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

This week we learnt that the rate of inflation remains very low in New Zealand and that there is little prospect of any frightening boost to borrowing costs being imposed by our central bank for a long, long time.

Over the June quarter consumer prices on average rose by 0.6% to take the annual rate of inflation up to 1.7% from 1.5% in the March quarter. The rate is in line with other economies and we all share the new environment post-GFC in which even strong economic growth is failing to reignite the inflation boogieman which occupied our thoughts so much from the early-1970s.

It appears that a combination of things explains persistently low inflation and there is no solid sign that these things are fading away. Factors include only a muted wages response these days to tight labour markets, for reasons we most definitely do not fully understand. Reduced rates of unionism probably play a role, social welfare systems, such as Working for Families, which penalise people for earning more also play a role in suppressing wage demands. The labour market has become internationalised to some degree, older people have remained in the workforce. Employers probably also push back harder against wage demands than in the past because their ability to raise selling prices is not what it used to be.

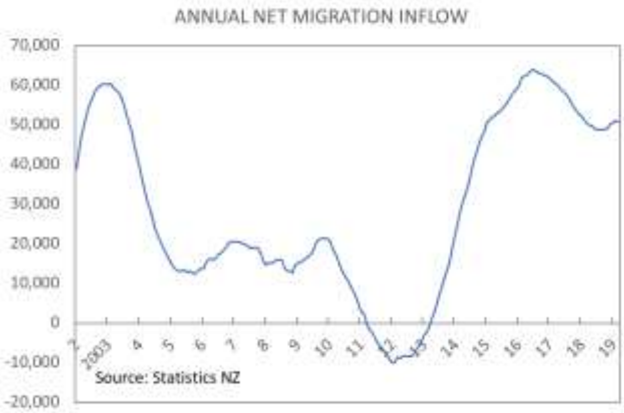
As discussed here many times in recent years, the ability of consumers and business buyers to search for products online at zero cost means any firm raising it's prices will immediately face a reaction from buyers. Before the internet and search engines, the cost of searching for alternative products, suppliers, and prices was very expensive in terms of time, driving around, calling companies, stress etc.

Every single forecaster over the past decade who has said that whatever factors suppressing inflation are about to fade and inflation and interest rates are about to jump higher with big growth-sapping effects has been wrong. Anyone saying that at the moment similarly will almost certainly be in error.

For borrowers the outlook remains one of continued low, and probably soon even lower, interest rates. For depositors the returns on low risk investments are likely to also remain low and to fall further. Welcome to the 1960s.

Statistics New Zealand have become so embarrassed about the inaccuracies of the model they have been using to estimate monthly migration flows that they have all but thrown in the towel. Now, instead of writing about what has happened up to the most recent month they have switched to talking about migration flows which ended over half a year ago. So in their press release put out on Tuesday they focussed on data to December 2018 and only at the end mentioned numbers for May.

In the year to May the net migration flow is estimated at a gain of 50,500. The year to April number has been cut from 56,000 to 51,000. All we can say is that the numbers remain strong and no trend is apparent since early-2018.



Continuing strong population growth will help keep customer base growth strong for businesses on average.

China

China's annual rate of GDP growth has slowed to a three decade low of 6.2% in the June quarter – if you believe the data, and you shouldn't. It is not feasible that the Chinese statistical agency could gather sufficient reliable data within two weeks of the end of a quarter to allow GDP calculations to be made. More than that, given that all branches of government including the police and courts, are required to undertake their activities in ways which promote the role of the Chinese Communist Party and social stability, it would be absurd to think that such an instruction does not exist for the data providers.

So chances are the numbers are rubbish – we just don't know how big a pile. Smaller indicators of growth have slowed down in recent years and those series, along with estimates made by serious analysts of the Chinese economy, suggest that growth has been slowing since the burst of activity undertaken by China to fight the GFC scenario. A lot of that activity has focussed on the infrastructure and construction sectors.

That is a key reason why Australia's economy has done so well these past three decades – strong demand for coal and iron ore. And that is one reason why immediate growth prospects for Australia remain good. The Beijing government has undertaken a number of stimulatory measures over the past year and one is further promotion of infrastructure and construction.

But, by one estimate China already has 65 million empty apartments, or some 21% of the housing stock. And about 47% of all mortgage debt is held over those empty apartments.

At some stage there will be a period of correction in the Chinese economy. One can run the argument that such a correction might occur soon under the pressure of United States trade sanctions hitting confidence and causing businesses to shift production out of China.

