Sporadic

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An Update On The Economy

Sporadic 15

In this issue of Sporadic I take a look at

- the easing of monetary policy this morning,
- how dairying is suffering but the woe is good for many other sectors and this means NZ growth is likely to continue,
- review some of the recent data releases,
- look at why legislation banning foreign house buying could be useful,
- look at why Chinese are buying property off the mainland,
- and reproduce part of the official 2002 NZ government apology to Chinese for discriminatory policies of the nineteenth and early twentieth centuries.

This morning the Reserve Bank met market expectations by cutting the official cash rate another 0.25% to 3%. We expect that by the end of the year the rate will be all the way back to the 2.5% it was at before the 1% tightening happened last year. Whether it goes lower than 2.5% depends upon factors which clearly we cannot predict and neither can the RB. After all, if they had expected the economy and inflation to be this weak currently they would not have raised rates last year.

Falling interest rates, exchange rate, steady world growth and some sectors happy means growth continues

This serves to remind us that predictability of your operating environment post-GFC remains very, very low and you should not develop plans highly vulnerable to things turning out different from the assumptions which you have adopted about what the future will bring. Go ask a dairy farmer. Or a gold miner. Or an iron ore producer. Or an oil explorer. But taking that warning into account, do recent events warrant you being more or less optimistic about the coming year? Well that depends substantially upon what sector you are in. If you will benefit from Auckland house prices rising or you export pipfruit, wine, Kiwifruit or tourism services things are better for you. If you have a job and a mortgage rate review coming up the future is bright. If you have been struggling to find staff things are looking up.

I say this because the currency has moved lower and interest rates keep falling as dairy prices decline further, but world growth prospects haven't really changed. So when we talk of some economic pain we are really talking about the dairy sector and its offshoots undergoing a massive correction in expectations rather than the whole economy suffering as happened over 2008 under the combined effects of high interest rates and a high exchange rate – then global recession. This situation is quite different. Specifically...

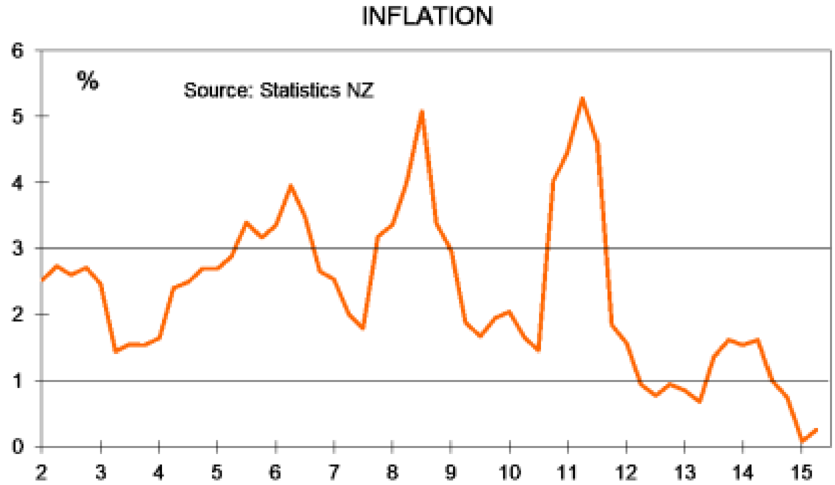
Dairy

Exports of dairy products from New Zealand brought in about $14bn of revenue in the past year but with that total already well down from around $17bn a year ago a further substantial decline looks likely in the coming year as a result of the continuing falls in dairy prices. The most recent Global Dairy Trade auction on July 15 saw an average price fall of 10.7%. This followed a 5.9% fall in the previous auction, was the ninth fall in a row, and means prices are now down 41% since the start of March and 64% from the multiyear peak of about two years ago.

The continuing fall in dairy receipts and therefore incomes for dairy farmers means we should anticipate extra weakness in dairying regions and the companies which service dairy farmers. Some highly indebted farmers will find themselves in trouble but we have all been here before and all parties know the key thing is to maximise communication and early on start ways of addressing cash flows and debt servicing.

Inflation Low

The cost of living for the average NZ family (Consumers Price Index) rose by 0.4% during the June quarter and by 0.3% in the past year. So if you got a wage rise above 0.3% this past year you are ahead of the game. If however you have had no pay rise for, lets say, eight years, then you'll need a 17.5% pay boost to catch up.

