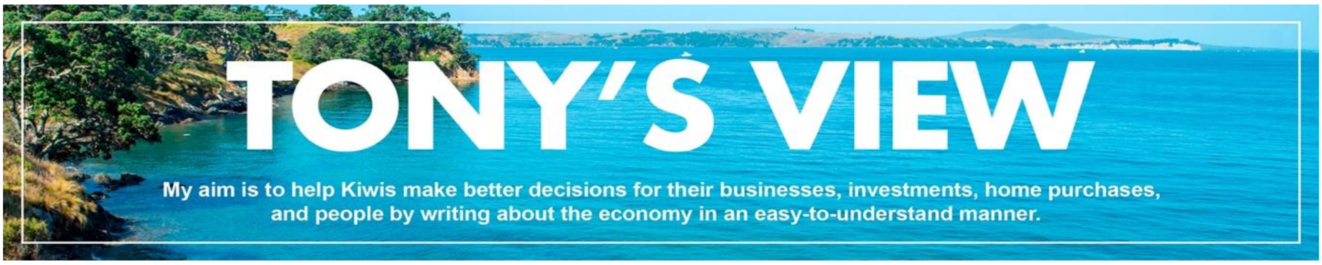

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The NZ dollar will rise

This week I'm starting things by repeating and expanding on something I wrote about three weeks ago regarding New Zealand's terms of trade. I do so following on from a question put to me at a conference I presented at during the week. Specifically, what is the outlook for the Kiwi dollar over the next 30 years?

You might think that we economists hate making forecasts for such a long period of time. But frankly the longer the better because by the time the end date comes around no-one will be holding us to account for what we said!

More seriously, if you are looking at such a long time frame you need to give thought to the key underlying fundamentals for our economy in comparison with the world in general. The current economic cycle is almost irrelevant apart from providing a starting point from which the unpredictable oscillations around a suspected trend will occur.

The starting point for some might be consideration of our level of indebtedness. The trouble there is that most people won't look at what is happening offshore and will instead just bemoan the state of debt in NZ – because that is what they have been taught to do. We love borrowing money but are taught to be ashamed of doing so.

But the ratio of government debt to GDP in New Zealand is about 43%, up from less than 20% before Labour took power in 2017. The OECD average is almost exactly twice that ratio at 85% earlier this year.

We can see growing debate offshore about the level of debt in the UK causing bond yields to rise, the inability of the French to get their debt under control, and the blowout underway in the United States courtesy of the new President.

Here, the focus is on getting the debt to GDP ratio back down in a very slow manner. There is always the risk it blows out because of an event like an earthquake, foot and mouth disease outbreak, new financial crisis offshore, or another pandemic. But recognition of this risk has long been one driver behind getting our debt down through running small budget deficits or surpluses (for 14 years once) since 1985.

Frankly, the debt angle argues for an upward trend in the NZ dollar. That is worth mentioning because it means there is not really an offset underway to the implied upward trend coming from the way our terms of trade are trending upward.

The debate around economic policies through the 1960s, 1970s, and early-1980s was driven by an accepted understanding that our terms of trade were falling. The rest of the world was perceived as not really wanting the primary products we were (are) very good at producing yet we wanted the things they made, and prices were rising.

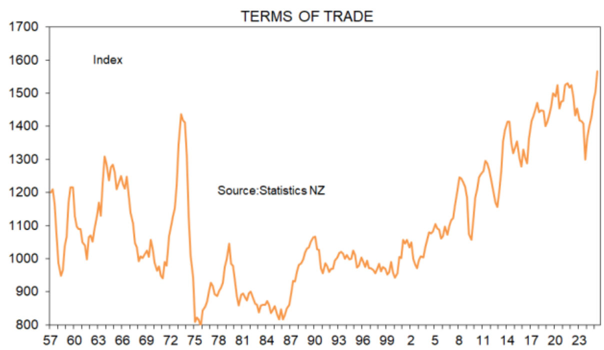
Here we are talking about fuel and manufactured goods like TVs, cars, whitewear etc. These beliefs led to policies aimed at creating some energy independence and trying to grow domestic manufacturing. These policies failed because we do not have sufficient population base or capital markets or expertise or closeness to markets or capitalistic flair to be successful in these areas by and large.

