BNZ Weekly Overview

5 July 2018

ISSN 2463-4328

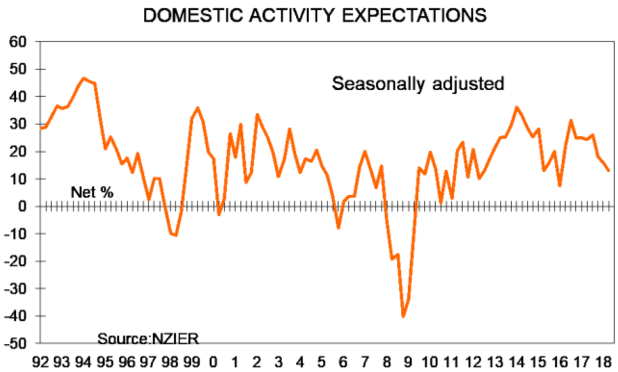
Mission Statement

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

Businesses Glum

The main new set of economic data made available to us this week came in the form of the NZIER's long-running Quarterly Survey of Business Opinion. As we all expected, the headline business confidence number declined during the June quarter to a net 20% pessimistic from 11% pessimism in the March quarter and 18% optimism a year ago.

A net 7% of businesses also reported that their trading activity rose during the June quarter which was down from 15% last quarter and 17% a year ago. A net 13% expect higher activity from 16% last quarter and 24% a year ago. The average reading for this important indicator is a net 17% positive. So trading expectations are below average but frankly not as much as could be the case given the downward bias.



As noted in our analysis of the ANZ's monthly release, there is a downward bias to business sentiment when Labour are in power as businesses worry about new regulations, the lack of business sector familiarity of the MPs, the eventual loss of fiscal bowel control, infighting by ideology-driven people, and this time around the fragile nature of the coalition and secret deals not yet revealed to the public. Arrogance and incompetence basically.

This means we have to be careful not to over-extrapolate these results into a dystopic economic outlook. It is best to acknowledge then move on from the headline sentiment reading and look at the underlying indicators. Doing that we get the following.

The labour market is very tight. A net 45% of businesses say it is hard to get skilled labour. The result last quarter was 44% and a year ago 47%. A net 30% say it is hard to get unskilled labour. A quarter ago this was 29% and a year ago 23%.

This tightness could explain why the employment intentions reading is low. Only a net 6% say they plan hiring more people from 6% last quarter and 12% a year ago. This 6% is right on the long-term average therefore in no way suggests a weakening labour market. That is important for things like continued demand for retail goods and services, domestic and outward travel, and housing demand from householders.

Businesses are continuing to indicate that their profits are under extreme pressure – from difficulties managing margins. A net 36% said their costs went up in the June quarter from 31% last quarter and 26% a year ago. The average is 25%.

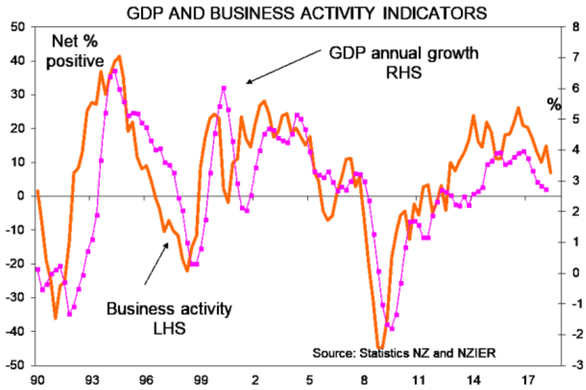
But only a net 29% plan raising their selling prices from 21% last quarter and 24% a year ago. The average is 21%. So price rise expectations are above average. Are prices actually rising?

A net 25% said they did raise their prices during the June quarter. This is well above the 11% average and suggests that there are some inflationary pressures bubbling underneath which will make our central bank wary of cutting interest rates in the coming year even if the global growth outlook continues to deteriorate.

Nonetheless, despite the price rise pressures, a net 12% of businesses say they expect their margins to compress which is above the 7% average.

Margin management pressures mean even though we see a good outlook for the economy many businesses are going to struggle.

One area of concern is a large fall in investment intentions to only a net 2% positive from 17% last quarter, 20% a year ago, and an average of 8%. Business caution does appear to be causing some rethinking of earlier investment plans. This is concerning because if businesses are to manage rising costs and labour shortages, prepare for change and boost capacity, they need to raise capital spending. We shall wait and see if this hit to investment intentions continues however before concluding that high pessimism is leading businesses to go back into their shells.



