TONY'S VIEW

Input to your Strategy for Adapting to Ongoing Challenges

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

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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.

Heading Back Down

In the past I have done some business travelling overseas and spoken with a lot of Kiwis in London in particular – but also Paris, Hamburg and Dublin – and many of these people like to keep an eye on what is happening back here. That is because they see a firmish possibility that they will one day head back.

So, say you are located in London at the moment, and without needing to reference the uncertainty regarding Brexit, you might be thinking about returning. What will you find?

First, we don't have fundamental financial imbalances which might eventually scare investors and cause some version of a shock. That is, the current account deficit (exports less imports) is only 3.6% of GDP compared with a 20-year average of almost 4.0%. Our terms of trade are only just below record levels with very strong demand offshore for New Zealand's primary products which in NZ dollar terms are bringing in prices 70% higher than 13 years ago.

The government has been running surpluses for the past five years and another one is expected this year. The ratio of net debt to GDP is only 19.2% and the gross debt to GDP ratio sits near 30% which is well below the UK's almost 90%.

Inflation is well contained at just 1.5%, but New Zealand has the same issue as other countries with inflation risking sitting at low levels for a long period of time.

The unemployment rate is only 3.9% compared with 5.3% in Australia, and job numbers are rising at about a 1.5% annual rate with businesses having difficulties finding people to hire.

Net migration flows are well above historical averages with a net population gain of 1% or about 54,000 people in the past year. The 17-year average gain is 29,000 per annum.

House prices are very high relative to income and that to a large degree reflects restrictions on what can be built where, high infrastructure costs, high materials costs, and absence of mass production of similar houses. Most NZ dwellings are standalone and not either attached or apartments.

Unlike Australia, where prices are now recovering after falling 10% - 15% in the largest state capitals, prices in Auckland have fallen about 3.5% but appear to now be starting to edge up again. Wellington's market is very strong with prices ahead by 7% in the past year, and Canterbury 2%. The regions generally are strong as they complete their catch-up to Auckland's earlier surge. Housing shortages of uncertain size exist in some cities and with investors returning to the market in response to falling mortgage rates and confirmation of no capital gains tax, price rises generally remain likely this coming year.

Key long-term support to growth comes from the structural shift upward in net migration flows, infrastructure and residential construction requirements, underlying growth in aged care, healthcare and the digital and green economies, innovation and land use change in the primary sector, and ever-rising connectivity with the rest of the world. The main threat to growth in the short-to-medium term is world trade disruption. Long-term the biggest threats are collapse of the tourism sector if global warming concerns cause people to avoid long-haul air travel, and development of cheap alternatives to reared meat and milk proteins. These threats are regionally-based but would hit the cities as well.

Politically, Kiwis have voted against parties of change since the early-1990s, and governments struggle to enact major legislative changes because of their dependence upon small coalition partners.

Tony's View

Basically, its nice down here, the economy is in okay shape though growth has slowed and businesses are struggling to adapt to the changed world. All you have to do is accept the low incomes and high house prices and life will be sweet.

Upcoming Presentations

I have quite a few presentations coming up in the next few weeks all over the country, and amongst them is a series of five for property syndication specialists Erskine+Owen on the following dates.

Tuesday 22nd October	Havelock North
Wednesday 23rd October	Hamilton
Thursday 24th October	Tauranga
Tuesday 29th October	Auckland
Thursday 31st October	Dunedin

My talk accompanies their presentation of information surrounding syndication of the Watties National Distribution Centre in Hastings. You will find information at the following link, and I shall reprint the comments regarding eligibility for the offering.
"This offer is restricted to "Wholesale Investors" Under clauses 3(2) and 3(3)(a) of schedule 1 to the Financial Markets Conduct Act 2013"
https://www.erskineowen.co.nz/watties/

Household Spending

The biggest sustained driver of changes in the pace of growth in any economy is household spending. We try and get an early feel for whether this spending is changing by looking at consumer confidence measures and actual spending indicators.

