TONY'S VIEW

Input to your Strategy for Adapting to Challenges

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

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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.

Bring on The Twenties

This will be the last Tony's View for 2019 and I anticipate sending the first issue for 2020 out toward the middle of January. Merry Christmas to everyone who has signed up and happy holidays to those able to get some time off work.

To finish the year, lets have a look at the broad factors in play which will drive our economy and the things affecting your business next year over which you can have no influence. If you have been waiting for a sustained house price collapse since October 2008, are still predicting doom on the basis of Brexit or President Trump, or if you are simply a pessimistic person wanting people who have done well from growth this past decade to get their come-uppance, best stop reading now.

My outlook is positive and has been for quite some time now. (Not blindly so. I'm rereading "The Day The Bubble Burst" this week, a Depression classic by Gordon Thomas and Max Morgan-Witts.) Post-GFC too many people have adopted excessively negative views of the world and have risked being left behind by failing to purchase assets as soon as would have been optimal for their finances, or failing to grow their business.

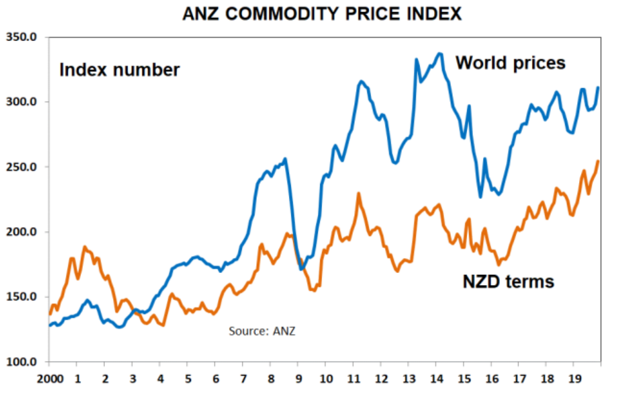
This is not to say that having an eye toward the many risks out there is a waste of time. Just don't make risk-fixating the driving force behind your business and investment planning.

Data out this morning tell us that in the year to September our economy grew by 2.6% with 0.7% growth in the September quarter which followed 0.1% growth in the June quarter. This makes a record 35 quarters of growth in a row. The underlying pace of growth is around 0.4% a quarter or 1.6% annualised which is not all that fast. Business investment only improved 0.4% after falling 0.1% in the June quarter which is not much of a gain and leaves me concerned about potential for productivity growth and the ability of businesses to generate cash flow to help pay for higher labour and compliance costs. Lots of other people and the media generally will have deeper detail so suffice to say we chug along reasonably well but without an improving platform as such for the coming decade. At least the government is boosting its investment strongly!

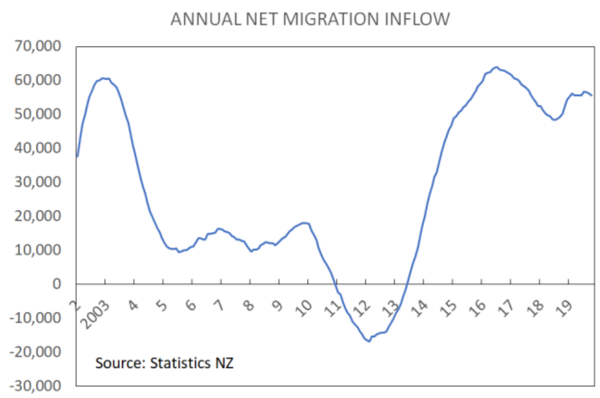
Nonetheless, putting to the side the growing concerns I have about business profitability, the economic fundamentals are supportive of a good pace of growth in our economy in coming years, with the coming year highly likely to show a rise to above 2% in the recent 1.6% annualised growth pace.

Here are the key growth-supporting factors.

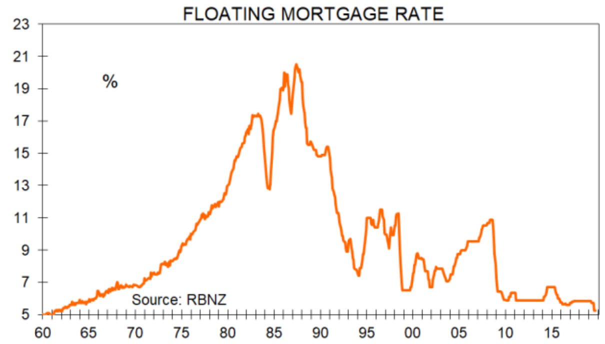
1. **Strong export prices**, a traditional key driver of NZ growth.



