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.

Construction Boom?

Firms in the construction sector need to be very careful not to commit to timelines which the newly tightening labour market might make it impossible for them to achieve.

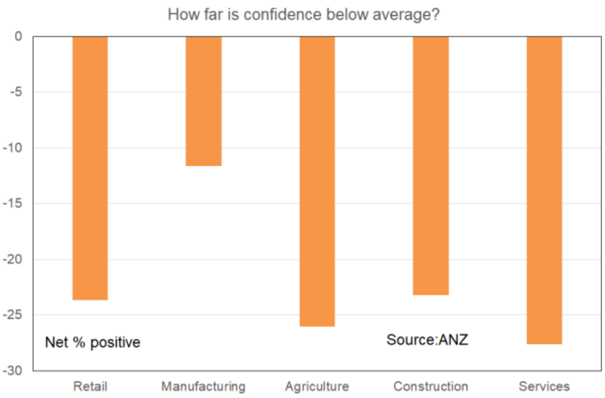
ANZ released their complete October Business Opinion survey results last week and I've taken a look through them just in case anything had changed a lot from their preliminary data released early last month. Nothing has really, with just a few indicators ever so slightly stronger.

Some of the interesting measures which might help some people perhaps feeling good or doing better and wondering if they are just weird could be these.

The net percent of manufacturers expressing confidence about the economy's prospects climbed to -8% from -21% in September, -65% in April, and -38% a year ago. The result is the strongest since September 2017 – just before Labour came to power.

The average reading for this measure is +4 so the manufacturing sector still has its doubts about where things are going, which is understandable. But it will be interesting to see what happens when anticipated reductions in orders for building materials do not happen now that the residential construction sector has a rapidly improving outlook.

Farmers also became a tad less pessimistic at -50%. But that just leaves them as far from average as people operating in the services sector where sentiment will clearly be depressed by the weak inbound tourism sector and hospitality sector woes. Oh farmers, when will you ever cheer up?



A net 12% of businesses in the construction sector intend hiring more people and that result is only just below the ten-year average of 16%. This backs up what the anecdotes are telling us about the construction sector – prospects look good. A net 14% of firms expect residential construction to rise, compared with a net 5% a year ago expecting decline. Can we suspect that Covid-19 will boost residential construction? Probably yes, given the impact on house prices which is driving people toward getting a new house built.

Pretty much all the indicators in the ANZ survey remain worse than average. But there is one which is not. A net 19% of firms in the commercial construction sector expect to be busy. This is up from a net 38% seeing weakness in April, and right on the ten-year average.

For me, that is the most interesting result in the ANZ survey because it raises the question of whether the boom in house building is going to be accompanied by a rise, rather than a fall in commercial construction? If so, then the current labour shortages in construction which operators are experiencing now will be nothing compared with what they might experience in 6-12 months. If you’re in the construction sector you want to be very careful about your assumptions of staffing levels before committing to timeframes on new projects.

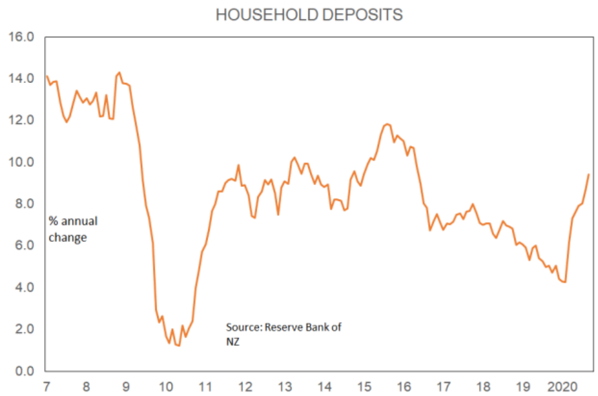
Money to Spend

We have a spare $10bn to spend or invest.

Part of what I aim to do with my various publications is to combat people’s acceptance of politically correct beliefs which are simply wrong. One of those beliefs is that we are all poor in New Zealand. So, every now and then I publish this reminder.

