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.

No Monetary Policy Surprise

This morning the Reserve Bank reviewed their official cash rate and released an updated set of economic forecasts in their Monetary Policy Statement. This was a tricky outlook to prepare for the Reserve Bank. There are many factors which suggest that the outlook for inflation has moved up. Fiscal policy is to be loosened, the minimum wage rate is to rise at a faster pace, the currency has depreciated a bit, the labour market has tightened further, and world growth forecasts have recently been lifted.

But there is restraint on growth from credit restraints, the recent decline in business confidence which may or may not be sustained, the easing in the housing market, a slight decline in two year ahead inflation expectations, and cyclically declining migration-driven population growth.

Taking all these and other factors into account the Reserve Bank has made only the barest alteration to its previous set of forecasts showing that the 1.75% official cash rate will start to be raised at the end of 2019. If one looks hard enough then they could have allowed for a rate rise slightly earlier than that.

Frankly though it is neither here nor there. We reckon that eventually they will have to shift their timing for tightening forward with the most likely start date for rates rising being sometime in the second half of next year.

The outlook is largely good news for borrowers with rates holding steady for quite some time yet. This will help underpin growth in the economy. For savers however the news remains bad and we can expect that once uncertainty surrounding the election eases off we will see investors once again looking for yields outside those offered by bank term deposits.

For the record, the Reserve Bank forecast that the NZ economy will growth by 3.8% in the year to March 2018 then 3.1% and 2.8% in the following two years. They see the annual pace of inflation at 1.5% in March next year then 2% for the two March years after. The unemployment rate is seen falling from the current 4.6% to hold steady near 4.4% while the household savings rate is seen remaining negative until March 2020 when it may hit a positive 0.6%!

Housing

Just a reminder this week of the macro trends people need to be aware of so hopefully some reasonable perspective can be gained when news items appear. The big trend is flattening of the housing market in Auckland from over a year ago with low activity and average prices drifting up at a slow yet up and down pace for the next five or so years. The rest of the country will follow in fits and starts over the coming year.

The ending of the period of strong price rises and buoyant turnover reflects the simple ending of the cycle associated with the ending of FOMO (fear of missing out) driving buyers, and new rules dissuading some buyers and keeping others locked out of buying. These rule changes are the LVRs introduced by the Reserve Bank – especially last year's 40% minimum deposit for investors - and more recent tightening of lending criteria by banks.

The next bout of rule changes will be initiated by the government and apply almost exclusively to landlords apart from the ban on foreign buyers. These rules will raise costs for landlords and make management of their properties more difficult. As a result many of the inexperienced people who have bought in the past four years will look to sell out. This will provide some opportunities for astute buyers who have an incentive to throw in low ball offers. Such buyers include first home seekers who now face an interesting psychological challenge.

FHBs have faced intense competition for stock but that competition has now faded. But, FHBs are now reading stories from some writers suggesting prices may fall a bit.

First of all that means they feel little FOMO. They feel time is on their side, and it is. But the risk is that FHBs get overly optimistic in their dreams of prices falling away. There is simply not enough labour in New Zealand to build the 40,000 – 50,000 houses desired by the new Housing Minister. In fact the labour market is not only tight but being tightened even further by the new government.

- Immigration cutbacks
- Extending parental leave
- First year tertiary study free
- Boosted spending on infrastructure and tree planting
- Easing of pressure on welfare beneficiaries

Note there will be a few extra people drawn into the labour market by increases in minimum wages. But there is already a record proportion of the working age population in work and feedback from employers suggests that not only are too many applicants suffering from drug problems, they turn a blind eye to drug use by some of their current staff.

That poses a huge risk for employers should an accident occur through fault of a drug-affected employee and it can be proven that testing was deliberately avoided by the employer to maintain staff levels.

Growth in house supply will fail to meet the desires of many people. Above average population growth however looks likely to continue. This imbalance at current prices between expected growth in demand and supply means that while we will see some periods of price declines, the floor on prices will nonetheless still be slowing rising.

First home buyers need to be careful that they do not fall into the classic traps of either believing politically motivated hype, or thinking they can time the market. Focus on your family needs, don’t get greedy in your price expectations, and start attending more open homes – not fewer. Anecdotal feedback now is that some real estate agents are standing forlornly in empty houses at the weekend waiting for someone to show up. Worse for the agents is yet to come as national turnover still has further to fall – probably by another 10,000 – 15,000 from 74,000 in the year to September.

The hype has gone from the housing market in Auckland and the same will occur around the rest of the country. New equilibriums will be established. Before then, look for some panicked selling from a few unsophisticated investors now feeling FOMO in the other direction.

And a final message to first home buyers – you are being actively chased by the country’s banks. You were cannon fodder before, trampled underfoot by foreign buyers and investors. Now you are gold and in their public pronouncements bankers are at pains to emphasise their growth in lending to yourselves. Bargain.

If I Were A Borrower What Would I Do?

I would look for a spread of 1 – 3 year rates with some left floating to allow cost-free early repayment should spare cash come along. The cost of buying insurance against rate rises beyond three years out is quite expensive with the four year fixed rate at 5.89% compared with 5.09% for three years. Paying an extra 0.8% for three full years as protection against the likes of the one year fixed rate being more than 2.4% above the current 4.59% seems too pricey. Fixing five years would cost 6.09%.

Across in the United States a strong employment report for November released last Friday was accompanied by an unexpected slowing in the pace of wages growth. Underlying inflation in the Eurozone economy, which grew at a 2.4% annualised pace in the third quarter, has slowed to just under 1%. Wages growth is slowing in Australia despite very strong jobs growth.

There is no convincing sign as yet from offshore that the post-GFC dynamic of strong jobs growth not leading to accelerating wages growth has altered. This means that while it is reasonable to expect wage growth measures in NZ over the next three years to be lifted by the planned increase in the minimum wage rate from $15.75 to $20 a hour, there is no basis for claiming that the old relationship between jobs growth and wages growth is about to reassert itself.

This means that although inflation does look like tracking higher than otherwise following formation

of a Labour-dominated government, threatening inflation a-lah a wage/price spiral is not in the offing.

So personally I do not feel fearful of the outlook for inflation and therefore my borrowing costs. Conversely, were I a saver rather than a borrower, I would not be hopeful of some friendly deposit rates appearing in the near future.

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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