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

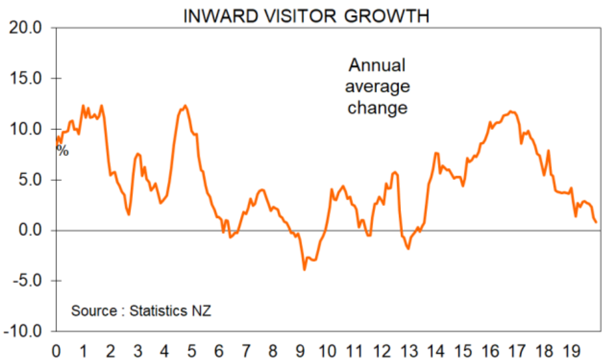
To help Kiwis make better decisions for their businesses, investments, home purchases, and people by writing about the economy in an easy to understand manner.

Insulating Factors

Back from 2009 – 2011 I spent a lot of time talking and writing about the "insulating factors" which meant our economy would be okay despite the lingering effects of the global financial crisis of 2008-09. The same applies now.

China's latest virus outbreak might take 0.5% off the pace of growth in our economy over the first half of the year, with the biggest impact being felt by the tourism sector – largely because Chinese tourists have been banned.

We received 407,000 visitors from China in calendar 2019 which was down from 448,189 over 2018 and 417,872 over 2017. Numbers were falling before the virus crisis and in fact from all countries visitor growth over 2019 was only 0.8% from 3.6% in 2018 and 6.6% over 2017. Growth has fallen to its slowest since the middle of 2013.



Excluding students and international airfares Chinese visitors spent $1.8bn in NZ in the year to September 2019. This accounted for 16% of all visitor spending. How many jobs is this relevant to?

Total direct and indirect employment in the foreign tourist-servicing sector is about 165,000 or 3.5% of all NZ jobs. 16% of that is just over 26,000 people whose jobs are directly at risk were the Chinese market to disappear entirely. It won't but we don't know when numbers will return to normal.

The government's proposed $12mn package to assist the tourism sector as it faces this downturn is useful. But the focus on replacing visitors from China with people from elsewhere reveals again the hollowness of the claim from the tourism sector that they are shifting their focus from quantity to quality.

What are some of the insulating factors for our economy this time around?

1. Low interest rates. Courtesy of the average interest rate on household debt falling to 4.8% from 6.4% five years ago, 7.7% ten years ago, 8% 15 years ago and almost 16% in 1996, the household debt servicing ratio is only 7.2%. This is the lowest rate since 1994.
2. The Kiwi dollar has generally weakened over the past year and the average measure known as the trade weighted index (TWI) sits down 3% from this time last year.

3. High job security. The unemployment rate sits at a 12-year low of 4.0% versus an average 5.3% for the past ten years. Businesses are struggling to find skilled and unskilled staff and employment intentions are positive.
4. Wages growth is accelerating.
5. Net immigration continues to boost our population and therefore roughly our economy by 0.9% a year.
6. House prices are rising strongly and this tends to make more people feel happy than feel sad.
7. Infrastructure spending by the government is being raised strongly in response to under-spending in earlier years and the need to catch-up after unsustainable growth in tourist inflows and faster than expected population growth.
8. Infrastructure spending is clearly going to need boosting by local authorities around the country as the long warned about deterioration in assets such as pipes becomes a matter of moment.
9. House building is strong and this benefits a wide range of sectors.
10. There is underlying strong growth in a range of sectors including wine, Kiwifruit, video production, games design, healthcare, aged care, the space economy ($1.7bn), renewable energy.
11. Further easing of government fiscal policy (more spending) is highly likely in the May 14 Budget.

But before anyone gets too focused on this long list and chooses to dismiss the coronavirus, there are some other negatives in play beyond just China's latest export.

- Labour is in short supply and that will constrain business ability to grow.
- Business caution is high and that means recent underinvestment in capital bases is likely to continue.
- Credit availability from banks worsened last year and further tightening will come as banks must meet new capital rules.
- Drought has hit farm production in much of the North Island and some of the South Island.
- Uncertainty about the effects of climate change – physical, financial and behavioural – risks retarding business investment and growth.
- Business difficulties managing margins will produce a "weeding out" process across most sectors in the next few years.
- The non-primary manufacturing sector's growth rate has largely stalled since 2017.

The picture for the year ahead looks weaker than it did a couple of months ago because of drought and the virus. But it still seems reasonable to think in terms of 2%+ growth for each of the next few years and that means this. The shock of Covid-19 is going to throw up some investment opportunities for those with capital. The tourism sector was due for a correction following an unsustainable boom and the virus is reinforcing weakness which was already underway. Substantial weeding out of undercapitalised operators with excess dependence upon the Chinese market is likely.

Housing Market

Auckland's Shortage 37,000 or 183,000?

Last week's TView was big enough so in this section I didn't include the following bit which would have continued the discussion about a housing shortage in Auckland. How do you calculate the size of a housing shortage?

Last week I noted that according to the 2018 census the occupancy rate in Auckland was 3.15. How many extra houses would be needed to take the occupancy rate back to the 2.94 it was at in 2001 before any talk of a shortage had appeared? 37,000. How many would you need to give Auckland the same occupancy rate as the rest of the country in 2018 of 2.68 people per occupied dwelling? 87,000.

