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.

Post-Election At Last

I shall be on leave during school holidays and the next Weekly Overview will appear on October 16.

Well the general election is now out of the way thank goodness. Support for the left fell in this election with Labour having their worst result since 1922, the Greens losing share, while National achieved the first ever majority of seats in parliament under the MMP system and their best result overall since 1951. Reputations of conspiracy theorists, money men, and their running dogs have been left in tatters and Kiwis successfully reclaimed the election from those who sought to use it for their own purposes.

Does the majority to a pro-business party rather than a rag tag coalition raising taxes and redistributing income mean we have to consider a different outlook for economic policy? Company tax rate cuts, big personal tax rate reductions, welfare slashing, cuts in health and education spending? Not at all. As the re-elected Prime Minister John Key said during interviews this weekend, the challenge now is to avoid arrogance. That is a challenge which Labour failed at heading into the 2008 election when National came in and as Kiwis we have a high degree of sensitivity to people getting up themselves and thinking that either normal rules don't apply to them (think one recent ex-cabinet minister), or that they are born to rule. In addition, since 1992 we have actively voted against parties which have promoted big changes, or in the case of this election, against parties trying to convince us to distrust everything we see in front of us and believe them when they say the economy and our society are munted and things need changing.

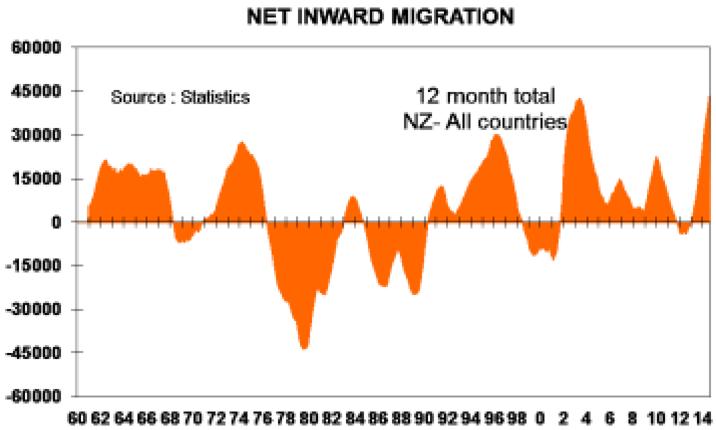
Thus policy settings are likely to be only marginally altered along the lines outlined by National going into the election, with the odd bone thrown to ACT, United, and the Maori Party. The focus on child poverty announced a few days ago by Mr Key is a very positive new direction.

Will the election campaign and outcome have much disturbed the attitudes of foreign investors toward ourselves? Not at all. They don't even know the election was on. Their minds instead have been focussed on such things as

-terror raids in Australia
-war in Ukraine
-spreading radical Islamism and barbarism in the Middle East
-the Scottish independence referendum
-Ebola
-and the still worrying state of many foreign economies.

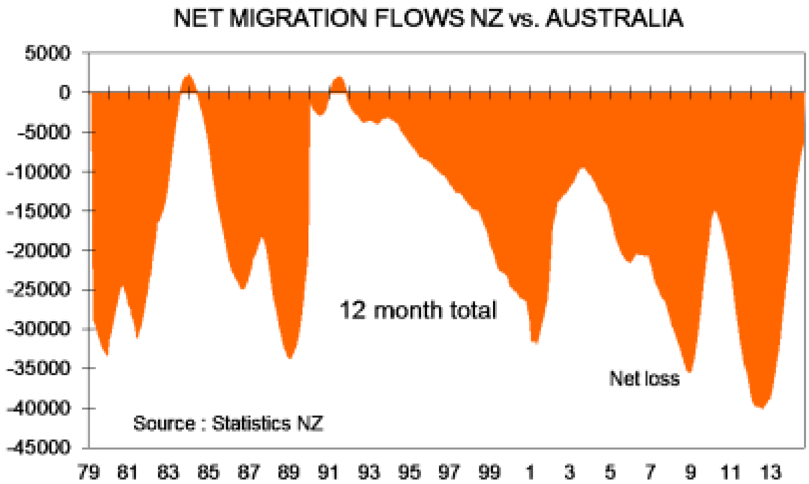
We haven't registered at all almost except on a US comedy show, and perhaps at the G20 gathering in Sydney this past week where comparisons between our good economy and performance were made with Northern hemisphere woe. Given that the National government does not need NZ First to govern there is little chance of a shift toward far greater restrictions on foreigners buying NZ property – both residential and rural. So back to analysing the data then, and in that regard one issue which we have been highlighting as hugely relevant for the housing market since the latter part of 2012 jumped up in front of everyone's faces big time this week.

