TONY'S VIEW

Input to your Strategy for Adapting to Challenges

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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.

Questions and answers

Last week I delivered two webinars (three this week), and afterward the organisers sent through a list of the questions which people asked. Here are some answers to a selected few. Enjoy, even if many answers just repeat things which have been written here previously.

If we are in a so-called recession why are house prices so high, buoyant?

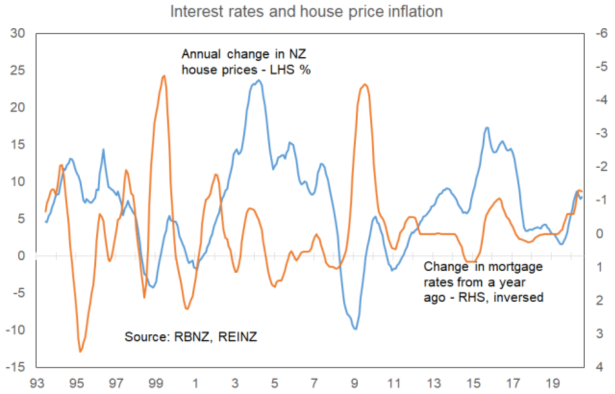
Lots of reasons canvassed here many times.

- A pre-Lockdown 1 net migration boom.
- Record low interest rates heading lower and expected to stay down for years.
- Knowledge of housing shortages.
- Removal of LVRs and first home buyer hopes of banks accepting smaller deposits.
- Gearing up of money no longer to be spent on offshore travel.
- Most people do not suffer income loss just because we are in (have already had and exited) a recession.
- A structural shift forward in time of home purchase plans.

Are we ever going to see increasing interest rates? If we do, we should probably assume declining asset prices?

Definitely. Best pick? Some year between 2022 and 2026. Do rising interest rates cause house prices to go down? Let's look at a graph.

The blue line shows the annual % change in NZ house prices based on the REINZ House Price Index, measured on the left side axis. When the blue line rises, house price inflation is accelerating. When it falls house price growth is slowing down. When it is below zero, house prices are falling from year earlier levels. Data are smoothed over three-month periods. Note the periods of price decline around 1999, 2001, 2009, and 2011.



The orange line shows the change in the average floating mortgage interest rate from a year ago, measured on the right-side axis, but inversed – that is, upside down. I've done this because the general theory holds that if interest rates rise then house price inflation will fall, and if interest rates go down, house price inflation will accelerate.

If interest rates were all that mattered for house price inflation, then the lines would tend to move together with interest rate changes leading house price changes. Let's start with 1993-95. Rates rose, house price inflation slowed a bit, picked up when rates fell, but kept slowing even though mortgage rates kept falling through to 2000. In the late-1990s both house price inflation and interest rates fell because the economy weakened in response to drought and the Asian Financial Crisis.

From 2001 to 2009 interest rates fell initially, house price inflation picked up, then as rates rose, house price inflation slowed down. The 2008-09 Global Financial Crisis was a bigger version of the late-1990s economic weakness and caused both interest rates and house prices to fall.

Since 2012 house price inflation has been strong on average but correlated with interest rate changes in a fairly good manner.

So now we have the Covid-19 period which is a different version of weakness in the late-1990s and GFC. We expect to see both interest rates and house prices falling because of economic weakness.

House price inflation has fallen from over 8% to about zero on an underlying basis now. Interest rates look like falling further, but economic pain will be around for a while longer.

Over 2021 I expect accelerating underlying economic growth (meaning stripping out simple catch-up spending factors), interest rates remaining low and falling early in the year a bit further, and house prices on average to be rising.

When interest rates start to rise, given the experience of the most recent inter-recession period, it is reasonable to expect that house price inflation will slow.

But will house prices fall? For that to happen you need either a recession, or a truly big lift in interest rates as happened over 1999-2000.

I see neither thing as likely to happen in the next few years, especially as the Reserve Bank these days seems to be operating monetary policy more to drive high employment than to influence inflation.

What alternative uses could be there for thousands of square feet of surplus office space we are going to end up with?

