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.

Unemployment Prospects

There is a theory I've been running on since early in this shock which goes like this. The extent to which the unemployment rate rises will be a lot less than people are thinking. There are many reasons for this, and I'll discuss some of them below. But the one I want to highlight at the moment is my view that many older people, seeing the shock to the labour market from the impact on businesses of fighting Covid-19, will choose to leave the labour market.

Some will have been minimally connected, simply doing some work because it yielded good social connectivity. Others will have been coasting along as we all do, happy with life and seeing no need to initiate any big changes.

But Covid-19 has generated a wave of soul-searching around the world which seems to have led many people to focus anew on the things which are most important to them. Many people seem to have decided to initiate lifestyle changes either earlier than they were planning, or which they had simply let slide.

For some this has meant buying a retirement home in a desired location earlier than planned, and this seems to be a phenomenon in Otago with older people buying properties in the Queenstown Lakes District. I imagine the same thing is happening all over the country. They may not move in right away, and they might rent the properties out for a while or simply use them as holiday homes. But they are solidifying their retirement plans.

For some it has meant choosing to step aside in order to help young people and that was the gist of an email which I received this week. The emailer noted that a company they know had just hired 16 new electricians because a lot of older ones had left the sector.

"The compliance was getting beyond them anyway and Covid just pushed them to finally stop."

This issue involving compliance is something I came across a couple of years ago with regard to older builders leaving the sector because of new certification requirements. The same probably applies to the many people in the financial planning sector where qualification requirements have been lifted.

With regard briefly to other reasons why the unemployment rate is unlikely to scale the heights many people predicted back in March we have the following.

First, the employment rate (not the unemployment rate) in New Zealand has averaged 67% in recent years compared with 65% ahead of the GFC. A lot of people have entered the workforce (accepted jobs) who don't have families to support but simply opted to accept a position because so many jobs were on offer. Why not tie a bungy cord for a while or work in a takeaway restaurant for a while? As I've written here before, it could be a fun experience.

Despite the image you are invited to accept of everyone in work desperately needing the job to put food on the table, the truth is somewhat different. For many people, working in paid employment is a choice. And for some of them, seeing the pain being

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felt by predominantly young people, will shift from paid to unpaid volunteer work with no loss of feelings of either worth or contribution.

Second, we have become dependent upon the labour of foreigners. We need them to pick our fruit, prune our vines, tend to us in old folks’ homes, drive equipment on our motorway construction projects, erect our multi-storey buildings, and increasingly work in our house building sector. Without them we have a problem.

The burden of some job losses will be borne by these people making up 8% of job numbers heading into this crisis as compared with 4% heading into the GFC.

Interestingly, one of the labour market developments of this crisis has not been the wholesale loss of jobs across many sectors. It has been the negative impact of the absence of these workers locked outside our borders in many industries.

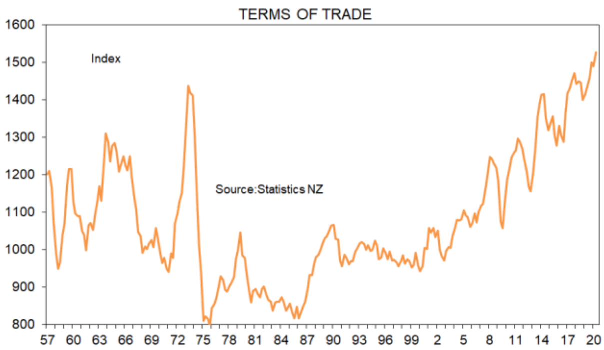
Third, we went into this crisis with a shortage not just of skilled motivated people, skilled unmotivated people, unskilled motivated people, but unskilled unmotivated people also.

Understanding this situation will be somewhat of a challenge to the many older people who lived through the 1970s and 1980s and remember the brain drain and the job creation schemes, PEP etc.

But we are not the NZ of old. We no longer suffer a structural deficiency of jobs occasioned by the loss of market access from the UK entering the EC in 1973 and the soaring of oil prices. We suffer a deficiency of staff.

And just in case you struggle to understand that between watching reruns of old British comedies on Sky, here is a graph showing the exact opposite of everything you were told during the 1970s into the 2010s – namely that our terms of trade are falling and we are essentially munted.

This graph shows the ratio of our export prices to our import prices (defined as the Terms of Trade) since 1957, a few years after the Korean wool boom which provided quite a boost to the NZ economy. A protracted war in a cold climate tended to be good for our economy.



We all learnt during our studies in the 1980s that the terms of trade for New Zealand was headed downwards along with the NZ dollar. We imported increasingly expensive oil and manufactured goods, while we exported food and fibre the world did not want and was shutting out through tariffs etc.

