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.

The Weekly Overview is written by Tony Alexander. 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 click here. http://feedback.bnz.co.nz/forms/lFdYSs5FGEq4kAjP95uzTA

Getting Ahead

At the moment I am running a smaller series of writings looking at getting ahead in one's work life as the best way to grow one's wealth over time as opposed to focussing on traditional investments like property and financial assets. Last week I wrote a little bit about how Kiwi employees should perhaps shout a bit louder when they achieve something. One issue attracting a bit more attention with regard to the labour market is the difficulty which people over 50 have in securing employment. This is a very large issue because the chances are that being Kiwis, people in this age group will not have saved much money given their faith in the provision of services by the state. But as they approach retirement more thought is given to how they will live on NZ Superannuation, perhaps in the context of expenses cropping up for home maintenance, and the body wearing out and needing repair. The desire is therefore strong to try and do as much saving as possible going into receipt of the benefit. But finding a job often proves hard.

Perhaps one of the issues is this. The chances are high that older people are seeking employment where they will report through to a younger person. Even though there is not the same automatic respect granted to older people these days as we are told (by older people) that there was a few decades ago, it is probably still the case that there is an age dynamic in play here. As Kiwis we do not like relationships of inferiority and superiority. Bossy people grate on us and frankly so too do people who may go out of their way to show they are subservient to us. (Recent migrants please note this.) That may well be the problem many employers feel when it comes to hiring older people. They are simply uncomfortable with the idea of telling an older person what to do, or they are uncomfortable with seeing an older person show what they consider to be subservience. The older person may feel they need to show high compliance and obedience in order to prove that they are not "up themselves". So they tip into subservience.

Maybe there is an issue also that with younger people one can give a strong benefit of the doubt to them not having anything to hide. But as we age we learn that everyone along the way builds up something to hide (hi Len) and so perhaps we look at older employees in a different light and think to ourselves that those apparently still waters may run deeper than we think. We are in this way perhaps less confident in our ability to assess, to read, an older person than we are a younger one. And we are probably more comfortable with the idea of saying things and taking actions to keep a young employee on the right path in their employment than we are an older person. Wide-eyed innocence and acceptance of views versus furrowed older brows and less willingness to change – to be moulded.

Can an older person seeking employment overcome these unseen obstacles? The only thing which springs to my mind is to show enthusiasm, willingness to learn, and unwillingness to talk repeatedly about past roles, ranks, and learnings. We Kiwis love people who are willing to give it a go. Any other suggestions would be welcome.

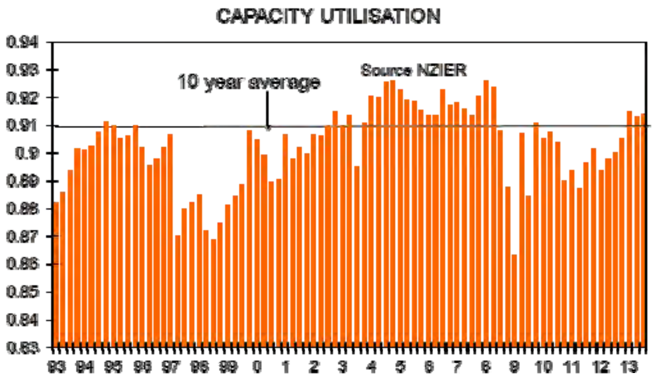
IF I WERE A BORROWER WHAT WOULD I DO?

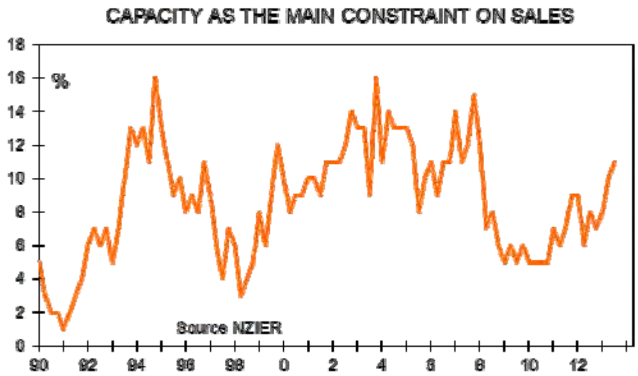
Uncertainty regarding developments in economies offshore remains very high and because what happens in particular in the United States has a big impact on fixed interest rates in NZ it is hard to take a firm view on how our fixed rates will change. Just this week we learnt that jobs growth in September in the US was much less than expected and that means money printing by the Federal Reserve continuing for a lot longer. That means more USDs sloshing around looking for a home. That means world property markets getting an extra push upward as those USDs leak into other countries (pushing non-USD currencies higher), into equities thus pushing share prices higher, and into fixed interest securities thus pushing interest rates down.

The US ten year government bond yield for instance this week has declined to near 2.5% from near 2.7% two weeks ago. That is basically what explains the decline in swap rates shown in our table just below. These up and down movements remind us that predictability of interest rate movements is still low and borrowers should take that into account when considering their mix of floating and fixed rates. I would have some debt floating then seek a mix of fixed rate terms in order to spread my risk.

