BNZ Weekly Overview

10 August 2017

ISSN 2463-4328

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.

Low Borrowing Costs To Stay

The Reserve Bank this morning undertook their three monthly review of the state of the economy and near six weekly review of the official cash rate. The economy they conclude in their Monetary Policy Statement is in good shape but inflationary pressures are both low and less than they were thinking back in April. The official cash rate they have again left at the 1.75% it was taken to in November last year.

The underlying story for monetary policy in New Zealand and almost all other countries since 2010 has been that inflation near persistently surprises on the low side and monetary policy tightenings have had to be reversed and/or projected tracks for increases scaled back.

In New Zealand over two months in 2010 the RB took the cash rate from the 2.5% it was taken due during the depths of the GFC to 3.0%. The move was quick because realisation had yet to set in amongst any of us that the inflation dynamic had changed – weakened. These days for reasons we still cannot adequately explain or necessarily treat as permanent, firm economic growth and/or firm jobs growth is not leading to much increase in inflation.

In March 2010 the RB cut the cash rate back to 2.5% with the second Canterbury earthquake being the trigger. They would have cut even without the event.

They had another go at raising the rate between March – July 2014 (again quite quick) but this time by 1% to 3.5%. Then they cut it back to 2.5% between June and December of 2015 before slashing it to a record low of 1.75% by November 2016 despite reported economic growth of close to 3%.

The rate this morning was left at 1.75% as had been universally expected and the projected time for raising it was left at late-2019.

So what does all this mean? For borrowers it is good news. But there are likely to be small rate rises here and there and further minor tightening up by lenders of the types of lending they do and the generosity of terms in response to

- ongoing difficulties raising deposits in New Zealand and
- continuing long-term tightening by central authorities of bank funding and lending rules.

For term deposit investors the news is bad and likely to stay that way for not just the forecast three years before rates start to rise, but even after that. Chances are that when the tightening cycle is one day done the magnitude of rises will be small. The chances that term deposit investors will again see 6% rates are quite slim. 5% is probable in three or four years time.

This means investors are going to continue to face an incentive to seek other assets which is good for the managed funds sector. Property prices are likely to remain underpinned though buyers should not anticipate that the RB will be easing LVR restrictions anytime soon.

The RB explicitly note “House price inflation continues to moderate due to loan-to-value ratio restrictions, affordability constraints, and a tightening in credit conditions. This moderation is expected to persist, although there remains a risk of resurgence in prices given continued strong population growth and resource constraints in the construction sector.”

While this risk persists they will remain cautious.

For the NZD there was no impact from this morning’s cash rate review and Monetary Policy Statement as near everything was as expected beforehand.

Ironies and Changes

We all hear and read a lot about how things are changing around us all the time. Sometimes it is disruptive technologies, other times societal shifts in attitudes toward and treatment of particular groups, the changing behaviour and challenges for different generations, new governments, new conflicts, and so on. In the field of economics everyone jokes about forecasting errors and the absurdity of trying to pick the future with accuracy. Yet people still like to believe that we economists do know something important and that we are worth listening to.

Fine. But it pays to acknowledge that a lot of what we postulate is based upon assumptions about how the world around us will develop. Often these assumptions prove wrong and in our field currently there are probably more such assumption/trend changes occurring than we have ever seen.

Here are a few of them.

USD Demise

No. The USD was supposed to be eclipsed by other currencies. But it remains solidified as the globally favoured store of value, medium of exchange and currency of denomination for commodities. The potential Euro replacement has fallen out of favour following talk of the zone breaking up. The Yen ceased being a serious candidate two and a half decades ago. The Chinese Yuan remains a managed currency of an increasingly controlling and assertive single party state which uses trade as a tool of influence on behaviour in/of other countries. Note that this underlying support is outside the current market reality where a pullback in expectations for US growth and monetary policy tightening is causing the USD to fall in price against other currencies.

House Price Collapse From Boomers Selling

No. For two or three decades people have wondered to what extent average house prices would decline as a result of retiring Baby Boomers downsizing and selling their housing assets. The opposite has happened and they are now partly-blamed for pushing prices higher. (Before that it was insufficient land supply. Before that Chinese buying. Wonder who the finger will point at next.) Their buying has been spurred by a search for alternative assets with better complete yields than term deposit rates at 1960s levels, and assets to help finance retirements expected to last a decade longer than the previous generation.

NZD Long-Term Decline Because of Falling Terms of Trade

No. Up until dairy prices soared a few years back the almost unanimous view was that the Kiwi dollar would trend downward over time to reflect falling export prices compared with import prices (the terms of trade). A former Prime Minister in 1988 described farming as a “sunset industry”. But now our terms of trade are set to soon hit a record high above 1973 levels and the world seems envious of our trade differentials. Namely, we export quality food products for which global demand is rising. We import increasingly cheap manufactured goods benefitting from the price impacts of the global supply chain, cheap labour, robotisation, etc., and increasingly cheap energy.

