BNZ Weekly Overview

22 June 2017

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.

With Fieldays being the focus last week there was not much time available to analyse data released while there from Wednesday to Friday. So here is a quick review of the important events including this morning's OCR review and the migration data.

GDP

Firstly we have New Zealand's pace of economic growth. We measure this from changes in GDP – gross domestic product – and on average since 1997 growth has been 2.6% per annum. The pre-GFC average was 3.4% and post 2.3% but be careful with calculations of such averages as whether or not the time period captures or just misses an upturn or downturn can make a big difference. The latest growth rate is 3.0% so we are running at a good pace post-GFC but less than before the crisis. Firm by current global standards, acceptable by NZ historical standards.

But we all know that booming net immigration has been a contributing factor, so what if we look instead at GDP growth per capita? The average per capita growth rate since 1997 has been 1.5% per annum. The pre-GFC average growth rate was 2.2%, post 1.0%, and the latest rate for the year to March was 0.9%.

So compared with the 20 year average recent per capita GDP growth has been below par. But one cannot say that population growth is the only reason we are growing. After all, we have near booms in some industries which have nothing to do with changes in net migration flows – the primary sector and tourism.

But at 3.0% GDP growth is on the low side considering the strength we can see in other measures. Jobs growth for instance has been around 4.5% over the past year. This means labour productivity has fallen, and the poor productivity of the NZ labour force was a key problem discussed by the OECD last week in their two yearly report on our economy.
http://www.oecd.org/newzealand/economic-survey-new-zealand.htm

They noted that factors contributing to our underlying poor productivity growth (and this is what ultimately determines income growth and our GDP per capita ranking in the OECD) include

-lack of international connections (we are not just remote we are focussed inward)
-agglomeration benefits and scale (meaning Auckland is not big enough and too few industries of very large size.)
-weak competitive pressures (meaning too many oligopolies in some sectors, think building materials, supermarkets for instance)
-low rates of capital investment (we make do with what we have rather than taking a long-term view and building a base for future growth in our businesses)
-meagre research and development activity. (1.3% of GDP versus 2.4% OECD average)

They also note that although we have high skills, we don't match those skills to actual jobs. People tend to be highly over-qualified for what they do. Sure, but go to page 24 of their 176 page report and look at the employment graphs. They show below average unemployment, massively below average long-term unemployment, and an employment rate (% of people over 15 in work) 10% above the OECD average. Our skill utilisation may not be optimal but plenty of countries would probably accept such mismatching if it was accompanied by our strong jobs market and the social inclusion it brings.

All up studies suggest our income per capita is perhaps 20% lower than would be suggested by our overall economic structure. Correcting things however looks quite difficult so no-one should anticipate a new big wave of economic reforms in the next few years which will boost incomes in the long-term. Why? Because the populace probably doesn't want the short-term pain which reform brings, and does not feel the need for radical change outside of perhaps the housing sector.

To see short-term pain in action and the backlash it brings, watch the French streets for the next few years as new President Macron tackles France's infamously regulated labour market which keeps young people out of employment.

For your guide, compared with five years ago in the year to March 2012 the NZ economy has grown 14% and the best growing sectors have been as follows.

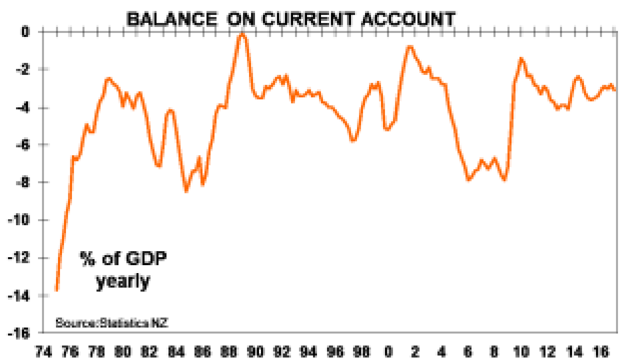
Construction	34%
Retail/Wholesale trade	27%
Info. Media and Telecomms	22%

The primary sector has grown just 8%, 10% for manufacturing excluding food, education 2% (health care 16%).

For your guide, weak productivity growth, poor per capita GDP growth, is not something special to ourselves post-GFC. Many economies are experiencing very weak labour productivity growth and no-one has come up yet with a good reason why. https://www.theguardian.com/business/2017/jun/21/productivity-crisis-uk-real-wage-growth

Current Account

Last week we also learnt that the country ran a current account deficit in the year to March of $8.1bn or 3.1% of GDP. This was up from 2.8% three months before and a tad higher than expected, but below the average for the past 20 years of 4% of GDP.

