BNZ Weekly Overview

17 December 2015

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.

Economic Growth Almost 3%

This is the last Weekly Overview for 2015. The first for 2016 will appear on January 21. Merry Christmas and I hope everyone gets a good summer break.

Growth in the NZ economy has averaged about 2.5% a year over the past two and a half decades and the latest growth rate revealed this morning was 2.9% in the year to September from 3.2% a year ago. A year from now the growth rate will probably be between 2% and 2.5% with the pace of growth suppressed by the dairying downturn, effects of El Nino, and slower growth in China.

This past year when we look at the gross domestic product breakdown at the industry level we see strong full year growth in retailing and accommodation (you and I spending, tourism), agriculture etc. though milk output now falling), construction, and the hard to gauge IT and science sectors. Mining and wholesale trade shrank.

	Full Year Growth %
Retail Trade and Accommodation	6.7
Agriculture, Forestry and Fishing	6.3
Construction	4.8
Information Media and Telecommunications	3.8
Professional, Scientific, Technical, Administrative and Support Services	3.3
GDP	**2.9**
Rental, Hiring and Real Estate Services (including Owner-Occupied)	2.9
Financial and Insurance Services	2.8
Public Administration and Safety	2.8
Health Care and Social Assistance	2.3
Manufacturing (excluding Food Manufacturing)	1.9
Manufacturing	1.8
Transport, Postal and Warehousing	1.6
Food Manufacturing	1.5
Electricity, Gas, Water and Waste Services	1.4
Arts, Recreation and Other Services	1.4
Education and Training	0.8
Wholesale trade	-0.3
Mining	-1.6

The result was near market expectations so left financial asset prices unaffected. Allowing for the restraining factors mentioned above, what sectors will boost growth this coming year? Construction of course with so many areas growing including housing, infrastructure and commercial. The services sector is currently growing well and manufacturing is also performing strongly, partly perhaps because most bulk manufacturers at risk of becoming uncompetitive in the face of cheap production costs offshore have already disappeared. Health care will grow with an aging population.

What else can you reasonably anticipate for 2016? Steady interest rates causing great concern for savers and investors, causing more to accept higher risk to boost returns and gravitating toward property. A firm NZD as our economy is in far better shape than most others.

Housing

We finish the year with the regions enjoying booms as Auckland investors do what they do every cycle and seek better yields and smaller mortgages outside our biggest city. And Auckland naturally as a result of that is cooling down for now with help from the 30% deposit requirement for investment purchases and Chinese buyers globally backing off as they struggle to get funds off their mainland. What will happen in 2016?

First, young buyers in Auckland for the first half of the year will have better choice of properties and face fewer competitors at auctions. But low interest rates will continue to bother investors and cause them to gravitate more to property. The continued high net immigration into New Zealand and Auckland in particular will receive more attention. There will be talk about regions getting overpriced, and if regional price rises hit 20% the Reserve Bank in all probability by year end will slap a 30% deposit requirement in place. The probability of them doing this will rise in line with strength in the NZ dollar as the higher NZD raises the chances of another cut in the official cash rate.

In fact in the event of big damage from El Nino be careful about thinking this will hit housing markets. Chances are the resulting lower interest rates will spur more investor buying. Same goes for any renewed decline in dairy prices – though that is not probable.

What happens with Chinese buyers is anyone’s guess as we do not feel certain about what growth will do in China. Eventually the restrictions on capital outflows will ease and the buyers will return to the rest of the planet. That happening, or anticipation of that happening, will, along with the factors above, provide potential for a new lift in Auckland perhaps in the second half of 2016.

Keep an eye out for the Reserve Bank first expressing concern about the speed of rises in regional house prices. They will do what they have always done and warn about the impact on bank balance sheets of a substantial fall in house prices, and the general media will do what they have always done and misinterpret this as the RB forecasting a big fall. Many people will then in turn make the mistake so many have made of looking at house price valuation gauges which take as their base the bad old days when mortgage interest rates were in double figures, when the RMA did not exist, when banks rationed credit, when the government subsidised first home buying and construction, when migration flows were weak or negative, when only one person in a household was working, when cities were much smaller and less demanding of their infrastructure, and so on.

Unless we get hit by an outbreak of foot and mouth, the chances are that in the next five years average house prices will rise at paces exceeding income growth, inflation, and interest rates because of rapid population growth, sustained low interest rates, rising construction costs, wobbly sharemarkets, foreign buying, and capitulation-buying by all those people who listened to those forecasters who said they should rent rather than buy. Durrr.

