TONY'S VIEW

Input to your Strategy for Adapting to Challenges

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

My Aim

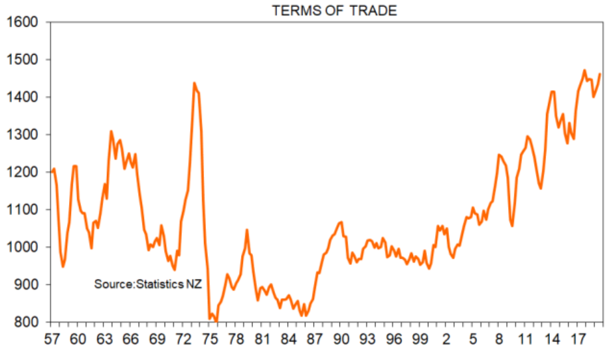
To help Kiwis make better decisions for their businesses, investments, home purchases, and people by writing about the economy in an easy to understand manner.

Survey Results

Many thanks to the over 200 people who responded to the survey request I sent out just under two weeks ago. Given the far better quality of the responses than when I used to run a similar survey from 2011-17 virtually everyone should be able to get something out of the collation released on Monday. As noted in that report, labour shortages are widespread and thankfully my warning for a long time has been that employers need to treat this situation as permanent and likely to worsen rather than a temporary cyclical thing.

It is not just that we have a slowly growing list of indicators suggesting that the pace of growth in the NZ economy will pick up a tad next year. We also have the announcement from the Finance Minister that the fiscal stimulus most of us have been expecting to commence from the 2020 election year is on its way. Sure, some restraint on growth may come from the NZ dollar now rising from its recent lowish levels. And for the tourism sector this currency rise, in conjunction with New Zealand becoming less the flavour of the month, and rising concerns about the polluting effects of air travel, implies downside risks.

But this week we learnt that our terms of trade (export prices versus import prices) rose almost back to a record level in the September quarter.



So much for farming being a "sunset industry" in this country as a Labour Prime Minister opined back in the late-1980s.

Business and consumer confidence levels have risen, retail spending growth was strong in the September quarter, consents being issued for residential and non-residential construction continue to rise, and hardly a day goes by without new proposals for heftier levels of infrastructure spending in NZ.

But we do have reducing availability of credit from the banking sector and that was the big focus at midday today. The Reserve Bank released their capital review and the outcome largely matches expectations. The four big banks will need to raise their minimum Tier 1 capital ratios (shares and redeemable preference shares) from 8.5% of lending to 16% while smaller banks will see their minimum rise from 8.5% to 14%.

Banks will have seven years to implement the change rather than the initially-indicated five years, and the Reserve Bank estimates the impact will be an average 0.2% increase in bank lending rates.

Raising the extra capital will be the big challenge for the banks. Because their Australian owners are likely unwilling to supply all the extra capital needed given the decreasing return on that capital and risk limits set by the Australian authorities, banks are likely to act to reduce their capital need. This can be achieved by redirecting lending from risky activities which can easily produce losses, toward activities where losses are rare. In other words, as I pointed out a year ago, the lending focus will shift away from business and farming toward home ownership.

Will today's announcement be a shock to anyone? No. It largely matches expectations and banks have been signalling their changing risk tolerance for some time – and that is what the following section is about.

Credit Availability Has Already Declined

In March last year the Reserve Bank started up a new Credit Conditions Survey. Every six months they ask the 12 larger banks a range of questions which produce opinions regarding changes in credit demand and changes in bank willingness to lend. The survey has only been run four times so far though the RB have jiggled around an earlier survey to produce semi-comparable data back to 2009. I'll ignore those back data for now and just concentrate on what the most recent surveys tell us because it is current and expected changes in credit conditions which occupy the minds of everyone today following the noon announcement from the Reserve Bank regarding future bank capital requirements.

Responses to my quarterly survey indicate high awareness of a tightening up of lending conditions recently, following an earlier tightening specifically of lending to property developers 3-4 years back. Plus, the loan to value ratio-induced tightening which started in October 2013 and truly hit its straps in late-2016 with the introduction of a 40% minimum deposit for investors – since eased to 30% but held steady in last week's Financial Stability Report.