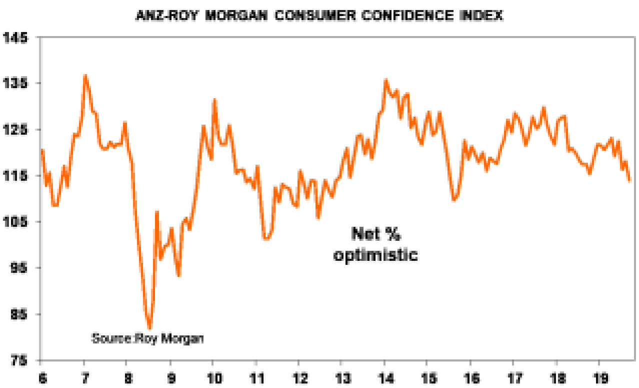
The confidence measures can easily move around quite a bit and reverse apparent trends, so need to be looked at for sure, but not heavily relied on to gauge short-term spending changes. In similar fashion the monthly Electronic Cards Transactions data from Statistics NZ warrants looking at – but not relying on. It has a history of sometimes giving misleading insight into what the eventual accurate Retail Trade Survey numbers show.

Keeping these caveats in mind, can we look at the numbers and say anything interesting with regard to what you and I are doing with our money here in New Zealand?

First, consumers are still overall feeling optimistic about their finances and the economy. The quarterly Westpac McDermott Miller index sat at 103 in the September quarter. A reading of 100 is neutral and the result was about the same a year before but down from 112 two years back. Of interest was a 20-year low reading in the proportion of people who said they would spend a windfall. So, much as people might be in work and not too worried about the immediate world around them, they see sufficient reason to personally exercise some caution with regard to their lumpier spending.

That is the sort of thing which interests us economists because we pay most attention when examining spending data on big ticket items called durables. More on that below.

The more up to date ANZ Roy Morgan monthly measure came in with a reading of 114 in September from 118 one year ago, 130 two year's back, and 118 in August.

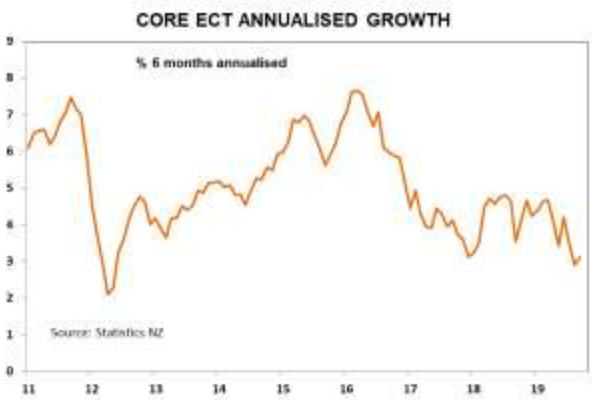


The reading is above 100 quite easily but is the lowest in four years.

So, what about actual spending? The monthly electronic card data showed a seasonally adjusted rise in core spending of 0.6% in September and 1% for the September quarter.

The annual growth rate was 3.4% from 4.9% one year ago and 3.7% two years ago.

These numbers go all over the place and I'm not going to waste space showing the three-month smoothed rate of change which usually does the trick for most other measures. Instead here are the monthly changes spread over six months.



We can see that retailers enjoyed bountiful times over 2014-16 but now spending growth is at the weak end of the spectrum.

This means that at a time when retailers are already under pressure from staff shortages, rising rents, fickle consumers and loss of pricing power, the cuddly blanket of strong consumer spending growth has been not exactly whipped off, but loosened to let in some cold air.

Will spending growth fall away further and expose a multitude of operators, causing even more emptying of high street shops?

We economists seek insight to this question usually by first of all looking at data on spending changes for durable items like furniture and vehicles. The numbers do not at all say to us that consumers have closed their wallets. That is, this type of spending in seasonally adjusted volume terms grew by an above average 1.6% in the June quarter and 2.2% in the March quarter. In nominal seasonally adjusted terms this type of spending measured in the monthly card transactions release grew at an annualised pace of 6% in the three months to September from 1.6% in the June quarter and 5.8% in the March quarter.

Confidence levels are above average. Net migration inflows remain strong. Interest rates are falling. Housing markets remain firm or could be getting newly firmer. It all sounds good. Where we are keeping an eye however is conditions in the labour market.

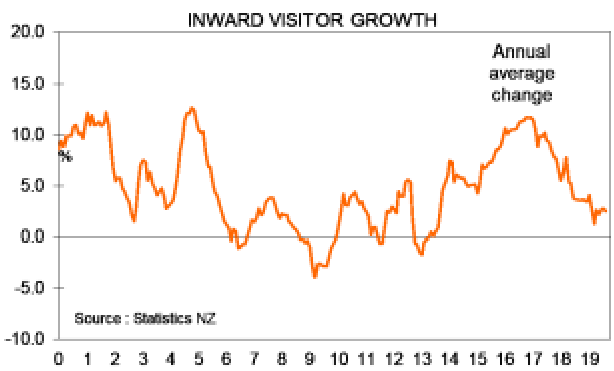
Overall job security remains good and businesses continue to struggle to find both skilled and unskilled people. Wages growth has picked up slightly but is still low by historical standards, except for those at the bottom of the wages spectrum where legislated increases are large.

