BNZ Weekly Overview

16 May 2019

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

Wellbeing Well Bought?

In a couple of weeks' time the Finance Minister will read the 2019 budget known commonly as the "Wellbeing Budget" because it will include measures designed to give insight into non-monetary/societal goals and outcomes. To anyone out there interested in these measures may I suggest that you take pause before calling us bank economists for our opinion on such things.

We consider ourselves to be experts in giving insight into developments in the financial markets and macroeconomy and potential impacts of identifiable trends and developments. For instance, we can speak for hours about likely impacts from tax rate changes, exchange rate shocks, monetary policy decisions, tariff impositions and so on. We can craft models designed to show interactions between different measurable factors and then generate and interpret results from simulation exercises.

Our university educations were built around such analysis and techniques and our employers and clients have required insight into such things.

But as far as I am aware, none of us has deep expertise in social policies. Probably none of us have ever been required by our employers to write an executive summary of the impact on societal welfare of tax rate changes or monetary policy trends. Or the optimal policy framework for addressing rising global homelessness. Just because we can conclude that some groups may be disproportionately affected by certain things does not mean we are the go-to people for societal welfare commentary.

Perhaps some of us may have spent time with NZ Treasury working on the financials surrounding programmes proposed in areas like housing, social welfare, health and education. But that does not necessarily give us insight into the true nitty gritty impact on the ground amongst potentially deprived families. Even experts from the likes of the Salvation Army can struggle to give insight into the true sustained impact of specific policies aimed at labour force participation, housing and so on. The world seems filled with different bodies, councils, and governments frankly outright conducting experiments to see what particular measures might "work" in their localities.

Sure, we have analytical minds which could be turned toward such things over time, perhaps with less emotional bias toward potentially successful programmes than those motivated by good sentiment to work in such areas. But our focus has to be on issues and impacts more relevant to our salary-paying employers and their fee-paying clients.

So when the 2019 Budget comes out by all means call us up for insight into the potential impact on inflation, wages growth, labour market stresses, interest rates, the NZ dollar and so on. But save your questions regarding whether wellbeing-focussed proposals may have a meaningful impact on different groups in our society for actual experts in such fields – experts you will not find writing weekly commentaries like this.

The Regions

Over the past four years our economy has grown by about 14% and job numbers have also jumped by about this proportion. Three key factors have accounted for an annual growth rate almost 1% above our long term average and much attention has focussed on one aspect of the role of above average net migration flows. This aspect is that net migration tends to greatly benefit the cities. Disgruntled envy of the cities and earlier chip on the shoulder discontent about Auckland house prices soaring but regional markets holding flat have underpinned this focus.

But consider the other two big factors driving average growth per annum of 3.5% these past four years. One is house building. Initially this soared in Christchurch from the second half of 2012 in exact coincidence with a big recovery in Auckland dwelling construction. The rest of the country only really got cracking from 2016.

House construction is a very labour-intensive activity so the regional construction surge has delivered some decent boosts to local economies and consumer spending rates of growth. But one of my key themes has been that low population growth in the regions will eventually reveal excess construction of dwellings in some parts of the country.

No big change in such construction has yet happened. But in the absence of evidence of a young person rush to the regions from our analysis here a few weeks back of CoreLogic data on home buyer types, my over-construction concern remains, though I hope to be wrong. If I am eventually right this will manifest itself as firm cutbacks in regional house building, employment, and therefore economic strength.

For now however one reason that we are not seeing popular discussion of deprived regions by and large is that construction has driven strong employment growth.

Another reason is the third factor driving above average GDP growth these past four years – a tourism boom. Visitors to New Zealand increasingly are getting out of the usual tourism destinations and travelling further afield. This is great for the regions where generally the most attractive scenery lies. And like construction, tourism is very labour-intensive. So again we have seen a good boost to job markets in the regions and consumer spending.

But inward visitor number growth has slowed to less than 2% this past year and it seems a bold call to expect a quick return to growth rates back near 10% in the near future.

The regions have basically had a good run these past two or three years of firm employment growth, rising house construction and prices, more buzz from more tourists hanging around, and good conditions for most parts of the primary sector. Popular regional discontent about Auckland has died away, chips on shoulders have been left unpolished.

