TONY'S VIEW

Input to your Strategy for Adapting to Challenges

Feel free to pass on to friends and clients wanting independent economic commentary

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To subscribe, email me…tonyalexander5@outlook.com
To enquire about having me in as a speaker, same address.

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.

Housing Market

None of the datasets relevant to the housing market which I consider truly useful were released this week. So, let's do a big macro recap of what's happened these past few years, focussing on why house prices have risen so much. Before that, let's just note that yesterday the NZ Treasury released their mid-fiscal year look at how the economy and fiscal accounts for the government are tracking and what likely lies ahead.

Included amongst their forecasts is a set of predictions that average NZ house prices will rise in the years to June as follows.

2020	4.9%
2021	6.1%
2022	6.2%
2023	5.6%
2024	4.9%

In the absence of any other information it seems valid to use these projections as a starting point when you calculate the likely return on your property investment in the next few years. But do give thought to local factors which might produce price rises above or below those shown, remembering that the Treasury numbers are averages across the entire country and not just your location. Plus, they are predictions. So be conservative and drop a couple of percentage points off per annum and run your numbers. In fact, note the uncertainty Treasury express regarding their house price forecasts.

"The past easing in house prices is unusual in the context of strong population growth, low unemployment, solid household income growth and low interest rates. These factors may cause house prices to increase more quickly than forecast and consumption may be stronger than forecast. On the other hand, house prices are high relative to incomes, household debt is at a high level and housing supply is increasing, which could result in more restrained house price inflation and consumption outcomes than forecast."

And for the record, having in earlier years criticised Treasury for being too pessimistic in their projections of net migration flows, it is good to see them finally firmly lift them. They see the net annual gain easing from the current 50,000 or so to 35,000 come the middle of 2024. That seems like a perfectly reasonable outlook which of course will contribute to a better outlook for population growth, jobs growth, tax revenue growth, and ability to support aging population costs in areas of health and pensions than was the case previously. Watch for insights into such things when Treasury release their 40 year four-yearly outlook at the end of March. I look forward to hopefully some less scary projections of the fiscal burden of the aging population. However, they will be projecting extra costs associated with global warming.

Back to why house prices have soared, and specifically, why the ratio of average house prices to average incomes jumped from "old" levels near three to at least double if not triple that in most locations. If you've been reading my housing material at virtually any stage since 2011, you'll have seen most of these factors before. But for the newbies, here we go. Note, there are other factors in play but these are the major ones in my opinion.

Lower Interest Rates

Inflation was a problem in New Zealand over the 1970s into the 1990s. Fighting it produced very high mortgage rates peaking above 20% in the late-1980s with lesser peaks above 11% in 1998 and 2008. There was a structural adjustment in average inflation downward from the very early-1990s and that produced a structural fall in borrowing costs from 1992 which opened up home ownership to a great many people.

We saw another structural adjustment downward in mortgage rates about ten years ago which initially we put down to simply the effects of the global financial crisis. But some people fairly early after the GFC saw that interest rates would be permanently lower and they shifted funds out of other assets like term deposits into housing. This year has produced a further structural adjustment and acceptance of lower interest rates as we have all seen monetary policy tightening cycles around the world flounder in the face of evidence of changes in the way firm growth and shortages of resources like labour feed through into inflation.

The structural declines in borrowing costs and alternative investment rates since 1992 have been factored into house prices.

Faster Population Growth/Higher Net Migration Inflows

I have heavily emphasised this factor since 2012 and note that a journalist who writes some good analytical pieces has nicely summed the situation up recently. He has received attention for noting that back in 2004 Statistics NZ projected that our population would reach 5 million by 2050. It has almost reached that level now.

What has changed is that following the changes in immigration rules from 1987, and development and deepening of the economy following the economic reforms of the same era, more people come here and fewer leave.

Over the ten years ending in 1988 NZ suffered an annual net migration loss on average of 16,000 people. In the ten years ending in 1998 that switched to an average annual gain of 9,000. In the ten years to 2008 that net gain rose to an average of 26,000 per annum. In the ten years to now the gain has averaged 29,000 and the actual flow in the year to October was around 55,000.

More people means more demand for houses. But as with our infrastructure, the level of construction has not kept up with the unexpected acceleration in population growth.

Double Income Households

Up until the 1970s there were few females in the workforce on a permanent, family-supporting basis. Those households in which both partners worked sustainably full-time were able to bid more for a desired property and had access to a greater level of bank funding than single-income families. Over the years the entry of more females into the workforce has boosted the proportion of households with two incomes. House prices have adjusted to reflect the structural lift in buying power, to the point where we commonly say that you need two incomes to support a mortgage these days.

