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.

Outlook

Last night saw the release of the latest six-monthly Economic Outlook from the OECD. As a small trading nation what happens overseas is highly relevant to ourselves though perhaps not as much as one might think. Generally outside the context of big shocks which slam world growth such as the 1997/98 Asian Crisis, Dotcom Crash of 2000, GFC of 2008/09, it will invariably be domestic factors which determine our economy's progress.

Briefly, before we look at the OECD report, in that regard domestically the outlook still looks good. There is a small fiscal stimulus running through the economy this year equal to about 1% of GDP. Prices are good for most of our exports though easing for dairy due to rising global supplies. Consumer spending growth has been good recently though anecdotes bespeak of some slowdown perhaps associated with the now reversed hike in petrol prices and slightly below average levels of consumer confidence. Plateauing of house prices in some locations may also be having an effect.

Business sentiment is sour and both employment and investment intentions are well below average. Yet jobs growth has continued at a strong pace, the labour market is very tight, and businesses keep searching for employees. Imports of capital equipment have continued to grow at a rapid clip for now though the long lags in this area mean some easing remains likely.

In the tourism sector the development of infrastructure to support the boom over the past five years continues apace. But numbers coming into NZ have grown only slightly this year.

Interest rates remain at low levels and some fixed mortgage rates have hit record lows recently. The exchange rate is about where it was a year ago on average though against the US dollar we are well down whilst rising against the Australian currency.

House building continues apace led by continuing growth in Auckland. But consent numbers are falling in the rest of the country and capacity constraints along with the collapse and poor management of many big building companies will likely cap activity levels soon.

Population growth remains strong courtesy of continuing above average net migration inflows. But these are slowly easing. We learnt this morning that the net annual gain slowed to just below 62,000 in October from just below 63,000 in September and a peak of almost 73,000 just over a year ago. At this pace a net gain near 30,000 in three years' time seems like a reasonable expectation.

All up it would be hard to run an argument that the pace of growth in the NZ economy is going to accelerate over the next three years. But equally it seems unreasonable in the context of continued low interest rates, slowly rising wages growth, firm population growth, good export prices and firm construction activity to expect any substantial slowing of growth.

Were I running a business at the moment I would continue to make preparations for higher demand levels down the track. But as I highlight in my talks with SMEs around the country, there are a lot more challenges facing businesses these days than the rate of GDP growth.

Turning to the scene offshore, this is where the risks lie (that is, risks lie elsewhere, but specific business pressures lie here) though it is extremely difficult to quantify them let alone know how they will progress. Suffice to say world growth is slowing with downward revisions to growth predictions but growth still seen above the likely average for the next half century of around 3.0% per annum. The OECD are picking that world growth over 2018 will come in at 3.7% then slow to 3.5% next year and in 2020. The 2019 forecast is down from their 3.7% growth pick made in May.

The slight reduction reflects cuts almost everywhere except the UK and Canada. In the US growth of 2.9% this year is expected to be followed by 2.7% in 2019 and 2.1% in 2020. In Australia the numbers are 3.1% then 2.9% then 2.6%, Eurozone 1.9% then 1.8% and 1.6%, Japan 0.9% then 1.0% then 0.7%, China 6.6% then 6.3% and 6.0%.

The OECD forecasters expressed concern about deepening trade tensions which are slowing the pace of world trade growth. In fact they see 0.5% coming off world growth in 2021 because of the China-US trade war.

They see NZ's pace of economic growth slowing from 2.9% this year to 2.8% next then 2.6% in 2020.

