# 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.

## Housing Shortages

Housing markets are not static. They change as rules applied by governments, central banks, local authorities and banks change. What we are seeing at the moment apart from the regions undergoing a delayed and soon fading temporary period of incomplete catch-up following the Auckland surge, is a flattening in markets. Turnover is falling on a year ago, properties are sitting on the market for longer, prices are plateauing.

This is not happening because our economy is tanking. It is not happening because unemployment is rising. It is not happening because interest rates are soaring. It is not happening because housing supply is unsustainably booming.

It is happening partly because the cycle has naturally become a bit tired. But mainly it is happening because borrowers simply can't get loans any longer – like back in the 1950s, 60s, and 70s leading up to deregulation of the mid-1980s.

Many young buyers have been denied credit because they cannot raise a 20% deposit to buy the existing house they want. Some cannot get a bank to make a loan secured against the smallish apartment they want to use as security.

Investors have been stripped out of markets because they cannot raise a 40% deposit, or they may be able to but the resulting portfolio they build ends up too heavily weighted toward residential property for their comfort.

So these are things which are. The question as always is what happens next? Some pundits are again telling people to hold off buying because prices are going to crash. If they do – and that is very unlikely – it won't be in our big cities of Auckland, Christchurch and Wellington, or the connected hangers-on of Hamilton, Tauranga, and at a stretch Whangarei. The dangers lie in regions where demand growth will not match optimistic expectations because population growth won't hold up, and where a supply response is occurring.

One issue is this. You don't need a 20% deposit as an owner-occupier buyer if you buy new or build. You don't need a 40% deposit if you are an investor buying new or building. Because of credit rule changes the buyers are gravitating toward new builds. Sounds great given the shortage of housing in some parts of the country as a result of some combination of under-building since before the GFC and accelerated population growth courtesy of a structural shift in net migration flows over the past four years.

But the problem is this. It is a struggle to get a builder in Auckland so investors are looking at getting something built in the regions where builders seem to be available. There is a supply response happening in the regions which has not and will not happen in Auckland.

Can we measure the extent of over-building or even calculate the extent of the shortages in some regions? Not really because it all depends upon what you consider equilibrium to be. Is it the number of houses needed to get housing affordability measures back to where they were in a year of your choosing in the past? Is it the number which will address the long-term trend rise in homelessness? Is it the number which will give a region of shortage the same average number of occupants as some other part of the country.

But for your guide, this week we repeat an exercise done a year or so ago where we take 2006 as the starting point for each region, look at population growth to 2006, look at the numbers of consents issued (85% assumed to add to the net stock), then see whether a shortage or over-supply exists assuming an unchanging average occupancy rate.

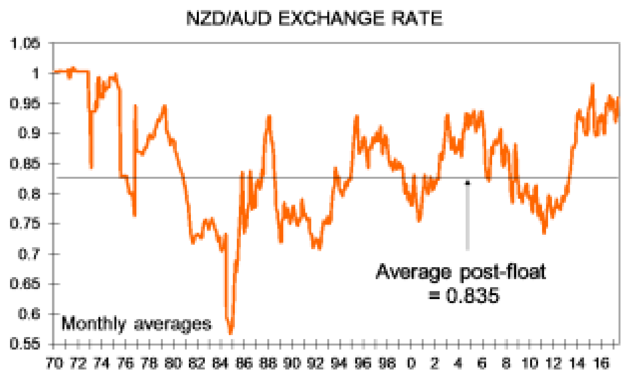
We get this following table.

| | 2006-16 Popn growth | Dwelling Shortage | As % hsg stock |
|---|---|---|---|
| Northland | 18700 | 272 | 0.4 |
| Auckland | 241400 | 37387 | 7.4 |
| Waikato | 56000 | 1480 | 0.8 |
| Bay of Plenty | 28200 | 181 | 0.2 |
| Gisborne | 1800 | -331 | -1.8 |
| Hawkes Bay | 9400 | -701 | -1.1 |
| Taranaki | 9400 | -131 | -0.3 |
| Manawatu-Wang | 7500 | -2367 | -2.4 |
| Wellington | 38500 | 1898 | 1.0 |
| Tasman | 4400 | -499 | -2.3 |
| Nelson | 6300 | 561 | 2.8 |
| Marlborough | 1900 | -1353 | -6.1 |
| West Coast | 400 | -1251 | -7.5 |
| Canterbury | 59900 | -10629 | -4.5 |
| Otago | 19400 | -1361 | -1.4 |
| Southland | 4800 | -473 | -1.1 |
| NZ | 508100 | 26586 | 1.5 |

Do not get fixated on the actual numbers, just cast an eye down the final column where we estimate the shortage as a proportion of the current housing stock. In Auckland we get a shortage of about 7.4%, Waikato 0.8%, Wellington 1%. The important point to note is the relationship between the shortage calculations – namely Auckland worst by a long shot, Nelson a bit short, lots of other regions over-supplied.

## NZD

The Kiwi dollar has risen to almost 96 cents against the Australian currency and once again we are wondering if this time around we could reach parity. We have seen too many wrong forecasts of parity over the past three decades to take such a stance. But if relative underlying economic fundamentals are the driving force behind the cross rate's movements then they are firmly suggesting 1:1 is imminent.




As previously noted, the NZ economy is in good state with our commodity export prices rising, and this suggests upside risks for the NZ dollar. It is no surprise then that over the past five weeks the NZD has risen from an unusually low level of US 68 cents to just over 72 cents now.

Some USD weakness has been engendered by a pullback in expectations of a rapid tightening of US monetary policy beyond the 0.75% worth of rate rises already enacted, following the release of data not quite as strong as expected, and dashed expectations for a fiscal stimulus from the new President.

The NZD has been boosted by strong data on the likes of retail spending and employment, a rise in the terms of trade to the highest level since 1973, a sharp lift in Fonterra's milk solids payout and payout projections, recoveries in consumer and business confidence levels, a slightly stimulatory Budget which appears to have reduced the chances of a change in leading party at the September 23 general election, and rising inflation expectations.

There has been some restraint on our currency however from the Reserve Bank maintaining a neutral stance recently regarding whether it will make its next rate change an increase or a decrease.

With regard to Australia, much of the economic news is bad and most of the discussion about the economy is couched in unusually negative terms. The Federal government has been unable to cut spending so it is hiking taxes across a range of areas. Some states are still suffering the ending of the commodities development boom. There are deepening worries about apartment markets in the major eastern capitals. There is even some talk of the Australian economy slipping into recession.

Looking through the factors in play and the tone of the three countries' commentaries, most risk clearly attaches to the Australian economy on the downside. Therefore if we are to reach parity against the AUD it is not so much likely to be because we get a fresh surge in the NZD upward (though one can make a well-based argument for this to happen), but renewed weakness in the Aussie dollar.

What to do? Personally speaking, if I had funds which I would like to shift into AUDs in the next few months my inclination would be to wait a tad until we are closer to parity then move them. Holding out for parity has been a failed gamble for the entire period since the NZD was floated in March 1985.

## If I Were A Borrower What Would I Do?

The drift for rates is upward, but not at a rapid speed given the caution on monetary policy displayed by the Reserve Bank. Rate rises will be driven by increasing costs of funds as banks try to raise local deposits to fund local lending – meaning slightly higher deposit rates. In addition there will be further efforts to curtail lending growth through a combination of new rules and higher pricing. I would still have a mixture of floating and two or three year fixed rates.

### 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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