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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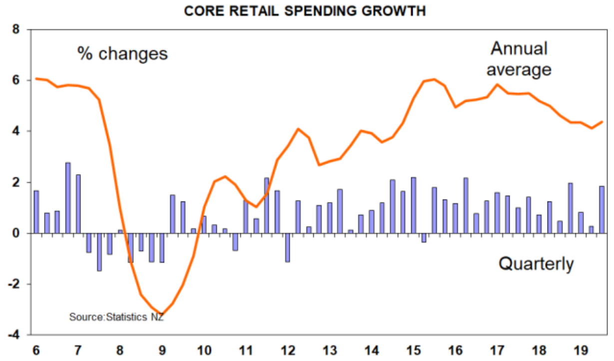
To subscribe, email me…tonyalexander5@outlook.com
To enquire about having me in as a speaker, same address.

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.

Retailing Surge Shouldn't Be Over-read

You would think going by the empty shops and seizing on any opportunity to run specials (Black Friday, Singles Day) that retailing is very weak. But in fact, over the year to September retail spending volumes undertaken by you and I rose by a firm 4.4% excluding volatile motoring expenses. During the September quarter we spent 1.8% more.

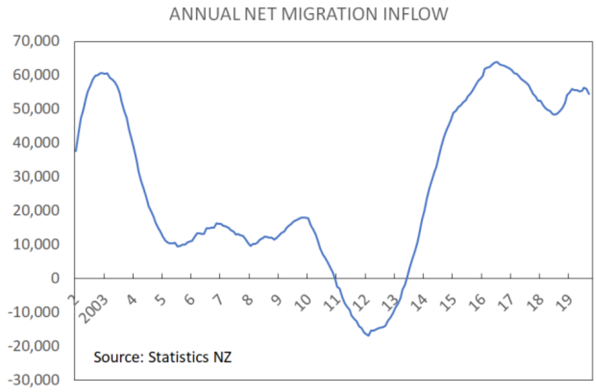


This surge in spending after only 0.3% growth in the June quarter was partly due to people stocking up on televisions, booze and snacks for the Rugby World Cup. Because of that effect and because these numbers do tend to be quite volatile, I don't think someone should look at these strong data and conclude consumers are newly opening up their wallets. Instead take a look at the orange line in the graph just above which shows that spending growth has slowed down at a casual rate from the middle of 2017. That is the trend.

To turn up from here we would need to see some combination of the following things happening.

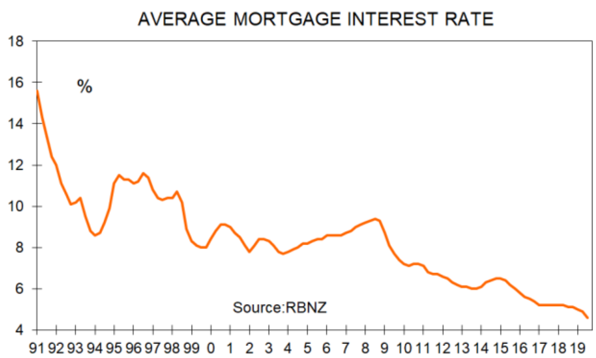
Surging net immigration

Flows are flat to perhaps rising not but surging.



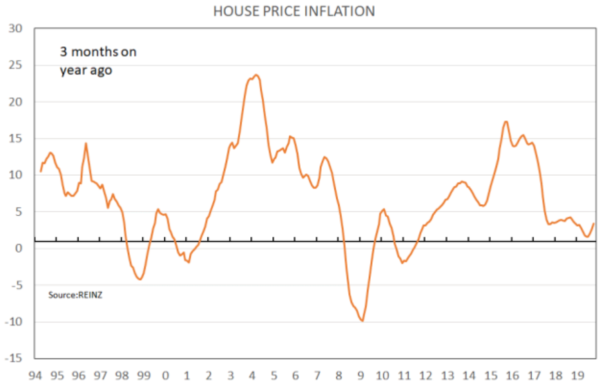
Falling interest rates

Actually, that's a red herring. Rates fall strongly when our economy is munted and that is not the case now. Falling rates tend only to have their big impact with a considerable lag. As it is, mortgage rates have fallen slightly in recent months because of low inflation reflecting low wages growth and business inability to raise prices. But further declines are doubtful and plenty of older people will be cutting their spending because of low deposit rates.