2. **Strong net migration** inflows driving above average population growth. That means more demand for housing, retail goods and services, plus pressure on infrastructure.



3. **Low interest rates**. Low borrowing costs encourage people to borrow and spend more and to bring planned future consumption into the present. Low investment returns on simple low risk assets encourages people to purchase riskier assets and this boosts wealth by lifting those asset prices – such as for residential and commercial property plus shares.



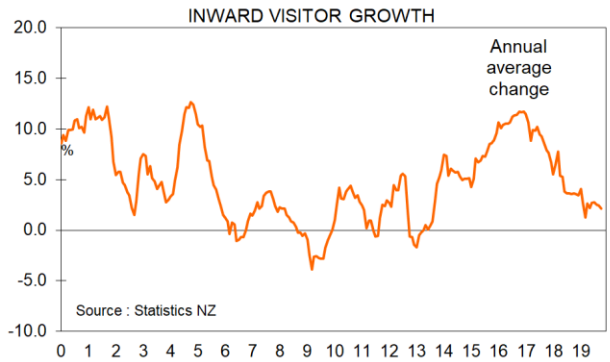
4. **Stimulatory fiscal policy.** The economy and labour market do not need a growth boost from increased government spending. But there are social ills to address and infrastructure which needs upgrading and expanding to reflect unexpectedly strong population growth. So, the government will raise its spending.

5. **Improving world growth**. Global growth forecasts are turning slightly for the better now that Brexit looks like a certainty at last, a trade deal of sorts has been agreed between the United States and China, and governments are increasingly talking about fiscal policy easing (raising spending).

Our growth rate is unlikely to lift to any major degree however because there is a shortage of labour which will not only restrain the ability of firms to grow, but will limit the speed with which the government can boost infrastructure spending in coming years. Businesses are also likely to still be fairly cautious regarding raising capital spending.

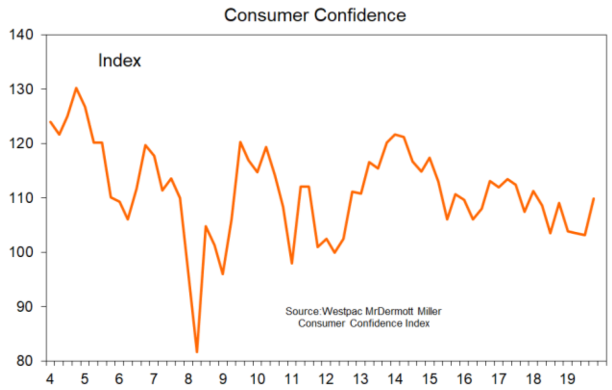
The general election late in the year is likely to be one factor continuing to keep business capital spending growth in check – especially when analysts start talking about the possibility of a Labour-Greens government without restraint from NZ First on the anti-business bent of these two parties. But higher business investment is sorely needed in New Zealand, if not to outright boost capacity then at least to supplant labour which cannot be found or which is of poor quality. Investment is needed also to meet rising environmental requirements coming first via social and customer pressure and eventually via legislation. Expenditure is needed on keeping up with new technologies and market place changes, and on boosting data flows to facilitate better analysis.

The lift in NZ growth will also be constrained by some sectors taking a step back because of developing climate concerns – tourism and dairying. The NZ dairy herd peaked at 6.7 million in 2014 and now stands at 6.4 million. The pace of inward visitor growth has slowed, and downside risks are growing as climate concerns are likely to increase in the coming year and discourage people from long-distance travel. Imagine if Australians back up their concern about climate change causing raging bush fires by curtailing their travel to New Zealand. But as yet, they, like most people around the world, are still demanding that governments, businesses, and people other than themselves make changes. We're not at the capitulation point yet. (When it comes, will it be like October 29 2029? A loss of wealth believed inherent in assets supported by both debt and unsustainable consumption. How could one track approaching proximity of the capitulation point?)

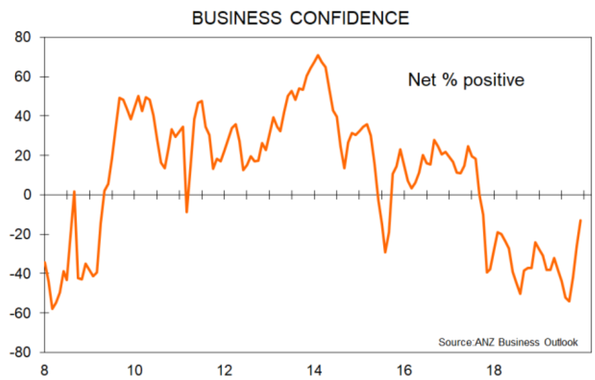


There might be a little bit of a constraint on growth from a firming NZ dollar. Our currency tends to rise as world economic conditions improve. But in the absence of a tightening of monetary policy it doesn't seem reasonable to expect any substantial upward movement.