Higher Construction Costs

By this we mean not just the cost of materials like wallboards, but consenting fees, inspection fees, health and safety-related costs, and developers' fees. In addition, over the years new requirements have been introduced regarding seismic strength, insulation etc. Houses these days also on average are bigger than in earlier decades, have toilets on the inside, and often have more than one of them. The average dwelling built today is not the same as the average one built in the past – though it seems to leak more and utilises less durable material in many instances.

Improved Credit Access

Some people may grumble about loan to value ratio restrictions. But the truth is that prior to deregulation of the banking sector in the mid-1980s, getting a mortgage was quite difficult and banks rationed credit according to government rules which seemed to follow an electoral cycle. The structural impact on house prices of this structural shift in credit availability ended quite some time ago however.

Save or Starve

For three decades now governments have been telling us that not only was our access to National Superannuation at risk because of worsening fiscal prospects, but that enjoyment of retirement necessitated both higher savings and ownership of a mortgage-free house. Unsurprisingly, people have reacted to the constant drumming of these messages by boosting their retirement preparations.

The problem however is that we Kiwi householders seem not to like to save. So, we have partly sought to prepare for this apparently precarious retirement by borrowing money to create housing assets.

Foreign House Buying

This effect has officially waned now since last year's ban. But internationalisation of housing markets from the 1980s brought new buyers into our cities which were not there before. More demand means higher prices.

Note that anecdotal evidence out of Australia is that foreign buyers have developed ways of getting around rules there, and maybe we will see the same eventually happen here.

Couples Divorcing

At the same time as average households have shifted from one income to two, more households have been splitting in two, requiring two houses instead of one. More recently, demographers have been noting increasing splitting of older couples in their late-50s and onward. The financial resources these people have and perhaps an aversion to becoming a flatmate, has seen one couple splitting into needing and perhaps owning two houses instead of one.

Airbnb

The shift in house use from rental or owner occupancy toward the provision of accommodation for the tourism sector has removed many thousands of houses from the pool available for Kiwis to occupy. This reduction in supply places upward pressure on prices – especially with increasingly stringent requirements being placed on landlords causing people to purposely purchase property for Airbnb use.

Foreign Students

An export education sector has developed in fits and starts over the past quarter of a century and this has logically boosted demand for housing accommodation. Construction of student units has taken resources away from construction of housing for owner occupancy.

Land Availability

Whether it be because of the restrictions imposed by the Resource Management Act, insufficient investment in transport networks, or simply organic growth, relative availability of land for housing in locations near to where people work has structurally declined in recent decades.

Housing Shortage

Not enough houses were built in Auckland from about the middle of the 2000s. Then after the global financial crisis, while our population kept growing, construction fell to the lowest levels since the 1960s with only 13,500 consents issued in 2011 versus 34,000 in 2004. Consents are now running at 37,000 but our population is almost 5 million. And Treasury noted something in their half-year outlook which I had not considered before "*The compositional shift towards higher-density dwellings, which typically take two to three times longer than houses to complete, … .*"

And it pays to note that the just announced $12bn boost to infrastructure spending will mean fewer people available to build houses. "*However, the labour market is tight and some resources will likely need to be reallocated to meet the increase in demand.*"

Too many analysts up until recently have failed to acknowledge these many structural factors relevant to the demand for and supply of housing. Their focus was on expecting NZ to follow (temporary) price collapses overseas from 2006, low rental yields versus equities yields and concluding an adjustment would come via lower house prices, adherence to old rules of sustainable house prices not relevant to the modern age, continuing to think in terms of a "brain drain" from NZ, and simply being too "victim" focussed.

That is, seeing a group of people missing out and feeling sad (young people who missed buying before prices jumped from 2011), concluding things simply have to change so that this sadness can be removed.

Auckland reached its new equilibrium factoring in all these factors and others in 2016. The rest of NZ continued apace in a lagged catch-up to the earlier Auckland surge. Auckland has now turned up again in response to new acceptance of low interest rates, confirmation of no capital gains tax, and sustained strong net migration inflows more than offsetting introduction of ring-fencing, new tenant-friendly legislation, and rising new house supply.

The regions are sustaining their strength longer than earlier thought because of low interest rates in particular. Their flattening periods will be cushioned by Auckland's new period of price rises producing expectations of another lagged regional price catch-up somewhere down the track.

Interest Rates

The general theme underlying interest rate prospects in New Zealand has shifted in recent weeks away from further declines towards a flattening of rates for an extended period of time. At this stage none of us forecasters are feeling confident or silly enough to start seriously warning about rate rises at any particular point in time – but this will happen one day.

This past week we have seen a couple of factors reinforce the ending of a period of rate declines. First, in the United States the monthly non-farm payrolls (jobs growth) report was a lot stronger than expected. Some 266,000 extra people found work whereas a rise of 180,000 had been expected. This development in conjunction with a rise in consumer sentiment means that additional US monetary policy easing is unlikely for some time following three rate cuts between August and October.