Or, if you think Aucklanders are really, really suffering and to fully be Kiwis they need an occupancy rate enjoyed by people in Nelson, then the shortage is 118,000. West Coast? 183,000.

So, you've got to ask yourself as you contemplate the shortage of housing in Auckland. What place and time do you want the city to look like? And as you do, acknowledge that this is something completely different from social housing availability and affordability.

Reader Comment

One reader sent these insightful comments through this week. They might help explain the growing demand for social housing.

"*You are right in your assumption about some investors upgrading their properties. I have held some property for around 20+ years and been busy finding and buying for the last 8 years but now focused on renovating, painting, landscaping plus meeting the new regulations for the last 12 months with another 12 months to go.*

With potential changes to the 90-day termination clause I won't be taking on anyone that has struggled to find a rental previously. I currently have 2 families in this position which consume 80% of my time. With no potential out clause for me if they prove too troublesome or costly then I will refocus on the top end of the market.

I've already started declining tenants with good references but poor history that my property manager has approached me about in anticipation of this change.

I usually add ventilation, insulation and heat pumps to new acquisitions but I've had to upgrade nearly all insulation and ventilation to meet the new regs, a costly exercise. I never applied for any insulation subsidies as it was still far cheaper for me to do the work myself. I hope to re-enter the market at the end of the year dependant on the bank!

One of my main concerns is moisture and ventilation. I struggle to get tenants to pull curtains and open windows. Even installing HRV systems doesn't work if they don't turn them on.

I'm enjoying the interest rate cut which helps offset the skyrocketing cost of insurance and rates. (Insurance has gone from $800 to around @2500 per property) however my rents have not moved much contrary to what I read in the news."

Housing Market Interventions

A reader asked for my comments regarding a report released last week by a research foundation set up by ex-Prime Minister Helen Clark looking at housing affordability. So, I had a quick look just in case it offered something with a realistic chance of being introduced to the effect that prospects for future house price gains would be reduced. It did not.

First, a capital gains tax was advocated. That has already been rejected by both sides of the political spectrum and I doubt we will see that debate open up again for many, many years.

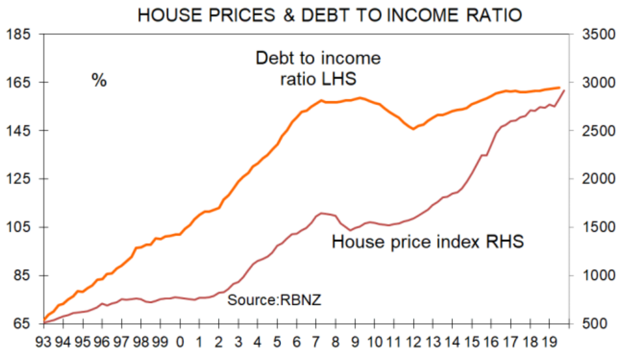
Second, the report proposes reducing debt availability based on income level. The more you earn the less you can borrow. This perverse incentive to work less in order to take advantage of government rules is a common thread through left-wing thinking and there is no chance such an aspiration-sapping policy will be introduced here.

Third, proposals are supplied for government financing of those affected by falling house prices. Muldoon would have loved it. React to the effect of one set of regulations and interventions with another set – then another.

Fourth, the report relies on one key belief/assumption – that it is debt growth which is driving house prices higher. Not completely so. Between 2002 and 2007 NZ house prices on average rose by 105%. The household debt to income ratio rose from 112% to 157%, a 45-percentage point gain. Debt was a driver then.

But, since 2012, NZ house prices on average have risen by 78%. The household debt to income ratio has only risen from 146% to 163%, a rise of only 17 percentage points and much of that a natural bounce up following the post-GFC plunge.

In fact, here is a better comparison. The debt to income ratio is only 4.3 percentage points above its previous peak in June 2009 and since then average house prices have risen by 94%. The following graph shows the household debt to income ratio as the orange line. Note the latest level is only just above that of 2009. The red line is the REINZ' nationwide House Price Index.



A debt splurge is not the driver of the latest run-up in prices. The desire by people on the left to forcibly redistribute wealth in New Zealand distorts their analysis and renders their already determined conclusions not just wrong but deliberately deceitful.

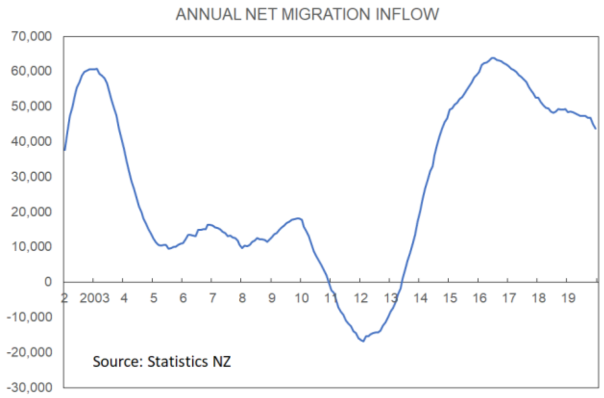
The report fails to adequately take into account the strong growth in total household incomes in New Zealand in recent years, the role of record low interest rates, long-term societal changes, government calls for people to invest for their retirement, and all those factors I've been pointing out since 2010 or so.