The Westpac McDermott Miller Consumer Confidence Survey out yesterday tells us that consumers are entering 2020 in good heart and this will be welcome news to retailers. But given the growing competition coming from new operators and online offerings retailing is still likely to be a sector in which many will be highly challenged next year and beyond. The confidence measure rose to an above average reading of 110 from 103 in the September quarter which was the lowest reading since 2012.



And yesterday we also saw the ANZ Business Outlook Survey reveal a decrease in pessimism for the third month in a row. A net 13% of respondents still have a bad outlook for the economy from a low of 54% in September. This is however still below the ten-year average reading of +13% sentiment.



A net 8% expect to boost staff numbers compared with a net 9% planning layoffs 2-4 months ago. This reading is also below the average which stands at 13% but certainly gels better with reality than the earlier pessimistic views.

A net 9% of businesses plan boosting capital spending and this result while below the 13% average is also a good improvement from -9% three months ago.

Is Everything Sweet Then?

What could go wrong? Probably not the world economy no matter how much the thought of a big downturn is psychologically attractive to certain types of people. The truth is we can't predict global downturns with any reasonable degree of accuracy. All you can do is take them as they come. Another one will hit us one day, but there is no obvious reason why it will be any particular year versus any other.

The thing most likely to go wrong lies less in the macro sphere and more at the individual firm level. I used to couch discussion of these factors in terms of blind spots for businesses. Nowadays I mainly discuss them with reference to why business sentiment is so depressed despite the good state of our economy.

Loss of pricing power

We consumers no longer blindly accept price rises when imposed by retailers. We go online seeking alternatives, and because we tend to be proud of our searching skills will stay online until we do find a cheaper price. Businesses can no longer easily recoup higher costs and this factor is going to be the death knell for many businesses which have grown during recent strong economic times.

Inability to handle staffing issues

The old days of many motivated and skilled unemployed people sloshing around the country looking for a job have gone. Businesses cannot find the staff they want and migration rule changes have made things more difficult. Long-serving staff are leaving to get working conditions and wage levels their existing bosses won't give them because they are used to taking advantage of the good attitudes of these previously loyal people. Costs of training and correcting the sometimes-poor work of new low-quality staff are rising, and under a Labour dominated government further regulatory burdens related to staffing are likely – including health and safety.

Social Pressures

Obfuscating poor practices by associating one's business with a good cause, sleeping on cardboard, advertising happy people, staff, animals in clean scenery, is no longer good enough. All such greenwashing can be undone with one viral image of a polluting activity – and the world is now literally filled with people wanting to be the next Erin Brockovich but without the effort.

Businesses are required by legislation to identify their workplace hazards. Wise operators need to get ahead of the next legislative curve directed at new definitions of polluting and harmful activities. Plastics, climate change gases etc. Identifying areas of activism vulnerability will be hard enough. Mitigating such factors may be costly and highly disruptive.

Speed of Change

New competition nowadays emerges at a pace never before seen – maybe online, maybe overseas franchises etc. New methods of distribution keep appearing and tardiness in adopting them can cost market share. New production methods, different staffing requirements and expectations, altered pricing points and so on. Things change at a quick pace these days and business survival for most comes down to this series of factors.

- How quickly am I able to recognise that change is happening?
- How rapidly can I develop a response?
- How quickly can I implement my response and what will it cost me?
- How can I know if my response is on track?
- How long before the next set of changes will be required?

Overall, the macroeconomic environment in which you run your business is important. It will determine your staff availability, wage cost growth, debt servicing cost changes, broad market growth, input cost changes, etc. But I am of the opinion that in this technological age which we are living through the major challenges facing businesses do not lie in the macro sphere outside of recessionary shocks.

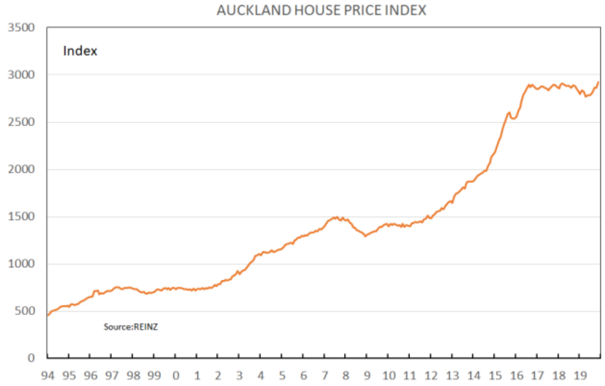
All the best to everyone in business for 2020 and I look forward to meeting with many of you at speaking engagements during the year.

