TONY'S VIEW

Input to your Strategy for Adapting to Challenges

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

ISSN: 2703-2825 Thursday 13 February 2020

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.

Employer Problem

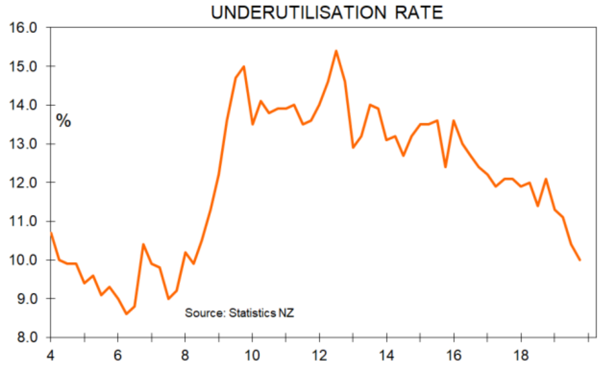
This week I'm going to take a look at the labour market data which were released last week, because it will allow me to make some comments on how businesses could best react to the virus outbreak, along with some of the long-term trends underway.

The tightening up of our labour market in favour of employees and to the cost of businesses is one of the key developments I've been highlighting in recent years. The development is not New Zealand-specific. You will find that things like an increasing mismatch between skills sought and skills offered, quantity sought and quantity offered, occur in all developed economies.

Officially around the world, if you're comparing the state of health of labour markets then you'll be looking firstly at unemployment rates, then probably employment growth. After that you'll examine a big mish-mash of full-time versus part-time jobs, sectoral growth etc.

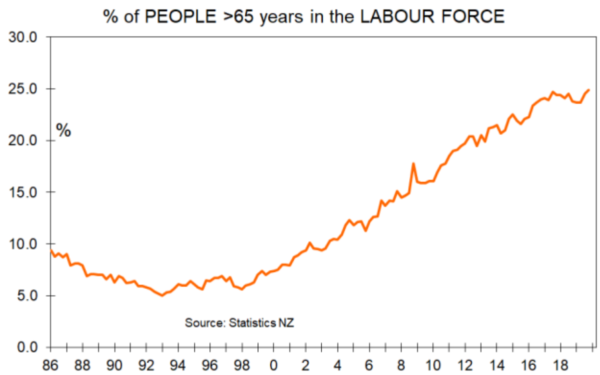
But if you are an employer looking for insight into staff availability you want to look beyond the unemployment rate to things such as the Underutilisation Rate. This measures the proportion of the working age population) over 15 years old) who are officially defined as unemployed, plus those working part-time who want more hours, those available to work but not actively looking, and those looking but who can't start for at least a month.

This measure has fallen to a 12-year low of 10% from 12.1% at the end of 2018.



Things have almost become as tight as they were back in 2008 as the economy was entering recession – to then be hit by the GFC just when we looked like improving. But in contemplating labour market conditions facing employers in coming years, things are worse.

For a start, employers have already taken advantage of the increasing pool of older people able and willing to remain in the workforce. The proportion of these people in work or looking for work has risen from 6% in 1998 and 14.5% in 2008 to a record 24.9% now. It doesn't matter whether you believe this change is due to personal financial circumstances, health, social engagement or whatever. The problem for businesses is that this pool might not be able to be tapped all that much more.



Another problem for employers is that the speed with which operating environments change now is the fastest we've ever seen. There is more pressure to modernise virtually everything on a continual basis, including staff knowledge and skills. Buying in the skills one newly needs is increasingly difficult.

A third problem is that the cost of housing is much more than 12 years back, transportation systems are generally more clogged, so the pool of potential staff one can access is probably smaller. That is, high commuting times from more affordable, distant, suburbs will dissuade some potential staff from applying for a new position.

Fourth, the government is slowly tightening up the ability of businesses to source staff from overseas.