A sense of despair in realising this and the near collapse of government accounts led to the deregulatory policies from 1984 – 1992. The underlying view was that farming was a sunset industry, we sucked at manufacturing having protecting the bejeebers out of it for a long time and achieved no great competitiveness with products from offshore. We didn't know what industries might sprout up as a result of opening up and reforming the economy, but surely something would. Deregulate and hope.

We can debate whether new things have been developed but the simple truth remains that we are dependent upon overseas producers for most of the manufactured goods which we consume and we continue to be dependent on the farming sector for our export receipts.

Does this mean then that the earlier view of the Kiwi dollar trending down because of our falling terms of trade still holds true? No, because our terms of trade have been trending up for over two decades.

Since 2004 while our import prices on average have gone up by 21%, our export prices have increased 75%.



The world wants what we produce, and foreign companies are having to repeatedly spend billions of dollars developing new technologies to make TVs 1mm thinner and motor vehicles more efficient.

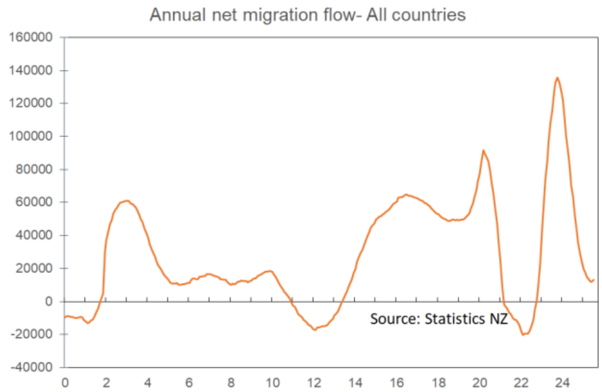
We are what we always have been – a primary producing nation dependent on capital from offshore along with fresh immigrants bringing new entrepreneurial flair and demand for local goods and services including housing. Beyond that is all fluffery filling up the newspapers and social media.

Having a view that the oscillating drift of the NZD will be upward over the next three decades does not necessarily lead to any implications for what one does with one's business, finances, or even investments at the moment. Unless that is you believe that the markets generally will come to accept a view that we produce what the world wants, we are not fundamentally munted, and having some exposure to NZD denominated assets would be a good move.

That is unlikely in the next five years so my long-term view does not in my opinion give any particular insight into where the NZD will be come 2030. But my punt would be higher than where we are now, though not necessarily against the Aussie dollar.

Net migration weak

Just for the record, late last week the monthly migration numbers were released. They show that in the year to July NZ enjoyed a net migration inflow of 13,100 people. This was down from 64,000 a year ago but up slightly from 11,900 in the year to June.

