BNZ Weekly Overview

18 May 2017

ISSN 2463-4328

Mission Statement

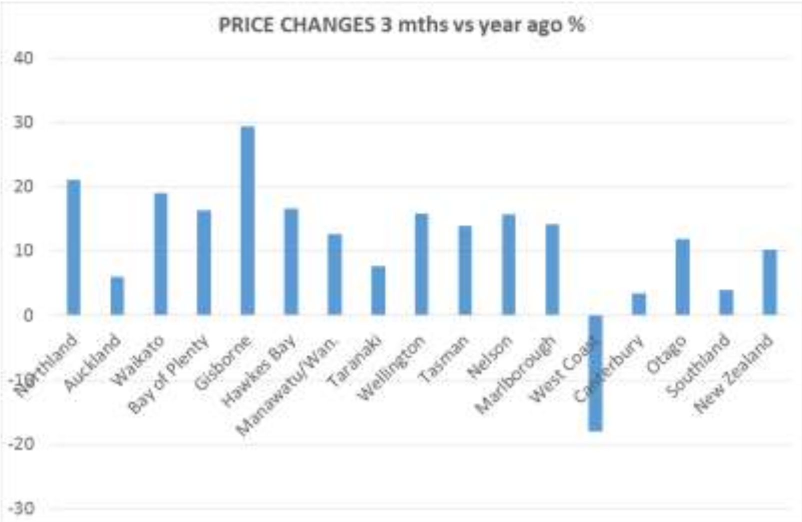
To help Kiwi businesspeople and householders make informed financial decisions by discussing the economy and its implications in a language they can understand.

Housing Market Slowing

REINZ this week reported that in April there were 5,845 dwellings sold around New Zealand. Over the past three months in rough seasonally adjusted terms sales have fallen about 5% after falling 10% three months earlier and 5% three months before that. So there is a firm downward trend underway in sales and the NZ annual total now sits at 84,907 from a peak of 94,633 in June last year. We seem to be headed back to the low 70,000s which is not good news for those in the real estate sector.

While one might think that the decline in sales is centred in Auckland that is not actually the case. Nationwide sales in the past three months were down 18.8% from a year ago. The Auckland decline was 21%, Waikato 24%, Bay of Plenty 27%, Wellington 14%, Otago 14% etc. Sales are falling everywhere except Taranaki which reported a small 1% rise.

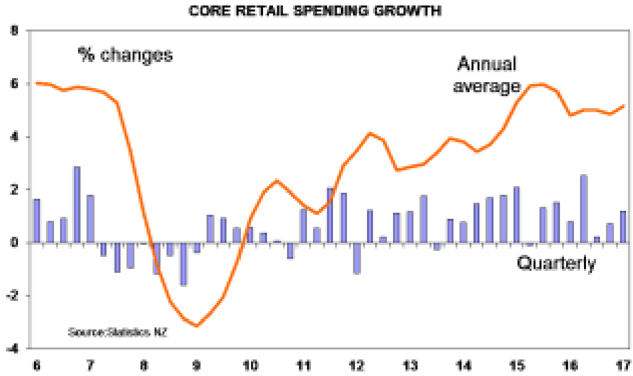
What about how long it is taking to sell properties? The nationwide average in the past three months was 2.3 days longer than a year ago and again this is not just Auckland driving the numbers. While Auckland was four days longer than average Waikato was the same, Bay of Plenty nine days longer, Wellington level. In almost all regions dwellings are starting to take longer to sell or improving at a slowing rate. Further slowing beckons.



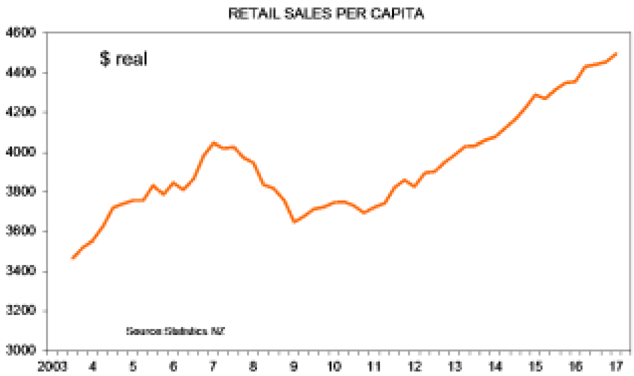
As for prices, on average in the three months to April nationwide prices were 10% up from a year ago. Auckland was ahead just 6% from 14% growth one year back, 14% two years ago, and 12% three years in the past. Waikato was ahead 19% from 18%, flat and 6%. Bay of Plenty 16% from 16%, 2%, and 11% three years ago. Manawatu/Wanganui 13% from 5%, -3%, and flat. Wellington 16% from 10%, flat, and 3%. Canterbury 3% from 3%, 3% and 13%.

