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.

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http://feedback.bnz.co.nz/forms/lFdYSs5FGEq4kAjP95uzTA

2014 Themes

- Interest rates will rise
- The NZD will remain highish
- The labour market will tighten, pushing employment costs up
- House prices will rise with gains spreading out of ChCh and Auckland
- Construction will boom
- World growth will improve with unprecedented uncertainty regarding monetary policies
- Business capital spending will grow
- Household spending growth will accelerate

Budget Shows Surplus Next Year

The highlight of this week is clearly the government's annual Budget which was read this afternoon. As usual I do not intend wasting time by going through the details because every man and his dog is already doing or has already done that in multitudinous forms of media so here are simply the main bits and some interpretation. From a deficit equal to 1.1% of GDP this year ending in June the accounts will return to surplus of 0.2% next year with increases out to 1.3% of GDP come 2017/18. GDP growth is projected by Treasury at 4% in the coming March year from 3.1% this past year, easing to 3% in the year to March 2016 then 2.1% aft that.

Yields on 90 day bank bills are seen rising from the current 3.4% to 4.3% next March then 5.3% come March 2018. This is a fairly slow rise but the important point to note is that no declining trend is predicted as yet. Average house prices are seen rising 7.3% in the coming year following rises near 8.5% this past year.

The return to surplus is a very positive development which stands in contrast with many more years of deficits projected in Australia. Across the ditch taxes have been increased and spending slashed. In the NZ budget it looks like scope exists for some tax cuts down the track and spending has been increased by small amounts in a variety of areas.

There are no al implications for the financial markets in the budget and it is not even a pre-election lolly scramble.

Labour Market

During the week an emailer said that the employment numbers last week were nothing to get excited about because with strong population growth courtesy of migration the numbers were distorted upward and the labour market was not really in good shape. Actually it does not matter what is happening to labour supply when job numbers soar by 83,000 or a ten year high pace of 3.7% in a one year period. Employers felt confident enough and had enough work orders to hire a heck of a lot more people and that is great. The emailer wondered however at the impact of more people sloshing around and we noted that this effect is easily captured in the unemployment rate.

The unemployment rate is calculated as the ratio of those in work and actively looking for it against the working age population. The rate is 6% which was unchanged in the quarter but down from 6.2% a year earlier. That is not much of an annual decline and that is because a lot more people have entered the workforce looking for work.

So what can one do to get a really good feel for the health of the labour market? Look at the proportion of the working age population which is actually in work and see how it is changing. This is known as the employment rate and it rose to 65.1% in the March quarter from 64.7% in the December quarter, 63.7% a year earlier, and a ten year average of 64.6%. More people about, but more jobs. Great outcome basically.

IF I WERE A BORROWER WHAT WOULD I DO?

I would not be getting all optimistic thinking that there will be a change in the monetary policy regime soon which will result in structurally lower interest rates. First Labour would have to be the biggest partner in a winning coalition once the election is over on September 20. Second they would need to convince those partners of the value of their policy to give control of Kiwisaver to the Reserve Bank - an institution which generally smaller and left wing parties prefer had less power to influence people's lives, not more.

Next they would have to pass the legislation, then everyone would have to be enrolled in a compulsory Kiwisaver account. Presumably there would be some stage before this when they would try to devise some way of minimising the impact on low income households of eventually having 9% of their income going into Kiwisaver. Meanwhile the unions will be trying to convince them that the best way to achieve that would be to make employers bear the brunt of higher payments. Employer groups would meantime be lobbying for that not to occur and warning of the impact on employment and New Zealand as a competitive location for businesses.

Eventually the scheme might be in place and over a period of a few years the contributions would be lifted to 9%. But by the time all of this occurs it is likely that this current monetary policy cycle will already have peaked and rates will be on the way down again. That means that while raising the contribution rate to 9% the Reserve Bank would also be cutting it as part of easing monetary policy. That of course is a ridiculous situation.

Given the time it will take for all of these things to happen even in the event of Labour helping form a government after this election, the increased volatility in equity markets, lower average interest rates, and higher profits to banks which this policy proposal will produce will take a potentially great number of years for implementation.

Borrowers therefore should pay as much attention to this proposal when considering their interest rate risk hedging strategies in the next few years as one should have paid to other policies from lobby groups over the past couple of decades - near zero. But again, full marks to Labour for trying.

