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.

Happy Crapmas

Happy Matariki, happy Winter Solstice, or in my family, happy mid-winter Crapmas. We used to celebrate mid-winter Christmas but decided the useless presents being exchanged meant we may as well officially retitle the event as Crapmas instead – ceramic dolphins for everyone!

This morning we saw the release of a set of numbers which in theory we economists should be really excited about because ultimately the studies we have undertaken and the predictions we make are all geared in the end toward predicting how strong the economy will be and what the implications of that growth will be for employment, inflation, interest rates and so on.

But by the time we get each quarter's Gross Domestic Product data the numbers are well out of date, and every quarter we come up with a list of reasons as to why the rate of change could be biased upward or downward by special factors.

This time around we are noting that the low quarterly growth rate of 0.5% is not really telling us that the economy is growing at only a 2.0% annual rate. Instead the number has been pushed downward by some temporary factors including an easing in construction activity probably in response to capacity constraints and the Kaikoura earthquake.

The true underlying rate of growth in our economy we believe is something closer to the actual growth in the 12 months to March versus the 12 months to March last year of about 2.7%.

Does the result this morning tell us anything interesting with regard to where the labour market and interest rates might be going? Not really. The number had been widely expected is one reason. The other reason however is that the relationship between GDP growth and outcomes like inflation and interest rates has fallen apart over the past decade.

Ever since the end of the global financial crisis in 2009 we have seen forecasts of rising growth producing rising inflation and rising interest rates wrong – except in the United States over the past couple of years where interest rates have been increased 1.75%.

We struggle around the world to fully understand let alone explain to our audiences exactly why inflation is remaining so low even in economies where economic growth and jobs growth are very strong. One reason is an absence of accelerating wages growth in spite of tight labour markets. But why is wages growth remaining so muted?

It might be because of reduced workforce unionisation rates, or internationalisation of jobs, or automation of processes, or simply employees being scared to ask for rises because they worry about global events and another big downturn. Maybe the wide range of opportunities facing new labour force entrants these days means they do not seek rapid wage rises as we all strove for in the past – instead aiming to garner higher incomes through lucking into the next Google or Apple start-up success.

No-one feels they have anything yet approaching a full explanation as to why wages growth remains muted. That means no-one can with confidence make any strong prediction as to when wages growth will actually accelerate. That means no-one can strongly state a forecast for when inflation will start really jumping up. And that means we have to all keep treating forecasts of rising interest rates with a huge grain of salt because since 2010 around the world almost all interest rate forecasts have been wrong.

Perhaps a big factor contributing to the restraint in wages is one we have highlighted for some years now – businesses pushing back more against wage claims because they cannot easily raise their selling prices. Unless you are a local authority, central government, electricity company, insurance company, or large technology firm, you're probably not going to get away with charging us consumers higher prices.

That is because these days we can easily look for an alternative supplier of a good or service online using our smartphones. Plus when we get angry we flock to social media to lodge our complaints and stir up indignation. For some companies such as those types mentioned above this will all be water off a duck's back. But for others producing products we can live without or easily find alternatives for these things matter.

Whatever the true causes of low inflation and low interest rates, there is nothing in this morning's GDP numbers suggesting to us that the outlook for pricing pressures or labour market growth is any different now from what it was yesterday. Enjoy your dolphin.

Cryptocurrencies

As of the start of this week there were 1,629 cryptocurrencies in existence for which price is commonly tracked, with market capitalisation of US$277bn of which Bitcoin accounts for US$110bn and Ethereum $50bn.
https://coinmarketcap.com/all/views/all/

This week the Bank for International Settlements devoted a chapter of their Annual Economic Report to cryptocurrencies.
https://www.bis.org/publ/arpdf/ar2018e5.pdf

The chapter runs to 24 pages, is not too difficult to read, and I would recommend it to anyone interested in this topic. Or you could just get the gist of it by reading an article penned by the founding CEO of PayPal Bill Harris
https://www.recode.net/2018/4/24/17275202/bitcoin-scam-cryptocurrency-mining-pump-dump-fraud-ico-value

In a nutshell, cryptocurrencies do not qualify as money because value is exceedingly unstable, neither volume nor transaction processing ability can be adequately scaled with increased use, they appear to be easily stolen, their use is favoured by criminals because of the anonymity of users, and they are exceedingly environmentally damaging. In the words of the BIS report…

"At the time of writing, the total electricity use of bitcoin mining equalled that of mid-sized economies such as Switzerland, and other cryptocurrencies also use ample electricity… Put in the simplest terms, the quest for decentralised trust has quickly become an environmental disaster."

Or by Mr Harris's estimation, mining one bitcoin consumes as much electricity as used by an average US household in a two year period. He also cited an Ernst and Young study suggesting 10% of funds raised in initial coin offerings (ICO) last year have been stolen.

https://www.ccn.com/10-3-7-billion-ico-funds-lost-stolen-ernst-young-report/

Based on what we know to date, there is little chance cryptocurrencies will achieve the global transactional dominance which some are predicting. Instead, as Mr Harris notes, they are more of a "pump and dump" investment scam set only to end in major ill-gotten gains for the unscrupulous and outright criminals, and losses for the gullible and greedy.

