BNZ Weekly Overview

10 May 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.

Loose Monetary Policy To Stay

The economic data highlight for this week was the Monetary Policy Statement released by the Reserve Bank this morning. This is something they do every three months in conjunction with their near six-weekly review of the official cash rate and as had been universally expected the cash rate was left at the 1.75% level it was taken to in November 2016. That was down from a peak of 3.5% reached in 2015 when the Reserve Bank, like the rest of us, was expecting strong growth and falling unemployment to produce a decent hike in wages growth and improvement in business pricing ability which would push inflation up.

Inflation in fact turned out to be near 2% lower than the RB were forecasting, hence the 1.75% worth of cash rate cuts over 2015-16.

Since late-2016, even though our economy has continued to growth strongly, the unemployment rate has fallen to just 4.4%, and the capacity utilisation rate has hit a record high, inflation refuses to trend up. In fact it has fallen over the past six months from 1.9% to 1.1% and a core measure I look at which excludes fuel and food has declined from 1.5% to only 0.9%. In the EU this measure is 0.7%.

It is likely the Reserve Bank has decided that having twice tightened monetary policy since the GFC ended and on both occasions having to quickly slash rates again, they are determined not to be fooled a third time. They probably won't start raising interest rates until they can poke the whites of the eyes of inflation advancing upon them.

That perhaps is why their forecasts show they do not anticipate having to raise the cash rate in order to contain inflation risks until 2020. This forecast is unchanged from the last Monetary Policy Statement in February.

What is interesting however is that the new document contains more explicit statement of the "need" to keep monetary policy loose. To whit, from page 17, "…stimulatory monetary policy is needed to drive GDP growth above its potential rate so as to generate a pick-up in capacity pressure, further increases in employment, and a rise in inflation."

The Reserve Bank forecast good economic growth over the coming three March years of 3.3%, 3.2%, then 2.9% with the unemployment rate falling to 4.2%. The chances are good that it will go lower than that given the 2007 low of 3.3%.

Support for growth is seen coming from a supportive world economy, stimulatory fiscal policy, strong net immigration, and low interest rates. This view is consistent with our own by and large and sends no signal to businesses that they should be contemplating pulling back on badly needed investment growth for fear of any imminent dearth of customers and cash flow.

Sheep and Beef Farming

After speaking in Greymouth, Blenheim and Nelson last week I gave a talk in Rotorua to a group of vets servicing the sheep and beef sector. There is awareness of the threat posed to the sector by factory grown meat and plant-based proteins synthesised into meat-like products. There is an intention and hope that middle and upper income consumers offshore and domestically will continue to demand the real thing and that the sector can over time reinforce its existing position as a supplier of premium, well grown product.

But this is a strategy which may not necessarily pay off as much as desired and required for a number of reasons. One reason is that consumers have always been prepared to shift product when something new and cheaper comes along, even if quality is not as good as the older item. Think of gumboots. We can buy excellent quality ones from certain stores servicing a largely rural client base. But most people buy the cheap item in bulk-type shops even though we know they will split within a year.

Think jerseys. Years ago we easily switched without even thinking about it from hand knitted ones to machine produced items. And we switched away from wool to synthetics.

One day meat alternatives will be as cheap as the real thing, and probably cheaper once farmers are fully brought into the Emissions Trading Scheme and have to fully meet ever rising ground and water environmental standards, and health and safety standards, and accreditation and traceability standards.

Consumers will switch to the cheaper stuff just as we switched from haberdasheries to department stores to bulk outlets. Red meat is quite expensive these days, especially compared with white meat, so the pricing point which synthetic producers need to meet seems to be improving in their favour all the time.

But there is more to it than that. Once the alternatives become viable we can fully expect those producers for marketing and differentiation purposes to highlight aspects of the red meat sector such as the necessary killing of an animal – even one raised in a lovely environment. Chances are the animal will be a very young one.

And then there is another thing which occurred to me and caused me to take an apple on stage to show everyone. The apple which I buy is exactly the same as the one picked from a tree. I can imagine picking it myself on a beautiful summer or autumn day. I have no image of anything dying. I have a warm feeling. I eat the thing which is undeniably an apple.

