TONY'S VIEW

Input to your Strategy for Adapting to Challenges

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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.

Welcome to the first four-page edition of Tony's View. This condensed version will better suit more people than the full Tview Premium plus extras. But if you are interested in the residential property market as an investor, real estate agent, broker, builder etc., then you'll find substantially more analysis in Tview Premium and can sign up if you want using either the POLi link ($110 1-year sub.) https://transact.polipay.co.nz/paynow/sjt6520610ukq

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Or email me for my bank account number for direct debit. My Spark-hosted website is still down, but in summary the Tview Premium descriptive page there lists extra services including webinars and so on.

Let's start this week with a reminder about housing fundamentals.

Housing Markets

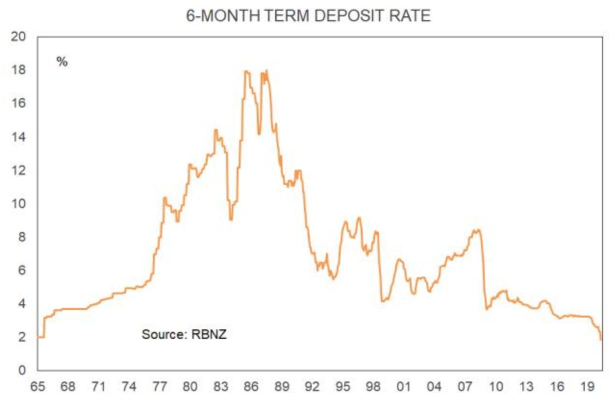
Remember the supporting factors

Some weeks the material contained here will be a selection of the longer analysis and discussion contained in Tview Premium. Other weeks it will be something bespoke. This week it's a bespoke article.

There are some important points which I've been emphasising these past three months as some commentators have presented a semi-apocalyptic view of our economy, unemployment, and the housing market. Following is yet another version of a list of most of those points, for those who might still be expecting big price falls.

Why do I still think such people are out there? Because the survey results you received yesterday from the REINZ & Tony Alexander Real Estate Survey show that 60% of agents feel investors are in the market looking for a bargain. They're probably not going to find many, and the fact that 63% of agents say investors are in the market because of low interest rates gives us our first big supporting factor.

Interest rates on mortgages and term deposits are at record lows. The benchmark six-month term deposit rate for instance now sits near 1.8% which is below the previous low of 2% in 1965. Peace, man. The 2-year fixed mortgage rate of under 2.7% compares with 9.6% at the start of the 2008-09 recession.



The Reserve Bank is printing money and the experience of countries that did this post-GFC, and the opinion of the RB, tells us that this action will push up asset prices.

House construction will fall and this will go a long way toward offsetting the slowdown in population growth due to closure of the borders.

The bulk of people losing their jobs as a result of this crisis come from the hospitality, retailing, and tourism sectors. These jobs tend to be low paying, and fluctuations in income mean many people never qualified for a home loan. So, they will not be under pressure to sell something they do not have.

Heading into the 2008 recession 4% of our workforce were people on working visas. That now stands at 8% and such visa holders have accounted for 25% of net jobs growth in New Zealand over the past ten years. These people are not property owners, but as many leave the country demand for rental property will decline.

We went into this recession with only 19,000 properties listed for sale. Going into the 2008-09 GFC that number was 58,000. Buyers in recent years have known nothing other than a shortage of stock to choose from. These frustrated buyers are now hoping that the recession will give them an opportunity to get a property at last. 50% of agents say that buyers remain concerned about a shortage of listings. 54% of agents feel buyers are worried that they might buy and then prices will fall. But they are still in the market regardless.

There are many other insulating factors I could mention related to the economy overall, including the way things are turning out better than expected and growth forecasts worldwide are tending to be revised upward in many countries. But the last point above is of some importance and worth thinking about.

There is strong awareness that prices of houses in New Zealand are high by world standards when compared with incomes. But high prices do not concern the overwhelming majority of buyers. They might worry about price falls, but they want to buy regardless because they hope that supply will appear.

But vendors are not going to be flooding the market with properties because interest rates are at record lows, (43% of owner occupiers don't have a mortgage), and why sell in uncertain times?

These and other factors do not add up to a picture or rising prices, even though my contact with real estate agents tells me that many places are selling well above expectations. I am of the opinion for the moment, that there are some people who just have to buy a property because they have already sold, and some who have to sell because they have already bought. The decreasing auction clearance rates in Australia these past two weeks give validity to the argument that what we have been seeing is tidying up of transactions which were planned but not anywhere near finalised before lockdown started.

