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.

Smooth Your Data

This week I thought it would be a good idea to highlight one of the key things you need to keep in mind when looking at economic data. It is extremely unwise to look at one month's results and extrapolate them into a trend. All data series are subject to fluctuations, and this is especially the case in a small country like New Zealand. You really need to look at where things are headed over three month periods and perhaps longer before making any strong statements about what seems to be happening.

Take the case of Auckland house prices for instance. The headlines read that they fell by 4% in October and this means a correction is underway. But prices on average rose 3.3% in September and 2.6% in August so if we smooth across all three months we see that prices have risen 3.8% compared with the three months ending in July. Back then they rose by 6.1% compared with the three months to April when they rose 8% compared with the three months to January.

Looking at those numbers I feel on very safe ground saying that the pace of house price increases in Auckland has slowed down. I cannot rule out a falling trend having started, but it is extremely unlikely, especially when one considers that ahead of October 1 there was a scramble by investors looking to buy property before new rules kicked in.

As the Reserve Bank Governor said yesterday when discussing the six-monthly Financial Stability Report, it is too early to conclude that things have fundamentally changed in Auckland. Personally I think they have – toward slower house price inflation rather than falls. This is because we have seen many buyers back off because of the new rules, and because investors are now into the buy outside Auckland phase of New Zealand's housing market cycle.

This can be seen in the plethora of data showing rapid growth in dwelling sales in the likes of Waikato/Bay of Plenty, and in accelerating house price inflation in some non-Auckland locations. How long will this phase last? It is unlikely that buyers will receive an interest rates shock in the next three years because of the low inflation outlook here and overseas taking into account the structural changes in links along the way from changing economic growth rates to inflation.

Specifically, and to emphasise again one of the key points I have been trying to get across for five years now, things have changed radically post-GFC. First, economic growth rates have tended to come in lower than predicted. Second, growth which has been achieved has generally not led to growth in employment which happened in the past. Third, even given lacklustre jobs growth in most countries the growth achieved has not produced upward pressure on wage rates as would have happened pre-GFC.

Fourth, even given the wages growth which has been achieved it has not produced rises in business selling prices as would have been the case pre-GFC. And thus we get to the end result that because of changes in all of these linkages the economic growth rates achieved globally post-GFC have not led to the sorts of interest rate levels or rises which we would have seen pre-GFC. As Taylor Swift sings, Everything has changed."

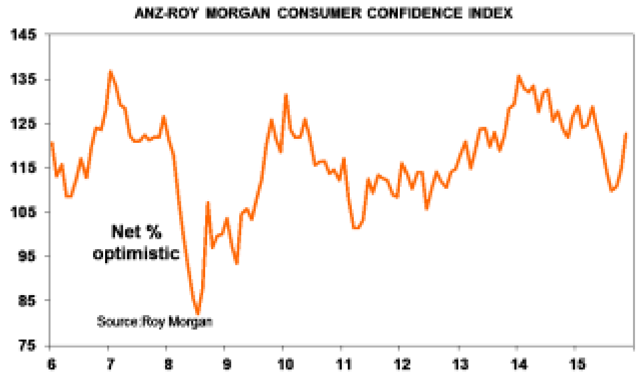
Nonetheless, if we have a look at the United States for a moment, their employment numbers released last Friday were much better than expected. Jobs rose by 271,000 in October and the unemployment rate fell 0.1% to 5.0%. The chances have therefore increased that the Federal Reserve will raise interest rates next month.

If they do then we will for the first time since 2006 gather new information on how the US consumer and business sectors react to rising financing costs. The chances that any forecasting group has a model which gives accurate insight into those reactions are very slim. So if rates do go up be prepared to see a huge level of discussion regarding the impact on growth and how much higher US interest rates will go. Scope for volatility in financial markets is huge, especially in the context of most emerging economies suffering at the moment with capital outflows and recession or slowing growth. There will be lots of debate about what rising US dollar-denominated financing costs will mean for them.

