

# Sporadic

## The Wind Shifts Direction

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Economies and the things affecting them never sit still. Every day we receive information which could alter the outlook you have for your business, your plans for employment and investment, your expectations for wages, price changes and interest rates. Us economists attempt to factor into our forecasts how we think you will change your behaviour. That is why economics, as a social science, can be extremely inexact at times. We are trying to pick what you are going to do, using our observations of how your behaviour has changed in the past to particular developments, and what we expect new developments will be in the future.

Since the start of this year there have been many things happen which will, at the margin, alter what you or some of you do. We have so far seen the balance of these things alter expectations for the future enough so that actual interest rates have fallen, while the government and Reserve Bank have been forced into sudden policy changes regarding housing.

Here is a run-through of the more significant developments which we are trying to balance off against each other, against our existing views, and in light of new developments we postulate for the future. On the positive side (some of these things fall also on the negative side for some people/sectors) we have the following.

### Lower NZD

The NZD is currently close to 72 US cents compared with 78 cents at the start of the year and 84 cents a year ago. Against the Australian dollar we are higher than the 91 cents of a year ago near 92.5 cents, but down from 96 cents at the start of the year. The NZD's depreciation will give some relief to exporters and may especially help the already fast improving tourism sector. But the NZD remains above long-term averages.

### Foreign Visitors

The number of people visiting New Zealand was ahead by 6.7% in the year to April from a year earlier, and 12.1% in the three months to April versus a year ago. The Cricket World Cup will account for some of the boost, but using the International Visitor Survey we see a rise in spending by visitors from China in the year to March of 61%, Germany 35%, Canada 27%, and Rest of Americas 88%. Maybe not very many cricket-lovers there. Total spending by all visitors rose 21% in the year to March. This is very positive.

<http://www.med.govt.nz/sectors-industries/tourism/tourism-research-data/international-visitor-survey/ivs-key-data/key-data-tables/ivs-ye-mar-2015-key-data.pdf>

### Migration

At the start of the year we had data in hand showing a net migration boost in the most recent 12 month period of 50,000 people. Now we have data showing a boost of almost 57,000 for the year to April. It looks like we might be at or about to hit the peak. But the level is a lot more than any of us were expecting and that means extra support for retail spending, the housing market, financial services and so on.

### Petrol

The pump price of regular fuel has averaged almost 20% below the level for the last quarter of 2014 since the start of this year. Although prices have risen from their lows of late-January consumers and businesses do still have lower fuel bills than was expected to be the case courtesy of the substantial decline in international oil prices. <http://www.med.govt.nz/sectors-industries/energy/liquid-fuel-market/weekly-oil-price-monitoring>

### Interest Rates

Although the Reserve Bank has not yet met prevalent financial market expectations and cut interest rates, rate expectations in the broader community have declined. The latest ANZ Business Outlook Survey shows that a net 30% of business sector respondents expect interest rates to fall over the next 12 months. In the last survey for 2014 a net 13% expected rate rises, and this proportion was a net 54% in the October survey. <http://www.anz.co.nz/about-us/economic-markets-research/business-outlook/>

Actual mortgage rates have also decreased, though for fixed rates only. The new customer average two year fixed rate in December was 6.16% but by April this had fallen to 5.92%. <http://www.rbnz.govt.nz/statistics/tables/s8/>

### European Economy

Although Greece could still default and exit the Euro, the most recent data on the Eurozone economy have come in better than expected. GDP for instance grew by 0.4% during the March quarter from 0.3% growth in the December quarter, 0.2% in the September quarter, and 0.1% in the June quarter. <http://ec.europa.eu/eurostat/tgm/table.do?tab=table&init=1&language=en&pcode=teina011&plugin=1>

## Now here is the (much longer) list of negatives.

### Dwelling Consents

In December the number of consents issued for dwellings to be built all around New Zealand was 164 above the number a year earlier. The average for the last six months of 2014 was a 226 gain each month from a year ago. However, the average for January – April 2015 has been a monthly improvement of just 89 with April up by only 30 from April 2014. In seasonally adjusted terms consents fell by 3.9% in the three months to April. Activity seems to be peaking at a relatively low annual total of near 25,000 compared with 33,000 in 2004.

