BNZ Weekly Overview

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Mission Statement

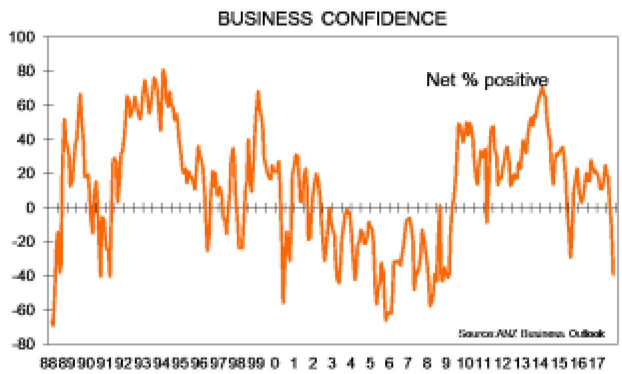
To help Kiwi businesspeople and householders make informed financial decisions by discussing the economy and its implications in a language they can understand.

Last 2017 Issue

This will be the last issue of the Weekly Overview for 2017. Merry Christmas everyone and enjoy the early summer fruit appearing as a result of the sudden switch in weather conditions around the country – from very wet to hot and dry.

Lets finish the year with a run-through of some of the recent data starting with one set I suggest we all ignore for the moment – the ANZ Business Outlook Survey.

Released last week it showed a decline in business sentiment about where the economy will be in a year's time to a net 39% pessimistic in early-November from 0% just ahead of the late-September general election and 18% in August.



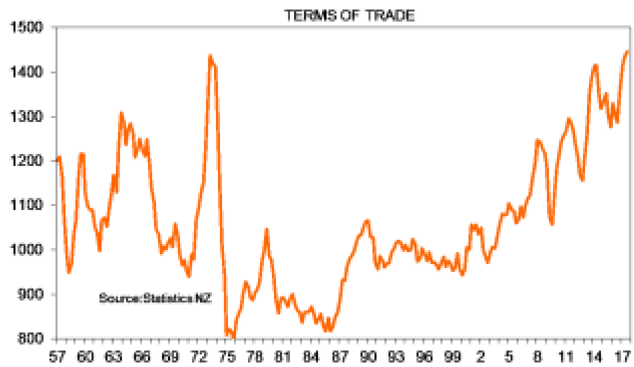
Employment intentions have dropped to a net 3% negative from 17% positive in August. Investment intentions have fallen to +4% from +23%.

Should we be forecasting recession on the basis that these readings and others are the worst by and large since the Global Financial Crisis? No. Business surveys have a downward bias in New Zealand when Labour are in power. Add in the uncertainties of having NZ First involved, the Greens in there for the first time ever, the inexperienced nature of the Cabinet and the gaffs made so far and a lot of uncertainty exists.

But the new government is not like the one which came to power in November 1999 intent on slamming employers and those with above average income. The drivers for our economy are strong, world forecasts have just been lifted, monetary policy is not being tightened, and consumer confidence is above average. This link will take you to our August 31 Weekly Overview where we discussed the chances of a repeat of the 2000 winter of discontent.
http://tonyalexander.co.nz/wp-content/uploads/2017/08/WO-August-31-2017.pdf

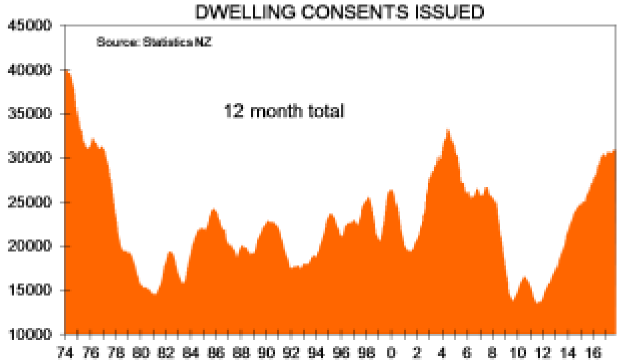
So for the moment there is no real point in drawing conclusions from this business survey. It would be best to wait for it to settle down – remembering though that it will have a downward bias for the entirety of the time Labour are in power.

Speaking of good growth drivers, we have just seen the country's terms of trade hit a record high. The terms of trade measure the size of a basket of imports one can buy with an unchanging basket of exports. The index has just gone above its June quarter 1973 high. Surely that is a sign that everything will be great. After all, things did go so swimmingly well from the second half of 1973 – not.



The slow grind upward continues in the house building sector with the nationwide number of consents issued in the year to October coming in at 30,866 from 30,892 in September and 30,225 a year ago.

