BNZ Weekly Overview

15 December 2016

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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.

Last Overview for 2016

This is the last Weekly Overview for this year and the first for 2017 will appear some time late in January.

I'd like to wish regular readers a lovely Christmas and happy New Year with family and friends and thank all those who have made comments during the year and responded to our quarterly survey.

Following on from the many discussion points listed here two weeks ago there are some worth highlighting again. One important one is the trend change in net migration inflows driving faster population growth, especially for Auckland, than people would have factored into their expectations over the past few decades.

As noted, in the ten years ending 1986 net migration averaged an outflow of 17,000 a year. That improved to an inflow of 3,000 on average from 1987 to 1996, then 11,000 in the ten years to 2006, and now 21,500 in the ten years ending 2016. Why?

Because New Zealand is no longer the big farm which it used to be and our economy's growth rate recently accelerated despite a $5bn fall in dairy export receipts. Our main cities led by Auckland are attractive places for the one million Kiwis offshore to return to and attractive places for many Kiwis still here to remain in and aspire to.

Faster population growth means faster economic/business growth which is very positive for the SME sector. It also means more housing pressures which means higher levels of construction on average but because of the long list of restraints on housing supply growth it means the surge in house prices in recent years will not be reversed.

The surge in property prices represents a response to structural shifts in the economy including structurally lower finance costs. It is not and has not been a bubble (something which many other forecasters who have incorrectly predicted a major decline in prices for many years still fail to grasp.

Another big demographic change you need to think about is the aging of the population. Your gut reaction upon reading this is to fret and worry about a fiscal blowout probably because of the advertising campaigns you have been subjected to for years. But here we have highlighted things other than scary stories of old people with no savings living in squalid conditions. One thing is the drive by people approaching retirement to find income yielding assets in a structurally lower interest rate environment delivering extra demand for investment properties. Aging of the population is producing more housing demand, not less.

In addition people are working longer because it gives them income, they are healthy enough to do so, it gives social engagement, it gives a sense of purpose, and because not everyone wants to spend 30 years in retirement rather than 15 now that expectations for when one carks it have shifted out toward 95 from 80.

As noted a few weeks back, in 1998 only 5.8% of people 65 years of age and older were in work. In the September quarter of this year that proportion had risen to 23.6%. It will go higher, especially as the benefits of continuing to work get greater attention. Just this week the UK's Chief Medical Officer said people should consider working until they are 70.
http://www.standard.co.uk/news/health/brits-should-work-into-their-70s-to-boost-life-expectancy-uks-top-doctor-claims-a3415036.html

Housing

The year started with the Auckland housing market rebounding following the imposition of a 30% investor deposit requirement from October 1 2015. We also saw high strength spreading to the regions with Auckland investors chasing yield and smaller mortgages, then locals joining in once they could see time was no longer on their side for making a cheap buy.

Responding to the renewed surge in house prices assisted by reductions in the official cash rate in December, March and August the Reserve Bank abandoned their experiment with regional LVRs and in mid-July required all banks to impose a 40% deposit for investors all around the country.

Since then we have seen things quieten down in Auckland but in the rest of the country less so as investors continue to find properties lowly priced compared with what they have become used to in Auckland. Wellington has shown high strength along with Hamilton and Central Otago Lakes, whilst in most other places people have been buying but seemingly ignoring population growth projections as they rejoice at the yields they can get in the likes of Wanganui.

In the Weekly Overview of August 18 we republished the Statistics NZ population growth projections in the hope that people will take population shrinkage risk into account when jumping at the prices and yields on offer in some locations. History shows when people find Auckland expensive they incorrectly predict a flood of people shifting to live in the regions. It never happens and won't this time either. The link to that issue is here.
http://tonyalexander.co.nz/wp-content/uploads/2016/08/WO-August-18-2016.pdf

Many parts of New Zealand are in permanent population and economic decline.

Where we sit now is waiting to see if the New Year will bring a similar return of buyers following an LVR change as happened after the October 2013 and 2015 rule changes. The odds of a rebound are decreasing as each week goes by but the possibility remains.

Factors supporting a new price surge include strong jobs growth, strong population growth, growing awareness that construction will fall well behind targeted levels in Auckland, more Baby Boomers seeking yield in retirement, buyers wanting to get in before even more stringent rules are imposed by the Reserve Bank, and the fact that many Chinese still want to get funds out of China to anywhere else on the planet as far as possible from their CCP masters whether the funds are legally gained or not.