Housing Market

The REINZ released their monthly data last month so let's have a quick look at what they tell us – noting that this time around media coverage of the release was very light, being swamped by other unfortunate events.

NZ house prices rose on average by 1.4% in November to sit 5.6% ahead of a year ago. Sounds boring right? The two interesting bits require deeper digging.

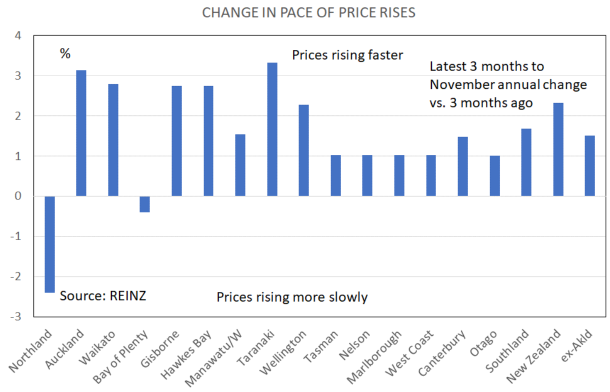
In the three months to November Auckland prices rose 3.1% after being flat three months earlier, falling 0.9% in the three months to May, falling 1.8% three months before that, and flat in the three months to November 2018. The Auckland market has decisively turned around. In fact, Auckland prices have now recovered all the ground they lost between November 2016 and April 2019 (a 4.3% decline). Yes, Auckland house prices are now hitting new record highs on average and are 0.9% above the previous 2016 peak.



I certainly hope all those young house-seekers unable to make a purchase during the boom years of 2011-16, when Auckland prices doubled, have been able to secure a place in the past three years, because fundamentals suggest prices are going to continue to go up.

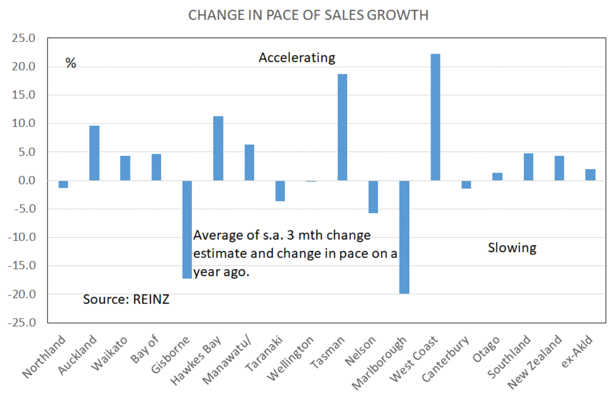
The second interesting thing to glean from the data is that the regions are continuing with their average price surge. In the three months to November average NZ prices excluding Auckland rose by 3.8% after rising about 1% three months and six months earlier. In fact, their price growth has accelerated. I like to show this using the following graph which is presented in bigger format at the end of Tony's View. Only Bay of

Plenty and Northland price rises are slowing on average.

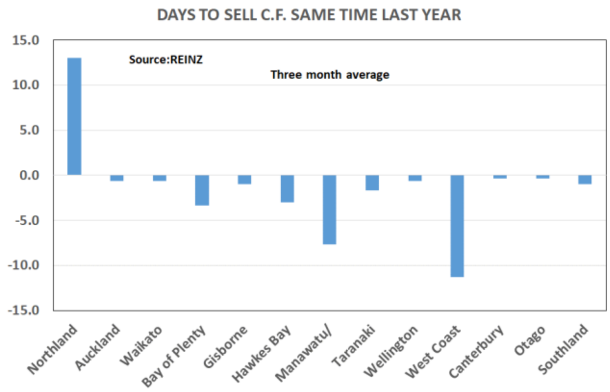


I have a set of graphs which show for each region how prices compare with historical averages. I only print those graphs about every three months at most and won't do so here. But if you are interested you can go to my Tony's View of October 24. http://tonyalexander.nz/resources/TV%2024%20October%202019.pdf

What about sales? Are they picking up? In Auckland yes, with sales in the November quarter 10.4% higher than a year earlier. But the rest of the country is a mish mash and it is hard for sales to grow if listings are in short supply. In this next graph I average across a couple of measures to see if sales seem to be rising or falling for each region. The graph is reproduced at the end of this document in bigger format.



