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 16 January 2020

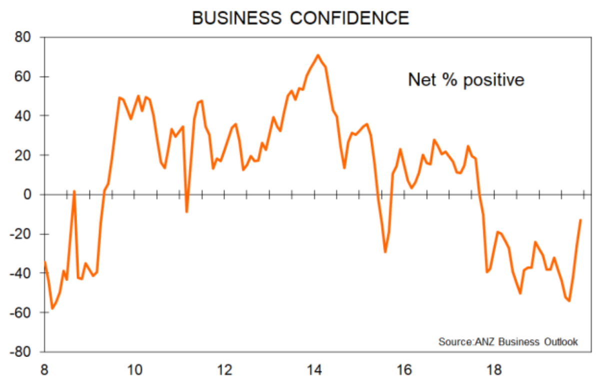
To subscribe, email me…tonyalexander5@outlook.com
To enquire about having me in as a speaker, same address.

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.

Businesses Slightly Less Dour

The ANZ's Business Outlook survey runs monthly and gives us some reasonably up to date insights into how businesses are feeling and their plans regarding hiring people, boosting capital expenditure, and setting prices. Late last year we saw all of these sorts of measures improve from some very low levels in the middle of the year which didn't really gel with reality on the ground.



That is, businesses were saying the outlook was dire and they planned laying people off, even though interest rates were low and falling, commodity prices were high, consumer confidence was reasonable, net migration inflows were good, and government spending was rising.

But with help from some extra weakness in the NZ dollar, further commodity price hikes, the government backing away from hefty welfare reform and a new capital gains tax, and easing fiscal policy, things got better.

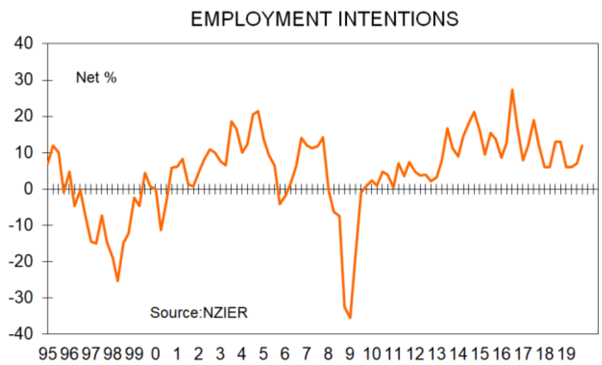
We got confirmation of this improvement on Tuesday in the NZIER's long-running Quarterly Survey of Business Opinion. This survey has been running since 1962 and gives good insight into cost and pricing pressures plus hiring and capital spending intentions. It used to be hugely focussed on for the insight delivered into capacity pressures in the economy, and forecasters running models still use their capacity measures to get a feel as to inflation prospects.

But reality on the ground in the form of capacity pressures not producing the rising inflation we used to get means that these sorts of measures are not as useful as they were before.

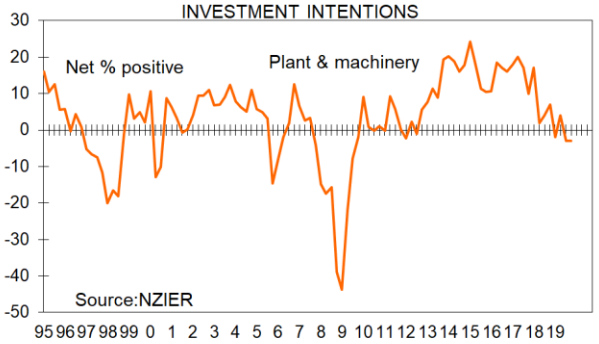
Nevertheless, let's have a look at what the survey tells us. Note that unlike the ANZ monthly survey the QSBO does not cover the farming sector where prices are good but regulatory burdens keep growing.

A net 7% of businesses expect their domestic sales to rise in the coming 3 months. This is below the average of 18% but up from 0% in the September quarter and -4% before that. So, an improvement, but not stellar and this merely reinforces the likelihood that our economy will grow 2% or thereabouts this year.

A net 12% of businesses plan hiring more people. This is a more interesting measure because it is up from near 6% in each of the previous 3 quarters and just above average. This tells us that the labour market is going to remain strongly in favour of employees and that drives job security which in turn drives willingness to spend and buy a house.

