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

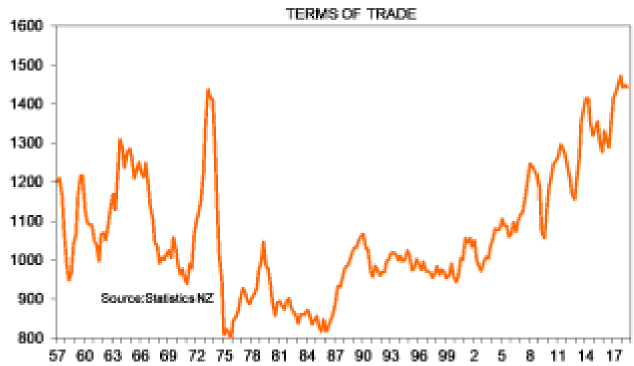
Which Direction The NZD?

An issue discussed possibly just once before in the Weekly Overview since we started it 20 years ago has been the way in which it is politically correct in the economic and financial field to forecast that the Kiwi dollar will go down. Sometimes the forecast is based upon the persistent current account deficit and talk of high foreign debt, sometimes our high reliance upon primary sector exports which were trending down in price, sometimes "last one out turn off the lights" mentality, and often a view that things are so much better and stronger overseas that currencies like the greenback and Yen have to rise therefore we have to fall.

The forecasting default position for the NZ dollar is it falls. I've tried to emphasise a slightly different view in recent years based not so much around the overall rate of growth in the NZ economy and fiscal position being fairly good compared with other economies post-GFC, but around the altered trend in our terms of trade.

Sometimes it pays to stand back and do a recount of how the dice seem to be falling with regard to our currency and if you do that now you'll find something interesting over and above the terms of trade factor. But let's start with that one and then move onto the interesting new pieces of information which need to be taken into account.

The terms of trade measures the size of the basket of imports a country can buy with an unchanging basket of exports. New Zealand's terms of trade peaked during the 1950s wool boom then fell away before hitting another peak in 1973 just before the world fell apart with soaring oil prices and the UK entering the EEC.



But since the 2000s our terms of trade have been trending up. It has paid to have an export sector highly dependent upon the primary sector rather than oil and manufactures! Our country's net international debt position has been improving for the past ten years and continues to do so.

So what are the new things? First, last week the US Federal Reserve stripped away their expectation that having raised their cash rate from 0.25% to 2.50% they would undertake more rises this year and maybe next. Acknowledging worries about building trade disputes, slowing US housing, and slowing growth in Asia and Europe, they adopted a neutral outlook. At the same time they assuaged concerns about upward pressure on bond yields from selling of the portfolio they built up post-GFC by noting that long-term the level of their holdings will be more than previously indicated.

In response to the Fed. changes but also simply reflecting things recently like slowing global growth signs and sharemarket turbulence, the yield on the benchmark ten year US government bond yield has fallen to 2.7% from 3.2% back in November.

All talk about a strong interest rate differential driving the NZD down against an appreciating US dollar has now gone out the window. Hence the NZD now sits near 68 cents from 65 cents in November and why in this publication we have suggested to exporters that they take advantage of occasional bouts of weakness in the NZD to get extra hedging on board. The fundamentals simply are not supportive of any substantial NZD weakness.

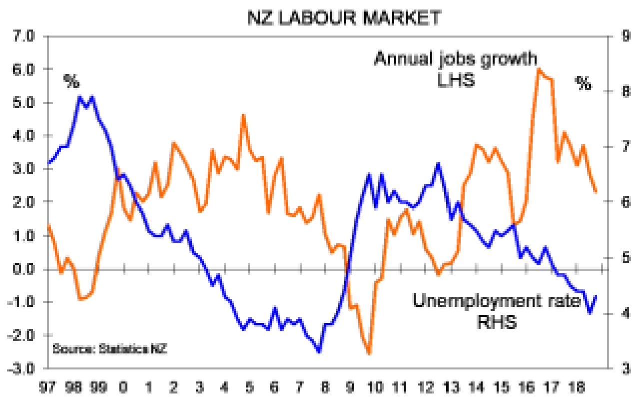
And maybe people realise that, because the level of publicity given to the sustained high rate of exchange between our currency and the Aussie dollar has been minimal. In the past anytime we rose above 92 cents we would talk with journalists about parity parties. Now, having sat above that level since October and over 95 cents now – virtually nothing.

