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.

Do Not Go Gentle Into That Good Night

I mention this theme of raging against the dying light (Dylan Thomas, 1947) because after giving a talk in Rotorua last week a 65 year old man came up to me and asked whether I thought it was a good idea for him to be buying his first home now. I wholeheartedly said yes if that is what he wants. Getting into one's first home is an exciting time so unless someone presents me with some fairly dire financials my answer will usually be in the affirmative.

The main reason I said yes however was that who would not want to undertake such a wonderful thing at a time when for decades we have been told that come 65 we are supposed to fade out of sight and confine ourselves to walking a small dog along the beach, riding buses for free outside peak times, and doing our best to not be a burden on the state. The message for at least 25 years has been that old people will be a problem for the rest of us and they will cause our taxes to rise.

One ancillary message has been that people need to save more for their retirement. But that makes near no difference to the fiscal impact unless you tie superannuation payments to the amount people have saved up, the value of assets they own generally, the income they earn. All of these things are present in Australia but few votes go to any politicians in New Zealand who propose not even abating national superannuation but simply raising the retirement age.

Saving for retirement is simply a very good idea regardless of your view of the sustainability of our superannuation scheme because accruing a diversified asset portfolio over time by sacrificing small amounts of consumption (saving) over a period of decades allows that capital to work for a person through compounding effects. The accrued assets give options in one's later years which will not exist for those who receive only national superannuation.

But it is not the saving issue which I wish to address here and I certainly feel no compunction to try and scare the bejeebers out of people so they do cut spending and boost saving. Instead I wish to focus on the interaction between four things.

- Sustained low interest rates
- Increasing life expectancy
- The tightening up of the labour market facing employers
- The joy gained from working

A key theme which I have been increasingly dropping into commentary since early this year is that the factors driving inflation globally have altered, low inflation is getting locked in, and that means low interest rates for a very long period of time. Probably decades. If you are planning on your term deposit rates sometime in the next five years jumping up to 5% - 6% then I think you will spend a lot of time being disappointed.

Low returns from the most conservative of portfolios means there is a very strong incentive for people to not switch away from equities and property as much as they approach retirement as might have been the case if we were still in the 1980s, 1990s, or 2000s before 2008. The case for young savers having a higher risk growth-oriented portfolio is even more compelling.

Low returns say to older people that there is value in holding onto investment property for the yield it will give and the long-term capital gain potential. Same for shares, local and offshore.

In fact, in the words of a respondent to our BNZ Confidence Survey sent out last Friday morning..." I am retired, saved hard all my working life, (80 before I retired) hoping to live on my savings etc. plus a little extra in the form of interest. Low interest rates to folks like us are a disaster. All day to day costs insurances, rates and the likes keep increasing. Regards BNZ client"

Which brings me to the second very important point. We are living longer and longer as medicines and medical procedures improve, and as those who take notice of the evidence and the warnings curb their calorie intake, smoking and drinking.

Rather than retire at 65 and die by 75-80 people will increasingly anticipate living into their 90s when perhaps come 95 they will go skydiving. People will need retirement era income over a far longer period of time than previously anticipated. That adds to the argument driven by sustained low interest rates to bias one's portfolio away from low yielding cash, term deposits and government bonds toward equities, corporate bonds, and property in its various forms.

This means not just holding onto one's investment properties but perhaps buying more – which is one factor I believe is helping to underpin our housing markets currently. It also argues, as I have long contended, against the idea that one should sell one's three or four bedroom house and shift as soon as possible into a low maintenance unit. It can pay to keep the spare bedrooms for the grandkids to use (both their parents are working and they need to offload the kids during school holidays). Also the spare rooms can be rented out on Airbnb to Swedish backpackers named Helga for $100+ a night.

Third, why stop working when there are plenty of employers having it slowly dawn on them that they need to employ more older people. Once this current migration boom passes the labour force growth rate will plummet. Employers will struggle to get staff and opportunities facing older people to remain in gainful employment will multiply. That is fortunate because in an environment of low returns on most portfolios many people may need to work to supplement their retirement income. My advice to employers is to think about how older employees could be usefully employed.