Cryptocurrencies are not money, and according to the US Securities Exchange Commission many including bitcoin and Ethereum are also not securities.

https://www.cnbc.com/2018/06/14/bitcoin-and-ethereum-are-not-securities-but-some-cryptocurrencies-may-be-sec-official-says.html

That means no official oversight.

The blockchain technology upon which the likes of bitcoin ride however is a totally different thing and potential exists there to near wipe out whole industries specialising in fake art, fake pharmaceuticals, mislabelled food products etc. Personally were I 30 years younger and of a technological bent it is in the blockchain field I would be working, not cryptocurrencies.

Business Confidence

Just to finish off last week's comments regarding low business sentiment during Labour's reign from 1999-2008 not being associated with a weak economy, here are some numbers. The ANZ Business Outlook gauge of business sentiment averaged -18% from 1999-08. The economy on average grew by 3.5%, employment 2.5%.

From 2008-17 when National were in power, sentiment averaged +23%, the economy grew 2.5% on average and employment 1.8%.

That is not to say this government will last three terms. Increasingly they look like a one term wonder.

Mycoplasma Bovis

At Fieldays in Hamilton last week no farmer expressed concern to me about either interest rates or the exchange rate. The topic of m. bovis came up far less than I expected. But when it did there was near universal expectation that the efforts being made to wipe it out will fail. There is simply not high enough professionalism it seems from all parties when it comes to tracing animals as they move location, notifying the authorities about ill animals, and warning neighbours when a farm is being actively tested perhaps because of an animal connection with one of the 38 officially infected farms.

According to the literature m. bovis is a "production limiting disease". This means it is safe for meat and milk from infected animals to enter the human food stream, but animal output is negatively impacted. This occurs because infected animals may need to be killed, and because infected animals cannot easily fight off illnesses when they come along.

The disease is bad for NZ farmers in terms of some big changes having to be made to age-old practices of shifting animals from one farm to another and properly identifying 100% of such movements. But it is not necessarily hugely economically damaging.

In the United States the cost of m. bovis is estimated at about US$110 mn per annum. The US has around 9 million cows. In Europe the cost is estimated near €0.5 bn spread over 23 million cows. New Zealand has just over 6 million cows so maybe the annual cost for NZ if and when the disease is accepted as endemic will be between $100mn and $200mn per annum. NZ dairy exports are over $15bn per annum.

But while the economic cost of m. bovis is bad but not all that high, what is really worrying is the implications should we ever get foot and mouth in New Zealand. The poor handling of the current crisis by MPI (won't tell neighbours a herd may be infected in case kids of the affected farm get bullied at school!) is one big problem. The other is the unwillingness of any farmer to own up to receiving an animal from the main infected farm in the South Island, the comment from the first affected farmers that they wish they had never reported the disease, and comments from farmers at Fieldays that those suspecting a diseased animal are now simply killing it without calling in a vet and not reporting anything. No-one wants to expose themselves to the horror of having all their animals slaughtered.

This url will take you to what looks to be the most up to date report examining the economic impact of a foot and mouth outbreak.

https://www.mpi.govt.nz/dmsdocument/4406/loggedIn

It assumes no South Island outbreak and may underestimate forced slaughtering.

Housing

While there is a general view that the housing market will slow down further in response to easing net immigration, an upward bias to interest rates, and growing supply, price rise expectations still remain strong. This is according to a quarterly survey undertaken by Colliers International of some 6,000 people.

https://colliersinternationalnewzealand.cmail19.com/t/t-l-udkilll-xtririyuk-i/

A net 28% expect higher prices over the next 12 months in Auckland, up from a net 23% in the March quarter survey and 24% a year ago. In Wellington a net 51% expect rises from 38% last quarter and 42% a year ago. Christchurch 0% from -2% and 0%. For NZ overall a net 36% expect higher prices from 28% last quarter and 32% a year back.

I have generally not found these sort of price expectation surveys to precede actual price changes. But the strength in Auckland in spite of prices actually sitting flat to slightly lower is interesting.

Another news item regarding housing this week was the government's decision to weaken the ban on foreign house buying by exempting not just Australia as expected but Singapore also, and allowing foreigners to buy up to 60% of units in a new complex of over 20 units as long as they rent them out to unrelated parties when complete. Foreign students can also now continue to buy property if they want (possibly on behalf of their parents, friends and/or relatives back home).

The allowing of purchases of new apartments is akin to the situation in Australia and has been made necessary by the realisation that funding for such large projects from banks is dependent upon high presales and achieving such solely from a Kiwi client base is difficult.

Will the eventual introduction of the ban make much impact? Not really. Only an estimated 3% of property sales go to foreigners (including Australians and Singaporeans) and the high 18% in Auckland Central reflects construction of apartments most probably and the impact there will therefore be minor. And it pays to remember that while 3% of purchases are by foreigners, so are 1.8% of sales. So the net foreign buyer impact is really small.

Are You Seeing Something We Are Not?

If so, email me at tony.alexander@bnz.co.nz and let me know.

If I Were A Borrower What Would I Do?

One day I hope to be able to write something new and interesting here. Today is not that day. Were I borrowing currently rather than sitting in woe looking at the low interest rate I am earning on my savings I would probably have most of my mortgage fixed for two years, some for one year, perhaps a little bit for three years, and a tad floating to allow for early repayments.

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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