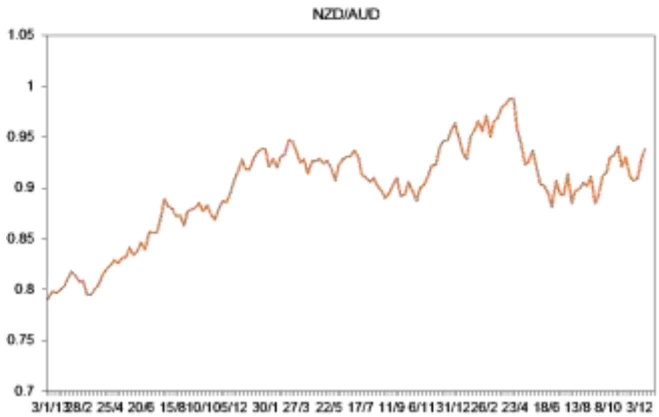
NZ Dollar

For your summer holiday thoughts on the NZ dollar let me offer the following. Compared with the rest of the world we are in very good shape. The government accounts are good, banking system had a good GFC and is in better shape than systems overseas, the economy is nicely deregulated, the political climate is stable, we have no war in our backyard, we have valuable food-related primary resources seen as good investments as Asian incomes rise, our economy is growing near a 2.5 – 3.0% pace, and we have strong population growth.

The NZ dollar is well down from its high against the USD last year of 88 cents, its high against the British Pound four years ago of 55 pence, early this year against the Euro over 70 centimes, and early this year also against the Yen above 91. So we are not pushing boundaries. Parity against the Aussie dollar was almost achieved in April, but we sit now near 93.5 cents.

The odds favour a higher NZD but three key things account for weakness this year and earlier, and restraint going forward.

1. Rising interest rates in the United States – though rate rises may not be sustained and this does not imply the NZD loses ground against anything other than the USD.
2. Slowing growth in China. But watch for when opinion forms that the Chinese economy is stabilising.
3. El Nino and global dairy prices.



Exporters should be wary of predictions that the NZD will decline strongly simply because we see our GDP growth rate slowing from 2.9% toward 2%. And although the Reserve Bank would like a lower NZ dollar, if they can't get it with a record low cash rate of 2.5% and proven ineffectiveness (in 2007) of currency intervention (which they won't repeat as actually New Zealand's non-dairy export sector is generally doing well), then there is nothing they can do to sustainably lower it.

This past week, in spite of US monetary policy tightening and dairy prices rising a less than expected 2%, the NZD has risen toward 67.8 US cents from 67.3 last week, 93.8 Aussie cents from 93, near 83 Yen from 81.5, 62 centimes from 61, and over 45 pence from 44. Upward pressure has come from the slightly stronger than expected September quarter GDP growth rate of 0.9%, and the Minister of Finance announcing an extra $1bn of capital spending next year.

You will find current spot rates here.
http://www.xe.com/currency/nzd-new-zealand-dollar

If I Were A Borrower What Would I Do?

If you are going to spend the next four or five weeks thinking about interest rates here are the key things to note.

- All forecasts of sustained interest rate rises in any country since 2007 have been wrong. Low global inflation is getting locked in and going forward average levels of interest rates and peaks in interest rate cycles (we haven't seen a proper cycle in eight years) will both be lower.
- We see good scope for NZ interest rates to remain at current levels through into 2018.
- The chances of additional cuts in the NZ official cash rate from 2.5% are very low given the support to growth coming from construction, migration, non-dairy exports, and now easing fiscal policy.
- US monetary policy is likely to be slowly tightened through 2016, applying mild upward pressure to fixed rates for two years and beyond. But experience of NZ, Australia, Canada, Israel, Sweden and the ECB suggests come 2017 the Fed. will be easing again.
- All up, the incentive to fix long-term is low.

For the first time since writing this section many years ago I became a borrower a couple of months ago. I fixed two years.

For Noting

I received a couple of suggestions from people to highlight entrepreneurial talent so here they are.

The first wrote...
"Our Young Enterprise Team have worked hard this year creating and marketing their product gaining them 1st place in the Regional Young Enterprise competition and at present they are away representing our school at the Nationals in Wellington.

Opotiki College has had a very tough year repeatedly attracting negative media attention (unjustly and through no fault of the school) so any positive media coverage for our students would be greatly appreciated.

The team created a series of QR code labels for use on chemical bottles in Science Departments which creates an easy way of accessing Chemical material safety data sheet information using a quick and easy QR code scanner compatible with every smartphone device. This would save valuable time in an emergency by not having to search through stored printed material for safety procedures when dealing with an accident situation. The codes can also be used as a teaching resource for teachers and students providing easily accessible information about various chemicals. The web site with more information can be found here"
http://chemiqr.co.nz/our-product
And then "They came third!"

The second stated simply "How about this girl for your next 'Christmas' edition of entrepreneurs. She just created a magical album for Christmas. Absolutely stunning singer."
www.annahawkinsmusic.com

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. To receive the Weekly Overview each Thursday night please sign up at www.tonyalexander.co.nz
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