Which brings me to my final point. Why stop working, even if you no longer need the money? The chances are you have not spent your life herding sheep or lugging coal so you will be in better physical shape than past retiring generations and able to keep working beyond 65. While plenty of people have great social networks and engage in many social activities, in my experience most people do not. They pretend to be loving life and actively engaged in things – but they aren't really. In that regard these older people are exactly like most young people – pretending to be part of some crowd because society demands that we not look too weird, and being alone is considered exactly that - weird. So we make up friends and outings, or perhaps more accurately allow the implication to lie in the air that we are more engaged than we really are. Don't ask, don't tell.

Work delivers social engagement even if it may not extend into the weekends or evenings. Actually, the nature of working these days is less and less nine to five Monday to Friday so all hours can be encompassed by work. At this point some people will be thinking "but what type of work will these older people do? Maybe they will end up flipping burgers." Fantastic. Who would not want to be a 73 year old tossing buns surrounded by pizza-faced kids shaking and overcome by FOMO because they cannot access their 'phone in the work environment, worried about who they saw with who last weekend, pretending they know more than they do, fretting about so many really simple things. It would be hilarious.

Just be careful not to get too up yourself as you shake your head at the impulsiveness and the earnest nature of youth. There is a risk that if at some point you say you wish you knew back then what you know now how different it would be, that someone asks "What exactly is it you know?" (Yes, that was a reference to one of my favourite BNZ ads of some years ago, along with the one with a clever bloke advising his jogging friend not to run home behind a bus to save $2, but to run home behind a taxi and save twenty!)

The upshot of this article then is this. Don't let the buggers talk you into retiring like you'll be doing the world a favour. Stick in it, perhaps build a "portfolio" of part-time jobs, and embrace the social interaction it will bring along with the extra money coming in. We'll all eventually have more than enough time to be in that good night. Why hurry the process by missing an opportunity for life-lengthening social engagement? And discuss with your financial advisor options for boosting long-term returns from growth assets by not switching as much of one's portfolio to conservative, low yielding assets as one approaches 65 as was the recommendation before 2008.

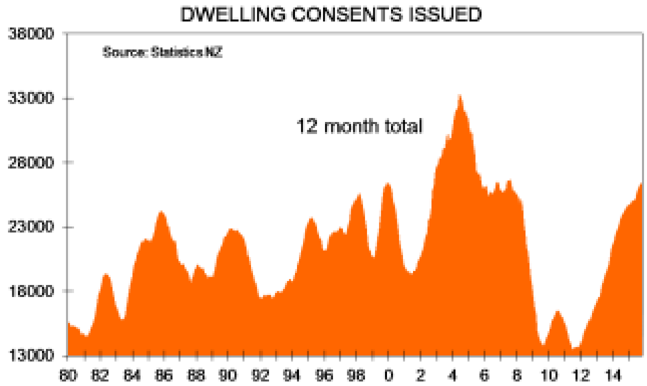
Driverless Cars

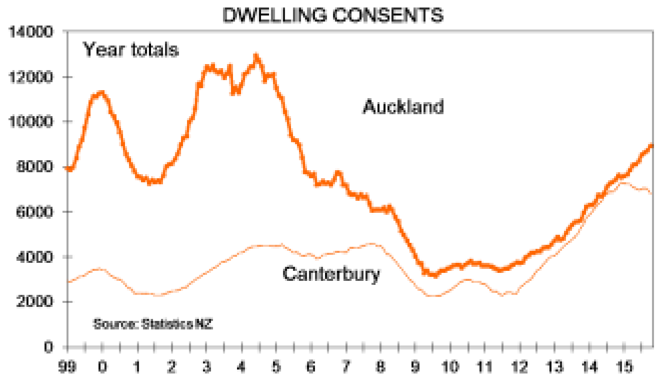
I received an email after last week's lead article on driverless cars which included this section.
"Your most current Overview coincides with my taking delivery of a new Tesla Model S last night here in Washington DC, so your driverless car topic was quite timely.