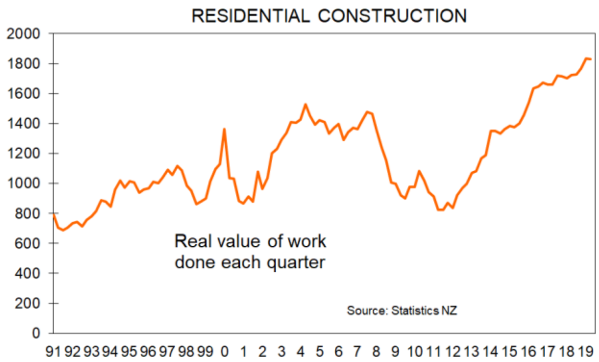
Surging house prices

Strength is continuing longer in the regions than I thought and Auckland has newly turned up, courtesy in both cases I believe of the low interest rates and absence of expectations of rises for a potentially long time. So, a slight positive here.



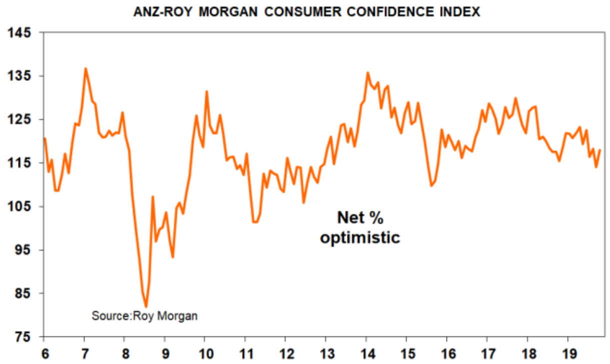
Surging house construction

Growth is constrained by labour shortages, but growth is occurring. So, this is a positive, but the big gains in levels of sales of building materials and home furnishings have already been made. From here we are mainly talking about high levels of sales of such items and related services being maintained rather than strong growth as such.



Consumer confidence rising strongly

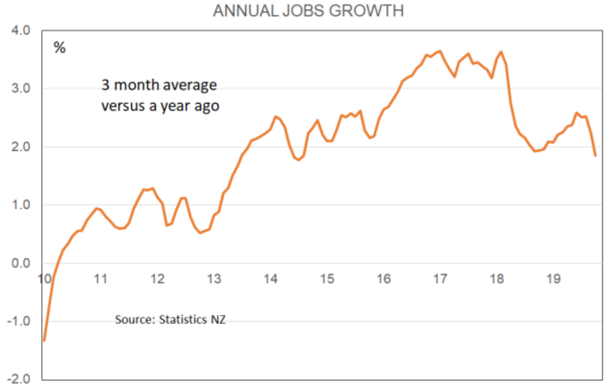
Not really. The monthly ANZ Roy Morgan measure has recently improved to 118 from 114 in September, but this is slightly below average and signalling nothing much at all.



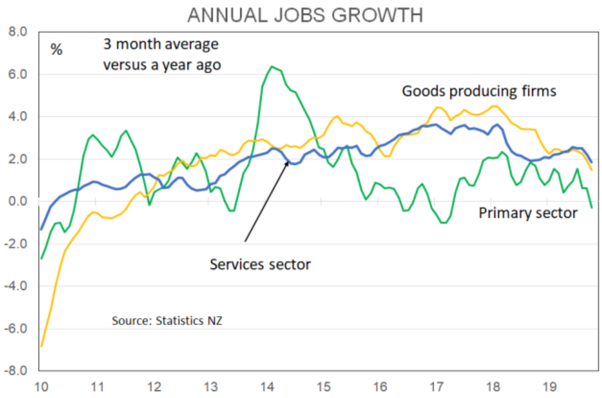
Jobs growth accelerating firmly

It can't because of a shortage of potential staff. Plus, the latest data showing that the annual pace of employment growth has slowed to just over 1% from an average 3.5% from 2014-18. So, this effect has weakened.

Actually, just this morning Statistics NZ released an entirely new and wonderfully up to date gauge of jobs growth in New Zealand. Called MEI, or the Monthly Employment Indicator, it tells us that late in October according to IRD data there were 2,163,503 filled jobs in New Zealand. This was a rise of just 0.9% from a year ago and represented a decline of 0.5% from three months back. I prefer to eliminate some volatility by smoothing over three months and doing that we get an annual growth rate of 1.7% and a decline in the past three months of 0.2%.



Our labour market has definitively weakened off. The weakness is across all three sectors of Primary, Goods Producing, and Services. Note the weak Primary sector jobs growth over the past four years.



And will this employment weakness continue? The ANZ Business Outlook Survey released this afternoon suggests it will. Only a net 3% of business across all sectors say that they intend boosting staff numbers, versus a ten-year average of a net 11% positive. These data can be volatile and smoothing over three months produces a reading of -5%.