The net annual migration flow into our country reached 43,483 in the year to August. This is the highest level ever, gives a 1% boost to the population, and was up from a gain of 12,848 a year ago and a loss of 4,118 two years ago. The speed with which the flow has turned around is very fast though not unprecedented. Between May 2001 and May 2002 the flow jumped a net 42,000 and kick-started the 2000s housing upturn.



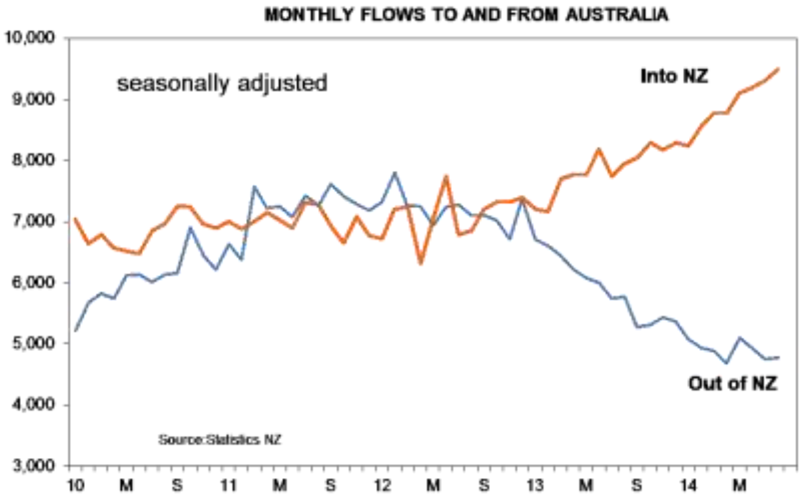
This time around the housing market has already strengthened quite a bit and what we were writing in late-2012 was a warning that up to then house prices in Auckland in particular had risen strongly while migration flows were below average. We invited people to think about what would happen when the migration cycle with Australia turned and population growth jumped.

The turning of the trans-Tasman cycle is the main factor so far behind the net 48,000 change in the flow in the past two years. Two years back the net annual loss to Australia was bang on a record 39,956. Now it is 33,479 less at 6,477. So 69% of the turnaround is due to a change in this flow. Mainly this reflects fewer Kiwis crossing the ditch to Australia.

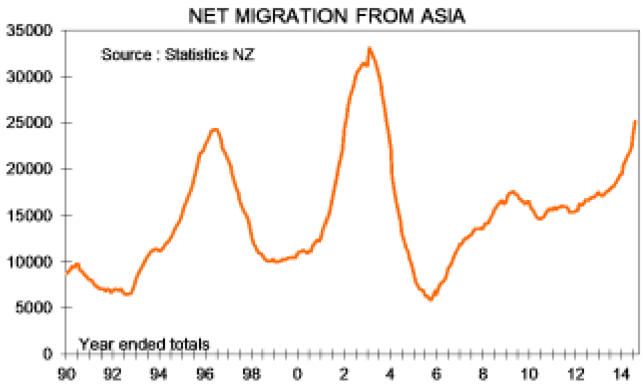


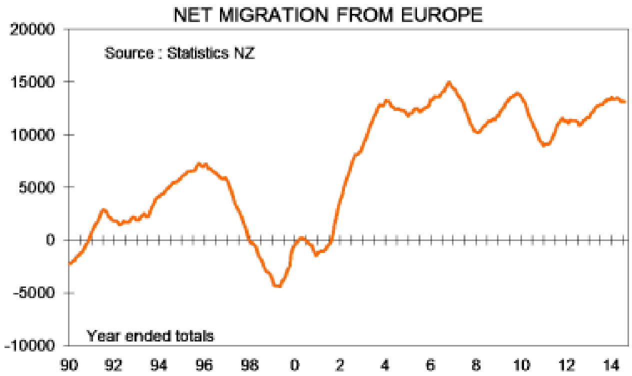
In aggregate however something interesting is now happening. The pace of the cyclical turnaround with Australia is slowing. The net trans-Tasman flow in August of -71 people was only 826 better than a year earlier. This is the least amount by which one month has showed less net loss than the same month a year earlier since January 2013 and compares with 1,042 in July, 2,541 in January etc. Thus it is now looking like we might not hit a net annual positive flow across the ditch.

This easing of the overall turnaround arises because the decline in the number of us leaving for Australia appears to have stopped. This is shown in the flattening of the blue line in the graph below. However the flow of people into NZ from Australia is continuing to rise strongly.