But since early this millennium our terms of trade have been rising. Oil prices have structurally declined and the phrase “peak oil” has come back into use. But now, it does not refer to peak supply. It refers to peak demand. And with regard to manufactured goods, production keeps shifting to

whichever country offers the cheapest wage rates and the most lax health and safety standards.

But with food, the increasing demand is for quality-assured product from sustainable sources. That is what New Zealand offers, although much as the dairy farmers may complain about emissions standards there is just one acronym you need to research right now CBAM. Carbon border adjustment mechanism. It is a potential trade barrier to come soon in the European Union.

Fourth, the extent of the rise in our unemployment rate will be mitigated by the government's useful implementation of wage subsidy schemes. When a shock arrives the inclination and instinct of most businesses will be to protect cash flows and working capital by cutting costs wherever possible – including staff. The wage subsidy scheme prevented that from happening, and we have now reached a point where businesses are still facing decisions regarding staffing numbers – but they are baulking.

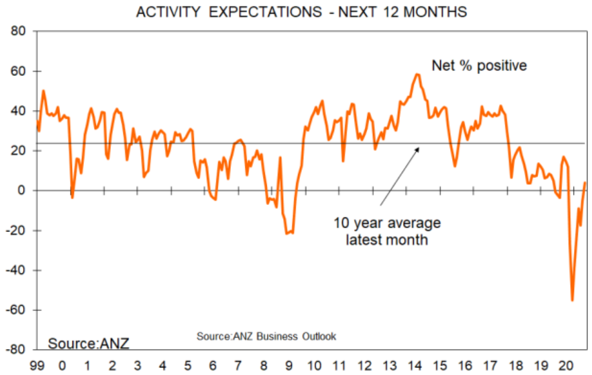
They remember the shortages which prevented them from growing over 2019. They see the increasing discussion about labour shortages. And they see the unwillingness of the government to make their lives easy and allow in a whole lot more migrants.

They are learning that growth and survival from now on is not a matter of laying off staff, it is a matter of keeping them.

Sentiment Trending Up

Last week, ANZ released the preliminary results from their monthly Business Outlook Survey and I did not have enough time to review the outcomes properly. So here is a run-through now.

A net 4% of businesses now expect that their levels of activity will rise over the coming 12 months. This is up from a net 5% pessimistic about activity in September, 18% in August, and 55% back in April. The result is in fact the best since February's 12%.



It still sits below the ten-year average of 23% but the trend is firmly upward and bespeaks of improving growth in the economy.

The question of course is whether businesses will back their improving outlook by raising their hiring and spending plans. They are – almost.

A net 3% say they intend laying people off. But this is up from 12% in September and 51% in April. The worst outlook for New Zealand's labour market from this crisis has been and gone. Again, as with the activity measure, the employment gauge is below average, which in this case is a net 9% positive hiring intentions. So, we are not out of the woods yet with regard to the labour market, and the outcome continues to suggest a mild rise in the unemployment rate.

But like so many other indicators noted here the trend is in the right direction. Businesses need to keep their minds focussed on the shortages of staff which they were experiencing before Covid-19 came along, and the low probability that a returned Labour government will open up the borders to let business meet staffing demand with foreigners.

The need to retain staff and boost labour-saving investment is growing again. In that regard, a net 1% of businesses now say that they intend raising their capital spending.

The trend in capital expenditure intentions is very important not just because of the need to supplant unavailable labour, and to boost flexibility and adaptability, etc. Many businesses are reporting that their sales to and production orders coming from the domestic (household) sector are very strong. But they are lacking orders from the commercial sector and fear somewhat of a production slump once current projects and production runs end.

It looks like it will be touch and go with regard to whether this production decline will be minor or extended through 2021. That is why getting the general election out of the way and hearing some (hopefully) positive signals about global vaccination are important with regard to businesses choosing to solidify their investment thoughts.

TONY'S VIEW

New Zealand's Housing Markets

RB says "Meh"

The Reserve Bank recently outlined their thinking with regard to the upward pressure on house prices being caused by their policy actions to fight the economic effects of Covid-19. Speaking at a briefing for the financial markets last week, two of their senior people noted their thinking is that it is better to take the risk of over-stimulating the economy, inflation, and the labour market than under-stimulating it. Experience offshore shows that under-stimulating then trying to catch up is extremely difficult whereas suppressing pressures from excess growth and inflation is relatively easy.

The markets have read these comments to mean that the chances of a negative official cash rate next year have gone up, and pricing now reflects a rate of -0.25% next year.