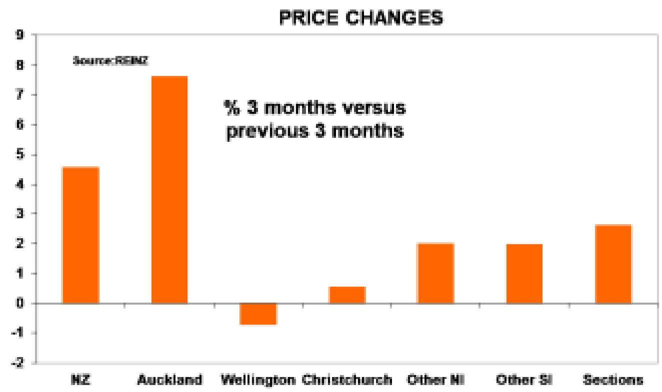


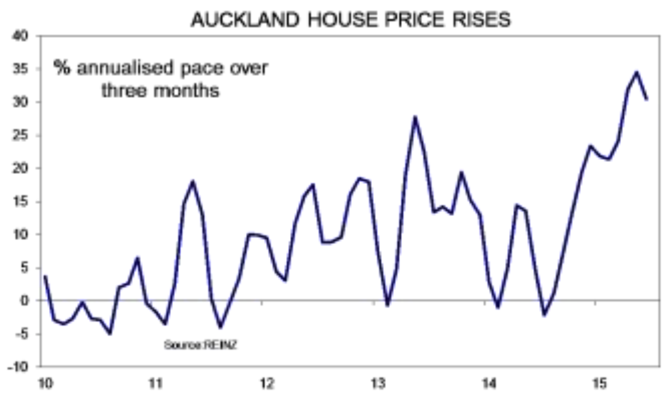
Excluding petrol price rises inflation was actually 0% in the quarter and core inflation using the method commonly used offshore of stripping out food and energy was just 0.9% for the past year from 1.4% one year ago, 1% two years ago, and 1.2% three years ago. Core inflation is very low in New Zealand though some items such as local authority rates keep rising at a high rate. The Reserve Bank is well away from doing its job of keeping inflation between 1% and 3% over the business cycle. The consistent pattern of under-shooting means thinking at the RB is highly likely to be turning more and more toward keeping interest rates low for a long time when the new base is reached, and when they think rates need raising not doing so until a lot more inflation is obvious than was the case for the rate rise periods in 2010 and 2014.

Can we see any signs suggesting that underlying inflationary pressures are building? Hardly, not with dairy prices tumbling. In fact in the QSBO from NZIER the net proportion of businesses expecting to raise their selling prices was only 7% in the June quarter from 33% a year earlier and a ten year average of 27%.

REINZ

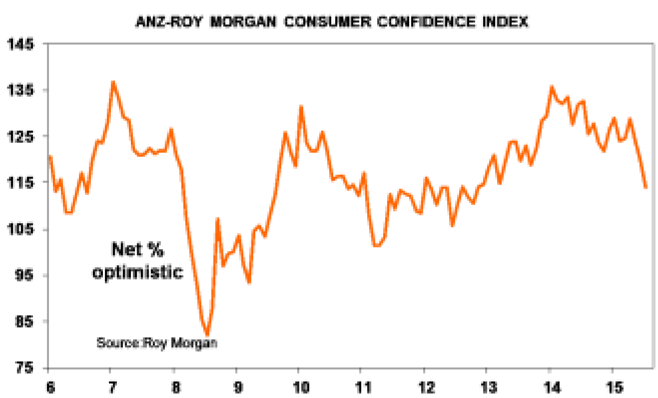
The REINZ's monthly data dump told us that sales nationwide in June were a strong 29% ahead of a year earlier, taking the annual sales total to 81,564 which is the highest since early-2008 and 8% up from a year ago. Sales growth has recently been quite strong in Northland and Waikato with Canterbury sales almost flat. Average sales prices rose 1.3% in the month and have gained 4.6% for the June quarter with Auckland ahead 7.6% and rises elsewhere much less. The data suggest housing market strength is starting to move out of Auckland to other places – as has happened in previous cycles. But price gains in Auckland have yet to decidedly slow.