In fact, this morning the US committee charged with setting monetary policy decided to leave their funds rate unchanged at a range of 1.5% - 1.75% and for the first time in a long while not a single person on the committee voted for a signal of rates being cut again in the future. In fact, the committee indicated rate rises were likely over 2021.

Second, yesterday when releasing NZ Treasury's Half-Year Economic and Fiscal Update, the Finance Minister announced the easing of fiscal policy spoken about a couple of weeks ago at the Labour Party annual conference.

These developments add to earlier ones including signs of business sentiment improving from dire to horrible, better consumer confidence, new bank capital rules being marginally less severe than predicted, and still-rising NZ export commodity prices.

But it is much too soon to start talking about a phase of monetary policy tightening in New Zealand, though eventually we will. For your guide, Treasury yesterday forecast that monetary policy tightening will start just over two years from now early in 2022.

The way things are tracking, at this stage there is little reason for expecting any big changes in bank fixed mortgage rates over summer. However, unless someone initiates a special campaign, the chances are that come the end of summer lending rates will be slightly higher than they are now.

CHOOSING YOUR FIXED MORTGAGE RATE TERM

Again, no new minimum rates this week, but I repeat my warning that further rate declines now look fairly unlikely.

When fixing a mortgage rate term most people take whichever rate is the lowest. So, each week I shall calculate what rates would have to be in the future to make this option better than some alternatives. Note, there are far, far more alternatives than calculated here. And always remember, it is worth paying a premium for rate certainty over a longer period of time. It's also worth using a broker to get the best deal. Broker use is far higher in Australia than New Zealand but we will probably catch up.

Current minimum fixed rates across the main banks. *

1 year	3.39%
2 years	3.45%
3 years	3.89%
4 years	3.99%
5 years	3.99%

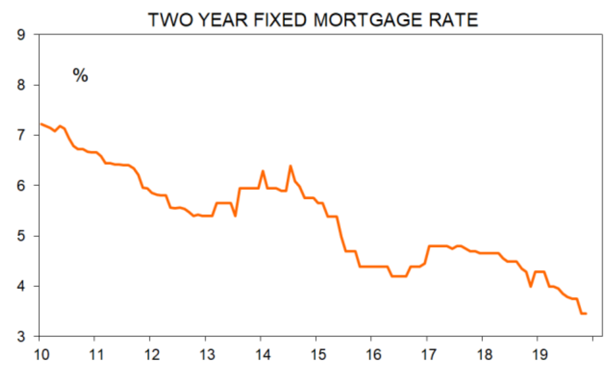
I can fix 1 year at 3.39%.

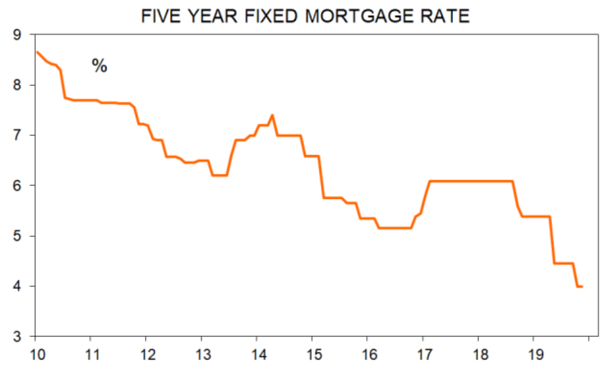
Is this better than fixing 2 years?	Yes, if in 1 year the 1-year rate is below 3.51%.
Is this better than fixing 3 years?	Yes, if in 1 year the 2-year rate is below 4.14%.
Is this better than fixing 4 years?	Yes, if in 1 year the 3-year rate is below 4.19%
Is this better than fixing 5 years?	Yes, if in 1 year the 4-year rate is below 4.14%.

If you fix one-year then you get a nice low rate. But the odds are now against further monetary policy easing, and tightening will eventually become more likely than any easing and interest rates will reflect this. Chances are in one year the one-year rate will be close to 3.51%, so if fixing two years was my preference, I'd be inclined toward that term instead of 3.39% as the cost of rate certainty looks quite cheap.

The odds that the two-year rate in one year will be below 4.14% look fairly good, so if three years was my preferred term, then taking the low one-year rate might be okay. But it is very easy to imagine that one year from now the three- and four-year rates will be higher than 4.19% and 4.14% respectively. So, if fixing for beyond three years was my goal, I'd be taking a gamble by fixing just one year now and personally would be inclined to take the current longer-term rate. Maybe this is as low as rates get outside of a recession situation. One might think about locking in for as long as possible.

*Minimum 20% deposit, owner occupiers.
Compounding is minor so is ignored.