Unlike sales volumes the pace of price inflation has yet to clearly peak in all regions. But while the regions have followed Auckland with a very long lag on the way up they will probably flatten out far more quickly given the absence of Auckland's strong population growth and restricted supply growth, and the appearance early in their price gain cycles of the 40% investor deposit requirement. Come the end of this year price growth is likely to be quite slow in most parts of the country.

This week we also learnt that the volume of core retail spending rose by a strong 1.2% in seasonally adjusted terms during the March quarter. Full year growth was 5.2% which was well above the ten year average of 2.6%. Big contributors to growth in the past year have been furniture and hardware ahead 7.6% and 9.3% respectively, and electrical goods up 11.7%. That latter group however has averaged growth of 12.4% in the past ten years so you can't say that it has helped produce this latest above average growth.



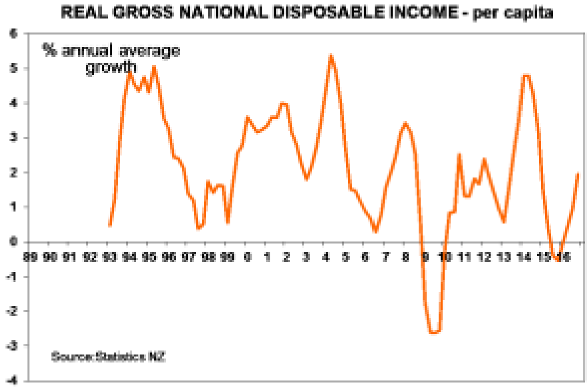
In per capita terms total retail sales have risen by 3.1% in the past year and are ahead 16% from five years ago yet just 14% from ten years back.



Speaking of things in per capita terms, often people pooh pooh the fast 3.1% pace of growth in the NZ economy and say it is only because we are experiencing a migration boom. NZ per capita GDP has risen by 0.9% in the past year (calendar 2016) after rising 0.6% in 2015, 1.9% in 2014, and 1.3% in 2013.

Per capita GDP growth has averaged 1.5% per annum for the past ten years, but 2.5% in the decade pre-GFC and 1% since. Growth is relatively weak in this measure – but not if we think in terms of the income which GDP delivers to us in NZ. This Real Gross National Disposable Income measure strips out the earnings part of GDP which goes offshore so is a better gauge of how you and I on average are gaining from the economy's progress. The news is good.

On average in the past ten years RGNDI per capita has risen by 1.9% per annum. Growth averaged 2.7% ahead of the GFC and 1.7% since. Growth in 2016 was 2%. This measure however can be quite volatile and moved around by quick commodity price changes.



Housing

Regarding Labour's proposal to remove negative gearing on residential property investments – too late. A letter to the editor in Tuesday's NZ Herald from an accountant, summed up the situation quite well. Negative gearing is relatively rare these days for small property investors as the expense of depreciation on the property is largely not available any longer, financing costs are much lower than before (low interest rates), rents are higher, and banks are less willing to advance funds if repayment is at risk of the borrower losing their job.

Removal of negative gearing will not much change the fundamentals of high house prices. As we have pointed out since 2008, there is a shortage of property. And as we have pointed out since 2009 on and off and more forcefully from 2012, the shortage is getting worse. The Auckland surge has not been a bubble. The shortage will continue to grow because growth in housing demand is exceeding growth in housing supply.

Even if National get to implement their plan to add a net 26,000 dwellings over the next ten years the shortage will barely change if at all. Every builder working on a government site means one less working on a private sector site. The only real way to eat into the shortage is to boost production capacity, not production demand.

For your guide, here is a link to our Weekly Overview of December 8 2011 in which from page 12 we list reasons why house prices would not collapse 25% as The Economist magazine were implying in one of their articles. The list includes a prediction of builder shortages. Average prices have risen about 50% nationwide since then.
http://tonyalexander.co.nz/wp-content/uploads/2011/12/WODec8.pdf

For the next wee while prices will likely sit flat as various groups of buyers pull back from chasing anything and a large part of the FOMO element exits the market. Many buyers these past three years have only been in the market because they felt that they were missing out on something. They are now starting to relax and that is a good thing.