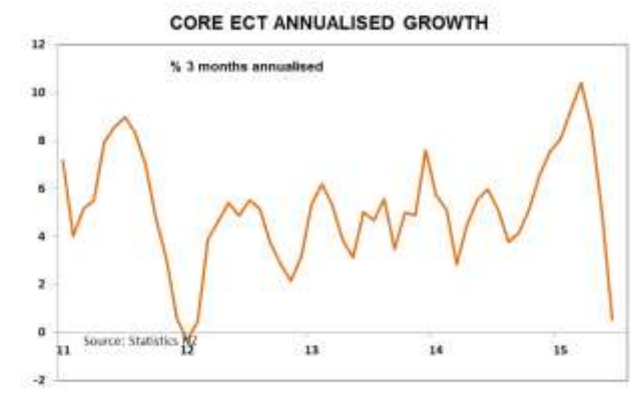




Consumer Confidence

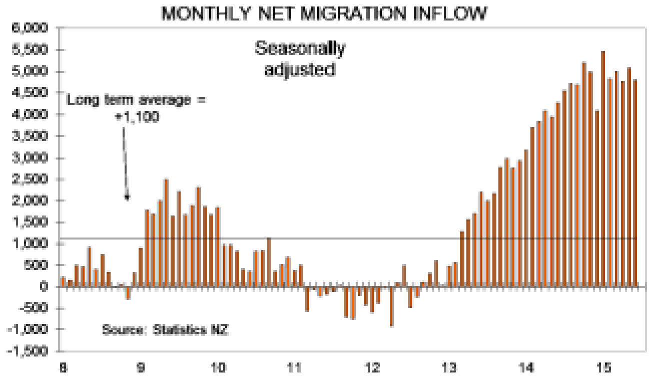
It is falling. Various measures have shown this recently and one we track is the ANZ Roy Morgan NZ Consumer Confidence Index which fell to 113.9 in July from 119.9 in June and 128.8 in April. The average reading the past decade has been 117 so sentiment is below average but not by much and still above the 100 level where optimists match pessimists. This suggests to us that retailers outside of dairying locations should not be too fearful of consumers closing their wallets to a great degree in the near future. But an early-year surge in retail spending may well be over according to the Statistics NZ data on transactions using debit and credit cards.



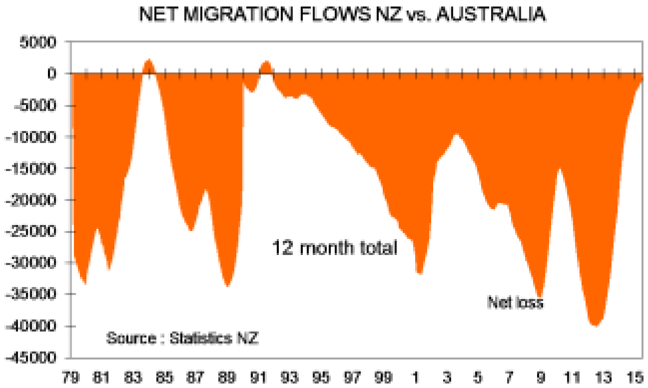


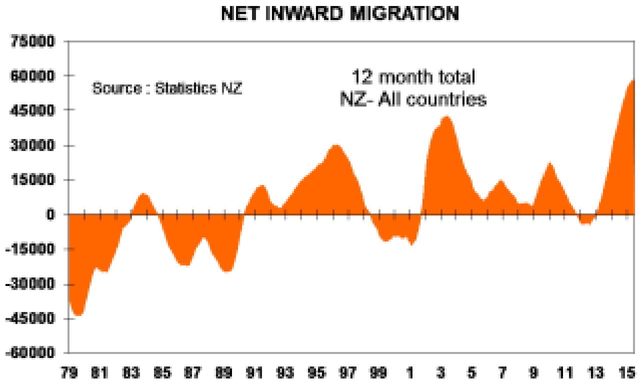
Migration Boom Continues

Data released on Tuesday tell us that in the year to June there was a net gain to our population from migration flows of 58,259 people. This is a record number well ahead of 38,338 a year ago, a loss of 3,191 three years ago, and an average gain for the past 20 years of over 13,000 people. There are some signs that the boom is peaking however with June only 437 stronger than June 2014 whereas May was ahead 1,009. More accurately, in seasonally adjusted terms the net gain at an annualised pace in the past three months was 58,600 which is down from 61,280 three months ago.