But what is the connection between the meat on my plate today and the animal in the field? I am not looking at a complete sheep on my plate. It has been killed, skinned, cut up, packaged, chilled, and I have then bought it. I then engage in my own processing. I cut it up into smaller pieces, I season it, I cook it.

An apple is made, I eat an apple. A lamb dies, I eat slices of something. This disconnect between the farm product and what I consume and enjoy will be a marketing nightmare for farmers when eventually the synthetic meat alternatives appear.

As for milk, we are already increasingly drinking alternatives sourced from plants. And when a vat-produced equivalent to the dairy product eventually comes along at a competitive price and level of availability we will be invited by such producers to think not just about the environmental impact of dairy farming, but the necessary killing of bobby calves – no matter how well they and their mothers are treated.

New Zealand has a vibrant, highly innovative pastoral farming sector upon which this country has grown. But driverless cars will one day render traditional service stations redundant. And wireless charging will one day render house wiring and most electricians redundant. Plant-based and factory-grown meat and milk alternatives may one day render much of our pastoral sector and its supporting industries redundant. This will impact on land prices.

Timeframe? No idea. But having discussed such big technology things in the past I know I will get an equal number of zealots saying such a development is imminent as I will get those saying it will never happen.

For your guide, in Australia and the United States concern is growing in the beef sector regarding meat alternatives. Lobbying has commenced to prevent producers of plant-based and lab-grown meat from using words like “meat”, “beef” etc. when describing their product. Will that make much difference for consumers? No. It’s hard to think of words more distant from wool than polyester, Synchilla, polypropylene. Yet we lap up them all. It’s the price, performance, quality, availability of a product which will sway consumers, not usually its name. Then again – Adidas, Nike.

Following on from the warning I have been dropping in now and then regarding the new centre-left government’s intention to address issues of environmental degradation from the primary sector, the Environment Minister gave a warning this week. Water pollution from dairying activities has to decline and although many farmers are altering practices to achieve this, it would be naïve to think that an environmentally activist government will not want to be able to claim that its actions are the direct cause of reductions in environmental pollution.

So no matter how fast dairy farmers alter their practices and how much they spend, politics dictates that there will definitely be new rules introduced which will be seen to accelerate the clean-up process. The Labour and Green (probably not NZ First) will want to parade those rules in front of the electorate ahead of the 2020 general election.

Housing

I write a fortnightly column in the Property Press magazine which sits outside real estate agent offices and various other places all around New Zealand. Apparently some 800,000 of us take a peek at this publication every week. Impressive. That probably reflects the attraction which property has to most of us – either in terms of undertaking an actual search for somewhere to live or invest in, gauging what one's house might be worth in today's market, peeking inside nice places to get redecoration ideas, or simply for pawing over.

A few weeks back I wrote an article comparing potential returns from keeping a property I have in Auckland or selling it and depositing the money and I thought Overview readers might find some interest in it. So here goes the same subject.

One of my properties is a little studio in Auckland. At a stretch it might sell for just under $300,000. Let's assume it did. I could bank a capital gain and feel clever. But what would I then do with the money as a conservative investor?

If I put the $300k in the bank I could get 3.5% which after tax would deliver $7,000 in the hand each year. After ten years I would have saved up $70,000 plus some compounded interest.

If I keep the apartment I also will get about $7k in the hand after expenses and tax adding up to $70,000 plus some compounded interest.

Am I indifferent between the two options? No. After ten years my $300,000 term deposit will still be $300,000 plus the accumulated interest. My little apartment however is really, really unlikely to still be priced at $300,000 a decade from now. I would expect it to rise at a pace of at least 2% per annum.

Therefore, attractive as the thought of getting $300k in the hand is at the moment, if the alternative is placing the capital on term deposit and watching inflation eat my capital away I opt to keep the property and rent it out.

Of course there are other alternatives such as investing in equities. Would I personally do that? If I did I would space my entry into the markets over an extended period of time, say 12–18 months. I would also probably not pick my own stocks and opt for whichever fund had the lowest fees. Over the long-term investment in a diversified portfolio of equities tends to yield good returns. You can opt for a portfolio biased toward high dividend stocks if you want some decent cash income along the way.