Housing

Following on from last week's comments regarding the shortage of builders here and offshore and government attempts to try and boost house construction using prefabs I received a good number of very insightful emails from experts in the field. Here are some of their comments.

A qualified builder working in a Scandinavian country noted that with ten hours a week overtime he is able to save as much as his annual net income would be in New Zealand and walks just ten minutes to work whilst getting six weeks annual leave.

A large NZ house construction company exec. noted that only one-third of the selling price for their houses reflects actual building costs. So even if a prefab costs 20% less than a build on site house, the price saving will only be some 6% - if it is passed onto the buyer. Prefab houses can be built faster. But the question is whether buyers will want one if the price at best is 6% less than a "real" house.

Regarding why costs are rising and margins reducing….

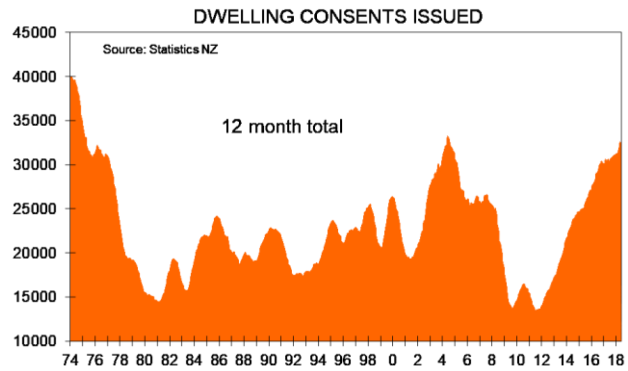
"ChCh and Kaikoura - A lot of cost is in the ground . I estimate in the last year the more conservative view and requirements of councils re liquefaction etc is now costing around an extra $20k a site (BTW South Auckland land is soft and most NZ towns /cities are built on the flat (Ed. flood?) plains which are runoff over millions of years - so soft ground …) Engineers are making us dig out the ground and put in aggregate raft floors on geo grid- Rib raft concrete floors on top . This will get more common.

Council - Auckland city has nearly ground to a halt due to development engineers and anyone related to the sector being swamped with paper work as the low risk threshold of councils is enforced at ever increasing levels .Time is actually a cost of around 10% of property development (e.g. the same as the cost of interest). Council time on developments is approx. half total time taken start to finish currently - so that's 5%. In other words it took us 6 months build houses and 6 months waiting consents and council CCC/224c

Funding Land developments
One of your fellow banks pulled the plug on all new land developments NZ wide a week ago .
Another pulled (out) of all provincial land development. So costs of funding will increase as second tier guys offering to do it at 12% inc fees (banks at say 7.5%) There goes another 5%"

Sceptical we may well be regarding the pace of growth in NZ dwelling supply over the next few days. But for now that growth rate is very good. In the year to May there were 32,628 dwelling consents issued all around New Zealand which was a rise of 6.5% from a year earlier and the highest 12 month total since July 2004.

Does this mean supply will overwhelm demand and prices fall? No. In the three years after that last peak in mid-2004 average NZ house prices rose by 41%. So be careful not to make strong conclusions regarding price movements on the basis of one number.



That also means don't be so silly as to think prices will rise 41% in the coming three years. You have to look at the big, big picture which we will do again soon.

In Auckland annual consent numbers now sit at 12,274, ahead 19.4% from a year ago and the largest number since August 2004. Note that Auckland's population is now about 30% larger than back then so for the market to feel as much supply boost as back then we actually need consent numbers near 16,000.

Note also, that especially in Auckland where housing intensification often involves demolition of one of more existing dwellings, the net addition to supply from consents can sometimes be as low as 80%. One factor pushing the net housing addition down is demolition of houses to make way for transport infrastructure. 22 townhouses are being removed for the Eastern Transport busway. And the 60 or so houses being used this winter for the homeless will eventually be removed for new roading.

And also note that with the shortages of labour it could be some time before many consents are in fact acted on.

The NZIER's QSBO discussed above also gives reason for caution regarding the ability of consent numbers to keep rising. A net 3% of architects expect housing design activity to decline over the next 12-24 months. This is a big change from last quarter when a net 10% were expecting activity to rise and 19% a year ago. The -3% reading is the lowest since June quarter 2009.