[http://stats.govt.nz/browse\\_for\\_stats/industry\\_sectors/Construction/BuildingConsentsIssued\\_MRApr15.aspx](http://stats.govt.nz/browse_for_stats/industry_sectors/Construction/BuildingConsentsIssued_MRApr15.aspx)

### Australian Economy

Although house prices and house construction are picking up in Australia, the overall economic outlook and mood have deteriorated from six months ago. Manufacturing volumes in March were down 4.2% from a year earlier in trend terms, engineering construction work was down 18.5%, and business capital spending expectations for the coming year are down 25% from a year earlier. When cutting their cash rate for the second time this year to counter the deteriorating outlook since late-2014, the RBA on May 5 noted “Looking ahead, the key drag on private demand is likely to be weakness in business capital expenditure in both the mining and non-mining sectors over the coming year. Public spending is also scheduled to be subdued. The economy is therefore likely to be operating with a degree of spare capacity for some time yet.”

### Chinese Economy

After growing by a slightly below target 7.4% last year the Chinese economy could easily undershoot this year's target of 7%. Responding to data coming in much weaker than expected in areas like retail spending, housing, industrial production, fixed asset investment and exports the People's Bank of China has cut interest rates three times in the past six months. They have also eased housing finance rules while the Beijing government has initiated a programme to help relieve local governments of hefty debt burdens built up from 2008.

### United States Economy

The US economy shrank at an annualised pace of 0.7% during the March quarter after growing at a 2.2% pace in the December quarter. Data have also been disappointing in areas like retail spending, the trade deficit, manufacturing, and home resales. The picture is not yet bad enough to take away expectations that the Federal Reserve will raise interest rates from September, but the direction of surprise continues on the negative rather than positive side.

### **Wages Growth**

Gauging the true rate of growth in wages is a very inexact exercise in New Zealand because of problems with each series one can use. But the measure we follow which attempts to track the same positions over time showed a decline in the annual pace of growth to 2.5% in the March quarter from 2.6% in the December quarter and 2.8% a year earlier. Slowing wages growth will tend to dampen consumer spending growth.

### **Housing Market Restrictions**

In the three months to September (pre-election) the annualised rate of growth in average Auckland house prices was 7%. Come December it was 23%, and April 32%. This acceleration in the pace of price rises despite the 1% rise in floating mortgage interest rates from March to July last year has generated responses from the government and Reserve Bank aimed at preventing a burst of "irrational exuberance" from getting out of control and threatening financial sector stability should a sudden price correction occur. From October 1 investors in Auckland will need a 30% deposit if borrowing money from banks, anyone selling an investment property within two years will automatically be liable for payment of a capital gains tax, and all non-residents must supply a New Zealand IRD number. The changes will probably have little impact but they are an important shot across the bow and it is highly probable that full foreign buyer restrictions will be introduced within two years (though they have little restraining influence in Australia), and bank capital requirements for investment property loans will be raised later this year or next year.

Note that we did not include surging Auckland house prices in our list of positives. This is because although rising prices can lift consumption through boosting perceived wealth, there is little evidence of this wealth effect being strong before the GFC and one suspects afterward the impact would be even smaller.

<http://www.rbnz.govt.nz/> <https://www.beehive.govt.nz/release/budget-2015-extra-property-tax-measures>

### **Lower Oil and Coal Prices**

While reduced oil prices will boost world growth they also retard activity in the energy exploration and development sectors which is what is happening in Taranaki. Low coal prices and reduced expectations of a rebound have impacted upon coal mining on the West Coast.

### **El Nino**

The Australian Bureau of Meteorology has warned that a full-blown El Nino weather pattern akin to that which cost NZ almost 1% of GDP in 1997/98 has a 90% chance of striking this year.

<http://www.bom.gov.au/climate/enso/>

<http://www.royalsociety.org.nz/organisation/panels/climate/archive/a1998/enso/>

### **Dairy Prices**

At the fortnightly Global Dairy Trade auctions average dairy prices have fallen 29% since March, are down 38% from a year ago and 57% from the peak in April 2013. There are many factors driving prices lower, but the greatest reasons for caution regarding the so far incorrect expectation that prices would recover this year are these. No-one seems to know by how much dairy production will be boosted in the European Union now that production caps have been removed effective from April. No-one seems to know by how much United States production will rise now that lower oil prices have caused lower biofuel prices which have caused lower prices for inputs such as grain which has produced reduced feeding costs for US beef and dairy feedlots. No-one knows the extent to which the pace of growth in China's economy will continue to come in below expectations this year. No-one it seems is at all certain of the true size of milk powder inventories in China with some commentators recently offering the opinion that lack of a return of Chinese buyers in force to the dairy market could be because they are carrying much higher than previously estimated inventories. Additionally, production volumes in New Zealand this coming season may or may not be influenced by the El Nino weather pattern noted above.