Factors suggesting no new surge will come include rising fixed interest rates, many buyers leaving the market because of already high prices, and the LVR rules this time hitting the sweet spot.

Will there be a crash? No because this is not a bubble. Amazingly many people still describe the soaring Auckland housing market as a bubble and reference Ireland. But ignorance is no barrier to getting your voice heard these days and the key thing these people have missed since 2007 is that unlike foreign housing markets pre-GFC we have not seen, are not seeing, and will not see a housing supply surge in New Zealand.

In this country we make it so difficult for anyone to build anything other than a kennel for their dog that growing supply is very difficult, with that difficulty assisted by shortages of builders, shortages of materials, and now a shortage of finance.

There won't be a price crash, but as noted in July, we have entered the end-game for this housing cycle and if the LVR tightening undertaken in July does prove to have only a temporary impact then there will be another tightening before the middle of this year. Chances are no further move by the RB will be needed.

Happy relaxed Christmas to all those who have read our analysis here and avoided putting off purchasing a property since mid-2009 through fear of the crash scenario put forward by so many emotion-driven people. As for those who have believed the crash scenario since 2007 and bought nothing – you've missed out. And as for the young people who have freshly entered the housing market in recent years – sorry, but buying a house will always be more difficult for you than it was for any of us in the past because the housing stock has been permanently repriced higher.

You will have greater problems getting credit and the entry level prices you pay relative to income are and will remain higher than what we were

faced with in the 1970s, 1980s, 1990s, and most of the 2000s.

NZ Dollar

I remain positive on the NZD on the basis of the NZ economy looking good, the next change in NZ monetary policy likely to be a tightening come 2018, and most other economies looking like poor (Europe and Japan structurally, Australia because of politics and inability to make reforms, US because of an electorate torn apart).

The two main risks facing the NZD are a more rapid tightening of US monetary policy should fiscal policy be massively eased by President-elect Trump, and slump in the Chinese Yuan should the economy stall. The former is more probable than the latter.

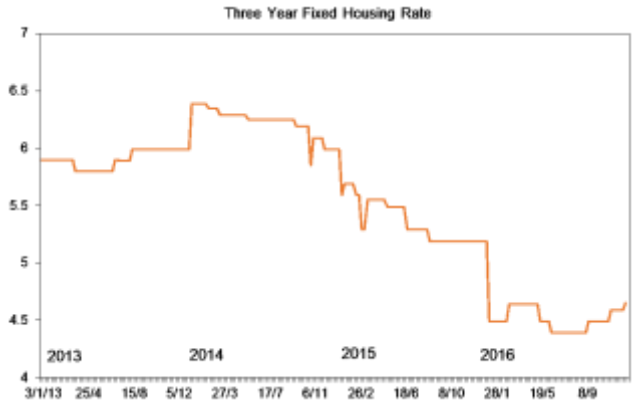
Watch for the NZD to break parity with the Aussie dollar some time next year. Recent data coming out of Australia show the economy to be in a weaker state than previously thought with a growing view that the non-mining sector is no longer taking up the strain of a weak minerals sector. The RBA looks likely to cut its 1.5% cash rate to 1% in 2017 and that could easily see the NZD go above one Aussie dollar.

If I Were A Borrower What Would I Do?

Interest rates look to have bottomed out. Upward pressure is coming from rising global interest rates driven by expectations of looser fiscal policy in the United States. In addition NZ banks are having to try and finance more lending in New Zealand from New Zealanders and that is likely to mean not just greater competition for term deposits (higher cost of domestic funds) but rationing of lending by more than just minimum deposit rules and such-like. Higher interest rates may be in the offing for riskier borrowers.

We don't expect interest rates to rise all that much next year and an outright tightening of monetary policy via an increase in the official cash rate is not expected until 2018. But borrowers might want to look at locking in a greater portion of their mortgage at longer terms.

Could this mean forsaking the likes of a 4.45% two year rate to lock in a five year rate at 5.45%? Personally speaking I would still baulk at taking that leap. But locking in some of debt at the three year rate of 4.65% would probably attract my interest. Note that all our fixed rates for three years and beyond have increased this week.



If I Were An Investor ...I'd see a BNZ Private Banker

The text at this link explains why I do not include a section discussing what I would do if I were an investor.
http://tonyalexander.co.nz/regular-publications/bnz-weekly-overview/if-i-were-an-investor/

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. To receive the Weekly Overview each Thursday night please sign up at www.tonyalexander.co.nz
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