BNZ Weekly Overview

19 October 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

Regarding the housing market, here is a reminder about the situation. Due to LVRs, tighter bank lending criteria, and the cycle simply getting tired, activity peaked in Auckland a long time ago and prices are largely stable. Some investors have over-extended themselves either in terms of debt or capital appreciation optimism and as they look to sell so they can sleep easy at night some buyers will pick up bargains.

But fundamentally, as have we have been pointing out through all the glossed up flowery talk of Special Housing Areas, accelerated consent granting, new house building techniques etc. there is a shortage of housing in Auckland which is getting worse because supply is constrained. Meanwhile population growth continues apace even with some anticipated easing of immigration flows as people seek the advantages which New Zealand's only true "agglomeration" can offer.

Thus the scene will eventually be set for another period of rapidly rising prices. But that may not happen for a few years. Until then all the writing about monthly housing data will be so much fluff and bluster not worth indulging. So in future when thinking about writing about the Auckland housing market we'll just put in a link back to this issue of the Weekly Overview unless something truly interesting comes along.

With regard to the regions things have done and are doing what they always do. First Auckland booms and the regions do nothing. This leads to locals building bigger chips on their shoulder regarding Auckland dominating the country, seeking out politicians who might force people to live outside Auckland. Then all the talk of jafas ends when investors and some owner occupiers seek better yields and prices in the regions and the locals jump in as well. Local newspapers run stories of young couples leaving Auckland for the regions and locals embrace the view that all that talk about Auckland growing and growing was the rubbish they thought it was and they start building more houses in their town in anticipation of making profits from Aucklanders seeking out the beauty and low prices of the regions.

Then reality sets in and someone looks at population projections, prices become too high for the locals and the newspapers run stories of families living in caravans and getting pushed out of locations their people have lived in for generations. The regions flatten out as Aucklanders cash up to shore up investments in the big smoke, excess building in the regions becomes apparent, prices fall for a while, and sections sit unsold or placed back on the market. Outright woe befalls should an actual nationwide recession come along and SME owners try to sell their holiday homes to raise cash so they can save their businesses as bank lending goes into retreat.

This year through next different parts of the country will go through this latter part of the regional cycle. Each region however will still come up with reasons as to why no crash will occur, and those reasons by and large will prove to be valid. Hamilton – connected to Auckland's economic growth. Tauranga – great place to retire, vibrant port, and also attracting plenty of young families. Hawkes Bay and Taranaki – also great places to retire but which too many people don't properly investigate. Still struggling though to get strongly enough on the tourism map. Christchurch and Wellington – mini-agglomerations with their own strong dynamics.

Nelson – great place to retire, big primary sector and tourism support. Rest of the South Island hanging in there but dependent upon tourism, still vulnerable to ages-old big companies rationalising and moving out. Northland – waiting for the next wave of Americans escaping nuclear war, good to retire to, dependent on tourism.

Apologies to any region not discussed. Maybe one more mention – West Coast of the South Island. A personal favourite for me which I always day dream about when stress levels get too high. Still to fall down to its true economic equilibrium unfortunately.

Along the way these next five years there will be frequent outbreaks of optimism from some that the Reserve Bank is about to give things a boost by easing or removing LVR restrictions. They probably will one day – but only when they are very confident such easing will not reignite the housing market.

Conditions needed for that confidence to be there are slowly being met. Banks themselves are tightening up lending criteria so that the proportion of lending which one might classify as risky is going down. Think in terms of low deposit, interest-only deals, financing of purchases by offshore buyers or those dependent upon offshore income (which may or may not exist).

Second, as noted, the cycle is over in Auckland and ending in dribs and drabs in the coming year for the rest of the country. So in that context, eventually, cutting LVRs will be like throwing a match into a pile of dead leaves made slightly damp by drizzle.

But, here are two reasons why the RB is in no hurry. First, the shortage of houses in Auckland continues to grow – even taking into account an easing of the population gain from net migration inflows. The market may well be in equilibrium now. But over time this shortage will naturally push prices higher. As long as this is a gradual thing then it is nothing to worry about from a financial stability point of view as few uninformed investors will likely get dragged into over-extending themselves. But the RB needs to be convinced that when these natural forces pushing prices higher reassert themselves there will not be an investor surge.