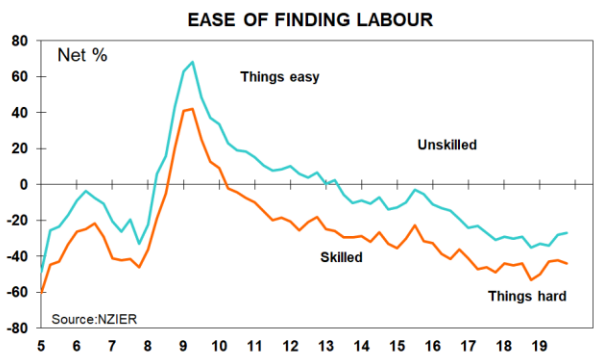


But in contrast, yet consistent with one of my key themes of 2019, businesses are hiring people because they have production targets to meet but are unwilling to invest. A net 3% of businesses plan cutting capital spending levels. This outcome is not just below the +8% average, it is unchanged from the previous quarter.



So, unlike almost all other measures in the survey which have improved, this one tells us businesses are not investing enough in new technologies let along sufficiently expanding capacity. This is why it is highly likely in the context of all the good employees having been hired a long time ago, productivity growth for New Zealand is likely to get worse in the near future. It also reaffirms a long-standing real-world observation that low interest rates do not drive business investment.

Unsurprisingly, with businesses decreasing their long-term planning and relying on labour, difficulties finding that labour are growing once again. A net 44% say they are finding it hard to get skilled staff. This is above the 32% average and 42% the previous quarter. A net 27% say unskilled people are hard to find versus an 11% average. Note how much further away from average the unskilled staff search difficulty rating is than for skilled.



If you don't invest then ability to maintain profits ends up compromised and we've been seeing this for some time. A net 16% of businesses expect their profits to worsen – better than 20% last quarter but well away from the 1% average. A net 39% expect their costs to rise (average 25%) and only a net 21% plan raising selling prices (average19%). Margins are tight and set to contract further.

There are no screaming inflation readings coming out of the survey so no reason to issue any warnings to borrowers.

All up, in the context of a government unable to understand the needs of the business sector, and some recent mild fluctuations in global growth prospects, chances are that heading into the general election businesses will remain in a dour mood. But with the labour market strong this won't be associated with widespread unhappiness amongst voters. Consumer sentiment measures are likely to continue their late-2019 improving track and that will be good for the retailing sector.

The big problem which the survey signals though is that businesses are setting themselves up for major profit problems because of insufficient capital spending.

Climate Change

One of my key themes and warnings through 2019 was that businesses, home buyers and investors need to pay greater attention to climate change in terms of physical and pricing effects, mitigation measures, and regulatory imposts. In the United States a climate research company is giving home buyers access to a database showing the risk of flooding for their property – something previously unavailable. Price impacts are expected. https://www.reuters.com/article/us-usa-floods-realestate/u-s-flood-risk-model-to-be-publicly-available-in-boon-for-homebuyers-idUSKBN1ZD1G0

A new US survey shows people intend flying less because of climate change worries, and to eat less meat. https://www.reuters.com/article/us-eu-climate-survey/europeans-chinese-americans-to-fly-less-in-2020-to-fight-climate-change-survey-idUSKBN1ZD1EE

Central banks and stock exchanges are moving to assess banks and companies on their climate change vulnerabilities. Social pressure is being applied to polluting industries. Credit rating agencies are warning of debt downgrades for entities at risk of change-related events. School children in NZ this year will receive specific instruction on climate change. The risk is that something major happens and voters ditch their opposition to change and vote for pain for themselves – rather than someone else which has been the norm so far.

A version of this shock effect is currently underway in Australia because of the huge and continuing bush fires resulting from a combination of climate change, poor forest management, and a three-year drought resulting from some weather system interactions. The interesting aspect however is this. It's not mainly about property destruction. The Christchurch earthquake did not prompt international entertainers and sports stars to donate huge quantities of money to help with relief and rebuilding.

It's not mainly about loss of life because the terrible deaths so far are far fewer than in some previous Australian bushfires.

