BNZ Weekly Overview

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Mission Statement

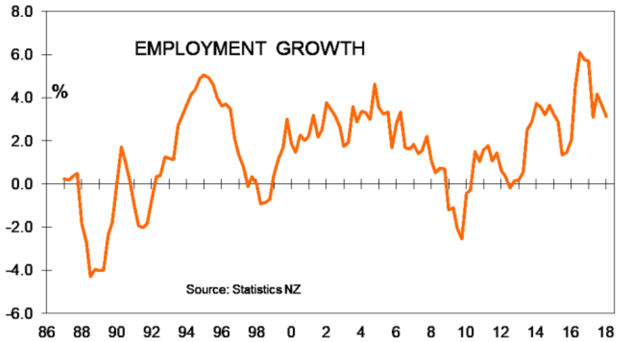
To help Kiwi businesspeople and householders make informed financial decisions by discussing the economy and its implications in a language they can understand.

Lots of Data

This week the most interesting collection of economic data released came in the form of the Household Labour Force Survey. This comes out every three months and tells us the unemployment rate, jobs growth, and interesting bits and pieces regarding the labour market.

The headline results are that the unemployment rate has fallen again to 4.4% from 4.5% in the December quarter, and a peak of 6.7% in 2012 – a rate very low by world standards post-GFC. The rate hit a low of 3.3% in 2007 so employers should be aware that much as they are already scraping the bottom of the barrel to find people things could easily get worse and almost certainly will for them. For employees on the other hand the news is exceptionally good.

Job numbers rose in seasonally adjusted terms by 0.6% during the March quarter and 3.1% from a year earlier. This is a fairly fast pace of growth which probably won't be sustained simply because labour force growth is not keeping up with strong demand. The labour force grew by 2.5% in the past year.



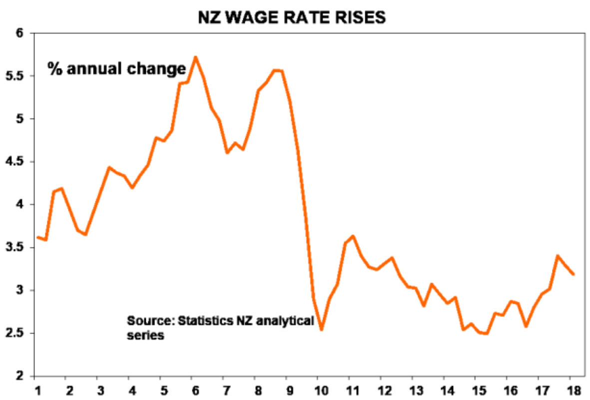
Full-time employment has grown by 3.5% this past year and part-time 1.7%. This is important because it reinforces the conclusion of solidity in the labour market.

Compared with ten years ago employment in New Zealand in the past 12 months has grown by 20% - full-time ahead 21%, part-time 14%. Agriculture forestry and fishing are up only 4%, mining is down 32%, and manufacturing is down 7%. But construction is up 32%, professional and scientific services plus admin is up 41%, public admin 27% education 32%, and health 30%.

Since 2008 jobs in Auckland have grown 27% to account for 46% of all NZ jobs growth this past decade. The rest of NZ has seen jobs growth of 20%.

	Jobs growth Since '08	% of growth
Northland	12.8	2.2
Auckland	27.4	45.9
Waikato	20.9	10.2
Bay of Plenty	21.6	6.6
Gisborne/Hawkes Bay	7.9	1.8
Taranaki	9.8	1.3
Manawatu/Wanganui	10.7	2.7
Wellington	18.0	10.6
Nelson etc.	11.9	2.5
Canterbury	15.8	11.1
Otago	17.6	4.4
Southland	5.5	0.7
NZ	19.5	100.0

So is this tight labour market producing accelerating wages growth as we saw in the 2000s? No. The measure which I like to use from the Labour Cost Index showed a slowdown in its annual pace of increase to 3.2% from 3.4% two quarters earlier, but was up from 3% a year back and a low of 2.6% a year and a half ago. That is not much of a trend improvement compared with the 5.7% peak seen in 2006.



This lack of accelerating wages growth is a global phenomenon and as yet there is no international consensus on exactly why post-GFC tight labour markets are not leading to strong wages growth.

