TONY'S VIEW

Input to your Strategy

Thursday 10 October 2019

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My Aim

To help Kiwis make better decisions for their businesses, investments, home purchases, and people by writing about the economy in an easy to understand manner.

Not Retired

That was interesting. A lot of people thought that because I was leaving a place I'd worked at for 26 and a half years then I must be retiring. Not so. I'm simply shifting from one main employer to many and I'll still be out on the speaking circuit at conferences and seminars, and helping businesses with input to the strategic planning sessions which have become increasingly vital amidst accelerating changes in operating environments.

So, if you're looking for someone to discuss economic trends and their implications with you and your staff, or you're looking for someone to discuss investing and property in the new low interest rate environment, just get in touch.

I'll also still be writing and this will be the main vehicle for my thoughts. This new publication, "Tony's View", will probably come out each Thursday night. But don't be surprised if the odd special issue appears now and then, or a week or two get missed. If nothing worth writing about is happening then nothing will be written.

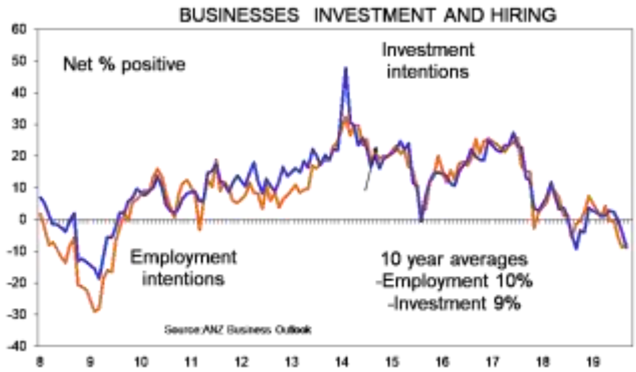
Many people suggested I charge for it and they'd be prepared to pay. I gave it some thought. But after 35 years in the banking sector, no mistresses along the way, no drug habits, and no interest in the nags, the need to maximise revenue isn't that great. So, I'm going to keep it free.

I've got a website www.tonyalexander.nz but it is just a signpost with my contact details and a place to post issues of Tony's View. If its interactive discussions you're interested in then there are plenty of other places to go on the web. You can also now find me on LinkedIn.

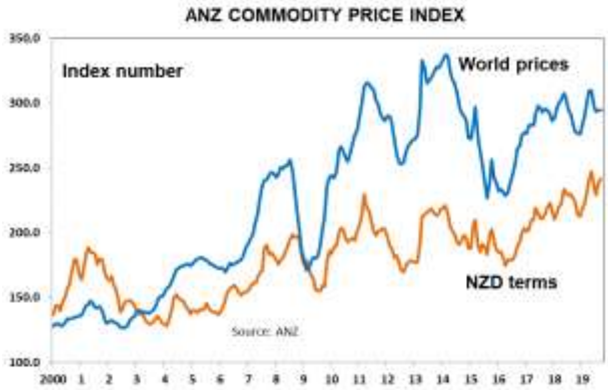
But there are things to write about at the moment, so let's have a look at some, but not all, of these key things – starting with the woe in our business sector.

The ANZ Business Outlook survey tells us that a net 54% of businesses in NZ have a bad outlook for the economy. This is the worst reading since 2008 – when we were in recession but the GFC had yet to start. A net 2% have a bad outlook for their own activity levels – the weakest outlook since early-2009.

A net 8% plan cutting staff numbers – the second worst reading since 2009 after August's -9%. And a net 9% plan cutting capital spending – also second worst since 2009.



Why the horrible readings? Is it because monetary policy is really tight and businesses are bleeding cash? No. Is the Kiwi dollar well over-valued? No. Have our commodity export prices collapsed? No.



Is the economy in recession? No. GDP (gross domestic product) rose by 0.6% in the June quarter and the March quarter and by 2.4% in the year to June. Has migration collapsed? No. The estimated net inflow was just above 50,000 in the year to July from just under 50,000 a year ago. Is there a financial collapse underway? No. Sharemarkets are volatile and look highly priced. But they continue to edge slowly higher on average.

So, what gives?