Overall the report advocates a level of intervention in the housing market never before seen in New Zealand and there is no chance of the agenda being implemented.

For your guide, latest data show 80% of bank lending going to owner occupiers and 20% to investors. Oh, and a visiting United Nations housing person has also advocated a rent freeze, capital gains tax, forcing people to rent out empty homes, and regulating short-term rentals. Divorced from political and community reality would be a polite description of their thinking … meaning social housing problems will continue because prices and rents are highly likely to keep rising in the absence of realistic interventions.

Migration Population Boost

Statistics NZ estimate that over calendar 2019 there was a net addition to our population from permanent and long-term migration of 44,000 people. This represents a population boost of 0.9% and compares with gains of 49,000 in 2018, 53,000 in 2017, and 62,000 in 2016.



There is a slow easing in the rise in demand for housing caused by migration-driven population growth. But the pace of easing is very slow and the boost to our economy and housing demand still strong.

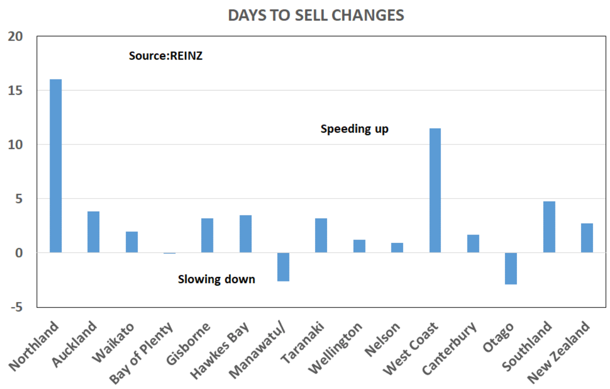
Time on the Market

REINZ released their monthly data on Tuesday and for the heck of it lets start our analysis not with prices or sales but time on the market.

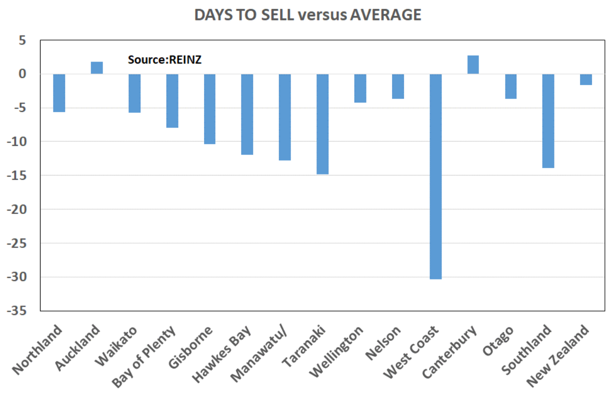
Over the past three months, on average it took 35 days to sell a dwelling in New Zealand. This was two days fewer than the average for the three months to January over the past ten years. So, we can say things are turning over faster than usual.

But three months ago, things were turning over one day longer than usual. So, in the most recent months there has been a pick up in the speed with which a property brought to the market will sell. This three-day improvement is shown in the blue bar to the far right of the graph just below. It is above zero and in the speeding-up part of the graph.

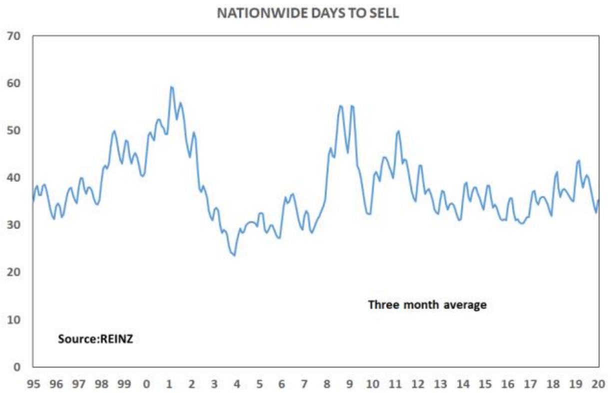
The following four regional graphs are reproduced in larger size at the end of Tony's View.



Also speeding up recently have been residential real estate markets in Northland, Auckland and so on. The only slowdowns have been in Manawatu/Wanganui and Otago. But that doesn't mean those two areas are weak, just that they are not getting stronger. The next graph shows that on average in the past three months dwellings sold in Manawatu/Wanganui 13 days faster than average and Otago four days.

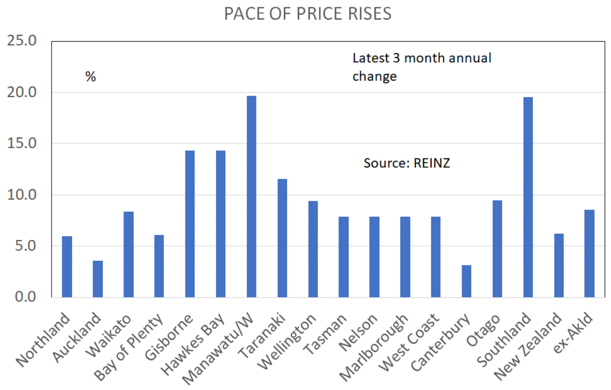


I look at these numbers and they tell me of strength and/or improving strength in all regional residential real estate markets around New Zealand. But I'm not seeing markets taking off in that the decline in the days to sell measure recently is nothing unusual over the past 25 years.