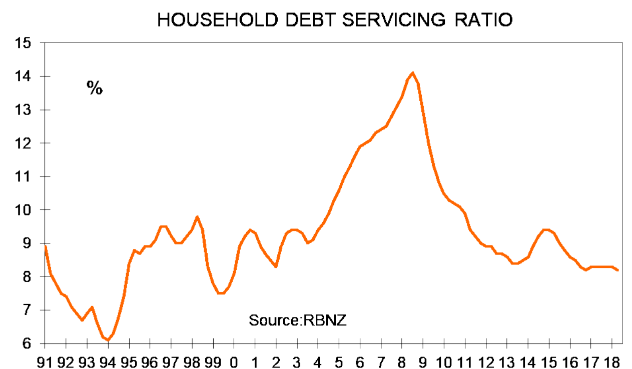
If I Were A Borrower What Would I Do?

Nothing new. Hot competition between lenders in a market not delivering the volume growth they may have inserted in their plans, and with some still trying to grow market share, means borrowers are being offered record low short-term fixed mortgage rates. Note the return of cash-backs to new borrowers telling us it is competition driving low rates and not so much falling wholesale borrowing costs.

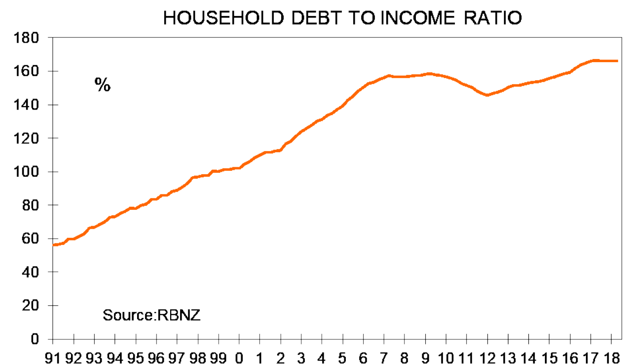
NZ monetary policy tightening is unlikely for a potentially long time and it is worth noting that yet again we have seen pullbacks in expectations of tightenings offshore – this time for Australia and the Eurozone. Hence the Kiwi dollar's rise against the Aussie dollar this week to above 94 cents despite dairy prices falling again at the fortnightly auction. Those prices have now declined 20% since the start of this dairy season in June and are off 13% from a year ago.

The chances are that NZ mortgage rates will remain low for – yet again – a lot longer than any of us have been expecting. Were I borrowing anew at the moment I would struggle to go past a sub-4% two year fixed rate.

These low interest rates in recent times mean that debt servicing costs facing NZ households are at their lowest levels since 1999 and still falling.



This is in spite of the debt to income ratio sitting at 166% from 102% back then. Australia's ratio is about 175%.



Note the mathematics of this situation now. When the Reserve Bank does some year see enough inflation risk to raise its official cash rate they will not have to crush the export sector by raising rates all that much. Consumer sensitivity to any given percentage point change in the cash rate/mortgage rate is much more than before. So be careful not to buy into the doom and gloom housing outlook still being peddled by some folk centred around mortgage rates one day soaring and finally those nasty owners of property getting their moralistic comeuppance. When rates rise they won't go far.

Speaking of property, keep an eye out Wednesday for the Reserve Bank's next Financial Stability Report. There is a good chance they will again slightly ease loan to value (LVR) rules as

they did last year in the six-monthly report. And remember that with the structural shift in inflation (downward with less impact from capacity shortages and strong growth than before) our central bank can no longer easily rely upon monetary policy to contain housing excess correlated with any rising inflation.

They have developed the LVR tool to use instead of interest rate hikes. And the thing about a tool is that you don't usually need or want to use it all the time. When there is no nail to bang you stop swinging the hammer. The Reserve Bank is afforded scope to cut LVR rules by the easing in the housing market. Then the next time the market surges ahead in maybe 3-4 years they can simply tighten LVR rules again without necessarily moving the official cash rate.

And note this very important point. If inflation does one day surge and the RB pushes the OCR up to slow the pace of GDP growth, if the housing market is not surging at the same time they will mitigate the negative impact on a quiescent housing sector by cutting LVRs. It's a new world with regard to the interaction between growth, inflation, interest rates, and the housing market.

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
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