Businesses are facing a massive range of challenges which lie near outside changes in the pace of growth of the economy, or even of their own customer bases and markets.

1. Maintaining margins is near impossible in most sectors because pricing power has been lost. You and I can easily go online and find alternative suppliers of and prices for things we want to buy. Businesses facing rising costs are seeing their profits fall because they can't raise their prices.

2. Labour, whether skilled or (increasingly) unskilled is hard to find. Skilled, motivated and long-servicing employees are leaving to get what they feel they deserve elsewhere. Hiring migrants has become more difficult. Skills are becoming obsolete at a faster pace.

3. Societal and regulatory pressures are rising and rising. Concerns surround the use of plastics, pollution of water, contributions to climate change, treatment of animals, staff, and customers, health and safety requirements, butt-covering by scared local authorities. Tourism faces medium to long-term decline as eventually global warming concerns will cause people to avoid long-haul travel. Farmers face medium to long-term change but with decline dependent upon consumer acceptance of meat and dairy alternatives.

4. Change is happening at an accelerating pace. Sectors face not just ever-changing online competition, but new entrants from offshore (Ikea, Costco, Chemist Warehouse), new products, new distribution methods, new rules and so on.

Then there is a long list of other things to worry about such as the low business friendliness of the centre-left government, the prickliness and lecturing from senior politicians and office holders, warnings from banks about lending cutbacks, worrying developments offshore, etc.

Running one's business has become a lot more difficult, and this is just one of the things to undergo a structural change recently. Others include average inflation, interest rates, oil prices, house prices, migration flows, and more which I go through in planning sessions.

What can average businesses do to handle this changed operating environment? First, don't expect that this situation will radically "improve" in the near future. The difficulties you face will not be solved by any set of government policies aimed at stimulating the rate of growth in our economy. In fact, faster growth will possibly make things worse for many because of the extra shortages of labour which will ensue.

That is why I am couching discussions in this document and in my talks in terms of strategic imperatives and not simply alterations in GDP growth prospects. Having said that, should GDP growth truly plunge then this removal of the cuddly blanket which hides business inadequacies will see widespread closures.

One useful idea is to stop planning output growth until first of all securing inputs including labour and finance. Another is to rigorously examine the profitability of all products, customers, locations etc. and move away from those making losses or yielding little at all.

Also, to handle the speed of change look at strategic partnerships and collaborations.

Housing Market

There is something interesting happening in the housing markets around New Zealand at the moment. You can see it in the increasing number of advertisements being placed by businesses involved in helping people invest in real estate. These ads coincide with those for other assets growing in number offering yields which in the past many people might not have been attracted by. But now they are paying attention because not only are interest rates very low, they are expected to fall further and to stay low for a long, long time.

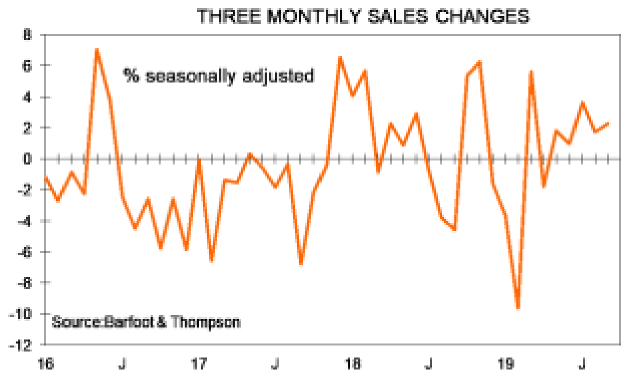
The demand for yield is stemming a flow of property investors who were selling because of pro-tenant legislation, worries about taxes, and simple banking of profits after some years of rises. People are thinking, if I sell my investment property what else can I do with the money which will give me a decent return?

In most instances the answer appears to be "nothing". So, while there may not be a wave of new investors purchasing as might be happening in Australia, those who were planning to sell may be holding on, and the traditional cyclical phase of investor buying in the regions is continuing for longer than was expected.

