BNZ Weekly Overview

12 April 2018

ISSN 2463-4328

Mission Statement

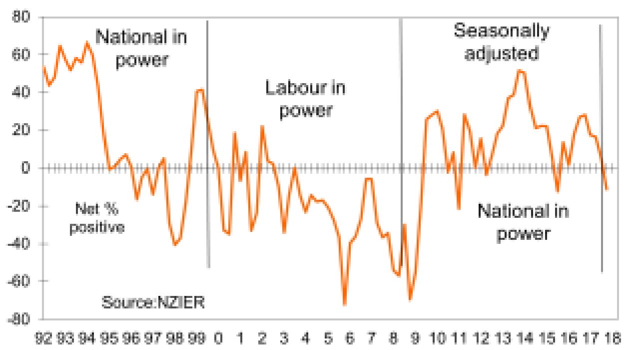
To help Kiwi businesspeople and householders make informed financial decisions by discussing the economy and its implications in a language they can understand.

Business Capital Spending Phase Beckons

For two reasons I have decided to restart the Weekly Overview. First, it is boring not having something interesting to write about each week. Second, people seem to desire its return. So here we are – until the next time I throw my toys out the cot.

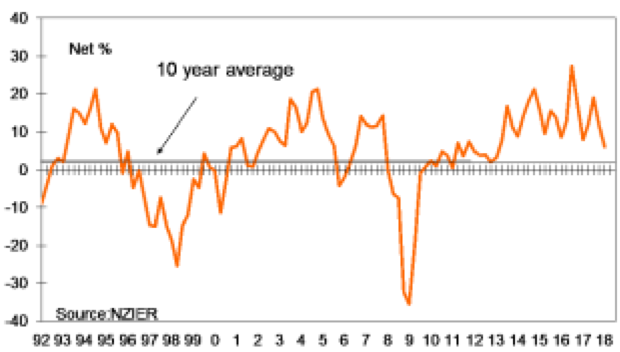
Lets start by looking at the NZIER's Quarterly Survey of Business Opinion. This survey has been running in its current form since the 1970s and contains some really useful insights into what businesses are experiencing and planning to do. Attention with these sort of surveys usually falls naturally on the overall sentiment measure on the basis that surely if businesses feel happy they will hire and invest more, and if they are worried about the economy ahead they will retrench.

But as we highlighted the last time Labour were in power from 1999-2008 there is a downward bias to business economic confidence when Labour govern. So lets ignore the -11% sentiment reading in the QSBO and -20% result in the ANZ's Business Outlook.

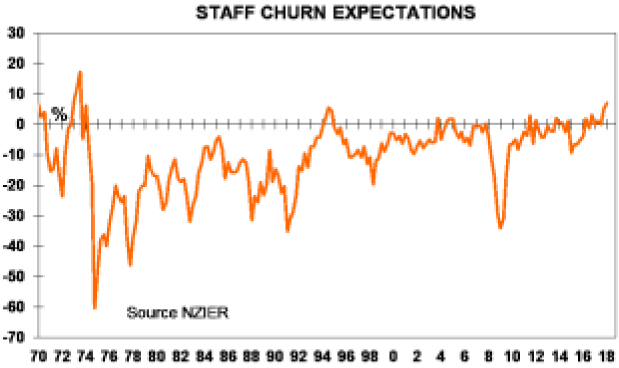


Instead we look at what businesses expect for themselves. In the QSBO a net 16% expect better trading conditions which is about on the ten year average. The ANZ measure is a slightly below average net 22%.

