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.

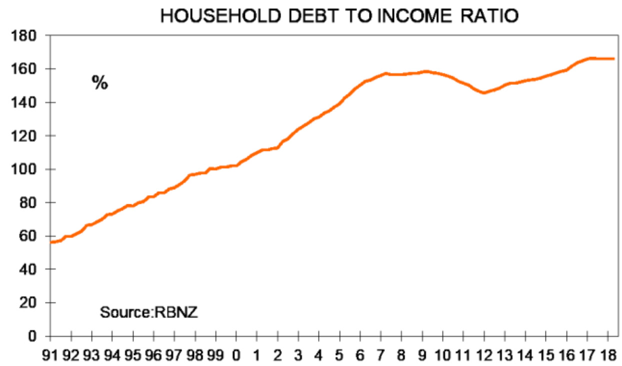
Our Economy

Last week in the monthly ANZ Business Outlook survey we saw a continuation of one of the worrying aspects of the collapse in business sentiment under Labour. Compared with early August the sentiment reading has gone from +18%to -37% net. The employment intentions measure has fallen from 17% to 2%. But the investment intentions measure has gone from 23% to -4%. The hike in pessimism is manifesting itself more as a pullback in investment than employment.

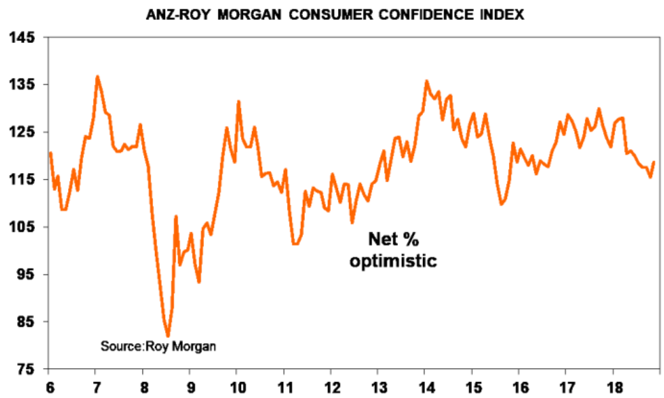
This might seem positive from a jobs market strength point of view and helps explain why we think the labour market is going to become even tighter. But the fall in business investment plans is going to be bad for future productivity growth. The operating environment facing all of us is changing quickly and that requires some hefty clever investment in technologies which allow us to recognise change quickly and react to it – if not lead it. But with businesses saying they intend holding back in the context of an already very tight labour market this means some big problems lie ahead.

As wage growth pressures become more intense more and more businesses will find themselves in a dire position of rising costs but the same limited ability to raise their selling prices. There is a clean out of the NZ business sector coming and the troubles we have seen affecting the construction and retailing sectors (strong sectoral growth yet failures aplenty, Corbel Construction the latest) will spread.

Speaking of retailing, there is still no serious reason for taking a downbeat view on household spending in the near future. Jobs growth is strong, interest rates are low, the ratio of household debt to income has been flat for a year and a half, the housing market is still rising, and confidence is okay.



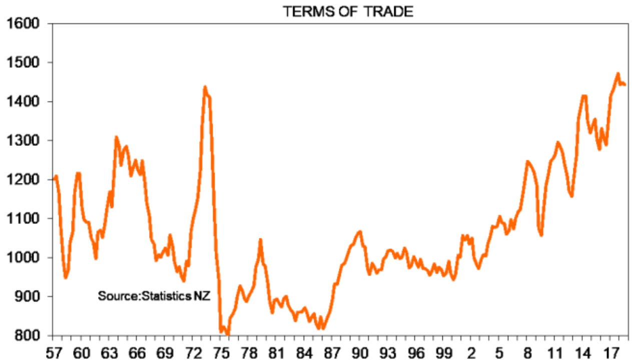
In fact the monthly ANZ Roy Morgan measure just lifted to a reading of 118.6 in November from 115.4 in October. The latest reading is the highest since July but equal to the ten year average.