The economic outlook we face is still challenging. After all, we have lost the international tourism sector and a fall in world GDP of a projected 5.2% this year (World Bank view) cannot leave one optimistic about prices of our primary exports in the coming year.

But at least the outlook is improving and that is enough to hopefully make people switch away from very depressing views toward acknowledging a key fundamental of our housing market. Housing gives us a stream of services over time. We gain shelter from the rain, warmth, security and a place to raise our families. But housing is also an asset traded (slowly) in an asset market. Some other asset markets have rallied very strongly since late-March in expectation of substantial support from versions of the factors listed above, and now the better than expected economic data.

If share prices can rally so far that some indexes are now at record highs, is it too far a stretch of the imagination to accept that another asset market, that for housing, would not also receive support for exactly the same reasons.

Food for thought as we approach our first Level 1 weekend and either go to, or envy those going to, one of the big sporting events over the weekend. Enjoy.

Interest Rates

Tview Premium contains detailed graphs and analysis of rate alternatives for borrowers and term depositors.

It's probably time that everyone kicked into touch thoughts that interest rates will go negative. First, some clarification. Negative interest rates refer to the Reserve Bank's official cash rate going below zero from 0.25% currently. That reduction will feed through to bank lending and deposit rates.

However, there is essentially no chance that those bank lending rates will go negative. Overseas, in countries which have had negative interest rates, lending rates remained positive. There are reasons for this and a big one is that banks are required to maintain a high proportion of their funding in retail term deposits. If rates on those deposits go too low people will place their funds into other assets such as shares and property – which is exactly what happened overseas even in countries with just very low interest rates. It is what is happening and will happen here over the coming few years of unusually low interest rates.

With extremely low rates, even if people leave their money in the bank, they are likely to shift toward short-term deposits and they don't qualify for meeting certain funding criteria our central bank requires of our banks.

Why is it very unlikely that the Reserve Bank will cut the official cash rate below 0%, or even cut it from 0.25%? Because of the evidence emerging around the world of improving economic conditions following lockdowns. The biggest of these is the US employment report for May which rather than showing an extra 8 million jobs lost revealed a net 2 million had been gained. And rather than rising from 14.7% to an expected 19%, the unemployment rate fell to 13.3%. That is still bad, but what matters is the direction of movement and the direction of movement in people's expectations for the future is toward the positive.

This will emerge soon in some improvements in consumer confidence here in New Zealand, but mainly business confidence. The next two ANZ Business Outlook monthly surveys will be extremely interesting.

The relevance of the emerging positive views is not just that sharemarkets have recovered even further, with some share prices and market indexes reaching new records. Interest rates are changing.

The benchmark United States ten-year government bond yield climbed for a while to almost 0.9% from 0.67% last week and below 0.6% a few weeks back. This is relevant to interest rates here because while short-term rates mainly reflect monetary policy settings, long-term rates get more and more influenced by US bond yields the further out you go along the yield curve.

So, this week the wholesale swap rates at which banks borrow in New Zealand in order to fund their fixed rate lending have increased.

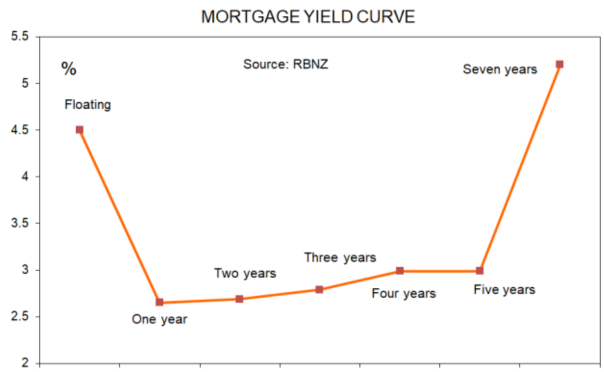
The one-year swap rate has stayed at about 0.25%, but the three-year rate has risen to 0.32% from 0.27%, and the five-year rate to 0.43% from 0.38%.

Is it likely that these rates will move higher? You have to always be careful not to over-extrapolate the most recent changes in financial asset prices. And currently it pays to remember that we are still facing a weak economic environment in our country on the ground. Our central bank will likely clamp down on any firm rises in bond yields and swap rates by lifting its buying of government bonds (printing money) in the secondary market if needs be.

Nevertheless, the developments over the past week do two things for me.