The most recent survey from the Reserve Bank undertaken in September and reported just over a month ago shows that a net 29% of bankers felt willingness to lend to commercial property developers had declined in the past six months and a net 29% also expected further decline in the coming half year. The table following shows these results and those for other sectors covered in the survey.

	Credit Availability	
	Past 6 mths	**Next 6 mths**
Mortgages	0	-1
Consumer loans	2	-1
Comm. Property	-29	-29
SMEs	1	-13
Corporates	-22	-31
Agriculture	-32	-36

There are a lot of negative numbers there telling us that bankers feel (know) that willingness to lend has fallen, and anticipate more unwillingness to come.

Contrast this situation with that of one year ago before the Reserve Bank announced its intention to make banks hold more capital.

	Credit Availability	
	Past 6 mths	**Next 6 mths**
Mortgages	3	2
Consumer loans	2	2
Comm. Property	11	0
SMEs	0	0
Corporates	17	0
Agriculture	0	-12

The changes are stark, though note the expectation of reduced lending to farmers has been around for some time – it's just worse now.

And why the big change? The survey asks bankers about the factors affecting credit availability. This final table shows it is not the cost of borrowing or competition causing banks to pull back from lending, but increased worries about the riskiness of lending to businesses (consistent with my view of a "weeding out" phase coming along), and balance sheet changes anticipated to come along.

	Last year	**This year**
Cost of funds	-1	0
Balance sheet constraints	1	-25
Competitive pressure	10	0
Perceived risks	2	-16
Risk tolerance	0	-26
Regulations	-9	-26

What does this all mean then to yourselves? If you are looking to borrow for a home purchase or residential property investment, nothing much really. If you are a commercial property developer you've already seen a fairly big tightening this past year, as have farmers and the Corporate and Institutional sector. Today's announcement from the Reserve Bank may not have been as bad (restrictive) as bankers were fearing. But it is hard to imagine anything other than that lending willingness will tighten even further.

This will place a constraint on the ability of affected firms to grow, and adaptation to this structural change in credit availability will be needed.

- You will need to satisfy harsher bank lending criteria by focussing more on ongoing income generation – cash flow – than capital gain.

- You'll need to boost the proportion of your long-term financing coming from retained earnings and new capital.

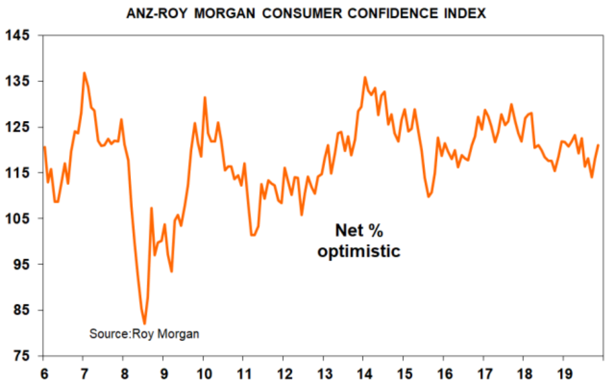
- You'll need better planning of your cash flows because the risk of over-trading and finding yourself unable to get quick overdraft financing and loan extension as in the past could see you closing down or forced toward a high-cost financing option.

Is this tightness of credit any sort of a surprise to businesses? No. The latest ANZ Business Outlook survey shows that a net 31% of businesses are finding it hard to get credit. This stands at a net 46% for farmers – the pinch point of credit supply now.

Housing Market

Happier People Buy More Houses

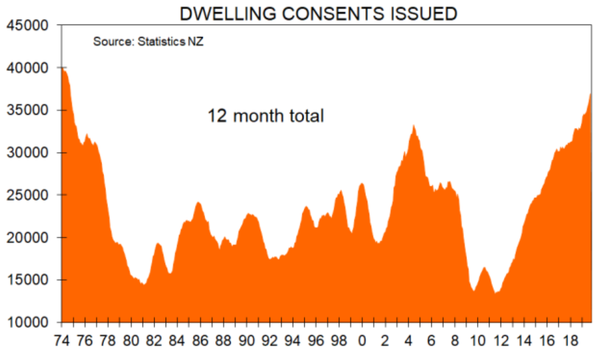
One factor relevant to the likely strength of the housing market – along with retail spending and outward travel – is changes in consumer confidence. The monthly ANZ-Roy Morgan NZ Consumer Confidence survey revealed a rise in sentiment for the second month in a row in November. Their gauge now stands at a slightly above average 121 from 118 in October and a four-year low of 114 in September just after the Reserve Bank panicked people by seeing conditions as so weak they needed to slash interest rates 0.5%. Opps.