It's partially about loss of forest cover – but burning of the Amazon forests did not prompt international stars (beyond Sting years back) to gather others and directly pay grazers and plantation developers not to burn the trees away.

It seems to be largely about the deaths of animals – over one billion of them. We have all spent decades watching ads on TV where charities seek money to help starving people – invariably in Africa. We slotted our concerns about those people into a manageable box many years back, rationalising that there are either too many people there anyway, you can't do anything about droughts, they need to adopt functioning democracy and stop tribal wars, they need to stop breeding, or whatever excuse for inaction suits an individual. Most of us (not all by any means) became inured years back.

But animals are blameless. They've done nothing to contribute to their deaths from our human actions. We decreasingly view them as needing to be conquered because they are dangerous to us. Most people these days see animals as cute or interesting things in zoos, anthromorphised characters in Disney movies, or actual or imagined pets. The way in which we say children these days don't know that beef comes from steers and eggs from chickens means that they don't see the animal world as anything other than a cutesy "other" land of friendly creatures.

This is working against farmers but in favour of climate change action and has created a seeming competition among donors to show support to the Australian bush fire cause – to the extent that some people have rolled out the idea of introducing Koalas into our country.

We humans long ago learnt to compartmentalise destruction of other humans (war, disease, accidents, "Forget it Jake. It's Chinatown"), destruction of buildings (war, earthquake, floods), destruction of our crops (drought, fire, insects, disease, floods etc.), and mass killing of insects. But wholesale destruction and death to animals which we largely only know about from increasingly sophisticated documentaries, or have commandeered as national symbols, is something different. It's an embarrassing failure in a new responsibility as a powerful apex species to look after the other species on the planet. Our "pollution" has moved beyond dirty rivers, smog and acid rain to species destruction.

My two cents worth (and just a developing theory) is that this species responsibility focus is the only way some in the older generations will actively join with the younger generation to drive change. We older people are so confident in our ability to adapt to change (because we have adapted already to massive economic changes) that frankly, most of us probably spend more time thinking about how we can profit from climate change than how it will affect others.

"With great power comes great responsibility."

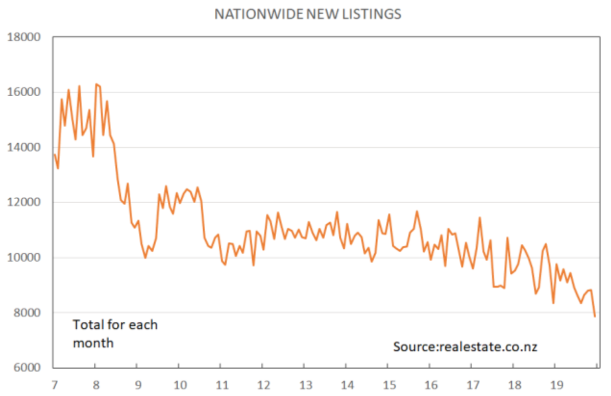
Housing Market

Listings Shortage – The New Norm

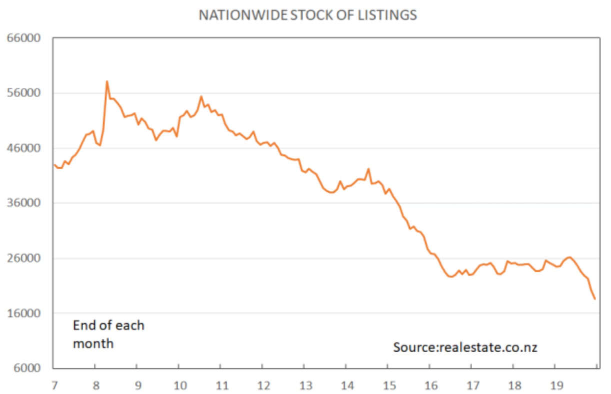
Property listings are in short supply all around the country virtually – and chances are this situation will be the new norm for a long period of time. Why? Because the incentive for investors to offer their properties onto the market to trade for some other property has been reduced by the brightline test. Also, the incentive to sell and invest in a non-dwelling asset has been slashed by the consolidation of interest rates at low levels and strong expectations that those low levels are the new norm.

And to top it all off, the failure of KiwiBuild has reinforced the realisation that there is a property shortage in most parts of New Zealand which won't disappear in a hurry – so why sell something in short supply?

