TONY'S VIEW

Input to your Strategy for Adapting to Challenges

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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.

Baby Boomers versus Millennials

For this week's TV I had two attempts at writing an article on the renewed discussion regarding Baby Boomers versus Millennials. Neither article satisfied me and I think the reason is this – both simply came down to discussing pointless moaning by one group over how the other is better off in terms of wealth, and the other group saying little different from what every generation in the past has said about the one following it.

I tried to fashion something interesting by noting Baby Boomers are currently aged 55-73 and Millennials 23-38 but got nothing useful. I tried listing the many things Millennials have today which BBs did not in their first three decades after birth from 1945-64. The list makes for interesting reading but such lists have been made for centuries between generations, and only socialist nations have any record of success in equalising things by pushing new generations back to the lower material, health and educational wellbeing of previous generations!

Both groups have it good in their own way. One has housing wealth to help fund a retirement which governments have told them for three decades is at financial risk. They have had the bejeebers deliberately scared out of them and have naturally reacted by building assets. Retirement Commissioners are still doing this. And house price asset growth has been assisted by policy changes from the late-1980s opening New Zealand to more migrants and driving population growth at a fast pace no-one imagined would occur. The structural collapses in interest rates courtesy of two big changes in inflation and inflation dynamics from 1992 and post-GFC account for much of the rest of the repricing job, with help from regulations and building costs escalating.

The other group has a lifetime of modern medicine, personal freedoms, travel, technology, longer life span etc. not enjoyed in early years by the Boomers.

But say you listed all the differences, somehow added them up, and concluded that ultimately Group A was better off than Group B. So what? No government wanting re-election will seriously consider trying to balance the intergenerational books by penalising A to benefit B. Such rebalancing between groups does occur through income differentials via the tax system. But it is primarily aimed at assisting those currently left behind in the opportunity stakes in some regard, not wealth relativities – thank goodness.

Nothing of concrete import will come out of the BB versus Millennials debate – Phil Twyford showed us that directly on housing supply, and so did the PM with quick rejection of vote-losing tax reforms.

Nevertheless, I find myself falling squarely on the side of the millennials in the housing debate. Interest rates are almost absurdly low, but the debt which young people have to take on in order to purchase a house is eye-wateringly high. Their vulnerability to job loss is strong. And what is one of the key things which we have learnt over the past few decades? Periods of job loss do come along. We can't predict when and we don't ever know how severe any downturn will be – though we economists make a good job of pretending we do.

Young people making their first purchase often have to buy much further away from work than we ever did. And unusually strong population growth courtesy of high net immigration in recent years has produced traffic congestion which we never experienced in the 1960s – 2000s.

The housing experience of millennials is going to be different from the housing experience of the Baby Boomers and the inbetweeners asked to look out for both groups – their aging parents and their offspring. The sandwich generation no-one much talks about.

As for global warming – a quick message here to the millennials. You know how you voice concern at the warming associated with the past few decades? Well that warming has been driven by two things principally. One is the lift in incomes in poor countries which has seen China for instance now account for 30% of global emissions from very, very little before 1978. Will you be going to Beijing to protest their emissions? So long and dibs on your stuff if you do.

Second, population growth has lifted emissions. Where has that population come from? You being born.

All generations are responsible for global warming in some way, and until people shift their protests away from demanding other people do something about it to doing something themselves, little will change. The planet is going to warm up. Australia will dry out and increasingly burn up as will some other parts of the world. Sea levels will rise and land and property will be lost to inundation events. Before that happens the removal of insurance for such locations will see relevant asset prices fall. If I were an investor or owner occupier, I would pay close attention to the increasing number of reports discussing the areas of NZ which will suffer most as inundation risk increases.