Let's move then to the second factor you need to take into account as you hopefully start challenging our downward bias toward the NZ dollar. Last week Standard and Poors maintained their credit rating for New Zealand government long-term foreign currency debt, but they raised their outlook from neutral to positive. That is not the sort of thing we got used to in the 1980s and 1990s when worries were legitimately deep about our external accounts and the risk attached by investors to lending to NZ entities, as encapsulated in our credit ratings.

None of this discussion leads to any improved ability to forecast the NZD which is low for all of us. It simply suggests that if there are people out there still of the view that either NZ is munted or that exporters are screaming in pain and need relief then their FX hedging decisions are likely to be quite poor. The chances are that in an uncertain world the NZD will at least not trend down as most previously thought and exporters may want to take advantage of bouts of the heebie geebies when they come along to boost NZD hedging.

Jobs

Subject to the problem that these particular numbers can be highly volatile on a quarterly basis, it seems safe to say that even with some smoothing the 0.1% growth in employment during the December quarter confirms a slowdown in NZ jobs growth. The near zero gain followed a strong 1.1% jump in the September quarter but compared with a year ago jobs growth fell to 2.3% from 2.8% and was the slowest since early-2016.

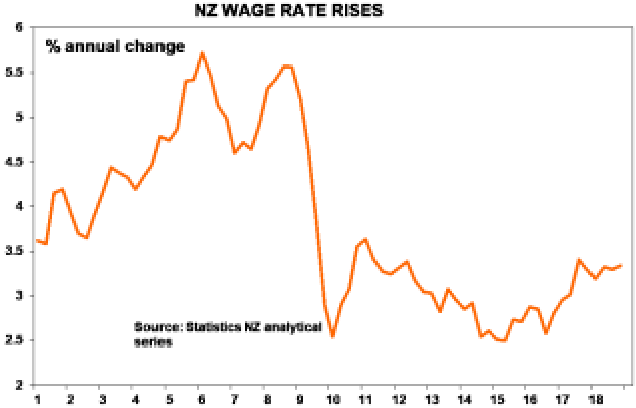


The unemployment rate has moved up to 4.3% from 4.0% but it was 4.4% in the June quarter last year. The labour market still however looks very tight. The anecdotes certainly bespeak of that and at 67.8% the employment rate is still the second highest on record down from 68.2% in the September quarter.

The NZIER's Quarterly Survey of Business Opinion told us a few weeks back that during the December quarter a net 53% of businesses said they were finding it hard to get skilled people and a net 35% said unskilled people were in short supply. A net 13% said they plan hiring more people which is above the long-term 10% average. A net 22% said they experienced a rise in labour turnover. So some of the just announced rise in the unemployment rate could be a lift in frictional unemployment – people who have quit or been let go from one job but have not yet signed up for another. In the past we would say maybe they have not found another job. Now we might say they are simply taking their time knowing that plenty of opportunities lie out there so one may as well take some time to sort the wheat from the chaff.

What I am leading up to saying is that while the politicians and some media will be able to rightly claim that jobs growth has slowed down under the new government, the labour market is still fundamentally strong.

What about wages growth? Is that picking up yet? No. The annual rate of change in the measure which I follow that captures an unchanging mix of positions held at an annual pace of growth of 3.3% in the December quarter. It has been at this pace for a year and a half. So the rise off low growth of 2.5% mid-2015 has not continued.