### **Geopolitics**

There has been a clear deterioration in relations between countries in many parts of the world. War initiated by ISIS is spreading in the Middle East and a new arms race which could embrace nuclear weapons is underway, partly driven by Iran's support for groups in other countries in the region. China is provoking regional and global concern by constructing military-capable terrain on disputed islands far from China but close to other Asian countries, drawing the Americans in particular physically back into the region and

invigorating the movement away from a defence-only military stance in Japan. The quickening pace of executions in North Korea has raised fears of a regionally destabilising regime change there. Russia continues to support rebels fighting the Ukraine for its territory whilst clamping down further on dissenting organisations and voices and suppressing information. The risk of a military event with severe economic ramifications has risen.

### Business Sentiment and Intentions

The shifting economic winds have been noticed in the NZ business sector. The net proportion of businesses in the Business Outlook Survey for May who felt confident about the economy over the next 12 months dropped to 16% from 30% in both April and December. The net percent expecting to hire more people eased to 17% from 22% in April. But the net percent planning to invest more in plant and machinery remained firm at 24% in May from 22% in April and 20% in December.

### What are the implications of this imbalance of new developments toward the negative?

The outlook for growth in the New Zealand economy is deteriorating with the greatest risk coming from the dairy sector. Government revenue forecasts for the coming two or three years are likely to be too high and a fiscal surplus in the coming financial year is unlikely. The probability of interest rate cuts from the Reserve Bank has increased, but because they will need to offset any stimulatory impact on the Auckland housing market it is very likely that additional housing restrictions focused on Auckland will be introduced before the end of the year and afterward. The NZD is likely to continue to edge lower though with high volatility.

Business and consumer sentiment gauges are likely to edge lower. However, it needs to be remembered that although the economic outlook has deteriorated since the start of the year, there remain some stimulatory factors which still have strong enough legs to carry the economy forward for another two to three years before a full-blown correction associated with world wobbles may arrive. On top of the long-term growth in expenditure on Auckland's infrastructure and housing stock there are projects such as the Transmission Gully motorway north of Wellington, rebuilding of Christchurch with infrastructure, CBD and anchor project construction taking up the strain of easing house building, investment in dairy infrastructure such as irrigation and processing facilities, the recovery in the Kiwifruit sector, low interest rates and a lower NZ dollar, and rising jobs security as businesses report worsening problems finding the staff they want.

Remember most of all however that few forecasters have established anything resembling a creditable record these past seven or eight years, and top bodies like the IMF note they simply do not know what the period of extremely loose global liquidity will do to the real economy. Stay nimble but focussed.

### Sporadic Library

8. Eight Records Driving Auckland House Prices. <http://tonyalexander.co.nz/wp-content/uploads/2015/05/Sporadic-8-May-12-2015.pdf>
7. Auckland Housing Shortage Again. <http://tonyalexander.co.nz/wp-content/uploads/2015/05/Sporadic-7-May-5-2015.pdf>
6. Auckland Housing Shortage is how big? <http://tonyalexander.co.nz/wp-content/uploads/2015/04/Sporadic-6-April-29-2015.pdf>
5. NZ Business Culture. <http://tonyalexander.co.nz/wp-content/uploads/2015/04/Sporadic-5-April-23-2015.pdf>
4. A Capital Gains Tax on Housing? <http://tonyalexander.co.nz/wp-content/uploads/2015/04/Sporadic-4-April-16-2015.pdf>
3. China is Important to us. <http://tonyalexander.co.nz/wp-content/uploads/2015/04/Sporadic-3-April-13-2015.pdf>
2. Kiwi/AUD parity – mainly a function of AUD weakness. <http://tonyalexander.co.nz/wp-content/uploads/2015/04/Sporadic-April-8-2015.pdf>
1. Implications of interest rates staying low for a long time. <http://tonyalexander.co.nz/wp-content/uploads/2015/04/Sporadic-April-7-2015.pdf>

Sporadic 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. It is a supplement to the monthly NZ Observer. Please sign up at [www.tonyalexander.co.nz](http://www.tonyalexander.co.nz)  
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