I have no hesitation when young people ask me about investments telling them to place what they can in Kiwisaver, build up a fund to get a house deposit together, pay down their mortgage as quickly as possible, and concentrate on their education, their work skills, their actual job, and training themselves to remain awake to the many opportunities continually presented to us all these days for skill and career advancement.

Here are a couple of psychological things you should be aware of when you sit across the table from an investment advisor.

First, having capital available to invest is a source of stress. You don't understand this until you are actually in that position. Are you a conservative or risk-loving investor? When might you need the money back? What other income sources do you have? Your desire to get rid of this stress will have your mind constantly on the lookout for something that seems to be a solution – whether it really is or not. Your mind will talk you into believing that if you invest in such and such a way you will be alright. All your mind wants is to get rid of the uncertainty stress as quickly as possible. Advisors know this.

This means that much as we have all heard the saying that if something looks too good to be true it probably is not, our minds in these times of stress actually seek out such things choosing to believe they are!

Second, we humans are 3-4 times more sensitive to the loss of a thing than a gain. So watch for the way an advisor will present you with alternatives. Instead of saying that investing in a growth portfolio will deliver you such and such extra **gain** over a low risk option in the next ten years, they may say if you don't take the risky option you will **lose** such and such a gain. That change in words can be very effective in pushing you to the higher risk option when really what will suit you better is something low risk and boring.

In a nutshell, when it comes to investing a lump sum you may be your own worst enemy.

Rent?

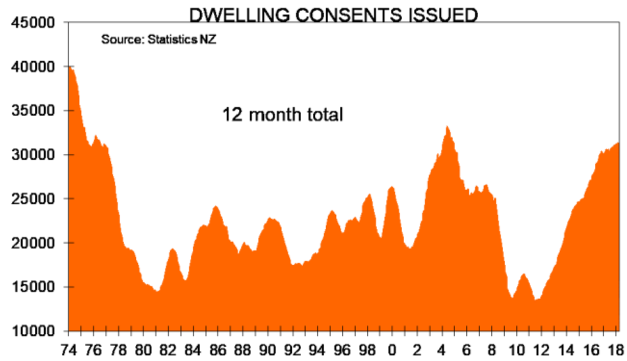
Still on housing, cast your mind back to any time over the past three decades when analysts, journalists and economists have run the numbers and concluded that people would be better off renting than buying. Now think – for all those people who opted to forsake purchasing a home for their family and instead focussed only on short-term cash flows – how are they left now? Rents are rising to reflect increasing costs and decreasing stock availability. Prices have already soared to reflect similar things.

This exercise of comparing renting with buying can be useful for gauging some short-term pressures in the housing market. But that is completely different from young buyers using such comparisons as an actual guide as to what to do. Unless you are in a market of minimal population growth and/or easy supply growth it really doesn't make much sense to pay strong attention to such cash-flow focussed exercises for family home purposes.

Personally speaking I have never run such numbers when considering the house purchases which I have made because my focus has been on the end use to which I will put the property and the utility (enjoyment etc.) it will deliver me. Those who have done the exercise and bought into potential long-term wealth outcomes under assumptions of minimal house price growth have lost focus on the real target – providing a stable family home.

House Building

For the record, two weeks back the monthly data were released by Statistics NZ telling us how many consents are being issued around the country for new dwellings to be built. The trend is upward but it is not at a pace which will please those hoping for good supply growth to help address worsening accommodation issues.



Ignoring monthly numbers because they are too volatile we see that in the March quarter consent numbers rose 6% seasonally adjusted from the December quarter but were just 4% ahead of a year earlier. That latter figure is probably a better gauge of the underlying growth trend because even the quarterly rates of change can fluctuate tremendously, often shifted around by large apartment consents.

For houses only consents rose just under 4% in the quarter after falling near 7% in the December quarter. Volatility dominates unfortunately and this is for nationwide numbers. When it comes to data for your particular area, frankly you had best stick to 12 month totals to get a feel for the trend.

The table on the next page shows for each region the change in consent numbers issued in the year to March. For instance Northland has seen a fall of 7.1%. The second column shows what this annual growth was six months ago. For Northland it was 15.2%. The last column shows by how much things are changing. If the number is negative it means growth has slowed. In the case of Northland the change is negative 22.3%. Growth in issuance has slowed quite a bit.