Here in NZ we expect to see some upward pressure on our long-term interest rates as a result of US monetary policy tightening. But please don’t ask us how high medium to long-term interest rates will be in a year’s time as none of knows truly how much US interest rates will rise. The Fed. tightening will be a huge experiment which they will not rush blindly into without massive monitoring of market and economic reactions in the US and elsewhere.

Switching back to NZ now and continuing the theme above of being careful never to make strong statements on the basis of one month’s data, spending using debit and credit cards grew by only 0.2% at the core level in October from September. The previous month growth was 1.1% and in August 1%. Does this mean we all closed out wallets last month? Of course not. Smooth over the three month period and you get an annualised pace of growth in core retail spending of 9.3% compared with 1.8% three months ago and 8.2% six months ago ending in April.

The picture we have is of you and I getting quite conservative over winter but from spring getting back into form with a spending surge. Note however that the average pace of growth in this particular spending measure is 5.6% so retailers should be careful not to over-extrapolate the last three months into a booming Christmas. Having said that, with the ANZ Roy Morgan consumer sentiment gauge jumping to a well above average 122.7 this month from 114.9 in October there seems little reason for believing that in most parts of the country this Christmas spending period will be quite good. Get in before the masses perhaps is the message now.

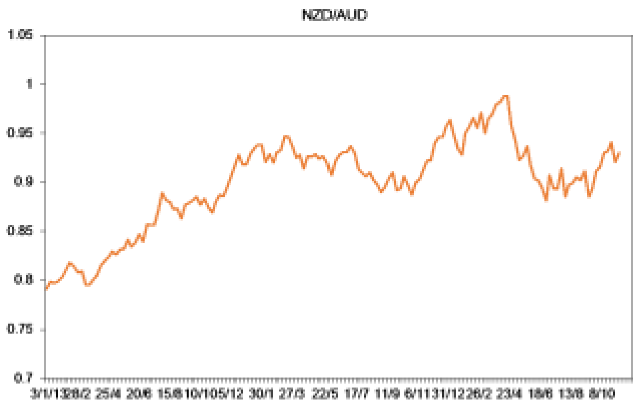


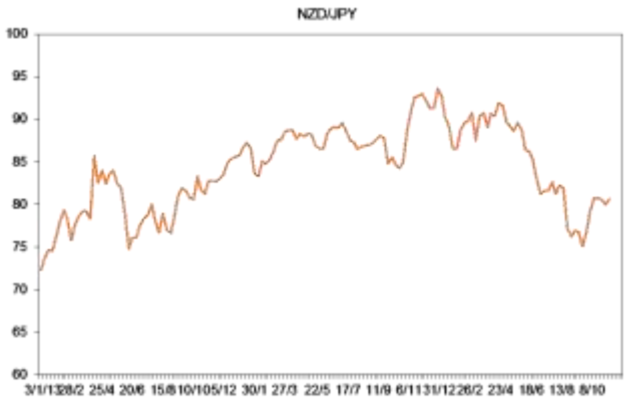
Housing

Nothing much beyond suggesting that you wait a few months before making strong statements about the extent to which the Auckland market has turned, and the pace with which prices will rise elsewhere.

NZ Dollar

Our currency has ended this afternoon essentially unchanged from where it was a week ago against the US currency near 65.5 cents. But because the USD got a boost from October’s employment growth in the US coming in near 100,000 better than expected we have made slight gains against the other currencies.





Perhaps this just goes to reinforce to some degree the line we have been running that there is fundamentally good support for the NZ dollar. The government has just recorded a fiscal surplus, the current account deficit is only 3.5% of GDP, we have lovely high rankings on ease of running a business and lack of corruption etc., lots of people love us so are staying here or not migrating across the ditch, we have lots of exporters not involved in dairying doing very well, and the construction sector is going gangbusters.

If I Were A Borrower What Would I Do?

I would not be worried about interest rates rising much on me over the next three years so I would be quite happy to take one of the lovely discounted two year fixed rates out there at the moment. Personally I have never been much of a fan of one year rates because they give little hedging against unexpected rate rises, and normally I would like to lock in a three year rate. But rates beyond two years are not so flash and it is in the two year area that the lenders are mainly concentrating their marketing efforts.

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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