So what?

History tells us that these regional periods in the sun are great but they do not last. And population growth projections from Statistics New Zealand reveal to us more realistic assessments of regional growth prospects than one might generate based on the past two to three years of good regional growth and calming of Auckland envy.

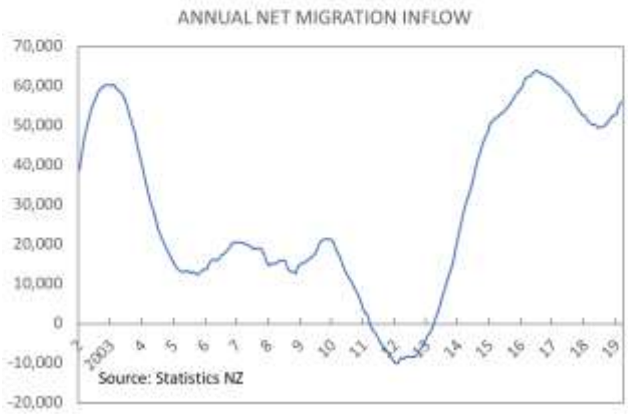
There is certainly no case for being despondent about the regions in the near future. That is because a traditional cause of their pullbacks – a collapse in farm incomes associated with a high NZD and high interest rates – is not in prospect. But I guess I have the same worry as Shane Jones – that without specific regional economic development efforts the long-term trends will re-establish themselves. So, much as people like myself might often pooh pooh the NZ First-driven slush fund, it is worth giving it a (properly assessed) go because regional lifestyles can be fantastic and the last thing we want is NZ growth occurring only in the big cities and some regional hubs.

Housing

Migration data released by Statistics NZ this week now suggest that rather than a net gain to our population from migration flows of 62,000 in the year to February there was actually a gain of 55,000. This 7,000 revision is unfortunately the sort of thing we have to get used to now that the method for calculating such flows has had to change following the removal of airport departure cards.

The latest data include March and that annual flow is a gain of 56,000. This is up from a low of just over 49,000 in the middle of last year so we can still say that the migration trend is upward and perhaps at a more realistic pace than was indicated a month ago. What does it all mean?

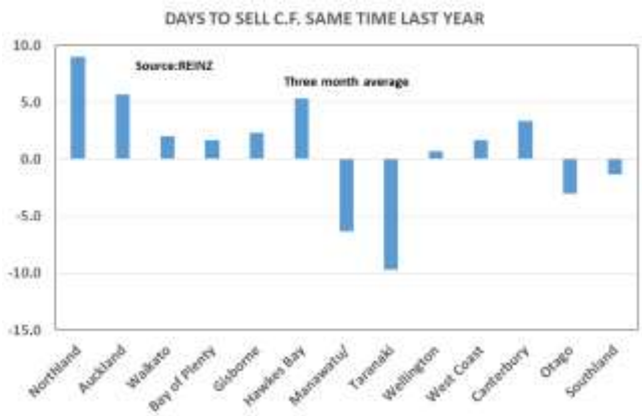
The net annual migration flow has averaged a gain of 29,000 per annum over the past ten years so the flow is well above average. Population growth remains strong and this of course is a huge underpinning factor for the housing market – on top of recent decreases in mortgage interest rates and confirmation of no capital gains tax regime being put in place or even an extension of the five year brightline test occurring! That's an unexpected bonus.



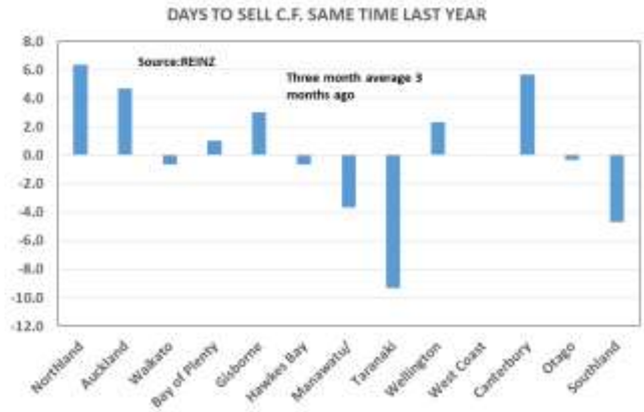
But while the migration flows are supportive of house prices neither they nor the level of interest rates lead me to say or feel that a fresh upturn in our housing market is approaching as some commentators opined last week. This cycle did it's dash in Auckland two years ago and will this coming year peter out eventually in the regions.