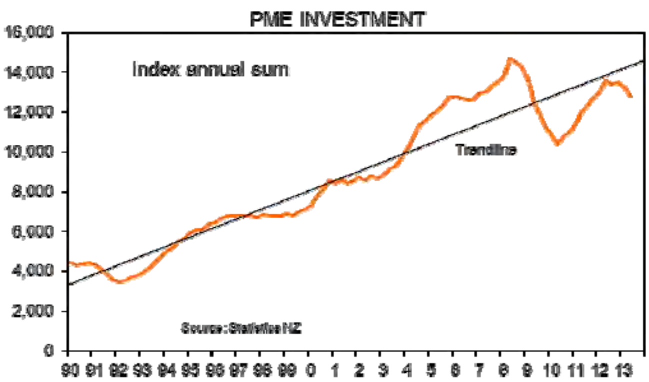
Regarding monetary policy, our view is that the RB will make its first move in March. Pressure to tighten policy is as yet not particularly strong. The NZIER's Quarterly Survey of Business Opinion showed that a net 26% of non-farm businesses expect their costs to go up in the coming quarter. That is unchanged from a year earlier and below the average of a net 36%. A net 24% expect to raise their selling prices which although up from 14% a year earlier is about equal to the long-term average.

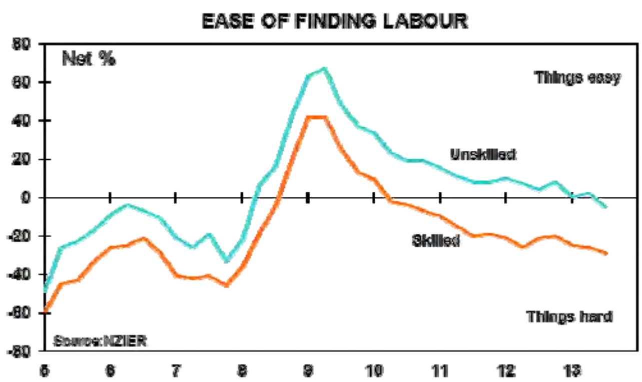
However a net 11% of businesses cite lack of capacity as the main constraint on their ability to grow output, up from 8% a year ago and above the 9% ten year average. The capacity utilisation rate at 91.4% is up from 90% a year ago and the average of 90.9%. This is interesting because at 6.4% the unemployment rate is well above the 4.6% ten year average. Why this shortage of capacity in the manufacturing and construction sectors?





Mainly because over these past few years businesses have held off investing. And this then is where the worry about inflation perhaps popping up its head more than cost and price expectations would suggest comes from. Those concerns are then made worse when we realise that even though the unemployment rate is above average businesses in the SQBO are reporting worse than average difficulties in finding not just skilled but even unskilled labour!





FINANCIAL MARKETS DATA

	This week	Week ago	4 wks ago	3 months ago	Yr ago	10 yr average
Official Cash Rate	2.50%	2.50	2.50	2.50	2.50	5.4
90-day bank bill	2.71%	2.71	2.66	2.67	2.76	5.7
1 year swap	3.05%	3.11	2.97	2.95	2.51	5.8
3 year swap	3.92%	4.10	3.93	3.75	2.73	6.1
5 year swap	4.41%	4.64	4.45	4.22	3.03	6.3
7 year swap	4.72%	4.95	4.76	4.50	3.32	

NZD Drifting Up – Bar Some Profit-Taking

Now that the US debt default risk has been solidified in place with agreement merely to delay thinking about getting finances in order rather than actually doing so, the green light has been given for a step upward in currencies such as the NZD. This arises because it is very unlikely that the Federal Reserve can ignore the obvious depressing impact on business and consumer confidence and therefore willingness to spend, hire and invest. Thus the starting point for the tapering exercise has been pushed even further out. Maybe March we are currently thinking.

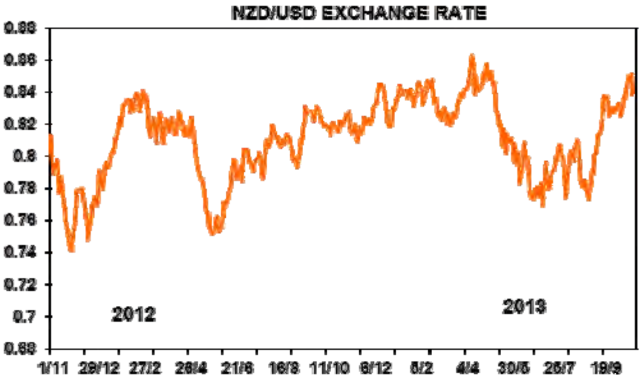
But not only that. The recent fiscal ructions show that underlying deep structural problems in the United States not only exist but they can erupt to the surface at any time. That means the tapering exercise may not only start many months from now but that it will proceed at a very measured pace, and it could be reversed should things turn bad again. That in itself then just reinforces the fact that one of the deep structural problems afflicting the United States is the trillions of dollars of liquidity injected artificially by the Federal Reserve which must eventually, over many years, be withdrawn.

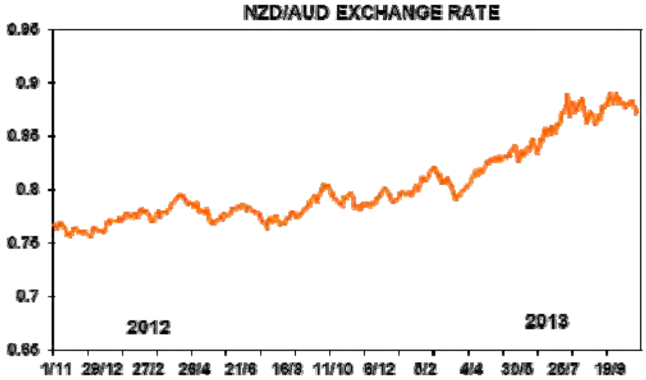
As we have written before, there is no chance that this withdrawal and the eventual tightening of monetary policy will proceed at an optimal pace. There will be big fluctuations, stalling, and backtracking along the way – which is exactly what we have just seen.