No-one should get overly excited by this two month rise in sentiment however. There is very little correlation in the short-term between changes in sentiment and actual consumer trending. The trend is the important thing and that means we can only start to talk more solidly about the economy's growth rate picking up next year perhaps after sentiment is confirmed as rising again in December.

House Supply Growing

Over the past year the number of consents issued for the construction of new dwellings around New Zealand grew by 12% to almost 37,000. This is a massive rise from 13,500 back in 2011 and the high labour intensity of construction means that this sector's growth has been a key driver of employment growth in recent years. In Auckland this past year growth has been 14% and at almost 15,000 consent numbers are more than four times the 2011 low.



In Canterbury consents have grown 13% in the past year and at 5,200, while down 28% from the 2014 peak, are 2.3 times the 2011 low. For the rest of NZ numbers have grown a healthy 10.3% in the past year to sit at 16,800 and 2.2 times the 2011 low.

So, all of the country (except Marlborough) is seeing strong house construction growth.

Will this 12% per annum growth in consent issuance, and presumably construction, continue? My survey suggests no given the shortage of staff. But activity is likely to remain at high levels for a great number of years given the continuing firm pace of population growth in New Zealand. The message to many young people is don't bother going to university and building up student debt. Get into the trades and related activities.

And for your guide, it is not just house building which is booming. The value of consents issued for construction of non-residential buildings reached $7.6bn in the year to October which is a rise of 12% from a year ago just over twice the 2011 low – though volume growth will be less as this measure is biased upward by cost inflation. Issuance of consents for farm buildings has fallen 15% by value this past year.

Speaking of non-residential construction. The announcement by the government that they will allocate $400mn to boost school maintenance was partly couched in terms of creating jobs. This shows that the thinking of some very important people high up in policy formation in New Zealand is still rooted in the 1980s and 1990s when unemployment was high and people were always hoping for job creation schemes. Now there is no need for such schemes outside the context of assisting the most disconnected in our society and those hugely less fortunate.

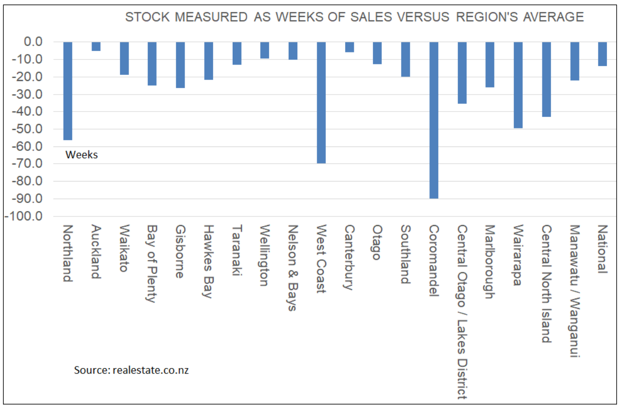
The extra money to be spent on schools will mean fewer tradespeople available to work on houses. This reinforces my expectation of a slowing then plateauing in growth of house construction which will add to upward pressure on house prices.

Note that the Finance Minister also tried to justify the extra spending by noting a deterioration in world economic conditions. But that's not entirely accurate either because indicators offshore are starting to turn slowly for the better, and NZ export commodity prices are at very high levels. No justification for a fiscal boost exists on the basis of either a weakening world economy in coming years or rising NZ joblessness. Simply stating that stuff needs fixing up so our kids get a better education environment is all that's needed.

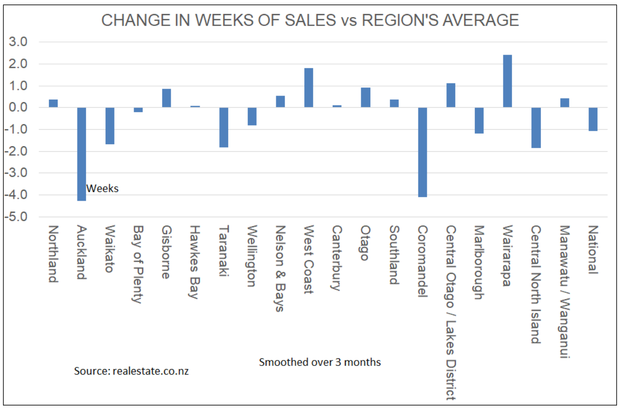
Listings Shortages

This week the website www.realestate.co.nz released their set of data giving us useful insight into the stock of residential property listings all around the country. I like to look at their measure showing weeks-worth of sales available and compare that with the historical average to get a gauge first for whether listings are in short supply or not. Then I like to see if that degree of tightness or looseness is changing. Both the graphs below are reprinted in large format at the end of this document.

