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

I gave a presentation to a conference of mortgage advisors this week as part of a burst of 23 presentations over a seven week period ending early in December. Next week it's off to Timaru, Ashburton and Christchurch to see what is happening down there.

For the mortgage advisors my message was I think a reasonably good one in that unlike a year earlier I was not suggesting that some would do best to find other jobs because of falling real estate turnover. Turnover has fallen in the past year but only down to a low of 74,113 sales by licenced real estate agents in the year to July from 90,000 at the start of 2017. I thought sales might get down to 65,000 but the market has held up very well with assistance from a rise in new house construction, falling mortgage interest rates, good strength in the regions, and net migration inflows falling only slowly.

Over the coming year turnover may be similar to the past year because the main factors influencing housing activity are not threatening in any large way.

The Reserve Bank have indicated they don't think they will need to raise interest rates until late-2020 and are prepared to cut them if necessary. Tightening US monetary policy has had no impact on our floating rates and fixed rates seem similarly unaffected.

The annual net migration flow has fallen from 72,000 just over a year ago to just below 63,000 now. Further decline is highly likely, but the pace of reversal is very gradual and no cause for concern.

The NZ economy itself remains very well supported by low interest rates, a lower exchange rate, slightly stimulatory fiscal policy with more easing to come, underlying growth in sectors like tourism, healthcare, aged care, digital, good prices for most of our exported commodities, strong house building and continuing firm expenditure on infrastructure.

There will likely be some restraint on house prices from tightening rules facing landlords but the impact is likely to be minor with far fewer investors being "speculators" as described incorrectly by the politicians and most of them looking like long-term holders.

Maybe there will be some restraint from the ban on foreign buying from October 22. But we received data this week showing that only 2% of property transfers during the September quarter were to non-residents. The net proportion will of course be lower as some people selling will be non-residents offloading to locals. Note that this proportion is substantially less than the sensationalist headlines used in media this week regarding one in ten sales in Auckland Central going to foreigners. These are largely high density apartments favoured by students.

Some restraint may come from tightening bank lending criteria as a tendril of what is happening in Australia reaches across to ourselves. But note that it would be wrong to extrapolate what is happening to apartment prices in Australia's eastern state capitals to NZ. Prices are falling but they have built too many apartments, the federal Labour opposition are proposing ending negative gearing, and lending to investors which had previously ballooned is now being reined back in quite aggressively. Similarly lending to low income families had been too aggressive before and that also is being reined in with proper expense calculations now being made for mortgage serviceability equations.

Blindly extrapolating changes in offshore housing markets to NZ proved very misleading from 2008-09 when many pundits picked collapses in Ireland and the US to be repeated here. Conditions here are different, most notably with regard to a lack of housing supply and lack of irresponsible lending surges as happened elsewhere.

On another point, discussion of the cost of housing in New Zealand tends toward the dystopic if not the apocalyptic. With a culture focussed around just rewards for just work we tend to look down upon "profits" made through means other than actual work. Disrespecting house price gains and secretly thinking those who profit are lazy we inherently long for a correction downward in prices which will punish those who have smiled so much at their apparent largesse.

In other words, we are culturally biased toward hoping house prices will fall so those who have benefitted get their comeuppance.

And one of the central tenets of those shaking their heads and flapping their jowls in warning of house prices collapsing is that housing costs have soared. No they haven't.

Statistics New Zealand this week released data showing that the average household income has risen by 40.3% in the past ten years while the median household income was up 42.5%. Inflation has been 19% so real incomes have improved quite strongly – on average by about 2% per annum.

Housing costs as a proportion of average household income were 16% in the year to June 2008 and 16.3% in the year to June 2018. Statistically unchanged. We are not burdened by a surge in the cost of our housing compared with our income. We are instead burdened by falling availability of housing and under-investment in social housing with that burden falling disproportionately on those at the lower end of the socioeconomic spectrum.

The Statistics NZ survey also asks people about their life satisfaction and adequacy of their income to meet expenses.

5.3% of near 1.7 million households are dissatisfied or very dissatisfied with their material standard of living, 11.7% are neither here nor there, and 83% are satisfied or very satisfied.