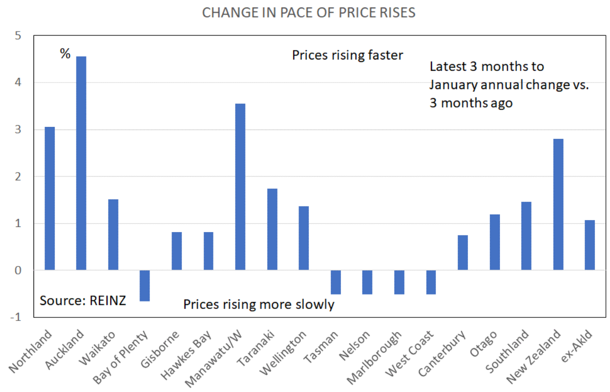


I'll give sales data a miss this month in the interests of saving space. What about prices? I look at trends and that means for this dataset focussing on three-month periods rather than months which can be volatile. I look only at House Price Indexes, not median prices which is what the media headlines display

In the three months to January, on average NZ-wide dwelling prices sat 6.2% ahead of a year before led by Manawatu-Wanganui up 19.6% and Southland up 19.5%. Auckland was ahead 3.6%.



Is the pace of prices growth slowing down or speeding up? Auckland was ahead 3.6% in the year for the three months to January versus falling 1% in the three months to October, so the market there has definitely sped up, as shown in the graph below. Price growth has accelerated in most regions.



Do I think price growth will continue? Yes. Interest rate rises lie a long way down the track. Our population continues to get a 0.9% boost per annum from net migration flows. Wages growth has accelerated. Construction growth is strong but will be retarded by shortages of labour and also shortages soon of some materials because of factory shutdowns and supply chain disruptions associated with China's latest virus.

Interest Rates – Will They Rise or Fall?

My view = Down if coronavirus effects get a lot worse. Otherwise flat then up at uncertain but probably very slow speed over 2021-22.

For this year it all comes down to the coronavirus impact. On paper the positives for our economy were outweighing the negatives. A strong construction sector with an infrastructure stimulus coming along. Low borrowing costs. Rising house prices. A strong labour market. Good prices for exports. Improving business sentiment. Underlying growth in sectors like game design, movies, aged care, healthcare, technology, wine Kiwifruit. Above average net immigration.

We used to note downside risks such as Brexit and the US-China trade war, the extent of correction in the tourism sector after an unsustainable growth period, the constraint from labour shortages, and the inadequacy of business capital expenditure.

But all up most of us were expecting our rate of growth to accelerate and that this would eventually place some very mild upward pressure on interest rates. It looked like locking in a tad more debt over a longer time period might be a good idea as fixed rates seemed to be creeping up.

But while the settling down of the US-China trade war has been a positive, and perhaps also the progress on Brexit, two minor negatives have come along and one big one. The first minor one is the combination of bush fires, drought, then flooding in Australia which will hit the Australian economy – but with offset from higher Federal and State government spending. The second is the NZ drought which mainly affects farming production but can reach the cities if it goes on long enough.

The big negative is China's latest virus – the result of the blind eye authorities have turned to trade in wild animals in confined spaces with people, (despite the lessons of SARs etc.) and the inherent tendency of their authoritarian political system to delay, weaken, and sugar-coat information flow up the chain.

Each day that goes by with still rising numbers of infected people the negative economic impact grows via numerous sources.

1. The absence of Chinese tourists and international students.
2. Weakness in China's economy.
3. Disruption to supply chains for final goods and manufacturing lines.
4. Reduced demand for and prices of primary products imported into China (food, beverages, minerals, energy).
5. Reduced confidence levels and willingness to invest and hire generally in countries outside of China.

This multiplicity of impacts from the virus means it is not enough to focus just on our Chinese tourism sector.

And each day that goes by without an end in sight the probability grows that we will see a precautionary easing of monetary policy in New Zealand. Note however that eventually the virus impact will fade and some sort of bounceback period of recovery will ensue. Knowing this will happen the Reserve Bank will not want to rush into rate cuts and will limit their magnitude if they occur.

As stated in the Reserve Bank's Remit which outlines how monetary policy will be implemented in order to meet the inflation and employment targets… "…and discount events that have only transitory effects on inflation."

Personally speaking, if I were borrowing at the moment, I'd be inclined toward a very short fixed term because of this growing downside risk. If you'd like to know the timing on this possible official cash rate cut please first tell me when the outbreak will end.

(Conspiracy theory: did Greta Thunberg start Covid-19 in order to reduce global tourism?)

CHOOSING YOUR FIXED MORTGAGE RATE TERM

Minimum rates are again unchanged 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 3.71%.

