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 19 November 2020

To subscribe to Tony's View click this link https://forms.gle/qW9avCbaSiKcTnBQA

Sign up to Tview Premium here http://tonyalexander.nz/test.php

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.

Questions and answers

I've delivered a great number of presentations over the past few weeks with a few more left before Christmas. People ask a lot of questions, which is great, and this week I include a selection of the many discussed in this week's Tview Premium.

Will people keep working from home and won't this permanently decimate city centres?

We humans have a tendency to over-extrapolate the most recent developments in our lives and societies, and this is one of the biggest areas of such extrapolation at the moment. Around the world more people are working from home and city centres are quiet.

But I am noticing an increasing frequency of articles noting people getting tired of working from home. Businesses report that their cultures are worsening, that it is hard to train new entrants and young workers, and it is hard to acquire new customers and service existing business relationships.

There is deepening concern about young people in particular and their mental health. While the end game from this is likely to be greater work location flexibility, the net ongoing loss of people to city centre offices is likely to be a lot less than most are currently thinking. Astute investors might want to think about that when considering some of the potential central assets coming available for purchase now.

How come the economy has not collapsed like so many were forecasting back in March and April?

We are a modern flexible economy (courtesy of the reforms from 1984-92) with highly adaptable people and good management of the Covid-19 outbreak on our shores. We entered the crisis with record low interest rates and very low unemployment with firms struggling to find both skilled and unskilled labour. We entered with our terms of trade at a record level.

Mitigating the extent of weakness and in many cases eventually driving a strong recovery, we have the many insulating factors which I have been highlighting since March. These include the following

1. Labour shortages already mentioned
2. Record low interest rates which got cut further
3. A shortage of property listings and houses to occupy
4. $10bn reallocated by Kiwis from not travelling overseas
5. Savings from seven weeks of lockdown
6. Wage subsidies
7. A pre-lockdown migration boom
8. Underlying strong growth in a range of sectors such as horticulture, space, games

development, healthcare, aged care, infrastructure…

9. Job losses concentrated in low paying sectors

What would you say to a young person looking to buy a house at the moment?

Five things.
1. It has always been challenging for young people to buy their first house; it's just that nowadays the challenge comes in terms largely of price rather than interest rate or ability to qualify for a rationed loan.

2. I will give you a dispassionate analysis of the factors explaining why prices are high and why they will stay high and rise further. I cannot help you if you want someone to sympathise with you, tell you that you are a victim, and tell you which cohort of the population you should blame. There are plenty of others who have made a living out of doing that at various stages over the past three decades. Anyone listening to their predictions that a knight on a white horse or a bolt from the heavens would deliver the lower price they "deserve" has either consigned themselves to permanent renting or ended up paying far more than if they had acted sooner.

3. Shift to Christchurch. The Christchurch City median dwelling sales price is $526,000 compared with $1mn in Auckland, and almost $800,000 in Wellington. Canterbury is the fifth cheapest region in the country behind only Manawatu-Wanganui, Taranaki, Southland, and the West Coast. You don't have to be in Auckland or Wellington to be a games developer, barista, accountant, or builder.

4. Speak with a Registered Master builder about getting a house built. In the old days young people often bought a section a long time in advance of getting a house built.

5. Think about where you have got with your search and how far out from your workplace you have now found yourself looking and are prepared to live. Now, look around 90 degrees, 180 degrees, and 270 degrees to see what other locations are at the same distance but which you have not considered. This is happening in Wellington with people looking at purchasing up the Kapiti Coast into the Horowhenua realising that such a distance opens up the Wairarapa to them. (That's about a 40-degree twist to the east.)

Will the Reserve Bank take actions to try and push house prices lower?

No. They have no mandate to do so and instead want house prices to rise because this will assist greater growth in residential construction plus feelings of rising wealth.

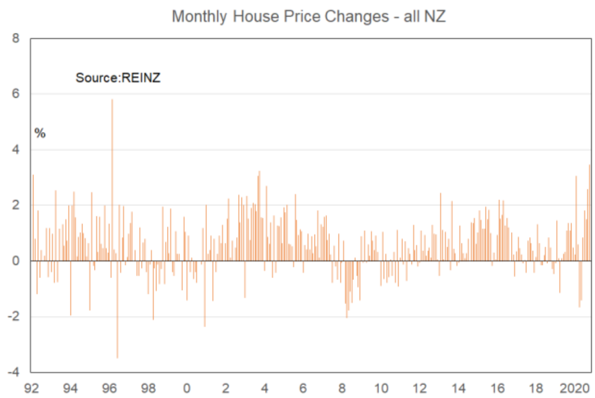
TONY'S VIEW

New Zealand's Housing Markets

Real estate data

Last week REINZ released their monthly data on transactions undertaken during the month by licensed real estate agents and there was much justified attention paid to the headline number on prices.