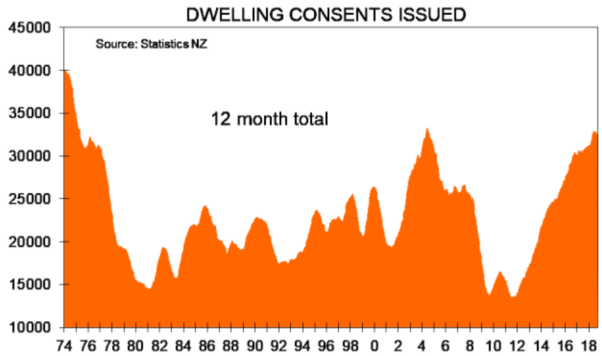
For those earning below average household incomes 7% are dissatisfied or very dissatisfied versus 2.8% for those earning over average household income.

10.5% of households say they do not have enough income to meet every day needs. This rises to 14.5% for those on below average household incomes and falls to 4.2% for those above average.

Continuing on… there is a chance over 50% that when the Reserve Bank release their Financial Stability Report on November 28 they will repeat what they did in it last year and announce a small easing of the LVR (loan to value) rules. Last time they cut the minimum investor deposit from 40% of the purchase price to 35%. A cut to 30% might occur this time. Last year they also gave banks more space to lend where the deposit is less than 20% for owner-occupiers. That rule might also be tweaked a bit as an experiment.

Further supporting housing turnover this coming year will be high numbers of dwellings being built. Note however that we may be close to peak construction numbers because of the shortage of builders and associated trades, the problems which have sent some large firms to the wall, and some contractors leaving the sector.

In fact this week we learnt that seasonally adjusted dwelling consent numbers have fallen by 9.3% during the September quarter and were down 4% from a year earlier. The annual total has eased back to 32,548 from 32,860 in June.



Some commentators have made much of the fact that the number of housing consents being issued is now at its highest level since 2004, for NZ overall and for Auckland. So should we start talking of an over-supply? Hardly.

Since 2004 NZ's population has grown by 20%, Auckland's population is up 32% and the rest of NZ 17%. Think about that for a minute if you lived in Auckland in 2004. There are now 32% more people around you than when Don Brash gave his Orewa speech, than when the Civil Unions Act passed, "bro'Town" started on TV3 and the Olympics were held in Athens.

More than that, more and more of the construction in Auckland involves demolishing existing houses to build townhouses. The net addition to the housing stock is therefore substantially less than the near 13,000 consents issued in the past year or the 10,500 issued in the year ending one year ago. In the past year the actioning of those earlier consents has led to only 6,500 houses being competed. So whereas I have been prepared in the past to say that perhaps 80-90% of total housing consent issuance ends up as net house number gains, in Auckland the proportion looks like it is a lot, lot lower.

That just means that whatever number you choose in your head as the housing shortage in Auckland it continues to get bigger and will do so for a few years longer. 6,500 is a long way off the 13,000 extra houses many have long claimed need to be built in Auckland each year for a few decades in order to address the housing shortage.

There is a shortage,
the shortage is still growing!
Bad for fresh home buyers.

As for KiwiBuild – it will make near no volume difference as every KiwiBuild house put up means one less non-KiwiBuild house put up because of the shortage of tradespeople. The programme won't change the volume dynamic – and it certainly won't do much for people at the lower end of the socioeconomic spectrum cramming into sub-standard housing if any at all. But KiwiBuild will lead to a greater proportion of houses being built in the "affordable" price bracket and fewer more expensive houses. The growing lack of supply of higher priced properties will eventually open up a price gap between entry-level housing and bigger, better specced properties.

Doom?

People keep asking whether we are about to have a recession or maybe some big international economic crisis. Their questions are being encouraged by the falls in share prices occurring in the United States which are causing people's Kiwisaver balances here to decrease slightly. If you are worried about your Kiwisaver balance then you probably don't understand the long-term nature of investing in shares.

