construction in New Zealand (excluding the special circumstances of Canterbury) and that in the regions not much is happening. Not true.

If we go back to the bad depths of the construction collapse in 2011 we see that nationwide consents issued for new dwellings to be built were at a four decade low near 13,500 from a 20 year average of 22,000. Consents now total just under 31,000.

Compared with 2011 Auckland consents have risen by 168%. In the regions (ex. Auckland and Canterbury) growth has been less at 96%. But here is the interesting bit.

At just over 10,000 the number of consents recently issued in Auckland was 35% above the 25 year average. At 14,800 the number of regional consents was 33% above the 25 year average. If we were to allow for the superior population growth of Auckland versus the rest of the country we would find that in terms relative to experience of the past quarter of a century, the strength of house building activity outside of Auckland is greater than in Auckland.

Moreover, after reaching average consent numbers of 7,500 right at the end of 2014 Auckland did not hit 35% above average until 27 months later. In the regions average was reached right at the end of 2015 and 33% above 16 months later. The speed of supply response in the regions is much faster than in Auckland. Almost twice as fast.

So efforts made to boost house construction in Auckland as a special case versus the rest of NZ have failed. (Just like infrastructure planning and execution in Auckland is a failure which will degrade living standards via congestion and environmental damage more and more.) Auckland house building activity lags other parts of the country in terms of both level and speed of growth. From this we drag out three implications which we have long highlighted. They are not new.

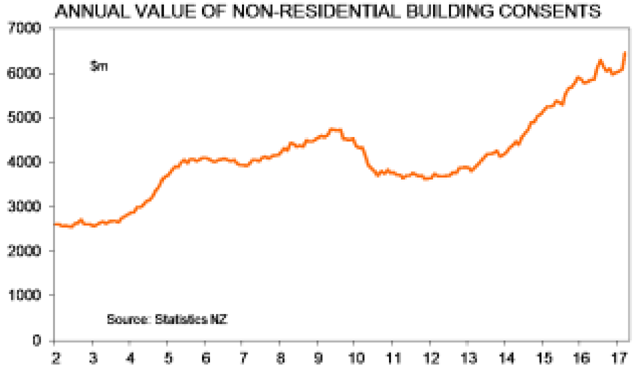
First, Economics 101 has long told us what this means for Auckland house prices. They rise. The pace of rises has been slowed by Reserve Bank intervention and buyers have more stock to pick and choose from this year. (See graphs on the next page.) But they will continue to rise after some adjustment this year in largely low socioeconomic locations which have been targeted by investors now finding their assets not being chased by other investors – because they can't raise the finance.

Second, outside Auckland, be careful. There is a housing supply response to increased demand which has not happened and will not happen in Auckland. There is more danger of house price corrections and failing projects caused by over-optimism regarding end-demand and prices in the regions than in Auckland.

And third, Auckland house construction is not as stellar as the politicians might want us to believe, but activity will remain strong for a far longer period of time than in the regions where this current surge in construction will not persist beyond this year and next.

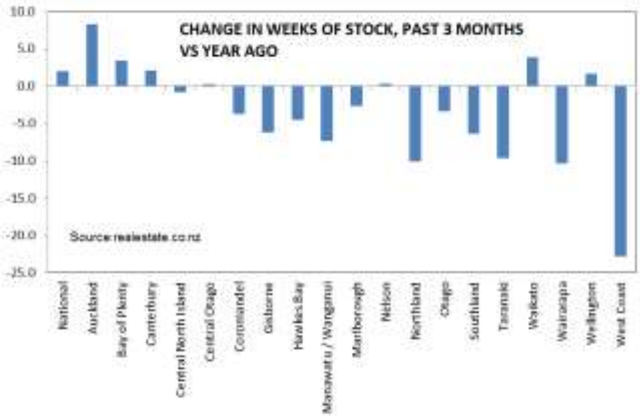
This strength in activity is also going to be present in the non-residential construction sector. In March the value of consents issued for the construction of non-residential buildings was the highest on record at $837mn. The monthly average is just below $400mn a month. Driving the huge number was a record value of consents issued for hotels and motels of $167mn, a high $191mn worth of consents for office buildings, $104mn for hospitals etc., and $102mn for shops and restaurants.

In the six months to March non-residential consents were ahead by 15% from a year earlier and at $6.5bn the annual total was the highest on record and up 11% from a year ago.