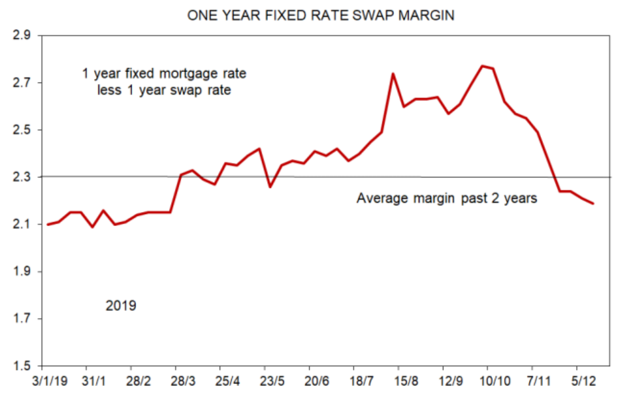


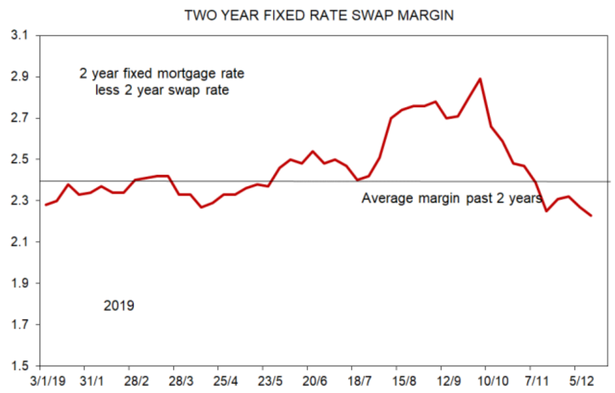


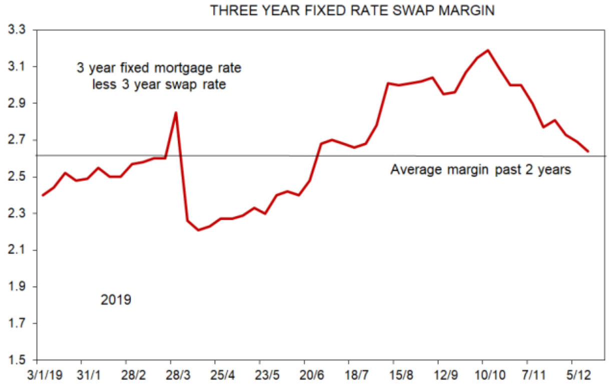
IS A FIXED RATE CHANGE IMMINENT?

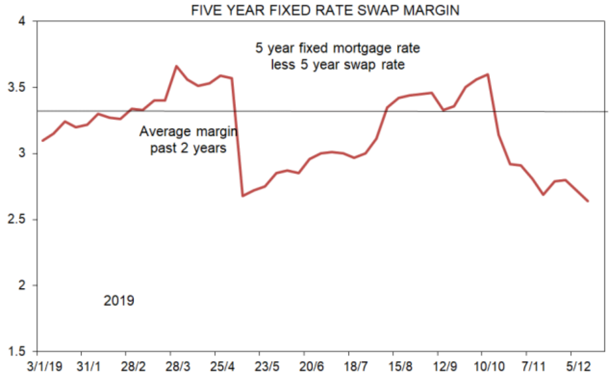
Margins have fallen a little bit further across all terms this week, lessening again the chances that any additional cuts will be made to fixed mortgage rates. Note how unusually low the five-year rate is.

You can form your own opinion as to whether banks might be about to raise or lower their fixed rates by looking at the following graphs. They compare published fixed rates with the most frequently changing component of the total cost of funds – the swap rate. Note that there are other funding costs which will not be captured here, but they change infrequently. But be warned. There is no real forecasting insight delivered by a thing (equity, exchange rate etc.) moving further from some concept of fair value or average. If a thing is 10% above trend, it might simply be on its way to being 40% above trend. For good bank rate comparisons access www.interest.co.nz









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.

Online - It's A Family Thing

For your guide, in my family it is not just myself communicating and informing people principally online and working from home.

My wife Dr Sarah Alexander manages the network of early education and care services around the country (www.ChildForum.com) and the website for parent ratings and reviews of children's services (www.myece.org.nz).

My daughter Lilia Alexander (finalist in the Youth category for Wellingtonian of the Year 2019) owns and runs Social Media based Wellington – LIVE (160,000 followers) https://www.facebook.com/WellingtonLIVENZ/ *"…the largest go-to social media-based updates and news platform for the Wellington region…"* Wellington – LIVE offers advertising options for local events and businesses. Email: info@wellington.live

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DETAILED GRAPHS ENLARGED

None this week.