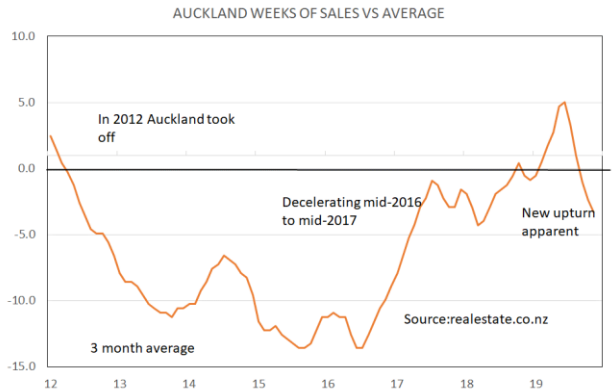
This first graph tells us that supplies are tight in all regions of the country but least so in Auckland and more so in Northland, Wairarapa, and Central North Island. The West Coast and Coromandel are quite small markets.



This second graph tells us that there is a real mish mash of places getting tighter and looser. But what I take notice of here is that Auckland supply is tightening up quite quickly.



So, for the heck of it, here is the long-term graph showing Auckland's stock measured as weeks-worth of sales in terms of distance from the average.

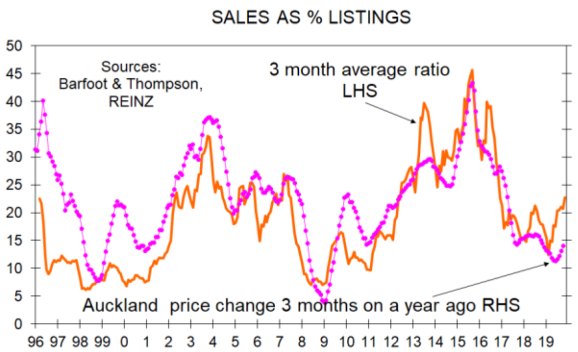


Auckland's Re-strengthening

And why is supply availability compared with sales rising? Because sales are picking up. Barfoot and Thompson released their Auckland data on Tuesday and we can see that in rough seasonally adjusted terms their sales have grown by almost

10% in the three months to November. The Auckland market has picked up. And what does this mean? Prices will rise and to show that I've printed here one of my favourite graphs. It shows the clear correlation between changes in stock availability measured as a ratio of sales to listings and the annual change in average house prices measured by the REINZ's house price index for Auckland.

What you want to notice is first, the historical correlation, then second the recent shooting up of the ratio of sales to listings shown as the solid orange line. History tells us the dotted pink prices line will follow and that history suggests that soon Auckland prices will be up by over 5% from a year earlier. Hence, little chance of interest rate cuts, no LVR easing by the Reserve Bank, and no great worries on their part when banks threaten higher mortgage rates in response to boosted capital adequacy requirements. The Auckland housing market momentum is doing the RB a favour in selling the capital rule changes.



Here is a thought for those interested in the regions. Will we see investors turning their attention back to our biggest market and forsaking the regions (for a while)? The anecdotal feedback I received in Rotorua at the NZ Property Investor's Association conference is that this is already happening.

Auckland $3m Average Price?

Yesterday a long-time follower asked for my thoughts on an NZ Herald article which calculated that come 2040 the average Auckland house prices would be $3m if the past two decades repeat. By definition they are correct as a maths exercise. But anyone can make such a calculation. The question is whether such an outcome is likely.

I expect prices to continue rising because of strong population growth, a preference for living as close to work as possible given dysfunction of the transport networks, and rising construction costs. But as I have been pointing out since 2011, there are many structural factors which have underpinned the jump in house prices these past few decades – but in more recent times I have been pointing out that these factors will not repeat themselves. They will continue to exist but not do the jump they did before.