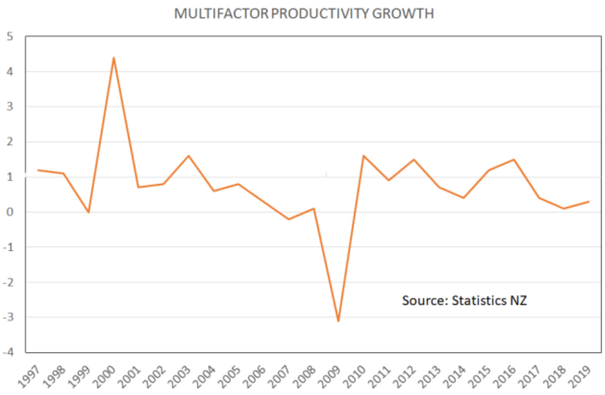
Fifth, back in 2008 when the underutilisation rate was last this low, the working age population had grown by only 2.1%. In the past two years it has grown by 3.6%. Things are this tight even after strong staff supply growth.

Sixth – well this is where it gets interesting. Back in 2008 the effects of our recession then the GFC saw labour market conditions radically change in favour of employers. The underutilisation rate rose to 15% from less than 10% in a year and a half following the mid-2008 low.

Even allowing for our economy losing over 0.5% growth as a result of the coronavirus effects, a quick easing of staffing pressure on NZ employers is very unlikely.

The pressure is on to boost labour-saving capital spending. But following a bout of high pessimism over 2018-19 and now worries about the coronavirus, businesses are gun-shy. Productivity boosting investment is not happening to sufficient degree. But the payoff for businesses who do undertake such investment could be large in terms of being able to deliver good product on time in an environment where increasingly their investment-shy competitors will struggle.

Earlier today, by coincidence, Statistics NZ released their annual productivity growth calculations. Since 1997 on average total productivity in NZ has grown by 0.8% per annum. It improved only 0.3% in the year to March 2019. Worse, the improvement was zero the year before and 0.4% in the year to March 2017. Productivity growth has almost stalled.



The economy however grew above the 2.8% long-term average in each of the past three years, in fact by 3.5% in the year to March 2019. This strong growth was only made possible by well above average growth in labour inputs – strong jobs growth.

On average since 1997 job numbers have risen 0.8% a year. Growth in the last three years has been 1.8% then 1.3% then 1.7% this past year. These growth rates are well above average – not so for the capital stock. Growth there has averaged 1.3% per annum since 1997 but was only marginally above that in the past three years – 1.4% then 1.7% then 1.5%.

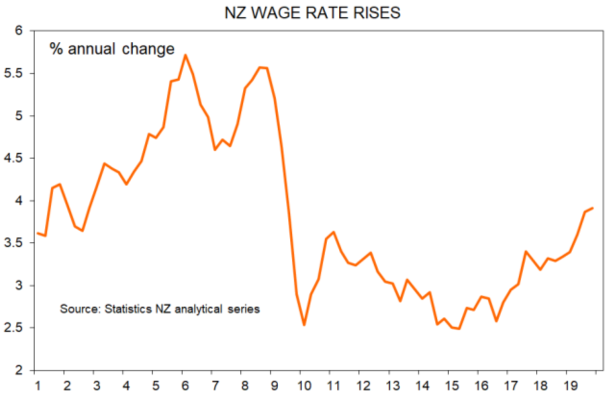
In the absence of an investment surge, as labour force growth inevitably slows down, our growth rate has to consolidate lower.

Wages Growth

Many people make the comment that there has been no wages growth in New Zealand. This is not correct.

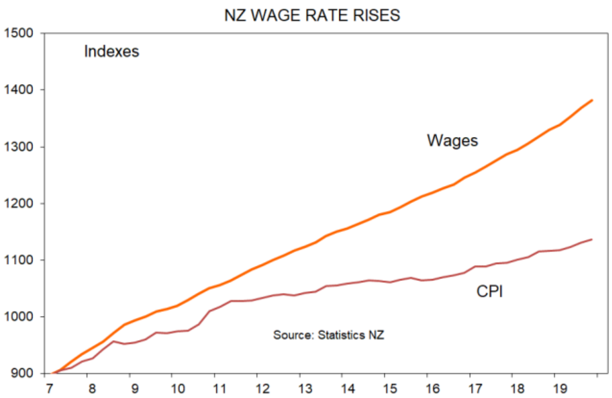
Since just before the GFC the cost of living for the average consumer in New Zealand, as represented by the Consumer Price Index, has gone up by 27%. And before anyone jumps in and says the CPI does not capture the mortgage cost of buying a house – true. But that cost has gone down courtesy of plummeting interest rates.

