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.

Correction

I got something wrong last week. I wrote that in the four countries offshore with negative central bank interest rates, banks were not charging people for their deposits. That is not correct. I got so busy finalising analysis of the Valuers and Mortgage Advisors surveys, plus the deep dive into Auckland's housing market, that I did not check the veracity of the statement which someone had put to me regarding negative rates offshore.

People are charged negative rates on new (not existing) retail deposits in Germany, and on large deposits in Switzerland.

Here in New Zealand, two weeks ago the Reserve Bank said that they do not expect interest rates on NZ term deposits to go negative and that might be based on feedback they have received from the banks.

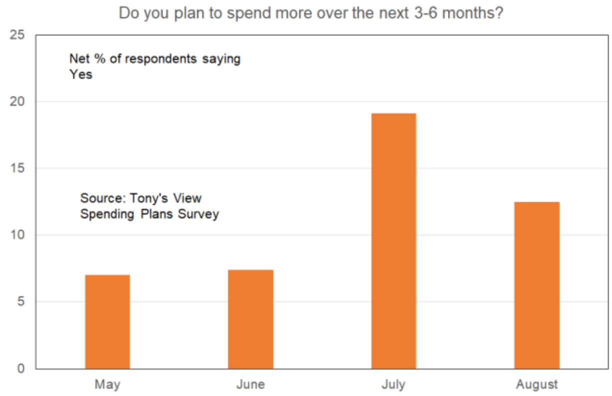
Whether the official cash rate does in fact go negative will depend upon what sort of upward momentum the economy has developed by April next year, and the extent to which banks by then will have started to open their lending doors a bit more. The RB's warnings of the potential for negative rates may be a way of encouraging the banks to ease up by then or else face a compression of their profitability – based on how such rates have affected banks overseas.

So, let's see if I can do a better job and not stuff it up this week.

Spending Plans Still Robust

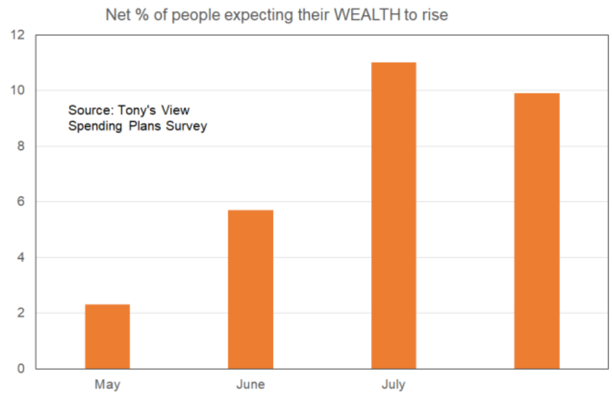
Last week I undertook the regular monthly survey of Tony's View readers to gauge people's intentions of spending or not spending more over the coming 3-6 months, on what, and why.

In both May and June, a net 7% of respondents said they intend spending more. This jumped to 19% in July, but this month has retreated to 12%. The trigger for this decline is likely to be the new lockdown in Auckland, and with that lockdown now ended by and large, sentiment could easily bounce back up again.



Most gauges of feelings about the future eased during the month, but one was unchanged statistically-speaking. The net percent of people feeling confident about the future went from +1% to -4%. Nothing surprising there.

The net percent expecting higher profits for their business went from 0% to -5%. Again, this sounds logical. But the net percent expecting their wealth to go up was virtually unchanged at 10% from 11% in July.

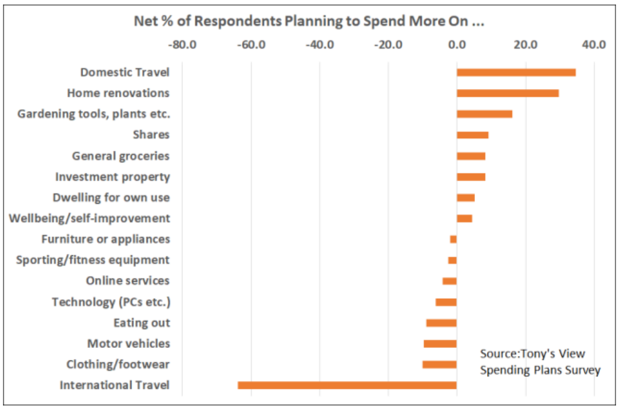


This is interesting and is likely to reflect the strong performance of the sharemarket, along with the absence of widespread falls in house prices. It also gives some validity to the deepening concern around the world that the gap between those with invested assets and those without and dependent largely on wage income, is growing. Central bank actions of printing money and forcing interest rates and interest rate expectations lower are driving prices for assets like shares, precious metals, and property higher. Wages growth meantime looks set to be contained by high unemployment.