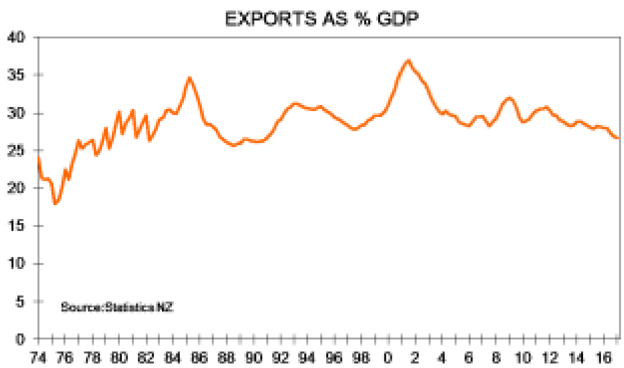


Many people over the years have fretted about the high level of the deficit with ongoing predictions of currency collapse, and implied justification for a return to the bad old days of import controls, export incentives, if not a fixed exchange rate. Thankfully most of these interventionists have moved on one way or another – yet their central thesis remains relevant. We do not pay our way. That is fine as long as foreigners remain willing to finance us by either buying our assets or lending financial intermediaries money. And that is the problem we discussed last week.

In times of global crisis people who previously were happy to send their money out of their home country wanted it back close to them as quickly as possible. Our vulnerability therefore is not so much to weakness in the NZ economy scaring investors and lenders away (that just causes big currency and interest rate declines), but world markets seizing up. That is why we banks have been instructed to reduce our dependence upon foreign financing, and that is why all borrowers now are having more difficulty getting someone to lend them money.

In other words, actions are being taken and have been underway since the GFC to try and reduce the potential for a big shock to our economy and society transmitted by our financial sector and caused by a global financing shock.

For your guide, using the current account data we can see how well the government is progressing in its goal to raise the ratio of NZ exports to GDP to 40% come 2025. Oh dear.



Migration

There was a net addition to the NZ population from permanent and long term migration flows in the year to May of 71,966. This record level was up from 71,885 in April and 68,432 a year ago and well above the ten year average net gain of 24,700. However when we look at the seasonally adjusted monthly numbers we can see that underlying flows were at their strongest about six months ago. The annual total is going to start drifting down fairly soon but probably at a slow pace which will still leave well above average flows for the next few years. A key contributor to the easing will be students who came here for long-term study finishing up and going back offshore.

Housing

I'd like to congratulate Justin Kean of Unitec's property development business Wairaka Land Company for a good article challenging the view that baby boomers are to blame for the current housing situation. He points out that the development of motorways in the past opened up new tracts of land not too distant from people's workplaces and this allowed cheap entry into the housing market for young people back then. They responded to the opportunity they were presented with and secured cheap home ownership early in their working lives.

But these days land being opened up is very distant from where people are working and a sense of remoteness makes many people reluctant to buy in such places – though probably it is the terrible commute involved rather than feeling like you are on Mars. Baby boomers moved into suburbs scraped of top soil with no trees, no shops, and lots of mud to start with. But their commuting times were small.

He argues as I did five or so years back that one way to assist home affordability would be to set up a government agency to undercut the oligopolistic pricing practices of our large building materials companies.
http://www.stuff.co.nz/business/opinion-analysis/93602857/justin-kean-blame-the-motorway-for-your-housing-problems

Or, as put by the OECD in their recent NZ report on page 15
Main Finding = "Significant price-cost margins and survival of less productive firms suggest that competition could be sharpened".
Key Recommendation = "Review the merits of refocussing competition law on the effects of potentially anti-competitive conduct, as opposed to its intent. Provide the Commerce Commission with the power and resources to undertake market studies."
http://www.keepeek.com/Digital-Asset-Management/oecd/economics/oecd-economic-surveys-new-zealand-2017_eco_surveys-nzl-2017-en#page15

Last week the REINZ reported monthly data on unconditional dwelling sales around New Zealand. Each month back data now get revised so there will be ongoing underestimation for the latest month of what actual sales were in each region. But acknowledging this new bias downward in their data we see that nationwide in May sales of 7,354 were 19% weaker than a year ago.

In the three months to May sales were down 20% from a year back. The annual sales total now stands at 83,326 which is down from this cycle's peak of 94,633 in June last year. Sales are probably declining to somewhere close to 70,000. They bottomed at 55,000 in 2011 and 64,000 in 2001. Employment in the residential real estate sector is likely to start falling away now.