But employment intentions measured in the ANZ monthly Business Outlook survey sat at -8% in September versus a +10% ten-year average. The NZIER quarterly survey showed in contrast a net 7% of employers planning to hire more people versus a 13% ten-year average.

The data are slightly confusing and at this stage I don't think we can firmly make the claim that New Zealand's labour market is rapidly softening. But given the other factors in play which largely look okay, this is one I will keep a close eye on.

So, for now, and as noted above, retailers face an environment of customer growth toward the low end of the spectrum. There seems no reason for believing a rebound lie just around the corner, or that sales will newly fall away unless firms close off their new hiring. That leaves retailers however still with ongoing issues of handling new forms of competition and fickle, price-sensitive customers.

As regards retailers in the hospitality sector servicing visitors from overseas, growth has almost flatlined. In the year to August visitor numbers were 2.5% up for the year. One year ago, growth was 3.6%, two years ago 9.3%, four years ago 11.3%, and five years ago 7.8%. In seasonally adjusted terms visitor numbers grew only 0.2% in the three months to August after falling 0.8% three months before.



Visitor numbers from China in the past 12 months fell by 7.4%, accounting for just below 11% of all visitor numbers. Given slowing world growth and the fact we have perhaps had our day in the sun for now in some markets, we should not be surprised if flows start falling very marginally on an annual basis soon – especially if people do start avoiding travelling by airplane.

Housing Market

In Australia the housing markets in the big cities are undergoing a fairly strong revival with a big lift in weekend auction clearance rates, and prices edging newly higher with forecasts of gains around 10% in the coming year.

For instance, while Sydney prices are down near 5% on a year ago, they rose near 4% in the September quarter. Melbourne -4% and +3%. Brisbane -2% and +0.5%.

What gives?

Interest rates have been cut three times by the Reserve Bank of Australia this year and further declines are expected. Few people have worries about mortgage rates rising anytime in the near future. Investors have also taken heart from the failure of the Australian Labour Party in the recent Federal election, which has meant no punishing changes in capital gains tax rules and negative gearing.

Will we see a similar surge in activity and potentially prices here? The first point to note is this. Earlier this year when prices were falling in Australia people were asking me if we would follow them down. I said no and cited factors such as the special restrictions introduced over there on lending to investors, imposition of new and higher taxes on foreigners by state governments, the effects on bank willingness to lend of the Royal Commission, greater impact from reduced Chinese buying compared with NZ, over-construction of houses across there, and ending of bank lending to people against their self-managed superannuation funds for the purposes of investing in houses.

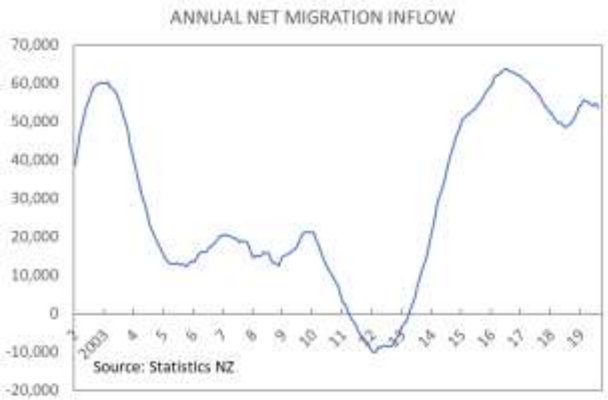
We won't follow the Aussie markets up now to the same degree, but strength here is likely to continue, principally in response to low and still falling interest rates encouraging investors to hold onto property assets and perhaps look at purchasing some more – both residential and commercial.

In Australia currently there is extra upward pressure on prices from these sources – those beyond falling mortgage rates.

- Rules on bank lending to investors have been eased.
- A big court case against Westpac alleging improper calculation of debt servicing ability was thrown out.
- Investors are catching up on buying after pulling back.
- A fresh wave of owner-occupier buyers has entered the market sensing that there is an opportunity to pick up something well-priced following 10%+ falls in properties.
- Hefty publicity is being given to the recent surge in prices with elements of FOMO likely to now be in play once again.