One would be advised to keep an eye on this development coming on top of existing concerns about wealth distribution, and the potential for social, then political, then policy changes.

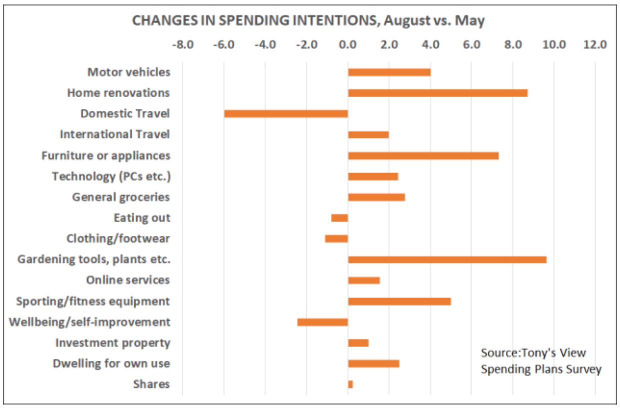
What is it that people plan to spend more on?

There is no change in the spread of things here, with domestic travel and home renovations continuing to be the most favoured areas of extra spending. In contrast, weakness persists for plans regarding spending on motor vehicles, clothing/footwear, and eating out.



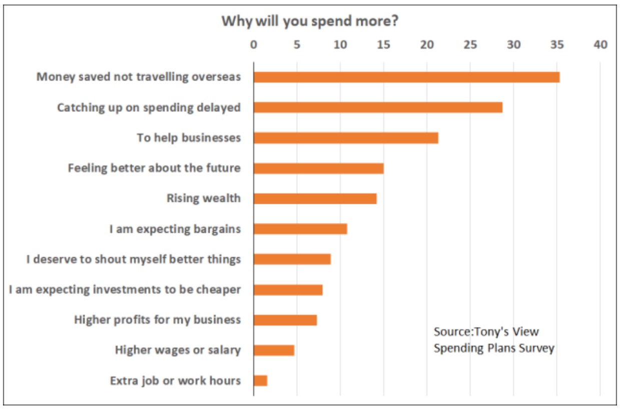
What is it that people are increasingly indicating they plan spending more on, versus increasingly less?

I choose to examine this by comparing August results with those for June. The graph below shows that you and I have most strongly changed our spending intentions toward the positive, or the less negative, on gardening supplies, home renovations, furniture & appliances, and sporting equipment. We have pulled back on intentions to spend on wellbeing, clothing/footwear, and eating out.



Why do people plan spending more?

As has been the case for the past three months of the Spending Plans Survey, spending of money saved not travelling overseas is the key driver. People are also still catching up on spending delayed. 21% of people say they want to help businesses, but this is down from being the top-ranked reason in May at 30%.



While 11% say they are spending because they anticipate bargains, this is down from 23% in May. Rising wealth is playing a role, and this is something the Reserve Bank will be pleased about as they know their policy actions will place upward pressure on asset prices and this can lead some people to spend more. Seeing validity to their policy approach they are likely to continue it.