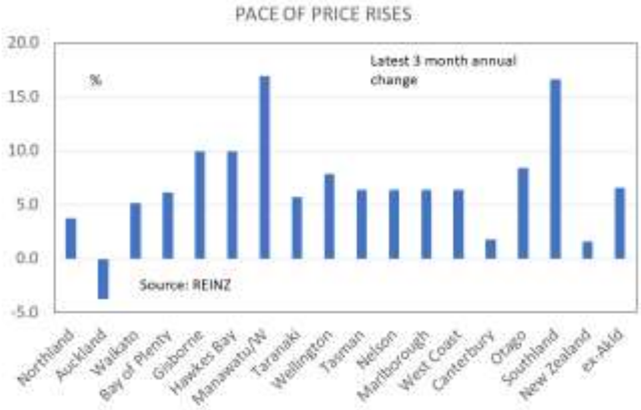
However Beijing retains considerable fiscal easing ability. Yes, debt levels are high and will one day generate a correction which will impact demand for our exports directly and affect us also via a possible recession in Australia. But it is hard to reach the conclusion that such a correction is imminent.

For now it still seems reasonable to expect that good levels of demand for our goods will come out of China. But one day, just as we are seeing now for logs, there will be a sudden cutback in imports of our primary products and this will cause weakening in our economy. It is impossible to know when, and all forecasts of such a shock to Western economies have been wrong for a few decades now. But ahead of this event exporters would be wise to concentrate efforts away from trying to sell more product into China toward developing markets elsewhere, perhaps ones not becoming more authoritarian and using slave labour such as in the police-controlled province of Xinjiang to produce clothing.

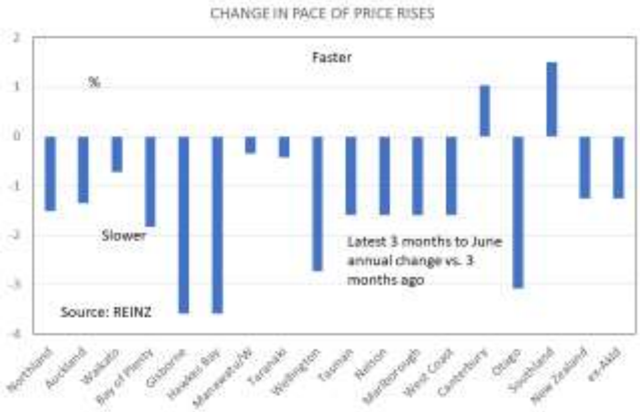
Housing

The REINZ released their monthly data for residential sales activity around the country this week. From a prices point of view the headlines coalesced around average NZ prices being 1.7% ahead of a year ago and Auckland down by 3.5%. Nothing much new can be seen simply by looking at such numbers. A year ago the NZ average was ahead 3.8% so a generalised slowing in prices growth has occurred.

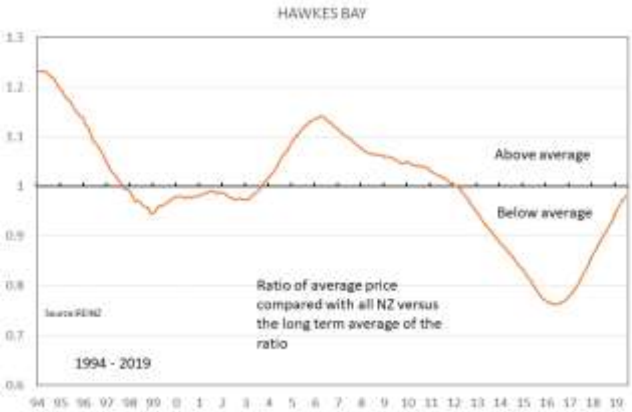
I like to look only at measures averaged over three months as that tends to smooth out inherent volatility which can lead to some stupid reports in the media. Here are price changes between the 2018 and 2019 June quarters.

