BNZ Weekly Overview

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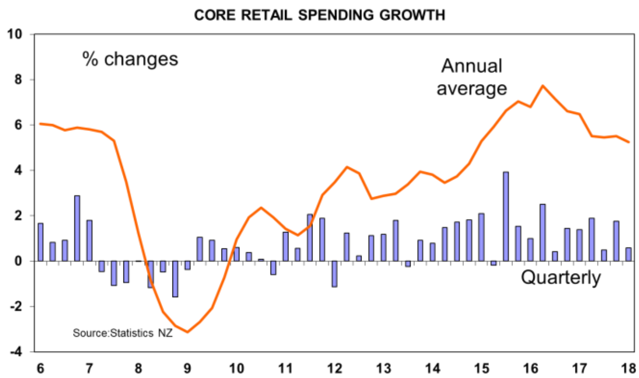
Mission Statement

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

Slowing Down?

This week we learnt that during the March quarter core retail spending (excluding fuel and vehicles) rose by 0.6% in seasonally adjusted volume terms. This is a slowdown from unusually strong growth of 1.8% in the December quarter but it is too early to conclude that a new easing trend is necessarily in place beyond the pullback from the 2015-16 surge. Much of the slowdown will simply be a payback from the strong December quarter and if we average growth for the six month period the outcome of 1.2% a quarter is consistent with the average for the past year and a half.



If we look at the best indicator of attitudes which consumers have toward how things are and where they are going we see that spending on store types selling mainly durable goods rose by 2.2% in the quarter. This was actually an acceleration from 1.5% growth during the December quarter. This again implies that treating the weak March quarter result as the start of an easing trend would not necessarily be correct. But as the graph above clearly shows, an earlier boom in spending growth has eased off slightly.

Looking ahead we see an environment which will provide continuing support for growth in consumer spending. Demand for employees is very high so we would expect people to feel a high level of job security. Interest rates look set to remain low for a continuing very long time. Population growth remains strong (see below), and house prices continue to rise in most parts of the country though at slowing paces. House construction remains strong and that is good for sales of home furnishings etc.

Yet there are reasons for retailers erring on the cautious side. Petrol prices have risen quite a bit recently and could go a tad higher. That saps spending available for other things.

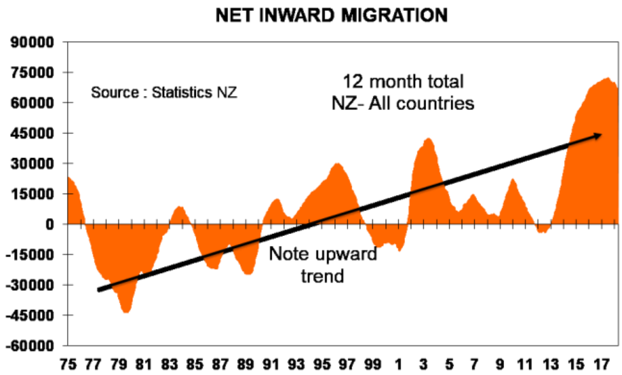
Of probably greater relevance for retailers however is the ongoing rise in competition from online sources, and the increased willingness and ease with which consumers can search for alternatives online. On top of that social media's omnipresence means that bad stories about a retailer or their product can spread very easily. And any stories of sales weakness may build expectations of failure or deep discounting to such a level that people sit still simply waiting for such discounting to occur.

Retailers also need to be aware of the increasing demand from consumers for environmentally friendly goods with a minimum of packaging. Plus staffing is becoming an increasingly problematic issue for many retailers. We more frequently see job vacancy signs in shop windows these days, and the rise in minimum wages will affect some.