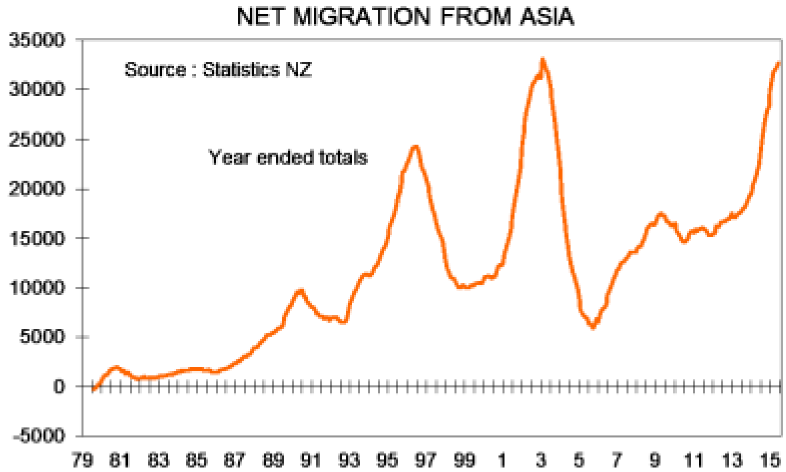
The question then becomes how quickly will the annual total turn? Well I may have picked late in 2012 that the turning of our migration cycle with Australia would see the losses over 2012 turn into big gains, but I anticipated maybe 30,000 and definitely not twice that. So don't get optimistic thinking that we have models which allow us to pick magnitudes of ups and downs. But the cycle is looking due to start easing off, especially with Australia.





I have placed two graphs just above starting in 1979 showing our net migration flow across the ditch and versus all the world. Note how the trend with Australia is for peak net losses to get bigger and bigger. But how does one reconcile this with the peak losses across all countries getting smaller and smaller in the second graph?

The answer is that we are seeing a trend increase in net inward migration from Asia.



Without our gain from Asian migration in 2012 of 17,215 the loss of 38,796 net to Australia would have seen a total net loss of 16,050 across all countries. Strip out Asian migration and our twenty year average net migration gain of 13,000 becomes a loss of 3,400 per annum on average.

Why A Foreign Buyer Ban?

Speaking of Asians, or Chinese specifically as the Labour Party have invited us to do, an emailer asked me why should NZ introduce a ban on buying by all foreigners bar Australians as Australia has excluding us Kiwis? Here are some reasons.

1. To reduce upward pressure on house and land prices and therefore reduce the decline in housing affordability in New Zealand.
2. To help address the Reserve Bank's concerns about financial sector instability potentially stemming from any big downward correction to Auckland house prices perhaps in the context of a deep economic shock.
3. To reduce the incidence of lowly-occupied dwellings or neighbourhoods where people buy property as an investment but never occupy it.
4. To reduce societal discord, fragmentation, and outright racism as people blame foreigners for affordability issues and politicians seek power by exploiting such divisive nationalistic tendencies.
5. To boost the chances that development land will be developed for housing rather than land banked to await capital gain over a possibly long time period.
6. To reduce Reserve Bank reliance on non-conventional tools to slow Auckland house price rises which disproportionately impact upon young buyers and now domestic investors.

On point number 4, in Sporadic 3 of 13 April I looked at how debate about China in NZ had eased off, included some reminders about the importance of China to NZ, and noted a survey by the Asia NZ Foundation. That survey included a question to which 54% of people in Auckland responded Yes, Do you think Asians are responsible for rising house prices? I noted the survey because it did not also ask "Do you think Kiwis are responsible for rising house prices?" and "Do you think Australians are responsible for rising house prices?" Even an agency aiming at smoothing NZ relations with Asian countries and peoples has been drawn into the blame Asia/China paradigm. And they also made no distinction between resident Asians and those offshore.

One emailer asked me why house sellers should be denied access to all the world's potential buyers. My reply included the point that we deny Kiwi employers access to the world's potential pool of cheap migrants through migration policy. We do so because we have a vision of what we want our society to look like and that vision does not include depressing wages to the lowest level the most desperate foreigner will accept. In the interests of fostering our particular society we limit the freedom of employers to choose.

The same argument needs to be more rigorously applied to our home sellers who in this case are not seeking someone cheap, but someone expensive – willing to pay the highest price. Yet just as minimal wages destroys our community so too can sky-high property prices take away a key element of what we want our society to deliver – the ability of a young person to own their own house in the city which more Kiwis want to live in than any other.

Why Here?

Another emailer asked "Why is it that many Chinese are buying in New Zealand?"

1. The number of families in China in a position to consider purchasing an asset offshore has risen strongly in recent years as a result of China's very strong sustained economic growth since 1978. It used to be just the wealthy, but now middle class people are buying. Chinese are in fact buying property all around the world. Here are some links showing this. Article. Another article.
2. Many Chinese families have purchased a home for their children to live in while studying in New Zealand. Of the 110,198 overseas students in NZ in 2014 27% were from China.
3. Many of the Chinese buying will already be living in New Zealand. Given that the household savings rate in China is about 30% whereas the NZ rate is 2% it is valid to conclude that it is highly likely Chinese migrants have more funds available to invest in housing, shares etc. than typical Kiwis who spend up large then buy Lotto tickets.