Properties are tending to sell more quickly than a year ago everywhere except Northland.



In brief – what do I think lies ahead for the residential real estate market over 2020?

Higher sales but not by all that much because listings are short and investors actively discouraged from trading by the brightline test and low interest rates making alternative (low risk) investments unattractive.

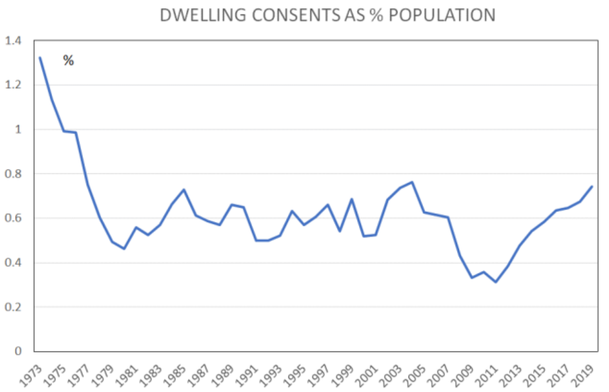
Higher prices probably everywhere given continuing low interest rates, a continuing strong labour market with slightly faster wages growth, continued firm migration-driven population growth, and rising construction costs.

Be Careful in The Boom

There is a boom underway in the residential construction industry in New Zealand at the moment and the chances are good that it will go on for quite a number of years given the growing population and housing shortages. Plus, there is old (and new) housing stock to be upgraded or replaced.

One way to look at the extent of the boom is by comparing the annual number of consents issued for the construction of new dwellings with the population size. This helps put into perspective the current situation versus for instance the early-1970s. Back then consents exceeded 40,000. But the population was only 3 million versus near 5 million near.

The following graph shows that as things stand, things in proportionate terms are about as busy as they were in the early-2000s. Note however that back then the surge in activity was driven to a high degree by the Auckland inner-city apartment market. This time around Auckland is once again a big contributor to the surge, but in the form of townhouse-type developments rather than CBD apartments – which back then were often of very small size.



The graph shows three main things. First, as mentioned, the current surge is nothing compared with the early-1970s. Second, activity is strong now. But third, activity is not unusually strong in the context of the past three decades.

That last point simply reinforces my perspective that there is little reason for anyone talking in terms of a housing over-supply. But it was not a desire to write that sentence which made me put this simple graph together. Instead it was reporting in media over the weekend of yet another house building firm going into liquidation and people losing their advance payments to the builders – who now conveniently cannot be found.

We are going to see a lot more examples like this in coming years. Building a house is something many people think they can do profitably for other people. Their initial examination of the numbers involved can seem attractive. But as with all businesses there are many hidden obstacles which can easily boost costs, slow production, and scare banks away from continuing to provide operational finance.

In the early days of the construction upturn it is likely that mainly established, existing, well-resourced and experienced firms were the main beneficiaries. As they grew a lot of people got employment experience in the building sector, and a lot of them will then have gone on to set up their own small business – to be the master of their own destiny, to be their own boss. But being skilful in swinging a hammer is a world away from having what's needed to successfully manage the world of regulators, suppliers, financiers, and staffing.

Given that house building activity remains strong, is likely to stay at high levels for many years, and staff know they are in short supply with the upper bargaining hand, expect to see a lot more people set out on their own. They will then see the other side of the hiring equation and in some cases won't have the skills to handle staffing and other issues. They will secure contracts but not be able to meet them – and then some will simply do a runner after placing their firms in liquidation.

So, my message is this. If you are one of the many people contemplating getting a new house built – perhaps because of the lower minimum deposit requirement – do not blindly accept the offer of the lowest bidder. Do not accept simply anyone because few builders may have submitted a quote. Investigate the background of whoever you are thinking about contracting with to get your house built, and check out what completion guarantee may be able to be put in place and who by.

Most of all appreciate this. You are desperate to get a house built as quickly as possible because you see prices rising and you want to maximise the period of time you will enjoy capital gains. You probably have zero experience in buying anything at higher price than a car. You're possibly uninformed fodder for inexperienced (not always shonky) builders.

If I or one of my kids were contemplating getting a house built in the near future my first port of call would be considering a home and land package offered by an existing operator who works at subdivision scale. Failing that, or if I had my own section to build on, I'd still be inclined toward discussing construction with an established operator who might have a stable of standardised houses. After that I'd be looking at newly built properties just placed on the market by large operators able to produce "spec" properties.