Were I a borrower at the moment I would recognise the rising trend for interest rates and the high uncertainty about where rates will sit in the next five years by seeking a mixture of floating, short-term and long-term interest rates.

Also if I were a borrower I'd look to cut expenses to accelerate debt repayment by avoiding eating out and going to cafes. Seriously, at $4.90 for a cappuccino is it really worth it? If you calculate your spending on coffee and associated muffins, brownies, biscuits, quiches etc. over a one year period you may like me discover that the cost is well over $5,000. Maybe it is not duty free allowances on alcohol and tobacco which should be in place but an allowance for coffee vouchers, or beans themselves.

	OCR	90 day bb	1 year swap	2 year	3 year	4 year	7 year
This week	3.00	3.42	3.75	4.06	4.25	4.39	4.69
Last week	3.00	3.35	3.7	3.99	4.22	4.37	4.68
4 weeks ago	2.75	3.28	3.74	4.08	4.35	4.52	4.86
3 months ago	2.50	2.95	3.53	3.93	4.25	4.47	4.95
1 year ago	2.50	2.66	2.75	2.99	3.18	3.34	3.77

NZD Firm As Usual

In a nutshell the Kiwi dollar remains firm, which personally I find unsurprising though there are plenty of people including those at the Reserve Bank confused as to why falling commodity prices have not taken more wind out of our currency's sails.

Maintaining upside risk for the Kiwi dollar over the remainder of this year are the continuing efforts by central bankers in major economies to dissuade the markets from thinking that they will be raising interest rates anytime soon. For the Bank of Japan no effort is required but the ECB President this week again expressed concern about the strength of the Euro (meaning he would like it lower against other currencies including the NZD). The Federal Reserve Chair meantime last week was at pains to emphasise again that there is no timetable set in place for raising interest rates in the United States once the tapering exercise is complete. She also highlighted again that she is looking for strong growth to become embedded before raising rates. "Interest rates are unlikely to begin rising until we are in a strong economic recovery.)

Across the ditch the RBA can now officially factor into it's forecasts a 0.5% of GDP tightening of fiscal policy in each of the next few years and that reduces pressure on them to start taking away currently very easy monetary policy.

The Kiwi dollar is basically well supported and there is growing awareness that now with NZ interest rates rising the carry trade, which has been inactive these past few years, is going to kick into life again. Here is a link.
http://investmentresearchgroup.cmail1.com/t/r-l-xtktjdl-xklijdkc-y/

	NZD vs. USD	AUD	JPY	GBP	EUR
This week	0.867	0.924	88.2	0.517	0.632
Last week	0.867	0.929	88.3	0.511	0.623
4 weeks ago	0.861	0.927	88.3	0.513	0.623
3 months ago	0.828	0.92	84.8	0.496	0.603
1 year ago	0.802	0.832	82.5	0.533	0.624

For more detailed FX analysis including the ‘BNZ Markets Outlook”, “BNZ Strategist” “BNZ Commodities Wrap” and lots more go here. https://research.bnz.co.nz/Research/NewZealand/Pages/NZpublications.aspx

Housing Market Update

LVR Rules to Disappear? Don't Get Too Optimistic

The Reserve Bank Deputy Governor last Friday made a speech in which he noted that although house building in Christchurch and Auckland is picking up, the job of correcting the housing shortage "...is likely to take considerably longer than three years to complete." Prices going up in other words.

He also gave a sign that were the right conditions of housing restraint to appear it is possible that the much-hated loan to value rules could be eased at the end of this year.

"We've stated that the LVRs are temporary, but before removing them we want to be confident that the housing market is responding to interest rate increases; and that immigration pressures are not causing a resurgence of house price pressures. It will take some time to gain this assurance. At this stage we consider the earliest date for beginning to remove LVRs is likely to be late in the year."

Is that likely? Possible yes, but likely, no. Firstly the rules are doing the job of about 0.25% - 0.5% worth of official cash rate rises. Were the rules to be removed then the OCR would need to be that amount higher than would otherwise be the case. Given that rising interest rates lift the Kiwi dollar and that this is something the RB would like to avoid given their recent strong expressions of concern about an over-valued currency, one condition which would have to be met is a falling NZD. Is that likely?