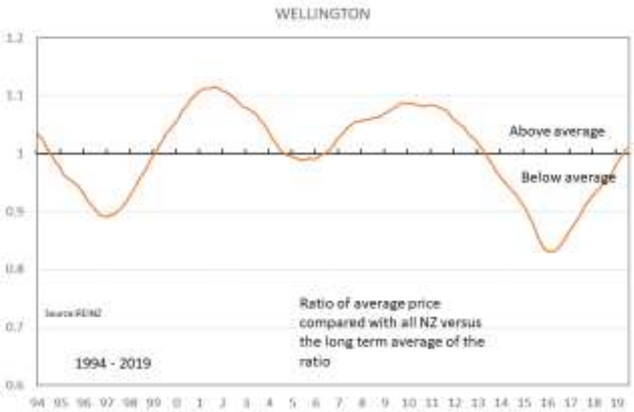


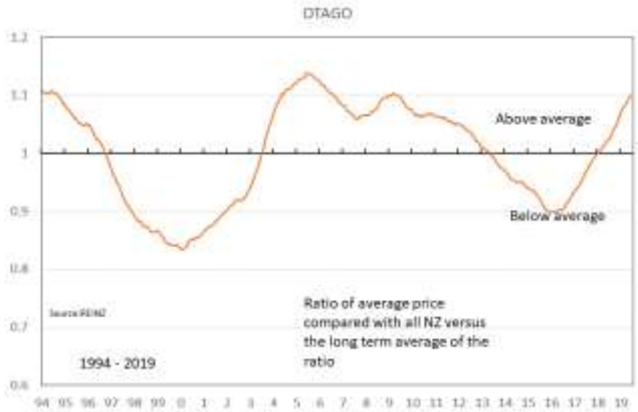
Where is the pace of prices growth slowing the most?



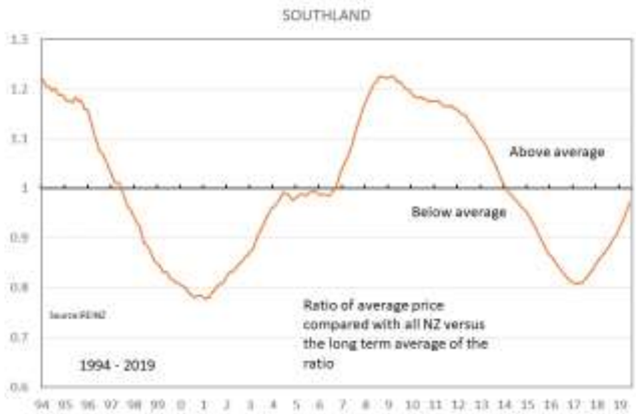
That would be Hawkes Bay, Wellington, and Otago. This is not surprising considering where prices in these regions now sit versus long-term averages.



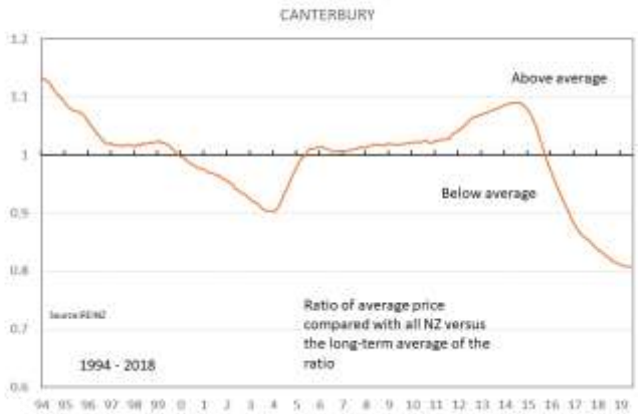




The pace of prices growth is slowing everywhere except Canterbury and Southland. I expect the pace to slow in Southland soon.



But I have a view on Canterbury. There is more catch-up to occur.



Do I have anything interesting to say with regard to sales around the country? Not really. Sales are falling in most regions but not at a particularly fast pace.

NZ versus Australia

During the week I was asked to provide some dot-points around the issue of whether NZ house prices might fall sharply, in the context of prices in Melbourne and Sydney having retreated 10% - 15% from their peaks. Here is what I wrote. Enjoy.

Forecasts of a collapse in New Zealand house prices have been made repeatedly since the 1980s and were most prevalent during and immediately after the GFC. None of these forecasts have proved correct. Average prices fell only 11% between 2007 and 2009 and have risen 88% since then. Nonetheless, focussing on a comparison with Australia, since 2003 while Australia's Capital Cities House Price Index has risen by 90%, NZ's nationwide index has risen by 150%. New Zealand ranks as one of the world's least affordable housing markets.

Here are some reasons suggesting it is not valid to extrapolate recent declines in Australian house prices into the NZ scene.

• Housing Stock Growth
One reason for the difference in price growth since 2003 is that although Australia's 27% population growth since 2003 exceeds NZ's 22%, Australia's housing stock has grown by 30% versus just 20% in NZ. In NZ there is a housing shortage which is getting worse, whereas in Australia there is a (temporary) oversupply.