On average in October, house prices as measured by the House Price Index rose by 3.5%. This is the highest rate of monthly house price inflation in New Zealand since a 5.8% rise in March 1996, and second only to that gain since data started in 1992.



Why has this happened?

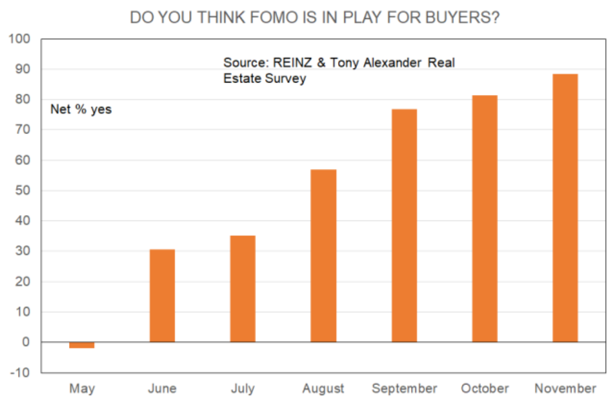
The underlying causes for this 3.5% rise, the 2.6% in September, and the 10.6% rise in total since the end of May include the following – plus the rest of the 25 factors I listed in the September 17 Tony's View issue.

- Record low interest rates expected to stay low and in the minds of some (not me) set to go lower again next year.
- Positive surprises for the economy including a stronger labour market than expected.
- A much greater than thought level of pent-up demand.
- $10bn being redirected from overseas travel.
- Spending of savings during seven weeks of lockdown.
- A record net migration boom ahead of lockdown.
- Anticipation of another boom once the borders fully reopen again (after some initial wobbly months as long-stay visitors go back to their poorly managed countries in the northern hemisphere.)
- Removal of LVRs.

I continue to give that last factor only a small weighting because there is no evidence of a surge in low deposit lending beyond the lift in bank low deposit lending to investors since July.

But why specifically these past two months and not earlier? I put it down to a surge in awareness of the shortage of listings, the turning of media discussion away from economic collapse toward positive news, a surprisingly strong housing market, and FOMO.

This is why I ask agents in the monthly survey I run with REINZ about their observations of FOMO (fear of missing out) on the part of buyers. When FOMO surges panic-buying follows, and my survey has revealed surging FOMO since August.



If I was able to garner a weekly FOMO reading I would imagine it would have gone through the roof late last week when the Reserve Bank made it clear LVRs are to return and then banks said they would apply the old rules right away or come the start of December.

I have already had feedback that Open Home attendance over the weekend was huge in Wellington.

Will reinstatement of LVRs dash FOMO?

I expect it to weaken slightly, but to remain at elevated levels.

Will the pace of house price inflation now slow?

I think so and as noted earlier on in this week's TVP, I expect price gains to settle down at around the 1% a month average seen in the six months leading into March and the seven months since then.

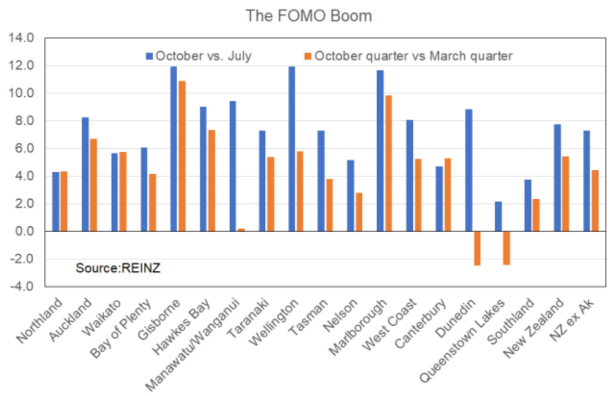
Have all regions just experienced a pace of price growth near an annualised rate of 37%?

Data are volatile enough at the national level for a little country like New Zealand. But when you get down to the regional level the numbers can be literally all over the place without any underlying change in trend actually occurring. But we are not talking about trends here, rather we are looking at the intensity of the FOMO-driven panic buying.

So, I will look at regional price changes over the past three months and also compare the most recent three months with average prices in the March quarter. We get the resulting pretty picture.

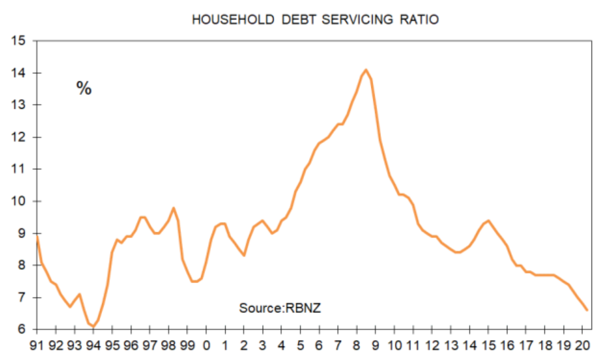
The blue bars show the change in each region's house prices over just the past three months measured as October versus July. The orange bars show the three months to October versus the three months to March this year.