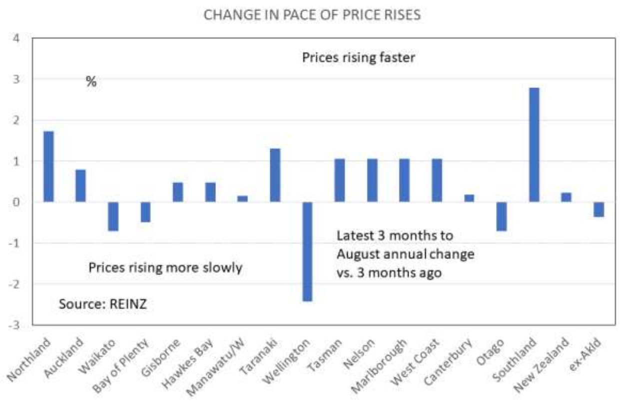
For the record and as a catch-up, let's have a run-through of some recent numbers on housing market activity.

The supply of new houses is still rising, with building consents ahead 9% in the past year, 48% above the 20-year average, and at 35,658 the highest annual total since October 1974. Since then however our population has risen from 3 million to almost 5 million and net migration flows are still adding about 50,000 extra people per annum for which are needed some 19,000 houses.

At 73,295 dwelling sales in the year to August were the lowest since 2014 and in the three months to August were down by 1% on a year ago. But seasonally adjusted sales have risen 3% with Auckland ahead 11% after a lot of weakness earlier in the year. This slight upward shift in Auckland sales can also be seen in data to September from Barfoot and Thompson.



As for prices, I use only REINZ House Price Index measures. Averaged over the three months to August prices nationwide were ahead 2% from a year earlier with Auckland down 2.7% and the rest of the country ahead 6.4%. Auckland prices now seem to have about flattened out while the rest of NZ is still rising at a pace not much out of line with the past two years.



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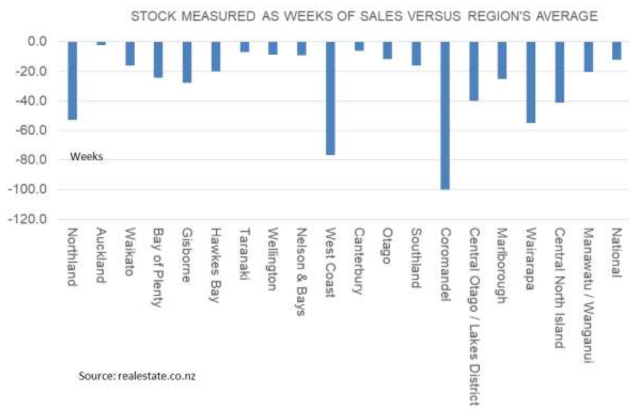
As for listings, people are increasingly tending to hold onto their properties. Measured as weeks-worth of stock Auckland sits at 21 weeks which is two weeks less than average versus four weeks more than average three months ago.



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What lies ahead? Is it likely that the trend toward lower interest rates will reverse? No. Do we think net migration inflows will much fall away? No. Is the labour market about to aggressively ease? No. Is credit for mortgages about to radically tighten up? No. Is new house supply set to radically boom? No, not with labour shortages and a net 19% of firms in ANZ's monthly survey expecting reduced house production.

Now throw in the confirmed absence of a capital gains tax, failure of KiwiBuild, seeming accelerated obsolescence of recently built houses, rising willingness of older folk to finance their younger people into houses because they can earn some tax-free interest, government infrastructure failures with anti-road bias, and probable announcement of easier LVR rules in November. Its hard to run a case that prices trend downward.

The chances are investor demand is set to strengthen slightly and prices will gain an upward bias. By how much? That is impossible to say as no model exists giving reasonable insight into likely price movements.

Interest Rates

The world is in an easing interest rates phase. But because so few countries managed to get rates higher than the levels they were cut to during the GFC debate is rife about negative interest rates, the declining effectiveness of easing monetary policies, and what to do the next time a global shock inevitably comes along.

Our central bank cut its cash rate 0.5% to 1% early in August. The Reserve Bank of Australia cut 0.25% to 0.75% early this month. The US Federal Reserve cut from 2.25% to 2% two and a half months ago and to 1.75% a month back. The European Central Bank eased also a month ago. Further rate cuts are widely predicted offshore and locally our central bank seems destined to cut further also in coming months.