Just because demand falls for a thing does not mean it sits unused. Its price will fall in order to attract other users. If empty space is to end up created, it will likely be second and third grade office stock. After all, this is what we had seen for many years in Christchurch ahead of the 2011 earthquake.

What is the outlook for house prices in March 2021 after the delay to mortgage deferrals comes off and unemployment has risen to 10%?

First, unemployment may not rise to 10% and even if it does the trend by then will be downward. Second, as I have been pointing out for many months, most (not all) people losing their jobs because of the fight against Covid-19 are in the services sector on low and variable wages. They tend not to be home owners.

Assisted by low interest rates I anticipate average house prices rising from early-2021 if not sooner.

Where is all the printed money going to go?

The printed money comes in the form of the RB buying bonds from someone selling the bonds. That investor now has cash in the bank instead of a bond holding. They are highly likely to seek another asset to invest in – because they are an investor. They will be inclined to purchase assets like shares, commercial and residential property, and maybe farm investment syndicates etc. They may also just leave it sitting in the bank earning a rate of return potentially better than the yield they were getting on the lower-risk bonds they just sold.

Can the NZ economy continue to function well if we stay shut off from the rest of the world for an extended time and if other economies suffer recessions?

We did alright when inbound tourism was minor some decades back, and the tourism hit has largely already been taken. No new weakness will come along except after the wage subsidy ends and those employers in the sector simply keeping staff on as an act of charity lay them off. Those people will seek employment in other sectors, train, and adapt as we humans are very good at doing. Many of them here on working visas will leave.

When other economies have recessions then fewer of their people come visit us – already factored in – plus our export prices tend to decline. So far, despite weakness offshore, our export prices have held up very well.

TONY'S VIEW

New Zealand's Housing Markets

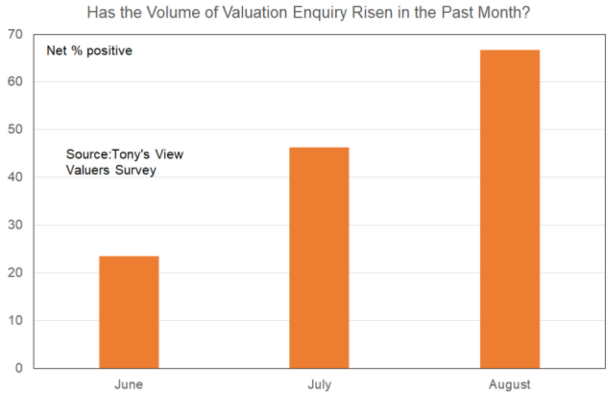
The views of Valuers and Mortgage Advisors

This week I have two of my monthly surveys to report on – one of valuers and the other of mortgage advisors. There is an interesting divergence between the two, even though both surveys were conducted after Auckland went into lockdown level 3. The survey of valuers reflects the perception of underlying trends held by valuers, and those results are stronger than in July.

The mortgage advisors survey however mainly captures completely up to the minute perceptions of those advisors, and those results clearly reveal a wave of caution cased by the lockdown. They also reveal big problems of congestion for people looking to borrow funds to finance a home purchase with long turnaround times for banks.

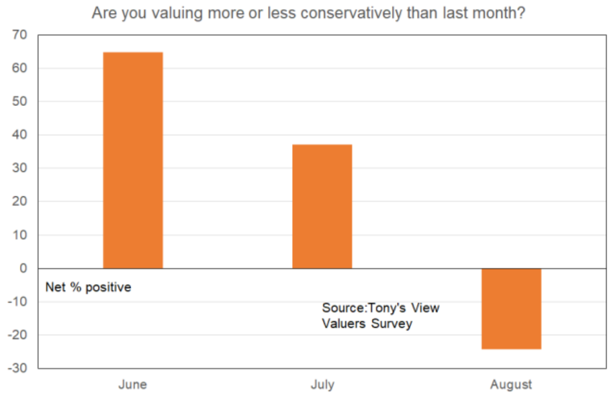
Tview Premium includes comments by valuers and advisors on a regional basis.

I'll start with the valuers' survey results. A net 67% of 33 respondents report that the volume of enquiry for valuations has gone up in the past month.