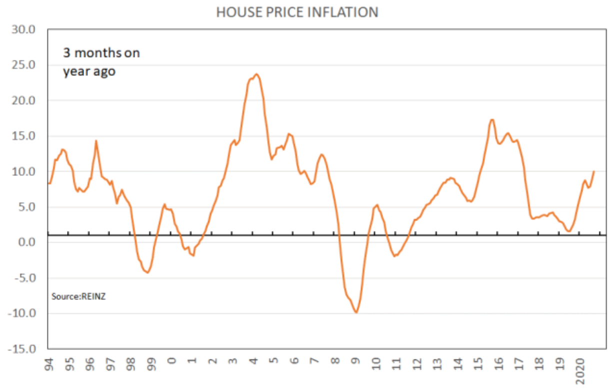
On another matter the RB noted that they expect to be ready to roll out a Funding for Lending programme next month along the lines of that in operation in Australia since March. The scheme involves the RB directly funding bank lending at a set low interest rate which in the case of Australia is a fixed 0.25% rate for three years.

The planned rollout of this programme will add to downward pressure on both bank lending and term deposit rates with the effect of encouraging even more money to flow towards assets like shares and residential property.

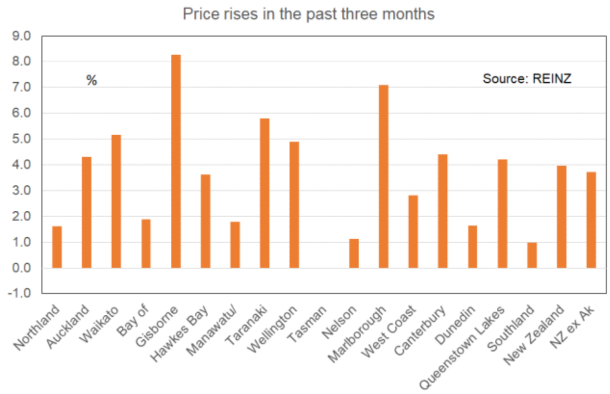
REINZ Data Strong

On Tuesday REINZ released their data on dwelling sales for the month of September and you'll already have seen many reports noting the strength in prices in particular. The nationwide House Price Index advanced by a strong 2.5% in the month to sit 11% ahead of a year earlier. This is the highest annual pace of house price inflation since February 2017's 11.8%.

The following graph compares three-month average prices with a year earlier in order to smooth out the bumps. The upturn is visually very clear.



Is this strength everywhere? I choose to gauge that by comparing the past three months with the previous three months ending in June. We see gains everywhere except Tasman. Strength in price gains is most notable in Gisborne and Marlborough. Note rises being recorded recently in Queenstown Lakes District.



In the past at this point I would probably do some deeper short-term comparisons to see where price gains might be accelerating or decelerating. But frankly, some of the data during and immediately after the lockdown look quite volatile for some locations and words and pictures could easily not portray the true underlying trends. Instead, let's just

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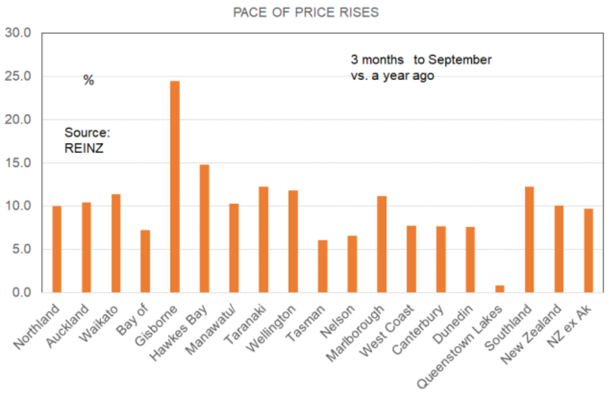
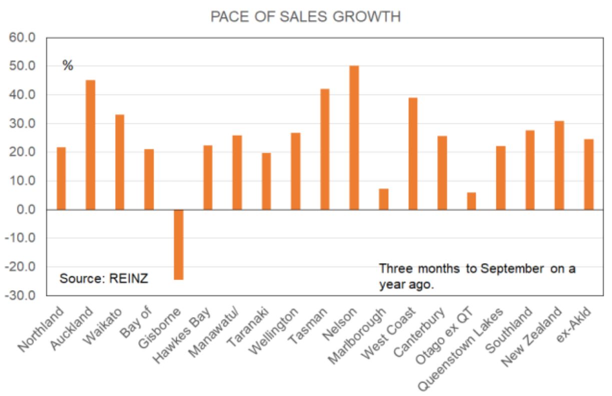
Property Investment Retirement Planning Wealth Creation

be satisfied for now with annual changes measured as the September quarter on a year ago.



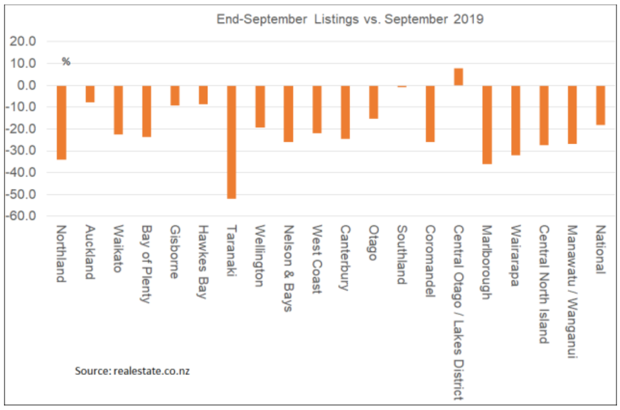
Most locations show house prices rising firmly, apart from Queenstown Lakes District.