Across the ditch falling commodity prices are causing even more resource development projects to be put back in the cupboard and the resulting reduction in demand for labour means more Kiwis coming back home at the same time as numbers coming in from Asia also continue to trend upward. The two graphs below show net annual gains from Asia and Europe – the latter directionless.





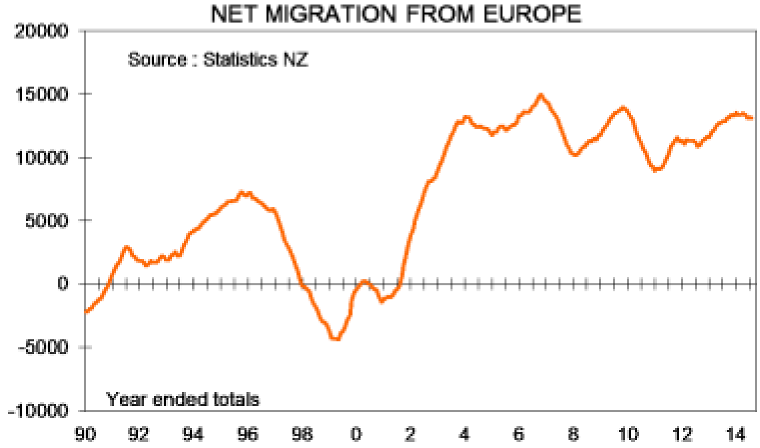
In the year to August gross flows into New Zealand overall were ahead 15% from a year earlier with this rate of growth up from 13.2% six months ago and 8.5% a year ago. Gross outflows were down 22% from a 19.6% pace of decline six months ago and 11.3% a year ago. But this strong lift in both measures is changing with gross inflows in the three months to August ahead 17.5% from a year ago which exceeds the full year growth of 15%. Yet gross outflows were down 17.6% which is less than the full year 22% decline.

This is significant because when the migration boom was being driven by you and I not leaving the impact was relatively evenly spread around the country. But immigrants tend to go to Auckland so this slow shift toward more people coming in being the driving force implies extra upward pressure on Auckland's housing market and economy than the rest of the country. Not that such a thing is new.

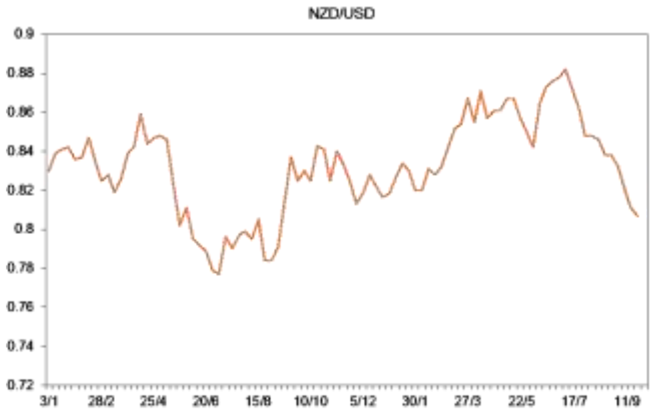
Are their monetary policy implications from this boom in migration flows? Yes. More people means some suppression of wages growth. But more people means a faster pace of economic growth and extra upward pressure on rents and house prices. Thus the boom reinforces the chances of the Reserve Bank tightening monetary policy again from March.

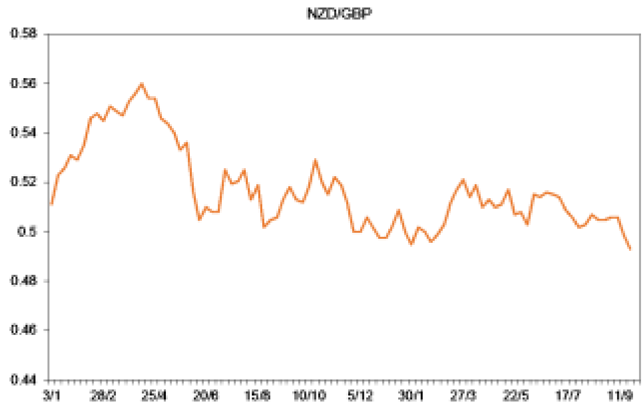
Having said that the thing most of us will now be watching is post-election data for a feel as to how much the apparent slowing in activity and easing in sentiment indicators was pre-election worries. If the election played a big role then we could see a firm lift in sentiment soon – after all, people got the result they voted for. (A completely silly statement, think about it.)

One sentiment measure actually went up pre-election! The ANZ Roy Morgan monthly consumer confidence gauge firmed to 127.7 in September from 125.5 in August. The average reading is just below 118 so the result is suggestive of support for retail spending growth. However it pays to remember the point which we have hammered here in recent weeks. Consumers still seem to be in budgeting mode and continue to show willingness to spend above average only when price discounts are being offered. So retailers should be wary of getting too much stock in for Christmas.