How much have wages moved over this 12-year period? The measure I pay attention to which tracks pay rates for the same positions over time has risen by 48%. That means a real wage rise of 21%.



A measure commonly quoted in the media focussing on ordinary-time hourly earnings has risen by 40%, giving a real wage rise of 13%. Or you could focus on average weekly earnings which have risen by 44%, or 16% in inflation-adjusted/real terms.

This following graph shows the rising index for my preferred wages measure alongside the CPI.



And for your guide, my preferred wages growth measure increased by 3.9% in 2019 after rising 3.3% in 2018 and 2017, and 2.8% in 2016. Growth is the highest since early-2009.

Turning briefly to the effects on our economy of the coronavirus – we don't know and all we're doing is making guesses which are getting more worrying each week. It largely depends upon how long it takes for the Chinese economy to get back to normal, for quarantining of cities and people to end. They don't know, we don't know.

But as each day goes by the global supply chain gets more and more affected in terms of components not being available for factories to use outside of the quarantine zones in China. You will already be reading articles warning of interruptions in the supply of consumer goods to NZ stores. If you've ordered something online from China the Tracking link may show it ready for pickup from the factory – but no-one can pick it up.

We can't even guess as to the economic effects of these supply chain and product delivery interruptions.

We can already see in NZ the dumping of seafood, logging gangs being placed on furlough, international prices falling for dairy products. Hard commodity prices are falling offshore and production of iron ore, coal, and LNG is getting slowed down in Australia as Chinese buyers exercise force majeure clauses. NZ universities are making estimates of the loss of revenue from Chinese students not being able to attend. Inflows of Chinese visitors to NZ have of course stopped. Many small and large businesses geared toward serving visitors will be affected all around the country.

Basically, there's noting but downside for our economy as long as the quarantines are running and then for some time afterward. At some stage there will be a period of catch-up in economic growth in some, but not all, sectors. But we cannot reasonably as yet pick when this spurt in growth will come, if it does come.

Businesses would be best advised to take things very cautiously at this stage. For some of course the slowdown in certain sectors like tourism will present an opportunity to acquire staff.

Here's hoping things start improving in China soon.

Housing Market

I was sent a link to an article yesterday in which the author claimed that there is no housing shortage in New Zealand. He based his view on the household occupancy rate (average number of people in an occupied house) falling from 3.29 in 1986 to 2.87 in 2013. If people were cramming in then surely this rate would be rising?

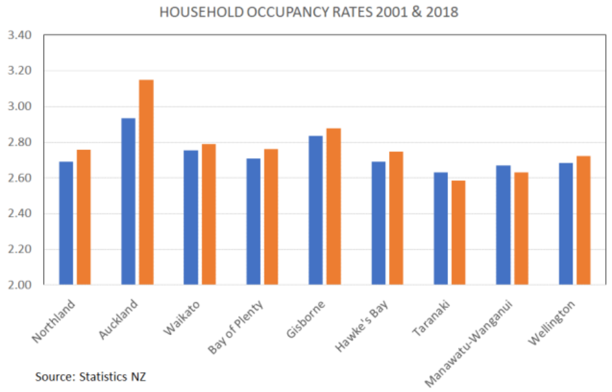
There are two problems with the interpretation you are being invited to take from the article. First, up until at the most three years ago, no-one spoke of a housing shortage in New Zealand anywhere other than Auckland. NZ-wide data are pointless in this context.

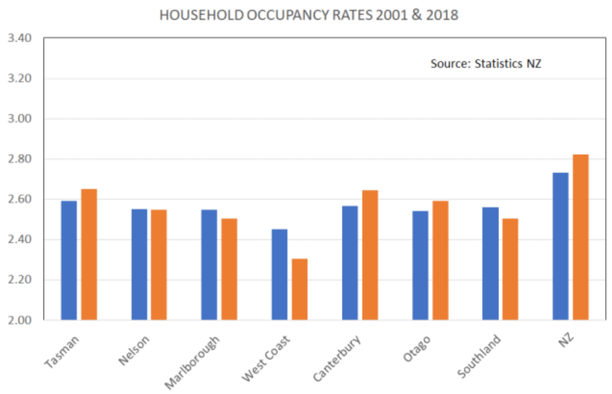
Second, the Auckland occupancy rate has in fact risen from 2.94 in 2001 to 2.98 in 2006, 3.0 in 2013 and 3.15 in 2018. It was 3.0 in 1996 so this gives us insight into how the shortage started appearing from the early to mid-2000s.