Specifically…

- Interest rates will not repeat the big structural declines of 1992 and post-GFC.
- Net migration inflows will not repeat their structural lift.
- The unemployment rate will not repeat its structural decline.
- Credit availability will not repeat the major loosening which commenced from the late-1980s.
- The structural shift toward two income families from one income which commenced in the 1970s will not repeat itself.
- A new set of scary messages to workers to purchase retirement assets will not appear.
- Foreign buyers will not newly enter the market as happened in fits and starts these past two decades – now contained by legislation.
- Airbnb will not newly appear taking rental properties off the market. In fact, global warming suggests the opposite in the long-term.

So, to repeat, I believe prices will continue to rise and see residential property investment as a profitable activity for those who approach the venture as if it were a business. But a repeat of the past two decades is a low probability outcome.

Interest Rates

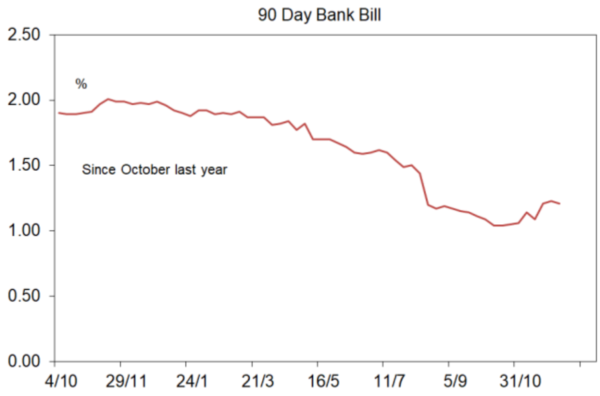
Driven by a desire to improve things and using the reason of low long-term borrowing costs, the centre-left government is starting to open the spigots. That is, loosen fiscal policy heading into an election. This extra source of demand in the NZ economy will probably not boost our rate of economic growth much because a key constraint on our ability to grow is a shortage of labour capacity, and increasingly, bank credit. The upshot according to our economic models and theory will be extra inflationary pressure.

So, a part of me is just aching to issue a decent warning here about interest rate increases. But I'm not going to because since the ending of the GFC economies displaying strong growth and resource shortages have not produced accelerating inflation. Things don't work the way they used to.

Nonetheless, we should expect that as the coming year proceeds and the government makes more spending announcements, in the wholesale markets interest rates will creep higher – but not necessarily by all that much.

So, let's just interpret the fiscal policy easing as confirming an end to interest rate declines rather than the start of decent rate hikes. What could make that rate decline ending comment wrong? Collapse of the US-China trade talks. We shall see. International concern about and discontent with China's authoritarian behaviour is growing. Eventual movement of the US toward a sanctions-imposing position as with Iran, Cuba, Russia, and Venezuela cannot be ruled out.

For your guide, the 90-day bank bill yield which is the main guide toward pressures on floating mortgage rates and business short-term financing costs, has crept up these past five weeks from just below 1.05% to just over 1.2%.



CHOOSING YOUR FIXED MORTGAGE RATE TERM

Again, no new minimum rates this week, but I repeat my warning that further rate declines now look fairly unlikely.

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%

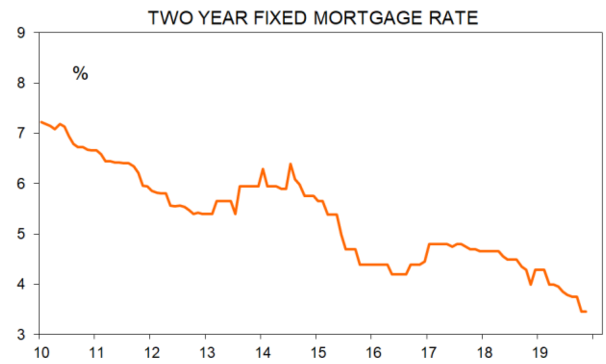
I can fix 1 year at 3.39%.