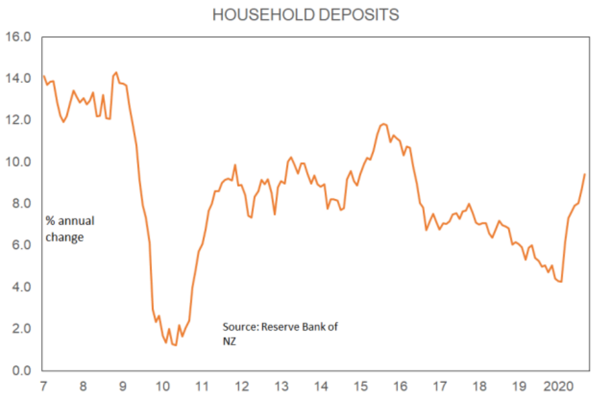
The net worth of NZ households is about $1.7tn. You and I might have debt of about $300bn (and that is what those with certain vested interests will look to scare you with). But we have financial assets of about $1tn and housing assets also of about $1tn. Our net worth is some $1.7bn. Note, it is not true to say that we hold all our wealth in housing assets. Net housing wealth of just over $700bn is less than financial wealth.

Part of our financial assets are the deposits we hold with banks are other institutions. Table HS40 from the Reserve Bank shows that at the end of September this year we households had exactly $200bn on deposit with NZ’s registered banks. This amount is 9.4% ahead of a year earlier and this is the strongest rate of growth in deposits since early-2016.



If we look at the nominal level of deposits in the next graph, we see that they just keep going up and up. It looks like without the Covid-19 shock the level of deposits wouldn’t have been 9.4% ahead of a year earlier in September, but instead maybe just 4% higher.

Therefore, I feel on reasonably safe grounds saying that you and I have an extra $10bn sitting in our bank accounts than if Covid-19 had not happened. This is a large amount of money equal to 3.3% of GDP, which will go a long way toward underpinning consumer spending through this summer. No wonder our spending intentions revealed in my monthly survey are so strong.



And a final little point. People frequently make the statement, as a bank leader did this week, that money being used to purchase houses diminishes the quantity available for other things.

"It means a lot of our capital is tied up in housing which is a deadweight asset whereas if people weren't investing in houses they might be investing in funds or equity markets where that money could get recycled into businesses who want capital for investment."

This is not correct.

There is an extra $10bn sitting in household bank accounts right now which people could place in managed funds and other assets if they wanted to. They choose not to.

One also doubts that any of the young people looking to buy a house ever thought that they were buying a "deadweight asset" yielding no return. The return they want is secure accommodation.

Also, just because house prices rise, say, 10%, does not mean all that near $100bn rise in value of the country's housing stock has been borrowed or diverted from other assets. You don't in fact need any money changing hands for an asset to be repriced higher – or lower.

The issue for New Zealand is not one of a deficiency of funds. It is

- a deficiency of good business experience and management competence,
- a deficiency of business operator willingness to accept outside capital to grow,
- an inefficient capital market,
- too short an investment time horison for most businesses,
- excess reliance upon labour input as a means of achieving growth,
- inadequate knowledge of trading conditions and customer preferences offshore,
- a small domestic market,
- oligopolies in many sectors raising prices,
- high infrastructure costs from a small population spread over a large area,
- distance from markets,
- etc.

It's also a bit rich at the moment for banks to rag on those purchasing houses diverting funds from businesses when banks have tightened up so much on their criteria for lending to businesses.

The issue for the housing market is not one of Kiwis having a far greater preference for housing assets than people offshore, or lax bank lending standards, or the tax system. At its heart, our high ratio of average house prices to average income reflects insufficient construction and high land and construction costs.

After all, in any other market a strong rise in prices for a thing would bring forth an increased supply of it. People would make many more. If dairy product prices go up and are expected to stay up, farmers will raise and farm more cows.

Housing supply has not responded to the construction incentive provided by high prices because of higher building costs and physical impediments to increasing supply. Consider Kiwifruit. There is a reason why land prices for Kiwifruit orchards are so high. Supply of growing licences is deliberately limited.

TONY'S VIEW

New Zealand's Housing Markets

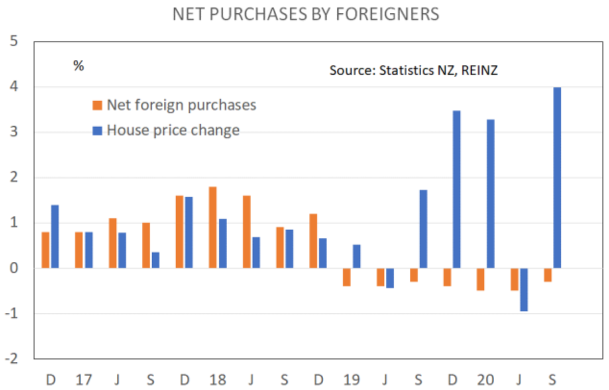
Banning Foreign Buyers Has Done What?