Are sales strong everywhere? Not quite. Sales were 25% lower in Gisborne during the three months to September than a year earlier, and ahead just above 5% in Marlborough and Otago excluding Queenstown Lakes.

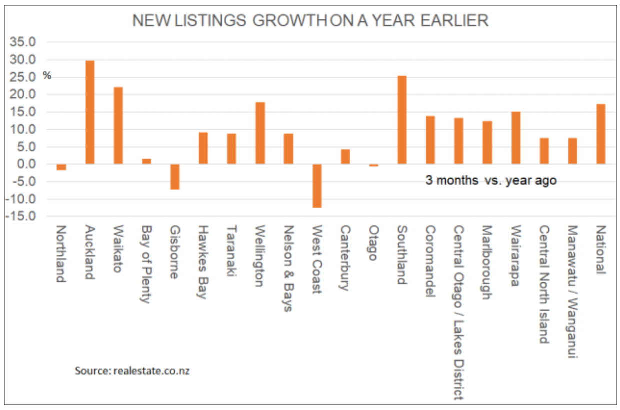


Sales for the country as a whole are basically back on track with where they would probably otherwise have been without Covid.

With regard to Gisborne, why are sales so low? It's not so much that the stock of listings is unusually low. At the end of September property numbers listed for sale in Gisborne were down 9% from a year earlier which was one of the smaller annual increases.



The real difference is that unlike almost all other regions, new listings are not increasing in Gisborne. The number of listings in the past three months was down by 7% from a year earlier whereas nationwide new listings were up 17%.



Interest Rates

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

In this month's Tony's View Spending Plans Survey I asked people if they felt better or worse off financially as a result of Covid-19. 324 people said they felt better off and I invited them to let me know why they felt that way. Lower interest rates ranked fourth and also drove the third rated factor as well.

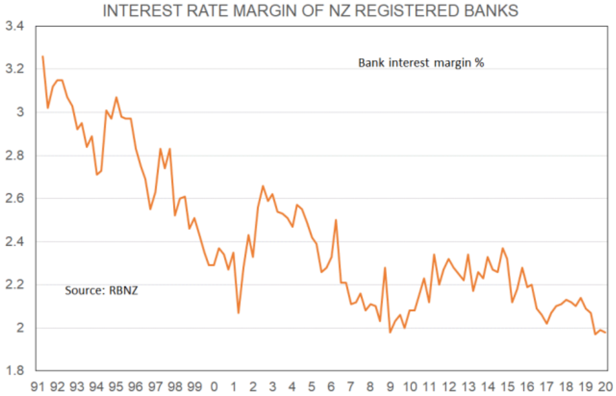
That is, 79 people cited money saved from not travelling offshore, 76 cited stronger sales for their business, then 32 cited higher property prices and 26 lower interest rates.

So, rate reductions are by no means as powerful an influence at the moment as the Reserve Bank might like to hope. But along with their effect of pushing house prices higher they do matter.

One way in which they matter is via encouraging people to take their money out of bank accounts and do something else with it in response to very low interest rates being offered by banks. But there is no great evidence from overseas that particularly large flows occur out of banks when rates get low. People simply accept the low returns and leave their funds sitting there.

For perhaps 15% of deposits there is no impact anyway as they were not receiving any interest in the first place. These are NBI or Not-Bearing Interest deposits which are very valuable to banks when interest rates are at high and normal levels. But when interest rates are low their relative value declines.

Here is an update of the graph I have produced before showing the downward trend in bank interest margins over the past three decades. Note that there is more to bank profits than just the difference between the average interest rate at which money is borrowed and the average rate at which it is lent out.



With regard to wholesale interest rate pressures this week, some of it was upward on the back of rising bond yields in the United States. Hopes of a new fiscal stimulus package in the United States have risen, if not via agreement between the President and Democrats then by a new Democrat President come late-January given what the polls suggest will happen in early-November's election.

The yield on the ten-year US government bond has risen to 0.77% from 0.69%. It's not a big move so it doesn't really change anything with regard to pressures on bank lending rates in New Zealand. Plus, there was some continued downward pressure on local rates this week following the dovish monetary policy comments by two senior RB personnel last week.

The yield on NZ 90-day bank bills has ended this week unchanged just under 0.3% while the one-year swap rate is near 0.11% from 0.12% and the two-year rate near 0.06% from 0.04%. Boring. So, so boring.

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

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