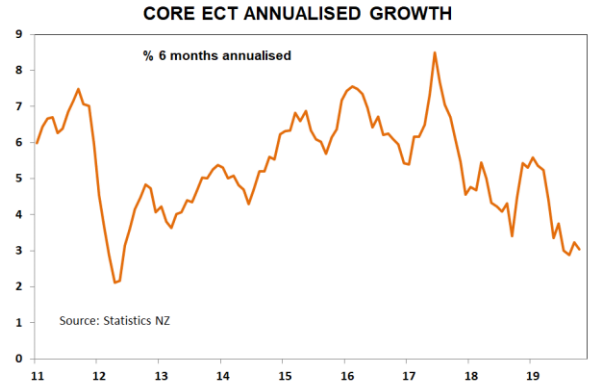
At some stage accelerated action to combat more obvious widespread and increasingly personal effects of climate change will see long-haul travel to and from New Zealand fall away. This will one day have an impact on the share prices of businesses involved in the tourism sector. Nothing however tells us when this price adjustment will occur.

Four-Year Slowing of Retail Spending Growth

Fresh economic data for NZ have been a bit thin on the ground this week. We learnt that the value of electronic transactions to buy core retail goods and services in seasonally adjusted terms fell 0.6% in October. A monthly move is fairly meaningless and it is best to smooth over three months. Doing that we see that core retail spending by you and I grew at an annualised pace of 6.4% in the three months to October from only 0.5% three months ago.

Even smoothed over three months this data series still goes all over the place and can't at all be considered a reliable guide to short-term changes in the pace of retail spending growth. Perhaps the best measure comes if we average over 6 months.

Doing that we get annualised growth of 3% from 4.4% six months back, 4.5% a year ago, and 5% 18 months ago. The pace of growth in retail spending has slowed down and as yet you couldn't say that the slowdown is over. But if things do slow further then it might not be by all that much.



I say this because growth in spending on durable goods (things which last a long time and which we tend to delay buying if unhappy with our financial futures), was a firm 7.7% annualised in the October quarter. Growth was 5.6% three months ago.

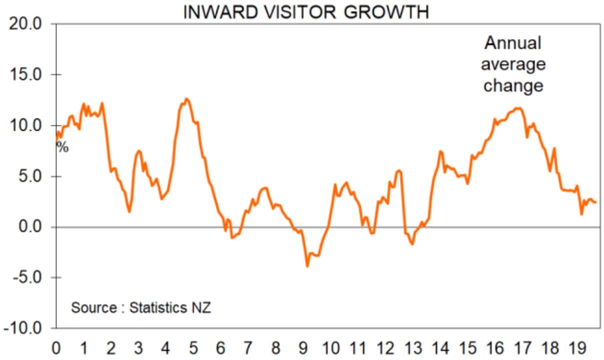
Retailing conditions are tough for many operators out there, and if the slowdown from 1-2 years ago is an issue for you, best change something because there is no reason for believing that consumers are going to suddenly soon throw their wallets open again as was happening from 2014-18.

Tourism Slowdown

Another piece of economic data this week came in the form of the monthly migration and tourism numbers. Let's start with the latter and discuss the migration numbers in the Housing section below.

In the year to September the number of people visiting New Zealand grew by 2.5% after rising 3.6% one year ago, 8.6% two years back, 11.4%

three years in the past, and 8.5% four years ago in the year to September 2015.



Has this slowing in visitor growth been spread evenly across all source regions? No. In the September year the number of people visiting from China fell by 9% (Asia overall down 5.1%) and from Europe 0.4%. But numbers were ahead 3.8% from Australia, and 4.8% from the Americas.

Maybe we have been just a flash in the pan for the Chinese travel market and they have moved onto other markets. The European easing is interesting however. For now, I would put that down to weak European economic growth. But if "flight strike" becomes a thing then it is from Europe that we are likely to see the first weakness in travel here showing through.

This is the biggest threat to our travel industry – consumers reacting to global warming by choosing to change what they do rather than demanding change in what others do.

Housing Market

If you are looking at taking out a mortgage or thinking about locking in a new fixed rate with potentially a different provider, do what most people do these days and use a mortgage broker.

There has always been a compelling reason for doing this in terms of making sure you could get the best rate which banks would have on offer. But now there is an extra imperative along the same lines but stronger.

Interest rates available to investors are much lower than they have become used to and people are seeking extra yield. For some that means perhaps seeking out a syndicated commercial property. For others it may mean placing funds with one of the mortgage trusts on offer. These are organisations which gather money from investors and lend it out to borrowers.