The data released a couple of weeks ago by realestate.co.nz shows us how short listings are. New listings received during the month of December for the entire country amounted to 7,874. This is the lowest number of new listings since data started in 2007.



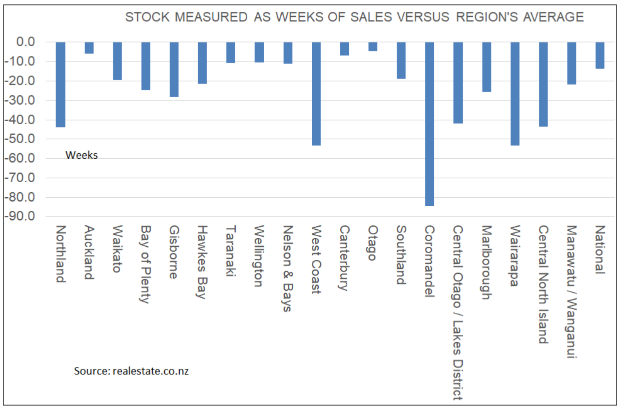
This dearth of new listings being brought to the market means the stock available for potential buyers to pick and choose from is reduced. By how much? Lots if you take a look at the far right of the following graph which shows the end-month stock of listings nationwide. The falloff in stock over the latter part of 2019 has been extreme.

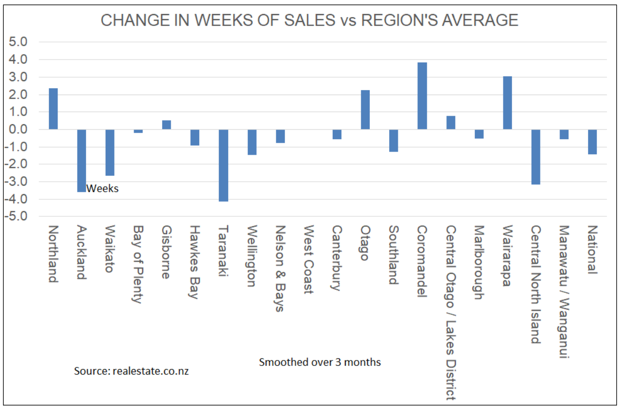


To analyse how tight things are by region I like to look at the REINZ's measure comparing stock with recent sales. That is, data might show low listings, but if sales are low then things aren't really tight. But if listings are low while sales are high then things are very tight and we can start to draw some pricing implications – upward.

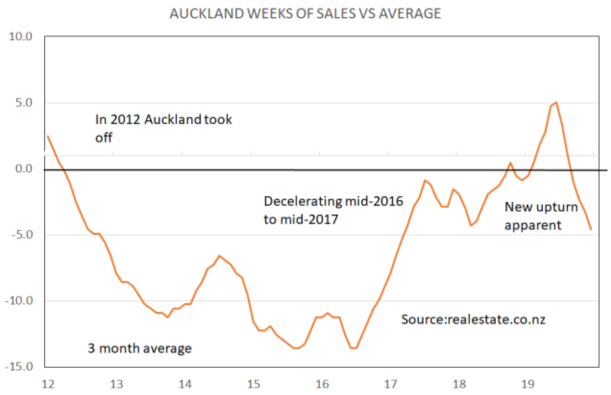
The next graph shows that when measured in terms of how many weeks-worth of sales stocks add up to things are below average everywhere and especially so in central North Island, Wairarapa, and Coromandel. The second graph shows how this measure of availability is changing and it tells us that things are tightening up especially in Auckland, Waikato, and Taranaki. But some easing is occurring in some areas of greatest shortage. (Note that I have stripped the tiny West Coast region from this second graph as the big value of +11 makes the whole graph look weird.

The first two graphs which show regional data are reproduced in large scale at the end of Tony's View.