Risk attached to USD-denominated investments has structurally risen. That means on average a lower USD than would otherwise be the case on top of the downward pressure implied by continuation of the money printing exercise. This adds up to extra strength in the NZD against the USD and one cannot at all rule out a move above 90 cents, especially as NZ monetary policy is going to be tightened via cash rate increases one to two years before any such move occurs in the United States – and Australia – and the United Kingdom – and Europe – and Japan (many years). The NZD is going higher.

Speaking of which, this week the employment report in the United States was weaker than expected and that depressed the greenback and has pushed the NZD above 85 cents. Non-farm payrolls rose by only 148,000 in September rather than the 180,000 expected and the 193,000 gain registered for August. That meant that heading into the Federal shutdown and near default the labour market had already lost some momentum. That means tapering is now pushed well out – hence more USDs sloshing around the world economy and another rise in the NZD.

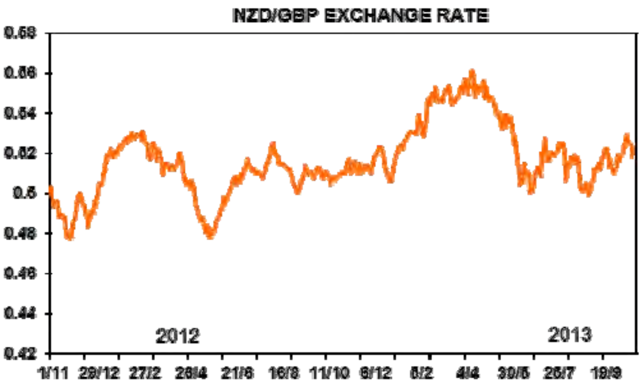
Domestically we received some very strong migration data for NZ this week. Stronger population growth will drive stronger economic growth and use of existing resources. That means more inflation. Plus extra inflation will come from the additional pressure which will be placed on the housing stock. These things mean extra pressure for interest rates to rise and the strong rule of thumb is that as NZ monetary policy tightens, probably starting in March next year, the NZD goes up. It is going higher.

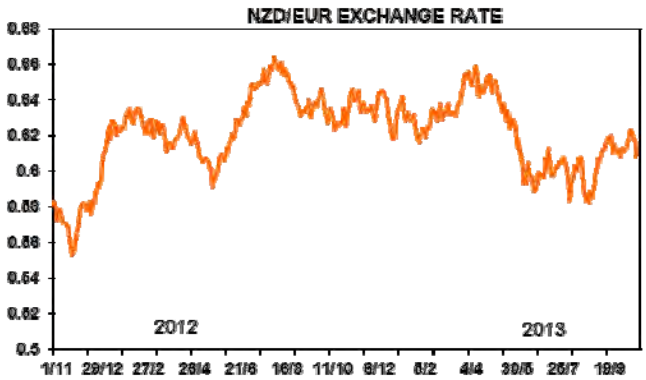




This week the NZD traded for a while well above US 85 cents following the weak US jobs report. But a bout of profit-taking set in yesterday and the NZD has finished down from a week ago against everything.

Exchange Rates	This Week	Week ago	4 wks ago	3 Mths ago	Yr ago	10 yr Average
NZD/USD	0.841	0.843	0.837	0.8	0.815	0.67
NZD/AUD	0.874	0.883	0.886	0.8612	0.785	0.85
NZD/JPY	81.8	83.3	82.7	79.57	65	69.6
NZD/GBP	0.52	0.529	0.522	0.5203	0.508	0.388
NZD/EUR	0.61	0.623	0.62	0.6049	0.627	0.52
NZDCNY	5.12	5.14	5.12	4.91	5.09	4.99
USD/JPY	97.27	98.81	98.81	99.46	79.75	105.7
GBP/USD	1.62	1.59	1.60	1.54	1.60	1.72
EUR/USD	1.38	1.35	1.35	1.32	1.30	1.28
AUD/USD	0.96	0.95	0.94	0.93	1.04	0.788
USD/RMB	6.0859	6.1002	6.1207	6.137	6.246	7.56





In Australia the September quarter inflation data came in higher than expected yesterday with a quarterly CPI rise of 1.2% rather than the anticipated 0.8%. Annual inflation now sits at 2.2% which is down from 2.4% in the June quarter. The result has fairly much dashed remaining expectations that the RBA will continue its two year programme of interest rate cuts with the markets now pricing in a 100% chance of a cash rate increase before the end of 2014. This implies that not long after monetary policy starts tightening in NZ it will do so in Australia therefore reinforcing our view that while the risks for the NZD lie on the upside, scope for gains against the AUD are relatively limited.