Note that the gains in Australia are not happening across all capital cities, (Darwin and Perth are still weak) and apartment markets are still affected by over-supplies for now. Falling construction will however eventually likely produce an apartment pricing catch-up somewhere down the track.

Of relevance to housing in New Zealand and Auckland in particular is net migration flows. Statistics NZ provisionally estimate that in the year to August our net migration gain was just below 54,000 from 56,000 six months ago and 49,000 one year ago. Basically, we continue to receive a 1% population boost from net migration flows. That supports the housing market but not overwhelmingly so from a fundamental supply and demand situation. That is because with an average household occupancy rate of 2.7 per house the extra 54,000 need about 22,000 consents to be issued (allowing for 90% being acted on), and actual consents are running above 35,000 per annum at the moment.



I can see the upward pressure on house prices argument as being valid from a debt servicing point of view. But from an imbalance angle the argument is not so newly strong. Nonetheless, REINZ data released on Tuesday showed sales and prices turning upward in Auckland and we could see prices rise more over the coming year than the flat to 4% I have been thinking given that interest rates will be lower than anyone was forecasting some months back. This probably won't be the start of a new sustained surge in house prices with prices rising 15% p.a., but rather a confirmation of the easing part of the cycle ending alongside some upside risk. With major events coming in Auckland over 2021 enough buyers are likely to be encouraged to see prices rise over the next couple of years.

Therefore, I retain the comment I have made for quite some time. Were I planning to make a purchase in Auckland I would be in the market kicking the tyres and throwing some low offers around, enjoying an environment as a buyer where FOMO is weak and most other buyers are just sitting on their hands.

Next week I will look at the September month data from REINZ just released and average things over the September quarter by region to see what is happening. Lots of graphs probably!

Interest Rates

It used to be a big thing – but that was a long time ago. The quarterly inflation numbers came out this week, they were much as expected, had minimal market impact, and left in place the problem of low inflation despite acceptable economic growth and tightness in resource markets.

The problem part is not really the 1.5% inflation we have now. It's the question of what inflation will fall to when the economy next goes into recession. If inflation goes negative you have deflation – falling prices on average. For anyone earning low interest rates on their savings at the moment that sounds like a great thing. Not so fast.

If you think the price of something is going to fall your incentive to buy it is reduced. Best to wait until it gets cheaper. So, you wait, it gets cheaper for sure. But the factory making it closes down and you get laid off because you worked for a firm designing new software management systems for that factory and others like it.

So now you buy less of virtually everything and we get a 1930s Great Depression scenario made worse by falling property prices pushing people into bankruptcy.

The problem in a nutshell then of current unusually low inflation here and overseas despite record low interest rates is that come the next recession, avoiding tipping into a deflationary Depression will be difficult. A central bank could give away money in the form of allocating each of us a special bank account, perhaps with the central bank, perhaps in digital currency form. It would be a modernised version of the "helicopter" money people used to advocate for Japan – basically drop money out of helicopters.

In this case, were I in control of the RB at such a time, I'd put a time limit on the special deposit so if a person did not spend it, they would lose it forever – and I would deny the ability to convert the funds into physical cash. Maybe that is another thing which could happen. Banks would be banned from letting people withdraw cash. Hmm – I wonder if that is one reason the RB is trying to garner legislative power to instruct banks what to do with their cash handling arrangements? https://www.rbnz.govt.nz/news/2019/10/reserve-bank-seeks-views-on-expanded-stewardship-role-for-cash

Or maybe they are just looking for a reason to exist now that monetary policy surely must take very little time and research to implement.

Maybe the search for a role by the RB also lies behind the proposed higher bank capital requirements and the increasing regulations generally being imposed on the financial sector. And will the RB try to retain its centrality to macroeconomic stabilisation policies by trying to get some influence on fiscal policy? Is that what time-limited special deposits would be? It may sound absurd, but the biggest issue in central banking is no longer the most effective way of suppressing inflation, but what to do the next time the excrement hits the fan and old tools of cutting interest rates and supplying banks with liquidity (printing money) prove worthless.

Just to finish this section, consider this unusual statement which the RB put out on Friday. https://www.rbnz.govt.nz/news/2019/10/acting-with-integrity-for-all-new-zealanders

For some fun, insert the name of any other organisation you can think of and you'll see it for the corporate-speak it is. For instance, try Waste Treatment plant, or the local prison.

I'll let you know if anyone from the Reserve Bank contacts me to set the record straight. Its been 12 years since I last received a call to pull my head in.