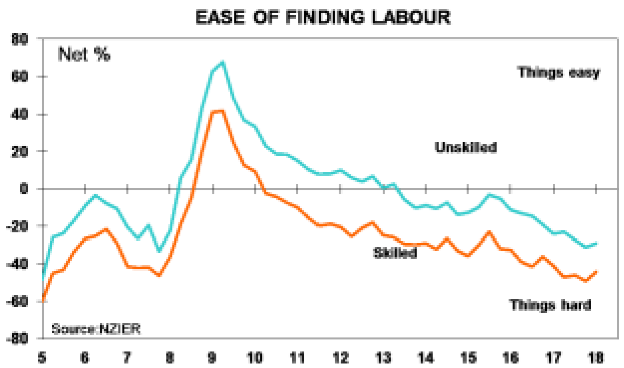
But to really get to the nitty gritty we look at what businesses are planning to do. In the QSBO a net 6% say they plan hiring more people – or at least trying to. This is above the 2% average but the lowest outcome in five years. We say "trying" because there now appears to be very high awareness of worsening staff shortages and this could mean that some businesses are not thinking of wasting their time trying to find decent staff given their experience over the past year.



A gross 20% say lack of staff is the main reason they can't grow. This is above the 10% average. A net 7% expect staff churn to rise. This is the highest reading since 1973. Barring a blip in 2005 the net 18% who experienced higher staff turnover is the highest reading since 1974.



A net 44% say they are finding it hard to source skilled people and a net 29% unskilled people. The averages are 19% and 4% easy respectively.



And this is now where things start to get interesting. Speaking with immigration people in MBIE offices in Wellington this week I noted that staff shortages are encouraging businesses to lobby for more migrants. But we should not blindly respond to such lobbying which if successful will retard the speed with which businesses are forced into an investment response to make up for the labour they cannot find.

That is, they need to boost capital spending. Such spending, which will tend to lift the average labour productivity rate, can take many forms. Better computer systems, better configured and located premises, better machinery, different product lines less reliant on labour (and suited for mechanical picking in the case of horticulture for instance.)

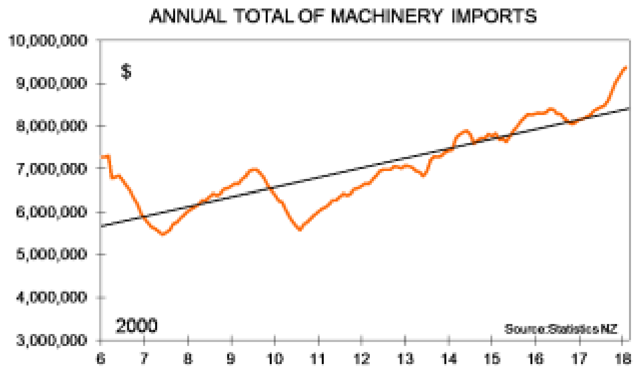
Those latter investments take time so turning off the work visa migration flow sharply would be a mistake. But it should be made clear that any acquiescence to business demands for more imported people is only temporary. Businesspeople often need a jolt to invest and to raise wages.

The QSBO showed us that a net 17% of businesses (non-farm) plan raising their capital spending. This is well above the ten year average of a net 6%. The ANZ survey has investment plans at a net 12% positive which is about right on average.

And such investment focussed on labour-saving technology will need to continue for a long time. Over the past five years job numbers in New Zealand have grown by 19%. The working age population has grown only by 11%. Already over 24% of people 65 years of age and over are working compared with fewer than 6% in 1998.

To the extent that the data properly capture things, import numbers back up the investment surge story. In the last six months the value if imports of plant, machinery and equipment was ahead 13% from the previous six months in seasonally adjusted terms.

The following graph shows the annual total.