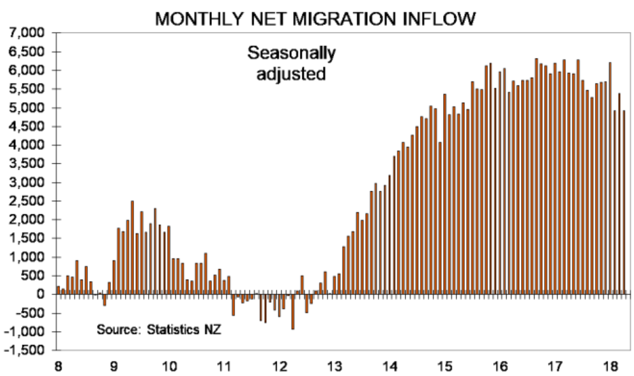
For others the issue might be the long-overdue crackdown on staff exploitation by some bad operators. This may be hitting others who following an inspection might lose staff who's work visas have been discovered to be out of date.

We also learnt this week that the population boost from net migration flows continues to ease off, largely because of a lift in the number of foreigners leaving the country. In April the net migration inflow amounted to 2,460 people which was down from 3,406 a year ago.

The annual net migration gain now stands at 67,040 from a peak of 72,404 nine months ago. The speed of turnaround is so far fairly slow at an annual pace of near 7,000 but a small acceleration in the decline could be underway.

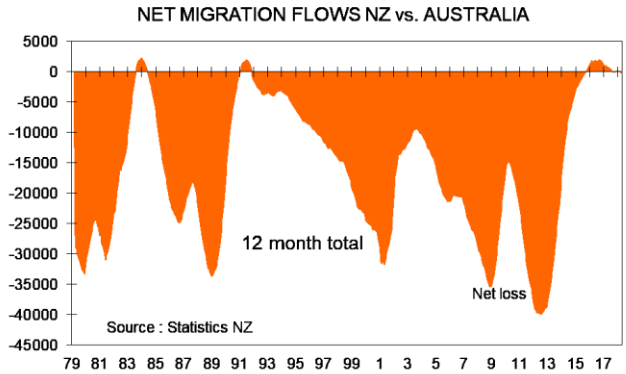


Over the past three months the annualised net migration gain has fallen to 61,000 from 70,000 three months back. But we have to be careful about over-extrapolating monthly and even three monthly changes as things can move around quite a bit. This graph of monthly seasonally adjusted net inflows probably best shows the turnaround.



Fundamentally speaking, a key driver for high net migration inflows of strong labour demand in New Zealand remains and is expected to persist for some years.

This is highly relevant not just in terms of people coming in on work visas, but Aussies coming in at will and those of us already here choosing not to leave. The annual flow against Australia is interesting. It peaked at a record net loss of 40,000 people in 2012 but now stands at only a small loss of 162 in the past year. This is down from a gain of almost 2,000 in NZ's favour late in 2016. The turnaround is minor but is likely to go further as jobs growth has been quite strong in Australia for the past year and a half with full-time employment in particular showing a turnaround from many weak years post-GFC.



Housing

I've been making number of presentations to people interested in the residential property market recently with more coming up. The questions people have are invariably centred around very specific things which have capacity to have some influence on the market. They ask about the changing brightline test, or the planned ban on foreign buying, or availability of bank finance. They are right at the coalface in the sector and their questions are quite specific. Rightly so.

But that is not where I live my job. As an economist my job in every forum is to take people briefly away from their immediate concerns and try and show them the big long-term picture. Sometimes I say to audiences that I will speak about the things over which they have no influence but which will influence their outcomes.

In the housing sector that means I am still writing and speaking about the same things I have been focussing on for a very long time. Consider this following collection of points.

- "New Zealand has a shortage of dwellings and not an over-supply like the US, Ireland, Spain etc. That means the extent to which house prices would fall this cycle was always going to be limited.
- Construction is at its weakest levels since 1965 near 14,000 per annum whereas 25,000 has been the average for the past decade.
- Population growth is accelerating courtesy of rising net immigration (fewer people leaving so

the mix is different from what we thought last year).