Failing that I'd be in the jungle of small operators where Darwinism will be in action these next few years – or I would curb my enthusiasm and effectively place an order with a preferred builder for completion further down the track. Good luck to those entering the construction business for the first time, either as a builder or as a buyer. Just be aware that it is in booming sectors that the biggest mistakes get made. And when a booming sector turns down, it can be violent and affect a great number of people. Thankfully that situation seems some way off for house building given the shortages around the country and absence of any strong chance of sharp interest rate hikes.

Interest Rates

I've nothing much new to add this week. The chances are not high that monetary policy will be eased again in New Zealand. Consumer and business confidence levels are rising. A fiscal stimulus is coming. The world outlook is slowly improving. Global sentiment among central bankers has turned against believing that additional rate cuts from historically low levels will do much good with regard to stimulating either growth or inflation. In fact, cuts might do the opposite.

Borrowers might want to spend a bit more time perusing mid to long-term fixed rates on offer rather than just chasing the lowest short-term rate.

CHOOSING YOUR FIXED MORTGAGE RATE TERM

Again, no new minimum rates this week, but banks are slowly raising fixed rates generally.

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	3.45%
3 years	3.89%
4 years	3.99%
5 years	4.09%

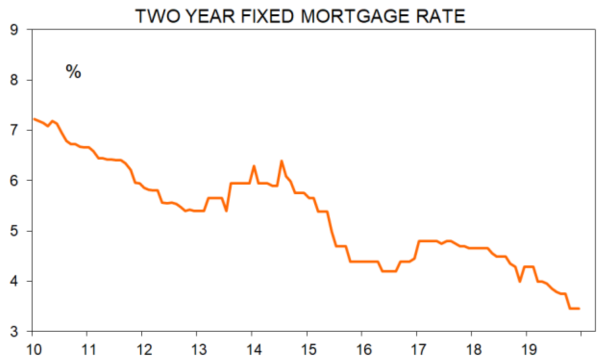
I can fix 1 year at 3.39%.

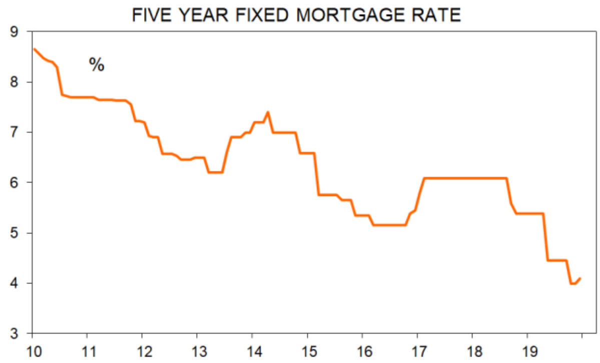
Is this better than fixing 2 years?	Yes, if in 1 year the 1-year rate is below 3.51%.
Is this better than fixing 3 years?	Yes, if in 1 year the 2-year rate is below 4.14%.
Is this better than fixing 4 years?	Yes, if in 1 year the 3-year rate is below 4.19%
Is this better than fixing 5 years?	Yes, if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