The rates available to investors are higher than simple bank term deposits, and chatting with one such provider ahead of speaking at a brokers' conference last week it is clear that fund inflows have trended up quite firmly in recent times.

These funds are not going to be as burdened by new capital rules likely to be put in place by the Reserve Bank in coming years as banks will be. So, their relative ability to lend in particular to investors currently struggling to get funding will rise from here on out.

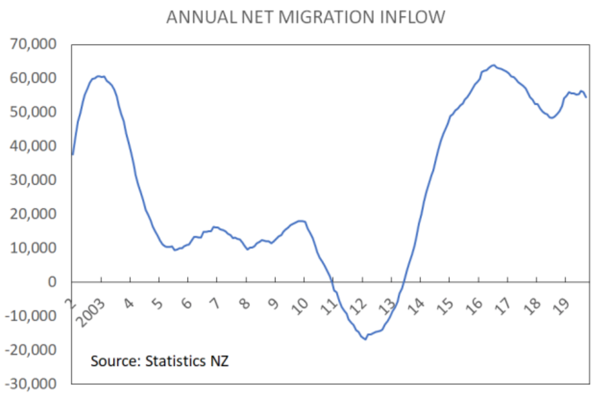
In fact, feedback from emailers this week indicates that last week's comment from a TV reader regarding LVRs not being a barrier to borrowing but debt servicing and debt-to-income becoming more binding were deemed accurate. This tightening up generally by banks of lending to investors (undertaken 2-3 years back) is one reason why it would not be reasonable to expect the current slight recovery in Auckland's housing market to spark anything approaching the doubling of prices which occurred from 2011-16. But it is reason to seek non-bank sources of home financing.

Why are Auckland prices rising anew?

- Interest rates have fallen, may fall slightly further, and are widely expected to remain low for years.
- The absence of a capital gains tax was confirmed earlier this year.
- Continuing strong net migration inflows

Plus, anyone commuting in Auckland will be able to attest to the continued inadequate functioning of the transport network. People are going to continue to want to live as close as possible to their place of work because of the inadequacies of the public and roading transport networks. The pointless light rail discussion and debacle can make no-one confident that congestion reduction is imminent. And how much roading and city public transport funding will be lost to the big project of shifting Auckland's port if that is to happen?

And speaking of net migration inflows above, we got the September estimated data from Statistics NZ this week. Their modelling (subject to change) suggests that in the past year we enjoyed a net migration gain to our population of around 55,000 people compared with 50,000 one year ago and 56,000 two years back.



These net flows are continuing to hold up at firm levels and provide an ongoing population boost of about 1.1% a year. We need around an extra 20,500 houses to be built each year just to house these extra people. Add in a Reserve Bank estimate that up to 13,000 houses need to be built each year to replace old ones and we can see that with annual dwelling consents running at 36,500, probably zero dent is being made in the housing shortage. The shortage is in fact probably still growing and that means rising average prices, especially considering rising household incomes and total construction costs.

Next week I'll be able to look at the monthly REINZ numbers to gain insight into whether Auckland's new, seemingly investor-driven, upturn is gaining momentum, and look for signs of any slowdown in the regions.

But just a quick note on housing turnover. Since 1993 the average annual level of sales by licensed real estate agents in New Zealand has been 81,000. The most recent total is just below 74,000.

Should agents, mortgage brokers, and bankers get happy thinking that we are about to move into an above-average period of turnover. I urge caution for a number of reasons.

- The regions are due to slow down and would have by now were it not for the extra easing of monetary policy and adjustment in people's interest rate expectations.
- The pace of growth in our economy and jobs market has structurally slowed down because of resource shortages.
- People already holding property are going to be less inclined to sell it than in the past for at least two reasons. First, they restart the five-year brightline clock if they sell then buy again as an investor. Second, investors are all asking themselves what else has potential to give them the returns possible on residential property in such a sustained low interest rate environment.

Interest Rates

This week the Reserve Bank reviewed their official cash rate which they last cut by a surprisingly large 0.5% to 1.0%. This time they defied market expectations for another cut and left it at 1%. While they noted the slowing in business investment and consumer spending growth, they also noted accelerating wages growth, the good terms of trade, and the stimulus from a lower NZ dollar.