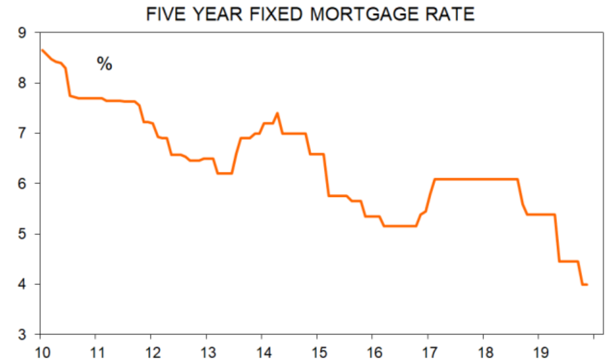
Is this better than fixing 2 years?	Yes, if in 1 year the 1-year rate is below 3.51%.
Is this better than fixing 3 years?	Yes, if in 1 year the 2-year rate is below 4.14%.
Is this better than fixing 4 years?	Yes, if in 1 year the 3-year rate is below 4.19%
Is this better than fixing 5 years?	Yes, if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



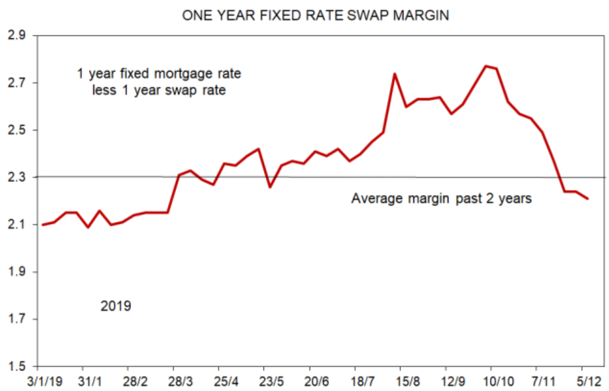


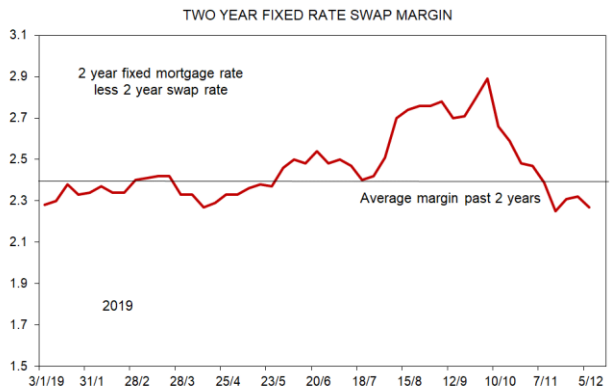
IS A FIXED RATE CHANGE IMMINENT?

Nothing new added this week – but do note the shift in market sentiment away from further falls in NZ interest rates.

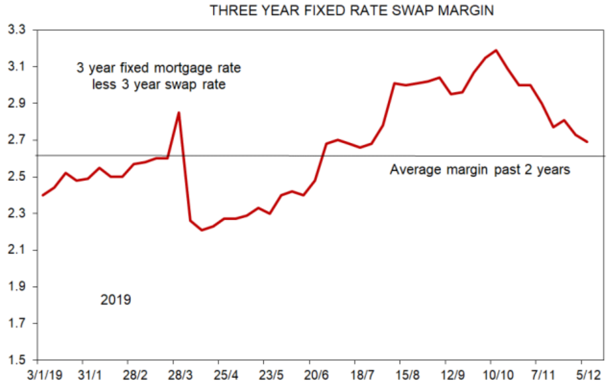
You can form your own opinion as to whether banks might be about to raise or lower their fixed rates by looking at the following graphs. They compare published fixed rates with the most frequently changing component of the total cost of funds – the swap rate. Note that there are other funding costs which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

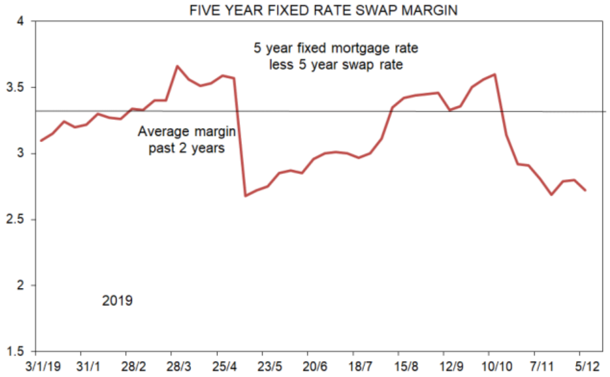
Margins have been falling since the middle of October with swap rates creeping up on diminishing expectations of further monetary policy easing here and offshore. Expecting additional fixed mortgage rate cuts from current levels would seem a tad optimistic. If you like long terms, doesn't the five-year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