In the short-term, for periods of perhaps less than six months, there is not a great correlation between changes in consumer confidence and consumer spending. But the slight downward trend since April this year does correlate with stories from retailers and some measurers of payment transactions regarding spending being reined in slightly. Nonetheless, there is little reason for believing this Christmas summer period will be weak for the country's retailers.

Terms of Trade

On Monday morning we learnt that New Zealand's terms of trade remain extremely high. The terms of trade measure the size of the basket of imports you can buy with an unchanging basket of exports – or the ratio of export prices to import prices. In the September quarter the terms of trade eased by 0.4% after rising 0.4% the previous quarter. The index now sits 0.5% down from a year ago and 17.4% ahead of exactly ten years ago.



Our terms of trade trended downward from the early-1970s – or at least it looked like that in the graphs of the terms of trade we were producing through the 70s, 80s, and 90s. To see this, use your hand to cover up the right hand side of the graph above from 2000 onward and then 1990 onward. But the trend has been upward since the start of the century, and you could even look at the graph above and suggest an upward trend from immediately after the mid-1970s!

The trend is important not just because it influences the pace of growth in incomes but because it gives insight into whether currency pressures are upward or downward. They are basically upward over the long-term for the Kiwi dollar now and the high level explains why my personal expectation for the NZD's movement remains on the positive side.

A big influence on the NZD however is how the Chinese economy is going as sometimes the Aussie and Kiwi dollars are treated as proxies for the Chinese currency which increasingly like the lives of ordinary Chinese is controlled by the Chinese state authorities. Growth is slowing in China and pressures are building around issues like debt and pushback from the West against expansion of the surveillance state outside China. China's own monitored citizens and companies are required by law to hand over information and spy for their leader for life if required. No wonder Chinese companies and products are being taken out of vulnerable utilities systems around the world. The private sector will be next. Including Chinese nationals?

The agreement between US and Chinese leaders at last weekend's G20 meeting to take a pause in their trade war has added to some of the current upward pressure on the NZD. Other such pressures include worries about Brexit hitting the British pound, worries about slowing Eurozone growth hitting the Euro, reduced expectations for the pace of monetary policy tightening hitting the US, Australian and Canadian dollars, and the AUD also affected by falls in iron ore prices. In fact across the ditch talk is growing of the RBA having to cut their cash rate as annual growth in the economy in the year to September came in at 2.8% which is much lower than the expected 3.3%.

The chances are that next year the US President will still boost the 10% tariffs on Chinese imports to 25% then move to levy tariffs against all remaining imports from China. When that happens some downward NZD pressure looks likely.

For NZ overseas travellers for now though the outlook remains positive with the NZD likely to remain strong. For exporters the rule of thumb remains the same as it has been for a few years now – build hedging when the Kiwi dollar goes through one of its dips. They always come along.

The Housing Market

KiwiBuild Focus Shift

Data requested by Stuff under the Official Information Act show that at the end of August there were 9,344 families on the state housing waiting list in New Zealand. This is almost triple the number in June 2015 and double the number of September 2016. Looking at the graph they supplied the rise looks to be quite steady and it comes over a period of time when the labour market has been strong along with the economy. https://www.stuff.co.nz/national/politics/107737757/waitlist-soars-more-than-9000-households-are-waiting-for-public-housing

I highlight this issue for one reason. At some point as

- Frustrations build about the speed of construction of KiwiBuild houses,
- pressure for price points to be lifted grows,
- market rents rise well above the inflation rate, and
- the state house waiting list gets longer,

a switch in construction focus is likely. The government will probably shift from building houses for young upwardly mobile medical school graduates needing four bedrooms for the two of them toward explicitly boosting the state-owned housing stock. The difficulties young people face achieving home ownership are well known. But continued low borrowing costs and flattening prices alongside rising incomes will improve affordability for them.

But the problems confronting those at the lowest ends of the socioeconomic spectrum are becoming larger all the time. Given the rising tendency for our two main daily newspapers to run extended stories about disadvantaged groups the pressure will grow on the government to address this other dimension of the housing shortage – affordability and availability for the poor, be they on a benefit or working.