For young buyers, watch for price declines in the lower socioeconomic locations which have been heavily targeted by investors these past few years. The large subdividable sections they have purchased cannot be subdivided and built on in the next few years despite the Unitary Plan changes because either no builders are available or more likely no developer can get finance. There is no shortage of subdividable sections any longer.

Some of these investors will get more and more nervous and will right now be looking to get rid of their purchase. It is in such areas which young first home buyers might want to start looking – but without being in a hurry. Once the first few reports emerge of prices easing in these specific locations FOMO will kick in with owners looking to sell before prices decline even further. That is where I would be looking were I a struggling buyer.

Relevant to this angle, during the week Goldman Sachs released a report in which they said there is a 40% chance that there will be a housing "bust" in New Zealand involving prices falling by 5%. Imagine what their sharemarket commentaries must look like each morning. "Yesterday stock of blah.blah company busted with a fall of 5.5% following a month when prices rose 33%."

A 5% decline is not a bust – but the media attention on the terminology is why I wrote the bit just above. Media these days don't so much exist to inform us about what is happening but to tell us what we should feel bad about and responsible for, what we should feel outraged about, and what they think we should panic about.

In Auckland when some suburbs which have been driven by investors start showing price "busts" of 5% the media will run stories about markets collapsing. These stories will accentuate the decline as owners panic and look to sell before prices fall much further. That is when the professional investors who hold large portfolios and have been around for yonks will start showing up at auctions again. They have been sitting out of the Auckland market for two or three years now. They will be looking to take properties off the hands of panicked investors at bargain prices.

The question however is this. Will young buyers show up as well? Chances are they will stick with the herd and convince themselves and others around them thinking of buying that they should not do so because they risk seeing their paper wealth fall in the near future (thinking which kept them from buying from 2009-12) – as if movements in such things are the key consideration when establishing a base for one's family.

Many young people talk about growing wealth through property ownership and bemoan their inability to raise a deposit. If wealth growth is their motivation and a deposit cannot be raised then forget housing and invest in shares instead. They are more affordable. Many people are concerned about housing affordability not because they are struggling to get a secure location to raise a family, but because they missed out on making a paper profit and want such a chance to come back again. There is nothing special in their thinking this way. Many of us might fantasise about some temporary shock coming along to cause Apple or Facebook share prices to fall 50% so we could buy some cheaply then ride the price back up.

People move with the herd. That is why markets can rise and fall quickly, and it is awareness of that behaviour which helps drive the successful investment strategies of professionals who have seen it all before many times. Housing analysis is only partly about the fundamentals of population growth, housing supply, and financing costs. It has to incorporate some awareness of the psychology of buyers and sellers, and that is a key area in which many commentators have failed in their analysis since 2008. They have forgotten that economics is a social science and not physics and you have to try and factor in the role of human emotions and especially the biggest one, which is not love as Barbara Cartland would have us believe, but fear. Fear of loss. Fear of missing out in particular.

Here are some more housing related links to add to our growing list for people willing to think outside the square.
http://www.stuff.co.nz/business/property/92517748/blenheim-p-house-sold-at-auction-for-bargain-price

http://www.stuff.co.nz/dominion-post/business/residential-property/92521645/interest-in-p-house-auction-highlights-state-of-wellington-housing-market

Someone has run the numbers in Australia for a young couple willing to sacrifice things to get another thing. Good insights are offered for those working toward building a deposit for a house purchase and willing to be good with their money.
http://www.news.com.au/finance/is-tim-gurner-right-how-much-can-you-really-save-from-giving-up-coffee-and-overseas-trips/news-story/286be12040a0c50100d06b585c22213a

If I Were A Borrower What Would I Do?

My personal preference remains for a mixture of floating and either two or three year fixed, probably three. The need for hedging longer than that in the minds of some took a jump up a few weeks back when New Zealand's annual inflation rate came in higher than expected at 2.2%. But a key measure of core inflation was just 1.6% and last week the Reserve Bank caused a decline in rate tightening expectations in the market by saying there still remains as good a chance that they will cut the cash rate again as raise it.

Then this week we saw further weakness in the chances of a strong fiscal stimulus getting through the US Congress (both houses) as President Trump generated controversy yet again – this time by apparently handing secret documents to the Russians, and according to a supposed memo trying to get the FBI investigation into Michael Flynn weakened.

We do not truly know what the truth is here, but the growing list of distractions means passage of legislation on virtually anything is becoming less and less probable.

So this week we have seen markets scale back expectations for the pace of tightening in US monetary policy (same old story again and again since 2010) and the yield on the ten year Treasury bond has fallen to 2.22% from 2.41% last week. Who knows what next week will bring?

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