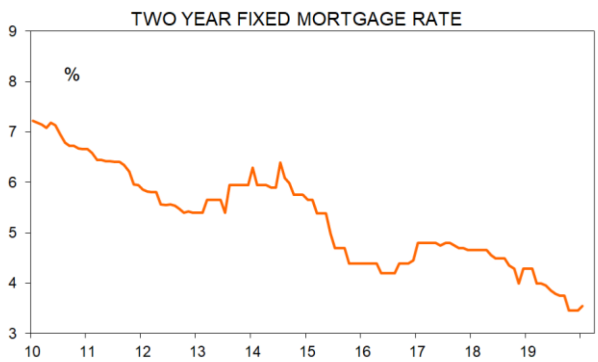
Is this better than fixing 3 years?	Yes, if in 1 year the 2-year rate is below 4.14%.
Is this better than fixing 4 years?	Yes, if in 1 year the 3-year rate is below 4.19%
Is this better than fixing 5 years?	Yes, if in 1 year the 4-year rate is below 4.27%.

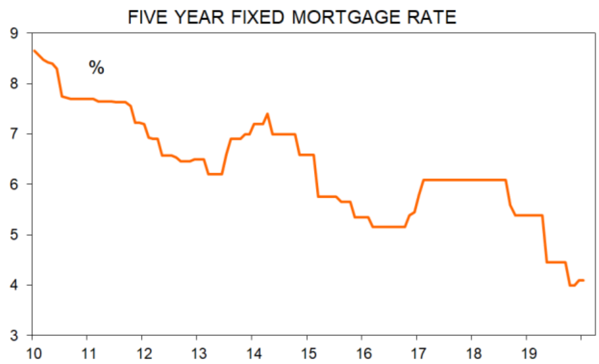
Given virus risks the chances are not high that in one year the one-year fixed rate will be above 3.71%. Therefore, if I am only choosing between fixing two years or rolling over a one-year fixed I now find myself preferring to fix just the one year. This is a change from previously preferring the 3.55% two-year rate.

What about if my inclination is toward fixing three years? Is it worth paying 3.89% the coming year rather than 3.39%? Not for me. Do I think that a year from now the two-year rate (to complete a three-year period) will be above 4.14% versus the current 3.55%? No.

All up, personally speaking, I feel the cost of rate security contained in the fixed mortgage rates for two years and beyond is currently too high when considering downside risks to growth, inflation, and monetary policies from the coronavirus outbreak. Much as it pains me to say so as a conservative borrower who likes rate certainty, I'd probably fix one year at the moment if I were taking out a new mortgage or rolling off an existing rate.

*Minimum 20% deposit, owner occupiers.
Compounding is minor so is ignored.

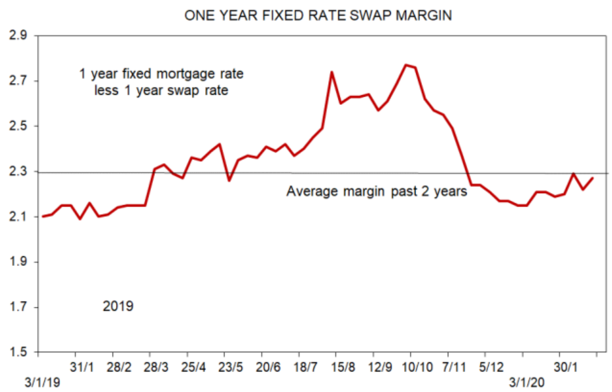


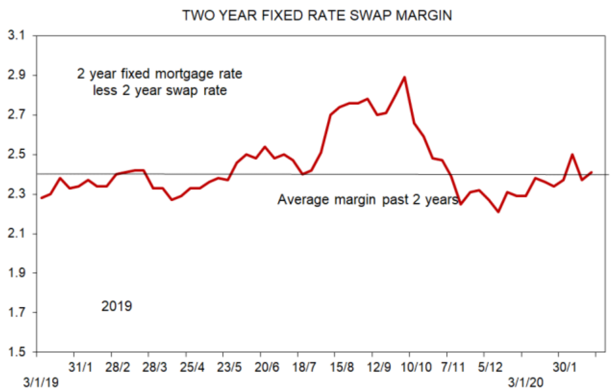


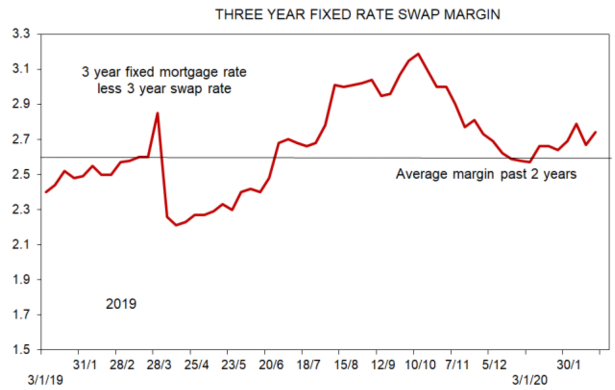
IS A FIXED RATE CHANGE IMMINENT?