Speaking of the housing market, on Tuesday we received the April house sales data from REINZ. Here is what they show. In April the number of days taken to sell a house on average was 37 nationwide and that was about the same as 36 days a year ago.

Best insight using this measure can be gained by breaking it down to the regional level then comparing the last three months with a year ago. Doing that we get the following graph.



Dwellings being sold are sitting on the market longer in most parts of the country compared with a year back, except Manawatu/Wanganui, Taranaki, Otago and Southland. Three months ago this graph looked like this.



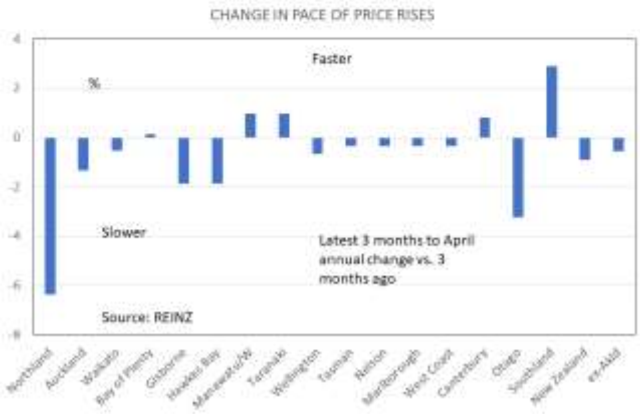
Slowing regions are slowing more, but you can't run an argument yet that the four regions still performing well in the past three months are performing less well. Their markets clearly are still in healthy condition from a seller's point of view.

What about prices? For this we look at the House Price Index data produced by REINZ – and this is the only house price dataset I look at for New Zealand because it is the most accurate.

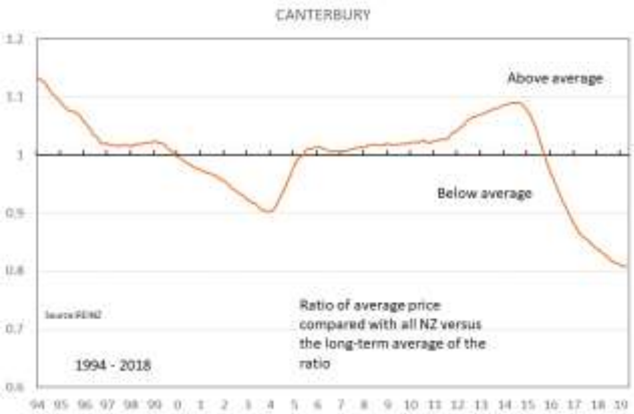
Nationwide in April average NZ house prices fell 1% to sit 1.3% ahead of a year ago with Auckland down 4.4% and the rest of NZ up 6.7%. Auckland prices have fallen in five of the last six months so the trend for the moment is down.

For regional insight and comparisons I like to smooth data over three month periods. Doing that we get the following graph showing average prices for the three months to April versus a year ago.

Prices are rising everywhere except Auckland which got out of the blocks two to three years ahead of other regions this cycle – so no surprises here. Is price growth slowing in the regions? Yes for all bar Manawatu/Wanganui, Taranaki, Southland, and Canterbury ever so slightly. Interesting that one.

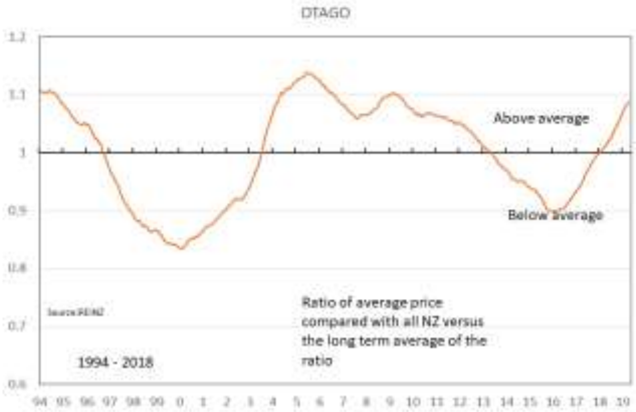


To get a feel for whether a region seems out of whack I produce a graph for each location comparing the region's latest price versus its average against the NZ-wide price versus its average. Canterbury looks under-priced.