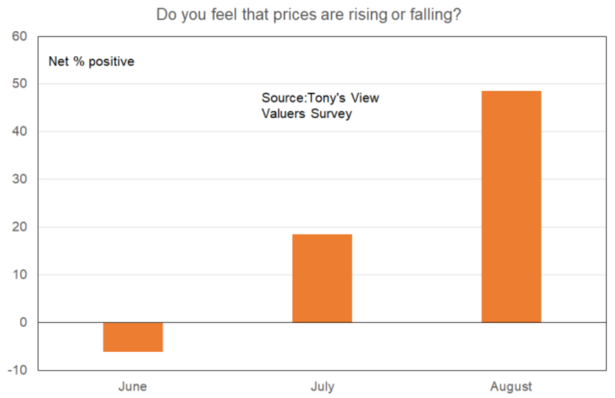


A net 9% say enquiries for off the plan valuations have increased. This is interesting because it suggests a rise in people and businesses thinking about undertaking construction. The improvement is entirely confined to residential work however, and this feeds into thoughts that while house construction will decline over the coming 1-2 years, the falling away of activity won't be as great as the 34% after the GFC.

A net 24% of valuers say they are now valuing less conservatively than last month which is quite a turnaround. But again, this is entirely due to the residential market where a net 57% are valuing less conservatively versus 29% more conservatively last month. For commercial properties a net 36% are still saying they are valuing things more conservatively.



Finally, with regard to prices, a net 71% of those valuing residential property and 27% of those valuing commercial property feel that prices are going up. The July results respectively were 33% and -11%. As with the graphs above, this one covers both residential and commercial responses.

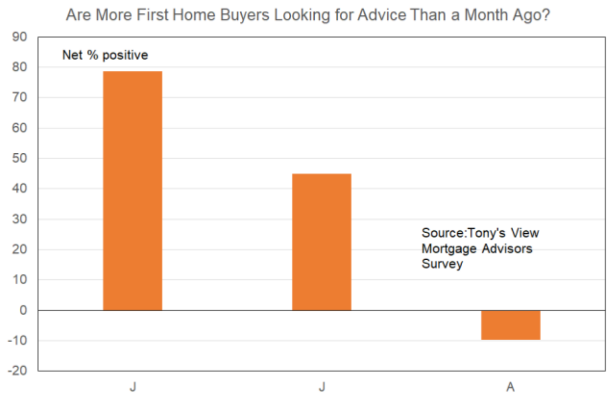


With regard to comments submitted by respondents I have discerned these key themes.

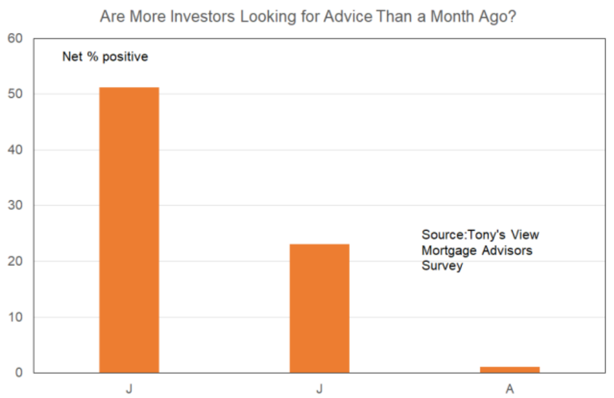
1. Investors are hungry for industrial property.
2. Retail property is weak.
3. Residential demand is strong, especially in lower-priced brackets.
4. Bank finance is very hard to get.

Now the mortgage advisors.

Of the 92 responses received a net 10% said that they are seeing fewer first home buyers looking for advice than last month. This is quite a turnaround from a net 45% seeing more FHBs in July and a net 79% in June. A fall from 45% would be expected given the simple passage of time away from Lockdown 1 and ending of the catch-up period. But the -10% result suggests young people have become much more cautious and have put things on hold for now.



For investors, the direction of change is the same, but not as intensely so. A net 1% of advisors said that they are seeing more investors seeking advice than a month ago, versus a net 23% in July and 51% in June.