For your guide, just in case you might be thinking the slowdown is all Auckland and in the regions its full steam ahead, here is a list of when peak annual sales occurred by region ranked by first peaker off the rank - Auckland. Only the booming West Coast is still rising!

	Peak
Auckland	September 2015
Nelson	March 2016
Tasman	April 2016
Waikato	May 2016
Northland	June 2016
Hawkes Bay	June 2016
Bay of Plenty	June 2016
Canterbury	June 2016
New Zealand	**June 2016**
Marlborough	August 2016
Otago	August 2016
Southland	September 2016
Wellington	September 2016
Gisborne	November 2016
Manawatu/Wang.	March 2017
Taranaki	March 2017
West Coast	May 2017 Rising

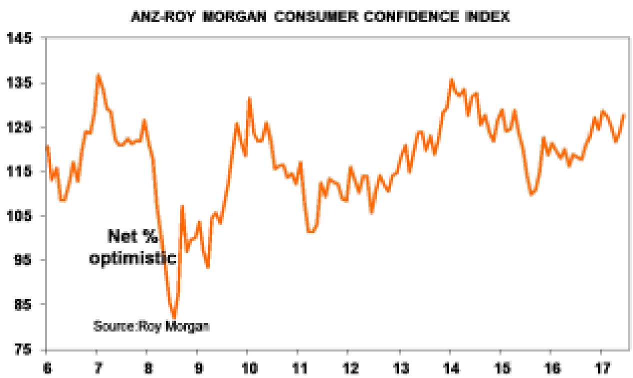
Now lets do the same thing for prices.

	Peak	Peak %	Now %
Canterbury	February 2016	5	2
Auckland	August 2015	23	5
New Zealand	**September 2015**	**13**	**9**
Southland	July 2015	18	10
Waikato	August 2016	25	21
Bay of Plenty	August 2016	25	14
West Coast	September 2016	28	-18
Nelson	December 2016	23	17
Manaw/Wang.	January 2017	16	15
Taranaki	January 2017	13	8
Wellington	January 2017	18	15
Marlborough	January 2017	16	14
Otago	February 2017	13	11
Tasman	March 2017	24	16
Gisborne	April 2017	29	24
Hawkes Bay	Rising	18	18
Northland	Rising	24	24

Consumer Spending

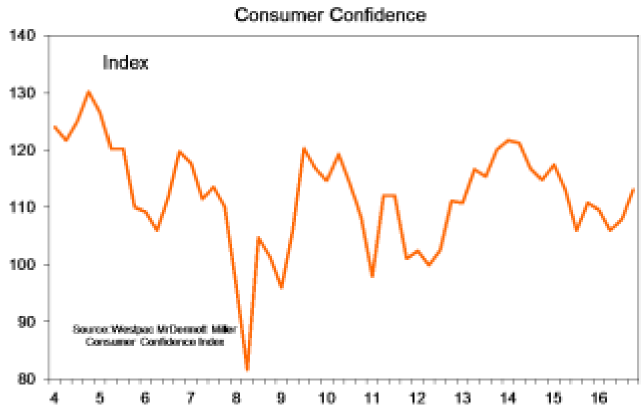
A key factor which influences the pace with which consumers will increase their spending and perhaps what they will buy is their confidence about the economy and their own finances. If people feel optimistic they tend to spend more. If they feel pessimistic they spend less.

But there is no correlation in the short-term (less than 3-6 months) between changes in confidence levels and spending growth. So retailers should not look at the following and conclude that happy days lie just around the corner. Just around the corner is Amazon and other online retailers eager to destroy your business model like online television is doing to Sky.



The monthly ANZ Roy Morgan Consumer Confidence Index rose to a reading of 127.8 in June from 123.9 in May. This is the highest reading since January so one cannot say that all of a sudden people are feeling magnificent. But the trend in this measure has been upward for the past two months so that is good for retailers – in theory. The average reading for the past ten years has been 116.6.

We also learnt this week that the Westpac sentiment measure improved in the June quarter to 113.4 from 111.9 in the March quarter. This is above the ten year average of 109.7 and the strongest reading since the start of 2015.



For your guide business confidence is a tad less positive. The NZIER's quarterly survey produced a reading for businesses' expectation for how busy they will be of a net 25% positive versus a 12.3% average. The ANZ Business Outlook sentiment reading sits at 15 which is actually below the net 20% positive average reading.

If I Were A Borrower What Would I Do?

Last week we wrote about the fall in swap rates over the past few months and how this provided scope for cuts in fixed lending rates – but that such cuts would likely only be small because of various increases in funding costs and bank operating costs not captured by swap rate changes. This week we received an example of such costs which are expected to flow from Moodys cutting their credit ratings for the major Australian banks. They are concerned about the combined effects of high household debt and bank exposure to a rampant housing market and especially the investor debt-driven surge into capital city apartments.