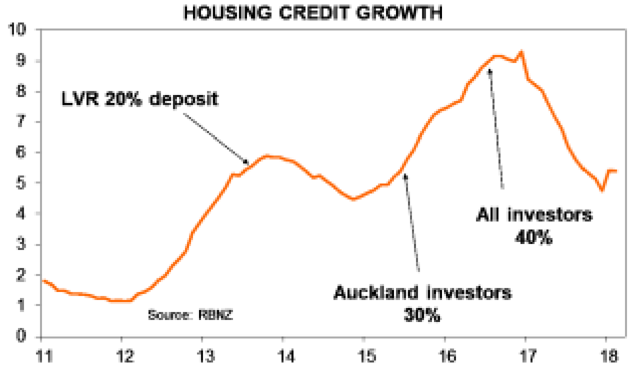
So my message to businesses out there is that the labour market is tight, it will get tighter, don't expect a centre-left government to acquiesce to your demands for more migrants, and plan a multiyear capital spending track. And pay your staff more. And as you develop that investment plan run an overlay asking whether you will improve or worsen your ability to react and adapt to shocks and changes like natural disasters, new competitors, new technologies, new products, and perhaps new regulations. Also, don't forget to keep an eye on the trend toward increasing consumer activism easily facilitated through social media in areas such as packaging, food miles, contributions to climate change, water pollution, bad labour practices (exploitation of migrants particularly), staff misconduct and so on.

LVRs

For your guide, here is a very simple way of thinking about LVR changes. The Reserve Bank announced the introduction of loan to value ratio rules in August 2013 effective from October when the annual rate of growth in housing debt had lifted from less than 3% in late-2012 to 5.4%.

They announced the introduction of the 30% deposit requirement for Auckland investment purchases in May 2015 effective from October after loan growth had lifted to 5% from a low of 4.5%.

The 40% nationwide deposit requirement for investors was announced and de facto implemented by banks in July 2016 when the pace of lending growth was approaching 8.5%.

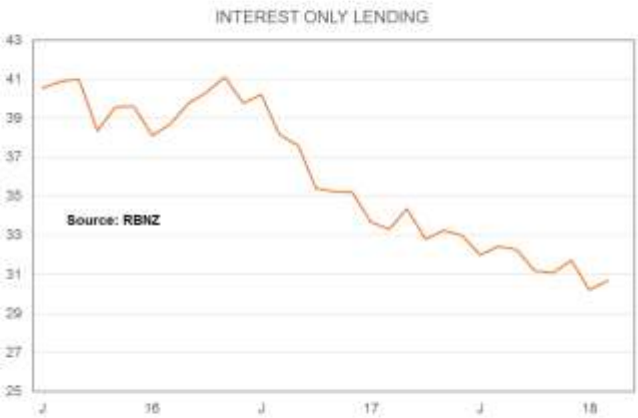


The rate of growth is now 5.4% and no longer trending down. Does this mean that the RB will not announce any further easing of the LVR rules following the decrease in the 40% requirement to 35% at the start of this year?

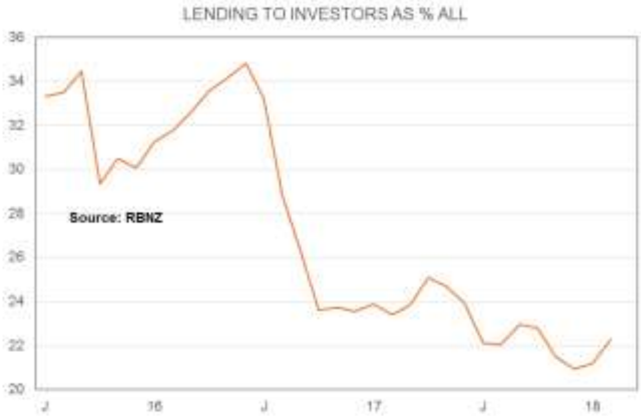
No. There is a small chance that another minor easing could occur this year. Being a landlord is becoming less trouble-free with the government clamping down in various ways on investor returns. Net migration inflows are slowly easing.

Most importantly though, the true lending measures which have driven the RBNZ's decisions, high risk lending, continue to improve. We only have these data from the middle of 2015 – hence the broad focus on all housing debt figures above.

The proportion of new bank lending which is interest only has fallen from 41% in 2015 and 40% in July 2016 to 30% in January and 31% in February this year. The proportion was 32% - 33% 6-9 months ago. Lets say a little downward trend remains in place.