Update On China

China's economy grew by 7.8% between the September quarters of this year and last compared with a 7.5% growth rate in the June quarter and 7.4% a year earlier. By world standards this is a stellar growth rate but it is quite important for China for a different reason. It effectively locks into place the structural slowing in growth from rates above 10% which occurred in 2011. It's a made up figure of course. No-one can assign high credibility to a GDP number for a massively diverse country of 1.2 billion people released just two weeks after the end of the quarter. The same goes for most other data coming out of China. After all, if the authorities admit two weeks ago to employing two million people to monitor and censor their citizen's use of the internet in the interests of national unity, it's easy to conclude the data must be controlled also to avoid worries about destabilising slow growth.

China has enjoyed strong growth averaging about 10% per annum since the late-1970s as it has opened its economy to Western capital, allowed firms to participate in the global production and supply chain, and allowed the spread of Western ideas about business. Achieving this has seen China produce the biggest movement of people out of poverty in world history, and through investing in Africa done more to lift African incomes than decades of aid from Western rock stars and hand-wringing liberals.

The China Communist Party has staked a claim to being the only organisation (dynasty) capable of not just holding the country together and restoring international mana, but of delivering strong economic growth and a sharp lift in the standard of living for all citizens. That means they need strong growth to continue and have on a number of occasions taken extraordinary measures to ensure it does so.

Every ten years or so there is a major bailing out of the state-owned banks which have extended too much credit for unprofitable ventures. Such is likely to be the case in the near future given the publicity being permitted regarding the high levels of central, regional, and bank debt. An official tally-up is currently underway of the money owed by all levels of Chinese government and when the number comes out there is likely to be a surge in worries about that debt, and more especially the chances of regional governments being able to pay back banks. Hence worries about bank asset bases. Hence the probability of some capital injections.

Most significantly recently the CCP responded to the huge threat to growth and legitimacy from the GFC by telling banks to go forth and lend – which they did in spades – and initiating a huge fiscal stimulus equal to around 16% of GDP. The result has been a surge in construction and infrastructure which helped keep Australia out of recession because 35% of Australia's exports go to China and almost all of them are iron ore and coal which go directly into the stimulus sectors.

But economies cannot forever survive of the basis of either government-initiated stimuli or the simple bringing into play of previously massively underutilised rural resources or reliance upon exports. So China's over-arching economic goal currently is to shift the burden of growth away from exports and fixed asset investment toward domestic consumption of Chinese households. However achieving this means more than just allowing the Chinese currency to rise and saying it would be good if rebalancing were to happen. Chinese consumers have to be willing to spend more and that is where there is a major road block.

Householders live in an environment of minimum state-assistance and know they have to provide for themselves for things such as good education, health, retirement income etc. So people save like there is no tomorrow. That does not mean there is not strong growth in retail spending – there is and it was at a 13.3% pace in September compared with a year earlier. But consumption growth is still not strong enough to remove worries that China is reaching the point where the normal Western economic driver of consumer spending is not going to be able to take over when exports get damaged by falling global competitiveness of Chinese products because of rising costs, and fixed asset investment stalls for either want of more loosely lent money or the simple obvious fact of too many things already having been built too quickly.

The challenge for China then is to boost household spending and there is as much chance of that radical change in behaviour happening in a short time as there is of Western consumers massively diverting their behaviour away from excessive debt-driven consumption toward higher savings and investment – unless there is a massive economic shock.

For us in NZ the track which Chia is on is overall positive given that we sell primary products which are increasingly demanded by the growing number of middle to high income households. But we exist on the back of our reputation is a supplier of safe high quality goods and that reputation has been badly damaged by the recent false botulism scare from Fonterra. For many of the small infant formula producers who have been growing their trade into China the event has been devastating and some may not return to or achieve profitability. Their ability to do so is hampered by the fact that above all else the goal of the CCP is the retention of power by the CCP through whatever means possible. One of those means is historical reputation for joining the country back together through defeating the Nationalists. Another is the delivery of good economic growth. Another is outright nationalism – something which we Kiwis struggle to understand.

Promoting nation-binding nationalism is a piece of cake for most countries and exceedingly easy in China where the CCP shortly after the Tiananmen Square massacre of 1989 coined the term “one hundred years of humiliation”. This refers to their being so easily beaten in virtually every military conflict by modern external forces from the first Opium War of 1840 or so. Chinese people feel that the rest of the world does not respect them (reactions to Chinese property purchases, building a navy etc.). So pressing the lack of respect button is easy for the CCP to do and they have done that with the false botulism scare and the invited implication that Westerners (Kiwis) have been shipping them inferior product.,

Stirring anti-foreigner sentiment not only helps bind the nation and keep people focussed on things other than massive graduate unemployment, a polluted environment, lack of human rights (the list goes on and one and on and on). Stirring also acts to encourage consumers and businesses to purchase Chinese-produced goods and services – in this case infant milk powder.

It is unlikely that the authorities will undertake any action to alter the recently created perception that Western formula may be dodgy. This then is a lesson for all other primary product exporters to China. Your market presence is something made possible by China’s membership of the World Trade Organisation and perhaps a bilateral free trade agreement. But your profitability is in the hands of the authorities and your presence stands as an ever-ready tool which the CCP can use when they want to stir up a bit of nationalistic sentiment in order perhaps to divert domestic attention away from something else. Good luck over there. China presents massive opportunities for Western companies. But the operating environment is unlikely to be anything you have ever seen before with regard to the speed of market change, the way business is conducted, and the political risk. Not that business markets are slow to change when opportunity knocks in other countries. In France small shops dedicated to selling e-cigarettes are popping up like wildflowers in summer in Paris. Back in NZ near where I live beside Whitby there used to be just one company providing pick-up and drop-off day care for doggies. Now there look to be about three new ones in the past year.

