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

Sorry about the font changes. I am running an old machine following collapse of the touchscreen in the other and it is hard to get the old Word conversion to pdf the way it used to be. Plus the old keyboard is hard to use so his week's issue is small. Hopefully a new PC next week will see things right. After that I need to get my website back the way it used to be before having to upgrade to the latest version of WordPress and losing all attachments and ability to have more than one post showing.

Fieldays

It's the second week in June so National Farm Fieldays are on again at Mystery Creek beside the Hamilton airport. When giving my short presentations each day at 11.00am and 2.00pm I concentrate on four key things.

First, two things which used to always be at the forefront of farmer minds and the main topic of conversation rarely come up these days. No-one has asked me a question about the exchange rate for a long time. No-one seems to have a problem with it and I invite people to focus on the good support for the NZD coming from our good export prices, high terms of trade, and worries about growth in various places overseas.

My view this year is the same as last year – potential for not much change over 12 months with minimal chance of any big decline, or big increase.

With interest rates these days the topic only ever comes up in the context of bank deposit rates being very low and how to get higher yield. The discussion then revolves around getting these older farmers to realise that if they want extra return for the millions they have on deposit then they will need to take higher risks and they would do best to chat with a qualified investment advisor.

Regarding interest rates my view is that they go slightly lower than they are now on their way to an equilibrium clearly at much lower levels than seen when rates were slashed to fight the Global Financial Crisis a decade ago. Welcome to the new low inflation, low interest rate world.

The other two things I discuss are first, the shortage of labour which will get worse and the need to either suppress output growth or seek it through means other than trying to find extra people.

And second, climate change and the impact anticipation of inundation degradation will have on insurance rates and property values in affected zones. Plus I discuss plastics a little bit and the speed of change in public attitude toward their acceptability.

The mood at Fieldays seems very good and lots of people have been on site these past two days. If the weather is good tomorrow may see truly untold show up right from the opening as has happened in the past.

Housing

The government, having failed to build affordable housing with KiwiBuild, is looking at contracting large construction companies to build high rise apartments for ownership presumably by institutions, with those apartments to be used only for rental purposes. Would an increased supply of rental properties place downward pressure on rents? Yes. Would lower than otherwise rents help suppress rises in house prices? Yes.

Sounds great. But here is the same problem which we have highlighted repeatedly these past years. Where will the extra builders come from? If build-to-rent apartment buildings are encouraged (subsidised) by the government then other dwellings, bridges, roads, and hospitals will not be built. Only if the extra construction is made possible by shifting construction of non-residential buildings and infrastructure into the next recession whenever that occurs would this policy lead to any sustained change in either average rents or average house prices.

It would be another failure for the Housing Minister unfortunately so renters, please do not get excited. Your rental costs are going to continue to rise in an environment of continuing rapid population growth and insufficient resources to build houses. Regarding insufficient resources, every week we get at least one sector bemoaning inadequate staff numbers. This week saw expressions of doubt regarding enough workers being available to plant 1 billon trees.

And regarding population growth, this week Statistics NZ estimated that in the year to April there was a net addition to our population from migration flows in the past year of 56,000 people. This was up from 50,000 a year ago and represents just over a 1% boost to our population which with an average occupancy rate across New Zealand of about 2.7 people per dwelling means a need for an extra 21,000 dwellings almost.

With natural population increase running at about 27,000 per annum that adds another housing requirement of about 10,000. Do we think that in the past year 31,000 dwellings were built around NZ?

Consents in the year to mid-2017 added up to 30,000 and with about 85% being acted on that means a stock boost of about 26,000. But this is not the net addition to the housing stock. That calculation needs to take into account construction of holiday homes/second homes, and bowling over of old, leaking, and non-compliant dwellings, those demolished to make way for new roads, carparks, and commercial buildings, plus those simply newly uninhabitable. I don't know what those things would add up to. But I feel on very safe ground saying that whatever your estimate was a year ago of the shortage of housing in New Zealand it must now be raised by at least 6,000.

If I Were A Borrower What Would I Do?

Here's what I reckon is happening with interest rates. Over a period so far lasting near 11 years with a few more to come they are settling to permanently low levels, so low in fact that they all but lose their effectiveness as a means of influencing the rate of economic growth. Central banks will soon spend 90% of their time doing what they used to do before inflation around the globe lifted in the 1970s, they got charged with lowering it, and then they morphed their job into preventing economic downturns. They will focus on prudential rules affecting financial institutions. That all but guarantees our Reserve Bank will, when they feel the time is right, lobby again for Debt to Income rules for mortgage lending. But that time is not here yet.

The more immediate issue is can governments and the public back away from the idea that recession prevention is what the central bank must do? Recessions are as necessary as floods down a dammed river to wash away the crap preventing smooth water flows and river health. The global belief that central bank act as guarantors of bad economic times being avoided or heavily limited in depth and duration has encouraged excessive levels of business, household, and public sector debt. And assets like people, land, equipment and technology are tied up in activities which "should" have been weeded out by now and those resources freed up for other uses.

But productivity growth has been impeded by this process of creative destructionalism not working properly. And you know something has gone wrong with the world when sharemarkets rally on the back of bad economic data as has happened following last Friday night's weak US employment report. Market participants expect that the poor data along with trade wars will force the Federal Reserve cavalry to once again ride to the rescue by cutting interest rates. Low returns to low risk assets boosts share prices.

Some analysts do worry about the dependence of asset prices upon central bank salvation, but their worries revolve mainly around what the saviour will do when interest rates are near zero. So they talk about money printing. Well that hasn't worked in Japan or Europe.

Monetary policy cannot drive productivity and long-term income growth. It can only buy time. It is starting to feel like time is almost up.

So what will happen when monetary policy options to save growth are used up? Fiscal policy will come to the fore. But again, big government spending and fiscal deficits cannot boost long term growth. They can only help offset weakness for a while, as has been seen again in Japan and Europe.

New Zealand has good fiscal accounts and great fiscal headspace – which we will need when the Wellington earthquake happens. But should recession come along the intensity here can be limited through government actions when the Reserve Bank eventually empties its lolly box.

But offshore, scope for such is already quite limited and our asset prices won't avoid a hit when global recession next comes and governments offshore have neither monetary nor fiscal options of meaningful magnitude to help them. Our export prices will fall, our economy will suffer. But the availability of fiscal headspace and the assistance from a lower NZ dollar will discourage Kiwis and residents from going offshore, will encourage Kiwis to come back, and as happened during the GFC will provide a further support to our economy from population growth.

Back to interest rates… the drift remains down. I would be happy to fix three years, partly because the rate is so low compared with my lifetime experience. But I can understand why some people would sacrifice rate certainty at low cost to try and get even lower rates in one or two years' time. So do not feel bad at all if you prefer to fix for shorter than three years. I am simply conservative and am prepared to pay a price for expense certainty.

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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