• NZ Shortage Worsening
In the past 5 years NZ's population has grown by 458,000. At an average household occupancy rate of 2.7 people per dwelling, this required 170,000 net extra houses to be built. Actual dwelling stock growth was only 126,000. The NZ housing shortage is growing and will continue to do so as net migration flows are remaining high near 50,000 (1% of population) per annum.

• Debt and Debt Servicing
Between 2003 and 2019 the household debt servicing ratio in Australia **rose** from 8.2% to 9.1%. NZ's ratio has **fallen** from 9.1% to 7.6%. Australia's household debt to income ratio has jumped from 134% to 190%, NZ's has risen from 130% to 164%.

• Foreign Buying
There has never been as great a level of foreign house buying in New Zealand as Australia. The official NZ data start only in 2016 but show average non-resident buying of 2.5% of all sales, falling now to 0.6%. In Australia, according to an NAB quarterly survey, foreign buying peaked in 2014 near 16% for new properties and 9% for existing ones. Fewer than 4% of existing dwelling sales now go to foreigners and 5% of new dwellings.

• Apartments versus Houses
Since 2003 67% of dwellings built in Australia have been in multi-unit developments. The NZ proportion is just 26%. Prices for apartments have historically shown greater volatility than prices for houses.

• SMSFs
In New Zealand there was no surge in people gearing compulsory superannuation money into housing as occurred in Australia, (given the absence of self-managed superannuation funds) and therefore no recent strong downward pressure on prices from the cessation of bank lending for such.

• Stamp Duties % Offshore Owner Levels
There are no stamp duties on dwelling purchases in NZ therefore there is an absence of the recent depressing price effect in Australia from states introducing and still increasing duties and levies on foreign buyers and owners.

• Interest-Only Lending
In 2015 in Australia near 40% of lending to households was interest only. In NZ at the same time the proportion was 28%. Due to the imposition of new restrictions this ratio in Australia now stands near 20% versus 26% in New Zealand.

- Construction Constraints

The most recent annual number of dwelling consents issued in NZ is 34,500 or 1.8% of the housing stock. In Australia the number is 190,285 and the proportion 1.9% - still greater than in NZ even after a fall from 230,000 a year ago. There is a shortage of builders across all trades in New Zealand – partly because shortages offshore have attracted some Kiwis away for higher incomes and opportunities.

If I Were A Borrower What Would I Do?

Just for your guide, in Australia one of the major banks has just responded to a change announced by APRA a few weeks back. Banks in Australia can now use a different, lower, minimum interest rate when assessing a borrower's ability to meet debt servicing criteria. It used to be 7.25%. Now the rate is 2.50% above the relevant borrowing rate. So if the customer is taking out a mortgage at 4.0%, debt servicing is assessed using a 6.5% rather than 7.25% rate.

The NAB variable rate is 3.35%, so presumably when they follow the other bank they will assess servicing using a 5.85% rate rather than 7.25%.

In New Zealand we have to use a rate which, I think, is 7.9% as a minimum. At some stage it is likely that our central bank will adjust its minimum rate requirement and this will open up the opportunity to get a mortgage and purchase a home to many more people. But I have zero insight to offer as to when this will happen. Best guess? Maybe in November when the next Financial Stability Report is released and LVR rules probably get eased a tad.

Regarding interest rates, scope for big declines in the near future has pulled back slightly as expectations of the speed of monetary policy easing in the United States have been pared back a bit. This reflects some economic data releases coming in better than expected. Nevertheless, easing of up to 1% in the US funds rate is expected over the coming year. Similarly, in Australia the RBA is expected to ease monetary policy further having already recently taken their cash rate from 1.5% to 1.0%.

The RBA have cited as reason for their cuts not so much the state of the Australian economy – which is well supported across a number of fronts – but new research suggesting that there is more spare capacity left in the labour market than previously thought. That is, they used to believe that wages growth and inflation would take decent hikes up when the unemployment rate got close to 5%. Now they think 4.5%.

Similar thinking is helping to drive a generalised lowering of interest rates in other parts of the world as well and will be relevant to the thinking of our own RBNZ.

If I were borrowing at the moment I would probably opt for two years at 3.85% but can understand why many people would be comfortable fixing one year for the same cost in anticipation of potentially fixing slightly lower for a longer term in one year's time.

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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