There are elements of labour market internationalisation, fear of redundancy because of lurking world worries, introduction and worries about Artificial Intelligence and similar things. But in all probability the big factors are reduced proportions of workforces in unions, young people expecting higher remuneration by lucking into the next big internet thing rather than incremental wage rises over many years, and big pushback by employers.

As I have highlighted here for some time, the ability of businesses to raise prices either because they feel like it or because costs have gone up has greatly diminished. This is because you and I can easily search for alternative prices, products, and suppliers online at virtually zero cost. In the old days undertaking such searches required lots of time, stress, and driving around looking for alternative merchants.

The absence of accelerating wages growth is going to impede productivity growth in the economy because labour resources will not be reallocated as quickly as otherwise from low profit businesses to high profit ones. That is where the increasing minimum wage will prove quite useful. It will force some businesses to lay off employees or close down and those people will become available for other labour-strapped employers who can afford to pay more because they produce something which can generate a higher profit.

The other angle on this is the government's concerns about lack of wages growth holding back the social, economic, health and education progression of people on low and middle incomes. Lack of accelerating wages growth is going to increasingly frustrate the government, especially because the lack of good growth for middle income earners will start to sway those important voters away from Labour back toward National.

There is little the government can do about this except try even harder to force employers to raise wages through one tool at their disposal – immigration rules. It is unreasonable first of all to expect that a centre-left government would boost immigration numbers and undermine the bargaining power of their union supporters and low income people. But as time goes by and wages growth remains muted it becomes more probable that new restrictions will be placed on employers using imported labour in the hope that this will force higher wages for the locals.

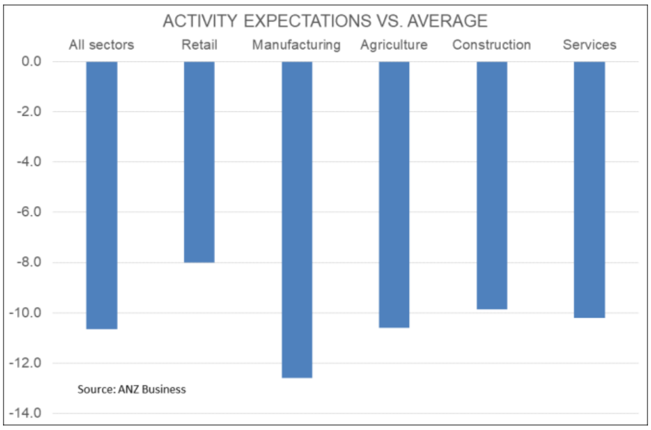
The message to businesses is fairly clear. There is a resource you are struggling to find. You have to expect its price will go up. Start paying more or lose first your staff's goodwill and then the staff themselves. If affording higher wages means labour productivity needs to rise then start investing in the new software, premises, training, machinery or whatever which will deliver this.

Businesses Wary

The monthly ANZ Business Outlook survey was released on Monday and it tells us that the economy is probably going to record growth somewhere between 2% and 3% this year. That is acceptable in the context of average growth for the past two decades of 2.7% per annum, but represents a slowdown from growth averaging above 3.5% per annum for the past four years.

A net 18% of businesses expect their levels of activity to rise in the coming year. This result is down from 22% in March but the average for the past three months of 20% sits above the average to January of 11% and this looks like a recovery after falling away once Labour was confirmed as winning the election auction of NZ First.

The ten year average reading for this measure is 30% and we see that for each of the five sectors – Retail, Manufacturing, Agriculture, Construction, Services – expectations are about 10% below average. So on this measure no sector sticks out as unusually in the doldrums and we think this is a better way to look at things than the commentary you will have already read on Monday and in Tuesday's 'papers.

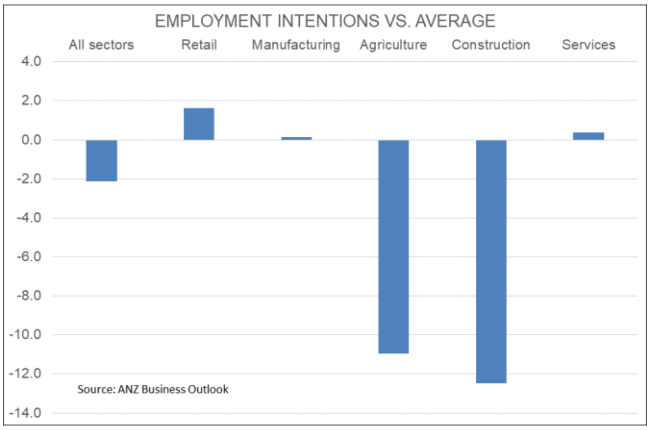


Those pieces of analysis will have focussed on the big fall in construction activity expectations to only 4% from 42% in March and 35% in February. The thing is, measures for construction go literally all over the place and you really don't want to pay any attention to one month's readings.