There is no silver bullet for high house prices in New Zealand, and simple analysis of gains following the October 2018 ban on foreign buyers shows that.

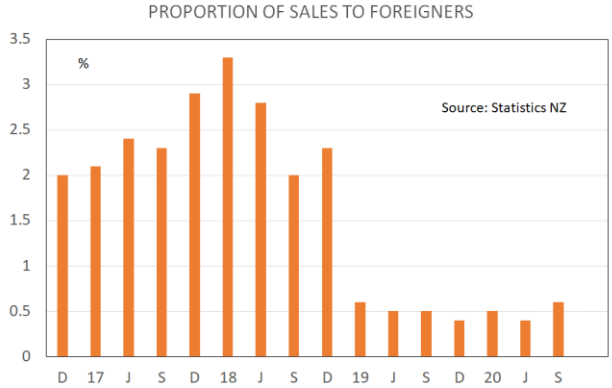
During the September quarter there were 240 dwellings in New Zealand which were sold to foreigners – people with no residency. But foreigners sold 369 houses. So, their actions represented a net increase in the availability of dwellings for Kiwis. Flows have been negative for the seven quarters following the ban on foreign buying from October 2018. In net terms they have sold us back 1,017 dwellings.

In contrast, in the year before the ban came in, they were net buyers of 2,016 houses. Has this made any difference to house prices – as the government and many people were hoping? No.

The following graph shows the net purchases of dwellings by foreigners as a proportion of total property transfers, measured as the orange bar for each quarter. The blue bar shows quarterly house price changes around New Zealand. Since the ban came into effect the only correlated quarter is June 2019. After that small decline the pace of house price gains accelerated.



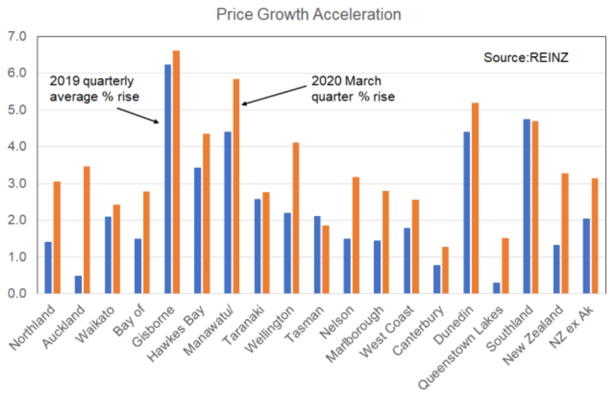
For your guide, this graph shows the proportion of sales each quarter to foreigners. Note that the data used are property transfers so there is not a 100% correlation with actual sales of property. But it's close enough.

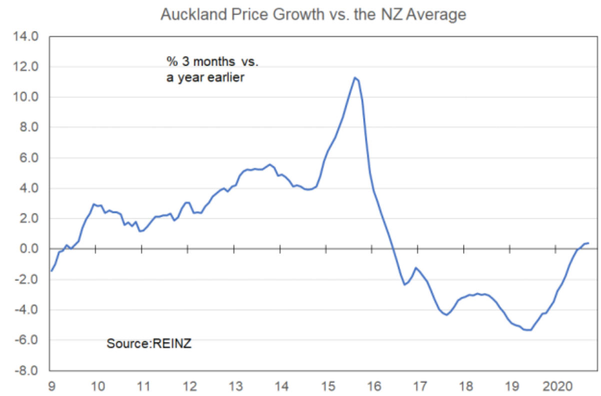


The graph in the other column containing quarterly house price changes provides me with an opportunity to remind people of this key point. Our housing market went into the lockdown with accelerating growth. As pointed out previously, on average during 2019 house prices around the whole country rose by 1.3% but during the March quarter of this year they gained 3.3%.

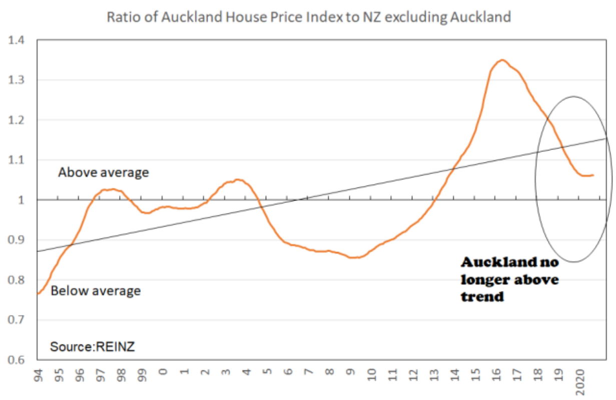
Changes for each region are shown in the following graph, and the thing which I have pointed out before is this. Auckland's pace of quarterly price gain lifted from 0.5% to 3.5% while outside of Auckland the change was from 2.0% to 3.1%.