Lowest Mortgage Rates Since The 1960s a Boon For New Home Buyers

No. Just the opposite. Low rates have brought a wave of investors into residential property seeking yield and first home buyers have been squeezed out not just by high prices, but since late-2013 by new credit controls aimed at controlling house price risks. Having said that, those rules have mainly impacted upon investors – but the price rises have already become locked into the market and continued low interest rates mean there is little pressure on existing investors to sell and address cash flow issues.

Peak Oil

No. No-one uses this term which up until a couple of years ago cropped up in most environmental, economic, and energy discussions. Now the popular term is “peak demand” – the soon to come year when demand for oil maxes out and then falls as users switch to alternative energy sources such as wind, solar, and gas assisted by improving battery storage.

Printing Money Causes Hyperinflation

No. Money printing by the Bank of Japan, Federal Reserve, Bank of England, and European Central Bank appears instead to have brought or accentuated the risks of deflation. This has happened because a world awash with cash and investors seeking anything with yield has allowed businesses to find finance and remain in business in spite of weak product demand for a lot longer than would normally be the case. Money printing has produced excess capacity and over-supplies of many manufactured goods, causing price declines.

Unitary Plan To Radically Boost Auckland House Construction

No. While the plan does provide space for enough intensification and new land to allow construction of 420,000 dwellings, in reality construction of sufficient volumes is prevented by insufficient labour resource and a cutback in property development finance from banks. Unfortunate timing.

Export Dependence Upon Farming Means Net Migration Losses

No. The migration trend has changed to ongoing gains. Export dependence upon primary exports remains as great as ever. But other sectors have boomed and export prices have been trending upward since the 1990s.

Communication Technology Means Most People Working Remotely

No. Instead more and more people are crowding into existing big cities – a process known as agglomeration (not the same as urbanisation). This is because technology is not static. Changes are swift and business competition is greater and faster. To stay near the forefront of developments people need to work in ever-changing teams, collaborate in ways not done previously, and try to develop and lead technology changes rather than be affected by them. The technological revolution is promoting aggregation of populations, not dispersion.

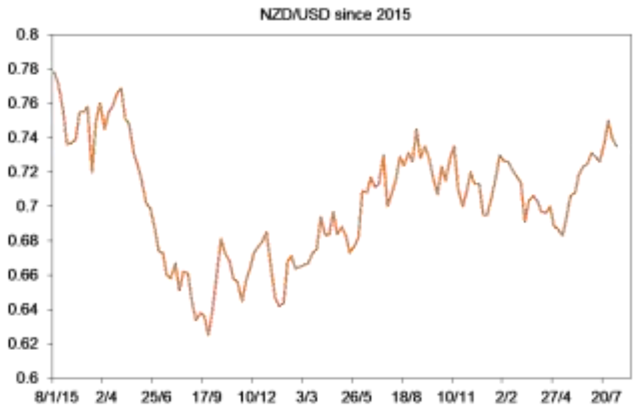
If I Were A Borrower What Would I Do?

Nothing new given that there was nothing new in the Reserve Bank's writings this morning beyond perhaps some noting of how key factors which have previously driven inflation do not work the same way these days.

Were I borrowing currently I would look for a mixture of one and two year fixed rates with a tad floating and a tad fixed three years for insurance.

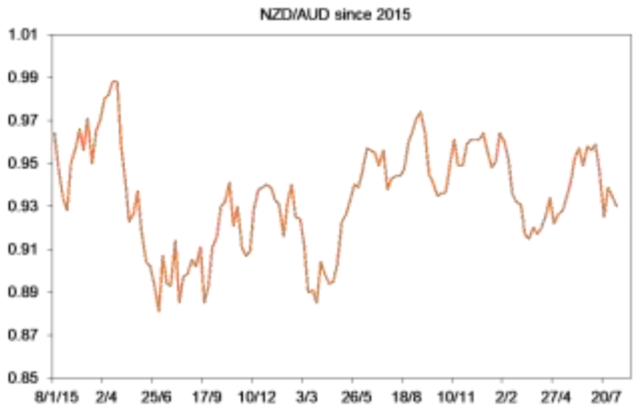
NZ Dollar

The Kiwi dollar this afternoon was trading against the USD near 73.5 cents from 74 cents last week and 75 cents two weeks ago. 13 weeks ago it was at 68 cents.



The trend since late-2015 has been upward and with our terms of trade set to hit a record level and the Reserve Bank forecasting an acceleration in the pace of economic growth, it seems reasonable to expect that this upward trend will continue.

Against the Australian currency we are near 93 cents from 93.5 last week and 94 cents two weeks ago.



There is no clear trend. But it would not be surprising if we were to rise back toward 98 cents. Here is one reason why. BIS in Australia this week forecast that the number of dwellings being built around Australia will fall 31%. In contrast, MBIE in this week's National Construction Pipeline Report predict a near 12% rise in NZ dwelling construction over the same period.

Personally speaking, on the other crosses I have no particular view other than perhaps anticipating mild NZD appreciation (Pound, Euro, Yen).

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
To change your address or unsubscribe please click the link at the bottom of your email. Tony.alexander@bnz.co.nz