Again this is possible, but not probable. Our economy is in fine fettle yet offshore other central bank leaders are at pains to emphasise that they do not plan raising interest rates for a long time. The European Central Bank in fact is expected to ease monetary policy next month. The chances are that come the end of the year the NZD will be at least as strong as it is now. However it does pay to note that such a scenario still would not rule out removing LVRs because the strong currency itself will be like a tightening of monetary policy beyond what the RB have factored into their forecasts.

Is it likely that come the end of the year the housing market will be as contained as the RB would like? Probably not. Although the pace of activity has eased population growth has accelerated and will almost certainly lift further as this week's black budget in Australia will discourage even more Kiwis from crossing over. The chances are now looking quite strong that within 12 months we will enjoy a net migration gain from flows with Australia. On average over the past twenty years the net loss of population across the ditch has been 20,000. In mid-2012 the net loss was a record 40,000 but now the net annual loss stands at 13,000 and falling quickly. The last time this flow was in surplus was in November 1991 with a peak gain in the middle of that year of almost 2,000 people.

More people, more price pressure, and that is exactly what the Reserve Bank Deputy Governor also expressed some concern about.

The media have chosen to highlight the chances of LVR rules disappearing but failed to outline the rather stringent conditions which will need to be met before this can happen. To all you first home buyers out there, best get on good terms with your parents and butter up those childless aunties and uncles if you are planning to make a home purchase in the near future.

Speaking of home purchases, REINZ released their numbers for April this week showing sales down 20% from a year earlier. But activity levels would have been depressed by the timing of Easter and lots of people taking a ten day break. It pays to note then that the average number of days taken to sell a dwelling came in at 34 which although one day longer than March was 2.4 days faster than average whereas March's outcome was only 1.7 days faster than average. Speed of sale has improved.

In addition the stratified median dwelling sales price which adjusts for changes in the mix of dwellings sold advanced by 0.1% in April to register a rise in the past year of 8.6% and a rise in the past three months of

2.5%. I still struggle to see evidence of house price inflation slowing down following introduction of the LVR rules. Frankly it looks like only turnover has been affected. The Reserve Bank have estimated that prices are 2.5% lower than if the rules had not been introduced. But to make such a calculation one needs to have a model which has proved it's accuracy in predicting house prices rises and in over a quarter of a century back in these shaky isles I have never seen such a model.

One final comment regarding the chances of LVR rules being relaxed. An industry commentary during the week noted that the is a huge level of pent up demand for houses from young buyers currently frustrated because of the rules. Were the rules to disappear he said a flood of buyers would then step forward. Thinking about that, if you were an investor contemplating a purchase, would you have more incentive to act early or less? More of course. To the extent one believes that the LVR rules are temporary they provide a good window of opportunity for investors to make more purchases.

Similarly, if you think Labour could defy the odds and help form a government with the Greens later this year, would anticipation of a capital gains tax on housing cause you to buy more or fewer houses now? More of course as the chances are that existing holdings would be grandfathered in tax free and only fresh purchases from a future date would attract the tax.

IRD Offshore Ownership Data

Last year the IRD supplied the Revenue Minister with data based upon rental property returns showing that in 2011 some 11% of all rental property owners lived offshore with no obvious upward trend in this proportion. There is no way of telling unfortunately what proportion of this 11% is foreigners and what proportion is non-resident Kiwis. One also can't tell what proportion of the foreign owners plan shifting to NZ or what proportion will sell as soon as their offspring finishes varsity.

In addition we don't know to what extent the 11% is biased downward by not capturing foreigners who own houses which they leave empty or perhaps just use for the occasional visit. We also don't know the proportion who own the houses through structures which may not show up as non-resident owners. We also don't know the current situation as the data are three years out of date.

In other words we still do not know what proportion of the NZ housing stock is owned by foreigners and whether that proportion is rising, falling, or flat over time. Hence plenty of scope exists for strong statements by those who think foreigners are on their way to buying lots of our houses as well as those who feel the problem is minimal therefore no legislation is needed.

For your guide with about 40% of NZ housing stock rented and with this stock owned by an estimated 199,000 investors in 2011, this means roughly 0.11*40 or 4.4% of the housing stock is owned by people living offshore. Maybe, who knows given that on census night information of house status as owned and occupied or rented was not available for 20% of the housing stock.

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