TONY'S VIEW

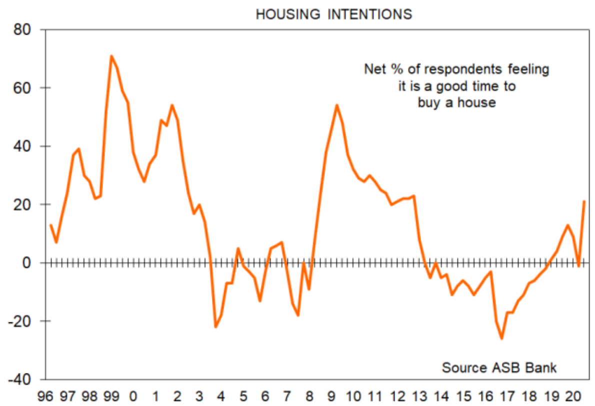
New Zealand's Housing Markets

House Price Expectations

I don't usually say a lot about the ASB Housing Intentions Survey, because it tends not to predict where house prices will go, but to reflect current activity. But it is useful currently in reinforcing what we have been seeing in the residential real estate market, and challenging those still clinging to the view that the sky will soon fall on house prices.

The latest ASB survey shows that a net 18% of people in Auckland and 21% nationwide feel that now is a good time to buy a house. These are the strongest results since 2011 and 2012 respectively. The June quarter results were 1% and -1% from 11% and 9% in the March quarter. These numbers tell us people got a shock, pulled back, but since lockdown have changed their thinking drastically on housing.

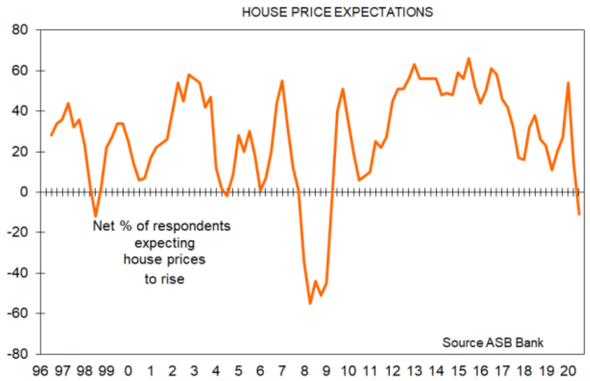
This meshes with what my surveys show and what we have seen happening in the marketplace with investors and first home buyers in particular piling in.



Are people feeling now is the time to buy because they expect prices to go up? Are they driven by some greedy expectation of tax-free capital gain as many haters would have us believe? No.

A net 17% of people expect Auckland prices to fall over the next 12 months, and a net 11% nationwide expect prices to go down over the same time period. (I do not share their views). These are the lowest results since the GFC.

People are buying despite thinking that prices will go down. They are thinking and acting now as they did during the GFC. Why? Because price expectations are not the only driver of house purchase decisions.



For investors, the alternative to buying a house may be leaving their money on deposit earning an already low, and still declining, rate of return.

Will that rate of return be negative after tax and inflation? If one invests in a term deposit currently for 12 months, the interest rate will be about 1.4%. At a 33% tax rate the net gain will be 0.9%.

The Reserve Bank forecasts that inflation over the coming year will be just 0.3%, so your real return will be 0.6%.

In a year's time the 12-month term deposit rate may be close to 1%. After tax that leaves about 0.7%. Take off projected inflation of 1.0% and your money will buy you 0.3% fewer goods and services after you've had it on deposit for a year. Place it on call and earn near zero percent and you'll go backwards then by about 1.0%.

Things might get worse for depositors in some countries such as the United States. This week the Federal Reserve Chairman made some important comments regarding the Fed.'s inflation targeting policy. He said they are concerned that the low average rate of inflation in recent years of 1.6%, risks becoming cemented in, and they want to raise inflation expectations.

So, going forward they will not target 2% inflation each year, but 2% on average, and they will run inflation above 2% for as many years as needed to achieve that average in order to balance off sub-2% years.

In other words, let's say you purchase a five-year certificate of deposit in the United States at the current 0.9%. After tax and inflation expected to average, let's say, 2%, you'll be going backwards by upwards of 1.5% per annum. After five years, your money will have declined in real value by perhaps 7%+.

In NZ currently, the five-year term deposit rate averages 1.5%. It looks like inflation may average 1.5%, so you'll go backwards by about 0.5% a year after tax then inflation, or 2.5% and probably more over the next half a decade.

What are the chances that the average, completely sight unseen, potentially radioactive, leaking student hovel you might purchase right now, will decline in price by 2.5% over the next five years? Not very high.

The Reserve Bank will know that people are making these calculations.