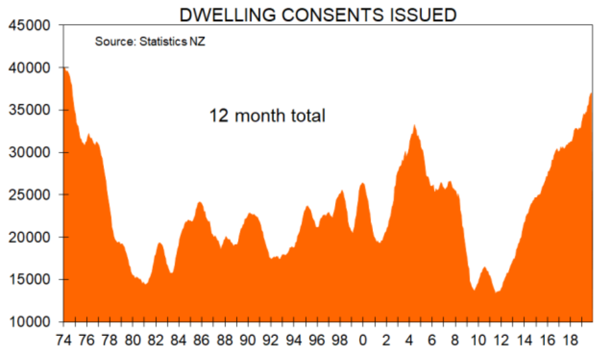




This next graph definitively shows the Auckland market moving strongly in favour of sellers since the middle of 2019. Will the return of Auckland housing market strength be an issue heading into the general election late this year?



Note that property listings are short despite the rising supply of new houses. In the year to November dwelling consents issued all around New Zealand added up to just over 37,000 from 33,000 one year ago and 31,000 two years back. Nothing new there – however, in seasonally adjusted terms consent numbers fell by 8% in November after falling 1% in October. If December records a fall then that will spark a lot of talk about capacity constraints preventing higher house building.



Pressure might go on the government to let in more builders. But anti-immigrant sentiment, concerns about quality of construction, and unwillingness to undermine wage bargaining ability of Kiwis will likely prevent any major easing of migration criteria for tradespeople. That will mean extra realisation of upward pressure on property prices continuing. Could Auckland prices this year repeat their average gain of 14% achieved from 2012-15? It's looking more and more like they will.

Just briefly, REINZ released their monthly data today. Auckland average prices are now 1.2% above their late-2016 peak having risen 5.7% in the past 8 months with a gain of 2.9% in the past three months versus the September quarter – 12% annualised. The rest of NZ has gained 3.8% the past three months – near 15% annualised. I'll have a look at the data this coming week to see what might be interesting around the country to report on.

Interest Rates

Let's say you accept the evidence I've been presenting in recent weeks regarding the firm and seemingly growing strength in Auckland's housing market. Maybe now you're starting to worry about the Reserve Bank raising interest rates to try and stem the strength. That's not how things go.

The Reserve Bank changes the official cash rate in order to influence overall inflation in the economy. They'll only start focussing on Auckland house prices if people start spending their rising paper wealth willy-nilly and retailers raise prices for people who are increasingly prepared to pay higher charges. Those steps are fairly unlikely in that the evidence of spending rising paper wealth is a tad patchy, and it's unlikely we will throw our price sensitivity out the window and start splurging – especially not in an election year.

The Reserve Bank's focus is going to be on the nature of bank lending which might follow then propel further strength. If risky lending jumps up then they will raise LVR requirements ahead of taking the OCR higher.

So, building a case for higher interest rates in New Zealand isn't something that can automatically follow this year's possible acceleration in Auckland house price growth from the annualised pace of over 12% achieved in the three months to November.

In fact, for now the international drift is once more toward lower interest rates. GDP and industrial production data out of the UK have been weak and the Bank of England might cut rates again. The economic effects of the Australian bush fires are being calculated and markets are prising in rate cuts. Data have been less than stellar recently in the US, and in Europe the data also suggest an earlier growth surge has petered out.

CHOOSING YOUR FIXED MORTGAGE RATE TERM

There are no changes in lowest available fixed rates 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%

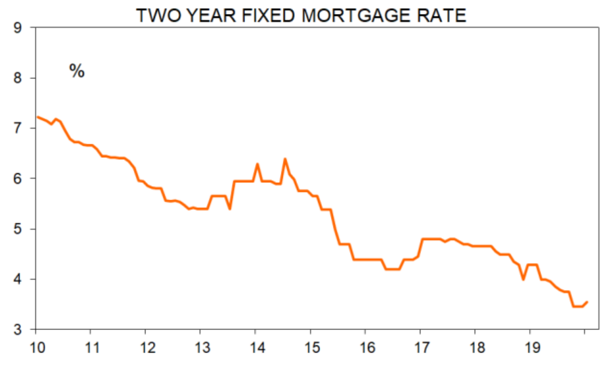
I can fix 1 year at 3.39%.