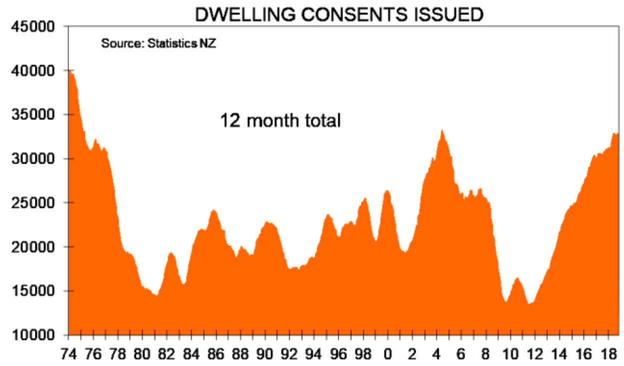
When will this switch happen? Hard to know but proposals for it are likely ahead of the next general election as the Opposition are likely to highlight housing failures. The change may coincide with the transfer of Phil Twyford to a different ministerial role. The dismissals of concerns about KiwiBuild, and secretly changing policy to let people sell their discounted properties within three years and keep all but 30% of the capital gains rather than none suggests insufficient appreciation of the importance of what needs to be done.

What will the impact be when the shift in focus comes? Good for our poorest (though from a worse housing position than where they are now) but bad for the upwardly mobile as expectations of the magnitude of increase in supply of “affordable” homes get scaled back. House price impact? Upward marginally but not by enough probably to kick off the next strong phase of the housing cycle.

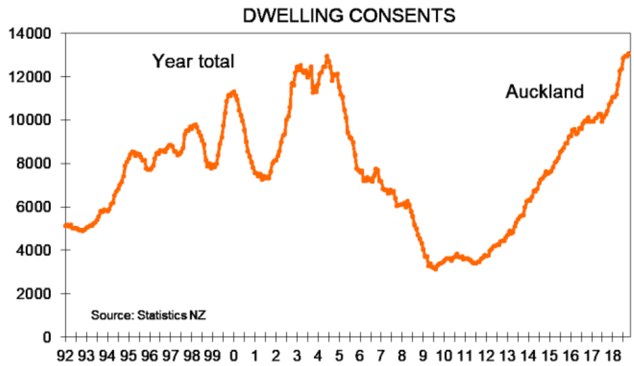
And as a related side issue, if concerns about affordability fade while problems for those at the low end of the socioeconomic spectrum build and elicit more vibrant discussion, a pathway will be provided for the government to back away from proposing introduction of a capital gains tax ahead of the 2020 general election. Just a theory but a factor supporting my view that a CGT is a 50:50 call.

House Building

There was again some excitement this week when Statistics NZ released monthly housing consents data. The nationwide annual total of consents rose to 32,925 in October from 32,548 in September and this is the highest annual total since mid-2004.



Auckland’s annual total is now 13,078 from 12,945 in September and this total now just exceeds the high in mid-2004 of 12,937.



Exciting? Not really. Since 2004 Auckland’s population has grown by 32.4% and the rest of the country 17.1%. To exceed the 2004 peak the current total for Auckland needs to be near 17,500. For the net addition to the housing stock however the number would need to be even higher than that for a 2004 comparison because of the way in which many developments now involve demolition of houses which are old and in the way.

Many people fondly talk about the house building boom of the early-1970s. Back then the annual number of dwelling consents hit over 40,000 in 1973. That was when the population was 3 million. Now it is almost 5 million. The equivalent boom level number of consents needing to be issued therefore would be just under 47,000.

Property News

For the moment Auckland's housing market is in the flat phase of its cycle with support for prices coming from a wide range of sources such as population growth, low interest rates, easing credit controls, a worsening shortage, rising construction costs, and a strong labour market. The restraint comes from the simple fact that a new equilibrium has been reached – meaning those who can't afford to buy are for now priced out of the market.