Second, investors are in fact going to keep searching for yield in property because interest rates are going to remain at historically low levels for years – maybe decades. Which brings us to Tuesday's quarterly inflation numbers.

The Consumers Price Index rose by 0.5% during the September quarter and 1.9% from a year earlier. This places inflation essentially smack bang in the middle of the 1% - 3% range targeted by the Reserve Bank. In other words, where interest rates have sat over the past 18 months to two years have delivered the RB's desired result. That average level for the official cash rate has been just over 2%. Therefore knowing nothing else we would say that at 1.75% there is a chance monetary policy will be tightened because things look marginally too loose.

But that is not the optimal way to approach a forecast of where interest rates are likely to go. Instead we need to look at changes in measures of capacity and business plans for raising prices.

Using the NZIER's Quarterly Survey of Business Opinion we see that during the September quarter the capacity utilisation rate came in at 91.3%. This is the lowest reading in three years and down from a peak of 93.6% early this year. This easing of capacity pressures suggests declining inflation.

With regard to the labour market we see that a net 46% of businesses are finding it hard to get skilled labour whereas two years ago this was just 23%. The labour market has tightened up. On the face of it wages growth should be accelerating. But around the world it is not and outside of the public sector and construction there is no statistical evidence in NZ of any acceleration in the pace of wages growth.

Therefore there exists no reason as yet for believing that whatever the factors are which have suppressed wages growth around the world post-GFC have ended. So counting on an imminent tightening of monetary policy on the basis of a seemingly tight labour market would not be wise.

No strong case exists currently for the Reserve Bank to tighten monetary policy. They forecast that no rate rise from the current 1.75% will occur until the end of 2019. We think they will move perhaps a year before that.

What this means for investors is continuing bad news on the term deposit front. For borrowers the chances are that mortgage rates will remain close to current levels for at least another year with bobbles up and down largely in response to fluctuating expectations for the pace of further monetary policy tightening in the United States.

If I Were A Borrower What Would I Do?

Personally I would seek a mix of floating and 1 – 3 year fixed rates.

Labour-NZ First Coalition

This evening the leader of the NZ First Party announced that he will go into coalition with Labour with support from the Greens on confidence and supply. With Labour having 46 seats and NZ First 9 their total of 55 is exceeded by National at 56 and ACT with 1. That means passage of legislation by the incoming government will be dependent upon the support of the Greens who now are in a position to influence legislation to a greater degree than has previously been the case. Hence about a one cent fall in the NZ dollar so far at the time of writing this at 7.25pm this evening.

How this role for the Greens manifests itself in actual policy outcomes we cannot know and will only learn progressively over the next three years.

With regard to policy agreements made in the negotiations between Labour and NZ First we do not have details and according to Mr Peters it may be some days before such details are fully encapsulated in a document which will be publicly released.

Therefore there is nothing new we can add here regarding policy changes beyond the answers Mr Peters gave to journalists' questions at the media briefing this evening which add up to things such as changes coming to the RB Act seemingly along the lines of Labour's desires but not the currency-controlling focus of Singapore which Mr Peter's desires. Farmers apparently should be happy with the deal – so no water tax probably. The regions will receive extra funding for infrastructure development. Attempts will be made (but they will fail because of resource shortages) to build 10,000 affordable houses each year.

There will be changes in immigration rules and it seems reasonable to expect at least the proposals of Labour aimed at cutting out up to 30,000 low skilled people and those doing sub-degree courses. Foreign buying of land and houses is probably going to be banned.

But as noted, we will have to wait some days to see details.

We covered the platforms of Labour and NZ First in the Weekly Overviews of 7 September and 28 September respectively. We discounted a repeat of the winter of discontent when Labour last came in back in 1998 in the Overview of 31 August. The links respectively are these.

http://tonyalexander.co.nz/wp-content/uploads/2017/09/WO-September-7-2017.pdf

http://tonyalexander.co.nz/wp-content/uploads/2017/09/WO-September-28-2017.pdf

http://tonyalexander.co.nz/wp-content/uploads/2017/08/WO-August-31-2017.pdf