They will fully expect that their interest rates policy will lead to people investing more in housing and holding onto housing assets more than would otherwise be the case.

If they follow the Federal Reserve and look to target inflation above a 2% average (given that here the rate has averaged just 1.7%), they will keep rates at low levels for many years. Plus, they will be in no hurry to raise them when inflation lifts a bit.

Throw in still falling term deposit rates and we get a central bank running a policy they know will boost housing investment over an extended period of time. The price implications are obvious.

Over 2021 it is likely that average house prices in New Zealand will be firmly back on a rising track – even if labour market weakness continues for a while and GDP growth is more muted than the common current expectation. The chances increase virtually every week currently, that this upward trend in house prices will commence before the end of this year. In many places, the trend will have already turned more upward.

What about the majority of bank term depositors who do not consider housing as a suitable alternative investment? In the old days they would have flocked to finance companies. The average margin of finance company rates above bank rates looks about the same old difference in the 1990s of 2% and more. So, investors will get more yield. But they will also get more risk, and the very people who might not feel comfortable investing in housing are likely to have the same risk aversion toward higher yielding deposit-takers.

What is going to happen?

We are likely to see the appearance of pooled funds property investment vehicles. That is, businesses where you and I can place $50,000 and gain exposure to a portfolio of property assets. If this were the old days such vehicles would be there in abundance already. But nowadays, there are many hoops to go through and monitoring regimes to satisfy for those planning on creating such a business. So, they will come, but there probably won't be an avalanche.

Some of these investment vehicles may take the form of purely build-to-let operations whereby they do not buy existing rental assets, but build their own.

For investors still too conservative to shift from term deposits into such investment vehicles, there are always shares. But again, if they are too conservative to invest in property in some way, they may be too conservative to invest in equities, even though plentiful vehicles exist to do so and to withdraw funds quickly if needed for expenses.

Ultimately, most of the money currently sitting in bank term deposits earning a low yield will still be there in one, three, and five years' time. Banks will not lose their funding bases, bank ability to extend credit to borrowers will not be compromised.

Interest Rates

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

A saver this week suggested to me that the Reserve Bank should force banks to pay depositors at least 3%. Resilience – it looks like it is not just the young generation that needs to build some.

The Reserve Bank is charged with keeping inflation down and employment up while maintaining economic and financial stability. There is nothing there regarding using its powers to force private institutions to make payments to a particular group of people. If the government feels savers are being grossly affected, they can use fiscal policy to provide assistance. But there is no chance of that happening.

The Reserve Bank wants to stimulate the economy by encouraging people to spend some of their savings. The government is hardly likely to undermine that policy with another policy.

Savings are there to be used for spending one day - capital preservation - and gaining a return along the way is a side benefit if one can achieve it. If such benefit is desired then the savers will have to move up the risk curve to do it - investing in other than low risk bank deposits. To understand what their options are savers will need to speak with a financial advisor.

In the old days money would likely have flowed strongly into finance companies. But these days raising money from the public is a very complicated business with substantial governmental oversight. When it was easy - we got the pre-GFC finance company collapses plus a few more when the GFC was underway.

Sustained low interest rates are going to actively discourage people from saving and encourage early purchasing of houses by young people, extra purchases by investors generally, and extra spending on retail goods and services. These are things which will contribute to a firming in the pace of economic growth, though not by all that much as history tells us spending from rising wealth via higher house prices might not be all that great. (But I can see hints of this effect in the monthly Spending Plans Survey, discussed above.) And spending generally on retail goods and services has a large "leakage" element - meaning a lot of the money goes offshore to whoever produces the goods in the first place.

Ultimately, whether an economy is growing strongly or slowly, interest rates are high or low, exchange rates are rising or falling, sharemarkets are strong or weak, there will always be winners and losers. After many years of being losers when interest rates were high, borrowers are now winners. After many years of being winners when interest rates were strong, savers are now losers. There was no programme of the government forcing the Reserve Bank to force banks to lower high mortgage rates when the outlook for growth and inflation did not warrant it, and there will be no programme of the government now forcing the Reserve Bank to force banks to raise deposit rates to assist the yield desires of savers.

Basically, you win some, you lose some.

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