If I were borrowing at the moment….
I'd probably be inclined to lock in a fixed rate for two years given that rates are higher for periods both longer and shorter.

Peer to Peer Lending

One of the things investors might be thinking about as they search for extra yield is placing money with a peer-to-peer lending platform. These offerings do have high flexibility with regard to the risk you choose to take on. But, much as some investors love them comprising a small portion of their portfolio, they have failed to take off overseas as was much talked about a few years back post-GFC.

Overseas these types of lenders have become increasingly reliant upon institutional funding, and investors have encountered difficulties liquidating their holdings when desired. The financial monitoring authorities offshore are also increasing their scrutiny.
https://www.ft.com/content/5a367b56-e9b9-11e9-a240-3b065ef5fc55
https://www.interest.co.nz/personal-finance/101804/harmoneys-neil-roberts-says-p2p-lender-which-launched-september-2014-has

One cause of investor caution is that the sector has yet to go through a credit cycle. That is, we don't really know what the loan failure rate does during a decent economic slowdown or recession.

For your guide and relevant to all types of financial institutions, there are two key sectors which have thrown up more credit problems (bad lending, defaults) than others – motor vehicle financing and property development. The returns from financing these sectors can be good, until they are not, and they then can become big loss makers which of course get passed on to the funders of the financial intermediaries.

Would I consider examining a peer to peer lending platform in order to get greater yield? Yes. But as with all investments one might not be used to, undertake a lot of research YOURSELF so you fully understand the risks. Find examples of things going wrong in the past. I emphasise doing the research yourself because we humans just love to put our trust in other people. We are hard-wired for it from birth. And if someone we decide we trust says P2P lending is a great thing, we will switch off the analytical part of our brain and hand over our money. We'll practically demand they take it. Or we vote them into office, or we marry them, or we lend them our car, or we let them take our daughters out.

Here is a very good article from September.
https://www.moneyhub.co.nz/peer-to-peer-lending.html

That's Ironic – Fiscal Salvation

Around the world as concerns grow about insufficient spending growth in the private sector and ineffectiveness of loose monetary policies, calls are growing for governments to loosen fiscal policies. That means some combination of spending more and taxing less. In New Zealand the debate is not truly there yet. How can we tell? Because we have the same doom-mongers getting easy headlines warning about a fiscal hole to be created by the aging population causing increasing spending on health and the pension.

Sorry, what was that? In New Zealand we already have a mechanism in place to boost government spending in a sustained ultra-low interest rate and debt-servicing environment? Thank goodness for the aging Boomers. They'll save us all. Heck, they're even supplying the labour businesses need with 23% of people aged 65 and over still in work now versus 7% two decades ago. And the tourism sector will desperately need these people as customers once foreigners start reacting to the high carbon cost of flying all the way down here by choosing instead to holiday at home. And meat growers will need them for their old-style Sunday roasts as young people go vegan or pursue protein alternatives.

Japan's Living Environment

Some 63 people have unfortunately died in Japan from the effects of Typhoon Hagibis. Each year Japan is hit by numerous earthquakes and about 25 typhoons. Northern Australia gets on average 11 a year and 4 cross the Queensland coast. This millennials-long environment of ongoing major disturbances has failed to prevent Japan from becoming one of the richest countries on the planet, with a current population near 127 million people.

As we contemplate the negative effects of human-induced climate change we perhaps want to keep this example in mind when considering the human impact and our need to adapt to the now inevitable changes to come. We will adapt and it is a question of who will have adaptations forced upon them most quickly and who will bear the cost.

This however is not the same thing as the impact on other species from a warming planet, including sea life from ocean acidification. So, don't go thinking what I've written here is meant to convey any sense that the effects of global warming should be ignored. It's just a note to say that we will be forced to adapt through diverting resources and money from other uses and doomsday cult predictions of billions of people dying are well off the mark. Its also a recognition that because protesters are in some quarters seen as screaming extremists actual legislative and personal action to slow global warming will likely remain weak. And that means anyone looking ahead a few decades would do better considering the scenarios of temperature rises easily exceeding 1.5 degrees by the end of the century.

Think about that before you lay money down for an expensive home on the beach or beside a river.

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).

And, in her words "…a leading expert in education, has recently lent her support to a petition for qualified teachers in all services to be paid on par with the kindergarten and primary school peers because improving pay and recognition is needed to ensure a good quality workforce and better outcomes for children. The petition is at https://our.actionstation.org.nz/p/ece-parity "

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.