We can see that the greatest recent jumps in prices have been recorded in Gisborne, Manawatu-Wanganui, Wellington, Marlborough, and Dunedin. But compared with early this year before Covid struck, prices have actually fallen in Dunedin and Queenstown Lakes.



Does this recent surge in prices justify an intense focus on household debt and potential unsustainability of debt levels? No.

Interest rates are so low that the ratio of interest payments to disposable household income is the lowest it has been since 1994. The data only go to the June quarter and chances are we will go below the 1994 low very soon. Servicing the debt is no big problem.

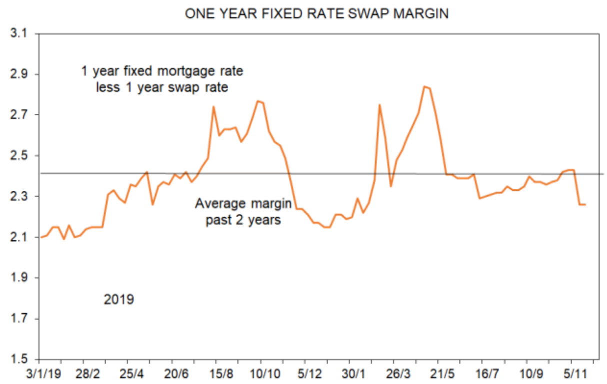


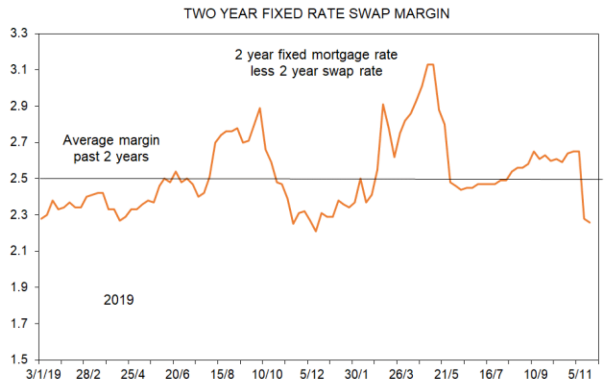
If I were a borrower what would I do?

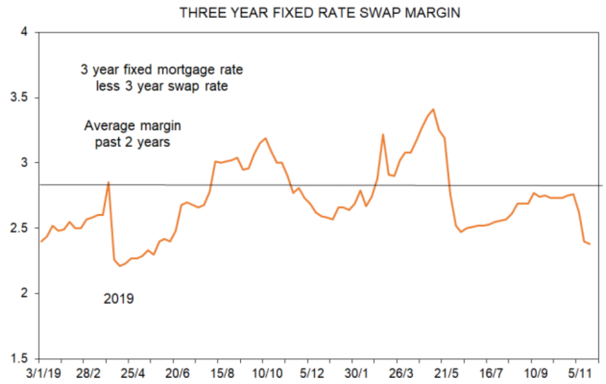
Personally, I remain a fan of fixing five years at 2.99% because in this world we face not just the normal uncertainty about the economy, but also the virus and Reserve Bank actions.

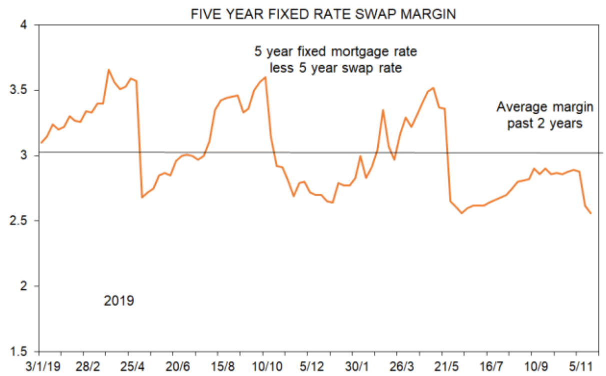
If the Reserve Bank within six and a half months can go back on its promise to leave LVRs unchanged for a year (no matter how justified) they can also go back on promises about steadiness in the OCR, capital requirements (yes, that just got pushed out another year), etc.

The following graphs show estimated margins on fixed home mortgage rates offered by NZ banks, using the minimum rate available for each of the terms. Margins are below average across all terms. This tells me that the chances of any further rate reductions from here are very, very small.









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