Now, before we get overly pessimistic consider the current situation facing employers. They cannot find the people they want whether they be skilled or unskilled. This was a strong element of feedback in the survey I've just run which I'll release on Monday. There is a lot of disruption in a spreading number of business sectors from a variety of sources

- inability to raise prices to maintain margins,
- societal pressures to change,
- offshore competition online and physically within NZ,
- new production and distribution technologies to understand and consider implementing,
- new regulations and compliance issues, and
- wage pressures.

A key recommendation at my talks is that businesses need to alter the way they operate away from always trying to gain new customers to slimming down and adjusting their operations to reflect these many new pressures. It would be unsurprising if for some this did not mean trimming away some surplus people initially before trying again to source more appropriate people down the track. In fact, all it takes for the net employment intentions measure to turn negative is businesses pulling back from trying to hire new people because they see little hope of finding them and don't want to waste time and money in fruitless searches.

So, as with so many other business sentiment indicators, I take the poor job intentions measure with a grain of salt and expect that the labour market will still remain strong from an employee's point of view and that job security will remain sufficient to sustain the willingness of people to spend.

Put all these factors together and I can't see why retail spending will suddenly jump upward to a new and higher growth track in the near future. But I don't think that weakness from current growth rates will be all that much – though weakness does look slightly more likely than September's strong retail growth outcome signalling an acceleration.

For retailers then, from a macroeconomic point of view, you're probably still going to face a good number of people coming through your doors. But you're still going to be radically challenged by

- the swift speed with which we consumers change our tastes these days,
- online shopping,
- entry of foreign chain stores,
- staff management,
- wage and leasing costs rising,
- consumer pressure to address issues of sustainability, and
- locational image problems when other retailers close down and neighbouring shops sit empty.

A reader emailed me a very good point last week regarding the inundation risks from global warming. In low lying areas not necessarily right by the ocean or near a river, generally rising groundwater levels from rising sea levels could lead to more frequent flooding and the need for pumping stations. Christchurch comes to mind in this regard as it was built on a swamp and pumps have had to be installed for the separate issue of the Flockton Basin sinking in the 2011 earthquake.

Is the case made for geoengineering of such locations by draining water and lowering the water table? Sounds ridiculous – but we should expect a tsunami of ideas to emerge once warming and its effects are a lot more obvious and people feel the need to accelerate responses. This lifting of responses will be assisted by the likes of Stuff "…establishing a permanent climate desk with dedicated full-time staffing, to bolster the ongoing work from our current team."

Housing Market

Early this year I started writing that come the November Financial Stability Report the Reserve Bank would probably make a further slight reduction in LVR rules as they had done in the previous two Novembers. But over the past three months we have seen continuing strength in regional housing markets, Auckland turn up anew, declines in interest rates to record lows, and an improvement rather than continued easing of net migration flows. There has also been a noticeable lift in people looking at property for yield in response to declines in term deposit rates to below 3%.

Reflecting these developments and others the Reserve Bank made no LVR changes yesterday and that is not surprising, especially after their decision a couple of weeks ago to not cut the official cash rate again.

The Reserve Bank were explicit in noting the risk that sustained low interest rates will lead to a resurgence in high risk lending – thus suggesting that perhaps their panicked 0.5% OCR cut back in August was not a good idea.

They also spent some time in the Financial Stability Report noting low solvency buffers for insurance companies with additional pressure from falls in interest rates hitting insurers' incomes. The RB have said that they will undertake a review of solvency requirements and it seems likely that the outcome will be higher minimum buffers. This will mean some further increasing of insurance premiums and perhaps an even faster move by insurers toward greater granularization of premium calculations (specific locational risks factored in).

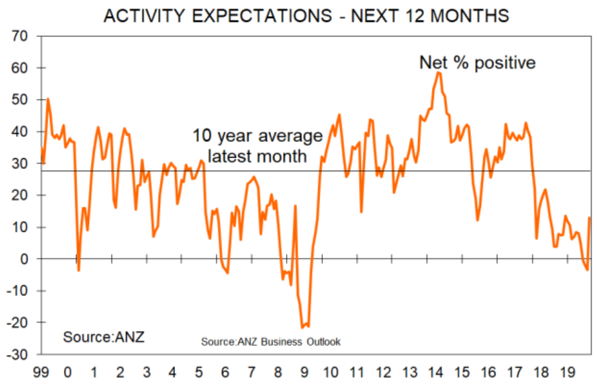
This could easily mean faster pullback from offering insurance in locations facing inundation risk as well as obvious earthquake-risk areas. Keep this in mind if you are considering buying a property in a risky area. Either insurance and therefore a mortgage will not be available, or premiums may soon jump sharply, or the insurance will not be reoffered.