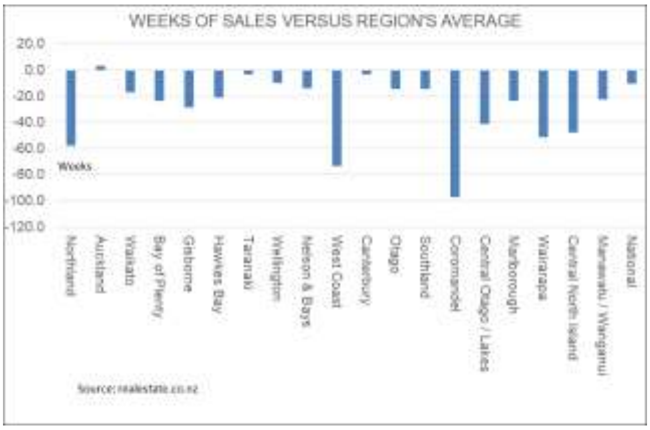


Housing

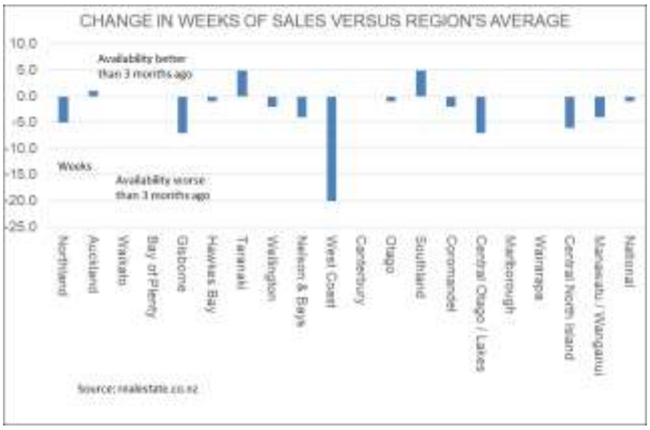
Last week realestate.co.nz released their monthly data using listings on their website. They supply four pieces of data for each region. The first is prices. But we get more accurate information from REINZ so won't use their numbers here. We also get data on New Listings. We'll look at those numbers one day, but not today.

We also get data on the stock of listings in each region at the end of the month and by comparing the stock with sales one month earlier (latest month sales have to wait a fortnight for REINZ data) we get an estimate of the number of weeks sales each stock equates to. That is what we will look at each month when the numbers appear.

The following graph shows the extent in weeks that each region has an inventory of dwellings for offer above or below their long term average starting in 2007.



For instance, at the end of January the stock of listings in Northland was 58 weeks below average. Auckland was 3 weeks above average. This means that if you are looking to buy in Northland the level of stock is very low compared with earlier years. But are things getting more and more into seller's market territory? To gauge that we need to compare the latest result with three months ago. The following graph shows this. Inventory was five weeks less in January than October. So Northland is getting even harder for a buyer to find a dwelling. Same for Gisborne, Nelson, Central Otago/Lakes District.

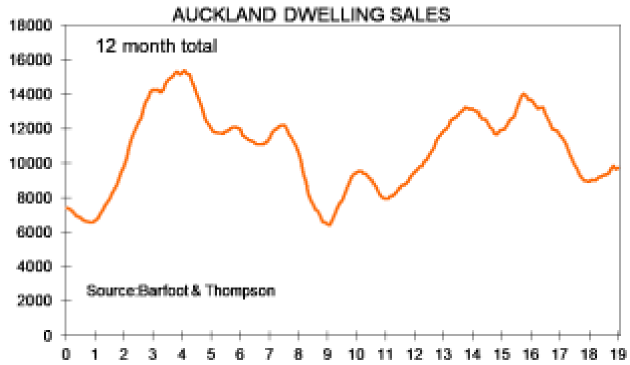


But some of the frenzy has eased off slightly in Taranaki and Southland. We expect that over the year this graph will change toward most of the blue bars being on the upper side as the cyclical frenzy wears off.