As for China’s immediate growth outlook. The quarterly and monthly numbers have stabilised in recent months after weakness earlier this year which led to worries that this year’s official GDP growth target of 7.5% might not be achieved. It now looks certain that it will but next year some extra slight lowering of the official target to 7% is likely. That should not pose any major problems for ourselves – unless the Chinese people start to express discontent and the authorities need something to distract their attention.

In a Global Times editorial this Friday the author wrote with regard to China’s high holdings of US government debt and its vulnerability to reductions in its value associated with the US debt crisis “It appears unfair that Beijing’s options to utilise its foreign reserves are basically in the control of Washington. It’s an arduous task for China to gradually turn around this situation”

As noted above victimhood (one hundred years of humiliation) is one of the strongest themes China displays to the rest of the world and teaches its people. Hence the ongoing question regarding what China wants from the rest of the world as it rises – revenge, control, independence, respect? And hence the uncertainty and fear from Western people as China enters into Western lives more and more. China cannot reasonably expect to achieve the respect it would like from the rest of the world as long as it continues to portray itself as the victim of outsiders.

Unfortunately for China and ultimately the world economy that is not a cloak which the CCP will be able to throw away given that nationalism is ultimately their claim to the divine right to rule in China. And given the link which exists in nationalistic cultures between the victimhood narrative and reasoned justification for turning the perceived bullying onto others, the risk of outward aggression from China in the interests of internal cohesion cannot be dismissed even though there is no historical precedent for it (depending upon your definition of traditional boundaries of China and whether you feel getting bogged down in the Vietnam War forestalled China spreading its communist model through Asia). The same does not apply to Japan where although nationalism is strong the victimhood narrative is not. Victimhood may be China's "exceptionalism".

Western apprehension regarding China will continue, especially as the rapidly rising number of Chinese families seeking investments outside China take a greater and greater presence in property markets as is happening in spades it appears in Australia at the moment. Chinese have become very large buyers of the off-the-plan apartment sales in some large developments planned in Sydney, they have started purchasing some of the trophy and upper price bracket houses and apartments on the Gold Coast, and the narrative employed by those in the residential property market in Australia has taken an interesting turn which we saw a few months ago in New Zealand.

It is basically that if the Chinese are keen enough to pay outrageously high prices for properties then let them. It means great returns to the sellers who can then go on and boost the local economy with their unexpected largess. The as yet unspoken bit is that the locals may be able to pick the properties up cheaply again some years down the track when the next correction comes along.

But back to China's victimhood vibe in the context of having too much exposure to US government bonds. Here is a hint on how to handle it. Let your currency rise more rapidly, cut back on subsidies (cheap land, loans, lax environmental and labour standards) for exporters, and make it easier for foreign companies to sell their goods and especially services in China. The resulting turning of the trade balance will reduce the continuing flow of funds needing to be placed in FX reserves and thus reduce holdings of those reserves relative to rising GDP. Just a thought.

Then again, it pays to remember one of the prime reasons why China has built up reserves totalling over $3tn. They know that global capital flows can change quite violently and that the Asian Crisis of 1997/98 was caused primarily by the rapid withdrawal of short term credit from Asian nations (the withdrawal then exposing gross inefficiencies in the financial systems and economies of those countries – just as the GFC has for Europe.) Shocks expose frailties and systemic weaknesses. China's large reserves will allow it to cushion the impact on their financial markets and credit flows the next time the world economy experiences a large financial shock involving the withdrawal of credit from Asian countries.

As a finishing note for this China Update, at a meeting next month of the CCP it is expected that the leaders may reveal details regarding opening up China's capital account. In simple terms this means allowing Chinese people to more easily invest overseas. We don't know what the new rules may be but the outcome is likely to be more Chinese money flowing into western assets including equities and property – both commercial and residential.

Property is likely to be a particular focus given that the market for residential property in China has gone ballistic in recent years in spite of huge efforts to try and cool things down. Prices in the major cities have risen five-fold over the past decade and are still running 20% ahead of a year ago in some places. This is in spite of the introduction of rules regarding purchases of second houses – something which encouraged a lot of couples to divorce so they could buy a second property. The Soufun Real Estate Index covering prices for new homes in 100 cities is running 9.5% ahead of a year ago with zero sign in the graph of monthly changes below that house price inflation is slowing.

US Default Avoided – For Now

China is the second biggest economy in the world and while the time when it causes a seemingly inevitable major ruction for the world economy and especially ourselves and Australia is probably a few years away, the world's biggest economy has just avoided creating yet another global financial crisis. Agreement has been reached to extend the Federal government debt limit to early February and funding for the government to early-January. Agreement has also been reached to have a joint committee put together proposals for improving the fiscal situation with those proposals to be released in December.

The chances of strong agreement on the way forward are extremely low. This is not just because of the split in the Republican Party between the Tea Party supporters and most others. There is also the fact that the Democrat President has refused to release an actual budget since 2009. This refusal may be due to the fact that such a budget would have to contain plans on getting the deficit back under control. Specifically the President would have to outline which tax rates he wants to raise and where he plans to cut spending. That is something which Mr Obama wishes to avoid especially in the context of the huge extra fiscal burden imposed by the Affordable Care Act which extends access to America's massively over-priced healthcare system to all citizens whether they want it or not. All citizens are forced to buy insurance, thus using young and healthy people to keep down the costs for those with problems. That is a bit socialistic for the Republicans to take.