It seems like a great car so far (traded a Ford Focus Electric (all electric)) for the greater range and size of the Tesla S. The S now has autopilot, so literally from the time I put it on the highway to home last night, the car drove itself, paced its distance to the car in front of me, varied its speed in traffic accordingly keeping its distance, took the curves and bends in the road, all without input from me (other than my foot hovering over the brake pedal cautiously). I do think that if it encountered the kiwi possum, it might do contortions to miss it. I will email Mr. Elon Musk to see if version 7.1 can't screen this troublesome glitch out of the system."

Housing

The upward trend in the number of consents being issued for dwellings to be built in New Zealand continues. In seasonally adjusted terms consent numbers rose by 5.1% in October after falling 5.8% in September taking the three month gain to 2.8% from 7.2% three months ago – meaning a slowing trend for the moment in issuance growth. However full-year consents were up 8.5% and 17.4% above the 20 year average number.

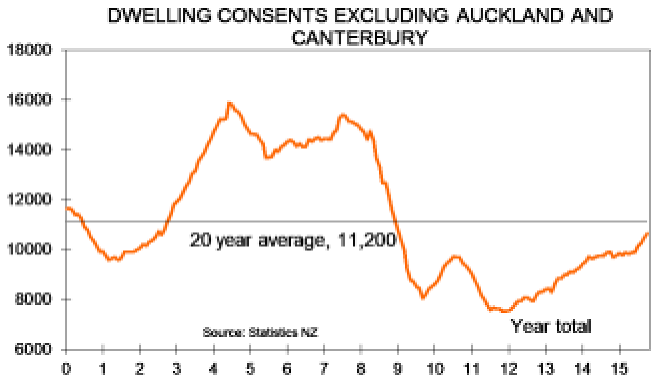




Growth is occurring though not at an especially rapid rate. In Auckland consents have grown by 20.1% over the year and at 8,935 sit 18% above the 20 year average. Things are moving in the right direction but the level of activity is still very low and certainly, as pointed out last week, well below the level needed to start eating away at the backlog. The shortage of houses in Auckland continues to worsen.

In Canterbury consents over the past year have fallen 2.5% which is the first annual decline since the start of 2012. At 6,810 the 12 month consent total is 91% above the 20 year average and falling.

Outside of our two biggest cities consents totalled 10,637 and this was a rise of 7.6% from the year to October 2014. The underlying annual growth rate is sitting close to 20% and may accelerate as rising regional house prices lead people to build new rather than buy used.



NZ Dollar

The NZD has firmed against all bar the AUD this past week, assisted by a small rise in dairy prices and perhaps simply the absence of any new weak data allowing any view to develop that our economy's growth rate is slowing. If anything, after the mid-year lull, it is accelerating again. Our gain against the Euro was assisted by expectations of increased money printing soon, against the Yen, by the fresh Japanese recession, and the GBP by weak economic data. We look quite good compared with most of the rest of the world hence exporters should not have an expectation that the NZD falls much in the coming year. Chances are we go up instead.

If I Were A Borrower What Would I Do?

Fix one or two years. I struggle to make any case for fixed rates rising much in the near future. But keep an eye on US monetary policy tightening which is likely to start soon. Higher US rates will tend to lift medium to long-term NZ fixed rates but there is no certainty at all about how much US rates rise, how rapidly etc. The biggest monetary policy experiment in decades is about to start.

For Noting

You can write the story of NZ's economy during 2015 using as your central character the monthly business confidence measure gathered in the ANZ Business Outlook Survey. We started the year with the first survey in February showing a net 34% of businesses expecting the economy to improve over the coming year. A net 23% planned hiring more people and a net 22% planned boosting capital spending. Come August however a net 29% were feeling pessimistic, only a net 3% planned hiring more people, and a net 0% planned extra investment.

The slumping of these measures was driven by the 50% fall in international dairy prices between March and August, the Kiwi dollar almost hitting parity against the Aussie dollar, worries about Greece, worries about China, and slowing house construction in Christchurch.

But the latest readings of the sentiment measures for economic growth, employment, and investment are now respectively 15%, 14%, and 15%. Average readings are in turn 15%, 7%, and 11%. So things are average to slightly better than average and this backs up our expectation of near 2.5% growth in the economy over the coming year.

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