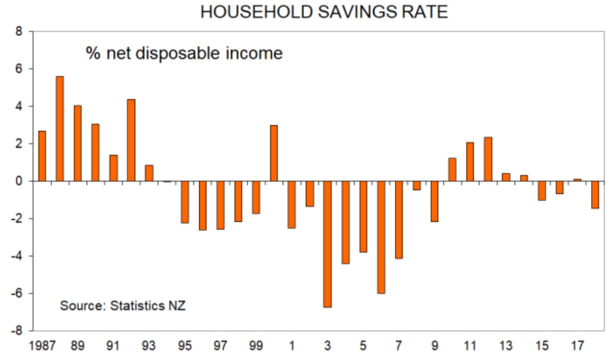
But perhaps they have been influenced by the points noted below regarding central banks starting to change their thinking about the usefulness of cutting already very low cash rates, and the need for NZ banks to maintain attractive term deposit rates. To whit, the section below written a couple of days before the OCR review yesterday.

Term Deposit Rates

How low might term deposit rates go? In Australia the 0.75% cash rate has produced an average six-month term deposit rate near 1.2%. Can we expect the same in New Zealand and therefore should you be rushing to the bank right now to lock in current rates above 2%? Not necessarily.

There is a key vulnerability of the New Zealand banking system. It is not bad lending facilitated by syndication of loans (bundling loans up and selling them to yield-hungry investors as in the United States pre-GFC). It is high reliance upon funding by people offshore.

We Kiwis seem to have a short time horizon with regard to our planning – and that means we save little and spend when we can. The household savings rate only got briefly to 2.3% in 2012 following the scare of the GFC, from -6% in 2006. It is -1.4% according to the latest statistics.



Ahead of the GFC we saw a lending boom in New Zealand. Household debt grew by 64% in the five years to 2003 then 74% in the five years to 2008. Banks funded this surge in lending by raising funds offshore, to the point where ahead of the GFC over 40% of bank funding was from foreigners. (Note that in the five years to 2014 household debt rose by just 17% and in the most recent five years it has grown 38% which is not much more than nominal GDP growth of 28%.)

When the GFC came along investors offshore wanted their money close to home so banks struggled to raise new money and to refinance maturing loans they had already taken out in earlier years. That is where our central bank stepped in to ensure liquidity was (temporarily) available.

Since then banks have boosted domestic retail funding and shifted offshore funding to longer terms, and the last time I saw a reference by the Reserve Bank to offshore funding the percentage was down around 20%. The data can no longer be easily found.

But this is a vulnerability which is still very high, and that probably is one reason why our central bank wants NZ banks to hold more capital – and we will find out how much over what time period early next month – December 6 I believe.

NZ banks need high levels of retail term deposits and that is why our term deposit rates sit far above Australia rates. Recall that with a 0.75% cash rate Australia's six-month deposit rates are near 1.2%. In NZ with a 1% cash rate the average six-month term deposit rate is about 2.7%.

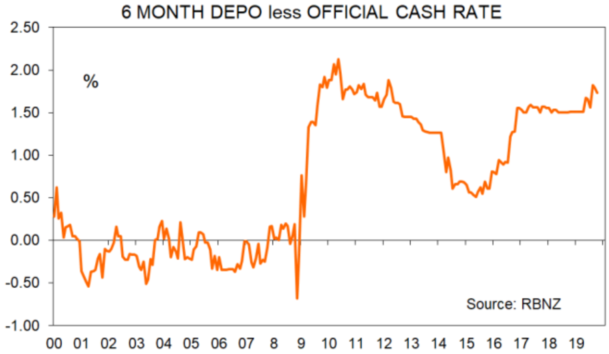
There is a limit to how much NZ banks can cut their term deposit rates in order to meet liquidity requirements set by the Reserve Bank and to curtail exposure to offshore funding. The need to keep deposit rates up means two things.

First, for us depositors things may be just about as bad as they are going to get. Second, any further cash rate cuts by the Reserve Bank will have only a limited impact on lending rates charged to customers because deposit rates will fall by very little.