My interpretation of such analysis is this – not relevant. As I have tried to point out since 2008, there is a huge range of factors which influence house prices and many of them have long been moving in the direction of pushing prices higher. Dwelling supply is only one factor and it certainly gives zero insight into where house prices will go if at the same time one might see a surge in construction, but the costs double, and/or investor demand soars, and/or interest rates fall a lot etc.

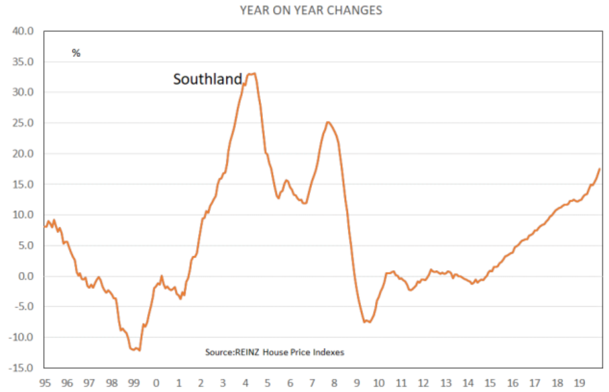
Here is a link to a 2017 article from Infometrics where they appear to have made their own calculations of occupancy rates between the censuses.
https://www.infometrics.co.nz/people-per-household-mean-construction-trends/

Here are a couple of graphs I put together showing occupancy rates for each NZ region in 2001 in blue then 2018 in orange. Occupancy rates have risen everywhere except Taranaki, Manawatu-Wanganui, Nelson, Marlborough, West Coast and Southland.

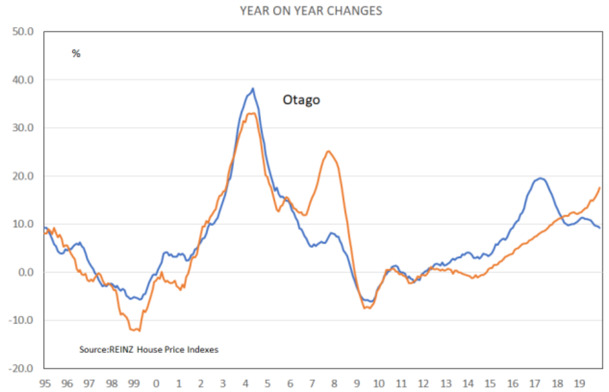




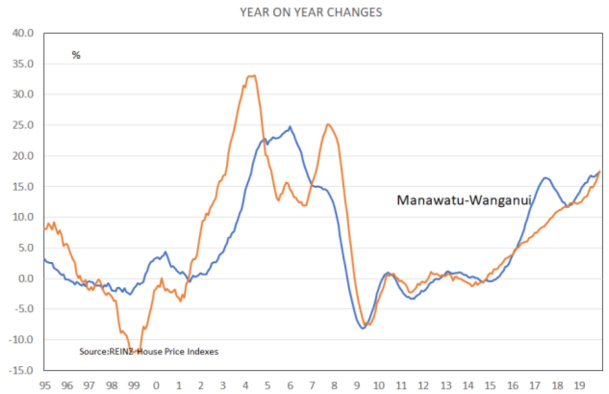
I'm toying with price data and graphs at the moment. This graph shows full year on full year changes in Southland region average house prices since 1995.



Ever wondered with which region these changes are most closely correlated? I have two answers. Over the long-term Otago.



But look at the divergence since 2017. Otago is the blue line. Only one other part of the country shows a similar continuing rise as Southland (almost) from 2015 – Manawatu-Wanganui.



Interest Rates – Will They Rise or Fall?

My view = Only down if coronavirus effects get a lot worse.

Were it not for the coronavirus my expectation for monetary policy and interest rates generally would be flat with upside risk next year more so than this year. This is because most of the data releases we have been receiving in recent weeks have been on the good side – meaning little chance the Reserve Bank would feel that things are slowing and they need to inject more stimulus.

Some of these positive things include the following.