Another way to gauge business happiness about the world around them is to look at employment intentions. The result for all sectors was a net 9% positive. This was down from 11%, and as I wrote over the weekend in response to a zealot who emailed me expressing disappointment that a "…person in my position…" would buy into the hypothesis of human induced climate change – meh.

Employment intentions are just below the 11% ten year average and there could be a downward bias as some firms are so despondent about finding labour, let alone people who can read, write, count, turn up on time and not have dope in their system, that they probably have given up looking. Kumara prices are rising in Northland because growers there cannot get enough pickers. Isn't that supposed to be a region of high unemployment?

Looking across the sectors for the past three months for employment intentions we get the following graph.

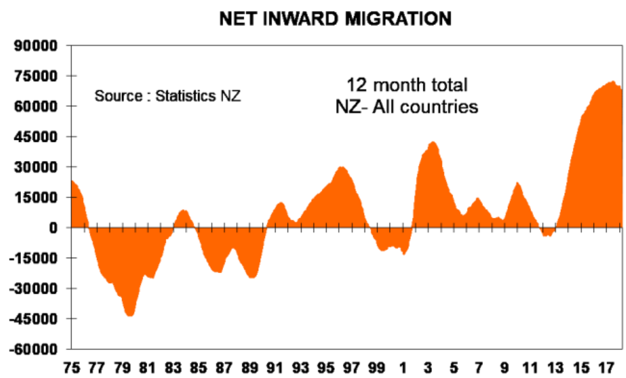


This is different. In the two sectors reporting the greatest difficulties sourcing labour employment intentions are the weakest from normal. This backs up our hypothesis that some employers see little point wasting money on a search for labour they don't expect to find.

Apart from that there's nothing too much more we can dig out of the long-running ANZ survey, except perhaps the fall in the net percent of businesses planning to raise their selling prices to 22% from 29%. Forget tightening monetary policy for a continuing long time.

Immigration

We saw the monthly migration numbers released two weeks back and there was nothing in there causing any surprise. The universal view is that the net migration annual gain which peaked at 72,000 in July last year is on a slow path down toward something between maybe 20,000 and 40,000 in three or four years' time.



Don't however lay money down on any of the forecasts being right because having been in this business for three decades I have never seen any reliable model for predicting net migration changes. Sure, back in late-2012 I picked that flows would turn around from a net loss of 4,000 as the cycle with Australia was due to turn. But I figured the flow would get to about the 34,000 peak we saw in 2004. The actual peak was 72,000.

The key thing to note is not so much that the trend is down, but that the decline is very, very slow. In fact with a decline of just 4,000 over a period of eight months that works out at an annual turnaround of only 6,000. At such a pace we won't hit the ten year average gain of a net 30,000 until over six years from now in 2025.

The slow pace of the net migration turnaround means that population growth for NZ is likely to remain above the 1.1% per annum average for the next half-decade. That means pressures on the housing market in big cities are likely to continue, rents will be pushed higher (with assistance from some investors leaving the sector and costs rising across many areas). But businesses will also continue to see above average growth in customer numbers ceteris paribus.

What that means is that if nothing else changes your customer numbers will go up. If you believe nothing else will change then I would suggest you sell your business now because things in most sectors have changed and will continue to change at a pace and in ways none of us can predict. Not a single one of us in the 1990s that I am aware of ever thought that the message behind Gary Larson's cartoon about parents stupidly watching their son playing video games dreaming of massive salaries being offered for his skills would prove completely wrong. Such people were on stage at the packed out Supanova Convention on the GC last weekend talking about their lives.