First, they make me happy with the glass half-full approach which I have taken to this downturn, as opposed to the Depression-approaching Armageddon view.

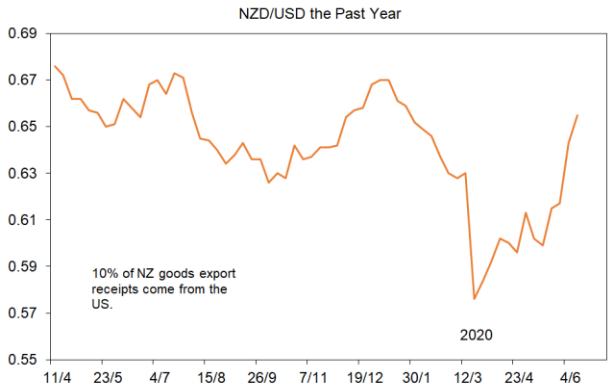
Second, if I were borrowing at the moment, I would be even more inclined to lock in for five years below 3% than grab the short-term clever feeling I would get from locking in for one or two years at 2.65% or thereabouts.



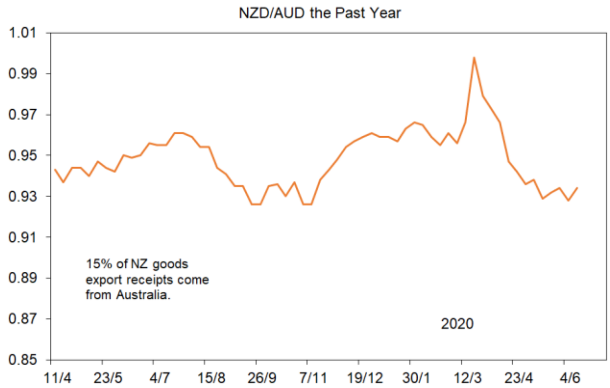
But that's just me. I am a conservative borrower (when I was borrowing), and a conservative investor also.

NZ Dollar

The Kiwi dollar is currently trading near US 65.5 cents compared with under 62 cents a fortnight ago. Why the rise? Basically, movements in our currency can reflect changes in investor perceptions of global risk. Those perceptions have improved recently in response to the surprisingly good US employment numbers released on Friday night, better than expected short-term economic and sentiment readings in numerous countries, and more and more countries easing up their lockdown restrictions.



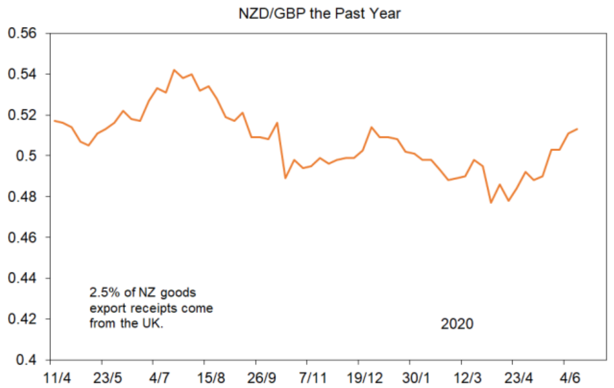
The Kiwi dollar has however also been helped by riding the coat tails of an Aussie dollar lifted by high iron ore prices caused by a surge in demand from China at the same time as Brazilian iron ore exports are compromised by Covid-19 hitting mining workforces. Note how we are not trending back up against the AUD.



The decline over March – May reflects a simple pullback from unusual parity back in March and our economy being worse affected by Covid-19 than Australia's. International tourism makes up 5.5% of NZ GDP versus about 2% in Australia, and our lockdown was more severe therefore the economic damage was and is greater.

Of interest to the many Kiwis in the UK who might be thinking about bringing forward in time their long-term plans to return to NZ, is the NZD's drift back above 50 pence. That is bad news for them, but it doesn't seem highly probable that the Kiwi dollar is now on a multi-quarter surge back up.

With the world in recession we have to anticipate some easing in export commodity prices and this traditionally places downward pressure on the NZD. Plus, sharemarkets have gone up a long way and should a correction occur this will push the NZD back down.



So, if I were an exporter looking at hedging my receipts anticipated over the coming year, I'd have a reasonable expectation of some better cover levels in coming months.

This publication is written by Tony Alexander, independent economist. You can contact me at tony@tonyalexander.nz Subscribe here https://forms.gle/qW9avCbaSiKcTnBQA