

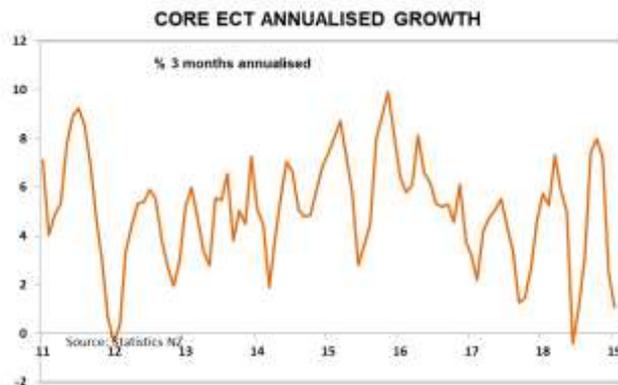
Mission Statement

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

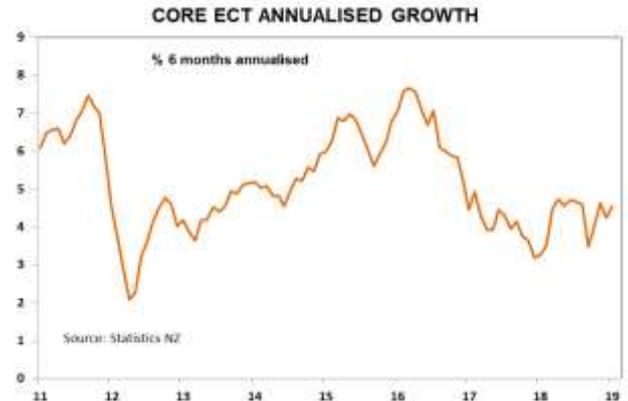
Our Economy

Consumer Spending Growth Highly Volatile

A piece of economic data we received this week was spending using debit and credit cards. In January the core measure in seasonally adjusted terms soared by 2.2% after falling 1.7% in December. The monthly numbers are extremely volatile. But smoothing over three months we see annualised growth in this measure was only 1.1%, down from 8% three months earlier. As the graph shows, even the three monthly measures are highly volatile.



You can say that the evidence suggests quite a slowdown over summer and I have spoken with some retailers who saw this weakness. But this could simply be a whip back from unusual strength leading into October. So let's smooth over six months. I reckon this picture is a more accurate indication of what is happening with consumer retail spending. A pullback which might be associated over 2016-18 with a slowing Auckland housing market, easing net inward migration, and pullback from very strong rates of growth seems to be over. I like this interpretation because it gels with our view on the Auckland residential real estate market pullback.



Looking ahead for retail spending we see continuing good support from low borrowing costs, a strong labour market, acceptable housing market, a recent slight recovery in consumer confidence levels (see graph following) and still only slowly easing net immigration. But for retailers times will still be challenging given firm online competition and perhaps new on the ground entrants into some key retailing sectors in New Zealand.



Housing

I now write monthly and quarterly housing reviews for OneRoof as well as fortnightly housing columns for Property Press. So apologies if you sometimes see the same numbers presented in different publications. But the columns will always be unique.

This week REINZ released their monthly numbers and the useful things we get from them are the House Price Indexes and sales numbers. Listing data we already have in hand from realestate.co.nz

Before looking at what the REINZ data tell us there is one important thing to note. Annual sales growth calculations you will see in the media are biased downward. Why? Because REINZ revise monthly sales totals upward as more confirmed sales come in. Months a year back are complete. The latest month certainly and even the month two months' back definitely are not. I try to overcome this bias by not revising old numbers up as new data appear. An alternative would be to immediately boost latest month data by a calculated revision.

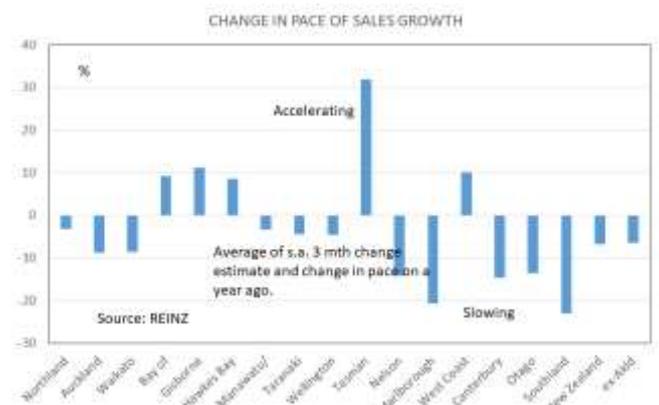
So what do we see from this month's data? January was very hot, people went to the beach, so sales were on the weak side. But I don't look at just one month and instead smooth things away from the volatility by looking at three month changes. In the three months to January dwelling sales around New Zealand were down just 2% from a year ago but off 4% in rough seasonally adjusted terms from the three months to October. Sales off slightly but not collapsing.