- In their last set of forecasts before yesterday the RB estimated our economy grew only 0.3% in the September quarter. It actually grew 0.7%.
- They calculated inflation in calendar 2019 to be 1.6%. It turned out to be 1.9%.
- The RB predicted average house prices would rise about 1.8% during the December quarter. They instead jumped near 3.4%.
- Business confidence has turned up quite strongly while consumer sentiment has also improved a bit.
- Dwelling consents continue to grow firmly.
- Export prices have been strong.

Countering these things however we have the following.

- The NZ dollar is tracking slightly higher than the RB allowed for.
- Drought conditions are affecting agricultural production in Northland and some other parts of eastern New Zealand.
- Coronavirus is causing immediate growth forecasts to be slashed first of all in China then in countries highly dependent upon exports to China – like New Zealand and Australia. Next will be downward revision to countries heavily dependent upon oil (prices have fallen away), though these economies were being hit already anyway. Next will be manufacturing-dependent economies unable to keep some factories open because of missing parts caused by factory downtimes in China – the world's supplier of manufacturing componentry.

Yesterday the Reserve Bank released their regular set of forecasts about the economy, announced whether they will immediately change the official cash rate or not, and let us know whether they think they are more likely to raise or lower rates in the future.

As was universally expected, they left the official cash rate at 1.0%. That means no changes in floating mortgage rates. But they did remove a hint of an interest rate cut in their earlier forecasts – meaning they no longer have a bias toward cutting rates again.

That makes sense based on the data noted just above and their own good outlook. They see the unemployment rate staying at 4.1%, and the economy growing 2.9% in the coming year. After that 2.6% then 2.0%.

They noted the virus risks and said they stand ready to act, but that at this stage no action is warranted. Like us they will wait and see what happens over the next few weeks. That makes sense.

So, what are we left with for anyone looking at their immediate interest rate costs? No change in floating rates for maybe all this year then creeping up over 2021-22. Fixed rates? In the short-term some risk of declines only if the virus effects worsen. But once that effect gets stripped out one day rates are more likely to rise than fall. Timing? Ask the virus.

CHOOSING YOUR FIXED MORTGAGE RATE TERM

Minimum rates are unchanged this week.

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	3.55%
3 years	3.89%
4 years	3.99%
5 years	4.09%

I can fix 1 year at 3.39%.

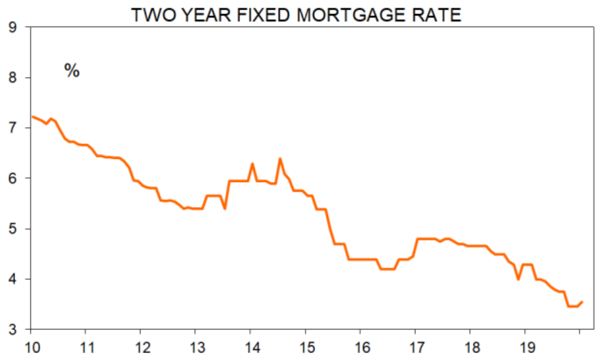
Is this better than fixing 2 years?	Yes, if in 1 year the 1-year rate is below 3.71%.
Is this better than fixing 3 years?	Yes, if in 1 year the 2-year rate is below 4.14%.
Is this better than fixing 4 years?	Yes, if in 1 year the 3-year rate is below 4.19%
Is this better than fixing 5 years?	Yes, if in 1 year the 4-year rate is below 4.14%.

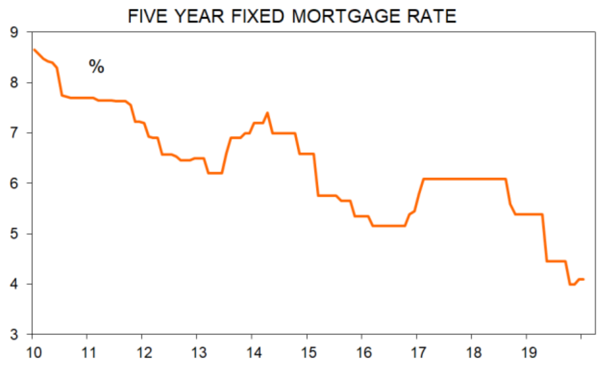
Given virus risks the chances are not high that in one year the one-year fixed rate will be above 3.71%. Therefore, if I am only choosing between fixing two years or rolling over a one-year fixed I now find myself preferring to fix just the one year. This is a change from previously preferring the 3.55% two-year rate.