I visited the city this week and three weeks ago. The CBD has some way to go and chatting with locals there is little hope that empty land south of the square will see development for a long period of time. There is great anticipation of the economic benefits expected to flow from completion of the convention centre fronting Cathedral Square plus the expanding motorway system making life easier for locals. But having grown up in the city I do wonder if the convention centre might not be somewhat monolithic in character for the special central location. Personally speaking, I see only a low chance of the older generations being attracted back into the city once it is "completed". Beyond the unchanged beauty of Latimer Square, Cranmer Square, and Victoria Park with Ice Cream Charlie, there is little else they would recognise.

Contrast the price relativities shown above with Otago



I haven't been in Dunedin for some time so cannot make comment about what is happening down there. But I have been in Queenstown and can sympathise with locals struggling to handle increased traffic flows. I've also been in Rotorua and the strip of restaurants in the location which I think is called Eat Street leading toward the Novotel is very impressive and worth a look at by people in other parts of New Zealand wondering in what direction they should facilitate development and change in their CBD. Rotorua has actually enjoyed some strong population growth in recent years and I think I can understand why. It's starting to feel a bit different from what I've experienced on infrequent visits there over the past three decades.

Late last year I visited Timaru and Ashburton. The latter has some truly great cafes now and is well worth a stop if one has landed in Christchurch and is headed south. I didn't spend enough time in Timaru to be able to offer much insight unfortunately, but people there seemed to be in good heart and feelings about the local economy were very positive. But people did seem sensitive regarding concerns others have about intensive dairy farming.

Levin in the Horowhenua north of Wellington where I spoke a couple of months back is looking up as locals anticipate the economic changes expected to flow from completion of the expressway system allowing easy connection with the Wellington city, port, and airport. Distribution opportunities abound from this important infrastructure development which includes construction of the Transmission Gully Motorway – 27 kms of virgin road crossing SH58 and expected to add near 5,000 cars right away to the

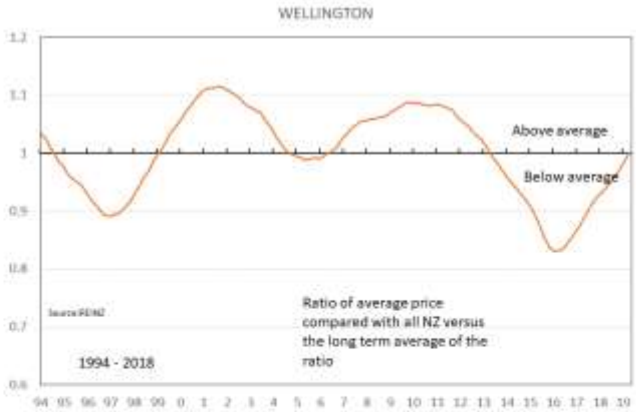
Hutt motorway. The case for replacing the Melling Bridge and upgrading SH58 I drive on most days is overwhelming.

In Blenheim last week I found very positive sentiment surrounding the state of the viticulture sector. However as with so many other locations around New Zealand there were some concerns regarding retailing in the town centre. In Nelson this retailing concern seemed to be even stronger. But such is the nature of strip shopping around the world these days and local authorities are struggling to retain the busy characteristics of their central shopping areas. One strategy being pursued is more focus on the hospitality sector which for Nelson lies at the end of the main road heading toward the cathedral on the hill. I suggest a trip to Rotorua to see what they have done there.

In less than four weeks' time I will be in Hamilton for Mystery Creek Fieldays so may be able to offer some comments about the city after that. If you are attending Fieldays I will be in the BNZ tent on the Wednesday, Thursday and Friday with talking times of 11.00am and 2.00m and general chats the rest of the time. Exhausting for sure but worth it for the interaction.