In Auckland sales were down 5% on a year ago versus unchanged all elsewhere. But seasonally adjusted they retreated 6% for Auckland versus 4% elsewhere. So summer has basically been quiet nationwide.

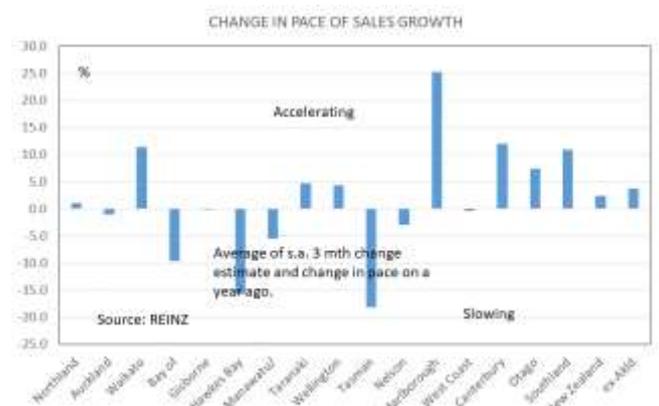
The following graph shows the annual number of dwelling sales for all NZ. Things have stabilised broadly after a fall from early-2016.



In this next graph we are trying to get some indication as to whether the pace of growth in sales is getting better or worse for each region by looking at an average of the change in the annual pace of growth from three months ago and the latest seasonally adjusted change. Things are broadly slowing now in most regions apart from the North Island east coast.



Compare this situation with three months back. Note more regions have moved into slowing territory. This is nothing major, just a visual sign of what we expect to see happen as this year progresses – regions slowly finishing their Auckland surge catch-up.



With regard to prices I also concentrate on three month changes and not volatile monthly movements, although the House Price Indices calculated by REINZ do give good validity even to monthly numbers.

In the three months to January nationwide house prices were ahead by 3% from a year ago with Auckland down 2% and the rest of NZ up 8%. Ex-Auckland price gains started accelerating late in 2015, almost four years after Auckland got cracking. Auckland peaked late-2016. If the four year relationship holds up then the rest of NZ will show price gains averaging above 3% p.a. until late-2020. But this pattern of Auckland taking off first is not really the norm and that is the important thing which the following graph shows.



The price gain lines generally changed direction at the same time from 1997. Before then we can put the difference down to a combination of Auckland gaining greater population growth following migration rule changes late in the 1980s, and the regions suffering from removal of special supports also in the 1980s. This relationship of broadly coincident movement will likely re-establish itself but not yet. That is why we placed here a couple of weeks back a graph for each region showing the extent to which some catch-up in prices might remain.

My gut says the regions will start experiencing on average house price inflation near 3% from late this year by and large. They will not catch up all price ground lost with Auckland because of the many factors discussed here and in other places since 2011. Greater population growth in Auckland, greater economic growth, greater land and bureaucratic constraints, holding onto young people many regions cannot, attracting foreign buyers (less relevant now but still happening

behind the scenes), and basically playing a role as New Zealand's main internationally-connected urban agglomeration which no other centre approaches.

	Three months on a year ago % price gains
Northland	9.0
Auckland	-1.8
Waikato	6.3
Bay of Plenty	7.5
Gisborne	13.9
Hawkes Bay	13.9
Manawatu/W	16.7
Taranaki	5.9
Wellington	10.6
Tasman	7.3
Nelson	7.3
Marlborough	7.3
West Coast	7.3
Canterbury	0.5
Otago	12.5
Southland	12.3
New Zealand	3.2
ex-Akld	7.9

This week we also received monthly house price indices from CoreLogic. So that means each month you get to see discussion of house price inflation derived from three separate sources – realestate.co.nz asking prices, REINZ sales prices, and Quotable Value/CoreLogic prices for recorded title transfers. I will concentrate on the REINZ measures.

Migration Flows

Some commentators have been saying that because the estimated net migration inflow in the past year was 43,000 and not the over 60,000 estimate using the old departure cards that there is far less pressure on the Auckland housing market than thought. Not so fast.