Keep in mind here that banks do not fund themselves using the official cash rate. That rate simply influences bank bill yields which in term influence deposit rates. The next graph compares the average bank six-month term deposit rate with the official cash rate from 2000. The first point to note is there is no equation we can use to determine what level of OCR will determine what level of deposit rate. There have been and, in the future, will continue to be, big structural changes in the relationship.

Note the huge structural leap in deposit rates versus the OCR following the GFC as banks scrambled to boost domestic retail funding – with success.

Second, the spread has been widening since 2015 (unusually low as the 1% OCR boost back then produced only a 0.4% deposit rate boost.)



For term depositors, things are not as bad as they could be, and the need by big NZ banks to retain a strong domestic retail funding base will limit further rate reductions.

We Kiwis have a short time horizon for our planning. We value stuff now versus stuff in the future very highly. We have a high tendency to borrow against our likely futures to consume stuff now like offshore travel, cars, consumer goods, education etc. What this means is that when interest rates fall, there is not necessarily a lot of extra spending from the future which we can willingly drag into the present (by borrowing money) because we have already bought that stuff.

This structural lack of potential to shift future spending to the now is one reason why interest rates in New Zealand are highly unlikely to go negative. The impact in terms of extra consumer spending would be minimal and might not exist at all.

There would likely be no impact on business investment as research for a long time has shown it is confidence of businesses which primarily determines whether they undertake capital spending or not – not finance cost.

On top of that the evidence out of Australia is that when mortgage rates fall people are tending to keep their repayments the same and have their period of indebtedness naturally shorten because of faster principal repayment.

And then there is the impact on retirees of falling interest rates. They will definitely spend less.

The upshot is that the stimulus which might come from continuing to reduce the official cash rate from current positions would probably be very, very small. It simply might not be worth making any further cuts, and that is the feeling increasingly being expressed by central bankers around the world.

Which means what for borrowers? If you have a preference for long-term fixed rates then we might be at the bottom.

CHOOSING YOUR FIXED MORTGAGE RATE TERM

Again, no fixed rate changes so nothing new to discuss 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, especially as increasing bank preference to lend outside the farming, property development, and business sectors has encouraged the return of mortgage cashbacks.

Current minimum fixed rates across the main banks. *

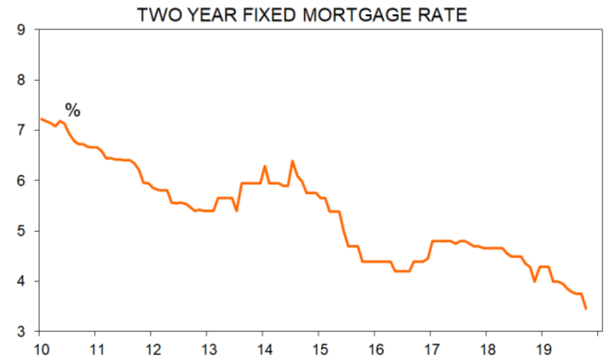
1 year	3.55%
2 years	3.45%
3 years	3.89%
4 years	3.99%
5 years	3.99%

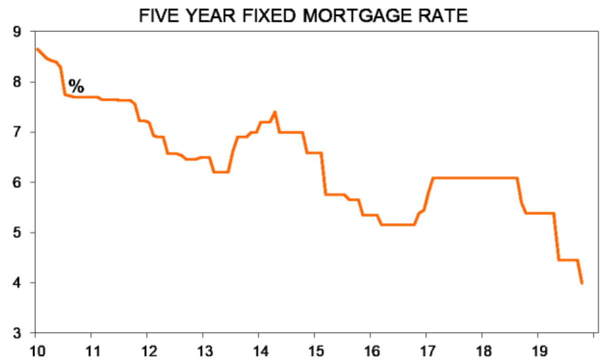
I can fix 2 years at 3.45%.

Is this better than fixing 1 year?	Yes, if in 1 year the 1-year rate is higher than 3.35%.
Is this better than fixing 3 years?	Yes, if in 2 years the 1-year rate is below 4.77%.
Is this better than fixing 4 years?	Yes, if in 2 years the 2-year rate is below 4.53%
Is this better than fixing 5 years?	Yes, if in 2 years the 3-year rate is below 4.35%.