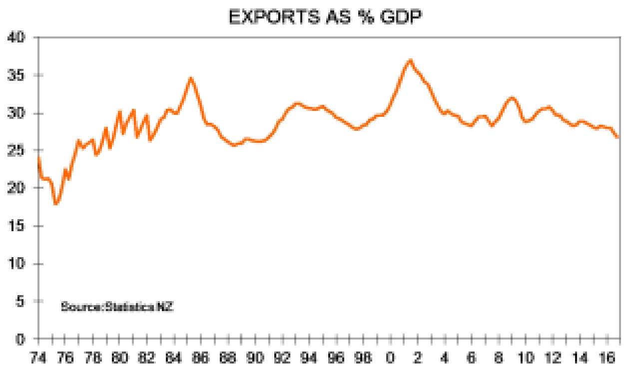
People in the construction sector are going to be busy for a long time. If you can swing a hammer, know which way to turn to tighten a screw, and can stay sober and off drugs, there is a job for you.

These two graphs come from realestate.co.nz showing how the inventory of housing listings has changed compared with a year ago (up near 40% in Auckland), and how measured in terms of weeks worth of sales the stock levels have changed.



Speaking of Auckland house construction and government infrastructure provision failures discussed above, here's another one. The government has a target of raising the ratio of exports to GDP to 40% by 2025. When this target was announced we said there was little chance of it being achieved. Whatever chance there was has now become even lower.

The denominator in the equation of nominal GDP has been boosted by the acceleration in NZ population growth from three years ago raising nominal GDP. The numerator of goods and services and export receipts has been hit by the pullback in dairy prices from earlier unrealistically high levels. In 2016 the ratio had fallen to 26.8% from 28.2% in 2015 and 30.8% five years ago in 2011.



The ratio has trended nowhere since the late-1970s and there is little chance of it rising much in the coming decade. The country has reached limits on fast growth in our two biggest export earners – dairy and tourism. The latter is limited by accommodation shortages. The former by a growing backlash against the sector because of the pollution it is producing.

It will be interesting to see if the way in which investors and lenders are curtailing exposure to industries like coal production spreads to dairying, a sector which employs just over 40,000 people plus on-farm business owners.

Google "NZIER dairy report 2017" for the best up to date overview of how important this sector is to our economy. Look for the February 21 2017 pdf link.

Read the summary and you'll understand why the most important area for farm research in NZ has to be controlling dairy sector pollution. Dairying accounts for 3.5% of our GDP, export growth has averaged 7.2% per annum over 25 years, jobs growth has been faster than the NZ average since 2000, wages are high by farming and manufacturing standards, and the sector strongly underpins many NZ regions.

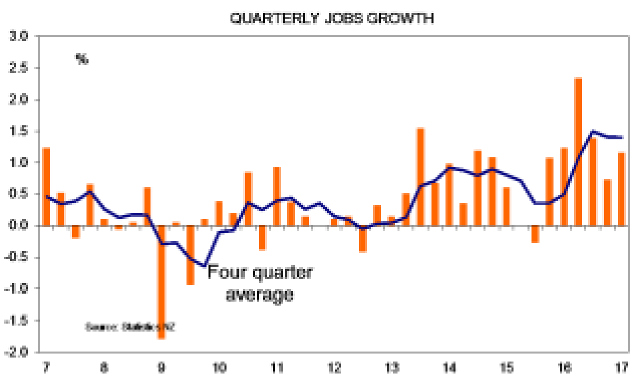
Here’s hoping the scientists can develop pollution-controlling techniques faster than growth in first the public backlash against the sector, and as a result of that the coming policy hits should a Labour-Green government be formed. Under National, with its many farming MPs, tighter anti-pollution legislation is not much likely.

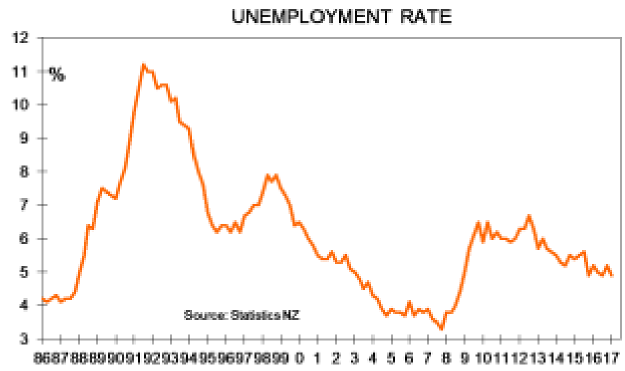
Jobs Market So, So Strong

Yesterday we learnt that employment in New Zealand grew by a very strong 1.2% during the March quarter with full-time job numbers ahead 5.9% from a year ago and part-time jobs ahead 5%. Compared with the low-point in the labour market cycle in late-2009 total job numbers have risen by 422,000 with full-time jobs accounting for 88% of the rise.