I've never seen so many costumed people in one place before or so much merchandise being pawed over. And these geeks were really happy to parade around in their loose-fitting gear. It made me think that if an actual costumed superhero did ever show up in reality we would laugh our heads off. Aussies would shout out "Dress normal ya plonka." Go Luke Cage.

It was a wonderful experience and I thoroughly recommend attending such an event in New Zealand next time one comes around.

Anyway, my key point is that it is your ability to recognise change and adapt to it which will be the key determinant of your business' success over the next few years.

The migration release from Statistics NZ also gives us tourism flows and what we see there is that during the March quarter the number of people visiting New Zealand was almost 8% ahead of a year earlier. Seasonally adjusted growth for the quarter was flatter at just 0.6% which tells us that this time last year was a tad weak.

The underlying trend in visitor numbers remains upward and with the world growth outlook seeming to be okay this will act to encourage investment in our capacity constrained tourism sector. Spending will be undertaken by central and local government to prepare for greater numbers and try and catch-up on addressing pressure points which have already developed. Hotel and motel construction is likely to remain strong and at the forefront of many people's thoughts as you and I sometimes struggle to get into reasonable accommodation if we make last minute bookings for our domestic travel. Book ahead these days is the rule else you'll end up billeted with goodness knows what company weirdo. Lock your door.

Note that a recent report estimated the tourism sector brings in $14.5bn worth of export earnings and that this makes it the biggest export sector. However, education exports are included in this total and that seems like a bold addition to make. Additionally, people often leave casein out of their dairy export calculations and probably are currently not factoring in the very good growth in dairy receipts which has occurred recently. In truth dairying remains our biggest export earner at $15.1bn in the year to March but the writing is on the wall.

Tolerance of negative environmental impacts of the expanding dairy sector seems to have been pretty much used up and dairy farmers should pay close attention to the strong green leanings and policy focus of the new government. Recommendations are coming thick and fast to move now and include farming in the Emissions Trading Scheme and when this happens the inability of farmers to pass on carbon credit costs into their selling prices will see sectoral profits decline. Many will effectively be forced to turn over grazing land to forestry or at least embrace agroforestry more strongly. Some will look more at horticulture and perhaps start from the position that labour they will need for harvesting etc. won't be there so fully mechanised operations will be pursued.

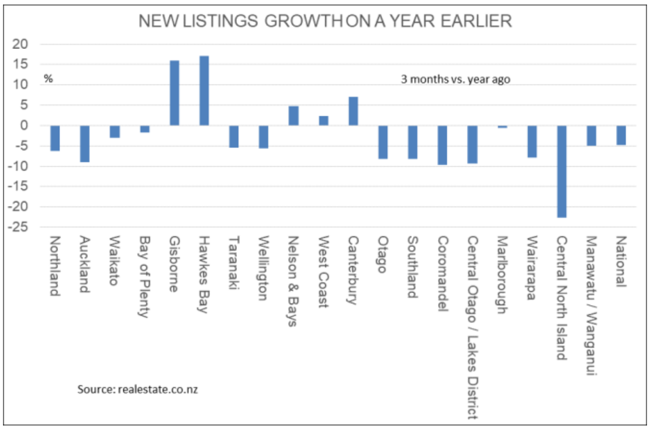
Don't be surprised if you find yourselves included in the ETS at a pace of, say, 10% of emissions added per annum until 100% after 10 years, with minimal if any consultation. Just ask the oil and gas sector how much consultation they had.

And one day down the track vat-produced milk will be a thing. It is easy to conceive of export sales falling away as such multinationals make their biscuits with bulk vat milk rather than our real milk. But we may be years from companies like Nestle being able to make such a switch. And years from driverless cars. And years from cheap electric cars perhaps using hydrogen fuel cells. And years from things we can't even imagine at the moment like home robots and widespread AI. I guess this is what it felt like living through the Industrial Revolution – massive unpredictability and disruption.

Housing

This week the people at realestate.co.nz released their monthly collection of data so let's dive in there to see if we can find anything interesting.