Tony's View





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

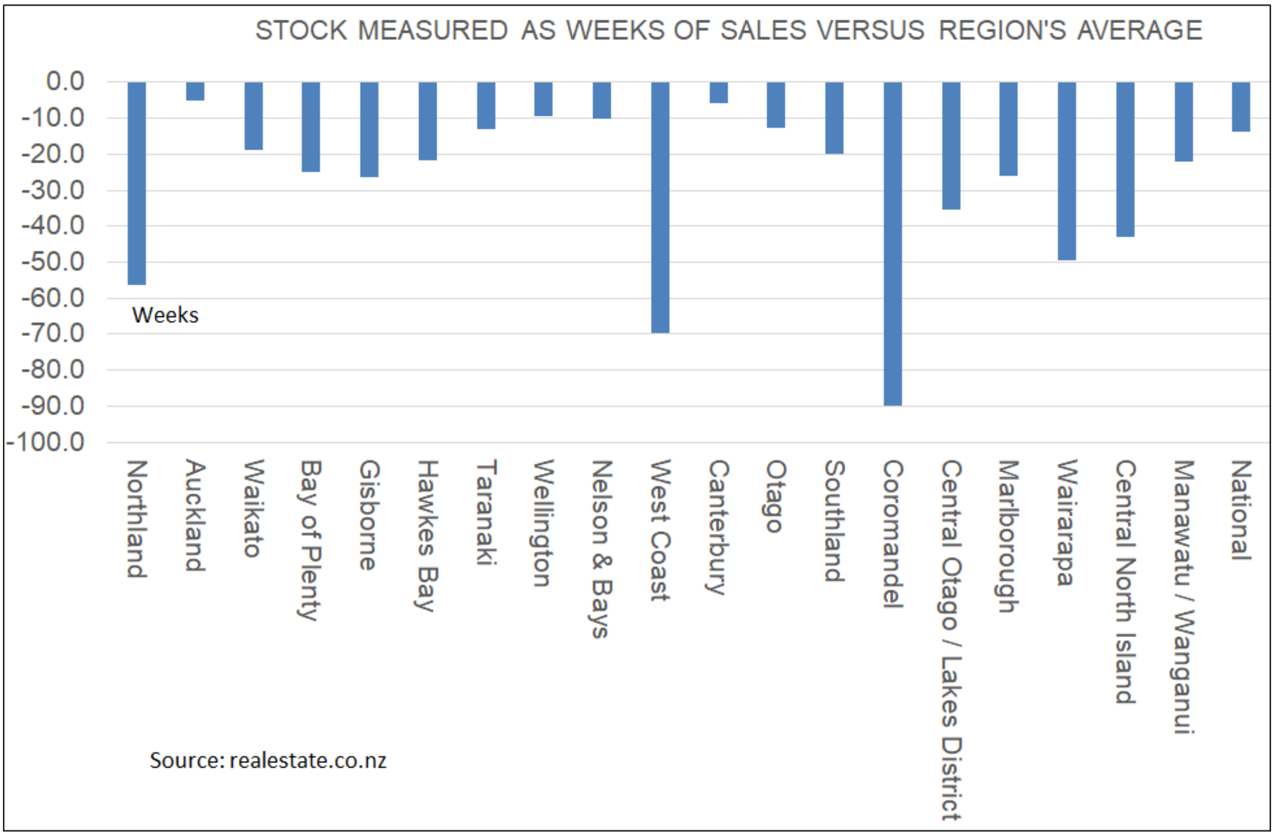
My wife Dr Sarah Alexander manages the network of early education and care services around the country (www.ChildForum.com) and the website for parent ratings and reviews of children's services (www.myece.org.nz).