As pointed out previously, this strong growth in secure employment stands in stark contrast with jobs growth overseas which is dominated by part-time, casual, and zero hour contract employees. The solidity of the NZ labour market is a key factor behind the Trans-Tasman migration flow in the past four and a half years going from -40,000 to +1,000. Of Australia’s jobs growth since 2009 only 54% is accounted for by full-time jobs.

New Zealand’s unemployment rate has fallen to 4.9% from 5.2% a year ago and in the December quarter. The employment rate, which measures the proportion of the working age population in work, has risen to another record of 67.1%. The previous peak was 66.1% in 2007.

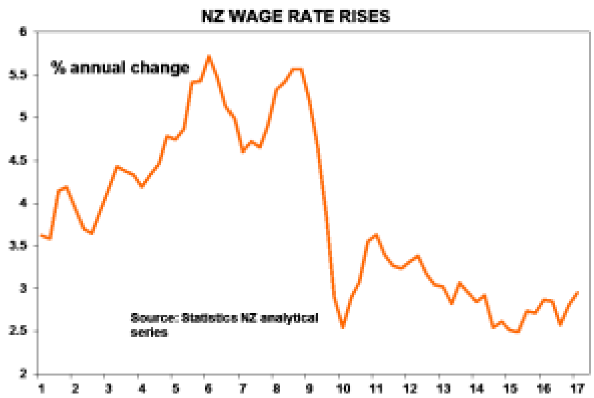




The proportion of people 65 years of age and over still working has risen further to 23.9% from 23.6% in the December quarter and only 5.8% in 1998.

What are the implications of this strong labour market? More consumer spending. More demand for housing. More offshore travel. More difficulties for firms already struggling to find skilled and unskilled staff. No evidence that migrants are keeping existing people in NZ out of the workforce. More upward pressure on wages, inflation, and interest rates.

But with regard to that last factor, yet again we have to report that there is only the barest statistical evidence of an acceleration in the pace of average wages growth in New Zealand. The change from a year ago in the measure we look at which captures unchanging jobs, the Labour Cost Index Analytical series, was 3.0% in the March quarter. A quarter earlier the annual change was 2.8%, a year ago 2.9%, and four years ago 3.0%.



The pace of wages growth in New Zealand needs to rise. It needs to accelerate not just so people can afford the high cost of living in this country but also so that firms unable to pay higher wages because their profits are low close down and the staff can go to other businesses running higher profits and able to pay more. This is a very important element needed to boost productivity growth in New Zealand – shifting labour from low return to high return areas.

Train to the Airport

The government's plan is that in three decades time when Auckland's population has increased by one million people they will build a light rail line between the CBD and the airport. Ridiculous.

I have to be missing something important here, but cannot a line be built from the Puhinui Station on the Southern Line to run into the airport. The train takes 33 minutes to get to Puhinui Station from Britomart and probably another three minutes would be needed to reach the airport as the extra distance looks only to be two times the length of the runway. Failing construction of a short line to the airport, it seems to me that there is a business opportunity here for someone to set up a shuttle service from that station to the airport for maybe $5 a head or less. Just a thought.

A housing-related link.
http://www.valuersnelson.co.nz/news-publications/property-news-1-may-2017#2

If I Were A Borrower What Would I Do?

If we were back before the 2008 GFC the news yesterday that job numbers shot up 1.2% during the March quarter and the employment rate hit a record high would send us typing warnings about quickly rising inflation and the value of fixing your interest rate as long as possible. But this is the post-GFC world and fast jobs growth is not producing accelerating wages growth.

Maybe this is because employers know they will struggle to get price increases past customers who will actively seek cheaper alternatives online. So they push back hard against wage demands. Maybe staff don't seek bigger wage rises because they worry about events offshore. Maybe the way in which people work these days of shuttling between teams and firms rather than sticking with one outfit means bargaining for a wage rise is not that important any longer as a way of boosting income. The plan is more and more to move to get ahead rather than negotiate in situ.

Whatever the reasons, while all our pre-GFC experience and economic theory tells us that the ongoing tight labour market will boost wage inflation, experience since 2010 tells us that the extent of any acceleration will likely be minimal.

Thus, personally speaking, I remain of the view that if I were borrowing at the moment I would favour fixing most of my mortgage for two or three years and placing a portion floating and/or at a cheap one year fixed rate.

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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