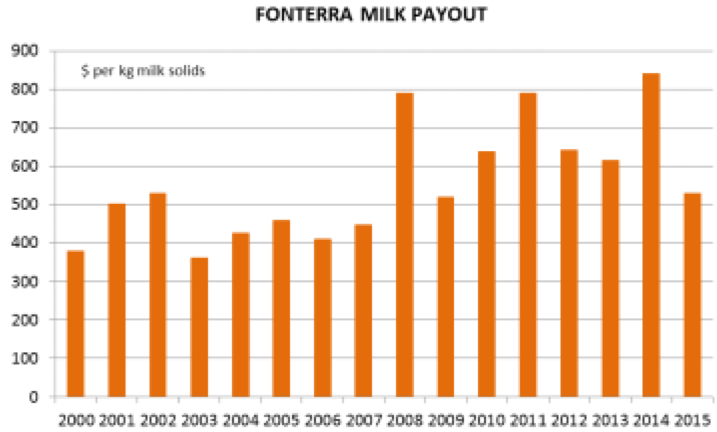


On the currency front there was a small 0.3 cent rise in the Kiwi dollar on Monday morning following the election result. But this evening the Kiwi is trading down from a week earlier near 80 US cents from just over 81 last week and 84 cents a month ago.



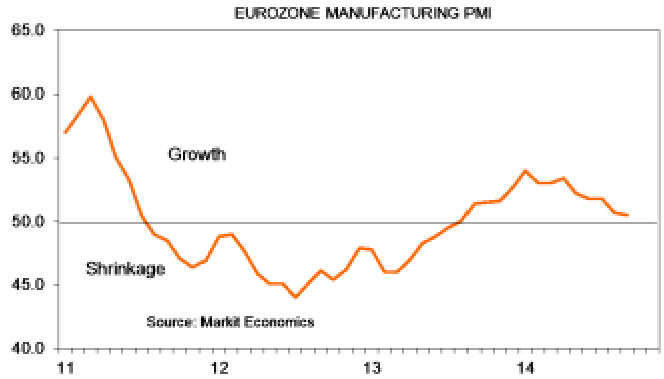


Why the decline? Partly it reflects Fonterra cutting their forecast payout this season from $6 to $5.30. This makes for a 37% decline from last season and clearly will suppress the pace of economic growth slightly and may delay further the next official cash rate increase. Six years ago the seasonal payout decline for 2009 was 34%, 2003 32%, 1997 9%, 1991 33%. This decline therefore is cyclical with the trigger largely being a sharp destocking phase in China – something also occurring for logs and to a greater degree affecting iron ore prices received by Australia.



The NZD has also been pushed lower by a generalised decline in global commodity prices. Also risk aversion around the planet has risen as the US-led coalition has initiated air attacks against ISIS and alert states have been lifted following threats of terrorist attacks.

Plus expectations for world growth continue to creep downward, this week assisted by a weak PMI reading for Europe continuing a string of declines best seen visually. Poor Europe. It does not appear on the point of collapse by any silly stretch of the imagination. But it is firmly on a low growth trajectory which will see it slipping behind more and more other parts of the world. Heck, even we will get relatively better.



There was also a half cent fall in the NZD this afternoon after the Reserve Bank released a statement describing the Kiwi dollar as unjustifiably and unsustainably high. They consider that not only is the NZD over-valued on the usual long-term measures, but well away from where short-term measures would suggest also, especially following the 45% fall in international dairy prices. They warn that historically when the NZD has corrected downward it has fallen sharply. The RBNZ are concerned about a substantial and sudden fall in the NZD though are not forecasting that this will happen, perhaps because that would imply that they are forecasting a repeat of the trigger which in the past has caused the NZD to drop down the elevator shaft – a collapse in world growth and sentiment.

The NZD fall following the statement’s release because it raises the chances of intervention to sell the NZD, and builds expectations of efforts to talk the currency lower becoming more frequent.

Speaking of China just above, how goes it in the land of non-freedom? Most indicators released recently have come in on the weak side and optimism that the leaders would initiate a new fiscal stimulus to ensure growth meets this year’s official target of 7.5% have taken a step backward. The central bank has eased up however on lending restrictions and local governments have reduced imposts in the housing sector in an attempt to stem the rot there caused by a large over-supply of dwellings. Maybe they can ship them to Dublin which now has a shortage. However there was some mild relief on Tuesday when the September PMI came in at 50.5 from 50.2 in August. The second little graph above shows this.