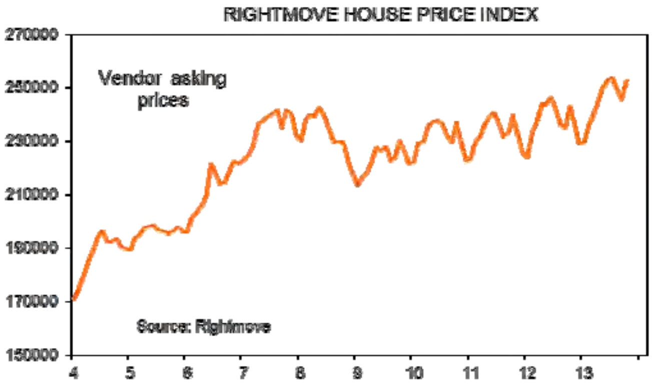
The United States appears to be on a very unsustainable fiscal path with no plan in sight for getting debt down. This path combined with the disturbances along the way as pressure points arise then fall can only act to retard the speed of growth in the US economy as uncertainty regarding these waves of ructions disincentivises businesses to invest and hire and householders to spend. That means a weaker USD on a wide range of fronts. 1, in the short-term because the US growth outlook has deteriorated and the current fiscal bout merely shifted in time for just over three months. 2, in the medium term because the Federal Reserve under a Democrat Chairman in favour of artificial stimulus is unlikely to stop printing dollars in the hope someone spends them until potentially well into 2014. 3, in the long term because the United States has lost its economic mana, has become a source of instability for the world, and looks to have embraced the useless faith in fiscal stimulus and over-spending as a growth driver as Europe has for years.

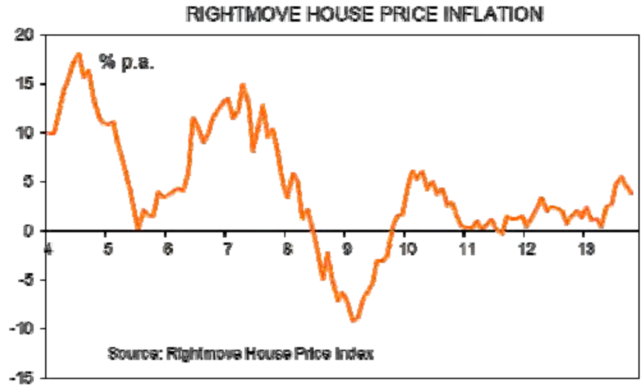
The greenback is on a long-term decline with a decent kick in that fall likely to occur when the Chinese Yuan passes some unknown tipping point to become one of the world's reserve currencies like the Japanese Yen, Euro, and British Pound.

The Kiwi dollar is headed higher against the USD in the usual volatile fashion – and that is before we even start talking about our central bank eventually having to admit credit controls are not the optimal contribution they can make to productivity growth in the NZ economy – and reverting to cash rate increases as the prime monetary policy tool. What chance NZD parity against the USD one wonders?

UK Economy Improving

For your guide, ahead of what is expected to be a strong GDP number to be released on Friday, in the UK this week we learnt that average house sale asking prices in England and Wales as measured in the Rightmove House Price Index rose by 2.8% in October from September to sit 3.8% ahead of a year earlier. The gain for London however was 10% during the month (13.8% on a year ago). London's housing market is going from strength to strength through a combination of buying by foreigners, low interest rates, a shortage of stock, accelerating economic growth, catch-up buying after a period of weakness, and the Help To Buy government subsidised house purchase scheme involving just a 5% deposit.
http://www.rightmove.co.uk/news/files/2013/10/october-2013.pdf



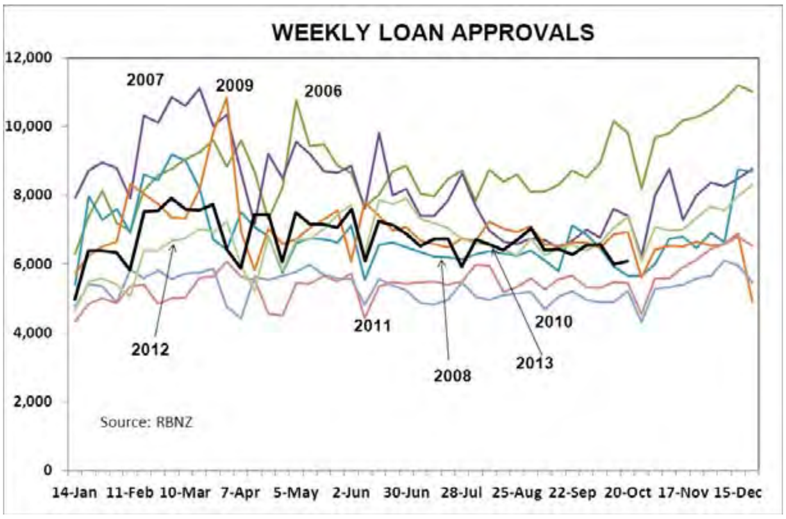


I shall be in Japan in a couple of weeks and hope to write more about the Japanese economy around that time.