- Interest rates are at very low levels – 40 year lows for floating mortgage rates.
- The ability of housing construction to respond this cycle will be limited by the collapse of the finance company sector and its generous loans of money to property developers, plus tighter lending criteria by banks.
- Investors have seen their equity investments and many others torn apart. The relative attractiveness therefore of housing from a psychological point of view has increased.”

I wrote those comments in the August 20 2009 issue of the Weekly Overview. Here are some more detailed comments from the September 3 2009 issue.

- “Average new house sizes are far larger than before so each “unit” of house involves 1.x units of older houses. With nothing else changing (ceteris paribus) average construction prices will be 1.x times higher.
- There are more double income families now than in earlier years so price/income measures using average individual income measures are less relevant. One can easily adjust for this using household incomes however.
- Average construction costs per meter are now higher than they used to be due to things such as tighter regulation of materials and construction personnel, compliance costs, insulation requirements, inspections, quarry availability and travelling distance for materials…
- What we expect in a house is more than before – inside toilet(s), computer wiring, patios, …
- Section sizes are smaller but land availability is worse than in the past so prices are higher.
- Councils have not only moved to make section developers pay the full cost of services that will run to their area, but extras as well as a form of subsidy for existing ratepayers.
- Availability of credit to individual buyers is far greater than in the old days so the pool of people who can consider making a purchase is greater than before, and if people choose they can access credit at an earlier age than before.
- People’s awareness of the need to save for retirement has soared in the past 15 or so years so there is a constant nagging feeling that one needs to invest in something. Housing appears to be the default investment for Kiwis.
- One could be wrong, but it appears harder in some locations to develop new subdivisions and therefore expand city boundaries (Auckland) than in the past. “

You can find these two old publications here

Page 7 in the former.
https://www.mortgagerates.co.nz/files/WOAug20.pdf

Page 10 in the latter.
https://www.mortgagerates.co.nz/files/WOSept3.pdf

And for your guide, here is the url containing our November 1 2012 listing of 19 reasons why Auckland house prices would keep rising.
http://tonyalexander.co.nz/wp-content/uploads/2013/02/WONovember-1.pdf

Have any of the factors discussed above changed enough to alter the new housing fundamental of higher prices? From the first set we can note higher consents at 31,500 but population growth well exceeding anything we envisioned back then as net immigration flows have boomed. From the second list we can note that credit availability has tightened up for house buyers through LVRs and changes in bank self-imposed rules. But development finance has also tightened up. On the last point above, development of new subdivisions still looks like a nightmare.

It is into the context of the long-term fundamentals like rapid population growth (see the net immigration graph trend line on page 3 above), hiking construction costs, desire/need to invest for long-term gain (that is the bit some people fail to grasp as they speak as if every investor were a speculator), and family changes that we need to place new developments.

Some investors will be discouraged by the coming anti-investor legislation. But that won’t change the above fundamentals. Once the mix of investors has adjusted the availability of housing stock will worsen as young couples move out of family homes to displace tenants, rents will be higher because of higher costs, and the market will move back up again. Timing for Auckland? Probably within the next 18 months. Relevance for the rest of the country? Underpinning of recent price rises with upside potential slightly further down the track, but lost in the wash for the next 18 months as the lagged booms following Auckland's earlier surge naturally end.

Are You Seeing Something We Are Not?

If so, email me at tony.alexander@bnz.co.nz with Housing Comment in the Subject line and let me know.

If I Were A Borrower What Would I Do?

Writing in this section has been a very boring exercise for some years and remains so even though we are seeing rises in US long-term interest rates. In theory such rises should place upward pressure on medium to long-term fixed interest rates in New Zealand. In practice we are yet to see that and it might take another 0.5% gain in the benchmark US ten year Treasury bond yield to cause a noticeable movement in average rates here.

Were I still borrowing at the moment my inclination would be to fix at about the two year period with some spreading of forecasting uncertainty by locking some debt in for one year and a tad also for three years with some also floating to allow for cost-free early repayments should such become possible.

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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