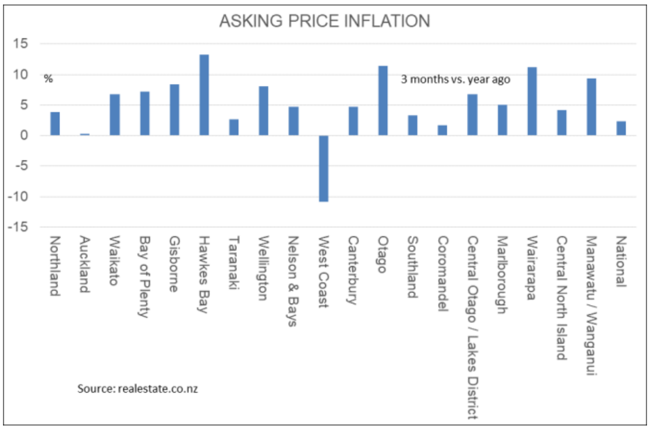
Starting with new listings we see that in most locations agents are finding fewer vendors making property available to them to sell than was the case earlier. Nationwide the decline in the three months to April from a year ago was 5%. That is not really here nor there. Central North Island sticks out as weak but those numbers are only 1% of the NZ total so 99% of you don't care. In Hawkes Bay and Gisborne more listings are appearing and things are up a bit in the top half of the South Island.



So what do you think that means if listings are up? Could it mean vendors are bucketing out for fear of prices falling so want to quit stock now? Could it mean people who have held stock for years now finally see a chance to offload and are doing so because there are many buyers?

You can't make any conclusion just from this dataset which is mainly relevant to agents contemplating leaving the sector as regional booms go the way of Auckland's earlier boom. You need to look at prices. Here goes.

The report from realestate.co.nz contains asking prices and comparing three month averages with a year earlier we get the following graph.



Sorry West Coast. Much as I enjoyed my time in Greymouth on Tuesday and the long drive Tuesday night through to Blenheim (a 16 hour day now and then really lets you know you're alive), you are the only region in the country with falling asking prices.

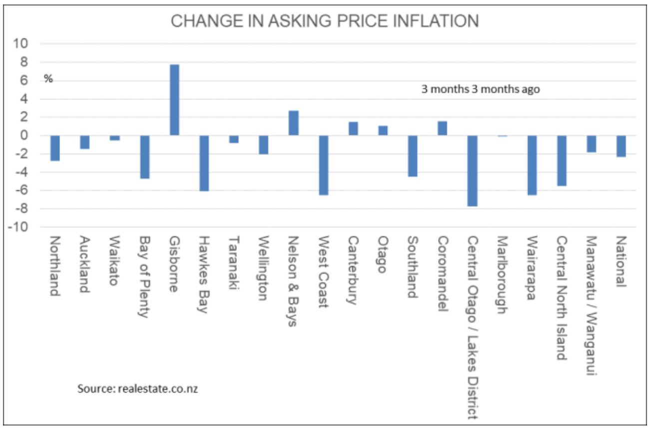
Personally I always search listings on the West Coast, usually the Buller region, when I want a dose of property porn. Prices are so low compared with the cities that the dreams flow freely and at certain times one thinks about buying, forgetting the flooding risk building in Westport through reduced river dredging, and the economic challenges as Labour governments every generation or so strip another natural resource from the list of things which can be extracted and sold by Coasters. Thankfully tourism is growing strongly.

In Hawkes Bay and Gisborne prices are rising firmly. Outsiders will be buying in, past cycle investors will be selling, and overall the markets still look strong. Canterbury is interesting – and I expect it to become more so over the next three or four years.

Prices there are rising at the fastest annual pace since mid-2015 (5%) and listings are rising. I have a theory that completion of the convention centre, hotels, and stadium along with the CBD being viewed as largely “done” will see an appreciable flow of young people out of Auckland and Wellington. They will be going for more affordable housing whilst still experiencing good job and career opportunities across a wide range of sectors. The risk is that people start thinking about such things over an earlier timeframe than I envisage and some canny purchasers start moving into the market over the next couple of years.

For your guide the average asking price in Canterbury over the past three months was $500k compared with $607k in Wellington, $956k in Auckland, $570k in Waikato and $670k in the Bay of Plenty. West Coast was $254k. Now there’s a beautiful place to free up capital to fund retirement.

Let’s finish by getting to the real nitty gritty. Is the pace of house price inflation accelerating or decelerating across NZ? We answer that by comparing annual asking price inflation in the three months to April with the three months to January. And voila we get this third graph.