On that last point, note that the household savings rate in China has increased in the past two decades rather than decreased as traditional life cycle hypothesis economic theory would suggest. Why? One answer according to this paper is that Chinese people are very uncertain about their future income following many years of turbulence and the loss from the 1980s-90s of guaranteed work in state-owned enterprises. Another paper here looks at high housing costs and intergenerational shared housing.

But answering this question leaves unchallenged the statement that Chinese are in fact doing an unusually high amount of buying of NZ houses. We do not have the data.

Nevertheless, whatever the current level of purchases by Chinese investors offshore, looking ahead there will be more buyers from China.

1. China's economy continues to grow thus more people are reaching the position of having sufficient wealth and knowledge to invest overseas.
2. The Chinese government will eventually relax restrictions on Chinese people taking funds out of China.
3. Worries about social, economic and financial stability in China will grow as the period of easy strong growth ends – a process currently underway – and people question the ability of their leaders to meet their rising lifestyle aspirations.

Bring Them On

As an aside, if you are looking to sell your property in the near future and would like to find out about accessing the Chinese market, you could start your learning here. Or here.

Here is a reminder about the importance of China to New Zealand's economy.

- Spending by Chinese visitors to New Zealand in the year to March rose by 61% from a year earlier to reach $1.2bn or 14.6% of all the $8.2bn of foreign visitor spending.
- Chinese account for about 28% of foreign students in New Zealand so contribute around $800mn to our economy.
- Exports of merchandise goods to China including Hong Kong SAR in the year to May added up to $9bn or 18.5% of all goods exports.

Lessons Of The Past

You may be asking yourself whether some people are displaying for the first time some bias toward Chinese people. Actually New Zealanders legislated such bias in the 19th century amidst worries about hoards of poor Chinese entering the country. Now people worry about hoards of rich Chinese buying the country. Here is an explanatory snippet from the apology issued on February 12 2002 by then Prime Minister Helen Clark.

"In the late nineteenth century, the New Zealand Parliament passed discriminatory laws against Chinese seeking to enter New Zealand. The Chinese Immigrants Act of 1881 imposed a poll tax of ten pounds per Chinese person and restricted the numbers able to enter the country to one person per ten tonnes of ship cargo. In 1896 the tax was lifted to one hundred pounds per person and there were further restrictions on the numbers of Chinese able to enter New Zealand.

No other ethnic group was subjected to such restrictions or to a poll tax. Other legislative initiatives also singled out the Chinese.

·In 1908, Chinese people had to put a thumbprint on their Certificates of Registration before leaving the country – no other ethnic group had to leave thumbprints.
·Chinese people were deprived of their right to naturalisation in 1908 and this was not rescinded until 1951. No other ethnic group was deprived of this right.
·A reading test in English was introduced – other immigrants had only a writing test in their own language.

·Even in 1935 when entry permits were introduced after a suspension of 15 years for reunification of family and partners of Chinese people, they were severely restricted."

And that is one reason I jumped into the China space a few years back – an expectation that New Zealand's rising economic dependence upon China and rising investment inflows would generate societal angst which would risk a trade backlash along with eventual Kiwi disgust at biased comments from people we have grown up with. For your guide, here is a link to my 2013 paper "Sources of Western Apprehension About China.

If I Were A Borrower What Would I Do?

This week the Reserve Bank reviewed their official cash rate and for the second meeting in a row lowered it by 0.25%. They have now unwound half of their 1% increase undertaken last year between March and July and the full increase is likely to be gone by the end of the year. In fact the RB said in this morning's statement "At this point, some further easing seems likely."

Whether they cut below 2.5% will depend substantially upon whether dairy prices keep falling, evidence regarding the extent to which dairy farmers and investors are cutting back on their spending, and how much the NZD declines.

The incentive for borrowers at the moment is to sit back and wait for the next round of cuts in fixed rates, unless, as I wrote in February, someone offers me a 5% rate for fixing three years or 5.5% for five years. At this stage I am not cutting another 0.25% off those targets because once US monetary policy starts tightening we will probably see upward pressure on fixed rates further out along the curve. Plus, one key thing to note when you are forecasting a thing and reality approaches your forecast, one's tendency is to over-extrapolate the trend and predict further movement in the direction one has anticipated. Do that once and you'll do it again and you'll chase rates down then chase them back up again and end up potentially worse off. This tendency applies more with currencies than interest rates but the risk is there.

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