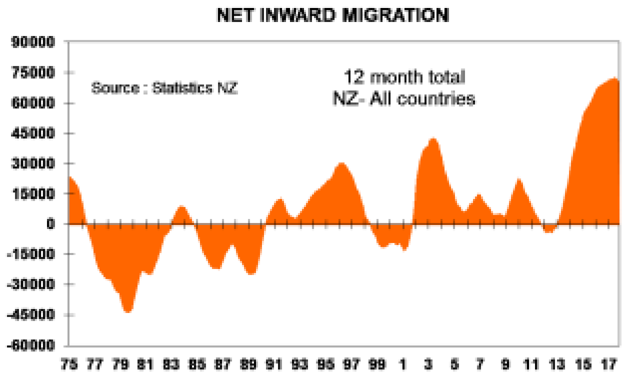
Over this one year period Auckland consents have risen slightly to 10,437 from 9,947 which is fairly mediocre considering the well known and growing shortage. In Canterbury numbers have fallen 16% from 6,168 to 5,156. This means in the rest of the country numbers have risen 8% from 14,110 to 15,273. The Auckland growth has accelerated a tad recently, Canterbury's decline has slowed, and the rest of the country has stopped growing – perhaps highlighting the key point we have been making for the past year or so.



The regions lag Auckland in prices and construction. The construction response however has been very fast. That means it will end rapidly as well, assisted by the realisation dawning on many people that Auckland's young and old are not leaving the big smoke for the "lifestyle" people in the regions think surely everyone values over everything else.

The media are getting quite excited about data showing prices edging down slightly in Auckland. But watch for some of the regions bereft of decent population growth. It is from those places that more interesting negative headlines may emanate over the coming year.

Whereas dwelling consents in Auckland look like bobbing along for the coming year with an upward bias versus downward elsewhere, net migration numbers look like bobbing along with a downward drift. In the year to October the net migration gain came in at 70,700 from 71,000 in September and a peak of 72,400 in July. A year ago the number was 70,300.



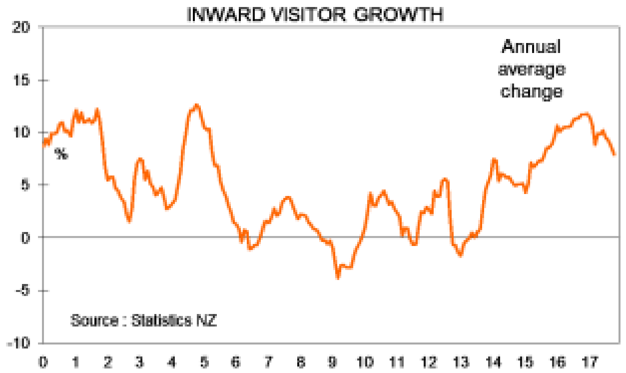
The turnaround so far is very slow. History tells us we can sometimes pick the direction of drift for the numbers, but picking speed of decline or increase and where the peaks and troughs will be is a very hit and miss game. Back late in 2012 I was quite confident that the net outflow of -4,000 was turning around and would head toward maybe a 35,000 net gain. That was well off the peak of 72,000 recently but the analysis in terms of picking further price pressure in Auckland was correct.

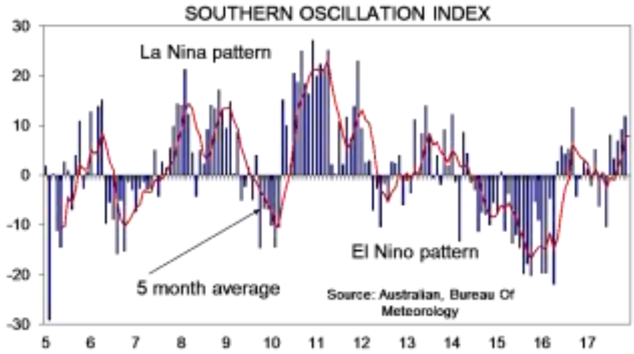
This time I personally don't think any of us really has a clue what the net gain will be in three year's time. On the downside one might cite the improving labour market in Australia, foreign students in NZ completing studies, and government plans to slash gross migrant inflows by up to 30,000.

But on the upside the NZ labour market remains very short of people, and the government has notably not repeated its commitment to slashing migrant inflows – perhaps in the face of feedback that some industries would be very severely impacted.

Net migration inflows will likely continue for quite a few more years and remain supportive of growth in the economy, housing markets etc.

The monthly migration data release from Statistics NZ also tells us what is happening with visitor flows. In the year to October the number of people visiting New Zealand was ahead by almost 8% from a year earlier. One year ago this growth rate was 12%, two years ago 9%, three years ago 5%. Growth has been strong for quite some time now and at 3.7 million the number of people visiting our country is double what it was in 2001.





