BNZ Weekly Overview

15 November 2018

ISSN 2463-4328

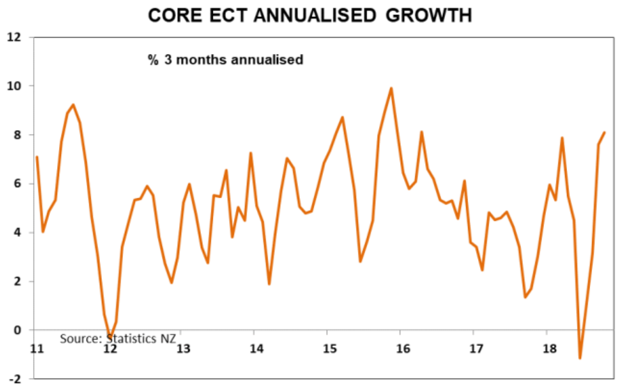
Mission Statement

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

Spending

We learnt this week that core retail spending using debit and spending cards was unchanged in October from September after adjusting for seasonal factors. Does this mean the high pessimism from retailers is apparently justified by no spending growth by consumers? Not really.

Monthly data can go all over the place in New Zealand and it is best to smooth over at least three months. Doing that we see that courtesy of this spending measure rising by 1.1% in September and 0.8% in August the annualised pace of growth in the three months to October was a very high 8.1%.



Yet in spite of these numbers we have data from other sources suggesting consumer spending growth is quite weak. It could be that some retailers have been affected by consumers pulling back on discretionary spending because of the hike in petrol prices. If so then the current declines in petrol prices should soon see such spending lift again. Some retailers may also be feeling the effects of a stalling in inward visitor growth since the start of the year.

Speaking of which. Last week brought agreement from people attending a large tourism sector conference that going forward the focus for operators would shift away from simple volume growth toward higher value activities as a means of growing revenue without overwhelming our country's infrastructure and affecting the traditional holiday experience for Kiwis.

Based on the experience of Fonterra adopting such a goal early in its 17 year life the chances are not good that we will see deliberate curtailment of volume growth. Under Fonterra and the rules it was legislatively required to operate by the focus has been on milk volume. This has come at a cost to NZ waterways and an acceleration in the pace of global warming through higher methane emissions whilst providing economic boosts in regions like Southland and South Canterbury.

Travelling down south last week when I mentioned the expansion of intensive irrigated dairying into unique landscapes of high aesthetic value the response was that this was the most economic use for the land. Yes, such thinking still exists in New Zealand. Someone also expressed concern that people in the cities did not appreciate dairy farmers, that dairy farmers felt sad because they felt unappreciated, and that all the people cramming into cities were also bad for the environment.

Actually, if a sector needs other people to appreciate them in order for them to feel happy then they have a problem. If the true environmental costs of intensive dairying were sheeted home to farmers then the economics of conversions would not always stack up. Just because dairying might be the most economic use of land by some calculations does not mean the capital allocated to it is achieving its best return. And as for people increasingly living in cities – that is more environmentally efficient than having populations spread through the regions requiring cars to travel everywhere.

Note that issues of the environment are starting to become a stronger influence at the ballot box. This can be seen in the types of candidates who won seats recently in the US mid-term elections in Florida in particular. Voters seem to have favoured candidates seeking to address issues related to hurricanes, red algal blooms, banning offshore drilling and favouring investments in renewal energy generation.

Environmental issues, as former Prime Minister David Lange might have said, are becoming a "matter of moment." Farmers are aware of such issues and the need to do something about them.

In fact it looks like a trend is developing in the allocation of capital and debt in the NZ farming sector. It is away from dairying toward high value horticultural activities plus things like sheep milking. In other words, at the margin investment in dairying is being eaten away, probably because traditionally very forward-looking farmers can see the writing on the wall with regard to costs now and coming in the future for mitigating negative externalities of their activities. Imagine if the next government is a pure Labour-Greens coalition with no NZ First.

Farmers have always been highly innovative and willing to change what they do and city-folk probably don't realise that. Every year brings an opportunity to improve herd genetics, to adopt better farming practices, to experiment with new outputs and new techniques. So while some people might think that dairy farming as it stands is a static sector unwilling to change to mitigate environmental damage that is not true. Farmers have been altering what they do and how for some years now and increasingly the investments dairy farmers make are less about more cows and more milk and about effect mitigation.

One effect to mitigate is dependence upon irrigation which in the absence of truly huge storage lake construction is vulnerable to extended dry periods – which is what we might be getting this summer according to NIWA. Pressure looks like it is going to go on water sources this year and if hydro lakes are low now and hurting electricity users on spot price plans, summer could bring a whole new world of pain plus electricity blackouts next winter.

One thing decreasingly of concern thankfully is fuel prices. With restrictions on sales of Iranian oil by the United States looking like being less than anticipated, some increases in production by other countries, coupled with some new worries about world growth, prices have fallen quite sharply. Throw in the firming of the NZD above US67 cents in response to some slight USD weakening and last week's very strong NZ employment numbers, and maybe the holiday driving season will be less a financial burden than it was looking. Though if petrol prices fall much further the government might see that as an opportunity to impose some new taxes.

At a Wellington function last week following talks in Timaru, Ashburton and Christchurch (CBD busier but still some ways to go) someone asked whether the government might shift departments out to the regions. This question comes up now and then and is motivated by concerns people have in the regions about people exercising their free will and shifting to where the jobs are more diverse and plentiful.

If nothing was to change then shifting government functions might happen. But the modern world in which we live changes more than any of us have ever seen before. People shift jobs, update skills, form new connections like never before. Some public servants might accept a shift to the regions, justifying it on the basis of cheaper housing and easier commuting. But once some of these people move on to other employment there or elsewhere, finding replacements could prove very difficult.

Technology allows most of us now to work remotely. But the rapid speed of change which has brought such technology and which these technologies accelerate means most of us have to live near the greatest concentration of people and businesses which we can tolerate in order to keep up. Keeping up with change and opportunities is not the same as finding and keeping a job.

One might think that with New Zealand's unemployment rate at 3.9% the cheapness of regional housing would see city folk heading off to regional employment. Some do. But just because there may be greater job availability in the regions than before does not mean people will shift in an age when getting a job is relatively less important than the future to which it may lead.

For your guide and as a message to those who think we can solve labour market shortages by bringing people in from overseas, it pays to note that labour is in short supply in most countries. The unemployment rate in Australia is 5%, United

Kingdom 4%, Eurozone 7%, Japan 2.3%, United States 3.7%, Canada 5.8%, Israel 4% (tech companies headhunting Palestinians.)

If I Were A Borrower What Would I Do?

These are strange days we are going through. Our economy is growing at a near 3% pace. The unemployment rate has just fallen to 3.9%. You would think inflation would be rising and interest rates lifting. In fact US monetary policy has been on a tightening path for two years and that might usually cause borrowing costs to rise here.

But underlying inflation in NZ is only 1.2%, wages growth has barely lifted these past two years, and the Reserve Bank is not signalling a potential tightening of monetary policy until 2020. Reflecting the low wholesale interest rates environment and perhaps a bout of extra competition for mortgages between banks we have just introduced our lowest two year fixed home lending rate ever at 3.99%. When I fixed for two years three years back at 4.39% I did not think I would see lower than that. But here we are.

If I were borrowing at the moment this rate would be good enough to have me forsake all others and lock in most of my debt at the two year period.

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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