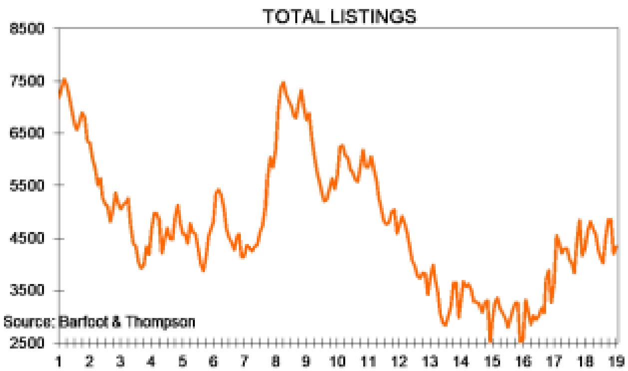
Auckland Data

This week Barfoot and Thompson released their sales data for January and following a massive seasonally adjusted sales decline in December of about 24% there was a jump of 29% in January. The monthly data are very, very volatile so smoothing over three months is needed at a minimum to gain any useful insight into what is happening in our biggest city.

Over the three months to January BT sales were up 4% from a year ago and down about 4% seasonally adjusted in the quarter. I call that flat – not really rising, not really falling. That in itself is interesting because it suggests the pullback in activity since late-2016 may be over.



We might draw a similar conclusion looking at the listings numbers. At 4,334 the stock of listings at the end of January was basically unchanged from a year ago. The same goes for December and November. It looks like the period of falling sales causing stocks to build up may have ended.



We perhaps can put this stabilising of stock levels down to few new listings coming forward. In January there were 981 compared with 1,200 in January 2018, 1,142 in January 2017, and 919 in January 2016.

And this is where we get a direct challenge then to scary stories about house prices falling sharply. Few people need to sell. Few people are pressed by interest rate levels or job loss, or maybe ring fencing ending etc. And a surge in listings by people looking to flog off something they can't afford any longer is what you need to build a convincing story of prices falling away firmly.

Speaking of which, the REINZ numbers out in a week are better, but for the record the Barfoot and Thompson average sales price in January was down 0.7% from a year ago and up 1% for the three month to January from a year back. I read that as flat.

So I don't feel I've learnt anything new regarding sales or prices from this month's BT data, but can run a theory that a period of downward adjustment in residential real estate activity from high levels over 2016 may have come to an end. And that then just feeds into my central view for the Auckland market for the next three years more or less – sort of boring. But that is good for young buyers as they can peruse the market without frenzy and without get rich quick investors in play.

Your Strategy

-Things to consider in your next annual strategy session.

Plastic packaging. This area of concern has ballooned over the past year moving rapidly from supermarket consumers rising in arms against charging for plastic carry bags to demanding they be removed and the government passing legislation banning all single use plastic bags from mid-year. The ball is rolling and we should not be surprised if attention does more than just move onto plastic packaging around fruit and vegetables which is where the focus is for the moment. Eventually attention will go on plastic bottles for all sorts of things like soft drinks, milk, sauces, dishwashing powder etc. If you manufacture or distribute such containers or products which are in such containers you had best be researching alternative materials.

If I Were A Borrower What Would I Do?

Last week the US Federal Reserve capitulated to the evidence of minimally accelerating inflation and growing economic growth risks by taking scheduled rate rises off the table and vowing to be "patient". This week it was the Reserve Bank of Australia's turn. In a speech the RBA Governor pulled back from previous insistence that the next rate move would be upward and said the probabilities of the next move being up or down were "evenly balanced". The AUD fell away and the NZD for a while rose above 96 cents before easing back to 95 following the rise in the unemployment rate this morning. But of importance here is that wholesale interest rates have fallen across the ditch and this has again pushed down wholesale borrowing costs here, with a little bit of help from the lack of accelerating wages growth shown in this morning's employment data. Plus the slowing of jobs growth has been taken into account.

The three year swap rate which forms a base onto which unknown other costs get added before banks calculate their cost of funds has fallen to near 1.9% from 2% last week, 2.2% two months ago, and 2.4% in November. Over the same period the three year fixed mortgage interest rate has not budged.

There currently looks to be some scope for fixed lending rates to be cut, so if I were borrowing at the moment I might be inclined to take it slowly to see if a bank cuts it's rates in the next week or so. My inclination remains to fix two years.

For your guide the financial markets in New Zealand are pricing in a rate cut of over 0.1% by November this year. In other words no further NZ tightening is expected.

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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