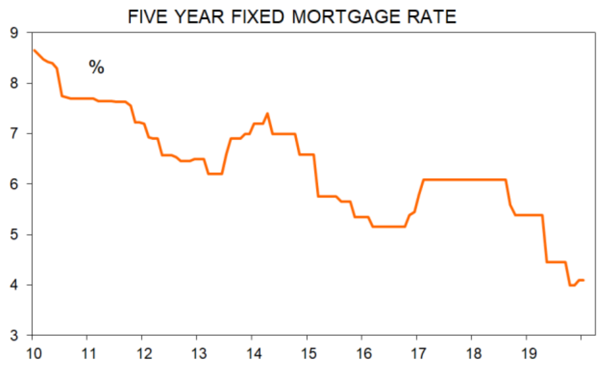
Is this better than fixing 2 years?	Yes, if in 1 year the 1-year rate is below 3.51%.
Is this better than fixing 3 years?	Yes, if in 1 year the 2-year rate is below 4.14%.
Is this better than fixing 4 years?	Yes, if in 1 year the 3-year rate is below 4.19%
Is this better than fixing 5 years?	Yes, if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

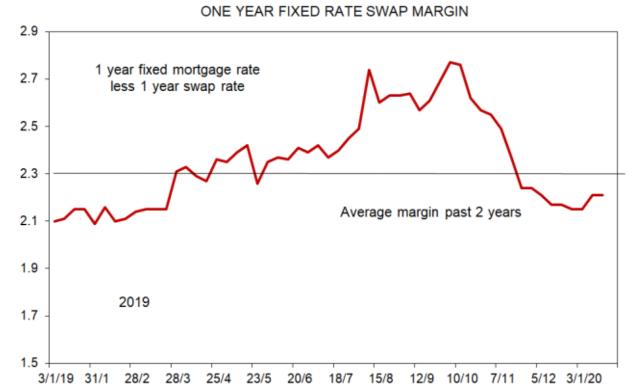


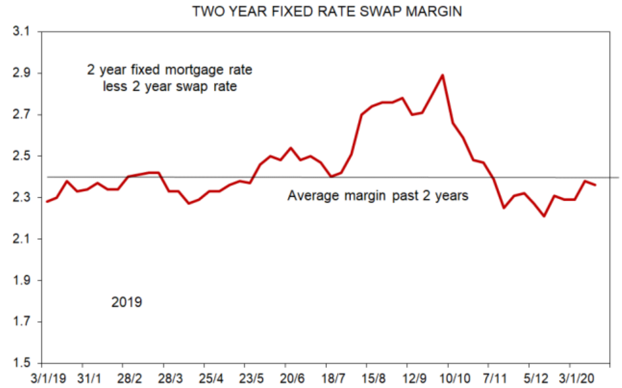


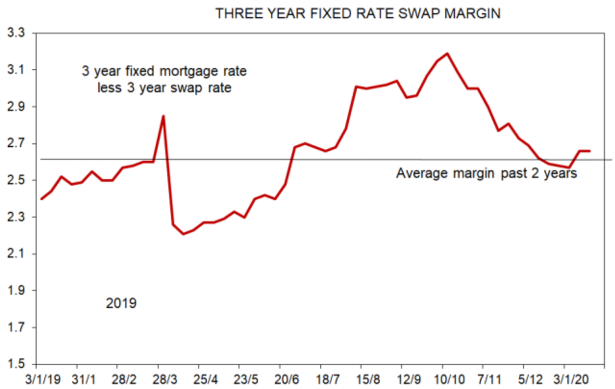
IS A FIXED RATE CHANGE IMMINENT?

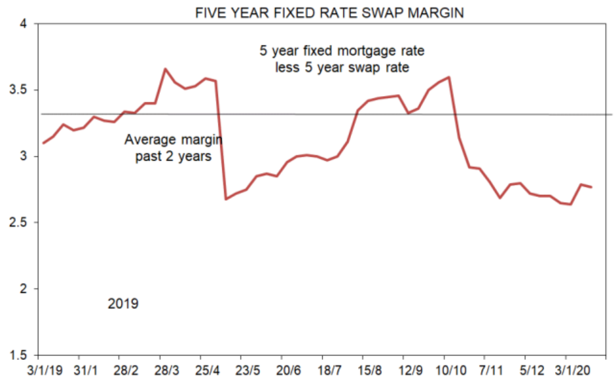
There have been no notable margin changes this week. Pressure on banks to shift fixed mortgage rates is fairly low.

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

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

DETAILED GRAPHS ENLARGED