BNZ Weekly Overview

13 December 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.

Our Economy

Tourism Exports

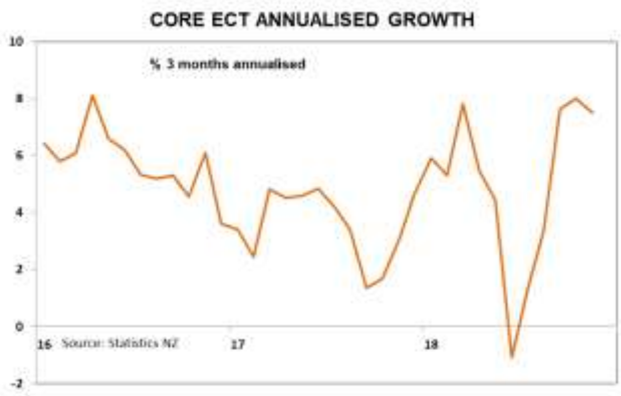
In the year to March 2018 the value of NZ tourism exports amounted to $16.2bn. This equates to 20.6% of our exports of goods and services. The dairy sector had exports of just over $15bn or about 19.2% of all exports. So tourism is now officially our biggest export earner. It directly and indirectly employs about 365,000 people though this includes domestic tourism – you and I driving to Taupo for instance. If we allow for foreign visitors accounting for 41% of total tourism expenditure then our tourism exports provide jobs for about 151,000 people.

A common complaint people make about the tourism sector is that the jobs are low paying. Many are, but that does not seem to be the case for the Air New Zealand staff who were planning a strike on December 21-23. Apparently the average pay for relevant engineers is $115,000 per annum including overtime. That is very healthy and belies the traditional criticism of tourism-related jobs.

The threatened strike by some Air NZ staff shows we cannot claim that the current surge in industrial action is simply public servants out for all they can get from "their" government. The labour market is tight in New Zealand and the chances are that industrial action will intensify as employers are finding it difficult to pass on cost increases from any source. So they are pushing back against wage increase demands more, perhaps hoping that provision of some greater flexibility in work hours and location will placate their staff.

Electronic Card Spending

Spending in NZ using debit and credit cards grew in seasonally adjusted terms by 0.5% in November after we remove the volatile fuel and vehicles categories plus services. Annualised growth in this measure was 7.5% over the three months to November so one cannot run an argument that NZ consumers have closed up their wallets. As pointed out last week, consumer confidence is running at an average level, the labour market is strong, house prices are rising in many parts of the country, population growth remains above average, and borrowing costs remain at extremely low levels.



This Christmas is likely to be one of firm sales growth. But as mentioned before, the strong competition in retailing means more store closures are likely across many categories.

The Housing Market

This week BNZ announced the start up next year of a shared equity scheme for home purchases. Details have yet to be fully thrashed out, but it looks like if buyers have a 10% deposit an investor can provide up to another 15% and the bank the remaining 75%. Or numbers like that. The buyer saves the extra interest charge for low equity purchases and becomes able to purchase when they would not otherwise have been able to. That last factor however may not be so substantial given that up to 20% of bank lending to owner occupiers can from January 1 entail deposits less than 20% of the purchase price. In October 8.9% of new lending involved less than a 20% deposit.

Nonetheless, the scheme will allow home ownership for more people than would otherwise be the case. Market impact? Numbers are not likely to be large but whatever they are they will add to demand therefore place additional upward pressure on prices. Housing is a supply/capacity constrained sector and only moves which boost construction will have much downward price impact.
https://www.stuff.co.nz/business/money/109248514/buyer-beware-there-will-be-pitfalls-with-bnzs-planned-shared-equity-home-scheme

Regarding KiwiBuild, popular commentary regarding the need to shift the focus from "affordable" accommodation for the upwardly mobile to social housing is growing and I find strong support for the eventual change when discussed at presentations. There is also growing awareness and cynicism regarding the way in which KiwiBuild seems to involve the government simply stamping the KiwiBuild brand onto apartments which were going to be built anyway by developers. But to the extent that acceptance by developers of the KiwiBuild financing backstop causes a rise in the proportion of a complexes' units which are "affordable" some difference is still being made.