In January and February the proportion of lending going to investors was 21% and 22% respectively from 22-25% 6-9 months earlier and 35% in July 2016 when the 40% deposit requirement was introduced. That looks also like a little downward trend still.



The proportion of interest only lending to investors with smaller than a 20% deposit was 0.1% in February and 0.2% in January from 0.8% nine months ago and 1.4% mid-2016. Again, a little downward trend.

And finally, the proportion of all lending at less than 20% deposit was 10.2% in February from 8.9% in January and 8.1% none months ago. This measure has gone up but that is what the RB intended when allowing a higher proportion of lending (up to 15%) at less than 20% deposit from January 1. The gap between actual (10.2%) and the limit (15%) is actually the largest since the data series starts in July 2015.

These are early days following the January 1 easing of rules. But so far so good is likely to be what the Reserve Bank is thinking.

But what about the housing market itself? There are so many monthly releases now it can be hard to really pick out short-term changes. But if we stick with Barfoot and Thompson's Auckland-only turnover numbers we see seasonally adjusted sales flat in the March quarter after rising 6% in the December quarter – though the early-Easter may have imparted a downward bias. No proof of an Auckland surge however. REINZ data nationwide for the three months to February shows sales ahead seasonally adjusted by about 5%. But the regions will naturally fade this year in a traditional lagged response to Auckland's slowing so I don't read much into that.

And REINZ nationwide data show the number of days taken to sell a property on average over the three months to February running just 1.7 days faster than average from 2 days faster three months earlier and 3 days faster six months ago. So no fresh acceleration apparent there.

At the margin the odds are that LVR rules will be eased again within a year. But the extent of the change is likely to be very small on the basis that the firm economy, strong labour market, continued low interest rates and above average net migration inflows are likely to contribute to reasonably good housing credit demand.

If I Were A Borrower What Would I Do?

I would still not be worried about interest rates rising. The annual inflation rate recently fell from 1.9% to 1.6% with the core measure excluding household energy and food falling to 1.1% from 1.5%. The net percent of businesses in the QSBO expecting to raise their selling prices has fallen from 31% to 21%. This is above the ten year average of 17% but not by much.

For your guide, when the Reserve Bank raised the official cash rate in 2010 from 2.5% to 3.0% this measure of pricing intentions had risen quickly from 13% to 40%. By this time in 2011 it was just 14% although the RB had already cut the cash rate back to 2.5% encouraged to do so by the Christchurch earthquake.

In 2014 when they again tried raising the rate, this time to 3.5% from 2.5%, the price expectations measure had risen from 10% to 37%. It then fell to zero mid-2015 and the cash rate ended up being slashed to 1.75% come late-2016.

Since then the 31% reading for the December quarter last year has been the highest price expectations measure. But this fell short of the near 40% potential trigger point, and the March quarter fall to 21% means the RB will feel zero inclination to raise rates.

What about fixed rates? These are influenced more by developments offshore. In that regard we have some upward pressure as bank funding costs have increased in response to some worries about sharemarkets and global trade. But we have had an absence of any extra lift in long-term US bond yields since the second week of February (10 year yield stuck near 2.8% and recently below). The stalling of US long-term rate rises reflects some weaker than expected data recently, worries about a weakening sharemarket and potential (though unlikely) trade war with China.

Rates might actually have fallen were it now for growing expectations for a US Federal budget deficit blowout, set to reach US$1 trillion come 2020. And we cannot rule out selling on the back of worries about a weaker greenback which traditionally follows increases in US tariffs.

The upshot of that is that as a depositor I sit as forlorn as ever expecting no great news regarding a return to old level bank rates in the near future. NZ interest rates could easily be near current levels a year from now. Were I once again a borrower I would still be sleeping relatively comfortably and happy to fix out to three years maximum. Beyond that would be too expensive for me relative to the shorter rates.

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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