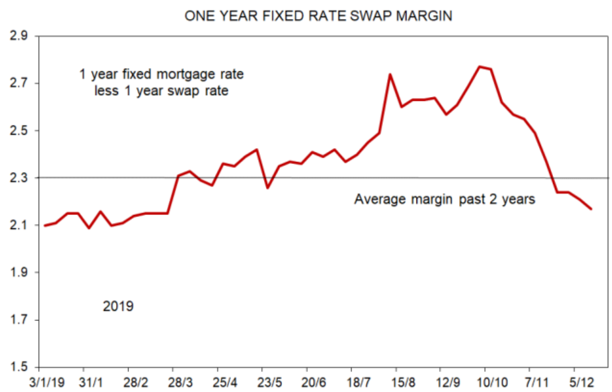


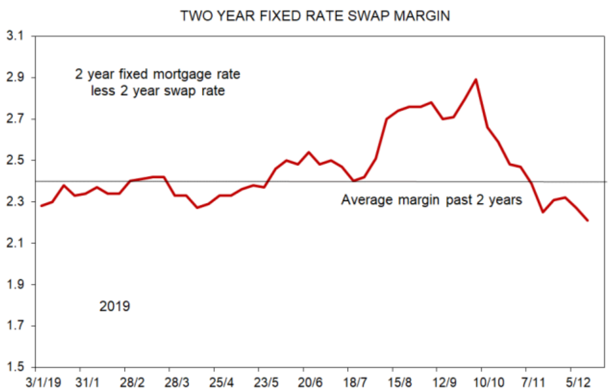


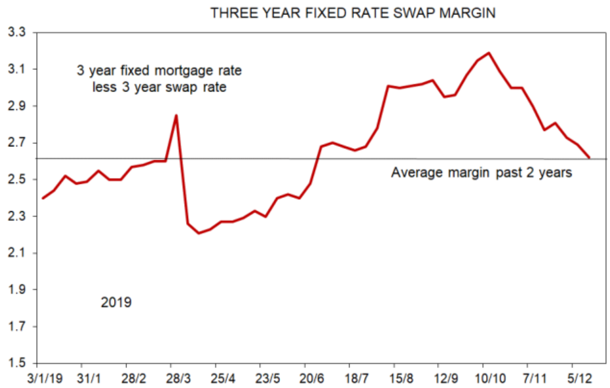
IS A FIXED RATE CHANGE IMMINENT?

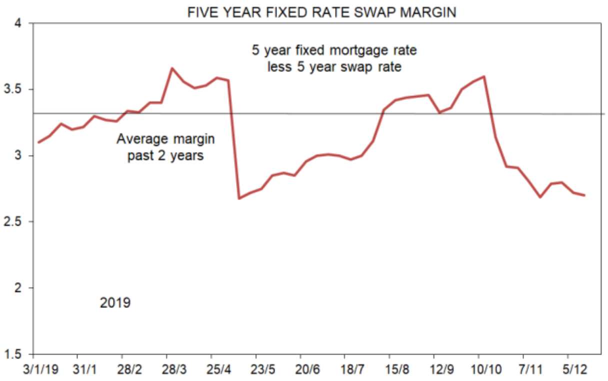
Margins are still slowly falling and banks are slowly, sporadically, raising their fixed lending rates.

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

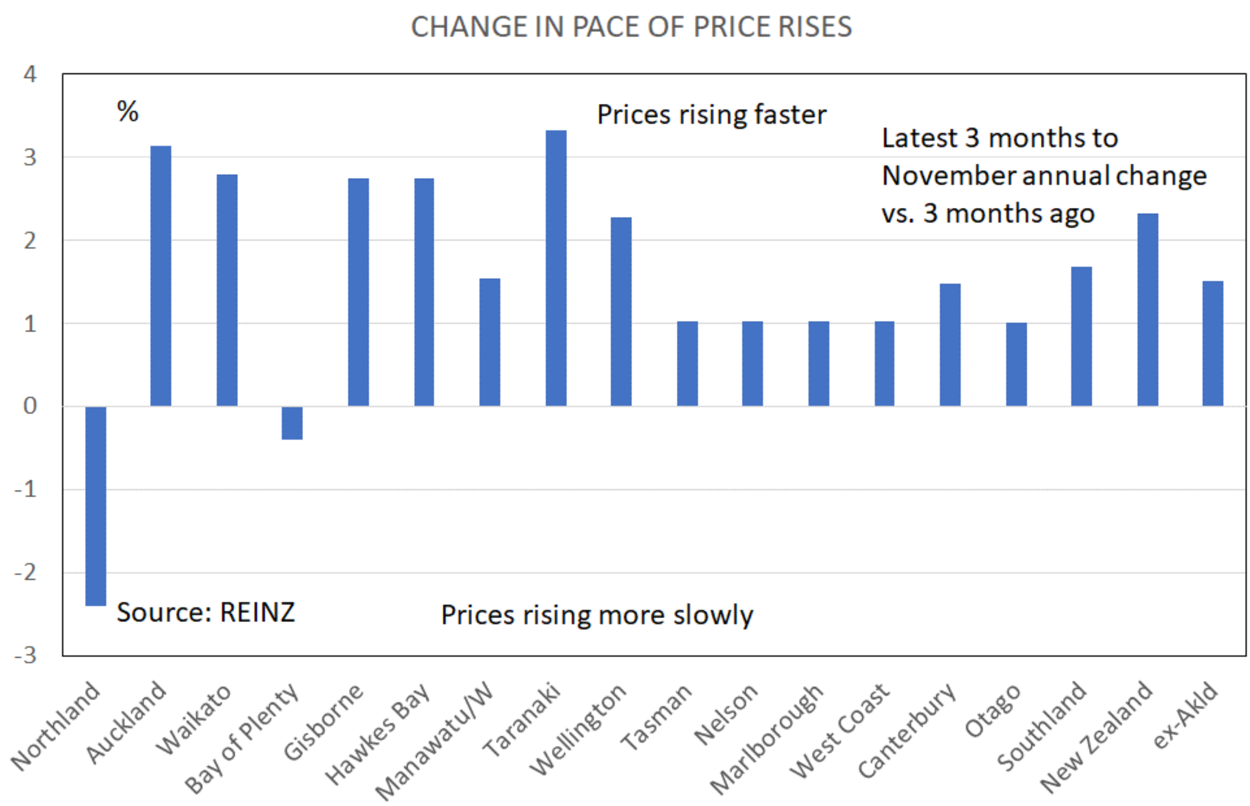
For your guide, in my family it is not just myself communicating and informing people principally online and working from home.