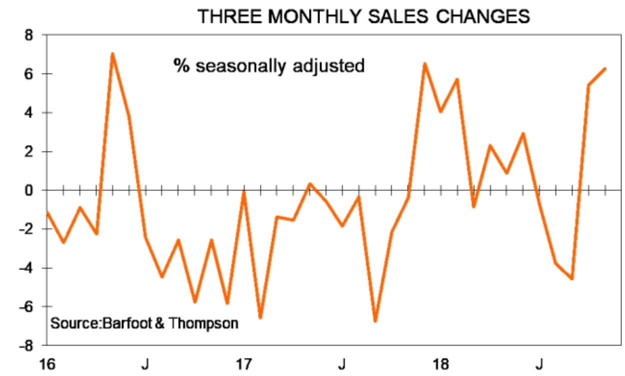
At some stage in perhaps 3-4 years' time the market will surge again. When that happens media commentary will once again blossom with stories of incredible prices, quick gains, and difficulties for people trying to make a purchase.

The discussion itself is one of the factors which in the past has helped propel the market higher and will do so again. Next time however there will be an extra boost from the OneRoof real estate information business set up and owned by NZME. https://www.oneroof.co.nz/

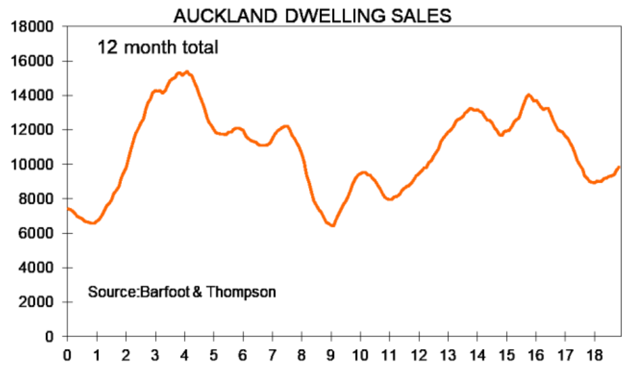
But on top of that we already have the increasingly useful data and discussion being supplied by CoreLogic. Individual real estate agents seem to have set themselves up regular newsletters as well. These discussion flows augment those already in play from the likes of Barfoot and Thompson in Auckland and REINZ data.

Auckland Okay

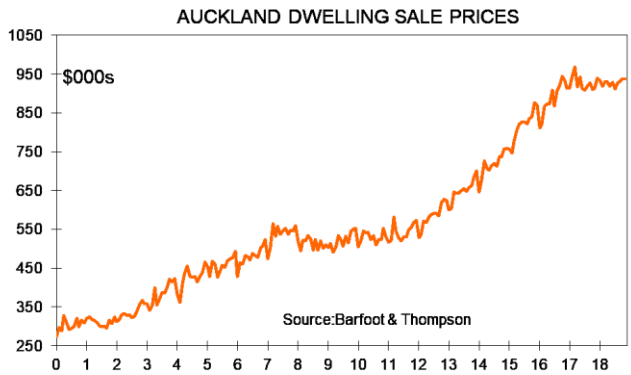
Data from Barfoot and Thompson show that in November in Auckland dwelling sales in rough seasonally adjusted terms fell about 2% after soaring 26% in October. Sales have improved about 6% s.a. over the past three months which sounds impressive but follows an 8% fall in the three months before that.



Are sales then flat in underlying terms? No. They have been recovering since early this year.



What about prices? Have they also started to edge up since early this year? The following graph suggests not really.



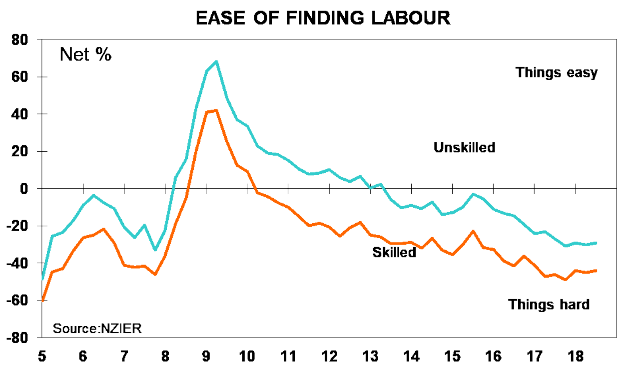
Your Strategy

-Thing to consider in your next annual strategy session.

Labour Availability

Despite a 1.3% boost to our population from net migration inflows over the past year the NZD labour market is tight and getting tighter. The unemployment rate has fallen to a ten year low of 3.9% following growth in job numbers of 2.8% over the past year and 15% exactly from four years ago.

