BNZ Weekly Overview

26 July 2018

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.

Trade War

For your guide, New Zealand is ranked as one of the small economies least likely to be badly affected by the deepening trade war initiated by the United States. This is according to a study using WTO data conducted by Pictet Asset Management.
https://www.am.pictet/en/globalwebsite/global-articles/2018/market-views/in-brief/us-china-trade-war

Only one-third of NZ's exports are linked to global supply chains (things needing to be imported and processed before the exports can happen) versus 68% for Taiwan, 65% for Hungary and 40% for the United States. Actually the NZ percentage sounds much too high considering the dominance of minimally processed primary products in our exports.

But the point nonetheless is made that as the trade war deepens, we will be negatively affected by slower world growth, reduced consumer and business confidence, and unpredictable shocks to prices for some exports as "dumping" or redirection of products potentially occurs. But the impact here will be less than elsewhere. So implied downward pressure on NZ growth and the NZ dollar may be less than one would think at first glance.

It also pays to note that the trade war reflects largely a desire by President Trump to somehow get manufacturing blue collar jobs back in the US from offshore. It does not stem from any desire to try and boost the fortunes of US farmers by shutting out competing products. In fact farmers in the US are being so negatively affected that Depression-era programmes aimed at compensating them for trade related hits are to be implemented. Note also that US chilled warehouses are overflowing with stored meat, principally white meats but also some red. This could depress NZ exported beef prices.

Housing

In economics the trick to gaining some insight into where things are going or what the impact of a particular change or set of changes will be is to look beyond the simple first round effects. Look at what happens after some initial price changes for instance, look at how incentives have changed for key players, and don't forget the role which politics and public policy may play.

In that regard, let's try and join some dots involving the still deepening trade war. We have reached the stage where President Trump is now threatening tariffs on all of the near half a trillion dollars' worth of Chinese goods imported into the United States each year. His upping of the ante beyond the threat to levy tariffs on $200bn worth of goods appears to have been driven by suspicions that the Chinese are devaluing their currency, along with the Europeans perhaps through continuing easy monetary policy signals.

As the Yuan and Euro weaken the USD by definition goes up. The falling currencies cause price changes which mitigate the final impact of higher tariffs for US buyers.

If the trade war is metastasising into a currency war all bets are off the table when it comes to peripheral currencies like our own. Chances are though that the NZD weakens. Or does it?

How can the Chinese weaken their currency? One method is simply through the daily setting of the range in which they will allow it to trade against a basket of other currencies. The other, less obvious way, is to start reversing policies put in place from late-2015 when they sought to boost the Yuan in the face of selling pressure causing the magnitude of intervention to be such (buying Yuan and selling FX currency reserves) that FX reserves started falling at a rapid pace.

One of those policies was a tightening up on loopholes and rat runs Chinese citizens could use to get around the main rule that only the equivalent of US$50,000 per adult could be shipped offshore per annum. It is starting to look a little bit possible that getting funds out is becoming easier. This is manifesting itself as an increase in Chinese residential property buying in Australia, or at least a rise in the number of Chinese settling off the plan purchases and not having to rely on some form of developer or non-bank provided finance.

If this is so then there is an implication for the level of Chinese property buying in NZ also. It is likely to increase.

That is, in fighting a trade war with the United States China may be looking to cause its currency to fall by allowing individuals to sell their Yuan and buy more foreign currencies to purchase assets overseas. And the key thing to note is this. Chinese individuals will be able to see that their currency is falling and that the government may want this to happen. They will see it as part of a wider effort to boost growth which includes loosening of lending restrictions previously placed upon banks, and injections of extra liquidity into the Chinese monetary system.

More Chinese citizens will be wanting to get their funds offshore in order to gain some wealth protection against a falling currency.

Its early days yet for this joining of the dots exercise which I have done here. But along with

- a decreasing chance of rising NZ interest rates over the next three years,
- still only gradual decline in the net immigration boost, plus
- construction sector capacity constraints,

average house price risks could be easing at the moment. It's worth keeping an eye on but not something likely to be big enough to outweigh the main dominant factor which is simply that the cycle has entered its flat period.

Are You Seeing Something We Are Not?

If so, email me at tony.alexander@bnz.co.nz and let me know.

Many thanks to the increasing number of people who each week are sending emails with details on what they are observing out there. Such emails help flesh out my view of where things are at and where they may be heading.

For your guide, word apparently is, if you want the Housing Minister to leave a meeting early, ask him what the average floor size is anticipated to be for the KiwiBuild houses. His inability to respond set alongside feedback we have already received of builders cutting corners and taking fittings out to try and meet KiwiBuild price points, suggests we are setting ourselves up for a situation where KiwiBuild houses could easily have the bad reputation of Chase commercial buildings in the 1980s-90s. Or leaky homes. Or leasehold apartments. Or low lying coastal/riverside properties. Or faultline-adjacent properties.

An emailer this week noted that there will now be increased pressure on construction sector resources following the successful prosecution of a commercial builder owner in the Hutt Valley for failing to undertake required earthquake strengthening. Other tardy property owners are likely to finally be spurred into action to do what has to be done.

If I Were A Borrower What Would I Do?

Nothing new. Inflation risks in NZ remain low, inflation in Australia yesterday came in slightly lower than expected, world growth forecasts are no longer being revised upward in light of trade tensions, and central banks globally remain very, very cautious in their approaches toward monetary policy tightening.

Our view is that the Reserve Bank will start raising the NZ cash rate in the second half of next year but that the extent of rate rises will be quite limited. The cash rate may only peak at 3.0% from the current 1.75%. Why such a low movement upward? Because debt levels are higher, because a whole new generation of borrowers probably does not realise interest rates can go up, and because inflationary pressures are still quite weak.

If I were borrowing currently I'd probably have most of my debt fixed for two years with some floating to allow for early repayment.

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 at www.tonyalexander.co.nz
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