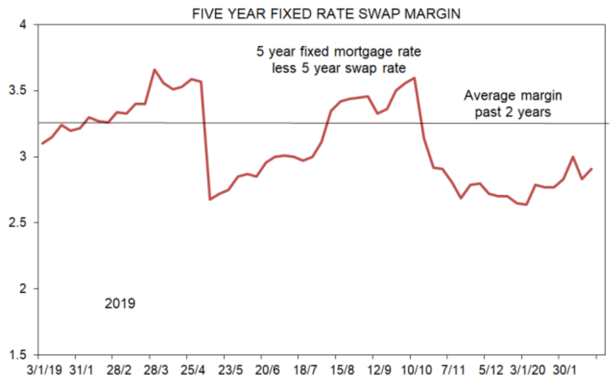
There is no clear trend in margin pressures currently, so any bank rate changes would likely be driven by a competitive drive were they to occur.

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

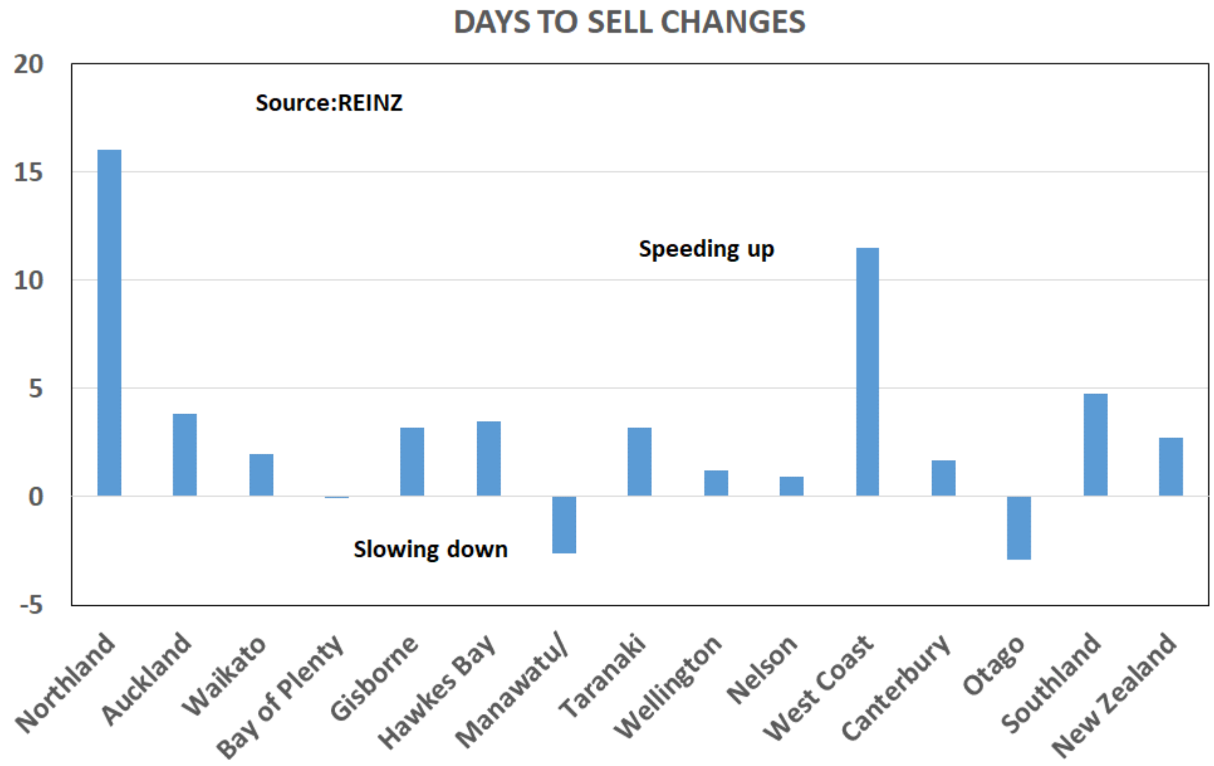
For your guide, in my family it is not just myself communicating and informing people principally online and working from home.