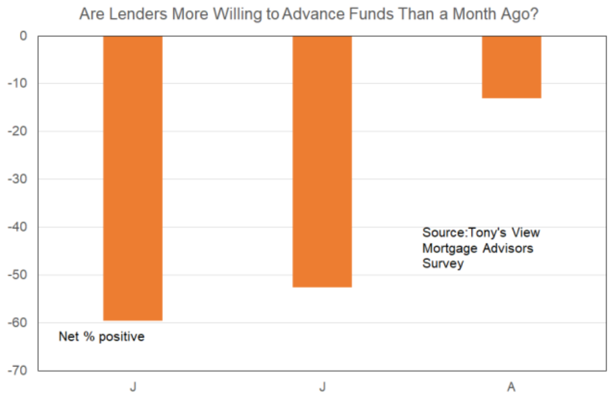
Why might this difference exist between FHBs and investors? Perhaps the Reserve Bank's comments regarding the potential for a negative cash rate next year. For both investors and first home buyers this will mean lower mortgage rates by perhaps up to 0.5%. But for investors it also means potentially much lower term deposit rates – rates which are already at very low levels and have continued to fall in recent weeks while mortgage rates have held static.

The fourth question in my Mortgage Advisors survey enquires about whether more or fewer property owners are seeking advice on refinancing. A net 3% of advisors report fewer people are doing so, versus 12% and 29% net in July and June respectively reporting more queries.

The real value of this monthly survey of mortgage specialists comes from the insights which we can glean regarding bank lending willingness and policies. The numerical result is produced by advisors answering the question of whether they feel banks are becoming more or less willing to advance funds for a residential property purchase.

In June a net 60% of advisors reported reduced bank lending willingness, and in July a net 53%. In this month of August, a net 13% reported reduced lending willingness.

So, banks are still perceived as keeping their credit reins tight. But each month a few more advisors have been reporting that things are becoming less tight. This trend will be welcome news to those seeking to buy property. But, at -13% things are still perceived overall as getting tighter.



From the comments submitted by mortgage advisors I discern these key themes.

- Banks require a lot more information than before and are particularly demanding of SMEs and the self-employed.
- High levels of UMI (uncommitted monthly income) are being demanded by banks.
- Listings remain in short supply.
- Turnaround times remain extremely high around 10-14 days. But many advisors note if clients go direct to a bank, turnaround is usually less than 48 hours.

Interest Rates

Tview Premium contains detailed graphs and analysis of rate alternatives for borrowers and term depositors.

Here is a reminder that floating mortgage rates and fixed mortgage rates are driven by different, though related, things. Floating mortgage rates mainly reflect the level of the official cash rate set by the Reserve Bank. The RB's overnight cash rate heavily influences 90-day bank bill yields and other short-dated bank funding securities, and those securities are used to fund floating rate lending. So too are short-dated retail deposits, and rates for those short-dated term deposits also move closely with changes in the OCR and bank bill yields.

When it comes to fixed mortgage rates, the influence of short-term funding costs diminishes the further out you go along the yield curve. In fact, whereas banks largely fund floating rate lending with floating rate borrowing, they fund fixed rate lending with fixed rate borrowing. That keeps risks in check. The last thing you want to do is fund a whole bunch of fixed rate loans at floating rates then have those funding costs jump up.

Fixed rate borrowing costs tend to be heavily influenced by rates for similar terms in the United States markets, and expectations of where short-term borrowing costs will go in New Zealand. This is why the Reserve Bank can sometimes seek to reinforce the impact of changes in its official cash rate with strong words. They want to change expectations for where borrowing costs facing banks will be in the future. By doing that they can influence not just short-term interest rates but long-term ones as well.

Hence, the strong comments by the RB regarding potential for a negative official cash rate next year are aimed at pushing medium to long-term interest rates lower now.

If you want to keep track of where bank funding costs are going for medium – to long-term fixed rate lending, your best bet is to track swap rates which is what I do in Tview Premium where I also present graphs showing margin shifts.

Term Deposit Rates

I'd say just about anyone reading this little section could also write it – along these lines.

- Banks are cutting term deposit rates little bit by little bit each week.
- These cuts will continue for the next few months with the RB targeting even lower wholesale interest rates.
- Rate rises for term depositors lie some years down the track.
- The effect of sustained low term deposit rates will be to encourage people into other assets, making their prices higher than would otherwise be the case – like housing.

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