Housing Market Update

Home Loan Approvals Ease Off

Has the mortgage market been severely dented by the new credit controls imposed by the RB? Not yet. The graph below shows the experimental home loan approval series compiled by the Reserve Bank with latest data running to October 18. The solid black line represents weekly approvals during 2013 and while the decline on its far right is in line with what happened at the same time of the year in 2008 (GFC post-Lehmans collapse at the time) it is not in line with rises which happened in all other years. So there is a lending impact underway with approvals in the latest week down 18% from a year earlier.



Population Growth Accelerates

One of the factors I have long cited as justifying a view that the housing cycle is as yet only in the early stages of an upturn has been the turning of the migration cycle and how eventually it would attract attention of property pundits in NZ. A year ago New Zealand's population was decreased by 3,280 because of more people leaving our shores permanently in the year to September than arriving. Now however there is a net gain of 15,174.

This is a rapid though not extreme turnaround which leaves the net gain above the ten year average of just over 10,000. More importantly however it looks like the annual total is headed to somewhere close to 30,000. That is because if we annualise the seasonally adjusted gains over the past three months (1,990, 2,160, then 2,740) then we get a flow of almost 28,000. We get 33,000 if we annualise just the September result which was the highest monthly seasonally adjusted net gain since July 2003.

It is a no-brainer that faster population growth will give an extra boost to retailing and the housing market. But it will do so via two key routes. The first is simply more people needing to be housed. The second is the belief held by many people that it is migration flows which drive the NZ housing cycle. Those people will be pricking their ears up at the strong migration numbers and will now be entering the market to buy an investment property before others do.

In this way we get a new wave of investors on top of

- those catching up on buying because the GFC did not cause NZ house prices to fall 40% as some people in 2008-10 were "predicting",
- those catching up on buying after waiting in vain for other investors to sell because of LAQC changes,
- those catching up on buying after waiting for depreciation rule changes to cause other investors to sell,
- those buying because they are in or approaching retirement and feel they have not saved enough so are gearing up to try and get capital gain on top of some yield,
- those buying because bank term deposit rates are too low to meet their income goals,
- those buying because they are concerned with stories of sharemarkets being over-valued,
- those buying now rather than later because they fear a change in government will alter the tax-free status of property capital gains,
- those buying because they figure if the biggest global financial crisis since the Great Depression does not cause a big house price correction in NZ then nothing will (wrong – foot and mouth will do it),
- those buying because they reckon there is little chance of Auckland's housing supply targets being met,
- those buying because they figure with young folk unable to raise a 20% deposit they will rent for longer thus the structural demand for rental accommodation has just taken a leg up, and
- those buying because they expect a lot more money to flow into our market from Chinese householders diversifying their wealth out of China coupled with stories of silly prices being paid simply to achieve an offshore wealth holding in a place they might never actually occupy.

Plus we have a whole new wave of young buyers turned into investors at the low-priced end of the market rather than geared up buyers in the price range and location they were seeking before October 1 – something I discuss further below.

Across The Ditch

The housing market has picked up strongly in Sydney and Melbourne this year with strength spreading to other parts of the country. A key driving force has been the cuts in interest rates engineered by the RBA to try and lower the AUD and offset weakness in construction, manufacturing and retailing stemming from the ending of the resource sector development boom and the falls in commodity prices seen since the middle of 2011.

Someone has also got around to creating an index measuring the number of cranes on the skylines of Australia's capital cities. One suspects this Rider Levett Bucknall Index (guess they had no branding people in the room at the time, RLB for short) will rise fairly strongly soon given the combination of many factors creating a surge in residential high rise construction. Demand for property from China and other parts of Asia is strong as the Chinese look to get wealth out of their country (polite-speak for escaping CCP control), some buyers divert from markets now more difficult to get into because of various rule and tax changes (Singapore, Hong Kong), low interest rates encourage local investors, and young people look for a foot on the property ladder.

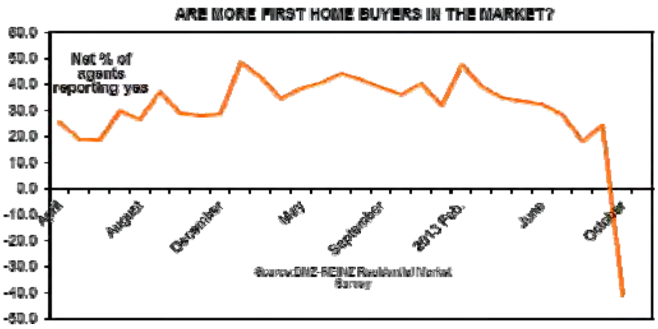
The RLB Index has risen 12% in the past year with Sydney up 27%, Brisbane 15%, and Melbourne 8%. Note however that the index captures commercial as well as residential project cranes with the latter making up 48% of cranes up there at the moment. So the RLB Index best reflects overall construction activity rather than specifically residential. In that regard construction prospects for non-residential as well as residential are improving. Various business sentiment measures have improved recently, especially with the Federal election out of the way. The Australian Chamber of Commerce and Industry which covers mainly construction and manufacturing said this week that its index of company trading conditions jumped to 61.2 points in the September quarter from 52.6 in the June quarter survey. This still leaves actual trading conditions at a below average level but the direction is important. It allows us in New Zealand to think in terms of the sharp turning of the migration cycle between NZ and Australia not being a permanent thing but simply a temporary part of that cycle which will eventually turn the other way again, maybe a couple of years from now. That will provide some extreme choke points for NZ employers seeking staff when it happens. http://www.acci.asn.au/getattachment/827788ac-954c-4704-9a4f-b209f7fc90cf/ACCI-Survey-of-Investor-Confiedence---October-2013.aspx