	This Week	Week Ago	4 Weeks Ago	3 Months Ago	Year Ago
NZD/USD	0.80	0.811	0.838	0.876	0.825
NZD/AUD	0.906	0.904	0.897	0.931	0.881
NZD/JPY	87.3	88.1	87	89.1	81.6
NZD/GBP	0.49	0.499	0.505	0.516	0.513
NZD/EUR	0.626	0.63	0.635	0.643	0.61
NZD/CNY	4.91	4.98	5.15	5.46	5.05
USD/JPY	109.13	108.63	103.82	101.71	98.91
GBP/USD	1.63	1.63	1.66	1.70	1.61
USD/EUR	1.28	1.29	1.32	1.36	1.35
AUD/USD	0.88	0.90	0.93	0.94	0.94
USD/CNY	6.134	6.143	6.1434	6.2346	6.1195

Summing up, the rest of the world is still munted, though with a small rather than capital F as was the case over 2008-09. We are doing well but some heat is coming out of growth with falling dairy incomes, interest rates up 1%, the LVR restrictions, worries about bad news offshore. Yet growth-supporting factors are firm including a record migration boom, construction activity, firm though off it's peak investment in dairy sector expansion, and a likely bounce in non-dairy confidence now that the general election is out of the way.

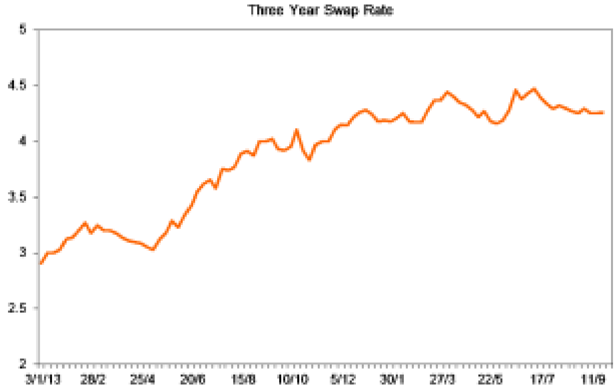
Interest rates don't look like going up again until sometime in the first half of next year. But be aware that we are likely to see further changes to this expected interest rate track given
evidence of changes in economic relationships post-GFC including a lengthened lag between labour demand rising and wages growth accelerating,
an apparent decrease in business perceived pricing power in the face of newly debt sensitive and price-focussed householders,
central bank willingness to experiment with non-interest rate means of implementing monetary policy, and
huge uncertainty surrounding a multitude of developments offshore.

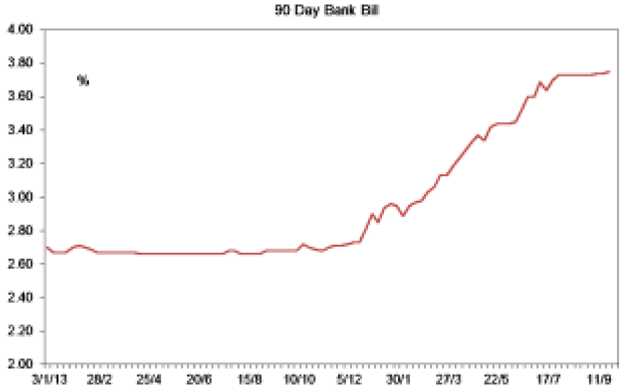
Be careful about making decisions which are highly sensitive to a particular set of outcomes in the economic sphere. Predictability of many things is low, which makes understanding why sharemarkets keep defying deepening economic woe and rising somewhat difficult. Time to cash? A parting though ahead of the holidays.

If I Were A Borrower What Would I Do?

I like the look of the three year fixed rate at 6.19% so would choose that for maybe 80% of my debt and fix the rest for one year at 5.99% as a low-cost slightly inflexible proxy for floating which would cost 6.74%. If you are a term depositor as I am, just be aware that there is strong competition between the banks for your cash so do what borrowers do and discuss what one bank is offering with another and see what response you get.

	This week	Week ago	4 wks ago	3 mths ago	Year ago
Official Cash Rate	3.50	3.50	3.50	3.25	2.50
90-day bank bill	3.75	3.74	3.73	3.60	2.68
1 year swap	3.89	3.90	3.90	3.97	2.97
2 year swap	4.12	4.10	4.06	4.21	3.50
3 year swap	4.26	4.25	4.25	4.38	3.93
4 year swap	4.37	4.37	4.34	4.50	4.22
5 year swap	4.46	4.46	4.42	4.59	4.45
7 year swap	4.55	4.59	4.54	4.74	4.76
10 year swap	4.68	4.72	4.64	4.90	5.00





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