It tells us that the pace of house price inflation is slowing down fairly quickly in some places, but has lifted in Canterbury and Nelson etc. Apart from what will probably be a short spell in the sun for sunny Gisborne, markets are easing off essentially everywhere except Canterbury and Nelson. So were I an investor looking for an area with perhaps a tad better buffer against new costs being heaped on landlords it is perhaps to those two regions that I would look. Plus I would still be a long-term buyer in Auckland based on the imbalance between construction (can’t get staff, see above) and population growth.

And if I were really looking for a property with a potentially high beta (go look it up), you know I’d be in the market for something other people would shy away from because of the extra work involved, especially in a non-booming environment – perhaps something contaminated or in need of labour-intensive doing up?

If I Were A Borrower What Would I Do?

Same old. I would fix in a mix of terms extending at most to three years. For sure, currently there is upward pressure on US interest rates and a lift in inflation to come from rising oil prices and perhaps more acceleration in wages growth.

But it pays to note that the pace of growth in the UK economy has just slowed down and the same has happened for the United States, China, ourselves and the European Union. There will be a growth-restraining effect from higher oil prices, and local growth will also be constrained by new levies the government is sure to come up with to fund spending plans aimed perhaps at holding their fragile coalition government together.

Having said that, this year's Budget on May 17 is expected to stick to the fiscal rules laid down by Labour ahead of the general election. (The media-shy Finance Minister just said so this week.) Namely, moving along a track to reducing the net debt to GDP ratio to 20% from 22% within five years, keeping government spending near 30% of GDP, and running operating surpluses. Eventually fiscal rectitude will go out the window because that is what has happened the last two times Labour occupied the Treasury benches. But probably not until they can see themselves being booted out.

Note that deliberately slowing the pace of debt reduction in order to accelerate infrastructure development is something different from loss of fiscal bowel control and not all that frightening (unless it involves the light rail to Auckland Airport from the CBD. That does not stack up. Go see the light rail on the GC and measure how many metres of road width the tracks take up.) But the Minister should be applauded for taking the long-term reality of another natural disaster one day hitting us hard and requiring a strong fiscal response as National undertook following the Christchurch earthquake. That shock came on top of the good fiscal response to the Global Financial Crisis.

For your guide, don't start thinking that predictability of interest rates is any better now than at any other time since 2008. Around the world interest rate forecast accuracy has been appalling post-GFC and as debate rages on things like why inflation is so stubbornly low and why wages growth is so benign internationally, it is unreasonable to think that high reliance can be placed yet on forecasts of these two important interest rate drivers. Consider also that there is another new element in the mix here – credit controls.

In New Zealand since the mid-1980s the view has been that it is best left to the market to ration credit and the central bank can influence inflation outcomes simply by changing the cost of that credit. But post-GFC the world has recognised the dangers of such a relaxed attitude toward lending growth and central banks have put various measures in place to give them greater control over areas of excessive lending growth – essentially for housing.

The existence of instruments such as our loan to value ratios means not only that interest rates won't have to go as high over the tightening cycle as has been the case in the past, but that if economic damage from rising interest rates becomes apparent – for exports basically – then a switch toward raising LVRs would be highly likely.

But we are well away from such a scenario potentially playing out and the chances are that the next change in LVRs will be a slight easing rather than a retightening. Facilitating this will be likely further unilateral bank tightening of lending criteria (no loosening will happen following Australia's Banking Royal Commission!). Additionally, investor credit demand for property finance is likely to ease as the government makes property investment bit by bit less attractive.

Does this mean average investors looking to prepare for their retirement through more than just placing funds into Kiwisaver will instead shift into equities? Probably not. Remember that a lot of the money people have been putting into housing has come from debt. There is not a pool of hundreds of billions of dollars ready to shift into New Zealand's forlorn sharemarket. And don't even think about trying to borrow money to buy shares. Banks remain replete with people who lived through the 1980s crash and know the dangers of borrowing to buy something for which the price (security backing) can halve or disappear very quickly. That hardly ever happens for residential property where valuations are far more stable than for shares. If equities are your choice, look to boost portfolio stability through buying a range of stocks and not just one or two because you think you understand their business, believe they run it well, and reckon disruption hitting them looks unlikely.

And seek to spread your risk by investing over a long period of time rather than just one day. That is where Kiwisaver is great. Your end value represents investments made over potentially a 45 year period.

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