The IRD released their official advice to the government regarding the likely impact of ring fencing investor tax losses on residential property. They estimate the change when legislated and enacted will bring in an extra $190 million in tax revenue per annum. They quite reasonably note that because this extra cost may encourage some investors to sell there is likely to be a reduction in the supply of rental property and an increase in average rents. They note that the occupancy rate for owner-occupied dwellings is less than for rentals so in aggregate demand for houses will actually go up.

How much rents rise is impossible to calculate but the change will place even more pressure on households earning low incomes and accelerate KiwiBuild's eventual shift from affordable housing to social housing.

Your Strategy

-Things to consider in your next annual strategy session.

Virtually everyone believes when running a business that the way to gain more profit is to sell more stuff. Activities are geared toward boosting the volume and spread of advertising, and opening new outlets and other distribution methods. Analysis and reports focus on growth and these days this growth sometimes is accompanied by ongoing annual losses which are accepted in anticipation of eventually gaining so much market share that profits will flow freely down the track.

This approach did not work so well for many Japanese companies in the 1970s and 1980s when pricing basic electronic products low in anticipation of eventual long term profits. As time passed and technology developed, cheaper alternatives to basic calculators appeared offshore and both market share and pricing power were lost.

Of relevance to ourselves here however is the assumption underlying the strong focus on sales growth. This is that the resources needed to handle the growth will be available. Those resources include people, premises, infrastructure, capital, finance, regulatory resources and even water and electricity.

Consider Auckland Airport. Auckland is the gateway to New Zealand for most foreign visitors, but if you have a choice it is best to avoid it because development has not kept up with volumes. The roading infrastructure into and out of the airport and on land around it is woefully inadequate for the new and rising volume of traffic. The terminals are terribly out of date, crowded, and increasingly industrial in their treatment of customers – which is where we run into a key problem when volume growth is the focus. The customer experience declines.

We scan our own bags before loading them ourselves onto tiny conveyor belts which dump them onto the main belt. We queue at inadequate security points. We muscle past each other in a domestic terminal bereft of strolling areas. And we suffer for hours if a water sprinkler goes off. Welcome to the third world.

This is what you get when competition is limited and the same applies across many sectors in New

Zealand – supermarkets, building materials suppliers for instance.

The two key points then which I wish to make are these. If you are a normal business then expanding volume without preparing adequately for it can cost you your reputation. But it will only cost you your business if there is strong competition. If there is not, well then your strategic plan probably includes a section dealing with complaints entitled "Meh".

Note Auckland Airport is not the same as Air NZ and the strike planned for December 21-23 was a different thing. Given the lack of competition for Air NZ (at least competition which can scale up suddenly if demand requires) – refer to Meh. At least had they gone on strike we would have been spared their appalling latest "safety" video.

I received an email during the week from a 29 year old called Jason contemplating leaving his secure job and buying a business of his own whilst maybe or maybe not purchasing a house or an investment property. He has a lot of balls in the air so I tried to give some clarity with these comments which maybe someone else might find useful – don't know if he did, he never sent a thank you. Snowflake.

"Regarding home ownership, I reckon it is best when one settles down and you are not at that point. So you'd need to treat any purchase as an investment. But if you are thinking of buying a business then I personally would not also be investing in property as your focus and cash reserves including borrowing capacity need to be at the disposal of your business' needs. Regarding finding a business you need first to have good insight into what you are good at then gain understanding not just about how to run a good business but why so many fail.

For finding a suitable business you would do best to contact business brokers to see what is out there. But if you really are good at what you do then think of starting from scratch without having to pay and raise debt for established fixed assets and goodwill of an existing business. And having a mentor or two would be a good idea.

Good luck and all the best for whatever you do. At 29 time is easily on your side still in this day and age." Nothing truly insightful I fear but hopefully of use nonetheless.

If I Were A Borrower What Would I Do?