The odds for now favour 1+1 being cheaper given the global and local monetary policy easing cycles underway. But not by much. I'd be happy with 3.45% for 2 years. But should central bankers talk more strongly about further interest rate cuts being pointless, I'd start eyeing up a longer term.

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

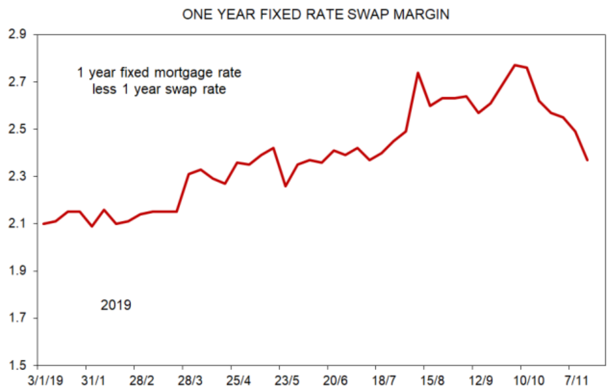


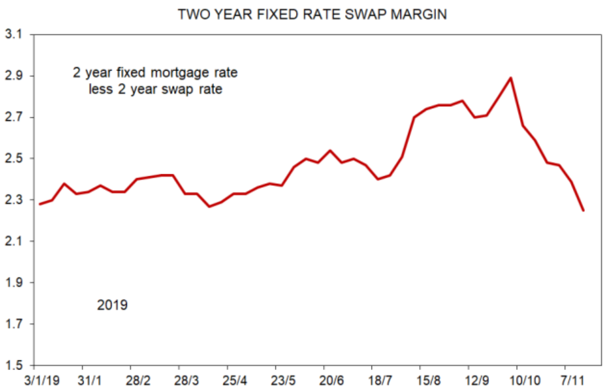


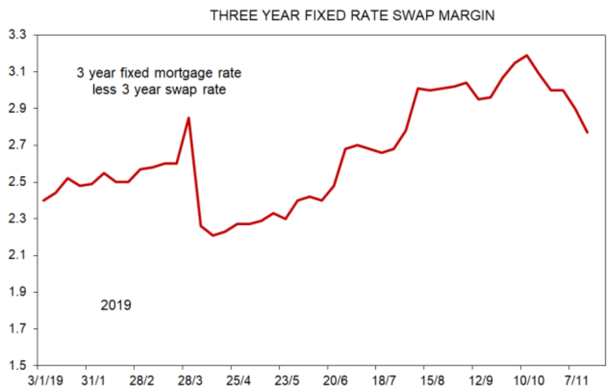
IS A FIXED RATE CHANGE IMMINENT?

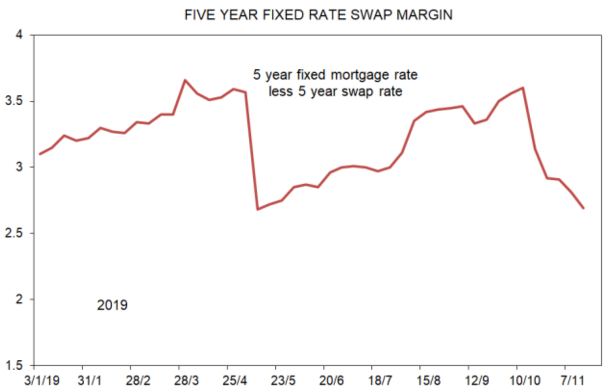
You can form your own opinion as to whether banks might be about to raise or lower their fixed rates by looking at the following graphs. They compare published fixed rates with the most frequently changing component of the total cost of funds – the swap rate. Note that there are other funding costs which 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

Margins have been falling since the middle of October with swap rates creeping up on diminishing expectations of further monetary policy easing here and offshore, especially Australia – confirmed yesterday with the RB leaving the cash rate unchanged at 1%. Expecting additional fixed mortgage rate cuts from current levels would seem a tad optimistic.









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

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

DETAILED GRAPHS ENLARGED

Nothing this week.