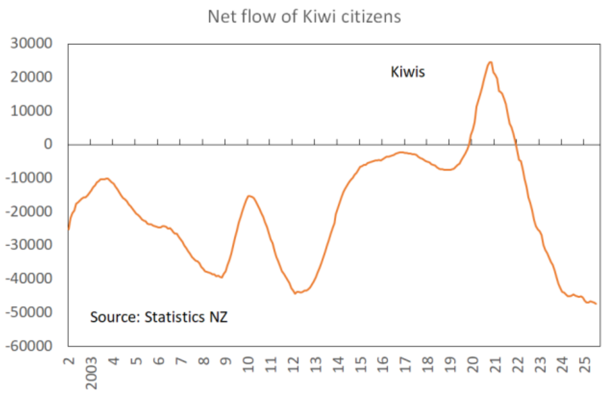


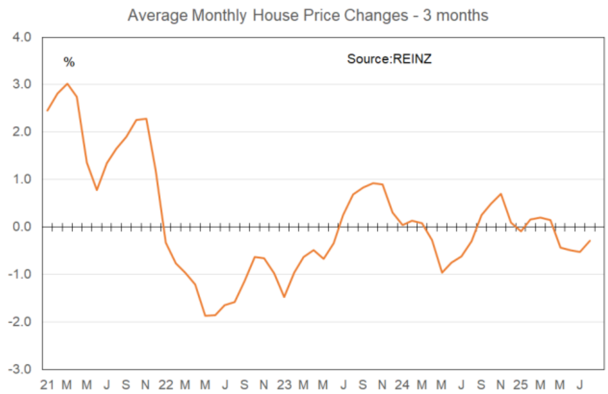
This gives a hint that maybe we are at the bottom of the net migration cycle. But that does not mean we have any idea at what speed the numbers will recover from here or how high they will get.

Our economy gets moved about at the margins by unpredictable net migration fluctuations attributable to sometimes quite small percentage movements in two very large numbers.

On average each year we lose about 2% of our population or around 106,000 people, while gaining around 2.7% or about 143,000 or thereabouts.

The net loss of Kiwi citizens offshore stands at 47,000 for the past year and continues to slightly worsen. We export primary product and our people. We import manufactured goods, capital, and foreigners.



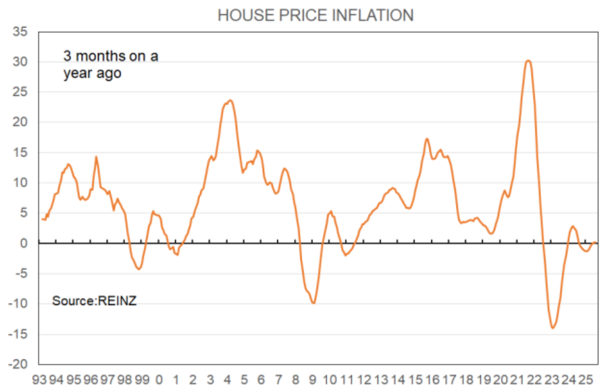


House prices creep up slightly

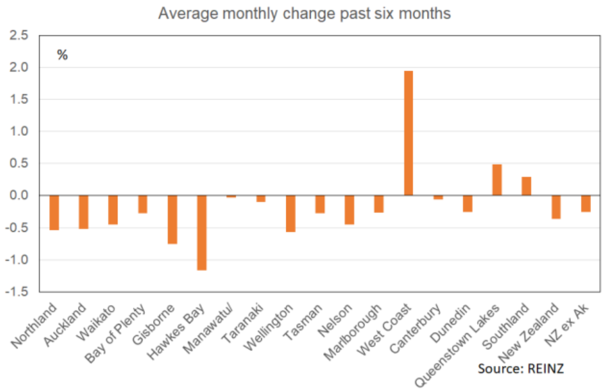
This week REINZ released their monthly set of data on the residential real estate sector around New Zealand. Theirs is the only price measure I look at nationwide because it is adjusted for changes in the mix of properties sold from one month to the next. If you want to use a different index, then be sure to stick with the same one month to month and smooth things over three month periods to reduce inherent volatility.

On average in August house prices as measured by the House Price Index recovered 0.4% after falling 0.4% in July. Over the past three months prices have eased by 1.3% after holding steady in the previous three months to May.

Compared with a year ago recent prices were basically unchanged.



To try and get a feel for what has been happening at the regional level we can look at data averaged over six months and see how prices compare with the previous six months ending in February. The following graph shows this, and we see prices have declined in all regions except on the tiny West Coast (highly volatile), Queenstown Lakes (more tourists, people with money immune to tough economic conditions), and Southland (higher farm incomes).



The most interesting thing is the strength in Southland. This tells us that as the boost in farm incomes flows through the economy it will reinforce the boost from lower interest rates and likely propel prices higher to an unforecastable degree in most regions through 2026.

If I were a borrower, what would I do?