A net 44% of businesses in the NZIER's quarterly survey say they are finding skilled labour hard to find and a net 29% say unskilled labour is hard to find.



Many businesses will be run by older people who have memories of high unemployment, calls for job creation schemes, and easy ability to grow one's business by hiring skilled and motivated people rather than investing in new equipment and processes. Such folk are probably keen on lobbying the government to let more migrants in – but only for their specific jobs!

The troubles they face with such calls however are twofold. First, a centre-left government concerned about the slow pace of wages growth and exploitation of migrants (usually by people from their original home country it seems) is unlikely to move to accelerate the inflow of people into the country. Second, the countries which we have traditionally sourced skilled people from are suffering their own skilled labour shortages. There is nothing unique about the tightening up of our labour market.

Businesses are going to face a still deteriorating environment for keeping and sourcing labour and the need to invest in labour saving technologies will only grow. Businesses need to give serious thought to whether they can sustain their current level of output and/or whether they can meet their expansion plans without running into potentially major issues around output quality, timeliness, redo jobs etc. For some the best answer for handling operating in our capacity-constrained economy is to constrain their own output, perhaps focussing on highest value clients which one has good relationships with and who can better facilitate experimentation to achieve future goals.

If I Were A Borrower What Would I Do?

For your guide, in the United States the markets have started to price in the possibility that the Federal Reserve will start cutting interest rates from the first half of 2020. This helps explain why the yield on ten year US government bonds this week fell to their lowest level in 13 weeks at 2.9% from 3.2% a month ago. Why such pricing? In six months the US economic expansion will be the longest on record. Betting that it will continue is becoming less safe in the minds of many – though in the absence of a surge in inflation, borrowing costs and oil prices it is hard to see why growth would slow precipitously.

With regard to our own inhouse official view on NZ monetary policy, we now see the first rate rise from our central bank as not likely to happen until almost the end of 2019, and the totality of rate rises only amounting to 0.5% with the official cash rate going from the current 1.75% to 2.25%. You'd have to be sitting on a fairly large pile of floating rate debt with little spare cash left over for that magnitude of move (if it happens) to cause any major trouble through 2020.

Personally I still see little chance of NZ inflation rising much in the near future and as a borrower would have to be presented with a remarkably better rate than currently on offer to get me to fix for longer than three years.

With our current rate slate showing 4.1% fixed for one year, 4.29% fixed for two years and 4.49% for three years I'd probably fix most of my debt for two years.

Investing

There was an interesting little piece of research discussed in the Financial Times last Saturday. A survey of 300 readers and 40 advisors enquired about the piece of advice most frequently ignored by clients. The most commonly cited one was "spend more". Older people tend to fear running out of money before they die and not well gauge what the pace of rundown in their funds will be as they age.

Of course these are results garnered from people in upper income/upper asset brackets and the result would not be anything approaching a universal one for the average retiree – especially in New Zealand where most people in retirement are dependent largely upon superannuation. But it is good to acknowledge that there does need to be some challenge to the scary stories which promoters of retirement saving have been pushing down our throats for three decades now. Save or freeze and starve basically. Personally speaking, once the new Retirement Commissioner comes along I'd like to see some more balance in the preparing for retirement story with more emphasis on calculating or "feeling" the impact of choices in consumption now on money made available for incontinence clothing in old age. Bullying people into saving is not the right way to go.

And I'd move away from trying to scare people into fearing that national superannuation will disappear or be radically cut in the future. Politicians respond to voters (France this week) and voters have made it clear they want the full untested super regime to continue. I'd move to emphasising the benefits of supplementing one's income in retirement through saving now.

And frankly in that light, as long as one is in Kiwisaver from an early age that supplementation may well be taken care of. As for raising the age of retirement to reflect improving health of older people, that won't happen as it would open a Pandora's Box of issues related to health of different groups in society. It would take a massive fiscal deterioration to elicit popular tolerance of a higher age of eligibility for national superannuation.

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/IFdYSs5FGEq4kAjP95uzTA
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