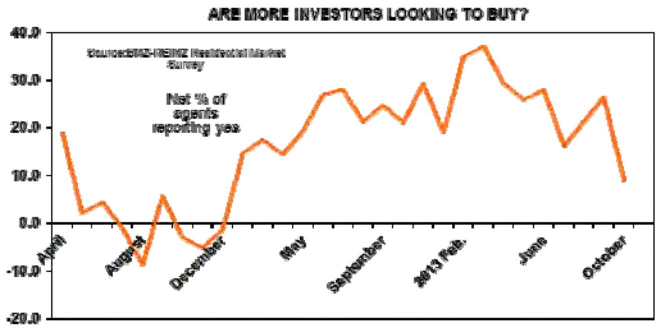
Changing Nature of NZ Young Buyers

Back on the Aussie housing market … there is a worsening shortage of listings in Australia with the number of properties on the market near 110,000 compared with 130,000 a year ago. Analysts are confused as to why people are not stepping forward to sell their properties. Perhaps it is because of the hefty role now played by investors. Prices are so high that people think less and less in terms of the ongoing services (occupancy) which a property will give them and apply a greater weight to the potential investment returns. Thinking that way means that if people see a market rising they will be more inclined to hold onto their existing property for the capital gain, and less inclined to think about the flow of benefits which a bigger or smaller house might give them were they to shift.

This sort of shift in sentiment may already have occurred here in New Zealand. Young people here are aware that prices are rising strongly, are aware that there is a shortage of property in our biggest city, and feel that they have to think more and more in terms of not just getting a foot on the ladder but staying on the ladder at a reasonable rung as well.

So young buyers speak in terms of first of all buying a property as an investment while they continue to rent themselves, then down the track selling that property and using the expected capital gain as part of their deposit for the home they will live in. If you can grasp that then you can start to achieve an understanding of why real estate agents in our monthly BNZ-REINZ Residential Market Survey reported a far smaller backing off of investors than first home buyers following introduction of the credit controls on October 1.





Young people are themselves becoming investors and courtesy of the credit controls have been incentivised to become even more so. That is why the Auckland inner city apartment market is going to boom. Young people want to get their foot on the ladder and the neatness and lower price needing to be paid for an apartment as opposed to a house and all the maintenance and landlord-type issues that brings makes buying an apartment as an investment very attractive.

This change in how young people approach property means more sales of books about property investment, more people looking to join investment groups, more people looking to attend investment seminars, and more young people looking to their parents not for a large deposit to get a house for them to live in, but to secure a smaller deposit to get a lower priced apartment which they will rent out.

Does this mean that the RB should not have introduced the LVR rules? Personally I would have taken a different route and more sharply increased the bank capital requirement for high LVR lending. In that way the risk which the RB is seeking to contain will be better priced into the market and people are freer to choose to pay for the risky debt level they want rather than having to queue for it. The philosophy underlying policy settings in New Zealand since the mid-1980s has largely been one of choice and change – creating an environment in which people can choose something they want as long as they are prepared to pay the price, and people and industries can change in response to movements in market pricing signals and personal preferences.

But before we get too critical of the RB it pays to remember that they are trying to grapple with something increasingly concerning central banks in other countries – booming housing markets bringing worries about bubbles developing. Such concerns are being expressed in Australia, the UK, and Germany. In addition the RB wish to mitigate the extent to which the NZ official cash rate will eventually need to be raised to contain cyclical inflationary pressures. The smaller the extent of the cyclical OCR rise the less the upward pressure on the NZ dollar and the less the damage to the export sector. But given the extent of the housing shortages in Christchurch and Auckland and the wave of catch-up buying to be done by investors, first-home buyers, and now new investors, the chances are high that the OCR will have to eventually be firmly boosted though we can only guess by how much at this stage. The NZD will go higher. Unless export prices collapse. Or Chinese growth slumps. Or the US defaults and the world enters a new financial crisis. Or….

Key Forecasts

Dec. year		**2011**	**2012**	**2013**	**2014**	**2015**
GDP	annual average chg	1.4	2.7%	2.5 – 3.0	3.0 – 3.5	2.0 – 3.0
CPI	on year ago	1.8	0.9	0.5 – 1.5	1.5 – 2.0	2.5 – 3.0
Official Cash rate	end year	2.5	2.5	2.5	3.5 – 4.25	3.5 – 4.5
Employment	on year ago	1.6	-1.3	2.5 – 3.5	2.0 – 3.0	1.0 – 2.0
Unemployment Rate	end year	6.3	6.8	5.5 – 6.5	5.0 – 6.0	5.0 – 6.0

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Tony Alexander has been Chief Economist at the BNZ since 1994 and apart from publications and advising management spends considerable time on the road around New Zealand making presentations and speaking with the media. He travels to the UK and Europe twice a year to assess economic conditions and present at numerous functions, has five children, tramps, and his partner Dr Sarah Farquhar runs the early childhood education network www.childforum.com www.myece.co.nz