But things are nonetheless thankfully heading in the right direction for the moment with regard to starting to reduce the pace at which the shortage of housing in Auckland is growing.

Fieldays and Meat

There is an observation I could have made three weeks ago regarding what I discovered at National Farm Fieldays but I chose not to because the farmers there seemed really sensitive on the issue. Now I chose to because the farmers there seemed really sensitive on the issue. That issue is one for which Air New Zealand should be praised for highlighting – the discussion about plant-based proteins and lab-grown meat.

When I discussed with farmers the growing development of substitutes to meat grown by an animal every single one of them rejected the idea and said that people would not eat it. To say that they have a blind spot to these technological developments would be an understatement.

There is growing concern about the impact which we humans are having on our planet and a realisation that because our activities are so dominant an influence we now have the responsibility of actively managing those impacts. Perhaps the most threatening of those impacts is climate change for which we are responsible. It is leading to warmer air and sea temperatures on average therefore heavier rain storms which appear to be more violent that before. These rain events are causing greater damage on average than those in the past and insurance companies are having to factor water inundation risk into the premiums they charge.

We individuals are doing the same as well, slowly adjusting the prices we are prepared to pay for property located near rising/more violent seas and in areas vulnerable to flooding.

A key contributor to climate change is the farming sector. Animal-less meat production uses 75% less water than the traditional method involving a living thing moving around and requiring extensive and expensive maintenance. Sans-animal meat production also involves 87% fewer greenhouse gas emissions than production using live beasties which only exist for the meat they give us when killed and chopped into pieces of ex-animal.

Our concern about the environment was not great enough two years ago to allow us consumers to accept supermarkets charging us for single use plastic bags. We rebelled, the supermarkets backed down. Now we can see the logic of removing such bags and personally I refuse to accept one from non-supermarkets when offered something to carry my wares.

Attitudes can change given time and in this case with assistance from our children coming home from school with details about sea creatures being killed by eating plastic bags. We have accepted the logic of ditching the bags to save the sea life. Eventually the same thing will happen with dead creature meat. We will eventually become concerned enough about the environmental impact of global meat production and seek to have an impact switching either away from all meat entirely – becoming vegetarian as some 10% of Kiwis are – or switching to the alternatives.

At this stage concern is not great enough about the meat sector's impacts or the pressures of feeding some billions more people for this to happen. In addition alternatives are not yet available in sufficient volume or at low enough prices. But eventually they will be – just as eventually electric cars will be cheap enough and readily available enough for us to switch from our petrol-driven vehicles. Just as broadband and Netflix combined have become cheap enough, available enough, and good enough to allow more and more of us to ditch Sky (or cable services in the United States).

Personally speaking, I am going to spend the next few weeks seeking out meat alternatives to see what they taste like. If they taste okay then I will start to replace my once a week meat consumption with them when the cuts I want become available. Perhaps for other people who consume meat more frequently there will be not just a taste and functionality test involved, but a price factor as well. Best guess? Once the alternative is priced within 20% of the carcass flesh people will start to shift.

We are almost certainly years away from that happening. But this is where the actions of Air New Zealand are important and to be applauded. NZ farmers are very good at changing what they do and how they do it – as long as time is available to do so. Early warning of a shift in household tastes is important for determining what crops to sow each year.

The actions by Air New Zealand are part of this early warning. The writing is on the wall especially for production of meat for bulk consumption by the masses. When the alternatives become cheaper the bulk buyers for the likes of meat patties in hamburgers will shift – just as Nestle and other large buyers of milk powder for biscuit production will shift to vat-grown milk powder when available.

Meat and milk farmers in New Zealand need to remove their blinkers so firmly clasped in place at Fieldays this year and open themselves to the possibility if not probability that the bulk of what they produce will not be in demand ten, twenty, or thirty years from now. And as for talk that we can retain what we do by moving up the value-added chain to produce high quality cuts which true aficionados will demand? How has that worked out for Fonterra so far?

Rather than trying to bully people into not talking about it farm sector representatives and small-minded politicians in New Zealand would do better to start a discussion about how to prepare for this future – just as three decades ago discussion was opened up regarding preparing the need to make better financial preparations for retirement.

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?

Nothing new.

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