Regarding Auckland, I've got an unusual gig coming up there next Tuesday 21 speaking on a panel at the Auckland Conversations function, 5.00pm, Shed 10 "Shared Prosperity: Taking advantage of Auckland's economic growth". Hopefully I don't sound too ignorant because while the focus of the conversation is meant to be on "Shared Prosperity", that's not the area of expertise for a single one of us speaking that evening!
https://conversations.aucklandcouncil.govt.nz/events/shared-prosperity-taking-advantage-aucklands-economic-growth

And what about Wellington, my reluctant base since 1987 upon returning from Sydney? (Actually it's Porirua as hometown since 1993.) Soaring rents and house prices are occurring but maybe the price correction has almost run its course? Not quite but perhaps over within a year. Watch for the internal migration switch to Christchurch. Earthquake issues are becoming more and more a matter of moment as former Prime Minister David Lange would have said. Every few months it seems like another building is taken out of action because of a reassessment of its true earthquake rating. RIP Wellington Public Library. Rebuilding that quickly would seem to be a more valuable use of resources than sinking more and more and more ratepayer money into the old Town Hall.



I will produce graphs again for all regions in a few weeks' time.

Regarding sales levels. The nationwide annual total has now slipped to 73,793 from 74,360 in March, and a recent peak of 76,432 in November. Sales are falling almost everywhere.

This means falling revenue for real estate agents and people leaving the sector – probably those who only entered the industry when times were strong. It's those who stick through the lean patches you want to deal with when things pick up again later. They'll have great insight to offer.

Falling house sales means weak growth if any in mortgages being written by banks and that means discounting of fees and interest rates to get business.

At this stage my expectation remains that nationwide annual sales will fall back toward 65,000.

For your guide, here is a calculation I did in an article published elsewhere looking at home lending growth these past few years. I was responding to an emailer who said banks flooding the market with cheap credit had caused surging house prices in recent years. Not true. As I have been trying to point out initially from October 2008 then more forcefully in articles and lists from 2011 (Google "Tony Alexander 19 reasons") many factors account for the permanent change in the ratio of average house prices to average incomes. I'll run through the list another time.

But with regard to credit growth consider the following. Over the five years to March this year home lending grew by 36%. In the previous five year period to March 2004 growth was 16%. In the five year period ending March 2009 growth was 70% and in the five years to March 2004 it was 63%. There has been no new lending boom.

In fact, consider this comparison. Over the past five years the nominal dollar value of our economy has grown by 29%. So the 36% growth in housing lending does not look excessive. 70% earlier on does.

If I Were A Borrower What Would I Do?

Nothing new to write here I am afraid. Mortgage rates are low, very low. If you are borrowing now you're living in a completely different world from your parents and grandparents who either could not get a mortgage up until the deregulation of 1984/95 or paid extremely high interest rates from that period through until 2009.

The advice they will give you will centre around building up a good savings record in order to get a mortgage in the first place, and/or paying down your mortgage as quickly as humanly possible by forgoing anything remotely approaching a non-essential once you are debted up.

But although banks have cut back on lending to investors and are repricing their loans, when it comes to first home buyers you are the fruit they want to pick. No savings record with us, no problem. Bank lending is actively biasing toward first home buyers. And sure, paying down your mortgage as quickly as possible is a good idea. But you'll be running cost saving numbers completely different from those we ran in the 1980s and 1990s when we were paying double digit mortgage rates.

Your vulnerability is this. Assuming that house price increases you have despaired about in recent years but now hope for going forward will not occur. They won't. You're not going to be bailed out of a high debt to house valuation ratio by quickly soaring house prices. You have lived through a one-off shift in average house prices from equilibrium x to equilibrium y to reflect a structural decline in interest rates available to investors and charged to borrowers plus some other factors.

This shift will not reoccur. We are not going to see a repeat of the large structural shift in net migration flows over the past decade. Or the structural shift in average interest rates, or the structural decline in builders following the global financial crisis, or the structural lift in property investment by baby boomers and foreigners.

Do not blindly extrapolate into the next decade what you have seen happen to average house prices in your locality over the past decade. Half it at least. And if you do that you will hopefully see that perhaps sacrificing a few annual holidays to the GC or Fiji might be a good idea after all, plus you'll be doing the planet and other species a big favour.

If I were borrowing at the moment rather than facing term deposit rates below 3.5% I would remain inclined to focus on two and three year fixed interest rates.

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