Especially, don't forget this. We saw the ending of a banking supercycle in 2008 and while to date the effects of this were not obvious because post-GFC credit demand fell away, now borrowers are feeling it. Businesses are feeling it as they think about capital expenditure to boost productivity and adapt to changing market requirements. Farmers are feeling it as they face new environmental pressures, the peaking of dairy sector activity, and reductions in capital gain expectations. Property developers mainly felt in 3-4 years ago when banks quickly tightened up lending to this riskier than average sector in response to worries about domestic funding bringing growth in dependence once again on foreign funding. Residential property investors also felt it around that time with the extra pressure from LVR rules.

Come December 5 we will learn the Reserve Bank's decision on increasing bank capital levels in New Zealand. While more dire scenarios may be avoided, the near certainty of more capital being required will affect further bank willingness to lend. And it is not hard to imagine in this world of increasing granularization of decisions, that banks will either voluntarily or eventually by RBNZ regulation, have to hold more capital when lending to at-risk properties. Don't be surprised if one day you see differential pricing of mortgages for such at-risk locations just as such pricing will first emerge for insurance premiums.

Interest Rates

The run of data recently goes against expectations that monetary policy in New Zealand will be further eased this "phase" outside of an external shock. The Reserve Bank have noted their concerns that already low mortgage rates may produce higher risk lending. The ANZ survey released this afternoon recorded some big improvements in most indicators. Business confidence went from -54% in September and -42% last month to "only" -26% now. Still bad, just not horrific. Employment intentions went from -9% last month to +3%, investment intentions from -6% to +6%. Profit expectations went from -21% to -5%. Own-firm activity expectations went from -4% to +13% - the ten-year average is +28%.



September quarter retail spending growth was strong. The most recent change in consumer confidence was upward. Export commodity prices have risen 7% from a year ago and the payout from Fonterra is projected by most to be further revised up this year from levels which already would make it the third highest on record. House price inflation has turned upward. Dwelling consent numbers continue to rise, consent values for non-residential construction are growing, and expectations have strengthened that the government will officially ease fiscal policy (tax and spending things) next year.

For borrowers, unless you think a big global downturn is coming, perhaps you might give consideration to the thought that we have passed the low-points for borrowing costs this multi-year period. I would have used the word "cycle" there but we economists can't use cyclical analysis any longer because cycles don't operate in the way they did in the past. We don't know what the new patterns are.

That also means investors should not be adhering slavishly to whatever investment clock they like looking at either. If you're not getting a decent kick up in inflation pressures when growth recovers from a weak period, you're not getting hikes in borrowing costs and exchange rates so you're not getting the scene set for the next downturn.

But if you do happen to miss the low-point in this interest rates phase, do this. Look in the mirror and say this to yourself. 'I'm borrowing at the lowest rates I've ever faced and no-one expected these rates either before the GFC, or at any time afterward. I am a lucky bastard." Custard squares for everyone.

CHOOSING YOUR FIXED MORTGAGE RATE TERM

No new minimum rates this week = commentary is the same as last week except the final sentence in this section in red italics.

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	3.99%

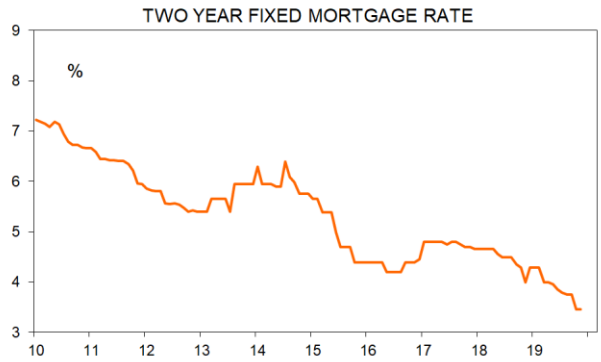
I can fix 1 year at 3.39%.