What about if my inclination is toward fixing three years? Is it worth paying 3.89% the coming year rather than 3.39%? Not for me. Do I think that a year from now the two-year rate (to complete a three-year period) will be above 4.14% versus the current 3.55%? No.

All up, personally speaking, I feel the cost of rate security contained in the fixed mortgage rates for two years and beyond is currently too high when considering downside risks to growth, inflation, and monetary policies from the coronavirus outbreak. Much as it pains me to say so as a conservative borrower who likes rate certainty, I'd probably fix one year at the moment if I were taking out a new mortgage or rolling off an existing rate.

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

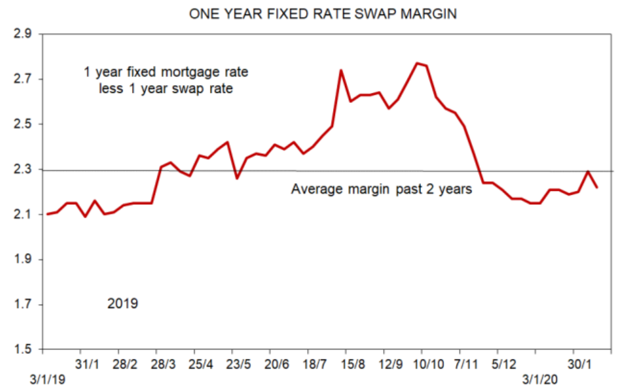


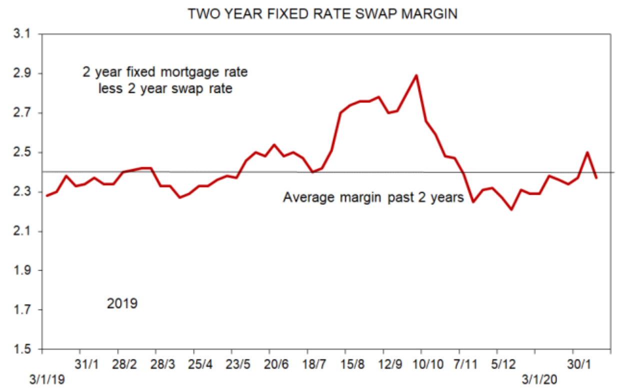


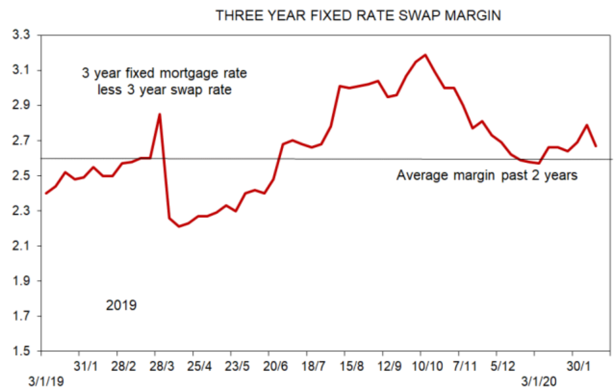
IS A FIXED RATE CHANGE IMMINENT?

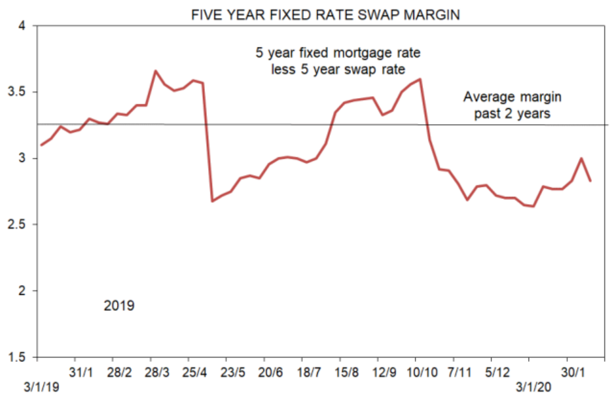
Markets are now factoring in less of an economic hit and potential monetary policy easing than over the past 2-3 weeks. Swap rates have risen, margins have compressed again, and chances of fixed rate cuts are low now.

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.

CHILD FORUM

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).

WL

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

This publication is written by Tony Alexander, independent economist. You can contact me via LinkedIn or email tonyalexander5@outlook.com

DETAILED GRAPHS ENLARGED

None this week.