Sharemarkets have had a great run over the past few years driven upward by the flood of liquidity provided by central banks offshore, sustained low interest rates, strong fiscal stimulus in the United States, companies buying back their own shares, and an overall fast pace of growth in the US economy. US GDP grew at an annualised pace of 3.5% in the September quarter from 4.2% in the June quarter.

Now however there are some worries.

- Companies may have seen peaks in their earnings.
- The US economy's growth rate may have peaked.
- The Fed may raise interest rates further because the pace of wages growth is picking up.
- The deepening trade war with China will create deepening uncertainty about supply chains.
- EU growth has almost stalled.
- The era of geopolitical stability has ended.
- Global debt levels seem a tad high.
- Rising financing costs and a stronger US dollar are causing problems in emerging economies with large external debts and current account deficits.
- Italian finances are a mess once more.
- The probability of a no-deal Brexit has increased.
- Oil prices have risen recently and oil price spikes have in the past preceded global downturns.
- Plus, in October the markets have long had a habit of undergoing corrections.

Given that inflation and interest rates are not soaring it does not seem reasonable to expect a particularly large decline in share prices. But lots of good news has probably already been factored into prices so some further weakness would not be surprising. The outlook for world growth however remains okay though forecasts have been cut slightly recently by the likes of the OECD and IMF.

For ourselves here in New Zealand it pays to remember that we have some good mitigating factors in hand which will help us through a period of weakness if it does come along.

The economy is highly flexible, the exchange rate has weakened 8% in the past year and would fall further in the event of global weakness. The government has low net debt and is running good surpluses. The Reserve Bank have already signalled their (keen) willingness to cut interest rates if any bumps appear. We have little involvement in global supply chains because virtually everything we export from New Zealand is entirely produced here.

The banking sector is also in a vastly different space from ten years ago. Back then over 40% of funding for lending in New Zealand came from offshore. Now that proportion is probably just over 20%. This strong improvement has been driven by a huge reduction in dependence upon short-term wholesale funding along with higher capital levels.

We also continue to receive growth support from strong net inward migration flows and the experience of 2008-09 tells us that in the event of global weakness our net inflows improve further.

What could possibly go wrong? In the short-term another big earthquake remains a constant risk. In the long-term we will need to deal with coastal water inundation as global sea levels inevitably rise. There is little chance increasingly nationalistic governments and leaders around the world will forsake domestic political muscle rippling for globally responsible emissions policies.

The pastoral sector faces challenges from increasing vegetarianism, meat alternatives, and deepening concerns about the negative environmental impact of intensive dairy farming.

The Western pushback against Russia, China and Iran has started under President Trump and companies and governments are having to newly give thought to their exposure to China's surveillance-heavy authoritarian state in particular.

Businesses generally face deepening challenges from worsening labour availability and their unwillingness (especially older business owners) to invest in technologies to offset the shortages. Businesses also face declining margins because of their loss of pricing power in the face of new technologies delivering an ongoing stream of new competition and near zero cost to consumers of searching online for alternatives.

Much as one sees the macroeconomic factors as supportive of NZ SMEs, the challenges are building up. Older owners remember downturns from the past and are decreasingly wanting to live through another one. So a trend is developing whereby they are maximising their cash withdrawals from businesses and writing down if not completely off the goodwill value in their businesses which previously was to be their retirement nest egg.

There seem to be fewer younger people around willing to buy the businesses, maybe because getting a job is a lot easier these days and because many businesses need deep technology upgrades which potential buyers are not willing to undertake for an established business. For them it is easier to simply start afresh and up to date from day one with their own venture.

Electric Cars

One final thing I forgot to mention a couple of weeks ago. Following my earlier article noting that buying an electric car would not reduce our non-renewables electricity generation burden an emailer noted that this would depend upon when the car was charged up. If you charge it up off-peak then carbon-emitting stations may not be in use. Thanks to Steve on the street in Auckland earlier today for reminding me of this

If I Were A Borrower What Would I Do?

Nothing new. Banks are competing quite strongly in the one and two year terms so I might favour two years. But personally I like the three year term at a pinch currently as the price increase from fixing two years is not very much. Certainty is worth something as we enter into what is likely to be a very long, long period of uncertainty on the geopolitical, economic, environmental and climate fronts.