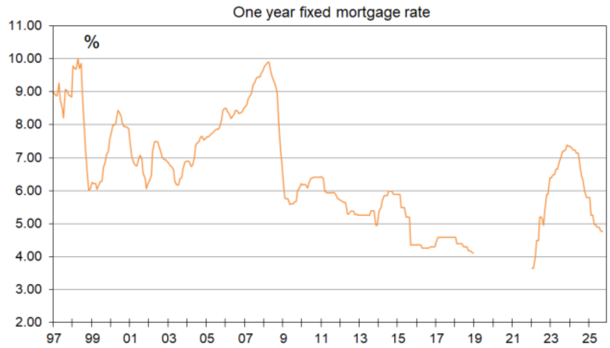
This week wholesale borrowing costs facing NZ banks in the local market have edged down slightly from where they were a week ago. A factor assisting this was the weaker than expected change in GDP for our economy in the June quarter – down by 0.9%. A fall of about 0.5% had been commonly expected and previously factored into thoughts for how monetary policy may alter.

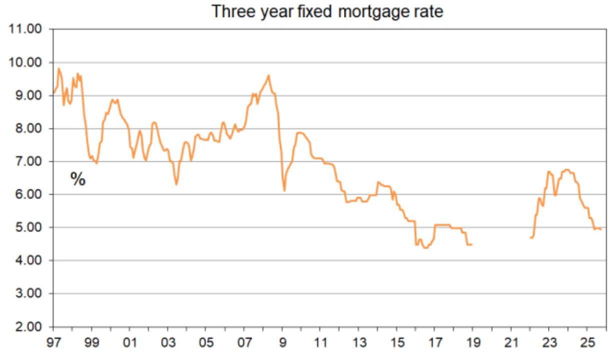
The small declines mean margins for fixed rate lending are running at above average levels and should a bank feel inclined they might make some small cuts to their fixed rates.

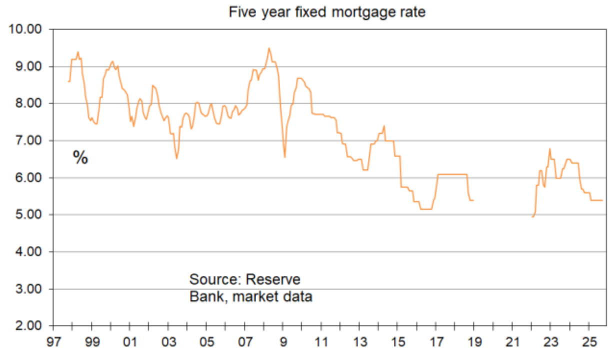
It is impossible to know if this will or will not happen, so if you have a rate to reset in the near future it will just be pure luck if your bank cuts 0.05% or 0.1% off the rate you are interested in just before you do so.

If I were borrowing at the moment, I'd be happy to fix three years but have no issue with anyone opting for a shorter term. Splitting across a couple of terms is often a good idea in order to smooth the impact of rate changes down the track.

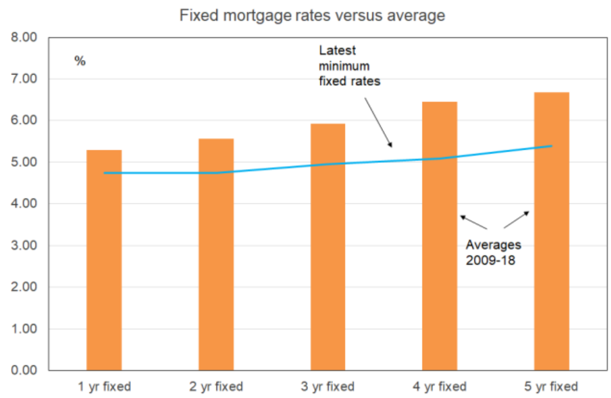
These three graphs show mortgage rates since 1997 excluding the period of deflation worries (2019) and the pandemic.







This graph shows how current rates compare with averages from 2009-18.



To see the interest rates currently charged by major lenders go to www.mortgages.co.nz

Nothing I write here or anywhere else in this publication is intended to be personal advice.

You should discuss your financing options with a professional.