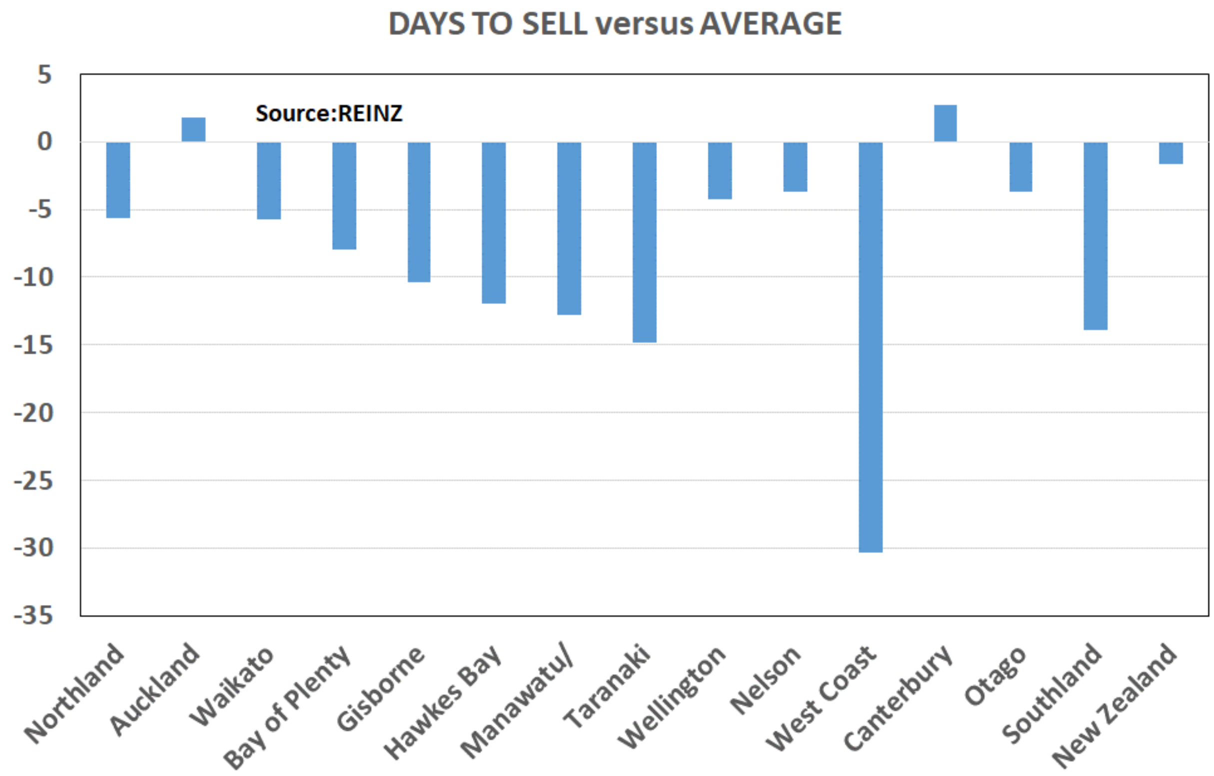
My wife Dr Sarah Alexander manages the network of early education and care services around the country (www.ChildForum.com) and the website for parent ratings and reviews of children's services (www.myece.org.nz).

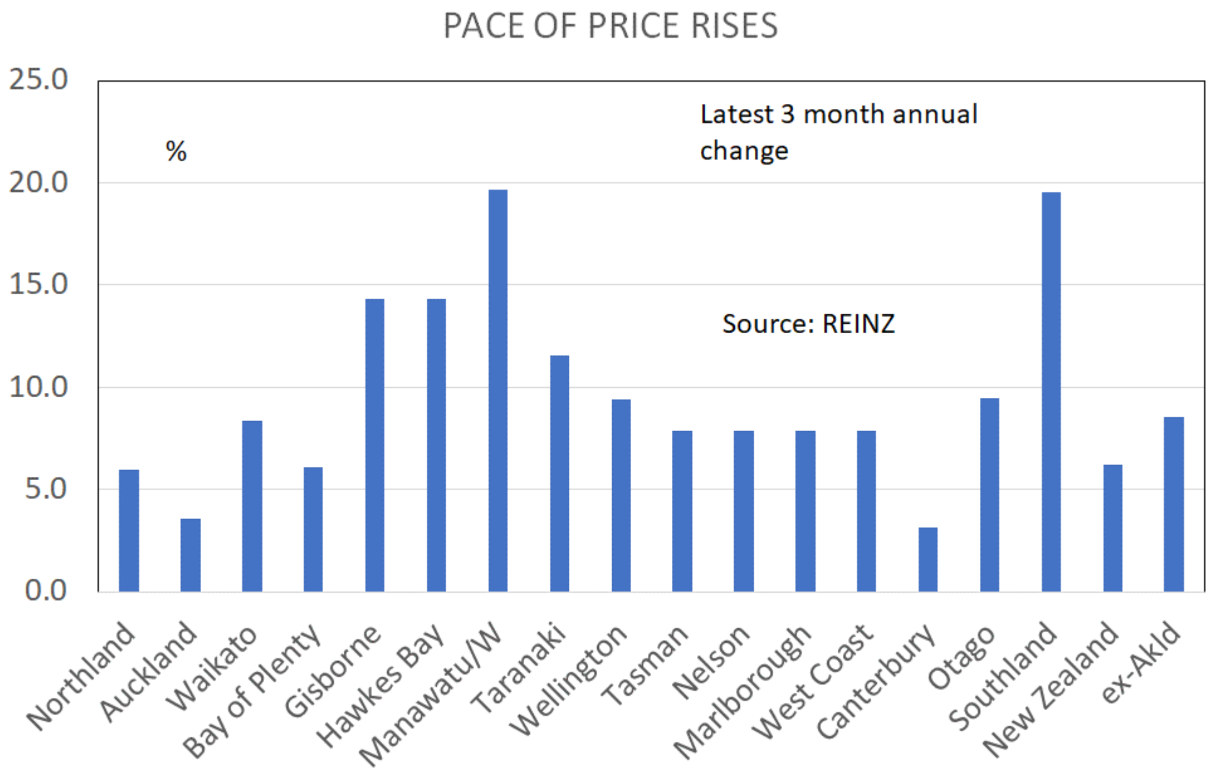
My daughter Lilia Alexander (finalist in the Youth category for Wellingtonian of the Year 2019) owns and runs Social Media based Wellington – LIVE (160,000 followers) https://www.facebook.com/WellingtonLIVENZ/ *"…the largest go-to social media-based updates and news platform for the Wellington region…"* Wellington – LIVE offers advertising options for local events and businesses. Email: info@wellington.live