The new migration data are available from the start of 2001. They show on average an annual net migration gain of 28,208 people. The old method shows an annual average gain over the same period of 27,356. The new method shows migration driven population growth since the start of 2001 of 506,233 people. The old method shows 486,785. The population boost is bigger, not smaller! There is no basis for claiming that the new migration data (subject to potentially hefty

revisions) imply less of a housing shortage in Auckland than previously thought.

One wonders if the Minister of Housing has apologised to the “kids at Treasury” who he criticised in May last year for daring to challenge his optimism regarding the pace of the KiwiBuild programme. Probably not. There is now no target at all for KiwiBuild beyond the meaningless 100,000 in ten years target. That’s right up there with having the country entirely smoke free by 2025, or zero road deaths in the next few years. Ahh the dreamers. Often really good at high flying speeches and photo-opportunity praise sessions on the international stage. But you wouldn’t want to go into business with any of them.

All that cynicism aside however, it would be great if Chief Executive of the new Ministry of Housing and Urban Development Andrew Crisp were to achieve success at greatly spurring the construction of more affordable houses.

On another topic, feedback from within the building sector in Auckland is that there is massive demand for anything small for young home buyers to go into but margins for developers are simply too small. They still prefer to build more expensive houses which generate a lot more profit. These types of well-specced apartments are in high demand from owners of now expensive older houses downsizing to free up capital and have no maintenance problems.

What is happening is that with the market delivering expensive houses and government efforts helping boost affordable housing supply slightly, a gap is opening up in construction of dwellings just below and just above \$1mn.

Your Strategy

-Things to consider in your next annual strategy session.

Very few industries grow in a straight line unimpeded for decades. Even the dairy sector which has expanded tremendously in recent years has seen massive ups and downs as international dairy prices have soared, collapsed and repeated the cycle.

But there is a big difference between dairy sector weakness caused by price fluctuations which invariably reverse, and longer term chickens coming home to roost and new threats. At the

moment and perhaps at an accelerating pace, the dairy sector is being challenged by a number of things. One is deepening concern about intensive dairying’s impact on our waterways and quality of drinking water. While operators are making bold efforts to mitigate their environmental damage the chances are that in a world of deepening environmental concerns those efforts will not be seen as deep enough fast enough. Needing votes in the cities as the negatives and revelations of policy failure build up for the Labour-led government, green-tinged policy changes ahead of next year’s general election are possible. After all, one could never accuse Labour of being a friend to the farming sector, or mining, or forestry.

There is also deepening concern about the greenhouse gas emissions from cows and the meat sector generally here and overseas. Public relations campaigns increasingly link global warming not just to the nexus between eating meat and emitting animals but consuming dairy products as well. It is hard to see consumers suddenly switching away from dairy products. But they will increasingly be open to at least trying alternatives.

On top of these concerns we also have the high levels of debt in New Zealand’s dairy sector. While buyers were queuing to take part in the white gold rush these past 2 – 3 decades banks have had little concern about high debt ratios. But foreign farm buyers are increasingly if not largely shut out by Overseas Investment Office regulations, young new local buyers balk at the level of debt they must take on, and new capital looking for primary sector exposure is focussing on horticulture. Pressures on dairy land prices are downward. And that is an important consideration at a time when banks may have to minimise their need for new higher capital requirements likely to be imposed by the RBNZ, through cutting back on risky lending needing above average capital backing.

So while the year to year fortunes of dairying have been and will continue to be influenced largely by payout levels, there are some new secular trends in place which will likely curtail new dairy sector growth, bring rationalisation, and eventually produce some forced farm sales. If you run a business with high exposure to the dairy sector you will probably still be okay as our second biggest source of export receipts is unlikely to much diminish in size in the next few years. But if your business is closely tied into expansion of the

dairy sector (rolling out new irrigator systems maybe for intensive operations), you may want to adjust your growth strategy to start looking outside dairying for future growth, or servicing the sector in a different way.

If I Were A Borrower What Would I Do?

This week it was the turn of the Bank of England to turn dovish on monetary policy with a pullback from warnings that the next direction for rates was definitely upward. The Bank of India also officially eased monetary policy and the People's Bank of China has been easing credit restrictions for some months. The BOE change in outlook associated with a 0.5% cut in their 2019 GDP growth forecast to 1.2% follows last week's pullback and 0.75% growth forecast cut by the RBA and the week before removal of rate rise warnings from the US Federal Reserve.