In Auckland growth has lifted a tad in the past six months – that will please many people. Wellington is also seeing a supply response to the rapid rise in demand and prices this past couple of years. Canterbury is slightly less negative but still falling nonetheless.

I look at these numbers and find them consistent with a view that we have seen a spurt of construction in the regions. But things are now easing off, perhaps as people do the exercise which I have been advising for a couple of years now. That is to keep an eye on population growth projections to see how they square up with the surge in construction.

This week's Overview is already big enough so let's do that exercise next week.

	Latest 12 month change	12 month change 6 mths ago	Diff.
Northland	-7.1	15.2	-22.3
Auckland	10.8	3.3	7.5
Waikato	-2.2	1.7	-3.9
Bay of Plenty	-7.7	4.8	-12.5
Gisborne	39.7	13.2	26.5
Hawke's Bay	27.6	28.6	-1.0
Taranaki	-14.4	7.8	-22.2
Manawatu-W	13.2	28.3	-15.2
Wellington	23.2	15.1	8.1
Tasman	6.9	6.8	0.1
Nelson	7.1	44.9	-37.8
Marlborough	31.6	32.9	-1.3
West Coast	-3.8	49.4	-53.2
Canterbury	-15.0	-18.3	3.4
Otago	10.7	25.4	-14.7
Southland	2.4	26.1	-23.7
NZ	2.8	3.1	-0.3

If I Were A Borrower What Would I Do?

Last week the Reserve Bank of Australia reviewed their cash rate and again left it at 1.5%. The NZ rate is 1.75%. They gave a good outlook for the economy but said inflation risks are still very low though they expect there is upward pressure to come once the labour market performs better, the unemployment rate falls below 5%, and wages growth therefore picks up. Good luck with that theory.

Around the world economies experiencing fast jobs growth and low unemployment rates have failed to see any decent inflation-lifting rise in the average pace of wages growth. Here in New Zealand last week we saw static to falling wages growth depending upon what measure you use, in spite of near 350,000 jobs appearing in the past four years and the unemployment rate falling to 4.4%.

In the United States on Friday we learnt that courtesy of 164,000 jobs growth in April the unemployment rate fell to its lowest level since 2000 at 3.9%. Employment has risen for a record 91 months in a row. The 110 month economic expansion is the second longest on record for the US. But wages growth continues to disappoint with a rise to just 2.6% from 2% earlier.

Analysts say one reason for this is the participation rate is still quite low at 62.8%

But the NZ rate is 70.8% and we have no or almost no acceleration in the pace of wages growth.

Maybe one day national labour markets will change and wages growth will appreciably lift, driving a surge in interest rates. Based on experiences in previous decades this should already be happening. But it isn't and betting on it occurring has been an error everywhere since 2010.

So if I were borrowing at the moment (rather than suffering the ignominy of the lowest deposit rates offered by banks since the 1960s) I personally would fix three years at the longest. Most of my debt I would probably fix for two years.

And this week's final thought is this. Want to know how bad Auckland's traffic has become? Skybus have come up with an innovative solution to avoiding most of the terrible jam of traffic coming out of the airport leading to the big roundabout. They go from the domestic terminal to the international terminal, then instead of heading from there straight back to the main road they cut through a paddock, past an old dairy shed by the looks of it, beautiful grass on both sides, no cows though, then re-join the highway close to the roundabout.

Imagine someone visiting NZ from overseas going along that route. They'll wonder where they heck they have landed – or what century! Congrats to Skybus for coming up with the solution however, but don't get clever and try it yourself. The route runs through a private property.

Skybus from July will be running a service to the North Shore and at that time also they will finally be allowed to take their buses all the way back down to the bottom of Queen Street again. Now if they can just take themselves off Eden and Dominion roads and use the motorways only we'll have a truly fantastic service for getting between the CBD and the airport in quick time. No need for a slow expensive light rail service which based upon the width of road required for the system on the GC will call into question not just any future for parking along Dominion Road, but also bus stops and actual tram stations which require even more width.

Look closely at the photos being used to promote the light rail system. People are walking all over the tracks, cars are sharing track lanes, or one lane with no parking or space for bus stops or tram stations runs alongside the rail lines. That is not how these systems function overseas.

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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