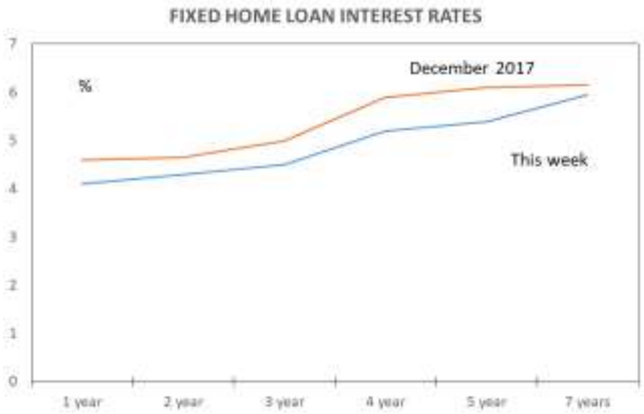
As noted in this week's email introduction, seemingly all we receive these days is a continuing stream of news items implying less economic growth, inflation, and need for tighter monetary policies offshore. The Brexit mess could throw the UK economy into recession and if so this will also disturb EU growth. The riots in France are bad for growth there. A Federal government shutdown looms in the United States – again. Commentary on China's economy is slowly getting more negative. Australian GDP growth has been weaker than thought. Sharemarkets are weak. OPEC, a traditional generator of inflation surges, frankly looks beaten.

Ironically, just as the UK is unwinding its 1973 entry into the European Union the decreasing relevance of OPEC represents an unwinding of their power first shown in force in exactly the same year.

If I were borrowing at the moment I would be inclined toward a two year fixed rate. Longer term gives more certainty of course, but the inflation outlook is mild and the cost of getting that extra protection is high beyond three years. Our current fixed housing rates for 1 – 5 years respectively are 4.10%, 4.29%, 4.49%, 5.19%, and 5.39%. The seven year rate is 5.95%. Residential investor rates are 0.1% higher.

If your deposit is 15% - 20% of the purchase price you will pay a premium of 0.35%. If it is 10% - 15% the extra is 0.75%. If 5% - 10% it is 1.0%. Less than 5% you pay an extra 1.15%.

This following graph compares the fixed home loan interest rates now with where they were a year ago. For all terms the rates are lower.



On Investing

Sharemarkets go up, sharemarkets go down, and the trick is not to panic when prices are falling and crystallise losses to avoid further losses. After all, how do you know what loss you are avoiding by selling like others are doing now rather than waiting another week or month? You did not forecast the initial fall in the first place so what miracle has just happened to now give you forecasting ability you lacked before the initial 10% market fall?

From a long-term portfolio point of view there seems little reason to radically adjust things at the moment just because a confluence of negatives is being factored into prices as a trigger for a potentially long overdue correction. These factors include Brexit and the increasing mess it is becoming, the Western pushback against an increasingly interfering Chinese state, slowing growth in many parts of the world (EU, Japan, China, Australia, UK, US next year), approaching regulation of the tech giants following abuse of their market power, rioting in France and fiscal incompetence in Italy, and Ukraine-related tensions.

Does it look like the world economy is radically slowing however? Not really. Some recent work by UBS Securities looking at the last 120 recessions in 40 countries has found an absence in the US in particular of the usual pre-recession indicators. Labour productivity growth is picking up rather than slowing and private consumption growth is accelerating rather than easing off. Data from JP Morgan shows corporate profit margins in the US are growing rather than shrinking.

Economic growth worries currently in play are tending to be specific to a country rather than systemic, and so far there is an absence of the sort of things going wrong which traditionally presage a recession – rapid interest rate hikes because of actual or feared high inflation, or a crash in an overvalued asset market.

Of course this is not to say that there is an absence of things which could go badly wrong. There is still a fair chance that the US trade dispute with China gets a lot worse. It all depends upon how quickly China adapts to being one amongst many international players rather than thinking it is the region to which the rest of the world should come and kow tow if wanting interaction – as was the case for many thousands of years.

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 here. http://feedback.bnz.co.nz/forms/lFdYSs5FGEq4kAjP95uzTA
To change your address or unsubscribe please click the link at the bottom of your email. Tony.alexander@bnz.co.nz