One analysts feels that the reduced credit rating will add about 0.1% to bank funding costs here in New Zealand because the ratings cut feeds through into NZ bank ratings as well.

Next cab off the rank could be an information paper due out in Australia soon from the

Australian Prudential Regulatory Authority (APRA) on bank capital requirements.
http://www.theaustralian.com.au/business/opinion/david-rogers-exchange/banks-face-fragile-equilibrium-over-capital-rules/news-story/659571eee40777a21c10336f129c021e

Next might be our own RBNZ review of bank capital requirements over the coming year.
http://www.rbnz.govt.nz/research-and-publications/speeches/2017/speech-2017-03-07

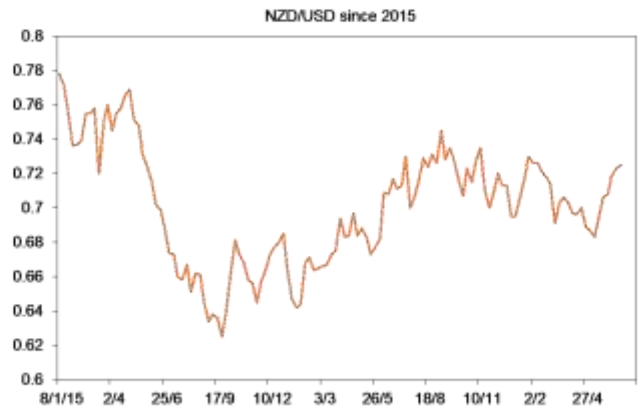
All these things and others add up to extra costs and funding costs being imposed on NZ banks, with one of the biggest being the need to boost retail deposit rates to try and raise funds in NZ for lending in NZ as the universal desire is that bank borrowing from offshore go down.

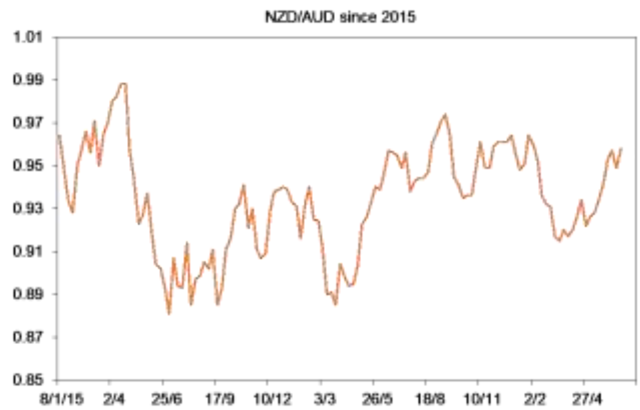
But with regard to the eventual drift up in interest rates more generally which all and sundry have been so far incorrectly predicting in New Zealand since 2010, as yet borrowers have little to fear. The Reserve Bank this morning left their cash rate unchanged at the record low of 1.75 they took it to last year when backtracking from an earlier rise to 3.5%. They noted "Monetary policy will remain accommodative for a considerable period."

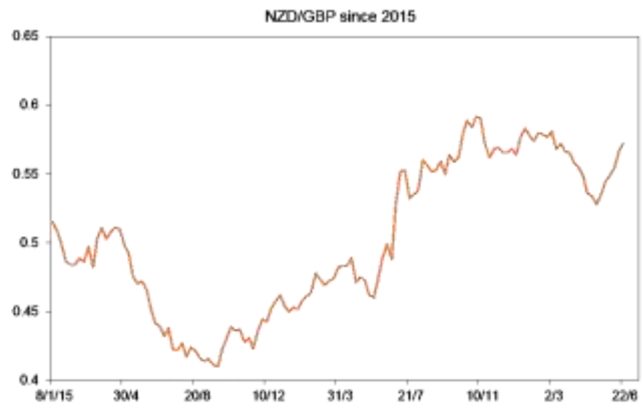
The chances are that 2-3 years from now floating interest rates will be a couple of percent maximum above where they are now. But as to when the movement starts is (proven to be these past seven years) anyone's guess.

NZ Dollar

The Kiwi dollar this afternoon was sitting against the USD just slightly higher than a week ago at 72.5 cents from 72.3. Underlying support for the NZD remains strong and we probably would have risen more against the USD this week were it not for the fall in oil prices causing general selling of commodity-linked currencies. As it is we have advanced anew against the British Pound to 57.2 pence from 56.7 with the Pound depressed by political worries.







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. **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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