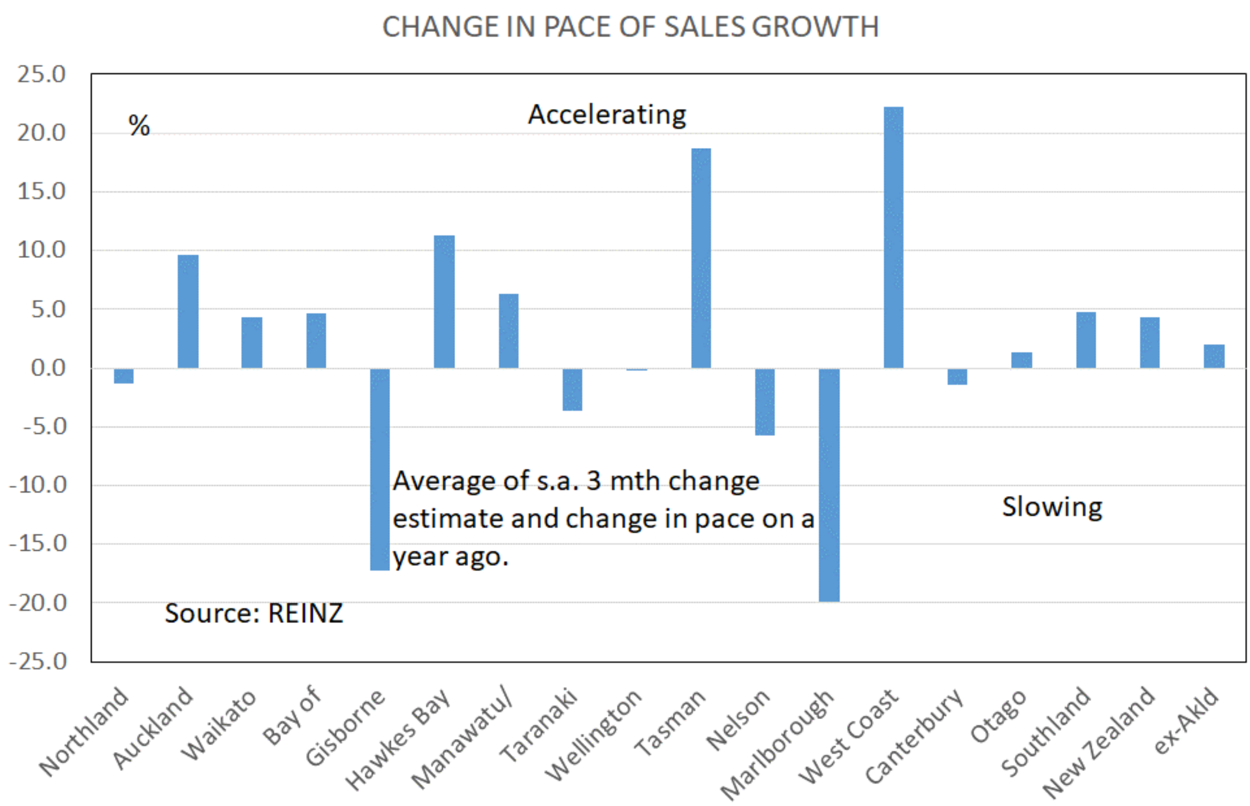
My wife Dr Sarah Alexander manages the network of early education and care services around the country (www.ChildForum.com) and the website for parent ratings and reviews of children's services (www.myece.org.nz).

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




CHANGE IN PACE OF SALES GROWTH
%
Accelerating
Slowing
Average of s.a. 3 mth change estimate and change in pace on a year ago.
Source: REINZ
25.0
20.0
15.0
10.0
5.0
0.0
-5.0
-10.0
-15.0
-20.0
-25.0
Northland
Auckland
Waikato
Bay of
Gisborne
Hawkes Bay
Manawatu/
Taranaki
Wellington
Tasman
Nelson
Marlborough
West Coast
Canterbury
Otago
Southland
New Zealand
ex-Akld