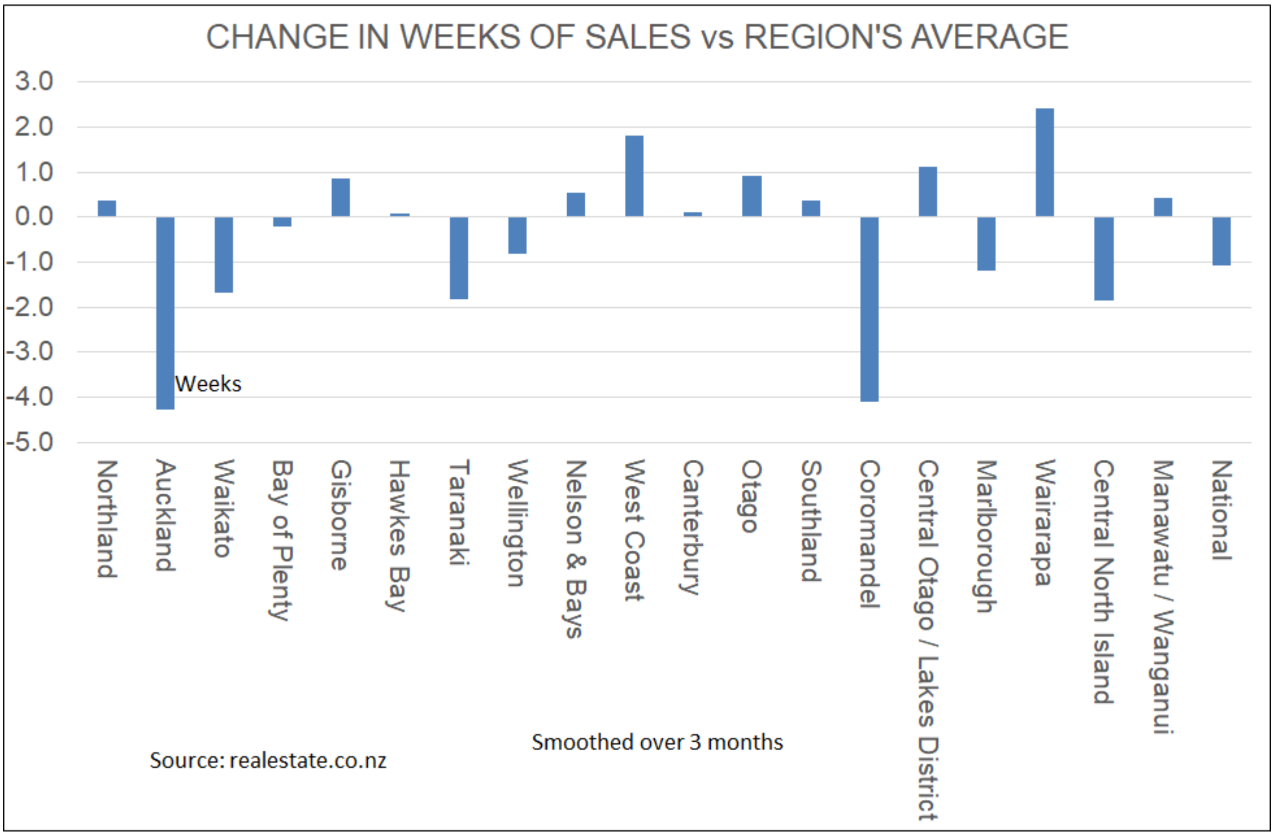
WL

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

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

DETAILED GRAPHS ENLARGED


STOCK MEASURED AS WEEKS OF SALES VERSUS REGION'S AVERAGE
0.0
-10.0
-20.0
-30.0
-40.0
-50.0
-60.0
-70.0
-80.0
-90.0
-100.0
Weeks
Northland
Auckland
Waikato
Bay of Plenty
Gisborne
Hawkes Bay
Taranaki
Wellington
Nelson & Bays
West Coast
Canterbury
Otago
Southland
Coromandel
Central Otago / Lakes District
Marlborough
Wairarapa
Central North Island
Manawatu / Wanganui
National
Source: realestate.co.nz


CHANGE IN WEEKS OF SALES vs REGION'S AVERAGE
3.0
2.0
1.0
0.0
-1.0
-2.0
-3.0
-4.0
-5.0
Weeks
Northland
Auckland
Waikato
Bay of Plenty
Gisborne
Hawkes Bay
Taranaki
Wellington
Nelson & Bays
West Coast
Canterbury
Otago
Southland
Coromandel
Central Otago / Lakes District
Marlborough
Wairarapa
Central North Island
Manawatu / Wanganui
National
Smoothed over 3 months
Source: realestate.co.nz