Will lower rates here make much difference to either the pace of growth or inflation? No. Businesses are wary of the world around them and reluctant to invest. Many will feel increasingly worried because of the concerns signalled by the RB through their rate cuts. The same probably goes for consumers, especially as they continue to be encouraged by most people except our central bank Governor to boost savings rather than debt. Consider for instance Australia where despite three rate cuts this year the Westpac consumer confidence measure has just fallen to a four-year low of 92.8 from 98.2. And investors will be cutting spending as they reduce their forecast interest returns.

At very low interest rates monetary policy loses its effectiveness – as Japan has shown us for three decades.

Does this mean we can anticipate much easier NZ fiscal policy soon as many are clamouring for? After all, the government's (Crown's) accounts released on Tuesday were splendid – a $7.5bn surplus and net debt down at 19.2% of GDP. Maybe, but it would be a bad move.

First, there are huge lags involved in using stimulative fiscal policy to affect the pace of economic growth. By the time a government receives data showing slowing, debates what to do, implements agreed measures, and those measures then have their effect, the economy can be naturally rising anyway. Governments can end up exacerbating the magnitude of the economic cycle, not smoothing it. Worse, they can lock in spending levels which see government spending rising as a proportion of GDP.

Second, the link between changes in the pace of growth and changes in inflation has changed – that is a key reason why monetary policy effectiveness has declined. Even if easing fiscal policy boosts growth (eventually), there is no reason for believing this will much lift inflation these days.

Third, frankly, in an environment where many inefficient businesses continue to operate (assisted by low interest rates and minimal wages growth above the lowest levels), boosting productivity and average incomes requires some slashing and burning. Periods of slow growth are not bad things and may be increasingly vital now and then these days to assist resource reallocation in capacity-constrained economies.

Fourth, the economy's outlook is still reasonable even though business investment and tourism are weak. A recession is not highly probable.

But there is a general election next year so we can be near certain that the Finance Minister will boost spending in the May Budget while the Reserve Bank cuts rates and implores people to get their debt higher. Given the developing problems for NZ First, what are the chances Labour write them off and attempt to claw some middle voters next year with tax cuts – undercutting a key reason many people vote for National?

Superannuation

I took a quick look this morning at the superannuation paper put out earlier in the week by Auckland University's Susan St John and Clair Dale, two respected researchers. https://cffc-assets-prod.s3.ap-southeast-2.amazonaws.com/public/Uploads/Retirement-Income-Policy-Review/2019-RRIP/Research-docs/Who-Gets-What/Ak-Uni-RPRC-Report-Sustainability-of-NZ-Super.pdf

I did so not because I regularly follow the generally unfruitful discussions about NZ Superannuation, but because in no media article I read was there any clarity regarding the proposed 39% marginal income tax rate causing the standard married person after-tax super payment to be completely offset via extra tax at an income level of $123,000.

I bet virtually everyone reading any media article assumed that all that was being proposed was a new tax bracket of 39% after the current top rate of 33%, cutting in at some high-income level. Not so.

The paper is based upon the 39% tax rate applying to the very first dollar which any superannuitant receives. The paper's writers do eventually realise the likely pushback against their proposal and put forward a Scenario 2 (page 47) involving a 17.5% tax rate up to $15,000 then 39% above that, producing a breakeven clawback at $177,000.

But superannuitants would still pay a high 39% tax rate from only earning an extra $15,000 per annum. Scenario 3 involves a 20% tax rate up to $20,000 then 45% after that.

These proposals have zero chance of being accepted by any group representing superannuitants. Consider the reality of the situation. Interest rates on term deposits and other fixed interest assets are at record lows. Older folk will be planning to supplement their declining income by working more and working longer. Now imagine how simple it would be for anyone to get elected to Parliament next year standing on a platform of opposing old people being taxed 39% for an extra $20,000 p.a. from part-time work down at a local store while the young person standing beside them gets taxed at 10.5% up to $14,000 then 17.5%. Absurd.

Are You Seeing Something I'm Not?

Don't be afraid to flick me an email at tonyalexander5@outlook.com if you reckon I'm missing something happening in the economy, or you've got experience or insight into some of the developments underway which you'd like to share.

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