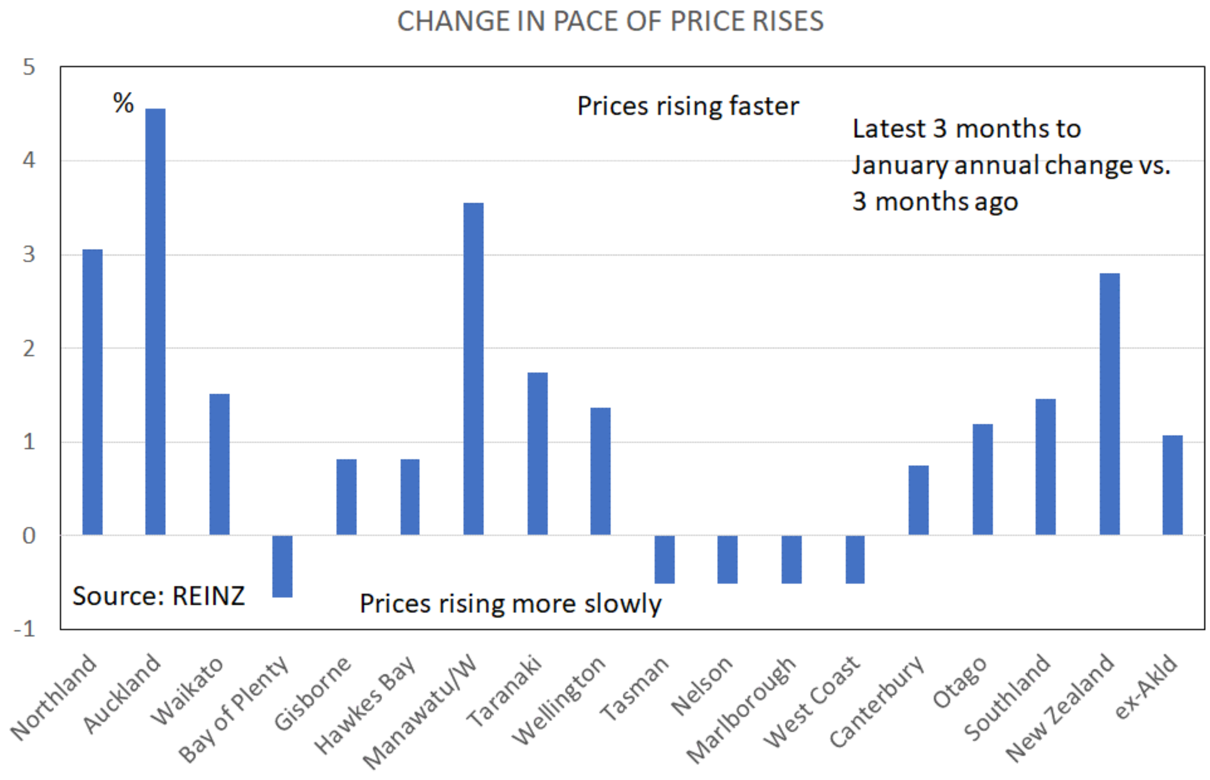
This publication is written by Tony Alexander, independent economist. You can contact me via LinkedIn or email tonyalexander5@outlook.com

DETAILED GRAPHS ENLARGED


DAYS TO SELL CHANGES
Source:REINZ
Speeding up
Slowing down
20
15
10
5
0
-5
Northland
Auckland
Waikato
Bay of Plenty
Gisborne
Hawkes Bay
Manawatu/
Taranaki
Wellington
Nelson
West Coast
Canterbury
Otago
Southland
New Zealand


DAYS TO SELL versus AVERAGE
Source:REINZ
5
0
-5
-10
-15
-20
-25
-30
-35
Northland
Auckland
Waikato
Bay of Plenty
Gisborne
Hawkes Bay
Manawatu/
Taranaki
Wellington
Nelson
West Coast
Canterbury
Otago
Southland
New Zealand


PACE OF PRICE RISES
%
Latest 3 month annual change
Source: REINZ
25.0
20.0
15.0
10.0
5.0
0.0
Northland
Auckland
Waikato
Bay of Plenty
Gisborne
Hawkes Bay
Manawatu/W
Taranaki
Wellington
Tasman
Nelson
Marlborough
West Coast
Canterbury
Otago
Southland
New Zealand
ex-Akld


CHANGE IN PACE OF PRICE RISES
%
Prices rising faster
Latest 3 months to January annual change vs. 3 months ago
Source: REINZ
Prices rising more slowly
5
4
3
2
1
0
-1
Northland
Auckland
Waikato
Bay of Plenty
Gisborne
Hawkes Bay
Manawatu/W
Taranaki
Wellington
Tasman
Nelson
Marlborough
West Coast
Canterbury
Otago
Southland
New Zealand
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