In the three months to October visitor numbers were 4.2% ahead of a year ago and annualised growth in seasonally adjusted numbers these past three months was actually a fall of 6%. So numbers have pulled back recently but feedback from the sector indicates that this is not expected to continue.

The key problem for the tourism sector as it looks at forecasts of the number of Chinese visiting for instance doubling in the next few years from 400,000 is that accommodation is in short supply and staff availability poor. The sector is undoubtedly working the phones with policy advisors and new government MPs pointing out the need for more, not fewer, working visas. Same for the farming sector. Same for aged care facility operators. Same for the construction sector, forestry tree planting, water deliverers etc.

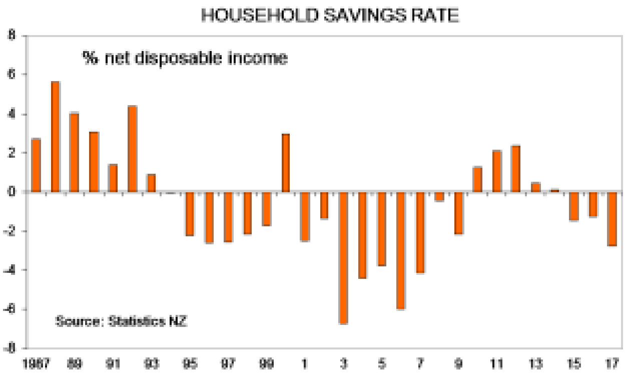
At least in the banking business staff don't appear to be in short supply – in fact the tone is more one of redundancies picking up driven partly by implementation of new technologies and declining numbers of people using branches, cheques, cash and personal discussions.

There are some negatives for our economy in play. The country is drying out like a bun in the back window and this will send a wave of caution through the agricultural sector. This includes farmers dependent upon irrigation facing restrictions on water access just like people in cities and towns are starting to face.

The Southern Oscillation Index has entered into a small La Nina pattern but truth be told there has been no big sustained movement in the SOI for the past year. Some discussion on the effects of La Nina and El Nino can be found here. https://www.niwa.co.nz/climate/information-and-resources/elnino/elnino-impacts-on-newzealand

International oil prices have also risen recently and with help from a lower NZ dollar pushed petrol prices higher just in time for summer driving – something about which you might want to think twice given the still rapidly rising number of mindless tourists in the country hiring rental cars and campervans with no idea how to drive. Hitting the road these days is not the same experience as a couple of decades back and it could easily cost you your life. Bring on compulsory driverless cars for all visitors.

Kiwi households have increased their dissaving rate – to -2.8% in the year to March 2017 from -1.3% a year before and a string of tiny positives from 2010 to 2014. This means in an environment where banks have to try as best as possible to fund domestic lending domestically, credit availability will remain marginally on the tight side of normal going forward.



But lending growth has slowed over the past year, most notably for investment property. So some of the worse case scenarios for credit availability doing the rounds ahead of mid-2017 are no longer on the table.

If I Were A Borrower What Would I Do?

The key fundamental underlying interest rate forecasts and their appalling failure rate since 2009 (2007 if you count not picking the GFC) has been the absence of a surge in wages in response to fast jobs growth, and technology limiting the ability of retailers to raise their selling prices.

This comment applies not just to New Zealand but most other countries as well. The big question then is when will inflation rise enough to promote a general rise in the level of interest rates. The answer is that we do not have any post-GFC models or relationships which give any reliable insight into when this will happen.

That is probably a harsh message to hear for those seeking to structure their mortgage to minimise cost over the next few years and those trying to maximise their term deposit returns. But its a simple fact. No-one can stand up and say they have a good interest rate forecasting record these past ten years. We are all useless.

So what does one do in this circumstance? Spread your risk. Take a range of fixed terms as a borrower and as an investor perhaps do the same. If you are an investor and find that the structural decline in interest rates has left you with insufficient income in retirement then be very careful about taking on riskier assets in order to boost your yield. Such assets are available but how will you be left if they flop or fail to pay back your capital in the timeframe you envisaged?

If an interest rate guess is what you want then here is the popular one at the moment. The Reserve Bank project that they will not start raising the official cash rate until the end of 2019 but in the markets the view is that a rate rise will come probably in the second half of next year. Of course if the drought worsens and persist then the RB might start thinking about an interest rate cut!

If I were borrowing here at the end of 2017 I'd probably lock most of my mortgage in for two years with perhaps a little bit at one and three years.

Enjoy summer.

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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