Our central bank has long said that the chances of rates going down are as good as the chances of them going up. They have been well ahead of other central banks in their thinking. Well done. And again yesterday in their cash rate review and Monetary Policy Statement release the RBNZ said rate risks remain evenly balanced. But while forecasting a slight acceleration in the economy's pace of growth this year they also pushed out further their predicted timing for a rate rise into 2021.

The rate forecast reversals offshore have caused falls in wholesale interest rates here and these are likely soon to lead to some cuts in mortgage lending fixed rates. Floating rates are more closely tied to the RBNZ's official cash rate and that remains unchanged at the 1.75% it was taken down to in November 2016.

As for the usual dire warnings about rates rising and finally all those people who bought houses before others wanting to buy finally getting their comeuppance, one day mortgage rates will go up. But every single forecast of sustained rate rises made in this country since 2009 has been wrong. 100% of them. No exception. No miracle has suddenly occurred to deliver improved rate forecasting ability to those who have been on the wrong side of rate calls for a full decade now so if I were borrowing at the moment I would be severely hard pressed to be convinced that fixing

longer than two years or at a discounted three year rate was worth it. Especially as the global interest rate cycle has probably peaked.

Sure, I'd pay attention to warnings that probable requirements for our Aussie owners to boost capital levels will boost overall lending costs. But as noted here last week, the Reserve Bank moves the official cash rate in order to achieve an average level of mortgage rates which in their opinion will keep inflation nicely between 1% and 3%. If increased bank capital costs push mortgage rates up then the RBNZ will cut the official cash rate to offset such rises. Were they not to do so then there would be unintended downward pressure on the pace of economic growth and eventually inflation.

So as a borrower I would have little concern about bank capital level changes causing me pain. Having said that, the RBNZ can influence floating rates and one to two year fixed rates. But beyond that they have minimal influence. If bank capital costs go up then we will see a structural steepening of the mortgage yield curve – medium to long-term fixed rates will permanently be higher than otherwise but by cutting the OCR floating and perhaps out to two year fixed rates won't change.

The attractiveness of fixing three years or more will collapse. We will get more insight into this issue come the end of May.

https://www.nzherald.co.nz/business/news/article.cfm?c_id=3&objectid=12196309

Unfortunately I am not a borrower enjoying the lowest mortgage rates since the 1960s or on record. I am a saver hoping for someone to offer me a good term deposit rate. But no-one is and I worry about the sharemarket at a time when

- the tech sector is facing political and consumer backlash,
- international trade relations are deteriorating,
- messy Brexit approaches,
- world growth forecasts are being cut,
- volatile sharemarkets and fragile financial market sentiment, and
- China's problems seem more multitudinous than at any other time since 1978.

Things feel unsettled. Maybe I should take advantage of the flattening in Auckland's housing market to suss out a cashflow positive investment

in readiness for the next cyclical rise in a few years. Why? Because nothing is appearing in front of me to suggest that the relative attractiveness of NZ to potential migrants is going to deteriorate in the next few years. Migrants go where migrants have gone and where the jobs are. That is predominantly Auckland. Sure, with the aging population there is some movement to the regions. But while that may cause some more cafes to open up its not going to drive new entrepreneurial attitudes and boost regional business growth. Neither is the NZ First \$1bn a year slush fund.

The lobby group for refugees, Changemakers Resettlement Forum, has criticised government moves to send refugees to the regions. Partly this

is on the basis of lack of established support networks, but also on the basis of lack of suitable employment opportunities for refugees, many of whom are well-skilled.

<https://www.radionz.co.nz/news/national/382115/refugee-group-unhappy-with-new-settlement-location>

So if I do decide to boost my housing investment because interest rate returns look like staying low for decades and because share prices might be stretched, it is to the large centres that I personally would look. 2-3 years ago my stated preference was for the regions in order to ride their lagged catchup to Auckland.

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/IFdYSs5FGEq4kAIP95uzTA>
To change your address or unsubscribe please click the link at the bottom of your email. Tony.alexander@bnz.co.nz

This publication has been provided for general information only. Although every effort has been made to ensure this publication is accurate the contents should not be relied upon or used as a basis for entering into any products described in this publication. To the extent that any information or recommendations in this publication constitute financial advice, they do not take into account any person's particular financial situation or goals. Bank of New Zealand strongly recommends readers seek independent legal/financial advice prior to acting in relation to any of the matters discussed in this publication. Neither Bank of New Zealand nor any person involved in this publication accepts any liability for any loss or damage whatsoever may directly or indirectly result from any advice, opinion, information, representation or omission, whether negligent or otherwise, contained in this publication.