Auckland ended its fallow price rise period late last year. That is, between the start of 2016 and the end of 2019, while house prices on average outside of Auckland rose by 44%, for Auckland the gain was only 14%.





Auckland is back in the strong price rise part of its house price cycle now. It is starting from a below trend position.



Am I saying I think the rest of the country will now go back to sleep? No. The cycle from 2011 to 2015 was unusual. Back then Auckland prices rose by 105% from the start of 2011 to late-2016, while outside of Auckland prices rose just 39%.

This time around the whole country is likely to see a period of firm price gains over an extended period of time. A dynamic in play back then was high attention to a shortage of dwellings in Auckland but an absence of such discussion in other parts of the country.

This time around the whole country will benefit from the various factors in play such as low interest rates, high pent-up demand from first home buyers, and a migration boom.

For the record, why did house price inflation lift from late last year?

1. The Reserve Bank cut the official cash rate by 0.75% in 2019.
2. Confirmation of no capital gains tax.
3. Absence of a strong decline in net immigration which many people were talking about over 2018-19.
4. No obvious negative impact from the ban on foreign buyers from October 2018.

Interest Rates

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

I have mentioned before that interest rates in New Zealand are heavily influenced by interest rate levels overseas. In that regard, if central banks offshore are saying they plan to keep their interest rates low for many years, then we will see the same thing happen in New Zealand.

A few weeks back the Reserve Bank of Australia said that they would keep interest rates low until the actual rate of inflation moved above 2%, rather than their forecast of inflation exceeding that level.

The US Federal Reserve also three months ago said that they would deliberately run a loose policy delivering inflation above 2% for some years so that the average would work out at 2%. Over the past decade their inflation measure has averaged 1.6% and they have grown concerned that investors no longer believe they are aiming for 2% inflation.

This week the RBA across the ditch cut their cash rate another 0.15% to 0.1% and said that they would keep rates low for the next 3-5 years.

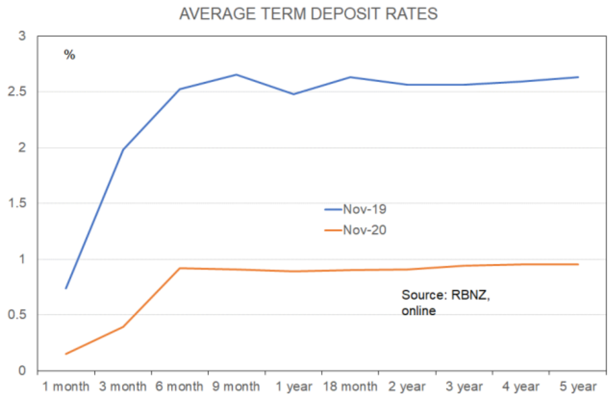
This suggests that we can reasonably have an expectation currently that our rates will also sit at very low levels for the next 3-5 years.

Deposit rates cut more than lending rates

Did you know that one year ago the two-year fixed mortgage rate averaged 3.5%? It now sits at 2.65% so there has been a reduction of 0.85%.

In contrast, a year ago the two-year term deposit rate sat at 2.6%. It is now 0.9% on average. That is a fall of 1.7%. Banks have slashed their term deposit rates twice as much as their mortgage lending rates. How can they get away with this?

The banks do not need your money. They are awash with funds. I calculate that household deposits with banks currently are about $10bn higher than they would otherwise have been had Covid-19 not come along.



On top of that, the bond buying/money printing operations of the Reserve Bank have injected $34bn into the private banking system. It looks like 90% of that money has remained with banks who now have on deposit with the Reserve Bank some $47bn compared with $16bn back in February.

The banks don't really need your money, and much as you might say that if rates go lower you will shift your funds somewhere else – no you won't. Other countries with even lower term deposit rates – negative in some instances – have not seen a flood of money leaving the banking system.

The chances are high that banks will be able to use widened interest rate margins to offset losses on lending gone sour because of the Covid shock. Yes – if you are a depositor, you are paying for the money banks are losing on some loans. This is essentially a direct transfer of wealth from the older generation in particular to bank bottom lines.

No wonder people owning investment properties who were thinking about selling them will now not do so. The returns from cash can no longer even keep up with inflation.

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