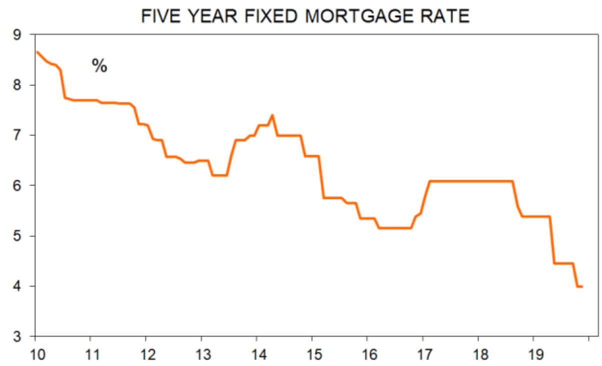
Is this better than fixing 2 years?	Yes, if in 1 year the 1-year rate is below 3.51%.
Is this better than fixing 3 years?	Yes, if in 1 year the 2-year rate is below 4.14%.
Is this better than fixing 4 years?	Yes, if in 1 year the 3-year rate is below 4.19%
Is this better than fixing 5 years?	Yes, if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



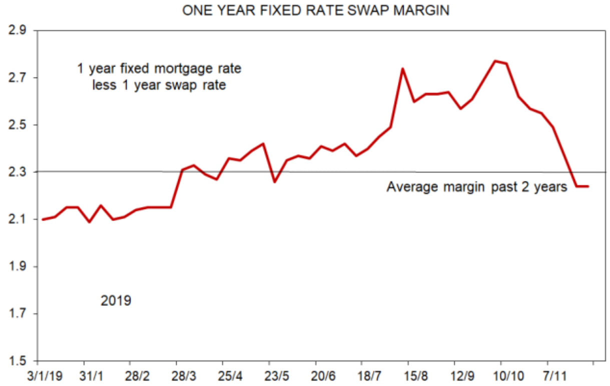


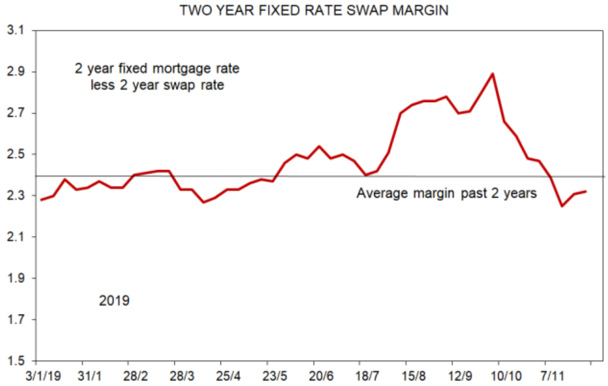
IS A FIXED RATE CHANGE IMMINENT?

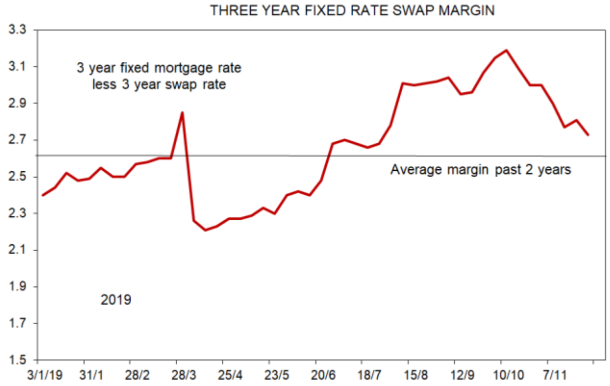
Only one extra sentence compared with last week – in red italics below.

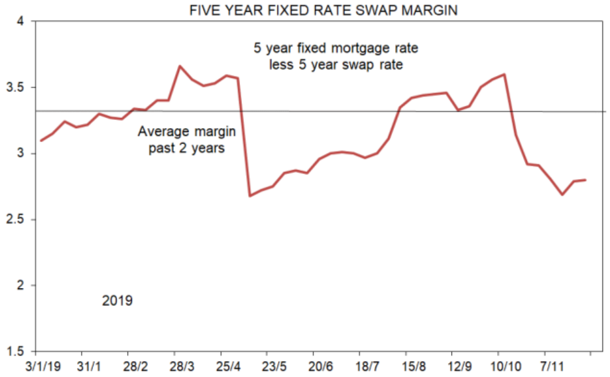
You can form your own opinion as to whether banks might be about to raise or lower their fixed rates by looking at the following graphs. They compare published fixed rates with the most frequently changing component of the total cost of funds – the swap rate. Note that there are other funding costs which 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

Margins have been falling since the middle of October with swap rates creeping up on diminishing expectations of further monetary policy easing here and offshore. Expecting additional fixed mortgage rate cuts from current levels would seem a tad optimistic. *If you like long terms, doesn't the five-year margin look unusually low?*









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.

CHILD FORUM

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).

WL

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

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DETAILED GRAPHS ENLARGED

None this week.